

# OPTIONS TRADING

## PLAYBOOK

Intermediate Guide to the Best Trading Strategies & Setups for  
profiting on Stock, Forex, Futures, Binary and ETF Options.  
Build up a remarkable Passive Income in weeks!

FOR  
INTERMEDIATE

Trading Online for a living

David Reese

# **Options Trading Playbook 2020**

*Intermediate Guide to the Best Trading Strategies & Setups for Profiting in Stocks, Forex, Futures, Binary, and ETF Options; Build up a Remarkable Passive Income in a Matter of Weeks.*

*By  
David Reese*

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# Introduction to Intermediate Trading Strategies

After having mastered the basics of options trading strategies, you want to advance your skills and trade at the intermediate level. At this stage, you will engage in real-time trading. To do this successfully, you will need to learn about the mechanics of trades.

As we have already determined, options trading can be extremely lucrative for traders of all account sizes and skill levels. This is because of the huge leverage that options strategies offer. These strategies lead to very large returns in a very short period of time.

A lot of options traders often start out by purchasing bullish call options. Such an approach can be profitable. However, this is only a scratch on the surface. There are trading strategies that can lead to much higher profits within a shorter period of time. It is at this point, where you apply multiple trading strategies, the trading gets interesting.

## *Intermediate Options Trading Strategies*

Intermediate strategies open your mind and opportunities to earn more money regardless of the different conditions of the market. As a beginner, you already know that directional investments such as buying put and call options are great ways of getting started in trading options. Such strategies are great but can only make you so much money. You need to learn some strategies that can earn you even better returns.

As an intermediate trader, you should learn how to benefit from volatility. Volatility needs to be your friend and partner as you can benefit from sharp and sudden movements in the markets. Options are mostly affected by implied volatility which is essentially the most crucial factor affecting options prices. You need to learn to be on the lookout for implied volatility and determine whether it is low or high. This way, you will easily be able to get a sense of direction regarding the type of options to engage with.

When implied volatility is high, then it is advisable to use selling strategies such as iron condors and vertical spreads in order to sell premiums. Such strategies are well suited to benefiting from any drop in implied volatility down to normal levels. However, when the volatility levels are low, then it is advisable to buy more vertical spreads and generally purchasing

long puts and long calls. This approach will enable you to benefit from movements in volatility. You can also benefit from selling premiums as you are able to benefit from time decay.

#### *Sideways market movement*

If you want to trade options successfully, then you need to identify the strategies that will enable you to benefit should the markets move sideways rather than upwards or downwards. Certain strategies will enable you to benefit from such strategies.

Most traders dislike this market condition because they like the knowledge of strategies they can implement to benefit them. Yet as a seasoned trader, you need to actually have strategies that can ensure you are profitable in such circumstances. Using options, it is possible to make money even with almost zero movements in the markets.

Most of the time traders consider selling premiums when there is no movement. You can use options to achieve this effectively. For instance, strategies such as calendar spreads and iron condor are effective in sideways market movements. Others include the sale of strangles, straddles, and vertical spreads.

#### *Reading an options table*

Some of the crucial things that you need to learn include how to read an options table. As it is, the values of options are determined by a number of factors including the distance between market valuation and contract initiation and the strike price, volatility of asset price, time till expiration, and others. Greeks are created by models that are the values determining the relationship between an underlying asset and the option price. It is these relationships that make options tables valid.

You will find out that a lot of the time, the market's attention is often focused on options trading. If you learn how to read the table properly, you should then apply your skills on paper before then applying your skills and techniques to actual or demo trading. Make sure that you engage in demo trading before live trading using real money. When you apply your skills and techniques on a virtual trading platform, you will successfully be able to apply these same techniques to other situations on the live trading platform.

#### *Acquire as much experience as you can*

Basically, the more you trade in options, the better you become. You improve your skills and gain more exposure to different trading conditions. As such, you gain the necessary techniques and knowledge that help to make

you a better trader. For instance, you will get to learn about certain techniques that can save you money. A good example is placing entries right between the bid and ask spread. This will not guarantee an instant fill, but you will be able to save a significant amount of cash by doing so.

Options trading is an incredibly powerful investment strategy. By learning some of these powerful trading strategies and tips, you will be able to make plenty more money from your trades and benefit from all kinds of market conditions.

# Chapter 1: 3 Actions for Intermediate Traders to Get Their Feet Wet

There are a couple of trades that you can involve yourself with as an intermediate trader just to get your feet wet. Remember that even at this stage, you should be patient. First of all, you need to learn your trades and make an effort to understand how each process works, and then wade into the waters gently and with caution.

Some great activities that you can engage in as an intermediate trader include;

- Writing covered calls
- Buying leap calls as a stock substitute
- Selling cash secured puts on stocks that you want to buy

As an investor who has already bought stock options in the past, these intermediate actions should be relatively easy. This is because options strategies begin with the purchase of stocks.

## 1. Writing covered calls

This is a strategy that is considered much safer than outright purchase of stocks. It is generally referred to as CCW or covered call writing. It should be among the initial strategies to initiate as an intermediary trader. There are reasons why this approach makes sense.

### *1. The strategy is easy to understand:*

With this strategy, you will simply sell your rights to purchase stocks at a specified strike price to another trader. After collecting the payment from this sale, you await the lifetime of the agreement to expire as it is limited. Should the buyer decline the opportunity to purchase the stock after the deadline, then your obligation to sell the shares will no longer exist.

*2. Covered call writing provides plenty of beneficial trades compared with stocks purchase:*

Basically, if you the value of your stock declines, you will only lose out less than the trader who did not have a covered call. You will earn a profit

when the stock price drops lower than the cost of the premium you collected.

Should the stock price remain largely unchanged even upon expiration dates, then you will earn a profit while other investors such as those who buy stocks will only break even. You also earn more should the price of the underlying stock rises beyond the strike price at prices lower than the collected premium.

This profit is also greater than direct stock investors. Should the related stocks experience a massive price increase, then this is the only situation where your earnings will be less compared to those of a buy and hold investor.

*3. Covered call writing or CCW offers some protection, albeit limited, against any losses should the markets decline*

Basically, when you collect money from the sale of the call option, you will have reduced the financial liability on the underlying stock.

### **What is a covered call?**

We can define a covered call as basically an options trading strategy where you enter a long position in an underlying stock and then sell or write a call option based on the same stock. This is a strategy designed to generate multiple streams of income.

As an investor or trader, this is a strategy that you will use when you have a short-term neutral opinion on a particular stock. In such cases, an investor would hold onto this position for a while holding a short position while still earning an income. The term “buy-write” is another name used to refer to covered calls.

#### *Covered calls – set up*

The covered call strategy is considered a neutral strategy because traders mostly expect minimal rise or fall in the price of the underlying stock price for the entire life of the call option.

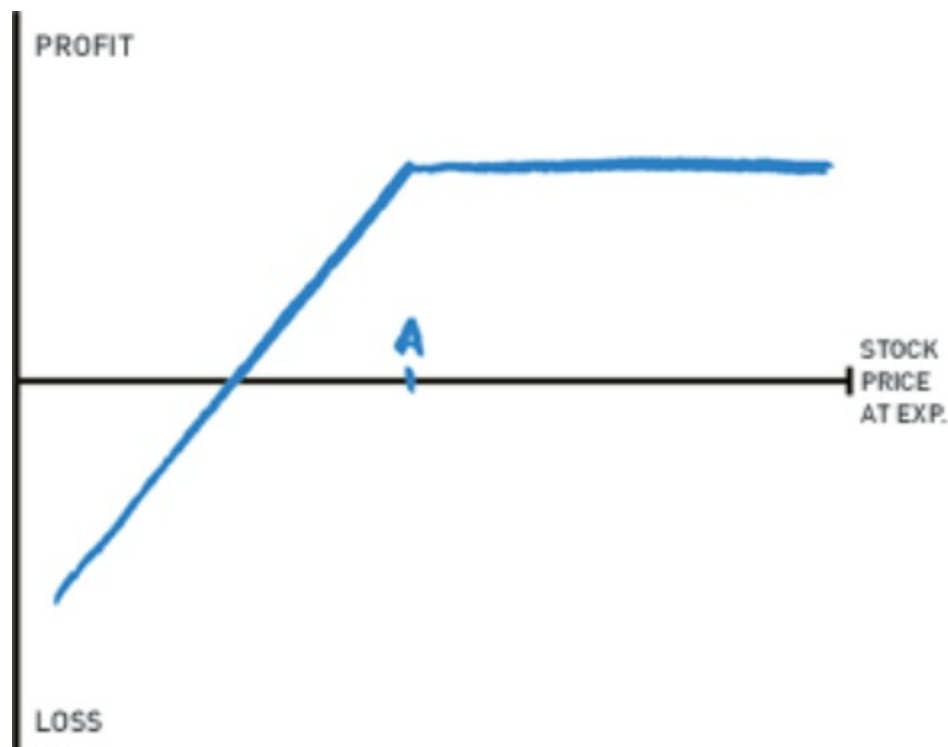
Basically, covered calls are not ideal for bullish traders or investors. Bullish traders should hold onto the stock rather than write a call option. The option will essentially cap the profit, and this will negatively affect the overall profit should the stock price go up.

Covered calls basically operate as a short-term hedge on a long position. This way, an investor or basically a trader gets to earn a profit from the profit received after selling the call. The challenge is that the investor will lose any gains the stock makes on the market. Also, if the call buyer decides to exercise their right to buy the shares, you will have to forfeit them.

This option strategy is also not suitable for investors who are very bearish. Such investors and traders should consider selling their stocks on the open market. This is because the premium received from selling the call option may not sustain any losses incurred by a losing stock.

#### *Best profit and loss scenarios*

With a covered call option, the maximum profit that you can get is equal to the difference between the strike price of the short call option and the buying price of the underlying stock added to the premium obtained. The maximum loss will occur when the premium received is larger than the cost of the underlying asset.



#### *How to write a covered call*

First, select your preferred stock within your portfolio of shares. Identify the stocks that you could be open to selling and avoid those that you consider very bullish especially in the long term. This way, you will not feel disappointed should you lose a stock which would otherwise have become profitable in the future.

Next, you should identify the strike price that you are comfortable with. This is the price at which you are happy selling the stock. The best approach to identifying the right strike price is to pick one that is out-of-the-money.

The reason for this approach is because our aim is for the stock price to increase before it has to be sold.

After this, you need to choose the appropriate expiration date for the call option contract. The most ideal in this case would be one that is 30 to 45 days in the future. However, this is only a guide, so consider the dates carefully. The best date is actually that which allows you a good premium if you sell the option at the chosen strike price.

## **2. Buying LEAP Calls as a stock substitute**

Another great way of making money as an intermediate options trader is investing in long term calls, also known as LEAPS. The aim of buying long-term calls is to enjoy benefits that are the same as those of owning the stock. However, buying the call option would limit your risk and exposure. In such a situation, the LEAP call would act as a substitute for your stock.

### *What are LEAPS?*

We can define LEAPS as options that you buy for the long-term. They are considered a long-term investment that acts as a substitute to actually owning shares. In essence, you get to benefit from LEAPS as you would if owning the underlying shares.

The acronym LEAPS stand for Long-term Equity Anticipation Securities. Generally, any stock options that have expiration dates more than 9 months are considered LEAPS. Such options are similar to other options with the only difference being that they have a longer “life expectancy” compared to ordinary options.

### *The LEAP set up*

Basically, if your thoughts on a given stock are bullish, then you can consider using LEAPS arrangement. This way, a simple rise of about 50 points could translate to a rise of over 300% which is highly profitable. Even then, there are risks involved, so it is crucial to be wary. Basically, use caution and apply this strategy wisely. If you do so, then you will be able to leverage your investment greatly.

In most cases, LEAP stocks often have an expiration date beyond one year while sometimes it is at least 9 months. This strategy allows you to invest a relatively small amount of money and buy options rather than spend larger amounts buying actual shares. Using this approach and strategy, you

will be able to earn huge returns especially if you make the correct decision regarding the movement of the shares.



### *How to get started*

The first step in investing in LEAPS is identifying the appropriate stock for this strategy. Simply follow the standard procedure of purchasing a stock at the stock market. To determine the most ideal stock for this strategy, you will need to do some research. There are websites where you can get useful information that will help with the analysis. Take for instance Ally Invest Quotes + Research. Do some fundamental analysis of the stocks until you find one that gives you enough confidence.

Once you determine the most suitable stock for this strategy, you will need to determine the strike price. Basically, you will need to invest in a stock option that is deep in-the-money. This basically means a stock whose strike price is lower than the stock's current price. If you apply this strategy, then aim for a delta that is equivalent to or higher than 0.80 based on your chosen strike price.

This delta reference simply means that should the stock price go up by \$1 your chosen stock option should rise by at least \$.80. The same reasoning

applies if you choose a stock whose delta is 0.95 which means that for a stock price increase of \$1.0 then your stock option price will rise to \$0.95. This is basically theoretic. Anytime you use the Options Chains on Ally Invest; you will be able to see the deltas for each listed stock.

#### *The starting point*

When you want to invest in a LEAPS strategy, you should consider one in which the in-the-money stock price is 20% or higher. For instance, should the price of the underlying stock equal \$100, then you should choose a call option whose strike price is lower or equal to \$80 but not more. But if the stocks are volatile, then you should consider that it is even deeper in-the-money in order to acquire the kind of delta that you need. However, you should note that your option becomes costly should you go even deeper in-the-money. The reason is that the option gains a lot of intrinsic value even though the upside is a higher delta value. When your options have a higher delta, the better they will serve as a stock substitute.

#### *Expiration date*

Always keep in mind that all options have an expiration date, include long-term options. Always keep this in mind. Now, should the stock price ascend sharply after the expiration date, this will do you no good at all. Also, as this date approaches, most options tend to lose their value at a pretty fast rate. Therefore, you need to be extremely careful with these dates.

When it comes to this particular strategy of LEAPS, then you should always opt for options that have at least a year to expiration. This is advisable as you will have sufficient time to benefit from stock movements in the course of the year without the burden or expense of actually buying the stock. Remember that in the end, this strategy is adapted for investment purposes where you want to make large sums of cash rather than just a speculative tool.

#### *Precautions when using LEAPS*

One of the biggest precautions or risks when using this strategy is to use it as a risky gambling tool rather than the investment vehicle it was meant to be. For instance, some traders may select stock options with bad pricing or those that may probably never strike.

At other times it may be the case of piling risk upon risk by choosing long-term, less costly stocks for this strategy. Such options may not even fit the definition so LEAPS because the expiration period may be less than 9

months. Sometimes traders make speculative trades and put themselves at high risk.

This strategy may not be suitable for all investors so please approach it with care and understanding the inherent risks involved. Pursue this strategy when you have the cash to spare and stocks that are just right. However, if you adopt the measures indicated and follow the right procedures, then you should be able to benefit immensely from this strategy.

