

THE TRADER'S BLACK BOOK


20 YEARS OF

BATTLE TESTED SECRETS

JEFF BISHOP

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FOREWORD

I've known Jeff for the better part of a decade. Few people in our lives have enough of an impact to change the course of events. Even after becoming a successful trader myself, I still think back on the basics he taught me. Given that I started out as a High School teacher making \$35,000 a year, I cannot express the depth of my gratitude.

Jeff not only gave me a chance to show the best of myself but he also enabled me to help others. At the end of the day, that's what Raging Bull is all about. One person parlayed his experience on me. I then had a chance to pay it forward to Kyle Dennis. Each of us continues to create more members with wealth every day.

I asked to write about Jeff's story to give you a sense of who he is. When you push past the confident exterior, you find someone that's been built layer upon layer. Jeff genuinely cares about helping people. Otherwise, he wouldn't have taken a chance on some no-name schoolteacher.

First, you need to understand something about Jeff. He didn't grow up in affluence. His family lived paycheck to paycheck. No one had a financial background, let alone invested in stocks. At the same time, Jeff had an entrepreneurial spirit fed by his mother. She always looked to contribute to the family. A traditional job was out of the question due to a handicap. His mother would try to sell crafts, quilting, or whatever she could do to help.

Achieving his current level of success took a lot of time and failures. Jeff headed to Junior college before he attended The University of Texas. He was the first person in his family to continue education beyond high school. Luckily, college was affordable back then. That helped Jeff, who worked the entire time. His Undergraduate degree took him 6-7 years as he got married early in the process. He eventually graduated with a degree in

Finance and a Masters in Economics. Start to finish, he spent 10 years in school.

Like many of us, the stock market held almost a mystic aura to him. He watched as the Gordon Gecko's of the world rode around in their high-end cars in expensive suits. He didn't know how to learn about the markets, but figured that a finance degree would be the key. Yet, as many of us learned, college doesn't teach you about trading stocks.

Taking his entrepreneurial bent, Jeff started up a few businesses. He flipped used cars from his house and later from a small lot. He owned a bagel shop for a year. He tried his hand at roofing. It wasn't until Jeff's landscaping venture that his life's direction started to change. Anyone who's had the desire to start a business thinks about how to grow. Jeff figured he could become the largest landscaping company in the Dallas area. Along the way, one client, Bob, pulled Jeff aside. Bob took a particular interest in Jeff. He asked Jeff what he was doing with his life. Jeff told him about his idea to grow the landscaping business.

Bob's response- "That's probably not going to work out for you." – Ouch.

Retired from the army, Bob told Jeff what he learned about the stock market. He explained how he valued growth and stability over speculation. Pointedly, he told him about risk management.

Excited and energized, Jeff threw himself back at his passion. He applied for jobs at hedge funds. He came across...bubkes. Turns out, when you have so-so grades from Texas, funds aren't interested in you. Like myself and many others, you take what you can find. In Jeff's case, that didn't go so hot.

At one job at a real estate investment company, Jeff made about \$30,000 a year. The whole process involved taking numbers off one sheet and dropping them into another. It's some of the most tedious work I'd heard of. During the day, Jeff would pull up his Ameritrade account, watch charts,

and place a trade here and there. Turns out the employer could see everything.

His boss pulled him in to confront him. Jeff dropped an excuse like any other young kid. He said he only 'watched' the charts but wasn't trading...hilarious. Did he stop? But did that stop him? Nope. A month later, he was still at it. Two weeks before Christmas, Jeff got axed.

And this was immediately after his first child was born!

After talking things through with his wife, Melissa, they decided that she would go back to work while Jeff stayed home with their son. At the same time, Jeff went back to school to get his Masters.

During his free time, you could catch Jeff playing a lot of online poker. Turns out he was decent. The only problem, the swings day to day would wreak havoc on his profits. It wasn't something that could sustain a family.

But Jeff never lost his interest in stocks. After blowing up a few accounts over the years, Jeff finally developed a strategy that worked. His profits grew. He would help people learn how to trade (like yours truly) over the years.

Along the way, Jeff realized that the retail trader stood at a disadvantage. He began to see the holes in everyday education. If it took him two decades to learn about the market, maybe he wasn't the only one.

Frustrated with what he saw, Jeff set out with the goal of creating Raging Bull. A company that offers traders a variety of styles to hone their skills. Traders pick among different personalities and styles that fit their lifestyle and their unique needs.

Jeff's [Bullseye Trades](#) help investors get started in the market. When I started trading, I couldn't dedicate all of my time to it. I wish I had this service starting out. Jeff picks out his best trade idea for the week and delivers you one winner after another. More importantly, he shows you how he picks them.

This service provides a great introduction to options trading and learning the markets. It's also an incredible way to build wealth part-time.

Throughout this book, Jeff goes over the **REAL** keys to trading and making money. Some may seem simple. Others might be somewhat new to you. Regardless of your skill level, you will absolutely find something to take away.

- Jason Bond

GETTING THE MOST FROM THIS BOOK

As I sat down to put this book together, I thought about how I got here. I could tell you about the stops run. My trades that almost made it. Selling a stock only to watch it go up immediately afterward. Fat-fingering the keyboard and shorting 1,000 shares instead of buying them

If you can think of it, I've done it. It's not a badge of honor. But it is an experience. Anyone you come across that's traded the markets has something to give. I've been through the wringer and then some. Take from me what you can. Use this material to shorten your learning curve. Why spend time on trial and error when I've already done the heavy lifting? Pair it with the **Bullseye Trades** service, and you'll start turning serious profits in no time.

With that in mind, I want to discuss several concepts to think about as you read this book.

Time Commitment

When I started trading, I worked full time and tried trading full time. I would not recommend you go that route. It involved a lot of stress that ultimately led to me getting fired.

Just like any skill, you must practice trading. This involves more than just clicking a mouse. However, it doesn't mean that you need to spend all day, every day in front of the charts.

So what's the appropriate amount of time to spend studying? How successful you become as a trader comes down to two things: *learning curve* and *time dedication*.

Working with [Bullseye Trades](#), you cut down the amount of time it takes to learn. Why is that?

Consider the journey most traders take. They start by learning the basics. Maybe you try things out in a demo account. One of the worst things that can happen when you start out is becoming randomly successful. You win a lot of trades, but you don't know why. That can lead you to believe something worked when all you had was luck.

Most of your journey will involve trial and error, jumping from one system to another. You hear of someone who became successful using the most amazing indicator. When you try it out, you end up losing your shirt.

90% of all retail traders blow up their account within the first six months. I went through several of these before I became successful.

Why don't we try something new? How about a system that has been battle-tested and proven to be successful? A system that's worked for me, Jason Bond, and thousands of other traders?

That's why you're here. Rather than spending inordinate amounts of time on the wrong things you want to,

make sure you dedicate enough time to matter, but not so much that you burn out.

Your time is valuable. Each person's situation is completely different. A college student may have 3-5 hours a day to watch videos and look at charts. Parents of multiple children may only have an hour every couple of days or on the weekend. That's ok.

Whatever time you can spare matters. I will give you one key piece of advice. **Make sure that you spend no less than 30 minutes at a time if possible. 45-60 minutes is ideal.** That gives you enough time to get deep enough into the material that it sticks with you.

Risk Profile

Some of you may have heard this story before. Several years back I went to the Bahamas for vacation. Market volatility was nowhere on the radar. So, I continued to sell far out of the money call spreads on the **UVXY**. I leave the U.S. and can't check my account.

Finally, I get somewhere that I can look at things. My account shows...**I'm down \$1 million!**

I hadn't seen a gray hair on my head until that day. Luckily, I was able to close the trade for only a **\$500,000 loss**. That's right. Only a measly \$500,000!

That is not a feeling any of you want to experience. I'd broken the basic rules of risk management.

As a trader and investor, you need to **understand your risk profile**. This involves figuring out a few items.

- 1) *Goals* – Planning for retirement usually involves a lower risk appetite than trying to earn cash for a new television.
- 2) *Volatility* – If you wake up one day and your account is down 10%, will you lose your mind?
- 3) *Time Horizon* – Do you plan on using the money in 10 months or 10 years?

Each of these defines how much or how little risk you want to take. You always want to have a mix of risk in any portfolio. It's a balance between having trades that keep you up at night and ones that earn you less than a savings bond.

Capital

A lot of talking heads will tell you that you need thousands of dollars in an account to start.

But that could not be further from the truth.

Across all of **Raging Bull**, we have numerous ways to trade that don't require lots of money. I've seen people turn over accounts with less than \$1,000 into some serious profits. For example, the **Weekly Money Multiplier** service is specifically designed to work with any account size.

That's one of the beauties of *options trading*. You can leverage your capital and define your risk. It takes the best attributes of stock trading and strips away many of the drawbacks.

However, make sure you understand some basic requirements for trading options before you begin.

First, if you have less than \$25,000 in an account, you become subject to *Pattern Day Trading*. This federal rule limits you to three opening transactions in a five-day period for any stock or options trades. The rule applies to each dollar you use.

Here are two examples of how it would apply to a \$5,000 account.

- You could buy \$5,000 of IBM stock 3 times in 5 days
- You could buy \$1,000 of IBM stock 15 times in 5 days
 - o Note that each dollar gets 3 opening transactions
 - o Since you broke it up into blocks of \$1,000, you get 3 opening transactions on 5 x \$1,000

Second, if you want leverage in stocks, to short stocks or to trade option spreads, you will generally need a margin account. This requires a minimum \$2,000 balance. If you want to buy and sell call and put options, you generally do not need a margin account and the \$2,000 minimum.

(See for a basic explanation on stock options)

Be sure to check with your broker about their rules as each is different.

VALUABLE DISCIPLINES

There are a couple of very basic, but immensely important disciplines that every successful trader practices. If you are just getting into the stock market, then these principles will be a key part of your journey to consistent trading profits.

