

Options Profits
DAILY

3 Simple

**OPTIONS
STRATEGIES
TO \$ PROFIT
IN ANY MARKET**



Introduction

One of the amazing things about the options market is that you can create a profile that you feel can best capitalize on current market conditions. Option strategies can be bullish or bearish, they can be highly speculative, high probability or can reduce portfolio risk. With every strategy there is a tendency to emphasize one or more of these attributes. The three option strategies that we're going to cover in this report are short puts, short verticals and married puts.

When trading options, there are three forces that affect their value. These forces are price, time and volatility. When analyzing which strategy will be best to take advantage of a setup on a stock, you'll want to address each of these factors. As each strategy is discussed, these forces will be addressed and the corresponding gauge that helps measure the impact of each force on the option price. These gauges are referred to as option "Greeks."

Before we dive into the strategies, let's review the effects of price, time and volatility on option prices.

Price

When we consider the effects on the value of an option, price is "king." That means that the movement of the price will always have the greatest impact on the price of an option both positively and negatively.

The effect of price on the value of an option is measured by the option Greek "delta." It's a Greek that is displayed on your broker's platform in per share terms and will be expressed as a number between zero and one. A value of 0.50 means that the price of the option will change by that amount given a \$1 change in the underlying stock. Call options have a positive delta because the option price increases in value as the price rises and a put has a negative value because its value increases as the price falls. Therefore, the sign of the delta is an indication of the direction the price needs to move to make money.

The strike or exercise price of an option is classified as either in-the-money (ITM), at-the-money (ATM) or out-of-the-money (OTM). The classification is determined by where the strike price is in relation to the stock price. If the option has intrinsic value, the option is considered to be ITM, if it is closest to the current stock price it is considered to be ATM and if there is no intrinsic value it is considered to be OTM. An option has intrinsic value if there is some value to be captured if the option is exercised and the stock is bought or sold.

For a call option, the intrinsic value is calculated as follows:

$$\text{Intrinsic Value (Call)} = \text{Stock Price} - \text{Strike Price}$$

Therefore, a call option has intrinsic value if the stock can be purchased at a price (the strike price) that is below the current market price. For example, if the stock price is at \$55 and the strike price is at \$50, the stock can be purchased for \$50 and sold for \$55, capturing \$5 of intrinsic value.

For a put option, the intrinsic value is calculated as follows:

$$\text{Intrinsic Value (Put)} = \text{Strike Price} - \text{Stock Price}$$

Therefore, a put option has intrinsic value if the stock can be sold at a price (the strike price) that is above the current market price. For example, if the strike price is at \$55 and the stock price is at \$50, the stock can be purchased for \$50 in the market and sold for \$55, capturing \$5 of intrinsic value.

Getting back to delta, ITM options have a delta that is greater than 0.50, ATM options have a delta that is approximately 0.50 and OTM options have a delta that is less than 0.50. The reason for this relationship is that delta is also a measure of the probability of the option expiring ITM. The fact that an ITM has a delta greater than 0.50 makes intuitive sense since it already has intrinsic value, and therefore will have greater than a 50% chance of keeping it and remaining ITM. An ATM option has a delta close to 0.50 because it's sitting near the current price of the stock and the price has a 50% probability of moving up or down from its current value. An OTM option has no intrinsic value and the stock would have to move in the direction of the strike price in order to move ITM, and there is always less than a 50% probability of that happening.

The concept of using delta as a measure of probability is very important when you consider strategy. The inclusion of delta in the way you select strike prices will be an important way to add consistency to your trading.

Time

We just discussed the concept of intrinsic value and an option either has it or it doesn't. The remaining portion of the option's value is referred to as extrinsic value. This is the value that you're paying for the opportunity for the stock to move. Part of the extrinsic value is directly tied to the amount of time the option has to expiration. The more time that you purchase, the more time value that you will be paying. This makes sense since the range of possible prices that the stock can reach increases with more time to do it. For example, the price will typically move less in a week than it will over the course of a year.

Since time value is directly tied to the amount of time before expiration, the value associated with time will be erased as each day passes. This dynamic is referred to as time decay and is measured by the option Greek "theta." Theta is the amount of value an option loses each day. The rate of decay, or theta, increases exponentially as you approach expiration until all of the extrinsic value is gone as the option expires. The fact that the option is decaying over time

benefits the option seller since the option can be repurchased at a lower price each day, all things being equal. Theta also works against the option buyer since the option purchased is worth less and less each day. This dynamic contributes directly to why certain option strategies have a higher probability of success than others. Option sellers naturally have a higher probability of success but is capped in the amount of money they make. The option buyer has a lower probability of success but has virtually unlimited return potential.

