OPTIONS TRADING

3 Books in 1

THE COMPLETE GUIDE TO INVESTING & MAKING MONEY ONLINE WITH OPTIONS TRADING

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Options Trading :

3 Books in 1 - The Complete Guide to Investing & Making Money Online With Options Trading

Options Trading

The Ultimate Beginner's Bible To Making Money Online with Options Trading

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Introduction

Congratulations on downloading *Options Trading:The Ultimate Beginner's Bible To Making Money Online with Options Trading* and thank you for doing so. Options trading offers numerous benefits to several different types of investors that make it superior to more traditional forms of investing, once you get the hang of it.

It is not without its own unique quirks that can leave you broke if not handled with care, however, which is why the following chapters will discuss everything that you need to know in order to ensure that you can benefit from everything that options trading has to offer. For starters, you will learn about the various types of options and how to utilize each properly along with the ideal mindset for doing so and the proper to terminology to go along with it. From there, you will learn about the various types of risk and how being aware of them can save you from making a huge mistake. Once you understand the risk, you will be ready to learn about all of the various factors that can influence the price of a specific option during its lifetime.

With that taken care of, you will be ready to make your first trade, including creating a personalized trading plan and a step by step walkthrough of what you will need to do in order to successfully place a trade. From there you will learn several important strategies that all options trading beginners should know in order to maximize your trading success. Next up you will learn how to interpret all of the data you will have been collecting on all of your trades up until this point and how it can make you a more successful trader all-around. Finally, you will learn a number of important tips for success that should help push your successful trade percentage over the top.

Chapter 1: Basics of Option Trading

What Is An Option?

First, let's try to understand what options are if you are not yet familiar with them. You might already be using them now. Imagine that you're the head of a movie studio.

The stock market may seem like a scary world to people only taking their first steps in it, but there are actually a variety of securities investors that people have at their disposal. One such security, known as an "option," opens the door to a world of opportunities for investors.

'Options' actually refer to contracts between two parties (buyer and seller of financial instruments) giving the former party the rights to sell or acquire underlying assets. The options also contain details of price and validity of the particular assets being traded. In option trading activities, you can actually protect your financial position from decline by prompt adaptations to the changing market behavior. Since there are numerous factors that influence business transactions in the option market, success in this field comes with experience and knowledge.

Options are one more way of making your money work for you while protecting against undue risk. Options are derivatives; that is, the value of an option depends on the value of the financial instrument upon which it is based and, in the case of options, the behavior of the market while the option is in effect. The value of stocks and bonds is based on the firm or organization issuing the instrument. For example, a stock issued by a company that is about to go bankrupt has little or no value, compared with the stock of a financially stable firm that is a leader in its industry. Similarly, a bond from a city that is thriving and has a good revenue base is more valuable and has lower risk than a bond from a city that is on the verge of bankruptcy.

Option trading is a very complex financial dealing field that can seem exciting and worthy of high, quick profits. A number of considerations have to be understood before partaking in this risky area, however. Option trading is not always based on stocks. An option is defined as a derivative financial instrument that involves a specific contract between two parties. Options involve future transactions. The option is itself is usually attached to an underlying financial asset. The option involves a future transaction affecting a specific asset with a set price, known as a strike, price. Whenever you see the word "future" in a transaction description, think of an option. An option can be exercised, or acted upon, when the strike price is satisfied.

Option prices are dictated in part by the difference between the strike price and value of the option's underlying asset. In addition, premiums are added to the option price to properly compensate the seller. Premiums are typically based on how much time is left before the expiry of the option, known as the expiration date. Any type of valuable asset can have an option created for it. An option transaction always involves a buyer and a seller, as with any contract. The option provides the buyer the mandate to purchase the instrument. The buyer is under no obligation to purchase the option. The option seller, however, incurs a legal obligation to fulfill their end of the transaction.

One type of trading option is known as over-the-counter, or OTC. These options are not listed on any options exchange since they are privately traded between two parties. One party is usually well-capitalized, as in an investment bank. These options are not regulated. Terms are unrestricted and up to the individual parties to serve specific purposes. Common OTC options include swaps, currency cross rates and interest rate instruments.

Another type of trading option is listed on any number of options exchanges, generally known as futures and options exchanges. Hence, these options are known as listed options. Instead of private parties handling the details, trading houses handle the transactions. And, all options must be settled via the clearing house. The trading exchange uses its credit worthiness to guarantee that options are fulfilled. Examples of these options include standardized contracts involving bonds, stocks, any futures contract, stock market indexes and callable contracts.

Employee stock options are another form of options that, depending upon the terms, can be traded. These options are usually awarded by the firm as an incentive, or employee benefit. Usually firms owning the asset handle the options trading, with the approval of the employee involved. Four types of options trading exist. They are a long call, long put, short call and short put. All involve extensive details that depend on what the trader believes will happen to the stock price. For instance, a long call gives the trader the right to purchase the stock, known as a call option, when they believe the price is going up.

Option trading has more risks if you do not understand what you are doing, since they are so speculative in nature. All facets of an option change throughout the exchange day. A premium in place when you purchase an option may change by the time you sell the option, for instance. Or, the underlying financial asset may change for any number of reasons. Making money from option trading is not easy but with the right training and the right knowledge, option trading can be highly profitable with a high winning probability ratio.

Here's a way to put this into context: Say you're interested in purchasing a piece of art that catches your eye. The seller wants $10,000, but you're not sure you're ready to make that big of an investment. Luckily, the seller lets you make an option of $500 until the date of April 3rd. You find out on March 30th that the painting in question is actually an authentic Jackson Pollack, worth upwards of $50,000. Because of that option, you are guaranteed the piece of art AT the price of $10,000-allowing you to make a potential profit of $40,000. Conversely, you get the painting appraised and-guess what, April fools-you find out on April 1st that it is only worth $2,000. That option does not mean you are stuck plopping down $10,000 for the faux art-but you will still lose the $2,000 used for the option.

Make sense? As previously stated, an option is a right, but not an obligation. Of course, if you let the option’s expiration date pass by, the option will become unprofitable-and you will thus lose 100% of your investment. Keep in mind, too, that an option is merely a contract that deals with an underlying asset. In our imaginary scenario, the piece of art was the underlying asset. An option is also called a "derivative," because it derives its value from something else (i.e. the piece of art). Underlying assets are most commonly stocks or indexes.

Let’s look at another example. A sales person calls you to set up a meeting with you. You can tell from the excitement in his voice that he thinks he is onto something big. Playing it cool, you tell him that you are busy. You request to make up for the meeting some time the week that follows.

As the person in charge of a movie workshop, it looks like you have listened to a million of these pitches. Some have been brilliant, while others ridiculous.

But you have developed a talent for knowing what will function. And you know from experience that this guy is normally pretty good. In fact, he has been involved with some of your studio’s most successful productions.

After setting up a time to meet, the agent sends you a synopsis of the film along with extracts from the script. He’s acting on behalf of his client, a writer, and wants to sell you the rights to make a film.

After sitting through the presentation you get down to business. Yes, you are interested. You think you might be on to a winner. However, it's a tough market that's already crowded with similar projects.

The agent, who is also well experienced in these types of negotiations, starts to play his game. ‘Look, if you are not interested, that's fine,' he says. 'Just let me know, I 'm meeting with two other studios this week.'

You're of two minds - you could call his bluff and let him go. However, your mind challenges you to pursue the chance which may turn out to be a great opportunity. So what do you do?

During your negotiations, the agent lays down his terms. He wants $100,000 outright for the script. With that amount comes lifetime rights to make the film. You may even sell it on if you decide not to make it yourself.

However, you do not want to pay this much money upfront. There are plenty of other scripts around that you could probably pick up for a better price.

But there's something about the film that resonates. And, you don't wish to run the risk of a competitor getting their hands on it. What if it becomes a massive hit?

So you make a counter offer.

You tell the agent that you'll give him $10,000 right away. For that money, you want exclusive rights to the film for a period of up to one year. If it doesn't go into production during this period, you agree to give up all rights at the end of the time. And, of course, they get to keep the $10,000.

However, if you do make the film during this period, you agree to pay $100,000 once it officially goes into production. Eager to make a deal, the agent agrees to these terms.

What have you done?

As the head of the movie studio, you have just agreed to take out an 'option' on the film. You have agreed to pay $10,000 for the rights to make a movie, within an agreed time frame (one year) for a set price of $100,000.

It's important to comprehend exactly what you've just paid for. It's the 'right' to make the movie. It doesn't mean you 'have' to make the movie. And you don't 'own' the movie either - not unless you pay the agent $100,000 before the option expires.

Compare this with the agent's obligations. By taking the $10,000, he has given up his rights to the movie for twelve months. Meaning that if someone else approaches him in the meantime and offers him $200,000 for example, he can't go and sell it to them instead.

Although you (as the option buyer) and the agent (as the seller) are both parties to the same transaction, you can see that your rights and obligations

are very different.
And so it is with share options.

The buyer has 'rights', whilst the seller (also known as the option 'writer') has 'obligations'. The option writer must deliver the underlying commodity, be it a film script, a tonne of wheat, or an ounce of gold, if and when the buyer exercises their rights. This can happen any time up until the option expires.

Why does the option writer take on this obligation? The answer is simple - they are doing it to receive a fee. Or in option jargon, to receive the 'premium'. Once any option expires, it is worthless. Meaning that the option writer gets to bank this premium.
To receive this premium, the option writer must fulfil their obligations until either of two things happen. One, the option lapses, which occurs at the expiry date. Or two, it's exercised by the option buyer.

What are the parts that make up an option?

You can see from the movie script example that there are certain parts that combine to make up an option. These components include:

i) Asset - the asset over which the option is being written. In this case it's a movie script, but it could be practically anything.
Options aren't a new concept, they've been used extensively throughout history.

ii) Fixed price - the amount that the buyer agrees to pay to the seller for the underlying asset, if and when they exercise their option. For the movie script, the agreed (or exercise) price is $100,000. For a share option, you'll also see this called the 'strike' price.

iii) Expiration date - which sets the deadline for the option to be exercised, otherwise it will expire worthless. In the movie example, it's one year from when they enter the option agreement.

iv) The premium - the amount the two parties agree that the buyer pays to the seller for the option. In the above example, it's $10,000.

These are the basic parts on which both the buyer and seller must agree in any option contract. They must be clear and specific. This way both the seller and buyer understand exactly what their role is in any option contract. That is, what their specific rights (the buyer) and obligations (the seller) are while the exercise price, expiry date and the premium seem straight forward enough, the 'asset' is the one part that needs the most clarity. It needs to be clear exactly what is going to change hands if the buyer exercises their option.

Creating option contracts with clear and consistent features makes for a transparent and readily tradable market. This increases the liquidity as both buyers and sellers become confident in how the option market works.

Likewise with the ASX, share options are made up of clear and consistent parts. For example, each option contract is typically 100 shares. And each option is for a specific share, whether it be ANZ, BHP or Woodside Petroleum.

The ASX also sets a series of expiry dates for each of these share options. It is usually done in March, June, September and December. Although some, like Telstra and the bank shares have many more expiry dates than this.

Each of these expiry dates typically repeat year after year, building confidence in the consistency of the market.

There exists two different types of options, a call option and a put option.

More descriptions will be provided later in the book. For an overview, a call option provides the buyer with the capacity to purchase the underlying asset for a specific price prior to expiry. With the put option, the buyer the right to trade the underlying asset for a specific price prior to expiry.

In the example with the movie script, you as the head of the movie studio are buying a 'call' option on the movie. That is, you're buying the right to take ownership of the movie script if you choose, within the agreed time frame, for a set price.

While you are the 'call' option buyer, the agent is the seller (or writer) of the 'call' option. You are both parties to the same transaction.

Option buyers and sellers have the same rights and obligations for both call and put options. The buyer gains rights when they purchase an option. The seller takes on obligations for which they receive a fee, the premium.

The only difference is that with a call option, the buyer has the right to buy something. Whereas, with a put option, they have the right to sell something.

The Concepts Behind Options

A. Options are Derivatives

Financial instruments are a varied lot and are changing and growing all the time, sometimes rapidly. Everyone has heard about derivatives. Derivatives are simply financial instruments whose value depends on the value of some other instrument. The financial instruments commonly referred to are things like stocks, municipal bonds, notes, commercial bonds, ETF's, index funds, and so many more. Options are just another financial instrument, but they are a form of a derivative. That is, the value of the option depends on the value of the underlying financial instrument.

An option is a choice because you have the option to act on the contract or not, depending on your decisions and the market conditions. Normally, we would act on an option if the decision is in our favor and not if it is to our disadvantage. That is a strong argument for dealing in options. However, in most cases, you are not required to act on the contract, an action called execution of the option. You don't have to if you don't want to. On the other hand, if you buy an option to buy at the contract terms, the seller of that contract is required to sell under those terms. That part of options is a one-way street. Historically, only 10% of options are exercised, that is acted upon, 60% are traded before expiration and the remaining 30% expire worthless.

B. Trading in Options Has Both Risks and Rewards

Trading in options is not without risk, especially for new traders. It is remarkably easy to lose money trading in options. All it takes is a few bad decisions, which are frequently based on lack of understanding on the part of the investor or by not paying attention. We strongly recommend trading only with risk capital. That is, money you can afford to lose if things go bad. Don't trade in options with the rent money or the money set aside for the kid's college education.

This book is designed to help you avoid those mistakes by providing an introductory understanding. Can you trade in options without reading or studying the subject? Of course, but no one can speak a new language without first studying it. Same thing with options trading. This book will get you started by pointing out the fundamentals, but you, the investor, must continue to study and learn, hopefully before you start trading options. Importantly, some of the resources listed in Chapter 7 offer virtual trading platforms, in which you can trade with virtual money, not your own. This is free training and allows you to learn without losing real money. Besides, it is fun.

C. Pick Your Own Trading Strategy

Your trading strategy can be speculative, income, or conservative. A speculative strategy is based on predicting the timing and amount of any movement in the price of the stock. A conservative strategy involves trading in a manner that protects against large losses for equities the investor owns. An income strategy is one under which you generate regular income above that from normal stock gains or dividends. We will cover these in due course.

Usually, options are based on common stocks. We will follow that custom, but options are available for many different instruments like ETF's and Stock Indices. It's just easier to understand with stocks.

D. Option Trading Uses its Own Vocabulary

When you understand a few basic concepts and some vocabulary, you will see that it is not all that complicated. However, you have to study not only the market, but the ins and outs of options trading, too. Now, some of the vocabulary may seem arcane, but it is the "lingo" of Wall Street and is used by all traders and brokers everywhere. You will need to understand this vocabulary to understand the business of options trading.

E. Decide to Pay Attention

Remember, if you choose to trade in options, you have new opportunities but also new responsibilities. If you are holding options on a stock or other instrument, you must keep a close eye on it. There is nothing automatic about options. If you hold an option and it suddenly becomes very valuable, it is up to you to act on it. It will not act on its own, in fact, it may expire and you will lose the premium cost and any value of the option. Under some circumstances, you may be assigned, which means you are required to act on the option. Apart from assignments, nobody is going to call you and ask you what you want to do. You have to follow it closely, but that is interesting and sometimes, exciting.

We assume in this book that you are already familiar with trading in the stock market but somewhat new to trading in options. We can't teach you all the fundamentals of stock market trading and options trading in one book, but we can give you a peek at trading in options. We do, however, offer some information about the stock market in the context of trading in options.

Chapter 2: Choosing the Right Options

So, everyone's making money trading options and you want to join the trade. That's good, but ever since you started options trading, you will experience hundreds of options available on every stock. Lets learn how to select the correct stock options for options trading.

Step 1: Decide on the outlook of the underlying stock.

There is no magic formula in options trading where you can simply trade and profit without concern for the trend of the underlying instrument. The first step to choosing the correct option to trade comes from what you expect the underlying stock to do in the first place. There are generally only three outlooks in stock trading; bullish, bearish or neutral. However, in order to optimize profits in options trading, there can be as many as six different outlooks; sustained bullish, neutral, moderately bullish, volatile, sustained bearish and moderately bearish. You need to decide on which of these six outlooks most closely conform to your expectation on the underlying stock as each of these outlooks require a different options strategy to best optimize its profit potential.

Step 2: Decide on the time frame of that outlook.

Now that you have decided on what the underlying stock is going to do, the next question to answer is WHEN you think the underlying stock going to fulfill its expected outlook. This answers the question of which expiration month to trade your options on. One of the first things that baffle new options traders is the number of expiration months available for each stock. Options are derivative instruments that expire once its lifespan is up. It isn't like stocks which can last as long as the company remains in existence. This makes choosing the correct expiration month so important. Options become more and more expensive and less and less sensitive to movements in the underlying stock with longer expiration. This is why trading options isn't as easy as simply trading options with the longest possible expiration. If you trade options with unnecessarily long expiration, you are paying more for nothing and lowering your return on investment. Conversely, if you trade options with too short expiration, you can end up with a worthless expired position even before the underlying stock has time to move according to your prediction. As such, the more accurately you can predict when the underlying stock is going to behave the way it is expected to, the better you can optimize return on investment in options trading. There are situations such as earnings releases or some major announcements where the exact timing of the outlook can be determined. Other than such objective events, predicting when a stock is going to hit a certain price or remain within a price range requires extremely strong technical analysis skill and experience.

Step 3: Decide on the magnitude of that outlook.

The magnitude of an outlook refers to how strongly you expect the underlying stock to move in the expected direction. In the case of an expected neutral trend, magnitude refers to the expected length of that neutral trend as well as how much volatility is expected within that neutral trend. This is also why in options trading, bullish and bearish trends are classified as either sustained or moderate. Knowing the magnitude of the outlook allows you to decide on the moneyness of the option that you should trade. Moneyness refers to how much in the money or out of the money an option is. The more an option is ‘in the money’, the more expensive it is and the lower the leverage but the better it is at capturing profits on small price movements of the underlying stock. The more out of the money an option is, the cheaper it is, the higher the leverage and the less sensitive it is to price movements on the underlying stock, making them better for use when the expected magnitude of price movement is big.

Step 4: Decide on the optimal options strategy for your account level.

Now that you have an idea what the underlying stock might do, when it is going to do it and how powerful the movement might be, this is when you should decide on the optimal options strategy to profit from that move. The optimal options strategy could be as simple as buying a call option or put option or as complex as a Double Butterfly Spread. Your choice of options strategy would also be limited by your account trading level which defines the range of options strategy that you are allowed to perform. This options account trading level is determined by your broker on an individual basis depending on your fund size and your trading experience.

Step 5: Decide on the exact option to trade taking all of the above into consideration.

Having taken all of the above factors into consideration, you would then be able to decide on the exact correct option to trade. Here's an example of how it works:
Assuming it is currently January and the price of a stock is $50. Assuming you think the price of that stock is going to move upwards but only moderately up to $55 by next month. You decided that this is a moderately bullish outlook which can be better optimized using a Bull Call Spread, writing out of the money call options on the expected price ceiling on at the money call options, rather than just buying in the money call options and your account trading level allows you to execute such debit spreads. Taking all of these factors into consideration, you decided to execute a 50/55 bull call spread on that stock's March expiration options, giving a little bit more time for the stock to move to that expected price.

Chapter 3: Pros of trading Binary options

Ability to invest limited amounts of money

The biggest benefit of binary options is being able to invest an x amount of money towards the options thus allowing the investor to limit the funds invested on a binary option trade. This is very important especially when the investors are new to the trade as they can limit the amount of money invested for each trade. Binary investment thus allows the trader to acquire practice before moving to invest further on the trades.

Binary offer fixed profits or losses

Another major attraction linked to binary options is the ability for the investments to receive a fixed profit or losses. The amounts are also higher in percentage then you would get from trading the stocks directly. This is due to the simple fact that the profits are not based on the stock price but on a fixed agreed amount of profit placed before investing.

Protection

During times when the market is volatile, protective put options can hedge a long stock position against a sharp drop in the underlying stock price. Think of it as the way a life insurance policy protects your family. You are not planning on dying, but should it come to that, your family would be able to survive.

Let me use another example regarding hedging as it relates to options trading. Let's say you decide to invest in seatbelt manufacturing. A company by the name of Keepsafe is rolling out a revolutionary seatbelt that you think is going to change the industry significantly. Keepsafe's seatbelts are being touted as twice as strong and capable as their competitor, Loose fit. For this reason, you feel Keepsafe's share value will show an increase this next year.

However, since you're a wise investor who has planned and investigated the industry, you also realize that seatbelts, in general, are subject to a lot of government regulations and safety approvals, which might make this stock rather volatile. This is known as industry risk. What happens next? Well,

you'll need to find a way to reduce this risk. You can hedge by going long on Keepsafe and short with Loose fit. Let's pretend the value of the shares for each company will be $1,000.
Here's how it works. If the whole industry goes up, you will make a profit on Keepsafe, but you'll lose some on Loose fit. If the entire industry tanks, you will lose money on Keepsafe, but you stand to profit on Loose fit. Sure, your overall profit that could have been made by not hedging is minimized, but you didn't have as much industry risk. You can hedge a long position with put options, or a short seller can hedge a position through call options (7).

Volatility Trading
There are so many ways an options trader can invest, and one of those is to predict whether there will be movement or no movement in the underlying stock price. This is what volatility trading is all about, allowing the trader to profit no matter the direction of the market.

Leverage
Being about to leverage is one of the greatest benefits of options trading; the investor controls the same amount of equity with only a small fraction of the capital needed (7).
Unlike other investments where the risks have no boundaries, options trading are still going to take risks, but they are more defined. Option buyers cannot lose more than the price of the option, or the premium. Most of the time, options are based on equity shares of an underlying investment. Other underlying investments on which you can place an option include Exchange Traded Funds (ETF's), foreign currencies or commodities like industrial products or agriculture, government securities, or stock indexes. When leveraging, investors fix the price for a particular period of time to allow the sale of 100 shares of an equity for a premium price, which is only a percentage of what it would cost if the investor had to pay to own the equity. Remember, the option is only trading risks. When you leverage, you increase your investment power while increasing the possibilities of greater rewards from an equity's price movements, or ticks (8).
When you discuss the benefits of options trading, you cannot avoid speaking of how you can protect and leverage the equity of a volatile

underlying stock price. You also cannot help talking about the cost efficiency of options trading.

Cost Efficiency and Practicality

Here's another example of how options trading offers practicality and cost efficiency. It just makes more practical sense to buy options that will give you the same equity power without the enormous upfront cash outlay. For example, if you needed to purchase 200 shares of Chico Goods while they are trading at $131 a share, you would have to take $26,200 out of your account. Instead, you could have turned to the options market, picked up an option that closely mimics the stock, and bought a call option with a strike price of $100 for $34.

