

# Trading Foundation

The First Class



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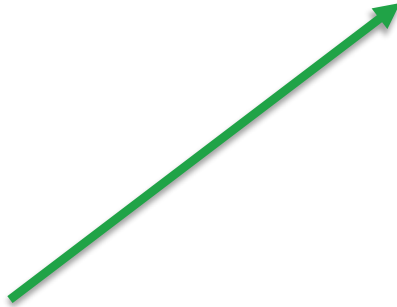
# Agenda

- Security Analysis
- Option Theory and Pricing
- Option Strategies
- Risk Management
- Practical Application and Lab

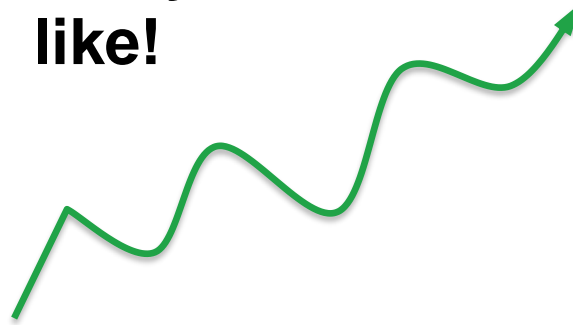
# Investment Foundation

## What is Success?

**Perception  
of success**



**What success  
really looks  
like!**



**Long Term – Retirement and Slow Growth Strategies**  
**Moderate Approach – Growth Strategies**  
**Short Term approach – Aggressive or Swing Strategies**

# Security Analysis

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- Fundamental Analysis
  - Quantifiable
  - Non-Quantifiable
- Technical Analysis
  - Price
  - Time
  - Indicators



# Fundamental Analysis

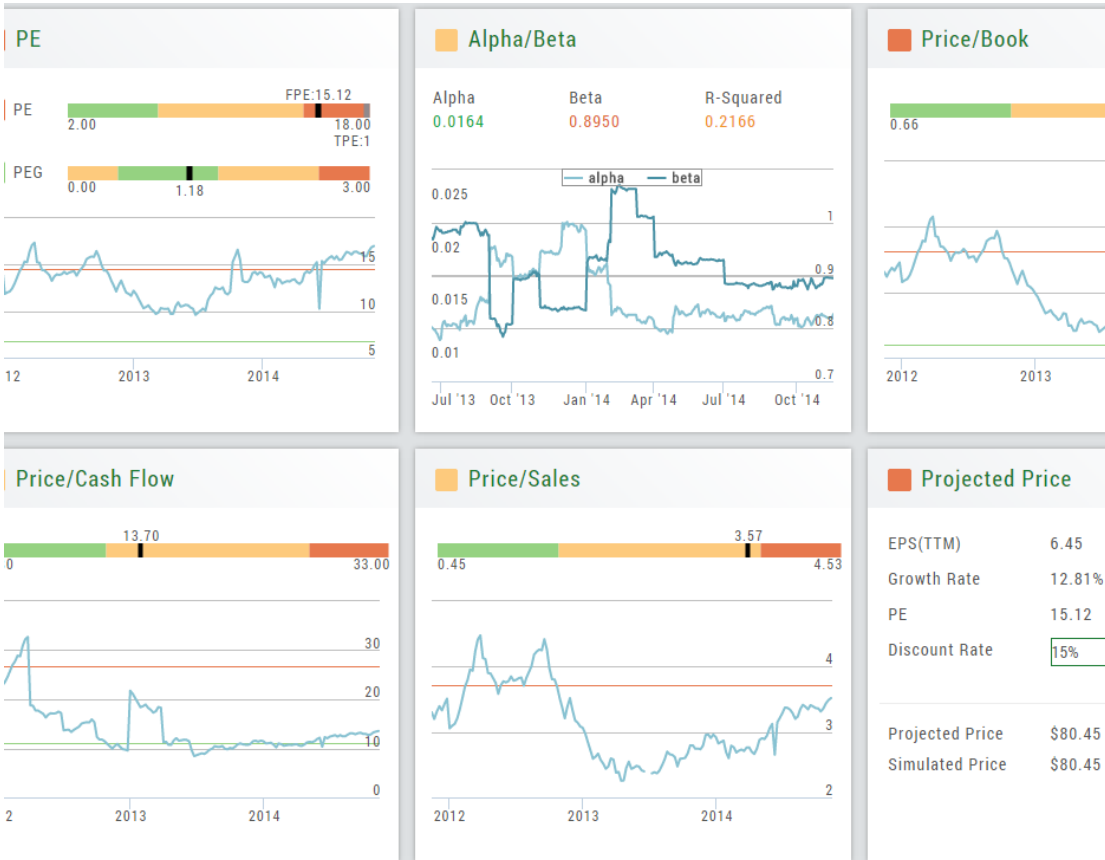


- Quantifiable
  - Ratios
  - Dollar Figures
- Non-Quantifiable
  - Management Team
  - Market Outlook



- Growth
- Profitability
- Viability

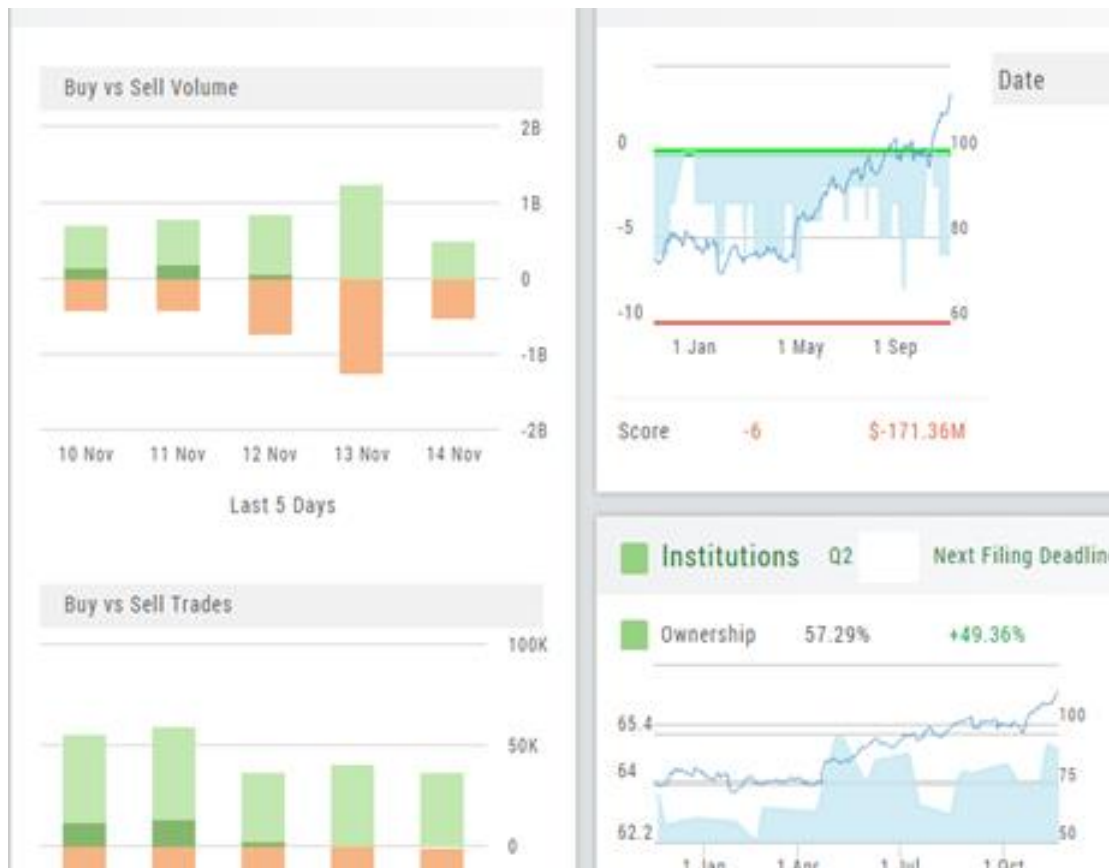
# Fundamentals



- Ratios
- Projections

# Valuation





# Inner Circle

- Money Flow
- Buy vs Sell
- Filings
- Institutions



## Technical Analysis

- Price forecasts based on patterns
- Visual indication of supply and demand
- Focus on “what” rather than “why”

