The Options Toolbox Glossary

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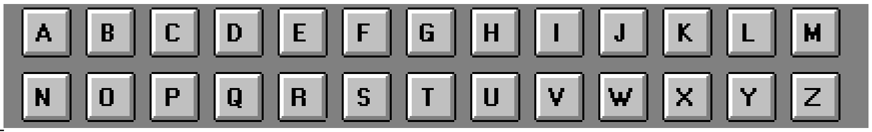

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- A -

adjusted option An option created as the result of a special event such as a **stock split** or a **stock dividend** (e.g., a 3-for-2 stock split). An adjusted option may cover more than the usual one hundred shares. For example, after a 3-for-2 stock split, the adjusted option will represent 150 shares. For such options, the **premium** must be multiplied by a corresponding factor. Example: buying 1 Call (covering 150 shares) at 4 would cost $600. See also **strike price interval**.

all-or-none order (AON) A type of option order which requires that the order be executed completely or not at all. An AON order may be either a **day order** or a **GTC order**.

American-style option An option that can be exercised at any time prior to its **expiration date**. See also **European-style option**.

AMEX / ASE American Stock Exchange.

arbitrage A trading technique that involves the simultaneous purchase and sale of identical assets or of equivalent assets in two different markets with the intent of profiting by the price discrepancy.

ask / ask price The price at which a seller is offering to sell an option or a stock.

assigned (an exercise) Received notification of an assignment by The Options Clearing Corporation. See **assignment**.

assignment Notification by The Options Clearing Corporation to a clearing firm member and to the writer of an option that an owner of the option has exercised and that the terms of settlement must be met. Assignments are made on a random basis by The Options Clearing Corporation. See also **delivery** and **exercise**.

ATM See **at-the-money option**.

at-the-money option A term that describes an option with a **strike price** that is equal to the current market price of the underlying stock.

automatic exercise A procedure used by The Options Clearing Corporation to exercise **in-the-money options**, unless specifically instructed by the owner of the option not to do so. This procedure protects the owner from losing the **intrinsic value** of the option because of failure to **exercise**. Unless instructed not to do so, The Options Clearing Corporation will exercise all expiring equity options that are held in customer accounts if they are in the money by 75 cents or more.

averaging down Buying more of a stock or an option at a lower price than the original purchase so as to reduce the average cost.

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backspread A delta-neutral spread composed of more long options than short options on the same underlying instrument. This position generally profits from a large movement in either direction in the underlying instrument.

bearish An adjective describing the opinion that a stock, or a market in general, will decline in price -- a negative or pessimistic outlook.

bear (or bearish) spread One of a variety of strategies involving two or more options (or options combined with a position in the underlying stock) that will profit from a fall in the price of the **underlying stock**.

bear spread (Call) The simultaneous writing of one Call option with a lower **strike price** and the purchase of another Call option with a higher strike price. Example: writing 1 XYZ May 60 Call, and buying 1 XYZ May 65 Call.

bear spread (Put) The simultaneous purchase of one Put option with a higher **strike price** and the writing of another Put option with a lower strike price. Example: buying 1 XYZ May 60 Put, and writing 1 XYZ May 55 Put.

beta A measure of how closely the movement of an individual stock tracks the movement of the entire stock market.

bid / bid price The price at which a buyer is willing to buy an option or a stock.

Black-Scholes formula The first widely-used model for option pricing. This formula can be used to calculate a theoretical value for an option using current stock prices, expected dividends, the option's strike price, expected interest rates, time to expiration and expected stock volatility. While the Black-Scholes model does not perfectly describe real-world options markets, it is still often used in the valuation and trading of options.

box spread A four-sided option spread that involves a long Call and a short Put at one **strike price** as well as a short Call and a long Put at another strike price. Example: buying 1 XYZ May 60 Call, and writing 1 XYZ May 65 Call; simultaneously buying 1 XYZ May 65 Put, and writing 1 May 60 Put.

break-even point(s) The stock price(s) at which an option strategy results in neither a profit nor a loss. While a strategy's break-even point(s) are normally stated as of the option's expiration date, a theoretical option pricing model can be used to determine the strategy's break-even point(s) for other dates as well.

broker A person acting as an agent for making securities transactions. An "Account Executive" or a "broker" at a brokerage firm deals directly with customers. A "Floor Broker" on the trading floor of an exchange actually executes someone else's trading orders.

bullish An adjective describing the opinion that a stock, or the market in general, will rise in price -- a positive or optimistic outlook.

bull (or bullish) spread One of a variety of strategies involving two or more options (or options combined with an underlying stock position) that will profit from a rise in the price of the **underlying stock**.

bull spread (Call) The simultaneous purchase of one Call option with a lower **strike price** and the writing of another Call option with a higher strike price. Example: buying 1 XYZ May 60 Call, and writing 1 XYZ May 65 Call.

