FREE SAMPLE CHAPTER

THE EFFICIENT OPTIONS BUYER

A Risk-First Guide to Buying Options, Using Spreads, and Building Better Trading Decisions

Chapter 3

The Five Enemies of Every Options Buyer

A practical reader perk for traders who want structure before risk.

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Before You Read

This free sample is taken from The Efficient Options Buyer. It is designed as an educational preview for readers who want a clearer, risk-first way to think about buying options.

Important: This material is for educational purposes only. It is not financial, investment, tax, or legal advice. Options involve risk and are not suitable for every investor. Examples are simplified for learning and may use rounded assumptions.

The core idea of this chapter is simple: an option trade can lose even when the market idea was not completely wrong. The problem is often structure, timing, volatility, strike choice, expiration, or position size.

Reader promise: after this chapter, you will know the five forces that hurt most option buyers and how to check them before placing a trade.

Chapter 3

The Five Enemies of Every Options Buyer

Chapter promise: You will learn why an option trade can lose even when your market idea was not completely wrong.

A trader can study the chart, understand the news, and still lose money on the option. That is what makes options so frustrating in the beginning.

With stocks, the question often feels simple: will the stock go up or down? With options, that question is not enough. A stock may move in the right direction, but not far enough. It may move far enough, but not fast enough. It may move fast enough, but the option may have been too expensive when you bought it.

After my own market tuition, I had to stop asking only, “Was I right about direction?” The better question became, “Was the trade designed correctly for the move I expected?” Many option losses are not random. They follow patterns.

For an options buyer, five enemies show up again and again: time decay, volatility changes, poor strike selection, wrong expiration, and emotional position sizing. This chapter is not meant to scare you away from options. It is meant to give you eyes.

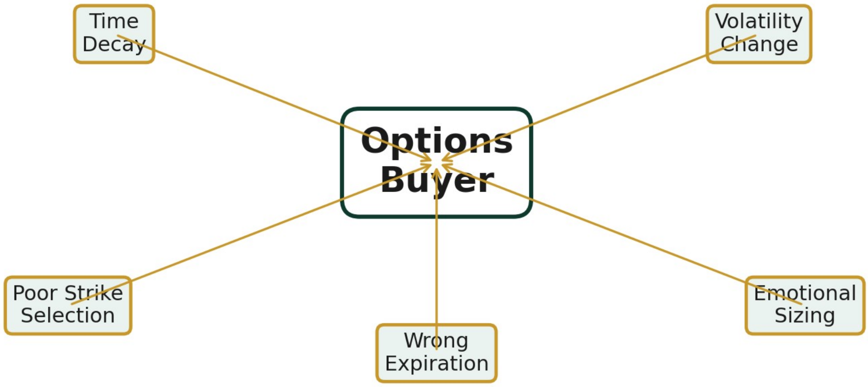

Figure 3.1: Most option-buying mistakes come from one or more of these five enemies.

Enemy 1: Time Decay

The first enemy is time. More specifically, time decay. When you buy an option, you are buying a contract with an expiration date. Every day that passes gives the trade less time to work.

This is very different from owning stock. If you buy shares of a good company and the stock does not move for three weeks, the shares do not expire. If you buy an option and the stock does not move for three weeks, the option may lose value simply because time passed.

Think of an option like an ice cube sitting outside. At the beginning, the ice cube is solid. As time passes, it begins to melt, slowly at first and often faster near the end. Short-term options may look cheap, but they are melting fast.

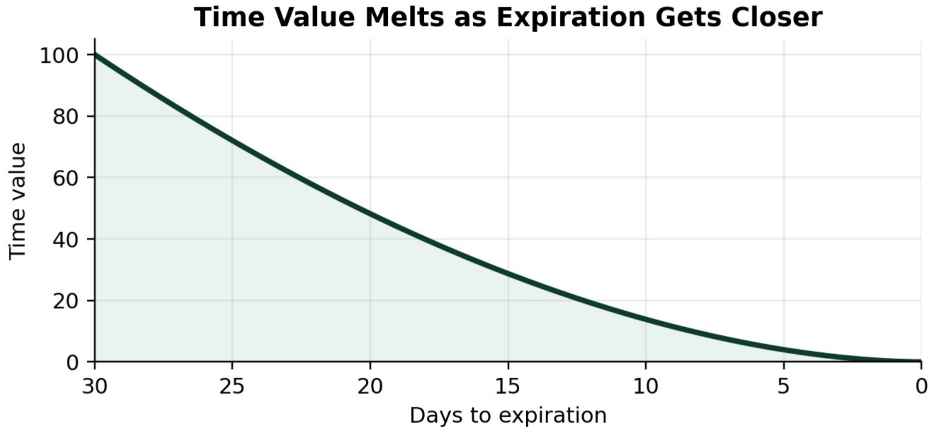

Figure 3.2: Time value often melts faster as expiration gets closer.

Imagine a stock is trading at $100. You buy a $105 call for $3, expiring in 30 days. Your breakeven is $108. Ten days pass and the stock is still at $100. Nothing dramatic happened, but your option may now be worth less because there are only 20 days left.

You did not lose because the stock collapsed. You lost because the expected move did not happen fast enough. Nothing has to go wrong for a long option to lose money. Sometimes time only needs to pass.

Enemy 2: Volatility Changes

The second enemy is volatility. Most beginners focus only on price, but option prices are also affected by implied volatility, which is the market's expectation of how much the stock may move in the future.

When traders expect big movement, options usually become more expensive. When traders expect calmer movement, options usually become cheaper. This matters because you can buy an option when it is expensive and then lose money even if the stock moves in your direction.

