Welcome to Options for Income and the wonderful world of stock options!

Stock options are derivatives. They derive their value from an underlying “something else” – typically the value of a stock or stock index. Each option contract represents the right to buy or sell 100 shares of that underlying stock at a certain price on or before a certain date. Compared to stock, they are very inexpensive.

In chemistry terms, call and put options are the “atoms” that make up a stock “molecule.” When you buy a stock, you are buying exposure to the full range of a stock’s price movement – up and down – for an unlimited period of time. Stock is a very blunt investment instrument that’s sort of like being forced to buy a telephone package of local, long-distance, call waiting, caller ID, and voicemail when all you really want is a local dial tone.

In contrast, options allow you to limit your capital at risk to only those portions of a stock’s price movement that you want – and for only the period of time you think necessary. This provides the trader with virtually unlimited flexibility to tailor his directional and temporal outlook concerning a stock and do so at the lowest possible cost.

Jack and the Bean “Stock”
I like to think of stock in terms of a bean “stock.” Everyone is familiar with the fairy tale Jack and the Beanstalk. In that fairy tale, a boy named Jack plants some magic beans and a beanstalk grows up to the clouds. It’s a nice story, but in options trading, people who believe in fairy tales don’t make...
money; only realistic people do. The roots and the trunk of a real beanstalk near the ground will always be there and don’t change. These sections have no growth and are like immutable rocks. When you buy stock, you are required to devote a large portion of your precious investment capital to the trunk portion of the beanstalk despite its inability to do anything. What a waste of money!

**Visualize Stock as a Beanstalk with Three Parts:**

1. Roots and Trunk
   - Solid as a rock, based on cash, tangible assets, and worst-case cash flows

2. Middle Section with Branches and Buds
   - Growth area, based on expected future cash flows
   - Area between trunk and stock’s fair value

3. Sky above the Branches
   - Speculation based on where the beanstalk could grow above its fair value based on takeover rumors or unrealistic earnings projections (a.k.a. time value)

**Buying the Middle for Realistic Growth**

The beanstalk only grows near the tip. Consider the strike price of a call option at a point along the beanstalk that is much nearer to the tip of the beanstalk than near its roots.

Buying an option in a beanstalk’s branches exposes you to the potential growth of the beanstalk without wasting money buying the beanstalk’s trunk near the ground. Because you are not buying the roots and trunk, the price of these call options is significantly less than the price of the underlying stock.

The lower price paid means that you will receive a much higher return on your initial investment with a call option than you will with stock if the stock moves up as anticipated. If the stock unexpectedly declines significantly below the trunk level of the bean-stock, the lower price paid for the call option will also mean that you will lose less than by owning the stock itself. Since you never paid for the stock’s trunk, you don’t lose any money if the trunk declines! Options for Income subscribers make money from the high-probability scenario that the beanstalk remains healthy and grows, but doesn’t grow to the sky.

**Selling Greed for Income**

Now consider the sky above the bean-stock. Real beanstalks grow towards the sky but they never grow all the way up into the clouds like Jack’s magic beanstalk. Yet, there are always some gamblers who are willing to believe in the fairy tale and buy call options on the future growth of the bean-stock with strike prices way up in the sky near the clouds. We sell these low-probability call options to collect cash upfront.

If the unlikely occurs and the stock rises above the call option’s strike price at expiration, you’re still okay because you already own the stock that can be sold to the call-option owner to satisfy the option exercise. Remember, you chose the strike price based on your opinion of what an overvalued exit point would be for selling the stock.

**Selling Fear for Income**

On the other extreme, there are chicken-little investors who believe the sky is falling. They are willing to bet that the beanstalk will die, roots and all and buy put options on disaster with strike prices way below the stock’s intrinsic value. We sell these low-probability put options to collect even more cash.

If the unlikely occurs and the stock falls below the put option’s strike price at expiration, you’re still okay because you simply buy the stock from the put-option owner at the strike price. Remember, you chose the strike price based on your opinion of what an undervalued entry point would be for buying the stock. Just be sure to limit the number of puts you sell to the number you would be comfortable having converted into 100-share lots of stock for purchase. For example, if you would normally buy 500 shares of a stock, sell no more than five puts.

**Risks of Options Can Easily Be Minimized**

All investments, including both stocks and options, risk loss if the underlying price goes in the wrong direction. If used wisely, however, options actually reduce the risk of loss from stock ownership. There are five main rules of option trading that protect you from assuming too much risk: (1) only sell the number of call options that are fully covered by stock that you own; (2) only sell the number of put options that you would feel comfortable having converted into stock; (3) only buy options that don’t expire for a long time; (4) limit the size of your option positions so that each option trade is only a small portion of your overall portfolio; and (5) choose an option’s strike price based on your analysis of the stock’s intrinsic value.

If you follow these rules, the risks of option trading will be greatly reduced while the substantial benefits will remain. Knowledge is power, especially when it comes to options.

**Three Main Options Strategies for Income and Growth**

To sum up, options can be used for many different investment objectives, but here at Options for Income, they are used for three main purposes, all of which serve to reduce risk. The two most commonly used strategies involve selling options – specifically, the fairy-tale call options with strike prices far above the stock’s intrinsic value and the chicken-little put options with strike prices far below the stock’s intrinsic value. By selling the two
extremely low-probability ends of the bean-stock, Options for Income can generate consistent income on a monthly basis.

In addition to these two income-generating strategies, Options for Income will focus on a third strategy that is growth oriented with unlimited profit potential: buying call options. In bean-“stock” terms, this involves buying the call option with the strike price in the growing, high-probability middle branches of the bean-stock between the trunk and the tip.

A more detailed explanation of each of these three options strategies — (1) selling covered calls; (2) selling puts; and (3) buying long-term calls — is available elsewhere in our introductory series.

### Setting Up Your Options Account

First things first. Before you can take advantage of the many income benefits options offer, you must be authorized to trade options. Many stock investors, once they are ready to include options in their trading strategies, are shocked to discover that they cannot make an option trade because their stock brokerage accounts do not authorize them to trade options. The cold, hard truth is that merely opening a stock brokerage account does not authorize option trading. To trade options, you must expressly request authority from your broker.

I can’t stress enough how important it is to take care of this first step to options trading right away. You’ll want to be ready to make your first option trade the minute my first recommendation arrives in your email inbox.

### Quick and Easy Process

The good news is that getting authorized for options trading is easy and usually takes less than five minutes to complete. For online investors who are opening up a new account, merely check a box to indicate that you want options trading authorization in addition to stock trading. The online account application will then simply add a couple of pages of questions on options. For investors with existing stock trading accounts that want to add options trading, you simply request an upgrade from your broker. Some brokers let you upgrade online whereas others will require you to fill out a form and send it in. In either case, once you have submitted the required information, the broker will take a few days to process your request and inform you what options trading level you have been assigned (more on trading levels a bit later).

