ALTOSTRADING

HOW TO FIX LOSING OPTIONS TRADES

And Turn Them into Winners!

OUR TOP TIPS AND TRICKS FOR ADJUSTING BAD OPTIONS TRADES

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Options Basics

Call Option –An option contract granting the holder the right, but not the obligation, to buy the underlying security at a specified price for a fixed period of time.

Put Option - An option contract granting the holder the right, but not the obligation, to sell the underlying security at a specified price for a fixed period of time. Typically, 1 contract controls 100 shares of the underlying security.

However, there are now “mini” contracts available on some securities that allow you to control only 10 shares for each contract traded.

Strike Price - The strike price is defined as the price at which the holder of an option can buy (in the case of a call option) or sell (in the case of a put option) the underlying security when the option is exercised. The strike price is also known as the exercise price.

Expiration Date - The last date on which the holder of the option may exercise it according to its terms.

BID Price - The bid price represents the maximum price that a buyer or buyers are willing to pay for a security

ASK Price - The ask price represents the minimum price that a seller or sellers are willing to receive for the security

BID/ASK Spread - The difference between the bid and asked prices. This is an indicator of the liquidity of the options contracts.Generally, the smaller the spread, the better the liquidity.

Options Income Strategy #1: Writing Puts

We will be selling Put options (STO), not buying them, because it gives us a much higher probability trade.

When you sell or “write” Put option contracts it allows you to profit from 3 outcomes, not just one.

When you write a Put option contract, you profit if the stock rises, stays stagnant, or even moves down slightly.

However, if you buy a Call option the stock has to move quickly and significantly to overcome time decay in order to profit. If it does not, you risk losing your entire investment.

Both are bullish positions, but Put selling has a much higher probability for success. High probability allows for consistency. And consistency is truly the “holy grail” of trading.

A naked Put write, or short Put, is when you Sell-to-Open Put options without first being short in the underlying stock.

When the stock rises, the put options that you sold expire out of the money, allowing you to keep the entire premium you collected when you sold them.

Example:

ABC stock is trading at $100 per share. You decide to sell-to-open (STO) 10 of the 95-strike contracts for $2.5/contract that expire in 30 days. Since each contract controls 100 shares of stock, you receive an immediate deposit of $2,500 into your brokerage account. As long as ABC stock closes above $95 (the strike price) at expiration, you keep the entire $2,500 premium you received when you initiated the trade.

One would sell Puts on a stock when they expect a rise in the price of the shares, but still want the ability to make a profit if the underlying stock stays stagnant or even declines.

When you Sell-to-Open a put, you are essentially playing the role of the “casino” where you are selling put options to “gamblers” who are betting on the price of the underlying stock going down. If they are wrong and the stock rises, you keep the money they paid you for the put options if the put options expires Out-Of-The-Money (OTM). If the gambler, or option buyer, is correct and the stock falls, you could potentially suffer a loss. That is how Put selling works in a nutshell.

There is a huge added benefit to selling Puts, and that is the ability to profit even if the underlying stock stays stagnant or moves against you. This is due to what is known as Time Decay.

Time Decay

The ratio of the change in an option's price to the decrease in time to expiration. Since options are wasting assets, their value declines over time. As an option approaches its expiration date without being in the money, its time value declines because the probability of that option being profitable is reduced.

The more the value of the options you sold decay, the more you profit from the sale. By writing a put option, you are not only making money if the underlying stock rises due to delta effect, you are also putting Time Decay, which is the biggest threat to buyers of stock options, in your favor.

Writing a put option is never really "Naked" or "Uncovered" because you need to have an amount of cash, known as a Margin, on deposit with your broker before you can initiate a trade. In fact, because you are obligated to buy the underlying stock at the strike price of the put options sold, some option trading brokers require option traders to have that corresponding amount of money before they are allowed to sell a put option. This is known as a Cash Secured Put.

Delta

Delta is the amount an option price is expected to move based on a $1 change in the underlying stock.

Calls have positive delta, between 0 and 1. That means if the stock price goes up and no other pricing variables change, the price for the call will go up. For example, if a call has a delta of .50 and the stock goes up $1, in theory, the price of the call will go up about $.50. If the stock goes down $1, in theory, the price of the call will go down about $.50.

Puts have a negative delta, between 0 and -1. That means if the stock goes up and no other pricing variables change, the price of the option will go down. For example, if a put has a delta of -.50 and the stock goes up $1, in theory, the price of the put will go down $.50. If the stock goes down $1, in theory, the price of the put will go up $.50.

