

# 3 Smart Ways to Make Money with

# OPTIONS

(Two of Which You Probably Never Heard About)

The background features a financial options trading interface with a green tint. A hand is visible pointing at the data. The interface includes a table of options with columns for Symbol, Bid, Ask, Type, Last, Change, Vol, Op Int, and Strike. The table lists various call options with symbols like +QAAEC, +QAAED, +APVEE, +APVEF, +APVEG, and +APVEH. The text 'NS = Non-standard' and 'S = Standard' is also visible. The date 'Jun 20 2009' is shown in the bottom right corner.

Symbol	Bid	Ask	Type	Last	Change	Vol	Op Int	Strike
+QAAEC	12.50	12.65	S	12.60	1.05	0	16,533	115.00
+QAAED	8.15	8.25	S	8.10	0.90	0	40,413	120.00
+APVEE	4.50	4.60	S	4.60	0.70	0	34,492	125.00
+APVEF	2.06	2.10	S	2.09	0.28	0	41,215	130.00
+APVEG	0.74	0.77	S	0.76	0.05	0	24,638	135.00
+APVEH	0.23	0.26	S	0.25	0.04	0	18,213	140.00

by Kevin Matras

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# Introduction

The stock market is full of opportunity, but also risk.

While the 7+ year bull market is in full swing, it has not been without its ups and downs.

Nowadays, volatility is just par for the course. Record gains notwithstanding, it can make investing more stressful than ever before.

Everything seems to be moving so much quicker these days. And the moves, in either direction, seem so much bigger.

So what does one do?

The answer is to be smarter.

Learn how to incorporate new trading techniques and strategies into your portfolio for today's and tomorrow's market.

Strategies that can both help reduce your risk and increase your returns, all at the same time.

Strategies that can make money in both up, down, and sideways moves.

And strategies to profit even when you're wrong about the direction of the market.

All for less money than what it would cost to get into the stock itself.

Those strategies I'm talking about involve the use of options.

In the following pages, we'll discuss three of those strategies that can help you do just that.

These three option strategies are my favorite ones to use. And it's time to get excited because two of these strategies I'll bet most have never even heard about, or at least had it explained. Until now.

So let's begin.



Kevin Matras  
Zacks Investment Research, Inc.

# Buying Calls and Buying Puts

Not all stocks are created equal.

Some will go up and some will go down and some will just go sideways.

And that's perfectly alright.

With options, you can take advantage of all of these scenarios.

Buying calls and buying puts is one of the most common ways investors trade options.

If you believe the price of a stock will go up, you can buy a call option on it and make money as it goes higher.

If you believe the price of a stock will go down, you can buy a put option on it and make money as the price goes lower.

Before I continue, let me go over some definitions.

## Options Definitions

Please read the following option definitions. It will help you fully understand the strategies outlined in this booklet.

### Call Option:

A call option gives the buyer the right (but not the obligation) to buy a stock (typically 100 shares) at a certain price within a set period of time.

### Put Option:

A put option gives the buyer the right but not the obligation to sell a stock (100 shares) at a certain price within a set period of time.

### Premium:

The amount paid (if buying) or collected (if writing) for the option.

### Strike Price:

The price on an option contract at which you can exercise your right to buy or sell the stock.

**Buy a Call Option if you believe  
the stock will go up.**

**Buy a Put Option if you think  
the price will go down.**

**In-the-Money:**

For a call option, an in-the-money option is a strike price below the current price of the stock. It's said to be 'in-the-money' because it has intrinsic value.

If a stock was trading at \$50 a share, a call option with a strike price of \$45 would be in-the-money.

For a put option, it's a strike price above the current price of the stock.

If a stock was trading at \$50, a put option with a strike price of \$55 would be in-the money.

(The term in-the-money is often times abbreviated as ITM.)

**At-the-Money:**

For both a call and a put option, it's a strike price that's at the same current price of the stock.

(The term at-the-money is often times abbreviated as ATM.)

**Out-of-the-Money:**

For a call option, it's a strike price above the current price of the stock.

This option has no intrinsic value and is only comprised of time value or extrinsic value.

If a stock was trading at \$50, a call option with a strike price of \$55 would be out of the money.

For a put option, it's a strike price below the current price of the stock.

If a stock was trading at \$50, a put option with a strike price of \$45 would be out-of-the money.

In-the-money options have greater deltas and out-of-the-money options have smaller deltas.

(The term out-of-the-money is often times abbreviated as OTM.)

**Delta:**

This is the percentage the option will increase or decrease in value in relation to the underlying price movement of the stock.

A delta of .60 for example, means the option will move (or change in value) equal to 60% of the underlying stock's price change, meaning a \$1.00 rise in the stock should see a 60 cent rise in the option premium. The delta changes as the stock rises and falls.

**Intrinsic Value:**

The difference between a option's strike price (that's 'in-the-money') and the current price of the stock.

For example: if a stock was trading at \$50, and a \$45 call option with 30 days of time left on it was selling for \$6.50 (or \$650, which is \$6.50 x 100 shares), that option would have \$5 (or \$500) of intrinsic value.

$$[\$50 \text{ (stock price)} - \$45 \text{ (strike price)} = \$5 \text{ (intrinsic value)}]$$

**Time Value (aka extrinsic value):**

The amount of the premium that's not comprised of intrinsic value. This part of the premium is said to be your 'time value'.

Using the same example as above, that same option would have \$1.50 or \$150 of time value or extrinsic value.

$$[\$6.50 \text{ (premium)} - \$5 \text{ (intrinsic value)} = \$1.50 \text{ (extrinsic value or time value)}]$$

**Expiration:**

This is the last day an option contract can be traded. At expiration, an option's only worth is its intrinsic value. Since there's no time left to hold your option to buy or sell, there's no more time value or extrinsic value left. And 'at-the-money' and 'out-of-the-money' option would expire worthless.

**Exercise:**

The time in an options trade (usually at expiration) when the underlying stock is assigned to either the buyer or the writer based on the rights and obligations of the transaction. Exercise usually takes place for in-the-money options. Most brokerage companies will automatically exercise in-the-money options at expiration unless notified otherwise.

The expiration date for most options is effectively the 3rd Friday, of the month of the option.

