



OPTIONS 101

**GET TRADING
WITH OPTIONS**

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Introduction

Welcome, everybody, to the NetPicks Options 101 eBook! In this guide, we're going to be covering how we trade options at NetPicks. It's designed to be an entry level course to make sure you have a foundation in place that you can build on going forward. I know some of you have already traded options in the past, and that's great, but others are probably brand new, either you've never traded options before or you're just now getting interested again.

What we want to do is walk you through some of the key basics that you'll need to know in order to trade options successfully. Then, we'll transition into some of our favorite options strategies that we like to use with the NetPicks trading systems. At the end of this book, you'll have some great strategies that you can start to use right away in today's market conditions.

Keep in mind, if you've traded options for years, there's probably going to be a lot of review here in this guide. That's not a bad thing. It's always good to get a refresher on some of the key concepts of how options work. Once we finish reviewing the basics, we will transition into the criteria that we use every day when identifying the proper options to take the trades with.

So, let's dive in and talk about how you can take advantage of options in your own trading.

Where do I start?

When working with new students, I often get the feedback from people saying, "I have never traded options before because they are too complex. They seem like risky products to trade." I always push back on that feedback and remind them to think back to your first day on a new job or your first day in a college course. You're walking into that college course or that new job and you're probably overwhelmed immediately. It always takes time to work through the learning curve. However, the people that push through that learning curve are setting themselves up for success.

There's going to be a lot of new information thrown at you. There will be new definitions and terminology being thrown around that you're not familiar with. It's easy to just say, "I don't have the patience for this. I want results now. I don't want to really dive in and really master this content." In many cases, it's natural instinct to want to give up. It's easy to just fall into the trap of moving on to the next system or market as soon as things get difficult. If you commit to staying patient and taking the time to learn your craft you will be set up for long term results. Trading can provide incredible profit potential, so make sure you take the time to establish that foundation up front that we can build off going forward.

I personally believe everybody should be using options as part of their overall trade plan. I'm not saying they should be used exclusively, but it's such a great way to get additional diversification in the mix.

What we like to do at Netpicks, is to give you a set of mechanics that you can work with. We want to be as mechanical as we possibly can in everything that we do. There's always going to be that discretion side of trading as well, but we want to try to minimize that as much as we can. If we can be as rule-based as possible, it's going to give you more consistent returns. We're going to talk about the options mechanics in this guide.

Before we get into how we take our trades using our trading systems, let's review some of the basics of how options work.

Options 101

The biggest issue that I see holding people back from trading options is their complexity. A lot of times traders walk away from options when they start hearing terms like 'Iron Condor' or 'Butterfly'. They feel if they don't understand the advanced trades up front then there is no reason to trade options. That's just not the case. There are many trade types that can be used with just a basic understanding of how options work.

I'm a big believer in keeping things simple. Oftentimes, people think the more complicated their system or the more complicated the trades that they put on, the more profit potential they will have and that's just not the case. Sure, it's going to sound impressive when you describe an Iron Condor to other people, but it doesn't necessarily mean you're going to make more money with that strategy. We can keep things simple and really focus on the basics, and then down the road if we decide to build off those basics that's great. You're going to have that foundation in place that will make the advanced trades much easier to understand.

What I want to do here initially is start going through some of the key terms and definitions related to options trading. We're going to start out at the very basics, just talking through what a call and a put option can do for you. There are a lot of different strategies that you have access to when you start trading options. A lot of times, people get focused on buying calls when you are bullish or buying puts when you are bearish. However, that is just scratching the surface on how these products can be used. To understand the different strategies, we need to take a closer look at what call and put options really do for us.

Call Options

Let's talk about the call options first. Call options are easy to understand for most traders regardless of your level of experience. This is true because we're all programmed initially to look for that bullish market, right? You turn on any type of financial media, and all you hear is people cheering the market higher. The market moves higher every single day and based on what we've seen this year, it's easy to fall into that trap thinking that it's going to move higher indefinitely.

A lot of times, people start out with the call options because the call option will give you great profit potential, for very little cost. The problem in many cases, is that traders don't really understand how these products work, which can lead to unnecessary losses if they are used incorrectly. Therefore, it's so crucial to talk about what using a call option really does for us.

An option is defined as a contract between a buyer and a seller for a specific period of time. The buyer of a call option has the right, but not the obligation to purchase 100 shares of stock at a specific price by a specific date. This has the effect of locking in the purchase price for a period of time.

What's the difference between buying a call and buying shares of stock? A couple of things.

First, when buying a call option, you're going to be able to get into the trade for far less capital. There's a lot of leverage that we can take advantage of when trading options. In many cases with our trades we're able to get in for a couple of \$100, sometimes even less.

The trade-off is this contract is only good for a set amount of time. Every day that you hold the position, it's going to lose a little value. If the stock moves higher, you can absolutely make money in a big way if the move higher happens fast enough. When trading shares of stock you can hold the position as long as you want, but the tradeoff there is you will be tying up more capital with each trade. This is why options can be so beneficial for traders with smaller account sizes.



The buyer of the call option has the right to buy 100 shares of stock if they want to. However, we are not obligated to do so. We can always sell the option any time before it expires to close out of our position.

The buyer of an option is considered long the option. In the case of a call option, we're also considered long the position. When I buy a call option, whether it be on a stock, an index, or an ETF, I want that product to move to the upside and I want it to move to the upside as quickly as possible.

Now on the flip side, we can also sell a call option to open a position. ***The big difference here is the seller of the call option has obligations.*** They have an obligation to sell 100 shares of stock. A lot of times, people get intimidated by selling options because they think there's a lot of additional risk there. *"I don't want to get assigned the shares of stock. I don't have the capital to trade the shares of stock."* We're going to show you later how you can use different options strategies to make sure you are in a risk-defined trade.

Don't immediately get intimidated when you hear the terminology like 'selling an option' or 'selling a spread'. You don't need to get intimidated by these terms because there's ways that we can utilize these trades to benefit from different types of market conditions.

The only time that you're going to have massive, undefined risk is if you sell a naked option. That's just not something that we like to teach. It's not a strategy that we like to use in our trading.

As the seller of a call option, we're considered short the option. When I sell a call option, I'm also in a bearish position. So, if I sell a call option, I want that stock to move to the downside.

Put Options

Now, here's where it starts to get fun. Most people can wrap their head around buying a call option. You are buying a contract that will increase in value as the stock or ETF trades higher. However, we all know that over time markets don't always move higher. We will have stretches when stocks and ETF's sell off.

In many cases, people get so focused on looking for the never ending bullish market that they miss out on some massive opportunities when the market does move lower. When I look back over my trading career,

going back to 2002, I have by far made the most money on moves to the downside. Things escalate quicker on the downside because people tend to panic. This is a good thing as an options trader as it will allow us to make more money.

The way that we're able to make money when a stock or ETF moves lower is through the use of put options. **Just like a call option, a Put Option is still a contract between a buyer and a seller for a specific period of time. However, in this case, the buyer has the right, but not the obligation to sell 100 shares of stock at a specific price by a specific date. This has the effect of locking in the sales price for a period of time.**

If I buy a put option, I have the right to sell those 100 shares at that specific stock price. That's great news for the owner of a put option because if the market decides to make a move lower, then the put option is going to increase in value. Even though I bought that contract, it actually increases in value when the market moves lower. It gives us a tremendous amount of flexibility because now, I don't care which way the market goes. We can make money in bullish and bearish markets.

A lot of times traders use the insurance example when describing how a put options works. It works well because we are all very familiar with how the whole insurance process works. We all buy a homeowner's insurance policy or a car insurance policy as protection from a bad event happening. We want to protect ourselves from a flooded basement or a car accident. Buying that insurance gives us the peace of mind knowing any damages will be fixed for us without a big monetary loss. However, we also know that each day that passes that we don't have a house fire or we don't get in a car accident, we don't get that premium back. It's just a policy in place that can protect against catastrophic events.



Well, buying a put option is going to work the same way as an insurance policy in that it can protect a stock position from a big sell off. We are paying a small premium up front to lock in the sale price of our stock until a future date in time. Each day that what passes where the stock doesn't move lower, the put option loses a little bit of value. It can also gain value if we get a big directional move lower.

An insurance policy might seem like a waste of money because every single day or every month that you hold it and you don't use it, you don't get that money back. However, all it takes is one accident, one car accident, one house fire and you're going to be happy to have that insurance in place to fix the damages. That's the way the options work as well.

When we buy an option, we want the directional movement back and forth in the price of the stock or ETF. As the price of the stock or ETF is moving up and down the price of the option will also be moving. If we get the stock or ETF to move lower, then the price of the put option will also increase in value. As long as we sell the put option before it expires we don't ever have to trade the shares of stock if we don't want to.

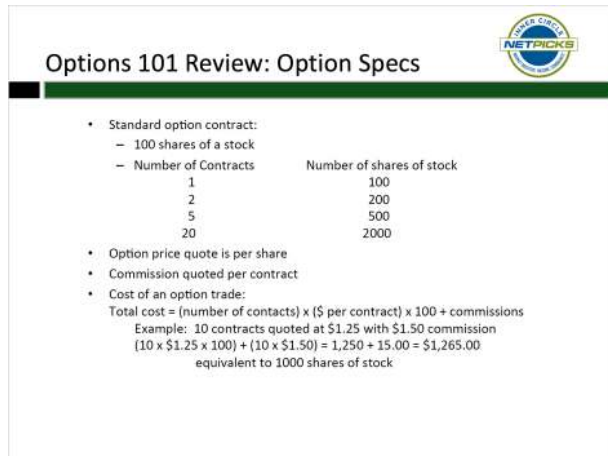
On the flip side, just like we said we could buy or sell the call option, we can do the same with the put options. ***If I decide to sell a put option, I have the obligation to buy 100 shares of stock at a specific price up until a specific date.*** So, the key point to remember as an options seller is that we have obligations. When you buy a put option, you have the right, but you don't have to sell the shares if you don't want to. If you sell a put and that directional move goes against you, you're going to have the

obligation to buy the shares of stock. We're going to talk more later how we can define that risk and put us in a safer position where we don't have to trade the shares of stock.

Anytime that we sell a put option, we're considered short the option, but it also means we are bullish on the price of the stock or ETF. Anytime that we sell a put, we want that stock to move to the upside. Whether it just be a naked put or if it's part of a vertical spread, we want that stock to move to the upside.

Options Contract Specs

We have a standard set of specs that we can use across the board with options. Every standard option is going to reflect 100 shares of stock. There are also mini options contracts that represent 10 shares of stock but I do not recommend that you trade those. The volume and open interest is not very good in many cases with the mini options.



Options 101 Review: Option Specs

- Standard option contract:
 - 100 shares of a stock
 - Number of Contracts Number of shares of stock

1	100
2	200
5	500
20	2000
- Option price quote is per share
- Commission quoted per contract
- Cost of an option trade:
Total cost = (number of contracts) x (\$ per contract) x 100 + commissions
Example: 10 contracts quoted at \$1.25 with \$1.50 commission
 $(10 \times \$1.25 \times 100) + (10 \times \$1.50) = 1,250 + 15.00 = \$1,265.00$
equivalent to 1000 shares of stock

You are going to find it far easier just to trade the standard options contracts which represent 100 shares of stock. Since each contract represents 100 shares, we must take that multiplier into account when determining how many shares we will control. If I come in and buy five contracts, that position is going to give me control of 500 shares of stock. If I buy 20 contracts that position will give me control of 2000 shares of stock. Knowing this multiplier will help give you a better understanding of the sizes of your options positions.

The option price is going to be quoted per share. If you look at an option trading for \$1, you've got to multiply it by 100. It's not going to cost \$1 to buy that option contract. It's going to cost \$100 to buy the contract.

The commission is also quoted per contract. Your total commission cost will depend on the broker that you're using. There can be different commission structures depending on your broker that you decided to go with, but they are all going to quote their commissions per contract.

Looking at the example in the screenshot above, if you're trying to buy 10 contracts quoted at \$1.25, and you're paying a \$1.50 commission per contract, then your total cost is going to be \$1,265. This options position would give you control of 1,000 shares of stock. As you can see when trading multiple contracts, you're going to have incredible leverage. That's why a lot of people get attracted to options.