The concept of theta helps when selecting an option expiration. An option buyer will typically want to buy enough time to more than accommodate their expected move and will often times avoid holding an option as the theta is increasing rapidly the last two weeks. An option seller will typically sell shorter amounts of time to expiration in order to capitalize on the time decay and may let the option expire worthless to reach their maximum gain.

Implied Volatility

Implied volatility is often times one of the more difficult things for option traders to understand. It is the portion of an option's extrinsic value that is determined by the supply and demand dynamics produced as buyers and sellers come together to determine the option's price. As demand for options increase, the value of an option increases and is reflected by an increase in implied volatility. The demand for options increase because of increased expectations for movement in the stock price. Therefore, implied volatility is the future expected movement or volatility "implied" in the option price.

Implied volatility is constantly changing throughout the course of the day as buyers and seller's expectations are constantly shifting with the price, news, etc. As implied volatility increases, the option value increases and thereby benefitting call and put option buyers. As implied volatility decreases, the option value decreases and thereby benefiting call and put option sellers.

Implied volatility has a tendency to remain range-bound over time. Therefore, analyzing volatility is important when determining which strategy to employ. In *Figure 1* you'll see a graph of implied volatility for Micron Technology Inc. (MU) for the last 6 months. For the most part, Micron's implied volatility has ranged between 40% to 50% with periodic spikes above 50%. The yellow line represents the average implied volatility for the last year at 44%. When the current implied volatility is greater than the average, you might assume that the implied volatility has a greater tendency to decline and would tend to benefit option sellers, and vice versa for option buyers.

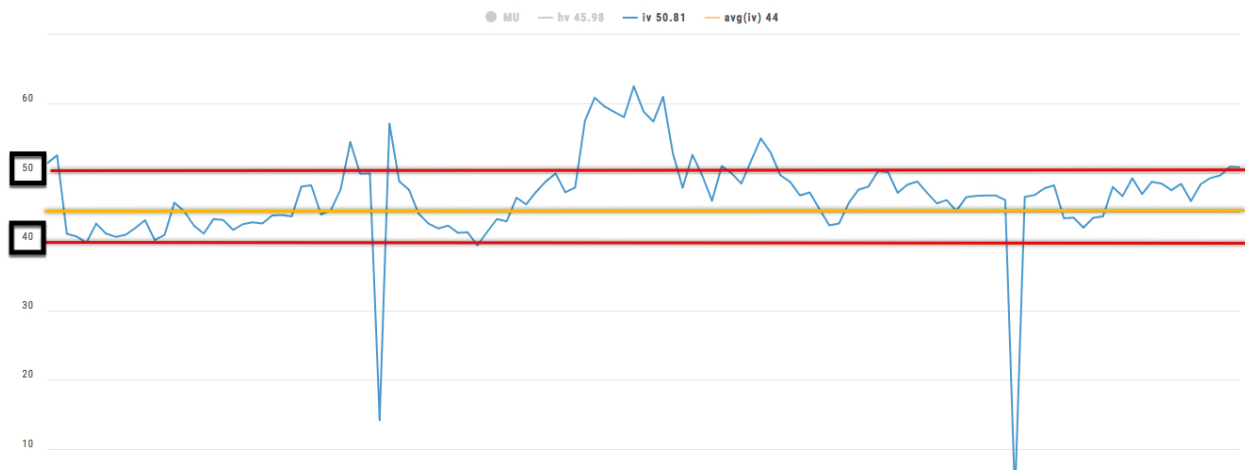


Figure 1—Implied Volatility for Micron Technology—source iVestPlus.com

The effect of implied volatility on the value of an option is measured by the option Greek “vega.” Vega is defined as the amount the option price will change with a 1% change in implied volatility. Call and put option buyers benefit by a rise in implied volatility since the option increases in value, and so they are considered positive vega trades. Call and put option sellers benefit by a drop in implied volatility as the option loses value, and so they are considered negative vega trades.

When selecting a strategy, your consideration for the direction of implied volatility will be very important in your selection process. A simple rule of thumb is if the implied volatility is above average you might lean more toward selling options, and if the implied volatility is below average you might lean toward being an option buyer.

Short Puts

When you enter an option trade, you can enter on either the side of the buyer or the seller. A short put is initiated as a sell-to-open order through your broker. A short put is also referred to as an “uncovered” or “naked” put since you aren’t purchasing any insurance to reduce the trade risk. With a short put trade you are paid a premium for the obligation to buy the stock at the strike price. In *Figure 2* you’ll be able to take a closer look at the profile of a short put.

