THE

OPTIONS CASH FLOW

BLUEPRINT

MY FAVORITE STRATEGIES TO GENERATE CONSISTENT INCOME IN JUST 2 HOURS A WEEK

OPTIONS WITH HANS

Contents

Introduction

Welcome to the Options Selling Blueprint!

I'm thrilled to have you here. As a professional options trader with nearly three decades of professional options trading experience—having managed $1 billion in options strategies as both a fund manager and pro options market maker—I can assure you that you're stepping into one of the most exciting and potentially rewarding areas of trading.

By joining us, you are taking an important step into the world of income trading. When approached with the right mindset and strategy, options selling can be both enlightening and highly profitable. The key to long term success lies in mastering risk management—balancing both offense and defense while staying attuned to market sentiment and individual stock behavior.

Throughout this book, I'll provide you with exclusive videos and bonuses packed with insights and techniques not found elsewhere. Additionally, at the end of the main book, you'll gain access to the first lesson of my Option Volatility Ninja series, where I break down how professionals analyze and navigate options pricing. This knowledge will give you an edge—a critical factor in achieving consistent success.

Finding that edge is at the core of everything I do. Simply repeating the same strategies regardless of market conditions is a recipe for mediocrity. While luck plays a role in any endeavor, true and lasting success comes from a combination of hard work, skill development, and expert guidance. As the legendary golfer Lee Trevino once said, "The more I practice, the luckier I get."

The same holds true in trading—with proper preparation, disciplined execution, and deep respect for the markets and sentiment, favorable outcomes become more than just chance; they become the expectation.

So, let's get started - happy learning, and welcome to the journey!

Hans Albrecht

Hans Albrecht

Hans Albrecht CEO

Cash Flow Insiders

5 Week Full Small Group Mentoring for Those With $500K or more. 5 Pillars of Edge – with Rules and Guardrails for Success.

Options with Hans

Full 12-month mentoring program for those who want to truly Master Options, income strategies, hedging, getting paid to buy stock lower, advanced trading, Gamma, knowing what stocks to invest in with options - the most comprehensive options program available anywhere

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Income Focused Approach Combined with 2-day Live Learning with Hans

Gamma Capital Advisors

RIA and Wealth Manager Option Overlay Solutions

Income, Hedging: *Options are Big Business - email support to discuss your wealth firm's needs:* ***hans@gammacapitaladvisors.com***

About Hans Albrecht

- 28 years professional options management experience
- 12 years professional options market maker
- 10 years managing 10 option-based ETFs for investors around the world – Options Selling and Black Swan protect
- Ivy League MBA
- $1 Billion in options strategies managed
- $750 Million in option cash flow generated for members and investors
- Regular on business television: *TD, Nasdaq, Bloomberg*
- Quoted in and written for over 100 articles in Investors Digest, Bloomberg, Advisor, Nasdaq, Wealth Professional, Globe&Mail, Financial Post, MX Exchange, many more
- Author of Let's Talk About Volatility, Crush the Premium, Volatility Ninja, and CFI Boot Camp

Hans in the Media

As Seen On

BNN Bloomberg

TD Ameritrade NETWORK

THE GLOBE AND MAIL

Nasdaq TradeTalks WITH JILL MALANDRINO

WP WEALTH PROFESSIONAL

ADVISOR'S EDGE

THE ALL-STARS OF OPTIONS TRADING

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Why investors shouldn't be reading too much into the 'fear index'

Pessimists see the decline of the VIX and disappearance of volatility as evidence of investor complacency – a dangerous precursor to many of history's most severe corrections.

But while an underappreciation of the market's risks is a legitimate concern, many investors are putting too much stock in the VIX index, said Hans Albrecht, a portfolio manager and options strategist at Horizons ETFs Management Canada Inc.

The market is calm because economic conditions largely justify calm, Mr. Albrecht said. And the VIX can remain subdued for very long periods of time.

"You can miss out on a lot of upside when you stare on the VIX and say, 'The market's missing something.'"

Mathematically, the VIX index is a reflection of what options prices on the S&P 500 index suggests is in store for market volatility over the next 30 days.

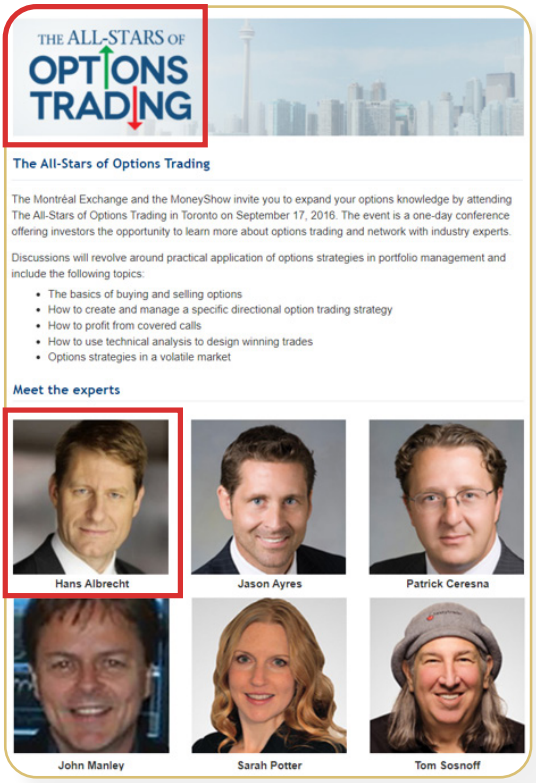
But in practice, it says more about the market's current mood than future conditions.

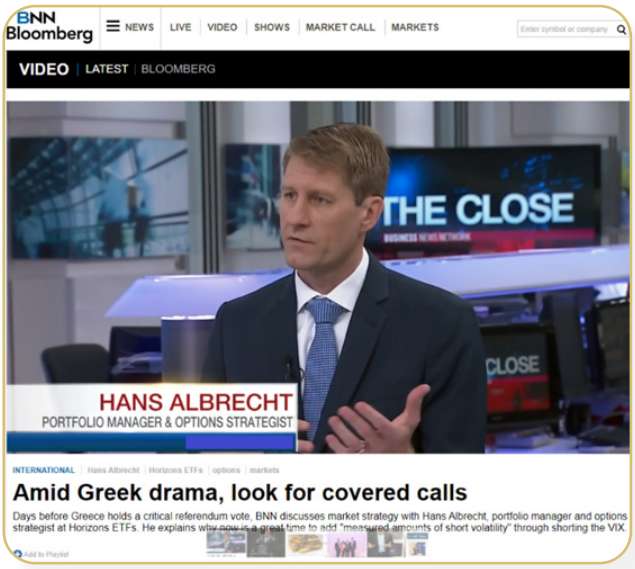
"The VIX tells us almost nothing beyond how much markets have been bouncing around lately," prominent U.S. hedge-fund manager Cliff Asness said in a recent blog post, titled Please Stop Talking About the VIX So Much.

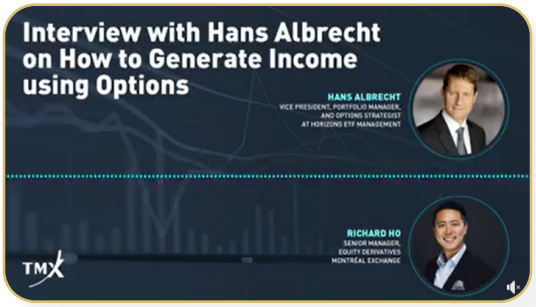
Pessimists see the decline of the VIX and disappearance of volatility as evidence of investor complacency – a dangerous precursor to many of history's most severe corrections.

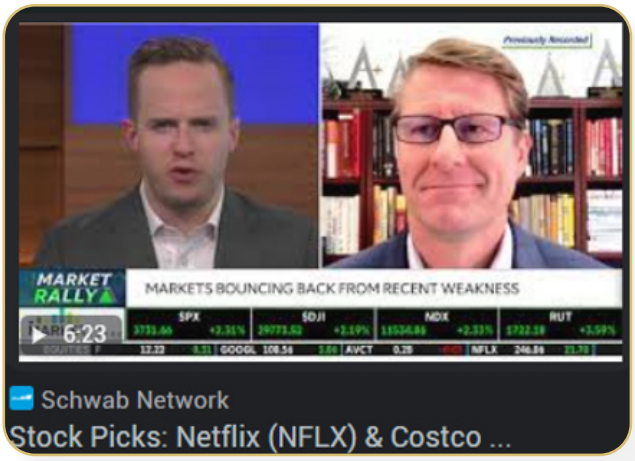
BRIAN JACKSON

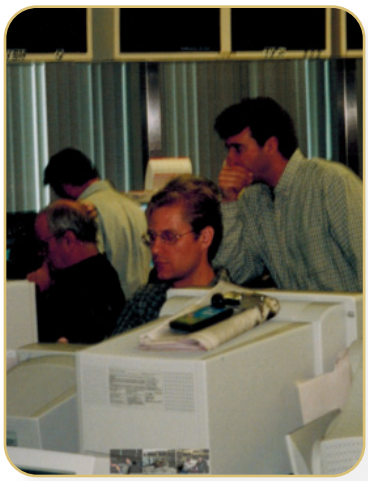
TIM SHUFELT » INVESTMENT REPORTER

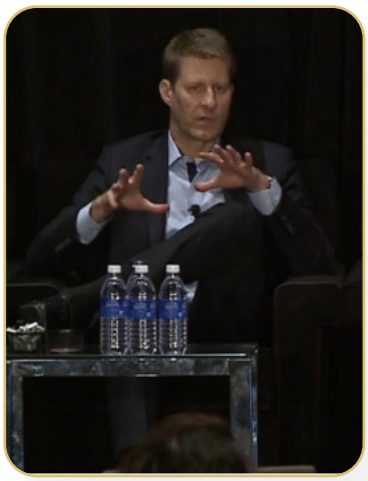












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Chapter #1

First things first. By its simplest definition, what is an option?

An option is a contract to buy or sell an underlying asset.
Establishes a strike price and an expiration date that are unchangeable in the contract.

An option is a contract to buy or sell an underlying asset. So, the contract is a specific and detailed sales agreement that you have with a counterparty (the person on the other side of the trade). It establishes a strike price as well as an expiration date. And because options have a kind of a language of their own, as we go through the concepts, we're going to be defining some of the terms. Learning options is a bit like learning another language and my goal is for you is to really learn how to speak options fluently!

We'll start with the strike price. The strike price is a predetermined price at which the contract may be acted upon. So, in other words, it's a specific price at which the underlying asset can be bought or sold, and this is established within the contract. It does not change.

The expiration date establishes the timeframe in which the option may be exercised. Remember, options they have a limited lifespan and are an eroding asset, or at least a small portion that is eroding. That lifespan can be very short, ie 0 days, and it can be very long, even measured in years.

But it is finite. Eventually that option's life will come to an end, and the expiration date is going to tell us exactly when that happens.

This date is pre-established for any given listed option – it does not change. On the expiration date, the obligation, if any, plays out and the option no longer has any kind of value. It may expire worthless, or it may expire with intrinsic value. It will no longer have any time value. We will discuss intrinsic and extrinsic value (time value) shortly.

When it comes to the underlying asset in this course, we're generally going be talking about equity options where the underlying asset is a listed stock, or maybe an ETF, which is an "exchange traded fund" or similar type of product like an ETN, or "exchange traded note."

ETFs can be thought of as holding wrappers for a single or basket of underlying assets. Like a mutual fund but generally much more cost effective, transparent, liquid throughout the trading day, and with a lower annual management fee. An ETF can be based on a precious metal, for example, or a bond portfolio, or even Bitcoin – it can be all sorts of things these days. The incredible proliferation of ETPs, or "exchange traded products" (ETFs, ETNs) in the last 10-15 years in particular, has given us the ability to generate accessible exposure to many asset classes.

The Multiplier:

One standard option contract represents 100 shares of that underlying asset.

An option is a contract to buy or sell an underlying asset.

100 shares of a listed equity product: ETF, stock or similar product

This is very, very important. In almost all cases for us, it will be 100 shares, which we call a multiplier. One contract = 100 shares. And as we'll see later, the multiplier will have an important impact on the capital we can allocate to option selling strategies. Sneak preview: to execute a sale of ONE put contract we will need to have enough cash set aside to cover 100 shares of the underlying stock.

Now, there are two kinds of options, calls and puts, and you can buy or sell either type based on what you hope to achieve as an investor.

Buyers have the RIGHT, Sellers have an OBLIGATION

Call and Put Behavior

	CALLS	PUTS
BUY	Right to Buy	Right to Sell
SELL	Obligation to Sell	Obligation to Buy

When you buy a call, you have the right to buy the underlying asset. And when you buy a put, you have the right to sell shares of the underlying asset. So very importantly here, we're going to be talking a lot about right versus obligation. So, when you buy a call, you have the right to buy the underlying asset at a certain price, which is our strike price, up to a given expiry date.

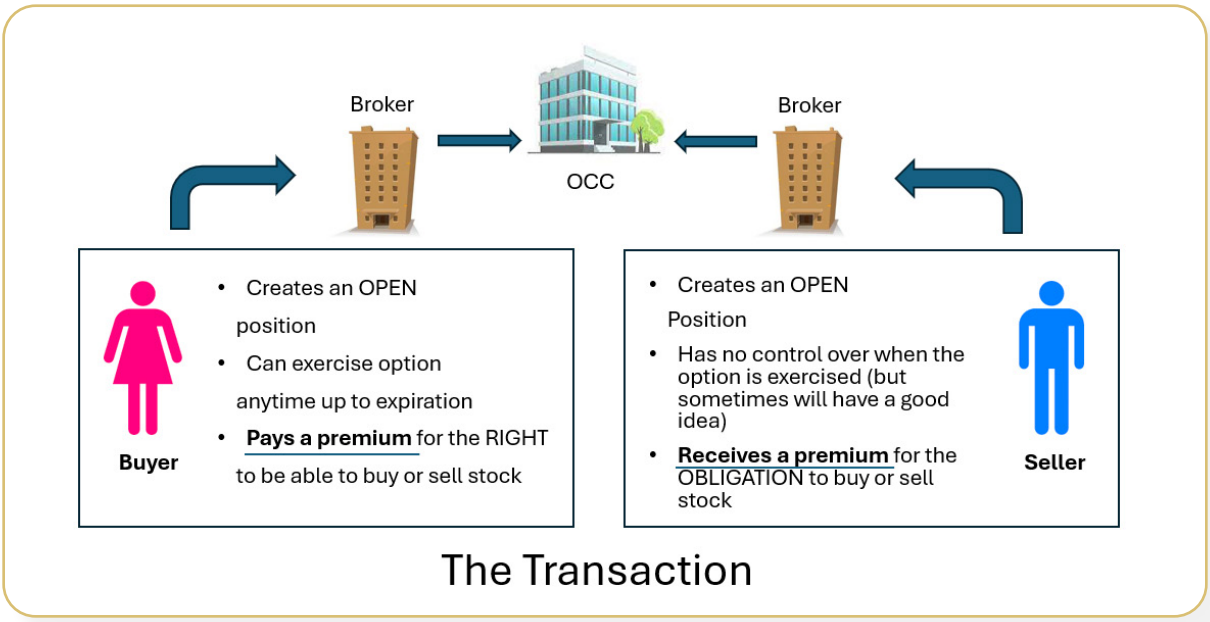
When you buy a put, you have the right to sell shares of the underlying asset at a certain price, which is dictated by the strike price, up to and including the close of the expiry. Standard expiry is the 3rd Friday of each Month, unless a holiday falls on that date – in this case the Thursday previous will stand as the expiration date.

In the last decade weekly expiries have proliferated so that every Friday is now an expiry date for many stocks. And more recently, 0DTE, or "Zero Days to Expiration" options have become very popular to say the least. 0DTE options now account for a greater than 50% share of daily option volumes! In other words, for mostly index options every day is expiry day.

The moneyness of the options on expiry, meaning whether they are ultimately in the money or out of the money at the end of their lifecycle, is generally set at the closing price at 4pm ET for most stocks and ETFs.

What if news comes out after 4pm? Depending on the brokerage you're using, and depending on the platform, you could have until say 5 or 5:30 pm ET on the day of expiry to exercise your options manually if need be. As a market maker I had to do this on a regular basis following market moving news, such as earnings events. You may also manually cancel an exercise that would otherwise auto-exercise at 4pm. Auto-exercise occurs when the option "settles" at least 0.01 in the money.

Let's take a look at the graphic below. On the one end of the spectrum, we have buyers. On the other end we have sellers. It is imperative that you understand that option buyers have rights, and option sellers have obligations. So, when you sell a call, you are obligated to sell shares of the underlying asset. The decision-making process is in the hands of the party that has purchased and gone "long" the option – the counterparty. And when you sell a put, you are obligated to buy shares. Again, the decision is in the hands of the holder of the put option.



The Transaction

So, if on one side, you have a buyer, and on the other side, you have a seller for a given transaction, you may assume that those two parties are going to have an agreement and are tied together personally - that's actually not the case. The two parties actually never interact. In listed markets, these processes play out more or less anonymously. Each party works directly with their brokerage firm to either buy or sell options, and then the brokerage firm sends the trades to an organization called the Option Clearing Corporation. We call that entity the OCC, a very important facilitator entity for options trades.

It's actually the OCC that buys from the seller and then sells to the buyer. The OCC, effectively, is acting as an intermediary, which is good because they're going to keep people honest. They're going to make sure that all obligations are fulfilled even in very, very volatile situations, as we saw during the financial crisis, when there was a lot of talk of counterparty risk. In those days there was a genuine fear that people would not honor contracts of all kinds - option contracts, and various other derivatives type contracts that played an intimate role in those historically chaotic times for financial markets.

The OCC, and Federal Reserve via liquidity, made sure that all these contracts were made whole. This was as good a test as we could have hoped for, as all obligations were fulfilled. So, having that neutral third party really allows either the buyer or the seller to trade in and out of a position on a listed and transparent market without involving the other party at all. Let's look at what each party is actually doing.

When someone with no existing position buys an option contract, they are establishing what's called an "open position". You're going to see that term used again later. But for now, you just must understand that option contracts can be either opened or closed. A new contract is opened, and an existing one is closed when desired. The option buyer has the right to exercise the option at any time before and up to its expiration.

In almost all cases, we're going to be trading something called American options. European options are a little bit different. They tend to be cash settled, and can only be exercised, or settled, on expiry. They settle into cash as opposed to an underlying stock position. But in 99.5% of cases, we are going to be trading American options on listed exchanges.

And so, it's important for us to know that the option buyer has the right to exercise that option anytime before its expiration, up to and including expiration.

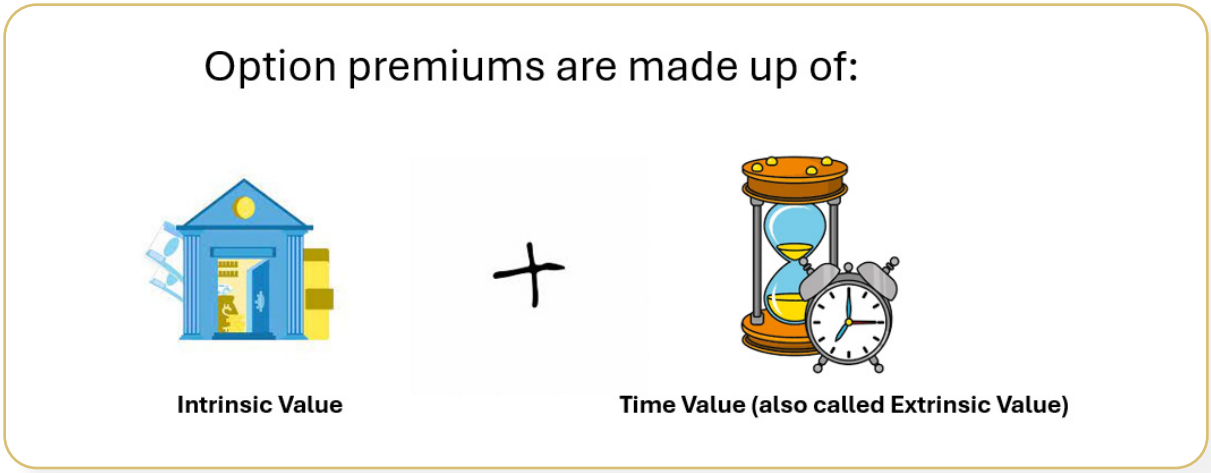
We're going to talk a little bit more in-depth in another lesson about ex-dividend dates and how we need to be very aware of certain days, when it comes to this concept of expiration and assignment. We need to know those dates if we want to be involved in this kind of business, particularly in Crush the Premium Cash-Machine type trades.

So, depending on whether the option buyer buys a call or a put, he or she can exercise that right to buy or sell shares anytime he wants up until the option expires. And for this right, he or she will pay a premium.

On the other hand, we have option sellers who are establishing an option position. Unlike the buyer, the seller has no control over when the option may be exercised. On the other hand, we have option sellers who also establish an open position. Unlike the buyer, the seller has no control over when the option may be exercised, which means he could be required to fulfill that obligation to either buy or sell shares any time up until the expiration. And remember, the primary benefit to selling something is that you're going to receive a premium.

Key Point: When you're buying an option, you are paying a premium for the right to do something. When you are selling an option, you are receiving a premium in return for the obligation to potentially have to do something.

Intrinsic value and time value.



Time value is also called extrinsic value. Intrinsic versus extrinsic are key concepts. I find that most people prefer the term “time value” over extrinsic value, although option trading platforms will often use the term “extrinsic value” in the option chain. Time value is perhaps more intuitive as the time value is generally impacted by the passage of time. It’s the value that erodes over time, as we’re going to see in a moment. Intrinsic value is the difference between the price of the underlying asset and the strike price. It is unaffected by volatility, time decay, interest rates and other variables. It JUST IS.

So, for example, let’s say you’re trading a call against a stock that’s trading at $25. And the strike price, the price at which that call can be exercised is $22. Well, the intrinsic value of that option would be $3.

Again, the difference between the stock price and the strike price is $3 in this case. The time value is simply the difference between the intrinsic value and the actual premium that we are paying or receiving, depending on what trade we are executing. So, if the total premium is $4.50, as an example, and the intrinsic value is $3 the time value is going to be a

$1.50. The total value of the option is 4.50, made up of $1.50 in time value (extrinsic) and $3 of intrinsic value.

Again, for reinforcement purposes... the intrinsic value is $3 Because the stock is trading $3 above the strike price, the intrinsic value MUST be $3. Then what is the extra $1.50 in the options value of $4.50? Time value.

Time value, or extrinsic value, is the amount over and above the intrinsic value that can fluctuate. The intrinsic value, you can think of as almost written in stone.

Intrinsic Value: Difference between the price of the underlying asset (stock, ETF) and the strike price:

👉Share Price – Strike Price = Intrinsic Value

Intrinsic Value

Option Premium:	$4.50
Share Price	$25
Strike Price	$22
= Intrinsic Value	$3

It must be worth what it's worth for an American option. The difference between the strike price and that share price when those options are in the money is an intrinsic value that is non-negotiable. You may see market makers bidding slightly less than intrinsic value - that's basically part of how they make a living. They make their money on a spread. They buy apples at 40 cents and sell them at 60 cents.

We're going to talk about this later on when discussing the very important nuances of closing option positions and dealing with market makers.

I was a professional market maker for many, many years, so I can tell you where a market maker is likely to close a position, and where we don't have to spend extra money and where we don't have to unnecessarily leave money on the table when we're closing a position.

