

Top Three Options Trades Second-Half 2013



Introduction...

Welcome to our free report, "The Top 3 Options Trades For Second-Half 2013".

Before we get to the actual trades, I'm going to take a few minutes to go over the basics for those who are new to options.

If you are indeed new to trading options, please know that it takes a little bit of getting used to. The lingo's different. And options work a little differently than stocks.

After reading this report, be sure to check your email inbox each day for our free e-letter, Options Trading Research.

This newsletter is one of the best ways to not only learn more about options, but also how to use them effectively.

With that said, let's go over how options work...

In a nutshell, options have changed the way professionals trade and invest. It's no longer just about stocks and bonds. These days, options trading is just as popular.

Quite simply, option trading is huge. And the market continues to grow everyday by leaps and bounds.

For instance...

During 2011 497 million equity contracts (options) were traded on the CBOE. That represents \$102 billion worth of options on 49.7 billion shares of underlying stock!

So what makes options so special? Why is the market so astronomically big - and growing?

First, let's start with the basics...

What Exactly Are Options?

By definition, an option is a contract that gives someone the right to buy or sell an underlying security at a given price for a specified period of time. If that sounds complicated to you, don't worry, it's actually fairly straightforward once you understand the lingo.

The underlying security is just the asset that your option is based on and tracking, such as a stock, ETF or commodity.

Although you can buy and sell options on just about anything nowadays, we're going to focus on options on stocks from here on out.

So, in the case of stocks, one option contract gives you control over 100 shares of stock.

The given price I mentioned is called the strike price of the option. That just means the price you'll be long or short

the stock if you exercise your option contract.

And since options have an expiration date, the “specified period of time” is the time until the option expires.

Finally, options can be either calls or puts. A call gives the buyer the right to buy a stock upon expiration. A put gives the buyer the right to be short, or sell a stock when expiration hits.

Here’s how it works...

The buyer pays a premium for a call or put option. The premium costs just a fraction of the actual stock price. And, it gives the buyer the right to be long or short the stock at the stated strike price... up until the expiration date.

Conversely, an option seller collects the premium. If the short call or put is never exercised by the expiration date, the seller keeps the premium.

It’s similar to an insurance company collecting premiums for insurance policies. If no claims are paid out during a specific period, the insurance company keeps the entire premium.

So how does all this work in real life?

Let's take a look at an example...

We’ll use **Cisco Systems (CSCO)** and we'll say CSCO is trading for \$25 a share.

Now, let’s say you believe the share price is going to go to at least \$30 within the next six months. So, you buy a CSCO \$25 call with an expiration six months

out. That means for six months, you control one CSCO call option at a strike price of \$25.

The premium, or cost, of the option is \$0.50. Since one option contract equals 100 shares of stock, you multiply the premium by 100 to get your out of pocket cost. In this case, one contract costs your \$50.

Within six months, if CSCO climbs above \$25 per share, you make \$100 for every \$1 the stock goes up, minus the premium. So, if CSCO climbs to \$30, you'd make \$500 on your option minus \$50 for the premium, or \$450 total.

Now, if you had bought 100 shares of CSCO instead of buying the option, it would have cost you \$2,500!

So to control the same 100 shares of stock, the option cost you \$50 while buying the stock outright would have cost you \$2,500.



That's a big difference and explains why options are so popular.

Of course, options aren't completely without risk. The risk of buying the call is that the option may expire worthless.

This would happen if CSCO closes below \$25 at the expiration date.

But for a cost of just \$50 and unlimited upside... it sure sounds like a better deal than buying the stock.

But What If I Think The Stock Is Going To Drop?

On the other hand, if you think CSCO shares are going to drop in the next six months, you could buy a put option instead.

A put option works exactly like a call option, but in reverse. Put options are used when you think a stock is going to drop.

Back to our Cisco example....

This time, let's say you purchase the \$23 strike put for \$0.75 in premium. That means for \$75 you'll make money if CSCO drops below \$23 in the next six months, minus the cost of the option.

