

TRANSCRIPT

Options 101: Buying options

Sam Shore: Welcome to everyone. Excited to take a look at buying options here.

This is the second part of a five-part introduction to options series that we do.

I'm with our trading strategy desk here. And really, we're here to help individual investors who are looking to actively trade leverage Fidelity's tool as part of a trading process. And whether that's trading stock, trading options, trading exchange-traded funds, we're really here to help with personalized education, hosting webinars like this, in addition to the classes you can access at [Fidelity.com/coaching](https://www.fidelity.com/coaching). So certainly, if you want to see what one of those is like or are curious, we'd be happy to have you join us.

As well if you feel like after the session there are additional questions you have around option trading or really feel like you need to start from square one, we do also host a four-week class for beginning option traders available at [Fidelity.com/classroom](https://www.fidelity.com/classroom).

So, let's go a little bit over our road map for our hour together today. We want to spend just a little bit of time reviewing some of the concepts that we

covered in prior sessions, making sure everyone's aware of some of the basics so that we can hopefully bring everyone forward with us. Then we're going to cover three different option buying strategies. Buying a call, buying a put, and buying a protective put. And then we're going to wrap up in the last say 10 or 15 minutes by taking a look at how we might implement some of these things on Fidelity.com and some considerations around risk management.

So, let me go ahead and allow Mai to take us away and start looking at some of the review of some of the basics so we can make sure we're bringing everyone along with us.

Mai Le: Thank you, Sam, and again my name is Mai Le. I'm with the active trader desk. I work with our high frequency traders and most of our options traders as well. We're going to go ahead and start off with a quick review of some of the options basics that we covered in our last webinar. We'll look at the options symbology and also options premium.

So, in our next slide here we have an example of an SPY January 21st, 2022 \$208 strike call option. We can look at the option symbol in four distinct parts. We start with the symbol for the underlying security which is SPY for the SPDR S&P 500 ETF. This is followed by the date of expiration. The format of the

date starts with the year, month, followed by the day of the expiration. Next, we have the letter indicating whether this option is a call or a put. We have C for call and P for put. Lastly, we have the strike price.

So, in our example here we have the holder, or the buyer of this call option has the right to buy 100 shares of SPY at \$208 per share at any time until January 21st of 2022.

Next here we'll discuss the components of the option premium. The option premium is the current market price of an option contract or the cost of the option if we were to buy. The premium for options is quoted as a dollar amount per share. So, most contracts represent a commitment of 100 shares. If we are quoted a premium of \$1.50 the total cost would be \$1.50 times 100 shares. That would cost us \$150 for one contract.

There are two components of the options premium. We've got intrinsic value and extrinsic value. Intrinsic value is the value given if the option were exercised today and closed out the resulting stock position. So, for call options this is the amount of the stock that is above the strike price. So, if we had a \$1 call and the underlying stock is trading at \$3, we'd have \$2 of intrinsic value. And as for a put option, the intrinsic value is the amount of the stock

that is below the strike price. So, let's say we have a \$3 put and the market value of the stock is \$1. We'd have \$2 of intrinsic value. So, the greater the intrinsic value, the higher the option premium.

When we buy a call with a lower strike, we'd expect to pay a higher premium because we've got greater intrinsic value.

Now you notice the pricing of options isn't always as simple as the difference between the strike price and the underlying stock. Option premium is also determined by extrinsic value, often referred to as time value. The option premium is greater given more time to expiration as it's considered more valuable. Time value can also be impacted by market participants' expectations for volatility.

Now when we determine whether an option is in the money or out of the money, we look at whether it has any intrinsic value. An option contract that has intrinsic value is considered in the money. And an option contract with no intrinsic value is considered out of the money. The premium that we pay for these options is completely extrinsic value, so combination of time value and volatility.

Now I'll go ahead and turn it back over to Sam here to review the outlook on the strategies we'll be discussing today.

Shore: So, whenever we're looking at the building blocks of any sort of option trade, there are four transactions that we can do with options, and only four. We can certainly combine them, as maybe we become more advanced in our trading in different ways. But they're still the same four building blocks. And we have all four listed here. And they come with a little bit of a window of course.

So, our top two that are listed in this grid, long a call or long a put, refers to when we're the holder or buyer of the option. At the bottom we have our short call and short put. So that's when we're a writer or seller of the option. And we have them color-coded by if they're bullish or bearish strategies. So bullish strategies, our outlook is that the underlying is going to rise in value. Bearish strategies, our outlook is that the underlying is going to fall in value.

