TRANSCRIPT

OIC: Options basics – What you need to know

MIKE RUGER: Good morning, everyone. Thank you for joining us for today's session, Option Basics: What You Need to Know. My name is Mike Ruger, I work as the Regional Brokerage Consultant for Fidelity, based out of Seattle, Washington, and my role really entails helping investors just like yourselves leverage Fidelity's trading tools, market expertise, to help guide your investment decisions and really get the most out of your Fidelity relationship. I'm joined this morning by Ed Modla, he is the Director of Education from the Options Industry Counsel, a 20-year veteran of the industry, former market maker. A pleasure to have him join us this morning and provide all of you with the education that you need to get started on your options journey.

And so, with that, Ed, I'd love to turn the floor over to you. Perhaps you could share a few words about yourself and kick things off for us.

ED MODLA: Sure. Thanks, Mike, I'm always happy to be here, and thanks to you and the whole Fidelity team for offering this opportunity to provide some options education. I got my career started in the late 90s on the trading floors in Chicago and in New York, as an options market maker for the largest options market making firm on the Chicago floors back at the time. Spent a number of years also as an independent trader, and then moved into the service side of the business. I was a futures broker for a number of years until some difficulties in that industry came up in 2011. And now for the last five and a half years, been exclusively teaching the options product to investors. That is what we do at the Options Industry Council, formed back in 1992 for the purpose of providing free education to the public about the options product, and I'm happy to be here to talk about options basics and walk through some foundational knowledge about the product, and to get into core concepts throughout the day and tie that into the resources that Fidelity has to offer and the platform, and how the options product is showcased and traded that Fidelity has to offer its clients.

First, our disclaimer, options are not suitable for everyone. They are a rather complex tool that needs to be understood before trading them in a live account, and to clarify today's relationship, there is no formal partnership between the OIC and Fidelity. We are teaming up to provide education, but the slides here prepared here by OIC, and there is a separation of business and interests.

I wanted to start, before we get into the outline of the presentation, spending a few minutes here on the options volume, annual volume through the years, as you see the inception of the listed options product back here in 1973. Obviously, this explosive growth at the turn of the century, electronic trading comes to mind right away. I would also say the age of do-it-yourself investing during these years. Investors took control of their money, worked more closely with their advisors and learned about the options products, awareness, education, really lead to taking off the volume that we see in options. I mentioned 2011 here, where we had a spike. The year of the European Sovereign Debt Crisis, increased volatility throughout 2011. No volatility at all going through 2012 through '17, and then we had the spikes in volume that came up in 2018 and 2019. Now, let's just take a look at these years here. This is five billion contracts. Those are that record-setting pace in 2018 and '19. If you break that down, it comes out to about 19.8 million contracts traded every day to get this record-setting pace of five billion.

Now, we know 2020 has been a year for the history books on so many levels, and options volume is one of those. Year-to-date here, we're sitting at the end of July. The industry's averaging 28.3 million contracts per day. Average that out, if we keep this pace once the 2020 number goes up, you're looking at it being just over seven billion, that's the pace that we're on right now in the options industry, and I have to be careful how I think about that. This certainly does not seem like a time to celebrate anything. We know what's going on around the world, from both the health and financial perspective for so many people. But instead of celebrating, it's more a time of reflection on just how popular this product is, and during times of market and personal stress, investors and money managers continue to turn more and more to the options product.

Speaking of our current environment, we've seen that sharp rebound after the March decline, and capturing the headlines are many symbols and names that have recovered well into green territory, are hitting huge years. But there really is a disparity between the market right now and taking a look at the S&P being basically flat on the year as we speak, while the NASDAQ is up 15%, and the Russell, the small caps, down 10%. There's a contrast in what's going on. I also took a little deeper look into the S&P and saw that 62% of those stocks today are sitting in red territory. So, it's a top-heavy market, and if you're in those symbols and those names, you might be doing quite well, and that's great. But for a lot of investors, if you don't have those top-heavy names, you might not be sitting with such a great year in 2020, and don't get discouraged. You're not alone. You have to have had your names in the right sectors and the right symbols in order to capture those big moves. Much of the market has not totally recovered, and it's an interesting year. It's a different type of year than any other. Mike, I'm sure you've had conversations regarding the market dynamics this year, and you know, I'm curious to know what kind of insight you've had and commentary with clients and colleagues about just what we've seen this year with the market.

