TRANSCRIPT

OIC: What you need to know about options

ALLEN HELM: Hello, everyone. My name is Allen Helm. I also have Ed Modla today with me from the Options Industry Council. We're going to review core concepts and options investing, so basic concepts and options. Once again, my name is Allen Helm, I'm the Regional Brokerage Consultant for the Austin, north Texas and Oklahoma market. There's 26 regional brokerage consultants spread out across the United States. Our role is to help our clients navigate Fidelity's brokerage tools to meet their goals and objectives. Keep in mind we do have brokerage and also fixed income RBCs, so we help clients that own individual securities, both in the brokerage space and also in the fixed income space and we're available to do meetings with you on a one-on-one basis. So, either it's in session or over the phone or we have another session called Clients where we can actually look at your screen and help you navigate our tools, so keep that in mind. If you have any interest with sitting down with one of our regional brokerage consultants, you can always reach out to your financial service advisor or your local Fidelity office and schedule that appointment. So, enough about me. Ed let's go ahead and we'll have you just do a little intro on your background. We're really excited to have you here today to go over options. And I know you're part of the Options Clearing Corp and also this is presented by the Options Industry Council. So, go ahead and you can introduce yourself, Ed, and then we'll start today's events.

ED MODLA: Hello Allen and thank you very much for that. I'm looking forward to presenting with you, so thanks to you and the Fidelity team for having me here today. As Allen said, my name's Edward Modla and I am the Principal of Investor Education at OCC. OCC's the clearing corporation who funds and provides the Options Industry Counsel. That's where the relationship is. My start in the business goes back to the late 90s, 1997 when I was a trader in the pits of Chicago and New York exchanges in options market making. I evolved like most others into the electronic environment, and then it was about six years ago when I teamed up with the Options Industry Council to provide education to the public. That's all we do, is free unbiased education on benefits and risks of options. We are not brokers, we don't sell advisory services or data, we just provide education. That is all we do, and as you can see, we can be found at optionseducation.org. In this presentation here we'll be walking through some core concepts at the basic level, we'll also throw in some commentary, and Allen and myself will have a discussion along the way. First our disclaimer: options are not suitable for everyone, they need to be well understood before using them in a live account, and also there is not a direct business relationship between Fidelity and the Options Industry Council. I'm going to start today's presentation with a few words about volume, particularly because

2020 has been such a unique year, and then we'll get into the two types of options, calls and puts. Me and Allen will proceed to discuss strike price and expiration, selection, and then we'll look at quotes and order types and do a demo on the Fidelity platform which is always useful to see some ticker symbols and some different things that you can do with respect to getting started with your options, order entries and managing those executions of strategy.

HELM: Yeah and Ed, just to add in a little color to this, for customers that don't have options accounts or have filled out the options paperwork with Fidelity, we will go in and show you guys how to set up the options accounts if you want to add options to your different accounts. Keep in mind that if you do add options -- so let's say you had a retirement account or a brokerage account, you wanted options on both of those, you do have to fill out an options application for each of the individual accounts. So, that's something that we'll show you how to do because this is just a concept and may be new for a lot of people. So, go ahead, Ed.

MODLA: Yeah, definitely a lot of new people, sure, yeah. And after our session here, Allen, hopefully there's going to be quite a few people that want to do just that --

HELM: Absolutely.