Buying two contracts would give you a size equivalent to the 200 shares of Chico Goods, but your total investment would be $6,800 instead of $26,200 with Chico Goods equity position. Because you still have so much more money in your account, you can use it to just gain interest or apply it to another investment opportunity and diversify.

If Used Properly, Options Can Be Less Risky

The most obvious reason that options can be less risky is that they don't require as much upfront money. With just a fraction of the cost, investors can control the same value of equity shares. As we've already mentioned, options are the most reliable form of hedge. Another great benefit of options is that the options market does not shut down at market closing. They protect you 24/7, and that is one of the main reasons they are considered more dependable for hedging.

A word of warning, though, options trading can only be less risky if the investor knows how to use them properly. It may take a few losses under your belt for you to figure out how and when to buy options. If you are short on capital, options may not be for you. Then again, it may not be for you to invest in a stock of any kind if you don't have the backing to see you through some losses.

Options Offer More Alternatives

Options traders learn multiple ways to achieve their same investment goals. You can trade based on the decrease or increase in stock value. You can trade based on movement or no movement of stock price. You can trade based on the passage of time and volatility of the market. Play your options right, and you could potentially profit in every kind of market. Brokers see the upswing in options trading, and because of this are also being more flexible with their fees, making it more feasible for investors to buy multiple contracts and take multiple positions in each one (9).

Greater Flexibility

Because of the incredible flexibility of options, traders can benefit from almost any market at any time. Investors can find options with virtually any underlying asset, at their desired expiration date, with an affordable strike price, and now with somewhat reasonable brokerage fees. The choices are almost endless. There is, however, a downside to having so many choices. Beginner investors can spend so much time trying to decide when, where, and how to make a move that they miss opportunities. Too many choices can be confusing, so how do you know where to put your money? That's the challenge. If we could give you an absolute on that one, you couldn't afford our advice.

If you can consider options trading with an open mind and implement a purposeful plan, soon you'll be able to reasonably predict the where, when, and how to invest. If options trading were so easy, we'd all be wealthy. The fun aspect of options trading is that the challenge of learning can be exciting and quite rewarding. Think of options trading as your sport. You can decide if you want to play as part of a community team, or are you training for the pros? What is it that you want to achieve by options trading?

It's important to get this settled before investing. Why? Well, what you want will drive the style and strategies you use in options trading. Your plan should focus on your vision of successful trading. The exit strategy you use should be dependent upon your ability to recognize that it's time to end the contract and move to the next trade. After all, if you don't have a clear vision of where you are going in this world of options, how will you know when you have arrived?

It's more effective if your investment goals are direct and specific. Goals with no step-by-step plans are no more than vague dreams that never come to fruition. Without investment goals, and set strategies to achieve those goals, investing will become a game of "your guess is as good as mine."

All beginners get confused and make mistakes, so preparing for those mistakes ahead of time is crucial to your success as an options trader.

Cons linked to binary trading

It is wise to weigh the potential risks of options against the benefits that may be gained before you decide to try your hand at options trading.

Binary options may be the first choice for some people but they are also noted to come with a certain amount of risk. This is especially apparent when a person takes in to consideration the fact that you can lose the entire investment. Unlike stock exchange market where you risk losing a portions of your investment with losses, with binary you lose the entire amount invested.

Levels of Risk

There are two levels of risk when trading options depending upon whether you are the holder or writer of the option.

As the holder of the option, your main risk is losing the entire premium that you paid for the option. If the option expires worthless then you are out your entire principal.

As the writer of the option, you are exposed to a significantly higher level of risk. If you are writing uncovered calls, for example, then your potential loss is unlimited as the underlying security could potentially rise very high.

Intrinsic Value

While purchasing a stock gives a certain amount of intrinsic value, with options it is quite different. An option that is currently at-the-money or out-of-the-money (these concepts are explored more in the next chapter) has no real intrinsic value. Its only value is its time value, which is constantly declining the closer it gets to its expiration date.

Time Decay

A risk that is unique to options is time decay. The closer an option contract gets to its expiration date the more it loses value. Once the option reaches its expiration date it will have no value unless it is exercised in-the-money. If the underlying security takes an unexpected turn during the timeframe of the contract, the investor will potentially lose all of the investment capital. Unlike with stocks, you cannot simply wait it out. For this reason, options are known as *wasting assets*.

Taxes

Another element to consider when investing in options is the tax implications of your trades. Since options are short-term investments they are taxed at a different rate than longer term investments. However, losses on options can also be used to offset gains in other investments, so they can work to your advantage in this regard as well. It is best to consult with a tax advisor to figure out your best strategy for tax savings.

The bottom line is that options trading can be used to leverage your positions and make significant profits. However, they come with their own set of risks and require the investor to be constantly on top of what is going on in the market. Due to their unique time constraints, they are not for investors who like to set and then forget their investments.

Either way it's important to understand that all forms of trading come with some level of risk and risk is part and parcel of trading and business as a whole. So are Daily binary options your preferred mode of trading? Well the answer to that purely depends on you and how you opt to observe the entire situation linked to trading equities or choosing to go with the binary option.

Chapter 4: Option Types

While the following chapters are going to talk mostly about options as they relate to the stock market, there are options for virtually every type of asset that is public traded. No matter what type of underlying asset is being coveted, however, all options can be classified as either calls or puts.

Call Options

In chapter one you read the example of a movie producer buying an option on a film from an agent. If you recall, the producer pays a $10,000 premium to the agent for the right to make the film. The option expires after one year. If the movie goes into production, he's agreed to pay the agent $100,000. If he exercises his right, he takes ownership of the film and can do as he pleases. He can make the film, cancel or postpone it, or sell it on to someone else.

However, from the producer's perspective, he has bought a call option on the film. That is, he paid a premium for the right to exercise his right (take ownership of the film) at any time until the option expires.

Buying a call option over shares listed on the stock exchange market is almost no different to the example of buying an option on the movie. The only difference being that the underlying asset is a share. A call option offers the buyer a right to purchase the underlying asset for a fixed price at any time up until expiry. With a call option on shares, it gives the buyer the right to buy the underlying shares for a fixed price (the strike price) at any time until expiry.

Call Options Consist Of

- A RIGHT to BUY
- At a FIXED rate
- Over a given PERIOD OF TIME

A June BHP $30 call option gives the buyer the right to buy 100 BHP shares for a fixed price of $30 up until the option expires in June. Remember, one contract = 100 shares, five contracts = 500 shares.

And a September $80 CBA call option gives the buyer the right to buy 100 CBA shares for a fixed price of $80 up until the option expires.

For this right, the option buyer pays the option writer a premium. For receiving this premium, the option writer must deliver the shares at the strike price if they get exercised.

Put Options

One day you come out of a meeting to discover that someone has crashed into your car. The car looks extensively damaged, and you wonder if your car will be a 'write-off'. You call the insurance firm to alert them of what has happened. They organize a tow truck to take your car away for assessment.

If the car is repairable, the insurer will arrange for the car to be taken to one of their designated repair shops. If, however, the insurer determines that the cost of repairing your car exceeds its market value, then they might choose to write it off. They might replace it with a new car. Or, depending on its age, write you a cheque for the market value of your car.

Your car insurance policy is really like a type of put option. Instead of paying a premium for the right to buy something (like with a call option), you are paying for the right to sell something. In this case, your car to the insurance company.

Put Options Consist Of

- A RIGHT to SELL
- At a FIXED rate
- Over a given PERIOD OF TIME

Components of A Put Option

Asset – in this case, it's simply your car.

Fixed price - the amount your insurer will pay you in exchange for your car if you make a claim - that is, exercise your put option. Depending on the lifespan of the vehicle, your insurer will replace your car with a new one, or pay you out its market value.

Expiry date - is simply the date at which your insurance policy lapses.

The premium - the amount you pay to your insurer when taking out or renewing your policy.

It is easy to remember how a put option performs by pondering about the word *put*. In this example, you have the right to 'put' your car to your insurance company. They have a contractual obligation to repair, replace or pay out the market value to you as the owner of the vehicle. As the holder of the policy, you have the right to exercise it.

When you take out the policy, you are buying a put option. The seller, in this case the insurance company, is selling you the put option.

If you buy a put option and therefore have rights, you have the ability to 'put' your asset to the put writer/seller, if you choose to exercise it. Note that irrespective of whether it's a call or a put option, the rights remain with the buyer, and the obligations with the seller.

How to use a put option with shares.

A put option buyer has the right to sell their shares to the put option writer for a set price (strike price) at any time until expiry. If exercised the option writer must take delivery of the shares.

A September $30 ANZ put option gives the buyer the right to sell 100 shares of ANZ for a price of $30 up until the option expires in September.

For this right, the option buyer pays the option writer a premium. For receiving this premium, the option writer must take delivery of the shares at the strike price if they get exercised.

If you are looking to purchase an option, then you are looking to create a call and if you are looking to sell an existing option then you are looking to create a put. When you create a call, what you are really doing is saying that you think the underlying stock in question is going to increase in value during the period that the option is valid for. Many people have exercised a call option, even if they aren’t aware of it, as this is what is taking place for anyone who has ever purchased company stock at a set price. On the contrary, if you looking to generate a put then you believe then the price of the asset that underlies the option is going to decrease in price between now and when the option expires.

Regardless of whether it is a call or a put, each option is also going to be either long or short. If an option is short then this means that it is set to expire in six days or less while long options expire either in weeks, months or years. If you are looking to speculate then you are likely going to be interested in short options and if you are interested in using options as a form of insurance then long options are going to be more useful.

In addition to being either a call or a put, an option is generally either classified as either European or American. Despite the obvious differences here, this type of classification has nothing to do with where the option originated and instead has to do when it can be acted upon. An American option can be exercised at any point up to and including the moment it expires. On the other hand, a European option can only be exercised at the time of its expiration which makes them less ideal for those who are just getting into the options game as you have to have a much more specific idea of the movement of the underlying asset in question.

Finally, European and American options can both be thought of as vanilla options as they are the most common types that you are going to encounter. There are also exotic options that can have quite a few more variables attached to them that can make them much more difficult to profit from, unless you know exactly what it is that you are doing. As such, novice options traders are advised to stay away from exotic options for the foreseeable future.

Like the options they deal in, options traders themselves can be classified as well. Those who typically spend their time buying options are known as holder while those who specialize in selling options are called writers. Furthermore, both writer as well as holders will frequently specialize in either puts or calls. The general consensus is that holders will always have the more desirable position in the relationship because they can choose to act at any point, forcing a writer to act before it is the optimum time for them to do so. Additionally, a holder can walk away at any time with very little consequence if their plan stops coming together as originally anticipated.

Chapter 5: Understand The Lingo

An option trader is anybody that purchases as well as offers choices within the capital marketplace. A good investor is actually anybody that purchases as well as offers choices within the capital marketplace. Because trading options are most often carried out via on the internet buying and selling agents. It is also often called on the internet trading options or even on the internet choice buying and selling.

Before starting your service as option traders, you will have to know the lingo.

When it comes to trading options effectively, one of the first things you are going to want to do is to familiarize yourself with the common terms that options traders are likely to use to ensure that even if you can't trade like a professional at least you can speak like one.

Strike Price: The price of a given underlying asset at the moment the option is purchased is called its strike price. The option becomes more expensive when the stock price comes closer to the strike price. The time value component of the option is the greatest when the stock and strike price are equivalent.

Exercised: When the movement of an underlying asset makes the specifications of a given option favorable then it is exercised or taken advantage of and the ownership of the underlying asset changes hands.

Time taken up to expiration. The option price goes higher if it has more time. The time value decreases at a faster rate when the option nears expiration date. On expiration, the option premium's time value component will be 0.

To emphasize, only the time value component of an option decays, and any intrinsic value remains constant and is only affected by a change in underlying security.

The implied volatility of the underlying security. This is an important component of the option price, because it adjusts for the anticipated price movement over the life of the option. Options on stocks that have a higher probability of making a large move are priced more expensive than options on slower moving, less volatile stocks.

The price of the underlying security. This is the simplest variable to understand, as most investors can easily visualize the relationship. As the value of the stock rises or falls, option price is changed correspondingly.

Trade out: If a holder exercises an option that the writer feels is not worth the current market value of the underlying asset then they can trade out which means they essentially buy back the holder's shares and relist them because they believe that a better deal is readily available even with the additional trouble taken into account. All told, some 50 percent of trades expire without any action being taken. Of the remaining 5o percent, only 10 percent are actually exercised with the remaining 40 percent ending up getting traded out.

Listing: The process of creating a new call is referred to as listing an option. Listed options appear on national exchanges and it is recommended that you only deal with listed options until you make it past your options trader novice phase. If you are dealing with vanilla options, then you can realistically expect all of the options you find to include 100 shares of the underlying stock in question.

In the money: If an option is currently in the money then the underlying stock that it is tied to is currently sitting at a point that is above whatever it is you initially paid for it. If, however, it is out of the money instead, then this means that it previously was in the money but has now dropped back down to a point where it is no longer profitable. If the underlying stock is exactly at the price at which you originally purchased it then the option can currently be thought of as at the money.

Value: The value of the underlying stock related to a given option can be broken into two parts, intrinsic and time. Intrinsic value is defined as the difference between the current price and the strike price, assuming it is a positive difference. If the difference is negative, then the intrinsic value is said to be zero as it cannot be a negative number. Time value is simply the amount of time that the option has until it expires, with options with a lower amount of time value having a lower overall value as a result.

Premium: The sum total of the intrinsic value, stock price, time value, strike price and total amount of volatility is said to be an option's premium.

Dividends. All known dividends are priced into the options value to ensure accurate pricing. This equalizes the benefits of being long on the underlying vs. creating synthetic long positions using options only.

Interest rates. The risk-free rate of interest is priced into the option. This is also priced into the option to equalize the benefit of being long on the underlying vs. creating synthetic long positions using options only.

Chapter 6: How to Avoid Costly Mistakes

Save yourself some heartache by avoiding these costly mistakes.

1. **Don’t try to invest more than what you can afford to lose.** Remember, options trading is a risky proposition and if your hunches are wrong or your timing is off it is entirely possible to lose your entire investment. Start off small, no more than 10-15 percent of your portfolio should be used for options trading.

2. **Do the proper research.** Don’t hurry into an investment because someone told you it was a good idea. Do your own research and make an informed decision before you make a trade.

3. **Adjust your strategy based on market conditions.** No one strategy is going to work in all markets. Keep abreast about what is going on in the economy and the financial world and adapt your trading strategies to match current market conditions.

4. **Know your exit strategy before you purchase.** Have a plan and stick to it. Don’t let your emotions overrule your rational decisions. Choose your upside and downside exit points as well as your timeframe and don’t let the euphoria of making larger profits sidetrack you.

5. **Don’t take on more risk than you are comfortable with.** Every investor has their own level of risk tolerance. Know your risk comfort level and choose strategies that stay within that territory. You don’t want to lose sleep at night wondering if you’ve made the right investment decisions.

Chapter 7: Pricing Principles

Traders may use options to obtain earnings through non-dividend-paying shares to buy a share as well as restrict for its danger. Investors may use options to include influence by having a suitable degree of danger that's genuinely restricted, in addition to industry upward, lower as well as range-bound marketplaces.

In spite of these types of advantages as well as constantly developing quantity (more compared to 15% substance quantity development because 1973), options continue to be within their childhood concerning open public knowing as well as popularity.

Listed here are 10 crucial concepts which beginners to options ought to bear in mind because they make plan for the options industry. Now I am going to discuss these concepts.

Concept 1

Understand the distinction in between utilizing options to get as well as utilizing options to industry: Traders concentrate on the advantages of long-term share possession, and they ought to make use of options to purchase, market, or even safeguard share jobs, in order to improve earnings through share jobs. Think about a good buyer likely to purchase share whenever he or she gets the year-end reward. This particular buyer can purchase 1 phone these days for every 100 gives he or she programs to buy. The phone option is really an agreement that provides the customer to purchase the fundamental share in the hit cost any time before termination day. Basically, it is with regard to having to pay the price of the shares for these days. When the share cost is greater once the buyer gets the actual reward, he then nevertheless can buy the planned-for quantity of gives. With no phone, the amount of gives would need to end up being decreased provided the larger share cost.

Investors, as opposed to traders, tend to be short-term marketplace timers along with small curiosity about having the fundamental share, and they frequently make use of a higher level of influence. Bought options provide investors the possibility of substantial influence along with restricted danger. However, the danger is real. Options may shed 50% or even more of the cost very quickly in the event that the buying prices of the fundamental share techniques the wrong manner. Additionally, out-of-the-money options end useless from termination for any complete lack of the cost compensated, in addition, profits.

Concept 2

Traders who make use of options require a strategy: May the bought option end up being worked out or even offered if it's in-the-money from termination? Protected authors have to know whether they are prepared to market the fundamental share. Otherwise, it is advisable to choose ahead of time from exactly what cost the phone call is going to be repurchased or even folded to an additional option.

Concept 3

Know how as well as the reason why option costs later: Option costs later in a different way compared to share costs, therefore option investors have to strategy in a different way compared to share investors. An average problem through beginners to options is real: “The share proceeded to go upward, however, my personal phone didn't!” Focusing on how costs alter is important to utilizing options effectively.

The worth associated with time provides theoretical ideals of the 50-strike phone from various share costs and various times to termination provided the mentioned presumptions regarding rates of interest, returns as well as volatility. Each one of the series within the desk is really a various share cost, as well as each one of the posts is really a various quantity of times to termination. This discloses 2 essential ideas regarding option costs -- the idea of "delta" which associated with "non-linear period rot.

The idea of "delta" is which for any $1 alter within the fundamental share cost, the worthiness of the phone can change through under $1. Within “The worth of your time, when the share cost increases through $50 to $51 from

3 months, the $50 increases through 50¢. Delta explains the anticipated alter within an option's cost for any $1 alter within the fundamental stock's cost, which means this is referred to as using a delta associated with 0.50.

The desk demonstrates which option costs don't reduce at the exact same price after a while to termination, presuming elements besides time for you to termination stay continuous. Think about the middle strip where the share is $50. Because the time for you to termination reduces through 50% through 3 months to forty-five times, the worthiness from the $50 phone reduces through around 31% through $3. 20 in order to $2. Twenty-five. It's this that “non-linear period erosion” indicates.

Searching throughout any kind of strip, you will see how the reduction in the passing of your time, so-called period erosion or even theta, differs based on regardless of whether an option is in-the-money, at-the-money or even out-of-the-money.

Concept 4

Option investors require self-discipline within getting earnings as well as deficits: Very first, possess a revenue focus on as well as near or even decrease how big a situation in the event that which cost is actually arrived at. 2nd, possess a stop-loss stage as well as near or even decrease how big a situation from which cost. 3rd, possess a time period limit as well as near or even decrease how big a situation in the event that nor the actual revenue focus on neither the stop-loss stage tends to be arrived at through the finish of times time period.

Concept 5

Don't get freaked away through volatility: Conceptually, options act like insurance coverage, and also the volatility element in options refers towards the danger element in insurance coverage. It's a key point, however, it's not the only real element. Whilst the idea of volatility isn't without effort apparent in order to beginners, it may be discovered in the event that the first is individual.

Concept 6

It possesses practical anticipation: Learning the actual ideas associated with delta as well as theta (time decay) is definitely an essential action towards the aim of building practical anticipation about how exactly option costs may as well as may not alter as well as just how much revenue possible as well as danger every technique offers.

Concept 7

Buying undervalued options as well as selling over-valued options aren't adequate methods: “Value” is really a very subjective dedication that each investor should help to make separately. Option investors should concentrate on their own three-part predict around or even more compared to “value” of the option.

Concept 8

Selling options" isn't a much better technique compared to "buying options": It's a fantasy which 80-90% associated with options end useless. Around 1 / 3, or even 33%, associated with options end useless whilst 10-15% tend to be worked out. The remainder will be shut just before termination. Whilst option composing (selling) could be a prosperous technique, beginners frequently misunderstand this. There's a cause, there's a high quality to take upon much more danger. There isn't any solution to it -- option purchasers spend reasonably limited associated with described danger as well as option retailers get a high quality to take on danger.

Concept 9

Influence is really a double-edged blade: Option investors ought to handle their own funds in a different way compared to share investors. Your decision is to buy two hundred gives off the trading from $50 for each reveal is extremely various how the option to buy 100 phone trading options from $1 every, despite the fact that each deal includes a good expense associated with $10, 000, excluding profits. Usually, options investors may commit an inferior part of complete funds to every industry.

Option investors, nevertheless, may have much more open up jobs compared to share investors.

Concept 10

Create a marketplace predicting method through beginning little, recognizing earnings with deficits as well as through operating at a constant speed: Investors will be able to clarify their own trade-selection procedure inside a couple of phrases. New people can deal which have just little possible earnings as well as deficits, simply because this can improve their own likelihood of sustaining objectivity. Deals should be started and shut to ensure that the trading rhythm is created.

Almost any person may learn how to work on options trading when they invest a couple of hours in each week on their own method. However, you may invest many years without having learning options. Discover these types of concepts as well as go one action at any given time. Options tend to be such as levels of the red onion -- there's always something a new comer to discover. Don't grow to become discouraged as well as, more to the point, don't turn out to be more than assured and believe you realize everything simply because you will get burnt.

Chapter 8: In Action

Writing A Put Option

Let's assume you are in possession of 100 BHP shares. You are scared that the prices may fall. An idea crops up in your head. You make up your mind to purchase a put option which has a strike price of $25. At any given time until the expiry of the option, you can 'put' your 100 shares to the option seller for $25.

In case there is a fall in price to $24, you will decide to exercise your option since it gives you the chance to sell your number of shares for $25 ($1 above the current market price). On the other hand, if the shares close at a price higher than $25, you won't exercise the option since you could sell for a higher price.

The put option behaves in the same manner as the insurance. The put option buyer pays a premium to lock in a guaranteed price at which they can sell their shares prior to the expiry of the option.

On the other side of the trade, the option buyer buys a premium for the rights to sell the shares as the option seller takes on obligations. The option sellers are obligated to purchase underlying shares from option holders at the strike price. In exchange, the seller gets a premium. The sellers are always assured of compensation when they perceive the trade to be riskier.

Whenever an individual writes an option, they receive money in their trading account after a day. You ought to remember that not unless the option expires, the obligations will not lapse. The time lapse can be up to three months. Nonetheless, the fact that you already have a put option written does not imply you are bound to hold to it until expiry. You have a chance to buy it before the expiry date. In simple terms, once you sell a put option and you get it exercised, you will have the opportunity to buy shares.

Taking an example of the BHP stated above, selling the BHP put option at a strike price of $25 and there was a drop in price to $20 will mean that you will still buy it at $25. It is above the market price and $500 loss is made on one option contract.

Reasons why people write options

People write options as a way to generate income. Options are written over shares. This is done at strike prices where they believe they will not be exercised. The general outlook is that 70% of the option contracts do not get to the level of being exercised.
Probably. You need to get prepared for the contract being exercised. If it does not happen, then, you ought to have funds ready in your account to purchase the stock if it is put across to you.

