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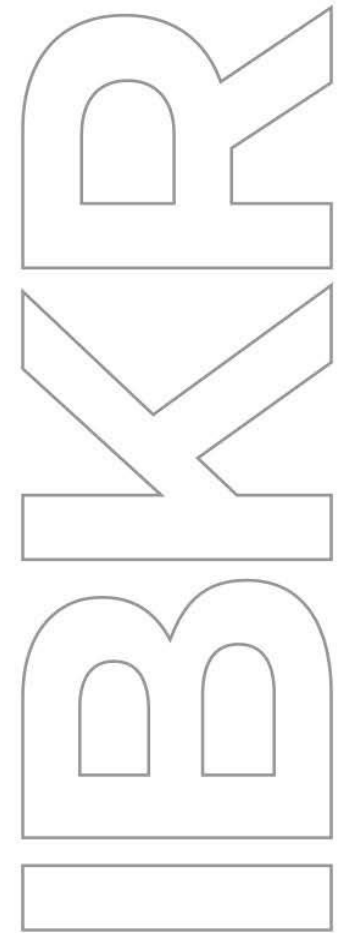
(OIC)

present:

Building Your Options Trade

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Options Industry Council**



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Building Your Options Trade

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Presentation Outline

- Motivations
- Buy vs Sell
- Strike Selection
- Expiration Selection
- Order Types
- Account Balances



Calls and Puts



Why Options?

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



Equity Call Options

- An equity call **buyer**:
 - Owns the **right to buy** underlying stock/ETF
 - Bullish on underlying
 - Needs stock movement > time decay

- An equity call **seller**:
 - Has the **obligation to sell** underlying stock/ETF
 - Likely already owns shares



Equity Put Options

- An equity put **buyer**:
 - Owns the **right to sell** underlying stock/ETF
 - If speculating, is bearish on underlying
 - If shares are already owned, is buying protection

- An equity put **seller**:
 - Has the **obligation to buy** underlying stock/ ETF
 - Generate income while waiting for share price drop



Choosing Strike and Expiration

Strike selection

In, At, & Out-of-the Money

Options pricing has two components:

- Intrinsic Value: Difference between strike price and share price
- Extrinsic (Time) Value: Comprised of time to expiration, implied volatility, dividends and interest rates

ITM options have intrinsic value and MAY have extrinsic as well

ATM/OTM options have extrinsic value ONLY

The “Moneyness” of an Option

In-the-Money (ITM)

At-the-Money (ATM)

Out-of-the-Money (OTM)

Moneyness \neq Profit

- Used to determine intrinsic value of the contract
- Stock price movements influence intrinsic value
- All ATM/OTM options have ZERO intrinsic value

Call Options

<u>Moneyness</u>	<u>Relationship to Stock</u>
In-the-Money	Strike price < Stock price
At-the-Money	Strike price = Stock price
Out-of-the-Money	Strike price > Stock price

Put Options

<u>Moneyness</u>	<u>Relationship to Stock</u>
In-the-Money	Strike price > Stock price
At-the-Money	Strike price = Stock price
Out-of-the-Money	Strike price < Stock price

Strike selection

In, At, & Out-of-the Money

In-the money strikes

- Higher total premium than ATM/OTM strikes of same expiry
- Premium will have intrinsic and extrinsic value
- Greater likelihood of contract having intrinsic value at expiry

At/Out-of-the money strike

- Lower premium than ATM/OTM strikes of same expiry
- More aggressive choice for buyers
- Less likelihood of contract having intrinsic value at expiry

Expiry selection

Weekly'sSM, Monthly's, and LEAPS[®]