The problem is, a lot of times, people utilize options in the wrong way. A lot of times, they try and structure their trades based on what they can afford instead of trying to make sure that the numbers and the statistics back up what they do. We will talk about how we use our criteria to identify the proper option to trade which will allow us to put better odds in our favor.

Strike Price

The strike price is the price at which the contract gives us control of the stock at. For example, if we are looking at XYZ stock trading at \$100 per share and we looked at the 95 call option the 95 is the strike price which we have control of the stock at. If XYZ stock goes to \$150 per share we have the right to buy 100 shares at \$95 per share.

Moneyness

An options **Moneyness** describes how far in or out of the money the position is. **At the Money (ATM)** is when the underlying price is equal to the strike price. An **In the Money (ITM)** call means the current price of the stock or ETF is greater than the agreed upon price in the contract. An **In the Money (ITM)** put means the current price of the stock or ETF is less than the agreed upon price in the contract.

An **Out of the Money (OTM)** call means the current price of the stock or ETF is less than the agreed upon price in the contract. An **Out of the Money (OTM)** put means the current price of the stock or ETF is greater than the agreed upon price in the contract. Moneyness, therefore is a measure of proximity to how in or out of the money the contract is.

Monthly & Weekly Options

When trading options we have access to both weekly and monthly options. The different length of the contracts can give us tremendous flexibility and we will use a combination of both in our trading. It just depends on the overall market environment. ***The monthly options will expire on the third Friday of every month. The weekly options will expire each Friday as the name suggests.*** You also have quarterly options and longer term leap options available as well but we don't use these options with our systems.

With the monthly options, we will typically trade the current month as well as 1 or 2 months out in the future. If you wanted to go out additional months you can but that is not something we do with the strategies that we teach.



Options 101 Review: Expiration

- **Monthly options**
 - expire on 3rd Friday of the month
 - Front month
 - Next month
 - plus about 6 out months
 - LEAPS®: Long-term Equity Anticipation Securities, longer term options expiring a year to up to 2 years and 8 months out
- **Weekly options, also called Weeklys, short-term or short-dated options**
 - Recent product first released for major indexes
 - First released for stocks in June 25, 2010: AAPL, BAC, BP, C
 - Listed on Thursday 8 days before expiration
 - More released each month
 - Available products: <http://www.cboe.com/micro/weeklys/availableweeklys.aspx>

One issue that you can run into with the weekly options is the lack of liquidity. When you compare the weekly vs the monthly options side-by-side, nine times out of 10, the monthly options are going to have more volume and open interest. Because of this, they are going to be easier for us to trade. We're going to be able to get in and out of trades faster and at better prices.

If you are trading multiple contracts, you are probably going to gravitate more towards the monthly options. They will be easier products to trade in many cases. However, that doesn't mean I won't ever trade the weeklies. I love to use them if market conditions are conducive. I will use more Weekly options if market volatility is high. If I look at my portfolio right now, I have a good mix of monthlies and weeklies. Building in that diversification can help produce more consistent returns over time.

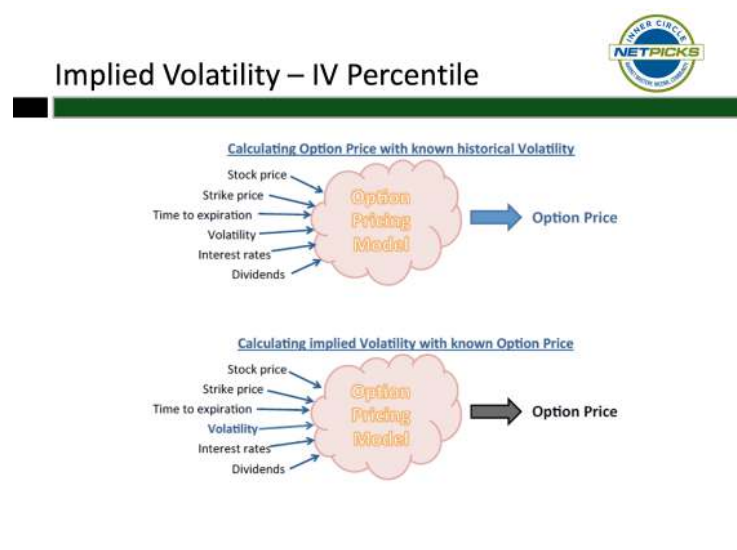
Most products that we trade will offer the weekly options. That doesn't mean that every weekly option is worth trading. There's going to be many stocks where you see the weekly options available but when you look at the volume and the open interest there's just not enough activity there. We will walk through some minimum volume and open interest requirements that look for later in the book.

Options Pricing Model

In many cases, traders will start trading options by buying calls and puts that are very far out of the money. They do this because the options are cheap. However, is this the best way to set yourself up for long term success? As we start to cover what factors can influence the price of an option, you will see that there are better strategies to use that will increase our performance.

It's a difficult lesson for many traders to learn initially and I had to learn it the hard way in my own trading years ago. There were cases in the past where I would buy a call option to put on a bullish trade but wouldn't make any money even when the trade moved in my direction. It made no sense to me initially until I realized there are more inputs that go into the pricing model of an option than just stock price.

In fact, there are six inputs that go into the pricing model of an option and you'll see them listed here. **You've got stock price, strike price, time to expiration, volatility, interest rates and dividends.** Out of these six inputs, five of them are very easily calculated. We can quickly see the stock price, strike price, time to expiration, interest rates and dividends. The one wild card input is volatility.



To figure out the volatility, the pricing model will work backwards. It takes the current price of that option, it backs out the five inputs that we already know, which will leave us with the 6th input or the volatility. It's known as the implied volatility of an option or IV. It's the level of volatility being used to give the current price of the option. It has a huge impact on the price of the option but is often overlooked by many traders. As a result, many traders are left without the consistent returns that they are looking for.

When we buy an option, ideally, we want the volatility to increase while we are in the trade. If it does, that will allow us to make more money on the trade. If I buy a call option and I get a directional move in my favor, but the volatility moves lower, that's going to zap a lot of my profit potential.

Volatility movement is a big reason why trading around earnings can be so difficult. A lot of times when earnings come out, the volatility gets crushed. If you buy an option in front of earnings, it's difficult to get a big enough directional move in the stock to overcome the volatility moving lower. Because of this, we teach our students to avoid earnings season all together.

When we start to talk about our strategy criteria in just a bit, there are ways that we can utilize the pricing model to increase our odds of success. When I start to pay attention to the levels of volatility, it can really help improve my performance long-term.

Out of the six inputs in the pricing model, there's three that will have a big impact on the way that we trade. ***The first is going to be the stock price.*** The directional move in the price of the stock will have a big influence on the outcome of many of our trades. ***The second input that we need to watch closely is the time to expiration.*** When we buy an option, we want the stock to move in our favor as quickly as possible. The faster the move happens in our favor, the more money we can make on the trade. If we are selling an option, then we get paid for each day that we hold the trade. Because of this, there are different options strategies that we can use to put the time to expiration in our favor. ***The third input that we watch closely is the volatility.*** As we mentioned earlier, the volatility movement can make or break your position. We like to buy options when volatility is low and sell options when volatility is high. We will talk about specific requirements that we look for in our trades later in the book.

“We like to buy options when volatility is low and sell options when volatility is high.”

Greeks

Now that we know there are 6 inputs that go into the pricing model of an option, how do we track how those inputs impact our trades over time? This is where the Greeks come in. The Greeks will help us understand how our trades will react to changing market conditions. Traders can get overwhelmed at this stage as the Greeks can get complex quickly. In fact, entire books are written on this topic. However, we don't need to have a master's degree in the pricing model to trade options successfully. Having a general understanding will benefit our trading, which is why we will cover the basics of the Greeks next. Let's start out with the Delta.

Delta

The Delta of an option is going to tell us how much the value of that option is going to change for every \$1 move in the price of the stock. For example, let's say we buy a call option with a Delta of 0.60. That tells us if a stock moves \$1, the option is going to move by \$.60. If you have a Delta of 0.40, that option is going to move \$.40 for every \$1 move in the stock.

The Delta will give us a feel for what we can expect during the life span of the trade. ***The call option will always have a Delta ranging between 0 and 1. Put options will have a negative Delta ranging from 0 to -1.***

The Delta of the call option increases in value as the stock moves up and decreases as the stock moves down. So, let's say we buy a long call option with a Delta of 0.60. This is telling us the option will change by \$.60 for every \$1 move in the stock. However, the Delta is not just going to stay right at 0.60. It is going to constantly be changing based on how the stock price is moving. We'll talk about that more in just a second when we get to Gamma.

The at the money options will always have a Delta close to +/- 0.50. When we get into our strategy criteria and we talk about wanting to get one to two strikes In the Money, it's nice to be able to quickly come in and find the At the Money option. Sure, we could just find a strike price that's closest to the stock price, but I can also look purely at the Delta. The Delta that's closest to +/- 0.50 is going to be the At the Money strike. Just a nice little shortcut for us to find the At the Money options.

The In the Money options will have a higher Delta, which means they react faster to movement in the stocks. For example, if I'm bullish on a stock and I'm trying to come in and buy a call option, why would I go one or two strikes In the Money? When I take a look at that option, it's going to be way more expensive. Why would I not just come out and buy a cheap Out of the Money option and tie up less capital?

We prefer the In the Money options, as they have a lot of factors working in their favor. If I look at a Delta of 0.60 versus a delta of 0.30, with a \$1 move in the stock price, the option with a Delta of 0.60 is going to give me more profit potential. It's going to move by \$.60, whereas the out of the money option is going to only react by \$.30. The Out of the Money options are also purely time decay. With the higher time decay it means we are paying more each day to hold the position. We will talk about time decay in more detail in just a second.

When trading the In the Money options, we can start using the pricing model of an option to increase our odds of success. Even though we're paying more for those options, we're getting what we pay for. They're higher quality options.

The Delta will also increase and decrease faster the closer we get to expiration. Earlier, we talked about using the weekly versus the monthly options. Why wouldn't we always trade the weekly options? Well, it's just a more aggressive play with the weeklies. If you have a strong directional outlook and you expect a big directional move coming, you're going to get more bang for your buck trading the weeklies. You're going to get a higher return if you get a directional move in your favor.

On the flip side, it comes with more risk because the Delta of the options start to react faster the closer we get to expiration. That can be a good thing or it can be a bad thing. If the market is in a very dull, slow environment where just things are taking longer to develop, you're going to be better off going out to the longer term monthly options. They're going to be safer play since the prices of the options will react slower the farther out in time that we go.

The At the Money options will always be closest to 0.50. In the Money options will have the delta above 0.50 and the Out of the Money options will have the delta below 0.50. With the put options the numbers will just be negative. The At the Money options is going to be closest to -0.50. In the Money, above -0.50. Out of the Money, below -0.50.

The Delta of an option will also give us the probability of that option finishing In the Money at expiration. If the option has a Delta of 0.60, that's telling me that the option has roughly a 60% chance of closing In the Money. When we get into our strategy criteria here later, you will see that we want to buy

an option that's one to two strikes In the Money. Oftentimes, that gives us a Delta between 0.6 and 0.65. That means the options have around 60% to 65% chance of closing in the money.

Options 101 Review: Greeks - Delta



1. Delta

- The delta of an option is a measurement that estimates how much an option premium will increase or decrease with every \$1 move in the underlying stock or index. Also known as the % change.
- Calls will have a positive delta ranging from 0 to 1
- Puts will have a negative delta ranging from 0 to -1
- The delta of a call increases in value as a stock moves up and decreases as the stock moves down.
- The delta of a put decreases as a stock moves up and increases as the stock moves down.
- ATM options will have a delta close to +/- .50
- ITM options will have a higher delta which means they react faster to the movement in the stock
- Delta will also increase and decrease faster as you get closer to expiration.

As you can see there are a lot of useful definitions of Delta. We can use the Delta in a lot of different ways to help us increase our profitability over time.

Gamma

Let's talk about Gamma next. Gamma is the second Greek that can be very beneficial to our trading. A lot of times, you will get into the training room and hear me say, "The gamma risk will increase the closer we get to expiration."

What does that mean?

