TRADING EDUCATORS PRESENTS

HIT AND RUN TRADING™

GUARANTEED INCOME WITH NO LOSSES

by Joe Ross

THE STRATEGY

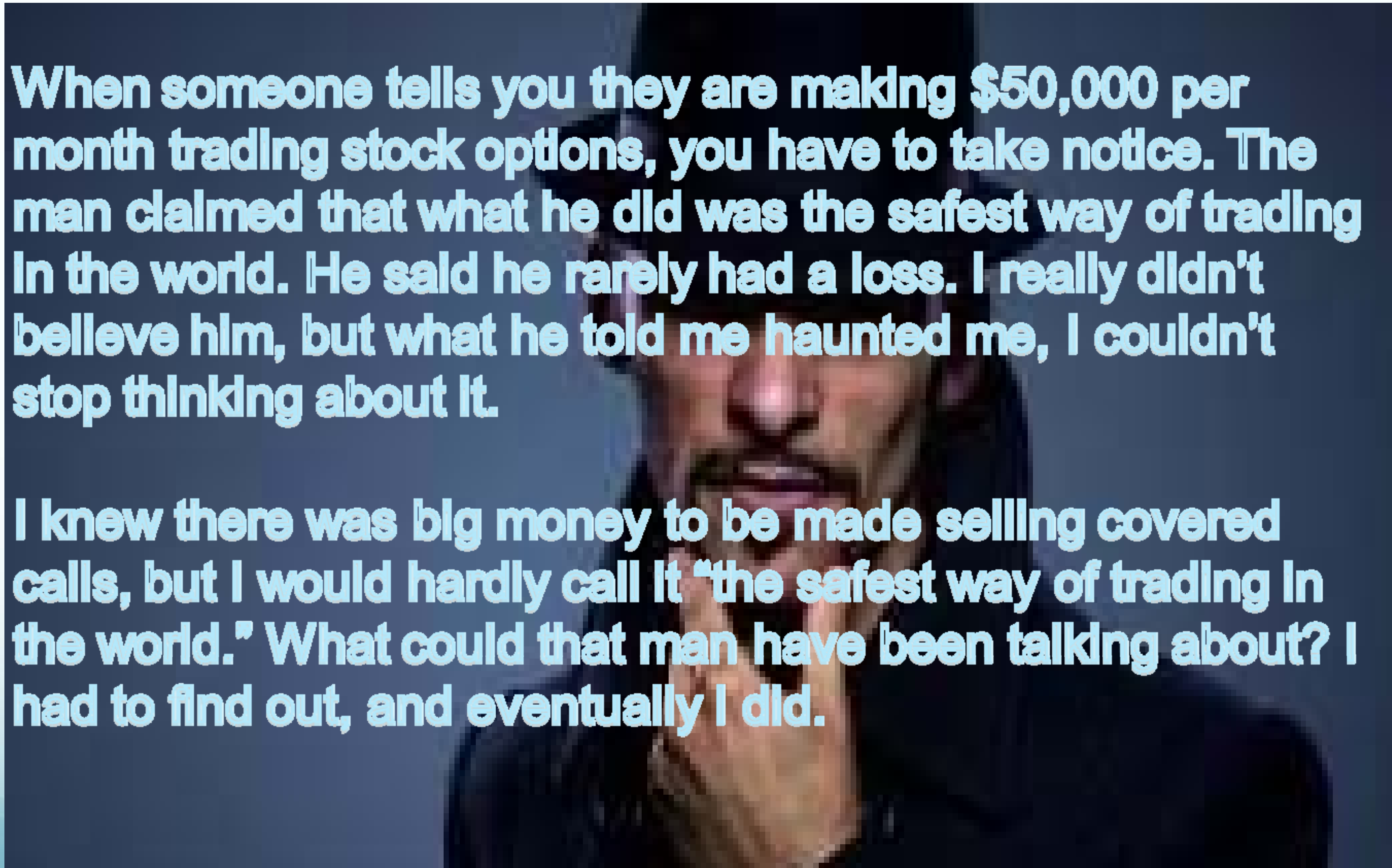
SELLING PRICE INSURANCE

Covered Calls?

At the beginning of the year 2007 I spent a month at a health resort. It was there that I met a mysterious man, and in the course of our conversations we discovered we were both traders. The man told me he was making $50,000 per month trading stock options.

He never gave me any details of what he did other than to tell me something I already knew: It is better to be a seller of options, rather than a buyer. From other things he said, I guessed that he must be selling covered calls, and that to do so, he must have had a huge amount of money in order to be making $50,000 per month trading stock options.

Losses Were Rare?