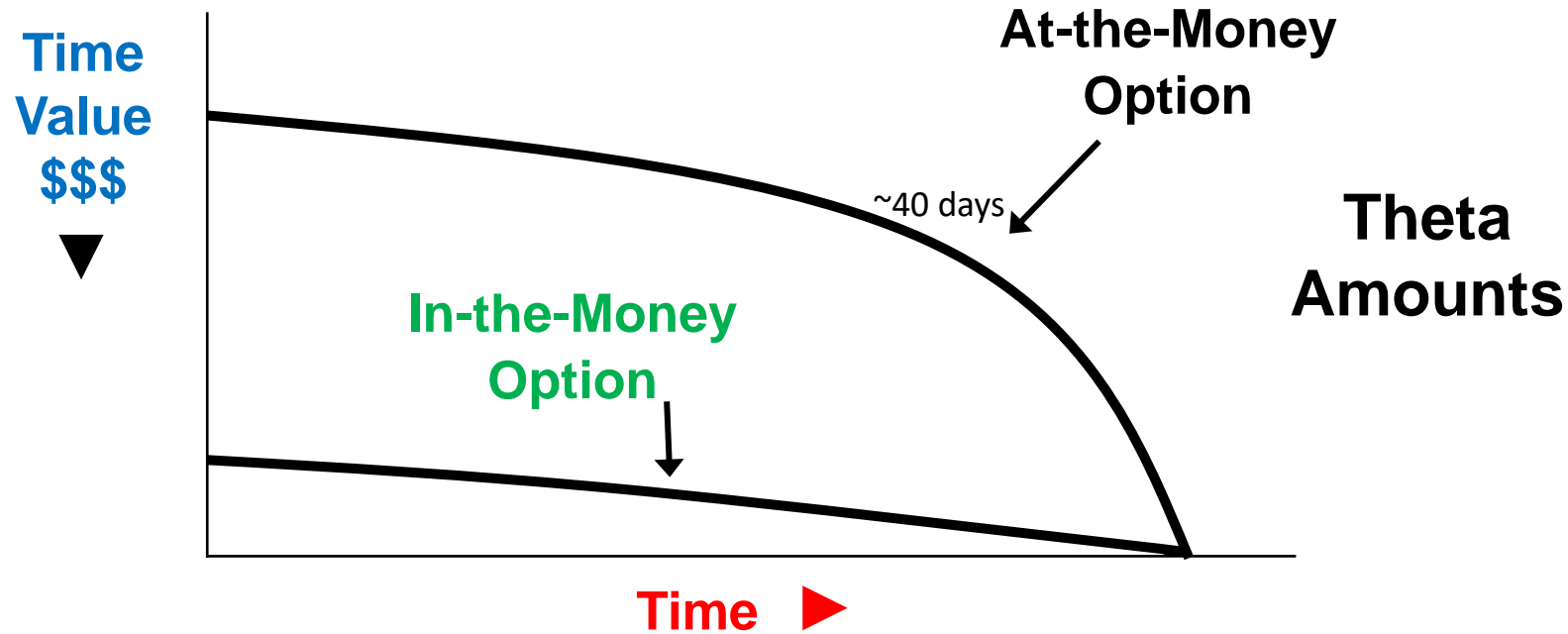
TIME IS MONEY!!!

As time is a component of options pricing (extrinsic value), *more time will translate into higher premiums*

Ex. 50 strike: LEAPS > Monthly > Weekly

Remember forecast? *Where is the stock going to go and how long will it take to get there?*

Option Theta and Expiry



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

ATM = decay exponential = volatility is key decay factor

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

Order Types



Order Types

Buy to Open: Purchase transaction to create or add to a long options position

Buy to Close: Purchase transaction to exit or reduce a short options position

Sell to Open: Sale transaction to create or add to a short options position

Sell to Close: Sale transaction to exit or reduce a long options position



Order Types

Market Order: An order placed with a broker to immediately buy or sell a stock or option at the best available price.

Limit Order: An order placed with a broker to buy or sell stock or options at a specific price.

Strike ?	Option Symbol	Bid/Ask Mean	Bid	Ask
311.0	C XYZ	4.545	4.52	4.57
	P XYZ	4.005	3.98	4.03
312.0	C XYZ	3.885	3.86	3.91
	P XYZ	4.415	4.39	4.44

Account Balances

How Does Your Trade Affect Your Account Balance? (Buying Example)

	Cash	Position	Account Balance
Sept 90 call quoted \$1.20b/\$1.30a Buy 1 Sept 90 call at \$1.30	-\$130 (\$1.30 x 1 x \$100)	+1 Sept 90c (\$1.20 x 1 x \$100)	-\$10 (\$120 - \$130)
After a market rally, the quote for the Sept 90 call is \$3.50b/\$3.70a	-\$130	+1 Sept 90c (\$3.50 x 1 x \$100)	+\$220 (\$350 - \$130)
The market weakens and you sell the Sept 90c for \$3.00	+300	No option position	+\$170 (\$300 - \$130)

Excluding commissions, fees, etc.

How Does Your Trade Affect Your Account Balance? (Selling Example)

	Cash	Position	Account Balance
June 35 put quoted \$2.75b/\$2.85a Sell 1 Jun 35 put at \$2.75	+\$275 (\$2.75 x 1 x \$100)	-1 Jun 35p (\$2.85 x 1 x \$100)	-\$10 (\$275 - \$285)
Three weeks later, the market for the Jun 35 put is \$1.55b/\$1.65a	+\$275	-1 Jun 35p (\$1.65 x 1 x \$100)	+\$110 (\$275 - \$165)
June options expire and the 35 put expires out of the money & worthless	+\$275	No option position	+\$275

Excluding commissions, fees, etc.

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