Trade Options With Me

For Your Financial Freedom

(Options) Trading Terminology Handbook

A Handbook Created To Improve The Learning Experience Of Traders

Option Trading Glossary

This is the Glossary for important option trading terms. Some of these terms are rather easy and used extremely often, but some may even be new to more advanced option traders. I would highly recommend that you always have this glossary next to you when following my or other courses. This would allow you to always look up any unknown terms easy and fast. It is a good idea to print this cheat sheet out. You don't have to learn all these terms by heart, if you follow my education and get into options trading, you will automatically learn these terms after a while and soon won't have to look them up anymore. The terms are in alphabetical order for an easy navigation.

A

Advanced/Contingent Orders: Advanced/Contingent orders allow you to set certain criteria before they get filled. You can even set chains of orders, where one triggers the next. For example, you can create a contingent order that will send out an order as soon as the market reaches a specific price. If the order that has been sent out will get filled, two more stop orders will be sent out and if one of these gets filled the other one gets canceled.

After Hours: The trading hours after the regular trading session are referred to as after hours. Typically, both volume and volatility are much lower during after hours than during the regular trading session.

American Option: Unlike European options, American options can be exercised whenever the buyer chooses to. Nevertheless, both options can still be bought and sold at any time.

Arbitrage Trading: Exploiting market inefficiencies and making risk free returns.

Ask Price: The lowest price a seller is willing to receive for an asset.

Assignment: When an option buyer chooses to exercise his option contract, a seller of this exact option contract will have to fulfill his obligation. This process is called assignment. The obligation for a seller of a put option is to buy the underlying asset at the strike price from the option buyer. The obligation for a seller of a call option is to sell the underlying at the strike price to the option buyer.

Assignment Risk: The risk of being assigned. This only exists for option writers/sellers and the risk becomes higher, the closer you get to expiration.

ATM – At The Money: An at the money option is an option with a strike at or near the current underlying's price.

B

Bearish: If you are bearish on an asset, you think prices will go down. A typical bearish position is short stock.

Bid Price: The highest price a buyer is willing to pay for an asset.

Bid/Ask Spread: The difference between the bid and ask price. Wide Bid/Ask Spreads are typical traits of bad liquidity and can impact your trading negatively.

Black Scholes Model: The Black Scholes Model is an advanced option's pricing model developed by Fischer Black, Myron Scholes and Robert Merton.

Black Swan Event: An unpredictable, unexpected event with big consequences. An example of a black swan event would be a market crash like the one in 1929.

Bullish: If you are bullish, you think prices will go up. A typical bullish position would be long stock.

C

Call Option: If bought, a call option gives the buyer the right to sell the underlying asset at the strike price. If sold, a call option obligates the seller to sell the underlying asset at the strike price, if the buyer chooses to exercise his option.

Covering a Position/Buying to Cover: To close a short position, you have to buy to cover it. So if you sell to open a position, you have to buy to close the position. This closing process of a short position is also referred to as covering.

Credit: When opening a position for a credit, it means that you get paid to open the position.

D

DAY Order: If you choose DAY when ordering, your order will run until the market closes that day, except if you get filled before that.

Debit: When you open a position for a debit, it means that you have to pay to open the position.

Defined Risk: A defined risk trade/strategy is a trade with limited downside risk. Before entering this trade, you already know how much you can maximally lose.

Delta: The option Greek Delta is the amount that an option's price is expected to change for a 1$ up-move in the underlying's price. So let's say the Delta of a specific option contract on ABC is 0.5, this would mean that for a 1$ up-move in ABC, this option would gain 0.5$.
Delta can be used as a gauge for directional risk. The more directional a strategy is, the higher its Delta will be. Neutral strategies have Deltas near zero.

Dividend: A certain amount of money paid out by a company to its shareholders.

E

ETF's: ETF's are Exchange Traded Funds and can be traded just like normal stocks on the stock market. They track indexes, commodities, bonds or other assets. Their behavior is similar to that of mutual funds. But ETF's have lower fees and often higher liquidity. ETF's, therefore, can be quite attractive for option traders.

European Option: Unlike American options, European options can only be exercised on the expiration date. Nevertheless, both options can still be bought and sold at any time.

