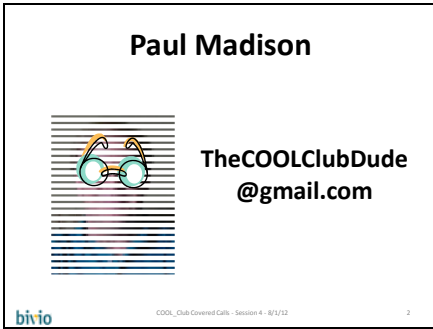




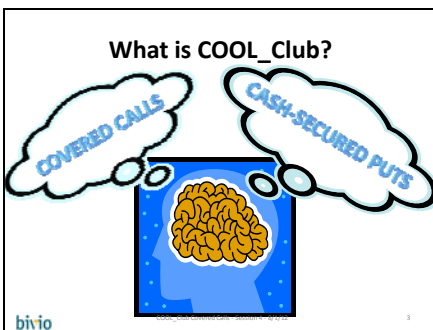
Welcome to Session 4 of the Covered Options Online Learning Club



First let me introduce myself, I am Paul Madison and I will be

TheCOOLClubDude and

You can reach me buy sending e-mail to  
TheCOOLClubDude@gmail.com.



Reminder:

This will be a weekly 30 minute session where we explore the thought processes associated with actual Covered Option Trades.

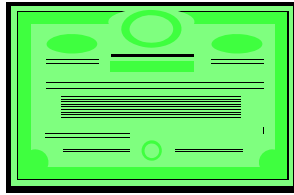
Every session we will walk through one or two trades from the recent past.

Going through the logic on why we are looking at a particular option on a particular stock.

How we sold it using screenshots of various brokers (Fidelity, Schwab)

We will look at both when trades are put on and we will come back and look again at them when they are closed

## Covered Calls (Stocks)



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We have three broad types of Covered Options we are going to talk about and we are going to focus on one of the three in a three week rotation.

The first type are Covered Calls these represent potential sells against Stock you own in your portfolio. This is the type we will be doing tonight.

## Cash-Secured PUTs (Stocks)



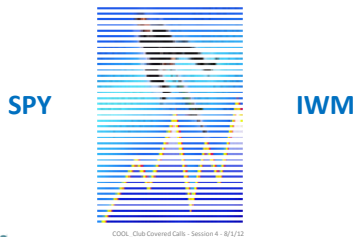
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The second type are Cash-Secured PUTs. As the name implies these are potential stock purchases that you have "secured" by having cash to cover the purchase in your account.

## Covered Options on Indexes



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We will also talk about both Cash-Secured PUTs as well as Covered CALLs on broad market index ETFs. This is what we covered last week.

There are some unique things with these that justify thinking about them differently than our Covered Stock options.

My two favorites ETFs that I will primarily talk about are  
(click)

SPY which is an ETF based on the S&P 500 index

(click)

And IWM which is an ETF based on the Russell 2000 index

## When we have time



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If we have time we will allow attendees to ask about one or two stocks that they are considering options on.

We will talk through the pros and cons of doing either a call or a put on the stock without make a recommendations on whether to or not to do an option on the stock.

In addition, we are going to strive really hard to keep to just 30 minutes each week

## COOL Schedule

- Second Wednesday (Aug 8<sup>th</sup>) 8pm ET
- Third Wednesday (Aug 15<sup>th</sup>) 9pm ET
- Fourth Wednesday (Aug 22<sup>nd</sup>) 10pm ET
- Fifth Wednesday (Aug 29<sup>th</sup>) Vacation

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A COOL Club has to have a COOL Schedule and we think we do. Since this is all about sharing with the most people and it is not critical for people to make every session we are being creative with our weekly schedule.

The second Wednesday of every month, August 8<sup>th</sup> this month, our schedule time will be 8pm ET

The third Wednesday will be at 9pm ET

And the fourth Wednesday will be at 10pm ET.