## Buying Calls

Options give an investor tremendous amounts of leverage, allowing someone to speculate on a stock without putting up a lot of money. And for the option buyer, this also comes with a guaranteed limited risk, which is confined to your purchase price (or premium) plus any applicable commissions and fees.

Let's take a look at how buying a call option works.

For example: let's say you were interested in a stock that was trading at \$90 per share.

Buying \$100 shares of a \$90 stock would require a \$9,000 investment.

But instead, you might be able to buy a \$90 at-the-money call option for an \$8.00 premium (which means  $\$8 \times 100$  shares or \$800). That's a significantly smaller investment with a guaranteed limited risk.

If for example the price of the stock fell \$20 to \$70 a share, your stock investment would have lost \$2,000.

However, at expiration, the maximum you could lose on your option investment would be only \$800 (plus your commission and fees).

The option gives you great upside as well.

A \$20 move up in the stock price to \$110, would mean a \$2,000 increase in your stock investment.

However, at expiration, that \$90 call option would be \$20 in-the-money, meaning it has \$20 of intrinsic value, or \$2,000.

\$2,000 less your \$800 premium is a \$1,200 profit or 150% gain.

The \$2,000 gain on your \$9,000 investment represents a 22% gain.

Now let me say that options aren't a panacea. Too many people use options recklessly by loading up on cheap out-of-the-money options that ultimately expire worthless. And even though they have a limited risk (limited to what you put in), if you put everything in there, you run the risk of losing it all.

But smart options trading in my opinion has a respectable place in one's portfolio.

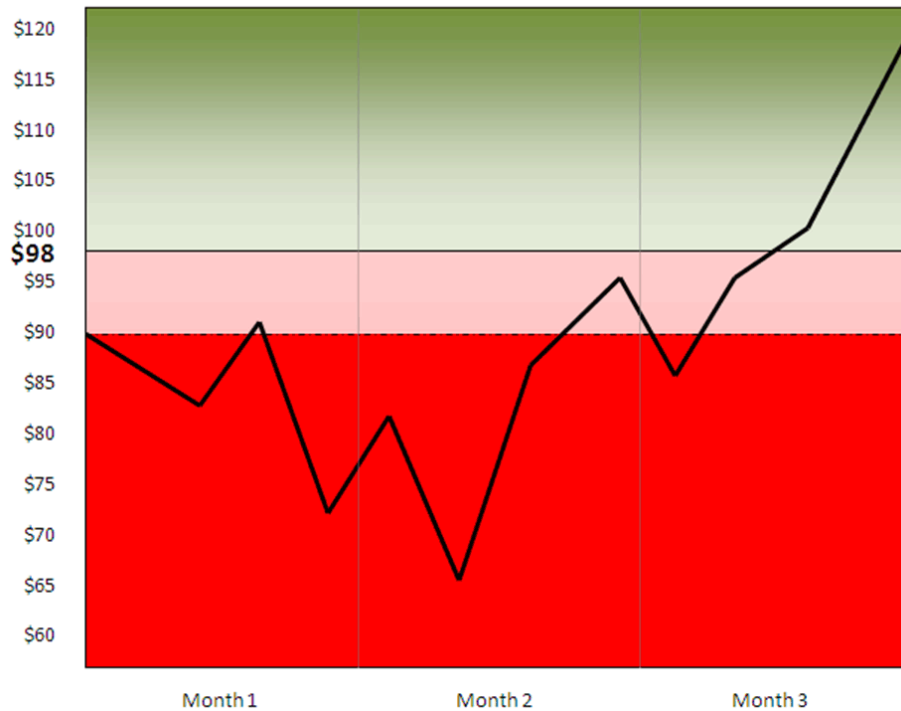
And only invest in an option what you absolutely can afford and would be 'willing' to lose if your assumptions on the market are incorrect.

Before we move on, let's take a closer look at the above call option example.

Once again, the stock is trading at \$90 and you decide to buy a \$90, at-the-money call option,

with 3 months of time on it, for an \$8.00 premium (which means \$8 x 100 shares or \$800).

Take a look at the image below.



- At expiration, the stock needs to be over \$98 in order to show a profit above your investment premium. (See the green shaded area.)
- Why? Because you paid \$8 for the right to buy 100 shares of stock at \$90. If it goes to \$98, that's an \$8 move. At expiration, a move to just \$98 would result in a breakeven trade (less trading costs).

**\$8 x 100 shares = \$800**

*(that's what you paid for the option in the first place, giving you neither a profit or a loss)*

You would need to see a move above \$98 to make a profit. The higher it goes, the bigger your gain. A move to \$110 is a \$20 move.

**\$20 x 100 shares = \$2,000**  
**less \$800 premium = \$1,200 gain**

You can either sell the option at that higher premium or you can exercise it and purchase the underlying shares at the agreed upon strike price. Please remember, that if you do not sell your in-the-money option at expiration, your brokerage company will likely automatically exercise it for you.



- If at expiration, the stock is above \$90 but below \$98, you will have a loss of SOME of your investment premium but not all. (This is represented on the chart in light red area.)

Why? Because your option still has some intrinsic value. The amount your option would be worth would be the difference between the strike price (\$90) and the stock price. For example: if the price of the stock was trading at \$96.50, your option would be worth \$6.50 or \$650.

$$\begin{aligned} &\$96.50 \text{ (stock price)} - \$90 \text{ (strike price)} = \$650 \\ &(\$800 \text{ premium} - \$650 \text{ value} = -\$150 \text{ loss}) \end{aligned}$$

- If at expiration, the stock is below \$90, you will have a loss of ALL of your investment premium. (Displayed in dark red.)

Why? Since there's no more time left, there's no time value. And since there's no intrinsic value either, the option would expire worthless.

The benefit of course is that that's all you can lose. No matter how low the market goes, you can only lose the amount you paid for the option, plus your trading cost. Never any more, unlike a stock, where your losses will get bigger the lower the stock falls. Of course, with a stock purchase, there's no time limit as to how long you can hang onto it though.

