

Option Trading Series – eBook 1 of 8

INTRODUCTION TO OPTIONS



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About the author

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Emmanuel has over twenty-five years experience in financial markets, including equities, CFDs, options and futures. Emmanuel started his career with Société Générale in Paris, then with Citibank, Jefferies, Brown Brothers Harriman in London in equities, options and fixed-income trading before joining Internaxx Bank (now Swissquote Bank Europe) in Luxembourg.

Emmanuel is a member of the Client Services team of Swissquote Bank Europe, where he works closely with clients and team members to service the advanced trading needs of our most active clients.

Hello and welcome to this training on options.

Options are a rather complicated financial product, and can be very risky. But if you gather sufficient knowledge about them, you should be able to use them to your advantage in a surprisingly diverse range of strategies.

This training is aimed at beginners. If you know nothing or very little about options, but you're curious about the possibilities for profit offered by this product, then you've come to the right place!

Options are a derivatives product, which means that they derive their price from an underlying financial asset. They exist on a wide range of securities, such as stocks, bonds, indices, and commodities. For the sake of simplicity, our examples will mostly cover options (calls and puts) on equities, i.e. stocks. We will use examples using real stocks and real options prices. Please note: these are just examples to help you understand how they work, and should not be considered financial or trading advice.

(Because of their inherent complexity, options will be available to Swissquote customers after they have passed a knowledge test. If you would like to take the test, please contact the Swissquote Client Services department, they will provide you with it.)

Our first goal will be to understand the basics of call and put options, as well as the variables that comprise them. We will explain the concepts which will make clear how options work for investors. We will then explore a few different options trading strategies, and we will make sure to take a moment to define their respective risk profiles. We will show examples using the Swissquote platform.

What we will not do, is talk about options pricing models, such as Black and Scholes, or discuss "The Greeks". If you would like to delve deeper into these topics, I'm sure you will be able to find great resources online or in books on options.

OK, so let's start with the definition of a call and a put option.

A call represents, for its buyer, the possibility, but not the obligation, to purchase for a limited time, a certain asset at a price that is set in advance.

Quantity	Call/put	Underlying (symbol)	Expiration	Strike price
1	Call	Swissquote (SQN)	December 2023	150

A put represents, for its buyer, the possibility, but not the obligation, to sell for a limited time, a certain asset at a price set in advance.

Let's take a look at all these variables.

Quantity

One option (either a call or a put) represents a set number of underlying shares. Often, one call or put represents 100 shares. One notable exception is options on UK stocks, which generally represent 1'000 shares.

Call or put

A call represents for its buyer the right to buy an underlying asset; a put represents for its buyer the right to sell an underlying asset – all for a limited time (see expiration).

Underlying (symbol)

This tells you what asset is represented. Stocks are often represented by a symbol, also called "ticker". For example, the symbol of the Swissquote stock on the Swiss exchange is SQN.

Expiration

Buying an option gives its buyer the right to buy or sell an asset, but for a limited time only. On a certain day, the option expires. We will discuss later the concepts of "in-the-money" and "out-of-the-money", and how they affect your options during their lifespan and on expiry date.

Strike price

The strike price is the price at which, during the lifetime of the option, its buyer is giving him-or herself the right to buy (for a call) or sell (for a put) the underlying equity. The relationship between the strike price of an option and the price of the underlying security is particularly important.

After you have bought a call option, you will want the difference of the stock price minus the strike to be as high as possible, as this will positively affect the price of your option. In other words, you will want to see the stock price move up. Buying a call is a "bullish" strategy, you are betting on the stock price moving up.

Conversely, after you bought a put option, you will want the difference of the stock price minus the strike, to be as negative as possible. A put option's price will move inversely to the underlying stock price.

