

WEALTH  BUILDERSHQ

COVERED CALL
MONEY
MACHINE



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COVERED CALL MONEY MACHINE

What Are Covered Calls

What Are Covered Calls

Covered Call – A trader buys a stock and sells to open an option for a determined period of time. The trader then obligates themselves to deliver the stock at the strike price that was sold.

The stock and the call need to be in the same account

In a Covered Call trade you want the stock to go up or sideways and you can still be successful in the trade. If the stock goes down a little the trader may still be successful.

Covered Call Terminology

Call – The right, but not the obligation, to buy a stock at a specified price on or before a specific date.

Put – The right, but not the obligation, to sell a stock at a specified price on or before a specific date.

Covered – Having a long position to cover the short option in a trade.

Write – When a trader sells a call on a stock they own, it is synonymous with writing the call on the stock.

Buy Write – When the trader “Buys” a stock and “Writes” the call on the same stock at the same time.

Collar – The trader institutes a traditional covered call and buys a put at a lower strike price to protect the stock from large decreases.

Net Debit – After purchasing the stock and selling the call the “Net Debit” is the amount of money removed from the trader’s account when they institute the trade.

Covered Call Terminology

Obligated – When a trader sells an option to open, they take on an obligation in a particular stock. This is unlike the trader that buys to open an option; they have a right, but not an obligation, in the trade.

Buy to Open – Buying an option to open a new position

Sell to Open – Selling an option to open a new position

Buy to Close – Buying an option to close out (or end) the trade.

Sell to Close – Selling an option to close out (or end) the trade.

Called Out – When an option is exercised, the covered call trader is called out of the stock they own.

Rolling out – If a trader is obligated in a covered call for a particular month, they could buy to close the option and roll out to another month further in time.

Selecting Covered Call Candidates

Candidate Selection

Criteria for selecting trading candidates will vary from trader to trader, but there are some core rules that all trader should consider prior to entering a covered call.

Choosing the correct stock is more than just getting a good premium. Many covered calls produced a nice premium, but the stock was the wrong one to purchase at the time.

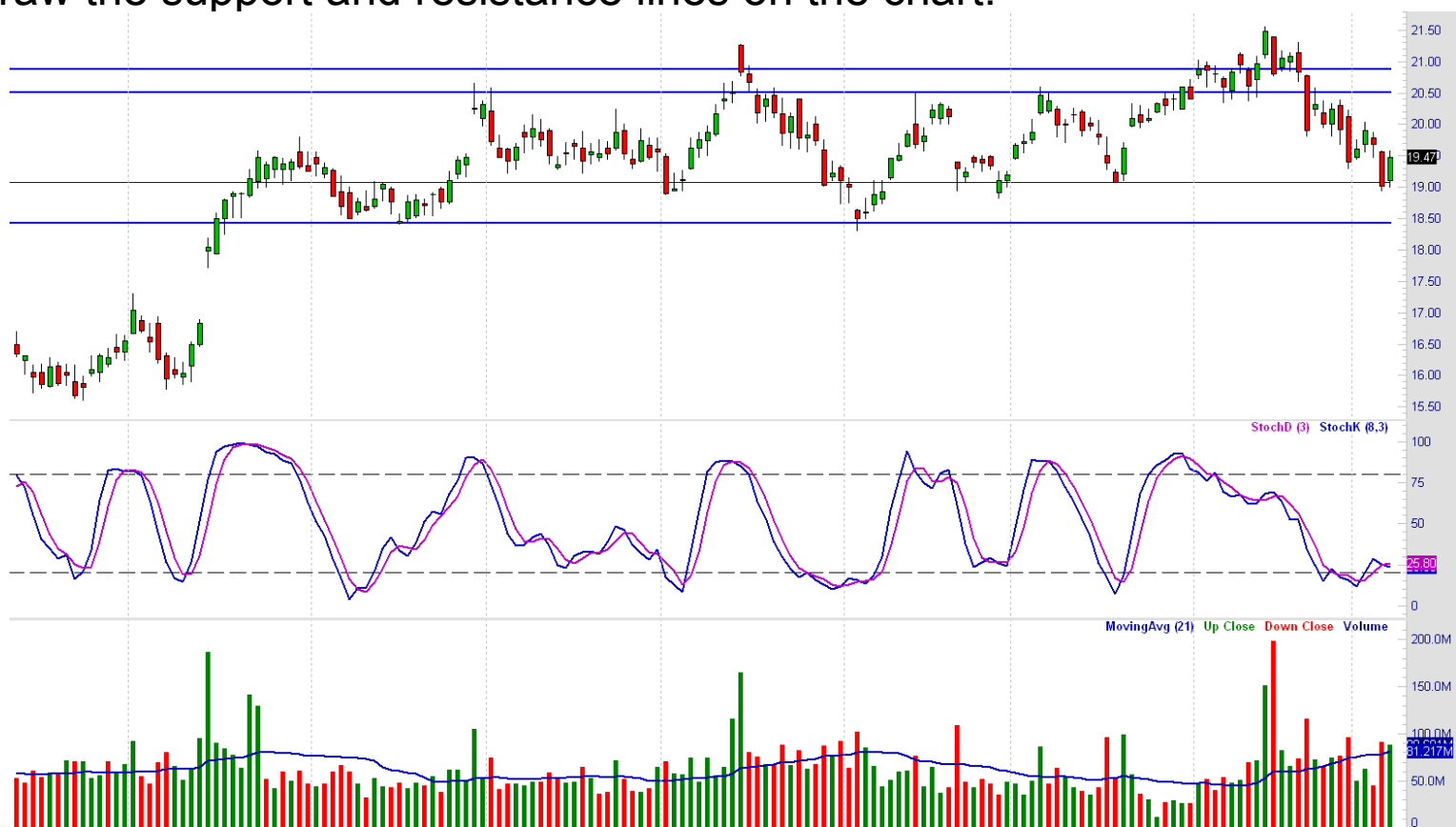
Options can potentially become overvalued when pending news is coming out on a particular stock. This could give a trader a false sense of security when choosing a candidate for covered calls.

Criteria for Candidate Selection

- Look for stocks that are between \$4 and \$40
- The volume of the stock should be greater than 500,000 shares traded per day.
- Check the stock's trend; it should be either trending up or sideways. Use at least two months of time when evaluating the trend. For a stock that is in a sideways channel, you will want to see the stock has channeled at least two times over the last two months. Don't purchase stock when it is trending down.
- Check the technical indicators and make sure they confirm the chart pattern you just looked at. (Technical indicators will be discussed later in workshop.)
- Make sure the earnings dates are coming out after the expiration month you will be trading.
- The stock needs to be bouncing off of a support level.

Criteria for Channeling Candidate Selection

- Once you have found a stock that has met the core rules, there are a few secondary criteria that have to be met.
- Draw the support and resistance lines on the chart.



Criteria for Channeling Candidate Selection (Technical Analysis)

When a stock is in a sideways channel look at the following indicators on your charting program:

- Candlestick chart
- Stochastics with the settings of 8,3,3 (These do not work in a trending market). Ideally the Stochastics will be crossing up through the 20% line, which is a buy signal.
- Volume bars with a 21 day simple moving average.

