

Twitter Thread by Nikita Poojary



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Options trading is luring a lot of inexperienced traders who are looking for supernormal gains.

However, most of them end up losing money as they aren't familiar with the basics yet.

8 basics you must know before placing your next trade ■:

Collaborated with @AdityaTodmal

1/ Option Premium consists of two things:

- i) Intrinsic value which represents how much money the option would be worth if it were to expire right now.
- ii) Time value represents the premium you pay since the option does not expire right now.

2/ Intrinsic value:

- It is the difference between the strike price and the asset's current market price when the difference is positive.
- Intrinsic value for ITM calls > 0.
- Positive payoff for the buyer.

Intrinsic Value of an option

- Represents the current value of the option, or in other words how much in the money it is
- When an option is in the money, this means that it has a positive payoff for the buyer
- A CE option of 1500 on a stock trading at 1550 would be Rs. 50 In the money
- If the buyer exercised the above option he would be able to buy the stock at 1500 and subsequently sell it at 1550 (ignoring all the transaction costs & nature of option) thereby capturing a neat profit of Rs. 50

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3/ Example of identifying ITM options:

Option chain data

Option Chain (Equity Derivatives)

Underlying : **BANKNIFTY 37,689.40** As on 28-Jan-2022 15:30:00 IST

	OI	CHNG IN OI	VOLUME	IV	LTP	CHNG	BID QTY	BID PRICE	ASK PRICE	ASK QTY	STRIKE PRICE	BID QTY	BID PRICE	ASK PRICE	ASK QTY	CHNG	LTP	IV	VOLUME	CHNG IN OI	OI	
🟢	301	-42	90	64.68	1,698.85	186.45	125	1,670.85	1,684.80	100	36,900.00	50	200.45	201.15	100	-126.50	201.00	27.39	35,747	2,820	4,218	🟢
🟢	10,586	-1,156	6,488	61.25	1,588.90	181.55	50	1,590.30	1,596.40	100	37,000.00	75	219.30	219.80	500	-124.50	220.40	26.81	3,14,363	17,775	41,416	🟢
🟢	700	-234	834	60.70	1,511.65	176.90	50	1,513.20	1,520.25	25	37,100.00	25	240.85	241.60	325	-128.90	242.15	26.37	58,264	2,588	4,485	🟢
🟢	1,186	-440	1,754	59.54	1,430.90	220.65	150	1,436.70	1,443.45	25	37,200.00	400	263.60	264.45	300	-141.85	264.00	25.76	83,105	4,653	7,099	🟢
🟢	1,150	-280	1,907	58.37	1,360.00	177.00	50	1,362.25	1,367.10	125	37,300.00	75	288.00	288.75	325	-153.70	288.90	25.20	95,913	3,414	6,099	🟢
🟢	1,477	-438	4,297	57.70	1,286.70	144.80	25	1,285.55	1,293.55	50	37,400.00	75	314.05	314.95	25	-146.05	314.95	24.59	93,015	5,063	6,952	🟢
🟢	21,015	3,479	31,530	56.06	1,212.15	138.70	25	1,214.45	1,218.00	25	37,500.00	50	341.45	342.35	225	-162.05	342.30	23.93	3,17,221	9,214	30,316	🟢
🟢	1,546	-338	4,725	55.77	1,145.00	149.85	75	1,143.80	1,151.05	50	37,600.00	25	371.40	372.25	150	-179.40	371.30	23.16	1,21,895	5,476	7,348	🟢
🟢	2,229	-450	8,631	54.30	1,071.80	129.10	25	1,077.70	1,082.65	150	37,700.00	50	403.35	404.40	300	-204.90	404.00	22.44	91,541	3,853	6,395	🟢
🟢	2,915	97	17,101	53.51	1,007.80	126.20	50	1,012.75	1,016.05	25	37,800.00	50	438.50	439.60	25	-194.70	439.40	21.63	1,51,685	5,820	8,844	🟢
🟢	2,733	652	20,626	52.59	947.25	113.60	25	951.05	953.75	125	37,900.00	25	475.70	476.80	50	-204.70	475.30	20.81	1,27,149	8,142	10,318	🟢
🟢	47,190	15,792	2,74,153	51.87	889.85	108.30	50	890.15	892.00	50	38,000.00	50	516.55	517.40	25	-184.10	516.35	19.92	4,59,358	36,117	50,886	🟢
🟢	8,767	2,875	1,13,179	51.16	835.00	96.90	75	833.10	835.00	300	38,100.00	25	556.75	557.55	25	-169.70	557.45	18.67	1,64,435	10,121	12,229	🟢
🟢	20,865	14,943	2,99,722	50.46	781.00	95.65	25	779.70	781.00	25	38,200.00	25	601.15	602.00	25	-180.45	601.20	17.37	2,76,669	16,699	19,135	🟢
🟢	31,346	25,015	3,16,340	50.06	728.55	89.75	50	728.05	728.55	1,200	38,300.00	50	649.90	650.50	25	-182.15	650.20	15.83	2,15,518	16,547	16,946	🟢
🟢	16,671	14,506	2,09,318	49.35	679.00	87.55	50	677.50	678.95	50	38,400.00	75	699.50	700.70	100	-213.50	701.15	13.57	1,09,282	7,459	7,764	🟢
🟢	43,065	28,993	4,68,512	48.86	630.00	87.85	25	629.20	629.75	25	38,500.00	475	750.00	751.00	25	-210.45	750.00	8.89	1,34,352	9,782	12,129	🟢
🟢	13,187	11,015	1,49,640	48.37	585.20	82.35	50	585.00	585.95	25	38,600.00	25	805.50	807.70	50	-218.05	807.70	-	12,406	1,033	1,320	🟢