bull spread (Put) The simultaneous writing of one Put option with a higher **strike price** and the purchase of another Put option with a lower strike price. Example: writing 1 XYZ May 60 Put, and buying 1 XYZ May 55 Put.

butterfly spread A strategy involving four options and three strike prices that has both limited risk and limited profit potential. A long Call butterfly is established by: buying one Call at the lowest strike price, writing two Calls at the middle strike price, and buying one Call at the highest strike price. A long Put butterfly is established by: buying one Put at the highest strike price, writing two Puts at the middle strike price, and buying one Put at the lowest strike price. For example, a long Call butterfly might be: buying 1 XYZ May 55 Call, writing 2 XYZ May 60 Calls and buying 1 XYZ May 65 Call.

buy-write A **covered Call** position in which stock is purchased and an equivalent number of Calls written at the same time. This position may be transacted as a **spread order**, with both sides (buying stock and writing Calls) being executed simultaneously. Example: buying 500 shares XYZ stock, and writing 5 XYZ May 60 Calls. See also **covered Call writing**.

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calendar spread Same as **time spread**.

Call option An option contract that gives the **owner** the right to buy the **underlying stock** at a specified price (its **strike price**) for a certain, fixed period of time (until its **expiration**). For the **writer** of a Call option, the contract represents an obligation to sell the underlying stock if the option is assigned.

carry / carrying cost The interest expense on money borrowed to finance a securities position.

cash settlement The process by which the terms of an option contract are fulfilled through the payment or receipt in dollars of the amount by which the option is in-the-money as opposed to delivering or receiving the underlying instrument.

cash settlement amount See **exercise settlement amount**.

CBOE The Chicago Board Options Exchange. CBOE opened in April 1973 and is the oldest and largest listed options exchange.

class of options A term referring to all options of the same **type** -- either Calls or Puts -- covering the same underlying stock.

close See **closing transaction**.

closing price The final price of a security at which a transaction was made. See also **settlement price**.

closing transaction A reduction or an elimination of an open position by the appropriate offsetting purchase or sale. An existing long option position is closed by a selling transaction. An existing short option position is closed by a purchase transaction. This transaction will reduce the **open interest** for the specific option involved.

collar A protective strategy in which a written Call and a long Put are taken against a previously owned long stock position. The options may have the same strike price or different strike prices and the expiration months may or may not be the same. For example, if the investor previously purchased XYZ Corporation at $46 and it rose to $62, a "collar" involving the purchase of a May 60 Put and the writing of a May 65 Call could be established as a way of protecting some of the unrealized profit in the XYZ Corporation stock position. The reverse -- a long Call combined with a written Put -- might also be used if the investor has previously established a short stock position in XYZ Corporation. This strategy is also known as a fence.

collateral Securities against which loans are made. If the value of the securities (relative to the loan) declines to an unacceptable level, this triggers a margin call. As such, the investor is asked to post additional collateral or the securities are sold to repay the loan.

combination A trading position involving out-of-the-money Puts and Calls on a one-to-one basis. The Puts and Calls have different strike prices, but the same expiration and underlying stock. A long combination is when both options are owned, and a short combination is when both options are written. Example: a long combination might be buying 1 XYZ May 60 Call, and buying 1 XYZ May 55 Put.

condor spread A strategy involving four options and four strike prices that has both limited risk and limited profit potential. A long Call condor spread is established by buying one Call at the lowest strike, writing one Call at the second strike, writing another Call at the third strike, and buying one Call at the fourth (highest) strike. This spread is also referred to as a "flat-top butterfly."

contingency order An order to execute a transaction in one security that depends on the price of another security. An example might be: " Sell the XYZ May 60 Call at 2, contingent upon XYZ stock being at or below $59 1/2."

contract size The amount of the underlying asset covered by the option contract. This is 100 shares for one equity option unless adjusted for a special event, such as a **stock split** or a **stock dividend**.

conversion An investment strategy in which a long Put and a short Call with the same strike price and expiration are combined with long stock to lock in a nearly riskless profit. For example, buying 100 shares of XYZ stock, writing 1 XYZ May 60 Call, and buying 1 XYZ May 60 Put at desirable prices. The process of executing these three-sided trades is sometimes called "conversion arbitrage." See also **reverse conversion**.

cover To close out an open position. This term is used most frequently to describe the purchase of an option or stock to close out an existing short position for either a profit or loss.

covered Call / covered Call writing An option strategy in which a Call option is **written** against an equivalent amount of long stock. Example: writing 2 XYZ May 60 Calls while owning 200 shares or more of XYZ stock. See also **buy-write** and **overwrite**.