Ex-Dividend Date: Like the name implied, the ex-dividend date has something to do with dividends. If you purchase a stock at or after the ex-dividend date, you will not be able to receive the next/upcoming dividend. Usually, the stock price is lowered by the amount of the dividend on the ex-dividend date.

Exercising an Option: Exercising your option means using your right to sell or buy the underlying asset at the strike price. A buyer of a put option has the right to sell the underlying asset at the strike price. The buyer of a call option has the right to buy the underlying asset at the strike price. Note that this only is a right, so you don't have to exercise your options. Instead of exercising options, you can also close long option positions by selling the options.

Expected Move: The expected move for an asset's price within a certain time period.

Expiration Date: The expiration date is the date at which options expire. There are different expiration cycles. There are weekly, monthly, quarterly and other option expiration cycles. Very long-term options that expire in over a year are also referred to as LEAPS.

Extrinsic Value: Intrinsic + extrinsic value = option's price. Extrinsic value is the value of an option that isn't intrinsic. Extrinsic value consists of time value. The further an option is away from the expiration date, the greater the extrinsic value of an option becomes. Additionally, other factors like volatility affect the extrinsic value of an option. ATM options usually have the most extrinsic value.

Here is an example: The underlying asset ABC is trading at $50 and the call option with a strike price of $45 is trading for $7. That call option is ITM by $5 and thus, the intrinsic value of it is $5. The remaining value is $2. These $2 are the extrinsic value of that call option.

F

Float: The float is the number of regular shares of an asset that are available to trade. The float is similar to the number of all shares issued by a company with one difference being that shares held by insiders aren't included in the float because these shares aren't available to trade.

Fundamental Analysis: A method of analyzing and evaluating a company's value by only analyzing fundamental factors such as earnings, sales, economic factors, liabilities, assets…

G

Gamma: The option Greek Gamma is the amount that Delta changes for a 1$ up-move in the underlying asset's price.

For instance, a Gamma of 0.2 would mean that Delta would increase by 0.2 if the underlying's price would increase by $1.

Getting Filled: In trading, you send opening and closing orders to open or close trades. If someone else is found that is willing to take the opposite side of your trade, your order will be executed and your position will be opened or closed. This is also referred to as getting filled (an order was filled).

GTC Order (Good Til Cancel): If you select GTC when ordering, your order will run until it is filled or you cancel it manually. Brokers often cancel these orders automatically after a very long time (e.g. half a year).

GTD Order (Good Til Date): An order that runs until a certain predetermined date unless it is filled or canceled manually.

H

Hedge: Hedging is a way of protecting positions against bigger losses.

(Option) Holder: An option holder is someone who is holding a long position in an option. So someone who bought to open an option position and is still holding on to that position.

HV – Historical Volatility: Historical volatility is the actual past volatility in the markets. It shows the change in prices over a given period of time. Historical volatility is not the same as implied volatility.

I

Index: A market index is a collection of different stocks or other assets within a market section. An indexes' price is calculated from the price of its stocks/ assets. The most common way of calculating an indexes' price is by using a weighted average.

Indexes can't be traded. However, many indexes have ETFs that track them. These can be traded just like stock. Alternatively, you can trade derivatives like futures or options on them.
Note that most countries/economies/sectors have their own set of major stock market indexes.

Intrinsic Value: Intrinsic + extrinsic value = option's price. The intrinsic value of an option's price is the amount that an option is In The Money (ITM). For example, ABC is trading at 20$, the call option with a strike price of 15 is 5$ ITM. If an option is OTM (or ATM), it has no intrinsic value.

ITM – In The Money: A call option is in the money if the call option's strike is below the price of the underlying asset. For put options, the strike has to be above the current underlying's price.

IV – Implied Volatility: Implied volatility is derived from option's prices. It can be thought of as expected volatility. In times of high implied volatility, options tend to be more expensive than in times of low IV.