### **3. Selling cash secured puts on stocks you want to buy**

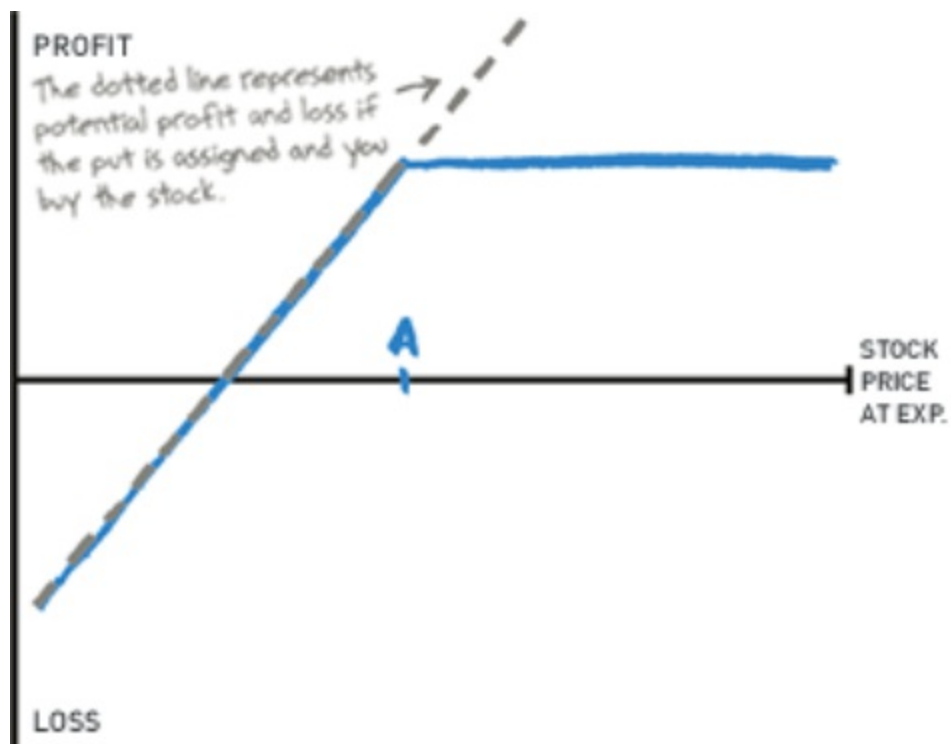
This is a put option that is secured by cash. The strategy involves simultaneously drafting a put option while putting money aside for the purchase of the underlying stock should they be assigned. The end goal of this strategy and every other is to generate a lucrative income or a big enough profit.

#### *Defining a cash-secured put option strategy*

The cash secured strategy is where an investor or trader sells a put option in order to acquire a stock or other security that they need to buy but at a significantly lower price than the actual cost of the security.

The strategy includes writing an out-of-the-money or at-the-money put options while at the same time securing money to purchase the underlying stock should the need arise. The main aim here is to actually acquire the targeted shares at a much lower price compared to the prevailing market prices.

This way, you will acquire upfront the option premium and in return the obligation to buy stocks at a lower price. If the situation was ideal, your stock would trade at a price that is above the strike price of the option for the life of the option.



Take the ideal situation where your stocks trade at levels higher than the option's strike price for the lifespan of the option. Should this be the case, then you will not have to purchase the underlying stock but still receive payment for the option premium. However, this is only one scenario out of a possible three distinct scenarios.

Apart from the ideal situation described above, it is possible that the stock price will fall to low levels that are below the difference between the option premium and the strike price. In such a situation, the trader or investor still fares well the adjusted cost basis is more attractive compared to what is available on the open market once the premium received from the option is accounted for.

The remaining scenario occurs when the stock price falls to levels that are well lower than the strike price less the option premium. Under such circumstances, an investor's adjusted cost basis fares much worse than direct access via the open market. This is even after the option premium received earlier is accounted for.

#### *Determining the secured puts to sell*

There are a couple of characteristics that you need to be on the lookout for. For instance, identify stock options that have between 45 and 60 days

before expiration. Also, look out for strike prices with approximately 1 standard deviation below the prevailing price at the markets.

Basically, you need to also keep in mind the fact that cash-secured puts enable traders to create a passive income stream from money that is lying idle in your bank account hoping to invest in blue-chip companies at a much lower price compared to the prevailing market rates.

#### *The strategy*

In this instance, you will be selling your put options with the hope of acquiring the underlying asset. While still pursuing this strategy, you probably should consider selling in the open market your out-of-the-money put. By doing this, you are of the opinion or hope that the stock will fall below the strike price and maintain that level. This is essentially a bearish move. As such you will be assigned the stocks that you were hoping to receive, and they will belong to you.

#### *Tips and advice*

The first rule of thumb when trading the cash secured options put is to never go overboard with any of the leverage available to you especially when trying to sell put options. As it is, if you are like most traders who purchase 100 shares per single trade, then you should work with a single contract that equals 100 shares. Should you prefer selling or buying 200 shares then make it 2 contracts of 100 shares each.

Therefore, first, sell the put option at the preferred strike price. Make sure that as you implement this strategy, you will be required to set aside some money in the form of cash. This money will then be used to purchase the underlying stock should you be awarded. Also, the stock price is most likely to be higher than the strike price you determined earlier.

This strategy is appropriate for traders with at least some basic experience as well as all other advanced traders. Investors at all levels are able to execute cash-secured puts. It is an ideal strategy to apply if you are bullish in the long term and bearish in the short term. At expiration time you will only break even if the strike price is less, the premium received cancels out.

You will suffer the maximum potential loss when the stock price drops to zero. Your losses in this instance will be limited to the strike price. Basically, the potential loss can also alter to the long stock position should the puts be assigned as well. You need to make sure that there is sufficient cash amount available in order to take care of the costs of purchasing the shares should need to purchase the stock arise.

Under this strategy, time decay is actually favorable. It is advantageous when the option price sold bends towards zero level. This will imply that it will be less costly to buy the option back when you choose to close a position before it expires. You will also benefit if there is IV or implied volatility.

Once the strategy has properly been established, you will benefit if the implied volatility decreases. This is because IV will lower the price of the stock option that you just sold to other traders. This will make it less expensive for you when the position is closed prior to expiration. Since there is collateral within this specific strategy, it is highly recommended that you ensure that you have experience trading options before actually attempting this trade.

# Chapter 2: Intermediate Strategies for Steady Profits

## 1. Short Call Spreads

Short call spreads are also known as bear call spreads. These spreads are a limited risk as well as limited profitability and have both a long call and short call option.

Traders describe short call spreads as a form of vertical spreads that consists of two calls with different strikes but similar expiration dates. Some refer to this strategy as a bear call credit spread. Using this strategy, a trader will be expecting a fall in the underlying asset's price.

You achieve this strategy by buying call options at a particular strike price then sell an equal number of calls at a lower strike price but with a similar expiration date.

### *Maximum profit*

In this instance, you will enjoy the maximum profit only when it is equal to the amount received at the initiation of the trade. Profitability will generally depend on the amount of initial premium that is retained upon or before the expiry of the strategy. This strategy fares best when the price of the underlying stock remains below the strike price for the lifetime of the options.

Therefore, the main purpose of the short call is to create an income or generate profits while the long call enables the management and limitation of risk.

### *Tips and advice*

There are certain advantages of this strategy, and one of them is that you will benefit if both options were to expire worthless. When this happens, you get to retain all the income from the commission received.

One of the things you will need to consider is to ensure that at initiation, strike A is out-of-the-money by about one standard deviation. This approach will increase your chances of success. Even then, you need to note that the more out-of-the-money that your strike price is, the lower will be the amount of credit obtained using this strategy.

You need to, as a rule of thumb, allow this strategy to run for a period of at least 30 to 45 days in order to have sufficient time for it to take root. You will also get the chance to benefit from accelerating the time decay when expiration dates get near. However, this will largely depend on market conditions like implied volatility as well as the underlying stock.

#### *The setup*

In this instance, you will sell a call option at a strike price known as strike price A.

You will then buy a call option at a price known as strike price B. The stock price should generally be lower than the strike price A. You should also ensure that both options have the same expiration month. You should use this strategy when you are bearish about the markets or a stock. The strategy can also be adapted when you expect some neutral activity when a particular strike A is generally out-of-the-money.

#### *Break-even and maximum profitability*

At the expiration of the options, you will break even when Strike A as well as the net premium received at the initiation of the strategy. At expiration, the stock price should be below or equal to the strike price. However, for maximum profitability, the best scenario is when there are no payouts necessary, and you get to keep the full premium paid when the position first opened.

#### *Implied volatility*

Once you have established this position, you should then proceed to ensure that implied volatility depends mostly on the position of your stock based on the strike price. Therefore, should your forecasts and analysis be right, then your stock prices will begin to approach or fall below strike price A, then implied volatility should decrease.

When it decreases, it will decrease the price of the two options, and this is positive because the main aim is that they expire worthlessly. Should your forecast be wrong, and the price of the stocks keeps appreciating and approaches the strike price B, then it will be in your best interest that implied volatility be increased. This will benefit you in two ways and help prevent losses.

Calls								Puts								
Symbol	Last	Chg	Bid	Ask	Vol	Optnl	Action	Strike	Symbol	Last	Chg	Bid	Ask	Vol	Optnl	Action
Jan 18 Calls (280 days to expiration)								Jan 19 Puts								
XGZAG	0.21	-0.06	0.22	0.30	150	8,537	Trade	2.50	XGZMO	1.41	0	1.28	1.39	00	22,515	Trade
WBAAZ	5.90	+1.25	5.60	5.80	401	4,817	Trade	2.50	WBAMZ	0.96	-0.14	0.93	0.97	1,322	40,939	Trade
XGZAA	0.05	0	0.03	0.05	263	15,568	Trade	5.00	XGZMA	3.60	-0.10	3.95	3.65	75	7,411	Trade
WBAAAP	4.20	+1.20	4.15	4.30	1,816	26,895	Trade	5.00	WBAMP	1.64	-0.31	1.57	1.83	1,588	31,061	Trade
XGZAR	0.02	-0.01	0.01	0.02	41	36,850	Trade	7.50	XGZMR	6.26	0	6.00	6.20	00	2,991	Trade
WBAAQ	3.04	-0.94	3.05	3.15	2,149	75,590	Trade	7.50	WBAMQ	3.05	-0.40	2.92	3.00	531	19,629	Trade
XGZAB	0.01	-0.01	0	0.01	05	20,665	Trade	10.00	XGZMB	8.00	0	8.20	9.05	00	2,269	Trade
WBAAAB	2.22	-0.72	2.21	2.25	2,179	57,337	Trade	10.00	WBAMB	4.60	-0.84	4.50	4.65	340	25,187	Trade
XPVAV	0.97	0	0.96	1.03	00	1,387	Trade	12.50	XPVMV	7.35	0	6.75	7.15	47	1,430	Trade
WBAAAR	1.53	-0.50	1.54	1.60	849	47,291	Trade	12.50	WBAMR	6.75	-0.65	6.35	6.50	118	11,804	Trade
XGZAC	0.02	0	0	0.02	05	8,312	Trade	15.00	XGZMC	14.25	0	12.95	14.00	00	174	Trade
WBAAAC	1.12	+0.41	1.10	1.12	1,037	36,741	Trade	15.00	WBAMC	8.65	-1.04	8.35	8.50	89	26,520	Trade
XPVAV	0.43	-0.09	0.42	0.48	37	1,305	Trade	17.50	XPVMY	11.90	0	11.15	11.65	00	3,374	Trade
WBAAAS	0.74	-0.01	0.74	0.80	904	19,009	Trade	17.50	WBAMS	10.70	-1.20	10.50	10.70	312	13,426	Trade

## 2. Short Put Spread or Bull Put Spread

The term bull spread refers to an options trading strategy used by traders hoping for a small or modest increase in stock price. When applying this strategy, a trader will first buy a put option and then at the same time write a put option of a higher strike price.

This is advantageous because first, the trader gets to receive the premium for selling the option. Should the price of the underlying stock remain the same or moves above the strike price, then the aim of the strategy will be realized. When this situation plays out, the written option will expire worthlessly, so the premium gets retained. This strategy's risk is basically only limited by the put option purchased.

### *The strategy*

When you enter this strategy, you will be obligated to purchase the underlying stock at a different price which is price B should the stock option though assigned awards you the right to sell the underlying asset that the strike price A.

While there is an inherent risk when investing in put options, they can also provide an excellent way of propping yourself up to purchase the underlying stock should the price of the underlying stock fall drastically. This will make them affordable and benefit you immensely. The short option put will lock in the buy price, and you also get to retain the premium that you receive for the option that you sell.

Basically, while you sell a put option at price B, you will purchase another put, but at the lower strike price A. This will limit your risk should the price fall significantly. However, there is a small challenge. You will reduce your net credit when you purchase the put option if you implement this strategy.

#### *Tips and advice*

One benefit of this strategy is that as a trader, you will desire to have the two options expire worth absolutely nothing. You should also endeavor to ensure that at initiation, strike price B is at one standard deviation from the out-of-the-money position. This way, you will raise your chances of winning. However, should the strike price be far away out-of-the-money, then you will lower your chances of success.

Basically, you should ensure that this strategy extends 30 to 45 days before expiration so that there is sufficient time to benefit from this strategy. However, this will largely depend on conditions in the market such as implied volatility as well as the performance.

### **3. The Long Straddle Strategy**

This is an options strategy that largely consists of buying both a put option and call option. Both options have the same expiration dates and strike price. Using this strategy, you get to enjoy the best of both worlds. This is because you get the opportunity to purchase at the strike price and also a chance to sell stocks at the same strike price. However, this does come at a cost to the investor.

#### *What is a long straddle?*

We can define a long straddle as an options trading strategy where investors buy a long put and a long call both based on the same stock. These two positions end up with a market position that is likely to profit should the stock move in a major way either downwards or upwards.

Ideally, traders purchase this straddle mainly due to predictions of an expected large movement in the near future. For instance, a trader could be hoping for a major announcement from the courts within a given quarter which could be either positive or negative. Due to the setup of this strategy, the chances are such that the trader will win when there is a large movement in any direction.

#### *Outlook*

Basically, traders opt for this position when they expect a large movement at the stock market either upwards or downwards. Since the setup is such that there are two premium outlays on the breakeven point, the trader or investor has high chances of really making a kill.

This options trading strategy consists of investing or buying both a put as well as a call option with similar expiration dates and strike price. This combination has been proven profitable when stock prices move either upwards or downwards.

#### *Breaking down the strategy*

On the long straddle, the strike is usually placed as close to the at-the-money position as possible. The aim here is to benefit when there is a major movement in the underlying security regardless of the direction.

Traders use this strategy as a hedge or bet that there will be significant movement in the price of the related stock. The position is going to win regardless of the direction of the price movement of the underlying stock. The stock is expected to transit from a situation of low to very high volatility.

Such a strategy should be adapted just before a major announcement is made. Certain announcements are known to cause market movements. These include any action by the federal government, earning releases by corporations, the outcomes of certain elections, as well as the passage of laws or acts of Congress.

Traders are of the view that markets are eagerly awaiting such news in order to cause movement in either direction. This kind of waiting often causes uncertain movement in small ranges. Only after the eagerly awaited news will volatility hit the market so that all the pent-up energy results in either bearish or bullish movements on the market.

Since no one generally knows the expected movement of the market after the announcement, traders choose the long straddle so as to benefit regardless of direction. Therefore, a long straddle is the perfect strategy that allows investors and traders to benefit from market movements even though the process is rather costly compared to hedging in one direction only.

The biggest risk to this strategy is that the market may not be impressed by the news and hence experience little or no movement. In such a situation, the stocks options are likely to expire worthless which means a significant loss for the investor. Owning both a put and call option eliminated any risk posed by direction of the movement.

#### *How to construct a long straddle*

We have established that the long straddle carries only a limited risk but a seriously high-profit opportunity. Should the price of the underlying stock keep rising, then the profits are likely to increase to unlimited levels. Also, should the price of the underlying stock fall to zero, then the profit in this situation will be equal to the strike price minus all premiums paid by the trader to set up the strategy.

#### *The setup*

As a trader or investor, you should first buy a call option with a strike price A. Then buy a put option with the same strike price A. In this and most other situations; the stock price is also similar to the strike price. Also, the two options will have similar expiration dates.