covered option An open short option position that is fully offset by a corresponding stock or option position. That is, a covered Call could be offset by long stock or a long Call, while a covered Put could be offset by a long Put or a short stock position. This insures that if the owner of the option exercises, the writer of the option will not have a problem fulfilling the delivery requirements. See also **secured option** and **uncovered option**.

covered straddle An option strategy in which one Call and one Put with the same strike price and expiration are written against each 100 shares of the underlying stock. Example: writing 1 XYZ May 60 Call and 1 XYZ May 60 Put, and buying 100 shares of XYZ stock. In actuality, this is not a fully "covered" strategy because assignment on the short Put would require purchase of additional stock.

covered combination A strategy in which one Call and one Put with the same expiration, but different strike prices, are written against each 100 shares of the underlying stock. Example: writing 1 XYZ May 60 Call and 1 XYZ May 65 Put, and buying 100 shares of XYZ stock. In actuality, this is not a fully "covered" strategy because assignment on the short Put would require purchase of additional stock.

credit Money received in an account either from a deposit or a transaction that results in increasing the account's cash balance.

credit spread A spread strategy that increases the account's cash balance when it is established. A **bull spread** with Puts and a **bear spread** with Calls are examples of credit spreads.

curvature Same as **gamma**.

cycle See **expiration cycle**.

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day order A type of option order which instructs the broker to cancel any unfilled portion of the order at the close of trading on the day the order is first entered.

day trade A position (stock or option) that is opened and closed on the same day.

debit Money paid out from an account either from a withdrawal or a transaction that results in decreasing the cash balance.

debit spread A spread strategy that decreases the account's cash balance when it is established. **A bull spread** with Calls and a **bear spread** with Puts are examples of debit spreads.

decay See **time decay** or **theta**.

delivery The process of meeting the terms of a **written** option contract when notification of **assignment** has been received. In the case of a short Call, the writer must deliver stock and in return receives cash for the stock sold. In the case of a short Put, the writer pays cash and in return receives the stock.

delta A measure of the rate of change in an option's **theoretical value** for a one-unit change in the price of the **underlying stock**.

derivative / derivative security A financial security whose value is determined in part from the value and characteristics of another security, the **underlying security**.

diagonal spread A strategy involving the simultaneous purchase and writing of two options of the same **type** that have different strike prices and different expiration dates. Example: buying 1 May 60 Call and writing 1 March 65 Call.

discount An adjective used to describe an option that is trading at a price less than its **intrinsic value** (i.e., trading below **parity**).

discretion Freedom given by an investor through his or her Account Executive to use judgment regarding the execution of an order. Discretion can be limited, as in the case of a **limit order** which gives the Floor Broker 1/8 or 1/4 point from the stated limit price to use his or her judgment in executing the order. Discretion can also be unlimited, as in the case of a **market-not-held-order**.

- E -

early exercise A feature of **American-style options** that allows the owner to **exercise** an option at any time prior to its **expiration date**.

equity option An option on shares of an individual common stock.

equity In a margin account, this is the difference between the securities owned and the margin loans owed. It is the amount the investor would keep after all positions have been closed and all margin loans paid off.

equivalent strategy A strategy which has the same risk-reward profile as another strategy. For example, a long May 60-65 Call **vertical spread** is equivalent to a short May 60-65 Put **vertical spread**. See also **synthetic positions**.

European-style option An option that can be exercised only during a specified period of time just prior to its expiration. See also **American-style option**.

ex-date See **ex-dividend date**.

ex-dividend date The day before which an investor must have purchased the stock in order to receive the dividend. On the ex-dividend date, the previous day's closing price is reduced by the amount of the dividend (rounded up to the nearest eighth) because purchasers of the stock on the ex-dividend date will not receive the dividend payment. This date is sometimes referred to simply as the "**ex-date**," and can apply to other situations; for example, splits and distributions. If you purchase a stock on the ex-date for a split or distribution you are not entitled to the split stock or that distribution. However, the opening price for the stock will have been reduced by an appropriate amount, as on the ex-dividend date. Weekly financial publications, such as *Barron's*, often include a stock's upcoming "ex-date" as part of their stock tables.

exercise To invoke the rights granted to the owner of an option contract. In the case of a Call, the option owner buys the underlying stock. In the case of a Put, the option owner sells the underlying stock.

exercise price See **strike price**.

exercise settlement amount The difference between the exercise price of the option being exercised and the exercise settlement value of the index on the day the option is exercised.

exercise settlement value For OEX options, the closing index value for any given day. This value is calculated using the last trade prices in the primary market for the stocks comprising the index. This is the index value used to calculate cash settlement amounts.

expiration cycle The expiration dates applicable to the different series of options. Traditionally, there were three cycles:

cycle	available expiration months
January	January / April / July / October
February	February / May / August / November
March	March / June / September / December

Today, equity options expire on a hybrid cycle which involves a total of four option series: the two nearest-term calendar months and the next two months from the traditional cycle to which that **class of options** has been assigned. For example, on January 1, a stock in the January cycle will be trading options expiring in these months: January, February, April, and July. After the January expiration, the months outstanding will be February, March, April and July.

expiration date The date on which an option and the right to exercise it cease to exist.

expiration Friday See **last trading day**.

expiration month The month during which the **expiration date** occurs.

expiration time The time of day by which all exercise notices must be received on the **expiration date**. Check with your Account Executive regarding your brokerage firm's deadline for submitting exercise notices on expiration Friday.