The Art of the Chart

Learning how to trade involves looking at charts. There's really no way around it. Company performance may drive long-term stock value. For traders, we look at charts.

Technical analysis (the study of charts) helps us visually see and calculate human behavior. If you've never looked at a price chart before, it can be a bit nerve-racking.

When you start out, come up with your initial ideas. Look at charts for patterns and trends. You can always test an idea by hand. Write down your trades using a historical chart. Then see if they worked out. Keep a journal to analyze the performance of your trades over time and make note of any patterns you see.

Then, compare your trades to trades you see on a service like [Bullseye Trades](#). See how I made a trade. What did I do differently? What did you miss and what did you get right?

Then rinse and repeat. Take notes on the charts. Each time you go through, try to learn something new. Test your ideas. Ask questions.

You will take less time and become profitable faster by starting with a profitable system as opposed to flailing around on your own.

Know Your News

I remember September 11th, 2001 vividly. Only a few years before I started trading. The tragedies of that date tore at the very heartstrings of our nation. At the same time, the widespread fear and risk aversion took hold.

When stocks finally reopened on September 17th, shares of airlines crashed. American Airlines dropped 39%. United Airlines dropped 42%. Banks like Merrill Lynch lost 11.5%. Morgan Stanley lost 13%.

Not every news event will impact a stock. With the global information age, stories spread like viruses in seconds.

As traders, we can't control the news. What we can control is how we manage uncertainty.

Earnings announcements, product releases, and dividend payouts are things we can know about in advance. You need to understand how events impact your trades.

For example, nearly every stock's Implied Volatility (IV) rises into earnings and drops right after. IV determines the price of an option. The higher the IV, the higher the option price. When you buy an option far enough in advance of earnings, you pay less for implied volatility (though you pay more for the time to expiration).

I used this exact idea with my trade on Zoom Video Communications (**ZM**) on August 26th. My chart setup was as follows:



I followed up with an email outlining the trade for members.

*“When **ZM** IPO’d back in April of this year, it went on to gain 80% in about a month. Since then, it has been in consolidation mode. I think it is gearing up for its next big move. It has been trading in a tight range, and holding its upward trend line for the last few weeks now, despite the recent volatility.*

*The way **ZM** is consolidating and still trending upwards in a market like this, tells me that it wants to break out soon. I like the idea of choosing an IPO here as well, as they tend to do their own thing and ignore what the overall market is doing. I think it can still find its legs to breakout even if we see some red in the markets this week. ZM has earnings on September 5th, and I think this will act as a catalyst as well.*

*I am going with the **ZM** Sep 6 2019 \$95 Call. Note that although this contract is the earnings series, I will *not* hold through earnings. I am looking for **ZM** to make a move back into the 100’s, which is where I will take my profits and be out before the earnings release. I would add to this position around \$90, but close below \$88 would break the setup and force me out of this trade.”*

By September 3rd I cashed in with members for a nice profit.



I just sold the **ZM calls @ \$4.60** that I bought last week. **That's \$4000 right in my pocket -- in less than a week!**

Great score and proves the value of patience in this market. Not chasing the opening pop last week and holding the options as long as the trend was intact was the right call here.

Awesome trade!

Some stocks constantly have news that drives share prices wild. Tesla (**TSLA**) lives and dies by whatever Elon Musk decides to say or do. Other companies like Hormel (**HRL**) won't have any news for years. Then one day you get a meat recall that slams the stock.

We can only work with the best information at the time. Everything else is up to the trading gods.

KEY CONCEPTS

If you are just beginning to try your hand at trading options, then there are a few critical concepts that you'll need to understand about how stock options function. Starting with these fundamentals will give you a good baseline before diving into the wide and fascinating world of options.

Leverage & Margin

Financial advisors tell clients to be cautious of margin and leverage. Rightfully so. They act like spider powers, requiring great responsibility.

However, using margin and leverage appropriately helps to better manage risk. These words don't deserve the negative press they get. But let's understand what they are to begin with.

Leverage

Leverage involves controlling more shares than the cash you have available would warrant.

You can have leveraged trading without margin. For example, you can buy and sell call and put options without margin. However, option contracts allow you to gain leverage.

Margin – When you borrow from your broker to place a trade, you borrow on margin. Margin accounts allow you to use the broker's funds as a backstop against any major losses. If you want to trade option spreads, sell naked options, short stock, or trade futures, you'll be required to have a margin account. Most brokers require a minimum \$2,000 balance to

maintain a margin account. You can trade on margin without leverage. Shorting a stock requires margin, but not leverage.

At first glance, trading on margin seems like a risky proposition. It definitely can be. When your position goes too far against you, the broker will “call” your account. Known as a “margin call”, this means you have to exit your positions immediately to prevent further losses.

The movie *Margin Call* highlights a company that begins to lose big. They soon realize that they cannot cover their losses.

This is the downside of leverage and margin. When your losses exceed your account, you still have to pay back the balance.

However, managed use of margin and leverage help many traders reduce their exposure to volatility and hedge risk.

Option spreads require margin. Traded correctly, they have defined risk and rewards that successful traders exploit through probabilities. Basic buying and selling of options doesn’t require margin accounts, but gives you leverage.

Why is that? Each option contract comes with 100 shares known as lots. You effectively control 100 shares for each option contract. If you buy a call option with a strike price of \$100 and a stock goes to \$101, you’ve made \$100.

That’s the power of options trading. With a small amount of capital, you control a large amount of stock. You can take advantage of small movements for major profits with a defined risk. When you learn to wield this weapon effectively, you gain a power over the market.

In my [Total Alpha](#) service, I help traders to fully exploit this concept by identifying trade setups that I think stand to make me huge amounts of profits by trading options on them. By alerting my members about the specific options contract I am looking at and why I think it’s an ideal setup, I help my members pick up large wins with limited capital.

Here’s an example of what members of my **Total Alpha** service see.



Such a great setup right now and as long as the market holds up, I think BA is going higher. Maybe tests \$400 in the next week or so just to cause shorts some max pain.

I just bought **BA Oct 04 '19 \$385 Call @ \$6.65**.

Here is what I see in the chart right now:



Members that followed my advice on this trade were able to carve out a healthy profit along with me.

>> Symbol ▾		Actions	Last Price \$	Change \$	Change %	Qty #	Price Paid \$	Day's Gain \$	Total Gain \$	Total Gain %
> BA ⓘ Oct 04 '19 \$385 Call		Trade ▾	10.15	4.58	79.91%	60	6.075	27,450.00	25,320.12	69.41%

OPTION BASICS

In a letter to shareholders in 2002, Warren Buffett infamously said, “In our view, however, derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal.”

Derivatives often have a negative connotation. Many believe they are just tools for speculation with a high degree of leverage invented by mathematicians.

That’s a load of garbage. Derivatives allow retail traders and institutions to manage risk and volatility. It’s when you use them irresponsibly and recklessly that they devastate portfolios.

Heck, derivatives have been around before all this fancy math and technology. The first reference to a derivative-like security dates back to Genesis 29 (that’s right, derivatives have actually been around for thousands of years, whether traders like it or not).

In this guide, we will be discussing options, how to use them to reduce risk, create consistent performance, and manage capital.

So, what are options?

Options Explained

Before we can become an effective options trader, we must understand some of the nuts and bolts that make up the options market. Let's start by looking at some of the most basic terms and concepts and how they play into your options trading strategy.

An *option contract* is an option to buy or sell an underlying asset, which could be a stock, index, futures or commodities. They work like insurance products. You buy auto insurance to protect you against an accident.

Picture a farmer who sells grain at the market. Over the course of a year, the price of grain varies between \$20-\$40 a bushel. Right now, he can sell his grain for \$30 a bushel.

The farmer goes to the market to buy an option contract. He wants the option to sell his grain at least at \$30 per bushel for the next year. The option seller thinks about this and offers him a deal: he will buy 100 bushels of the farmer's grain at \$30 all year. But, he wants \$100 in return.

This contract is known as a put contract. The farmer bought the right to sell (put) 100 bushels of grain to the trader for at least \$30 during the year. If grain stays above \$30, he'll just sell at the market rate. If the price falls below \$30, he'll sell it to the trader.

That's all an option contract is – the right to buy or sell the asset at a given (strike) price. Here, we will be sticking with stock options because it's our community's bread and butter.

Now that we understand what an option contract is, let's dive into some of the other elements that make up the options landscape.

Call - Option contract that gives you the right to **BUY** the underlying stock at the specified strike price, on or before the expiration date.

Put- Option contract that gives you the right to **SELL** the underlying stock at the specified strike price, on or before the expiration date.

Premium - When trading call or put options on the long side, you pay a premium to receive the right to buy or sell 100 shares of the underlying asset, and you're not obligated to do so. The amount of premium you paid is the maximum amount you could lose. If you sell an option, you receive the premium.

Underlying – This is the stock, index, or other instrument that the option derives its value from.

Strike - The price you choose for your contract on puts and calls is known as the strike price. This will be the price that you have the option to execute the contract.

Expiration Date - Option contracts don't last forever. They only last until the expiration date. American options could be exercised at any time up to the expiration. European options can only be exercised at expiration. Stocks trade with American style options. Index options will trade with European style options.

Terminology Note: American and European options have nothing to do with the geography. They just refer to a type of option.

Let's now explore some of the concepts related to the value of a stock option.

In-The-Money - You are in-the-money when the value of the option has value if the option were to expire immediately. Call options become in-the-money when the stock's price exceeds the strike price. Put options become in-the-money when the stock's price falls below the strike price.

Going back to our farmer example, if he holds a put option (right to sell) grain at \$30, he is in-the-money when grain falls below \$30. At that point he can sell his grain at above market rates.

Out-Of-The-Money - You are out-the-money when the value of the option has no value or if the option were to expire immediately. Call options are out-of-the-money when the stock's price is below the strike price. Put options are out-of-the-money when the stock's price is above the strike price.

