paradigm press presents:

THE ULTIMATE BEGINNER'S GUIDE TO STOCK OPTIONS:

Everything You Need to Know to Buy, Sell and Profit From These Powerful Moneymakers

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Everything You Need to Know to Buy, Sell and Profit From These Powerful Moneymakers

With a few simple moves, you could boost your portfolio's earning potential tremendously — collecting bigger, faster gains from small changes in a stock's price.

For instance, if a stock's price goes up just 5%... you could collect 251% gains.

You can also use this strategy to profit from falling stock prices.

Imagine turning a 10% drop in a stock's price into a 205% profit.

It's possible. And you don't need to be a millionaire or a market genius to make these kinds of profits, either.

You just need a brokerage account... a few hundred dollars in risk capital... and the courage to buy a type of investment that many investors irrationally fear.

We're talking about stock options.

You might even feel scared just seeing those words.

So before we tell you everything you need to know about profiting from these powerful moneymakers, let's quickly clear up some misconceptions.

The Truth About Stock Options

If you're relatively new to trading, you may have heard that stock options are complicated and risky.

Even experienced traders have been told to stay away from them.

Now, to be fair, trading stock options isn't as straightforward as trading stock shares.

Their rules and terminology are a bit different than what you might be used to.

Puts and calls... in-the-money and out-of-the-money... expiration dates and strike prices.

It sounds like a lot to keep track of.

But once you understand what it all means — and how it could translate into profits for you — you'll see these terms are nothing to worry about.

Then there are the risks.

Let's be perfectly clear — options can be risky, especially if you don't know what you're doing.

As you may know, with options, it's possible to lose 100% of your investment.

With a few simple precautions and proper money management techniques, however, you can keep your potential losses in check.

In fact, under the right circumstances, trading options can actually be less risky than trading stocks.

The key to succeeding with stock options is to understand exactly what you're trading.

Buying and Selling Promises

You probably know that when you buy stock shares, you are buying part ownership in a company. Selling your shares means you give up your ownership stake.

If you buy an index fund or other kind of exchange-traded fund (ETF), you are buying a share of a pool of assets. You can also sell the ETF at any time.

Stock shares and ETFs trade on stock exchanges, which you can access through a brokerage account.

Stock options also trade on stock exchanges and require a broker. But what you're trading is completely different.

Technically speaking, stock options are standardized contracts — like the kind you sign when buying a house or closing a business deal.

A contract gives you certain rights and obligations… so it's a lot like a legally enforceable promise.

In other words, when you trade stock options, you are essentially trading promises. Those promises have value… and the value fluctuates with market conditions.

That means it's possible to buy these promises, then sell them for a profit or loss.

How much a stock option trades for at any given moment depends on a lot of different factors — starting with the kind of promise you're buying.

Understanding Calls and Puts

There are two broad categories of stock options — **calls** and **puts**.

When you buy a call option contract, you are buying the right to buy 100 shares of a specific stock or ETF at a fixed price.

The specific stock or fund is called the **underlying instrument**. The specific price is known as the option's **strike price**.

And like most contracts, a call option's rights and obligations are only enforceable for a certain period of time. The day the contract becomes void is known as the **expiration date**.

It may help to think about it another way.

When you buy a call option, you are buying another trader's promise.

You give them money, and they promise to sell you 100 shares of the stock for the option's strike price. They must sell the shares to you at that fixed price — no matter what the stock is currently trading for.

The only catch is that you must act on that promise before the option's expiration date.

Put options are very similar. Only this time, buying one gives you the right to sell 100 shares of a particular stock or ETF at an agreed price.

There's still an underlying instrument... strike price... and expiration date.

But someone is promising to *buy* your shares — not sell you some.

Don't worry if this isn't clear yet, because next we'll look at some examples.

A Cheaper Way to Play Stocks

Let's say it's January and Microsoft's stock is trading for $330 a share. But you expect the stock to be trading for $375 in a year.

You could spend $33,000 to buy 100 shares. If you're right, your position could be worth $37,500 in 12 months.

But $33,000 is a lot to bet on a hunch. Imagine what would happen if Microsoft reports a few quarters of bad news.

