SUBSCRIBER QUICK START GUIDE

Let's Get Started!

Welcome to Schaeffer's Investment Research!

We're thrilled that you've taken the leap to join us as we hunt down big trades and serious profits in today's fast-paced market environment.

But before we start placing day-limit orders and closing out expiration Friday winners together, there's one quick thing we need you to do:

READ THIS BOOK!

This *Subscriber Quick Start Guide* includes absolutely everything you need to start trading with Schaeffer's, and to keep trading successfully and profitably for years to come.

In this easy-to-follow reference, you'll find out:

- Who we are
- What we do
- Why we do it
- How we do it...
- ...and what YOU need to do to make the very most out of your new Schaeffer's subscription.

Plus, we've included invaluable reference material on options mechanics, money management, and allocation -- all critical components of long-term investing success.

We know you must be eager to start targeting some portfolio-changing gains, so let's get to it!

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Read This Before you Trade!

OK, what's so special about this *Subscriber Quick Start Guide*?

What could we possibly teach you that you haven't already learned from Google, Twitter, Yahoo Finance message boards, or the school of hard knocks? (Or, as we refer to it on Wall Street, "the school of cold margin calls.")

Truth is, no matter how much investing capital you're working with in your new trading venture, we can assure you the information in this guide itself is priceless.

The key to attaining the optimal profit results with your Schaeffer's options (or stock!) program -- whether your goal is super-leveraged triple-baggers or slow, steady put-writing income -- is to adhere to a disciplined program with consistent money management.

That's it; that's our big secret. It's that simple!

Read This Before You Trade!

Of course, simply knowing the importance of discipline and good money management is one thing. But actually putting that knowledge into practice -- say, when you've got your real-life money on the line in a trade that's tanking fast?

Well... for a lot of us, that's *not* so simple.

In this guide, we'll explain how it all works. How you can conquer fear and greed, and establish an easy-to-follow trading system that lets you exploit hot streaks and protect your precious capital during slumps.

And just as crucially, we'll tell you all about your Schaeffer's account -- what to expect from our trade recommendations, how to access your subscription, and what to do when you need help.

So, yes; we know, you're excited to get started with the whole "trading" part of it -- but read this guide BEFORE you place your first order, or you could be risking your long-term investment success. And to be frank, we're hoping this is the beginning of a steady relationship! steady relationship!

Please refer to your product-specific handbook for details on trade timing, frequency, profit targets, portfolio management, and more.

Who We Are

Welcome to Schaeffer's Investment Research! We are a privately held provider of stock and options trading recommendations, options education, and market commentary, headquartered in Cincinnati, Ohio.

Our founder and CEO, Bernie Schaeffer, is widely regarded as one of the pioneers of the options research industry. Not only that, he helped bring the once-"fringe" field of sentiment analysis to the forefront with his proprietary Expectational Analysis® methodology -- a unique combination of fundamental, technical, and sentiment analysis indicators that finds stocks poised to pop or drop. steady relationship!

What We Do

We trade options and stocks (yes, in that order) from our home office in Cincinnati, Ohio.

We also publish daily stock market news & research reports to our website, schaeffersresearch.com, throughout each trading day. Our proprietary research and analysis is regularly featured by outlets including Forbes, Yahoo Finance, CNBC, MoneyShow, The Wall Street Journal, Bloomberg, Nasdaq, and more.

But we're not a broker! We're just a niche research firm with a knack for finding high-probability trades.

In other words, we don't manage your money for you. We just tell you which stocks & options are likely to deliver big returns, based on our years of experience and exclusive in-house indicators.

When we find the kind of trades you like, we send the alert to your phone or email.

Then, you take it from there.

Why We Do It

At Schaeffer's, our goal has been to bring options trading to the people from Day 1.

Back in 1981, Bernie Schaeffer and Bob Bergen were working as actuaries for Great American Insurance, and both had recently moved to Cincinnati from New York City. Although they enjoyed the actuary business, both men were fascinated with following the stock market, especially the little-followed options market. Both Bernie and Bob hoped that they could one day make a living pursuing this hobby.

At the time, there were very few newsletters that followed options, and none that concentrated entirely on the options market. From their personal options trading, Bernie and Bob realized that there was a pressing need for an options newsletter for everyday investors. After attending a few seminars on producing newsletters, they both resigned their positions as actuaries and set out to produce a newsletter.