An options Gamma is a measurement that estimates the rate of change in an options Delta for each dollar move in the underlying stock. When we talked about an option's Delta, I mentioned it represents how much that option value is going to change for every \$1 move in the stock. I also mentioned that the Delta will change as the price of the stock changes.

The rate of change of the Delta can be determined by looking at the Gamma. Using Gamma to our advantage is like throwing fuel on a fire. When you start a bonfire and you need it to take off quickly you can throw gasoline on it and it will explode. That's what Gamma will do for an options trade. It will cause a call or a put option to increase or decrease in value faster with every \$1 move in the price of the stock or ETF.

Gamma will increase the closer we get to expiration. Gamma risk increasing the closer we get to expiration can help or hurt us depending on our position. If we're in an options position that is underwater, the Gamma risk is going to help us. It will allow us to recover much faster if the stock or ETF

turns around and starts to move in our favor. If you're in an options position and that stock moves very quickly in your favor, the Gamma is going to help you make more money. The closer we get to expiration, everything starts to become more active for us because of the Gamma.

This is one reason why the weekly options can be so powerful. With the Gamma increasing the closer we get to expiration, we can see very large returns immediately. In fact, it can lead to big returns in a matter of hours. However, we don't always want the big Gamma. There are times when we want to be more conservative. If the market is moving slower, or if we are less certain on a big move coming, we will be better off using the longer term monthly options, as they will provide a trade that reacts slower to changes in stock price. This means we have less risk but with less profit potential. In some cases, we are ok with this trade off.

Gamma will also reflect the volatility of the stock. The higher the volatility, the lower the Gamma. This reflects the fact that a larger move on a volatile stock isn't as significant as a larger move on a slower stock. The markets know how to price this in. When we start to get higher volatility, or if we have a product that's more volatile, the Gamma is going to be less of an impact.

Greeks - Gamma



• 2. Gamma

- An option's gamma is a measurement that estimates the rate of change in an option's delta for each dollar move in the underlying stock.
- **The delta of the delta**
- **Buy an option = long gamma**
- **Sell an option = short gamma**
- **Gamma will reflect the volatility of the stock**
- **Higher volatility = lower gamma**
 - This reflects the fact that a larger move on a volatile stock isn't as significant as a larger move on a slower one.

Let's look at an example using XYZ stock which is trading at \$30 per share. The 30 strike call options are trading for \$1.50. Then the stock moves up \$1 to \$31 per share. After this \$1 move in the stock, we can see that the option increased in value from \$1.50 to \$2. The option increased by \$.50 which means the Delta on that \$1 move was 0.50.

We then take it a step further and see that the stock makes another \$1 move from \$31 to \$32. We again look at our call option and see it increased in value this time from \$2 to \$2.75. This means on that second \$1 move in the stock, the Delta was 0.75. On the first \$1 move, our Delta was 0.50. On the second \$1 move, the Delta was 0.75. The .25 difference between the two Delta values means the Gamma of these options was .25. The Gamma is showing us how quickly the options values can change as the price of the stock changes.

The key takeaway, is that Gamma is telling us the directional risk of our position and we know that it will increase the closer we get to expiration. We'll talk about that a lot in the training going forward.

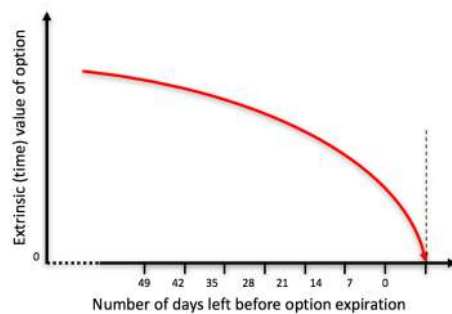
The Gamma is also going to be highest in the At the Money options. The further In the Money or Out of the Money an option moves, the more stable the Gamma becomes. This is another reason why we like to go further In the Money with the options that we buy.

Theta

The final Greek that we will talk about is the Theta. ***The Theta represents the time decay of the options.*** Remember in the beginning of the book we talked about an option being a contract that's in place for a set amount of time. Each day that we hold a long option position, it's going to lose a little bit of value. That can be measured by looking at the Theta. It's telling us how much premium is going to come out of that option for each day that we hold the position.

The key take away here with Theta is that it's not going to be the same for each option and it's not going to be the same each day. Time decay moves in a nonlinear fashion. It's best to see this looking at a graph. As you can see below, the graph tells us the closer we get to expiration, the curve will start to steepen. When I start to go out 50, 60 days there's still time decay however it does not have as big of an impact on the price of the options.

Time Decay



Look what happens during the last 7 to 14 days. See how this curve just starts to drop off a cliff? That can be a good thing or a bad thing depending on your position. If we're long on option, it's very dangerous. Once you start to get into the last two weeks, you're going to be paying a premium to hold that position because there's going to be more time decay that comes out of that trade each day it doesn't move in your favor.

If you sell an option, or when we start to talk about selling vertical spreads here in just a bit, that increased time decay can help us. The time decay picking up as we get closer to expiration is what we're trying to profit from.

I'm not one of those instructors that says we should sell options 100% of the time nor do I believe you should buy options 100% of the time. I think having a good mix of trades and taking what the market is giving us will lead to far better results over time.

The Theta, or the time decay, is always highest with the At the Money options. It will start to decrease the farther In the Money or Out of the Money that you go. This is another reason why we like to go a couple of strikes In the Money when buying our options. The farther In the Money that we go, the less impact that time decay will have on our position.



Greeks - Theta

3. Theta

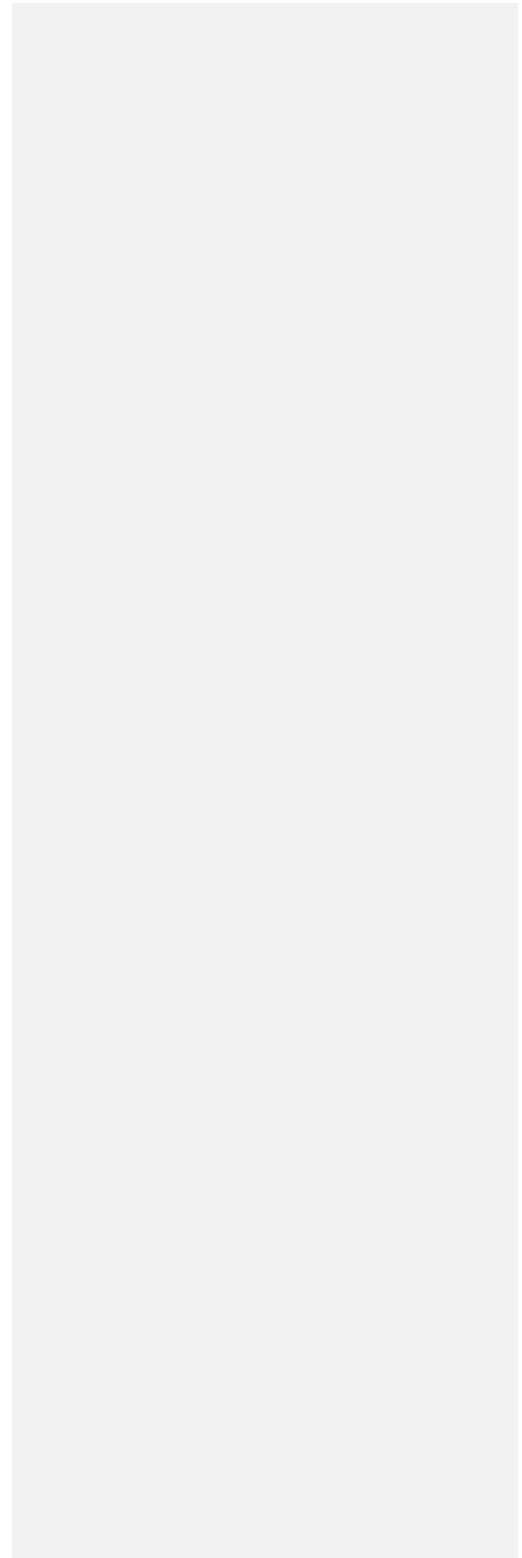
- A measure of time decay on an option with a one day change in time.
- Options have 2 values
 - Intrinsic value – does not decay
 - Extrinsic value – value over and above intrinsic value.
- Not the same for each option
- Not the same each day
 - Decay at a non-linear fashion
- Highest with the ATM option
- Decreases the further ITM or OTM you go
- Highest in the front month options
 - Decreases the further out in time that you go

When I start to show that time decay graph, a lot of times people say, ***"Why don't we just go out three or four months when buying our options? That way we can limit the effect of the time decay."*** Well, remember what we said about the Gamma. The Gamma tells us how quickly that option is going to change due to changes in stock price and it decreases the farther out in time that we go. If we go out three months, yes, the time decay is going to be less, but due to the Gamma the option is also going to react slower due to directional moves in the stock.

So, even though you're limiting the time decay, if you go out too far in time the option is not going to react quick enough to a quick change in the price of the stock. You are going to have a very small profit on your trade if you hit a quick target level. Knowing this, when we start to walk through the criteria that we look for in an option next, you will see that we like to look for between 20 and 40 days left to expiration. This will give us the best return on our trades while limiting our risk.

Greeks Take Away

Your success is not going to depend on your understanding of Delta, Gamma, and Theta, but having a general understanding of what they represent will give you more confidence when placing your trades on a daily basis. When I start to walk through the criteria that we look for in an option, you'll see that we're not just pulling these criteria out of the sky. We're taking the pricing model, and utilizing the inputs to our advantage to increase our odds of success long-term.



Options Playbook

Long Calls & Long Puts

Let's talk about how we can take these terms and definitions and apply them into how we select the best options to take our trades with. We will start with buying Long Calls and Long Puts. These are the most basic strategies that we teach, but just because they are basic doesn't mean they aren't powerful. If I look at my portfolio right now, I have many Long Call and Long Put positions. They are going to be positions that give us the most profit potential. Let's cover the Long Call side first.

If I buy a call option, I will have unlimited profit potential just like I do if I buy the shares of stock. The difference here is I have limited risk. When I buy a call option, I can't lose more than what I pay for that option.

Long Call



- Outlook: Bullish
- Duration: 1 day – 3 weeks
- Max Profit: Unlimited
- Max Loss: The amount paid for the call
- P/L Graph Listed Below



When I buy a call option, I must have a bullish outlook for that stock or ETF. Our duration on these trades is typically anywhere from one day on out to three weeks with the strategies that we use with the Inner Circle systems.

We're not looking to hold trades for months on end. When I buy a call option on Tesla, for example, I'm looking to hold that trade for maybe three to five days. What happens six months from now in Tesla, I couldn't care less. My outlook is very short-term with these trades.

Long Call & Long Put Criteria:

Step 1: Wait for our system to produce a valid setup that fits our trade plan.

This is true whether you are using any one of the Inner Circle trading systems or if you've got your own system in place. While this seems very basic, it is a big road block that many traders run into. They start placing trades without a plan of attack. We don't want to trade off emotion. I can't buy a call option unless the system gives me an actual setup. I've got to have the entry point, the targets, and the stop right there on the chart in real time. Otherwise, I can't go ahead and enter the position.

Step 2: Make sure the options on the stock have an open interest of at least 30x the number of contracts that you're looking to trade.

I've put 30x in here as our minimum requirement. However, I'd like to have that number closer to 100x. What I'm saying is if I'm looking to trade 10 contracts, I want to have at least 300 contracts of open interest.

If the options don't meet that criteria and I try to get filled on 10 contracts, it's going to be very difficult for me to execute the trade. The higher the volume and open interest, the easier it will be to execute the trade quickly and at good prices.

Step 3: Make sure we have target and exit points before entering the position.

This step is very similar to step one that we just discussed. If we don't have these levels in place, it's too easy to act off emotion. If we buy a call option and if we don't have a target or a stop in place, the minute that the trade starts to move against us, it's going to be instinct to just get out right away. I don't know too many traders that are very good at trading off emotion. The nice part about the Inner Circle is you've got systems in place that do give you the targets and the stops ahead of time. That takes a lot of the guesswork out of the equation and it allows us to have a rule set in place that we can stay disciplined to.

The only time I will exit out of a trade is when a target or stop level is touched on the chart. Until that happens, I must stay patient and trust the odds that the system will give us.

Step 4: Form an opinion on how long we feel the move in the stock is going to take.

