Your Quick-Start Guide to Options Success

By Don Fishback

YOUR QUICK START GUIDE TO OPTIONS SUCCESS

Don Fishback

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Although we do not provide any futures information, the CFTC provides an excellent description of the limitations of hypothetical trades and, therefore, we are providing it to you: HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM. ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

OPTIONS INVOLVE RISK AND ARE NOT SUITABLE FOR ALL INVESTORS.
PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS.

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INTRODUCTION

Mastering the fundamentals of any sport, business, or other activity is important if you expect to succeed.

Before going out on the PGA tour, my uncle learned how to hold a golf club, address the ball, improve his swing, and a myriad of other game fundamentals. It is no different when trading.

In fact, it's even more important. That's because, at least with professional sports, it's the pros versus the pros. But in trading, even the beginners trade with the professionals.

Trading is a business. And it's up to *you* to learn the fundamental aspects of this business if you want to have a chance to be a winner in this game – a game where amateurs and pros compete against one another each and every second.

So what are the fundamentals of options trading? Contract specifications, market behavior, exchange trading hours, money management, risk-reward parameters, and market analysis to name just a few. And, of course, order entry.

The types of orders available, how they differ, what to expect when placing orders, and how to enter orders properly are fundamental to the art of successful trading. That is what this book will focus on. Because if you don't know or master order entry, you have no chance at long-term success.

That does not mean knowing proper order procedure will make you a great trader, just as knowing how to dribble a basketball does not make you an All-Star. But not knowing how to place orders properly could have a negative impact on your trading results.

I know, because I see it all the time.

So why, after all that, would anyone even attempt to trade? Well, for one thing, trading can be profitable. Trading can also be fun. Trading also lets you validate your ideas. Trading can also produce the opposite of these positive effects.

The difference is not luck.

The difference is mastering the trading business through learning and experience in the same way we would expect to achieve positive results in any new venture. We have tried to present this information on order entry in a straightforward, easy to follow format.

Our hope is that this book will add to your fundamental knowledge, and help you master skills that will help you trade successfully.

ENTERING OPTIONS ORDERS

One of the most important aspects of successful trading is learning to enter orders correctly.

You can analyze markets, subscribe to the best trade recommendation services, and learn to employ sound money management techniques and all of that will be important at some point. But if your order goes in wrong, you will not get the position or market action you expected.

Proper order entry is one of those basic, fundamental actions that should become second nature to you. You must enter your orders properly each and every time, and all orders must contain at least nine vital pieces of information.

A quick note about the sequence below. In almost all instances, you'll first need to identify yourself, and then provide the underlying asset. But after that, the sequence in which you enter these various pieces of information varies from firm to firm.

IDENTIFICATION

Identify yourself with your Account Number. When entering an order online, this is done for you when you log in. When entering an order by telephone, the first thing you'll need to do is provide your Account Number.

A brokerage firm will not execute an order if the company cannot identify the trader. The receiving computer, phone clerk, or broker uses that number to identify you and determine whether or not there is enough equity in the account to cover financial commitments required for new positions.

UNDERLYING

This is the security or index upon which the option is based. The underlying is a stock, ETF, closed end fund, ADR, or an index. Depending upon what you choose as the underlying, the exercise could be either physical delivery or cash.

And for the settlement, it could be either European style or American style. If you need to familiarize yourself with these terms, we highly recommend may we suggest you check out www.whatareoptions.com.

ACTION

Action is the process of buying or selling. The broker must know whether to buy or sell for your account. Remember, if you hold a short position and are liquidating, or covering that position, your order is to buy, not sell.

Under stressful conditions a trader might think, "I have to get out of my short position right now," and mistakenly enter an order to sell the position with the intent to exit the trade.

Instead of offsetting the short position by buying it back, however, the trader actually **doubled** the short position.

OPENING OR CLOSING TRANSACTION

As part of the Action, you need to distinguish whether the buy or sell is an opening transaction or closing transaction. Placing an option position in your account (either buying or writing) is an opening transaction and adds to the option's open interest calculation by the exchange.

Removing the option position is a closing transaction. When entering by computer follow instructions on the screen, typically clicking on "Open" or "Close."

QUANTITY

This is the number of contracts to buy, sell, or spread. It is possible to receive a partial fill when entering multi-contract orders, such as filling only 3 contracts where the order was to buy 5.

It is also possible to receive different fill prices, such as 2 filled at $3.00, 1 filled at $3.10, and 1 filled at 3.20 on an order to sell 4. By the way, here is some industry jargon for you. When there is an order to buy or sell 5 contracts, we call it a *five-lot*. If the quantity is 4 contracts, we call it a *four-lot*.

EXPIRATION

You <u>must</u> accurately identify the expiration date (also known as series). *This is important, and a common source of error we see all too often, even with experienced traders*. And believe it or not, it's getting even more complicated.

Years ago, options only expired – or should I say, stopped trading – on the third Friday of the month. They actually expired on the following Saturday. Now, equity options expire on the day they stop trading. Not only that, we now have weekly options.

They expired on Fridays too. We also have quarterly options that expire on the last trading day of the quarter, no matter what day of the week. And now, we have the addition of options that expire on Mondays and Wednesdays.

Because of the proliferation of so many potential expiration series, it is imperative that you identify the exact day that your option expires. Whether entering by phone or by computer, you need to provide the month, the day of the month, and the year.

Fortunately, when entering by computer, the broker usually gives you a selection from which to choose. That makes it easier, but you still need to be very careful when selecting your expiration date.

STRIKE PRICE

To properly identify the options you want to buy or sell, you need to provide the strike price of the options involved in the transaction.

Additional information on strike price can be found at www.whatareoptions.com.

TYPE

Here you identify the option as a put or a call.

ORDER TYPE / PRICE

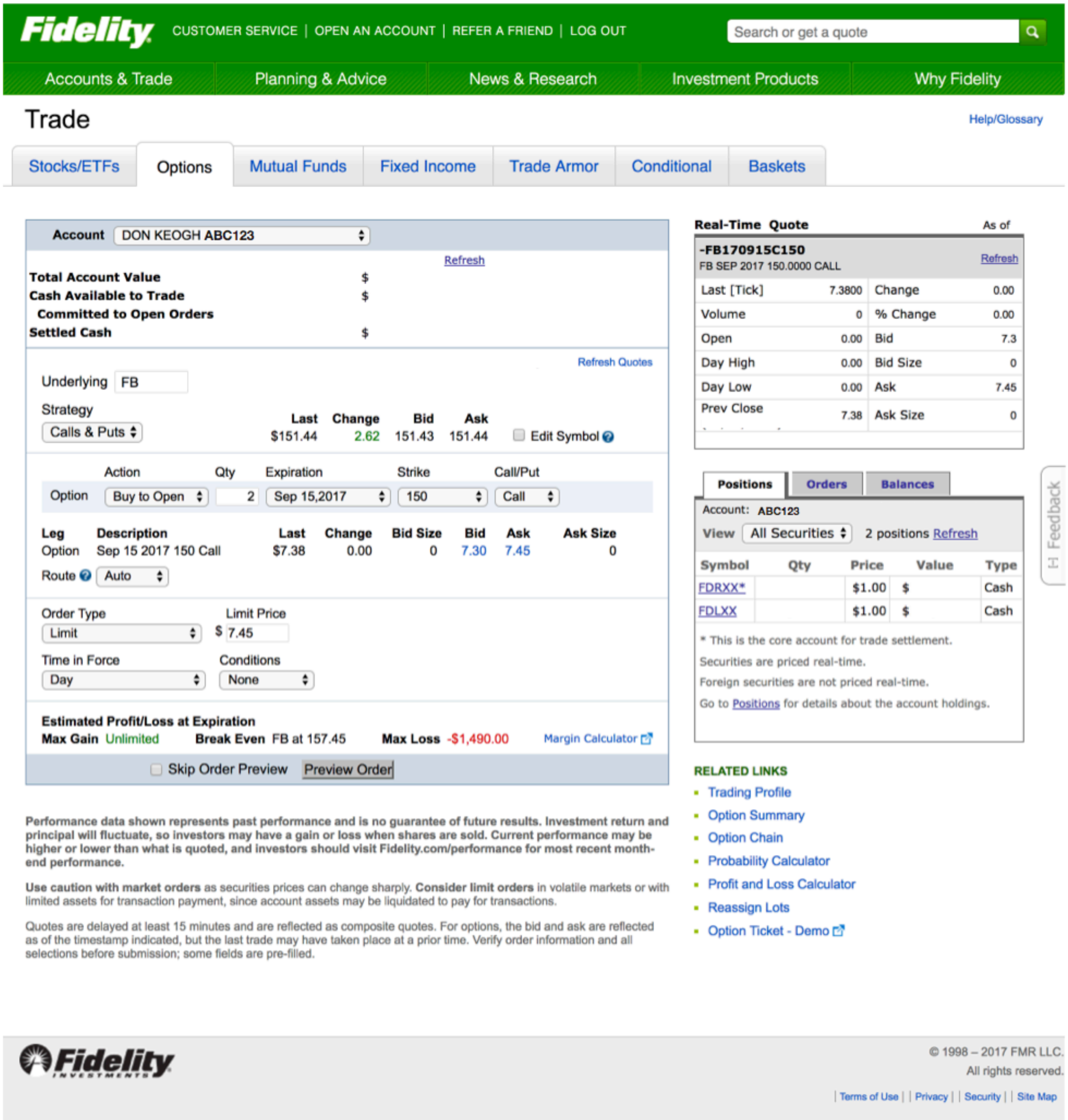
This is how you tell the broker when or at what price to fill your order. The following section will discuss various types of orders in detail so that you get the right price.
Certain types of orders require additional information that will be discussed in the following section on order types.

Most online trading systems will ask you specific questions about the topics discussed above and will display a list of answer choices.

As an example, assume that you are on-line and entering an order to "**BUY TO OPEN 2 FACEBOOK SEPTEMBER 15, 2017 150 CALLS AT THE MARKET**".

We're going to use images from several different brokerage platforms to so that you can get an idea of what's out there as it relates to order entry.

Here's what it looks like if you're using Fidelity's basic on-line system, which is one of the brokerage firms I use.



Notice all the selection menus. Having everything pre-filled so you're simply selecting from a menu makes the process much easier.

1. **IDENTITY**
   Log in and make sure the proper account number is being used. It will then take you through the proper sequence for entering an order by asking:

2. **UNDERLYING**
   Enter the ticker symbol of the stock, ETF, or Index whose options you want to trade.

3. **BUY OR SELL**
   Click on the correct response. Using our example, you click “Buy”.

