Option Alpha

Ultimate Options Strategy Guide

Step-by-step guide to choosing the best options strategy for any market setup

Kirk Du Plessis

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Why Trade Options vs. Stocks?

A Special Note From Kirk Du Plessis

I've been exactly where you are right now. . . so you're not alone.

You're looking at some stock chart and see a setup that you'd like to trade. Maybe the stock looks like it could go higher, fall quickly or just stay range-bound for the next month.

Whatever the situation you've decided that you want to jump in with both feet and make a trade. You're excited at first but quickly realize that you haven't got the slightest clue how to play this setup to maximize your chance of success.

If you're new to options trading your mind naturally will default to what you already know, and that's stock trading. Stock trading is easy to understand; you either buy stock or sell stock short. No decision needs to be made about choosing strike prices, expiration dates or assessing underlying volatility.

You buy shares and make money if the stock goes up. You sell shares short and make money if the stock goes down. Plain and simple.

But, we both know where this story ends. . .

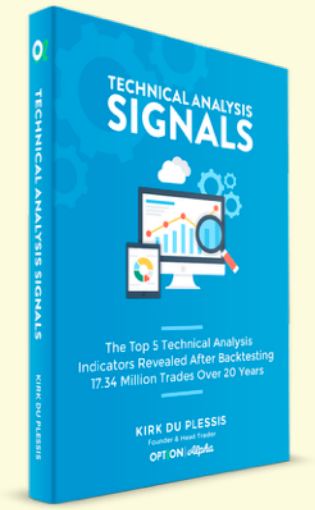
You've either tried or are in the middle of trying to be a day trader of sorts, and it's not working out is it? Through no fault of your own, it's because it never works out long term for the at-home investor like you and me. Tough to accept but it's the reality.

In fact, we did the painstaking research to prove that day trading didn't work when we released our 20-year backtesting report named SIGNALS back in January. Inside we tested

more than 1,476 different technical analysis indicators and trading variations that tracked more than 17.34 million trades to see what really worked and what didn't. It was a massive project that took us nearly 12 months to complete.

After compiling all the performance data, we found that only a small handful of indicators were able to consistently generate profitable buy and sell signals for trading stocks; none of which were useful in shorter time frames under 60 days. Moral of the story here is that trying to pick the direction of a stock is incredibly hard for the average trader like you and me - and that's okay because we don't need to trade the underlying stock to be profitable.

IMPORTANT NOTE: Not many companies have 20-years of backtesting data to back up their statements. To this day, Option Alpha is the only options education company that has done thorough research on technical analysis indicators and trend trading.



Alright, so now we know that you can't day trade the actual stock, what are you to do then? You still like the setup and want to get into a trade somehow. Trade the options of course!

Naturally, most newbie options traders are scared off by the added factors that go into an options trade, but the reality is that these choices you have to make about strike prices and expiration dates give you the opportunity to control your risk and increase your profit potential at the same time.

So, yes, it will take a little extra work and time on your part to understand and learn how to use the most appropriate options strategy for different market setups. Yep, it's not for everyone and surely not an "overnight, get rich quick" system, but it's absolutely worth the journey. Having seen more than 30k traders come through our program just last year, I can honestly say that there's a direct correlation between those people who invest just a small

amount of time each week in their trading education and the ones who see incredible growth in their confidence and income.

Mastering just one options strategy start to finish would elevate you into a select group of investors who have the ability to trade with extremely high probabilities of success. Add in the ability to trade and profit in any direction and you've got the ultimate system for generating recurring income in the financial markets. Trading the underlying stock won't get you there, but learning how to trade options will.

You've got to grow up intellectually as an investor and trader if you want to see your monthly income and portfolio grow. It's a simple as that - either your all-in and determined to make this work or you're not. It's time to start taking control of your investment account and learning how to leverage the power of options trading.

In the pages that follow, you'll find one of the most comprehensive guides to the top options strategies we use month after month at Option Alpha to generate income. We've laid it all out for you in an easy to follow blueprint that you won't find anywhere else online. This will be your "go-to" resource for many years and should always be something you keep close to your desk.

My sincere hope is that this guide brings you tremendous value and helps you consistently make smarter, more profitable trades in the future.

Happy Trading!

Kirk Du Plessis
Founder & Head Trader

How To Find The Absolute Best Options Strategy

The 3-Step Options Strategy Process

Fired up by my little pep talk during the introduction? Me too. But now it's time to get down to business and dive into the entire process for choosing the best options strategy.

Before we go any further, you have to understand and accept the following statement because it's 100% **TRUE**:

> *"Choosing which option strategy to use for any particular trade setup is a process of elimination, NOT selection."*

Let me explain with a quick story you'll find helpful...

My grandfather was an excellent craftsman and a master carpenter all his life. He was even hired back in the early 1960's to help remodel and work on The White House in Washington DC for President Kennedy. So, yeah, he had skills.

During summers as a child, I would stay with my grandparents in the Colorado mountains where they lived. As many times as I can remember, I would spend hours with my grandfather in his workshop helping build all kinds of stuff. I was his "little helper" when he needed something. But as a kid, I didn't really understand the difference between all the tools.

Everything was a hammer to me apparently because that's all I would bring over to him. He'd ask for something to smooth the wood grain, and I'd bring the hammer. He'd ask to bring something to drill holes in the wood, and I'd bring the hammer. He'd ask for something to cut a board with and, you guessed it, I'd bring the old hammer.

Each time I brought the hammer over he'd stop working and help me understand why the hammer wasn't the best tool for that particular job. If we were trying to cut something in half, he'd even demonstrate why the hammer couldn't accomplish the job but an 18" saw could. Over time, I learned that my favorite hammer was great at driving in nails but horrible at cutting boards in half.

At this point, I understood that hammers were good for driving in nails, but I still looked for shortcuts. So the next time he asked for a tool to smooth out the wood surface, I took a shortcut and brought over the entire toolbox and dumped it out on the table! Forget logical thought and reasoning; I'd give him the whole toolbox and let him dig through the pile.

Quietly staring at the 20+ tools piled on his workbench, I vividly remember him looking at me and saying, "Kirk, we need something that smooths the wood's surface, do you know which tools won't make the wood smooth?"

"The hammer?" I responded softly.

"Yes, what else?" my grandfather chuckled. And back and forth we went until we eliminated all the tools that we knew wouldn't be best for the job. After a couple minutes, we were left with the electric belt sander and a small hand-held sanding block.

"Now, we've got a lot of wood to sand down today, which one of the remaining tools will help us get the job done fastest?" he asked me once more. "The belt sander!" I replied.

This simple lesson that my grandfather taught me as a kid now seems so trivial and intuitive as an adult doesn't it? We all know that some tools are just better at accomplishing tasks than others. Of course, you can't cut a wood board in half with a hammer - duh. And if you've got hundreds of wood boards to smooth out then a belt sander is by far the better choice to the hand-held sanding block.

Here's the part that hopefully hits you over the head (like a hammer)… When it comes to investing in the stock market, most traders are doing one of the following:

A) Only using the hammer a.k.a buy stock, hope and pray it goes higher or B) Dumping all of the possible tools a.k.a. options strategies, out on the table and blinding plugging them in until something works.

Now, be honest with yourself here because we both know it's completely true. We use the tools we understand and feel comfortable with. For most of your life, that might have been trading the underlying shares of stock. You bought stock when you assumed it was a good deal and hoped to sell it later at a higher price. It's like using a hammer to build a house.

> *"Don't be another 1 trick pony - buying stock is not always the best choice."*

As you make your transition into options trading, the universe of options strategies now expands your "toolbox" exponentially. You could trade a long call, short credit spread, iron condor, straddle, butterfly, ratio spread, and on and on. And what you likely did before was dump them all out on the table and hammer away at whatever options strategy you happened to pick that day, rather than taking the time to understand which strategy works best right now.

Great carpenters know which tools help leverage their energy and time best and take the extra couple minutes to find the right tool. Sure you could cut a board in half with a hammer, but it would take days of pounding away. Why not take the extra 3 minutes to find a saw and have the board cut quickly.

In the same way, great options traders recognize that not all option strategies work well in every market situation. They take the extra couple minutes to analyze the setup, eliminate the strategies that clearly won't work, and choose the best strategy from the remaining few.

There are good and bad options strategies for every market setup and in the next section, I'll introduce our 3-step process that helps you quickly and easily find the right options strategies to use.

I guarantee that when it comes to choosing the best options strategy, you're probably overthinking it.

Don't worry; I've often suffered from and continue to have fleeting moments of "Analysis Paralysis" syndrome too. You know where you look at something from so many different angles you burn yourself out and end up paralyzing your chances of doing anything at all? Look, it's human nature to balance risk and reward, and we all do it. The goal, however, is to move past "Analysis Paralysis" and develop a systematic way of approaching an options trade.

You may think that having a 3-step process seems cliche, but it's my mission to simplify the method for choosing an options strategy down to the absolute core principles. If I could have narrowed it down to 2-steps, I would have. Still, 3-steps is all it really takes.

#1 - Make A Directional Market Assumption

And Why Portfolio Balance Matters More

The first step to finding the right options strategy is to make a directional assumption on where you believe the stock might go in the future. Namely, this means asking yourself, "Am I bearish, bullish, or neutral on this stock?" You can arrive at your hypothesis however you like, using technical analysis, fundamental analysis, chart patterns, etc. but you've got to pick a direction.

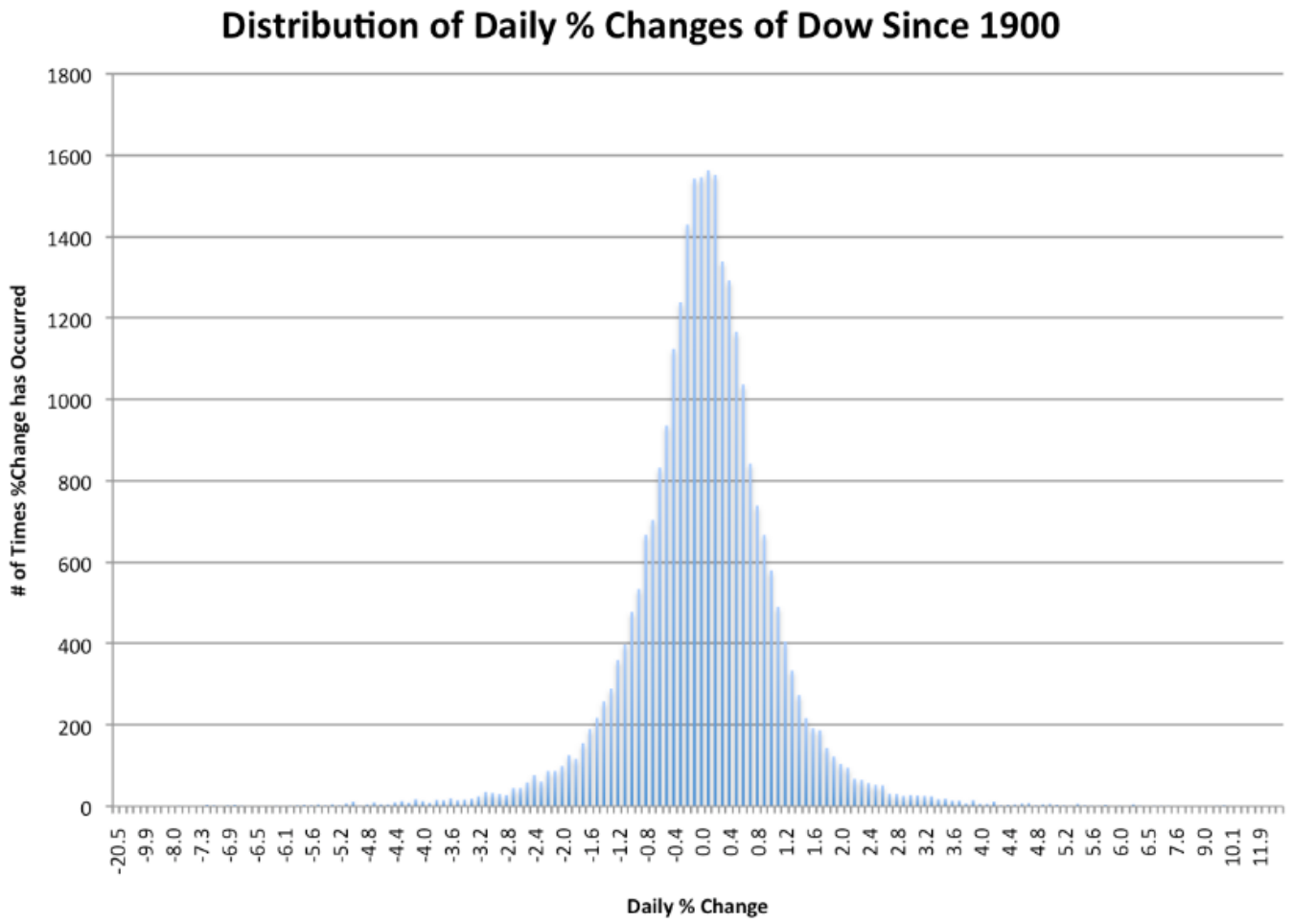
"Easier said than done Kirk!" you might be saying. Well, YES, it is a very easy part because it frankly doesn't matter. Follow me on this because it's going to change your entire outlook on the stock market and picking directions forever...

To some traders, picking the direction is the hardest part of trading, but those are the people who don't understand how high probability options trading works. You have to remember that the market is fair and efficient and there has to be a balance of risk and reward on each side. So, when you were just a stock trader, you used to trade with a 50% chance of success buying or selling stock shares.

Now, how profitable are you likely to be when your best opportunity for making money comes from a "coin flip" game of chance.

To prove this concept and really solidify the point, on the next page you'll find a graph that tracked the daily % moves up and the daily % moves down in the Dow Jones Industrial Average going back to 1990.

Ahem, that's nearly 27 years of data just in case you didn't do the math…



What you'll clearly notice, regardless of what you may read from other sources, is undeniable proof that markets move in a normalized and standard distribution over time. Empirically, the Dow fluctuated between a 2% loss and 2% gain 94% of the time and between -0.7% and +0.7% 64% of the time on a daily basis. If you're a math junkie like me you'll know how powerful this one chart is for proving our point.

Now, this doesn't mean that you can't have extended runs up or down, you can and there often are, but the point here is that there is no consistent patterns or predictable cycles on a long-term basis. There is an equal and even number of days when the market moved up 1% as it moved down 1%.

Herein lies the #1 reason why traditional stock picking is so hard…

> *"You're trying to pick the direction of something that's more or less random."*

You need to accept this as fact now, or you'll waste countless years and money only to end up at the same conclusion. Don't believe me, ask anyone who's tried day trading.

The beauty of trading options, on the other hand, is that you can choose to target any probability of success you want. Want to win 70%, 80% or 90% of the time on your trades long-term. You've got it; you can learn to build strategies that win at these high levels consistently by using option selling strategies with strike prices far out-of-the-money.

CALLS								Strikes: ALL	
Volume	Open.Int	Prob.OT...	Delta	Bid	X	Ask	X	Exp	Strike
398	22,330	31.96%	.70	6.08	Q	6.11	Z	15 JUL 16	205
170	19,662	35.72%	.66	5.32	Z	5.35	Z	15 JUL 16	206
151	21,636	39.87%	.62	4.60	Z	4.63	Z	15 JUL 16	207
433	23,709	44.36%	.58	3.92	Z	3.94	Q	15 JUL 16	208
3,062	28,362	49.21%	.53	3.28	Z	3.31	Q	15 JUL 16	209
4,102	50,336	54.37%	.47	2.70	Q	2.71	H	15 JUL 16	210
2,406	40,393	59.79%	.42	2.16	Z	2.18	Q	15 JUL 16	211
1,246	61,090	65.38%	.36	1.69	Z	1.70	H	15 JUL 16	212
1,355	42,893	71.00%	.30	1.28	Z	1.29	Z	15 JUL 16	213
1,767	52,023	76.49%	.25	.93	W	.95	X	15 JUL 16	214
5,584	107,582	81.66%	.19	.65	W	.67	X	15 JUL 16	215
2,578	90,678	86.27%	.14	.44	X	.45	I	15 JUL 16	216
2,536	128,992	90.02%	.10	.29	X	.30	Q	15 JUL 16	217

Briefly looking at the options pricing table above for SPY you'll notice that the probability of SPY never going higher $213 or $217 from where it is currently at $209.50 is 71.00% and 90.02%, respectively. This means that if you sold the $213 strike call options you'd have roughly a 70% chance of winning. Sell the $217 strike call options, which are a little further away from the current market price and you've got roughly a 90% chance of winning on the trade.

Too good to be true? It's not - I just showed you an example.

It's like trading stocks directionally but instead of making a 50/50 bet one way or the other, you've got this huge margin for error. You can be completely wrong in your directional

assumption of where the stock will go in the future and still make money. Seriously, how many investments can you say that about?

> *"Trading options is like having an unfair advantage - and it's always present."*

Now, does this mean that you can make the same amount of money regardless of which probability of success level you target? No, the market is still fair and efficient meaning that if you have a 90% chance of success, you're going to make less money when you win than someone who trades with a 70% chance of success.

Look back at the options pricing table on the last page and review the Bid & Ask prices for each of the two contracts we mentioned. Notice that the $213 strike call options are worth $128 each and the $217 strike call options are worth $29 each. It's all fair and efficient, but the key here is that picking the right direction doesn't matter as much with options trading.

Again, rather than just spout off theory, let's prove this concept using real numbers and backtesting data from our in-house research.

We took 7.5 years worth of historical options pricing data for the SPY, which is an ETF that tracks the S&P 500, from 2008 to present and religiously sold single leg, naked short calls and single leg, naked short puts every 30 days. We'll cover these in more detail later but for now, you should know that selling short calls is a bearish strategy and selling short puts is a bullish strategy.

We entered each trade at the strike price that correlated to as close to a 70% chance of winning as possible. Again, this is very similar to selling the $213 call options in the SPY pricing table on the last page which had a 70% chance of success. In between entry and expiration we did nothing; no stop-losses, no profit taking, nothing. At each expiration date, we totaled up our overall profits and losses.

IMPORTANT NOTE: Please keep in mind that 2008 was effectively the market bottom for stocks and since then we've been in an almost 8-year bull market run.