- F -

fence See **collar**.

fill-or-kill order (FOK) A type of option order which requires that the order be executed completely or not at all. A fill-or-kill order is similar to an **all-or-none (AON)** order. The difference is that if the order cannot be completely executed (i.e., filled in its entirety) as soon as it is announced in the trading crowd, it is to be "killed" (i.e., cancelled) immediately. Unlike an AON order, a FOK order cannot be used as part of a **GTC order**.

floor broker A trader on an exchange floor who executes trading orders for other people.

floor trader An exchange member on the trading floor who buys and sells for his or her own account.

fundamental analysis A method of predicting stock prices based on the study of earnings, sales, dividends, and so on.

fungibility Interchangeability resulting from standardization. Options listed on national exchanges are fungible, while over-the-counter options generally are not. Classes of options listed and traded on more than one national exchange are referred to as **multiply-listed / multiply-traded options**.

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gamma A measure of the rate of change in an option's delta for a one-unit change in the price of the underlying stock. See also **delta**.

good-'til-cancelled (GTC) order A type of **limit order** that remains in effect until it is either executed (filled) or cancelled, as opposed to a day order, which expires if not executed by the end of the trading day. A GTC option order is an order which if not executed will be automatically cancelled at the option's expiration.

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hedge / hedged position A position established with the specific intent of protecting an existing position. For example, an owner of common stock may buy a Put option to hedge against a possible stock price decline.

historic volatility A measure of actual stock price changes over a specific period of time. See also **standard deviation**.

holder See **owner**.

horizontal spread See **time spread**.

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immediate-or-cancel order (IOC) A type of option order which gives the trading crowd one opportunity to take the other side of the trade. After being announced, the order will be either partially or totally filled with any remaining balance immediately cancelled. . An IOC order, which can be considered a type of **day order**, cannot be used as part of a **GTC order** since it will be cancelled shortly after being entered. The difference between **fill-or-kill (FOK) orders** and IOC orders is that a IOC order may be partially executed.

implied volatility The volatility percentage that produces the "best fit" for all underlying option prices on that underlying stock. See also **individual volatility**.

index A compilation of several stock prices into a single number. Example: the S&P 100 Index.

index option An option whose underlying entity is an index. Generally, index options are cash-settled.

individual volatility The volatility percentage that justifies an option's price, as opposed to historic or implied volatility (which see). A theoretical option pricing model can be used to generate an option's individual volatility when the five remaining quantifiable factors (stock price, time until expiration, strike price, interest rates, and cash dividends) are entered along with the price of the option itself.

institution A professional investment management company. Typically, this term is used to describe large money managers such as banks, pension funds, mutual funds, and insurance companies.

in-the-money option An adjective used to describe an option with **intrinsic value**. A Call option is in the money if the stock price is above the strike price. A Put option is in the money if the stock price is below the strike price.

intrinsic value The in-the-money portion of an option's price. See **in-the-money option**.

iron butterfly An option strategy with limited risk and limited profit potential that involves both a long (or short) **straddle**, and a short (or long) **combination**. An iron butterfly contains four options as is an **equivalent strategy** to a regular **butterfly spread** which contains only three options. For example, a short iron butterfly might be: buying 1 XYZ May 60 Call and 1 May 60 Put, and writing 1 XYZ May 65 Call and writing 1 XYZ May 55 Put.

ITM See **in-the-money option**.

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No entries.

- K -

Kappa See **vega**.

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last trading day The last business day prior to the option's expiration date during which purchases and sales of options can be made. For equity options, this is generally the third Friday of the expiration month. Note: If the third Friday of the month is an exchange holiday, the last trading day will be the Thursday immediately preceding the third Friday.

