



CHEAT SHEET

Selling Options (Puts and Calls)

“Create Monthly Income While Protecting Your Capital”

Advantages of Selling Options (Puts and Calls):

Puts:

- You will “turn” or use capital more frequently
- Shorter-term positions, and more of them
- Less capital required for each trade

Calls:

- You will collect more cash for each trade
- Less frequent trading
- Leverage existing stock or ETF positions

When to Sell Puts:

If you have a positive view on a stock (Slightly Bullish to Bullish) . . . **SELL PUTS.**

When to Sell Covered Calls:

When you own a stock or ETF and ...

- If you are neutral to mildly bullish on a stock short term
- Trade the build-up but exit before events like earnings

Selecting the Put:

Time Decay: Near-term expiration dates to leverage time decay (no more than 2 months out).

Rich Premiums: Look for stocks with high volatility and rich premiums.

Implied Volatility: **35** is the magic number—looking for Implied Volatility between 30 and 40 (above 55 it gets hairy).

Sell Put Strikes: Sell puts one or two prices in the money

Liquidity: 1,000 open contracts at strike, narrow bid/ask spreads of \$.01 to \$.05 (at most \$.10)

Selecting the Covered Call:

Time Decay: Near-term expiration dates

Rich Premiums: Look for stocks with high volatility and rich premiums.

Implied Volatility: **30** is the magic number—looking for Implied Volatility between 25 and 30.

Sell Out of the Money Calls: Less likely you will get called out of the stock and benefit from time decay.

Target Buy Back Price: Assume that you are going to buy back your covered call at 30% to 50% of the original value.

Narrow Bid-Ask Spreads: You want options with narrow bid/ask spreads --**\$.01 to \$0.05 or maybe \$0.10.**

Entering and Exiting the Put Trade:

Enter Sell and Buy-Back Orders at Same Time: If you don't want to wait for the option contract to expire in the third week of the month, you can enter your "buy back" trade when you enter the "Sell position" with your target price.

Closing a Position: Although the goal is to allow our monthly options to expire worthless (good for the seller), don't equate buying back your puts with not having a successful position. You just put cash in your account by doing so.

Entering and Exiting the Covered Call Trade:

Enter Sell and Buy-Back Orders at Same Time: Set your “buy back” trade when you enter the “Sell position” with your target price.

Stop Loss: A stop loss on a stock will not be “executed” if you have written a covered call and it is still open.

Closing a Position: Don’t equate buying back your calls with not having a successful position. You just put cash in your account by doing so.

Anatomy of a Put Options Trade:

Trade Date: January 17, 2012

Stock: General Motors (GM)

Support for the Trade: The car business is booming in the US – America is now considered the best growing auto market in 2012 – and General Motors is in great shape as a company and as a stock to benefit from this boom.

Step-by-Step Trade Recommendation: Sell the GM March \$23 puts for \$.95 (ninety-five cents) or \$95 per contract.

1. Sell (not Buy)
2. GM (stock ticker)
3. March (month in which the option contract expires)
4. \$23 Strike price of the stock (underlying stock) supporting the option. (GM was trading around \$24.20 at the time)
5. Puts (we are selling puts)
6. \$.95 (ninety-five cents)—price of each share in the contract
7. \$95 per contract = \$.95 x 100 (100 shares are in 1 contract) = \$95.00 per contract.

Result: In less than 30 days, the price of GM ran up to over \$27 and on February 16th we bought back the GM March \$23 puts for \$.15 (fifteen cents).

Cash in Hand: The seller of this trade kept \$80 for every contract of GM March \$23 puts sold (\$95 less \$15).

Trade Return: 3.4%

Annualized Return: 41.7%

Anatomy of a Covered Call Options Trade:

Trade Date: January 26, 2012

Stock: SPDR Gold Trust ETF (GLD)

Support for the Trade: Gold broke above some key technical levels and yesterday, Ben Bernanke said we are going to get cheap money for at least three more years. Gold spurted and has far more room to run for it is an inflation hedge for many, a fear hedge for those afraid of Europe and fundamental demand for the metal is growing in emerging countries such as China and India.

Step-by-Step Trade Recommendation: Sell the GLD February \$170 calls for \$1.65 or \$165 per contract.

1. The ETF (The GLD is a widely held ETF for gold and for this trade you either need to own the GLD or would buy at least 100 shares before you make this trade).
2. Sell (not Buy)
3. GLD (ETF ticker)
4. February (month in which the option contract expires)
5. \$170 Strike price of the ETF (underlying stock) supporting the option. (The GLD was trading around \$167.50 at the time)
6. Calls (we are selling covered calls)
7. \$1.65—price of each share in the contract
8. \$165 per contract = $\$165 \times 100$ (100 shares are in 1 contract) = \$165.00 per contract.

Result: The price of gold grew modestly and the GLD basically varied between \$167 and \$168 allowing the calls to expire worthless after the close on February 17th (options expiration week).

Cash in Hand: The seller of this trade kept \$165 for every contract of the GLD February \$165 calls sold.

Trade Return: .9%

Annualized Return: 14.4%