THE REBEL'S GUIDE TO TRADING OPTIONS

TheoTRADE

TheoTrade

The Rebel's Guide to Trading Options

How to Protect & Profit in Any Market

Edition V5

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Contents.

TheoTrade Mission.

You want to learn about the markets, and that's what gets us up in the morning at TheoTrade. We do it for the love of the trade. Forget what you think stocks are going to do and start focusing on the right trades with the right trade logic. We are not some run-of-the-mill talking heads. We trade, and we do this to evoke change in the flawed reality of classical Wall Street finance. Step up to the plate, commit yourself to learning the markets from our experience and join us in our pursuit of financial revolution.

Don Kaufman

Co-Founder TheoTrade

Learn. Chat. Trade.

Introduction.

Congratulations on beginning your journey towards learning the options markets with TheoTrade! You are about to embark on a learning experience that will teach you risk-averse concepts for trading known and used by less than 1 percent of the people in the stock market. To begin, we shall introduce the TheoTrade Principles:

TheoTrade Principles

1. Trade Logic
2. Capital Allocation
3. Directional Bias

Trade Logic

At TheoTrade, we put your strategy and trade logic first. The vast majority of people involved in markets are infatuated with market direction attempting to predict the next move a stock is going to make. The reality, what you "think" a stock is going to do, does not always translate into profits. Many investors and traders alike place far too much emphasis on being right or picking the next move a stock might make. Our veteran traders dictate the right strategy coupled with established entry and exit criteria so you do not need to be "right" in picking a direction in a stock or the markets in order to be profitable.

Capital Allocation

How and where you allocate capital should be strongly considered as a viable portion of your trading methodology. At TheoTrade, Capital Allocation takes precedence over being "right" in the markets. Why you ask? Experience and watching order flow for decades has taught us invaluable lessons. Have you ever been stopped out of a trade or bailed out of a position only to see the markets turn around shortly thereafter? How and where you allocate capital can define not only losses, but it can be the defining factor in your overall success or failure in the markets. Our war cry is "duration over direction," and you need to be capable of sustaining trades long enough to be profitable.

Directional Bias

We are not anti-charts. Rather, we recognize that where you "think" a stock might go does not always mean the markets will agree with your sentiments. Being right directionally cannot define us as investors or traders for we may not be "right" often enough. At TheoTrade, we are realists of the marketplace, and we must place our capital at risk ONLY with the correct trade logic and a comfortable allocation.

Introduction to Options

This *TheoTrade Introduction to Options* is designed to help you become familiar with some basic Wall Street concepts and the fundamentals of call and put options. Understanding how options work is paramount to becoming a more effective trader. The fact that options are widely regarded as risky is ironic, as options were originally designed as risk management tools. Like any tools, one must learn how to use options. A power saw has many advantages over a handsaw for cutting wood. However, if you don't learn how to use a power saw, you can cut your fingers off. Similarly to a power saw, those without an understanding of options can put themselves at risk. For the most part, brokers are right in advising their clients to stay away from options. They know most will want to grab hold of the "saw" without learning how to use it. However, once a person is properly educated on the proper use of these risk management tools, options can be the quickest, easiest, and safest route to financial success in the financial markets.

The strategies taught in our online classes, chat rooms and workshops are used by trading professionals around the world, and you will be learning from some of the best traders in the world. Our instructors have a minimum of 15 years' experience working within the finance industry as traders, market makers or brokers. They will teach you how to hedge your stocks and mutual funds to enhance your returns and minimize losses on major downturns. You will learn how to place trades that can produce large monthly returns with very small moves in a stock. All this can be done with minimal capital and in only a few hours per week. At TheoTrade, our courses and coaching will provide you with step-by-step criteria for each strategy that will help you select and validate candidates, establish loss limits and profit goals and enter and exit each trade. You'll learn in a very short time what takes most traders many years to discover through trial and error. The greatest experience is other traders' knowledge and learning from their mistakes.

If you have little or no experience with options, some of the material in this study guide may be difficult to grasp at first. Don't let that worry you. It is our job through online classes, coaching and workshops to help you understand the concepts. If you merely become familiar with the material, it will help shorten your learning curve.

TheoTrade Mantra

Traders, speculators and investors who do not utilize risk-management techniques are at the mercy of the market. They may fall victim to market corrections and reversals. The best traders -- the ones that last -- utilize strategies designed to reduce risks and protect capital.

TheoTrade Characteristics of Traders

We at TheoTrade:

- Hate risk.
- Use any tool available to reduce risk.
- Use options to reduce risk and enhance returns.
- Never put all of our money on one trade.
- Never trade on tips.
- Sleep at night because our positions are covered.
- Do our homework before executing any trade.
- Use margin only when they are hedged.
- Buy on weakness and sell on strength.
- Are disciplined.
- Plan our strategies.
- Are always prepared to execute our plan.
- Stick with our plan; we don't panic.
- Know when to exit.
- Thrive on chaos. It's their manna.
- Identify our maximum loss before entering a trade.
- Factor in commissions and interest when evaluating returns.
- Are always ready to pounce on volatility and opportunity.

Understanding Options.

Note: Pay particular attention to this section on options. You will need to understand how to use options to trade in the market with reduced risk. It is not unusual to be confused by this material. The concepts are abstract and hard to grasp at first. The good news is that this is as difficult as it gets! And we will lead you into a fuller understanding during TheoTrade classes. The more familiar you are with this section at the outset, the more quickly you will master our courses at TheoTrade.

Ancient Roots of Option Contracts

Although many believe options are a recent innovation, they actually date back thousands of years as options originated as risk-management tools. Evidence that the use of option contracts was standard in ancient times appears during the Greek civilization.

All option contracts that trade on U.S. exchanges are issued, guaranteed and cleared by the Options Clearing Corporation (OCC). Founded in 1973, OCC is a standalone clearinghouse that issues and clears options and futures on common stocks, indices, currencies and interest rate composites listed on 12 participating exchanges, of which five are shareholders. Since July 18, 2012, and as part of the Dodd-Frank financial overhaul, OCC was designated a systemically important financial market utility. As such, the Federal Reserve has become a third regulator along with the Commodity Futures Trading Commission and the Securities and Exchange Commission, with some form of supervisory role.

Definition

A stock option is a contract that gives the holder the right to buy (a call) or sell (a put) on a particular stock, at a predetermined price (the strike price), on or before a particular date (the expiration date). For everyone who buys stock, there is someone who sells it. Likewise, for every option (call or put) buyer, there is an option seller.

Option Advantages

- Options give the holder the opportunity of maximum gain through leverage.
- Options can be used as risk-management and loss-prevention tools.
- Options can be sold to earn premiums and create cash flow.

Options Disadvantages

- The buyer/owner can lose his or her entire investment.
- The limited life of an option is a double-edged sword; a disadvantage if you're a buyer but a distinct advantage if you're a seller.

Option Buyer's Rights and Option Seller's Obligations

Calls

The buyer or holder of a call option pays a premium for the right, but not the obligation, to buy a particular stock at the strike price prior to expiration. He may also choose to sell the option purchased at any time prior to expiration or let it expire worthless. The call buyer wants the stock to go up.

Buying a call is similar to having an option to buy a house. If the house goes up in value, you can either exercise your right to buy the house or sell your option to someone else who would like the right to buy the house. If expiration approaches and the house has gone down in value below your agreed to right to purchase, you can let the option expire with no obligation to purchase the house. Your loss is limited to the premium you paid for the option.

You could buy a call for speculation hoping to make a profit by selling the call at a profit should the stock go up. Calls can also be used to hedge a short sale. The risk of selling short is that the stock could go up. However, owning a call would limit your price to buy the stock at the strike price prior to expiration, regardless of how high the stock would go.

The seller or writer of a call option collects the premium and is obligated, if called upon prior to expiration, to sell a particular stock at the strike price. This is likely to happen if the option is "in the money" (i.e., if the stock price is higher than the strike price) at expiration. He/she may buy the call back to prevent this from happening. If the stock stays below the call strike price, the call will expire worthless and the seller of the call will keep the entire premium received. The call seller wants the stock to go down.

The seller of the call is like someone who has sold you an option to buy a house. He or she is obligated to sell you the house anytime you exercise your right. If the house goes down in value and you don't exercise your right to buy the house, the call seller keeps the premium. However, if you exercise your option to buy the house, he is obligated to sell it to you at the agreed-to price.

One does not need to own the stock to sell a call option. This would be referred to as selling an uncovered call (also frequently referred to as "selling naked") and the risk can be unlimited. If the call is exercised, the call seller would have to buy the stock at the current price and resell it at the strike price to the call buyer. If a trader has sold a call on a house and expiration approaches and the house has gone down in value below your agreed-to right to purchase, you can let the option expire with no obligation to purchase the house. Your loss is limited to the premium you paid for the option.

You could buy a call for speculation hoping to make a profit by selling the call at a profit should the stock go up. Calls can also be used to hedge a short sale. The risk of selling short is that the stock could go up. However, owning a call would limit your price to buy the stock at the strike price prior to expiration, regardless of how high the stock would go.

