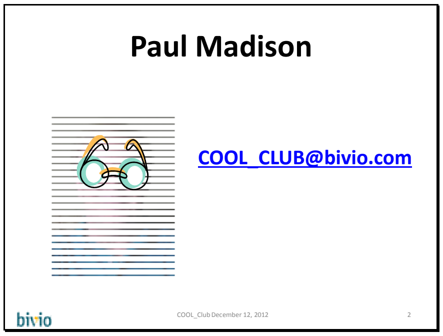
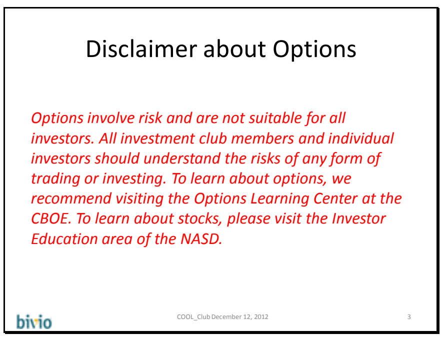
Good afternoon and welcome to the Covered Options Online Learning Club otherwise known as COOL_Club. For any new people in the audience tonight a hardy welcome to you. We are very casual here in the clubhouse so if you have any questions you can type them into the GoToMeeting questions box and Laurie Frederiksen who is helping out in the back room will monitor those and get them to me.

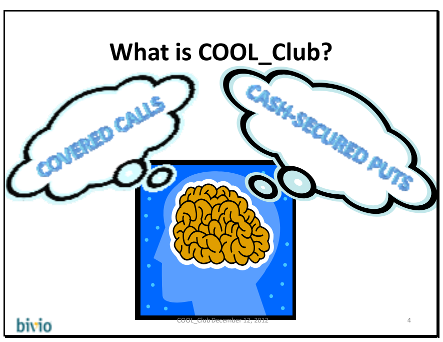


I am Paul Madison and I am your host for the COOL_Club

If you want to contact me you can write to me at the COOL_Club discussion list which is COOL_CLUB@bivio.com

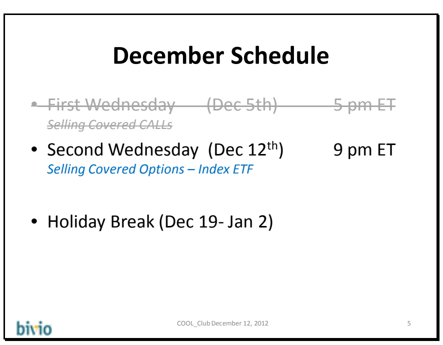


Remember that options do involve risk and are not suitable for all investors. All investors should understand the risks involved in any investment instrument including stocks and options. The slide mentions a few places that you can do some additional research around both options and stocks.

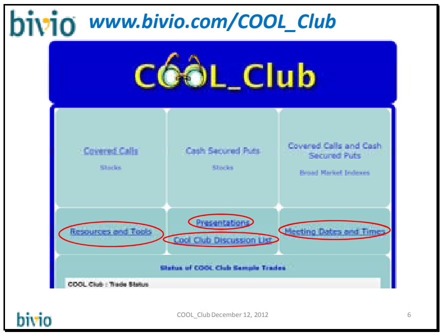


For those that are new to COOL_Club.

This is a weekly 30 minute session where we explore the thought processes associated with actual Covered Option Trades. We will entertain questions and discussion for up to an extra 30 minutes after our presentation.



For December we will only have two sessions. Last week we talking about selling Covered Calls and this week we are talk ing about selling Covered Options on Index.



Here is our COOL_Club home page

The link is www.bivio.com/COOL_Club

Both Handouts and recordings are under the Presentations link

Join the email discussion list by clicking here

You can get to the COOL TOOLs like we are using tonight by clicking on “Resources and Tools”

And finally the schedule and registration links are here.

