Income using credit spreads
Money and Investing

- Income using credit spreads

Roger Manzolini
July 26, 2012
Disclaimer

- This presentation is the creation of Roger Manzolini and is to be used for informational use only
- Roger is not a certified financial planner nor a financial advisor of any kind, so use of this information is at your own risk
- None of the information provided should be considered a recommendation or solicitation to invest in, or liquidate, a particular security or type of security
More Disclaimer

- Further, the content in this presentation should not be considered as a recommendation to buy or sell a security.
- All information is intended for educational purposes only and in no way should be considered investment advice.
- Options involve risk and are not suitable for all investors. All rights and obligations of options instruments should be fully understood by individual investors before entering any trade.
Agenda

- Introduction
- Covered calls revisited
- Credit spreads
- Trading Examples
- Actual Results
- Closing comments
Introduction
High Level Strategic View

Portion of money to be managed

10% but not more than $30K

75-50%

15-40%

Money Engine

Options used to **generate** money
High risk/high return (30% or more)

Investment Portfolio

Stocks / Bonds used to **grow** money
Moderate risk/moderate return (8-12%)

Savings Portfolio

CDs / Treasury Bills used to **preserve / protect** money (1-5%)
# Introduction

## Market Composition

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>102</td>
<td>207</td>
<td>105</td>
<td>90</td>
<td>70</td>
<td>37</td>
<td>57</td>
<td>122</td>
<td>708</td>
<td>78</td>
<td>224</td>
<td>11</td>
<td>164</td>
</tr>
<tr>
<td></td>
<td>26</td>
<td>37</td>
<td></td>
<td>28</td>
<td>49</td>
<td>83</td>
<td>23</td>
<td>158</td>
<td>101</td>
<td>34</td>
<td>43</td>
<td>71</td>
</tr>
<tr>
<td></td>
<td>62</td>
<td>84</td>
<td></td>
<td>45</td>
<td>27</td>
<td>712</td>
<td>52</td>
<td>33</td>
<td>369</td>
<td>38</td>
<td>48</td>
<td>27</td>
</tr>
<tr>
<td></td>
<td>23</td>
<td>42</td>
<td></td>
<td>44</td>
<td>15</td>
<td>202</td>
<td>22</td>
<td>344</td>
<td>76</td>
<td>49</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td></td>
<td>23</td>
<td>159</td>
<td></td>
<td>91</td>
<td>175</td>
<td></td>
<td>127</td>
<td>296</td>
<td>347</td>
<td>38</td>
<td>66</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,045</td>
<td>197</td>
<td></td>
<td>25</td>
<td>12</td>
<td>183</td>
<td></td>
<td>38</td>
<td>28</td>
<td>66</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>48</td>
<td>11</td>
<td></td>
<td>43</td>
<td>79</td>
<td>2,252</td>
<td>66</td>
<td>266</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>384</td>
<td>15</td>
<td>12</td>
<td>43</td>
<td></td>
<td>49</td>
<td>17</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>81</td>
<td>12</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>649</td>
<td>75</td>
<td>129</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>92</td>
<td>83</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>201</td>
<td>19</td>
<td>272</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>41</td>
<td>15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>345</td>
<td>586</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>12</td>
<td>8</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>13</td>
<td></td>
<td></td>
<td>41</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>14</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>16</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>17</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>18</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>19</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>20</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>21</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>22</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>23</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>24</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>25</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

# Stocks in each Industry

- Basic Materials: 207
- Capital Goods: 105
- Conglomerates: 90
- Consumer Cyclicals: 70
- Consumer Non-Cyclicals: 37
- Energy: 57
- Financial: 122
- Healthcare: 708
- Services: 78
- Technology: 224
- Transportation: 11
- Utilities: 164
Introduction
Basic premise

- You’re familiar with typical buying, holding and selling stocks
- Portfolio performance can be improved over that typical approach through the use of options
- You can set up positions that generate monthly income via:
  - Selling call options on stock that you already own
  - Selling and buying calls and/or puts for a net credit
    - credit spreads that we’ll talk about today
- The risk is low and easily managed
Money and Investing
Option lingo