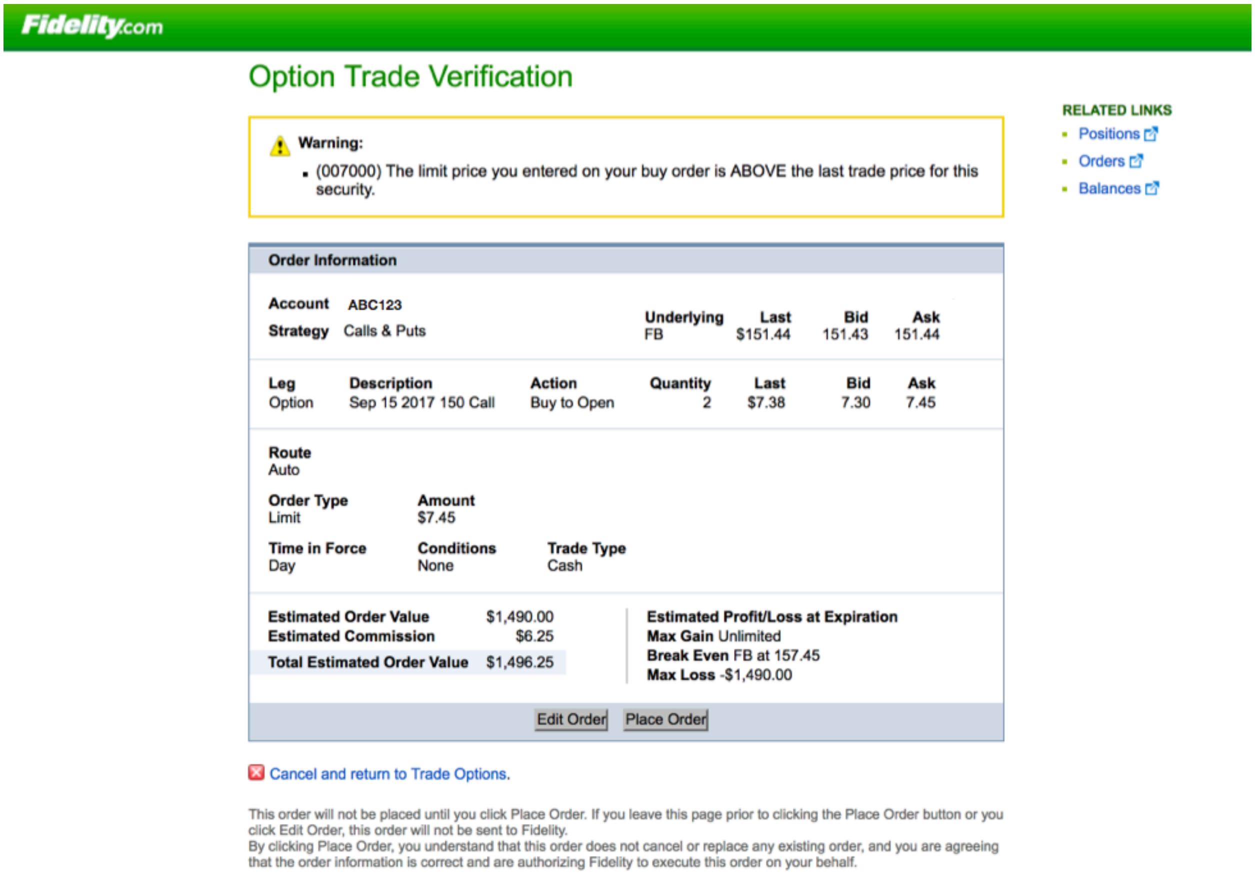
4. **OPEN OR CLOSE**
   In our example, we chose open. In some situations, the open or close selection is incorporated into the Buy or Sell.

5. **QUANTITY OR NUMBER OF CONTRACTS**
   Enter the correct number of contracts. “2” in our example

6. **CONTRACT**
   Here you identify the type (put or call), the expiration date, and the strike price.

7. **TYPE OF ORDER**
   Choose the correct order type on the pull-down menu. In our example, click on “Limit” and enter limit price, “7.45”

The screen will display your order in printed form and give you the opportunity to make any corrections:



Fidelity.com

Option Trade Verification

RELATED LINKS
- Positions
- Orders
- Balances

Warning:
- (007000) The limit price you entered on your buy order is ABOVE the last trade price for this security.

Order Information

Account ABC123
Strategy Calls & Puts

Underlying	Last	Bid	Ask
FB	$151.44	151.43	151.44

Leg	Description	Action	Quantity	Last	Bid	Ask
Option	Sep 15 2017 150 Call	Buy to Open	2	$7.38	7.30	7.45

Route
Auto

Order Type Limit
Amount $7.45

Time in Force Day
Conditions None
Trade Type Cash

Estimated Order Value $1,490.00
Estimated Commission $6.25
Total Estimated Order Value $1,496.25

Estimated Profit/Loss at Expiration
Max Gain Unlimited
Break Even FB at 157.45
Max Loss -$1,490.00

Edit Order | Place Order

Cancel and return to Trade Options.

This order will not be placed until you click Place Order. If you leave this page prior to clicking the Place Order button or you click Edit Order, this order will not be sent to Fidelity.
By clicking Place Order, you understand that this order does not cancel or replace any existing order, and you are agreeing that the order information is correct and are authorizing Fidelity to execute this order on your behalf.

Be sure to look closely. This is your chance to fix any mistakes. If there are mistakes, you can click the **Edit Order** button. If there are no mistakes and you're ready to implement the trade, just click the **Place Order** button.

This is important. Your order is not filled if you do not receive a confirmation from your brokerage firm. Never assume anything.

The brokerage firm computer receives information and instructions that you provide and cannot know that you want the order to trade several sessions (open order), or that you really meant to place a stop order. **Be careful! Keep records!**

When entering orders through a trading desk, keep in mind that you are giving instructions to a phone clerk who may or may not know anything about what you are doing. If you are short the market and want to get out of your position, the order is to "Buy" it back, which means you want to Buy to Close. But if you mistakenly say "Sell" the clerk will write "Sell" and does not know that you are covering a short position and should have said "Buy." **Be careful! Keep records!**

Even when entering orders through a live broker you must take the time to do things correctly. **Be careful! Keep records!**

In the unlikely event that there is an error, alert your brokerage firm immediately. There is a limited time in which to have any errors corrected, even if the error is caused by the firm. It is important that you check your confirmation.

ORDER TYPES

MARKET ORDER

The most common type of order is the Market Order. Market Orders are used primarily when immediate order execution is required. When entering a Market Order, you state the number of contracts you want to buy or sell.

You do not specify a price, since your objective is to have the order executed as soon as possible at the best possible price. Once a Market Order is placed, it is filled and cannot be canceled.

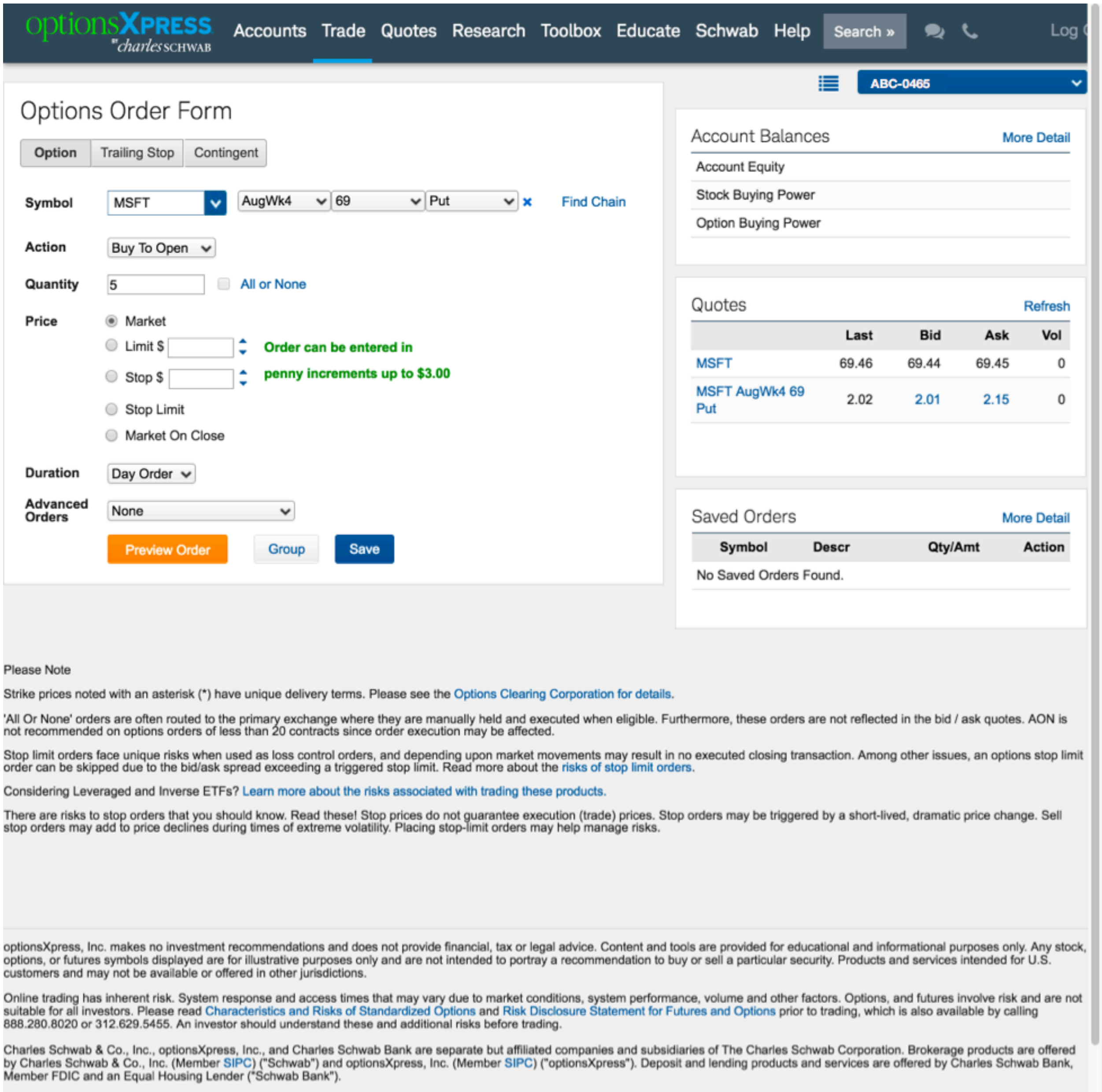
As an example, in anticipation of a decline in tech stocks you want to implement a bearish trade on Microsoft. You enter an order to **BUY TO OPEN 5 MICROSOFT AUGUST 25, 2017 69 PUTS AT THE MARKET**

To enter a **Market Order** to buy **5** of the puts, you need to provide the following information:

1. **Account Number: 0465**
2. **Underlying MSFT**
3. **Expire August 25, 2017 (Week 4)**
4. **Strike 69**
5. **Type Put**
6. **Market Action: Buy**
7. **Open or Close: Open**
8. **Quantity: 5**
9. **Order Type: Market**

The puts are 2.01 bid / 2.15 ask. Because you are using a market order, your order will be filled at the best possible price, which may be below, at or above 2.15. The key is, the order will be filled immediately. If conditions are normal, you should expect a fill somewhere near 2.15. If conditions are hectic, however, the fill could be drastically different.

