VectorVest

Welcome To The VectorVest Basic Options Course

Basic Options Course - Agenda

Session 1 - Introduction to Options

Session 2 - Options and the VectorVest System

Session 3 - Buying Long to Open

Session 4 - Selling Short to Open

Session 5 - Covered Calls as a Strategic Income Source

Session 6 - Putting it all Together and Q&A Session

VectorVest

Session One

Introduction To Options

Stock Options

Stock options provide the *right*,
but not the obligation, to buy or sell units
of 100 shares of stock at a *certain price*
by a *certain date*.

Options Terminology

Types of Options

There are only two types of options:

Calls and Puts

Call Options

<u>Call Options</u>: Provide the right to buy units of 100 shares of stock at a certain price by a certain date.

<u>Call Options</u>: Increase in value when the price of the underlying stock rises.

Put Options

Put Options: Provide the right to sell units of 100 shares of stock at a certain price by a certain date.

Put Options: Increase in value when the price of the underlying stock falls.

Options vs. Stocks

Option Characteristics

vs.

Stocks

Options vs. Stocks

Less Capital

Options generally cost about 10% of the price of the underlying stock.

Options vs. Stocks

More Leverage

A 5 point increase in an $80 stock

would give a 6.25% gain.

A 5 point increase in an $8 Call option would give a 62.5% gain.

Options vs. Stocks

Lower Risk*

Options control a given number of shares of stock with substantially less investment exposure.

* Long Positions Only.

Options vs.Stocks

<u>Time Dependent</u>

Every option has an expiration date, and, therefore, is a depleting asset.

Options vs. Stocks

<u>Higher Probability of Loss</u>*

Most options are not exercised, and, therefore, expire worthless.

*Long Positions Only

Options Terminology

Placing An Option Order

"I want to buy to open 10 Microsoft Dec 45 Calls @ 2.60 or better. Good for the day."

Options Terminology

10 Microsoft Dec 45 Calls @ 2.60

1. 10 **Contracts** equals 1000 shares.
2. **Name** of the underlying stock.
3. **Expiration date**, (Duration).
4. **Strike Price** of the option, and
5. **Type** of option.
6. **Option Premium**, per share of options.

Options Terminology

1 Contract = 100 Shares

An equity option's contract size is ordinarily 100 shares. To purchase the right to control 1,000 shares of an underlying stock, one buys 10 Option Contracts: (10 Contracts x 100 Shares each = 1,000 Shares)

Options Terminology

Expiration Date

The date on which the owner of the option ceases to have the right to buy or sell the underlying stock as conveyed by that option, which is the Saturday following the third Friday of each month. There are four expiration months available on each option equity.

Options Terminology

Strike (Exercise) Price

The price at which the owner of a **Call** option has the right to **buy** the underlying, and the owner of a **Put** option has the right to **sell** the underlying.

Option Pricing

Rule of Thumb

At-the-money option prices, six months out, typically run about 10% of a stock's price.

Option Pricing

Limit Orders

You will always pay the higher of the Bid and Asked prices to buy and receive the lower of the Bid and Asked prices to sell, so use Limit Orders at all times.

Option Pricing

Option Premium

The price a buyer pays for an option.

Price = Intrinsic Value + Time Value

Option Pricing

Intrinsic Value of a Call

= Stock Price - Strike Price

In-The-Money: Stock Price > Strike Price.

At-The-Money: Stock Price = Strike Price.

Out-of-the-Money: Stock Price < Strike Price.

Option Pricing

Stock Price	Strike Price	Status	Intrinsic Value
40	30.00	ITM	
35	30.00	ITM	
30	**30.00**	**ATM**	**0.00**
25	30.00	OTM	
20	30.00	OTM	

Option Pricing

Intrinsic Value of a Put

= Strike Price - Stock Price

In-The-Money: Strike Price > Stock Price.

At-The-Money: Strike Price = Stock Price.

Out-of-the-Money: Strike Price < Stock Price.

Option Pricing

Stock Price	Strike Price	Status	Intrinsic Value
40	30.00	OTM	
35	30.00	OTM	
30	**30.00**	**ATM**	**0.00**
25	30.00	ITM	
20	30.00	ITM	

Option Pricing

Time Value

The amount a buyer is willing to pay for an option above its intrinsic value.