- Strike price; also called exercise price
  - The price the underlying stock may be bought or sold
- Premium
  - The cost of the option to the buyer
  - A credit to the seller
- Expiration date
  - The date the option expires. The last day the option can be exercised
    - Typically up to 9 months (longer out...leaps)
    - The 3rd Friday of the month
- Exercising the option (option is assigned)
  - When the underlying stock is bought or sold
## Money and Investing
### Option Rights and Obligations

<table>
<thead>
<tr>
<th>Initiator</th>
<th>Call option</th>
<th>Put option</th>
</tr>
</thead>
<tbody>
<tr>
<td>Option buyer (holder, long in options)</td>
<td>Right to buy stock at strike price</td>
<td>Right to sell stock at strike price</td>
</tr>
<tr>
<td>Option seller (writer, short in options)</td>
<td>Obligation to sell stock at strike price</td>
<td>Obligation to buy stock at strike price</td>
</tr>
</tbody>
</table>
Money and Investing
Options

- Price = intrinsic value + time value
  - **Intrinsic value** = The amount by which an option is “in the money”
    - Call: stock price – strike price
    - Put: strike price – stock price
  - **Time value** = the portion of the option price that is in excess of the intrinsic value, due to the amount of volatility in the stock; sometime referred to as premium. Time value is positively related to the length of time remaining until expiration
Other things to know

- Options can be traded just like stocks
- Options provide significant leverage and are volatile
  - Returns range from 100% loss to very significant gains (1,000%)
- Each option represents 100 shares of stock
  - E.g. selling 5 call options grants the buyer the right to buy 500 shares of your stock at the strike price
- Most (65 to 90%) options expire worthless
  - This is very advantageous for option writers
  - I liken this to being the “house” at a casino
    - High probability (65 to 90%) for small gains
    - No probability (0%) for large wins
Covered Calls
Money and Investing
Covered Call - Strategy for “undisciplined sell, cash flow”

- The plan
  - To improve your profit over just stock ownership by the premium received from the sold call

- Characteristics
  - Limited maximum profit – strike price minus the purchase price of the stock plus the net credit received
  - Unlimited loss – loss in stock value plus net credit

- Set up
  - Own or buy a stock
  - Sell a call option with a higher strike price than the purchase price of the stock
Money and Investing
Summary of profit (loss) Graphs

Stock Transactions

Buy Stock

Sell Stock Short

Call Option Transactions

Buy Call

Sell Call

Put Option Transactions

Buy Put

Sell Put
Money and Investing
Covered Call - Strategy for “undisciplined sell, cash flow”

Typical Covered Call Set-up Example

- Own stock
- Sell call with higher strike price
- Trade profit

Lost Opportunity

Improved Gain
Possible Outcomes

Covered Call

- Stock goes down
  - Your loss is $2 less than if you hadn’t sold the call
- Stock remains the same (or goes up to just below the strike price of $35)
  - Your gain is $2 more than if you hadn’t sold the call
- Stock goes up and exceeds the strike price of $35
  - Option is assigned and you must sell your stock at $35
  - Your gain is $7 per share (forfeiting additional gain)
    - $2 premium from the sold option
    - $5 from the stock sale

WIN          WIN          WIN
Credit Spreads
What is a credit spread?

- When you sell a credit spread
  - you simultaneously sell one option and buy one option for a stock as a single transaction
  - The options are traded for the same expiration month, with different strike prices and are either both call options or both put options
  - You sell the more expensive option, and buy the cheaper option
- Resulting in a credit to your account
Why sell credit spreads?