In a year, your position could be worth $25,000…

Stock options offer a cheaper way to play your belief on Microsoft's direction.

For any given stock, there could be hundreds of available options. In addition to puts and calls, there are a variety of strike prices and expiration dates.

You could buy a Microsoft call option with a $330 strike price that expires next January.

The call option gives you the right to buy 100 shares of Microsoft for $330 — no matter what they are trading for at the time.

The price you pay for an option is called a **premium**, similar to what insurance payments are called. An option's premium at any given moment depends on multiple market factors.

For this example, let's say the option is selling for $25 a share. That's the price you'll need to pay per share to buy the contract.

And since every option contract represents 100 shares of stock, your total cost will be $2,500 — not including any broker fees.

In other words, you're spending $2,500 instead of $33,000 — cutting your risk to a fraction of what it would have been if you bought the shares outright.

But before we discuss what could happen next, let's make sure you understand the other side of this trade.

The Promise Seller

For every buyer, there must be a seller — whether we're talking houses, stock shares or stock options.

When it comes to stocks and options, buyers and sellers are paired on the stock exchange.

So to buy the Microsoft call option with a $330 strike price, you'll place the order with your broker. Then you'll be paired with a trader who is selling that call option.

The trader takes your money for the obligation to sell you 100 shares of Microsoft at the option's strike price, which is fixed at $330 a share in this example.

Since these are standardized contracts, no negotiation or signatures are required. The promises trade just like ownership stakes in companies trade back and forth in the form of stock shares.

In this example, we said the option was trading for $2,500 when you placed your order.

When the trade goes through, the seller gets the $2,500 premium, which is deducted from your cash account. Then the call option will be transferred into your stock portfolio.

Now it's just a matter of waiting…

How Calls Pay Off

For this example, you now own a Microsoft Inc. $330 call option that expires in January of next year.

Let's say January rolls around, and your estimate was too low — Microsoft is trading for $390 a share.

You can choose to exercise your stock option, forcing the trader to fulfill the obligations of the promise you bought.

He *must* sell you 100 shares of Microsoft for $330 apiece, even though they are trading for $390 on the open market.

You'll have to pay a total of $33,000... but you'll be getting stock that's currently worth $39,000.

Take out the $2,500 you paid for the option, and you're ahead by $3,500.

You also own the stock now, which you can sell or hold for higher gains. As the shareholder, you're also entitled to the dividends Microsoft pays.

But what if your prediction had been wrong?

Being Wrong Doesn't Have to Be Costly

Let's say Microsoft completely failed to live up to expectations and fell to $250 a share.

Your option would be worthless, because you would not choose to exercise it. There's no reason to buy Microsoft shares for $330 each when you could buy them for $250 on the stock exchange.

The trader would keep the $2,500 you paid for his promise, too. So this position would be a total loss.

But that's a lot better than what would have happened if you had bought 100 shares of the stock to start with. A year later, your $33,000 position would be worth $25,000 — a loss of $8,000.

Buying the stock option reduced your losses by over a third.

So in effect, you paid $2,500 to ensure you could buy shares of Microsoft for a good price — which is why call options are essentially opportunity insurance.

Put options, on the other hand, can insure you against downside losses.

Puts Are Profit Insurance

Let's keep using our Microsoft example. We'll say your call option paid off, and you now have 100 shares of Microsoft stock.

The stock is trading for $390 a share, and you don't want to risk losing any of that if the price pulls back.

Once again, there are a variety of put options available for Microsoft stock — with dozens of strike prices and expiration dates to choose from.

So you could buy a Microsoft put option with a strike price of $390 that expires a year from now.

Remember, buying a put option allows you to sell your Microsoft stock for the option's strike price of $390 — no matter how much the shares are actually worth.

Once again, your stock broker will pair you with a trader who's willing to make that promise.

While the premium you'll pay for the option will vary, we can pretend it's $3 a share — meaning you'll pay a total of $3,000 for the put option.

Once again, you wait.

Downside Protection

If Microsoft stock falls to, say, $350, you can exercise your put.

The trader on the other side of your option trade will pay you a total of $39,000 for your 100 Microsoft shares.

You'll no longer own Microsoft shares, of course, but you'll make $4,000 on the deal.

