



Good evening and welcome to tonight's session of the Covered Options Online Learning Club otherwise known as the COOL\_Club. If you are new to COOL\_Club, I hope you enjoy our sessions.

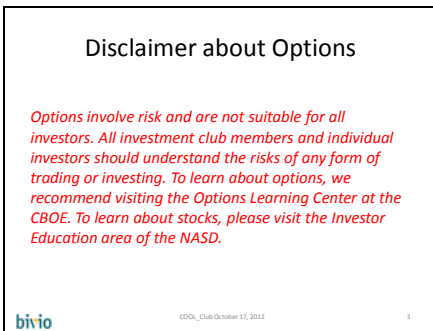


I am your host Paul Madison and  
<Click>  
resident COOL\_Club Dude.

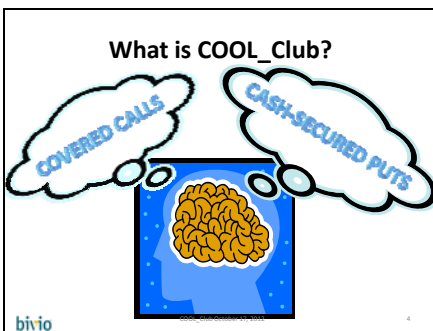
As always Laurie Frederiksen from bivio is helping out in what we like to call the backroom and tonight Sharon is also giving us a hand. They will help keep track of questions that come in through chat.

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You can always write to me at the COOL\_Club Discussion List which is [COOL\\_Club@bivio.com](mailto:COOL_Club@bivio.com)



Our usual Disclaimer about Options... Options do involve risk and are not suitable for all investors. All club members or individual investors should understand the risks associated with options or any other investment instrument before investing. Also on the slide are places to go to help learn about options as well as stocks.



So what is COOL\_Club  
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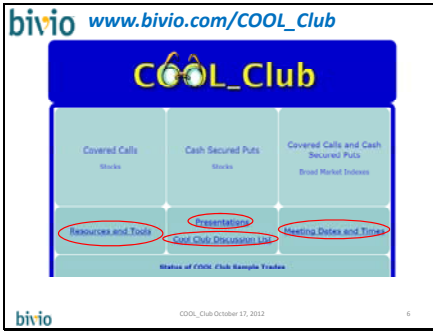
For those of you who are new, COOL\_Club is a weekly 30 minute session where we explore the thought processes associated with doing Covered Options. Some nights, like tonight, we explore side topics that are related to selling covered options that I believe will help you better understand them.

### October Schedule

|  |                    |
|--|--------------------|
| • <del>First Wednesday (Oct 3<sup>rd</sup>)</del>        | <del>5 pm ET</del> |
| <i>Why I Sell Rather Than Buy Options</i>                |                    |
| • <del>Second Wednesday (Oct 10<sup>th</sup>)</del>      | <del>8 pm ET</del> |
| <i>Covered Options: Getting started with your broker</i> |                    |
| • Third Wednesday (Oct 17 <sup>th</sup> )                | 9 pm ET            |
| <i>Covered Options &amp; Earnings Season</i>             |                    |
| • Fourth Wednesday (Oct 24 <sup>th</sup> )               | 10pm ET            |
| <i>Selling Covered Options Index ETFs</i>                |                    |
| • Fifth Wednesday (Oct 31 <sup>st</sup> )                | Break              |
| <i>Halloween - watch out for Mr. Volatility!</i>         |                    |

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Here is our October schedule. This week we will be doing an extra topic about Covered Options and Earnings Season. Next week after I think we will look at Covered Options on Index ETFs as we may or may not be starting to see some opportunities at that point. Of course our fifth Wednesday will be Halloween and I assume all the COOL\_Kids will be out having fun.



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

<Click>

Both Handouts and recordings are under the Presentations link  
<Click>

Join the email discussion list by clicking here  
<Click>

You can get to the Excel Spreadsheet COOL TOOLS by clicking on "Resources and Tools"  
<Click>

And finally the schedule and registration links are here.

**Tonight**

- Covered Options & Earnings Season
- Recent Trades
- Open forum

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Tonight we

<Click>

Fall is in the air, but as a Covered Options Sellers what is even more fun is it is Earnings season.

This is always a really interesting time. There are opportunities to harvest but be careful. Some fruit is not too sweet to eat. Tonight at COOL\_Club we will talk about how to avoid the latter and enjoy the former.