With most of the NetPicks systems, our typical holding time is three to five days. The reason this is important is we want to make sure that there's enough time left before expiration for that stock move to happen in our favor.

Now, how do I do that?

When determining how much time we expect the stock move to take, we can use a few key tools. First, we like to use the same watch list over time as it will allow us to get familiar with how those products trade. I've traded names like Apple, Facebook, and SPY for years. I also like to keep a detailed trade journal where I document all the trades that I take. This allows me to track stats like P/L and average holding time. This can be beneficial when deciding which stocks and ETF's are moving well and also when deciding how long I expect a trade to take. I have a trade journal of literally hundreds of trades from each stock and ETF on my watch list. It's very easy for me to go back and see what my average holding time been on Apple or Facebook.

If you haven't traded those products or maybe you're newer to our systems, how do you get those numbers? You need a starting point. This is where your back test comes into play. It's crucial to go back and test the last three, four, or five months to look at the system trades to get a feel for the key statistics that we mentioned a few moments ago. We want to know our winning %, P/L, and average holding time. These can be very beneficial statistics to have when structuring your trade.

What you don't want to do is take a trade on a stock or ETF on our list with a weekly option when it has an average holding time of two weeks. That approach doesn't match up. You might like that weekly option with only four days left because it's cheap. The problem is it's cheap for a reason. There just isn't much time left before expiration. You're not going to have enough time for that trade to work out in your favor based on how that product trades historically.

Step 5: Make sure the options being traded have at least 2x the expected holding time left before expiration.

We then take our average holding time and make sure we have at least two times that expected holding time left before expiration. For example, if I know that my average holding time is three to five days, I want to make sure I have at least six to 10 days left to expiration on any option that I trade. I want to give myself a little bit of a cushion in case we get an outlier mover where the trade takes longer than anticipated. I might have a trade that completes in 24 hours or I might have a trade that takes three weeks. You don't know when you're going to get that outlier move so it's good to have a little buffer in there so the time decay doesn't hurt us too badly.

Step 6: Determine which option strike price is best for our trade.

In the training room, we really simplify Step 6. In most cases, we are going to be using the options that are 1-2 strikes In the Money. We can also use the Delta to identify the best option to take the trade with. We're looking for the option with a Delta between 0.6 and 0.65.

The benefit of going farther In the Money is we can start to limit the effect of the time decay. The Gamma is also not as significant the farther In the Money that we go. This way, we start to build in a few layers of safety. We can use the options pricing model that we talked about earlier to put better odds in our favor.

Why do I say one or two strikes In the Money? We will look at an example in just a second. The reason is to leave a little wiggle room there to account for liquidity. We want to make sure the option we are trading meets the criteria outlined in Step 2.

When deciding whether to go one or two strikes In the Money, in the grand scheme of things, it's not going to have a big impact on the P&L if you decide to go with one over the other. The difference there is one might clearly have better liquidity. It might have way more volume and open interest and if that's the case, that makes my decision easy. I always want to be trading the option contract that has the additional liquidity. That's going to allow me to get filled much faster and at better prices.

Step 7: Manage the trade according to the system's trade plan.

Notice, how when I outlined these criteria three of the seven steps are very similar and that's by design. When working with newer traders, one common issue that comes up is not being able to stay disciplined to their system or to their trade plan. The entry, stop, and target levels are there for a reason. They will guide us on where to get in and out of trades but they will only work if we stay discipline to our system on every trade.



Long Call Strategy Criteria

1. Wait for your system to produce a valid setup that fits your trade plan.
2. Make sure the options on your stock have an open interest of at least 30 times the number of contracts that you are looking to trade.
3. Make sure you have target points and exit points before entering the position.
4. You need to form an opinion on how long you feel the move in the stock is going to take.
 - Backtest
 - Get to know the stocks that you are trading



Long Call Strategy Criteria

5. Make sure you have 2x the amount of time that you expect to be in the position left before expiration
 6. Length of trade:
 - 1 week or less: delta of .50 (ATM) or .60-.65 (1 strike ITM)
 - 1-3 weeks: delta of .60-.65 (1 strike ITM)
 - More than a month: delta of .70-.75 (2 strikes ITM)
 - Short Cut: Look to buy the option that is 1-2 strikes in the money from the entry point on the chart.
 7. Manage the trade according to your trade plan.
-

Long Call Example - NFLX

Let's bring this trade check list together by looking at a trade example. The nice part about having the checklist is once you learn the set of mechanics, you can use it on any system that we have at NetPicks. The criteria is always the same.

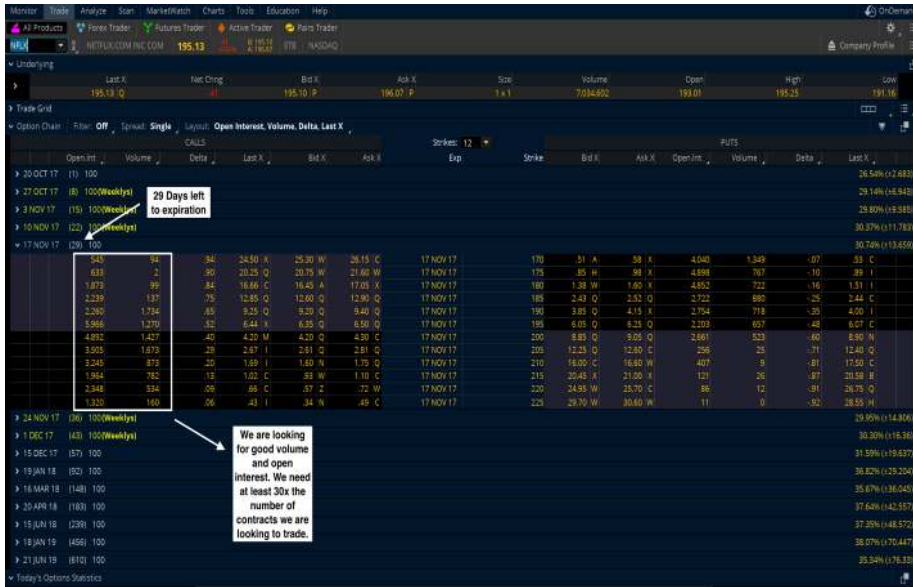
For this example, we will use Netflix (Symbol: NFLX). As you can see on the chart below, we have a long trade setting up using our Options Fast Track Reversal system. **The setup dots on the chart show us the entry at \$197.32, target 1 at 201.72, target 2 at 204.01 and the stop at 190.28.** Going back to our check list, we must make sure we have a valid setup with entry, target, and stop levels before ever considering a trade. We have all of that outlined for us on the chart so we are set to go.



Even though we haven't hit that entry point, I can still begin the process of identifying the best call option to take the trade with once it does trigger into the trade. I can use the trade details that we just talked about to pinpoint the best option for this trade.

Looking at the trade page below, you can see all the different options that we have available to us in the November monthly options. You will also notice in the Volume and Open Interest columns that there is plenty of liquidity in these options. Remember, we need 30x the number of contracts in open interest for the option that we are looking to trade. If we are looking to trade 5 call options, we need at least 150 contracts of open interest. This won't be a problem with the NFLX options.

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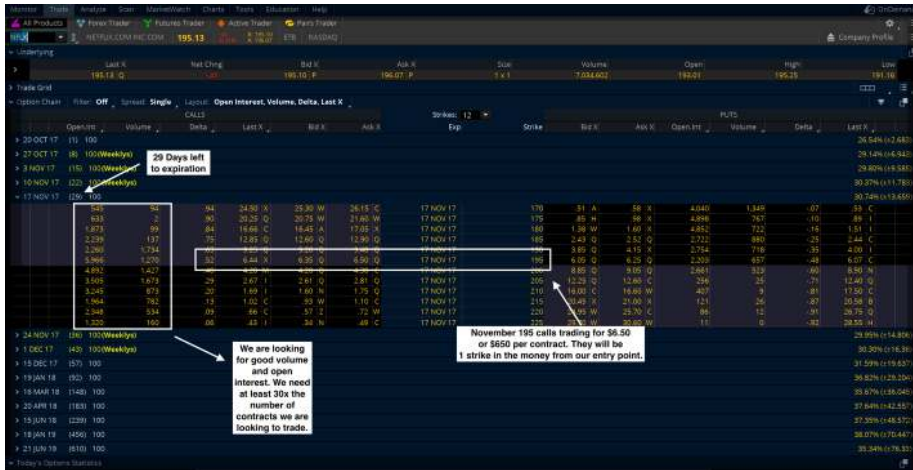


Trades on NFLX typically complete in three to five days. With this in mind, I want to make sure that I have around 10 days left to expiration. The November options have 29 days left to expiration which is more than enough time for this trade to complete. Ideally, having 20 to 40 days is perfect in most cases.

Could I trade a Weekly option in this example? I wouldn't be opposed to it, but in this case, I like the November monthly options better because of the slow market conditions that we have been dealing with for most of this year. Trades are taking longer to complete and volumes have also been low. Using the monthly options will give us more time for the trade to complete without the time decay hurting us too badly. They will also allow us to get in and out of the trade quicker and at better prices when compared to the weekly options.

In many cases, I lean towards the monthly options because I know they are going to be easier for me to trade, especially if I'm using multiple contracts. If you're looking to trade a few contracts on NFLX, you're not going to have any issue trading the weeklies. There's plenty of liquidity in the options to trade small size.

Now that we have settled in on the November monthly options, we need to determine which strike price is best for us. We know the entry point is at \$197.32 on the chart. Going back to our checklist, we know we need to get 1-2 strikes In the Money from this entry point or find the option with the Delta between .60-.65. Remember, we need the entry point to be touched before we initiate the trade. We are only trying to prep the trade at this point. Once the entry point is hit, the 195 calls will get us slightly In the Money (the strike price is slightly below the entry price). While the Delta is only at .52 right now, once the entry point is hit it will most likely be right in our sweet spot between .60-.65.



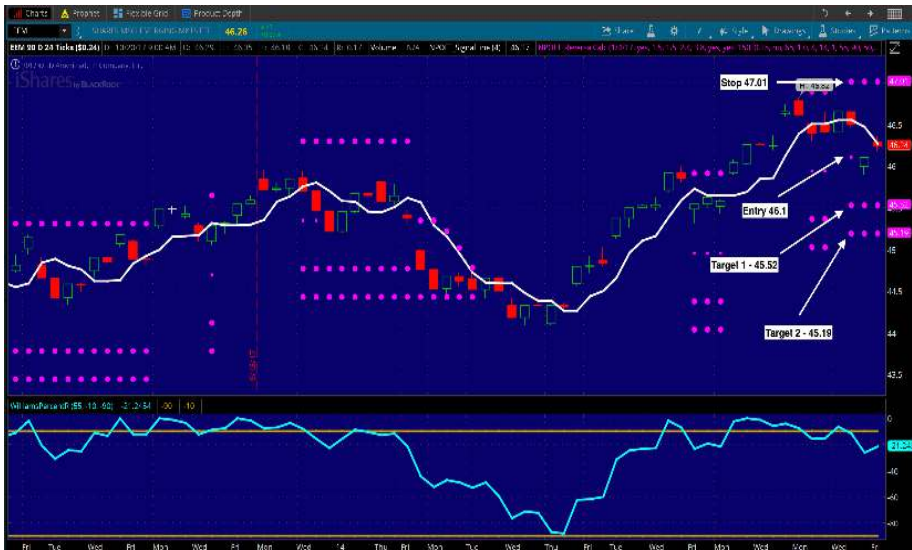
The 195 calls are currently trading for around \$6.50 or \$650 per contract. They have 5,966 contracts of open interest and on the current session shown in the screen shot 1270 contracts have been traded. This is plenty of liquidity for use to get filled quickly on a trade and at a good price.

All I need to do is create my order to buy the November 195 monthly calls once the entry point is hit on the chart. Once we trigger into the trade, our focus shifts to the target and stop levels that are also on the chart. This gives us a road map to follow from start to finish on the trade. We have criteria that we can stay disciplined to instead of placing and managing the trade based off emotions. The last step in the process is to manage the trade to completion following the trade plan.

I've taken the criteria that we just got done talking about and structured the trade from start to finish. If you do this in real time on your own, you're going to be able to go through the steps in 30 - 60 seconds. It's a very simple process because we have our checklist to follow.