Writing options are a way of trading. You will expect prices to rise and fall. Options may be sold for no apparent reason than the expectation of buying it at a lowered price in the future. For instance, you may sell an option contract at 80 cents for one share expecting to buy them back at 40 cents a share.

Writing options is a way of giving the players a right to own the underlying shares. Being ready to buy the underlying shares means you are ready to own them. Selling the put options lowers your entry price.

How it works? If a given firm has shares trading at $30 and you want to own them, you will have the privilege of purchasing the shares outright. The other way is selling a put option at a strike price of $30. You may receive 50 cents for every share and end up being exercised. The entry price is at $29.50 per share, which is cheaper as compared to buying the shares directly.

In the event you won't be exercised, you will keep the 50 cents and no ownership of the shares.

Writing strategy for a put option

We write options with the aim of generating income. If not exercised, then it is okay because we will continue writing more to continue the cycle of generating more income. Once an option expires, we move on by writing the next in line.

Never be tempted to sell a put option unless you are prepared to take full ownership of the underlying shares. The stock can be put to you at any given stage. Thus, you should write options that you are willing and happy to own.

On the other side, writing a put option does not directly imply that you must own it until its expiry period. It is a free trading market that entails buyers and sellers. If things do not go as your plan, you will have the chance to buy back a put option to close out your position.

You need to avoid such situation because options are not very liquid as compared to underlying shares. Meaning you may end up paying more to buy them back. Another reason is about brokerage where you pay for one lot of brokerage in the event you write an option that expires worthless. When you need to buy them back, you will pay a second lot of brokerage as well which becomes a lot of money with time.

The outcomes of this strategy include:

- You won't be exercised meaning you keep the cash and can repeat the process.
- You are exercised meaning you will have to buy the shares.

Rules of writing a put option

1. Only write an option at a given strike price that you are willing and ready to pay for the underlying shares. If you are prepared for $25 a share, do not write a put option that has a strike price above the $25.

2. Stocks that are more volatile have a higher premium on the option. Therefore you are not ready to take the risk, then do not write a put option over shares of a given company just because you expect a larger premium.

3. Option expiry time can range from a month to three while others can exceed six, nine or twelve months and beyond. Tie value makes the writer earn a good-sized premium but more risk is involved. Therefore, do not write a put option with an expiry date too far away.

4. Write a put option on shares that you are willing and happy to own.

The Process of Writing A Call Option for Income

In the previous section, we discussed the two scenarios that happen when you 'write' a put option. They all end up to where the share price is when the option expires. A higher share price over the strike price means the option is worthless on expiry. If the share price is lower, the buyer exercises their option at the strike price.

Our aim is to write put options that we are happy to own. Thus, we are ready to own the shares. If we are exercised, we will have the different choices as discussed below. Now that the shares have ‘put’ to you, what next?

If you wrote a put option and it expires in the money, a broker will notify you that you have been exercised. From here, it won’t have a difference to buying shares outright in the market by yourself. You will pay the brokerage fee and settlement will T + 3 just as a normal share transaction.

The ways to take when you get ‘put’ the shares.

a) You may decide to keep the shares. This is so since you wrote put options that you are happy to own. You keep them in your portfolio and manage them just as shares. The put options will earn you a dividend.

b) You may decide to sell the shares and make a profit from the proceedings.

c) Another way is to keep the shares and write call options over them. Selling call options over the underlying shares ‘put’ to you allows one to generate cash. Writing call options means you are obligated to sell underlying shares at options strike price if you get exercised.

Before writing call options you ought to understand the tax implications in the event you are exercised. If the options have gained a lot in value with time, you will get profits once you are exercised. You will thus attract capital gains meaning you will be liable to the tax bill.

Writing call options to generate income

Take a situation where you wrote a put at a strike price of $20 and you have been exercised. This means that you have paid $20 for shares which is less the premium you would receive for writing the option.

As a call option writer, you have an obligation to deliver the shares at the strike price if you are exercised. What you ought to do is pick a strike price that you are happy to sell the shares at.

Therefore, if you are not ready to sell the shares below $21, then you are not supposed to choose a call option that has a strike price below $21.

For this example, given that you're happy to sell these shares at $21. You write a call option with a strike price of $21 for which you receive 50 cents per share. If the share price is trading above $21 when the expiry of the option, you'll get exercised. This means that you'll have to deliver your shares for which you'll receive $21. Don't forget that you've already received 50 cents in premium so you're really getting $21.50 for your shares, less any brokerage and other charges.

Now that you have paid $20 per share when the shares were 'put' to you which is less the received premium and now you have received $21.50 per share, less brokerage. Not a bad return.

What about a situation when the share price does not trade above $21? Well, when the option expires, you will be forced to keep the premium and repeat the process again. Another call option indeed. You may sell the next option on expiry of one option. For example, assuming the shares are trading at $20.50, you may sell a $22 call option for which you will receive another different premium. The repeated process is a way to build an income generating stream.

Are there some risks associated with this strategy? With this strategy, you may find yourself buying shares at a price that is higher as compared to the current market price. You need to be aware that some share prices may take a big hit. Reasons can be associated with the given company announcing bad news or the existence of a big fall in the market shareholding.

While you have a choice to buy the option back in the market before it expires, it's vital to know that options are not as liquid as the share market. You will end up paying more just to exit the position. You will find that people write options over the firms they are happy to own for dividend incomes and at a price that they are willing and ready to pay.

A deviation on the theme

In the strategy above, we will write call options on shares if they happen to be 'put' to us. Instead of writing a put option and waiting for it to be exercised on you, you may decide buy the shares outright in the market and then write a call option over them at the same time. This is a' buy/write' strategy.

For example, you may buy a company’s shares trading at $8 and then write a $9 call option over them. If you don't get exercised, you will retain the premium. If you are exercised, you lock in a profit from the share sale, plus the premium you've already received.

Let’s look at an example. We use a random company called ABC Corporation.

Step 1
After having a thorough analysis, you have resolved to but shares for ABC Corp. since you are happy to own them. They are trading at $11 but your intention is to buy when the price is $10.

Action to take: You will write a put option with a strike price of $10 and get a premium of 30 cents a share. On one contract, if you get 'put' shares, you will be needed to pay up a total of $1,000 ($10nper share multiplied by one contract –equivalent to 100 shares).

If you traded out the put option, you would get 30 cents per share, meaning you will get $30 for the contract. If you are not exercised, you will keep the

premium, less any charges including brokerage. You will generate more income by ensuring that you repeat the process again given that you are happy to own the shares at the strike price.
If you are exercised, you will buy the shares in ABC Corp. at $10, irrespective of the price it is trading at. The operational entry price is now $9.70 ($10 strike price less the 30 cents earned in premium).

Step 2
If you have 'put' your shares, you may earn additional income writing a call option over them.

If ABC Corp. shares are currently trading at $10, then the action to be taken is as follows. Write an $11 call option. Here, you get 30 cents per share. Given a situation does not trade above $11 and you are not exercised, you will keep the premium. You can opt to repeat the process. You will write the call option at a strike price that you are willing and prepared to sell the shares at. If they trade at a price above the $11 strike price and in the eventuality that you are exercised, you will sell the shares at a price that you are happy with.

Step 3
If the call option you sold over ABC Corp. is exercised and you now own the shares (and received the strike price as well), you may decide to repeat the procedure from step 1.

Chapter 9: Top Secrets from Various Experts

When you are starting out with options trading, you will feel like you're bombarded with a ton of information. Which is true. But if you want to have the motivation right from the start and avoid those beginner losses, you have to have a couple of tricks up your sleeve to gain an advantage. Because at the end of the day, the advantages/leverages is the only thing that will bring you the profits you want.

While most people might think that there are really some kind of "secrets" that keeps the rich people rich, and not letting the other trading win. But that cannot be far away from the truth. In fact, all the secrets that you will be reading here, are all common sense and they all depend on your ability to recognize those things and apply them.

The biggest secret to everything (yes, even life) is patience and self-discipline. You want to make sure that you are learning new things with every trade and that your knowledge about a particular subject is constantly increasing. This way, you will be challenged, but in a hard and positive way.

1. Never Think in Dollar Amounts. Think In Terms of Fixed Percentages

This is one of the huge mistakes that even intermediate traders make – they tend to think in terms of the dollar amounts that they'll be profiting or risking on every trade.
When you think of making trades in dollar amounts, you will be thinking that you want to make at least $2 for every $1 you have in your trading account. And let's say that you have a $5000 dollar account. Common sense says that you already have $2 on the line, which can go both ways – it can either turn into a profit, or it can turn into a loss. And that includes your original $1 too.

So you decide to put $500 on the line to make a profit of $2 for every $1. Simple calculation says that it will only take 10 bad trades for you to run out of money.
On the other hand, if you think of these things in terms of fixed percentage, you will be preventing yourself from taking a lot of risk. So, if you decide to risk 3% of your total capital to make a profit, you will only be risking $150 per trade.

Of course that also means that the amount you will be able to risk will increase as your account grows.

So, save yourself from taking huge risks by thinking in terms of fixed percentage, and not in dollar amounts.

2. Hedge, Hedge, Hedge

Hedging is one of the most important parts of options trading.

Consider for instance that you are purchasing an opposing position and you're also maintaining your current position. After that purchase, if you think that the stock will go higher, you can simply purchase 10 call options to profit.

But what if the universe plays a game against you and the stock doesn't go higher? You will end up losing that money as the options expire.

But with hedging, you can turn that loss into a profit by purchasing 5 put options when things are going against you. So, even if things go really bad for you, you can still come out of it with a profit in hand.

There is one other technique of hedging that is called covered call. In this technique, you own the underlying stock and you sell a call on that stock. When you sell the call, you agree that you will cover sell the stock at strike price in the option. This means that the risk on your capital is converted to the asset, which results in you losing less money when things hit the fan.

One thing you should remember with every trade, is that you should use everything in your arsenal and have as much leverage as you can to come out with a profit. Make use of different techniques and options you have. Plus, leverage the security that you get with options trading.

3. There is never an “All-Purpose” strategy

Traders and investors who follow a single strategy no matter what the market conditions are, are usually the ones who get scared with the stock market. They keep investing and don’t sell unless there is a huge change in the fundamentals.

That is completely wrong if you want to make a quick profit and avoid the long-term risks.

Also, there is never an “All-purpose” strategy as some traders use. In this case, you need to go with the flow and adapt according to the market conditions. Moreover, let the conditions of the market guide you in the right direction. More often than not, you will come out with a profit.

This means that you should never overlook any opportunities of buying calls, spreads and puts. But of course, you should know what’s happening in the market before you buy any of that. This is where the research comes into play.

4. Always have an exit strategy

This should go without saying.

You should always be ahead of the curve and have an exit strategy in place. It doesn’t matter whether you are winning or losing. A good exit strategy will help you limit your losses when things go south. Plus, it also helps you get unstuck from some trades that keep sucking in your money.

On the other hand, an exit strategy also keeps you from losing the profits in the future.

This rule is universal for any type of investing. You want to make sure that you can get out of the situation with a smile and a healthy sum.

5. Research before doubling down

It is tempting to double up your profits when you know that a trade is going according to your plan. But then too, bad things happen. And that’s why you want to make sure that you are ahead of the game.

You figure out the trends and then play according to that to prevent yourself from losses. Make sure that you know that a trend is solid and you can trust it to bring your profit.
Even after that, you should have an exit plan everything in place to save yourself when things go south.

Never play catch up when it comes to options trading because you’ll end up blowing your account.

It might be easy to open a new options trading account, but it is not worth the work. You should try to stay low and learn to ropes when starting out, and then gradually increase the risks that you take. And over time, you will be able to live a trading lifestyle.

6. Never start trading with out-of-the-money (OTM) call options

On the surface, it might look like the right thing to do, but it is more of a gamble and less of a trade. It feels right to buy low and sell high because that’s the business/trading mentality all of us have. But you see, there is a lot more to options trading than just buying low and selling high. There are a ton of other leverages you can have to increase those profits consistently.

OTM calls is one of the biggest mistakes that options trading newbies make. They do not know that it is one of the hardest ways to make money on a consistent level.

So what is so wrong about buying calls?

It takes a lot of research and toughness to call the direction in which the stock will move. Not only you have to be right about the direction, you also have to be right about the timing of that direction. If anything goes against that, you lose the premium you paid for that option.

And when things go south, each day the stock doesn't move in your desired direction, your option evaporates just sitting under the sun. Each day it will be waiting for the expiration date because there's not much that you can do.

What you can do to have an informed trade in this situation is sell an OTM call on a stock that you already own. This is called "covered call" in options trading terms. What you're basically agreeing to, is that if the strike price is higher than the current price of the stock, and if the price of the stock reaches the strike price or goes beyond that within the mentioned time period, you won't have any obligations selling the stock to the buyer if they "call" it.

When you do this, you will be making some money by selling your OTM call. And if the stock price reaches the strike price, you'll earn even more profits.

Selling your OTM call reduces the risk and puts the risk on the stock itself. This means that even though the risk is substantial, you won't be losing as much as you would if you hadn't sold the OTM call.

But if the stock price doesn't reach the strike price and if the market remains flat, you won't lose much and you will also collect the premium for selling the call. Eventually you will have your long stock position you had before you sold the OTM call.

On the other hand, if you familiarize yourself with the world of options trading by selling covered calls, you will learn the ropes much faster and without losing a lot of money. Selling covered calls is considered as a smart strategy because the risk is very low, while you can still earn a substantial amount of profits.

Plus, you will also learn how the price of options reacts to small moves in the stock and how the price decays over time.

7. Trading illiquid options

If you want to make quick profits, liquidity is important.

Liquidity means that a market is ready and already has active buyers and sellers at all times.

The mathematical definition of liquidity will be: The probability that the next trade will be executed at a price equal to the last one.

Unlike options trading, Stock markets are usually more liquid. This is because the stock traders are trading just one type of stock. While on the other hand, options traders have a plethora of contracts that they can choose from.

For instance, a stock trader will only have to buy one form of IBM stock, that's it.
An options trader on the other hand, will have a ton of expiration dates, and a bucket load of strike prices to choose from. This means that the options trading market is not as liquid as the stock market. But IBM does not have to do anything with the liquidity in options trading or the stock market.

Let's take another example of a company that is smaller than IBM.

The stocks of SuperiorProcessors will be much more inactive compared to IBM, and the options will be even more inactive. SuperiorProcessors is an imaginary processor manufacturing company that promises that the world will use quantum processors in their daily life within 5 years. But since they are a small company, their stocks are only traded once a week and by appointment only.

When the stocks are inactive, the bid and ask price of the options get artificially wide. For instance, if the bid-ask spread is \$0.30 (bid=\$1.90, ask=\$2.20), and if you buy the \$2.20 contract, you will be establishing a position at a loss right off the bat. Plus, you will also have a ton of issues dealing with it because of the lack of liquidity in the market for that particular stock.

The best thing you can do for yourself when starting out with options trading, is to trade liquid options. This will not only help you save a lot of time, money and stress, but it will also help you learn a lot more in a short amount of time.

8. Never wait too long to buy back your short options

It doesn't matter whether you are just hoping that you would be able to squeeze out that tiny profit from the trade, or you are just waiting for the contract to expire worthless. You should never wait too long to buy back your short options.

Buying short options early is much better than dwelling on why you committed the same mistake again.

If you think that a trade is getting out of hand, and you can buy your short option back to cut off the risk and end the trade with a profit, then do that immediately. It will be worth the extra money you pay.

For instance, if you sold a $1.00 option, and its worth has now dropped to 20 cents, you wouldn't sell it because it is not worth it. Also, you shouldn't be thinking of squeezing out a couple of cents in profit from that trade.

The best thing you can do to save your 80% from going away, is to buy back the short option immediately. Because it is just a matter of time when the short option will come around like karma and bite you just because you waited too long to buy it back.

9. Never fail to include the earnings or dividend payments dates in your options strategy

You want to be aware of when the dividend is approaching of the underlying stock because as an options owner, you have no right to a dividend of a stock. To collect the dividend, one has to exercise their options contract and buy the underlying stock.

Keeping track of these dates will work in your favor and avoid the risks of being assigned early. You will see in the next secret that being assigned is a random thing that happens and it is a threat for options traders. Impending dividends are one of the few factors you can identify and avoid to reduce your chances of being assigned.

If you think this in the real world scenarios, you will realize that options contracts get pricier during the earnings season. Options contracts are like insurance. If you want to get a home insurance in Florida, and your weather forecast says that there is a hurricane heading your way, then it is obvious that the insurance will be much expensive compared to other scenarios.

The same thing happens with options contracts. They get expensive during the earnings season.

If you like trading high volatility stocks, the earnings season will be the best time for you to do that. But you should also go with a mindset that there will be a lot of ups and downs, and you'll have to gain a lot of leverage to stay above the water.

To be on a safe side as a beginner, you want to trade options after the earnings have been announced and the effects have been absorbed by the market.

If you want to experience the volatility and learn, you should stay safe by buying just one option and selling another. This will create a spread.

How will this help you?

The price of the option you will be buying, is likely inflated due to the earning season. But the price of the option that you will be selling will also be inflated thanks to the season.

10. Know what to do when you're assigned early

Most newbies panic when they are assigned. And the decisions they make during that time, can be devastating to their strategy.

It is always better to know that if you are selling options, there is a chance that you might get assigned. This can happen especially if you are having a multi-leg strategy where you are dealing in both, long and short spreads.

You are running a long call spread and the higher strike short option is assigned for instance. Most beginner and even intermediate traders will panic and try to get themselves out of the situation by exercising the lower-strike long option to deliver the stock. But in the long run, that is not the best decision that you will take.

The best thing you can in this situation, is to sell the long option in the open market. This will help you capture the premium and also the option's value. You can then use that to purchase the underlying stock. Once you have the stock, you can then deliver the stock to the option holder at the higher strike price.

This will barely affect your strategy. In fact, it will push you to take steps and ensure that you come out with a profit out of every trade.

Being assigned is one of those moments in the market that seem irrational and that universe is playing a game with you. You won't have any reason as to why that happened. It just happens and you have to deal with that in the best way possible.
The best thing you can do to avoid being assigned, is exercising your call early if a dividend is pending. But we both know that it is not that simple.

As I said, the best defense against early assignment, is to include the dates of dividends and earnings into your strategy before getting into a trade. Or else, it will push you into making decisions that you won't like in the future.

When you factor those dates, you will ask yourself which option to exercise early – put or call?

Exercising a put option means that you will sell the stock and get cash right now. But before doing that, you should ask yourself whether you want the cash right now, or at the date of expiration? Some traders will want the cash, while others might want later. This means that put options are usually exercised earlier than calls, unless of course if the stock is paying a dividend.

When you choose to exercise a call, this means that the trader is willing to spend the cash now and wants to buy the underlying stock. But usually, traders are more compelled towards spending the cash later in time. And this is when less skilled options traders make the mistake of pulling the trigger too early. And by doing that, they leave time premium on the table.

Conclusion

You should now have a basic understanding to options and the world of options trading. If you have carefully read and understood everything that has been taught in this book, you will now be in possession of the knowledge that is required to help you confidently start trading options to earn a consistent income every month.

Now you are ready to apply what you have learned and get started in investing.

Remember, do your research and don’t take on more risk than you are comfortable with.

Best of luck!

Thank You

Thank you again for downloading and reading this book!

I believe it has helped you to have more information about options trading. Find time to explore more about the topic.

If you enjoyed reading this book, then I’d like to ask you for a small favor. Could you be so kind enough to leave a review for this book.

It would be greatly appreciated!

Investing For Beginners

The Ultimate Bible to Investing In The Stock Market, Options Trading & Forex

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Introduction

Congratulations for downloading the book, *"Investing For Beginners: The Ultimate Bible to Investing In The Stock Market, Options Trading & Forex"*.

What does investment mean to you? We need to see it as a way of sparing any extra money you have so that it can work for you. The education system we pass through trains us into believing that our fate of income lies into getting a 9 to 5 job. What this implies is that if you need more money you need to work for extra hours at your job. This will make you to give up on the leisure activities that you enjoy during weekends to enable you earn some extra money. Sad that you may not have the time to spend your extra money.

Now, if you need to enjoy much of your free time, you need to place your funds to work in a nice investment. With an investment, you may travel around the world, sleep or undertake other tasks while you will earn money. Whether you have that overtime or not, you will still make extra money. Are you happy about that?

What you need to understand most is the idea of ensuring that you have money working for you. There are nnumerous channels available for you to invest in including stocks, options, bonds and forex among others. Each has positives and negatives which are crucial for one to know. Making losses is part of the game and you have to face the storm and hang on to realize the profits. Have a sound plan to ensure that you are financially stable for years to come.

Investing is a hope of gaining a profit in the future; a profit is the surplus of an investment and is the motive for investing; an example of an investment is CFD (contract for difference) trading in currency pairs, stocks, commodities and indices.

Investing in an item as CFD trading has potential risk and the success depends on the investor's background, dedication, desire and motivation; in the disclaimers on the online trading platforms are also written that the investors should not trade with money they cannot afford to lose.

What should an investor invest in and gain a future profit?

It is always a good idea investing in a well-known item as the likelihood gaining a profit is higher; an example is trading currency pairs; the volume in the market is highest when the New York market and London market are open at the same time; the high volume makes the price trends less volatile and easier predicting the price fluctuation.

Trading CFD in currency pairs, stocks, commodities and indices are different markets which means the items and the price fluctuations are divergent; if an investor would like to trade in one of the market's he should follow the fluctuations and the volatility in the market and the item he would like to invest in; an example of an item is the currency pair EURUSD or the stock Goggle.

When the investor monitor the markets he will discover that the prices are different which means that an investment in a stock is more expensive than buying a currency pair; the equity trading a stock is higher than trading in a currency pair.

He will also discover that it is difficult finding an item he would like to trade in even if he know the items; one way to learn how to trade is to be a part of a social investment network; it is a net where traders follow and copying other traders and interact. The advantages being a part of a network is that it is possible to learn how different currency pairs or other items fluctuate and when to enter a trade as the traders on the social platform can follow other trader's open and closed positions.

One of the main advantages of a social network is the copy trade; a copy trade is copying another trader's open position and gain the profit he will bring in on the position. One of the social investment networks has announced that 64 percent of their open positions are copy trades.

All in all, it is always a good idea investing in a well-known item as the likelihood gaining a profit is higher; if it is a copy trade it is also a good idea knowing the performance of the trader before copying him.

Read on to enjoy the great information outlined in this book!

Chapter 1: Basics of Fundamental Investing

Fundamental investing really boils down to investing in a company because you believe in what the company is doing and its potential. Such an arrangement requires more work to be done as compared to technical trading.