MODLA: -- set a time. Set aside some time. Here is that look at volume. This goes all the way back to the inception of the listed options product back in 1973, huge year for this industry. Options used to trade before that in an over-the-counter fashion, but 1973 was when Cboe launched, the listed standardized options contract. It was also when the Clearing Corporation was formed to clear options and when the Black Scholes options pricing model was published. So, quite the year there in '73. You can see the volume really exploded when you had electronic trading and also education, access to education, but what I'm going to focus on here is the end and where we're at. Two-thousand eighteen and 19 were record-setting years; five billion contracts a year, that comes out to about 19.8 million each day on average. We're going to see where 2020 ends up, we've got a couple of weeks left. Right now, we're averaging about 29.6 million contracts traded every day, and if you average that out when we finish the year, that number's going to be way up around seven and a half billion contracts, almost 50 percent higher than the record-setting years. And I'm always careful when I explain this and go through the volumes slide because this year has had an awful lot from start to finish and not all of it has been good things. So, it's not a time to reflect in any kind of celebratory way. What we instead view this volume number as being is just the unique features of the options product continue to be used during times of market stress. And when investors and money managers need to tweak their portfolios a little more acutely and to fit their market thesis and to manage risk, the options product really comes to the forefront, and that's where we're seeing a lot of that volume come from. So, let's take a look. There's two types of options, there are calls and there are puts and you can buy or sell either one of those two. So, those are the four signs you can do: long call, short call, long put, short put. And me and Allen are going to talk about each of those four sides, but first let's just take a step back and talk about motivation: Why options? And there are a number of different reasons why investors use options, ranging from reducing risk, this could be protecting your portfolio, speculating on a move higher or a move lower or possibly in either direction. There are strategies that would capitalize on that motivation. Income generation refers to selling options, you can do so in conjunction with reducing risk, you'll see that when we walk through examples. And stock acquisition also involves selling options, generating income and doing so at a favorable risk/reward profile. There's a lot of different reasons to use options and this is where I'd like Allen's insight. When I speak to investors about this flexibility nature of the options product, Allen, I often find that investors are using one or two of these motivations, but maybe they don't have the depth of knowledge to use all of them and that's where opportunities lie. So, I was wondering what your thoughts were on that.

HELM: Yeah, yeah, and so, the thought process a lot of times clients when they think of options quite frankly, they're fairly new to options, they think of maybe Las Vegas and we're going to take a huge risk and do these crazy and wild strategies. The reality is is you can use -- and you mentioned this in the record volume that you're seeing in this share, you can actually use options to potentially generate income, you can use options to hedge risk. So, maybe you have a really big gain on a specific stock or an exchange traded fund or whatever that is, and you want to hedge some of that risk, you have the ability to do that. You can use it as an acquisition tool, so maybe where generating income to potentially buy a stock at a lower price and if that stock gets to that price, we have the ability to take in those shares at a maybe better price than the current market and get paid to do that. And then, we can frankly speculate. I mean, if we don't want to put X number of dollars in XYZ or let's say the stocks like I don't know, Tesla, Google, Amazon, those type of stocks, you can play directionally both up and down. And so, maybe you have strong feelings that the stock's going to up, or you have strong feelings that the stock's going to go down. With a little amount of capital, you can directionally take a shot at whether you think that stock might go up or down. So, it gives you a lot of flexibility to do different things. I'm always a little saddened when I talk to clients and all they think options provide is just that really risk type of strategy, when in reality you can use options to really reduce risk and/or create income flow by doing different strategies.

MODLA: Yeah, for sure. Yeah, learning options is a matter of progression and there's nothing wrong with picking a motivation, selecting one or two strategies, getting to know them. But as you learn more and more, you open up doors that sometimes you didn't even realize were there with the options product. There's so many different things you can do. So, let's get started then. We've said there's calls and puts, let's talk about each of those. First, we'll focus on calls and walk through the risk profile from the buy and sell side, then we'll do the same thing for puts. First, the call buyer is going to pay an option premium -- that's a cash debit -- immediately out of their account, and they have now purchased the right to buy shares of stock or ETF at a particular price and they own that right for a certain length of time. Now, the standard options contract is written on 100 shares. The options are quoted on a per-share basis, so if you pay one dollar for a call option, that would actually translate into 100 net dollars that you would pay, and now you'd own the right to buy shares of stock at a price that is identified in a contract and upto an expiration date that's also identified in the contract. Of course, those two pieces of information, they're going to go a long way in determining what that price you paid for is and what the sellers are willing to sell it for. But if you did make this transaction, this would be speculating, being bullish on the underline. As the stock price moves higher, the right to buy stock at a certain fixed price gets more valuable or looks more and more attractive. This is what the option buyer -- the call buyer's trying to take advantage of. A move higher in the stock price that works to their advantage to a greater extent than they will lose due to time decay. We will break apart a little bit on time decay later on in this session. Options have this natural component to their price that decays over time. An option buyer or owner suffers from that, so they need the stock price movement to overcome that. On the flipside --