Drawing Lines For Channels

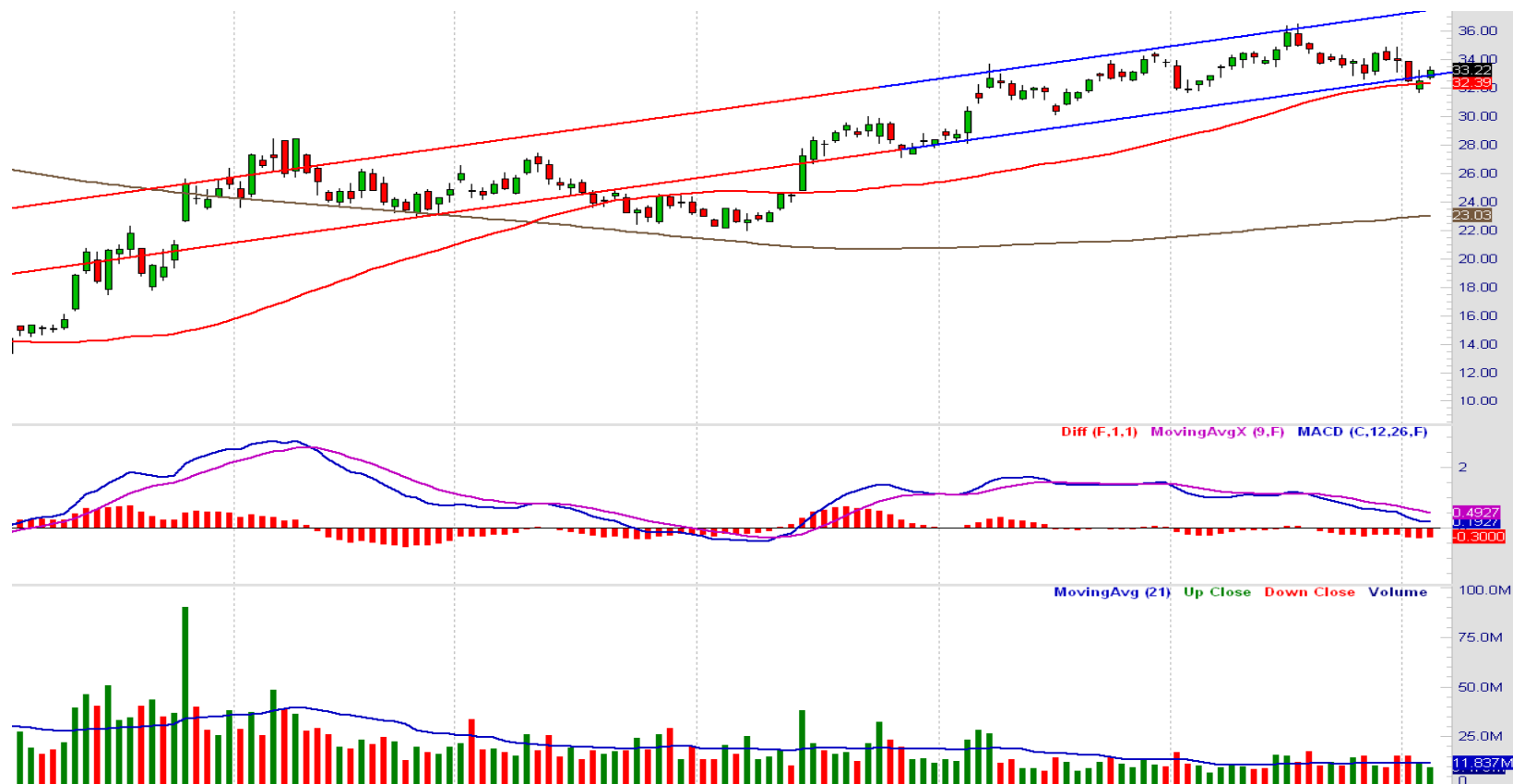
Drawing Lines On A Channeling Stock

- First, draw the support line (the Primary Support) that best represents the bottom of the current channel that the stock is in. This is done on a line chart.
- Second, draw the resistance line (The Primary Resistance) that best represents the top of the current channel that the stock is in. This is done on a line chart.
- Third, draw the next lower support level for the chart.
- Last, draw the next higher resistance level for the chart.

Note: The stock would only be considered for a trade if it is bouncing off of the Primary Support level.

Trending Candidate Selection

- Once you have found a stock that has met the core rules, there are a few secondary criteria that have to be met.
- If the stock is in an upward moving trend, draw the support and resistance lines on the chart.



Trending Candidate Selection (Technical Analysis)

When a stock is in a trending channel, look at the following indicators on your charting program:

- Candlestick chart with the 50 and 200 day simple moving averages overlaid on the price graph. The 50 day is red and the 200 day is brown in the example above.
- MACD with the settings of 12, 26, 9 (These work in any market condition) Ideally the MACD should be coming out of spring moving into summer time.
- Volume bars with a 21 day simple moving average.

Drawing Lines For Trending

Drawing Lines On A Trending Stock

- First, draw the support line that best represents the bottom of the current trend that the stock is in. This is done on a line chart.
- Second, draw the resistance line that best represents the top of the current trend that the stock is in. This is also done on a line chart. (It must be parallel to the support line.)
- Third, draw the next lower support level for the chart.
- Last, draw the next higher resistance level for the chart.

Note: The stock would only be considered if it is bouncing off of the Primary Support level.

Covered Call Candidate Criteria Checklist

Channeling Or Trending

- Is the stock price between \$4 and \$40?
- Is the stock's volume greater than 500,000 shares traded per day?
- Is the stock bouncing off of a horizontal or diagonal support?
- Do the technical indicators confirm what the price graph shows?
- Is the earnings date after the option expiration that is being sold?

Note: If you are using charting software you may be able to set up a filter to help in finding potential stock candidates for consideration.

Once The Stock Is Chosen,

It is Time to Pick a

Covered Call Strategy

Covered Call Strategies

There are numerous ways to trade Covered Calls. Each of these methods will be discussed in detail in this class:

- A Traditional Covered Call (Out-Of-The-Money)
- In-The-Money Covered Calls
- At-The-Money Covered Calls
- Diagonal Spreads

Traditional Covered Call

A Traditional Covered Call

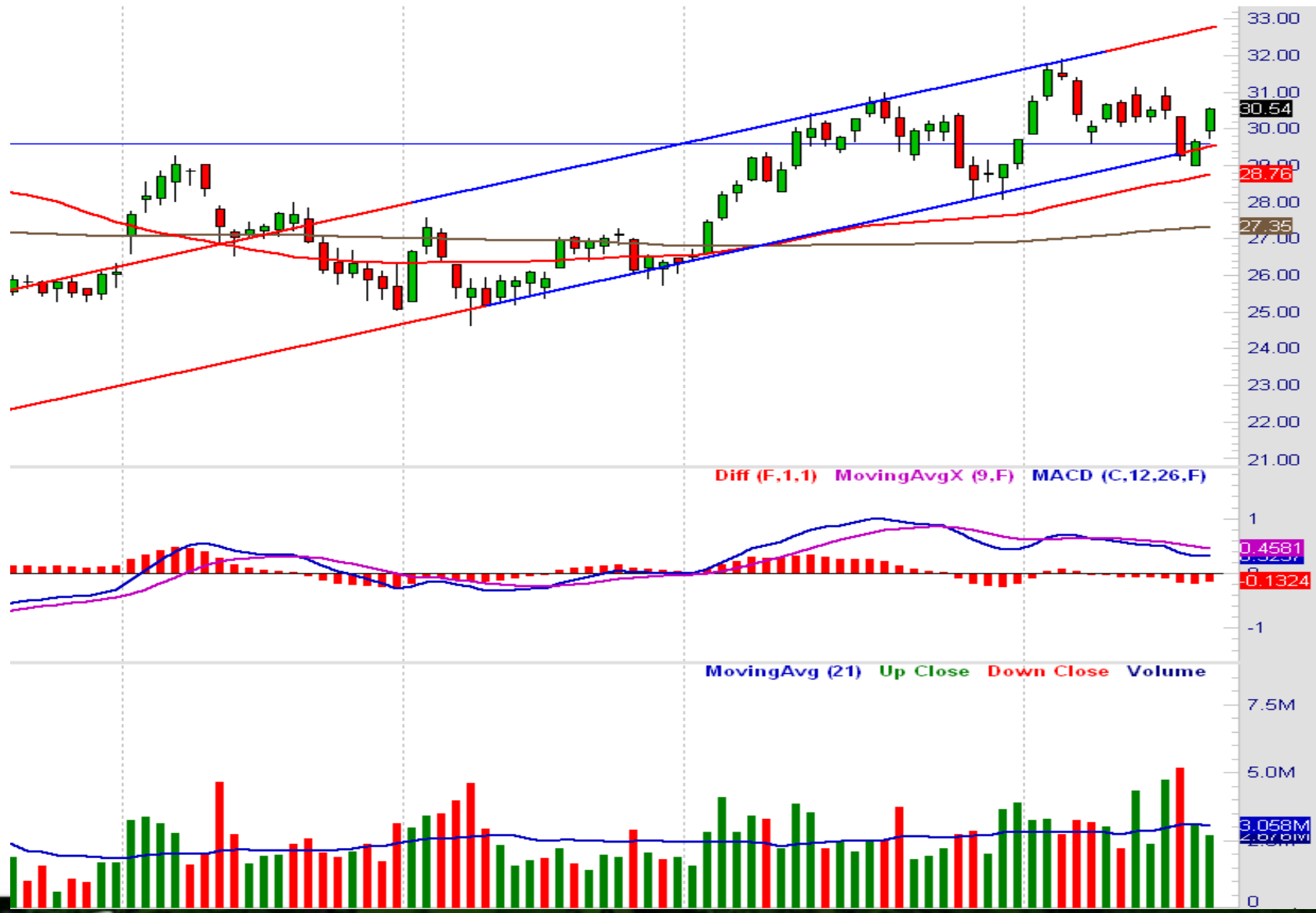
- A Traditional Covered Call starts off with either purchasing or already owning the stock in 100 share increments.
- Use the rules on the previous pages to find a candidate to buy the stock if you do not already own it..
- Just because the stock meets all of the rules doesn't mean that it is a good selection for a covered call.
- A review of an option chain will help the trader determine if the selected stock is a good choice for a covered call.
- When selling, never sell more than 6 weeks of time.
- If there are weekly options a decision will need to be made to pick the one that best fits your personal risk tolerance.