Tonight

- Refresher on Covered Options Index ETFs
- Index ETF COOL TOOL
- Work through some examples
- Open Floor

We will do a little bit of a refresher on selling Covered Options on the Index ETFs.

Using the Index ETF COOL TOOL

We walk through some examples.

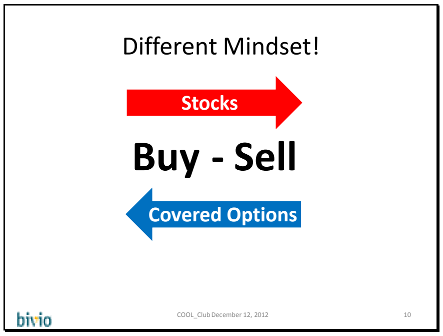
Then we can open up the floor for questions and discussion.

COVERED OPTIONS:
INDEX ETF

Word of Caution

- In this presentation I may use the following interchangeably:
  - Broad Market
  - Index
  - ETF
- Should be “Broad Market Index ETF”

Before I get started again I did to make sure you understand that when I say Broad Market or Index or ETF I am really always talking about the same thing. I should always be saying Broad Market Index ETF I just don’t remember to say it all as it is a mouthful.



First some general reminders about Covered Options

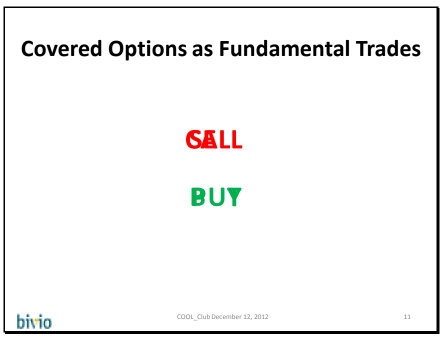
Something that is really hard for people when they start is the fact that your whole mindset is different.

When we are dealing with stock we always start by buying and then at some point we sell (although some of us never get to that side of the equation)

When we are doing Covered Options we have to think backwards

.... we start by first selling and then we have to close the option

which often means a BUY

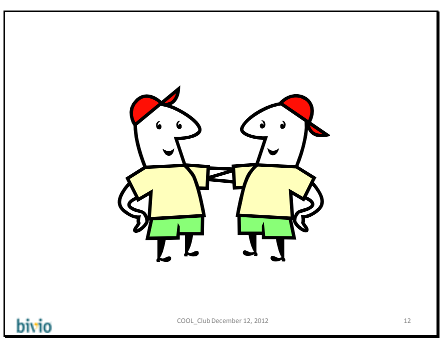


Also the following little picture may help you remember that Selling Covered CALLS

can turn into stock SELLs

And Selling Cash Secured PUTs can

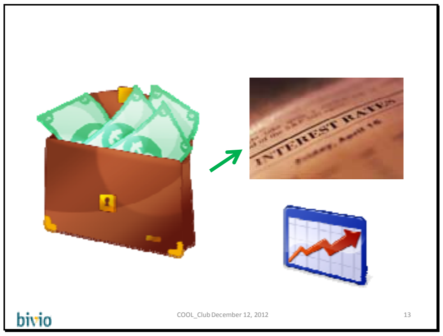
turn into stock BUYs



Now let's about Covered Options on Index ETFs.

Let's start by saying that logistically selling Covered CALLs and Cash-Secured PUTs on Index ETFs looks identical to selling Covered CALLs and Cash-Secured PUTs on Stocks.

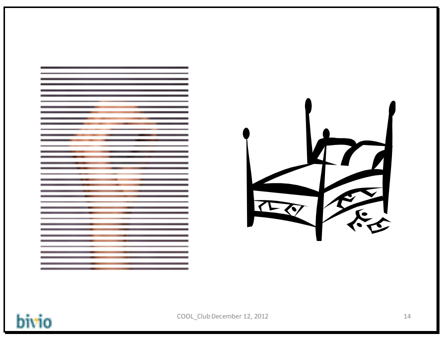
But, for me, it is how one plays them, and or what they use them for, that is where the difference lies.