And with each of these we have one bullish strategy that involves buying an option and one bearish strategy that involves buying an option. One bearish strategy that involves selling, one bearish strategy that involves buying. And as they're color-coded might be what you expect they are. So, the long call is

a bullish strategy. So is the short put. Our bearish strategies are going to be the long put and the short call.

Now each of these in addition to being bullish or bearish does have a different risk and reward profile. So, let's start to take a look at our first example. And it'll be one of our option buying strategies as you might expect from the name of the session. We'll take a look at buying a call option.

So, buying a call option is going to be a bullish strategy. We envision that the stock that we are buying a call option on is going to rise in price. So, let's walk through an example here. I think that's one of the best ways to try to learn this. So, in our example we're eyeing stock XYZ. And currently stock XYZ is trading at \$42 a share. Now with stock XYZ we think the stock is going to go up. We don't necessarily know if it's going to go up \$5 or \$10 or \$30. But we think the stock is going to go up. We want to take advantage of that. We want to make money when the stock rises.

But we want to be able to limit our downside risk. If we buy 100 shares of XYZ stock, well, if the stock falls from \$42 to \$0, we'd lose \$4,200. So, we have all that downside risk in the share price. But when purchasing an option, we can actually limit our risk when comparing it to the stock transaction that we might

do otherwise. So, in this example we're going to go in and we're going to buy a call option. And on stock XYZ we're going to buy the April call option, the 42.50 strike, and that call option is currently trading at \$2.10 a contract. You'll notice when we write out the option premium that we write it in terms of per share of stock because typically the option represents 100 shares of stock. So, the full amount we'll actually be paying is \$210. But we'll refer to the premium of this option as \$2.10.

So, the other thing we also want to recognize taking the pricing consideration from a moment ago is the strike price that we're purchasing, the 42.50 strike, is above the current price of the stock. It's above the current price of the stock by 50 cents. And that 50 cents is commonly referred to as the out-of-the-money amount. So with our thought processes around intrinsic and extrinsic value right now with the stock at \$42 and us looking at the 42.50 strike call, the call option is out of the money, and it has no intrinsic value, 100 percent of the option premium at that price is extrinsic or time value.

So now let's go through and see some examples of what this might look like as the life of the trade goes on. And here's a profit and loss table. We're going to take a look at several of these. So, let's go over what we have on the page here. The far left-hand side column is a column showing the price of the

underlying stock at the expiration of the option, so at the April expiration. The column second from the left is the cost of the option. You'll notice of course that stays constant. When we buy that option, we have that initial outlay of capital and that stays the same. We don't have to put more capital into the trade while we own the option. The next column we have is given the price at expiration what would the value of the option be. And then our last column, the rightmost column, is the summation between the cost of the option and the value of the option. So, the value of the option is a positive value. The cost of course negative value. And that gives us our profit or loss on the trade.

So, let's walk through some of these examples. You'll notice at prices equal to or below the strike price of the option at expiration the option is worth nothing. There's zero value. And think of why that might make sense. If the option entitles us to buy shares at \$42.50 a share, and if we can go out into the market and buy the shares at \$40, \$37, \$35, and so on, well, there's no value to exercising that option and using it to buy shares at 42.50. So, at expiration if the stock is at the strike price or lower, the option will be worthless, and you would have a complete loss.

Now you'll notice in this case a complete loss is \$2.10 no matter how far down the stock goes. This is that limited risk feature of purchasing a call option. The

stock can go all the way down to zero and we would still only lose \$2.10 a share whereas if we were to buy the shares, we could lose \$42 a share.

Now moving our eyes up the rows, we can see there's a price there of \$44.60 and we might think to ourselves that's sort of an odd number to have in this table, everything else seems to be in \$5 or \$2.50 increments. So why do we have 44.60? And the reason why that's the case is that's going to be what's referred to as our breakeven point at expiration. What that simply means is remember, if we can buy the shares at \$42.50 and we paid money for that right, in this case \$2.10, well, we need the stock to be above 42.50 by more than the \$2.10 we paid in order for our trade to be profitable. So to calculate our breakeven on the purchase of a call option we take the strike price of the call plus the premium that we paid, and in order for that trade really to make sense, if we're going to hold it to expiration, we would need to have the outlook that the stock is going to be above that breakeven come expiration.

Now you notice as we go to higher and higher prices above that breakeven, we have increasing levels of profitability. And when we have a call option, we have unlimited profit potential. So if the stock goes up and up and up, \$50, 60, 70, 80, so on and so forth, we make more and more and more money, because the value of the option at expiration is going to be equal to the price

at expiration minus the strike price, minus the price at which we can purchase the shares using the option.

