THE #1 BEGINNER'S GUIDE TO MAKE MONEY WITH TRADING OPTIONS IN 7 DAYS OR LESS!

OPTIONS TRADING CRASH COURSE

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Options Trading Crash Course

• The #1 Beginner's Guide to Start Making Money with Trading Options in 7 Days or Less •

By Frank Richmond

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Before we begin, I would like to give you something back in return – exclusive ONLY to my readers - an **IMPERATIVE** bonus chapter of my options trading book. **FOR FREE**.

This offer is extremely time limited, so go get it now while it's still available:

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Now that you have everything you need, let's begin...

Taking the Risk

For the novice, options trading is a daunting concept. Packed with jargon and seeming to need a degree in math to figure out, the very idea of learning the basics has put off countless curious traders.

I've written this book to bridge that gap, taking you from thoroughly confused to fully aware of what options trading entails. It's aimed either at complete beginners who have no idea where to get started or at readers who have dipped their toes in the waters and found themselves flailing.

It's also aimed at readers who think that options trading is far more risky than its siblings – stocks, shares, bonds and mutual funds. If you think these are the safer way to go and you've avoided options trading until now, I'm here to show you that they are just as fruitful a direction, if not more.

Much as with any other skill in life, options trading gets easier over time. Once you've mastered the basics and are fluent in the language, you'll find that it becomes less and less difficult to decipher the possibilities in front of you and pick the best one. In fact, eventually, it becomes like learning to use a tool or ride a bike – you know it so well that you barely need to think about what you're doing.

So put your feet up, grab a coffee and prepare to start that process of understanding. Trust me when I tell you that it's not nearly so daunting as you thought.

What is an Option?

Let's start out with a basic overview of what options are. An option is a contract that confers upon you the right to buy or sell an underlying stock at what's known as a "specified strike price". It comes with a deadline – a date by which you must buy or sell in order to attain that price.

You are not obligated to buy or sell by that date – hence it being called an "option" rather than a "demand". However, the cost of purchasing that possibility is set at a premium.

There are two types of contract on offer: one allows you to buy a stock at the price specified, which is known as a "call", and the other allows you to sell a stock at the price specified, which is called a "put".

In order to start options trading, you first need to select a broker and open a "margin account". These usually have a minimum starting amount attached to them that is often set at around $5000.

These are the basics of options trading, but what does it actually mean and why would you want to do it? This is where the risk comes in: options trading is all about predicting what a certain stock is going to do in the near future.

To illustrate, let's use an example that's easily familiar from everyday life: buying a car. You've been saving up for a few months, but you're not quite ready to head to the dealership – except, one day, you drive past a local sales room and spot the hatchback of your dreams.

Because you want to buy that car, you decide to speak with the dealer and negotiate. You work out a deal that will allow you to buy the vehicle from him in two months for the price of $10,000. Because the dealer is agreeing to keep the car for you and fix the price, you will also be paying $300 to secure that option for yourself.

The two months start to pass and one of two things might happen:

- The dealer opens the hood of the vehicle and discovers it has an engine system that's completely one of a kind and was a test by the manufacturer. That makes the car ultra valuable as a collector's item. Under normal circumstances, the dealer would instantly double its asking price – but, because he made an agreement with you, he can't. He is obligated to sell that car to you as long as you buy it before the two months are up. Obviously, you're keen to exercise that right, so you purchase the car for $10,000 and decide to sell it on for $20,000, doubling your money in the process.

- The dealer opens the trunk of the vehicle and discovers that it contains a dead body. It's removed and the car is cleaned, but the police investigation causes quite a bit of damage. The value of the vehicle halves and, under normal circumstances, the dealer would slash the asking price to $5000. However, because you entered into the agreement, the dealer must still sell you that car at the agreed price of $10,000. On the other hand, because you as the buyer are not obligated to make the purchase, you can always decide to walk away and see what the Toyota dealer has in stock instead. You won't lost the $5000 value, but the dealer will get to keep the $300 you paid to create the opportunity for yourself in the first place.

This, in a nutshell, is how options trading works. As the buyer of an option, you are in exactly the same position as you would be if you had gone out to buy that car. You cannot know what the future will bring – and it does have a habit of throwing out the unexpected – but you can make a decent prediction.

Now, let's zoom in a little bit closer. Though options trading really is as simple as the example we just looked at, there are a few more things you need to know in more detail before we move on.

Firstly, there are two types of options:

- **Calls:** These give the right to BUY an asset at the specified price before the time limit expires. You'd do this, for example, if you felt confident that a certain stock is going to continue rising in price for a period of time, allowing you to purchase that stock at its current price at a time when it has risen to a much greater value.

- **Puts:** These give the right to SELL an asset at the specified price before the time limit expires. You'd do this, for example, if you felt confident that a certain stock is going to continue dropping in price for a period of time, allowing you to sell that stock at its current price at a time when it is worth a whole lot less.

Let's translate what we know into a trading example so that you can see how options trading works in the real world. This time, we'll look at a put, because, as you are now aware, the example we covered of purchasing a vehicle was an illustration of a call: you obtained the right to BUY before the deadline.

This time, we'll look at what might happen if you purchased a put option, giving you the right but not the obligation to SELL before a deadline. We'll assume you're looking at a particular stock in your portfolio that is currently trading at $1. Knowing the market, you have predicted that it is going to drop to 50 cents within the next three months.

You purchase an option with a trader that will allow you to sell the stock in three months at 75 cents. If, during the interim, it turns out you are correct and the stock drops to 50 cents, you have made a 25 cent profit on the sale. If, on the other hand, you were wrong in your prediction and the stock climbs to $1.20, you have no obligation to sell it and lose that 20 cent profit.

To decipher this example fully, it's important to understand the difference between a buyer and a seller, as it's likely that you'll end up filling both roles over the course of your options trading experience:

- A buyer is NOT OBLIGATED to actually buy or sell the option when the deadline arrives. What he or she has bought is the right to make that sale or purchase, not the obligation.

- A seller is OBLIGATED to buy or sell that stock when the deadline arrives. As the seller, you made a promise when the contract was agreed and you must fulfil it when the time comes, no matter the consequences.

If follows, therefore, that you could find yourself in four very different situations during the options trading experience. Let's outline them for your reference, as this is often where it can start to seem confusing:

- **Call buyer** – you have the choice to buy a stock at the deadline, but are not obligated.

- **Put buyer** – you have the choice to sell a stock at the deadline, but are not obligated.

- **Call seller** – you are obligated to sell a stock at the deadline and will keep the premium that was included to secure the deal.

- **Put seller** – you are obligated to buy a stock at the deadline and will keep the premium that was included to secure the deal.

There are more intricacies to the experience of stock trading, but we'll cover those in more detail later. First, make sure you have a full understanding of these basics – they are the essence of options trading and the heart of your experience as a trader.

Why Options Rather than Stocks?

One very good question that newcomers often ask is why a trader would want to trade in options rather than stocks. What's the difference? Is one better than the other?

It's true that the stock market is less complicated to work with. All you really need to worry about in the case of the stock market is the direction things are heading: down is bad for your shares but could be good for buying; up is good for your shares and could be good for selling.

