An Experienced Option Trader Shares His Knowledge Like Never Before…

"The How, What, When & Why of Share Options in Australia"

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Introduction:

Welcome to my first ever EBook, specifically designed to take you on a gentle and fascinating journey into the incredible world of trading Share Options in Australia!

My intention is to provide you with plenty of tools, resources and knowledge to be able to understand Options in a sufficient enough way to achieve the following:

- A sound understanding of how Options work, including explaining the most common "jargon" in simple, plain English. You will be amazed at how easily you'll actually "get it"!
- **A firm grasp on how to structure an Option trade which can profit from literally any opinion that you may have of the market.**
- What to look for when choosing a Stockbroker for your Option trading, plus learn how to accurately and effectively communicate with them. Also discover exactly how brokerage fees work and the impact they can have on your trading.
- **Some priceless tips on Money Management, Analysis and planning Exits.**
- All sorts of gems of information to help you know what to look for & perhaps even more importantly what to avoid when it comes to trading Options.
- **I'll reveal a structured way to plan your own trades, including many safety checks to help minimise the risk.**
- An insight into learning more about who you are, so that your trading can be performed in the best way to suit your unique personality and risk profile.
- **Ongoing support, via free access to my Forum web-site, so that you can ask any questions that you might have. You'll also be given VIP treatment and priority access to my *"Virtual Shares & Options Trading Game"*.**

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Let's begin…!

Firstly, thank you so much for expressing an interest in my EBook. ☺

This is the first EBook that I have written (although hopefully not the last!) and I have entitled it "*The How, What, When & Why of Share Options in Australia*".

I have organised this EBook into 5 sections, specifically as follows:

Part 1 – "**What are Options?**"

A typical book about Options will use a definition that goes something like this:

> ***"A call (or put) option contract is an agreement between two parties that gives the taker the right, but not the obligation, to buy (or sell) a specific quantity of the underlying shares at a preagreed price, on or before a preagreed future date."***

In case that confuses you a little the first time you read it, please don't panic – this is perfectly normal for most people.

For those of you who already understand exactly what I just said, you should take a moment to congratulate yourself as you have already come quite a long way...

It is my intention that by the end of this EBook, not only will you understand clearly what the above statement means, but you will also have a good working knowledge of Options and how they can be used to make a profit from literally any view of the market that you might have. You're in for a real treat! ☺

Firstly, I would like to start by rewriting that rather technical-sounding statement into my own words. Just before I do that, it's important to realise that there are two basic types of Options. They are:

"**Call Options**" & "**Put Options**"

Here is my definition of what they actually are, using plain English:

> **Call Option:** A Call Option gives you the ability to ***buy*** a certain number of someone else's shares at a price you both agree upon upfront.
>
> **Put Option:** A Put Option gives you the ability to ***sell*** a certain number of shares to someone else at a price that you both agree upon upfront.

Hopefully that is a lot easier to make sense of! There is, however, a little bit more you should know...

For every Option that is traded, two people are involved (although sometimes one of the "people" involved might be a company or institution of some type, rather than an actual person like you or I). One person is the **buyer** of the Option and the other is the **seller**. It is always the **buyer** who has the control over what actually

happens during the life of the Option. Speaking of which, Options only last for a limited period of time, although this is clearly decided upon upfront before anyone actually buys or sells the Option. The buyer of the Option pays an amount of money, known as the **Premium**, to the seller of the Option. This works exactly the same way for both Call Options and Put Options.

There is still a little bit more jargon to learn, but very soon I'll be able to bring it all together for you with some simple examples...

The buyer of an Option is also known as the "**Taker**" of that Option. There may be occasions where you decide that it is more appropriate to be the *seller* of an Option instead of the buyer. In this instance, you will *receive* the Premium instead of paying it. This does, however, mean that you are taking on an obligation (just like any other transaction in real-life, i.e, if someone pays you money then they usually expect something for it!). Here is how it works if you are the **seller** of an Option (please note also that the seller of an Option is more commonly referred to as the "**Writer**" of that Option):

> **Call Option:** A Writer of a Call Option agrees to ***sell*** a specific quantity of shares to the Option Taker (at a price agreed upon in advance). This may occur (*)*at any time* that it suits the Taker of the Option. This agreement remains in place until a particular future date which is also decided upon in advance.
>
> **Put Option:** A Writer of a Put Option agrees to ***buy*** a specific quantity of shares from the Option Taker (at a price agreed upon in advance). This may occur (*)*at any time* that it suits the Taker of the Option. Once again, this agreement remains in place until a particular future date which is also decided upon in advance.

The preagreed price that the selling or buying of shares takes place at is known as the "**Strike Price**" or "**Exercise Price**".

It is also interesting to note that you don't actually need to buy an Option before you can sell it! This may sound a bit strange, but since an Option is really just an agreement between two people, all you are doing is deciding which side of the agreement you wish to be on (based on whether you are buying (Taking) or selling (Writing) the Option). This will become a lot clearer as we progress…

(*) *In Australia, most Options are "American-style" and can be Exercised at any time. Less common are "European-style", which can only be Exercised on their Expiry Date.*

Ok, so I have explained that Options give you either the ability (if you're the Buyer/Taker), or the potential obligation (if you are the Seller/Writer), to buy or sell a quantity of shares. But which shares are we actually talking about? And how many? The good news is that most aspects of Options are standardised. For example, one specific Option will only ever apply to one particular company's share. Also, when buying or selling Options, you will find that this always takes place in the form of buying or selling an Option **Contract**. In the Australian Market, each Contract usually covers 1,000 of the underlying shares.

I will now provide you with an example to help demonstrate what I mean…

From time to time in this EBook, I will refer to a hypothetical company known as XYZ. This is simply a made-up company name, which I will be using as the basis for all trading examples. Although this is not a real company, the prices I will use in the examples are based on real-life quotes.

Here is a simple example of a transaction involving the purchase of Call Options:

It's the end of the first week in December and Mary sees that XYZ shares are currently priced at $10.00 each. She calls her Stockbroker and requests the following Option trade:
"Could I please Buy to Open 5 XYZ December $10.50 Call Options at 5c?"

Let's start by breaking this down a little to understand exactly what it means...

Firstly, Mary has stated "**Buy to Open**". This simply means that she wishes to commence the transaction by **buying** the Option (you'll recall that it takes two people for an Option Contract to be traded, i.e, both a buyer and a seller). Next is "5 XYZ December $10.50 Call Options". This refers to **5 Contracts** worth of **Call Options** (this would therefore cover 5,000 **XYZ** shares, because there are 1,000 shares covered per Contract), each with a **Strike Price** of **$10.50** and an "**Expiry Date"** in **December**. A note on Expiry Dates: There is always only ever one Expiry Date available per calendar month (although some shares might not have Options listed for every month, i.e, they might only be quarterly for example). The actual Expiry Date within a given month will usually be the business day before the last Friday in the month. Most of the time this means that Expiry usually falls on the last Thursday in the month, but sometimes it is a week earlier and on rare occasions it might be a completely different day altogether! Confused? An easy way to confirm the Expiry Dates is to visit the ASX web-site, as they keep a full list of the upcoming (*)Option Expiry Dates available online.

(*) *To see a current list of future Option Expiry Dates, you can use this web-site:*
http://www.asx.com.au/investor/options/trading_information/expiry_calendar.htm

Back to our order... The last part mentioned in the order is a specific price of **5c**. This is the **Premium** that Mary is prepared to pay. The Premium is always expressed as an amount per individual share covered in the order. Therefore, in this particular example, the total cost to Mary would be 5c x 5,000 shares – which is $250.00 in total. **Brokerage fees** would also apply and be in addition to this. (I'll provide some examples of how Brokerage fees are usually calculated a little later in this EBook).