Exercise an Option – Option contracts aren't just for trading. Investors, like the farmer, may want to execute the contract. We call that 'exercising' an option. When you buy an option contract, you have the right to exercise the option. When you sell an option, only the person who bought it can exercise the option.

Word of Caution: You will never have anyone exercise an out-of-the-money option you sold. However, in-the-money options you sold (especially where the stock has moved far past the strike price) may be exercised. This can happen without warning. Make sure you have a plan if this happens to your trade.

Intrinsic Value – Once your option goes 'in-the-money' it has intrinsic value. Imagine if an option were exercised right now, or we were at expiration. Whatever value it has is known as intrinsic value. If you owned a call option with a \$100 strike price, and its stock trades at \$102, your option will have \$2 of intrinsic value.

Extrinsic Value – Any value an option has when it is at-the-money or out-of-the-money is known as the extrinsic value. Unlike intrinsic value, extrinsic value goes to \$0 at expiration or when an option is exercised.

Note: Until expiration, an in-the-money option can have both extrinsic and intrinsic value. Using the above example, say you own a call option with a \$100 strike price. The stock currently trades at \$102. Your option currently trades for \$3. That option has \$2 of intrinsic value and \$1 of extrinsic value.

Writing/Selling Options - When you sell (Aka short) options, you become the insurer. You receive a premium for taking on the risk. This means you are on the hook for the value of a call or put option that goes in-the-money.

Note: Your risk when selling options can be unlimited on puts, just like shorting a stock. It's nearly unlimited when you write calls, just like buying a stock. The difference is the loss for a call stops when the stock hits \$0. In the pages ahead, we'll go over ways you can create trades that sell and buy options at the same time which limits your losses.

Real World Examples

Let's look at a few examples of actual option contracts to bring this all to life. We'll use some popular stocks that you might be familiar with.

AAPL Feb 16 2018 170 Call

If you owned the call option, you would have the right to buy 100 shares of AAPL at \$170 per share, on or before the expiration.

SBUX Feb 16 2018 58 Put

If you owned these SBUX put options, you would have the right to sell 100 shares at \$58 per share, on or before the expiration.

OPTIONS PRICING

Options pricing models involve heavy math. I don't think it's necessary to overwhelm you with all that information when you're just starting out. But, it's worth mentioning the most common out there is known as the *Black Scholes* model.

What you do need to know is what affects option prices. In this section we will cover some of the important factors that influence the price of an option.

Plus, we'll give you the fancy Greeks so you can impress your friends!

Underlying Stock's Price – Known by the Greek Symbol Delta

Obviously, the stock's price influences the price of an option. How much it impacts it depends on the other factors below.

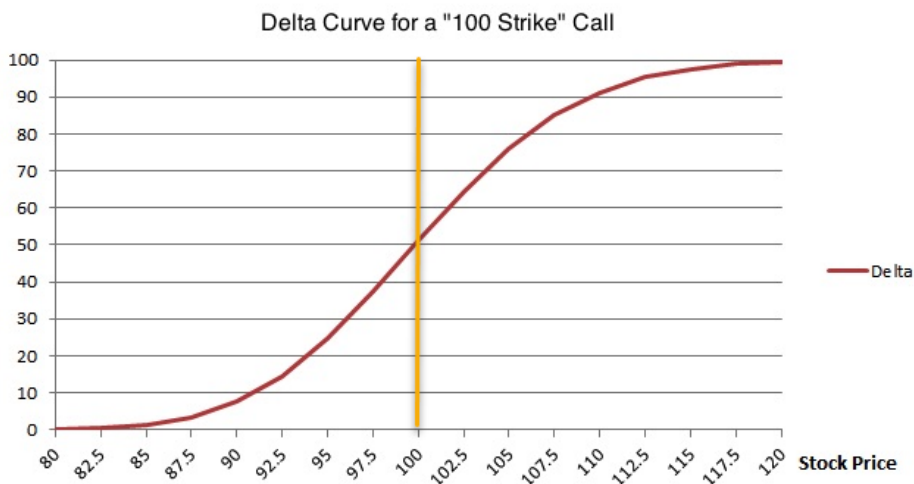
The amount that an option's price changes per \$1.00 movement in the stock is known as Delta (AKA price sensitivity). A delta of 16 means that the option price changes \$0.16 for every \$1.00 change in the stock price.

For call options, when the underlying price rises, the premium rises. With puts, as the underlying price rises, put option premiums fall.

Now flip it around... When the underlying price falls, call option premiums would fall, while put option premiums would rise.

ADVANCED FACT: Delta is known as the “price sensitivity”. As you get closer to expiration, Delta changes. The rate of that change is known as Gamma. Think of Delta as the speed of a car and Gamma as the acceleration/deceleration.

Here’s a chart to illustrate how the value of the price component in an option changes on a \$100 call option that still has plenty of time before expiration.



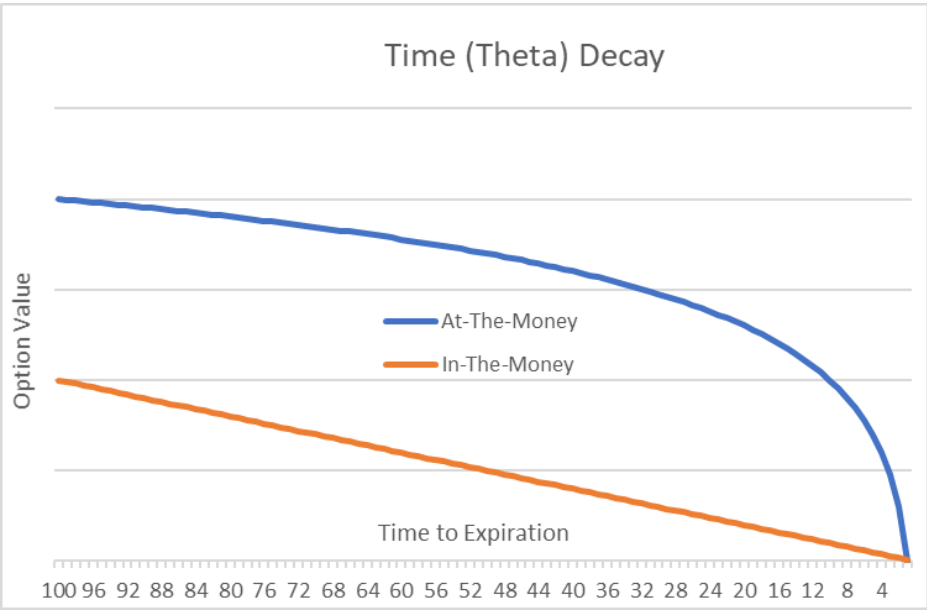
Notice how the further out-of-the-money (below \$100) you go, the value drops. When you go further in-the-money, the value moves near \$100.

Time Value and Expiration – Known by the Greek Symbol Theta

Think back to our discussion about the farmer and insurance. Imagine you are the insurer. Would you charge more for a policy that lasts 10 days or 10 months? Instantly, we know that the longer contract should cost more. The longer the option remains active, the more time it has to move in-the-money.

That’s why option contracts cost more the further they are from expiration. Out-of-the-money and at-the-money options have a time decay that speeds up as you get closer to expiration. In-the-money options move in a linear fashion.

Here’s a graph that illustrates how the option value changes as it gets closer to expiration.



Theta tells you the amount the option loses in value per day. As time goes on, Theta will change just like the graph above.

PRO TIP: Try to avoid buying options that expire same day or next day. Unless you're in-the-money, the time decay works so quickly that you greatly reduce your chances of success.

Implied Volatility – Known by the Greek Symbol Vega

Let's go back to the farmer and the grain insurer. The insurer needed to think about how likely it was the price of grain would drop below \$30 from the current market rate. He has two ways to do this. First, he can look at historical price movement (known as volatility). Second, he can look at what everyone else in the market thinks about future volatility.

The second method is known as implied volatility (IV). Implied volatility measures the market's expectation of price movement in the next year.

Here's how it works. Everything else that goes into an option's price is known: interest rates, dividends, time to expiration, and stock price. If you knew the price of the option, you could solve for the implied volatility.

So, implied volatility is actually an output using the current price of an option. I know it sounds a little weird. How do we know the price of an option? Isn't that what we're trying to calculate?

When options trade in the open market, investors 'discover' the correct price through negotiating (this happens electronically). Eventually, they

settle on a price and execute a trade. This is the same way stock prices are 'discovered'.

This means that the traders' willingness to buy and sell the option (supply and demand) actually figure out the price of an option. That then tells you what the implied volatility is.

INTERESTING CONCEPT: The idea that buyers and sellers come up with the 'right' price based on implied volatility isn't entirely accurate. In fact, implied volatility often overstates actual volatility. That's why option sellers always have an advantage in the marketplace. If implied volatility didn't overstate actual volatility, they wouldn't have any incentive to sell the option. Think...why would your auto insurer sell insurance to only break even? They want to make money!

Interest Rates – Known by the Greek Symbol Rho

Generally, interest rates do not affect premiums as much as the time value, the underlying stock price and volatility. However, in a highly volatile interest rate environment, rates matter. An increase in interest rates typically increases call prices and decreases put prices.

Dividends

Options are often priced assuming they would only be exercised on the expiration date. That means if a stock issues a dividend, the call options could be discounted by as much as the dividend amount. However, put options would be more expensive since the stock price should drop by the dividend amount after the ex-dividend date.

HOW TO TRADE OPTIONS

Though most of us know about the stocks, option markets work a bit differently than the stock market. Most of the options trading we know of occurs at the Chicago Board of Options Exchange (CBOE). Though a few other exchanges exist, we'll use the CBOE as the primary reference.

Options trade only between 9:30 a.m. to 4:00 p.m. Eastern Standard Time, Monday through Friday with few exceptions. Options do not trade pre and post market like stocks simply because there isn't enough demand.