HELM: You know, the other piece to that, Ed, is on that contract -- so keep in mind, some of the stocks or companies that you look at, they have maybe weekly calls where the contracts are only good for a week or maybe they have contacts that are good for a month or several months. So, that time decay becomes a bigger factor; it's a factor in the overall options. But that wasting component to that time decay on that option contract, those accelerate as it gets closer to expiration. So, if we were to go out and buy let's say a call on Microsoft a week from now, so we looked out into next week that a contract that expired not this Friday but next Friday, we would see a faster decay in that time component than if we bought a Microsoft contract three months from now. We would also expect to pay more for that contract with that time decay. So, keep in mind on a lot of these different options that we have as far as on the different companies or ETFs, there are weekly contracts, there are monthly contracts, there's quarterly contracts, and when there's even contracts that you can go or extend longer than one year. So, sorry, Ed. I didn't mean to interrupt.

MODLA: Yeah, no that's good info and yeah, there's a lot of different expirations. Time decay is a major component in the decision making process and I think we're going to pick up a little of that conversation when we get a little deeper and show that curve that you referred to, Allen, with that non-linear decay that you get over time. And both buyers and sellers need to be aware of that. Back to looking at the call option, the equity call seller, they're taking the other side of the buyer's transaction. They're getting paid, this is income generation. The call seller is paid upfront and has taken on the obligation to sell shares of stock at the strike price and they are under that obligation until the expiration date. In exchange for the obligation, they are paid, and that's why they sell calls. When we look at our example of this in a couple of slides, undoubtedly this investor already owns the shares and is comfortable selling stock that they own at that particular strike price. That strategy is the covered call and we're about to get there in a couple slides for a little more detail on that. Let's just look at the risk profile of each of these. Allen, go ahead.

HELM: Yeah, and just one thing, that when clients are new to this thought process, a lot of times they don't get the covered call piece of that or why you would sell a call. So, the way I always tell customers, have you ever put a limit order to sell maybe Facebook at a higher price? And so, let's say Facebook right now today is running -- here, let me a get a quick quote here on it. So, right now Facebook is 276, so let's say you were agreeable to sell your

Facebook a month from now at 285. And you could go in and put in a limit order to sell your Facebook at 285, but what Ed's showing you is a way to sell a contract at 285, agree to do that, and get paid to put in basically a limit order to sell your Facebook at that higher price. So, that's how you generate the income piece. If you're selling a covered call potentially, think of it as a strategy where maybe you're putting in a potential limit order to get a better price for your stock and you're actually getting paid to do that. So, sorry Ed. I didn't mean to interrupt.

MODLA: That's exactly what it is, it's an alternative. And when you have these alternatives and you're investigating should I do this or should I do that and options are involved, there's undoubtedly a benefit and a cost. You're going to have some advantage and you're going to have to give something up. So, if you're not finding both of those pieces, look a little harder because they're going to be there. And put up that P&L graph of the covered call just a second. Let's just take a look quick at the buy and call strategy that we outlined. We're going to have hypothetical stock XYZ trading at 60 dollars and this investor is bullish, but instead of paying for the shares, they decide to look at the options trade instead as an alternative. And you see the 60 strike calls trading for three dollars, again that's 300 total dollars. And another bullish trade outside of buying stock would be to buy the call option. Now, keep in mind first of all, these profit and loss graphs that we're drawing here on this example and the others are drawn as if we are at expiration. And that's because we cannot precisely calculate what the option's going to be worth prior to expiration, there's market dynamics involved in what the option might be worth. But at expiration, we know exactly what it's worth given a certain stock price. So, that's what we're drawing here at expiration. If the stock was at 60, your long stock position would still be at break even. Your option position would have expired worthless and you would have lost your 300 dollars. If the stock rallies, you need that stock to rally, and in this case five percent, before you break even and continue to profit. Now, this option price was derived fairly volatile stock a couple moths till expiration, so this might be considered a relatively high-valued option in a stock that is a mover. And here you need that five percent move just to break even. There's a time and a place for buying options and speculating, but as we'll see and I will say again later, you do have to be right on direction of the move, the magnitude of the move, and the timing of the move, and you will see all those words come up again later as we drive this home. Then taking a look at --

HELM: And so -- go back just one second, Ed. So, basically what we're looking at here guys, is that the topside. There is no limit on the topside, so if we buy this contract goes to 80 bucks, our break even's 63 on this overall position and we profit -- I mean, we really want that stock to go up. The risk is that 300 dollars, and to Ed's point, there is that time volatility component to that which may add value or decrease value depending on the volatility and what's going on with the underlying stock position and how that's moving in the marketplace.