Now this can be a little difficult to look at or envision in a table. So, we actually have another way that we'll view this sometimes and it's going to be our profit and loss diagram. You can construct profit/loss diagrams for your potential option trades on Fidelity.com or Active Trader Pro and it's another way, another visualization we can use. And let's go through together once again so we see and understand what we're looking at. So, we'll notice the horizontal axis is going to be prices of the stock, moving from left to right we have increasing prices of the stock. The vertical axis up and down is going to be the profitability of our option trade. And so, this is our profit/loss diagram for the exact same trade at expiration. So, this is the exact same information as the table we were looking at just displayed with a different picture. And so, we'll notice at prices equal to or below the strike price of the option, we have that limited loss potential, that \$2.10, and if we were to extend that line to the left it would go further and further and further.

Now at stock prices above the strike price, so above \$42.50 a share, you'll notice we have decreasing levels of loss, until we get to that breakeven point, \$44.60, and then we start having increasing levels of profit above that point.

And there's not a cap on that profit. That line would go on in perpetuity up and to the right if the diagram went further, if we had it beyond 47.50. So just looking at that you can see for your trade limited loss potential, unlimited gain potential. And remember this makes sense if you're bullish. Increasing levels of the stock price, everything else being equal, is what makes this trade profitable.

So, let's now go through and compare, well, we could buy shares, that's bullish, we could buy the call option, that's bullish, why might we do one versus the other?

Le: All right. So now you're probably wondering if it's better to buy stock or to buy options. And the answer just depends. Compare buying stock versus buying a call, both are bullish strategies as Sam had mentioned. So, looking back at our XYZ example here, if we were to buy the stock that would cost us about \$42 a share or \$4,200 for 100 shares.

Going long on the stock requires quite a bit of capital, so the risk is substantial. Hypothetically you can lose the entire \$4,200 if the stock goes to zero. So, analyzing a stock purchase is pretty straightforward. We gain dollar for dollar in upwards movement and lose dollar for dollar in downward movement.

Comparing that to purchasing a call, the premium we pay is significantly less than buying the stock itself. So, we capped our risk to losing the premium we paid. We can also look at the difference between the breakeven points when comparing the two strategies. Our breakeven for buying the stock is just the price per share. When buying a call our breakeven is higher. Recall that the breakeven for a long call is the strike plus the premium paid. So, if we had a strike of 42.50 and we paid \$2.10 for the option we would only break even once the stock reaches \$44.60, versus our breakeven of \$42 for the long shares.

Lastly, we want to consider is time. Buying stock, we expect growth over time. This is different when we buy a call option. Options have an expiration date and the value generally decreases with time. So, the longer we hold on to a call option, the less time value we have. Neither strategy is considered better than the other. Each does have its own trade-offs. You need to evaluate the choices based on your forecast and goal, weigh the potential risk and rewards of each, and choose a strategy that's appropriate for you. So again, how much capital are you willing to put up and how much risk are you willing to take on?

All right. So, let's go ahead and switch gears to buying puts. Recall that the directional outlook for long calls was bullish. So, buying puts is actually the opposite. It is a bearish strategy. The buyer of a put pays a premium which gives them the right to sell the underlying stock at the strike price until the expiration date. Now how many of you have ever shorted stock? Shorting stock involves buying shares to immediately sell in speculation of a decline in that stock. The risk on shorting is infinite. Theoretically the stock price can continue to go up further and further, increasing your loss potential. Buying a put is an alternative to the short stock strategy. Our risk here is the same as buying a call option. We are capped at the premium paid. Our potential profit is substantial but not unlimited. Remember that our stock can in theory climb infinitely in value, but it can only go as low as zero. Although you'd still lock in a pretty healthy gain if this were to happen.

Now let's go ahead and take a look at our example again. We are still looking at XYZ which is currently trading at \$42.50. We've reevaluated our research and have now decided we are not bullish on XYZ. This time we have a bearish forecast and we're anticipating a decline in stock value. Once again notice that our forecast is what helps us choose our strategy. Since we are looking for a decline in the stock and also want to limit our risk, we are going to purchase

one XYZ April 42.50 strike put for a premium of \$2.30. So, we'd be paying \$230 for one contract.

Notice here we are purchasing a put that's at the money so the premium we pay here is all extrinsic value. There's currently no value if we were to exercise early.