Not every stock will have options. Exchange Traded Notes (ETNs) cannot have options (these are usually leveraged products). Qualified stocks will have options that trade based on demand

For this book we'll be focusing on options around stocks. However, you can trade options on pretty much any asset; commodities, metals, bonds, etc.

Option Quotes and Option Chains

Different platforms may display option quotes differently. When you search for an option, it will often come in a string like this:



Options have 4 possible trades you can make:

- Buy to open – purchasing options
- Sell to close – selling back purchased options
- Sell (write) to open – selling options
- Buy to close – buying back sold options

TIP: Make sure you double check the trade you put in. Not all platforms prevent you from making the wrong trade. Enter the wrong trade and you could find your account frozen.

Here's what an option chain might look like.

Last	Change	Bid	Ask	Volume	Open Int	Imp Vol	Delta	Action	Strike ▲	Action	Last	Change	Bid	Ask	Volume	Open Int	Imp Vol	Delta
CALLS										PUTS								
Oct 07 '19 (2 days)																		
4.66	0.00	4.46	4.55	0	7,498	12.80 %	0.8993	▼	290	▼	0.16	0.00	0.16	0.17	0	10,277	12.92 %	-0.1019
3.70	0.00	3.55	3.63	0	2,195	12.07 %	0.8512	▼	291	▼	0.23	0.00	0.24	0.25	0	2,654	12.15 %	-0.1475
2.78	0.00	2.69	2.73	0	3,607	11.18 %	0.7844	▼	292	▼	0.37	0.00	0.38	0.39	0	6,927	11.43 %	-0.2204
1.96	0.00	1.90	1.94	0	4,662	10.54 %	0.6843	▼	293	▼	0.55	0.00	0.58	0.59	0	2,728	10.64 %	-0.3172
1.26	0.00	1.22	1.25	0	5,905	9.89 %	0.5532	▼	294	▼	0.87	0.00	0.89	0.90	0	3,693	9.93 %	-0.4469
0.69	0.00	0.68	0.70	0	6,527	9.21 %	0.3975	▼	295	▼	1.33	0.00	1.34	1.38	0	2,738	9.35 %	-0.6011
0.33	0.00	0.33	0.34	0	4,943	8.79 %	0.2439	▼	296	▼	1.97	0.00	1.97	2.02	0	3,292	8.85 %	-0.7549
0.15	0.00	0.12	0.14	0	4,784	8.36 %	0.1206	▼	297	▼	2.66	0.00	2.77	2.83	0	1,399	8.62 %	-0.8724
0.05	0.00	0.03	0.04	0	7,271	7.83 %	0.0424	▼	298	▼	3.53	0.00	3.68	3.74	0	1,009	8.53 %	-0.9437
0.02	0.00	0.01	0.02	0	13,394	8.24 %	0.0194	▼	299	▼	5.45	0.00	4.62	4.72	0	37	8.14 %	-0.9835
CALLS										PUTS								
Oct 09 '19 (4 days)																		
5.11	0.00	4.98	5.06	0	3,014	15.86 %	0.791	▼	290	▼	0.62	0.00	0.64	0.66	0	3,481	15.90 %	-0.2097
4.27	0.00	4.16	4.21	0	5,637	15.17 %	0.7432	▼	291	▼	0.81	0.00	0.82	0.84	0	1,627	15.35 %	-0.2592
3.46	0.00	3.39	3.43	0	2,738	14.61 %	0.6839	▼	292	▼	1.05	0.00	1.04	1.06	0	3,147	14.73 %	-0.3176
2.78	0.00	2.66	2.70	0	3,777	13.95 %	0.6151	▼	293	▼	1.26	0.00	1.31	1.33	0	2,783	14.05 %	-0.3859
2.12	0.00	2.01	2.04	0	2,303	13.31 %	0.5355	▼	294	▼	1.59	0.00	1.65	1.68	0	1,770	13.42 %	-0.4652
1.49	0.00	1.44	1.47	0	5,210	12.70 %	0.4467	▼	295	▼	1.98	0.00	2.08	2.11	0	1,834	12.80 %	-0.5534
1.03	0.00	0.96	0.98	0	5,937	12.01 %	0.3515	▼	296	▼	2.49	0.00	2.59	2.63	0	919	12.11 %	-0.6483
0.60	0.00	0.60	0.61	0	18,227	11.46 %	0.2578	▼	297	▼	3.14	0.00	3.22	3.27	0	1,143	11.56 %	-0.7416
0.34	0.00	0.33	0.34	0	5,336	10.83 %	0.1707	▼	298	▼	3.88	0.00	3.92	4.03	0	1,014	10.95 %	-0.8289
0.18	0.00	0.17	0.18	0	4,202	10.46 %	0.1041	▼	299	▼	5.49	0.00	4.75	4.87	0	1,107	10.49 %	-0.898

Here's a rundown of what you'll see in most option chains.

Open Interest – Open interest is the number of option contracts that remain outstanding at any given moment. When you close an option contract, it reduces the open interest.

Volume – Option volume works just like stocks. It represents the number of contracts traded for that day.

Bid – The best available price you can sell an option.

Ask – The best available price you can buy an option.

Midpoint – The halfway point between the bid and ask.

Delta/Gamma/Theta/Vega/Rho – These are the Greeks we previously mentioned. Option chains will either provide you a whole number or

decimal less than 0. Whole numbers like 15,16 should be assumed to be 0.16. All of these measure the sensitivity to a change of one unit for that component. Example: the delta under the puts for October 7th \$290 strike price shows -0.1019. That tells us for every \$1 increase in the SPY that put option will lose -\$0.1019.

Put/Call Ratio – This represents the number of puts traded to the number of calls traded for that day. Traders tend to buy more puts when they believe the market will decline or need protection. The ratio is very different for stocks vs indices. Stock's averaged 0.65 from 2006-2019. The S&P 500 averaged 1.75 from 2010 to 2019.

NOTE: One major drawback with the ratio is that it cannot tell you whether the volume comes from people buying or selling the puts or calls. Some traders like to use it as a contrarian indicator. When the ratio for the S&P 500 gets too high, it many indicate the end of a recent decline.

Available Expirations

Option expiration choices depend on the interest in the stock. Highly traded stocks, like **AAPL** or the **SPY** exchange traded fund (ETF), will have intra-week expirations. Small cap stocks tend to only have quarterly options.

Here's a list of the most common expiration periods available.

Quarterly – Every stock with options will have quarterly options at a minimum. Quarterly options expire on the third Friday in the last month

(March, June, September, and December) of every quarter. Traders call this date ‘quadruple witching’ because stock options, index futures, single stock futures, and stock index options all have an expiration.

Monthly – Stocks that trade monthly options will generally trade weekly options as well. Monthly options expire on the third Friday of every month. You will also find monthly expirations for the next two months plus two additional months from the January, February, or March quarterly cycles.

Weekly – Options that expire on stocks every Friday are known as ‘weeklies.’ Weekly options only go out two months. After that, you’re left with quarterly options.

Intra-Week – Highly traded stocks like the **SPY** will have multiple expirations during a week. Intra-week options tend to expire on Monday and Wednesday on top of the Friday weekly options.

LEAPs – Options that go out at least one year are known as long-term equity anticipation (LEAP) options.

Note: If the expiration Friday happens to be a holiday where the market is closed, the expiration will move to the third Thursday of the month.

Placing Option Orders The Right Way

You probably think I don’t need to tell you how to place an option order. It may be easy to make a trade. Getting the best price is another matter. Let me give you a few tricks I’ve learned over the years.

Know the tick size – Option orders priced below \$3 need to be submitted in ticks (increments) of \$0.05. Anything above \$3 needs to be placed in \$0.10 ticks. However, the CBOE has a *Penny Pilot Program* with many popular stocks (IE **SPY**, **APPL**). This allows them to trade in \$0.01 ticks on options less than \$3 and \$0.05 ticks on options greater than \$3.

Only use limit orders – Option volume isn't nearly as heavy as stock volume. Some of the best options only trade 50,000 contracts in a day. Most only trade a few hundred. Sometimes you will be the only person trading those options (it happens more often than you think).

Place limit orders at the midpoint of the bid/ask. Move your order by increments of \$0.01. Do not go past halfway between the midpoint and ask price. As a last resort you can place a limit order at the ask price (you will sometimes still get filled at a better price).

KNOW YOUR TRADE: You should not accept limit orders at the ask price if the spread is too wide or it does not work with your strategy. If you want to make 10%-20% on an option trade, you should not give up 10% of the option price just to get filled.

Often the best way to trade is pick your price and leave the order. Let the market come to you. It's ok if you don't get filled. There is always another trade around the corner.

Sell options at the open, wait to buy them – Traders and computers work feverishly to figure out the right price at market open. This uncertainty drives up the implied volatility in options. That makes options more expensive when the market opens.

It's a great time to sell, but a bad time to buy. If you want to buy an option, try waiting 30 minutes. The market will die down which brings down implied volatility and options price. However, if you have a price you've decided to buy an option, go ahead and place the order at the open.

Be careful of wide spreads – A red flag should go up when you see a bid of \$0.15 and an ask of \$4.25. That doesn't mean you can't buy or sell those options. However, do not use midpoints. Most platforms will have a tool that will give you the theoretical price of an option. Use that price for your trade. I would not move more than 1-2 ticks from that price to get filled.

If your platform doesn't have that tool, you can use free tools online. They require you to input things like the implied volatility, stock price, days to expiration, and other data you can get from your option chain.

I love how all the different components of options relate to one another. While I could go on for hundreds of pages, the concepts you've just learned are the most critical for you to get started. The CBOE website goes into more depth on many of these topics as well as the underlying mathematics if you want to learn more.

TYPES OF TRADING

Options give you incredible flexibility with trading. They let you use your capital in ways that stocks cannot.

Buying Options for Directional Bets

Options give you exposure to the price movement of an underlying stock. Buying puts and calls is the simplest way to trade options.