As shown in the table below, consistently selling short naked call options, against the prevailing bull market, registered 1,805 trades with a 71.9% win rate overall. Remember these trades were each placed every 30 days targeting a 70% win rate at the onset and even though you would have been 100% wrong in picking the market direction, the option probabilities were so efficient that you still won 71.9% of the time.

Sell 1 CALL @70% Probability Level Every Month

Backtesting Statistics

Expected Value	Standard Deviation	Profitable Trades	Loss Trades
-$3.45	$168.78	71.9%	28.1%
Median Payoff	**Maximum Payoff**	**Minimum Payoff**	**Number of Trades**
+$63.71	+$197.62	-$1,084.67	1,805
Sharpe Ratio	**Median Gain**	**Median Loss**	**Backtest Years**
-0.02	+$75.82	-$154.87	7.4

Portfolio holding period = 30 days; systematic backtest.
Underlying price, implied volatility, time, dividends, and interest rates are evolved in the backtest.
Past performance is not indicative of future returns.

Now to be fair, selling calls against this 8-year bull market wasn't profitable as a stand-alone strategy and rightfully so. You didn't lose a lot of money, but you didn't make money either. Still, the option probabilities held true over time. Selling short calls, which is a bearish strategy, still had 71.9% winning trades even though your directional assumption would have been dead wrong month after month.

Naturally you'd expect that taking the other side, i.e. selling puts during a raging bull market would prove to be very profitable - and that was exactly the case.

Consistently selling short naked put options, shown in the table on the next page, registered the same 1,805 trades with an 88.3% win rate overall. No big surprise because of the huge bull market right? The strategy won more times than expected, well, because

the market just continued to march higher and higher. Does it mean it'll always be this way? Of course not.

Sell 1 PUT @70% Probability Level Every Month

Backtesting Statistics

Expected Value	Standard Deviation	Profitable Trades	Loss Trades
+$84.60	$227.97	88.3%	11.7%
Median Payoff	**Maximum Payoff**	**Minimum Payoff**	**Number of Trades**
+$136.42	+$462.72	-$1,713.48	1,805
Sharpe Ratio	**Median Gain**	**Median Loss**	**Backtest Years**
0.37	+$141.88	-$313.41	7.4

Portfolio holding period = 30 days; systematic backtest.
Underlying price, implied volatility, time, dividends, and interest rates are evolved in the backtest.
Past performance is not indicative of future returns.

What's the big takeaway or lesson we can learn after analyzing these two powerful backtesting studies…

> *"It rarely pays to be a one-sided trader. If you want to be successful trading in any market you've got to trade in both directions."*

Using the same time period and backtesting framework as above, if you sold **BOTH** the call and the put into a combined neutral position every month, called a Short Strangle, you would have had even better results, as shown in the table on the next page, without having to pick a direction each month.

The Strangle won an incredible 74.7% of the time and remember you **NEVER** had to pick a direction. Each and every month you're portfolio was neutral and non-directional, and yet you still make almost as much money as if you had just sold the short naked puts.

Sell 1 CALL & Sell 1 PUT (Short Strangle) at the Combined 70% Probability Level Every Month

Backtesting Statistics

Expected Value	Standard Deviation	Profitable Trades	Loss Trades
+$81.16	$258.63	74.7%	25.3%
Median Payoff	**Maximum Payoff**	**Minimum Payoff**	**Number of Trades**
+$169.95	+$614.79	-$1,659.09	1,805
Sharpe Ratio	**Median Gain**	**Median Loss**	**Backtest Years**
0.31	+$200.62	-$154.39	7.4

Portfolio holding period = 30 days; systematic backtest.
Underlying price, implied volatility, time, dividends, and interest rates are evolved in the backtest.
Past performance is not indicative of future returns.

Oddly enough, Short Strangles are one of the most profitable strategies you can trade as shown in my personal _____ and it's because I recognized long ago that selling options and remaining directionally neutral is a reliable framework for generating long-term income.

The point that I'm trying to make is that you have to try to always be as balanced and neutral as you can with your portfolio. Does this mean that every trade has to be a neutral trade such as a Strangle or Iron Condor? No - of course not. It means that if you trade five stocks directionally higher or bullish, try to build five different positions in five different stocks that you play directionally lower or bearish.

Don't make the same directional bet over and over again. In essence, you need to stop thinking like every other stock trader out there. Spread your risk out across different stocks, and directional plays as much as you can. At the end of the day, you'll still win 70% of the time overall, or whatever probability level you target, which is what you're after in the first place.

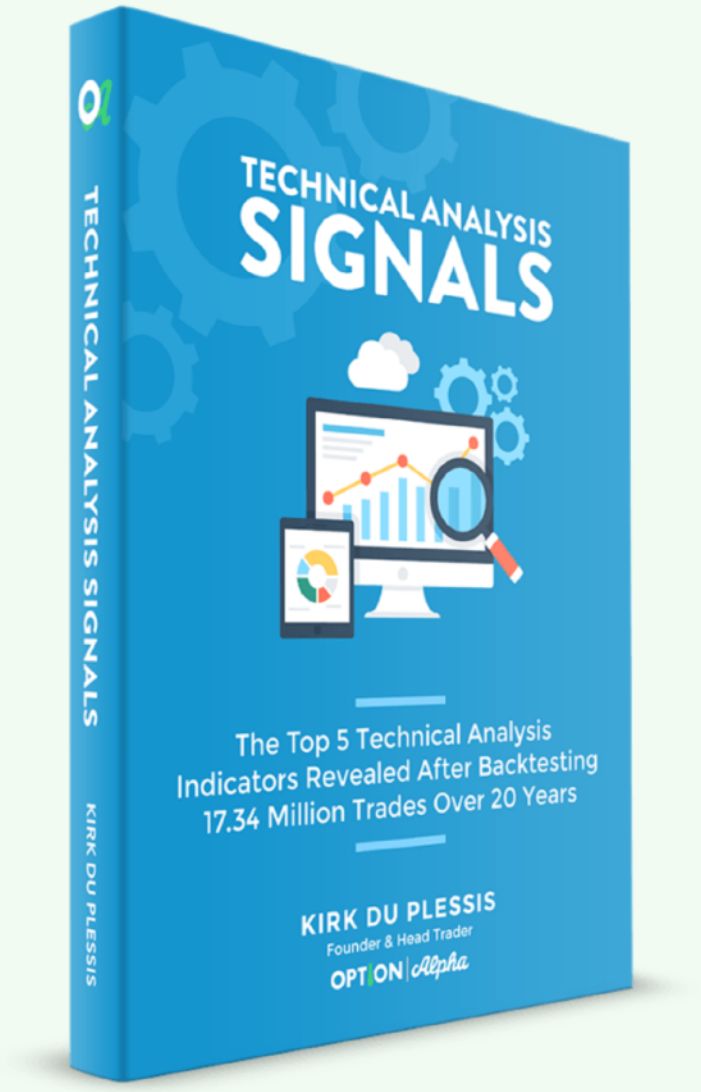
SIGNALS: The 20-Year Technial Analysis Backtesting Report...

Do you really know which technical analysis indicators really work?

Well, our team backtested more than 17.34 million stock trades over 20 years and found that 95% of the technical indicators we tested failed miserably.

Inside our newest book, we'll reveal the specific indicators that generated winning trades 82% of the time and actually beat the benchmark index by 2.602% on average.

Gain insights from 12 months of backtesting reearch covering more than 1,476 different indicator variations. Pick up your copy today and read the entire report in just 30 minutes.



Show Me The Backtesting Results →

#2 - Find Implied Volatility's Relative Ranking

Our Mathematical "Edge" As Option Sellers

By first deciding which direction you want to trade the stock: bullish, bearish, or neutral, you've now eliminated two-thirds of all options strategies. Congratulations, you're well on your way to finding the best options strategy for your current stock setup.

The next step in the process is to find the stock's current Implied Volatility (IV) reading and determine the current Implied Volatility Rank (IV Rank). The goal at this stage is to assess whether the options for the underlying stock are relatively cheap or relatively expensive.

IMPORTANT NOTE: Point blank, understanding IV and its impact on option pricing is the most important concept that you'll need to learn if you want to be successful trading options. Without completely understanding what we'll cover here, you can all but forget about making money.

You see, every successful business has an "edge" that gives them a long-term competitive advantage over someone else or some other company marketplace. And before we dive deeper into options implied volatility, I first want to cover the business models of casinos and insurance companies.

"Wait, Kirk, casinos & insurance companies? What the h*ll does this have to do with implied volatility or options trading?" you might be asking.

Just follow me on this, I promise your portfolio will thank me later…

How Casinos Make Money

The way that casinos make money is dead simple and you probably already know how. They make money on small, theoretical probability imbalances in each of the hundreds of gambling games they create. And they do this either through reduced payout or the reduced odds of winning over time.

Here's a simple example to demonstrate how an imbalance is created in the casino's favor...

Let's say they have a game to simply flip a two-sided coin. At this point, you know that the probability of getting either "Heads" or "Tails" flipping a coin is 50/50. Sure you might get Heads a couple times in a row but if you flipped the coin 10,000 times you expected roughly 5,000 Heads and 5,000 Tails.

In this example, the casino has **NO** edge with regard to the expected outcome or probability of the coin flip that they control. No matter what they do, the coin will land on Heads 50% of the time and Tails 50% of the time. Well, that's assuming they don't have some sort of weighted coin.

Now, the casino might then designate Heads as the winning side and Tails as the losing side - nothing odd there either. But here's where the casino creates an imbalance in the way they pay out winnings.

Let's say the minimum bet is $10 and if you win they pay you $9 when the coin lands on Heads. If you lose, they take the entire $10 bet when the coin lands on Tails. Notice that there is an embedded edge of $1 back to the casino over time. This is their edge, and it's purely a math based approach to making money.

But what if we take it one step further. Let's assume you walk into a casino and want to play the "Coin Flip" game described above, the only difference being that you want to place a $1,000,000 bet on a single flip of the coin. One flip, Heads or Tails, win you make a $900,000 profit, lose and you are out the entire $1,000,000 instantly. Quite the gamble but you're up for it.

The reality is that is that even **IF** you wanted to do this, the casinos wouldn't allow it because of the "Table Limits" placed on the game. Table limits prohibit players from betting too much on any one roll, spin or play. In the eyes of the casino, they don't want someone like you walking in off the street and betting $1M on one coin flip. It's just too much risk for one play; so, they limit the maximum amount of money bet at one time to $100 per player.

> *"Having this table limits increases the number of 'plays' a person will make which thus increases the house edge back to the casino. The longer you play, the more you stand to lose - period."*

They would much rather have you take your $1M and systematically bet $100 over and over again so that they can get you to play the game more times. Remember, their edge only profits from many coin flips and payouts. One coin flip on a $1M bet could be terrible for the casino, but 10,000 coin flips with a $100 bet each time is sure to make them money.

This, of course, was a simple example to prove a point. If you do research more into casino math and probabilities, you'll find the same logic holds true with games like blackjack, roulette, craps, etc. Each game is stacked in favor of the casino either through reduced payout or the reduced odds of winning over time.

I'm sure you're starting to see why "edge" is so important to your ability to generate consistent income with options. And before we get deep into the implied volatility "edge" that I'll describe, I think it's warranted that we also cover how insurance companies make money.

It's slightly different from how casinos make money, and it sets the foundation for options trading beautifully. So, let's talk about insurance briefly...

How Insurance Companies Make Money

In the most simple sense, insurance companies make money through actuaries and expected probabilities. Unlike casinos, insurance companies cannot build a game that controls the probability of winning or losing. They can't control how many houses burn down, how many car accidents happen or how many people die each year.

So, they have to manage their business "edge" by overpricing policies above and beyond their expected loss. This works in nearly all cases but let's take life insurance or the payout your family receives when you die, as our primary example.

When you apply for life insurance, you'll fill out a big stack of paperwork about your age, weight, health history, medical issues, and regular activities that you participate in. You know; skydiving, NASCAR racing, surfing with sharks, whatever. The insurance company actuaries then take all your data and plug it into their models to predict (or imply) your life expectancy into the future.

If you're in good health, non-smoker, non-racecar driver, you're statistically likely to live a long time - maybe another 50 years. If you're not in good health, overweight, smoke, skydive on the weekends, you're not likely to live as long of a life statistically - maybe another 30 years based on the models. Again, it's all math based.

Once the insurance company knows the probability of you dying before the end of the policy, they can build a policy just for you that charges you some amount over and above their expected loss when you die. Referencing the chart to the left, if the probability of you dying was 0.25% and when you died the insurance company had to pay $100k to your family, then the insurance company will assume an expected loss/payout of $250 when writing policies for people like you.

Event	Probability	Value to Company	Prob. X Value
Dies	0.0025	-$100,000	-$250
Lives	1 – 0.0025 = 0.9975	$0	$0

Expected Value = -$250 per policy

Company should charge $250 + $40 = $290 per policy to make $40 per policy.

In order to make money, they'll charge you $290 for the policy so that over time their expected payout is $40. Notice that they can't control the likelihood of you dying but they can control how much money they are willing to take in order to ensure your life. They are basically assuming you'll die sooner than the model is telling them you will and charging you more money up front.

This is called over-expectation, and it happens in all forms of insurance; car insurance, fire insurance, liability insurance, etc.

From here the insurance company's goal is simply to minimize risk by writing as many policies as they can. This about it logically, it would be too risky for them to have one policy outstanding on you alone and nobody else. If you die tomorrow (sorry I love you, and I'll miss you) then they'd be out $100k immediately. But if they wrote life insurance policies on 100,000 people just like you, then the likelihood that they all die tomorrow or anytime soon is practically nonexistent.

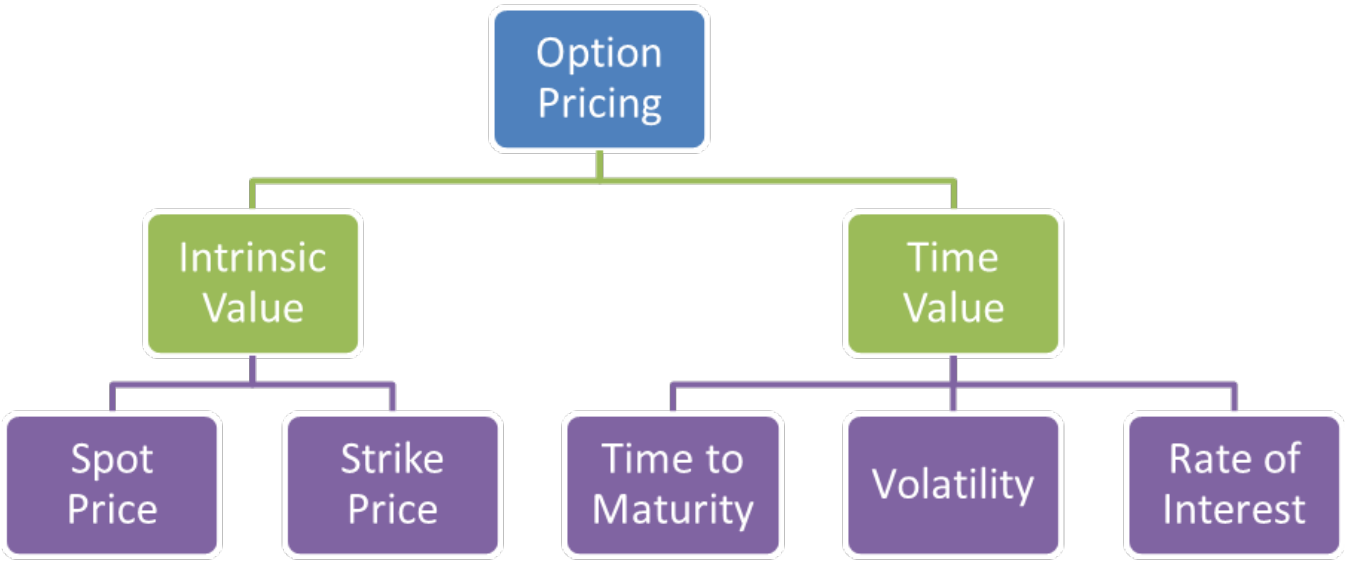
Notice it's the same take on risk and probability as we discussed with casinos applying table limits. Casinos want you to place lots of small bets so that one play doesn't skew the results. Insurance companies want to endorse as many small life insurance policies as they can so that one person dying doesn't bankrupt them.

> *"As options traders, we need to follow similar logic and structure with regard to how we run our business. Namely, once you understand the math; you'll master the game."*

Hopefully, the concept of "edge" is becoming clearer? The casino, insurance company and the options market are nothing more than games of math and probabilities. And now that we have a solid understanding of edge let's talk about my favorite topic: implied volatility.

Option Pricing & Implied Volatility

An option's price is comprised of two major components. The first being the option's Intrinsic Value or value should the contract be exercised/assigned right now.



For example, let's assume you are long a $50 strike call option, which is a bullish strategy, and the stock was trading at $55/share. In this example, you'd have $5 of "intrinsic value" because you could exercise your call option, buy the stock at the $50/share strike price and then immediately re-sell the shares in the open market for $55/share. Logical right?

Now, the second component of an option's price is Extrinsic Value or Time Value. This is the additional premium that is priced into an option which represents the amount of value given based on the remaining life of the contract.

Generally speaking, an option contract with 200 days until expiration is more valuable than an option contract with 20 days until expiration. The price of time, therefore, is influenced by various factors in the market, such as the number of remaining days until expiration, current stock price, current strike price, and interest rates, but none of these are as significant as implied volatility.

Implied volatility is the only element or piece of an option's Extrinsic Value that is "unknown" or "estimated" by the market. Another fancy way of saying "estimated" in finance is to use the word “implied".

If you think about it for a second, we know all of the factors mentioned above that contribute to the time premium of an option contract, except the volatility of the stock in the future. We can calculate how many days are left until expiration. We know where the stock price is relative to the strike price or the contract's intrinsic value. And, we can look up the current long-term interest rates.

> *"The ONLY data point in an option's price we don't know for certain is how volatile the stock will be in the future."*

Sure, we can easily see how volatile a stock has been historically but what will happen in the future, say 30 days from now when we reach the next expiration date? Will the stock still move 20% per year on average? More than 20%? Less than 20%? Again, we don't know for certain, so we have to imply, or estimate, the future volatility.

In the most simple terms possible, implied volatility is derived from an option's current price and shows what the market "implies" about the stock's volatility in the future. It's based on the pricing from a combination of at-the-money and out-of-the-money calls and puts on both sides. In other words, the market itself determines expected or implied volatility through the activity of the investors like you and me placing trades.

