

**Welcome to the  
Covered Options Online Learning  
Club**



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**Paul Madison**



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**Disclaimer about Options**

*Options involve risk and are not suitable for all investors. All investment club members and individual investors should understand the risks of any form of trading or investing. To learn about options, we recommend visiting the Options Learning Center at the CBOE. To learn about stocks, please visit the Investor Education area of the NASD.*

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**What is COOL\_Club?**



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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

Reminder:

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

Most sessions 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.

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

Tonight we will be using the cash secured put Cool\_Tool that was introduced last week but we will be using it to close Puts

## September Schedule

- First Wednesday (Sep 5<sup>th</sup>) 5 pm ET  
*Closing Cash-Secured Puts – Cash Secured PUT Cool Tool*
- Second Wednesday (Sep 12<sup>th</sup>) 8 pm ET  
*Opening Covered Options – Broad Market Cool Tool*
- Third Wednesday (Sep 19<sup>th</sup>) 9 pm ET  
*Closing Covered Options – Broad Market Cool Tool*
- Fourth Wednesday (Sep 26<sup>th</sup>) 10pm ET  
*Meet Mr. Volatility*

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Here is the September schedule along with projected Topics as well.

The next two weeks will be around Covered Options on the Broad Market Indexes using a new Cool Tool for them. Then at the end of September we will introduce that rascally Mr. Volatility.

## 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)

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 going to discuss tonight by clicking on “Resources and Tools”

And finally the schedule and registration links are here.

## Tonight

- Closing Cash-Secured PUT Refresher
- Closing Puts in “Cash Secured PUT COOL TOOL”
- Work through some examples
  - COH
  - CRR
  - ROST
  - Others added today through the Cool\_Club Discussion List
    - DVA
    - PII
    - HD
    - QCOR
    - FAST (Selling rather than closing)

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We will do a little bit of a refresher of what it means to close a Cash Secured Put

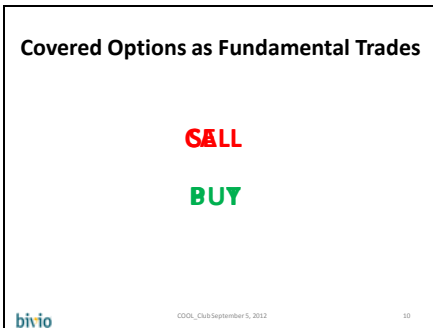
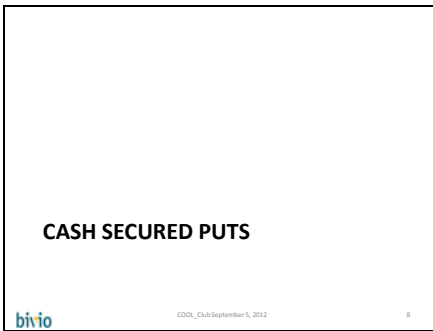
Then we will look how to use the Cool Tool for Cash Secured Puts

And actually walk through several examples or at least as many as we have time for as we had several additions from the today’s discussion list.

PII – Polaris Industries

DVA – DaVita Inc.

QCOR – Questcor Pharma



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 as we are going to talk about tonight we have to close the option

which often means a BUY

Just a reminder that the following little mnemonic may help you remember that CALLS

can turn into SELLS

And this week we are talking about Cash Secured PUTs and they can

turn into BUYS

## Closing an Option (Put)

- **If left open to expiration:**

- Stock Price larger than strike - **Expires worthless**
  - Keep all premium collected
  - Retain your cash
- Stock Price less than Strike - **Exercised**
  - Buy stock at the strike with your cash
  - Cost Basis equals Strike – Premium + Commissions

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Cash Secured Put left open to expiration can have one of two things happen. If the Stock price ends higher than the strike than it will expire worthless and you get to keep all of the premium collected and that will be considered short term capital gains. Your Cash is freed up so that you can buy stock with it or sell another cash secured Put against it.

If the stock price closes below the strike then your option will be exercised meaning that you will buy the stock at the strike price. Your cost basis will be the strike price less the premium you collected when you sold the cash secured put plus commissions paid on both the selling of the option as well as the whatever your brokerage charges for “assignment”. Some brokers (like Fidelity or Schwab), assignment cost is the same as a normal stock trade. Some brokers have a much higher cost for Assignment, some as high as \$20.

