

**CBOE** : THE OPTIONS  
: INSTITUTE<sup>SM</sup>



# 10 Common Myths About Options

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- Listed options were introduced in the US by the CBOE in 1973
- Since the exchange was established, there have been myths regarding the option market
- For 38 years, the CBOE has been trying to clear up these misunderstandings

Myth –

Options are only for speculators.

Reality –

Many professionals use options  
for portfolio protection.

Options may be used as insurance policies.

Options make investors think differently.

Example –

Long 100 Shares of XYZ @ 41.50  
Concerned about XYZ over next 30 days.

Buy 1 XYZ 30 Day 40.00 Put @ 1.00

## Example Outcome –

XYZ @ 35.00 at expiration.

Loss of 6.50 on XYZ Shares

Gain of 4.00 on 40.00 Put

Net loss = 2.50 instead of 6.50

Myth –

Options are risky because they use leverage.



Reality –

Options may be used in non risky ways.

The key is capital management.

Example –

QRS @ 38.50

Bullish on QRS for long term.

Worried about QRS over near term.

Don't want to 'miss' stock.

Buy 1 QRS 15 Day 40 Call @ 0.75

## Example Outcome –

15 Days Later

QRS @ 30.00 (down 8.50)

Loss on 40.00 Call = 0.75

0.75 loss buying call versus  
8.50 loss if shares had been purchased

Myth –

Options are only for short term trading.

Reality –

Options may be used with a long time horizon.

Many stocks have options with well over a year  
until expiration.

Example – May 10, 2011 –  
U.S. Steel Option Expiration Dates –

May 20, 2011

June 17, 2011

July 15, 2011

October 21, 2011

January 20, 2012

January 18, 2013

Myth –

90% of options expire with no value.

Reality –

The majority of option contracts are closed out before expiration.



Example\* –

Less than 10% of options assigned.

About 20% of options expire with no value.

About 70% of options positions are closed out before expiration.

\*Options Clearing Corporation – 2010 Statistics

Myth –

Only sellers of options make money.

Reality –

As noted in Number 4 more contracts are closed out before expiration.

The truth is option buyers and sellers can profit from option trading.

Logical Explanation –

If only sellers made money,  
there would be no buyers.

With no buyers there would be no market.

Myth –

The market makers can not be beat.

Reality –

Market makers trade as arbitrageurs.

Their primary function is to provide liquidity to the marketplace.

Example –

Market Maker Posts Following Quote –

XYZ Apr 40.00 Call – 0.90 x 1.00

Customer pays 1.00 for option.

Market Maker sells at 1.00.

Market Maker hedges position for small gain.

Example –

April Expiration - XYZ @ 45.00

Customer makes 4.00 on trade.

Market Maker unwinds hedge for small profit.



Myth –

Covered calls force you to sell winners and hold losers.

Reality –

Stock may be called away if price is higher than strike.

If called away shares may be repurchased.

Short call option may be covered to avoid assignment.

Example –

Long XYZ @ 43.50

Sell 1 XYZ 30 Day Call @ 1.50

25 Days Later

XYZ @ 45.50

Buy Back 1 XYZ 30 Day Call @ 1.00

Still long stock – small profit of short call trade

Myth –

Trading options is a zero-sum game.

Reality –

Options may be used as insurance policies.

They are more like risk management tools than trading vehicles.

Example –

Long 100 XYZ @ 43.00

Willing seller of XYZ @ 45.00

Sell 1 XYZ Jun 45.00 Call @ 1.00

Example –

June Expiration – XYZ @ 50.00

Stock called away at 45.00 (2.00 gain)

Income from selling call 1.00 (1.00 gain)

3.00 profit on trade

Myth –

Selling puts is risky.



Reality –

Put selling has been shown to be an excellent method of owning stock.

Through selling puts an investor takes on the obligation to buy shares.

Example –

XYZ @ 38.50

Willing owner of XYZ @ 35.00

Sell 1 XYZ Apr 35.00 Put @ 1.00

Example Outcome –

April Expiration – XYZ @ 34.00

Assigned on short put position  
Long 100 shares of XYZ.

Myth –

Option positions must be constantly monitored.

Reality –

Any investment should be regularly checked.

Option positions should be monitored as regularly as other investments.

- As long as option trading has been around there have been common misperceptions
- Options are a tool that may be used to control risk and potentially enhance returns
- Now you can help us in clearing up some of these myths