With stocks trading, you are also seldom going to lose 100 percent of your investment if things go sideways. If you pick a stock thinking it will climb but instead it plummets, you can sell quickly and lose only the difference between your initial investment and the price of that stock as you sell.

Not so with options trading, where you will lose the lot if you make a bad judgment call. Stocks trading can be a great introduction to the market, but it's less flexible and less likely to win big than an options trade.

When you enter the options trading market, you quickly find out that you actually have three things to worry about – and what those things are doing is not so simple as "down is bad, up is good". You are interested in the direction stocks are heading, but you can make big money on a downward direction as easily as upward, if you make the right call. Meanwhile, you are also concerned about your timing and the magnitude of the trade.

In a nutshell, the biggest reason to choose options over stocks is that it provides you with flexibility within your own portfolio and allows you to play the market at its own game, whether bull or bear.

So let's take a closer look at options trading and its benefits, shall we?

Why is Options Trading Worth the Risk?

So what's the point of all this horse trading? If, while reading the previous chapters, it seemed that options trading involves a lot of risk and an uncertain gain, you might be interested to know that that's not necessarily the case. It all depends how you go about trading your options.

While, yes, you can place your focus on a whole slew of risky ventures and you would stand to either lose a fortune or gain even more, that's not the only way to options trade. Let's take a look at the advantages of options trading:

- When you trade in options, the uncertainty lessens. You create an option that tells you exactly how much you will either lose or gain once the deadline arrives – unlike trading in stocks or shares, you are not at the mercy of the markets. You have confirmation from the outset of what you will either receive or spend on that particular date.

- Options are more versatile than stocks or shares, which means you can make money no matter the state of the market. It doesn't matter if stocks are dropping as it would if you were simply trading in stocks. With an option strategy, you can take advantage of what's happening in the markets in either direction.

- You can also use options trading as a form of security to protect your investments. That might sound strange, but it's actually a very common strategy known as "hedging". If, for instance, you are concerned that a stock you own a large amount of is set to drop, but you're not completely sure, you can use an options trade to protect yourself against that possibility. You would simply buy a put that would allow you to sell that stock at a greatly reduced loss on the deadline – you wouldn't be obligated to make that sale if you turned out to be wrong, but you can do so if your fears prove to be founded.

- You can also "hedge" to protect yourself against risk altogether. If it seems that the market as a whole is set to drop over the coming months, you can hedge your entire portfolio by buying certain options known as exchange-traded funds. These will actually gain value as the market drops in value – it's a very common strategy among the experts.

- The opposite of "hedge" is "speculate", and it's one of the most profitable ways to invest if it's done properly. Beware, however, that it is also the strategy that carries the most risk. By speculating, you can leverage the investments you have made and you have the chance to make a lot of money in the process, all for a relatively small cost.

- Finally, arguably the most important advantage of options trading is that you don't need to know the complicated and advanced strategies to prevail. Actually, it's the simple strategies that are very often the best, which means you can dive into options trading with confidence that you can learn as you go without sacrificing your potential for profit.

How to Get Started in Options Trading

Walking you through the learning curve of options trading will always start with the most basic move you'll need to make: setting yourself up in a position to actually be able to trade.

To do that, you're going to need an options account. Don't worry, we're going to talk a whole lot more later about what to do with your account once you have it in the coming chapters. For now, it's important that you know your starting point – and just how easy it is to reach it.

One thing to know before you pick your firm: times have changed considerably over the last couple of decades when it comes to options trading. Back before the internet became such a constant part of our lives, your brokerage firm – or, at least, your personal representative at the firm – would make your options trades on your behalf and you paid a hefty price for their services. Nowadays, however, you'll be doing most of your trades yourself.

Commission for your representative is thus a whole lot lower than it used to be, which means it won't cost you an arm and both legs to rely on your rep in the early days of your experience. While you are learning, feel free to make use of your firm's services to place and confirm your trades, if it helps you feel more comfortable getting to know the process.

With this in mind, there are going to be certain things to look for when you select your firm:

- Compare commission prices to make sure you're getting a great deal.

- Make sure the firm has up to date software and is capable of setting up trades quickly and reliably to make sure you get those trades you want at the best prices.

- Check out the hours of service to ensure they are compatible with your needs. In these days of online firms, you could be dealing with a firm that's across the ocean from the markets you have an interest in, or you might find that a firm only makes its reps available for the length of the working day, which might not suit your own timing.

- Speak personally with the reps at the firm, as these are the people who are going to help you during the process of setting up your strategy. You want someone who is personable and knowledgeable – and, most importantly, who speaks in terms that you personally find easy to comprehend.

- Take a look at the additional services the firm supplies. Many will offer learning materials, guides and even classes or webinars to help you hone your strategies. Even if you feel that you know all you need to know already, there's no harm in a refresher course or a little nugget of inspiration every once in a while.

Once you select a firm, you'll then need to consider signing a "margin agreement" with that firm. This agreement allows you to borrow money from the firm in order to purchase your stocks, which is known as "buying on margin".

Understandably, your brokerage firm is not going to allow you to do that if you don't have the financial status to pay them back. They will therefore run a credit check on you and ask you for information about your resources and knowledge.

A margin account is not a necessity for options trading – you don't actually use margin to purchase an option, because it must be paid for in full. However, it can be useful as you graduate to more advanced strategies – in some cases, it will be obligatory. If you opt to sign a margin agreement, talk it through thoroughly with the firm as there are certain restrictions on the type of money you can use that may apply to you.

Next, you'll need to sign an "options agreement" – and, this time, it's an obligatory step. This agreement is designed to figure out how much you know about options and how much experience you have of trading them. It also aims to ensure that you are absolutely aware of the risks you take by trading and make sure that you are financially able to handle those risks.

By ascertaining these things, your firm can determine what level of options trading you should be aiming for. It will therefore approve your "trading level", of which there are five:

- Level 1: You may sell covered calls
- Level 2: You may buy calls and puts and also buy strangles, straddles and collars. You may also sell puts that are covered by cash and by options on exchange-traded funds and indexes
- Level 3: You may utilize credit and debit spreads
- Level 4: You may sell "naked puts", straddles and strangles
- Level 5: You may sell "naked indexes" and "index spreads"

Don't worry if you're not sure yet what each of these things means – you will be by the time you finish reading this book. For now, all you need to be aware of is that your firm will determine for you which level you should be at. As a beginner, don't be surprised if you only reach the first two levels.

Once you've signed the agreement, you'll be handed a booklet that contains a mine of information about risks and rewards within options trading. Right now, if you were to read that booklet, it would seem to be in a foreign language. By the time you finish this crash course, it will be a lot more decipherable – and it's very important for your success that you do read it.

Finally, your firm will present you with a "standardized option contract". It's the same for every trader, which means you stand the same chance of success as every other person out there in the options market.

By trading an option, you are entering into a legal agreement that is insured by the Options Clearing Corporation, which guarantees the contract will be honored in full. Make sure you read that contract to be aware of not only the rights you have as a trader, but also the obligations you must follow in the same role.

Congratulations, you have an options account. This is the conduit through which you will create and implement your strategies and begin your adventure in options trading.