It's the equivalent of shorting the stock... but a lot easier to accomplish and less risky.

One thing to keep in mind-- you can always sell any option you've purchased before expiration if you so choose. You don't have to wait until it expires.

Further, you can sell an option before you buy it. Briefly, here's how that works...

Selling Options...

In addition to buying calls and puts, you can also sell them to buyers.

There are lots of reasons to sell options.

In fact, 2 of the 3 trades I'm recommending right now involve selling options (we'll get to those in a second).

Just know for now that selling options is one of the best ways to reduce risk and generate income.

Our free newsletter, Options Trading Research will cover how to do this in great detail.

But for now, let's quickly go over an example of how selling options works...

Let's say you don't think CSCO shares are going to move much in the next six months.

By selling either calls or puts, you'll collect the buyer's premium. And, if CSCO stays near \$25 over the life of the option, you'll get to keep the premium.

However, if the stock moves considerably higher or lower, you may get assigned the shares. All that means is, depending on if you sold a call or a put, you may end up being long or short the shares if you get assigned.

As you'll see later on, there are times when you actually want to get assigned on shares.

In a nutshell, selling options allows you to collect income upfront, and is an integral part of some of the most profitable options trading strategies!

Okay, so those are the basics...

By now you should have a good idea of how options work.

But what are the benefits of using options, and why are they generally considered the investment of choice for most professionals?

Why Professional Investors Use Options

It's no secret that options have exploded in popularity over the years.

The reason is simple.

No other investment offers the broad range of benefits to investors that options do.

Here's the 5 most important...

For starters, options can increase your profits substantially.

It's not unusual for options to rocket up hundreds and thousands of percent in a very short amount of time.

For the cost of an option premium, you control 100 shares of stock. That means for a small investment, you have the ability to make a lot more on a stock's move (than if you had just bought the stock outright).

Second, the amount of money you need upfront with options is SUBSTANTIALLY less than just about any other investment out there.

You can control huge amounts of assets with a relatively small amount of money. And for many options strategies, you can

actually generate income with no money out of pocket.

Try that with stocks!

Third, options give investors amazing flexibility.

There are literally hundreds of strategies you can use with options. From straddles to strangles, from call buying to put selling, the variations are endless!

You can use options to create strategies to profit from just about any scenario you can envision...

Fourth, when used correctly, options are one of the best risk management tools known to man.

This is the main reason why options are used so heavily by big-time investors and Wall Street insiders.

No matter what investment you're using, or what investment strategy you're following, options can always be used to reduce risk.

Last, but not least, options make it very easy to generate income on a regular basis.

Whether it's collecting option premiums on stocks you already own, or generating credits by selling options to eager buyers, generating income is a very popular way to use options.

In a nutshell, when selling calls or puts, you can make money not just on the direction of the stock, but even if the stock doesn't move at all. Plus, selling options gives you a ton of flexibility on how you design strategies.

With so many benefits, it's no wonder the pros trade options so heavily. You've likely heard the term "smart money" when referring to professional traders. Well, the smart money is often in options.

And when you take a look at the three powerful strategies I'm about to explain, you'll see how you can become the smart money... just like the pros.

Top Three Option Trades For Second-Half 2013

Ok, we just went over the basics on how options work.

Now we're going to go over 3 actual option trades you can make that take advantage of the benefits that options provide.

In addition, the 3 strategies you're about to discover can be used in a variety of ways to increase your profits and generate income on a regular basis.

Once you start using these strategies, you may never look at trading stocks (or options) the same way!

Option Trade #1: Buy This Stock For Half The Price

If you ask any investor off the street to pick just one stock to buy, there's an excellent chance their choice will be **Apple** (AAPL).

Apple is one of the largest public company on the planet.

And just about every person in the civilized world has heard of the company. Apple's products are always the trendiest gadgets out there.

Just look at the lines that queue up when they release a new product.