In 1981, under the name Investment Research Institute (IRI), they began to publish ***The Option Advisor***, a monthly newsletter featuring option recommendations and market commentary. We changed our name to Schaeffer's Investment Research, Inc. on March 1, 1998 -- but we still publish our flagship *The Option Advisor* newsletter every month.

Now, though, our flagship newsletter is complemented by a full slate of options & stock recommendation services geared toward traders at every level of interest, experience, income, and risk tolerance. And thanks to the constantly updated research, information, and education available at schaeffersresearch.com, options trading has never been more accessible.

How We Do It

The core team of traders and analysts here in Schaeffer's research department has well over a century of combined experience in the options market (with most of those years clocked right here within our walls!). During that time, we've had plenty of opportunities to test, refine, re-test, and refresh our trading toolkit, and our subscribers have reaped the benefits of our experience.

Our in-house experts have developed a core set of proprietary trading indicators, keyed toward measuring investor sentiment, options pricing & volatility, and the unique technical quirks of thousands of individual stocks. And every Schaeffer's Investment Research recommendation is based on Bernie Schaeffer's pioneering **Expectational Analysis® methodology** -- a powerful combination of technical, fundamental, and sentiment analysis that has uncovered countless home-run winners for us over our nearly four decades in the options industry.

What Exactly is Sentiment Analysis?

Sentiment analysis is the measurement of how bullish or bearish the prevailing attitude is toward a given stock or sector. The metrics used can be either **quantitative** (i.e., what are investors actually doing with their money?) or **qualitative** (i.e., what are they saying and feeling?).

At Schaeffer's, we combine quantitative indicators -- like put/call ratios, short interest readings, and analyst ratings -- with qualitative measures (such as investor sentiment surveys and media coverage) to create the most holistic picture possible of the mood on Wall Street.

There's no such thing as an infallible indicator, and sentiment is no exception. But without a feel for the consensus expectations surrounding a stock, equity analysis is simply not firing on all cylinders. Very often, a stock's sentiment backdrop can make the difference between a winning trade and a total dud.

How We Do It

Not Just Contrary, but *Contrarian*

Bernie Schaeffer's signature methodology is built on the same thoughtful contrarian principles espoused by Humphrey B. Neill, author of the 1954 investing classic The Art of Contrary Thinking. We agree with Neill that "when everybody thinks alike, everyone is likely to be wrong" -- and as such, our contrarian radar goes up whenever it seems that there's a generally unanimous bullish or bearish opinion toward a given stock or sector.

That's because, as Neill put it, "The public is often right during the trends, but wrong at both ends." When seemingly *everyone* is bullish, it can signal a potential lack of future buying power. Likewise, when *everyone* is crowded into the bearish camp, it's possible that the worst-case scenario is already priced into the shares.

Finding Stocks Set to go F.A.R.

Once stocks are teetering at these types of potential turning points, that's when we start to uncover major contrarian trade fodder. That's because consensus opinion can be slow to adapt to a stock's changing technical picture -- creating plenty of opportunities for savvy contrarians to capitalize on the unwinding of bearish sentiment on uptrending stocks, or a capitulation by bullish traders on downtrending stocks.

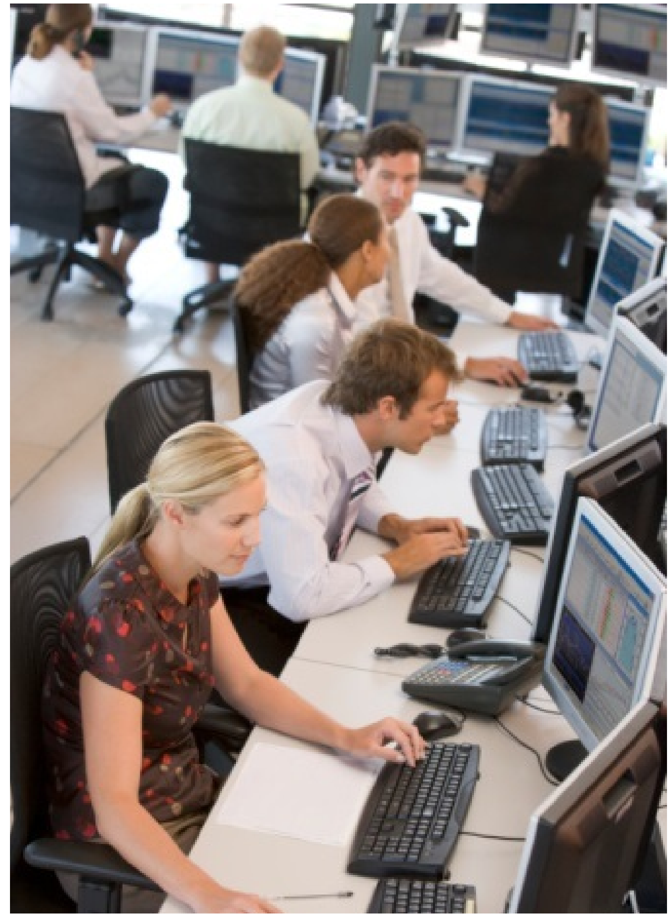
By screening for outperforming stocks surrounded by pessimism, and underperforming stocks that have attracted unwarranted optimism, we're able to drill down on the equities that have the most potential to move **F.A.R. -- a Fast, Aggressive move in the Right direction** -- which is critical for option buyers looking to maximize their profit potential.

