TOP 10 OPTION HACKS FOR QUICK INCOME

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HOW TO GET THE MOST OUT OF THIS BOOK

Thank you for accessing *Top 10 Options Hacks for Quick Income*. This book is designed for beginning, intermediate and advanced traders. The authors in this book are leading experts in trading Options and Stocks.
As you read this book, you will be exposed to multiple strategies that have high probabilities of success and/or high profit. Most of the strategies in this book are divided into three sections:

- **"The Game Plan"** – An introduction to a charting technique. The strategy is then thoroughly explained along with illustrations and examples.
- **"The Movie"** – The chapter is accompanied with a video which outlines how to use this strategy, with examples.
- **"Special Offers"** – If you really like a strategy, you can follow the presenter and the strategy.

There are thousands of dollars' worth of trading tools, indicators, training and mentoring services, books and videos available at steeply discounted prices.
In short, you will have all of the information you need to trade your new favorite strategy tomorrow. Some of the things you will learn in this book are:

- 4 Easy Steps to Find the Right Options Trade
- Secret for Generating Retirement Income with Options
- Picking the Best Stocks with Weekly Options
- Using Order Flow to Detect Unusual Options Activity
- Military Tactics for Improving Your Trading Consistency

At **www.optionPub.com**, it is our sincere hope that you take away several strategies that you can use when you are done reading this book. You will also learn about markets that you currently don't trade, and you will find out if they are suited to your trading personality.
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4 Steps to Finding The Right Options Trade

By Mike Rykes, www.NetPicks.com

One of the benefits of working with hundreds of options students on a daily basis is the great interaction that comes along with it. In fact, I had a newer student recently write in and ask a few really great questions. These are questions many traders wonder about as they look to gain an edge in their options trading. Let's take a look at how the answers to these questions can help us increase our profitability in the options markets.

"How do YOU determine when to buy a call or put versus using a spread, collar, butterfly, or iron condor? What are the criteria you are using to make the decision?"

The number one reason I love trade options is the flexibility that they offer. We aren't limited to buying and selling calls and puts. We can actually use different options strategies that will allow us to adjust how aggressive we want to be. To take it a step further, we can use different strategies to adjust whether we want to be bullish, bearish, or market neutral. You can't say this about any other market. If you are trading futures, Forex, or stocks you are limited to buying or selling individual contracts, lots, or shares. This is fine if you want to put on a directional trade, but we all know that the market doesn't always trend. In fact, more often than not we are stuck in a sideways range. Trading options allow us to profit from these sideways moves instead of getting whipped back and forth with false breakouts.

While the flexibility that options offer is great, it can be intimidating when starting out to know which strategy is best to use at any given time. Over the last 13 years, I have taken thousands of trades and have tracked each one in my trade journal. As a result, I have come up with a method that fits my trading style and makes sure the odds are in my favor long term. Let's walk through what my normal process looks like when setting up a trade.

Steps for Identifying Options Trades:

1. **Have a small universe of stocks/ETF's that you look at on a regular basis.**
   I write and talk about this all the time in our training materials. I don't want to look at hundreds of names on a daily or weekly basis because in those cases you can be left trading names that you aren't familiar with. I would rather focus on a small list of names that I get to know over time. This way I can easily determine whether I am bullish, bearish, or neutral without spending a ton of time each day staring at the charts. My watch list can change once a month. Currently, my list is 24 names which you will see below. These 24 names come from my universe of 50 stocks and ETF's that I track on a monthly basis. In other words, when I created my watch list of 24 names for the month, those names came from my universe of 50 products that I have tracked and researched for an extended stretch of time.

We will share more insight into my favorite Stocks/ETF's below including a great list that you can start trading today.

2. **Look at the charts for each product on your watch list to get a feel for any key levels, directional outlook, or overbought/oversold extremes.**

   This step is very important in helping you determine which options strategy should be used. For example, we just closed out of a short call spread on EWZ that we opened back on 4/13. We chose this trade because we looked at the EWZ chart and saw that we were at a bullish extreme. We then took a look at the level of implied volatility on the EWZ options and saw that it was also high. When we see this type of scenario, we know that the options prices will also be high. Instead of buying a put option to take advantage of a move lower, we decided to sell a call spread which is still a bearish position but it also gave us more ways of making money.

   We decided to sell the May 29/30 call spread for $.41 or $41 per spread. This gave us a maximum profit potential of $41 per spread while our risk was $49 per spread. While this doesn't look like the greatest reward to risk scenario, it was actually a great trade because of all the different ways we could have made money. We made money if EWZ moved lower, sideways, or slightly higher as long as it stayed below our break-even point of $29.41. We made money from time decay adding up and also from the implied volatility contracting. This meant we had 5 different ways of making money on the trade. Instead of having to pick market direction perfectly in order to make money, we were left with a trade that gave us a tremendous amount of flexibility.

   We were fortunate enough that after opening the short call spread, a few weeks later EWZ made a move slightly lower. The levels of implied volatility also contracted and the time decay added up over the few weeks that we held the trade. As a result, we ended up closing the trade by buying the call spread back for $.11. This gave us a profit of $.30 or $30 per spread. That's a nice return given we only tied up $49 of capital for each spread that we put on.

The only way I had a feel for using the EWZ short call spread was because I have traded EWZ for years. This gave me a comfort level with the ETF that I wouldn't have had if I just pulled it up off a stock scan. Looking at the charts will help us determine how aggressive we want to be. If we are strongly bullish or bearish then we can reflect that in both position size and the options strategy that we will use. If we are neutral then we can also adjust position size and go to options strategies that work well in sideways moves.

3. **Look at the levels of volatility to determine if it's high or low.**

   We track the Implied Volatility (IV) levels for each stock/ETF on our watch list. This helps us know if those levels are high or low at the given time. If the IV is high, then we know we have an opportunity to sell premium (short vertical spreads, iron condors). If it's low, then we will lean towards using strategies like long calls/puts and long vertical spreads. My first choice is always to sell premium because those strategies give us so many ways of being profitable. However, we have also seen over the years that when we wait for high IV when selling premium our odds of success really improve.

4. **Determine which options strategy best fits our outlook. **

   We started by looking at the charts of each of the products on our watch list. This helped us decide if we wanted to be bullish, bearish, or neutral.This also helped determine how aggressive we want to be (position size, option strategy). Once we have an opinion on what we think the stock or ETF is going to do, then we go to our playbook to follow the guidelines that we outline for each strategy. Let's take a look at a few of our favorite strategies.

   What criteria do we use to select the best options to trade?

Long call or put:

When buying a long call or put we need to make sure we have a strong opinion on which way the stock or ETF is headed in the near term. We have to keep in mind that whenever we buy an option the clock is ticking the second we decide to initiate the trade. The time decay will start to add up and potentially eat into the profit potential that we have. This means not only do we need to be right on market direction, but the move needs to happen in our favor quick enough.

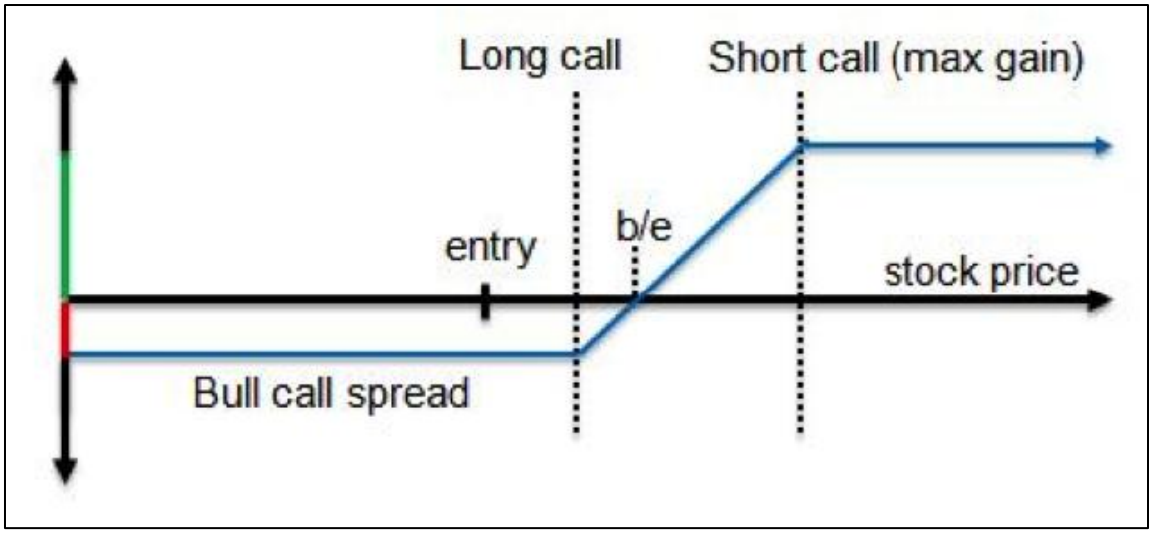
To combat some of the negative features of buying an option, we like to be very picky with the criteria that we use when selecting the call or put option. First, we don't pick the option based on what we can afford like so many retail traders make the mistake of doing. In many cases, this will leave you with an out of the money option which has a very low probability of success. Instead, we like to trade the in the money options.

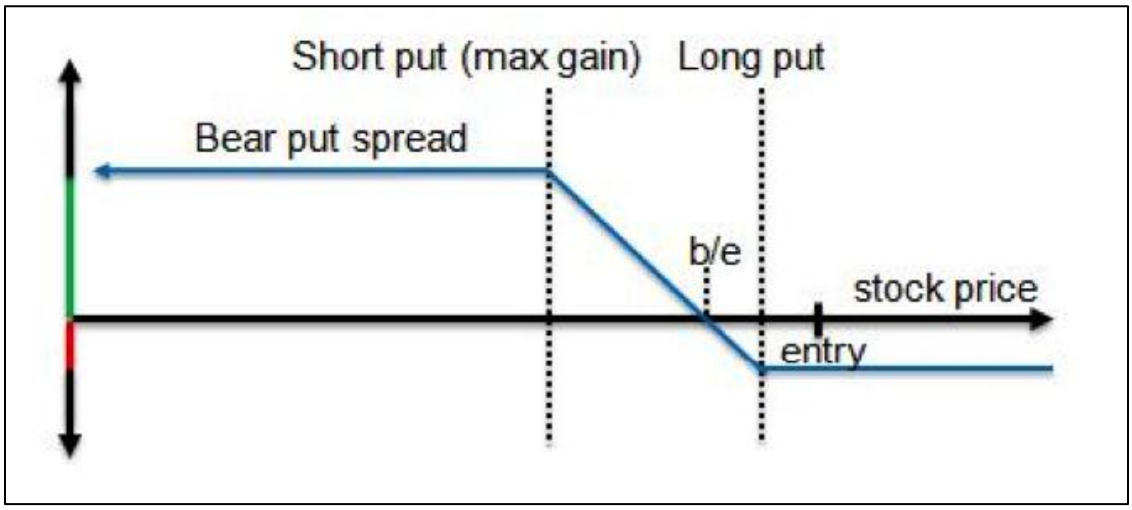
Our criteria have us going out 20-40 days until expiration and buying the call or put option that is 1-2 strikes in the money. This criterion is the same whether we are trading GOOGL, DIA, or C. By using the same criteria on all stocks and ETF's, we are able to take much of the discretionary decisions out of the equation.

Long Call and Put Criteria	
Time to Expiration:	20-40 days
Strikes In the Money:	1-2 Strikes
Exit Trade:	When target price is hit on the chart

Long Vertical Spread:

When using a long vertical spread, we still need to have a strong opinion on which way the stock or ETF is heading in the near term. While the time decay is still going to be there like with a long call or put, the long vertical spread is able to limit the effect of the time decay slightly. We like to use the long vertical spread when we desire to be in a more conservative position. We are able to do this because a long spread is constructed by both buying an option and selling an option with a different strike at the same time. Vertical spreads offer a unique ability to control risk and reward by allowing us to determine our maximum gain, maximum loss, break-even price, maximum return on capital, and the odds of having a winning trade, all at the time we open a position.





When setting up a long vertical spread we still like to trade the options that have between 20-40 days left until expiration. We structure the trade by always buying the option that is 1 strike in the money and then selling the strike that is closest to our target for that stock or ETF in the near term. The nice part about using this simple criterion is that it is the same when using call or put options. The criteria are also the same regardless of the symbol of the stock we are trading.

Long Vertical Spread Criteria	
Time to Expiration:	20-40 days
Buy:	1 Strike in the money
Sell:	Strike closest to target price on the chart
Exit trade:	When target price is hit on the chart

So why wouldn't we trade a spread on every trade? While it's great that vertical spreads limit the risk, they also limit the profit potential at the same time. Our profit is limited to the difference between the strike prices minus what we paid for the trade. For example, if we are putting on the long 25/30 call spread that would have us buying the 25 call and then selling the 30 call. This leaves us with a $5 wide call spread. If we paid $2.00 for the spread our maximum profit potential would be $3.00. This is calculated by taking the $5 difference between the strikes and subtracting the $2.00 price that we paid for the spread.

Many newer traders get intimidated by trading spreads because they think they will be left with huge risk. However, in reality, the long vertical spread is actually safer than buying an outright call or put. The reason for this is that we can never lose more than what we paid for the vertical spread. It is a defined risk trade. This is due to the fact that we are buying the option that is one strike in the money and at the same time offsetting some of that cost by selling the option that is farther out of the money. As a result, we are able to lower the overall cost of the trade.

The long vertical spread is one of my favorite trade types and should be a part of your overall options toolbox.

Short Vertical Spread:

Trading long calls and puts or a long vertical spread give us great ways to put on an aggressive trade when we have a strong opinion on market direction in the near term. ***What if we are a little less certain of market direction?*** Selling vertical spreads to open a position can give us a great way of scratching out a profit even in a period of choppy price action. We do this by selling an option that is closer to the current price of the stock and then going out and buying an option with a strike price that is farther out of the money. By doing this we are still able to be in a risk defined position but it does give us multiple ways of being profitable. Let's take a look at the criteria that we use when setting these trades up.

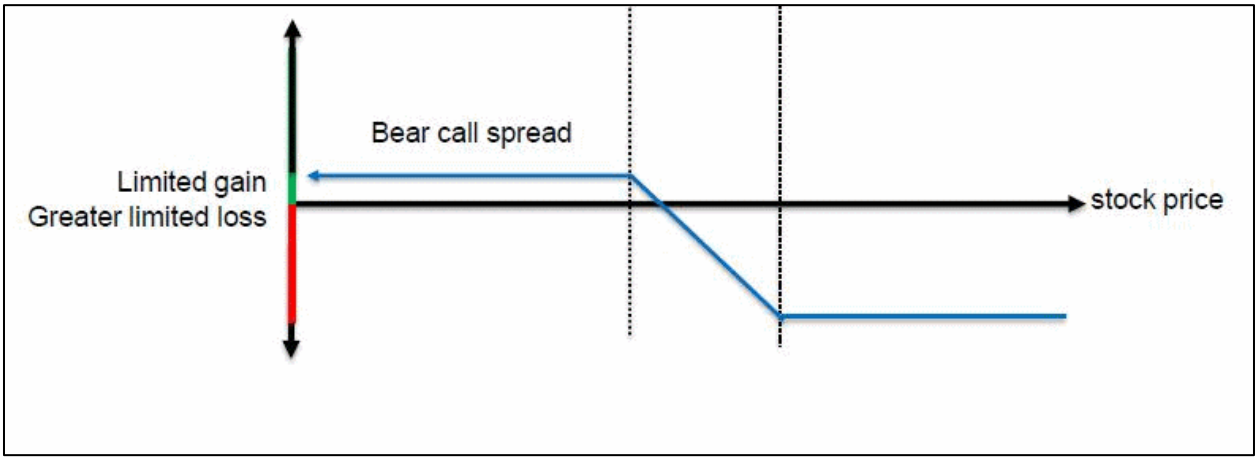
Short Vertical Spreads	
Time to Expiration:	20-40 days
Premium to Collect:	As close to 40% of the width of the strikes as possible
Profit Goal:	50-75% of max profit

When selling vertical spreads to open a trade we still like to use options with between 20-40 days left until expiration. Why do we prefer to go out farther in time? In most cases the monthly options will have more volume and open interest when compared to the weekly options. This will make them easier to trade.

Going out to the monthly options will also give us more time to be right just in case the market moves against us initially. This gives us time to recover while the weekly options don't give us that flexibility.

When selling spreads, we like to collect as close to 40% of the width of the spread as possible. For example, if SPY is currently trading at $204.76 and we wanted to put on a bearish trade to take advantage of a pullback we could sell a call spread. We would look at the available strike prices to see that they are $1 wide. This means we could go out and sell a $1 wide spread that would allow us to collect around $.40 or $40 per spread (40% of the width of the spread). This $40 is our maximum profit potential. The most we can lose on this trade is $.60 or $60 per spread.

When looking at the SPY options, we see that the 208/209 call spread is trading for $.40 or $40 per spread. This would have us selling the 208 call and then buying the 209 call to make it a risk defined position. Since we are collecting $.40 when putting the trade on, we would add that to our short strike to give us a break-even point of $208.40.



Why would we risk $60 to make $40? That doesn't sound like a very good risk to reward ratio. The reason we would like a trade like this is it would allow us to make money 5 different ways:

1. **We make money if SPY moves higher as long as price closes below $208.40.**
2. **We make money if SPY moves lower.**
3. **We make money if SPY moves sideways as long as price closes below $208.40.**

4. **We make money as the time decay adds up each day that we hold the trade.**
5. **We make money if the implied volatility contracts.**

When I see a trade that allows me to make money in 5 different directions I get excited. These are the opportunities that I look for each and every day.

We like to close out of our short vertical spreads when we can keep 50-75% of the maximum profit potential. In our case of the short SPY call spread, we collected $.40. When I can buy the trade back for between $.10-$.20 I will close the trade out and book my profit.

It's important to note that the criteria outlined above is the same for both short call spreads and put spreads. By staying consistent with a rule set it allows us to be more consistent and eliminate much of the discretionary decisions that so many retail trades get stuck on.

Selling vertical spreads to open positions is a very powerful approach that many retail traders miss out on. While short spreads are not the holy grail of trading, they give us the flexibility that we need to make money in any type of market condition that comes our way.

Is there a perfect recipe for finding the right trade?

Selecting the right trade and determining the right size of the trade is not always a perfect science. There are times when I want to be conservative, so I trade more spreads and use smaller position size and end up leaving profit on the table. The whole goal here is to have a method in place that you can follow every day. We aren't going to be perfect on every trade but by following a method we will be sure to have trades on that leave us with risk that we are comfortable with. The key is to follow a set of criteria that put the odds in your favor and then diversify your account by adding numerous trades that fit your criteria. When doing so, you won't be backing yourself into a corner by putting on 2-3 trades and hoping for the best. By having a bigger sample set of trades then the odds will better play out in the long run.

Which stocks and ETF's should I be trading?

Now that we have talked through how we identify trade opportunities, let's circle back and talk about how we establish the best watch list of products that we should be looking at on a regular basis. With thousands of possible stocks and ETF's available to trade, I'm often asked how I decide which ones to trade. It's really a simple process based on a few criteria. The hot list that I trade from each and every day is based on the criteria that I outline below.

1. **Liquid Options** – I want to trade the products with the most actively traded options. This way I can get in and out quickly at good prices.

2. **Volatility** – I'm looking for products that show a history of good movement back and forth. Ideally, I'm looking for quick moves so I can get in and out as soon as possible. A stock or ETF that only makes a few decent moves each year is not going to make the cut into my hot list.

3. **Diversification** – It would be really easy for me to load up my entire list with tech names and call it a day. The tech sector tends to lead the market and has an endless number of quality names to trade. However, I would rather establish a broad list of names covering a number of different sectors (tech, energy, financial, index are the big ones for me).

With the above criteria in mind, I have created the following watch list of products that give you a diversified universe of products to trade.

Options Fast Track Hot List:

SPY - The S&P 500 ETF remains one of the most liquid products in the world. The massive volume of the stock and the options make this an easy one to trade. The Implied Volatility has also increased in the past few months which really opens up our options playbook giving us endless trade opportunities to consider. Others to consider: **IWM, DIA**

QQQ - While not as liquid as SPY, the Nasdaq ETF has plenty of volume for us to work with. It's an easy way to diversify as many of the big tech names are reflected in this product. I like this one for pure directional plays as well as for short premium plays (selling spreads).

TLT - With everyone's focus on the Fed these days, I want to have exposure in names that will be active with anything the Fed throws our way. The bond market is an area that can make big moves with anything a Fed speaker says. As a result, having access to a bond ETF like TLT is a great option. TLT is liquid enough for us to do anything that we want with either basic or advanced options strategies. Implied Volatility has also increased in the past few months giving us more flexibility.

AAPL - Apple is still one of the most popular stocks to trade for day traders and swing traders alike. It is a very liquid product, with both the shares of stock and the options very active on a daily basis. I like trading it because it doesn't like to stay quiet for long. It is also an easy name to see defined ranges in. While I love the products that Apple produces I like it as a trading product even more.

NFLX - Netflix has been a really fun stock to trade for years now. It continues to make really great swings back and forth. When it's not moving, the Implied Volatility is high enough to sell

premium making it one of my favorite products to look at these days. The stock split from last year has also made it more accessible for retail traders to look at. The options are reasonably priced and have decent liquidity, making it a top candidate going forward.

C and GS - The financial sector is another area that can be very sensitive to Fed speak. Regardless of experience or account size, you will want to have some exposure to this sector. I like Citigroup and Goldman Sachs for my personal account. They are names that tend to lead the sector both higher and lower and have reasonably priced options as well. The options have decent liquidity, which means we can trade many different strategies with both of these and get filled at good prices. As long as interest rates remain the center of attention, make sure you have a handful of financial names on your list. ***Others to consider: XLF, BAC, JPM, FAS***.

XLE and USO - The price of oil has been all over the place for most of this year and I don't see that changing anytime soon. Both XLE and USO are energy ETF's that we have had nice success within the Options Fast Track program. I like the liquidity in the options and I like how each one does something different for us. XLE is the slower one of the two and it typically does a better job of getting through the volatile moves back and forth better. USO is directly correlated with the price of the Crude Oil futures market, which means it's a more aggressive way to play directional moves. Both products are liquid enough to do just about any options strategy that you can think of.

