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WHAT IS A PUT OPTION

A PUT OPTION IS

a financial contract that gives the buyer the right, but not the obligation, to sell a specific quantity of an underlying asset at the strike price up until or on the expiration date. The seller of the put option, on the other hand, has the obligation to buy the underlying asset from the buyer if the buyer decides to exercise the option.

LONG PUT OPTION

Definition:

Being "long" a put option means that an investor has purchased a put option.

Mechanics:

- **Buyer's Rights:** The holder has the right to exercise the option. When an option is exercised the holder sells the underlying asset at the strike price.
- **Profit Potential:** Limited to the difference between the strike price and the underlying asset's price, down to zero.
- **Loss Potential:** Limited to the premium paid for the option.

Risks:

- **Limited Losses:** The maximum loss is limited to the premium paid for the option.
- **Time Decay:** Put options lose value over time, especially as they approach the expiration date. For more information on time decay read the article titled "Option Greeks".

Returns:

- **Limited Potential Returns:** Profits are bounded between the strike price and zero.

SHORT PUT OPTION

Definition:

Being "short" a put option means that an investor has sold a put option.

Mechanics:

- **Seller's Obligation:** The writer of the put option is obligated to buy the underlying asset from the buyer at the strike price if the buyer exercises the option.
- **Profit Potential:** Limited to the premium received for selling the option.
- **Loss Potential:** Limited to the difference between the strike price and the underlying asset's price, down to zero.

Risks:

- **Limited Losses:** While losses are limited, they can still be very large. Maximum loss is difference between strike price and zero.

Returns:

- **Limited Potential Returns:** The maximum gain is limited to the premium received for selling the put option.