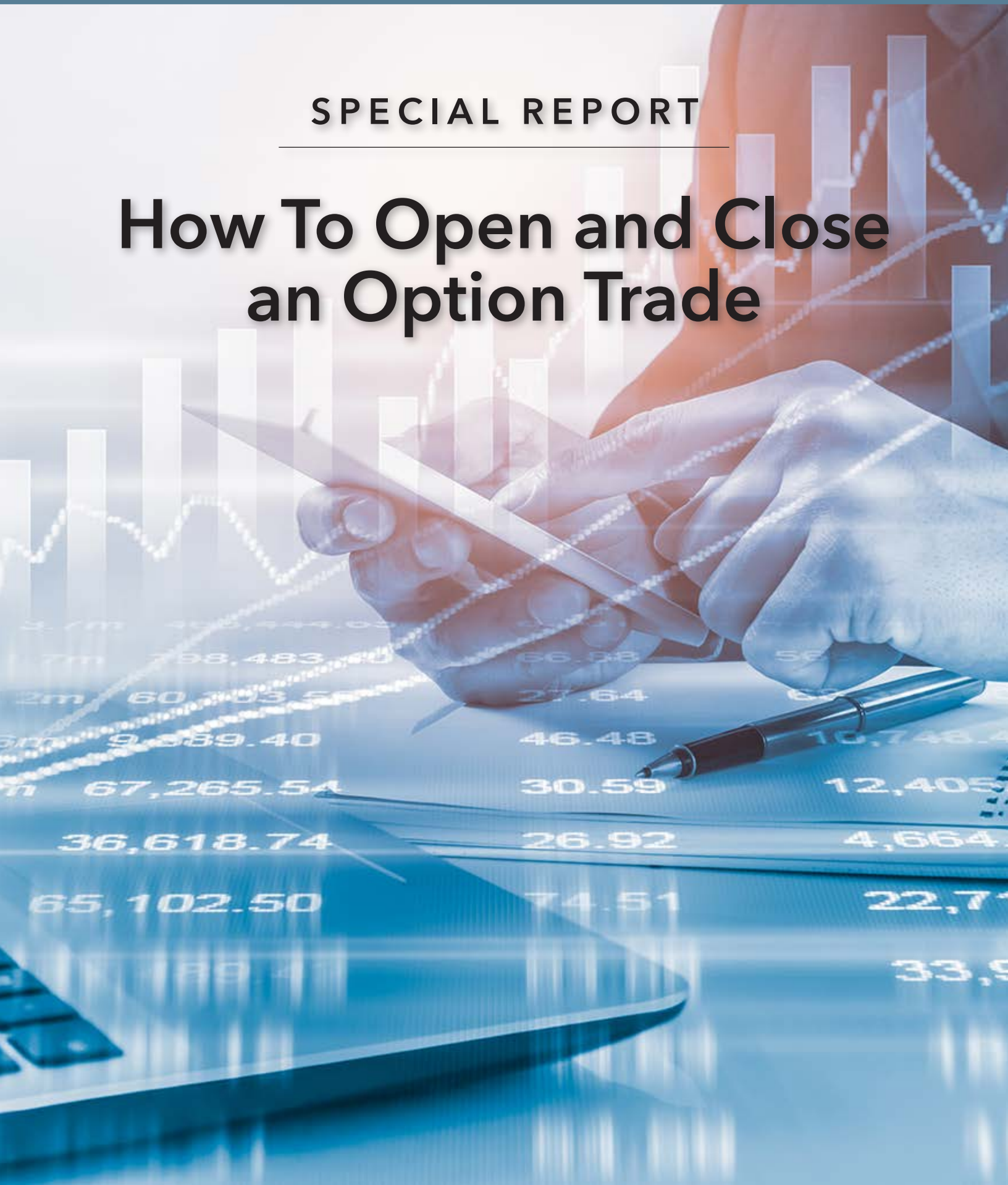


SPECIAL REPORT

How To Open and Close an Option Trade



How To Open and Close an Option Trade

By Jeff Clark, editor, *Jeff Clark Trader*

Options are a powerful trading tool. They help traders determine their risk by showing the precise downside potential, while still offering outsized profit potential.