Here's what it looks like using my account at optionsXpress by Charles Schwab.



Notice in this example that the expiration date is different: AugWk4. Schwab provides the month (August) and the week (Week 4). That means the option is a weekly option that expires on the 4th Friday of the month of August, which is August 25.

[*NOTE: I have to say that I don't really like using the Wk# style to designate the expiration. I've seen too many people who use a system like this make too many unforced errors. For those of you whose broker uses this type of expiration designation, you need to be extra vigilant.*]

LIMIT ORDER

A Limit Order specifies a price limit at which the order must be executed. In other words, it must be filled at that price or at a better price.

The advantage is that you know the worst price you will get if the order is executed. The disadvantage is that you cannot be certain that the order will be filled because the market may not trade at your price.

BUY LIMIT

If you want to be sure that when you are buying that you pay no more than some maximum price, then you use a Buy Limit order. Typically, the order price is lower than the current market price.

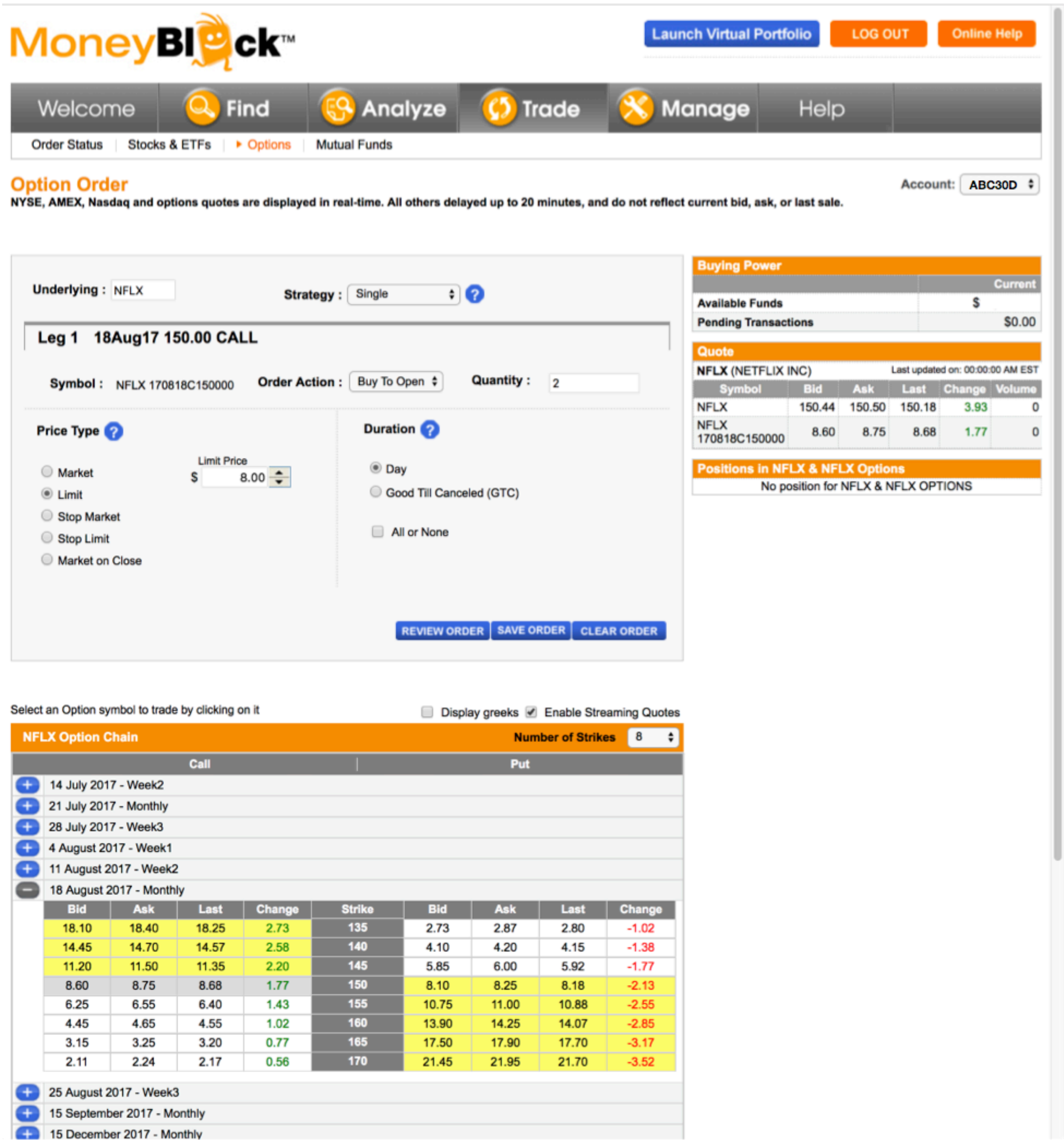
By way of example, the **NETFLIX AUGUST 18, 2017 150 CALLS** which are trading at 8.60 bid / 8.75 ask. Let's say you would like to **BUY TO OPEN 2** calls but not at the price shown.

You are only willing to buy it if the price is $800 or less. If the price does not come down to what you are willing to pay, you are willing to risk not getting into the trade. To accomplish this, you use a limit order.

To enter a **Limit Order** to buy these options, which would be an opening transaction, you need to provide the following information:

1. **Account Number: ABC30D**
2. **Underlying NFLX**
3. **Expire August 18, 2017**
4. **Strike 150**
5. **Type Call**
6. **Market Action: Buy**
7. **Open or Close: Open**
8. **Quantity: 2**
9. **Order Type: Limit**
10. **Price: 8.00**

Here is how I enter this trade in my MoneyBlock account:



Notice in this image, there is a table at the bottom called an **Option Chain**. I simply click on the option I want to trade. That's pretty easy. Also notice that this platform has the expiration date and the week of the month. It's like a combination of Fidelity and optionsXpress.

Above the chain is the trade itself. Because this is a limit order, the order can only be filled at the **Limit Price** of 8.00 or better. Because I am buying, the "better" price is lower. If the market never trades that low you will not be filled.

You may not be filled even if the market trades at 8.00 but not lower because there is no guarantee that enough contracts changed hands at that price to fill all orders. If the market trades below 8.00 you are filled at your price or lower.

Remember that the only time you can be certain your order was filled is if the market trades better than the stated price. When buying, a better price is lower than the stated price. When selling, a better price is higher than the stated price.

SELL LIMIT

If you want to be sure that when you are selling that you receive some minimum price, then you use a limit order. Typically, the order price is higher than the current market price.

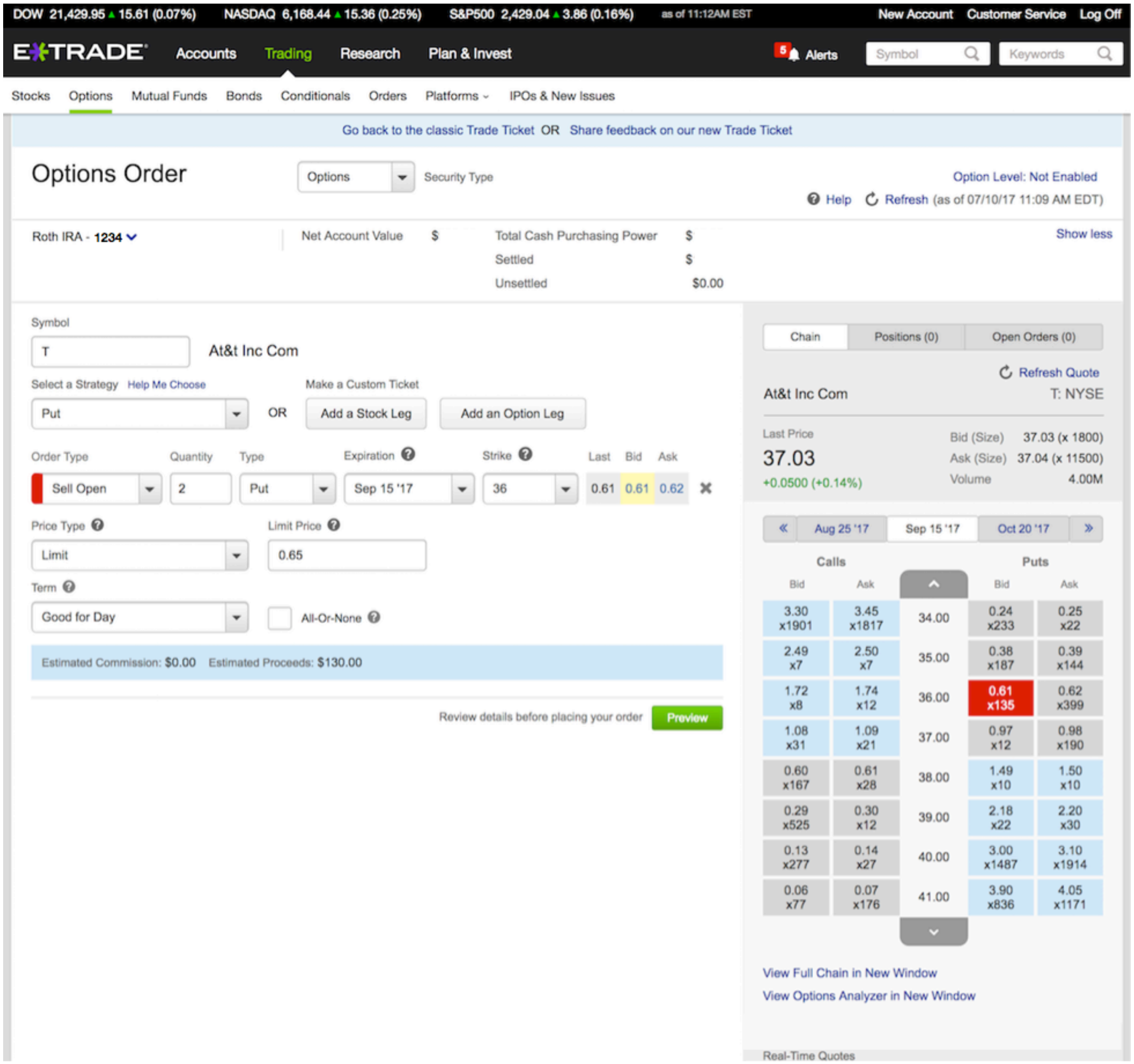
By way of example, the **AT&T SEPTEMBER 15, 2017 36 PUT** which is trading at 0.61 bid / 0.62 ask. Let's say you would like to **SELL TO OPEN 2** puts (instead of implementing a covered call), but you want a better price than 0.61.

You are only willing to sell the option if the price is at least 0.65, or $65 per option. If the price of the puts does not rise up to what you are willing to accept as payment for selling the put, you are willing to risk not getting into the trade. To accomplish this, you use a limit order.