Learning the Lingo

Options traders speak their own language – it's not meant to confuse you, it's just the natural process of creating a shorthand by which one trader can converse with another more easily and thoroughly.

Of course, it does make it difficult to plunge into the waters of trading if you can't speak that language. A lot like trying to decipher road signs in a foreign country, it makes it hard to know the right direction – or even where you're standing right now.

We're going to take a look at the common terms you'll be dealing with as you enter the world of options trading before we begin taking a deeper look at your strategies.

Don't worry about trying to learn them by rote – they will all become clear as you forge onwards. This glossary will always be available to you to check on a meaning if you need to:

- **Strike Price:** A price per share agreed upon before an option is traded. At this price, stock may be bought or sold under the terms of your options contract. Also known as the "exercise price".

- **Bid/Ask:** The latest price that a market maker has offered for an option is its "ask" price. In other words, it's what the seller is willing to accept for the trade. The latest amount that a buyer has offered for an option is the "bid" price.

- **Premium:** The premium is a per-share amount paid to the seller to procure an option. The seller will keep this premium no matter whether the buyer exercises their right to buy or sell the stock at the deadline.

- **In-the-Money:** Often shortened to ITM, this means that the stock price is above the strike price for a call or below the strike price for a put. In other words, it is now at the right price to be traded.

- **Out-of-the-Money:** Often shortened to OTM, this means the price is below the strike price for a call or above it for a put. Such an option is priced according to "time value".

- **At-the-Money:** The strike price is equal to the stock price.

- **Long:** In this context, "long" is used to imply ownership. Once you purchase a stock or option, you are "long" that item in your account.

- **Short:** If you sell an option or stock that you do not actually own, you are "short" that security in your account.

- **Exercise:** The owner of the option takes advantage of the right to buy or sell that they purchased by "exercising" it.

- **Assigned:** When the owner exercises their option, the seller is "assigned" and must make good on the trade. In other words, they must fulfill their obligation to buy or sell.

- **Intrinsic Value/Time Value:** The intrinsic value of an option refers to how much it is ITM. Most options also include time value, which refers to how long left until its expiry. This time has value because, during that time, the stock can still change in price. An OTM option has no intrinsic value because it's a loss, but it does have time value because that loss might change.

- **Time Decay:** Linked to time value, this term refers to the fact that, as time ticks on, the amount of time value slowly decreases. At the expiration date of the options contract, the contract has NO time value and is worth only its intrinsic value.

- **Index Options/Equity Options:** Index options are settled by cash, whereas equity options involve trading stock. The main difference between these two types of option is that an index option usually cannot be exercised before the expiry date, while an equity option usually can.

- **Stop-Loss Order:** This is an order to sell either an option or a stock when it reaches a particular price. Its purpose is to set a point at which you, as the trader, would like to get out of your position. At this price, your stop order is activated as a market order; in other words, by looking for the best available price at that moment in order to close out your position.

These are the most common terms you will hear used as you venture into the world of options trading. It's worth mentioning that, as you extend your understanding, you'll encounter more. However, these are plenty to help you decipher your first trades and get stuck in.

The Role of the Underlying Stock

It's vital to understand that stocks do play a fundamental role in options trading, even though they are not what you are buying and selling. Bear in mind that an option is only a piece of paper that gives you the right to buy or sell that stock – without the stock, you would have nothing to buy or sell.

You might say that the stock is Oz behind the curtain, changing and moving while your attention is fixed elsewhere. Letting Oz get up to his tricks without you is a bad idea – you need to be keeping an eye on your stocks just as much as you do the options themselves.

Not every stock is allowed its options to be traded on an options exchange. In total, you'll find somewhere in the region 3600 stocks spread across 12 different exchanges, though this number changes all the time.

What does this mean? Well, the exchanges have in place some very solid rules that dictate which stocks may and may not participate in options trading. You'll find some of the biggest business names on the planet there, and you'll also find what are known as "penny stocks", which buy and sell for less than $3.

In general, the latter won't do you much good for options trading. There simply isn't enough liquidity in such a small number for you to bother with the effort required to trade on them.

Instead, I would recommend sticking with the big names – the recognizable companies, such as Microsoft, Apple, Google and McDonalds.

Another point to bear in mind is that there is a fixed relationship between options trading and its underlying stock. One option contract will always equal a hundred stock shares.

In other words, a single contract will give you the right to buy or sell 100 shares (or one stock). Multiply the number of contracts involved in a trade by 100 and you'll know how many shares are also involved.

A third factor of that relationship between an option and its underlying stock: whenever the stock goes up or down, in most cases so too will the option contract.

Because the two are so inextricably linked, you will need to study the stock market in detail to be a whizz at options trading. You will need to be able to predict which stocks are going to head in which direction and when – only if you get this right will your trading be truly successful.

For that reason, a lot of options traders started with the stock market itself, giving themselves experience of its whims before taking a step up to the next level. If you haven't done this, it will be worth spending a month or three trading on the stock market. Even a theoretical portfolio that you manage in a folder rather than on your own desktop and never pay a penny to invest in is a helpful step.

Doing this will allow you to get a sense of how the market functions overall and will familiarize you with some of the stocks you might be interested in trading on with options. The best options traders have almost a sixth sense of how an underlying stock is going to perform. The only way to develop that uncanny ability is through exposure, research and experience.

Understanding the Strike Price

We've touched on the idea of the strike price before, but it's such a fundamental aspect of options trading that it bears looking at in greater detail.

To review: the strike price is the fixed price at which the underlying stock can be either sold or bought. When you purchase a call option, what you are purchasing is the right to buy that stock at this price, while selling a call option means that you are selling the right for your buyer to purchase the stock at that price.

The strike price is an aspect of every options trade that you will want to hone in on every time – it's that important. Never forget that, if the underlying stock never reaches that strike price, the trade is worthless because the option will simply expire on the deadline.

The difference between the current market price of the stock and the strike price of the option also represents the profit-per-share you can expect to make.

Let's say, for example, that you find two trades on a stock that is currently worth $150. One has a strike price of $125 and the other has a strike price of $100.

In the first trade, the stock price will need to drop to $125 before you have the right to buy or sell it (depending on whether the option is a call or a buy). In the second, it will need to drop to $100 before you get that right.

The value of the option is simple to calculate: it's the difference between the strike price and the current worth of the stock. In the first of these examples, the trade has a potential worth of $25; in the second, the potential worth is $50.

At first glance, that would seem to mean that the second option is the one to go for, because its value is so much higher. However, you also need to bear in mind that you cannot dictate what the market does.

This is where risk comes in. How confident are you, in this example, that the stock will plummet $50 before the expiration date of the option? If you're as certain as it's possible to be, it's a great investment. If you're not, you stand to lose the premium you paid for the option, because it will never reach the price at which you have the right to realize the trade.

The trade that has a strike price of $25 is therefore a surer bet – it's always going to be more likely that a stock will rise or fall by the smaller amount than the larger one. The trade-off, as you can see, is that you won't make nearly the profit you would on the riskier option, so you have to ask yourself whether the premium you'd be paying is worthwhile.