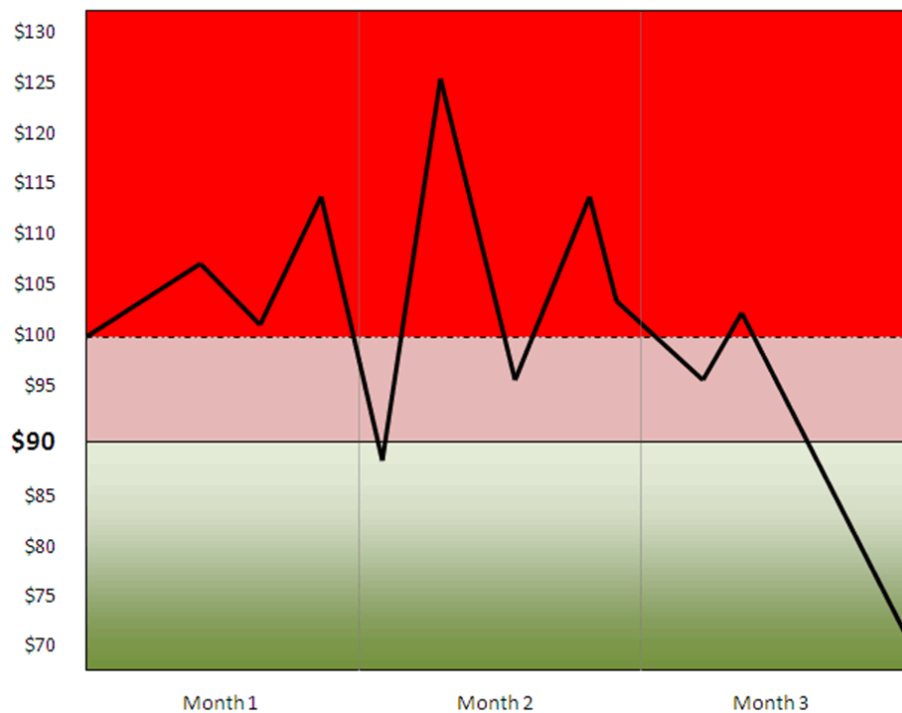
- I should also mention too that you don't have to hold onto the option until expiration. It's completely liquid and you can sell it at any time before it expires. Doing so will let you benefit from both intrinsic value (if there is any) and time value as well.

## Buying Puts

A put option works the same way except you're profiting if the market goes down.

Let's say a stock is at \$100 and you buy a 3-month, \$100 put option, for a premium of \$10 (i.e., \$10 x \$100 a share = \$1,000).

Let's look at the image below.



- At expiration, the stock needs to fall below \$90 in order to show a profit (in green) beyond your investment premium.

Why? Because you paid \$10 for the right to sell 100 shares of stock at \$100. If it goes to \$90, that's a \$10 move. At expiration, a move to just \$10 would result in a breakeven trade (less trading costs).

**\$10 x 100 shares = \$1,000**

*(that's what you paid for the option in the first place, giving you neither a profit or a loss)*

You would need to see a move below \$90 to make a profit. The lower it goes, the bigger your gain. A move to \$70 for example is a \$30 move.

$$\begin{aligned} & \$30 \times 100 \text{ shares} = \$3,000 \\ & \text{less } \$1,000 \text{ premium} = \$2,000 \text{ gain} \end{aligned}$$

You can either sell the option at that higher premium or you can exercise it and sell the underlying shares at the agreed upon strike price. Please remember, that if you do not sell your in-the-money option at expiration, your brokerage company will likely automatically exercise it for you.

- If at expiration, the stock is below \$100 but above \$90 (light red), you will you will have a loss of SOME of your investment premium but not all.

Why? Because your option still has some intrinsic value. The amount your option would be worth would be the difference between the strike price (\$100) and the stock price. For example: if the price of the stock was trading at \$93, your option would be worth \$7 or \$700.

$$\begin{aligned} & \$100 \text{ (strike price)} - \$93 \text{ (stock price)} = \$700 \\ & (\$1,000 \text{ premium} - \$700 \text{ value} = -\$300 \text{ loss}) \end{aligned}$$

- If at expiration, the stock is above \$100 (dark red area), you will have a loss of ALL of your investment premium.

Why? Since there's no more time left, there's no time value. And since there's no intrinsic value either, the option would expire worthless.

The benefit of course is that that's all you can lose. No matter how high the market goes, you can only lose the amount you paid for the option, plus your trading cost. Never any more, unlike a stock, where your losses will get bigger the higher the stock goes up. Of course, with stocks, there's no time limit as to how long you can hang onto it though.

- Once again, I should mention that you don't have to hold onto the option until expiration. It's completely liquid and you can sell it at any time before it expires. Doing so will let you benefit from both intrinsic value (if there is any) and time value as well.

Another benefit to buying put options is that it's a great alternative to short-selling.

Some people simply do not want to short sell a stock either because they are simply uncomfortable in doing so, or their account is not set up for margin, or they are in a qualified account (i.e., retirement account) and can't, or their brokerage can't borrow the shares to facilitate a short sale.

Either way, all of these conditions make buying put options a great alternative for betting that a stock will go down.

# Covered Call Writing

Covered call writing is an excellent strategy to use in both up, down and sideways markets.

This is a strategy used to reduce risk and generate income.

In fact, you can even execute a strategy like this in many retirement accounts.

So, let's review: buying an option gives you the right but not the obligation to purchase 100 shares of a stock at a certain price within a certain period of time.

The price you pay, let's say \$500, is the premium. In general, if the stock goes up, the call option will increase in value. If the stock goes down, it'll decrease in value. But your risk is limited to what you paid for the option. Even if the stock went to zero, you could never be on the hook for more than you paid for the option.

If you write an option, you're collecting that premium. Someone else is buying the right to own 100 shares of a stock at a certain price within a certain period of time. If that stock goes down and the option expires worthless, the buyer of the option loses -\$500. But the writer of the option, makes \$500.

For a covered call strategy, this is who we're going to be -- the writer.