EWZ, EEM, and FXI - All three of these are global ETF's which we have had nice success with. EWZ is the ETF tracking the Brazil markets. EEM is the ETF that tracks the emerging markets. FXI is the ETF that tracks the Chinese markets. Much of the volatility that we have seen in the U.S. this year can also be tracked to the movement in the global markets. I like having products that allow us to participate in that movement without being overly exposed to one individual stock. You have to be careful with these names as they do tend to see overnight gaps for us in the U.S. A good number of the moves happen during the overnight hours so you have to be disciplined to not chase trades that have moved without you. The liquidity in these names also tends to be streaky. Over the last few months it hasn't been an issue, but if markets start to settle down in the coming months you will want to watch volumes closely. If they start to go down we will want to potentially reconsider some of these names.

AMZN - Amazon has been a streaky product for us the last few years. When it's on there aren't many products out there that will outperform AMZN. However, when this stock settles into a range it can get ugly quickly. The liquidity in the AMZN options also needs to be watched closely. I haven't had an issue getting filled on my trades at good prices the last few months but if volume does dry up in the coming months we are willing to put this one back on the sidelines. It is a $600 stock so the options aren't cheap, but I have had really nice success trading vertical spreads on AMZN which is a good way to lower the cost.

GOOGL - I know Google is another expensive stock, but I have found that it likes to make really nice tradable moves back and forth on a regular basis. This is another product that I like to use vertical spreads on to lower the cost of the trades. However, it is also another one that you have to be picky where you get in and out of trades at. The bid/ask spread can widen out quickly on the GOOGL options, so make sure you do your best to get filled at or near the mid price.

AAL, BA, DAL - The airlines have been a new area to my watch list this year. I like any of these 3 names but I personally trade AAL and BA. I don't always trade these names directionally, though. For newer options traders, what I'm talking about here is that I like to sell premium on these 3 whenever possible. Selling spreads is a great way to get exposure to some of these names without placing a big directional bet. With energy prices all over the place, along with the health of the consumer in doubt, I think the airlines could be a good play for the coming months.

GLD - Gold and silver tend to be names that get more active as more doubt starts to creep back into the market. When fear jumps, there are many traders that start looking at the metals for safety. I like GLD over SLV in my own trading as GLD tends to be more liquid and easier to trade. If we continue to see volatility at elevated levels, look for Gold and Silver to remain active.

FXE - With global currencies in focus these days I also want to have some exposure there. FXE is an ETF that tracks the Euro. It's not the most liquid product that I have ever traded, but as long as we see the global currency wars front and center I want to be able to profit from some of these moves. The implied volatility on the options of FXE has also been at levels where we have had good success selling premium by using strategies like Iron Condors. I hope to continue that trend over the coming months.

These are some of my favorite names that I continue to find great success within the current market conditions . I'm not saying these are the only names to look at or that you should trade every one of these. However, taking what the market is giving us right now, these are the areas

I feel give us the best opportunities to make money. If you want some other areas to look at the argument could be made to have exposure to more retail/consumer related names or even the social media names. Just remember, a bigger watch list doesn't mean bigger profits. Create a list of names that is diversified, but is also small enough where you can get in and out each day without spending hours looking at the charts. All of the names listed above are active enough to where we can have multiple types of trades on for each name if we wanted to.

As is the case with any trading approach the key is having a system that you can stay disciplined too. Swaying in the wind with everything you hear in the media these days or from other traders can lead to inconsistent results. Every trader is a little different, so make sure you

are using a method that fits your style and risk tolerance. This might take time to develop your methodology but in the end, it will make all the difference in the world. ***It's so important that if you don't have a system in place now then take a big step back and don't put any more money to work until that system is in place.*** You will see the benefits right away not only in your P/L but in your confidence as a trader. In the end, trading is all about discipline. If you can become that disciplined trader with a detailed system in place then you will be well on your way to success.

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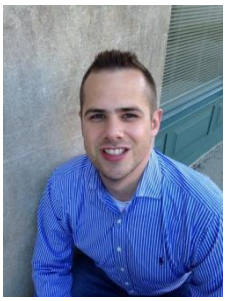
ABOUT THE AUTHOR



Mike started trading back in 2002 as a finance major in college. It was quickly apparent during one of his first business classes that there was great wealth to be made in the stock market. Not one to be patient and wait for his degree to start making money, Mike discovered the great leverage that can be used in the options markets. This allowed him to start trading options with a very small account size while still in college.

Mike found success early in his trading career and decided to take the leap into full time trading soon after. Along the way, he had to learn many lessons the hard way like so many retail traders can relate to. It wasn't until a visit to the floor of the CBOE (Chicago Board Options Exchange) that he realized he had to put a system in place that he could stay disciplined to.

Mike discovered the NetPicks trading systems back in 2006 and quickly became a customer. This was the missing piece to the puzzle. This has allowed him to trade full time for a living ever since. After learning the systems inside and out over the span of the next 2 years, Mike joined the NetPicks team as a trading coach in 2008. He quickly became the resident options expert and has been Lead Options Instructor ever since. While he has dabbled in other markets over the years, trading options has become his go to market. Mike has worked with thousands of traders since 2008 and enjoys the opportunity to help others reach their trading goals.

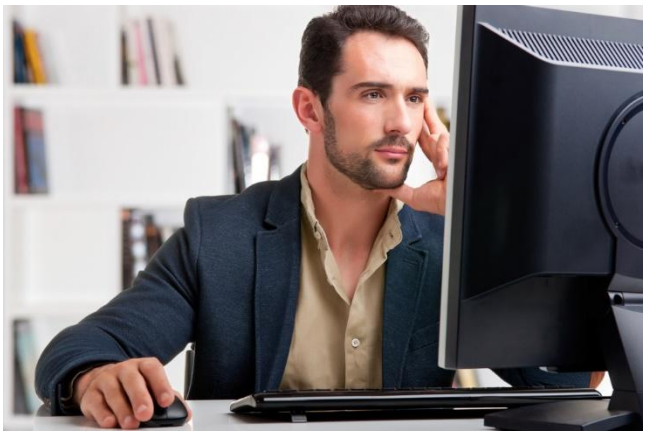
Option Trading Guidelines

By Lawrence G. McMillan, www.OptionsStrategist.com

I was recently asked what guidelines I generally follow in my option trading. This is actually a rather thought-provoking question, especially when it regards something one does almost every day. In our feature articles, many useful general strategies have been given, but not assembled all in one place. After giving the matter some thought, it seemed like it might be beneficial to list some of the "rules" that we follow, either consciously or sub-consciously after all these years. For the novice, they may be eye-opening; for the experienced option trader, they may serve as a reminder. These guidelines are not the path to easy riches, or some such hype, but following these guidelines will generally keep you out of trouble, increase your efficiency of capital, and hopefully improve your chances of making money with options. They are not presented in any particular order.

Trade in accordance with your comfort level and psychological identity.

If you are not comfortable selling naked options, then don't; even though such strategies are nicely profitable for some traders, they should not be used if they cause you sleepless nights. If hedged positions drive you crazy because you know you'll have a losing side as well as a winning side, then perhaps you should trade options more as a speculator — forming opinions and acting on them accordingly. The important thing to realize is that it is much easier to make money if you are "in tune" with your strategies, whatever they may be. No one strategy is right for all traders due to their individual risk and reward characteristics, and accompanying psychological demands.



Always use a model.

The biggest mistake that option traders make is failing to check the fair value of the option before it is bought or sold. It may seem like a nuisance — especially if you or your broker don't have real-time evaluation capability — but this is the basis of all strategic investments. You need to know whether you're getting a bargain or paying too much for the option.

Don't always use options -- the underlying may be better (if options are overpriced or markets are too wide).

This is related to the previous rule. Sometimes it's better to trade the underlying stock or futures contract rather than the options, especially if you're looking for a quick trade. Over a short time period, an overpriced option may significantly underperform the movement by the underlying instrument.

Buying an in-the-money call is often better than buying the underlying instrument; buying an in-the-money put is usually better than shorting the underlying (if the underlying is stock)

An in-the-money option has a high delta, meaning that it moves nearly point-for-point with the underlying stock or futures contract. Furthermore, the option's price contains only a small amount of time value premium — the "wasting" part of the option asset. Thus, the profit potential is very similar to that of the underlying instrument. Finally, the risk is limited by the fact that one cannot lose more than the price he paid for the option, while one has much larger risk when owning or shorting the underlying instrument.

Don't buy out-of-the-money options unless they're really cheap.

This is really a corollary of the above rule, but it's important enough to state separately. Obviously, you can't tell if the option is "cheap" unless you use a model. If the out-of-the-money option is expensive, then revert to the previous rule and buy the in-the-money option.

Don't buy more time than you need.

The longer-term options often appear, to the naked eye, to be better buys. For example, suppose XYZ is 50, the Jan 50 call costs 2, and the Feb 50 call costs 2¾. One might feel that the Feb 50 is the better buy, even if both have the same implied volatility (i.e., neither one is more expensive than the other). This could be a mistake, especially if you're looking for a short-term trade. The excess time value premium that one pays for the February call, and the resultant lower delta that it has, both combine to limit the profits of the Feb 50 call vis-a-vis the Jan 50 call. On the other

hand, if you're looking for the stock or futures contract to move on fundamentals — perhaps better earnings or a crop yield — then you need to buy more time because you don't know for sure when the improving fundamentals will reflect themselves in the price of the underlying.

Know what strategies are equivalent and use the optimum one at all times.

Equivalent strategies have the same profit potential. For example, owning a call is equivalent to owning both a put and the underlying instrument. However, the capital requirements of two equivalent strategies (and their concomitant rates of return) can vary widely. The purchase of the call will only cost a fraction of the amount needed to purchase the put and the underlying stock, for example. However, the call purchase has a much larger probability of losing 100% of that investment.

Naked put selling is equivalent to covered call writing, but is generally a better strategy.

We've mentioned this often before, but it bears repeating because so many option traders don't follow this rule, or don't believe it. Both strategies — naked put selling and covered call writing — have limited upside profit potential and large downside risk. However, the naked put sale involves less of an investment in terms of collateral required, has a lower commission cost, and allows one to earn interest on his collateral while the position is in place. For these reasons, naked put selling is the better strategy of the two.

The option positions that are equivalent to long stock (or long futures) and to short stock (or short futures) are perhaps the most important ones.

Buying a call and selling a put, both with the same terms (strike price and expiration date) produces a position that is equivalent to being long the underlying instrument. Similarly, buying a put and selling a call with the same terms is equivalent to being short the underlying instrument. The next two rules deal with these equivalences.

The equivalent option strategy may be better than owning the underlying stock itself.

If one buys a call and sells a (naked) put, his investment is smaller than that required to own the stock, and the "investment" may be in the form of interest-earning collateral.

The equivalent option strategy is mandatory knowledge for futures traders, for it allows one to extricate himself from a position that is locked limit against him.

When futures are locked limit, the options will generally still be trading. The prices of the options provide a price discovery mechanism, in that one can see where the futures would be

trading were they not locked at the limit. Furthermore, one can take an equivalent option position opposite to his (losing) futures position, and effectively close out the position at the current loss without risking further limit moves on succeeding days.

Naked combo selling in indices is usually less trouble than selling combos in individual futures or equity options.

Selling both puts and calls is an attractive strategy to many option traders, since the benefits of the wasting asset are on your side. Unfortunately, large or sudden moves by the underlying instrument can create some nasty surprises for the option writer. One way to counter this is to concentrate the option selling in index options. The broader the index, the less likely it is to experience a gap opening. There cannot be a takeover attempt on an index nor can an individual earnings report, for example, cause the index to move a great distance as it can for a stock. For the index to gap, many of the stocks that comprise the index would have to gap as well; that might be possible in a very narrow-based index, but is quite unlikely in a broad-based one. These statements generally apply to U.S. indices; indices on foreign markets (JPN or FSX, for example) gap virtually every day since the actual trading in those markets is occurring while the U.S. markets are closed.

Trade all markets.

There are strategic option opportunities in all markets — equities, indices, and futures. To ignore one or two of these just doesn't make sense. The same principles of option evaluation needed to construct a statistically attractive strategy apply equally well to all three markets. Furthermore, there are often inter-market hedges that are extremely reliable, but in order to take advantage of them, one has to trade all of the markets.

Trade in accordance with your comfort level and psychological identity.

This is the first and last rule and, ultimately, the most important one.

THE SPECIAL OFFER

In its 25th year of publication, The Option Strategist Newsletter remains one of the industry's most respected stock options newsletters. Written by renowned analyst and bestselling author Larry McMillan, The Option Strategist continues to be an essential investing tool for novices and experts alike. Inside every edition of this weekly newsletter, you'll find market commentary, opinion and recommendations on option trading and the stock market.

CLICK HERE to receive 1 Free Month of McMillan's The Option Strategist Newsletter! Use coupon code **TPFREE** at checkout for discount.

ABOUT THE AUTHOR

Lawrence G. McMillan is the President of McMillan Asset Management and McMillan Analysis Corporation, which he founded in 1991. He is perhaps most well-known as the author of Options As a Strategic Investment, the best-selling work on stock and index options strategies. The book – initially published in 1980 – is currently in its fifth edition and is a staple on the desks of many professional option traders.

His career has taken two simultaneous paths – one as a professional trader and money manager, and the other as an educator and proponent of using option strategies.

In these capacities, he currently authors and publishes "The Option Strategist," a derivative products newsletter covering options and futures, now in its 24th year of publication. His firm also edits and publishes three daily newsletters, as well as option letters for Dow Jones. He has spoken on option strategies at many seminars and colloquia, and also occasionally writes for and is quoted in financial publications regarding option trading.

Mr. McMillan is the recipient of the prestigious Sullivan Award for 2011, awarded by the Options Industry Council in recognition of his contributions to the Options Industry.

A Better Way to Find and Trade Stocks

By Ron Groenke, www.WallStreetWinning.com

Did you know that 69% of the new millionaires created last year are a result of the stock market? It's true. This is an opportunity that stands right before of you. Every day stocks go up and down and someone makes a profit. The question is, how can you win in the stock market? I have been working on this question for over twenty-five years and have finally developed the magic formula (algorithm) that will help anyone become a winner on Wall Street. In fact I have made my trade technology available for anyone to use at WallStreetWinning.com.

My career has been in the computer hardware, software, and communications industry. I have a degree in mathematics and have developed many simulations and models to optimize almost anything. The range has been from production/distribution, warehouse layout and computer hardware to communications/networking software. I have written many programs, starting my career at NASA writing code for handling the communications for Apollo 7 & 8. More recently I have developed code that searches the Internet for excellent investment opportunities. I have won Excellence in Engineering and Innovation awards and became a NCR Laureate. My product ideas have generated billions of dollars in product revenue for multiple firms.

This base of knowledge has allowed me to develop a stock and options investing model that has been used and perfected over the last ten years, which I am now revealing to you so that you can also become a Wall Street winner.

To be successful in the stock market you need to take control and be in charge of how your assets are invested. Would you like to spend less time analyzing and more time enjoying life?

It's time to stop giving the market permission to steal your hard-earned money. You can discover for yourself how to produce amazing, consistent, and reliable investment results month after month and year after year.

Contrary to popular belief, the biggest threat to your wealth is the age-old idea of "buy and hold" investing. Millions of investors, possibly you included, have fallen prey to this antiquated, failed system and have lost tens of thousands of hard-earned dollars. I want every investor to be on the right side of every trade. Yes, the proprietary algorithms behind my system are complex, but I've made it easy for you to use.

Just click a few buttons and the computer will get to work crunching all of the numbers. Within a few minutes you'll have a guide for a list of stocks and ETF's that you can either invest in or let the system AUTO trade for you directly. You will know:

- Which Stocks to BUY? It's time to BUY.
- Which Stocks to SELL? Make sure to SELL
- Which Stocks to HOLD? Do nothing. You're fine or you can write covered calls against your positions to generate some additional cash flow.

- Which Stocks to WAIT on? Wait means wait.

Even with all of the fundamental analysis, price to earnings ratios, economic projections, news events and TV talk shows on investing; all they tell you is where they "think the market should be." Just remember, they are all just selling air-time.

It's actually true that the market will tell you what it's going to do next. That's right, the market will tell you everything you need to know, you just need to learn how to listen, which I'll show you how to do.

Does history repeat itself? Some say yes, some say no, others say everything is random.

My investing experience over the last twenty-five years has taught me that the stock market is not random and that history does repeat itself. The key to investing success is to recognize this and take advantage of it, which I have done very successfully.

By knowing what to look for and observing just a few of the signals on any given stock or ETF, you can catch the most profitable market swings. This is even possible on a weekly basis.

The incredible breakthrough I've been talking about is called the Winning Signal based on the Groenke V theory. It is a part of my tool set that has made a lot of investors a lot of money. If you are able to predict the direction of a stock with a high degree of accuracy, then the opportunity for success is endless. That is just what I'll reveal in this book along with fully implemented strategy at WallStreetWinning.com.

The Winning Signal implements a Black Box algorithm that looks at what has happened in the past, for any stock or ETF, and provides an indication of when to Buy, Hold, Sell, or just Wait (do nothing). The details of the algorithm are revealed and described for your review and analysis.

Here is one of the many opportunities that could make a significant positive impact in your portfolio. AMAZON [AMZN] ended down by 22% in 2014. So holding it all year gave you nothing. Following the Winning Signal would have netted you a 29.67% return for the same time frame. Now that is significant. Another example is American Express [AXP]. It had a gain of 5.14% in 2014. The Winning Signal produced a 20.57% return with three trades that were all profitable. How about this one, CVR Energy [CVI]. It was down 1.53% in 2014 but WS produced a 46.14% return with four trades. Using the Winning Signal low risk weekly trade rules provided a return of 33.22% with 23 trades and ownership of 21 days or less.

What Kind of Investor Are You? Can Investing Actually be Sexy?

Are you an investor, trader, collector or gambler? It depends on your point of view. An investor is a person who commits money in order to earn a financial return. A trader is a person whose business is buying and selling regularly. I consider myself an investor that trades stocks. I commit assets to generate a return. In the process, I buy and sell, knowing that to earn a return, one needs to sell the asset at a higher price than its purchase price. You make money by selling. We don't simply suggest that you buy low and sell high. Most times we buy high and sell higher.

If you buy and hold equity without the intent to sell, perhaps you are a collector. The asset may be worth a lot more in the future, but that could be generations away. If the past ten years is any indication of the future, to buy and hold could be termed a collector strategy.

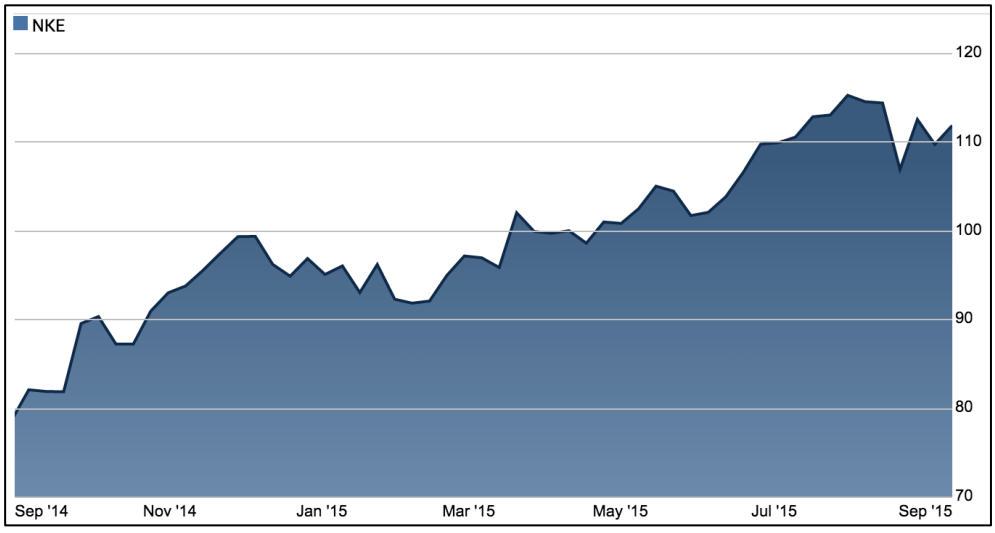
If you are the type of person that takes stock tips from the shoeshine boy, then you are definitely the gambler. If you base your trades not on history, not on facts, not on fundamentals and simply on what some talking head on TV says, or because you like a certain symbol, you just might be the gambler. Gamblers can be sexy when they are winning, but sooner or later if the gambler plays long enough they will eventually lose. That is not sexy.

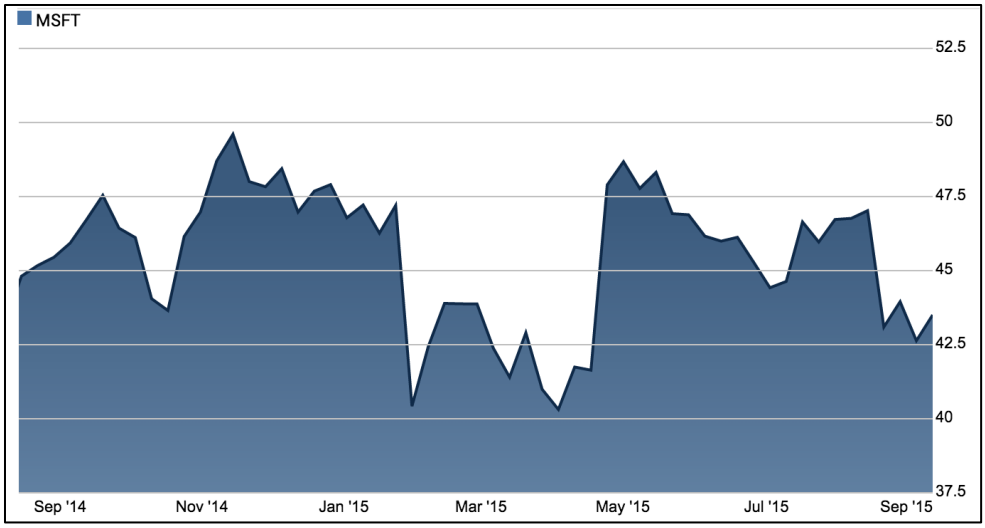
Being successful is about winning and the confidence associated with a consistent positive return. This is possible if you know when to buy and when to sell. Equities have up and down cycles just like the economy. Some equities are in step with the economic cycle and others are not. During 2014, many equities like General Electric (GE) or Boeing (BA) were falling with the economic uncertainty, while other companies like Apple (AAPL) were moving up and making new highs. The problem is, there are very few stocks that perform like Apple. It is a fact. So how do you win in this type of environment?

