Module 13 · Printable reference

Options Trading Fundamentals

Key concepts, worked examples and risk reminders. Use alongside the full free course.

153 Options contracts

An option gives its buyer a contractual right under specified terms; the writer assumes obligations.

Example: A call strike 100 has expiry intrinsic value 10 when underlying ends at 110.

Check: Which side pays the premium when opening a long option?

Answer: The buyer.

Caution: Premium and settlement terms affect actual results.

154 Call options

A long call has expiry profit/loss max(spot minus strike, zero) minus premium.

Example: Strike 100 premium 5 spot 112 yields profit 7 per unit.

Check: Strike 100, premium 5, expiry spot 103: profit?

Answer: −2 per unit before costs, despite being ITM.

Caution: The entire premium can be lost.

155 Put options

A long put has expiry profit/loss max(strike minus spot, zero) minus premium.

Example: Strike 100 premium 4 spot 90 yields profit 6.

Check: Strike 100, premium 4, expiry spot 98: net?

Answer: −2 per unit before costs.

Caution: A put may expire worthless.

156 Moneyness

Moneyness compares spot with strike for calls and puts.

Example: Spot 110 strike 100 means call ITM and put OTM.

Check: A put strike 100 with spot 105 is what?

Answer: Out of the money.

Caution: ITM does not mean profitable after premium.

157 Intrinsic and time value

Premium can be separated into intrinsic value and remaining extrinsic value.

Example: Call spot 110 strike 100 premium 13 has intrinsic 10 and extrinsic 3.

Check: Call strike 100, spot 110, premium 13: extrinsic?

Answer: 3 under the simple decomposition.

Caution: Quotes may be stale; check executable prices.

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158 Option chains

An option chain lists strikes, expiries, prices and other contract data.

Example: Compare bid and ask for two strikes of the same expiry.

Check: Does large call OI prove traders expect a fall?

Answer: No; each open contract has both a buyer and a seller.

Caution: Open interest is not a directional forecast.

159 Implied volatility

IV is the volatility input that matches a quoted option price under a model.

Example: A higher call premium with other inputs fixed generally implies higher IV.

Check: What does a higher IV mean, all else equal, for a conventional long vanilla option?

Answer: Its model value generally rises.

Caution: IV is model-dependent and not guaranteed future volatility.

160 Delta

Delta approximates option price sensitivity to a small underlying move.

Example: Delta 0.5 suggests about 0.5 change for a one-unit underlying rise, other things fixed.

Check: Put delta −0.4, underlying rises 2: approximate change?

Answer: −0.8 per unit, other inputs unchanged.

Caution: Delta changes with price, time and volatility.

161 Gamma

Gamma describes the sensitivity of delta to underlying price.

Example: Gamma 0.02 suggests delta rises about 0.02 for a one-unit move.

Check: Delta 0.5, gamma 0.02, spot rises 2: approximate new delta?

Answer: 0.54, assuming locally constant gamma.

Caution: Near expiry sensitivities can change sharply.

162 Theta

Theta measures model sensitivity to passage of time under stated conventions.

Example: Daily theta -0.20 suggests a 0.20 decline with other inputs fixed.

Check: Daily theta −0.20 for two days: linear estimate?

Answer: −0.40 per unit, all else fixed; actual theta changes over time.

Caution: Actual price changes also depend on spot and volatility.

163 Vega

Vega measures sensitivity to implied volatility.

Example: Vega 0.15 per volatility point suggests 0.30 change for two points.

Check: Vega 0.15 per point, IV falls 3 points: approximate change?

Answer: −0.45 per unit, all else fixed.

Caution: Check whether the quote uses percent or decimal units.

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164 Expiry and settlement

Option exercise and settlement depend on contract specifications.

Example: A cash-settled call with positive intrinsic value may settle in cash under its rules.

Check: Why verify settlement even when a payoff diagram shows profit?

Answer: Actual delivery, cash and margin obligations may differ from a simplified payoff.

Caution: Physical delivery obligations may apply to some contracts.

Further reading

SEBI investor education: investor.sebi.gov.in · NSE: nseindia.com. References for background only; no endorsement or independent validation is implied.

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