

# UNDERSTANDING BINARY OPTIONS

Lesson 1





# Understanding **BINARY OPTIONS**

Lesson 01

## Getting Started

### *What are Binary Options?*

Binary options, sometimes called digital or fixed return options, are a simple yet exciting way to trade the financial markets, based on your opinion of whether the price of an asset—such as a share or commodity like gold—will close ABOVE or BELOW the current price over a certain period of time such as the next one hour. If your prediction is correct, you earn a fixed, pre-determined payout for that particular asset—generally 70%-80% of your investment amount.

Like traditional options, binary options are cash-settled and cannot result in the delivery of the underlying asset.

### *What are the basics in binary options trading?*

What are the basics in binary options trading?

There are a few basic considerations to binary options trading: the asset to trade, the direction of the price at the option expiration time relative to the current price, and the amount you wish to trade. If you believe the price of the asset will finish ABOVE the current price at expiry, you would want to buy a CALL option; if you believe the price of the asset will close BELOW the current price at expiry, you would want to buy a PUT option. As a trader you determine the amount which you want to invest on any given trade, whether it is \$50, \$100, \$500 or any other value depending on your confidence level and risk tolerance.

If your prediction is correct, you are “in-the-money”. If the market moves in the opposite direction of your prediction, you are “out-of-the-money”. If the underlying asset price closes at the exact same level, you are “at-the-money” and receive back your original investment amount.



## *What are the benefits of binary options trading?*

### → **Simplicity**

Tradesmarter simplifies the trading process to allow you to trade in multiple markets--forex, commodities, shares and stock indices--in an easy and exciting way. Binary options are much simpler to understand than other types of financial instruments since you only need a sense of direction, e.g. 'Will the AUD/USD be up or down in an hour?' and are not concerned with the magnitude of the move.

### → **Defined Risk & Return**

The return is known from the outset, as is what you stand to lose, in contrast to margined forex, CFDs, futures, sold options and other derivatives where losses can increase exponentially. Binary options traded on the Tradesmarter platform automatically close out at expiry time, so there's no need to constantly monitor your positions.

### → **Profit from Rising & Falling Markets**

Binary options provide trading opportunities in all market conditions and are ideal for traders who want to profit from both rising & falling markets. If you believe the price of the underlying market will rise, buy a call binary option. If you believe the price of the underlying market will fall, buy a put binary option.

### → **No Commissions**

Tradesmarter offers its clients the ability to trade online with no fees or commissions charged on trades.

### → **No leverage or margin to calculate**

Unlike margined forex, futures or CFD trading, binary options are not a leveraged product. Therefore, losses can never exceed your initial deposit and so you do not need to worry about margin calls, using stop orders or monitoring your open positions.

### → **Risk management**

Binary options are often used for speculative trading but when used properly, can also be an effective risk management tool to hedge exposure of a current holding in an underlying market.

### → **Profit opportunities in multiple markets**

Binary options provide convenient access to a wide range of markets and asset classes including forex, shares, commodities like oil futures and stock indices all on one account. Often times a share or forex trader will need to endure long periods of relative inactivity and short bursts of trading. Binary options trading is more versatile and offers opportunity even when markets are trading flat. A winning trade will receive the entire payoff (up to 81%), even if it was 'in-the-money' by a fraction of a pip since you are speculating simply on directional movement.