Now, the more time there is to expiry the greater the time value will be all else being equal. Shorter term options will have less time value, for a giving underlying stock, than longer term options. Makes sense as more time = more of a chance for the stock to move through the strike. Current interest rates, as well as things like implied volatility, and the dividend rate of the underlying asset, also play a role in option premiums. We will discuss implied volatility in depth in the Options and Volatility Ninja video series. It is a must-watch for options traders.

Chapter #2 The Options Chain

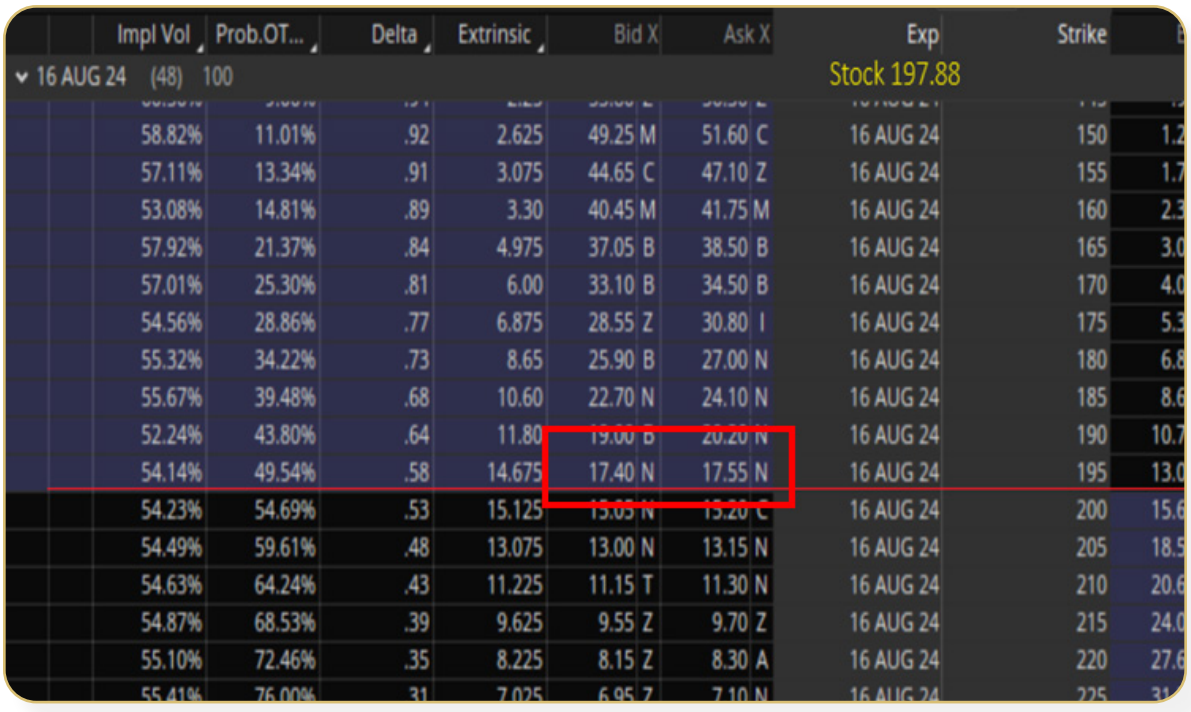
This topic is crucial, so we'll revisit it multiple times. It's essential to become thoroughly familiar with all the key parts of the options chain — it's the dashboard and access point for what we're aiming to accomplish here. We need to know the various aspects of what's going on in the chain.

Impl Vol	Prob.OT...	Delta	Extrinsic	Bid X	Ask X	Exp	Strike	Bid X	Ask X	Impl Vol	Prob.OT...	Delta	Extrinsic
16 AUG 24 (48) 100						Stock 197.88							56.97% (±33.054)
58.82%	11.01%	.92	2.625	49.25 M	51.60 C	16 AUG 24	150	1.28 Q	1.32 N	56.28%	90.16%	-.07	1.30
57.11%	13.34%	.91	3.075	44.65 C	47.10 Z	16 AUG 24	155	1.72 N	1.77 N	55.26%	87.58%	-.09	1.745
53.08%	14.81%	.89	3.30	40.45 M	41.75 M	16 AUG 24	160	2.31 N	2.37 A	54.47%	84.44%	-.11	2.34
57.92%	21.37%	.84	4.975	37.05 B	38.50 B	16 AUG 24	165	3.05 A	3.15 Z	53.79%	80.79%	-.14	3.10
57.01%	25.30%	.81	6.00	33.10 B	34.50 B	16 AUG 24	170	4.05 A	4.15 N	53.45%	76.51%	-.18	4.10
54.56%	28.86%	.77	6.875	28.55 Z	30.80 I	16 AUG 24	175	5.30 Z	5.45 A	53.39%	71.70%	-.22	5.375
55.32%	34.22%	.73	8.65	25.90 B	27.00 N	16 AUG 24	180	6.80 A	6.95 A	53.24%	66.64%	-.27	6.875
55.67%	39.48%	.68	10.60	22.70 N	24.10 N	16 AUG 24	185	8.60 A	8.75 Z	53.26%	61.32%	-.32	8.675
52.24%	43.80%	.64	11.80	19.00 B	20.20 N	16 AUG 24	190	10.70 N	10.80 N	53.31%	55.93%	-.37	10.75
54.14%	49.54%	.58	14.675	17.40 N	17.55 N	16 AUG 24	195	13.05 N	13.20 A	53.46%	50.56%	-.42	13.125
54.23%	54.69%	.53	15.125	15.05 N	15.20 C	16 AUG 24	200	15.65 A	15.80 N	53.45%	45.36%	-.47	13.525
54.49%	59.61%	.48	13.075	13.00 N	13.15 N	16 AUG 24	205	18.55 A	18.70 N	53.60%	40.36%	-.52	11.425
54.63%	64.24%	.43	11.225	11.15 T	11.30 N	16 AUG 24	210	20.65 C	22.90 C	53.75%	35.65%	-.57	9.575
54.87%	68.53%	.39	9.625	9.55 Z	9.70 Z	16 AUG 24	215	24.05 I	26.30 C	53.98%	31.30%	-.62	7.975
55.10%	72.46%	.35	8.225	8.15 Z	8.30 A	16 AUG 24	220	27.65 I	29.90 C	54.18%	27.31%	-.67	6.575
55.41%	76.00%	.31	7.025	6.95 Z	7.10 N	16 AUG 24	225	31.30 Z	33.90 C	54.50%	23.73%	-.71	5.40
55.55%	79.23%	.27	5.95	5.90 J	6.00 N	16 AUG 24	230	35.20 W	37.75 C	54.31%	20.37%	-.75	4.275
56.03%	81.99%	.24	5.10	5.05 T	5.15 N	16 AUG 24	235	39.35 W	42.00 C	54.88%	17.61%	-.78	3.475
56.41%	84.46%	.21	4.35	4.30 N	4.40 Q	16 AUG 24	240	43.80 W	46.15 C	55.33%	15.17%	-.81	2.775

It's essential to be able to respond quickly when necessary, and to establish a routine that consistently works for us over time. The more you become familiar with it, the greater your confidence will become, which will, in turn, reduce the likelihood of making mistakes—a key goal in any trading strategy. Every stock or equity product with options available will have an options chain, which provides all the relevant trading information we'll discuss throughout this chapter.

It's also important to note that not all stocks have options. That has become increasingly rare in recent years. In the past, only the more popular stocks typically had options available, while most others did not. Today, however, the majority of stocks offer options. That said, it's important to note that not all of these options are actively traded. Some stocks have options listed, but they may rarely see any significant daily trading volume.

These options often exhibit poor liquidity, with bid-ask spreads that are quite wide. By "spread," I'm referring to the difference between the bid price and the ask price. For instance, if we examine the $195 calls here, we see a bid of $17.40 and an ask of $17.55, which results in a 15-cent spread. For a $17 option, this is considered a relatively tight spread.



Impl Vol	Prob.OT...	Delta	Extrinsic	Bid X	Ask X	Exp	Strike	
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58.82%	11.01%	.92	2.625	49.25 M	51.60 C	16 AUG 24	150	1.2
57.11%	13.34%	.91	3.075	44.65 C	47.10 Z	16 AUG 24	155	1.7
53.08%	14.81%	.89	3.30	40.45 M	41.75 M	16 AUG 24	160	2.3
57.92%	21.37%	.84	4.975	37.05 B	38.50 B	16 AUG 24	165	3.0
57.01%	25.30%	.81	6.00	33.10 B	34.50 B	16 AUG 24	170	4.0
54.56%	28.86%	.77	6.875	28.55 Z	30.80 I	16 AUG 24	175	5.3
55.32%	34.22%	.73	8.65	25.90 B	27.00 N	16 AUG 24	180	6.8
55.67%	39.48%	.68	10.60	22.70 N	24.10 N	16 AUG 24	185	8.6
52.24%	43.80%	.64	11.80	19.00 B	20.20 N	16 AUG 24	190	10.7
54.14%	49.54%	.58	14.675	17.40 N	17.55 N	16 AUG 24	195	13.0
54.23%	54.69%	.53	15.125	15.05 N	15.20 C	16 AUG 24	200	15.6
54.49%	59.61%	.48	13.075	13.00 N	13.15 N	16 AUG 24	205	18.5
54.63%	64.24%	.43	11.225	11.15 T	11.30 N	16 AUG 24	210	20.6
54.87%	68.53%	.39	9.625	9.55 Z	9.70 Z	16 AUG 24	215	24.0
55.10%	72.46%	.35	8.225	8.15 Z	8.30 A	16 AUG 24	220	27.6
55.41%	76.00%	.31	7.025	6.95 Z	7.10 N	16 AUG 24	225	31

As option premiums decrease, you'll notice that the bid-ask spreads tend to tighten or narrow. In this case, the spread is around 10 cents.

49.54%	.58	14.675	17.40	N	17.55	N	16 AUG 24	195
54.69%	.53	15.125	15.05	N	15.20	C	16 AUG 24	200
59.61%	.48	13.075	13.00	N	13.15	N	16 AUG 24	205
64.24%	.43	11.225	11.15	T	11.30	N	16 AUG 24	210
68.53%	.39	9.625	9.55	Z	9.70	Z	16 AUG 24	215
72.46%	.35	8.225	8.15	Z	8.30	A	16 AUG 24	220
76.00%	.31	7.025	6.95	Z	7.10	N	16 AUG 24	225
79.23%	.27	5.95	5.90	J	6.00	N	16 AUG 24	230
81.99%	.24	5.10	5.05	T	5.15	N	16 AUG 24	235
84.46%	.21	4.35	4.30	N	4.40	Q	16 AUG 24	240

When the premium drops below a dollar or even 50 cents, the spread can shrink to just a penny. For heavily traded stocks, penny spreads are quite common, which is advantageous for retail traders. Narrow spreads are ideal, as they help minimize slippage and reduce trading costs.

Slippage refers to the loss incurred due to the bid-ask spread. For example, if an option has a 50¢ spread between the bid and ask prices, you're facing a 50¢ difference when buying and selling the option. This is a significant amount of slippage, as it directly reduces your potential gains over time. If you need to exit a position later at a higher ask price, it cuts into your profitability.

These factors are critical to consider because, over the course of many trades and throughout the year, small details like slippage can have a substantial impact. Therefore, it's essential to focus on trading options with good liquidity. In general, many of the top S&P 500 stocks tend to offer strong liquidity in their options. Likewise, most of the Nasdaq 100 stocks also provide decent liquidity and narrower spreads. However, the most liquid options are typically concentrated in the most popular names.

So, near the top of the option chain screen, you're going to see, usually, a stock price.

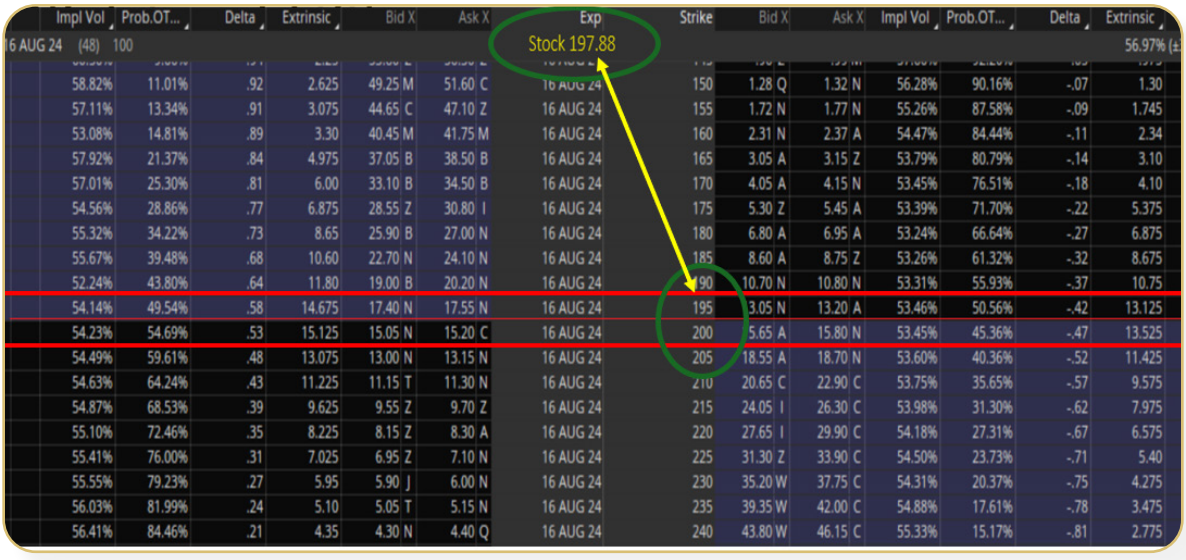
Impl Vol	Prob.OT...	Delta	Extrinsic	Bid X	Ask X	Exp	Strike	Bid X	Ask X	Impl Vol	Prob.OT...	Delta	Extrinsic
16 AUG 24 (48) 100													56.97% (±33.054)
58.82%	11.01%	.92	2.625	49.25 M	51.60 C	16 AUG 24	150	1.28 Q	1.32 N	56.28%	90.16%	-.07	1.30
57.11%	13.34%	.91	3.075	44.65 C	47.10 Z	16 AUG 24	155	1.72 N	1.77 N	55.26%	87.58%	-.09	1.745
53.08%	14.81%	.89	3.30	40.45 M	41.75 M	16 AUG 24	160	2.31 N	2.37 A	54.47%	84.44%	-.11	2.34
57.92%	21.37%	.84	4.975	37.05 B	38.50 B	16 AUG 24	165	3.05 A	3.15 Z	53.79%	80.79%	-.14	3.10
57.01%	25.30%	.81	6.00	33.10 B	34.50 B	16 AUG 24	170	4.05 A	4.15 N	53.45%	76.51%	-.18	4.10
54.56%	28.86%	.77	6.875	28.55 Z	30.80 I	16 AUG 24	175	5.30 Z	5.45 A	53.39%	71.70%	-.22	5.375
55.32%	34.22%	.73	8.65	25.90 B	27.00 N	16 AUG 24	180	6.80 A	6.95 A	53.24%	66.64%	-.27	6.875
55.67%	39.48%	.68	10.60	22.70 N	24.10 N	16 AUG 24	185	8.60 A	8.75 Z	53.26%	61.32%	-.32	8.675
52.24%	43.80%	.64	11.80	19.00 B	20.20 N	16 AUG 24	190	10.70 N	10.80 N	53.31%	55.93%	-.37	10.75
54.14%	49.54%	.58	14.675	17.40 N	17.55 N	16 AUG 24	195	13.05 N	13.20 A	53.46%	50.56%	-.42	13.125
54.23%	54.69%	.53	15.125	15.05 N	15.20 C	16 AUG 24	200	15.65 A	15.80 N	53.45%	45.36%	-.47	13.525
54.49%	59.61%	.48	13.075	13.00 N	13.15 N	16 AUG 24	205	18.55 A	18.70 N	53.60%	40.36%	-.52	11.425
54.63%	64.24%	.43	11.225	11.15 T	11.30 N	16 AUG 24	210	20.65 C	22.90 C	53.75%	35.65%	-.57	9.575
54.87%	68.53%	.39	9.625	9.55 Z	9.70 Z	16 AUG 24	215	24.05 I	26.30 C	53.98%	31.30%	-.62	7.975
55.10%	72.46%	.35	8.225	8.15 Z	8.30 A	16 AUG 24	220	27.65 I	29.90 C	54.18%	27.31%	-.67	6.575
55.41%	76.00%	.31	7.025	6.95 Z	7.10 N	16 AUG 24	225	31.30 Z	33.90 C	54.50%	23.73%	-.71	5.40
55.55%	79.23%	.27	5.95	5.90 J	6.00 N	16 AUG 24	230	35.20 W	37.75 C	54.31%	20.37%	-.75	4.275
56.03%	81.99%	.24	5.10	5.05 T	5.15 N	16 AUG 24	235	39.35 W	42.00 C	54.88%	17.61%	-.78	3.475
56.41%	84.46%	.21	4.35	4.30 N	4.40 Q	16 AUG 24	240	43.80 W	46.15 C	55.33%	15.17%	-.81	2.775

This is Tesla, for example, trading at $197.88. Options derive their prices from the price of the underlying stock, so this price is important. And over on the top left corner here, you see 48 days left in this August expiry. These options expire on August 16th. They have opened up because I've clicked the little down button, which opens up this particular month.

Impl Vol	Prob.OT...	Delta	Extrinsic	Bid X	Ask X	Exp	Strike	Bid X	Ask X	Impl Vol	Prob.OT...	Delta	Extrinsic
16 AUG 24 (48) 100													56.97% (±33.054)
58.82%	11.01%	.92	2.625	49.25 M	51.60 C	16 AUG 24	150	1.28 Q	1.32 N	56.28%	90.16%	-.07	1.30
57.11%	13.34%	.91	3.075	44.65 C	47.10 Z	16 AUG 24	155	1.72 N	1.77 N	55.26%	87.58%	-.09	1.745
53.08%	14.81%	.89	3.30	40.45 M	41.75 M	16 AUG 24	160	2.31 N	2.37 A	54.47%	84.44%	-.11	2.34
57.92%	21.37%	.84	4.975	37.05 B	38.50 B	16 AUG 24	165	3.05 A	3.15 Z	53.79%	80.79%	-.14	3.10
57.01%	25.30%	.81	6.00	33.10 B	34.50 B	16 AUG 24	170	4.05 A	4.15 N	53.45%	76.51%	-.18	4.10
54.56%	28.86%	.77	6.875	28.55 Z	30.80 I	16 AUG 24	175	5.30 Z	5.45 A	53.39%	71.70%	-.22	5.375
55.32%	34.22%	.73	8.65	25.90 B	27.00 N	16 AUG 24	180	6.80 A	6.95 A	53.24%	66.64%	-.27	6.875
55.67%	39.48%	.68	10.60	22.70 N	24.10 N	16 AUG 24	185	8.60 A	8.75 Z	53.26%	61.32%	-.32	8.675
52.24%	43.80%	.64	11.80	19.00 B	20.20 N	16 AUG 24	190	10.70 N	10.80 N	53.31%	55.93%	-.37	10.75
54.14%	49.54%	.58	14.675	17.40 N	17.55 N	16 AUG 24	195	13.05 N	13.20 A	53.46%	50.56%	-.42	13.125
54.23%	54.69%	.53	15.125	15.05 N	15.20 C	16 AUG 24	200	15.65 A	15.80 N	53.45%	45.36%	-.47	13.525
54.49%	59.61%	.48	13.075	13.00 N	13.15 N	16 AUG 24	205	18.55 A	18.70 N	53.60%	40.36%	-.52	11.425
54.63%	64.24%	.43	11.225	11.15 T	11.30 N	16 AUG 24	210	20.65 C	22.90 C	53.75%	35.65%	-.57	9.575
54.87%	68.53%	.39	9.625	9.55 Z	9.70 Z	16 AUG 24	215	24.05 I	26.30 C	53.98%	31.30%	-.62	7.975
55.10%	72.46%	.35	8.225	8.15 Z	8.30 A	16 AUG 24	220	27.65 I	29.90 C	54.18%	27.31%	-.67	6.575
55.41%	76.00%	.31	7.025	6.95 Z	7.10 N	16 AUG 24	225	31.30 Z	33.90 C	54.50%	23.73%	-.71	5.40
55.55%	79.23%	.27	5.95	5.90 J	6.00 N	16 AUG 24	230	35.20 W	37.75 C	54.31%	20.37%	-.75	4.275
56.03%	81.99%	.24	5.10	5.05 T	5.15 N	16 AUG 24	235	39.35 W	42.00 C	54.88%	17.61%	-.78	3.475
56.41%	84.46%	.21	4.35	4.30 N	4.40 Q	16 AUG 24	240	43.80 W	46.15 C	55.33%	15.17%	-.81	2.775

If I close that, I'm going to see a whole bunch of other tradable expiries. So, there'll be weekly expiries these days. Weekly options have become increasingly popular, as many traders prefer to engage in short-term trades on a weekly basis. As a result, more and more weekly options are being listed on the most actively traded stocks. In addition to weeklies, there are also monthly options, which expire on the third Friday of each month.

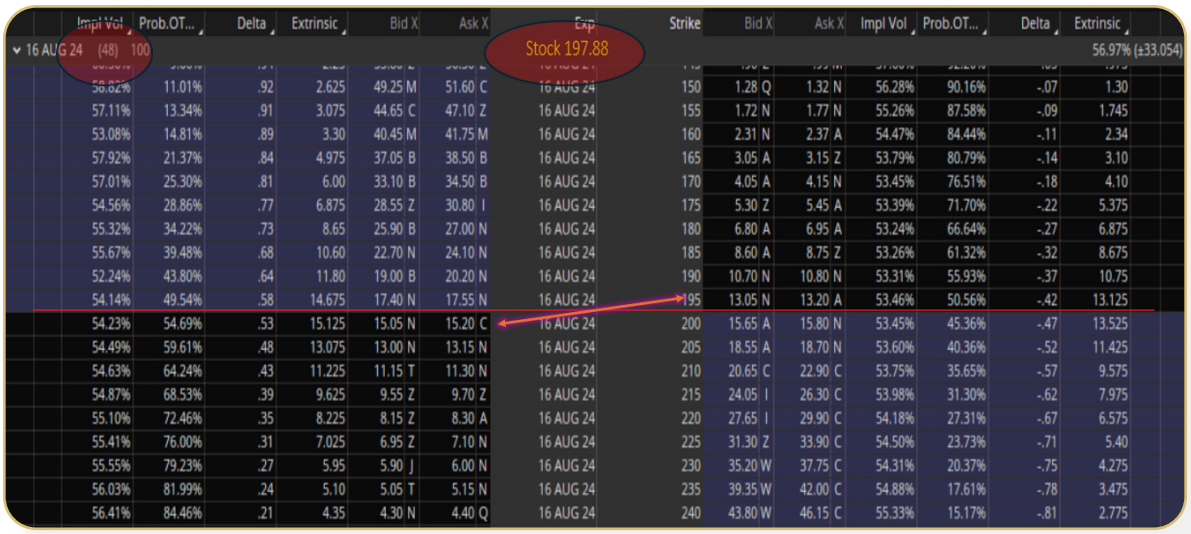
These are the standard August options that we're looking at above, which expire on the third Friday of the month. To make it easier to distinguish between in-the-money, out-of-the-money, and at-the-money options, I've added a red line across the middle. However, "Think or Swim" (A Schwab product), the platform I'm using, already provides this information by shading the appropriate options. The in-the-money calls are clearly marked, as are the out-of-the-money calls, with a similar color scheme for puts. This color-coding helps identify the at-the-money strike price, which is roughly where the market stands at this moment.