### Options Trading Authorization Questions

The information you must submit to the broker to obtain options trading authorization falls into one of four different categories:

#### 1. Investment Objectives

- Speculation
- Aggressive Growth
- Growth
- Income

Your best chance for a high trading level authorization is if you put down “speculation” as one of your objectives. Many option traders simply check off all of the investment objectives listed. But even if you put down only “income” as an objective you will still probably be authorized for covered calls, which is a good options strategy.

#### 2. Trading Strategies

- Buy Stock
- Long Calls/Puts
- Covered Calls
- Debit Spreads
- Credit Spreads
- Selling Puts
- Short Stock
- Selling Naked Calls
- Mutual Funds

The more option trading strategies you check off as being of interest to you, the better your chances of getting a high trading level authorization. If you only select “buy stock” and “mutual funds,” you won’t get anywhere so be sure to check off more choices than those two. At the very least, check off “covered calls” and “selling puts.” Feel free to check off all of the strategies listed. Even if you don’t plan on using them now, after some education you may change your mind and it would be good to have your authorization locked and loaded when you decide you want to pull the trigger. So, the more option strategies checked the merrier!
3. Trading Experience

- Years of Stock Trading Experience
  - Number of Trades Per Year
  - Average Size Per Trade (# of shares and/or dollar amount)

- Years of Options Trading Experience
  - Number of Trades Per Year
  - Average Size Per Trade (# of contracts and/or dollar amount)

Don’t be shy when answering this question. The more years trading stock and options, the higher your trading level authorization will be. The average size per trade is less important for the trading strategies Options for Income will recommend, but a larger trading size number might tip the scales slightly in favor of a higher trading level.

4. Personal Finances

- “Liquid” Net Worth (Investments easily sold for cash – your home doesn’t count)
- Total Net Worth
- Annual Income
- Source of Income (Job, Investments, Pension)

Higher numbers are better, but honesty is always the best policy.

Option Trading Levels

Every broker is different, but a typical breakdown of option trading levels is as follows:

- Level 1: Covered calls
- Level 2: Long calls and puts
- Level 3: Spreads (both debit and credit)*
- Level 4: Short equity puts **
- Level 5: Short equity calls
- Level 6: Short index calls and puts
  
  *Minimum trading level recommended
  **Ideal trading level recommended

The majority of trades in Options for Income will be spreads, so make your goal getting approved for at least Level 3. Some recommended strategies involve spreads and short equity puts, so Level 4 is the ideal trading level to strive for, but Level 4 is absolutely not necessary to benefit from the service.

Highly-Rated Options Brokers

Barron Magazine’s annual ranking of online brokers is a valuable informational resource for investors looking for a broker. Below are four highly rated options brokers:

- Thinkorswim ($3,500 minimum deposit)
- TradeKing (no minimum)
- Fidelity ($2,500 minimum)
- TradeMonster ($3,500 minimum)

Note: Federal regulations require that all brokers impose a $2,000 minimum to trade on margin, including credit spreads.

I personally use thinkorswim, but any of these four are great. I don’t get compensated for mentioning any of these brokers and I offer them up simply to provide you with some names that you can research further. I also suggest that you read the Barron’s brokerage ranking to get more possible brokerage names to consider.

The Basics of Options

Calls and Puts

There are two types of options: calls and puts. And there are two sides to every option transaction: the party buying the option, who has a long position, and the party selling (also called writing) the option, who has a short position. Each side comes with its own risk-reward profile and its own strategies.

A call is the option to buy the underlying stock at a predetermined price (strike price) by a predetermined date (expiration, which is usually the third Friday of a month). The expiration can be as soon as next month or as distant as two and a half years away. If the call buyer decides to buy the stock — an act known as exercising the option — the call writer is obliged to sell his shares to the call buyer at the strike price.

A put option is the opposite of a call option, providing the put owner with the option to sell the underlying stock at a predetermined strike price until the expiration date. The put buyer has the right to sell shares at the strike price, and if he decides to sell, the put writer is obliged to buy the stock at that price.

<table>
<thead>
<tr>
<th></th>
<th>Call</th>
<th>Put</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Buyer (Long)</strong></td>
<td>Right to buy stock</td>
<td>Right to sell stock</td>
</tr>
<tr>
<td><strong>Seller (Short)</strong></td>
<td>Obligation to sell stock</td>
<td>Obligation to buy stock</td>
</tr>
</tbody>
</table>

* Note: Because an option is a derivative contract, it can be sold without owning it first.

A call buyer makes a profit when the price of the underlying shares rises. The call option’s price will normally rise as the shares do, because the right to buy stock at a constant strike price becomes more valuable if the stock is priced higher. The call writer is making the opposite bet, hoping for the stock price to decline or, at the very least, not rise above the strike price by more than the amount he received for selling the call in the first place.

The put buyer profits when the underlying stock price falls. A put increases in value as the underlying stock decreases in value, because the right to sell stock at a constant strike
price becomes more valuable if the stock is priced lower. Conversely, a put writer is hoping for the stock price to rise or, at the very least, not decline below the strike price by more than the amount he received for selling the put in the first place.

Bottom line: option buyers have unlimited upside/downside profit potential but must pay money up front for this privilege. In contrast, option sellers get a fixed amount of cash up front that immediately goes into their account earning interest, but expose themselves to the risk of unlimited losses if the sold option explodes in value and is not “covered” by stock or another option owned.

Option Symbols
Options come with a plethora of symbols, but they’re really quite easy to decipher. An option symbol consists of the following six components:

- underlying stock’s ticker symbol
- two digits representing the calendar year
- two digits representing the expiration month
- two digits representing the expiration day
- letter P or C identifying a put or a call
- strike price

For example, the ticker symbol of an Apple (NasdaqGS: AAPL) put option with a strike price of 100 that expires on January 17, 2015 is:

AAPL 15 01 17 P 100

“In the Money,” “At the Money,” “Out of the Money”
Traders describe options by the relationship of the strike price to the price of the underlying stock. For calls, if the stock price is above the strike price, the option has intrinsic value, because it allows you to buy the stock at a better (lower) price than someone who doesn’t own options could buy it on the open market. That makes the option in the money (ITM).

For puts, the reverse is true; the option has intrinsic value if the stock price is below the strike price, because it allows the holder to sell the stock at a higher price than available on the open market. If the stock price is equal to the strike price, the option is considered at the money (ATM), because it’s “on the verge” of having intrinsic value.

