The Pre-Trade Risk Checklist

The questions worth answering before you commit capital.

Understand stocks, options, and risk.

The Pause Rule: If you cannot answer a critical question below, pause. Slowing down costs a little. Skipping the question can cost a lot. And no trade is also a valid decision.

v1.2 · 2026-07-19 · thesmarterposition.com

Work top to bottom before entering any stock or options position. This checklist does not tell you what to trade — it helps you see clearly what you are about to accept. It is general education for your own process, not individualized investment advice.

1 Purpose and thesis

- [ ] I can state, in two sentences, why this position and why now.
- [ ] I know what I expect to happen — and roughly by when.
- [ ] This decision comes from my plan, not from someone else's urgency.
- [ ] I could explain it to a skeptical friend without saying “obviously.”

2 What must happen for this to work

- [ ] I have listed the things that must go right — each one.
- [ ] I know which of those I have verified and which I am assuming.
- [ ] I know what evidence would prove the idea wrong (my invalidation).

3 Mechanics of the instrument

- [ ] I can describe exactly what I am buying or selling, and every obligation it creates.
- [ ] Options: I know a standard U.S. equity contract represents 100 shares — and that adjusted contracts (after splits or other corporate actions) can have a different deliverable.
- [ ] Options: I know standard U.S. equity options are American-style — the holder can exercise any time before expiration, so a short position can be assigned early.
- [ ] Options: I know what happens in every expiration scenario, including expiring worthless.

4 Maximum realistic loss

- [ ] I have written down the dollar amount I lose in the worst realistic case.
- [ ] I know the path to that loss (gap, assignment, forced exit) — not just the number.
- [ ] Short options: I know the loss can be far larger than the premium received.
- [ ] I can accept that loss without needing to “win it back.”

5 Assignment, collateral, and obligation (options)

- [ ] I know my collateral — e.g., for a standard contract, a cash-secured put sets aside the strike × 100.
- [ ] If assigned, I know exactly what I will own or owe — and whether I actually want it.
- [ ] I know assignment can arrive before I expect it, not only at expiration.

6 Liquidity, spread, and exit mechanics

- [ ] I have looked at the bid–ask spread and what crossing it costs me both ways.
- [ ] The displayed size, volume, and open interest are large relative to my intended order size.
- [ ] I know how I would exit in a hurry — and what that could cost on a stressed day.

7 Size and account-level exposure

- [ ] I sized this against my account size, risk tolerance, concentration, correlation with what I already hold, liquidity, time horizon, strategy risk, and maximum acceptable loss — there is no universal right percentage.
- [ ] This position does not quietly double an exposure I already have.
- [ ] If the worst realistic case happens, the rest of my plan still works.

8 Volatility, events, gaps, and time

- [ ] I have checked for earnings or scheduled events inside my holding period.
- [ ] I know prices can gap past my intended exit — overnight and at the open.
- [ ] Options: I know what time passing does to this position if the stock goes nowhere.

9 Opportunity cost and alternatives

- [ ] I compared at least one alternative: a different structure, a smaller size, or nothing.
- [ ] I know what this capital cannot do while it is committed here.
- [ ] Covered calls: I have priced the upside I am giving away, not just the premium received.

10 Exit, review, and invalidation

- [ ] My profit exit, loss exit, and time exit are written down before entry.
- [ ] I know what would make me adjust versus simply close.
- [ ] My invalidation signal is observable — a price, a date, a fact — not a feeling.
- [ ] I have scheduled when I will next review this position.

11 Limits of the data

- [ ] Any example or backtest I am relying on is historical — it guarantees nothing here.
- [ ] I am not acting on numbers I could not verify myself.

12 Fees and taxes

- [ ] I know the commissions and fees on entry and exit, and their effect on breakeven.
- [ ] I have noted my tax questions (assignment, early sale, wash-sale issues) to take to a qualified tax professional — this checklist cannot answer them.

THE DECISION

- [ ] Proceed as planned
- [ ] Resize or restructure
- [ ] Research further first
- [ ] Pass — no trade

Any of the four is a legitimate outcome. The checklist worked if the choice was deliberate.

Red flags — stop and investigate

- Anyone is urging speed. Ask what, specifically, expires — and who benefits from your hurry.
- The premium or yield looks like free money. Find the risk being paid for before assuming there is none.
- You cannot explain the loss path out loud.
- The idea only works if your timing is right too.
- The spread eats a meaningful share of the expected gain.
- “Everyone” already agrees with the idea.
- You would hesitate to show the position size to a cautious friend.
- You are adding to a loser with no new information — to win it back.

Plain-English terms

Strike price — The set price at which an option can be exercised.

Expiration — The date the option contract ends.

Premium — What an option buyer pays and a seller receives — the seller's compensation for accepting risk.

Assignment — When an option seller is required to fulfill the contract — buying or delivering the shares.

Bid–ask spread — The gap between the best selling and buying prices; a real cost of getting in and out.

Implied volatility — Expected movement inferred from current option prices. Holding other factors constant, higher implied volatility generally increases an option's theoretical value.

Cash-secured put — Selling a put while holding cash to buy the shares (100 for a standard contract) at the strike if assigned.

Covered call — Selling a call against shares you own (100 for a standard contract) — income now, capped upside until expiration.

Invalidation — The observable fact that would tell you the idea is wrong.

Notes — your reasoning, not your identity

Ticker / structure · date · decision · reason. No account numbers or personal details needed.

Read this before using the checklist

This checklist is for general educational and informational purposes only and is not individualized investment, tax, or legal advice. Options involve risk and are not appropriate for every investor. Historical examples do not guarantee future results.

Options mechanics referenced here are described in the Options Clearing Corporation's disclosure document, “Characteristics and Risks of Standardized Options,” which brokers provide to options customers — read it before trading options.

Prepared by The Smarter Position with AI-assisted drafting under human editorial review. No part of this document is a recommendation to buy or sell any security.

Full disclaimer: thesmarterposition.com/disclaimer/

Every question here comes from a lesson. → thesmarterposition.com · YouTube: The Smarter Position
https://www.youtube.com/channel/UCKD2Jp66FvjTx4Dymb76Z6A