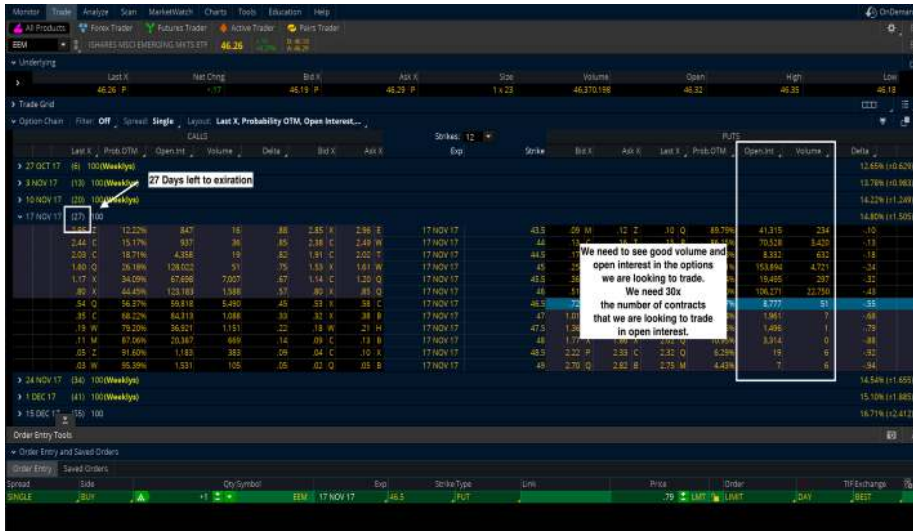
Long Put Example - EEM

Now let's look at a bearish position using the Long Put. For this example, we will use the Emerging Markets ETF (Symbol: EEM). As you can see on the chart below, we have a short trade setting up using our Options Fast Track Reversal system. **The setup dots on the chart show us the entry at \$46.1, target 1 at 45.52, target 2 at 45.19 and the stop at 47.01.** Going back to our check list, we must make sure we have a valid setup with entry, target, and stop levels before ever considering a trade. We have all of that outlined for us on the chart so we are set to go.



Even though we haven't hit that entry point, I can still begin the process of identifying the best put option to take the trade with once it does trigger into the trade. I can use the trade details that we just talked about to pinpoint the best option for this trade.

Looking at the trade page below, you can see all the different options that we have available to us in the November monthly options. You will also notice in the Volume and Open Interest columns that there is plenty of liquidity in these options. Remember, we need 30x the number of contracts in open interest for the option that we are looking to trade. If we are looking to trade 5 call options, we need at least 150 contracts of open interest. This won't be a problem with the XLE options.



Trades on EEM typically complete in 5 to 10 days. With this in mind, I want to make sure that I have around 10 days left to expiration. The November options have 27 days left to expiration with the which is more than enough time for this trade to complete. Ideally, having 20 to 40 days is perfect in most cases.

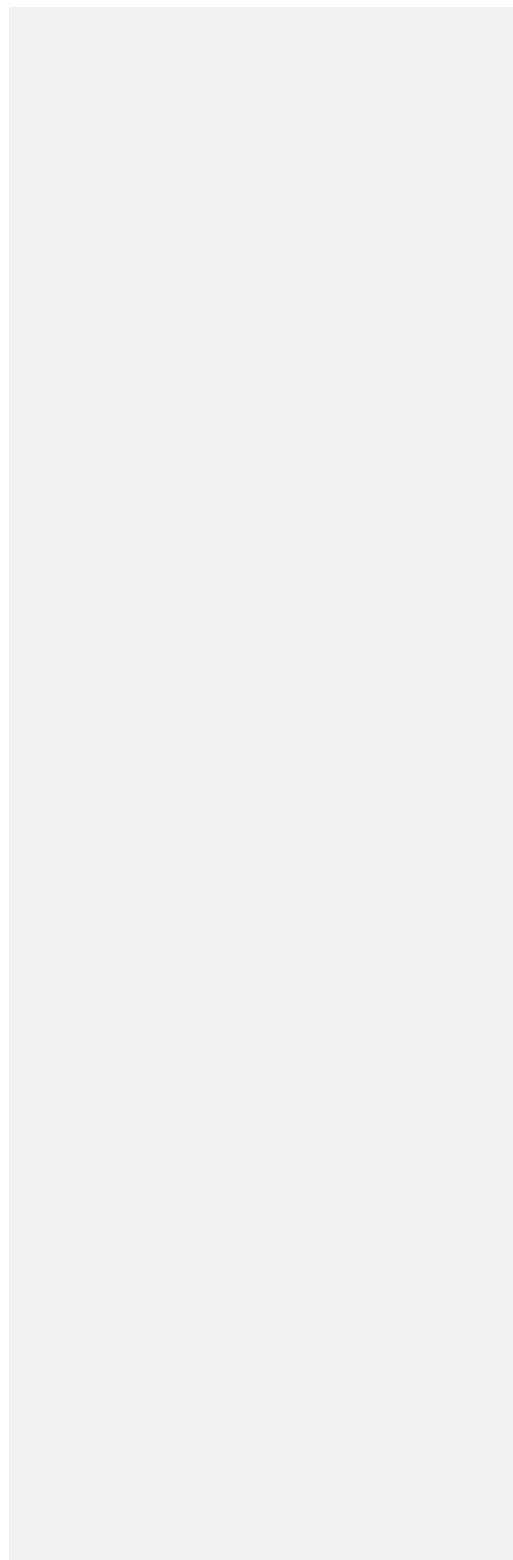
Could I trade a Weekly option in this example? I wouldn't be opposed to it, but in this case, I like the November monthly options better because of the slow market conditions that we have been dealing with for most of this year. Trades are taking longer to complete and volumes have also been low. Using the monthly options will give us more time for the trade to complete without the time decay hurting us too badly. They will also allow us to get in and out of the trade quicker and at better prices when compared to the weekly options.

In many cases, I lean towards the monthly options because I know they are going to be easier for me to trade, especially if I'm using multiple contracts. If you're looking to trade a few contracts on EEM, you're not going to have any issue trading the weeklies. There's plenty of liquidity in the options to trade small size.

Now that we have settled in on the November monthly options, we need to determine which strike price is best for us. We know the entry point is at \$46.1 on the chart. Going back to our checklist, we know we need to get 1-2 strikes In the Money from this entry point or find the option with the Delta between .60-.65. Remember, we need the entry point to be touched before we initiate the trade. We are only trying to prep the trade at this point. Once the entry point is hit, the 46.5 puts will get us slightly In the Money (the strike price is slightly above the entry price).

The 46.5 puts are currently trading around \$.79 or \$79 per contract. They have 8,777 contracts of open interest and on the current session shown in the screen shot 51 contracts have been traded. This is plenty of liquidity for use to get filled quickly on a trade and at a good price.

All I need to do is create my order to buy the November 46.5 monthly puts once the entry point is hit on the chart. Once we trigger into the trade, our focus shifts to the target and stop levels that are also on the chart. This gives us a road map to follow from start to finish on the trade. We have criteria that we can stay disciplined to instead of placing and managing the trade based off emotions. The last step in the process is to manage the trade to completion following the trade plan.



Vertical Spreads

Let's go back to the Netflix trade that we just got done walking through. The call option that we were looking at was trading for \$650 per contract. At \$650 per contract to control 100 shares of a \$195 stock it's still great leverage, but it might be too high of a risk if you have a small account size. Having \$650 tied up in one position might be too high. What I don't want you to do is to immediately throw Netflix out the window and ignore it as a trading product because there are other strategies that we can use to lower the cost of the trade.

Let's talk about how we can do that with a Vertical Spread. For those of you that are new to options trading, starting out with the long calls and long puts is great way to go. That's the foundation for all other trades that we use going forward. After you master the Long Call and Put strategies, the next step is learning the Vertical Spread. If all you ever did is learn the Long Call, Long Put and the Vertical Spread strategies, you're going to be setup nicely for long term success. It will give you a good toolbox of strategies that you can use in many different market conditions.

Anytime that somebody starts out, a lot of times they'll say, "I only want to learn the Long Call and Long Put strategies. I just want to keep it very basic." What I always do with students is challenge them to add the Vertical Spread as quickly as possible. The reason for that, it's just going to give you tremendous flexibility on the risk side, which we're going to talk about right now.

Don't let the names of these trades like a Vertical Spread or a Bull Call Spread, a Bear Put Spread intimidate you because when we start to break it down, these are very basic trades. When I start to talk about a Vertical Spread, all we're doing is buying an option at one strike price and we're selling an option at another strike price. We're trading two options at the same time.

Why would we trade a spread?

Because a spread is going to allow you to reduce the cost of the trade, which in return is going to allow us to reduce the risk on the trade. In many cases, utilizing the spread with our criteria, we're able to reduce our cost by 30% to 50%. ***The definition of a vertical spread is purchasing one call or a put at a given strike, within a given expiration cycle, and selling a different strike call or put with the same expiration cycle.***

If you're using the October monthly options for a Vertical Spread, you will use the same October monthly options for both options. You're not going to mix up the expiration cycles.

Let's go ahead and talk about the strategy criteria in more detail. The easiest way to start talking about a Vertical Spread is to look at a trade example. We will go back to XYZ stock for this example. Let's say XYZ stock is trading at \$40 per share. We expect the stock to move higher and want to put on a bullish trade.

Looking at the trade page we see the 40 call trading for \$3. In seeing the \$3 price per contract, I don't mind paying \$300 to buy the call option but would love to reduce the cost if possible. I also see there is a 45 call that's selling for \$1. I can sell that call option and collect a dollar. By buying the 40 call for \$3 and selling the 45 call for \$1 I'm able to lower my total cost to \$2. I'm putting this trade on all at once using the same monthly expiration cycle for both contracts.

In this case, we have the right to buy 100 shares at 40, but we're also selling the 45 call. We would be obligated to sell 100 shares at 45. Our maximum profit is limited to the difference between the long and

the short strikes minus the debit paid. In our example here, we had a \$5 wide difference between the strike prices (difference between the 45 call and 40 call). We paid \$2 to put this trade on. So, we take that \$5 wide difference, subtract the \$2 which leaves our maximum risk on the trade at \$3 per spread.

Isn't selling options too risky?

This is a question that I get all the time from newer traders. When selling options as part of a Vertical Spread it leaves you with an extremely safe position. It's just like buying a call or a put. We can't lose any more than what we paid for that position. This is why the Vertical Spread is a popular strategy for many experienced options traders.

The main difference between buying a Call Spread and buying a Long Call, is that I give up my unlimited profit potential when using the Call Spread. If I buy a Long Call as long as that stock moves higher, I can make money. When I buy a Call Spread, my maximum profit is realized right at my short strike. So, if I sell the 45 call and the stock goes all the way up to \$60, once it reaches \$45, I really can't make any more money on the trade. I'm realizing as much profit as possible on that trade at that point.

In many cases, that's a fair trade off. I'm giving up the unlimited profit potential, but in return, I get lower risk. That's why I love this strategy. There's times when I don't want to be as aggressive. I don't want to just buy the Call or the Put. I've been utilizing the Long Call Spreads a lot this year due to the extreme overbought conditions that we have seen. I don't want to get aggressive buying Calls because this move is already extended. I want to be more conservative and the Call Spreads allow me to do that. I can still trade the move to the upside, but in doing so, I'm able to keep the lower risk on my trades.

The max loss again is limited to whatever we paid for the trade. Our breakeven point on the trade is the long strike, plus the \$2 debit that we paid to put the trade on. This puts our breakeven point at \$42.

When do we use this trade? When we're bullish and we want to lower the cost, when we want to define risk position, or when we feel the volatility is low. If we're not expecting a quick move, then the spread is a good way to go.

Where do we want that stock or ETF to finish? We want the stock or ETF to be right at or above the short strike. Since we sold the 45 call, ideally, I would love to have that stock or ETF go right to 45 and just settle in right there. That's where I would make the most money on the trade.

How does volatility impact the Vertical Spread? As we mentioned earlier, volatility is a huge input in the pricing model of an option. Anytime that you buy an option, whether it be buying a call or a put or buying a vertical spread, you want the volatility to go higher, or at the very least, not go lower. When we're long on option and the volatility decreases, it will hurt our position. If the volatility increases, it's going to help us make more money quicker.