In both cases of calls and puts, the intrinsic value is the value the option owner could receive right now if she exercised the option. For example, if you own a call at a strike price of $50 and the underlying stock is trading at $57, the intrinsic value is $7 because right now you could exercise the call, which allows you to buy the stock at the option strike price of $50, and then sell the stock at the current market price of $57, netting $7 in the transaction.

An option is out of the money (OTM) when it has no intrinsic value. For calls, this occurs when the strike price is above the stock price and for puts, this occurs when the strike price is below the stock price. The following table illustrates the point with a fictional “XYZ” stock trading at different prices in relation to its call and put options at the $75 strike price:

<table>
<thead>
<tr>
<th>XYZ Stock Price</th>
<th>$70</th>
<th>$75</th>
<th>$80</th>
</tr>
</thead>
<tbody>
<tr>
<td>$75 Call</td>
<td>OTM by $5</td>
<td>ATM</td>
<td>ITM by $5</td>
</tr>
<tr>
<td>$75 Put</td>
<td>ITM by $5</td>
<td>ATM</td>
<td>OTM by $5</td>
</tr>
</tbody>
</table>

“Time Value”
Prior to expiration, all options (even those sorry OTM ones) have another type of value: time value. This refers to the value of an option that is not intrinsic value:

Time value = Price of option - Intrinsic value
Or
Price of option = Intrinsic value + Time value

Stock prices are always moving, so there’s the chance that an option will move ITM or, if it already is ITM, move further ITM during its “lifetime” (i.e., before it expires). Time value puts a price on that potential for — and degree of — ITM movement. At an option’s expiration, there’s no time value remaining, and the final value (if any) is limited to an option’s intrinsic value.

An option’s time value has a unique feature called time decay. Since options are, in essence, a bet on the future price movement of a stock, time is a prime component of an option’s value. The less time remaining until expiration, the less value an out-of-the-money call option — where the strike price is above the current stock price — has, because it becomes less likely that the stock will rise enough to let the option expire in the money. With each passing day, the time value of an option declines. The rate of decline is not constant, however. Time decay accelerates the closer you get to expiration.

Consider the following range of call options on hypothetical stock XYZ Corp as of August 3, 2014:

<table>
<thead>
<tr>
<th>Call Option</th>
<th>Strike Price</th>
<th>Expiration</th>
<th>Intrinsic Value</th>
<th>Time Value</th>
<th>Option Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$19.00</td>
<td>August 2014</td>
<td>$1.28</td>
<td>$0.22</td>
<td>$1.50</td>
</tr>
<tr>
<td>2</td>
<td>$19.00</td>
<td>September 2014</td>
<td>$1.28</td>
<td>$0.47</td>
<td>$1.75</td>
</tr>
<tr>
<td>3</td>
<td>$19.00</td>
<td>October 2014</td>
<td>$1.28</td>
<td>$0.68</td>
<td>$1.96</td>
</tr>
<tr>
<td>4</td>
<td>$21.00</td>
<td>August 2014</td>
<td>$0</td>
<td>$0.33</td>
<td>$0.33</td>
</tr>
</tbody>
</table>
There are three key takeaways here:

- Whenever the strike price is greater than or equal to the current stock price, the call’s intrinsic value is zero. In those cases, the option’s value is attributable solely to its time value — the expectation (hope?) by the call purchaser that by expiration, the stock price will get itself above the option’s strike price by at least the current time value.

- The less time remaining until expiration, the lower the time value. Note that call options 1, 2, and 3 all have $19 strike prices and thus identical intrinsic values. But option 1 expires in August (14 days away) and has a time value of only $0.22 while option 3, expiring in October (70 days away), has a time value of $0.68. More time means more value.

- For options with a common expiration date, time value is greater the closer the strike price is to the stock price. As the stock price moves further away in either direction, time value falls. The option’s time value decreases further into the money the option becomes because once an option is ITM, it’s “made the big time” and has intrinsic value. Time now is a two-edged sword for the option — whereas before time was purely a positive when the option was OTM. Although the stock continues to have time to move in the direction that increases the option’s value (positive), it also now has time to move in the wrong direction causing the option to fall back OTM (negative).

**Expiration**

Options have a limited lifespan, which is one reason they are much cheaper than stock. In other words, the right to exercise under an option contract expires after an agreed-upon period of time. For stocks, the expiration day is usually the Saturday after the third Friday of the expiration month. An option’s lifespan prior to expiration can range anywhere from next week to two and a half years in the future. The more time an option has prior to its expiration, the more expensive the option.

Personally, I buy long-term options (i.e., they don’t expire for more than a year) despite their higher cost because I want to make sure that my investment thesis has time to play out before I lose my rights to exercise the option. In contrast, I sell short-term options (i.e., they expire in 90 days or less) even though they yield less money because time decay speeds up nearer to expiration and I want my sold option to lose value quickly.

In reality, few retail investors hold options all the way to expiration and actually end up transacting stock through the exercise process. Options are, after all, tradable securities. As circumstances change, most investors lock in their profits (or losses) before expiration by selling options they had previously bought or buying back options they had sold.

**Exercise and Assignment**

Exercise at expiration is automatic if the option is at least one penny “in-the-money”. Most stock and ETF option traders close out their positions prior to expiration to avoid the complications of stock transactions and potential margin calls (most index options settle in cash, so there are no such complications with those).

Exercise prior to expiration (i.e., early exercise) must be elected by the option owner. Early exercise of options is relatively infrequent (i.e., less than 20% of the time) because it means that the owner is forfeiting whatever time value the option possesses. Early exercise, when it does occur, most often involves a call option that is in-the-money, the underlying stock pays a dividend, and the option is near expiration.

The matching of an “exercising” option owner with an “assigned” option writer is handled behind the scenes by the Options Clearing Corporation, a triple-A rated organization that guarantees performance by both buyer and seller.

**Exercise Style: European or American?**

Options are either “European” or “American” style. These terms don’t refer to geography, but simply denote differences in the exercise stipulations attached to the options. A European-style option is one that can only be exercised at expiration and not before. This makes European options desirable for traders who sell options because they don’t risk waking up in the morning and finding out they have been assigned overnight. An American-style option is one that can be exercised at any time right up to expiration. Most cash-settled index options are European, whereas options on individual stocks and ETFs are American.

**Selling Covered Calls**

Selling call options against your pre-existing stock positions (a.k.a. “covered” calls) generates income that is similar to receiving a cash dividend.

For example, let’s go back in time to Jan. 15, 2003 and assume that you’re a longtime holder of 100 shares of IBM (NYSE: IBM). The company’s annual dividend was $0.60 per share, which equaled an annual yield of only 0.7%. Since its October 2002 low of $54, IBM has rallied strongly to its current price of $87.59. With the stock up more than 60% in three months, you don’t expect much more upside in the short term, yet you think the stock won’t go down much, either, since it’s a bastion of blue-chip safety. You want to supplement its 0.7% yield as the stock stagnates.

