Our 3 Favorite Expert Strategies on Making a Paycheck from the Options Market
Is it really possible to retire in five years or less on $13,000 per month, tax-free? At Cashflow Heaven, that’s exactly what we teach. What we do is teach people how to safely and effectively generate cash flow from the stock market, tax-free. Once you learn how to do that, you can literally create an income—and perhaps even financial independence—from anywhere in the world you can find an Internet connection.

It is important to realize that as appealing as that sounds, you are going to need a really good plan to make it happen. The strategy needs to be safe and it needs to work consistently. The truth is, $13,000 per month is a pretty tall order. So how do we do that?

Well, it’s an especially daunting task if you try and generate that income the way most people do it—the traditional way. If you’ve met with a professional financial advisor, you know that can be a pretty sobering experience. For example if you want to generate $13,000 per month it comes to $156,000 per year ($13,000 per month x 12 months).

**Conventional Investing for Retirement Requires a Lot of Money—Maybe Too Much Money**

At conventional interest rates, you are going to need a lot of money working for you to generate that level of income—maybe more than you have. For example, the interest rate on the 10-year Treasury bond is hovering around 2%--and the dividend yield on the S&P 500 is also around 2%.

So at an annual rate of return of 2% you are going to need $7,800,000 to generate $156,000 per year. That’s a huge amount of money. If you’ve got that kind of money, congratulations. However you don’t have to be good at demographics or statistics to know that most of us don’t. If you’re dealing with somewhat less than that, you need a good plan.
Maybe you’re a little bit better at getting returns. Maybe you’re a good investor—maybe you’ve invested in some higher-paying dividend stocks, and you can generate 5% per year. Even at 5%, you’re going to need over $3 million to generate $156,000. As you can see, at today’s returns and today’s interest rates, you need a tremendous amount of money to create a really good income.

You don’t necessarily need to get hung up on the $13,000 per month figure. Maybe you don’t need that much money, maybe you need a lot less. We’re just using that as an example because that’s an amount most people can live on pretty comfortably (if you keep your trips to Starbucks to a minimum!).

TO RETIRE IN STYLE, WE NEED SUBSTANTIALLY BETTER RETURNS

To reach our goal, we need to get substantially better returns than what the conventional strategies offer. Most people have mutual funds along with some dividend stocks, but are dissatisfied with their returns and want to do better.

You may be an individual who’s really investigated trading and perhaps you’re doing a lot of trading right now. Some people are even day trading. The problem with that is you can get mixed results. Many active traders I’ve spoken with go one step forward and two steps backward. You can have losses, and it can be pretty stressful. Sometimes the market throws some pretty frustrating curve balls.

So even if you are an active trader and enjoy it, take a look at this method because it’s a way to generate some good monthly income that tends to grow faster than any other strategy out there—and you don’t have to worry so much. If you’re an active trader, that alone is going to be a refreshing change. In the world of investments, however, there’s always uncertainty, and if you’ve been out there, you know that. We need as much going for us as possible, and this plan has a mathematical probability of success that is greater than 80%.

The trick with any investing is to try and get the greatest amount of return possible for the lowest amount of risk. And that’s what this program is focused on—high probability and high returns. Most investment advisors tell you that’s impossible—to get high returns you must take on higher risk—but that’s not true if you have a mathematical edge.
To Make Far Better Returns Safely—Get a Nobel-Prize-Winning Formula Working for You

How do we do that? How do we engineer high returns and a high probability of winning? We’re basing our expectations on a formula that is so remarkable it won the Nobel Prize back in 1997 for the mathematicians that discovered it.

The formula was actually developed back in the early 70s, and it made standardized options and the modern options market possible back in 1973. That formula is called the Black-Scholes Options Pricing Model—and here’s what it looks like:

\[
\text{Black & Scholes model: } \\
\frac{dS_t}{S_t} = r dt + \sigma dW_t \\
\text{We deduce from the model the price of a call option: } \\
C(S_0, \text{strike}, r, T, \sigma) = S_0 N(d_1) - e^{r(T-t)} N(d_2) \text{strike} \\
\text{and the price of a put option: } \\
P(S_0, \text{strike}, r, T, \sigma) = -S_0 N(-d_1) + e^{r(T-t)} N(-d_2) \text{strike} \\
\text{where: } \\
d_1 = \frac{1}{\sigma \sqrt{T-t}} \left[ \ln \left( \frac{S_t}{\text{strike}} \right) + \left( r + \frac{\sigma^2}{2} \right) (T-t) \right] \text{ and } d_2 = d_1 - \sigma \sqrt{T-t} \\
N(\cdot): \text{the cumulative distribution function of the standard normal distribution}
\]

Now, if you are thinking that looks really complicated and wondering how are you going to figure it out, well, don’t worry—you don’t have to. The metaphor I like to use is that you don’t need to know all the complex workings of the internal combustion engine to drive your car to the bank—and it’s the same idea here. You just need to know enough to take advantage of it.

We’re going to use this formula to stack the odds in our favor, and to set up a mathematical expectation of winning the majority of the time. The key to using this formula to our advantage is to be selling options instead of buying them.

