

STEP ONE

**Understanding the
Long and Short of
“Call” Options in
the Market**

<http://www.pbookshop.com>

CHAPTER 1

Lon and Shorty

Lon was tall, prematurely graying, a creative thinker with interesting hobbies and intelligent children, and he was starting to feel like a real dope.

He was trying to secure his family's financial future, looking for this investment and that, the way a good father and forward-thinking man should, but he was starting to doubt his intelligence. Lon had started playing the stock market.

Well, of course, first he'd had to convince his wife he wouldn't lose everything they had on wild chances. That took some doing. Lon liked to think of himself as a pretty smart guy, but Cass had taken a pretty dim view of his creative enthusiasms ever since they took that trip to China without using a tour guide and spent the better part of a week trying to find a bathroom. And then there was that time he'd bought a time-share in London . . . *Nebraska*. He could never win an argument once she mentioned that.

But invest they must if they wanted to retire well, and Cass knew it as well as he did. They wanted to travel; spoil grandchildren; wear big, high-priced hats—Retire with a capital R. No 401(k) was going to do that for them. And even she knew he wasn't as big a dope as Bruce.

Bruce was the reason Lon and his wife didn't use a fund manager or financial adviser of their own. Bruce was Lon's fat, loudmouthed brother-in-law, and the biggest oaf on the planet. Lon's sister would start a family crisis if they used any *other* money manager, so he had to handle his investments himself. For a while he'd asked Bruce for stock tips just so he could do the exact opposite. That strategy was pretty satisfying on a personal level, but it didn't last long. Even Bruce, who last year had accidentally set

12 UNDERSTANDING THE LONG AND SHORT OF "CALL" OPTIONS IN THE MARKET

his boat on fire before he'd insured it, could make the right guesses often enough to stay ahead of the market. Barely.

So Lon was feeling a little dumb. He, too, performed about as well as the market as a whole, which meant that all his thorough studying, clear thinking, and careful diversifying put him in league with his oafish brother-in-law. Stocks sometimes rose, sometimes fell, and no matter how careful or sure he was, sometimes they surprised him and cost him money. Surely, *surely*, there was a way for an intelligent person to do better than simply hope his luck balanced out.

And without all the stress! *What if this happens, or that?* he would ceaselessly ask himself. Before he started investing he used to spend his free time chatting with his wife or dreaming up contraptions to make with his son; now he was spending half his free time checking financial reports and the rest of it worrying about what he would find the next time he checked.

Tonight, Lon was in his study, thinking about his most recent investment, and fiddling dejectedly with the model spaceship he'd made with his son last summer. He had just bought 100 shares of Plum stock (PLUM) at \$40 per share, and, based on his study of the company, he believed the stock price would grow to \$55 per share over the next six months. That would be a nearly 38 percent increase, and meant his investment would then be worth \$5,500. That kind of increase would be terrific—if it happened.

What would really be best, Lon mused, would be if he could travel through time—go six months into the future. Then he'd know if the price really had grown to \$55. And—*even better*—if he could bring, say, a coupon that promised he could buy Plum for only \$40. Then he could buy for \$40 and sell for \$55 on the very same day, and make \$15 almost instantly.

Time travel was pure science fiction, of course. But he couldn't help wondering. *Wouldn't it be great if there were a way I could buy 100 additional Plum shares in six months and still buy them at today's price of \$40, rather than the \$55 I think they will be selling at by then?*

Lost in thought, Lon swiveled back and forth in his hand-me-down and worn-out office chair. At work, he often completed projects that had started out as no more than an interesting but impossible idea. Maybe there was a way to actually make that happen. Maybe he could make some sort of deal with someone . . . but who? And what *kind* of deal?

Lon's imagination failed him. Anyway, it was late. He turned to cable news for a financial update and went to bed. "How's the money, honey?" Cass asked him drowsily when he leaned over to kiss her.

"Just call me Bruce," he replied. She chuckled and returned to sleep.

Sleep came to Lon eventually, too. But not rest.

* * *

Fifteen miles away, on the opposite side of Wichita, Shorty sat at the maple desk in his cramped bedroom, poring over the day's mail. He was a small but muscular man, a steady, clear-thinking accountant in the same firm that employed Lon. Shorty was one of those friends Lon had been talking to about investing. Little known to Lon, their most recent conversation had really gotten Shorty thinking. Surely there must be some way to make money in the stock market that was more certain than just hoping for the best.

Shorty rather enjoyed following the market; its ins and outs and near-unpredictability fascinated him. Sharon, his wife of four years, teased him that he would check financial news even if he didn't invest. But he never risked very much or bought too much of any one stock; he'd worked diligently for his money and didn't like the thought of losing it all on a gamble. Still, he'd had one stretch where every stock he bought immediately went down. In disgust, he'd decided that the best way to make money would be to go around the country, demonstrating his track record to CEOs, and threatening to buy their stock if they didn't pay him a sizeable fee. Extortion? Sure. But what was a person to do?

Still, he knew that investing was his only real chance at the future he envisioned. He dreamed of retiring to someplace warm, maybe by the ocean. He fantasized sitting on a porch with Sharon, worry free, sipping cold soft drinks even in the winter—maybe writing a nice book. If he wanted that to happen, he simply had to plan ahead. And he was too well-informed to be satisfied with his 401(k). Playing the stock market was the only way he knew to secure that blissfully quiet dream.

Finishing the mail, Shorty turned his attention to his stock picks. He, too, had just purchased 100 shares of Plum at \$40 per share. He believed that the price of Plum would grow over the next 18 months, but he had just gotten some news that made him think it might actually go down in the near term—maybe as low as \$25 per share, or even lower.

Shorty pondered the situation. He was probably going to lose money on those shares, but he wouldn't sell them because he was pretty sure the price would go back up and above the \$40 he had spent. But he wished there was some way he could turn the situation to his advantage in the short term. That was the problem with the stock market. You couldn't know for sure what it was going to do, and now he would have to sit on his \$40 shares while the price dropped. Of course he could always sell Plum now and buy again later when the price was lower, but that just required more guesswork, and after all, he wasn't *that* sure that the price was going to drop.

Shorty sighed. What he wanted was a sure thing. Some way to make sure he could make money, or at least not lose money, no matter what

14 UNDERSTANDING THE LONG AND SHORT OF "CALL" OPTIONS IN THE MARKET

happened to the market. *Oh well*, he thought. *Nothing to do about it. That's just not how it works.*

When he finally climbed into bed at 11:30, Sharon asked about his investments. He had to confess he thought his most recent investment would take a hit. "But I'm pretty confident it'll go back up again."

"Then I'm sure it will," she soothed. Sharon was an encouraging, supportive wife, and a pretty good liar.

<http://www.pbookshop.com>