To enter a **Limit Order** to sell this option, which would be an opening transaction, you need to provide the following information:

1. **Account Number: Roth IRA-1234**
2. **Underlying T**
3. **Expire September 15, 2017**
4. **Strike 36**
5. **Type Put**
6. **Market Action: Sell**
7. **Open or Close: Open**
8. **Quantity: 2**
9. **Order Type: Limit**
10. **Price: 0.65**

Here is how one of my employees would enter this trade in his ETrade account:



The order can only be filled at the stated price of 0.65 or higher (better). You will not be filled if the market does not trade at 0.65 and may not be filled even if it does. The market must trade higher than 0.65 for you to be sure that the order was filled.

NOTE: There are conditions where the price shown on your screen is above your minimum price, but you still want to use a limit order. In this case, the market is experiencing substantial volatility and you want to be sure that you get a minimum price. So, you use a limit order to make sure that by the time your order is directed to a market maker, the price hasn't dropped below your minimum price.

I typically always use a limit order to prevent such an occurrence, thereby avoiding a bad fill on my trade.

STOP ORDER

A Stop Order specifies a price that, when reached, converts the Stop Order into a Market Order. By placing a Stop Order you are saying that you want to buy or sell on a Market Order, but not at the current market price level. You want the market to trade at a certain price before your order is executed.

BUY STOP

When using a Buy Stop, you are specifying a certain price where you want the option to trade, before a buy order is executed at a price that is higher than the current option price.

As an example, assume your technical analysis indicates that if the market moves higher, it is exhibiting strength, and you want to profit from further strength.

Right now, SPY is trading at 242.64. The current at-the-money strike is 243. The 243 call for the September 15, 2017 expiration is 3.97 bid / 3.98 ask.

You believe that if SPY breaks out such that the **SPY SEPTEMBER 15, 2017 243 CALL** trades above 6.00, SPY will have broken out to the upside and you want to be long those calls. You place an order to **BUY TO OPEN 10** of the calls on a stop should the calls trade at 6.00.

To enter a **Stop Order,** provide the following information:

1. **Account Number: ABC2468**
2. **Underlying SPY**
3. **Expire September 15, 2017**
4. **Strike 243**
5. **Type Call**
6. **Market Action: Buy**
7. **Open or Close: Open**
8. **Quantity: 10**
9. **Order Type: Stop**
10. **Price: 6.00**

Here is how one of my employees would enter this trade in his Think or Swim account:

In a textbook situation, if the market trades (or is "offered") at 6.00 or higher, your Stop Order will become a Market Order and your order will be filled. Your fill may be 6.00, but it may be higher or lower.

If you had entered the Limit Order to **BUY 10 SPY SEPTEMBER 15, 2017 243 CALLS**, when the ask price was 3.98, you would have been filled immediately because 3.98 is a better price than 6.00. Your Stop Order tells the broker to wait until the market reached 6.00 before doing anything.

SELL STOP

When using a Sell Stop, the price you want the option to trade at is below the current price. It is often used to protect an existing position from further loss.

Here's an example using USO, which is the United States Oil Fund, an ETF (exchange traded fund). Let's assume that you were bullish on Oil and had previously purchased **10** of the **USO AUGUST 18, 2017 9 CALL** at a price of 0.46.

Now that you are long those calls, you want to try to protect the position against a loss that is worse than 50%, in case you are wrong and USO shares fall. To do that, you would use a **SELL TO CLOSE** stop, with the price set at half of what you paid.

To enter a **Stop Order,** provide the following information:

1. **Account Number: ABC2468**
2. **Underlying USO**
3. **Expire August 18, 2017**
4. **Strike 9**
5. **Type Call**
6. **Market Action: Sell**
7. **Open or Close: Close**
8. **Quantity: 10**
9. **Order Type: Stop**
10. **Price: 0.23**

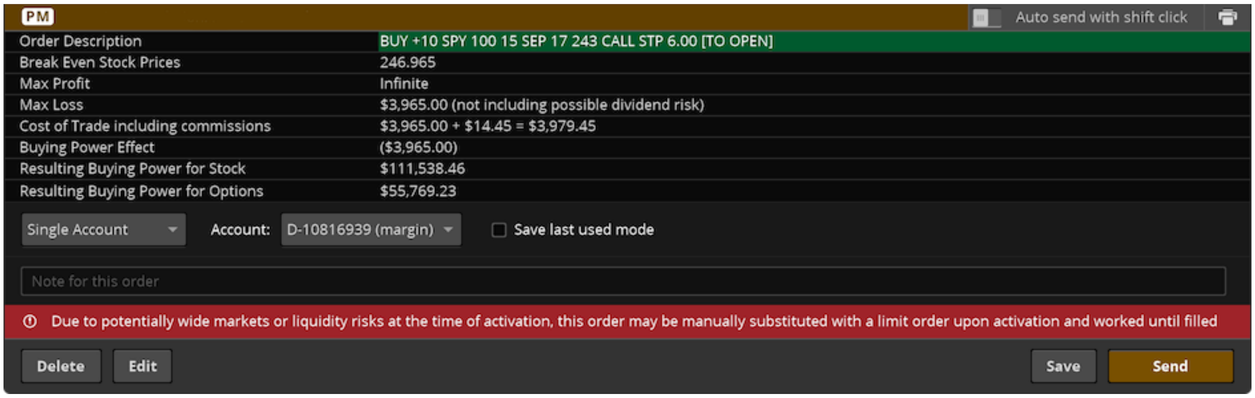
Here's what it looks like in Think or Swim:

If the market trades (or is "bid") at 0.23 or lower, your Stop Order will become a Market Order and will be filled. Your fill may be 0.23, but it also may be higher or lower. If the market does not trade as low as 0.23, your order will not be executed and you will still be long the 10 options at the end of the day.

NOTE: You need to be very careful using stop orders on options. If the options are illiquid, there can be extended periods where the options do not trade even while the stock price fluctuates.

This can cause large gap moves in the options when an order is placed and filled. As a result, stops can be triggered and your option is at a price that is nowhere near where you placed your stop.

Some brokers realize this, and may modify your stop order such that when triggered, the broker will convert the trade into a limit order instead of a market order. The section in red in this confirmation from Think or Swim illustrates this.


PM
Auto send with shift click
Order Description
BUY +10 SPY 100 15 SEP 17 243 CALL STP 6.00 [TO OPEN]
Break Even Stock Prices
246.965
Max Profit
Infinite
Max Loss
$3,965.00 (not including possible dividend risk)
Cost of Trade including commissions
$3,965.00 + $14.45 = $3,979.45
Buying Power Effect
($3,965.00)
Resulting Buying Power for Stock
$111,538.46
Resulting Buying Power for Options
$55,769.23
Single Account
Account:
D-10816939 (margin)
Save last used mode
Note for this order
Due to potentially wide markets or liquidity risks at the time of activation, this order may be manually substituted with a limit order upon activation and worked until filled
Delete
Edit
Save
Send

GTC ORDER

In nearly every trading platform, the order you entered is good for that particular day only. If the order is not filled by the end of the day, the order expires unfilled.

Good Till Canceled Orders (also known as Open Orders, or GTC) do not cancel until the option expires. By designating a Limit Order or a Stop Order as Good Till Cancelled, the Limit Order or Stop Order will remain valid and working until it you cancel the order, or it is filled, or the option expires.

Here's an example using Apple. Let's say you want to **BUY TO OPEN 5** near-the-money call options on Apple that expire on December 15, 2017. The **APPLE DECEMBER 15, 2017 145 CALL** is 8.90 bid / 9.00 ask. At 9.00, 5 of those calls would cost $4,500.

You determine that is too high. But if the price drops to 8.00, 5 calls would cost $4,000. That is within your price range. You decide that if the price drops to 8.00, you want to buy 5 of those options.

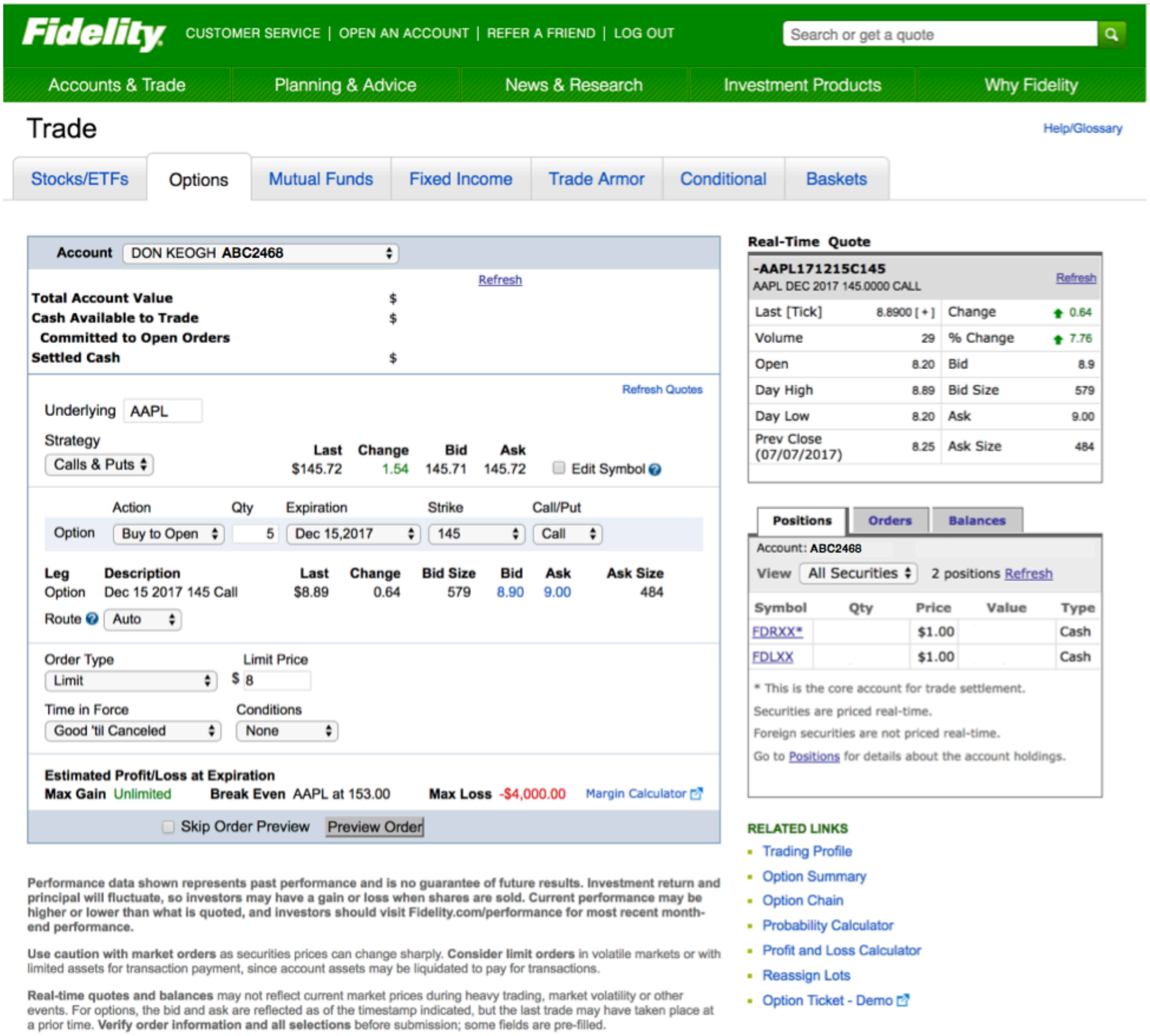
As noted before, we can use a limit order to accomplish that. But because option orders expire at the end of the trading session, if you're not filled at the limit, you need to re-enter the limit order every morning until you are filled, or the option expires.