That said, options have a steep learning curve. And if it's your first time trying to trade them, you might get a bit overwhelmed with the process.

So, in this simple-to-understand guide, we're going to walk you through the most basic aspects of option trading: opening and closing a position.

THE GUIDE

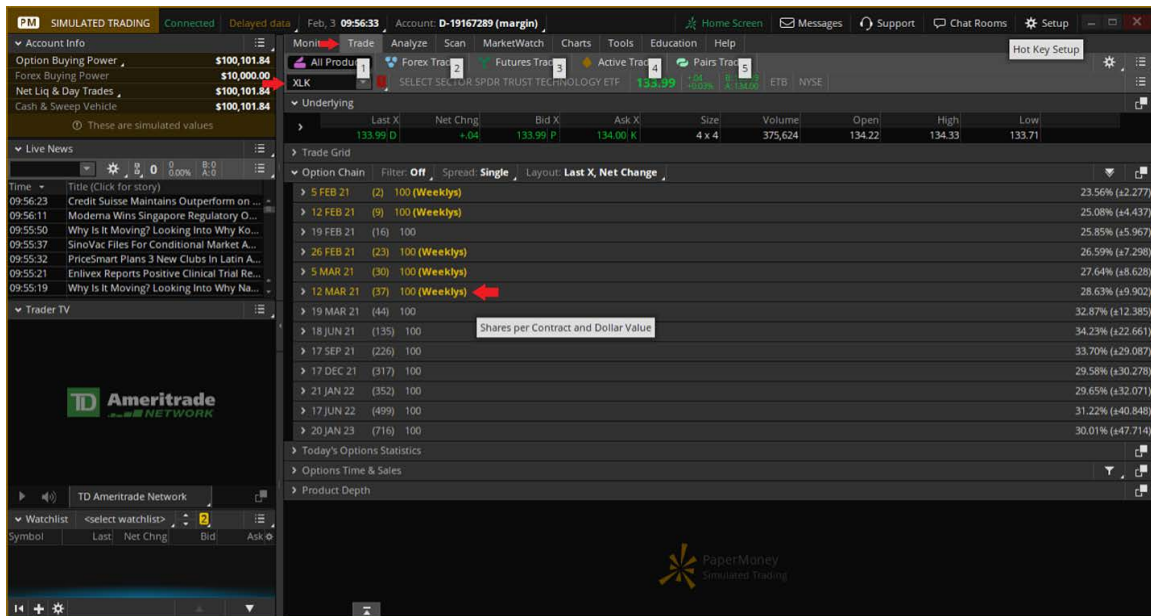
For this guide, we'll use the thinkorswim trading platform from TD Ameritrade. We highly recommend downloading this app from TD Ameritrade and using it as your primary option trading tool. In our experience, it's the best platform for placing the kinds of options trades we recommend.

Of course, other platforms have similar functionality, and may work better for you. But it's important to keep in mind that they may look different from what's shown in this guide.

