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# The Options Course

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*High Profit & Low Stress  
Trading Methods*

**Second Edition**

**GEORGE A. FONTANILLS**



**WILEY**

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# The Options Course



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*To Charlene Fontanills—  
the one true love of my life.*





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# Preface

*An investment in knowledge always pays the best interest.*

—Benjamin Franklin

**M**ost new investors and traders, whether they are beginners or professionals, usually lose money for two reasons. First, they do not have a grasp of how the markets really work. Second, they are under too much stress when they trade because they fear losing money. Many times, traders liquidate good trades too quickly or have no idea when to take profits. But learning to trade successfully is not an impossible task. This book is designed to build your knowledge base of the markets to a professional level and to provide you with strategies that make money in the marketplace. My trading program is the result of many years of trading experience, as well as many years of research and development, all in the pursuit of developing the optimal methodologies to trade the stock, options, and futures markets.

Students often ask me how I got started as a full-time investor. Perhaps like you, I was looking for an opportunity that would allow me to achieve my financial dreams after a long road of despair. After attending high school in Miami, I felt a college career was necessary to become successful. Although I questioned what success really meant to me and whether college would bring me that success, I settled on the University of Florida in Gainesville for the wrong reasons. It was close to home and all my friends were going there.

One day, after just a few semesters, I woke up having difficulty breathing. I went to the university clinic and was told I had a mild case of pneumonia. After a week of useless medications, my breathing troubles increased. Finally X-rays were taken, and at the age of 18, I was diagnosed with Hodgkin's disease, a form of cancer. There is no news that can be more devastating to a young person and his family.

Perhaps the hardest thing I had to face was the loss of my physical prowess. Until that time, I was in exceptional shape, working out every day and participating in lots of sports. Over the next year, I was hospitalized

and had to undergo chemotherapy treatments and radiation therapy. Throughout this dark time, I continued my studies at a community college.

At this point, I realized that life was too short to waste time, and that I needed to work as hard as I could to achieve everything I wanted to do. As my resolve to succeed took flight, I coined the phrase, “Out of adversity comes inspiration.”

I slowly recovered and went on to attend New York University, graduating with honors with a bachelor’s degree in accounting. I subsequently earned my CPA license and joined a large accounting firm. However, after spending several years in public accounting, I once again felt disillusioned. I needed something more. I applied and, to my surprise, was accepted at Harvard Business School. After two grueling years (but something I would do again without hesitation), I graduated.

Here I was, a bright and energetic young man with an MBA from the finest business school in the world with countless job offers others would never dream of turning down. But somehow I just couldn’t get excited about any of the positions, no matter what they paid me. I had already traveled down that road and knew that it led to a dead end. Instead, I decided to go into business for myself.

Driven by my need for a more rewarding career, I started my first business. It failed. Strike one. Undaunted, I started a second business, which never even got off the ground. Strike two. On my third attempt—an attempt to strike gold in the real estate business—I realized that I could actually be good at something. Working with some wealthy individuals in Massachusetts, I was just able to keep my head above water. I would find great real estate deals and they would put up the money to buy them. Subsequently, I would get a small piece of each deal.

Unfortunately, I forgot one thing: I needed to eat and pay the rent without the benefit of a consistent salary. Finally, the day came when my landlord (one of my partners) came to collect my rent and I had no money to pay it. I hedged as best I could and asked him to give me a little more time. He turned me down, adding that he was going to throw me out regardless of how much money I made him in the past. I was shocked. At first I thought he was kidding around. But with a stern look on his face, he proved me wrong, stating unequivocally, “One day you will thank me for teaching you this lesson.” At the time, I cockily replied that I’d be much happier with a wheelbarrow full of money. In hindsight, I realize that he was probably referring to my favorite personal proverb about finding inspiration in adversity. However, he is still waiting for me to thank him.

Crushed and downhearted, I went to my parents to borrow money to eat and live. Being a Harvard MBA and having to borrow money from your parents is very demoralizing. Having to listen to “Why don’t you get a real

job?” not only from them but from others made me decide to give corporate life another shot.