Here's the thing...

Apple's stock has been very expensive for years. The average investor can only afford a few shares at a time.

What if there was a way to control many more shares of Apple (and participate in its upside) without needing nearly as much money upfront to buy the shares?

That's where options come in.

Using a special option strategy, you'll be able to buy Apple at roughly half the price that the actual shares cost!

Only through options can you get this sort of opportunity.

Let me show you what I mean...

Let's say AAPL is trading at \$425 per share.

Clearly, the current price is extremely high and most investors would only be able to afford a handful of shares at most. In fact, 100 shares of AAPL would cost you a cool \$42,500.

Instead, you can use long-term Deep-In-The-Money calls on AAPL.

By long-term, I mean as far out as you can go. We'll use January of 2015 as an example.

If you were to buy one long-term Apple call, let's say the 250 strike, it would probably cost you a little over \$180. Remember, one option equals 100 shares, so we need to multiply the premium by 100 to get the actual cost.

In this case, that's \$18,000 to own the call.

While, that's still a decent chunk of change, it's less than half as much as buying the shares outright. And, you control the shares through January 2015.

Why wouldn't you want to invest half as much for the same thing?

By buying long-term deep-in-the-money calls you can "control" any stock for about half what it would cost to buy the stock outright.

And if Apple starts moving higher as many people anticipate, you'll profit just as you would if you owned the stock!



By the way, if Apple's stock drops all the way to zero (fat chance!), your risk is limited to the amount of money you invested in the call options (\$18,000) in this case.

Compare that to the \$42,500 you would have lost in the stock had you bought it directly.

That's the power of options.

Full participation on the upside, limited risk on the downside.

Not a bad combination, eh?

Option Trade #2: Generate Income On A Stock You Already Own

While buying options is a nice way to get leverage for cheap, there's even more opportunity when it comes to selling options.

Let's say there's a stock in your portfolio you really like (or a stock you want to buy and hold for the long-term).

For example, say you own (or buy) 100 shares of **McDonald's** (MCD).

MCD is a solid long-term addition to any portfolio. It's one of the most recognizable - and valuable - brand names in the world.

The fast food giant pulls in \$27 billion a year in revenue, and generates \$5.5 billion in profits. Plus, it's a fairly recession-proof stock.

Hey, people still eat their Big Macs during a recession!



Okay, so once you have MCD in your portfolio, here's how you can continuously generate additional income from it.

The strategy I'm referring to is selling covered calls.

It's simple...

First, pick an out-of-the-money call. If MCD is trading at \$100, we'll use next January's 110 strike as an example. For this example, we'll say the 110 call is trading for a premium of \$1.50.

Now, when selling covered calls, you'll want to sell options at least six months out. I personally like to go out nine months to a year.

Here's how it works...

You own MCD at \$100. The stock typically doesn't move that much - it's what we call a low volatility stock. Chances are, MCD won't hit \$110 in six months to a year. As such, we'll sell the 110 call for \$1.50.

If MCD stays below \$110 before the option expires, you earn \$1.50 on your covered call, or \$150 (for every 100 shares you own)... all for doing absolutely nothing.

Basically, if the stock drops, you've given yourself an extra \$1.50 cushion on the downside. But, if MCD stays around the current level, you'll make money on your call without losing a dime on your stock position.

If MCD goes up but stays below \$110, you'll make money on the stock increase up to \$110 and from the premium you collected on the covered call. That's the best of both worlds!

Finally, if MCD blows through \$110, your option will get exercised. Since you're already long 100 shares, all that means is that your broker will remove the shares from your account. In other words, you'll be cashed out of your position for profit.

If that happens you've just made \$10 on your stock appreciation and another \$1.50 from selling the option.

Plus, you can always buy more shares and do the same thing over and over again.

(If McDonald's does not reach \$110, your options expire, you keep the premium, and then you can do it all over again!)

Look, it's basically a no-lose strategy. You're somewhat protected on the downside, and every other scenario is profitable for you.