When someone tells you they are making $50,000 per month trading stock options, you have to take notice. The man claimed that what he did was the safest way of trading in the world. He said he rarely had a loss. I really didn't believe him, but what he told me haunted me, I couldn't stop thinking about it.

I knew there was big money to be made selling covered calls, but I would hardly call it "the safest way of trading in the world." What could that man have been talking about? I had to find out, and eventually I did.

Is Selling Covered Calls Low Risk?

Covered Calls

I opened a $10,000 account in my wife's name and began selling covered call options on stocks, and doubled that account in 4 ½ months. But I could see that it took a huge amount of capital to first have to buy shares, and then sell a call option based on those shares. Where was the leverage? I was having to put up 100% of the money just to buy the shares.

Sometimes life brings some unexpected turns so that you discover something you hadn't seen before.

Covered Calls

In late 2007 and into early 2008, the stock market turned down and although I was selling covered calls, I was getting stuck holding shares that I really didn't want to hold. I wanted to trade my money, not invest it, but prices were falling and all I had to show for it was the option premium from the call options I had sold, plus any dividends paid by the company during the time I was still holding the shares.

I can tell you that selling covered calls and collecting dividends is a fairly safe and wonderful way to trade, but selling covered calls really wasn't what I was looking for. It was tying up my money for too long.

Uncovered Put Options

To protect against falling prices I considered buying price insurance via put options to protect against falling stock prices, but buying put options was very expensive, and would have eaten up all of my call option premium. Buying put options is how investors and speculators are able to buy price insurance.

The only thing I could see to do was to become a seller, NOT A BUYER, of price insurance by selling put options. As stock prices began to fall like a rock, put option premium (the cost of buying price insurance) skyrocketed. Volatility hit “80” as measured by the VIX, Volatility Index. Investors were paying prices for insurance that could be justified only if stock prices would go to minus $15 per share, which of course is impossible. I began selling price insurance by selling uncovered put options on blue chip stocks.

Uncovered "*Naked*" Put

Selling uncovered puts was wonderful. Most of the time I was never put upon, but when shares were put to me, since I then owned the shares, I could sell covered calls and collect even more money. But even if I couldn't sell a covered call, I could collect whatever dividends the company paid out. I could see that it was important to sell puts on dividend-paying companies. There were other refinements which I'll cover later.

What I was seeing was that it's possible to sell a naked put solely for the purpose of being able to invest, at a reduced price, in shares of a company I might want to own.

Uncovered "*Naked*" Put

I could repeatedly sell puts against the shares until I was finally put upon, at which time I would own the shares at a discount, thereby lowering the cost of my investment.

Investors do that as part of a dividend accumulation/investment income strategy. Why not own shares of great businesses at a reduced price if I was able?

Buy shares at a discount; compound dividends; and over time the investment will grow into a sizable holding. Wonderful! But, investment wasn't what I wanted. I am a trader, and not particularly interested in owning stocks.

What is a Put?

- It's simply a contract in which the put seller agrees to buy the shares of a company if prices ever fall to a certain price called the strike price. In other words, the put seller is acting in the same way as does an insurance company.
- And just like with insurance, the put buyer pays a premium for the assurance that the put seller will buy the shares if prices drop to the level of the Strike Price.
- Because a put option is a binding contract, the contract has to have a time limit called the Expiration Date. At expiration the contract ends.
- Approximately 80% of the time a put contract ends up worthless, and the seller keeps the premium.

What is a Put?

- An **Option Contract** is simply an agreement to buy or sell a stock at a certain price.
- The **buyer** of the option has the right but not the obligation to force the option **seller** to buy shares at any time prices drop below the **strike price**. This right is called **Exercising** the option.
- The **strike price** is the price stated in the agreement.
- The **seller** of the option simply has to relax and wait to see what happens.

The **seller** has no right to **exercise**, because he owns nothing. The **seller** can just wait for the option to expire at or above the **strike price**, which on average will happen about 80% of the time. The odds greatly favor the **seller**.

What is a Put?

- An Option Contract always has an expiration date. Most stock options expire on the third Friday of the month. Technically they expire at noon on Saturday but since there is no trading on Saturday we can say they expire on Friday.

- At expiration the contract is settled, in other words, it is over. Unless prices finish below the strike, and the option is exercised, the buyer loses all rights under the contract and also loses the premium paid.

- If prices finish at or above the strike, the seller keeps the premium and has no further obligation. If prices finish below the strike, the put will be exercised and the seller will be obligated to buy the shares at the strike price. No matter where prices finish, the seller keeps the premium

What is a Put?