MODLA: Yeah, and that's all right. And like I said, the call buyer is looking for movement, and this would be if you're very confident. If you really think you know this stock is going to move in this direction, I have a sense of timing, I have a sense of magnitude, that is when buying options comes in because you know you've got to be right on all three of those levels.

HELM: Well, and you do also get that leverage potentially. So, instead of outlaying 6,000 bucks to buy the underlying, you may decide to buy one contract, or two contracts outlay a little less. Of course, you've got that risk of if you don't get the direction right, you could lose that capital that you put in.

MODLA: Yeah. Always that difference between the cost benefit. Lower cost, lower risk, but higher break even, you need that move. We talked about covered call already and Allen outlined some of the details here in the hypothetical example, what we're looking at, you own shares at 52. Maybe you've owned them for a few weeks, they're going anywhere, stock's not moving, you're waiting for something to happen, but now you're a little less confident so you sell a call option to bring in some premium, income generation. By doing so, you've lowered your cost. Instead of your cash outlay being 52, you're now receiving 175 dollars back that's lowering your break even to 50 and a quarter. So, in addition to income generation, you are reducing risk and reducing cost. I'd also like to point out by lowering a break-even point, you are improving the likelihood of being successful on this trade. If the stock stays right at 52, you've made some money. Stock rallies, of course you're profitable. If the stock drops in this case, that's roughly three and a half percent, you're then going to reach your break-even point on the downside. So, more possibilities to be profitable. Those are great advantages and as Allen was pointing out, what you give up -- you always give something up -- and that's the far upside potential. Remember what it means to sell a call option, obligating yourself to sell stock at 55 means you have to give those shares away at 55 and you can't capitalize on that further upside. As long as this is consistent with your market thesis, it's a very viable strategy to use.

HELM: And so, here's the other thing you want to think about on a covered call. So, if you're the type of person that it's going to bother you if you own this stock I don't know, let's say at 45 bucks or 40 dollars, and you decide to write that covered call, you do cap that upside potential of that stock. So, you have to ask yourself, if I sell a covered call and I'm obligated basically to deliver this stock at that set price, and in this example let's say we have the 55 call, we get the dollar 75 for that premium, if that stock goes to 75 dollars in that timeframe, you would miss out on the upside potential of that stock.

Now, some people that bothers, some people are very analytical and they're like well, at the time I was willing to sell it at this price, so we had a great profit in the position, I just missed out on some upside potential. So, those are the things that you have to ask yourself when you're looking at doing a covered call is if that stock moves -- a recent example would be Tesla over the last year. Maybe you did a covered call on Tesla at 350 and you agreed to sell it at 400 and then watched it move higher. Those are things that you would want to consider. You could potentially go back in and buy that covered call, but that would be probably in most examples a loss, and those are some things that you would want to consider when you're doing or looking at a covered call.