Why Should We Care So Much About Implied Volatility & Option Pricing?

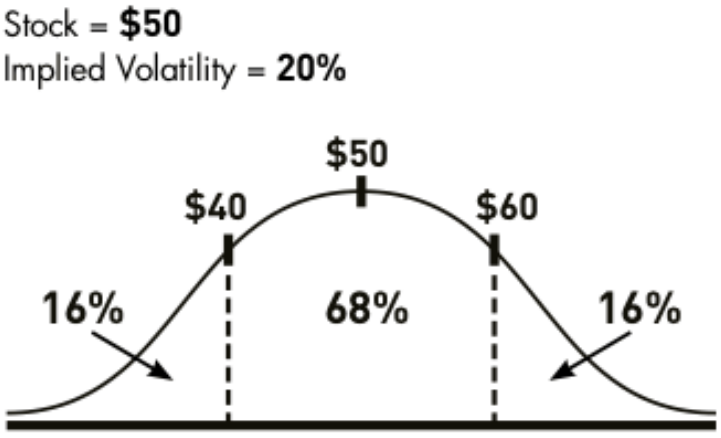
It's important because all else being equal, an option's price will move up and down with the rise and fall of implied volatility. This means than an option contract could gain or lose value purely on the market's changing expectation of volatility even if the underlying stock price doesn't move at all. There are not many financial products that are priced so aggressively on the future expectation of volatility as with option contracts.

Let's use a simple example on the next page to demonstrate how it works...

Assume that a stock is trading at $50/share right now. You are given the choice to purchase a $70 strike call option that expires one year from today. At the end of the year, if the price of the stock is above your strike price of $70 then you could make money. So, the question becomes; how much would you pay for this $70 strike call option contract?

Tough question right? Now let's introduce two different volatility scenarios.

In the first scenario, let's assume that this stock is an average mover historically, moving maybe 20% per year on average. If this were the case moving forward, maybe the most market participants would expect the stock to move in the next year would be the same 20%. That's an expected range of about $10 up or down each year 68% of the time as shown in the graph to the right.



How valuable is the $70 strike call option to you now? Probably not worth anything at all because the likelihood of actually seeing a profit is incredibly small. If the probability of just getting above $60 is 16% then the probability of moving 2X the normal $10 move is likely much lower, maybe just an 8% chance of reaching the $70 price level in the next year.

Consider this the "lottery ticket" example because just as a lottery ticket's price might be cheap, the probability of winning is extremely low. In the same way, this option contract might cost a small amount to purchase the contract, maybe $0.10 or less, but the resulting probability of success is poor.

Shifting gears, in the second volatility scenario, let's now assume that this stock is a small technology company, moving as much as 80% per year. In this case, because the market might expect the same type of volatility in the future, the new expected range over the next year is now $40 up or down. That means there is a 68% chance the stock trades between $10 and $90 before your call option contract reaches its expiration date.

How valuable is the $70 strike call option to you under this second scenario? Likely much higher because the stock has a greater potential to move into a profitable zone at expiration. Naturally, if the stock is expected to swing wildly in the future than the value of options on both sides, calls and puts, would be higher because traders expect a higher chance of making money.

Hence, the relationship between implied volatility and an option's price can be summarized as the following:

> **(1) When implied volatility or market expectations increase, an option's price increases as well - all else being equal.**
>
> **(2) When implied volatility or market expectations decrease, an option's price decreases as well - all else being equal.**

Notice, that it's not one-sided here meaning all option values increase, on both sides for calls and puts, with higher implied volatility like a tide raising all ships at sea. And, market expectations of implied volatility change day by day as new information about the company, their industry, the economy, etc. comes out and is made public. Everything that is known or assumed is priced into the future implied volatility estimate.

With me so far? It's pretty logical how option pricing works when you break it down like this huh? But there's one key point we haven't defined, until now, and that's our "edge".

Over-Expectation of Implied Volatility

I've likely convinced you by now of two important truths when it comes to options trading. Neither point can be argued because the data supports both cases. First, financial markets are efficient, in the sense that there is no "edge" you can gain picking stocks directionally. Second, that implied volatility, i.e. the market's expected future move, has a dramatic impact on the value and price of an option contract.

If both of these statements are true, then the next reasonable question to ask is, "If the markets are efficient and implied volatility influences option pricing, then how can we gain an 'edge' trading options?"

Here's the long awaited answer...

"Our edge trading options is gained by taking advantage of the mis-pricing that occurs from implied volatility's over-expectation of the actual volatility a stock sees long-term."

In even simpler terms, we consistently sell options that are overpriced because of implied volatility. And, understanding and accepting this statement is the key to your ability to trade options successfully long-term - period, end of story.

You see, up until now what you haven't discovered about implied volatility is that even though the market might imply that a stock will move 80% up or down in the next year, and price the options according to this assumption, the reality is that in nearly all cases long-term, stocks tend to move **LESS** than expected.

So, if the market expected a stock to move 80% last year, when we go back and track the actual range vs. the expected range, we might find that the stock only moved as much as 70% last year. It could have been up or down but in any case, the market had higher expectations than what actually took place.

On the options side, this means that if you purchased options all year expecting another annual move up or down of 80% but only saw a 70% move up or down, you lost money because you always paid for an option expecting a wild move in the stock that never lived up to your expectations. If you paid $500 for a call option every two months when the market was expecting the stock to move 80% for the year, at the end of the year since the stock only moved 70% those contracts might have been worth $450 each because the stock didn't move as much as the market assumed it would.

Think back to our life insurance company example in the previous pages. Life insurance companies price their policies on the expectation that people die more often than they actually do in reality. Maybe they assume that new clients like you die 1% of the time before the policy terminates, and charge you an insurance premium relative to this risk when in fact the chance of you dying is only 0.25%. In essence, they priced the policy with some margin (a.k.a. "edge") above what the actual expected probability of you dying is in the future.

Does Your Watch List Tell You Which Options Strategy To Use?

iShares Brazil Index (ETF)

EWZ

$27.4

Last Quote: 10:21 AM

+0.14 (0.51%)

IV Rank: 32

Best Options Strategies:

Debit Spread
Calendar
Diagonal

1 Day Expected Range
$26.75 - $28.05

1 Week Expected Range
$25.97 - $28.83

1 Month Expected Range
$24.42 - $30.38

United States Oil Fund LP (ETF)

USO

$12.05

Last Quote: 10:21 AM

+0.23 (1.9%)

IV Rank: 11

Best Options Strategies:

Calendar
Ratio Spread
Debit Spread

1 Day Expected Range
$11.81 - $12.29

1 Week Expected Range
$11.52 - $12.58

1 Month Expected Range
$10.95 - $13.15

Monsanto Company.

MON

$109.77

Last Quote: 10:22 AM

-1.23 (-1.11%)

IV Rank: 68

Best Options Strategies:

Credit Spread
Butterfly
Iron Condor

1 Day Expected Range
$108.39 - $111.15

1 Week Expected Range
$106.73 - $112.81

1 Month Expected Range
$103.43 - $116.11

The Option Alpha Watch List Helps You Find The Best Trades!

★★★★★

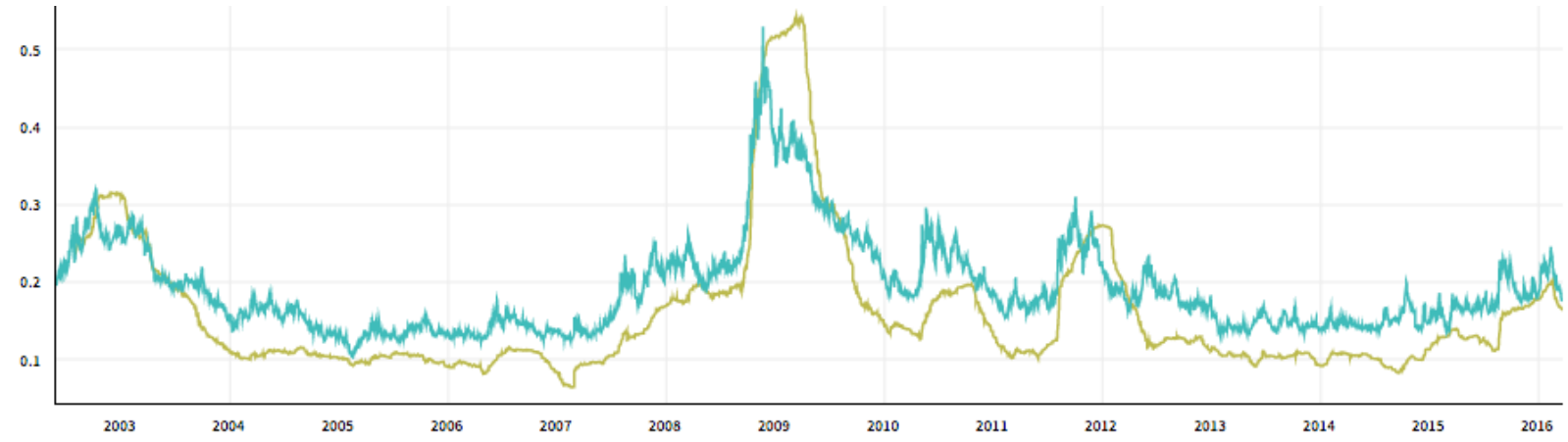
"I use the watch list every single day..."

The same concept of over-expectation holds true in the options market. Implied volatility commonly prices in a more volatile move in the underlying stock than actually occurs. Therefore, the value of option contracts, both calls and puts, at the beginning of an expiration cycle are always slightly high relative to what it ends up being when the underlying stock moves play out.

Our "edge" therefore, is decisively in selling these over-priced options; much like an insurance company selling life insurance. Except, well, we can make money without having to ensure someone's death.

In typical fashion, I don't just want to spout off theory. I want to prove that this over-expectation caused by implied volatility is a reality so that you become even more confident in your ability to trade options successfully for years.

Implied Volatility vs. Actual Volatility (DIA)



On the chart above you'll see that we tracked volatility for DIA, a major market ETF for the Dow Jones, all the way back to 2003. The blue or teal colored line shows the monthly implied volatility reading each day. The lighter green line shows the actual or realized volatility 30 days from the date of measurement for each period.

So, was the Dow Jones less volatile than the market expected it to be? Yep! On average, the DIA expected the market to have a slightly more volatile environment than had been realized over the last 13 years. The average difference between the DIA's implied volatility and actual volatility during this period was approx. 6.25%. This indicates that the options market consistently expected DIA to move on average 6.25% more than it actually did.

Recall that if an options only unknown factor in pricing is determined by implied volatility or future expected moves, and that future move turns out to be less volatile than anticipated, then the option is theoretically overpriced. So if your option contract is priced assuming a 25% move and the stock only moved 20%, you paid too much money for that option contract.

> *"Those traders who are net option sellers more often than net option buyers have a defined, mathematical edge even in an efficient market."*

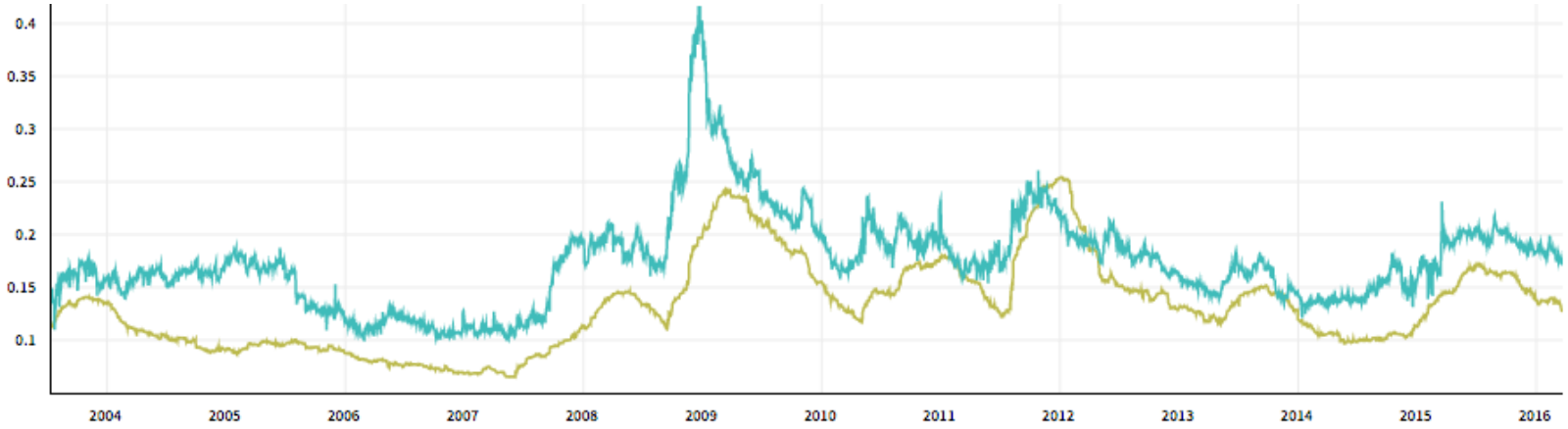
In the case of DIA above, you've got undeniable proof that long-term option pricing during this 13 year period was overpriced, meaning that option sellers, not buyers, were the real winners here. Sure there were times when volatility was briefly greater than expected, namely in 2009, but the long-term data is consistent with this implied volatility over-expectation that we've discussed. Let's look at some more examples…

Implied Volatility vs. Actual Volatility (GLD)

In the chart above, you'll find the same volatility data comparison for GLD, an ETF that tracks the price of Gold going back to 2009. Again you'll notice that actual volatility was much less than the market's implied volatility. The spread for GLD between actual and implied during this period was 5.20%.

Finally, below you'll see volatility data for TLT, an ETF tracking 20+ year maturity bonds all the way back to 2004. Yet again, implied volatility exaggerated the actual move in TLT by 5.67% on average during the 12 year period.

Implied Volatility vs. Actual Volatility (TLT)



There you have it, three incredibly liquid and popular market ETFs tracking stocks, precious metals, and bonds; all of which show the same implied volatility over-expectation.

Congratulations, you've now discovered the "edge" you have as an options trader; consistently selling options due to the over-expectation of implied volatility. Feels good right? You bet it does!

Determining Implied Volatility's Ranking

Know that you know what our "edge" is trading, you can absolutely sell options on a consistent basis and make money long-term. But what if you want to dramatically increase your win rate, probability of success and profits while trading less often?

Well, you can by focusing on selling options when implied volatility readings are higher than average, and our "edge" is maximized.

I relate this to picking apples from a tree. You're free to pick all the apples you want, and they're all ripe and taste great, but it's the low hanging fruit that is easiest to pick.

Since we know that we have to be net option-sellers when implied volatility is high, we need to have some way of determining implied volatility's relative ranking. A way of accessing if the implied volatility reading we are looking at is really high or not?

Luckily, we have an indicator that we use to determine if implied volatility is ripe for selling or too low and should be avoided, and it's called implied volatility rank (IV Rank).

The goal of ranking implied volatility is to determine when option pricing is relatively expensive compared to its historical past for a given security. Volatility observed in a Gold ETF (GLD) might have a radically different range or profile than volatility observed in Apple stock (AAPL) or Google stock (GOOGL) or Exxon Mobile (XOM).

> *"Applying IV Rank helps us compare stocks we are analyzing on an apples to apples basis - making it easier to see which stock has the highest volatility and therefore is the best candidate to sell options on."*

For example, let's assume AAPL's IV right now is pricing in a 50% expected move per year and XOM's IV is only pricing in a 30% expected move per year. On the outside, it might seem that AAPL has higher IV than XOM and is a much better candidate for selling options. But how do we know if a reading of 50% IV in AAPL is really high? AAPL is a large technology company and XOM is a large energy company. You might expect technology companies to be a little more volatile than energy companies.

Let's dig a little deeper by applying an IV rank…

What if I told you that over the last year AAPL has seen its IV reading as low as 40% and as high as 60%. That means that the current reading of 50% IV is right in the middle of the historical range right? Using this range, let's apply an absolute ranking scale; from 1 to 100.

The reading of 40% is relative to a ranking of 1 on the scale since it's the lowest reading observed over the last year. On the other hand, the reading of 60% is relative to a ranking of 100 on the scale since it's the highest reading observed over the last year.

Finally, our current IV reading of 50% sits at the 50th rank since it's in the middle of this historical range. Now do you see how using a ranking indicator helps brings some context to AAPL's implied volatility?

While an absolute reading of 50% IV might seem high to you, it's actually pretty average for AAPL meaning that option pricing in AAPL is average as well. Not significantly low or high at the moment.

Changing gears and looking at XOM stock now, what if we saw that the stock's implied volatility range over the last year was between 10% and 35%. Applying the same absolute ranking scale means that the lowest reading of 10% equals a rank of 1, and the highest reading of 35% equals a rank of 100. Therefore, the current reading of 30% IV is at the 85th rank, and the underlying options are relatively overpriced given the historical range.

With IV rank determined in both stocks now, it's clear that XOM's options are more expensive on a relative basis than AAPL. Even though the pure IV reading of 50% on AAPL is higher than XOM, we have to consider that XOM's 35% IV right now is near the upper end of its one year range, and therefore a more attractive candidate for option selling.

So, what's the cut-off in deciding between high or low volatility rank?

> *"The 50th IV Rank becomes the 'line in the sand' for choosing between net option selling strategies and net option buying strategies."*

If IV is above the 50th rank, we need to be option sellers; if it's below the 50th rank, we should either avoid option selling or be less aggressive option buyers. Remember, our defined and mathematical edge is selling options, not buying them. This doesn't mean you can't use option buying strategies at all, you can, it's just that they shouldn't be the foundation of your trading system.

It's important to note here that implied volatility is always shifting. As the market or expectations by the market participants change so does IV. Hence, it's critical you accept that IV could always go much higher or much lower than whatever it's current reading is at

the moment. So you'll need to scale your strategy, and approach as IV rank leans toward the extreme ends of the spectrum.

For now, the key takeaway for Step #2 is your need to determine if IV rank is above or below the 50th rank. Above 50 we're sellers; below 50, we're either not trading or buying options on a small scale. Answering this question further cuts the list of possible options strategies down by half.

#3 - Targeting The Best Options Strategy for You

Focusing On The Optimal Strategy To Trade

This final step in the strategy process is simply to target the best options strategy that combines the directional assumption choice you made in Step #1 and the implied volatility rank you found in Step #2.