So as with our call example let's go ahead and work through our profit/loss table on this example as well. We've got the price of the stock at expiration on the far left and the option cost and the option value at expiration in the middle column and the profit/loss on the far right. Here we see that as the stock price falls the put becomes more valuable. We see here that at \$40.20 we have our breakeven. The value at expiration of \$2.30 offsets the cost of the premium that we originally paid.

At \$42.50 we see that we've got a loss of \$2.30. And as you can see anything above 42.50, your options are worthless, and your loss is capped at the premium that you pay.

Now let's also go ahead and take a look at these numbers and we'll plug them into the diagram. Just like Sam did with the long call option example. Notice

as the stock rises the most you can lose is the premium paid. But as it falls the put becomes more and more valuable. The gain potential is substantial but again not unlimited. Our profits are limited as we get closer and closer to the stock reaching zero. So, at what point do we reach our breakeven on this diagram? Remember that our breakeven for our put is the strike price minus the premium paid. So as the stock rises and gets closer to \$40.20, we get closer to breaking even.

Now recall also our short stock strategy. We have an inverse linear relationship. As the stock rises, we lose money. And as the stock falls, we make money. Notice on our long-put strategy it actually flattens out as our max loss is capped. We see that the difference here is that we've got unlimited loss potential as the stock rises with a short stock position. And also, we're looking at higher capital due to the margin requirement. Unlike the call though maximum profit is achieved if the stock goes to zero. So again, we're looking at which is better. Neither is going to be considered better than the other strategy. They are just considered different strategies that you can take on. Buying puts gives the conservative investor an alternative to shorting stock. So, you limit the amount you lose to the premium that you pay. Now I'll go ahead and have Sam review the two strategies we discussed so far.

Shore: So, with both of these option buying strategies they're ways where we can generate market exposure in our desired direction, and the only thing we have to put up is the cash to be able to buy the option. We don't have to own shares of stock. We don't have to have cash in excess of the purchase price of the option. All we're doing with either one is purchasing the right to do something. When purchasing a call option, it's the right to buy shares at strike. When purchasing a put option, it's the right to sell shares at the strike. And with both trades our risk is limited to the premium paid for the contract plus commission. That's the most we can lose on the option contract. And with calls we have our bullish exposure. With puts we have our bearish exposure.

Now we mentioned at the outset there were three different option buying trades that we're going to look at. And if you were really astute you remember we were looking at four different option trades, only two of them listed were buying, the long call and the long put. So, let's introduce and start to think about the third strategy that we want to discuss today, which is using a put option to protect a position or an entire portfolio. We're going to refer to this as a protective put.

Now with this our trade actually has two components. The long call and the long put we were just talking about, there was just one component. Just the

option component. But when we're looking at buying a protective put, we're going to have as I said a second component. We're going to have the option that we bought, but we're also going to have if we're buying it on a single stock 100 shares of that stock. And this rationale for buying a put here is not to speculate on being bearish but in order to create protection on the stock that we own. Because remember that put entitles the owner of the put to sell shares at a fixed price through the expiration date.

So, if we own 100 shares and we have the ability to sell at a fixed price no matter what occurs, that turns our stock trade into a limited loss potential trade. Now we've got to remember, and sometimes this will throw newer option traders for a little bit of a loop, this is a bullish strategy. The way we make money on our protective put is the stock price rising in value. Because we have no cap on how much we can make on the stock. If the stock goes up and up and up and up, we have additional profits on the stock. If the stock were to go down we're going to have losses on the stock and those will be reduced or offset depending on how far down the stock goes and what put we purchase, but it's not going to net have us profiting on that trade.

And so, let's think about some circumstances where we might want to do this. So let's say we're bullish on a stock and we think there's going to be continued

good news, it's going to continue moving to the upside, but maybe there's some uncertainty on the horizon, maybe we're worried about an earnings announcement, maybe we're worried about the news, maybe there's some sort of macro event. Any one of a number of reasons as to why we're still bullish, we still think and our base case is the stock going up, but we're not comfortable with all of the downside risk, we want to cap that downside risk on the stock that we own.

Now let's say we're worried about the news, but we think that news is going to be unfavorable for our stock, we think the stock is going to go down. Would the protective put be a strategy we might want to employ? Not really.

Because remember you're still losing money on the protective put if the stock goes down. You're just limiting the size of the loss. So, if we're bearish on the stock, if what we envision is the stock most likely is going to fall in price, really, we've got to be looking at other alternatives. Mainly looking at selling the stock.

