Options Fundamentals
Ep 1

Introduction to Options

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Disclaimer

This presentation is for educational purposes only. Nothing in this presentation is intended to be trading or financial advice.

What is an Option?

- An option is a contract that allows the buyer to buy or sell a stock at a given price for a certain amount of time
- A standardized options contract represents 100 shares of the underlying stock
- Options are traded like stocks on regulated exchanges through brokers

Why Use Options?

- Protect a stock position
  - Options were originally a form of insurance against a long or short stock position
- Make money entering and exiting a position
- Trading equities without owning the stock
  - Leverage: Control 100 shares of stock for far less money

Call Options

- The **buyer** of a call option has the **right** to buy 100 shares of a stock at a given price for a certain amount of time.
- The **seller** of a call option has the **responsibility** to provide 100 shares of a stock at a given price for a certain amount of time if requested by the buyer in exchange for the premium received from the buyer.
- If the buyer requests the shares, it is called “excercizing” the option or the buyer is “assigned” the shares.
  - This is why it’s named a “call” option because the shares are “called away” from the seller.
- This can protect a buyer’s short position in the stock

Put Options

- The **buyer** of a put option has the **right** to sell 100 shares of a stock at a given price for a certain amount of time.
- The **seller** of a put option has the **responsibility** to purchase 100 shares of a stock at a given price for a certain amount of time in exchange for the premium received from the buyer.
- If the buyer requests to sell the shares, it is called “exercising” the option or the seller is “assigned” the shares.
  - This is why it’s called a “put” option because the shares are “put to” the seller
- This can protect the buyer’s long position in a stock

Basic Options Components

- Underlying (Stock)
- Expiration
- Strike Price
- Example:
  - AAPL (Apple) March 15 $100 Call option
  - Underying Expiration Strike

“The Money”

- In the Money (ITM)
  - An call option is considered in the money if the strike price is lower than the price of the underlying
  - A put option is considered in the money if the strike price is higher than the price of the underlying
- Out of the Money (OTM)
  - A call option is considered out of the money if the strike price is higher than the price of the underlying
  - A put option is considered out of the money if the strike price is lower than the price of the underlying
- At the Money (ATM)
  - A call or put option is considered at the money if the price of the stock is exactly the same as the strike price of the option

Exercising

- American Style:
  - An option can be exercised at any time until expiration.
- European Style
  - An option can only be exercised at expiration
- Brokers typically will automatically exercise an ITM option at expiration unless otherwise directed by the buyer

Value

- Intrinsic Value
  - If an option is ITM, it has intrinsic value
- Extrinsic Value
  - Every option has extrinsic value until it expires
- Example:
  - Assume IBM is at $120. A $100 call has $20 of intrinsic value
  - The rest of the option price is extrinsic value
- ATM/OTM options only have extrinsic value

How to buy/sell options

- Most brokers will offer options, but you need approval to trade them.
- Approval is granted in levels
  - Level 1: Covered Calls/Protective Puts only
  - Level 2: Long Calls/Puts
  - Level 3: Spreads
  - Level 4: Uncovered or “naked” selling

Thank you for your time. Let’s keep talking!
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