Although we will be looking at earnings with an eye to Covered Options, there will be some things to consider for those that are just stock investors and not doing Covered Options.

In addition we will look at some of the feedback from the discussion list about brokers.

Then, we have a few outstanding trades that have been discussed that we will do an update on and as always if we have time,

We will have an open floor discussion around any questions on covered options, specific stocks, and or tool questions.

**QUESTIONS**

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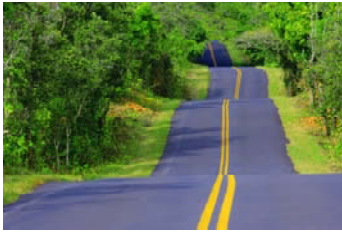
Done with the housekeeping any questions out there Laurie?

**COVERED OPTIONS & EARNINGS SEASON**

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Let's go see what Earnings Season means for investing and specifically Selling Covered Options

## After Selling Options



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As a seller of options what we like to see after we have sold our option is for the stock price to meander around making neither significant moves up or down. Why? Because then we know that there is a very high likelihood of the option expiring worthless or us being able to buy it back before expiration for a profit. We get to keep all (expiration) or at least most (buy it back) of the premium.

## Earnings Season



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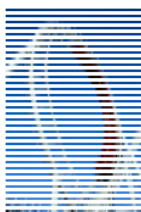
Why is earnings season so important?

First just like April 15<sup>th</sup> is a well known deadline. A company's earnings release date is a known date where we all together learn new information. It focuses everybody's attention (at least everybody that cares) on that company on that date.

It is an opportunity for owners (shareholders) to get to hear from the leaders of our companies. We get to see some insight into how they see the current business and sometimes how they see the business going forward.

But the most important thing that happens is we as shareholders get to test our expectations for the company with another period of real performance.

## Result?



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But what does all this mean for stock prices? Well, for one very short period, often one day, the market seems to believe they have perfect unifying clarity about the company. The net result is often fairly violent moves in one direction or the other. Either it is much worse than expected or it is much better than we expected. The move in either direction can be nothing short of death-defying. Enough to make our stomachs queasy.

### Small Premiums + Huge Moves



As option sellers, we really are only collecting very small premiums in contrast to the risk we are taking at certain times. We have no business getting on this dramatic of a ride. I am afraid that if we do it,

### Recipe for Disaster



it could be a recipe for disaster. You have heard me say before that selling options whose expirations are after a company's earnings date is equivalent to an insurance company selling hurricane insurance after the storm is identified and is heading to a certain location. It is not a wise plan.



So if that is true then is that the End of the Story? Should we just pack up our bushels of CALLs and PUTs and go home until the storm blows over? And my answer is heck no, there are still opportunities out there so let's talk about what and where they are.

### Golden Rule

***Don't sell options  
across Earnings!***

But before we do, let me one more time put in bold concrete words that the golden rule for option selling is to not sell covered options whose expiration date is after a company's earnings release.

## But....

- Might Sell Covered Calls if:
  - I am extremely happy to sell at the strike
  - Price is up ahead of earnings (Expectations high!)
  - I am HAPPY to be called away (Even if stock jumps)
  - My only risk is a loss of opportunity

But then I have always believed rules are made to be broken so the one place I might consider breaking this rule is for covered calls.

There are times when I am happy to sell covered calls that go across an earnings date.

First and foremost, it needs to be a strike level that I am very happy to sell at (which should be another golden rule).

Next, I look to see if the stock price has been running up ahead of earnings. This is a sign that expectations are running high. Often high expectations are not justified. So often when the price goes up ahead of earnings, there will be a correction after the release as the reality is not quite as good as the rumor.

And then if I have not already said it I am happy to sell if called away. Even if the stock jumps up significantly, I do not chase that jump.

The reason I do not chase it is because I know that what I have missed is a loss of opportunity. I know that I miss out on opportunities absolutely every single day I am in the market. If I start trying to beat myself up for missing a loss of opportunity then I might as well not even be in the game.

## Cash-Secured PUTs

***Do Not Break The Rule!***

But on Cash-Secured PUTs, I do not think the reward we are getting is anywhere close to being enough to take on the risk.

If the company disappoints on the earnings, the price drop can be HUGE. I have seen 20, 30 and even 40% haircuts to the stock price.