So, let's define this risk-reward profile a little bit and make sure especially in terms of the risk that we're on the same page. So, the risk when we have a protective put in place is going to be the distance between the stock price and the strike price of our option. We can also think of this. We have a lot of

synonyms in option trading. And this is going to be equal to the out-of-the-money amount. Certainly, we'll walk through an example of this. So, if it doesn't quite click yet don't worry. But we've got to remember there's still loss potential, it's just lessened.

And we actually have a choice. Because remember, since we're the holder of a put, we can either exercise that put at some point in the future, or we can turn around and sell that put. We don't have to exercise the put and sell our shares. We can just recoup whatever remaining value there is in the put by selling it. The other thing too of course is this does not cap our gain potential. If the stock continues up the put purchase will reduce our gain potential slightly, but if we have a \$100 stock that goes up to 500, 1,000, 1,500, what have you, well, the reduction in our gain potential is going to be relatively small, but it does serve as a drag on return. So if you didn't feel that you needed that protection, if you thought you know what, I have really high conviction that the stock is going up, and if it goes down the downside is not very much, in a lot of cases like that the drag on your return of purchasing a put might not be something you want to accept or take on.

So, let's walk through our example here. Similar to before. So, in this case we have a slightly different stock. We have stock QRS. In our account we already

have 100 shares. And those shares are currently trading at \$92 a share. Now we're bullish on the stock. We still think it's going up. But we're concerned about the downside. Remember all those things that might be making you nervous about downside, those are in play here.

And so, we want to cap that downside. And so, we'll look at purchasing one put per 100 shares that we own. Now we also -- whenever we're looking at an option trade -- not only have to think about what is the downside protection that we want, but also how long do we need that protection for. Well, the longer we have that in place, oftentimes the more expensive it's going to be.

So, let's say we're worried about stock QRS between now and February, or now and March. And we go and we look at the options that are available. And the option that includes all of the time that we're worried about happens to be April. Let's say there was a January option, there's no February or March option, we got to go with April. And so, we'll look at purchasing that April option because it includes the time that we're concerned about.

And you'll notice in our example here we're purchasing a strike price below the current price of the stock. Stock is at \$92. We're buying the 90-strike option. And we're paying 95 cents per share. Or remember \$95 for this put.

So, I'm going to let Mai take us through the profit/loss table and diagram for this strategy. But definitely hang with us. And keep in mind it might be a little different than you expect because of that difference between the current price of the stock at 92 and the strike price of 90.

Le: Sorry, Sam, I think this one is yours.

Shore: Oh, okay, my apologies. And so, on this table similar to the other examples we have the price at expiration on the left-hand side. But the guts or middle of the table are going to be a little different. On the far right-hand side we still have the total profit/loss. But our middle two columns here are going to be what is our profit or loss on the stock, and what is our profit or loss on the option.

Now you'll notice at price point equal to or below the strike price of the option, that's that \$90, our loss is \$2.95 per share. And let's think about how we got there. So, at \$90 the stock has fallen \$2 from \$92 to \$90, that's our \$2 loss on the stock. And our option isn't worth anything at expiration if the stock is at 90. There's no value to selling the shares at 90 if we can go and do so in

the market. And so, our loss on the put contract is total. The whole 95 cents.

And so, when we sum those together, we get a \$2.95 loss.

Now as we go further down in price, so as our trade goes further against us, at \$85 you'll see we have a \$7 loss on the stock, but now we have a little bit of a gain on the option. We've made \$4.05 because that's the \$90 minus the \$85, those two different price levels, the strike versus the current price or the price at expiration, but we also paid 95 cents for the option, so we can't leave that out, got to factor it in. We sum those together, \$2.95.

So, we can see at price point equal to or below the strike price of our option at expiration the loss level is constant. We lose \$2.95. And so, if some really terrible news comes out and stock QRS goes all the way down to \$50, well, instead of losing \$42 a share on our \$92 stock, we lose \$2.95 a share.

Now let's start to look at it going in the other direction. Our breakeven price is no longer \$92. If the stock moves up by a penny between now and expiration, we're not making money yet. We need the stock to rise by at least the 95 cents we paid for the put option just to break even. And so, our breakeven on the protective put is going to be taking the current price of the stock and adding the option premium to it. And you'll notice our total profit/loss there at

92.95, we make 95 cents per share or \$95 on the stock. We lose 95 cents per share or \$95 on the put. No gain or loss. And then at prices above breakeven that's where you'll notice net we wind up with a profit. And our profit is just how much did we make on the stock less that 95-cent drag on our return that was the cost of the option. And there's no cap on our gain potential here. Stock goes up and up and up, we're going to have increasing levels of profitability. Just keep in mind we have that small 95-cent drag on our return at every price level.

