

The Married Put – Plain Vanilla

This section will show a RadioActive Profit Machine as a position trade. A position trade is generally understood to be a simple buy and hold with the intent to hold longer than 30 days. First we'll look at a straight, plain Jane married put with no Income Methods applied. In a later section, we'll look at different ways to play the exact same issue using the several Income Methods or combinations thereof.

The married put play is the heart of all RPMs in RadioActive Trading, so we'll take the time to look at it verbally, numerically, and graphically. Instead of exploring all the Income Methods just yet, we'll just examine a "Plain Vanilla" married put.

The Income Methods are used to cancel the risk that's in a trade, but every time we use an Income Method we give something up; either 1) control or 2) a part of the maximum profit. You'll see what I mean in the Income Method sections. But for now, let's look strictly at the structure of the Married Put assembly as our base.

The Married Put and RadioActive Trading

I started this quest after losing everything in 1999 selling covered calls. When I finally got the guts (and capital) to get back in the market, I started off by doing the reverse of almost everything that I was taught. Ever since 2002 I've been looking for the market to repeat a performance for me...

I picked up AMZN in 2002 for \$16.09 with a Jan 2005, \$20 put option for \$8.90. Let me introduce here the type of accounting we'll be using for the rest of this Blueprint:

October 1st, 2002

Buy AMZN 100 Shares	\$16.09
BTO 1 Jan 2005 \$20 put	+\$ 8.90
Total Invested:	\$24.99
Guaranteed Return:	-\$20.00 (guaranteed by the \$20 put)
Total AT RISK:	\$ 4.99 or 20%
(AT RISK is the difference between the total invested and the guaranteed return)	

Now, you KNOW I wouldn't risk 20% in a trade TODAY. Not with what that silly Trade Simulator Tool would tell me is likely to happen. But remember that at the time all I knew was even more risky ideas like trading covered calls, or just bloody buying the stock..!

If AMZN had gone south, I could well have lost my whole \$4.99, or twenty percent in this trade. But that's not what happened...

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Here's a nice little birthday present, just over a year later:

October 21st, 2003

AMZN closes at \$61.15
Jan 2005 put at \$.12 (Bid Price)
\$61.27 TV (total value)

The investment in this AMZN married put trade went from \$24.99 to \$61.27. That's a 145% gain in twelve months. Not bad!

SO that was my very first married put entry, with AMZN and 20% AT RISK. Today, to eliminate even more of the risk I might have gotten a 2004 put instead, perhaps at the \$25 strike, and paid \$30 something for the whole position, but with only about 5% AT RISK. Even so it still would have been almost a 100% return if I had closed it on October 21st. Run THAT through the Trade Simulator Tool!

Position Sizing and Skewed Risk/Reward

Let's look at a more recent entry. As we do, I'll be unfolding and explaining the accounting that I like to use. This is how I share all of my RPMs to RadioActive Trading members and Fusion' subscribers:

October 10th, 2007

Buy STP 100 Shares	\$39.99
BTO 1 Mar 2008 \$45 put	+\$ 8.10
Total Invested:	\$48.09
Guaranteed Return:	-\$45.00
Total AT RISK:	\$ 3.09 or 6.4%

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As of the date I'm writing this section, the STP report looks like this:

STP 100 Shares	\$51.70
1 Mar 2008 \$45 put	+\$ 4.10
MVP:	\$55.80
Total Invested:	-\$48.09
Profit/Loss today	\$ 7.71 or 16.0%

I call the **Most Valuable Player** (or number, in this case) the **Married Value with the Put**. I know, it's a stretch to make that acronym, but hey, it sounds catchy. Point is, this is the number I use day-to-day to track the value of my married put position. The **MVP** is the sum of today's bid prices for the stock and the put option. If no Income Methods are applied that change the picture, the MVP tells us what we would have if we closed the position today.