Let's assume that Mary's trade is successfully "**filled**" (this simply means that Mary's order has been successfully traded in the market, i.e, an Option Writer has sold her the Options she wishes to buy in this example). So what does Mary's Option trade actually mean? How might it benefit her? What can go wrong?

Keeping in mind my earlier definition ("A Call Option gives you the ability to ***buy*** a certain number of someone else's shares at a price you both agreed upon upfront"), this therefore means that Mary is now able to purchase 5,000 XYZ shares at any time she wishes, up until the December Expiry Date, at an agreed price of exactly $10.50 per share. It's as simple as that! ☺

As XYZ shares are currently trading at only $10.00 (as at the time Mary placed the trade), it wouldn't make any sense for her to "**Exercise**" her right to buy those 5,000 shares at $10.50 each just yet. Can you see why? The reason is because whilst XYZ shares are trading **BELOW** the $10.50 Strike Price, Mary would simply be better off buying the 5,000 shares in the open market at the going price. If, however, XYZ shares moved above $10.50, then Mary would have a tangible advantage in Exercising her right to buy the shares at only $10.50 each. This is because Mary would now be buying them at a discount to the current market price.

Now is a great time to explain a few additional terms, which are also very commonly used when discussing Options. They are:

1. **at-the-money**
2. **in-the-money**
3. **out-of-the-money**

These terms refer to whether or not the current share price is roughly equal to, or above or below an Option's Strike Price. In the case of Call Options, if the current share price is *below* the Strike Price, then the Option is said to be "**out-of-the-money**". There is usually no reason to Exercise out-of-the-money Call Options, as this means that you would be paying more for the shares than you could simply buy them for in the open market at that point in time. "**In-the-money**" refers to the opposite situation, i.e, when the current share price is *above* the Strike Price of the Call Option. In this case, Exercising the Option allows you to acquire the

shares at a price which is at a discount to the current market price. An option is termed "**at-the-money**" when the share price and Strike Price are identical, or at least fairly close to each other. Please see the table below to see how different share prices and Call Option Strike Prices can be identified as in-the-money, at-the-money, or out-of-the-money:

XYZ Share Price	*$9.50 Call Option*	*$10.00 Call Option*	*$10.50 Call Option*
$9.00	out-of-the-money	out-of-the-money	out-of-the-money
$9.50	at-the-money	out-of-the-money	out-of-the-money
$10.00	in-the-money	at-the-money	out-of-the-money
$10.50	in-the-money	in-the-money	at-the-money
$11.00	in-the-money	in-the-money	in-the-money

I'll now move onto a brief explanation of **Put Options**. Rather than having the right to buy the underlying share, a Put Option gives you the right to ***sell*** the underlying share at a preagreed price. Let's assume that Mary decides to place another trade with her Stockbroker, this time buying a Put Option. We shall further assume that XYZ is still exactly at $10.00 when she requests this new order. Mary gives her Stockbroker the following instructions:

"Could I please Buy to Open 5 XYZ December $9.50 Put Options at 4c?"

Working through this order, we can see that Mary is "**Buying to Open**" **5 Put Option Contracts** on **XYZ** shares which expire in **December** and she is prepared to pay **4c** of **Premium**. In case you're wondering how you determine what price to pay for an Option, rest assured I will explain that shortly. For now, let's see what this last trade actually means to Mary…

By purchasing 5 XYZ December $9.50 Put Options, Mary now has the ability to ***sell*** 5,000 XYZ shares at any time she wishes (up until the Expiry Date) for a preagreed price of $9.50 per share. Would it make sense for Mary to Exercise her right to sell the shares at $9.50 each, knowing that the current market price is still $10.00?

Hopefully you've said, "No!", as Mary would be missing out on 50c per share extra that she could have received simply by selling the shares in the open market at $10.00 each. Therefore, Exercising Put Options doesn't appear to make sense if the underlying share price is *above* the Strike Price of the Put Options. You might have already guessed it, the way we would describe Mary's Put Options at this particular point in time would be "out-of-the-money"! Just like Call Options, Put Options can also be in-the-money, at-the-money and out-of-the-money. However, unlike Call Options, a Put Option is in-the-money when the current share price is *below* the Strike Price. Here is another simple table to demonstrate when various

Put Options are in-the-money, at-the-money or out-of-the-money, based on different prices of the underlying share:

XYZ Share Price	***$9.50 Put Option***	***$10.00 Put Option***	***$10.50 Put Option***
$9.00	in-the-money	in-the-money	in-the-money
$9.50	at-the-money	in-the-money	in-the-money
$10.00	out-of-the-money	at-the-money	in-the-money
$10.50	out-of-the-money	out-of-the-money	at-the-money
$11.00	out-of-the-money	out-of-the-money	out-of-the-money

I'm now going to explain some of the reasons why Mary might be interested in purchasing a Call Option or a Put Option (or perhaps even both at once!), along with the risk she is exposed to, as well as the potential profit she might make…

Let's go back to the purchase of the Call Options and see what Mary might have been thinking... Mary's order, once again, was:

"Could I please Buy to Open 5 XYZ December $10.50 Call Options at 5c?"

XYZ was trading at $10.00 at the time and this order cost Mary $250.00 (5 Contracts x 1,000 Shares covered per Contract x 5c Premium). Mary now has the right to purchase 5,000 XYZ shares at $10.50 each, anytime she wishes up until the December Expiry Date.

Let's consider some "What If's"... What would happen if XYZ fell from $10.00 to $8.00? What if it stayed at $10.00? What if it rose to $12.00? To answer these questions, I'll start by firstly explaining how Option Premiums are determined. I'm going to start by showing you how to calculate the value of an Option as at its Expiry Date, as this will help you to identify the outcome required for a trade to be profitable if it runs the full duration. It will also allow you to understand the potential risk involved…

The first thing to realise is that an Option's Premium is never a fixed price. In fact, it usually varies immensely throughout the life of the Option. Here are the primary factors which influence the price of an Option:

(a) The current underlying share price at any particular point in time.
(b) The type of Option – is it a Call Option or a Put Option?
(c) The Strike Price of the Option.
(d) The number of calendar days remaining until the Expiry Date.
(e) The expected Volatility of the underlying share (I'll explain this in more detail later on in this EBook)
(f) The current risk-free interest rate (as set by our Reserve Bank,

which is 5.5% as at the time of writing)

(g) Any upcoming ex-dividend dates which occur on the underlying share within the life of the Option and also the anticipated dividend amount(s) payable.

(h) Natural market forces of supply and demand for this particular Option.

I will provide a brief overview of the effects of these, although rather than hit you with it all at once, I will gradually provide more details as you work your way through this EBook.

Clearly the factors (a) - (c) (i.e, the underlying share price, type of Option and the Option's Strike Price) are all vital in determining the price of an Option. These three factors combined are actually used to determine the "**Intrinsic Value**" of an Option. I'll sidetrack briefly for a moment before I clarify exactly what this is:

Option Premiums are made up of two major components, known as:

(1) **Intrinsic Value**
(2) **Extrinsic Value** (also quite commonly referred to as "**Time Value**")

The Intrinsic Value is simply a measure of how far in-the-money an Option currently is at any given point in time. If the Option is **not** in-the-money, then the Intrinsic Value is simply zero. Here is a simple table showing the relevant Intrinsic Value amounts, based on various combinations of the underlying share price, type of Option (i.e. Call or Put) and Strike Prices:

XYZ Share Price	***$9.50 Call Option***	***$10.00 Call Option***	***$10.50 Call Option***
$9.00	0c Intrinsic Value	0c Intrinsic Value	0c Intrinsic Value
$9.50	0c Intrinsic Value	0c Intrinsic Value	0c Intrinsic Value
$10.00	50c Intrinsic Value	0c Intrinsic Value	0c Intrinsic Value
$10.50	$1.00 Intrinsic Val	50c Intrinsic Value	0c Intrinsic Value
$11.00	$1.50 Intrinsic Val	$1.00 Intrinsic Val	50c Intrinsic Value

XYZ Share Price	***$9.50 Put Option***	***$10.00 Put Option***	***$10.50 Put Option***
$9.00	50c Intrinsic Value	$1.00 Intrinsic Val	$1.50 Intrinsic Val
$9.50	0c Intrinsic Value	50c Intrinsic Value	$1.00 Intrinsic Val
$10.00	0c Intrinsic Value	0c Intrinsic Value	50c Intrinsic Value
$10.50	0c Intrinsic Value	0c Intrinsic Value	0c Intrinsic Value
$11.00	0c Intrinsic Value	0c Intrinsic Value	0c Intrinsic Value

The Intrinsic Value for a Call Option is determined simply by subtracting the Option's Strike Price from the current Share Price.