This is the beauty and challenge of investing in equities. If you are able to predict the direction of a stock with a high degree of accuracy, then the opportunity for success is endless. Endless success is SEXY! That is what I am revealing to at WallStreetWinning.com.

My technical analysis algorithm and process (Winning Signal) uses stock price trend, pattern, and trading history to determine when to buy and sell any stock.

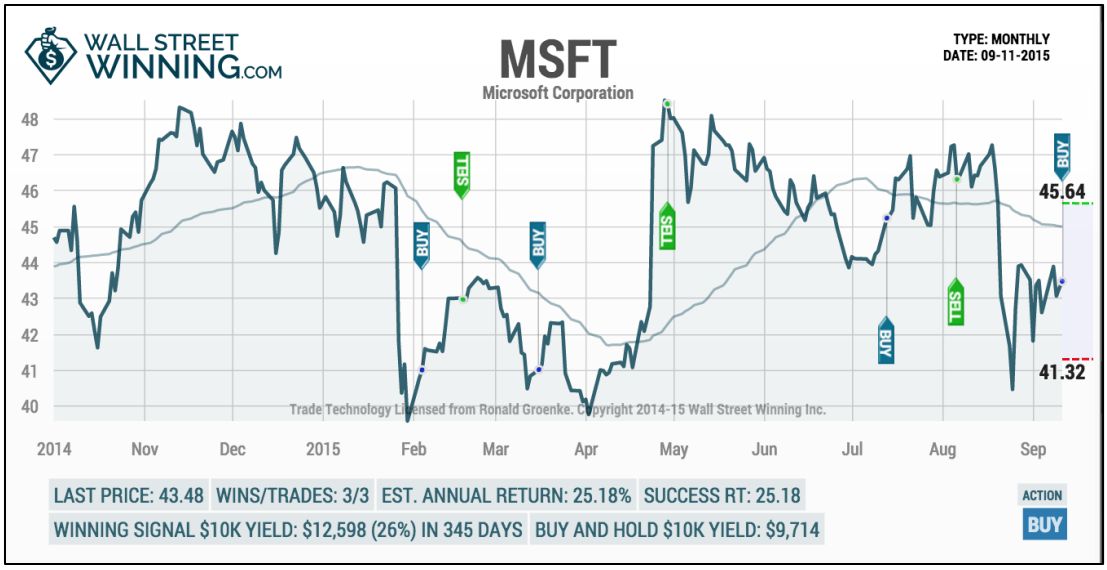
To demonstrate my process, let's look at the opportunity to generate a return in Microsoft [MSFT] or Nike [NKE]. In looking at the charts below, it seems rather obvious that one could buy NKE and just hold it, since it is going up (in hindsight). With MSFT it is more difficult since it was up and down and ended slightly down for the past twelve months. But there is significant opportunity with MSFT if you know when to buy and sell.





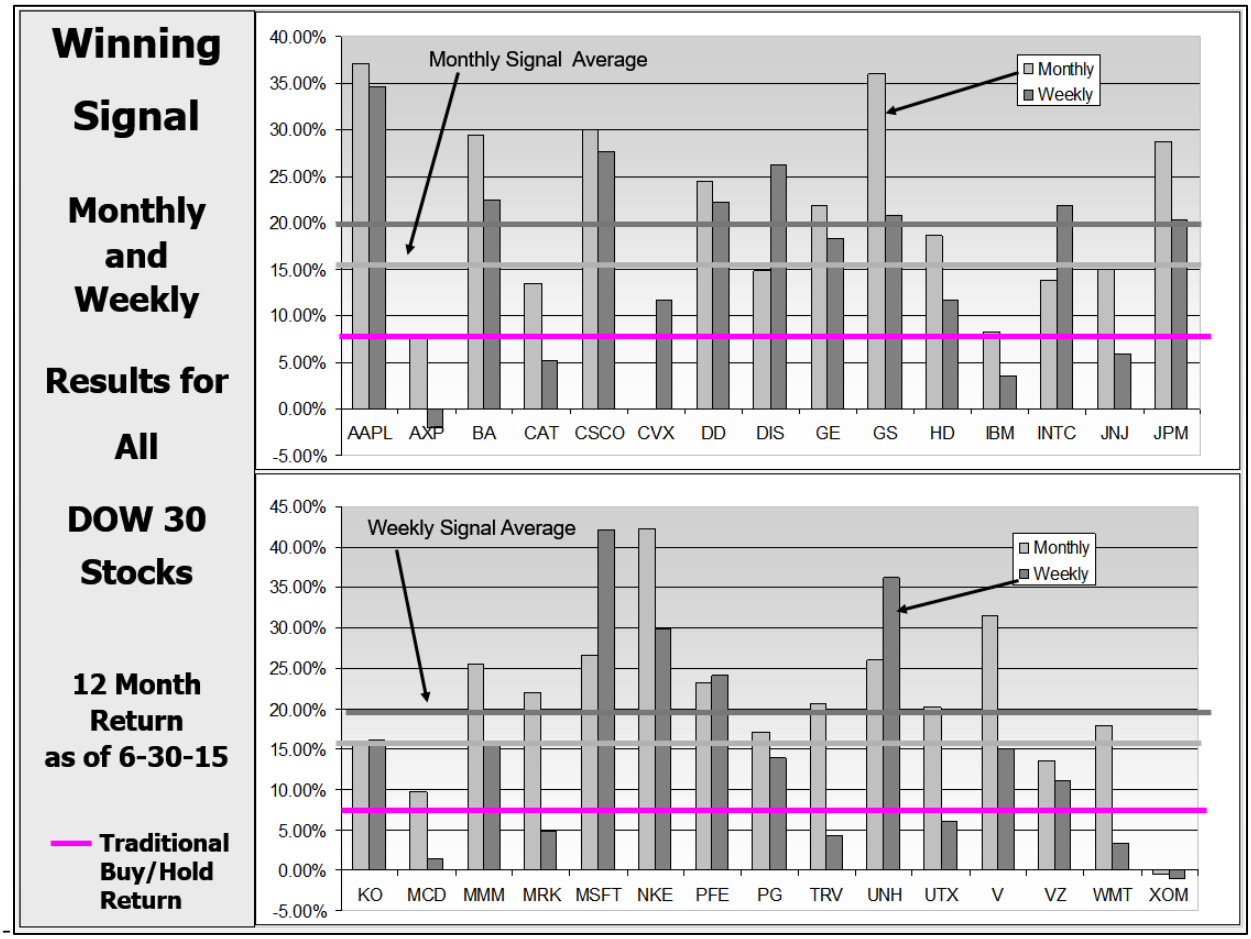
If you had invested $10,000 in each at the beginning of the period, you would have had a $2,870 gain with NKE and a $286 loss with MSFT.

Now, let's apply the Winning Signal technology to these two stocks and see what the results are. For NKE there were 3 trades with a net return of $4,036. For MSFT there were 3 completed trades with a positive return of $2,598. So in both cases the Winning Signal outperformed the straight up buy and hold strategy by a wide margin.



Okay, now I am sure you are already thinking in your mind that this seems a little too good to be true and that I picked the example to make everything look super. Well, that is not the case and, to dispel those thoughts, here is a summary of the results for all thirty stocks in the DOW index.

The Winning Signal on average provides significant additional return when compared to the



traditional buy and hold strategy. Do a review, and judge for yourself.

Now that we have determined that you are an investor and that investing can be sexy. What kind of investor are you? Are you conservative? Are you moderate? Are you aggressive? There really is no wrong or right answer here. Your level of risk is a personal taste and everyone is different. At different times in your life and even different days in your life, you may be one, all three, or none at all. The choice is up to you.

You can be a successful investor as any other, by using Winning Signals. It works for the most conservative investors to the most high-risk, aggressive investor. Why? Because, it uses math and science to give you the best possible outcome. This alone gives you both an advantage and a strategy in your investing. Strategy is the cornerstone of making money in the markets.

This is where judgment and style of investing enter the picture. I personally believe it is more productive to take a number of small gains to the bank over time rather than going for the big win. Singles and doubles win a lot of baseball games. Home runs are nice but very unpredictable. There is nothing sexy about unpredictability. Sex appeal and confidence go hand in hand. Greed is not sexy. Losing is not sexy and most certainly, striking out is not sexy.

I have experienced many singles and doubles during the last twenty-five years of my investing life. And my wife Jean will tell you that is pretty sexy. Singles and doubles have allowed me to buy nice cars for my wife, a beautiful, Florida home on the water and anything her heart could desire. It allowed me to put my kids through college, and it allows me to leave a legacy for my grandchildren.

There is no need to get greedy and try to triple your money overnight. It's just not attractive and, more times than not, it is gambling and you will end up a long-term loser. You may think you are missing out on the out of the park "big one" gain, but the trade data shows that you can be just as successful with a slow moving industrial like MSFT versus a high fashion trendy stock like NKE. Predictability, dependability, and financial stability is sexy, as that is what will make you richer.

THE SPECIAL OFFER

So we hope that you learned something from reading this chapter. As a FREE gift for giving us your valuable time we want to give you an entire eBook called "Wall Street Winning - Sex. Lies, and Getting Rich". This eBook is 85 pages of to the point, how to win, proof in how to become a Wall Street Winner. **Get the Free, 85-page EBook- CLICK HERE** to get your copy!

ABOUT THE AUTHOR

Ron Groenke was a NASA mathematician who discovered the stock market secret to low risk and big payoffs. He created an algorithm utilizing techniques he learned at NASA, and adapted them to the stock market with returns of 20-25%, winning 80 percent of the time. Ron is the Founder of WallStreetWinning.com

Combat Trade Planning

By Matt Buckley, www.TopGunOptions.com

The most important trading floor for any trader, individual or professional, is the five-inch trading floor between his or her ears. Having the proper mind-frame and controlling emotions is critical to making good decisions under the pressure of the markets and, ultimately, to trading success. It all comes down to **discipline**. We need to know why we are getting in, when to stay in and when to get out of a trade. At Top Gun Options a quality trade plan is the foundation for our disciplined execution in every trade.

As flying fighters in the US Navy we planned everything, from a simple 30 minute maintenance flight to a 7 hour combat mission. Every mission had an objective and we always had a plan to achieve our objectives. These plans spelled out exactly how we intended to achieve each objective. The team at Top Gun Options learned how to plan and plan well.

At Top Gun Options, we were trading before we joined the Navy to fly fighters, so we had built up some habits about how we went about our business of trading. Some were good, some were bad, but these habits lacked discipline and continuity. Then one day, shooting the breeze at the Officer's Club (which is where we solved all the world problems over a cocktail) it just kind of hit us; why don't we apply the same planning and execution disciplines that we use flying fighters in combat to our trading?

After all, our combat plans defined many things, to include: our objective, tactical mindset, targets, Commit Criteria (our go-no-go decision), the Tactic we intend to use to achieve our objective, employment method to achieve the Tactic, our course of action (steps we are going to follow executing the plan), contingency plans in case things don't go exactly as planned and we must also have a clear Exit Plan. So this tactical planning we used every day out on the aircraft carrier seemed a perfect fit for the options trading world as well!

You have to plan for combat in this manner, because combat is dynamic, it's dangerous, the battlefield is in constant change and you don't know where your enemy will strike from next. Sound familiar? Where did this Greek debt crisis come from, how about Enron or WorldCom? Which bubble is going to burst next? Who's cooking the books at our favorite company? Well, it seems to us, this definition of combat applies directly to the financial markets.

Which is why at Top Gun Options, "**Trading is Combat"** because it is!

In this lesson we are going to share with you our planning process. Is it perfect and suited for everyone? We certainly like it and we believe that you will benefit by applying the same discipline to your trading.

Defining a Plan

So just what is a plan? You don't have to be a Rocket Surgeon to understand this one!

A plan is a series of steps to achieve an objective.

This makes sense if you're going to hang some shelves in the garage or cook a pot roast. A plan is just a recipe and when it's complete you have some more shelves in the garage or a pot roast for dinner.

But, how does this definition work when you are playing in one of the most dynamic arenas in the world, where things are constantly changing and often appear to be directly against us? It still works, but the ***plan has to suit the environment where it is going to be executed*** and we are executing plans in one of the most complex environments in the world, the financial markets. So, we need to account for a few more things than cooking a pot roast.

When I am giving a presentation on planning, I always ask the crowd to write down the components of a plan. Invariably they are always slightly different and in many cases folks can't break a plan down into its important components. This lesson will solve this issue.

Why Plan?

Discipline

A trade plan is the foundation for disciplined execution. It allows us to keep our head on straight when all the talking heads are telling us the world is falling apart. It memorializes our reason for being in the trade and helps us make good disciplined business decisions under the pressure of the markets. It is because we built a plan, before the heat was on, that allows us to remove as much emotion as possible from our trading. In short, a trade plan is our tool to keep us disciplined in a trade.

Risk Management

Risk management is built into the plan. We know exactly when to get out, what our maximum acceptable loss is for the trade and how we are going to get out or adjust the position to save profits or limit losses. We define all of this before we get into a tight spot where emotions can take over and lead us to bad decision making. Emotions: greed, fear, attachment to a trade, whatever the issue, will influence your decision making. If you think it doesn't, you are going to spend a lot of money realizing that you're wrong. Laying out your risk parameters before being under the gun, will greatly assist you in suppressing your emotions and help you make good decisions.

In the Top Gun Options Pocket Checklist (OPCL), we layout planning guidelines for several different option tactics. In each, we identify our profit targets and maximum risk parameters for each trade to assist you in building your plan.

Superior Execution

When we get down to the brass tacks of trading, it's all about execution. Being disciplined and mapping out our risk parameters before we are deep in trades leads to Superior Execution. The

decisions we make in the heat of battle are key to our success in trading. We have a saying as flying fighters, "A bad plan executed well is better than a good plan executed poorly, but a good plan with good execution Discipline is unbeatable!" When you go through our Top Gun Options program, we will go over several options tactics and discuss optimum execution whether the market is trending favorably or unfavorably.

Ultimately **Discipline, Risk Management and Superior Execution** come down to the individual trader. As traders, we have to commit to being disciplined. We have to commit to sound Risk Management. We have to commit to achieving Superior Execution with our trading. It takes practice and courage to execute your plan, but the end result is consistent Superior Execution and more profits.

Components of a Plan

A plan has to be tailored to the environment we intend to execute. The planning process needs to flow sensibly, be easily understood and address as many potential scenarios as possible that can threaten the achievement of our objective.

The very first component in any plan is "The Objective," As traders and investors it does not matter if you are trading options, stocks, commodities, bonds, currencies or anything for that matter. Our objective as traders and investors is universal:

Make Money, Don't Lose It!

This is why we play in this financial arena; **there is no other reason**. We want to **make money, not lose it!** Every trade plan we create supports this objective…we want to make money, not lose it! If we are wrong in our trade, because we are not going to get them all right, we want to get out with minimal damage and keep our money to play another day.

Since this is our universal objective, we don't need to write it down every time. It is our guiding precept for trading.

After the objective, a Top Gun Options trade plan has seven components, designed specifically for trading options. A Top Gun Options trade plan…

…Defines our **Strategic Mindset**
…Identifies our **Target**...which is the underlying we want to engage.
…Outlines our **Commit Criteria**…Our justification for the trade.
…Identifies the **Tactic** we will use.
…Sets up our **Tactical Employment.**
…Outlines our **Mid-Course Guidance**…which is our trade execution plan.
…And finally outlines our **Exit Plan**…

Once the planning process is understood, a trader can complete the plan in as little as 5-10 minutes. We will go through each one of these components in this lesson.

Some of these terms may be new to you and that's because they have their roots in air combat, but they dovetail very nicely into our planning and, in our view, tighten our focus up another notch. We will explain each as we come across them if not,there is a Top Gun Options Terms glossary in the back of the book for reference.

Strategic Mindset

Our Strategic Mindset is the stance we take regarding how we think our underlying asset (our target) or the market will perform given the current financial climate. Strategic Mindset falls into one of four categories:

1. **Bullish**
2. **Bearish**
3. **Neutral**
4. **Volatile**

We can qualify our mindset if needed; we can be short-term bearish if we think something is overbought and might correct. Or we can be neutral to bearish or neutral to bullish. It just depends on our analysis of the current situation and guides our Tactic selection to fit our Strategic Mindset.

When developing our Strategic Mindset we take a big to small approach. We start with the global financial situation and drill down to specific sectors, then to the stocks within a sector using both fundamental and technical analysis. As options traders we always take a look at our main barometer, the VIX, to tell us what the market is thinking and how the current market is priced.

Our Strategic Mindset drives many of our trading decisions. It helps us to analyze potential positions with an appropriate bias for the current market. It also gives us a baseline to challenge our own market assertions and those assertions of all the information we absorb. We don't want to be mindless sheep following the talking heads on CNBC or a tip we hear at work. We want to be proactive in the development of our Strategic Mindset and verify or disqualify the information we hear around us.

Target

Our target is simply the underlying asset with which we are looking to open a position. We will focus on an asset because we have clearly defined our Strategic Mindset on this target and we think we can profit from an options position supporting this mindset.

There are literally thousands of optional targets: Stocks, ETFs, futures, commodities. We will focus on stocks while going through Top Gun Options.

Commit Criteria

Commit criteria is our justification for entering in a trade. Commit criteria should be easily understood and explained in 1 – 3 sentences. Commit criteria is supported by our Strategic Mindset, our fundamental and technical analysis, and the volatility of the target.

Here is an example of what Commit Criteria might sound like if we had a bullish mindset on Freeport McMoRan (FCX).

"The recent pullback in FCX is exaggerated. The stock has come off its recent lows with heavy volume and appears to be at the beginning of bullish trend with a short-term technical price target of 70. Fundamentals remain strong and copper prices are rebounding."

This is a valid Commit Criteria for entering a trade. Commit criteria memorializes why we are in the trade. During the course of a trade, if we can no longer justify our Commit Criteria then we get out, immediately.

Tactic

At Top Gun Options, a "Tactic" is the option position we are opening, and there are many different positions we can open using options: calls, puts, condors, butterflies, credit spreads, etc. In the Top Gun Options Pocket Checklist (OPCL) you will find 32 different option tactics.

In current options lingo this is referred to as a strategy, but to call this a strategy is not true to the word's meaning. A strategy is a bigger vision that supports our "objective" and refers to a plan of "actions" to achieve our objective; in this case, our investment objective. The "actions" taken to achieve these goals are referred to as "tactics."

Example:
Objective: Make Money, Don't Lose It!
Strategy: Use options to achieve our objective.
Tactics: An option position to support our strategy.

For instance: If a trader wants to earn income from stocks in their portfolio by selling covered calls. This supports our objective and the strategy is to earn extra income with options. The Tactic to achieve this extra income is to sell covered calls on stocks in their portfolio.

To us at Top Gun Options, this is a more correct way to add detail to our intentions. In short, a strategy tells us **what** we want and a Tactic is **how** we get what we want.

Tactical Employment

Tactical Employment is the set up for our option position. It includes:

- Leg Set Up
- Net Debit or Credit
- Max Profit potential
- Maximum Risk of the trade
- Break Evens
- Probabilities of success
- Adjust and Eject Criteria
- Greek Effects

Outlining Tactical Employment lets us know what we are getting into when we enter a trade. Think of Tactical Employment as defining the performance envelope for our trade. It defines the parameters, both good and bad, where the trade can perform.

Mid-Course Guidance

Mid-Course Guidance encompasses our trade management plan. The term comes from an air-to-air missile and refers to the control of the missile until just before it reaches its target. At Top Gun Options, Mid-Course Guidance encompasses our Risk Management parameters in terms of profit goal and max allowable loss, threats to success, contingency plans and Eject Criteria.

Max profit goals and max allowable loss are independent trader decisions based on individual investment goals and risk tolerance. At Top Gun Options we are not trying to hit the ball out of the park on every trade; base hits can add up fast. When setting our max allowable loss, we determine the maximum we are willing to lose to see if this trade will work. This does not mean we have to wait to reach this point to get out, it is simply defining the most we are willing to let this trade work against us. This keeps us from saying to ourselves, "I just need a few more days for this to work!" or "I love this trade, it will come around," and staying in a losing trade. If we hit our max allowable loss, we get out; lick our wounds and move on to the next trade.

Threats to success are occurrences that can negatively affect our position during the life of the trade. An example of a threat to our success: We were bullish and then implied volatility increased unexpectedly due to a negative economic report.

Contingency planning is simply having a basic game plan if our trade is not going per design: do we roll up, roll down or get out?

Our Eject Criteria are our "no questions asked," just get out of this trade; examples include: our max allowable loss limit is reached or our Commit Criteria is no longer valid.

Embedded in your options PCL tactics section is guidance for setting many of these parameters and can serve as a great starting point for determining your own risk parameters.

Exit Plan

The Exit Plan is how we are going to get out of a trade. We never get into a fight unless we know exactly how we intend to exit. Factors for planning an exit include: a sound reason for exit, layout our closing trade set up, whether we are exiting prior to expiration or taking it all the way to expiration.

It is important to know exactly how you are going to exit a trade before the volatility of the markets gets the better of you.

Planning Complete

That's the plan! It's just a logical sequence of steps that encapsulates and memorializes our research, lays out the playing field for the trade, sets risk tolerance tripwires for action while in the trade and lines out how we will exit. Don't trade without one!

Once you have the system down it will take 5 -10 minutes max to complete and will keep you aligned very closely with our universal objective.

Make Money, Don't Lose It!

Example Trade Plan

Back in January 2010 we were beginning to think that Google (GOOG) was getting a little lofty in price. Even though the talking heads could not stop talking about how great GOOG was and it was going to the moon non-stop. At this point we took a short-term contrarian's view. So we took a short term bearish Strategic Mindset on GOOG, 7 days, and decided to target GOOG with a bearish trade.