Impl Vol	Prob.OT...	Delta	Extrinsic	Bid X	Ask X	Exp	Strike	Bid X	Ask X	Impl Vol	Prob.OT...	Delta	Extrinsic
6 AUG 24 (48) 100													56.97% (±
58.82%	11.01%	.92	2.625	49.25 M	51.60 C	16 AUG 24	150	1.28 Q	1.32 N	56.28%	90.16%	-.07	1.30
57.11%	13.34%	.91	3.075	44.65 C	47.10 Z	16 AUG 24	155	1.72 N	1.77 N	55.26%	87.58%	-.09	1.745
53.08%	14.81%	.89	3.30	40.45 M	41.75 M	16 AUG 24	160	2.31 N	2.37 A	54.47%	84.44%	-.11	2.34
57.92%	21.37%	.84	4.975	37.05 B	38.50 B	16 AUG 24	165	3.05 A	3.15 Z	53.79%	80.79%	-.14	3.10
57.01%	25.30%	.81	6.00	33.10 B	34.50 B	16 AUG 24	170	4.05 A	4.15 N	53.45%	76.51%	-.18	4.10
54.56%	28.86%	.77	6.875	28.55 Z	30.80 I	16 AUG 24	175	5.30 Z	5.45 A	53.39%	71.70%	-.22	5.375
55.32%	34.22%	.73	8.65	25.90 B	27.00 N	16 AUG 24	180	6.80 A	6.95 A	53.24%	66.64%	-.27	6.875
55.67%	39.48%	.68	10.60	22.70 N	24.10 N	16 AUG 24	185	8.60 A	8.75 Z	53.26%	61.32%	-.32	8.675
52.24%	43.80%	.64	11.80	19.00 B	20.20 N	16 AUG 24	190	10.70 N	10.80 N	53.31%	55.93%	-.37	10.75
54.14%	49.54%	.58	14.675	17.40 N	17.55 N	16 AUG 24	195	3.05 N	13.20 A	53.46%	50.56%	-.42	13.125
54.23%	54.69%	.53	15.125	15.05 N	15.20 C	16 AUG 24	200	5.65 A	15.80 N	53.45%	45.36%	-.47	13.525
54.49%	59.61%	.48	13.075	13.00 N	13.15 N	16 AUG 24	205	18.55 A	18.70 N	53.60%	40.36%	-.52	11.425
54.63%	64.24%	.43	11.225	11.15 T	11.30 N	16 AUG 24	210	20.65 C	22.90 C	53.75%	35.65%	-.57	9.575
54.87%	68.53%	.39	9.625	9.55 Z	9.70 Z	16 AUG 24	215	24.05 I	26.30 C	53.98%	31.30%	-.62	7.975
55.10%	72.46%	.35	8.225	8.15 Z	8.30 A	16 AUG 24	220	27.65 I	29.90 C	54.18%	27.31%	-.67	6.575
55.41%	76.00%	.31	7.025	6.95 Z	7.10 N	16 AUG 24	225	31.30 Z	33.90 C	54.50%	23.73%	-.71	5.40
55.55%	79.23%	.27	5.95	5.90 J	6.00 N	16 AUG 24	230	35.20 W	37.75 C	54.31%	20.37%	-.75	4.275
56.03%	81.99%	.24	5.10	5.05 T	5.15 N	16 AUG 24	235	39.35 W	42.00 C	54.88%	17.61%	-.78	3.475
56.41%	84.46%	.21	4.35	4.30 N	4.40 Q	16 AUG 24	240	43.80 W	46.15 C	55.33%	15.17%	-.81	2.775

Based on the red line and the shading on the options chain, we can see that the closest strike prices to the at-the-money level, with the stock currently trading at $19.78, are the 195 put and the 200 call.

These two strikes—one put and one call—effectively straddle the current price of the stock. As is standard, calls are listed on the left side of the options chain and puts are on the right. This format is consistent across most trading platforms. Between these, you'll find the strike prices, which represent the agreed-upon price at which the underlying asset can be bought or sold.



Impl Vol	Prob.OT...	Delta	Extrinsic	Bid X	Ask X	Exp	Strike	Bid X	Ask X	Impl Vol	Prob.OT...	Delta	Extrinsic
16 AUG 24 (48) 100													56.97% (±33.054)
	11.01%	.92	2.625	49.25 M	51.60 C		150	1.28 Q	1.32 N	56.28%	90.16%	-.07	1.30
57.11%	13.34%	.91	3.075	44.65 C	47.10 Z	16 AUG 24	155	1.72 N	1.77 N	55.26%	87.58%	-.09	1.745
53.08%	14.81%	.89	3.30	40.45 M	41.75 M	16 AUG 24	160	2.31 N	2.37 A	54.47%	84.44%	-.11	2.34
57.92%	21.37%	.84	4.975	37.05 B	38.50 B	16 AUG 24	165	3.05 A	3.15 Z	53.79%	80.79%	-.14	3.10
57.01%	25.30%	.81	6.00	33.10 B	34.50 B	16 AUG 24	170	4.05 A	4.15 N	53.45%	76.51%	-.18	4.10
54.56%	28.86%	.77	6.875	28.55 Z	30.80 I	16 AUG 24	175	5.30 Z	5.45 A	53.39%	71.70%	-.22	5.375
55.32%	34.22%	.73	8.65	25.90 B	27.00 N	16 AUG 24	180	6.80 A	6.95 A	53.24%	66.64%	-.27	6.875
55.67%	39.48%	.68	10.60	22.70 N	24.10 N	16 AUG 24	185	8.60 A	8.75 Z	53.26%	61.32%	-.32	8.675
52.24%	43.80%	.64	11.80	19.00 B	20.20 N	16 AUG 24	190	10.70 N	10.80 N	53.31%	55.93%	-.37	10.75
54.14%	49.54%	.58	14.675	17.40 N	17.55 N	16 AUG 24	195	13.05 N	13.20 A	53.46%	50.56%	-.42	13.125
54.23%	54.69%	.53	15.125	15.05 N	15.20 C	16 AUG 24	200	15.65 A	15.80 N	53.45%	45.36%	-.47	13.525
54.49%	59.61%	.48	13.075	13.00 N	13.15 N	16 AUG 24	205	18.55 A	18.70 N	53.60%	40.36%	-.52	11.425
54.63%	64.24%	.43	11.225	11.15 T	11.30 N	16 AUG 24	210	20.65 C	22.90 C	53.75%	35.65%	-.57	9.575
54.87%	68.53%	.39	9.625	9.55 Z	9.70 Z	16 AUG 24	215	24.05 I	26.30 C	53.98%	31.30%	-.62	7.975
55.10%	72.46%	.35	8.225	8.15 Z	8.30 A	16 AUG 24	220	27.65 I	29.90 C	54.18%	27.31%	-.67	6.575
55.41%	76.00%	.31	7.025	6.95 Z	7.10 N	16 AUG 24	225	31.30 Z	33.90 C	54.50%	23.73%	-.71	5.40
55.55%	79.23%	.27	5.95	5.90 J	6.00 N	16 AUG 24	230	35.20 W	37.75 C	54.31%	20.37%	-.75	4.275
56.03%	81.99%	.24	5.10	5.05 T	5.15 N	16 AUG 24	235	39.35 W	42.00 C	54.88%	17.61%	-.78	3.475
56.41%	84.46%	.21	4.35	4.30 N	4.40 Q	16 AUG 24	240	43.80 W	46.15 C	55.33%	15.17%	-.81	2.775

It's important to remember that once you enter into a contract to buy or sell an option, the strike price is fixed and cannot change. The strike price represents the agreed-upon price at which the underlying asset may be bought or sold, and it remains constant throughout the life of the option. Like a stock's price, strike prices are determined by the market. During my time as a market maker, when we identified a stock with strong potential for trading, we would request that the exchange list options for it. The exchange would then select a few strike prices that were near the stock's current price. As the stock moved, additional strike prices would be listed, as both exchanges and market makers typically prefer to have strike prices close to the stock's trading range, since those tend to attract the most trading activity.

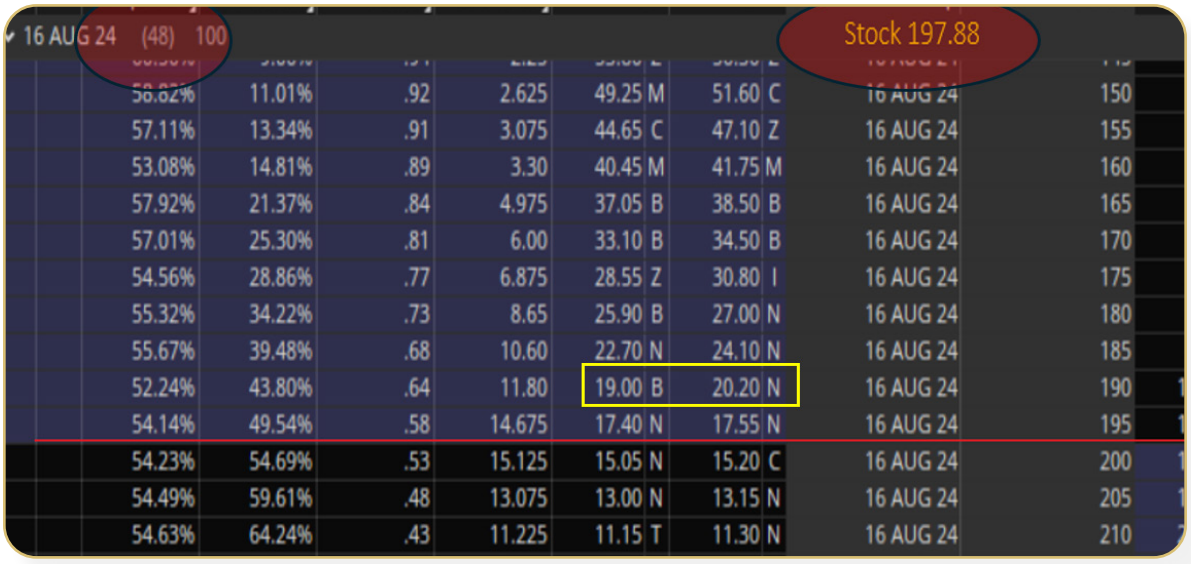
You'll find that a lot. The near the money options are usually (not always) much more heavily traded. And so that's why you're going to see many, many different strikes on stocks that really have risen a great deal over time. If you look at something like an NVIDIA, you have strikes all the way down to $10 and $20 even though the stock is trading well above $100.

It can be somewhat unusual to see a stock priced at $1,200 with options listed at $50 strike prices. These strike prices were originally established when the stock was trading at lower levels. Once listed, strike prices remain available until they expire, which is why some of these older strikes are still present. They were initially set up as longer-term options, such as one-year or two-year contracts. Now, let's revisit the concepts of in-the-money, at-the-money, and out-of-the-money options.

As a reminder, calls are listed on the left side, while puts are on the right, with the red line helping to distinguish between in-the-money, out-of-the-money, and at-the-money options.

From this, we can clearly identify the in-the-money options on the call side. The strike prices start low and increase as we move down the screen. Let's now look at some examples to better understand what's going on.

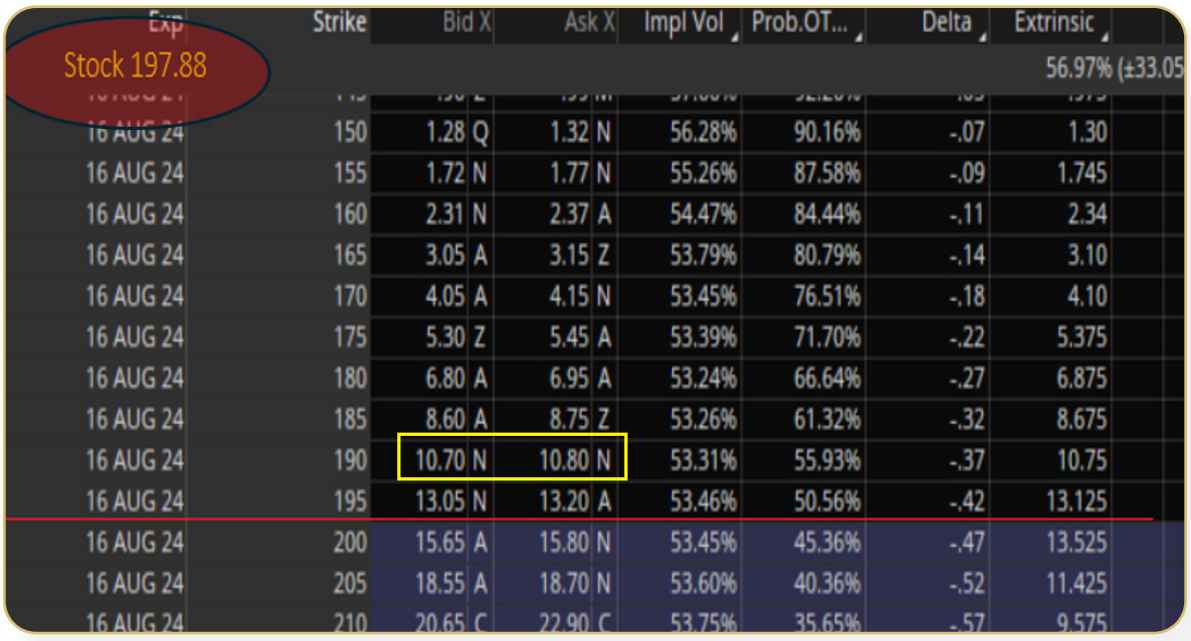
First, let's consider the $190 call, which is in the money. Given that the stock is trading at $19.78, the $190 call has intrinsic value of $7.88, calculated by subtracting the strike price from the stock price. Now, you might wonder why this option is trading at $19 (if we're selling on the bid side at $19), well above the intrinsic value. The reason is that there is still a great deal of time value remaining in the option, with 48 days left until expiration. This provides plenty of time for the stock to move, so market makers are willing to pay a premium for that time value. If we subtract the intrinsic value of $7.88 from the $19 price, we're left with $11.12 in time value.



Next, let's look at the $205 strike call, which is out of the money. Since the stock is trading at $19.78, the $205 strike call is out of the money and has no intrinsic value. In this case, **the entire value of the option is time value**, and if we sell it on the bid side we would receive $13 for the time value.

11.01%	.92	2.625	49.25 M	51.60 C	16 AUG 24	150
57.11%	13.34%	.91	3.075	44.65 C	47.10 Z	16 AUG 24	155
53.08%	14.81%	.89	3.30	40.45 M	41.75 M	16 AUG 24	160
57.92%	21.37%	.84	4.975	37.05 B	38.50 B	16 AUG 24	165
57.01%	25.30%	.81	6.00	33.10 B	34.50 B	16 AUG 24	170
54.56%	28.86%	.77	6.875	28.55 Z	30.80 I	16 AUG 24	175
55.32%	34.22%	.73	8.65	25.90 B	27.00 N	16 AUG 24	180
55.67%	39.48%	.68	10.60	22.70 N	24.10 N	16 AUG 24	185
52.24%	43.80%	.64	11.80	19.00 B	20.20 N	16 AUG 24	190
54.14%	49.54%	.58	14.675	17.40 N	17.55 N	16 AUG 24	195
54.23%	54.69%	.53	15.125	15.05 N	15.20 C	16 AUG 24	200
54.49%	59.61%	.48	13.075	13.00 N	13.15 N	16 AUG 24	205
54.63%	64.24%	.43	11.225	11.15 T	11.30 N	16 AUG 24	210
54.87%	68.53%	.39	9.625	9.55 Z	9.70 Z	16 AUG 24	215
55.10%	72.46%	.35	8.225	8.15 Z	8.30 A	16 AUG 24	220

Now, let's consider the $190 strike put. Unlike the $190 strike call, this put is out of the money because the stock is trading above the strike price. If this were the expiration date, there would be no reason to exercise the put, since the stock is worth more than the strike price. As a result, this put is entirely time value, just like the out-of-the-money call.



Exp	Strike	Bid X	Ask X	Impl Vol	Prob.OT...	Delta	Extrinsic
Stock 197.88							56.97% (±33.05
16 AUG 24	150	1.28 Q	1.32 N	56.28%	90.16%	-.07	1.30
16 AUG 24	155	1.72 N	1.77 N	55.26%	87.58%	-.09	1.745
16 AUG 24	160	2.31 N	2.37 A	54.47%	84.44%	-.11	2.34
16 AUG 24	165	3.05 A	3.15 Z	53.79%	80.79%	-.14	3.10
16 AUG 24	170	4.05 A	4.15 N	53.45%	76.51%	-.18	4.10
16 AUG 24	175	5.30 Z	5.45 A	53.39%	71.70%	-.22	5.375
16 AUG 24	180	6.80 A	6.95 A	53.24%	66.64%	-.27	6.875
16 AUG 24	185	8.60 A	8.75 Z	53.26%	61.32%	-.32	8.675
16 AUG 24	190	10.70 N	10.80 N	53.31%	55.93%	-.37	10.75
16 AUG 24	195	13.05 N	13.20 A	53.46%	50.56%	-.42	13.125
16 AUG 24	200	15.65 A	15.80 N	53.45%	45.36%	-.47	13.525
16 AUG 24	205	18.55 A	18.70 N	53.60%	40.36%	-.52	11.425
16 AUG 24	210	20.65 C	22.90 C	53.75%	35.65%	-.57	9.575

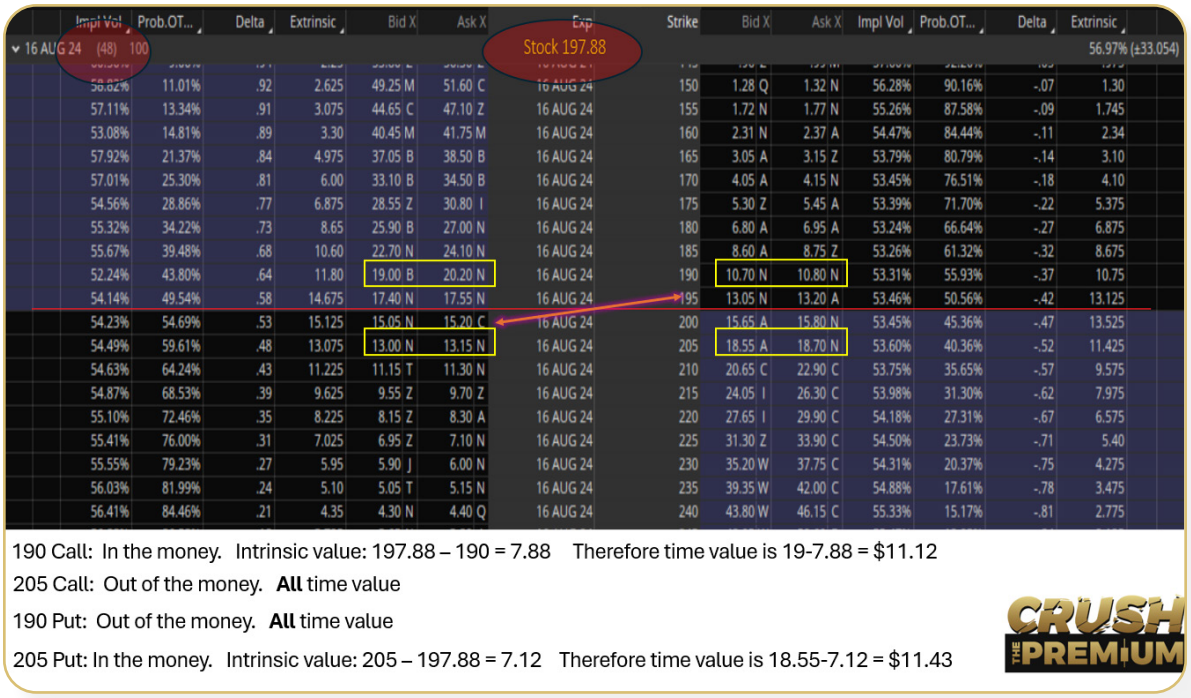
We can observe a pattern: **all out-of-the-money calls and puts are entirely time value.** Additionally, the highest time value is typically found near the at-the-money strike. For example, the $150 strike put, priced at $1.28, has low time value because it is $47 out of the money, making it unlikely to move into the money. The delta on this option indicates a 7% chance of it being in the money by expiration, which is why it has minimal value. Distant out of the money strikes will always have less time value since they are a lower probability bet.

On the other hand, the $195 strike put has a much higher time value—$13—because it is much closer to being in the money. The delta on this option is -.42, meaning there is a 42% chance of it being in the money by expiration, which increases its value.

Finally, let's look at the $205 strike put. Like the $190 strike call, this is an in-the-money option. The stock is already trading below the strike price of 205, meaning this option has intrinsic value at a minimum, and in this case also some time value. The intrinsic value is $7.12, calculated by subtracting

the stock price from the strike price. If Tesla doesn't move, this option would be worth at least $7.12. The additional value above this intrinsic value represents time value.

The current price of the option is $18.55, so the time value is $11.43 *(calculated by subtracting the intrinsic value of $7.12 from the total price of $18.55)*.



Time value erodes as we approach expiration, while intrinsic value remains unchanged. As expiration nears, options will lose all time value and will be worth only their intrinsic value, if any. At expiration, options either expire worthless (if they have no intrinsic value) or are worth the amount by which they are in the money. As we can see from the screen, the green squares represent the out-of-the-money options, and these are diagonally opposite each other when comparing calls and puts. The in-the-money options are also diagonally arranged, with in-the-money calls in the top left and in-the-money puts in the bottom right.

