Trading Strategy

Profits Run

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Objectives

- Why trading options can be less risky and more profitable than trading stocks
- How to select the best options for swing trading directional markets
- How to determine the best optionable stocks and ETFs
- How to identify deliberately trading markets
- When to stand aside
- How to diversify your trades by Sector
- Why swing trading the markets with options using powerful but simple risk management techniques avoids being subject to massive market sell offs
- Expectations – It is not possible to buy every low and sell every high
- Why the over-arching goal is trade the best setups, not every setup

Objectives: Understand why trading options can be less risky and more profitable than trading stocks; How to select the best options for swing-trading directional markets; How to determine the best optionable stocks and ETFs. And how to identify deliberately trading markets, very important concept for any kind of trading. When to stand aside, another important concept. How to diversify your trades by sector. Why swing trading the markets with options using powerful but simple risk management techniques avoids being subject to massive market sell-offs, like we have already seen two or three times in the past decade.

Expectations: This is really important. It is not possible to buy every low and sell every high. Or win on every trade. But thankfully it is not necessary to do very, very well, as you will see. And then why the overarching goal is to trade the best setups not every setup. You can't trade them all anyways so why not limit your trading to the very best.

Options vs Stocks and ETFs

- Buying Options is less risky than buying the underlying security (stocks or ETFs)
- Options provide significant leverage that allows you to control 100 shares per option with a fraction of the margin that would be required for 100 shares of stock
- You must limit your option position size using good risk management principles to avoid over-leveraging
- Using options, smaller accounts can better diversify with more opportunities than would otherwise be possible trading the stock or ETF directly
- With options, you have more time to be right without taking on more risk – this enables you to achieve a high percentage of winners vs trading stocks or ETFs directly

Okay, so let's get into it. Options vs stocks and ETFs. Buying options is less risky than buying the underlying security. Plain and simple, because your risk is limited to the debit you paid for the option. So no matter what the market does, you cannot lose more than the relatively small debit that you paid. Options provide significant leverage that allows you to control 100 shares per options with a fraction of the margin that would be required for 100 shares of stock.

Now, in order to take advantage of the leverage that options have to offer, and this is really important, you must limit your option position size using good risk management principles to avoid over-leveraging. This is where most people go astray, and we are going to show you exactly how to do that. Using options, smaller accounts can better diversify with more opportunities than would otherwise be possible trading the stock or ETF directly. And then this one is a really big deal as well, with options, you have more

time to be right without taking on more risk. This enables you to achieve a high percentage of winners vs trading stocks or ETFs directly.

The Best Options for Swing Trading

- We want to trade only liquid high delta options
- 1 or 2 strikes In-The-Money
- 90 to 60 days until expiration
- Open Interest > 100
- Narrow bid ask spreads
- Low implied volatility

Okay, the best options for swing-trading. Well it's fairly simple. From all the options available out there at a given time for any given stock or ETF there are hundreds, we want to trade only liquid high-delta options, that are 1 or 2 strikes In-The-Money, 90-60 days until expiration, with an option interest greater than 100. In doing so we should be able to achieve narrow bid ask spreads which is important because we don't want to be paying too much to get into an option and then to get out of it. And then also options with low implied volatility because we don't want to be paying too much for the time value associated with options.

Trade Duration

- When buying monthly calls or puts it is best to aim for minor trend moves that can last anywhere from a week to several weeks
- Trades that are still open on the 1st trading day of the expiration month will be rolled forward into a more distant option month to minimize Theta decay
- Trading options this way is very simple to do with minimum trade management requirements

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Trade duration: Now when buying monthly calls or puts it is best to aim for minor trend moves that can last anywhere from a week to several weeks. These are the kinds of moves that have the potential to deliver triple digit gains over and over again. Now Trades that are still open on the 1st trading day of the expiration month will be rolled forward into a more distant option month to minimize Theta decay. You don’t want to hold your option position into expiration, which is the third Friday of the expiration month, because you will incur too much Theta decay which is the time value of the option eroding rapidly in those last couple of weeks. So you want to roll forward into the next month that meets the options selection criteria that we just talked about. And I will go through an example in a moment on how to do that. So, trading options this way is very simple to do with minimum trade management requirements.