This strategy should be implemented by experienced traders who are either intermediate or advanced options traders. The reason is that this strategy may seem pretty simple on the surface but it probably actually isn't. Generally, it should not be implemented by novice traders and those with little experience. The main reason for this is that it requires high prediction skills and advanced forecasting capabilities.

#### *Break-even point at expiration*

This strategy has two break-even points. These are the strike price A less the net debit paid, and the Strike price A added to the net debit paid. The best aspect of this strategy is that the stock price will be either head to the moon or fall completely down below.

#### *Time decay and volatility*

Both time decay and volatility are crucial to the success of this strategy. Basically, time decay will negatively affect the strategy while volatility is crucial and essential for the success of the strategy.

Volatility will cause the price to shoot high or low which is a desired outcome while time decay will likely result in both options expiring worthless. This would be a trader's worst nightmare because they will incur a maximum loss which is equal to the cost of setting up the options.

## **4. The Long Strangle**

### *What is a strangle?*

We can define a strangle as a strategy used in options trading by an investor or trader where the trader adapts a position in a call option and a put

option both of which have different strike prices. However, these two options have similar underlying assets and expiration dates.

#### *The long strangle*

The long strangle also has a number of other names. It is also known as the buy strangle and sometimes simply as strangle. In the world of options trading, this is a neutral strategy and involves purchasing a call option and a put option with similar expiration dates and underlying security. Both the call and put options, in this case, are slightly out-of-the-money.

#### *How to construct the long strangle*

To set up this strategy, you will first by one out-of-the-money call option and one out-of-the-money put option. One reason that this is an excellent option is the fact that profits are unlimited while losses are limited.

Traders choose this specific strategy in situations where they expect the underlying stock to undergo substantial volatility in the coming days and weeks. Basically, most of these strangles are debit spreads. The reason is that to enter a trade, net debt is more often taken out.

#### *Profit potential is virtually unlimited*

The goal of this strategy is to ensure that a trader earns a profit should the underlying stock price rise or fall. Basically, profitability is guaranteed should there be a significant price movement in any direction. However, such a position is never cheap to enter so you will require substantial price swing in either direction in order to just break even.

There is a difference between long straddle and a long strangle. This difference is the separation of the strike prices for each of the two legs of a particular trade. In short, long strangles are actually debit spreads.

There is a simple formula for working out profits. At the onset, the maximum profitability of this strategy is unlimited. You will be profitable only when the underlying stock's price exceeds the sum of the premium paid and strike price of the long call. It can also be achieved when underlying stock's price is less than the difference between the long-put strike price and the net premium paid for the options.

#### *The risk is limited*

If you implement this strategy, then you can expect to suffer maximum loss only when the stock price of the underlying stock at expiration trades between the strike prices of the two options. The two options will, at this price, expire worth nothing so as the trader, you will lose your total initial investment used to set up the trade.

### *Tips and advice*

Numerous investors and even traders who apply this strategy are often on the lookout for major events and breaking news that are likely to have a huge effect on the market. Such news items can shock the market seriously enough such that it results in major movement in either direction.

You need to be sure that there will be a large movement in the markets before setting up this strategy. Otherwise, it is advisable to choose instead the long straddle which would be a safer option. Straddles cost a lot more in comparison, but the movement necessary to just break-even is not that much.

### *Who should implement this strategy?*

This strategy should strictly be undertaken by at least an intermediate trader and seasoned investors who can accurately read and predict events. Seasoned veterans are also free to apply this strategy.

This strategy, just like the long straddle, seems fairly simple and looks like anyone can implement it. However, it is really not for the inexperienced. To be successful with this particular strategy, you will require some advanced forecasting skills.

If you are to implement it, then make sure to implement it when you are expecting a significant swing in the price of a particular stock even though you are unsure the direction in which the movement will take place.

This strategy has two main break-even points. The first is the strike A price less any debit paid while the other is the strike B price including the net debit paid. The potential earning for this strategy is in theory unlimited especially if the stock price movement trends upwards. Should this movement be downwards, then profitability will still be substantial albeit limited.

### *Difference between the straddle and the strangle*

Both the long straddle and the long strangle are options trading strategies with numerous similarities. They enable traders and investors to benefit immensely should there be significant price movement of underlying stocks in the market.

The movement can be in either direction. The only difference is that the long straddle basically requires traders to buy both call and put options that are at-the-money. On the other hand, short straddles are very similar to short strangles. Both have limited profit possibility which is in numerous ways equal to the amount that would be collected from writing call options and put options that are at-the-money.

Also, it is a lot cheaper to invest in strangles compared to straddles which are a lot more expensive. This is because strangles are usually bought out-of-the-money while straddles are at-the-money.

#### *Similar strategies*

Certain strategies are almost similar in nature. For instance, we have short strangles which is an options trading strategy that is almost similar to this strategy. These strategies are quite volatile with mostly limited risks and unlimited profit.

The short strangle is ideally the converse of the long strangle. You will use the short strangle when you believe that the movement on the market will not be that significant and expected gains will be modest.

## **5. Back Spreads with Put Options**

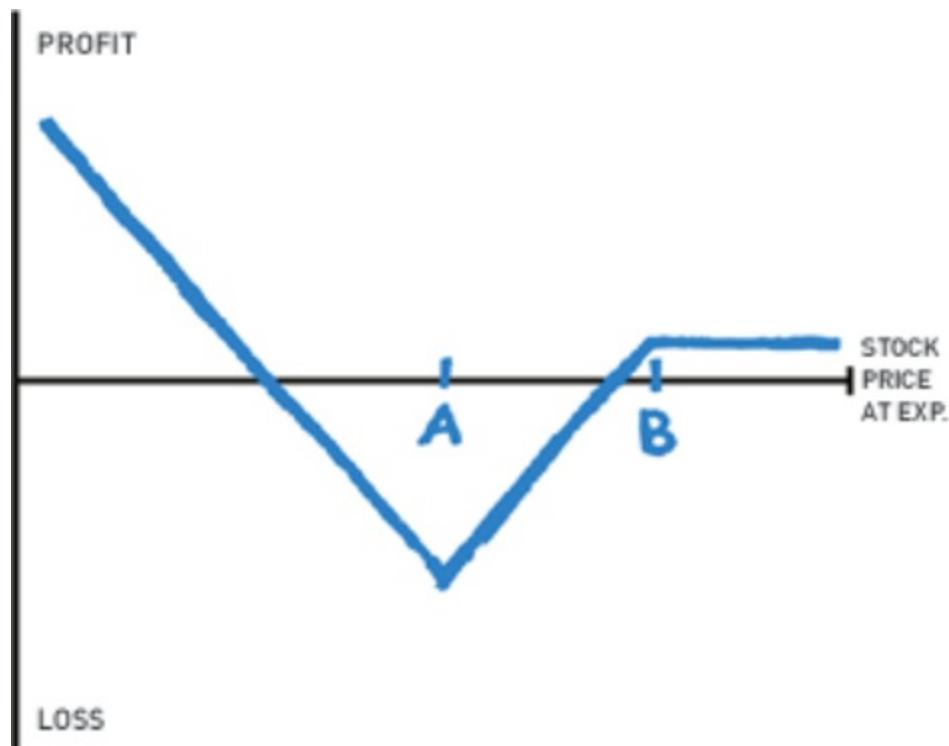
Another popular trading strategy suitable for intermediate and advanced traders is the back spread with put options. This is considered an unusual albeit interesting strategy. When you adopt this strategy for your trading, you will be required to sell short put spread options so as to get funds to pay for additional long put option that is out-of-the-money at a strike price A.

You will basically adopt this strategy if you wish to obtain a small net credit anytime you desire. This way should your predictions be wrong, then you earn a small profit while if the predictions are correct, you will make a large profit. Even then, it could be necessary to set this up for a cool net debit albeit small depending on certain factors including days to expiration, the distance between strike price A and strike price B, and market conditions.

#### *What is a back spread with put?*

A back spread with put option is also known as a put ratio back spread. This is simply an options trading strategy that involves both a long put and short put in order to come up with apposition that can earn a profit based on the ratios of these two put options.

A back spread with put options is referred to as such because its main aim is to earn profits based on the volatility of the underlying security. It combines long puts and short puts in order to come up with a suitable ratio for profitability. The design of this strategy is such that there is a limited loss but potentially unlimited profitability. Sometimes, though, the prospects of small limited profits can exist. Most of the time the ratios are 3:1, 3:2, or 2:1 of long puts to short puts.



### *The strategy*

In this instance, a trader is selling short put spreads that are at-the-money so as to raise funds to pay for the additional out-of-the-money long put option with a strike price A. Generally, the aim in this instance is to create this strategy in order to benefit from a small net credit anytime the opportunity presents itself.

For this reason, should your analysis be wrong, and your stock undergoes a positive increase in price, then you will still earn a profit. Even then, it is important to set this strategy up for a tiny net debit. This though depends on a couple of factors including the distance between the strike prices, days before expiration as well as market conditions such as volatility.

Also, it will be easier to establish this specific strategy for profit should the strike prices be much farther apart. However, there is always a tradeoff in such instances. In this case, if you increase the distance from one strike price to the next one, you increase your risks as the stocks obtain a much larger margin of movement. When stocks have to move such large moves, it increases risks greatly.

Once a trader establishes this strategy, the stock could move one way or the other. Now should the movement be towards strike price A in the short

term, then profits could accrue should levels of implied volatility go up. However, should there be a delay then the position will get negatively affected by time decay. It is crucial that the stock keeps moving in a bearish manner below the strike price before expiration.

#### *Tips and advice*

Basically, if your stock is volatile with the price rising or falling drastically, then you will be able to protect against major downturns as well as smaller cash requirements when compared to buying a put option as a form of protection.

Think about this strategy if you are expecting a major news break or other announcements that could cause serious movement in the market. Such events include negative outcomes of a legal case or even rejection of a major drug thought to be a miracle cure. Also, think about the banking crisis that happened in the USA and around the world in 2008.

#### *The setup*

In this instance, a trader will purchase two put options at strike price A and then sell one put option as the strike price B. In this instance, ensure that the stock price is at the strike price B. The two options will generally have the same expiration date.

Ensure that experienced traders only implement this strategy at the intermediate or advanced level. Also, it is important that you are bearish on a very volatile stock in order to set up and implement this strategy. The maximum potential profit is enjoyed when the stock price drops to zero. However, most stocks hardly touch the zero mark. Therefore, select your stocks carefully and have realistic chances about possible outcomes.

#### *Potential losses*

Fortunately, in this case, your risks are limited. As a trader, your risk will be limited to the difference between strike B and strike A plus the net debit paid or less the net premium received. Time effects decay will largely depend on certain factors such as the position of a stock in relation to strike prices as well as whether the strategy has been established for debit or credit purposes.

#### *Implied volatility*

Implied volatility is pretty crucial in this instance. When the implied volatility value goes up, then this will affect your strategy positively. While it will increase the value of the two options purchased, it will also, unfortunately, affect the value of the sold option. Also, when implied volatility occurs, there will be expected a large price swing. However, even to

this rule, there is an exception. Basically, if you are able to establish this strategy with the aim of gaining a net credit yet the price of the stock is higher than the strike price B, then you will desire a drop in implied volatility. When the volatility declines then the options will all expire worthlessly and, in this case, you will then get to keep all the credit even though it may be small.

# Chapter 3: Additional Strategies for Intermediate Traders

## Diagonal Options Spreads

In the previous chapter, we examined basic spreads such as debit and credit along the horizontal as well as debit and credit along the vertical. It is now time to examine diagonal spreads and how they can be applied to different strategies. Keep in mind the fact that options spreads can either be credit or debit spreads and are easily created using call and put options. However, there is a variation when it comes to the diagonal spread.

In the case of diagonal spreads, we focus on the time spread along the horizontal time spread so as to move the length of the legs to another strike. When you choose a back-month leg, this is known as the diagonal spread. The back-month leg should be different from the front month leg.

### 1. Diagonal spread with calls

The diagonal spread with call options is also known as the diagonal bull call spread. This strategy consists of simultaneously purchasing long term call options as well as writing a similar number of call options. The call options are near-month with a higher strike price but the same underlying stock.

You would use this options strategy when you are neutral or slightly bullish about a stock in the near term and quite bullish in the long term. As such, when you are putting the strategy together, you will buy one long term in-the-money call option and then sell 1 near term on-the-money call option.

#### *The strategy*

It is easier to think of this strategy as a two-step process. The diagonal spread strategy with call options is basically a cross between a short call spread and a long calendar spread option with some calls.

However, this strategy consists of only two similar strike combinations. These need to be similar in order to work as desired. In this situation, it is the differential theta that is at work. This is true in both diagonals and

horizontals. However, it is possible to come up with an out-of-the-money horizontal spread.

*Profits on the upside are limited*

When dealing with the diagonal spread with call options, then your best scenario is the instance where the price of the underlying stock remains unchanged but rises above the strike price of the call option that is sold off at the time that the call expires.

When implementing this strategy, it is important that a trader writes another call and repeats the entire process each month once the near-month call option expires. This repetition should continue each month until when the long-term call option expires so as to minimize the cost of the trade. In some cases, the costs may come down so much that it becomes a free process.

Under a perfect scenario, the maximum possible profitability is scenario is a situation where all the profits or premiums obtained from the sale of call options as well as the difference between the strike price of the different call options less the cash obtained as debt to initiate the trade.

On the other hand, we can have a downside, but in this case, any loss or downside is generally limited. As such the largest possible loss when this strategy is applied will be limited to only any debt that is taken to initiate the position. Such a situation will arise should the price of the underlying stock decrease and remain down until such a time as when the call option (long-term) expires.

*Tips and advice*

Certain benefits can be accrued when applying or implementing this position. For instance, when the diagonal spread with calls is used for credit spread, then there will be potential profits in the long back month option. The vega short can easily turn into the Vega long.

As an example, this position can begin as slightly Vega short position or perhaps even a neutral one. Vega short position is possible when creating a credit. However, in the nearby position, the time value may begin to decay and as such the Vega position changes from short to long.

This scenario functions almost perfectly when put options are utilized to create the spreads. Should the stock price drop any lower, then the rise in the value of implied volatility will be captured by the long option. Implied volatility often goes hand in hand with fears of a drop in the surrounding stock's value.

### *Reversal of the position*

Sometimes diagonals are reversed. Now when this happens, then the spread will undergo a turn or flip in the same way that reversed horizontal spreads do. They flip back to the short Vega from the long one. This happens when there is a loss incurred due to volatility rise.

Under a perfect scenario, the maximum possible profitability is scenario is a situation where all the profits or premiums obtained from the sale of call options as well as the difference between the strike price of the different call options less the cash obtained as debt to initiate the trade.

Generally, these trades possess an exact image of potential success and profitability. The trades should be created under the impression that a profit can be generated from a very brief and fast change in volatility as the chances of huge movements of the price of the underlying stocks are almost zero.

### *In summary*

The diagonal spread with call options is also known as the diagonal bull call spread. This strategy consists of simultaneously purchasing long term call options as well as writing a similar number of call options. The call options are near-month with a higher strike price but the same underlying stock.

You would use this options strategy when you are neutral or slightly bullish about a stock in the near term and quite bullish in the long term. As such, when you are putting the strategy together, you will buy one long term in-the-money call option and then sell 1 near term on-the-money call option.

## **2. Diagonal Spreads with Puts**

We have already noted that diagonal spreads constitute an options trading spread strategy with both sale and purchase of the same number of options, similar underlying securities, and also within the same class. However, they have varying expiration dates and strike prices.

