3 SECRETS TO MAKING MONEY IN ANY MARKET

MARKET TAKER MENTORING, INC.

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MarketTaker.com

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3 Simple Ways to Make Money in Any Market

By Dan Passarelli
President & Founder, Market Taker Mentoring, Inc.

There is no such thing as a bad day in the markets. If you know where to look, the stock market offers option traders opportunities every day.

Up days, down days, sideways days, and even wildly volatile days provide opportunities in the market.

It doesn't take only a bearish market to reduce any one's portfolio to ruins. Nor does a thousand-point run-up in the Dow Industrials mean all your trades will become insanely profitable in just one afternoon. Often, the markets can actually be quite dull, so you have to plan for boring times and be prepared for those "exciting" times that catch everyone else off-guard.

Vast amounts of money are made and lost all the time by traders in the market. Even the "big guys" make bad decisions – and on those days it's nice to be a "little guy" investor who doesn't blow up his or her account when a surprise event moves the markets unexpectedly.

Education is Mandatory

To be on the profitable in the market, you must be properly educated. There's no need to go back to school and get a degree in economics. But when you dedicate yourself to learning more about what you trade, the time you invest usually shows up again and again in your results.

With options, it's possible to make money in any kind of market. You just need to learn how. Think about that for a second… Smart traders can make money no matter what the market is doing when trading options. That cannot be said when considering most trading vehicles. And that's where I can help you …starting right now.

Before we get started, let's be real. We all know there truly are no secrets to guaranteed success in the market. If that were the case, the person who uncovered these secrets would not want to share them with the rest of the trading community …at any price!

But the basics behind making money in the options markets aren't necessarily a state secret.

The markets love to take advantage of beginners or traders that are not educated and disciplined. Even if you've "been around the block" a few times, each new day has the potential to bring something new that you haven't seen or succeeded with before. This can be difficult to overcome, especially if you are ill-prepared.

Professional traders however, have a pretty good idea how to prepare or react. And they get ready to take everyone else's money, especially those that don't have experience or confidence on their side. Don't hand your hard-earned money over to them needlessly!

One thing I can tell you from my 20-plus years in the markets is that even though things turn out OK much of the time, the period of time that the market can stay volatile varies. And there's a reason why the old saying that the market can remain irrational far longer than you can remain solvent never goes out of style.

It's not just my goal but also my life's work to ensure that you are still in the markets, protecting your cash and generating more income for as long as you continue trading options.

There are three basic principles you can use to greatly enhance your success in any market. Read on for these introductory guidelines that can help make you a more profitable trader.

Secret #1: Technical Analysis Gives Traders a Statistical Advantage

To make the most out of this first "secret", traders need to understand what technical analysis can do for you …and what it can't.

Technical analysis is a study of a chart (or graph) of the price of a stock. While it doesn't predict the future, the study of past prices helps traders understand how the stock behaved in the past so they can make informed decisions about the future.

It is relatively simple. The key is looking to the left. That is, study as much as you can from previous price movements. Often traders will find recognizable patterns that may repeat themselves or observe certain indicators that can tell a tale that cannot be observed from reading financial statements, press releases or news articles.

It's easy enough to look at a stock chart, but what you see (or don't see) can make the difference between a winning trade and a losing trade. Technical analysis one of the basic tools traders can use to put the odds in their favor.

One of the most important criteria to understanding charts is identifying support and resistance levels. Support is an area that a stock has a difficult time moving below. Resistance is an area that a stock has a difficult time moving above. Support and resistance can be observed in many ways: Previous price levels where the stock has reversed before, moving averages, opening and closing prices and trend lines just to name a few.

Support and resistance levels can be critical to identify because often, the underlying will struggle to move through resistance and support. Thus they become important to recognize. Many times, traders will use these levels as a barrier that they expect the stock to not permeate. And sometimes, traders will patiently wait until the underlying indeed moves through support or re-

sistance to execute a momentum trade. These concepts guide traders in their option strategy selection.

Practice reading charts. Through trial and error and repetition, you'll be able to see recurring patterns. It boosts your confidence to successfully place a bullish, bearish or neutral trade with the help of technical analysis. Of course there is no guarantee the pattern will repeat itself, but the charts offer an edge to skilled traders who use them.

First, start looking for patterns in every time frame. Look at the weekly chart, then the daily chart, and then maybe a 60-minute chart. You will start to recognize patterns in every time frame. All technical set-ups can work on all different chart time frames. The weekly chart offers a broad, general view. The daily chart is the most important for most option strategies. And the shorter-term charts are good for planning execution prices.