This gets into a really interesting area of psychology. Most options traders are buying options. The reason is they are looking for a home run—they want to double or triple their money in a very short amount of time. And the truth is, if you buy options, you will get some big winners.
But there’s a problem with that approach. If you talk to a lot of options traders, they’ll typically tell you things were going really good for a while, and then all of a sudden they blew up their account. They lost all their money.

A funny thing happens in the stock market: sometimes the things that you think are going to happen don’t. You get surprises. The market turns around. It reverses. The Fed makes a certain announcement. The company that you’re betting on comes out with a warning, or whatever. Whatever you thought was going to happen didn’t—and that’s what makes options buyers go broke.

**HOW TO JUMP ON THE RIGHT SIDE OF OPTIONS TRADING**

When you become an option seller you are on the opposite side of that trade, so the odds jump considerably in your favor. A lot of surprises can happen and you can still make money. That’s what I love about selling options. I’ve been an options trader for a long time now and I still occasionally buy an option when there’s a really good setup—but the vast majority of the time I’m selling options because it’s so forgiving.

When we talk about selling options, we’re not talking about covered calls or selling naked. The strategy I’m talking about is selling **credit spreads**. When you sell a credit spread, you immediately take in money, and it’s pretty inspiring to see that cash hit your account right off the bat.

**WHAT IS A CREDIT SPREAD?**

A credit spread is simply selling an option and then buying another option to hedge. The option we’re selling is more valuable than the one we’re buying so it creates a credit in our account. A credit, if you don’t know, is money that you can use for anything you want—to buy the things you need, or to build up in your account, or to reinvest for even great profits.
SO HOW DO WE SELL A CREDIT SPREAD FOR IMMEDIATE CASH?

Let’s take a look. In the chart below you can see the stock going up and down, but it’s in a general uptrend. What we want to do is sell an option strike that’s likely never going to get touched by the stock.

The stock is up at 107 and we’re going to sell a put option down at 99 and we’re also going to buy another option as a hedge below it at 98. That limits our risk to just the distance between them, and in this case, that’s just a dollar.

We’re selling the 99 puts for 30 cents and buying the 98 puts for 23 cents and as you can see, there’s a finish line on October 28. So in this case we’ve got about three weeks until expiration. One of the beauties of this strategy is you always know where your finish line is. At some point, in the not too distant future, these options are going to cease to exist. And if that time comes and the stock isn’t below 99—then both options expire worthless. And if you sell these spreads correctly, that’s exactly what happens the vast majority of the time.

If you ask speculative options buyers how they lost money, they’ll almost always tell you their option ran out of time before the stock could move in their direction. When that happens, the options seller is the one who makes the money. That’s who wins the majority of the time, and that’s who we want to be.
SO WHAT CAN YOU MAKE ON THIS TRADE?

If we sell the 99 puts for .30 and buy the 98 puts for .23 we collect a net of .07 cents on that trade—
or $700 for 100 contracts. To figure out our rate of return, we divide that .07 credit by our possible
loss. The maximum that you can lose is the distance between the strikes, in this case, that’s $1 but
we’ve already taken in seven cents so the maximum we can lose is 93 cents. If we divide seven
cents by 93 cents, it comes to a 7.5% return before commissions. For three weeks of time, that’s
2-1/2% per week. If you get out your calculator and figure out what 2 ½% per week adds up to over
time, you could become extremely rich trading this strategy.

These returns can pile up on themselves pretty quickly. It’s like the old compounding illustration with
the chessboard where you take a penny and put it on square one and you go to the next square
and double it and go to the next square then double that, and then keep doing that for the rest of
the squares on the board.

That’s the way these compounding returns work—you make money on the money you just made.
We get some pretty decent returns, so keep in mind, people are hoping to make 2% or 3% on their
money for a year with bonds and regular dividend stocks. We’re talking about making 7.5% in just
three weeks!

THESE RETURNS CAN GET PRETTY EXCITING—but it gets even better...

You can also go above the stock and do the same thing with a call spread and take in another 7.5%.
Now we’re up to 15% for that same three weeks of time. We’ve got lots of room for the stock to
move, but not a lot of time to do it, so you tend to win on these trades the majority of the time.

If you have a stock that’s going up, you want to sell put spreads. If you have a stock that’s going
down, you want to sell call spreads. But oftentimes the stock is moving up and down within a range
so we can sell both spreads, collect a double return, and have that stock stay within the range we’ve
defined with both expiring worthless.

When we sell both call spreads and put spreads on the same stock, they are called ‘wings,’ and the
whole trade is called an Iron Condor.
You can see how forgiving these trades are because we’re staying away from the stock price and giving the stock room to move. The stock can go up a little bit, it can go down a little bit, it can waver all around and you still end up winning.

**That Sounds Good, but How Do You Know What Your Chances of Winning Are?**

You can look at the above trade and think the chances of winning are pretty good—but how do you know? Well, one of the neat things about options is that they are based on a mathematical formula. So whenever we want to sell an option, we can instantly see what the odds are that will expire worthless. That’s one of the really cool advantages of this strategy—I don’t know anywhere else you can do that.