Quickly recall the story I told about my grandfather, the carpenter, and how we laid all the tools out on the table trying to find the best one for smoothing out the wood surface of some boards.

In the end, we were left choosing between an electronic belt sander and a small hand-held block sander. Both would have accomplished the job but in our case, the belt sander was the better fit because we needed to sand long, flat stretches of boards. Had we needed to do some fine sanding around edges or curves, possibly the small hand-held block sander would have been the better choice.

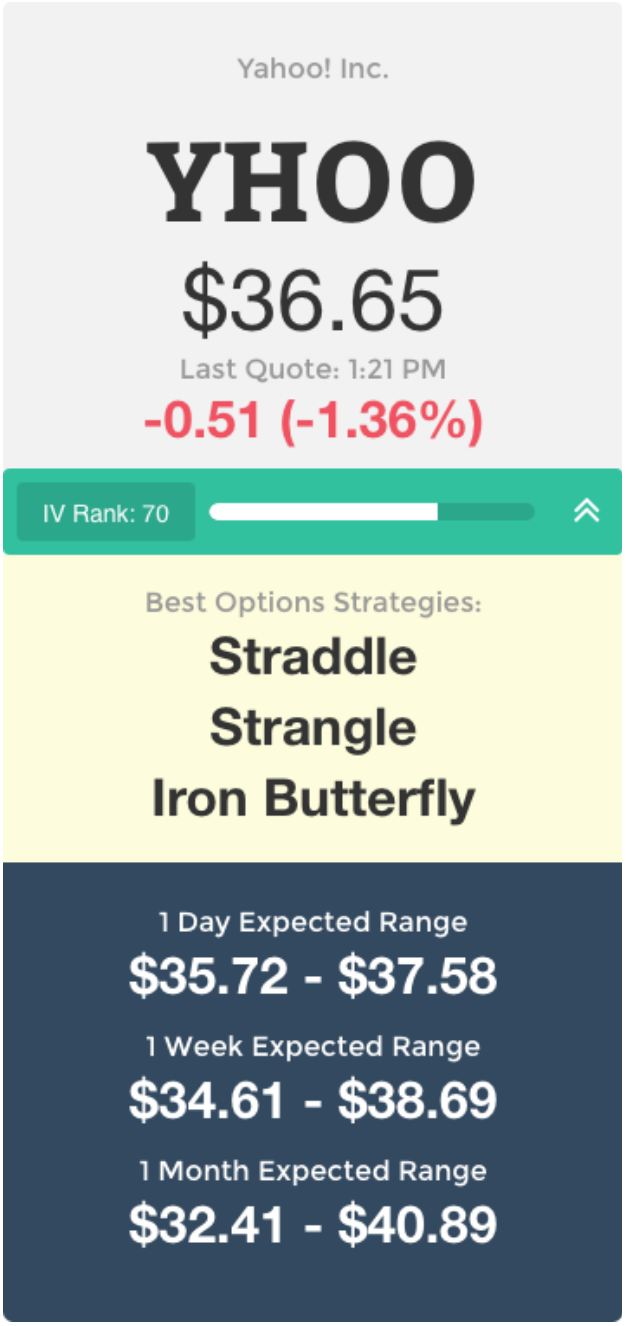
The same general concept applies here in Step #3 with choosing the best options strategy for whatever market setup you're analyzing. All of the options strategies that remain after you apply the directional and IV rank filters will get the job done. But maybe one particular options strategy, however, will accomplish the mission a little better than the other.

Before I set you free to bolt through the 18 different strategy guide pages that follow, let's quickly go over an example start to finish together. Just so we're clear on how to work through the steps…

Options Strategy Example (YHOO)

Suppose you're neutral on the future direction of YHOO stock. You don't really care where it goes (up, down, left, right, etc.) nor do you have a strong opinion. Well, you've now completed Step #1 and made a directional assumption. ***Check!***

From here you look up the current IV rank of YHOO using the Option Alpha Watch List and see that implied volatility is in the 70th rank based on the last year's range. A reading at the 70th rank is above the 50th rank level used to determine whether we should be option sellers or option buyers. In this case, we have to be options sellers because IV rank is higher than 50. You've now completed Step #2 and determined IV relative ranking. ***Check!***



With only three options strategies to choose from, your decision just got a whole lot easier. The three best strategies to use when you are neutral on the direction of the stock and IV rank is high is to trade either a Short Straddle, Short Strangle, or an Iron Butterfly. Each strategy uses net option selling and takes advantage of a drop in implied volatility as well as an overall neutral move in the underlying stock price. The point here is that they all will accomplish roughly the same goal.

So which options strategy do you ultimately go with? The answer is - it depends.

My suggestion is to read the "Strategy Description" sections for each of the possible options strategies you are considering in the next section of this book. Inside I'll outline the best setup and application for each particular options strategy to maximize your probability

of success. And as always, concentrate on the strategies that fit into your tolerance for risk and trading style.

Back to our YHOO example, after reading more details on Short Straddles and Iron Butterflies you would've learned that they are both aggressive options selling strategies only when IV rank is near the upper end of the 1-100 range. However, the Iron Butterfly is an option selling strategy whereby you have defined risk similar to an Iron Condor. Since you may not be comfortable at this point selling naked options, or if you are trading in an IRA account which restricts naked option selling, then the more appropriate and conservative strategy would be to use a Iron Butterfly in this example.

At last, you've completed Step #3 and have the Ultimate Options Strategy chosen! Be honest with me for a second. Doesn't it feel good to have a clear process for finding the right options strategy?

Sure this book might have a tough read for you as it challenged some deeply held thoughts you've had about the stock market and how traders make money with options. Still, once you go through the steps a couple times, you'll find that it's an incredibly efficient and profitable way to trading options.

Here Are Your Next Steps…

The remainder of this book details the top options strategies we use for generating monthly recurring income. The strategies are broken out into different sections based on your underlying assumption (bullish, bearish, neutral) and implied volatility's ranking (high or low). From there each strategy offers details instructions on how to setup the trade, optimal timelines, profit taking levels and risk management tips.

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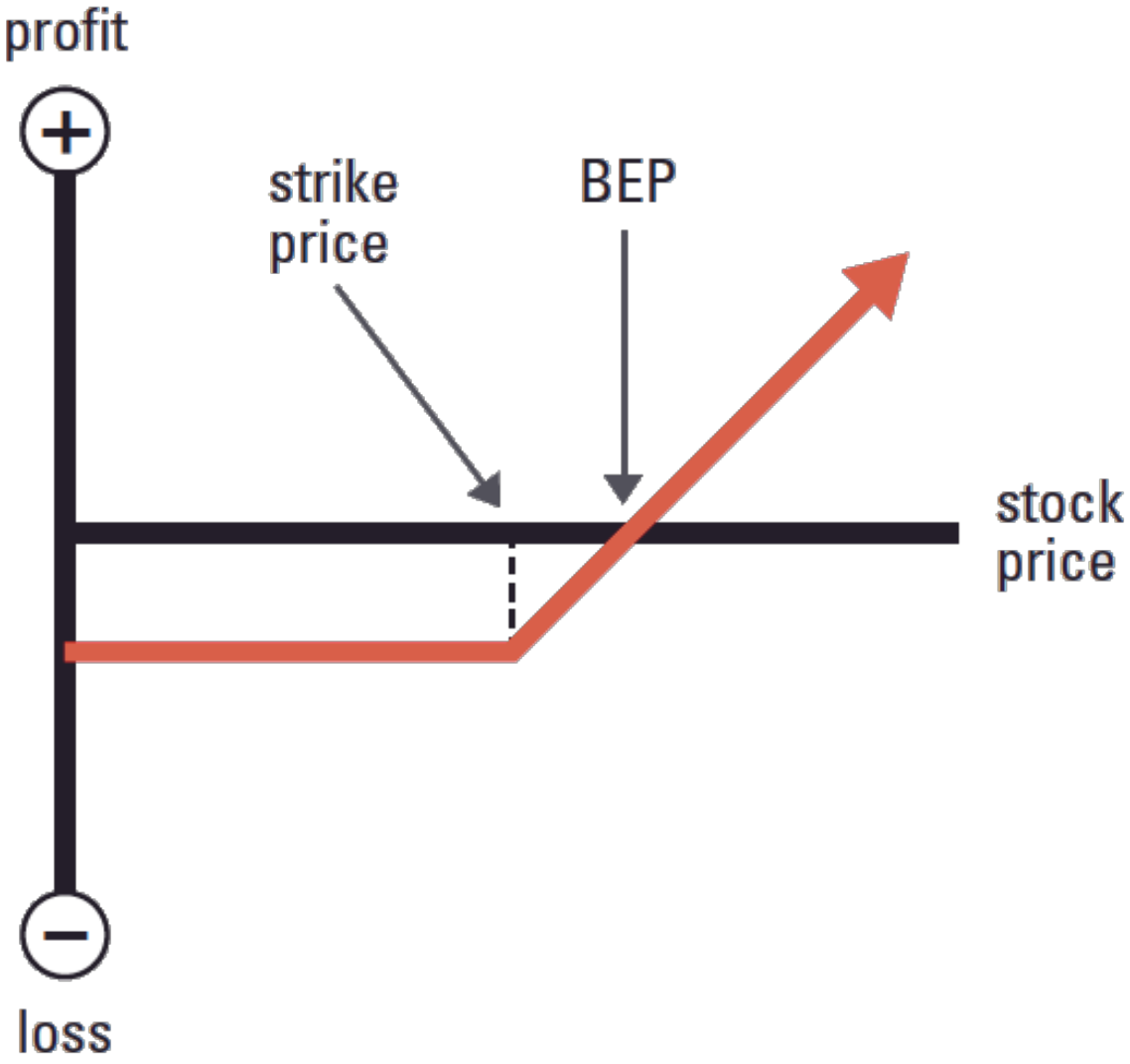
Quick Review

Option Payoff Diagrams

Correctly Reading The Strategy P&L Charts



Option Payoff or Profit and Loss (P&L) diagrams help us understand where our options strategies win or lose money at expiration based on different stock price points. They are incredibly useful aids to our discussion of options trading and once you understand how they work, they can help you build out more complex options strategies and analyze possible trade adjustments. Review the graph above before moving forward.

Terms & Definitions

Understanding Options Trading "Lingo"

Long — When talking about options and stocks, "long" implies a position of ownership. After you have purchased an option or a stock, you are considered "long" that security in your trading account.

Short — If you've sold an option or a stock without actually owning it, you are then considered to be "short" that security in your account. Interestingly enough, options trading gives you the opportunity to sell something you don't actually own. But when you do, you may be obligated to do something at a later date such as buy back the option contract to close, hopefully for a lower price, or let the contract expire worthless.

Call — An option contract that gives the holder the right to buy the underlying security at a specified price for a certain, fixed period of time.

Put — An option contract that gives the holder the right to sell the underlying security at a specified price for a certain, fixed period of time.

Premium — The price a put or call buyer must pay to a put or call seller (writer) for an option contract. Market supply and demand forces determine the premium.

Strike Price — The stated price per share for which the underlying security may be purchased (in the case of a call) or sold (in the case of a put) by the option holder upon exercise of the option contract.

In-The-Money (ITM) — For call options, this means the stock price is above the strike price. So, if a call has a strike price of $50 and the stock is trading at $55, that option is in-the-money. For put options, it means the stock price is below the strike price. So if a put has a strike price of $50 and the stock is trading at $45, that option is in-the-money.

Out-of-The-Money (OTM) — For call options, this means the stock price is below the strike price. For put options, this means the stock price is above the strike price. The price of out-of-the-money options consists entirely of "time value."

At-The-Money (ATM) — An option is "at-the-money" when the stock price is equal to the strike price. Since the two values are rarely exactly equal, when purchasing options the strike price closest to the stock price is typically called the "ATM strike."

Intrinsic Value — The dollar amount that an option is in-the-money. A call option with a strike price of $50 and the stock is trading at $55 would have intrinsic value of $5. A put option with a strike price of $60 and the stock trading at $50 would have intrinsic value of $10. Obviously, only in-the-money options have intrinsic value.

Time (Extrinsic) Value — The part of an option price that is based on its time to expiration and implied volatility. If you subtract the amount of intrinsic value from an option price, you're left with the option's time or extrinsic value. If an option has no intrinsic value (i.e., it's out-of-the-money) its entire worth is based on time value.

Theta Decay — A term used to describe how the time value of an option can "decay" or reduce with the passage of time. One of the four major Option Greeks.

Volatility — A measure of the fluctuation in the market price of the underlying security. Mathematically, volatility is the annualized standard deviation of returns.

Exercise — This occurs when the owner of an option invokes the right to buy or sell underlying stock in the option contract. In English, it means the option owner buys or sells the underlying stock at the strike price, and requires the option seller to take the other side of the trade.

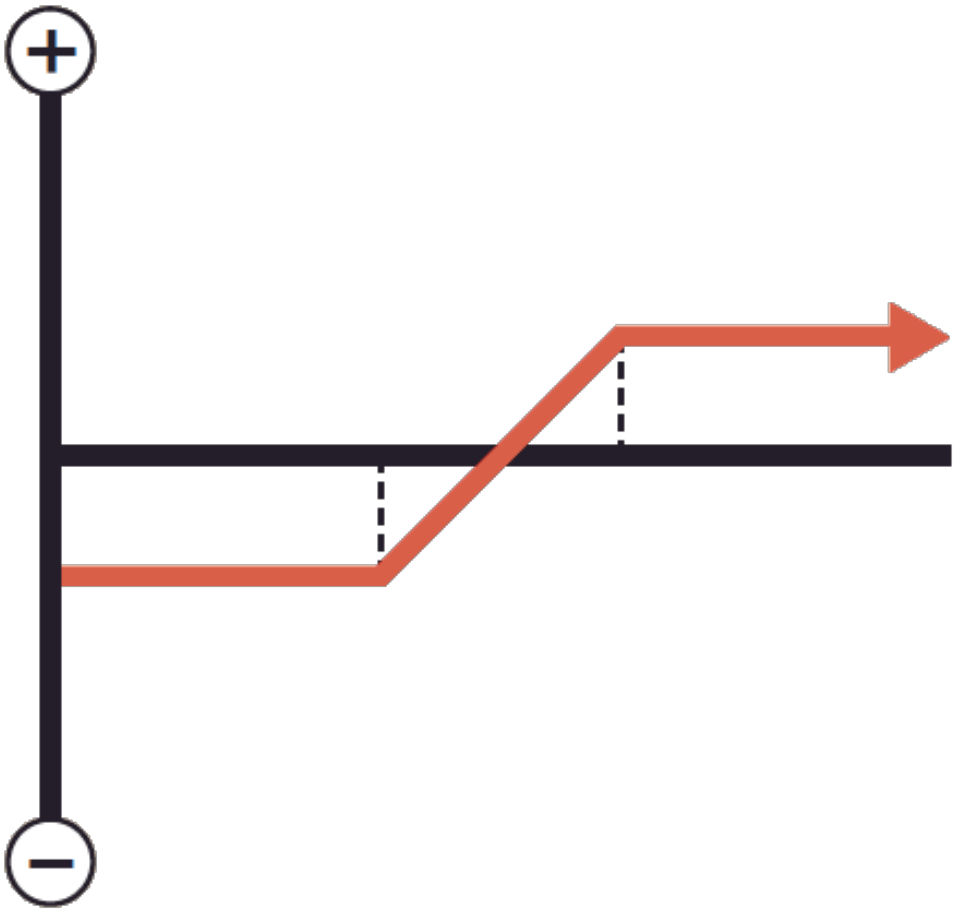
Assignment — When an option owner exercises the option, an option seller (or "writer") is assigned and must make good on his or her obligation. That means he or she is required to buy or sell the underlying stock at the strike price. They can however immediately close or reverse the position if they choose not to hold the stock.

High IV Bullish Options Strategies

If you are bullish on the underlying direction of the stock and implied volatility is over the 50th percentile you'll choose from the following options strategies...

Put Credit Spread

Bullish Outlook & High Volatility…



Bull put credit spreads are strategies that are designed to profit from both a one-way directional move up in the underlying stock and a drop in the underlying implied volatility.

These are high probability strategies where you are a net a seller of options below the stock price, and you are looking for those options to decay in value and become worthless at expiration.

The Trade Setup

Sell 1 OTM Put; Buy 1 OTM Put at Lower Strike Price. The combination of options should result in a net overall credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

Optimal position sizing for option selling strategies like this can be scaled up slightly between 3-5% of your equity balance per trade of notional risk.

Profit Targets

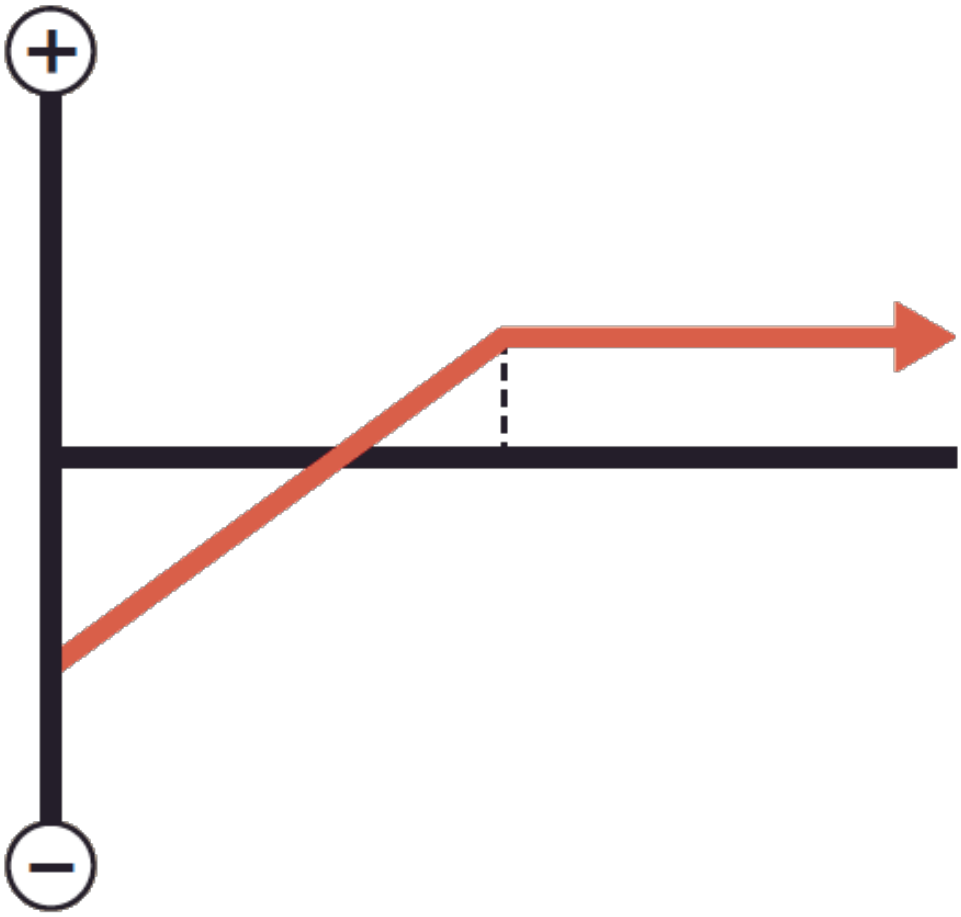
If your position shows a profit near 50% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Short put strike minus net credit.

