KALEXIS GROUP

STOCK OPTIONS: HOW AND WHEN TO USE THEM

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PLAYING THE LOTTERY

POWERBALL CHANCES

Have you ever bought a lottery ticket? Did you win the millions of dollars? Many people buy lottery tickets for a chance to win the big jackpot. Despite the known odds of winning (less than 1%), people purchase lottery tickets on a consistent basis. This is what the trader that turns $100 into $4 million from one investment is doing, “playing the lottery” with stock options. Don’t get me wrong, there is a much higher probability of making a profit from buying stock options (10%–50%), but the odds are still against you. If you think about how much money the average person spends each month or year on lottery tickets, you may think of starting your own lottery company and keep the money for yourself. Well there is a way to collect money from investors through stock options.

INSURANCE

LOST IN FEAR

The Geico lizard, deep voice Dennis Haskins announcing Allstate's stand, and the Aflac quacking duck are part of insurance company's advertisement campaign to entice us to buy their insurance. We buy insurance out of fear of what could happen. There is also insurance to protect investors against stock losses. Just like people can buy car or home insurance to protect them against damages or complete loss, stockholders can buy insurance in the form of put options. The put option gives the stockholder the option to sell the stock at a certain price (usually at or above the price it was originally purchased) to protect from losses. For instance, if you buy a stock for $50, you can purchase a stock option to allow you to sell your stock at $50 for a certain time period no matter the price of the stock. So, if the stock drops to $40, you will be able to sell the stock for $50 and not lose any money.

Money Made

Whether we are trying to make a big profit or trying to protect our money, stock options can be used. But who is selling us the stock options? Just like the lottery sell tickets and insurance companies sell policies, there is an investor that sell the stock options and keep the premiums paid. Why would they do that? The probability of a tree falling on your house or you winning the lottery are slim. The insurance company and lottery understand the exact probability of either of these instances occurring (very low), so they take your money, give you the policy or lottery ticket, and wait.

The insurance company, lottery, and the customers buying tickets and policies, are all taking risks. As an investor, you must decide which type of risk is best for you in the moment. Sometimes you may see its better to play the role of the insurance company and sell put options to another investor because you think the stock is going up in value. In this case you have a higher probability of making a profit, but the profit is small in comparison to how much you invest (10%-20% return). Other times you may want to play the role of the lottery and sell call options to investors because you think the stock is going down. Just like the insurance scenario, you make a small profit in comparison to how much you invest (10%-20%).

What if you want to actually play the lottery and take a chance? Or if you want to protect you stock or think the stock is going down? You can buy stock options and have a chance on making big returns for a small investment. This is when you can invest $200 and have a chance on making $5,000 or more. Even though the chances of an investor making a large profit are slim (20%-40% chance), the big payday can outweigh the small lost. So always think about what your goal is for the trade and invest accordingly.