Since you think IBM has topped out for now, why not sell the rights to further upside — upside you don’t think will actually occur — to some greedy speculator who
thinks differently? The closest strike price to the stock’s current price of $87.59 is the $90 strike. You decide to sell a February 2003 call with a $90 strike price for $3.25 per share—remember, you don’t need to already own the call option to sell it. The $3.25 received is like a “dividend” and equates to a yield of 3.7% ($3.25/$87.59) for just one month’s time!

**Pros and Cons of Covered Call Writing**

The additional income provided by covered-call writing is very attractive, but there is a trade-off involved (i.e., no “free lunch”). What is the IBM call seller forfeiting?—the ability to participate in the stock’s gain above the option’s $90 strike price. Consequently, if IBM goes up in price, writing the February $90 call limits your profit to $5.66 per share (the potential $2.41 gain in the stock up to the $90 strike price plus the certain $3.25 you receive for selling the call).

In other words, selling the covered call limits your upside over the next month to 6.5% ($5.66/$87.59). For conservative investors, the guaranteed income from covered-call writing is arguably more important than gambling that IBM will gain more than 6.5% in a month’s time (see table in next column).

**Covered Call Writing Wins Most of the Time**

As the table in the next column demonstrates, covered-call writing reduces your downside risk from owning IBM stock at all price points below your purchase price of $87.59. It also increases your profit at all price points between $87.59 and $93.25. The only scenario where the covered call is not superior is if the stock appreciates 6.5% or more ($93.25 or higher). If you’re like me, sacrificing a bit of potential – but far from guaranteed – upside is a small price to pay for reduced risk and peace of mind.

**Profit off of Someone Else’s Low-Probability Gamble**

What are the odds that a large, blue-chip stock will appreciate by more than 6.5% in the next month after having already gone up 60% in the previous three months? Unless you have insider information, I think it’s almost always a bad bet to make. In fact, in IBM’s case, the implied volatility of the February $90 call option indicated less than a 38% chance that the stock would close above $90 at February expiration. Consequently, based on statistics 62% of the time (100%-38%) writing the February $90 call should turn out to be the right decision.

The beauty of options is that they let you profit from someone else’s risky (and often wrong) bets. If somebody is greedy enough to want to pay me money for the right to profit from something that has only a 38% chance of playing out, I’ll take his money every time. Even if the “Greedy Gus” strikes pay dirt, I’ll be happy with my 6.5% return in one month! And you can always buy back into IBM stock after getting exercised if you think IBM offers further upside in the months and years ahead.

**IBM Covered Call: Profit/Loss at February Options Expiration (2-22-03)**

<table>
<thead>
<tr>
<th>IBM Stock Price at February Option Expiration</th>
<th>Cash Return with Covered Call*</th>
<th>Cash Return with Straight Stock Purchase at $87.59</th>
<th>Advantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>$80.00</td>
<td>-$4.34</td>
<td>-$7.59</td>
<td>Covered Call</td>
</tr>
<tr>
<td>$84.34</td>
<td>$0.00</td>
<td>-$3.25</td>
<td>Covered Call</td>
</tr>
<tr>
<td>$87.59</td>
<td>$3.25</td>
<td>$0.00</td>
<td>Covered Call</td>
</tr>
<tr>
<td>$90.00</td>
<td>$5.66</td>
<td>$2.41</td>
<td>Covered Call</td>
</tr>
<tr>
<td>$93.25</td>
<td>$5.66</td>
<td>$5.66</td>
<td>Equal</td>
</tr>
<tr>
<td>$95.00</td>
<td>$5.66</td>
<td>$7.41</td>
<td>Stock Alone</td>
</tr>
<tr>
<td>$100.00</td>
<td>$5.66</td>
<td>$12.41</td>
<td>Stock Alone</td>
</tr>
</tbody>
</table>

*Assumes IBM stock purchased at $87.59 and Feb. $90 call sold at $3.25.

**40 Times The Yield!**

Don’t forget that the 3.7% yield you received for selling the February 2003 call option was only for one month. Assuming the stock stayed around its then-current price of $87.59 at February expiration, you could have written another one-month $90 call at that time (i.e., March expiration) and pocketed another 3.7% dividend. Altogether, you could theoretically have written this call twelve times per year and received a total dividend yield of 44.4%. Pretty amazing yield-enhancement potential for a stock that paid a dividend of less than one percent!
What Actually Happened to IBM Using the Covered-Call Strategy

At the February 2003 expiration, IBM fell to $79.95, so selling the call was definitely better than just owning the stock and doing nothing. The covered call reduced your stock’s paper loss by $3.25, but you would have still had a net loss of $4.39 ($87.59-$79.95) + $3.25.

With the stock now below $80 and the February $90 call expiring worthless, you could have sold another covered call to bring in more income, this time at a lower strike price: the March $85 call for $1.00. At the March 2003 expiration, IBM closed at $84.90, so the $85 call expired worthless, too. You could then have sold the April $85 call for $3.20. At the April expiration, IBM closed at $84.26, and the call once again expired worthless.

You’ve now generated $7.45 per share in income by selling covered calls for three months, money that you wouldn’t have had by merely holding onto the stock. A stock-only approach would have resulted in a loss of $3.33 per share ($87.59-$84.26), while the covered call approach absorbed the stock losses and still generated a net profit of $4.12, or 4.7% ($4.12/$87.59):

<table>
<thead>
<tr>
<th></th>
<th>Jan ’03</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
</tr>
</thead>
<tbody>
<tr>
<td>IBM</td>
<td>$87.59</td>
<td>$79.95</td>
<td>$84.90</td>
<td>$84.26</td>
</tr>
<tr>
<td>Profit From Stock Only</td>
<td>$0.00</td>
<td>($7.64)</td>
<td>($2.69)</td>
<td>($3.33)</td>
</tr>
<tr>
<td>Profit From Covered Calls</td>
<td>$0.00</td>
<td>($7.64) + $3.25 = ($4.39)</td>
<td>($2.69) + $3.25 + $1.00 = $1.56</td>
<td>($3.33) + $3.25 + $1.00 + $3.20 = $4.12</td>
</tr>
</tbody>
</table>

Based on the above table, do you see how covered calls can turn a losing stock into a winner? Amazing!

