For the collective:

Equity Options are contracts, with each contract normally representing a contract on 100 shares of the underlying stock. (Futures options are similar but would be the subject of a separate missive.) US Equity Options can be exercised by the option buyer at any time up until expiration. European-style options are only exercisable at expiration. I am describing US Equity Options here because the discussion started with options on Apple stock.

Puts convey the right, but not the obligation, to require the put-seller to buy the put-buyer's stock at a fixed price ("strike price") by a fixed date ("expiration"), in exchange for a premium. "I am buying the right to put my stock to you."

Calls convey the right, but not the obligation, to require the call-seller to sell the call-buyer the stock at a fixed price by a fixed date, in exchange for a premium. "I am buying the right to call away your stock."

In summary, if you choose to use options, you generally use them as follows:

Buy calls: expect stock to go up before expiration, risk limited to price of call.
Buy puts: expect stock to go down before expiration, risk limited to price of put.

Sell calls against stock you own ("covered calls"): usually sold "out of the money", so if the stock stays flat or goes down you collect the premium and keep your stock. Risk is that the stock goes up instead and your stock gets called away, leaving you with the tax bill and no position, but with your profits. Sounds great, but seller is usually left with seller's remorse, unless you really really meant you would have sold the stock at that price anyway. This is a good strategy in tax-free accounts, as long as you understand the seller's remorse issue. In taxable accounts, this works fine on stocks which you are not planning on holding for long-term capital gains treatment.

Sell calls "naked" (you don't own the stock): a <u>bet</u> (underlined to emphasize risk) that a stock will be below the call strike price through the expiration date. If you are wrong on price or timing, the option will be exercised by the buyer, and you will have to buy the stock at the new high price and sell it to the call buyer at the (lower) strike price. Risk is potentially huge (usually described as "unlimited"). Play this game with life preservers, 25 year old Laphroaig, and a strong stomach.

Sell puts "naked" (you are not short the stock) - this is a bullish bet on the stock:

Case 1:you are absolutely confident that the stock will not go below a certain price by a certain date, and probably will go up or stay flat instead. Selling an out-of-the-money put generates a premium based on this bet. If you are wrong, and the stock plunges below your strike price, you will be forced to buy the stock at the strike

price. Risk is potentially substantial, limited to the stock dropping to zero. E.G. iRobot - IRBT (US) - on 2 Feb the stock was trading over 35 and moving up in a parabolic move. You were convinced it would not drop back below 30, and so you sold 10 Feb 18 (expiration) 30 (strike) puts for a total premium of $600. (10 contracts = 1000 shares) Earnings came out and on 9 Feb the stock plunged to 25 at the open. You are still obligated to buy the stock at 30, and you will, unless you take your loss and buy back the puts you sold. You just lost $4400.

Case 2: you want to own the stock, and would like to get a little premium to discount the price a bit. You sell near-the-money or in-the-money puts. You collect the premium (time premium); if the stock goes up faster than you expected, you keep the premium and the puts expire worthless; if the stock is below your strike price (for long enough or at expiration) you will be exercised, and you will have bought the stock at a discount (subject to all the risks of owning stocks). See the Case 1 example.

Note: put premiums normally go down as the stock climbs, and go up when the stock goes down, and go up a lot when the stock plunges at the end of a parabolic move. Hence selling puts towards the guessed-at end of a parabolic move results in a small premium in exchange for a large risk. The ideal time to sell naked puts is when the stock bottoms after a fast drop, when the premiums will be high. Of course that can mostly be observed in hindsight, so note the high risk.

There are, of course, many combinations of option trades one can make, and these combos can modify your risks and potential gains. Larry McMillan writes some good books on this.

As a person who invests in companies, and trades options for income and losses, I would suggest that anyone who wants to explore options start with buying puts and calls, possibly selling covered calls, and spend a lot of time learning about how options work in the real world, before jumping into the shark-infested waters of selling naked options.