Traditionally we have all had some amount of cash in our portfolio. That amount might vary in size depending on how bullish or bearish we are about the market and can also vary depending on other things going on in our own lives.

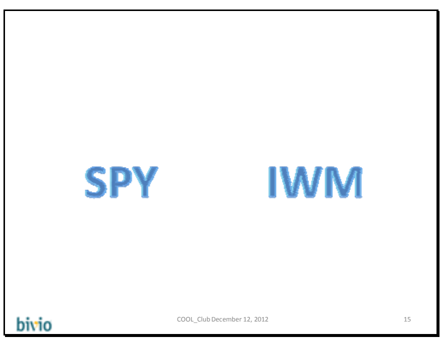
This is money that we are not looking to "be in the market" but rather generate some amount of interest. Interest rates on that money use to be fairly reasonable maybe even as much as half of what we expected our stock return to be.

We were comfortable with not getting price appreciation but just a reliable constant income stream.



But these days our interest on the cash portion of our portfolio is almost not worth talking about. So far they are not charging us to hold our cash, at least not in the US, Europe is another story.

It would seem there might be a better place.

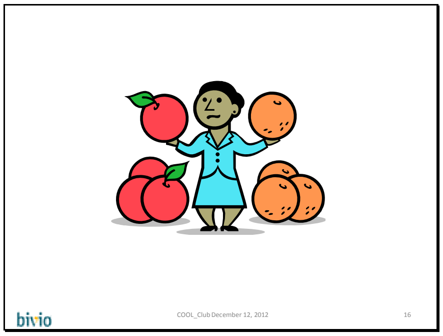


I believe done properly, Covered Options on Index ETFs can somewhat take the place of our low risk reasonable interest rate portion of our portfolio.

And as you have heard me say a number of times my two favorites are

SPY – which is an ETF that emulates the S&P 500 index - The 500 largest US companies.

And IWM – which is an ETF that emulates the Russell 2000 – I have misrepresented the IWM on previous occasions so I need to correct what it actually is. The IWM is the bottom 2000 smallest US companies in the larger Russell 3000 index. It is a Small Cap Index. The median Market Cap of the companies in the Russell 2000 is just over $500 million as of summer of last year. The average market Cap is over twice that so that tells you there are a lot that are really small that pull the median down.



So what is different about Covered Options on Index ETFs versus Stock?

When we do stock we should be doing fundamental analysis that tells us where we think the stock is undervalued, which we call our buy target, and where it begins being overvalued, which we call our sell target.

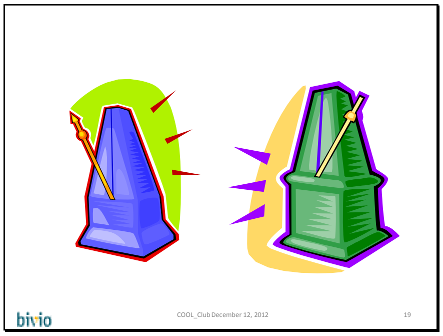
And we would expect that there is a fairly respectable difference in between these two numbers. We should desire to buy when it is undervalued and sell when it is overvalued. Our biggest gain should come from price appreciation.

Selling covered options can add some return on the edges but it should be the smaller amount if we are sticking to High Quality Growth stocks. I cannot stress enough that, for at least me, fundamental analysis is the key to stock investing AND on doing covered options on stocks.

The way I approach Covered Options on Index ETFs is to focus more on making sure I am consistently collecting option premiums over and over and over and I am not trying for a lot of price appreciation.

What does that remind us of …oh yeah our Money Markets use to give us consistent payouts but did not give us any price appreciation …………….hmmmmmmmmmmmmmmmmm

I have been told that institutional fund managers use this approach to generate a very respectable return on the cash portion of their portfolio, and I totally believe it!