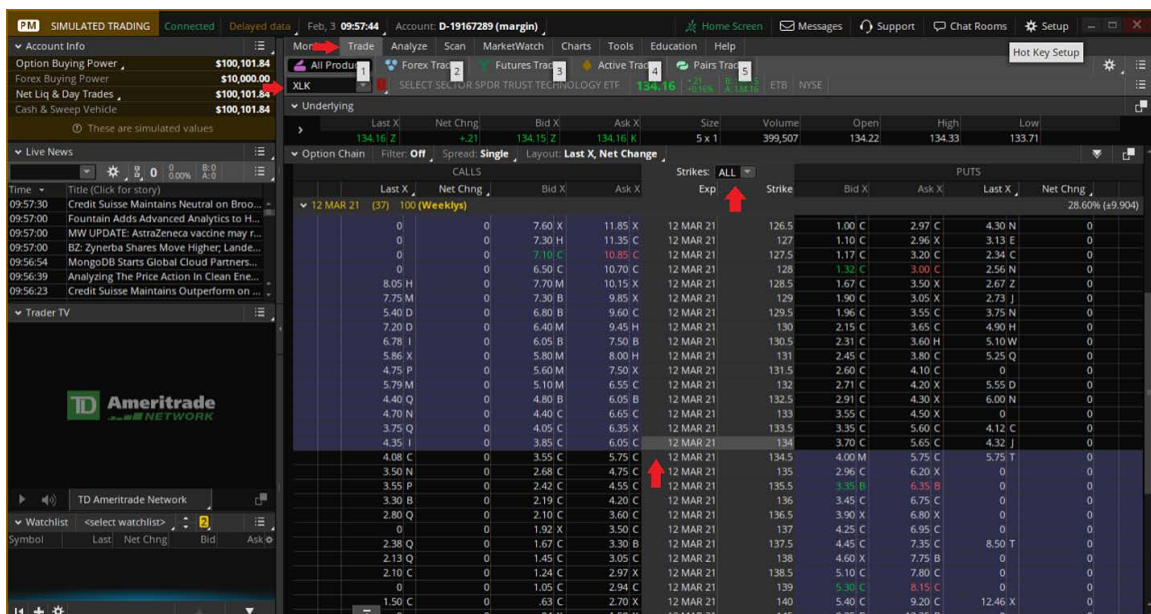
If you use a different platform that looks vastly different from thinkorswim, I highly recommend searching on Google or YouTube for a guide showing how to use your platform of choice.

IMPORTANT NOTE: What follows is a demonstration, NOT actionable advice.

PART 1: PLACING A NEW OPTION TRADE



1. From the thinkorswim home screen, select the "Trade" tab on the top bar. (The top red arrow in the image above.)
2. In the search bar (the middle red arrow above), enter the name of the stock ticker you want to trade. For this demonstration, we'll use one of Jeff's three stocks in *Jeff Clark Trader*, the Financial Select Sector SPDR Fund (XLF).
3. Under the "Option Chain" section you will find the various [expiry dates](#) for the options on the security you chose. Select the expiry date you want by clicking on it. This will open a list of the available [strike](#) prices available for that expiry.



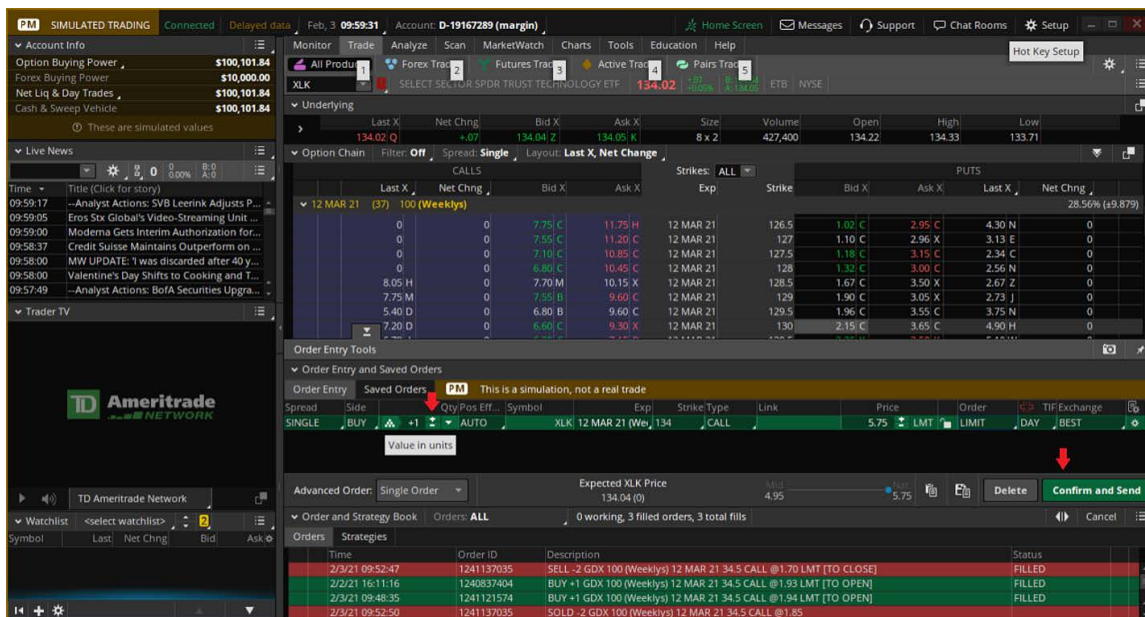
- Note the "Strikes" dropdown menu at center (top red arrow). Select "All" to ensure that all available options to trade are shown.
- There are two columns on either side of the "Strikes" column. One for calls (on the left), and one for puts (on the right).