Short Naked Put

Bullish Outlook & High Volatility…



A short put is an undefined risk trade where you are selling options below the current market price of the stock anticipating both a drop in IV or the stock to remain above your strike price at expiration.

This is one of the key building blocks for income and premium selling strategies because you collect a credit for entering the trade and typically have a very high probability of success overall.

The Trade Setup

Sell 1 OTM Put below the market for a credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

With undefined risk strategies, you want to be a little more cautious. Allocate between 1-2% of equity per trade based on initial margin requirements.

Profit Targets

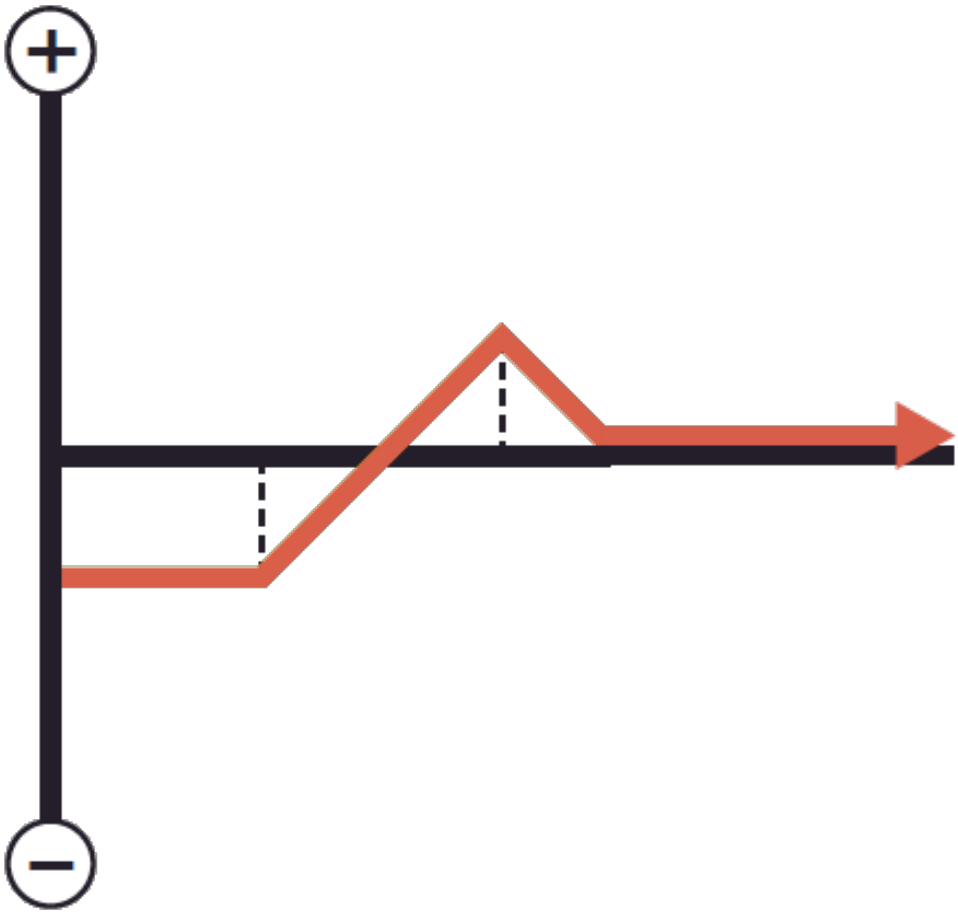
If your position shows a profit near 50% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Strike price minus credit received.

Put Broken Wing Butterfly

Bullish Outlook & High Volatility…



A put broken-wing spread is an advanced strategy whereby you take a traditional butterfly spread below the market and skip 1 strike to create an unbalanced spread.

These strategies are typically done for a net credit with the goal of having no risk to the upside. Skipping a strike allows you do to this because you buy a further OTM put option at a cheaper price which reduces the overall cost of the strategy.

The Trade Setup

Buy 1 ITM Put; Sell 2 OTM Puts near the ATM options; Skip Strike and Buy 1 OTM Put. If possible the trade is done for a net credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

Optimal position sizing for option selling strategies like this can be scaled up slightly between 3-5% of your equity balance per trade of notional risk.

Profit Targets

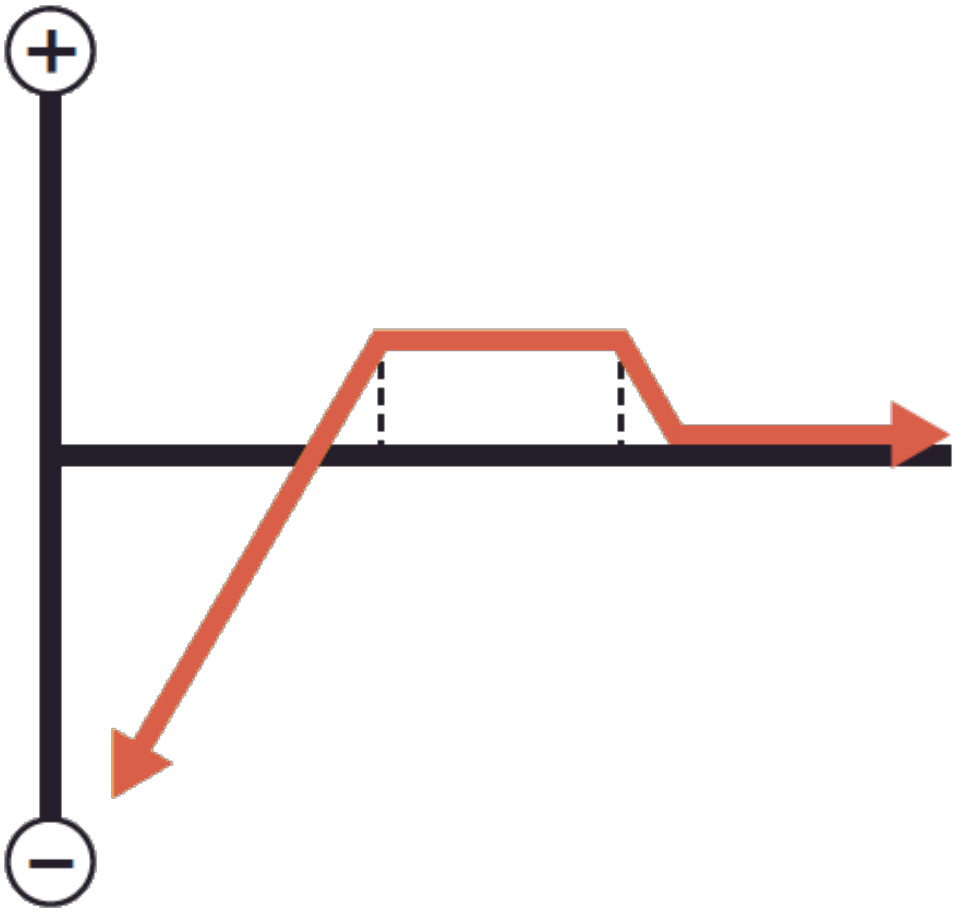
If your position shows a profit near 75% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Two BEPs. 1) Higher long put strike minus net debit paid 2) Lower long put strike plus net debit paid. Reverse if entered for a net credit.

Custom Naked Put

Bullish Outlook & High Volatility…



A custom naked put is an advanced strategy created by combining a short credit call spread above the market with a short naked put below the market. These strategies profit from falling IV and a bullish-neutral outlook on the stock.

The short credit call spread is added to increase the overall credit received on the entire strategy, and when done for a credit greater than the width of the credit call spread strike prices, you would have no risk to the upside.

The Trade Setup

Sell 1 OTM Put; Sell 1 OTM Call; Buy 1 OTM Call at Higher Strike Price. If possible the trade is done for a net credit wider than call spread width.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

With undefined risk strategies, you want to be a little more cautious. Allocate between 1-2% of equity per trade based on initial margin requirements.

Profit Targets

If your position shows a profit near 50% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Short put strike price minus net credit received.

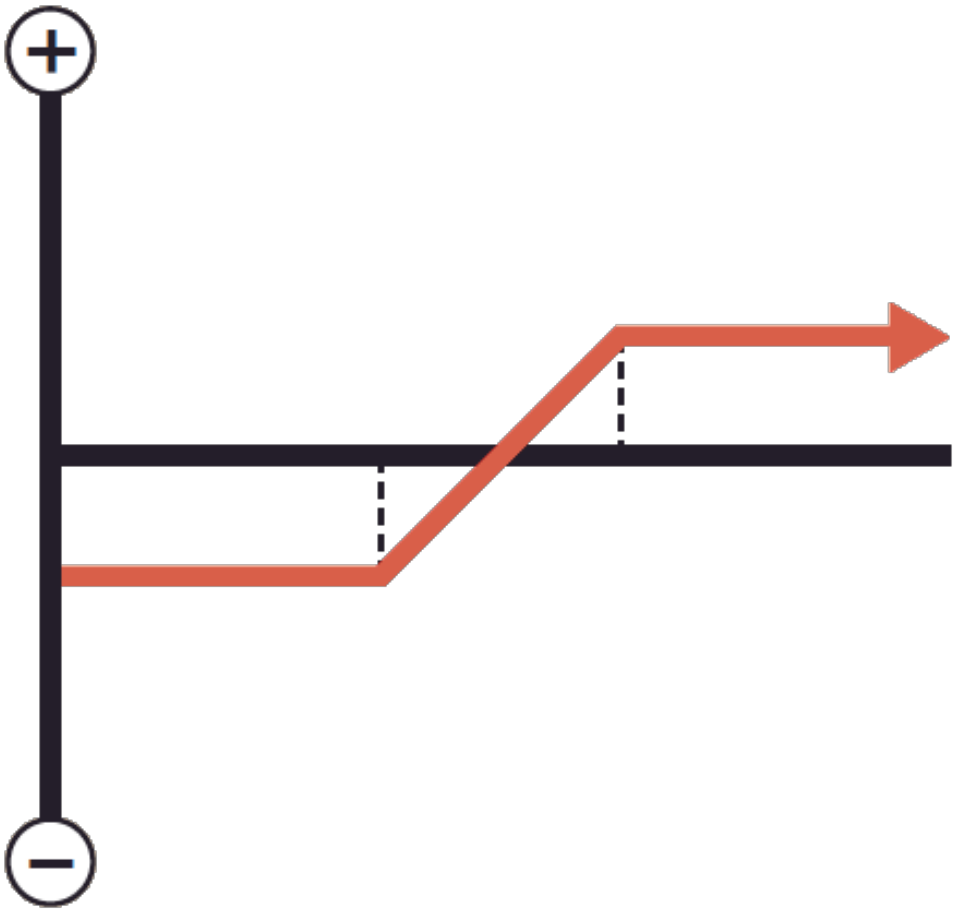
Low IV Bullish Options Strategies

If you are bullish on the underlying direction of the stock but implied volatility is under the 50th percentile you'll choose from the following options strategies...

OPTION | Alpha

Call Debit Spread

Bullish Outlook & Low Volatility…



Bull call debit spreads are strategies that are designed to profit from a one-way directional move in the underlying stock higher. They also might profit (though is not as likely) from increasing implied volatility.

These are generally low probability trades because that end up being 50-50 bets on the underlying direction. As a result we do not trade these types of strategies often in our portfolio and will occasionally use them for rebalancing purposes.

The Trade Setup

Buy 1 ITM Call; Sell 1 OTM Call at Higher Strike Price. The combination of options should result in a net debit.

Optimal Timeline

Entering these trades 60-90 days until expiration is preferred. Since option pricing is generally be low, you'll want to increase the trade duration and give yourself ample time for the stock to move into a profitable zone.

Volatility Impact

Since we are net buyers of options, you should be entering this trade only when IV Rank is below 50. All else being equal, raising IV will generally help this position while falling IV will generally hurt this position.

Time Decay

Time decay or Theta works negatively against us as part of this position. As net buyers, if the strategy is not ITM at expiration it expires worthless.

Risk Management

Optimal position sizing for option buying strategies like this should be considerably small at less than 1% of your portfolio equity balance.

Profit Targets

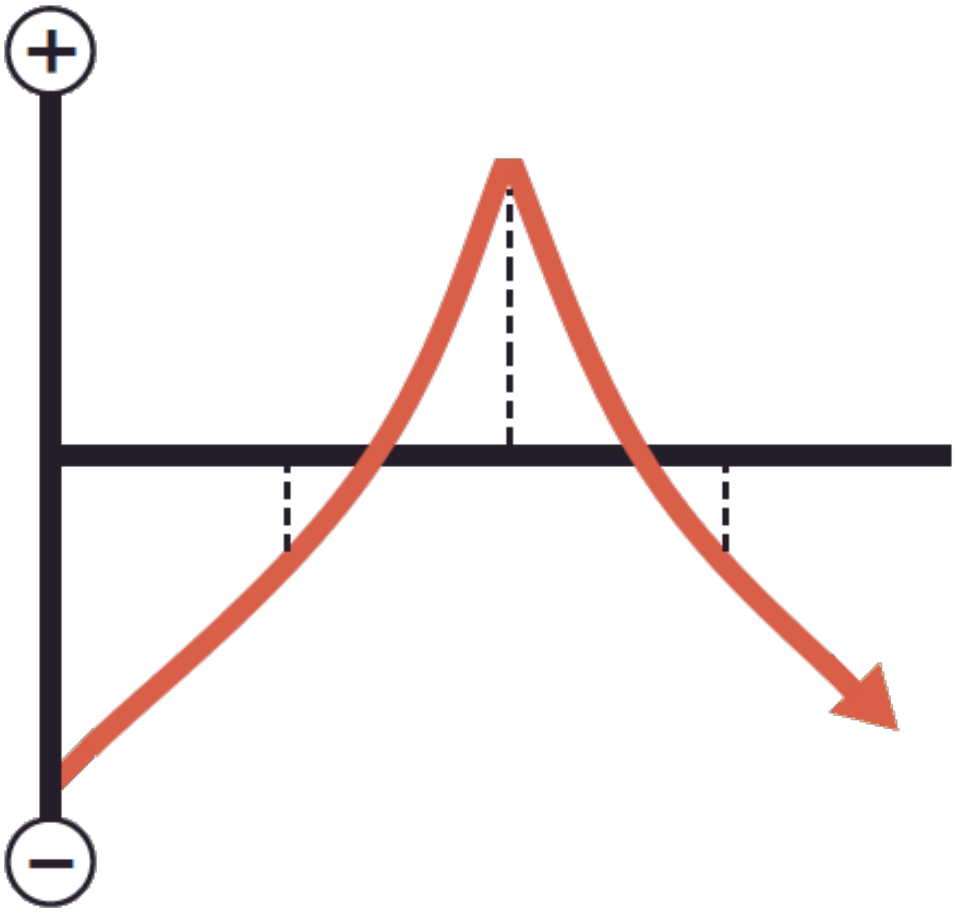
Given the low probability nature of this position, earlier profit taking should be done between 25-50% of the max potential gain.

Break-Even Point(s)

Long call strike plus net debit paid.

Call Calendar Spread

Bullish Outlook & Low Volatility...



Long call calendar spreads profit from a slightly higher move up in the underlying stock in a given range. Calendar spreads lose if the underlying moves too far in either direction. The maximum loss is the debit paid, up until the front-month option you sold expires.

This trade is best used when implied volatility is low and when there is implied volatility "skew" between the months used, specifically when the near-month sold has a higher implied volatility than the later-month bought.

The Trade Setup

Sell 1 OTM Call in the Front Month; Buy 1 OTM Call in the Back Month at the Same Strike Price. The combination of options should result in a net debit.

Optimal Timeline

You should look to target the front month options at least 20+ days out to give yourself enough room for premium decay. Anything shorter than 20 days in the front month or longer than 45 days should be avoided.

Volatility Impact

Since we are net buyers of options, you should be entering this trade only when IV Rank is below 50. All else being equal, raising IV will generally help this position while falling IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position as long as the stock remains range bound which maximizes the monthly contract skew.

Risk Management

Optimal position sizing for option buying strategies like this should be considerably small at less than 1% of your portfolio equity balance.