- Selling credit spreads allows you to trade options with:
  - Minimum risk
  - The deck stacked in your favor
  - Time decay working in your favor
  - Low margin requirements to make it possible for smaller investors
  - The opportunity to manage the outcome to still win if the trade begins to work against you
- To regularly make trades of 15% per month
Money and Investing
Credit Spreads - Strategy for “cash flow”

- For a bull market:
  - Use bull credit spread, also called put credit spread
    - Sell out of the money put (for credit)
    - Buy further out of the money put (protection)

- For a bear market:
  - Use bear credit spread, also called bear call spread
    - Sell out of the money call (for credit)
    - Buy further out of the money call (protection)

- For a sideways market:
  - Use iron condors
    - Subject for another time
Bull Credit Spreads
Bull Credit Spread
also called Put Credit Spread

- The plan
  - To anticipate and experience an upward move in the underlying stock. Have both options expire worthless. Retain the premium received.

- Characteristics
  - Limited maximum profit – net credit received
  - Limited maximum loss – difference in strike prices minus net credit

- Set up
  - Sell a put option
  - Buy a put option with a lower strike price (and lower cost)

- Comments
  - There is less risk to trade out of the money options
Money and Investing
Summary of profit (loss) Graphs

Stock Transactions

Buy Stock

Sell Stock Short

Call Option Transactions

Buy Call

Sell Call

Put Option Transactions

Buy Put

Sell Put
Bull Credit Spread
also called Put Credit Spread

Sell out of the money put
Buy further out of the money put
Profit line

Maximum profit = Net credit
Maximum loss = difference in put strike prices – net credit
Bull Credit Spread Example

- Example:
  - In mid June MRK trading at $40.00
  - Sell MRK Aug $39 put for $0.50
  - Buy MRK Aug $36 put for $0.15

  - Collect $35 \( (100 \times (\$0.50 - \$0.15)) \) for every contract
    - Yours to keep no matter what
  - Risk $265 \( (100 \times (\$39 - \$36) - \$35) \) for every contract
Money and Investing
Credit Spread - Strategy for “cash flow”

Bull Credit Spread Set-up

- Sell put below market price
- Buy put with lower strike price
- Trade profit

Max gain $35 (13.2%)
Max loss $265

Stock Price
Profit (Loss)
Possible Outcomes

1. **Stock remains above the strike price of $39** (WIN)
   - Both options expire worthless; Your gain is the net credit received when the trade was set up

2. **Stock goes down to $36 or lower** (lose)
   - If you did nothing, both options are assigned. You suffer the max loss of $265
     - The difference in strike prices minus credit already received
     - $100*(39-36)-$35

3. **Stock drops to below $39, but above $36** (lose)
   - Your short option is assigned, you are obligated to buy the stock at $39
   - Your long option expires worthless
Can you manage the outcome?

- Yes often enough, and no about once every 10 years
  - As the trade turns against you (i.e. stock begins to fall),
    Manage your trade by buying back the spread
    - This will limit your loss to near zero
- Thus outcomes 2. or 3. are prevented (not realized)
  - And you almost always win
  - The only time you lose is when:
    - You don’t manage your trade, or
    - The market unexpectedly and dramatically drops rapidly without warning
      - This happens about once every 10 years; that is why you buy the protective put (limit your loss to $265)

Plan to gain 15% per month
Bear Credit Spreads
Money and Investing
Credit Spreads - Strategy for “cash flow”

● For rising (bull) market:
  ➤ Use bull credit spread, also called put credit spread
    ■ Sell out of the money put (for credit)
    ■ Buy further out of the money put (protection)

● For falling (bear) market:
  ➤ Use bear credit spread, also called bear call spread
    ■ Sell out of the money call (for credit)
    ■ Buy further out of the money call (protection)

● For sideways (neutral) market:
  ➤ Use iron condors
    ■ Subject for another time
**Bear Credit Spread**
also called **Bear Call Spread**

- **The plan**
  - To anticipate and experience a downward move in the underlying stock. Have both options expire worthless. Retain the premium received.