How to Choose the Best Put Options to Sell

Use Delta or ‘Probability Out-of-the-Money’ statistics

Choose options with expiration dates 30-60 days out

Support/Resistance levels – Sell Put options with Strike prices below key support levels

Trade with the trend – Sell Put options on quality stocks in a strong uptrend or bouncing off a key support level

Implied Volatility (IV) – Focus on selling Put options when IV is relatively high

Advantages of Selling Put Options

A strategy which results in a credit, or deposit, into your account upon initiating the trade

Unlike other more complex option strategies, it is a simple strategy which requires no difficult calculations to execute

Commissions tend to be lower due to the nature of the trade. If the trade expires out-of-the-money (OTM) you pay nothing to close the trade.

It allows you to profit even if the underlying stock stays completely stagnant.

Unlike a long Call option, writing Put options offers you a margin of error if the underlying stock falls instead of rises.

It is a versatile option strategy which can be transformed into other option strategies prior to expiration, in order to accommodate changing market conditions or outlook.

What to do When Things Go Wrong

Imagine you've sold 10 Put option contracts on ABC stock, but then the stock immediately begins to go down in price. However, rather than closing the position and taking a loss, you are able to repair the position and prevent further damage, and even turn the trade into a profitable one. Well there is a way to do this and it's called Delta Neutral hedging. This is a technique which will create a position that will not only help halt further directional losses, but also allow the overall position to start making a profit. This is the first trade adjustment we make when a trade moves against us.

Trade Adjustment: Delta Neutral Hedging (DNH)

Delta neutral hedging is a very useful and powerful method to repair losing positions.

In order to transform a naked put write into a delta neutral position, all you have to do is to buy (buy-to-open) enough at the money or near the money put options in order to completely (or as completely as possible) offset the positive delta of your existing short put options.

By executing this adjustment, if the stock should continue to fall, you will profit on the Put options that you purchased. This will offset losses on the ones that you sold if the stock continues to move lower.I will typically do this if my short Puts move in-the-money.

Calculation: # of Contracts X (Delta X 100) = Position Delta

Then divide at-the-money (ATM) option delta by the Position Delta to get the number of contracts to buy

Trade Adjustment: Rolling

Let’s say we make a Delta Neutral trade adjustment to a losing trade, and it still does not become profitable by the time the options are set to expire. In this case, we will execute our next trade adjustment method: Rolling.

Rolling involves closing out our initial trade (the short Puts) and opening a new trade at a further out expiration. Ideally we want to do this for an equal or greater “credit” or deposit into our account.

Depending on where the stock price is, and any profit we made from Delta Neutral Hedging, we may also want to continue to hedge our trade using our first trade adjustment.

Rolling buys us more time, and allows us to recover losses from our initial position should the stock price increase. It is a very powerful technique, but should only be used with high quality stocks.

Generally we will roll a position right before expiration if we have not yet achieved a profit.

Options Income Strategy #2: Credit Spreads and Iron Condors

An Iron Condor Consists of two credit spreads: both a vertical bull put spread and a vertical bear call spread with the same expiration dates

I will teach you the best way to structure the trade

•The best ticker symbols to trade
•How to pick the right strike prices
•How to pick the best expiration dates

How to determine the correct number of contracts to trade

How to fix a losing trade and turn it into a winner!

There are two problems with credit spreads:

There is an unfavorable risk/reward profile, so that a losing trade can wipe out a series of winners

If you hedge a losing credit spread to prevent further losses, you incur additional costs by having to purchase more option contracts

The Anatomy of a Credit Spread

Credit Spreads are options positions created by buying cheaper options contracts and simultaneously writing an equal number of more expensive options contracts

A Credit Spread refers to options spreads that you actually receive cash (net credit) for executing them. This credit to your options trading account is why such options spreads are known as "Credit Spreads”

When you write an option, you are putting on a short options position but when you buy a cheaper option on the same underlying stock using the premium received from the sale of the short options position, a Credit Spread is created

Why Iron Condors Can be Your Best Bet

Profit from Multiple Outcomes & Benefit from Time Decay

Bull put spread (which you would execute if you expect the underlying stock to stay above a certain price called the strike price)

Bear call spread (which you would execute if you expect the underlying stock to stay below the predetermined strike price)

To initiate a bull put spread, you would simultaneously sell an out-of-the-money (OTM) put, andbuy an equal number of contracts at a further out-of-the-money (OTM) strike price.Because you would collect more premium on the short put than you will have to pay for the long put, this trade results in a net credit that is deposited into your brokerage account when you initiate the trade.

To initiate a bear call spread, you simply do the opposite. You would simultaneously sell an out-of-the-money (OTM) call, andbuy an equal number of contracts at a further out-of-the-money (OTM) strike price.Because you would collect more premium on the short call than you will have to pay for the long call, this trade results in a net credit that is deposited into your brokerage account when you initiate the trade.