If our call option on SQN with a strike price of CHF 150 is quoted at 2.30 CHF, while the stock price is about CHF 145, then buying one such option will cost you 230 CHF plus commission (and eventual exchange fees). In our example, buying a call on Swissquote with a strike of CHF 150 will give you the right, until a set day in December 2023, to buy 100 shares of Swissquote at a unit price of CHF 150. This will be particularly interesting to you if the price of this stock moves up after you buy the call, say to 165 CHF. Why? Because you will be able to buy 100 shares at the strike price, i.e. 150 CHF, and then, if you wish, sell these 100 shares on the market at 165 CHF. Your gross profit before commissions will be $(165 - 150) \times 100 = 1500$ CHF, minus the 230 CHF you paid upfront to buy the call. So a gross profit of 1270 CHF.

Actually, as profitable as this theoretical option trade was, it has a drawback: you need to have 15'000 CHF handy to be able to "use" your call (it is called to "exercise" the option).

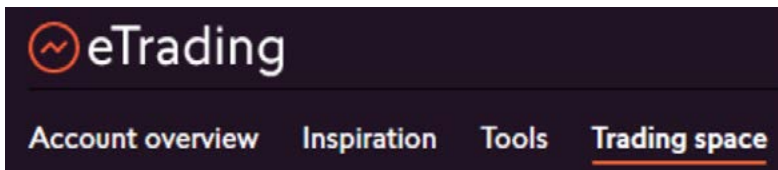
Well, the good news is that you do not need to exercise it to take your profit from this call: instead, you could just sell the call. Your profit will approximately be similar as the 1270 CHF we calculated earlier.

But how to find options on the Swissquote platform?

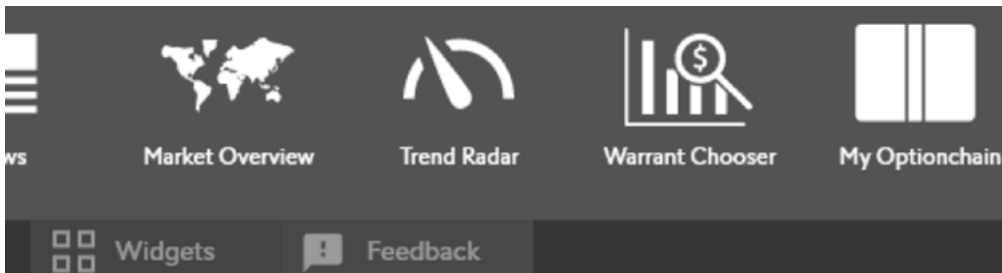
Let's find out, using a random stock on the Swissquote web platform.

For this example, we will find available options on Microsoft, symbol MSFT on the US Nasdaq market. Our first goal will be to find what options are available for this stock.

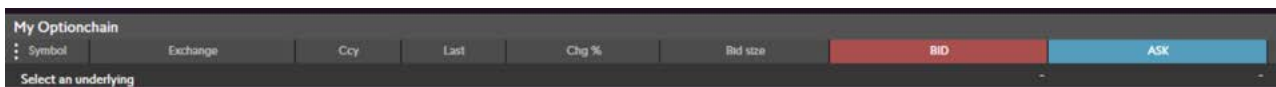
On your trading platform, first make sure you are on the Trading space.



Then select the "Widgets" icon at the bottom of the screen, and drag "My Optionchain" to the main part of the platform.



You will get a new table which looks like this:

The image shows a table titled "My Optionchain". The table has columns for "Symbol", "Exchange", "Ccy", "Last", "Chg %", "Bid size", "BID", and "ASK". The "BID" column is highlighted in red and the "ASK" column is highlighted in blue. Below the table, there is a text input field with the placeholder "Select an underlying".

Symbol	Exchange	Ccy	Last	Chg %	Bid size	BID	ASK
Select an underlying							

Click where it says "Select an underlying", and enter either Microsoft, or MSFT.

You will then need to select your underlying amongst a list. Make sure you click on the security next to "US/ Nasdaq National Market". This will bring you the options chain.

A large list of columns and prices will appear.

In our next session, we will learn how to read this new screen, and we will carry out our first options strategy: **"Buying a call to open"**.

Thank you for following our introduction!

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