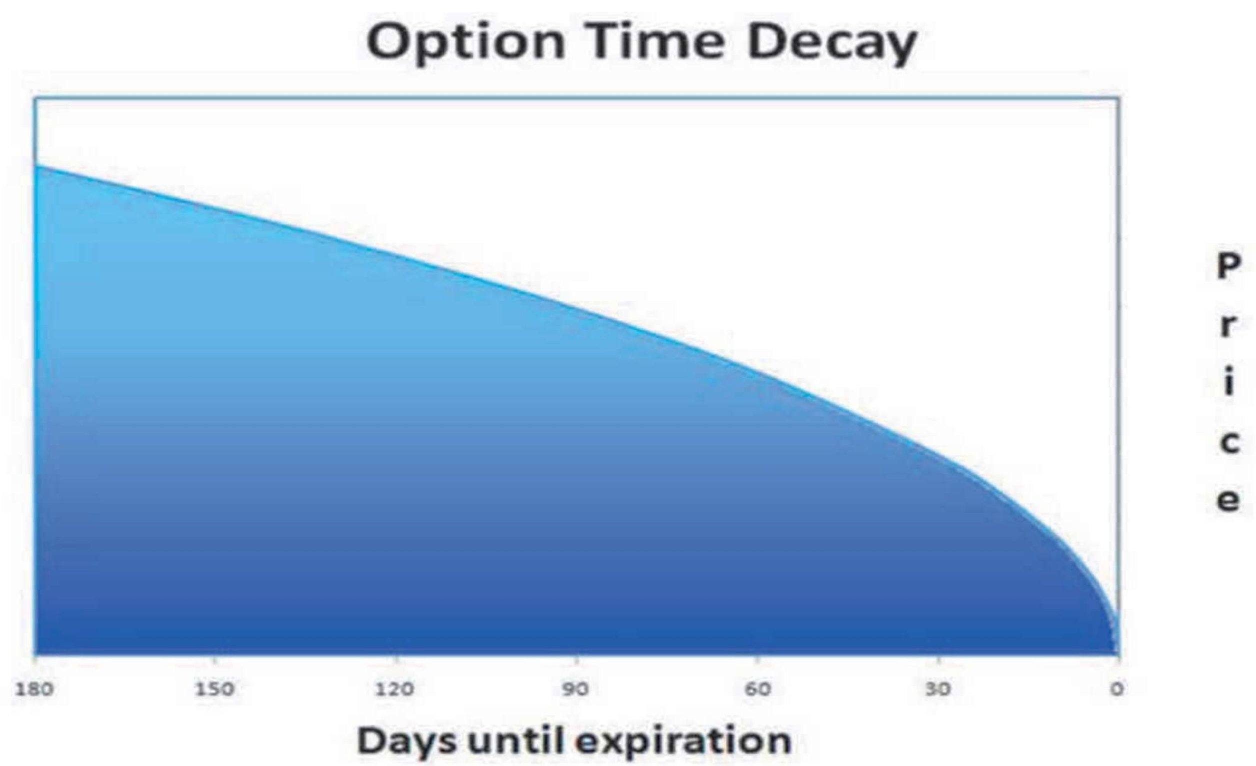
Time Value = Premium – Intrinsic Value

Option Pricing

Time Value

The Time Value component of an options premium is greatest when the stock price and strike price are the same, i.e., at-the-money.

Option Pricing



Option Pricing

Stock Price Behavior

Statistical theory says that at any given moment, the odds are 50/50 as to which direction a stock's price is likely to go.

Option Pricing

Volatility

Measures the fluctuation of a stock's price movement in a given period of time. It is expressed in terms of annualized percentage change, i.e., percent/year.

Option Pricing

Which Stock is most Volatile?

Stock	52 Week High	52 Week Low	52 Week Avg.
GILD	110.64	58.81	84.72
WMT	81.37	71.51	76.44
MS	35.23	26.41	30.82

Option Pricing

Approximate Volatility

= 100 x (52WkHigh – 52WkLow) / (52WkAvg)

GILD = 61.17%

MS = 28.61%

WMT = 12.91%

Option Pricing

Volatility

The probability that a stock's price will rise above or fall below a given price increases as volatility goes higher.

Volatility Analysis

Implied Volatility

The estimated volatility of a security's price. In general, implied volatility increases when the market is bearish and decreases when the market is bullish. This is due to the common belief that bearish markets are more risky than bullish markets.

Volatility Analysis

High Implied Volatility vs. Low Historical Volatility is Good for the Option Seller

Low Implied Volatility vs High Historical Volatility is Good for the Option Buyer

Option Pricing

The Greeks

- Delta: Amount that an option's value changes per dollar of stock price change.
- Gamma: Amount that Delta changes per dollar of stock price change.
- Theta: Amount that an option's value changes per unit change in time.
- Vega: Amount that an option's value changes per unit change in volatility.
- Rho: Amount that option value changes per 1% change in interest rates.

Premium vs. Strike & Expiration

WAG @ $64.78/Share on 02/14/14*

Call Strike	February	March	April	May
60	4.81/97	5.37/82	5.93/76	6.42/73
62.5	2.57/81	3.57/67	4.28/64	4.86/63
65	0.98/48	2.19/50	2.95/51	3.56/52
67.5	0.24/17	1.23/34	1.75/38	2.54/41
70	0.05/03	0.63/20	1.23/28	1.75/32

***Premium/Delta**