Buying a call option lets you profit when a stock moves higher. Put options profit when a stock moves lower. Options don't need to be in-the-money to make good trades. As long as you give yourself enough time to expiration, out-of-the-money options will increase in value as the stock price increases.

Note: This means the extrinsic value is increasing.

Traders place directional bets with options based on bullish chart formations, upcoming product releases, or anything else they believe will move the stock.

Let's say you want to figure out the payout of a put option.

- You choose the \$50 strike price.
- It costs you \$1 to buy the option.
- You plan to hold the option to expiration

In order to breakeven by expiration, you need to make at least \$1 on the option. Here is how you get to your breakeven price.

Put Option Breakeven = Strike Price - Cost of an option (premium)

OR

$\$50 - \$1 = \$49$

Traders often use payout diagrams to help their decisions. Here is a payout diagram for this put option.



Up until \$50, the option will have no (intrinsic) value at expiration. That means you lose the \$1 you paid for the option. At \$49, you make \$0.

Everything below \$49 you make a profit. You can calculate your profit below \$49 as follows:

$$\text{Profit} = \$49 - \text{Stock Price}$$

Now let's look at a similar call option.

- You choose the \$50 strike price.
- It costs you \$1 to buy the option.
- You plan to hold the option to expiration

Again, you need to make at least \$1 on the option to break even. Here is how you get to your breakeven price on the call option.

$$\text{Call Option Breakeven} = \text{Strike Price} + \text{Cost of an option (premium)} = \\ \$50 + \$1 = \$51$$

With the call option, you add the cost of the premium to the strike price. Why? You must exceed the strike price by the amount you paid just to break even.

As you might expect, the payout diagram for a call option is the mirror image of a put option.



NOTE: A put option's profits stop once a stock gets to \$0. A call option's profits could go to infinity theoretically.

Here's an example from one of my [Bullseye Trades](#).

On September 3rd, I sent out the following trade and analysis on Twitter ([TWTR](#)).

*"This week's **Bullseye** trade is TWTR, and I am playing it for a breakout. What we have here is a strong stock that is consolidating under all-time highs, taking a breather before it makes its next move. Check it out on the daily chart here:*

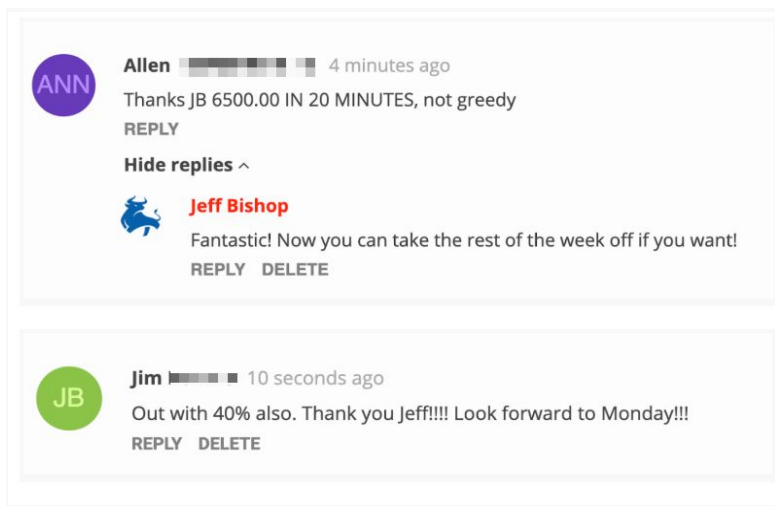


See how it is consolidating along that upward sloping trend line? This is bullish price action, and tells me that TWTR wants to break out to new all-time highs. One reason I like setups where a stock is poised to make new highs is because once it clears the breakout line, there is no overhead resistance for it to hit its head on.

My target for TWTR is a move to \$45, which would be a great win for us. I will leave room to add to my position around \$41, but a breach of \$40 would mean that the pattern has broken down and would force me out of the trade.

*The contract I am looking to buy is the **TWTR Sept 27 \$42 Call.**"*

My trade idea was simple: I expected TWTR to move higher...so I bought a call option. Turns out we didn't have to wait long for this trade to work out.



Selling Options for Directional Bets

Most of us only think about buying options. However, you can sell options as well. In the previous examples, the options cost us \$1 to buy. That means someone sold it to us for \$1. You can be that someone!

When you sell a call, you are saying, “I don’t believe the stock will get above \$X strike price by expiration.” It doesn’t mean you have to be bearish. All it means is that you’re not bullish.

Let’s look at the same call option as before. This time we’ll be the seller.

- You choose the \$50 strike price.

- The buyer pays you \$1 for the option, which you get immediately.
- You plan to leave the option open until expiration.

that's

Your breakeven price is still \$51. However, the payout diagram is flipped upside down.



Notice how you keep losing money as the stock's price goes up. In theory, your losses could be unlimited. That's why selling open-ended options like this requires margin accounts.

Imagine you sell a \$50 option on this stock. The stock closes at \$35. Overnight the company announces they plan to be bought out at \$125 per share. You wake up the next day and the stock is trading at \$125.

Suddenly, you're down $\$75 \times 100 \text{ shares} = \$7,500$! You could only make $\$1 \times 100 \text{ shares} = \100 on the trade.

CAPITAL CONSIDERATION: When you sell open-ended options, your broker requires you to set aside a lot of money to cover potential losses. Rarely do I sell open-ended options.

So, what does selling a put look like? Again, it's not a bullish bet...it's just a bet against bearish.

We'll use the same put option as before. This time we'll be the seller.

- You choose the \$50 strike price.
- The buyer pays you \$1 for the option, which you get immediately.
- You plan to leave the option open until expiration.

Your breakeven price is still \$49. The payout diagram flips upside down.



NOTE: Selling puts is like buying a stock. Many brokers will let you sell put options in self-direct 401k accounts. They require you to set cash aside as if you were buying the stock. This is known as a ‘cash-covered put.’

Stock & Portfolio hedging

Large portfolio managers and retail traders use options to hedge their stock holdings. They treat options like insurance. Hedging reduces the risk of one holding by taking a position in another.

Investors with a variety of stock holdings may purchase puts on the **SPY** to protect them against market drops. In fact, this practice is so common that puts on the **SPY** tend to cost more than calls.

Like insurance, hedging with options tends to lose money over time. However, it can reduce volatility in your portfolio.

One common hedge that investors use is a covered call. Covered calls allow you to sell a call option against a stock that you already own. This lets you collect the premium from selling the option and own the stock.

Covered calls are considered one of the safest option strategies around. Investors will sell a covered call against a stock that has run up significantly. They're not bearish on the stock necessarily. But they don't believe it will go higher before the option expires.

Hedging is part art and part math. You need to make several decisions to create a hedging strategy.

- 1) How much of the portfolio do you want to hedge?
- 2) Which part(s) of the portfolio do you want to hedge?
- 3) How long do you want to hedge?
- 4) How do the options you want to trade relate to your portfolio?

A friend of mine shared a great anecdote from back when congress was flirting defaulting on debt several years ago.

Back in 2011, Congress and the Obama administration were heading towards an impasse. S&P downgraded U.S. debt. People feared the U.S.

might actually fail to raise the debt ceiling and default on its debt. Given the aftermath of the Great Recession, no one knew what that might mean.

My friend's father was about 10 years away from retirement. He'd been fairly balanced with his portfolio, but did have a good amount of stock holdings. Instead of selling his stocks, he bought put options on the SPY. Those options equaled the dollar amount equivalent to 50% of his portfolio (or about 75% of his stock holdings).

If the market tanked, the stock would fall, but the put options would pay off. When nothing happened, he sold back the put options at a small loss. This allowed him to protect his portfolio through the event.

Spread Trading

So far, I've only alluded to the possibility of limiting your risk when selling options. The wait is over! I'm going to take you into one of my favorite ways to trade options – *spread trading*.

Spread trading involves buying and selling the same number of option contracts on the same underlying stock.

Both option contracts will be puts or calls. You cannot mix the two. You only change the strikes or expirations of the contracts to create the trade.

Here's an example of a short (bear) call spread trade.

- AAPL trades at \$49.
- I sell 10 call contracts with a \$50 strike price expiring in two weeks and receive \$2.00.
- At the same time, I buy 10 call contracts with a \$51 strike price expiring in two weeks and pay \$1.75

- In total I received $\$2.00 - \$1.75 = \$0.25$

$\$0.25$ is the maximum amount I can make on the trade. My breakeven price is $\$50.25$. Anything above $\$50.25$ at expiration and I lose money.

My maximum loss is $\$51 - \$50 + \$0.25 = \0.75 . The maximum loss occurs at anything at or above $\$51.00$.

The payoff diagram for a call spread adds together the two graphs we looked at for buying and selling call options. The only difference here is that the contract we buy is now a $\$51$ strike instead of a $\$50$ strike.



CRITICAL POINT: You must have the same number of contracts buy and sell. Any imbalance will be 'uncovered'. This isn't a problem with options you buy. Your losses cap at the total amount you paid. But it's very much a problem with ones you sell. Your losses are unlimited for calls, and extensive until the stock hits \$0 for puts.

OPTIMIZING YOUR TRADES

Raise your hand if this has happened to you (I won't see it, but I trust you). I bought a few call options on a stock. Within a day the options are up 45%. I sell my contracts and take a profit.

Right now, I'm feeling good. Two days later news comes out sending the stock soaring. Those options I sold would be up 450%. I clench my fists in rage. "Why didn't I just wait a little longer?"

A few days later, I run into the same situation. This time I know better. "Hahaha Mr. Market, I know your tricks. I'll wait until I'm up at least 100%." The next day the stock craters and your options are worthless.

Now, let's visit the other end. I remember all too vividly when I had an option that continued to decline in value. By the time it dropped 35% I'd had enough. I sold the option at a loss. The next day, the stock reversed, and the option was now at breakeven.

