

Options
on the
Dow Jones
Industrial
Average



**Act on the
Market You
Know Best.**

A glossary of options definitions appears on page 21.

The Chicago Board Options Exchange (CBOE) is the world's largest options market and the second largest securities exchange in the United States. CBOE was founded in 1973, creating the world's first standardized, listed equity options. Today, CBOE continues to be a dominant force in the financial industry. This success has been accomplished by CBOE's leadership and innovation, and its commitment to individual and institutional investors worldwide.

Do you often have
strong opinions
on the market's direction?

Are you looking to
participate in the market
without holding a large stock portfolio

Are you looking for a
new type of investment tool
that allows you to trade
the market like a stock?

Are you interested in
short-term protection
of your portfolio in a sometimes
volatile stock market?

**Then Options
on the Dow Jones
Industrial AverageSM
may be for you.**

Options on The DowSM



Now, you can use options to trade on one of the most recognized and followed market indicators in the world — the Dow Jones Industrial AverageSM (DJIA).

With options based on The Dow (trading symbol DJX), you have a tool for participating in the market, allowing even the most conservative of investors to participate in the performance of 30 blue-chip stocks. Armed with widely available research and investment advice, you can act on your market opinion with just one trade.

With DJX options:

- **Risks of purchase are known.**
- **Trading is easy.**
- **Capital outlays can be minimal.**

A product with unlimited possibilities.

With DJX options, you can choose a strategy to participate in a bull, bear or neutral market. Purchasing calls may enable you to commit less capital than you would need to buy the stocks outright — with the added advantage of knowing your risks ahead of time. Purchasing puts gives you the opportunity to participate even in bearish markets. With options based on The Dow, the possibilities are endless.

It's simple.

A stock index is simply a collection of stocks. DJX is the DJIA divided by 100. With DJX options, you can trade on the overall direction of the market, whether it rises or falls. You can do this through two kinds of options: calls and puts.

For the sake of simplicity, taxes and commissions have been omitted from the discussions and strategies that follow.

A DJX call option gives the buyer the ability to profit if the index rises *above* a predetermined level — the break-even point (call strike price *plus* premium paid) — during the life of the option. When you purchase a call option, your profit potential is unlimited in a rising market. Should the market fall, your loss is limited to the amount paid for the call option.

A DJX put option, on the other hand, provides its owner the potential to profit if the index falls *below* the break-even point (put strike



price *less* premium paid) during the life of the option. The holder of a put option has substantial profit potential in a down market — the more the index falls below the option's strike price, the higher your profit potential. Again, if the market does not react the way you have anticipated, your loss is limited to the amount paid for the option.

As an investor, you have a choice of options with short-term and long-term expirations, as well as many strike prices. No matter what your market outlook, there is an options strategy for you. DJX options are [cash-settled](#); meaning no actual stocks are ever bought or sold on behalf of the option buyer. They have a [European-style exercise](#) — they can be exercised only at expiration.

Your risk is limited.

The buyer of a call or put option pays the seller of the option a price known as the *premium*. The options premium for DJX options is stated in decimals. The prices are multiplied by \$100 to determine total cost. For example, if the option price is quoted at 4.5, the premium paid is \$450. The risk for the buyer of

an option is limited to the amount of the premium. So the risk is both known and limited.

DJX options are regulated securities, in the same class of investments as stocks or bonds. Like trading in stocks, options trading generally takes place only on registered securities exchanges and is regulated by the Securities and Exchange Commission. DJX options trade exclusively at the Chicago Board Options Exchange (CBOE).

CBOE: The world's leading options marketplace.

CBOE revolutionized options trading in 1973 by creating the first exchange listed options. It is only natural that CBOE, the pioneer of and leader in listed options trading, offers investors options on the Dow Jones Industrial AverageSM.

In 1983, CBOE created the world's first index options product — options based on the S&P 100 Index[®]. Known as OEX[®], this product is one of the most actively-traded index options contract in the world. Additionally, CBOE trades options based on eight broad-based market indices — including the S&P 500 Index[®], which is generally considered to be the performance benchmark for the market followed by institutional funds; the Russell 2000[®] Index, a measure of the performance of small companies; and the Nasdaq-100[®], a benchmark of OTC issues. Further, CBOE lists options on over 1,400 securities, 25 sector indexes and 17 structured products.

