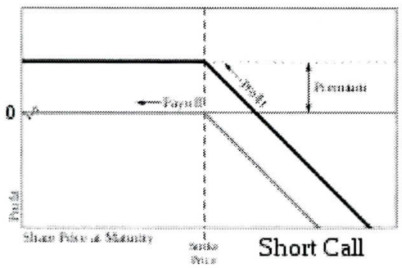
Options Writing 101

Selling options is also known as writing or granting options. For the purpose of this discussion we will examine outright Put and Call selling to establish a new position and not the offsetting of an existing position. These trades are described from the point of view of a speculator.

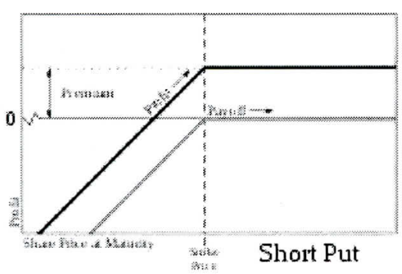
Short call



Short Call

A trader, who believes that a Commodities (Futures) price will decrease, can sell the Futures Contract short or instead sell, or "write," a call. The trader selling a call has an obligation to sell the Futures Contract to the call buyer at the option strike price at the buyer's discretion. If the option expires out of the money the short call position will make a profit in the amount of the premium less commissions. If the Commodities (Futures) price increases over the strike price by more than the amount of the premium the short seller will lose money, with the potential loss being unlimited.

Short put



Short Put

A trader who believes that a Commodities (Futures) price will increase can buy the futures contract or instead sell a put. The trader selling a put has an obligation to buy the Futures Contract from the put buyer at the option strike price at the buyer's discretion. If the Commodities (Futures) price at expiration is above the strike price, the short put position will make a profit in the amount of the premium collected less commissions. If the Commodities (Futures) price at expiration is below the exercise price by more than the amount of the premium, the trader will lose money, with the potential loss being up to the full value of the futures contract and any commissions paid. This is a simple explanation of options writing. You may contact me with any additional questions:

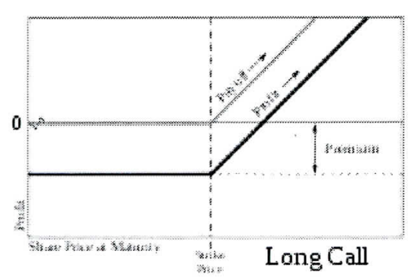
While Options Selling (Writing) has been one of the top profitable strategies used by many professional and institutional traders worldwide. It carries a high degree of risk and should only be used as an investment vehicle under the supervision and guidance of experienced options traders.

Options on Futures: A Primer on Buying Options.

Trading in options actually goes back to ancient Greece. Supposedly the first option buyer in the world was the ancient Greek mathematician and philosopher Thales. In 323BC, he predicted that the season's olive harvest would be larger than usual and during the off-season he acquired the right to use a number of olive presses the following spring. When spring came and the olive harvest was larger than expected he exercised his options and then rented the presses out at much higher price than he paid for his 'option'. Since then options have been prevalent throughout the history of markets. For the purposes of this article we will discuss options on Futures contracts which are primarily traded on regulated exchanges worldwide. Options contracts are quite simply rights but not obligations to buy or sell a specific Stock, Commodity, Bond, Forex Currency or even Property. While the underlying asset the option represents may differ the overall mechanics of options remains the same.

The two types of options are the Call which entitles the holder the right but not the obligation to buy a specific commodity within a specified time at a specific price.
The time is known as the options Expiration Date and the specific price is known as the Strike Price. Put options are exactly the same except the buyer has the right and not the obligation to sell a specified asset within a specified price and date. The price paid is known as the premium. This premium is negotiated between the buyer and seller on the exchange. If, for example, one believed the price of Gold would be above $1500 per ounce at or before June 2010 the investor could BUY 1 (100oz) June (expiration) Gold 1500(strike) Call at the best possible premium (price). Of course if one is bearish on the price the investor would buy a put. Here are two more examples:

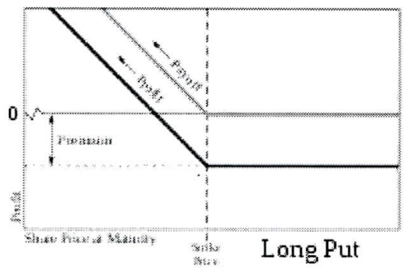
Long call



Long Call

A trader who believes that a Commodities Futures price will increase might buy the right to purchase the Futures Contract (a call option) rather than just buy the Futures Contract. He would have no obligation to buy the Futures Contract, only the right to do so until the expiration date. If the commodities price at expiration is above the exercise price by more than the premium (price) and commissions paid, he will profit. If the Commodities price at expiration is lower than the exercise price, he will let the call contract expire worthless, and only lose the amount of the premium and commissions paid. A trader might buy the option instead of the underlying futures contract because, for the same amount of money, he can obtain a much larger number of options than Futures Contracts. If the commodity rises high enough, he will thus realize a profit with less risk than if he had directly purchased the futures contracts.

Long put



Long Put

A trader who believes that a Commodities Futures will decrease can buy the right to sell the Futures Contract at a fixed price (a put option). He will be under no obligation to sell the Futures Contracts, but has the right to do so until the expiration date. If the Commodities price at expiration is below the exercise price by more than the premium and commissions paid, he will profit. If the Commodities price at expiration is above the exercise price, he will let the put contract expire worthless and only lose the premium and commissions paid.

This is just a brief primer on purchasing options to get you familiar with the concept of options trading. In subsequent articles we will go in depth on the many different strategies involved in the trading of Commodities Futures Options. Please join us next week as we review options selling (writing). In the meantime if you have questions. please contact Trader's Edge