GOOG Trade Plan
January 7, 2010

Strategic Mindset: ***BEARISH, Short term (7 days) on GOOG***

Target: ***GOOG currently trading at 593.52***

Our commit criterion was simple:

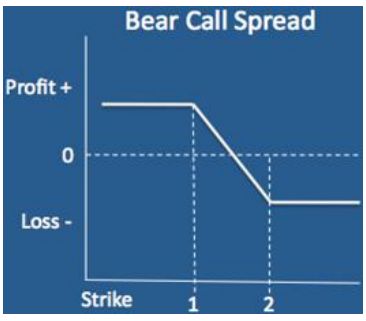
Commit Criteria:

Thinking GOOG is going to give some back in the short term with some of the uncertainty surrounding the release of various mobile devices and some profit taking. On the technical side, the 20 day MACD is diverging to the down side and RSI is indicating an overbought condition.

We had some technical indicators and some fundamental uncertainty we thought would lead skittish traders to take some profits off the table. The Commit Criteria is short, sweet and it made sense. Little did we know at the time but this was a turning point for GOOG and it is off about 20% since this call.

Our Tactic was a Bear Call spread two strikes above where GOOG was trading. One of our intermediate tactics and in this instance it had a high probability of success.

Tactic: *Bear Call Spread on GOOG, 610/620*



Tactical Employment is petty straight forward and requires just a little math:

Tactical Employment:

Leg Set up: *Sell JAN 610 Call at 3.90*
Buy JAN 620 Call at 2.10
Net Credit: 1.80

Max Profit: *1.80, 22% return on risk.*
Max Risk: *8.20*
Breakeven: *611.80*
Probabilities*: 72% probability of max profit.*

The Greeks:

Theta (Time Value): *Time is our Friend, the longer that GOOG stays below our breakeven of 611.80 the stronger our chance of a profit.*

Vega (Volatility): *For this trade we want volatility to decrease for the duration of the position. An increase in volatility with GOOG can easily threaten our Breakeven (B/E) on the down side.*

The last part of our Tactical Employment is an understanding of the Greek effects. In this case Vega and Theta are what we were concerned with and in a bear call spread. Theta is our friend because the longer that we stayed below our breakeven, the better our chance of profit. We also wanted to keep volatility in our scan because an increase in volatility could decrease our chances of success.

Mid-course guidance, which is our trade management plan, is relatively simple:

Mid-Course Guidance:

Profit Target: *Profit Target is 1.80, 22% return on risk. 100% return on premium.*

Threats to Success:

- *Jobs Data is being reported Friday, a positive report could cause a move to the upside.*
- *We are going against the longer-term trend of GOOG and buyers could step in if they don't see any more down side.*

Eject Criteria/Contingency Plan:

- *Commit Criteria becomes invalid*
- *We will set our stop loss 25%...Eject if the premium gets to* ***2.25***

Our threats to success over the trade are researched and listed so we don't drop them out of our scan.

Our Eject Criteria is set; in this case we had a tight stop for two reasons. First, the short term on the trade did not give us too much time for it to reverse if it went strongly against us. Secondly, we were going against the long term trend and did not want to get caught in a minor downdraft. Our only contingency plan was to get out if the trade went against us; we did not want to roll this trade.

Finally, our Exit Plan was simple:

Exit Plan

- *Profit Target or Eject Criteria Reached.*
- *To close position, simultaneously,*
  - *Buy JAN10 610 Call*
  - *Sell JAN10 620 Call*

This is all there is to putting a plan together. Once complete it should fit nicely onto one or two pages. The actual trade plan is depicted below:

Google

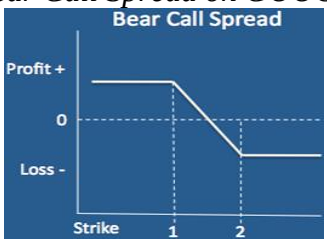
Trade Plan
January 7, 2010

Strategic Mindset: ***BEARISH, Short term (7 days) on GOOG***
Target: ***GOOG currently trading at 593.52***

Commit Criteria:

Thinking GOOG is going to give some back in the short term with some of the uncertainty surrounding the release of various mobile devices and some profit taking. On the technical side, the 20 day MACD is diverging to the down side and RSI is indicating an overbought condition.

Tactic: *Bear Call Spread on GOOG, 610/620*



Tactical Employment:

Leg Set up: *Sell JAN 610 Call at 3.90*
Buy JAN 620 Call at 2.10
Net Credit: 1.80

Max Profit: *1.80, 22% return on risk.*
Max Risk: *8.20*
Breakeven: *611.80*
Probabilities: *72% probability of max profit.*

The Greeks:

Theta (Time Value): *Time is our Friend, the longer that GOOG stays below our breakeven of 611.80 the stronger our chance of a profit.*

Vega (Volatility): *For this trade we want volatility to decrease for the duration of the position. An increase in volatility with GOOG can easily threaten our B/E on the down side.*

Mid-Course Guidance:

Profit Target: *Profit Target is 1.80, 22% return on risk. 100% return on premium.*

Threats to Success:

- *Jobs Data is being reported Friday; a positive report could cause a move to the upside.*
- *We are going against the longer-term trend of GOOG and buyers could step in if they don't see any more down side.*

Eject Criteria/Contingency Plan:

- *Commit Criteria becomes invalid*
- *We will set our stop loss 25%...Eject if the premium gets to* ***2.25***

Exit Plan

1. *Profit Target or Eject Criteria Reached.*
2. *To close position, simultaneously,*
   - *Buy JAN10 610 Call*
   - *Sell JAN10 620 Call*

CONCLUSION

The time invested in putting a plan together is well worth the effort.

This trade ended up working out for us and we bought it back for 10 cents and made 1.70 on the trade. We got out prior to reaching our profit target because we had made a nice profit in the short time the trade was open and market volatility, the VIX, was starting to show signs of life heading into earnings season back in January.

Wrap Up

Having a plan will substantially increase your trading Discipline; it lays out your Risk Management plan and will lead to consistent Superior Execution. You can complete your plan before or after pulling the trigger. If we complete the plan after executing the trade, it is because we are familiar with the target and are comfortable trading it. After we pull the trigger though, we sit back and fill out the plan immediately.

Our planning process represents the minimum knowledge we want to have before we open a trade and it is the tool that gives us the confidence we need to execute our trades with Discipline, manage our risk based on our comfort with the current market climate and consistently manage our trades with Superior Execution. You may want a bit more or a bit less in your plan, but our system provides a solid foundation for customizing your own trade plans to suit your trading needs.

Your Options Pocket Checklist (OPCL) contains a planning guide that will help you build solid plans every time. Plus, we will walk you through many trade plans as we go through Top Gun Options.

THE SPECIAL OFFER

CLICK HERE to enroll in our live trading programs and to see this trade plan being used by our professional traders. Visit our site **www.topgunoptions.com** to learn more information.

ABOUT THE AUTHOR

E. Matthew "Whiz" Buckley is the founder and CEO of Top Gun Options LLC and is the Chief Development Officer and a partner at Black Bay Fund Management LP.

Whiz is a highly experienced financial business executive with decades of leadership and execution experience from the front lines to the front office. Whiz was the founder and CEO of PEAK6 Media LLC, a financial media company. The company provided options and futures news, commentary, analysis, entertainment, and up to the minute reporting directly from the floors of the Chicago Board Options Exchange (CBOE) and Board of Trade (CBOT). This exclusive information allowed retail and professional options and futures traders around the world to execute at a higher level.

Whiz has written a book called *From Sea Level to C Level: A Fighter Pilot's Journey from the Front Lines to the Front Office*, which combines his experiences in the military and in corporate America.

Whiz is a decorated Naval Aviator who flew the F/A-18 Hornet for the United States Navy. He flew 44 combat sorties over Iraq and graduated from the Navy Fighter Weapons School ("TOPGUN").

Reading Order Flow for Unusual Options Activity

What are Options and Why Is Reading Order Flow Important?

By James Ramelli, www.AlphaSharkTraders.com

An option is a contract between the buyer and the seller. There are two types of options: calls and puts.

Calls give the buyer the right, but not the obligation, to buy a specified stock or financial instrument (the "underlying") at a specified price (the "strike price") on or before a specific date ("expiration"). The buyer has the right to buy the underlying at the strike price, and the seller has the obligation, but not the right, to sell the underlying should these conditions be met.

Puts give the buyer the right, but not the obligation, to sell the underlying at the strike price on or before expiration. Put buyers have the right, but not the obligation, to sell the underlying stock (or other instrument) at the strike price on or prior to expiration. Alternatively, put sellers are obligated to buy the underlying at the strike price should a buyer choose to exercise these rights.

So what factors determine how these options are priced? Six factors, or price inputs, determine an option "premium:"

1. The stock price
2. The strike price of the options
3. The time remaining until expiration
4. Dividends
5. Interest rates
6. Implied volatility.

In general, the more a given stock fluctuates in price on a daily or weekly basis, the more expensive its options will be, and vice versa. Options usually tend to be more expensive prior to earnings reports and other major announcements but decrease in price sharply after the announcement, once the "uncertainty" has been removed. A good example of this is biotech stocks and drug announcements.

Options are traded for one of two reasons: as speculation, or to hedge against a stock position.

Options are bought as a speculation that a stock will move in a certain direction. Calls may be purchased because a trader believes the stock will move higher prior to expiration. Alternatively, puts may be purchased because a trader believes the stock will move lower prior to expiration.

The terms "in-the-money," "at-the-money," and "out-of-the-money" are used to describe the relationship of an option's strike price to the price of the underlying stock. A call is in-the-money when the stock price is above the strike price. Alternatively, a call is out-of-the-money when the stock price is below the strike price. As you might guess, if a call is at-the-money, its strike price is equal to the stock price.

The inverse is true when looking at puts: if the stock price is above the strike price, a put is considered to be in-the-money. A put is out-of-the-money if the strike price is below the stock price, while the at-the-money definition is the same as for calls.

Options are also purchased to hedge against stock positions. Each day, I watch over 2,000 trades in real-time as they hit the tape. I always try to determine, are these orders a hedge against a stock position, or a speculative play? In the eleven years I spent trading on the floor, I learned how to "Read the Tape."

Most certainly a combination of art and science, it is a skill I've honed over the years. A large part of my trading strategy is based on my ability to do this. By watching for big block option orders, dubbed "unusual options activity," I try to determine the positions of Paper. "Paper" is term originating from the trading floor, when orders were actually written on paper and run to traders in the pit by clerks. It is used to describe large institutions such as hedge funds, mutual funds, or large banks. In other words, institutions who have access to better information – even "insider" information – than your average trader or investor.

When trading off of unusual option activity, I only want to take trades based on orders I believe to be speculative plays. Given the sensitive, and even illegal, natures of their positions, hedge funds tend to be a secretive bunch. Thus determining if these trades are speculative or a hedge is like piecing together a puzzle.

Let's put it another way: what if you could have taken the same trades as Raj Rajatnam, or SAC Capital's Steve Cohen, the moment they were put on? I'd go to jail for insider trading, you might say? Not so fast.

The moment an order hits the tape, it becomes public information. I can trade off it, based on the fact that I believe someone placing such a large bet has access to insider information, and it is completely, 100% legal. This isn't a matter of debate, or speculation, ask any SEC lawyer you know. This is why I trade unusual options activity. *And this is why it works.*

The Unusual Options Activity Trading Plan

There is no secret to becoming a profitable trader, and you should be skeptical of anyone who tells you otherwise. That being aid, the techniques I've outlined in this text served me very well in my trading career and without them I would not have made the money I did.

Reading order flow and watching unusual options activity continues to be one of my most profitable techniques, just like it was on the trading floor. I had two very profitable years in Apple stock when my net profits in AAPL were over a million dollars. Once a week for a year, a Merrill Lynch broker would walk into the pit and sell AAPL put spreads. His acronym was "HES," and whenever I would see him coming, I would know to get long and sell volatility. How did he know? No clue, but by watching him I made quite a few profitable trades.

By combining order flow with technical indicators like the Ichimoku cloud, I devised my OCRRBTT trading plan to trade profitably off of the floor.

The OCRRBTT Trading Plan

Pronounced "Oak Ribbit," this trading plan will give you a step-by-step method for breaking down unusual option activity. After evaluating unusual trades with this plan, you will be able to decide if you want to follow it or ignore the trade altogether. The letters in the acronym stand for:

- **O**pen interest
- **C**hart
- **R**isk
- **R**eward
- **B**reakeven
- **T**ime

- **T**arget.

Here you will see the importance of each of these elements in the plan.

Open interest: The first thing you need to look at is if the trade volume is bigger than the current open interest in that line. If it is, this means that this is an opening position and is worth taking a look at. You don't want to buy an option on unusual activity if it is really just paper covering a short. Only consider trades where volume is greater than open interest.

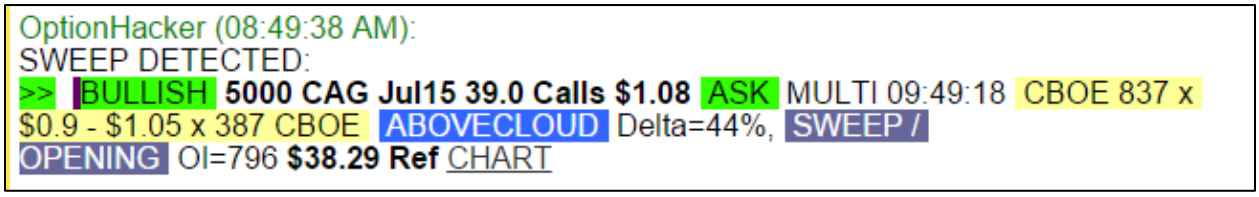
Chart: This is the second most important element of the plan. Once an unusual order is confirmed to be an opening order you must then look at the chart of the underlying stock. You need to ask questions. Is the stock in a strong bullish or bearish trend? Is there support or resistance at the strikes the institution is trading? Is it more likely they are speculating on more upside or downside or could they be hedging? The answers to these questions will help you determine if the trade is speculation or a hedge. This will keep you from trading against the institution when you actually want to trade with them.

Risk, Reward, and Breakeven: Once the direction of the trade is determined, you have to evaluate if the risk vs. reward profile of the trade the institution executed is in line with your risk tolerances. Some trades they take could be far too risky for the average retail trader. However, since you know the direction the institution is betting, you can tailor a trade that has the right risk setup for you. The risk of each trade must also be measured against the potential reward. If the institution is risking $5 to make $1, this is a trade you would want to avoid. You should also always be aware of the breakeven of each trade. If there is significant support or resistance at the breakeven point, you may want to consider another strategy.

Time and target: Always be aware of potential catalyst events that might be near. You want to know if paper is playing the overall direction of the stock or if they are playing a near-term catalyst event like earnings, drug announcements, or new product launches. This might factor into your decision to take the trade or not. Once you have your time horizon set, you want to pick a profit target. Are you leaving this trade on to expiration? Taking off half at a double and letting the rest ride? Knowing the answers to these questions at the onset of the trade make it easier to manage going forward.

Putting the Plan to Work

Once a trade hits the tap, a trader must use the OCRRBTT trading plan to analyze the setup and determine if it represents an actionable trading opportunity. Let's look at the example below and determine if it is a trade setup that we actually want to take. This order hit the tape on June 16th 2015.



Before running this trade through the plan, we need to understand the information we have.

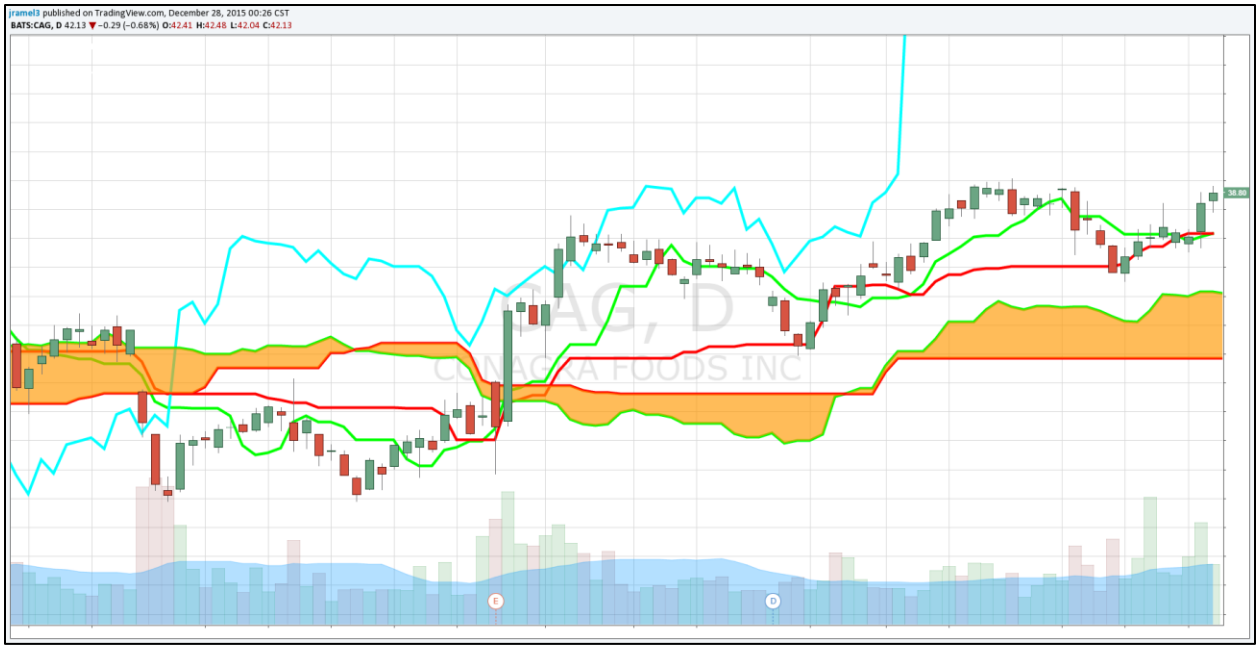
We are able to get a lot of information from order flow. We can see how many contracts this trader bought, that it was a $540,000 bet and that the trader that bought these options paid through the market maker's offer to get filled. Although all of these things make this trade interesting, they still do not necessarily qualify it as an actionable setup.

To make this determination, we must evaluate this trade using the OCRRBTT trading plan.

Open Interest: Was this an opening position? This trade is labeled opening, so there is no doubt it was an opening position. If for some reason the trade was not labeled opening, we would still be able to confirm that it is because the volume of 5,000 contracts is greater than the current open interest in the line of only 796 contracts. With open interest smaller than volume, there are not enough open contracts in the line for this to be a closing trade. It is confirmed opening.

Chart: Does the chart indicate this trade is more likely to be a hedge or a speculative bet? We need to confirm that the underlying trend of the stock supports this as a speculative bet. If it does not, the trade may be a hedge, and it is less likely to be actionable. To do this, we will use an indicator called the Ichimoku Cloud. It may look intimidating, but for this purpose a trader only needs to know that anything trading above the shaded area on the chart is in firm bullish territory and anything below it is in bearish territory.

Here is the chart of CAG on the Ichimoku Cloud the day these calls hit the tape:



We can see that the stock is trading above the Ichimoku Cloud and is in an established bullish trend. This does not confirm with 100% certainty that this order was indeed a speculative bet, but it makes it far more likely that this is the case. With the trend supporting the idea of this trade as a speculative bet, we will move on to the next part of the analysis.

Risk and Reward: Does the potential reward justify the risk? This is a very large trade in what is generally a boring stock. ConAgra (CAG) doesn't usually get much unusual activity, so if the risk and reward setup makes sense, it might be a trade that we want to take. This is an outright call buy, and a trader knows that they can never lose more than $1.08 in this trade. This translates to $108 in risk per one lot with what is a technically unlimited upside reward potential. This sets up for a good reward-to-risk setup, and a trader can take this trade.

Breakeven: Where is the breakeven point in this setup? These options are just out of the money and are being bought for $1.08. At that strike price, this trade's upside breakeven is $40.08, or about 4.6% higher than the stock's price at the time of the trade. This is only a 4.6% move to the upside. That is not an unreasonable move. With that in mind the setup becomes even more attractive.

Time and Target: What is the trader expecting? In this trade, they are looking for a move to the upside of at least 4.6% by July expiration. Since the trader bought the July, $39 calls, we will buy the same ones. A trader should never trade a different expiration or price target than the institutional trader. Remember, they have better information than us.

Everything about this trade sets up well. All of the evaluations in the OCRRBTT trading plan point to this being an actionable trade setup.