Ahead of Expiration

## Buy-To-Close

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Our last way we can close the position is to do something ahead of expiration (that includes while the market is open on the day of expiration).

So the action here is “To-Close” the open position

And since we started by selling first we have to

BUY-To-Close

## What does "Buy-To-Close" Mean?

- Action taken to close option early
  - Pay premium to buy back the option
  - Retain cash
  - No longer obligated to buy
  - You keep difference between
    - Collected when you "Sold-To-Open"
    - Spent to "Buy-To-Close"

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So as we said Buy-To-Close is a way that we can close our option before the expiration date.

We turn around and become a buyer of the same option that we sold. We would be paying a premium rather collecting a premium.

By closing the position, we retain our cash

... and we are no longer obligated to buy.

You get to keep the difference between what you collected when you "Sold-To-Open" and what it costs you to "Buy-To-Close"

## When to "Buy-To-Close"?

- Simple target
  - When premium is 20% of original
    - Example - **STO** @ \$1 ....**BTC** @ \$.20
- Time based target
  - Remaining premium yields less than 10% APR

*My approach uses a combination of these two!*

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COOL\_Club-August 15, 2012

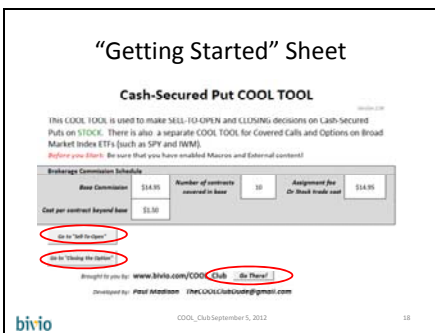
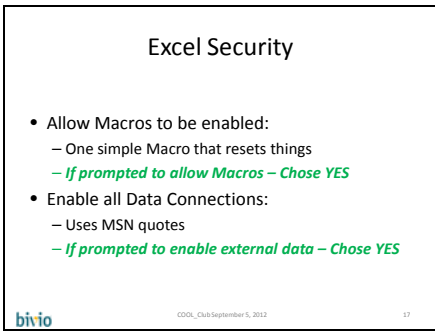
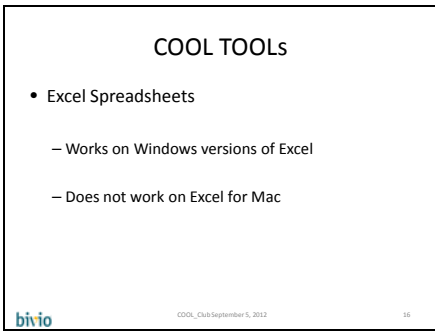
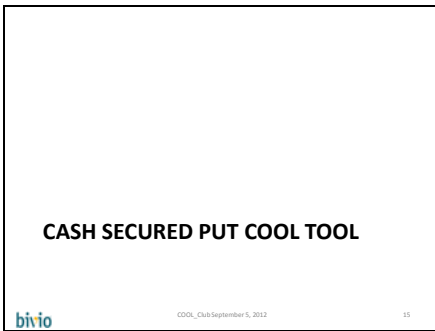
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There are two approaches to determining when to Buy-To-Close

The simplest and easiest to do is to say when the premium drops to 20% of the original premium collected, I will buy it back. So an example would be if we Sold-To-Open an option at \$1 we would wait to buy it back when it was .20 or a little lower if we do it net of commissions.

But I also like to take the time component in to account so I like to look at what the APR is on the remaining premium for the time left and if that drops below 10%, I consider that a time to buy the option back. That means if the option is going to remain on for me I want at least a 10% or better return.

The COOL thing is the COOL\_TOOL will do the math for you and tell you what a maximum buy-back premium would be net of commissions and it looks at both of these approaches.



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.

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.

The downloaded sheets will open on the Getting Started page.

This has a little bit of information about the COOL TOOL and is also where you would input the information about your particular broker’s commission schedule.

New in the sheets are Buttons that do things. So here you have buttons that take you to the

“Sell-To-Open” sheet or the

“Closing the Option” sheet and

there is even a button to take you out to the COOL\_Club home page.

### Where can you download it?

COOL Club  
Resources and Tools

There are many places to go to learn more about options trading, and we will expand this list as new materials come to our attention.