Basic Trading: Selling Covered Calls

As a beginner, most people choose to dip their toes in the complicated waters of options trading through selling covered calls. It's arguably the most basic level of options trading and, while also not the most adrenaline-inducing, a great way to find your feet before moving on to more complicated strategies.

Selling covered calls is also likely to be an aspect of your options portfolio in the long term. Many traders use it as a steady way of generating income – a conservative baseline for their account.

A third benefit to starting with covered calls is that it includes the majority of the knowledge and strategy that you will use as an options trader, so it's a perfect training ground.

Using this strategy, you are going to be selling the right to buy underlying stocks that you own. A "covered" call is so called because you own those shares, therefore you have the sale covered.

Before you can begin, therefore, you will need to own at least 100 shares, or one stock. By writing an option for those shares, you are offering buyers the right to buy them by the expiration date if the share price hits your strike price.

When a buyer takes advantage of your offer, you will receive the premium. That's yours to take home – you will never have to give it back, whether the strike price is met and the buyer exercises their right or not. That, right there, is your reason for selling covered calls: the steady influx of cash from the premiums.

It's also a good way to sell your stock – a clever trader will use this type of strategy to clear their portfolio of shares they no longer want to own. There are advantages to owning that stock in the interim, too. If it goes up in price, you may receive dividends and you'll receive capital gains (the difference between the price now and the increased price at time of sale) when the deadline arrives.

One final advantage of this strategy is that it can usually be used in a tax-deferred account or an IRA; you won't be taxed on the revenue from your trade until you take that money at the time of your retirement. There are caveats to this rule, of course, so you may want to book an appointment with your accountant to make sure it works for you.

The downside? There is always the danger that your shares skyrocket before the deadline is up and you are forced to sell them to your buyer anyway, which means you're losing out on a potential big win. That's the gamble, and the truth is that even this risk will even out in the end because you'll be making money on the premiums for those trades that didn't turn out to be a bad idea.

When the deadline arrives, you will EITHER have the premium in your pocket and no shares, or you will have both the premium and the shares because the buyer didn't choose to purchase them after all. Either way, you're always walking away with something.

So let's work through selling a covered call, step by step, and take a look at every aspect of the process:

1. First, choose a stock that's already in your portfolio and has been performing well recently. It also needs to be one that you are willing to no longer own if the buyer exercises their right to buy it.

2. In your account's online space, you will first bring up the underlying stock by entering its symbol. This will allow you to see its option chain; in other words, all the bids and calls currently on the table for those particular shares. Obviously, we're interested right now in the calls. You're going to be picking one of these offers to sell your shares.

3. First, take a look at the premiums on those calls. Take a look at the "bid price" column. These are

displayed per share, so it's the amount you will receive for every share that you trade on. You'll probably find that there is a huge range of premiums for the same stock – that's a function of the market. To be clear on your potential profits: for every option (one stock, or 100 shares), you will receive that premium for every share. If, for example, the premium is listed as $2.50, you'll make this amount for every share in the stock. If it's a single stock, that's $2.50 multiplied by 100, which is $250.

4. You want to focus on pulling up options a few months from now, so pick a date range about two or three months down the line. This is because the premium will increase the later the expiration date. You want to be reasonable in your expectations, because there are downsides to going too far out, so a few months is usually a golden spot.

5. Take a look at the other columns. Compare the "bid price" and "ask price" columns on that list of options. The bid price is the amount that a trader out there somewhere is prepared to pay to own the call option. The ask price is the amount that a trader somewhere has said they

are prepared to sell that call option for. You can accept that bid price and you'll sell your covered call instantly for that amount. Alternatively, you can instruct your broker to sell your option at a certain ask price or better. This won't be fulfilled immediately, but it will mean a better return for you in the long term if there's a buyer out there who is willing to accept your negotiation.

6. Take a look at the list for options that are currently "in the money". Most lists will have a mark of some kind to denote the ones that are. If an option is in the money, that means that exercising it instantly will yield a profit – though it does not factor in the cost of buying that option in the first place, i.e. the premium. As an example to illustrate this, if there is a contract with a strike price of $50 and the stock is worth $52 right now. If the buyer exercised their right to buy this stock immediately, they'd make a profit of $2 per share. However, if the premium per share is also $2, the buyer hasn't actually gained any net profit.

7. What you are looking for is a contract with a strike price that's slightly "out of the money".

You want to unload your shares at a slightly higher price than they are currently worth to make it a good purchase for your buyer and because you will make a profit on the actual sale as well as on the premium. If the shares never reach that price, you won't have to sell them, of course. If that happens, you can simply pocket the premium and list the shares again.

8. You can also consider a contract slightly "in the money" if the premium is high enough to offset the loss you would make on the sale. You should be calculating overall profits rather than relying on just the sale price or the premium alone. The bottom line is that you will need to calculate a strike price you're happy to sell that stock at, whether it's a loss or a gain, and a premium that makes the sale worthwhile.

9. Once you've chosen the contract that best suits your needs, you can simply enter into it and wait for the expiration date. At that time (though sometimes before), your broker will let you know whether the buyer exercised their rights or you still own the stocks. Keep in mind that, if your buyer does NOT exercise their rights, you have generated a certain amount of

money through the premium. When you repeat the exercise, you can factor this overall profit into your thinking to help guide you towards the right contract.

10. Select the "Action" that says "Sell to Open", as this is the one that applies for selling a covered call. Now enter the number of contracts you want to sell – and, remember, one contract equals 100 shares.

11. Now you must choose between a market order or a limit order. A market order allows the market makers to figure out the price to fill your order, while a limit order allows you to choose your own price. The latter is usually the better option. Once you've selected it, you can decide on your price.

12. Now enter the information how long you want the option to appear on the marketplace. I would recommend selecting "day" rather than "until cancelled", because you want to be able to re-list with new information if it doesn't get bought.

13. Next, set your bid price, which will

likely appear under the heading "Limit Price". Ignore the information about last sale when you are doing this as there is no way to tell when that last sale actually happened, so it may not reflect the current bid and ask prices you should be using to guide you.

14. That's it – hit the order button. Your first covered sell is now on the marketplace and awaiting a buyer.

Strategy for Selling Covered Calls

We've covered the process, but what about the strategy behind it? In the last chapter, we looked at the absolute basics of that strategy, but an experienced trader knows there's always going to be more to an option than meets the eye.

There's a whole list of considerations that you will eventually want to bear in mind as you expand your knowledge and develop your own, personal strategy. Every trader has a different attitude towards what works and what doesn't – there are plenty of ways to make selling a covered call work, but you'll probably find yourself preferring one or two strategies.

We'll take a look now at those considerations in more detail to guide you as you delve into the covered call more deeply:

- **The Market Environment:** You are no doubt aware that traders of stocks and shares are happy in a bull market and disgruntled in a bear market. You may also know that such traders hate a flat market most of all, because very little is happening and there aren't many big profits to be made. For you, as a seller of covered calls, the opposite is true. I highly recommend waiting for the market to temporarily flatten before embarking on a spate of covered call sales. This is because you're only really interested in small changes to your share prices – if they are sky-rocketing, you're losing more money on your contract. There also isn't as much danger of the bottom falling out of the market and your stock prices plummeting at the same time, which would be problematic.

