Never Trade Stocks Again!

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Editor – Options Profit Engine, 30 Day Dividends

Investors Alley

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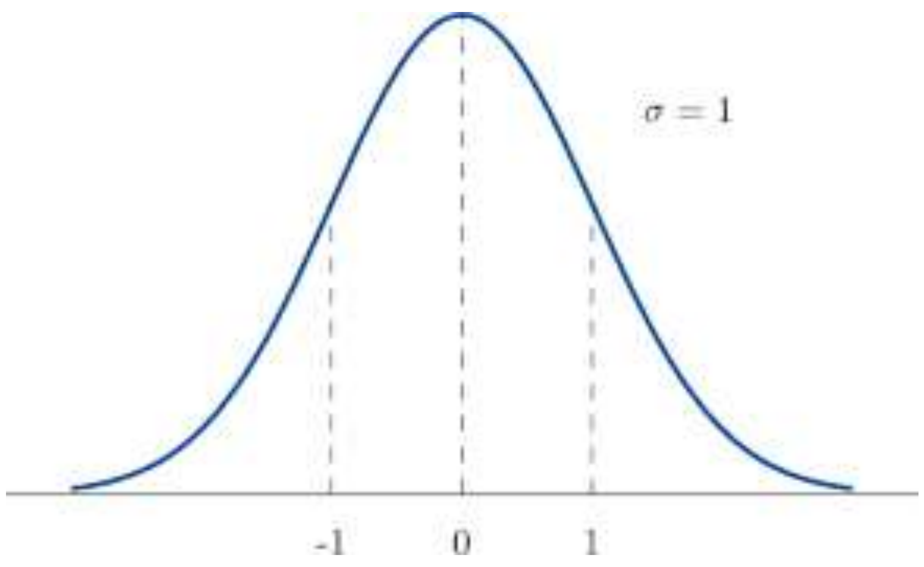
About Me

- 20 years of experience trading options
- 8 years of online research & options services
- CBOE floor trader and market maker – provided liquidity on the largest options exchange in the world for stocks like Amazon
- Hedge fund analyst, options portfolio
- MBA, MSIM, Arizona State University
- BA Economics, University of Illinois

Options Trading Online Resources

- Marketchameleon.com (analytics, screener)
- Cmlviz.com (backtesting)
- Cboe.com (videos, education)
- Optionseducation.org (education)
- Vixcentral.com (volatility)
- Sixfigureinvesting.com (volatility)

What Does This Show?



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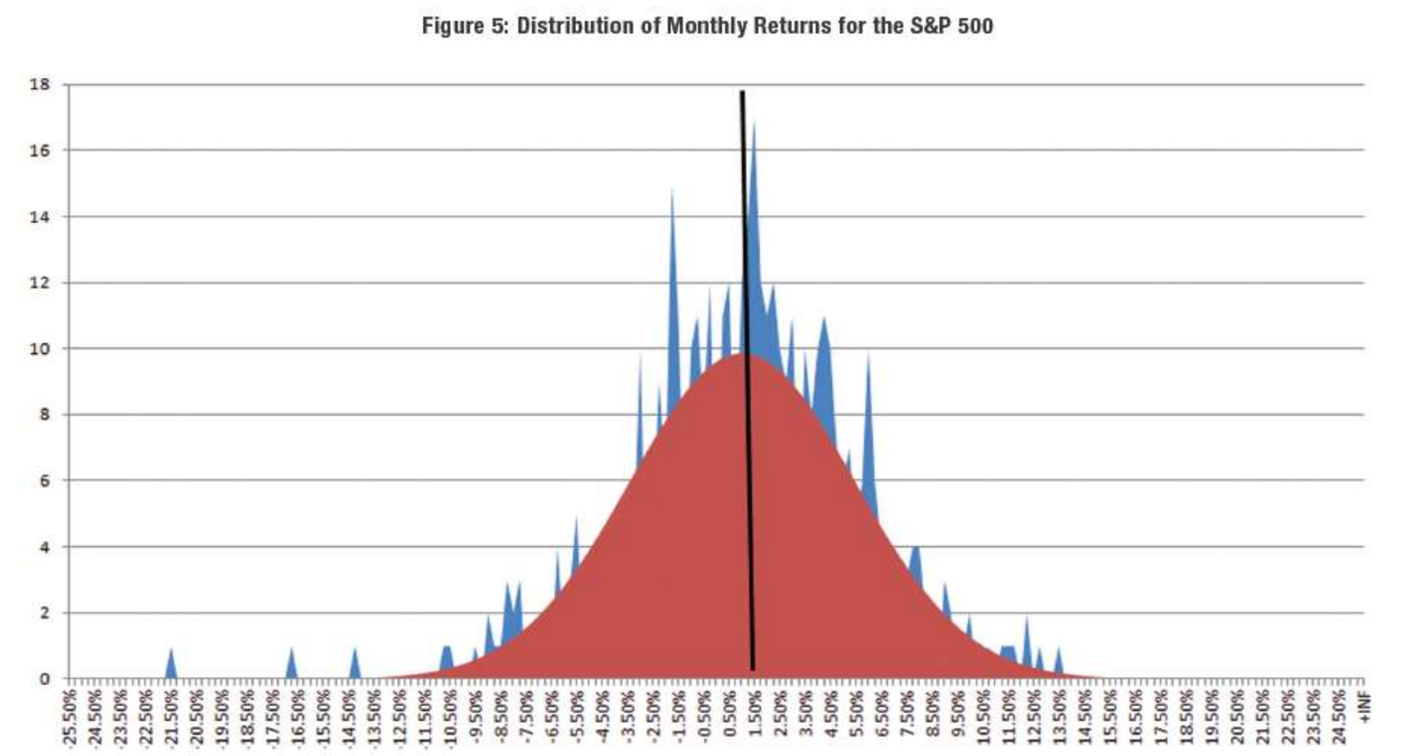
How Market Returns Really Look



