PHOENIX CAPITAL INVESTMENT RESEARCH

SPECIAL REPORT

OPTIONS 1-1-1

An Introduction to Options

For many investors options appear both confusing and highly risky.

There are two reasons for this:

1) Options involve investment terms most investors are unfamiliar with (strike price, premium, etc.).

2) Most options trading systems lose money, which leads investors to view options as highly risky.

Regarding #1, options are actually quite easy to understand once you grasp their terminologies.

As for #2, the fact of the matter is that it is the trading system, not the options themselves, that is risky. With careful position sizing and strict discipline, options trading can actually offer far greater gains with less capital at risk than traditional stock trading.

I'll outline exactly what options trading rules to follow and how to maintain investment discipline in our other investment guide ***Options 111 System Trading Guide***.

However, before we get into the important rules of options, trading, you first need to understand what options are and how they work.

At their core, options offer you the right (but not the requirement as I'll explain in a moment) to buy shares in an underlying security (usually a stock or an ETF).

There are two types of options: Calls and Puts.

Calls offer you the right to buy shares in an investment (a stock or an ETF) at a *higher* price in the future.

Puts do the exact opposite: they offer you the right to buy shares in an investment (a stock or an ETF) at a *lower* price in the future.

In their simplest form, options let you net that the company's share price will either rally (a Call Option) or fall (a Put Option).

Bear in mind, you are not actually *buying* shares in the company; all you're buying is the "right" to buy those shares at a specific price, called the **strike price**, in the future.

This is the part where most investors get confused. Everyone understands the concept of buying shares in a stock. But the idea of paying money for the "right" to buy shares at a particular price is confusing.

So let me give you an example.

Let's say there is a company called ABC Company that is currently trading at $50.00 per share.

You believe that ABC shares are undervalued and should rally to $55. But instead of buying shares of ABC at $50 today, you buy ABC's $50 call options. The price of these options contracts is called the **premium.** In this example let's say that the premium (price) of for the ABC calls is $1 per share.

So in this situation, your **premium** is $1 and the **strike price** or price at which you can buy ABC shares based on your calls is $50.

What you've just done is pay $1 for the right to buy shares in ABC's stock for $50 at a future date. So if ABC's shares *do* rally above $50, then the right to buy these shares at $50 becomes worth *more*.

For example, let's say that ABC's stock *does* rally to $55 per share. In this scenario, the Call Options you bought for $1 should increase in value to $5 or so (if ABC shares trade at $55, someone would be willing to pay you $5 for the right to buy them at $50).

So instead of making 10% by buying ABC's stock (you buy at $50 per share and ABC shares rally to $55) you end up making **400%** by trading its options (you paid $1 for ABC calls which then rallied to $5 as ABC shares increased from $50 to $55).

So you actually made a *greater gain* (400% vs. 10%) by risking *less money* ($1 for ABC calls premiums instead of $50 for ABC shares themselves).

This is the power of options: the ability to see big gains by risking smaller amounts of capital.

Now, there's one more component to options: "expiration" or the date at which the option contract expires.

You see, options don't run forever; instead they expire at a set date in the future. So when you buy an option, you are buying the right to buy in a company at a set date in the future (it could be a few weeks away, a month away, several months away, or even several years away).

When the expiration date hits, you have a choice, you can either exercise your "right" to buy the shares at the **strike price**, *or* you can let your options expire, which means you lose the money you paid for the premium (nothing else).

Remember how I mentioned before that options represent the right but not the requirement to buy shares in an investment? This is what I meant, you don't *have* to buy the shares, you can simply let your options expire at their expiration date (usually the third Friday of every month).

However, all of this only applies if you hold your options to expiration. Up until expiration, you are trading options based solely on the movements their **strike prices***.*

With ***Options 111*** we *NEVER* hold options until expiration. But I wanted to explain this concept to you because you will inevitably run these terms at some point in our trading (I'll be mentioning expiration dates and the like).

So we've covered the **premium**, the **strike price**, and the **expiration date**. Now let's discuss how options contracts are listed on the exchanges.

This is the part most investors find confusing. Everyone understands how stock symbols work, for example, ABC company will likely have the stock ticker, ABC.

However, in the case of options tickers, you need to include:

1) The underlying security the option is trading
2) The expiration date
3) The strike price
4) Whether it's a put or a call

That's quite a bit of information. So let's take a look at a real world example of a recent trade that ***Options 111*** made.

FXI Sep 2013 35.000 put

In this case, the particular option is a **Put** option for the ***China ETF (ticker: FXI)*** with an ***expiration date*** of ***September 2013 (likely the third Friday of the month)*** and a ***strike price of $35.00.***

Put another way, this option constitutes a bet that FXI shares will fall, likely to or below $35 per share, by their expiration date on the third Friday of September 2013.

At the time of this writing, this particular option is trading at a **premium** of $0.73 per contract. That's how much it would cost you to buy 1 contract of this option.

Based on this contract, if FXI falls from its current level between now and the third Friday of September 2013, this Put option will rise in value.

Indeed, this was precisely the case with our recent trade at ***Options 111***: we bought this option

on August 20th 2013 at 11:18AM when its **premium** was $0.71 per contract.

Over the next day, FXI fell 1.4% in value. As a result of this, our **FXI Sep 2013 35.000 puts** jumped dramatically in value and we sold this position the next morning at 9:39AM at **premium** of $0.95.

Put another way, we used options, specifically Puts, to turn a 1.4% drop in FXI into a 33% gain.

This is why this newsletter is called ***Options 111***: we make one trade… on one option… once per week… to see HUGE profits.

I've done my best to explain how options work, but I realize that all of can sound confusing given that there are a lot of issues involved. So I want to take a moment to review the key concepts here.

In terms of how options work, there are three key terms:

1) **Premium**: the price it costs to buy an option contract.

2) **Strike Price**: the price at which you have the right to buy an underlying security.

3) **Expiration Date**: the date at which the option contract expires.

With that in mind… let's review the key concepts with options.

1) An Option represents the right (but not the requirement) to buy shares in an underlying security at a given price.

2) There are two types of options: Calls (bets the underlying security will rise in value) and Puts (bets the underlying security will fall in value).

3) When you trade an option, you are trading it based on its **premium** or the price of the option's contract. This is the case until the option expires on its **expiration date**.

4) ***Options 111*** does not hold options to expiration, so we are trading options simply based on price movements in the **premiums**.

In order to make the trades suggested in ***Options 111*** you need to have funds with a broker that can trade options in the **China ETF (ticker: FXI).**

Most online discount brokers can do this including:

1) Ameritrade (https://www.tdameritrade.com)

2) Charles Schwab (https://www.schwab.com)

3) eTrade
(https://us.etrade.com/home)

4) Interactive Brokers
(https://www.interactivebrokers.com)

5) Scottrade
(https://www.scottrade.com)

… and others.

There are also specific brokers who specialize in trading options. These include:

1) Think or Swim
(https://www.thinkorswim.com)

2) OptionsXpress
(https://www.optionsxpress.com)

This concludes this Special Report. For an outline on how the ***Options 111*** system for trading options works… as well as the THREE CARDINAL RULES of successful options trading… please see our ***Options 111 System Trading Guide*** at the ***Options 111*** subscribers only website:

http://phoenixcapitalresearch.com/options111/

Yours in Profits

Graham Summers
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Options 111

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