



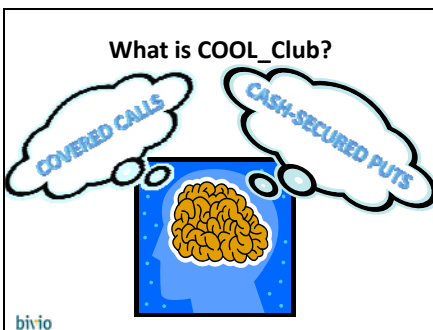
Welcome to our kickoff and introduction to the COOL Club!



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

TheCOOLClubDude and

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



So you are probably saying, " I guess that's COOL but what is it exactly?"

Glad you asked,
(click)

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

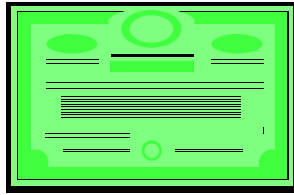
Every session we will walk through one or two trades from the recent past.

Go 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 start with 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.

This is what we will talk about next week.

Covered Options on Indexes



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Last we will talk about both Cash-Secured PUTs as well as Covered CALLs on broad market index ETFs.

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

My two favorite 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

What we are not going to talk about



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There are lots of different kinds of option spreads like:

Butterflies

Calendars

And a host of others.

We are not going to talk about any of them. We are just sticking to basic Conservative Covered Calls and Cash Secured Puts.

If we have time each week



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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 making a recommendation 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

- First Wednesday 5pm ET
- Second Wednesday 8pm ET
- Third Wednesday 9pm ET
- Fourth Wednesday 10pm ET
- Fifth Wednesday Vacation

This schedule will begin in August

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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 first Wednesday of every month our schedule time will be 5pm ET

The second Wednesday of every month our schedule time will be 8pm ET

The third will be at 9pm ET

And the fourth will be at 10pm ET.

The fifth Wednesday when it occurs will be a “Holiday” – nice...at least for me.

This new schedule will begin in August.

Rest of July Schedule

- July 18th 4pm ET
- July 25th 10pm ET

Register at www.bivio.com/COOL_Club

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To finish out July –

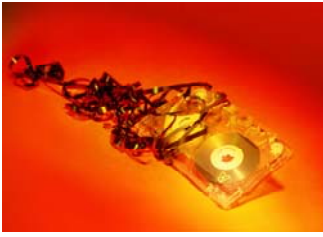
Next week’s session on July 18th will be at 4pm

And the following session on July 25th will be at 10pm ET.

Register now at COOL_Club under Meeting Dates and Times

For now, you will only be able to register for the upcoming July meetings.

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 working on developing a COOL_Club home page

It is in its infancy but over the next few weeks we will outfit it with additional information and resources useful for conservative covered options.

The link is www.bivio.com/cool_club

Email Discussion Group

On our home page -www.bivio.com/COOL_Club

Click the [COOL_Club Discussion List](#)

After joining, questions can be sent to:
Cool_Club@bivio.com

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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 group.

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.

QUESTIONS?

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COVERED CALL REFRESHER

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What is a Covered Call?

- Covered Call
 - Option contract on a Stock
 - Buyer of CALL has the **OPTION** to buy stock
 - Seller of CALL has the **OBLIGATION** to sell their stock
 - **STRIKE** price is the price the stock sale would happen
 - **EXPIRATION DATE** – The day the contract expires if it has not been **EXERCISED**
 - Buyer pays Seller a **PREMIUM** for this **OPTION**

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Let us remind ourselves what a Covered Call is

It is an option contract on a given stock where the Buyer of the option has the right to buy the stock at the strike price from the Seller of the option until the expiration date.

If the Buyer of the option chooses to exercise their right to Buy the stock then the Seller is obligated to sell their stock at the strike price.

For this right, the Buyer of the option pays a premium to the Seller that is paid up front and the Seller of the option keeps this premium regardless of whether the option is exercised or expires worthless.

Why sell a Covered Call?