A Traditional Covered Call (Option Considerations)

- The option has less than 6 weeks until expiration.
- Consider the front month before looking out to the next full month.
- Consider “Weekly Options” if they are available.
- Time value deteriorates the quickest in the last two weeks of an options life cycle.
- Does the Rate of Return (“ROR”) with this option meet your minimum expectations? (This will be discussed shortly).

Note: As a covered call seller you do not care about delta, intrinsic value greater than time value, or open interest. They are only important when you are buying to open (“B.T.O.”) not when you sell to open (“S.T.O.”)

A Traditional Covered Call



A Traditional Covered Call

An Option Chain

The stock price is \$30.54 & there are 4 weeks left until expiration date.

Option Symbol	Strike Price	Bid Price	Ask Price
SUN MAY10 15 C	15.00	14.70	15.60
SUN MAY10 17.5 C	17.50	12.20	13.00
SUN MAY10 20 C	20.00	9.70	10.60
SUN MAY10 21 C	21.00	8.90	9.50
SUN MAY10 22.5 C	22.50	7.30	8.00
SUN MAY10 24 C	24.00	5.90	6.60
SUN MAY10 25 C	25.00	4.90	5.60
SUN MAY10 26 C	26.00	4.30	4.60
SUN MAY10 27 C	27.00	3.30	3.70
SUN MAY10 28 C	28.00	2.60	2.75
SUN MAY10 29 C	29.00	1.90	2.00
SUN MAY10 30 C	30.00	1.30	1.40
SUN MAY10 31 C	31.00	0.85	0.95
SUN MAY10 32 C	32.00	0.50	0.60

Note: You do not care about delta, intrinsic greater than time or open interest!

A Traditional Covered Call

An Option Chain

- When selling a covered call on a stock that is trading at \$30.54 the trader would look to the next 1 or 2 higher strike prices.
- In this example, the April 31 call would be sold for \$0.85 (the Bid Price)

Option Symbol	Strike Price	Bid Price	Ask Price
SUN MAY10 15 C	15.00	14.70	15.60
SUN MAY10 17.5 C	17.50	12.20	13.00
SUN MAY10 20 C	20.00	9.70	10.60
SUN MAY10 21 C	21.00	8.90	9.50
SUN MAY10 22.5 C	22.50	7.30	8.00
SUN MAY10 24 C	24.00	5.90	6.60
SUN MAY10 25 C	25.00	4.90	5.60
SUN MAY10 26 C	26.00	4.30	4.60
SUN MAY10 27 C	27.00	3.30	3.70
SUN MAY10 28 C	28.00	2.60	2.75
SUN MAY10 29 C	29.00	1.90	2.00
SUN MAY10 30 C	30.00	1.30	1.40
SUN MAY10 31 C	31.00	0.85	0.95
SUN MAY10 32 C	32.00	0.50	0.60

A Traditional Covered Call (Trade Review)

- Select a stock using the criteria on the stock selection pages.
- Sell to open the May 31 call for \$0.85 (Bid Price) per share or \$85 per contract.
- Make sure earnings (on the stock) are not coming out until after the expiration date.

Calculating Rate Of Return (ROR)

$$\frac{\text{Cash In}}{\text{Cash Out}} = \text{Rate Of Return}$$

Cash In My Pocket

Cost In The Trade

Example: Not Called Out

<u>Cash In</u>	<u>\$0.85</u>				
		=		2.8%	
ROR	\$30.54				
Cash Out					

Example: Called Out Of The Stock

<u>Cash In</u>	<u>\$1.31</u>				
		=		4.4%	
ROR	\$29.69				
Cash Out					

Entering The Trade

There are many different ways to enter into a trade that consists of two different positions, in this case a stock and a call option.

Here are the three most common ways to do so:

- The trader buys the stock (or already owns it) and immediately sells the covered call against their stock.
- The trader buys the stock (or already owns it) and waits to sell the covered call against their stock sometime in the future.
- The trader buys the stock and sells the call against it at the same time. This is called a “Buy Write With a Net Debit.” (Check with your broker to see if they allow this type of trade)

Managing The Trade

Once in the covered call trade there are management decisions to be made.

If The Stock Is Moving Higher:

- Do nothing and allow the stock to be called away from you.
- Buy the call back. (The call price might be more than you sold it for.)

If The Stock Is Moving Sideways:

- Do nothing and allow the call to expire worthless.
- Buy To Close (B.T.C.) the option as it becomes almost worthless and roll out to the next month.

If The Stock Is Moving Down:

- Do nothing and allow the call to expire worthless.
- Buy To Close (B.T.C.) the option (Usually at a lower price than you sold it for) and consider either rolling out and/or rolling up / down or selling the stock.

Note: If the option has not been exercised and the trader still owns the stock, they could consider selling the next month out.

Results Of A Covered Call Trade

Trade Example

Stock Price (B.T.O.) - \$30.54

Call price (S.T.O.) - \$0.85 (31 call)

Maximum Reward – The stock closes above the strike price sold. For example: Stock closes at \$34 on expiration Friday. The call is exercised and the stock is sold for \$31 per share. The trader made \$0.85 on the call and \$0.46 on the stock for a total profit of \$1.31 per share.

Break Even Point - The stock price minus the call premium (\$29.69). As long as the stock stays above this price the trader will make money.

Maximum Risk in the Trade – The stock price minus the call premium (\$29.69). This would happen if the stock went to \$0.00.

Covered Call Cost Basis Tracking Sheet

Stock Details

Date: _____ Stock Name: _____
 Ticker: _____ Bid _____ x Ask _____ Qty Purchased: _____

Option Details

Date: _____ Option Month: _____ Strike: _____
 Ticker: _____ Bid _____ x Ask _____ Contracts Purchased: _____

Initial Trade Details

B.T.O. # of Shares: _____ Shares Total Cost: _____
 S.T.O. # of Contracts: _____ Options Total Credit: _____ Cost Basis: _____

Cost Basis Tracker

Date	Stock Cost	STO Call	BTC Call	Total	Notes

Covered Call Cost Basis Tracking Sheet (Filled In)

<u>Stock Details</u>		
Date: <u>4/1/12</u>	Stock Name: <u>XYZ Inc.</u>	
Ticker: <u>XYZ</u>	Bid <u>\$14.45</u> x Ask <u>\$14.50</u>	Qty Purchased: <u>1000</u>
<u>Option Details</u>		
Date: <u>4/1/12</u>	Option Month: <u>April</u>	Strike: <u>\$15.00 call</u>
Ticker: <u>XYZAR</u>	Bid <u>\$1.00</u> x Ask <u>\$1.05</u>	Qty Purchased: <u>10</u>
<u>Initial Trade Details</u>		
B.T.O. # of Shares: <u>1000</u>	Shares Total Cost: <u>\$14,500</u>	
S.T.O. # of Contracts: <u>10</u>	Options Total Credit: <u>\$1,000</u>	Cost Basis: <u>\$13.50</u>

<u>Cost Basis Tracker</u>					
Date	Stock Cost	STO Call	BTC Call	Total	Notes
4/1/12	\$14.50	\$1.00	N/A	\$13.50	Expired Worthless
4/18/12	N/A	\$1.50	N/A	\$12.00	Expired Worthless
5/22/12	N/A	\$1.00	-\$2.00	\$13.00	BTC Call
6/22/12	N/A	\$1.00	N/A	\$12.00	Expired Worthless

In The Money

Covered Calls

Selling In The Money Covered Calls

Covered calls is one of the most diverse strategies a trader has available to them. There are numerous ways to enter, manage and exit the trade. Once you understand a traditional covered call, selling an in the money covered call is a natural progression.

