

Trading Process / Notes / Observations / Miscellaneous Ramblings

Below is an overview of my trading process as well as notes and observations I have made over the years of trading in the market.

1) Trading Process:

- a) First, I scan ALL stocks and indices greater than \$50.00.
- b) Second, I look for upcoming scheduled events during the week cycle I am selling. I also look at the 2 weeks before and 2 weeks after.
- c) Third, Option Chain, I look for the following criteria;
 - i) Premium 0.20, 0.25
 - ii) at lease 3 points OTM (Out of The Money)
 - iii) AND DELTA LESS THAN 20
- d) Charts, I use LinearRegressionChannel 100, Simple moving averages 10/30 and 50/200 Volume, MACD, and Stochastic. Is the stock trending Up, Down, or Sideways. And trade the other way.

Channel decisions;

- Top of channel trending up: Wait: See what develops
- Top of channel trending down: Look at selling Calls
- Bottom of channel trending down: Wait: See what develops
- Bottom of channel trending up: Look at selling Puts
- At center line: Wait: See what develops
- Between Center Line and top or:
Between Center Line and bottom: Look at selling in the opposite

NOTES

Trading Check List:

Select a strategy – Sort Vertical Spread

e) Select a Candidate

- liquidity
 - Spreads
 - Delta, less 20
 - Open interest at least 100s or 1000s

f) Directional Bias

- bullish selling OTM Put spread
- bearish selling OTM Call spread
- over bought / oversold

g) time frames

- announcements
 - scheduled announcements 2 weeks prior, 3 week following. don't trade
 - dividends don't trade

h) probability of success

--60% to 70%

i) capital allocation

j) order execution and pricing

Closing trades

Monthly

- a) Closing window
- b) 4 to 10 days early
 - 80% of profit
- c) impactful news/announcements

Weekly

Let it expire

2) Exit Plan

- a) If the short position is violated at the day's close
- b) As long as the underlying stays "OTM" by at least 0.60 at expiration let it expire
- c) 2 consecutive days in a row of big market moves against us
- d) If the trade is going against us watch and exit when premium is
 - Between 4 and 5 times the premium received.

e) If we are assigned we can sell the position, OR sell covered calls against the position.

NOTE: With weeklies I tend to wait as long as possible before exiting. Depends on your risk profile. Be safe, trade smart. Capital preservation is more important than capital appreciation.

3) Credit Spread Stop Losses:

First there are no stop losses for credit spreads.

However you can use the following:

One method of using credit spreads for stops is as follows:

- Determine your max loss per trade. Let's say \$1000
- As I am selling 3 point spreads for .20 cents your max contracts per trade is 3
 $3.00 - .20 * 100 \text{ shares} = 280.00 \text{ per contract. } 3 \text{ contract} = 840 \text{ max loss per trade}$
- If assigned you will have 3 days to settle with your broker.
 - You can sell
 - You can buy it and then sell covered calls against it

As I normally watch the trades all week so I can trade with a larger max loss. I just buy it back early.

4) Commissions:

First try negotiating a lower commission rate. If you're trading 10 contracts, then on a spread that's 20 contracts. Another 20 when you close that's 40. If you have three positions a month that's 120 contracts, 240 if you use iron condors. Most brokers will negotiate a lower rate for their top traders. 100 contracts per month will make you a top trader. Try to at least get them to drop the ticket charge and just pay a flat rate per contract.

5) How many contracts do we trade? That is a very good question.

First let's discuss maintenance. Maintenance is what your broker will hold in case you experience a total loss on the trade. Let's say you sell 10 contracts of XYX 36/34 put @ 0.20. Your maintenance is as follows. $36 - 34 - 0.20 = 1.80$ per share per contract or $1.80 * 100$ per contract * 10 contracts or 1800. This is what your broker will hold in case the trade goes bad. This can be stocks, bonds, funds, cash etc. My rule is maintenance should not exceed a TOTAL of 1/3 of available CASH. Let's say you have a 100,000 account. 70,000 in stocks, funds etc. and 30,000 in cash. I would trade 10,000 of maintenance for the first or current period (week) and 10,000 for the next period. 1/3 or 10,000 stays in READY CASH for contingencies.