Our favorite broker for this strategy is Thinkorswim, because they have such good analytical tools, and such a great trading platform. Fortunately, with a little guidance, their platform is not hard to use—in fact, I’ll show you a little bit of it right here:

This is the trading platform at Thinkorswim, and if you look at the column on the far right, you’ll see a heading that says ‘Prob OTM’—that means ‘Probability of being Out of the Money’. In other words, it tells you the exact mathematical probability of this trade winning—because if the sold strike expires out of the money, the options seller wins.

One of the red arrows on the platform above points to the 98 strike price and the other points to the 99 strike price. We want to focus on the 99 strike price because that’s the one we sold. If we follow
the red arrow all the way over to the far right column, we'll see that the probability of this strike expiring out-of-the-money is 88.96%—so those are our odds of winning—which is pretty high.

It's interesting that these probabilities actually do tend to play out over the long run, which makes your odds of winning close to nine out of 10 trades. Which is fantastic, but even on the trades that become threatened, there are things we can do to fix them when they do go against us.

**TRADE WITH CONFIDENCE KNOWING YOU CAN FIX Trades THAT AREN’T WORKING OUT**

We call these little fixes “adjustments” and they give you a second chance to win if the trade doesn’t work out the first time. Everybody’s always very interested in adjustments because they give you a kind of “get out of jail free card” where you can fix those one out of 10 or two out of 10 trades that aren’t working out.

Knowing how to adjust gives you a lot of confidence, which is important if you are trying to use this strategy to retire.

I know it sounds crazy, but sometimes I welcome a trade that needs to be adjusted because it says 2 things:

Number 1, we’re selling close enough to the underlying to have to adjust once in a while. “Selling close” means we’re bringing in more money. In other words, we’re right at that edge where we’re bringing in the maximum amount of dollars and still trying to minimize our risk. When you do that, when you sell a little closer to the underlying, once in a while you’re going to have to adjust, but that’s okay because we have some great ways of doing that.

Number 2, we have the means to adjust our way out of almost any situation. That makes you feel pretty darn confident in trading this way. Now I just want to be clear upfront, it is possible to lose trading credit spreads. The market can do crazy things, so it’s good to know that even in a worst-case scenario, the amount you can lose is absolutely limited—that’s why we buy that hedge option to limit our risk. But in any normal market situation, even if your spread is over-run, we’ve got ways to adjust out of it to make the trade better.
So the vast majority of the time, you can expect to win using this strategy, but it’s important to understand there is risk in trading—but we’re going to be stacking the odds in your favor as far as we possibly can.

**Sounds Good. But is Anyone Actually Doing This Successfully in the Real World?**

Yes, lots of people are quietly cash flowing the markets using this strategy with great success. But nobody talks about it because everyone wants to sell you on the idea of making lottery-size profits buying options. But once you figure out what’s really going on, you’ll realize the real money is being made by the lottery ticket *sellers*.

We’ve been showing people how to sell credit spreads successfully since 2010, and we’ve got a lot of people that are real believers—they tell us with great conviction they wouldn’t trade any other way.

I want to share an email I got from one of our subscribers. I just absolutely love this guy’s attitude—his name is Bob Milota. He’s the kind of guy that really gets the strategy. He’s a retired engineer so he understands numbers and probabilities—Bob is a smart guy.

After doing lots of different kinds of trading, he decided that this is all he wants to do now. This is what Bob says: “As promised, here are my trading results for the year. I very nearly had an undefeated season in my high probability credit spread trading this year. Unfortunately, I suffered my first loss for the year a week ago. My record so far for the year is, 13 put ratio spreads, all done for a credit. eight iron condors, two of which consisted of three credit spreads because I closed the winning-est side and rolled in. Plus five single credit spreads, one of which is the above-mentioned loss. That amounts to 25 wins and one loss, which is a 96% success rate.” He goes on to say, “I made a total of $19,126 making $1,594 per month and averaging a return of 9.5% per month, including all commissions and losses.”

That’s pretty wonderful for Bob and those like him. I know people that are taking second jobs to make an extra $500 a month—but Bob, with a few mouse clicks, is making far more. Plus he says it’s kind of fun (and I agree). He says it keeps him sharp and it keeps him interested. He’s making about $1,600 per month and that amount is constantly increasing, and we’ve got people that are doing a lot better than that.
So the returns are there and your probability of winning is high—but can we do even better?

**Building Up Your Account Quickly and Consistently is a Big Benefit—but Can We Do It Tax Free?**

There is a special account where we can trade these credit spreads so that they can build to infinity without having to pay ANY tax on the profits…Ever!

This special account is called a Roth IRA.