- **Characteristics**
  - Limited maximum profit – net credit received
  - Limited maximum loss – difference in strike prices minus net credit

- **Set up**
  - Sell a call option
  - Buy a call option with a higher strike price (and lower cost)

- **Comments**
  - Here too, trade out of the money options to manage risk

*Roger Manzolini*
Money and Investing
Summary of profit (loss) Graphs

Stock Transactions

- Buy Stock: profit (loss) vs. Stock Price
- Sell Stock Short: profit (loss) vs. Stock Price

Call Option Transactions

- Buy Call: profit (loss) vs. Stock Price
- Sell Call: profit (loss) vs. Stock Price

Put Option Transactions

- Buy Put: profit (loss) vs. Stock Price
- Sell Put: profit (loss) vs. Stock Price
Bear Credit Spread
also called Bear Call Spread

Sell out of the money call
Buy further out of the money call
Profit line

Maximum profit = Net credit
Maximum loss = difference in put strike prices – net credit
Bear Credit Spread Example

Example:

- Near end of May Stock trading at $100.00
- Sell Stock June $120 call for $0.80
- Buy Stock June $125 call for $0.30

- Collect $50 (100*($0.80-$0.30)) for every contract
  - Yours to keep no matter what
- Risk $450 (100*($125-$120)-$50) for every contract
Money and Investing
Credit Spread - Strategy for “cash flow”

Bear Credit Spread Set-up Example

- Sell 1 call
- Buy 1 call
- Trade profit

Max gain $50 (11.1%)
Max loss $450

Stock Price

Roger Manzolini
Possible Outcomes

1. Stock remains the same or rises up to just below the strike price of $120 **WIN**
   - Your gain is the net credit received when the trade was set up

2. Stock goes up to $125 or higher **lose**
   - If you do nothing, max loss is $450
     - The difference in strike prices minus credit already received
       - $100\*(125-120)-$50

3. Stock rises to above $120, but below $125 **lose**
   - Your short option is assigned, you are obligated to sell the stock at $120
   - Your long option expires worthless
Can you manage the outcome?

- Yes:
  - As the trade turns against you (i.e. stock begins to rise), manage your trade by buying back the spread
    - This will limit your loss to near zero
- Thus outcomes 2. or 3. are not realized
  - And you almost always win
  - The only time you lose is when:
    - You don’t manage your trade, or
    - The underlying security dramatically rises rapidly without warning
      - This seldom happens, but that is why you buy the protective call just in case it does

Roger Manzolini  Plan to gain 15% per month
Cookbook
Step by Step Overview

**Step One:** Pick your stock
- Complete a trend analysis on the stock
- Look ahead to make sure that there are no earnings dates or dividends due, as these both can have an effect on your trend
- Scan the news on the stock, so you have feel for what is happening with the company
- Expensive stocks provide better returns for each trade

*DO NOT PROCEED UNTIL YOU HAVE A GOOD TREND IN PLACE!*
Step by Step Overview

- **Step Two:** On the Tuesday (or later) following a given month's expiration Friday
  - Prepare to sell a credit spread for the next month's expiration (no more than 30 days out)
Step by Step Overview

- **Step Three:** Choose which spread to sell. To do this, you need to use an option probability calculator using:
  - The current stock price
  - The number of days to expiration
  - Implied Volatility of the stock (your broker software should have this information with the stock price)
  - The price of your closer option as the first target
  - The further out option as the second target
  - Choose an option where probability is >80%
    - Bearish Call Spreads: ending below lowest target
    - Bullish Put Spreads: ending above the highest target

*80% chance of winning*
Step by Step Overview

● **Step Four:** Sell your Credit Spread
  - Depending on your broker, you will need a certain margin per spread that you sell (typically <$1,000)
  - For a $5,000 account
    - you could sell 5 spreads for one stock (not recommended), or
    - one spread for each of 5 stocks (diversity reduces risk)
  - Retain a little cash in case you need to do a spread repair
Step by Step Overview

- **Step Five**: Calculate your profit
  - You do this by calculating the Return on Margin
  - If your margin is $1,000, and you sell your spread for $150, you have a ROM of 15%
  - Remember, this is the monthly return
    - not a bad return!
Step by Step Overview

- **Step Six:** Monitor your stock
  - You can do this quickly each day. You do not need to worry unless the stock comes very close to or even touches your closest option (the one you sold)
  - As long as it does not cross this line, you can pretty much ignore what happens to the price
  - Remember, there is only a 20% chance of the line being crossed

- **Step Seven:** When your option contracts expire worthless
  - do it again next month
What if?