So, let's go ahead and take a look at the diagram of this now. And we actually have a slightly different one here because we have a comparison on this diagram.

Le: Yeah. So as Sam mentioned, this is slightly different than the previous diagrams that we've looked at. For this one we added the long QRS shares shown as the light green line. We see here that the long shares show a linear relationship. We make money as the stock goes up and lose money as the stock goes down.

Downside is capped at the value of your investment which was \$92. And your upside potential theoretically is unlimited.

The protective put is illustrated by the darker green line. So, we see here as the stock rises, we get closer and closer to our breakeven point with our protective put. Where the dark green line intersects the horizontal axis, we have a breakeven at \$92.95. With the cost of the stock at \$92 plus the 95 cents in premium that we paid on the put.

Notice here that our line starts to flatten out at 90 and lower. And as the stock decreases the dark green line shows our loss is capped at \$2.95 versus being long the QRS shares we could continue to lose all the way up until \$92.

So, at \$95 we are starting to see that we have a \$3 gain on the stock less the 95-cent premium paid. Which gives us a gain of \$2.05. And similarly, we see that at \$100 we have a gain of \$8 on the stock offset by the 95 cents paid on the put option. Bringing our gain to \$7.05.

So, the upside potential on this is similar to being long the stock. The only difference here is that we've slightly decreased our profits by buying that put option.

So, as we're looking at this chart here it may look familiar to you, and it should. Long stock plus the long put is equivalent to a long call. Our protective put like a long call is still going to be a bullish trade. They both have limited risk as the stock price moves down. Your risk is limited to the difference between the cost of the stock and the strike price plus the premium paid. And the reward on the strategy is still unlimited.

Now that we've got an understanding of our three strategies, how do we actually execute these types of trades?

Shore: So we want to go through just a couple of quick considerations about having an option position, and then just like Mai mentioned and as we had said at the outset, we're going to take a look at where can we find some of this information and implement it on Fidelity.com.

So, the first thing we definitely want people considering, and I think it's important especially when you're moving from trading stock to trading options, is we have to be very aware of the leverage that we're utilizing. Now depending upon the stock of course it might be uncommon for you to say, "I'm going to buy a single share of stock." And so, for some reason trading a quantity of one might feel like a small trade. But we've got to remember with

an option trade typically buying one option contract controls 100 shares of stock. So, if we're buying a call option, we're controlling owning 100 shares of stock. If we're buying a put option, we're controlling similar to shorting 100 shares of stock.

And the reason why we mention this is a lot of times people start option trading and they say, "You know what, I would buy 100 shares, and so let me buy 100 option contracts." And we've got to remember that if you're buying 100 option contracts you are controlling 10,000 shares of stock. It's a much larger position, it's a lot more leverage than buying 100 shares of stock.

And so, whenever you're placing a trade, the quantity that you're entering is the number of contracts that you're trading. And if the quantity of contracts that you're trading controls a quantity of stock that you're uncomfortable with, that might be a moment where we need to tap the brakes and say, "Wait a second. Is this really an amount of risk that I'm comfortable with?" And we need to be mindful of how that position sizing is going to impact our risk.

With the examples that we've gone through, including the profit/loss diagrams, we've been talking about it in terms of one contract. So, in terms of price per share. But we certainly can't ignore or forget that if we start

multiplying that by a lot more shares those numbers can get really big really quickly. And so it's always important that whenever you're looking at an option trade certainly the profit/loss diagrams help with this, but also take a look at well, what is going on with this trade in terms of actual dollars in my account, my actual net worth, if the trade does poorly. And certainly, if that type of a loss is a loss that would be unacceptable to take in any circumstance, we've got to be very very careful if that's really the size option trade that we want to place.

So, at a minimum when we're starting out, we want to have some idea in our head of okay, I'm comfortable trading 100 shares of stock, 500 shares of stock. Maybe you are comfortable trading 1,000 shares of stock. But we need to also have in mind as well one option contract is that 100 shares. And so, we don't want to just increase the size of our option trade simply because it's less capital per trade. We've got to realize the leverage that's coming into play there.

Now the other thing we also of course would be I think remiss without mentioning is the now what. So, we've talked a lot about opening up trades and we've talked a lot about what the value or profitability for a given trade might be at expiration.

And we have this handy table here. We're mostly going to focus on the left-hand side of this today. I'll leave the right-hand side, the short option trades, for Thursday's session. But with our long option trades, after we enter the trade, we really have three things we can do to close out our trade.

