Introduction to Options

Part 1: Calls, Puts, and Exchange of Options

GREENE CHARTER

What are options?

- A contract which gives the buyer the right, but not the obligation, to buy or sell an underlying asset or instrument at a specified strike price prior to or on a specified date, depending on the form of the option.
- Options enable traders to leverage with small amounts of capital to create future profits or, at least, to accept risks in the hope the purchased options will be profitable at a later point.
- Mainly used on stocks and indexes

When to use Options?

- Insure long portfolio positions
- Hedge short risks (with calls/ options strategies)
- Trade short-term volatility
- Amplify profits by using options as a means to leverage

What is a Call Option?

- A Call option is the Right to Buy 100 Shares
- A call option is a contract that grants its owner the right, but not the obligation, to buy 100 shares of a specific underlying asset at a fixed price per share and on or before a specific expiration date
- The owner of the call acquires these rights in exchange for a premium paid for the option. (Think insurance premiums)
- The value of the option increases if the terms become more attractive before expiration
- Ex: If the market price of the underlying asset rises, the call option will appreciate. If it remains at or below the fixed price, the value of the contract decreases in value. (Note: In the money and out of the money)
- A call holder is not obligated to exercise the option; there are three choices:
- An option’s owner can exercise the option and buy 100 shares at the fixed strike price

- An option expires worthless if the current market value remains below the strike price or the contract can be closed at a profit and sold off into the market
- The sale of the contract occurs at a loss and letting the contract expire or go back on the market prior to expiration
- Ex: If a strike is $40 and current price per share is $50, exercise of the option enables its owner to buy 100 shares at the fixed price of $40 per share, which is cheaper than the current market value

What is a Put Option?

- The opposite of a call option
- A put option grants the holder the right, but not the obligation, to sell 100 shares of stock at a fixed strike price, on or before a specific expiration date
- This is inverse what a call option holder seeks, a put owner hopes the value of the stock will fall
- The more the price falls, the more valuable the put option is.
- A put holder is not obligated to exercise the option; there are three choices:
- A put option can be closed at its premium value at a profit or a loss
- A put option can expire worthless, which occurs if the underlying asset is at/above the strike price by expiration
- A put option can be exercised, which occurs when means the holder is permitted to sell 100 shares of the underlying asset at the strike price
- **EX:** If a trader owns 100 shares of $amd purchased at $40 per share and also buys a 50 put, exercise will occur at that price. If the stock's value falls to $25 per share before expiration, the put owner can exercise the put and sell 100 shares for $40 per share anyways

Option Sellers

- The seller of an option is the one who receives the premium
- When someone sells an option, the trading sequence is reversed
- The seller of the option expects the contact to expire worthless

The exchange of options

- The seller and buyer do not actually meet
- All options trading is done through the Options Clearing Corporation (OCC), who facilitate the market
- When an options contract is exercise, the OCC matches the transaction and assigns the shares of stock to an options writer
- For someone short a call option (call option seller), the seller has a obligation to sell 100 shares of the underlying asset at the strike price.
- Ex: If the strike of a contract sold is $40 and current market value is $50, a seller is obligated to sell shares at the fixed strike of $40 per share, even if that means having to buy the same shares at $50 per share and a loss occurs

Article Sources

Chen, James. “How Options Work for Buyers and Sellers.” Investopedia. Investopedia, March 2, 2020. https://www.investopedia.com/terms/o/option.asp.

Downey, Lucas. “The Essential Options Trading Guide. Investopedia. Investopedia, April 22, 2020. https://www.investopedia.com/options-basics-tutorial-4583012.

Disclaimer

THE INFORMATION PROVIDED ON THE PLATFORM DOES NOT, AND IS NOT INTENDED TO, CONSTITUTE AS FINANCIAL ADVICE; INSTEAD ALL INFORMATION, CONTENT, AND MATERIALS AVAILABLE ON THE PLATFORM ARE FOR GENERAL INFORMATION PURPOSES ONLY.

INFORMATION ON THE PLATFORM ARE THE PERSONAL OPINIONS OF THE EMPLOYEES AND CONTRIBUTORS OF GREENE CHARTER (TOGETHER THE “CONTRIBUTORS”) AND ARE IN NO WAY TO BE CONSIDERED FINANCIAL ADVICE RENDERING, PROMISING, OR GUARANTEEING ANY SPECIFIC OUTCOME. GREENE CHARTER IS IN NO WAY MANAGING THE FUNDS OR FINANCES OF MEMBERS AND IS NOT RESPONSIBLE FOR ANY PERFORMANCE OR NON-PERFORMANCE OF MEMBER’S FINANCIAL ASSETS OR INVESTMENTS.

MEMBERS OF THE PLATFORM SHOULD CONTACT THEIR FINANCIAL ADVISOR TO OBTAIN ADVICE WITH RESPECT TO ANY PARTICULAR FINANCIAL MATTER. VIEWS EXPRESSED AT, OR THROUGH, THE PLATFORM ARE THOSE OF GREENE CHARTER AND ITS CONTRIBUTORS THEIR INDIVIDUAL CAPACITIES ONLY. ALL LIABILITIES WITH RESPECT TO ACTIONS TAKEN OR NOT TAKEN BASED ON THE CONTENTS OF THE PLATFORM HEREBY ARE EXPRESSLY DISCLAIMED. THE CONTENT ON THIS PLATFORM ARE PROVIDED “AS IS”; NO REPRESENTATIONS ARE MADE THAT CONTENT IS ERROR-FREE.