Never Trade Stocks Again!

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Investors Alley

Options Floor Trader PRO

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In addition, you can go to **www.Optionsfloortrader.com** to find out more about the product.

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

How Does The Stock Market Trade?

- Most investors assume the market trades with a normal distribution, that is, the standard bell curve which many observable events fall into when tracked over time
- If that was the case, we would expect a daily 5% move in the S&P 500 (up or down 5% or more in one day) to happen once every 6,900 years!
- From 1950 to 2016, a +/- 5% daily move **happened 50 times!**
- Plenty of reasons for this but the biggest is one is that investors have a memory – they remember what it feels like to lose money
- **Solution:** Use options instead of stock!

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, such as 60/40 stock/bond portfolios and 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 **Qualcomm** (QCOM) is going to flatten out or go higher
- You also don't mind owning the shares around $48/share
- On January 31st, with the stock near $49.50, you could sell the February 15th 49 puts for about $0.90
- That's a 1.8% yield in about 15 days (3.6% per month, 43% per annum)

Cash Secured Puts – Example

- If QCOM goes up or stays where it is, you simply collect the $0.90 and write another put after expiration
- If QCOM drops below $49, you get assigned on the stock at $49 (which is the price you want), and your actual cost is at $48.10 (49 strike - $0.90 premium)
- You are protected down to $48.10, 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)

Quick Definition: Delta

- For my upcoming trading strategies and examples, I talk a lot about delta.
- Delta tells you how much an option price will move in relation to the underlying, so for example a 50 delta option will move $0.50 for every $1 move in the underlying asset
- Delta gives you a rough probability of the option finishing in the money, so a 50 delta options has about a 50% chance of ending up in the money, 30 delta/30% and so on
- 50 delta options are at the money, below 50 are out of the money, and those are the options we usually deal with.

Cash Secured Puts Backtest Results

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	AMZN: Sell 35 Delta Put	MSFT: Sell 35 Delta Put	IWM: Sell 35 Delta Put	XOM: Sell 35 Delta Put	SPY: Sell 35 Delta Put
Expiration:	30 Days	30 Days	30 Days	30 Days	30 Days
Risked:	$9111	$602	$2117	$1437	$3184
Total Return:	$28663	$3403	$1701	$1902	$7052
% Return:	315%	565%	80.3%	132%	222%
Commission:	-	-	-	-	-
% Wins:	81.5%	83.8%	78.5%	79%	90.6%
Wins:	53	57	51	49	58
Losses:	12	11	14	13	6
Gain:	$77572	$4349	$7780	$4635	$10844
Loss:	-$48909	-$946	-$6079	-$2733	-$3792

5 years back
30 day holding period
Held to expiration
No stops for gains/losses
No earnings

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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

Covered Calls

- **Results!**
  - SPY closed on November 30th for $275.65
    - The trade earned $3.5 million on stock appreciation
    - The trader also collected the $3.2 million in call premium
    - Total gains $6.7 million
    - **That's a 2.2% in just one month or 26.4% annualized**

Synthetic Covered Calls

- Synthetically, you can make the same trade by purchasing a deep in-the-money SPY call versus the short call (the 279 strike)
    - The SPY 80 delta call (around the 259 strike 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 if you are dealing with long-term asset holdings

Covered Calls Results (40 Delta)

CMLviz.com TradeMachine

	GOOGL: Buy Stock, Sell 40 Delta Call	V: Buy Stock, Sell 40 Delta Call	MSFT: Buy Stock, Sell 40 Delta Call	KO: Buy Stock, Sell 40 Delta Call	MCD: Buy Stock, Sell 40 Delta Call
Expiration:	None	None	None	None	None
Risked:	$126K	$26018	$11174	$4803	$17986
Total Return:	$215K	$30450	$6053	$2457	$8702
% Return:	171%	117%	54.2%	51.2%	48.4%
Commission:	-	-	-	-	-
% Wins:	71.8%	75.6%	74.4%	81.6%	80%
Wins:	28	31	29	31	32
Losses:	11	10	10	7	8
Gain:	$276K	$46624	$7944	$2997	$12379
Loss:	-$60651	-$16174	-$1891	-$540	-$3677