Let's focus on the bottom two first, because these are typically done at expiration. Certainly, with American style options you are able to exercise it early. But excluding some rare circumstances it's relatively uncommon. And so usually if we're looking at exercising an option we're doing so at expiration, on the expiration date, maybe after the conclusion of the trading session for that day. And certainly, if we're letting it expire, well, then we're just taking no action and just allowing the right that we've purchased to expire worthless.

But let's talk a little bit about selling options. And solely in terms of selling an option that we've purchased. So, we're long an option. And the option contracts are fungible. You can buy or sell them at any time prior to expiration. There's an active market for most contracts. And so if you own an option and you no longer want that exposure, or maybe you hit a profit target or maybe the trade has gone against you and you've gone and the loss

threshold that you had for the trade has been hit, then you can go in and sell the option contract prior to expiration.

In our examples we were talking about purchasing an April option. Well, if we decide come January or February that we no longer want that option trade, we no longer want that exposure, we want to close it out, you can absolutely sell the option as long as there's a willing buyer for it.

So certainly, for in-the-money contracts it would be very uncommon for there not to be a willing buyer. If you had a very very far out-of-the-money contract maybe in some circumstances you might not be able to sell it because the contract is functionally worthless. But we've always got to remember. We're not locked into our trade all the way until expiration. We can close it out as long as the market is open and there's a market for that contract.

So, let's take a look at some of these things on Fidelity.com. So, give me just a moment here. And I'll share my screen on Fidelity.com. And it should look pretty similar to what it looks like when you log in to your account. Give it just a moment to come up for everyone here. And then we'll walk through how to get to the option chain. So that'll allow us to see what expiration strikes are available as well as the pricing for them. And then after that we'll take a look

at how would we actually go in and place an option trade that we want to place.

So, from this main page we'll just go up to the very top of the page to news and research. We'll see about two-thirds of the way down our menu. Sixth from the bottom is options. Let's go ahead and click on that. It'll bring us to our options research section. Along the top there are a myriad of tools that we can utilize in our option trading. Our focus here is really going to be on the option chain. And we have a field here we can type in the symbol for the underlying and hit enter or hit the little magnifying glass here.

Up at the top it'll show you what is the underlying you've plugged in, as well as giving you a quote. You'll notice down below we have a lot of information. But let's talk through how this is going to display for us, and how we can customize the display. Up along the top here are several buttons as well as menus we can click on. So, for those who might be more advanced in your option trading, you can go through and choose the strategy that you're wanting to display in the option chain.

Right now, and I think one of the most commonly used views by traders is going to be just calls and puts. You can choose how many strikes are

displaying at one time. For something that's nearly a \$300 per share underlying, there are going to be more than just the 10 strikes that initially show. But it might be a little overwhelming if we're looking at a 10 strike and a 50 strike and a 100 strike on something that's trading at nearly \$285. Or if you're looking at a 400 strike. Maybe not pertinent to us. But we're able to control what strikes are displayed here or set a custom range.

You can filter out by volume or open interest if you're only wanting certain types of contracts or certain amounts of contracts with activity to be highlighted. We can control if it's displaying that visual aid, that histogram, behind the volume and open interest up at the top here. And show or hide weekly options. Right now, for simplicity's sake we have the weekly options hidden. And then we can also go here into the settings. And in the settings, we can control what columns are displayed and the order in which they are displayed. You can actually set defaults for those filters that we just mentioned and walked through.

So just above where we start listing option contracts you can select or deselect the expiration that you want to show. And then after you make the appropriate changes that you want, be sure to hit the apply button here so that it implements the changes and reloads it as you're intending to see it.

Down below we have a variety of columns. You'll notice with calls and puts our middle column here is going to be strike prices. And there are going to be separators for the different expirations that we've chosen to view. So, you'll see here September 18, 24 days out, September 30, 36 days out, so on and so forth.

In the columns that we have remember we have some customizability here. So, we have some of those maybe for those who are more advanced option traders what are commonly known as the Greeks, which are a type of pricing analytic. And the implied volatility for the option. But maybe more importantly, and certainly necessary for all of us, we have the current bid and ask price for the option that we're interested in.

Now you'll notice we have our strike price here in the middle. On the left-hand side we have calls. On the right-hand side we have puts. So, if we said, "What is the current price for a 280-strike put for September 30th?" Well, we'd go down here to our September 30th expiration. We look at our list of strike prices. And go to 280. We said, "Well, we want to look at the puts." So that means we're going to be looking on the right-hand side. And if we're looking to purchase, we're going to be interested in the asking price.

