Using Options

When Trading the Stock Market

Why Options?
Here are the Top Five Reasons

1. **Pre-Defined Maximum Risk**
2. **Much Lower Capital Requirement than Trading Shares**
3. **Leveraged Profit Potential**
4. **Unlimited Strategy Applications**
5. **Profit in ANY Market Condition (Up-Down-Sideways)**

Pre-Defined Maximum Risk

When you buy an Option Contract, the most you can lose is the cost of the Option.

Example:

Let's say you are bullish in IBM (you think IBM is going up in price).

Current share price is $129.05 per share.

Buy a Call Option that gives you the right to buy IBM at $129.00 per share.

The Option cost is $5.00 per share.

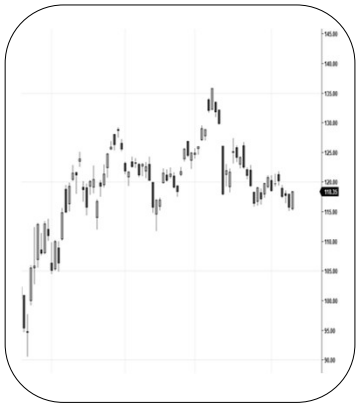
If IBM goes up in price, the Call Option's value will go up as well.

If IBM drops in price, the most you can lose on the Call Option is $5.00 per share.

Pre-Defined Maximum Risk

When you buy an Option Contract, the most you can lose is the cost of the Option.

Example:



In this case, you were wrong about IBM moving up in price.

At the Option's expiration, IBM's share price has dropped to 118.35 (down $10.70 per share).

The Call Option you bought is worth $0.

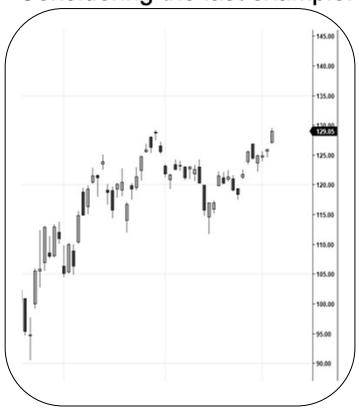
Total loss on the trade is the $5.00 per share that you paid for the Option.

Had you bought the Stock, your position is down $10.70 per share. The loss could easily continue to get far worse.

Much Lower Capital Requirement

When you buy an Option Contract, the amount of capital required is the cost of the Option.

Considering the last example:



If you bought 100 shares of IBM at the initial price of $129.05 per share, the capital required would be $12,905.

(129.05 x 100 shares)

Options (in the U.S.) control 100 shares of Stock.

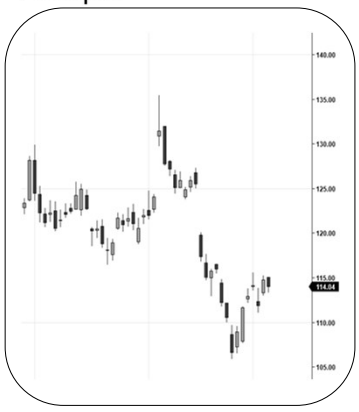
The Call Option's cost was $5.00 per share – or $500.

Total capital required for the Option was $500, which is $12,405 **less** than buying the shares.

Leveraged Profit Potential

Options (due to their leverage) increase in value at a greater rate than the underlying shares based on ROI.

Example:



Again, you are bullish in IBM (you think IBM is going up in price).

Current share price is $114.04 per share.

Buy a Call Option that gives you the right to buy IBM at $114.00 per share.

The Option cost is $2.16 per share (2.16 x 100 = $216.00).

If IBM goes up in price, the Call Option's value will go up as well.

If IBM drops in price, the most you can lose on the Call Option is $216 per contract.

Leveraged Profit Potential

Options (due to their leverage) increase in value at a greater rate than the underlying shares based on ROI.

Example:

In this case, you were right about IBM moving up in price.

At the Option's expiration, IBM's share price has increased to 127.20 (up $13.15 per share).

The Call Option you bought is worth $13.08 per share. A gain of 10.92 (13.08 – 2.16 original cost = 10.92).

Stock gain is $13.15 per share | Option gain $10.92 per share.

Why is the Option trade a better choice?

Leveraged Profit Potential

Options (due to their leverage) increase in value at a greater rate than the underlying shares based on ROI.

Because of the Option's ROI.

What is ROI, and how do I calculate it?

ROI is **R**eturn **O**n **I**nvestment.

Here's how it's calculated:

Return / Investment = ROI

Example:

You invest $150 into a trade. When you exit the trade, the return (profit) is $90.

