

Covered Call: S - C_K

Mindset

- All about the underlying stock.
- There's no secret formula nor silver bullet.
- When writing options, the odds of being right are high; but you will win small, lose big. Don't get carried away by the stream of wins. Covered calls should be a boring strategy.

Entry

S: uptrend

- Fundamental analysis
- Technical analysis

K: pick the strike price with a delta close to 0.4

T:

- Ensure no event during the period you hold your options contract, e.g. earnings announcement.
- Usually the final week prior to expiry is when most options are exercised.
- Time decay is not linear. It accelerates once the option moves within 30 days of expiry. This means the best time frame is 30-45 day window.
- Longer term? Do a quick math, because you could've had 2 short term trades.

IV: between 30 and 70. If it's too small, you don't get much premium. If too large, too volatile

Exit

Max profit = $K - \text{stock purchase price} + \text{premium}$

BE = $\text{stock purchase price} - \text{premium}$

- Sideways (1% rule): when time value $< 1\% * \text{underlying price}$, roll the option over ("roll" functionality)
- Win (2 & 20 rule): if the price of buying back your option is less than 20% of the price you paid, within the first 2 weeks of entering the contract, buy it back. For example, you sold it for \$1 and now it costs less than \$0.2, you can buy it back. Why? Lock in a solid profit. Look for other opportunities.
- Lose: what matters most is the underlying stock. If it's disappointing, don't wish your options to compensate.

Fundamental Analysis

(1) stability: boring in the short term, thrilled to own for the long run

Coca-Cola; ATT; Ford; FedEx, Ups

(2) low debt: otherwise quite volatile

(3) age: mature enough, 5 years old, not cyclical sectors such as travel, real estate, basic materials, commodities, etc

(4) management team: well versed, promote from within, not bring outside CEOs on board

(5) trading volumes: over a million shares a day

(6) better pay dividends, but you want large companies that paying out less than 40% of their net profits

Example: finviz

description: dividend yield, average volume, optionable

technical: 50-day SMA

Technical indicators: keep your system as simple as possible.

(1) Choppiness Index

- whether it is trending in a direction or moving sideways.
- A range between 0 and 100. If closer to 0, very trendy.
- 38.2/61.8
- When it goes beyond the upper threshold, it was traded in a range. This would be a great time for CC.

(2) Average Directional Index

If value > 25, a trend is on. Else. sideways.

(3) Bollinger Bands

- It measures the degree of volatility. 3 curves: middle is 20 day EMA, top is 2 std up, bottom is 2 std down
- If the band is quite wide, too volatile
- If the band becomes very narrow, traders anticipate a strong move in some direction. When you see the bands continuously squeeze, write your calls at a farther distance than usual.

(4) Parabolic SAR

- SAR stands for stop and reverse. When the dots are plotted above price, go short. When the dots are plotted below price, go long
- It doesn't work very well in sideways markets. But it is useful when it's trendy.
- If you spot a dots pattern that alternate in quick succession, you can risk a closer call.
- If you see dots constantly printing on one side, especially at the bottom, you need to push it out further.

Poor man's covered call

- Diagonal spread: long ITM call with expiry 1y, short OTM call with expiry 30-45 days
- By buying a LEAP call, you are basically long the stock.
- This substitution strategy works best in mature bull markets.
- This offers an advantage in terms of handling volatility. A long dated option has larger Vega than short dated one. If volatility up, no matter the price is up or down, you gain more than holding a stock. Theta is also very small since it's long.
- LEAP shall have delta greater than 0.75, i.e. deep ITM
- But it is dangerous when your short term option is moving ITM. In such a scenario, you have to exercise the LEAP and deliver the stock of the short options' buyer. You are screwed.

A list of practice

- (1) study 5 charts every weekday
- (2) entry rule
- (3) exit rule
- (4) log every trade, review them every week
- (5) 100 trades under my belt
- (6) only place one trade at one time