How We Do It

How to Tell a Top From a Trend

So why do we consider Expectational Analysis -- and the dozens of indicators and screens we've developed in service of this methodology over the years -- our "secret weapon" for finding explosive options trades?

Well, let's put it like this. There's an old saying in technical analysis to the effect that, "the chart looks prettiest just ahead of a top." But an informed study of a stock's sentiment backdrop can help you distinguish the pretty chart that's going to get even prettier from the one that's about to turn very ugly.



Money Management 101

It's not fun or exciting or adrenaline-pumping (it shouldn't be, at least!), but consistent, disciplined money management can make the difference between building a serious pile of options-trading wealth... and making some seriously costly options-trading mistakes.

Because options are cheaper to trade than stocks -- based on the price of a single options contract relative to the notional value of the underlying shares -- newcomers to the field might mistakenly assume that options trading capital is basically "fun money," and the usual rules of the road in terms of capital management can be loosened.

But, unlike those underlying shares, option contracts carry time value as a component of their price. Time value decays at a steadily accelerating pace until the option's expiration date, which means (all other things being equal) that the option will inevitably decline in value unless the stock moves as predicted within the time frame of the trade. So while a holder of the shares would effectively break even on sideways price action over any given time frame, an options holder would take a loss on the same directionless move.

Given this caveat (and, OK, maybe a few more), there's many a burned rookie options trader who can confirm that money management does, in fact, matter when it comes to puts and calls. And the key concept here can be summed up in a single word: **Allocation.**

All About Allocation

We don't want to tell you something as cliché as "Don't put all your eggs in one basket," but... frankly, that's solid investing advice. As a general rule of thumb, we recommend that you **invest no more than 20%** of your options trading capital in any one trade.

Money Management 101

That's right; there's no such thing as "all-in" here. You should always keep a big portion of capital in reserve for new opportunities, and to function as a "cash cushion" when needed.

And never attempt to "pyramid" your profits by drastically increasing your dollar commitment to any one recommendation. Always invest approximately equal percentage amounts in each trade.

Our guideline on this comes from *New Thinking in Technical Analysis: Trading Models from the Masters* (Bloomberg Press), where Courtney Smith discusses how to "play the game long enough to master the skills and information needed to become a profitable trader" using a system he calls the fixed fractional bet.

In this system, every trade should represent a set percentage of your total account -- let's say 10%, since it's a nice round number.

- Starting with a $20,000 options trading account, you'll want to dedicate no more than $2,000 to each trade.
- If your first trade goes belly-up and you lose 100% of the initial $2,000 you invested, you'll be down to $18,000 in your options trading account. At that point, you'll want to dedicate no more than $1,800 to each trade.
- On the flip side, let's say you doubled your money right out of the gate on that initial $2,000 trade. Now, you've got $24,000 in your options trading account -- and $2,400 to put toward your next options trade.

Money Management 101

As you can see, using this fixed percentage allocation system lets you put more money to work after winning trades -- thereby leveraging your upside to the utmost -- while simultaneously conserving capital after losses.

Since these benefits are built right into the system, make sure you don't vary the percentage you allocate on a trade-by-trade basis, or "double up" on the next trade after a loss in hopes of making your money back right away. Either approach effectively negates the benefits of using the fixed fractional approach to manage your money and protect your capital.

And one more point of caution, as well -- **d**on't let the option prices dictate your trades. In other words, don't go for a "cheaper," deeper out-of-the-money option than you originally intended just so you can afford to buy more contracts. (Remember, that out-of-the-money option is cheaper because it has a correspondingly lower likelihood of expiring in the money.) Instead, buy only the number of contracts you can cover with your fixed allocation percentage, without going over.