There are two different ways to sell in the money covered calls:

- Buy the stock and sell the in the money call immediately
- Buy the stock and wait and sell the in the money call later

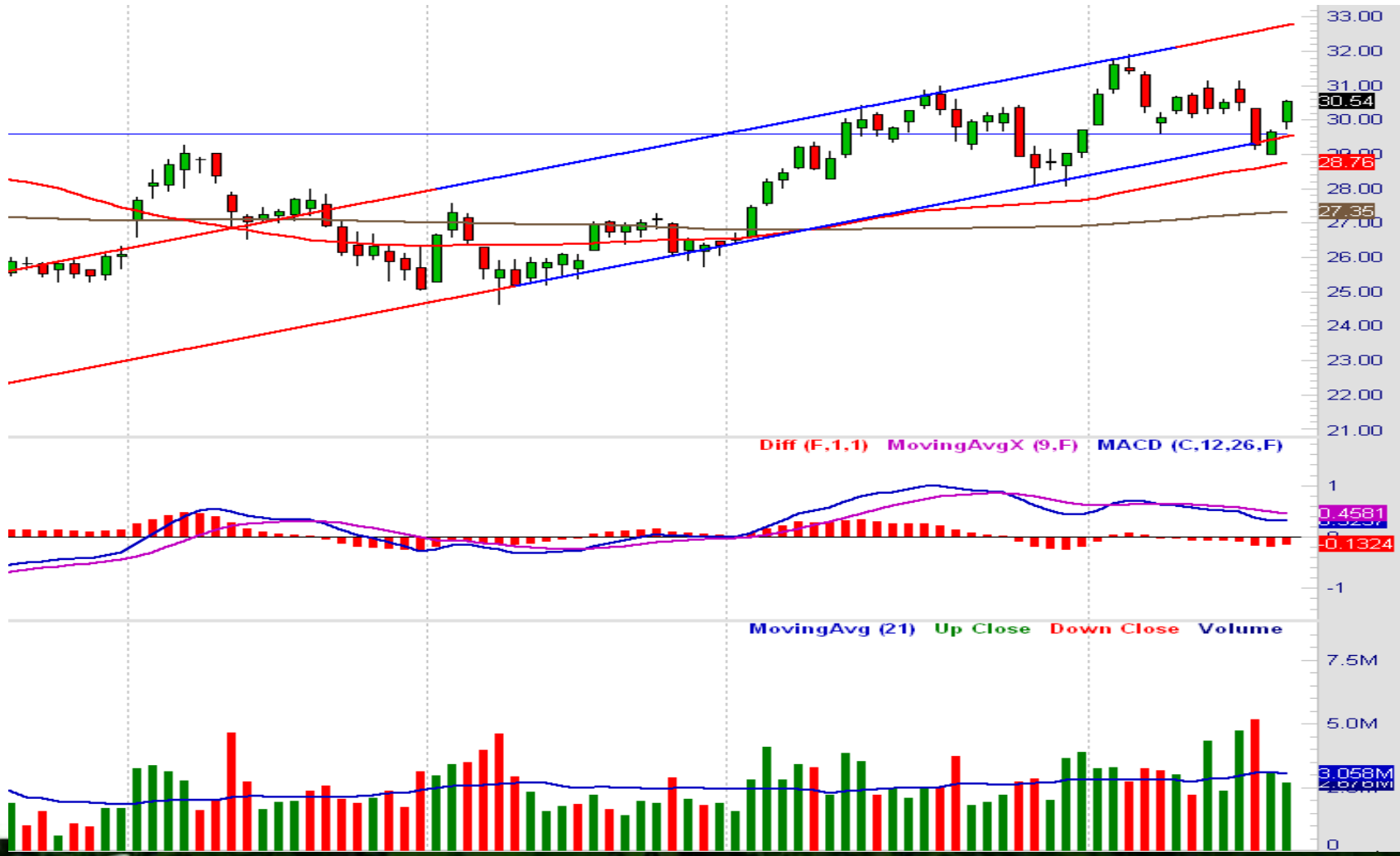
Selling In The Money Covered Calls

Strategy #1

- Buy the stock using the same criteria listed above.
- Sell one or two strike prices lower than the stock is trading at.
- The trade is managed the same as the traditional covered call
- If the stock is called away, the trader will have to give back the in the money portion of the option.

Selling In The Money Covered Calls

Strategy #1



Selling In The Money Covered Calls

Strategy #1

Stock is trading at \$30.54

Buy to open the stock at (\$30.52 x \$30.54) at the ask of \$30.54

The May \$30.00 call is trading for \$1.30 x \$1.40. The trader will sell the call for \$1.30 (The bid)

Option Symbol	Strike Price	Bid Price	Ask Price
SUN MAY10 15 C	15.00	14.70	15.60
SUN MAY10 17.5 C	17.50	12.20	13.00
SUN MAY10 20 C	20.00	9.70	10.60
SUN MAY10 21 C	21.00	8.90	9.50
SUN MAY10 22.5 C	22.50	7.30	8.00
SUN MAY10 24 C	24.00	5.90	6.60
SUN MAY10 25 C	25.00	4.90	5.60
SUN MAY10 26 C	26.00	4.30	4.60
SUN MAY10 27 C	27.00	3.30	3.70
SUN MAY10 28 C	28.00	2.60	2.75
SUN MAY10 29 C	29.00	1.90	2.00
SUN MAY10 30 C	30.00	1.30	1.40
SUN MAY10 31 C	31.00	0.85	0.95
SUN MAY10 32 C	32.00	0.50	0.60

Selling In The Money Covered Calls

Strategy #1

Results

- If the stock closes above \$30 the call option will be exercised. The stock is taken away at \$30 per share.
- If the stock closes below \$30 the call expires worthless.

Enter Covered Call	
B.T.O. Stock	\$30.54
S.T.O. Call	\$1.30
Cost Basis	\$29.24

Selling In The Money Covered Calls

Strategy #1 Results

On Expiration Date		
Stock Price	Called Out	Stock Sold For
\$29.99	No	Not taken away
The trader still owns the stock with a cost basis of \$29.24 and they can sell the stock or sell another covered call.		

On Expiration Date		
Stock Price	Called Out	Stock Sold For
\$30.01	Yes	\$30.00
The stock was exercised and the trader sold the stock for \$30.00 and made a profit of \$0.76		
Bought the stock for \$30.54, AND Sold stock for \$30.00. The stock sold for \$0.54 less than it was bought for but you keep the call premium of \$1.30. The profit in the trade is \$0.76		

Selling In The Money Covered Calls

Strategy #2

- Buy the stock using the same criteria listed above.
- Allow the stock to go up to resistance and start to move down.
- Sell at least one lower strike price than the stock is trading at.
- The trade is managed the same as the traditional covered call
- If the stock is called away, the trader will have to give back the in the money portion of the option.

At The Money

Covered

Calls

Selling At The Money Covered Calls

Selling At The Money Covered Calls are similar to selling In The Money Covered Calls. When selling At The Money the trader will normally receive the highest premium for the option.

- Buy the stock using the same criteria listed above.
- Sell the At The Money strike price.
- The trade is managed the same as the traditional covered call
- If the stock is called away, the trader will have to give back the in the money portion of the option (If any).

Selling At The Money Covered Calls



Selling At The Money Covered Calls

The stock is trading at \$24.93 (Close enough to at the money). The trader would look to sell the \$25.00 call option.

What you give up by selling at the money is any price appreciation by the stock.

The major benefit is it gives you a greater downside protection.

Option Symbol	Strike Price	Bid Price	Ask Price
MDC JUL11 20 C	20.00	4.90	5.10
MDC JUL11 21 C	21.00	3.90	4.20
MDC JUL11 22 C	22.00	3.00	3.20
MDC JUL11 23 C	23.00	2.15	2.35
MDC JUL11 24 C	24.00	1.45	1.60
MDC JUL11 25 C	25.00	0.90	1.00
MDC JUL11 26 C	26.00	0.45	0.55
MDC JUL11 27 C	27.00	0.20	0.30
MDC JUL11 28 C	28.00	0.05	0.15

Covered Calls

Using Spreads

Covered Calls Using Spreads

There are many different types of spreads a trader can employ in their trading. Each has a different purpose and a specific time to use them.

Today's workshop will examine two of them, with the main focus on the one that has the most value to today's discussion.

Diagonal Spread

It uses different strike prices and different expiration dates.

Calendar Spread

It uses the same strike prices and different expiration dates.

Covered Calls Using Spreads

Diagonal Spread

Instead of buying a stock and selling a call against it (A traditional covered call) a trader can use an option as a proxy for the stock.