MIKE RUGER: Yeah, it's a great question, and I think any time you go through a period like we have for the last six months, you know, a lot of volatility, a lot of uncertainty, it forces a lot of investors to pay closer attention to their portfolios. So, we've certainly been having discussions, and I also think it's important to have conversations like we have today. As we'll be discussing, when you think of the role that options can play in a portfolio, you know, really multi-purpose, and it's just so important to fully understand the mechanics of how they work, but also broaden your horizons a bit, so you know, whether you're a novice option trader looking to reaffirm your understanding of basic strategies or build on those strategies, perhaps you want to use options to speculate on some of those big movers or to protect positions or generate income to try to enhance some of your returns. Options can be used for all of those things.

To your point, Ed, in addition to just a recognition of how much different the marketplace is this year than we've seen in recent years, I do think that options have the opportunity to play a role for investors, perhaps moreso than any time in the recent past.

ED MODLA: Yeah, you're absolutely right. The versatility of the product is going to be clear as we get through the presentation today, a quick outline, we'll get started with the definition of options from the ground floor, Options 101, what are options by definition, rights versus obligations, then we'll break apart calls versus puts, and look at the four outright options positions, which form the foundation for all strategies, and then the final segment will be interesting. A couple things going on there, we'll look at how your account balances change as you enter options positions, then we'll also include there in that final segment a reference to some very valuable resources that Fidelity has to offer, so make sure that you are able to write down where those resources are. You know where they are, the more education and knowledge you have, the better your trading decisions are going to be, and having those resources at your fingertips are very important.

Now, let's just take a step back and think about stocks for a second. Most investors, all investors, are familiar with what it means to buy or sell shares of stock. You enter an order, and whether it's to buy or sell, that order is set to a stock exchange, and it's worked to execute against an opposite side, and when you do make that execution, the transaction occurs on the stock exchange. Separate entirely from those exchanges are options exchanges, where buyers and sellers, all market participants, are sending bids and offers to trade options contracts.

What are they? Let's start with broad options terminology. Options are contracts that give buyers the right to purchase or sell an underlying asset, and for our purposes today, this underlying asset is shares of stock. The buyer pays money upfront and receives the right to execute some transaction in shares of stock.

On the flipside, the seller of an options seller is paid upfront, non-refundable, and in exchange for getting paid, the seller of an option takes on the obligation to fulfill the buyer's rights, or to buy or sell the underlying stock at the buyer's discretion. If the buyer wants to do so, the seller is obligated to fulfill those buyer rights. That's the key difference between buyers and sellers.

The contract itself will define what price might this transaction take place at, and for how long does this right and obligation exist. Investors choose which price and which expiration date they would like to trade. Buyers have rights, sellers have obligations.

Now, back in 1973, when the options contract was listed for the first time, there were standard terms which made the contracts fundable. You can buy them from somebody and sell them to somebody else. Prior to 1973, that didn't exist. So, what are standard, listed options contract terms? First of all, you need to know what stock you're trading here. That's rather obvious. The stock will be identified. The unit of trade is going to be 100 shares for a standard options contract. That's how they all start. It is possible that the unit of trade changes due to a corporate action, but that's rather rare and not for our purposes today. A standard contract is written on a unit of 100 shares of stock. The strike price, or the exercise price, is, again, the price at which the buyer has rights and the seller has obligations. And then the expiration month, how long does this contract exist, and when does it expire? All of those components come together to develop a price. How much does this option cost? Well, you need to know all of these details, where's the stock? What strike price is it? How long does it exist, and there's also the element of volatility, which we will get into in session two today. All of those variables determine the options price, and it's important to make sure you're aware of all of these details, specifically volatility, when you get into selecting your options contract.