The key to Index ETFs Covered Options is learning to understand the “trading ranges” or what I call the rhythms of the market.

We want to be selling Cash Secured PUT’s on the down beat

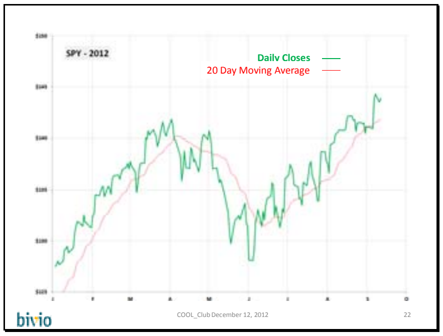
and selling Covered CALLs on the upbeat

Now I have used a metronome example but this is a slow metronome that may take a week or two or longer to swing from down to up

Sometimes when I have talked about the Index ETF I told you that you had to decide the trading range of the index you are looking at. But I have introduced another approach in the COOL_Tool that you might like even better.

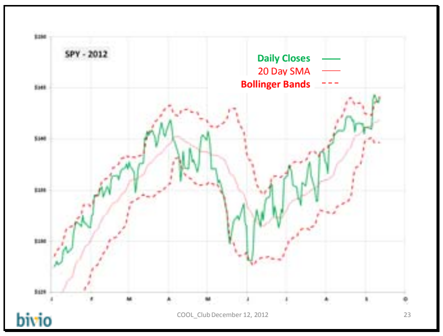
I personally do use a gut approach to determining market ranges but that is not for everybody, especially if you are new and have not developed that gut. It is a bit like Chefs when they cook. They don’t use recipes because they just know what works and what doesn’t. But when you are just learning to cook, recipes are a much better way to start off. This approach gives you a bit more of a “recipe” to follow at least until you are ready to play with spicing it up.

So here is a simple line graph of the daily closing prices of SPY for this year. The line connects the actual data points from each day. This only goes through mid September but not to worry we will be looking at some live data as well.



Now lets add a line to this graph that is what is called a simple moving average you will some times see this abbreviated as SMA.

So what the computers do is everyday they average the last 20 days of closing prices which gives us a new number that we can plot and look at versus every other day that we did the same average. It is called a moving average because every day we add today's price into the average and we drop off the oldest day that was used in the average the previous trading day.



OK here comes a little statistics part so everybody take a deep breath and swallow a big gulp of coffee if you have it.

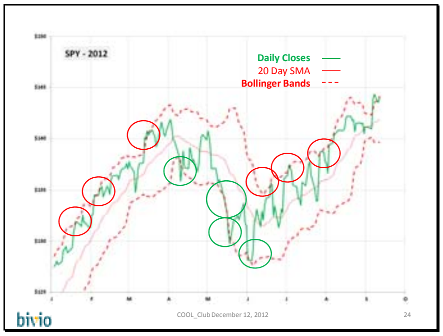
In addition to calculating the moving average the computer can crunch standard deviations. This is a statistical measure around how much variation there is in the 20 numbers that are being averaged. The good news, NO make that the really good news, is that you do not need to know how to calculate standard deviations, the computers will do that for you.

What you may remember of your college statistics course (unless this lecture fell on a Wednesday after election night and you were napping) is that 68% of all the data is within one Standard Deviation of the average but if you go up to two times the standard deviation then 95% of all the points will be within a range of the + or – two standard deviations from the average.

So you can see we have added two dashed lines representing + or – two standard deviations from the moving average.

Before we go any further lets see if there are any questions around this (I am about to get to why this is important but just wanted to make sure everybody understands what we are looking at).

OK because some smart Cool Dude named John Bollinger was the first to realize that these bands had real meaning in stock prices we don't call these Standard Deviation Bands we call them Bollinger Bands.   But as the Bard said "What's in a name? That which we call a standard deviation By any other name would still be really sweet". Or something like that.