Short Put

Direction: Bullish
Delta: Positive
Theta: Positive
Vega: Negative

Max Gain: Premium Paid
Max Loss: Strike Price - Premium

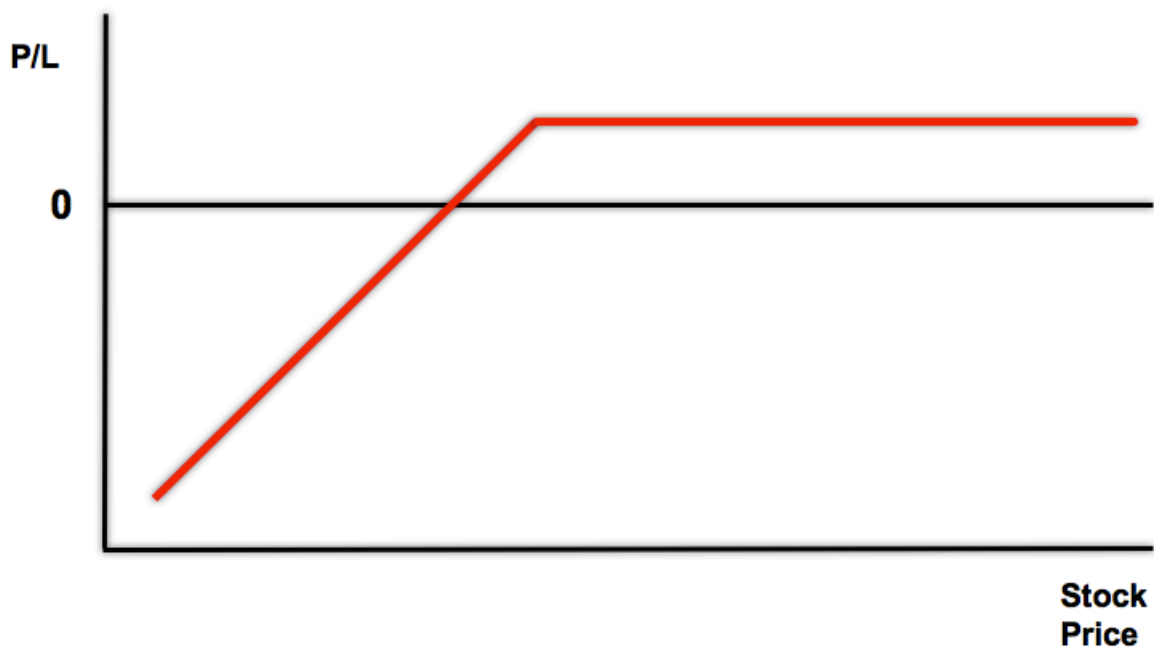


Figure 2—Short Put Profile

From the profile, you'll see that the most you can make as a put option seller is the premium, and for this strategy that maximum gain is achieved if the price closes at or above the strike price at expiration. The maximum loss is the strike price minus the premium received when the put was sold. This price also represents the breakeven stock price at expiration for this trade. This is a bullish trade since it is delta positive, but depending on the strike price, the price of the stock doesn't necessarily need to go up to make money at expiration. This is because the trade is theta positive and each passing day the trade is making money through time decay. Lastly, the trade is vega positive since it will benefit from declining implied volatility.

Since short puts carry the obligation to buy the stock, some traders will sell a put with the intent to buy the stock and set aside the necessary capital to do so. This approach can be a particularly applicable strategy on large cap stocks that pay a relatively high dividend yield and are trading at good valuations. If the stock continues to decline and expires below the strike price, the stock will be purchased at the strike price. If an OTM option is sold and the implied volatility is high, the strike price may be at a significant discount from where the stock was trading at the time of the put option sale. This approach to selling puts is what's referred to as a "cash secured put." This strategy has a similar degree of risk to owning the stock but has a higher probability of making money. When selling puts in an IRA there is no opportunity to trade on margin and so every short put is cash secured.

Margin

When a put option is sold in a margin account, you have the potential to sell more contracts than you actually have cash to buy the shares. This is because your broker will only require you to put up the initial margin required to place the trade. Think of the initial margin as a good faith deposit. The margin requirement can increase or decrease depending on what the price of the stock does and other considerations. FINRA sets the minimum required margin, but many brokers require higher amounts of margin than they're required to do so. This is where people can put themselves at greater risk.