This kind of an IRA has some special advantages that make it perfect for trading high-probability credit spreads. Here the characteristics of a Roth:

- Contributions are not tax deductible—however…
- You can contribute up to $5500 per year under age 50, and $6500 over age 50.
- Direct contributions to a Roth IRA may be withdrawn tax free at any time.
- Earnings may be withdrawn tax free and penalty free after age 59-½.
- Distributions from a Roth IRA do not increase your Adjusted Gross Income, so these earnings do not increase your tax bracket on your other income.
- The Roth IRA does not require distributions based on age. All other tax-deferred retirement plans require withdrawals by 70½.
- Unlike distributions from a regular IRA, qualified Roth distributions do not affect the calculation of taxable social security benefits.
- Assets in a Roth IRA can be passed on to heirs.
- Single filers can make up to $110,000 to qualify for a full contribution and can make $110,000 to $125,000 to be eligible for a partial contribution.
- Joint filers can make up to $173,000 to qualify for a full contribution and $173,000–$183,000 to be eligible for a partial contribution.
As you probably noted from the list above, the most compelling characteristic of a Roth is that you can build up any amount of wealth in the account you want. And as long the distributions are taken after the age of 59-½, the money you take out is Completely Tax Free.

Combine that huge advantage with a strategy that consistently makes money, and you’ve got a blueprint to create a comfortable retirement no matter where you are starting from now.

So Your Odds of Winning are Excellent—and Now You Have a Way to Build Up Those Profits Tax Free—but How Much Can We Expect to Make?

We typically shoot for 15% to 25% returns for just two weeks of time. But it’s important to realize you want to hold back about a third of your account in cash for buy-backs and adjustments, so you’re not getting those returns on the whole account. Plus, in spite of our best efforts there will be losing trades—that’s how trading works, so we have to factor those in.

Trading this strategy with our probability of winning typically returns about 10% every two weeks. Now if you are a speculative trader, that might not sound like much—but it is when you consider your win ratio. If you are consistently making that kind of money every two weeks, you are going to be very wealthy within just a few years.

But let’s say you’re a little skeptical about those returns. Let’s say that in the real world something always happens, and our theoretical rate of return doesn’t quite materialize.

Let’s say that all you can generate is just 5% per month—not 10% every two weeks, but just 5% per month—that’s about a quarter of what we can mathematically expect even factoring in losses and holding a portion of the account in cash.

If the maximum we can put into a Roth is $6,500 per year—and we faithfully put that in every year—what does your account turn into at “just” 5% per month? Here’s what your account looks like if you invest $6,500 per year and get 5% per month over a five-year period:
As you can see from the chart above, by year two you are making approximately what Bob is making now—but by year five you are making an inspiring $12,965 per month—and the very next month that grows to $13,613 and the income grows even more steeply after that.

And your account itself has grown to over a quarter of a million dollars! At that point, you can start living off some of your profits and still see your account grow. And the inspiring thing is all it took was an investment of $6,500 per year—an amount most people can save or already have.

Which means you aren’t more than five years away from a comfortable retirement—all you need is a little know-how to make it work!

Learn More about Peter Shultz and his Strategies: Visit the Website Here:

http://www.cashflowheavenpublishing.com/
The Strategy for a Scheduled Options Payday Each Quarter

By Chris Irvin, MarketTrader.com

Four times each year, stock and equity options traders’ ears perk up. Like clockwork, their gears start to turn and they type away at the keyboard, looking for the earnings season schedule of big-name companies like Google, Apple, Netflix, Tesla… The list goes on. It’s like an appointment for profits.

Each earnings season, the stock market sees a spike in volatility, in profit potential, for traders with a weather eye on the horizon. As stock traders take to the charts, equity options traders do the same, looking to take advantage of stock movements for pennies on the dollar and get a little piece of the pie.

What if you could do the same?

What if each quarter, you set aside a handful of hours to execute a few options trades where you could potentially profit 25-30% overnight?

It happens, and more frequently than you might think. I’ve been trading for more than 15 years and I’ve not only seen it happen through my students’ successes at Market Traders Institute, I’ve watched it happen in my own account too. The beauty of it is that no matter what time of year it is, you could be preparing for earnings season.

This is the precise strategy that I use each and every quarter…

What is the Earnings Season?

Earnings Season: The time around the beginning of each financial quarter when publicly-traded companies release earnings reports for the previous quarter.
THE CATCH

Despite what some traders will tell you, as an equity options trader, the actual earnings number is not the issue. I really don’t even care if the company makes money or loses money. What counts is how investors react to the news.

What is the important part? The knee-jerk reaction of investors.

Because investors assign a positive or negative emotion to those numbers, the stock can jump, or dump. These moves can make for great opportunity if you know how to play the move.

I focus on the reaction that the stock’s price has to the earnings number.

That’s what will drive the intrinsic value in my options, and therefore the profitability in the trade. The intrinsic value of an option is the component of the options price that is DIRECTLY affected by the movement of the underlying stock. If the stock goes up $1.00, the intrinsic value goes up $1.00. That is why we need the stock price to move big. In order for a straddle to work, intrinsic value needs to take off.

The other day, Netflix (NFLX) had its earnings announcement. The company made $0.06 per share, but the bigger story to me was that the $100.00 stock moved approximately $17.00 the next day. That is the type of move that we are after. The total cost of the straddle in this situation was on $12.80 per share. Since the underlying stock moved $17.00, the intrinsic value boosted the trade to a profit. Like I said, I don’t care about the $0.06. I care about the $17.00 and what that move will do for my options.