And unlike CALLs, for Cash-Secured PUTs, your loss will be a real loss. Paper, but still real, and not a loss of opportunity. It is not worth the risk, regardless of how attractive the premiums might seem.

Have I ever broken the Golden Rule on the Cash-Secured PUTs? Yes. I regretted it almost every single time. Will you be tempted and try it? Since it is human nature to have to learn things for ourselves, I will bet yes and then you will be telling others "don't do it".

## The Real Opportunity

**Wait until the market reacts to Earnings!**

Our real opportunity is not before the earnings. That is dealing in speculation. If we wait until the earnings come out. then we can deal in facts.

Traders, which I am not, work on the axiom "Buy the rumor, sell the fact". Often their selling can lead to some great opportunities for investors who are more patient and deal in the realm of fundamentals.

## We are Option SELLERS!

Buy the rumor (nope not us)

..... Sell the fact (must be our cue!)

So in other words

We are Option Sellers.

Thus, Buy the rumor...nope that is not us.

Sell the fact....must be our cue!

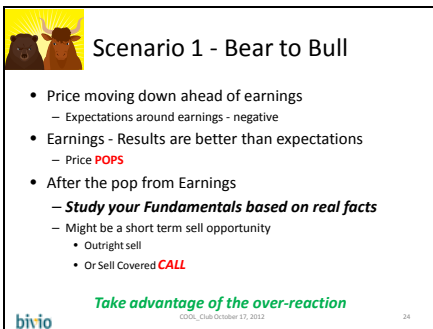


Lets look at some of the opportunities that Earnings can provide.



But before we do let's all chant our battle cry which is

“Traders deal in rumors but Investors deal in facts”



The opportunity we are going to talk about is when sentiment ahead of earnings is negative and so the price is moving down.

After the earnings come out, the results are actually perceived to be much better than the negative expectations and

so the price POPS.

After the POP

Study the facts and your fundamentals

Often the reaction is extreme and it might be a short term sell opportunity

You might do an outright sell or

You could consider selling a covered Call





**Scenario 2 - Bear to Bear**

- Price moving down ahead of earnings
  - Expectations around earnings - negative
- Earnings - Results are even worse than expectations
  - Price **DROPS**
- After the drop from Earnings
  - **Study your Fundamentals based on real facts**
  - Might be a short term buy opportunity
    - Outright buy
    - Or Sell Cash-Secured **PUT**

*Take advantage of the over-reaction*

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The next pattern we are going to talk about is when the sentiment ahead of earnings is negative and so the price is moving down.

After the earnings come out, the results are actually perceived to be much worse than the negative expectations and

so the price DROPS.

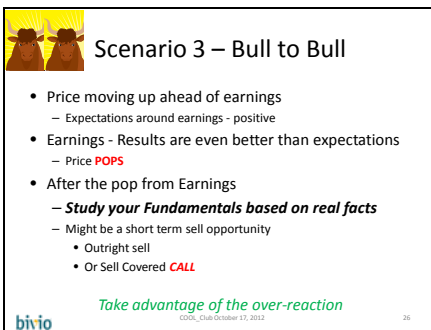
After the DROP

Study the facts and your fundamentals

Often the reaction is extreme and it might be a short term BUY opportunity

You might do an outright BUY or

You could consider selling a Cash-Secured PUT



**Scenario 3 – Bull to Bull**

- Price moving up ahead of earnings
  - Expectations around earnings - positive
- Earnings - Results are even better than expectations
  - Price **POPS**
- After the pop from Earnings
  - **Study your Fundamentals based on real facts**
  - Might be a short term sell opportunity
    - Outright sell
    - Or Sell Covered **CALL**

*Take advantage of the over-reaction*

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Next we have a positive sentiment ahead of earnings so the price is moving up.

After the earnings come out, the results are actually much better than even the positive expectations and

so the price POPS.


After the POP

Study the facts and your fundamentals

Often the reaction is extreme and it might be a short term sell opportunity

You might do an outright sell or

You could consider selling a covered Call



**Scenario 4 – Bull to Bear**

- Price moving up ahead of earnings
  - Expectations around earnings - positive
- Earnings - Results are worse than expectations
  - Price **DROPS**
- After the drop
  - *Study your Fundamentals based on real facts*
  - Might be a short term buy opportunity
    - Outright buy
    - Or Sell Cash-Secured **PUT**

*Take advantage of the over-reaction*

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Finally we have a positive sentiment ahead of earnings and so the price is moving up.