August does have five Wednesdays so we will have a “Holiday”

## Recordings



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To the best of our ability we will strive to record each week's sessions and post them on bivio if you cannot attend a session

## COOL\_Club Home Page



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We are continuing to build out our COOL\_Club home page

The link is [www.bivio.com/COOL\\_Club](http://www.bivio.com/COOL_Club)

## Email Discussion Group

On our home page -[www.bivio.com/COOL\\_Club](http://www.bivio.com/COOL_Club)

Click the [COOL\\_Club Discussion List](#)

After joining, questions can be sent to:  
[Cool\\_Club@bivio.com](mailto:Cool_Club@bivio.com)

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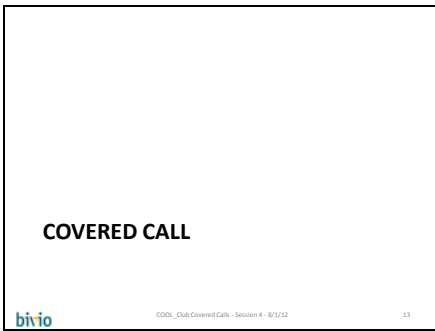
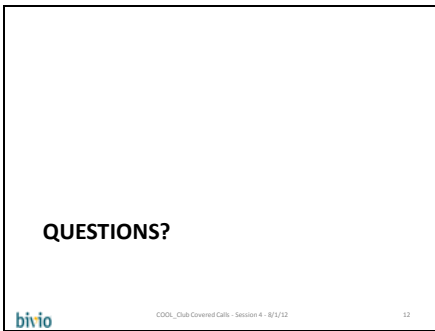
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If you would like to join the COOL\_Club Discussion group

Go to the COOL\_Club home page to register for the email discussion list.

You can certainly still attend COOL\_Club sessions without joining our email discussion group.

All questions and replies to COOL\_Club will be sent to the entire email discussion group.



So why might you want to sell a covered call?

(click)

Maybe Your Stock is up nicely

(click)

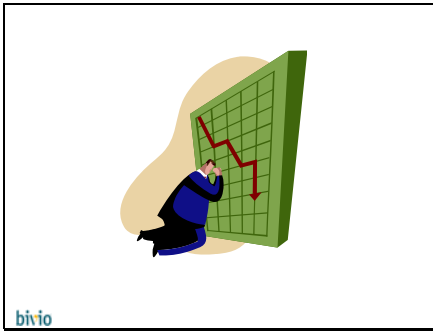
Your stock is not quite to a sell level however

Maybe Your stock's PAR or projected return has dropped below your threshold

Maybe You have made a nice gain in a short time

Maybe Your stock has moved quite a bit in a short time

But you are not ready to sell because it has not reached your sell target

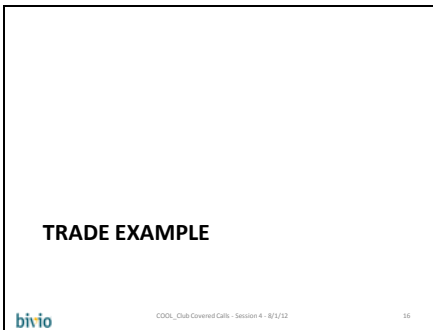


***Despite not wanting to sell you think your stock might go down!***

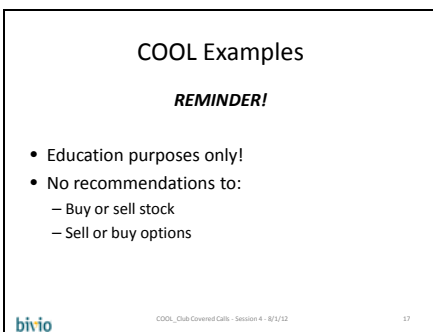
***Maybe not a precipitous fall like the picture, but maybe you are thinking it is about to experience a more minor correction just because it has moved up so fast or so long.***

Selling a covered call is a way for you to generate some income on your appreciated asset after it has moved up in price but you are not to the point of selling.

***By the way, if you do believe that your stock is going to have a significant drop you should consider just selling outright.***



If there are no questions at this time we will go into our Trade Example.



ALIGN TECHNOLOGY, INC.

- Ticker: ALGN
- Based on fundamental analysis:
  - 18% EPS growth
  - Buy < \$31
  - Sell > \$48

 COOL\_Club Covered Call - Session 4 - 8/1/12 18

Our first Covered Option for COOL\_Club was a Covered Call on Align Technology and is so often the case if we buy back the option to close it then we might be able to sell a call again. So that is what we are going to do tonight is another covered call on Align Technology.