A Covered-Call Strategy Beats the S&P 500

The IBM example may be an ideal example of the benefits of covered-call writing, but its success is also representative of covered-call writing in general; it is not a fluke. In fact, academic studies have concluded that call options are often overvalued. Consequently, selling covered calls on your stock portfolio has historically outperformed a stock-only strategy. For example, a 2006 Callan Associates study concluded the following about the S&P 500 Buy-Write Index (Chicago Options: ^BXM):

The results show that the BXM Index has generated superior risk-adjusted returns over the last 18 years (18 years and 3 months, to be exact), generating a return comparable to that of the S&P 500 at approximately two-thirds of the risk. The compound annual return of the BXM Index since June 1, 1988 is 11.77 percent, compared to 11.67 percent for the S&P 500. The BXM returns were generated with a standard deviation of 9.29%, two-thirds of the 13.89% volatility of the S&P 500.

Possible Tax Implications of Covered Calls

The risk of selling a covered call – besides losing out on stock appreciation above the strike price – is that the call option may be exercised “early” (i.e., prior to expiration) and you will be required to sell the stock at the strike price, which may cause you to incur a significant tax liability if the stock is in a taxable account and your cost basis in the stock is low. Early exercise is more likely for dividend-paying stocks. Sometimes the call option buyer will exercise the call the day before a stock’s ex-dividend date in order to capture the dividend. However, this is only a significant risk if the option expires soon and is “in the money.” If the stock price is below the strike price, the buyer would have to pay an above-market price for the stock, and it’s unlikely that collecting the dividend would make up the difference.

Of course, you may have the opportunity to buy back the covered call before it gets exercised, and thus avoid the taxable event, but there is no guarantee. At expiration, any call option that is “in the money” (the stock price is above the call option’s strike price) by at least $0.01 will be automatically exercised by the Options Clearing Corporation. Consequently, covered calls on stocks that you have owned for a long time (and which have significantly appreciated) work best in a tax-deferred IRA or 401k account.

Selling Covered Calls Is Worth a Try!

If you are very bullish on a stock, simply buy the stock. If, however, you want to enhance your dividend income and reduce the risk of owning stock, selling covered calls against your stock holdings will be the better choice a majority of the time. The above examples of IBM and the academic studies are powerful evidence that a covered-call strategy can provide significant risk-reducing benefits to your stock portfolio.

Selling Put Options

If you already own stock, selling call options against them is a great way to earn extra income on your stocks (even non-dividend paying ones).

Put Options Are Great Too

But there is another way to generate extra income that doesn’t require that you own stock. It involves selling a call option’s opposite twin — the put option. Selling put options allows you to buy stocks at a discount below its current market price. C’mon folks, to paraphrase the late “Queen of Mean” Leona Helmsley, only the little people pay retail! With put options, you never need to pay retail for a stock again.

Buying stock can be scary because the stock price could fall after you purchase it. One way to reduce this risk is to sell a put option on the stock rather than purchase the stock.
directly. The beauty of selling a put is that you don’t mind getting exercised because you wanted to buy the stock in the first place. By selling the put, you are basically setting a limit order to buy the stock at a below-market price. Unlike a limit order, however, you get paid up front and get to keep the money even if the stock never falls to your limit price (i.e., the put’s strike price).

**Selling Puts or Placing a Limit Order, That is the Question**

As an example, let’s assume we’re in the month of October and you are interested in fictional **XYZ Company**, a high-priced stock trading for $135 per share. You haven’t purchased the stock because, at its current price of $135, you think it’s too expensive. You only want to buy the stock if its share price falls to $130.

I see two choices: (1) enter a limit order at $130 and wait to see if the stock falls back to that level, or (2) sell a put option right now with a $130 strike price that expires in January for $4.60 per share. If XYZ falls below $130 at January expiration, the put will be automatically exercised by its owner and the seller (i.e., you) will purchase the stock at $130 per share. But don’t forget the $4.60 per share you received for selling the put — that means you’re actually buying the stock for $125.40 per share ($130 - $4.60). Compared to buying the stock at a limit price of $130, selling the put saves me $4.60 per share or 3.5%! If you ask me, 3.5% is a nice discount off of the retail price.

<table>
<thead>
<tr>
<th>Stock Price at Option Expiration</th>
<th>Per-Share Return Selling Puts vs. Stock Limit Order</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sell $130 Put on XYZ: Profit/Loss at January Options Expiration</strong></td>
<td><strong>$130 Limit Never Hits and Stock Not Purchased</strong></td>
</tr>
<tr>
<td><strong>Stock Price at Limit Price of $130</strong></td>
<td><strong>Purchase Stock at Limit Price of $130</strong></td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>---------------------------------</td>
</tr>
<tr>
<td>$120.00</td>
<td>$10.00</td>
</tr>
<tr>
<td>$126.00</td>
<td>$4.00</td>
</tr>
<tr>
<td>$129.00</td>
<td>$1.00</td>
</tr>
<tr>
<td>$130.00</td>
<td>$0.00</td>
</tr>
<tr>
<td>$134.60</td>
<td>$4.60</td>
</tr>
<tr>
<td>$140.00</td>
<td>$10.00</td>
</tr>
<tr>
<td>$150.00</td>
<td>$20.00</td>
</tr>
</tbody>
</table>

*Based on selling the Jan. $130 put for $4.60

### There’s a Catch

What’s the catch and why doesn’t everyone buy stock this way? Well, as with selling calls, your profit potential is capped at the premium you receive for selling the option. If the stock closes above the option’s strike price at expiration, your put will not be exercised, you will never own the stock, and you will not participate in any of the stock’s subsequent price gain.

### A 3.7% Return in Four Months? Sign Me Up!

But even if you don’t get to own the stock, there are a lot worse things than earning a 3.7% return ($4.60/$125.40) in less than four months’ time! That’s more than 10% annualized.

### Puts Reduce Risk at Every Price Point

As the above table demonstrates, if the limit order is filled, selling the put is superior to the limit order at all prices below $134.60. That’s a nice risk reducer in case the stock declines or rises only a little. If the limit order is not filled, selling the put is superior to the limit order at all price levels.

### Limit the Number of Puts You Sell

Brokers allow you to sell more put options than you can afford to have converted into stock. Don’t be tempted by the siren song of excessive leverage! For a short put, the brokerage firm’s initial margin requirement is:

\[
100\% \text{ of the option proceeds} + (20\% \text{ of the Underlying Stock’s Market Value}) - (\text{Out of the Money Value})
\]

For example, if you sell a $45 put for $1.50 per share on a $50 stock, the initial margin requirement would be: $1.50 + (20%*$50) - ($50-$45) = $6.50 per share ($650 per contract). In contrast, if you were to simply buy the stock at $50, your margin requirement would be half of $50, or $25 per share. Selling the put has a margin requirement that is almost 75% less than the stock purchase. Sounds great, but this small margin requirement is not constant but can increase if the stock goes down based on the following formula:

\[
\text{Market value of the option} + (20\% \text{ of the Underlying Market Value}) - (\text{Out of the Money Value})
\]

For example, if after selling the $45 put, the stock declines from $50 to $45, the put could increase in value from $1.50 to $3.50. Furthermore, the option’s strike price would no longer be out of the money. The margin requirement would increase to: $3.50 + (20%*$45) - 0 = $12.50 per share. In other words, the margin requirement would have almost doubled ($12.50 vs. $6.50)! Bottom line: never “max out” on the margin that your
broker permits you for short puts because it is very likely this initial margin requirement will increase -- perhaps substantially -- during the life of the option. Trust me, you don’t want to face a margin call!