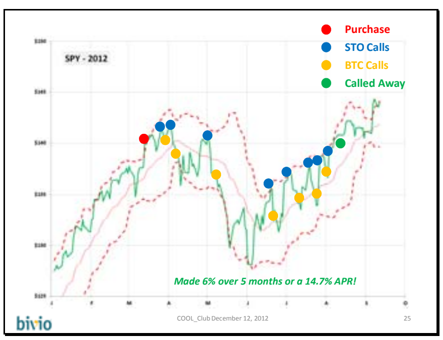


Some of what John Bollinger discovered is that when a price moves up close to the two standard deviation line it often means that it is about to reverse direction, not always but often.

So you can see most of this year we have been trending up but you can see we have bumped the top band a number of times, about 6 or 7 in 9 months. And almost every time we did, the market retrenched a bit.

We have not had near as many opportunities on bumping the lower band but we did have about 1 a month in April, May, June period and the same phenomenon once the band was hit the price bounced or rallied.

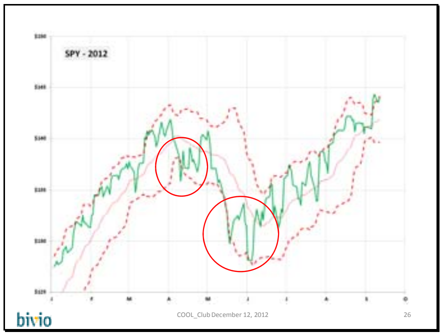
Except for this one period where it continued to fall when it hit the bottom of the range. But even that one period you could have been selling calls at a higher level about one month later.



So let's see how this works. This is a series that I did in one of my portfolios this summer.
I bought some SPY in Mar right around the $140 level.

Then whenever the market was pushing to its upper bounds then I would sell calls and collect premiums and consistently the market would pull back and I would buy the calls back at low cost and get ready to do it again.
I did this through out April, May, June, and July

Until finally in August it was called away from me. I owned the SPY for five months and between dividends (paid twice in that time span) and call premiums collected I made 6% on my money for an APR of 14.7%.



So if you have cash how do you get started? Well, you look for periods like this where the prices are touching the lower part of your trading bands and you start selling Cash Secured Puts.

When I gave this talk in the fall it seemed like we might have been starting to get to another period where we could sell PUTs. And in just a bit we will look at what that has actually looked like.

Optimum Time to Sell
Cash-Secured PUT on an ETF

- Market has:
  - Moved down for several days
  - Is down on the day
  - Close to a perceived trading bottom
  - Volatility is up

bivio COOL_Club December 12, 2012 27

Best time to sell puts is when the market has been trading down is down on the day is close to a perceived trading bottom and the Bollinger Bands can help us see that. And you want our friend Mr. Volatility going up.

When an ETF PUT is Exercised

- Look to start selling CALLs

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If you sell a PUT and hold it to the expiration and the ETF is PUT to you then you just turn around and look for the next opportunity to sell a CALL at a level higher than where the ETF was PUT to you.

Optimum Time to Sell
Covered CALL on an ETF

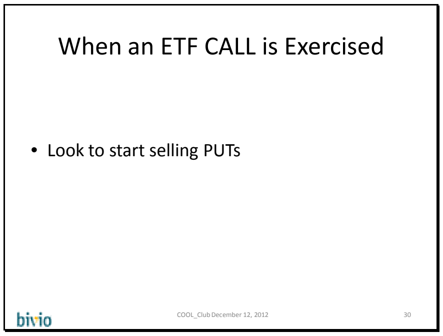
- Market has:
  - Moved up for several days
  - Is up on the day
  - Close to a perceived trading top
  - Volatility is up

bivio COOL_Club December 12, 2012 29

When we are selling a CALL on our ETF we want the market to be up for several days and up on the day we are selling the CALL

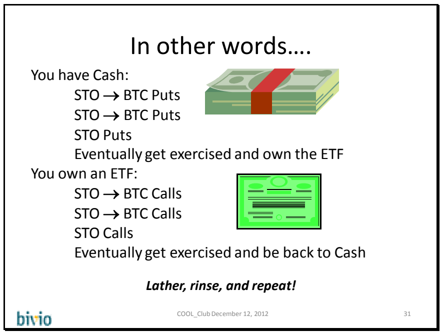
We want to be selling at what we perceive to be towards the top of the trading range which again the Bollinger Bands may help us in understanding where that short term top in the market might be.