Impl Vol	Prob.OT...	Delta	Extrinsic	Bid X	Ask X	Exp
11.01%	.92	2.625	49.25 M	51.60 C	16 AUG 24
57.11%	13.34%	.91	3.075	44.65 C	47.10 Z	16 AUG 24
53.08%	14.81%	.89	3.30	40.45 M	41.75 M	16 AUG 24
57.92%	21.37%	.84	4.975	37.05 B	38.50 B	16 AUG 24
57.01%	25.30%	.81	6.00	33.10 B	34.50 B	16 AUG 24
54.56%	28.86%	.77	6.875	28.55 Z	30.80 I	16 AUG 24
55.32%	34.22%	.73	8.65	25.90 B	27.00 N	16 AUG 24
55.67%	39.48%	.68	10.60	22.70 N	24.10 N	16 AUG 24
52.24%	43.80%	.64	11.80	19.00 B	20.20 N	16 AUG 24
54.14%	49.54%	.58	14.675	17.40 N	17.55 N	16 AUG 24
54.23%	54.69%	.53	15.125	15.05 N	15.20 C	16 AUG 24
54.49%	59.61%	.48	13.075	13.00 N	13.15 N	16 AUG 24
54.63%	64.24%	.43	11.225	11.15 T	11.30 N	16 AUG 24
54.87%	68.53%	.39	9.625	9.55 Z	9.70 Z	16 AUG 24
55.10%	72.46%	.35	8.225	8.15 Z	8.30 A	16 AUG 24
55.41%	76.00%	.31	7.025	6.95 Z	7.10 N	16 AUG 24
55.55%	79.23%	.27	5.95	5.90 J	6.00 N	16 AUG 24
56.03%	81.99%	.24	5.10	5.05 T	5.15 N	16 AUG 24
56.41%	84.46%	.21	4.35	4.30 N	4.40 Q	16 AUG 24

Strike	Bid X	Ask X	Impl Vol	Prob.OT...	Delta	Extrinsic
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205	18.55 A	18.70 N	53.60%	40.36%	-.52	11.425
210	20.65 C	22.90 C	53.75%	35.65%	-.57	9.575
215	24.05 I	26.30 C	53.98%	31.30%	-.62	7.975
220	27.65 I	29.90 C	54.18%	27.31%	-.67	6.575
225	31.30 Z	33.90 C	54.50%	23.73%	-.71	5.40
230	35.20 W	37.75 C	54.31%	20.37%	-.75	4.275
235	39.35 W	42.00 C	54.88%	17.61%	-.78	3.475
240	43.80 W	46.15 C	55.33%	15.17%	-.81	2.775

190 Call: In the money. Intrinsic value: 197.88 – 190 = 7.88 Therefore time value is 19-7.88 = $11.12

205 Call: Out of the money. **All** time value

190 Put: Out of the money. **All** time value

205 Put: In the money. Intrinsic value: 205 – 197.88 = 7.12 Therefore time value is 18.55-7.12 = $11.43

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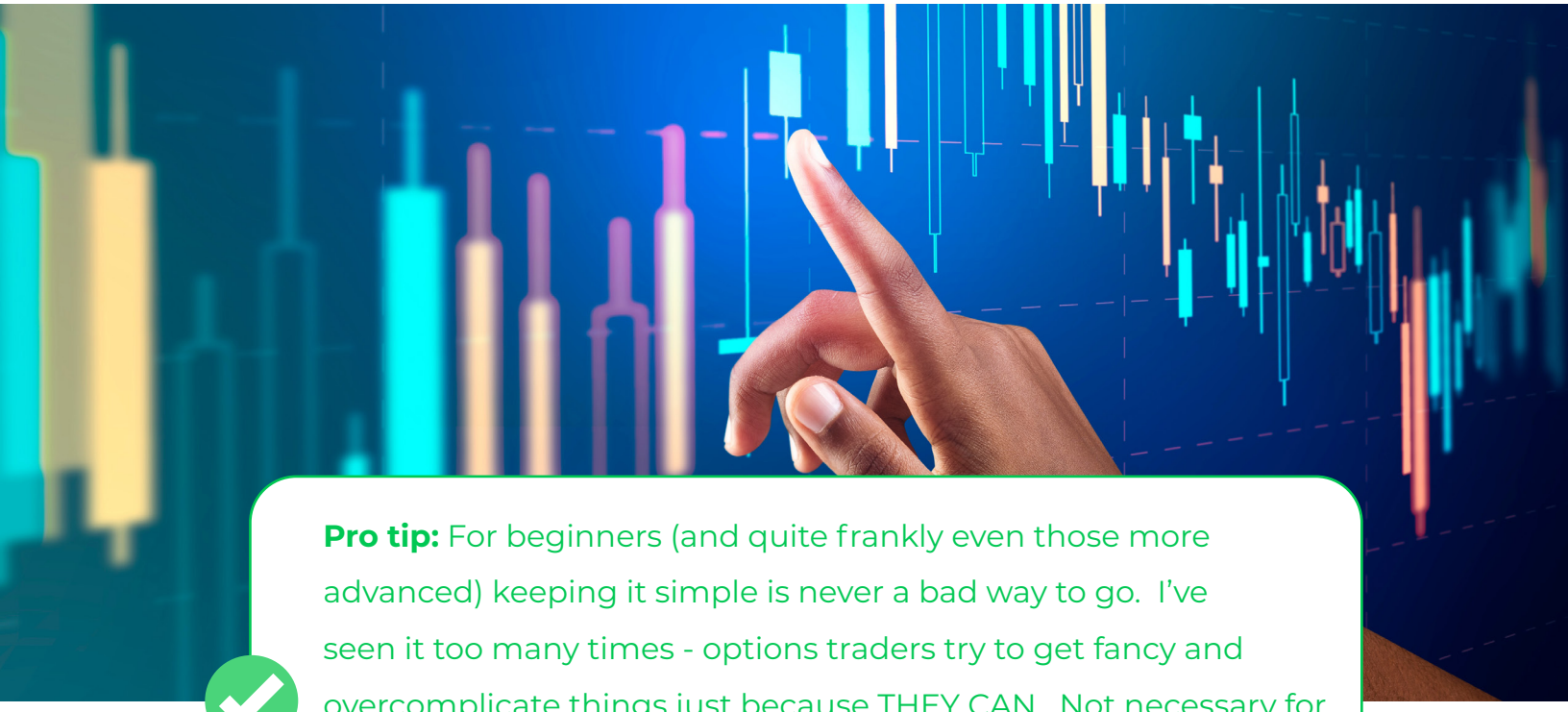
190 Put: Out of the money. **All** time value

205 Put: In the money. Intrinsic value: 205 – 197.88 = 7.12 Therefore time value is 18.55-7.12 = $11.43

Chapter #3

Let's explore the various methods of trading options and the nuances associated with each approach. While there is a wide range of options strategies, especially as you move into more complex multi-leg strategies involving four, five, or even six legs, these can become quite intricate. They often combine long and short options positions and incorporate various Greeks, such as Theta, Vega, and Gamma, which we will not delve into in detail here.



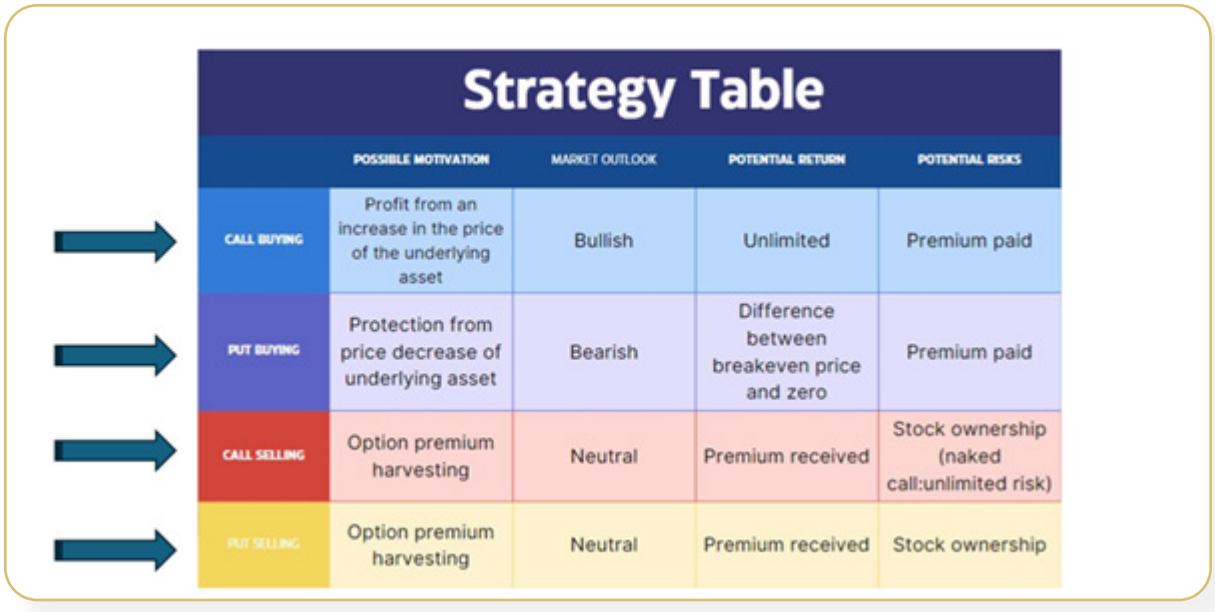
Pro tip: For beginners (and quite frankly even those more advanced) keeping it simple is never a bad way to go. I've seen it too many times - options traders try to get fancy and overcomplicate things just because THEY CAN. Not necessary for most people. That's why the Crush the Premium Method Course keeps it to single leg option trades, with the occasional spread for when conditions require it.

There are four basic trade types.

Strategy Table

	POSSIBLE MOTIVATION	MARKET OUTLOOK	POTENTIAL RETURN	POTENTIAL RISKS
CALL BUYING	Profit from an increase in the price of the underlying asset	Bullish	Unlimited	Premium paid
PUT BUYING	Protection from price decrease of underlying asset	Bearish	Difference between breakeven price and zero	Premium paid
CALL SELLING	Option premium harvesting	Neutral	Premium received	Stock ownership (naked call:unlimited risk)
PUT SELLING	Option premium harvesting	Neutral	Premium received	Stock ownership

The four fundamental options strategies are call buying, put buying, call selling, and put selling. These are essential concepts to understand and provide a solid foundation for learning more advanced options strategies.



Let's examine the key elements of each trade, including the objective, market forecast, potential returns, and associated risks.

When buying a call option, the buyer acquires the right to purchase shares of an underlying asset at a predetermined price. The primary goal is typically to profit from the asset by purchasing shares at a lower price than the market value, with the intention of selling them later for a profit. This strategy benefits from leverage, allowing an investor to control more shares for a smaller initial investment. As a result, call buyers can realize substantial profits if the asset's price rises significantly, especially within a short timeframe.

This is an inherently bullish strategy, suitable when an investor anticipates that the price of the underlying asset will increase before the option's expiration. It's important to note that there's no need to wait until expiration to realize profits; the position can be closed at any time. The profit potential is high due to leverage, as even modest price increases can lead to gains. However, the risk is limited to the premium paid for the option itself.

It's worth noting that options often trade at a higher price than their fair value due to the concept of Volatility Risk Premium (VRP). In equity options in particular, this premium tends to be high, meaning options are frequently priced above their underlying "risk". Over time, this has led to the observation that options are often more expensive than what might be considered fair value, which can be an inherent challenge when buying options. While the market dynamics can change rapidly, it's important to recognize this embedded cost when entering long option positions. We will delve more into this concept later on in the first Volatility Ninja Lesson.

On the other hand, buying puts is a distinctly different strategy as compared to buying calls. When purchasing a put option, the buyer gains the right to sell shares at a specified price before the expiration date. Many investors use put buying as a form of insurance, particularly when concerned that a stock they own may decrease in value. This strategy is often referred to as a "protective put," as it serves to hedge against a potential decline in the value of the underlying asset they own.

While call buyers typically have a bullish outlook, put buyers are generally more focused on protection or risk mitigation, especially if they already hold a long position in the underlying asset. Additionally, put buying can be used to speculate on price declines, but in the context of hedging, the primary goal is to offset the potential downside risk of a portfolio.

This often leads to some confusion over options flows – the occurrence of large purchases of puts is often taken to mean a very bearish stance, which in truth much of the time indicates that investors are often simply buying insurance for their stock holdings. In fact, in the same way that we don't mind losing our house insurance premiums each year (because our house didn't burn down!), we also don't mind losing the money we spent on put protection as markets continue to rise. Insurance has served its purpose and that equals peace of mind for many.

Pro take: In our advanced programs we learn how to read into whether investors are aggressively buying puts or are mostly complacent. This can help to inform the potential for market selloffs. As an example, in the first half of 2024 investors had all but given up on buying insurance for their stock holdings – metrics showed an utter disregard for the need for downside protection. This played out in violent fashion in early August as panic levels soared in the absence of protective positions.

They were complacent but then decided to buy insurance after the roof had “already started burning”, which pushed insurance costs to levels not seen in years. An expensive lesson for many.

	POSSIBLE MOTIVATION	MARKET OUTLOOK	POTENTIAL RETURN	POTENTIAL RISKS
PUT BUYING	Protection from price decrease of underlying asset	Bearish	Difference between breakeven price and zero	Premium paid

So many new put purchases are often paired with either new or existing stock positions, functioning much like an insurance policy. Some portfolio managers, in fact, may be mandated to implement such hedging strategies. The key point here is that, while they hope their stocks will appreciate over time, they are willing to "lose" the option premium, as it provides a form of protection.

As with any option strategy, the risk in buying puts is limited to the premium paid for the option, meaning the maximum potential loss is confined to that amount.

Now, let’s turn to the strategies of selling calls and puts. Unlike buying options, where you have a right but no obligation, selling options comes with the obligation to buy or sell the underlying asset if the option is exercised. The primary goal in selling options is to generate income, which is the premium received when you sell the options. These strategies are typically neutral in nature, as the focus is on income generation rather than predicting the future direction of the asset's price.

In fact, movement in the underlying asset is generally detrimental to a short option strategy. When selling calls and puts, you are essentially acting as the "insurance company" in the transaction: you profit from stability, and you want the price to remain relatively unchanged or move within a specific range depending on the strategy. Significant price fluctuations, either upward or downward, could trigger your obligation to buy or sell the asset, potentially resulting in a loss – unless you are perfectly happy to own shares as a result of assignment. This is NOT the end of the world – in fact it is the basis for continuing the Wheel Strategy. But generally, the ideal scenario for a seller of options is a stable or range-bound market. IF one is particularly bullish or bearish there are better ways to play it.

	POSSIBLE MOTIVATION	MARKET OUTLOOK	POTENTIAL RETURN	POTENTIAL RISKS
CALL SELLING	Option premium harvesting	Neutral	Premium received	Stock ownership (naked call:unlimited risk)

In other programs that I teach, we delve much deeper into the concept of volatility, particularly the direction of volatility. The direction in which volatility is moving is critical to understand. If volatility is sharply increasing, and the volatility chart shows a steep upward trend, selling puts becomes risky—similar to selling homeowners insurance when you see a hurricane forming on the horizon. It's prudent to wait until volatility stabilizes before becoming more aggressive in selling options.

The direction and pace of volatility are important factors when engaging in serious volatility or options trading. A thorough understanding of these dynamics becomes essential as you develop expertise in the field.

As for the potential return in selling puts and calls, it is simply the premium received for selling the option. If you sell a call for $1, the maximum profit you can make is $1. Unlike buying options, where there is the potential for profit to increase as the price moves, the maximum return in selling options is fixed by the premium received at the time of the sale. Therefore, unless you add to or adjust the position, you are capped at the premium amount.

Next, you will learn the distinction between covered and naked calls, but for now, it's important to understand that the primary risk in selling covered calls and puts stems from stock ownership. For example, when you sell a put, you may end up owning the underlying stock. In the case of selling covered calls, if the stock price declines enough, you could end up continuing to own the stock without any further protection. In contrast, the risk for selling naked calls is unlimited as the stock can theoretically rise and you are "un-covered" as you don't own the underlying stock. Your obligation to deliver the stock at the strike price could result in a very uncomfortable and potential unlimited loss position. For this reason, we NEVER recommend this strategy. As a professional market maker I had to do this on a regular basis but for beginner to intermediate level retail option traders and investors this is a strict no-no in my opinion.

Now that we have a clear understanding of the basic strategies, let's explore how we will implement these strategies in our approach.

Chapter #4

The Crush the Premium strategy is an advanced variation of the traditional wheel method, designed to generate income through options. What distinguishes this approach is its emphasis on capturing potential upside, in addition to the typical focus on premium collection. While many option strategies revolve around selling options—mostly via put selling, covered calls, and various other premium-selling strategies—this program takes a unique approach by integrating the opportunity for capital appreciation in the underlying asset. This dual focus on both income generation and asset growth offers a more holistic approach to trading options, one that is often overlooked in conventional strategies.

In addition, the Method recognizes when the environment may have changed, and will attempt to mitigate downside risk as well. The holistic approach aims to address the two main risks in options selling – downside exposure, as well as upside capture challenges.

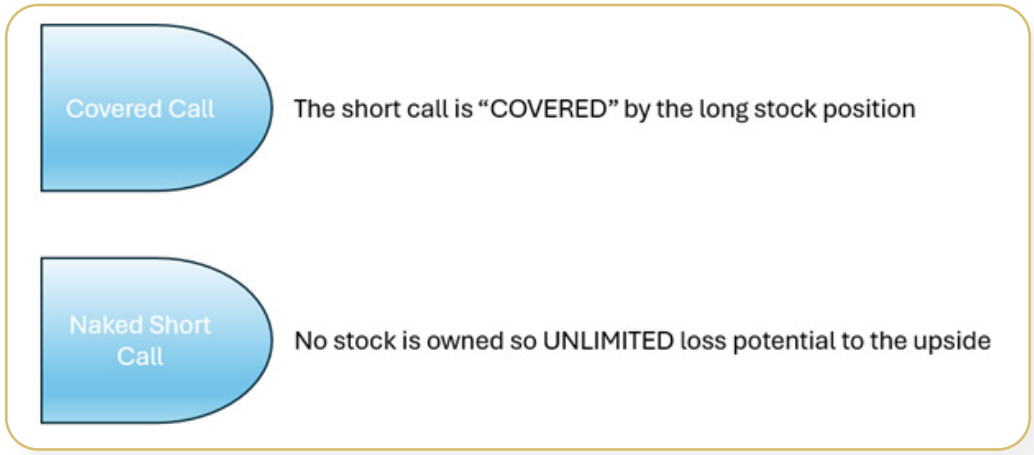
The Crush The Premium Method is an enhanced wheel approach that uses a combination of **covered calls and cash-secured puts** to generate income but ALSO aims to participate in upside in markets due to of our belief that equity markets are the greatest vehicle for long-term wealth generation that exists.

In addition to generating income through option selling, you can also create “income” from the appreciation of the underlying stock. This potential for capital appreciation becomes particularly relevant when market conditions signal a strong opportunity for upward movement. It's important to note that there may be different tax implications depending on the type of income involved, so it's crucial for individuals to assess their specific situation and consult with a tax professional as needed.

When a stock appreciates—say, from $100 to $110—before reaching a higher strike price on a call option, the $10 gain can be seen as income for all intents and purposes. At times, a focus on MORE of this appreciation is a key part of the strategy, thus creating a more compelling way to maximize returns as we target various environments that have different sources of “torque”. Sometimes this will be more from option decay. Sometimes it will be from movement in markets. Sometimes it will be from a resetting of option pricing. We should always pivot to where the edge lies.

So while our primary focus remains on generating income, it's important to balance immediate returns with the potential for future gains. For example, when selling calls, a near-the-money strike typically offers a higher premium, which is guaranteed income at that moment. In contrast, a more distant strike introduces an element of speculation, as the stock's appreciation is uncertain. **This decision involves weighing the immediate, guaranteed premium against the potential for future price movement.** Ultimately, we prioritize the immediate income from selling options, while remaining mindful of the upside potential in the underlying asset.

Next, let's take a deeper dive into two of the core strategies we use: covered calls and cash-secured puts.



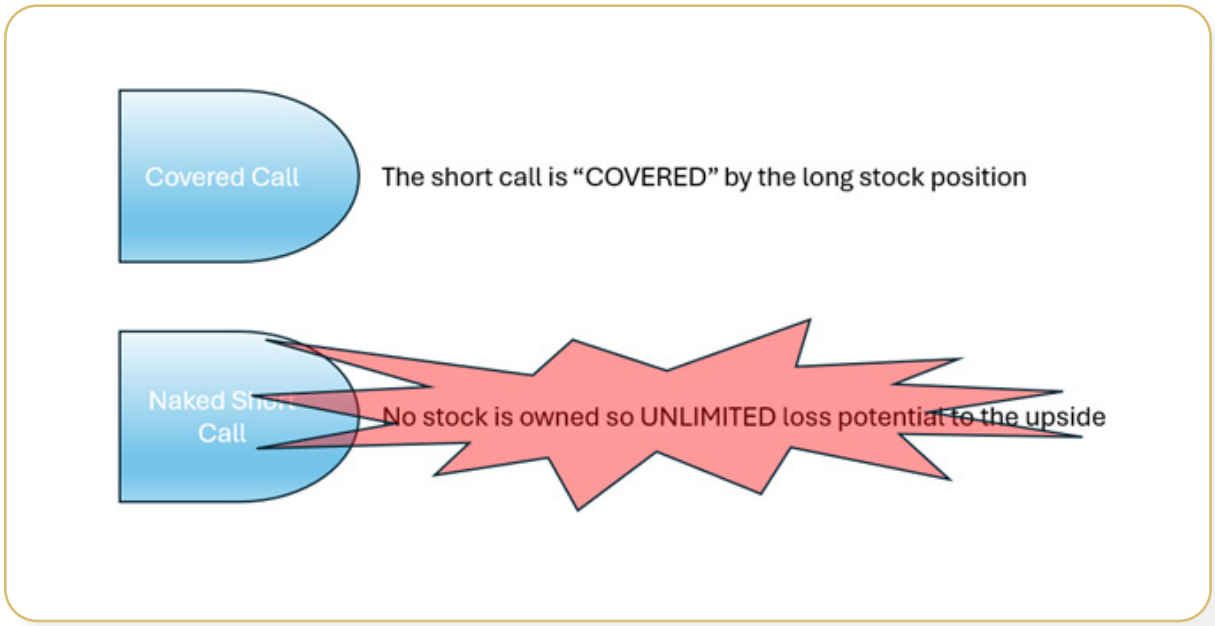
Let's begin by reviewing the call selling strategy. As you've learned, there are two primary ways to sell calls: covered calls and naked calls.

- **Covered calls** involve selling call options on a stock you already own. In this case, the underlying stock serves as collateral for the call options you sell. By selling a covered call, you are agreeing to sell the stock at the strike price if the stock price rises above that level - you already own the shares necessary to fulfill that obligation.

- **Naked calls**, on the other hand, involve selling calls without owning the underlying stock. This strategy introduces a significant level of risk, as you are obligated to buy shares at the market price if the stock price rises above the strike price, potentially incurring substantial losses if the stock moves sharply higher.

- Selling **naked calls** is considered a highly speculative strategy, and it carries an unlimited risk because there is no cap on how high the stock price can go. Even for advanced traders, this strategy is rarely recommended. In fact, many traders who engage in naked call selling can find themselves in difficult situations when the market moves against them. For example, a large gap up in the stock price can force the trader to buy back the calls at a much higher price than they sold them for, leading to significant losses.

This is a strategy best avoided due to the potential for large, uncontrolled risks. For this reason, we recommend a more conservative approach, focusing on covered calls. With covered calls, the risk is limited because you own the underlying stock. The premium you collect from selling the call is yours to keep, regardless of whether or not the option is exercised. This approach offers a safer, more predictable method of generating income from options.



You will retain the premium from the call option regardless of whether the contract is exercised, and you must be prepared for the potential outcomes when they occur. To recap, a short call is covered by your long stock position, meaning you must own at least 100 shares of the underlying asset to sell one call option contract.

	POSSIBLE MOTIVATION	MARKET OUTLOOK	POTENTIAL RETURN	POTENTIAL RISKS
CALL SELLING	Option premium harvesting	Neutral	Premium received	Stock ownership (naked call:unlimited risk)

Remember, one call option contract is tied to 100 shares of stock. Therefore, for every call option you sell, you must own at least 100 shares of the underlying asset. For example, if you own 187 shares of a stock, such as Tesla, you can only sell one call option, as selling two would obligate you to deliver 200 shares, which you do not fully own.