All grey shaded strikes are ITM options

Green highlighted one at ATM options

White colored strikes are OTM options

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4/ Time value aka Theta:

- Theta represents the time value decline of an options contract.
- Time value is the additional amount over & above Intrinsic value.

- Time value on an option with 20 days to expiry > Time value on an option with 2 days to expiry.

Time value of an option

- It is the additional amount a trader is willing to pay over the current Intrinsic value
- Traders are willing to pay because an option could increase in value before its expiration date
- In simple terms, it means that if an option is months away from its expiration date, we can expect a higher time value on it because there is more opportunity for the option to increase or decrease in value over the next few months
- Alternatively, if an option is expiring today, we can expect its time value to be very little or nothing because there is little or no opportunity for the option to increase or decrease in value.

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5/ Time decay is non-linear:

- Means the rate of change increases as the options contract approaches expiration.
- Hence option contracts are very volatile on the day of expiry.
- An option buyer doesn't want the options to expire worthless & vice versa for an option seller.

Swimming against the tides of time

- The longer the time frame, the higher the chances for a contract to move ITM
- However after buying an OTM option, time is working against you, so for a buyer to make money the move in the market/stock has to be big enough in the buyer's favor to offset the time value of the option
- However if it fails to give that move prior to expiry all that OTM option is made up of is time value which goes to 0 at expiry
- So essentially if one has bought the option at the beginning of a series and the small move happens at the far end of the series the buyer doesn't benefit much



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January 15, 2022

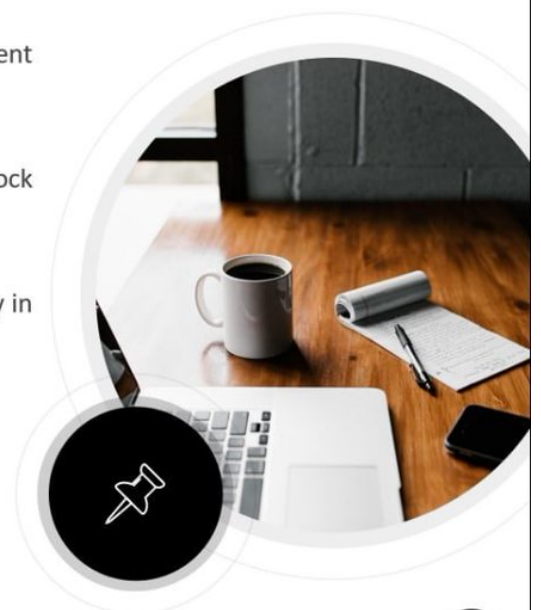
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6/ How theta/time decay affects you?

- After buying an option if the stock moves in your favor & again retraces to the level where you bought option, the value of the option gets eroded.
- Hence traders complain of not being able to make money despite the favorable stock movement.