Soon after, I found a consulting job that lasted a whole 30 days. It was supposed to be a permanent job. But as I was being fired, I was told I had the wrong attitude. In fact, they said much more than that, but most of it could never be printed. Unfortunately, they were right. I did have the wrong attitude. I just didn't want to work for anyone but myself. I returned to real estate and started looking for new projects, but this time I was determined to control them. In this roundabout way, I was first introduced to the concept of an option. A real estate option allowed me to control a piece of property with very little cash for a specific period of time. As I later learned, stock and futures options are very similar.

My first deal was exciting. I found a great apartment complex going into foreclosure and convinced the owner I could buy the property. In fact, I had no cash at all. Even worse, my credit was destroyed and my shiny BMW had been repossessed. Since I was approximately \$50,000 in debt, I did what I had to do: I convinced an investor to put up the option money and split the profits after the property was sold. I made a nice \$35,000 profit on that deal—finally, a success.

After a series of profitable deals, the bottom fell out of the real estate market. There was no money available anywhere. Once again, I was left with a big question mark as to what I should be doing with my life. Luckily, serendipity intervened. One day, I received a small advertisement in the mail for a book on futures trading. Although I had no clue as to what futures trading was all about, I ordered the book. What struck me most were tales about making large amounts of money in a short period of time using very little cash. This sounded very similar to what I had been doing with real estate.

Why had I never learned any of this when I attended Harvard Business School? How could the great “boot camp of capitalism” neglect to teach me about futures markets? My interest was now piqued. I picked up a few more books. I began to watch the markets. I even played with a few introductory strategies; but although I found them interesting, they were not very profitable. My first big mistake was to convince my investment partners that we should begin trading by hiring experienced professionals. In less than 30 days, these so-called professionals lost about 30 percent of our capital. This was an extremely poor way to inspire confidence in my investors. I decided to fire everyone and learn to do it myself. I knew that I could lose at least 30 percent without even trying (even more if I really tried). I was determined to make a profit, and the trick was to get a competitive edge. That much I did learn at Harvard. To be successful, you need to have an edge.

I began to analyze where I could find this edge, focusing my attention

on using computers to garner information faster than others did. I gained experience as a trader, even learning how to write my own computer programs. Eventually, this long and eventful journey gave birth to Optionetics. Today, I teach this system to individuals all over the world. Hopefully, this book will enable you to develop a better understanding of the markets and will assist you in learning how to profitably trade. In my opinion, there is no better lifestyle than that of a successful trader.

GEORGE A. FONTANILLS  
*Miami Beach, Florida*  
*December 2004*

# Acknowledgments

I attribute my success as a teacher, trader, and businessman to the incredible support I receive each and every day from my friends, family, and colleagues. I am fortunate to be able to do the job I enjoy with some of the most extraordinary people in the business. I would like to thank everyone at Optionetics who has helped to build our company into a global one. Your hard work and team spirit allow me to do what I love to do: trade options. Without you, this book would not be possible. You are all simply the best. In particular, and in no order of importance, I would like to especially thank the following people:

Tom Gentile is the Chief Trader for Optionetics. I would like to thank him for contributing a lot of great material for the second edition of this book. We work so closely together as a trading group that I often cannot distinguish my original ideas from Tom's. Simply stated, Tom is a trading genius, and his nickname "the option guru" is well deserved.

Richard Cawood is the CEO of the Global Group and Optionetics and the mastermind who perhaps maintains the lowest public profile of our group while having the highest influence. I am very fortunate to have his business acumen leading our team. The success of our full-time trading endeavors is made possible only because Richard manages our business. And with that I have to acknowledge his right hand, Tony Clemendor, an old friend and groundbreaking COO. My partners—Tom Gentile, Richard Cawood, and Tony Clemendor—are the backbone of the company and deserve the bulk of the credit in building our company.

In addition, I wish to recognize Amy Morris, who has been with us since we started. Without her dedication and inspirational management skills, my life would be much more difficult. And of course, I send waves of gratitude to Kym Trippsmith, my Editor-in-Chief. Her resourcefulness, hard work, and determination are the reasons this book—as well as all the others—exist. Thank you, Kym!