- **Your Underlying Stock:** There is nothing more important to your success than choosing the right stocks to invest in in the first place. I cannot stress strongly enough that your success will be heightened if you pick stocks that move up very slowly. You don't want stocks that rise and fall very quickly, especially as a beginner, because they have a habit of making surprising moves that ruin your strategy. If they drop too far, you stand to lose a lot of money in the sale; if they rise too high, you lose the money you could have made if you'd sold them at that price. Traders who deal in risk often enjoy these stocks because they have higher premiums and a chance for huge profits, but that goes against the idea of selling covered calls: you're looking for a steady income that will underpin your riskier strategies elsewhere. By all means go for the riskier stock elsewhere in your strategy, but avoid it like the plague for this particular function.

- **The Premium:** Always remember that the premium is your guaranteed profit. Whatever else happens, you're going to walk away with that cash. When you factor in the cost to list the option and any commission you will lose to your broker, you'll be able to calculate the actual profit you'll make on that premium. Set yourself a minimum premium – a number that you consider to be enough to provide a profit you'll be happy with, on the assumption that it's the only profit you make. When you move ahead on setting the strike price, you'll likely adjust this base figure up or down based on what you think the underlying stock is going to do before the expiration date. Remember that the premium is only one component of the overall profit you will make – if you then set a strike price that means you lose the same amount of cash on selling the shares as you made through the premium, the trade wasn't worth doing in the first place.

- **The Expiration Date:** There's a reason that the premiums on covered calls get higher the further out the expiration date. It's because, much like the weather forecasts we all deride on a daily basis, it gets harder and harder to predict what's going to happen to a share price the further out you go. Also bear in mind that your money is going to be tied up until the expiration date, so the premium will increase as a nod to that sacrifice. Most investors believe that a time span of between a month and three months works best.

- **The Strike Price:** You might think that the strike price you set should be based on what you, as the seller, are comfortable with, but actually it's the opposite. You're looking for a strike price that your buyer will feel comfortable with, because otherwise they aren't going to buy. That, in turn, is going to be dictated by the expiration date you set, as well as the premium you're asking for and how stable or volatile the underlying stock is. Your best bet is to put yourself in the shoes of your buyer: would you purchase that contract? How much would you stand to gain? Set your strike price accordingly and then take a look at it from your own point of view. Would this be an acceptable profit for you? If so, you've hit the nail on the head.

With all these factors in mind, you are likely starting to see that there is no single "correct decision" when it comes to selling covered calls. It's going to take practice and concentration to figure out which ones work best for you.

It's also important to note that your strategy is probably going to change as you gain experience. The more options you sell, the more you will see new and more advanced ways to take advantage of the market. For now, I urge you to be conservative in your approach and accept that selling covered options is not going to win you your fortune – but it is going to help you increase the seed money you have available to do just that.

Outcomes of a Covered Sell

As we're using the idea of selling covered calls as a trade example to help you learn the basics of option trading overall, let's now take a close look at what is going to happen to your option once you've listed it.

- **The stock increases in value:** If the stock moves up and hits your strike price, this means that your buyer can now exercise their right and buy the shares. The more it rises, the more likely that the buyer will do exactly that. When your goal is to sell shares, this is what you want to happen – and you will pocket the premium as well as, of course, the difference between the shares as they were valued when you listed them and the value they are at on the expiration date (in other words, capital gains).

- **The stock value doesn't move:** If the shares don't change either up or down during the time the option is open, then they won't hit the strike price and you won't have to sell. You will pocket the premium and can factor it into your overall profits when you relist the stock. Many options traders actually count on this outcome – it's the one they are hoping for because it means they make a profit AND keep the shares. Feel free to follow the same logic, but make sure your entire plan doesn't hinge on it. You don't control the market, so you could find yourself met by a nasty surprise.

- **The stock drops in value:** If this happens, the outcome is very similar to the share price not moving at all. The difference is that you are losing money on the shares themselves all the time they are dropping. They might bounce back, but if they don't then the expiration date will arrive and you'll be holding shares that are now worth a lot less than they used to be, which constitutes a loss. If, while monitoring your option contracts, you see that a stock is starting to drop, you need to prepare to take emergency action. Do this by calculating your "breakeven" price: subtract the premium per share from the price of the share at the time you listed it. For example, if the share was worth $50 and the premium per share is $1.50, your breakeven price per share is $48.50. If it falls below this price, you have the option to buy back your option – not something you should rely on or do often, but good as an emergency action. To do this, go back to the order entry and select "Buy to Close". Enter either the current ask price or something lower, depending how risky you want to be. Once the trade goes through, you are back in control of your shares and can either keep or sell them, as you deem fit.

As an aside, you should know that buying back your options is actually a deliberate strategy used by some people who trade in covered calls. Doing so allows you to manage your own risk, ending trades that are likely to be disadvantageous for you so that you can list those stocks again at a later date.

For instance, let's say that your underlying stock is rising fast and you think you're going to lose out on a lot of potential profit as it continues to skyrocket. You could "roll up" your options by buying back your call at the current ask price or lower and then selling them again at a higher strike price.

Simply setting your stock to sell is enough to garner you a regular income to support your options trading, but there are other ways you can make the most of the market.

A typical strategy for a person who deals in selling covered calls is to purchase a stock and sell a covered call on that stock at the exact same time. It's called a "Buy-Write Strategy". Your brokerage firm will almost certainly allow you to do this and may even have it listed on their online order screen for you to select.

So what would you be looking for if you did this?

- A stock that you would be happy to have in your share portfolio, assuming that the buyer never realized their right to purchase it.
- A stock that is showing a premium rate on the marketplace you would be happy to accept.
- A stock that is predictable in that it is rising or dipping in worth slowly over time.

Keep your eyes firmly on the stock market over time and you will start to see those trends. You'll also develop an eye for spotting good trades – the ones where you can make a quick profit by selling a few contracts at a good premium price.

A second advanced strategy is to use options trading to get rid of stocks you don't want to own any more. Maybe, for instance, they've been flat for a long time and you aren't seeing enough movement to make them worthwhile. You can set up a sell that would return a good premium while allowing you to get rid of your stocks at close to their current price. Instead of simply unloading them, you'd walk away with the premium as a potentially tidy profit.

Thirdly, you can choose to use the "half and half" strategy: keep some of your stocks in a particular company and sell the rest. This works well if you aren't really sure whether you should sell them all, but make sure you are keeping records of what you have done.

Stepping Up a Tier: Buying Calls

We're ready to move on to the more sophisticated areas of options trading. You have tested the waters, made a little cash and you feel comfortable with the mechanics of the market. Now, you can start actually buying those calls and hopefully begin to make some real money as you do.

It's actually a simpler business to buy a call, in terms of physically going ahead and doing so. However, it's not quite so easy to make a profit. You're going to need to start small and dedicate yourself to the learning curve – and you need to understand that there is a risk involved in buying calls, so you don't want to stake your life savings on your efforts.

Let me take the opportunity to advise you to build up slowly over time rather than jump straight in with a hundred buys in a single day. Be circumspect about your actions: a small profit is better than no profit at all. Save your riskiest ideas for when you've set up a nest egg through your sells and you feel confident enough in your own judgment that you're as sure as it's possible to be that your risk will pay off.