The diagonal spread and the calendar spread are very similar. Under the diagonal spread, we buy long-term options and at the same time sell near-term stock options. It is also extremely similar in nature to the calendar spread because long term options are purchased while short term options are sold. This enables traders to benefit from the fast time decay employed by this strategy because options are almost about to expire.

The one major contrasting feature between diagonal spreads and calendar spreads is only the near-term outlook. Both are near-term, but the diagonal spread's outlook is a little more bearish or bullish.

#### *The diagonal spread with calls*

If you are an options trader with a bullish outlook on a certain stock, then you can initiate this strategy. Implement the diagonal spread using calls by writing call options that are near-month and with a high strike price as well as call options that are far-month with a lower strike price.

#### *Diagonal put spreads*

In this case, if your outlook in the near term is sort of bearish, then you should implement this strategy. If you do, then you will be required to write put options with a higher strike price and a far month outlook against put options with a lower strike price and a near month outlook.

#### *The strategy*

The diagonal spread strategy with put options is basically a dual step strategy that includes elements of short spread put options, as well as a long calendar, spread with put options. This strategy basically starts out as a play with time decay and proceeds to morph after an additional put is sold at strike price B. In this instance, it is said that you have entered or legged into a short-put option spread. Basically, as the trader, you will easily set up this strategy if you want a small net debit or even a net credit.

#### *Tips and advice*

Whenever you implement this strategy, you need to ensure that there is some volatility in the market. You also need to have some predictability with the volatility. The reason for this is that some volatility is acceptable because we hope to sell the two options and earn as much from the sale as possible. Even then, it is crucial that our stocks remain as stable as possible. This is sort of contradictory and hence the need for this strategy to only be implemented by a seasoned trader. A good trader will know exactly how to manage the trades and how to implement risk management techniques.

#### *How to set up the strategy*

Start out by selling a put option that is out-of-the-money at strike price B. Ensure that it is a front-month with near term expiration. Next, you will buy a put option that is out-of-the-man with a strike price A as well as back-month expiration date that is a month away. Once the front month attains expiration, then you should sell a put option at the strike B price. This option should

have a similar expiration date as the put option with a month later expiration. In general, the price of the stock should ideally be high than strike B price.

This is a strategy that should only be managed or implemented by a seasoned intermediate or advanced trader. This is because you need a deeper understanding as well as experience implementing this strategy because it involves options that have varying expiration dates.

This specific strategy should only be implemented when the trader thinks there will be plenty of neutral activity in the course of the front month followed by more neutral or even bullish movement on the markets in the option's back month.

You will break-even at expiration if your approximation is accurate. However, this can be difficult to predict basically because of too many variables involved. The strategy actually has more than one expiration dates on this diagonal spread. As such, you will need to come up with a pricing model that will estimate what variables are in play and what possible outcomes are.

#### *Profit and loss*

When you apply this strategy correctly as required, you will receive maximum profit based on the net credit that you obtain after selling your put options at the strike price B and then deducting any costs incurred when buying a put option with strike price A.

Calculating the exact profit when using this strategy can be tricky as this will depend on factors that are yet to occur such as the premium received from the sale of the put option which occurs at a later date.

You can also incur a loss when you apply this method. Basically, when you set up this strategy for purposes of net credit, then any possible risks will be limited to strike price A less strike price B less the net credit obtained. However, when the strategy is set up for purposes of a net debit, then your risk will be limited to the difference between the two strike prices added to the net debit paid.

#### *Time decay*

At the onset of this strategy, time decay will be favorable to you. This is because any short-term put option will suffer losses in time value at a much quicker rate compared to long-term options.

#### *Implied volatility*

Once you establish this diagonal put options spread, you will be in a better position when the implied volatility value goes up significantly

especially towards the expiration dates of the front month. Once the front month expiration is over, your strategy will have put in a leg in a short-put spread. The effect of implied volatility will mostly rely on the position of the stock based on the strike prices.

### **3. Long Butterfly with Calls**

The main purpose of this advanced technique is to make money from using short calls for price action that is close to the strike price with minimal risk. Therefore, this technique should be reserved for expert traders with some experience. Novice traders should not try this technique because of the high risk involved.

#### *Definition*

The long call butterfly is a strategy that will earn you a profit should the underlying stock at expiration be within the body of the butterfly. This strategy makes use of two short call options each at a middle strike as well as a long call option at an upper strike price and another at a lower strike price. These three create what is known as the long call butterfly.

#### *Three-part strategy*

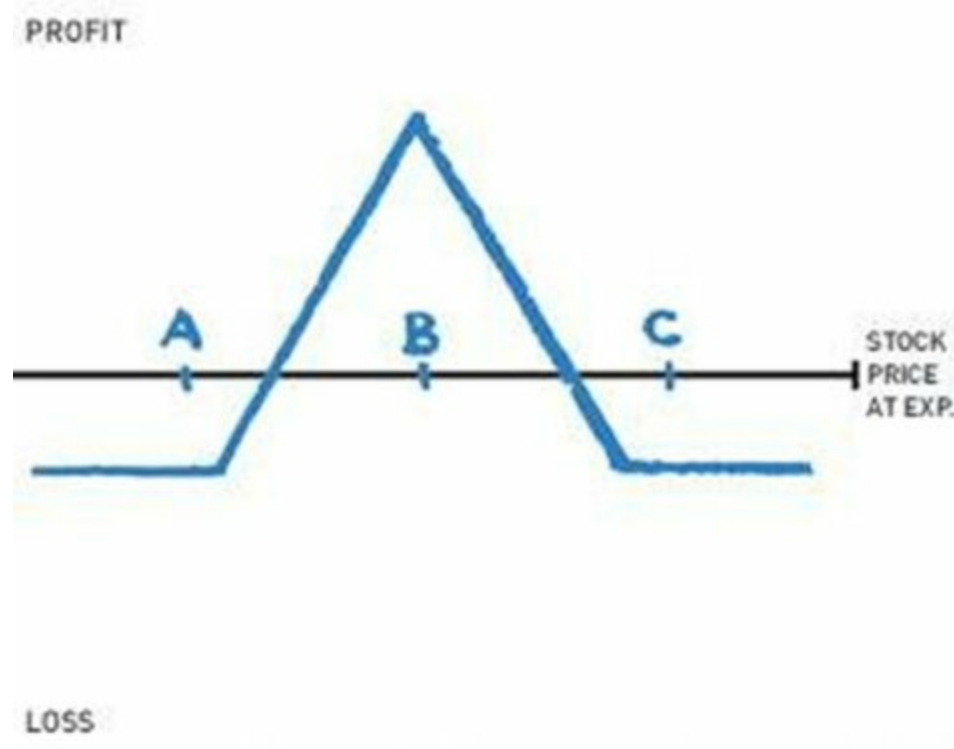
A long butterfly spread with calls is essentially a strategy consisting of three distinct components. You create this strategy by first purchasing a single call option whose strike price is lower, then buy another call option with an even larger strike price, and finally sell two call options that have a higher strike price. All these call options have similar expiration dates and with equidistant strike prices.

A trader will establish this strategy to get a net benefit where both the maximum risk and maximum benefits are limited. As a trader applying this strategy, you will receive the maximum benefit anytime the stock price, and strike price of the short calls are equal upon expiry. However, the maximum risk includes the total cost of setting up the strategy, and this includes costs such as commissions that have to be paid. The loss will occur when the stock price is lower than the lowest strike price or higher than the highest strike price upon expiration.

#### *The strategy*

As noted above the long butterfly spread with call option is an advanced strategy that requires careful planning, market analysis, and a seasoned trader. Basically, the profit potential of this strategy is considered tiny when

viewed in terms of dollars as costs incurred are steep. Keep in mind that this strategy involves a number of commissions as well as multiple payments for the different strike prices. Also, there are three bid-ask spreads during the time of opening and closing a position.



In this case, it is important to ensure that the prices are as affordable or attractive as possible. Low prices will help to maximize profitability. Therefore, as a trader, you should focus on opening and closing on what is considered as good prices. This way, you will be able to comfortably manage the risk/reward ratio that also includes commissions.

This long call butterfly position combines a short call spread with a long call spread where the spreads trend towards and eventually meet at strike price B.

In an ideal situation, you will benefit greatly when call options with the strike price B and strike price C expire worthless. Even as they expire, they should possess the intrinsic value of the call options that are in-the-money at price A.

When you apply this strategy, you will be selling at strike price B two option calls. This makes butterfly strategies relatively low-cost strategies to implement. For these reasons, traders may get tempted to implement the

strategy. However, the risks are a little higher because the chances of success are pretty slim.

To make this a successful strategy, you should create it such that the strike price B is either a little in the money or a little out of the money so as to make it less costly to operate. This approach will also introduce a bias in the direction of the trade. For instance, should strike price be larger than the prevailing stock price then the trade is considered bullish. On the other hand, should strike price B be lower than the prevailing stock price, then

#### *The setup*

To create a perfect setup, first purchase a call option at strike price A. Once this is done, you will then sell two call options at strike price B. Finally, you will then purchase a call option at strike price C. In this instance, the stocks are at the strike price B. Also, all options expire within the same month, and the strike prices are generally equidistant.

#### *Maximum profitability*

When you apply this strategy, you can expect to attain maximum profitability under certain conditions. This maximum profitability is equal to the difference between the middle and lowest strike prices minus the cost of setting up the position as well as all commissions. These kinds of profits are realized anytime the price of the stock is equal to the short calls strike price upon expiration.

#### *The total risk possible*

As a trader, it is important to understand the kind of risk that you are exposed to. In this setup, the size of total risk possible is equal to the net cost of setting up the strategy as well as all commissions. In such cases, there are not one but two possible results that can lead to a maximum loss.

First of all, should the stock price at expiration be below the least of the strike prices then the calls will collectively expire and be completely worthless. You will lose all money including all costs incurred in setting up the strategy and the commissions.

Also, should the price of the stock at expiration be more than the highest strike price, it will mean all call options are in the money. As such, the long butterfly spread strategy at expiration will have a zero-net value. This way, the total cost of setting up the strategy and all commissions paid are lost.

#### *Tips and advice*

Sometimes traders prefer to implement this strategy with index options instead of individual stocks or even options. The reason for this is because in

the past indexes were not known to be as volatile as stocks. Also, when an index fluctuates, it will be cancelled out by another which tends to reduce the volatility of the entire index.

## **4. Long Butterfly with Puts**

The long butterfly spread strategy is, in essence, an options strategy with limited risk. Traders adapt this strategy when they are of the opinion that the underlying stock is not going to rise by much at the expiration of the trade. The main goal of this strategy is to profit the trader or investor with limited risks from stock price action that is close to the strike price of the short puts.

This long butterfly strategy is basically a three-component strategy which is designed by first purchasing a put option at a high strike price then selling two put options that have a lower strike price before finally investing in a put that has a lower strike price.

As such, we can say that the long butterfly put option strategy has 3 striking prices which are known as strike price A, strike price B, and strike price C. You will construct this strategy through purchasing writing two put options that are at-the-money, then buying a put option at a lower strike price before finally purchasing another option.

### *Construction*

This long butterfly put options strategy is a limited risk and limited profit strategy. Traders implement this strategy when they are of the opinion that the price of the underlying stock will not rise or fall significantly upon expiration.

To construct this long butterfly put option strategy, you first need to purchase 1 out of the money put option then sell 2 at the money puts before eventually buying one in the money put option.

From the construction above, you will note that there are three distinct strike prices in this long butterfly put option strategy. You construct it through the purchase of the put option with a lower strike price A, then write two put options that are at the money before eventually getting the put option that is in the money.

### *Advanced strategy*

The long butterfly put option spread is an advanced options trading strategy that should be left to advanced traders with sufficient experience. For instance, the strategy has three bid-ask spreads, three prevalent strike prices

together with multiple commissions. Therefore, it is advisable to be cautious and find good prices for the options opening and closing positions. Also ensure that the risk to reward ratio is sufficient so that even after paying off commissions, the rewards are sufficient.

#### *Limited profits*

As a trader, you will be exposed to limited profits when implementing this strategy. In the same way, you will enjoy maximum profit when the price of the underlying stock is unchanged upon expiration. Basically, it is at this price that the put option will prevail and expire in the money.

Basically, maximum profits will be obtained when we subtract the net premium paid, strike price of the short put option and commissions paid from the strike price of the higher long put option. Essentially, you will achieve maximum profit when the strike price of the short put is equal to the price of the underlying stock.

This long butterfly strategy is basically a three-component strategy which is designed by first purchasing a put option at a high strike price then selling two put options that have a lower strike price before finally investing in a put that has a lower strike price.

#### *Maximum profitability*

In this instance, it is important to note how you acquire the maximum possible profits. This only happens when profits are equal to center strike price and highest price minus the cost of setting up the strategy including all the commission. You will basically achieve maximum profitability when the stock price and strike price of the short puts are equal when the puts expire.

#### *Maximum risk*

When you execute the long butterfly strategy with puts, your highest possible risk including commissions that you have to pay can be one of two outcomes. One possible outcome is when the price of the underlying stock is greater than the biggest strike price when the option expires. At this juncture, the put options will expire worthlessly. This includes all the associated costs such as setting up the strategy, commissions to be paid and so on.

The second situation is when, at expiration, the price of the stock is lower than the strike price. At this juncture, the butterfly position will have a zero net value and all the put options will be in the money. With this situation, you will lose the entire position including all the costs incurred and commission paid.

#### *Suitable market forecast*

This long butterfly spread with put options enjoys the best profitability scenario when the center strike price is equal to the stock price when the options expire. As such, the best forecast scenario in this instance is when the stocks are slightly bearish or simply neutral. This, though, depends on the relationship of the center strike price with the stock price when the position is established.

The long butterfly put option spread is an advanced options trading strategy that should be left to advanced traders with sufficient experience. For instance, the strategy has three bid-ask spreads, three prevalent strike prices together with multiple commissions. Therefore, it is advisable to be cautious and find good prices for the options opening and closing positions. Also ensure that the risk to reward ratio is sufficient so that even after paying off commissions, the rewards are sufficient.

This long butterfly strategy is basically a three-component strategy which is designed by first purchasing a put option at a high strike price then selling two put options that have a lower strike price before finally investing in a put that has a lower strike price.

As such, we can say that the long butterfly put option strategy has 3 striking prices which are known as strike price A, strike price B, and strike price C. You will construct this strategy through purchasing writing two put options that are at-the-money, then buying a put option at a lower strike price before finally purchasing another option.

## **5. Iron Butterfly Strategy**

The iron butterfly option strategy is part of a group of strategies referred to as wingspreads. These strategies earn their name from the fact that each is named either after a condor or a butterfly.

This specific strategy is created by putting together a bull put option spread and a bear call option spread with similar expiration times and these meet together at a strike price. The body of the butterfly in this strategy is formed by a put option and a short call option which are sold at the cost of the middle strike price. These converge in the middle. Then we have a put option and a call option also at the middle or central strike price. These constitute the butterfly's body. To complete the strategy, we buy put options and call options that are either below or above the median strike price. These form the butterfly's wings.

It is evident that this is a complex strategy that should be implemented only by a seasoned trader. It differs from the other butterfly strategy in two ways. For instance, it makes use of four distinct options contracts and not three like the basic butterfly spread. Also, the investor receives a net premium from this credit spread strategy compared to the ordinary butterfly which happens to be a debit spread.

This four-part strategy has both a bull call spread, and a bear put spread both of which share a similar strike price. All the options expire at the same time or on similar dates. The strike prices are equally spaced from each other. We establish this specific options strategy in order to gain a net debit. The profit and loss margins are limited.