One safe way to ensure that you will never receive a margin call is to limit the number of puts you sell to the number of contracts that translates into the amount of stock you would feel comfortable owning. Each option contract represents 100 share of stock, so if you would normally buy 500 shares of stock, limit your put sales to five contracts.

**Buying Call Options as a Stock Replacement Strategy**

The two most conservative options strategies involve selling options: (1) selling covered calls on stock you already own, and (2) selling puts to purchase stock below the current market price. Both of these conservative strategies provide solid income that can be thought of as a dividend or a price discount, but it’s not going to double or triple your initial investment.

**Buy Long-Term Call Options**

To make the really big returns, however, you must buy call options. Buying call options promises a higher return because they offer the same upside exposure to stock price appreciation, but at a fraction of the cost.

The reason call options cost less is because you get to choose a strike price which is much higher than zero. To use the beanstalk imagery, purchasing stock requires that you shell out money for the entire beanstalk, including the roots and trunk that simply tie up capital without providing any growth. In contrast, the call option buyer can bypass the roots and trunk altogether and focus only on the growth portion of the beanstalk by purchasing options with a strike mid-way up.

The disadvantage of options is that their value includes a speculative component called “time value.” As time passes, this value decays and detracts from your profit potential, but the decay is very slow when the expiration date is far away. There’s no way to buy an option without paying this speculative and decaying surcharge, but you can minimize its detrimental effects by: (1) buying long-term options that don’t expire for a couple of years; and (2) choosing a strike price that is deep in-the-money because the price of ITM options is almost entirely composed of intrinsic value, with time value only a very small portion of the price.

**Using Call Options Can Save Cash and Permit Greater Portfolio Diversification**

As an example, let’s take a fictional stock like XYZ Company and assume it’s trading at $164 per share. To buy a round lot of 100 shares would cost you $16,400 which isn’t chump change.

An alternative to buying the stock outright would be to buy two January 2015 call options at the $165 strike for $16.10 per share. Since each option contract represents 100 shares, the cost for purchasing two call options would be $3,220. In other words, purchasing two XYZ call options would cost only 19.6% ($3,220/$16,400) as much as buying the stock. An investor gets the same or more profit potential from XYZ for $13,180 less cost ($16,400-$3,220)! The cash savings can be used to diversify into other investments, including keeping some of it in cash.

And this substantial cash savings involves just one case where you substituted call options for stock. Just imagine how much money you could save if you used this option-based stock replacement system with multiple stocks in your portfolio!

**Potential Percentage Gains of Options Are Astronomical**

Take a look at the following table, which shows the profit potential of buying two XYZ call options now and then selling them in one year, which would still leave them with one year of life prior to their expiration in January 2017. This example is very conservative because it assumes that it takes a full year for the XYZ up-move to occur (i.e., the options will have experienced one year of time decay). The comparative results would be even better if I had assumed XYZ’s up-move occurred closer to now.

<table>
<thead>
<tr>
<th>XYZ Stock Price</th>
<th>Purchase Two $165 Call Options for $3,220</th>
<th>Purchase 100 Shares of Stock for $16,400</th>
</tr>
</thead>
<tbody>
<tr>
<td>$115</td>
<td>-$3,160 (-98.1%)</td>
<td>-$4,900 (-29.9%)</td>
</tr>
<tr>
<td>$136.50</td>
<td>-$2,750 (-85.4%)</td>
<td>-$2,750 (-16.8%)</td>
</tr>
<tr>
<td>$173.50</td>
<td>$187 (5.8%)</td>
<td>$950 (5.8%)</td>
</tr>
<tr>
<td>$192</td>
<td>$2,800 (87.0%)</td>
<td>$2,800 (17.1%)</td>
</tr>
<tr>
<td>$205</td>
<td>$5,020, (155.9%)</td>
<td>$4,100 (25.0%)</td>
</tr>
<tr>
<td>$220</td>
<td>$7,780 (242.6%)</td>
<td>$5,600 (34.1%)</td>
</tr>
</tbody>
</table>

*Note: option values one year prior to expiration are based on theoretical calculations*

As the table above shows, buying XYZ call options beats owning stock on a percentage basis at all prices above $173.50. In other words, XYZ only has to rise 5.8% from its current price of $164 for the call option to be the superior investment. The percentage gains from options truly become huge the higher
the stock goes. If XYZ were to increase by 34% to $220, the call option would profit almost eight times as much (243%).

Dollar Gains Are Up to You

Potential dollar returns from options are strictly a function of how many option contracts you wish to purchase. The more contracts, the more dollars you can potentially make based on the leveraged percentage returns shown in the above table. Typically, the immense positive leverage of options is used to significantly reduce the amount of capital required to initiate a stock position.

But option leverage can also be used to magnify your dollar profits by double, triple, or even quadruple those you would get from owning the stock. This would involve investing a similar dollar amount in options that you would in the stock itself. In this scenario, using options wouldn’t lower capital at risk and increase your diversification capability, but it would turbo-charge your potential portfolio returns into the stratosphere.

Call Options Provide Insurance Protection Against Big Stock Declines

Options don’t just help on the upside; they also help on the downside. As the XYZ table above shows, breakeven between buying XYZ stock and XYZ call options occurs at $136.50 on the downside. If XYZ were to fall by 16.8% or more by January 2017, the call options position would lose less money.

Although the option position’s loss at $136.50 would be almost total (85.4%) compared to a stock loss of less than 17%, percentage losses are irrelevant when dealing with different initial investment amounts. What’s important to wealth is the actual dollar amount lost. I would rather lose 85.4% of a $3,220 option investment ($-2750) than 17% or more of a $16,400 stock investment ($-2,788 or more). The lower investment cost of the call options acts like an insurance policy against a significant XYZ price decline.

Options Spreads: Buy and Sell Options Simultaneously

As I’ve discussed, selling call options against your existing stock position lowers the cost of your stock investment and creates dividends out of thin air. Selling put options allows you to purchase stock at a discount. And buying long-term call options as a stock replacement can provide you with all the upside of stock ownership at a fraction of the cost of stock ownership.

