Top Sectors To TRADE THIS YEAR

Focus on these market sectors for massive profits

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At the end of every year, it's very common to see investment analysts produce "Top Sectors for the New Year" reports. These types of reports usually highlight two or three sectors which may get a boost over the coming year for a variety of reasons. The reasons typically are very high level and can involve anything from interest rate policy to global demand for certain goods to new government regulations taking effect.

For instance, I could tell you to buy a financial sector ETF (for US companies) because I think the Fed's higher interest rate policies will be a boon to those companies. That's straightforward enough that any investor should be able to judge the merits of the argument and make an investing decision.

With options trading, it's not nearly that simple. Sure, I could just say buy a long-term option on a financial sector ETF and go hang out at the beach. But, just suggesting directional trades using options doesn't really provide any additional insight for options traders. Most importantly, we would be completely ignoring the volatility aspect of the trade.

Do you think investors would want to hold a long-only options position in a financial sector ETF if the sector is going to be in a constant state of flux? If bank stocks are jumping all over the place because of uncertain interest rate expectations, many investors would prefer being in cash instead.

With that mind, let's look at two sectors which should be good for options traders while also taking into account the impact of market/sector volatility.

Technology

Without a doubt, technology is my favorite sector to use for trading options strategies. There are very few years when I wouldn't recommend tech as one of the top areas in this category. I find that established tech stocks tend to have to more predictable volatility patterns than many other types of stocks.

Now, I wouldn't necessarily apply the same belief to newer and younger tech companies. They can be too volatile to trade at times. I also don't typically trade options in known highly volatile stocks like **Tesla** (TSLA) which can be so jumpy that the options are too expensive to buy and selling options is too risky.

However, established tech companies like Apple (AAPL) and Amazon (AMZN) can be excellent for certain options trading strategies. For example, both companies tend pick up a lot of doubters in between earnings periods despite typically producing solid growth numbers. As such, the companies tend to beat expectations and the stock prices rise after earnings periods. Even when they don't beat expectations, they usually have far smaller drawdowns compared to the magnitude of their up days.

What's more, many of the most heavily traded tech stocks can have very high stock prices (AMZN anyone?) so they are cost prohibitive for many stock traders. The cost issue becomes a lot more manageable when you start using options, which give 100 to 1 leverage compared to the stock.

The bottom line is, tech stocks can be volatile, but the best tech stocks tend have more predictable patterns around earnings. Using options can allow you take advantage of these patterns without having to pay full price for the stocks, which can be prohibitively expensive for most traders.

Basic Materials

The other sector I really like for options trading over the coming year is basic materials. Basic materials can include a variety of industries, but I'm mostly focusing on the companies that produce commodities, like gold and oil.

What I like about using options trade basic materials stocks is that they tend to have longer-term trends based on macroeconomics variables. For example, oil tends to make a very good hedge against inflation. If we start to see inflation going up next year (a distinct possibility), we may also see a sustained rise in the price of oil.

More importantly, even if oil prices don't climb substantially over the year, they aren't likely to fall that much either. The possibility of higher inflation should keep a floor on the price of crude.

This is where options come in. With stocks, there's not much you can do to make money from an asset you expect has a price floor. But with options, you can simply sell a put spread or cash secured put and collect money if the asset price goes up or stays where it is.

Basic materials stocks also include companies that produce industrial metals such as copper, aluminum, and steel. These are products which should continue to see higher demand if the economy continues to recover. In addition, there should be opportunities to use options to follow trends or take advantage of price floors.

Generally speaking, raw materials producers are very much tied to the macroeconomic outlook. There could be some very clear trends in this area looking ahead, which we can profit from by utilizing the leverage and flexibility of options.