The Intrinsic Value for a Put Option is calculated by subtracting the current Share Price from the Option's Strike Price.

(Did you notice the subtle difference, which one is being subtracted from which?)

Under normal trading conditions, there can never be a negative Intrinsic Value. This explains why it is only ever in-the-money Options that are considered as having Intrinsic Value.

Earlier I mentioned that Mary paid 5c Premium for a $10.50 Call Option and the current share price was $10.00 at that time. What Intrinsic Value did Mary pay?

The correct answer is zero. This is because the $10.50 Call Option is out-of-the-money, therefore it has no Intrinsic Value. So in this particular case, through a process of elimination we are able to determine that the 5c of Premium Mary paid was entirely made up of "Extrinsic Value" (or "Time Value").

Extrinsic Value is calculated by taking into account the remaining factors (d) - (h) as listed previously. Fortunately, since an Option's Premium can only ever be made up of Intrinsic Value + Extrinsic Value, it is always simply a matter of subtracting the Intrinsic Value from the current Premium to determine what (if any) Extrinsic Value is currently included in the Option's Premium. Here is an example to show how this works, based on some hypothetical Option Quotes:

XYZ Currently trading at $10.00 per share:

Strike Price	***Option Type***	***Premium***	***Intrinsic Value***	***Extrinsic Value***	***Description***
XYZ $9.50	Calls	56c	50c	6c	in-the-money
XYZ $10.00	Calls	21c	0c	21c	at-the-money
XYZ $10.50	Calls	5c	0c	5c	out-of-the-money
XYZ $11.00	Calls	1c	0c	1c	out-of-the-money
XYZ $9.50	Puts	4c	0c	4c	out-of-the-money
XYZ $10.00	Puts	19c	0c	19c	at-the-money
XYZ $10.50	Puts	53c	50c	3c	in-the-money
XYZ $11.00	Puts	100c	100c	0c	in-the-money

Knowing this, we can now look back at Mary's trades and estimate the likely profit and/or loss that she may face if she were to simply keep the trade open right up until the Expiry Date. One point that I'd like to make is that once an Option reaches its actual Expiry Date, the Extrinsic Value always becomes zero by the time the market finally closes for the day. On the Expiry Date, Mary could end up with any of the following three possible scenarios:

(1) XYZ's share price could be *above* the Strike Price of Mary's Call Option (this means the Option is in-the-money and therefore would have Intrinsic Value); or
(2) XYZ's share price could be *exactly at* the Strike Price of Mary's Call Option (the Option would then be classed as at-the-money); or
(3) XYZ's share price could be *below* the Strike Price of Mary's Call Option (this means her Option would be out-of-the-money).

At market close on the Expiry Date, the only way that Mary's Call Option could have any remaining value would be if it ended up finishing in-the-money. Otherwise, the Option would simply **Expire** "worthless" and in this case Mary would lose the entire Premium amount she had originally paid for the Option. This is actually Mary's worst-case loss amount (i.e, the maximum risk) that she is exposed to by placing this trade. She could lose the entire $250.00 she paid to buy these Call Options (plus whatever brokerage/fees she paid in addition to this).

If XYZ did end up above the Strike Price of Mary's Call Options, thereby moving them in-the-money, let's see what choices Mary now has available:

(a) Mary could decide to **Exercise** her Option, thus enabling her to purchase the 5,000 XYZ shares at the preagreed price of $10.50 per share. Her instruction to her Stockbroker would be something like: ***"I would like to Exercise all 5 Contracts of my XYZ December $10.50 Call Options"***

(b) Mary might prefer to simply **onsell** her Call Options to someone else, hoping to realise a profit without even needing to buy the underlying shares! In this case, her order request would be: ***"I would like to Sell to Close 5 XYZ December $10.50 Call Options"***
(Mary may, or may not, decide to request a specific limit price, although it is unlikely she could achieve a higher price than the available Intrinsic Value of the Options if she had waited until the actual Expiry Date to sell them).

You'll notice that in the case of choice (b) above, although Mary is selling Call Options she is "**Selling to Close**" the position. This is very different to Mary creating a new Option position by "Selling to Open". By Selling to Close her Option Contracts, Mary is simply handing over her rights to whomever it is that ends up buying her Options from her. It's important to understand the difference. Don't worry if this isn't clear just yet, as you'll pick up on it as we progress from here.

Let us now work through these two scenarios, to see Mary's potential profit if XYZ was to hypothetically rise to $12.00 per share.

(a) Mary simply Exercises her Calls, thus purchasing 5,000 XYZ shares at the preagreed price of $10.50 each. This means she has bought them at a $1.50 discount to the current market price of $12.00 per share. Remember, though, that she originally paid 5c in Premium to purchase the Call Options, therefore her true purchase price is $10.55 ($10.50 + 5c) per share (plus any applicable brokerage costs). Mary may then choose to hold onto the shares, or if she prefers she could sell them back to the market to realise her profit.

(b) Mary onsells her Call Options to someone else and receives about $1.50 in Premium, as this is the Intrinsic Value which is currently available (i.e, $12.00 Share Price - $10.50 Strike Price). Taking off the cost the Calls at 5c each, Mary has made a total profit of $1.45 in Premium which equates to $7,250.00 for all 5 Contracts ($1.45 x 5 x 1,000). (Sidenote: As this example is taking place on the Expiry Date, the person buying Mary's Call Options would need to either onsell them again on the same day or else Exercise them to receive any benefit from them before they Expire!).

You might have noticed that Mary has made the same profit either way. As for which approach to use, as a general rule Mary would be better to onsell (i.e, "Sell to Close") her Call Options if the Premium available still contained any Extrinsic Value. Another factor to take into consideration would be whether or not Mary wished to own the underlying shares plus also the Brokerage Fees payable for each scenario.

Brokerage Fees apply to both Share trades and Option trades, although usually when Exercising an Option position you only pay Brokerage based on the dollar value of the actual shares that are traded. Most Stockbrokers calculate brokerage rates as the greater of a "minimum fee per trade" or a specific percentage of the total dollar amount traded. For example, your Stockbroker might have a minimum fee of $55.00 per trade, or 1.1%, whichever is greater. This means that a trade which has a total dollar value amount of $5,000.00 or less will simply cost a flat $55.00 per trade. Above this it would be 1.1% of the total amount traded.

Brokerage Rates can vary immensely, and furthermore different Stockbrokers can offer varying levels of service. To further complicate matters, some Stockbrokers charge a different rate for Share Trades as compared to Option Trades. Some also vary their rates if you place trades online via their internet site, rather than phoning

them to place the trade. It is beyond the scope of this EBook to provide a comparison of all Stockbrokers and their fee structures, however discussions about Stockbrokers (including some people's personal opinions/recommendations) can be found online at my Forum web-site (you will find my internet address, plus many other useful links, in the "Online Resources" section near the end of this EBook). Later I will disclose details of the Stockbroker that I personally use, although please understand that I am not in a position to recommend them to you, as they may not be appropriate for your circumstances and/or there may be a different Stockbroker that is far superior for your particular needs.