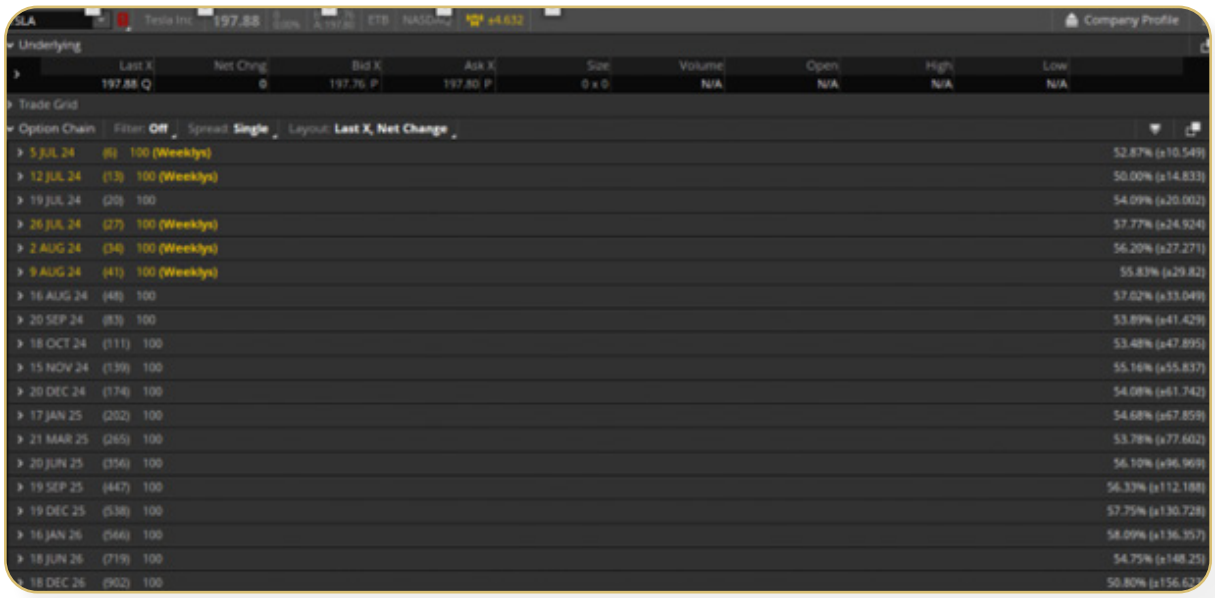
In cases where an investor finds themselves with an odd number of shares, they may choose to purchase additional shares to bring their position up to a multiple of 100, allowing them to sell more call contracts. For instance, if you have 187 shares, you might buy an additional 13 shares to bring your total to 200, enabling you to sell two call contracts against that position.

Beware the temptation to add stock to a position in order to be able to sell calls or puts if it means sizing up the underlying position size to a level that is inappropriate for one's portfolio. For example, a smaller portfolio might be able to own 10 shares of $1000 Netflix (NFLX:US) stock – but adding 90 shares in order to be able to sell a covered call may be inappropriate and position the portfolio very heavily in this name ($100,000 per one contract).

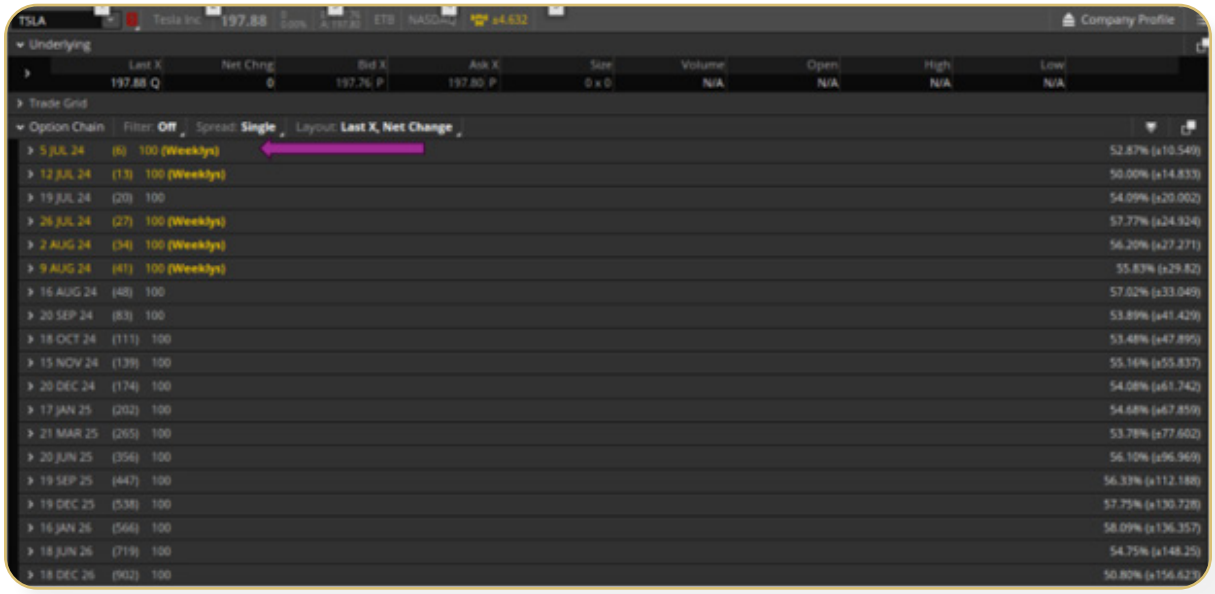
When you sell a call, you are obligated to deliver the underlying asset at the strike price if the option is exercised, either at or before expiration. This could happen before the expiration date, so it's important to be prepared for that possibility. We will discuss strategies for managing this obligation in future lessons.

When you sell a call, you will receive the option premium immediately, which is yours to keep regardless of whether the option is exercised. Now, let's walk through an example using the option chain to better understand how this works.

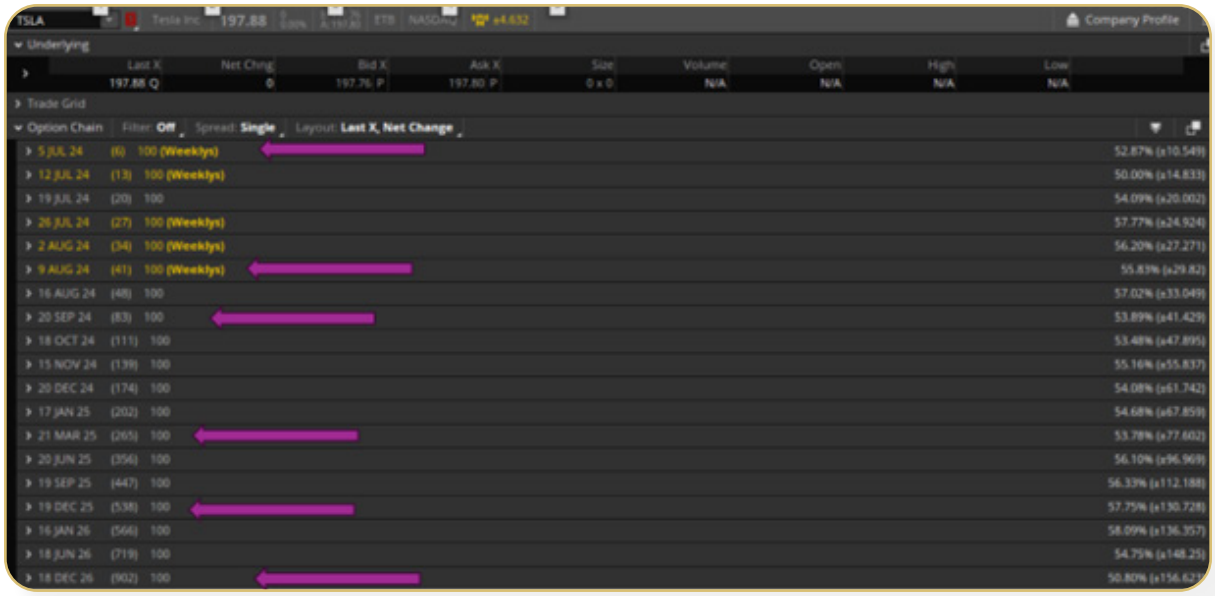
In most trading platforms, such as Think Or Swim, you can enter the stock symbol in the designated search box. This will bring up the option chain for that stock—in this case, Tesla. Typically, the option chain will be displayed in a compressed form, unless a specific expiration month is already expanded. At this point, you will see a range of strikes available for each expiration date.



The option chain initially displays a compressed view of the available expiration months and weekly options, such as July 5th, July 12th, July 19th, July 26th, and further months like August, September, October, and beyond. At this stage, the specific strike prices within each expiry are not yet visible. To view them, you will need to click on a particular expiration date. Once selected, the option chain will expand to show the available strikes for that specific expiration period, allowing you to explore a variety of different expiration dates and their corresponding strike prices.



The option chain also displays the expiration dates along with the number of days remaining until each option expires. For example, you may see options expiring in 6 days, 41 days, 83 days, and so on. Some options may have expirations further out, such as 265 days, 447 days, or even up to 902 days. The number in parentheses indicates the remaining time to expiration for each specific option.



These longer-term contracts are known as LEAPS (Long-Term Equity Anticipation Securities). They sometimes have expiration dates several years in the future. While there are a variety of expiration dates available for trading, we will focus on a specific range—typically those with expiration periods of around 3 to 6 weeks. This 3- to 6-week window is ideal for capitalizing on premium decay, allowing for repeated, effective income generation.

Focusing on contracts in the near-term allows us to take advantage of accelerated time decay, which is a key element of the strategy. Over time, this approach can provide consistent results, especially when the options are in the "front month" (the nearest expiration date). This time decay, which we will explore in more detail in the "Decay" lesson, plays a critical role in enhancing returns.

Though weekly options have gained popularity due to their rapid time decay, they come with a trade-off. The time value of these options decays quickly, but they also offer lower premiums and potentially higher risk.

The rapid erosion of time value—referred to as theta decay—is most pronounced in options with short expiration periods, like one-week options.

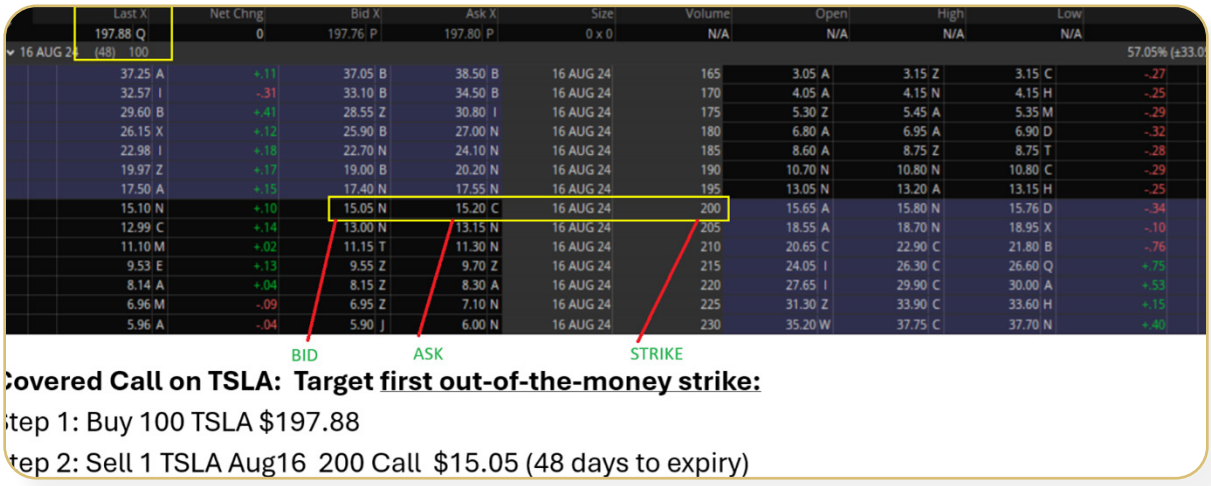
While selling weekly options can be appealing due to this fast time decay, the lower premiums earned and increased exposure to risk can make this strategy more volatile. The concept of gamma risk is also at play here, which involves the potential for quick, large moves in the underlying asset that could quickly diminish the gains from selling these options.

As we approach expiration—especially when there's less than three weeks remaining—the risk-to-reward ratio begins to wane, and we must carefully assess whether the potential premium is worth the remaining “risk”.

In the next lesson, we will dive into specific examples to illustrate these concepts more clearly.

Chapter #5

In this example, our first step is to purchase 100 shares of Tesla at the current market price of $197.88, as indicated in the top left corner of the screen. Next, we will evaluate which covered calls to sell. To start, let's consider selling a call with a strike price of $200, which is slightly **out-of-the-money**. This strike price is the first available option above the current trading price of the stock. We will explore a few different strike prices to illustrate the potential outcomes of each choice.

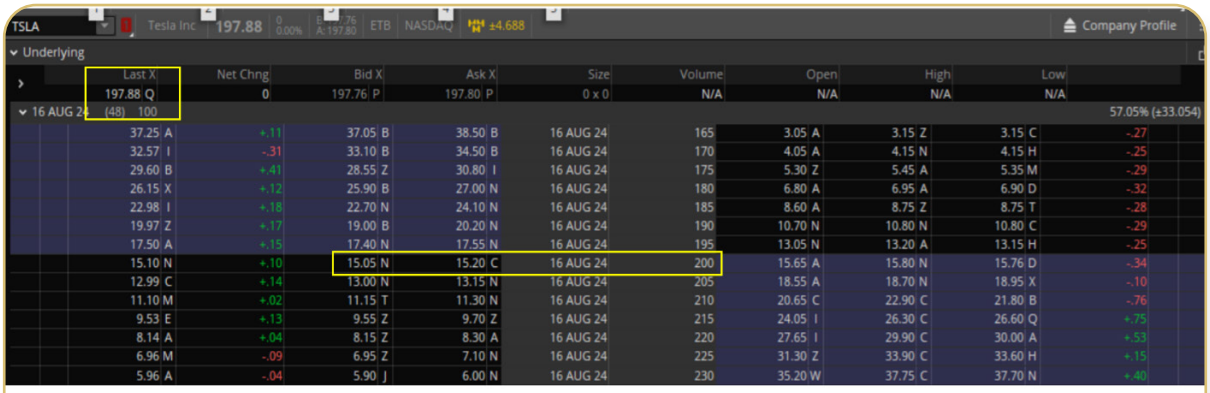


In this example, Tesla is currently priced at $197.88. The first out-of-the-money strike, which still carries full time value, is the $200 strike. The bid price for that call option is $15.05, while the ask price is $15.20. For our purposes, we are more concerned with the bid price, as this represents the price at which we can sell the call options. Typically, we will be able to trade all we need at the bid price of $15.05, unless dealing with very large orders, which may require negotiations with market makers.

However, for most retail-sized trades, the posted bid-ask prices will allow for smooth execution of trades.

Next, let's consider what would happen if the call option is exercised, and you are required to sell the shares. After purchasing 100 shares of Tesla at $197.88, we sell the $200 strike call for a premium of $15.05. If Tesla's price rises to $205 at expiration, the buyer of the call will **exercise** the option (remember they have the right to do this), and you will be **assigned** on the short call position (remember you may have the obligation to do this). This means you must sell the 100 shares at $200 per share.

In this scenario, you would have made a capital gain of $2.12 per share, as the stock price increased from $197.88 to $200. However, you also received the premium of $15.05 from selling the call, which adds to your total gain. So, while you are no longer able to participate in any further upside beyond the $200 strike price, you have already locked in a solid return.



Covered Call on TSLA: Target first out-of-the-money strike:
Step 1: Buy 100 TSLA $197.88
Step 2: Sell 1 TSLA Aug16 200 Call $15.05 (48 days to expiry)
100% time value of $15.05 (7.6% of TSLA)
What if call gets exercised? Make $2.12 (capital appreciation) + $15.05 = $17.17
Capital appreciation + option premium = Call away return of 9.39% in 48 days

To summarize: the total gain from this position would be the $2.12 in capital appreciation, plus the $15.05 in option premium, resulting in a total profit of $17.17 per share. This represents a return of 9.39% on your position, calculated as the combined capital appreciation and option premium relative to the original purchase price. The $15.05 premium alone represents a 7.6% return on the underlying stock price of $197.88 over a period of approximately 48 days.

How to calculate Covered Call returns under various scenarios:

Trade: Buy TSLA 197.88 and sell 1 Aug 200 Call for $15.05

Breakeven: $182.83 (197.88-15.05)

Max gain: at TSLA $200: Make $2.12 from 197.88 to 200. + Make 15.05 from call sale.
Total gain at $200= $17.17 on risk of $182.83 (197.88-15.05=max risk of 182.83)
Max (**Call Away Return**) Gain: $17.17 is 9.39% return on $182.83 risk
Annualized return: 48 days annualized = (365/48)*9.39% = 71.40% annualized

Gain if TSLA not changed from $197.88 : 15.05/182.83 = 8.2%, 62.35% annualized

It's important to note that your breakeven point on this trade is $182.83, which is the price, at expiry at which you could liquidate the entire position to break even, taking into account the premium received.

The reason for this is that we purchased the stock at $197.88 and sold the call for $15.05. This effectively provides us with a cushion of $15.05, or a hedge, against potential downside. Therefore, the stock could decline to $182.83 before we begin to incur any losses, as the premium from the call option provides this initial buffer.

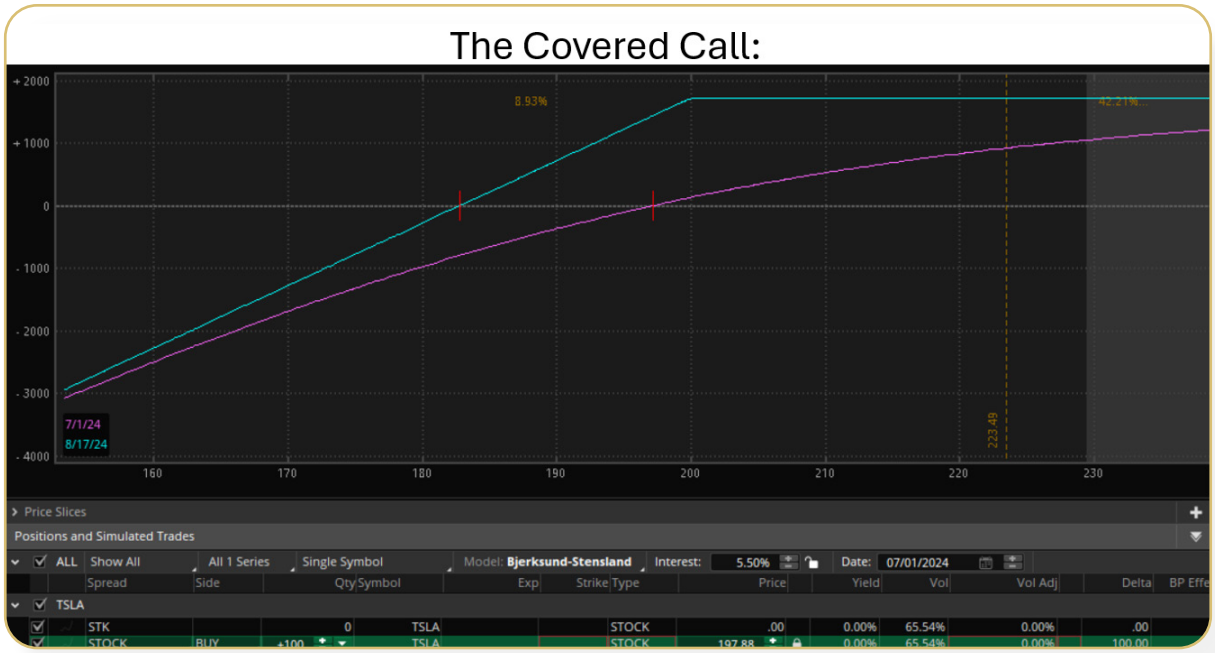
This is one of the key benefits of selling covered calls — the built-in hedge that the option premium provides. In this case, the $15.05 premium gives us a cushion, and if the stock appreciates, our total return, including both the capital gain and the option premium, would be $17.17, which represents a 9.39% return on our risk of $182.83, not the initial $197.88 stock price.

The reason we consider $182.83 as the risk in this trade is that, in the worst-case scenario where Tesla's price falls to zero, we would only lose the difference between our entry price of $197.88 and the premium of $15.05 received from the call option. As a result, the total capital at risk is $182.83 per share, not the original $197.88 purchase price.

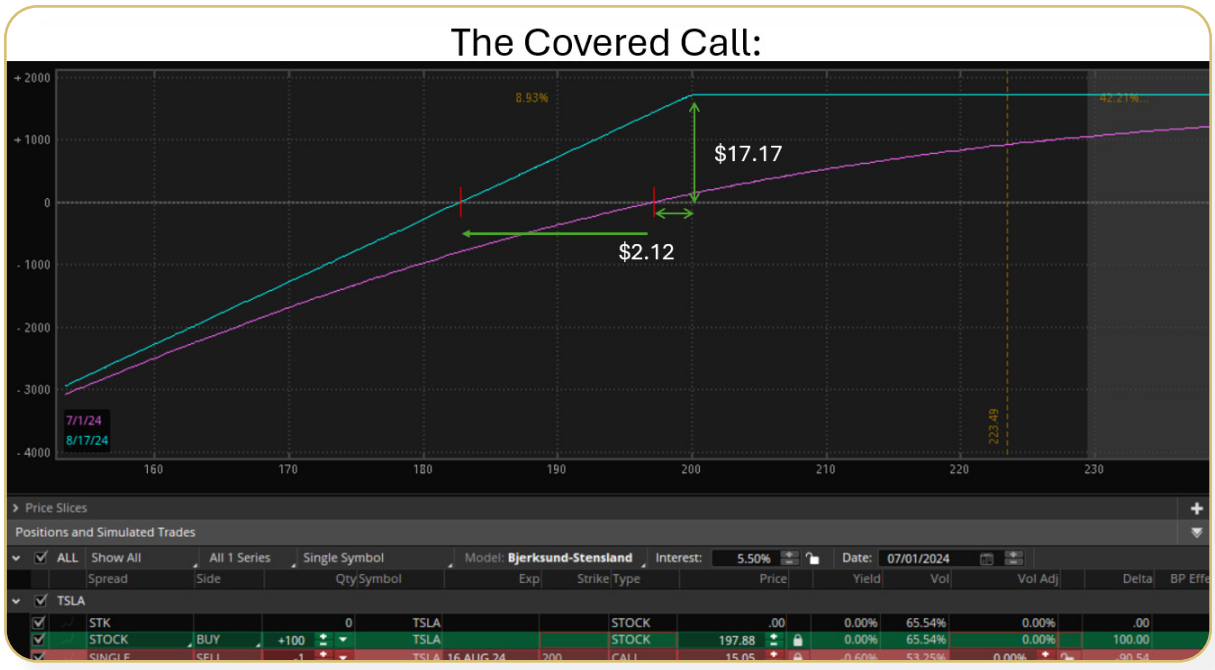
To calculate the annualized return, we need to determine how many 48-day periods fit into a year (365 days). This comes out to approximately 7.6 periods per year. Multiplying our 9.39% return by 7.6 periods gives an annualized return of 71.4%, assuming we can replicate this trade successfully every 48 days for the next year.

If Tesla's stock price remains flat at $197.88 and doesn't appreciate, we would still generate the $15.05 premium, which provides a return based on our risk of $182.83. The calculation is as follows: $15.05 (option premium) divided by $182.83 (capital at risk) equals an 8.2% return. Annualizing that gives us a return of approximately 62.35%, assuming we can generate the same premium every 48 days.

Finally, let's visualize this performance. Seeing a graphical representation of these returns can help solidify the understanding of how this strategy works in practice and how it generates consistent results.