CBOE consistently trades a majority of all U.S. index options. Its innovative products and markets set the standard for exchanges around the world. In short, CBOE is *the* global leader in index and equity options.

Options trading at CBOE is supported by state-of-the-art systems and automation, enabling CBOE to execute options trades with unsurpassed levels of speed and efficiency.

**The Dow Jones Industrial Average:
a barometer of the U.S. economy.**

Developed by Charles Dow in 1896, the Dow Jones Industrial Average is the oldest continuing measurement of the U.S. stock market. Simplicity is the primary reason this market gauge has stood the test of time. The index is currently composed of 30 of the most widely-held and actively traded stocks listed on the New York Stock Exchange.

All over the world, experienced and novice investors alike are familiar with the Dow Jones Industrial Average. From news reporters to analysts' forecasts to internet chat sessions, it is one of the best known and followed indicators in the world. It continues to be a convenient benchmark for comparing the performance of individual stocks to the overall market. It is computed real-time throughout the trading day and is maintained by the editors of *The Wall Street Journal*, which is published by Dow Jones & Company, Inc.

The 30 stocks in the Dow Jones Industrial AverageSM are*:

**AT&T Corp.
Alcoa, Inc.
AlliedSignal Inc.
American Express Co.
Boeing Co.
Caterpillar Inc.
Citigroup
Coca-cola Co.
E.I. duPont de Nemours & Co.
Eastman Kodak Co.
Exxon Corp.
General Electric Co.
General Motors Corp.
Hewlett-Packard Co.
Home Depot Inc.
Intel Corp.
International Business Machines Corp.
International Paper Co.
Johnson & Johnson
J.P. Morgan
McDonald's Corp.
Merck & Co. Inc.
Microsoft Inc.
Minnesota Mining & Manufacturing Co.
Philip Morris Cos. Inc.
Procter & Gamble Co.
SBC Communications Inc.
United Technologies Corp.
Wal-Mart Stores Corp.
Walt Disney Co.**

**As of July 5, 2001.*

DJX calls:

Participating in a bull market.

Although the Dow Jones Industrial Average is over 100 years old, it took more than 70 years to reach 1,000. Its upward growth began in the 1980s and soared through the late 1990s to close the century well above the 11,000-point mark. In the 90s, the combination of low inflation, low interest rates and the soaring value of technology stocks, together with strong corporate earnings and a massive influx of money into equity mutual funds contributed to this increase.

The Dow continues to rise and fall above the 11,000 mark as the market adjusts itself to the accelerated growth it experienced in the late 90s. As the technology sector reacts to its growing pains, The Dow will continue to reflect the current trends of the market.

If you see the market rising, you can explore DJX call options.

Challenge:

You believe that the stock market will continue to rally in the near-term and would like to participate, but you wish to limit the capital outlay required to buy the stocks outright.

Solution:

Buying a DJX call option.

Purchasing a call option is the simplest of bullish options strategies. There is unlimited profit potential with this tactic. Profit increases as the DJX rises above the break-even point — the point at which the DJX equals the call strike price *plus* the premium paid. Investors are aware of the risks in advance; losses are solely limited to the premium paid, no matter how far the DJX moves below the break-even point.

Buying DJX Calls

This strategy is based on a hypothetical situation and should only be considered as an example of a potential trading approach. Taxes, commissions and margin requirements are not included but must be taken into account when calculating the actual net returns for any option transaction.

Suppose the DJIA is at 10,500. DJX is based on 1/100th of the DJIA, so the options index value would be at 105.00. As shown in the table, you could purchase five 6-month call options with a strike price of 105.00. Each premium point is multiplied by \$100 to determine total cost. Therefore, if you paid a premium of 5.50, you have paid \$2,750 for five contracts ($5.50 \times 5 \times \$100 = \$2,750$). To make a profit, the DJX must rise above a break-even point of 110.50 ($105 + 5.50 = 110.50$).

If the Dow reaches 11,550 at expiration (DJX = 115.50), the five 105.00 calls would be worth \$5,250 [$(115.50 - 105) \times 5 \times \$100 = \$5,250$]. You would then reduce this amount by the premium paid (\$2,750) to arrive at a profit of \$2,500.