Can we use a Vertical Spread for a bearish trade?

Let's also talk about how we can use a Vertical Spread to trade the market moving lower. We can place a bearish Vertical Spread utilizing the put options. If XYZ is trading at \$40, we could come in and buy the 40 put for \$3. At the same time, we could also sell the 35 put for \$1. That would bring our cost down to \$2 for the Vertical Spread. If all I did was buy the Long Put, I would be paying \$3 per contract. However, by using the Put Spread, I'm able to lower my cost to \$2. That's a 33% decrease in my cost which is a nice little savings.

Our profit when buying a Vertical Put Spread is limited to the difference between the strikes minus the debit being paid to buy the trade. In our case, there's a \$5 wide difference between the strikes. We're paying \$2 to put this trade on. So, we subtract the \$2 that we paid to buy the spread which leaves us with a maximum profit of \$3. We still have a nice profit potential on the trade if this stock moves to the downside but we do give up the unlimited profit potential that we would have if we only bought the Long Put.

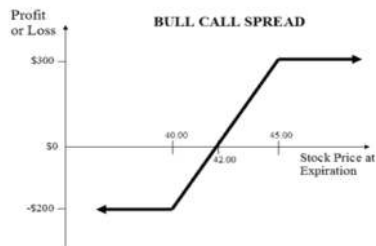
If XYZ stock makes a big move lower, I don't get to profit on any price action lower than my short strike. In our case, we sold the 35 put option as part of the spread. Let's say the stock goes down to \$20 per share. I don't get to profit from any price action below \$35. In return, I have a trade with limited risk which is a fair trade off in many cases.

When do we want to use the Long Put Spread? When we're bearish on a stock or ETF and we want to lower the cost of the trade. Keep in mind, we are limiting our profit potential but we are also defining our risk.

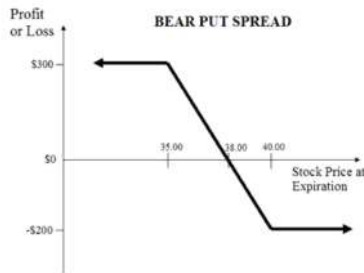
Where do we want that stock or ETF to finish? We want the stock or ETF to be right at or below the short strike. Since we sold the 35 put, ideally, I would love to have that stock or ETF go right to 35 and just settle in right there. That's where I would make the most money on the trade.

How does volatility impact the Vertical Spread? As we mentioned earlier, volatility is a huge input in the pricing model of an option. Anytime that you buy an option, whether it be buying a call or a put or buying a vertical spread, you want the volatility to go higher, or at the very least, not go lower. When we're long on option and the volatility decreases, it will hurt our position. If the volatility increases, it's going to help us make more money quicker. There's another P&L graph just showing you the limited profit potential with the defined risk as well.

Long Vertical Call Spread – P/L Graph



Long Vertical Put Spread – P/L Graph



What criteria do we use when buying a vertical spread?

The nice part about having a defined rule set that we use for each strategy is that we can use that rule set on any stock or ETF that we are trading. Whenever I buy a Vertical Spread, whether it be a Call Spread or a Put Spread, the criteria is the same. ***We will always buy the option that is 1 strike In the Money from the entry point on the chart and sell the option that has a strike price closest to the second target on our chart.*** That's the criteria that we use every time.

How much time do we look for before expiration? Ideally, we'd like to see between 20 and 40 days left to expiration, but even more so than that, I'm ok if we have 2x our average holding time left before expiration. Let's talk about this in more detail by looking at an example.

Let's use Google (Symbol: GOOGL) for a Long Put Spread example. Using our Options Fast Track Reversal system, we can see that we have a short trade setting up for us at \$994.36. Our full second target on this trade is at \$971.03. That second target is crucial because it's going to help us structure the Vertical Spread. If all we did is buy the long put, we were talking about buying the 1000 put option for \$9.00. It gets us one strike In the Money. It has good volume and open interest. The only downside to that is we're talking about \$900 per contract, which is very expensive. Let's see if we can reduce the risk by using a Put Spread instead.



We already determined earlier that that 1000 put option is one strike in the money once we hit the entry point on our chart. Instead of buying the 1000 put by itself, I also want to sell the strike that's closest to the second target on the chart which is at \$971.03. The closest strike price to the second target on our chart is the 970 put. This means I will be buying the 1000 put and selling the 970 put at the same time leaving me with the 1000/970 long put spread.

Open Int	Volume	Delta	Last X	Bid X	Strike	Ask X	Open Int	Volume	Delta	Last X
30 OCT 17 (0)	100				1000					
27 OCT 17 (7)	100				1000					
3 NOV 17 (14)	100				1000					
10 NOV 17 (21)	100				1000					
17 NOV 17 (28)	100				1000					
24 NOV 17 (35)	100				1000					
1 DEC 17 (42)	100				1000					
15 JAN 18 (49)	100				1000					

Strike	Bid X	Ask X	Open Int	Volume	Delta	Last X
970	15.20	16.00	244	35	-28	13.23 W
980	15.20	16.00	412	0	-33	15.43 C
990	16.40	16.70	1,163	266	-39	18.40 X
1000	25.10	25.20	232	27	-46	23.83 C
1010	31.00	31.00	97	0	-51	26.11 C
1020	33.60	33.70	14	1	-59	26.40 H
1030	39.80	40.80	26	0	-67	26.30 C
1040	42.80	44.00	3	0	-65	26.50 C
1050	46.30	47.40	59	0	-68	26.10 W
1060	51.40	51.40	0	0	-70	0
1070	56.40	56.40	31	0	-78	25.30 W

Annotations on the table:
 - '28 Days Left to Expiration' points to the 17 NOV 17 row.
 - 'The 970 put is the closest strike to target 2 on our chart. We will sell this option as part of our spread.' points to the 970 strike row.
 - '1000 puts are 1 strike in the money. We will buy this option as part of our spread.' points to the 1000 strike row.

In this case, I would be able to buy the spread for \$11.50 or \$1150 per spread. If this trade was triggering in right now, the put spread would lower my cost from \$2400 (for the long put only) all the way down to \$1150. *That gives me a savings of \$1250 or close to a 50% savings when compared to buy the long put.* The Long Put Spread can be much more realistic for traders with smaller account sizes as it can open trade opportunities on higher priced stocks.

The beauty here is that both trades are bearish positions. They both want that stock to move lower. We still use the same money management rules that we talk about in the system training. When I hit first target, then I move my stop to breakeven. I do that for the Long Put and the Long Put Spread. The big difference is that we're in a lower risk type of a trade with the spread.

The Profit and Loss potential on these trades will also be different. The Long Put will give us more profit potential but also come with more risk. The Long Put Spread will cut our risk but also leave us with a lower profit potential. There is no right or wrong answer on which strategy is best. It all depends on what your outlook is for that stock or ETF and how much risk you feel comfortable taking. If you think a quick move is coming and you want the bigger profit potential then the Long Put will be the way to go. If you are less certain on market movement and want to be more conservative then the Long Put Spread is best.

Many times, I will use the vertical spreads on the higher price stocks, names like Tesla and Amazon and Google. I like the spreads because I can lower my cost by 30% to 50%. That's a significant savings and allows me to manage my risk a lot easier.

Many times, I will use the vertical spreads on the higher price stocks, names like Tesla and Amazon and Google. I like the spreads because I can lower my cost by 30% to 50%.

For example, let's say I'm trading Amazon and Citigroup. I want to keep my dollar risk similar between those the two positions. I'm willing to risk \$2,500 per trade. Using \$2,500 per position might have me trading one or two contracts on Amazon but 10 contracts on Citigroup. It's not always easy to get filled on bigger position sizes on some of the smaller stocks and ETF's which is necessary when keeping the risk similar across all position. By using the spreads on the higher price stocks, it allows me to keep my position sizes similar across the different stocks and ETF's on my list.

The vertical spreads also tend to be more conservative trades. Some of those high flyers like Amazon, Google, and Tesla can be volatile. By using the spread, it's one way for me to lessen the impact of the volatility on these products.

By having access to this bigger toolbox of options strategies, there's more than we can do depending on our outlook for the market and depending on our risk tolerance. Maybe trading Long Calls and Puts on a stock like Facebook is not realistic at \$460 per trade but \$200 per trade for a Vertical Spread is doable. You can open your universe of stocks and ETF's considerably when trading the Long Vertical Spreads.

Advanced Options Strategies

For those of you that are just getting started with options, I would recommend taking a pause at this point in the book. The strategies that we've talked about so far are going to be your starting point. The Long Calls, Long Puts, the Long Vertical Spreads are going to give you a lot of flexibility to get started with.

Once you master those strategies, then you can consider adding some of the more advanced strategies that we will be talking about next. Once you start to get some trades under your belt and see for example how a vertical spread works, then the advanced strategies will come much easier for you.

What I don't want people to do is try and master everything before they jump in and start taking trades. The best way to learn is to review a video or review a document that has the criteria outlined for you and then put that criteria into practice. The faster you can put this into practice, even if it's on a demo account, you will find that the criteria is going to sink in much faster.

When we start talking about advanced strategies, we don't want you to get intimidated by the terminology. These strategies aren't overly complex if you have a feel for the basics first. We will be building off that foundation that we laid with the earlier strategies.



We will talk about one of these advanced strategies next and that is selling a Vertical Spread to open a position. These are known as Credit Spreads. So far, we've talked about buying options to open our trades. Anytime that we buy an option, the time decay is working against us. We need those directional moves to work in our favor quickly. If they don't happen quick enough, we're in trouble. The time decay will start to eat away at any profit potential that we have.

Instead of watching that time decay hurt us, we can also put it in our favor. Instead of buying a Vertical Spread to open a trade, we can also sell a Vertical Spread. For example, if I look to buy the Put Spread on Facebook that we talked about earlier, for me to be able to buy that Put Spread, there must be somebody else on the other side of the trade. There's got to be somebody else out there that's willing to sell me that spread.

We're always going to be able to buy or sell the Vertical Spread. The long Vertical Spreads are great for your directional trades. They profit when the market goes in your direction. The problem with these trades is they only profit in one of three possible market moves. If I buy that Put Spread on Facebook, the only way I make money is if Facebook moves to the downside. ***However, if I sell a Vertical Spread, the difference is I have the potential to make money in 5 different ways.*** This allows us to increase our probability of success on each trade. I'll walk you through that in just a second.

With multiple ways of making money on each trade, we don't need everything to line up perfectly like we do when we buy an option. The Debit Spreads will give you a lower probability of success, but a higher potential return. Your win rate with a Debit Spread is going to be lower in most cases, but you're also going to have higher returns on your winning trades. That can be a fair trade off in many cases.

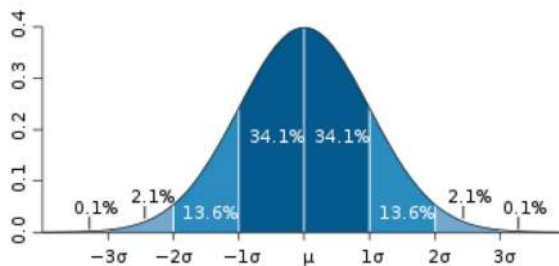
The Credit Spreads will give you a higher probability of success, but a lower potential return. I use the Credit Spreads quite often when I'm a little less certain on market direction or when I'm willing to give up the home run potential in return for having multiple ways of making money.

The Credit Spreads are great to use if the market is moving slower where we're not getting near the big swings back and forth. If we're not getting the big follow-through, putting that time decay in your favor is one way to grind out a profit in a very slow market environment.

The Bell Curve

Why do Credit Spreads work so well? If you have ever taken a statistics class in the past, you have heard the Bell Curve being discussed. While it can be applied in many different areas, the Bell Curve can be especially helpful in the trading world. It will tell us the probability of an event outcome falling within a certain range. Essentially it will tell us how often the movement of a stock or ETF will stay inside of a defined range and how often we will see the big directional moves.

Standard Deviation - Bell Curve



When looking at the Bell Curve above you will see the dark blue center section of the curve. That's telling us 68.2% of all occurrences are going to fall inside of this range. As we start to go farther out on the curve to one standard deviation, two standard deviations, three standard deviations, that's telling us that we still have the tail risk of a big directional move happening. There's still a chance of an outlier move happening, either on the upside or the downside.