And it is good if Mr. Volatility is up as well.



When your ETF is finally called away you will be back to CASH and you can start the cycle all over again.

So your "CASH" portion of your portfolio will cycle between being in cash with covered PUTs on and owning the ETF Index and having CALLs on.

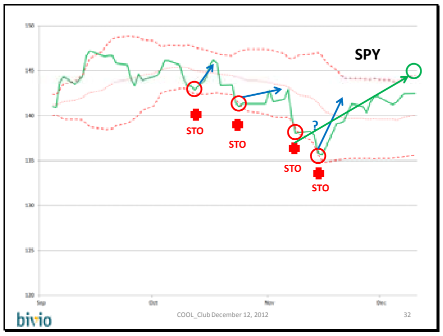


If we have cash
We start by Selling To Open (STO) PUTS which we then Buy To Close (BTC) and we keep repeating that until we have the index PUT to us via an exercised option.

Once we own the Index then we start Selling To Open (STO) CALLS which we then Buy To Close (BTC) until our Index is CALLED away from us via an exercised option.

And as our shampoo bottle reminds us.....

Lather, rinse and repeat.



Here is an update on what has happened since early September.

So early in October we came very close to the lower band at about $142.50 or so and if we had sold a $140 or $141 PUT we would have been able to buy it back over the next week as the priced bounced back.

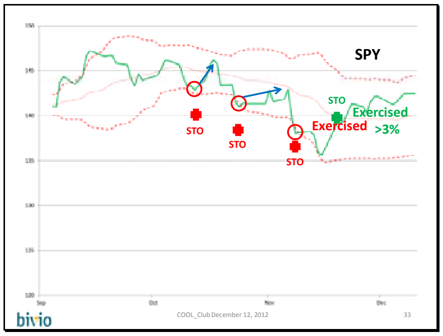
Once again about a week and half later we hit the bottom of the band at about $142 and we could have sold a $139 or $140 CSP and again over the next week it traded sideways to up and so you would have been able to buy it back again.

The next time we hit the bottom of the band was early November at about $138. Depending on what level you sold a CSP at you might have had this option exercised and so you would own SPY but you can see from our chart fairly quickly you could have been selling CALLs at levels above the strike price that you bought at.

If you did sell this CSP at a low enough level such that it was not exercised then again in middle of November we hit the lower level again at about $136 and could have sold $134 or $135 strike CSPs and we could have easily bought those back within the next week or possibly let them expire worthless.

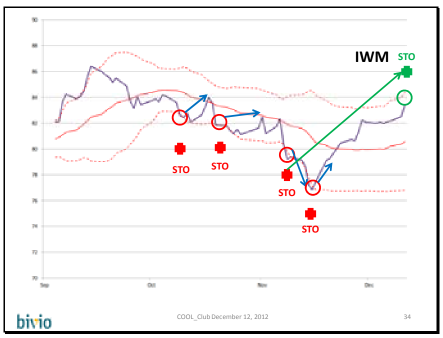
If you are using the COOL_Tool to help know what level premiums to sell and were not exercised on any of the trades then you probably made about ½% per trade for four trades and so about 2% over about a month and half time frame. Not bad.

If you did get SPY put to you say at $137 and you waited to sell Covered CALLs at the $145 or higher level then you would be getting almost a 6% price appreciation over a little over 1 month time frame.



