Option Trading: Terminology

AMERICAN-STYLE OPTION: An option contract that can be exercised at any time prior to the expiration date.

ASSIGNMENT: The option contract seller (writer) is notified they need to either buy or sell the underlying stock.

AT-THE-MONEY (ATM): The option strike price that is closest to the current price of the underlying stock.

AUTO EXERCISE: Any option contract that is at least $0.01 *in-the-money* at expiration will be exercised automatically. The buyer of the option contract will automatically buy or sell the shares of the underlying stock.

BREAK-EVEN: The price the stock reaches where the option contract has neither a profit nor a loss.

BUY TO CLOSE: You pay money from your account to close a 'short' option position.

BUY TO OPEN: You open a trade and pay money from your account to enter a trade on an option contract.

CALL OPTION: An option contract that gives the buyer the right to buy the underlying stock at a specific price (strike price), for a specific period of time.

CALLED AWAY: The process where a call option writer is obligated to sell their underlying stock at the strike price. Also called 'assigned'.

COVERED CALL: A strategy where one sells a call option against the underlying stock they own; you need at least 100 shares of the stock for this strategy.

CREDIT: Money received in your account for the sale of option contracts, either to open or close a position.

DEBIT: Money taken out of your account for the purchase of option contracts, either to open or close a position.

DELTA: One of the Option Greeks. Delta reflects the change of the option's value based on a $1 move of the underlying stock.

EUROPEAN-STYLE OPTION: An option contract that can only be exercised on the expiration date.

EXERCISE: When the option owner (buyer) exercises their right to purchase or sell the underlying stock at the strike price.

EXPIRATION DATE: This is the date an option expires and can no longer be traded.

EXTRINSIC VALUE: The dollar amount of the option premium that is *out-of-the-money*. Also referred to as 'Time Value'.

GAMMA: One of the Option Greeks. Gamma reflects the change in the option's delta for a $1 move of the underlying stock.

GREEKS: Mathematical criteria used to calculate the price of option contracts based on the movement of the underlying stock.

HEDGE: Buying or selling an option contract to protect against losses on an existing position you hold.

IMPLIED VOLATILITY (IV): The movement the market expects the underlying stock to move in a certain time frame. This is shown as a percentage.

IN-THE-MONEY (ITM): An option strike price that has *intrinsic value*. A call option is *in-the-money* if the market price is above the strike price. A put option is *in-the-money* if the market price is below the strike price.

INTRINSIC VALUE: The value any given option would have if it were exercised today. Basically, the intrinsic value is the amount by which the strike price of an option is profitable or *in-the-money* as compared to the stock's price in the market.

LEAPS® (Long-term Equity AnticiPation Securities℠): A very long-term option contract that can have an expiration date up to 2 ½ years into the future.

LISTED OPTION: An option contract that is traded on any of the national option exchanges.

OBLIGATION: The person who sells-to-open an option contract is liable to either buy or sell the underlying stock at the option strike price if the option is exercised.

OPEN INTEREST: The number of option contracts that are currently being traded on any given strike price. There is no limit on how much open interest an option contract can have.

OPTION CHAIN: Shows all the available option contracts to trade on the underlying stock, including strike prices and expiration dates.

OUT-OF-THE-MONEY (OTM): An option contract that has no intrinsic value and the option premium is completely extrinsic value. An OTM call option will have a strike price that is higher than the market price of the underlying asset.

PREMIUM: The value of an option contract which includes both intrinsic and extrinsic value. This is the value you either buy or sell the option contract for.

PROTECTIVE PUT: A trading strategy where a person buys a put option that hedges against a price drop on an underlying stock you own, or a hedge against the market in general.

PUT OPTION: An option contract that gives the buyer the right to sell the underlying stock at a specific price (strike price), for a specific period of time.

RIGHT: A person who buys-to-open the option contract has the right to do one of 3 things: exercise the option contract, sell the option, or let it expire.

SELL TO CLOSE: You receive money into your account by selling a 'long' option you own.

SELL TO OPEN: You open a trade and receive money into your account by selling an option contract that you do not own. The person who sells-to-open is referred to as the 'writer' of the option contract. This is also referred to as '*shorting an option contract*'.

SHORTING AN OPTION: Selling an option contract you do not own. This person is considered the 'writer' of the option contract.

STRIKE PRICE: The price at which you can either buy or sell the underlying stock.

THETA: One of the Option Greeks. Theta reflects the change in the value of the option contract for one day that passes, up to the option contract's expiration. Also known as '*time decay*'.

TIME DECAY: The rate an option contract loses money for each day that passes all the way up to the expiration date. Shown by the Option Greek *theta*.

UNDERLYING: A reference to the stock someone is trading options on.

VEGA: One of the Option Greeks. Vega reflects the rate of change in the value of the option contract for a one-point change in volatility.

VOLUME: The number of option contracts that trade on any given strike price for the trading day. Volume starts at zero each day.

WRITE: Also known as '*sell-to-open*' or '*shorting an option*'. This person creates a new option contract to sell and will increase the open interest number.