

# Taking Your First Step: Placing an Option Trade

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# Presentation Outline

- Moneyness
- Options Pricing
- Choosing Expiration
- Choosing Strike

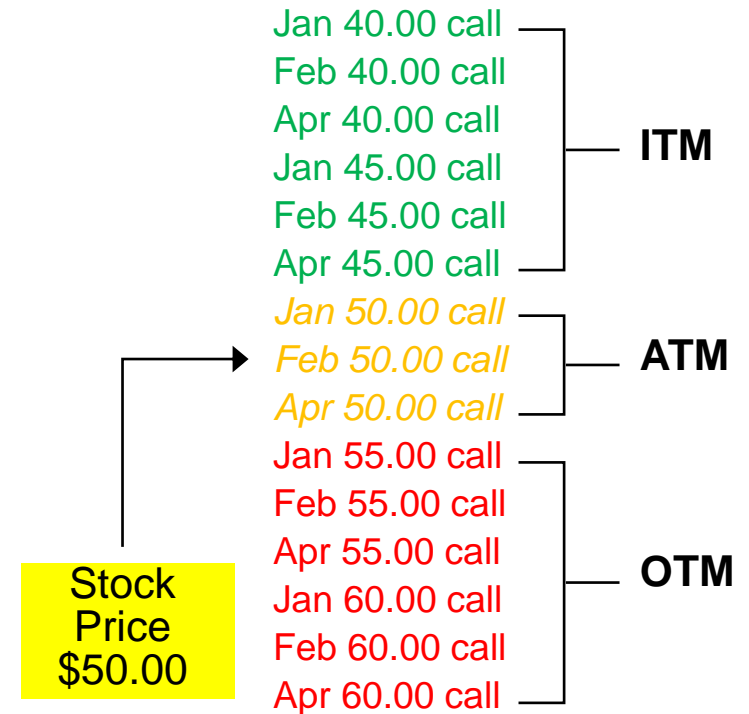


# Moneyiness



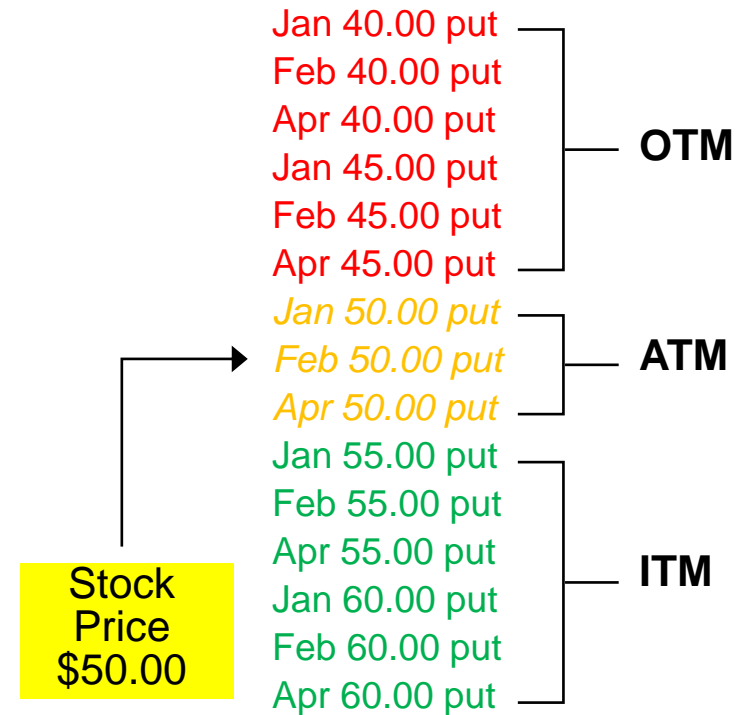
# Calls: In-the-Money, At-the-Money, Out-of-the-Money

- Call is in-the-money (ITM)
  - Strike price **below** stock price
- Call is at-the-money (ATM)
  - Strike price **same** as stock price
- Call is out-of-the-money (OTM)
  - Strike price **above** stock price



# Puts: In-the-Money, At-the-Money, Out-of-the-Money

- Put is in-the-money (ITM)
  - Strike price **above** stock price
- Put is at-the-money (ATM)
  - Strike price **same** as stock price
- Put is out-of-the-money (OTM)
  - Strike price **below** stock price