Basic Diagonal Spread Setup

- Buy to open a call option
- Sell to open a call option against the one you bought

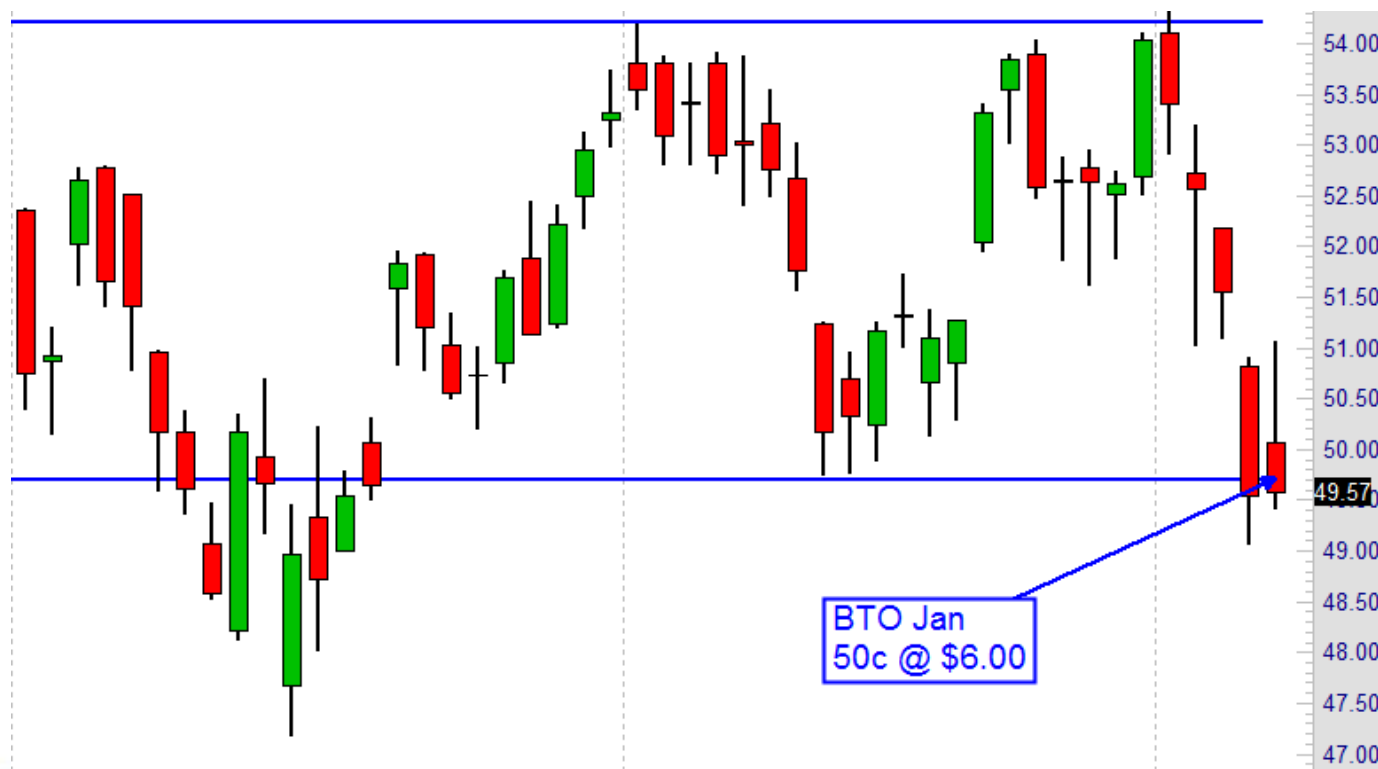
Buy to open the January 50 call

Sell to open the July 55 call

Covered Calls Using Spreads

As the stock bounces off of support and you decide to buy the stock there for a covered call.

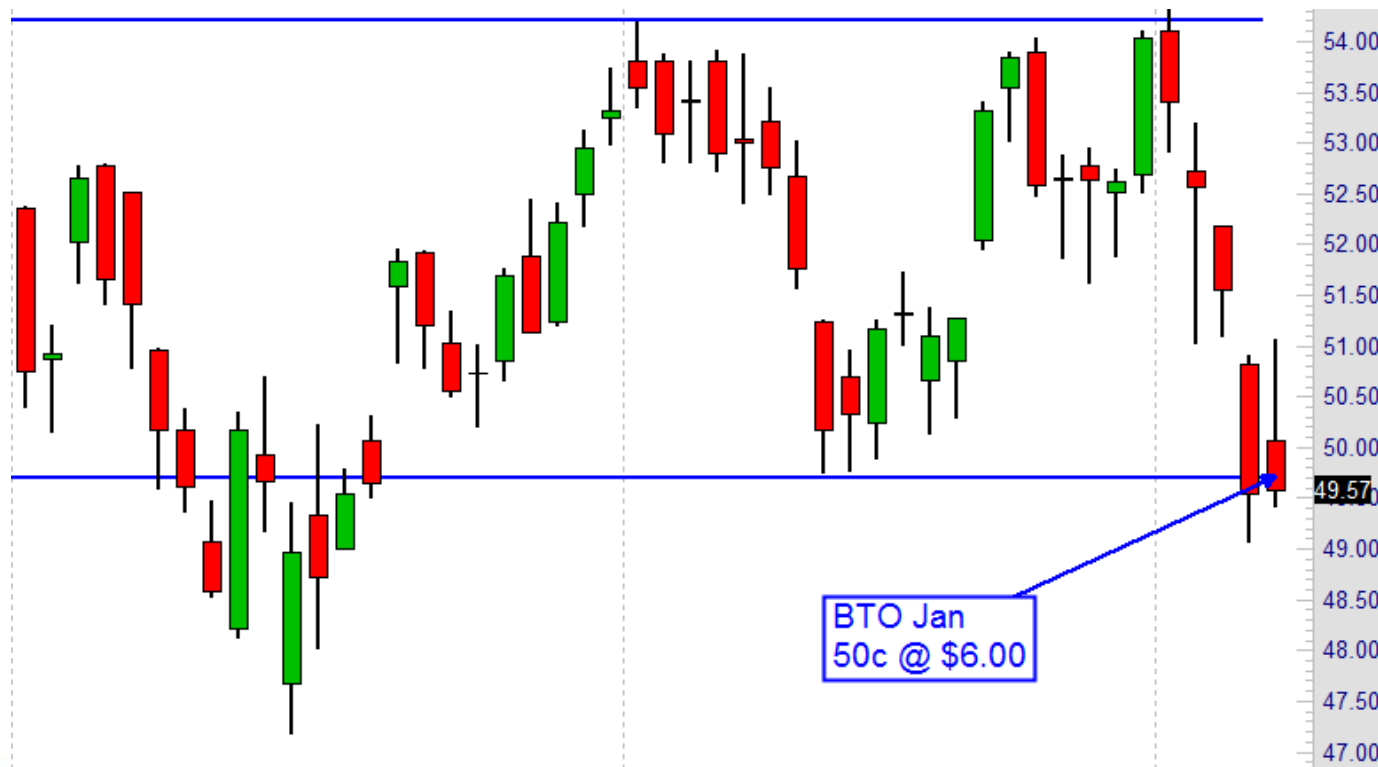
Instead of buying the stock you could BTO Jan 50 call for \$6.00. This allows you to control the stock instead of owning it.



Covered Calls Using Spreads

The trader would then sell the front month or next full month option on the same stock.

STO the July 55 call for \$1.40



Covered Calls Using Spreads

Trade Example

BTO the Jan 50 call for \$6.00

STO the July 55 call for \$1.40

Trade Results if the stock closes below the 55 strike on expiration day

The 55 call expires worthless.

Cost Basis

Initial cost basis - \$4.60

What's Next

The trader could sell the next month's 55 call and take in another \$1.40 (aprox.)