Here is the breakdown of our covered call position: We purchased 100 shares of Tesla at $197.88, as indicated at the bottom of the screen. We then sold one August 16th $200 call for a premium of $15.05, totaling $15.50 in premium received. Below, we can see the performance profile of this position. Let's take a closer look at how it appears.



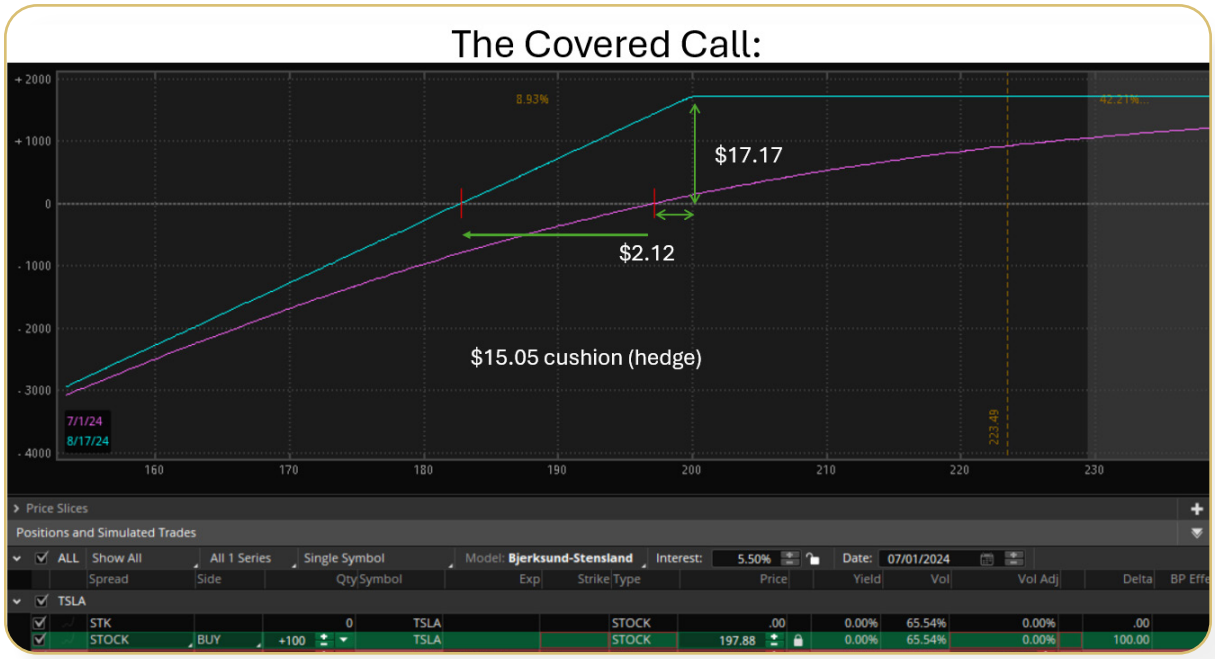
Here are the different scenarios for this covered call strategy. Looking at the upside potential, the maximum gain we can achieve is $17.17. This is comprised of two parts:

- **$2.12** from capital appreciation on the underlying stock as it moves from $197.88 up to the $200 strike price.
- **$15.05** from the premium received for selling the call.

Thus, our total gain is $17.17. Beyond the $200 strike price, we will not benefit from any further appreciation in the stock's price. Whether the stock reaches $210, $220, or higher, our maximum gain remains capped at $17.17, as indicated by the blue expiry line.

The lavender line represents the real-time profit and loss (P&L) during the life of the option, showing how the position fluctuates before expiry. However, our main focus is on the **expiry P&L**, as this reflects the outcome when the options expire, or when we decide to buy them back, let them expire, or roll them to a new strike price.

The premium of $15.05 provides a cushion, which means that the stock can decline as low as **$182.83** before we start to incur any losses. This is the effective breakeven point for our position.

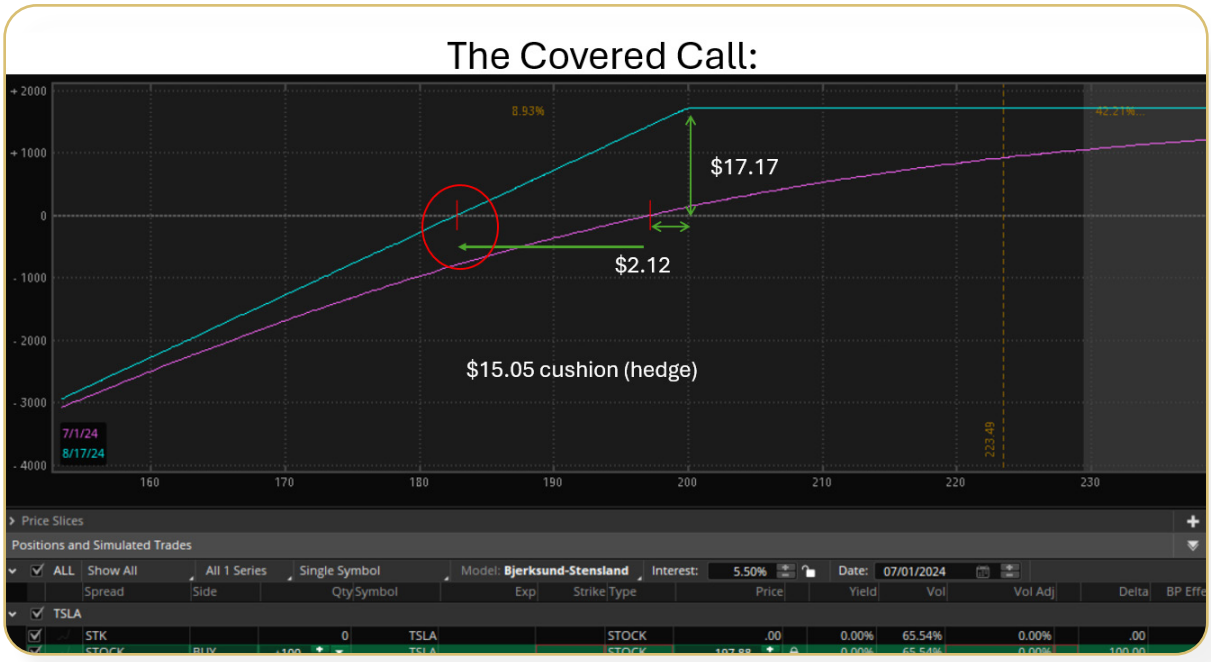


Again, by receiving the premium of $15.05, we create a cushion that provides some protection against a decline in the stock price. However, it's important to note that once the stock falls below our breakeven point, we start to fully participate in the downside risk of Tesla. This means that while a covered call can help limit losses to a certain extent, it does not fully protect against significant downward movement.

If the stock price drops significantly and the options expire worthless, we can sell new calls to re-hedge our position. This strategy allows us to defend our position as the stock moves lower, and we'll discuss specific techniques for managing this situation in the Enhanced Wheel Program.

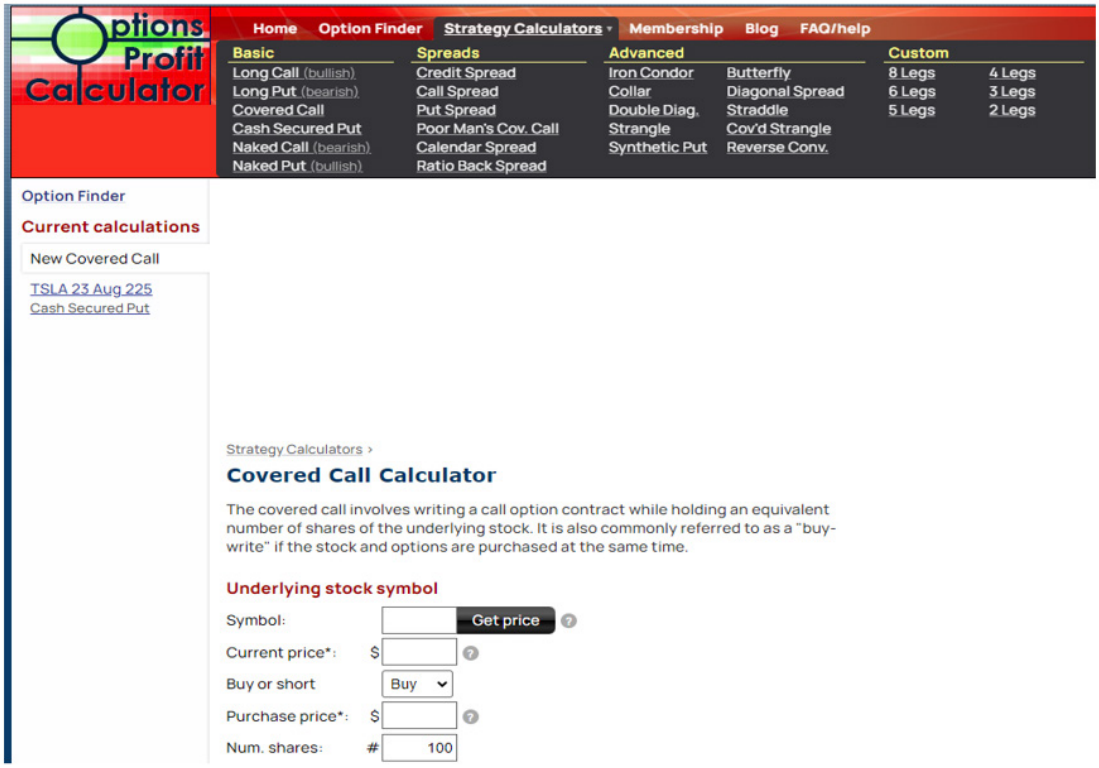
We can, in theory, continue this call selling process throughout the year, selling covered calls approximately every 48 days to collect premium income.

It's also important to observe that as the stock price moves closer to the breakeven point, the cushion provided by the premium begins to diminish. This reduces the protective effect of the hedge, meaning the further the stock falls below the breakeven price, the less benefit we gain from the premium received. While the covered call strategy still serves its purpose of generating income and providing some downside protection, the best-case scenario remains limited to the $200 strike price + premium received, with the breakeven point acting as the key threshold for profitability to the downside.



Let's now look at a valuable tool: *OptionsProfitCalculator.com*. This free online resource allows you to input various scenarios, providing insights into the potential outcomes of different options strategies. It's an incredibly useful tool for analyzing strategies such as covered calls, cash-secured puts, and many others. As you continue your education and perhaps work with me as a coach, you'll have the opportunity to explore and apply a variety of strategies to approach options trading in the markets.

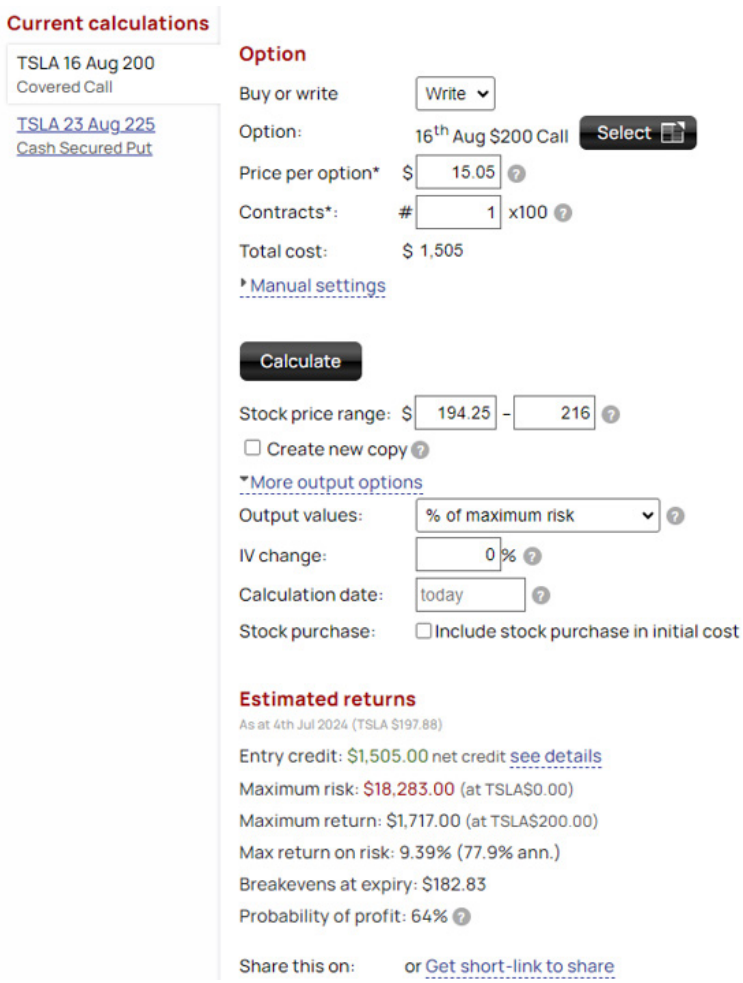
Handy Covered Call and Cash Secured Put Calculator
https://www.optionsprofitcalculator.com/calculator/covered-call.html



In this course, we will primarily focus on the covered call and cash-secured put strategies as primary sources for income. To begin, click on the *Covered Call* option, which will bring up a new screen where you can input the stock price. After clicking “Get Price,” the tool will provide the current market price for the stock.

Once the price is displayed, you have the flexibility to override it and input any price you want, allowing you to create “what-if” scenarios. You can customize the stock price, option price, and the number of shares you’re considering for this strategy. After entering these details, scroll down to view the results. For example, if you are buying 100 shares of Tesla at $197.88, this will be reflected in the cost summary.

You will select the appropriate option, as a covered call strategy is also referred to as a "buy-write." In this case, you will write one call option at the $200 strike price, receiving a premium of $15.05.

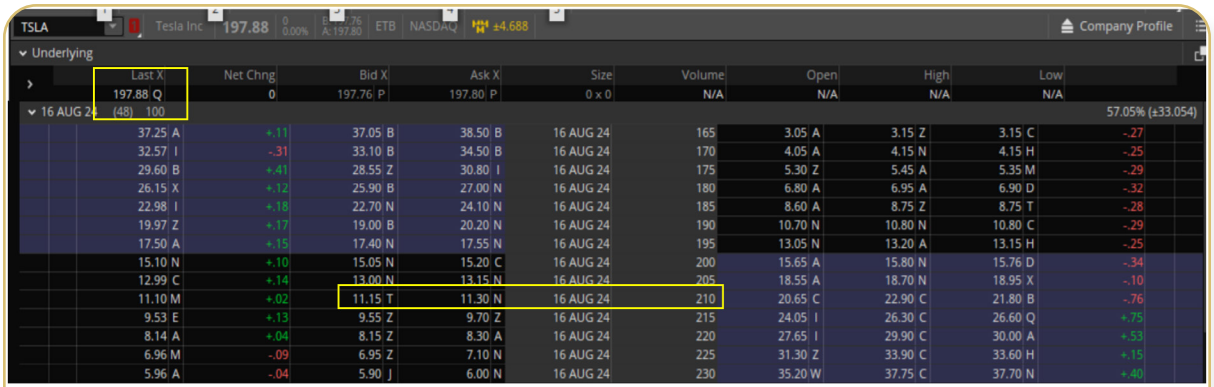


The call premium of $15.05 (less any applicable commission) will be deposited into your account, typically appearing the next day.

Next, you can click the “Calculate” button on the platform, which will generate a detailed breakdown of the trade. This includes the credit received, maximum risk, and the breakeven price for Tesla, which in this case is $182.83. Your maximum risk is calculated as 100 shares times $182.83.

The tool also calculates your potential risk/reward ratio, highlighting the maximum potential return. If Tesla's price reaches $200, you would realize a 9.39% return over 48 days, translating to an annualized return of approximately 77.9%. The dashboard gives you a comprehensive view of your position and potential outcomes.

Now, let's examine a second scenario to highlight how different strike prices can lead to varied results, even with minimal changes. In this case, the initial step remains the same: purchasing 100 shares of Tesla at $197.88. However, this time, we are selling a $210 strike call option with the same 48-day expiration, which generates a premium of $11.15—about $3.90 less than the $15.05 received for the $200 strike call. The reason for this lower premium is that the $210 strike is further out-of-the-money, meaning the option is less likely to be exercised, and as a result, buyers are willing to pay less for the option.

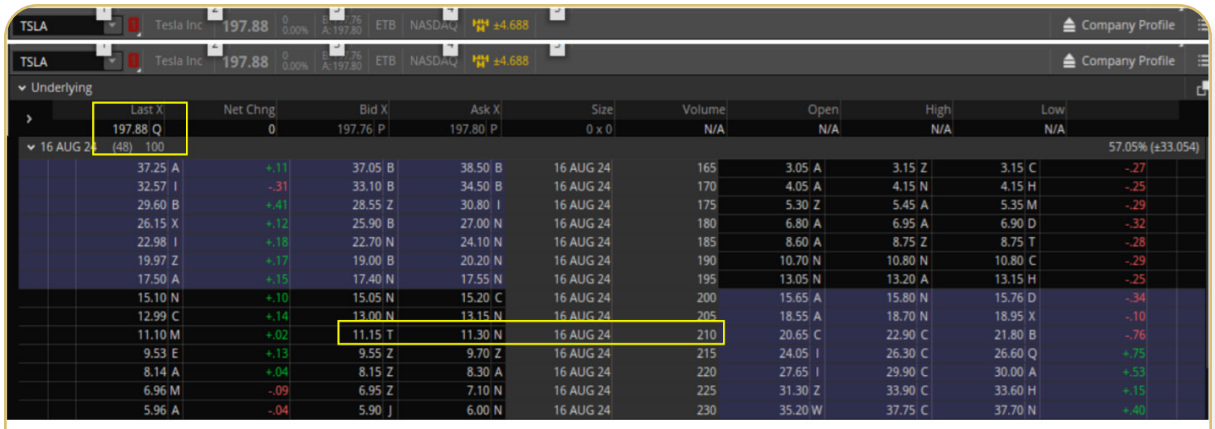


Covered Call on TSLA: Target <u>second out-of-the-money strike:</u>
Step 1: Buy 100 TSLA $197.88
Step 2: Sell 1 TSLA Aug16 210 Call $11.15 (48 days to expiry)
100% time value of $11.15 (7.6% of TSLA, 58% annualized)

This call option carries a lower probability of being in-the-money at expiration, which is why the premium received is lower. Similarly, options with strikes far out-of-the-money, like the $230 call, typically trade for less

(in this case, $5.90), because they are less likely to be in-the-money at expiration. Despite this, we are still able to sell the $210 strike for $11.15, all of which represents time value. As a reminder, out-of-the-money options are entirely composed of time value, which will erode to zero if Tesla remains below $210 at expiration.

If the call option is exercised at $210, meaning Tesla's price exceeds that strike, we would realize $12.12 in capital appreciation from TSLA moving to the strike price.



Covered Call on TSLA: Target second out-of-the-money strike:
Step 1: Buy 100 TSLA $197.88
Step 2: Sell 1 TSLA Aug16 210 Call $11.15 (48 days to expiry)
100% time value of $11.15 (7.6% of TSLA, 58% annualized)
What if call gets exercised? Make $12.12 (capital appreciation) + $11.15 = $23.27
Capital appreciation + option premium = $23.27 Call away return of 12.46%

In the first scenario, where we sold the 200 strike call, our capital appreciation was capped at $2.12. However, in this second scenario, by selling the 210 strike call, we can achieve $12.12 in capital appreciation before reaching the cap. While the premium for the 210 call is lower—only $11.15 compared to the $15.05 from the first scenario—the total gain from both capital appreciation and the option premium amounts to $23.27, which is higher than the $17.17 from the first scenario.

This results in a total *call-away* return of 12.46%, approximately 3% higher than the first scenario, over 48 days. If this performance were replicated consistently throughout the year, it would translate into an impressive annualized return of 94.7%. However, it's important to acknowledge that this idealized scenario rarely unfolds in real-world trading conditions.

Let's examine some key differences in picking the different strikes:

Breakeven Price

In the second scenario, our breakeven price increases to $186.72, as the cushion from the premium ($11.15) is applied to the original stock price of $197.88. In contrast, in the first scenario, we had a **larger cushion** down to $182, meaning we had a greater downside protection in that case. The second scenario gives us more upside potential but less protection on the downside.

Risk of Assumptions

The second scenario also assumes Tesla could rise to $210, a more aggressive move compared to the first scenario where we capped our potential at $200. While it's certainly possible for Tesla to exceed $200, predicting price movements with certainty is impossible. In real-world investing, there's always a degree of uncertainty.

When we sold the $200 strike call for $15.05 in the first scenario, we knew exactly what we could expect in terms of premium. There was no guessing involved—it was a straightforward transaction. We know that we can collect the higher premium immediately.

In contrast, the second scenario involves a certain amount of speculation on our part, as we're hoping for Tesla to move beyond $200 to reach the $210 strike price.

Income vs. Capital Appreciation

When choosing between these two strategies, it comes down to balancing income versus potential capital appreciation. If your primary focus is generating income, the first scenario, with the near-the-money strike and higher premium, may be more appealing. As an income-focused investor, you might prioritize immediate returns over additional upside potential, which is why many investors in the "Crush the Premium" strategy tend to lean toward strategies that deliver a more predictable income stream, even if it means limiting capital appreciation.

In contrast, if you're more focused on growth and have a higher risk tolerance, the second scenario—selling the $210 strike call—will offer more upside potential, though it "trades" less certainty of higher premiums for the higher uncertainty of more growth.

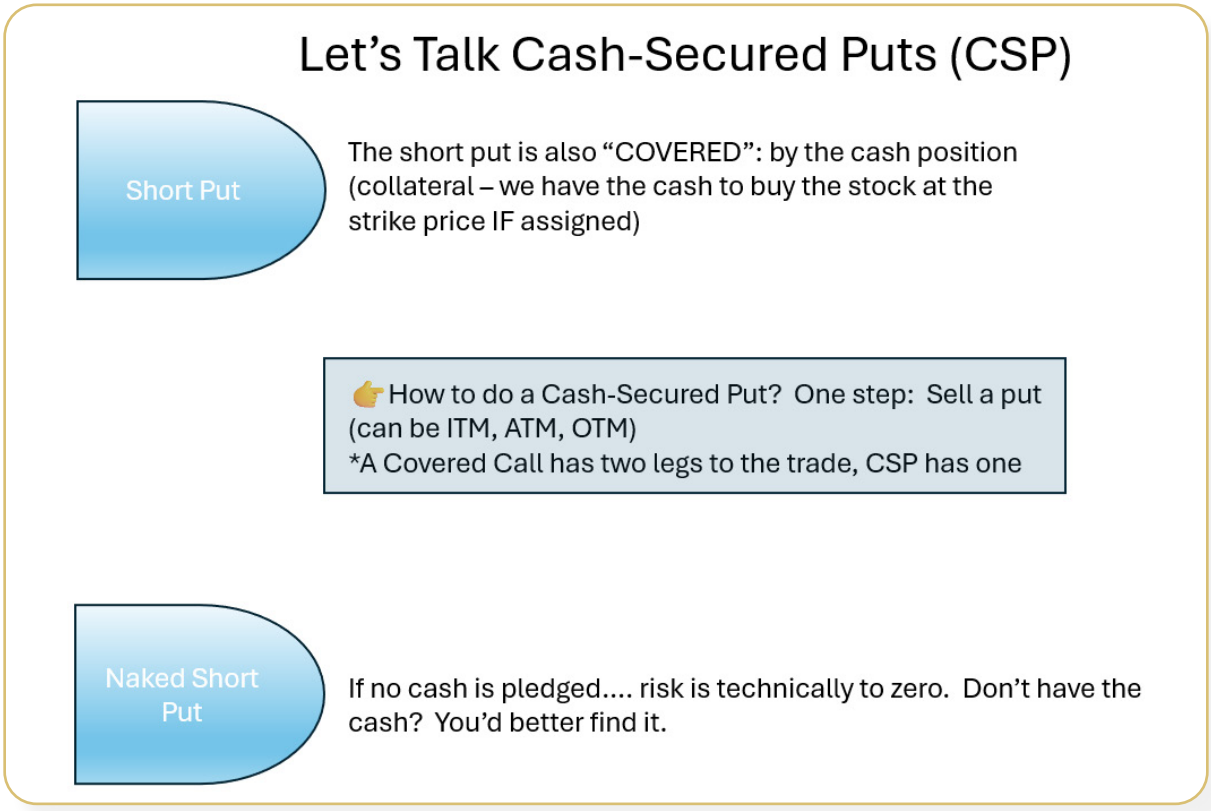
Personal Considerations

The decision between these two scenarios will also depend on your personal financial goals and stage in life. For a younger investor looking for more growth potential, the second scenario might be more appealing. However, for someone closer to retirement and prioritizing income, the first scenario could align better with their needs.

