

FRANS DE WEERT

AN INTRODUCTION TO  
**OPTIONS  
TRADING**



SECURITIES &  
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INSTITUTE

# AN INTRODUCTION TO OPTIONS TRADING

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Frans de Weert



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Frans de Weert



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*To Jan and Annelies*



# CONTENTS

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|   |           |
|---|-----------|
| <i>Preface</i>                                  | xiii      |
| <i>Acknowledgements</i>                         | xv        |
| <i>Introduction</i>                             | xvii      |
| <b>1 OPTIONS</b>                                | <b>1</b>  |
| 1.1 Examples                                    | 3         |
| 1.2 American versus European options            | 7         |
| 1.3 Terminology                                 | 8         |
| 1.4 Early exercise of American options          | 13        |
| 1.5 Payoffs                                     | 15        |
| 1.6 Put–call parity                             | 16        |
| <b>2 THE BLACK–SCHOLES FORMULA</b>              | <b>21</b> |
| 2.1 Volatility and the Black–Scholes formula    | 28        |
| 2.2 Interest rate and the Black–Scholes formula | 29        |
| 2.3 Pricing American options                    | 31        |

---

|          |   |           |
|----------|---|-----------|
| <b>3</b> | <b>DIVIDENDS AND THEIR EFFECT ON OPTIONS</b>            | <b>33</b> |
| 3.1      | Forwards  | 34        |
| 3.2      | Pricing of stock options including dividends            | 35        |
| 3.3      | Pricing options in terms of the forward                 | 36        |
| 3.4      | Dividend risk for options                               | 38        |
| 3.5      | Synthetics  | 39        |
| <b>4</b> | <b>IMPLIED VOLATILITY</b>                               | <b>41</b> |
| 4.1      | Example   | 44        |
| 4.2      | Strategy and implied volatility                         | 45        |
| <b>5</b> | <b>DELTA</b>  | <b>47</b> |
| 5.1      | Delta-hedging   | 52        |
| 5.2      | The most dividend-sensitive options                     | 57        |
| 5.3      | Exercise-ready American calls on dividend paying stocks | 57        |
| <b>6</b> | <b>THREE OTHER GREEKS</b>                               | <b>61</b> |
| 6.1      | Gamma   | 62        |
| 6.2      | Theta   | 65        |
| 6.3      | Vega  | 69        |

---

|          |   |           |
|----------|---|-----------|
| <b>7</b> | <b>THE PROFIT OF OPTION TRADERS</b>   | <b>73</b> |
| 7.1      | Dynamic hedging of a long call option   | 74        |
| 7.1.1    | <i>Hedging dynamically every \$1</i>  | 75        |
| 7.1.2    | <i>Hedging dynamically every \$2</i>  | 76        |
| 7.2      | Dynamic hedging of a short call option  | 77        |
| 7.2.1    | <i>Hedging dynamically every \$1</i>  | 78        |
| 7.2.2    | <i>Hedging dynamically every \$2</i>  | 79        |
| 7.3      | Profit formula for dynamic hedging  | 80        |
| 7.3.1    | <i>Long call option</i>   | 81        |
| 7.3.2    | <i>Short call option</i>  | 83        |
| 7.4      | The relationship between dynamic hedging and $\theta$   | 86        |
| 7.5      | The relationship between dynamic hedging and $\theta$ when the interest rate is strictly positive | 88        |
| 7.6      | Conclusion  | 91        |
| <b>8</b> | <b>OPTION GREEKS IN PRACTICE</b>  | <b>93</b> |
| 8.1      | Interaction between gamma and vega  | 94        |
| 8.2      | The importance of the direction of the underlying share to the option Greeks                      | 97        |
| 8.3      | Pin risk for short-dated options  | 98        |
| 8.4      | The riskiest options to go short  | 99        |

.....

|  |     |
|--|-----|
| <b>9 SKEW</b>  | 101 |
| 9.1 What is skew?  | 102 |
| 9.2 Reasons for skew   | 103 |
| 9.3 Reasons for higher volatilities in falling markets               | 104 |
| <b>10 SEVERAL OPTION STRATEGIES</b>                                  | 105 |
| 10.1 Call spread   | 106 |
| 10.2 Put spread  | 107 |
| 10.3 Collar  | 109 |
| 10.4 Straddle  | 111 |
| 10.5 Strangle  | 112 |
| <b>11 DIFFERENT OPTION STRATEGIES AND WHY INVESTORS EXECUTE THEM</b> | 117 |
| 11.1 The portfolio manager's approach to options                     | 118 |
| 11.2 Options and corporates with cross-holdings                      | 119 |
| 11.3 Options in the event of a takeover                              | 120 |
| 11.4 Risk reversals for insurance companies                          | 122 |
| 11.5 Pre-paid forwards   | 123 |
| 11.6 Employee incentive schemes                                      | 126 |
| 11.7 Share buy-backs   | 126 |

|  |     |
|--|-----|
| CONTENTS   | xi  |
| .....  |     |
| <b>12 TWO EXOTIC OPTIONS</b>                                 | 129 |
| 12.1 The quanto option                                       | 130 |
| 12.2 The composite option                                    | 135 |
| <b>13 REPO</b>   | 137 |
| 13.1 A repo example  | 138 |
| 13.2 Repo in case of a takeover                              | 139 |
| 13.3 Repo and its effect on options                          | 140 |
| 13.4 Takeover in cash and its effect on the<br>forward       | 141 |
| <br><b><i>Appendices</i></b>                                 |     |
| <b>A PROBABILITY THAT AN OPTION EXPIRES<br/>IN THE MONEY</b> | 143 |
| <b>B VARIANCE OF A COMPOSITE OPTION</b>                      | 145 |
| <i>Bibliography</i>  | 149 |
| <i>Index</i>   | 151 |



# PREFACE

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This book is appropriate for people who want to get a good overview of options in practice. It especially deals with hedging of options and how option traders earn money by doing so. To point out where the profit of option traders comes from, common terms in option theory will be explained, and it is shown how they relate to this profit. The use of mathematics is restricted to a minimum. However, since mathematics makes it possible to lift analyses to a non-superficial level, mathematics is used to clarify and generalize certain phenomena.

The aim of this book is to give both option practitioners as well as interested individuals the necessary tools to deal with options in practice. Throughout this book real life examples will illustrate why investors use option structures to satisfy their needs. Although understanding the contents of this book is a prerequisite for becoming a good option practitioner, a book can never produce a good trader. Ninety percent of a trader's job is about dealing with severe losses and still being able to make the right decisions if such a loss occurs. The only way to become a good trader is to accept that, when helping clients to execute their option strategies, the trader will inevitably

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end up with positions where the risk reward is against him but the odds are in his favour. For that reason a one-off loss will almost always be larger than a one-off gain. But, if a trader executes many deals he should be able to make money on the small margin he collects on every deal even if he gets a few blow-ups.

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# INTRODUCTION

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Over the years derivative securities have become increasingly important. Examples of these are options, futures, forwards and swaps. Although every derivative has its own purpose, they all have in common that their values depend on more basic variables like stocks and interest rates. This book is only concerned with options, but once the theory behind options is known, knowledge can easily be expanded to other derivatives.

This book has three objectives. The first is to introduce terms commonly used in option theory and explain their practical interpretation. The second is to show where option traders get their profit and how these commonly used terms relate to this profit. The last objective is to show why companies and investors use options to satisfy their financial needs.