Fast forward a few days and the same situation comes around again. It hits my stop, but I think I know better. I hold and hope...all the way to \$0.

This hasn't just happened to me once...it's happened multiple times. For years I tried to come up with the perfect way to figure out when to let them run and when to take profits. I studied when to cut my losers.

Finally, I developed some tricks of the trade. I don't make hard and fast rules. But, these guidelines will improve your trading performance immediately.

Maximize Profits by Scaling Trades

Coming up with winning trades only gets your foot in the door. Truly successful traders learn to manage their trades.

Trading will test your patience. I can't count the number of times I've had to wait on a trade. And wait. And wait. Other times I'd buy at my entry price. 10 minutes later it would be down near my stop. Nothing is more aggravating.

Here's what I learned. Most traders start by simply executing a trade one at a time. They set their entry price, their target, and their stop. Once the trade triggers, they let it fly. It wins or it loses.

Great traders learn to scale their trades. They buy in at increments and exit at increments.

You know what famous trader uses this all the time – Warren Buffet.

Warren constantly advocates for 'dollar-cost-averaging'. He tells average investors they cannot time the market. Their best bet is to buy at some regular interval over time (assuming they want to remain in the market).

Averaging in and out of trades lets you play the probabilities. When you have a winning strategy, it maximizes your return potential.

Let me give you a visual. Assume a stock is coming into 3 different prices to buy: \$100, \$75, and \$50.



You come up with a target of \$125 and a stop of \$45. What you don't know is which level will provide support.

So let's walk through the different scenarios:

- 1) Price hits \$100 and bounces
- 2) Price hits \$100, then goes to \$75 and bounces.
- 3) Price hits \$100, then hits \$75, and finally hits \$50 before it bounces.
- 4) Price goes through all the prices and hits \$45 and stops you out.

Trading revolves around probabilities.

So what's the probability it stops at \$100...or \$75...or \$50?

Even the best traders only muster up rough numbers. That's why we scale in to trades. We can't know with 100% certainty which level will be the one. So let's use them all!

Split the trade into equal thirds. Buy a third at \$100, a third at \$75, and a third at \$50. When you only take trades at \$50 you miss out on all the ones at \$100 and \$75. Drop it all at \$100, and you risk everything down to \$45 to get up to \$125.

But split it evenly and your average cost drops to \$75. If it never drops below \$75...congratulations, you've got a winner anyhow.

There are tons of ways to scale in and out of trades. Let me introduce you to the ones I've found work best.

Scaling Basics

The goal of scaling is to reduce your risk and maximize your profits. I've found that scaling positions helps you maintain discipline in trading.

Scaling into trades looks more at reducing risk than maximizing profits. When you scale-in you have four main methods to choose from.

- 1) **Total amount risked** – This trade is setup so in the worst-case scenario you lose the total amount risked. You determine your entry levels. The total potential losses from each of the entries to the stop should add up to the total amount you're willing to risk. With options you have to estimate the price of what the option will be if a stock hits a stop level.
- 2) **Same number of contracts** – The easiest method is to buy the same number of contracts at each entry point.
- 3) **Minimum profit** – Minimum profit sizes each entry so when you hit the target you make the same amount for each entry. If you keep the same target for each entry, the number of contracts you buy each time goes down.
- 4) **Near the stop** – One my favorite ways to scale-in is to use a level near the stop. If I'm using a daily close below a stop (or above, for puts), I may use the stop itself as an entry level.

Scaling out of trades focuses more on maximizing profits than reducing risk. New traders often assume they must take off the entire profit at their

target. That couldn't be further from the truth. You don't know how far a stock can run when it really gets going.

Once you get to any target, always put a stop for your remaining shares at breakeven. You never want to lose once you've already hit a target.

- 1) **Use multiple targets** – Traders often use multiple target levels to exit trades. There's multiple methods to finding levels we'll discuss shortly.
- 2) **Set trailing stops** – Trailing stops work well with highly liquid option contracts such as the **SPY**. Otherwise, traders should use a trailing stop on the actual stock (this is usually done manually). Once the stop is hit, the remaining contracts are sold. Never have a stop below your entry.
- 3) **Set profit targets** – You can set various profit targets for each entry or the entire trade to find exits.
- 4) **Let it fly** – Sometimes you just let it ride. Again, never let the trade get below your entry. But, take a portion off at some target, and then let the rest fly. See how far you can soar!

Entry Points

Next, let's go over ways to decide on places to enter a trade.

- 1) **Support & resistance levels** – Look for areas of support and resistance as potential entry points. You can use Fibonacci retracements, congestion areas, or any other methods to define these levels.
- 2) **Regular intervals** – You evenly space levels between the entry and the stop. Generally, I have one level in between, and a maximum of three.
- 3) **Indicators** – Traders who like technical indicators can use them as places to load up on additional shares. Most tend to look at

overbought/oversold conditions, channels, or moving averages. Common indicators include simple and exponential moving averages, Bollinger Bands, and Average True Range.

RISK MANAGEMENT

Don't Overtrade

We all get the itch to trade. That's why we're here. Trading for the sake of trading will get you broke fast. Nothing hurts beginners more than overtrading.

Sometimes called *churning*, overtrading occurs when you excessively trade your account and get into trades you shouldn't. Your account can quickly get eaten up by commissions. So when you're first starting out to trade, you need to understand the costs of trading options.

NOTE: Just because some sites are commission free doesn't mean you should assume there aren't any hidden costs.

Overtrading is one of the hardest lessons to learn in a trader's career. It took me years to tame this beast. After getting torn to shreds multiple times, I've come up with some great ways to help you avoid the same disasters.

- **Focus on your A+ setups.** For me, that's the 13-30 hourly moving average crossover, macroeconomic variables, understanding risk-reward, and having an exit strategy in place. I explain these concepts in greater

depth with my [Total Alpha](#) members as well as alerting them as to when I see trade setups that align perfectly with this trading strategy.

- **Trade the same amount each time.** Don't change the amount you trade until you've reached a goal. Clearly define what your increase would be at that point. But don't forget to write out how to adjust your size if you start losing.
- **Focus on one setup and stock.** Don't try to be the master of everything. Pick a few stocks and one or two setups. Work those until you've mastered them. Then slowly build out from there. Eventually you'll have a whole repertoire of trades.
- **Take your urges out on a demo account.** No one gets hurt there.
- **Keep a trading journal.** Nothing keeps you more accountable than a solid trading journal. Look at your performance every day. Focus on the decisions and not the outcomes.
- **Create a trading plan.** Trading plans work best when you include your strategies, risk management tactics, and milestones.
- **Don't stare at the charts.** Unless your strategy involves tick by tick movements, step away once in a while. You'll get sucked in emotionally if you try to watch every little movement on the chart.
- **Be Mindful of Catalysts (Earnings)**I've seen this time and time again... Beginner traders buy options contracts, not knowing that there's an event coming up... Only to wake up and see their entire investment gone. New option traders don't consider how catalysts like earnings announcements could affect their positions.

Recall how we discussed that implied volatility generally rises into earnings. This increases the price of options right up until an event. Once the event occurs, implied volatility decreases rapidly, along with the option price. Even if you picked the right direction, you can still lose on the trade.

Here's a few ways to double check upcoming events for stocks:

Company website - Companies typically include their earnings announcement dates on their investor relations page.

Brokerage platform – Most platforms include earnings calendars in their data feeds.

Financial websites– The NASDAQ website contains a lot of the earnings announcements. Yahoo Finance has a great earnings calendar I look at all the time.

Knowing about upcoming events like earnings will help you avoid many of the mistakes I made (and still sometimes make).

PRO TIP: **Buying options leading into earnings works great. Just make sure you sell them before the earnings announcement. I can count on one hand the number of options I've held through earnings.**

Subscribe to a System

Okay, so I'll be honest. There can be a lot to this when you're first getting started. One of the most common questions I get is "*where do I even start*". The simplest way to discover your trading strategy and get your account going is to identify a system. Find something that has been proven in the marketplace and is attested to by its subscribers.

There are services out there that make it stupidly simple to follow along and make huge profits. If you're like most people, then you don't have the time to watch the market like a hawk, analyze countless charts and keep

tabs on related events. This is why thousands of traders subscribe to services like [Dollar Ace](#). This service greatly simplifies the trading experience by alerting members when unusual options activity is detected by *Kyle Dennis*' proprietary scanner. Members love the convenience of getting text message alerts right to their phone when a new opportunity emerges to profit on a \$1 option contract. This service is perfect for new traders looking to grow their small accounts.

Risk Profile

Have you ever woken up one day to see a trade go against you and had that deep fear in the pit of your stomach?

You probably took on too much risk. No one trade should ever make you feel like the world is ending. I've done it plenty of times. The story about my \$500,000 loss certainly tops the list.

Newer traders find it difficult to size trades. They don't understand what they can handle. It's entirely normal.

When you start trading, go small. You can always build up your size later. Use small losses to figure out what you can handle. Most of us like to focus on the wins. Back when I started during the dot com bubble, that's all I had. It wasn't until years later that I spent time understanding the losses side.

To figure out your risk profile, ask yourself a few questions.

- 1) What's the biggest loss I can handle in one trade, one day, one week?
- 2) Are there any thresholds, such as margin levels or pattern day trading, that I run the risk of tripping?
- 3) If I lose this money, will it create a financial burden on me or my family?
- 4) Am I trading with borrowed money (excluding margin)?

- 5) How many trades do I need to take to decide whether this strategy works or not?

You never want to put yourself in a position that you can't recover from. Again, demo accounts and backtesting work well to test ideas. Sure, they take some work and aren't gratifying. But you learn how to trade without sacrificing your capital.

WORD OF CAUTION: Backtesting with options can be very difficult. You're better off assuming 100 shares for each contract and backtesting against the stock. Assume some slippage for the bid/ask spread. You can look at current options bid/ask spreads to get an idea of how much slippage to add.