As a reminder, what you are actually doing when you buy a call is purchasing the right to buy the underlying stock if it reaches the strike price before the deadline. You aren't obligated to buy it – if you choose not to, all you have lost is the premium you paid for that right.

The best case scenario for you, as the buyer, is that the stock suddenly starts rising at a high speed before the deadline arrives. You want it to go beyond the strike price so that, when it comes time to exercise your right, you are purchasing your stock at a lower rate than it is now worth. Obviously, you then have the option to instantly list that stock as a covered sell, which would allow you to realize that profit in real money.

That final piece of the puzzle is the important one. As an options trader, you are not in the business of building a stock portfolio. You don't really want to actually own those shares – you want to make a profit on them as they pass through your hands. You want to buy them for less than they are worth and then sell them on, perhaps even for more than they are worth if you are lucky. It's within that transaction your money will be made.

Buying calls has several advantages for you as an options trader:

- It doesn't cost much to get involved in the movement of a particular stock. You only need fork out the amount for the premium, after which you can sit back and wait to see what the stock does before making your purchase decision based on actual information, rather than on speculating what the market will do.

- It allows you to make use of the kinds of "tips" that market experts have a bad habit of swearing by. You read the news, you're watching the markets and you have information that makes you think a certain stock is about to rise fast and hard. You want to take advantage of that, obviously, and options trading allows you to do so much more safely than simply buying the stock. If you're wrong, you'll only lose your premium and you may even make a small profit. If you were wrong and purchased the stock and then it plummeted rather than rose, you stand to lose a whole lot more cash.

- Buying calls also allows you to consider shares that would ordinarily be out of your price range. You can play around with the big boys, like Walmart and Apple, without putting a second mortgage on the house. Buying options on those stocks is a whole lot less expensive than buying the stocks themselves, so if you see something on the horizon that makes you think the trade would be worthwhile (a new product or service, for instance, or a change in leadership), you can use call buying to get in on the game. This is called "leverage": the ability to control thousands of dollars in stock for just hundreds of dollars in premium.

One thing to note before you start buying calls is that you'll want to wait for the right time. You are no longer interested in a flat market – this time you want a bull market where stock prices are rising.

What you are looking for is an underlying stock you have faith in – you think it's going to rise in value over the next few months. Let's say you've found a stock that's currently at $50 and you believe it will continue to rise steadily. Predicting the rate of its growth, you think it will be at $80 in two months' time.

What you would be looking for in that scenario is a call contract that would allow you to purchase shares for LESS than the $80 you think they will rise to at that time. You must also juggle the math to make sure that you will not be paying a premium that would wipe out the profit you would make.

For example, you might find a contract option that will allow you to buy the stock at $80 per share on the deadline, with a premium of $1 per share. You think the stock is actually going to be worth $85 on that date, so you would actually be making a profit of $4 per share. Had the premium been $5, you'd have made no profit at all.

Bear in mind, of course, that you won't walk away from a call option with cash in hand. The profit we are talking about in this case is "intrinsic value". You can now take that stock and write a buy contract on it, selling it on and making that tangible profit in the process. This was what we were discussing in the previous chapter: as an options trader, you're not looking to keep hold of a stock portfolio. You're purchasing stocks through contracts to turn around and sell for a profit.

Strategies for Buying Calls

I have urged you several times throughout this book to start paying attention to the stock market and learn how to spot trends in the ups and downs of particular shares. As you become increasingly familiar with that part of your options trading career, you can also make use of a column in the trading screen itself to guide you.

That column is titled "Open Interest" and it represents the total amount of open contracts on that particular underlying stock that are still running at the time you are viewing the page.

What you are looking at is the supply and demand on that stock. The more open interest on a particular contract, the more people believe it's a sure bet. You can also watch for sudden changes – if a call contract has 500 in that column one day and 2000 the next, it means that a significant number of traders believe that stock is going to move in that direction.

Those people aren't necessarily right, so it's up to you to use your judgment. Nevertheless, it can be a very helpful addition to your tool kit when it comes to predicting the movement of the stock market and making the right calls in your own trading.

At the same time, there are a number of factors that should be guiding you as you choose the right contract. As a call seller, you were mostly interested in the premium. As a buyer, you want a bargain. These factors include:

- **In or Out the Money:** As a call seller, you were mostly interested in the premium. As a buyer, you want a bargain. You'll find that the premium is cheaper the more out of the money a contract is. In other words, the further the stock needs to climb before you can call in your option, the cheaper the premium will be. That doesn't mean it's the best bet – if you don't believe the stock will climb that high, it doesn't matter how cheap the premium is as you're not going to be able to purchase that stock. Calls that are slightly in the money are a good option for beginners and more likely to bring you a modest (or sometimes larger) profit.

- **Stock Movement:** There is absolutely no point buying a bargain call that has a strike price higher than you believe it will go. If it never reaches that price, you've lost the premium you paid. Sometimes it can be worth the risk if you are reasonably sure the stock has a chance of rising that high, but not very often

- **Time Value:** If you're purchasing a contract that would require the stock to rise above a price, it stands to reason that you need to give it enough time to do that. Premiums also are lower on short term contracts, but that's because there's probably not enough time for the stock to reach its target. Be circumspect when looking for contracts with cheap premiums – the lowest price is often not the best one. It's important to give your strategy breathing room, so lean towards the calls with long enough expiration dates to allow the stock to do what you hope it will.

- **Spread:** This is the difference between the bid and ask price and it has a direct impact on the price you will pay. A fair price usually falls somewhere between the two – the higher you pay, the more you are taking from your profit. Bear in mind that you will usually begin at a loss in your trade; if you pay $1.50 when the bid price was $1, that's a 50 cent loss on each share. As the whole idea is that the stock will rise in value, that's not necessarily a big issue – though it can be. As a general rule, if there is a wide spread, you should aim for somewhere in the middle. If it's narrow, you can probably pay the ask price without too much concern.

To make a profit buying covered calls, you have to be right on all these fronts. You need to choose the right time, the right direction and the right contract price if you're going to be successful. If you get one of these things wrong, you will likely lose that profit. Be aware that buying calls is where the risk comes in for options traders – which is why I highly recommend balancing your activity and relying on covered sells for your steady income, while keeping your buying activity relatively modest.

Understanding Time Value

At this stage, let's take a deeper look at one of the factors influencing the price of the options you are considering. Time value, as we've mentioned before, is what's left after you take the intrinsic value away from the premium.

In other words, if your option is priced at $2 and the intrinsic value is $1.50 (the stock price minus the strike price), then the time value will be 50 cents. The time value will slowly bleed away as you get closer to the expiration date.

Time value is your friend as a buyer, but as a seller it's quite the opposite. You are on a timer from the moment you buy that call because, the closer you are to the deadline, the less time there is left for the underlying stock to do what you want it to do and for your option to increase in its value.

The closer you get to the deadline, the faster the time value will trickle away. Be very aware of the time value, because it's far more important than a lot of beginners realize. This is why you will want to factor it in very carefully to any decision you make.