We are focusing on calls today, so we'll be looking to the left of the "Strikes" column.

The purple highlighted options are "in the money" and the black highlighted options are "out of the money." For this example, we have selected the March 12, 2021 Calls with the \$134 strike price (XLF210312C00134000). The calls at this strike price are in the money, while the puts are out of the money.

The screenshot displays the TD Ameritrade trading interface. The main window shows the option chain for XLF. The 'Strikes' dropdown is set to 'ALL'. A red arrow points to the 'BUY' button in the context menu. Another red arrow points to the 'Single' trade type selection. The interface includes a sidebar with account information, a top navigation bar, and a bottom status bar.

- Right click your chosen call option. Hover over "BUY" and select your trade type (the leftmost red arrow above). To buy-to-open, or sell-to-open, a single option at a time, select "Single" as your trade type (the rightmost red arrow).



- The "Order Entry Tools" box will then appear at the bottom of the window. This shows the type of order, whether you're buying or selling, the number of contracts, and information about the option you selected.

The default number of contracts will be 10 (value in units). Select the number of contracts you would like to purchase. In this example, will we purchase only one contract.

It's important to always use a "limit order" when acting on trade recommendations. These types of orders only execute at the price you specify. When entering a limit order, include the price that comes with each recommendation, and set it to "GTC" under the TIF column. This will ensure that the order will only execute at our recommended price guidance, and will stay open until the option reaches that price. You can use this same technique when selling options, as well.

Of course, if the price of the option is more favorable our recommended guidance, go ahead and trade it at that level. However, you should still use a limit order even in this circumstance. Placing a "market" order on options trades often results in a poor price execution, as the order is executed at whatever the best price is available at that time. That's the intention, anyway –the reality is that market orders often result in you paying more than the current level of the option.

(See the end of this document for more detailed notes on using limit orders vs. market orders.)

- Once you're happy with the number of contracts and the price you're paying, hit "Confirm and Send."

Order Confirmation Dialog

PM This is a simulation, not a real trade Auto send with shift click

Order Description	BUY +1 XLK 100 (Weekly) 12 MAR 21 134 CALL @5.75 LMT [TO OPEN]
Break Even Stock Prices	139.75
Max Profit	Infinite
Max Loss	\$575.00 (not including possible dividend risk)
Cost of Trade including commissions	\$575.00 + \$0.65 = \$575.65
Buying Power Effect	(\$575.00)
Resulting Buying Power for Stock	\$199,053.68
Resulting Buying Power for Options	\$99,526.84

Single Account Account: D-19167289 (margin) ☐ Save last used mode

Note for this order

Please note that you have selected a weekly option series with a "non-standard" expiration date.

Delete Edit Save Send

- The "Order Confirmation Dialog" box will then appear. Ensure all the information is correct, then select "Send" to place your order.

PM SIMULATED TRADING Connected Delayed data Feb 3 10:02:01 Account: D-19167289 (margin)

Account Info: Option Buying Power \$99,661.18, Forex Buying Power \$10,000.00, Net Liq & Day Trades \$100,156.18, Cash & Sweep Vehicle \$99,661.18

Live News: January ISM Services Index 58.7% Vs. E..., Credit Suisse Maintains Neutral on M&A..., GameStop Creates CTO Position, Hires..., MW Amazon stock price target raised to \$1,000, MW Treasury yields extend climb after..., Uber Eats Launches 'Eat Local', Offers \$100M..., AIG Retirement Services Selected As Excl...