IV Rank: IV Rank compares the current level of implied volatility of an asset to past levels of implied volatility of the same asset. This gives traders an idea about how high or low the current level of IV is compared to past times.
IV Rank displays a figure between 0 and 100. If IV Rank is over 50, implied volatility is considered relatively high and if IV Rank is under 50, implied volatility is considered relatively low.
IV Rank can and should influence an options trader's strategy selection process. Most option buying strategies profit from increasing IV and therefore,

should be entered in times of low IV and the opposite is the case for overall short option strategies,

J

K

L

LEAPS – Long-Term Equity Anticipation Securities: Very long-term derivatives (options) with over a year until expiration.

Leg/s: A leg is one option of an option strategy. For example, a strangle requires two options to set up. So strangles consist of two legs.

Legging into a trade: This refers to the opening process of a multi-leg option trade. If an option trader opens the different legs of an option strategy separately, he is legging into his trade.
For instance, iron condors have four legs (2 different calls and 2 different puts). If you want to leg into an iron condor, you would open these legs separately.

Leverage: If something small controls something big, it is leveraged. In finance, leverage is referring to controlling a big sum of money with a little sum of money. Leverage can increase your potential rewards and your risks.

Limit on Close (LOC): A limit order that is sent out as close as possible to the market's close.

Limit Order: Order for one specific price and one price only. If the price won't drop/rise to your set price, you will not get filled.

Liquidity: The ease of entry/exit in an asset without affecting the asset's price. Typical features of very liquid assets are high volume and tight Bid/Ask spreads.

Long: Going long an asset is the same as buying it to open a position. To close a long position, you will have to sell.

M

Margin: If you trade on margin, you borrow funds (from your broker) to trade with. Usually, you have to pay interest on the borrowed money.

Mark: The price of the last traded contract. This is a good way to get an idea of which prices are getting filled, especially for wide Bid/Ask spreads.

Market Cap(italization): The market cap can be calculated by multiplying the number of shares outstanding by the current market price of an asset. For instance, if a stock is trading at $45 and there are 50 000 000 shares outstanding of that stock, the market cap is:
$45 x 50 000 000 = 2 250 000 000
So the market cap tells you the total value of all outstanding shares of an asset.

Market on Close (MOC): A market order that is sent out as close as possible to the market's close.

Market Order: If you use a market order when ordering, you will receive the next available price for the asset. This is the fastest way to get filled, but the pricing probably won't be good.

Mid Price: The mid-point between the bid and ask price.

N

Naked Option: Selling options without owning the underlying asset and without buying any other options as protection is also known as selling naked options. So a standalone short call or short put position would be a naked option position. Naked options are also referred to as uncovered options.

Nasdaq: The Nasdaq is an American stock exchange. Nasdaq stands for National Association of Securities Dealers Automated Quotations.

NYSE - New York Stock Exchange: An American stock exchange located in New York. The NYSE is the largest stock exchange in the world by market capitalization.

O

Open Interest: The number of outstanding option (or futures) contracts. In other words, the number of contracts that have not yet been closed. This usually indicates how deep a market is.

Option Chain: The option chain is a list of all available options for a certain asset. Most option chains display the following information: underlying asset, expiration date, type of option (call or put), option's prices, strike prices and more.

Option Greeks: Option Greeks measure changes in an option's price for changes in market factors like an implied volatility, time, price and more. The most commonly used Greeks are Theta, Vega, Delta and Gamma.

Option Spread: An option spread is a combination of the same number of long and short options on the same underlying asset. The options only differ in regards to strike price and/or expiration date. For example, a call credit spread is set up by selling a call option and by buying a call option with a higher strike price.

OTM – Out of The Money: A call option is Out of The Money if its strike price is above the underlying's trading price. A put option is OTM if it's strike price is below the underlying asset's trading price.

P

Payoff (Diagram): A diagram that displays the potential profit and loss for a position at different prices. Usually, the Y-axis shows the potential P&L for that position and the X-axis shows the underlying asset's price.

Portfolio: All of your open positions.

Pre- Market: The trading hours before the regular market open are referred to as pre- market. Usually, volume and volatility are much lower during the pre-market session than during the regular trading session.

Premium: The credit received when selling options or the debit paid to buy options.

Probability Of ITM: The probability that an option will expire ITM.

Probability Of OTM: The probability that an option will expire OTM.

Probability Of Profit (POP): The probability that a position will be profitable.

Probability of Touch: The probability of touch shows the probability that the underlying's price will touch or breach the strike price of an option sometime before expiration.