Expiration Selection

When selling puts, you need to balance selling an amount of time that will generate a significant enough return for the risk, the ability to manage the trade and make money. Selling too short of time carries the risk of collecting relatively little premium and risk if the stock moves quickly against you. Selling too much time, will yield a larger initial premium, but will take longer to realize gains without a significant move in the stock price. Selling options with one-month to expiration tends to balance a lot of these considerations.

Strike Selection

Typically, short puts are sold OTM in order to yield greater than a 50% probability of expiring worthless. However, it's easy to take this to an extreme and sell really far OTM options that have an extremely high probability of success. While the probability may be high, the small credit received will take until expiration to realize. Typically, selling OTM options with about a 60-70% probability of success is a good balance between having a connection to the stock price and still be able to benefit by a drop in implied volatility. That means selling put options with about a 0.30 to 0.40 delta.

Return Expectations

When selling puts on large companies that have lower volatility, the amount of credit received will typically be around one to two percent of the strike price sold. For more volatile, growth-

oriented companies the credit will typically be over two percent. Be careful if premiums are too high, this could be a signal there is a pending announcement that could create a significant price move.

Exits

When selling premium, you're typically engaged in a higher probability strategy. However, in order for the high probabilities to be realized, the trade must be carried toward expiration. In circumstances where a short put is traded without having the cash to cover buying the stock, you'll need to have a price point to exit early. This is typically below the strike price sold and would be based on your allowable risk per trade. In the case of a profitable position, it's important to have a point where the option will be bought back, and the trade closed. Typically, this would be if you've made about 70% to 80% of the maximum gain.

Trade Example

In this example, we're going to use Micron Technology Incorporated (MU). In *Figure 1* we already saw that the implied volatility is above average, which means that this will allow us to sell further away from the stock price than at other points with lower volatility and collect a larger premium. This is the type of stock that one would typically not sell puts on to buy the stock but would be looking for the price to remain stable and the implied volatility to drop.

In *Figure 3* below is a chart of MU. You'll see that it is currently trending above its 30-day moving average but has recently faltered as it tested the March 2018 high. Selling an OTM put will allow the premium to be made if the stock goes up, sideways or down a little. The option that fits the sample rules given for strike and expiration is the July 55 put that is selling for \$2.07 at the bid. The July expiration has 33 days until it expires, and the \$2.07 premium provides a 3.8% return if it expires worthless. The delta of the put is at -0.33, which indicates this trade has a 67% probability of reaching maximum gain.



Figure 3—Chart of Micron Technology Incorporated (MU)

In this example, the maximum gain is achieved if the stock closes above \$55 at expiration. There is a partial gain if the stock finishes below \$55 and above \$52.93, and the trade begins to lose money at expiration if the stock finishes below \$52.93. That means that the stock can drop over 9% from its current price before the trade begins to lose money at expiration.

Short Verticals

One of the most popular option trading strategies and a building block of many high probability trades is short verticals. With the proper setup, these trades can provide a winning percentage of greater than 50%, and also provide limited downside risk. High probability and defined risk—what a beautiful combination! Let's take a closer look at this strategy.

Short verticals are created through buying and selling either calls or puts at different strikes, but within the same expiration. Thus, they're setup "vertically" within the option chain. The idea is to sell the more expensive option and buy a less expensive option further out-of-the-money for protection. As a result, a credit is paid the moment the trade is entered. As the term "short"

implies, this is a selling strategy and the max gain is the credit received. One could look at this strategy as simply selling a short call or a short put but using part of the proceeds from the sale to buy insurance to define the trade's risk.

Since this is a selling strategy, selling a call vertical would be considered a bearish trade, and selling a put vertical would be considered a bullish trade. Thus, short call verticals are often referred to as "bear call spreads", and short put verticals, "bull put spreads."

Short Put Vertical

In *Figure 4* you'll be able to take a closer look at the profile of a short put vertical. For this strategy, the higher strike price is sold for a credit and a portion of the premium is used to buy downside protection in case the stock drops dramatically. The premium received is referred to as the "net credit."