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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

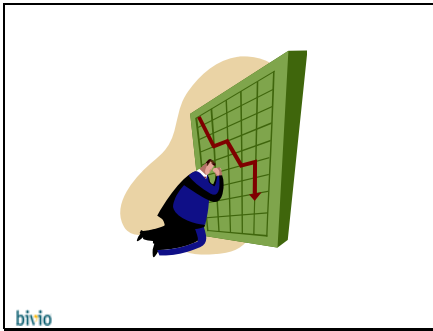
Maybe Your stock's PAR or projected return has dropped below your threshold

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.

Optimum Time to Sell a Covered Call

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

- The stock has moved up for awhile
- The stock is up on the day
- The market is up on the day
- Volatility is up

Technical analysis, look for "bearish" reversal indicators

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So when is an optimum time sell a covered call

Stock is up several days and on the day you want to sell the call

It will also help if the general market is also positive on the day

And we won't spend much time tonight on Volatility (a measure of Angst in the market) but it would also be good for volatility to be up

But for some reason, maybe

(Click)

Technicals, your sense is your stock is going to correct

Selling a Covered Call is a bearish move and it works best after a Bull run

It should be viewed as a contrarian play – you are bearish while the market is still somewhat bullish

Selling a Covered Call

- Must own at least 100 shares of a company
- Determine minimum selling price for your stock
- Recommend selling front month *expiration*
- Sell one contract for each 100 shares
- *Sell as far out-of-the-money as reasonable*

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Getting ready to sell a CALL

You will need 100 shares of the stock for each contract you sell

You need to know what **your** minimum selling price for stock as this sets the floor on what strikes you can do

I recommend when you are first doing options that you stick with doing the front month.

I recommend selling as far out-of-the-money as reasonable. Reasonable meaning that you get a good return for putting the option on ...more on that later

After you have sold

One of three things will happen:

1. Option expires worthless
2. Option is bought back to close it
3. Option is exercised

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1. Call Option Expires Worthless

- Option open until *expiration date*
- Underlying stock closes below the *strike*
- You retain your stock
- You keep all the *premium* you collected
- Taxable account - short term capital gain

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2. Call Option is Bought Back to Close

- Prior to the *expiration date*
- Option is bought back to close the position
- Keep difference between *premium* you sold and the *premium* you paid to buy it back
- Released from obligation to sell stock
- Taxable account - short term capital gain (or loss)

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3. Call Option Gets Exercised

- Option open until *expiration date*
- Underlying stock closes above the *strike*
- Keep all the *premium* you collected
- Stock is sold at *strike* price of the option
- Sales price = *strike* plus the *premium*

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TRADE EXAMPLE

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COOL Examples

REMINDER!

- Education purposes only!
- No recommendations to:
 - Buy or sell stock
 - Sell or buy options

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ALIGN TECHNOLOGY, INC.

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

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So our stock is Align Technology. A global medical devices company focusing on orthodontics and most known for invisalign braces.

The Ticker is A L G N

My assumption on 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

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Status

\$35+

45%+ gain in 6 months

PAR < 10%

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The stock was at 35.28 when I did this trade.

At that price I have a 45%+ gain on the stock and it has been for only 6 months.

The 52 week high is 35.56

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

Why sell a Covered Call?

- Your stock is up nicely...
- But you are not quite ready to sell!

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So yes my stock is up nicely

No, I am not quite ready to sell as the stock has not reached my Short Term Sell Target

*but you think
your stock might
go down!*

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But yes I am feeling like the stock will correct a bit!

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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So yesterday morning

Technical Indicators



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Another caution on COOLClub – First I am a novice Technicals person at best. Second I am not planning to spend a lot of time on technicals. Again what I want you to accept are not my technical judgments but to understand how my novice technical judgments played a role in my selling covered options.

But let us look anyway

Now there may be Technical gurus in the audience who say

“That chart is a raging Bull chart!” and they may be right but....