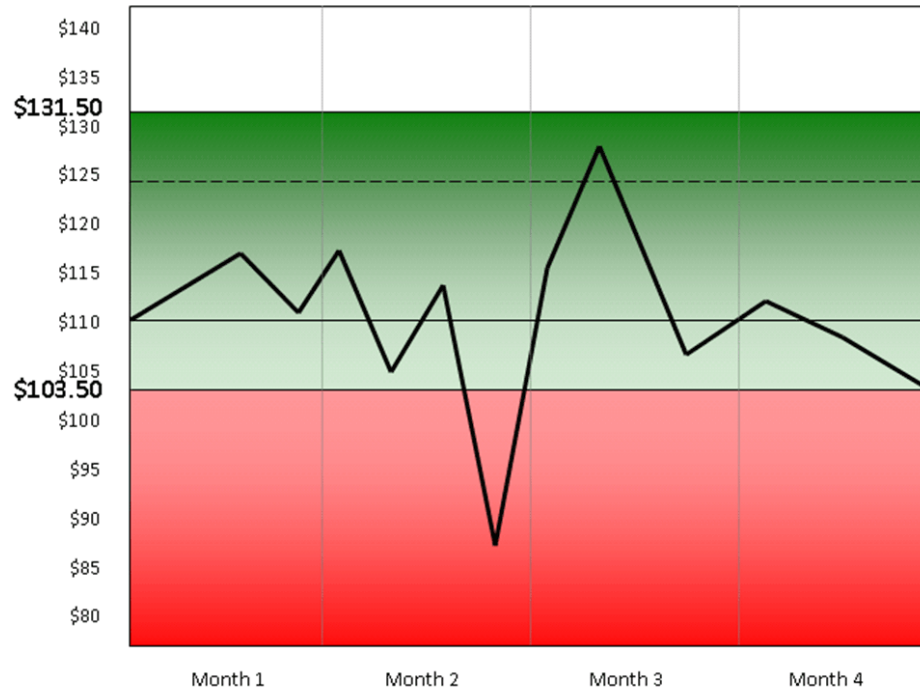
Let's say you have 100 shares of stock at \$110 for instance – for every dollar the stock goes up or down, your investment will increase or decrease by \$100.

Now let's say you wrote a 4-month, \$125 call option for a premium of \$6.50. (You stand to collect \$650.)

Let's go thru some examples.

## Example 1:

If the stock goes down \$6.50 to \$103.50, between when you wrote the option and expiration, you've just offset \$6.50 or \$650 worth of your downside risk.



How? Because if the stock went down \$6.50, your stock position just declined by \$650. But, at option expiration, you've gained \$650 on the option you wrote – essentially losing nothing even though your stock position declined by \$650.

$$\begin{aligned}
 &\$110 \text{ (stock purchase price)} - \$6.50 \text{ stock decline to } \$103.50 = -\$650 \text{ loss on stock} \\
 &\text{collected } \$650 \text{ (premium) for writing option} = \$650 \text{ gain on option} \\
 &-\$650 \text{ stock loss} + \$650 \text{ option gain} = \$0 \text{ (or breakeven)}
 \end{aligned}$$

The shaded green area represents your maximum profit zone (\$103.50 to \$131.50). The higher up in the zone, the more profitable your trade becomes.

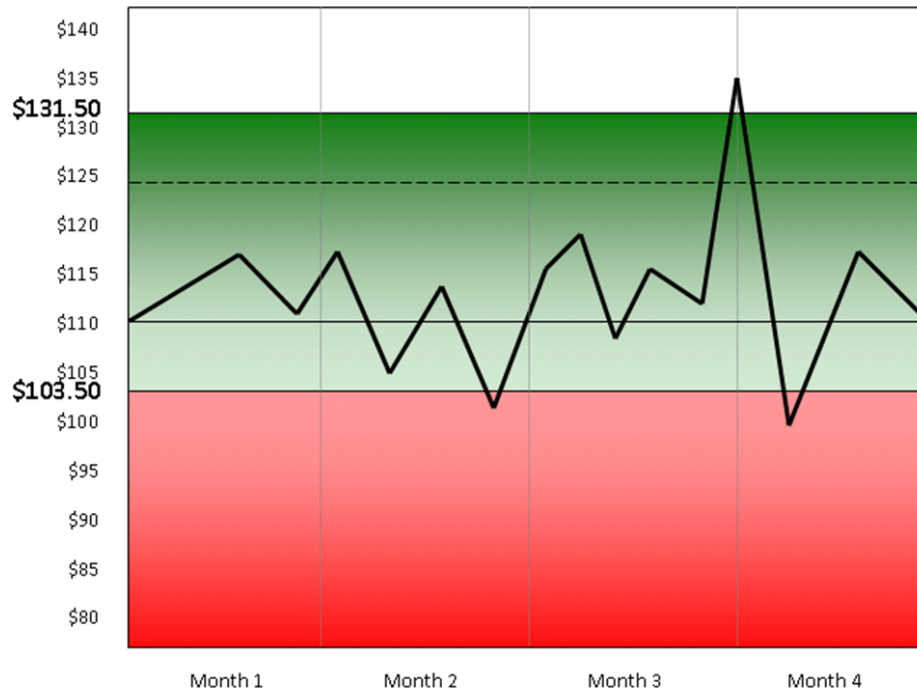
The lower you are in the zone, the less profitable your trade is, with \$103.50 being your zero dollar mark or breakeven mark.

Below \$103.50, your trade starts to lose money as the loss in your stock becomes greater than the downside protection the covered call provided.

But if you're worried about downside risk in your stocks, this is a great way to hedge some of it away and potentially make money at the same time.

## Example 2:

Now let's say the stock stays flat. It doesn't go up or down. Just stays at \$110. You haven't made anything or lost anything on that stock. But at expiration, that \$125 call option you wrote for \$650 would expire and be paid to you. So even though the stock didn't budge, you still made \$6.50 or \$650.



How? Because if the underlying stock at option expiration ended unchanged from where you purchased it at, that means the stock neither made nor lost anything. However, you also collected (kept) the entire \$6.50 premium or \$650 from writing the \$125 call option, resulting in an overall gain of \$650 on the trade (less trading costs).