Learn It, Live It, and Level Up in Your Trading

To get the most out of your Schaeffer's subscription, and really start building your investing wealth, make these simple money management rules an integral part of your trading system.

Following these effective, time-tested techniques will reduce your risk, increase your profit potential, and -- most crucially -- substantially increase your odds for long-term success in options trading.

Fear & Greed: The 2 Deadly Trading Sins

One of the most oft-repeated investing idioms of the modern age might be Warren Buffett's observation that one should "be fearful when others are greedy and greedy when others are fearful." At Schaeffer's, we'd generally agree with this simplified contrarian take... but we'd suggest you go one step further by aiming to eliminate fear and greed from your trading entirely.

Instead, follow a systematic money management system, as outlined above, that keeps heightened emotions entirely out of the equation. And whether you naturally tend toward the fearful or greedy end of the investing spectrum, we have a few specific pointers to help you dodge these common trading pitfalls.

The Fear Factor

Fear can lead you to shut down positions too early, which caps your gains and prevents you from closing out the kinds of big percentage winners necessary to offset a lower overall win rate.

Here are three easy ways to offset the ill effects of fear on your portfolio:

1. **Use only speculative capital for options.** Playing with "scared" money brings unnecessary emotional baggage to the trade and puts you immediately on the defensive.

2. **Diversify directionally & across sectors.** You should aim to include a mix of puts and calls among your options portfolio, with exposure to a variety of different areas of the economy. (In fact, playing options is a great way to add diversity to your portfolio of stock holdings.)

3. **Stay the course!** Trades can turn around in an instant, and there's no worse feeling than panic-selling at the bottom. If the fundamental case for the trade hasn't blown up, and key support levels haven't broken down, there's no need to panic out of a trade. Instead, stick by your original profit and loss targets.

Fear & Greed: The 2 Deadly Trading Sins

Don't Get Greedy

On the flip side of fear, we have those traders that become so obsessed with chasing down "just a few more points" of profit that they occasionally overstay the trend -- and watch their paper profits evaporate along the way.

We're all in the options game to make money trading, so this can be a difficult urge to squash -- but follow these two tips to help keep avarice at bay.

1. **Set target exit points for each trade.** These should be targets that are achievable, based on the stock's own price history and the current chart setup. In other words, something along the lines of, "this option can return a 100% profit if the stock rallies back up to its highs from two months ago in the next six weeks" -- as opposed to an arbitrary "I'd like a 300% return, please," or "let's see how high this baby can go before expiration."

2. **Only take orderly profits.** What do we mean by this? Well, taking profits haphazardly can encompass a multitude of sins. It includes having no specific profit objective (see above), as well as setting illogical and insufficient profit objectives (a 20% gain on an option), or emotional profit objectives ("this will be my lucky week"). Bottom-line, don't take profits just for the temporary thrill of adding a few dollars to your brokerage account.

How MEPs Can Help

Depending upon your Schaeffer's subscription, your trade recommendation may come with a maximum entry price (or minimum entry price, for option-selling recommendations), known as an MEP. If you're unable to enter a given trade at or below the MEP by the time the entry window closes, we advise that you skip it and wait for the next recommendation.

Fear & Greed: The 2 Deadly Trading Sins

Using an MEP lets you maintain control over your entry costs and breakeven on the trade. And when entry costs get away from you, as can happen when trading a fast-moving stock, you need proportionally bigger gains out of the options trade to recoup your initial investment. Depending on how far and how fast the MEP is moving intraday, this can throw your initial risk/reward analysis significantly out of whack

Be sure to observe this guideline carefully, and consider it a "dealbreaker" for the trade if the MEP isn't achievable within the given trade window. We certainly will, and we won't be tracking that trade in our portfolio.

What to Expect When You're Expecting Trades

Whether your first trade is set to arrive via email or text, it's sure to be an exciting day -- so make sure you're prepped and ready to act on that very first recommendation ahead of time.

Getting Ready for Greatness

Most crucially, confirm your account access in advance by logging into our website at schaeffersresearch.com:

- From our home page, click "My Account" in the top right corner.
- Enter your username and password in the fields provided.
- Your Schaeffer's services should appear under "My Products," organized by "Alert Services" (delivered in real-time, during market hours) and "Bulletin Services" (delivered on a set schedule, typically outside of market hours).

Need any help? Contact Customer Service via chat, email, or phone call for quick assistance with account log-in (pg 21).