- **If your trend holds:** As the stock gains or drops in price, your Credit Spread will drop in value very quickly, boosted by time decay
  - As the spread gets really cheap, you can buy it back and sell another one closer in
  - usually you can buy the spread back for much less than you sold it for, and then sell a new spread for another credit
  - for a fast dropping or growing stock, you can sometimes do this three or four times in a month, resulting in huge gains

*Good*
What if?

- **If the stock stagnates** and goes neither up nor down
  - sit it out till expiration, where your Credit Spread will expire worthless - you keep your profit
  - Sometimes a good trick is to buy back your spread and sell a new one 2-3 days before expiration
    - Time Decay will have reduced the value of your spread, and the chances of the stock making a big jump in two days is minimal, so you can squeeze out more profit

*Good*
What if?

● If the stock moves against you
  ➤ No problem, monitor it, but as long as it does not get to your closest option strike price (i.e. the one you sold), it will still expire worthless - you keep your profit

● If your stock hits your break even line (which is just inside your closest option, the one you sold)
  ➤ Do a Credit Spread Repair
    ■ Buy the Credit Spread back, and immediately sell another Credit Spread
    ■ You can either buy the same kind of spread (call or put) or if the trend has definitely changed, buy the opposite. It is mostly possible to do this for no loss, or even a little gain

*OK, manageable*
Credit Spread Repair

- EXAMPLE OF CREDIT SPREAD REPAIR

  - **Step 1.** In a bearish trend, you have sold a call credit spread
    - XYZ is at $100
    - SOLD XYZ June 120/125 Call Spread@ 0.80. Net Credit $80

  - **Step 2.** The trend reverses, and the stock hits $120. Trade a repair as follows
    - BUY XYZ June 120/125 Call Spread@1.50. Net Debit $150
    - Sell XYZ June 135/140 Call Spread@0.80 Net Credit $80

  - **RESULT**
    - Total Credit (from both trades) = $160
    - Total Debit (from buy back)=$150
    - Total Net = $10.
Credit Spread Repair

EXAMPLE OF CREDIT SPREAD REPAIR

Alternate Step 2. The trend reverses, and the stock hits $120. Trade a repair as follows
- BUY XYZ June 120/125 Call Spread @1.50. Net Debit $150
- Sell XYZ June 135/140 Put Spread @0.80 Net Credit $80

RESULT
- Total Credit (from both trades) = $160
- Total Debit (from buy back)=$150
- Total Net = $10
Results
## Actual Results – Trades (2008)