Short Put Vertical

Direction: Bullish

Delta: Positive

Theta: Positive (if OTM)

Vega: Negative (if OTM)

Max Gain: Net Credit

Max Loss: Strike Width - Credit

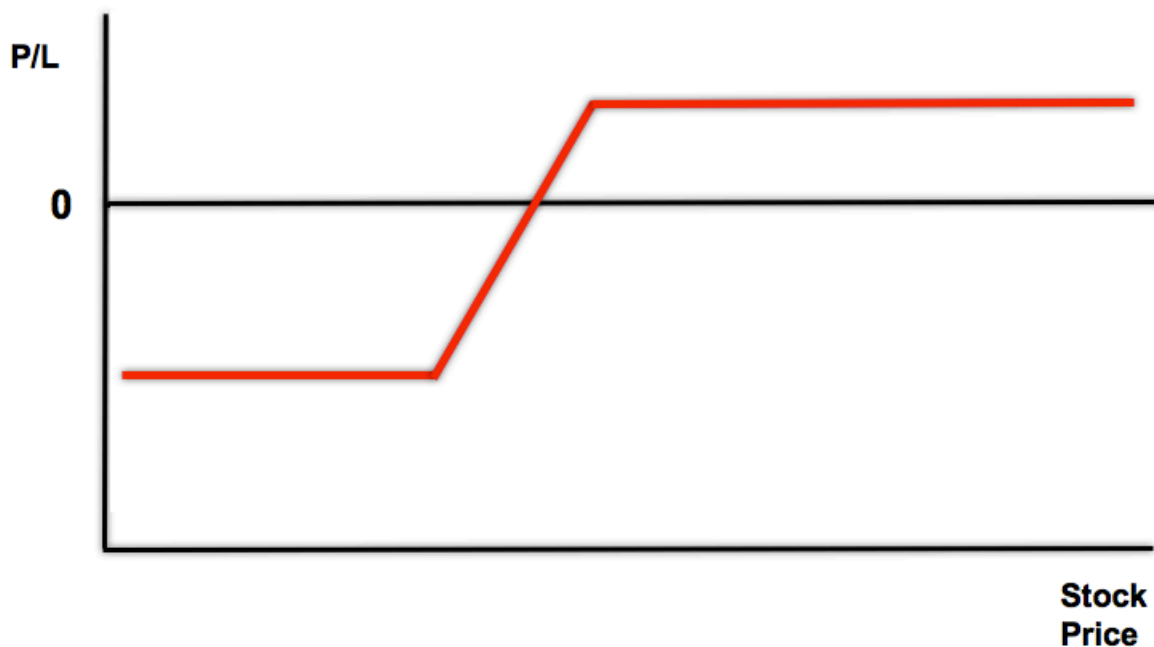


Figure 4— Short Put Vertical Profile

You'll see in the profile that the maximum gain from a short put vertical is the net credit received and the maximum loss is the difference between the strike prices minus the credit received. You may notice some similarity to the short put strategy, except that the downside risk is capped at the strike price of the option purchased. Since this is a credit spread, the maximum gain is reached when both options expire worthless. For that to take place, the stock needs to be trading at or above the short strike price. Therefore, this strategy is delta positive (bullish), theta positive and vega negative when the strikes are OTM.

Short Call Vertical

In *Figure 5* you'll be able to take a closer look at the profile of a short call vertical. For this strategy, the lower strike price is sold for a credit and a portion of the premium is used to buy upside protection in case the stock rises dramatically. The premium received is referred to as the "net credit."