If the Dow fell to a level of 9,450 (DJX = 94.50), your calls would have no value and your loss would be limited to the total premium paid of \$2,750.

Possible outcomes of purchasing five DJX 105 calls at a premium of 5.5:

LEVEL OF DJX AT EXPIRATION:	112.35	115.50	120.75
Move in the DJIA	+ 7%	+ 10%	+ 15%
Expiration value of five 105 strike calls	\$3,675	\$5,250	\$7,875
Less: premium paid (five calls @ 5.5)	-\$2,750	-\$2,750	-\$2,750
Net gain/loss*	\$925	\$2,500	\$5,125

LEVEL OF DJX AT EXPIRATION:	97.65	94.50	89.25
Move in the DJIA	- 7%	- 10%	- 15%
Expiration value of five 105 strike calls	\$ 0	\$ 0	\$ 0
Less: premium paid (five calls @ 5.5)	-\$2,750	-\$2,750	-\$2,750
Net gain/loss*	-\$2,750	-\$2,750	-\$2,750

*Exclusive of commissions, taxes, and other transaction costs.

Choices:

If a call is not sold prior to expiration, and the DJX is above the strike price, you will receive a cash payment at expiration equal to the difference between the DJX and the strike price, multiplied by \$100.

However, suppose the market begins to turn away from your position, another method you might use to limit loss (premium paid) is to close your position. In this case, you opened your position by purchasing the 105.00 calls. By selling the 105.00 calls, you are making a closing sale, thereby creating a zero net position. Remember that you've already paid \$2,750 for the five call option contracts. If you

could sell the calls at the current bid, for example, 4.25, and receive \$2,125 ($4.25 \times 5 \times \$100 = \$2,125$), you could limit your net loss to \$625 ($\$2,750 - \$2,125$). Therefore, using this technique could enable you to recover a portion of the call premium you have already paid and limit your net loss on the position. Don't forget that if you wish to trade out of your DJX options position, you must complete your transaction no later than the Thursday prior to the expiration date.

DJX puts: Taking advantage of a market downturn.

Consider economists and market forecasters turning bearish on the market in the short-term. They feel that despite the Federal Reserve's attempts to lower interest rates to curb the market decline, the correction in the technology sector will continue to have a strong impact on consumer spending and corporate earnings. Put options provide investors who have correctly forecasted an adjustment with a simple tool to participate in the market with a single trade.

Challenge:

You believe that the stock market will remain volatile as you anticipate the technology correction to continue in the short-term. You would like to protect some of the gains you made in your portfolio.

Solution:

Buying a DJX put option.

Purchasing a put is the most fundamental options strategy for investors who expect a market decline. There is significant profit potential with this approach. Profit increases as the index falls below the break-even point — the point at which the DJX equals the put strike price *less* the premium paid. The risks in buying are known in advance. Losses are limited to the premium paid, regardless of how far the index moves above the break-even point.

If you expect a
market correction,
there is a DJX put
option strategy for
you.

Buying DJX Puts

This strategy is based on a hypothetical situation and should be considered only as an example of a potential trading approach. Taxes, commissions and margin requirements are not included but must be taken into account when calculating the actual net returns for any option transaction.

Suppose the DJIA is at 10800, DJX is based on 1/100th of the DJIA, so the options index value would be at 108.00. As shown in the table, you could purchase five 6-month put options with a strike price of 108.00. As shown in the table, you could purchase five 6-month put options with a strike price of 108.00. Each premium point is multiplied by \$100 to determine total cost. Therefore, if you paid a price of 6.60, you have paid \$3,300 for five contracts ($6.60 \times 5 \times \$100 = \$3,300$). To make a profit, the DJX must fall below a break-even point of 101.40 ($108.00 - 6.60 = 101.40$).

If the DJIA falls to 9,720 at expiration (DJX = 97.20), the five 108.00 puts would be worth \$5,400 [$(108 - 97.20) \times 5 \times \$100 = \$5,400$]. You would then reduce this amount by the premium paid (\$3,300) to arrive at a profit of \$2,100.