By using a Good Till Canceled order, however, we do not need to re-enter the order. Instead, the order remains "open" and active, until you cancel the order, your order is filled, or the option expires.

To enter a **GTC Limit Order** to buy the 5 Apple call options, you need to provide the following information:

1. **Account Number: ABC2468**
2. **Underlying AAPL**
3. **Expire December 15, 2017**
4. **Strike 145**
5. **Type Call**
6. **Market Action: Buy**
7. **Open or Close: Open**
8. **Quantity: 5**
9. **Order Type: Limit**
10. **Price: 8.00**
11. **Time in Force Good Till Canceled**

Here's what it looks like in Fidelity:



As noted before, the order will remain valid and working until it is filled, until you cancel it, or until the option expires.

NOTE: Don't make this mistake. If you go on vacation and come back and decide to just buy the call at a higher price, and you do so by entering an all new order, realize that your existing order is NOT canceled. Buying the option via a different order does not automatically cancel the earlier GTC Order.

GTC ORDERS DO NOT CANCEL AUTOMATICALLY! YOU MUST ALWAYS CANCEL A GTC ORDER IF YOU NO LONGER WANT IT WORKING!

ORDERS FOR MULTIPLE OPTION STRATEGIES

Straight purchases and sales of puts and calls offer a plethora of wonderful benefits that many traders can utilize. But the real power of options comes when you combine different options into various strategies.

These strategies involve the simultaneous purchase and sale of different options to establish a position with a specific risk-reward profile. This section will deal with structuring your orders to achieve the desired result.

As we present examples of various options strategies, please keep in mind that the order types covered in the previous section are all operable when entering orders for option spreads. In other words, our upcoming examples of option spreads may be entered as Limit Orders, Market Orders, Stop Orders, and/or GTC Orders.

VERTICAL DEBIT SPREAD

A vertical debit spread results when simultaneously buying and selling puts or calls on the same underlying, with the same expiration date, but with different strike prices. The price of the option you are buying is higher than the option you are selling. Because of that, the net is a payment, or a debit.

The maximum amount that can be earned on a Vertical Debit Spread is the difference between the strikes less the debit. The maximum risk is the amount of premium paid out.

CALL DEBIT SPREAD (also known as BULL CALL DEBIT SPREAD)

Assume that you are bullish and decide to establish a bullish position in Exxon Mobil (XOM). Your vehicle of choice is a call debit spread. The **XOM OCTOBER 20, 2017 77.50 CALL** is 4.05 bid / 4.20 ask, while the **XOM OCTOBER 20, 2017 82.50 CALL** is 1.41 bid / 1.48 ask.

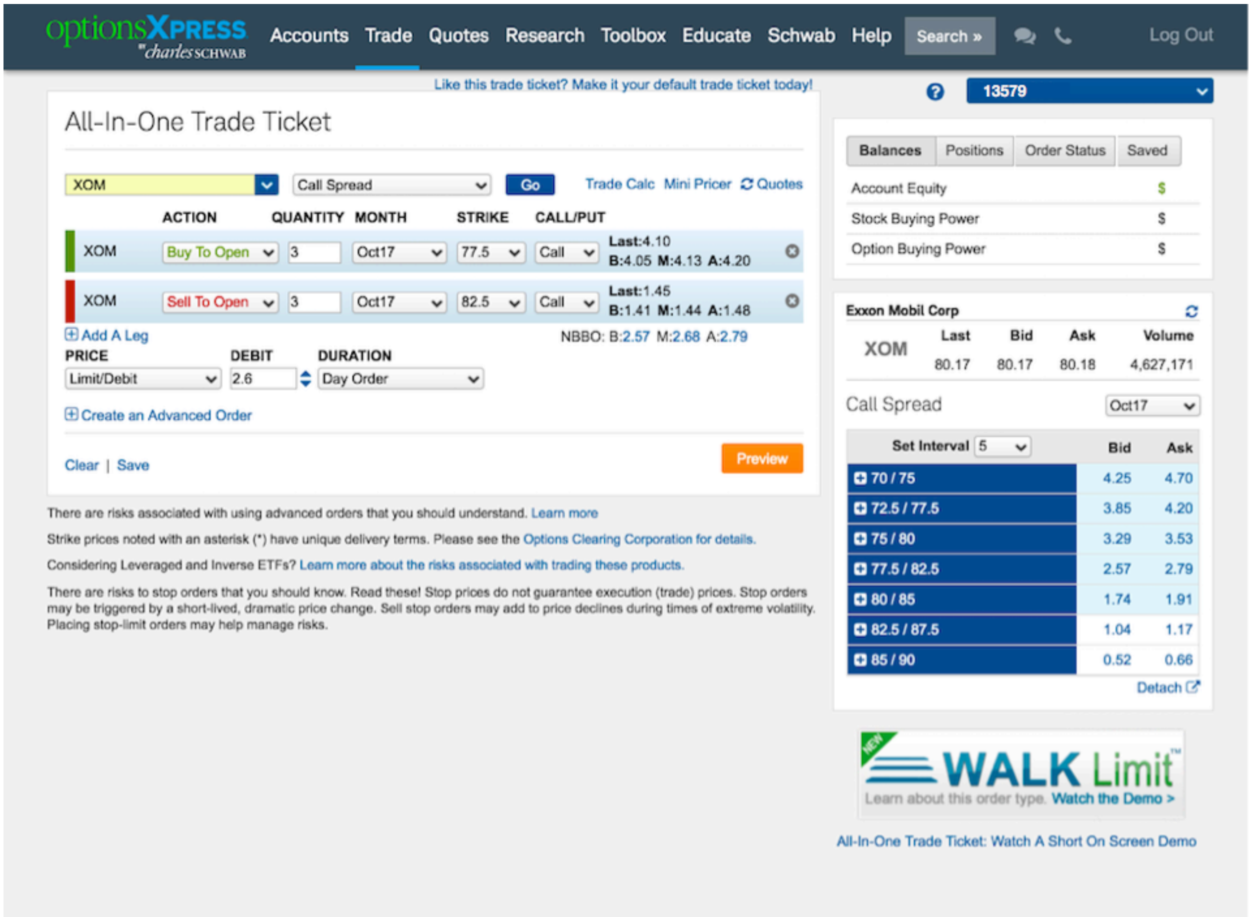
Because you are buying the expensive 77.50 call, and selling the inexpensive 82.50 call, the net debit of the spread is the ask price of the 77.50 call minus the bid price of the 82.50 call. That net debit is 2.79. You would like to **BUY TO OPEN 3** of these spreads. But you do not want to pay more than 2.60 per spread. That means you need to use a **Limit Order**.

You only want to try to enter this trade today, so you use a **Day Order**, not a Good Till Canceled.

This is the information you'll need to provide:

1.	**Account Number: 13579**		
2.	**Underlying**	**XOM**	
		Option1	**Option 2**
3.	**Expire**	**October 20, 2017**	**October 20, 2017**
4.	**Strike**	**77.50**	**82.50**
5.	**Type**	**Call**	**Call**
6.	**Market Action:**	**Buy**	**Sell**
7.	**Open or Close:**	**Open**	**Open**
8.	**Quantity:**	**3**	**3**
9.	**Order Type:**	**Limit**	
10.	**Price:**	**2.60**	
11.	**Time in Force/Duration: Day**		

This is what it looks like in optionsXpress. Notice that optionsXpress uses Duration instead of Time in Force:



Note that you do not provide a price for the individual options!

When entering an order for an options strategy that involves more than one option, you enter the price for the combination.

In this case, the order was placed as a limit order at a net debit of 2.60 (per spread) and each spread will be filled at a net price of 2.60 or better (less expensive). Since the order was placed as a spread it must be filled as a spread. That means that the broker cannot buy all 3 of the 77.50 calls and sell only 1 or 2 of the 82.50 calls.

When liquidating the position, however, the order can go in as a spread or as individual options.

PUT DEBIT SPREAD (also known as BEAR PUT DEBIT SPREAD)

In this example, we're going to assume that we have a bearish bias on Johnson & Johnson. We are going to implement a bearish Put Debit Spread.

We will **BUY TO OPEN** the **JNJ JANUARY 19, 2018 130 PUT** and **SELL TO OPEN** the **JNJ JANUARY 19, 2018 110 PUT** as a vertical spread. The JNJ January 19, 2018 130 put is 4.85 bid / 5.20 ask while the JNJ January 19, 2018 110 put is 0.96 bid / 1.14 ask.

Because you are buying the expensive 130 put, and selling the inexpensive 110 put, the net debit of the spread is the ask price of the 130 put minus the bid price of the 110 put, which is 4.24.

Now, let's say you would like to enter the spread, but you look at the options prices and realize that the difference between the bid price of the spread (3.71) and the ask price of the spread (4.24) is quite wide. So you are going to use a **Limit Order** to get filled somewhere between 3.71 and 4.24.

You only want to enter **1** spread, and you only want to try to enter this trade today, so you use a **Day Orde**r, not a Good Till Canceled.

This is the information you'll need to provide:

1.	**Account Number:**	**13579**	
2.	**Underlying**	**JNJ**	
		Option 1	**Option 2**
3.	**Expire**	**January 19, 2018**	**January 19, 2018**
4.	**Strike**	**130**	**110**
5.	**Type**	**Put**	**Put**
6.	**Market Action:**	**Buy**	**Sell**
7.	**Open or Close:**	**Open**	**Open**
8.	**Quantity:**	**1**	**1**
9.	**Order Type:**	**Limit**	
10.	**Price:**	**4.10**	
11.	**Time in Force / Duration: Day**		

This is what it looks like in optionsXpress:


optionsXPRESS charles SCHWAB
Accounts
Trade
Quotes
Research
Toolbox
Educate
Schwab
Help
Search »
Log Out
Like this trade ticket? Make it your default trade ticket today!
13579
All-In-One Trade Ticket
JNJ
Put Spread
Go
Trade Calc
Mini Pricer
Quotes
ACTION
QUANTITY
MONTH
STRIKE
CALL/PUT
JNJ Sell To Open 1 Jan18 110 Put
Last:0.98
B:0.96 M:1.05 A:1.14
JNJ Buy To Open 1 Jan18 130 Put
Last:4.75
B:4.85 M:5.03 A:5.20
Add A Leg
NBBO: B:3.71 M:3.98 A:4.24
PRICE
DEBIT
DURATION
Limit/Debit
4.10
Day Order
Create an Advanced Order
Clear | Save
Preview
There are risks associated with using advanced orders that you should understand. Learn more
Strike prices noted with an asterisk (*) have unique delivery terms. Please see the Options Clearing Corporation for details.
Considering Leveraged and Inverse ETFs? Learn more about the risks associated with trading these products.
There are risks to stop orders that you should know. Read these! Stop prices do not guarantee execution (trade) prices. Stop orders may be triggered by a short-lived, dramatic price change. Sell stop orders may add to price declines during times of extreme volatility. Placing stop-limit orders may help manage risks.
Balances
Positions
Order Status
Saved
Account Equity $
Stock Buying Power $
Option Buying Power $
Johnson and Johnson
JNJ
Last 131.55
Bid 131.20
Ask 131.89
Volume 4,003,358
Put Spread
Jan18
Set Interval 5
Bid
Ask
125 / 130 1.45 2.10
130 / 135 2.15 3.00
135 / 140 2.85 3.90
Detach
NEW
WALK Limit™
Learn about this order type. Watch the Demo >
All-In-One Trade Ticket: Watch A Short On Screen Demo
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VERTICAL CREDIT SPREAD

A vertical credit spread results when simultaneously buying and selling puts or calls on the same underlying, with the same expiration date, but with different strikes. The price of the option you are selling is higher than the option you are buying.