With technical trading, your data points basically begin and end with the performance of the stock. Now, your data set can extend for a long time in the past and can be projected quite some time in the future, but it only comes from one place. It only comes from the actual performance of the stock. There is no other source of data points. This gives you a greater sense of control.

With fundamental investing, you're focused on three key questions. Is the company making money? Will it continue to make money in the future? How well does it compare to others in its industry?

Now, it may seem that these questions are pretty simple and straightforward, but you have to understand how you get information to answer these questions.

Fundamental investing, ultimately, is all about the midterm to long term value of the company. It's not really the stock itself that you're paying attention to, but the company‘s quality, how well it's doing, and how likely it is that it would do better in the future.

Another key aspect of fundamental investing is that you are looking for bargains. That's the bottom line. Either you are looking for a company that is underpriced by the market now or in the future.

It's easy to understand the first scenario. For example: Company A is doing really well in its industry. It is a market leader, has great products in its development pipeline, and possesses a tremendous client base. Still, it's in an industry that is, for some reason or other, not very sexy. Similarly, its growth rate is not as stunning as internet companies or other technology-based companies.

While this company is making more money than companies in sexier industries, it doesn't matter to the market. The market thinks that this company is simply just not interesting enough. However, when you look at the cash flow of the company, how much debt it has, and all other important factors, you can see that there is a tremendous amount of discounting going on as far as its market valuation. There's a big disconnect between what its stock price should be based on its earnings and earnings potential and what the company currently trades at.

Before you even think of investing the money that you have saved up in the bank, you need to do some serious self assessment. Go out of your way to try to understand what your investment profile is. There are two key factors that you need to focus on: risk tolerance and risk profile. You can't confuse these two.

Also, you have to make sure that you are completely honest with yourself regarding these two factors. If you get your signals mixed or you're confused as to these two very important investment factors, it's very easy for you to make the wrong investment decisions. It's very easy for you to invest in asset classes and specific investments that might lead to you losing money.

Just because other people have different risk tolerance and risk profiles, it doesn't necessarily mean that you have to copy them. In fact, if you copy them, you might find out that their particular investment style doesn't fit you. You might have different priorities.

Risk Tolerance

Your age actually has a lot to do with your risk tolerance. Risk tolerance boils down to how much risk you can take on. This may seem pretty straightforward. You are a risk taker, you might be thinking that you would be able to bet all of your savings on a risky stock. That would be a foolish way of assessing risk tolerance. Instead, you should look at your risk tolerance based on one simple metric: How long would it take for you to earn back the amount of money you invested and lost?

In other words, risk tolerance measures your ability to gather the same amount of resources if your investment failed. You have to look at your risk tolerance from this perspective because it has nothing to do with how courageous you are. It has nothing to do with how well you can handle adversity. Instead, it assumes that if you are younger, you have a lot more opportunities to earn your investment capital back.

Whether you work for that capital or you start businesses to recoup that capital, you have to have enough time to earn that money back. This is why age is such a big factor. When you're younger, you simply have more time to recover from investment failures.

On the other side of the spectrum are older people. If you are older and you're getting close to retirement age, you really can't afford to take big risks. You should focus on less risky investments like government-backed securities.

As you get closer to retirement age, you can't earn your investment cash back as quickly as if you were in your 20's. In fact, if you are really close to the age of 65, it's almost all but impossible for you to earn back your life's savings.

Accordingly, your risk tolerance should be on the conservative side. While you may be a very courageous person and you can definitely see the upside of making the right investment at the right time to produce the right returns, in practical terms, you just might not have enough time to recoup your investment should things go south.

Risk Profile

Your risk profile indicates your personal comfort level with particular types of investments. As mentioned in a previous chapter, some investments are less risky than others. For example, government-backed securities are not very risky at all. While there's always a remote chance of a government default, it's so remote that it's not really a consideration. This is why if you're looking for a very conservative investment, you should look into government-backed securities like national bonds, state bonds and even municipal bonds.

Your risk profile measures your personal risk tolerance. In other words, it indicates how courageous you are when it comes to investment choices.

Different asset classes have different risk profiles. For example, real estate has historically been a conservative investment vehicle. However, within real estate, there are riskier deals and less risky deals.

You have to also pay attention to your risk profile when you decide to invest. Different asset classes appeal to different people of different risk profiles. Stocks, on average, have a higher risk profile than bonds. Bonds, on average, have a higher risk profile than government-backed securities. And on and on it goes.

You should look at your risk tolerance and your risk profile. You have to come up with a happy balance between the two factors, otherwise, you might simply be rolling the dice with your hard earned money.

You have to always weigh your risk profile and your risk tolerance. You don't want to get too far ahead of yourself. You don't want to focus so much on the return that you overlook the fact that to get that return, you have to assume a ridiculous amount of risk.

I hope you can see how this works. You have to know yourself. You have to be completely honest regarding your risk profile and your risk tolerance. If you assume that just because some investors that you admire have a certain risk tolerance and risk profile mix that you simply need to copy them, you might be greatly disappointed. In fact, you might end up worrying a lot because they might have such a higher tolerance of risk than you. Blindly following other people's investment advice without cross referencing such advice against your risk tolerance and risk profile is a sure recipe for disaster.

Chapter 2: Stock Market

The stock market is a public *equity* marketplace where shares in listed companies can be bought and sold between investors. Shares grant the holder the transferable right to a portion of the equity of a company—equity which is subject to change over time.
In practice, there are actually multiple exchanges where these trades take place, including the United States' New York Stock Exchange (NYSE), Canada's Toronto Stock Exchange (TSX), and United Kingdom's London Stock Exchange (LSE). These exchanges are in turn owned and/or operated by other companies. In fact, it's not unusual for a company that operates a stock exchange to also be listed on that exchange. For example, in the United States, the NASDAQ OMX Group Inc. operates the NASDAQ exchange, and is traded under the ticker NDAQ. In Canada, the TMX Group Inc. operates the TSX, while also being traded under the ticker X. Companies that operate these exchanges make money through listing fees, and by selling market data to individuals and investment firms.

Each exchange usually lists different stocks based on region and/or industry. For example, many American companies listed on the NYSE are not traded on the TSX. However, there are exceptions; a company is not prevented from listing on multiple exchanges (cross-listing). In these cases, shares on different exchanges are limited to those exchanges, but tend to trade at similar prices after currency conversion.

Different exchanges may also have different rules and regulations when it comes to meeting listing requirements and trading activity. Governments will usually impose some of their own financial regulations as well.

While these exchanges may have physical locations, one must open an investing account through his or her bank or a brokerage firm, and execute buy or sell orders online or by phone to buy or sell shares directly.

Why Invest In Stocks?

Investing in stocks can be a great way to grow your net worth, and because of the way the market is distributed, there are plenty of ways to do it. There are many different companies that you can own a part of. It's all about understanding and weighing the risks in relation to your expectations and purpose for investing in the first place. Investing in stocks may not be for everybody, and in few cases will it actually replace the income you generate through employment, but for many people it can be a good way to grow your money. If you have outstanding debts, it is probably a better idea to pay those down prior to investing.
Some people like to divide their investments, where most will be allocated to more conservative funds for retirement, and a smaller amount will be invested in a mix of stocks in the hopes of identifying undervalued opportunities. For most people, this is a good approach. For others, the objective of investing is to preserve wealth rather than to grow it, something equally important, with its own unique approaches and challenges.
One commonly held belief is that the stock market is reserved for wealthy participants only. This couldn't be further from the truth. There is no significant financial barrier to participating. If anything, education and understanding are the greatest obstacles to becoming involved. While the level of starting capital varies from individual to individual, every investor has the same opportunity, and access to the same financial information.

In fact, the stock market serves as one of the *most* effective means of achieving something so often advocated by those most opposed to its very existence: distributed ownership. Whereas a small group of individuals might previously have laid claim to the equity of a large business, tens of thousands, if not more, can own a stake instead. You don't have to be Bill Gates to own a part of Microsoft. This is an incredibly powerful concept.

Public and Private Companies

When it comes to investing, there are two sorts of companies: those that trade on the stock market, and those that do not, referred to as being "public" or "private," respectively.

If a company is private, it means that one or more individuals have full rights and ownership to the earnings and equity of that company. You cannot buy shares in privately owned companies on the stock market. Ownership can only be transferred in a private sale. These companies are not required to disclose any financial information to the general public. Private companies can become public in the future.

Many other companies have issued shares that can be traded on the stock market. These companies are referred to as being “public,” where the initial public offering (IPO) of shares to investors is a process often referred to as “going public.” Shares can be issued one or more times, and subsequently traded between investors on the stock market, where each share represents an equity stake in the company. Public companies can return to being private if all shares are repurchased.

Just about any individual can buy or sell shares in a public company. This is why we call the stock market a *public* equity marketplace. Private companies have equity too, but you cannot buy or sell that equity on the stock market. Public companies are also required to disclose their earnings, assets, and liabilities, among other financial information, to the general public. This information is typically reported every three months (quarterly), to meet listing requirements, though a company may provide additional news and guidance on a more regular basis of their choosing.

Public companies will usually have a section of their website dedicated to investors. Here you can expect to find general information about the company, financial statements, and other documents and presentations, which highlight the past performance and direction of the company using both quantitative and qualitative information. This information is available to everybody, and not just shareholders. Financial transparency is extremely important; it provides insight into the financial health and profitability of a company. It is this financial information that investors should first seek when trying to determine whether an investment is a good idea or not.

Finally, public companies require insiders (senior executives and members of the board of directors) to report when they buy or sell shares in the company.[6] This may or may not be an indicator of the health of the company; many large companies use automatic disposition plans on a regular basis to sell shares held by executives as a means of compensation, irrespective of company performance or share price. For this reason, an investor would be wise to investigate whether such activity is unusual or not.

Issuing Shares

One of the first questions you might ask is, “Why have some companies gone public while others have not?” The most common reason is to raise money. All companies require cash at some point to expand, maintain operations, or pay down debt. There are several ways to obtain this cash; they can use their existing cash from previous profits, or even borrow money from the bank, through a loan, if they are approved. In the latter case, the company will be required to pay back the loan, plus interest. Private companies have access to both of these methods of raising cash. There is another method of raising cash, and this is the primary method with which this book is concerned—that is, issuing stock in exchange for cash.

Companies cannot print money like governments. They can, however, create and issue shares that grant the holder(s) certain transferable entitlements and rights in exchange for cash. Each share entitles the shareholder to an equity stake in the company—fractional ownership. An equity stake may increase in value over the course of a company’s operations, and this is the investor’s incentive. In turn, the company does not need to pay shareholders back directly, as it would a loan. The caveat is that the former private owner(s) (every company is owned by at least one individual) give(s) up part of their stake in equity. While they were previously entitled to all of the equity in the company, they receive a portion of the newly created shares in the company instead, which they can sell on the stock market to “cash out” their remaining stake in equity if they so choose. In some cases this is also the *reason* why companies go public—as a means for private equity owners to sell all, or part of their ownership.

The former private equity owners usually hold a very large number of shares, and in some cases maintain a *controlling interest* (more than 50% of the outstanding shares, which can have significance when shareholders vote on a motion).

While the company still *controls* its assets, equity is *owned* by shareholders instead. Employees and senior executives still operate the company, and are paid for their performance on *behalf* of shareholders. Keep in mind that executives, and even employees may also hold shares that entitle them to the same rights and equity as any other shareholder.

Shares can then be traded between investors on the stock market. In the case of very large companies worth billions of dollars, this can be a very good thing. It means that no one individual lays claim to the earnings and equity of a private company; rather, any investor can own a piece.

Of course, while you may have a stake in ownership, most investors will not have a stake large enough to make decisions on how the company is run (though as an owner of common shares you may have some voting rights). The board of directors—a group of people responsible for representing the interests of the shareholders—oversees senior executives, who are responsible for company operations.

Companies can issue as many shares as the board of directors allows to raise more cash. All else held equal, the more shares that exist for that company, the less each share is worth—something called *dilution*. Well-run companies should not need to issue more shares. When shares are first issued, the equity value per share is almost always less than the price per share; investors pay a premium today for the prospect of future value.

Companies can issue shares as a means of raising cash, but also as a form of compensation in place of cash. For example, it is not unusual for senior executives to be granted restricted stock—shares that will be transferred to them if and only if certain conditions are met (financial targets and/or they have been employed for a minimum period of time), or the option to buy shares at a fixed price. The idea is that this can motivate executives to perform at a higher level because they will benefit directly through higher share prices. Of course, nothing is free; issuing more shares does dilute the value held by shareholders.

On the limitation of liability for shareholders, you should know that you can lose no more than your initial investment should a company go bankrupt. Of course, losing your entire investment is not a good thing. This simply means that you are not personally liable for outstanding debts in the company—publicly listed companies must be incorporated, and exist as their own legal entity. Creditors are always paid first, before shareholders. If a company's liabilities exceeds the value of its assets, then creditors will be paid only a fraction of what they are owned, leaving nothing for common shareholders.

Trading Shares

There is an important distinction to be made between issuing and trading shares, which is easily overlooked. Once shares have been issued to investors for cash, those shares can be traded *between* investors for higher or lower prices on the stock market. Investors offer to buy and sell shares based on what they believe those shares will be worth in the future (which may or may not be rational), as a consequence of the company's current financial health, and expected earnings (or losses). In this way, the right to equity ownership is transferred to new shareholders.

These price movements have absolutely no impact on the cash the company had already raised. Therefore, the price chart reflects what some investors have been willing to pay for shares, between themselves, since those shares were first issued. The price at any one instance of time represents the most recent transaction for some fixed volume of shares. For every buyer there must be a seller.

Factors to Consider

Making your first ever stock trade can be very exhilarating. However, you need to be careful that you follow the right procedure so that you avoid making costly mistakes.

But before we look at how to buy a stock for the first time, let us examine the particular aspects of the stock trading process that every new trader should keep in mind.

Firstly, make sure that you clearly understand the reasons why you want to trade a particular stock. The obvious reason may be to make money, but there has to be a deeper motive. If you are merely seeking a modest return of, say, 3% per annum, then you are better off with a mutual fund. Stock trading is for aggressive people who want to have double digit profits. As a stock trader, your goal should be to take advantage of stock price changes quickly, whether it is in a matter of weeks or just a few seconds.

Secondly, you must have realistic expectations. For example, it is unrealistic to expect to trade consistently without suffering any losses. Every trader – even the veterans – loses some money once in a while. Unrealistic expectations can make you abandon a great trading strategy just because you lost some money.

Thirdly, you need to view stock trading as a marathon and not a sprint. It is not a get-rich-quick scheme so don’t expect to become an overnight millionaire. Be prepared to invest time, patience, and effort.

Finally, it is recommended that you open a practice or virtual stock trading so that you can learn to trade. You will be using virtual funds instead of real money. Your broker should help you set this up. Practicing with a virtual account gives you the opportunity to test your strategies and minimize mistakes.

How to Pick Stocks

So, where do you start when you want to identify a stock to invest in? There are two general approaches: the top-down approach and the bottom-up approach.
When it comes to the top-down approach, the news and media can be a good place to start. In this case, you may hear about a sector or company, and then do your own research to investigate the company and its current valuation relative to other industries and its peers.

In the bottom-up approach, you begin with a set of quantitative investment criteria like P/E, P/B, market capitalization, and net profit margin (the criteria and thresholds you use are up to you), and screen for companies that meet these criteria. To achieve this, an investor can make use of a stock screener. This is a tool provided by many financial websites, allowing you to quickly sift through all of the companies on a given exchange.
Both of these approaches allow you to identify potential investments, but this is only where your analysis should begin.

News and Media

Stocks are a hot topic for many news and media outlets. There are a number of publications and news networks that focus exclusively on the stock market. This can be both good and bad. First, the bad: for just about every large, publicly traded company you can think of, there will be a number of analysts who cover it. Their opinions will often vary, and they will frequently reassess their price targets in response to the market (reacting rather than forecasting), or be flat-out incorrect in their assessments. For this reason, it is very important to do your own research. Never rely on subjective assessments or vague statements like, “We see this as a good investment, and we see this going well beyond where it is currently.” It’s easy for investors to have a false sense of confidence about such statements, especially if they reinforce their own beliefs.

However, there are two clear advantages to financial news and media. First, they can keep you in check. You may hear an opinion based on real figures and numbers that are worth considering. This might conflict with what you had originally believed. This doesn’t necessarily mean that you should panic, but it does provide a check for your own investment thesis. Secondly, there may very well be good companies mentioned that do warrant your attention.

Therefore, the subjective coverage and ratings of the news and media should never be taken for granted, or dismissed, but rather used to provide checks and balances on your own analysis.

Finally, it is not unusual for the CEOs of many large companies to participate in interviews on major investment networks. These interviews can provide clear insight into the vision senior management has for the company.

Stock Screeners

Stock screeners allow you to screen for companies based on quantitative financial variables. You can screen based on just about anything, from the company’s size and industry to the financial ratios described earlier. Most banks and brokerage firms will provide these stock screeners, but so will many investment news sites. Find one that you are comfortable with.

After identifying these companies, you must then do a thorough analysis of their financial information to look for anything that is out of place. For example, a company’s P/E ratio may be inflated due to earnings from discontinued operations, and so may not be representative of what its P/E will be next year.

There may also be certain events that could influence future earnings, so ratios based on previous financial data are not necessarily an indication of what investors can expect in the future. For example, a mining company might be expecting a significant increase in operational costs, which is not reflected in currently reported financial ratios.

A stock screener can also miss companies that have tremendous investment potential while presently demonstrating no earnings.

Chapter 3: Options Trading

Take a look at an investor's profile, and you'll see stuff like stocks, bonds, and mutual funds. You will probably also see options. So, what are options, exactly? An option is a contract that gives you the right to sell or buy an asset or security (like a stock, bond, etc). It's like getting a key to a house where once you open the front door, the house is yours. You don't own the house yet with just the key, but you have the option to use the key and have the house if you want. You would be "exercising" your option. Another term used to describe options is "derivative." For a tangible example, jelly is a derivative of fruit.

Options cost a fixed price for a certain length of time. Sometimes that length of time is a day, other times it's years, depending on the option. When you are the buyer of the option, you are not obligated to actually use it, but if you are the seller and someone wants to buy, you have to sell.

Options by assets

One way to categorize options is by what asset or security they are a derivative of:

Bond: A bond is a debt investment where the investor loans money to a government or company. That company then uses the funds for a variety of projects for a certain length of time with a fixed interest rate. Most corporate or governmental bonds are traded on public exchanges. A bond option gives you the opportunity to buy or sell a bond at a certain price, by a certain date.

Commodity: A commodity is any basic good used in commerce, like beef, oil, or grain. When they're traded on an exchange, they need to pass a minimum standard or quality, which is called a "basis grade." Many people like commodities because they're tangible and represent something real. Commodities move very quickly, sometimes by 100%, so commodity options are more expensive than other asset options.

Currency: Currency includes any accepted form of money that's issued by a government, like coins and paper money. Other currencies include bitcoin and other cryptocurrencies. The exchange rate of digital currencies can change dramatically in a very short time. Trading in currency is also known as "forex," or foreign exchange trading. To trade forex options, you enter into a contract that gives you the right to engage in a currency transaction.

Future: The "future" term describes a contract that can be about a variety of assets, like commodities, say, wheat. In futures, there's always a contract with very specific guidelines: price, quantity, quality, date, and how it's going to delivered. That date is called the settlement date, while the price is called the futures price. In a future, both parties must fulfill the contract. The market where futures are traded is simply known as the future market. A futures option is a contract that allows a person to either buy or sell an asset at the futures price at a future date, but there isn't an obligation. Since futures are not an asset in themselves, you can enter future contracts for a variety of products, like indexes or commodities like gold.

Index: An index is basically an imaginary group of securities that symbolize the statistical measurement of how those securities are doing on the market. The concept is kind of weird, because they aren't tangible at all; the single number of the index represents how the index has done over time, and you don't actually "buy" an index, you're getting index funds. An index option gives you the right to buy or sell the value of an index at the index's exercise price before the expiration date. They're always cash-settled.

Stock: Stocks represent shares of a company. It is not as if you actually own part of the company, though: if you own 20% of the stock shares of a company, you own 100% of 20% of the company's shares. With an option, you do not own shares, and unlike stocks, option expire. A stock option is a contract between two people (or parties), and usually represents 100 shares of the chosen stock. Like the other asset options, that doesn't mean you own the stock, it's just the option to buy or sell it, by a certain date, at a certain price. The term equity is used synonymously with stock or shares, though it technically refers to the value of the stock/shares.

Options by rights

There are two types of options: calls and puts. For both types, there is always a buyer and a seller. The seller is also known as the "writer," so when they sell, they are "writing" an option.

The call option

A "call" is the type of option that gives a trader the right to buy, say, 100 stock shares at a "strike" price within a certain time frame. The end of that time frame is called the expiry. The money the writer/seller receives for the option is called the premium. In a call option, the premium increases as the stock's price goes up, because the call option is gaining value. The buyer has the "long" position, while the writer has the "short" position. We'll get into what that means later.

When you are the seller/writer of a call option, you are obligated to sell the shares to a buyer at the "strike" price should they decide to use their option. That strike price is determined by the buyer and seller of an option, and it's fixed, no matter what the security does. Traders want to buy call options when it looks like the market is going to rise, while they would want to sell call options when they think the market is going to fall, because they profit from the premium if the security price closes lower than the strike price. That means the option is worth more than the actual security, and by selling it, they aren't stuck with a bad deal.

The put option

A "put" option is buying the right to sell at the strike price within a certain time period. If a trader believes the security price is going down, they will often buy a put option. The put writer must buy if the seller wants to sell. Like with a call option, the "strike" price refers to the agreed upon cost of shares, the expiry is the date the option expires, and the cost of the option itself is called the premium. As a security's price decreases, the premium on a put option (the option to sell) goes up, because put options increase in value when the market is falling.

If you have a put option when the market price is lower than the strike price, you profit by selling. The option writer will have to pay the higher strike price. The put writer wants the security price to go up, so they are paying the other party less than what they (the writer) can make from the security.

Option styles

The call and put options are the two main categories, but options can be broken down even further into "styles," which have to do with factors like their trading method, expiration cycle, and so on. These include Exchange-Traded Options, which is the most common type of options and refers to any options that are listed on a public trading exchange, and American-Style Options, which just means you have the flexibility to buy or sell any time before the expiry.

What does it mean to go "short" or "long?"

When you are in the position of the writer (you are the one selling), you are in the short position. This is because you are the one with the obligation. Those in the short position profit if the option's value goes down.

When you buy, you're in the long position, because you have no obligation to do anything with the option. If you do nothing, it will eventually expire. You want the option to go up in value.

Understanding option orders

When you are buying and selling options, you are putting in "orders." Unlike in regular stock trading, there are a lot of ways you can order options, which on one hand is complicated, but on the other, it gives you a lot of flexibility and control.