Profit Targets

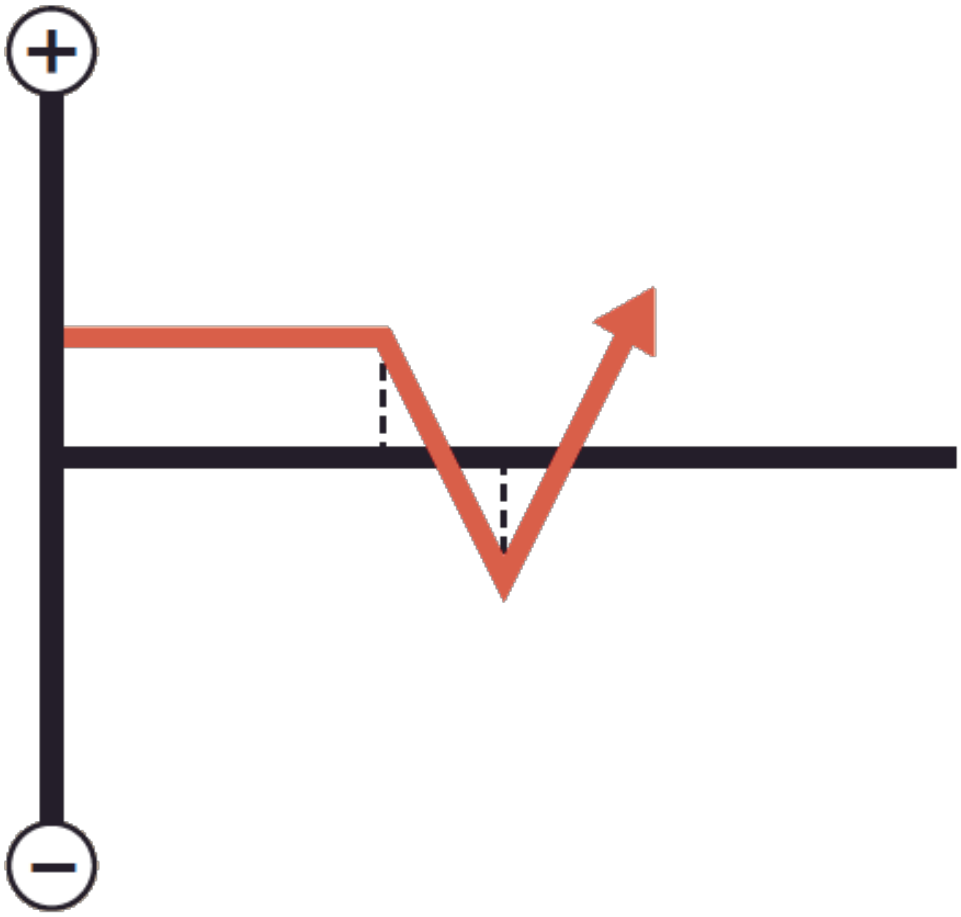
Given the low probability nature of this position, earlier profit taking should be done between 25-50% of the max potential gain.

Break-Even Point(s)

Varies depending on strike prices and volatility.

Call (Ratio) Backspread

Bullish Outlook & Low Volatility…



A Bull Call Backspread is similar to a long call option as far as your outlook on the underlying stock but you use the sale and purchase of different ratios of options to protect against a possible move lower in the stock price.

These are often referred to as “ratio spreads” because you are buying and selling options at intervals of 1:2 or 2:3 etc. With this particular strategy you would sell a call option and then buy 2 higher strike calls making you still a net buyer of options at a ratio of 1:2.

The Trade Setup

Sell 1 ATM Call; Buy 2 OTM Calls at Higher Strike Price. The combination of options should result in a net debit.

Optimal Timeline

Entering these trades 60-90 days until expiration is preferred. Since option pricing is generally be low, you'll want to increase the trade duration and give yourself ample time for the stock to move into a profitable zone.

Volatility Impact

Since we are net buyers of options, you should be entering this trade only when IV Rank is below 50. All else being equal, raising IV will generally help this position while falling IV will generally hurt this position.

Time Decay

Time decay or Theta works negatively against us as part of this position. As net buyers, if the strategy is not ITM at expiration it expires worthless.

Risk Management

Optimal position sizing for option buying strategies like this should be considerably small at less than 1% of your portfolio equity balance.

Profit Targets

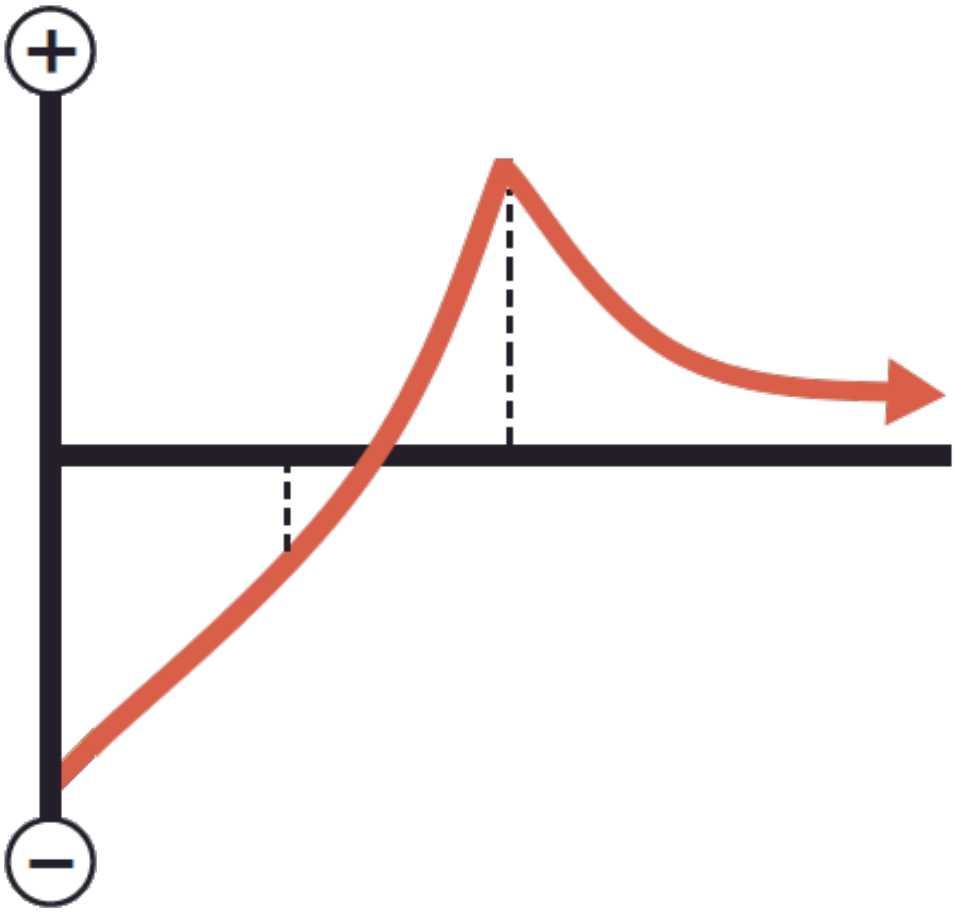
Given the low probability nature of this position, earlier profit taking should be done between 25% of the max potential gain.

Break-Even Point(s)

Two BEPs. 1) Short call strike plus net debit paid 2) Long call strike plus the difference between the long call strike and short call strike plus net debit.

Put Diagonal Spread

Bullish Outlook & Low Volatility...



Long put diagonal spreads profit from a higher move up in the underlying stock in a given range. Diagonal spreads combine the directional nature of put credit spread with the volatility impact of a calendar spread. If established for a net debit, risk is limited to the difference between the strike prices, plus the net debit paid.

This trade is best used when implied volatility is low and when there is implied volatility "skew" between the months used, specifically when the near-month sold has a higher implied volatility than the later-month bought.

The Trade Setup

Sell 1 OTM Put in the Front Month; Buy 1 OTM Put in the Back Month at a Lower Strike Price. The combination of options should result in a net debit.

Optimal Timeline

You should look to target the front month options at least 20+ days out to give yourself enough room for premium decay. Anything shorter than 20 days in the front month or longer than 45 days should be avoided.

Volatility Impact

Since we are net buyers of options, you should be entering this trade only when IV Rank is below 50. All else being equal, raising IV will generally help this position while falling IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position as long as the stock remains range bound which maximizes the monthly contract skew.

Risk Management

Optimal position sizing for option buying strategies like this should be considerably small at less than 1% of your portfolio equity balance.

Profit Targets

Given the low probability nature of this position, earlier profit taking should be done between 25-50% of the max potential gain.

Break-Even Point(s)

Varies depending on strike prices and volatility.

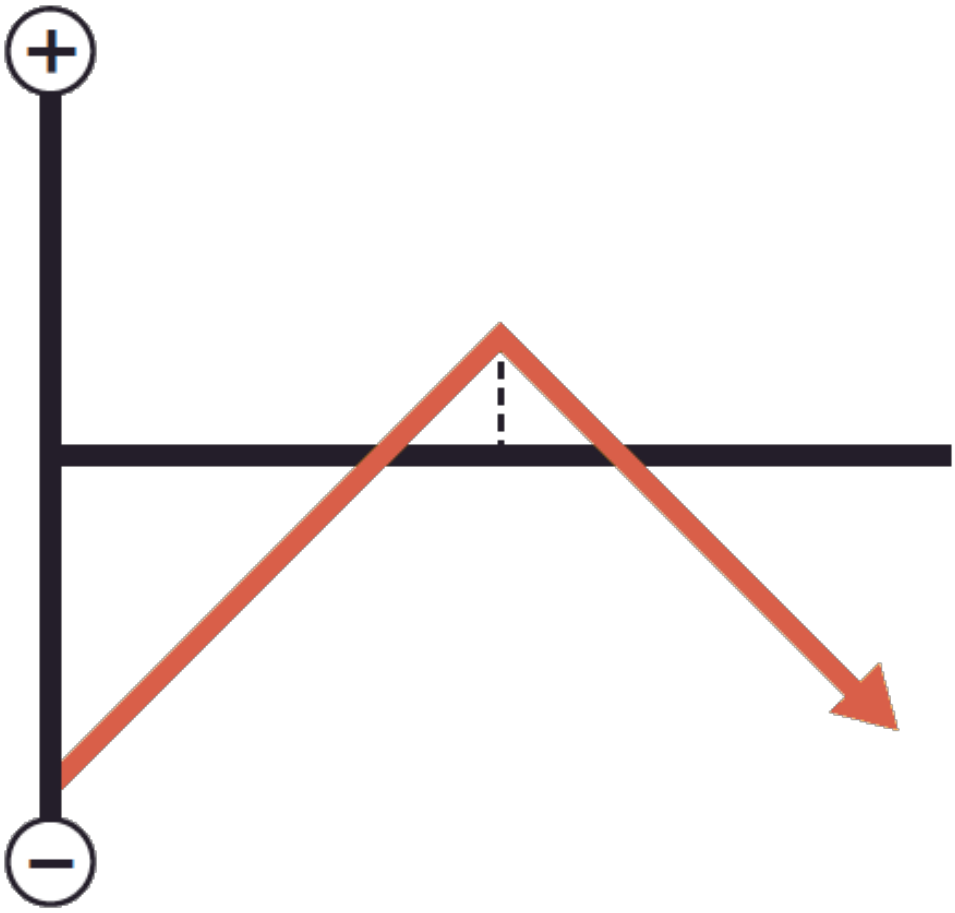
High IV Neutral Options Strategies

If you are neutral on the underlying direction of the stock and implied volatility is over the 50th percentile you'll choose from the following options strategies...

OPTION | Alpha

Short Straddle

Neutral Outlook & High Volatility…



Short straddles are aggressive premium selling strategies that maximizes the credit received and is best used with ultra-high implied volatility ranking stocks.

Because of the undefined risk nature of this strategy it's best to use this sparingly (again only with great setups). We will typically only trade 1 to 2 straddles in our portfolio at a time to conserve the high margin used by these trades.

The Trade Setup

Sell 1 ATM Put; Sell 1 ATM Call at Same Strike Price. The result of both sales is a net credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

With undefined risk strategies, you want to be a little more cautious. Allocate between 1-2% of equity per trade based on initial margin requirements.

Profit Targets

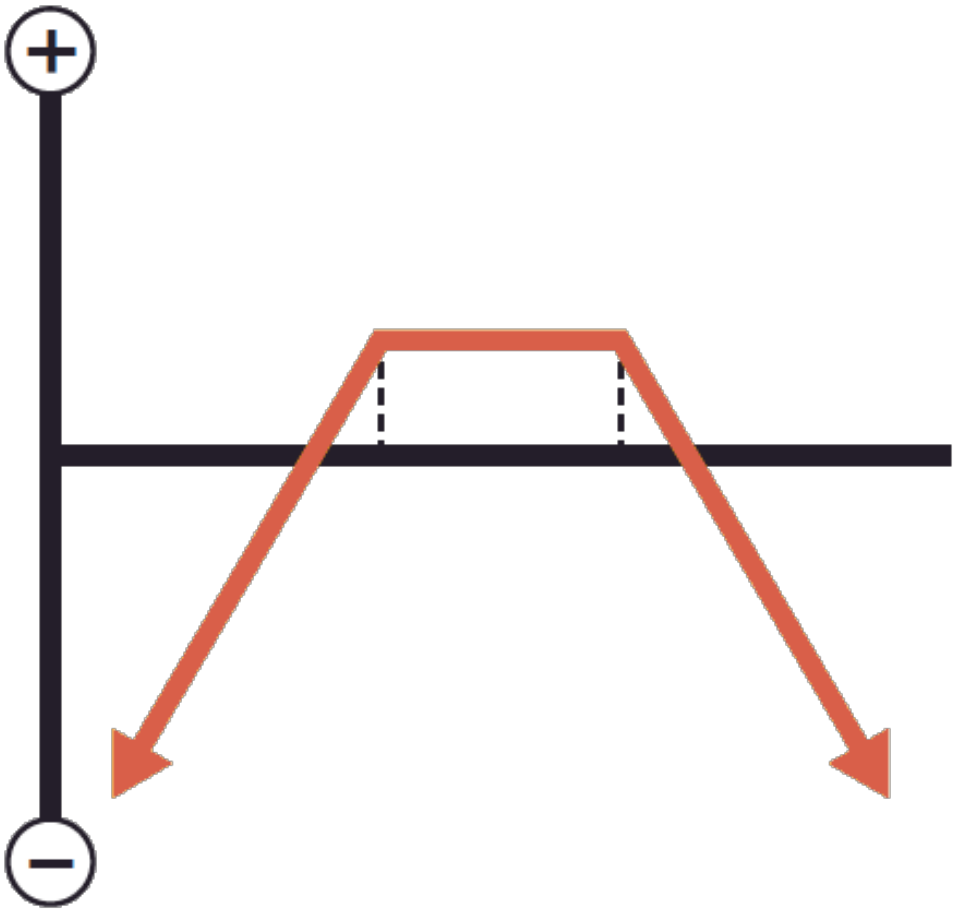
If your position shows a profit near 25% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Two BEPs. 1) Short strike plus net credit. 2) Short strike minus net credit.

Short Strangle

Neutral Outlook & High Volatility…



The short strangle could possibly be the ultimate strategy for options traders. Though it requires more capital in the form of margin with naked options on either side, theses strategies offer the highest probability of success of any trade and generally the highest P&L long term.

This trade is best used when implied volatility is high and when you are looking for the stock to move in a defined range over the trading timeline. We can generally place these trade with more than a 70% chance of success each month.

The Trade Setup

Sell 1 OTM Put; Sell 1 OTM Call at Far Out Strike Prices. The result of both sales is a net credit..

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

With undefined risk strategies, you want to be a little more cautious. Allocate between 1-2% of equity per trade based on initial margin requirements

Profit Targets

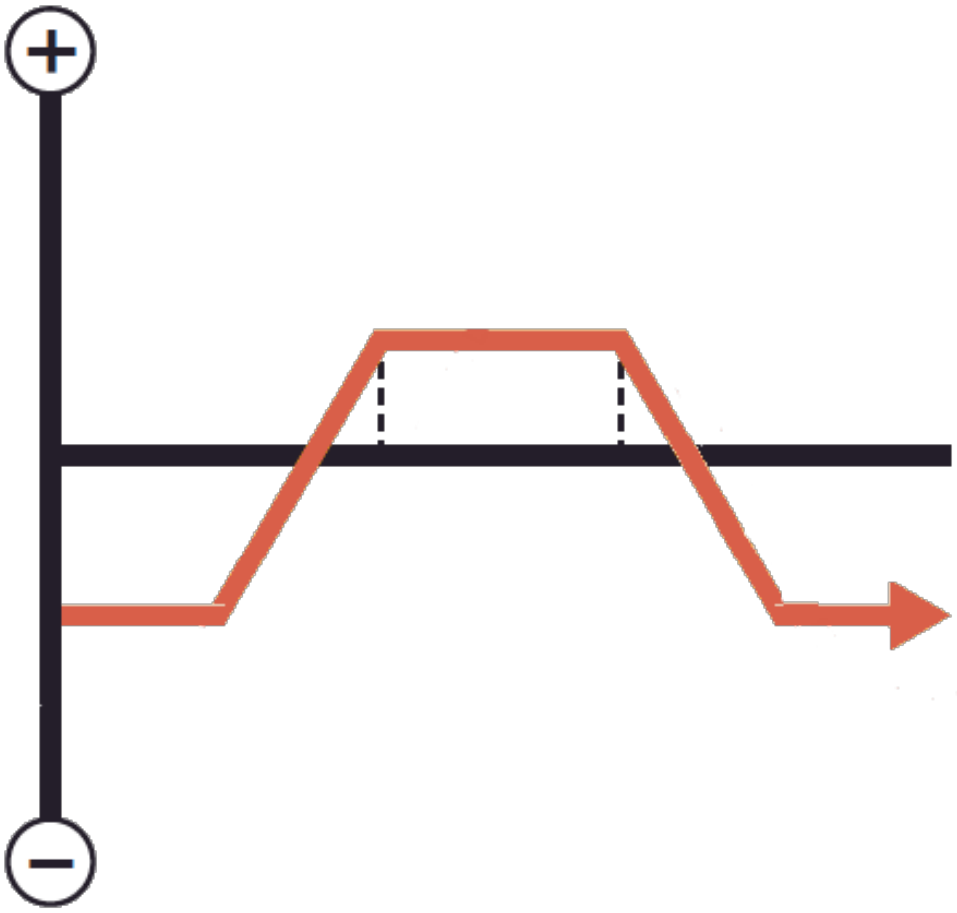
If your position shows a profit near 50% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Two BEPs. 1) Short call strike plus net credit. 2) Short put strike minus net credit.

Short Iron Condor

Neutral Outlook & High Volatility…



Iron condors are one of our most reliable and favorite options strategies. A combination of selling a credit put spread and credit call spread these birds profit from the stock remaining range bound and a drop in implied volatility.

In order to make these high probability trades work we suggest selling the short strikes on either side at the 1 SD level (or 15% prob. ITM level). This will create approximately a 70% chance of success long-term.

The Trade Setup

Sell 1 OTM Put; Buy 1 OTM Put at Lower Strike; Sell 1 OTM Call; Buy 1 OTM Call at Higher Strike. The combination should yield a net credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

Optimal position sizing for option selling strategies like this can be scaled up slightly between 3-5% of your equity balance per trade of notional risk.