<table>
<thead>
<tr>
<th>Date</th>
<th>Day</th>
<th>Stock</th>
<th>Price</th>
<th>Action</th>
<th>Spread</th>
<th>Call / Put</th>
<th>Price</th>
<th>Trade Credit</th>
<th>Com &amp; Fees</th>
<th>Net credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>23-May</td>
<td>1</td>
<td>BIDU</td>
<td>335.01</td>
<td>Sold</td>
<td>380/390</td>
<td>C</td>
<td>1.65</td>
<td>165</td>
<td>10</td>
<td>155</td>
<td>5155</td>
</tr>
<tr>
<td>23-May</td>
<td>1</td>
<td>ISOG</td>
<td>274.75</td>
<td>Sold</td>
<td>310/320</td>
<td>C</td>
<td>1.35</td>
<td>135</td>
<td>10</td>
<td>125</td>
<td>5280</td>
</tr>
<tr>
<td>23-May</td>
<td>1</td>
<td>GOOG</td>
<td>549.46</td>
<td>Sold</td>
<td>590/600</td>
<td>C</td>
<td>1.9</td>
<td>190</td>
<td>10</td>
<td>180</td>
<td>5460</td>
</tr>
<tr>
<td>23-May</td>
<td>1</td>
<td>CME</td>
<td>464.20</td>
<td>Sold</td>
<td>510/520</td>
<td>C</td>
<td>1.42</td>
<td>142</td>
<td>10</td>
<td>132</td>
<td>5592</td>
</tr>
<tr>
<td>23-May</td>
<td>1</td>
<td>RTP</td>
<td>524.46</td>
<td>Sold</td>
<td>570/580</td>
<td>C</td>
<td>2.1</td>
<td>210</td>
<td>10</td>
<td>200</td>
<td>5792</td>
</tr>
<tr>
<td>30-May</td>
<td>8</td>
<td>GOOG</td>
<td>585.80</td>
<td>Bought</td>
<td>590/600</td>
<td>C</td>
<td>-4.45</td>
<td>-445</td>
<td>10</td>
<td>-455</td>
<td>5337</td>
</tr>
<tr>
<td>30-May</td>
<td>8</td>
<td>GOOG</td>
<td>585.80</td>
<td>Sold</td>
<td>610/620</td>
<td>C</td>
<td>2.7</td>
<td>270</td>
<td>10</td>
<td>260</td>
<td>5597</td>
</tr>
<tr>
<td>30-May</td>
<td>8</td>
<td>CME</td>
<td>430.30</td>
<td>Bought</td>
<td>510/520</td>
<td>C</td>
<td>-0.28</td>
<td>-28</td>
<td>10</td>
<td>-38</td>
<td>5559</td>
</tr>
<tr>
<td>30-May</td>
<td>8</td>
<td>CME</td>
<td>430.30</td>
<td>Sold</td>
<td>470/480</td>
<td>C</td>
<td>1.75</td>
<td>175</td>
<td>10</td>
<td>165</td>
<td>5724</td>
</tr>
<tr>
<td>30-May</td>
<td>8</td>
<td>RTP</td>
<td>483.25</td>
<td>Bought</td>
<td>570/580</td>
<td>C</td>
<td>-0.58</td>
<td>-58</td>
<td>10</td>
<td>-68</td>
<td>5656</td>
</tr>
<tr>
<td>30-May</td>
<td>8</td>
<td>RTP</td>
<td>483.25</td>
<td>Sold</td>
<td>520/530</td>
<td>C</td>
<td>2.4</td>
<td>240</td>
<td>10</td>
<td>230</td>
<td>5886</td>
</tr>
<tr>
<td>5-Jun</td>
<td>14</td>
<td>CME</td>
<td>402.54</td>
<td>Bought</td>
<td>470/480</td>
<td>C</td>
<td>-0.15</td>
<td>-15</td>
<td>10</td>
<td>-25</td>
<td>5861</td>
</tr>
<tr>
<td>5-Jun</td>
<td>14</td>
<td>CME</td>
<td>402.54</td>
<td>Sold</td>
<td>420/430</td>
<td>C</td>
<td>1.32</td>
<td>132</td>
<td>10</td>
<td>122</td>
<td>5983</td>
</tr>
<tr>
<td>5-Jun</td>
<td>14</td>
<td>RTP</td>
<td>475.17</td>
<td>Bought</td>
<td>520/530</td>
<td>C</td>
<td>-0.43</td>
<td>-43</td>
<td>10</td>
<td>-53</td>
<td>5930</td>