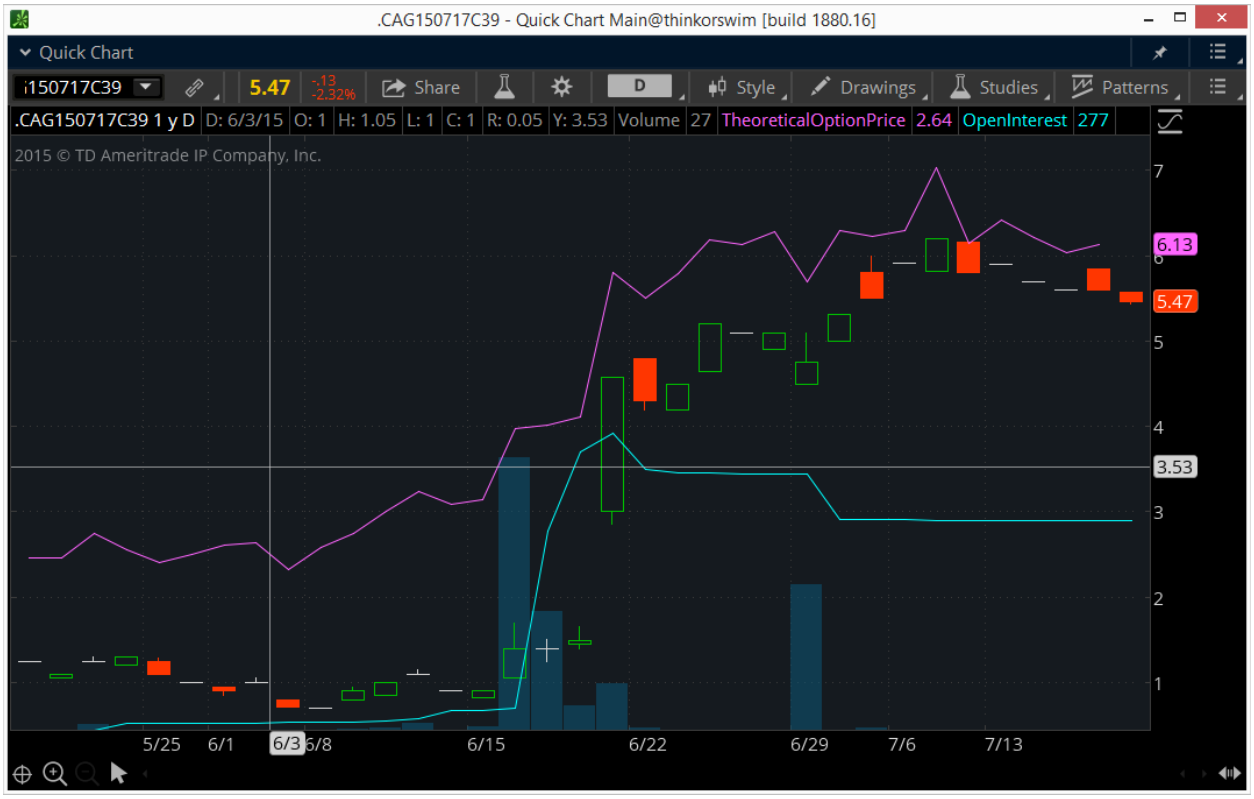
The Result

This trade ended up being a fantastic winner. The trader's motivations behind this trade become much more clear three days later when news breaks of activist activity in CAG.

Look at how the stock responded to the news:

The stock gapped to the upside and these options exploded in value. Anyone looking at the reaction in the stock might be surprised by the huge move to the upside, but those paying attention to unusual options activity were alerted to this potential move three days before it actually happened.

The options that the institutional trader bought saw an enormous move to the upside, trading as high as $6.20 before expiration. This means that at the highs, this trader would have profited $2.56 million dollars at the highs. Look at a chart of the options below.



A retail trader who followed this trader with a 20 lot of these options would have profited $10,240 at the highs. This is a perfect example of how a retail trader can harness the power of institutional order flow and trade more like the biggest and most successful hedge fund managers in the world.

How Can AlphaShark Trading Help Me?

Since founding AlphaShark Trading in February 2012, I've been overwhelmed by the positive feedback and response I've received. Business is booming, which is great, because I love helping traders improve their P&L through setting up better risk-versus-reward trades. Every day in the office, the other traders and I discuss strategies, options set-ups, and reasons why we did or didn't take certain trades. AlphaShark trading began as a blog, but I realized I wasn't just content with sharing my market commentary. After all the monetary success options brought me, I wanted to help others *stop losing money* at the very least.

To learn more about trading unusual options activity and how you can get unusual options activity alerts live and in real time, please check out our Gold Package here for a HUGE discount!

THE SPECIAL OFFER

Get one month of trade alerts for just $7! **CLICK HERE** to get your copy of the gold package!

ABOUT THE AUTHOR

James Ramelli is a trader and options educator at **AlphaShark Trading**, where he actively trades futures, equity options, currency pairs and commodities. As one of the moderators of the Live Trading Room, Ramelli educates members on strategies, trade setups, and risk management while trading his own capital.

Ramelli regularly appears on Bloomberg TV, BNN, and CBOE TV, in addition to writing a weekly column for Futures magazine and being featured in CME Group's OpenMarkets as a guest contributor.

Ramelli holds a B.S. in Finance with a concentration in Derivatives and Financial Engineering from the University of Illinois at Urbana-Champaign.

How to Use Straddles to Trade Options

By Kim Klaiman, www.SteadyOptions.com

For those not familiar with the straddle strategy, it is a neutral strategy in options trading that involves the simultaneous buying of a put and a call on the same underlying, strike and expiration. The trade has a limited risk (which is the debit paid for the trade) and unlimited profit potential. If you buy different strikes, the trade is called a strangle.

You execute a straddle trade by simultaneously buying the call and the put. You can leg in by buying calls and puts separately, but it will expose you to directional risk. For example, if both calls and puts are worth $5, you can buy a straddle for $10. If you buy the call first, you become bullish - if the stock moves down, the calls you own will decrease in value, but the puts will be more expensive to buy.

The Options Guide explains straddle:

Long straddle options are unlimited profit, limited risk options trading strategies that are used when the options trader thinks that the underlying securities will experience significant volatility in the near term.

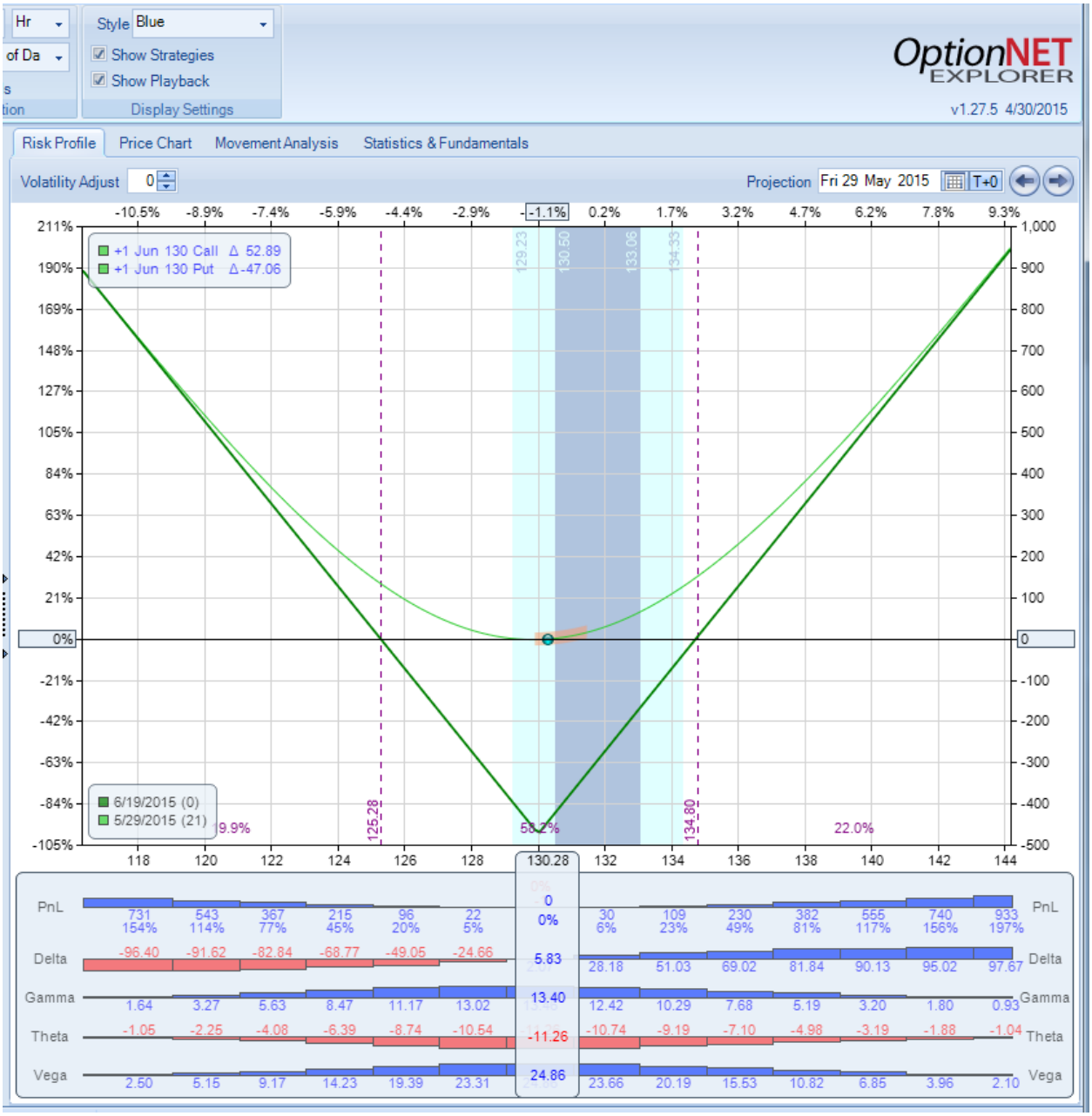
Maximum loss for long straddles occurs when the underlying stock price on expiration date is trading at the strike price of the options bought. At this price, both options expire worthless and the options trader loses the entire initial debit taken to enter the trade.

INVESTOPEDIA explains straddle:

Straddles are a good strategy to pursue if an investor believes that a stock's price will move significantly, but is unsure as to which direction. The stock price must move significantly if the investor is to make a profit. Should only a small movement in price occur in either direction, the investor will experience a loss. As a result, a straddle is extremely risky to perform. Additionally, on stocks that are expected to jump, the market tends to price options at a higher premium, which ultimately reduces the expected payoff should the stock move significantly.

Example

With AAPL currently trading at $130.28, you could buy AAPL straddle by buying 130 put and 130 call. This is what the P/L chart would look like:



How straddles make or lose money

A straddle is a vega positive, gamma positive and theta negative trade. That means that all other factors equal, the straddle will lose money every day due to the time decay, and the loss will accelerate as we get closer to expiration. For the straddle to make money, one of two things (or both) has to happen:

1. The stock has to move (no matter which direction).
2. The IV (Implied Volatility) has to increase.

A straddle works based on the premise that both call and put options have unlimited profit potential but limited loss. While one leg of the straddle loses up to its limit, the other leg continues to gain as long as the underlying stock rises, resulting in an overall profit. When the stock moves, one of the options will gain value faster than the other option will lose, so the overall trade will make money. If this happens, the trade can be close before expiration for a profit.

In many cases IV increase can also produce nice gains since both options will increase in value as a result from increased IV.

When to use a straddle

Straddles are a good strategy to pursue if you believe that a stock's price will move significantly, but unsure as to which direction. Another case is if you believe that IV of the options will increase - for example, before a significant event like earnings. IV (Implied Volatility) usually increases sharply a few days before earnings, and the increase should compensate for the negative theta. If the stock moves before earnings, the position can be sold for a profit or rolled to new strikes. **This is one of my favorite strategies that we use in our model portfolio for consistent gains.**

Many traders like to buy straddles before earnings and hold them through earnings hoping for a big move. While it can work sometimes, personally I don't like it. The reason is that over time the options tend to overprice the potential move. Those options experience huge volatility drop the day after the earnings are announced. In most cases, this drop erases most of the gains, even if the stock had a substantial move.

Buying a straddle before earnings

Few years ago, I came across an excellent book by Jeff Augen, "The Volatility Edge in Options Trading." One of the strategies described in the book is called "Exploiting Earnings - Associated Rising Volatility." Here is how it works:

1. Find a stock with a history of big post-earnings moves.
2. Buy a strangle for this stock about 7-14 days before earnings.
3. Sell just before the earnings are announced.

IV (Implied Volatility) usually increases sharply a few days before earnings, and the increase should compensate for the negative theta. If the stock moves before earnings, the position can be sold for a profit or rolled to new strikes.

Like every strategy, the devil is in details. The following questions need to be answered:

1. Which stocks should be used? I tend to trade stocks with post-earnings moves of at least 5-7% in the last four earnings cycles.
2. When to buy? IV starts to rise as early as three weeks before earnings for some stocks and just a few days before earnings for others. Buy too early and negative theta will kill the trade. Buy too late and you might miss the big portion of the IV increase. I found that 5-7 days usually works the best.
3. Which strikes to buy? If you go far OTM (Out of The Money), you get big gains if the stock moves before earnings. But if the stock doesn't move, closer to the money strikes might be a better choice.

Under normal conditions, a straddle or a strangle trade requires a big and quick move in the underlying. If the move doesn't happen, the negative theta will kill the trade. In case of the pre-earnings strangle, the negative theta is neutralized, at least partially, by increasing IV. In some cases, the theta is larger than the IV increase and the trade is a loser. However, the losses in most cases are relatively small. Typical loss is around 7-10%; in some rare cases it might reach 20-25%. But the winners far outpace the losers and the strategy is overall profitable.

Market environment also plays a role in the strategy performance. The strategy performs the best in a volatile environment when stocks move a lot. If none of the stocks move, most of the trades would be around breakeven or small winners. Fortunately, over time, stocks do move. In fact, a big chunk of the gains come from stock movement and not IV increases. The IV increase just helps the trade not to lose in case the stock doesn't move.

Would you like to rent your options for free?

I would like to explain the "underneath" of this strategy.

Let's take a step back. When someone starts trading options, the first and most simple strategy is just buying calls (if you are bullish) or puts (if you are bearish). However, when doing that, you must be right three times: on the direction of the move, the size of the move and the timing. Be wrong just in one of them - and you lose money. You will also find out very quickly that options are a wasting asset. They lose value every day. If the stock doesn't move, the option is losing value. If it moves but not fast enough, it is losing value as well. It is called a negative theta. You can read more about the options Greeks here.

Another factor having a great impact on options value is IV (Implied Volatility). Rising IV will increase the option value, falling IV will decrease it. For volatile stocks, IV usually becomes extremely inflated as the earnings approach and collapses just after the announcement. This is why if you buy calls or puts before earnings and hold them through the announcement, you might still lose money even if the stock moves in the right direction.

Having said that, I would like to achieve the following three goals when trading options:

1. Not to bet on the direction of the stock.
2. To minimize the effect of the time decay.
3. To take advantage of the rising IV.

The strategy of buying a strangle (or a straddle) before earnings fits all three parameters. First of all, since I'm buying both calls and puts, I'm not betting on the direction of the stock. Second, I'm holding for a very short period of time, so the impact of the time decay is minimal. Third, since I'm buying a few days before earnings, the IV in most cases will rise into earnings. However, I will be selling just before the announcement, so the options will not suffer from the IV collapse.

Now, few scenarios are possible.

1. The IV increase is not enough to offset the negative theta and the stock doesn't move. In this case the trade will probably be a small loser. However, since the theta will be at least partially offset by the rising IV, the loss is likely to be in the 7-10% range. It is very unlikely to lose more than 10-15% on those trades if held 2-5 days.
2. The IV increase offsets the negative theta and the stock doesn't move. In this case, depending on the size of the IV increase, the gains are likely to be in the 5-20% range. In some rare cases, the IV increase will be dramatic enough to produce 30-40% gains. For example, AAPL strangle could be purchased on Friday before October 2011 earnings and sold the following Monday for 32% gain.
3. The IV goes up followed by the stock movement. This is where the strategy really shines. It could bring few very significant winners. For example, when Google moved 7% in the first few day of July 2011, a strangle produced a 178% gain. In the same cycle, Apple's

3% move was enough to produce a 102% gain. In August 2011 when VIX jumped from 20 to 45 in a few days, I had the Disney DIS strangle and few other trades doubled in a matter of two days.

This is why I call those trades "renting a strangle/straddle for free" (or almost free). Even under the most unfavorable conditions, your loss is usually limited to 7-10%. But if you get a decent IV increase and/or a stock movement, the gains could be much higher.

Another big advantage of this strategy is the fact that it is not exposed to the gaps in the stock prices - in fact, it benefits from them. So you cannot suddenly find yourself down 30-50%. You can always control the losses and limit them.

Selection of strikes and expiration

I would like to start the trade as delta neutral as possible. That usually happens when the stock trades close to the strike. If the stock starts to move from the strike, I will usually roll the trade to stay delta neutral. To be clear, rolling is not critical - it just helps us to stay delta neutral. In case you did not roll and the stock continues moving in the same direction, you can actually have higher gains. But if the stock reverses, you will be in a better position if you rolled.

I usually select expiration at least two weeks from the earnings, to reduce the negative theta. The further the expiration, the more conservative the trade is. Going with closer expiration increases both the risk (negative theta) and the reward (positive gamma). If you expect the stock to move, going with closer expiration might be a better trade. Higher positive gamma means higher gains if the stock moves. But if it doesn't, you will need bigger IV spike to offset the negative theta. In a low IV environment, further expiration tends to produce better results.

Profit Target and Stop Loss

My typical profit target on straddles is 10-15%. I might increase it in more volatile markets. I usually don't set a stop loss on a straddle. The reason is that the upcoming earnings will usually set a floor under the price of the straddle. Typically those trades don't lose more than 5-10%. I believe our biggest loss on a straddle was around 25%, and only a handful of them have lost more than 20% since inception.

The biggest risk of those trades is pre-announcement. If a company pre-announces earnings before the planned date, the IV of the options will collapse and the straddle can be a big loser. However, pre-announcement usually means that the results will be not as expected, which in most cases causes the stock to move. So most of the time, the loss will not be too high, especially if there is still more than two weeks to expiration. But this is a risk that needs to be considered.

As a rule, I will always close those trades before earnings.

Why I don't hold through earnings

Some people would argue that selling before earnings is premature. Why not tohold through earnings, hoping for a big move?

The problem is you are not the only one knowing that earnings are coming. Everyone knows that those stocks move a lot after earnings, and everyone bids those options. Following the laws of supply and demand, those options become very expensive before earnings. The IV (Implied Volatility) jumps to the roof. The next day the IV crashes to the normal levels and the options trade much cheaper.

For example, holding straddles on stocks like AMZN or NFLX could be very profitable during some of the last cycles. However, we have to remember that those stocks experienced much larger moves than their average move in the last few cycles. Chances are this is not going to happen every cycle. There is no reliable way to predict those events. The big question is the long term expectancy of the strategy. It is very important to understand that for the strategy to make money it is not enough for the stock to move. It has to move more than the markets expect. In some cases, even a 15-20% move might not be enough to generate a profit.

Some people might argue that if the trade is not profitable the same day, you can continue holding or selling only the winning side till the stock moves in the right direction. It can work under certain conditions. For example, if you followed the specific stock in the last few cycles and noticed some patterns, such as the stock continuously moving in the same direction for a few days after beating the estimates. Another example is holding the calls when the general market is in uptrend (or downtrend for the puts). However, it has nothing to do with the original strategy. From the minute you decide to hold that trade, you are no longer using the original strategy. If the stock didn't move enough to generate a profit, you must be ready to make a judgment call by selling one side and taking a directional bet. This might work for some people, but the pure performance of the strategy can be measured only by looking at a one day change of the strangle or the straddle (buying a day before earnings, selling the next day).

The bottom line:

Over time the options tend to overprice the potential move. Those options experience huge volatility drop the day after the earnings are announced. In most cases, this drop erases most of the gains, even if the stock had a substantial move.

Jeff Augen, a successful options trader and author of six books, agrees:

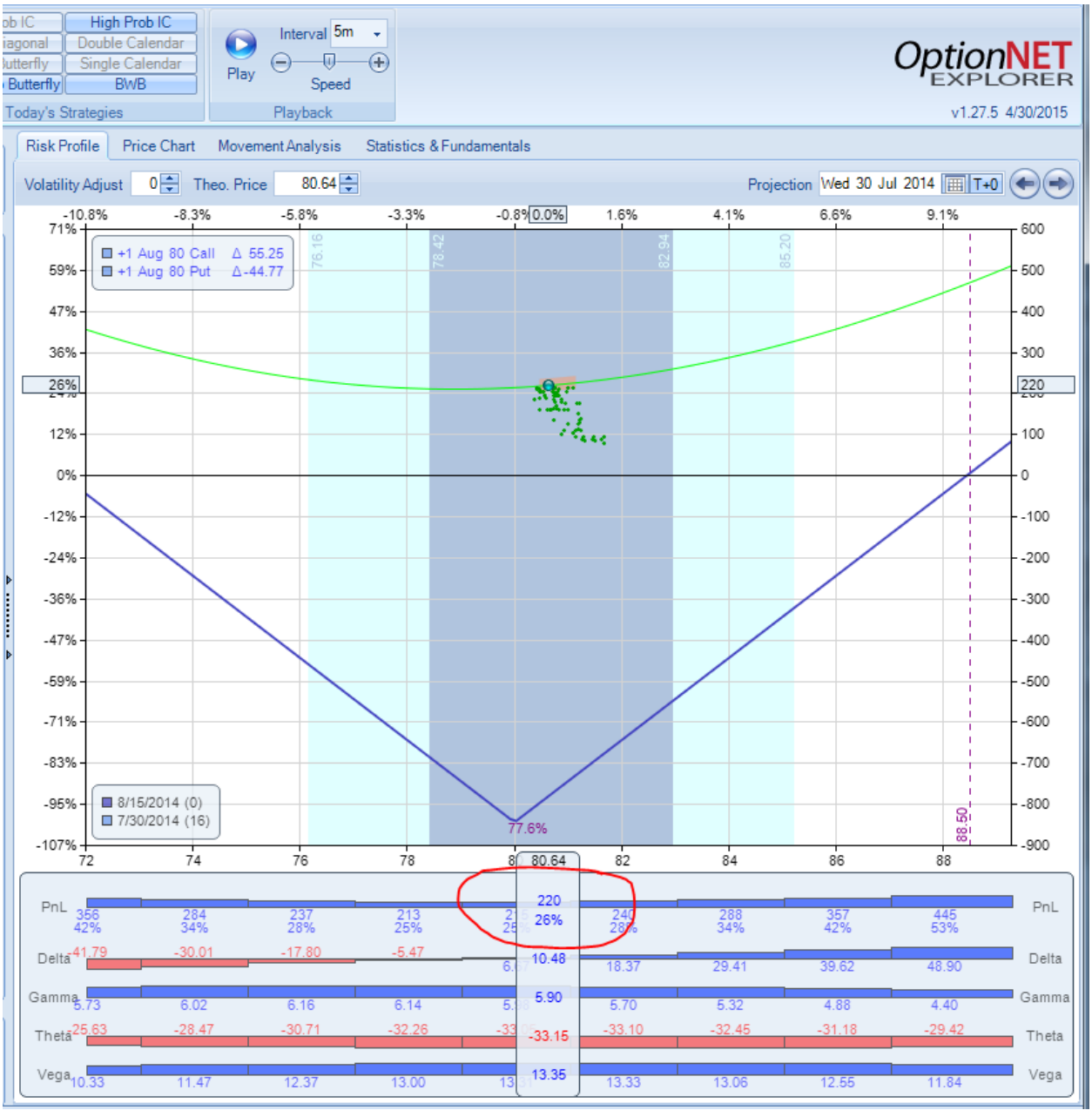
"There are many examples of extraordinary large earnings-related price spikes that are not reflected in pre-announcement prices. Unfortunately, there is no reliable method for predicting such an event. The opposite case is much more common – pre-earnings option prices tend to exaggerate the risk by anticipating the largest possible spike."

