

Prices & Pricing Sample Lesson

Now that we understand how to read the first few columns of a pricing screen, let's figure out how to visualize those prices in terms of the range of exposure methodology that we introduced in the Option Basics mini-course.

We are again looking at the options for Target, trading on February 14, 2018. Let's turn our attention to this call option struck at \$75.00 and expiring on March 16, 2018. We see that the bid price is \$3.00 and the ask price is \$3.05 per share.

Let's imagine buying this call option first and graphing out the position's range of exposure and Effective Buy Price.

The option expires on March 16th, so we know that our range of exposure will extend only this far. A call option represents the upside potential of the stock, so we know that we are looking at the upside above the \$75.00 strike price. We have assumed a purchase, which means we gain exposure to that upside potential and that the shading is green.

By process of elimination, we have determined our range of exposure for this option. Now, recall that the option was priced at 3.00 bid / 3.05 ask. Since we are buying the option, we will buy at the ask price – \$3.05. With this transaction, we have effectively bought the stock at the \$75 strike price plus the \$3.05 ask price, so our effective buy price works out to be \$78.05.

The order here would have been “Buy to Open one March 16, 2018 call option struck at \$75.” The exchange will record this as a trading volume of 1 contract, increasing the number of open contracts by 1.

Vocabulary

N/A