Take out the $3,000 you paid for your option and you're still ahead $1,000 — on a stock that fell nearly 12%.

Of course, if Microsoft's stock price doesn't fall below $390 while your option is in force, you'll have no reason to exercise it.

It will expire worthless, meaning your $3,000 premium will disappear. But at least you didn't lose money on your stock position!

Now, you might be wondering what the big deal about options is. Insurance is boring… and the gains and loss prevention we've talked about so far aren't anything to write home about.

That's because options offer the best gains when they're used for **speculation!**

Speculating for Profits

As we mentioned, option premiums are always in motion. They fluctuate based on a number of factors.

If you're using stock options for insurance, these fluctuations don't matter much to you. All you care about is not paying too much to buy one of these promises.

However, you don't have to hold options until expiration to profit from them. You can buy them even if you have no intention of exercising them.

That's right — you can buy Microsoft calls and never plan to own Microsoft stock shares.

You can also buy Microsoft puts without having a single share in your portfolio.

Instead, you can simply buy stock options and plan to sell them for a profit down the road.

So it's important to know the factors that go into an option's price.

Where Premiums Come From

Like all investments, an option's premium is largely determined by supply and demand.

The more traders want a particular stock option, the higher its premium will be.

Demand is governed by three forces. The first is the option's **intrinsic value**. The remaining two factors are the **extrinsic values** of **time decay** and **volatility**.

Intrinsic value means an option can be exercised at its strike price for a profit.

In a call option, that means the option's strike price is *lower* than what the stock shares are currently trading for.

Let's say Microsoft is trading for $350 and you have a Microsoft call option with a $330 strike price.

If you exercised the rights the option gives you, you could immediately buy 100 shares of Microsoft for $330 apiece, then sell them for $350 a share.

So, in effect, your option has a tangible value of $20 a share, or $2,000 total — the actual dollar amount you would get for exercising the option.

Put options, as you might expect, work the other way.

We're in the Money

A put option has intrinsic value if its strike price is *above* the underlying stock's current price.

Let's say you have a Microsoft put with a $330 strike price, and Microsoft shares are trading for $300 on the stock exchange.

You've paid a trader to promise to buy your Microsoft shares for $330 — no matter what.

So if you exercise your option, you could sell 100 shares of Microsoft for $330 each — even though they're worth $300 apiece.

In this example, the put option has an intrinsic value of $30 a share, for a total of $3,000.

Again, that represents the money you'd make if you exercised the option. Your 100 shares of Microsoft disappear, but $33,000 is deposited into your cash account.

If you had sold your 100 Microsoft shares on the open market when shares were trading for $300, you'd only collect $30,000 from the sale.

Any option with intrinsic value is considered **in-the-money**.

Keep in mind that an in-the-money option has intrinsic value even if you have no intention of exercising it. The mere fact that it could be exercised can act as a floor to its price.

It's also important to note that an in-the-money option's price at any given moment may be above or below its intrinsic value.

That's because of the extrinsic factors that influence an option's supply and demand.

Out-of-the-Money Isn't Bad

Let's say Microsoft is trading for $330 a share. So an option with a strike price of $330 has no intrinsic value.

That's true for both calls and puts. Either way, the option's intrinsic value is $0. So the option is known as **at-the-money**.

But that doesn't necessarily mean the option has no value on the markets. Investors may still wish to buy the option… and that demand will give it a price.

Likewise, traders are willing to buy stock options with negative intrinsic value — known as an **out-of-the-money** option.

This is what speculating is all about.

You buy a put or a call with no intention of exercising it.

Instead, you hope the underlying stock moves in the correct direction compared to your option.

If you own a call, you want the stock price to go up. If you own a put, you want the stock's price to drop.

As your option gets closer to having intrinsic value, demand for your option will increase. That means its price could rise — giving you a chance to sell it for a profit.

Of course, it's also possible for your option to lose value… especially if the stock's price moves away from your option's strike price.

And you need to be aware of the other factors that can affect an option's price…

Time Is the Fire

Remember, every stock option has an expiration — the last day it can have any value.

After that, it's worthless.

So options naturally lose a little value each day as that countdown ticks down. That's why it's called time decay.