You should never risk more than a "TOTAL" of one third (1/3) of your trading capital in any single trading period. One third (1/3) should remain in ready cash. Should any unforeseen catastrophe

happen it would wipe you out. Also if a trade(s) goes bad you will need ready cash available to buy it back

6) Delta Rules:

NEVER NEVER get greedy!! That's when I lose. That's what I did this week

a) Weekly Indexes and Equities:

As far OTM as possible

Delta 20 **OR LESS**, credit about 0.20 to 0.25 NOT MORE

Higher credits and/or deltas equal higher risk.

I will always trade credit for a greater buffer zone.

b) Monthly Indexes:

When trading Monthly Indexes look for the following

SPX, 100 to 120 points out of the money

RUT, 80 to 100 points OTM

Look for a 10 point spread

Delta 7 but not more than 9, credit 0.50 but not more than 0.70

If you play both sides that 1.00 on a 10.00 spread, or 10% monthly

7) Now, The Ins' and The Outs'.

To get "In" I look for a delta of 20 or less with a premium .20 cents. These trades have an 80% probability. If the trade is going against me I watch and exit. There are several strategies to exit a trade when it goes bad. I normally just close it out, walk away, lick my wounds, and fight another day.

Observations

1) How far Out to Trade:

When I first started trading I was told to BUY puts/call 2 or 3 months out. To give myself time to be right. Now that we are selling, do we want to give the other guy time to be right? I know weeklies are scary. I looked at them for several years before trading them.

2) Earnings:

Never ever ever ever hold over earning. Never ever ever ever Buy/sell into earning.
Except sometimes.

NFLX earnings Mon July 22. Mon morning at 9:30 NFLX @ 267 sold 205/200 puts 62.06 points out and 335/340 calls 68 points out. With 130 point range with only 4 days to expiration it worked but I lost some sleep.

3) When I first started trading:

When I first started trading I was told to BUY puts/call 2 or 3 months out. To give myself time to be right. Now that we are selling, do we want to give the other guy time to be right? I know weeklies are scary. I looked at them for several years before trading them.

4) DON'T GET GREEDY!!!!!!!

Hello Rik,
this is a regular "Debit Spread"
we have made a lot of money selling spreads on NDX
and each week i see the index rising 50,75,points or more
thought i'd try buying one this week.
3 contracts, 1 each in my 3 accounts

Fri paid .80 for a total of 240
Mon could have sold it for 3.50 (1050 or more) for a profit oh 810
was not happy with 3.50 or 3.00 or 2.50 or 2.00
I WANTED 5.00
now, i have nothing

DON'T GET GREEDY!!!!!!!
if u open a position for .80 AND
the very next day u can close it for 3.50 or 3.75
take the money!! take ur family to McDonalds for lunch

ed

5) On 7/24/15 Douglas N. Wrote

As always, thanks for your generous sharing. While I have followed you for years and believe you have a well thought out investment strategy and a more than reasonable track record, I have yet to fully commit. (confidence, knowledge and time). I have two questions for you:

1) Given the nature of option trading and the need to make quick adjustments or exits from trades if the market threatens a position, can I assume that in order to be successful essentially you need to be monitoring trades each and every day when the market is open. I have a TorS account and have that capability to do so but usually find it difficult to be at my home computer (don't have an ipad etc.) every day during the market open hours. Are you at your computer to monitor trades every day during most of the markets open trading hours?

2) How soon after you fill 'watching' trades, does your email come out that the watched trades have been filled. Obviously in a fast moving market the premium or spread requirements could change significantly from the time you filled an order until your shared email of same is received by your followers.

Thanks for your time.

Regards,

Douglas N.

Answer Question 1.

I watch the market all day as I am retired and have nothing better to do except watch soap operas all day.

I look at upcoming events and the the charts. Try to determin the direction of the stock and sell OTM positions in the oppeset direction. Our positions start OTM and go further OTM.

