The three judgements an options view requires

> **THE THREE JUDGEMENTS**
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> An options view requires three correct judgements where a share view needed one: direction (which way), timing (by when, because the option expires and decays), and volatility (whether the move is larger or smaller than the premium prices). All three must be right for a bought option to pay - which is why options are harder than the underlying, and why a correct direction alone, the share trader's whole edge, is not enough here.

The options analysis module opens on the structural fact that governs it: an options view is three judgements, not one. A share trader needs direction; an options trader needs direction, timing and volatility, all correct, because the instrument prices all three.

The three judgements

Direction: which way the underlying moves - the share trader's whole judgement, and only the first of the option trader's three; necessary, and far from sufficient.Timing: by when the move happens - because the option expires and decays (module 1), a correct direction that arrives too late still loses; the option prices time, so the view must judge it.Volatility: whether the move is larger or smaller than the premium already prices - because implied volatility is baked into the premium (module 1), a move the market already expected is priced in, and the view must judge whether the actual move will exceed the priced one.

Why all three must be right

A bought option pays only if all three judgements are correct: right direction, wrong timing loses to decay; right direction and timing, but a move smaller than the premium priced, loses because the volatility was already in the premium; right direction and volatility, wrong timing, still loses to expiry. The three judgements compound - each is a way to be wrong even when the others are right - which is why options are structurally harder than the underlying, and why the share trader's intuition, honed on direction alone, fails here. The instrument prices three things, so the view must judge three things.

The reframing this forces

An options view is a disagreement with the market's priced distribution (module 2) on one or more of three axes: the underlying will move further than priced (a direction-and-volatility view), sooner than priced (a timing view), or the priced volatility is wrong (a pure volatility view). This is why module 2 said an options view is about the distribution's shape, not just its centre - the three judgements are the axes of that disagreement. The rest of the analysis module takes each judgement in turn: why direction alone fails (lesson 2), timing as a judgement (lesson 3), volatility as a judgement (lesson 4), and how the three combine into a view a structure can express. Three correct judgements, compounding - the honest difficulty of options analysis, stated first.

Check your understanding

1. What three judgements does an options view require?

a. Entry, stop and target

b. Direction (which way), timing (by when, because the option decays and expires), and volatility (whether the move exceeds what the premium already prices) - all three correct

c. Strike, expiry and premium

Answer: b. A share view needs direction alone; an options view needs three, because the instrument prices direction, time and volatility. All three must be right for a bought option to pay.

2. Why can a correct direction still lose in options?

a. Direction is never correct

b. Wrong timing loses to decay, and a move smaller than the premium priced loses because the volatility was already in the premium - the three judgements compound

c. Commission takes the profit

Answer: b. Each judgement is a way to be wrong even when the others are right. The share trader's whole edge - direction - is only the first of three, and far from sufficient.