Another type of fee, which needs to be taken into consideration when trading, is known as "**ACH Fees**". ACH stands for **Australian Clearing House**. This is a subsidiary of the ASX which clears options (and futures) traded on the ASX. They charge a fee which is calculated on a "per Contract" basis, as follows:

> When ***buying*** or ***selling*** Option Contracts, the fee is $1.12 per Contract.
> When ***Exercising*** an Option Contract (or being Exercised, if you were the Writer of the Contract), the fee is 55c per Contract.

Therefore, using Mary's trading example once again, here are the likely fees she could expect to pay:
To Buy 5 Contracts of XYZ $10.50 December Calls at 5c ($250.00 total Premium payable) would cost $55.00 (Brokerage) + 5 x $1.12 (ACH Fees) which totals $60.60 in fees. This takes the total cost of placing this trade to $310.60.

If Mary chose to Exercise all 5 Contracts to take ownership of the 5,000 XYZ Shares, the fees would then be as follows:
To Buy via Exercise 5,000 x XYZ Shares at $10.50 each ($52,500.00 total purchase price) would cost $577.50 ($52,500 x 1.1%) in Brokerage + ACH fees of 5 x 55c which totals $580.25 worth of fees.

Therefore Mary has effectively paid about $10.68 per share after all costs are taken into account (this figure includes the purchase of the original Call Options). This was calculated as follows:
Cost Per Share = ($52,500.00 + $580.25 fees + $250.00 Premium paid + $60.60 fees) / 5,000 Shares

Let's now take a look at Mary's other trade, the purchase of the Put Options, to see the possible profit or loss potential relevant to it. The original trade was:

"Could I please Buy to Open 5 XYZ December $9.50 Put Options at 4c?"

XYZ was $10.00 at the time, so therefore the $9.50 Put Option is definitely out-of-the-money. This means the 4c Premium is entirely Extrinsic Value (as Intrinsic Value only exists on in-the-money Options). Mary now has the right to sell 5,000 XYZ Shares at $9.50 per share at any time up until and including the December Expiry Date. (Hopefully you are finding that this is making quite a lot of sense by now. These concepts are actually quite easy to understand, once you get your head around the basics!) ☺

I should point out that it doesn't matter whether or not Mary actually owns any XYZ shares at the time of purchasing the Put Options. Either way, she still is able to buy the Put Option Contract irregardless. Remember, an Option Contract is simply an *agreement* between two parties.

For the sake of curiosity, let's assume that Mary doesn't own any XYZ shares (I will provide an alternate scenario for you a little later in which she does own the shares, just to show you the difference it makes). Once again Mary has decided to do nothing until the Expiry Date (Mary doesn't always trade this way, as if she did she would probably end up losing money in the long run!). Let us see now what her Put Options might be worth, so that we can determine if she has made a profit or loss...

Scenario (1) XYZ has moved up to $11.00

In this case, Mary's $9.50 Put Options are most definitely out-of-the-money (i.e, it makes no sense to Exercise her right to sell XYZ shares at $9.50, knowing that they could be sold in the open market at that point in time for $11.00 each!) Therefore Mary has lost her entire Premium, which in this case was $200.00 (5 x 1,000 x 4c) plus brokerage/fees. In actual fact her total loss amount is $260.60 including fees. As you can see, ***the risk in buying Options is that you can lose the entire Premium amount (plus any applicable fees) that you have paid***.

Scenario (2) XYZ has moved down to $9.00

Now Mary's $9.50 Put Options are in-the-money and have an Intrinsic Value of 50c ($9.50 - $9.00). Mary will be pleased with herself in this case and can choose to handle the situation in either of the following two ways:

(a) Mary **onsells** her Put Options and receives about 50c in Premium (i.e, the Intrinsic Value). This provides Mary with $2,500.00 (5 x 1,000 x 50c) less any applicable brokerage/fees. To work out her actual net profit, we would simply deduct the original cost of buying the Puts as well as the extra brokerage/fees. For your curiosity, in this particular example Mary has actually made a net profit of $2,178.80 after all fees are taken into account.

(b) Mary may instead decide to **Exercise** her Puts, thus generating a "Sell" order for 5,000 XYZ shares at the preagreed price of $9.50 each. To allow this to work (since Mary doesn't actually own any XYZ shares at this point in time), Mary would immediately purchase 5,000 XYZ shares from the market at the currently available price of $9.00 each, thus realising a 50c gain per share from the transaction. Once again, the original cost of the Put Options plus all of the brokerage/fees paid would need to be deducted from the net proceeds of this to work out Mary's actual net profit. In this case her profit would be just $1,219.15.

In a situation like this, choice (a) is definitely superior because it saves the additional brokerage costs of buying and selling the 5,000 XYZ shares.

What if Mary already owned the 5,000 XYZ shares? How does this change things? I'm glad you asked... ☺

Let's assume Mary had previously bought the 5,000 XYZ shares at $10.00 each. For now we'll just focus on the Put Option order that she placed. Can you think of a good reason why Mary might have wanted to buy the $9.50 Put Options, considering that she already owned the underlying shares?

I'm sure you've figured it out, but in case you haven't, what Mary has effectively done is bought herself a form of "Insurance" for her shares! For the cost of just 4c per share, Mary has guaranteed herself a worst-case selling price of $9.50 per share for her 5,000 XYZ shares. This is no matter how low they might fall between now and the Option's Expiry Date! The exciting part is that Mary is still entitled to any profits she might make if XYZ was to rise in price. In this particular example, she has given up 4c per share for some peace of mind and a massive reduction in her worst-case possible loss, whilst still being able to potentially make an open-ended profit should XYZ's share price rise. This is useful to remember, especially in times of uncertainty or panic in the market.

If the worst happened and XYZ did fall significantly in price far enough so that Mary's Put Options moved in-the-money, then once again Mary would be faced with the possibility of either Exercising her Options (and thereby selling her shares at the preagreed price of $9.50 each), or simply onselling her Put Options to someone else to recover at least their Intrinsic Value. If Mary thought that the fall in share price was only temporary, then onselling her Put Options may be the best choice. This is because this approach would still allow her to retain ownership of her XYZ shares, therefore a subsequent rise in their price in the future could provide a profit for Mary.

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with unexpected "**Early Exercise**"! This is quite common around this time and caused by the Option Taker's efforts to capture dividends and/or unload their holdings once their shares have reached an ex-dividend date.

I am now going to sidetrack a bit and spend quite a bit of time explaining the Exercise process. This is a bit of a fuzzy area for many people, where certain aspects of it are either misunderstood or perhaps not even known. Usually a full understanding of the Exercise process only comes to those who have built up considerable experience in the market. Understanding how Exercise works and when it is likely to happen can also make a huge difference to the amount of Brokerage fees that you end up paying. Once you are aware of what may trigger Early Exercise, you then at least have an opportunity to react before it's too late.

Firstly, a brief recap… By now it should be quite clear that when you Write (Sell) a Put Option, you are taking on the obligation to possibly ***buy*** a quantity of shares at any time up until the Option expires. When you Write a Call Option, you are taking on the obligation to possibly ***sell*** a quantity of shares at any time up until the Option's Expiry Date. It is up to an Option Taker (i.e, the person who has bought the Option) as to whether or not they may wish to Exercise their right and force you to buy or sell the underlying shares at any particular point in time.

