

Leverage Introduction

Welcome to Framework Investing's Understanding Leverage Mini-Course. I'm Erik Kobayashi-Solomon, the author of *The Intelligent Option Investor* and Framework Investing's Director of Research and Content.

In my experience, most people who incorporate option strategies into their investing have a poor understanding of the topic. Because markets usually drift upward by small degrees, a poor understanding of leverage is *usually* not a problem. However, when markets fall, ignorance of leverage can literally wipe out a portfolio overnight. If you invest using options, an understanding of leverage is not a "nice-to-have" but an essential skill. Our aim in this minicourse is to provide you with that skill.

We have split the lessons into four sections:

1. Leverage basics
2. Leverage when accepting exposure
3. Leverage when gaining exposure
4. Extended leverage topics

In the leverage basics section, we will introduce you to three different types of leverage, offer a definition for investing leverage, and introduce the topic of overleverage.

Accepting exposure means selling options, and the next section of this mini-course involves showing how leverage impacts option sellers.

Gaining exposure means buying options – investments that are most likely to involve levered structures. In this third section of the mini-course, we offer a framework for thinking about leverage in an option context, show how altering strike prices alters one's leverage, and set forth a way to conceive of and manage leverage which suits the needs of fundamental option investors better than any other method we've found.

In the final section, we will cover levered ETFs, introduce you to how traders manage leverage, and show you how Buffett's conservative approach to leverage has enabled him to become such a successful investor.

By the end of this mini-course, you will feel much more comfortable with the topic of leverage, understand how to measure leverage in a sensible way, and have the tools you need to decide whether to incorporate levered strategies into your portfolio and if so, how to assess how much risk is sensible to take.

We'll introduce you to the topic by explaining the three types of leverage.