You will enjoy the highest possible profitability when the price of the stock at expiration is lower than the lowest strike price or higher than the highest strike price. On the other hand, the highest possible risk will occur when the price of the underlying stock is the same at expiration as the long options' strike price.

#### *Applying the iron butterfly strategy*

This strategy has limitations in both losses and profitability. Traders use this strategy and other iron butterfly strategies so that traders are able to withhold some of the premium that is paid by options buyers. This situation occurs when the underlying stock's price is between the two strike prices at expiry. These are the lower and upper strike prices.

Traders and investors at the markets apply this options strategy when they are of the opinion that the underlying stocks will finish in between the two strike prices at expiration. Higher profits are possible depending on how close the underlying stock is to the middle strike price at the time of expiration. Basically, higher profits will accrue the closer the middle strike price the underlying stock gets.

Losses are likely, should the price of the underlying stock be somewhere below the lower put option's strike price or above the upper call option's strike price. However, there is a breakeven point which can provide some relief to traders. This position is arrived at by subtracting and adding the premium paid from the median strike price.

#### *Tips and advice*

Basically, the strike prices do not necessarily have to be equally spaced out. Having a bias one way or another is ok. This is because the iron butterfly strategy is designed to allow some bias in either direction should a trader

believe that they stand a better chance by adopting a bias on either side. Also, these iron butterfly strategies can be switched or inverted such that a trader can assume short positions on the wings of the butterfly while long positions are applied at the middle strike price. You can use this approach profitably when there is relatively high volatility affecting the underlying stocks.

This strategy can also be thought of as a combination of a short call spread together with a short-put spread. The spreads in this instance will all converge at the strike price B. Now since this strategy is a combination of two short spread strategies, it is possible, for a net credit, to create an iron butterfly.

The purpose when implementing this strategy is for all the options to expire worthless at the expiration of the strategy. Even then, the chances that this will happen are very little, so it may be necessary to pay an amount just to close the positions.

#### *Setting up the strategy*

In this setup, you will first buy a put option at strike price A and then sell a put option at strike price B. Please note that these are all put options up to this stage. The next step is to deal with call options. You will sell a call option at strike price B and then buy a call option at strike price C. In this instance the price of the underlying stock is at strike price B. At this juncture, we choose to have the strike price equidistant with all options sharing the same expiration month.

#### *Pros and cons of the iron butterfly strategy*

The iron butterfly strategies have a number of beneficial aspects to it. Traders can use this strategy yet spend minimal amounts of capital. They can generate a steady income with lower risks compared to other forms of spreads such as the directional spreads. It is possible to roll down or up the butterfly strategies should the price begin to extend beyond certain ranges.

You will also have the benefit of clearly defined risk to reward ratios. In this instance, the maximum possible profit for the trader is the net paid premium. Also, the maximum loss is known in advance; it is defined as the difference between the net loss of the short and long call options or perhaps the short and long put options less the premiums initially paid.



# Chapter 4: Managing Option Positions

## Rolling positions

*What is rolling?*

Sometimes options traders wish to make adjustments to positions they hold in the market. When this happens, it means the trader's market outlook has changed. It is actually possible to roll a short or long option position.

The term rolling refers to changing the outlook on the underlying security of an option. This change is often driven by a change in the outlook of the markets and positions held on certain trades. In such situations, a trader is often worried that certain positions will be assigned.

Rolling is similar to making a different turn other than the one initially planned. Think, for instance, you leave home heading to the grocery store only to end up at the movies. This is very similar to what rolling is about.

The aim of rolling is to either deter or cancel the assignment. Basically, managing positions through rolling is an advanced technique that should only be applied by seasoned traders and experienced investors. Therefore, as an intermediate trader, you need to ensure that you thoroughly understand this process before applying it.

*Rolling a position*

Anytime that a trader rolls a position, he or she will be purchasing options very close to a current position in the marketing then sell this position in order to start another one. This process will cause small, minute but significant tweaks to the strike prices of options held by the trader. The effect of this move will be to shift the expiration times further out, so positions do not expire as initially planned. Even then, this process is not a guarantee that the strategy will work. In extreme cases, rolling will only compound losses, so it is advisable that only experienced traders apply this technique.

### 1. How to Roll a Covered Call

When you hold covered calls, you can choose to sell them in order to reduce the cost of holding them in long positions. When rolling calls forward, you will improve the break-even position and make it easier to be successful in

the long run. However, you need to know if a position should be rolled on and when to do so. For instance, should rolling of a position occur 20 days to expiration or possibly at expiration?

Also, just about any trader can write a covered call. The most crucial thing is to manage such a position appropriately. Certain factors should be considered when rolling a position especially near expiration Fridays.

First, you need to confirm whether the underlying stock is suitable for this kind of management. Then you will need to confirm the option chains for statistics involving current and next month.

Now use the Ellman Calculator and enter the statistics in order to determine whether the dates are viable for rolling management. The 1-month goal for initial returns stands at 2% to 4%. With this information, you will finally need to conduct a thorough evaluation chart technical information and the prevailing market conditions. This way, you will comfortably be able to make adjustments to your trades to benefit more.

#### *Example*

Take the example where you invest in ABC stock at a price of \$53 per share. You invest in this particular stock in the hope that the price will rise albeit modestly. At the same time, you wish to sell a 60-day covered call of ABC stock at a price of \$55 per share. However, within a few days, you get to find out through a news item that ABC stock has good prospects in the long term.

This information changes your outlook so that you are now of the opinion that the stock price could actually rise to about \$70 per share within six months. This catches your interest because your initial estimate about the profitability of ABC stock has increased exponentially. In such circumstances, there are a couple of things that you could do.

This is a clear demonstration of how a covered call with set positions and initial forecasts can go through some changes. It also could be that the initial forecast was wrong. As such, you have some options, and you can take action. Rolling action can help you switch your strategy and have a different approach.

Now if the stock price increases and you have no intention of selling the stock, then you will need better management skills as well as high assignment risks simply because the covered call that you have is now in the money. As such, you choose to purchase all your covered calls in order to cancel out any

obligation to sell the stock. It is advisable at this stage to then sell a call option that has little chance of being assigned at a better strike price.

The common strategy when a stock forecast or objective changes is to adopt a rolling process. Rolling covered calls are usually adapted by seasoned traders. Even then, as a trader, you should understand that there is really no specific formula about the implementation of a rolling plan. For instance, as a trader, you may be wondering the current covered call should be shut down and replaced with yet another call that is in line with the new changes. If the answer is yes, will you prefer a covered call with a further expiration date and higher strike price compared to the previous call? There is generally not a correct or wrong solution and what you think is the best approach, should do. This is why experts say that covered call rolling is a decision that is subjective, and all investors and traders should take it into consideration in an individual and careful manner.

#### *Rolling up a covered call*

The process of rolling up a strategy like a covered call, for instance, entails buying out a position as well as closing existing covered call options. At the same time, you will sell a covered call with a higher strike price but similar expiration dates and the same underlying stock.

#### *Rolling example*

Our previous situation had the stock ABC at a price per share of \$79. In this instance, the trader thinks the stock will trade within a confined range in the coming two months. As such, the trader decides to create a covered position by selling 1 ABC Call at \$80 and then this price suddenly moves to \$83 so that the call option is now at \$85. While there are costs involved in making the adjustments, the possible benefits are much higher in essence.

Initial covered call: ABC stock costs \$79 and has an expiration period of 60 days till October. The first step in this instance is to create another covered call by purchasing ABC shares at a price of \$79. The next step would be to sell ABC stock at \$80 with each call selling at a price of \$2.50.

## **2. How to Roll the Short Strangle**

Rolling is the process of making adjustments to options strategies that a trader sets up. There are varied reasons why traders actually make adjustments to their trades. These include erroneous initial predictions,

changing market positions, and news that will affect the performance of a stock.

Now on a strangle strategy you always have a negative delta on the put and a positive delta on the call option. Therefore, we can deduce that we have a neutral delta in this instance. A neutral delta is okay at the onset. However, if the position remains that way then you lose money. As a trader, your desire is to make money; therefore, when there is movement in the stock price you want this movement to be huge. As such you may use gamma which will ensure the price goes up. However, should the stock price remain constant without any movement then you will lose money.

The short strangle is sometimes considered by traders as a very risky strategy. However, as an experienced trader who knows what he is doing; this is not necessarily the case. Here is a look at some circumstances where risk is reduced by rolling action.

First of all, premium is considered rather rich. As it is, a short straddle requires a trader to sell a put option, and a call option based on an underlying option with similar expiration dates and strike price. The best ones are the ones that offer a very rich premium under near-the-money or at-the-money conditions.

Also, it is crucial that short straddles have expiration dates that are within one month or less. It is time decay that causes the value of options to decline. This is why short straddles should be limited to only short-term options. Time decay often happens extremely fast within the first month.

Traders should focus their eyes on the current price, and the strike price then note the relationship. It is advisable to close positions once it becomes practically possible. This should happen especially when positions begin to move in the money. It is always a great idea to close at a profit because time decay will affect the value of the trade.

Also, keep a lookout for time decay. Therefore, once it begins to occur, you should plan to close the positions entered. Also, it is advisable to consider duplicating the strategy should the intrinsic value advance too fast. The forward movement in some instance can be unavoidable depending on certain factors such as price movement direction. In short, the price of the stock will not be volatile and as such time decay could have a positive effect on the two sides.

### 3. Rolling a Short Call Spread

When you roll a spread, the action is similar to rolling a single option. A trader who rolls a short call spread is most probably exit a position in a timely fashion with the strike prices moving down or up. The difference between rolling the short call spread and an individual option is that with the short call spread you will be engaged in a four-way trade. You will essentially be trading four different options instead of the usual two. This means opening two new positions while closing two existing ones.

#### *Example*

Let's say you have ABC stock that is trading at a price of \$53. After a while, you begin to have bearish thoughts about this stock believing that the price will eventually go down. As such, you choose to sell a 30-day short call spread at 55/60. For this, you receive \$1 per contract.

After some time, you realize that your prediction was wrong, and the price of ABC stock was not going to go down. The stock, instead of acting bearish suddenly turns bullish. ABC stock suddenly moves from the initial price of \$53 to a short-term price of \$55. At this juncture, your short call spread still has 15 days left to expiration. If you are to buy back the option, it would cost you \$1.80 per contract. In this instance, you may choose to believe your initial forecast or follow the current trend.

If you choose to follow your initial analysis, then you may need to roll the strategy. When you do so, you will roll the expiration time out further and increase the strike price. As such, you will need to buy back at \$1.80 the call spreads you sold at \$1. You will then sell a short call spread with 45 days till expiration, a long strike price of \$65 and a short strike price of \$60. You will sell these options at a price of \$1.10 per contract.

At the start of this position, you were \$0.80 down because of selling the options \$1 and buying at \$1.80. However, after the rolling process, should the ABC stock price be below \$60 at the prevailing expiration date, then you will be ahead with the \$0.30. You should hope that all your analysis was correct and that this stock will expire below the \$60 mark. This way, you will end the trade at a profit. However, should this not happen, then you will begin incurring losses pretty fast.

Basically, if you implement a roll process on a stock option position, be careful not to compound your losses because this is something that is quite possible. Therefore, if you are confident about your initial predictions, you

should try and stick to your game plan. Alternatively, you could choose to exit the strategy rather than roll and incur even larger losses.

This particular roll management process applies to most two-legged trades and not just the short spreads. Rolling also applies to other formations including back spreads and straddles.

## **4. Rolling Short Put Spreads – cash secured**

Let us use an example to understand how this roll operation works. Let us assume that you have sold a cash-secured put option with underlying stock ABC at a strike price of \$50. During the process, you sold some put options and received \$0.9 per contract even as ABC price at the time was \$51. After some time, the price of ABC stock dropped to \$48.5 as it approaches expiration.

Some of the few options that you have as a trader include purchasing back some of the options that you sold. As such you will buy back options with the strike price of \$50 before these are reassigned. The major challenge now is that you will buy back the options at a price of \$1.55 even though you purchased the same at a price of \$0.90.

There are several tools that you can use when rolling the call. One of these is making use of Ally Invest spread order screen. When you use this screen, you will notice that you can actually buy the \$50 strike price option. As you execute this trade, you will also sell options with a \$47.50 price which is an actual roll down of the strategy. This will have a 90-day expiration period, and the cost per trade is \$1.70. As such, you will receive a net credit of \$15 for 100 share contracts at \$0.15.

The example above indicates clearly how you can roll out and actually save yourself from an impending loss or improve an existing position. There will also be a significant increase in the time value which is crucial after obtaining the 90-day option.

Let us assume that put with the \$47.50 strike price goes on to expire worthless after a period of 90 days then you will gain \$1.05 per each. This will eventually earn you \$105 per contract. Even then, you need to take precaution because you could be taking a loss every time you roll down. Also, you should secure any gains that you make in the market. When you do not, then you risk compounding your losses. This kind of risk is not worth it so always take precaution when rolling out positions.

Always make sure that you roll out within the shortest time so as to face fewer risks in the market. Sometimes it may be necessary to incur some costs in order to roll out a position. Once a position that you have sold gets into the money, you will need to make a determination as to whether rolling is necessary. Basically, you need to think about rolling a position before it gains more than 2% to 4% in the money. This will also be based on other factors such as market conditions, volatility, and value of the stocks among others.

If you let a position get too much into the money, it will be difficult to end up in a profitable position. Also, think about what is known as a preemptive roll which basically dictates that you should implement any rollouts on positions before options get into the money. Do so if you think the position is headed that way. This lowers your rolling costs and makes it much better for you as a trader.

## **5. Rolling out a Butterfly Position**

As a trader, you need to have a great trading plan that allows adjustments to positions that you have taken in the market. This is because markets and positions keep changing in the course of a trading period. Therefore it is advisable to work within a set of guidelines rather than a set of strict rules.

### *Butterfly trade example*

Take the example of the ABC April 2016 put options butterfly strategy that was set up with a long call. The long call is initiated for hedging the upside of the trade. An unforeseen instance happened where the price of ABC stock went up steeply while the trade did not have a promising outlook.

After about a week's time, some adjustments became necessary. In our case above, the most appropriate solution was to initiate a rolling process. To do this effectively, it was determined that another butterfly position with a long call should be introduced. The initial butterfly is therefore rolled so that its outlook improves to avoid incurring unnecessary losses.

Making the adjustment is crucial because it helped save an otherwise desperation situation. As it is, such adjustments serve numerous purposes, but the best are those that allow trades to proceed to a conclusion and within desirable profit margins.

It is essential to note that the intervention described above as one that was not based on any rules and had not been initially planned. It was only designed and executed when the need arose and based on the needs at the

time. This is basically how trades are supposed to be executed as well as intervention methods such as rolling. You will find that this kind of approach works best and helps to reduce risks and improve outlooks.

## **6. Adjusting a Butterfly to a Condor**

As a trader, you may set up a butterfly position which may then experience certain challenges that may cost you significant losses. One of the options you may want to consider is turning the position from a butterfly to a condor. A butterfly spread can easily be split into two distinct spreads.

Ideally, you will want to split the original butterfly and create an additional butterfly. When you do this, you will come up with a condor. You will still have two spreads but with completely different sold strikes. At this juncture, you would not necessarily adjust the butterfly. However, the intervention is necessary especially when the price of the underlying stock was rising and while other indicators showed the option was headed towards a loss.

Making such adjustments is necessary especially where losses seem inevitable based on conditions, but the situation can be rescued. But the interventions should be designed and implemented based on market trends, conditions, volatility, price action, and other related factors.

## **Rolling other Positions**

You can also implement the rolling process as a management action on all other positions when the need arises. Sometimes you can roll up a position and other times you get to roll down on positions.