If the MVP is higher than the Total Invested amount, we have a profit. If it's lower, we have a loss. Subtracting the lower number from the higher number will give us the dollar amount for profit/loss. Dividing the dollar amount by the Total Invested dollar amount will give the

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percent of the profit/loss. SO! What if we plug these numbers into the Trade Simulator Tool? If we had roughly half winners and losers, limited loss to 6.4%, and shot for a 16.0% gain, this might be our picture after 100 trades:

Win Target: 16.0%
Loss Target: 6.4%
Results Summary out of 100 trades
of Wins: 51
of Losses: 49
High Value: \$714,028.
Low Value: \$ 11,548.
Ending Amount: \$668,279.

Not bad. You win some, you lose some, you pick up a 66-fold (look...6,683%!) increase in 100 trades. This is the value of limiting risk while leaving the upside open.

The idea of the RPM is to reduce exposure to loss to an ideal amount. As we'll see in a later section, there is a way to reduce risk *too* much. Just as with Ryan Jones' position sizing exercise, there is an ideal amount as a percentage to put AT RISK in each trade. IBD puts that amount at 7-8% with his trading rules. I actually am more comfortable with 5-6%. The married put actually *forces* this kind of position size, and does it better than any rule or stop-loss order.

There is a tool on PowerOptions that I use to evaluate married puts. It enables me to list, in descending order, the risk of various stock and put combinations. This tool helps me compare and select the best maximum risk based on my specific criteria. Let's take a look at how this screen illustrates the trade-off between risk and cost:

Stock Symbol		Expiration Month	Filters		Submit	Lookup Symbol		
More Info	Option Sym	Expire/Strike & Days To Exp	Opt Ask	Net Debit	Max Risk	% Max Risk	% In Money	Implied Volat.
▶	ZQNPN	09 APR 70.0 (180)	21.25	74.22	4.22	5.7	+32.2%	0.64
▶	ZQNPMP	09 APR 65.0 (180)	17.75	70.72	5.72	8.1	+22.7%	0.66
▶	ZQNPPL	09 APR 60.0 (180)	14.55	67.52	7.52	11.1	+13.3%	0.69
▶	ZQNPK	09 APR 55.0 (180)	11.70	64.67	9.67	15.0	+3.8%	0.71
▶	ZQNPJ	09 APR 50.0 (180)	9.20	62.17	12.17	19.6	-5.6%	0.75
▶	ZQNPPI	09 APR 45.0 (180)	7.10	60.07	15.07	25.1	-15.0%	0.78
▶	ZQNPPH	09 APR 40.0 (180)	5.25	58.22	18.22	31.3	-24.5%	0.82
▶	ZQNPNG	09 APR 35.0 (180)	4.00	56.97	21.97	38.6	-33.9%	0.87

Source: PowerOpt.com Married Put Search by Symbol

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Notice that the more ITM choices have the lowest risk while the least expensive net debit choices have the highest max risk. The least expensive puts are those that are further OTM. But there's a catch to bargain shopping... the insurance policy doesn't kick in until your stock drops way down toward that lower put strike price.

The least expensive put option on the chart above is the April 35 put currently trading for \$4.00 per contract. But, the **AT RISK** value for the position is \$21.97, or 38.6% **AT RISK**. AMZN has to drop over 33% before the benefit of the \$35 strike put kicks in. With put options, as with ANY insurance coverage (be it home, auto, health...) you get what you pay for.

On the OTHER hand..! It doesn't make sense to OVER buy insurance either. You could go further ITM and limit your max risk even more... but be assured that you are also reducing the chance that the trade will work out. Think about it... if you never have an opportunity to apply any Income Methods (to be discussed in later sections), your stock will need to go well above the strike price at which it's insured or you won't make any money. The higher your strike price is set, the less likely that is to happen.

Length of Time in RadioActive Trades...

Let me take a minute to address a question that might come up right now: "Gee, Kurt! What if I'm in a position like you're suggesting for four months... to do 100 trades that last four months would take over 33 years!"

Well, yeah, it would. Actually, most RadioActive Trades involve a holding period of only two to three months. I've done several that returned 16% or better in only two months time. But say three months is the average, that's four a year. Then it would indeed take 25 years to get to 100 trades. Not 100 wins, just 100 trades. You'd probably get better at picking winners during that time, so assuming 50/50 wins is more than conservative.