My thanks also go to my trading family, writers, and friends. In particular, Frederic Ruffy and Jody Osborne are two of the most outstanding writers I have ever had the pleasure of working with. Their timely revisions

to this edition of *The Options Course* were invaluable. Finally, I want to thank Kim Diehl, the Associate Editor, for her eagle eyes and editing acumen. There are many others and I hope they forgive me for not being able to list everyone.

My loving family has supported me in all my adventures over the years. I thank them for always believing in me even when I didn't believe in myself. When my battle with cancer occurred, they were always at my side and their prayers were answered with my recovery. I thank God for my second lease on life.

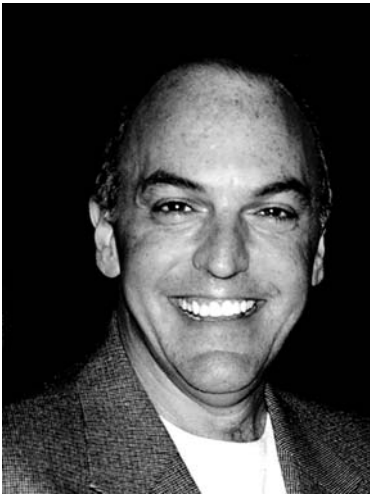
People continually ask me why I publish material. For the record, I enjoy passing on my knowledge to others. However, without my team supporting me, I would probably stick to trading full-time for a living. Thanks to the help of my incredible support team, I am able to do both of the things that I love: trade and teach.

Finally, I would like to thank my students, who inspire me to keep writing and publishing. Over the years, we have made numerous friends and received many great ideas from our students that have enhanced our own trading. I look forward to meeting you someday at one of my many speaking engagements or at an Optionetics seminar coming to a town near you. Until then, good luck and great trading.

G. A. F.



## About the Author



**H**aving struggled to overcome a life-threatening illness as a young man, George Fontanills is a true believer in the idea that pursuing your dreams is something that should never be put off until tomorrow. Like many people, George followed the typical educational and work-related path: From high school he went to college, and from college to an accounting job at the prestigious firm of Deloitte, Haskins Sells. Upon receiving his CPA license, George started work with Andersen Consulting. Not quite satisfied with where his life was headed, he left this job to attend Harvard Business School's MBA program.

After receiving his MBA, George decided to get off the treadmill of unsatisfying jobs. In the face of several high-paying job opportunities, George decided that he needed to start his own business. His first business failed. Undaunted, he started a second business that never left the starting gate. A survivor, he kept going. Running low on money, George became a real estate investor buying property with no money down. Finding a business he enjoyed, he quickly began to build a successful track record and increase his net worth. Just as he began to feel that he had found his lifelong career, the bottom fell out of the real estate market—strike three.

As George pondered his next move, he received a brochure on making money in the markets. After ordering the book, he began trading . . . and losing money. Rather than concentrating on his own losses, he began studying successful traders to see what they were doing differently. Using the analysis skills he developed at Harvard, George conducted a comprehensive investigation to determine what differentiated the winners from the losers. Risking the money he made in real estate, George tested his conclusions, eventually developing a unique approach to trading that involved utilizing

managed risk strategies to strategically attack any market. By mathematically controlling risk every time a trade is placed, consistent profits can be made without the stress of unbridled losses. Fontanills called this trading style “Optionetics.” As his net worth soared, he gained a reputation as an expert in nondirectional, managed-risk trading and has become a well-respected teacher and speaker at trading conferences all over the world. Today, Optionetics offers several of the best-attended trading courses in the world. George’s straightforward and insightful approach to trading has enabled thousands of people to learn how to limit their risks and maximize their trading successes.

These days, Fontanills is President Emeritus of Global Investment Research Corp. and an active options and stock trader. George’s reputation as “the dean of options trading” has led to numerous guest appearances on television and radio shows across the country. Most recently, he has been quoted in *The Wall Street Journal*, *Barron’s*, *Research* magazine, CBS MarketWatch, and TheStreet.com. He also appears on CNBC, Bloomberg, and CNNfn, as well as numerous radio stations across the country. In addition, George Fontanills has written two best-sellers, *The Options Course* and *Trade Options Online*, and co-written with his partner, Tom Gentile, two others: *The Stock Market Course* and *The Volatility Course*. These “definitive guides to trading” have added to his critical acclaim as one of the best trading instructors in the world.