If you're in the SHORT POSITION...

Sell to open

With sell to open orders, the trader wants to sell instead of buy, as the name indicates. If the trader believes that a certain options contract is going to fall in value, they would use a sell to open order to get rid of the option. You are the writer, so you have the short position.

Buy to close

When a trader uses a buy to close order, they are essentially “taking back” a previous action. To leave the option as a writer, this is the order you need to execute. Let’s say the value of an options contract goes down. The writer could buy back the option with a buy to close order, and then collect their profits.

If you’re in the LONG POSITION...

Buy to open

A trader uses this order when they want to buy a call or put option, or both, so it’s the most basic type of order. As an example, let’s say call options for 3-months with company X trades at $2, while the 3-month put option sells for $1.00. By putting in a “buy to open” order, the trader gets calls for $2, and put options for $1.00. As the name suggests, you are opening an order, and as the purchaser of the contract, you have the long position.

Sell to close

A trader used a buy to open order, and now needs a sell to close to exit the contract. You would use this order when the value of option contracts are going up, so you can collect the profit, or cut your losses when the contract value is going down.

Market and limit orders

With a market order, the trader wants to buy or sell their options at the current market price. As long as there is a buyer or seller in the market, the order can be filled quickly. However, the market price might be bad, so there’s more risk of losing money.

With limit orders, there’s more control over the price. The trader tells their broker they can only buy or sell below or at a certain price. If you’re buying, your order will never be filled at a price higher than your limit, whereas if you’re selling, it won’t be filled at a price lower than your limit. The idea is that you won’t get stuck in a bad deal, but the problem is your order just might never get filled.

Tips for Trading

These are the most tried-and-true tips from years of expert investing, distilled into a few words. By now you have (hopefully!) gotten the message that options trading is anything but simple. These tips, however, are the most fundamental of all options advice, so make sure you follow them before all else.

1. Cover your calls (and puts!), but cover them wisely. This means that you should remember that you always have the option to buy opposing options to limit your risk if you aren't sure what direction the market will move in. The most common covered call is to sell out of the money options on stock you already own. This absolutely doesn't mean that you should always cover every option you buy. If you did that your capital would be quickly wasted on fees, commissions, and the less profitable purchases. What it means is to cover where appropriate, and when you do, to always try to find a way to make money on the spread between your positions. This may mean buying a call and writing another call instead of buying a complimentary put. It may mean shorting a call to lessen the risk of a put.

2. Don't ignore fees and commissions. Many options trading strategies require you to make two or more transactions to enter a position, and just as many to exit it. These can seriously add up, especially when you stack them on top of premiums you're paying for the options themselves. It may seem obvious, but in the heat of the moment during the trading day, you can find yourself making moves without fully considering the consequences. Moving quickly is great, important even, but without proper care and thought, it can cause you a lot of trouble.

3. Remember your spreads. If you choose to cover, marry, or in any other way trade adjust your options, calculate the potential gain from the spread, and factor that into your decision making.

4. Have an exit strategy. You learned this as an equity trader, and it is no less important in options trading. You may think that an expiration date acts as its own exit strategy, but that's simply not true. Exercising or refusing to exercise an option is only the endpoint of a long process that has just as

many possibilities within it as any other time period on the market. You need to know what loss you will accept and what you won't before you make the decision to purchase an option, and opportunity cost factors into that as well.

5. Chasing losses is a sure-fire way to lose more than you need to. You might have heard during your equity trading career that you have to "double up to make up" a loss. Not only is this usually terrible advice in stocks, it's even worse with options. Not only do you have the same market factors to contend with, you also have time decay to worry about, which means that whatever choices you make doubling down on your losses are going to be compounded by the time factor.

6. Beware niche options. In some circumstances, a small, appointment-only stock can be a great buy. The options based on that stock, however, are very infrequently as good a bet. The reason for this boils down to liquidity. All of the traders buying and selling a stock only have the choice of that one stock, so the stock is going to be liquid relative to an option, which may have five or six variations to choose from.

7. When deciding when to sell short options, don't aim for 100% of your initial investment. A mistake that new traders make all the time is to wait for their short options to drop much too far. If your short option has dropped more than 80% of your investment, it's time to consider cashing out. Remember that pivots are hard to accurately calculate, and by chasing those last few percentage points you may find yourself on the wrong side of a pivot.

8. If you write (sell) options, be aware that you may be assigned at any time. This means that you may be required to supply the stock specified in the option before the expiration date. This is called early assignment, and it's never a great experience, but it happens to everyone if they trade options for a long enough period of time. You may be tempted to rush out and exercise your accompanying call option in order to fill the assignation, but that may be a mistake. Look at the current stock price and do your best to make a level-headed decision about whether it would be better to

exercise your call option or to purchase the stock outright to fill your written option.

9. Don’t treat neutral movement as neutral in value. If you buy a call option, for instance, and the stock stays about the same in price from the time of purchase to the expiration date, it’s common for traders to feel so much relief at having not experienced a loss that they treat this neutral profit as a win. It isn’t! In fact, not only have you lost your fees and commissions, you’ve left capital tied up for weeks, months, or even a year that could have been making you more money. If your pride keeps you from calling this as the loss that it is, you will never learn to avoid those situations in the future. Don’t waste the lesson on top of the money you’ve already lost!

Chapter 4: Forex Trading

The Forex market is the largest currency exchange market available in the foreign market. You can use it to trade in a variety of different currencies and to earn large amounts of money. Before you can do so, however, you need to take the time to understand what the Forex market actually is and how you can start earning money there.

What Is Forex?

The foreign exchange market, or Forex, is a virtual trading post where currencies are traded. Trading currencies is important to virtually everyone because it allows countries to conduct foreign trade and business among each other. Imagine you wanted to buy makeup from France, and you reside in Canada. If you were to do so, either you or the business you purchased from would have to convert your currency from Canadian Dollars (CAD) to euros (EUR). The same goes for whenever you are traveling, or otherwise converting dollars from one market to the next. You cannot purchase items with currency from a different country because it won't be accepted there. So, you have to trade your currency in order to purchase items.

This very need is exactly why Forex exists, and it is the reason why it is the most liquid financial market in the entire world. This market is actually even larger than the stock market itself, which it dwarfs in size. Every single day about $2000 billion U.S. Dollars' worth of trades are made. This volume constantly changes based on what day it is; however, it is generally quite large.

One reason why the Forex market is so unique is because it does not have a headquarters or central marketplace. Instead, the entire program is conducted electronically, and so are all of the trades and everything to do with the Forex market. You can access this market five and a half days per week, twenty-four hours per day. There are several major financial centers across the world where the trades take place, so when one place closes, another opens and you can continue trading. The market is extremely volatile. The prices change constantly at any time of the day or night, regardless of where you are from.

What Are the Different Trading Strategies?

There are three primary ways that you can trade on the Forex market, and these three ways are used by anyone who trades on it. You can use these whether you are an individual, an institution or a corporation. These ways include the spot market, the forward market, and the future market. The spot market tends to be the largest method of trading, as it has an "underlying" real asset that is the basis for the forward and future markets.

The Spot Market

The spot market is the market where currencies are bought and sold according to the current price they are worth. Depending on supply and demand, current interest rates, political situations and economic performance, that price will be set and then trades can be made. Once a deal has been finalized for a set price, this trade is known as a "spot deal". It means that both parties agreed upon a currency amount and they are willing to trade it for said value. Once a position has been closed, the settlement is owned in cash. This trade is considered the one that happens in the moment, as it is based on the present state of the market. However, it does still take about two days for these trades to take place and finalize.

The Forward Market

The forward market is a more privatized version of trading for future exchanges. On these trades, currency trade terms are agreed upon in advance and on a set date the currency is purchased for a predetermined price. The agreement is determined by and agreed upon by two independent parties.

The Future Market

The future market is a publicized version of the forward market exchanges. In these exchanges, future contracts are bought and sold on public commodities by national associations. These contracts are set with specific details that are already determined and the general public can buy into them. These details include information such as delivery and settlement dates, the number of units being traded, and a minimum price that cannot be customized by anyone involved in the exchange.

Both the forward and future markets are contracts that are binding. When you enter one, you must buy and sell before the exchange expires. These are a great way to purchase into future situations without waiting for the spot market to take hold, where the potential purchasing price may be much higher than it would be if you were to purchase in advance.

How Can You Profit Large?

As an individual, the best way to profit is typically through the spot market. When you buy and sell in these markets, you can maximize your profitability and the amount of money you make.

To get started in Forex, you do not need a lot of money. You can start with virtually anything that you have and go from there. Due to the vast size of this market, there are many options that you can take. Regardless of your present income or net worth, you can get involved in the Forex market and start making a major passive income through it. It is a great way for everyday people to get involved in trading and start making money off of it. You do not need to be an expert or have any special equipment to get involved in this market. Instead, you can learn how through this guide book and start winning big right away.

Chapter 5: The Trading Mistakes

Stock Trading Mistakes

Overconfidence

If there is one particular mistake that can ruin the chances of a beginner trader becoming successful in the stock market, it is overconfidence. What normally happens for beginners is that they make a couple of stock trades just to test the waters, get lucky, and then fall into the trap of believing that they are invincible. The problem here is that you begin to make silly moves without thinking of the consequences. You start to see yourself filling the shoes of those big wig traders portrayed in Hollywood movies. The reality is usually much different.

Investing in multiple stocks too early

Beginners need to avoid putting their money in several different stock markets when they are still in their initial stages of learning. If you consider the contents of this book, you will realize that there are some terms that are a bit complex for you as a beginner. However, with time, you will become more familiar with them. It would be a mistake to start reading another trading book before you even finish reading and fully comprehending this one. It’s the same principle with stock trading. You need to stick to one stock market until you get the hang of it, and then move on to another one. If you do not take the time to learn how one stock market works, then how will you manage to figure out several at the same time?

Not conducting adequate stock trading research

The truth is that the majority of newbie stock traders are getting younger than ever before. There’s no problem with young people trying their hand at stock trading. However, their lack of patience is likely to lead to poor research about the company they want to invest in. If you don’t have any concrete information about where your money is going, then you are likely to lose it. Conduct proper research before making any kind of stock trade.

Following trends blindly

Though it is a common thing for seasoned traders to examine trends before making any trades, new traders tend to go overboard with this. You may feel safer sticking with the herd, but remember that the veteran traders know the perfect time to bail out. Unfortunately, you don't. Following trends without having the right information is a recipe for disaster.

Trading too frequently

One of the most significant aspects of the stock market is that it should be viewed using a long-term lens. Most beginners tend to engage in too many short-term trades, thus negatively affecting their profit margins in the long run. The temptation may be great at first, but you must learn to resist that urge. Otherwise, you will find it difficult to realize real profits.

Failure to create and follow a proper trading plan

A comprehensive trading plan is what will guide every investment decision you make from day one. If you fail to develop a proper plan, then you will definitely set yourself up for failure. If you already have a good plan in place, then stick with it, regardless of what other traders are doing. Straying from your trading plan may lead to losses, and you will be unable to explain just what went wrong in the first place.

Hanging on to losing stocks for too long

Most beginners tend to be infatuated with their stocks even if they notice that it is on a downward spiral. There is this belief that the stock will stabilize soon and go back up, but this shouldn't be part of your strategy. Every seasoned investor will tell you that you should learn to cut your losses while you still have time. Hanging on to a losing stock may potentially eat into your profits. The longer you wait, the worse it will be.

The benefits of avoiding the above mistakes include:

- Saving a lot of money.

- You will save more time in cleaning up your mistakes
- You will be able to train others on the trade.
- You will be effective in trading since you won't be fatigued by a lot of mistakes.

Option Trading Mistakes

Everyone makes mistakes, but in options trading, a mistake can lead to losing a lot of money. You want to protect yourself from losses while maximizing opportunities for market. Here are some common mistakes that traders make that you should do your best to avoid:

1. Not having enough knowledge right off the bat

Most beginners start out without enough knowledge. They've heard that trading options is easier than trading other securities, so they get excited. They might know a few strategies, but in order to consistently be successful, you need to be really prepared. Option trading is not simple, and it's risky. You want to be very knowledgeable about how options work, how they're linked to the market, how to read an options table fluently, and all the strategies available to you, and when to use them.

2. Using one strategy all the time

When you start trading, it's tempting to stick to what you know. However, if you start paying attention to your option's table, and see how things can change quickly, you'll realize that one strategy isn't going to work all the time. Not adjusting based on factors like volatility and the Greeks can lead to a lot of losses or at the very least, minimal profits. If you don't feel comfortable using more than one strategy, you need to do more research before you start trading in earnest.

3. Not having an exit plan

Having an exit plan and executing it appropriately is the only way to keep the profits you make options trading. Without an exit plan, you are much more likely to lose whatever profits you make, and put yourself at risk for even greater losses. It's always better to play it safe: exiting early may leave you with fewer profits, but if you're consistently gaining, it's much better than going on a rollercoaster. There are three ways to plan an exit. One is by time, so no matter what, you exit after two months. The other is target profit; as soon as you hit a certain profit, you leave. The last strategy is a technical exit, which means you only leave when the security does something, like the prices begin to fall, it stalls, and so on.

4. Not having a trading plan at all

The most disastrous mistake any trader can make is not having a plan. All their decisions will be on-the-fly, without any history or research to back them up, and it'll be next to impossible to start building up steady gains. Without a plan, there will be no boundaries about risk based on factors like the trader's capital, so it's only a matter of time before they run out of money or experience a devastating loss. Before starting out in options trading, you absolutely NEED a plan. Think of it as a map to an unknown territory; without it, you will get lost.

5. Trying to make up losses by taking on more risk

In movies, you've probably seen a scene in a casino where a character keeps losing, and so desperately goes double or nothing. That rarely works out, because the person is acting on emotions instead of stepping back and reassessing the situation. You should never try to "make up" your losses by acting rashly and taking on more risk than you would normally be comfortable with. Instead, focus on strategies that will allow you to more gradually build up gains that aren't too risky.

6. Focusing too much on out-of-the-money options

A lot of beginner traders might be tempted to focus on out-of-the-money puts and calls because they're usually cheaper. Experienced equities traders also make the same mistake, because they're used to buying low and selling high. However in terms of making consistent money, OTMs aren't a good strategy.

It's difficult to actually make profits. This is because in order to make money back, the price of the asset needs to either move above (call options) or below (put) option the strike price, and it needs to do it before the option expires, and it needs to move enough above or below to offset how much you paid for the option. That’s a lot of blocks that need to fall in place for you to actually profit.

7. Not picking good time frames for options

Timing is key in options trading, so a very common mistake that traders of all experience levels make is not picking good time frames or expiration dates. This might mean they pay more than they should for an option with a longer time frame, or they buy an option with a time frame that’s too short, in an attempt to save a few bucks. You should always consider what the market might do and at what speed before choosing a time frame.

8. Choosing the wrong broker

It is possible to choose the wrong broker. If you go with one who just makes trades on your behalf and doesn’t provide any advice, it’s all your responsibility, but if you do choose a more full-service broker, you have to be more selective. Some brokers will push for the cheapest options, because clients will buy a whole bunch, which means more commissions for the broker.

Chapter 6: Risk Management

Risk management can be defined as the identification and evaluation of risks with the aim of formulating strategies to minimize these risks and maximize the profits. The stock market always has the two elements of risk and return. If the risks are high, then in most cases the returns are likely to be high.

This section covers a number of different types of risks that an investor might encounter, beyond the scope of what has been covered so far. Up until this point, the assessment of risk has largely been limited to information that is available on a company's financial statements.

As an investor, you must recognize that it is important to develop your understanding of all types of risk that can exist—those that are directly financial *and* those that are not. Understand that some of these risks cannot be controlled for. For example, investors put their trust in those who control a company on their behalf, but sometimes that trust is broken—serious cases of financial fraud have occurred that have cost investors enormous amounts of money.

If you are investing your own money directly, you can't expect anybody to assess the risks for you.

Financing Risks

Sometimes a company will need to spend a significant amount of capital to acquire, or to develop an asset. This asset could be a mine or an expensive industrial process. Capital expenditures can amount to hundreds of millions of dollars, or more—money that the company may not have. For this reason, investors should be conscious of the business's ability to raise that money, if it does not already have it in the first place. The company may need to raise that money by issuing more shares or by taking on debt. However, if market conditions are poor, it may be unable to issue shares. If the company needs to raise money through a debt placement, lenders may refuse. This can have a significant impact on a company's ability to do business. For this reason, investors need to be aware of a business's ability to finance or raise capital for any large, outstanding capital expenditures.

Cost Overruns

Sometimes a company's actual expenses exceed its original estimates. When a company encounters expenses well in excess of what it had planned or even budgeted for, we call it a cost overrun. It is important for an investor to weigh carefully the projected expenses reported by a company. For example, other companies might have similar projects where you can use their costs as a reference. If the company projects a range of possible expenses, it's usually a good idea to use its most conservative estimate. Otherwise, consider adding some margin of safety to those expenses in your analysis. If the success of the business hinges on a small margin, then one should be aware of this.

Unusual Expenses

Some expenses appear one time, and are not a part of normal operations. These expenses are usually unexpected. While unusual expenses might not recur, they can have a significant impact on a business's earnings, or even value. Some unusual expenses can mean the difference between a healthy, profitable quarter and a substantial loss to shareholders' equity.

Impaired Assets

Sometimes the value of an asset listed on a company's balance sheet is worth much less than what was originally reported. Goodwill is a common example of an intangible asset that can become impaired. If the premium paid for an acquisition proves to be worth less than originally accounted for under goodwill (e.g., software or technology that is purchased becomes obsolete or uncompetitive), it may be written off. This means that it is removed, all or in part, from the balance sheet. This can have a significant impact on shareholders' equity, and may come as a surprise to investors. Writing off impaired assets is important, because the purpose of financial statements is to provide a fair and accurate depiction of the financial health of a company. This is why many investors calculate tangible book value in place of equity.

Bankruptcy

In cases of bankruptcy, creditors always come first, and so there may be nothing left for common shareholders (this is almost always the case if equity is negative).

What you will find on almost all company financial and news releases is a standard disclaimer about the uncertainty and risks related to forward-looking statements. Unfortunately, you will not always get a cautionary announcement from management when it comes to the company's ability to sustain operations. Executives may simply have the disclaimers in place and avoid communicating the risks in an open and transparent way to investors, unless they are challenged directly in a conference call—this is why it's important for shareholders to challenge management.

Bankruptcy announcements can really surprise investors who have not examined a company's financial health. It is not unusual for a conference call to be quite normal, or to have an extended period of no news, only to be followed by a bankruptcy announcement. Unprofitable operations might rely on financing to sustain day-to-day activities. If executives can't secure that financing, for whatever reason, the company is out of luck, and you may not receive very much warning if you haven't been paying attention. It is precisely for this reason that one must watch the cash balance of a company that is losing money.

Qualitative Risks

Management

At the end of the day, people run companies. They come up with the ideas, control the assets, and follow through with operations. For this reason, it is always desirable to invest in companies with strong management. This isn't always an easy thing to assess. One of the ways that an investor can try to do this is to examine the history of senior executives. Were they able to successfully turn around failing businesses? Did they go bankrupt? Do they jump to a new company every few years? Were they former private equity owners—founders—of the company?

Stepping back for a moment, one very important question you might ask yourself is: Once the company raises capital, what further obligations and incentives does the company have toward shareholders? After all, once cash has been raised from the initial public offering, share price has no direct impact on the company itself. This is a bit of a trick question, but that doesn't make it any less important. There are both indirect and direct mechanisms at play, providing some of this obligation and incentive. Some of these mechanisms can also provide insight into the type of people running a company.

First, most companies will grant senior management the option to buy shares. This has two potential benefits. First, it is a form of noncash-based compensation. It allows a company to attract and pay individuals who have a rare and in-demand skillset without having to expend cash. Second, it provides an incentive. The executive is now not only earning a salary, but is a shareholder as well. By examining insider transactions (reported buy and sell orders), one can get some insight into the type of individual. If executives are selling a significant number of shares on an ongoing basis (unless those transactions are part of an automatic disposition plan), it may indicate that they have little interest in growing the company. They are looking to make some cash on the side at their convenience. They aren't *really* invested in the business. Conversely, insiders who acquire significant numbers of shares in the open market, with their own money, are without question shareholders. These individuals may be more interested in the company's operations, because the outcomes affect them more directly.

The second incentive is that they get paid to do their job, and to do it well. While senior executives are responsible for the direction of the business, they are not without oversight. The board of directors is responsible for ensuring that those executives are keeping the best interest of shareholders in mind. Note that one can also examine the previous experience of board members and their buy/sell activity just as one can with senior management.

Good management teams will make decisions that maximize shareholder value, and respond to market conditions accordingly. However, some executives may be committed to "business as usual," even if it is not in the interest of shareholders based on current market conditions. They might burn through shareholders' equity without any reservation as part of their day-to-day activities. It happens.

Finally, some companies can experience a high level of management turnover; new individuals might be hired and fired on a regular basis. This can set a company's operations back significantly. Different individuals can have very different visions for a company’s direction. A new management team can have a very different strategy. Indeed, they may very well need to. However, it can take time and money to realize these strategies, especially for larger companies.

Economic Risks

Inflation

Inflation refers to the general increase in the price of goods and services over time, as the purchasing power of each unit of currency decreases. Inflation can occur when governments increase the money supply. This is an intentional tactic in some cases to reduce the relative debt owed by the country, since the dollar amount of debt remains the same, but more dollars exist. This is sometimes the lesser of two evils, but generally something most people will want to avoid (especially savers).

Deflation

Deflation occurs when the price of goods and services decreases over time, and so the purchasing power of each unit of currency actually increases. In this case, one does not want to be holding debt, since the absolute dollar amount of debt remains fixed, while incomes will usually drop.

Deflation can occur as a result of decreasing demand for goods and services. In order to compete, businesses are forced to lower prices, and so they may be forced to lower their costs, meaning that many companies in the manufacturing and service chain must also lay off staff and decrease wages. Central banks can try to compensate for deflation by increasing the money supply or by lowering interest rates in order to encourage borrowing, spending, and investing—something they will probably do at all costs.

For *investors*, deflation is a greater risk than inflation. Whereas in the case of inflation some businesses will simply be earning more dollars, effectively compensating for the loss in purchasing power per dollar, deflation results in lower earnings, lower margins, and lower profits, resulting in lower cash flow and lower share prices.

Geopolitical Risks

Forced Nationalization

Every company must abide by the laws of the country in which it operates. Some countries are friendlier than others when it comes to free markets and capitalism.

In some extreme instances, there have been cases of *forced* nationalization, often during regime changes. This is where a government seizes the assets of a business on the grounds that it can, effectively taking control of the equity that used to belong to shareholders. This is a risk that investors take when they invest in some politically unstable places.