If you're 40 years old and began today with \$10,000, would your **\$668,270.90** be enough to live on at retirement age? I'm thinking yes. I'm also thinking you might put more than \$10,000 in your account with a forced savings plan, say that deducts a few hundred bucks a month from your budget and puts them in your trading account.

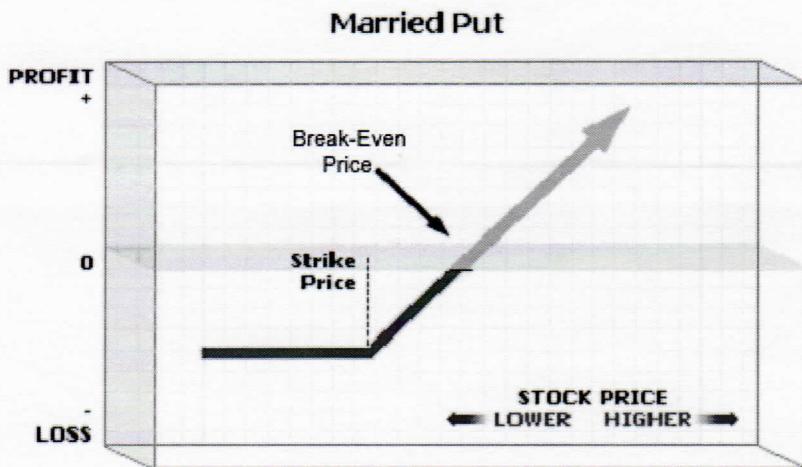
Isn't this kind of investing a thing you'd want to pass along to your children and grandchildren? Sure. SO let's stop wondering about whether or not it makes sense to take positions and hold them for months. This isn't day trading. In fact it's the opposite.

Some folks may want to do RadioActive Trading in order to pay for the groceries, but I'll just go on record here and say that I'm more about making big sums of money over the long haul, not chunk change in this or that, quickie in-and-out trading. Although sometimes that is how it goes down because that's what the market gave me. Sometimes I take advantage of an opportunity to slam-dunk quick profits, but it's not what I look for. I go RadioActive to grow the account big time over longer holding periods rather than to shave a sliver of quick money.

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Why RadioActive Trading Works Over the Long Haul

Here is the risk/reward graph of a married put trade:



In the married put scenario, you actually begin a little underwater. That is, you *start out* accepting the biggest hit you will ever take in this arrangement. In the graph above, the bottom, flat line represents the price you paid for the stock and the put option that insures it. Here are the black and white numbers again:

October 10th, 2007

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Buy STP 100 Shares	\$39.99
BTO 1 Mar 2008 \$45 put	+\$ 8.10
Total Invested:	\$48.09
Guaranteed Return:	-\$45.00
Total AT RISK:	\$ 3.09 or 6.4%

See that? The \$45 strike price is the bottom, black line on the graph, and the upward, sloping RadioActive line above zero represents the stock's climb to overcome the premium paid for the insurance.

No matter what happens to the stock's price on the downside, it's impossible to lose more than part of the option's price, called the time value. On the other hand, the stock does need to rise before the – Break-Even Point – is reached.

As the stock rises, there's really no limit to how far it can go. The lower, flat black line represents the furthest that the value of your investment can crash, while the arrow pointing upwards shows how far it can go -- unlimited. This is what makes the married put arrangement a skewed risk/reward scenario. Given a long enough time horizon, this strategy is mathematically sound.

Now, remember that this graph is made without the Income Methods from the following sections. See, the main reason for the Income Methods is to take out even the piddly risk

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that you begin with and make the “risk” side of your Calculator ZERO. Imagine that... How about running the Trade Simulator Tool with a “0” in the Loss Limit column, and “fill in the blank” for the Win Goal? Stay tuned because that’s exactly what we’ll be exploring soon.

SO why use the Married Put to reduce your risk exposure instead of selling a covered call? Why not just buy a semi-volatile stock and sell calls against it? You will most likely get called out at a small gain, and if you don’t get called out you still have the stock and can sell calls again.

Hold on there, partner. The question is not how long it will take to see the fruits of your labors -- the question is, WILL you see them? The problem with most investing programs out there, most weekend seminars, is that they sell a romantic dream of 5% per month earnings, month after month on stocks that MAY stay up or go down.