LEAPS (Long-term Equity AnticiPation Securities also known as **long-dated options)** In English, this means Calls and Puts with an expiration as long as thirty-nine months. Currently, equity LEAPS have two **series** at any time with a January expiration. For example, in October 1994, LEAPS are available with expirations of January 1996 and January 1997.

leg A term describing one side of a position with two or more sides. When a trader *legs into* a spread, he/she establishes one side first, hoping for a favorable price movement so the other side can be executed at a better price. This is, of course, a higher-risk method of establishing a spread position.

leverage A term describing the greater percentage of profit or loss potential when a given amount of money controls a security with a much larger face value. For example, a Call option enables the **owner** to assume the upside potential of 100 shares of stock by investing a much smaller amount than that required to buy the stock. If the stock increases by 10 percent, for example, the option might double in value. Conversely, a 10 percent stock price decline might result in the total loss of the purchase price of the option.

limit order A trading order placed with a broker to buy or sell stock or options at a specific price.

liquidity / liquid market A trading environment characterized by high trading volume, a narrow spread between the **bid** and **ask prices**, and the ability to trade larger sized orders without significant price changes.

listed option A Put or Call traded on a national options exchange with standardized terms. In contrast, **over-the-counter options** usually have non-standard or negotiated terms.

long-dated options See **LEAPS**.

long option position The position of an option purchaser (**owner**) which represents the right to either buy stock (in the case of a Call) or to sell stock (in the case of a Put) at a specified price (the **strike price**) at or before some date in the future (the **expiration date**). It results from an **opening purchase transaction** -- e.g., long Call or long Put.

long stock position A position in which an investor has purchased and owns stock.

- M -

margin / margin requirement The minimum equity required to support an investment position. To buy *on margin* refers to borrowing part of the purchase price of a security from a brokerage firm.

market-maker An exchange member on the trading floor who buys and sells options for his or her own account and who has the responsibility of making bids and offers and maintaining a fair and orderly market. See also **specialist / specialist group / specialist system**

market-maker system, (competing) A method of supplying liquidity in options markets by having market makers in competition with one another. An alternative to a specialist system (which see). They are similarly charged with making fair and orderly markets in a given class of options.

mark-to-market An accounting process by which the price of securities held in an account are valued each day to reflect the **closing price**, or market quote if the last sale is outside of the market quote. The result of this process is that the equity in an account is updated daily to properly reflect current security prices.

market-not-held order A type of market order which allows the investor to give discretion regarding the price and/or time at which a trade is executed.

market-on-close order (MOC) A type of option order which requires that an order be executed at or near the close of trading on the day the order is entered. A MOC order, which can be considered a type of **day order**, cannot be used as part of a **GTC order**.

market order A trading order placed with a broker to immediately buy or sell a stock or option at the best available price.

market quote A quotation of the current best **bid / ask prices** for an option or stock in the marketplace (an exchange trading floor). This information is usually obtained by the investor from someone at a brokerage firm. However, for listed options and stocks, these quotes are widely disseminated and available through various commercial quotation services.

married Put strategy The simultaneous purchase of stock and Put options representing an equivalent number of shares. This is a limited risk strategy during the life of the Puts because the stock can always be sold for at least the strike price of the purchased Puts.

model A mathematical formula used to calculate the **theoretical value** of an option. See **Black-Scholes formula**.

multiply-listed / multiply-traded option Any option contract that is listed and traded on more than one national options exchange. See also **fungibility**.

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naked option See **uncovered option**.

NASD (National Association of Securities Dealers) A national association having many characteristics of an exchange. Rather than a floor or physically central market place, trading takes place via computer terminals.

NASDAQ (National Association of Securities Dealers Automated Quotation system.) Dissemination of quotations from the NASD and/or members thereof.

neutral An adjective describing the belief that a stock or the market in general will neither rise nor decline significantly.

neutral strategy An option strategy (or stock and option position) expected to benefit from a neutral market outcome.

90/10 strategy A conservative option strategy in which an investor buys Treasury bills (or other liquid assets) with 90 percent of his or her funds, and buys Call options (or Put options or a mixture of both) with the balance. The proportions of this strategy are subject to change based on prevailing interest rates.

non-equity option Any option that does not have common stock as the underlying asset. Non-equity options include options on futures, indexes, foreign currencies, Treasury security yields, etc.

not-held order A type of order which releases normal obligations implied by the other terms of the order. For example, a **limit order** designated as "not-held" allows discretion in filling the order when the market trades at the limit price of the order. In this case, there is no obligation to provide the customer with an execution if the market trades through the limit price on the order. See also **discretion** and **market-not-held order**.

NYSE New York Stock Exchange.