One of the great things about a straddle trade is that I really did not even care if the stock moved up $17.00 or down $17.00. I would profit either way. That is correct – I do not have to choose a direction. It’s just one more way that this strategy takes the stress out of your trades.
THE 4-STEP EARNINGS SEASON PROFIT PLAN

THE STRADDLE TRADING STRATEGY

An options straddle blows some traders’ minds. You don’t pick the stock’s direction. Truly, your only concern is that the stock moves. Period.

Not a bad strategy, right?

Volatility: The amount of market action. Also known as “the spread” in the market’s waves or the price fluctuations a stock experiences.

Typically, if you’re buying a call option, you’re looking for the stock price to go up.

If you buy a put option, you are looking for the stock’s price to move down.

In an options straddle, you buy a call and buy a put simultaneously.

When you place these orders, you just want the stock to react to the earnings announcement. The bigger the reaction the better. Positive or negative does not matter, we just want it to move dramatically.

Options Straddle: When you buy a call option and buy a put option at the same time, you straddle the market price so that no matter which direction the stock moves, you could profit.

Why Trade In Both Directions?

So you might be thinking, if I’m trading in both directions, won’t the trades cancel one another out? Or worse, won’t that mean that the market will inevitably go against me?

Yes and no.

When the market moves big in one direction, one of your options, either the call or the put, will increase in value. The other decreases in value. You will be losing money in that negative trade, but the objective is to have the winning trade outweigh your losing side. This is where you start to see profit. The profit of the winning trade should be much larger than the loss in the losing position.
As a matter of fact, your loser may get crushed into oblivion. The good news is that when you buy options, your risk is limited to the cost of the option, and your reward is unlimited. So if your winner increases by more than the cost of the total loser, we have a winning straddle.

**HOW IT WORKS**

The key is buying equal numbers of “at the money” calls and puts prior to the announcement. This is why having the announcement release date on your calendar is so critical. When you buy an equal number of at-the-money calls to puts, you are creating a “delta neutral” strategy. At-the-money call options will have deltas of .50, and At-the-money put options will have deltas of -.50. When these deltas are added together, we end up with a delta of “0,” or delta neutral.

Delta: Stemming from the Greek word diaphora, which means “difference.” This number tells you how much you will profit based on a $1.00 move of the stock, e.g., if a trader buys an option with a 0.75 delta, and the underlying stock moves $1.00, the option will increase in value by $0.75.

Delta Neutral: Puts always have a delta from -1 to 0 and calls from 0 to 1, so when you buy a put with a delta of -0.5 put and a call 0.5 delta, your deltas will cancel each other out and you will be left with a delta neutral position.

You are dealing with two deltas in this case.

Let’s say that we get into a straddle trade where the call option has a delta of 0.50 and the put option has a delta of -0.50. The earnings are released and the stock gaps up in the pre-market. This causes the call options to increase in value, and along the way the delta is ratcheting up, 0.50, to 0.55, to 0.60, to 0.65 eventually moving up to 0.85. This means that my call option is now making me $0.85 every time the stock move up $1.00. That is great!

But what about the put positions? The put delta will start moving in the opposite direction; -0.50, to -0.45, to -0.40, eventually falling to -0.20. The put, being on the losing side of the trade, is actually losing money slower. In this case, at this level, the put option is losing $0.20 for every $1.00 the underlying stock price moves up. Here is the great thing about the current state of our hypothetical trade. We are making $0.80, with our Call option, for every $1.00 move of the underlying stock,
while we are losing $0.20 for the same move with the put. The net result is a $0.60 profit. That is why straddles work!

**PRO TIP:** The Ultimate Stock and Options Course teaches to buy options with deltas between 0.5 and -0.50 for straddle trades during earnings season. (The trade is not a straddle if you use options with deltas other than 0.50 and -0.50.)

**WHEN TO STRADDLE THE MARKET**

It’s simple really. The straddle strategy allows a trader to take advantage of a known event that has a high probability of causing the stock to move 10% to 15%, regardless of direction. This is why it’s a perfect strategy to master when trading earnings announcements.

**THE KEY TO THE STRADDLE**

Understand this: a straddle is not an ideal strategy for every stock at earnings. The reason is that not every stock has the potential for the required move it will take to put the trade into a profitable position. For this reason, you will need to do your homework before placing a straddle.

Now, let’s explain the top five ways to judge whether or not a particular trading opportunity is a good pick for an earnings season straddle trade.

**5 STEPS TO SUCCESSFUL OPTIONS STRADDLING**

**STEP 1: STALK YOUR PREY**

First and foremost, you’ll need potential stock shares that you’ll want to monitor. All of the following steps require that you have particular companies in mind, access to their current share prices and, preferably, have an idea of when their earnings reports will be released for the coming quarter.
Our 3 Favorite Expert Strategies on Making a Paycheck from the Options Market

Step 2: Look to the Past to Profit in the Future

Now that you have several stocks in mind, you’ll want to look back on the historical data for the stocks in question, be it Apple, Google, Netflix, Tesla, whichever stock you’re looking to profit from.

To do this, you want to look back on the stock charts and identify the four most recent earnings report releases dates. Once you have found them, check out the price fluctuations in that company’s stock price following each announcement.

You’ll want to answer three questions:

1. What was the closing price prior to the announcement’s release?
2. What was the opening price the day after the announcement’s release?
3. What was the peak or valley before turn price – after the announcement’s release?