Now, there are two types of options. We had earlier said that buyers have rights and sellers have obligations, the buyer has the right to purchase or sell shares of stock. So, which is it? Do they have the right to buy shares or sell shares? It depends on which option is being traded. Investors can buy a call, buy a put, or sell a call, or sell a put. Those are the four outright positions that can be traded. Every other option strategy is derived from those four outright positions, which we're about to outline. Maybe you can already start to see the flexibility of the product that Mike spoke about earlier, as you can combine those four with each other. You can combine options with stock, choosing different strike prices, expiration dates, choosing different quantities. There's all sorts of different things you can do with the options product, and it speaks to why people use options. Put together with other options or with stock, you can reduce the risk in your portfolio. Income generation refers to selling options, which is synonymous mostly with reducing risk, specifically less risk than owning shares of stock. You can enter an options transaction to attempt to acquire stock, an alternative to using limit orders. You can speculate, we'll talk a little bit about that today, using leverage and speculation. But all-in-all, the options product is flexible. And Mike, you mentioned this earlier, flexibility. Do you often find that investors grasp that? Is it a conversation you're having with clients about why should I care about learning about options? Why is it important, and what can it do for me?

MIKE RUGER: Yeah, absolutely. I think the biggest hurdle to options trading, in my experience, is that for most investors, they're confusing, right? They're a complicated financial instrument, and what I always try to bring it back to, really to drive home the simplicity, if you will, is that that term, "contracts," you know, that's not arrived at by happenstance, and we enter into contracts on a regular basis throughout life. Option contracts are no different. The nomenclature is different, and sometimes, unfortunately, the language is a bit of a barrier to entry. But at their core, you know, when you think of what an option contract represents, it's simply an agreement to potentially transact shares of a stock. And part of that agreement is how long is it in place for, right, your expiration date; at what price are we agreeing to transact the stock, that's your strike price; and then finally, to your point around the puts and the calls, there's really only two types of contracts, and that's going to determine what do I have the right to do versus what do I have an obligation to do. And so, again, just to summarize, at the end of the day, when you think about option contracts, agreement to trade stock at a predetermined price on or before a predetermined date. And once you understand those core concepts, I mean, you can literally take any position, any exposure that you want to capture price movement, volatility, things of that nature. So, again, I love driving home that point around the flexibility, but before you start building out complex strategies, and I would even argue building out basic strategies, it's critically important to have a solid and firm understanding of what are the terms of the contract, and do I understand, as an investor, what the implications are to me if I buy or sell this option.

ED MODLA: Yeah, it's largely often about tailoring your portfolio to more closely resemble your risk tolerance and your market outlook, and options can do that unlike any other investment product. You said, calls and puts, there's two types. Let's dissect and get into each of those two. And we're going to focus first on calls for a few minutes, and then we'll get into puts later. Equity call options, an equity call buyer, again, has paid money upfront, they've paid the cost or the price of the option, that's a debit, and non-refundable. In exchange, they now own the right to buy shares of stock. They have that right for a certain length of time, they know the price that they own this right at, and that price has largely determined how much did the option cost in the first place. Equity call buyer is bullish on the market. If you own the right to buy shares at 60, stock's trading at 55, and it goes up to 65, the right to buy shares at 60 you would expect to increase in value and work in your favor. So, an equity call buyer is bullish and is entering the market with a bullish stance as a substitute to buying shares of stock.

On the other side, the call seller is paid, non-refundable, up-front cash. That goes into their account as a credit, and the seller has taken on the obligation to sell shares of stock. Now, undoubtedly, the overwhelming majority of the time, call sellers already own shares of stock, and that's the example we'll walk through in just a second. Owning 100 shares of stock and using the sale of a call to emulate a limit order to sell those shares at a certain price while getting paid to take on that obligation. We're going to walk through that example in just a second.