Option Spreads Reduce Risk Even More

Do you see any pattern here? In each case, options are used to lower your out-of-pocket cost and thereby reduce your risk. But there is yet another step you can take with options to reduce your risk even further. It is a secret that option professionals have been using for decades but which has only recently entered the mainstream. This extremely powerful tool is known as spreading.

Buying Stock on the Cheap

Here’s how it works using my favorite fictional stock XYZ Company. Let’s say you’re bullish on XYZ’s prospects, having determined that the stock is worth $155. With XYZ very high-priced at $130 a share, you don’t want to risk a large amount of your capital buying stock, so you decide to buy a call option that expires in January 2013 as a stock replacement.

Using Calls as a Stock Replacement is the First Step

One possibility would be to simply buy the $130 call, which currently costs $9.30 per share or, because one options contract equals 100 shares, $930 per contract. Buying 100 shares of XYZ stock would cost $13,000, which is quite a bit bigger capital commitment than the $930 needed to buy the equivalent options position, wouldn’t you say? At January expiration, break-even for the options position is $139.30 ($130 strike plus $9.30 option cost). If XYZ makes it up to the $155 target by then, the call option contract will be worth $2500, resulting in a profit of $1,570 or 169% ($1,570/$930).

In contrast, the buyer of 100 shares of XYZ stock at $130 would make a profit of $2,500 but only a 19% profit ($2,500/$13,000) because of the much higher capital commitment involved in buying the stock. The option buyer could easily surpass the stock buyer in dollar profit simply by purchasing two $130 call options instead of one. This would double the option cost to $1,860 but would still cost 85% less than buying the $13,000 worth of stock.

Converting Calls into Call Spreads is the Second Step

But in my world of maximum risk reduction, even 85% less is still too expensive, still too much risk. Consequently, I recommend selling the $135 call against the purchased $130 call — thus creating the 130/135 call spread — in order to reduce the cost of the bullish position even further. Remember, since an option is a derivative contract, it can be sold without owning it first. The $135 call is trading at $6.90 per share ($690 per contract), so selling it against the $130 call would reduce your overall cost to $240 per contract ($930-$690), a 74% reduction from the original cost of $930 for the $130 call option alone.

Another advantage of selling a call to reduce cost is that you can often totally eliminate the “time value” surcharge on the long-term call option that you are long. In other words, you get all of the upside of stock ownership (up to the strike price of the sold call) at a fraction of the cost of stock and without suffering any time decay — the best of both worlds!

Sound Familiar?

If the mechanics of creating this call spread sound vaguely familiar, you’re not imagining things. It’s very similar to the covered call strategy. The only difference in the case of the spread is that you are selling the covered call
against another long-term call rather than against stock. The risk reduction benefits are simply magnified many times over in the option spread situation, since the sale proceeds of the call you are selling ($690) is much closer in value to the call you purchased ($930) than to the value of the 100 shares of stock you could have purchased ($13,000).

I’ll Sacrifice Huge But Unlikely Upside for Regional Leverage Any Day

As in the case of a covered call strategy, the “catch” is that you limit your potential upside profit in the stock. In the case of the 130/135 call spread, your maximum profit at expiration occurs at $135; any further appreciation in XYZ’s stock price above $135 is collected by the purchaser of the $135 call you sold. But the cost reduction you enjoy by selling the $135 call is so great that the profit potential remaining is tremendous:

<table>
<thead>
<tr>
<th>Stock Price at Expiration</th>
<th>$130/$135 Call Spread</th>
<th>Call Spread % Profit</th>
<th>Individual $130 Call</th>
<th>Individual Call % Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$125</td>
<td>-$2.40</td>
<td>-100%</td>
<td>-$9.30</td>
<td>-100%</td>
</tr>
<tr>
<td>$130</td>
<td>-$2.40</td>
<td>-100%</td>
<td>-$9.30</td>
<td>-100%</td>
</tr>
<tr>
<td>$135</td>
<td>$2.60</td>
<td>108%</td>
<td>-$4.30</td>
<td>-46%</td>
</tr>
<tr>
<td>$140</td>
<td>$2.60</td>
<td>108%</td>
<td>$0.70</td>
<td>8%</td>
</tr>
<tr>
<td>$141.90</td>
<td>$2.60</td>
<td>108%</td>
<td>$2.60</td>
<td>28%</td>
</tr>
<tr>
<td>$145</td>
<td>$2.60</td>
<td>108%</td>
<td>$5.70</td>
<td>61%</td>
</tr>
<tr>
<td>$149.34</td>
<td>$2.60</td>
<td>108%</td>
<td>$10.04</td>
<td>108%</td>
</tr>
<tr>
<td>$150</td>
<td>$2.60</td>
<td>108%</td>
<td>$10.70</td>
<td>115%</td>
</tr>
</tbody>
</table>

As the table shows, the call spread is the superior investment at all price levels under $149.34 on a percentage profit basis and under $141.90 on a dollar profit basis. What’s so impressive about the spread’s profit outperformance is that it occurs while reducing risk at the same time! Between XYZ’s current price of $130 and $141.90 (9.2% higher), the spread makes more money on a dollar basis than the individual call and yet requires 74% less of a capital commitment.

Because the outperformance of spreads is limited to cases where the stock rises only modestly, option traders often characterize spreads as possessing “regional leverage.” Within the region of modest price appreciation, the spread can’t be beat, but individual calls will outperform in cases where the stock makes a huge price move. But isn’t it better to bet on modest price moves than huge price moves? You betcha.

I especially like the comparison at the $135 stock price. The spread more than doubles your money while the individual call loses 46%! Amazing. The stock only has to increase by 3.8% for the spread to gain 108%. Now that’s what I call leverage! Financial theory always teaches us that to get more reward you need to take more risk. This options spread illustration belies that notion; you can have your cake and eat it too!

Option Spreads are Worth a Try

If you are very bullish on a stock, simply buy an individual call option. If, however, you are only moderately bullish on a stock and think it will go up some but not a lot, buy a call spread. Substantially reducing your cost — while at the same time substantially increasing your profit potential — makes a lot of sense.

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Placing an Option Trade with Your Broker

Once you have obtained option trading authority from your broker, you are ready to trade options and take advantage of my profit-making recommendations the minute they hit your email inbox.

Congratulations!

The next step is to actually place an option trade with your broker. How does one do this? The first thing to remember is that each option contract represents the right to buy or sell 100 shares of stock. Yet, option quotes are priced on a per-share basis. Consequently, if you want to buy one call option on XYZ stock that is quoted at $1.50, the cost of that trade for you will be $150 (100 shares * $1.50). Do not enter a trade expecting to pay only the per-share price! Always multiply the quoted price by 100 to get the cost of the trade.