MODLA: Yeah, the far upside is certainly a concern and you would have to make sure that giving up shares at your strike price is something that's consistent with your market thesis and you're comfortable with it. And Allen said you could manage this position, but as it goes too far above your strike, it becomes much less viable to do so. That's why this is considered more or less a neutral to moderately bullish strategy. That's where you really get your gain and oftentimes that is the market circumstance, neutral to moderately bullish. Let's move on and take a look at put options. We'll do this a little quicker as it's very similar just from opposite perspective. It starts out the same way, a put option buyer, just like a call buyer, is paying cash up front that goes right out of their account as a debit, and now they own something. They own an options contract that gives them a right. But in the case of a put option, they own the right to sell shares of stock at a particular price and they own that right for a specified period of time. Really two common ways to use equity put options from the long side. One is to speculate on a downside move, just the way me and Allen talked about call buying, it's speculating to the downside. Another objective for using the long put, which is where we're going to go with our example on the next slide, is to buy protection. And this is protecting against that big downside move and there may be circumstances at which you would want to do that. We'll show a risk profile graph coming up of that, of protective put strategy in just a second. Just looking at the equity put seller, again just like the call seller, they are receiving premium upfront. That cash flows directly into their account as a credit. That's income generation, and this investor has taken on the obligation to buy shares of stock at the strike price of the option contract. Oftentimes, this put option seller is comfortable with that obligation. They may want the shares there. This is known as the cash-secured put, and that's what this seller's trying to achieve, generate income while the stock is trading at a price level above where they want to buy it. That's cash-secured put and again, this is coming up as well as we get through the examples. Allen, the protective put, just looking at this real quick, I would say oftentimes it starts similar to that covered call, you've got long stock at 60, maybe you found that to be a support level. Stock just really isn't going anywhere, you're still bullish but now you're a little concerned about the downside, what if it breaks the support and gets crushed. The protective put is a viable alternative to a stop loss order here. Maybe you're like okay, I'm going to give this trade a couple more weeks but I'm buying protection so I can sleep easy at night, get around the clock protection, and that's when buying a put option say you're going on a couple of weeks, pay a dollar, and now you know you own the right to sell shares in our example at the exact same price you're long them at. All you'd potentially lose here is that dollar premium. You'll see the kind of circumstance, Allen, where I think investors might look at protective put. Stop losses certainly would work as well. If you want to put a stop loss to the downside at 59, there's just some differences there, particularly the protective put gives you that around-the-clock coverage.

HELM: Well, yeah, so big differences there. So, we know we have a price certain with this protective put, so we know that we can deliver those shares to somebody on the other side of that trade at 60 bucks. So, we can go in and say hey, we have the right for that protection. A lot of times with a stop, if there's bad news, a stock doesn't cost anything to do and you can most certainly put those in. So, you know, get me out of XYZ if it goes down to a certain level, let's say 60 bucks, whatever that is and then you have a choice of either doing a market order or a market with a limit order. The market order gets whatever's going on in the market. So, if that stock drops to 55 and that's the current market, that may potentially what you get. With the put option, you have the ability to deliver those shares against that if you wanted to sell the contract potentially at a profit. So, it provides a certainty on the price component. It costs money to do that, but you know as long as that contract's in force or in place, you have the ability to sell that stock at 60 bucks.

MODLA: Yeah, and I would --

HELM: Then it's going down.

MODLA: Right, and again, we're using this example cause I think more often investors are using the long put in this respect to protect the portfolio and do that risk reduction rather than speculating. Although again, maybe there is that circumstance where you're extremely bearish and you're not going to be shortening stock, most investors don't take that position. So, the put option is there as a speculative trade if you feel strongly enough in that market outlook. Let's take a look at the other side, the fourth and final side. We've covered long call, short call, we covered long put, let's look at the cash-secured put risk profile. The stock in this case trading at 50. Maybe that's a level that's just too high for you, you're not comfortable purchasing shares at 50, you're looking to buy them lower. After a pullback you could be looking at a support level in the low 40s, maybe it's trading in a channel and it's just setting new highs here at 50, you're waiting for it to come back down. Instead of waiting and working a limit order at lower levels, you could sell a put option and bring in some capital. Again, this option is calculated with an option going out about six weeks, a relatively high volatility level. And you can receive two dollars selling a put option 10 percent below where the stock currently is. That 200 dollars goes into your account immediately. If the stock stays about that strike price, nothing happens. You don't get the shares if the stock rallies, you're not long stock, you don't capitalize on that, but you do make the 200 from the put option. Somewhat like working a limit order and getting paid for it with one important difference: the option is likely only going to assign you shares if the stock is below the strike at expiration. That's a key difference. A limit order at 55's going to get triggered as soon as the stock trades there. The option will likely not give you the shares unless the stock is below 45 at expiration, meaning it could drop and then pop and you never get the shares. As Allen was mentioning position management earlier with the covered call, you could do something to manage your way out of that. Same thing here with cash-secured put. You could buy the put back, eliminate that obligation, go into the open market and buy shares outright if you felt like you were going to lose your opportunity. But this is a viable alternative to using limit orders and I think it's a popular strategy, Allen, from investors of all skill levels. You find investors across the board using cash-secured puts.