Here is what I see (and I do believe the art of technicals is not black and white and the answer is in the eye of the beholder) (click)

First, although we do not have snow on the mountain which is what the technical folks call sustained periods of above 70 RSI we are flirting with snow showers (click)

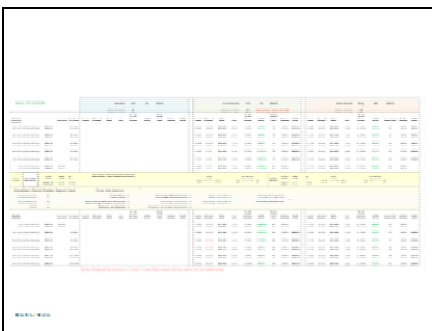
Second, I think it is very interesting that the other two fall offs happened in the summer of the last two years (click)

I also want you to see that in fact the stock has been going up for awhile.

But even with this price run, it is the high RSI and the two drops in the last two summers that makes me a bear in the short term.



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OK, DECIDED TO SELL A CALL

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.... BUT WHICH ONE?

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Front Month



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To begin with it is good to start with a front month expiration date that is roughly two to four weeks out.

Remember that each monthly expires on the Saturday after the third Friday. So if you are a couple weeks into the month, of lets say, July, then you would probably want to be looking at August.

So the current Front month is July The july monthly option expiration date is July 21st.

We have slightly less than 2 weeks to go to July 21st and it is a July option that I elected to do on Align.

Strike Price



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So we need to make sure we have in our mind what our minimum acceptable stock selling price is

For Align Tech, my minimum selling price would be 33 which would give me a 35% gain in six months

Out-of-the-money

\$40
\$39
\$38
\$37
\$36

ALGN \$35.28 +.64

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Remember we want to sell higher than the current market

So we want to sell Calls that are above the current market price which we call out of the money strikes

So if our current price is a little above \$35 then all strikes \$36 and higher are out-of-the-money

And all are above my minimum sell level of \$33.

Rules are made to be broken!



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In general a GOLDEN RULE is to not sell covered options whose expiration date goes over an earnings release.

In the case of Align, I am breaking that rule. Their earnings are coming out July 19th ahead of the July expiration date of July 21st. The reason I am breaking the rule is because it seems the market is over anticipating positive earnings by moving up to quickly in which case, I am betting the reality may not be as great as the anticipation or hype.

If I am right then I will make money on my covered CALL, if I am wrong and the price goes up even more...

then I am still fine because I will be called away at a price I am very happy with selling at.

Could I have maybe made more, yes, but that never drives my trading.

Acceptable Return



$$APR = \frac{\text{Net Premium}}{\text{Stock Value}} \times \frac{365}{\text{Days left}}$$

Net Premium = Premium Collected less commissions

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So that leaves us with one final test. Does our premium give us an acceptable return?

Remember this is our formula.

The Annualized Percent Return is equal to the net premium received after commission divided by the stocks value (which is current price times shares) times 365 days divided by the number of days left to expiration on the option.

I do this APR calculation to help me better compare different opportunities with different strikes and different expirations

What is an acceptable return? ...I like to target greater than 20% APR and my average is right around the high 20's

TIME TO GO TRADE

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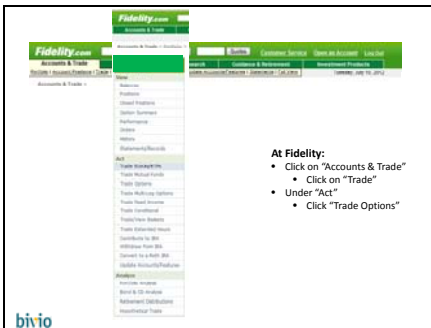
For tonight's example I am going to use Fidelity.

Once you have your Fidelity Page open

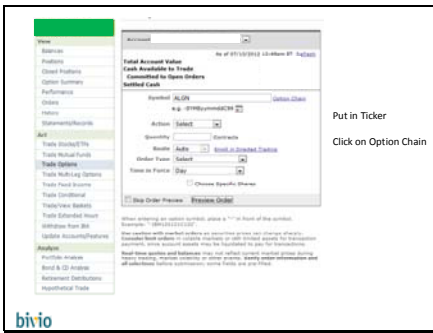
Click on Accounts & Trade

Then the submenu of Trade

Then on the side Trade Options.