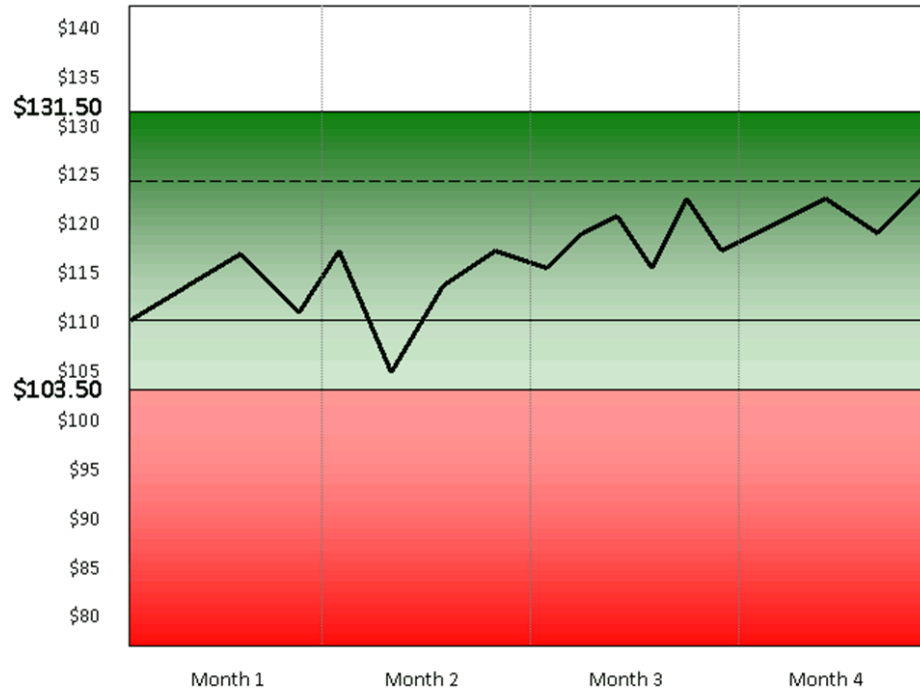
$$\begin{aligned}
 & \$110 \text{ (stock purchase price)} - \$110 \text{ (stock price at option expiration)} = \$0 \text{ change} \\
 & \text{collected } \$650 \text{ (premium) for writing option} = \$650 \text{ gain on option} \\
 & \$0 \text{ change in stock position} + \$650 \text{ option gain} = \$650 \text{ gain on trade}
 \end{aligned}$$

Once again, the shaded green area represents your maximum profit zone (\$103.50 to \$131.50). The higher up in the zone, the more profitable your trade becomes. The lower you are in the zone, the less profitable your trade is.

If the market enters into a period of sideways action, this is a great way to generate returns if your stocks get stuck in a sideways pattern as well.

### Example 3:

Now let's say the stock goes up instead. It rallies all the way up to \$125. That's even better. You've just made \$15 on your stock and that \$125 call you wrote will expire 'worthless' and you'll pocket \$650. Your grand total is now a \$21.50 gain or \$2,150 on a \$15 move.



How? Because the stock increased in price by \$15 for a \$1,500 gain. And at option expiration, you'll end up keeping the entire \$6.50 premium or \$650 you collected for writing the option. Even though the stock only increased by \$15, you would end up making \$21.50 in total, as both your stock and option made money, resulting in maximum profitability on the trade.

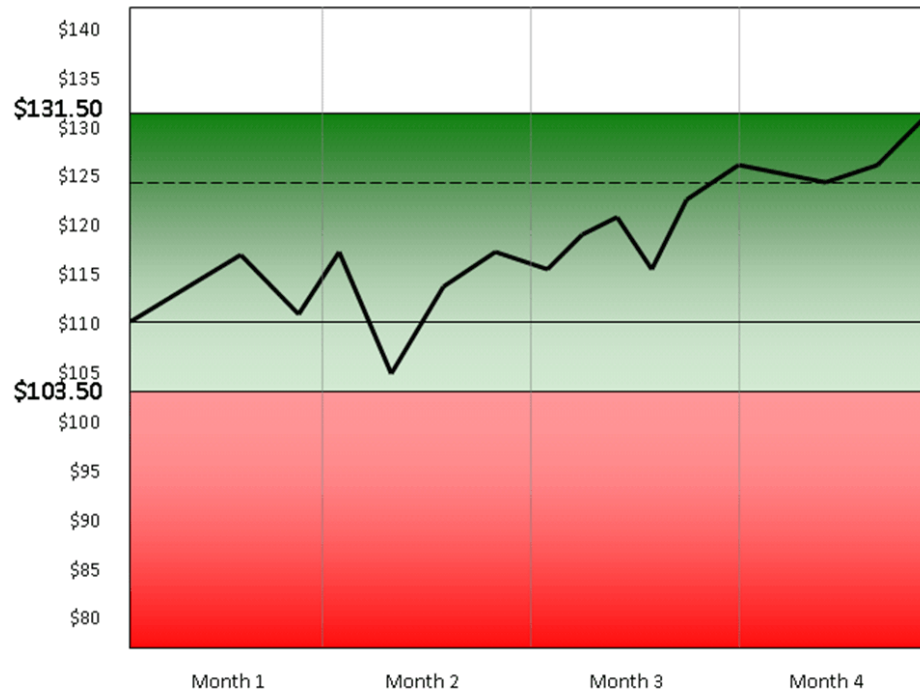
**\$110 (stock purchase price) to \$125 = \$15 price increase or \$1,500 gain on stock  
 collected \$6.50 (premium) or \$650 for writing option = \$650 gain on option  
 \$15 gain on stock + \$6.50 gain on option = \$21.50 or \$2,150 gain on trade**

As in the previous examples, the shaded green area represents your maximum profit zone (\$103.50 to \$131.50).

If the market goes up, you can profit on both the stock movement and the options income.

## Example 4:

In this example, let's say the stock rallies to \$131.50. Your profit is still \$21.50 or \$2,150 in total on the trade. But the way you arrive at that point of maximum profitability is a bit different than the example above.



Why? Your stock increased from \$110 to \$131.50 for a \$21.50 gain. But you're now giving up your option premium gain of \$6.50 on the \$125 call you wrote. At expiration, that \$125 call is now \$6.50 in-the-money, which means that option is actually worth \$650, which would go against your gains.

(Remember, when you're the purchaser of an option, you want the premium to increase in value. As the writer or grantor of an option, you want the premium to go down. An option that expires worthless represents the maximum loss for the buyer, but it also represents the maximum gain for the writer.)