Align Technology is a global medical devices company focusing on orthodontics and most known for invisalign braces.

The Ticker is A L G N

On my fundamental analysis my assumption on Earnings growth rate is 18%

and my short term targets are buy below \$31

And sell above \$48


Word of caution about COOL - We are going to focus on the process of selling covered options and not on debating fundamentals or assumptions. You do not have to accept my assumptions, just understand they were part of my decision process for selling the covered option.

**Position**

300 shares

Jan 13 '12

\$24.20

 COOL\_Club Covered Call - Session 4 - 8/1/12 19

So just a refresher on our first trade.


My 300 shares of ALGN were bought in January at a price just above \$24

**Status**

\$35+

45%+ gain in 6 months

PAR < 10%

 COOL\_Club Covered Call - Session 4 - 8/1/12 20

The stock was at 35.28 when I sold the first Covered Call on Align.

At that price I had a 45%+ gain on the stock and had owned it for only 6 months.

The 52 week high is 35.56

My PAR (projected annualized return) had fallen below the 10% level ... a level I like to maintain for stocks in my portfolio.

## When to Sell a Covered Call

- **Covered Call premiums are best when:**

- The stock has moved up for awhile **45% in 6 months**
- The stock is up on the day **ALGN was up 1.5% 7/10**
- The market is up on the day **Dow was up .7%**
- Volatility is up

*If you do technical analysis, look for "bearish" indicators*

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COO, Club Covered Calls - Session 4 - 8/1/12

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This was our checklist the first go around.

## Sold-To-Open – July 10<sup>th</sup> - \$38 Calls -\$.75



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Here is our price chart the first time we sold the Covered Call.

On July 10<sup>th</sup> at the beginning of the day ALGN was above 35 and we sold a \$38 Call for .75

By the end of the day the price had already started to weaken.

## Bought-To-Close – July 18<sup>th</sup> - \$.15



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COO, Club Covered Calls - Session 4 - 8/1/12

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By July 18<sup>th</sup> the stock had traded off going into the Earnings on July 19<sup>th</sup>

So the option was bought back to close it at .15.

## So how did we do on ALGN?

- Sold-To-Open - ALGN120721C00038000
  - July 10<sup>th</sup>
  - Collected \$214.72
- Bought-To-Close
  - July 18<sup>th</sup>
  - Paid 300 \* \$.15 + Commission = \$53
- Total
  - Made \$161.72
  - Open for 8 days
  - % Earned =  $\$161.72 / (300 \times \$31) = 1.7\%$
  - APR = 79%

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COO, Club Covered Calls - Session 4 - 8/1/12

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## ALIGN TECHNOLOGY, INC.

Invisalign iTero iOC OrthoCAD

- Ticker: ALGN
- Earnings came out 7/19
  - Sales up 21%
  - EPS up 70% (Non-GAAP) (100%+ GAAP)
- Based on fundamental analysis:
  - 18% EPS growth
  - Buy < ~~\$31~~ \$33
  - Sell > \$48 \$50

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Earnings came out on July 19<sup>th</sup> and they were better than expected. Sales were up 21% and EPS grew by 70% on Non-GAAP or pro-forma basis and by over 100% on a GAAP basis as the year ago quarter had some one time charges in it.

Tried to Sell-To-Open – Jul 26<sup>th</sup> - \$36  
Calls - \$1



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COO, Club Covered Calls - Session 4 - 8/1/12

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So for the week after earnings the stock price traded up and was back to the \$35+ range.

So on July 26<sup>th</sup> I was travelling but took a minute to look at ALGN and decided to sell an August 18<sup>th</sup> \$36 CALL for \$1

Here is the option chain and you can see that the August 36 CALL was bid at .85 and ask at \$1