1975-2011 time period (looks about the same if you go back further or extend to today)

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So What Does It Mean?

Plus / Minus Sigma Level	Probability of occurring on any given day	How often event is expected to occur	Associated S&P 500 percentage move	Actual S&P 500 occurrences (Jan 1950-2016) vs (expected from normal distribution)
>+-1	31.73%	80 trading days per year	+-0.973%	3534 (expected 5276)
>+-2	4.56%	12 trading days per year	+-1.95%	776 (expected 758)
>+-3	0.27%	1 event every 8 months	+-2.92%	229 (expected 44)
>+-4	6.33×10^{-3} %	Once in 62 years	+-3.89%	98 (expected 1)
>+5	5.73×10^{-5} %	One in 6900 years	+-4.86%	50 (expected 0)

https://sixfigureinvesting.com/2016/03/modeling-stock-market-returns-with-laplace-distribution-instead-of-normal/

- Why is the market like this?
- Why do many market risk models still use the normal distribution?
- **What can we do to take actual market risk into account?**
    - Trade OPTIONS instead of STOCKS!

Trading Is Different Than Investing

- **Let’s start with a few clarifications**
  - Clearly, if your goal is long-term dividend collection, then you need to own stocks
  - Retirement investing, especially the kind that does dynamic asset allocation between ETFs is not the same as trading
  - Using stocks in conjunction with options (like covered call trading) is perfectly reasonable, although once again, you don’t need to own stocks unless you want to collect a dividend
  - **Bottom line** – for short and medium-term trading, I strongly prefer options to stocks. I consider this a very different realm than long-term investing.

Don’t Buy Stocks, Use Short Puts Instead

- **Use cash-secured puts to enter into long stock positions**
  - A cash-secured put is when you sell a naked put in a stock you want to own at a lower price, and you have enough money in your account to buy the shares if you get assigned (short 1 put = long 100 shares on assignment)
    - Why not get paid to get long a stock?
    - Plus, the premium collected protects your downside some (and gives you a lower entry point for your long shares)
  - Or, just use short puts to increase yield even you don’t necessarily want to own the shares but believe stock is going to be neutral or higher in the near future
  - If you want to own shares anyways, only real risk is missing a big rally
    - It may go without saying, but if you think the market is about to tank, it isn’t the right time to use this strategy

Cash Secured Puts - Example

- Let's say you think Twitter (TWTR) is going to flatten out or go higher
- You also don't mind owning the shares around $33/share
- On November 1st, with the stock at $34.62, you could sell the November 30th 33.50 puts for about $1.30
- That's a 3.8% yield in about 30 days (45% annual rate)