Too far out and your contract could start moving in the opposite direction again – plus the premium will be dauntingly high. Too close and you simply won't have enough time to watch your stocks head for the magic value you were hoping for, leaving you out of pocket on the premium.

Aim for two to three months, plenty of time for your strategy to see fruition without risking it heading in the opposite direction or paying a fortune in premiums.

Understanding Volatility

There's one final factor that affects the prices of contracts on a fundamental basis, though it's not really something we've touched on so far. The volatility of a contract is, however, an incredibly important concept to grasp for an options trader.

Volatility refers to the movement of the underlying stock. Some stocks will slowly wend their way up and down in a predictable manner – those are not very volatile. Others change on a day to day basis and change between up and down along the way.

To sum up the effect of volatility in a single sentence: the more volatile the stock, the more that an options trader is willing to pay for it. A volatile stock has a better chance of reaching the strike price and perhaps shooting far beyond it before the expiration date.

However, it's also the most dangerous of the factors that you need to bear in mind because it's arguably the most likely one to force you into a bad decision. A volatile stock, for example, can lead to a much higher premium and therefore a higher contract price; unless that stock shoots through the roof, you could actually end up losing money even when you should be making it.

One way to estimate the volatility of a stock is to take a look at what it has done in the recent past. This tells you how much it has moved up and down already, which some use as an indicator of how much it will move up and down in the future.

Unfortunately, it's not always true that the past repeats itself and you can't predict the future based on what's already happened. Instead, options traders use "implied volatility" to make their guesses: the value that the market believes the option is worth.

You can see this reflected in the activity on the options for that stock. Buyers will be keen to get their hands on options before a certain event takes place, such as the announcement of a new product or a release about the company's earnings. Because of this, options increase in price because there is implied volatility – the market thinks the stock is going to shoot up.

You'll see lower demand on a stock that's flat or moving gently, because there is no implied volatility and therefore no hurry to get in on the action. You'll also see correspondingly low prices for the option.

Volatility is obviously a good thing – as a buyer, you want the stock to be volatile, because you need it to climb to the strike price and beyond. However, there is also such a thing as too much volatility. It's at that point the contracts become popular, the prices rise and you stand to pay more for a contract than you will ultimately profit.

Your brokers will likely be able to provide you with a program that will help you determine implied volatility, asking you to enter certain factors and then calculating it for you. However, it's only through experience that you'll learn how to spot a stock that's just volatile enough to justify its higher price – again, practice is key.

It's also worth noting that a lot of the risk in options trading comes from volatility, largely because it's impossible to be accurate in your estimates. What happens if an earthquake destroys that company's headquarters? Stocks are going to plummet, and you had absolutely no way to see it coming.

That's why options traders are forced to accept that their fancy formulas are not going to be perfect predictors. They will help, but you should still be conservative in your trading and avoid the temptation to sink everything into a trade you believe could make your fortune thanks to its volatility.

Keeping an Eye on Your Calls

Once you've purchased a call contract, your job is not over. In fact, it has only just begun. From now until the expiration date, you need to keep an eye on what your stock is doing to see whether it goes up, down or nowhere at all.

- **Down:** If the stock unexpectedly begins to move down, it's moving further and further away from the strike price. If that trend continues, it's going to mean that you can't exercise your right to buy at the expiration date and you've lost out. You could choose to try to sell your option to regain some of that potential loss if there's still time value enough to justify someone taking it off your hands. If you choose to keep hold of it, remember that you don't actually have to buy the stock – you are only going to lose the premium on that expiration date.

- **No Movement:** The stock is hovering around the strike price and is losing time value as it does. Again, you may want to think about selling on the call option to reap back some of that premium. However, if you think there's a chance that things will change before the expiration date and the stock will start moving up, that's not always a good idea. It's a tough call to make because you could end up losing out on a tidy profit if you don't give the stock breathing room to start moving. Again, remember you'll only lose the premium if it doesn't reach the strike price or you decide not to buy.

- **Up:** Here's where options traders have a habit of getting antsy. You're watching the stock rise and it's gone far beyond the strike price. Naturally, you want to call in the contract right away and hit the "sell to close" option so you can sell it on and bank that profit. If the stock has indeed reached the top of its curve and is about to start dropping again, that can indeed be the right call. However, you also have the option to "roll up" your call, closing out your position and moving it to one with a higher strike price or "roll over" to one with a later expiration. And then there's your third option: actually exercising the right to buy that you purchased in the first place.

Exercising Your Right to Buy the Stock

Bearing in mind that an option is all about the right to buy a stock, it might seem strange that most traders are not looking to do that. Instead, they are looking to immediately pass the stock on as a sell, making the profit by taking the premium along with the increased price on the stock from what they paid for it.

That's what you should be basing your strategy around: the idea of gaining stocks to instantly sell back onto the options market, making your profit in the process. In 99 out of 100 cases, that's what you will be aiming to do.

Nevertheless, there are still going to be times when you want to exercise your right in order to purchase the underlying stock itself. Usually, this is when you genuinely want to add a particular stock to your portfolio. It's up to you to decide when those times arrive.

First things first: be very aware that you will automatically exercise your right at the expiration date if the option is in the money unless you tell your broker not to take that action. That won't happen if it's out of the money, but it's still imperative that you keep a calendar of your trades so that you aren't surprised by the sudden arrival of stocks in your portfolio you'd completely forgotten about.

If and when you decide to exercise your right, you should almost always do it at the expiration date and not before, because you'll lose the time value if you exercise early. When you alert your broker to this decision, it's also important to know that you cannot then change your mind – the decision is permanent.

How to Buy and Sell Puts

Buying puts can be a winning strategy if done right. The stock market wouldn't be the stock market if it only moved in one direction; by buying puts as well as calls, you're making the most of the market by profiting no matter which direction it's heading. Puts, during a bear market, are your ally.

Buying a put means that you are going to make a profit through the stock declining in price. Just as you're looking for the stock to skyrocket in a call, you're looking for it to plunge in a put. The strategy is therefore very similar, it's just that you're looking in the opposite direction.

Most traders buy puts either because they're speculating on a stock and think they can make a profit in a short term as that stock plummets, or because they can function as insurance for your overall portfolio. If you actually own the stock in question, you can buy puts on it if you believe it's at risk of heading downwards.

For instance, let's say you own stocks in a company and you think the business environment is going to see the share price drop. You aren't sure, but you can make an educated guess. Simply leaving that stock sitting in your portfolio means potentially watching as its value bleeds away.

On the other hand, you could buy a put and give yourself the option to offload that stock if it does drop to a certain value. As the buyer, you are not obligated to sell your stock when the deadline arrives – you're just giving yourself the option to do so. Of course, as always, you'll lose the premium.

The biggest difference between buying calls and puts is that the stock market has a habit of falling much faster than it rises. A stock can drop through the floor in just a single day, whereas it can take weeks or months to climb to magical figures.

To buy puts for the sake of speculation, you'll need to master the art of spotting weaker stocks – the ones that are likely to fall. This is easiest during a bear market and when the overall economic outlook is poor.

Even the most successful companies have down times, after all, and if you own a put contract when that happens, you stand to make money.