The question that is never directly addressed in these seminars is, “How much CAPITAL is **AT RISK** in these trades?” The answer is: **ALL OF IT**. All of the deposited funds in a straight stock purchase are **AT RISK**, and the teensy little premium that one collects by selling covered calls mitigates only a few percent of this risk. The covered call trader that consistently makes 5% a month every month is like Bigfoot: I suppose that critter could exist, but I have never seen him.

Assignment: ask a covered call trader that claims to consistently make 5% per month to show you his trading record... ALL of it, including the value and cost basis of every holding in his portfolio. Make sure that it's for more than eighteen months, and shows up and down markets.

Hint: I'll save you some time... don't look for this animal for very long.

On the other hand, how about a trade that returns 15-16%, but takes three or four months to develop? Y'know, we do lots of those. Doesn't that add up to 4-5% per month anyway? We know that the Martingale has a hearty appetite and bountiful feeding ground where folks are in a hurry to get rich. RadioActive Trading actually delivers when it comes to limiting risk and slaying the Martingale. Remember?

The position size in a RadioActive Profit Machine is equal only to the time value in the premium of the put. That is the entire downside risk. Whether the RPM has \$100,000 or \$1,000 invested the most that can be lost is computed on the front end and totally in check. It's a small amount, about 5% or less. If our stock loses 10%, 15%, 50%, 75% or more of its value, the loss of the RPM's value will always be limited to the time value of the put's premium – period.

On the other hand, as our stock rises it's nearly a dollar-for-dollar gain on the WHOLE invested amount. This is how we achieve an arrangement that the Trade Simulator Tool loves. This is true financial leverage, much more so than a real estate investor uses when he borrows money from the bank. And the maintenance is so much cleaner... who's ever had their stock call them at midnight to complain about a clogged toilet or busted hot water heater? And put insurance is much more powerful than home insurance. We do not have

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to specify if it is fire, flood, earthquake, or property value that effects our stock value. The put insures any catastrophic event without specifying it.

Let's Recap...

A RadioActive Profit Machine (RPM) is formed by simultaneously buying a stock and an In The Money (ITM) put option that is five or more months to expiry.

April 22nd, 2009
GMCR (Green Mountain Coffee Roasters) RPM

Buy GMCR 200 Shares	\$54.20
BTO 2 Sep 2009 \$65 Put	+\$16.70
Total Invested:	\$70.90

The only money **AT RISK** in the arrangement is the **time value** portion of the put option at the time of purchase. Remember, there are two components that make up an option premium...the intrinsic value of the option and the time value of the option. The GMCR \$65 strike put option is \$10.80 ITM, or we can say it has \$10.80 of intrinsic value (\$65 strike put - \$54.20 stock price = \$10.80 ITM). The remaining value of the put option is the time value:

Put Total Cost	\$16.70
Put Intrinsic Value	-\$10.80
Put Time Value	\$ 5.90

However, I feel it is easier to calculate the time value or **AT RISK** value by simply subtracting the guaranteed return from the total amount invested:

Total Invested:	\$70.90
Guaranteed Return:	\$65.00
Total AT RISK :	\$ 5.90

Dividing the dollar amount of the **AT RISK** amount by the Total Invested will yield the **AT RISK** as a percentage: **\$5.90 (At Risk) / \$70.90 (Total Invested) = 8.3%**. Now as GMCR goes up in value, the put will lose value, sure. But it does so slowly and not at a 1:1 ratio with the increase in the stock price.

In a mere 8 days, GMCR spiked up due to a favorable earnings report.

April 30th, 2009

GMCR 200 shares	\$72.10
2 Sep 2009 \$65 puts	+\$ 9.70
MVP:	\$81.80
Total Invested; 4/22/2009	-\$70.90
Profit/Loss; 4/30/2009	\$10.90 or 15.3%

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Now, the only problem with this picture is that, even though there is a current gain if the position is liquidated, GMCR could come back down again. With only \$5.90 **AT RISK**, we could still lose...well, \$5.90! There is nothing sure about the gains we had seen so far in this RPM.