Investors should be aware of where the companies they invest in operate, or are thinking of operating in the future, and whether governments there are friendly to business or not.

Regional Conflict

Unfortunately, war and conflict are still very much a part of the world today. Many of these regions are rich in resources, and therefore attractive to mining companies, for better or for worse. Should a conflict arise in a region where a company operates, it is a good idea to follow the news, check where it is operating on a map relative to the known areas of conflict, and understand the nature of the conflict.

Many of these countries are quite large, and whether a company's operations are affected or not can depend on where it is located relative to the regional areas of infighting (it is not unusual for some parts of a country to be in conflict while others remain defended and stable). Depending on where the company's operations are located, operations may need to be ceased and personnel evacuated for an unknown, perhaps indefinite, period of time.

Local Unrest

Sometimes the local population will protest against a company project. Sometimes this is for very legitimate reasons (environmental concerns, etc.). In very poor areas, where mines are often developed, the local governments usually require the operating company to contribute to the local area (building schools, etc.) and hire some of the local population. Even then, the local population might protest, sometimes violently, which can result in operations being halted for an uncertain period of time.

Securities Fraud

Stock-Manipulation Schemes

As an investor, you need to be aware of the existence of certain forms of fraud that can occur. One of the most common examples of fraud that an investor might encounter is called a “pump and dump” scheme, and it can exist on a number of different scales. In this case, somebody purchases shares in a company that may or may not have any value (“penny stocks” are a common choice because they typically trade at lower volumes, and so the price can be manipulated more easily with only a few trades). The fraudsters will then promote this stock, sometimes by making false claims through online forums in an effort to drive demand for the stock, with the intent to sell once enough investors get on board. This is completely illegal, and people have been prosecuted for it.

Financial Deception and Fraud

While it is the job of senior management and the board of directors to accurately report a company’s financial results, there have been some very serious cases of financial deception and fraud.

Short-Sale Market Flooding

While it is not this book’s intent to suggest that any institutions are actually guilty of this practice, an investor should be aware of the risk of market manipulation. Most large firms will have access to market-depth information, including where other investors have placed sell orders that will be triggered should the stock drop below a certain price. A large enough firm, with sufficient capital, might flood the market with a significant number of short-sale orders (selling borrowed stocks, which must be purchased back at a lower price to make a profit), thereby triggering a chain of automatic sell orders and/or margin calls if there is not enough buying volume. The company may then be able to cover (buy back to close their short position) as this selling takes place at a much lower price in order to make money (perhaps by buying into a larger volume sell order that has been triggered).

Normal short selling would not be able to move the price so significantly, but large investors do have the ability to really move stock prices, because of the sheer volume of shares they are able to buy and sell. While this is an illegal practice, investors should be aware that it can occur.

Price Risks

Low-Volume Stocks

Sometimes only a few shares of a stock will trade on a given day. Sometimes no shares of stock will trade for days on end. This can make it difficult to liquidate your position should you need to, and can result in significant changes to share price based on only a small number of shares, because of the limited market depth.

At the same time, if investors become more interested in a company, daily trading volumes can increase significantly.

Panic Selling

Investors are people, and people have emotions. When it comes to money, people can have strong feelings, whether they are rational or not. If the price of a stock is dropping, many people will sell out of fear or for their peace of mind—*especially* if they didn't understand what they were buying in the first place. Sometimes this is the right decision, and sometimes it isn't. In either case, panic does result in selling. Never assume that all investors are rational. To be fair, we all make mistakes. If a stock has only a limited market depth, it may take only a few people to panic for the stock to drop significantly in price.

Margin Calls

Some investors and funds make use of leverage (borrowed money) in order to try and improve their returns, by increasing the number of shares that they control. While this can provide a higher return, it also exposes them to a greater risk. If the share price drops enough, or the market is flooded with short sales and there aren't enough buyers, lenders can force those investors to liquidate their positions in order to recover the borrowed money (leaving the investor with nothing). This can cause further declines in price as a result of automatic selling, whether the investors wanted to sell or not. This is one of the reasons why you should always invest with your own money, and never somebody else's.

Stock Market Crashes

Stock market crashes can occur for a variety of reasons. Quite often they are proceeded by serious economic events. If you have invested in companies with lower speculative premiums, solid margins, and reliable cash flow, you should be less worried. People who don't understand the link between stocks and companies will certainly be afraid of "stock market crashes" no matter what.

When markets crash, quite often larger players will simply liquidate many of their holdings across the board, in an effort to "sell before the price drops

even further"; this is an unfortunate reality, based more on gaming market price than actually buying and holding good stocks that should provide a solid return over time. Some mutual funds may be forced to sell large blocks of shares as units are sold back to the fund and redeemed. For the investor, this is still a price risk. For those who have not invested, it may represent an opportunity.
Stocks will almost always crash the hardest when speculative premiums are the highest.

Here are a few steps you can use to implement a basic risk management strategy.

1. Learn the rules of risk management and commit yourself to implementing them. Develop your personal risk management plan and follow them, especially when you find yourself stuck with a bad trade. Just because it's a Blue Chip stock doesn't mean you should ignore your plan and stick with it. If the stock is dropping, dump it and come back later when you are ready.
2. Learn how to follow the trends in the market. The stock market is usually defined by its trends, and having the knowledge of what these trends look like is one of the best ways to minimize your risks. However, this is easier said than done because the market tends to shift extremely quickly. It may sometimes be difficult to spot a trend fast enough before it changes.
3. Diversify your portfolio. Always invest your stocks in different companies, asset classes, and sectors. In the event that some of your stocks perform poorly, then the rest may still increase in value.
4. Put in place a stop loss. A stop loss is a monitoring tool that alerts you whenever your stock is going to drop. It will give you the option of exiting a trade in the event that your stocks drop below a specific limit.

Option Trading Risks

1: Time is a factor

Options expire over time, and they usually go down in value until they hit zero. That makes holding on to long options risky. Time decay speeds up as the expiry gets closer, so you need to pay close attention to what's going on with your option. If you bought out-of-the-money options, they are only going to move further out-of-the-money the longer you hold on to them, so you risk losing your entire investment before the expiration date.

In order to reduce the risk that time presents, you want to buy options that are at or near-the-money, only trade options with expiries that fit into your prediction of the investment opportunity (so you aren't forced to get rid of it before you would like), or buy options when you think they're underpriced and sell when you think they're overpriced.

2: Prices move quickly

The only risk with options trading is that prices move really fast, faster than stocks. They can fall or rise significantly in just minutes or seconds. A security might make a little change, but it affects the option in a dramatic way. You could stand to lose a lot of money in mere moments.

The solution is to only enter option trades where the potential for profit is large enough so you don't have to be glued to the computer at all times. You can also pay closer attention to strike price and expiration months, so you know that an option doesn't have a history of dramatic movements that result in high losses.

3: Some strategies carry unlimited risk

Another big risk with options trading is that there are some decisions you can make that result in hefty losses. Some people have a rose-colored view of options trading, because it can initially be very affordable, but if you aren't smart, you can end up losing everything you invested. It's essential that you know what strategies are inherently extremely risky, so you can avoid them.

The riskiest strategy is the naked call, which is when you sell a call option on its own without owning any shares of the security. This has unlimited risk, which means you could lose everything. The risk is specifically in selling a naked call, because you only stand to profit if the security's share price remains below a certain price line, but if the security goes up, you see huge losses. It's just not worth it.

Risk management is one of the skills you will have to develop quickly as a trader if you want to become a successful forex trader. Do it from your first trade. Never risk more than 2% of your equity on a single trade. Make sure the maximum open positions total risks do not exceed 6%. Trade in micro lots, mini lots and standard lot sizes.

Chapter 7: Pooled Investments

You might be thinking that since you have a lot of other things going on in your life and the fact that time is a luxury for you, you might not have what it takes to invest on your own. You might have arrived at the conclusion that the best way to invest would be to simply find professionals that would handle your investments.

It's easy to understand this perspective. It's easy to see why a lot of people, especially when they're just starting out, would prefer that their funds be professionally managed. After all, these individuals have been in the game for far longer than you. They know how things work like the back of their hands. A lot of them have a solid track record of producing success.

With that said, just because you have decided to hire a professional to handle your investment, this doesn't mean that you can just pick any mutual fund. This doesn't mean that you should just pick a random fund out of a hat. Just like with picking stocks, you need to size them up and compare them properly. This way, you increase the likelihood that you would be making a truly informed decision.

This is crucial because if you make decisions on a whim or through incomplete or even incorrect information, it's anybody's guess whether you would get the return that you are looking for. In fact, you run the risk of not getting a return at all.

It's one thing to realize that you may not have the time and the expertise at the present time to make your own stock pick so you get expert assistance. It's another matter entirely to just basically roll the dice.

Make sure that pooled investment is right for you and make sure that you pick the right choice as far as your options are concerned.

Mutual Funds

Mutual funds are the meat and potatoes of many small investors. A lot of individual investors love the fact that mutual funds are professionally managed by people who have many years of experience in the fund management industry.

These individuals know the ins and outs of the stock market. They have access to a tremendous amount of research resources. Chances are quite good that these individuals would at least produce a decent return as far as the Dow Jones Industrial Average is concerned.

The great thing about mutual funds is that you are relying on somebody else's expertise. They are headed by a professional manager. Individual investors like you buy into the fund. In a way, it's like buying stock, but instead of a stock in a company, you buy a stake in the mutual fund, which gives you a share of its total asset value per investment unit.

You're buying an investment unit and this unit goes up and down in value based on the underlying stock prices of its assets. A mutual fund, really, is just a basket of stocks in different proportions that the fund manager bought into. When you buy into a mutual fund, you get an investment unit at a certain price.

However, that price tends to go up or down, depending on how well the stocks that the mutual fund invested in do. If the fund manager does an amazing job of picking more winners than losers, the total net asset value goes up, so your investment unit is worth more.

Different Types of Mutual Funds

Keep in mind that mutual funds pretty much mimic the different investment strategies individual investors could pursue. There are income mutual funds that focus solely on dividend-paying stocks.

Other funds focus on growth. These growth funds actually are quite diverse. Don't let the name throw you off. It's easy to think that if a fund is a growth fund, then you are necessarily dealing with an aggressive investment strategy.

Not necessarily. Some growth funds are quite moderate. Their main focus is on solid, stable, predictable growth of companies with real potential, not just market hype. There are also index funds.

Index funds are essentially mutual funds that enable you to bet on how the market overall is trading. All it does is it just tracks a certain index. For example, if you buy a Dow Jones Industrial Average index fund, the contents of that mutual fund are the stocks that comprise the Dow Jones Industrial Average.

This is just one type of index fund. In fact, there are many different indexes out there. There are also metals indexes or commodities indexes. When you buy into these funds, they invest in a way that tracks those specific stocks, specific industries or specific commodities. This way, when you like the progression of a particular industry, you can bet on that industry as a whole through an index fund.

Conclusion

Thanks for making it through to the end of *Investing for Beginners*, let's hope it was informative and able to provide you with all the tools you need to accomplish your goals, whatever they may be.

The next step is to take the things that you learned about investing and apply it towards your business practices.

It is extremely difficult for beginner investor to perform well than a professional investment expert. If you don't have sufficient energy or slant to deal with your investment, you ought to think about paying an expert to do it for you. Every investor wants to make profit, so there is no harm in trusting your investment in good hand.

Thank you and good luck!

Thank You

Thank you again for downloading and reading this book!

I really hope that this book was able to help you to gain more information about Investing.

If you enjoyed reading this book, then I'd like to ask you for a small favor. Could you be so kind enough to leave a review for this book.

It would be greatly appreciated!

Options Trading For Beginners

The Ultimate Guide to Making Money Online with Options Trading

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Introduction

Congratulations on downloading this book *Options Trading for Beginners: The Ultimate Guide to Making Money Online with Options Trading*, and thank you for doing so.

The following chapters will discuss everything you need to know about options trading and how you can make money trading options. Options are a type of security traded at stock markets. They are a part of market instruments referred to as derivatives. Derivatives are stock market instruments that derive their prices from an underlying asset such as stocks, bonds or shares.

There are many other types of derivatives including mortgage backed securities, futures, and swaps. If you eventually learn how to trade in options and understand how to trade them competitively, then you will have a real chance to make money at the stock market. Options can be speculative in nature which might introduce elements of risk taking. It is still possible to make make money without speculation.

Options have their power vested in their versatility. They are very versatile and interact seamlessly with traditional assets on the stock market such as bonds, shares, and foreign currency. They can be used for hedge purposes and speculative purposes as well.

By reading this book, you will learn about the fundamentals of options trading. However, do not expect to become an expert options trader overnight. Many successful options traders have many years of experience. To understand properly how options work, you will need to also know how stocks operate and how they are traded at the stock market.

There are plenty of books on this subject on the market, thanks again for choosing this one! Every effort was made to ensure it is full of as much useful information as possible, please enjoy!

Chapter 1: A look at Options Trading

The basics of options trading

There are many different ways of investing money at the stock exchange. Common investment instruments include stocks, mutual funds, and bonds. One type of security that is gaining popularity and providing an alternative investment avenue is known as options.

Options present a whole new world of investment opportunities to experienced investors who understand how this particular security works, its practical use as well as associated risks.

In order to successfully trade in options and make money, you need to understand how options work. However, let us first learn the terminology used.

What is an option?

Basically, an option can be defined as a contract that allows an investor to purchase or sell an underlying stock at a defined price for a given amount of time before it expires.

Call option

A call option gives permission to an investor or buyer to purchase 100 shares at a certain set price before a certain date or time. Options always have an expiration date. An investor may sell the underlying stock at a set price, known as the strike price, before the expiration of its indicated date and time.

What is the underlying stock?

The price of an option is always linked to the price of an asset, usually a stock, or 100 shares. In options trading, this asset is often referred to as an underlying stock. You are never obligated to purchase the underlying stock. The options contract simply gives you a contract that offers you a right to buy the stocks but not an obligation.

Put option

A put option is an option that grants a buyer the right to sell the stock at a given price, known as the strike price before its expiration date. An investor is required to sell a put option at the strike price.

The strike price

The strike price, or exercise price, is the indicated price per share that an investor can buy or sell an underlying stock.

What is the expiration date?

This date indicates the final day that an option may be exercised. For weekly traded options, this date is the Friday of that week. For monthly trade options, this date is usually the third Friday of that particular month.

Exercise

The term exercise in options trading refers to the process where an options investor calls in the terms of the options contract. A put option owner will upon an exercise sell the underlying share while a call option owner will buy the underlying stock

Hedging

This is a term that refers to a very conservative trading strategy. Hedging is often applied where there is need to reduce the risk of the investment by dealing in transactions that offset the existing positions.

Intrinsic value

Options have an intrinsic value which refers to the profit that an investor can make if they were to exercise it immediately and the underlying stock either purchased or sold at market rates.

Premium

The term premium simply refers to the price of an option at a given time. It usually refers to the total dollar value of a contract. Premium is obtained from the price per share X 100 shares.

Time Decay

All options have an expiration date. This makes them wasting assets that lose value with time. You need to trade your options within the stipulated time frame and if not, it will run out of time and become worthless. You will lose all the money you invested in the options.

Short Option

An option is said to be short if it has been sold in an open transaction. This position is considered negative and a later repurchase is needed to close out.

Long option

An option is said to be long if it is bought in an open transaction and the buyer gets to own it.

Time value

This term refers to the amount by which the intrinsic value of an option has been exceeded by the market price.

Long-Term Equity AnticiPation Securities – LEAPS

LEAPS refers to long term options that have distant expiration dates such as 3 years. Expiration date often occurs in January.

The basics of options trading

Options are basically a kind of derivative security. The term derivative simply means the security derives its price from the price of an underlying security. You may think of options as contracts that grant the owner a right to dispose of the underlying security but not an obligation within a certain time limit.

We already know that the right to sell is referred to as a put option while the right to buy is a call option. We also know that stocks often grant you a tiny bit of ownership of a company. However, options are different because they are simply contracts granting you rights to either purchase or sell the stock within a given time frame and at a set price.

Now when you sell options, it amounts to creating a new security that did not exist before. This is also known as writing an option and is the main source of options. Companies, stocks and options exchanges do not create options. Only traders and investors do. You can go to the options market and take a look at all the options available. The best options are those affiliated with blue chip companies.

You need to find a reputable broker who will support you and advise you regarding online options trading. Not all brokers are trustworthy so it is advisable to seek referrals and recommendations. A good broker should have platforms where you can practice and apply your skills for free. This way, you will be able to sharpen your skills and become a good trader. The broker should also have plenty of other tools that you require in order to be successful online.

How to price options

The option price is often referred to as its premium. If you purchase an option, you cannot lose more money than the initial price paid for the contract. This means the underlying security will not determine the premium of the option. This helps limit the risk of a buyer to a maximum of the buying price. However, the profit potential of the option is considered unlimited.

What are the different styles of options available?

There are basically 2 styles of options. These are the American-style options and the European-style options. A European option is only exercised on its expiration date while the American-style option can be traded anytime between purchase date of the option and its expiration date.

Most of the index options are European-style options while the exchange-traded options are American. Then all stock options are American-style. Now all stock options have an expiration date. For regular, listed options, the period is often nine months from the listing date. LEAPS or longer term options have much longer expiration dates of up to 3 months.

Regular shares of stock have a settlement period of 3 days but options often settle the very next business day. Stock options officially expire on a Saturday but since traders and investors are unavailable on Saturdays, the trades are often exercised on the Friday prior to expiry date.

In conclusion

Options are often used by traders as an integral part of their overall investment strategy. Since options trading is completely different from stock trading, it is important that you first understand the concepts and terminology used before you begin trading in options.

Call and put options

How a call option works

In the most basic form, a call option can be considered a deposit for future use. For instance, a property investor may wish to buy a vacant piece of land for future development. However, the purchase is conditional on new zoning laws. The investor may choose an any time call option from the landowner. However, the land owner may accept the call option but not for free.

The buyer will then be required to make a down payment. This, in the world of options trading, is referred to as the premium. It is the cost of the options contract. Now within a period of 1 or 2 years, probably the zoning regulations will be approved according to the buyer's wishes.

He will purchase the land at the initial offer even after the value of the land increases dramatically. If the 3-year time limit was to expire, the seller would keep the premium and the buyer would have to buy the land at market prices. This is essentially how a call option works.

How a put option works

It is easier to understand how a put option works with an example. Put options are often considered as an insurance policy. For instance, consider an investor with a large portfolio of stocks and shares. The investor may be afraid of a recession in the next 2 years and does not want his shares to lose much value.

The investor may then purchase a put option with certain conditions so that he may sell his shares within the next 2 years without losing more than a certain value, regardless of the market price of the shares then. For instances, if the price is set at not less than 10% of the value of the stocks and shares, this is the amount the investor stands to receive even if the shares lose all their value. However, he will still have to pay the premium.

There are other factors that are evident from the way call options and put options operate. Anyone who purchases an option is not obligated to do anything with it but has the right to sell or buy.

The option can be allowed to expire after which it becomes worthless. When this happens an investor loses all the money they paid for the premium. It is also becoming clearer now that an option is essentially a contract that is tied to an asset such as stocks and shares. This is why they are also referred to as derivatives. Options are also tied to other types of assets such as foreign currencies, bonds, other derivatives, and commodities.

Chapter 2: How Options Trading Actually Work

Before you begin trading options, you will require a steady hand and careful research. Once you understand the terminology used, you will need to follow the habits of seasoned options traders. There are also important concepts that you should grasp, such as volume or volatility.

You need also need additional resources, and a reputable broker, if you are to trade in options online and make money. For instance, you need charts and analysis tools which will help you arrive at profitable decisions. You also need to keep learning new techniques, getting more knowledge and also studying market trends and how they affect the stocks you are interested in. trading with knowledge is very important.

Options contracts

An options contract can be simplified as the probability price of a future event. An option is more expensive if the probability of an event coming to pass is likely. This concept is crucial in understanding exactly how options function.

This can be better explained using an example. Now imagine a company such as Hewlett Packard (HP) whose shares are priced at $100. An investor may place a call option with a price of $150. The call option is valid for 3 months. A call option awards the right to buy HP shares at $150 within the 3-month period.

Now if the HP share price rises above $150 in the next 3 months, the investor wins. Please note that this option will cost more than one that is valid for 1 month or 2 weeks. This is because there is little likelihood of any significant changes to the share prices. Also, a call option for 1 year will cost more because shares are more likely to see a significant price change.

There is also another critical factor that you should consider. This factor can significantly increase the odds of the share price to go up. If the volatility of the IBM stock, considered the underlying stock in our case, then it is likely that the price will rise. However, volatility can swing the price of the stock either way. Just that there is volatility is a good sign for the call option. It will cause the option price to increase drastically. We can conclude that volatility and options trading are closely related in this manner.

Again, to understand better the concepts of options trading, it is advisable to go with an example or a hypothetical situation. Supposing on June 1 the price of Bank of America, BOA, is $100. Assume the cost or premium of a call option with this stock is $5 for the 3rd week of July. The strike price, in this case, is $110. Therefore, the total price of this particular contract without commissions is $5 X 100 = $500. In reality, commissions actually apply.

Now, stock option contracts are often for 100 shares hence the figure 100. The strike price in our case is $110. This is the price at which the call option will be worth selling. The break-even price then should be $113. Now suppose after 3 weeks, the price rises to $120. This is a significant price increase of $10 X 100 = 1000. The difference between contract price and the current price is the profit, which now stands at $500.

The investment doubles in just 3 weeks so it would be a good idea to sell at this time. However, the price may fall with time to about $95. Once the time limit is over, this contract will be worthless. The price will be $95 X 5 = $475 so this contract at this point will incur a loss.

Important points to note

In our examples above, we note that each option has an underlying stock. The option gives you the right to sell or buy this underlying stock. However, in reality, most of these options are not disposed of. It is possible to make money out of options by simply exercising then selling the stock back to the stock market and earning a tidy profit in the process. The stock can also be kept since it was purchased at a cheaper price than it currently costs.

Many traders or time holders often choose to cash in on the profits by selling their position. According to statistics, just around 60 percent of options are traded out while 10% get exercised. Only 30% actually get to expire and lose all value.

You need to be careful with the pricing. The price of an option is heavily dependent on the chances that something will occur. Even then, a pricing formula is needed. There are many models out there used to determine the price such as trinomial and binomial, but the most common formula used today is the Black, Scholes-Merton model.

Options Exchanges

Options can be traded on exchanges known as options exchanges. Such options are known as listed options. These exchanges that accept options listing are both electronic and physical.

At these exchanges, options are traded either over-the-counter or directly between parties via an exchange. Plenty of financial institutions adopt the OTC or over-the-counter model where they can carve out desired outcomes that may not be available among other listed options.