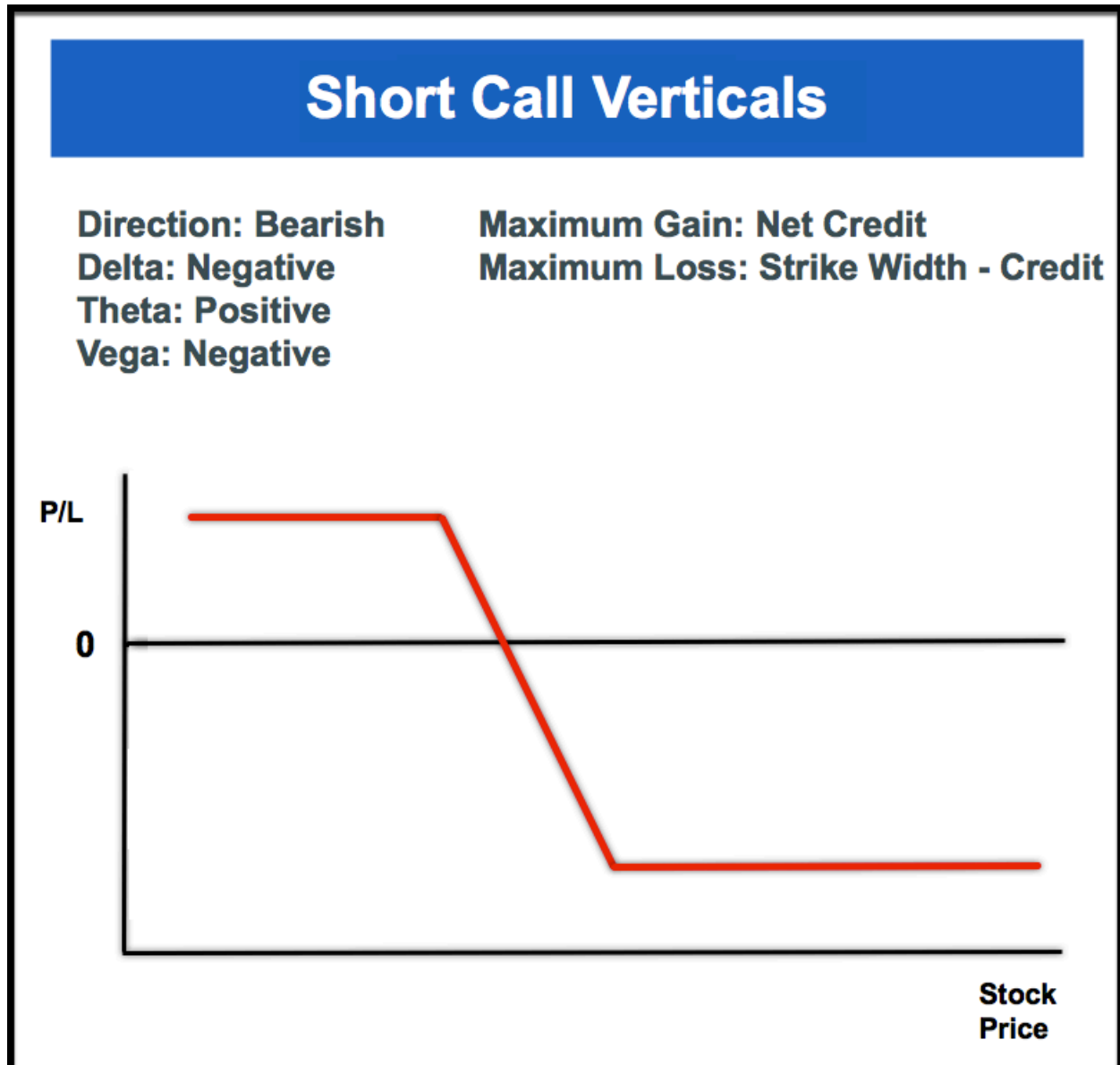


Figure 5—Short Call Vertical Profile

You'll see in the profile that the maximum gain from a short call vertical is the net credit received and the maximum loss is the difference between the strike prices minus the credit received. Since this is a credit spread, the maximum gain is reached when both options expire worthless. For that to take place, the stock needs to be trading at or below the short strike price. Therefore, this strategy is delta positive (bullish), theta positive and vega negative when the strikes are OTM.

Margin

You will need to put up margin for short verticals, but the margin needed is equal to the risk in the trade. Verticals can be traded in margin accounts and IRA-type qualified accounts, but it is subject to your broker's rules and the trading authorization you have for the account you're trading.

Expiration Selection

Similar to short puts, there are things that you need to balance when selecting the expiration for short verticals. The main difference is that selling more or less time doesn't change the amount of the net credit received if the probabilities are the same. With verticals there is a time element that is more significant than with a single short option because you're buying an option with negative theta and selling an option with positive theta. As a result, the net theta is smaller than for a single option that is sold. Therefore, selling a lot of time results in a significant delay in realizing your return without a significant move in the price, and selling short amounts of time results in achieving max gain or max loss more frequently. Similar to short puts, selling options with one-month to expiration tends to balance a lot of these considerations.

Strike Selection

When selling short verticals, you're trying to balance the probabilities with gaining enough of a credit to compensate you for the risk. Because two separate strikes are traded, commissions are higher and has to be a consideration. Therefore, it's important to sell a strike that gives you enough credit to not only enter the trade but exit, while keeping a large portion of your credit.

Unlike single options, selling when implied volatility is high doesn't increase your credit, but it does allow you to sell further OTM for the same credit. When implied volatility is above average, selling a 0.30 to 0.40 delta helps to balance a lot of these considerations and will allow the trade to benefit from a drop in implied volatility. If implied volatility is below average, selling the first OTM strike price will generate a higher return on risk. Typically, the option price purchased will be one to two strikes further OTM.

Return Expectations

When selling short vertical with a 0.30 to a 0.40 delta and buying one to two strikes further OTM should yield a return greater than 30% ROR. The ROR is calculated by dividing the credit by the maximum loss. When selling ATM, the credit should typically be greater than 60% ROR.