Peak or Valley Before Turn Price: The price the stock hits, before its first reversal, after the report’s release.

The measurements from close to open, and close to peak/valley can give you an indication as to whether the stock has moved substantially in the past at earnings announcements. If the cost of the straddle is less than the historical movement at earnings releases, you may have a potential straddle candidate.

Example:

Let’s take a look at an older example of this for the sake of clarity.

Below are four consecutive earnings report numbers for Netflix (remember that you’ll always want to pull the four MOST RECENT earnings numbers for judging your potential straddle trade):

Earnings Report from 1/20/15

Pre Earnings Close - $349.40
Post Earnings Open - $414.68 ($65.28 move or 18%)
Post Earnings Peak - $457.38 ($108.28 move or 30%)
Earnings Report from 10/15/14

Pre Earnings Close - $448.59
Post Earnings Open - $332.73 ($115.86 move or 25%)
Post Earnings Low - $331.00 ($117.59 move or 26.2%) – immediate bounce

Earnings Report from 7/21/14

Pre Earnings Close - $452.00
Post Earnings Open - $442.98 ($9.02 move or 1.9%)
Post Earnings Low - $412.51 ($39.48 move or 8.7%)

Earnings Report from 4/21/14

Pre Earnings Close - $348.49
Post Earnings Open - $376.63 ($28.14 move or 8%)
Post Earnings Peak - $380.88 ($32.39 move or 9.2%) – immediate drop

In these examples, you can see that the two most recent earnings releases caused the stock’s price to move between 18% and 30%. If we were looking at a straddle that hypothetically cost 15% of the current cost of the stock’s price, the trade would have potential.

WHAT’S THE MAGIC NUMBER?

Unfortunately, there is no magic number and there’s no holy grail. In the past, I have looked for stock price fluctuations between 12-15% minimum. That often creates enough movement to produce a profitable trade in a straddle situation. The only way to truly make a sound judgement is to determine the current price of the straddle and compare that price against the average price movement over the past four earnings releases. If the cost of the straddle is greater than the average move, the trade probably will not work. If the average move is greater than the cost of the straddle, the trade has a good chance of working.
**STEP 3: LET THE BIG DOGS WEIGH IN**

Now, this is a dangerous one if you’re not careful. While we want to consider what key analysts are projecting, we don’t want to trade the news, we want to trade the moves. At the same time, once you have your stock picked out in Step 1, it’s good to check in on the analysts’ insights.

You want to focus in on the highest analyst price target. When the cost of the straddle is added to the current value of the stock, you arrive at a number that is less than the analyst target, indicating that your straddle has the potential of working out.

**PRO TIP:** Don’t pay attention to the earnings estimates. Instead, look to see where the analysts have set their highest price targets for the stock. This is what they think that the stock is worth. Traders like to drive prices up to the analyst targets and stop, so if the straddle profit target is lower than the analyst price target, the straddle should be in good shape.

**STEP 4: DON’T FORGET THE FIBS**

The Fibonacci sequence is an old mathematical golden ratio you probably learned in some middle school or high school math class and quickly forgot about it, dismissing it as something you couldn’t possibly, ever in a trillion years use… That is, until you began to trade the markets.

The next step (the decision-making process) for your trade is to draw out the Fibonaccis.

In this instance, you want another point of confirmation. You’re looking to be able to say that the stock has the potential to make the range of movement you’re after within the current extension or retracement. If it is not, then your technicals do not match up with what you require to be profitable in your trade. While this may not be a 100%, sure-fire way to decide whether or not to avoid the trade, it is a critical component many traders take into consideration in passing up a trade.

See what the Fibs look like on the charts:
STEP 5: GIVE THE VOLATILITY CHARTS A VOTE

Have you ever seen a volatility chart? These charts help options traders determine whether an option is overpriced or underpriced. This is a wonderful gauge for seeing if the options are priced at a level that is just too expensive to place the straddle.

The chart is very visual, and simple to read. The chart will have two lines. One shows the historic volatility and the other represents the implied volatility. If the implied volatility line is higher than the historic volatility line, the options are thought to be expensive. If, on the other hand, historic volatility is higher than implied volatility, the options are thought to be inexpensive.

What we really want to see is just how expensive our options are. What you’re looking for is the skew between the historic and implied volatility. The closer these two numbers are together, the smaller the skew. The smaller the skew, the less expensive the options and the better your chances will be of covering the cost of the straddle. The wider the skew, the more expensive the trade becomes and your chances of covering the straddle cost goes down.

**Skew:** A fancy math term for the difference or distance between two numbers.

**Historic Volatility:** Gauge of how much the stock’s price has flopped around and moved based upon past data.
**Implied Volatility**: Representation of the average analyst sentiment as to what they believed the volatility will be in the future. (This directly ties into Step 2!)

**CONCLUSION**

Earnings season trading is as close to appointment-style trading as you can get. With just one strategy, the options straddle strategy, you could have a payday scheduled for every quarter.

Do you want to get more hands on experience with this strategy?

**Learn More about MTI: Visit our Website Here:** [http://www.marketraders.com/](http://www.marketraders.com/)
An option is a contract between the buyer and the seller. There are two types of options: calls and puts.