**Virtual Trading Simulators**

**COOL TOOLS**

- Download Cash Secured Put COOL Tool
- Using The COOL Tool to Buy a Stock as a Hedging Tool
- Using The COOL Tool to Determine How to Write a Covered Call Position
- Cash Secured Put COOL Tool

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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 two TOOLS and we also have links that go to the presentations on how to use the tools.

### SCREEN SHOTS

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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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### Coach \$52.50 Sep 22 PUT

CASH SECURED PUTS-COOL TOOL *Choosing the Option*

Version 2.06

Done mid-day Aug 31st

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Just a reminder that the current version of the Cash Secured Put COOL Tool is 2.06. If you do not see 2.06 on each sheet you do not have the most recent. Go back and download from COOL\_Club the latest.

The Covered Call Tool is still just version 2.04

So here is what the COOL Tool was making as a recommendation last Friday ...8/31 ...eight days after the Cash Secured Put was sold. So we can see a recommended buy back of \$.20 but that is using the simulators fairly high commission rates.

### What if Fidelity Commissions?

CASH SECURED PUTS COOL TOOL

Enter Ticker	Price	Today's Change	Buy Date	Sep 22
COH	\$57.42	+0.07	Initial	\$52.50
Current Price			Minimum Premium (per share)	\$0.00
Original Sell-To-Open Position			Buy Amount	
When You Buy	Sep 22		Collected on Open	Cost To Close
Initial	\$52.50		Net	APR
Sell-To-Open Premium	\$1.00		Collected on Open	Cost To Close
Number of Shares	1		Net	APR
Buy Date	Aug 23		Collected on Open	Cost To Close
			Net	APR

Done mid-day Aug 31st

Just to show how much impact commissions can have on our work I have tweaked the sheet to show Fidelity commission rates and you can see the minimum buy back goes up to \$.26 almost a third higher.

### Coach \$52.50 Sep 22 PUT

CASH SECURED PUTS COOL TOOL

Enter Ticker	Price	Today's Change	Buy Date	Sep 22
COH	\$57.42	+0.07	Initial	\$52.50
Current Price			Minimum Premium (per share)	\$0.00
Original Sell-To-Open Position			Buy Amount	
When You Buy	Sep 22		Collected on Open	Cost To Close
Initial	\$52.50		Net	APR
Sell-To-Open Premium	\$1.00		Collected on Open	Cost To Close
Number of Shares	1		Net	APR
Buy Date	Aug 23		Collected on Open	Cost To Close
			Net	APR

Done mid-day Aug 31st

But lets go back to the Higher Commissions and a .20 Minimum premium ....click on the button for Option chain

### Option Chain

Option Chain

Put Options	Symbol	1 unit	Open	High	Low	Volume	Open Int
0.00	COH120922P000000	0.00	0.00	N/A	0.00	0	0
0.05	COH120922P005000	0.05	0.00	N/A	0.00	0	0
0.10	COH120922P010000	0.05	0.00	N/A	0.00	0	0
0.15	COH120922P015000	0.05	0.00	N/A	0.00	0	0
0.20	COH120922P020000	0.05	0.00	N/A	0.00	0	0
0.25	COH120922P025000	0.05	0.00	N/A	0.00	0	0
0.30	COH120922P030000	0.05	0.00	N/A	0.00	0	0
0.35	COH120922P035000	0.05	0.00	N/A	0.00	0	0
0.40	COH120922P040000	0.05	0.00	N/A	0.00	0	0
0.41	COH120922P041000	0.05	0.00	N/A	0.00	0	0
0.42	COH120922P042000	0.05	0.00	N/A	0.00	0	0
0.45	COH120922P045000	0.05	0.00	N/A	0.00	0	0
0.50	COH120922P050000	0.05	0.00	N/A	0.00	0	0
0.55	COH120922P055000	0.05	0.00	N/A	0.00	0	0
0.60	COH120922P060000	0.05	0.00	N/A	0.00	0	0
0.65	COH120922P065000	0.05	0.00	N/A	0.00	0	0
0.70	COH120922P070000	0.05	0.00	N/A	0.00	0	0
0.75	COH120922P075000	0.05	0.00	N/A	0.00	0	0
0.80	COH120922P080000	0.05	0.00	N/A	0.00	0	0
0.85	COH120922P085000	0.05	0.00	N/A	0.00	0	0
0.90	COH120922P090000	0.05	0.00	N/A	0.00	0	0
0.95	COH120922P095000	0.05	0.00	N/A	0.00	0	0
1.00	COH120922P100000	0.05	0.00	N/A	0.00	0	0

and here is the option chain but I wanted to mention that you can click on the ticker for the option you are interested in and