</tr>
<tr>
<td>5-Jun</td>
<td>14</td>
<td>RTP</td>
<td>475.17</td>
<td>Sold</td>
<td>500/510</td>
<td>C</td>
<td>1.87</td>
<td>187</td>
<td>10</td>
<td>177</td>
<td>6107</td>
</tr>
<tr>
<td>10-Jun</td>
<td>19</td>
<td>ISRG</td>
<td>275.09</td>
<td>Bought</td>
<td>310/320</td>
<td>C</td>
<td>-0.18</td>
<td>-18</td>
<td>10</td>
<td>-28</td>
<td>6079</td>
</tr>
<tr>
<td>10-Jun</td>
<td>19</td>
<td>ISRG</td>
<td>275.09</td>
<td>Sold</td>
<td>290/300</td>
<td>C</td>
<td>0.9</td>
<td>90</td>
<td>10</td>
<td>80</td>
<td>6159</td>
</tr>
<tr>
<td>11-Jun</td>
<td>20</td>
<td>RTP</td>
<td>441.95</td>
<td>Bought</td>
<td>500/510</td>
<td>C</td>
<td>0.27</td>
<td>27</td>
<td>10</td>
<td>17</td>
<td>6176</td>
</tr>
<tr>
<td>11-Jun</td>
<td>20</td>
<td>RTP</td>
<td>441.95</td>
<td>Sold</td>
<td>490/500</td>
<td>C</td>
<td>1.65</td>
<td>165</td>
<td>10</td>
<td>155</td>
<td>6331</td>
</tr>
<tr>
<td>17-Jun</td>
<td>26</td>
<td>CME</td>
<td>419.41</td>
<td>Bought</td>
<td>420/430</td>
<td>C</td>
<td>-6.45</td>
<td>-645</td>
<td>10</td>
<td>-655</td>
<td>5676</td>
</tr>
<tr>
<td>17-Jun</td>
<td>26</td>
<td>CME</td>
<td>419.41</td>
<td>Sold</td>
<td>450/460</td>
<td>C</td>
<td>2.27</td>
<td>227</td>
<td>10</td>
<td>217</td>
<td>5893</td>
</tr>
<tr>
<td>18-Jun</td>
<td>27</td>
<td>BIDU</td>
<td>332.64</td>
<td>Bought</td>
<td>380/390</td>
<td>C</td>
<td>0</td>
<td>0</td>
<td>10</td>
<td>-10</td>
<td>5883</td>
</tr>
<tr>
<td>18-Jun</td>
<td>27</td>
<td>BIDU</td>
<td>332.64</td>
<td>Sold</td>
<td>350/360</td>
<td>C</td>
<td>0.72</td>
<td>72</td>
<td>10</td>
<td>62</td>
<td>5945</td>
</tr>
<tr>
<td>18-Jun</td>
<td>27</td>
<td>GOOG</td>
<td>562.38</td>
<td>Bought</td>
<td>610/620</td>
<td>C</td>
<td>-0.03</td>
<td>-3</td>
<td>10</td>
<td>-13</td>
<td>5932</td>
</tr>
<tr>
<td>18-Jun</td>
<td>27</td>
<td>GOOG</td>
<td>562.38</td>
<td>Sold</td>
<td>580/590</td>
<td>C</td>
<td>0.82</td>
<td>82</td>
<td>10</td>
<td>72</td>
<td>6004</td>
</tr>
<tr>
<td>20-Jun</td>
<td>29</td>
<td>BIDU</td>
<td>334.81</td>
<td>Bought</td>
<td>350/360</td>
<td>C</td>
<td>-0.23</td>
<td>-23</td>
<td>10</td>
<td>-33</td>
<td>5971</td>
</tr>
<tr>
<td>20-Jun</td>
<td>29</td>
<td>BIDU</td>
<td>334.81</td>
<td>Sold</td>
<td>340/350</td>
<td>C</td>
<td>0.8</td>
<td>80</td>
<td>10</td>
<td>70</td>
<td>6041</td>
</tr>
<tr>
<td>20-Jun</td>
<td>29</td>
<td>GOOG</td>
<td>546.43</td>
<td>Bought</td>
<td>580/590</td>
<td>C</td>
<td>-0.08</td>
<td>-8</td>
<td>10</td>
<td>-18</td>
<td>6023</td>
</tr>
<tr>
<td>20-Jun</td>
<td>29</td>
<td>GOOG</td>
<td>546.43</td>
<td>Sold</td>
<td>570/580</td>
<td>C</td>
<td>0.62</td>
<td>62</td>
<td>10</td>
<td>52</td>
<td>6075</td>
</tr>
</tbody>
</table>
Actual Results – Account Balance

