WealthCE

Underlying Categories

Options can be divided into multiple categories depending on which underlying asset they represent. The more known underlying asset categories are Bonds, Commodities, Currencies, Equities, Futures, Indexes, Interest Rates, and Yields.

Bond Options have bonds as the option's underlying asset. The market value of bonds move inverse to the interest rate of the bond's currency notation. The ability to exercise is indirectly affected by interest rate movements, bond values, and credit ratings interacting with the bond's market price.

Commodity Options have commodities as underlying assets such as gold, oil, silver, coal, timber, and rice. Futures are forward instruments instead of options, and are more popular for commodity trading. Trades are usually settled in either cash or commodities in futures trading.

Currency Options give the holder the option to buy (using calls) or sell (using puts) a stated currency for another coinage. These options are based on the exchange rates. Currency options also have alternatives in the futures market.

Equity Options give the holder the choice to transact a number of company shares. They can use a call to buy or a put to sell. Note the option itself does not give the holder any of the benefits of holding shares. You won't receive dividends, control, or voting rights over the underlying firm from the option. You must own the shares to receive those benefits. The firm receives no investment capital from you purchasing the option.

Equity options represent an underlying bundle of shares, typically 100. Share splits will result in changes to the bundle's delivery number. The options are increased by the same multiple as the share split, and the price is divided by that number. Share dividend payments are also increased by the same proportion as their distribution, and price is lowered accordingly. Cash dividend payments have no effect.

Futures Options give the holder the option to buy using calls, or sell using puts, a specific amount of futures contracts. The future contract's price is in relation to the future's exercise price, not the underlying asset price. You must still remain aware of the underlying instrument's market price, and its relation to profit and loss.

Index Options use an index as the underlying. The option trades a basket of securities weighted in the same proportions as the index. This can be any index which options can represent: shares, bonds, commodities, and etc. It can be customized indexes, as long as the target is popular enough to support options and has easily accessed price levels. The loss and gain is based on index level in relation to strike price. You obviously can't receive or deliver an index, so it multiplies the difference across the money specified in the option.

Interest Rate Options use interest rate levels as the underlying. Profit relies on the direction and amount of interest rates changes. If you believe interest rates will rise, you will buy call options or write put options. If you think interest rates will fall, you will buy a put option or write call options. Your profit depends on the interest rate relative to the exercise level.
Yield Options use the yield of a debt instrument as the underlying. They give you an inexpensive way to profit from guessing interest rate movement. You can protect yourself against both directions of interest rate movements which may hurt your bond portfolio positions. If you expect the underlying instrument's interest rate to increase, you buy yield based calls or write puts. If you expect the underlying instrument's interest rate to fall, you buy yield based puts or write calls.