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OPTIONS RISK & ODTE

Hedging, position sizing, and the truth about same-day options — Part 4.

Alpha Academy · Team Alpha Trading

Options Part 4: Risk, Hedging & the Truth About ODTE

This is the most important document in the options series. Parts 1–3 taught you what options are and how the strategies work. This part teaches you how people actually lose money with them. The losses are rarely a surprise: they come from the same few causes, over and over, and every one of them can be understood before you ever place a trade.

You will learn why most option buyers lose, how to size a position so one bad idea cannot wreck your account, how to use puts as genuine insurance for a portfolio, and the plain truth about **0DTE** options — trades that expire the same day you buy them. Nothing here is meant to scare you away from options. It is meant to keep the market's tuition — the money every trader pays while learning — small enough that you are still trading next year.

> **RISK**
> Most beginners who trade options lose money, especially in their first year. That is not a insult and it is not bad luck. It is the predictable result of the mechanics in this chapter: time decay, overpaying, oversizing, and trading instruments designed to expire in hours. Read this chapter twice before your first live options trade.

Why Most Option Buyers Lose

Buying an option feels safe because your loss is capped at the premium. That part is true. But a capped loss that happens almost every week is still a fast way to drain an account. Here are the four causes that do the damage.

1. Theta: the rent you pay every day

Theta is time decay — the amount of value an option loses each day simply because one day of its life is gone. An option is a wasting asset, like an ice cube in the sun. It does not need the stock to move against you. Standing still is enough.

Watch it happen. You buy a call for **$2.50** with 30 days until expiration. The stock goes nowhere for two weeks — not down, just flat. Your call is now worth roughly **$1.20**. You lost about half your money and the stock did nothing wrong. Theta speeds up as expiration approaches, so the last week of an option's life is where value evaporates fastest. Every day you hold a bought option, the clock charges you rent.

2. Buying too far out of the money

An option is **out of the money** when its strike price is far from where the stock trades — for a call, a strike far above the price. These options are cheap, and cheap is seductive: "It's only $0.80. If the stock pops, I make ten times my money."

Run the real math. A stock trades at $100. You buy the **$110 call** for $0.80, expiring Friday. For that call to be worth anything at expiration, the stock must climb more than 10% in four days. That happens occasionally — and fails to happen most of the time. The stock rises a healthy 3% to $103, you were right about direction, and your call still expires worth exactly **$0**. A string of "only $80" losses is how accounts quietly bleed out: ten of them is $800 gone.

3. Overpaying when excitement is high

Implied volatility (IV) is how much movement the options market is pricing in. When big news is coming — an **earnings report**, the company's quarterly profit announcement, is the usual case — IV rises and every option gets expensive. Buyers pay panic prices, the news prints, IV collapses (this is **IV crush**, from Part 3), and the option loses value even when the stock moves the way the buyer hoped.

4. No plan: no exit, no size limit, no reason

The final cause ties the others together. Many beginners buy an option because a price was moving, a stranger posted about it, or it "felt cheap" — with no target for taking profit, no plan for cutting the loss, and whatever size the account allowed. Professionals work the other way around: the reason, the exit plan, and the size are decided **before** the order is placed. The next section covers size, because size decides whether a losing streak is a lesson or a funeral.

Position Sizing: Deciding Your Loss Before It Happens

Position sizing means choosing how much money a trade is allowed to risk before you enter it. For options, the honest way to size is by **premium at risk**: if you buy an option, assume the entire premium could be lost, because sometimes it will be. Size the trade so that a total loss is annoying, not devastating.

> **RULE**
> A common professional guideline is to risk a small fixed slice of your account on any single options idea — often **1% to 2% of the account** — counting the full premium (or the full maximum loss of a spread) as the amount at risk. This is a risk guideline, not a promise: it cannot make a bad trade good, but it can keep a bad trade small.

Work it with real numbers. Your account holds **$10,000**. At a 1% risk guideline, one idea may risk **$100**. Now look at a call priced at $2.50 — that is $250 per contract. One contract risks $250, which is 2.5% of your account: too big under a 1% rule. Your choices are to find a cheaper structure (a spread, from Part 3, can cut the amount at risk), choose a smaller premium, or skip the trade. Skipping is a legitimate answer.

Notice what this rule does to a losing streak. Ten losses in a row at 1% each cost about 10% of the account — painful, recoverable. Ten losses at 10% each cost about 65% and usually end the trader. Same trades, same market. The only difference was size.

> **NOTE**
> Percentages and account examples here are educational illustrations, not financial advice. The right risk level for you depends on your finances and goals — talk to a licensed professional about your own situation.

Hedging: Puts as Portfolio Insurance

A **hedge** is a position designed to lose a little money in good times so it can protect you in bad times. The most direct options hedge is the **protective put** from Part 3, scaled up from one stock to a whole portfolio.