Calls give the buyer the right, but not the obligation, to buy a specified stock or financial instrument (the “underlying”) at a specified price (the “strike price”) on or before a specific date (“expiration”). The buyer has the right to buy the underlying at the strike price, and the seller has the obligation, but not the right, to sell the underlying should these conditions be met.

Puts give the buyer the right, but not the obligation, to sell the underlying at the strike price on or before expiration. Put buyers have the right, but not the obligation, to sell the underlying stock (or other instrument) at the strike price on or prior to expiration. Alternatively, put sellers are obligated to buy the underlying at the strike price should a buyer choose to exercise these rights.

So what factors determine how these options are priced? Six factors, or price inputs, determine an option “premium:”

1. The stock price
2. The strike price of the options
3. The time remaining until expiration
4. Dividends
5. Interest rates
6. Implied volatility.
In general, the more a given stock fluctuates in price on a daily or weekly basis, the more expensive its options will be, and vice versa. Options usually tend to be more expensive prior to earnings reports and other major announcements but decrease in price sharply after the announcement, once the “uncertainty” has been removed. A good example of this is biotech stocks and drug announcements.

Options are traded for one of two reasons: as speculation, or to hedge against a stock position.

Options are bought as a speculation that a stock will move in a certain direction. Calls may be purchased because a trader believes the stock will move higher prior to expiration. Alternatively, puts may be purchased because a trader believes the stock will move lower prior to expiration.

The terms “in-the-money,” “at-the-money,” and “out-of-the-money” are used to describe the relationship of an option’s strike price to the price of the underlying stock. A call is in-the-money when the stock price is above the strike price. Alternatively, a call is out-of-the-money when the stock price is below the strike price. As you might guess, if a call is at-the-money, its strike price is equal to the stock price.

The inverse is true when looking at puts: if the strike price is above the stock price, a put is considered to be in-the-money. A put is out-of-the-money if the strike price is below the stock price, while the at-the-money definition is the same as for calls.

Options are also purchased to hedge against stock positions. Each day, I watch over 2,000 trades in real-time as they hit the tape. I always try to determine, are these orders a hedge against a stock position, or a speculative play? In the eleven years I spent trading on the floor, I learned how to “Read the Tape.”

Most certainly a combination of art and science, it is a skill I’ve honed over the years. A large part of my trading strategy is based on my ability to do this. By watching for big block option orders, dubbed “unusual options activity,” I try to determine the positions of Paper. “Paper” is term originating from the trading floor, when orders were actually written on paper and run to traders in the pit by clerks. It is used to describe large institutions such as hedge funds, mutual funds, or large banks. In other words, institutions who have access to better information – even “insider” information – than your average trader or investor.
When trading off of unusual option activity, I only want to take trades based on orders I believe to be speculative plays. Given the sensitive, and even illegal, natures of their positions, hedge funds tend to be a secretive bunch. Thus determining if these trades are speculative or a hedge is like piecing together a puzzle.

Let’s put it another way: what if you could have taken the same trades as Raj Rajatnam, or SAC Capital’s Steve Cohen, the moment they were put on? I’d go to jail for insider trading, you might say? Not so fast.

The moment an order hits the tape, it becomes public information. I can trade off it, based on the fact that I believe someone placing such a large bet has access to insider information, and it is completely, 100% legal. This isn’t a matter of debate, or speculation, ask any SEC lawyer you know. This is why I trade unusual options activity. And this is why it works.

THE UNUSUAL OPTIONS ACTIVITY TRADING PLAN

There is no secret to becoming a profitable trader, and you should be skeptical of anyone who tells you otherwise. That being said, the techniques I’ve outlined in this text served me very well in my trading career and without them I would not have made the money I did.

Reading order flow and watching unusual options activity continues to be one of my most profitable techniques, just like it was on the trading floor. I had two very profitable years in Apple stock when my net profits in AAPL were over a million dollars. Once a week for a year, a Merrill Lynch broker would walk into the pit and sell AAPL put spreads. His acronym was “HES,” and whenever I would see him coming, I would know to get long and sell volatility. How did he know? No clue, but by watching him I made quite a few profitable trades.

By combining order flow with technical indicators like the Ichimoku cloud, I devised my OCRRBTT trading plan to trade profitably off of the floor.
THE OCRRBTT TRADING PLAN

Pronounced “Oak Ribbit,” this trading plan will give you a step-by-step method for breaking down unusual option activity. After evaluating unusual trades with this plan, you will be able to decide if you want to follow it or ignore the trade altogether. The letters in the acronym stand for:

- Open interest
- Chart
- Risk
- Reward
- Breakeven
- Time
- Target.

Here you will see the importance of each of these elements in the plan.

**Open interest:** The first thing you need to look at is if the trade volume is bigger than the current open interest in that line. If it is, this means that this is an opening position and is worth taking a look at. You don’t want to buy an option on unusual activity if it is really just paper covering a short. Only consider trades where volume is greater than open interest.