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Cash Secured Puts – Example

- If TWTR goes up or stays where it is, you simply collect the $1.30 and write another put after expiration
- If TWTR drops below $33.50, you get assigned on the stock at $33.50 (which is the price you want), and your actual cost is at $32.30 (33.5 strike - $1.30 premium)
- You are protected down to $32.30, that's your breakeven point
- Once you are long the shares, you can take the next step: sell a covered call (more on that in a minute)

Cash Secured Puts Backtesting Results

CMLviz.com TradeMachine

	AAPL: Sell 40 Delta Put	SPY: Sell 40 Delta Put	WMT: Sell 40 Delta Put	TLT: Sell 40 Delta Put	TSLA: Sell 40 Delta Put
Expiration:	30 Days	30 Days	30 Days	30 Days	30 Days
Risked:	$9081	$3277	$1425	$2094	$2526
Total Return:	$9471	$7457	$1821	$1334	$14888
% Return:	104%	228%	128%	63.7%	589%
Commissions:	-	-	-	-	-
% Wins:	73.4%	89.1%	75.8%	73.8%	69.9%
Wins:	47	57	47	48	51
Losses:	17	7	15	17	22
Gain:	$15438	$11467	$4196	$4816	$36157
Loss:	-$5967	-$4010	-$2375	-$3482	-$21269

5 years back
30 day holding period
Held to expiration

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Use Covered Calls Whenever Possible

- **Covered calls (along with CSPs) are the single best strategy in the market**
  - If you get assigned on stock from a cash secured put, then the natural next step is to sell a call against the shares
  - In most years, you are better off with covered calls versus only long stocks (plenty of data to support this, not to mention – just look at block trades)
  - Covered calls are very easy and take very little time to implement
  - Perfect complement to dividend collection
    - If the stock doesn’t pay a dividend or you don’t want to pay the price for long stock in 100 share increments, you can use a **synthetic covered call** (more in a minute)

Covered Calls

- A covered call is when you write a call versus every 100 shares of a stock you own to help amplify the yield
  - Example: An actual SPDR S&P 500 ETF (SPY) covered call trade on Oct. 31st
    - Purchased 1,125,000 shares of SPY at $272.55
    - Sold 11,250 November 30th 279 calls for $2.86 (collecting $3.2 million)

Covered Calls

- Payoff scenarios
  - **Scenario 1: SPY is at $272.55 on November 30th**
    - Stock gains = $0
    - Option gains = $3.2 million (1 month)
    - Return = 1% (premium/long stock), monthly = 1%, yearly = 12%
  - **Scenario 2: SPY is at $279 or higher on November 30th**
    - Stock gains = $7.3 million ($6.45 move x 1,125,000 shares)
    - Option gains = $3.2 million
    - Return = 3.4% (appreciation + premium/long stock), monthly = 3.4%, yearly = 41%
  - **Scenario 3: SPY is at $269.69 on November 30th**
    - Stock loss = $3.2 million ($2.86 move x 1,125,000 shares)
    - Option gains = $3.2 million
    - Return = 0%
    - Any lower price would result in a loss

Synthetic Covered Calls

- Synthetically, you can make the same trade by purchasing a deep in-the-money SPY call versus the short call (279)
  - The SPY 80 delta call (around 259 at the time) costs around $16.50, or $1,650 for 1 contract (same as 100 shares)
  - 100 shares of SPY cost roughly $27,000
  - You pay 6% of the cost and the call spread functions almost exactly the same as a covered call
  - Primary differences are no dividends and different tax considerations

Covered Calls Results (5% OTM/45 Delta)

CMLviz.com TradeMachine

	AAPL: Buy Stock, Sell 45 Delta Call	SPY: Buy Stock, Sell 45 Delta Call	WMT: Buy Stock, Sell 45 Delta Call	TLT: Buy Stock, Sell 45 Delta Call	TSLA: Buy Stock, Sell 45 Delta Call
Expiration:	30 Days	30 Days	30 Days	30 Days	30 Days
Risked:	$90477	$16133	$5906	$7806	$17772
Total Return:	$73629	$11122	$3237	$1745	$12836
% Return:	81.4%	68.9%	54.8%	22.3%	72.2%
Commissions:	-	-	-	-	-
% Wins:	64.1%	78.1%	69.4%	54.7%	65.8%
Wins:	41	50	43	35	48
Losses:	23	14	19	29	25
Gain:	$173K	$17670	$7138	$7621	$45143
Loss:	-$98984	-$6548	-$3901	-$5876	-$32307