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OCC See **Options Clearing Corporation, The**.

offer / offer price In the options business this means the same as **ask / ask price**, or the price at which a seller is offering to sell an option or a stock.

one-cancels-other order (OCO) A type of option order which treats two or more option orders as a package, whereby the execution of any one of the orders causes all the orders to be reduced by the same amount. For example, the investor would enter an OCO order if he/she wished to buy 10 May 60 Calls or 10 June 60 Calls or any combination of the two which when summed equaled 10 contracts. An OCO order may be either a **day order** or a **GTC order**.

open interest The total number of outstanding option contracts on a given **series** or for a given **underlying stock**.

open outcry The trading method by which competing **market makers** and Floor Brokers representing public orders make bids and offers on the trading floor.

opening transaction An addition to, or creation of, a trading position. An opening purchase transaction adds long options to an investor's total position, and an opening sale transaction adds short options. An opening option transaction increases that option's **open interest**.

option A contract that gives the **owner** the right, but not the obligation, to buy or sell a particular asset (**the underlying stock**) at a fixed price (**the strike price**) for a specific period of time (until **expiration**) . The contract also obligates the **writer** to meet the terms of delivery if the contract right is **exercised** by the owner.

optionable stock A stock on which listed options are traded.

option period The time from when an option contract is created by a **writer** of that option to the **expiration date**; sometimes referred to as an option's "lifetime."

option pricing curve A graphical representation of the estimated **theoretical value** of an option at one point in time, at various prices of the underlying stock.

option pricing model See **model** and **Black-Scholes formula**.

Options Clearing Corporation, The (OCC) A corporation owned by the exchanges that trade listed equity options, OCC is an intermediary between option buyers and sellers. OCC issues and guarantees all option contracts.

option valuation model See **model** and **Black-Scholes formula**.

option writer The seller of an option contract who is obligated to meet the terms of delivery if the option owner **exercises** his or her right. This seller has made an **opening sale transaction**, and has not yet closed that position.

OTC / OTC market See **NASD**.

OTC option An over-the-counter option is one which is traded in the over-the-counter market. OTC options are not listed on an options exchange and do not have standardized terms. These are to be distinguished from exchange-listed and traded equity options with NASD stocks as the underlying equity issue, which are standardized. See also fungibility.

OTM See **out-of-the-money option**.

out-of-the-money option An adjective used to describe an option that has no **intrinsic value**, i.e., all of its value consists of **time value**. A Call option is out of the money if the stock price is below its **strike price**. A Put option is out of the money if the stock price is above its strike price. See also **intrinsic**

value and **time value**.

over-the-counter option See **OTC option**.

overwrite An option strategy involving the writing of Call options (wholly or partially) against existing long stock positions. This is different from the **buy-write** strategy which involves the simultaneous purchase of stock and writing of a Call. See also **ratio write**.

owner Any person who has made an **opening purchase transaction**, Call or Put, and has that position in a brokerage account.

- P -

parity A term used to describe an option contract's total **premium** when that premium is the same amount as its **intrinsic value**. For example, when an option's **theoretical value** is equal to its **intrinsic value**, it is said to be "worth parity." When an option is trading for only its intrinsic value, it is said to be "trading for parity." Parity may be measured against the stock's last sale, bid, or offer.

payoff diagram See **profit/loss graph**.

PHLX Philadelphia Stock Exchange.

physical delivery option An option whose underlying entity is a physical good or commodity, like a common stock or a foreign currency. When that option is exercised by its owner, there is delivery of that physical good or commodity from one brokerage or trading account to another.

pin risk The risk to an investor (option **writer**) that the stock price will exactly equal the strike price of a written option at expiration; i.e., that option will be exactly **at the money**. The investor will not know how many of his/her written (short) options he/she will be assigned. The risk is that on the following Monday he/she might have an unexpected long (in the case of a written Put) or short (in the case of a written Call) stock position, and thus be subject to the risk of an adverse price move.

pit See **trading pit**.

position The combined total of an investor's open option contracts (Calls and/or Puts) and long or short stock.

position trading An investing strategy in which open positions are held for an extended period of time.

premium (1) Total price of an option: **intrinsic value** plus **time value**. (2) Often (erroneously) this word is used to mean the same as time value.

primary market For securities that are traded in more than one market, the primary market is usually the exchange where trading volume in that security is highest.

profit/loss graph A graphical presentation of the profit and loss possibilities of an investment strategy at one point in time (usually option expiration), at various stock prices.

PSE Pacific Stock Exchange.

Put option An option contract that gives the **owner** the right to sell the **underlying stock** at a specified price (its **strike price**) for a certain, fixed period of time (until its **expiration**). For the **writer** of a Put option, the contract represents an obligation to buy the underlying stock from the option owner if the option is **assigned**.

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- Q -

No entries.