When I was quite new to trading Options, I remember watching like a hawk as an Option I had sold moved just slightly in-the-money during the day. I felt a little nervous and excited all at the same time, thinking that perhaps my Broker would call me at any minute to give me the news that I'd been Exercised! Of course this didn't happen and when it finally was time for me to be Exercised on one of my sold Options, I realised that the process worked very differently to what I had imagined...

You see, despite reading a number of books and actually doing a fair bit of trading, I had no idea that being Exercised was actually something that occurred outside of market hours! The reason for this is that no matter what time of day it is when someone decides to Exercise their bought options, the actual transfer of the shares (known as "**Assignment**") doesn't take place until after the market closes for the day. Here I was sitting near the phone and waiting for a call that NEVER could come during market hours!

Here is a simple example to help explain exactly what happens:

Let's assume that it's 11:00am on Wednesday morning and it's the ex-dividend date for XYZ shares. An XYZ shareholder who also happens to have bought some Put Options decides it's time to Exercise their right and sell their shares to

free up some cash. So they telephone their Stockbroker and instruct him or her that they wish to Exercise their Put Options, saying something like this:

"I already own XYZ shares and would like to Exercise all my XYZ Put Options"

The interesting thing is that regardless of what time it is during the day that the Stockbroker receives this call, all the broker does is simply add this request to a list of jobs which are to be processed after-hours.

Therefore, a Writer of Options actually has until the time the market closes each day to "Buy to Close" their sold Options and thereby remove themselves completely from the possibility of being Exercised on any given day. It doesn't even matter if today is the Option's Expiry Day, or if these Options still will last a year or more before they expire, the procedure is always exactly the same.

Let's say that the Option Writer forgets to buy back their sold Options and it turns out that they are selected for Early Exercise... Here is what happens in this case:

The first sign that you have been Exercised is usually an Email from your Stockbroker. This may arrive either late in the evening (perhaps 10:00pm at night or even later on the day of Exercise) or at the latest it will be sent to you by the start of trading on the following working day. Many Stockbrokers will also follow-up with a phone call, just to be sure that you know what's happened. This is especially the case if you've been exercised on sold Call Options but do not own the underlying shares. Remember that when selling Call Options, you have taken on the obligation to ***sell*** a quantity of shares – so if you don't already own the necessary shares, your Broker will want to know how you intend on handling the situation (obviously you are going to need to get the shares from somewhere pronto – more on this a little later)!

In any case, the point I'm trying to make is that unless you are advised of being Exercised prior to the market opening for the day, then you can relax and choose to "Buy to Close" your sold Options at any time you like during market hours with no risk of suddenly being Exercised at some random time during the day. I guess in one way this takes away a bit of the fun of thinking that your Broker might call at a moment's notice during the day, but I'm sure you'll agree that it also gives you plenty of peace of mind to know that you literally have all day to close an existing position without fear of being Exercised.

Another point which I'd like to make is that when you do find out that you are Exercised, it can be quite common to discover that you were only Exercised on a part of your position, rather than on the full quantity of sold Contracts. Furthermore, despite the fact that two specific parties (the Option Taker and

yourself, the Writer) are involved at the time when you initially "Sold to Open" an Option position, the original Option Taker may, *or may not*, be the one that actually Exercises you! Here is an example to show how this works:

Let's say that the current "**Open Interest**" on a particular Option is 495 Contracts. (Note: Open Interest is a measure of how many Option Contracts are currently open for any given Option. Each time a new Option Contract is created, the Open Interest rises by 1. If an Option Contract is Exercised, then the Open Interest falls by 1. Therefore it represents only the "yet to be Exercised" number of currently open Option Contracts that have been traded). Anyhow, let's say that you decide to "Sell to Open" 5 Contracts, thus taking the total Open Interest from 495 to 500 Contracts. For the sake of this example, let's assume that on the following trading day a total of 100 Contracts are subject to Early Exercise.

The first point to note is that there could be as many as 100 different Option Takers, each holding 1 Contract all choosing to Exercise on that day, or as little as 1 Option Taker Exercising all 100 Contracts (or indeed any combination in-between!). The ACH then *randomly* selects which 100 out of the 500 written Option Contracts are the actual ones to be Exercised!

Knowing that you have sold 5 Contracts out of a total pool of 500, there is a "1 in 100" chance that you could be selected as the "lucky" recipient of Early Exercise of a single Contract.

So back to our example – If 100 Contracts out of a possible 500 were Exercised, you may be fortunate enough to avoid Exercise entirely, or you could quite possibly be Exercised on all 5 Contracts (or anything in-between).

Whilst this may initially seem unfair, it actually works very well and in my opinion is a very fair approach for all concerned.

Bear in mind also that an Option Taker always has the right, but not the obligation, to Exercise any or all of their bought Contracts on any trading day which may suit them (up until and including the Option's Expiry Date). Whilst they shouldn't have any reason to Exercise an out-of-the-money Option (as they could achieve a better price simply by trading the underlying stock in the open market), in very rare occasions it can happen. If it does, though, this is usually a blessing because it means that you can buy or sell the underlying share in the open market and once again resell the same option and end up with a small profit for your troubles! ☺

However, when an Option moves in-the-money, there can be various reasons and triggers which may apply to individual Option Takers.

So... **How can you tell if Early Exercise is becoming likely?**

If the Option is in-the-money, here are some of the factors which will help you to be more aware of when you might be a likely candidate for Early Exercise:

Put Options:

1. If the current Premium value for your sold Option on any given day is solely made up of Intrinsic Value with zero or very little Time Value, this is a definitely a warning sign. Remember that the Put Option Taker is able to sell their shares by Exercising their Put Option, so this is potentially freeing up their money to invest elsewhere. This is one of the reasons that in-the-money Put Options actually have considerably less Time Value as compared to Call Options which are a similar distance in-the-money.

2. If the underlying share price **falls** 5% or more below the Strike Price of your sold Put Options, this could mean that early Exercise is becoming likely (even if there still may be a small amount of Time Value remaining). Please note that 5% is just a very rough guide and may vary depending on the volatility of the underlying share.

3. **Important:** If the underlying share has just reached an ex-dividend date, you may find that your Put Option has suddenly moved in-the-money. If this occurs, this could significantly increase your risk of Early Exercise (especially on this particular day, as many people will sell their shares once they know that they are entitled to the dividend).

Call Options:

1. Although less common than with Put Options, Call Options may still be Exercised early if the Time Value in the Premium is zero or close to it. The reason they are less likely to be Exercised early is because a Call Option Taker is required to hand over sufficient funds to purchase the underlying shares – so it generally makes sense for them to delay this as long as possible so they can keep their funds elsewhere earning them some interest unless there is a compelling reason to exercise early (for example, see point 3 just below).

2. If the underlying share price **rises** 10% or more above the Strike Price of your sold Call Options, this may mean Early Exercise is becoming increasingly likely (even if there is still some Time Value remaining). Please note that 10% is just a very rough guide and may vary depending on the volatility of the underlying share.

3. **Important:** If the underlying share is due to go ex-dividend on the next trading day, this is an extremely probable time to find yourself Exercised early on any in-the-money sold Call Options. This is because the Option Taker knows that they will be entitled to the dividend if they Exercise you on the day prior to the ex-dividend date. There is also an additional risk when being Exercised on written Call Options on the day prior to the ex-dividend date, which is due to the fact that most Company's dividends have a "Franking Credit" component.