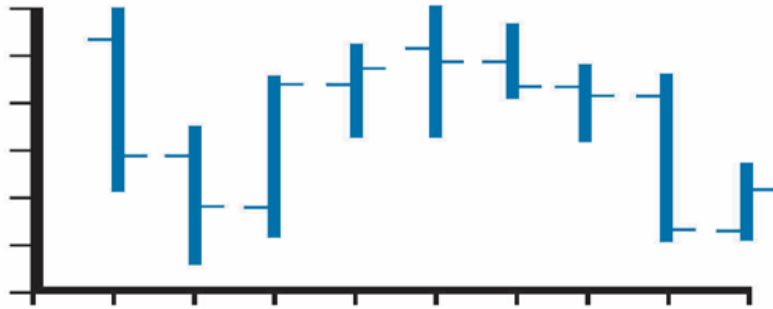


- Chart Styles
- Trend
- Support/Resistance
- Indicators
- Chart Patterns

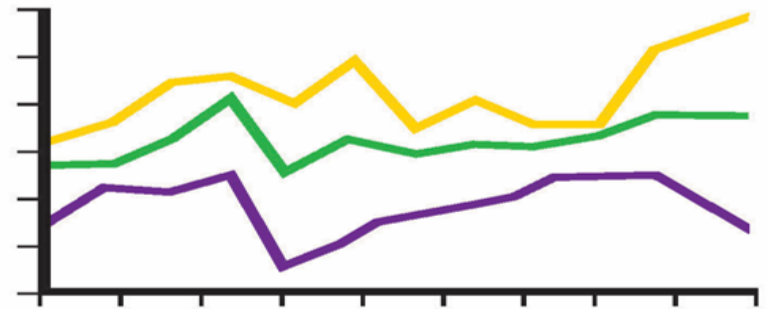
# Technical Analysis

# Investment Foundation

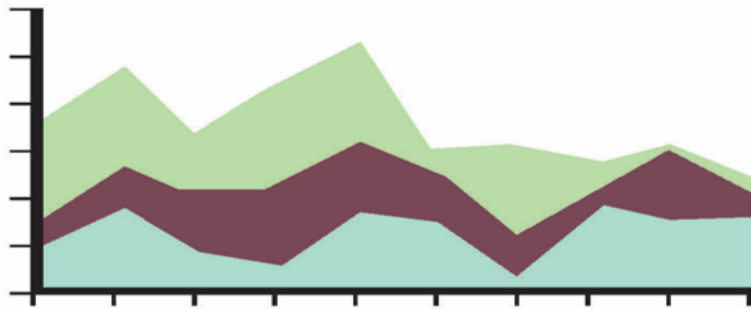
## What are Charts?



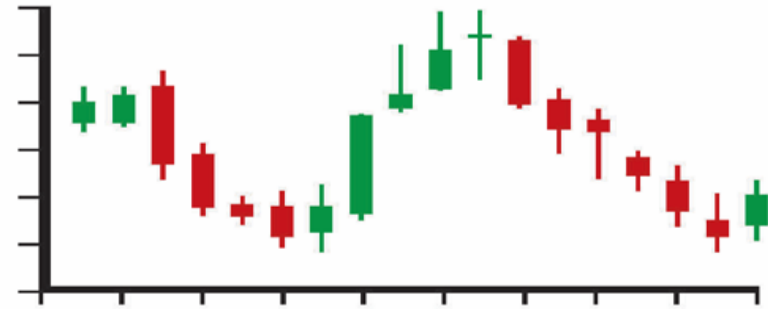
Bar Charts



Line Charts



Area Charts



Candlestick Charts

## Support and Resistance

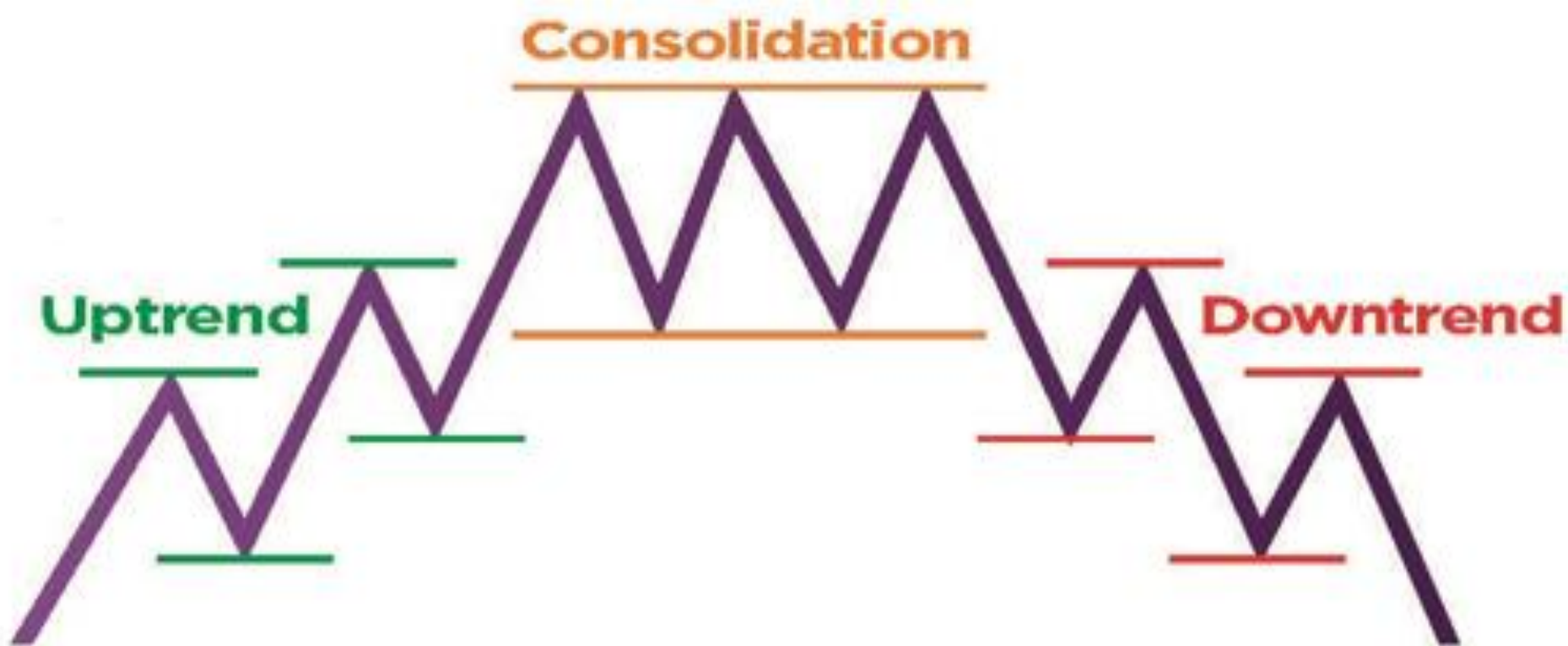
» Stock can move:

1. Up
2. Down
3. Sideways

» Near major levels of support and resistance

# Technical Analysis

Identifying trends



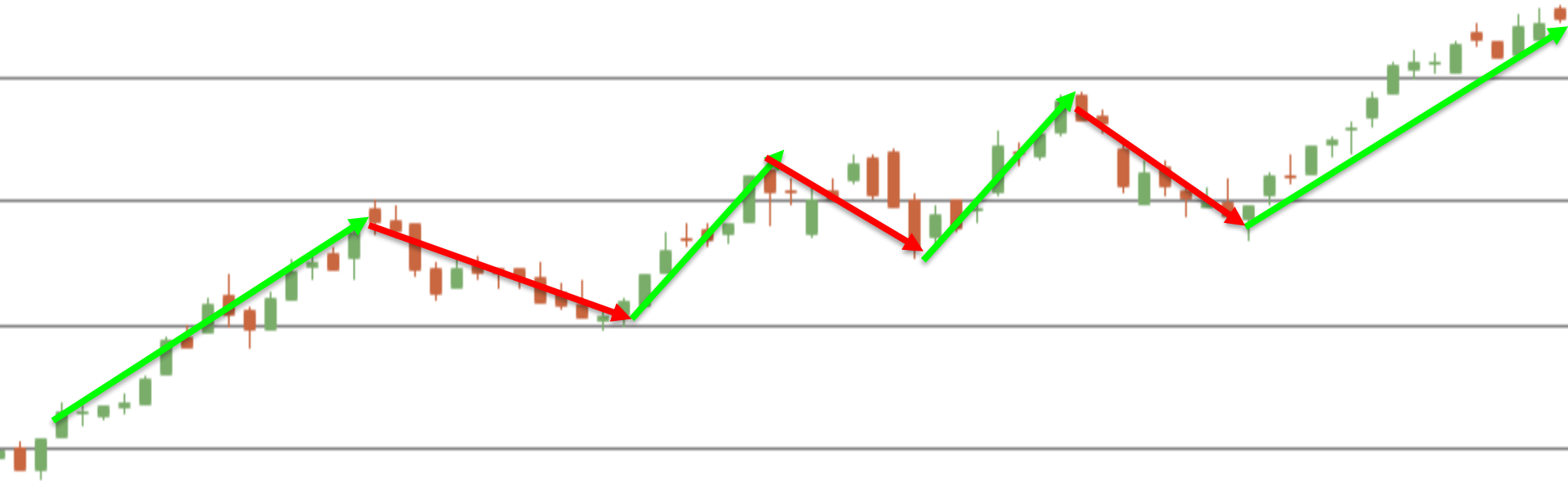
**Uptrend** – Higher highs and High Lows