It doesn't necessarily mean that the strategy cannot work and produce great results. However, in most cases, you should be prepared to hold beyond the earnings day, in which case the performance will be impacted by many other factors, such as your trading skills, general market conditions, etc.

Test Case #1

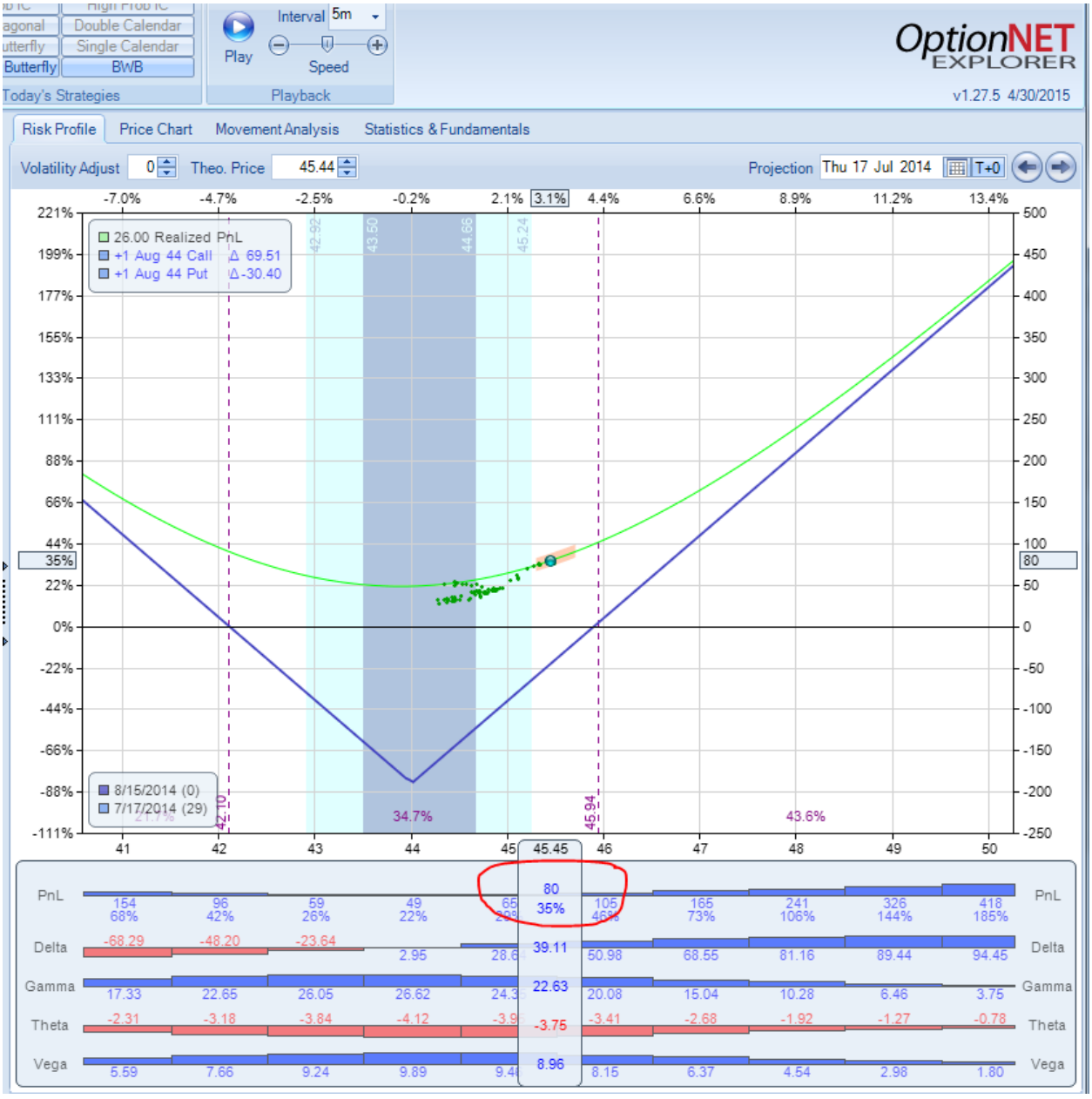
On July 28, 2014 we purchased EXPE 80 straddle expiring in 18 days. We paid $8.45 for the trade. The IV of the options was around 59%.

Two days later, the IV of the options jumped to 73% and we sold the straddle at $9.85, for 16.6% gain. An hour later, IV reached 80%, and the straddle could be sold for 26% gain. The stock itself moved less than 1%.



Test Case #2

On June 24, 2014, we purchased MSFT $42 straddle expiring in August. We were able to roll the straddle twice, and finally closed it on July 17 for 35.4% gain. In this case, most of the gains came from the stock movement.



Conclusion

Buying a straddle or a strangle few days before earnings can be a very profitable strategy if used properly. Of course, the devil is in the details. There are many moving parts to this strategy:

1. When to enter?
2. Which stocks to use?
3. How to manage the position?
4. When to take profits?

And much more. But overall, this strategy has been working very well for us.

Here is an example how this strategy performed during the August 2011 crisis:

08/09/11	08/20/11	11 Days	CRM strangle	41.5%
08/09/11	08/17/11	8 Days	NTAP strangle	19.0%
08/03/11	08/08/11	5 Days	DIS strangle	107.1%
08/0311	08/08/11	5 Days	HPQ strangle	109.7%
08/03/11	08/08/11	5 Days	CRM strangle	101.7%
08/03/11	08/08/11	5 Days	NTAP strangle	104.5%
07/27/11	08/03/11	7 Days	GRMN strangle	20.1%
07/27/11	08/03/11	7 Days	DNDN strangle	82.3%
07/27/11	08/04/11	8 Days	CF strangle	19.0%
07/27/11	08/08/11	12 Days	RL strangle	124.2%

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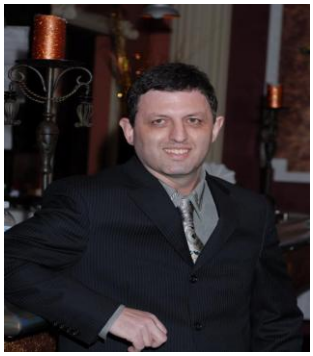
ABOUT THE AUTHOR



Kim Klaiman is a full time options trader. He is a founder of **www.SteadyOptions.com** - options education and trade ideas, earnings trades and non-directional options strategies. Kim has been trading stocks and options for more than 10 years. He likes to trade variety of non-directional trades with low correlation to limit the total portfolio risk. Kim wrote over 100 articles for Seeking Alpha. He

started the SteadyOptions educational forum after numerous requests from his Seeking Alpha readers, to share his experience and trading ideas. Kim holds a BSc degree in Computer Science. He lives in Toronto, Canada.

SteadyOptions.com is a combination of a high quality education and actionable trade ideas. Our style is non-directional trading. We aim for steady and consistent gains with a high winning ratio and limited risk. Our focus is on trading Earnings-Associated Implied Volatility rise, Iron Condors, Calendar spreads, etc. Our performance is based on real fills, not hypothetical performance. We provide a full trading plan with complete portfolio approach.

Best Advice for Options Traders

By Michael McNelis, www.DelphianTrading.com

As an Option Strategist at Delphian, I am often asked for advice on how to trade options. Quite frankly, people expect me to be able to answer that question in a single sentence. But let's be honest. If you want to be successful in any endeavor, there are no quick fixes.

Are you trying to create income? Is your trading for hedging your portfolio or is this speculative money look for high returns? Every time we make a trade, whether buying stocks or options, we want to make money. We have to realize that there are different strategies when buying or selling options. What is your personality? Can you handle four losses in a row to get to a fifth option trade that makes 150%?

Options give us tremendous flexibility which can be a blessing and a curse. This leads to my **first piece of advice** for options traders:

Plan your trade and trade your plan.

Wall Street preys on peoples' fear and greed, and these two emotions can be detrimental to your portfolio. With flexibility, it is easy to change your mind or strategy, and then you end up chasing the market constantly.

What's my **second piece of advice**?

Diversify your options portfolio into different strategies.

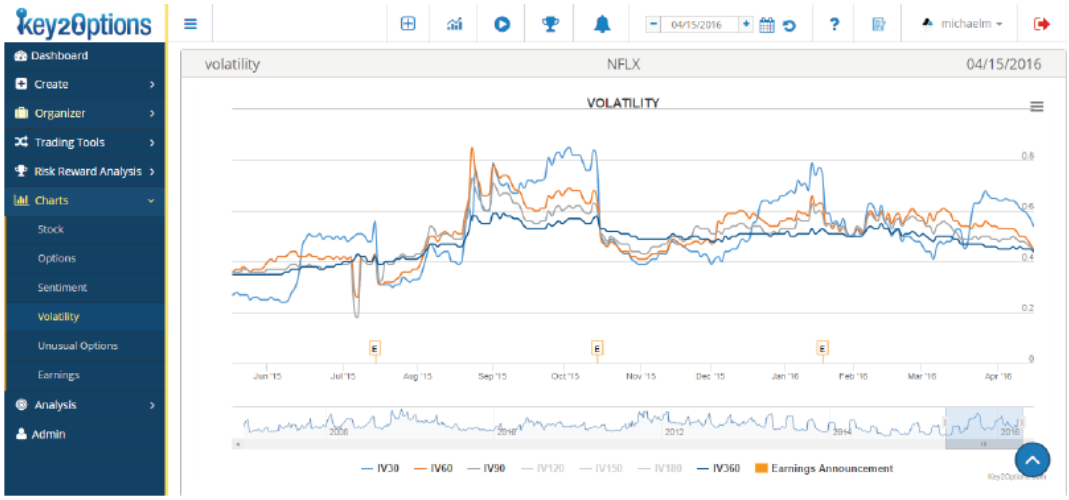
Option trading is a business and it needs to be treated as such. When creating a stock portfolio, it is important to diversify. There are times in the market when it makes sense to buy options and there are times when selling options is a better decision. Become a buyer and seller of options depending on market conditions.

Which leads me to my **third piece of advice**:

Time can be a friend or foe.

As buyers of options, we want to have enough time for our prediction to come to fruition. People tend to buy front month options because the price is cheaper. Options are a wasting asset and the extrinsic value of an option erodes greatly during the last 30 days of an option. Extrinsic Value refers to the price component of the option that includes time and volatility.

On the other hand, as an option seller, we have to gauge how much risk we want to take. The further out in time we sell an option, the more premium we take in, but it also gives us more of a chance to be wrong.



At Delphian, we've developed a software program that empowers traders with institutional-grade trade analytics and gives them the ability to test trading strategies with historical options data.

You no longer need to hypothesize what has been the best Facebook option to buy since it went public. Delphian gives you the ability to analyze, create, backtest and trade your option strategies.

The Delphian program allows you to create buy and sell signals, input your money management parameters, and pick your strike price and expiration date to find out historically what option has performed the best.

Delphian is not a Holy Grail. What it *is*, though, is a tool that gives you the ability to analyze data and, based on your risk/reward profile, create quantitative models that increase ROI and reduce risk.

How do we do that?

We have a proprietary trade signal that classifies each stock or index in one of 8 States. Using an algorithm is based off finite mathematics, we will classify and quantify each stock and index as bullish or bearish as well as giving you an expected price movement over a defined period of time. This helps keep you on the correct side of the market.

Tip #1: Plan the Trade and Trade the Plan

Plan your trade and trade your plan is our motto at Delphian...and it should be the motto for all options traders. Because after all, how often does making rash decisions pay off?

Typically, when it comes to trading, volatile swings can create turmoil for the trader. You must be incredibly disciplined to trade options. By the very nature of options, the leverage created from option can cause your Profit and Loss statement to have huge swings.

It is important to know why you made the trade, and how you will react to possible scenarios. What's the solution? Plan the trade and trade the plan!

Before we get to specific trades, let's take a look from 10,000 feet.

Your plan should start as a business plan. If you are trading options as fun or for just a couple hours a week, don't expect to be successful. I like to go fishing on the weekends. I catch fish, but at the end of the day, the charter boat captains that fish full time, day after day, will always perform better than I do.

Are you properly capitalized?

Most businesses fail due to undercapitalization. Even savvy options traders will have a drawdown. It is important to set up your business knowing how you will allocate your money. That means you will need to determine what strategies you will use and on which markets.

Any good trader also needs to incorporate a risk management strategy into their trade plan. Here, we will determine how much we will invest per trade. A common method might be to take 2-5% of your trading capital per trade.

You will also need to decide where to take our profits and take losses. One of the hardest things for traders to do is let winners run and cut losses. So many times, I see people suffer with two or three losses, then as soon as the next trade makes a little money, they want to capture the profit.

The problem for most traders is they have no idea what when they should sell for profit or when to take a loss. It's great to have a theory, but is it correct?

The Delphian program takes the idea of *"plan the trade and trade the plan"* to another level. With it, you can backtest your theory and find out where you should be taking profits and cutting losses.

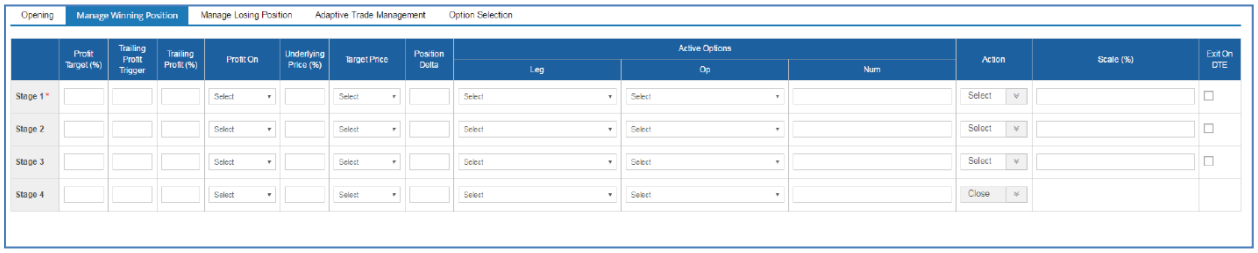
Backtesting: Don't Trade Without It!

Backtesting is a key part of developing your trading plan. Why backtest? You want to make sure your strategy is profitable. If you are getting recommendation from a noted "guru," it just makes sense to see how his methodology has performed in the past. I always recommend doing your own homework.

With the Delphian program, you can test to find out the movement pattern of the particular stock or index you are looking to trade. Unlike the majority of other backtesting systems, which are extremely complicated to navigate or feel as if you need to know how to write computer programming code, Delphian was

designed so that you could backtest a trading plan with no computer coding experience needed.

You simply enter your profit targets and stop losses to find the optimal spot to take profits. It is as easy as putting a number into the profit target box and then running the backtest.



Of course, past performance does not guarantee future performance, but it *will* at least give you an idea of how your strategy has performed in different time periods and market conditions. After all, if a strategy has not worked in the past, it probably will not work in the future.

Because of Delphian, when I enter a trade, I have the confidence of knowing that my plan has been vetted over a nine year period.

Tip #2: Diversify Your Option Strategies

The concept of diversification is the primary tenet of portfolio theory. The market is dynamic and ever changing, and in options trading, you are basing your trading on either direction or volatility.

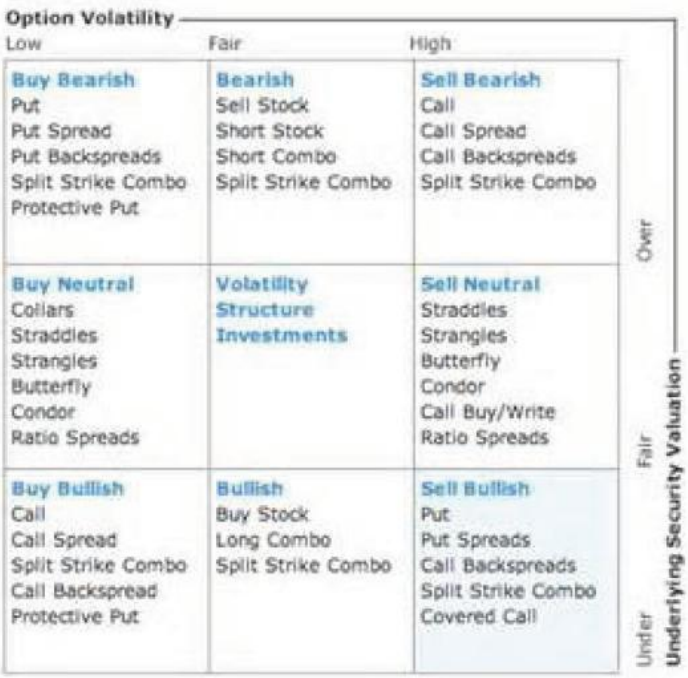
You can be short or long direction or volatility, and there are multiple combinations of trading strategies for each. I am not saying you need to know every option strategy, but you *do* need to know what environment the market is in.

We want to make sure we have a few different strategies for different market conditions. When volatility is low, we want to be a buyer of options. When volatility is high, we want to be a seller of options.

Why? Implied volatility (IV).

Implied volatility is one component of an option price. Even if the stock price doesn't move, an option may increase or decrease in value due to an increase or decrease in implied volatility. Implied volatility shows how volatile the market may be in the future.

Things like earnings announcements or pending news of FDA approval on a drug can drive up



implied volatility and, therefore, make the option more expensive. Implied volatility helps you gauge the expected price movement.

Option sellers might drive up the prices so high that it becomes too costly to buy the options. Once the news has been released, the volatility comes down and the option loses value. Even though we had a move from the news, the options proved to be more costly than movement in the stock, making a losing trade for the person who bought the option.

When you are making your trade plan and determining your strategy mix, you need to keep in mind your trading style. **This can be the key to your success.** If you are going to buy out of the money calls, don't expect to be right on 80% of your trades. Can you mentally and financially stand to lose on trades? Using the Delphian program, you can find out how your strategy performed historically.

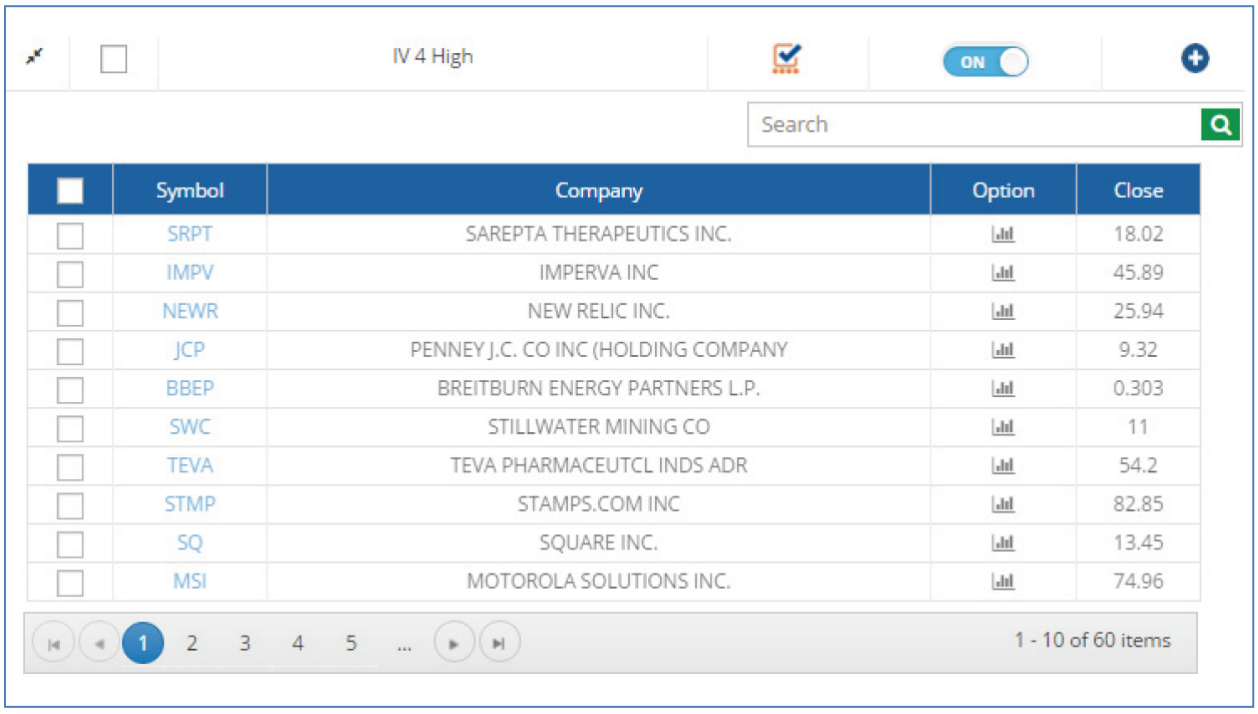

SUMMARY

	RUN	TRADE RULES	PROFIT	PROFIT FACTOR	WIN%	NUM WIN	NUM LOSS	REJECTED	DAYS IN TRADE	AVG DAYS PRIOR TO TRANSITION	AVG RISK OPEN	AVG RISK AFTER TRANSITION	EFFICIENCY	MAX RUN UP	MAX RUN DOWN	BIGGEST LOSS	REQUIRED CAPITAL	GAINS	LOSSES	ROI	ROI TRANS	P/DAY	TIED UP CAPITAL (%)
	Run2		$8,429.00	15.02	76%	16	5	2	10	0	($15,951.00)	$0.00	89%	$9,495.00	($1,650.00)	($343.00)	17321	$9,030.00	($601.00)	5.22%	0%	40.14	9.49
	Run1		$3,409.00	8.38	78%	18	5	0	9	0	($14,050.00)	$0.00	82%	$4,162.00	($981.00)	($324.00)	15346	$3,871.00	($462.00)	2.86%	0%	16.47	9.35

The markets generally do not go straight up or down, you can have upside and downside trades running simultaneously. If you spread the expirations over 90 days, you will likely have an opportunity to take a profit on both positions at a given point in time.