After the earnings come out, the results are perceived to be much worse than the positive expectations and

so the price DROPS.

After the DROP

Study the facts and your fundamentals

Often the reaction is extreme and it might be a short term BUY opportunity

You might do an outright BUY or

You could consider selling a Cash-Secured PUT

We are listening to Warren

**Be fearful when others are greedy...**

**Be greedy when others are fearful!**

*Only works if we do fundamental analysis!*

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All of this goes to trying to use Warren Buffet's words of wisdom when he said

"Be fearful when others are greedy and

be greedy when others are fearful."

BUT and that is a capital BUT

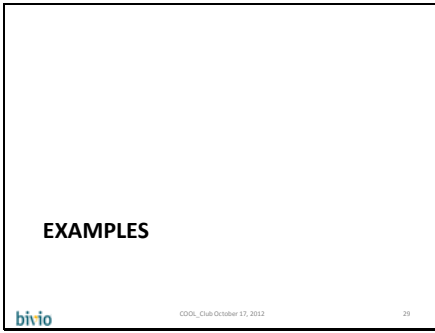
This only works if you do good fundamental analysis.

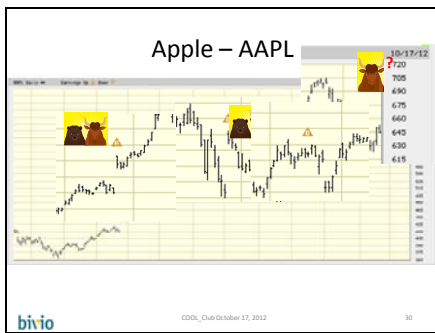
There will be times when the crowd goes running to the hills and that is the right movement and you should run away as well.

There will be times when people are backing up the truck and buying by the handful and that is the right action and you should try to jump the front of the line.

The only way you can know whether being contrarian is right or not is to do good fundamental analysis. I cannot stress that enough. Investing, rather than trading, is about dealing in facts. Selling covered options in my book is not trading, it is an extension of our fundamental investing strategy.

Laurie do we have any questions at this point? If not let's look at some price charts.





This is Apple Stock.

First I want to say although some may play with Apple as a “trading stock”. I am going to talk about it as an Investment.

This is prices over the last year. We are going to look at what happened around each earnings

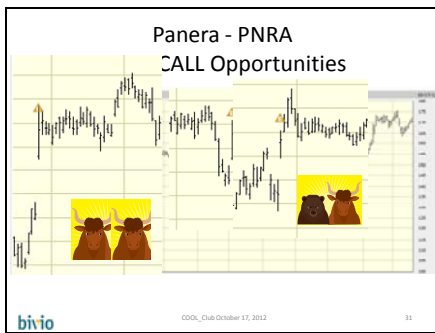
Ahead of 1<sup>st</sup> Quarter earnings the price had been going up but just before earnings it weakened. When earnings were released there was a 7% pop based on the strong results. So this is a BEAR BULL opportunity. If you studied your fundamentals you would have seen that they definitely supported this move. What do I mean by fundamentals? Well, the price to earnings was a very conservative low teens, more than half of their growth rate. So the right thing was not to do anything. Hold your Apple and maybe buy an iPad for someone in the family. By the way had you been treating Apple as a trading stock and sold a Call after the price jump you most likely would have the stock called away from you.

The prices ahead of 2<sup>nd</sup> quarter results were moving down fairly hard meaning the market was very concerned about earnings. The price actually dropped 14% from the short term high. However when the results were released they were very good and the stock jumped 11%. This is a Bear Bull pattern. But again when we looked at our fundamentals we saw that Price to Earning multiple (PE) had moved up but was still fairly reasonable in the mid teens. I would again hold as the fundamentals continued to be really strong. By the way, had you been viewing Apple as a trading stock you might have been tempted to sell a call and it would have worked as prices fell back after the jump on earnings day.

In the 3<sup>rd</sup> quarter, reactions both ahead and after earnings were muted meaning a fairly decent balance of positive and negative sentiment before and after the results. Shortly after these earnings we saw a sell off but then very quickly we went up strong and got to 700+.