### *Rolling up a position*

The term rolling up refers to the process of closing a position that has been set up while at the same time opening up another position. However, in the second instance, you will be using options that have a much higher strike price. When you do this, it means that you are essentially rolling up your position to a higher strike price. While you could be saving your positions from losses, rolling up also helps to improve your position and earn you a higher profit.

### *Rolling up long and short options*

You can roll up all sorts of positions whether you are short on certain positions or long on others. Alternatively, you can close a position in order to save yourself from losses or a worse position. This process is similar when applied to call options as when it is applied to put options.

As you roll up your short option positions or even long positions, you will basically be switching your existing ones for others with contracts that are cheaper and hence affordable. Basically, cheapest contracts are those with highest strike prices. When rolling output options, the process will involve changing current options position to another position that has more costly contracts. This is because puts with a higher strike price are also generally more costly. However, the situation will also depend on whether you are holding a short or a long position.

#### *Net cash gain*

You can expect net cash benefit if you roll a long position. The reason is that you will get into a cheaper position after selling your previous position. When it comes to short call positions, you may be required to pay a higher price for contracts, and in return, you will get as the new contracts will be at a higher price.

Also, when you roll a long position on a put option, this basically means that you will sell contracts constituting your current position at a low price and then purchase costly positions. Therefore, when you roll up a short position on put options, you will basically be closing the same positions through purchasing of lower cost contracts followed by writing more costly contracts.

#### *Why roll up positions?*

Rolling up options positions is crucial in a number of ways especially to options traders. The most important aspect is to understand the exact reason why a position should be rolled up. One reason is that you may want to avoid assignment of share contracts that you own especially when you are in short option call positions.

In other instances, you may want to roll up positions of call options that you hold. This happens mostly when stock prices shoot upwards unexpectedly. This rise in stock price before the expiration of a contract before expiration may alter your position and predictions. To prevent your contracts from being assigned, you will need to roll your position and attain a higher strike which will be out of the money.

When you hold a long position on an option, you will want to roll the position so that you end up with a higher strike price especially if the underlying stock is deep in the money after the price rises steeply. This way, you will be able to profit from your current position even as you continue to predict and speculate on the future performance of the stocks and options that you hold but without putting your profits at risk.

Supposing you had positions on long put options and your predictions indicate that the value of the underlying stock will fall drastically. However, your predictions were inaccurate, and the stocks actually go up. In this instance, you do not want to suffer any losses so you may decide to roll your position. This will help you hedge your losses. The best instance, in this case, would be to sell your put options that are out of the money. This way, you stand a great chance of recouping some extrinsic value. And then you will buy additional put options whose strike price is higher than the previous one. You will, therefore, benefit more even if the stock price was to fall from this point.

#### *Risks with rolling process*

It is important to note that there are certain risks involved when applying this technique. This tends to happen when the market moves pretty fast in one direction or when volatility is significantly high. There could be a major impact on your positions when the options prices fluctuate in a major way.

Also, anytime that there is a time delay with two distinct but related orders with price changes involved, then there will be a challenge known as slippage. The term slippage refers to a challenge encountered by traders when they place different orders that converge towards a single position. There is a good solution to this problem that is available and regularly used by options traders.

Traders prefer to roll up in order to avoid or evade this specific challenge. This mostly involves closing out one order and then investing in another order that has much higher strike prices.

#### *Benefits of rolling out an option*

There are definite benefits of rolling out an options position. Most of the time rolling out helps to prevent traders from incurring losses due to inaccurate predictions or unexpected market movements. In other cases, traders use rolling techniques to adjust their positions for increased profitability. They tend to earn more money from their positions by rolling operations.

Also, it is a fact that most rollout processes are conducted through a single transaction rather than multiple ones. As such, they cost less and hence save a trader from incurring much higher prices compared to closing out a position then opening new ones. This also includes paying for contracts and commissions. This way, traders tend to save money even though this is not necessarily the reason why traders roll out positions.

If you conduct plenty of transactions, then such savings will come in handy. It is crucial at this stage to remember that rolling out on options positions generally depends on your outlook on positions more than anything else.

Traders also get to avoid the situation where they lose out due to what is referred to as price slippage. This is a situation that occurs when in between different opening and closing transactions. As a trader, it is advisable to always be on the lookout for savings and profit generation. Smart traders take all opportunities to avoid costs, save money, and earn profits.



# Chapter 5: Trading Tips for Intermediate Traders

## 1. Trading Forex Options Tips for Intermediate Traders

As a trader, the more experience you gain, the more variables seem to be at play. Some of these may improve your performance while some may not. In most cases, these just add layers of complications and are mostly settings and indicators.

It is advisable to focus on factors that actually support your trades and enable you to perform and increase your profitability. Here we shall examine a couple of tips that will help you become a better and more successful trader. These tips are directed at intermediate traders even though others too could benefit from these tips.

One of the most crucial factors in Forex trading is consistency. If you wish to develop and become a successful Forex trader, then you should be consistent. Being consistent is essential, yet most people are not even consistent in their lives. Certain platforms provide systems with a set of reasonable rules. Following these rules helps traders to perform well, excel, and become successful.

You need to keep in mind that Forex trading is all about taking risks. However, these are measured and calculated risks rather than blind groping in the dark. As a Forex trader, you are mostly a risk manager, so you need to be totally vigilant as you place trades and invest monies in your trades. There are a couple of things you need to focus on once the trades are entered.

### *Find triggers*

One of the first things that you need to do after placing a trade is to dial down for triggers. This is one way of managing risks and lowering your risks. When you lower down your risks, you improve your chances of success, and as such, you can go for a great size.

To achieve this successfully, you will need a chart that makes use of Fibonacci symmetry and retracement. Such a chart will have a slanted line and an upper line. Find the upper line because it is the trigger line. This line

basically indicates or points to the nearest level that has to be broken just so you may continue with the upward trend.

As an intermediate Forex trader, you should endeavor to identify a pathway to enter the trade at a point that is nearer to the market's determined turning point. In order to find such an entry point, you will basically do what is known as down dialing.

With a good chart, you should be able to trade with a risk profile of close to 78 pips. At such a level, the price will begin to showcase another preferred entry point. At this stage, you will want to enter the trade at the 51 pips level with a buffer of about 5 pips. The most likely scenario is that the trend will begin an upward climb. What this will have achieved is reducing our risk profile by 50% and allows you better performance with higher performance at the end of it.

### *Scale your trades for risk*

As a trader, the bottom line is always driven by the desire to be profitable. This is what you will achieve by following this specific tip. Now, we will identify another entry point known as level 2.



At this point, we will enter at 51 pips. As a trader, when you scale out to half of your position, it will enable you to have free trade. Therefore, should the price retrace back to the beginning then we can only breakeven even in the worst-case scenario. Other than that, your trades will only be profitable from here. You can add a couple of extra pips so that if your trades have to stop, then you will still have had free trade.

Such an approach is excellent especially for traders who are unable to watch the market or make adjustments to their stop-loss systems. As an intermediate trader, you should have sufficient experience to set up a trade then forget all about it, so the price action determines the trade without the need for regular interventions.

*We can be wrong sometimes*

By now we know that even the best analysis does not always win. There is never a 100% guarantee that the market will move as predicted. It is, therefore, the reason why you can take the risk out of the trade.

*Go for profits*

As an intermediate trader, you have learned all about setting up trades, learning how to enter and exit trades, how to identify great opportunities, how to read charts and all that. By this stage now, you should focus on profits. This is because we learn all this technical stuff in order to eventually learn how to be profitable. There are different ways of going about this. There are generally two great ways of doing this. These are using moving averages and using price structure.

You can also keep close track of your stop by using one of the moving averages. Using such approaches for profits will help remove emotions from your trades and enable you to trade with confidence and thereby become profitable.

*Effective indicators that you should be aware of*

As a Forex trader, you are likely to encounter plenty of various trading methods. Making use of only four chart indicators is possible. These can help you with almost all Forex trading opportunities. These chart indicators are the MACD indicator, the Moving Average, Stochastic, and the RSI. As a trader, you will receive Forex indicators and free reinforcement tools to use each trading day.

*Use a simple strategy*

A lot of traders tend to complicate matters, especially in their early trading days. As an intermediary trader, you should try as much as possible to avoid complicating things. Instead, you should focus more on simplifying your trades so that everything is clear and all that you do must have a clearly defined purpose.

Plenty of traders think that complicated trading strategies with plenty of variables perform better yet the main focus should be on simple strategies that will have a direct bearing on profitable trades. Also, strategies that are

simple and straightforward have less stress and allow for fast reactions should this be necessary. As an intermediate trader, you need to work on coming up with simple strategies that are effective and will help you identify trades.

## **2. Tips for Intermediate Futures Options Traders**

As a futures trader, you should make sure that you understand very clearly what a short position is and a long position is. There are plenty of novice traders who believe that you only make money or are profitable when markets are on an upward trend. However, you need to understand that futures' trading constitutes a lot more than just following the upward market trend. You also should know by now that as a futures trader you can benefit greatly when you focus on asset types that have attained a climax and are close to failure.

As a trader, anytime that you wage your money against an asset, then you will be said to be selling it short. Selling an asset short simply means that you will engage your broker and purchase the rights to access the asset with the hopes of selling it back later once it becomes profitable. Using this analogy, we can purchase apples at the market for \$1 each and then selling them back at \$2 each making a profit of \$1.

In real life, this \$1 can be exponentially multiplied to earn you large sums of money. This is the way futures markets work. You stand to make large sums of money from simple trades.

### *Long positions*

As a futures trader, you are ready to invest your funds in a particular asset when you take a long position in it. In this situation, you will only benefit from this position when the price of the asset rises. As a futures trader, you need to be able to determine whether and when an asset is likely to rise in price. This determination requires you to learn about the fundamentals of the asset. For instance, how is the supply and demand in the market? Being able to answer such questions with a high level of accuracy will enable you to decide whether to invest in it or not.

Basically, each asset market has its own rules that help interested parties, including traders, to provide intrinsic value as well as the determination of momentum, both negative and positive. The Central Bank is the premier institution when it comes to currency, so currency traders need to take note of the policies and statements released by this institution.

In this instance, currency fluctuations sometimes depend on interest rates. If you anticipate a rate hike, then it is advisable to go long on the specific currency. Higher interest rates should provide a suitable incentive to hold long an asset. This way, there will be increasing demand in the currency, and you will be able to eventually sell at a great price and make lots of profits.

When it comes to stocks and other instruments, it is corporations that drive their value. For instance, the earnings report will determine the value of a company's stock in the short and long terms. Earnings reports are often released quarterly. During these events, company executives reveal their earnings for the past three months as well as their forecasts for the future. Therefore, if a company announces a reduction in production, closure of a store or plant and so on, then you should assume a long position. The reason is that reduced production will very likely result in higher prices within a couple of months.

#### *Short position*

When it comes to short positions, there are plenty of similar factors compared to long positions at play but in reverse. Therefore, factors or elements that cause you to choose a long position will, in reverse, determine a short position. For instance, if you are interested in currency and there are signs of reduced inflation, then you may want to take a short position on the currency.

Basically, when there are signs of declining inflation, central banks may decide to lower interest rates in order to provide a stable financial position in the markets. On the other hand, when interest rates are high, then as a futures trader, you will want to take the path that all other futures traders do. When interest rates are high, products and services are generally expensive for the consumer.

Costly products mean lower sales figures, and this will mean reduced incomes for corporations and so on. As such, it will be appropriate for futures traders to sell short because of the high-interest rates. Some of the instruments that can be sold include shares and stock indices. Commodities markets and their instruments also operate in the same manner. When there are high-interest rates at play, the markets tend to experience low demand. Commodities such as gold and oil will then most likely begin selling short at the markets.

Basically, it is advisable to have a good idea regarding factors that are actually negative and which ones are considered positive especially with

regards to your preferred asset. This way, you can do your research and analysis to determine if you are to sell an asset or buy.

#### *Intermediate futures trading*

It is often difficult for traders with small accounts to make any significant gains in the futures market. As an intermediate trader, you do not need to be too concerned about this. This is because you can use leverage to overcome your small account size challenges.

Leverage provides an effective pathway that enables you to capitalize effectively on your positions. Leverage also provides a reliable pathway that will enable you to increase your profit potential as you maximize on your positions in the trade. This means that you will be able to leverage in a manner that allows you to profit in numerous ways not otherwise possible.

Leverage can help you maximize your gains. However, be extremely cautious because leverage can also compound your losses should you incur any. It is possible that your analysis could travel in the wrong direction. When this happens, you could incur some losses, and these could have an impact on your account. You could, for instance, receive what is known as a margin call. When this happens, you will be required to fund your trading account. Should you not be able to fund your account due to losses, then it will be shut down.

### **3. Binary Options Trading Tips for Intermediate Traders**

Every binary options trader needs to have some useful tips if they are to be successful and profitable in their binary options trades. Trading binary options are risky and not simple. However, with the right information and tips, you can always turn it into a profitable venture.

While it is not easy, it is definitely much easier or less complex compared Forex trading. As a trader, you need to invest your time and resources into understanding the trade and putting your knowledge to the test especially on different trading platforms. Here are some advanced tips for intermediate traders.

#### *1. Learn to set up your workstation professionally*

As a trader, one of the first things that you need to get in order is setting up your workstation as required. As you transition from a novice to a more

experienced intermediate trader, you will need to make big changes to your trading environment. You need to aim for a more professional platform.

It is not necessary at this stage to invest lots of money on infrastructure or trading platforms, but the least you can do is to open up and widen your horizons, so you have access to more and better resources. There are a couple of things that make intermediate or other options traders successful. One of the most crucial is having access to all the information, data, and other resources necessary. It is this access to information that makes binary options traders a lot more successful compared to all others without this kind of access.

Keep in mind that setting up a conducive trading environment does not necessarily entail only improving your systems. It is more than that as you need to have a variety of ways of accessing tools such as charts, performing fundamental analysis, technical analysis, and choosing chart types for instance.

#### *Improve consistency with progressive technical analysis*

As an intermediate trader, you are aware of the kind of information that traders, especially beginners, are bombarded with. There is plenty of information from all over including news, analysis, and so on from numerous different sources. In many cases, it becomes difficult to sort out all this information and find what is actually useful and adds value to your trades.

As an intermediate binary options trader, you should not just take in all the information or technical analysis that comes to you. This is what happened to you as a beginner, and it probably slowed you down and confused you. What you need to do is to slowly study the various tools out there as well as the various strategies accessible to you. Check them out and find the ones that are suitable for you. There are thousands of different tools out there. Simply sieve through most of them and find the few but effective ones that fit your purposes and meet your needs. Sometimes using multiple tools and information sources may sometimes be detrimental to you.

#### *Experiment with different options*

Beginners often get caught up in the different options and assets out there. These are numerous in number and can possibly confuse traders. Novices and beginners will not necessarily be able to handle this large pool of options and assets. They will get confused and lost, not knowing what to do.

However, as an intermediate trader, you will need to develop a little bit of skill based on your experience on how to identify the tools and systems that

you need. Not all trading platforms offer all the tools that you need. However, you should be able to take the time to find the tools that will help you devise a strategy that works for you. If you devise and work with a flexible system, then you can almost be guaranteed to be successful in your trades heading forward.

It is advisable to experiment with different options binary tools and products. However, do not over-experiment because it can cost you time and resources. Spend some quality time implementing some of these strategies and find the one that works best for you.

#### *Adapt expert money management skills*

One of the most crucial aspects of binary options trading begins right away. Basically, you will need to adopt some rules as well as systems that will assist you with money management. This is an aspect that seriously determines the outcome of your trades as well as long term profitability.