5 years back
30 day holding period
Held to expiration

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For Rapid Upside Or Downside Protection

- **Use long vertical spreads for directional trading**
  - For any short or medium-term directional trade, using vertical spreads is almost always a good idea
  - My rule of thumb is any option that costs more than about $0.75 should be countered with a short option to reduce costs
  - Lower cost (which means lower risk!) is almost always a better plan than going for higher upside potential
- A vertical spread is simply buying and selling a call or put in the same expiration, but using different strikes. Long (debit) verticals are when you are buying the closer to the money options and selling the further out ones

Vertical Spreads: AAPL Example

- Apple stock at $185.50 on May 8th
  - Bought 1,000 September 195 calls for $5.52
  - Sold 1,000 September 200 calls for $3.93
  - Total cost is $1.59
    - **Breakeven point is $196.59**
    - Max profit is $5 (gap between strikes) - $1.59 cost = $3.41
      - That’s $341,000 or 214% gains
      - **Max loss is $159,000**
  - Conversely if you bought the 195 calls for $5.52
    - **Breakeven is $200.52**
    - **Max loss is $552,000**

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Vertical Spreads – Facebook (FB)

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Naked Calls

Buy 50 Delta Call

Expiration: 30 Days

Risked:	$1405
Total Return:	$444
% Return:	31.6%
Commissions:	-
% Wins:	38.5%
Wins: 10	Losses: 16
Gain: $4580	Loss: -$4137

Buy 45 Delta Call

Expiration: 30 Days

Risked:	$1339
Total Return:	$388
% Return:	28.9%
Commissions:	-
% Wins:	34.6%
Wins: 9	Losses: 17
Gain: $4042	Loss: -$3654

Call Vertical Spreads

Buy 50 Delta, Sell 40 Delta Call

Expiration: 30 Days

Risked:	$251
Total Return:	$1420
% Return:	566%
Commissions:	-
% Wins:	61.5%
Wins: 16	Losses: 10
Gain: $2519	Loss: -$1099

Buy 45 Delta, Sell 35 Delta Call

Expiration: 30 Days

Risked:	$246
Total Return:	$1498
% Return:	609%
Commissions:	-
% Wins:	57.7%
Wins: 15	Losses: 11
Gain: $2410	Loss: -$912

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Vertical Spreads – Tesla (TSLA)

CMLviz.com TradeMachine

Naked Puts

Buy 50 Delta Put

Expiration: 30 Days

Risked:	$14582
Total Return:	-$13088
% Return:	-89.8%
Commissions:	-
% Wins:	26.9%
Wins: 7	Losses: 19
Gain: $7299	Loss: -$20387

Buy 45 Delta Put

Expiration: 30 Days

Risked:	$13974
Total Return:	-$13151
% Return:	-94.1%
Commissions:	-
% Wins:	19.2%
Wins: 5	Losses: 21
Gain: $5879	Loss: -$19030