The goal with this strategy is for the underlying stock to expire above the short strike price (in the case of a bull put spread) or below the short strike price (in the case of a bear call spread) by the time the options expire. Because of Time Decay, which we previously defined, this will occur most of the time.

An Iron Condor is simply the combination of a “bull put spread” and a “bear call spread” on the same underlying equity with the same expiration.

How to Calculate Margin Requirements

The Margin requirement is also your maximum loss in the very worst case scenario

To calculate the required amount of money you need in your brokerage account to execute a trade, also referred to as margin, you take the difference between your short and long strike prices and subtract the credit you received when you initiated the trade

Let’s say you simultaneously sold 10 contracts of ABC stock at the 100 strike price for $1, and bought 10 contracts of ABC stock at the 102 strike price for $.50. You would receive a credit, or deposit into your brokerage account of $500 before commissions ($1-$.50) x 1,000. The difference between your strike prices is $2, which equates to $2,000 since we are trading 10 contracts (each contract controls 100 shares of stock.)

We subtract our credit of $500 from the difference in strike prices of $2,000 and arrive at our margin requirement of $1,500

Now here’s the beauty of the Iron Condor: it is impossible to lose both sides of the trade

Brokers do not increase the margin requirements for trading Iron Condors versus trading a single Credit Spread

The Secret to Choosing the Best Strike Price

To figure out our odds of success before we even place a trade, we will use a readily available statistic called the Option Delta

Delta is the amount an option price is expected to move based on a $1 change in the underlying stock

You can also use Delta to estimate the probability an option contract will expire out-of-the-money (OTM), which is our main goal when trading Iron Condors

To figure out the percentage chance your trade will finish OTM, you simply subtract the Delta of the option contracts you sold from 1

When we setup an Iron Condor trade, we want to sell options that have at least an 80% chance of expiring out-of-the-money

Choosing an Underlying Security

The Index and ETF list I am going to provide to you also have weekly options available, providing plenty of trading opportunities...

The List:

- SPX
- RUT
- NDX
- SPY
- IWM
- TNA
- GLD

Trade Adjustments to Fix Losing Credit Spreads and Iron Condors

The adjustment requires us to “Roll” the trade

We will roll up if the Bear Call Spread is threatened

We will roll down if the Bull Put spread is threated

We may also roll the trade out in time if there is little time left till expiration, and the overall position has not reached profitability

Close (Buy-to-Close) the threated side of your Iron Condor trade if the price of the underlying closes past either of your short strike prices

Open a new spread on the threatened side that is further out-of-the-money (80% chance of expiring OTM)

If the other side of your trade has captured at least 75% of its potential profit, close that side and open a new trade with at least an 80% chance of expiring OTM

Conclusion

No need to use charts, indicators or any fundamental analysis

Select one of the Indexes or Exchange Traded Funds (ETFs) from the list provided earlier in the course
Follow the steps to select the best strike prices and options expiration dates

If one side of the trade is threatened, adjust the trade using the rolling technique (often this creates even more income)

Repeat this process with a new ticker symbol each Friday

ABOUT US

Altos Trading was created to help traders become successful and consistent with their trading results. The products and services that we offer have been designed with our students in mind. All new additions to Altos Trading are developed with the students guiding the way in terms of functionality, ease of use and application.

Our courses are structured to give students of all skill and experience levels the ability to follow along on an easy path to mastery. Students reinforce the strategies within the courses with trade alert signals which deliver live real-time trade examples to drill in the teachings. Our students are able to "Earn while they Learn". If students want more trade signals or want to pick their own, we offer TradeTrend which is our award winning signal software available on most major trading platforms.

If a strategy does not meet our high standards of excellence, it will not be added to our curriculum. We do not teach strategies based on popularity or what's in the news lately. We only teach strategies that can be consistent and adjustable if necessary.

About the Author

Jeff Tompkins, a professional stock, options and futures trader currently serves as Hedge Fund Manger at Altos Capital and has over 20 years of experience trading the markets. Jeff's successful career led him to create Altos Trading, LLC in order to help others achieve financial freedom through consistent and profitable trading strategies.

Over the years Jeff has developed an arsenal of highly tested trading strategies which have remained effective regardless of market conditions. The main objective of the organization is to teach these disciplined strategies to others who are interested in supplementing or replacing their current income.

Altos Trading's philosophy is to give students the best learning experience without any fluff, complicated techniques or unnecessary software. All students and alert service subscribers receive a direct path to success with clear instructions that drastically reduce the learning curve to profitability.

To learn more of our best stock and options strategies with trade adjustments to fix losing trades, visit www.altostrading.com

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