HELM: Oh yeah, this is once again, an income strategy that customers take a look at. It gives you the ability -- so once again, to Ed's point, we can put in a limit order to buy the stock at, in this example at 45, we get paid nothing to do that, so if XYZ gets to 45 dollars, we're willing to buy it. But we could go in and now we have the cash in the account -- and you can do these type of strategies in your retirement accounts as an example -- but we have the cash sitting in the account and we say, hey you know what? If I have a shopping list and maybe the market's down today and the puts are a little higher because the market's down and I'm willing to buy this stock XYZ if it gets to 45, and so I have that money to buy the stock, potentially in the account and I sell this put and I get 200 dollars put in the account and then I use that time decay to my advantage for the wasting away of that time value on that contract and maybe I get the stock if it goes to that price point. If it stays neutral or right around that same price point that contract just expires worthless, maybe I go back in and do it again in another month or two or whatever the timeframe that you're looking at. So, it is an income strategy that you can do and what I tell clients is, create a list of companies or stocks or ETFs that you maybe like, watch those companies and you can always go back in and this is a strategy that you can use to generate cashflow in basically a zero interest rate environment.

MODLA: Certainly, I totally agree. And we've just covered the four sides which really touched on all of the different motivations you can have. Let's just talk for a few minutes before we go to the demo about strike selection and expiration selection. We're going to do that when we look at the trade examples as well, but first we want to make sure everyone understands the term moneyness. The term is meant to describe where an option sits with respect to its strike price compared to the stock price. In-the-money options, you can say have some form of inherent value to them in the form of say call options for example, if the strike price is below the stock price, there's already some value there. If the stock's trading at 60 and you're pricing up a call option that's trading at 50, the buyer already has the right to buy shares 10 dollars below where the stock is. That's in the money by 10 dollars. The owner or buyer of the option already can execute their stock transaction at a better price than the open market. And that value's going to be reflected in the option premium. Conversely, out-of-the-money options and at-the-money options, they don't have that inherent value. It's when these strike prices we'll say at an equal or less favorable level than where the open stock price is. They're going to be cheaper, they're going to cost less, but they will also entirely consist of time value and be sensitive to decay and that factor of one day to the next, that theta decay we talk about, and also volatility will play a role there as well. In-the-money options have intrinsic -- that's what it's called -- intrinsic value and time value. Intrinsic value is not going to decay at all, while time value does. At-the-money and out-of-the-money options consist entirely of time value. Make sure you don't confuse moneyness with profit. Profit is just simply comparing the price you paid and the price you sold it for, and that's it. That's where your profit comes from. Moneyness just identifies where they stock sits in relation to your strike price. And Allen, when it comes to this dynamic of looking at in the money versus out of the money, what I always say is you're in-the-money options are going to be more expensive. You're a buyer, you're paying more money, but you know you're paying for intrinsic value. That's going to be sensitive to stock price movements. The rest of the value of the option is going to be a decay. If you are a seller of options, you want to know that, too. Yeah, there's a lot of premium here in in-the-money options, but only the time value portion decays. The intrinsic value is going to move as the stock moves. You're going to want to know what those levels are. I think, Allen, that goes a long way towards deciding your strike price and how aggressive you want to be. I think most trading occurs at the money and out of the money. Do you find the same thing, or how often are investors looking at in the moneys?

HELM: Yeah, so a lot of moving parts here on this and if you're fairly new to options, this could be confusing. Keep in mind that Fidelity does have resources and help. You can go to our learning center on Fidelity.com, take a lot of the options classes and resources there. But to go back to this slide with Ed, topics like intrinsic value, time value, those type of things, if that's first time you've heard of that, it definitely can be confusing. We do have tools that we'll actually break some of that out for you and show you. But the reality is this, if you're looking at a call option and the stock's at 50 bucks and the option you're looking at is 50 bucks, you're at the money. You're right, right where it is, so in theory the stock has probably a 50 percent chance to go up or down because stock's at 50 and you're looking at it at a 50 call. If you're looking at something like a 55 call and your 60 call, that's going to be out of the money, and you need that stock to go up at least five points plus whatever premium you paid for that before you can break even. So, that's out of the money. Those are typically going to be cheaper to purchase. In theory, you would get more leverage probably with those out-of-the-money contracts because you can buy more typically, but your break evens are going to be a lot higher than they would be at let's say in the moneys or at the moneys. So, you want to do a little math. And then if you're in the money, you know the stock's at 50 bucks, you're looking at the 45 contracts to Ed's point, it's going to have at least -- if that stock is at 50 bucks and you're buying the 45 calls, it's going to have five points of intrinsic value. So, we have the right to buy stock at 45 bucks by buying that contract, but the stock currently is selling in the open market at 50, that's our intrinsic piece. And then anything over that five dollars we pay is going to be time volatilities. Puts in a similar way, if we're at 50 bucks on a put and we're buying a 50 put, we're at the money. If we're buying a 55 put and the stock's at 50, we're in the money. And the out of moneys work in a similar fashion. So, puts tend to be for folks that are brand new.