Working Orders:

Time Placed	Spread	Side	Qty/Pos Effect	Symbol	Exp	Strike/Type	Price	TIF	Mark/Status
2/3/21 10:00:44	SINGLE	BUY	+1 TO OPEN	XLK 12 MAR 21	134	CALL	4.40		4.40 LMT
2/3/21 09:52:50	SINGLE	SELL	-2 TO CLOSE	GDK 12 MAR 21	34.5	CALL	1.85		1.85 LMT
2/3/21 09:48:39	SINGLE	BUY	+1 TO OPEN	GDK 12 MAR 21	34.5	CALL	1.83		1.83 LMT
2/3/21 09:31:07	SINGLE	BUY	+1 TO OPEN	GDK 12 MAR 21	34.5	CALL	1.86		1.86 LMT

Cancelled Orders

Rolling Strategies

Position Statement: Beta Weighting NOT WEIGHTED

Instrument	Qty	Days	Trade Price	Mark	Mrk Chng	P/L Open	P/L Day	BP Effect
GDX	0	0	.00	133.880	-.07	\$0.00	\$1.00	\$0.00
XLK	0	0	.00	133.880	-.07	\$0.00	\$1.00	\$0.00
SELECT SECTOR SPDR	0	0	.00	133.880	-.07	\$0.00	\$1.00	\$0.00
100 (Weekly) 12 MAR 21	+1	37	4.40	4.950	N/A	\$55.00	\$55.00	\$0.00
Subtotals						\$55.00	\$56.00	\$0.00
Overall Totals						\$55.00	\$56.00	\$0.00

ACCOUNT STATUS: OK TO TRADE

FOREX ACCOUNT STATUS: OK TO TRADE

Cash & Sweep Vehicle: \$99,661.18
OVERALL P/L YTD: \$164.00
AVAILABLE DOLLARS: \$99,661.18

FOREX CASH WITH UPL: \$10,000.00
AVAILABLE DOLLARS: \$10,000.00

- Now select the "Monitor" tab on the top bar. At the top of the window, you'll see menu dropdowns for "Working Orders," "Filled Orders," "Cancelled Orders," and "Rolling Strategies." If your order has not yet been filled, it will appear in "Working Orders." If your order has been filled, it will appear in "Filled Orders."

PART 2: CLOSING AN OPTION TRADE

Now, let's demonstrate how to close the same option contract.

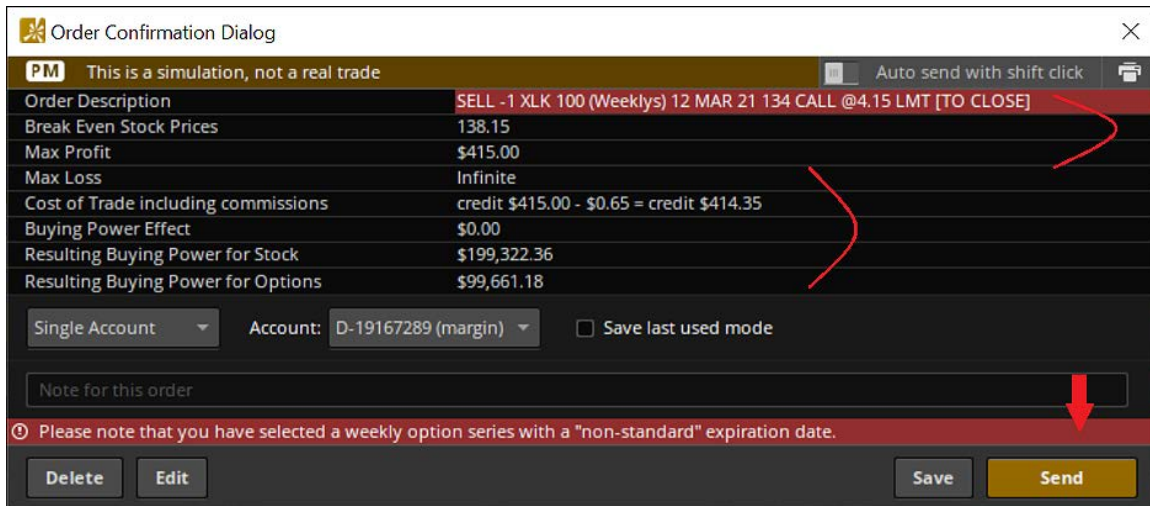
1. Under the "Position Statement" drop down, you will see your current open positions. Select the dropdown arrow of the ticker you would like to close.
2. On the furthest right side of the column, right click. Hover over "Create Closing Order," and then confirm and click the position you would like to close.