Phillip Morris Example

As an example, let's say you notice that every time Philip Morris International Inc. (PM) moves close to a resistance area around $85 on a daily time frame it tends to trade there for several days and even weeks. Remember, resistance is an area on the chart that the stock had a hard time rising above. With options, a trader can devise a strategy to take advantage of an anticipated move sideways or lower for a particular length of time to capitalize on this observation. That brings us to our next "Secret".

Secret #2: There Is an Option Strategy for All Markets

This "Secret" to making money in any market is to structure the best option position for the given market situation. In the Phillip Morris example above, a trader could structure an option position to potentially make money if the stock doesn't rise through resistance. This is something traders cannot do by trading stocks. Options give traders strategies to profit in any market situation.

With options, there is an endless amount of strategies and combinations that can be used. Options allow traders to hedge and reduce risk and still profit from moves in any direction, or even if the underlying stock doesn't move at all. Even at the most basic level, just by using calls and puts, traders can create a strategy to profit in basically any scenario.

The Basics

Buying a call is a strategy that makes money when the stock rises. Its risk is limited to the price paid for the call, and has unlimited profit potential.

Buying a put is a strategy that makes money when the stock falls. Its risk is limited to the price paid for the put, and has substantial potential for profit.

Traders can also short options…

Selling a call is a strategy that makes money when the stock does not rise (it can fall or stay the same price). It has limited profit potential and unlimited risk. Generally traders don't sell calls "naked", and rather do so as part of a spread. More on that later.

Selling a put is a strategy that makes money when the stock does not fall (it can rise or stay the same price). It has limited profit potential and the same risk associated with owning stock. Some investors use a variation of this called a cash-secured put.

If a trader buys an option, he or she wants to sell them for more. And if a trader sells an option, he or she wants to buy them back for less or let them expire.

Now here is the exciting part about options. We've only touched upon four strategies, and observed that traders can make money if the market rises or falls, or even stays the same price. Once you are comfortable with the four option strategies above, you can now use them to create a multitude of spreads. All spreads are a combination of any of the four strategies listed above.

Option spreads can help traders create a more optimal risk-reward. Spreads involve the buying of one option and selling another option at the same time.

One basic strategy is the debit spread. A debit spread can reduce the cost (and therefore the risk) of a trade. Depending how the debit spread is structured, it can sometimes outperform another strategy while still offering lower risk. There are two types of debit spreads…

Debit call spread: Buying a call and selling a call with the same expiration, but a higher strike price. The maximum risk is the net premium paid for the spread, which occurs if the stock is below both strike prices at expiration. The maximum profit potential is the difference between the strike prices, minus the premium paid, which is achieved if the stock is above both strikes at expiration. Traders use debit call spreads when they think a stock will rise, but the move higher will be limited.

Debit put spread: Buying a put and selling a put with the same expiration, but a lower strike price. The maximum risk is the net premium paid for the spread, which occurs if the stock is above both strike prices at expiration. The maximum profit potential is the difference between the strike prices, minus the premium paid, which is achieved if the stock is below both strikes at expiration. Traders use debit put spreads when they think a stock will fall, but the move lower will be limited.

Spreads have some advantages and disadvantages when compared with a long-only option strategy. Let's take a look…

Google Options Example

Imagine a trader was bullish on Google Inc. (GOOGL) when the stock was around $690. The trader could buy a call, or buy a debit call spread. Let's compare the two choices.

GOOGL long call

When Google Inc. (GOOGL) was trading right around $690, an option trader could have purchased a 690 call option with around 30 days to go until expiration for 16.50 (or $1,650, because a call option gives the right to buy 100 shares, thus a trader would multiply the premium by 100). The breakeven point of the trade at expiration is at $706.50 (690 + 16.50).

This trade has risk limited to 16.50 if the stock falls. And it has unlimited profit potential, meaning that if the stock continues to rise until expiration, the call option premium will continue to increase because the trader will always have the right to buy the stock at $690 a share.

GOOGL debit call spread

With the debit call spread, the trader will still buy the 690 call for 16.50 but in addition to that, the trader will, at the same time, sell a 700 call with the same expiration for 12.50. This results in a net debit of only 4, or $400 of actual cash.

Here the capital at risk is significantly lower than that of buying the call—it's only $400. The trade-off is that the long call had unlimited profit potential, but the debit spread had a maximum profit potential of 6, or $600 (that's 700 minus 690 minus 4).