Rolling Forward

- If a position is still open on the 1st trading day of the expiration month, roll forward to the next month that meets the option selection criteria
- STC the current position and at the same time BTO the new option month at the same strike price as the original position
- This order will be placed as a spread order and will be a debit order

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Okay, rolling forward. If a position is still open on the expiration month, roll forward to the next month that meets the option selection criteria. So, what you would do is sell to close the current position and at the same time buy to open the new option month at the same strike price as the original position. And, you would do this by placing this order as a spread order, which will be a debit order.

Rolling Forward

- For example, let's say you were long a June 40 Call option from $3.00 and the current price was $5.00 on June 1st and the next month out that meets the option selection criteria was a July 40 Call with a current price of $5.50
- You would place a spread order to STC June 40 Call and BTO July 40 Call at a net debit of $0.50
- By doing this you are maintaining your long position via the July call option that will avoid the theta decay that the June option position would have suffered

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For example, let's say you were long a June 40 Call option from $3.00 and the current price was $5.00 on June 1st and the next month out that meets the option selection criteria was a July 40 Call with a current price of $5.50. So, you would place a spread order to sell to close the June 40 Call and buy to open the July 40 Call at a net debit of $0.50, the difference between the price of the option you are selling and the price of the option you are buying. By doing this you are maintaining your long position via the July Call option that will avoid the Theta decay that the June option position would have suffered. Now on a rare occasion a trade may last long enough where you may have to roll forward again. But if that were the case you are probably making a lot of money on that trade and you wouldn't mind rolling forward again to make even more money.

The Best Stocks and ETFs to Trade

- There are thousands to choose from – you can't trade them all – so why not focus on the best?
- Criteria: Optionable, Daily Volume > 500,000, Price > 10, Beta > 1.3, Deliberate Price Action
- Applying this criteria will give you a Master List of the safest, highest probability list of stocks and ETFs
- Must refresh the Master List periodically

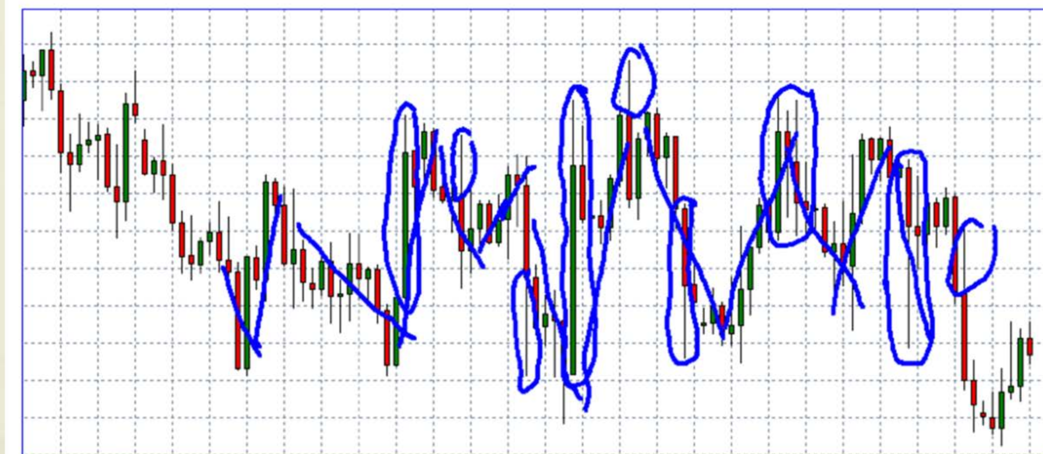
The best stocks and ETFs to trade: Now, there are thousands to choose from, you can't trade them all, so why not focus on the best. So here are the criteria; it is very simple but very powerful. The stocks or ETFs must be optionable, of course, daily volume of the stock or ETF greater than 500,000, the price greater than 10 and the beta greater than 1.3. Now the beta measures the volatility of the stock or ETF vs. the general market. So let's say if the S&P 500 goes up 10% over a period of time, a beta of 1.3 would have the stock generally going up 13%. So the stock or ETF would move more up or down than the general market. And that's what we want we want price movement. And then lastly, deliberate price action which is very important and we will go over than in a moment. Applying these criteria will give you a master list of the safest, highest, probability list of stocks and ETFs this is your first line of defensive before you ever place a trade. You've automatically put the odds in your favor when you do this. Now you must refresh the master list periodically because the behavior of stocks and ETFs will change.