Now, you're ready to receive your first trade!

What to Do When the Trade Arrives

Once the recommendation arrives, you'll get a link via email or text letting you know it's ready, depending upon your personal preference.

Clicking that link will take you directly into your Schaeffer's "My Account" portal, where you'll find:

- Our trader's research notes that led to the trade recommendation.
- Charts and visuals to support the case.
- Complete entry instructions, including entry window and recommended entry price, if any.
- Recommended exit parameters, for many of our bulletin service trades.

What to Expect When You're Expecting Trades

Once you have your trade details in hand from Schaeffer's, the ball's in your court!

Log into your trading app or forward the email to your broker; it's up to you. Enter the trade using our provided parameters, being especially careful to note the following:

- The recommended entry window for the trade (usually 1 or 2 trading days)
- Whether a maximum/minimum entry price is provided
- If a market order or limit order is advised

Market Orders vs. Limit Orders

Some of our Schaeffer's subscriptions recommend the use of market orders, while others prescribe the use of limit orders. Read your trade recommendation carefully to see what our research team advises:

The market order is a very broad direction to your broker to buy (or sell) to open the options in question. The primary advantage here is speed, since there are no restrictions placed on the entry price. Most market orders will be filled the same day, and often quite quickly.

However, since the trade will be executed at the prevailing market price, you do lose some control over the cost of entry. This can be a disadvantage if the underlying stock is moving rapidly, or in the event of an overnight gap move.

The limit order specifies a given price at which you're willing to buy (or sell) to open the option contract(s). When buying to open, you'll generally provide a maximum entry price, and the trade order will not be filled unless your broker can do so at or below this stated price. When selling to open, conversely, you'd provide a minimum entry price, and the order would not be filled unless your broker can collect an amount equal to or greater than this premium per contract.

What to Expect When You're Expecting Trades

The primary advantage of the limit order is the ability to maintain tight control over your entry price. On the downside, you may have to wait longer than you'd like for the order to be filled -- or, if the stock doesn't cooperate, your order may be filled either partially or not at all.

What's Next?

After placing your trade, simply wait for the stock's expected move to play out. We'll be in touch again soon with follow-up instructions on the trade, and/or with your next trade recommendation!

And in the meantime, we're always here to address your questions or concerns. Contact Customer Service every day the market is open from 8:30 AM to 5:30 PM Eastern, using either our toll-free number at 1-800-448-2080, or the chat box on our website. For after-hours or non-urgent requests, please drop us a line at service@sir-inc.com.

Quick Options Reference Guide: *Advantages of Stock Options*

If you've never traded options before, you might be wondering why you should start. The simple truth is that options offer several appealing advantages over stocks -- even for true rookies who are just playing straightforward call- and put-buying strategies. Here are four advantages of stock options that might convince you to try your hand at calls and puts.

Low Cost of Entry

This is simple arithmetic: options are cheaper to buy than the stocks from which they derive their value. If a stock is trading at $50 per share, it would cost you $5,000 to buy 100 shares. By contrast, one at-the-money call option affording you control of 100 shares might cost $200. Whether you've purchased 100 shares or one call option contract, you're long 100 shares of the stock. However, when you buy the option rather than the stock, you lower your cost of entry dramatically. As a result, you're not only risking less, but you're also leaving more investing capital free for other opportunities.

Leverage

That lower cost of entry provides a great segue into our next options-related benefit: leverage. Because an option is cheaper to buy than the equivalent amount of stock, there's greater potential for impressive percentage gains on your investment. Again, this is just basic numbers -- it's simply a lot easier to double your money on a $200 investment than a $5,000 investment.

Limited Risk

The uninitiated might incorrectly assume that options are inherently risky. Myths abound regarding the potential pitfalls of options trading, and the very mention of the word "derivatives" is enough to give some investors bad flashbacks to to the financial crisis of 2008. However, if you're buying puts and calls, you're actually risking less capital than if you traded the stock directly. In a basic option-buying strategy, your maximum potential loss is limited to the initial amount you paid to buy the contract(s). Yes, you do risk losing 100% of your investment if the trade should turn against you. However, to return to the above hypothetical -- if the stock tanks to zero, you'd probably rather take a 100% loss on your $200 call option than a 100% loss on your $5,000 worth of shares.

Flexibility

For the most part, stock traders have two choices: long (bullish) or short (bearish). Conversely, options players have a wide variety of strategies at their disposal. Calls and puts can be combined in myriad different ways to profit from any type of price action: bullish, bearish, sideways, and anywhere in between.