But now we have corrected almost 11% from the top. Recent news around another product release means again we are starting to move up again just before earnings. What will the results be next week? Will there be an opportunity? Only you can decide for your situation. We probably have a BULL going into Earnings but we need to wait for the earnings report for us to evaluate both the facts and the market’s reaction to those facts.

Now having gone through this whole chart you notice I did not say there were any selling option opportunities, at least not for the investor. So why did I show you this, because it shows you



Here is a chart of Panera. Let's first look at the quarter that finished in September of last year. We can see during the days going into earnings the stock was up. When earnings came out the price popped over 15%. This is a bull-bull and the fundamentals based on Price To Earnings said Panera was getting a little rich in price. If you had sold Covered Calls you can see the price moved sideways for about a month so. Most likely you could have bought that call back or maybe even let it expire worthless.

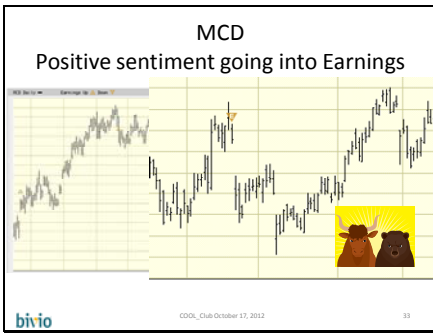
Let's skip the 4<sup>th</sup> quarter as there was no big move there around earnings. Next is the Quarter that ended in March of this year. This time ahead of earnings the price moved down demonstrating that the market was worried about earnings. When the earnings came out again the stock popped but this time between 5-10%. This would be a Bear-Bull pattern. Again the stock had gotten a little rich on the basis of price to earnings and if you had sold a Covered Call that would have worked out well for you as the stock moved down in price for the next two months.

The Quarter that ended in June was very similar. Traded down ahead of earnings, popped between 5-10% after earnings. A covered call sold after earnings would have fared well as the price moved sideways for the next month.



Here is Coach.

Just before the June earnings Coach had been trading up for the week before but it gapped down on the earnings. But looking at the fundamentals, the price to earnings multiple was very attractive and so it would have made sense to either buy Coach outright or to sell Cash-Secured PUTs. Both would have proven profitable as the price has moved up since those earnings.



Similar pattern here for McDonalds for the June quarter. Prior to the earnings the price had been moving up. There was something in the earnings the market did not like and it moved down on earnings day by about 3-4%. If you had sold a Cash secured put, you might have bought it back over the next two weeks but if you held it for more than that then MCD might have been put to you. The result of that would have been good too as the stock then rallied by over 7%.



Align Technology came out with earnings tonight and in after hour trading the stock dropped significantly. I have not looked at the earnings yet so I do not know whether that is over-reaction or valid. If it is an over-reaction it might be a buy-side opportunity tomorrow including CSPs. PLEASE, PLEASE, PLEASE do not do anything just because I brought it up. Do your own due diligence. Be sure you have a solid understanding of their past fundamentals and what the reaction to this earnings report is about.

**QUESTIONS**

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- 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
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## Open Trade: MCD

- MCD
  - Oct 10 - Just put on
    - MCD \$92.90
    - STO \$92.50 Call for 10/20 Exp. (10 days)
    - Collected \$1.50
    - APR 55%
- MCD closed at \$93.68 and best bid was \$.60
  - Will look for cheap price to buy back or expire worthless

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## CSP COOL\_Tool: MCD

| CASH SECURED PUTS COOL TOOL  |  | Closing the Option   |  |
|--|--|--|--|
| Enter Stock: <b>mcd</b><br>Price: \$93.63<br>Today's Change: -0.46   |  | Buy Date: Oct 10<br>Strike: \$92.50<br>Maximum Premium (ask price): \$0.18   |  |
| All Dividend's Corp  |  | Buy Premium: \$0.50<br>Option Type:  |  |
| <b>I. Original Sell-To-Open Position</b>   |  | <b>II. If you Buy-To-Close</b>   |  |
| What Exp. Date? Oct 20<br>Strike? \$92.50<br>Sell-To-Open Premium? \$1.50<br>Number of Contracts? 1<br>Date Sold? Oct 20 | Collected on Open - Cost To Close = Net APR<br>\$140.50 - \$89.70 = \$70.80 55%<br>Collected on Open - Cost To Close = Net APR<br>\$140.50 - \$0.00 = \$140.50 55% | <b>III. If option is exercised, the price you will buy the stock at</b><br>Strike Price - Premium + Assignment = Cost per share<br>\$92.50 - \$1.40 + \$0.09 = \$91.19 |  |