The strategy selected would thus be predicated in part on the trader's specific expectations as to how high he expects GOOGL to rise. If the trader thought GOOGL would only rise to $700, the spread is far superior. It would make $600 on a $400 investment. With GOOGL at $700 a share at expiration, the long call would actually lose money. But if the trader thought GOOGL would rise significantly, he'd select the long call because the profit potential is capped at 6 on the spread and the long call can have a very leveraged profit if the stock rises sharply. For example, if the stock is at, say, $750 at expiration, the call would make 4,350 on the initial $1,650 investment (that's 750 minus 690 minus 16.50 times 100).

In addition to debit spreads, there are also credit spreads. A credit spread can be used in low volatility environments when a trader expects a stock not to move above or below a certain level like support or resistance. Just like debit spreads, credit spreads can be used with calls or puts.

Credit Call Spread: Selling a call and buying a higher strike call with the same expiration. The maximum profit is the credit received, which occurs if the stock is below the short strike at expiration; both options would expire worthless. The maximum risk is the difference between the strikes minus the premium received, which is achieved if the stock is above both strikes at expiration. Traders use credit call spreads if they believe the stock will move lower or not move above a certain area like resistance.

Credit Put Spread: Selling a put and buying a lower strike put with the same expiration. The maximum profit is the credit received, which occurs if the stock is above the short strike at expiration; both options would expire worthless. The maximum risk is the difference between the strikes minus the premium received, which is achieved if the stock is below both strikes at expiration. Traders use credit put spreads if they believe the stock will move higher or not move below a certain area like support.

Tesla Options Example

During a selloff, Tesla Motors Inc. (TSLA) dropped to about $10 above its 200-day moving average. A trader believes the stock will rebound higher or the potential support from the moving average may keep the stock from moving any lower.

TSLA Credit Put Spread

Tesla Motors Inc. (TSLA) was trading around the $240 level with the 200-day moving average residing in the $230 area. With the credit put spread, the trader will sell the 230 put for 7.80. But in addition to that, the trader will, at the same time, buy a 220 call with the same expiration for 5.00. This results in a net credit of 2.80, or $280 of actual cash. The maximum profit that can be achieved if TSLA is trading above $230 at expiration.

Here the capital at risk is significantly more than the potential profit—it's 7.20, or $720 (that's 230 minus 220 minus 2.80).

Why would a trader risk more than he or she is willing to make with a credit spread? The simple answer is probability. The trader is more likely to make the $280 than he or she is to take the maximum loss. In the scenario above, the credit put spread has essentially three out of four ways to make the maximum profit. The stock can move higher and farther away from the put strikes, it can trade sideways and still have the puts expire worthless and it can lose about $10 (240 [current price] – 230 [short strike]) by expiration and still stay above the put strikes and receive the credit.

If the trader had an outlook on TSLA that was more bullish, a debit call spread as described above, may be a better fit because it would potentially have a better risk/reward scenario. That being said, the stock would have to rise in order to be profitable where as with the credit put spread, that would not be the case.

One the great aspects about options that has been mentioned is there is a strategy for basically every outlook. But what if a trader is not sure what the underlying will do and the market is smack dab in the middle of a volatile period? Equity traders would have two choices: Either buy or sell—and either they will be right or wrong. But an option trader could buy a straddle and potentially make money whichever direction the market moves.

Straddle: Buying a long call and a long put each with the same strikes and expiration. Generally the shared strike price is close to the current stock price. The maximum profit should the stock

rise is unlimited because of the long call; and if the stock should fall, is quite substantial because of the long put. The maximum risk is what was paid for the straddle, which would be realized if the stock was trading exactly at the strike price at expiration. The breakeven to the upside is the strike price plus the debit and the breakeven to the downside is the strike price minus the debit.

Keurig Green Mountain Options Example

A trader has been watching Keurig Green Mountain Inc. (GMCR) for some time and has noticed how volatile the stock has been in the past. Although the stock has been falling for a long time, the trader feels the drop may be over and if not he or she would like to have the ability to profit if the stock continues to descend.

GMCR Straddle

Take a look at Keurig Green Mountain Inc. when it was trading around $80. Over the last couple of years, the stock has traded as high as almost $160 and as low as about $20. It obviously has room to drop to support around $20 and rally back to resistance around $160. Buying a straddle which consists of buying an $80 call and an $80 put with over 500 days until expiration could be initiated for around 20.00 (or $2,000). All the stock would need to do is move $20 higher or lower in 500 days, or even much sooner than that, to profit.

Again, trading stock alone cannot give you that type of advantage when you don't know where the underlying is going. An option trader has that ability if he or she knows when and how to take advantage of a particular scenario.

Another aspect to understand about options is being able to differentiate between various implied volatility levels. Options are composed of time value and are priced at different levels. This can be particularly important when buying a straddle in the above GMCR example. Knowing when would be a better time to sell options versus buying options is a key component to being a profitable options trader. This is actually an area that many option traders surprisingly do not know or are not comfortable with analyzing.