# Options Pricing

# Options Pricing

## Who makes options prices?

- All market participants (buyers & sellers)
- Individual & institutional investors
- Professional market-makers
- Best bid/ask is consensus of all bids and offers

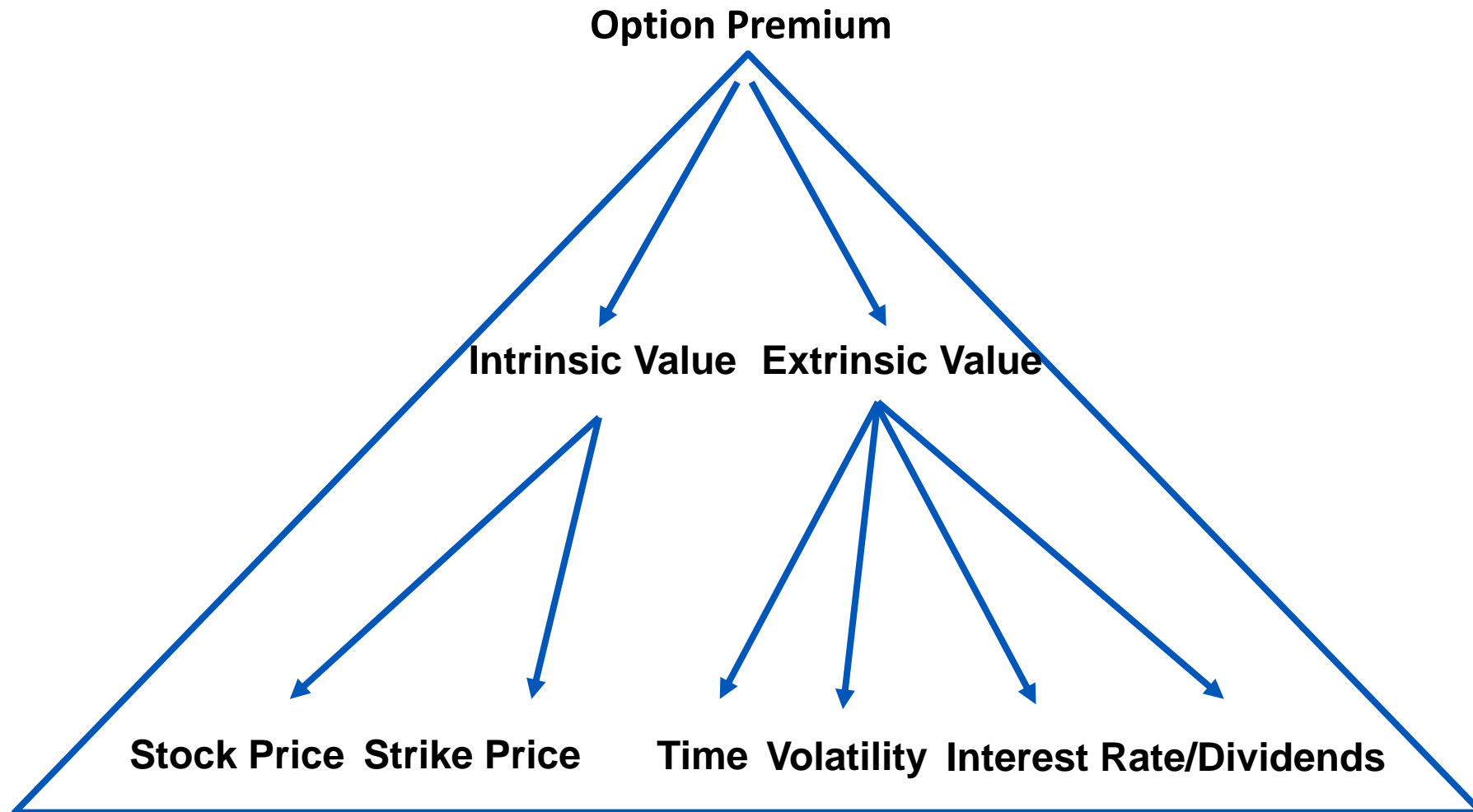
## What is an option ultimately worth?