Covered Calls Using Spreads

Trade Example

BTO the Jan 50 call for \$6.00

STO the July 55 call for \$1.40

Trade Results if the stock closes above the 55 strike on expiration day

- The 55 call is in the money and the stock will be called away from you at \$55 per share.
- You would be required to deliver the stock at \$55 per share
- You could exercise your 50 call and buy the stock for \$50 per share
- This would allow you to have the stock to be taken away from you at \$55

Cost Basis Details

Initial cost basis - \$4.60

Buy the stock for \$50

Sell the stock for \$55

Cost Basis Details

Stock Profit - \$5.00

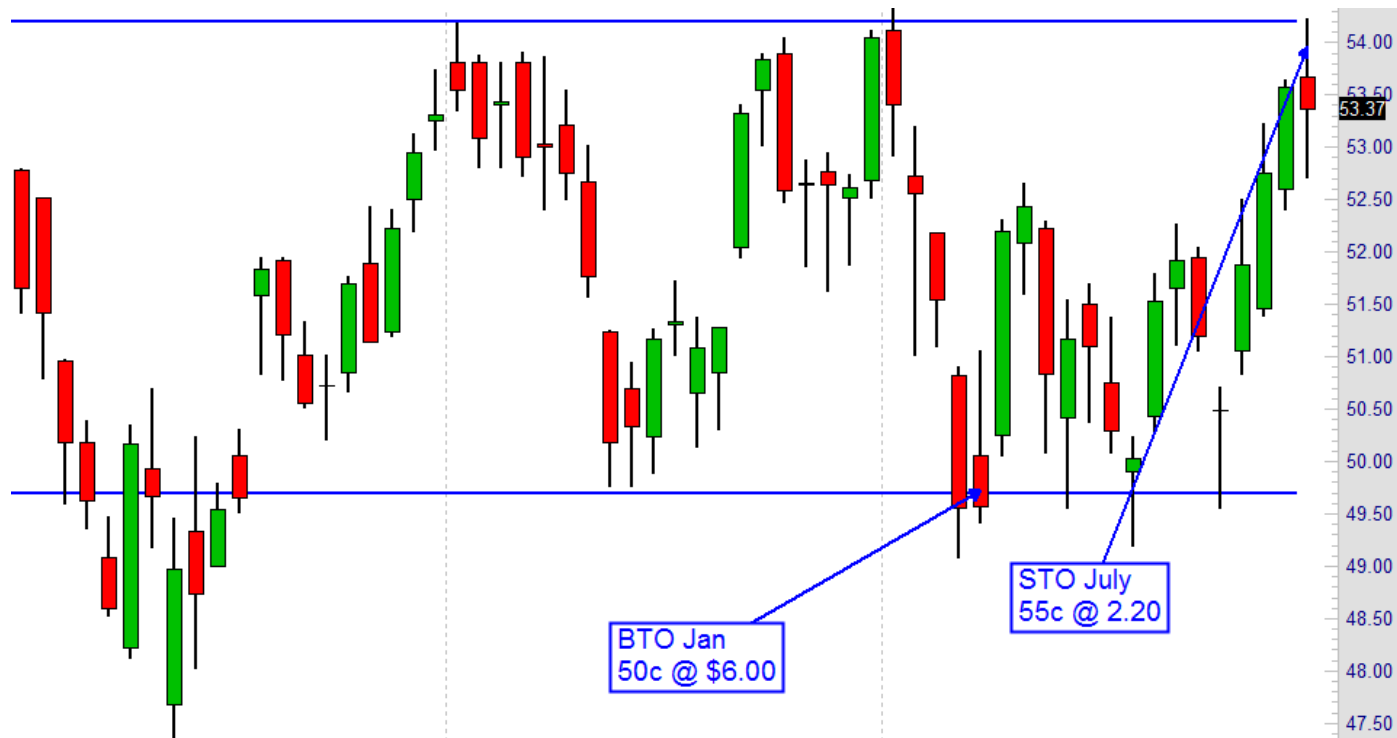
Option Cost - <-\$4.60>

Net Profit - \$0.40

Covered Calls Using Spreads With A Twist

What if instead of selling the call immediately, the trader waited until the stock gets to the resistance level and sells the call there.

STO July call @ \$2.20



Covered Calls Using Spreads With A Twist

Trade Example

BTO the Jan 50 call for \$6.00

STO the July 55 call for \$2.20

Trade Results if the stock closes above the 55 strike on expiration day

- The 55 call is in the money and the stock will be called away from you at \$55 per share.
- You would be required to deliver the stock at \$55 per share
- You could exercise your 50 call and buy the stock for \$50 per share
- This would allow you to have the stock to be taken away from you at \$55

Cost Basis Details

Initial cost basis - \$3.80

Buy the stock for \$50

Sell the stock for \$55

Cost Basis Details

Stock Profit - \$5.00

Option Cost - <-\$3.80>

Net Profit - \$1.20

Diagonal Spreads Strategy Creation System “SCS”

Stock Criteria

- Stock price between \$4.00 and \$40.00
- Volume is greater than 500,000 shares traded per day
- Stock must be in a sideways channel or in an uptrend
- It must be bouncing off of support
- It needs a confirmation day, so when the stock hits support the next day the entry would be the stock trading higher than the previous day's close.
- Draw the support and resistance lines to verify what you see on the chart
- Draw the next set of support and resistance lines.
- Check earnings date to make sure it is coming out after the expiration date.

Technical Indicators

- Stochastics crossing up through the 20% line (channeling only)
- MACD is in springtime headed into summer or in the early stages of summertime.
- Volume is greater than 500,000 shares traded per day
- Volume is increasing as the stock is bouncing off of support (Not a requirement but it is better if it is.)

Diagonal Spreads Strategy Creation System “SCS”

Option Criteria

- There must be \$1.00 strike prices.
- Delta, Open Interest and Intrinsic Value greater than Time Value are not important as a seller.

Option To Buy & Sell

- Make sure to verify the numbers, make sure you know what the cost basis is as well as what happens if the stock is exercised.
- Buy to open the at or slightly out of the money strike with at least 6 months of time.
- Allow the stock to move up towards resistance and then sell to open one higher strike price than resistance.
- Sell no more than 6 weeks of time.
- Again be sure to check the numbers that these strikes will all work out.

Diagonal Spreads Strategy Creation System “SCS”

Once in the spread trade there are management decisions to be made.

Stops

- If the stock breaks support BTC the call option you sold.
- Next STC the call option you bought.

If The Stock Is Moving Higher:

- Do nothing and allow the call to be exercised. “OR”
- Buy the call back you sold. (The call price might be more than you sold it for) and sell next month’s call

If The Stock Is Moving Sideways:

- Do nothing and allow the call you sold to expire worthless. “OR”
- Buy To Close (B.T.C.) the option as it becomes almost worthless and roll out to the next month. **(Use THETA to help in making this decision)**

Note: If the option has not been exercised and the trader is still long the call, they could consider selling the next month out.

Protecting Your Assets Using Insurance

Insurance On Your Stocks

Protective Puts or Collars

- Place a traditional covered call
- B.T.O. a put one or two strike prices below support
- Buy one contract for every 100 shares of stock are owned
- Buy the same month put as the month the call was sold for

Protective Puts or Collars

Example:

- Stock is purchased for \$10.50
- Support is \$10
- The May 11 call was sold for \$1.00
- Cost Basis is \$9.50 (This is the traditional Covered Call)
- Buy to open the \$9 put for \$0.20
- The new cost basis is \$9.70

Protective Puts or Collars

Results:

If the stock were to go to \$0.00:

- The stock would be worthless
- The call would be worthless
- The put would be worth \$9.00

The trader would still lose money in the trade, but the loss would be limited because the insurance policy was in place.

If the stock did not close below the \$9.00 put that was purchased, the put would be worthless on expiration day.

The purpose of buying the put is to prevent a catastrophe, not in case the stock drops a small amount.

Insuring Your Mutual Funds

Insuring Your Mutual Funds

Most brokers will tell you that this isn't possible, but with some work it is. This is not a complex strategy but it will take some work on your own or with your broker.

Steps

- Pick one fund to start with (you might want to start with the fund that has the highest value to it).
- Work with your broker to determine what type of fund you have (what does the fund track)
- Determine (with your broker) what ETF most closely tracks your mutual fund.
- Determine (with your broker) how many shares you will need to protect your fund.

Insuring Your Mutual Funds

Example:

- You have a mutual fund that tracks the S&P 500
- You would find an ETF that tracks your fund type (As closely as possible)
- For the S&P 500 you could use the SPY
- Determine how many shares of the mutual fund you own. (This is how much you need to protect). For this example, say you have 485 shares.
- You would buy 5 contracts of the “SPY” puts (5 contracts control 500 shares of stock).
- Keep in mind that the SPY tracks the S&P 500; there is an almost 1 to 1 correlation between them, this will not always be the case for all mutual funds.
- You will need to determine how much time you want to protect your mutual fund for.

Subscribe today

“Rob’s Covered Call Explorer”

Every Week Rob Shares His TOP PICKS For Covered Calls, Naked Puts & Diagonal Spreads

When: Weekly (Sunday by 2pm)
Location: Online (Recorded For 30 Days)
With: Robert Roy (Trading Coach)

Retail Cost:	\$149
Discount:	<u>-\$ 30</u>
Your Investment:	\$119



Register online to receive your discount!