As the option writer, you are obligated to deliver that stock at \$125, even though it's at \$131.50. That represents a 'loss' of -\$650. In this example, since you collected \$650 for writing the option in the first place, you're essentially giving it all back, either by getting the stock called from you at \$125 even though it's now at \$131.50 or by buying the option back at \$650, thus avoiding having your stock called away from you. So while you didn't really lose anything on the option, you also didn't gain anything either.



**Scenario 1:** As the option writer, you're obligated to sell that stock at the strike price you wrote (in this case \$125), even though the price of the stock is at \$131.50. This means you're essentially buying the stock at \$131.50 and selling it for \$125, for a loss of -\$6.50 or -\$650. This is offset by the premium you collected of \$650, making the option portion of the trade a wash.

**Scenario 2:** You can also choose to buy the option back before the stock is called from you. But the dollar result is the same. With the option now \$6.50 in-the-money, you'd have to pay \$6.50 or \$650 to offset your obligation on the call you wrote. If you collected \$650, but then paid \$650 to exit the trade, that's a net result of \$0 (less transaction costs).

**Note:** Most people don't get their stock called away from them. Usually they'll simply buy that option back before it expires.

You have the same maximum profitability in this overall example going to \$131.50 as in the previous example (Example 3) where it went to \$125. But this time, your profit on the trade is coming from just the stock increase and not from the option.

$\$110$  (stock purchase price) to  $\$131.50 = \$21.50$  price increase or  $\$2,150$  gain on stock

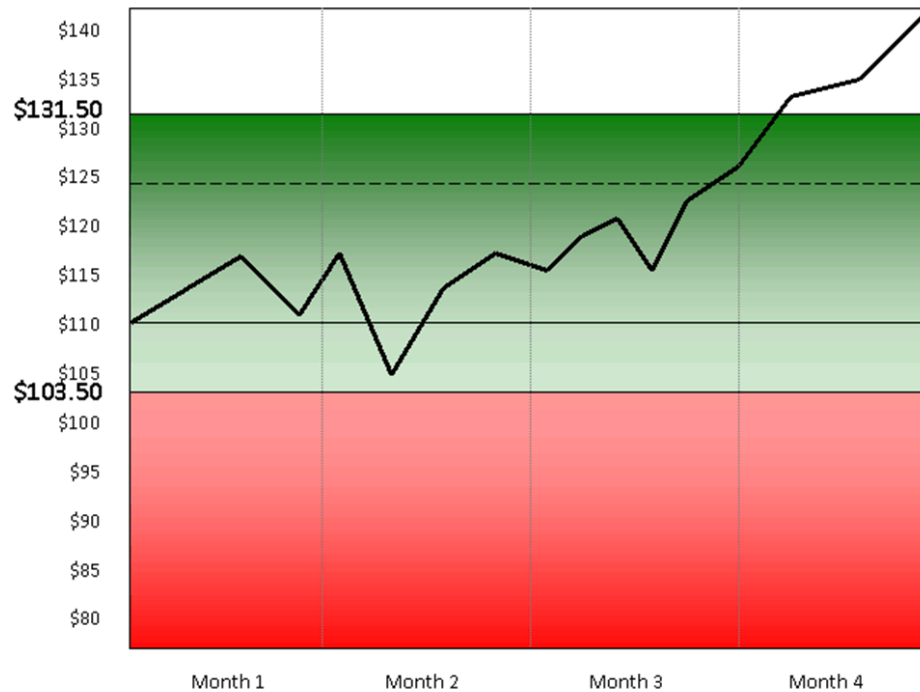
wrote the  $\$125$  call option for  $\$6.50$  (premium)  
 at expiration, with the stock at  $\$131.50$ , the option is now  $\$6.50$  in-the-money  
 =  $\$0$  gain/loss for the writer

$\$21.50$  gain +  $\$0$  gain/loss on the option =  $\$21.50$  or  $\$2,150$  gain on trade

If the price goes above \$131.50 (above your maximum profit range), the option portion of the trade will preclude you from profiting anymore on higher prices. (See Example 5 on the next page.)

## Example 5:

In this example, let's say the stock goes above \$131.50 to \$140. No further gains can be made above \$131.50. Because as we illustrated above, while your stock continues to gain the higher it goes, your option will begin to lose money commensurately.



Why? Your stock increased from \$110 to \$140 for a \$30 gain. But you're now giving up not only your option premium gain of \$6.50 on the \$125 call you wrote, but you're now losing money above and beyond that as well. For every additional \$1 rise in the stock, you're losing an additional -\$1 on the option. At expiration, that \$125 call is now \$15 in-the-money (or is \$850 above the \$650 premium collected), which means that option is actually worth \$1,500, which would go against your gains.

As the option writer, you are 'obligated' to deliver that stock at \$125, even though it's at \$140. That represents a 'loss' of -\$1,500 stock loss less the \$650 premium collected for a net loss of -\$850. Or you can buy that option back instead for \$1,500, which is \$850 more than you collected for it for a loss of -\$850. Either way, this will result in a loss of -\$850, which will go against your stock gains.

Once again, you have the same maximum profitability in this overall example at \$140 as you do at \$131.50 or even \$125; and that is \$21.50 or \$2,150. But above \$131.50, precludes you from any further gains.

**\$110 (stock purchase price) to \$140 = \$30 price increase or \$3,000 gain on stock**

**wrote the \$125 call option for \$6.50 (premium)  
at expiration, with the stock at \$140, the option is now \$15 in-the-money  
= \$850 loss for the writer**

**\$30 gain - \$850 loss on the option = \$21.50 or \$2,150 gain on trade**

Essentially, when you write an option, you're reducing your downside risk by a set amount, but you're also potentially giving up some upside if the stock goes above the strike price that you wrote.

Sometimes this will happen. Although, you can simply 'roll' your option up by buying back the original strike price and writing another one further out, thus opening up your profit opportunity.

You can even buy a call option which would give you additional upside potential as well.

But stocks won't always go straight up. And while sometimes you may lose out on some upside potential, you'll likely find yourself consistently collecting premiums on your covered calls over and over again.

This is a wonderful strategy and it truly is a shame more people don't know about it.

But now you do.

And you now have more tools to beat the market.

# Put Option Writing

If covered call writing is considered a lesser known strategy, then uncovered put option writing is probably one of the least known strategies.