Last week and this have been unusual weeks. And did need a lot of watching. This can be a problem also and can result in larger than normal losses as it brings emotions into play.

So if you cant watch the market what can one do.

- 1.use stop losses (available on TOS). Or
2. Trade smaller positions so that a total loss will not be a total loss.

With my number of positions per week (4 to 6). If one goes bad we can still make a few hundred. If two go bad we are +/- 50 or 60 dollars.

Answer Question 2.

My procedure is this,

1. I first setup the trade so that I know exactly what strikes and premium.
2. I create my email, may have 3 or 4 trades built and ready on it
3. I email you guys
4. Return to my trade screen to submit the trade.

sometimes the market moves so fast that from the time I hit "Send" email and return to TOS the trade has already moved on, sometimes that good for us, sometimes not. We then need to adjust our trades.

Thank you for writing

Happy trading

Ed

6) Rule 1256 and Taxes

On 7/23/15

Ming L. wrote:

"I'm also retired and can certainly use the extra money from the weekly option trades. However I wonder the number of trades incurred might give me headache during tax filing time. Any thoughts on this would be appreciated."

YES! and no.

In the 1980s I know a man said when he does his taxes

He starts with a candle light dinner...

A sip of wine (just a sip)...

And then does his taxes...

He said he has a check made out to the IRS for 1,000,000 and can't wait for the day he gets to mail it...

"Just Imagine How Much I Get To Keep!"

Me, I have my own records, spread sheets, ledgers of course

But for taxes I print out everything from TOS and dump it on my CPA

For \$325.00 year ThinkOrSwim does my records, my CPA does my taxes, files electronically and I have my refund in a few weeks
Worth 325?

Don't forget rule 1256 for broad based indexes

Although these are short term trades, rule 1256 Para B broad based indexes states only 40% are taxes as normal income,

And 60% is taxes as Long Term Cap Gains. Most accounts don't know this. You must tell them.

FYI, I don't pay taxes

I trade in three accounts, Cash, Roth, IRA.

Each year I draw 12,500 from my IRA. 10,000 and 2,500 for withholding, this is covered by standard deductions

The money I draw out for living comes from my ROTH, no taxes

Plus the money I make in my cash accounts equates to only small taxes

So my taxes are small to not at all

Happy trading

Ed

7. Okay, So. **When do we place my trade recommendations**

Okay,

So. **When do we place my trade recommendations, Thur, Fri, or Mon ?**

And the answer is ... YES ! and No !

I prefer late Fri afternoon. The last 30 to 60 minutes of the day.

When I see the current positions are going to expire worthless, or have been closed.

I'm always afraid someone will fly an airplane into a building or bomb some country.

In this way I avoid double exposure to the market except for 30 to 60 minutes.

Thank You for Writing, I'm always happy to hear from my subscribers

Ed

8. How do you decide whether to wait out credit options that have gone ITM.

A****,

How do you decide whether to wait out credit options that have gone ITM.
Getting in is easy, getting out not so easy.

I have several exit rules on my emails.

I DO USE RULE A. "If the short position is violated at the days close, look for an exit the next morning"

I got this from a female trader who managed billions of dollars. I don't remember her name.

B thru E, are mostly use as considerations or influence points.

This keeps me from bailing on a trade only to watch it turn and end up expiring worthless.

Yes, sometimes it gives me larger loss. But far fewer of them.

Trading Earnings:

I don't trade earnings or other expected announcements. With weekly options, we may not have time to recover from bad news.

Roll the position:

I don't roll the position. Or I do, I will most likely play the stock again next week anyway. I don't refer to this as rolling.

Close the Short Position only:

Or convert it to a Debit Spread. I never do this. Once in a million times you will make a fortune. The rest of the time pay a high price for the short and watch the long position expire worthless.

Again, I use rule a. **"If the short position is violated at the days close, look for an exit the next morning"**. Most of the time the stock reverses. Or at least we have one day less premium to pay for. With this rule, I have avoided many a loss. Most every time I have bailed early I have taken an unnecessary loss.

Hope this helps.

Thank You for Writing, I'm always happy to hear from my subscribers

Ed