# Introduction

Options are one of the most profitable tools available to traders today. They offer traders the ability to leverage positions, manage risk, and enhance returns on existing portfolios. To those who choose to trade options, this book provides the practical knowledge—from basic concepts to sophisticated techniques—necessary for successful options trading. It is designed to provide novice and intermediate traders with methods and strategies that will enhance profits and manage risk more effectively.

The investment world has gone through amazing gyrations since the first edition of *The Options Course* was released back in 1998. We have lived through the boom of the Internet along with the subsequent bust—when the dot-com became the dot-bomb. During this period, fortunes were made and lost virtually overnight. Traders who made money so fast they didn't know what to do with it turned around and lost it so fast it made their heads spin. It is always painful to see how fast investors can lose money—especially when techniques to limit risk could easily have been employed.

In addition to this wild time in early 2000, we saw a precipitous decline in the technology sector as well as in many blue-chip stocks. In the years following the collapse of the Internet bubble, almost everyone lost money. Even people with mutual funds saw tremendous drops in their monthly statements. Meanwhile, many small as well as institutional investors kept betting that the market would rebound, only to see it fall again and again. This continual drain destroyed the confidence of many stock market players.

Conversely, bond investors saw their yields rise dramatically as the Federal Reserve had to keep dropping interest rates. Apparently, the economic slowdown would not halt unless dramatic reductions in interest rates could spur economic recovery. It was a slow process and the American economy continues to slowly recover.

World events have also changed our lives dramatically. September 11, 2001, was one of the most horrific and unforgettable events in the history of humankind. Unfortunately, too many mothers, daughters, fathers, and

sons as well as all the heroes of 9/11 will be remembered in history due to the horrible deeds of a few. As someone who was in New York and saw this event firsthand, I will never forget this day for the rest of my life. This event—along with surviving Hodgkin’s disease when I was only 18—has led me to understand the importance of living life to its fullest every day. Undoubtedly it has woken us all up; we are now more fully aware of the global scope of the world we live in and the importance of appreciating the gift of life on this amazing planet.

As options traders, we have to focus on the many events that can make markets move in any one of three directions: up, down, or sideways. One of the most vital factors that must become part of your daily market approach is to pay close attention to volatility. How fast can an event drive the markets, and how can we take advantage of this event? What strategies can be employed when historical and implied volatility diverge? Options provide the knowledgeable investor or trader opportunities to create scenarios that others may not see. A stock investor can only buy or sell a stock, whereas an options trader can have a number of different strategies for different time frames. I like to say that we are playing a chess game with the markets. The market makes a move; I counter that move until, hopefully, I “checkmate” the market.

During the past 10 years of teaching individuals how to make money in the markets, I have had the opportunity to meet thousands of people, and they each seek ways to improve their lives—both for themselves and for their families. I hope that your own personal success will enable you to help your loved ones. Just remember that life is short and there are many roads it may take; but if we do our best to be good to others, then any path we take should also reward us many times over.

I certainly hope this book will help you to change your life in a positive way. The powerful strategies reviewed in it offer traders the ability to consistently make good returns when these trading approaches are solidly understood and strategically applied. Although at times it may seem like an insurmountable task to comprehend all aspects of options, I promise that it is well worth the effort. Just think back at how much time and money you spent in getting to where you are today. A little more consistent time and effort can reward you many times over.

The first question you need to ask yourself is: Why do you want to trade? The most common answer is to make more money. While trading can provide a great living, it’s important to make sure you love what you do—no matter what it is. This will lead you to become more successful in the field of your choice. Once you have asked yourself why you want to trade, then ask yourself why you want to trade options. Most individuals want to trade options because these incredibly flexible instruments enable traders to control an asset for less money. For example, let’s say I

want to buy your house from you one year from today. I am willing to pay you the appraised value today plus another 10 percent on top of that. (If you don't take 10 percent, maybe I offer 15 percent or 25 percent.) Once you agree on the price and I pay you a deposit (known as the premium), I will have an option contract to purchase an asset (your house) at an agreed-to time (one year from today) at an agreed-to price. For this I pay you a premium. This is a simple example of a call option. The buyer (me) will have a right to buy the asset (your house) from the seller of the option (you), who will have an obligation to deliver the option (sell the house) to the option buyer.