A little bit of terminology, as you might hear different terms, an equity call buyer is also the holder of the contract or is long the contract. The word long can mean a few different things, as opposed to, say, short the contract here on the call seller, synonymous with being the writer of the contract or short the contract.

Traditionally, long means you're bullish, and short means you're bearish, but not defining it here, being long the contract simply means you own it, you purchased it, you own this contract, and you're long the call. Short means you sold it, not necessarily market direction at all. So, two different meanings for the terms, long and short, and we'll actually use both of those.

Let's look at each of these long and short calls on a profit and loss graph, so you can see how it looks. First with the call buying example, now, as we put up these different profit and loss graphs today, it's probably important to mention that these risk profiles are drawn at expiration, as if we've reached expiration. And that's because you can only calculate with certainty, given a certain stock price, what will an option be worth if you're looking at it at expiration. We're going to break apart options pricing in session two, but to forecast that a little bit, if you're a week till expiration, or two weeks before expiration, there's going to be value in the option to account for the possibility of movement in the market, and movement in the stock. And it's impossible to draw a profit and loss graph if you can't know for sure what the option is worth. At expiration, different story. Given a stock price, you can calculate with simple arithmetic what would the option be worth.

So, here's our example, buy the 60-strike call at $3. This is opposed to buying shares of stock, and just look at the difference. If you bought shares of stock, in this case say 100 shares, you pay $6000, and you have a larger cash outlay. You have significantly more risk to the downside, but you also have a clean entry and a break-even point right here at 60. As soon as the stock rallies, you start making money.

The options contract operates differently. You paid $3 for the contract. Prices are quoted and traded on a per-share basis; we've already said that the listed standard contract is written on 100 shares. This costs $300 total dollars. Now, if the stock stays under 60, the right to buy shares at 60 isn't worth anything. If that happens and you've reached expiration, you've lost all $300. If the stock rallies, by the time you get to expiration, you need a $3 move before you even reach your break-even point. This is what you give up, this is on the negative side. You can see right here that your cash outlay is small, the potential for profits can be big. If you hit the right trade when you're speculating by buying the returns, the percentage returns can look rather large, however, your percentage losses can also be rather large, and, if you're thinking through these price dynamics and market movements, you need to be right when you're buying options, on the direction of the move, the magnitude of the move, and the timing of the move, in order for that option to start working in your favor. Now, we say breakeven is 63, that's true at expiration. If the stock happened to move up to 61 or 62 right away, within a day or two, you might be able to get out of that trade for a profit without seeing 63. And oftentimes, that is what happens, is the exiting early transaction with options.

Selling, let's move over to call selling, and we've got the covered call, arguably the most popular options trade, options strategy that exists. In our example, we owned 100 shares at 52, and maybe this stock just isn't moving the way we thought. It's trickling, it's going up, 52, 53, it's just not getting there. We'd like a little more profits, but we're ready to get out of this trade if it gets up to 55. We're comfortable selling there. We could use a limit order and exit as soon as the stock reaches 55, or we could sell a call contract that obligates us to sell shares at the target price of 55 and receive in this case $175 of premium up-front to work this obligation. Now, that seems like a pretty good idea. Not only are you getting paid for selling the call, but you've also lowered your total cost. You paid 52, and then you received $1.75 lowering your break-even point. So, there's a couple of benefits here to the covered call. Keep in mind, if the stock does rally, say it goes above 55, your limit order would have filled you and exited the trade where you wanted to. The option may not get you out right away. Most likely, assignment on your short call would occur at expiration, it's rather rare for it to happen prior to expiration, so it is possible here if you're not paying attention, the stock goes through 55 and then comes back down and you never got out of your position. If you do see something like that, you may have to take some active position management techniques to trader out of the position when the stock goes above 55.

Now, maybe I took liberty to say covered calls arguably the most popular. Mike, would you agree with that? Do you talk a lot about covered calls with clients, would you say?