Diversification

Ahh, good old diversification. The stalwart of conservative investment guidance. It's a word financial advisors love to throw around as if it has magical powers to protect you from volatility.

Still, we shouldn't entirely dismiss this idea. I've run into plenty of situations where I see the same setup on similar companies. Taking a trade in Bank of America and Citigroup may be the right move. But, know that they'll be influenced by similar factors. If your play is on a chart pattern and a potential interest rate cut, you're essentially taking the same trade.

When you diversify option trades, you have similar choices to stocks.

- Sector
- Market cap
- Macro-economic factors such as interest rates, global trade, etc.

However, you get a few additional flex points.

- Long or short
- Leverage
- Expiration
- Implied volatility

The first time I realized you could bet against stocks, I was stunned. I never knew this was possible. But you need a margin account to short stocks. Plus, not all accounts let you make these trades.

I wanted something that didn't require a huge amount of money to create a flexible strategy. Options give me a way to play both sides of the market. I can go months where I have the same amount invested in puts and calls...and I still make money.

As a trader, I think it's important to focus on the trades. If that means you have a balanced amount of puts and calls, so be it. Just make sure that you don't get too heavy in one area unintentionally. The last thing you want is to have tons of option contracts in banks and a sudden interest rate announcement comes along and decimates your portfolio.

Position Sizing

New traders struggle a lot with position sizing. They don't know how much to put on any one trade. Eventually, they'll put too much on one dog that cleans them out.

The reality is position sizing isn't hard. It's just tough to stick with.

Plenty of capital management books pack library shelves. I'm going to cut through the clutter and give you the best and easiest strategies for position sizing. The goal is to create enough trades that one or two won't obliterate your account.

Percent of portfolio – The total amount you can lose on a trade should be a small percentage of your portfolio. Anywhere between 1%-5% works well. If you have a really small account, 10% can work. Just know that it increases the odds of failure.

Set amount - Choose a set amount you're willing to lose each trade. Stick with that amount. This can be \$25, \$50, \$1,000. It doesn't matter. Just be consistent

Stair step – The stair step method works. Start with a set amount. However, each time you get to a certain milestone you increase or decrease the amount you trade. For example, I may start with \$100 per trade. As my account grows or declines by \$1,000 increments, I'll either double or halve the amount.

Risk Vs Reward

Before I started really trading, I played a lot of online poker. The best players understand how much to bet, and when to bet based on the odds. They don't just look at the current decisions, but all decisions that follow after. The math and logic involved gave me invaluable tools to understanding options trading.

Successful traders understand the balance of risk and reward. The higher the risk, the more you should be paid. A strategy that wins 85% of the time may stack up small wins against a few big losses. That type of strategy should focus more on loss management than maximizing rewards. On the other hand, a strategy that only wins 20% of the time should have some real big winners.

Traders measure risk to reward based on expected value. The expected value looks at how much you make or lose on average if you repeated the trade over and over. You may not make this amount on every trade. But, repeat the trade enough and the results should converge on this number.

Here's the formula for expected value:

$$\text{Expected value} = (\% \text{ chance of winning} \times \text{profit potential}) - (\% \text{ chance of losing} \times \text{loss potential})$$

Imagine you had a trade where you wanted to buy calls in Apple. Based on your past performance, you expect the trade will win 30% of the time and lose 70% of the time. You plan to invest \$1,000. Based on your target and stop, you could win \$500 or lose \$200.

The expected value calculates as follows:

$$\text{Expected value} = (30\% \times \$500) - (70\% \times \$300) = \$150 - \$210 = -\$60$$

If you made this trade hundreds of times, you'd expect to make -\$60.

Let's look at a real example from the [Bullseye Trades](#). I sent the following note out to members.



PYPL has been on absolute fire this year. A bad earnings report this quarter and the recent volatility have brought it back down to a more reasonable level.

It has been holding the \$102 level really well for the past 2 weeks, and I think it is building up strength for its next move. Stocks that are this strong don't stay subdued for long.

I am looking for PYPL to break out of the range that it has been trading in. You can see what I mean on the hourly chart below.



If PYPL can bust through the breakout line, It has room to run all the way up to the 200 hourly resistance level around \$112. This would net us the 100% return that we are looking for.

I will leave room to add to this position around \$103, but I will be forced to cut the trade loose if PYPL closes below strong support at \$102.

The contract I am looking at is the PYPL Sep 6 2019 107 Call.

Congrats to everyone for the big "WYNN" last week, let's keep it going!

Jeff Bishop

Jeff Bishop

BullseyeOptionTrading.com

I was looking to get a 100% return on the upside, but I settled for 65%. The downside at the time was a 30% loss. My win rate tends to land around 40%.

My expected value on the trade would have been:

$$\text{Expected value} = (40\% \times 65\%) - (60\% \times 30\%) = 26\% - 18\% = 8\%$$

Note: With a win rate of 45%, my loss rate is $100\% - 40\% = 60\%$

This one worked out great for members.



Michael  10 minutes ago

In at 2.72 out at 3.8. Another \$500 in the bank. 6 weeks in a row now!

REPLY **DELETE**



Rick  16 minutes ago

In at 2.57 and out at 3.70! 1st trade ever! Woohoo!

REPLY

Hide replies ^



Jeff Bishop

Awesome! Proud of you for taking those quick profits

REPLY **DELETE**

Win and loss rates come out over time. If you're trying a new strategy, you can do backtesting to figure out your win-rate or do some demo trades.

While you can't always control your success rate, you can control your potential profits and losses. In fact, by tweaking these numbers you can turn a losing strategy into a winner.

PRO TIP: You figure out the breakeven win-rate, profit potential, or loss potential by back solving the expected value equation. It's a little algebra, but you can find calculators online.

So, let's look at some stop loss strategies.

The Best Stop Loss Methods

I've always found that stop losses are easier to come up with than targets. You can always cap your losses. However, it's tough to know how far to let a stock run.

I've only ever found two methods that work well for me.

- **Support & resistance levels** – Similar to scaling, you can use key levels as stops. Fibonacci retracements, congestion areas, recent highs or lows, and any other method that identifies these levels will work.
- **Percent of profit** – I like setting my losses relative to my potential profits. By adjusting this proportion, I can control my expected value.

CAUTION: Changing your stop losses in a strategy will often change your win-rate. Test out any strategy changes before you implement them.

TIMING ENTRIES

I cannot stress enough the importance of timing your entries into a trade.

Entering a trade at the wrong time is just as bad as picking the wrong trade.

Being a solid trader requires good timing.

I don't get obsessed about too many things. Market timing consumed me for years. I studied market cycles, ranges, intermarket relationships, anything and everything under the sun.

This led me to some of the greatest discoveries of my career. And I'm going to share them with you...

The 'Money' Pattern

It's so simple...so easy...and yet it took me years to figure out:

The crossover of the 13-period simple moving average with the 30-period moving average.

Many of us have tried crossovers before. Yet, this one worked time and again for me a good amount of the time. This pattern works to identify trend changes in stocks. It works especially well after large drops or runs in a stock.

However, there are two main keys to making it work.

First, make sure the moving averages haven't crossed recently. There isn't a specific amount of time. But you want to make sure it has been at least 7-10 candles.

This chart from the **Weekly Windfalls** ROKU trade shows a setup getting ready to work it's magic.



ROKU had been in a slide for quite some time. Picking a bottom wasn't easy. However, the crossover gave us our first indication that the trade would work.

Second, try to align the trade with a chart pattern. In this case we have a rounding bottom in the stock. When you put these two pieces together, you get a trade that took off like a rocket.

Catalysts

Any significant news event can act as a catalyst for a stock. Earnings, product launches, press releases...all of them have the potential to give price a jolt.

Catalysts come in two forms: known and unknown. We won't talk about unknowns because...well you can't really count on them, can you?

Known catalysts work great for trade setups. I've mentioned a few times how a stock's implied volatility increases going into earnings. Pair this with a chart pattern, a stock that has a history of running into earnings, or any other timing mechanism, and you greatly increase your odds of success.

Support & Resistance

Rarely do I trade without using support and resistance levels. They act as obstacles to stop price dead in its tracks. Identifying them is only half the battle. Understanding how they enter the level, the reaction when it gets there, the amount of time it spends, all tell you how well the level holds.

Here's a few easy ways to identify these areas.

Previous congestion points

Stocks will sometimes trade in a range for a while. Big money will work to accumulate or distribute shares over time. Once they've finished, the stock will usually take off higher or lower. These areas of 'congestion' often work as support and resistance levels.

Here’s an example with Raytheon (RTN).



Notice how price traded in a tight range back in late 2018. Eventually price fell to close the year. Price struggled to break through the bottom end of that zone for several months.

When it finally did break out it found resistance again at the top end of the zone. When it bounced off the top end, where did it find support? Right back at the bottom of the zone.

Swing/Pivot Points

Regardless of the stock, at some point it will make a high that sits above all the others and a low that is beneath all other lows. These extreme points

I've circled a handful of them in the chart below. Lesser swing points are in purple. Main swing points are in orange.



Check out how a previous swing low in AT&T (T) acted as support for price.



As the stock traded down, it only pierced the previous low by a small amount.

PRO TIP: Small pierces of swing points on intraday time-frames is often the big money looking to trigger stop orders. This let's them force you out of a trade. They swoop in and pick up the stock at a great price.

Fibonacci Retracements

I'm not sure if Fibonacci levels always worked. However, enough traders use them now that they become a self-fulfilling prophecy.