Put Vertical Spreads

Buy 50 Delta, Sell 40 Delta Put

Expiration: 30 Days

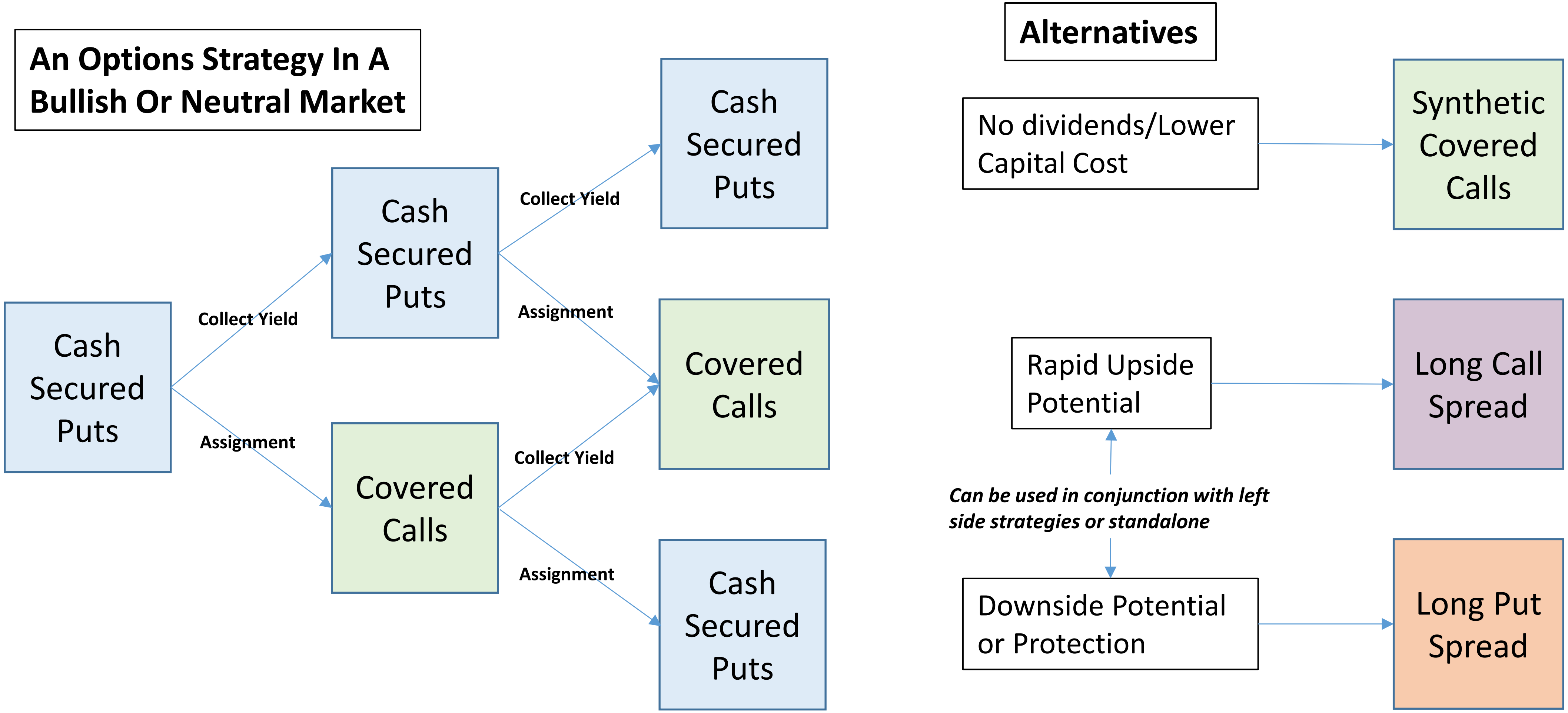
Risked:	$2322
Total Return:	-$341
% Return:	-14.7%
Commissions:	-
% Wins:	50%
Wins: 13	Losses: 13
Gain: $4156	Loss: -$4497

Buy 45 Delta, Sell 35 Delta Put

Expiration: 30 Days

Risked:	$3606
Total Return:	-$1116
% Return:	-31%
Commissions:	-
% Wins:	30.8%
Wins: 8	Losses: 18
Gain: $4057	Loss: -$5174

An Options Trading Roadmap



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Bonus Trading Tips!

- **Six tips to improve your success rate:**
  - Trade liquid options – bid/ask spreads are narrow
  - Look at the tape – big trades (block trades) generally come form savvy sources
  - Option Sentiment (calls versus puts) can be a useful directional indicator
    - Check out Marketchameleon.com
    - Timing a direction is always tough but sentiment can help you determine when a change may be coming
  - Don't trade "teenies"
  - Always understand the underlying product you are trading options on (mostly relevant to ETFs – leverage, complexity, inverse)
  - Trade your edge!

Summary

- Use cash-secured puts to enter into long stock positions
- Once you are long stock, you can use covered calls to increase your yield
- Use vertical spreads for directional trades
- You can develop an options trading roadmap using cash secured puts, covered calls, and vertical spreads when necessary
- Remember the six tips for options trading success

Q&A

To Get a Copy of This Presentation

1. Text the word **Jay** to
   213-516-9803.

2. You'll get a response with the presentation link.

3. I'll also send a couple of updates on options trades I'm watching.

Bonus Training

Be sure to sign up for my newest training presentation, “Become a Fearless Options Trader in 60 Minutes or Less.”

Here’s what you’ll learn in this new training session…

- **The 3 Steps to Fearless Options Trading**
- **The Real Reason Why 80% of Options Traders Fail** (And How Not to)
- **My “Do Less Make More” Options Trading “Hack”**
- **How to average a 28% gain on every winning trade by playing both sides of the**.
- **How to put it all together ... and create your own “No Fear” options**

Click here for more…

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