Ultimately, the choice between “a bird in the hand” (a guaranteed premium) and “two in the bush” (the potential for greater capital appreciation) depends on your objectives, risk tolerance, and financial situation. These are decisions that every investor must make, and the right approach will vary depending on individual circumstances.

Chapter #6

Let's now turn our attention to cash-secured puts and examine how this strategy works. We will begin by understanding the fundamental concept behind the trade and then proceed with a series of practical examples to illustrate its application.



A cash-secured put strategy involves selling a put option while simultaneously setting aside enough cash to purchase the underlying stock if you are assigned the position. This cash serves as collateral for the trade. When you sell a put with sufficient cash reserves, it is referred to as a *cash-secured put*.

This is distinct from the covered call strategy, where you own the stock and sell a call against it. In contrast, a cash-secured put is covered by the cash you pledge to potentially purchase the stock, rather than by holding the stock itself.

Mechanically, these strategies differ in execution. A covered call involves two legs: buying the stock and selling a call against it. A cash-secured put, on the other hand, involves just one leg: selling the put option. Thus, a cash-secured put is simpler in structure compared to a covered call, which requires the ownership of the stock in conjunction with the call sale.

Despite these differences in execution, the two strategies are conceptually quite similar. In both cases, you are ultimately positioned to own the stock. With a covered call, if the stock price drops and the option hedge becomes ineffective, you effectively end up long the stock. Similarly, with a cash-secured put, if the stock price falls to or below the strike price, you may be assigned and forced to purchase the stock at that price, rendering you long the stock.

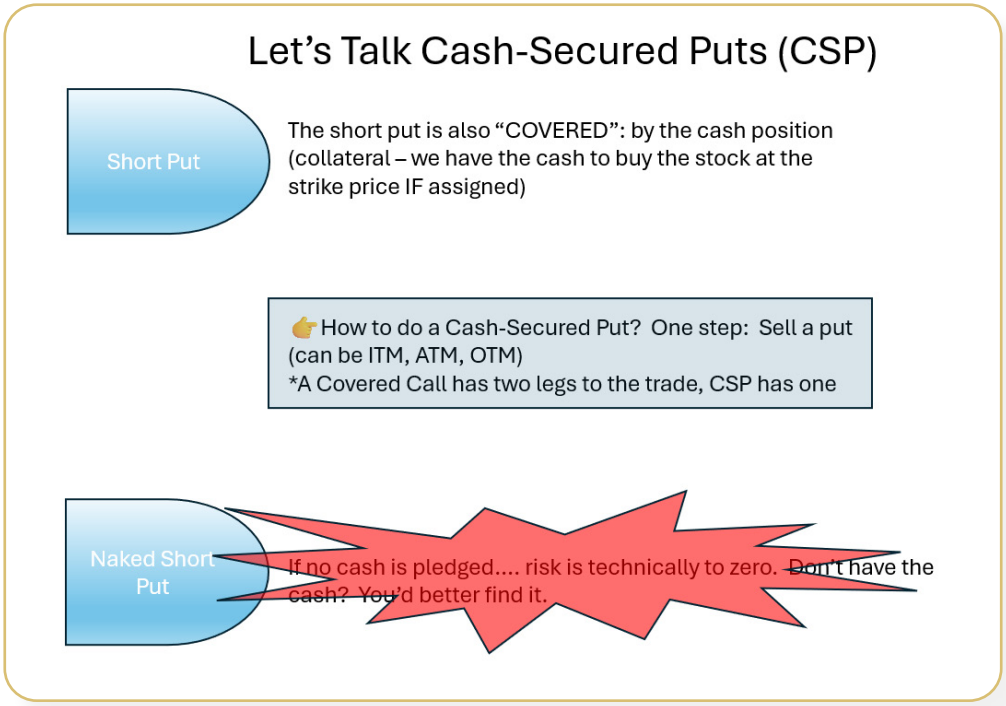
From a technical perspective, a covered call can be seen as a synthetic short put. This is because the combination of being long the stock and shorting the call option has a similar payoff to selling a put option. The relationship between calls and puts is crucial in options markets, and understanding this connection helps clarify why these strategies have similar profiles.

Although conceptually similar, some investors prefer covered calls because they feel more aligned with traditional investing. They can own the stock and also receive dividends, which feels more like an investment.

On the other hand, selling a put involves holding cash in reserve and executing a strategy based on potential future assignment, which may not appeal to everyone.

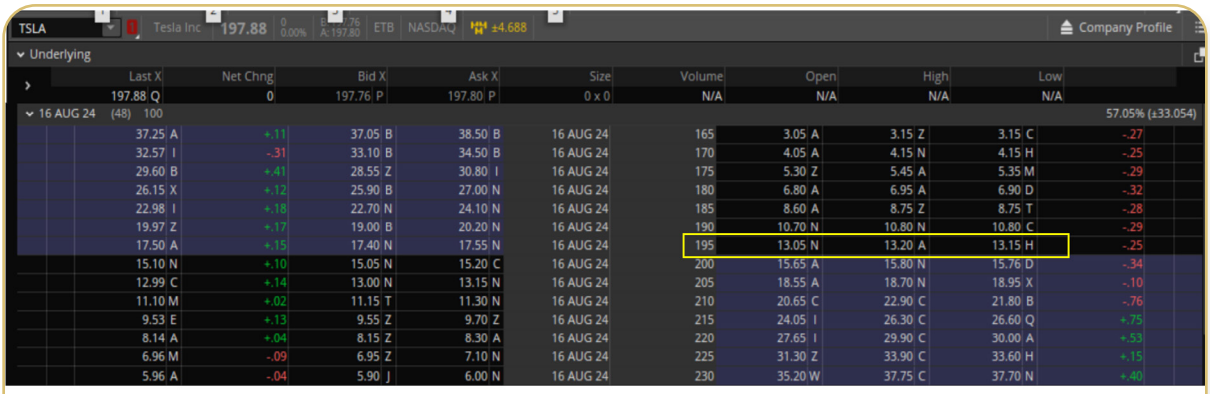
A critical distinction to note is the concept of a *naked put*. This occurs when a trader sells a put without having the required cash set aside to purchase the stock if assigned. A naked put is considered a high-risk strategy, as it leaves the seller exposed to the possibility of having to purchase the stock without sufficient cash to cover the transaction. Many brokers restrict the ability to sell naked puts due to the inherent risk, and we do not recommend this approach for most investors.

In summary, while covered calls and cash-secured puts are executed differently, they are similar in terms of their risk-reward profiles and can both be used to generate income while potentially acquiring stock at a favorable price. However, selling naked puts introduces significant risk and should be avoided.



This is not a recommended approach. Just as we focus exclusively on covered calls in our method, we only engage in cash-secured put sales when utilizing this strategy. It is essential to understand this distinction.

Now that you have the general concept, let's dive into the specifics of how this strategy works in practice.



Cash Secured Put on TSLA:

Step 1: Have enough cash in the account to cover the full value of the potential purchase (non-Portfolio Margin account)

Step 2: Sell 1 TSLA Aug16 195 Put $13.05 (48 days to expiry)

We will begin once again by reviewing the option chain. As before, we are focusing on short-term options with expiration dates ranging from 3 to 6 weeks. In this case, we are still trading in July, and the options we are considering will expire in August, with the expiration date set for August 16th, as indicated in the top left.

Our goal is to maximize premium income while balancing the distance at which we may potentially be assigned the stock. For example, you could choose the 190 put instead of the $195 put, but by doing so, you would reduce the premium you receive, although you would gain a larger cushion.

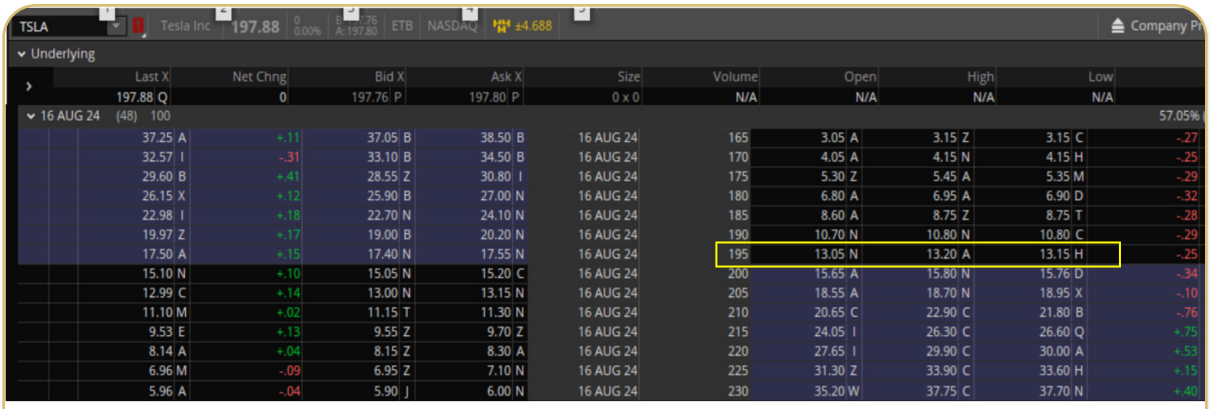
In this case, Tesla could decline from its current price of $197.88 all the way down to $190 before you would be obligated to purchase the stock. This decision mirrors the approach we discussed with covered calls, where we compared different strike prices (such as the $200 strike versus the $210 strike) to assess various potential outcomes.

These decisions can be influenced by market conditions and your own judgment. However, from an income-focused perspective, we often take a more systematic approach to selling options that offer a higher premium. In this example, we will consider the August $195 put. Given that Tesla is trading at $197.88, the $195 put is out-of-the-money. The bid price for this option is $13.05, which represents pure time value since the option is out-of-the-money. Recall that while we may get filled within the market we will generally be receiving a price closer to the bid price at the time our order is sent into the marketplace.

Selling one August $195 put option for $13.05, which expires in 48 days, results in a 7.1% return on risk. To annualize this return, we can calculate how many 48-day periods fit into a year (approximately 7.6 periods) and multiply the return accordingly.

When discussing risk, we focus on our adjusted risk based on the current stock price and the cushion created by the option premium. The premium of $13.05 received from selling the put reduces the effective purchase price of Tesla. If assigned, we will be required to purchase the stock at $195, but because of the $13.05 premium, our adjusted cost basis is effectively $181.95. This means we are acquiring Tesla at a lower price than its current market value.

For example, if Tesla closes at $190 on expiration, we will still need to buy it at $195. However, our cost basis remains $181.95, giving us a buffer of $8.05. Any price above this cost basis at expiration will result in a profit, allowing us to effectively own Tesla at a favorable price.



TSLA Tesla Inc 197.88 ETB NASDAQ ±4.688 Company Pr

Underlying

Last X	Net Chng	Bid X	Ask X	Size	Volume	Open	High	Low	
197.88 Q	0	197.76 P	197.80 P	0 x 0	N/A	N/A	N/A	N/A	
16 AUG 24 (48) 100									57.05%
37.25 A	+.11	37.05 B	38.50 B	16 AUG 24	165	3.05 A	3.15 Z	3.15 C	-.27
32.57 I	-.31	33.10 B	34.50 B	16 AUG 24	170	4.05 A	4.15 N	4.15 H	-.25
29.60 B	+.41	28.55 Z	30.80 I	16 AUG 24	175	5.30 Z	5.45 A	5.35 M	-.29
26.15 X	+.12	25.90 B	27.00 N	16 AUG 24	180	6.80 A	6.95 A	6.90 D	-.32
22.98 I	+.18	22.70 N	24.10 N	16 AUG 24	185	8.60 A	8.75 Z	8.75 T	-.28
19.97 Z	+.17	19.00 B	20.20 N	16 AUG 24	190	10.70 N	10.80 N	10.80 C	-.29
17.50 A	+.15	17.40 N	17.55 N	16 AUG 24	195	13.05 N	13.20 A	13.15 H	-.25
15.10 N	+.10	15.05 N	15.20 C	16 AUG 24	200	15.65 A	15.80 N	15.76 D	-.34
12.99 C	+.14	13.00 N	13.15 N	16 AUG 24	205	18.55 A	18.70 N	18.95 X	-.10
11.10 M	+.02	11.15 T	11.30 N	16 AUG 24	210	20.65 C	22.90 C	21.80 B	-.76
9.53 E	+.13	9.55 Z	9.70 Z	16 AUG 24	215	24.05 I	26.30 C	26.60 Q	+.75
8.14 A	+.04	8.15 Z	8.30 A	16 AUG 24	220	27.65 I	29.90 C	30.00 A	+.53
6.96 M	-.09	6.95 Z	7.10 N	16 AUG 24	225	31.30 Z	33.90 C	33.60 H	+.15
5.96 A	-.04	5.90 J	6.00 N	16 AUG 24	230	35.20 W	37.75 C	37.70 N	+.40

Cash Secured Put on TSLA:

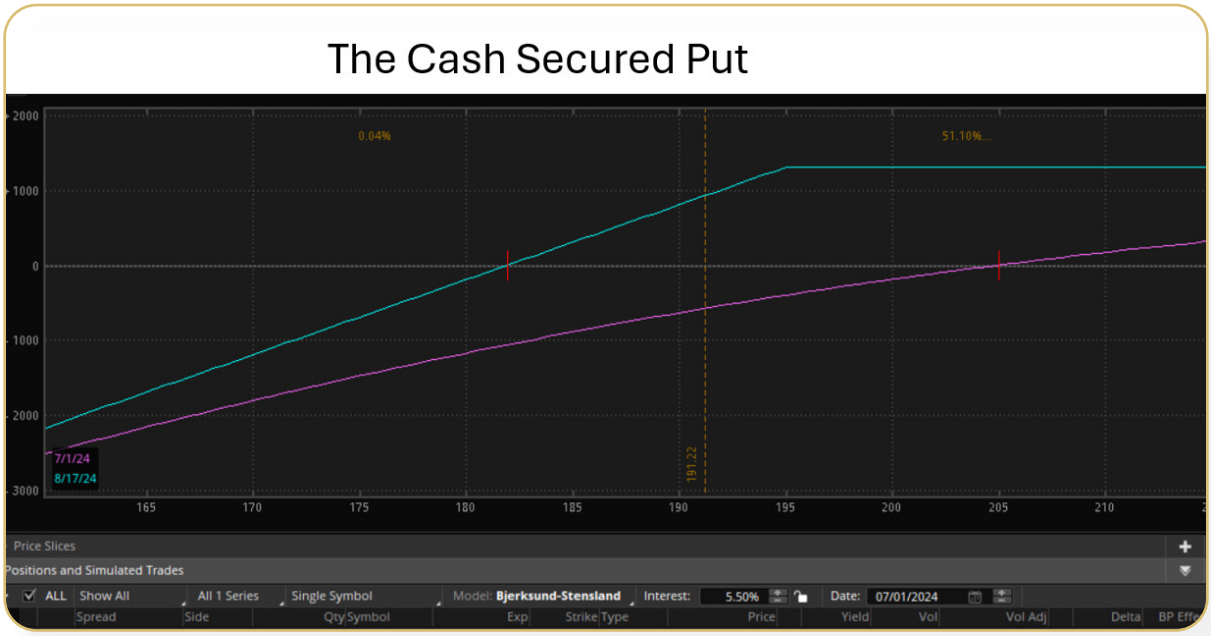
Step 1: Have enough cash in the account to cover the full value of the potential purchas (non-Portfolio Margin account)

Step 2: Sell 1 TSLA Aug16 195 Put $13.05 (48 days to expiry)

100% time value of $13.05 (7.17% of risk, so 54.5% annualized)

By consistently using this strategy and generating premiums, we can lower our cost basis over time, even if the stock fluctuates within a certain range. This approach can be especially effective unless the stock experiences a sharp decline, which is why it is essential to understand the fundamentals and quality of the stock being traded. The Enhanced Wheel Method begins with a thorough examination of quality and how to use my Easy-Button Scanner method to find these kinds of stocks. By continuously receiving premiums, we reduce the cost of owning the stock, often below its current market price, which can significantly improve the overall returns on the position.

Let's now take a look at how this strategy plays out in practice.

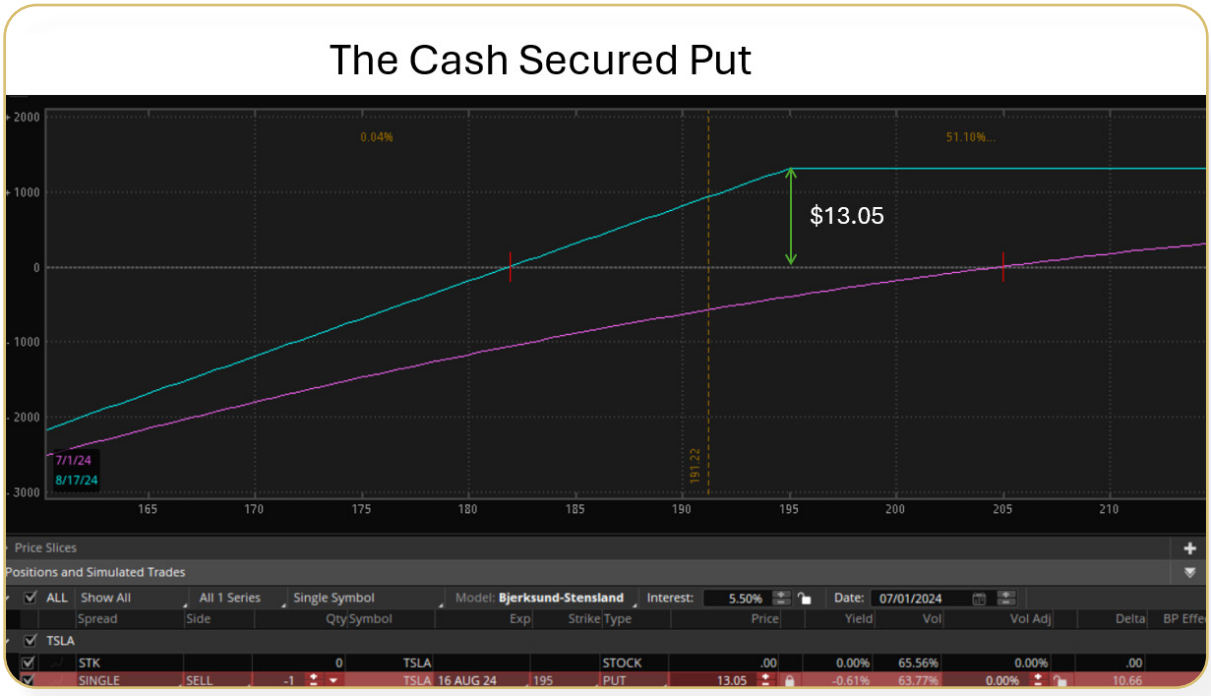


As we can see visually, the cash-secured put strategy closely resembles a covered call. While owning stock entitles you to receive dividends, which you do not receive when selling a put, the option market accounts for this difference. Specifically, the price of the put option will be adjusted to reflect the absence of a dividend, as the option price incorporates factors like interest rates, dividends, and volatility. You may also notice a difference in extrinsic value between the same strike put and call option premiums. This is due to the "carry" of dividend and/or risk-free rate.

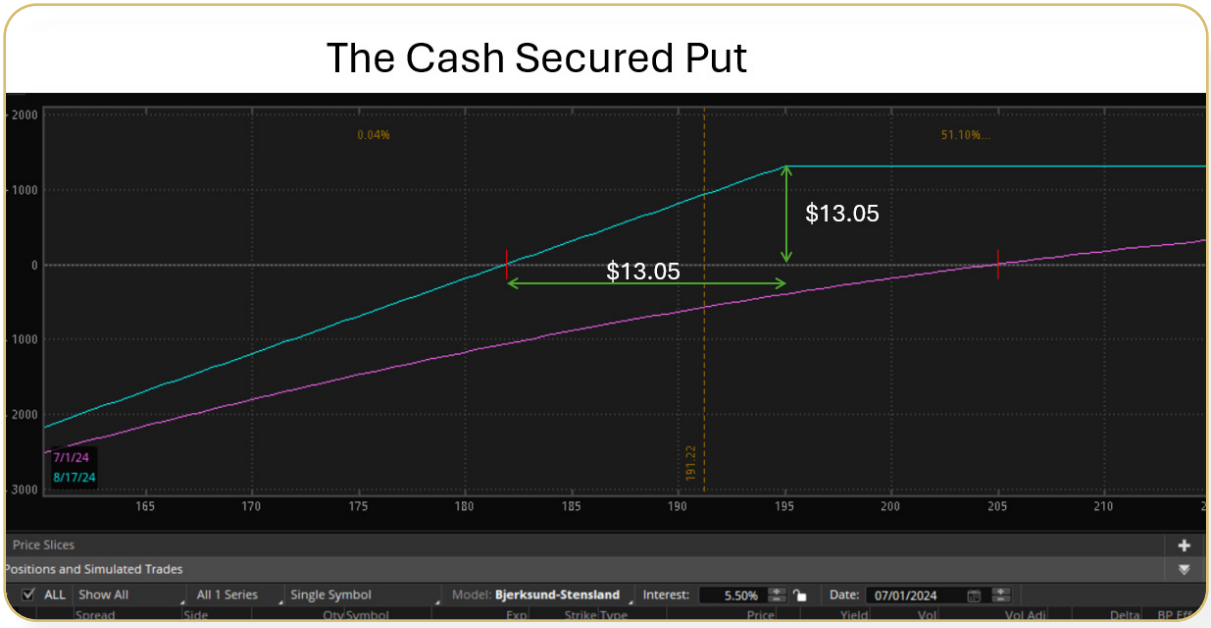
Deeper Dive: Think of the impact of rates on the value. A cash-secured put requires a balance of cash to be pledged – this balance should receive a rate of return. A covered call entails a commitment to buying the stock – it does not receive this interest income become the call is allocated to buying the stock. BUT these factors must play into the extrinsic value (time value) of each option. The concept of put-call parity ensure that these factors are considered in pricing the options.

So the ultimate return on cash-secured-puts should incorporate the interest received on the cash balance during the option-selling campaign.