In the current market that we are working with, where this market moving higher every day, there are many stocks and ETF's that are at two or three standard deviation moves. What that's telling me is if we start to go out two or three standard deviations, there's only a 2% chance or less, of that event happening. When we see that type of price action it can influence what type of options strategies we use going forward with our trades. We can use the statistics to increase our results over time.

My takeaway is if I know that 68.2% of the time all occurrences are going to fall inside of this range, I can start to use different strategies to benefit from those numbers. When I sell an option or if I sell a spread, I'm looking to make money from that stock staying inside of that range, which it should do 68.2% of the time. I'm changing my whole thought process of how I approach a trade. Instead of looking for the big directional move like I would be doing if buying an option, when I sell a spread, I'm looking for the stock to stay inside of a quiet range. In doing so, I take the pressure off needing to pick market direction as I can make money if the stock or ETF moves up, down, or sideways inside of our defined range.

If I'm anticipating a slower market move or I'm a little less certain on market direction, the credit spreads are going to be better strategies to use. They will give me a higher winning percentage long-term since I have multiple ways of making money with these trades.

This is not even scratching the surface of how the Bell Curve works. We could go on and on talking about standard deviations and what these statistics really mean. I'm trying to keep this as simple as possible. Remember, I don't want to over-complicate things. I want to give you a set of mechanics that you can use but also show you that there is a reason why we have outlined the criteria the way that we have. I'm looking to put the statistics in our favor. We aren't just guessing which options will be best for us to use. We have looked at the statistics to help us squeeze as much profit out of the market while limiting our risk at the same time.

When should I use the Credit Spread vs the Debit Spread?

Debit Spreads are ideal strategies to use when you have a strong directional opinion on that stock or ETF. They will give you a higher profit potential if you get that big move quickly. The Debit Spread is one of my favorite strategies as they can produce some nice results while leaving me with much less risk.

You'll typically buy the Debit Spread when the volatility is low. When the volatility is low, we know that the prices of the options are cheap. It goes back to the buy low, sell high mentality. If I buy an option when it's cheap, it will leave us with more profit potential while tying up less capital when buying placing the trade.

It's ideal to have high volatility when selling a Credit Spread because when volatility is high, the prices of the options are more expensive. Anytime you sell a product, whether it be a car, a house, a stock, or an option, we always want to collect as much money upfront as possible, right?

The same goes for a spread. When the volatility is high and the prices of the options are expensive, that's going to allow us to collect more money up front. This can leave us with more profit potential. We can certainly sell spreads when volatility is low, but as you will see in a minute that you won't have as many factors lining up in your favor.

Do we have to have high volatility to sell a premium? You can certainly sell spreads in low volatility. Just realize that you don't get the benefit of the volatility contracting. In this case, we're betting strictly on the time decay and the potential directional move. If we sell an option or if we sell a spread in low volatility, we essentially go from having five ways of making money down to four. We give up one way of making money.



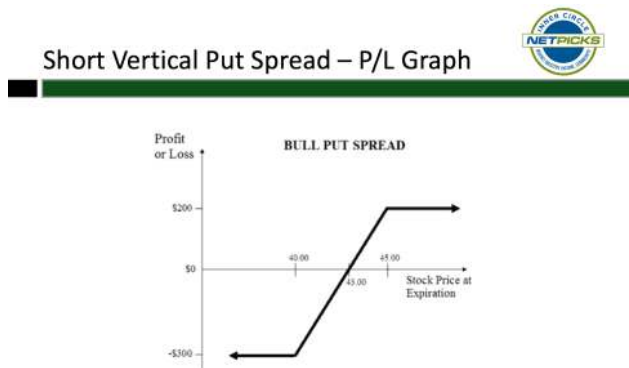
It's not the end of the world. It's just it's not the perfect scenario where everything is lining up in our favor. When selling low volatility, you won't have as much wiggle room if the trade moves against you. The breakeven point will be closer to the current stock price. When the volatility is low like it is now, we can still sell options, but in order to collect enough premium, we will have to move our short strike closer to the current stock price. When we do that, we don't have as much room to be wrong and still make money. Selling high volatility is ideal for us because we can get that breakeven point far away from the current stock price. That just improves our odds of success long-term.

When selling a Credit Spread, we are looking for a higher probability of success which also comes with a lower profit potential. This scenario is ideal if you're a little less certain on the overall direction move and would like multiple ways of making money on the trade. They can be great trades for grinding out a profit in a slow market environment.

The best way to learn a Credit Spread is to see it in action. Let's look at selling a Put Spread first.

Bullish: Selling A Put Spread

Earlier we talked about buying a Call or a Call Spread if we wanted to put on a bullish trade. **However, there is a third way we can initiate a bullish position. That is by selling a Put Spread to open a trade.** In many cases using Put Options means we are looking for a move to the downside. In this case, selling a Put Spread will leave us in a bullish position. We will still have profit potential to the upside but with defined profit potential and defined risk.



All we're doing is we're flip flopping everything we have talked about so far. Instead of being the buyer of an option, we're becoming the seller of an option. Once we walk through an example, you'll see why that can be so powerful.

For our example, we will use GLD which is the Gold ETF on our watch list. Looking at the chart of GLD below I have determined that I want to have a bullish trade on. However, I'm not convinced that the move higher will happen immediately so I would rather be in a conservative trade.



In many cases, we like to use the monthly options as they typically have more volume and open interest. This will make it easier for us to get in and out of the trades quickly and at good prices. In this example, we will use the November monthly options which have 27 days left to expiration.

When selling a Vertical Spread, the whole goal of the trade is for it to expire worthless. If it does we will be left with a full profit. With this in mind, we like to use Out of the Money options that have a low probability of closing In the Money. ***We want to sell a spread where we can collect between 30-40% of the width of the strikes.*** For example, if we are looking at a \$1 wide spread we would like to sell the spread for between \$.30-\$.40.

Looking at the GLD trade page, I decided to sell the 121/120 put spread. This has me selling the 121 put for \$1.02 per contract and at the same time we will be buying the 120 put for \$.66 per contract to make sure we are in a risk defined trade. In total, we will collect \$.36 or \$36 per spread (\$1.023-\$.66).

Underlying	Last X	Net Chng	Bid X	Ask X	Size	Volume	Open	High	Low
SPDR GOLD TR GOLD SHS ETF	121.61 P	-0.18	121.28 P	122.95 P	2 x 1	8,481,162	121.68	121.98	121.39

Option Chain	Filter: Off	Spread: Single	Layout: Last X, Probability OTM, Open Interest...	Strikes: 12	PUTS										
Last X	Prob.OTM	Open Int.	Volume	Delta	Bid X	Ask X	Last X	Prob.OTM	Open Int.	Volume	Delta				
> 27 OCT 17 (6) 100(weekly)											11.34% (+1,517)				
> 3 NOV 17 (3) 100(weekly)											11.85% (+2,247)				
> 10 NOV 17 (20) 100(weekly)											11.23% (+2,613)				
> 17 NOV 17 (27) 100											11.46% (+3,268)				
5.91 Q	9.26%	186	90	91	-5.80 X	5.95 M	17 NOV 17	116	-11 W	-12 Z	-12 W	92.56%	2,517	927	-07
5.05 A	12.01%	513	61	68	-4.85 X	5.00 X	17 NOV 17	117	-7 W	-18 Z	-17 Z	69.66%	2,152	5,488	-10
4.14 Q	16.70%	696	44	64	-3.95 X	4.10 X	17 NOV 17	118	-26 W	-27 Z	-27 I	65.02%	3,261	1,027	-14
3.20 C	22.20%	181	63	76	-3.00 X	3.20 M	17 NOV 17	119	-41 W	-42 Z	-39 I	78.19%	4,187	4,933	-21
2.44 I	31.73%	2,699	204	69	-2.38 W	2.42 W	17 NOV 17	120	-45 W	-44 Z	-43 W	88.34%	3,348	5,592	-36
1.83 Q	41.51%	3,558	1,204	56	-1.75 Q	1.77 C	17 NOV 17	121	-1.00 W	-1.00 H	-99 Q	57.73%	7,845	1,622	-41
1.31 X	53.91%	3,105	2,825	47	-1.24 Z	1.26 Z	17 NOV 17	122	-1.51 Z	-1.53 Z	-1.43 C	46.99%	5,896	3,395	-53
.87 I	64.73%	9,406	1,823	36	-86 Z	87 Z	17 NOV 17	123	-2.13 Z	-2.15 Q	-2.07 C	35.00%	5,352	188	-64
.60 Q	73.80%	4,827	3,321	27	-59 Z	61 W	17 NOV 17	124	-2.86 W	-2.89 Q	-2.89 W	25.73%	3,696	217	-74
.42 Q	80.80%	29,907	2,283	20	-41 Z	42 W	17 NOV 17	125	-3.83 X	-3.75 X	-3.66 C	18.53%	6,483	158	-81
.30 P	88.54%	10,464	1,460	15	-29 Z	30 Z	17 NOV 17	126	-4.55 M	-4.55 X	-4.56 Q	13.76%	10,118	30	-86
.22 I	89.71%	18,217	1,809	11	-21 Z	22 W	17 NOV 17	127	-5.45 X	-5.55 C	-5.63 B	8.27%	6,565	44	-91
> 34 NOV 17 (34) 100(weekly)											11.06% (+3,324)				
> 1 DEC 17 (41) 100(weekly)											11.07% (+3,615)				
> 15 DEC 17 (51) 100											12.09% (+4,336)				

The \$36 we collect when selling the spread is the most we can make on the trade. We are risking \$64 per spread to put the trade on. The max risk is calculated by taking the difference between the strikes (\$1) minus the \$.36 credit that we are receiving for selling the spread. This will leave me with close to a 2:1 risk to reward ratio. While this doesn't seem attractive initially, we are ok with the ratio since we have 5 different ways of making money on the trade.

Order Confirmation Dialog	
Order Description	SELL -1 VERTICAL GLD 100 17 NOV 17 121/120 PUT @.36 LMT [TO OPEN/TO OPEN]
Break Even Stock Prices	120.64
Max Profit	\$36.00
Max Loss	\$64.00 (not including possible dividend risk)
Cost of Trade including commissions	credit \$36.00 - \$3.00 = credit \$33.00
Buying Power Effect	(\$67.00)
Resulting Buying Power for Stock	\$78,416.68
Resulting Buying Power for Options	\$35,202.18
Single Account	Account: 86*****74 (Rysco12) <input type="checkbox"/> Save last used mode
Note for this order	<input type="checkbox"/> Share order

Our breakeven point on this trade is at \$120.64. This is calculated by taking our short strike (121 put) and subtracting the \$.36 credit that we are receiving for putting on the trade. We don't care if GLD moves up, down, or sideways as long as price closed above \$120.64 over the next 27 days we can make money on the trade. We also make money for each day that we hold the trade from the time decay as well as from volatility decreasing. This gives us 5 different ways of making money on the trade.

Even though we are bullish on GLD, price can move \$1 lower against me and I will still make money on the Short Put Spread. This takes much of the pressure off needing to be perfect on the timing and the direction of the trade. I can be dead wrong on direction and still make money. When I start to put all these factors working in my favor, it is why am I willing to risk two to make one.

Make sure when you sell vertical spreads, that you are trading liquid products because if I can't get filled here on GLD at \$.36 and I have to adjust this price down to let's say \$.30, it makes an impact on my P&L. I go from having \$36 of potential profit down to \$30. That's a big difference. Giving up \$.06 per trade can add up to big number after dozens of trades over the course of a year. Whenever we're selling a spread, we want to collect as much as we can right up front.



Short Vertical Spread Criteria

1. Make sure implied volatility is higher than the 50th percentile (using TOS)
2. Use the front month if there is at least 20 days left to expiration. If not then go to the next month out.
3. We will select the spread where we can collect around 35-40% of the width of the spread.
 - \$10 wide spread: Want to collect around \$3.50
 - \$1 wide spread: \$.35
4. Once in the trade we will look to exit when we can keep 50-75% of the potential gain. Exit the trade no later than Wednesday of expiration week if still in the position at that time.