As an intermediate trader, you are able to take advantage of advanced money management tips often adapted by advanced traders. Some of these include tips on how to manage and control risks, how to minimize or reduce capital outflow, how to basically manage your funds so that you capitalize on profitability and minimize losses.

You will also have to work and improve your technical analysis skills that actually provide you with the information that you need. If you can access the right kind of information, have access to tools and systems to perform analysis, and learn the proper money management skills, then you will be well on your way to successful binary options trading. Also, remember always to keep learning. The more you learn about your trade, the better you become at it. Plenty of successful binary traders are often learning new things as well as learning from their mistakes.

## **4. Tips for Intermediate ETF Options Traders**

Exchange traded funds also referred to as ETFs, have numerous pros that make them ideal for novice and intermediate traders. Some of these pros include low investment threshold, diversification, plenty of liquidity, a wide range of investment choices, and low expense ratios. Here are some tips for intermediate ETF traders.

#### *Start with the most basic strategies*

As a trader, you need to pursue some of the most basic strategies before advancing to more complex strategies. This way, you will gain the experience and learn the techniques and skills necessary to make you an expert trader. One of the best strategies is dollar-cost averaging.

The dollar-cost averaging is ideally a technique that traders and investors use to purchase assets based on fixed-dollar amounts within a set schedule. This strategy does not take into account the varying cost of the asset. Novice and intermediary ETF traders can spare a couple of hundred dollars each month and invest in the ETF with the hope of growing the account with time.

Periodic investment into an ETF has two distinct benefits. The first of these is that it instills discipline in you as a trader so that you learn to put away some money and save each month. This is absolutely crucial to building wealth for your future. Paying yourself periodically is actually advisable and financial planners always advice their clients to follow this path and reward themselves. The other benefit is that you grow your investments periodically such that within a couple of years, you will have a substantial amount put away.

Let us assume that you invest about \$500 per month each month for a period of three years from September 2013 to August 2015. If you put this money in an ETF such as SPDR S&P 500 ETF, then you would purchase over 103.8 SPY units in that period of time. If you were to cash out this amount, you would receive at least \$21,860. This is equal to an annual return of close to 13%.

### *Swing trading*

Another approach that you can consider is the swing trading strategy. This strategy calls for trading the large swings in market instruments such as commodities and currencies. Such trades do not necessarily take a small time to execute. Most of them take a while longer ranging from a few days to a couple of weeks.

ETFs are absolutely suitable for swing trading. This is because of two main reasons. One reason is that ETFs contain pretty tight bid-ask spreads. The other is that they are pretty diversified. This diversification is significant, and it is the reason why traders love ETFs. When trading ETFs, you can choose to begin trading those that suit your background. For instance, if you have a tech background, then trading tech ETFs will make more sense to you. The same way if you are from the pharmaceutical background then you can focus on ETFs within this sector.

### *Short selling*

As an intermediate trader, you may want to consider short selling. The term short selling simply means selling instruments or assets that you do not own in order to profit from them before buying them back and keeping the profit. This action can be quite risky and should not be attempted by beginners or novices. However, as an intermediate trader with substantial experience trading options, you should consider short selling to increase your profitability.

When you short a security through ETFs, then you will be able to benefit from the broad vast of opportunities presented. As an intermediate to the advanced trader, you are probably familiar with the risks posed by short selling. However, with the right safeguards and management techniques, you should be able to short sell successfully.

### *Bet on seasonal trends*

One other strategy that you can implement for success is to find seasonal trends and focus your energy on these. ETFs also serve as excellent tools that provide options traders with a chance to benefit from seasonal trends. There are a couple of trends that you can focus on. One of these is the likelihood of gold to gain value in the months of October and September. Another is the sell in May phenomenon.

There is often a strong demand for gold in India during the months prior to Diwali, the festival of lights. This festival often occurs between the months of September and October. In the US, equities often perform poorly from the month of May all through to October.

It is possible to successfully exploit these and other seasonal trends to make some money from ETF trading. Think about the SPDR Gold Trust and others that can work for you.

### *Hedging*

Another excellent strategy that you can work with as an ETF trader is hedging. Hedging is excellent if you wish to protect yourself or your trades against certain risks or downsides. When you put substantial amounts of funds in a portfolio, then you may want to consider hedging. It will provide protection against possible downsides.

Take the example where you have a number of stocks of a blue-chip US company. If you are concerned about a possible decline in the price of the stock, then you may want to take out some protective measures. For instance,

you could buy some put options as a means of hedging against the possible negative outcome.

Apart from investing in options as a hedging strategy, you can choose instead to invest in or create a short position on an ETF. Think about S&P 500 or the Dow Jones. Should the market slow down and your stock loses value, this will be offset nicely by some of the stocks on the ETF because there will be some losses as well as some gains. The only problem with this approach is that your gains will be limited because the portfolio will be offset with any gains on the ETF. Even then, you will be able to hedge successfully using ETFs compared to many other financial instruments.

## **Further Tips and Advice on Successful Options Trading**

If you are new to options trading, then you will need all the advice, tips and guidance necessary, in order to trade successfully. It is, however, first recommended that you understand a concept, apply it and master it then add more knowledge. This is a much better and more successful strategy. Here are some helpful tips and advice that should guide you as you trade online in options.

### *1. The price of any stock can move in 3 basic directions*

These directions are up, down and no movement at all. Depending on the kind of call that you have, you can leverage from this movement to make a profit or at least avoid incurring losses.

Plenty of first-time traders and investors assume that prices of securities will go either up or down. However, this is a wrong school of thought because sometimes there is no movement at all in the price of stocks and shares. This is a very important fact in the world of options trading.

Plenty of real-life, practical examples show a particular stock or share did not move significantly for quite a lengthy period. For instance, the KOL share traded within a \$4 range for a total of 23 days. If you had invested money in either a call option or a put option through this stock, you would have lost money.

According to seasoned traders, chances of making a profit with a call or put option are hardly ever 50% but only 33%. This is likely due to the fact that stock price movements are random. You will eventually realize that 33%

of the time, stocks rise, 33% of the time they dip in price and another 33% of the time they stay the same. Time will more often be your worst enemy if you have a long put or call option.

A purchase of a call option is usually with the hope that prices will go up. In the event that prices do rise, then you will make a profit. At other times the prices will remain the same or even fall. In such events, if you have an out-of-the-money call, the option will most likely expire, and you will lose your investment. In the event that the price remains stagnant and you have an in-the-money option, then you will at least recoup some of the money you invested.

There will be times when frustrations will engulf you. This is when you just sit and watch prices start to skyrocket just a couple of weeks after the options you purchased had expired. This is often an indicator that your strategy was not on point and you did not give it sufficient time. Even seasoned traders sometimes buy call options that eventually expire in a given month and then the stocks prices rise sharply in the following month.

It is therefore advisable to purchase a longer-term call option rather than one that expires after a single month. Now since stocks move in 3 general directions, it is assumed that close to 70% of options traders with long call and put options suffer losses. On the other hand, this implies that 70% of option sellers make money. This is one of the main reasons why conservative options traders prefer to write or sell options.

## *2. Before buying options look at the underlying stock's chart*

Basically, you want to find out as much information as possible about the performance and worth of an underlying stock before investing in it.

You should, therefore, ensure that you take a serious look at the chart of the stock. This chart should indicate the performance of the stock in the last couple of days. The best is to look at a stock's performance in the last 30 and 90 days. You should also take a look at last year's performance.

When you look at the charts, look at the movement of the shares and try note any trends. Also, try and observe any general movement of the shares. Then answer a couple of questions. For instance, is the stock operating within a narrow range or is it bending upwards or downwards? Is this chart in tandem with your options trading strategy?

To identify the trend of a particular stock, try and draw a straight line along in the middle of the share prices. Then draw a line both above and below so as to indicate a channel of the general flow of the share.

### *Chart readings and buying call options*

Let us assume you wish to invest in a call option. Then you should ask yourself if the stock price is likely to rise and why. If you think the stock will rise and trade at a higher level, then you may be mistaken, unless something drastic happens or new information becomes evident. New information can be a shareholders meeting, impending earnings announcement, a new CEO, product launch and so on.

If there is a chart showing the presence of support at lower prices and stock prices fall to that level, then it may be advisable to buy call options. The call option will be a great bet when prices are down because prices will very likely head back up. However, never allow greed to occupy your mind. When you see a profit, take and do not wait too long.

### *Chart readings and buying put options*

Now supposing the stock chart indicates a solid resistance at a higher price. If the stock is beginning to approach this higher level, then it is possible that the price might begin to move in that direction as well. So as the price moves, expect to gain small but significant profits. Avoid greed so that anytime the stock price falls simply move in and make some money.

### *Chart readings for purchase of call and put options*

Now, if your chart readings indicate that the shares are within the lower levels of its range, then it is likely that daily changes in price will send it towards the middle of the range. If this is so, then you should move in and make a profit as soon as the price tends upwards. Even minor profits such as buying at \$1 and selling at \$1.15 means a 15% profit margin.

### *3. Find out the break-even point before buying your options*

Now you need to identify a call option that you wish to invest in, especially after studying its performance on the market. Before buying, however, you should work out the break-even point. In order to find this break-even point, you will have to consider things such as the commissions charged and the bid spread.

It is very important that you are positive the underlying stock of your options will move sufficiently so as to surpass the break-even point and earn a tidy profit. You should, therefore, learn how to work out the break-even point in options trade.

### *Calculating the break-even point*

As an options trader, you need to know how to calculate and find the break-even point. In options trading, there are basically 2 break-even points.

With short term options, you need to make use of the commission rates and bid spread to work out the break-even point. This is if you intend to hold on to the options until their expiration date.

Now if you are seeking short term trade without holding on to the options, then find out the difference between asking price and bid price. This difference is also known as the spread.

#### *4. Embrace the underlying stock's trend*

As an investor and trader in options, you need to consider the trend of the underlying stock as your friend. This means that you should not fight it. Basically, if the stock price is headed upwards, you should find a strategy that is in tandem with this movement. If you oppose it, you are unlikely to win.

Similarly, if the stock is on a downward trend, then do not oppose this movement but try and find a strategy that will accommodate this trend. You need to understand however that this saying is intended to guide you but is not necessarily a rule. This means you apply it even while you consider all other factors. For instance, the major news may have an immediate effect on the price trend of a stock or shares.

As a trader, you should learn to jump successfully on a trend and follow the crowds rather than go to extremes and oppose it. Most amateurs who see an upward trend often think the stock is about to level out. However, the reality is that the momentum is often considered a great thing by seasoned traders. Therefore, do not try and oppose the trend because you will surely lose. Instead, try and design a strategy that will accommodate the trend. In short, the trend is always your friend, do not resist as momentum is great.

#### *5. Watch out for earnings release dates*

Call and put options are generally expensive with the price increases significantly if there is an earnings release announcement looming. The reason is that the anticipation of very good or very bad earnings report will likely affect the stock price. When this is an underlying stock in an options trade, then you should adjust your trades appropriately.

Once an earnings release has been made, then options prices will fall significantly. You need to also watch out very carefully for this. The prices will first go up just before the earnings are released and then fall shortly thereafter. It is also possible for call options prices to dip despite earnings announcements. This may happen if the earnings announced are not as impressive as expected.

As an example, stocks such as Google may rise insanely during the earnings announcement week only to dip significantly shortly thereafter. Consider Apple shares that were trading at \$450 at the markets. Call options with Apple as the underlying stock were trading at \$460. However, the market had targeted a price of \$480 within 3 days, which did not happen. This costs investors money. Such underlying assets are considered volatile due to the high increase in price, rapid drop shortly thereafter and a related risk of losing money.

# Chapter 6: Advanced Technical Indicators Analysis

In options trading, technical indicators are used to enable the trader to determine a couple of facts. These include the following;

- Duration of stock movement
- Direction of the move
- Movement range

There is a difference between trading options and other securities. The main differences are that options are subject to time decay and their value diminishes as time goes. The holding period is therefore quite significant. For this reason, the difference between an ordinary trader and an options trader is clearly visible.

An options trader is constrained by time while an ordinary trader can hold a position indefinitely. This is the major difference between the two and hence the need for additional technical indicators.

## Technical Indicators

What are the technical indicators? These are useful indicators that provide information about trends and even possible turning points in the prices of stocks and securities. Technical indicators are among the tools that are used by traders and even analysts to predict the best times to purchase or sell stocks and options. The technical indicators also predict the cycles.

A technical analyst will calculate the essential particulars of a stock. Many of the technical indicators are calculated using data such as;

Closing price

Highs

Lows

Trading volumes

And opening prices among others

Stock prices from the past couple of trades provide most of the raw data required to work out technical indicators. Data mostly used is often from the

previous 30 days. The data is then utilized to come up with a chart or trend that indicates what has been happening and what will happen to a particular stock. This is because past performances are a great indicator of future trends.

Technical indicators are widely used by options traders to predict the future movement of price movement of stocks. They also indicate trends within the market. When it comes to technical indicators, there are two main types. These are; leading indicators and lagging indicators

Lagging Indicators are indicators that closely monitor and follow a stock's price pattern. This is why they are called lagging. These indicators are solely based on previous data and are hence excellent at indicating whether there is any trend developing in the market or if a stock has entered a trading range. Lagging indicators can, for instance, point to a stock with a major downward trend and will most probably continue falling.

#### *Future Trends and Pullbacks*

You should keep in mind that lagging indicators are not recommended when it comes to predicting future pullbacks or rallies. These indicators can indicate the trends that have developed until the latest point. However, they cannot point to future trends or events even just for the next couple of days. Some common lagging indicators that are popularly used by options traders include ADX indicators, the Moving Average, and the MACD.

In summary, therefore, lagging indicators are excellent at pointing out the developing trends but are poor at predicting or forecasting any future stock price movement.

## **Leading Indicators**

The other very useful technical indicators are the leading indicators. These technical indicators are extremely useful at predicting future events. They often provide relevant information regarding possible crashes and future price gains. Some of the leading indicators include momentum indicators. These are capable of predicting or gauging the momentum of the price movements of a stock.

Momentum indicators are more like tossing a football in the air. No matter how high the ball rises, we know that it will eventually fall back to the ground. We may not know when it will stop going up, but we are sure that it will do so at one point. This is basically the genesis of momentum indicators.

Leading indicators such as the momentum indicators are excellent at revealing if a stock price has gone too far down or too high up. They also let us know whether there is a reduction in the momentum of the price movement. When the price moves too high simply means there has been an over-purchase of the stock. In such cases then the stock has been overbought.

Should the price move too low, then this says that there is an oversupply of the stock and buyers are possibly dropping it. When a stock has been overbought or oversold, it will not remain in this state for long. We can, therefore, make a deduction that a pullback is likely to happen. Most momentum indicators and the RSI are good examples of leading indicators.

## **Lagging and Leading Indicators**

Most traders appreciate both lagging and leading indicators because they are both invaluable. It is important that as a trader, you are informed about any possible price pullbacks and slowdowns. Ideally, you should never rely on just one of these indicators but on both. This way, your predictions, and trades will always be accurate and reliable.

Most indicators sometimes produce false signals occasionally. Since this is a risk that you want to avoid, then we recommend using at least two or three different indicators. Identify 3 specific indicators that you like, and if they all give you positive information about a stock, then you can feel confident enough to invest in it. There are essentially hundreds of different indicators in use across the world. In fact, most seasoned traders will have developed their own technical indicators so as to predict the markets accurately. You should learn about how to use about 5 different technical indicators. This way, you will have a wide variety of options to choose from.