**Chart:** This is the second most important element of the plan. Once an unusual order is confirmed to be an opening order you must then look at the chart of the underlying stock. You need to ask questions. Is the stock in a strong bullish or bearish trend? Is there support or resistance at the strikes the institution is trading? Is it more likely they are speculating on more upside or downside or could they be hedging? The answers to these questions will help you determine if the trade is speculation or a hedge. This will keep you from trading against the institution when you actually want to trade with them.

**Risk, Reward, and Breakeven:** Once the direction of the trade is determined, you have to evaluate if the risk vs. reward profile of the trade the institution executed is in line with your risk tolerances.
Some trades they take could be far too risky for the average retail trader. However, since you know the direction the institution is betting, you can tailor a trade that has the right risk setup for you. The risk of each trade must also be measured against the potential reward. If the institution is risking $5 to make $1, this is a trade you would want to avoid. You should also always be aware of the breakeven of each trade. If there is significant support or resistance at the breakeven point, you may want to consider another strategy.

**Time and target:** Always be aware of potential catalyst events that might be near. You want to know if paper is playing the overall direction of the stock or if they are playing a near-term catalyst event like earnings, drug announcements, or new product launches. This might factor into your decision to take the trade or not. Once you have your time horizon set, you want to pick a profit target. Are you leaving this trade on to expiration? Taking off half at a double and letting the rest ride? Knowing the answers to these questions at the onset of the trade make it easier to manage going forward.

**PUTTING THE PLAN TO WORK**

Once a trade hits the tap, a trader must use the OCRRBTT trading plan to analyze the setup and determine if it represents an actionable trading opportunity. Let’s look at the example below and determine if it is a trade setup that we actually want to take. This order hit the tape on June 16th 2015.
Before running this trade through the plan, we need to understand the information we have.

We are able to get a lot of information from order flow. We can see how many contracts this trader bought, that it was a $540,000 bet and that the trader that bought these options paid through the market maker's offer to get filled. Although all of these things make this trade interesting, they still do not necessarily qualify it as an actionable setup.

To make this determination, we must evaluate this trade using the OCRRBTT trading plan.

**Open Interest:** Was this an opening position? This trade is labeled opening, so there is no doubt it was an opening position. If for some reason the trade was not labeled opening, we would still be able to confirm that it is because the volume of 5,000 contracts is greater than the current open interest in the line of only 796 contracts. With open interest smaller than volume, there are not enough open contracts in the line for this to be a closing trade. It is confirmed opening.

**Chart:** Does the chart indicate this trade is more likely to be a hedge or a speculative bet? We need to confirm that the underlying trend of the stock supports this as a speculative bet. If it does not, the trade may be a hedge, and it is less likely to be actionable. To do this, we will use an indicator called the Ichimoku Cloud. It may look intimidating, but for this purpose a trader only needs to know that anything trading above the shaded area on the chart is in firm bullish territory and anything below it is in bearish territory.

Here is the chart of CAG on the Ichimoku Cloud the day these calls hit the tape:
We can see that the stock is trading above the Ichimoku Cloud and is in an established bullish trend. This does not confirm with 100% certainty that this order was indeed a speculative bet, but it makes it far more likely that this is the case. With the trend supporting the idea of this trade as a speculative bet, we will move on to the next part of the analysis.

**Risk and Reward:** Does the potential reward justify the risk? This is a very large trade in what is generally a boring stock. ConAgra (CAG) doesn't usually get much unusual activity, so if the risk and reward setup makes sense, it might be a trade that we want to take. This is an outright call buy, and a trader knows that they can never lose more than $1.08 in this trade. This translates to $108 in risk per one lot with what is a technically unlimited upside reward potential. This sets up for a good reward-to-risk setup, and a trader can take this trade.

**Breakeven:** Where is the breakeven point in this setup? These options are just out of the money and are being bought for $1.08. At that strike price, this trade’s upside breakeven is $40.08, or about 4.6% higher than the stock’s price at the time of the trade. This is only a 4.6% move to the upside. That is not an unreasonable move. With that in mind the setup becomes even more attractive.

**Time and Target:** What is the trader expecting? In this trade, they are looking for a move to the upside of at least 4.6% by July expiration. Since the trader bought the July 39 calls, we will buy the same ones. A trader should never trade a different expiration or price target than the institutional trader. Remember, they have better information than us.
Everything about this trade sets up well. All of the evaluations in the OCRRBTT trading plan point to this being an actionable trade setup.

THE RESULT

This trade ended up being a fantastic winner. The trader’s motivations behind this trade become much more clear three days later when news breaks of activist activity in CAG.

Look at how the stock responded to the news:

![Chart showing stock price movement](image)

The stock gapped to the upside and these options exploded in value. Anyone looking at the reaction in the stock might be surprised by the huge move to the upside, but those paying attention to unusual options activity were alerted to this potential move three days before it actually happened.

The options that the institutional trader bought saw an enormous move to the upside, trading as high as $6.20 before expiration. This means that at the highs, this trader would have profited $2.56 million dollars at the highs. Look at a chart of the options below.
A retail trader who followed this trader with a 20 lot of these options would have profited $10,240 at the highs. This is a perfect example of how a retail trader can harness the power of institutional order flow and trade more like the biggest and most successful hedge fund managers in the world.