**Downtrend** – Lower highs and lower lows

**Consolidation** – Lack of a trend

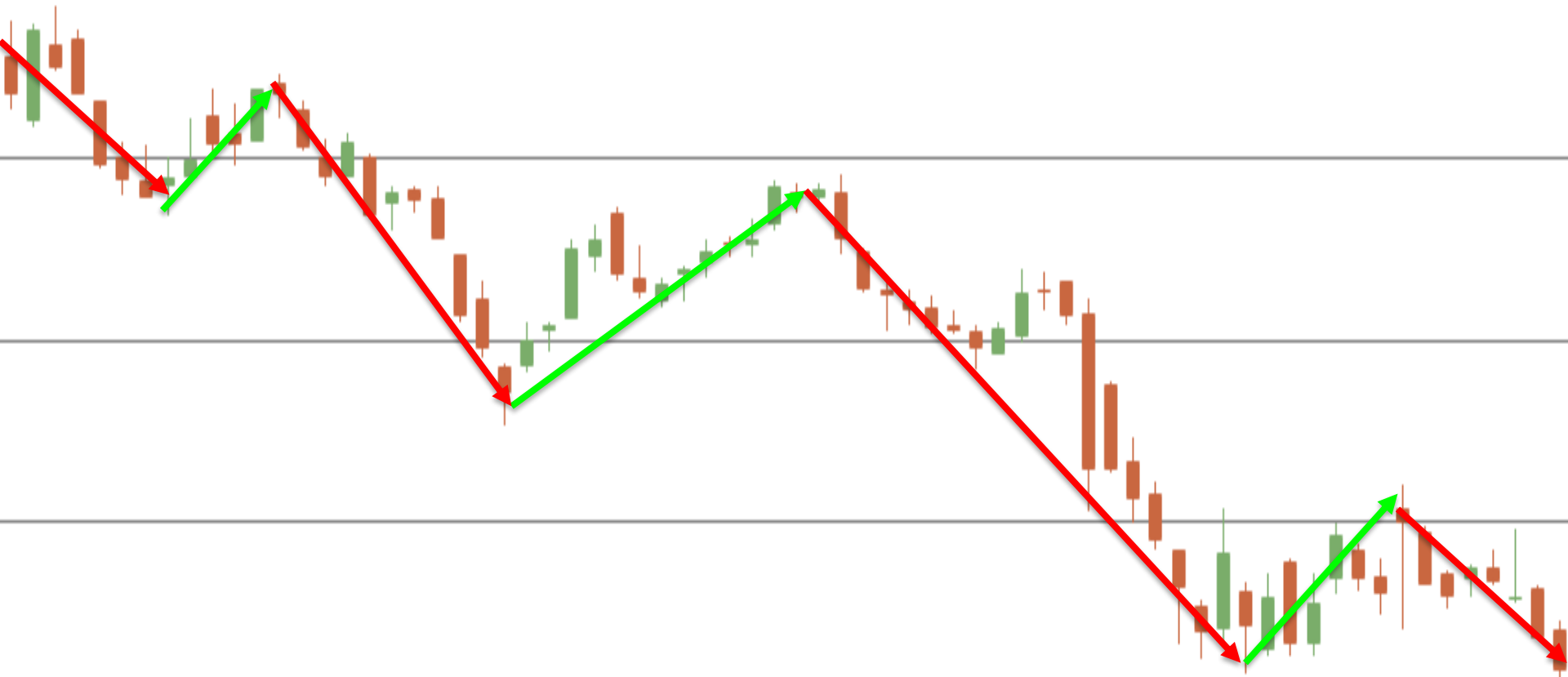
# Technical Analysis

Identifying trends



# Technical Analysis

Identifying trends





# Technical Analysis

Identify major levels of resistance





# Technical Analysis

Identify major levels of support



# Technical Analysis

Resistance followed by support

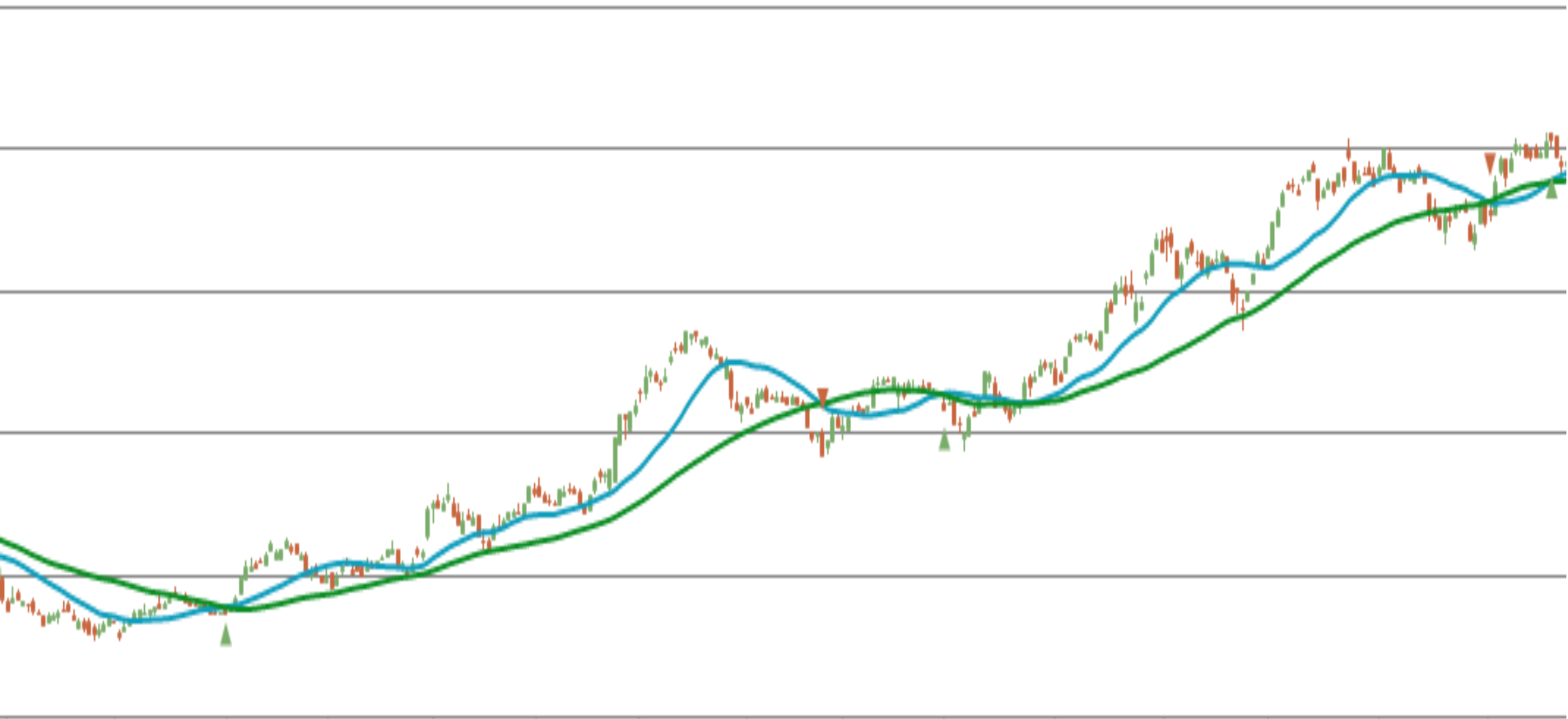


# Technical Analysis

Support followed by resistance



# Technical Analysis



# Technical Analysis

## Linear Regression Channels



# Technical Analysis

## ➤ Chart Patterns

➤ A series of support and resistance points that forecast a movement

## ➤ A Chart Pattern has two functions

➤ Trend Confirmation

➤ Trend Reversal

# Double Top



# Double Bottom

O: 52.07 H: 52.35 L: 50.80 C: 50.96





# Symmetrical Triangle



# Descending Triangle

(Bearish Breakdown)



# Ascending Triangle

(Bullish Breakout)



# Option Principles



- Basic Contractual Obligations
- Risk vs Reward
- Option Lingo
- Pricing Model
- Greeks

# Option Principles

- What is an Option?
  - A Contract
    - Buyer
    - Seller
- Buyers Have Rights
- Sellers Have Obligations



# Option Principles

	Right (Buyer)	Obligation (Seller)
Call	 Buy the stock	Sell the stock
Put	 Sell the stock	Buy the stock

# Option Principles

➤ Buy a Call

Limited Risk

Unlimited  
Reward

➤ Sell a Call

Limited  
Reward

Unlimited  
Risk

➤ Buy a Put

Limited  
Reward

Limited Risk

➤ Sell a Put

Limited Risk

Limited  
Reward



Stock Price



# Option Principles

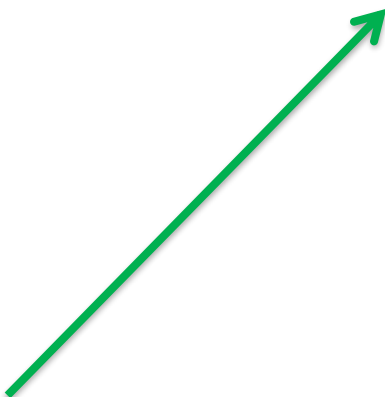
- Option Lingo
  - Strike Price
  - Expiration
  - Contract Size
  - Long
  - Short
  - Bid
  - Ask
  - ITM/ATM/OTM



# Long

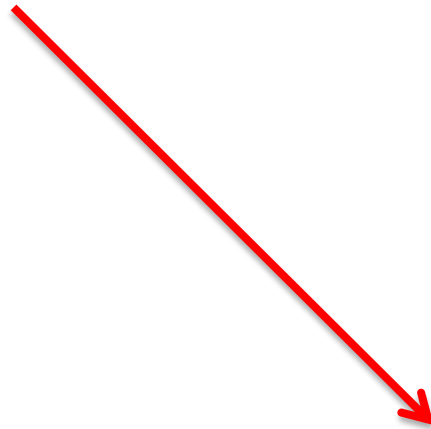
Sell to Close \$10

Buy to Open \$5



# Short

Sell to Open \$10



Buy to Close \$5

# Option Principles

## Intrinsic Value

- Real value
- In the money options (ITM) options have intrinsic value

## Extrinsic Value

- Time value
- Extrinsic value will drop to zero at expiration

# Option Principles

Option Price = Intrinsic Value + Extrinsic Value

# Option Principles

## Intrinsic Value

- Stock Price = \$50
- Call Strike = \$45
- Intrinsic Value = \$5

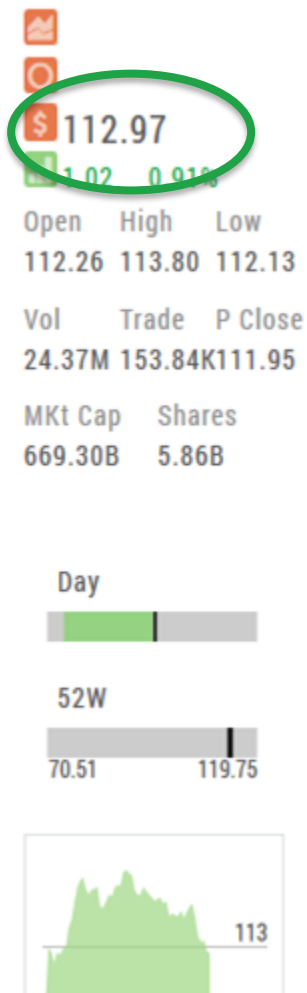
## Intrinsic Value

- Stock Price = \$50
- Call Strike = \$55
- Intrinsic Value = \$0

# Option Principles

## Extrinsic Value

- Stock Price = \$50
- Call Strike = \$45
- Intrinsic Value = \$5
- Call Cost = \$7
- Extrinsic Value = \$2