But this a great strategy and another great way to generate income.

Not to mention a way to potentially get into a stock you'd like to own at a much cheaper price.

Although, you will need full option privileges to do this in your account. So check with your brokerage to see if you qualify.

Here's how it works.

As you know, if you buy a put option, you're buying the right to sell a stock at a certain price within a certain period of time. The buyer pays a premium for this right. He has limited risk – which is limited to the price he paid for the option.

However, the writer is taking the other side. He's obligated to buy the stock at a certain price within a certain period of time. As in the call example we went thru earlier, the option writer collects a premium.

We're, going to be the option writer.

So, the benefits are: if you write an out-of-the-money option on a stock you wouldn't mind owning if it went down, you might just get the chance to own it at a cheaper price than it's currently trading at if it does go down.

If however, it never gets to that level, you've collected the premium for writing the option and taking the risk that the stock would be put to you at that price.

But again, if you wouldn't mind owning it if it did go lower, you've still won because now you've got that stock at a better price.

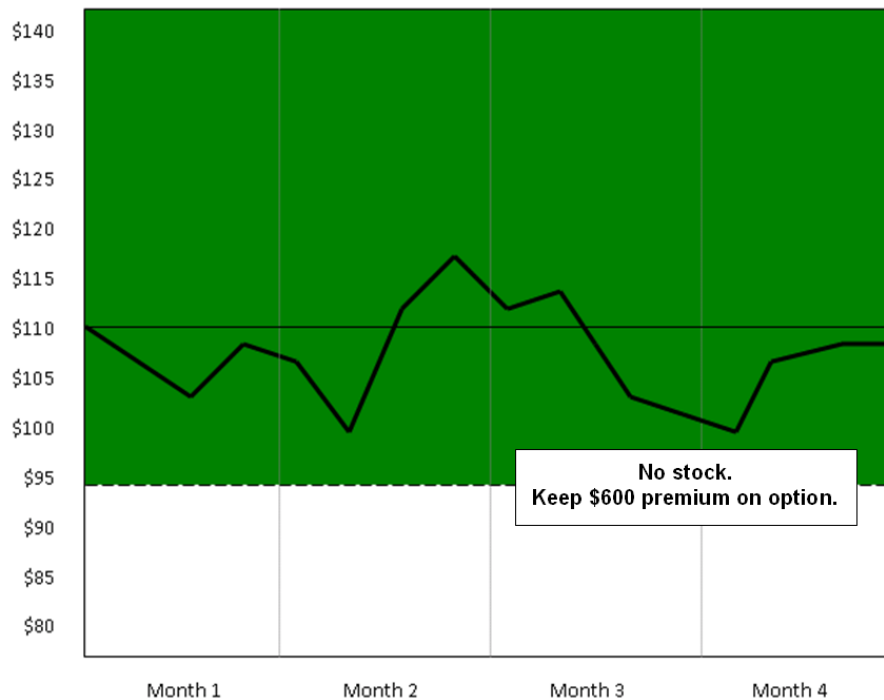
Let's look at some examples.

## Example 1:

Let's say a stock is at \$110 and you wrote a 4-month, \$95 put option, for a premium of \$6.00 or \$600.

If you'd like to own that stock, but would like to buy it at a cheaper level, you can either put in a buy stop at \$95 and hope one day it gets hit. Or, you can write the \$95 put option instead.

If it never goes down to \$95, you'll keep the entire \$600 at expiration. This is better than a buy stop that never gets hit because there's no reward if it doesn't hit you. But with the put writing, you're collecting a premium.

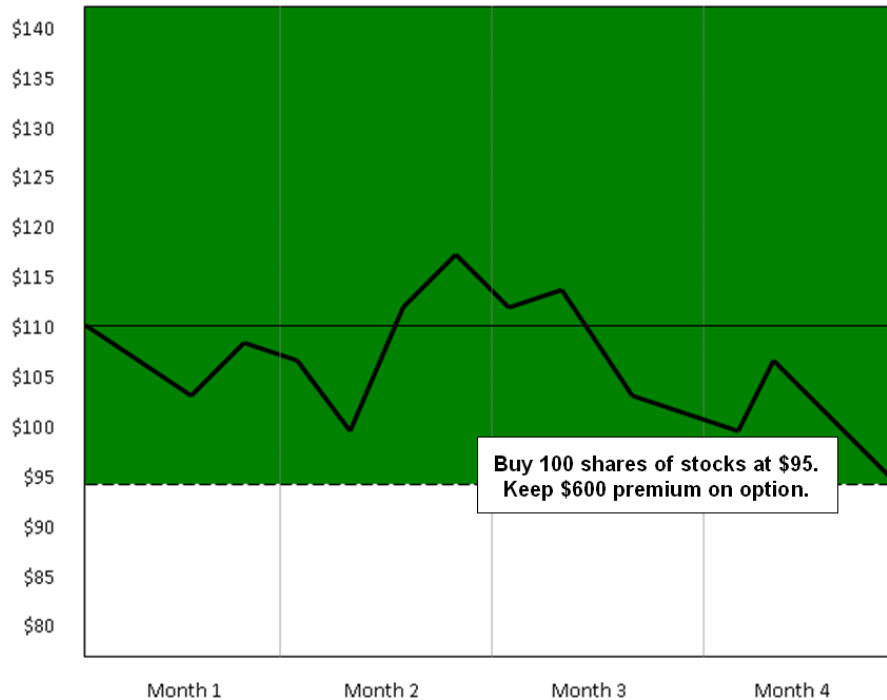


In the example above, if the price never gets to \$95, i.e., stays above \$95 at expiration, you'll keep the entire premium you collected which was \$600.

## Example 2:

Let's say it does go down to \$95 this time.

If it does, the option could be exercised and you'd now be obligated to buy that stock for \$95 a share.



Options can be exercised (the shares put to you) at any time. Of course this would only make sense if the price fell below the strike price.

*Note: Most options do not end in exercise, but instead are bought and sold until expiration.*

Continuing with the example, at expiration, you could now be obligated to buy that stock for \$95 a share. At expiration though, that at-the-money option has no intrinsic value and is worthless to the purchaser, which means you (the put writer) has pocketed the full \$600.