Puts tend to be the hardest concept to understand because it's kind of inverse of what we would be used to on on calls.

MODLA: Yeah, and if you're trading in-the-money options you will certainly want to make that calculation to determine how much of this premium is intrinsic value. Buyers and sellers are going to want to do that. You will know anything above that is time value. And as Allen said, it is I would say more aggressive if you're an option buyer to go further out of the money. It might be counterintuitive to say that because you're paying less, but you need a bigger move in the stock in order to be profitable and that's why we consider that more aggressive. When it comes to expiration selection, I'm just going to show and what Allen was referring to earlier, that decay is not linear in the area where most options are traded. If you go deep in the money or deep out of the money where options have very little time value to begin with, there's a more linear rate of decay. This isn't exactly linear, but it's very close. All of your at the money, using that term loosely, close to where the stock is trading where most options of volume occurs right around 40 days or so you see that progression. Buyers are concerned about that, they don't like time decay. Sellers do, but then the other factor to consider, it's not just the rate of decay, it's how much premium is actually there. A buyer may be fine accepting very fast decay if the price of the option is cheap. And conversely, a seller who wants fast time decay may decide there's not enough premium here to justify selling this options contract, so you look out a little bit further. There's always that balance between the time decay factor and the actual premium amount that's there. You're not only managing your account against your market thesis, but you're also managing money, and that's important as well. So, Allen, do you find making decisions on expiration a combination of these things as well, premium and the rate of decay curb that we're looking at?

HELM: Yeah, I mean definitely if you're a seller of options, you're very interested in that decay component of it. You want to collect that premium and have those contracts decay as quickly as possible and potentially move on. And then depending on the strategies that you're looking at, another thought process is maybe you have a low-cost stock that's maybe you bought it at 20 dollars and it's at 50 and you want to get just a little more protection, you can sell an in-the-money call and get a little bigger premium. Of course, you have that intrinsic value piece, but that does give you a little bigger downside cushion. We actually have tools, Ed, that will run a lot of this data for clients as far as looking at ideas based on whether those are in the moneys, at the moneys, or out of the moneys, what the rate of return would be for both the downside protection -- they call it static rate of return -- and then also the if-call rate of returns on current market prices. So, a lot of tools that clients can use -- and once again if you're fairly new to this, this may seem not to be funny but maybe you're seeing Greek with our theta, but anyways it may seem Greek initially for the first time around and we do have tools to go through and explain this in a little greater detail.

MODLA: Speaking of those tools, let's go to it. We're going to get to talking about quotes throughout the education that we're giving you today and different order types, some buy to open, sell to open, buy to close, sell to close. We've talked about those types of four orders that you can make when you're opening a new position. It's either buy to open, sell to open, and when you're closing, it is the opposite side that you're taking to close, those are the four order types. And then quotes of course, you're looking at bid ask, you're looking at midpoints, you're looking at how aggressive you want to be when you get into that trade with respect to using market orders or most likely limit orders. So, Allen, I think this is a good time to pull up some of those tools and some of the things you wanted to show us on the platform.

HELM: Yeah, so let me transition in and then Ed, if you'd be so kind to let me know when you can see my screen.

MODLA: What I'm seeing is you have started screen sharing, but that's all I'm seeing, is a blank screen there.

HELM: Okay, let me try reconnecting here again. I'll stop the screen sharing and open again.

MODLA: Yeah, and as you that, I'll just talk through some of this topic. When I was referring to quotes -- now you're looking on your options chain, you have different strike prices, different expiration dates. If you're new, that can be a lot to look at, so as you've -- first of all, you've got your market thesis, you know what you want to accomplish, you've selected a strategy. Now it comes time strike price and expiration -- and Allen, you're good there, it's coming up nicely. So, we're going to look at some of those things and what kind of quotes you're going to look at and how you would make decisions on entering orders. Looks good, Allen.