To understand why it happens, let's consider our Microsoft example again.

Let's say the stock is trading for $330. Is it more likely Microsoft's price will be higher in six months… or a year?

Obviously a Microsoft option that expires 12 months out gives the buyer more time to be right than an six-month option does.

So, all else being equal, the option with a 12-month time frame will be in more demand… giving it a higher price.

Time until expiration is one reason that options without any intrinsic value can be worth buying. As the days go by, the stock could move enough to give the option intrinsic value.

It's also the reason why an in-the-money option might trade for more than its intrinsic value.

In both cases, you are paying for the time that could see your option's value increase.

The price can also fluctuate depending on the market's volatility.

Uncertainty Can Be Expensive

One of the things that makes stock options so attractive is the power of leverage.

Each option contract represents 100 shares of stock. So for every dollar change in the stock's price, the option's value should move $100.

Leverage works both ways, of course. A small move in one direction could deliver nice profits… and a small move in the other direction can take them away.

Traders price that risk into the option's premium.

In other words, an option's price is influenced by how likely it is to be exercised.

If a stock's price is generally stable, there's less risk that it will jump above or below an option's strike price.

Since few people will be interested in an option with little chance of being exercised, demand for it will be low — keeping the premium relatively low, too.

But if a stock's price bounces around a lot, there's a greater chance the option could be exercised. That attracts option buyers, increasing demand, therefore increasing premiums.

In other words, you'll pay more for options on a volatile stock. That means more money at risk with lower profit potential.

So ideally, speculators focus on stock options covering sleepy stocks with oversized breakout potential.

If their analysis is right, the leverage from their options can deliver oversized gains.

An option can be sold at any time before the expiration date. All you have to do is contract your broker, and you'll be matched with someone looking to buy it. The money from the sale is deposited into your account and the option goes to the new buyer.

Whether you take a gain or loss on the trade, that is the end of it for you. The promise belongs to someone else, and you no longer have the right to exercise the option.

Again, this is a lot to take in… so let's take a quick look back.

A Quick Review

Here are the most important things to remember about stock options:

- Stock options are tradable contracts designed to mirror moves in stocks, index funds or exchange-traded funds (ETFs). They trade alongside stocks and funds on the major exchanges.

- There are two main types of stock options: calls and puts.

- When you buy a call option, you are buying a contract — or promise — that gives you the right to buy 100 shares of a given stock at a set price. The fixed price is known as the strike price.

- A put option gives you the right to sell 100 shares of stock at the option's strike price.

- Stock options have a time limit, called the expiration date. It's the last day you can exercise your rights — forcing the trader to fulfill the promise of the option contract.

- Exercising a call forces the trader to sell you 100 shares of stock at the option's strike price. Exercising a put forces them to buy 100 shares of the underlying stock from you at the strike price.

- But you don't have to exercise your rights to profit trading options. Since they are tradeable contracts, they have prices of their own.

- A stock option's price is called the premium. It fluctuates with supply and demand, just like a stock's price. That means you can buy a stock option, then sell it for a profit or loss.

- Three factors determine an option's premium at any given moment. The first is its intrinsic value. The other two are the extrinsic factors of time decay and volatility.

- A stock option has intrinsic value if it could be exercised immediately for a profit — known as being "in the money."

- An option without intrinsic value is "at the money" or "out of the money." Its premium is dependent on the other two extrinsic factors: expiration and volatility.

- Every move in the underlying stock's price brings it closer or further away from the option's fixed strike price, affecting the option's premium.

- Time decay is a key factor in an option's extrinsic value. The closer an option gets to its expiration date, the less value it has.

- Volatility is the wild card of extrinsic value. It prices in the odds that a given option could be exercised profitably. The more volatile the underlying stock's price is, the more the related stock option's price will be.

- You can sell your options anytime you wish, whether for a loss or profit. Once the sale goes through, you are done with the option.

Don't worry if you're still struggling with these concepts, though. We'll end with some real-life examples that will make everything clear.

Before we get to them, though, let's look at how to start trading options.

Permission to Trade

Most brokers will let you start trading stock shares the moment you fund your account.

But if you want to buy and sell stock options, many brokers require you to jump through additional hoops.