When buying a put, you'll need to think in reverse. The lower the strike price, the cheaper the option will be (in other words, the opposite of buying a call). You should also factor in the speed of the market when looking at expiration dates. If you think the stock is going to drop hard and fast, you probably want a shorter deadline. If you think it will take a while for the full effects of the drop to realize, then you will want a longer one.

The most successful put strategies, at least at first, will probably be slightly in the money, because you can profit from a smaller change in the underlying value. Conversely, you'll make more money on a smaller premium with an out of the money put, but you have less chance of actually making that money.

Selling puts can be a gamble. The idea behind it is that, by selling your promise to buy stocks, you are earning a steady premium, but you're choosing contracts that you believe will never hit the strike price. That way, you walk away having been paid for the contract without having to actually own the underlying stock.

It's also a way to increase your stock portfolio and get paid for doing so. This can be useful if you think a stock's dropping price is temporary and you want to snap up a few of them before they start to rise again, when you can sell them on.

Be aware, of course, that when selling a put you are obligating yourself to buy that stock if it does reach the strike price, so it's a bad gamble if you lack the funds to do that when the deadline comes.

Strategies for New Options Traders

Now you know the basics of options trading, you're no doubt raring to get stuck in with your first trades. All that remains is to introduce you to some of the strategies you now have open to you.

First up, the Greeks. You're going to see these all over the place and they can really help you understand your chances with a particular trade, so it's important to understand what they are:

- **Delta:** This stands for the change in price of the option when compared to the change in price of the underlying stock. For call options, it will be between 0 and 1; for put options, it will be between 0 and -1. The closer to 1 or -1, the more likely that the price of that option will increase or decrease dollar for dollar as the stock price changes. If it's at 0.5 or -0.5, it will increase or decrease by 50 cents for every dollar of change on the stock. The further in the money the option is, the higher its delta will be. The higher the delta, the more likely your option is going to finish in the money.

- **Gamma:** This stands for the change in the delta of the option relative to the change in the price of the underlying stock. It therefore tells you what the rate of increase of the delta is. As a buyer, a high gamma is good assuming that your assumptions about what the underlying stock is going to do are correct. If you're wrong, it can be very bad indeed, because your mistake is going to work against you more quickly.

- **Theta:** This stands for the change in the price of an option relative to how much time is left until it expires. It is directly related to the time value and will decrease as that value does. You want a low theta risk with options more than 90 days before expiration if you are long on your position (because you don't want the time value to drop) and high theta if you are short with options less than 30 days to deadline.

- **Vega:** This stands for the change in price relative to the option's change in volatility. Premiums increase with volatility, so vega will too. Specifically, it will tell you how every 1 percent point change in the implied volatility affects the premium. If the volatility drops or disappears altogether, it's possible that your option could lose value, so vega is important to keep an eye on.

Now for some of those all-important strategies you've been waiting for:

- **Straddling a Stock:** If you are good at spotting market trends, this strategy is for you. Let's say that you know a company is about to have a big event or release an announcement, but you don't know exactly what that will do to its shares – just that it's bound to affect them. You could use a straddle strategy to purchase both a put and call option at the same strike price, setting the expiration shortly after the date of the event in question. Your breakeven point on this is going to need to factor in both trades – you need to be doubling your profit, in other words, to justify the spend on two contracts. Therefore, you'll need to include this thought in your choice of strike price and you'll need to watch out for volatility – you need higher implied volatility for this to work. You should also be aware that you won't be the only one who sees the change coming, so the contracts could be pricey.

- **The Strangle:** This can be a better way to tackle the situation we looked at just now. It's the same idea, except that the call and put are set to different prices, with the put strike price usually lower. When you do this, you will break even if the stock rises above a certain price OR drops below a certain price, "strangling" the possibilities from both ends.

- **Bull and Bear Spreads:** This strategy again tackles the question of, "What is going to happen to this stock?" by giving you a surefire way to see some cash, but with the possibility of trading away a serious profit. Again, it's all about flexibility. In this example, for a stock that's now trading at $50, you could buy a call with a strike price of $55 and sell a call with a strike price of $60. You'll likely pay more to buy your call than you gain from selling the second call: let's say it was 25 cents for the $55 contract and 60 cents for the $60, leaving you paying 35 cents in total to set your position. For this to work best, you're hoping that the stock will end up somewhere between $55 and $60 at the deadline, because the second contract will not be exercised and you will make a profit. If it rises above the $60, you'll still make a profit, but it will be capped at that exact profit if your buyer exercises their right to purchase the stocks. The downside is that your stock could skyrocket to $65 and you won't see a profit above the $60, but this can be acceptable if you're looking to cut down your costs and still make a profit. The example above is a bull spread – this can also work on a bear spread if you reverse the trades and sell your call lower than you buy your call.

- **Cash Secured Puts:** This can be used as a way of purchasing a particular stock at a discount. It only works if your account has enough money to actually buy the stock, because you will be obliged to do so if the option is exercised. If it isn't, you've made some money because it will expire without forcing you to buy, but you'll still bank the premium in the process. Either way, assuming you really do want that stock, you win. In this strategy, you'll set the strike price at the exact price you're looking to obtain that stock for. The only downside is that it could drop a lot lower, at which point you really won't feel like you got the best bargain. Out of the money puts have a better chance of expiring without being exercised so, if you're only looking to make profit on the premium or you're not desperate to own the underlying stock, that can often be your best bet. If you do end up owning the stock, your usual hope is that it will change direction and you can trade it on while making another profit.

- **Married Puts:** To do this, purchase stock and a put at the same time. This provides an insurance for you and a “floor” to protect you if that stock suddenly plunges. It will make sure you don't lose the clothes on your back if the stock does plummet, but also has the chance to make a little money if your timing is good and the stock price rises.

- **Rolling Your Positions:** We've covered this briefly, but just as a reminder: rolling your position can help you increase your profit over time. When you do this, you simply set up a new call as soon as the old one expires in the hope that the stock will continue to move in the same direction it has been until now. You will be looking to go up in strike price and out in time to deadline. It can be risky, because there is no guarantee that the stock will continue to do what it's doing, so it's only worth taking the risk if you think there is a reasonable chance it will. If you roll a put, on the other hand, you're going down in strike price and out in time to deadline because you want to avoid actually selling the stock. For both these alternatives, you'll be entering a buy to close order and initiating a new contract.

In Conclusion

From novice to initiated, you've now gained the basics of knowledge that will help you enter the exciting world of options trading. It certainly isn't everything there is to know, but you now have enough of a grounding to get started.

From here out, it's all about practice and being conservative as you improve your understanding and develop your own strategies. Only you will know what works best for you, how much risk you want to play with and how your personal ability to predict and determine the stock market can be best put into practice.

As you dip your feet into the water, you'll start to see profits coming in and you'll feel that buzz all options traders enjoy. The more you trade, the more you'll see all these fundamental mechanics at play and the more you'll start to connect the dots and figure out your own personality as a trader.

You're in for a treat – options trading is rewarding and exciting when done right. Remember to keep that calendar updated and to stay conservative at least in the beginning and you'll enjoy that learning curve every step of the way!