Put Option: If bought, a put option gives the buyer the right to buy the underlying asset at the strike price. If sold, a put option obligates the seller to buy the underlying asset at the strike price, if the buyer chooses to exercise his option.

P50: The theoretical probability that a defined profit option position will reach 50% of its max profit.

Q

R

Rho: The option Greek Rho shows the change in the value of an option for a 1% change in interest rates. So a Rho of 0.1 would mean that an option's value would rise by $0.1 if a 1% increase in interest rates would occur.

ROI - Return On Investment: The ROI simply shows the return that you made or could make on an investment. Let's say, you invest $1000 and

potentially could make $200 in profit on that investment. The return on that investment (ROI) would be 20% (200/1000).
To calculate the ROI, you have to divide the profit by the total cost of the investment.

Roll(ing): Rolling an option positions means closing out a current position and opening a new one at a later expiration date. Often, the only difference between the old and new position is the expiration date.

S

SEC - U.S. Securities and Exchange Commission: The SEC is an independent federal government agency. Its goal is to protect investors and keep the securities market fair.

Shares Outstanding: The number of shares held by all of a company's shareholders including those held by institutions, insiders and more.

Short: Shorting (or going short) an asset is the same as selling an asset to open a position. To close a short position, you will have to buy back the position.

Standard Deviation: An indication of volatility. Standard deviation measures how far prices differ from their mean.

Stop Limit: As soon as the price reaches one custom set price, a limit order will be sent out.

Stop Order: As soon as the price reaches one custom set price, you will get filled at the next available price.

Strike Price: Every option has a strike price. Buyers of a call option have the right to buy shares of the underlying asset at the strike price. Buyers of a put option have the right to sell shares of the underlying asset at the strike price.

Systematic Risk: Systematic risk is the unavoidable risk. This risk is completely unavoidable because there always is the risk that some unexpected event that will affect the entire market will occur.

T

Technical Analysis: A method of analyzing an asset's price by only looking at technical factors such as the price chart, technical indicators, price action, price trends…

Theta – Time Decay: The option Greek Theta represents the amount that an option's value will change after one day passes. Theta basically is time decay. A Theta of -0.1 would symbolize a 0.1$ loss in value after the passing of one day. Theta increases the closer an option gets to its expiration date.

Trail Stop: A stop order that moves up with the market price, but not down (for long positions). A stop order that moves down with the market price, but not up (for short positions).

Trail Stop Limit: A stop limit order that moves up with the market price, but not down (for long positions). A stop limit order that moves down with the market price, but not up (for short positions).

U

Undefined Risk: An undefined risk trade/strategy is a trade with unlimited downside potential. This means that you do not know how much you could lose.

Underlying Asset/Security: The security that a derivative is based on. For example, if you trade an option on Apple, Apple is the underlying asset.

Unsystematic Risk: Unsystematic risk is the avoidable risk. This risk is the risk that only affects parts of the market like individual stocks. An example of this would be the bankruptcy of certain companies. This will affect positions in that company, but not the entire market.

V

Vega: The option Greek Vega shows how an option's price will change for a 1% increase in implied volatility. A Vega of 0.6 means that the value of an option will increase by 0.6$ for a 1% rise in implied volatility.

Volatility Skew: Volatility Skew describes the differences between the implied volatility of different options on the same underlying asset with the same expiration date.

Volume: The total amount of securities traded over a given period of time. This shows how active a market is. Usually, asset's with high volume also have tight Bid/Ask spreads.

W

(Option) Writer: An option writer is someone who sells an option to open his/her position.

X

Y

Z

Zero-Sum Game: A zero-sum game is a game in which every loss is offset by a same-sized gain and every gain is offset by a same-sized loss. So in a zero-sum game, the total amount of money never changes. If someone wins $100, someone else makes $100,
An example of a zero-sum game is a coin flip. If you bet $10 on heads and your friend bets $10 on tails, one of you will lose and the other one will win $10. It doesn't matter how often you repeat this, the total amount of money will always stay the same.

Hopefully, you can find some value in this handbook. If you have any comments, feedback or recommendations for future improvements, please contact: **Louis@TradeOptionsWithMe.com**