In brief, "**Franking Credits**" may provide you with a discount on some of your tax payable (or possibly a tax refund) in the financial year that you receive any dividends containing Franking Credits. This is because you are able to take into account that the Company paying you the dividend has already paid tax on their profits at the company tax rate of 30c in the dollar (this applies to dividends which are classed as "Fully Franked", or sometimes known as carrying "100% Franking Credits"). Here is a brief example to help show how this actually works:

Let's say XYZ is due to pay a dividend amount of 49c per share and they have declared this dividend to be Fully Franked. This means that this 49c dividend actually carries with it a taxation benefit of 21c. (It actually works out to a 70c gross dividend, less Company Tax at 30%, leaving a 49c Fully Franked dividend). So if you were to find yourself being Exercised on Call Options on the day prior to the ex-dividend date, this means that not only are you forced to supply the underlying shares, but you also need to ensure that the Option Taker receives the **appropriate dividend amount *along with any applicable Franking Credits!***

This is fine if you already own the underlying shares, as you would simply hand them over. But, if you did not own the necessary shares, then by the time you find out you have been Exercised (which would effectively be on the next trading day), this means you would be faced with only being able to buy the required shares on the actual ex-dividend date. Therefore, these shares will **NOT** have the dividend included in them and you will have to add from your own pocket the 70c per share (49c declared dividend + 21c franking credit, based on this example) to satisfy your obligations to the Option Taker that has Exercised you. This usually results in a loss that is much worse than simply "Buying to Close" your sold Calls on the day prior to the ex-dividend date. Although it is not my intention to give you specific advice, I feel that **it is extremely important to AVOID having Sold Call Options open on the day prior to an ex-dividend date, *unless you already own the underlying shares***. It can be horrible to find out about this the "hard way". ☹

It should also be noted that if an Option is even just 1c in-the-money as at the close of the market on the Option Expiry Date, then you can expect to be Exercised. There is even a 50/50 chance that you will be Exercised on the Expiry Date if the sold option finishes up exactly at-the-money. In some cases, Exercise

may even occur if the option is 1 or 2c out of-the-money (remember that the Option Taker might have given their Exercise instructions to their Stockbroker earlier during the day, perhaps whilst the share was trading at a lower price than where it actually ended up closing for the day).

If in doubt, it is usually a good idea to "Buy to Close" any sold Options just to be on the safe side. Furthermore, if the Premium value ever falls to just 1c or half a cent, then I think it makes a lot of sense to close the position sooner rather than later, as this takes away any future risk irregardless of what happens next…

Trading Tip:
Sometimes you might notice that your sold Option has moved very far out-of-the-money and its Premium has become virtually worthless. Whenever this occurs, I look to see if the very next Strike Price closer to-the-money might also be worth very little. If it is, instead of "Buying to Close" my sold Option I may decide to "Buy to Open" an equal number of contracts of the Option at the closer to-the-money Strike Price. This not only takes away any risk from an abrupt change in the market, but it actually can on very rare occasions give you an opportunity to make an additional profit. Here's an example to clarify what I mean:

Let's say XYZ was trading at $20.00 and you'd sold 5 x $19.50 Put Options for 30c Premium. You're excited to notice that 1 week before the Expiry Date, XYZ has climbed up to $21.75 per share. You check the cost to buy back the $19.50 Puts to close the position and your Broker suggests that if you offer 0.5c (half a cent) of Premium you could probably buy them back. You then ask for a quote on the $20.00 Puts (being the next Strike Price closer to-the-money). You are told that the market quotes are a Bid price of 0.2c and an Ask price of 1c. You instruct your broker that you'd like to ***"Buy to Open 5 x XYZ $20.00 Put Options at a limit price of 0.5c"***, as you would have paid this price anyway to buy back the $19.50 Puts. Assuming this trade is filled, what you have now is a "**Bear Put Spread**" (this spread, plus many other basic Option strategies, will be explained in more detail in Part 2 of this EBook). Now, if for whatever reason something happens and XYZ drops below $20.00 prior to the Expiry Date, you'll actually make additional profit! Admittedly 99 times out of 100 this probably wouldn't happen – but considering that it cost no more than just closing the position outright, I see it as very attractive way to finish off a successful trade whenever possible. ☺

Another area which may seem confusing is how much money you actually need to have on-hand, in case you find yourself Exercised unexpectedly. Fortunately, if you are happy to immediately onsell or purchase the shares from the market (depending on whether you were Exercised on written Put or Call Options), all you need on-hand is sufficient funds to cover the shortfall between the purchase

price of the shares and the sale price, plus brokerage/fees. Here are two examples to show how this works:

Scenario 1: You've sold 1 x XYZ $20.00 naked Put Option and you've received the dreaded (or pleasant, depending on your plan!) Email telling you that you were Exercised. When the market opens, you notice XYZ is trading around $19.20 per share. At this point in time, assuming you didn't wish to retain ownership of the shares, you could contact your broker and tell them to place a sell order for the shares. In this instance, the capital required would be $800.00 plus enough to cover brokerage/ACH fees for both the purchase and the sale of the shares. If your brokerage rate was a flat 1.1%, here is how to work out the total amount required:

Assigned: Buy 1,000 x XYZ Shares @ $20.00 each (pay $20,000 + $220.00 Brokerage + 55c ACH Fee)
Sell at Market 1,000 x XYZ Shares @ $19.20 each (receive $19,200 - $211.20 Brokerage)

The actual total cost involved would therefore be $1,231.75. Bear in mind that you would still retain whatever Premium amount you were paid when you initially sold the Put Option, so if this was 40c for example then this will reduce your loss by $400.00 (less the brokerage paid when establishing this trade initially).

Scenario 2: You own 1,000 x XYZ shares and decide to sell 1 x XYZ $20.00 covered Call Option. XYZ shoots up to $24.00 per share on rumours of a take-over, and sure enough you find out overnight that you've been Exercised. In this case, you are simply forced to hand over your shares at a selling price of $20.00 each and would not require any additional funds to complete the transaction. If, however, you didn't own the shares and had sold a naked $20.00 Call Option, here's how this would work out:

Assigned: Sell 1,000 x XYZ Shares @ $20.00 each (receive $20,000 - $220.00 Brokerage - 55c ACH Fee)
Buy from Market 1,000 x XYZ Shares @ $24.00 each (pay $24,000 + $264.00 Brokerage)

The funds needed to support this transaction would be $4,484.55 (noting that $4,000.00 of this is the loss made due to being forced to sell the 1,000 shares at $4.00 below market value). This helps demonstrate how nasty selling naked Call Options can be, as it's little consolation even if you'd received 50c upfront premium (i.e. $500.00) for example when initially selling the Call Option.

If your position is protected by other bought Options, then it's simply a matter of determining if it is better value to Exercise your bought Options or to simply buy

or sell the shares at market prices. Generally speaking, unless your bought Options are also in-the-money, you would NOT Exercise them. Sometimes it makes more sense to onsell your Bought Options after buying or selling the underlying shares in the open market. The main factor to consider is that you're probably better off onselling a bought Option if there is still some Time Value remaining in it, as opposed to Exercising it (because this would effectively forfeit whatever Time Value is remaining). Always remember to take Brokerage and ACH fees into account when doing your calculations.

Another point I'll make in relation to being Exercised is to do with the timing of settlement of the underlying share. Normally share settlement is calculated as "T+3", however by the time the market next opens after you have found out that you have been Exercised, this only leaves you "T+2" until settlement is meant to occur. Fortunately, most Stockbrokers will manage things in such a way so that you don't need to worry about this 1 day difference. It is vital, however, to ensure that you act prior to the market close once you have found out that you have been Exercised. There is only this one-day window of opportunity should you need to buy and/or sell shares to be able to fulfill your obligation to the Option Taker.