If you want the right to sell an asset, you can employ the use of a put option. A good analogy can be the purchase of auto insurance, which provides the right to sell your car (the asset) to the seller of the put (the insurance company) if the value goes down due to an accident. Let's say you purchase a policy that values your car at \$25,000 and you pay \$1,000 for one year's coverage. What you have done is purchased the right to sell your car (the asset) for \$25,000 for a one-year period in exchange for the premium of \$1,000. If nothing happens in the year, your option will "expire worthless" and you will have to buy another put option (next year's insurance policy).

These relatively simple analogies are the initial steps to managing trading risk and leveraging your capital more effectively. In this book, you can learn how to use these amazing trading instruments in the volatile markets of the twenty-first century.

I have been fortunate to work with some of this country's best traders. This has enabled me to pass on an abundance of knowledge geared to help people become successful traders. This information comes from years of experience spanning from my first days as a novice trader through my experience running a floor trading operation at the American Stock Exchange and in the Chicago futures pits.

It is my sincere hope that you can learn to develop moneymaking trading acumen by reading this book. Most importantly, you will be able to avoid many of the costly errors commonly made in trading and investing and ascend your own learning curve in leaps and bounds. I have confidence that you will gain significant insight into the world of investing by studying the strategies in this book. By applying this knowledge to stocks, futures, and options markets, I have no doubt that you will find trading a lucrative endeavor.



# **Options Trading: A Primer**

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**T**rading is an elusive beast to the uninitiated, filled with mystery and complexity. Although trillions of dollars' worth of stocks, futures, and options change hands every day, learning to trade is a complicated puzzle that takes patience and perseverance to navigate effectively. Perhaps you have a friend who has made money or know other friends who have lost money playing the markets. Learning to trade can be the beginning of an exciting new career, especially if you master combining options with futures and stocks.

Many years of teaching and trading have taught me that the most successful investors are those who do not think of trading as work, but as play. Obviously, a love affair with anything you do will increase your chances of success dramatically. Perhaps that's why I like to call what I do "grown-up Nintendo." Making money is just a natural consequence of my daily play.

My systematic approach to trading emphasizes risk management. I know how to spot optimal moneymaking opportunities to increase my chances of high returns from low-risk investments. I share this trading knowledge with individuals throughout the world through seminars and various innovative products designed to foster a strong foundation in options trading in the stock and futures markets.

Stock, futures, and options trading provide investors with the best opportunity to find rewards that satisfy almost anyone's financial objectives. My investment philosophy is to make money any way we can, in any market we can. It's a matter of working with a matrix of trading strategies, developing a feel for how to trade profitably, and learning the tricks of the trade.

What separates those investors who make consistent returns year after year from those who can't ever seem to make a winning investment? Vision. Simply put, the winning investor has the vision to systematically spot good opportunities, while the losing investor simply never developed this insight. Can this vision be developed? Some say that a great investor has an innate sense that drives his or her ability to make money. However, I believe that although there may be a few individuals with this innate sense, most great investors learn by trial and error until they find what works best for them.

For example, many people refer to Warren Buffett as the greatest investor of all time. He appears to have a knack for turning anything he touches into gold. Is it because he is just so much smarter than everyone else, or has he developed a methodology over the years that works for him on a consistent basis? For someone as successful as he is, I would have to say that he has *both* innate skill and a formula for success. This formula for success can be developed by anyone. The problem is that most investors don't have the persistence and drive necessary to achieve success.