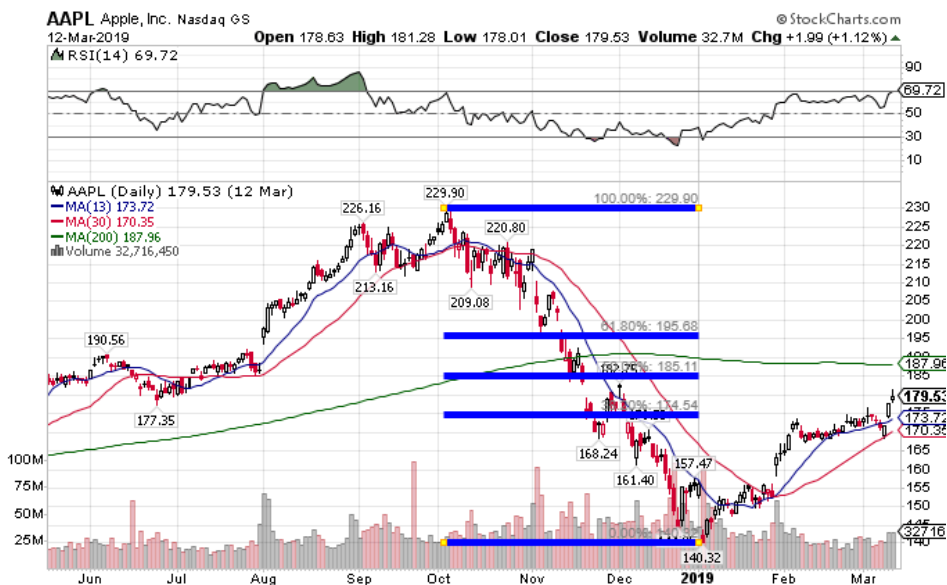
Fibonacci levels work by breaking down the distance between a swing high and swing low into 'Fibonacci' retracement levels. These include 23.6%, 38.2%, 61.8%, and 78.6%. Most traders also include 50%, even though it's not part of the sequence.

Let's walk through how to draw these levels.

I recommend using a charting tool that comes with your broker or online. Otherwise, these can be tough to draw.

- 1) Look for the most recent swing high and swing low
 - a. It's best to go with your first instincts on what are the swing points. If it's not clear, then move on.
 - b. If the most recent swing point is a high then you are looking for a retracement lower. When the most recent swing point is a low, you're looking for a retracement higher
- 2) Draw your Fibonacci points from the most extreme prices
- 3) Your tool should automatically calculate the levels

Your chart should look something like this.



Here's the cool part. Let's extend the 38.2% line out into the future and watch what happens.



Twice price came into that level and found either support or resistance. How cool is that?

Now that we've learned the tools needed, let's put it all together to come up with some big trades.

How to Capture a 100% Move

I've hinted at it a few times. But now I'm going to put it in black and white. So get ready for it to hit you in the face.

Find trades where multiple stars align!

The money pattern works great by itself. It works even better when it happens of a support level. When that support level comes from both congestion and a Fibonacci retracement? Now we're cooking. Add in a 200-day moving average? We've got a lot of things going for us.

Think about it like trying to pick the winning numbers for a lottery. Everyone starts with five numbers they have to pick. The money pattern cuts that down to four. Congestion support cuts that to three, Fibonacci to two, and so on.

Millions of traders compete every day in the market. Some follow trends. Others use moving averages. Everyone has their own system. Imagine finding a setup that worked for most of their systems. Think it has a good chance of working out?

Nathan Bear uses this better than anyone I know in **Weekly Money Multiplier**. His TPS system looks for trends, patterns, and squeezes. When he gets all three, he takes a trade. This is a guy who turned a \$37,000 trading account into over \$1,000,000 in two years.

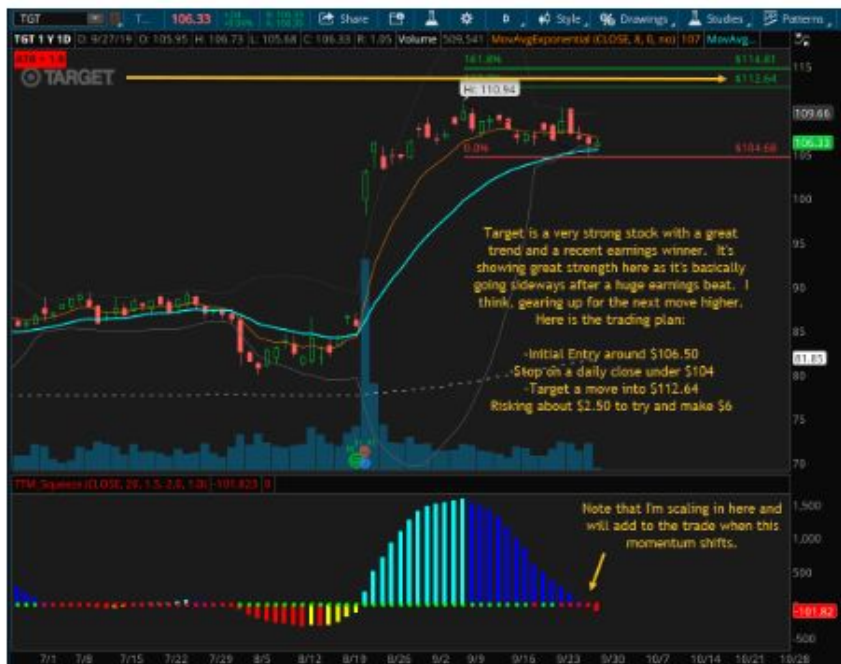
Here's a great example of his. The market had been very choppy leading into this trade. Nathan found a perfect setup in Target (**TGT**).



Good Morning MRM!

BOT +10 TGT 15 NOV 19 105 CALL @4.80 -- daily TPS setup, scaling in, see below for details

I am not going to do a ton of trading this Friday before the weekend with all of the potential news, but I do feel pretty comfortable getting into some Target here. I love shopping at Target and I really like the stock, it's very steady. I am going to start SCALING into a position here with the intent to add more over time. I'm going out 2 months so we have plenty of time on the options as well. Below is the chart with my thoughts, as well as the trade plan. Again, please understand that I start new trades like this with the intent to SCALE IN - I'm not jumping in with my full size. In this case, my max size will be 50 contracts. Note that I'm starting with just 10 of these. That way if Monday is a red day in the markets, it's OKAY and we can just add a few more. Take it SLOW gang, there is no rush here.



More to come!

Nathan Bear

Look at everything he included here.

- Trend
- Chart pattern
- Squeeze
- Support level
- Scaling-in
- Broader market analysis

This is the kind of trade that we all live for. Sometimes they don't work out and that's ok...we made the right decision.

But when they work out...you get results like this:

10:49

Positions

TGT
(●●●●●0426)

108.36 -0.74 (-0.68%)		Bid	108.34 Size: 2	
		Ask	108.37 Size: 3	
Symbol		P/L Day	P/L Open	P/L %
11 OCT 19 110 C 100 (Weeklys) +50		\$1,675.00	\$1,675.00	101.52%
15 NOV 19 105 C 100 ITM +10		(\$450.00)	\$2,000.00	54.05%

And for members that are smart enough to tune into these kind of trade ideas from Nate, they profit too!

JW

Jeffrey

3 days ago

Nate, Hit 100% on \$TGT lotto this morning. Thanks

REPLY DELETE

SF

Shawn

3 days ago

Wow, thanks Nathan. I took half of the TGT trade at 42% in less than a minute. About a half an hour later I took the rest off at 92%.

Put Volatility on Your Side

Buying options means you're immediately on the clock. You want your trade to work out as quickly as possible. One factor you don't need to fight is volatility.

I've talked several times about how implied volatility impacts the price of an option. Higher IV means higher option prices. Lower IV translates to lower option prices.

When you buy options, you want implied volatility as low as possible!

Buying options with low implied volatility means that any increase in implied volatility works for you. That's why setups that play up into stock earnings work great.

How do you know whether the current implied volatility is low? Look at history.

Most brokerage platforms let you look at historical implied volatility for a year. You can also find the information on the internet as well.

There's two main ways to look at implied volatility.

IV Rank – Implied volatility rank looks at the highest and lowest implied volatility values in the past year. It then tells you how far up you are off the bottom by a percentage. Here's an example. The low and high of implied volatility for a stock was 15 and 60. Current implied volatility is 25. 25 is 22.2% of the way between 15 and 60.

IV Percentile – Implied volatility percentile looks at all the implied volatility values for the last year. It then tells you in what percentile the current volatility ranks. Essentially, IV percentile is like IV rank but weighted.

Look at the VIX and VVIX

The VIX tells you the implied volatility for the S&P 500 over the next year. Stock market declines frequently coincide with spikes in the VIX. When the VIX starts to turn down, stocks recover. This is pretty common knowledge.

But, they don't know my secret weapon...the VVIX!

The VVIX tells you the implied volatility of the VIX over the next year. This can get tough to wrap your head around so let me give you an analogy.

Imagine the stock market is a car. The speed of the car is measured by the VIX. Acceleration and deceleration are measured by the VVIX.

But if that hurts your brain...the VVIX is a good leading indicator for turns in the market. You can look for reversals in the VVIX to give you a heads up for reversals in the VIX. This trickles down to the stock market.

Check this out. The candle in the chart below marks July 30th.



The VVIX broke out above it's previous trading range and closed above support. It's possible it was a fake out. However, fake outs don't tend to happen in second derivative indices.

24 hours later, look what happened to the SPY.



I don't know of any magic indicators out there...but this one comes darn close.

FINAL THOUGHTS

At some point I had to stop myself. I could keep writing for days. The markets absolutely fascinate me. Trillions of dollars exchange hands across the globe. Entire fortunes are made and lost at the click of a mouse. Global economies live and die by its ebbs and flows.

Trading is one of the most exciting adventures you can take. I never get tired of seeing the look in someone's eyes when it dawns. That single moment when it all changes for them. And for all that I think I've learned, the market continues to teach me new things all the time.

I designed Raging Bull so that no one is left out of the market. New traders or ones with decades of experience...large accounts or small...it doesn't matter. We've got something that fits you.

You don't need to go this alone.

Share in the journey at Raging Bull.

To YOUR Success!