Option Buyers dilemma

- So when people say TCS moved up, but why did my Call position go down???
- It's because the OTM option was bought earlier and the move in the stock happened at the far end of the series
- The move in the stock wasn't good enough to offset the premium decay in the OTM option
- So it's important to decide on exit conditions as well



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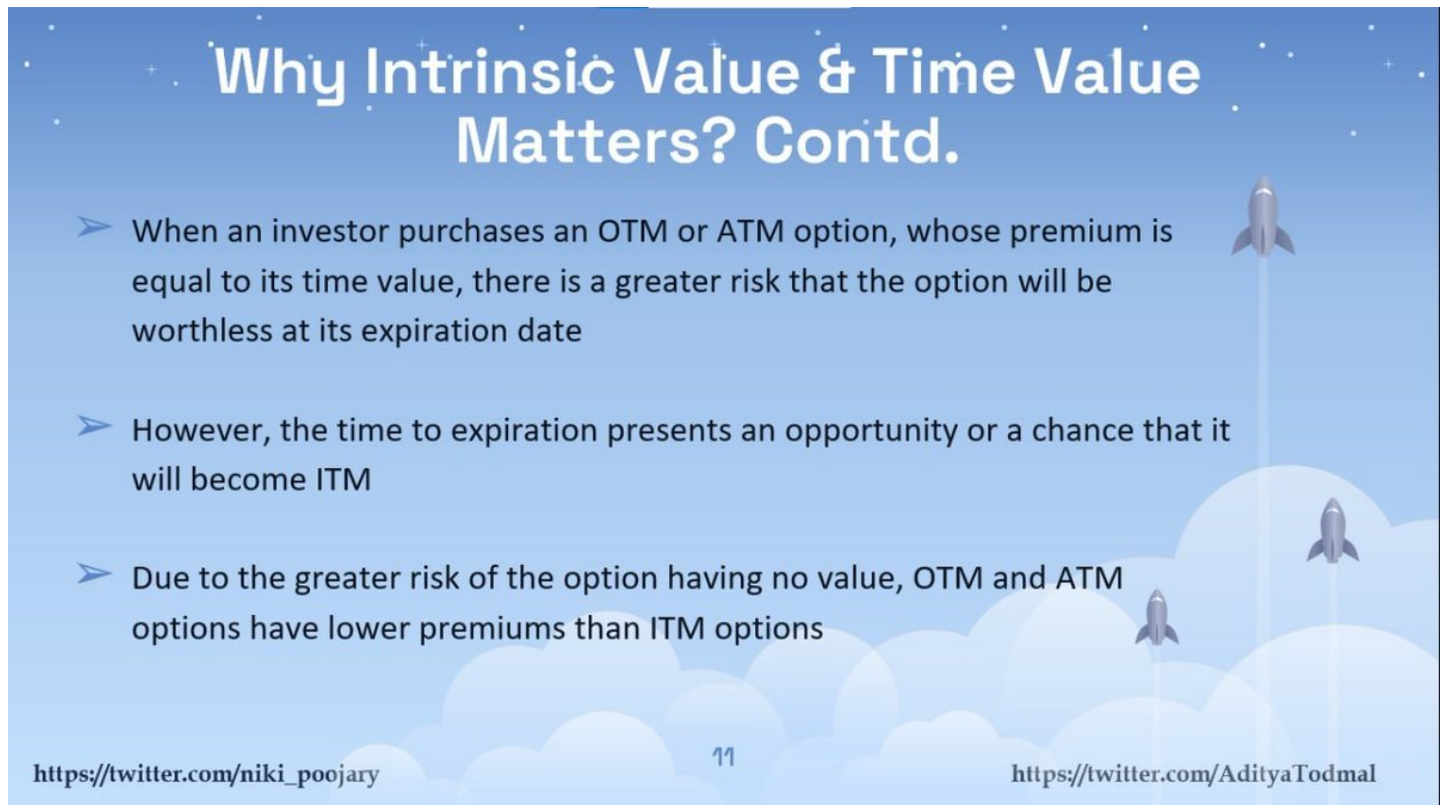
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7/ Perils of buying deep OTMs:

- Many retail traders (unskilled) buy options worth Rs. 20-50 on expiry days expecting that it will quickly double (Hero ya Zero) without following any rules.
- Even though they might be lucky once or twice they can't replicate it every time.



Why Intrinsic Value & Time Value Matters? Contd.

- When an investor purchases an OTM or ATM option, whose premium is equal to its time value, there is a greater risk that the option will be worthless at its expiration date
- However, the time to expiration presents an opportunity or a chance that it will become ITM
- Due to the greater risk of the option having no value, OTM and ATM options have lower premiums than ITM options

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8/ Liquidity:

- Trading in stock options which has less liquidity will have wide spreads, which means your position is likely to start out in the red.
- Go for options that have high liquidity as they have tight spreads.

If you enjoyed this thread, here's another one which might be helpful:

<https://t.co/0fmuhhJfPf>

99% of the newbie traders fail terribly in stock market.

Over the last 310 days I explored how one can systematically work on becoming a successful trader.

Here are the 10 proven ways that will make you profitable in your trading journey\U0001f9f5:

— Nikita Poojary (@niki_poojary) [June 4, 2022](#)

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