First and foremost, you have to learn how to invest and trade the right way. Typically, most new investors lose money when they first begin due to their lack of understanding of what it really takes to succeed. Many may listen to their stock or commodity broker from the outset and never develop an understanding of the markets. Many more lose money until they realize their main error is taking someone else's investment advice. A word of caution: Just because someone is licensed to take an order and execute a trade does not mean that person has the knowledge to invest your money wisely. Gaining the right kind of knowledge, however, is critical to trading success. Although there is risk in virtually all investments and trades, you can mitigate risks by learning how to protect yourself using innovative option strategies. Once you learn how to manage risk, the rewards come more easily.

If you intend to enter the markets, you'll need to decide what kind of investing/trading you want to engage in. Keep in mind that there is a big difference between investing and trading. An investor is an individual who takes a long-term perspective. For example, if you have \$5,000 to invest and you place all the money in a mutual fund—a pool of investments managed by a professional manager—then you are taking a passive role for the long term. If you choose to set up an individual retirement account (IRA), you will more than likely keep it until retirement.

A trader, on the other hand, takes a more active role. Traders may make investments that last for seconds, minutes, hours, weeks, or even years, always looking for an opportunity to move the money around to capture a greater return. Typical traders actively make investment decisions on a continuous basis, never allowing anyone else to control the



funds. As a trader, you need to focus on strategies that provide the best chance to create profitable trades. Combining stocks or futures with options provides you with extra leverage; but this extra leverage is a double-edged sword. Options give you the chance to make a very high return using smaller amounts of cash than futures or stocks require, but this leverage also creates an opportunity for you to lose money just as fast.

The losing traders are those who do not respect risk. To survive in this business and have the opportunity to enjoy the fruits of your labor, you must develop a very healthy respect for risk. Before entering any investment, you should ask yourself four questions:

1. How much profit can I make?
2. What is the maximum loss I can take?
3. At what point will I get out if I am wrong?
4. When should I take profits?

As you make the transition to becoming a motivated, knowledgeable, and successful trader, you will have to undertake a realistic examination of your personal goals, habits, dreams, and dislikes. This step is of utmost importance. Many individuals believe that they will enjoy a certain profession, but then give up before the opportunity to achieve success appears.

You must have a good understanding as to why you want to participate in any endeavor. Why are you taking the time to learn a new profession? What are your goals? What are your strengths? What are your weaknesses? Before you can become a serious and successful trader, you need to search for these answers. Make a list and add to it every day as more things become apparent. Try to be honest with yourself. Keep your highest goals in mind and work toward them one step at a time using your list of attributes to strengthen your willpower to succeed.

The three primary reasons for developing trading savvy are:

1. *To achieve more wealth.* The number one reason that most people want to become traders in the stock, futures, and options markets is to attain financial rewards. Stories about the large sums of money to be made and the successes of the rich and famous inspire a desire to achieve the same level of financial success. Just as it is a business's objective to produce more cash flow to pump up the bottom line, a trader's objective is to make more money from money. That is how a trader monitors progress. Although "money doesn't buy happiness," having plenty of money sure helps. However, there is no need to make having money your sole goal in life; as far as I'm concerned, that would undermine your development as a well-rounded individual.

2. *To improve family life.* The ultimate goal, other than trading just to make money, is to create a better life for yourself and your family. The success I have been fortunate enough to achieve through hard work has allowed me to help my family and friends financially when they needed it; I have found this ability to help others very enjoyable. Once you have achieved a financial level where you can live each day without worrying about which bills need to be paid, you will have more freedom to discover your true purpose in life. As an added bonus, you can also afford the time and energy to help others, which will make your life as an investor even more fulfilling.
3. *To gain greater autonomy in the workplace or be your own boss.* The third most common reason is the desire to break away from a day-to-day job that has been emotionally and/or financially unfulfilling. This is the main reason I started trading; I needed more than what real estate offered. As I like to ask my seminar students, “How many of you are here to try to get out of a real job?” More often than not, it’s better to describe the day-to-day grind most people subject themselves to as an *unreal* job, since many cannot believe they have to go through the motions each day. In essence, it has become a nightmare.

Whether you enjoy what you are doing today and just want to supplement your income, or you are looking to become your own boss, there is no better profession than that of a trader. For example, I travel extensively and live in various locations. With a small laptop computer, Internet access, and a cell phone, I can conduct my business from almost anywhere, which maximizes my freedom. For me, trading is a dream come true.