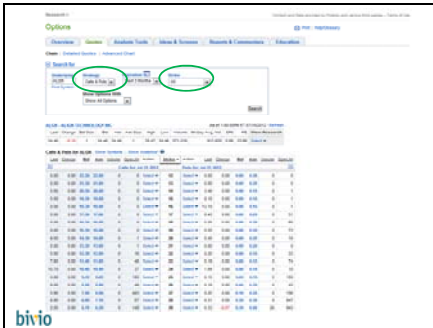
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This screen will come up

On the line that says Symbol we put in our ticker

And then click on Option Chain



Which brings up the page that is referred to as an Option Chain

This can be daunting to begin with but we can streamline it to help us out

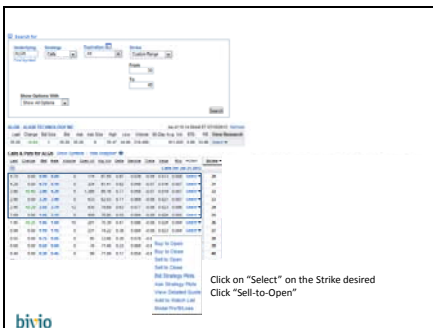
(click)

Where it says strike we can open the menu and choose

Custom which allows us to limit the range of strikes

(click)

Under Strategy you can also change to just CALLS



So now I have narrowed our range to either side of our current price of 35 so 30-40 and just CALLS.

Looking at the quotes:

If I go all the way out to a \$40 call the best buyer is only .30 which would not be over \$100 for the 3 contracts.

I went up to the \$38 strike and the best buyer (the bid price) is \$.75 and so I elect to sell at \$.75 and I should have the trade done since there is currently a buyer at that price (they may disappear or be taken out before I get my trade entered so there is no guarantee that I can get that price).

So next to the 38 Strike there is a select button.

(click)

Click on the "Sell-to-Open"

APR if the Option expires Worthless

$$\text{APR} = \frac{\text{Net Premium}}{\text{Stock Value}} \times \frac{365}{\text{Days left}}$$

$$\text{APR} = \frac{\$214.72}{300 \times \$35.28} \times \frac{365}{11}$$

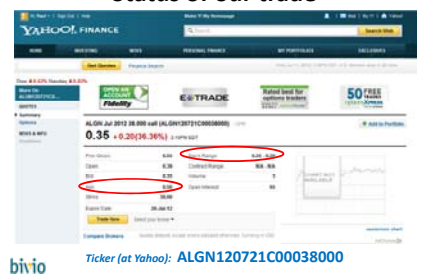
= 67%

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WE HAVE OUR FIRST COOL TRADE

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Status of our trade



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So here is what has happened to our trade today (click)

First we see that the day range is .35-.39 which is .36-40 lower than where we sold.

If we had been the buyer at .35 today we would have netted right around \$100 on our trade. Which is why my options buddies and I say it is kind of like walking around picking up \$100 bills.

(click)

For you Home Gamers out there you may want to follow the trade between tonight and next week's COOL_Club session. If you go to Yahoo quotes and enter the ticker shown it will tell you the current activity for that day.

By the way when we are thinking about buying back an option

(click)

We want to look at the "Ask" price as that is the current best seller of the option and we now need to "Buy to Close"

How I decide to buy back

APR drops below 10%

$$\text{APR} = \frac{\text{Net Premium}}{\text{Stock Value}} \times \frac{365}{\text{Days left}}$$
$$\text{APR} = \frac{(300 \times \$10) - \$10}{(300 \times \$32.77)} \times \frac{365}{10}$$
$$= 52\%$$

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To decide when to buy back an option to close it, I look at what the APR is for current premium.

If it falls below 10%, then I feel like I should buy back the option.

In other words I do not want to settle for a less than 10% return on my asset for the time remaining.

QUESTIONS?

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NEXT WEEK July 18th 4:00pm EDT

CASH-SECURED PUTS

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We also will most likely talk about closing the trade we just put on as it is already down to where it could be bought back today for under \$.40 ...this would be around a \$100 gain ...which is why my Options gang and I say that trading covered options is like walking around picking up \$100 bills.