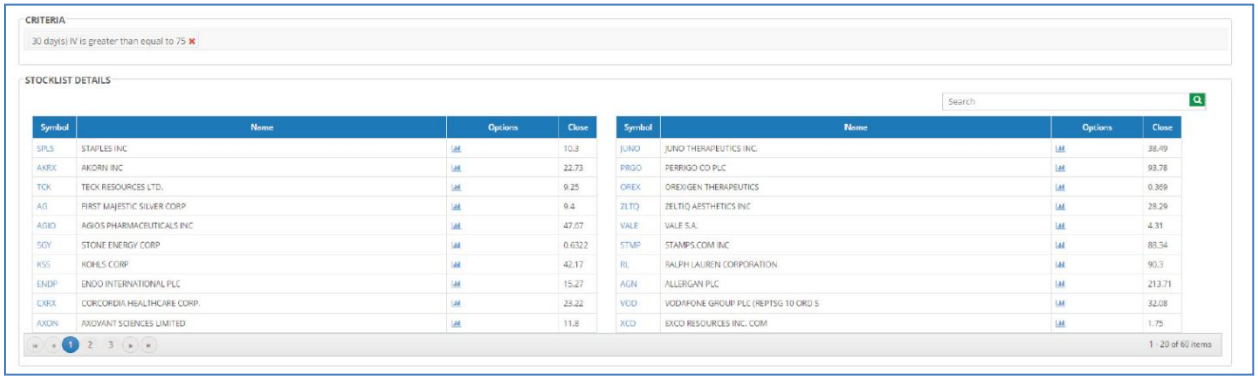
If you are conservative buy nature, I would suggest a mix of 70% selling options and buying calls or credit spreads, 30 % of the time. We want to be selling options when volatility is high. With Delphian, you can find stocks that have high implied volatility.

See the below screenshot, for example.



Symbol	Company	Option	Close
SRPT	SAREPTA THERAPEUTICS INC.		18.02
IMPV	IMPERVA INC		45.89
NEWR	NEW RELIC INC.		25.94
JCP	PENNEY J.C. CO INC (HOLDING COMPANY		9.32
BBEP	BREITBURN ENERGY PARTNERS L.P.		0.303
SWC	STILLWATER MINING CO		11
TEVA	TEVA PHARMACEUTCL INDS ADR		54.2
STMP	STAMPS.COM INC		82.85
SQ	SQUARE INC.		13.45
MSI	MOTOROLA SOLUTIONS INC.		74.96

Not only can I find stocks with high IV, I can also use the IV Rank. This judges the stock versus itself. It is important to know when the IV of a stock is high relative to itself.



From here, I can pick an option selling strategy, create a trading model and backtest it prior to implementing the strategy.

Tip #3: Time – Friend or Foe?

Part of an option price is the time premium. Theta is the measurement of an options time decay. The theta of an option reflects the amount by which the options value decreases every day.

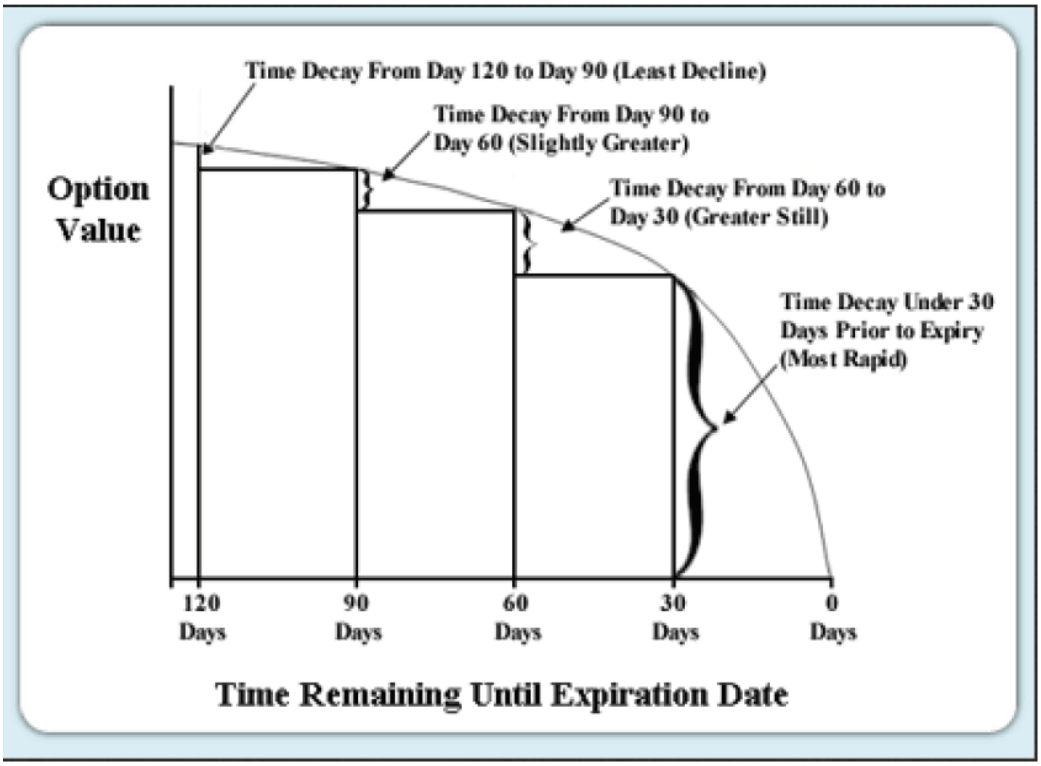
Let's look at an example. Pretend a call option is priced at $3.00 and has a theta of -.05. After two days, and assuming the underlying price didn't move and everything else is equal, the option would lose $0.10.

Is this good or bad?

Well, that depends on whether you are the buyer or seller of the option.

As the buyer of an option, this is not good. Regardless of what the underlying does, your option is losing money on a daily basis. The decay speeds up as expirations nears.

In the chart to the right, we can see the



dramatic decline in the final 30 days.

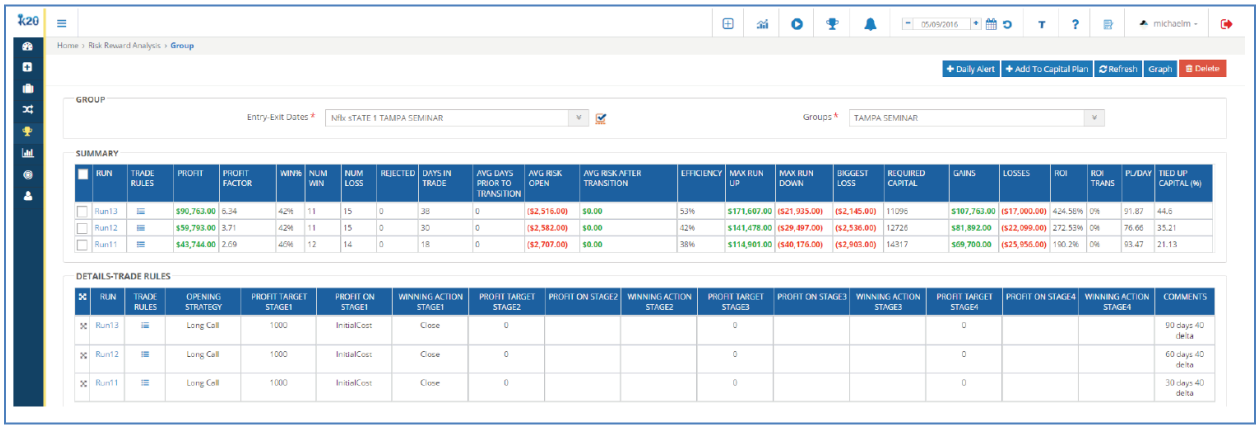
The most frustrating thing about buying a call option is watching the stock price rise the week after your option expires. When we buy options, it is important we buy expirations past 60 days. There are 2 reasons why we do this.

First, we are making a directional trade. We would always like our move to happen immediately whether it be up or down. The fact is the further out your option expiration is, the better chance you have of being correct.

Secondly, the time decay of our option is dramatically reduced. It is more expensive to buy the option but the payoff is far greater.

I ran a long call model on Netflix (NFLX). The only parameter I changed was the days until expiration; I used 30, 60, and 90 days to expiration.

The differences are dramatic. By going further out in time the profit dollars go from $43,744.00 for 30 days of expirations to $90,763.00 for 90 days of expiration. The profit factor goes up dramatically as well. The profit factor measures the gains divided by losses for a particular run.



Many people who start out in options are lured by the price of options with 30 days until expiration because they are less expensive. We can now quantify exactly what the changes can do by going further out in time by using the Delphian program.

Would you rather buy a cheap option or one that makes money? Whether you're a buyer or seller of options, it's essential that you make sure to use time to your advantage.

We want to make sure we treat trading like any other start-up business. With Tip #1, we see the importance of a plan and how essential it is to know what to do under different circumstances. How will I handle losses? Gains? Do I have a profit target? If my profit target is hit, will I close out the position or convert it into another strategy? With the Delphian program, you can cre¬ate and backtest all of your theories without the need for extensive programming experience.

With Tip #2, we explored diversifying your trading strategy. It's important to both buy and sell options, and to understand that certain market conditions will determine whether we should be a buyer or seller. You need not put all of your eggs in one basket. Different strategies will make you a more successful trader.

And finally, with Tip #3, we discussed keeping time on your side. Time is one of the pricing components of extrinsic value in an option. Each day, an options value erodes. We need to be aware that the price of options erodes greatly during the last 30 days.

Options trading can create dramatic returns, both positive and negative. At Delphian, we believe that it is important to backtest to minimize the negative returns. Like we say at Delphian:

Plan Your Trade and Trade Your Plan!

Inner Confidence, Outer Discipline

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ABOUT THE AUTHOR

Michael McNelis is an Option Strategist with **Delphian**. He began his career working for J.W. Investment Bankers, then co-founded Hatshack, a mall-based retail chain that eventually grew to 49 stores before being acquired by the publicly traded company Genesco.

Michael has been trading financial markets for over 20 years and has managed portfolios including equities, options and futures contacts. He has extensive use of options for income through covered call writing, hedging, and for capital appreciation, and has traded S&P, oil, natural gas, gold and U.S. dollar futures contracts.

My 27% Weekly Option Strategy

By Ryan Jones, www.SmartTrader.com

Are you looking for the best options strategy? My 27% Option Strategy is one of the best option trading opportunities you will come across. When you see the power and long-term probabilities of this strategy, you are going to wish you had known about this sooner.

My 27% Option Strategy is not the holy grail of trading strategies. There are risks, and I will fully and completely explain those risks in this report. Do not take a trade with this strategy unless you have thoroughly gone through the risks and have determined that these risks are acceptable to you. In this report I will go into detail about what the risks are, why they exist, and in what market conditions they exist in.

Having said that, it is my opinion that the risk/reward metrics associated with this strategy are some of the best out there.

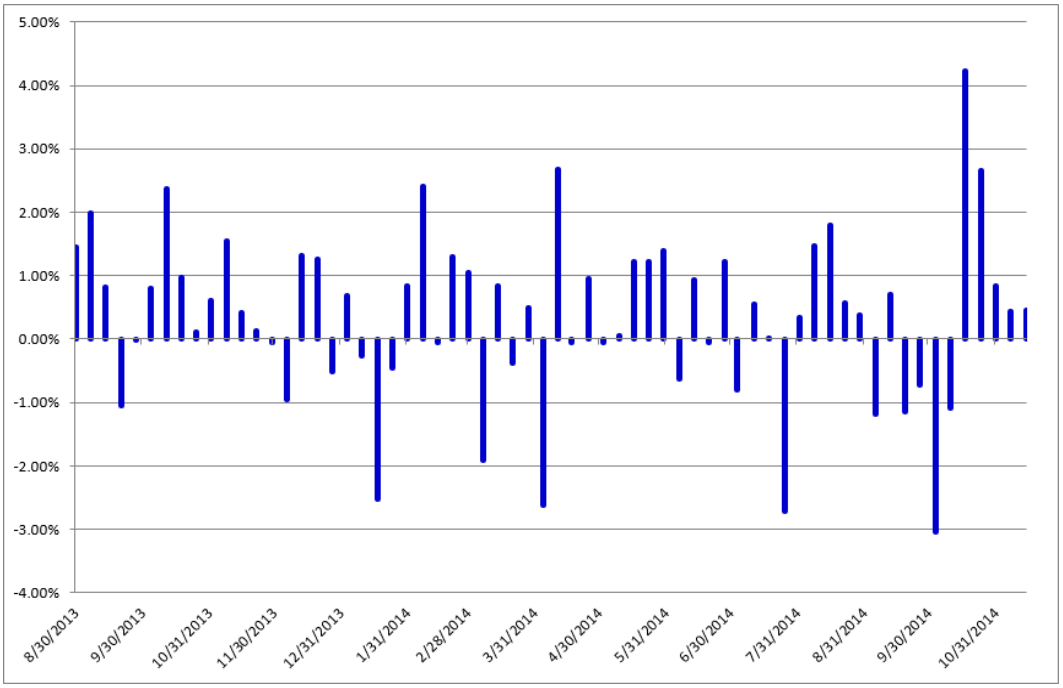
- Each Trade Risk is Absolutely Limited (Most Trades Around $200 - $225)
- Average Size Losses are $100 or Less
- Probability of Success is Upwards of 70% - 80% (sometimes greater)
- Average Expected Gain Win/Lose or Draw is 27% Per Trade

What does this mean? It means if you risk $200 each week, after 100 trades, you will have produced approximately $5,400. Not bad considering that it is very conceivable that you will never suffer a drawdown of more than $1,000 if you follow these guidelines. Add to this that you are GUARANTEED a 25% - 35% gain if the market stays the same or moves down (even crashes), thus making this an incredible opportunity all around. The risk only exists if the market moves up significantly within a short period of time We are therefore limited in the application of this strategy to SPY.

As you may know, SPY is the largest stock index ETF (Exchange Traded Fund). Stock indexes have an inherent "governor" if you will, that prevent large weekly moves to the upside from being a normal event. In fact, over the last 22-years, SPY has only moved higher from Friday to Friday 3% or more just 5% of the time. That means that 95% of the time, SPY has not moved 3% higher during the week.

We will be trading "My 27% Weekly Option Strategy" to take advantage of this characteristic of SPY.

The graph below represents the Friday to Friday move in SPY over the last 1½ years. As you can see, SPY has only moved higher by 3% just one time. It has only moved higher from Friday to Friday by at least 2% on just 6 occurrences, and this during one of the most consistently bullish years in the stock market.



With this strategy, there is no risk to the downside. If SPY tanks, even goes to zero, we are guaranteed to make money that week, usually about $60 - $75 per position.

Once a trade is placed, the breakeven level is usually around the 2.5% level (meaning that on Friday of the option expiration, if SPY closes at around 2.5% above the previous Friday's close, the trade could suffer a loss). This level is different for each trade, but is relatively close to this regardless as long as the guidelines are met. When a loss occurs based on a 2.5% movement higher, it is almost always small (less than $100). Only if the market makes a move higher by more than 3% (in most cases) is there a risk of suffering a loss closer to the maximum risk ($200 - $230). For the maximum risk of $230 to be suffered, the market would have to make a move higher of about 7% in 1-week (which is technically impossible barring a reaction from a significant decline occurring first).

In other words, the risk/reward metrics are tremendously in our favor, but why? In this report, I will show you exactly why that is.

Weekly Options & PPD

If you have not watched my video entitled "The Power of PPD", you need to do so. I will briefly cover PPD in this section and how they relate to weekly options.

Weekly Options are relatively new. Back in 2009, the CBOE introduced the first weekly options for a limited number of securities. The option would come on the board on the opening of Thursdays and expire the following Friday (8-days later).

So every Thursday, there would be 2 different weekly options available. One that expired the next day, and another that would expire the following Friday.

Then, in 2014, CBOE extended weekly options to exist for 6 different expirations at the same time. In other words, weekly options exist for this coming Friday, and each Friday after that for the next 6-Fridays. I can buy or sell options for 6 different expirations at any given time, or at the same time if I wish.

This provides unprecedented opportunities for individual traders. This is because of the characteristics of options in general. The greatest time decay occurs at the end of the life of an option. Prior to weekly options, the benefits that can be taken advantage of from accelerated time decay were only available once a month. ***Now, there is a continual ability to take advantage of accelerated time decay.***

To demonstrate the magnitude of this benefit, we will take a look at a couple of examples. I want to introduce to you what I call PPD. This stands for "Price Per Day". It is a simple, straight-forward way to gauge the value of an option during any given time link.

Let's use SPY as an example since that is what we will be using with My 27% Weekly Option Strategy. We will look at "at the money" options since those will ALWAYS have the greatest time value associated with them. The example below is based on calls, but the same process is used for puts.

8-Days left = 1.70
30-Days Left = 3.25

To determine the PPD of these options, simply divide the time value of the price by the days left until expiration. Since these are "at the money" options, the entire price of the option is time value.

8-Days left = 1.70 = 0.21 PPD
30-Days Left = 3.25 = 0.11 PPD

Here, you can see that the price of the 30-day option is obviously more expensive, but based on the PPD, it is half the price of the 8-Day option.

However, this is not an accurate comparison. The reason is because we are comparing all 30-days to all 8-days. The question is, what the PPD value is for each of the options over the *next 8-days* only.

We already know that the 8-day option PPD value will remain the same since it expires in 8-days. However, we can get a more accurate idea of the true PPD value over the next 8-days of the 30-day option by subtracting the 8-day price and 8-days from the 30-days and re-calculating.

In other words, what will the 30-day option be worth when there is only 8-days left? That will give us the PPD value between the 30-day and 8-day time span.

3.25 (30-day option price) – 1.70 (8-day option price) = 1.55
30-Days – 8-Days = 22-Days.
1.55/22-days = 0.07 PPD.

Accordingly, we can say that over the next 8-days, the 30-day option should devalue by 0.07 cents per day, or by a total of 0.52 cents. This means the 30-day option should drop from 3.25 down to 2.73.

Meanwhile, the 8-day option will drop to 0.00, or by 1.70 total.

So the 30-day option loses 0.52 while the 8-day option loses 1.70 over the next 8-days. The total net difference is 1.18.

This is, of course, assuming that the underlying price of SPY goes nowhere over the next 8-days, and is there for an illustration only of the time decay arbitrage that is available as a result of weekly options. Obviously, markets move, so you cannot rely solely on the differences in PPD.

I cover this more thoroughly in my video "The Power of PPD" and I strongly suggest you watch that video.

PPD is the major contributing factor to the unprecedented opportunities we have with trading weekly options. However, it is not the ONLY contributing factor.

For example, the obvious play in this situation would be to sell the 8-day option and buy the 30-day option and make money off of the advanced time decay of the 8-day option. And, if that were the only thing to consider, then you need to look at the lowest PPD option available.

We already know that the 30-day option has a PPD value of approximately 0.07. However, if you look at an option that expires in 47-days, it has a PPD value over the next 8-days at only 0.04 cents PPD. Accordingly, it should only devalue by 0.32 total, while the 8-day option devalues by 1.70 total. That difference is 1.38, a full 0.20 better than the 30-day option.

But the price of the 47-day option is 5.00.

What if the market tanks, say, by 2% - 3%?

You'll still make 1.70 on the 8-day call option because it will expire worthless, but the 47-day option drops from 5.00 down to around 2.25, meaning you would lose 2.75 on that leg. That is a loss of 1.05.

In this same scenario, the move down would drop the 30-day option from 3.35 to around 1.00 for a loss of 2.35. This is a 0.40 difference in loss size (1.05 net loss compared to a 0.65 net loss).

In short, price movement can negate the time decay arbitrage, which is why it is very important to make sure you are taking into consideration both PPD and price movement before determining a strategy, or trade to make.

I want you to notice something about this example. If SPY goes nowhere, you will make about 1.20 on the example trade. However, for you to lose about the same amount, SPY has to make a significant move in either direction. So, on the one hand, you have to take into consideration price movement, but on the other, the time decay arbitrage is a very powerful foundation from

which to build any weekly option strategy, whether spreads, or buying or selling individual options.

The principle is buy low PPD options and sell high PPD options.

Here is the Over-Riding Principle You Need to Remember When Trading Weekly Options, and it Doesn't Matter What Option Strategy You Want to Trade…

Buy Cheap PPD Options
Sell Expensive PPD Options

This Principle Alone is Worth More Than You Have Paid for All Option Related Books or Educational Courses in Options Combined.

Buy Cheap PPD Options
Sell Expensive PPD Options

I Know Because it is the Backbone Behind Every Option Strategy I Trade. I Don't Look at the Price of the Option First to Determine Which is the Best Option to Buy or Sell, I Look at the PPD Value First.

With that as the foundation, let's get to the strategy.

My 27% Weekly Option Strategy

What is the 27% Weekly Options Strategy? This is a simple strategy where you buy one option that has a low PPD and sell another option that has a high PPD.

The type of strategy is what is called an ITM Diagonal Put spread. ITM means "in the money" diagonal put spread.

A diagonal spread is simply where you buy one option and sell another option that has a different strike price and expiration date from the option you bought. As long as those two things are different, you have created a diagonal spread. There are thousands of possible combination diagonal spreads, so don't think they are all the same. Remember, our foundation is going to be to buy a low PPD option and sell a high PPD option within the confines of this strategy.

Here is what an ITM Diagonal Spread according to My 27% Weekly Option Strategy looks like (actual trade).

Short Jan 30th 206.00 put from 1.81
Long Feb 6th 209.00 put from 4.04
For a Debit of 2.23

At the time of this trade, there was about one week left on the January 30th option and SPY was trading at 205.50. This means the Jan 30th 206.00 put was 0.50 point in the money, while the 209.00 strike option was 3.50 points in the money.

The first thing I want to point out is the PPD of each of these options.

Short 206.00 put is 0.50 in the money. We therefore subtract that from the total price of the option to determine the time value.

1.81 – 0.50 = 1.31.

