

Investing In Options Contracts Can Be Fun And Profitable

More and more people discover options contracts every year, and it's really no wonder why. You can get a potentially larger return on options than on stocks, because options allow you to execute a greater sized trade with less current capital. This leverage can be your best friend or your worst enemy, depending on how the options trade works out. Option contracts have four standardized terms which we'll examine now:

This is the basic structure of every options contract, so this is where your learning begins. We'll examine each one, in limited detail:

1) Expiration Month - The expiration month is the easiest to understand. Options are not like stocks, they have specific expiration dates, specified in months. Options won't go on forever. They will either expire worthless or be exercised and this occurs by a certain date. In this sense, you're betting on the future when you dabble in options.

2) Type of Option - is it a call or a put? A call is the right to buy 100 shares of a certain stock by a certain date. If you think XYZ corp will be \$100 in June and it's \$80 right now, you will purchase a call today that guarantees you the right to buy the shares at \$80. If you think XYZ is overvalued, and you believe it will go down in price by a certain date, then you will purchase a put. A put is the right to sell 100 shares of a stock at a certain price on a certain day.

3) The underlying security - You can't get around the fact that purchasing options essentially makes you an investor in a company's stock. You may plan on selling before the expiration date, but there's a risk you won't be able to, so you have to be aware of all the factors that make investing in the company a good or a bad decision. Options markets are more illiquid than the stock market, so factor that risk in when making your purchasing decision.

4) The striking price - This is the price at which the stock can be purchased. The striking price remains the same for as long as you hold the contract, despite the price of the actual shares of the company. If you finish above the striking price, then you're "in the money". You can exercise the option, sell the 100 shares at a higher price and buy them at a lower price simultaneously. You pocket the difference immediately, and this profit is what is so intriguing to options investors.

The best bet when it comes to investing in options is to invest in a company where you actually want to own the underlying stock. This way, you're prepared to hold the investment through its' maturity, if you have to. Savvy investors usually use "straddles" with options to help offset risk of their large holdings. There's also a growing class of options traders who trade them because of the potentially huge returns they offer. Many traders trade index futures daily based on very short term trends. Options trading is growing enormously. It's easier than ever to trade options in your brokerage account, and more stocks have options associated with them than ever before. Good luck to you on your endeavor into this highly lucrative global field.

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About the Author

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