MIKE RUGER: (laughs) Yeah, absolutely. Far and away the most common strategy that comes up. And I think it's for a number of reasons, one of which, in my experience, call options tend to be a little bit easier to understand than put options. So, folks that are kind of getting their feet wet so to speak with options are selling calls to great compliment, has the potential to be a great compliment to an existing stock portfolio. And you know, we talked about flexibility a moment ago. Even within just this one strategy, there's so much flexibility. So, I love the example here, when you think about what's being achieved by selling this $55 call on a stock that you're in at $52, well, on the one hand, it's an income generation strategy, right? So, that premium of $1.75, that's collected upfront. You never have to pay it back necessarily. So, that's income that the stock wouldn't have otherwise generated. I also loved and commonly use that same analogy. It's like a limit order, right? So, if as an investor, I'm looking at that $55 strike price as a potential profit target, that provides an opportunity to, instead of setting a limit at $55, sell the covered call at $55, and in a sense, it's like getting paid to have a limit order outstanding. Now, there's some intricacies there we won't get into full details around, but by and large, it accomplishes the same purpose.

ED MODLA: Yeah. You're right.

MIKE RUGER: Yeah, and the third, I think a commonly overlooked use of covered calls is actually kind of taking the opposite approach and being a little bit more aggressive as an exit strategy. So, this is, especially with some of the appreciation that we've seen with some of the big names you alluded to, you see a lot of investors who are looking for a way out, so to speak, taking profits. And when you calculate the break-even here, this is a great way to, again, you sell a call option, and if you kind of flip this on its head and say, "Well, what if I sold a $50 call option on this $52 stock?" Sounds a little counterintuitive, but that gives you a much higher likelihood that the end result is that you do sell the shares, and you're going to collect more money upfront. So, you know, again, just multipurposed here. You're generating income, you're reducing your break-even. You can control your exit strategy. Something that we commonly think of as simple as a covered call has so many different uses.

ED MODLA: There's a lot of choices that the investor has here, as you've outlined, certainly maybe for the next level discussion on covered calls beyond today.

But yeah, different strike prices can be chosen, different expiration dates. If you have 1000 shares, you can sell fewer calls than 10. You can choose different call options to sell four, three, and three, all sorts of different things you can do, and a common theme is just how flexible the product is, and how you can tailor it to your liking.

Call buying and call selling, here we have more call buying being the speculative trade most often here, sell calling undoubtedly the risk-reducing trade as a limit order substitute to covered call. Let's look at puts. I'm going to say the same exact things here, but just from the opposite perspective, opposite direction. An equity put buyer pays upfront as a debit, cash right away out of their account, and owns the right to sell shares of stock. Now, also the holder or long the contract, they bought the contract, they're long the contract. Nothing to do with market direction or market bias.

An equity put seller has been paid upfront and now taken on the obligation to buy shares of stock, again, at the strike price, and they're under that obligation until expiration date, known as the writer or short the options contract. Let's break apart these two, just as we did with calls, with some commentary on why you would do this. I'm going to go through put buying a few different ways. First of all, as a speculative trade, most often investors are not going to be shorting shares of stock if they're bearish. So, here you have put buying as a substitute for that type of objective. If the stock's trading here at 36, shorting stock is not something most investors would do, but if you're very bearish, put buying is a choice. In our example, buy the 35 put, pay $225 upfront, and now you own the right to sell shares at 35. The stock stays above that level and selling shares at 35 isn't worth anything if you can sell them at 40 or 45 in the open market. So, if that happens, that's a full loss of the cost of the option. As the stock drops, the right to sell shares at 35 will increase in value. Shares are trading at 30, this option is going to have at least $5 of value to it. You paid two and a quarter, and that's where you start to make money, maximum loss, maximum gain. That's buying puts as a speculative trade.

There's another very popular way to use buying puts, and that's as a hedge against a stock position you already own, again, combining stock with options. Buy 100 shares at 42 and buy a protective put for $1.55.

