

# Trading Options: Cracking the Code

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In order to simplify the computations used in the examples in these materials, **commissions, fees, margin, interest and taxes have not been included.** These costs will impact the outcome of any stock and options transactions and must be considered prior to entering into any transactions. Investors should consult their tax advisor about any potential tax consequences.

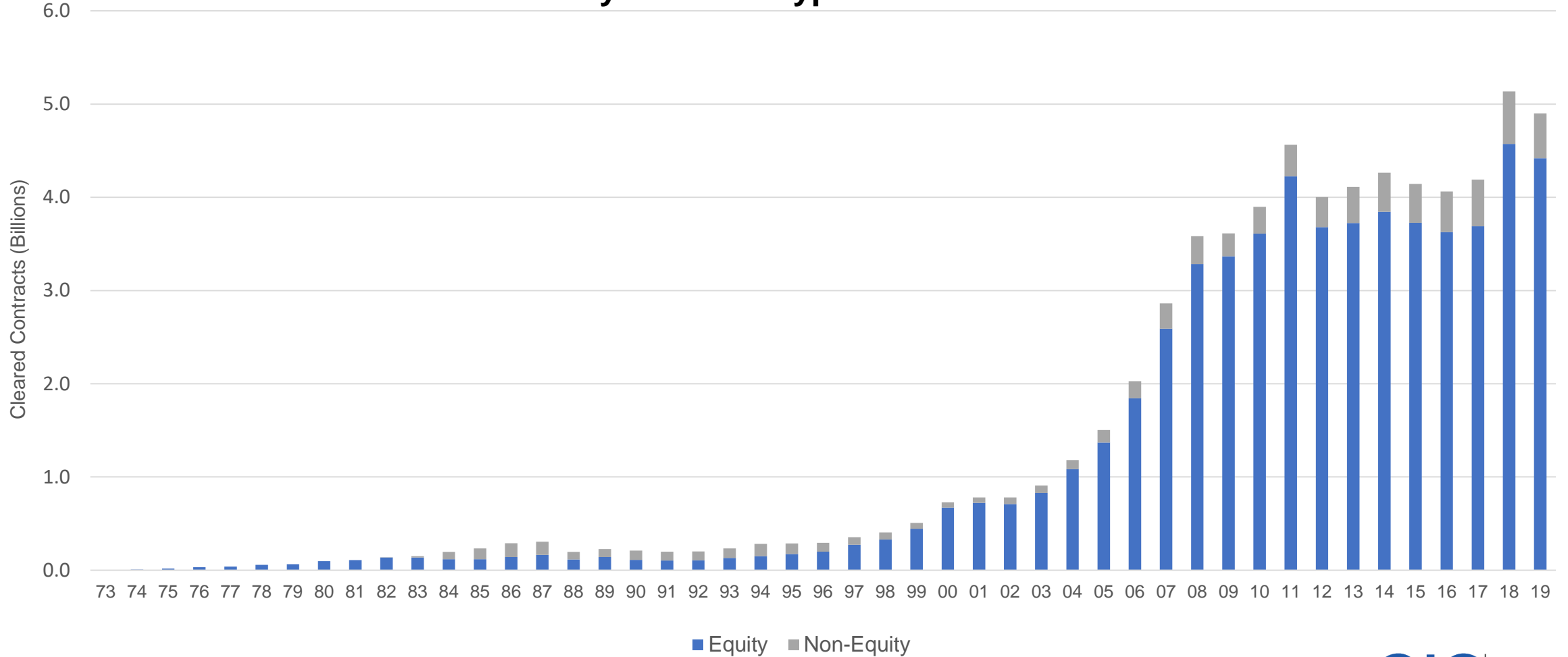
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# Annual Options Volume 1973-2019