HELM: So, yeah, let's step back just a real quick second and let me just show our customers if you're brand new to options and you want to put options on your account, if you just go to investment products and go right here to options, this is going to take you into the options page. And here's where you would go in and apply for an options application on different accounts. So, once again, if you were looking maybe at doing covered calls or cash-secured puts, some of the income-generating type strategies, maybe you own a retirement account or whatever that is, a brokerage account, you would go in and you would need to fill out the options application for each and every account that you're wanting to do. I'm sorry that there's no way around where you can do just like a universal option application for all the accounts. Unfortunately, it does need to be for each account. Also, we do have a speaker series. So, I know clients are always looking for ideas. This is a weekly series with Dan Nathan, who a lot of folks might know is a CBNC contributor. We have a lot of our colleagues in the RBC role that will host this with Dan. He also gives you some specific ideas in options trades that you might take a look at, so that gives you some overall ideas and things that you can go in. And then, here are articles and videos with options coaching sessions with my colleagues on the Strategy Desk and then webinars that you can take a look at. They probably have some things that Ed's done, and other folks recorded in those sessions that you can watch and build on your overall options knowledge. So, that's something that you can just take a look at. Now, Ed had mentioned taking a look at some of the options tools and once again I'm just in Fidelity.com. We do have a streaming platform called Active Trader Pro, which everything in that platform is real-time, dynamic, tick-by-tick market data. But if we just go to news and research in here, we just go to the options page. Notice this will take us into our home options page, once again, the Dan Nathan weekly series is here. And then you can also go in and look at different ideas. So once again, if you're looking at trading ideas, you can go into the trading ideas tab. It'll go in and take a look at different screeners that you can do and scans that you can look for options ideas. There is an expert's options analysis right here that you can go into. And notice it's dated, so you can go back and read previous reports, ideas that come from live all, which looks at different options, plays, and strategies that you can take a look at.

Here's the market overview tab from right here. This is going to take you into more information on kind of what's going on in the market, which options are the most active. This is going to be probably a new term for a lot of folks, but it exploding implied volatility. The reason implied volatily's going up on typically a stock is there's something working with the stock maybe that's earnings, upcoming earnings, maybe implied volatility could be some sort of a rumor out in the marketplace or a dividend, something like that that's happening. So, we can take a look at those stocks where we do have some of that volatility. And then imploding volatility is typically the company has announced earnings and that volatility is now decreasing because it's a known factor. We know that XYZ may, you know, whatever it is... and so, a lot of that volatility will come out of that stock. So, that's just some information that you can take a look at when you get a chance. And then if you go into quotes and research, we can type in any stock that we want to. So, let's do Microsoft. So, we can type in Microsoft. From here, it's going to give us an options chain to look at, and notice on the chain right here it goes in and it'll show us the dividends, the estimated earnings, the different chains from here. And then just a simple reminder that I would tell folks to do. So, I have three-plus decades of experience, I'm an ex-commodities trader, I'm a registered options principal licensed manager. Even I sometimes make mistakes, okay? You have four, five, six different accounts potentially. If I'm thinking calls, what you ought to do is just switch it over to calls. This is then going to show, if we hit apply, if it's going to show only calls. And so then, to Ed's point, if you're looking at a certain strike and I want to look at the Januarys and Februarys, I just hit apply. This is now going to load up just those calls for me and then I can see the strikes. So, the stock's at 219.37, if I'm looking at the 220 calls, here they are. We have a histogram here that shows color coding of the number of contracts traded and then the open interest on those contracts. And from right here, we can actually go in and place an order, so these are all (inaudible) on what's going on the individual contracts. And then from there, if I'm looking to buy calls long and I hit the buy to open button, it'll load up a trade. If I'm doing maybe a covered call, I can hit the sell to open button. And so, this'll allow us then to place the trade. If I'm long calls and I want to maybe harvest a profit on that, I can sell those to close. If I sell to open, I'm going to buy those to close on the covered calls. So, that wraps I guess today's overall session. Thanks again, Ed. Thanks for joining our discussion.

END OF AUDIO FILE

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.

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.

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

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