5 years back
60 day holding period
Held to expiration
No stops for gains/losses
No earnings

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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**

Vertical Spreads – Facebook (FB)

CMLviz.com TradeMachine

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

Vertical Spreads – Tesla (TSLA)

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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

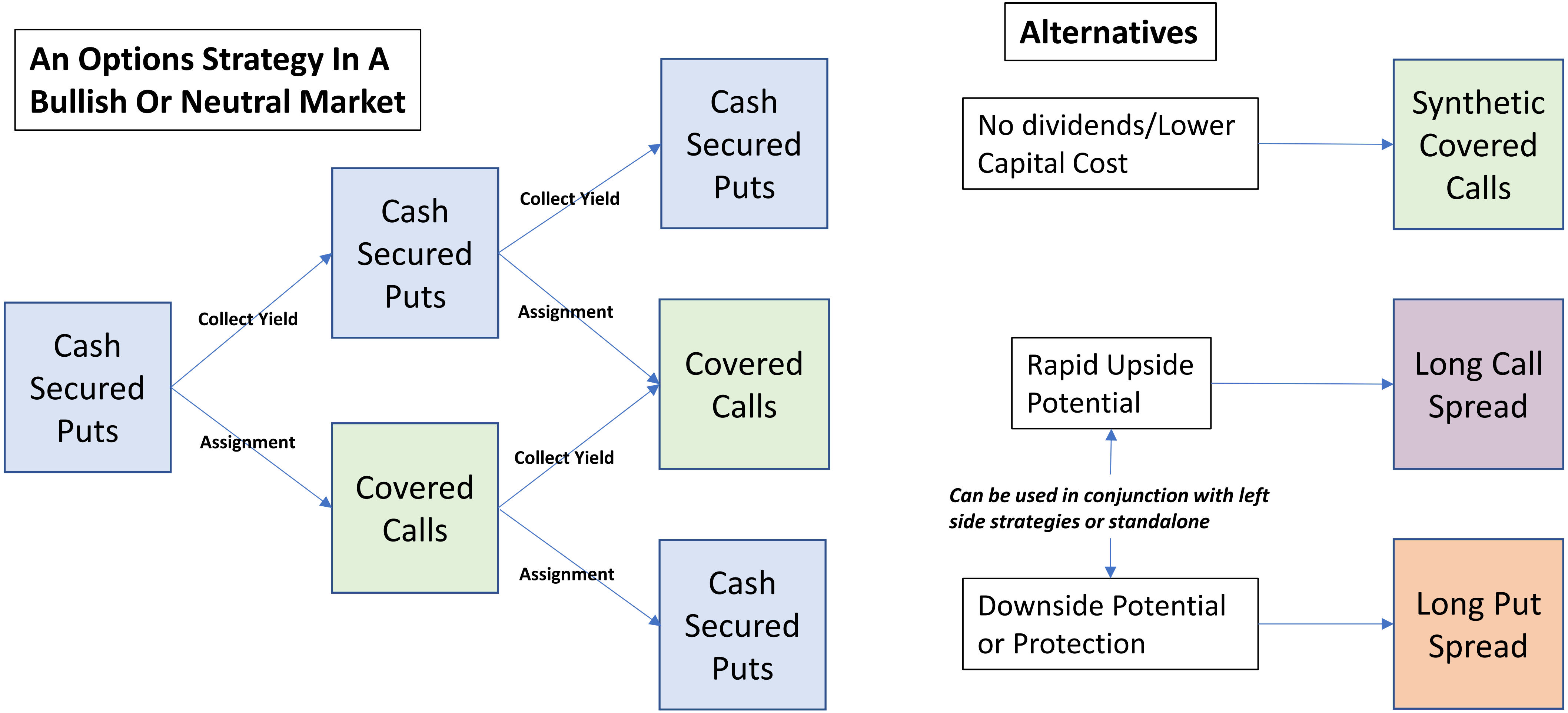
Buy 45 Delta Put	
Expiration: 30 Days	
Risked:	$13974
Total Return:	-$13151
% Return:	-94.1%
Commissions:	-
% Wins:	19.2%
Wins: 5	Losses: 21
Gain: $5879	Loss: -$19030

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



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

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