Exits

Trade Example (Short Put Vertical)

MICRON TECHNOLOGY, INC., 1D, BATS - O 58.53 H 59.10 L 57.30 C 58.23
 Vol (30) - 45,442M 52,953M
 MA (30, close) - 56,967

\$55 Strike
 Breakeven \$54.20
 \$52.50 Strike

Partial Gain
 Partial Loss

Max Gain
 Max Loss

Trade Example (Short Call Vertical)

For this example (see *Figure 7*) of a short call vertical we're going to use the SPDR S&P 500 ETF (SPY). The SPY recently retested an established area of resistance from February and March and began breaking down. The implied volatility is fairly low for the SPY and so the ATM \$278 strike price will be used for a credit of \$2.99. The \$279 strike price will then be bought for a debit of \$2.43, generating a net credit of \$0.56 for a 127% ROR. The maximum gain is achieved if the price closes below \$278. Between the short strike of \$278 and the breakeven price of \$278.56 there will be a partial gain, and above the breakeven and to the long strike at \$279 will yield a partial loss. Anything above the long strike of \$279 will a maximum loss scenario of \$0.44 a share or \$44 a contract.



Figure 6— Chart of SPDR S&P 500 ETF (SPY)

Married Puts

I'm sure you find yourself many times wondering whether you should buy a stock or not because you're worried about the downside risks associated with stock ownership. Maybe it's an upcoming earnings report or maybe the stock has a fair amount of volatility. Whatever the

reason, options provide you with the opportunity to remove most of your risk for a premium. The strategy of buying the stock and a put at the same time is what's called a "married put."

During certain types of markets, the best way to grow your portfolio is by preventing losses in the first place. Think of a protective put as an insurance policy. When you buy auto insurance, for instance, you pay a premium in return for protection, just in case you get in an accident or your car gets damaged. Similarly, when you buy a protective put, you pay a premium in return for protection, just in case your stock loses value.

Whether you're looking to buy car insurance or to do a married put you know that you'll lose the premium if you never use the coverage, you'll need to pay more for increased coverage and your coverage expires at the end of the period with which you paid your premium for.

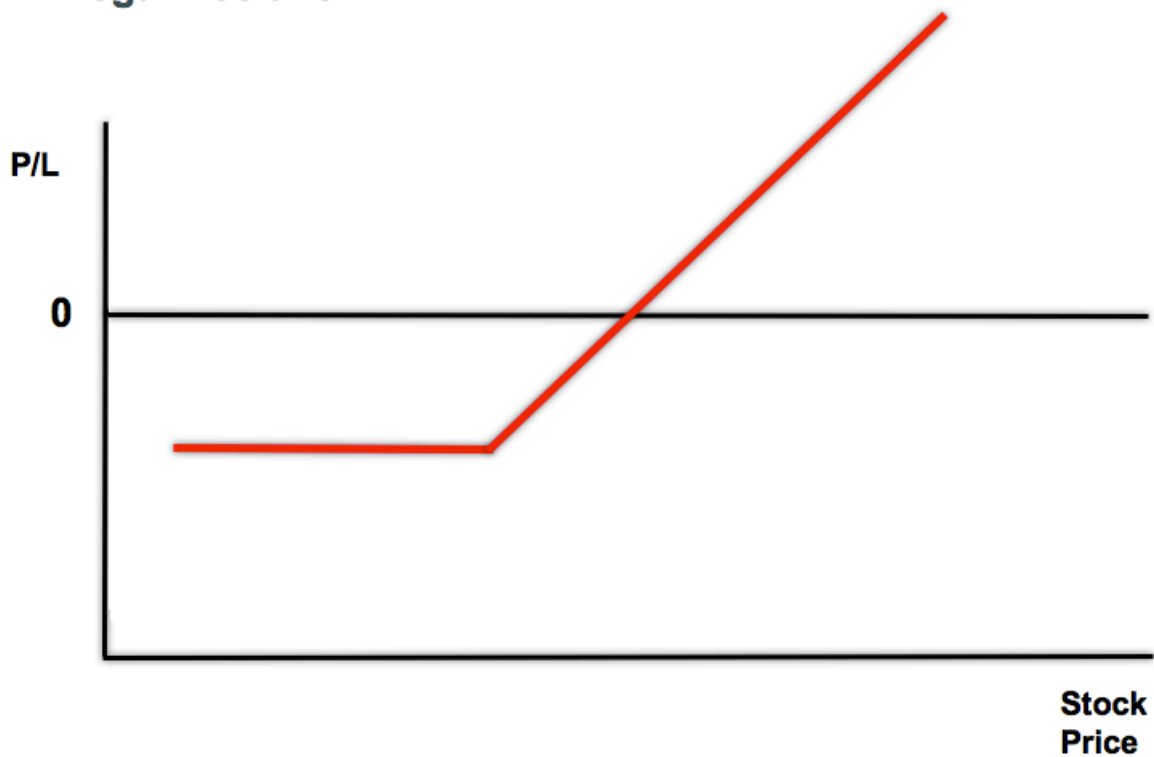
As you evaluate whether to purchase a put against a stock that you're considering buying, remember that the put reduces your downside risk, but you have to pay upfront for the protection. Therefore, the stock has to increase in value to compensate you for the put option premium.