To calculate the ROI:

$90 (Return) / $150 (Investment) = .60 (convert to percentage) is 60% ROI

Leveraged Profit Potential

Let's compare the results from the recent example…

Calculate the ROI for each trade:

Instrument	Investment	Return (Profit)	R O I
Stock (100 shares)	$11,404	$1,315	11%
Option (1 contract)	$216	$1,092	505%

505% ROI vs 11% ROI

NO Contest!

Unlimited Strategy Applications

There's more to Options than simply buying a Call or a Put.

- There are two types of Options – Calls and Puts.
- We can Buy or Sell them to open a position.
- We can combine them to create an unlimited number of strategies.
- A very popular strategy is the Vertical Spread.

Let's look at an example…

Unlimited Strategy Applications

There's more to Options than simply buying a Call or a Put.

In the prior example, we bought the 114 strike Call Option for 2.16 per share. It made a profit of $1,092 (505% ROI).

Real IBM Option prices		
IBM 2020 Dec 04 120 C	0.58	**Buy**
IBM 2020 Dec 04 121 C	0.45	
IBM 2020 Dec 04 122 C	0.35	
IBM 2020 Dec 04 123 C	0.40	
IBM 2020 Dec 04 124 C	0.19	
IBM 2020 Dec 04 125 C	0.16	**Sell**

In this example, we will create a combination trade or what's referred to as a Vertical Spread.

Buy the 120 Call…

At the same time Sell the 125 Call to open the position – forming the 120-125 Call Spread.

The cost of this trade is 0.42 per share [0.58 – 0.16 = 0.42].

The most this trade can lose is $42 per spread.

Unlimited Strategy Applications

There's more to Options than simply buying a Call or a Put.

With a Vertical Spread, the most it can ever be worth is the distance between the Option strikes - in this case, it's 5.00 (125-120).

The maximum potential profit is the distance between the strikes (5.00), minus the original cost. For this example, 5.00 - 0.42 = 4.58 per share.

Real IBM Option prices	
IBM 2020 Dec 04 120 C	7.15
IBM 2020 Dec 04 121 C	6.15
IBM 2020 Dec 04 122 C	5.18
IBM 2020 Dec 04 123 C	4.20
IBM 2020 Dec 04 124 C	3.03
IBM 2020 Dec 04 125 C	2.13

At expiration, the spread has reached it's maximum profit of 4.58 per share. That works out to 1,090% ROI!

4.58 / 0.42 = 10.90 or 1,090%

That's more than 10 times your money!

Profit in ANY Market Condition

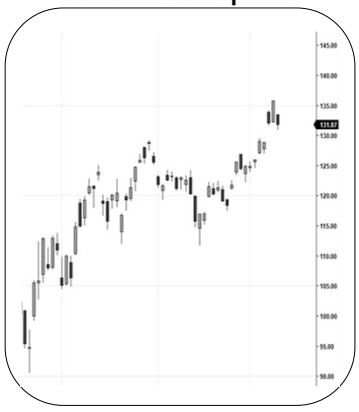
Options can profit when the Stock moves **up**, **down** or **sideways**.

- In the prior examples we were looking to profit when the stock moves up using Call Options.
- What if our outlook is bearish – we think the Stock will move down in price?
- Options work in both directions, or even when the Stock moves sideways.

Profit in ANY Market Condition

Options can profit when the Stock moves **up**, **down** or **sideways**.

Bearish example…



You are bearish in IBM
(you think IBM is going down in price).

Current share price is $131.87 per share.

Profit in ANY Market Condition

Options can profit when the Stock moves **up**, **down** or **sideways**.

Bearish example…

Real IBM Option prices	
IBM 2020 Jul 10 126 P	2.22
IBM 2020 Jul 10 127 P	2.34
IBM 2020 Jul 10 128 P	2.54
IBM 2020 Jul 10 129 P	3.02
IBM 2020 Jul 10 130 P	3.90
IBM 2020 Jul 10 131 P	3.93

Buy a Put Option that gives you the right to sell IBM at $131.00 per share.

The Option cost is $3.93 per share.

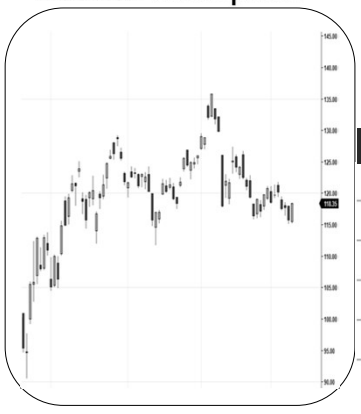
If IBM goes down in price, the Put Option's **value will go up**.

