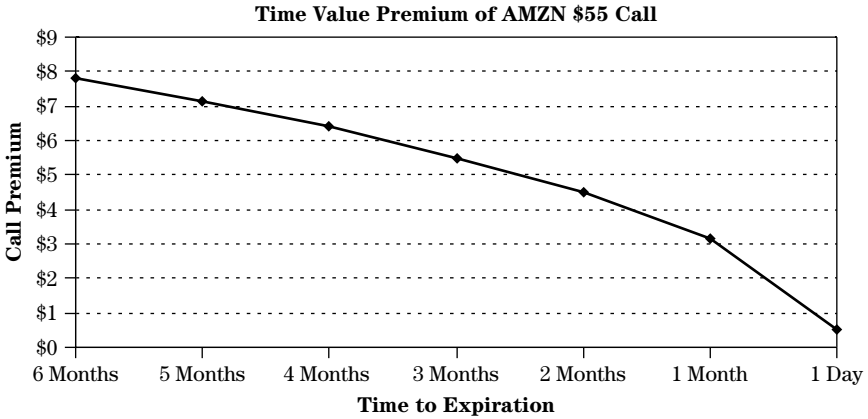

FIGURE 2.2

absolute dollar and percentage changes in the call price increase. The difference in the value of the call price between 6 months and 5 months to expiration, and even between 5 months and 4 months to expiration, is not that significant. However, the difference in the value of the call between 2 months to expiration and 1 month to expiration and in the last month before expiration is quite dramatic. Figure 2.2 shows the value of the $55 Call versus time to expiration.

Figure 2.2 gives us a visualization of the properties of time decay in an option. The further out from the expiration date the option is, the smaller is the effect of time decay, which is greatest in the last 30 days. These characteristics of time decay are extremely important to remember when trading options because they can be used to your advantage.

When purchasing long options, you are susceptible to time decay in your options if the stock moves sideways. For each day the stock does not move, your option loses value. This loss in value is smaller the further out you go in time. Therefore, the best way to minimize the effect of time value on your long option position is to use options with as much time to expiration as possible based on your risk/reward requirements. When purchasing a long call or long put, for example, you want to have as much time as possible not only for your option to move ITM, but also to reduce the effects of time decay in case the underlying stock moves sideways for a period of time.

Most traders do not understand this concept of time value or time decay because they think short term. When a stock is expected to move, many beginners fall into the habit of buying options with less than 30 days to expiration because they are the cheapest. The stock begins to move back and