The house-insurance analogy is exact. You pay a premium on your house every year. In a normal year that money is simply gone, and you do not call it a "losing trade" — you bought protection, and protection has a price. In the one year the fire comes, the policy pays out and saves you. Portfolio insurance works the same way, with the same honest cost: in calm years, it drags your returns down by what you spent on it.

Here is a concrete version. You hold **100 shares of an S&P 500 index ETF** — a fund that trades like a stock and tracks the 500 large companies of the S&P 500 index — at **$500 per share**. Your position is worth **$50,000**. You buy one put with a **$475 strike** (5% below the current price), expiring in three months, for **$6.00**. One contract covers 100 shares, so the insurance costs $6.00 × 100 = **$600**.

- **A calm quarter:** the market rises or drifts. The put expires worthless. You are out $600 — the price of sleeping well.
- **A crash:** the market falls 20%. Your shares drop to $400 each: a loss of **$10,000**. But your put is now worth $475 − $400 = $75 per share, or **$7,500**. Your total result is roughly −$10,000 + $7,500 − $600 premium = **−$3,100** instead of −$10,000. The put did not make the crash painless. It made it survivable.

Renewed every quarter, protection like this costs about **$2,400 per year** — roughly 5% of this portfolio. That is real money, which is why many long-term investors hedge only around specific worries (a big event, a concentrated position, money needed soon) instead of all the time. Cheaper puts struck further below the price cost less and protect less. There is no version of insurance that is both free and effective.

0DTE: The Truth About Same-Day Expiration

0DTE stands for **zero days to expiration**: options that expire **today**, at today's close. Major index options now offer an expiration every trading day, so there is always a contract living its final hours. 0DTE trading has exploded in popularity. You should understand both sides of why.

Why it is popular

The attractions are real. Premiums are small in dollars — a contract might cost $0.90, or $90 — so a trade feels cheap. The moves are fast: a contract can double in twenty minutes. There is no overnight risk, because the position is gone by the close. It is easy to see why screenshots of 0DTE wins spread online. What the screenshots leave out is the base rate: most of those cheap contracts expire worthless, because they are built to.

Why it is the fastest way to lose

Two forces from earlier chapters reach their extreme in the final hours.

Theta, at full speed. An option with four hours of life left loses value by the minute, not the day. Buy a call at 1:00 PM for $0.90. If the index simply goes sideways until 2:30 PM, that call may be worth $0.25 — a 70% loss while the market did essentially nothing.

Gamma, the accelerator. Gamma measures how violently an option's price sensitivity changes when the stock moves. Far from expiration, gamma is tame. In the final hours, near the strike price, gamma is enormous: a $0.50 move in the index can swing a 0DTE contract from $0.20 to $2.00 — or from $2.00 to $0.05 — faster than a beginner can react. Near the close, prices jump around so quickly that the price you click and the price you get can also differ badly.

> **RISK**
> 0DTE options combine the fastest time decay, the wildest price swings, and the least time to recover from a mistake. A contract bought at lunch can be worthless by the close with the market barely moved. If options are a casino for anyone, this corner is the slot machine. Beginners should watch 0DTE, study it, and leave it alone until defined-risk trading on longer expirations is boring and routine.

Assignment and Pin Risk at Expiration

Two end-of-life traps catch people who hold options into expiration day.

Assignment means the other side of your sold option used their right, and you must complete the deal: buy the shares (if you sold a put) or sell them (if you sold a call). Assignment on a sold option can happen any time before expiration, but it clusters at the end, and it is usually processed overnight — so you can wake up Monday owning 100 shares you never planned to hold, with the market gapping over the weekend against you.

Pin risk is the nastier cousin. It appears when the stock closes expiration day almost exactly **at** your sold strike price — "pinned" to it. Your option's buyer may or may not exercise; their decision can depend on news released after the close, which you cannot see. You spend the weekend genuinely not knowing whether you own the shares, while your own protective option on the other side of the spread may have expired worthless by a few cents. This is why experienced spread traders close positions before expiration day: the last $20 of profit is the most expensive money in options.

Early Exercise and Dividends

Most stock options are **American-style**, meaning the buyer can **exercise** — use the right in the contract — at any time, not only at expiration. The most common moment for early exercise is the day before a stock's **ex-dividend date** (the date by which you must own a stock to receive its next **dividend**, the cash payment some companies send shareholders). If a call's remaining time value is smaller than the dividend, the call's owner may exercise early to capture the payment. If you sold that call, you can be assigned and have your shares taken the night before the dividend — and the dividend goes to the new owner. If you sell calls on dividend-paying stocks, know the ex-dividend dates.