Puts

The buyer or owner of a put option pays a premium for the right, but not the obligation, to sell a particular stock at the strike price prior to expiration. He may choose to sell the option prior to expiration or simply let it expire worthless. The put buyer wants the stock to go down.

Think of buying a put like buying insurance on a car. If the car is damaged, you have the right to file a claim. The insurance company is the seller of the put. If you exercise your right to sell, the seller of the put is obligated to buy the stock at the agreed-to price, even if the stock should go to zero. Just the same, the insurance company must give you the dollar value of your car even if it is demolished and worthless. Of course, the insurance company is hoping you never wreck your car so they can keep the premium. Likewise, the put seller is hoping the stock stays above the strike price of the put so you never exercise your right to sell the stock, and the put eventually expires worthless. In such cases, the put seller will keep the premium received.

You could buy puts for speculation hoping that a stock goes down and the puts go up in value. Or puts can be used to hedge a stock position, giving you the right to sell the stock at the strike price regardless of how low a stock should go.

The seller or writer of a put option **collects the premium and is obligated, if called upon prior to expiration, to buy a particular stock at the strike price**. This is likely to happen if the option is "in the money" (i.e., if the stock price is lower than the strike price) at expiration. He could buy back the put to prevent this. If the stock stays above the strike price, the put will expire worthless and the put seller will keep the entire premium received. The put seller wants the stock to go up.

Option Buyer (Holder)	**Option Seller (Writer)**
Buys option contracts	Sells option contracts
Call = right to buy	Call = obligated to sell
Put = right to sell	Put = obligated to buy
Pays the premium	Receives the premium

Option Particulars

Option Holders and Writers

The buyer of an option is referred to as the option holder. The seller of an option is referred to as the option writer.

Option Contract

Options trade in contracts and not shares. All option contracts are bought and sold in one hundred-share lots only. One call or one put is a contract to buy (a call) or sell (a put) one hundred shares of an underlying stock. One call is the right to buy 100 shares; two calls, 200 shares; three calls, 300 shares; etc. Note: a recent innovation in markets are Mini options. Mini options are option contracts where the underlying security is 10 shares of a stock. This is the main difference between mini options and standard options, which have 100 shares as the underlying security.

Option Premium

The premium is the price that the buyer/holder of an option pays and the seller/writer of an option receives for the rights conveyed by the option. It is the price set by the holder and writer or their brokers in a transaction in an options market where the option is traded. The premium does not constitute a down payment or a credit towards the purchase of a stock; it is simply a nonrefundable payment in full from the option holder (buyer) to the option writer (seller) for the rights conveyed by the option.

The premium is always quoted on a per-share basis. If the 120 strike price calls are trading at $5, this means $5 per share. Since one call covers one hundred shares, one call option would therefore cost $5 x 100 or $500.

Strike Price

The strike price is the price at which the option allows the holder to buy or the writer to sell the underlying stock. The strike price is not negotiable. To establish a more orderly and liquid market, strike prices are fixed in $.50, $1, $2.50, $5, or $10 increments. Index products, ETF's, and stocks with heavy volume (liquidity) often offer more strike price variety. Everything from $.50 increment strike prices are now available on hundreds of liquid products. Below is an example of strike price increments from December 2015 expiration in a prominent ETF product.

Expiration	Strike Price
December 2015	205
December 2015	205.5
December 2015	206
December 2015	206.5
December 2015	207
December 2015	207.5
December 2015	208
December 2015	208.5
December 2015	209

Exceptions to the rule: Options on stocks that split may trade in various increments to account for the split. (For example, one, 95 call trading for $4, will become two, $47.50 calls trading for $2 on a 2:1 stock split.)

Expiration

Equity (Stock) Options expire the Saturday following the third Friday of the month. The closing price of the stock on the third Friday of the month at 4:00 p.m. Eastern Standard Time is used to determine whether an option has value or not at expiration. Effectively therefore, equity options expire at 4:00 p.m., Eastern Standard Time, on the third Friday of the month. In addition, Weekly Options or "Weeklys" are now available on over 400+ underlyings and offer expirations every Friday! Weeklys should be regarded as options with shorter lifespans but similar attributes.

Open Interest

Open interest refers to the number of outstanding option contracts of a particular strike price and expiration date that have been bought or sold to open a position. If or when an option is bought to open a position, the open interest increases by one. If or when that option is sold to close the position, the open interest decreases by one. Likewise, if an option is sold to open a position, the open interest increases by one. When it is bought back, open interest decreases by one. Open interest is calculated at the end of each business day. Open interest is an indicator of the liquidity of a particular option.

Option Volume

Option volume is the number of option contracts that have been bought or sold within a particular time period. Volume is disseminated on a real time basis.

Understanding Option Premium

The premium is made up of intrinsic value and time value.

Premium = Intrinsic Value + Time Value

Intrinsic Value

Intrinsic Value = Premium - Time Value

The intrinsic value is the value of the option with no consideration for time. It is the value of the option at expiration. Therefore, it is the value of the option when there is no time. It is the REAL VALUE of an options contract. It reflects the amount, if any, by which an option is "in the money." The intrinsic value is usually the minimum value an option will have as an option will rarely trade below its intrinsic value.

To understand intrinsic value, think of having an accident insurance policy (a put) on your car. You paid a premium of $3,000 to insure your $50,000 auto for one year. If you were to sell your car within the year you could get a refund on part of the premium because you did not use all of the time. (The put would still have some time value in it.) However, pretend on the day your policy expires, you total your car and you are unconscious for a week. When you wake up you find out that your car was totaled. Even though the policy expired a week earlier and there is no time value left in it, you are still covered. This is because the accident happened before the policy expired. Your policy expired with an intrinsic value of $50,000. You can still file a claim and receive the full difference between the face value of the policy and the current value of the car. In this example, you had a $50,000 policy and the auto was totaled. Therefore, you will receive $50,000. This is the policy's (the put's) intrinsic value and it does not go away even though the policy has expired.

If at expiration an option is in-the-money, that is, has intrinsic value equal to or greater than one penny per share ($.01 in the money), then the Options Clearing Corporation (OCC) will automatically exercise that option on behalf of the option buyer. To determine the intrinsic value of an option, use the following formula:

Intrinsic Value Formula

What is the right to buy/sell _____
Call Put Company

for/at $ _____ worth, at expiration,
Strike Price

when its current market price is _____?
Stock Price

For example, to determine the intrinsic value of the $50 strike price call when XYZ stock is at $52, we would ask ourselves, "What is the right to buy XYZ for $50 worth when its current market price is $52?" It is worth $2. The right to buy the stock for $50 when the stock is at $52 saves us $2. With the 50 call, we could buy the stock for $50 and immediately sell it for $52 and make a profit of $2. Therefore, the 50 call has an intrinsic value of $2.

The right to buy the stock for $50 when its current market price is $49 would be worth nothing! Why pay for the right to buy at $50 when you can buy for $49?

Now, let's determine the intrinsic value of the 50 put when XYZ is trading for $52. Using the formula above we would say, "What is the right to sell XYZ at $50 worth when its current market price is $52?" It is worth nothing. The stock is trading for $52, so why pay for the right to get only $50? However, if the stock was at $49, the $50 put would be worth at least $1 intrinsically and even more, if there was time some time value left.

The intrinsic value of a call option equals the stock price less the strike price. However, it can never have a negative value. An option either has value or not.

Intrinsic value cannot go below 0.

	Stock Price	**$52**	**$53**
-	**Strike Price**	**-$50**	**-$55**
	Call's I.V.	**$2**	**$0**

The intrinsic value of a put option equals the strike price less the stock price.

The intrinsic value of the 55 put when the stock is trading at $57 is 0, not -2. **Intrinsic value cannot go below 0. The** 55 put with the stock at $57 would be $2 out-of-the-money. When the stock is at $53, the intrinsic value of the 55 put would be $2. The 55 put with the stock at $53 would be $2 in-the-money.

	Strike Price	**$50**	**$55**
-	**Stock Price**	**-$52**	**-$53**
	Put's I.V.	**$0**	**$2**

Relationship of Stock Price to Option Price.

The "Money" is the stock price.

At-the-Money (ATM) Call or Put: The stock's price is the same as the strike price. Intrinsic value is zero.

Out-of-the-Money (OTM) Call: The stock's price is below the strike price. Intrinsic value is zero.

Out-of-the-Money (OTM) Put: The stock's price is above the strike price. Intrinsic value is zero.

In-the-Money (ITM) Call: The stock's price is above the strike price. Intrinsic value is positive.

In-the-Money (ITM) Put: The stock's price is below the strike price. Intrinsic value is positive.