Symbol	Last	Change	Bid	Ask	Volume
ALGN	36.20	+0.14	35.16	35.24	224,361

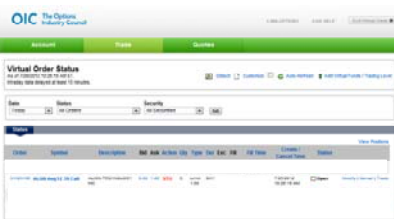
Month	Strike	Delta	Gamma	Theta	Vega	Price	Bid	Ask	Volume
Aug 15 Call	30.00	0.80	0.02	-0.02	0.10	1.00	0.97	1.00	70.0
Aug 15 Call	31.00	0.70	0.03	-0.02	0.10	0.80	0.78	0.84	100.0
Aug 15 Call	32.00	0.60	0.04	-0.02	0.10	0.60	0.58	0.64	100.0
Aug 15 Call	33.00	0.50	0.05	-0.02	0.10	0.40	0.38	0.44	100.0
Aug 15 Call	34.00	0.40	0.06	-0.02	0.10	0.20	0.18	0.24	100.0
Aug 15 Call	35.00	0.30	0.07	-0.02	0.10	0.10	0.08	0.12	100.0
Aug 15 Call	36.00	0.20	0.08	-0.02	0.10	0.05	0.04	0.06	100.0
Aug 15 Call	37.00	0.10	0.09	-0.02	0.10	0.02	0.01	0.03	100.0
Aug 15 Call	38.00	0.05	0.10	-0.02	0.10	0.01	0.00	0.01	100.0

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So I put in a Sell-To-Open that was good for just the Day at a \$1 limit.



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I was not able to check on the trade until two days later on Saturday July 28<sup>th</sup>.

What I discovered was that I was not filled on the order to sell at \$1 on Thursday and so it was cancelled. But I also notice the same \$36 Call closed on Friday at a bid of \$1.15 and a ask at \$1.30. So obviously ALGN went up on Friday.

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COO, Club Covered Calls - Session 4 - 8/1/12

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And so when we look at the price chart through Friday we see indeed it got to a high a bit above \$36 and closed just shy of \$36



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Option Chains for ALGN

Symbol	Range	Type	Expiration
ALGN	Filter the strikes	Call	Aug 12

Symbol	Last	Change	Bid	Ask	Volume
ALGN	37.62	+0.22	37.67	38.55	0

All 99 Expiration Months: Aug 12 (See All Expirations)

Strike	Last	Chg	Bid	Ask	Vol	Open
25.00	0.00	0	0.70	1.10	00	1
27.00	0	0	0.60	1.00	00	4
29.00	0.10	0	1.00	1.40	00	14
31.00	0.30	0	0.80	1.20	00	2
33.00	0.60	0	0.60	0.90	00	100
35.00	1.10	0	0.80	1.00	00	200
37.00	1.50	0	1.10	1.50	00	300
39.00	2.00	0	1.30	1.80	00	300
41.00	2.60	0	1.50	2.00	00	400
43.00	3.30	0	1.70	2.30	00	400
45.00	4.10	0	1.90	2.50	00	270
47.00	5.00	0	2.10	2.80	00	140
49.00	6.00	0	2.30	3.00	00	140
51.00	7.20	0	2.50	3.20	00	37

COO, Club Covered Calls - Session 4 - 8/1/12 31

Decided to put another order in and move the strike to a \$37 CALL.

When I looked at the option chain on Saturday, the \$37 CALL was bid at \$.70 and ask at \$.85

OIC The Options Industry Council

Account: [Name] | Trade | Quotes

Order Entry

Symbol: ALGN | Action: Buy To Open | Quantity: 3

Strike: 37.00 | Expiration: 08/12/12

Order Type: Limit

Price: 0.85

Order Status: Pending

COO, Club Covered Calls - Session 4 - 8/1/12 32

So I clicked on the bid price and the following order sheet came up.

Action is automatically Sell-To-Open because of clicking on the Bid price.

It fills in the detail for the Stock, the Strike Level and the expiration date.

We need to fill in the Quantity (3 contracts for 300 shares)

I decided to put the limit order in at the Ask price that it went out on Friday so \$.85

Finally because I am doing it on the weekend I need to say Good Until Cancelled so it will stay on until the Market is open on Monday.