When Your Broker Closes Your Position

Here is a protection you might not know exists. If you hold expiring options that could be exercised or assigned, and your account lacks the money or margin to handle the result — say, a call expiring in the money would exercise into shares costing more cash than you have — many brokers will **close the position for you** during the final afternoon of expiration day, at whatever price the market gives. The details differ broker by broker: some warn you first, some act without asking, some charge a fee. Before you ever hold an option into expiration day, find and read your own broker's current policy on expiring positions.

A Sane Beginner Path

Options reward patience and punish tuition paid at full size. Here is the order of operations that gives a beginner the best odds of surviving the learning curve:

1. **Paper trade first. Paper trading** means practicing with simulated money in a realistic account. Use it until you can place, manage, and close every basic strategy without hesitation — and until you have watched theta and IV crush happen to your own fake positions.
2. **Start with time on your side.** Choose expirations **30 to 45 days out** or more. Decay is slower, prices are calmer, and a wrong idea can be managed instead of expiring on you by Friday.
3. **Prefer defined-risk trades.** Bought options and spreads state their worst case in dollars up front. Let that be your whole world until it is routine.
4. **Trade tiny.** One contract, at a size where a total loss is a shrug. You are buying experience at its cheapest price.

5. **Keep a journal.** The reason for every trade, the plan, and the result. Your future skill is hiding in your past mistakes, written down.
6. **Save 0DTE and event gambles for later — or never.** They are not a shortcut around the learning curve. They are the learning curve, set on fire.

Common Beginner Mistakes

- **Treating a capped loss as a small risk.** Losing "only" the premium is no comfort when the premium was 10% of your account. The cap does not save an oversized trade.
- **Buying cheap, far out-of-the-money options as lottery tickets.** Most expire worthless. A pile of small certain losses adds up to a large one.
- **Holding bought options while the stock goes sideways.** Theta does not need the stock to fall. Flat is enough to drain a position to zero.
- **Jumping straight into 0DTE because the contracts look cheap.** Cheap in dollars, extreme in speed — the hardest options environment that exists.
- **Holding spreads through expiration for the last dollars.** That is where pin risk and surprise assignment live.
- **Ignoring ex-dividend dates on stocks whose calls you sold.** Early assignment the night before a dividend is a normal event, not bad luck.
- **Assuming your broker will always save you.** Brokers may liquidate risky expiring positions, but policies differ and prices at that moment can be terrible. Managing your own exits is your job.

Chapter Summary

- Most option buyers lose for mechanical reasons: theta charges rent every day, far out-of-the-money options usually expire worthless, hyped events inflate premiums through IV, and trades entered without a plan or size limit repeat until the account is gone.
- Size by premium at risk. A common guideline: risk about 1–2% of the account on one options idea, counting the full premium — or a spread's full maximum loss — as the amount at risk.
- A hedge costs money on purpose. Protective puts on a portfolio work like house insurance: a steady small cost in calm times that converts a catastrophic loss into a survivable one.
- 0DTE options expire the same day. In their final hours, theta runs at full speed and gamma makes prices swing violently — the fastest environment in which to lose money.
- Assignment can deliver shares to your account over a weekend, and pin risk means not knowing until Monday whether it happened. Close positions before expiration instead.
- Call owners may exercise early before an ex-dividend date; if you sold the call, expect possible assignment.
- Brokers may close risky expiring positions on expiration day if your account cannot handle exercise or assignment. Know your broker's policy before you need it.
- The beginner path that survives: paper trade, use expirations 30–45+ days out, trade defined risk, trade tiny, and write it all down.

Check Yourself

1. A call you bought for $2.50 is worth about $1.20 two weeks later, and the stock has not moved. What ate the value?
2. Your account is $10,000 and you follow a 1% risk guideline. A call costs $2.50 per contract. Can you buy one contract within the guideline? Why or why not?

3. In the insurance example, the market falls 20% and the shares lose $10,000. Roughly what is the total loss with the $475 put in place, after its payout and the $600 premium?
4. What are theta and gamma doing in the final hours of a 0DTE option's life?
5. What is pin risk, and what simple habit avoids it?

Answers: 1) Theta — time decay. Half the option's life passed with the stock flat, so its time value melted away. 2) No. One contract risks the full $250 premium — 2.5% of the account, more than the $100 the 1% guideline allows. Use a cheaper structure, a spread, or skip the trade. 3) About $3,100: the put pays $7,500 against the $10,000 loss, minus the $600 premium you paid. 4) Theta drains the option's value by the minute, and gamma is at its maximum, so small stock moves cause violent percentage swings in the contract's price. 5) Pin risk is the uncertainty when a stock closes expiration day almost exactly at your sold strike — you cannot know over the weekend whether you were assigned. Closing positions before expiration day avoids it.

> **RULE**
> Risk is decided before the trade, not during it. Fix your maximum loss, keep it near 1–2% of your account per idea, and let time — not today's expiration — be on your side.