Intrinsic Value of an Option When the Stock is at $50

Strike Price	Intrinsic Value of a Call	Intrinsic Value of a Put
65	0 (15 OTM)	15 ITM
60	0 (10 OTM)	10 ITM
55	0 (5 OTM)	5 ITM
50	0 ATM	0 ATM
45	5 ITM	0 (5 OTM)
40	10 ITM	0 (10 OTM)
35	15 ITM	0 (15 OTM)

ITM = in the money, OTM = out of the money, ATM = at the money

Time Value (Extrinsic Value)

The time value of an option is that portion of the option premium over and above its intrinsic value. Generally speaking, the more time before expiration and/or the more volatile the underlying stock, the higher the time premium will be. Such factors increase the probability of a stock reaching a certain price point. Thus, time value will be higher when the option is farther from expiration and will decrease as the option gets closer to expiration. A May option will cost more than an April option because there is more time for the stock to reach or go beyond the strike price. Out-of-the-money options carry only time value, if they have any value at all. **Time value can be determined by subtracting the intrinsic value of an option from the premium.**

Time Value = Option Premium - Intrinsic Value

If there is some time left before expiration, an option may be worth more than its intrinsic value by an amount equal to its time value. An option that still has time value left prior to expiration will rarely be exercised, as it will bring the holder a greater value by simply selling it.

For example, let's say XYZ stock is trading at $52 with a week left until expiration. The 50 call is trading at $2.50 because it has $2 of intrinsic value and $.50 of time value. If one were to exercise the call and buy the stock for 50 and then immediately sell the stock at $52, he would realize $2.00. However, if he simply sold the call, he would realize $2.50. Even if the call holder wanted to own the stock, he would be better off selling the call and then buying the stock. By doing so he would be able to buy the stock for fifty cents less per share. **This is why an option that still has time value remaining is rarely exercised.**

At expiration, all the time value goes away and only intrinsic value remains. Time value usually diminishes as an option goes further ITM or OTM, or as it moves closer to expiration, to the point where it will eventually be reduced to nothing. If prior to expiration, an option has intrinsic value (ITM) and there is little or no time value remaining, there is a high likelihood it could be exercised. **Such an option is now trading at "parity." An option is trading at parity with its stock if it is in-the-money and has no time value.**

For example, if the 50 call was trading for $2 with the stock at $52, it would be trading at parity. If the option holder wanted to own the stock, he/she would exercise his option as there is no advantage in selling the call when there is no time value remaining. However, if he/she was merely speculating with the option and did not want to own the stock, he/she would still sell the option to avoid being automatically exercised and owning it. Remember, if an option expires with

intrinsic value equal to or greater than one penny per share ($.01, it will be automatically exercised by the Options Clearing Corporation (OCC). If a long call is exercised, the option holder will now have a long stock position. If he wants to avoid this, he will sell the put even if there is no time value remaining.

Factors that Influence Time Value

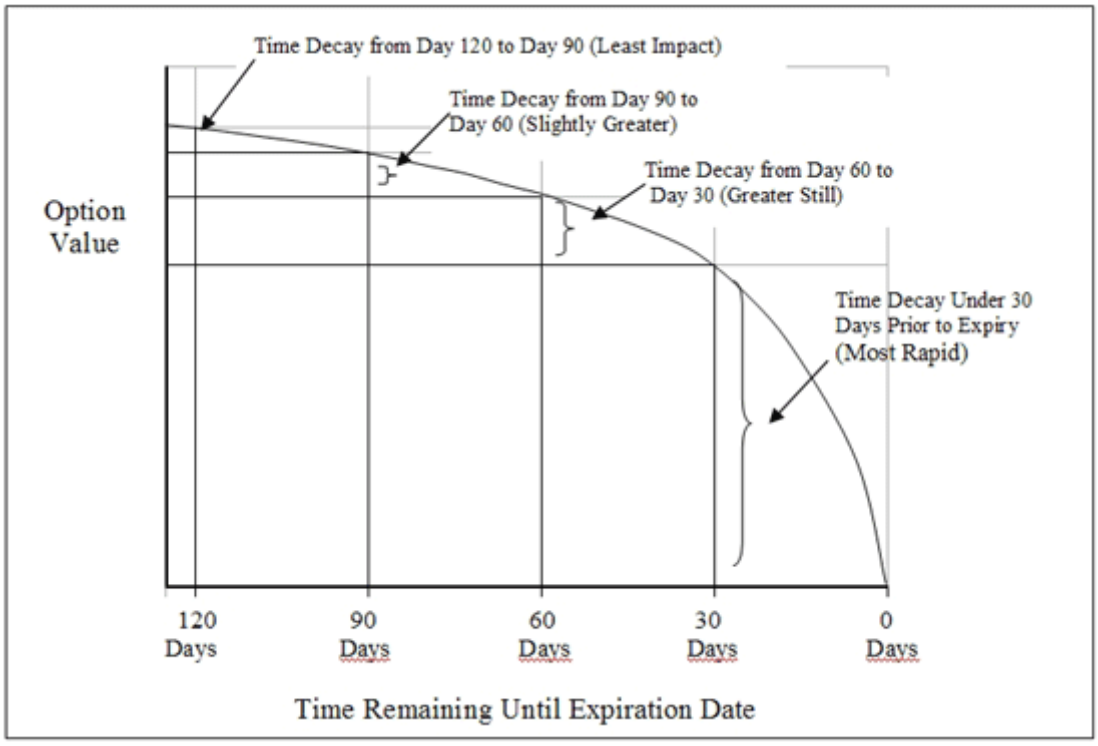
The primary factors that influence time value are the length of time remaining until expiration, the underlying stock's volatility and an option's supply and demand.

Time Decay

Just like the premium would be more to insure a car for two months than one month, so too the time value of a May option will be more than an April. The time value is a wasting asset. Other factors being equal, the time value decreases as the option approaches expiration.

This decrease accelerates in a nonlinear fashion the closer the option gets to expiration as the following time graph illustrates. This process is referred to as "time decay." At expiration, only those options that are in-the-money will have any intrinsic value remaining (remember, intrinsic value does not change with time) but no options will have any time value remaining. If the option is "out-of-the-money" and is not sold or exercised prior to its expiration, it will become worthless.

Time decay is advantageous to sellers of options and a disadvantage to buyers of options. For example, the seller of a call option may, due to time decay be able to buy back the option at a lower price than he originally sold it for, even if the stock does not drop in value. In such situations, the option seller can make a profit and eliminate the risk of being "assigned." If the option is well OTM, the seller may allow the option to expire worthless and keep the entire premium. When he sells an OTM option, an option seller is collecting money for time as there is no intrinsic value. Should the stock at expiration be below the strike price, if it is a call, or above the strike price, if it is a put, the seller will retain the entire premium.



Time decay is disadvantageous to an option buyer because he now owns a wasting or decaying asset. Even if the stock doesn't move, the option will decrease in value every day due to time decay. The option buyer is hoping the stock moves up quickly so he can retain as much time value as possible.

ATM Options have the most time value.

An option whose strike price is at-the-money (ATM) will have more time value than the other strike prices because there is more uncertainty as to its closing in-the-money or out-of-the-money at expiration. This uncertainty diminishes as the option moves more into or out-of-the-money. An option that is already in or out-of-the-money has a greater probability of remaining so than one that is at-the-money. The time value will be approximately the same for options equal distance ITM and OTM because they have relatively the same amount of uncertainty.

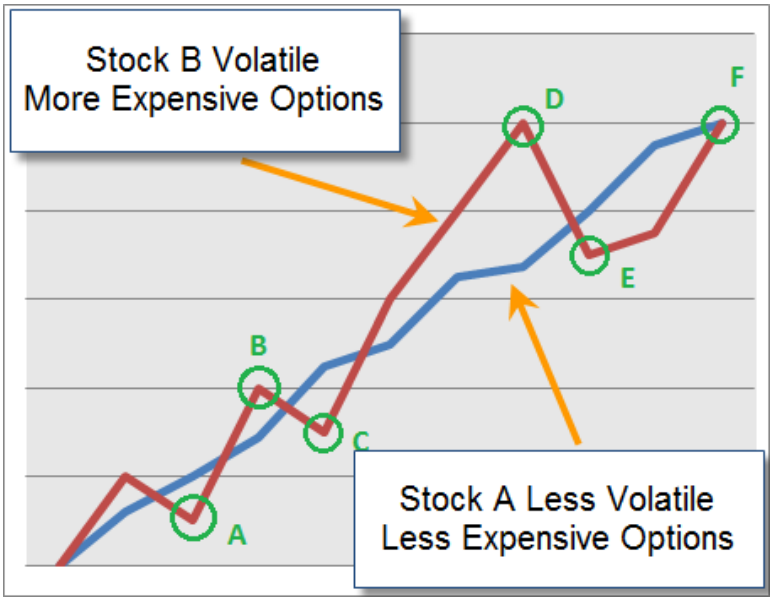
In the following table, notice for example that the 120 call that is five dollars OTM, has the same time value ($3) as the 110 calls, which is five dollars ITM. However, the 110 call has a total premium value of 8 because it also has five dollars of intrinsic value. As the following table illustrates, the time value for options equal distance in or out-of-the-money on the same stock will be approximately the same.