In Figure 7 you'll be able to take a closer look at the profile of a married put.

Married Put

Direction: Bullish
Delta: Positive
Theta: Negative
Vega: Positive

Maximum Gain: Unlimited
Maximum Loss:
Stock Purchase Price - Strike Price - Premium



For this strategy the stock is purchased and a put is purchased at the same time. The premium from the put reduces the downside risk on the stock to the strike price minus the premium paid. This is because the strike price is the price that you have the right to sell the stock and the additional cost of the put will be subtracted from that sale price. Looking at the risk profile graph, you may notice that it has the same risk profile as a long call. That is because you are synthetically creating a long call trade with a married put. The breakeven price for this type of trade is the cost of the stock plus the cost of the option. The profit beyond that level is infinite as the stock price can theoretically go to any price.

Margin

The margin requirement for a married put is the same as buying the stock. Typically a broker will require you to put of at least 50% of the stock price plus the premium of the put option.

Expiration Selection

When choosing an expiration, it's important to remember that the more time that you buy, the greater the cost. Typically, you would buy enough time to cover your position during whatever phase you feel that you need protection. Typically, buying 50-120 days is pretty typical. More time can always be purchased at a later date if you feel that you still need the coverage and are willing to pay it.

Strike Selection

If you were to eliminate 100 percent of your risk, you would probably be better off to just sell the stock. Therefore, you would typically buy a put that would reduce less than 100% of your stock risk. Purchasing an OTM option with a 0.30 to 0.40 delta will reduce your stock risk by 30-40% and will track the stock like you bought an ITM call option with a 0.60 to 0.70 delta. If the stock falls, the delta will increase until the option becomes ITM and which it will eventually begin to perfectly offset your stock risk dollar-for-dollar since you have the right to sell the stock at that strike price.

Return Expectations

For this type of trade, the reward is similar to that owning the stock. The option will cost about one to two percent of the stock price for ETFs and large cap companies. For more volatile stocks the price will increase to about 3 percent or higher. The overall return is reduced by the amount of the cost of the option.

Exits

For the stock, the exit would be based on your trading plan for the stock. For the option, if the stock price increases eventually the option will be worthless. This outcome would be good because it means that the stock had performed well. If the stock doesn't appreciate a lot, it's possible that you may need to roll the option if you still feel that you need protection. Rolling entails selling the strike price that you're in and buying another strike price with 50 to 120 days to expiration and a 0.30 to 0.40 delta. Rolling to increase the time to expiration would typically happen within 2 weeks to expiration.

Trade Example

In Figure 8 you'll see an example of the chart of Proctor & Gamble Company (PG). The stock has been underperforming the market significantly over the past several months but has recently showed some signs of life and the 30-day moving average is rising. In this trade example, the stock is bought for around \$77.38 and a put option could be bought for \$1.20 at the \$75 strike.

That means that the max loss is \$3.58 ($\$77.38 - \$1.20 - \$75$) and the breakeven is \$73.80 ($\$75 - \$1.20$).



Conclusion

Option strategies are something that can be traded in any market condition because you can always get the type of profile you want. As you weigh which strategy to consider, think about your anticipated direction for the stock price, the time the trade needs to make its move and what the overall level of implied volatility is. Considering these three areas of impact on option prices will help you be more consistent in your option trading.

ANNOUNCING
THE *ONLY*
INCOME
GENERATING
TRADING STRATEGY WHERE YOU CAN...
Screw Up ALL Of Your Trades
& Still Bank Gains Every Month

WANTED

Risk averse, conservative active traders who don't mind being **100% WRONG** on every trade while dragging in consistent, predictable and reliable cash from the markets on a weekly and monthly basis.



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