So, from 45, well, here you have the break-even point, 43, 55, your entry point 42, all you have to add what you paid for the option to get your break-even point, but here's your risk. From 42 down to 40, that $2 move down is similar to a deductible. That's where that 40 line comes into play. So, there's your deductible, and here's your premium, $1.55. Again, you can choose the terms, 30-day will cost less, 90-day will cost more, you can choose different strike prices. The larger deductible you're willing to accept, if you go down to $35, the higher this is going to cost. The lower deductible you have, if you chose the 41 strike, you know, the less risk you're taking to the downside. So, here you have this dynamic of using puts, the right to sell shares, as protection against a long stock that you already own in your portfolio.

And then let's flip to the cash-secured puts. This is selling put options, if you -- it doesn't really matter where the stocks' trading in our example here. If you sell a put option at the 80 strike, you are receiving premium upfront, and have taken on the obligation to buy shares at 80. Now, you might want to do that. That might be something you're perfectly comfortable doing is buying shares at that level, and in this case, selling the option for $390. Now, you might be thinking, where does that premium come from? And we use calculators to put these numbers together, maybe this is a long-term option, maybe it's a short-term, higher-volatility stock, and we'll get into more on options pricing in session two, but selling the put option here at 80 obligates the investor to buy shares there at 80. If the stock stays above that level, you would not expect the put buyer to exercise their rights, and the option just expires with this profit of the premium received upfront. If the stock does drop below 80, you can expect assignment with a cost basis, break-even point of the price you had to pay, the strike price of the option, minus premium upfront. That gives you $76.10, and again, this might be a strategy for a stock you already want to own, but maybe not at the level it's trading today. And if it doesn't get down to your target price, well, you're going to make something off that trade by selling puts. If it does retrace and move lower, you've got an opportunity to come in there at 80 and get paid along the way. It's somewhat of a use of a stock acquisition strategy and limit order strategy

So, both sides there, Mike, on puts, you know, speculating hedging, cash secured, you know, what are your thoughts on these three with respect to their viability for the investors and clients that you work with?

MIKE RUGER: Yeah, so, I think the first thing I'll point out here, I made a comment earlier that for most, you know, beginners, folks getting into options trading, it's a little bit more challenging to kind of wrap your head around the mechanics of put options in general. And I think a lot of that has to do with, like you alluded to, when we think of long, we think of bullish, when we think of short, we think of bearish. Kind of the opposite with puts, right? But, I guess the one piece of advice I'd like to share is, I find it easiest and always recommend if you kind of think of the option contract itself as a first step, think of the option contract from the perspective of the buyer. Meaning, if I buy a call, or if I buy a put, I know that that entails the right to do something, meaning I control the outcome, what does it give me the right to do, right? And so, with a call, you have the right to buy the shares, with a put, you have the right to sell the shares.

So, then it's very easy, if you think of it from that perspective, well, if the person buying the put has the right to sell the shares, so then think from the other side. So, if I'm selling a put, I'm then obligated, then, right, to purchase those shares. So, kind of a roundabout thought process, but I find it easiest, you know, for those of you who are looking to get into options, or perhaps have struggled with that understanding in the past, if you think of the option from the perspective of the buyer or the holder first, makes it very easy to kind of think of the cash-covered put example. What does it mean if I sell a put?

So, to more directly answer your question, Ed, I think that this particular strategy is a really important one, because it's one of the few options strategies, number one, that you can do on an IRA account. So, this is a question that commonly comes up, "what can I do in my IRA account at Fidelity as it relates to options?" Many investors are surprised to even know that they can trade options in their IRAs, but you are going to be a little bit limited. So, you can do covered calls. You can also do cash-secured puts, which we see an example here. And, the additional strategies are the ability to buy calls and buy puts.