- What the market is willing to pay
- Pricing models used as guideline
- **Supply/demand** & market dynamics override theoretical values





# Intrinsic Value vs. Time Value



# Choosing Expiration and Strike



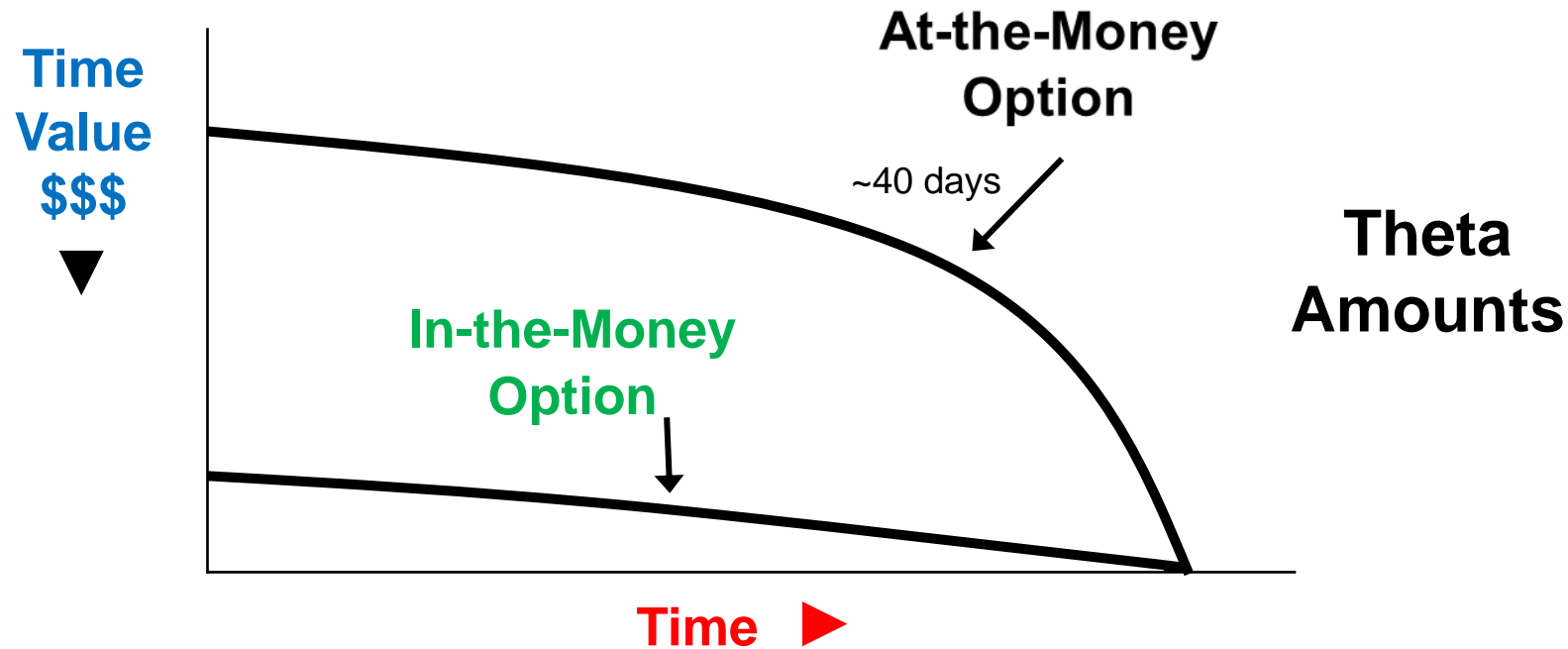
# Expiration selection

## ***TIME IS MONEY!***

As time is a component of options pricing (extrinsic value),  
*more time = greater premiums*

- Remember forecast - Where is the stock going to go and how long will it take to get there?
- Check calendar – capture or avoid earnings?
- Bid/ask spreads - compare short term vs long term.

# Option Theta and Expiry



Overall rate of time decay is exponential (**accelerates** towards expiry)

ATM = decay exponential = volatility is key decay factor

ITM = decay linear = cost-to-carry is key decay factor

# Strike selection

## *In, At, & Out-of-the Money*

In-the money strikes:

- Higher total premium than ATM/OTM strikes of same expiry
- Premium will have intrinsic and extrinsic value
- Premium is more sensitive to stock price changes

At-the-money or Out-of-the money strikes:

- Lower premium than ITM strikes of same expiry
- Buyers = farther OTM strike selections are more aggressive
- Sellers = premium received needs to be worth taking on the obligations of the contract

# Summary

- Intrinsic value is sensitive to stock price movements
- Extrinsic value is sensitive to several factors and will be zero at expiration
- At expiration, an option will be worth only its intrinsic value, if any
- Market outlook might drive decision on expiration and strike selection
- Have an exit plan



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