Call Premium 30 days Prior to Expiration with Stock at $115

Strike Price	premium	intrinsic value	time value
95	20.375	20	0.375
100	15.75	15	0.75
105	11.5	10	1.5
110	8	5	3
115	5	0	5
120	3	0	3
125	1.5	0	1.5
130	0.75	0	0.75

Volatility

Volatility is the measurement of the amount by which the price of the underlying security is expected to fluctuate over a given period of time. Generally speaking, stocks that fluctuate over a wide price range have more volatility. Typically, with all other factors being equal, an option's time value will be higher on a stock with greater volatility. Earthquake insurance will cost more in San Francisco than in Chicago because San Francisco can "move" more. For example, take two stocks trading at 100. The 105 May calls on both stocks are $5 out-of-the-money and therefore have no intrinsic value, just time value. The premium for the 105 May calls is at $1 for Stock A and $2 for Stock B. Even though both options have the same time remaining, Stock B's calls are trading $1 higher than Stock A's. This is because Stock B is more volatile. The market is saying that Stock B has a greater chance of moving to 105 than Stock A. Therefore, Stock B demands a higher premium.



Historical Volatility

Historical volatility is a statistical measurement of a stock's price movements based on history. Typically, it is calculated by taking the standard deviation of the stock's daily closing price over the past 21 trading days.

Implied Volatility

Implied volatility is the volatility derived from looking at the current market price of an option. Option prices don't imply a direction of movement for the stock. They only imply a probable distribution or volatility. Increased volatility increases the expected value of an option but not the expected value of a stock.

Although there are more technical methods of measuring volatility, it is a general rule that if the stock is flat, volatility should be low. If the stock is fluctuating greatly, volatility should be high. The higher the volatility, the higher the risk, and thus option sellers will demand more option premium.

The market ultimately determines an options price. The "market" includes market makers, liquidity providers, hedge funds, institutional investors, the public and even YOU. Remember, the intrinsic or real value of an option will always be constant. The intrinsic value of the 50 call with the stock at $51 will always be $1.00. However, the options will most likely be trading for more

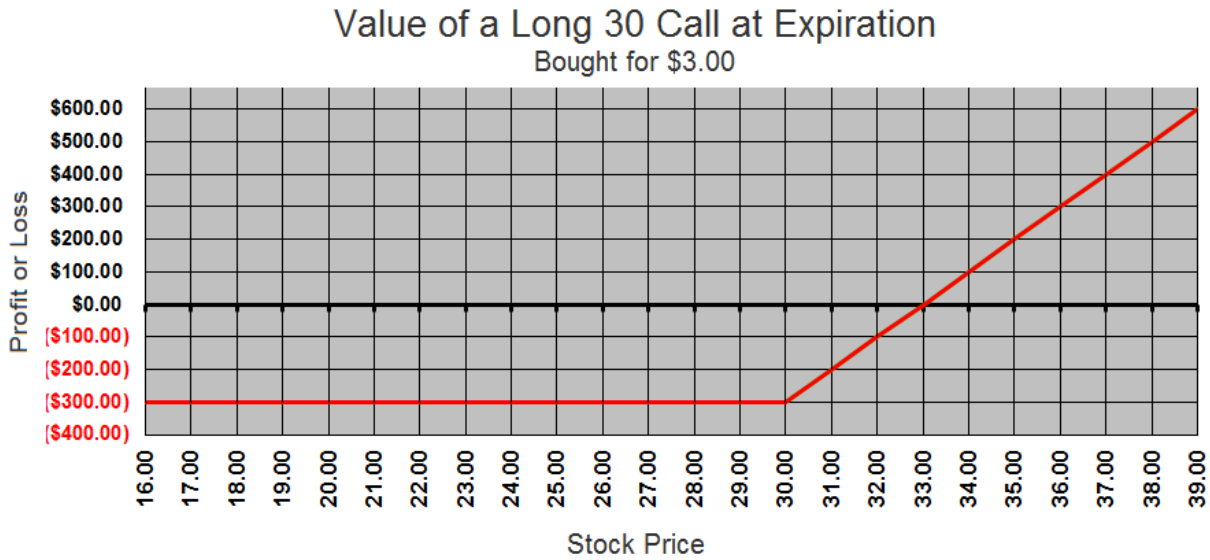
than $1 due to its time value. The time value is determined primarily by the distance the option's strike price is to the stock price, the stock's volatility, the current demand for the option and the volatility of the stock. The more a stock can move in price, the more money option sellers will want to receive and the more option buyers will have to pay for an option. The marketplace which factors in all these variables determines at what price we can buy or sell an option for in the same fashion it establishes stock prices.

Option Positions

Buying Naked Calls

One who buys a call to open a position (goes long) wants the underlying stock to go up. This will typically increase the option's premium. If the stock price goes above the strike price, the call buyer can either exercise the option to buy the stock or simply sell the option. His risk is limited to what he paid for the option, plus commission.

The following graph illustrates the value at expiration of a 30 call bought for $3. The graph illustrates a worst-case scenario as the option will usually be worth more prior to expiration when there is some time value remaining. The stock must go to $33 at expiration to break-even, and the call position begins making money above $33. The potential profit is unlimited (minus the premium paid); a loss is limited to $3 a share.

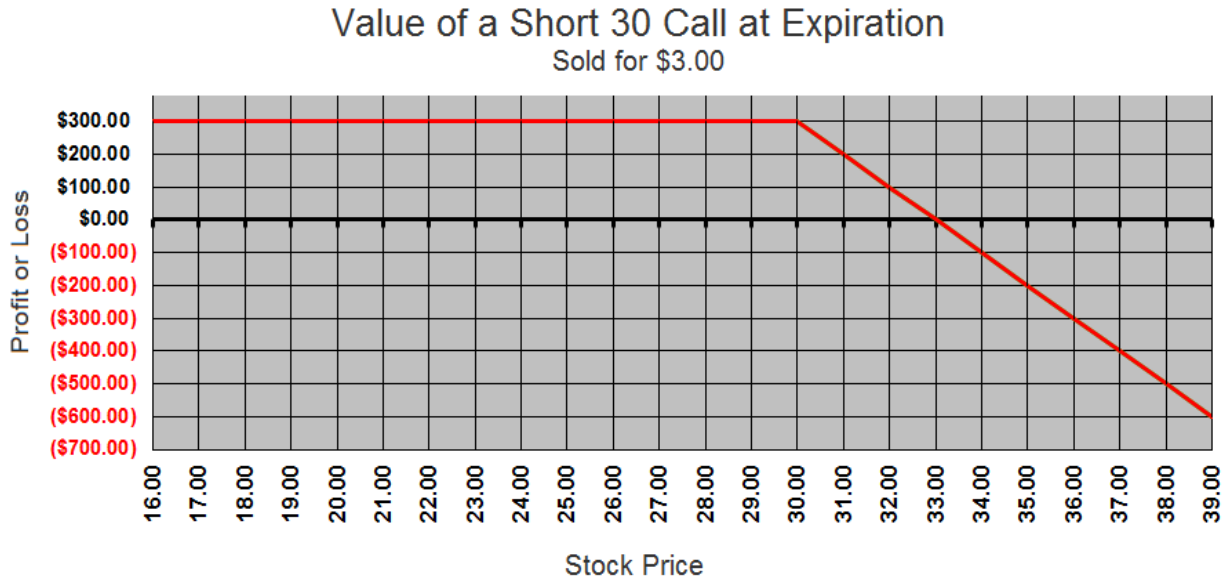


Selling Naked Calls

When one sells a call option (short) to open a position without owning the underlying stock or another call (long) on the same security, it is called a naked or uncovered short call position. It is called "uncovered" because the seller has no protection if the underlying security rises in price. When you sell (go short) a call, you are giving someone the right to buy the underlying stock at the strike price in return for the premium.

One who sells a call (to open a position) wants the underlying stock to go down. The seller collects the premium and realizes maximum profit at the time of sale. Typically, if the stock price stays the same or goes down, the value of the call will be reduced. The call seller can then close out his position by buying back the call at a reduced price. The profit is then the difference between what was originally received for selling the call less the price paid to buy it back. Alternatively, if the stock price is below the strike price at expiration, the seller can let the option expire worthless and keep the entire premium. However, should the stock price rise above the strike price, the seller runs the risk of being exercised and having to deliver the stock at the strike price.

The following graph illustrates the value at expiration of the 30 call sold for $3. If the stock is at $30 or below, the call seller will keep the entire premium received. Maximum profit is limited to $3 per share. However, if the stock goes above $30, the seller begins giving back the premium and breaks even at $33. A loss is incurred as the stock closes above $33, and it can become unlimited. Selling calls naked can cause extreme risk. TheoTrade advises clientele have extensive experience prior to selling calls naked.