Virtual Trade

Virtual Option Order Preview

Please Review Your Virtual Order Carefully

Order Summary

Symbol	Description	Last	Change	Bid	Ask	Volume
ALGN	ALGN TECHNOLOGY INC	37.62	+0.22	37.67	38.55	0
ALGN Aug12 37 Call	ALGN TECHNOLOGY INC	0.85	0.15	0.70	0.85	0

Action: Sell To Open

Symbol	Quantity	Description	Contract Size	Price	Expiration	All or None
ALGN	3	ALGN Aug12 37 Call	100	0.85	08/12/12	Yes

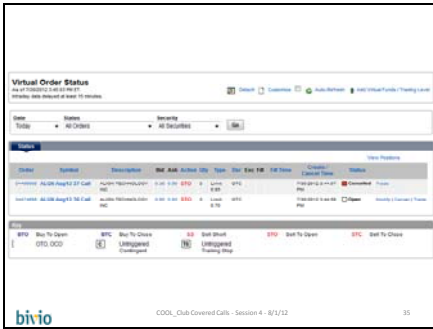
Estimated Commission: \$74.85  
Estimated Order Total: \$281.55  
Time: 08/01/12 10:57 AM EDT

COO, Club Covered Calls - Session 4 - 8/1/12 33

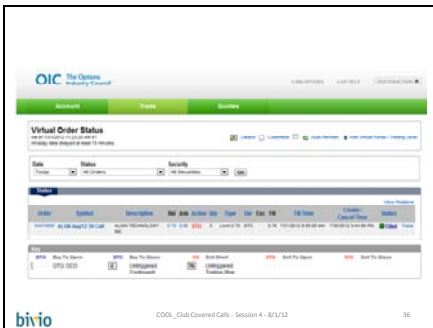
The screen tells us that the market is closed and so the trade will be in effect until the Market opens up on Monday.



When we look at the chart for Monday we see that Align did correct again on Monday



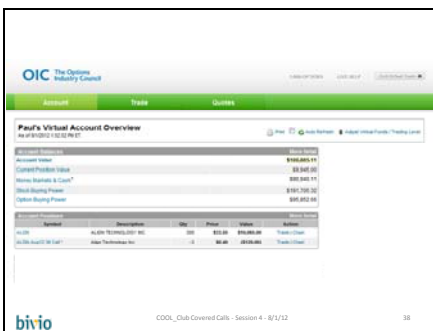
And so when I looked at my order once again I did not get filled as the price moved down to where it was bid at \$.35 asked at \$.50 ...less than half the \$.85 I was trying to get. So I cancelled that order and you can see I replaced it with a \$36 CALL at \$.70 and because there was only 15 minutes left of trading on Monday, I chose to do it as a Good Until Cancelled so that it would still be on for Tuesday.



When I checked mid day on Tuesday, my order was in fact filled at \$.70 and the bid ask had moved up to bid of \$.75 and ask of \$.90. So obviously ALGN had traded up again.

### Recap of Trade

- Sold-to-Open:
  - Open Date: July 31<sup>st</sup>
  - Stock: ALGN – Align Technology
  - Type: CALL
  - Strike: \$36 (Price obligated to sell our stock at)
  - Expiration: Aug 18<sup>th</sup> (18 days from sale)
  - 3 Contracts (requires 300 shares of Stock)
  - Premium collected \$.70 per share or \$210
  - Commission (OIC) \$15.03
  - Net Premium = \$225-15.03 = \$194.97
  - APR = 36%



When I checked the option on Wednesday afternoon ALGN had moved down again and the option was last traded at \$.40

### Premium for Buy Back below 10% APR

$$\text{Premium} = ((10\% \times \text{Price}) - (\text{Commission}/100)) \times (\text{Days Left}/365)$$

$$= ((.1 \times \$33.55) - (.15/100)) \times (17/365)$$

$$= (\$3.355 - \$0.15) \times (17/365)$$

$$= \$0.15$$

To calculate what the premium would have to be to be under a 10% APR, I used the formula of 10% of the stock price minus Commission (assumed) divided by 100 and that is multiplied by the days left on the option divided by 365 days

So we see the option premium would have to be \$.15 or less to be under a 10% APR.

So I did go ahead and put in a Buy-To-Close order at .15 for the day just in case the stock moved down some more on the day.

The screenshot shows the OIC Virtual Options Order Form. The order type is set to 'Buy To Close'. The underlying stock is 'AAPL' and the option is a 'Call' with a strike price of '\$33.55'. The quantity is 1. The order is placed at a price of \$.15. The order is set to expire on 'Aug 17, 2012'. The order is set to be filled on 'Aug 17, 2012'. The order is set to be filled at 'Market'.

QUESTIONS?

NEXT WEEK Aug 8<sup>th</sup> 8:00pm EDT  
COOL TOOLS