

Audio Script

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So why do people trade options?

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Generating Income

Investors can sell options against shares they own and collect the premiums

Script:

People trade options for a variety of reasons

One reason to trade options is to generate income. This is commonly done by selling call options against shares you own, and collecting the premiums from the buyers. This strategy is called a covered call.

Before we explain for this strategy works, we would like to make you aware of some key concepts:

A covered call strategy can be bullish, bearish, or neutral. A call represents the right to buy stock. The seller of a call is obligated to sell that stock. Each contract represents 100 shares, has an agreed upon price known as the strike price, and an expiration date – which is the sellers obligation period.

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Imagine you purchased 100 shares of XYZ at \$50.00 a share.

You feel bullish about this company long term, but you don't expect it to make any big moves in the near term.

Based on this belief, you decide to sell a call, which is a type of options contract.

When you sell the contract, you set an agreed upon price, called the strike price and an expiration date which is your obligation period.

You immediately collect the premium for that contract

If the stock never goes above the strike price you set, the option expires worthless and the money you collected is yours to keep. You can think about it like a discount on your purchase of 100 shares.

If, however, the stock goes above that price, and the buyer chooses to execute, you will have to sell your shares at the strike. However, you still keep the premium.

This is why selling a covered call is one way option traders generate income

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View definitions for investment terms in our Glossary.

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