Call+Put

Strike-Near

1X

stk qty

Feb 16

Mar 16

Apr 16

May 16

Jun 16

Jul 16

Sep 16

Dec 16

Jan 17

Mar 17

Calls

Puts

\$

V

G

T

	Bid	Ask	Volume	OI		Strike		Bid	Ask	Volume	OI
▶	6.90	7.10	111	804		106.00		0.01	0.02	2,422	7,336
▶	5.95	6.05	84	1,092		107.00		0.02	0.03	1,668	7,170
▶	4.95	5.05	263	1,498		108.00		0.02	0.04	1,698	8,146
▶	4.00	4.05	1,645	1,503		109.00		0.03	0.04	3,329	10,005
▶	3.00	3.10	2,438	4,915		110.00		0.06	0.08	5,226	18,234
▶	2.09	2.14	6,217	4,790		111.00		0.14	0.15	6,809	15,522
▶	1.28	1.31	3,349	10,373		112.00		0.32	0.34	9,744	18,564
▶	0.66	0.67	19,907	14,709		113.00		0.68	0.71	13,402	12,048
▶	0.25	0.26	21,615	17,171		114.00		1.27	1.30	6,587	9,269

Price = Intrinsic Value + Extrinsic Value

$$\$1.31 = \$0.97 + \$0.34$$

# Option Principles

## 6 Inputs to an options pricing model

1. Stock price
2. Strike price
3. Volatility
4. Expiration
5. Interest rates
6. Dividends



# Option Principles

## The Five Greeks

1. Delta – Rate of Change, Price Sensitivity
2. Gamma – Rate of Change of delta
3. Theta – Time Decay
4. Vega – Sensitivity to Volatility
5. Rho – Sensitivity to Interest Rates

# Option Principles

## Delta



The rate of change of the option value for the next \$1 move in the underlying security

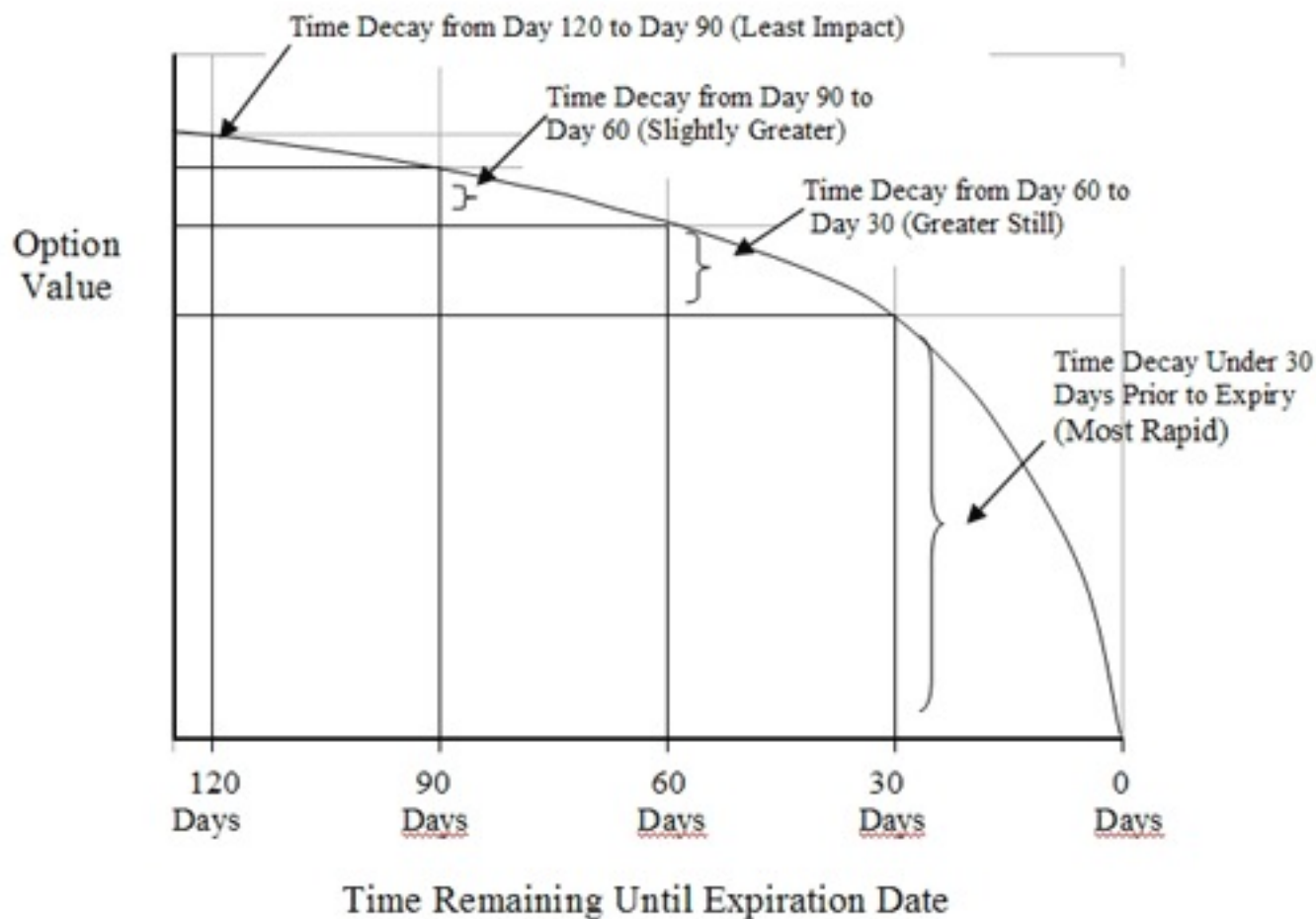
# Option Principles

## Theta



The amount by which the option value changes after one day of time

# Theta – Time Decay



# Option Strategies

- Long Options
- Vertical Debit Spreads
- Vertical Credit Spreads
- Iron Condor Credit Spread
- Practical Application

*Selecting the correct strategies will directly affect your ability to succeed.*

# Option Strategies

Go through the following four steps for every trade.