Because of that, the net is cash received, or a credit. The maximum amount that can be made on a Vertical Credit Spread is the net credit received. The maximum risk is the difference between the strikes less the net credit received.

CALL CREDIT SPREAD

Let's say you believe interest rates are headed higher. There is an exchange traded fund that is designed to track long-term US Treasury Bond prices: iShares 20+ Year Treasury Bond ETF (ticker TLT). As many of you may remember, bond yield and bond prices move inverse to one another. That means if rates head higher, bonds head lower. Therefore, if you are someone who believes rates are headed higher, then you also believe that bond prices will <u>not</u> move higher.

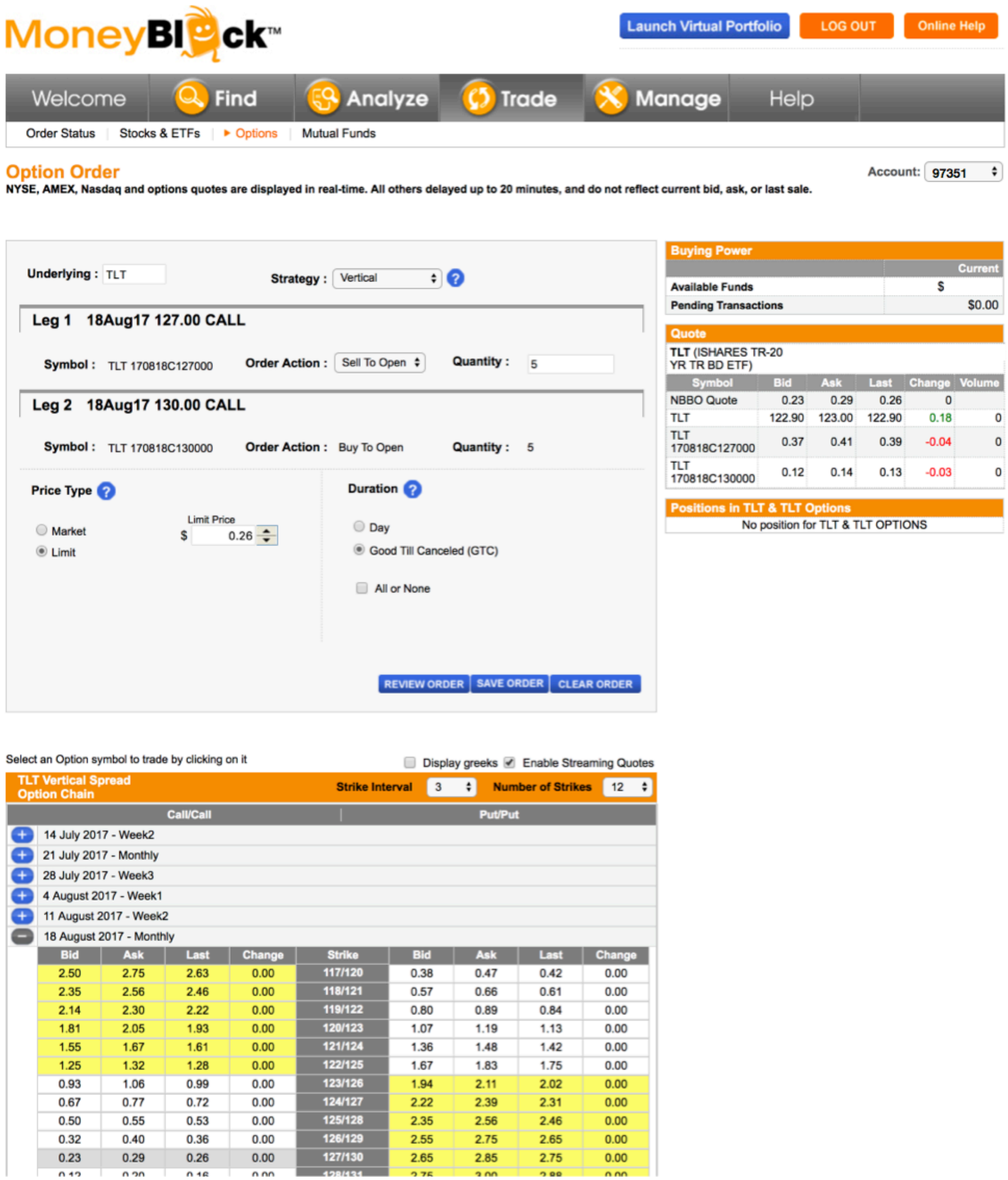
Credit spreads are strategies designed to make money if something does not happen. A call credit spread is designed to make money if the underlying price does not rise in price.

The call credit spread you choose to trade is to **SELL TO OPEN** the **TLT AUGUST 18, 2017 127 CALL**, which is 0.37 bid / 0.41 ask and **BUY TO OPEN** the **TLT AUGUST 18, 2017 130 CALL**, which is 0.12 bid / 0.14 ask. Because you are selling the expensive 127 call, and buying the inexpensive 130 call, the net credit of the spread is the bid price of the 127 call minus the ask price of the 130 call. That net credit is 0.23. You would like to enter **5** of the spreads. But you want to get a bigger credit than 0.23, you want a credit of 0.26. That means you need to use a **Limit Order**. As far as when you want to try to enter this trade, you want to try to enter this trade until filled. So, you use a **Good Till Canceled** (GTC) order.

This is the information you'll need to provide:

1.	**Account Number:**	**97531**	
2.	**Underlying**	**TLT**	
		Option 1	**Option 2**
3.	**Expire**	**August 18, 2017**	**August 18, 2017**
4.	**Strike**	**127**	**130**
5.	**Type**	**Call**	**Call**
6.	**Market Action:**	**Sell**	**Buy**
7.	**Open or Close:**	**Open**	**Open**
8.	**Quantity:**	**5**	**5**
9.	**Order Type:**	**Limit**	
10.	**Price:**	**0.26**	
11.	**Time in Force / Duration: Good Till Canceled**		

This is what it looks like in MoneyBlock. Like optionsXpress, MoneyBlock also uses Duration instead of Time in Force.



Similar to debit spreads, you do not provide a price for the individual options!
When entering an order for an options strategy that involves more than one option, you enter the price for the combination.

In this case, the order was placed as a limit order at a net credit of 0.26 (per spread) and each spread will be filled at a net price of 0.26 or better (more expensive). Since the order was placed as a spread, it must be filled as a spread. That means that the broker cannot sell all 5 of the 127 calls and buy only 1 or 4 of the 130 calls.

When liquidating the position, however, the order can go in as a spread or as individual options.

PUT CREDIT SPREAD

Let's say that your analysis indicates the stock market has a slight bullish bias, especially the stocks of smaller companies. There is an exchange traded fund (ETF) that tracks an index of small-cap companies. The index is the Russell 2000 Index, and the ETF that tracks the Russell 2000 Index is the iShares Russell 2000 ETF (ticker IWM).

As noted before, credit spreads are strategies designed to make money if something does <u>not</u> happen. A put credit spread is designed to make money if the underlying price does not drop in price.

The **IWM AUGUST 18, 2017 134 PUT** is 0.93 bid / 0.96 ask, while the **IWM AUGUST 18, 2017 131 PUT** is 0.58 bid / 0.62 ask. In a put credit spread, you sell the put with the higher strike. Because the trade is to **SELL TO OPEN** the expensive 134 put and **BUY TO OPEN** the inexpensive 131 put, you get a net credit.

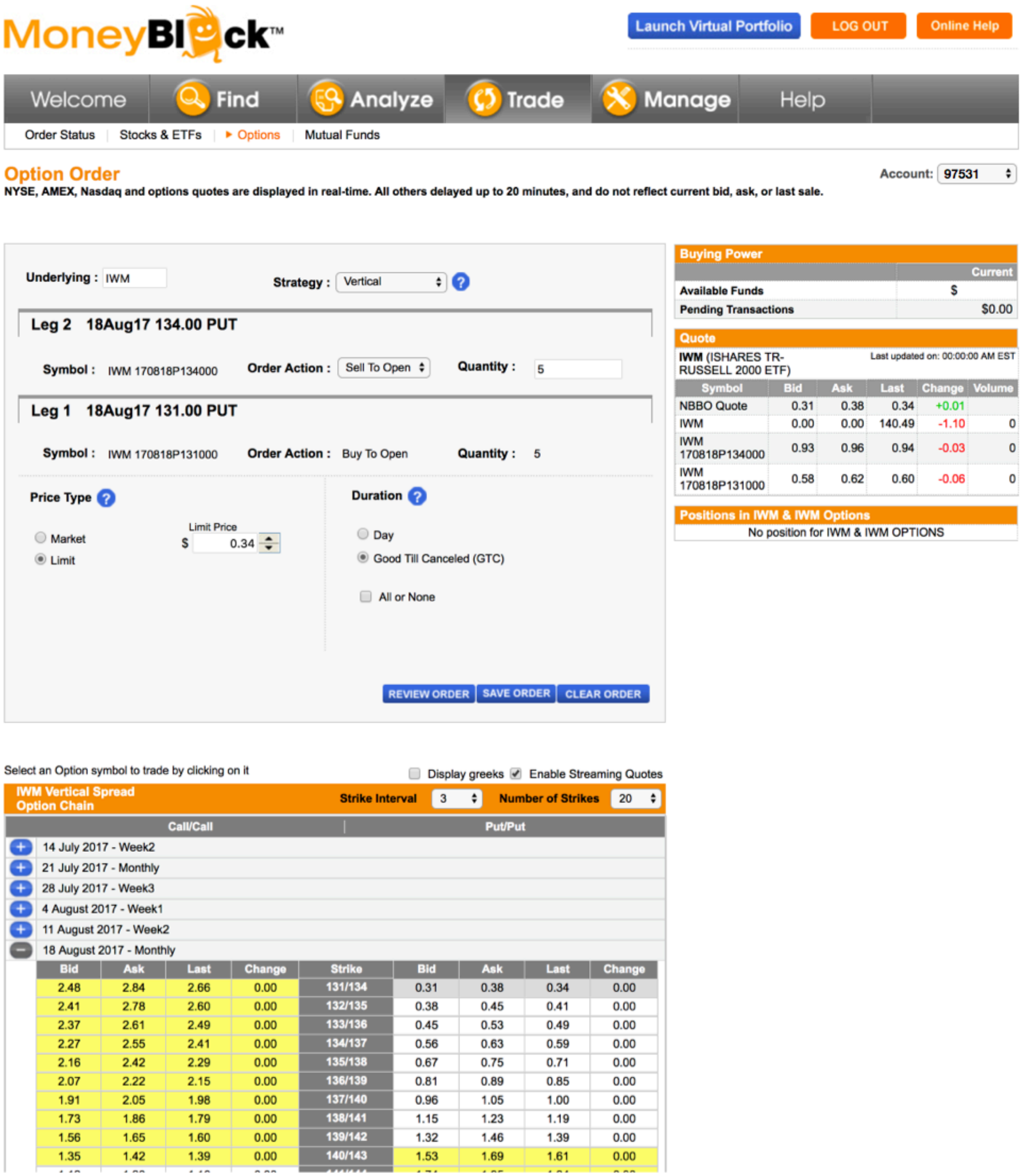
The amount of the credit is the bid price of the 134 put minus the ask price of the 131 put, which is 0.31. You would like to enter **5** of the spreads. But you want to get a bigger credit of 0.34. That means you need to use a **Limit Order**.