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- R -

ratio spread A term most commonly used to describe the purchase of an option(s), Call or Put, and the writing of a greater number of the same **type** of options that are **out-of-the-money** with respect to those purchased. All options involved have the same expiration date. For example, buying 5 XYZ May 60 Calls and writing 6 XYZ May 65 Calls. See also **ratio write**.

ratio write An investment strategy in which stock is purchased and Call options are **written** on a greater than one-for-one basis; i.e., more Calls written than the equivalent number of shares purchased. For example, buying 500 shares of XYZ stock, and writing 6 XYZ May 60 Calls. See also **ratio spread**.

realized gains and losses The net amount received or paid when a **closing transaction** is made and matched together with an **opening transaction**.

resistance A term used in **technical analysis** to describe a price area at which rising prices are expected to stop or meet increased selling activity. This analysis is based on historic price behavior of the stock.

reversal / reverse conversion An investment strategy used by professional option traders in which a short Put and long Call with the same strike price and expiration are combined with short stock to lock in a nearly riskless profit. For example, selling short 100 shares of XYZ stock, buying 1 XYZ May 60 Call, and writing 1 XYZ May 60 Put at favorable prices. The process of executing these three-sided trades is sometimes called "reversal arbitrage." See also **conversion**.

rho A measure of the expected change in an option's **theoretical value** for a 1 percent change in interest rates.

rolling A trading action in which the trader simultaneously closes an open option position and creates a new option position at a different strike price, different expiration, or both. Variations of this include rolling up, rolling down, rolling out and diagonal rolling.

- S -

SEC The Securities and Exchange Commission. The SEC is an agency of the federal government which is in charge of monitoring and regulating the securities industry.

secondary market A market where securities are bought and sold after their initial purchase by public investors.

sector index An index that measure the performance of a narrow market segment, such as biotechnology or small capitalization stocks.

secured put / cash-secured put An option strategy in which a Put option is written against a sufficient amount of cash (or T-bills) to pay for the stock purchase if the short option is assigned.

series of options Option contracts on the same **class** having the same **strike price** and **expiration month**. For example, all XYZ May 60 Calls constitute a series.

settlement The process by which the **underlying stock** is transferred from one brokerage account to another when equity option contracts are **exercised** by their **owners** and the inherent obligations **assigned** to option **writers**.

settlement price The official price at the end of a trading session. This price is established by **The Options Clearing Corporation** and is used to determine changes in account equity, margin requirements and for other purposes. See **mark-to-market**.

short option position The position of an option writer which represents an obligation on the part of the option's **writer** to meet the terms of the option if it is **exercised** by its **owner**. The writer can terminate this obligation by buying back (**cover** or **close**) the position with a **closing purchase transaction**.

short stock position A strategy that profits from a stock price decline. It is initiated by borrowing stock from a broker-dealer and selling it in the open market. This strategy is **closed** (**covered**) at a later date by buying back the stock and returning it to the lending broker-dealer.

specialist / specialist group / specialist system one or more exchange members whose function is to maintain a fair and orderly market in a given stock or a given class of options. This is accomplished by managing the limit order book and making bids and offers for his/her/their own account in the absence of opposite market side orders. See also **market-maker** and **market-maker system**.

spin-off A **stock dividend** issued by one company in shares of another corporate entity, such as a subsidiary corporation of the company issuing the dividend.

spread / spread order A position consisting of two parts, each of which alone would profit from opposite directional price moves. As orders, these opposite parts are entered and executed simultaneously in the hope of (1) limiting risk, or (2) benefiting from a change of price relationship between the two parts.
See also **leg**.

standard deviation A statistical measure of price fluctuation. One use of the standard deviation is to measure how stock price movements are distributed about the mean. See also **volatility**.

standardization See **fungibility**.

stock dividend A dividend paid in shares of stock rather than cash. See **spin-off**.

stock split An increase in the number of outstanding shares by a corporation, through the issuance of a set number of shares to a shareholder for a set number of shares that the shareholder already owns.
For example, a corporation might declare a "2-for-1 stock split." This means that for every share of stock an investor owns, he/she will be given another, thus owning 2 shares instead of 1. There will be a corresponding reduction in equity value per share. In this case, the new shares (post-split) will be worth one-half their previous value but the investor will own twice as many shares. See also **stock dividend**

and **adjusted option**.

stop-limit order A type of **contingency order** placed with a broker that becomes a **limit order** when the stock trades, or is bid or offered, at or through a specific price. See also **stop-limit order**.

stop order A type of **contingency order**, often erroneously known as a "stop-loss" order, placed with a broker that becomes a **market order** when the stock trades, or is bid or offered, at or through a specified price. See also **stop-limit order**.

straddle A trading position involving Puts and Calls on a one-to-one basis in which the Puts and Calls have the same **strike price**, **expiration**, and **underlying stock**. A long straddle is when both options are owned and a short straddle is when both options are written. Example: a long straddle might be buying 1 XYZ May 60 Call, and buying 1 XYZ May 60 Put.

strike / strike price The price at which the owner of an option can purchase (Call) or sell (Put) the underlying stock. Used interchangeably with striking price, strike, or exercise price.