The screenshot shows the PaperMoney Simulated Trading interface. The top bar indicates 'SIMULATED TRADING' and 'Connected' status. The left sidebar displays account information, including 'Option Buying Power' at \$99,661.18 and 'Forex Buying Power' at \$10,000.00. The main window shows the 'Position Statement' for the selected option, 'XLK 12 MAR 21 134 CALL'. The 'Position Statement' includes a table with columns for 'Instrument', 'Qty', 'Days', 'Trade Price', 'Mark', 'Mk Chng', and 'P/L Open'. The 'Create closing order' button is highlighted in the top right corner.

3. Under the top bar "Trade" tab, go down to the "Order Entry and Saved Orders" box at the bottom. Confirm the information of the position you're selling – the number of contracts, desired price, etc. – is correct. Press "Confirm and Send."

The screenshot shows the PaperMoney Simulated Trading interface. The top bar indicates 'SIMULATED TRADING' and 'Connected' status. The left sidebar displays account information, including 'Option Buying Power' at \$99,661.18 and 'Forex Buying Power' at \$10,000.00. The main window shows the 'Order Entry and Saved Orders' box. The 'Order Entry and Saved Orders' box includes a table with columns for 'Spread', 'Side', 'Qty/Pos Eff', 'Symbol', 'Expi', 'Strike Type', 'Link', 'Price', 'Order', and 'TIF/Exchange'. The 'Confirm and Send' button is highlighted in the bottom right corner.

- The "Order Confirmation Dialog" box will reappear. Review the information carefully and ensure that it is correct. Select "Send."



Order Confirmation Dialog

PM This is a simulation, not a real trade Auto send with shift click

Order Description	SELL -1 XLK 100 (Weeklys) 12 MAR 21 134 CALL @4.15 LMT [TO CLOSE]
Break Even Stock Prices	138.15
Max Profit	\$415.00
Max Loss	Infinite
Cost of Trade including commissions	credit \$415.00 - \$0.65 = credit \$414.35
Buying Power Effect	\$0.00
Resulting Buying Power for Stock	\$199,322.36
Resulting Buying Power for Options	\$99,661.18