Brokers have an obligation to make sure their clients don't get in over their heads. So you may have to apply for permission to trade options.

To simplify the process, brokers often break specific types of options trades into "levels" or "tiers."

In general, the higher the level or tier, the riskier the activity.

Levels and tiers are also not universal — brokers set their own, including the criteria for each one.

So what one broker considers a "level one" trade might be a "level three" trade at another broker.

If you're just starting with stock options, you won't be interested in more complicated strategies. You should look for permission to "buy puts and calls"... "trade long puts and calls"... or something similar.

In general, you'll need to fill out a quick three- or four-page form that your broker will provide. Once you submit it, your broker will typically give you approval within two or three days.

If you are approved, you just need enough money in your account to fund your trades.

Then it's time to look for an option.

Your First Trade

Every stock brokerage uses its own proprietary software to help its clients make trades.

So there is no one-size-fits-all guide for the exact steps you'll need to take. On the bright side, every broker's platform should have some things in common.

First, you should be able to search for a specific stock symbol, or ticker. From there, you should be able to find a list of options that are available on that stock — called an **options chain**.

Technically, every option also has a standardized 21-character code that brokers use to identify the right option. It's similar to a stock ticker... but not every site uses the standardized symbols.

Still, you should be able to tell the calls from the puts, as well as choose the option's strike price and expiration day.

The majority of stock options expire mid-month, but there are also ones that expire weekly or at the end of the month.

Once you've selected the option you want, there should be a button that lets you buy it.

Don't Pay Too Much!

Your broker will want to know how many options contracts you wish to buy.

Keep in mind that most sites quote options per share. And since stock options cover 100 shares of stock, you'll need to multiply the shown price by 100 to see how much you'll actually pay — not including commission.

A good rule of thumb is to never buy more options than the amount of stock you'd be comfortable trading.

In other words, if you would never buy 5,000 shares of a stock, then you shouldn't buy more than 50 stock option contracts.

Your broker's software will also make you choose the type of order you wish to place.

A market order goes through right away — meaning you'll pay whatever premium the option is trading for at that moment.

If the markets are moving fast, you could accidentally pay much more than you wanted to.

A better option is to use a limit order. It simply tells your broker not to make the trade unless the option is trading below your limit price.

So if you set a limit price of $1 on an option and the option is trading for $1.05 when you make the order, your broker will not buy it.

You may have to choose how long you want that order to stay on your broker's books.

A "day order" expires when the market closes. If the option hasn't traded below your limit price when Wall Street shuts down, your order is canceled.

You'll have to try again when the markets open for business again.

A "good till canceled," or "GTC," order means your order will be in the broker's system until you cancel it or it gets triggered.

Thanks to time decay, it's likely an option will eventually fall below your limit price — which might not be a good thing. So in most cases, you're usually better off using day orders.

When your order is triggered, the premium you paid will be deducted from your cash account and the option will be added to your portfolio.

If you are using options for speculation instead of insurance, this is where the waiting and watching begins...

Watch for a Sell Point

An option's price will rise and fall based on the factors we've talked about. Most of the price moves will be in response to changes in the underlying stock's price.

Also keep in mind that the option will lose time value as expiration draws near.

You can set orders for your broker to automatically sell your options — or even just a portion of your position — if it hits certain price targets.

A sell-limit order or take-profit order triggers when the option's price rises to the amount you select. A stop-loss sell order triggers if the option's price falls to a specified level or percentage.

You don't have to set these orders, of course. You're also free to modify or cancel them at any time.

So don't be afraid to take profits when they appear... or to sell early if it looks like your initial prediction was wrong or mistimed.

And if you're speculating, never hold an in-the-money option to expiration.

Avoid Being Exercised

An out-of-the-money option will expire worthless on its expiration date.

In some cases, it might be better to hold the option until the very end. That's because selling could incur brokerage fees, which will just add to your losses.

But holding an in-the-money option until expiration could be costly for you.

That's because brokers automatically exercise in-the-money options when they expire.

If you have an in-the-money call, you could be forced to buy 100 shares of the underlying instrument at your option's strike price — even if you don't want the shares.