## OCC Annual Contract Volume by Contract Type



# Presentation Outline

- Industry Insight
- Options Defined
- Calls and Puts
- Covered Call



# Why Options?

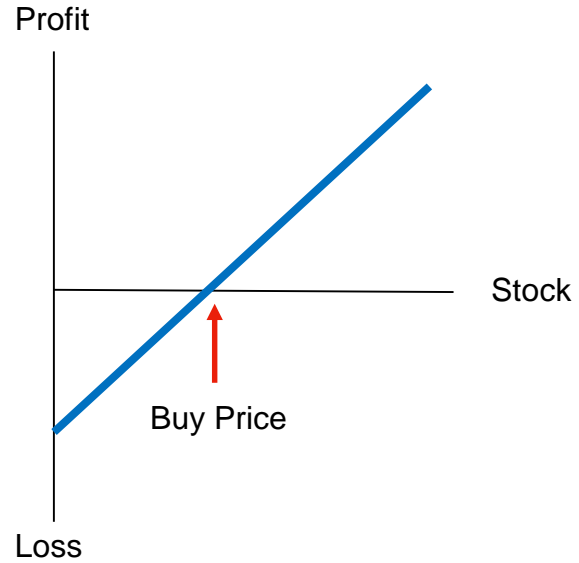
# Why Options?

- Options give you more ways to implement your market research
- Options make it possible to target a variety of investment objectives:
  - *Risk Reduction*
  - *Income Generation*
  - *Stock Acquisition*
  - *Leverage*
  - ***FLEXIBILITY!***

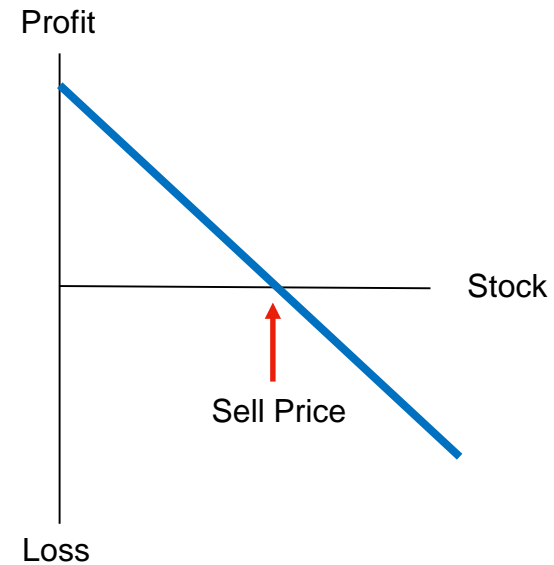


# Long Stock vs. Short Stock

In a world without options, stock investors have limited choices.



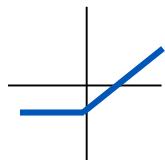
Long Stock



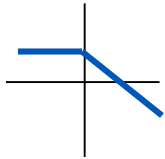
Short Stock

# Flexibility

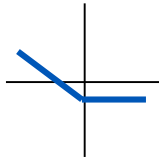
With options, these are some of the available choices.



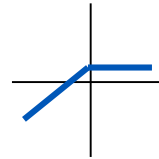
Long Call



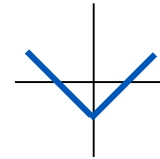
Short Call



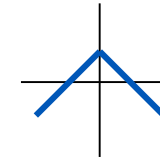
Long Put



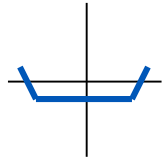
Short Put



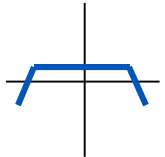
Long Straddle



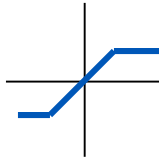
Short Straddle



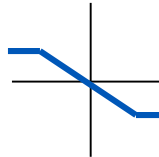
Long Strangle



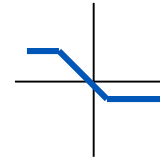
Short Strangle



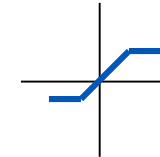
Long Call Spread



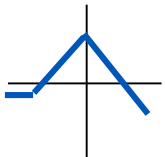
Short Call Spread



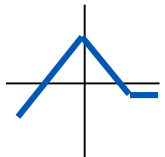
Long Put Spread



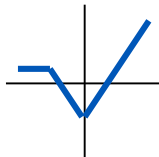
Short Put Spread



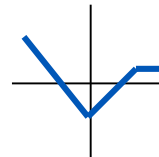
Ratio Call Spread



Ratio Put Spread



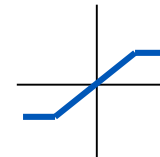
Call Volatility Spread



Put Volatility Spread



Long Split-Strike Synthetic



Collar



# Defining an Option

- Options are **contracts** that give:
  - the **buyer** the *right* to buy or sell an underlying asset
  - the **seller** an *obligation* to buy or sell an underlying asset
- Each contract defines a *specific stock price* and exists until a *given date* in the future.