Deliberately Trading Markets

- Stocks and ETFs that trade in a deliberate fashion are the safest and offer the best profit opportunities
- A deliberate market is one in which the daily price action (The True Range) does not exhibit unusually wide range bars or large gaps in price from day to day or choppy erratic sideways action
- When a stock or ETF is trading in a non-deliberate fashion do not trade its option until it begins trading deliberately for at least two weeks

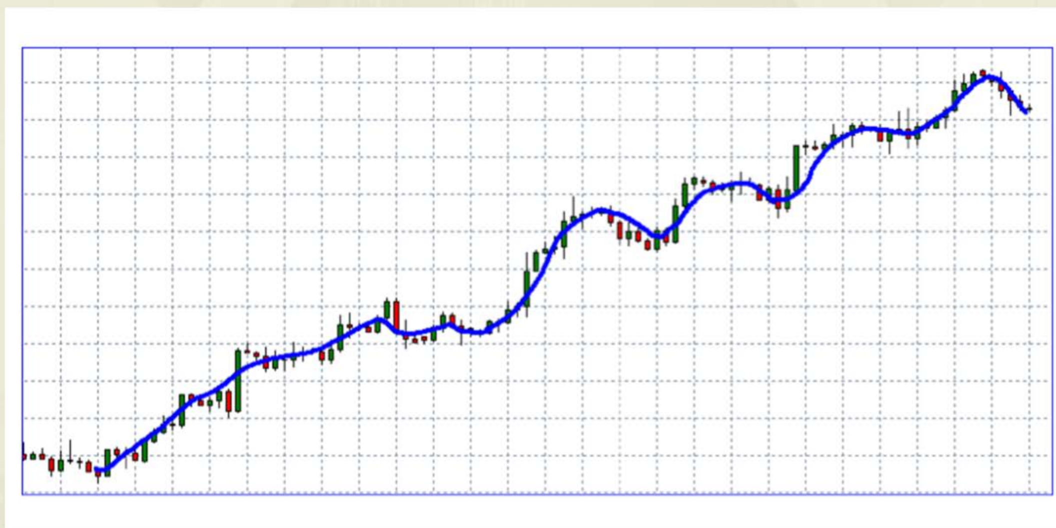
Okay, deliberately trading markets: Stocks and ETFs that trade in a deliberate fashion are the safest and offer the best profit opportunities, without a doubt. A deliberate market is one in which the daily price action, or the true range, from the high to the low of the day, or the close of the previous day if it was higher than the current day's high to the current day low, or the low of the previous day if it was lower than the low of the current day to the high of the current day, a lot of words, but that is what the true range is for any given day. We do not want the price action to exhibit unusually wide range bars or large gaps in price from day to day or choppy erratic sideways action. When this occurs you have a non-deliberate market. So when a stock or ETF is trading a non-deliberate fashion do not trade its option until it begins trading deliberately for at least two weeks.

