

Stock Street University

Options Trading Terms & Definition Study Guide



Additional Resources to help learn Investing and Fundamental Analysis:

www.investopedia.com

www.Yahoofinance.com

www.SeekingAlpha.com

www.finviz.com

www.bloomberg.com



Options Terms & Definitions

Options - are derivatives based on the value of underlying securities such as stocks. An options contract offers the buyer the opportunity to buy or sell—depending on the type of contract they hold

Rights of the owner of an options contract - A call option gives the owner the right to buy a specific number of shares of stock at a predetermined price. A put option gives its owner the right to sell a specific number of shares of stock at a predetermined price.

Call Options - Bullish position of an underlying security or stock, projecting that it will rise within the specified time frame

Puts Options- Bearish position of an underlying security or stock, projecting that it will fall within the specified time frame

Long- Refers to a bullish position in which you think the stock price will increase

Short- Refers to a bearish position in which you think the stock price will decline.

Obligations of an options seller - Sellers of call options have the obligation to sell a specific number of shares of the underlying stock at a predetermined price. Sellers of put options have the obligation to buy a specific amount of stock at a predetermined price.

Premium - The total value of the option you buy or sell. The premium is based on the market quote for the option and its multiplier.

Underlying security - The stock that you buy or sell and that determines the value of the option.

Strike price - The price you would pay per share if you decided to exercise your rights as call option buyer. For put option buyers it's the price you would receive for exercising and selling stock.

Expiration date - The date the option and your rights disappear.

Option deliverable - The number of shares and the name of the underlying security that you can call away or put to someone.

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Market quote - The most current price of an option that is being bid on by buyers and offered by sellers of options

Multiplier - The number used to determine the value of the option and how much money you pay when you call away or put options to someone. Most stock options deliver 100 shares per contract, so the multiplier of a per-share option market price and strike price quotes is 100

Open interest - The number of existing contracts for each call and put option strike that currently exist cumulatively between a buyer and a seller based on yesterday's market price. Popular options have higher open interests and are more liquid (easier to buy and sell).

Market quotes - May be delayed or in real time, depending on your data source. They offer the last traded price, the bid, and the ask for any listed option.

Be disciplined - When you enter a trade for a specific reason, such as an earnings announcement, pending economic report or a particular value for an indicator you use, you must exit the trade when conditions change or your original reason for purchasing the security no longer exists. Don't let a stock or option position you intended to hold for three weeks become part of your long-term portfolio. Being disciplined and following your rules is a must for all traders.

Keep track of the expiration date - Many option chains include the actual expiration date for each month along with the option quote data. The expiration date may also be included with your account position information. Knowing when the option expires is critical to managing the position.

Practice - Always remember that you can paper trade a security that is new to you. Although the emotions you experience trading this way don't exactly mimic having real money on the line, it helps you get familiar with new types of securities.

Brokers - A broker with a specialized license must approve your account for option trading. Not only does the firm need to protect you, it also needs to protect itself because unlimited risk option positions, such as short naked calls, could expose you both to high losses. Be patient with the approval process and only use trading strategies in which you fully understand the risks associated with a worst-case scenario. If you want to trade options, you need to complete an additional application for each brokerage account you want to include. There are different approval levels for option trading that reflect an increasing amount of risk for the strategies approved. Typically, you can receive approval for basic strategies when starting out. » Brokers must follow minimum rules and regulations, but can also operate under ones that are stricter. Communicate with your broker to understand key trading items such as margin and

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maintenance rules, minimum balances for option trading, cutoff times for submitting exercise instructions, and similar issues.

Market makers and specialists - Market makers and specialists are responsible for providing a market for your orders — meaning they're required to take the other side of your trade at the quoted level. You may not always agree with their quotes, but they are crucial to the exchanges by providing liquidity and assuming risk. They also keep the markets orderly so your orders are handled by price and time priority, even when chaos erupts during buying frenzies and selling panics.

Options Clearing Corporation - When I enter into a financial contract, I want to know as much as I can about the person on the other side of the agreement. So, if you are a little concerned about who's protecting your option rights, pay attention. The Options Clearing Corporation (OCC) is the clearing firm that guarantees option sellers will meet their obligations. This means when you buy an option contract on an exchange, you don't have to seek out the seller when it's time to exit the position. When you buy an option that trades on multiple exchanges, it has the same terms regardless of whether you bought it on the CBOE, ISE, or any of the other exchanges. All of these exchanges clear through the OCC (www.optionsclearing.com)

Liquidity - The ease with which you can enter and exit a trade without impacting its price, varies by option. Low liquidity securities are more expensive.

Time - The more time you are purchasing, the greater the cost of the option.

Volatility - Stocks with greater price movement in the past are expected to continue such movement in the future. The more volatile the underlying stock, the more expensive the option will be.

Intrinsic value - The value of the contract rights if the contract is exercised and the resulting position is then exited in the market. With a call option, this value is the profits realized if you were to exercise the call and then immediately sell the stock. When these two transactions result in a gain, that gain is the option's intrinsic value. When there's a loss, the intrinsic value of the option equals zero. Intrinsic value is calculated differently for calls and puts:

- Intrinsic Value (Call) = Market Price of Stock – Option Strike Price
- Intrinsic Value (Put) = Option Strike Price – Market Price of Stock

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Extrinsic value - The remaining value, which is attributable to time, is also known as time value because it adds potential value for the option based on future moves for the stock. The extrinsic value is what remains after you account for intrinsic value. To determine the time value for an option contract, subtract the intrinsic value from the option price:

- Extrinsic Value = Option Price – Intrinsic Value

Delta - Represents the expected change in the option value for each \$1 change in the price of the underlying stock.

Gamma - Represents the expected change in delta for each \$1 change in the price of the underlying stock.

Theta - Represents the option's expected daily decline due to time.

Vega - Represents the expected change in the option value due to changes in volatility expectations for the underlying stock.

Rho - Estimates changes in the option value due to changes in the risk-free interest rate (usually T-bills). Option price changes attributable to interest rates are much smaller, so this last measure receives less coverage.

Calls					Puts						
Delta	Gamma	Theta	Bid	Ask	Expiry	Strike	Bid	Ask	Delta	Gamma	Theta
0.92	0.02	-0.01	5.65	5.95	JUN	21	0.02	0.07	-0.03	0.02	0.00
0.92	0.03	-0.01	4.7	4.95	JUN	22	0.04	0.08	-0.04	0.03	-0.01
0.90	0.05	-0.01	3.75	4.00	JUN	23	0.07	0.11	-0.07	0.05	-0.01
0.88	0.08	-0.02	2.85	2.95	JUN	24	0.14	0.16	-0.12	0.08	-0.02
0.79	0.12	-0.03	1.99	2.07	JUN	25	0.26	0.29	-0.20	0.12	-0.03
0.65	0.17	-0.04	1.25	1.31	JUN	26	0.50	0.54	-0.35	0.17	-0.03
0.47	0.19	-0.03	0.69	0.72	JUN	27	0.91	0.95	-0.54	0.20	-0.03
0.28	0.17	-0.02	0.31	0.34	JUN	28	1.53	1.61	-0.73	0.17	-0.02
0.14	0.11	-0.01	0.12	0.15	JUN	29	2.34	2.46	-0.86	0.11	-0.01
0.07	0.07	0.00	0.05	0.08	JUN	30	3.15	3.40	-0.92	0.07	-0.01
0.04	0.04	0.00	0.01	0.05	JUN	31	4.10	4.40	-0.93	0.05	-0.01

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