Profit Targets

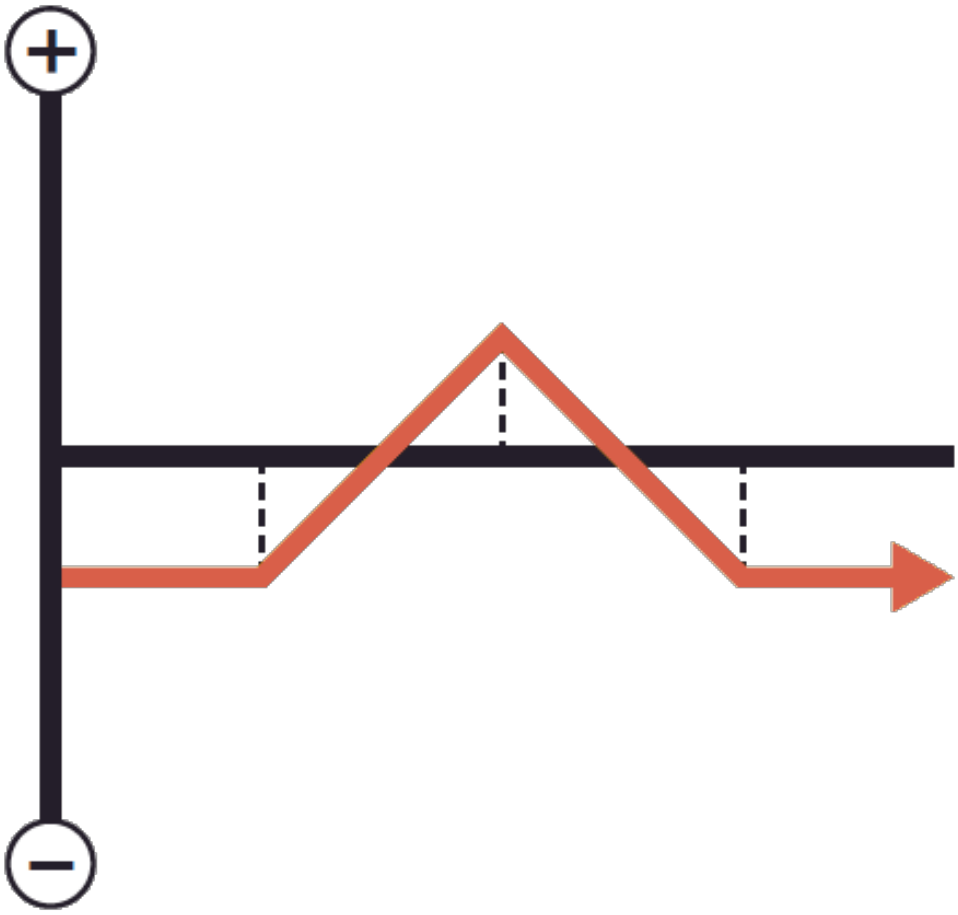
If your position shows a profit near 50% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Two BEPs. 1) Short call strike plus net credit. 2) Short put strike minus net credit.

Short Iron Butterfly

Neutral Outlook & High Volatility…



Iron butterflies are the risk-defined cousins of short strangles and a popular alternative strategy for IRA accounts. A combination of selling ATM puts and call with wider options bought at OTM strikes for protection, these birds profit from the stock remaining range bound and a drop in implied volatility.

In order to make these high probability trade work we suggest buying the long strikes (or wings) at the 1 SD level (or 15% prob. ITM level) or further out if possible. This will create approximately a 70% chance of success long-term.

The Trade Setup

Sell 1 ATM Put; Buy 1 OTM Put at Lower Strike; Sell 1 ATM Call; Buy 1 OTM Call at Higher Strike. The combination should yield a net credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

Optimal position sizing for option selling strategies like this can be scaled up slightly between 3-5% of your equity balance per trade of notional risk.

Profit Targets

If your position shows a profit near 25% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Two BEPs. 1) Short strike plus net credit. 2) Short strike minus net credit.

Low IV & Neutral?
PASS On The Trade!

If you are neutral on the underlying direction of the stock and implied volatility is below the 50th percentile, the best trade is actually ***NOT*** make any trade at all.

Since you have very little edge with respect to implied volatility and no assumption on the underlying direction, skip the setup and find something else - don't force it.

OPTION | Alpha

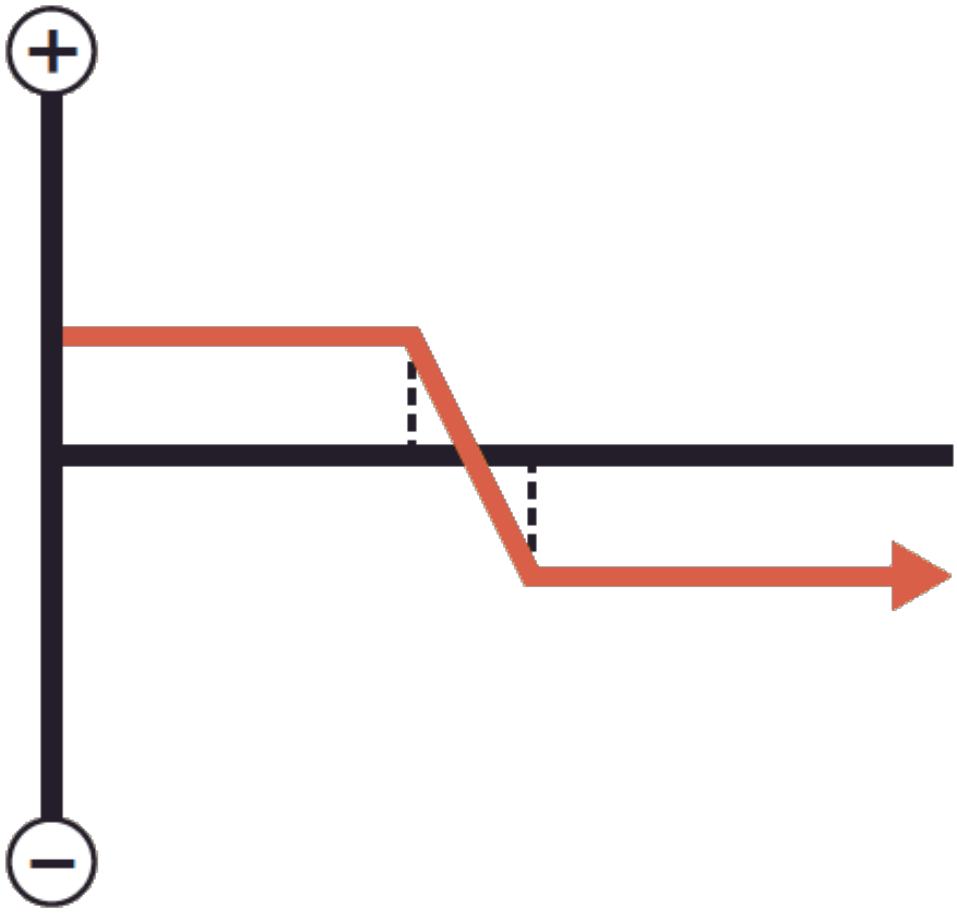
High IV Bearish Options Strategies

If you are bearish on the underlying direction of the stock and implied volatility is over the 50th percentile you'll choose from the following options strategies...

OPTION | Alpha

Call Credit Spread

Bearish Outlook & High Volatility…



Bear call credit spreads are strategies that are designed to profit from both a one-way directional move down in the underlying stock and a drop in the underlying implied volatility.

These are high probability strategies where you are a net seller of options above market price and you are looking for those options to decay in value and become worthless at expiration, allowing you to keep the full premium as profit.

The Trade Setup

Sell 1 OTM Call; Buy 1 OTM Call at Higher Strike Price. The combination of options should result in a net overall credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

Optimal position sizing for option selling strategies like this can be scaled up slightly between 3-5% of your equity balance per trade of notional risk.

Profit Targets

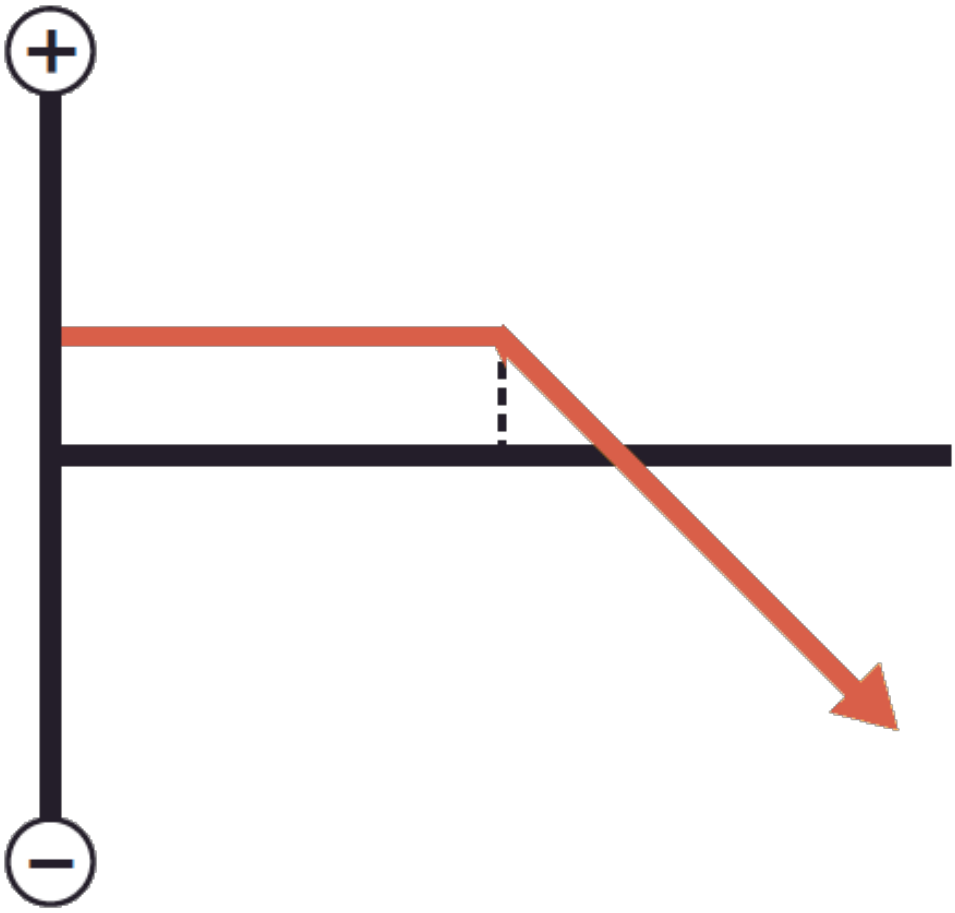
If your position shows a profit near 50% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Short call strike plus net credit.

Short Naked Call

Bearish Outlook & High Volatility…



A short call is an undefined risk trade where you are selling options above the current market price of the stock anticipating both a drop in implied volatility or the stock to remain below your strike price.

This is one of the key building blocks for income and premium selling strategies because you collect a credit for entering the trade and typically have a very high probability of success at expiration.

The Trade Setup

Sell 1 OTM Call above the market for a credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

With undefined risk strategies, you want to be a little more cautious. Allocate between 1-2% of equity per trade based on initial margin requirements.

Profit Targets

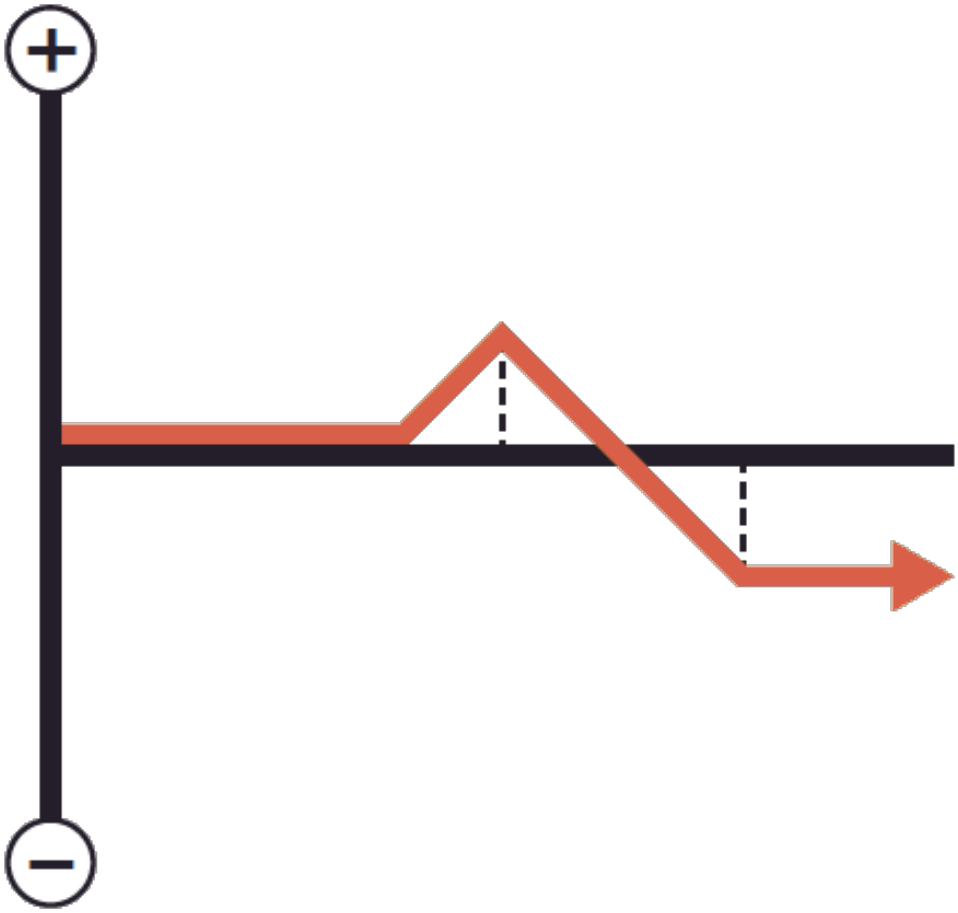
If your position shows a profit near 50% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Strike price plus credit received.

Call Broken Wing Butterfly

Bearish Outlook & High Volatility…



A call BWB spread is an advanced strategy whereby you take a traditional butterfly spread above the market and skip 1 strike to create an unbalanced spread.

These strategies are typically done for a net credit with the goal of having no risk to the downside should the stock keep falling. Skipping a strike allows you do to this because you buy a further OTM call option at a cheaper price which reduces the overall cost of the strategy.

The Trade Setup

Buy 1 ITM Call; Sell 2 OTM Calls near the ATM options; Skip Strike and Buy 1 OTM Call. If possible the trade is done for a net credit.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

Optimal position sizing for option selling strategies like this can be scaled up slightly between 3-5% of your equity balance per trade of notional risk.

Profit Targets

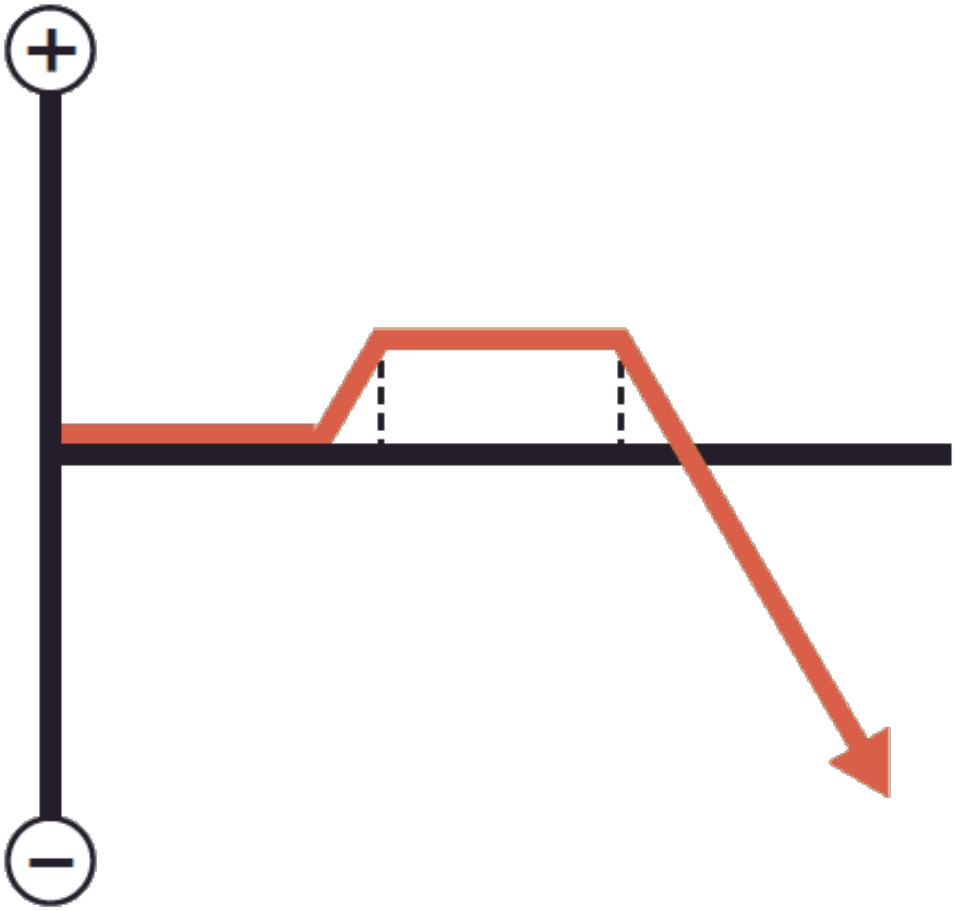
If your position shows a profit near 75% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

Two BEPs. 1) Lower long call strike plus net debit paid 2) Higher long call strike minus net debit paid. Reverse if entered for a net credit.

Custom Naked Call

Bearish Outlook & High Volatility…



A custom naked call is an advanced strategy created by combining a short credit put spread below the market with a short naked call above the market. These strategies profit from falling IV and a bearish-neutral outlook on the stock.

The short credit put spread is added to increase the overall credit received on the entire strategy, and when done for a credit greater than the width of the credit put spread strike prices, you would have no risk to the downside.

The Trade Setup

Sell 1 OTM Call; Sell 1 OTM Put; Buy 1 OTM Put at Lower Strike Price. If possible the trade is done for a net credit wider than call spread width.

Optimal Timeline

Entering these trades 30-60 days until expiration is preferred and should allow you to collect enough premium after commission costs to make the trade worth placing.