- The strike price, usually referred to as "strike" is based on the underlying stock. Put option buyers have the right to sell shares at the strike. The seller then, has to buy shares at the strike.
- If you want to sell a $25 put on company xyz, $25 is the strike price.
- The premium is the amount of money the put buyer pays to the put seller for the right to sell shares at the strike.
- The put seller is actually selling *price insurance* and just as with any insurance, the buyer of the insurance pays a premium to the seller.
- Regardless of the outcome of the contract, the seller keeps the premium. Premium is what the seller receives for taking the risk the buyer doesn't want.

What is a Put?

- There's only one additional term you need to know before we can begin seeing examples of put selling. That term is margin requirement, or simply margin.
- Margin is the minimum amount of money you need to have in your account in order to complete a put selling transaction.
- Since a put seller is not actually buying anything, the seller needs to put up only a percentage of the price of the underlying. For most options the margin percentage is 20%.
- The put seller is agreeing to buy shares, at a specific price, on a specific date in the future. Therefore, the amount of margin is really a good-faith deposit.

What is a Put?

- In a case where you agree to buy $2,500 worth of stock, you'd need just $500 in your account as a good faith deposit.
- The $500 is the margin requirement. To trade using margin, you will need to get margin approval from your broker.
- Let's review one more time the terminology you will need to get started selling naked puts.
- Be certain that you understand the terminology on the following page.
- You will need to know it during the workshop.
- There are only eleven terms to know. Make sure you understand them.

Be Familiar with These Terms

- Put Option Contract
- Expiration Date
- Strike Price
- Premium
- Underlying
- Margin Requirement
- Bid/Ask Spread
- Open Interest
- Volume
- Return on Margin
- Return on Principal
- Some of these will be defined in the workshop

Consider looking them up on the Internet

Naked Put

- Selling naked puts on stocks you wouldn't mind owning is one of the greatest trading strategies in which you can engage. It generates super-safe income. And if done properly, your odds of losing money are slim to none.
- To correctly sell naked puts, sell them only on dividend-paying companies, and sell them for a price at which, if you have to buy the stock, you wouldn't mind owning it.
- However, as you will soon see, we are going to trade in such a way that there is only the slimmest chance that we will ever have to own a stock. If done correctly, it can be *never!*

Naked Put

- Between 75% and 90% of naked puts sold can be expected to expire worthless. Industry averages say “around 80%.”
- However, it is possible that sometimes the stock will trade for less than the put option's strike price on option-expiration day. In that case, for every option sold you would normally have to buy 100 shares at the strike price. (Remember that for every put-option contract you sell, you are responsible for 100 shares of stock.)
- However, **we are not going to allow ourselves to be put upon.**

Naked Put

- How are we going to avoid being put upon? We are going to buy back the put option as soon as the put is threatened.
- We will buy back the put and sell another put for more money and at a lower strike. When you see how this works, you will understand why we do not incur losses, while at the same time we earn guaranteed income.
- I want to show you why selling options has all the advantages when trading in the markets.

Seller's Advantages

- You are already aware that on average options expire worthless 80% of the time. *Advantage is to the seller.*

- If an option closes at the strike, the option seller wins and the option buyer loses. A put must close below the strike for the put buyer to win….but even then the buyer loses until prices reach below the strike for a distance sufficient to cover what was paid for the premium. In other words, if a put buyer pays $1.00 for a $25 put, the buyer is not profitable until prices reach at or below $23.99. *Advantage is to the seller.*

- Meanwhile, the seller has $1.00 with which to lower his cost in the event he has to buy the shares. The seller will pay only $24 for the $25 shares. *Advantage is to the seller.*

Seller's Advantages

- In general, options are exercised only when they are "in-the-money. A $25 put is not likely to be exercised with prices at or above $25. However, these days exercise is automatic, so as a put seller you want to avoid holding any put that is anywhere close to the strike on option expiration date. *Advantage is to the seller.*

- In fact, unless a put option is very far out-of-the money, you should buy it back or roll it out no later than the Monday prior to the expiration date on Friday of the week options will expire.