Account Balance

Roger Manzolini
Actual Results – Analyzed Summary

- Started month with $5,000
- Traded 5 different ‘stocks’
- Best trade: $658 65.8%
- Worst trade: -$82 -8.2%
- Total trade credit for the month: $1365
- Total commission and fees for the month: $290
- Total net credit for the month: $1075
- Monthly results % 21.5%

<table>
<thead>
<tr>
<th></th>
<th>BIDU</th>
<th>ISRG</th>
<th>GOOG</th>
<th>CME</th>
<th>RTP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>244</td>
<td>177</td>
<td>78</td>
<td>-82</td>
<td>658</td>
</tr>
<tr>
<td>%</td>
<td>24.4</td>
<td>17.7</td>
<td>7.8</td>
<td>-8.2</td>
<td>65.8</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1075</td>
</tr>
</tbody>
</table>
Actual Results - Comments

- This was a good month
  - There were two bad ‘stocks’ (one of which went really bad)
  - One exceptional ‘stock’
  - One out of the five ‘stocks’ needed a repair
  - There were 29 trades, of which two went wrong
  - That is a 93% success rate
    - Vs the 80% expected
  - 21.5% return for the month
    - Much better than the plan of 15%
Conclusion

- It doesn't actually matter too much what happens to your stock
  - You have an 80% chance of keeping your profit upon expiration
  - If a worst case scenario occurs (20% chance), you can enact a repair and come out with nothing lost except broker fees

- With this approach
  - you don't need to lose money
  - You have a maximum of 20% chance of one of your trades coming out a net zero
  - You have an 80% or greater chance of any of your trades earning 15% or more each month.
Money and Investing
Parting Thoughts

- What does it take?
  - Some money; $5,000, more is better
  - An options trading account
  - The desire and time to continue to educate yourself
  - Time to manage your trades
  - Positive attitude
    - Belief in yourself that you can do it
  - Separation of emotion from trading decisions
  - Learning from your mistakes
  - Tenacity to continue
The End
Money and Investing

Intrinsic value – ‘in the money value’

Buy Call

Buy Put

Sell Call

Sell Put

Stock Price

Stock Price

Stock Price

Stock Price

profit (loss)

profit (loss)

profit (loss)

profit (loss)
Money and Investing

Time value

Most of the value lost close to expiration

Value

2 months 1 month 1 week expiration

Time

Roger Manzolini

Return

July 26, 2012
When You Sell Put Options, What Happens on Options Expiration Day?

- Only two things can occur at expiration
  - the price of the stock is below the chosen strike price or
  - the price of the stock is at or above the chosen strike price

- If the stock finishes below the strike price
  - the option buyer will “exercise” his right to the contract and
  - you will be required to fulfill your end of the agreement – which means you have to buy the stock you wanted at the price you wanted

- If the stock finishes at or above the strike price
  - the trade is over and the option expires worthless
  - the option buyer walks away with nothing
  - you get to keep the upfront cash with no further obligations
When You Buy Put Options, What Happens on Options Expiration Day?

- Only two things can occur at expiration
  - the price of the stock is below the chosen strike price or
  - the price of the stock is at or above the chosen strike price

- If the stock finishes below the strike price
  - you will “exercise” your right to the contract and
  - the option seller will be required to fulfill his end of the agreement – which means he has to buy the stock at the strike price

- If the stock finishes at or above the strike price
  - the trade is over and the option expires worthless
  - you walk away with nothing
  - the option seller get to keep the upfront cash with no further obligations
Tips when selling put options

- Only sell put options on stocks you want to own
- Only sell enough contracts that you can cover
  - If you normally trade in 500-share blocks, then only sell five option contracts
- If you’re uncomfortable at any time during a trade, unwind the trade
  - buy back the put options you’ve sold
- Know ahead of time what your potential total outlay will be if obligated to buy the shares
  - No surprise endings
Guidelines (per Ken Trester)

- Don’t buck the trend
- Select stocks with low price volatility
- Find overpriced options
- Diversify
- Write options that are at least 15% out of the money
- Write options with next month expirations
- Write options against Treasury Bills
- Set a bailout point and use it
- Maintain a strict stock/options surveillance program