Remember, you planned on holding these shares long-term anyway, even if the price falls over the next year.

So tell me again, why wouldn't you sell covered calls every chance you get?

Option Trade #3 – Get Paid To Buy Your Favorite Stock

Have you ever wanted to buy a particular stock, but it's just priced too high?

You know, that one stock you've been coveting, but you don't want to pay the current price.

Yet, you're also afraid the stock might continue to run, and you'll miss out completely.

Fortunately, there's a perfect way to handle this situation... and even better, make money in the process!

Sound interesting? Of course it does.

The best part... it's easy to do - with naked put writing.

Take **Intel** (INTC) for an example.

It's the largest semiconductor company in the world. As a matter of fact, it's one of the largest companies in the world.

Intel pulls in over \$50 billion a year in revenue, \$12 billion in profits, and has billions of dollars in cash to boot. Plus, they pay a solid dividend.

Okay, say you want to own Intel at \$20 a share. But, the stock's been hanging out around \$25 for several weeks.

Here's what you do...

Sell a 20 strike put on INTC three to six months out. You'll collect anywhere from \$0.50 to \$1.00 in premium depending on how far the option is to expiration. We'll use \$0.75 for this example.

Now you've collected \$75 on one naked put contract. If INTC moves sideways or climbs higher over the life of the



option, you've just collected the premium for doing absolutely nothing.

And, you can keep on doing the same trade over and over again, collecting more cash each and every time.

However, if INTC drops below \$20, you'll be assigned the shares.

In other words, your option will be exercised and 100 share of Intel will be put in your account at \$20 a share. Actually, you get to keep your \$75 in premium, so you'll be long the shares for \$19.25.

That's perfect! You just got paid to buy a stock at the price you wanted to pay.

But what if the stock shoots higher?

If the stock continues to move higher - and you think it's going to continue moving higher - you can sell another put at a higher strike price. That way you'll be earning a consistent premium while giving yourself a chance to buy the stock on a pullback.

On the other hand, if the stock plunges, you don't need to do anything. You've already decided you'd be happy owning Intel at \$20 (or \$19.25 in this case).

Presumably, you like this stock enough to hold it for the long-term, so why worry if you get the stock at your preferred level?

Clearly, naked put selling is a powerful strategy that can be used in just about any scenario where you want to buy a stock. And it's just another example of how you can really supercharge your profits with options.

A Final Word

By now you can see just how powerful options are.

The benefits are plentiful... and plain to see. Not only can options boost your profits, they can also lower your risk and increase flexibility. That's why the pros use options!

Done correctly, option trading can provide huge upside potential. Even better, they can do it without increasing

your risk. In fact, they'll even lower your risk in many cases.

Speaking of that, there are hundreds of situations you can use options and options strategies. They can be ideal trading instruments for just about any scenario.

You've seen just how easy it is to own your favorite stock for half-price, generate income on a stock you already

own, and get paid to buy a stock you like at the price you want.

These popular strategies can make you loads of money. That's why so many expert investors use deep-in-the-money calls, covered calls, and naked put selling.

And there's so much more to discover about options. We just scratched the surface of all the possibilities...

Where To Get More Options Trading Ideas On These Strategies And Many More...

One of the additional benefits you'll receive along with this report is a free subscription to our Options Trading Research newsletter (delivered straight to the email address you provided).

Published several times a week, Options Trading Research will give you professional options trading ideas, market commentary and analysis all designed to make you a better options trader!

Authored by my expert team and me, we'll show you what's working in the options market and what you need to know to generate the biggest returns.

To make it as useful as possible, we've also tailored it so both beginners and advanced traders can profit immediately from what they read...

So if you're serious about making money and securing your retirement using options-- welcome aboard!

I promise that you won't find a better source of proven, useful options trading ideas anywhere on the web!

Sincerely,

Gordon Lewis,
Chief Options Strategist
Options Trading Research

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