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## Open Trade: COH

- COH
  - STO on 9/25 \$55 PUT for 10/20 Exp.
    - Collected \$1.80 APR 45+%
  - Waiting to BTC or Buy COH @ \$55 - \$1.80
  - Currently @ \$.25 (COH @ \$56.43)
  - Probably allow it to expire worthless

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## CSP COOL\_Tool: COH

| CASH SECURED PUTS COOL TOOL   |   | Closing the Option   |  |
|---|---|--|--|
| Enter Stock: <b>COH</b><br>Price: \$56.50<br>Today's Change: +0.29  |   | Buy Date: Oct 10<br>Strike: \$55.00<br>Maximum Premium (ask price): \$0.13   |  |
| Buy Premium: \$0.25<br>Option Type:   |   | Buy Premium: \$0.25<br>Option Type:  |  |
| <b>I. Original Sell-To-Open Position</b>  |   | <b>II. If you Buy-To-Close</b>   |  |
| Enter Exp. Date? Oct 20<br>Strike? \$55.00<br>Sell-To-Open Premium? \$1.80<br>Number of Contracts? 1<br>Date Sold? Sep 25 | Collected on Open - Cost To Close = Net APR<br>\$529.00 - \$89.20 = \$444.00 44%<br>Collected on Open - Cost To Close = Net APR<br>\$529.00 - \$0.00 = \$529.00 49% | <b>III. If option is exercised, the price you will buy the stock at</b><br>Strike Price - Premium + Assignment = Cost per share<br>\$55.00 - \$1.77 + \$0.03 = \$53.26 |  |

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## Open Trade: QSII

- QSII
  - STO on 9/26 \$17.50 PUT for 10/20 Exp.
    - Collected .55 APR 45+%
  - Waiting to BTC or Buy QSII @ \$17.50 - .55
  - Currently @ \$.10 (QSII up to \$18.60)
  - Wait to expire worthless

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## CSP COOL\_Tool: QSII

| CASH SECURED PUTS COOL TOOL <span style="color: red;">Closing the Option</span> |         |                                |             |
|---|---------|--------------------------------|-------------|
| 1. Original Call For Open Position  |         | 2. Recommended Maximum Premium |             |
| Enter Ticker  | Price   | Enter Strike                   | Exp Date    |
| qsii  | \$18.75 | \$0.58                         | Oct 28      |
| Quantity (contracts)  |         | Enter Strike                   | Strike      |
|   |         |                                | \$17.30     |
|   |         | Maximum Premium (ask price)    | \$0.28      |
| 3. Original Call For Open Position  |         | 4. If you Buy To Close         |             |
| Enter Exp. Date   | Oct 20  | No. of Shares To Buy           | Pay Premium |
| Enter Strike  | \$17.50 |                                | \$0.00      |
| Call For Open Position  | \$0.00  |                                |             |
| Number of Contracts   | 8       |                                |             |
| Date Held   | Sep 26  |                                |             |
| Collected on Open - Cost To Close = Net   |         | APR                            |             |
| \$426.00 - \$23.90 = \$372.10   |         | 43%                            |             |
| If option expires worthless in 3 days   |         |                                |             |
| Collected on Open - Cost To Close = Net   |         | APR                            |             |
| \$426.00 - \$0.00 = \$426.00  |         | 48%                            |             |
| If option is exercised, the price you will pay for the stock is:                |         |                                |             |
| Strike Price + Premium + Assignment = Cost per share                            |         |                                |             |
| \$17.50 + \$0.58 + \$0.01 = \$18.09   |         |                                |             |

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Next week, October 24<sup>th</sup> at 10pm EDT we will be talking about selling covered options on Index ETFs.

NEXT SESSION Oct 24<sup>th</sup> 10:00pm EDT

**SELLING COVERED OPTIONS INDEX ETFs**

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## Homework

- Pick one of your stocks
  - Watch it ahead of earnings
  - Watch it after earnings
  - Write up what you observed on the discussion list
  - If you want to try a covered option after earnings (real or virtual) great but not necessary
  - Just share what you saw around earnings and your reflection around the facts and fundamentals

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## QUESTIONS & OPEN FLOOR

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## GOOD NIGHT AND GOOD SELLING

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