It's a good idea to ask your Stockbroker if they have an automatic Exercise policy for Options that expire in-the-money. There is one other significant risk of Exercise which relates especially to "multi-legged" Option Positions as at the Expiry Date. (The Term "**Leg**" is used to refer to a single part of an Option Trade. For example, in our earlier example of buying a Strangle, the bought Call Option was one leg and the bought Put was a second leg. A Strangle therefore is a two-legged strategy). Let's say you have a "**Bull Put Spread**" (this is another one of the strategies that I will describe in Part 2 of this EBook) which is a common two-legged strategy. I'll assume this is your actual trade:

XYZ currently trading at $10.00 per share:
"Sell to Open 5 XYZ December $10.00 Put Options & also Buy to Open 5 XYZ December $9.00 Put Options at a combined limit price of 25c net credit"

Let's say XYZ basically drifts sideways and finally the December Expiry Date comes a long and XYZ fluctuates during the day from $9.95 to $10.15, finishing up at exactly $10.02. Clearly, your $9.00 Put Options will expire worthless and you might be excited to think that your $10.00 Put Options are just out-of-the-money and therefore they will also expire worthless. Whilst this is quite likely to be the case, let's consider what happens if someone actually had decided to Exercise their $10.00 Puts and therefore you discover on the next trading day that you are forced to buy 5,000 XYZ Shares @ $10.00 each…

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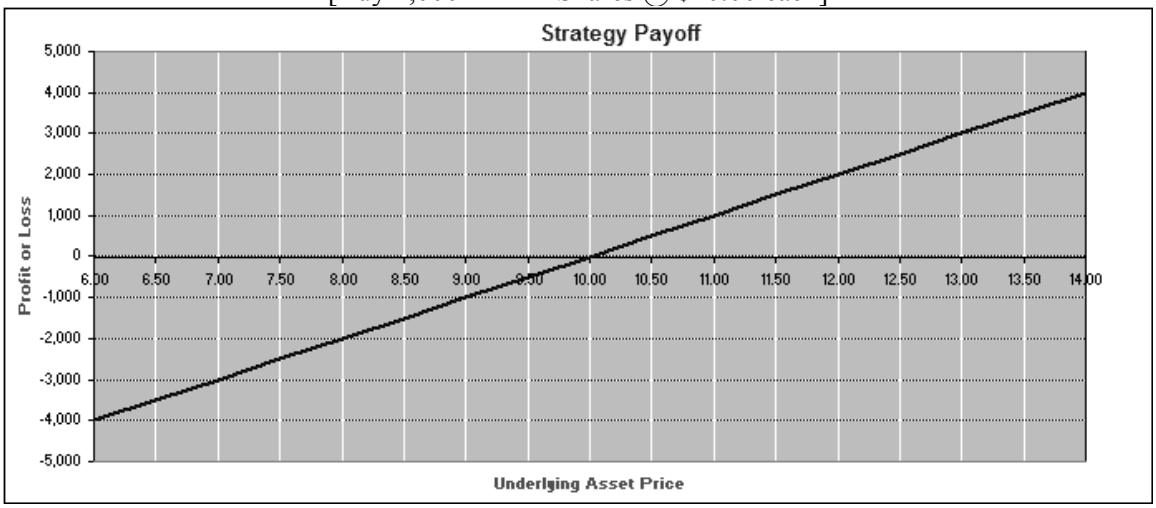
Part 2 – **Basic Option Trades, Combinations & Comparisons**

The idea of the following tables and charts is to help give you an excellent understanding of which types of trades may be more (or less) suited to any given market conditions that you are seeking to profit from. Firstly, let's start with one of the most basic positions of all which we should all be very familiar with:

Example – **Bought Share:**

[Buy 1,000 x XYZ Shares @ $10.00 each]



Introduction: This is a simple Payoff Diagram showing the potential for Profit or Loss, based on purchasing 1,000 Shares at $10.00 each. The diagonal line shows the actual amount of Profit or Loss based on variations of the current share price (the Share Price is shown along the X-axis). The Y-axis lists a range of potential Profit (the top half of the chart) or Loss (the lower half of the chart) amounts.

For example, if the Share Price moves up to $12.00, you should be able to clearly see that your profit at this point in time is $2,000.00. If the Share Price fell to $7.00, the chart shows that you will have lost $3,000.00. Finally, whilst the share remains at $10.00, this is the "break-even" point. I will use this style of diagram from this point forward to help show you the profit and loss characteristics of various Option positions.

Outlook: You would only wish to place this trade if your view was: **Bullish**
Max Profit: Potentially Unlimited!
How to Profit: A rising price of the share directly relates to an equivalent profit cent for cent based on the number of shares purchased. Receipt of dividends also enhances returns, however often the share price falls (hopefully just temporarily) on the ex-dividend date, thereby offsetting to a degree the benefit of the dividend paid.
Max Loss: Potentially your entire investment in the Share (if the Share Price fell to $NIL).
Cause of Loss: Bearish Market action. As the share falls in value, this position rapidly loses.
Break-even:: Simply the purchase price of the Shares.
e.g. Synthetic: Long Call Option + Short Put Option (see Strategy 15).

Strategy 1 – **Bought Call Option (at-the-money):**

[Buy to Open 1 x XYZ $10.00 Call Option]

Description: Purchasing a Call Option is a basic strategy which has limited risk (which can be calculated upfront) and a potentially unlimited profit on a significant bullish move in the underlying share price.

Outlook: This trade performs best when your view is: **Strongly Bullish**

Max Profit: Potentially Unlimited!
How to Profit: The Call Option should increase in value on a sufficiently bullish move that occurs quickly enough.
Max Loss: Limited to the total Premium paid for the Call Option.
Cause of Loss: Neutral or Bearish Market action. Also may fail if Bullish move is too small.
Break-even: The Strike Price of the Call Option plus the Premium paid.
Time Decay: Hurts this Trade. The sooner the bullish move, the better!
Volatility: Rising Volatility helps this trade, whereas falling Volatility hurts the trade.
e.g. Synthetic: Long Shares + Long Put Option (see Strategy 14).

Notes: As Time Decay works against this trade, it is usually not advisable to buy Call Options with less than 2 months remaining until Expiry. This is because Time Decay works at its fastest rate in the last few weeks of an Option's life. Also, be careful not to purchase Call Options at a time of high Volatility, unless you are very confident of a significant bullish move.

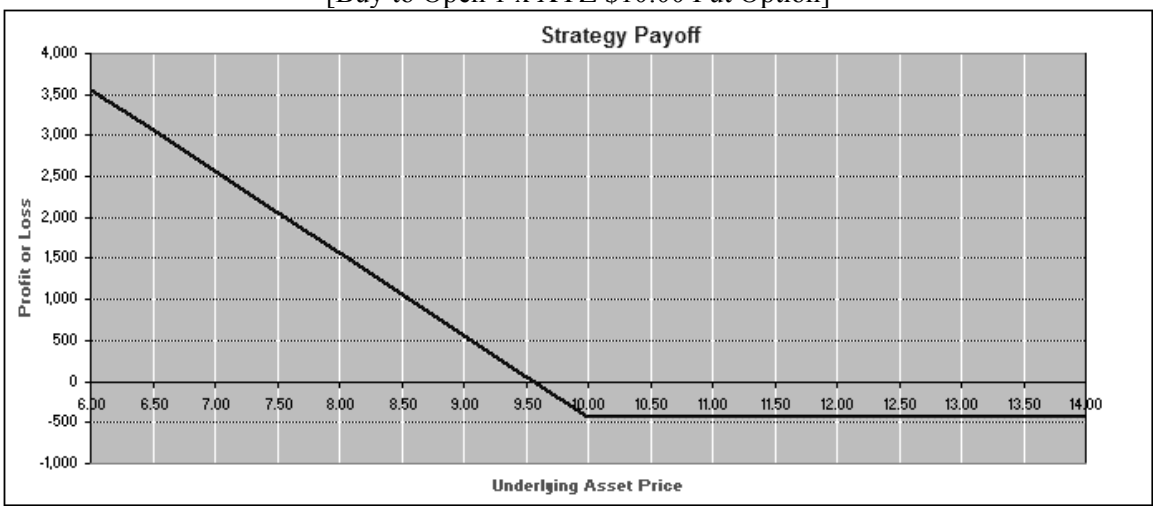
Variations: **out-of-the-money** **in-the-money**

(Smaller risk amount, but bigger move required)

(Larger risk amount, but smaller move required)

Strategy 2 – **Bought Put Option (at-the-money):**

[Buy to Open 1 x XYZ $10.00 Put Option]



Description: Purchasing a Put Option is a basic strategy which has limited risk (which can be calculated upfront) and a potentially almost unlimited profit on a significant bearish move in the underlying share price.