It's unlikely that the at-the-money option would be exercised as there's no financial incentive for the holder or buyer to do so. But even if it was, you were paid the full \$600 premium that you were hoping to receive and you also got the stock you wanted at the price you were comfortable in owning it at.

You can then happily hold the stock or sell it. Whatever you want to do. It's just as liquid as if you bought the stock on your own.

Of course you don't need to hold onto that written option until expiration if you don't want to. You could buy that option back right before expiration at virtually nothing and be done with it, locking in your gains.

### Example 3:

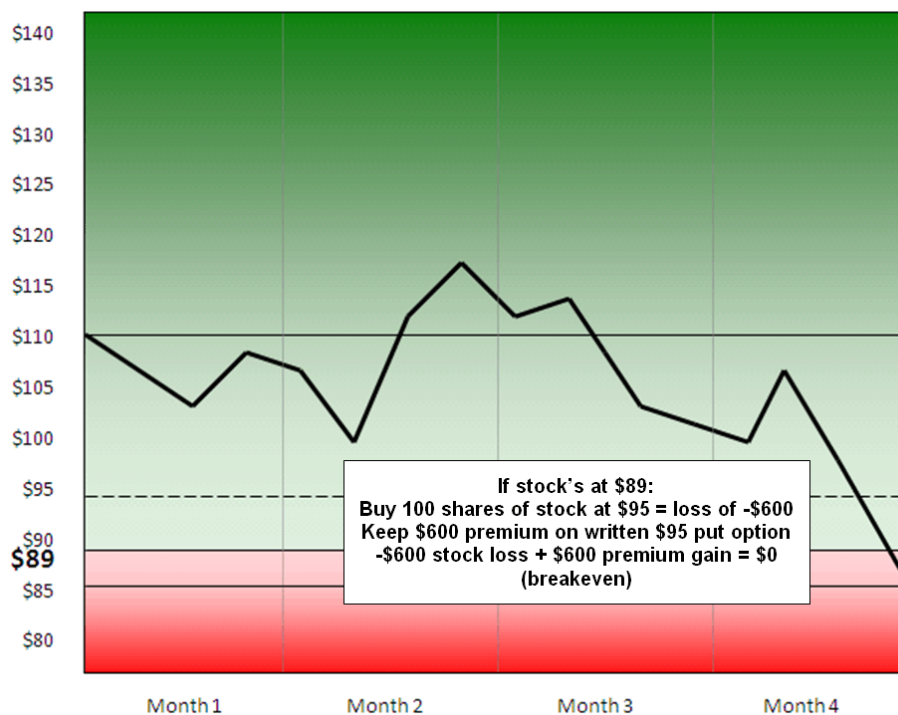
This time, let's say it goes down to \$85. You'd now be obligated to buy that stock \$95 even though it's selling at \$85.

So you're now down -\$1,000 on the stock that was put to you. But you also collected \$600 premium for writing that put option in the first place. So your capital loss on owning that stock at \$95 is currently -\$1,000, but this is offset by the \$600 premium that you took in for a net loss of only -\$400 for owning that stock at \$95.

This is a better deal than simply putting in a buy stop on that stock you were interested in owning because if your buy stop did get triggered, you would've gotten your stock at \$95 but you would not have gotten any offsetting premium that you could have gotten for writing a put.

Your capital loss in this case would be -\$1,000 as opposed to only -\$400 for writing the put option in the above example.

**Note:** The \$89 mark on the chart example below, represents how low the stock can go without 'losing' any money on the trade, i.e., the breakeven point where there's no gain or loss on the trade.



wrote the \$95 put option for \$6.00 (premium) or \$600

if stock falls to \$89 (that's \$6 below my strike price)

stock will be 'put' to me at \$95

$\$95 \text{ stock purchase price} - \$89 \text{ market value} = -\$6.00 \text{ or } -\$600$

$\$600 \text{ gain on premium for writing the put} - \$600 \text{ loss on the stock} = \$0 \text{ gain/loss (breakeven trade)}$

If you thought the stock could fall below your strike price and even below your breakeven point, and you didn't want the stock to be put to you at the strike price that you had, you could do what's known as 'rolling down' your option before expiration. This is done by buying back your current put option and writing a new put option with a further down strike price.

Of course, the money spent on buying back the nearby strike price would be greater than the premium received for writing the further out strike price, but your full purchase price of the stock if it were put to you at a lower price would now be less expensive.

You would have to work out the math to see if it would make sense for you. And you'd have to review your outlook to determine your interest in still owning that stock.

And of course, in a bear market, you better be very sure that you're OK with owning a falling stock if it's put to you.

But if you're interested in owning stock, but only at a lower price, this is a great way to generate income and potentially get the stock you want.

Of course, you don't have to want to own the stock to use this strategy.

If you have a belief that a certain stock simply won't go down below a certain price, then writing a put option is one way to make money, especially if you believe there's more upside risk than down.



# Summary

As you can see, there are many different ways to make money in options.

And the ones in the preceding chapters are just some of the many different options strategies that you can use to make money in the market no matter what.

And there are many, many more:

- Straddles
- Strangles
- Debit spreads
- Credit spreads
- Ratio spreads
- Iron Butterflies
- Condor spreads
- Calendar spreads
- and more

Take the appropriate amount of time to research each one of these before you attempt to place one on your own.

But my three favorite options strategies are the ones I just described: Buying Calls and Puts, Writing Covered Calls and Put Option Writing.

But start slow.

After you've put on any of the above options trades and see it in your account, it'll make even more sense to you and you'll be able to feel what it feels like to have one of these positions on and see how it fits with your trading style.

And keep in mind, when you're considering these different options strategies, remember to consider their Zacks Rank.

The Zacks Rank 1's and 2's are Strong Buys and Buys. The 4's and 5's are Sells and Strong Sells. The 3's are Holds or Market Perform.

If you're expecting a Zacks Rank 1 stock to blast off, you probably shouldn't be writing a call against your long stock position.

And you may not want to be in such a hurry to write a put option on a stock that's just been ranked a 4 or a 5. You might want to give it some time to see if it'll go any lower first.

But decide to learn how to use these different options strategies as yet another set of tools to gain an advantage over the market.

And you can make 2016, your best year ever.