Seasoned speculators might ignore price action altogether, and instead use options to profit from dividend payouts or changes in implied volatility. Plus, options can be sold to generate income on existing stock positions, or to set the cost of entry on a planned share purchase. Rather than limiting yourself to the stark black-and-white palette of stock trading, you can use options to fine-tune your approach for any market environment.

Quick Options Reference Guide: *Uses of Stock Options*

As you may already be aware, calls and puts can be used to place bullish or bearish bets on an underlying stock. However, there are several compelling reasons to add stock options to your portfolio, even if you're not trying to target a time-sensitive directional move in the shares. While there are many different uses of stock options, most traders are pursuing one of these three goals: speculation, hedging, and generating income.

Speculation

Stock options can be used to speculate on the future price direction of the underlying shares. Traders predicting positive price action may want to buy calls or long call spreads, while puts and put spreads can be used to capitalize on a stock's expected decline.

What's more, calls and puts can be combined in various configurations -- including straddles and strangles, for example -- that allow the trader to benefit from a sharp move in either direction...or, for that matter, a period of complete stagnation in the underlying shares.

Whether the stock is expected to move up, down, or sideways, there's a viable option strategy that can be used to profit from that particular scenario.

Hedging

Due to their classification as derivatives, options occasionally get a bad rap as "risky" investing vehicles. However, options are actually a crucial tool in guarding a stock portfolio against the volatile ups and downs in the market.

To cite a popular example, put options can be purchased against existing long stock positions to lock in a favorable exit price on the investment.

Quick Options Reference Guide: *Uses of Stock Options*

Depending upon the strike price selected, these "protective puts" can be used to limit losses, or even to guard some unrealized paper profits. Traders can also hedge their portfolios more broadly by purchasing puts on index-based exchange-traded funds (ETFs), such as the SPDR S&P 500 ETF (SPY) or iShares Russell 2000 Index Fund (IWM).

Inverting this paradigm, short sellers can buy call options to limit their upside risk, or to lock in paper profits on a winning bearish trade.

Generating Income

During periods of relatively quiet price action, options offer a number of ways to boost your bottom line with premium-collecting strategies. Perhaps the best-known of these is the covered call strategy, wherein an investor sells (or writes) call options against a stock in his portfolio. The sale of the call results in an immediate credit, allowing the trader to profit from an otherwise lifeless equity.

More seasoned investors can use stock options to play credit spreads, which profit from a stock's sideways price trend. These two-legged spreads can be constructed with either puts or calls, with the trader simultaneously selling a higher-priced option and buying a lower-cost option on the same underlying stock. The ultimate goal is for both options to expire worthless, allowing the trader to retain the initial credit received as his or her maximum profit.

Quick Options Reference Guide: *Leverage*

In the mechanical world, a lever is a tool that allows you to amplify the amount of force you exert without expending extra effort. In the same manner, options afford traders the benefit of leverage -- that is, options allow you to amplify your potential investing returns by minimizing the amount of capital you commit to the trade upfront.

A call or put option is a derivative asset, typically based on 100 shares of the underlying stock. So, when you buy a call option, you're not buying 100 shares directly; you're simply buying a contract that affords you control of 100 shares of that stock. As such, option contracts are cheaper to buy than the same number of shares from which they derive their value.

As it pertains to options, leverage is probably best explained through an example:

With XYZ trading at $25 per share, it would cost $2,500 to buy 100 shares.

Meanwhile, a 25-strike call option on XYZ expiring in one month is asked at 0.75, which means a trader would pay $75 (0.75 x 100 shares) to buy one contract.

If XYZ rises to $30 per share by options expiration, 100 shares of stock would be worth $3,000. A trader who bought in at $25 could sell all 100 shares, and net a profit of $500 in the process ($3,000 - $2,500).

On a move up to $30, that 25-strike call option would carry 5 points of intrinsic value at expiration. After multiplying the ask price of 5.00 by 100 shares per contract, the option could be sold for $500. Since the contract was initially purchased for $75, that's a gain of $425.

Quick Options Reference Guide: *Leverage*

In this example, the call-buying strategy actually put $75 less profit in the trader's pocket

However, consider the return on investment: The stock trader netted $500, which is a gain of just 20% on the $2,500 he shelled out in the first place. On the other hand, the option buyer raked in $425, which represents a profit of 567% on his initial investment of $75.