# Calls and Puts

- There are two “types” of options:
  - **Calls**
  - **Puts**
- For **equity** or **ETF** options, the underlying asset to be purchased or sold:
  - 100 shares of underlying stock or
  - 100 shares of an ETF (Exchange Traded Fund)



# Equity Call Options

- An equity call **buyer**:
  - Has the **right to buy** underlying stock/ETF
  - “Holder” or long the contract
- An equity call **seller**:
  - Has the **obligation to sell** underlying stock/ETF
  - “Writer” or short the contract



# Equity Put Options

- An equity put **buyer**:
  - Has the **right to sell** underlying stock/ETF
  - “Holder” or long the contract
- An equity put **seller**:
  - Has the **obligation to buy** underlying stock/ETF
  - “Writer” or short the contract



# Calls and Puts

	Call	Put
<b>Long</b> (buyer or holder)	<b>Right to buy</b>	<b>Right to sell</b>
<b>Short</b> (seller or writer)	<b>Obligation to sell</b>	<b>Obligation to buy</b>

- 100 shares of the underlying
- at the strike price
- any time before expiration

# Option Contract Terms

- Equity option contracts have standardized terms including:
  - Underlying stock/ETF
  - Expiration date
  - Strike or exercise price



# Option Components

XYZ Jan 17, 2021 45 call at \$2.50

## Underlying

- Typically 100 shares of the stock/ETF on which the right or obligation exists
- 100 shares of XYZ is the underlying for this option

## Expiration Date

- The day on which the option ceases to exist
- This option expires on Jan 17, 2021

# Option Components

XYZ Jan 17, 2021 45 call at \$2.50

## Strike or Exercise Price

- Price at which the underlying may be bought or sold
- Stock may be bought or sold at \$45 per share

## Premium

- The price of an option that is paid by the buyer and received by the seller
- The open market price for this option is \$2.50
  - (\$2.50 per share or \$250 per option plus/minus commissions)

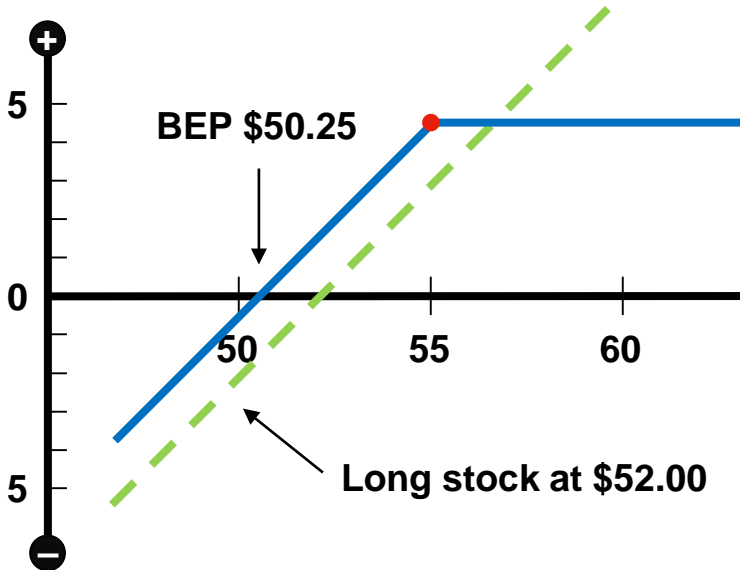


# Covered Call Definition

- Covered call:
  - Investor writes (sells) one equity call contract for each 100 shares owned
- Primary goal – increase returns
  - Call premium received and kept (assigned or not)
  - Stock break-even point is lowered
- Investor's forecast
  - Neutral to bullish on the underlying stock

# Covered Call Example

Own 100 shares XYZ at \$52.00  
Sell 1 XYZ 55 call at \$1.75



Maximum Profit if Assigned:  
Effective Stock Sale Price –  
Stock Price Paid  
 $(\$55.00 + \$1.75) - \$52.00 = \$4.75$   
\$475.00 Total

Break-even at Expiration:  
Stock Price Paid –  
Call Premium Received  
 $\$52.00 - \$1.75 = \$50.25$