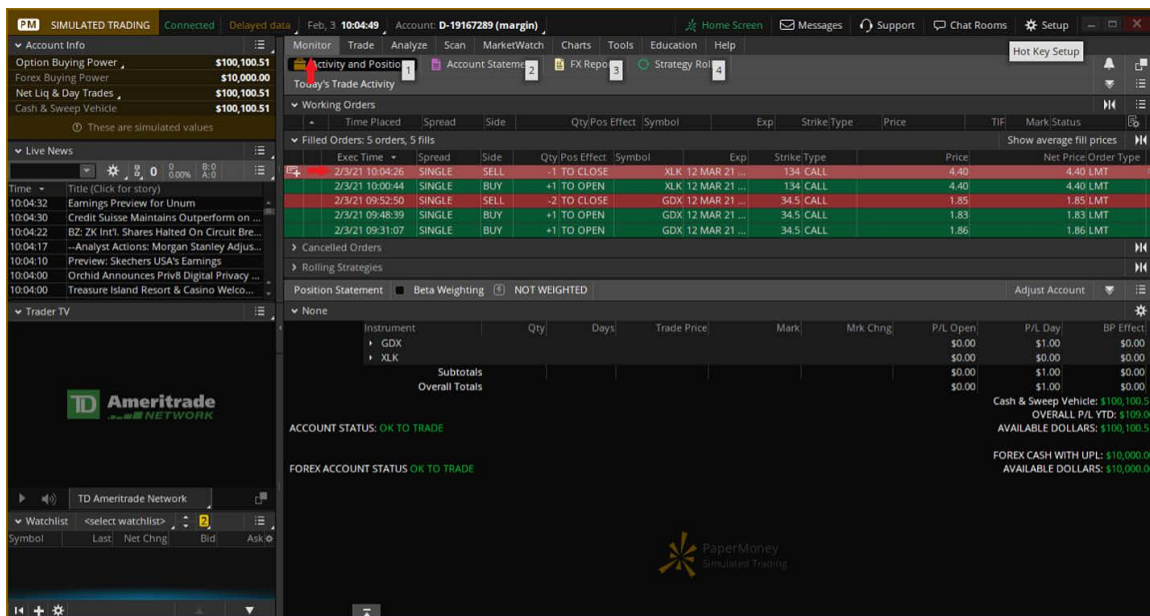
Single Account Account: D-19167289 (margin) ☐ Save last used mode

Note for this order

Please note that you have selected a weekly option series with a "non-standard" expiration date.

Delete Edit Save Send

- Go back to the "Monitor" tab on the top bar. Under the "Filled Orders" drop down, you will see your newly sold option contract.



PM SIMULATED TRADING Connected Delayed data Feb 3 10:04:49 Account: D-19167289 (margin)

Monitor Trade Analyze Scan MarketWatch Charts Tools Education Help

Activity and Position Account Statements FX Repo Strategy Roll

Working Orders

Filled Orders: 5 orders, 5 fills

Time	Exec Time	Spread	Side	Qty/Pos Effect	Symbol	Exp	Strike/Type	Price	TIF	Mark/Status	Show average fill prices
+	2/3/21 10:04:26	SINGLE	SELL	-1 TO CLOSE	XLK 12 MAR 21	134	CALL	4.40		4.40 LMT	
	2/3/21 10:00:44	SINGLE	BUY	+1 TO OPEN	XLK 12 MAR 21	134	CALL	4.40		4.40 LMT	
	2/3/21 09:52:50	SINGLE	SELL	-2 TO CLOSE	GDK 12 MAR 21	34.5	CALL	1.85		1.85 LMT	
	2/3/21 09:48:39	SINGLE	BUY	+1 TO OPEN	GDK 12 MAR 21	34.5	CALL	1.83		1.83 LMT	
	2/3/21 09:31:07	SINGLE	BUY	+1 TO OPEN	GDK 12 MAR 21	34.5	CALL	1.86		1.86 LMT	

Cancelled Orders

Rolling Strategies

Position Statement Beta Weighting NOT WEIGHTED Adjust Account

None

Instrument	Qty	Days	Trade Price	Mark	Mark Chng	P/L Open	P/L Day	BP Effect
GDK						\$0.00	\$1.00	\$0.00
XLK						\$0.00	\$0.00	\$0.00
Subtotals						\$0.00	\$1.00	\$0.00
Overall Totals						\$0.00	\$1.00	\$0.00

ACCOUNT STATUS: OK TO TRADE

FOREX ACCOUNT STATUS: OK TO TRADE

Cash & Sweep Vehicle: \$100,100.51
OVERALL P/L YTD: \$109.00
AVAILABLE DOLLARS: \$100,100.51

FOREX CASH WITH UPL: \$10,000.00
AVAILABLE DOLLARS: \$10,000.00

PaperMoney Simulated Trading

With that, you should now have everything you need to execute options trades in your brokerage account, using our recommended price guidance. If you have any further questions, please write in to feedback@jeffclarktrader.com, and we'll look to respond to your questions in future issues of the *Market Minute* and *Jeff Clark Trader*.