If IBM goes up in price, the most you can lose on the Option is $3.93 per share or $393 per contract.

Profit in ANY Market Condition

Options can profit when the Stock moves **up**, **down** or **sideways**.

Bearish example…



At the Option's expiration, IBM is trading at 118.35 down 13.52 per share.

Real IBM Option prices	
IBM 2020 Jul 10 126 P	7.63
IBM 2020 Jul 10 127 P	8.65
IBM 2020 Jul 10 128 P	9.40
IBM 2020 Jul 10 129 P	10.40
IBM 2020 Jul 10 130 P	11.6[illegible]
IBM 2020 Jul 10 131 P	12.25

Your 131 strike Put Option is worth 12.25

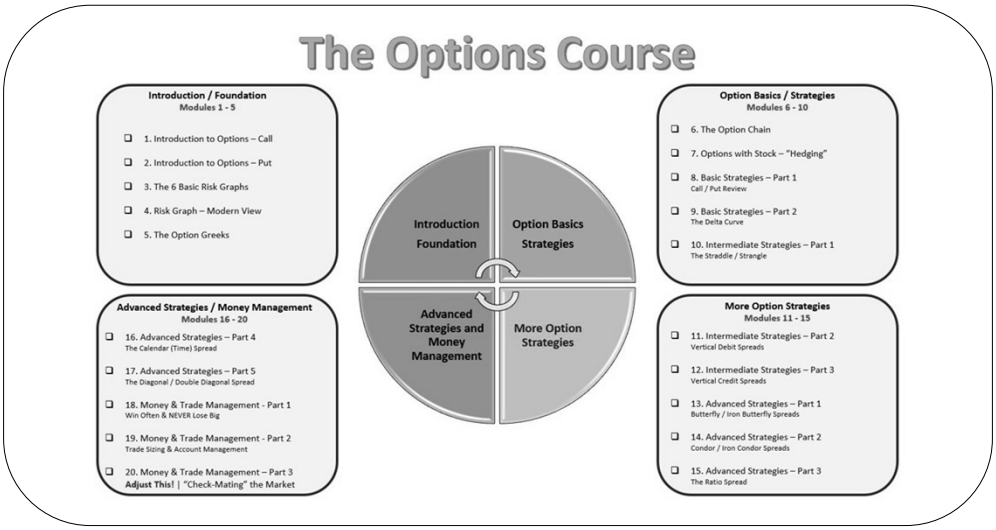
That's a profit of 8.32 per share on only 3.93 of risk

12.25 - 3.93 (cost) = 8.32 (profit)

ROI is 212% !

8.32 / 3.93 = 2.12

Want to Learn More?



The Options Course

Very comprehensive series of 20 education modules

Module #	Title	Content
1	Option Basics - Calls	Introduction to Equity Options – Highlighting the Call Option
2	Option Basics - Puts	Introduction to Equity Options – Highlighting the Put Option
3	The 6 Basic Risk Graphs	Graphical "Picture" of the Risk/Reward Profile
4	Modern View Risk Graphs	Continuation Discussion of Risk Graphs, but in the new View
5	Option Greeks	Introduction to Delta, Gamma, Vega, Theta and Rho
6	Options Chains	A look at how Options are Displayed and Priced
7	Options with Stock	Combining Stock Ownership with Options to "Hedge" Risk
8	Basic Strategies – Part 1	Strategies – Long Call, Long Put, Covered Call and Married Put
9	Basic Strategies – Part 2	The Delta Curve – Which is better, ITM, ATM or OTM
10	Intermediate Strategies – Part 1	Delta Neutral Strategies – Straddles / Strangles

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Module #	Title	Content
11	Intermediate Strategies – Part 2	Vertical Debit Spreads
12	Intermediate Strategies – Part 3	Vertical Credit Spreads
13	Advanced Strategies – Part 1	Butterfly and Iron Butterfly Spreads
14	Advanced Strategies – Part 2	Condor and Iron Condor Spreads
15	Advanced Strategies – Part 3	Ratio Spreads
16	Advanced Strategies – Part 4	Calendar (Time) Spreads
17	Advanced Strategies – Part 5	Diagonal and Double Diagonal Spreads
18	Money / Trade Management – Part 1	Risk-Reward-Probability-Profile (RRPP)
19	Money / Trade Management – Part 2	Trade Sizing and Account Management
20	Money / Trade Management – Part 3	Trade Adjustments / “Check-Mating” the Market

MicroDog Trading

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