Outlook: This trade performs best when your view is: **Strongly Bearish**

Max Profit: Potentially almost Unlimited! (The underlying share can't fall below $NIL).
How to Profit: The Put Option should increase in value on a sufficiently bearish move that occurs quickly enough.
Max Loss: Limited to the total Premium paid for the Put Option.
Cause of Loss: Neutral or Bullish Market action. Also may fail if Bearish move is too small.
Break-even: The Strike Price of the Put Option minus the Premium paid.
Time Decay: Hurts this Trade. The sooner the bearish move, the better!
Volatility: Rising Volatility helps this trade, whereas falling Volatility hurts the trade.
e.g. Synthetic: Short Shares + Long Call Option.

Notes: As Time Decay works against this trade, it is usually not advisable to buy Put Options with less than 2 months remaining until Expiry. This is because Time Decay works at its fastest rate in the last few weeks of an Option's life. Also, be careful not to purchase Put Options at a time of high Volatility, unless you are very confident of a significant bearish move.

Variations: **out-of-the-money** **in-the-money**

(Smaller risk amount, but bigger move required)

(Larger risk amount, but smaller move required)

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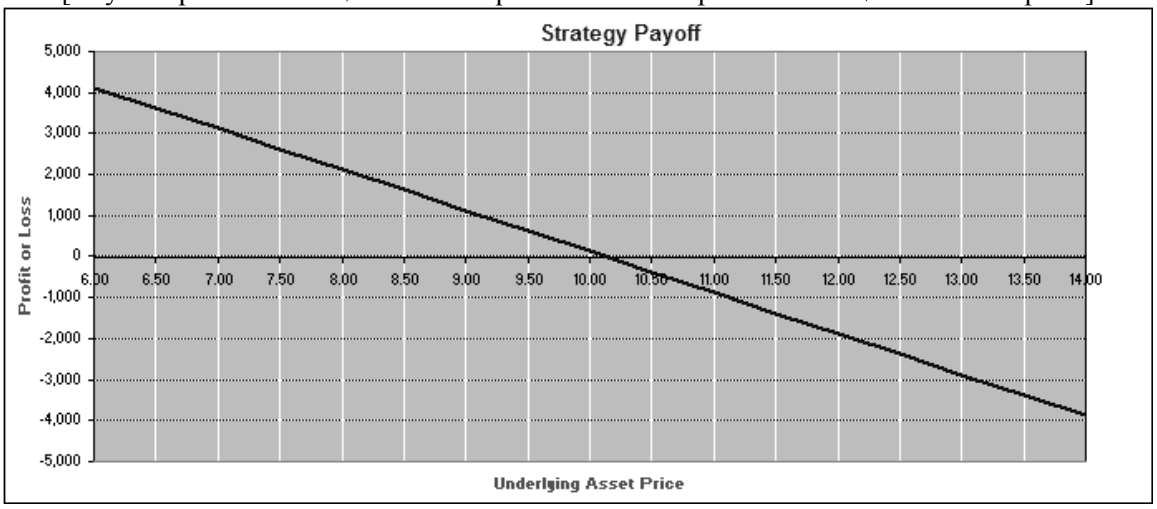
Strategy 15 – **Synthetic Long Stock (Buy Call Option + Sell Put Option):**

[Buy to Open 1 x XYZ $10.00 Call Option & Sell to Open 1 x XYZ $10.00 Put Option]

Description: This is simply another way of having an equivalent position to owning the underlying share, however the trade will cost you little more than the Margin Requirement for the Sold Puts, instead of outlaying the full purchase price of the shares! Early Exercise risk exists if the Share price moves below the Sold Put's Strike Price. Bear in mind that you won't receive any dividends as you do not actually own the underlying share (unless you Exercise your Call Option!)
*** ***Warning*** *** This position involves selling Naked Put Options!

Strategy 16 – **Synthetic Short Stock (Buy Put Option + Sell Call Option):**

[Buy to Open 1 x XYZ $10.00 Put Option & Sell to Open 1 x XYZ $10.00 Call Option]



Description: Here is a simple, yet effective way to take the equivalent position to "Short Selling" the underlying share. The only cost to you in maintaining the position will be the ongoing Margin Requirement for the Sold Calls.
*** ***Warning*** *** This position involves selling Naked Call Options!

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Part 4 – **Online Resources Section:**

Here is the main web-site for the Australian Stock Exchange. It is actually an excellent online resource, packed full of some extremely useful information, many interesting articles, Option Lists & Price Quotes, etc... They have links scattered all around the place, so sit back, relax, and take your time exploring what they have to offer:
http://www.asx.com.au

This is the start page I normally use at the ASX web-site (it is their main Options page, and has many useful links on it):
http://www.asx.com.au/investor/options/index.htm

To find out more about Options, the ASX also provides some free downloadable Option Booklets. You can find them at this web-address:
http://www.asx.com.au/investor/options/booklets.htm
Some of the titles include: "Options fact sheet", "Options – a simple guide", "Index options", "Options Margin Lending", "Understanding Options Trading", "Margins", "Understanding Options Strategies", "Differences between options and warrants".

There is also a great section known as the "Options strategy library". Here is a direct link to it:
http://www.asx.com.au/investor/options/how/library/index.htm

Another really handy part of the ASX web-site that I visit regularly is this area:
http://www.asx.com.au/investor/options/trading_information/index.htm
In particular look for "Declared dividends on ETO stocks", "Dividend and Volatility Estimates", "Monthly Statistics", "Market Makers".

This is a great free web-site which is useful for looking up historic dividend data and also historic price quotes on both shares and Options over the last 12 months. The data is available in the form of simple online charts or as a table showing the Open, High, Low and Close prices of each day for the past year as well as the volume traded. This applies to both shares and Options. All you need is the individual ASX Code for the share or Option you are interested in:
http://www.tradingroom.com.au

Another free web-site, this being the Australia & New Zealand finance section of Yahoo. Has some useful data available including "Research", which gives you some earnings estimates and access to other fundamental information online. It even includes Broker recommendations, although I always recommend making your own trading decisions!
http://au.finance.yahoo.com

Following are some of the "less common" sites that I have found to be quite useful…

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The complete EBook consists of 83 pages of useful and fascinating information – including many topics that are ***not*** discussed elsewhere in other Option Trading books.

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http://www.number.com.au/forum/viewtopic.php?p=2234#2234

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If you know someone else that you think may benefit from the information contained in this EBook, you are most welcome to pass on this free sample version to them.

(Providing that no part of this document is edited, omitted or added-to in any way)

"I would just like to congratulate you on a "sensational" ebook, i finally got through it (my head is overloading lol) but its something that put a ultra complex information overload into a very simplistic format…" –Adrian (NSW)

"I have spent this morning going reading through your book. I am very impressed. I like it and I found it very informative." –Edward (NSW)

"This is what I've really been looking for; a relatively detailed and clearly explained (and compared!) list of the more common Options strategies... this is fantastic! :-)" –Donovan (SA)