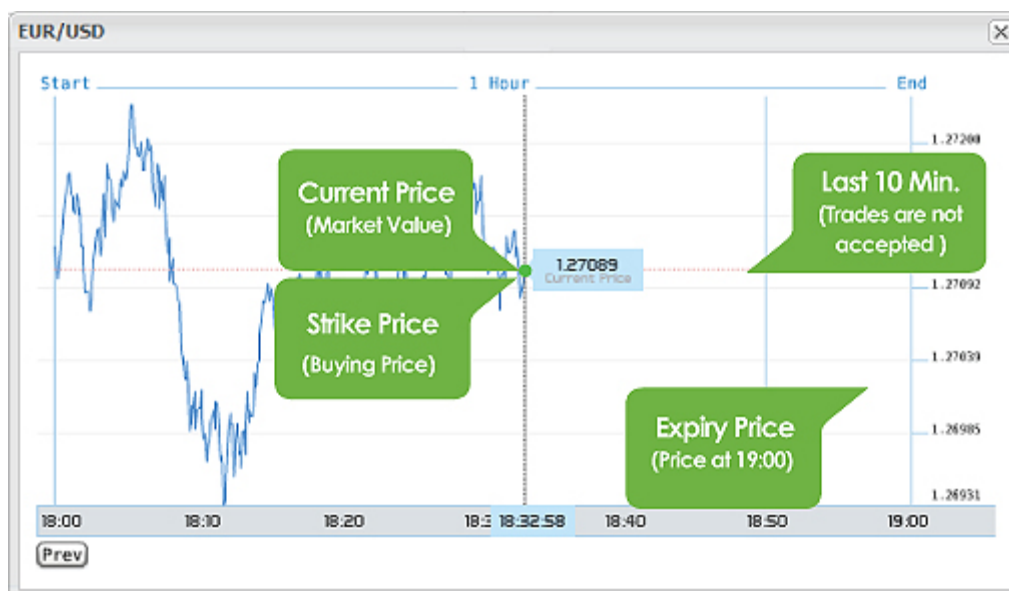
### → **Free Training & Support**

Tradesmarter offers its clients free training & support, depending on deposit levels. Ask us today for the range of support and trading tools we provide to our clients.



## Basic Terminology

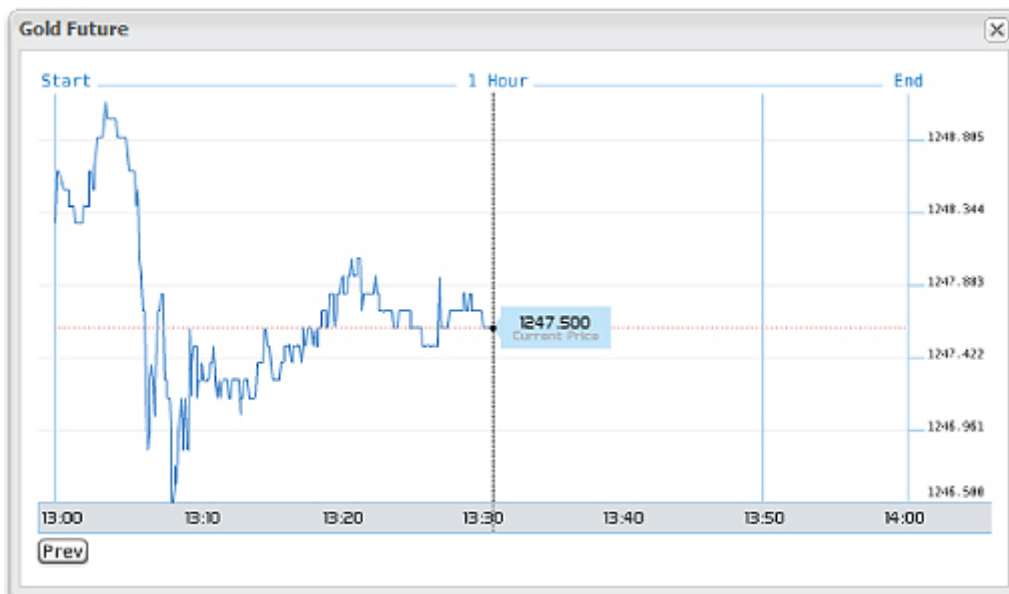
- 1) Current price: the price of the underlying asset.
- 2) Strike price: the price of the underlying asset when the binary option is purchased.
- 3) Expiry price: the price of the underlying asset at the time of expiry of the binary option.
- 4) In-the money: a successful option trade i.e. a CALL option that expired above the strike price or a PUT option that expired below the strike price.
- 5) At-the-money: an option trade in which the price during expiration is identical to the level at which the option was bought--in such a scenario the initial investment amount is fully returned to the customer.
- 6) Out-of-the-money: a failed option trade i.e. a CALL option that expired below the strike price or a PUT option that expired above the strike price.





## How Does it work?

Example: It's 1:30pm and Gold is trading at \$1,247.5. Positive economic news on US jobs is moving the US dollar up, and you believe that gold prices will fall as investors move their money out of safety and into higher profit US assets. Current payout on the binary option is 81%.



You believe gold prices will fall below current levels and execute a \$100 trade or “Put Option” for 2:00pm expiry. The strike price on the trade is 1,247.50. You were right and gold prices closed at 1,246.80, below the strike price of 1,247.50. In this case the in-the-money payout is 81% of our trade so you win \$81:

$$\mathbf{\$100 \times .81 = \$81}$$

If you were wrong and gold prices closed above the strike price of 1,247.50, say 1246.8, you would receive back the out-of-the-money payout of 10%, in this case \$10.

$$\mathbf{100 \times .10 = \$10}$$

Binary options trading are based on limited risk, meaning in the above example \$90 represents the maximum loss on that trade.