Glossary

Arm One side of a spread position.

American Option an option allowing exercise prior to expiration. All stock options are American-style.

Arbitrage The purchase and sale of the same product in different markets to take advantage of a price disparity between the two markets. The ideal arbitrage is risk-free.

Annualize a method for comparing returns from options or stocks that are held over different time periods. First compute the return on the investment. Then divide the holding period by the number of months you held it, and multiply by 12. Then multiply by the return from your investment.

Assignment The process by which the seller of an option is notified of the buyer's intention to exercise his rights.

At-the-money Strike price of option is equal to current stock price of underlying.

Automatic Exercise When options are in-the-money at expiration, they will be automatically exercised unless prior action is taken.

Bear Spread Any spread that will increase in value with a decline in the price of the underlying.

Break-even point Price at which there are zero losses and zero gains.

Bull Spread Any spread that will increase in value with a rise in price of the underlying contract.

Buy write Simultaneously buying the underlying stock and selling an option on that stock.

Buy To Close Repurchase a short option.

Buy to Open Open a long option position.

Call Option A contract between buyer and seller where the buyer acquires the right, but not the obligation, to purchase a specified underlying contract at a fixed price on or before a specific date. The seller of the call option assumes the obligation of delivering the underlying should the buyer wish to exercise his right.

Called Away Usually used with calls. The buyer of the call exercises his right to buy the shares from the seller calls. The price paid is determined by the strike price of the call option.

Class All options with the same underlying stock and expiration date.

Collar Short call, long stock and long put.

Combination A two-sided option spread which does not fall into any well defined category of spreads.

Covered Call The sale of a call against an existing long position on the underlying. The long position may be a long stock position, or a long call position with a lower strike price.

Covered Write Sale of a call (put) with a covering long (short) position.

Contract a single option. All options are contracts, conveying rights to buyers, obligations to sellers. They specify a term, strike price and underlying stock.

Cover Owning enough stock to cover a sold call. Typically, 100 shares of stock must be owned for each call sold to cover the call. A short call may also be covered by a long call with a lower strike price.

Credit Spread Any spread that you establish for a payment to you.

Debit Spread Any spread that you establish with a payment to someone else.

Delta The rate of change of the option premium with respect to the stock price.

Derivative A security whose price is determined by its relationship to the price of another security. Stock options (calls and puts) are examples of derivatives.

Diagonal Spread Any spread with different strike prices and different expiration dates.

Dividend Yield Dividends paid, expressed as a percentage. Calculated by dividing the dividend per share by the current market value of the stock.

Downside Protection Arranging to protect yourself against potential loss in your position, so that you do not lose money.

Early Exercise Exercise of an option prior to its expiration date.

European option An option that can be exercised only at expiration.

Ex-dividend The first day a dividend-paying stock is trading without the right to receive the dividend.

Exercise The process buy which the holder of an option notifies the seller of his intention to take delivery of the underlying (if a call), or make delivery of the underlying (if a put), at the strike price of the option contract.

Expiration Date The date after which the option may no longer be exercised. expires.

Hedge Using one position to protect another. For example, using one security that will go up in price as another one goes down.

Horizontal Spread A spread with identical strike prices but different expiration dates.

Implied Volatility Assuming all other inputs are known, the volatility that would have to be input into a theoretical pricing model in order to yield a theoretical value identical to the price of the option in the marketplace.

In-the-money For calls: The stock is above the strike price. For puts: The stock is below the strike price.

Intrinsic Value The amount by which an option is in-the-money.

Leg One side of a spread position.

LEAPS Long-term Equity AnticiPation Security. Options with expiration periods of a year or more.

Leverage Use of investment capital that uses a small amount of capital to control a large value.

Lock-in To freeze a loss or profit so they can not be changed.

Long position To buy calls, puts or stocks.

Margin An account with a brokerage firm that contains a minimum amount of cash and securities to provide collateral for short positions or for purchases for which payment has not yet been made.

Naked Option An option sold without a covering long position.

Odd lot Not a round lot. Anything other than a multiple of 100 shares.

Open Interest The number of open contracts of a particular option at any time.

Option A contract specifying the right to buy or sell 100 shares of specific stock, at a specific price, during a specific time period.

Out-of-the-money For calls: The stock is below the strike price. For Puts: The stock price is above the strike price.

Paper Profits Profits that exist only on paper, due to appreciating securities such as stocks or options.

Parity The premium of an option is equal to its intrinsic value.

Point 1/100 of something. Options premiums are specified in points.

Position The total of a trader's open contracts and holdings in a particular underlying market.

Premium The price of an option. Premiums are expressed in points, and must be multiplied by the number of shares in a contract (usually 100) to get the total price for the option.

Put Option Grants the buyer the right to sell shares at the strike price of the option. Goes up in value as the stock price goes down.

Return The ratio of profits to net investment made.

Realized Profits Closing a position to convert paper profits into cash.

Return if Exercised The return an option seller will make if the option is exercised.

Return if Unchanged The return an option seller will make if the option expires worthless. In some cases, when the option was purchased in-the-money and is still in-the-money at expiration, the return if unchanged will be the same as the return if exercised.

Roll down Replace one option with another with a lower strike price.

Roll Forward Replace one option with another with a later expiration date.

Roll Up Replace one option with another with a higher strike price.

Round Lot An even multiple of 100 shares of stock.

Series All options with the same underlying contract, same exercise price, and same expiration date. Subset of a class.

Short Selling shares of stock, or options which you do not own.

Short seller Someone who sells shares or options they do not own.

Side One option in a spread position, either the short option or the long option.

Sigma (σ) The notation used for standard deviation. Since volatility is usually expressed as a standard deviation, the same notation is often used to denote volatility.

Spread A long and a short position held at the same time on the same underlying stock.

Strike Price The price that will be paid for selling or buying 100 share of stock, set at the time of purchase of an option contract.

Theoretical Value An option value generated by a mathematical model given certain assumptions about the option, the contract, market and interest rates.

Time Value the portion of an options premium above the intrinsic value. If the option is out-of-the-money, the entire premium is time value.

Time Value Premium A synonym for time value.

Underlying The stock to be delivered if the contract is exercised.

Vertical Spread A spread using options with different strike prices but identical expiration dates.

Volatility The degree to which the price of a security fluctuates over time.

Wasting asset Any asset that declines in value over time, such as an option.

Write Same as short.

Writer Short seller.