## THE ROAD TO SUCCESSFUL TRADING

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Achieving trading success is not easy. In fact, just getting started can be an overwhelming process. The road to wealth can take many paths. To determine your optimal trading approach, start by making an honest assessment of your financial capabilities. Successful traders only use funds that are readily available and can be invested in a sound manner. It is also critical to accurately assess your time constraints to determine the style of trading that suits you best. If you want to trade aggressively, you can do so using various short-term strategies. If you want to take a hands-off approach, you can structure trades to meet that time frame. All of these choices are less difficult to make if you respect the following trading guidelines.

1. Gain the knowledge to succeed over the long run.
2. Start with acceptable trading capital.

3. Establish a systematic approach to the markets.
4. Be alert for trading opportunities at all times.
5. Develop the fine art of patience.
6. Build a strong respect for risk.
7. Develop a delta neutral trading approach.
8. Reduce your stress level.

### **Gain the Knowledge to Succeed over the Long Run**

You have to have knowledge to succeed. Most new investors and traders enter this field expecting to immediately become successful. However, many have spent tens of thousands of dollars and many years in college learning a specific profession and still do not make much money. To be successful, you need to start your journey on the right path, which will increase your chance of reaching your final destination: financial security. To accomplish this goal, learn as much as you can about low-risk trading techniques and increase your knowledge base systematically.

Successful traders have an arsenal of trading tools that allows them to be competitive in the markets. I have used the word *arsenal* purposely. I believe that as an investor or trader, you need to recognize that each and every day in the marketplace is a battle. You must be ready to strategically launch an attack using all the resources in your arsenal. Your first weapon—knowledge—will enable you to make fast and accurate decisions regarding the probability of success in a specific investment. Is it incongruous to suggest that trading is war and also that to trade successfully one must reduce one's level of stress? I believe not. The most composed and well-armed opponents win wars. The same is true for traders. In most cases, winners will be more comfortable (less stressed) regarding their ability to win. Knowledge fosters confidence. If you are well armed, you will be confident as you go off to fight the battle of the markets. Increased confidence leads to lower stress and higher profits.

### **Start with Acceptable Trading Capital**

Many investors start with less than \$10,000 in their trading accounts. However, it is important to realize that the less you have in your account, the more cautious you have to be. Perhaps the toughest problem is to establish a sufficient capital base to invest effectively. If you begin investing or trading with very little capital, you will assure yourself of failure. Making money in the markets requires a learning curve, and incurring loss is part of the trading process. When it comes to trading, "you have to pay to play." You don't need to be a millionaire, but trading does require a certain

amount of capital to get started. In many cases, the brokerage firm you choose will determine how much is required to put you in the game. However, no matter how much you begin with, it is a good idea to start out by trading conservatively. If you invest smartly, you can make very good returns and your financial goals will be realized.

### **Establish a Systematic Approach to the Markets**

The third key to successful moneymaking in the markets is to develop a systematic approach that combines all the weapons in your arsenal to compete effectively in the marketplace. Then, and only then, will you be able to reduce your stress enough to believe in the plan and stick with it. A systematic approach diffuses the inherent madness of the marketplace, allowing you to make insightful trading decisions.

### **Be Alert for Trading Opportunities at All Times**

By opening your receptivity to opportunity, you will be able to find many more promising trades than you thought possible. Where do you find opportunities? Everywhere. When you begin to train yourself to automatically look for trading opportunities in everything you do, you are on your way to being an up-and-coming successful trader.

### **Develop the Fine Art of Patience**

Patience is one of the most difficult aspects of trading and investing and extremely hard to teach. I have to work at applying patience conscientiously each and every day, even after years of trading.

As a professional trader and investor, I have the opportunity to sit in front of computers all day long, day after day. This is another double-edged sword. Yes, I have the ability to look for promising trading opportunities because I have lots of information in front of me; however, I also have the opportunity to second-guess great trades due to fluctuations in the market that may be unimportant. Therefore, I have learned that the best investments are those in which I have thoroughly studied the risk and reward and have developed a time frame for the trade to work. For example, if I place a trade with options six months out, I try to stay with the trade for that period of time. This takes patience. Of course, if I reach my maximum profit level before that time, I take that profit and get out.