Non-deliberately Trading Market

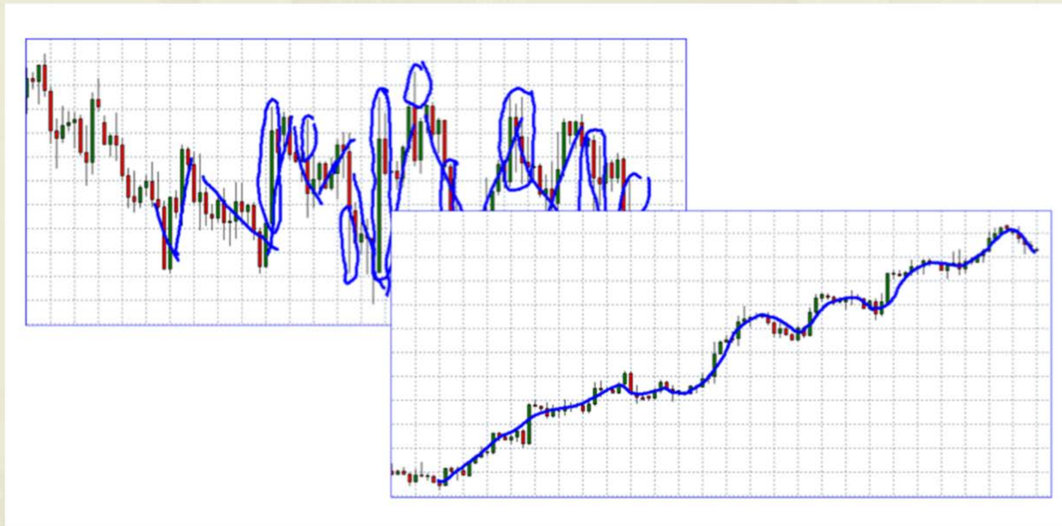


Okay, let's look a non-deliberately trading market. Look at this market. Look at the number of wide range candles or bars, unusually wide range, they are circled in blue. Look at the tails on these candles of what are called shadows that indicate price instability. Look at the sideways chop. Now this is a very dangerous market, a very high risk market to trade. So, why trade it? Now this is an extreme example but once you have this picture in your mind you'll be able to easily spot what a non-deliberate kind of price action looks like.

Deliberately Trading Market



Okay let's look at this one. This of course is deliberately trading market. Look at how it smoothly ebbs and flows day to day. Now it doesn't have to go up to deliver, it can go down as well. But the point is we don't have any unusually wide range bars, we don't have gaps in prices, and we don't have any sideways chops. This is a far safer more profitable market to trade. And you will be able to easily spot this once you understand this concept, when you look at any chart. Now you may have non deliberate price behavior on a particular chart that morphs into deliberate price action, but give it at least two weeks of deliberate price action before you consider trading it.



Okay, so which is better? A picture is worth a thousand words. Clearly the deliberate market on the right is the way to go.

When to Stand Aside

- In general do not trade non-deliberate markets until they trade in a deliberate fashion for at least two weeks
- Stand aside the week of earnings announcements for stocks, markets tend to react violently in an unpredictable, non-deliberate fashion at earnings announcement
- Stand aside the week of FOMC meeting
- Following a severe 5% or more one day move in the market indices or a 20% one or two day drop for a stock

Okay when to stand aside? In general do not trade non-deliberate markets until they trade in a deliberate fashion for at least two weeks, as I just said. Now you want to stand aside the week of earnings announcements for stocks, because markets tend to act violently in a unpredictable, non-deliberate fashion at earnings announcement. And to a lesser extent the same thing the week of the FOMC meeting, which is the United States Federal Reserve Open Market Committee meeting where they announce interest rate policy changes. And so, the safe thing to do would be to stand aside the week of the FOMC meeting, which occurs about 8 times a year.

Another time to stand aside, this doesn't happen very frequently, but following a severe 5% or more one day move in the market indices, so if the S&P 500 or the Dow Jones Industrial average drop 5% in one day, there's trouble in the market so just stand aside don't put any new trades on, or a 20% one or two day drop for a stock. When that happens then again there is trouble for that stock and the likelihood is that it is going to

trade sideways in a non-deliberate choppy fashion for several weeks thereafter. Now remember, we haven't even begun to select the options to trade yet we are just talking about the underlying security. And it is all about managing the risk, even before you enter into a trade.

How To Diversify by Sector

- Depending on your account size, trade up to 10 positions at a time
- Do not risk more than 1 to 2 percent per trade, 5 percent is permissible for smaller accounts
- Trade only one stock or ETF per Sector at any one time
- Sectors: Consumer Discretionary, Consumer Staples, Energy, Financials, Health, Industrials, Materials, Technology, Telecom, Utilities

How to diversify by sector: Depending on your account size, a good guideline is to trade up to 10 positions at one time. If you go more than that it starts to get too complicated, you may be prone to making mistakes, and when you are trading it is better to just keep things simple. Do not risk more than 1-2% per trade, 5% is permissible for smaller accounts, and for very large accounts even less than 1% is not a bad idea. We are not gambling here, this is serious business and we want to treat it as such.