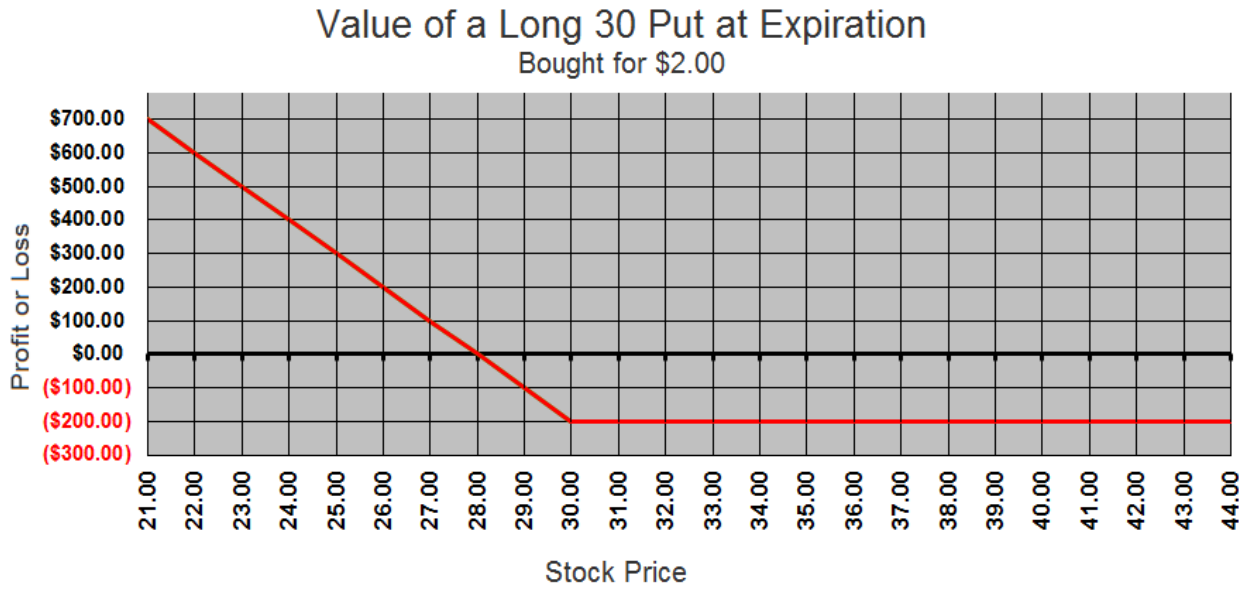
Selling Covered Calls

When one sells a call option to open a position and owns the underlying stock, one has sold a covered call. The risk of having a short call, as shown above, is covered by the underlying stock position. In the event the stock goes above the strike price of the call, one would most likely be called to deliver the stock at the strike price of the call sold. When one sells a covered call, he/she limits the upside on the stock while only slightly reducing the downside risk of owning the stock. In various TheoTrade classes, you will learn how to reduce the risk of covered call strategies.

Buying Naked Puts

One who buys a put wants the stock to go down, which usually increases the price of the put. The buyer's goal is to sell the put at a profit or exercise his right to sell the stock.

The following graph illustrates the value at expiration of the 30 put bought for $2. To break even, the stock must go to $28. Below $28, the put increases in value dollar-for-dollar with every dollar drop in the price of the stock; this can continue all the way to zero. However, a loss is realized at expiration if the stock stays above $28. The maximum loss of $2 per share is realized at $30 or above.



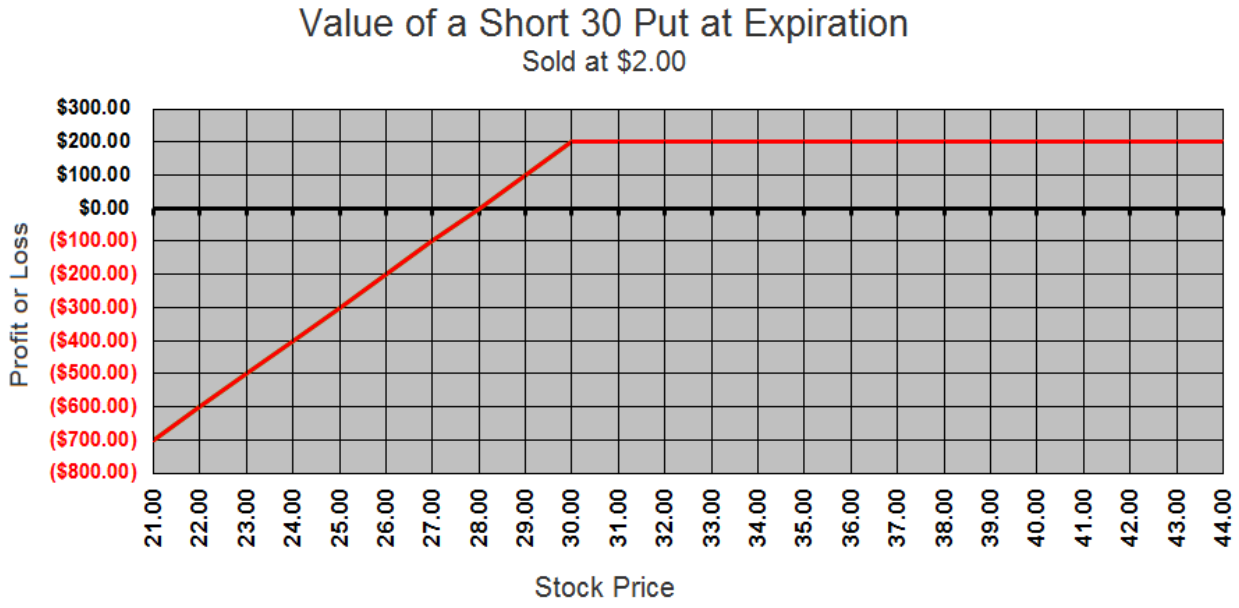
Selling Naked Puts

When one sells a put option to open a position without being short the underlying stock or long another put option on the same security, it is called a naked or uncovered short put. The put

seller wants the stock to go up so he can keep all or part of the premium. However, the potential risk is high. The potential loss is the difference between the value of the underlying stock (which could go to zero) and the strike price, less what was originally received for the sale of the put, plus commission.

One who sells a put (to open a position) wants the stock to go up. The seller realizes maximum profit at the time he sells the put. He/she will retain maximum profit if the stock closes at or above the strike price at expiration. Should the stock go below the put strike price, the seller could be obligated to buy the stock at the strike price, if exercised. Typically, he/she will buy back the put prior to expiration to avoid this.

The following graph shows the value, at expiration, of the 30 put sold at $2. A maximum profit of $2 per share is realized if the stock is at $30 or above at expiration. Break-even is at $28. The put seller could lose up to $28 should the stock go to zero at expiration.



Selling Covered Puts

When one sells a put option to open a position and is short the underlying stock, he/she has sold a covered put. Also, if one owns a put and sells another put on the same stock, he is no longer naked but hedged.

Vertical Spreads

A vertical spread is one strategy to use when you are confident a stock will move in a certain direction. It does not employ the use of stock, only options making this a relatively inexpensive method to benefit from stock movement. They are called "vertical" because they employ strike prices of the same month that are higher or lower than each other vertically. With vertical spreads, you are paying a premium to buy one option while at the same time collecting a premium by selling another option. With a vertical call spread, you buy a call at one strike price and sell another call at a different strike price. With a vertical put spread, you buy a put at one strike price and sell another put at a different strike price.

Vertical Spread Formula:

- Buy one strike option
- Sell another strike option
- Same series (calls with calls or puts with puts)
- Same expiration month
- Same underlying asset (stock, index, ETF)

A vertical spread is an alternative strategy to a costly or risky naked long or short option position. The profit potential remains relatively high while risk is dramatically reduced. Buying a naked call or put can be expensive. The vertical spread reduces cost by selling another option. Selling a naked call or put to open a position can be an extremely high-risk strategy. However, the sale of a vertical spread to open is a much less risky strategy. Rather than being naked short a call or put, one simultaneously buys a further out-of-the-money call or put to reduce the risk. These positions are called spreads because the risk is "spread out" instead of being concentrated on one naked long or short position.

A vertical spread's maximum value whether it is a call or a put spread can only go as high or low as the difference between the two strike prices used. Therefore:

Maximum value a $2.50 spread (i.e., 17.50-20) could go to is $2.50, or $250 per spread.

Maximum value a $5 spread (i.e., 25-30) could go to is $5, or $500 per spread.

Maximum value a $10 spread (i.e., 75-85) could go to is $10, or $1,000 per spread.

Maximum value a $15 spread (i.e., 75-90) could go to is $15, or $1,500 per spread.

Profit or loss when buying a vertical spread to open:

When buying a vertical spread to open a position, maximum profit is limited to the difference between the strike prices of the options bought and sold less the cost of the spread. Maximum loss is limited to what you pay for the spread, that is, the premium of the option bought less the premium of the one sold.

Maximum PROFIT when BUYING a Vertical Spread

Maximum profit = difference between strikes - cost of the spread

Maximum LOSS when BUYING a Vertical Spread

Maximum loss = net cost of the spread

Buying the Vertical Call Spread (Bull Call Spread)

This is a bullish play. By definition, you want the underlying stock to go up.