Options exchanges have what are known as market makers. They provide liquidity in the options market. They apply common market pricing models to leverage the market.

Now the simple pull and call options described previously are as simple as options trading can get. Traders and investors often refer to these simple calls and puts as plain vanilla options. Others that exist include exotic options. Exotic options include binary options. They are also pretty simple to understand with a determined payoff structure.

How to buy and sell call and put options

If you are selling a call option, you have what is known as a short position in the market. However, if you own a call option, then you have a long position. The reverse is true for put options. If you own a put option, you have a short market position and when selling, you will have a long market position.

It is very important to master these 4 crucial principles. By mastering these four things, you will understand exactly what you can do with any options. You can essentially buy or sell call options and buy or sell put options.

When you sell options, you will be referred to as an options writer. And when you buy options, you will be referred to as an options holder. There are some distinct differences between buyers and sellers.

Options holders having either call or put options have a choice to either buy or sell but are not obligated to do so. The reason for this is so that any losses they may incur are limited. This way, they can only lose the premium of the options.

Options writers with either put or call options are obligated to sell or purchase. This means that a writer with a call or put options will be required to make a purchase or sale. Their risk is not protected and so they stand to lose a lot more than just the cost of the option.

What reasons do people have to use options?
Ideally, options trading is a great way of making money and earning a tidy income. This can be achieved in different ways. There is hedging, spreading, speculation and other different reasons. Here is a look at some of these.

Spreading
In options spreading, spreading is the process where 2 or more different options positions are used. It combines aspects of speculation with hedging. This means a combination of limiting of losses with a market opinion. The

spreading design is such that it can put some limitation on potential gains as well.

The benefit of spreading technique in options trading is that it has low implementation cost and limits any potential losses. Spreading largely involves the sale and further purchase of options. The versatile nature of options is largely visible through the use of this technique.

Spreading allows traders to come up with a spread that allows them to earn a profit from any situation at the market. This also includes situations where the market is stagnant without upward or downward movement.

Speculation in options trading

This can be defined as the process where a trader gambles with the eventual outcome of a future cost of an asset or an event. For instance, an investor may have the firm belief that the price of a certain share will rise. This belief may be based on the desire to make a quick profit or even gut feeling, government policies and so on.

Many traders prefer to speculate using call options rather than investing directly in the underlying stock. This is mostly because of the options and leverage that options have to offer. Some call options may be very affordable especially compared to the cost of investing in the underlying stocks.

People think of options as risky mostly because of this speculative nature. Investors in options are required to be as accurate as possible especially in the determination not just of the stock direction but the timing and magnitude of the movement.

Powers of prediction in this regards need to be top notch. A successful options trader needs to accurately predict the upward or downward movement of stocks, the time frame that this will happen and the price changes after the movement.

Synthetics options spread

Synthetic in options trading is another type of spread. This particular spread type is mostly used to come up with a position similar to the desired position but does not control the underlying asset.

Instead of buying the underlying asset, an investor creates a synthetic position. For instance, let’s say you purchase a call option with at-the-money position then dispose of a put option with same strike and expiration date. The effect of this is to create a synthetic long position in the related stock.

Some consider that it might be easier to just purchase the underlying stock. However, there are many reasons why investors do not do this. Reasons could include costs, regulatory and legal limitations.

Hedging technique in options trading

The reason why options were formulated is to enable firms and individuals to engage in hedging. Basically, hedging can be defined as a strategy that enables investors to reduce their risks but incurring a reasonable cost in the process. Therefore, hedging can be thought of as taking out an insurance policy against a likely, future event.

Options work just like a car or health insurance. By hedging on options, investors can ensure their investments against any future event that may drastically affect the price of that investment. There are some traders who think that if you need to hedge then you should not invest in the first place. However, this is just their opinion. Many people use hedging techniques successfully every single day.

Hedging techniques are particularly useful to large organizations with significant investments. However, even individual investors can benefit from this options trading technique. For instance, you may want to invest in health sector securities but wish to avoid any major pitfalls. By use of hedging strategies, you can achieve this. Hedging will restrict the pitfalls while allowing you to benefit from any price gains.

Chapter 3: How to Trade Profitably with Options

As already noted, options simply involve putting a price on the possibility or probability that a future event will take place. If an event is likely to actually happen, then that particular option related to that event becomes very expensive. Therefore, the more likely an event is, the better the profits from the option.

It is important to learn how to trade in options because it offers a reliable and long-term source of income. Many investors have generated wealth and become prosperous by simply trading in stock options. Options are a preferred means of investment because of various reasons. One of these is the relatively low cost of investment required. As an investor, you do not need large sums of money to buy options. They are very cheaply priced yet they offer rewards that are just as good as those enjoyed by investors in the stocks markets.

There have been plenty of advances made, over the last couple of decades, on how commodity markets function. One of the most notable of these advances is the development of online trading platforms and the speed at which deals are concluded. Trading online is fast, easy and convenient. It enables any interested investor to open an account through a broker and then start trading options and earn good returns as soon as is practically possible.

Options trading present a new, more advanced method of investing. To be successful in options trading, it is very important that you understand exactly what you are doing. This will ensure that you are not just an amateur groping in the dark but a true investor.

One of the most important reasons why trade in options is gaining popularity is that investors do not need to invest large sums of money as compared to those investing directly in stocks and shares. This is because traders do not need to actually buy the underlying stocks or shares but simply the rights affiliated with the options. However, the returns are just as great, if not greater, as those gotten from trade in securities.

Options require an arsenal of successful methods and tactics to be profitable. For a beginner or the average investor, a powerful and successful strategy is definitely essential. Whenever you invest money in the stock market, always diversify your portfolio and if possible, include options. This way, you will greatly increase the income that you derive from your investments.

Basic ways of investing in options

One of the best ways of investing in options is to purchase call options. As an investor, you buy this option with the expectation that the value of underlying stock will increase its value. However, as an investor in options, you want to amplify the benefits while minimizing the potential downside. This is the primary reason people choose options over just shares.

Example of a call option contract

Let us assume Company X shares are currently trading at $100 in the stocks market. Now, assume a buyer comes and buys a call option contract on Company X shares at a premium of $2 and $100 strike price.

Now it is important to understand that the $2 premium is the right to buy the 100 shares at $100. Ordinarily, this would ideally cost $10,000. However, this costs the investor only $200 because 100 shares X $2 = $200. Several things can happen to this share in the coming days.

Let us assume the shares gain at a price of $105. Remember the call option gives the right to buy the shares at $100. So the buyer could choose to buy the shares at $100 and then sell them at the market for $105. This is a cool $500 made in just a couple of days or weeks. However, since the options cost $200, the net income will come to $300. This is $500 - $200 = $300. The ROI or return on investment, in this case, is 150%.

Now imagine a situation where the option expires while Company X shares are trading at $101. The buyer will then be able to dispose of the options and make $100. However, the initial investment that was made was $200. This trade will, therefore, result in a net loss of $100.

Yet another situation that could arise from this trade is when the share price of Company X drops to below $100. The contract becomes worthless once it expires and the buyer will suffer a 100% loss. This means he loses the entire $200 that was used to purchase the options.

This is basically how options trading works. In our example above, the investor does not lose much money so it is not the end of the world for him. However, many investors often trade with large amounts of money. When traders or investors use large money amounts, this is known as being “in the money” and brokers make what is known as a deep call. These are made when there is a higher chance of making money and being profitable.

There are also orders known as stop-loss orders. This order is used to protect the investor from incurring losses when they invest large amounts of money. Our example above of buying a call option is one of the simplest ways of investing in options. Ensure that you can understand it so you can apply it to your trades when the time comes.

Another example

Here is another example that will make options trading clearer. Suppose you want to purchase an antique clock and you find a great one that you really like. Now the owner of the antique clock is selling at $3000 which you don’t have at the moment but will have in 3 months time. So you request the owner to keep it for you and sell it at the same price once you get the money. The owner agrees but you have to pay him $100.

Then 3 months later, you get the $3000 and buy the clock. Suppose it is discovered that this clock once belonged to Abraham Lincoln. This causes its price to hike from $3000 to probably $15,000. You may exercise your right to buy the clock for $3000 and then sell it for $15,000. In the process, you will make a tidy profit of $11,900.

But then again, suppose it is discovered that the clock is not an antique but a mere imitation made of inferior material. Its value then drops from $3000 to about $500. You will not be obliged to purchase it at this price and may just let the contract expire. You will still lose the initial $100 which was the cost of the contract but you will not suffer any major losses.

If you can understand the example above, then you are well on your way to becoming a successful options trader. While this is a simple analogy, there are more complex solutions but which are also very profitable. Options trading definitely has its advantages. For a relatively small amount of money, it is possible to receive a significant return within a short period of time.

Before trading options, there are a couple of things that you will need to consider. These are leverage, hedging, and flexibility. Leverage allows you to control a large investment without having to purchase it and for a small amount of money. Leverage ensures that you have potential to earn huge sums of money even though it can result in some losses.

When you have a certain position on a commodity, it is possible to lock in using an options contract and minimize any potential losses through hedging. And you get to do this with very little initial capital. Flexibility enables you to make a speculation in a variety of ways. You can use clever strategies to speculate on the market. The market has very many options contracts that allow you to trade on many different kinds of securities including bonds, shares, foreign currencies and lots more.

Option trading is popular because you can make money regardless of other market trends. As an investor, you can benefit from the market when it trends upwards when it is in decline and even when there is little or no movement. Being able to make money under any market conditions is a feat that no other trades can achieve. For instance, you can only make money with stocks and shares when the market is on an upward trend.

Opening an options trading account

Trading in options can be a little more complex than trading in stocks, shares, and other financial instruments. You will need to identify a broker and then open an account. Even after opening a trading, you will still need to engage in a more extensive process to get the account up and running.

Your broker, once you find one, will need to receive more information from you. This is because of the kind of capital required for options trading and the complex nature of predicting future events. Getting information from you is important to the broker so they understand more about you.

A prospective broker will require certain information from you. This information will include the following:

Your personal information such as your net worth, your annual income, employment details and your total net worth

Your investment aims including growth, income, speculation and capital preservation

Any trading experience that you may have; this includes your general knowledge about investment, the time period that you have been investing and the general size of your trades

The kind of options you wish to trade in

As soon as you provide this information, the broker will then proceed to open an account for you and assign you a preliminary trading level. This level often ranges from level 1 to 4. These levels allow you to spend certain amounts of money at given relatively safe and simple trades online.

Even then, you also need to screen your broker because screening needs to be both ways. The broker you finally choose to engage with will be the single most important decision you will make as an investor.

A good online broker should offer you all the necessary tools, advice and resources that you need in order to successfully trade online. Before getting online and trading in options, you should learn how to identify a suitable options broker so that you are able to find the right one for you.

Traders at options markets do not need to physically get to the market. Most trades are conducted online. You can therefore trade and make money from the comfort of your home. All you need is a computer, reliable Internet connection and a trading account with a reputable broker.

Points to ponder when you start trading options

It is always important to remember that when you invest in an option, you are actually acquiring a contract that allows you to sell a stock or share.

This is according to the contract you sign, within a given period of time and at an agreed price.

There are 3 very crucial decisions that you will need to make once you get into the actual trading. You will first need to determine the direction that you think the stock will head. Then you will have to predict how low or high the price of the underlying stock will rise and finally determine the time frame within which the price of the stock will move.

Deciding which direction the stock will head

It is important to predict which direction the stock will head as this will determine the type of contracts you can sign up to for your options trading. For instance, if your prediction is that the price will rise, then you should get a call option. This option has a contract that allows but does not obligate, you to purchase a given stock at a set price or strike price, within a given time period.

If on the other hand, you are of the opinion that the price of the underlying stock will decline, then you can opt for a put option. This option comes with a contract that deprives you the obligation but gives you the right to sell shares at a given time and before the contract expires.

Predict how low or high the stock price will fluctuate from initial price

It is very important to make a correct prediction about how high or how low the stock price will fluctuate. Basically, the aim is to have the stock price close “in the money”. This term means that the stock will close above the strike price for call options and below the strike price for put options. Essentially, you will want to buy a stock option whose strike price will reflect the direction in which you think the stock will head within the lifetime of the contract.

For instance, if you are of the opinion that IBM shares currently trading at $100 will rise to about $130 within a given period of time, then you can purchase a call option whose strike price is much lower than $130. You should remember to include the cost of the option in your calculations. This way, the option will be in the money at $130.

The same applies for a put option. If for instance, you think Kellogg's share price, currently at $100, will fall to $80 within a given time frame, then you can purchase a put options contract. This means that the stock will be in the money if it falls below the $80 mark.

Now choosing the strike price is not a simple and straightforward process. Option quotes usually come with an entire range of strike prices available. The incremental prices are standardized across the options trading platform. With the right kind of tools and direction, you will be able to choose the strike price wisely.

Make money with long-straddle options trading

With options, traders and investors are able to earn a tidy profit in other different ways that other trades may not be able to. One of these ways is to buy or sell short an underlying asset. Dealing with this underlying security only puts a trader in a position known technically as a long position.

The long position provides an opportunity to profit from a price hike. On the other hand, the short position benefits traders when the underlying stock's price dips. It is also possible to hold neither long nor short positions when it comes to the price of the underlying stock. By using options, a trader or investor can then come up with a position that enables them to benefit from the market position.

The long-straddle technique

A long-straddle technique is one where you purchase a put option and a call option, both having similar strike price and same expiration date, usually a month. An alternative position to this is the long strangle.

A long strangle is a position that is entered by a trader or investor when a call option, which has a higher strike price, is purchased together with a put option that also has a much lower strike price. In both cases, the aim here is that the related stock will either rise sufficiently to generate a profit that is much larger than the loss expected from the put option, or drop far down so that a significant profit is earned.

The issue with this kind of trade is that there is a certain risk that you need to consider. This risk is that the stock associated with the contract will not make a significant move in either direction such that the two options lose their time premium due to time decay.

The important point to note at this point is that there is unlimited profit potential with a long straddle. The greatest risk will occur only if the current position is maintained till the expiration of the option and the related stock closes at the strike price declared for the two options.

Costs and breakeven points

Example: Consider an example where an investor buys a put option and call option on a share selling at $100 and a strike price of $100. In this example, we shall assume that there are about 60 days until the options expire. Also, assume that the put options and call options are trading at $3.

Now, to get into a long straddle with these particular options, the investor needs to part with a total of (100 * 3 *4) = $1200. Each individual option, call and put, is for 100 shares at $3. So for each option, you have $100 * 3 * 2 = $600. The figure of $1200 is basically the highest amount the investor stands to lose. But this loss can only occur should the stock close at exactly $100 upon expiry after a period of 60 days.

For a breakeven position at the time the contract expires, the price of the underlying stock needs to be above $106 or below $94 per share. Getting these breakeven points is easy. You simply add or subtract the price of the long straddle from or to the strike price.

For instance, let us assume that the underlying asset closed at exactly $106 when the option contract expired. Our initial strike price of $100 would amount to $6 which indicates a gain of $3. The strike price of 100 would then be worthless, indicating a loss of $3. These two distinct positions offset each other which goes on to show that there is no loss experienced on the straddle.

Now assume, on the other hand, that the related stock closed at the price of $94 when the contract expired. This would render the 100 strike price completely worthless, signifying a loss of $3. On the opposite end, the 100 strike price would be valued at $6, indicating a net gain of $3. These two positions would negate each other, leading to a breakeven position in the straddle.

Profitable position

It is possible to get a profit with the long straddle option. It was observed earlier that the profit potential in this position is virtually limitless (but is limited by a pricing of zero on the underlying commodity). Now suppose, in the example above, the underlying stock closed at $120. Now, remember that with our 100 strike price, the call would amount to $20.

Since we paid a price for this option, ($3 * 2), the net gain will be $14 because (20 – 6 = 14). The strike price at 100 would also be rendered worthless. Remember there was a cost of $3 so this is considered a further loss. The total gain therefore becomes $14 - $3 = $11. On this long straddle, the overall gain is $11 * 100 = $1100. Now our initial cost was $600 so this means a net gain of $500.

Benefits and disadvantages of the long straddle option

Like with everything else, long straddle has its pros and cons. The most important advantage of this type of option is that there is no need to make accurate forecasts on the price direction. Should the price go up or down is not an issue. What is important is that the price moves in either direction far enough before the expiration date of the options contract.

Another benefit of this type of option is that investors have the chance to benefit from certain situations such as expected earnings, anticipated break out after consolidation and from very low option time premiums.

Shares will typically trend up or down before stabilizing within a trading range. As soon as the trading range settles down, another trading range will emerge. When these ranges extend beyond the ordinary, the time premium that is a component of the options price gets to be very low. Stocks experiencing this kind of situation become prime targets for long straddle options trading.

There are some downsides to the long straddle options. One of these is that investors have to pay 2 premiums and not just one. These are for both the call and put options. You may, therefore, have to fork up more money than you may have initially planned. Fortunately, options are relatively cheap compared to shares so you will probably just be alright.

Another disadvantage of the long straddle options is that in order to realize a profit, the underlying stock has to move significantly in either direction so as to generate a profit. This movement may not necessarily favor your position so be careful especially if there is volatility in the market.

In conclusion

In general, different investors trade in options for their own different reasons. But the fundamental purpose here is to take advantage of an opportunity that would not necessarily be available through trade with ordinary shares.

A short or long position in the related stock will only be profitable if the stock price inches towards the desired direction. Also, if the related stock does not change its position, then an investor will suffer no loss and will make no profit.

This is not so with a long straddle. With this system, an investor can make a tidy profit regardless of which direction the underlying stock moves. However, if the stock remains unchanged, there may be losses accrued. Since this is a unique strategy, it is important that traders and investors learn more about it.

Chapter 4: Tips and Advice on Successful Options Trade

If you are new to options trading, then you will need all the advice, tips and guidance necessary, in order to trade successfully. It is, however, first recommended that you understand a concept, apply it and master it then add more knowledge. This is a much better and more successful strategy. Here are some helpful tips and advice that should guide you as you trade online in options.

1. The price of any stock can move in 3 basic directions.

These directions are up, down and no movement at all. Depending on the kind of call that you have, you can leverage on this movement to make a profit or at least avoid incurring losses.

Plenty of first-time traders and investors assume that prices of securities will go either up or down. However, this is a wrong school of thought because sometimes there is no movement at all in the price of stocks and shares. This is a very important fact in the world of options trading.

There are plenty of real-life, practical examples that show a particular stock or share did not move significantly for quite a lengthy period. For instance, the KOL share traded within a $4 range for a total of 23 days. If you had invested money in either a call option or a put option through this stock, you would have lost money.

According to seasoned traders, chances of making a profit with a call or put option are hardly ever 50% but only 33%. This is likely due to the fact that stock price movements are random. You will eventually realize that 33% of the time, stocks rise, 33% of the time they dip in price and another 33% of the time they stay the same. Time will more often be your worst enemy if you have a long put or call option.

A purchase of a call option is usually with the hope that prices will go up. In the event that prices do rise, then you will make a profit. At other times the prices will remain the same or even fall. In such events, if you have an out-of-the-money call, the option will most likely expire and you will lose your investment. In the event that the price remains stagnant and you have an in-the-money option, then you will at least recoup some of the money you invested.

There will be sometimes when frustrations will engulf you. This is when you just sit and watch prices start to skyrocket just a couple of weeks after the options you purchased had expired. This is often an indicator that your strategy was not on point and you did not give it sufficient time. Even seasoned traders sometimes buy call options that eventually expire in a given month and then the stocks prices rise sharply in the following month.

It is therefore advisable to purchase a longer term call option rather than one that expires after a single month. Now since stocks move in 3 general directions, it is assumed that close to 70% of options traders with long call and put options suffer losses. On the other hand, this implies that 70% of option sellers make money. This is one of the main reasons why conservative options traders prefer to write or sell options.

2. Before buying a call or put option, look at the underlying stock's chart

Basically, you want to find out as much information as possible about the performance and worth of an underlying stock before investing in it.

You should, therefore, ensure that you take a serious look at the chart of the stock. This chart should indicate the performance of the stock in the last couple of days. The best is to look at a stock's performance in the last 30 and 90 days. You should also take a look at its past year's performance.

When you look at the charts, look at the movement of the shares and try and note any trends. Also, try and observe any general movement of the shares. Then answer a couple of questions. For instance, is the stock operating within a narrow range or is it bending upwards or downwards? Is this chart in tandem with your options trading strategy?

To identify the trend of a particular stock, try and draw a straight line along in the middle of the share prices. Then draw a line both above and below so as to indicate a channel of the general flow of the share.

Chart readings and buying call options

Let us assume you wish to invest in a call option. Then you should ask yourself if the stock price is likely to rise and why. If you think the stock will rise and trade at a higher level, then you may be mistaken, unless something drastic happens or new information becomes evident. New information can be a shareholders meeting, impending earnings announcement, a new CEO, product launch and so on.

If there is a chart showing the presence of support at lower prices and stock prices fall to that level, then it may be advisable to buy call options. The call option will be a great bet when prices are down because prices will very likely head back up. However, never allow greed to occupy your mind. When you see a profit, take and do not wait too long.

Chart readings and buying put options

Now supposing the stock chart indicates a solid resistance at a higher price. If the stock is beginning to approach this higher level, then it is possible that the price might begin to move in that direction as well. So as the price moves, expect to gain small but significant profits. Avoid greed so anytime the stock price falls, simply move in and make some money.

Chart readings for purchase of call and put options

Now, if your chart readings indicate that the shares are within the lower levels of its range, then it is likely that daily changes in price will send it towards the middle of the range. If this so, then you should move in and make a profit as soon as the price tends upwards. Even minor profits such as buying at $1 and selling at $1.15 mean a 15% profit margin.

3. Find out the breakeven point before buying your options

Now you need to identify a call option that you wish to invest in, especially after studying its performance on the market. Before buying, however, you should work out the breakeven point. In order to find this breakeven point, you will have to consider things such as the commissions charged and the bid spread.

It is very important that you are positive the underlying stock of your options will move sufficiently so as to surpass the breakeven point and earn a tidy profit. You should, therefore, learn how to work out the breakeven point in options trade.

Calculating the breakeven point
As an options trader, you need to know how to calculate and find the breakeven point. In options trading, there are basically 2 break-even points. With short term options, you need to make use of the commission rates and bid spread to work out the breakeven point. This is if you intend to hold on to the options till their expiration date.

Now if you are seeking short term trade without holding on to the options, then find out the difference between asking price and bid price. This difference is also known as the spread.

4. If you are dealing with call and put options, embrace the underlying stock's trend

As an investor and trader in options, you need to consider the trend of the underlying stock as your friend. This means that you should not fight it. Basically, if the stock price is headed upwards, you should find a strategy that is in tandem with this movement. If you oppose it, you are unlikely to win.