1. Select Stock
2. Build the strategy
3. Calculate the risk
4. Calculate the reward

# Option Strategies

## ➤ Long Options (Buy)

1. Extremely Directional

2. Build the Strategy

### ➤ Construction Rules

➤ Delta 80-85, Time as Needed

### ➤ Exit Rules

➤ 50% loss, Take Profit at 75%

### ➤ Alternative Profit Rules

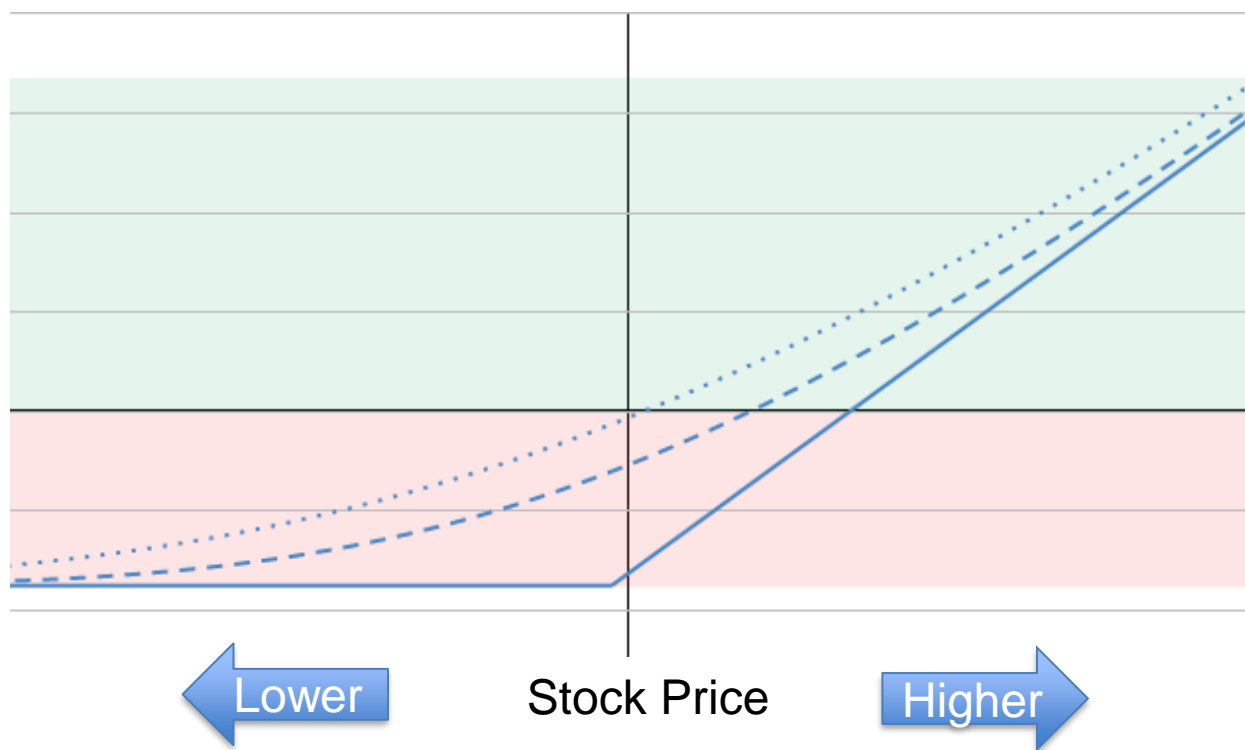
➤ Roll or Exit at delta 90-95

3. Max Loss = Option Cost

4. Max Profit = Unlimited for Calls, Limited for Puts

# Risk vs Reward

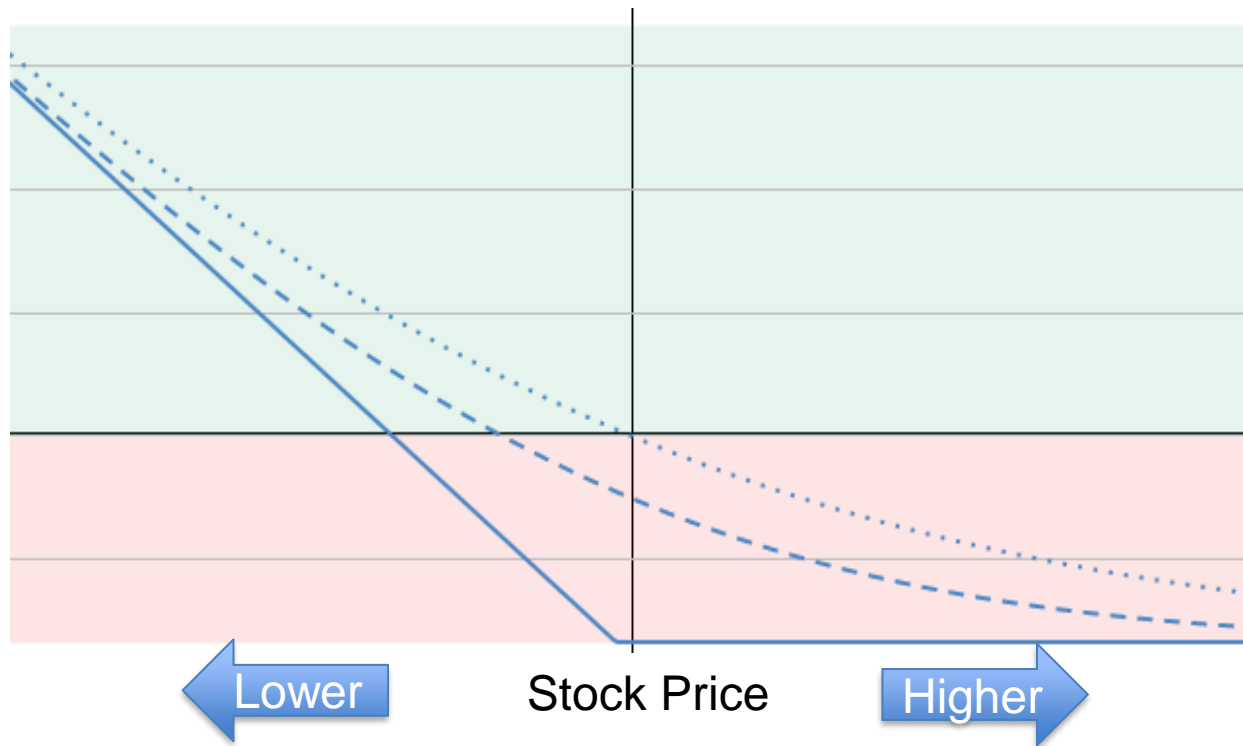
- Long Call
  - Limited Risk
  - Unlimited Reward





# Risk vs Reward

- Long Put
  - Limited Risk
  - Limited Reward



# Option Strategies

## ➤ Bullish Vertical Spreads

1. Mildly Bullish or Neutral
2. Build the Strategy

### ➤ Entry Rules

- Sell the Strike You Expect the Stock to be Above at Expiration
- Buy a Lower Strike