- Options are almost always overpriced, even when there is only 1 cent between the bid and the offer. The difference between the bid and the offer is called the spread (bid/ask spread). The spread always favors the option seller, never the option buyer. *Advantage is to the seller.*

Seller's Advantages

- Time is the enemy of the option buyer. The option buyer owns a wasting asset. *Advantage is to the option seller*
- An option can have only two values. One is intrinsic value, the amount by which the option is in-the-money. The other value is time until expiration, which for the puts we sell are eroding away at an ever increasing rate of speed. *Advantage is to the option seller*
- The puts we sell never have any intrinsic value, only time value. All we have to do is wait for our reward – the option finishing out-of-the-money. In other words, worthless. Or, we buy it back for less than we receive for it. *Advantage is to the option seller.*

Tools You Will Need

You'll Need a Broker

- **Interactive Brokers** http://www.interactivebrokers.com **877.442.2757**
- **ThinkorSwim** http://www.thinkorswim.com **866.839.1100**
- **OptionsXpress** http://www.optionsxpress.com **888.280.8020**
- **eOption** http://www.eoption.com **888.793.5333**
- **OptionsHouse** http://www.optionshouse.com **877.653.2500**
- **Trade King** http://www.tradeking.com **877.495.546**4

You'll Need Resources

- **Optionable Stocks --** http://www.poweropt.com/optionable.asp
- **Dividend Stocks Online --** http://www.dividendstocksonline.com/dividend-paying-stocks/
- **Dividend Detective --** http://www.dividenddetective.com/big_dividend_list.htm
- **Investor Place --** http://investorplace.com/
- **Divdend Opportunities --** http://www.dividendopportunities.com/
- **Dividend Ladder --** www.dividendladder.com

These are all Free

Additional Resources

- http://www.theocc.com/webapps/weekly-options
- OCC is a list of options with weekly expiration dates. More about this just ahead.

This is Free

- www.seekingalpha.com
- Seeking Alpha will let you evaluate stocks in which you are interested, and it will let you set up a portfolio of your positions. It's definitely worth investigating.

This is also Free

You May Want to Annualize Return on Principal

(Premium divided by Strike Price) divided by (Days until expiration) multiplied by 365 days multiplied by 100

or

Annualize Return on Margin

(Premium divided by Margin) divided by (Days until expiration) multiplied by 365 days multiplied by 100

Days Until Expiration

Days.To

http://days.to/until/20-june

Type* Days.To *your browser

Free Resource

Or copy

http://days.to/until/20-june

And change the date from 20 June

To look up a single stock to see if it pays a dividend…

http://www.dividend.com

It's free for single searches

Free Resource

To View Stocks with Weekly Options

http://www.optionsclearing.com/webapps/weekly-options

IMPORTANT: Read the Text and then click on the link after "PLEASE NOTE:"

THE LIST CHANGES EVERY WEEK

Use dividend.com to see if the stock pays dividends

Free Resource-See Next Slide

Weekly Options

The options exchanges list equity and index options (including ETF options) that have series that are approximately one to five weeks to expiration following their initial listing. These options are called "Weekly Options" or "Weeklys". Because these options have such a short expiry, the options exchanges have the ability to list different series from week to week, but please note that Weeklys are not eligible to be listed for each and every week of a month. For the convenience of market participants, OCC publishes a list of newly added and newly delisted Weekly Option Products that have been processed through OCC's internal series listing application. These series are in the weekly program for the next eligible weekly expiration. This list is compiled from sources believed reliable, but certain Weeklys could be included in the list or omitted from the list in error. Also, changes in listing decisions by the exchanges may not be immediately known or reflected in the list. You should always check with your brokerage firm or an exchange directly if you have any questions about the availability of any particular Weekly Options Series.

PLEASE NOTE:

The Weekly Options Spreadsheet has been updated to include two weekly option summary lists. The left list is the most current and applies to weekly Option Products that have series expiring with the next eligible expiration date, highlighted at the top of the table. The right list applies to the previous week's active weekly options. They are presented side-by-side for easy comparison.

- Weekly Options

Click Here for list

Subscribe to Email Alerts

Get trading data delivered to your inbox. OCC Alerts is a FREE email service providing options and futures related data.

Email:

Check each list to subscribe:

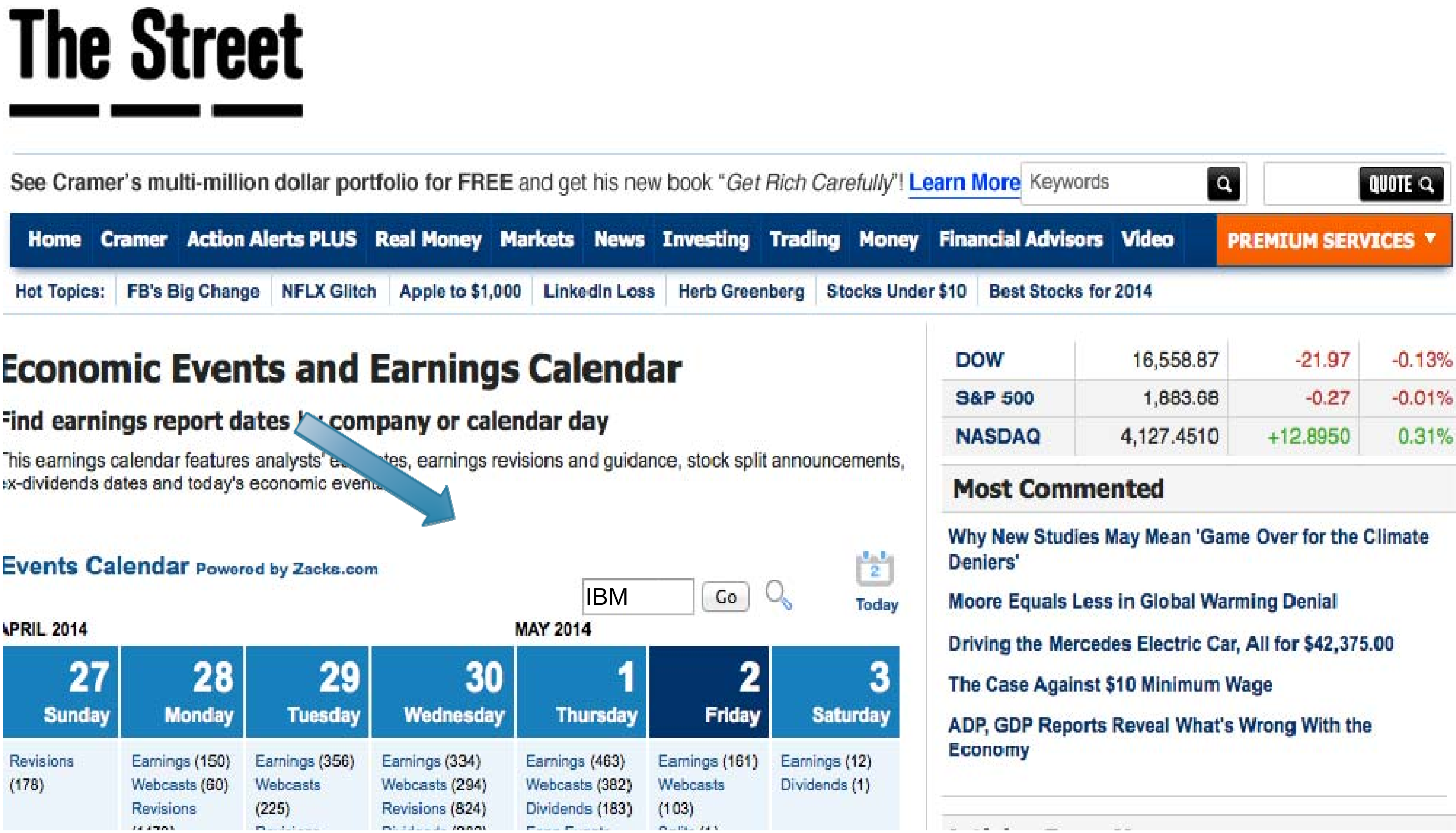
- Contract Adjustments
- Intraday Contract Adjustments
- Market Data Updates
- Expiration Notice
- OCC New Listings

Submit Request

Click here for more information and examples of each mailing list.

A Very IMPORTANT Resource

http://www.thestreet.com/event-calendar/



Economic Events and Earnings Calendar

Find earnings report dates by company or calendar day

This earnings calendar features analysts' estimates, earnings revisions and guidance, stock split announcements, ex-dividends dates and today's economic events.

Events Calendar Powered by Zacks.com

IBM Go

Today

IBM INTERNATIONAL BUSINESS MACHINES CORP.

Upcoming Events

On April 29, 2014, INTERNATIONAL BUSINESS MACHINES CORP. announced a dividend of $1.10 per share, that will be payable on June 10, 2014 for all owners of record May 9, 2014.

Earnings Announcements | Webcasts | Analyst Revisions | Splits | Dividends | Guidance

Earnings Announcements for INTERNATIONAL BUSINESS MACHINES CORP. Print

Date	Period Ending	Estimate	Reported	Surprise	Surprise%
16-APR-14	Mar 2014	$2.54	$2.54	0.00	0.00 %
21-JAN-14	Dec 2013	$6.01	$6.13	0.12	2.00 %
16-OCT-13	Sep 2013	$3.95	$3.99	0.04	1.01 %
17-JUL-13	Jun 2013	$3.78	$3.91	0.13	3.44 %

Another Resource

You can also use this free stock screener
to find stocks that pay dividends

www.finviz.com

Guaranteed Income with No Losses

This session is finished. I'll see you at the workshop.

Be sure you review the PDF file for the material we covered today.

Be familiar with the Resources we will use.