INCOME ON DEMAND

The Simple Secret for Unlimited Stock Market Payouts

Your Options Trading Cheat Sheet

Options can be complicated — that's why we've created this quick go-to reference guide for you. It's designed to answer your biggest options questions at a glance.

What's an Option?

An option is a contract that gives its owner the right, but not the obligation, to buy or sell a specific **UNDERLYING** stock at a predetermined price on or before a predetermined date. The predetermined price is called a **STRIKE PRICE**, and the predetermined date is called the **EXPIRATION DATE**. Buying (e.g., going long) options limits your risk to your investment.

Buying a **CALL OPTION** gives you the right to buy 100 shares of its underlying stock.

Buying a **PUT OPTION** gives you the right to sell 100 shares of its underlying stock.

So, for example, buying a General Electric $25 call option gives you the right to buy 100 shares of General Electric for $25 — regardless of its current price — any time before the option expires. If it's trading for $30, you can buy 100 shares for just $25 apiece.

How Do Most Traders Use Options?

Options are leveraged instruments, which means they magnify small changes in a stock's price. For instance, a 10% gain in the stock's price could cause the option's premium to soar, say, 50% or more. Since options are much cheaper than their underlying stocks, they are a low-cost way to wring profits from changes in a stock's price.

There are two potential problems with this approach. First, since options expire, you have a limited time for the stock to move in the direction you want. The second is that losses are magnified just as easily as gains. Traders who buy option contracts often lose the entire value of their investment when the options expire. (But I'll tell why our method is different in a second.)

How Do Option Prices Work?

Like stock prices, option prices are determined by the buying and selling of investors — what people are willing to pay for the option weighed against the price other investors are willing to sell it. But since an option's value is also tied to the price of its underlying stock, options have an added fundamental backstop.

First, there is **INTRINSIC VALUE** — the difference between the underlying stock's current price and the option's strike price. If you're holding a General Electric $25 call option and the stock is trading for $30, the option has $5 of intrinsic value. A General Electric $25 put option, on the other hand, only has intrinsic value if GE's price is below $25. Either way, an option with intrinsic value is called **IN THE MONEY**.

The other factor in an option's price is **TIME VALUE**. It factors in the option's time until expiration and the likelihood that the option will have intrinsic value before the option expires. Time value is the reason an option's current price can be higher than its intrinsic value — investors are willing to pay more for the option because they believe its intrinsic value will continue to increase before the option expires. It's also the reason why options with a strike price equal to the stock's current price — **AT THE MONE**Y options — or options without intrinsic value — **OUT OF THE MONEY** options — have any premium at all.

To calculate an option's time value, simply subtract the intrinsic value from the option's premium. If the option does not have intrinsic value, it's premium is solely based on time value.

Option Premium = Intrinsic Value* + Time Value*
(* times 100 shares per option contract)

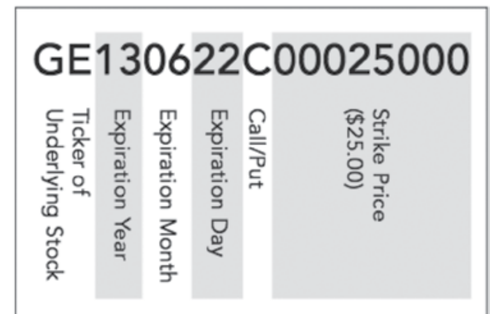
What's Different About Our Income Strategy?

Instead of buying call contracts or put contracts, we sell these contracts (this is known as writing option contracts). We receive instant income whenever we sell an option contract. That income is ours to keep regardless of what happens to the stock price.

Traders who buy put contracts have the sell stock to us. So we sell puts only on stocks that we are willing to buy. And traders who buy call contracts from us have the right to buy stock from us. So we sell call contracts only on stocks that we already own.

How Do I Read an Option Ticker?

Like stocks, options have unique ticker symbols. They help investors identify all of their important information in a few moments. Here's the anatomy of an options ticker:



That is the symbol for a General Electric $25 call option that expired on June 22, 2013. Keep in mind this is just the formal symbol — brokers and financial websites may have their own method for options symbols.

What Kind of Account Do I Need to Trade Options?

Typically, you'll need at least a margin account to trade options. The requirement can vary from broker to broker, however. A quick phone call to your broker can provide you with the details specific to your account — or visit our broker guide here.

Often brokers need to authorize a client for options trading. They divide their options trade authority into tiers or levels (based on the trader's account balance and experience level). These can vary from firm to firm, but typically a "Level 2" options account will allow you to buy call or put options, which is all you'll need to be able to do for this service.

Do I Have to Hold Options Until They Expire?

You can buy or sell an option whenever you want at its current premium, or market price — just like with any stock. When an option expires in the money, it will automatically be **EXERCISED** by your broker. In other words, if you're holding an in-the-money call, your broker will automatically take money out of your account to buy shares of the underlying stock at the option's strike price. Or if you are holding an in-the-money put, he will sell shares of the underlying stock from your account at the option's strike price.

Theoretically, you can then **OFFSET** your position (selling the stock you just bought or buying the stock you're obligated to sell) for the intrinsic value that your option had when it expired, less any commissions and exercise fees. But it is usually better to just sell the option and collect your profits.

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