## **Top Technical Indicators**

We have noted above that there are hundreds of different technical indicators currently in use. However, there are some that are absolutely crucial for options traders. If you can learn how to use about 5 of them, then you will have a strong foundation for your technical analysis. Here is a look at some of the more important ones.

**Average Directional Index Indicator, ADX**

The ADX or average directional index is a popular indicator that is mostly used for confirmation purposes. It essentially works to confirm the information or signals that are produced by other indicators. This technical indicator works by measuring the strength of any given trend. As an example, you can use the ADX to measure if an upward trend or maybe even a downward trend is slowing down or gaining momentum.

This average directional index, ADX, combines the positive directional indicator, +DI, and the negative directional indicator, -DI. The -DI or negative directional indicator tracks the downwards trend while the +DI or positive directional tracks the upward trend at the stock market. When these two indicators are combined together, we get the Average Directional Index. This combination of two strong indicators produces one powerful and unified trend strength indicator.



### Chart

In the chart above, the +DI is showcased as a green line while the -DI is shown as a red line. The ADX indicator itself is shown as a fat black line. We note that from late February until mid-April, there was a strong stock trend as indicated by the ADX. The stock was trending upwards.

It is possible to notice that the ADX indicator never went below the 20 mark. This is a clear indicator when the stock ever traded flat. An accurate assessment mostly is visible from the stock price. In general, we notice that

this is an accurate assessment as it is visible from the strike price. There was a remarkable uptrend for the first three months and the last three months indicate a downward trend.

### *Oscillating Indicator*

The ADX technical indicator also happens to be an oscillating indicator. Its oscillations range from zero to a hundred with zero representing flat trades while a hundred represents a plunging or rising stock. Please note that the ADX indicator showcases the strength of a trend only without pointing its direction.

Also, the ADX values often range between 20 and 40. Rarely will you see ADX values above 60. The reason is that high values above 60 point to a trend that usually appears when there is a long recession or a long bull run. Any values that are below 20 often point to a stock entering the trading range.

### *Summary*

According to our chart above, we notice that signals produced by the Average Directional Index, or ADX, indicator, any move that is way below 40 points and above will simply indicate the slowdown of the trend. Now our options strategies always rely on large volumes of shares, so a trend that is slowing down is absolutely undesirable. Therefore, as a trader, if you notice any ADX indicator is a simple pointer that the trend is actually slowing down and that now would be the best time to buy out.

Similarly, any index indicator that moves above 20 indicates that the sideways trading strategies are over because a new trend is currently developing. This then is a clear indication that the current upward trend is almost drawing to an end. As such it is time to make a positive movement which can be either bullish or bearish. Also, sometimes the ADX indicator can move way above 20. This is always a clear indication that the current upward trend has started to fade.

Again, in our chart above, the ADX technical indicator produced a signal right in the middle of April. As a trader, you should learn how to look for stuff and be observant. Signals on this example can be obtained by observing and noting where there is. When the +DI, green, and wring signal process above +61422 – 5840364. When the two indicators, the +DI and the –DI cross paths with each other, we will identify our signal here. When they meet together, they should form a bullish signal. You should therefore always base your investment opportunity on recommendations from the map. Experts

advise that you make use of only one or additionally two types of indicators. This way, you will be sure of what to do.

## **2. Bollinger Band Strategies**

Another technical strategy that is commonly used to showcase the voracity of stocks is Bollinger Strategy. There will always be an opportunity to learn from the boss. Basically, a Bollinger Band strategy or theory is mostly meant to showcase how volatile the stocks are.

This is a simple technical indicator as it is composed of a simple moving average together with both its upper and lower bands. These upper and lower bands are only about 2 standard deviations away.

We can confidently say that standard deviations are more like statistical tools. This is because most of the movement occurs around these positions. When you use the Bollinger Band theory, you will discover that it only works as a guide or gauge and should, therefore, be used in conjunction with other indicators. If you learn how to apply these indicators, then you stand a great chance for success.

### *Bollinger Band Theory*

The Bollinger Band Theory is written in a manner that allows it to resemble a stock's volatility. It is a simple theory that consists of the simple moving average together with its lower and upper bands. These upper and lower bands are about 2 standard deviations apart. We are aware that standard deviations are commonly used in statistics to manage the deviation around the average value. Therefore, whenever you use the Bollinger Band Theory, use it only as a guide, or gauge, together with other indicators.

The Bollinger Band theory operates optimally in conjunction with the 20-day SMA or simple moving averages. We also need the standard deviations of the 20-day SMA in order to create the Bollinger Bands. Some of the strategies that emanate from this indicator include long-term and short-term Bollinger Bands. The shorter-term bands which are less than 20-days are highly sensitive to price movement while the longer-term bands that exceed 20 days are less sensitive and more conservative.

### *Application of the Bollinger Band Theory*

The Bollinger Band theory is meant to be used only as a guide. It will not point to the exact point in which to purchase or sell an option or a stock. It guides traders by enabling them to gauge a stock's volatility.

Any time that the price is too volatile, the Bollinger Bands will be wide apart. This is demonstrated in the chart below. We can observe stock price volatility at the beginning of March, in the middle of April and mid-May. The Bollinger Bands are seen to be a little closer in the absence of price fluctuations. When there is almost no price fluctuation and little volatility, Bollinger bands are observed to be within a tight range. This is clearly observed within the chart below as circled areas. They can be observed in the months of February, in late March and late June.



## How to Use Bollinger Band Theory

Historically, we can deduce that stock prices usually do not stay within a narrow, confined, trading range for a long while. You can use strategies such as the relationship between the length and width of the bands. Ideally, the closer the bands are to each other, the shorter the time that will be taken.

Therefore, if a stock begins to trade in a narrow Bollinger Band, like the ones circled in the chart, then we can deduce that there is going to be large price fluctuations in the coming days. The challenge is that we do not have an idea of the direction that the security will move. This is therefore why we should use Bollinger Bands in conjunction with other technical indicators.

It is possible that the stock may turn volatile. When the volatility becomes extreme, then you will be able to note this from the image above. You will notice the stock will approach very closely to either the lower or upper Bollinger Bands. The bands will, in turn, widen significantly. We can

confidently say that the wider the Bollinger Bands are then, the more volatile the stock prices become.

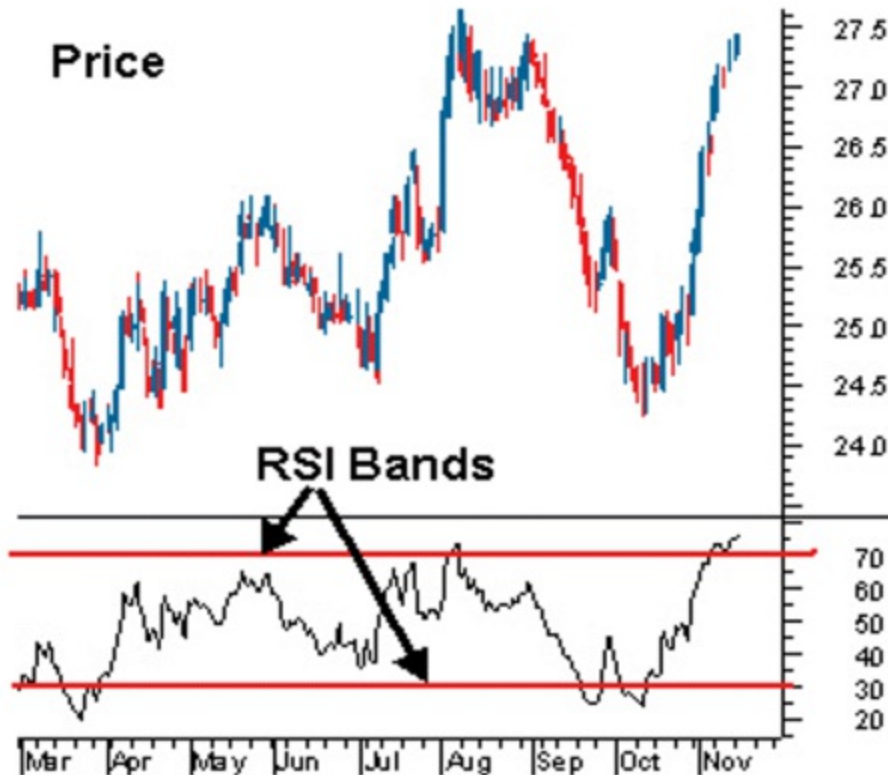
As soon as the stock prices depart away from the bands and closer to the moving average, this can be viewed as a sign that the price momentum has decreased momentum. When it slows down in this way, it tends to move back closer to the moving average. Even then, it is not uncommon for the stock price to move away from the bands again before moving back closer to the moving average.

### *Summary*

In conclusion, a wide Bollinger Band often results in the price moving closer to the moving averages. Also, if a Bollinger Band narrows down, then it becomes very likely that prices will begin to shift towards the moving average. Essentially, when it comes to the Bollinger Band theory, we need to observe that individual indicators like moving averages should not be used alone. They should, instead, be used in conjunction with other indicators, preferably one or two more. These additional indicators should be of different types so as to prevent false signals and to ensure confirmation of signals.

## **Relative Strength Index**

One of the most useful indicators for options traders is the relative strength index. The RSI is a momentum indicator and is used by traders to compare the size of gains made recently to losses incurred over a time period. Using the RSI, a trader is able to measure a stock's change in price and speed movement.



These parameters aim to help a trader determine which stocks or securities have been oversold or overbought. This is usually achieved using values that range from 0 to 100. Now any values above 70 indicate that the stock has been overbought while values below 30 simply imply that a stock has been oversold.

RSI ideally works best with stocks and options rather than indexes. Stocks tend to clearly indicate their status as either overbought or oversold. This makes it easy for options traders to tell which stocks are oversold, which ones are overbought, and which ones are available. It is not that simple with indexes. The best stocks for options traders are often high-beta stocks that are very liquid especially for short-term trading.

## Simple Moving Averages

Some of the most important and widely used technical indicators are moving averages. Their main purpose is to smooth out the price pattern and to provide clear indication of whether a stock is trending or is within a trading range. The moving averages are basically based on the mean stock price, usually the closing price.

If we take the 20-day moving average, we will consider the mean of the stock's closing price for the past 20 days. These average changes each day as long as the particular stock is traded. Therefore, the 20-day Moving Average will have a different value each day. This tends to create a trend of a particular stock that keeps moving.

### *Charting*

Normally, when we chart the price pattern, the resulting chart indicates a very volatile pattern. It is possible for the price to vary by as much as \$3 or even \$5 in a single day. Now if we take the 20-day moving average to the same chart, then the price pattern will be smoothed out.

The reason why the price is smoothed out is that the Moving Average considers the 20 days' worth of data. This tends to smooth out the volatile price pattern, making it easier for an options trader to disseminate information.

### *Summary*

Moving averages are crucial technical indicators. They provide information that is of paramount importance to options traders. The averages are based on the average closing price of a stock for a set number of days. When applied to the stock's price chart, they smooth out the price pattern. This makes it easier to note if the stock has an upward or downward trend.

## **Exponential Moving Averages**

Apart from the simple moving averages that we have observed, we also have the exponential moving averages. With the simple moving averages, we considered all the 20 days' prices as having the same weight when working out the averages. However, this is not the case when it comes to the exponential moving averages or EMAs. In this instance, the latest prices carry more weight compared to earlier ones.

Due to the weighted prices, the EMA or exponential moving averages tend to respond much faster than the SMA or simple moving averages. The EMA also starts to respond and trend upwards much faster compared to the SMA. As a trader, which one of these two moving averages should you consider? Well, both averages have their own merits. The exponential moving average might register false alarms should they occur. The simple moving average resists false alarms and is also resistant to other challenges.

However, we also note that the EMA or exponential moving average is able to react faster to price volatility in the market. In options trading, traders prefer the EMA over the SMA because they are far more sensitive to price changes and showcase quick movements. The quick and sensitive movements are preferred by options traders especially due to the volatile yet short-term nature of options trading.

### *Summary*

The exponential moving averages give additional weight to recent data compared to earlier data. This makes them more sensitive to price fluctuations and can react better to such changes. These are the properties that make them suitable for options trading.

The main aim of the averages is to the direction of a stock. The averages will indicate whether a stock is trending downwards, upwards, or sideways. This kind of information is useful to options traders because they will be able to avoid trading in stock stuck in a trading range or on a downward trend.

Both the simple and exponential moving averages are useful in other ways as well. For instance, if the stock price moves above or below the moving average, we will know that there is a reversal of the current trend and a new trend is probably about to begin. When the stock price crosses the moving averages line from below moving upwards, it shows that investors and traders are beginning to purchase the stock.

As the trend begins to move upwards, it indicates a great opportunity to purchase call options or acquire a bullish options strategy. However, when the stock price crosses the EMA and starts to trend downwards, then this becomes a great opportunity to set up a bearish options strategy.

### *False Alarms*

There can be some challenges with the moving averages, especially the Simple Moving Average or SMA. Apparently, they sometimes give off false alarms. For instance, the stock price crosses the moving average line several times within a couple of months. If a trader had relied on the moving averages to buy stock options, then they would have suffered painful losses.

The reasons for the false alarms are mostly due to the sensitivity of the 20-Day simple moving average. This technical indicator is erratic and too sensitive. It is possible, fortunately, to modify these indicators so that they are focused on specific periods of time or even certain date ranges. We can, for instance, work with a 50-day exponential moving average rather than the 20-day SMA.

## **Relative Strength Index**

The Relative Strength Index or RSI is another crucial indicator that is popularly used by options traders. It is among the leading indicators and is considered important because it is able to accurately forecast the movement of a stock's price way before it happens.

The RSI is an oscillating indicator and a momentum indicator. As a momentum indicator, it points to overbought stocks whose prices are too high and oversold stocks whose price is too low. The RSI is based largely on gains and losses rather than a stock's closing price.

As an oscillating indicator, RSI fluctuates between 0 and 100. When RSI is at 100, it means that the stock is most overbought while at 0, it is the most oversold. Basically, any amount above 70 is thought to be overbought while any amount below 30 is considered oversold. While this technical indicator is able to inform us about stocks that have been overbought or oversold, it is valued even more because it can indicate when stocks will exit the oversold or overbought conditions. When stocks exit these positions, they move closer towards the moving averages.

In summary, we can view the RSI or relative strength index as a leading, oscillating, and momentum indicator used to inform traders when a stock exits the oversold and overbought conditions.

# Conclusion

Thank for making it through to the end of this book, let's hope it was informative and able to provide you with all the tools you need to achieve your goals whatever they may be.

This book has opened your eyes and minds to the exciting opportunities that exist in the trading markets. It has also recommended ways to improve your techniques and increase your knowledge. As a novice trader, you spent plenty of time scouring the markets and learning the ropes. You learnt how to trade, how to buy options, sell them, and how to profit from them. However, you cannot remain a novice trader all your life, and therefore you need intermediate and advanced techniques to trade options.

This book has taught you more superior techniques that you can apply to be even more profitable. For instance, we have learned about more complex options spread's strategies including the iron butterfly and the diagonal spreads. We have also looked at techniques that you can use if you wish to roll, manage, improve and otherwise save your trades from losses. Applying some of these techniques has shown that it is possible to avert losses, move position and make adjustments to improve the profit outlook.

To cap it all, this book has introduced numerous tips and advice to help you manage and even excel in your trades. It has also provided tips on how to be profitable when trading ETFs, binary options, futures, and Forex options.

The examples included in the book provide a practical way of applying the techniques. Take your time to examine the examples as well as the images provided in order to be successful. If you follow these techniques and tips, then within a couple of months of active trading, you should become a professional and skilled trader earning large amounts from your trade.

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