Formula: buy near-the-money calls (lower strike price) and sell an equal number of calls farther out of the money (higher strike price) in the same expiration month.

Maximum Risk: the cost of the spread.

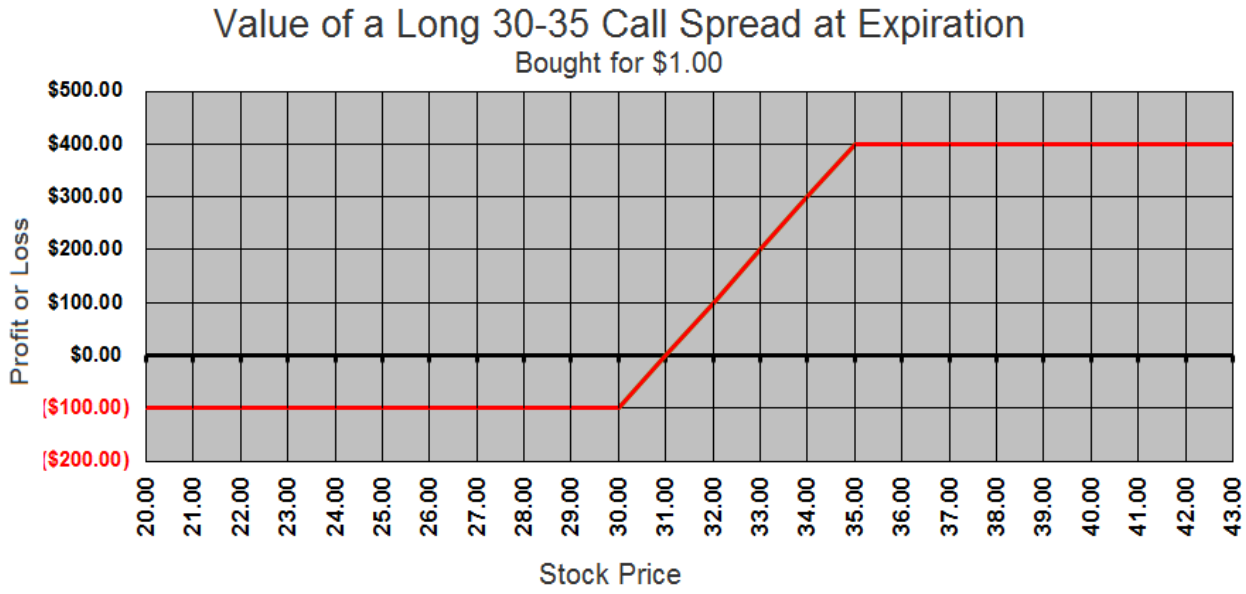
Maximum Profit: the difference between the two strikes, less the cost of the spread. If you pay $1 for the 30-35 call spread, your maximum profit is 5 - 1 = 4.

Break-Even at Expiration: the stock must go above the lower strike price by an amount equal to the cost of the spread. If you paid $1 for the 30-35 call spread, the stock must go to $31 at expiration to break-even. As the stock increases in value from that point, you make money.

Example:

XYZ stock is trading at $28. The Aug 30 call is $2 and the Aug 35 call is $1. If you buy one Aug 30 call and sell one Aug 35 call, the spread costs $100.

- $200	Paid for Aug 30 call
+$100	Received for Aug 35 call
- $100	Total cost (before commissions)



You are risking $100 for an opportunity to make up to $400, a 400% return on investment. The following chart shows the profit or loss on this trade at expiration. Of course, this position can be closed at any time prior to expiration. To close this position, you would sell the calls that you bought and buy back the calls that you sold.

Value of 30-35 Call Spread at Expiration

To open the position, buy the 30 call and sell the 35 call.

To close the position, sell the 30 call and buy back the 35 call.

Stock Price	Sell 30C	Buy 35C	Debit Less Credit Cost	Gain Loss	1x $	% Return
29	0	0	-1	-1	- 100	-100
30	0	0	-1	-1	- 100	-100
31	1	0	-1	0	0	0
32	2	0	-1	1	100	100
33	3	0	-1	2	200	200
34	4	0	-1	3	300	300
35	5	0	-1	4	400	400
40	10	- 5	-1	4	400	400

Buying the Vertical Put Spread (Bear Put Spread)

This is a bearish play. Execute it when you expect a stock to go down in price.

Formula: buy a put at or near the stock price (higher strike price) and sell an equal number of farther out-of-the-money (lower strike price) puts in the same expiration month.

Maximum Risk: the cost of the spread.

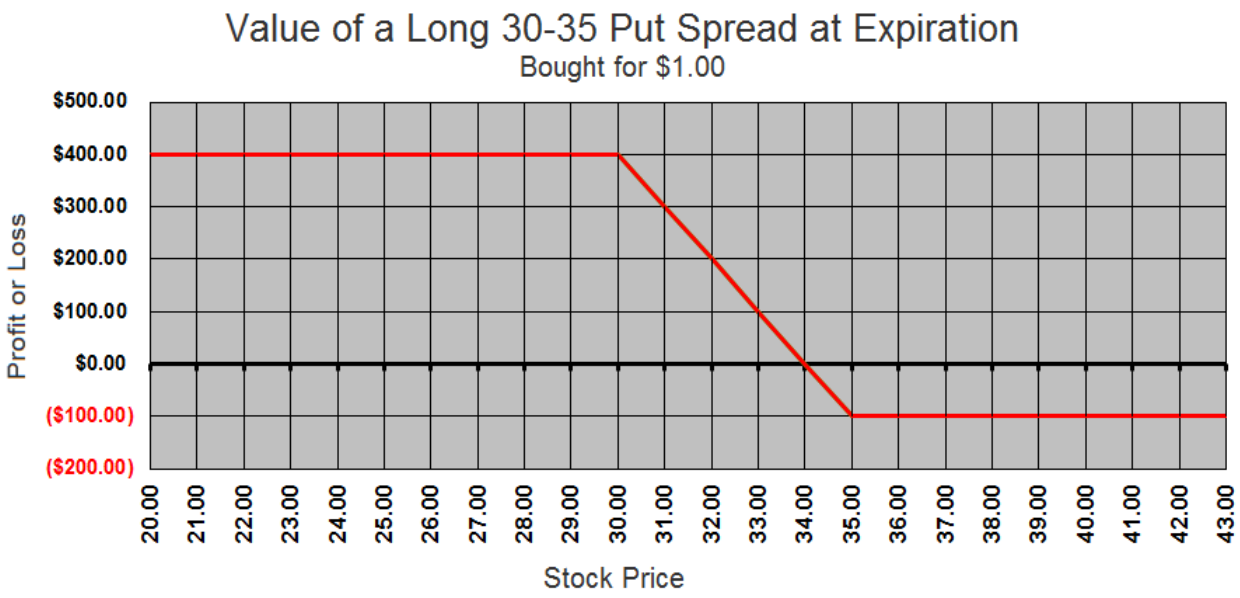
Maximum Profit: the difference between the two strike prices less the cost of the spread. For example, if you pay $1 for the 30-35 put spread, your maximum profit is 5 - 1 = 4.

Break-Even at Expiration: stock must go below the higher strike price by the cost of the spread. If you paid $1 for the 30-35 put spread, the stock must go to $34 at expiration to break-even.

Example:

XYZ is trading at $37. The April 35 put is trading at $4.50 and the April 30 put is trading at $3.50. If you buy the April 35 put and sell the April 30 put, you are paying $1 for the spread.

- $450	Buy one April 35 put for 4.50
+ 350	Sell one April 30 put at 3.50
-$ 100	Cost of the spread = -$1



The following chart shows the profit or loss you would realize if you were to close this position at expiration. To close this position, you would sell the puts that you bought and buy back the puts that you sold.

Value of 30-35 Put Spread at Expiration

To open the position, buy the 35 put and sell the 30 put.

To close, sell the 35 put and buy back the 30 put.

Stock Price	Sell 35P	Buy 30P	Debit Credit	Less Cost	Gain Loss	1x $	% Return
36	0	0	0	-1	-1	-100	-100
35	0	0	0	-1	-1	-100	-100
34	1	0	1	-1	0	0	0
33	2	0	2	-1	1	100	100
32	3	0	3	-1	2	200	200
31	4	0	4	-1	3	300	300
30	5	0	5	-1	4	400	400
25	10	-5	5	-1	4	400	400

Closing Option Positions

Buyers and sellers of option contracts may close out their positions in one of the following ways:

1. Let the option expire if it is out-of-the-money and worthless.

2. Offset the option by doing one of the following:

    a. Buy back the options that were sold when opening the position.

    b. Sell the options that were bought when opening the position.

3. Exercise the option if it is in-the-money.

4. Automatic exercise. If at expiration an option is in-the-money, that is, has intrinsic value equal to or greater than one penny per share, then the Options Clearing Corporation (OCC) will automatically exercise that option on behalf of the option buyer.