Volatility Impact

Since we are net sellers of options, you should be entering this trade only when IV Rank is above 50. All else being equal, falling IV will generally help this position while rising IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position. As net sellers we expect all or part of the trade to expire worthless at expiration.

Risk Management

With undefined risk strategies, you want to be a little more cautious. Allocate between 1-2% of equity per trade based on initial margin requirements.

Profit Targets

If your position shows a profit near 50% of the max potential gain, you should look to close the position early and lock in profits.

Break-Even Point(s)

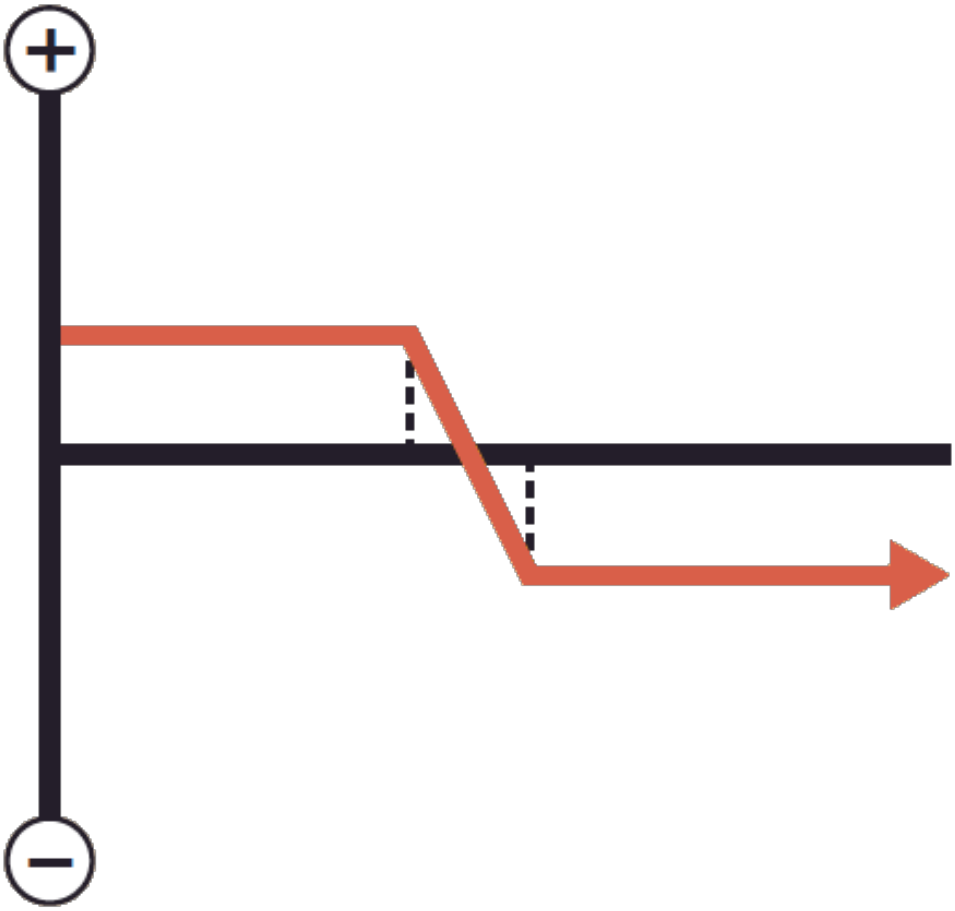
Short call strike price plus net credit received.

Low IV Bearish Options Strategies

If you are bearish on the underlying direction of the stock but implied volatility is below the 50th percentile you'll choose from the following options strategies...

Put Debit Spread

Bearish Outlook & Low Volatility…



Bear put debit spreads are strategies that are designed to profit from a one-way directional move in the underlying stock lower. They also might profit (though not as likely) from increasing implied volatility because you are a net buyer of options.

These are generally low probability trades because that end up being 50-50 bets on the underlying direction. As a result we do not trade these types of strategies often in our portfolio but will occasionally use them for rebalancing purposes and as hedges for other positions.

The Trade Setup

Buy 1 ITM Put; Sell 1 OTM Put at Lower Strike Price. The combination of options should result in a net debit.

Optimal Timeline

Entering these trades 60-90 days until expiration is preferred. Since option pricing is generally be low, you'll want to increase the trade duration and give yourself ample time for the stock to move into a profitable zone.

Volatility Impact

Since we are net buyers of options, you should be entering this trade only when IV Rank is below 50. All else being equal, raising IV will generally help this position while falling IV will generally hurt this position.

Time Decay

Time decay or Theta works negatively against us as part of this position. As net buyers, if the strategy is not ITM at expiration it expires worthless.

Risk Management

Optimal position sizing for option buying strategies like this should be considerably small at less than 1% of your portfolio equity balance.

Profit Targets

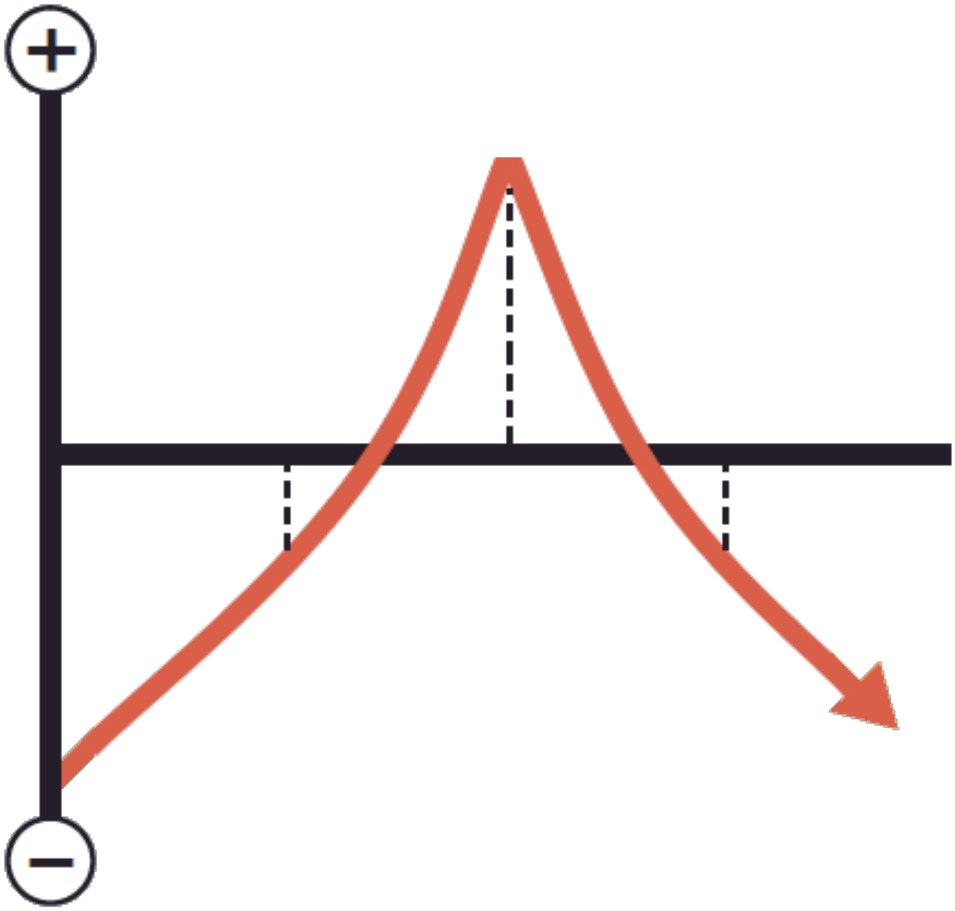
Given the low probability nature of this position, earlier profit taking should be done between 25-50% of the max potential gain.

Break-Even Point(s)

Long put strike minus net debit paid.

Put Calendar Spread

Bearish Outlook & Low Volatility...



Long put calendar spreads profit from a slightly lower move down in the underlying stock in a given range. Calendar spreads lose if the underlying moves too far in either direction. The maximum loss is the debit paid, up until the option you sold expires.

This trade is best used when implied volatility is low and when there is implied volatility "skew" between the months used, specifically when the near-month sold has a higher implied volatility than the later-month bought.

The Trade Setup

Sell 1 OTM Put in the Front Month; Buy 1 OTM Put in the Back Month at the Same Strike Price. The combination of options should result in a net debit.

Optimal Timeline

You should look to target the front month options at least 20+ days out to give yourself enough room for premium decay. Anything shorter than 20 days in the front month or longer than 45 days should be avoided.

Volatility Impact

Since we are net buyers of options, you should be entering this trade only when IV Rank is below 50. All else being equal, raising IV will generally help this position while falling IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position as long as the stock remains range bound which maximizes the monthly contract skew.

Risk Management

Optimal position sizing for option buying strategies like this should be considerably small at less than 1% of your portfolio equity balance.

Profit Targets

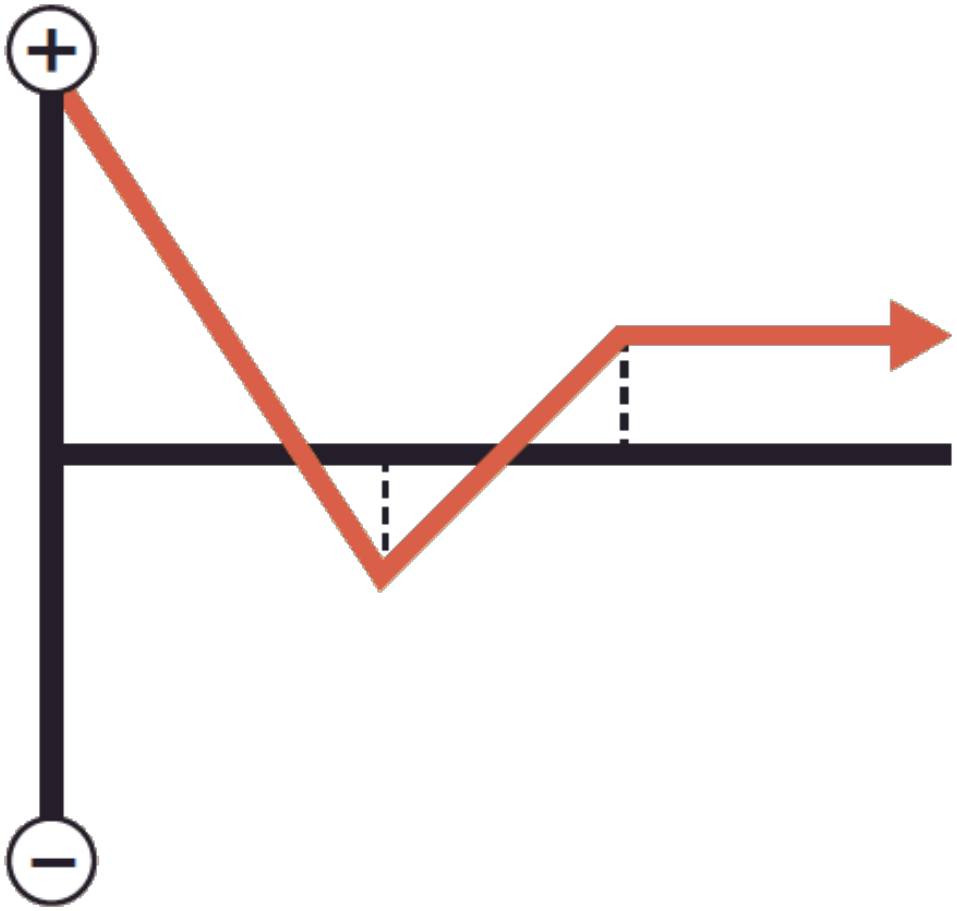
Given the low probability nature of this position, earlier profit taking should be done between 25-50% of the max potential gain.

Break-Even Point(s)

Varies depending on strike prices and volatility.

Put (Ratio) Backspread

Bearish Outlook & Low Volatility…



A Bear Put Backspread is similar to a long put option as far as your outlook on the underlying stock but you use the sale and purchase of different ratios of options to protect against a possible move higher in the stock against you.

These are often referred to as “ratio spreads” because you are buying and selling options at intervals of 1:2 or 2:3 etc. With this particular strategy you would sell a put option and then buy 2 lower strike puts making you still a net buyer of options at a ratio of 1:2.

The Trade Setup

Sell 1 ATM Put; Buy 2 OTM Puts at Lower Strike Price. The combination of options should result in a net debit.

Optimal Timeline

Entering these trades 60-90 days until expiration is preferred. Since option pricing is generally be low, you'll want to increase the trade duration and give yourself ample time for the stock to move into a profitable zone.

Volatility Impact

Since we are net buyers of options, you should be entering this trade only when IV Rank is below 50. All else being equal, raising IV will generally help this position while falling IV will generally hurt this position.

Time Decay

Time decay or Theta works negatively against us as part of this position. As net buyers, if the strategy is not ITM at expiration it expires worthless.

Risk Management

Optimal position sizing for option buying strategies like this should be considerably small at less than 1% of your portfolio equity balance.

Profit Targets

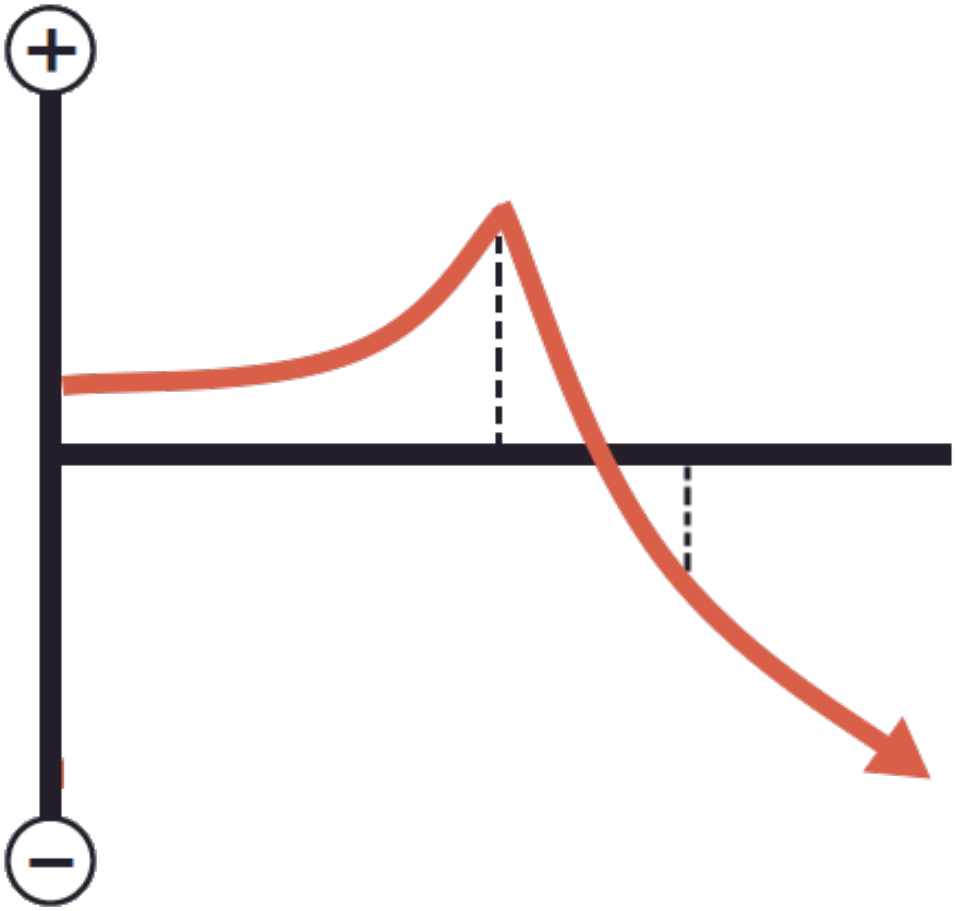
Given the low probability nature of this position, earlier profit taking should be done between 25% of the max potential gain.

Break-Even Point(s)

Two BEPs. 1) Short put strike minus net debit paid 2) Long put strike minus the difference between the long call strike and short call strike less net debit.

Call Diagonal Spread

Bearish Outlook & Low Volatility...



Long call diagonal spreads profit from a lower move up in the underlying stock in a given range. Diagonal spreads combine the directional nature of call credit spread with the volatility impact of a calendar spread. If established for a net debit, risk is limited to the difference between the strike prices, plus the net debit paid.

This trade is best used when implied volatility is low and when there is implied volatility "skew" between the months used, specifically when the near-month sold has a higher implied volatility than the later-month bought.

The Trade Setup

Sell 1 OTM Call in the Front Month; Buy 1 OTM Call in the Back Month at a Higher Strike Price. The combination of options should result in a net debit.

Optimal Timeline

You should look to target the front month options at least 20+ days out to give yourself enough room for premium decay. Anything shorter than 20 days in the front month or longer than 45 days should be avoided.

Volatility Impact

Since we are net buyers of options, you should be entering this trade only when IV Rank is below 50. All else being equal, raising IV will generally help this position while falling IV will generally hurt this position.

Time Decay

Time decay or Theta works positively for us as part of this position as long as the stock remains range bound which maximizes the monthly contract skew.

Risk Management

Optimal position sizing for option buying strategies like this should be considerably small at less than 1% of your portfolio equity balance.

Profit Targets

Given the low probability nature of this position, earlier profit taking should be done between 25-50% of the max potential gain.

Break-Even Point(s)

Varies depending on strike prices and volatility.

About The Author

Kirk N. Du Plessis

Kirk is a full-time options trader, real estate investor, and stay-at-home Dad. A former Mergers and Acquisitions Investment Banker for Deutsche Bank in New York and REIT Analyst for BB&T Capital Markets in Washington D.C., he founded Option Alpha in 2007. Kirk's been interviewed on dozens of investing websites/podcasts/shows and was recently featured in Barron's Magazine as a contributor to their Annual Broker's Review among other financial publications.

What started as a small blog has quickly grown into one of the industry's most respected authorities on options trading with more than 5.4 million visitors each year and 30,000 active members representing 42 different countries.

Each month Option Alpha coaches thousands of people from all over the world who desperately want to be successful trading options but absolutely haaa-ate the run around they get from other training companies.

We show them how to consistently make smarter, more profitable trades while also boosting their confidence by showing them Kirk's personal, real-money trades each and every night after the market closes (good + bad).

When he's not helping thousands of people turn options trading into a passion and income stream they love, you'll find him spending time with his beautiful wife and two baby girls or working on his 1974 Pontiac GTO in their home state of Pennsylvania.