So, virtually everything we've discussed today can be done in both an IRA and a taxable account. I would say second to the covered call, this cash-secured put is probably the second-most-common strategy. And it kind of makes sense, when you look at the risk-reward profile, if you will, this graph looks awfully similar to one we looked at earlier, right, in terms of, you know, you've kind of got a cap on your upside, you're collecting some premium upfront, and your risk -- the risk to you is if the stock price goes down. You know, similar to a covered call, right? So, in those situations where you kind of had the same outlook, have the same objectives, for a lot of investors, they -- they like to use cash-secured puts in place of or where covered calls don't fit in. So, another example of a really common strategy, really useful strategy.

ED MODLA: Yeah, you're right. Those P&L graphs look the same, they are, and oftentimes for investors, the cash-secured put is used unless they already own shares that have moved, and then they're looking to overlay the calls on them, but certainly it was nice to hear you explain the account permissions and the account types, cause that certainly plays a big role, you have to be aware of what you can and can't do in various accounts, we really want to look at the tools and the resources that Fidelity has, but very quickly, I just want to walk through for just a couple minutes what it might look like in your account as you buy and then sell an options contract. Nothing here is different from the way it would work with stocks, but just because options so often involve selling and receiving credits and having debits in your positions, it's worth looking at how your account balance changes, and I'll also stress the importance of checking your account, and not just looking at the bottom line, but seeing all of the changed as you're entering and exiting positions, just so you have a full understanding of what's going on with your cash, your positions, and how your overall balance is affected.

First example here is going to be through the lens of buying an options contract, and in our example, we're going to use the September 90 call quoted $120 bid offered at $130 and we buy at the offer price of $1.30. Remember, this is on a per-share basis, options are written on 100 shares. So, if we pay $1.30 for this contract, the cash outlay is $130, $1.30 times one contract times 100. Now, in exchange for that debit of cash of $130, we now own a position. We have a position that has value, one long September 90 call. Undoubtedly, your position is going to be valued at the best price someone is willing to pay to buy it from you right now. And at the moment, that is $1.20, the best bid. If you made a mistake and you had to get out of this position right away, best price you can get is $1.20. This difference between the bid ask spread and your cash outlay versus position credit is most often going to initially result in some kind of small account balance change to the negative. The wider this bid ask spread is, the more you might see that account balance change to the negative right away. It doesn't mean you're losing money right away; it just means the best price you can get right now based on the bid offer is worse than the price that you entered the trade at.

Now, let's move forward. Now, say the market rallies, goes in our favor, and now the bid ask is $350 at $370. Well, the cash position in our account is not going to change. It's still down $130, that was our paid upfront cash account. The position we have is the same, but it's being valued at the current bid of 350 or $350. Put those together, and our account balance has drifted higher, now up to 20 as the market's rallied and the option position has moved in our favor. Let's go a little bit further out in time, and the market pulls back, and you say, "I've had enough of this position. I've made decent money. I could have got $3.50, but I'll take $3." You sell and exit the position there. Again, your cash position doesn't change, you're still down $1.30 there on your cash side initially. Now you have no options position, but this profit of $1.70 is now going to go into your overall account balance, $300 cash is going to get moved into your cash account, and positive $1.70.

So, you have this evolution, no different from when you buy shares of stock. But maybe worth looking at from the sell side, as this is something you might not be used to doing or seeing is selling first, and in options you're often doing that, selling to open calls and puts.

Here, you have 35 strike-price put quoted 275, 285, and you choose to sell the option for $275 dollars. You receive that cash upfront in your account, $275, and now you have a short position in your account, short one June 35 put, being priced at the best available offer, the best price you can get to purchase it back today, that's the offer, $285. Receive $275 upfront, you have a position that right now is being valued at a best price to close at $285, again, a negative account balance initially.

Three weeks later, the market changes, and the bid offer has moved lower, again, in our favor. The cash position is the same, $275. We now have a position - same position, short June 35 put, now being valued at the best offer of $165, and our account balance is growing gradually as this value is decreasing. A little bit further on later down the line, the option expires worthless out of the money, this trade's worked out exactly as we wanted it to, and you have a positive $275 reflected in your overall account balance.