As far as when you want to try to enter this trade, you want to try to enter this trade until filled. So, you use a **Good Till Canceled** (GTC) order.

This is the information you'll need to provide:

1.	**Account Number:**	**97531**	
2.	**Underlying**	**IWM**	
		Option 1	**Option 2**
3.	**Expire**	**August 18, 2017**	**August 18, 2017**
4.	**Strike**	**134**	**131**
5.	**Type**	**Put**	**Put**
6.	**Market Action:**	**Sell**	**Buy**
7.	**Open or Close:**	**Open**	**Open**
8.	**Quantity:**	**5**	**5**
9.	**Order Type:**	**Limit**	
10.	**Price:**	**0.34**	
11.	**Time in Force / Duration: Good Till Canceled**		

This is what it looks like in MoneyBlock.



At the risk of repeating myself, notice that you do not provide a price for the individual options. When entering an order for an options strategy that involves more than one option, you enter the price for the combination.

In this case, the order was placed as a limit order at a net credit of 0.34 (per spread) and each spread will be filled at a net price of 0.34 or better (more expensive). Since the order was placed as a spread it must be filled as a spread. That means that the broker cannot sell all 5 of the 134 puts and buy only 1 or 4 of the 131 puts.

When liquidating the position, however, the order can go in as a spread or as individual options.

STRADDLES AND STRANGLES

Straddles are strategies used to profit from large moves in the underlying. A straddle is the purchase or sale of a put and a call of the same month, same underlying market, and same strike price.

A strangle has the same objective and characteristics with one exception: different strike prices for the put and call.

STRADDLE

Let's say you've been watching Starbucks. Earnings and chart action lead you to expect a lot of uncertainty, and consequently, your forecast is for a big increase in the volatility of Starbucks shares. You just don't know in which direction: up or down.

This highlights the power of certain options strategies; *you don't need to guess*. With a straddle, you are creating an options strategy that makes money if the stock goes up or down.

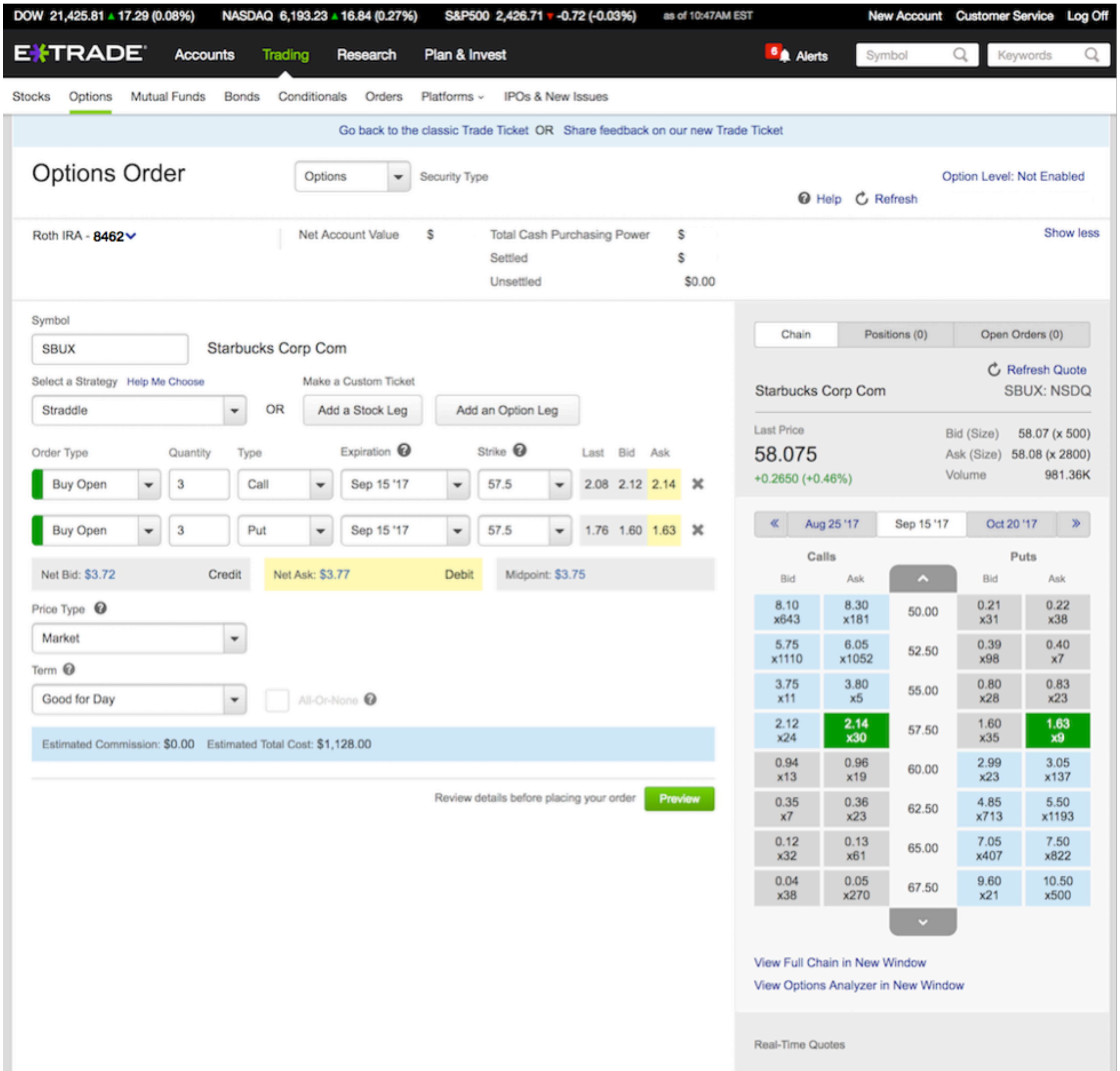
You decide to implement **3** long straddles. The straddle trade is to **BUY TO OPEN** the **SBUX SEPTEMBER 15, 2017 57.50 CALL**, which has 2.12 bid / 2.14 ask, and **BUY TO OPEN** the **SBUX SEPTEMBER 15, 2017 57.50 PUT**, which has 1.60 bid / 1.63 ask.

Notice how the strike prices and the expire dates of both options are identical. Due to the high degree of liquidity in the options, the bid / ask difference of the straddle is small: 3.72 vs. 3.77. Because the bid/ask is relatively tight, you choose to go with a **Market Order** instead of a Limit Order.

This is the information you'll need to provide:

1.	**Account Number:**	**Roth IRA-8642**	
2.	**Underlying**	**SBUX**	
		Option 1	**Option 2**
3.	**Expire**	**September 15, 2017**	**September 15, 2017**
4.	**Strike**	**57.50**	**57.50**
5.	**Type**	**Call**	**Put**
6.	**Market Action:**	**Buy**	**Buy**
7.	**Open or Close:**	**Open**	**Open**
8.	**Quantity:**	**3**	**3**
9.	**Order Type:**	**Market**	
10.	**Time in Force / Term: Good for Day (Day Order)**		

This is what it looks like in ETrade.



Again, notice how the order to enter the trade is placed as a straddle, not the individual options. When exiting the position the order can go in as a straddle or as individual options.

Something else to note is that ETrade's jargon is a bit different as it pertains to how long the order is good for. ETrade calls it "Term".

Finally, the maximum risk in the example above is the net debit; there is unlimited profit potential.

STRANGLE

Let's say you have the same outlook for Deere as you do for Starbucks; you expect DE shares to move big. You just don't know the direction.

