

From:

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One of the hardest concepts traders face when entering the world of options for the first time, is realizing that the movements in the underlying stock price is NOT the only factor that influences profits and losses.

For example, say you bought XYZ stock at \$100 and then XYZ stock moved from \$100 to \$102, in order to calculate your profits you would just take your \$2 gain and multiply it by the number of shares you had. So, if you had 100 shares, we would take 100 and multiply it by \$2 to figure out what your profits are ($100 \times 2 = \$200$)

Pretty simple stuff...**Price Movement** is the ONLY thing that matters when you trade stocks or futures.

On the other hand, if you bought the \$100 call option and the price of XYZ stock went from \$100 to \$102 what would your profits be?

The answer is:

I DON'T KNOW...***There is even a possibility that this position could actually be a LOSER***

The reason is that when you trade options, price movement is *only one* of the factors that influence your profits and losses. In order to value an option you need to know ***the cost of carry, the risk-free interest rate, time to expiration, the volatility of the relative price changes to the underlying asset price, the strike price along with the price movement of the underlying assets price.***

Traders who are new to options need to understand this, and STOP thinking that price movement is the only factor that influences profits and losses.

Before jumping into trading options you should get a basic understanding of options pricing theory.

IN ORDER TO MASTER OPTIONS....YOU NEED TO KNOW THIS FIRST!!!



Option Basics:
Option Pricing Theory