There are two ways to lock in gains we've had so far:

- 1) We could sell the RPM itself and realize the 15.3% gain we've had so far...

OR

- 2) We could use one or more of the Income Methods to bring in a chunk of change big enough to offset the \$5.90 and cancel the amount **AT RISK**.

As it turns out, we actually closed this Fusion position for the gain of 15.3% during a live seminar. Fusion members can see the track record of this actual trade on www.radioactivetrading.com. I opted not to apply an Income Method to this position as I was quite happy with the 15% gain in 8 days...but that is not what was important. What was important on this trade, and what is unique to all RPMs that I trade, is that I was never at risk for more than 8.3% of the invested capital. Hey, if GMCR could move up by 20 points due to a favorable earnings report...isn't it also possible that GMCR could have **DROPPED** 20 points with a negative earnings report? But, even if that had happened, I was never at risk for more than 8.3% of my invested capital. Pretty sweet...some extra sugar in the coffee!

Previously I mentioned that the put option in this RPM would not drop in price equal to the increase in the stock price...that the put will decline more slowly. Let's look at the initial setup of the GMCR position again:

April 22nd, 2009
GMCR (Green Mountain Coffee Roasters) RPM

Buy GMCR 200 Shares	\$54.20
BTO 2 Sep 2009 \$65 Put	+\$16.70
Total Invested:	\$70.90

Even though I put up all my trades for everyone to see, my detractors will still look at this position and say: "*Why are you buying a put option so deep ITM? You have added to your cost basis and can't make a dime unless the stock goes above \$70.90!!!*"

"Oh, is that so..." I will counter. What happened with the GMCR position, exactly?

In a mere 8 days, on April 30th, 2009, GMCR had spiked up to \$72.10. So...that means I only made a profit of **\$1.20**, right? After all, my Total Invested was \$70.90, and with the stock trading at \$72.10 I can only make \$1.20...

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But, I made much more on that with GMCR. Why? Well...it is because the far out in time, deep ITM put option did not lose 1:1 with the increase in the stock price. Let's look at each leg of the RPM:

April 22 nd , 2009, Buy 200 shares GMCR	\$54.20
April 30 th , 2009, GMCR spikes to	<u>\$72.10</u>
Total Gain in GMCR	+\$17.90

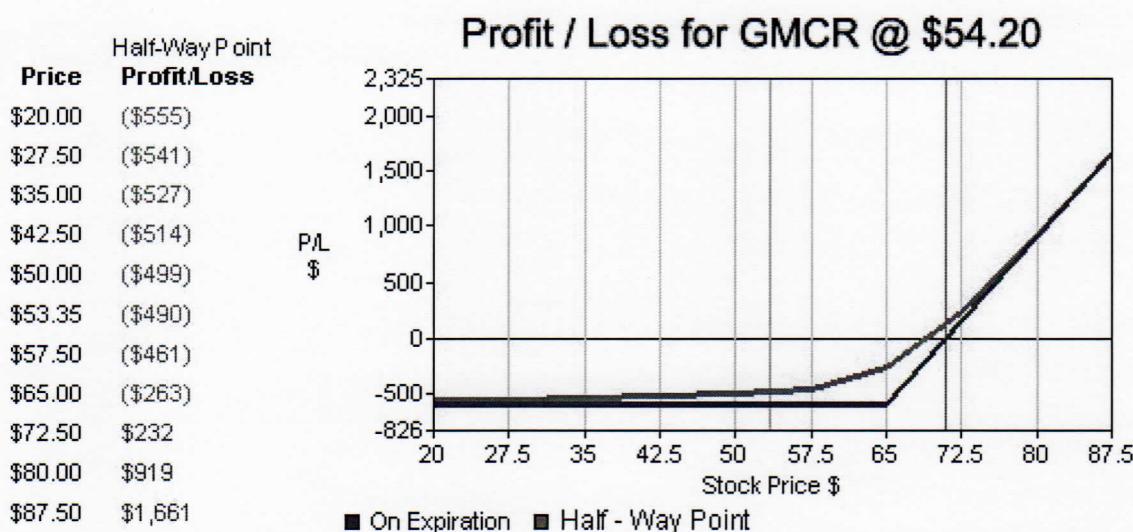
April 22 nd , 2009, Buy 2 Sep \$65 puts	\$16.70
April 30 th , 2009, Sep \$65 puts	<u>\$ 9.70</u>
Total Loss on Sep \$65 puts	-\$ 7.00

Yes, my put lost value as the stock price moved up...but by how much? Let me put it to you this way...if I took \$7.00 out of your pocket would you be happy? No, of course not, in fact you might be pretty darn mad. If I took \$7.00 out of your pocket and gave you \$17.90 back, how would you like me now? What if I did that 200 times in a row?