Bonus Section

Bonuses

- **Repairing Broken Stocks**
- **Trading Plan**
- **Trading Mantra**
- **Transfer 401k to your own retirement account**
- **Covered Calls Cost Basis tracking sheet**

Repairing

Broken

Stocks

Repairing Broken Stocks

A “Broken Stock” occurs when the trader bought a stock for a higher price than it is currently trading and they don’t want to sell it because it would cause a paper loss to turn into an actual loss.

A historical example is CSCO. There are traders who purchased it near its all-time high of around \$82 in 2000 and 12 years later are still holding it at around \$15.

The trader feels that they don’t want to sell it because the loss will be realized once they sell the stock. The problem isn't realizing the loss BUT it is the lost opportunity that is not considered in this type of equation.

If the trader owns a stock at a higher price than it is trading at now there are ways to still rent out the stock.

Repairing Broken Stocks



Repairing Broken Stocks

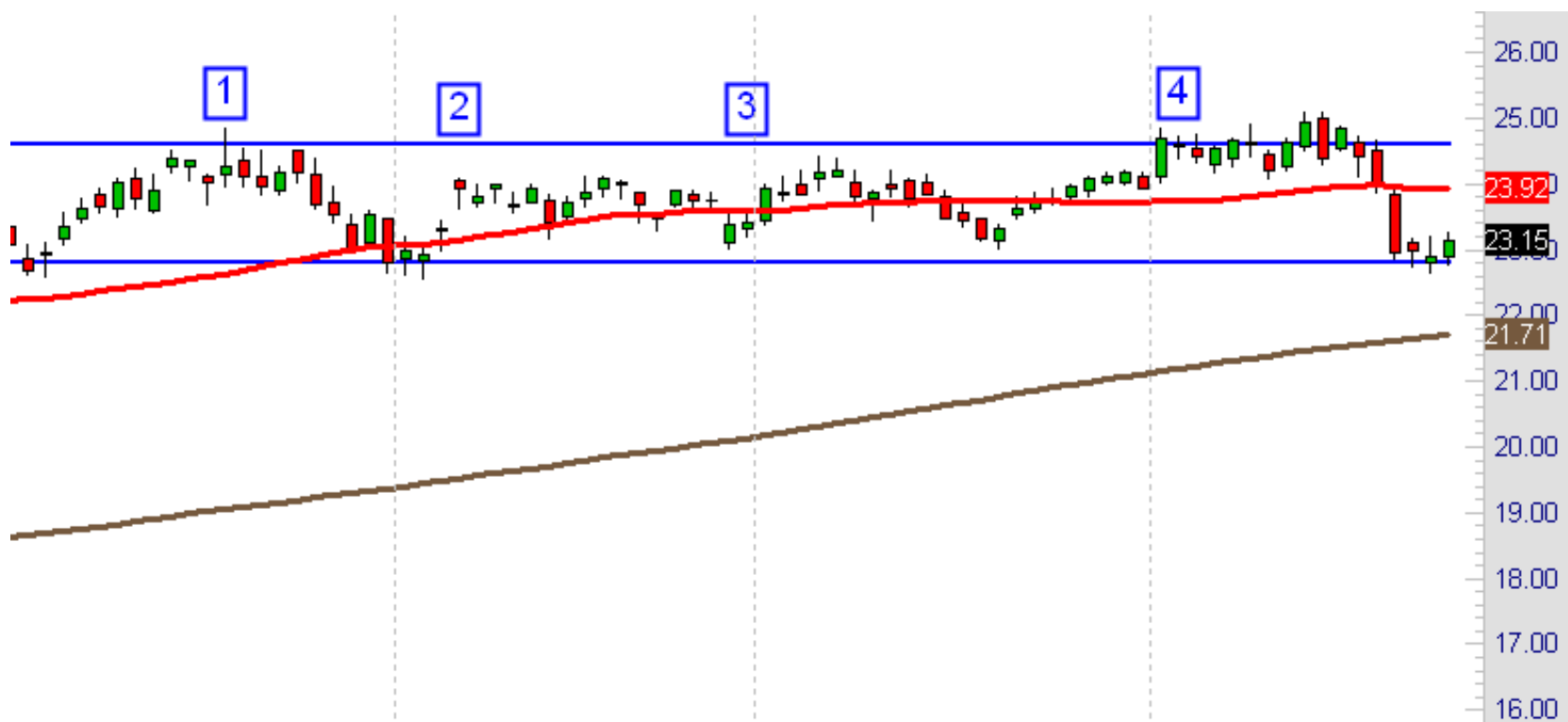
- In 2000, CSCO was purchased for \$80 per share.
- It has been held in the trader's account since and nothing has been done with it.
- In order to sell the covered call there are specific criteria to employ for this strategy.

Repairing Broken Stock Entry Rules

- The trader already owns the stock at a higher price.
- When looking at the chart the trader wants the stock to be near a resistance and headed down.
- Sell one or more strike price higher than the resistance level

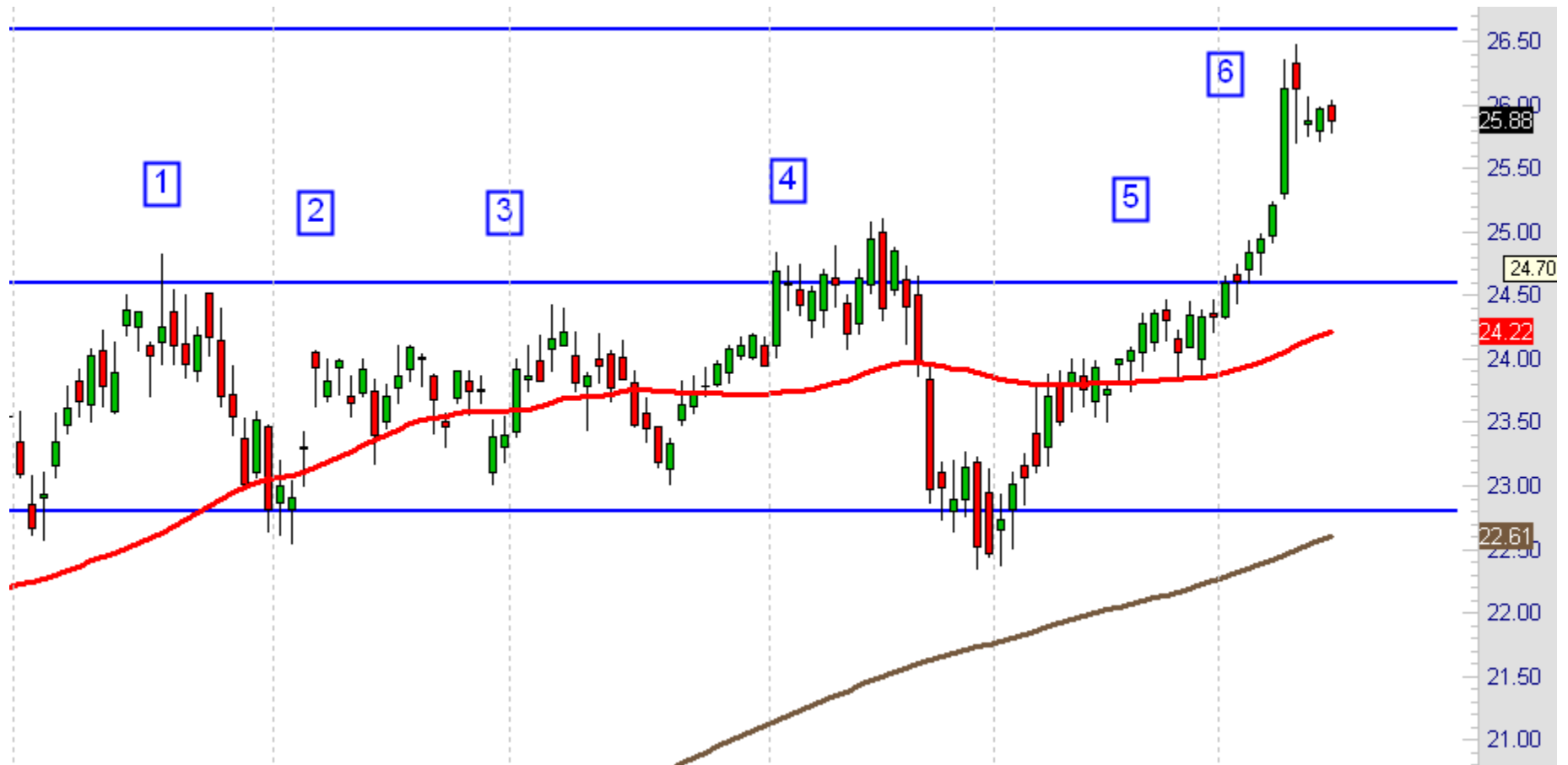
Note: See the marked up chart on the next page

Repairing Broken Stocks



Numbers 1 through 4 are potential entry points for writing covered calls

Repairing Broken Stocks



Repairing Broken Stocks

Reacting Quickly If You The Stock Goes Against You

- On the previous chart, you can see the areas to enter into the trade
- Looking at the previous slide, you will see that point 5 seemed like a potential entry point. As it turned out, the stock rallied and broke through resistance.
- The trader must react quickly and Buy to Close the call they sold to end their obligation.
- After buying to close the call option at point 5 the trader would wait for Point 6 and sell one or more strikes above the resistance level.