Strike	Prob	OTM	Open Int	Volume	Delta	Bid	Ask	Exp
142.71	21.10%	3,740	194	-80	5.47	1	9.56	17 NOV 17
143.00	24.52%	17,531	265	-77	5.82	0	9.68	17 NOV 17
143.50	28.44%	18,219	565	-73	4.77	0	4.83	17 NOV 17
144.00	33.17%	41,940	886	-65	2.97	0	4.01	17 NOV 17
144.50	38.74%	21,400	1,115	-63	3.35	0	3.34	17 NOV 17
145.00	43.30%	43,880	1,754	-56	3.50	0	2.52	17 NOV 17
145.50	52.85%	77,540	14,283	-48	1.87	0	1.89	17 NOV 17
146.00	61.39%	83,766	3,977	-40	1.32	0	1.35	17 NOV 17
146.50	69.67%	14,819	976	-31	0.89	0	0.91	17 NOV 17
147.00	77.81%	46,895	6,218	-23	0.56	0	0.58	17 NOV 17
147.50	84.84%	17,510	486	-16	0.33	0	0.33	17 NOV 17
148.00	91.07%	8,809	401	-10	0.19	0	0.21	17 NOV 17

The \$43 we collect when selling the spread is the most we can make on the trade. We are risking \$57 per spread to put the trade on. The max risk is calculated by taking the difference between the strikes (\$1) minus the \$.43 credit that are receiving for selling the spread. This will leave me with between a 1:1 and 2:1 risk to reward ratio. While this doesn't seem attractive initially, we are ok with the ratio since we have 5 different ways of making money on the trade.

Field	Value
Order Description	SELL -1 VERTICAL QQQ 100 17 NOV 17 150/151 CALL @.43 LMT [TO OPEN/TO OPEN]
Break Even Stock Prices	150.43
Max Profit	\$43.00
Max Loss	\$57.00 (not including possible dividend risk)
Cost of Trade including commissions	credit \$43.00 - \$3.00 = credit \$40.00
Buying Power Effect	(\$60.00)
Resulting Buying Power for Stock	\$78,430.68
Resulting Buying Power for Options	\$35,209.18

Our breakeven point on this trade is at \$150.43. This is calculated by taking our short strike (150 call) and adding the \$.43 credit that we are receiving for putting on the trade. We don't care if QQQ moves up, down, or sideways as long as price closed below \$150.43 over the next 27 days we can make money on the trade. We also make money for each day that we hold the trade from the time decay as well as from volatility decreasing. This gives us 5 different ways of making money on the trade.

Even though we are bearish on QQQ, price can move \$1.70 higher against me and I will still make money on the Short Call Spread. This takes much of the pressure off needing to be perfect on the timing and the

direction of the trade. I can be dead wrong on direction and still make money. When I start to put all these factors working in my favor, it is why am I willing to risk two to make one.

Make sure when you sell vertical spreads, that you are trading liquid products because if I can't get filled on QQQ at \$.43 and I have to adjust this price down to let's say \$.38, it makes an impact on my P&L. I go from having \$43 of potential profit down to \$38. That's a big difference. Giving up \$.05 per trade can add up to big number after dozens of trades over the course of a year. Whenever we're selling a spread, we want to collect as much as we can right up front.



Short Vertical Spread Criteria

1. Make sure implied volatility is higher than the 50th percentile (using TOS)
2. Use the front month if there is at least 20 days left to expiration. If not then go to the next month out.
3. We will select the spread where we can collect around 35-40% of the width of the spread.
 - \$10 wide spread: Want to collect around \$3.50
 - \$1 wide spread: \$.35
4. Once in the trade we will look to exit when we can keep 50-75% of the potential gain. Exit the trade no later than Wednesday of expiration week if still in the position at that time.

Is the Short Vertical Spread the perfect strategy?

Why wouldn't I sell a spread all the time? With 5 ways of making money it seems too good to be true.

Remember, we have max profit potential of \$36 per spread on the GLD trade. If GLD makes a large move higher, the most we can make on the trade is \$36. We give up the home run potential in return for the many ways of making money. In certain market conditions, I'm more than ok with this trade off.

Could I buy a call option and sell a few put spreads at the same time? I'm not opposed to this approach. We'll talk about this in the training room going forward. I'm not opposed to putting on multiple different types of trades on the same stock or ETF. Buying a Long Call will give me unlimited profit potential on a small part of my trade. If I also sell a few Put Spreads they will give me a lower profit potential but many ways of making money just in case we don't get a quick move higher. This can be a powerful combination and a great way to implement more diversification into your trading.

Many times, people teach diversification just by mixing up the products that you trade and that's a big part of it. However, I also like to take that a step further. I like to have a diversified list of options strategies being used. For those of you that are part of the Weekly Options Express, we had a phenomenal stretch back in mid to late summer. We had a stretch there where we're just winning week after winning week.

The last two and a half weeks or so, it's been a struggle. This market has been completely one directional. We've been in a very low volatility environment, so selling the Vertical Spreads have not done well. If all I was doing was selling those spreads it would have been a rough few weeks.

What's neat is that during that same stretch, my long option positions with the Options Fast Track and the Options Academy programs have done really well. I'm not just loading the boat with one strategy. Now, I'm getting a mix of strategies in there that benefit from different types of markets. Ultimately, no one knows what the market is going to do next. We all have opinions on what we think is going to happen, but that doesn't guarantee it will happen. Having a good mix of strategies in place will give me a better overall equity curve long term.

Vertical Spread Trade Management

When selling Vertical Spreads using our criteria, we don't have a defined stop and target stock price in place ahead of time. We have rules that guide how we manage the trades from start to finish but they are rules based on the value of the options and not the stock price. First, we have the option to hold these trades to expiration. If it goes to expiration and stays above or below our breakeven point (above our breakeven point on the short put spreads and below our breakeven point on the short call spreads), then we can then keep the entire premium that was collected and take the full profit. ***However, our initial target is between 50% and 75% of our maximum profit potential.*** For example, if I collect \$.43 to sell the QQQ call spread then I will look to close it out when I can buy it back for .11-.22. That would allow me to keep between 50% and 75% of the premium collected to put the trade on.

The thought process behind closing the trade out with 50-75% of max profit is we can book that profit ahead of time and avoid the increased Gamma the closer we get to expiration. We don't want to have a trade that's moving well in our favor for the first 20 days of the trade and then 5 days before expiration it turns around and moves against us. We could potentially go from a nice profit to an immediate loss. Instead, I would rather book the partial profit and free up the capital for the next trade.

Which Strategy Should You Use?

There is no perfect options strategy for all market conditions. Your strategy selection will depend on your outlook for that stock or ETF and your risk tolerance. If you're strongly bullish, the Long Calls are the way to go. They will give you the most profit potential but will also come with more risk.

If you want to be a little bit more conservative, a Long Call Spread is our way of reducing that cost by 30% to 50%. The Short Put Spread could also be a good choice if you are willing to sacrifice the home run potential in return for the higher winning percentage and lower risk.

If you're moderately bullish, I like to go with either the Long Call Spread or the Short Put Spread. Those have been the way to go for me as I have been very cautious on the upside lately. I've been trading a lot of Long Call Spreads, just as my way of getting more conservative given the overall overbought nature of the market.

If you're strongly bearish, the Long Puts are the way to go. They will give you the most profit potential but will also come with more risk.

If you want to be a little bit more conservative, a Long Put Spread is our way of reducing that cost by 30% to 50%. The Short Call Spread could also be a good choice if you are willing to sacrifice the home run potential in return for the higher winning percentage and lower risk.

If you're moderately bearish, I like to go with either the Long Put Spread or the Short Call Spread. They will leave you with bearish positions but will do so with far less risk.

Options 101 Q&A

Question: "Can you place order in advance for the targets and stops?"

Answer: You can use Conditional Orders which will allow you to create an order to close out of an options position if a specific stock price is hit. I'm not going to be able to get into this topic today as it's beyond the scope of this training. It's not anything too difficult. There's a training video on the owner's site that will walk you through how to use these orders inside of the Thinkorswim platform.

If your broker doesn't support conditional orders then we like to set price alerts around the target and stop levels to notify us when it's time to come in and manage the trades. These alerts can pop up on your computer or sent as an email or text message to a mobile device. This way we don't have to be stuck in front of the computer all day long waiting to manage a trade.

Question: "Can you buy long calls and puts and vertical spreads with standard margin at TD Ameritrade?"

Answer: If you will be trading Long Calls and Puts only then you can get away with a cash account with your broker. If you would like to trade the spreads then you will need a margin account. Some brokers have different tiers that they place their traders in. Make sure you communicate with your broker to let them know you would like to trade Long Call and Put options as well as Vertical Spreads to make sure they place you in the right tier.

Question: "How long do you usually keep your GTC order working or how long do you wait for them to fill before you cancel the orders?"

Answer: I want to make sure I get in as close to that entry point as possible. Let's say I placed the order and I don't get filled. I don't want to just jump in at any price. I want to get filled as close to the entry price on the chart as possible and ideally at the mid-price between the option's bid and ask prices.

If I place my order and I don't get filled right away, I can always adjust the price of the order. If I'm trying to buy a call option I can adjust my price up and be willing to pay more. By adjusting that price up, I'm going to increase my odds of getting filled quicker. If I'm trying to sell an option and I don't get filled right away then I can always adjust my price down and accept less for the option.

I don't want to adjust my orders right away. I don't want to give up some on that price if I don't have to. Ideally, I'd like to get filled as close to the mid-price as possible.

I prefer to use Day orders as that is a way to prevent mistakes from happening. I find with GTC orders it's easy for me to forget about an order that is in place. Using day orders forces me to come in and review things each day.

Question: "Are we making money on the increase in value of the option only, not on the actual purchase or sale of the underlying stock?"

Answer: We are not actually trading the shares of stock at all. The nice part about options trading is we don't ever have to touch the shares of stock. We can just trade the option back and forth. The value of the options will change as the price of the stock or ETF changes so we will watch price closely. We just don't want to tie up all the capital trading the shares of stock so we stick with the options.

Question: "Would you consider doubling your options on a vertical spread over a standard call or put option?"

Answer: You could definitely do this. It just depends on your outlook for that product. I would do that if I wanted to be in a slower moving trade where the options are going to react slower to change and stock price. Vertical Spreads will always move slower than the trading the Long Calls and Puts.

Just know that there are pros and cons of that. Trading multiple Vertical Spreads is going to result in higher commission costs. I always tell people, there's no perfect position. There's no perfect position that works for everybody all the time. We all might look at our GLD trade and it might be split 50/50, where some people might like the Long Call and others might like the Long Call Spread. For me, it doesn't matter. We're all going to be in bullish positions on GLD if the trade triggers in. It just depends on how much risk you feel comfortable taking.

Question: "Is the Call Spread the same as a Strangle or an Iron Condor?"

Answer: No, it's not. An Iron Condor is selling a Call Spread and a Put Spread at the same time. It's just taking things one step further and instead of expecting a directional move, you're essentially creating a profit window that you expect that stock to stay inside of. That's how we make money. I love iron condors but we're just not going to have time to get to that strategy here today. We can certainly cover it in the live training room down the road.

Question: "If you're short options are at the money at expiration, do you have to close out of the trade or will it be handled?"

Answer: As long as that short spread is out of the money, you can let the whole thing expire worthless. If there's doubt at all, you'll want to close that trade out even though you're going to have to pay the commission to close out of the trade. I would hate to have you try to hold the expiration and then suddenly have that trade turn against you and go from a winner to a loser.

Conclusion

Hopefully, you found this guide helpful. We covered the main strategies that we teach inside of the option programs that are part of the NetPicks Options Blueprint program. I'm not expecting you to understand all this information the first time through. If it takes you a couple of weeks to review the material, start to track some trades live, get into the live training room, that's perfectly fine.

Remember, we're trying to set you up for long-term success. This is not a get rich quick scheme. We're trying to set ourselves up for years of consistent returns. So certainly, ask questions along the way. We're here to make sure you're successful with the system.

If you have any questions along the way, feel free to send me an email directly. My email is mike@netpicks.com. My direct phone number is 269-978-0971. Reach out with any questions or comments that you have and I'll be in touch right away to help with any of those issues.

