## What is a Put and Call Option

To mitigate risk, many successful investors turn to options as an alternative to investing directly in a security. Options' investing as the name suggests gives the investor the rights to either buy or sell a security (e.g. stocks, ETF's, market indices, etc.) at some future point, while at the same time limiting capital outlays for a position.

### What Are Calls and Puts?

Understanding options begins with a discussion of the two different types available; calls and puts.

*Call Options* – Calls allow an investor to purchase a security from an option seller at a specified price on or before a fixed date. Call option prices have a direct relationship with the price swings on the underlying security. When the security price rises the option price rises and vice versa.

*Put Options*- Puts allow an investor to sell a security to the option seller at a specific price on or before a fixed date. Put options have an inverse relationship with the price swings on the underlying security. When the security price rises the option price loses value and when the security price drops the put option gains value.

### Elements of Options Contracts

Here is some contract terminology that must be understood to become a successful options investor.

*Strike Price*- The fixed price at which the owner of the option can buy (call option) or sell (put option) an underlying security or commodity.

*Expiration Date*- The last day that an options contract is valid. If the investor does not exercise the contract on or before the expiration date, the option becomes worthless. The expiration date for listed stock options in the United States is normally the third Friday of each contract month.

*Contract Size*- The deliverable quantity of the underlying security per contract. Stock options contracts are typically 100 shares.

### An Options Example – How Contracts Work

Here's a hypothetical investment scenario. Apple, Inc. is releasing the latest iPhone, and you believe the release will boost the company's stock price. Apple is currently trading at $100 and you would like to participate in a stock price increase while limiting your investment outlay.

You could buy a six-month option to purchase 100 shares of Apple at $110 for $3 per share. You would pay approximately $300 for a call option ($3 per share times 100 shares), which gives you the right to purchase 100 shares of Apple anytime in the next six months at $110 per share.

If sales go better than expected and the price increases to $125, your contract would be "in the money." You can exercise the contract and net $1,200 ($15 profit per share less the $300 option investment). You can also profit by selling the option on the market and realizing a similar gain.

If, sales of the new iPhone tank and the share price never reaches $110, your option expires "out of the money" and your loss would be limited to your original $300 investment.

Compared to the $10,000 required to buy 100 shares outright, you can see that buying the option allows you to participate with less capital exposed.

Options are a useful tool for this type of investment play. They open the door to larger investment opportunities without placing significant sums of money in jeopardy. If you are new to options, make sure that you consult a professional and understand the risks.