### Option Quote Detail

Option Quote Detail

COH Sep 2012 \$2.00 put (COH120922P020000)

0.55 +0.03(5.77%)

Price Class	0.02	Ask Change	0.00
Open	0.41	Contract Range	0.00 - 0.00
High	0.50	Volume	00
Low	0.00	Open Interest	0.00
Close	0.00		
Expiration	21 Sep 12		

You will get a detail page on that particular option. So here we are looking at the 52.50 PUT for Sep 22 expiration. We see that it opened at .41 and that the range of trades actually done has been from .41-.55

### Coach \$52.50 Sep 22 PUT

CASH SECURED PUTS COOL TOOL

Enter Ticker	Price	Today's Change	Buy Date	Sep 22
COH	\$57.42	+0.07	Initial	\$52.50
Current Price			Minimum Premium (per share)	\$0.00
Original Sell-To-Open Position			Buy Amount	
When You Buy	Sep 22		Collected on Open	Cost To Close
Initial	\$52.50		Net	APR
Sell-To-Open Premium	\$1.00		Collected on Open	Cost To Close
Number of Shares	1		Net	APR
Buy Date	Aug 23		Collected on Open	Cost To Close
			Net	APR

Done mid-day Aug 31st

So even though the .41 is above the minimum lets try putting .40 in and see what that looks like.



CASH SECURED PUTS COOL TOOL Closing the Option

Order Type	Price	Change	Order ID	Order Price	Order Status
Market	\$57.42	+0.03		\$57.42	Open
Market	\$57.42	+0.03		\$57.42	Open

Order Type	Price	Change	Order ID	Order Price	Order Status
Market	\$57.42	+0.03		\$57.42	Open
Market	\$57.42	+0.03		\$57.42	Open

Order Type	Price	Change	Order ID	Order Price	Order Status
Market	\$57.42	+0.03		\$57.42	Open
Market	\$57.42	+0.03		\$57.42	Open

Done mid-day Aug 31st

The thing that is interesting here is that if we bought back at .40 we essentially would have locked up half of our gain (\$55 of the \$110 maximum) and have done so in only a little over a week and yet it is going to take us 3 more weeks (to Sep 22) to get that last 50% of the premium. So I think I like that and I am going to go ahead and put in a buy back for \$.40 to see if I can get it done.

Put my order in to BTC my CSP

Virtual Order Status

Order	Symbol	Description	Buy	Sell	Order Type	Order Price	Order Status	Created	Cancel Time	Status
1	BTC	Buy To Open	1	0	Market	57.42	Open	8/31/2012 11:30 AM		Ready To Trade
2	BTC	Sell To Close	0	1	Market	57.42	Open	8/31/2012 11:30 AM		Ready To Trade

Here you can see my buy back at .40 and that it was a GTC (good till cancelled).

Now as it turns out this stayed in the rest of Friday and all day Tuesday and it still did not get bought back.

Let's go look at it again and see what is going on.

QUESTIONS?

LET'S GO PLAY

- Other Examples looked at
- Carbo Ceramics – CRR
    - Date Done 8/23
    - Sold either a:
      - Sep 22 \$65 PUT for \$1.40
      - Sep 22 \$70 PUT for \$2.65
  - Ross Stores – ROST
    - Date Done 8/23
    - Sold Sep 22 \$70 PUT for \$2.20

## QUESTIONS

## HOMEWORK

### Assignment – Still Open

- Exercise:
  - Sell 1 Cash Secured PUT on one of these stocks:
    - FAST
    - PNRA
    - ORLY
    - ALGN
- Send to COOL\_Club
  - Provide details, your Fundamentals, What Strike and Expiration, Net Premium Collected & what day it was done, and your APR

No one has posted any homework from last week so I am going to leave this assignment open for another week.

NEXT SESSION Sep 12<sup>th</sup> 8:00pm EDT

### SELLING COVERED OPTIONS ON BROAD MARKET INDEXES COOL TOOL

Next week we will look at the new Cool Tool for selling Broad Market Indexes. We will focus next week on the selling side and the following week we will look at the closing side.