The second thing to remember is that options are derivative contracts, not physical objects like a share of stock. Contracts are agreements that can be created or cancelled by the parties involved. Consequently, an investor can sell an option contract that he does not already own. This can be done with stock also, but the short seller of stock must first locate actual shares outstanding and borrow them from their owner prior to selling them. This “locate and borrow” requirement is not necessary when selling option contracts. But more to the point, when an investor places an option trade, he must indicate whether he is creating a contract or cancelling a contract. To create a contract, the option trader must indicate that he is “opening” a position and to cancel a contract, he must indicate that he is “closing” a position. For option purchases, classify the limit order price as a “debit” and for option sales, classify the limit order price as a “credit.”

Lastly, when the option strategy you wish to trade involves two different securities (e.g., a stock and option combination or two options), you should enter the order as a single trade with a single limit price. Doing it this way ensures that you
know exactly what the net cost of the strategy is. Always start with the “buy” portion of your order and finish with the “sell” portion. If the combined order will cost you money, then classify your limit order price as a “net debit.” If the combined order will yield you income, classify the limit order price as a “net credit.”

With that introduction, let’s go through some examples of option strategies and how to enter the trade.

1. Buy/Write (i.e., covered call strategy)

   This option strategy involves two separate securities (buying stock and selling a call option), so you should enter it as a single order. Some brokers label this a “buy/write” and others call it a “covered stock” trade. As an example, let’s assume you want to do a buy/write on XYZ stock that is selling for $50 per share and you want to sell the July $55 call on XYZ that is trading for $2.25 per share. Below is a script for what you should say to a broker:

   I’d like to enter a buy/write order on XYZ stock. Specifically, I want to buy 100 shares of XYZ stock and sell to open one July $55 call on XYZ for a net debit of $47.75 per share.

   The broker may ask for the option ticker symbol just to be sure which option you want to sell. The symbol can be found on virtually any option chain website, including your broker’s. For example, click here to see the option chain for IBM on Yahoo! Finance. If you trade online and don’t speak with a human, look for your broker’s advanced option order entry screen.

   If your short call is “out-of-the-money” at expiration and set to expire worthless, you don’t need to do anything. It will just happen automatically. If your short call is “in-the-money” at expiration, it will be exercised, and you can just let it happen. But if you don’t want to sell your stock, you can try to buy back the call prior to expiration. If the call is currently selling for $1.50, say the following to your broker:

   I want to buy to close one July $55 call for a debit of $1.50 per share.

2. Option Spreads

   Similar to a buy/write, an option spread involves two separate securities that should be entered as a single trade. For example, let’s say you want to buy a bullish vertical call spread on XYZ that involves buying a July $50 call for $3.00 and selling a July $55 call for $1.40. Start off by letting the broker know that it is an option spread order, and then provide the buy and sell portions of the spread order without a quantity attached. After you have detailed which options are involved in the spread and what your limit price is, only then tell the broker how many times you want to trade the spread. Below is a script for what you should say to a broker if you want to buy three of the $50 calls and sell three of the $55 calls:

   I’d like to enter an option spread order on XYZ stock. Specifically, I want to buy to open the July $50 call and sell to open the July $55 call for a net debit of $1.60 per share. And I want to do that spread three times.

   If you subsequently decided to get out of the spread position after it had increased to a value of $2.00, you would say this:

   I’d like to enter an option spread order on XYZ stock. Specifically, I want to buy to close the July $55 call and sell to close the July $50 call for a net credit of $2.00. And I want to do that spread three times.

3. Selling Puts

   Since this strategy involves a single security and no buy portion, just start with the sell portion. As an example, let’s use a July $40 put on XYZ stock trading for $1.35:

   I’d like to sell to open the July $40 put on XYZ stock for a credit of $1.35 per share.

4. Buying Long-Term Calls (i.e., LEAPS)

   Long-term options typically expire in January, so there will be several different January option series based on the different years involved. Consequently, you have to be sure to include the expiration year along with the expiration month when placing an order to trade LEAPS. Providing the ticker symbol is a second way to make it crystal clear which January option series you want to trade. As an example, let’s use a $55 call on XYZ that expires in January 2017:

   I’d like to buy to open the $55 call on XYZ that expires in January 2017.

Subscription Information

As a member to Options for Income, you can expect to receive approximately 4-5 trade recommendations each month. There is no schedule for these—they will be issued only when I have identified a high-probability play. You’ll also receive 24/7 flash alerts whenever I spot an opportunity that just can’t wait, or when it’s time to take profits, or exit a trade. In addition, every Monday you will receive a weekly briefing, with a complete review of open positions, in-depth follow-up analysis and my take on where the market is headed.

Here are some ways to ensure timely receipt of your e-mailed trades, weekly briefings and flash alerts:

• Add our CustomerService@InvestingDaily.com e-mail address to your address book, contacts, e-mail filters or safe list. By adding our e-mail address, you are notifying your
Internet Service Provider that we are a known contact with mail you wish to receive and ensuring that the mail does not end up in your SPAM folder. If you need assistance with this, please contact your Internet Service Provider.

- Check the settings on your mail filters. For example, if you are filtering out all e-mails with a clickable hyperlink, you are automatically blocking delivery of important trade recommendations, weekly updates and flash alerts. And, if your filters are set to automatically delete blocked mail, you will never know that these important communications were filtered out. If you need assistance with accessing your mail filters, please contact your Internet Service Provider.

- Clean up full mailboxes and make sure there is sufficient space in your Inbox for your issues. One of the most common reasons for missed e-mail is a full mailbox.

Get Started!

I hope you have found this beginner’s guide to options helpful. We’ve learned about the benefits of options, how to get authorized to trade them, and how using a few great option strategies can help reduce your investment cost and enhance your returns. Knowledge is power.

My final piece of advice is to make an options trade and get started! Once you are “over the hump” with your first option trade, you will be actively engaged in a lifetime of learning and taking control of your financial future. Of course, it makes sense to start small – trading only one option contract per trade – during your initial learning process. But eventually, you can increase your position size as you gain confidence and start to make some big money!

I’ll be here – as much or as little as you want — to hold your hand throughout your journey of discovery. I’m ready to start and hope you are too.

So check your email inbox for my next trade alert and good luck trading!

Direct Access to Jim Fink

If you would like to let us know about your success trading the Options for Income recommendations please feel free to email us at: OptionsForIncome@InvestingDaily.com

If you have any comments or questions about the trade recommendations, weekly updates, flash alerts, or even about some of the strategies and tutorials, please send an e-mail to OptionsForIncome@InvestingDaily.com.

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E-mail: CustomerService@InvestingDaily.com
Phone: 1-800-832-2330

We are available to take your call Monday through Friday, from 9:00 a.m. to 5:00 p.m. Eastern Time.