### ➤ Exit Rules

- 50% loss, Exit for Profit at 50% of Max Profit

# Option Strategies

## ➤ Bullish Vertical Spreads

### 3. Max Loss

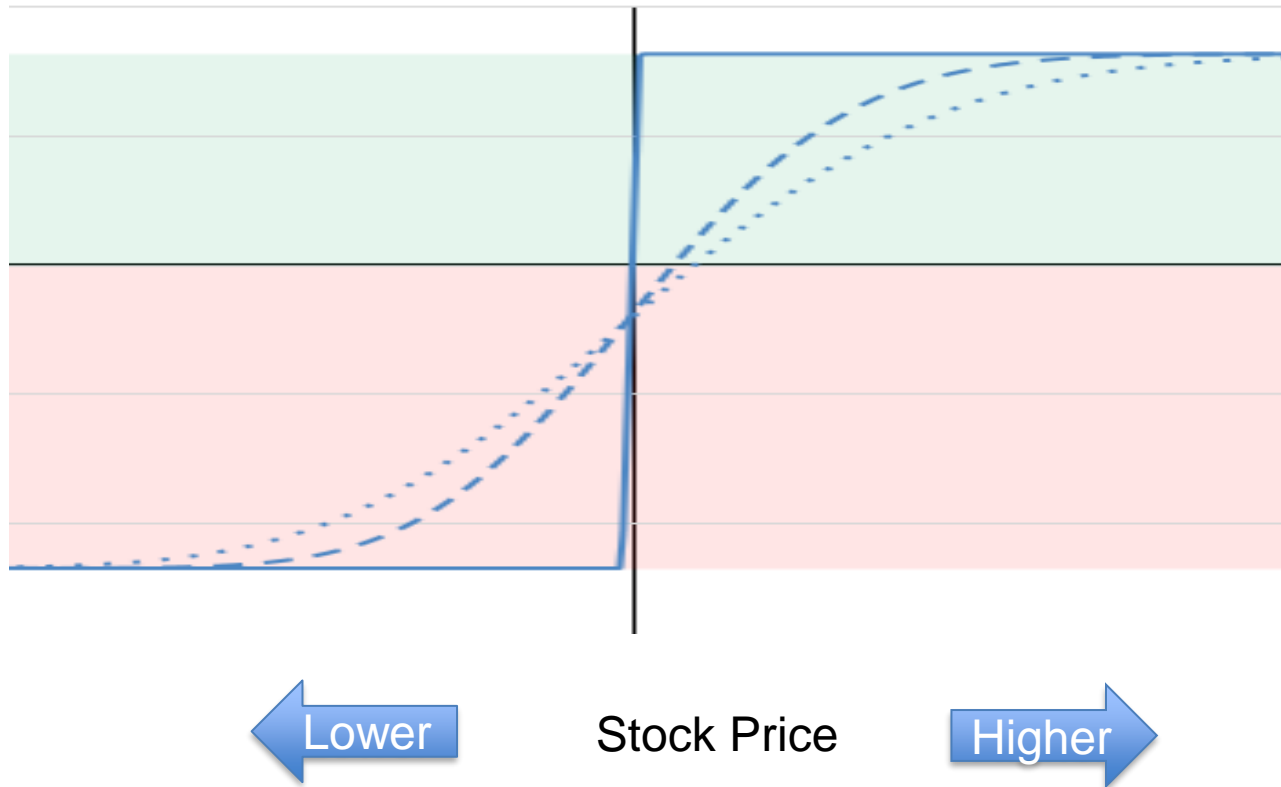
- Max Loss for Debit Spread = Net Debit
- Max Loss for Credit Spread = Spread - Credit

### 4. Max Gain

- Max Gain for Debit Spread = Spread - Debit
- Max Gain for Credit Spread = Credit

# Risk vs Reward

- Bullish Vertical
  - Limited Risk
  - Limited Reward



# Bull Call Spread



- Maximum Loss = \$3
- Maximum Gain = \$2

# Bull Put Spread



- Maximum Loss = \$3
- Maximum Gain = \$2

# Option Strategies

## ➤ Bearish Vertical Spreads

1. Mildly Bearish or Neutral

2. Build the Strategy

### ➤ Entry Rules

➤ Sell the Strike You Expect the Stock to be Below at Expiration

➤ Buy a Higher Strike

### ➤ Exit Rules

➤ 50% loss, Exit for Profit at 80-90% of Max Profit

# Option Strategies

## ➤ Bearish Vertical Spreads

### 3. Max Loss

- Max Loss for Debit Spread = Net Debit
- Max Loss for Credit Spread = Spread - Credit

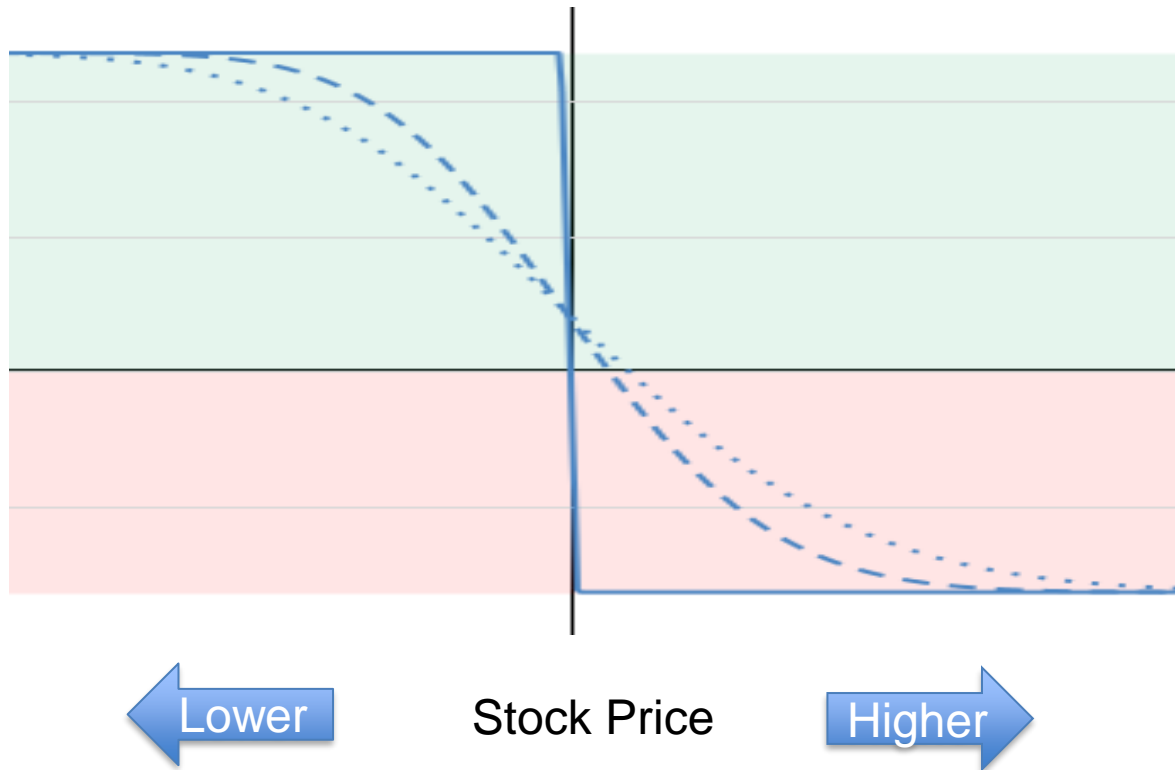
### 4. Max Gain

- Max Gain for Debit Spread = Spread - Debit
- Max Gain for Credit Spread = Credit