In other words, options allow you the ability to capitalize on the same directional moves that benefit stock holders, but they require a proportionally smaller investment on the front end. Since option players are able to collect profits many times greater than the amount dedicated to the trade, it's safe to say the benefit of leverage is a major draw for veteran and aspiring options traders alike.

Quick Options Reference Guide: *Understanding Options Pricing*

Option pricing may seem complicated at first, as contract values are derived from a few different factors. Specifically, option premiums are based on the Nobel Prize-winning Black-Scholes model, which considers multiple variables to arrive at a fair price. Specifically, the calculation weighs:

- The price of the underlying stock, assuming constant drift and volatility
- The strike price of the option
- The amount of time until the option expires.
- A constant, risk-free interest rate

The Black-Scholes option pricing model does not account for dividends. In the case of dividend-paying stocks, the pricing formula is adjusted to account for these payouts. Scheduled dividend payments lower the value of call options, and raise the value of put options.

To break it down in very simple terms, option pricing consists of two main components:

- Intrinsic value
- Time value (or "extrinsic value")

Only in-the-money options carry intrinsic value, which is equal to the difference between the current stock price and the strike price of the option. The remainder of an in-the-money option's premium is the contract's time value.

Meanwhile, at-the-money and out-of-the-money options have no intrinsic value, so their entire worth consists of time value. Time value is based primarily upon two factors:

- Time until expiration
- Implied volatility

Time value will erode at an increasing rate until it finally dwindles to zero upon expiration. This decline in extrinsic value is known as "time decay." So, if an option remains at-the-money or out-of-the-money through expiration, its value will eventually diminish away to nothing.

Upon expiration, an option is worth only as much as its remaining intrinsic value, if any.

Quick Options Reference Guide: *Expiration, Assignment, and Exercise*

There are a few different ways your stock options can meet their logical end. In many options strategies, it might make sense for you to buy to close or sell to close your option contract(s). However, there are also scenarios where you might prefer to let your contracts expire worthless, or even exercise your option to buy or sell the underlying stock. Here's our beginner's guide to options expiration, assignment, and exercise.

Options Expiration

If you're trading traditional monthly equity options, expiration will fall on the Saturday following the third Friday of each month. Weekly options are typically listed each Thursday and expire on Friday of the following week (although no weeklies are offered during the expiration week for monthly options). In both cases, that final Friday is your last chance to take action on the trade. Otherwise, the market will decide your course of action for you.

If your option is out-of-the-money on expiration Friday, you might simply choose to let the contract expire worthless. There will be very little time value remaining at this point for you to capture, so it's probably not worth the additional brokerage fees and commissions for you to sell to close. If you take no action to close an out-of-the-money option prior to expiration, it will expire worthless. No further action is required on your part to exit the trade.

In fact, there are a number of strategies where the best-case scenario involves your options expiring worthless -- including multiple premium-selling tactics, such as the short put spread and short call spread. In these strategies, you collect your maximum potential profit upfront, so the ideal outcome is for all of the options involved to remain out-of-the-money through options expiration.

Quick Options Reference Guide: *Expiration, Assignment, and Exercise*

Assignment

As noted above, when you take up the selling end of an options trade, you'd most frequently like to see the contracts expire worthless. However, if your sold options move into the money by expiration, you are at risk of assignment. This means the buyer on the other end of the transaction may exercise their option for you to either sell (in the case of a call) or buy (in the case of a put) shares of the underlying stock at the strike price of the contract.

If your call option or put option is hedged -- either with cash or shares -- the transaction can be completed with relatively little hassle. However, if you've written naked calls or puts, assignment can be an unwelcome expense. When selling options, always bear in mind the possibility of assignment, and be sure you've planned for such an occurrence.

There's at least one scenario where assignment is your ultimate goal: with the cash-secured put. In this strategy, a trader sells to open put options on a stock he'd like to acquire, aligning the strike with his preferred entry price. Simultaneously, the trader sets aside sufficient capital to buy shares at the strike price of the option. A premium is collected from the sale of the option, which can be used to partially offset the cost of entry on the trade. If the stock falls below the strike price by expiration, the trader welcomes assignment as the chance to buy into a stock he likes on a dip.

It's worth noting that assignment is a possibility whenever your sold options move into the money. However, the risk of assignment increases exponentially as expiration draws closer. If you're short a call or put option that's in-the-money, and you doubt the trade will swing back in your favor by expiration Friday, you may prefer to buy to close your contract(s) in order to avoid an unwanted assignment.