And with an in-the-money put, your broker may sell 100 shares of the underlying stock from your portfolio, depositing the proceeds from the sale in your account.

If you don't have enough cash to cover these transactions, your broker may shut down your account.

So always be aware of when your option positions expire and be sure to take action before that last day.

Follow these tips, and you'll be all set for stock options profits.

Here's a quick look at real-life options that could have helped you earn triple-digit profits!

Call Options in Action

In May 2023, shares of tech company Cognex Corp. (CGNX) were selling for around $51.

But Zach Scheidt, the lead analyst for *James Altucher's Buyout Trader*, predicted they were on the verge of a major breakout.

You could have played his research by just buying the Cognex shares — picking up 100 for a total of $5,100.

Zach, however, recommended buying call options on Cognex Corp. with a strike price of $55 and a June expiration date.

Since the options were out-of-the-money and so close to expiration, they were very cheap.

You could have picked the calls up for just $0.45 a share — meaning the 100-share contract would have cost you just $45, not including broker fees.

The stock needed to move above $55 a share for the options to have any intrinsic value.

If they didn't, the options could expire worthless — meaning a total loss of your $45 investment.

But even a small increase in the stock's price was enough to make these calls profitable…

251% Gains in a Month

Just a week after Zach's recommendation, CGNX stock shares were trading for $53 and appeared to be in an uptrend.

Since the share price was below the $55 strike price of the call options, the calls still didn't have any intrinsic value.

But thanks to the stock's volatility and time left until expiration, the calls were in higher demand — meaning they were selling for a higher price.

Zach recommended selling half the position for $0.90 — meaning you had a chance to collect a 100% gain on stock whose price had only risen 4%!

And by the end of May, CGNX shares had gone above $55, so the CGNX $55 calls were now in-the-money.

Traders were willing to pay as much as $1.58 for the calls. So Zach recommended selling the rest of the position... locking in gains of 205%!

Keep in mind, if Zach's analysis had been wrong, you could have lost your entire investment — the full $45.

On the other hand, if CGNX had fallen from $51 to $50, a 100-share position would have lost $1,000!

That's the power of leverage.

And don't forget, you can use that leverage to see big gains from falling stocks...

Profit From Falling Prices

Goldman Sachs Group Inc. (GS) is one of the largest and most prestigious investment banking firms in the world.

And in late February 2023, its stock shares traded for around $351.

Analyst Dan Amoss of *The Situation Report with Jim Rickards* saw trouble brewing for the company, however. So he recommended buying puts on GS with a $320 strike price and a June expiration date.

At the time, the put options were selling for $6.65 a share, meaning the total cost per contract was $665.

For the puts to increase in value, Goldman's share price would have to fall. They'd need to drop more than $31 to be in-the-money.

And if Goldman stock rose or even just stayed in place, the $320 puts would steadily lose value until they expired. At worst, you would have lost your entire $665 position.

That's not what happened, though...

205% Gains in Two Weeks

In the early days of March 2023, Goldman Sachs shares plummeted.

As they did, the value of the GS $320 puts increased in value.

In just two weeks, GS was trading for around $315 each. That meant the GS $320 puts now had $5 of intrinsic value.

There was still a lot of time until expiration, however. And the stock's volatile fall had increased the demand for Goldman Sachs puts.

So Dan recommended selling the puts when they were trading for $20.27 a share... a 205% gain from the $6.65 you would have paid to enter the trade.

Thanks to the power of leverage, you could have more than tripled your money due to a 10% stock collapse.

Now do you see why options are so exciting?

And That's Just the Beginning!

Once you have stock options basics down, you'll open up an entire new world of possibilities.

Options can be used in a wide variety of moneymaking strategies.

For instance, you could become an options writer — the person on the other side of the options trade.

Instead of paying a premium for an option, a writer gets paid the premium to accept the option's obligations. It can be a reliable way to regular income to your portfolio.

You can also make multiple options trades at the same time.

These strategies have names like spreads, straddles, strangles and more — all of which employ different combinations of buying and writing options simultaneously to achieve certain goals.

But first you need to get comfortable with simply buying and selling regular stock options.

Hopefully we've given you the knowledge and confidence you need to succeed with them!