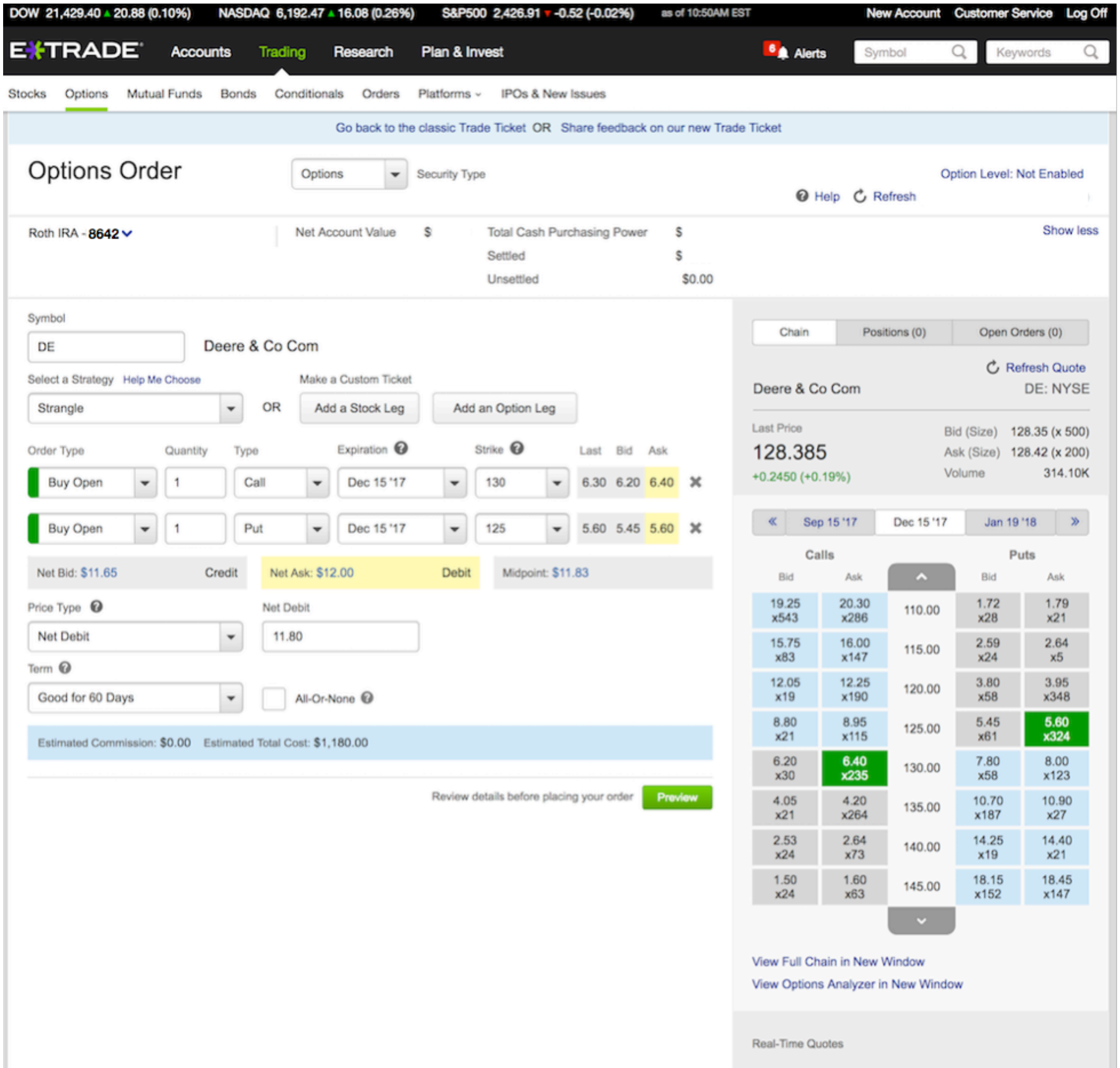
You decide to buy a strangle. A strangle is very similar to a straddle. The only difference is that the strike prices are different in a strangle. In this example, you will **BUY TO OPEN** the **DE DECEMBER 15, 2017 130 CALL**, which has 6.20 bid / 6.40 ask, and **BUY TO OPEN** the **DE DECEMBER 15, 2017 125 PUT**, which has a 5.45 bid / 5.60 ask.

Notice how the expire dates are the same, but the strike prices are different. In this example, you use a **Limit Order**. That means you want to get in at your price, or not at all. We'll address the Time in Force / Duration / Term on the next page.

This is the information you'll need to provide:

1.	**Account Number:**	**Roth IRA-8642**	
2.	**Underlying**	**DE**	
		Option 1	**Option 2**
3.	**Expire**	**December 15, 2017**	**Dectember 15, 2017**
4.	**Strike**	**130**	**125**
5.	**Type**	**Call**	**Put**
6.	**Market Action:**	**Buy**	**Buy**
7.	**Open or Close:**	**Open**	**Open**
8.	**Quantity:**	**1**	**1**
9.	**Order Type:**	**Limit**	
10.	**Price**	**11.80**	
11.	**Time in Force / Term: Good for 60 Days**		

This is what it looks like in ETrade.



Again, the order to enter the trade is placed as a straddle, not the individual options. You do not want to get filled on the call and not the put or vice versa. So, it is imperative that you enter the trade as a strangle. When exiting, however, the order can go in as a strangle or as individual options.

Also, notice how ETrade handles Good Till Canceled. They don't have that setting. Instead, ETrade has **Good for 60 Days**. That means, if the trade is not filled within 60 days, it is canceled.

Finally, the maximum risk in the example above is the net debit; there is unlimited profit potential.

WRITE THINGS DOWN

Errors happen... from newbies to the some of the most experienced traders on earth.

Almost always, the errors can be attributed to missing the little things. The good news is that as you gain experience, the errors become less frequent.

For beginners, it is essential that you keep the errors to a minimum as you move up the learning curve. The most common mistake I currently see beginners make started when weekly options were introduced: people get the expiration date wrong.

Other potential sources of errors occur when you accidentally click Buy instead of Sell. Or you select Open instead of Close. Sometimes we see people place a limit order to buy, then enter the limit as a credit. They'll never get their order filled.

For experienced traders, the most common severe error is the "fat finger". That is, you meant to press 1,000, and you ended up pressing 1,000,000.

Because there are so many things that have to be entered correctly, we strongly suggest that beginners write down any order on a piece of paper first.

As crazy as that sounds, this simple step forces you to organize your idea and put everything in writing for you to review prior to you actually getting on your computer and entering the order. Because once you're online and using real money, which gets your adrenaline flowing, accurately editing a trading screen can be challenging.

KEEPING TRADE RECORDS

Proper record keeping is another one of those basic, fundamental activities that should become second nature to you. Not only is it important from a pure financial tracking standpoint, you can learn a massive amount by studying what worked and what didn't.

That's right, not every options trade will be a winner. And learning from those mistakes will help prevent a repeat. That's where good record keeping comes in.

There are three sets of records you should *always* keep up to date.

Individual Confirmations
Trading Log
Open Order Log

INDIVIDUAL CONFIRMATIONS

Fortunately, electronic record keeping by brokerage firms is well suited to the first set of records. These digital tools have gotten very sophisticated and are fantastic.

TRADING LOG

The trading log is a compilation of information taken from the confirmations. Why bother with a log if you have confirmations? It is much easier to review a summary of trades than to sort through a bunch of confirmations.

I keep my log in a spreadsheet so I can go back and analyze the overall performance of various trading systems we use in our office.

One of the biggest benefits is that I have a timeline, so I can compare what was going on in the world with what was going on in my straddle and credit spread recommendation services.

I can see what worked and what didn't, and when things worked and when they didn't. That way I am always learning.

OPEN ORDER LOG

Say that you bought a bunch of index call options hoping that the market headed higher. You place a GTC Stop Order to sell the calls to protect the position in case the market turns lower. All Good!

You log on to your computer and see that the stock index spiked 15 points higher at the opening and you decide to get out now. Even Better!!

You are very excited; this was a great trade; you cannot wait to tell your spouse; must find the nearest Lexus dealer. You sell your position and book the profit. Life Is Awesome!!!

That afternoon the market turns sharply lower, finds support, then rallies back to the highs. Big problem: You forgot to cancel your Good Till Canceled Sell Stop and are now short a bunch of calls. Say goodbye to the Lexus.

OPEN GTC ORDERS DO NOT GO AWAY AUTOMATICALLY! YOU MUST ALWAYS CANCEL AN OPEN ORDER!

These things do happen because traders forget to deal with their open orders. Most brokerage firms now maintain a log of open orders, whether they are open for the day or Good Till Canceled (or in the case of ETrade, Good for 60 Days).

The Open Order Log will help to eliminate the kinds of problems I just mentioned. By simply scanning your Open Order web page each day, you know immediately which orders are still working and which ones should have been canceled or filled.

And if the brokerage firm reports a fill on an order canceled previously, you have immediate access to very necessary information.

TRADING IS A BUSINESS

How much time should you spend on record-keeping chores? As much time as needed to keep accurate, helpful, necessary records. Trading is a business for many people. Is it a business for you?

GLOSSARY OF COMMONLY USED OPTIONS TERM

AMERICAN STYLE An option that can be exercised at any time up to the option's expiration.

ASK The price at which the counterparty is willing to sell. It's the price at which a retail trader is willing to buy. Also called the offer.

ASSIGNMENT Notice to an option writer that an option has been exercised by the option holder.

AT-THE-MONEY An option whose strike price is equal or near to the current market price of the underlying.

BETA The relationship between the movement of an individual stock or a portfolio and that of the overall market.

BID The price at which a counterparty is willing to buy. It's the price at which a retail trader is willing to sell.

CALL OPTION An option that gives the buyer the right to assume a long position in the underlying at a specific price prior to the option's expiration date. When assigned, a call option seller assumes a short position.

CASH SETTLED OPTION An option where the intrinsic value (the difference between the underlying price and the option strike price if in a favorable direction) is paid to the option holder by the option seller. Most index options are cash settled.

COVERED OPTION An option written against an opposite position in the underlying market.

CREDIT SPREAD An option spread in which the value of the option sold exceeds the value of the option purchased.

DEBIT SPREAD An option spread in which the value of the option purchased exceeds the value of the option sold.

DELTA A measure of the price-change relationship between an option and the underlying asset.

EUROPEAN STYLE An option that can only be exercised at the option's expiration.

EXERCISE The process whereby the holder of an option exercises his or her right to exchange their option position for a position in the underlying (physical delivery) or cash (cash settled).

EXERCISE PRICE The price at which positions are established upon the exercise of an option. Also called the strike price of an option.

EXPIRATION DATE In the case of American style options, it is the last day an option may be exercised. In the case of European style options, it is the only day the option may be exercised.

IN-THE-MONEY A term describing any option that has intrinsic value. A call option is in-the-money if the underlying price is higher than the option's strike price. A put option is in-the-money if the underlying price is below the strike price.

INTRINSIC VALUE The value derived if the option were to be exercised. Also, the amount by which an option is in-the-money.

LIMIT ORDER An order that specifies an execution price. The order can be executed only if the market reaches or betters that price.

LONG POSITION In options, you are "long" the options that you purchased.

MARK-TO-MARKET An adjustment of all open positions to reflect the current price. Each position is credited with profit or charged with loss.

MARKET ORDER An order for immediate execution given to a broker to buy or sell at the best obtainable price.

NAKED OPTION An option written without an opposite position.

OFFSET Any transaction that liquidates or closes an open position.

OPTION HOLDER Trader (buyer) who pays a premium to own the rights granted by an option contract.

OPTION SERIES Series is equivalent to the expiration date.

OPTION WRITER Trader (seller) who, in exchange for the premium, agrees to assume the opposite side of an option's exercise at a fixed price any time prior to the contract's expiration.

OUT-OF-THE MONEY An option with no intrinsic value. A call is out-of-the-money if the current price of the underlying price is below the option strike price. A put is out-of-the-money if the current price of the underlying price is above the option strike price.

PREMIUM The total price paid for an option.

PHYSICAL DELIVER An option where the actual delivery of the underlying security is delivered to the option holder. All equity and ETF options are physical delivery.

PUT OPTION An option that gives the buyer the right to sell (or assume a short position) in the underlying at the strike price. If assigned, a put option writer assumes a long position at the strike price.

SHORT POSITION In options, the short has sold an option that he or she does not already own. To establish a short position, you would “Sell to Open”.

SPREAD Simultaneously holding a long and short position in two related options with the object of capturing profit from a changing price relationship. Spread can also refer to the difference between the bid and the ask price.

STOP ORDER An order to buy or sell at the market when a definite price is reached.

STRADDLE The purchase or sale of both a put and a call having the same exercise price and expiration date.

TIME VALUE That portion of an option’s premium that represents the amount in excess of the intrinsic value.

UNCOVERED SALE Writing an option without an offsetting position in the underlying. Uncovered sales are one form of a “naked” option.