Perspectives: Option Visualization

We have spent this mini-course learning more details about options by means of two methods for visualizing their risk / return characteristics: the range of exposure method and the hockey stick method.

The difference between these two visualization methods is born from a difference in investment strategies and perspectives. The range of exposure method views options more from an investor perspective, whereas the hockey stick method views them from the perspective of the “inventorier” groups we discussed in the Introduction to Options mini-course.

Investors, as personified by these stately gents here, implicitly believe that assets’ market prices can vary from some true, intrinsic value. In these cases, they want to expose themselves to directionality, and in fact the only way to make excess returns is by doing so. Even the most trade-oriented investor here – George Soros – still has a relatively long investing time horizon.

In contrast, inventoriers, as personified by this frenetic looking group of gents, don’t necessarily hold a view about the value of assets, but see that sometimes, there are economically exploitable market dislocations that allow them some profit if they are quick on the uptake. These dislocations are fleeting, so inventoriers seek to protect themselves from exposure to too much directionality and time horizons are relatively short – on the order of minutes, hours, or days.

The range of exposure diagram is well-suited to the needs of investors because it allows for a comparison between the price and the value of an asset, highlights the directionality to which an investor is exposed, and importantly illustrates for how long that exposure will last.

Vocabulary

No new vocabulary