Trade only one stock or ETF per sector at any one time. So sectors for example: Consumer Discretionary, Consumer Staples, Energy, Financials, Health, Industrials, Materials, Technology, Telecom, Utilities; you know if you are only going to trade up to

10 positions, make sure each position is in a different sector. There is no point in putting 3 or 4 financial sector trades on at the same time. Now you are over exposed on risk. You want to combine not risking more than 1-2% on a trade with the diversity offered by only one position per sector.

Avoiding Massive Market Sell Offs

- The buy and hold investor is perpetually vulnerable to a market collapse that can and does occur from time to time without warning
- Swing trading with options avoids this situation all together
- When you buy a call or put your maximum risk in the trade is strictly limited to the amount or debit you paid for the trade
- If you buy 1 call option for $2.00 on a $40 stock giving you the right to buy 100 shares of the stock, your maximum risk is $200 per option. If instead, you buy 100 shares of the stock, your maximum risk is $4000.
- Furthermore, following the Options Income Engine trading method will almost always have you out of your position long before any such collapse occurs, limiting your risk to less than $200 per option in the example above

Avoiding massive market sell offs: Now this is a really big deal. The buy and hold investor is perpetually vulnerable to a market collapse that can and does occur from time to time basically without warning. Swing trading with options avoids this situation all together. When you buy a call or put option your maximum risk in the trade is strictly limited to the amount or debit you paid for the trade. So if you buy 1 call option for $2.00 on a $40 stock giving you the right to buy 100 shares of the stock, your maximum risk is $200 per option. If instead, you buy 100 shares of the stock; your maximum risk is $4000. So in a market collapse, the most you could lose on your options trade would be $200 but your stock position could easily drop by half, where you would lose $2000 or

even more. And even if you had stop losses in, in a market collapse, your stock could blow right through the stop, where you would be filled at a much, much lower price than expected. Furthermore, following the Options Income Engine trading method will almost always have you out of your position long before any such collapse occurs, limiting your risk to less than $200 per option in the example above.

Expectations

- As good as the Options Income Engine Method is, it will not win on every trade – there is no method that can win on every trade.
- However, with the Options Income Engine Method you have a decided edge over other traders that when applied over a series of trades should do very very well.
- Proper position size will protect you from doing great damage to your account in the event of a losing trade.
- The Options Income Engine Method will not buy every low and sell every high. Methods that attempt this are generally very unreliable.
- Since you cannot trade more than a few positions at any one time, it is better to be highly selective and only enter a market when a high probability Options Income Engine Method setup occurs.

Okay, Expectations: As good as the Options Income Engine is, it will not win on every trade- there is no method on the face of the earth that can win on every trade that is a fable. However, with the Options Income Engine Method you have a decided edge over other traders that when applied over a series of trades should do very, very well. Proper position size will protect you from doing great damage to your account in the event of a losing trade. The Options Income Engine Method will not buy every low and sell every high. Methods that attempt this are generally very unreliable. We only want the best of the best setups. Since you can't trade more than a few positions at any one time, it is

better to be highly selective and only enter a market when a high probability Options Income Engine Method setup occurs.

The Overarching Goal

- To maximize gain and minimize risk over a series of trades with an effortless well defined trading approach by taking advantage of the high probability setups that occur again and again using the power of options

So the overarching goal is to maximize gain and minimize risk over a series of trades with an effortless well defined trading approach by taking advantage of the high probability setups that occur again and again using the power of options and doing it the Option Income Engine way.

Action Steps

- Make sure you understand the trading strategy
- Email us with any questions you have
- Using historical charts, practice identifying the difference between non-deliberate and deliberate markets

OPTIONS INCOME ENGINE

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Action Steps: Make sure you understand the trading strategy and email us with any questions you have. In using historical charts, practice identifying the difference between non-deliberate and deliberate markets. This concludes Trading Strategy.