A NOTE ON BID AND ASK PRICES

Just like when you're buying and selling stocks, when you buy an option you pay the "[ask](#)" price. And, when you sell an option, you sell it on the "[bid](#)" price. Sometimes, there's a fairly widespread difference between the bid and ask. In those cases, it's often possible to split the bid and ask prices, and trade in between.

For example, if an option bid is \$1.00 and is offered at \$1.10, then it's reasonable to enter an order to trade at \$1.05. Sometimes you'll get it. Sometimes you won't. But, there's no harm in trying. If the trade isn't executed within a few minutes, then you can always cancel the order and re-enter it at the bid or ask price.

FURTHER NOTES ON LIMIT AND MARKET ORDERS

When buying and selling options, you have two choices in how to make the trade.

The first is a limit order. Buying an option using a limit order means your buy order will only be filled at or below the price you enter as your limit. For example, if you set a limit order to buy call options for \$2, your order will only be filled if you can buy the calls for \$2 or less.

Selling an option with a limit order means your sell order will only be filled if you can collect at least the price you enter as the limit. For example, if you set a limit order to sell call options for \$2, your order will only be filled if you can collect at least \$2.

So with limit orders, you run the risk of not being able to get into or out of a trade right away. But it's much better than the alternative...

You see, the other option is a market order. In theory, buying an option using a market order means your buy order will be filled as quickly as possible at the best available price. Selling an option using a market order means your sell order will be filled as quickly as possible at the best available price.

Like I said, that's how a market order is supposed to work, in theory.

You see, when we buy or sell options, options market-maker firms are often the ones selling them to us and buying them from us.

An options market maker is a firm that stands ready to buy and sell options on a regular and continuous basis at a publicly quoted price. Market makers keep the markets flowing.

Options market makers make money by profiting on the bid-offer spread of options (the difference between the prices at which a market maker buys and sells a security).

For example, if a market maker buys a call option for \$1.90, and is willing to sell it for \$2, the bid-offer spread is \$0.10. The larger that market makers can make this spread, the more they will profit. And that's what's so dangerous about market orders.

That same routine occurs with small orders, too – especially right at the opening of the market.

Yes, that's collusion. Yes, that's a prohibited practice. And, yes, there are rules against it. But there are also rules against driving more than 65 miles per hour on most of this nation's freeways. Yet nearly everyone does it.

LIMIT ORDERS VS. MARKET ORDERS

To see how damaging this can be to your trading account, let's look at an example. Let's say some call options are trading at \$1.90 bid and \$2 ask. If you use a limit order to buy two call options at \$2, it will get filled for \$2 or less, assuming the price doesn't change in the few seconds it takes your broker to submit your order ticket. Since each call option covers 100 shares, and you're buying two, it will cost you \$400 or less.

But, let's say you use a market order. Thanks to some market-maker collusion, you end up buying the calls for \$2.40 – 20% higher than the last trading price. Now, it'll cost you \$480. You'll also likely end up the subject of one of the stories shared at the bar later that night.

The same holds true for selling options. In the above example, you can use a limit order to sell your two calls at \$1.90. Again, as long as the price doesn't change within a few seconds, you're going to get the order filled at \$1.90 or more. So you'll collect at least \$380 on your two calls.

But let's say you use a market order. The market makers step away from their bids, only to come back with a bid that's 20% less than the previous price. So instead of selling your calls for \$1.90, you end up selling them for \$1.52. Now, you only collect \$304 on your two calls.

Even if market orders always worked like they should, you'd still run the risk of buying or selling for a price drastically different from what you intended – especially in volatile markets.

So, for your own sake, NEVER use market orders when trading options. Only use limit orders. Yes, you risk not being able to get into or out of the trade right away. But most of the time (probably all of the time) even if you have to move your limit order down or up in order to get an execution, you're still going to be better off than if you had sent a market order to the options pit.

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