# Risk vs Reward

- Bearish Vertical
  - Limited Risk
  - Limited Reward



# Bear Put Spread



- Maximum Loss = \$3
- Maximum Gain = \$2

# Bear Call Spread



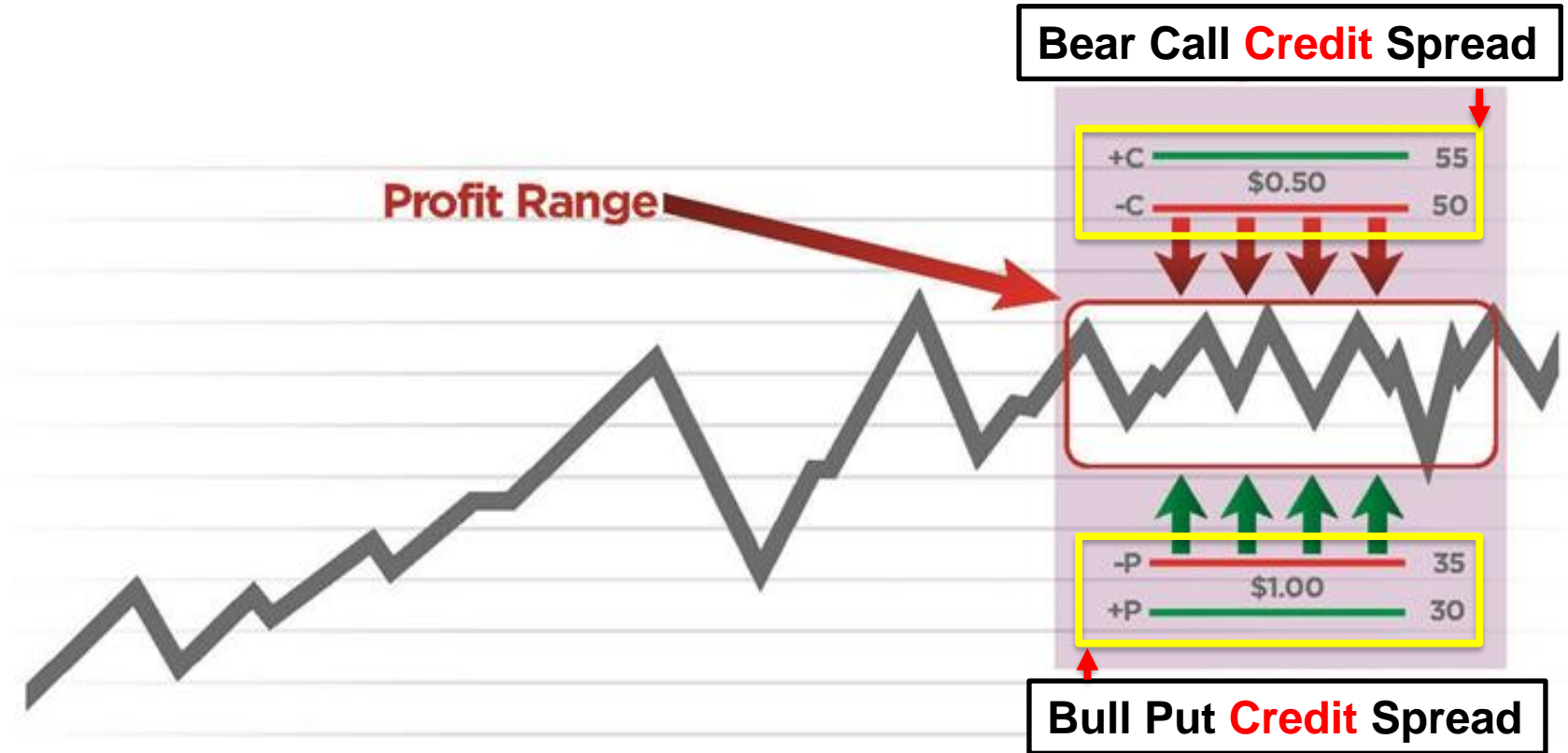
- Maximum Loss = \$3
- Maximum Gain = \$2

# Option Strategies

## ➤ Iron Condor

1. Neutral Outlook
2. Combine the Bull Put and Bear Call Spreads on the Same Underlying
3.  $\text{Max Loss} = \text{Spread} - \text{Credit}$
4.  $\text{Max Gain} = \text{Credit}$

# Iron Condor Credit Spread



# Rights and Obligations

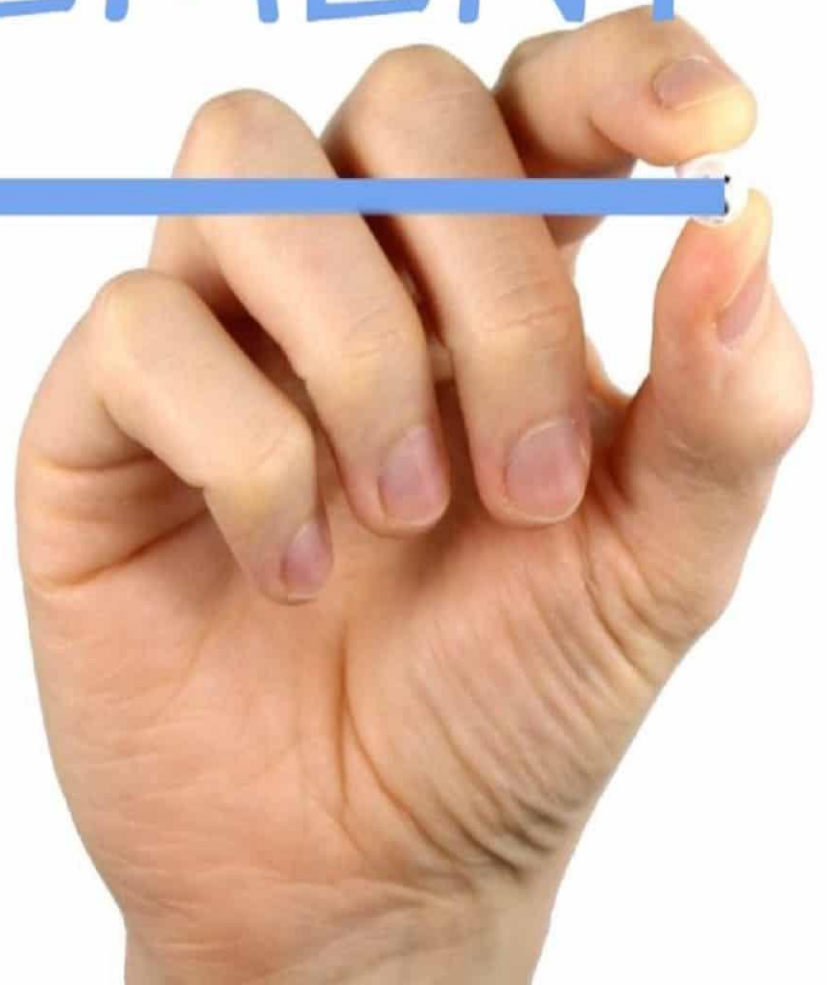
Options that are ITM at expiration will be exercised!!!



# RISK MANAGEMENT

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- Have a plan
- Know what type of trader you are
- Understand and follow analysis rules
- Understand and follow risk rules



# Risk Management

- Risk Rules

- Rule #1 – Position Risk

- How much risk per trade?

- Rule #2 – Portfolio Heat

- How much total risk at once?





# Risk Management

## ➤ Example

### ➤ \$10,000 Account

➤ Rule #1 – 2%

➤ Rule #2 – 10%

### ➤ Maximum Position Size

➤ \$200

### ➤ Maximum Portfolio Heat

➤ \$1,000



# Action Items

- Monitor Account
  - Monitor and adjust paper trades
  - Place paper trades using all the strategies
  - Use the Resource Line
- Solidify Risk Rules
  - Test variations to find your comfort level