strike price interval The normal price differential between option strike prices. Equity options generally have $2.50 strike price intervals (if the underlying stock price is below $25), $5.00 intervals (from $25 to $200), and $10 intervals (above $200). LEAPS generally start with one at-the-money, one in-the-money, and one out-of-the-money strike price. The latter two are usually set 20%-25% away from the former.

suitability A requirement that any investing strategy fall within the financial means and investment objectives of an investor or trader.

support A term used in **technical analysis** to describe a price area at which falling prices are expected to stop or meet increased buying activity. This analysis is based on previous price behavior of the stock.

synthetic position A strategy involving two or more instruments that has the same risk-reward profile as a strategy involving only one instrument. The following list summarizes the six primary synthetic positions.

synthetic long Call A long stock position combined with a long Put of the same **series** as that Call.

synthetic long Put A short stock position combined with a long Call of the same **series** as that Put.

synthetic long stock A long Call position combined with a short Put of the same **series**.

synthetic short Call A short stock position combined with a short Put of the same **series** as that Call.

synthetic short Put A long stock position combined with a short Call of the same **series** as that Put.

synthetic short stock A short Call position combined with a long Put of the same **series**.

- T -

technical analysis A method of predicting future stock price movements based on the study of historical market data such as (among others) the prices themselves, trading volume, **open interest**, the relation of advancing issues to declining issues, and short selling volume.

theoretical option pricing model See **model** and **Black-Scholes formula**.

theoretical value The estimated value of an option derived from a mathematical model. See **model** and **Black-Scholes formula**.

theta A measure of the rate of change in an option's **theoretical value** for a one-unit change in time to the option's expiration date. See **time decay**.

tick The smallest unit price change allowed in trading a security. For listed stock, this is generally 1/8th of a point. For a listed option under $3 in price, this is generally 1/16th of a point. For a listed option over $3, this is generally 1/8th of a point.

time decay A term used to describe how the **theoretical value** of an option "erodes" or reduces with the passage of time. Time decay is specifically quantified by **theta**.

time spread An option strategy which generally involves the purchase of a farther-term option (Call or Put) and the writing of an equal number of nearer-term options of the same **type** and strike price. Example: buying 1 XYZ May 60 Call (far-term portion of the spread) and writing 1 XYZ March 60 Call (near-term portion of the spread). Also known as **calendar spread** or **horizontal spread**.

time value The part of an option's total price that exceeds its **intrinsic value**. The price of an **out-of-the-money** option consists entirely of time value.

trader (1) Any investor who makes frequent purchases and sales. (2) A member of an exchange who conducts his or her buying and selling on the trading floor of the exchange.

trading pit A specific location on the trading floor of an exchange designated for the trading of a specific option class or stock.

transaction costs All of the charges associated with executing a trade and maintaining a position. These include brokerage commissions, fees for exercise and/or assignment, exchange fees, SEC fees, and margin interest. In academic studies, the spread between bid and ask is taken into account as a transaction cost.

type of options The classification of an option contract as either a Put or a Call.

- U -

uncovered option A short option position that is not fully collateralized if notification of assignment is received. A short Call position is uncovered if the writer does not have a long stock or long call position. A short Put position is uncovered if the writer is not short stock or long another put.

underlying (stock) The stock subject to being purchased or sold upon **exercise** of an option contract.

unit of trade The number of shares of the underlying stock that are to be delivered, or taken delivery of, when an option contract is **exercised** by its **owner**. For listed equity options the unit of trade is generally 100 shares of the underlying stock, unless adjusted for **stock splits, stock dividends** or **spin-offs**.

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- V -

vega A measure of the rate of change in an option's **theoretical value** for a one-unit change in the **volatility** assumption. Also known as Kappa.

vertical spread Most commonly used to describe the purchase of one option and writing of another where both are of the same **type** and of same **expiration month**, but have different **strike prices**. Example: buying 1 XYZ May 60 Call and writing 1 XYZ May 65 Call. See also **bull spread** and **bear spread**.

volatility A measure of stock price fluctuation. Mathematically, volatility is the annualized **standard deviation** of a stock's daily price changes. See also **historic**, **individual**, and **implied volatility**.

A B C D E F G H I J K L M
N O P Q R S T U V W X Y Z

- W -

write / writer To sell an option that is not owned through an **opening sale transaction**. While this position remains open, the writer is subject to fulfilling the obligations of that option contract; i.e., to sell stock (in the case of a Call) or buy stock (in the case of a Put) if that option is **assigned**. An investor who so sells an option is called the writer, regardless of whether the option is **covered** or **uncovered**.

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- X -

XYZ / XYZ Corporation A fictitious company used as the underlying stock throughout *The Options Toolbox.*

A B C D E F G H I J K L M
N O P Q R S T U V W X Y Z

- Y -

No entries.

A B C D E F G H I J K L M
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- Z -

No entries.