If a call is automatically exercised, on the next business day after expiration (usually Monday after expiration Friday), the call holder will now have a long stock position and will be required to pay for the stock at the strike price of the call purchased by the close of the business day. Alternatively, the holder could elect to sell the stock to pay for it. The holder gets to keep any profits or must make up any loss resulting from a stock movement between expiration and the time the stock is sold. If a put is automatically exercised, on the next business day after expiration (usually Monday after expiration Friday), the put holder will now have a short stock position and will be required to deposit the margin requirement for a short stock position by the close of the business day. Alternatively, the holder could buy the stock back to close the short position. The holder keeps any profits or will have to make up any deficit.

Most options are either offset or expire worthless at expiration and are not exercised. The vast majority of options exercised are done so on the expiration date. The risk of an option being exercised prior to expiration is minimized when there is time value still left in its premium. This is because one would receive more by simply selling the option to retain the time value. For example, say the 50 call is trading at $3.50 with the stock at $53. If you sell the call, you receive $3.50. If you exercise the call, you buy the stock at $50 and sell it for $53, thus netting only $3. In this example, if the call buyer wanted to own the stock, he would be better off selling the call and using the additional 50 cents per share to buy more stock or to reduce his basis in it. Thus, it is rare for an option to be exercised when it still has time value remaining. Conversely, when an

option is trading at parity with no time value, it runs a higher risk of being exercised prior to expiration.

Options may be offset (sold if they were bought and bought back if they were sold) at any time prior to expiration. Let's repeat this sentence. *Options may be offset or closed out at any time prior to expiration*. Typically, an option will be offset when a profit can be made or to reduce a loss. Note: the prudent investor always makes note of expiration dates so he/she can avoid leaving any profits at expiration.

Exercising Options

Buyers of option contracts have the right to exercise their option prior to expiration. Sellers of option contracts are obligated to deliver the stock (call seller) or to accept delivery of the stock (put seller) if called upon **(assigned)** prior to expiration.

Exercising Calls

When you own or hold a long (buy) call position, you have the right to exercise your option to buy the stock prior to expiration. If, for example, you own one IBM Jan 85 call option, you may choose to exercise your option to buy 100 shares of IBM stock at $85 per share plus commission. If you are a seller of the IBM Jan 85 call, the OCC (Options Clearing Corporation) may call upon you to deliver the stock. As the recipient of an exercise, you are assigned.

If you have sold the call without owning the underlying stock, you are what is referred to as **naked short** the call (i.e., uncovered). You are now short the stock (naked) and will have to buy it at the current price to deliver it. You will lose the difference between what you are forced to pay for the stock and the strike price of the call less the premium received when you sold the call. If you have sold the call and own (long) the stock (covered), your stock is now gone. This is commonly referred to as having the stock **called away**. It has been delivered to the call owner who exercised his call.

Exercising Puts

This same process works for puts. If you are long (bought) one IBM Oct 95 put, you may choose to exercise your right to sell IBM at 95. You tell your broker to exercise the put, and he in turn instructs the OCC. The OCC then makes a random selection from its list of sellers of the IBM Oct 95 puts and informs that person to take delivery of 100 shares of IBM at $95 per share. The following morning you have a sell transaction for 100 shares of IBM at $95 per share in your account (i.e., $9,500 less commissions). Because you exercised your put, your position of being long one IBM Oct 95 put is now eliminated. If you own the stock and choose to exercise your option to sell, you are forcing the seller of the put contract to accept delivery of the stock you own at the agreed upon strike price.

If you are the seller (short) of a 95 put, you may be called upon to accept delivery of IBM stock at $95 per share. As the recipient of an exercise, you are assigned. When you are assigned, you become the owner (long) of the stock. This is commonly referred to as having the stock put to you. You must have all the money in your account the next day to pay for the stock. You are now flat if you were short the stock (i.e., a covered put) when you had the stock put to you.

Transaction Costs

The transaction costs of options investing consist primarily of commissions (which are imposed in opening, closing, exercise and assignment transactions) but may also include margin and interest costs in particular transactions.

Enhancing Returns and Managing Risk with Options.

Hedging Your Long Term Portfolio with Put Options

Would you drive a car without insurance? Would you even think of owning a home without insurance? Most people buy insurance to protect their investments from loss. One never wants to collect on a policy, but buying insurance is prudent, regardless. Options like insurance policies can be used to limit risk.

Professionals believe that the only way one can safely be in the market for the long haul is by being hedged. Put options can be used as an insurance policy to protect stock or mutual fund holdings. As a good rule of thumb, when you buy stock or mutual funds, you should buy puts. Buying puts to hedge a stock position is referred to by the professionals as "married puts." You will learn at TheoTrade how to hedge a mutual fund by using index options. A mutual fund is a basket of stocks, as is an index. You should buy enough puts to cover your long stock position. (Remember, one put contract gives the holder the right to sell 100 shares of the underlying stock at the strike price before the expiration date.) By purchasing puts, you minimize the potential loss on a stock or mutual fund, should it decline in price.

For Example: You buy or own 1,000 shares of XYZ at $31 and ten 30 strike puts, one month from expiration at $1. By purchasing the put, you have increased your investment in XYZ to $32. (TheoTrade philosophy: If the stock is not worth $32 with protection, it is not worth paying $31 without. You are buying XYZ because you think the stock is going up. If you don't believe the stock or mutual fund will go up by at least the cost of the put in the time remaining until expiration, it's not worth owning!)

Buying puts for protection is obviously a bullish strategy. If you thought a stock was going down, why own it. However, you don't mind paying insurance for something you feel will continue to go up in value. Therefore, it is important to understand that buying married puts is not a cure for poor performing stocks. If you own a stock that is not going up, why do you continue to own it?

Sell it and buy one you are confident will go up along with a married put, in case you're wrong! With married puts, you should be confident that the stock will increase in price and also be willing to give up a little upside profit to offset your downside risk protection. By purchasing puts, you set the maximum loss on the stock at the put strike price less the cost of the put. In our example, you are guaranteed $29 for the stock (the put strike of 30, less the $1 premium paid for the put) even if it goes to zero prior to expiration.

The advantage of buying puts over stop-loss orders:

Stop-loss orders are poor protection against sudden downturns in a stock. Bad news, poor earnings, political problems and many other factors can cause a stock to gap down. In our example, should the stock gap down from 31 to 20, a 30 stop loss order would sell the stock near 20 not at 30 since the stock never hit a price between 30 and 20. If you have a 30 stop order once the stock hits 30 or below, the stock is immediately sold at the market price. If you had a "stop limit order" at 30, you wouldn't be sold until the stock goes back to 30. However, the stock could continue to drop. Stop and stop limit orders, therefore, provide very little protection. But, if you own the 30 strike put, you have the right to sell the stock at 30 any time prior to the option's expiration. A stop-loss order can also force an untimely sale. When a stock price reaches the stop, it is sold automatically thereby eliminating the chance of participating in upward movements should the stock turn around. Owning the puts allows the holder to ride out these downturns.

The options of the married-put holder: Should your stock decline in price, you have two options as a married put holder:

1. You can exercise your right to sell the stock at the put strike price.

2. You can sell the put option and keep the stock and then re-hedge the position with another put. You will then own the stock at the current price, but the sale of the put option will give you the difference between the put strike price and the current price of the stock, plus any remaining time value in the put. The following table will show you the value of the put option at expiration based on various stock prices. Notice that if you keep the stock, you will own the stock at the current price plus have cash equal to the intrinsic

value of the option. Adding the two together, your net loss in this example will never be more than $2, no matter how low the stock goes.

Profit or loss on XYZ stock bought for $31 with 30 strike put purchased for $1 for a total investment of $32.

Stock Price	+	30 Put Value	-	Cost	=	Net Gain/Loss
$40		$0		$32		$8
$35		$0		$32		$3
$32		$0		$32		$0
$28		$2		$32		-$2
$20		$10		$32		-$2
$15		$15		$32		-$2
$5		$25		$32		-$2
$0		$30		$32		-$2

Maximum Loss: The difference between the price you paid for the stock less the strike price of the put, plus the cost of the put and commission.

When you buy a put, you are buying the right to sell the stock at the strike price less the cost of the put. If your stock declines, you can sell the put and buy a lower strike price put for the next month. If the stock moves up, you can lock in profits by purchasing a higher strike put.

At TheoTrade, you will learn specific criteria on what strike price put and expiration month to purchase to properly hedge your stocks or mutual funds. Then you will learn specific criteria for re-hedging the position to lock in profits should the stock or mutual fund increase in price or minimize losses should the stock or mutual fund drop in price. TheoTrade emphasizes “Trade Criteria” and is worth the investment in our course materials.

Using Options to Benefit from Price Movements (Speculating)

Traders can use options to benefit from price movements in underlying stocks without the expense or risk of owning or shorting stock.