Implied volatility is a good way to determine if options are considered cheap, expensive or priced like they should be. If options are priced on the expensive side, it is a good idea to sell expensive options premium in conjunction with your technical analysis outlook.

If implied volatility indicates that option premium may be on the cheaper side, it is a good idea to buy inexpensive options for either a bullish or bearish bias based on your technical analysis.

Forming an outlook based on the technicals and then combining your implied volatility analysis can put considerable odds on an option trader's side.

In addition, an option trader can profit from volatility positions that are independent of market movement. Think about that for a second! If a trader is right about the expected move in volatili-

ty, he or she can profit regardless of what the underlying does. In fact, just like stocks, bonds, forex and cash—volatility is an asset class and can make up part of a well-diversified portfolio.

Secret #3: Successful Traders Trade with a Plan

Most importantly, the final "secret" is to have a trading plan. Developing a solid trading plan requires commitment and discipline. Most traders will not take the time to come up with and follow a plan. Then they wonder why they are not successful. A trading plan creates rules for, and holds the trader to, his or her own accountability.

Trading can make a person lazy. Why? The simple reason is that all you need to open an account, besides filling out the application, is money. If you have money to trade , you have obviously been successful in some previous endeavor. Once you have deposited your money, you are ready to start in your pursuit of additional wealth. That's it. It looks much easier than it is because it was relatively easy to set up the account. But to make money trading takes education and formulation of a plan.

Not sure how to start your trading plan? Here are a few things to consider.

Your Goals

The first section of your trading plan should contain your goals. Yes, you want to make money. But if you are a new trader, don't set monetary goals for yourself initially. It is doubtful you will achieve them on a consistent basis. Concentrate on taking and managing the best trades possible and learning from your failures as well as your successes.

Money Management

The next section that needs to be addressed is money management. Lack of discipline dooms most traders. Traders should set limits and targets per trade, per week and on a monthly basis. What you are willing to risk should never exceed your target limit. Limits are crucial because you need to be held accountable to yourself. How many trader stories are out there about having accounts blow up? Unfortunately there are way too many.

Use Specific Strategies

Using specific trading strategies is next. This is your blueprint for successful trading. The key is to start out with one or two strategies and become proficient at them before moving on to more complex strategies.

Create a Trading Journal. You will have to define in detail your set-ups, entry points, time frames, etc. Be clear and concise. When you are done with this section, another trader should be able to read it and know exactly what to do to spot the correct set-up.

Trade Management

Trade management is maybe the most important section of your trading plan. This is extremely important because most traders concentrate on the entry of the trade and pay little attention to where to exit for a loss and even a profit.

This is the section in which you will decide what you will do for every imaginable scenario that can happen before you enter the trade. This is important because this will help you remove your emotions from the trade. You will know exactly what to do no matter what happens.

Conclusion

As discussed above, whatever your outlook, there is an options strategy to coincide with it. As long as you know how to read a stock chart, understand the versatility of options, acknowledge the importance of implied volatility and have a well-defined trading plan, you are off to a good start to becoming a successful trader.

There are no great secrets or mysteries to be uncovered to profit in any market. Extracting money from the market on a continuous basis is no easy task. It all boils down to treating your trading like a business and always continuing with your education so you can become the most successful trader you deserve to be.

Here's to your trading success!

Dan Passarelli
Founder & President, Market Taker Mentoring, Inc.

Dan Passarelli is an author, trader and former member of the Chicago Board Options Exchange (CBOE) and CME Group. Dan has written two books on options trading — "Trading Option Greeks" and "The Market Taker's Edge." He is also the founder and CEO of Market Taker Mentoring, Inc., the global leader in options education, which provides online options education, options newsletters and personalized, one-on-one coaching for option traders.

Dan began his trading career on the floor of the CBOE as an equity options market maker. He also traded agricultural options and futures on the floor of the Chicago Board of Trade (now part of CME Group).

In 2005 Dan joined CBOE's Options Institute and began teaching both basic and advanced trading concepts to retail traders, brokers, institutional traders, financial planners and advisors, money managers, and market makers. In addition to his work with the CBOE, he has taught options strategies at the Options Industry Council (OIC), the International Securities Exchange (ISE), CME Group, the Philadelphia Stock Exchange, The Shanghai Futures Exchange and many leading options-based brokerage firms.

Dan also contributes to financial media such as TheStreet.com, FOX Business News, Bloomberg Television, BNN, Public Radio (NPR), and the CBOE blog. And he has a weekly featured video on CBOETV.

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