That is exactly what happened with GMCR. Yes, the put declined by \$7.00, but in order for that to happen the stock had to gain \$17.90...and that happened 200 times!

This relationship can be better illustrated using those neat tools on PowerOptions. Let's take a look at the Profit / Loss chart for the initial GMCR position:

Current Stock Price □: \$54.20	Total Cost: \$7,090.00
Break Even ■: \$70.90	Monetary Requirement: \$0.00
	Total Requirement: \$7,090.00
	Put Guarantee Price: \$6,500.00
	Max Risk: \$590.00
	% Max Risk: 8.3%
	Max Profit: Infinite



Source: PowerOpt.com Profit / Loss Graph

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The straight line, the hockey stick graph, shows us our P/L at September expiration. As you can see, that 8.3% I had at risk only occurs at the expiration date...that is, if I held the stock and did nothing for the next 5 months and the stock was trading below \$65 per share.

But, notice the curved line...this shows us the gain or loss of the position **Halfway** between now and the September expiration. Notice how the Break Even point is much lower and that I did not need the stock to reach \$70.90 per share to reach a profit...because the put does not lose 1:1 with an increase in the stock price. It just so happens that GMCR moved well above the Break Even point much sooner than the halfway point...more sugar in the coffee!

Some practical considerations on entering a trade

The bid/ask spread on stocks is generally small, however, the bid/ask spread on put options can be much larger. Bid/ask spreads are especially wide when the put is deep **ITM** and far out in time, which is just how we position the put when we trade RadioActively. Therefore, we prefer to buy the put first using a limit order with the price set half way between the bid and asked option prices for the put chosen. Then after the put is purchased, buy the stock at the market price. Since stocks tend to have a much narrower spread the market order will have a reasonable price and it will execute quickly to complete the RPM position.

If the put limit order does not execute, it will be because the stock price is declining and the put is increasing in value and getting more costly. That actually helps with the timing of the put and stock buy, since the limit order will not execute if the stock is declining. Just wait for a better buying time.

If the put is executed, then the stock is probably rising in price and should be purchased quickly once the put is already purchased. Entering a market order for the stock will get immediate execution and the RPM will be complete.

We generally like to enter a RPM when the stock is advancing or is breaking out technically. But the timing on entering a married put position is not very sensitive because the position is hedged (stock + put). Since we are buying the combination, if the stock is up when we want to establish a position, the put will be down. Therefore, getting into a position on an up day vs. a down day probably will not make much of a difference to the total invested or the risk amount.

A similar question often arises with subscribers to our Fusion service. An investor who wants to follow our trades is concerned that our position was established in the morning and they missed the opportunity to buy because they did not see that the trade was made until the afternoon or even the following day. But a change of a point or two in entry price of the stock is cancelled by a similar change in the put. Therefore, timing of entry into the position is not critically important.

Well Done!

You have just completed the first four chapters of The Blueprint! You have gone through the Option and RPM Basics, seen the importance of limiting risk as illustrated in the Trade Simulator Tool *and* viewed how to properly setup a Married Put position to take advantage of the 3 Core Principles of RadioActive Trading.

Before you press forward into the Income Methods, this would be a great time to pop-in the F.O.R.T.S CD – Foundations of RadioActive Trading. This Video CD Compliment will further discuss the concepts of F.I.S.T (Force and Ideal Sized Trade), The ATM Bell Curve and the REDLine (RadioActive Decay Line).

Once you have gone through the material on the F.O.R.T.S CD, you will be set to explore a whole new section: the Income Methods. See you there!



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