

Max Loss, Max Gain, and Stating Risk First

Knowing your max loss before entry is the single habit that separates traders from gamblers.

State the maximum loss before you click. If you can't name the number, you're not ready to click.

TERMS

Max loss: The worst-case dollar loss, named before you click, not discovered after.

Defined risk: A nameable worst case, known before entry. Doesn't mean the loss is small.

Undefined risk: No ceiling on the loss. The naked short call is the clearest example.

Naked short call: Selling a call without owning the shares. Loss grows without limit if the stock rallies.

Cash-secured put: A short put backed by cash to buy the shares. Bounded because stock can only fall to zero.

BEFORE YOU ACT, CHECK

- ☐ What is the position type?
- ☐ Is the risk defined or undefined?
- ☐ Can I state the maximum loss in dollars right now?
- ☐ If I can't fill in that number, am I still clicking?

QUICK RECALL

1. What is the maximum loss on a long call?
The premium paid, nothing more. A call buyer's worst case is capped at what they spent.
2. Which position carries undefined, uncapped risk: a long put or a naked short call?
A naked short call. Selling a call you don't own exposes you to unlimited loss if the stock keeps rising.

NUMBERS

Max loss, long call or put	premium x 100 x contracts	\$1.50 premium, 2 contracts: \$1.50 x 100 x 2 = \$300.
Max loss, naked short call	unlimited, no ceiling	Stock can rise without limit, so the loss has no cap.
Max loss, cash-secured put	(strike - premium) x 100 x contracts	Bounded because the stock can only fall to zero, not below.

THE TRAP

"Buyers lose over time, so selling is the smart side."

Premium decay is real: most options that finish out-of-the-money expire worthless. But that's a mechanics fact, not a hint to flip and sell. Selling brings its own risk, sometimes undefined, covered later in the course.

CARRY FORWARD

- Long call and long put max loss = premium x 100 x contracts. Say the number before you click.
- Defined risk means a nameable worst case. Undefined means no ceiling on loss.
- Risk-first is a ritual: name the max loss before every entry, not just when worried.

Next: Module 1.8 Assignment, Expiration, and Meet Delta: what happens when the clock runs out.

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