Imagine you live in an area where a big storm is expected next week. Everyone wants insurance, so insurance becomes more expensive. When the storm passes and uncertainty drops, the storm premium disappears. Options can work in a similar way around earnings and major events.

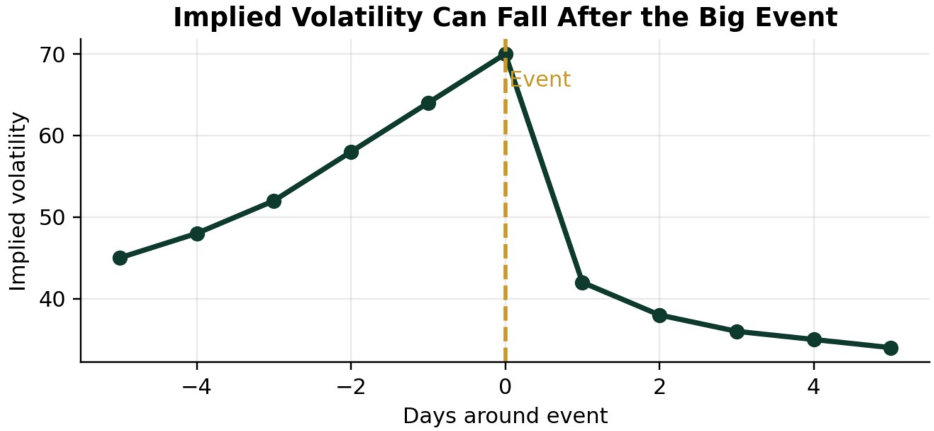

Figure 3.3: After a major event, implied volatility can fall quickly, reducing option value.

Suppose a stock is at $100 before earnings, and you buy a $100 call for $7. Your breakeven is $107. The company reports good earnings, and the stock rises to $103. You were right about direction, but your call may still lose because the option was priced for a bigger move and the event premium disappeared.

Good news does not guarantee option profit. You can be right about direction and still lose because the option was too expensive when you bought it.

Enemy 3: Poor Strike Selection

The third enemy is choosing the wrong strike. This is where many beginners get trapped by cheap options. A cheap option is often cheap because the probability is low.

Far out-of-the-money options are like a bus stop that is far away. It is not impossible to reach, but you must move quickly, perfectly, and with enough time. Sometimes those options work, but repeated lottery-style option buying can quietly destroy an account.

The $120 call looks cheap, but the stock must rise more than 20% in 30 days just for the trade to break even at expiration. Instead of asking which option is cheapest, ask which strike gives a realistic chance based on the expected move, time remaining, and your target.

Real-Market Translation: The NVDA Cheap-Call Temptation

A trader looking at NVDA may feel the same temptation. Assume NVDA is trading near $140 and has already made a strong move. A $145 call may look expensive, a $155 call may look more affordable, and a $170 call may look cheap enough to buy several contracts.

The cheap $170 call is not automatically bad, but it is asking for a very large move in a limited time. If the premium is $1.50, the breakeven at expiration is $171.50. NVDA must not only rise; it must rise far enough to justify the strike and premium.

This is where beginners often confuse a great company with a great option trade. NVDA can be a powerful business and still produce a poor option result if the strike, expiration, and premium do not match a realistic move.

Enemy 4: Wrong Expiration

The fourth enemy is choosing the wrong expiration. Some beginners buy expirations that are too short because they are cheaper. Others buy expirations that are too long without understanding how much extra premium they are paying. The right expiration depends on the trade idea.

If your trade idea needs one to two months to work, a one-week option may be too short. If your trade idea is based on a quick event, buying a two-year option may be unnecessary. Expiration is part of the strategy.

Enemy 5: Emotional Position Sizing

The fifth enemy is the most dangerous because it lives inside the trader. Position sizing means deciding how much money to risk on a trade. Emotional position sizing means the trade size is based on feelings instead of rules.

A strategy can be reasonable at small size and dangerous at large size. The setup did not change; the risk changed. Position sizing controls the emotional volume of the trade. If the position is so large that you cannot sleep, think clearly, or follow your plan, the size is wrong even if the trade wins.

How the Five Enemies Work Together

The five enemies rarely attack one at a time. They often combine. Imagine a beginner sees a stock at $100 that has already moved up strongly. Social media is excited, earnings are coming, and the beginner buys a $120 call expiring in one week because it costs only $0.40.

In that one trade, time decay is aggressive, volatility may be inflated, the strike is far away, the expiration is too short, and the cheap price may encourage too many contracts. If he buys 20 contracts, the real risk is $0.40 × 100 × 20 = $800. Repeated enough times, small lottery tickets become a real account problem.

From Prediction to Design

Most beginners think options trading is about prediction. They ask where the stock will go. That question matters, but it is incomplete. The better question is how to design the trade around what you think may happen.

If you think the stock may rise a little, maybe a bull call spread makes more sense than a far out-of-the-money call. If you want protection, maybe a bear put spread can work like insurance. The strategy should match the situation, not your excitement, not your fear, and not the cheapest contract on the screen.

Before buying any option, ask five questions: am I giving this trade enough time to work, am I buying expensive volatility, does the strike match my realistic target, does the expiration match the idea, and is the position small enough that I can follow my plan? If two or more answers are weak, the trade may not deserve your money.

In the next chapter, we will learn the language that helps measure these forces more clearly: delta, theta, vega, and gamma. They are the dashboard lights of an options trade.

Keep Reading

This sample chapter shows one of the central ideas of The Efficient Options Buyer: option buying is not only about direction. It is about designing a trade that can survive time, volatility, strike selection, expiration, and human emotion.

For the full book, look for The Efficient Options Buyer by Kanwar Gautam on Amazon.

Thank you for reading this free sample from Kanwar Gautam Publishing.