Do not feel that you are at a disadvantage if you cannot trade and invest full-time. This allows you to avoid the “noise” in the market that occurs each and every trading day. Many of my successful students make more money by not watching the markets too closely.

## Build a Strong Respect for Risk

You must respect risk if you are to survive as an investor or a trader. Before you ever place an order with your broker, make sure you calculate the maximum potential risk and reward as well as the breakeven(s) of the trade. This will help you stay in the game so you can achieve your goals. Risk graphs, which are explored in later chapters, are important tools for assessing risk and reward.

## Develop a Delta Neutral Trading Approach

Delta neutral trading is composed of strategies in which a trade is created by selecting a calculated ratio of short and long positions that balance out to an overall position delta of zero. The term *delta* refers to the degree of change in an option's price in relation to changes in the price of the underlying security. The delta neutral trading approach reduces risk and maximizes the potential return. Effectively applying these strategies in your own personal trading approach generally requires four steps:

1. *Test your trading systems by paper trading.* Paper trading is the process of simulating a trade without actually putting your money on the line. To become a savvy delta neutral options trader, you will need to practice strategies by placing trades on paper rather than with cash. Although it may not feel the same as putting your money on the line, it will help you to develop practical experience that will foster confidence in your abilities. This will come in very handy in the future. Since there is no substitute for personal experience, you should test all ideas *and* your ability to implement them properly prior to using real money.
2. *Discuss opening a brokerage account with several brokers.* Make sure you have a broker who is knowledgeable and fairly priced. Brokers can be assets or liabilities. Make certain your broker is an asset who will help make you richer, not "broker." Do not sacrifice service by selecting the broker with the lowest cost. Shop around for the right person or firm to represent your interests. Your broker will play a crucial role in your development as a successful trader. Take your time, and if you are not satisfied, find someone else.
3. *Open a brokerage account.* It's best to consider a brokerage firm that specializes in stocks, futures, and options. Then you can easily place trades in any market using the same firm. When it comes to trading, flexibility and precision are equally important. Today, some online brokers specialize in options. We provide examples in later chapters.

4. *Start small.* Any mistakes you make early in your trading career will obviously cost you money. If you start with small trades in the beginning, you will be able to gain the knowledge, experience, and confidence necessary to move on to bigger trades. The bottom line is that a mistake made in a small trade means a smaller loss of capital, which can help keep you in the game.

## Reduce Your Stress Level

Successful traders have to find ways to reduce the stress commonly associated with trading. I reconstructed my trading style after experiencing more stress than I had thought I could ever handle. In a typical trading day with the S&P 500 (Standard & Poor's 500 Index, which represents the 500 largest companies in the United States), I found myself buying close to the high of the day. Immediately the market started to tumble so fast that I was down 100 points even before I got my buy filled (i.e., before my order was executed). I finally was able to regain my composure just enough to pick up the phone in a panic to sell as fast as possible. By then the market had tumbled almost 200 points. Worst of all, I had purchased too many contracts for the money I had in my account; and, to top it all off, it was my first trade ever in the S&P.

That was the point in my trading career that I experienced the panic and stress of losing more than 40 percent of my account in three minutes—more than one month's pay as an accountant. I did not trade again for more than two months while I tried to figure out whether I could really do this for a living. Luckily, I did start trading again; however, I reduced my trading size to one contract position at a time for more than a year.

Many professional floor traders and off-floor traders have had similar experiences. However, these kinds of stressful events must be overcome and used as lessons that needed to be learned. Simply put, stress produces incomplete knowledge access. Stress, by its nature, causes humans to become tense in not only their physical being but also their mental state. For years, physicians have made the public aware that stress can lead to many illnesses including hardening of the arteries with the possibility of a heart attack or other ailments. Reducing stress can lead to bigger rewards and can be accomplished by building a low-stress trading plan.

To create your own plan, follow this three-point outline:

1. Define your risk.
2. Develop a flexible investment plan.
3. Build your knowledge base systematically.