Similarly, if the stock is on a downward trend, then do not oppose this movement but try and find a strategy that will accommodate this trend. You need to understand however that this saying is intended to guide you but is not necessarily a rule. This means you apply it even while you consider all other factors. For instance, the major news may have an immediate effect on the price trend of a stock or shares.

As a trader, you should learn to jump successfully on a trend and follow the crowds rather than go to extremes and oppose it. Most amateurs who see an upward trend often think the stock is about to level out. However, the reality is that the momentum is often considered a great thing by seasoned traders. Therefore, do not try and oppose the trend because you will surely lose. Instead, try and design a strategy that will accommodate the trend. In short, the trend is always your friend, do not resist and momentum is truly great.

5. When trading options, watch out for earnings release dates

Call and put options are generally expensive with the price increases significantly if there is an earnings release announcement looming. The reason is that the anticipation of very good or very bad earnings report will likely affect the stock price. When this is an underlying stock in an options trade, then you should adjust your trades appropriately.

Once an earnings release has been made, then options prices will fall significantly. You need to also watch out very carefully for this. The prices will first go up just before the earnings release and then fall shortly thereafter. It is also possible for call options prices to dip despite earnings announcements. This may happen if the earnings announced are not as impressive as expected.

As an example, stocks such as Google may rise insanely during the earnings announcement week only to dip significantly shortly thereafter. Consider Company X shares that were trading at $450 at the markets. Call options with Company X as the underlying stock were trading at $460. However, the market had targeted a price of $480 within 3 days, which did not happen. This cost investors money. Such underlying assets are considered volatile due to the high increase in price, rapid drop shortly thereafter and a related risk of losing money.

Chapter 5: Options Trading Strategies You Can Use

One of the best ways of making money is by trading and investing in stock options online. Many investors love this sector because you can make money whether the stock market is thriving or going through a slump. You can also make money when stocks are trending sideways.

The ability to make money from stocks regardless of market trends is vastly different than trading directly with commodities such as shares and bonds. Ordinary securities like stocks usually rise and fall depending on the stock market.

By now it should be evident that while options are contracts based on an underlying stock, not all stocks are listed for options trading. However, the ones that are listed often have a lot of options for traders. These options provide plenty of trading opportunities for investors and traders, especially online.

Options, unlike shares, are not tangible. They simply provide a right to sell or purchase a given stock. They are derivatives that derive their value and existence from related or underlying stocks. For instance, IBM stock options are derivatives of IBM shares. It follows therefore that the price of the options will depend largely on the price of the underlying stock.

The options also mirror largely the movement of the stock on the market. The quality of the stock also matters. Therefore, most blue chip companies will likely be on the options market. However, stocks from other companies are quoted here as well so the choice of underlying stock is very important.

Generally, good stocks have great options for traders. Therefore, always aim to deal in options derived from great stocks. You will find mostly that there is no broker who will undertake research for you. It will be up to you to conduct your research and use the various tools at your disposal to identify the best stock options to invest in.

This places the success of your trades squarely on your shoulders. You need to figure out exactly what stocks options to trade when the best trading time is and how much risk you should consider in your trades. Fortunately, there are great resources available and traders that can help you get around these challenges.

Options trading strategies to use online

The basic instruments of options trading are put and call options. From these, you can come up with your preferred option trading strategies. A trade will consist of a call option, a put option or a combination of both.

There are a plenty of different options trading strategies that exist to you as a trader or investor. You should learn a few of these and find out which strategies suit you and your investment objectives and which ones do not.

Options trading strategies

1. Married put

Basically, a married put can be compared to an insurance that you take out on your securities purchase. This is because it works just like insurance for your stocks. This strategy does not take a lot of skill to implement. All that is necessary is to understand the workings of options.

Married options are also referred to as hedging. Hedging your investment helps you save lots of money should any drastic effect happen and affect your investments. For instance, if you buy a brand new car for $20,000 and insure it against theft, fire, and accidents.

If the car gets into an accident and is completely wrecked, the insurance company will reimburse you. You will receive a check for $20,000. The only money you will lose is the premium paid for the insurance. This strategy acts in exactly the same way.

A married put is where you purchase a put option as well as shares in the underlying stock. The option and the stock, therefore, become joined into an investment. If you get rid of one, you no longer have a married option. The benefit of this strategy is that no matter how low the price of the stock falls, you can always sell them at the initial price.

The question now is how many puts you need to purchase. Now recall that one stock represents 100 shares. Therefore, every option you buy is equivalent to 100 shares. If you buy 60 options, the equivalent is 60 * 100 = 6000 shares. This strategy is easier understood through an example.

Suppose an investor acquires 200 shares at $50 each. This will cost him $10,000. Now the investor then decides to buy a put option with the same stock as an underlying security. He buys just one contract backed put option at $2. This is at a cost of $2 * 100 = $200.

Now suppose the shares lose value after some time to trade at $30. The investor can exercise the put option which gives him a right to sell the shares at the initial price of $50 per share. The only loss he suffers will be the cost of the option at $200. If the put option was not purchased, then the loss would have been $4000.

Real life examples include the stocks and shares of Bear Stearns and Enron. Had the shareholders invested in a married option, many would not have suffered the huge losses that they did.

2. The protective put

This put option, known as the protective put, is very similar to the married put. The aim of this put option is to also provide protection in case of any drastic market situations. The only difference between the two is that the protective put is purchased for shares already owned. This is in contrast to marriage option where options and shares are purchased together.

This strategy is viewed as protective as investors use it to protect their profits. The options can also be used to hedge against investment losses. Here is an example. Now suppose that an investor puts his money in shares which are trading at $50 per share. For 100 shares, this amounts to $50 * 100 = $5000.

Now 3 months later, these shares are trading at $80 per share. Herein lies a profit of $3ooo.

To get these profits, the investor has to sell the shares at the stock market. However, buying a protective put option helps the investor lock in the profits without having to sell the shares. It is after the gains have been made that the put option is acquired. All the gains will be locked in and the rights to sell maintained.

The main advantage of this type of option is that it allows you the investor to hold onto your stocks, participate in future gains while protecting you from any losses. The cost of the put options is pretty low compared to the savings made. The disadvantages are that the cost of the options eats into the profits and the protection is only for a limited only. Repeat buys might, therefore, be necessary.

How to trade in put options

If you desire to make money at the stock exchange, then you need to master the art of trading in put options. This is especially lucrative when the market is on a downward trend and share prices start dipping. An important point to note is that you make more money selling put options because stocks generally fall and rarely gain value.

Remember that put options give the buyer rights to sell but not necessarily an obligation. You will, therefore, be in possession of a contract that declares you can sell the shares for a price higher than the market price. Now assume there is someone holding lots of IBM stock at $50 per share. Supposing the price drops to about $35 per share. This particular investor would be distressed at the thought of losing so much money. If you, an investor, held a put option with IBM stock would easily sell to the investor. He would gladly buy in order to stave off losses.

Here is another practical example. Let us say you purchase some “Put” stock option in January. If the stock is worth $150, then you purchase a contract that says you have the right to sell these shares at this or better price for the next 3 weeks. If the price falls within that period, then you can sell the shares at above market price.

However, you need to be careful in case the price goes up. There will hardly be any investor willing to buy a contract to sell the shares at $150 if the price gets to $200. Therefore, put options are great for a declining market.

How to trade in call options

You can also profit from the stock market by engaging in low-risk call options trade. Buying options are 90% cheaper than buying the actual underlying shares yet you stand to make just about the same profit. And what’s more, you stand to lose very little so the risks are very low.

Many people with funds to invest often opt to buy shares and stocks. However, this is not the wisest way to invest. People who want to own companies buy shares while those who want to make money trading in options. You spend much less yet make almost the same amount of profit.

Let us demonstrate this with an example. Now suppose you purchase June $100 call option. This option will be a contract with rights to buy the shares for $95 before the 3rd Friday of June. Let’s suppose they releases a new, exciting product so the share price hikes to $115. The contract you own allows you to purchase this stock at $95. There will definitely be investors willing to buy these rights from you.

However, should the price dip below $95, then no one will be willing to buy your call option and it will become worthless or expire after 3 weeks. The benefit here is that you stand to lose very little when the price dips but you will benefit greatly if there is a price hike.

How to make money with covered call options

One of the great ways of making money on the stock exchange is by use of covered call options. If you own shares in your portfolio, then you should consider selling stock options. You stand to realistically make up to 60% of the worth of your shares or even more.

But for you to become competent in dealing with covered call options, you need to understand how to buy and sell shares and stocks. This is very important. You also need to understand important terminology. For instance, selling is referred to as writing because you will write a contract granting certain rights to buyers.

Now, remember that a call option gives its owner or buyer the right, but not an obligation, to buy shares at a given price within the duration of the contract. The process of selling covered options is best undertaken when the prices are threading within a channel or slightly rising.

Covered options act in a similar manner to renting out your house. Suppose you rent out your house to someone who intends to purchase it. The tenant will first pay rent for a given amount of time and will then earn the right to purchase it at a given price. Should the investor not buy the home, then he will lose out on all the money paid as rent.

The covered call options operate in the very same way. As an investor, you first need to purchase the stock or shares. This is similar to buying a house. Now you will then write a call option with the shares as the underlying stock. This equates to putting your house up for rent.

So now you can sell the call option to an investor who will pay you money for the right to buy the shares from you. The money the investor pays is not refundable regardless of whether they buy the shares eventually or not.

If the shares do not get purchased, you get to keep the money paid to you as the cost of writing the call option. You can then put the shares up in the market again. If the shares are "exercised", it means they have been purchased. You will have to then sell the shares at the agreed strike price.

Swing trading options strategy

Another great strategy that can earn you a good return with stock options is the swing trading options strategy. This is a very simple, straightforward and profitable trading strategy that can help you generate a steady and reliable income over time.

Generally, swing trades are carried out within a period of 2 to 10 days. It is important to use such a short time frame in order to succeed with this strategy. Options trading has been proven to be a profitable means of investing and generating good returns. There are a good number of strategies available and this is one of the most popular ones.

When it comes to swing options trading strategy, you really need to keep it simple. If not, then you will encounter stressful situations which may cause you to lose money. Then, remember to start with a safe, profitable and most basic strategy. Lots of beginners often start off too quickly yet statistics indicate that up to 90% of them will make a loss.

When it comes to swing trades, volatility is crucial. Many traders run into trouble when they implement this options trading strategy simply because they lack the basic understanding of concepts such as implied volatility and how it distorts and impacts the cost of options.
It is, therefore, crucial to understand some of these basic concepts. For instance, the most important aspect of options trading is traders' perception of the future as well as implied volatility. This volatility tends to indicate the market's opinion regarding the direction that the underlying stock is likely to take. These are fundamental principles of swing trading options and learning them is crucial for the success of this simple yet profitable strategy.

One fact about this strategy is that the more you learn about implied volatility, the better you are bound to become. Another important fact you need to remember is that if you sell high volatility options for a while, then you are likely to make good profits. Therefore, learn to trade options when volatility is high and then buy them back when it is low. This strategy is similar to selling something when the price is high and then buy it back when its price dips.

With swing options trading strategy, you will be buying call and put options. However, you need to buy options when they are cheap or when volatility favors you. Try and adopt the market exhaustion patterns. Essentially, you will need to buy puts when premiums are low and buy calls when premiums are cheap. Finally, remember to always keep the strategy simple. If you learn more about volatility and how it affects options, then you will be able to successfully trade and make profits.

Trading in binary options

Another type of options that you can profitably trade in is referred to as a binary option. Basically, binary options provide a simple method of trading with capped options. The risks and profits are capped and based on a yes or no proposition. The proposition can be a question with a yes or no answer. If the outcome is positive then the option earns money while a negative outcome means money is lost.

For instance, a proposition may be posed asking: “Will the price of copper hit the $400 mark by 3.00 pm Thursday? If you believe the price will get to the indicated one, then you may buy the option but if not, you should sell.

Generally, the price of binary options is between $0 and $100. But there are bids placed on these binary options. Therefore, if you head to the options market, you may come across bids placed on certain propositions. For instance, you may find gold trading at a bid price of $45 and an offer price of $50. If you choose to purchase this binary right away, then you will pay $50. But if you sell it immediately, you will sell it for $45.

Now if the proposition occurs and you hold the binary option, then you will earn $100. This is often referred to as being in the money by traders and investors. If the proposition does not occur, then you will lose everything. When you lose, you will be said to be out of the money.

Binary options are referred to as a zero-sum game. This is because every single proposition will settle at either $0 or $100. If the proposition turns true, then the settlement is $100 while a false outcome will return a $0. This is what a zero-sum game is all about. Here is another example.
Now suppose there are bids and offers at $75 and $80 for the following proposition. The price of gold will get to $4500 by 3.00 pm. Now, if you are of the opinion that this proposition will hold true, then you purchase the binary option at $80. You may also offer this option at a lower price and hope someone will come along and accept that price.

Now if you think the price of gold will rise, you can sell or purchase more contracts. Once the set time expires, the contracts will be worth $100 each so you may work out the profits. Alternatively, if you think the price of gold will fall below $4500, then you can sell at $75. If not, at 3.00 pm, the time will run out and the binary option will expire. If you can master these simple techniques, then you will be able to execute binary options trades and over time, become a pro trader.

Tips for profitable binary options trading

Trading in binary options can be profitable and lucrative. However, making money with these options is not necessarily easy. However, you can generate an income trading with binary options. All you need is to master the basics and then apply a couple of tried and tested tips. Plenty of traders have become successful after following some or all of these important pointers.

- *Always trade in assets or commodities you are comfortable with*

Basically, deal in a commodity that you know well. For instance, if you understand how gold works, then choose options based on gold and avoid commodities you are unfamiliar with. If you prefer stocks from the auto industry then go for those stocks. You are bound to perform better and be successful when you are in familiar territory.

- *Ensure you start trading on a demo account*

Before you actually begin trading binary options, ensure that you get enough practice on demo accounts. Find a broker who offers demo accounts. These demo accounts will offer you an opportunity to place trades but without the need to risk your own funds. Demo accounts allow you to gain the wealth of experience that you need before you finally begin investing real money. Therefore, you will not have to worry about whether your trades are making you money or not.

- *Discipline is a must when trading binary options*

Binary options trades can be a lot of fun. This is true especially when you watch your options expire in the money. Making money online trading in options can give you an amazing feeling.

However, you should never treat it as a game because if you do, you will likely lose money. Many pro traders know this and they always take their trading very seriously. Staying disciplined is therefore very important and the key to your success.

- *Try not to make up for any losses*

A pattern that you are likely to encounter especially with beginners is their attempts to recover lost money. What happens is that, after a couple of losses, they become desperate to recoup lost money. In the process, they panic and lose focus. This kind of desperation causes them to lose even more money.

Some traders become so agitated that they throw caution to the wind. They begin placing bets without any considerations or due diligence.

Basically, if you suffer losses, take a breather or even time out. Breathe in and out, and do not let this get to your head. Try and figure out what went wrong and always invest small amounts of money initially. This way, you will only suffer minimal losses.

- *Ensure you work only with trusted brokers*

As a trader, you want to only work with brokers who have a good reputation and a proven track record. Plenty of investors, especially beginners, often entrust their money to untrustworthy brokers who then disappear with it. A lot of the time people assume that a broker with a website is trustworthy. This is far from the truth so it is much better to seek a reference or search for referrals online.

- *Take regular breaks away from your trades*

Options and binary trades can sometimes be addictive. However, obsession is never a good thing and addiction to trades needs to be avoided. It is definitely a good idea to know when you are worn out. Therefore, whenever you feel tired, exhausted or have spent too much time on the computer, simply log off, switch off the computer and take a much-needed break. You will be surprised at how much good this break can do.

Chapter 6: Options Trading Mistakes and How to Avoid Them

No one can claim to be the perfect trader. We all make mistakes, even the best of us. When we note our mistakes and admit to them, we get a chance to become better. Some mistakes are often repeated over and over again, yet they can be avoided. There are, however, some general mistakes that you need to avoid if you are to trade options successfully.

1. *Trading without a definite exit plan*

As a trader, you really need to learn how to control your emotions. This is true whether you are trading in stocks or options. The important thing is to always have a plan, work with the plan and stick to it no matter what your feelings may be. An exit plan is necessary whether you are losing or winning. In short, have an upside exit point and a downside exit point.

2. *Trying to make up for losses incurred*

Most traders will lose money at one point or other. This is a common occurrence. However, many beginners or rookie traders often get into a panic after losing money. Inexperienced traders often panic after losing a couple of trades and will try and pump in more money in a panic. You should not do this as it will only cost you more money. Instead, take a deep breath, relax and even take a break.

Sometimes traders tend to double up, a way of investing more money in trades in their attempt to recoup their losses. While this can be a tempting affair, you should learn to avoid and stick to your investment plan. Your plan is very important and will guide all your online trading ventures.

3. Not doing your homework

It is very important to conduct due diligence and to do your homework. If you do not use the tools provided, study charts, compare performance and lots of other things that you should, then your trades may not be successful. You will only lose money and not even have a chance to understand why. Ensure that you put in the work necessary and work hard so that you can trade successfully. An informed trader is most often a successful trader and vice versa.

4. Trading with a fixed mind

Many traders often trade with a fixed mind, thinking they are always right. Sometimes even when evidence is available to the contrary, traders still stick to their positions. Instead of insisting on being right, the focus should be on being profitable and this means being flexible and having an open mind.

5. Waiting a long time to buy back short strategies

As a trader, you need to always be ready to purchase short strategies and do so early enough. Sometimes when a trade happens profitably and according to your wishes, you may tend to relax. You may form an opinion that this run will continue for ever. Such trades or runs can easily change direction.

Should a short option that you have goes out-of-the-money, then you should buy it back. Basically, if you can manage to rescue over 80% of your earlier gains, you should actually buy back the option.

6. Purchasing out-of-the-money options

Some of the cheapest options in the options market are the out-of-money options. Many beginners often rush to buy these because of their low cost and this might seem like, therefore, to them. However, there is a reason these options are so cheap. Most of them have very little chance of ending up in the money so they may be worth nothing eventually.

If you are to purchase these options, you have to be accurate in terms of time and direction. If you sit on them too long, then even if the direction is accurate, you will still lose out. The expiration date is often the most crucial determinant about whether the options will finish in the money. Keep this in mind always so that you never face the risk of losing out.

To fix this, try and go for straight long puts and calls. Get these in the money as soon as possible. While they are likely to be more expensive, they possess a better chance of success and will likely earn you a profit.

7. Letting short options go unmonitored

One of the most outstanding features of short options is that they carry limited rewards and unlimited risks. While this might be a turnoff to some investors, it should not deter you. Short options can be a very lucrative way of getting an income. However, as a trader, you have to remain in-charge and involved.

You should monitor both the upside and downside of this option and see how it is performing. Many traders, however, try to get as much out of their options as possible. This might see them end up in a loss. The best approach with short options is to never let them go in the money. That is unless they are covered calls or when you are applying puts to find stocks. Also, ensure to set your points where you will exit. It could be determined by a maximum loss amount or your technical analysis of the trades.

8. Trading low volume options

One of the important factors of options trading is dealing in liquid options. Liquidity here stands for the speed at which you can enter or exit a given position at a desirable price. If the liquidity is low, then the chance of exiting at your preferred time or price is limited.
Remember that just because options are listed on the market does not imply that they are good for trading. As a matter of fact, most listed options will not be traded. Smaller companies do not have liquid options. Try and avoid being so far out-of-the-money or even in the money.

9. Not being informed as you trade

It is very crucial that when you start trading, you have all the necessary information so you make the correct and informed decisions. However, not being informed is a problem experienced not just by rookie traders but even experienced ones. Remember the part about doing your homework? This is very important.

You should always keep abreast of matters pertaining to macro and micro economics. Also, make sure to have the economic calendar so that you know when a major economic news item is to be announced. Such information is definitely important and will help guide you even as you make financial decisions in your trades.

At a micro level, you want to look at a company's information. For instance, do they have any major impending announcements? Major announcements can have a great impact on the stock exchange. Stocks may rise dramatically or drop significantly. It is okay to trade around these events but you should have sufficient knowledge to understand how they affect your overall trading strategy.

10. Trading options without properly understanding them

Plenty of beginners often lack a deeper understanding of options. For instance, a trader purchases a call stock option when the share experiences an increase in price but the option loses money. This usually happens due to the volatility of the stocks. It also goes to show the lack of deeper understanding of stock options.

Basically, it is not essential to know or understand every minute detail before you embark on your trades. But you need to have at least some basic information about the company whose stocks you are about to deal in. You also need to understand how different stock trading strategies can benefit you and how each strategy reacts to time, direction and volatility.

11. Limiting your trades to simple, long call and put strategies

Most beginners venture into options trading by trading with long puts and long call strategies. There is nothing wrong with this and it is actually a good strategy. In fact, first trades should not be complicated and should not be within an iron condor. The only issue here is that, as a trader, you may get stuck into these strategies and forget that there are many other great strategies out there. If you do not diversify your strategies then you may really lose out.

In options trading, traders can move in any direction and leverage the market. For instance, options can allow you to trade profitably whether the market is volatile or not, whether the market is moving upwards, is on a downward trend or not moving at all. All these different market situations can be exploited by a good trader to ensure that they can benefit from them and maximize their profits.

However, not all strategies will work for everyone or in all situations. However, by venturing out with knowledge and understanding, it will be possible to eventually identify the kinds of strategies that work for you in every different situation. Strategies can be tried in small sizes after a proper understanding of how they function.

Conclusion

Thankyou for making it through to the end of this book, let's hope it was informative and able to provide you with all of the tools you need to achieve your goals whatever they may be.

The next step is to arm yourself with knowledge and techniques that will make you a worthy trader. Learn as much as you can about different types of options and best ways to maximize on trades. There are plenty of strategies that you can use to make money trading in options. Remember that you can take advantage of any market trend. Basically, this means you can trade in options and make money when the market is doing well when it is down and even when it does not move.

You also need to learn more about charts and how to interpret them. Charts are part of the tools that are essential in studying market trends so that you can get the information that you need. Always remember that you need all this knowledge and information before you trade in options. Charts point out the general trend of shares in the market. Check out the monthly, 3-months and annual movement charts for a deeper understanding of how each stock performs.

Another important feature that is important is regular knowledge. You should find out if there are any major events about to happen that may affect certain shares or the market in general. For instance, earnings releases always have a major effect on the market and especially on specific shares.

Always learn to keep abreast of macro and micro news that have an effect on stocks.

Your broker should be able to advise you and guide you as you embark on trading options on their website. The broker will interview you to great detail as they try to find out how solid your foundation is and how much you are worth. This information is useful to him, so provide it when prompted. However, you need to interview him as well. Ask him lots of questions about his experience, any successful clients, what strategies he uses or advice and so on.

Finally, if you found this book useful in any way, a review is always appreciated! Thank you!