As I mentioned last week, I was exercised on the PUT at the beginning of November and sold a covered CALL that was also exercised. That round trip alone actually gave me a return of about 3% again over 1 month.

In reality I could have and should have done better if I had followed my own COOL_CLUB advice. If I had been a bit more patient, something I am not always very good at, I would have waited to sell a Covered Call at the upper band of $145 rather than $140. Most likely I would have been able to do that several times before eventually being called away.



Now let's look at IWM. We see a very similar patern.

Early in October it hit our lower band at about $82 and maybe we could have sold a CSP at the $80 $81 level and we see over the next few days it bounced back up and so we could have bought back the CSP at a low level or maybe even let expire worthless.

Again about 10 days later we hit the bottom again and again we could have sold $80 or $81 CSP. Although it did not immediately rebound it did stay above the $81 level for the next week and so it could have been bought back and or again expired worthless if we held to expiration.

We hit the low end of the band again in early November at about the $80, this time if we sold at the $78 level or higher we might have actually had the IWM put to us. If we did no problem as we are now seeing a push up again to the higher band as we will talk about shortly.

If you did not get exercised on the last option and/or you were able to sell again in the middle of November at the $75 or $76 level. Once again the price bounced off of the lower band and we would have been able to buy that option back or allowed it to expire worthless.

If you had IWM put to you at the $78 level and you started selling $86 CALLS, you would be enjoying over a 10% price appreciation in around a month if called away.

QUESTIONS?

INDEX ETF COOL TOOL

COOL TOOLs

- Excel Spreadsheets
  - Works on Windows versions of Excel
  - Does not work on Excel for Mac

The COOL Tools are all Windows Excel Spreadsheets they are saved in Excel 97-2003 file formats but work with the newer versions of Excel as well.

The Tools currently do not work on Mac OS X Excel but could be run on a Mac that is capable of running Windows through BootCamp or Parallels or VMWare's Fusion.

Excel Security

- Allow Macros to be enabled:
  - One simple Macro that resets things
  - ***If prompted to allow Macros – Chose YES***
- Enable all Data Connections:
  - Uses MSN quotes
  - ***If prompted to enable external data – Chose YES***

To run the TOOLs most effectively you must enable Macros as there are simple macros for clearing data and for going out to the web for data.

You must also enable external content so that the TOOLs can go get delayed stock quotes.

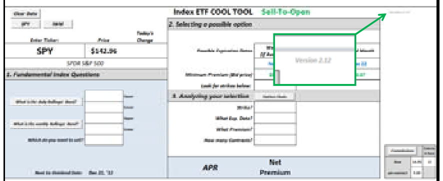
Where can you download it?

Reminder you can get the tools by clicking on the Resources and Tools link on the COOL_Club home page and then you will see the tools under the COOL Tools heading on the lower right side.

Here you will find the three COOL TOOLs.

At the bottom of the list is the Index ETF COOL Tool.

Index ETF COOL TOOL – Version 2.12



Version 2.12 posted on COOL_Club today, November 7th, 2012

The latest version of the Index ETF COOL TOOL is 2.12 and so if you are seeing a version number on the sheets that is less than 2.12 then you will need to go download the latest version.

COOL Examples

REMINDER!

- Education purposes only!
- No recommendations to:
  - Buy or sell stock
  - Sell or buy options
- Before investing in anything:
  - Consult a professional
  - Or do your own research

LET'S GO PLAY

NEXT SESSION Jan 9th Time TBD

STAYED TUNED TO:
COOL_CLUB AND CLUB_CAFE

We will start COOL_Club back up on January 9th. Watch for word from COOL_CLUB and/or CLUB_CAFE for word on event timing and topic.

MERRY CLIFF-MESS .....

Finally I want to wish all the COOL_Club a very hardy Merry Cliff-Mess

... AND A BETTER NEW YEAR

and let’s hope for a Better New Year