If the DJIA rose to a level of 11880 at expiration (DJX = 118.80), your puts would have no value and your loss would be limited to the total premium paid of \$3,300.

Possible outcomes of purchasing five DJX 108 puts at a premium of 6.6:

LEVEL OF DJX AT EXPIRATION:	100.44	97.20	91.80
Move in the DJIA	- 7%	- 10%	- 15%
Expiration value of five 108 strike puts	\$3,780	\$5,400	\$8,100
Less: premium paid (five calls @ 6.6)	-\$3,300	-\$3,300	-\$3,300
Net gain/loss*	\$480	\$2,100	\$4,800
LEVEL OF DJX AT EXPIRATION:	115.56	118.80	124.20
Move in the DJIA	+ 7%	+ 10%	+ 15%
Expiration value of five 105 strike calls	\$ 0	\$ 0	\$ 0
Less: premium paid (five calls @ 5.5)	-\$3,300	-\$3,300	-\$3,300
Net gain/loss*	-\$3,300	-\$3,300	-\$3,300

*Exclusive of commissions, taxes, and other transaction costs.

Choices:

If the puts are not sold prior to expiration and the DJX is below the strike price, you will receive a cash payment at expiration equal to the difference between the DJX and the strike price, multiplied by \$100.

If the market turns against you, another method you might use to limit your loss (premium paid) would be to sell your put options (close the position), leaving your net position flat. Rather than allowing your options to expire worthless, you could sell them at the current bid, for example, 4.20, and receive \$2,100 (4.20 x 5 x \$100). Since you originally paid \$3,300 when you purchased them (opened your position),

selling them limits your net loss on the position to \$1,200 (\$3,300 - \$2,100). Don't forget that if you wish to trade out of your DJX options position prior to expiration, you must do so no later than the Thursday before expiration.

LEAPS® : The long-term option.

Long-term Equity Anticipation Securities™ (LEAPS) based on the Dow Jones Industrial Average offer investors a way to take a long-term position in the stock market with quantified risk at a fraction of the cost of purchasing shares of stock. Investors can capitalize on their long-term forecasts for the market, up to three years in the future, with one transaction.

The investment time frame of DJX LEAPS is much longer than that of traditional DJX options. While traditional options provide opportunity to capture market gains due to short-term, even daily, fluctuations in the market, LEAPS based on the DJIA allow investors to buy and hold a market position for up to three years. Investors need not predict precise timing of the market movements to profit — they need to correctly predict market trends over time. Like all options transactions, the buyer's risk is limited to the amount of the premium paid.

LEAPS offer the possibility to generate a greater percentage return and tie up less capital compared to a similar position in the stock market. Because few investors can purchase every stock they follow, LEAPS allow them to diversify with fewer dollars at risk.

Product Specifications

Symbol: DJX

Index Description: The Dow Jones Industrial Average is a price-weighted index composed of 30 of the largest, most liquid NYSE and NASDAQ listed stocks.

Underlying Level: Options are based on 1/100th of the DJIASM level.

Multiplier: \$100

Premium Quote: Stated in decimals. One point equals \$100. Minimum tick for options trading below 3.00 is 0.05 (\$5.00) and for all other series, 0.10 (\$10.00).

Strike Prices: Strike prices for options are set to bracket the index level in minimum increments of 1 point.

Expiration Cycle: Generally, up to three near-term months plus up to 3 months on the March quarterly cycle.

Expiration Date: Saturday following the third Friday of the expiration month.

Last Trading Day: Trading in DJX will ordinarily cease on the business day (usually a Thursday) preceding the day on which the exercise-settlement value is calculated.

Exercise Style: European.

Settlement Value: Calculated based on the opening prices of the component securities on the business day prior to expiration, usually a Friday. The exercise-settlement amount is equal to the difference between exercise-settlement value and the exercise price of the option, multiplied by \$100.

Settlement Value Symbol: DJS

Settlement: Cash-settled.

Position and Exercise Limits: No position and exercise limits are in effect. Each member (other than a market-maker) or member organization that maintains an end of day position in excess of 1 million contracts in DJX (DJX and DJX LEAPS) for its proprietary account or for the account of a customer, shall report certain information to the Department of Market Regulation. The member must report information as to whether such position is hedged and, if so, a description of the hedge employed. A report must be filed when an account initially meets the aforementioned applicable threshold. Thereafter, a report must be filed for each incremental increase of 25,000 contracts. Reductions in an options position do not need to be reported. However, any significant change to the hedge must be reported.