Since there is 7-days left on the option, we divide the time value by 7:

1.31/7-days = 0.18 PPD

We do the same thing for the long option. The total time value of the long option is only 0.54. However, we won't be holding onto it until expiration, we will only be holding onto it for the next 7-days. It is projected that this option will still have 0.25 of time value in 7-days if SPY goes nowhere.

0.25/7-days = 0.04 PPD

Short Jan 30th 206.00 put from 1.81 (0.18 PPD)
Long Feb 6th 209.00 put from 4.04 (0.04 PPD)
For a Debit of 2.23
This means that our short option will decay at a rate of about 450% faster than the rate of decay on the long option.

But, there is something else going on here. Remember, PPD is not the only contributing factor to profitable (or losing) option strategies. Price movement is also a factor. Accordingly, My 27% Weekly Option Strategy is a strategy that is designed to guarantee a profit if the market stays the same or moves down (and even if it moves up within a certain amount).

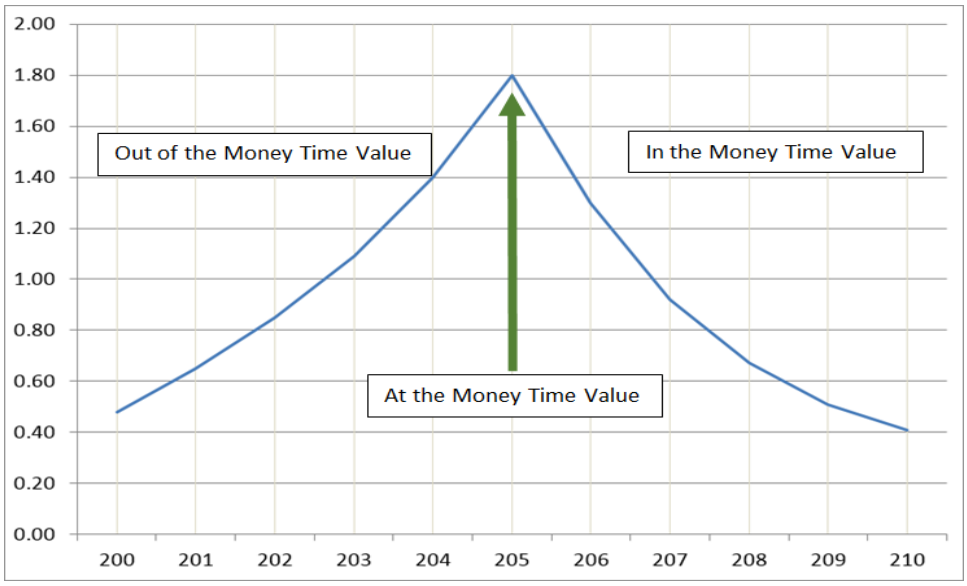
And, in this case, it is guaranteed to make $77 if SPY stays the same or moves down.

Why is that?

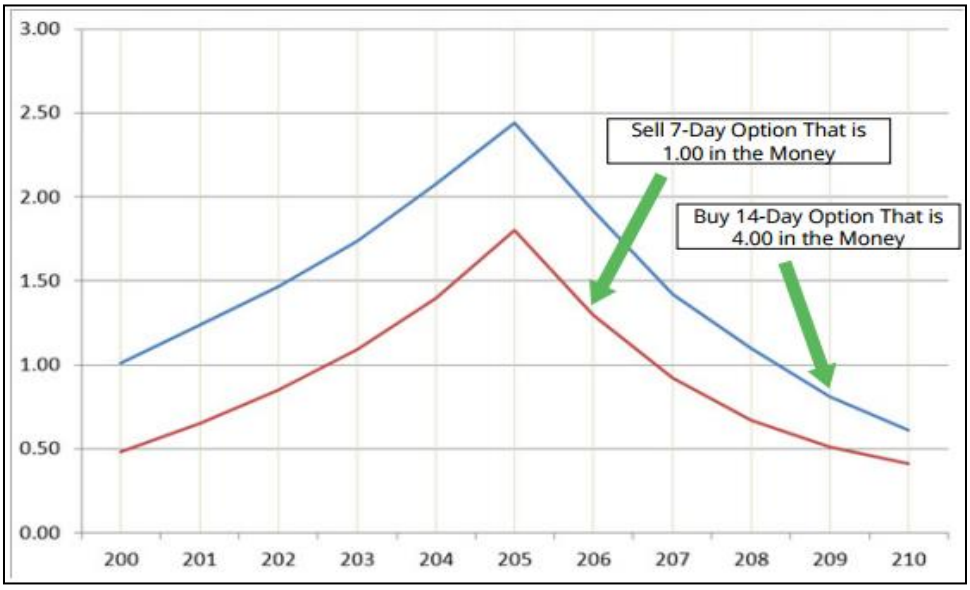
The greatest time value of any option is always "at the money". If SPY is trading at 205.00, the 205.00 put option will be the option with the greatest amount of time value. It will have more time value than either the 204.00 put, or the 206.00 put (one is 1.00 "out of the money" and the other is 1.00 "in the money"). The further away the strike is from the "at the money" strike, the less time value.

Notice that we sold an option that is closer to the "at the money" option, and bought an option that further away, meaning that it should have less time value associated with it.

Here is a graph of a 7-day expiration of time value as of the close on January 23rd:



If I were to overlay the 14-day option time value graph, this is what it would look like:



The red graph is the 7-day option time value, the blue graph is the 14-day option time value. We sell the 1.00 in the money put with 7-days left and buy the 14-day option that is 4.00 in the money. Based on the close of option prices on January 23rd, this is what it would look like:

Time Value =

Sell 1.30
Buy 0.81

PPD Value =

Sell 0.18 PPD
Buy 0.04 PPD

Here is what the PPD graph looks like:

This should be abundantly clear why we structure the option spreads to sell high PPD and buy low PPD. Let's move on and take a closer look at the actual trade example:

Short Jan 30th 206.00 put from 1.81
Long Feb 6th 209.00 put from 4.04
For a Debit of 2.23

Before looking at the P/L range it is important to take notice that the difference between strikes is at 3.00. This means that when the Jan 30th put expires, if SPY is at or below 206.00, that put will be worthless. However, the absolute minimum value the 209.00 put can be is at 3.00. This would mean that if SPY closes at 206.00 or lower on the short option expiration, the spread has to be at least 3.00, no matter what (and will often be more than 3.00 because there could still be time value left on the long option so that it is worth more than 3.00).

Since we bought the spread at 2.23, we know that at 206.00 or below, my minimum profit is going to be 0.77 because we will be able to in essence exit the spread at 3.00.

We also know that our MINIMUM breakeven level is 209.00 – the Debit, or 206.77.

That is because the long option has to be worth at least 2.23 if SPY closes at 206.77 on the short option expiration.

Since we bought the spread when SPY was trading at 205.50ish, we know we are going to make money if SPY closes at or below 206.77 in 1-week.

The key here is how big the difference is between the debit on the trade, and the strike differences. The smaller the debit, the better the trade (general rule).

Risks

The maximum risk with this trade is technically the debit of the trade. In this case, 2.23, or $223 trading a single lot. However, I use the term technical because in order for this risk to actually occur, SPY has to SKY-ROCKET to ridiculous levels within about a 1-week period. In fact, it has to move higher so much that the long put is worthless. That is the ONLY way you can lose the maximum loss here.

Currently, a 1-week put that is 10.00 points out of the money is worth about 0.10. Accordingly, we would lose 2.13 on the trade if SPY moved from 205.50ish (when we bought the spread) to 219.00 in just 1-week. That is almost a 7% move in a single week, and you still don't quite lose the maximum risk on the trade.

The Key with the risk is the value of the long put option at the time the short put option expires. Here is where this gets really interesting.

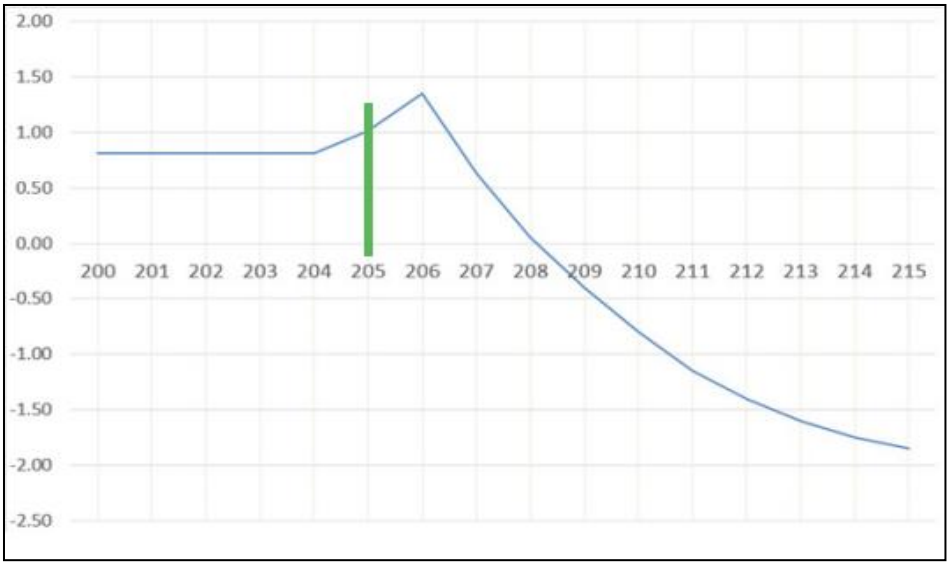
Remember the time value graph above? The "at the money" options ALWAYS have the greatest time value.

That means if SPY moves from 205.50 to 209.00 in 1-week, our long 209.00 put becomes the "at the money" put, and we gain the greatest value possible from this leg of the trade with regard to time value. That value is generally between 1.25 and 1.75, depending on the volatility in the market (I have seen it over 2.00 in the past).

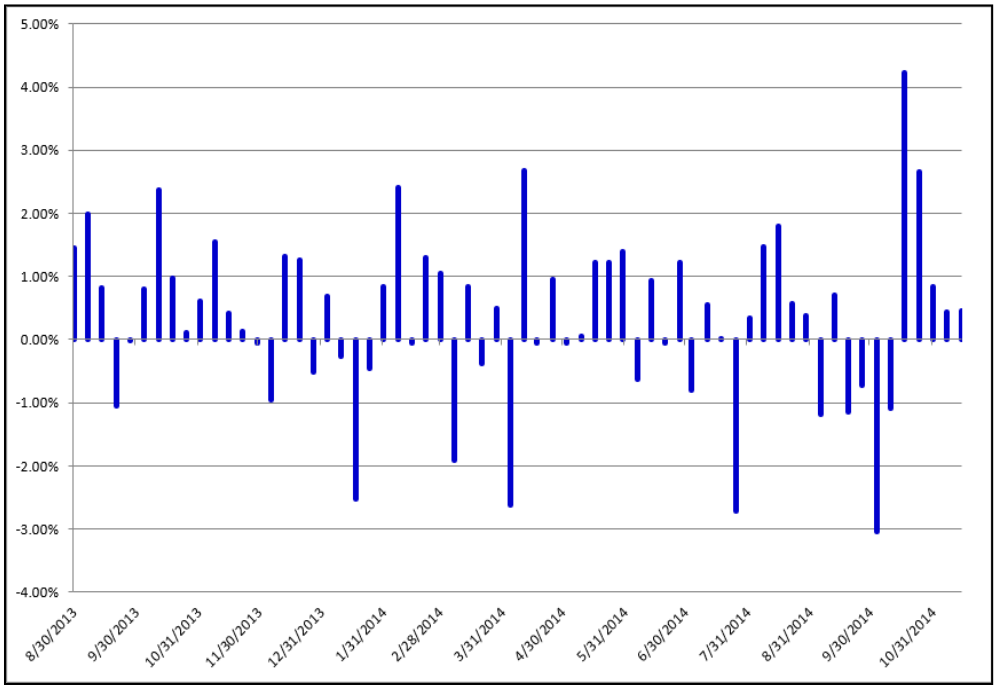
We will split the difference and use the average of 1.50. This means that we bought the put spread for a debit of 2.23 and will exit it at 1.50, for a loss of 0.73.

That would occur with a move of about 2% in SPY from when we bought the spread. There will be times when that loss is smaller, and times when that loss is bigger. Based on the projections, check out the P/L chart of this trade:

SPY Closed right under 205.00 on January 23rd. The projected breakeven is around 208.50ish. At around 210.00 is when you would be projected to lose what your minimum gain is at 206.00 or below. The largest profit projection on this trade is about $135 and would occur if SPY closed at 206.00 on the short option expiration.



Over the long run, SPY has averaged a 2% move higher about 15% of the time from Friday to Friday. However, that includes times when the market has been down significantly the previous week(s), increasing the odds of a bounce of at least 2% the following week (or within a few weeks of the move down).



On the chart above, there are 64 weeks. The blue bar is the SPY movement from Friday to Friday.

12 Times Down > 1% for Minimum Profit of $81. **+$972**
34 Times Within 1% Higher or Lower for Avg Profit of $95 **+$3,230**
12 Times Between 1% - 2% Higher for Avg Profit of $30 **+360**
6 Times Up > 2% for an Avg. Loss of $100 **($600)**

The net profit would be $4,022

At 64 trades total, that comes to an average gain win/lose or draw of $61. If you risk $220 on each trade, that average gain comes to 27.7%

There is a lot of room for error. Consider this, of the 64 weeks above, 46 of them saw SPY close LESS than 1% higher from the previous Friday's close. If we only won the minimum $81 gain 72% of the time, and lost an average of $100 on every other trade (28% of the time), that still comes to an average of just over $30 profit, or a gain of almost 15% per trade.

This is where many traders say bet the farm, mortgage the house and go all-in. This is where many traders are foolish. There is a lot of room for error, but, there are also a lot of things that can prevent this from being quite as consistent as we would like.

Extra Risks

Increased volatility can skew these numbers. What if, over the next 6-months, instead of seeing 6 times when the market moves higher by 2% or more, SPY sees the market move higher 6-times by 3% or more, virtually guaranteeing a sizeable loss. Let's average that at $200 per trade, for a total loss of $1,200.
Then, we see that it moved higher between 2% - 3% on 12 occasions. That is another $1,200 loss at $100 per occurrence. That is 18 times in 26 weeks. If we gain the average of $80 the remaining 8 weeks, we are looking at a gain of $640 from those weeks, and a total net loss of $1,760.

Could that happen? Anything is possible. Is it probable? Absolutely not. From the 18-weeks the market is higher in this example, it would be higher by 48%. If the other 8-weeks were down 2%, that is still a 32% gain in the stock market index in just 6-months. That would be some crazy manipulation.

What if you can't get a debit of $220? What if the volatility tanks and you can only get a debit of $270? At that point, the potential gain is not worth it and I wouldn't take the trade (see "Guidelines" below). But what if that is what happens during weeks the market moved down and you aren't in to capture a gain? The next week, you can get your $220 debit, but then the market moves higher and you take a loss. It doesn't take too many of these types of occurrences to take a big swipe out of your profit potential.

Or, what if you can get your debit of $220, the market moves up 2% and instead of breaking even, the volatility in the puts drops like a rock and you end up losing $100?

You get the point. The probabilities are incredibly good long-term. But probabilities are not certainties, and to trade them accordingly would be foolish.

Start small and apply proper money management. This will ensure that you can trade through the anomalies, which will happen from time to time.

How to Address the Variables that can Diminish the Probabilities

There are a couple of things you can do to help diminish the risks associated with these variables. The biggest thing you can do is, as I have said many times, START SMALL. I always prepare for the worst case scenario. Compounding is what makes trading worth the risks. Start small, then as you ACTUALLY make money with the strategy, start to compound.

There is a specific compounding table I have included in this report you can follow starting with only $2,500. If you are only filled on trades half the time but can average the 27% gain per trade, $2,500 turns into over $300,000 in just 5-years using this straight-forward, powerful compounding plan.

If you only get filled half the time and can only manage to gain an average of 15% per trade, you can still grow the account from $2,500 into over $100,000 during the same time period.

It pays to stick with a strategy and compound.

The second thing you can do is follow these guidelines for putting on the trades. You should increase your probability of success and address at least some of the variables that could diminish the overall potential profitability.

My 27% Weekly Option Strategy Guidelines

1. **Make Breakeven at 2% above where the market is with 1-Week (approximately) left on the short option.**

A good estimate for breakeven is about 1.50 points above the short strike. Structure the trade signal so this level is 2% above where the market is trading.

For example, if the market is trading at 200.00 with approximately 1-week left on the short option, a 2% move to the upside would be 204.00. You would then sell the 1-week 202.50 put and buy the 2-week 205.50 put for a debit of 2.40 on a limit.

You won't always be filled, but that should be a very solid trade 90% of the time. Also, by the time you are filled, the market may be closer to an at the money situation with the short option. That is fine, whether you were filled immediately or 2-days after you placed the order and the market moved higher a bit, you would still have the same position.

2. **Make Sure You Place a Maximum 2.40 Debit Limit Order**

You really don't want to go higher than 2.40 on the debit. That gives you a minimum profit of $60 per position. You can often get better than a 2.40 debit, especially if you place the trade a day or two early after the market has made a significant move to the upside. I have been able to get filled at almost 2.00 in some cases. However, if you are a day or two early, there is a slight additional risk of the market exceeding the 2% level above where the market was trading when you placed the order. However, that is offset by the minimum profit level, smaller maximum risk and bigger overall average trade. 3-days early would be about the earliest I would consider (Wednesday prior to the following Friday).

3. Don't Take Trades After a Significant Down Move

4 of the 6 times on the weekly SPY movement chart that SPY went up by at least 2% were preceded by a down week of more than 2%. There are some issues with this guideline, especially if we move into more of a sideways to bearish market trend. This might keep you out of a lot of good trades in that situation. You could then simply wait for a bit of a bounce and still get in, or you could implement another strategy that is designed to make money if SPY moves higher to diminish the overall risk of this strategy. This will drop your profit potential a bit, but it will also drop your average loss size considerably.

My 27% Weekly Option Strategy Compounding Plan

Accout Size	Trade Size	Non-Compounded
$2,500	1	$2,500
$2,600	2	$2,600
$2,800	3	$2,700
$3,100	4	$2,800
$3,500	5	$2,900
$4,000	6	$3,000
$4,600	7	$3,100
$5,300	8	$3,200
$6,100	9	$3,300
$7,000	10	$3,400
$8,000	11	$3,500
$9,100	12	$3,600
$10,300	13	$3,700
$11,600	14	$3,800
$13,000	15	$3,900
$14,500	16	$4,000
$16,100	17	$4,100
$17,800	18	$4,200
$19,600	19	$4,300
$21,500	20	$4,400
$23,500	21	$4,500
$25,600	22	$4,600
$27,800	23	$4,700
$30,100	24	$4,800
$32,500	25	$4,900
$35,000	26	$5,000
$37,600	27	$5,100
$40,300	28	$5,200
$43,100	29	$5,300
$46,000	30	$5,400
$49,000	31	$5,500
$52,100	32	$5,600
$55,300	33	$5,700
$58,600	34	$5,800
$62,000	35	$5,900

You start with an account size of $2,500 trading a single lot on every trade. As your account grows eclipsing each number in the "Account Size" column, you increase to the corresponding trade size. If you begin increasing and then start to hit a drawdown, you would decrease trade size according to the same levels at which you originally increased. By the time you hit 8-lots in the trade size, it will be virtually impossible to give back all the profits.

Accout Size	Trade Size	Non-Compounded
$65,500	36	$6,000
$69,100	37	$6,100
$72,800	38	$6,200
$76,600	39	$6,300
$80,500	40	$6,400
$84,500	41	$6,500
$88,600	42	$6,600
$92,800	43	$6,700
$97,100	44	$6,800
$101,500	45	$6,900
$106,000	46	$7,000
$110,600	47	$7,100
$115,300	48	$7,200
$120,100	49	$7,300
$125,000	50	$7,400
$130,000	51	$7,500
$135,100	52	$7,600
$140,300	53	$7,700
$145,600	54	$7,800
$151,000	55	$7,900
$156,500	56	$8,000
$162,100	57	$8,100
$167,800	58	$8,200
$173,600	59	$8,300
$179,500	60	$8,400
$185,500	61	$8,500
$191,600	62	$8,600
$197,800	63	$8,700
$204,100	64	$8,800
$210,500	65	$8,900
$217,000	66	$9,000
$223,600	67	$9,100
$230,300	68	$9,200
$237,100	69	$9,300
$244,000	70	$9,400

The "Non-Compounded column is where your account would be if you stuck with a single lot the entire time. Notice that once you hit $6,000 in the non-compounded column ($3,500 in non-compounded profits), the compounded account has grown to a whopping $65,500! If you don't stick with the trading, it is impossible for you to ever realize this kind of success.

In closing, the Key to extraordinary success in trading is not whether you have the Holy Grail trading strategy. In fact, such a strategy does not exist. The Key in trading is applying the proper money management approach to whatever strategy you are trading.

THE SPECIAL OFFER

As you know by now, PPD stands for Price Per Day, and is one of the most powerful techniques for finding the best option trading opportunities regardless of the option strategy you are trading. As mentioned earlier, if you have not watched my video entitled "The Power of PPD", you need to do so.

My 27% Weekly Option Strategy is a simple, but powerful strategy designed to take advantage of warped time decay between two options. Applied to weekly options in stock index ETF markets like SPY, QQQ and IWM, I fully reveal the strategy with actual trade examples in the link below.

Click here to access the video training about The Power of PPD & My 27% Weekly Options Strategy

ABOUT THE AUTHOR

Ryan Jones is considered one of the trading industries "most complete traders." Starting his trading career at the early age of 16, he had traded nearly every major market and strategy by the age of 21. At the age of 26,

Mr. Jones signed a book deal with John Wiley, making him one of the youngest authors ever in the field of futures trading. His book, ***The Trading Game, Playing by the Numbers to Make Millions***, is still considered the authority on the subject of trading and money management by many leading traders.

Mr. Jones' advanced experience and knowledge across many trading fields such as technical analysis, option trading, money management, and the S&P, have lead to several trading feats, including turning a $15,000 account into over $107,000 in less than 90-days, short-term trading the S&P (real money). Ryan is also the creator of QuantumCharts.com, which provides charting and backtest trading strategy software. It uncovers profitable trading opportunities and creates simple or complex automated trading systems.