SETTING UP YOUR TRADING PLAN

General Trading Plan Criteria

- * KISS: Keep It Simple Stupid.
- * Be flexible to change the criteria if experience shows a better way. But you must be in total control. You must not make a change to try to fix a position. Follow the rules. The trend is your friend. Don't fight it.
- * A good trader cannot predict the direction the market will go. You will have an opinion on the market direction but you must follow the direction the market decides to go. You are not a player in the game. You are only a spectator.
- * Don't trade if you are not in the right frame of mind.
- * Set up a trading environment that allows you to trade without distractions. Keep the trading environment clean and neat; this may help set your mind at ease. Organization in your trading environment will allow for better organization in your trading.
- * Never become emotional about a trade or a position. Be objective and mechanical.

* Believe in yourself.

General Trading Plan Criteria

- * The most important qualities in a trader are to be patient, disciplined, able to pull the trigger, able to take a loss and be honest with myself.
- * Believe in your ability to win in the long run. Do not allow a loss to discourage you.
- * Never allow anyone to steal your dream.
- * Trading is a battleground for testing your self-control, self-discipline and wisdom. It is also a place to better yourself in all three of these areas.
- * Work on thyself by playing motivational tapes, working out and reading. These are all positive things that put you in the correct frame of mind for trading.
- * Trading is not about finding the Holy Grail. It is about learning to use a system to make more than you lose.
- * Find an exposure point that will allow you to trade without feeling uncomfortable.
- * Know thyself; this is where the real battle will be.

Setting Up Your Trading Plan

Questions To Ask Yourself

1. Why do you trade?
2. What do you trade? What do you prefer trading? What are you most comfortable with? (stocks, futures, options)
3. What time frame do you prefer to trade in? (day, swing, intermediate-term, etc.)
4. What position size do you trade? (Is it too large or too small) (What percent of the total account are you trading)

Setting Up Your Trading Plan

5. How many positions at once are you comfortable trading?

6. What overall market conditions must be met for you to trade? (What conditions do you avoid?)

7. What are your trade entry signals? Are you using them effectively? Do you use a combination of signals?
Market Conditions, specific patterns, technical Indicators

8. When do you get out of a winning position?
What are the criteria? Do you have any?

Setting Up Your Trading Plan

9. When do you get out of losing positions?

- Do you always use protective stops?
- What are the criteria? (Percentage, set dollar amount, support/resistance levels, volatility based, technical indicators, fear)

10. What do you do when you have a losing streak?

- How do you define a losing streak?

11. What specific money-management tools do you use?

- How much do you risk on each trade?
- If you were stopped out of all positions at once, what would the result be?

12. Do you trade both long and short?

- Do you need to?
- Are you comfortable with going short?
- What is your experience trading on the short side?

Plan Your Life And Live Your Plan

AND...

Plan Your Trade And Trade Your Plan

Setting Up Your Trading Plan

13. How do you trade the open? Or do you? Should you?

- What is your gap-up strategy?
- What is your gap-down strategy?

14. How do you create a watch list?

- How can you improve it?
- How often do you update it?

15. What is your trading style? What traders do you follow?

16. What do traders that you admire do that you don't do?

Setting Up Your Trading Plan

17. How much time do you spend daily outside market hours doing research/homework?

- What is your routine? Do you have a routine?
- How much better would your trading be if you were more disciplined about this?
- What specifically needs to be done?

18. What is your annual income goal?

- Break it down to daily/weekly goals (i.e. \$250,000 = \$1,000/day or \$5,000/week)
- What do you need to do to achieve this goal?

The next two questions are designed for newer traders:

19. How much money will you start out with?

- What percent of your net worth does this represent?

20. When do you plan on becoming profitable? (if not already)

- How long will your “paper trading” period last?

Setting Up Your Trading Plan

When this exercise is complete, you'll have two things:

1. A better understanding about yourself, and your trading
2. The basis for your Written Trading Plan.

Writing Your Trading Plan

1. Goals

- Long-term, short-term, daily
- Make them specific and realistic

2. Tasks

- What do you need to do to get there?

3. Trading Criteria

- You'll use these daily
- Make these very specific
- (This is perhaps the most important section)

For trading criteria, here are some examples to consider:

“I will only trade stocks with MACD crossing over.”

“My daily goal is X.”

“I will only trade 100 shares until I'm profitable for three straight months.”

Writing Your Trading Plan

Once your plan is written, it's important to review it on a regular basis. This is done for a number of reasons:

- to track profitability
- to track how closely you are following your trading criteria
- to identify areas that need improvement.
- to modify it as needed (At least once a year)

ROBS

TRADING

MANTRA

Rob's Personal Trading Mantra

- * I admit that I am powerless over the market. The market is unmanageable by me. As a trader I am not in the game, I am on the sidelines.
- * I realize that I can do great harm to my family's finances in the market.
- * I believe that a power greater than I can restore my sanity when in a trade (good or bad).
- * I am entirely ready to have God remove all of my defects of character in my trading.
- * I humbly ask God to remove all of my shortcomings in my life.
- * I made a list of all of the ways that I can harm myself while I am in a trade. If I follow my system, then the market will not be able to hurt me.
- * I made amends with myself for the harm that I have done to myself in past trades. I will no longer do harm to my families finances.
- * I will continue to take a personal inventory and when I am wrong in a trade I will admit it and follow my system.

Rob's Personal Trading Mantra

MY PROMISE

I am going to know a new freedom and a new happiness in my trading. I will not regret the past nor wish to shut the door on it. No matter how bad my trading has been, I will use my experience to benefit others and myself. The feeling of helplessness and self-pity while in a trade will disappear. My whole attitude and outlook about trading will change. Fear of losing and of economic insecurity has left me. I will intuitively handle situations that used to baffle me. I now realize that God is doing for me what I could not do for myself.

SPIRITUAL EXPERIENCE

Most emphatically I wish to say that as a trader I am capable of honestly facing my problems in the light. My experience can recover, provided I do not close my mind to my trading criteria. I can only be defeated by not following my system or belligerent denial. Through experience I have found that willingness, honesty and open mindedness are the essentials of good trading.



401K

TRANSFER TO

YOUR OWN ACCOUNT

Using Your 401k For Covered Calls

If you have a 401k plan that is not self directed (meaning you can not make your own trading decisions) there are ways to possibly move those monies into your own 401k plan or into a traditional retirement account.

If You No Longer Work For The Company

- That is the company holding the 401k plan then you are allowed to legally transfer your money from the plan and place it in your own qualified plan or IRA account. Check with your accountant on how to do this properly.

If You Currently Work For The Company

- Open your own IRA account titled the same as your 401k plan
- Send a letter to the plan administrator asking them to transfer 90% (or less) to your new plan. If you ask for 100% of the money you may be removing yourself from the 401k plan.
- Do not contact Human Resources or the interoffice person responsible for the 401k plan, their standard answer is that you can't move the money.
- Work with a qualified tax professional to iron out all of the details.



COVERED CALL

TRACKING

SHEET

Covered Call Cost Basis Tracking Sheet

Stock Details

Date: _____ Stock Name: _____
 Ticker: _____ Bid _____ x Ask _____ Qty Purchased: _____

Option Details

Date: _____ Option Month: _____ Strike: _____
 Ticker: _____ Bid _____ x Ask _____ Contracts Purchased: _____

Initial Trade Details

B.T.O. # of Shares: _____ Shares Total Cost: _____
 S.T.O. # of Contracts: _____ Options Total Credit: _____ Cost Basis: _____

Cost Basis Tracker

Date	Stock Cost	STO Call	BTC Call	Total	Notes

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