Margins: Purchases of puts or calls with 9 months or less until expiration must be paid for in full. Writers of uncovered puts or calls must deposit / maintain 100% of the option proceeds* plus 15% of the aggregate contract value (current index level x \$100) minus the amount by which the option is out-of-the-money, if any, subject to a minimum for calls of option proceeds* plus 10% of the aggregate contract value and a minimum for puts of option proceeds* plus 10% of the aggregate exercise price amount. (*For calculating maintenance margin, use option current market value instead of option proceeds.) Additional margin may be required pursuant to Exchange Rule 12.10.

CUSIP Number: 12486C

Trading Hours: 8:30 a.m. to 3:15 p.m.
Chicago time.

Glossary of Options Terminology

American-Style option: An option contract that may be exercised at any time between the date of purchase and the expiration date. Most exchange-traded options are American-style.

At-the-money: An option is at-the-money if the strike price of the option is equal to the market price of the underlying security.

Call: An index call option gives its owner the right to receive the amount by which the settlement value of the index exceeds the strike of the call at expiration, and obligates the seller to pay such difference.

Divisor: A mathematical quantity used to compute an index. It is initially an arbitrary number that reduces the index value to a small, workable number. Thereafter, the divisor is adjusted for stock splits (price-weighted index).

Equity options: Options on shares of an individual common stock.

European-style options: An option contract that may be exercised only during a specified period of time just prior to its expiration.

Exercise price: The price at which the holder of an option can purchase (call) or sell (put) the underlying stock from or to the option writer. For listed options, the exercise price is the same as the strike price.

Exercise settlement: DJX exercise-settlement value is calculated based on the opening prices of the component securities on the business day prior to expiration, usually a Friday. The exercise-settlement amount is equal to the difference between the exercise-

settlement value and the exercise price of the option, multiplied by \$100.

Expiration cycle: An expiration cycle relates to the dates on which options expire.

Expiration date: Date on which an option and the right to exercise it, cease to exist.

Holder: The purchaser of an option.

In-the-money: A call option is in-the-money if the strike price is less than the market price of the underlying security. A put option is in-the-money if the strike price is greater than the market price of the underlying security.

Intrinsic value: The amount by which an option is in-the-money (see above definition).

LEAPS: LEAPS® are long-term stock or index options. LEAPS, like all options, are available in two types, calls and puts, with expiration dates up to three years in the future.

Long position: A position wherein an investor's interest in a particular series of options is as a net holder (i.e., the number of contracts bought exceeds the number of contracts sold).

Margin: The minimum equity required to support an investment position. To buy on margin refers to borrowing part of the purchase price of a security from a brokerage firm. The Federal Reserve Board sets the margin requirement—the maximum percentage of the investment that can be loaned by the firm.

Open interest: The number of outstanding option contracts in the exchange market or in a particular class or series.

Out-of-the-money: A call option is out-of-the-money if the strike price is greater than the market price of the underlying security. A put option is out-of-the-money if the strike price is less than the market price of the underlying security.

Premium: The price of an option contract, determined in the competitive marketplace, which the buyer of the option pays to the option writer for the rights conveyed by the option contract.

Put: An option contract that gives the holder the right to sell the underlying security at a specified price for a certain fixed period of time.

Series: All option contracts of the same class that also have the same unit of trade, expiration date and strike price.

Short position: A position wherein a person's interest in a particular series of options is as a net writer (i.e., the number of contracts sold exceeds the number of contracts bought).

Time value: The portion of the option premium that is attributable to the amount of time remaining until the expiration of the option contract. Time value is whatever value the option has in addition to its intrinsic value.

Underlying security: The instrument, such as a stock or an index value, subject to being purchased or sold upon exercise of the option contract. In the case of options on The Dow, the underlying index level, DJX, is equal to 1/100th of the the Dow Jones Industrial Average.



400 S. LaSalle Street
Chicago, IL 60605
1-877-THE-CBOE
www.cboe.com

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