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Tonight's Agenda

The Power of Consistent Cash Flow

We'll cover:

- Becoming the options seller
- Using options to juice your returns
- Getting paid to own stock
- The Do's and Don'ts of selling options
- **VIP Only:** Turn every Friday into Pay Day!

A green pencil is positioned diagonally, pointing towards a vertical checklist. The checklist consists of four square boxes. The first three boxes have a green checkmark inside them, while the fourth box is empty. The pencil's tip is touching the top of the fourth box.

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Selling Options



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Remember Anna?

Last class, Anna locked in the price of a house that she wanted to buy using a call option.

Now we're going to look at the other side of that transaction...

...the **seller** of the home

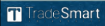


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Meet Josh

Josh owns the house that Anna wants to buy.

For \$2,000, he agreed to sell the house to Anna for \$400,000 any time in the next 3 months.



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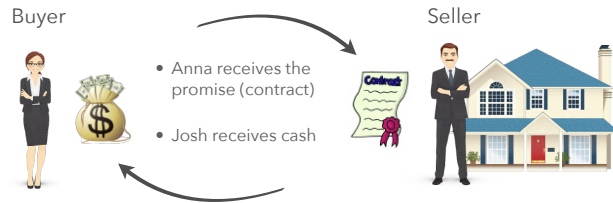
What Has Josh Done?

- He made a promise
- He wrote a contract explaining the rights and obligations of both parties
- He sold the contract to Anna for \$2,000



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Here's What That Transaction Looks Like



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Who Has What?

Anna

- Has bought a contract
- She has rights
- She paid money



Josh

- Has sold a contract
- He has obligations
- He received money



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What If Anna Decides To Buy The House?

Anna

- Pays Josh \$400,000
- Loses \$2,000 for the contract
- Gains a house



Josh

- Receives \$400,000
- Keeps the \$2,000 for the contract
- Loses a house



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What If Anna Decides *NOT* To Buy The House?

Anna

- Loses \$2,000 for the contract
- Can buy another contract



Josh

- Keeps the \$2,000 for the contract
- Can sell another contract



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Why Would Josh Want To Do This?

- He wants to lock in a good sale price for his home
- He thinks the house might go down in value
- He wants to create cashflow from his asset *whether he sells it or not*



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Now Let's Translate This Example Back To The Stock Market

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AMD Example

Josh owns 100 shares of AMD at \$160.

He doesn't know what's going to happen with AMD, but he'd be happy to sell his shares at \$180 if it goes up.

He could simply set a limit order to sell his shares at \$180...

...Or he can sell an option for more \$\$!



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AMD Example

Josh can write (Sell To Open) a call option.

He makes a promise to sell his shares of AMD for \$180 over the next couple of weeks.

This is just like when he promised to sell his house to Anna for \$400,000.



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What If AMD Goes Down?

Anna

- Loses \$2.70/share for the contract
- Doesn't buy shares
- Can buy another contract



Josh

- Keeps the \$2.70 per share for the contract
- Keeps his shares
- Can sell another contract

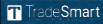


Josh Has Created \$270 of
Cash Flow From His Stock

If AMD goes up to \$180, he makes
\$20/share, PLUS an extra \$2.70/share
(for doing exactly what he would have done anyways!)

That increases his return by +13.5%!

**If AMD never goes above \$180,
Josh gets to keep his stock
AND the extra \$270**



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**...And he can simply repeat the
process again and again**



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**In effect, he has created
his very own dividend!**



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Who else thinks this is SUPER Cool!?!?



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Covered Call Strategy

You just learned the Covered Call strategy!

Any time you are in a stock trade with 100+ shares, consider selling a call option at your target price.

At the exact same exit price, you can get more bang for your buck by using options to exit your position.

Simply sell the call option with the closest strike to your target price.



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Covered Call Strategy

This is the safest options strategy of all time.

Your broker will let you put on this trade even if you have ZERO options knowledge.

That's because the only risk on this trade is the risk you had with the stock trade.

Selling the call option adds no additional risk, but does create a new stream of cashflow from your stock!



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Covered Call Strategy

Essentially, you're "renting out" your stock – just like renting out an investment property!

(Technically it's closer to "lease to own")

One of the advantages of doing this with options is that you can choose how often you want to get paid.

You can create your own monthly or even weekly dividend!



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ULTRA CRITICAL WARNING!!!

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Covered Calls MUST Be Covered


Some people get greedy and want to sell the option *without* owning the stock

This is a huge no-no!

What would happen if Josh sold the 180-strike call option but did NOT own 100 shares of AMD?

Remember, he made a promise to sell shares at \$180 – What happens if the buyer demands he keep his promise?

He has to go into the market and buy shares at the market price. What if AMD is trading at \$200 but he has to sell at \$180? $+2.70 - 20 = \mathbf{\$-17.30 \text{ per share!}}$

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Covered Calls MUST Be Covered

Promising to sell (writing a call option) when you don't own the offsetting asset is called "Selling Naked".

We Never, Ever, EVER Sell Naked Options!


By doing that, you would be transforming the safest options strategy into possibly the most risky structure.

Selling naked options is the #1 way people blow up their options trading accounts.

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Don't Be This Guy:



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Covered Calls MUST Be Covered

As long as you always make sure that you own the offsetting asset, you take that risk off the table.

When Josh sold the call option, he already owned the AMD shares that he was promising to sell, so his obligation was *covered*.

That's why the strategy is called the "Covered Call".

When done correctly, selling options can be a great way to create regular, consistent income in your trading account.

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**I'll be back later to wrap up
class by showing you guys
some LIVE options trades!**

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