The sell side is a little different, and some people, I've posed the question, "When you sell an option and it works out in your favor, when do you recognize those profits?" Oftentimes, that answer is "right away," because people hear that you get paid right away for options, and you do. But the overall profit is a gradual process over time, if it works out in your favor. So, that's how it would look from the buy and sell side, and now I think it's a very good time, Mike, to look at some of the resources that investors can tap into at Fidelity to get further education and knowledge about some of the things we talked about today.

MIKE RUGERS: Perfect. Yeah, I appreciate your commentary, your insights, Ed, always valuable. I do want to point out, as Ed alluded to, some of the additional education, additional resources. If you feel you're kind of starting from scratch and want to reevaluate some of the information for today, we'll take a look here.

In terms of education, information, really to drive home and support today's conversation, there's a couple of resources that I find myself leaning on regularly, and that I feel really resonate with newer option investors, the first of which is our Options Strategy Guide. And so, from this same page, again, just to revisit those steps, fidelity.com, News & Research, and then you've got The Learning Center, then on the left side of the page, you'll see the Options Strategy Guide. This is a very comprehensive, case-by-case guide, kind of goes over any options strategies that you might be learning about, reading about, hearing about in the news, provides a nice breakdown of things like risk and reward and what you need for that trade to end up profitable for you. So, you can see kind of the library of various strategies here. Just to give you a sampling, just come into the covered call, which we spent a lot of time today on, and we can see the full explanation. Risk reward, and then again, what is the outlook and how does the strategy work out?

So, the other item that I think is worth mentioning is for those of you who are looking, again, to further your education, additional events and webinars that we host include a four-week class, very comprehensive four-week class, an introduction to options, reviews some of the content we've discussed as well as builds on that. That can be accessed under the Classes for Beginners. And then the calendar can be accessed right here under Options: Learn More About It. This will give you each of the monthly sessions. So, we obviously would love if you can join us. We spend a lot of time, energy, into making sure that these classes, this content is valuable, so please feel free to reach out to us if you have any trouble signing up, any additional questions.

So, with that, Ed, again, thank you for joining us. I know we've got a couple of more sessions here today, but I'd love to take the last couple minutes we have for session one to field some questions here.

So, let's kind of take a look at some of the most common questions we've received. Question one: Can I exercise an option before the expiration date, and then the second part of that is how do I do that at Fidelity? So, I guess, Ed, if you want to kind of take the first part of that question, I'll take the second part.

ED MODLA: The answer is for American-style options, which equity and ETF options are, you can exercise on any day prior to and including expiration dates, so if it's in your best interest, you can exercise early a call or a put option on stocks. The next question is, is it in your best interest? But the answer is yes, you can.

MIKE RUGER: Perfect. Yeah, and in terms of exercising early, some time before expiration, what that means is you can essentially manually exercise your contracts, and that's just a matter of calling Fidelity, you can reach out to our Trading Desk, and they can manually exercise it. Without going into a ton of detail around this, any contracts that hold value would be automatically exercised as well, meaning we won't let them expire worthless, but they can be exercised early, or exercised at expiration.

The second question here: Could you provide additional information around the meaning of "time value?" So, we talked about time value and intrinsic value, maybe if we can just give a brief overview, give a little bit more context to time value, that would be helpful.

ED MODLA: Basically, time value is any cost or value attached to an options contract to account for the potential for movement in the stock between today and expiration date. Of course, that involves how many days there are between today and expiration date, and also a sense of volatility in the market. Soon, we're going to be defining the word volatility and applied volatility. That sense of how much movement might we see goes a long way towards determining how much extra value might there be in this options contract, and all of those details go into determining what time value is, and it's very important to be able to calculate that number.

END OF AUDIO FILE

Risks of Standardized Options. 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.

A covered call writer forgoes participation in any increase in the stock price above the call exercise price and continues to bear the downside risk of stock ownership if the stock price decreases more than the premium received.

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