From this page if you click on the asking price it'll bring you a trade ticket prefilled to buy the option. If you click on the bid price it'll bring you to a trade ticket prefilled to sell the option. If that's confusing, you're ever uncertain of which, don't worry, you are able to change whether it's a buy or sell prior to placing the trade after you click on the bid or ask.

Alternatively, if that's difficult to keep straight -- sometimes it can be -- you'll notice to the left and right of the strike price we have a little triangle. If we click on that triangle it brings us to a menu. The bottom four selections in that menu are where we can go in and maybe do some additional research or analysis around the underlying or our potential trade. But our top four selections here are going to be our trade actions. So, let's say we want to buy to open this option contract. If we click buy to open it'll bring us to the trade ticket. And allow Mai to take us through the trade ticket.

Le: Great. So now that we've done our research and we've got our strategy, we're ready to go ahead and place the trade. Here we've got our options trade ticket. Now if you weren't using the options chain to get to the trade ticket you can actually also access the options trade by going to accounting trade up in

the green banner there. And go down to click on trade which would be the third option down.

So, we'll start from the top of the trade ticket and we'll work our way down. At the top here we have a drop-down menu. We can choose which account you want to trade in. I get calls about this fairly frequently with placing trades in the wrong account. Oftentimes our clients do have multiple accounts that they trade in. And they may not trade in their default account they have set up every single time. So, if you do have multiple accounts always just double-check and make sure the correct account is selected.

Now once you select your account here, you'll see that your balances for that corresponding account comes up and it shows you what your buying power is.

Below that we have the underlying stock symbol here. Sam has chosen QQQ. That was auto-filled there directly from the options chain.

Now you'll notice here that we don't type in the entire symbol for the option. It actually just gives you the drop-down menu for each part of the option. If you do like typing in the option symbol and you already know what you want

to trade, you can always click on that checkbox for edit symbol. And you can manually type in the symbol. It's just to the right of the quote there.

Now for our example I'm going to go ahead and use the drop-down menu to select our option here. So, our first part here is our action. We can think of this in two parts. To initiate the trade are we buying or are we selling? And then we need to decide if this is going to be to open or to close. If we are adding to the position it would be an opening transaction. If we are reducing or removing a position, we already have in our account we would choose closing.

So, since we discussed buying options today, our action we'll select is buy to open. Next, we have the quantity. The quantity here indicates the number of contracts that we want to open up. So, remember that each contract usually covers 100 shares. So, when we enter in a quantity of one, that would be for one contract covering 100 shares.

Next, we've got the expiration here. Sam has chosen September 30, 2020.

Let's say we want to go out further. We just click on the drop-down menu and we can choose any other dates that are listed.

And for our option here for our strike price Sam has also chosen the \$200 strike price and we are bearish on our strategy for QQQ, so we've chosen a put.

Once we select our options here, you'll see below the description of the option that you've chosen. It's also going to show our last price it traded at, the change in price, our bid size, the bid, ask, and ask size.

Next, we'll have to choose our order type. So, we click on the drop-down menu for the order type. You'll see there's a lot of options. The main ones that our clients usually use for options trading, usually we're looking at market order or limit order.

We choose a market order. We're looking to get this executed at the next available time. Limit order would be something that's a little bit more common for options. Oftentimes options are not as liquid. So, we want to limit our risk. And go ahead and place a limit order on this. We can place a limit on based off of the ask or we can go in at the midpoint, so whatever your preference is.

Next, we have our timing for tonight or Tuesday. If we just want this order good until the close of market, or you can choose good till canceled. You want to keep this open for the next six months.

And then we've got our trade type here. Usually if you have a margin account it's going to default to margin. If for any reason if your preference is to trade in cash, you can click on the drop-down menu and choose cash.

So once everything is filled out, you'll see below there's a preview order screen there. If you click on that. Just make sure you read over everything. Make sure that all of your features were selected correctly, that everything reads back correctly. You can go ahead and place the order on the next page.

END OF AUDIO FILE

Options trading entails significant risk and is not appropriate for all investors. Certain complex options strategies carry additional risk. Before trading options, please read Characteristics and Risks of Standardized Options, and call 800-544- 5115 to be approved for options trading. Supporting documentation for any claims, if applicable, will be furnished upon request.

There are additional costs associated with option strategies that call for multiple purchases and sales of options, such as spreads, straddles, and collars, as compared with a single option trade. Examples in this presentation do not include transaction costs (commissions, margin interest, fees) or tax implications, but they should be considered prior to entering into any transactions.

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Greeks are mathematical calculations used to determine the effect of various factors on options.

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