Quick Options Reference Guide: *Expiration, Assignment, and Exercise*

Exercise

As an option buyer, you have the prerogative to exercise your call option or put option if it moves into the money by expiration. This means you have the right to either buy (for a call) or sell (for a put) shares of the underlying stock.

When you're holding in-the-money calls, you may choose to exercise if you're long-term bullish, and you'd like to acquire shares of the stock at a discount to current market prices. Alternately, if you're short the stock and using call options as a hedge, you can exercise the calls to lock in a maximum repurchase price on the shares.

As a put buyer, you can exercise your option to sell shares of the underlying stock -- which is particularly useful for traders who are long the stock and using protective puts to hedge. By selling shares at the strike price of the put, traders can ensure a minimum exit price on their stake, thereby protecting paper profits or limiting losses on their investment.

Option buyers should be aware that all in-the-money options will be automatically exercised by the close of trading on expiration Friday if no other action is taken to close out the trade. If you'd prefer to unwind the trade by some other means, be sure your broker has the correct instructions.

Quick Options Reference Guide: *Basic Option Terms*

Adjustment| An alteration to the terms of an option contract due to events such as a stock split or a stock dividend.

Ask Price| The lowest price a seller is willing to accept for a security (also called the "offer price" or simply the "ask").

Assignment| The receipt of an exercise notice by an option seller (writer) that obligates him or her to sell (in the case of a call) or purchase (in the case of a put) the underlying security at the specified strike price.

At-the-Money| A call or put option is "at the money" if its strike price is equal to or very near the market price of the underlying security.

Automatic Exercise| A procedure whereby the Options Clearing Corporation (OCC) automatically exercises an expiring in-the-money option on behalf of the option holder.

Back-Month| Any option series other than the current front-month series.

Bid/Ask Spread| The difference in price between the latest available bid and asked quotations for a particular option contract.

Bid Price| The highest price a buyer is willing to pay for a security (also referred to as simply the "bid").

Black-Scholes| An option-pricing model that factors in the current stock price, strike price, time until expiration, level of interest rates, and volatility of the underlying security.

Exercise| The process by which an option holder/owner invokes the terms of the option contract. To exercise, call owners will buy the underlying stock, while put owners will sell the underlying stock under the terms set by the option contract.

Quick Options Reference Guide: *Basic Option Terms*

Expiration Date| The date on which an option and the right to exercise it expire. For equity options, this is the Saturday following the third Friday of the month.

Expiration Friday| The last trading day prior to an option's expiration date on which an option may be purchased or sold. If Friday is an exchange holiday, the final trading day will be the preceding Thursday.

Front-Month| The next class of futures or options contracts set to expire.

Greeks| A set of measurements to determine the sensitivity of an option's price to a number of underlying variables.

Implied Volatility| The assumption of the stock's volatility that helps determine the option's price.

In-the-Money| An option is in the money when it has intrinsic value. A call is in the money when the market price of the underlying stock is greater than the option's strike price. A put is in the money when the market price of the underlying stock is lower than the option's strike price.

Intrinsic Value| The difference between an in-the-money option's strike price and the current market price of the underlying security.

LEAPS| Long-term Equity AnticiPation Securities are put or call options with expiration dates set as far as three years into the future.

Leverage| The control of a larger number of shares with a smaller amount of capital.

Open Interest| The number of outstanding option contracts on a given series for a particular underlying stock.

Quick Options Reference Guide: *Basic Option Terms*

Out-of-the-Money| This describes an option that has no intrinsic value. A call option is out of the money when the strike price is higher than the market price of the underlying security. A put option is out of the money when the strike price is below the market price of the underlying security.

Rolling Out| Substituting an option of the same class and strike price with one expiring at a later date.

Rolling Up/Down| Substituting a call option of the same class and expiration with one of a higher strike price (or a lower strike price, in the case of rolling down a put).

Series| All option contracts of the same class that have the same unit of trade, expiration date, and exercise price.

Strike Price| The stated price per share for which the underlying stock may be purchased (in the case of a call) or sold (in the case of a put) by the option buyer (holder) upon exercise of the option contract.

Spread| A position involving two or more different options on the same security.

Time Decay| The nonlinear loss of value in an option over time when all other factors are constant. Time decay is quantified by theta.

Time Value| The difference between the total cost of an option premium and its intrinsic value. Out-of-the-money options consist solely of time value.

Volatility| The propensity of the market price of the underlying security to change in either direction.

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