Suppose ABC is trading at $98, and you buy one 100 strike price call for a premium of $4. Since one call is an option to buy 100 shares, your total investment would be $400 (4 x 100). If the stock were to go to $105 prior to expiration, the 100 call would be worth at least $5 per share, or $500 per contract. Selling the call would result in a $100 profit, earning 25% return on a $400 investment. By comparison, the stock owner would have realized only $700 on a $9,800 investment. This is only a 7% return for the same movement in the stock. The stock owner could lose up to $98 per share for a total of $9,800 should the stock decline in value! The call holder's loss is limited to $4 per share, or $400 for one contract, regardless of how far the stock declines.

Risk-Reward Analysis of Options versus Stocks

Buy 100 shares ABC @ $98 = $9,800 or

Buy 1 ABC $100 call @ $4 = $400

The stock drops to $80:

The stock owner loses 18% or $1,800

The option owner loses 100% or $400

The stock goes to $105:

The stock owner gains 7% or $700

The option owner gains 25% or $100

Trading with Spreads

Although options can be purchased naked for speculation, TheoTrade believes that most trades should be hedged. Rather than being naked long or short an option, TheoTrade prefers to lower your risk by using a **combination of options in one position.** These "spreads," as they are called, can be used to establish lower-risk trades. A Vertical Spread, for example, is created by simultaneously buying one option and selling another option of the same stock at a different strike price.

Suppose, in our previous example with ABC stock at $98, three-and-a-half weeks from expiration you buy ten near-month 100 calls for $4 and simultaneously sell ten near-month 105 calls at $2.25. You now have the ABC 100-105 a Vertical Call Spread for a net cost of $1.75, or $1,750 for ten spreads.

Buy (Open) 100-105 Vertical Call Spread with Stock at $98:

Buy 100 call for	-4.00	-	10(4 x 100)	= -4,000
Sell 105 call at	2.25		10(2.25 x 100)	= 2,250
Cost of Spread	**-1.75**	**-**	**10(1.75 x 100)**	**= -1,750**

Value of 100-105 Call Spread at Expiration with Stock at $105:

Sell 100 call for	5 -	10(5 x 100)	= 5,000
Buy 105 call at	- 0	10(0 x 100)	= - 0
Sale of Spread	**5**	**10(5 x 100)**	**= 5,000**
Less Spread cost	- 1.75 -	10(1.75 x 100)	= -1,750
Gross Profit	**3.25**	**10(3 x 100)**	**= 3,250**

You now own the right to buy the stock for $100 and have sold someone else the right to buy the stock for $105. If the stock is close to or above $105 at expiration, you could be required to sell the stock for $105. However, you could exercise your right to buy the stock for $100, thus receiving $5 per share, for a total of $5,000 on the ten spreads.

Alternatively, you might also receive close to $5,000 by simply selling the spread at or near expiration. When you subtract the $1,750 you paid for the spread, you are left with a $3,250 profit. That is a 185% return for a 7% move in the stock! In addition, you have limited your risk to only $1.75 per share, or $1,750 for ten spreads, plus commissions.

Stock and ATM Option Equivalents and Related Risks.

The following compares 4 bullish and 4 bearish positions and the associated risk with each position. You should note the risk of owning stock and selling stock or options short in comparison to the limited risk of spreads and buying options.

Bullish Positions				
Trade Type	Buy Stock @ 100	Sell 100 Put @ 3	Buy 100 Call @ 3	Buy 100-105 Call Spread for 1.50
Risk/share	$100	$97	$3	$1.50
Stock Break Even	100	97	103	101.50
Max Profit/share	Unlimited	$3	Unlimited	$3.50

TheoTrade will cover a number of stock and option combination strategies designed to limit risk and increase profit potential in bullish, bearish, volatile or neutral markets including:

- Straddles
- Strangles
- Vertical Bull Call Spreads
- Vertical Bear Call Spreads
- Vertical Bear Put Spreads
- Vertical Bull Put Spreads
- Iron Condors
- Calendar Bull Call Spreads
- Calendar Neutral Call Spreads

- Calendar Bear Put Spreads
- Calendar Neutral Put Spreads
- Hedging Stock with Married Puts
- Hedging a Mutual Fund or Portfolio
- Collars
- Writing Covered Calls
- Hedging a Short Sale
- Locking in Stock Prices
- Locking in Stock Profits
- Using Options to Buy Stock
- Using Options to Sell Stock

Stock Market Terminology.

The following are some of the most common terms used in trading that will be used throughout this manual and Theotrade course materials. Your familiarity with these terms will be helpful.

- **Bull/Bullish:** Moving up.
- **Bear/Bearish:** Moving down.
- **Bid:** The highest price a buyer is willing to pay for a stock or option.
- **Ask:** The lowest price a seller is willing to sell a stock or option.
- **Price Spread:** The difference between the bid and ask. For example, if the bid price is 2.50 and the ask price is 2.75, the price spread is .25.
- **Market Order:** An order to buy or sell at the current market price.
- **Limit Order:** An order to buy or sell at a specified price limit.
- **Day Order:** A buy or sell order that is good only for the day and if not filled, canceled. Typically, buy or sell orders are considered day orders unless otherwise specified.
- **GTC:** An order that is "Good Till Canceled."
- **Stop Order:** An order used to limit loss. When a stock reaches the specified "stop" price, the stock is sold at the market price.
- **Stop Limit Order:** An order also used to limit loss, except the stock will be sold at the limit price.
- **OCO Order:** One Order Cancels Other.
- **Opening Transaction:** The original order placed with a broker to buy or sell.
- **Closing Transaction:** An order that closes the transaction by selling something bought or buying back something sold.
- **Offset:** The action of selling something originally bought to open a transaction or buying back something originally sold to open a transaction.
- **Long:** Own or bought stocks or options.
- **Short:** Sold stocks or options.
- **Write:** To sell an option. The seller is called the "writer."
- **Selling Short:** Selling a stock without owning it.

- **Naked:** A position when the option seller or buyer doesn't own the underlying stock or another option on the same stock.
- **Covered:** A position when the option seller or buyer owns the underlying stock or another option on the same stock.
- **Call:** An option that gives someone the right to buy a stock.
- **Put:** An option that gives someone the right to sell a stock.

The following will describe the difference between going long and selling short:

LONG		SHORT
Buy	Opening Transaction	Sell
Sell (offset)	Closing Transaction	Buy (offset)

Long refers to a position where one buys a stock or an option as an opening transaction. He is now long that particular stock or option. He offsets or closes this long position by selling the stock or option. Think of being long as an auto dealer who buys a car with the intention of one day selling it at a profit. He is now long a car. He will eventually offset this long position by selling the car.

Short refers to a position where one sells a stock or an option that he does not own. The sell is the opening transaction. He is now short that particular stock or option. He offsets or closes this short position by buying the stock or option. An auto dealer who receives payment (or a deposit) for a car that he doesn't have in stock is now short a car. He has sold the car and hopes to buy one at a lower price than he has sold it for to fulfill the order. He will later offset his short position by buying the car and delivering it.

Technically speaking, when a stock is sold short, the broker has already delivered the stock to the buyer. The short seller now owes the stock to his broker. The money received for the stock remains in his margin account and cannot be withdrawn until the stock is bought to replace the stock the broker has loaned. The risk is that the stock goes up. If so, the short seller must bring in more money (a margin call) so that there is enough to buy the stock at its current price. As long as there is enough money in the account to buy the stock at its current price, one can remain short indefinitely.

"Naked long" refers to a position where one is long (buy to open) with no protection. For example, the risk in being naked long stock is that you could lose all of your investment. When you buy a protective put you are now "hedged." Without fire insurance on your home, you are

naked, no protection. However, if you buy a fire insurance policy, you are now protected against loss.

“Naked short” refers to having a short position (sell to open) without protection. If you are naked short stock your risk is unlimited, as the stock has no limit as to how high it can go. When you buy a protective call, you are now hedged. The call limits the price you would have to pay for the stock.

TheoTrade Continued Education

Our first recommendation would be to shut off all the noise. While Don Kaufman was at TD Ameritrade they would run studies on the hundreds of thousands of the most active accounts. They found out what works and what doesn't work. If you're subscribed to any other service, cancel immediately. Stop giving them money to entertain you and then turn around to use your money to fund their own trading accounts. I know it's brutally honest, but sadly, the so-called trading education community is nothing but salesmen. TheoTrade has an all-inclusive membership meaning you have access to all our educators, indicators and scanners. We don't have eight different subscriptions, and you'll never find us selling some fancy indicator. TheoTrade is all you need so save your money for trading. :-)

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* Analyze Tab - The Analyze tab, feared by those who do not know of its strengths and revered by those that do. Fear NOT the analyze tab for I shall take you into the depths from which there is no return. You will learn more about options and analytics than you bargained for!

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Every traders' dream is to pick the top and bottom of the stock market. With these indicators you finally can! Without these indicators, you might as well be gambling with your money. If you want to gamble, go to Las Vegas. If you want to learn how to pick tops and bottoms, watch this free online seminar. The indicator is available for free for thinkorswim® users. The indicator is posted on the page below. Don't worry, we included step-by-step directions on how to install the indicators on your thinkorswim® platform. It's easy!

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