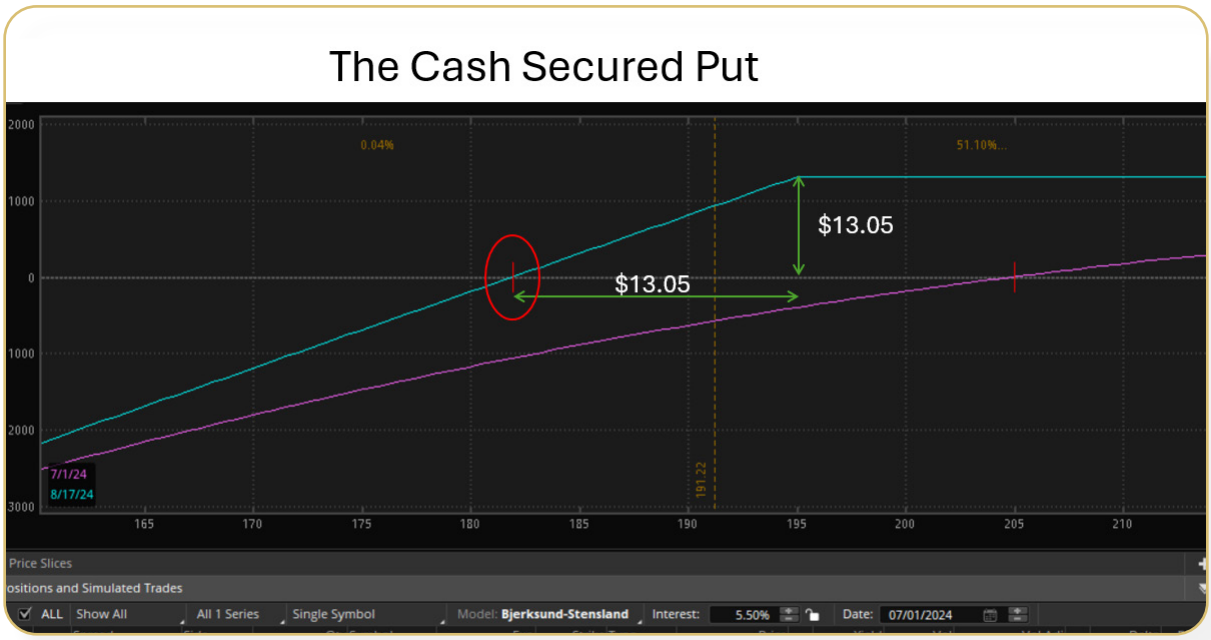
These variables are continuously reflected in the pricing of options, ensuring that all relevant market factors are integrated into the option's value. With the cash-secured put, we have established a cushion of $13.05, which helps to mitigate the potential risks of the trade.



By creating this cushion, we've established a cap on our potential gains. Regardless of how far Tesla's price increases—whether it reaches $210, $220, $230, or $250—the maximum premium we will collect is $13.05. This premium effectively acts as a cushion for any potential decline below the $195 strike price. If Tesla's price remains above $195 at expiration, we simply retain the premium, and we can repeat the process, provided we continue to have a favorable outlook on the stock.



If the stock closes below $195 at expiration, we begin to give back some of the premium, with the loss increasing as the stock price declines toward our adjusted cost basis. The $13.05 premium effectively creates a cushion, and our breakeven point is determined by the adjusted cost basis.



To calculate the returns from our put sale under various scenarios, let's consider the example where we sold the $195 put for $13.05. This results in a return of 7.17% over 48 days, based on our adjusted risk of $181.95, which represents our breakeven point.

How to calculate Put Sale returns under various scenarios:

Trade: 1 Aug 195 Put for $13.05 (48 days to expiry): all time value (extrinsic)

Breakeven: $181.95 (195-13.05 (the cushion))

Max gain: **Anywhere** above $195: Keep the full $13.05

Always think of maximum risk in these scenarios!

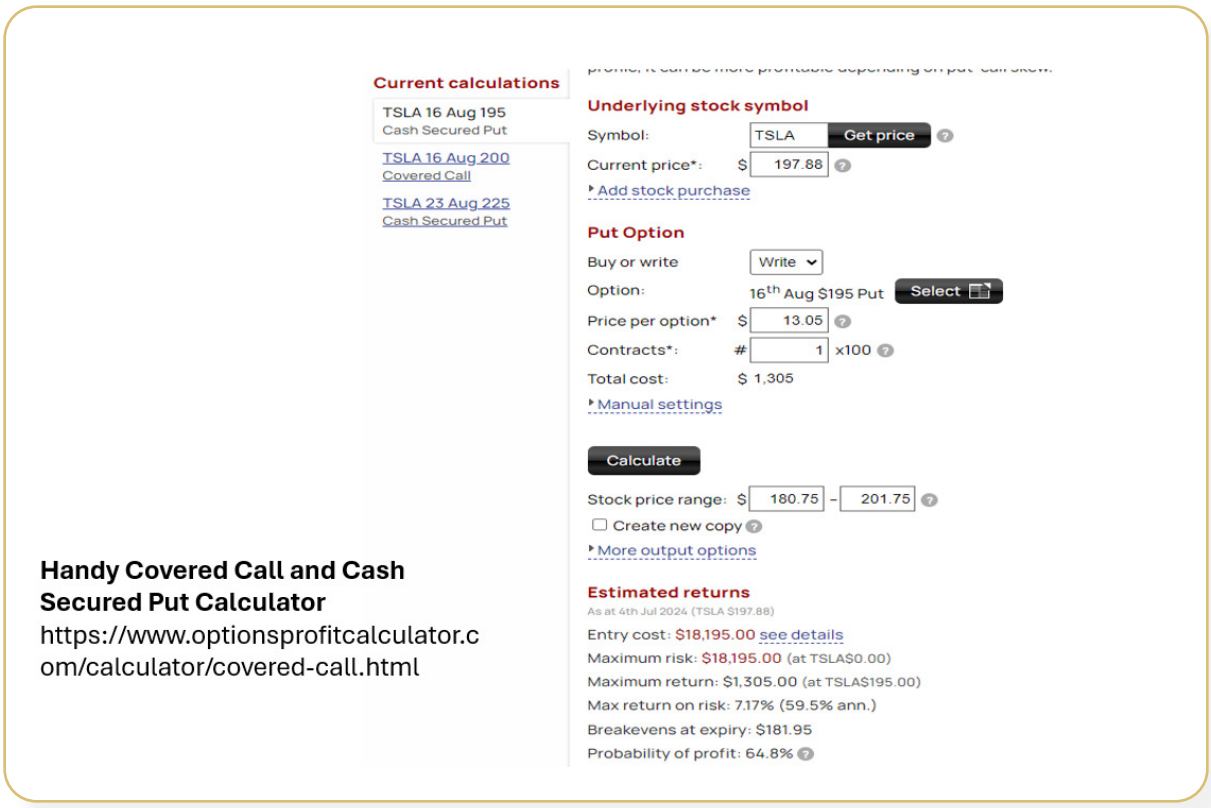
We have made 7.17% (13.05/181.95 (Max risk is 181.95))

Below 195 we start to give away some of our maximum gain, until we own TSLA at a cost basis of $181.95. Keeping in mind that we are going to be assigned at 195!)

The breakeven point for this trade is $181.95, reflecting the cushion we've created with the $13.05 premium below the $195 strike price. Below the $195 strike, we begin to give up some of our maximum potential gain. In the worst-case scenario, if we are assigned at $195, our effective cost basis for owning Tesla would be $181.95, due to the premium received.

This means that if the stock price falls below $181.95, we are effectively long Tesla at that adjusted cost basis, similar to how we would handle a covered call position. In such a scenario, owning the stock becomes the default outcome. It's crucial to understand the various potential scenarios, as they help define the risk and reward of this strategy.

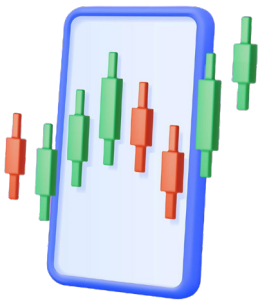
Additionally, we can use the Options Profit Calculator to better visualize these scenarios. By entering the stock symbol, the tool will display the current price, which can be overridden for hypothetical scenarios. For a put option, we will select the "Write" option (since writing means selling), input the $13.05 premium, and see our entry cost and potential returns.



Handy Covered Call and Cash Secured Put Calculator
https://www.optionsprofitcalculator.com/calculator/covered-call.html

Our maximum risk in this trade is $181.95, which is significantly lower than the stock's current price of $197.88, and lower than the strike price of $195. If we had not received the premium, our risk would have been the full strike price of $195. However, the premium of $13.05 reduces our effective risk by that amount, serving as a cushion or protective value for the trade.

This results in a maximum return on risk of 7.17%, which translates to an annualized return of approximately 59.5%. Our breakeven point for this position is $181.95.



Possible outcomes review:

Covered Call:

1.Stock closed below written strike (out-of-the-money) on expiry: expires worthless on expiry Friday.

Re-write new options on Monday after expiry Friday (third Friday of the month)

2.Stock closes above the strike (in-the-money) on expiry: let stock get called away.

You will no longer be long this stock come Monday morning

Don't want to get called away?

Between 2pm and 2:30pm ET: Buy the call back only, or "roll" to your next strike according to the CTP Method

Important: buying back an in-the-money call where the buy is MORE than the newly written call, you will require capital (cash).

If you are FULLY invested and don't have cash handy you will need to raise cash (sell some of the stock, some other asset...) in order to buy back the calls: you will need the net amount of the buyback amount less the new option sale amount.

Chapter #7

Managing Covered Call Expirations: Key Scenarios and Actions

Let's review the potential outcomes for the strategies we've discussed, starting with the covered call.

1. The Stock Closes Below the Written Strike Price

In this scenario, the call option expires out-of-the-money. By expiration, the option's time value has eroded to zero, and its intrinsic value is also zero since the stock price is below the strike price. As a result, the call expires worthless.

What's the next step? On Monday, after the Friday expiration, we can sell new options to continue generating option cash-flow. It's important to note that unless the calls were closed on Friday, there is still risk associated with the position, even if the option's value has dropped to zero. This is because the stock position remains open, leaving us exposed to the possibility of a significant price movement. Therefore, we continue to monitor the position and manage it accordingly.

If we do not close our position, ie buying back the call or put, we will always have a small risk of market movement in the after-hours that may impact the outcome of our position. For example, if we are short a call against stock (we use the term short to describe the call leg of

the covered call strategy) and do not buy it back, even for a few cents, on the day of expiry, the market in that stock may react positively to some sort of news and move through the strike after the 4pm ET market close. Stocks do trade quite freely in the pre-market and post-market (before 9:30 am ET and after 4:00 pm ET), and will continue to do so as efforts to expand trading hours undoubtedly continue.

If the stock moves above the strike after 4pm, even on expiry, you may get assigned even though the closing price of the stock may have been below the strike price. In order to prevent this, if you desire, is to buy back the call, particularly when the market closing price is somewhat close to the strike price. Some people may elect to just accept assignment and reevaluate on the Monday post-expiry. This will come down to personal preference and trading plan. There is no technical inherent danger in this because we do own the stock, but some may prefer to close positions so as to not lose their stock position.

In summary, while the expired call might have no intrinsic value at expiration, it is still important to manage the risk until the position is fully closed or rolled forward into a new trade.

Possible outcomes review:

Covered Call:

1.Stock closed below written strike (out-of-the-money) on expiry: expires worthless on expiry Friday.
Re-write new options on Monday after expiry Friday (third Friday of the month)

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You will no longer be long this stock come Monday morning
Don't want to get called away?
Between 2pm and 2:30pm ET: Buy the call back only, or "roll" to your next strike according to the CTP Method

Important: buying back an in-the-money call where the buy is MORE than the newly written call, you will require capital (cash).
If you are FULLY invested and don't have cash handy you will need to raise cash (sell some of the stock, some other asset...) in order to buy back the calls: you will need the net amount of the buyback amount less the new option sale amount.

If the stock closes below the strike price at expiration, the written call option expires **out-of-the-money**. Its time value has eroded to zero, and it holds no intrinsic value, so it expires worthless.

Timing is crucial when dealing with these positions. Many traders prefer to close or adjust their options during the late afternoon on Friday (typically between 2:00 PM and 3:00 PM ET), as this allows them to avoid being caught in unpredictable market conditions that may arise after trading hours. If you're unavailable on Friday afternoon, some traders opt to make adjustments earlier in the day, or even by Thursday, to ensure the position is managed before the weekend.

2. Rolling Options (Friday vs. Monday)

An alternative approach is to "roll" the position. This means buying back the existing, expiring call option and selling a new one with a later expiration date. By rolling the position on Friday afternoon, you can immediately reinstate your income-generating strategy, starting the process of time decay (theta) again. However, this carries the advantage of avoiding any weekend risk where news might impact the stock price.

If you wait until Monday to roll the position, you face potential "weekend risk." This is the possibility that the stock moves significantly during the weekend (e.g., due to a news release) and could cause the call options to get exercised. Again, while not pronounced in most cases, this is a real concern when options are close to the strike price, as sudden market movements over the weekend could trigger the exercise of your short calls before the market reopens.

The decision to roll on Friday or Monday depends on several factors:

- **Weekend Risk:** If you roll on Friday, you reduce the risk of unexpected market moves during the weekend. Options will expire on the Friday, and you will have no call-selling exposure over the weekend. BUT...
- **Potential for Better Pricing:** Waiting until Monday could allow you to sell new options at better prices, particularly if the stock jumps on Monday morning. There is some debate as to the validity of the "Weekend Effect" theory that postulates that stocks tend to drop on Mondays.

- **Option Pricing Nuances:** While more a focus of our Volatility Ninja Series it bears mentioning that option pricing tends to get compressed by market makers on Fridays (I did this all the time as a market maker!) – meaning that Mondays may be a more opportune time for new option writing as pricing bounces back.

3. Stock Closes Above the Strike Price (In-the-Money)

When the stock closes above the strike price at expiration, your call options are now in-the-money, and they will likely be exercised. This means you'll be required to sell your stock at the strike price. The result is that you will still retain the premium received from the original option sale, but you will lose your stock at the strike price.

On Monday morning, you'll have no position remaining, as the stock will have been called away. However, this is still a profitable outcome, as you've locked in the premium income, as well as potential appreciating if the sale price (strike price) is higher than your initial stock cost basis.

What can you do to avoid being called away?

- **Buy Back the Call Option:** If you wish to retain your stock because you believe it will continue to rise, you can buy back the short call option. This action will close the position, but it may cost you a bit, as the call will likely have intrinsic value (the difference between the strike price and the current stock price).

- **Roll the Position:** If you don't want your stock to be called away, you can roll the position into a new call. This involves buying back the in-the-money call and selling a new call at a later expiration date, often with a higher strike price. This is called "rolling up and out" strategy: you're moving to a more distant expiry data and likely to a higher strike price as well. Although you may roll out and down, or out and sideways if using the same strike. Market conditions will help to determine the course of action, which the Method guides in great detail.

Example: if your original strike was at $200 and the stock is now trading at $205, you might roll into a $210 strike price, moving the strike price upward and extending the expiration date from February to March.

4. Managing Deeply In-the-Money Calls

If you're holding a deeply in-the-money short call (for example, the stock has risen significantly), you may need additional cash to buy back the option. This scenario could arise if you've sold calls against stock in a fully-invested account and now need to cover the exercise or assignment of those options.

In such cases, it's essential to ensure that you have enough capital in your account to execute a buyback or to cover the assignment process without incurring margin issues. **Planning ahead** and having sufficient liquidity is crucial in these situations.

Conclusion

The decision-making process surrounding covered call expirations often requires swift, thoughtful action. Whether letting the calls expire worthless, rolling positions to reduce risk, or managing in-the-money options, each scenario comes with its own set of considerations. By understanding these outcomes and strategies, you can more effectively manage risk and optimize returns.

Possible outcomes review:

Covered Call:

+100 TSLA $197.88
Short $200 strike August call
Stock closes at $205.00
2pm ET:
Buy back the calls you are short at around $5, and if you so choose sell the Sep 210 Calls $13.00

What price? Buy back the call at intrinsic +0.05 if you can. Raise bid to intrinsic +0.10

Managing Covered Call Rollovers: A Practical Example

Let's continue with the scenario where we are short the August $200 strike call, and the stock closes around $205 on expiration day (or looks likely to close near $205). Here's how to handle it:

1. Buying Back the Calls (Intrinsic Value)

By 2:00 PM on expiration day, you'll notice that the calls are primarily made up of intrinsic value, with no time value left. The difference between the stock price ($205) and the strike price ($200) is $5, so the calls will be worth approximately $5 at expiry.

The market maker will typically provide a bid-ask spread on the calls, say $4.90 (bid) and $5.10 (ask). In this case, the call options are priced based on intrinsic value, and the slight spread reflects the market maker's business model of buying at the bid and selling at the offer. Similar to how a store buys apples at one price and sells them at a higher price, the market maker is profiting from the spread between the bid and ask prices (among other things – a much deeper conversation!).

As a result, you might need to pay a little more than the intrinsic value of $5—perhaps $5.05 or $5.10—depending on where the market is. This is an important consideration when closing out positions, as the final cost to buy back the calls could be slightly higher than their intrinsic value.

2. Rolling the Position

Alternatively, if you decide not to buy back the calls and instead wish to continue the strategy, you can roll the position. This involves buying back the current in-the-money August $200 strike calls and selling new calls with a later expiration date, such as the September $210 strike calls.

By rolling the position, you're effectively moving your covered call strategy "up and out." This means you're extending the expiration date (moving from August to September) and increasing the strike price (moving from $200 to $210). The September $210 calls will likely be sold for a premium of around $13, reflecting the increased time value and the higher strike price.

3. When the Roll Results in Paying More to Buy Back the Calls

Now, let's examine what happens if you need to pay more to buy back the in-the-money August calls than the premium received from selling the September $210 calls.

For example, if you buy back the August $200 calls for $5.05 and sell the September $210 calls for $13, you've essentially rolled the position. However, this raises the question: **What happens if the cost to buy back the existing calls exceeds the premium received for the new ones?**

In this case, the cost to buy back the calls is $5.05, and you're receiving $13 for the September calls, which results in a net credit of about $7.95. So, while you're paying more to close out the August calls than their intrinsic value, you're still receiving a premium for the new September calls. The net result is a slight increase in your position's overall income, and you maintain your exposure to the stock while continuing to generate premium.

4. The Importance of Roll Management

This example highlights why rolling can be a powerful tool in managing a covered call strategy. By rolling up and out, you're adjusting to market conditions, increasing your potential upside, and potentially collecting additional premium, all while extending the duration of the position.

However, it's also essential to carefully monitor the costs of rolling. If the cost to buy back the in-the-money calls approaches or exceeds the premium received for the new position, it may affect your overall profitability. Understanding this dynamic is key to making informed decisions when rolling options.

Summary

- **Buy Back:** If you choose to buy back the calls, you'll be paying around the intrinsic value ($5), plus any market maker spread.
- **Roll Up and Out:** If you roll, you buy back the current calls and sell new ones with a later expiration and a higher strike price, generating a net credit in most cases.
- **Market conditions may affect the "Up" part of this decision:** We may roll down or sideways.
- **Cost Considerations:** When rolling, ensure that the cost of buying back the calls doesn't outweigh the premium received for the new calls. In this example, you end up with a net credit, maintaining the integrity of your strategy.

Understanding these roll mechanics and costs will allow you to make better decisions about when and how to manage your covered calls and continue generating income in line with your market outlook.

Chapter #8

The key question to consider is: What happens if the buyback costs more than the premium you receive from selling the new call? If the cost to buy back the existing position is less than the premium you receive for the new sale, then the transaction is a net credit received, as you are effectively receiving more than you are paying out. However, if the buyback exceeds the premium you are receiving for the new covered call, this presents a challenge that requires careful consideration and management.

Expensive buyback:

Covered Call:

What if your buy back costs more than the new premium you are receiving?

Example, TSLA closes at $215. We have to pay $15 for the buyback, and we will receive $10 for the new September 220 calls. Net we have to pay an extra $5 for the buyback.

Pay $15 for 1 contract = $1500
Sell new contract for $10 = $1000.
Where does the extra $500 come from?

If we are fully invested (have little cash in the account), we may have to fund the account
OR
Sell some assets to cover the imbalance. Sell TSLA? We can't sell any.
If we are long 150 shares, we could sell 4 shares to cover the $500 (raises $860)
We could get called away and then re-initiate position on Monday.
Tax consequences to keep in mind

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For example, if Tesla closes at $215 and we need to buy back the call for $15, but we are only receiving $10 for the new September $220 calls, this creates a net deficit of $5.

Specifically, if the buyback costs $15 (reflecting the intrinsic value around 2:00–2:30 PM on expiration Friday), this amounts to $1,500 for one contract. We are then selling a new contract for $10, or $1,000. The net difference between these amounts results in a $500 shortfall.

In such a scenario, if the account is fully invested with minimal cash available (e.g., $50 to $100), additional funds will need to be sourced to cover the $500 deficit. This could involve depositing more money into the account or liquidating other assets.

However, we cannot sell any Tesla shares if we are presently short calls against them, as doing so would **leave the position uncovered**. If we are long exactly 100 shares, selling any would leave us unhedged, risking naked exposure. Your broker may not allow any such stock sale while short calls are attached. On the other hand, if we hold more than 100 shares, such as 110, 120, or even 150, we could sell 4 shares to cover the $500 shortfall. In this case, selling 4 shares would raise approximately $860, which would cover the deficit, allowing us to proceed with the buyback and sale of the new calls.

Alternatively, we could liquidate other assets in the account if we prefer not to touch Tesla. This could include selling different stocks or securities.

Key Concept: It's essential to be mindful of potential tax implications when liquidating assets, particularly if selling any shares with a low-cost basis, as this could trigger capital gains taxes.

Another option is to let the position play out and allow the stock to be called away. If the calls expire and the stock is called, we will lose the stock that was used to cover the short call. Any shares in excess of the 100 shares that were used for the covered call will remain in the account. For example, if we had 134 shares of Tesla, we would be left with 34 shares once the 100 shares are called away.

In this case, we would come in on Monday with no position in the stock for the portion covered by the short call, but we would still hold any shares above the 100 shares that were called away on assignment. We can then reassess the situation and explore new options for potential trades. We may have to “top-up” owned shares in order to sell one or more covered calls.

Chapter #9 Theta Decay and Option Expiry Date to Target

Duration of Options: Understanding Time to Expiry

Let's discuss the duration of options, which refers to the lifespan of the options contract. This can range from very short durations, such as one day, to several weeks, months, or even years. For example, some options may expire within a day, known as zero-day options (0 DTE), while others may have a duration extending for months or longer.

Zero-day options, or 0DTE options, have gained significant attention in recent years. In fact, approximately half of all options traded daily are 0DTE. This phenomenon has transformed the landscape of options trading, with many traders actively engaging in these ultra-short-term positions.

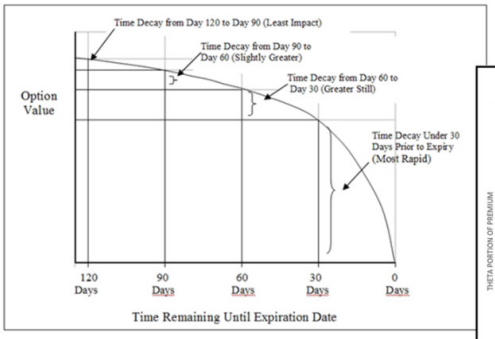
For our strategy, understanding the duration of options is important. Some may choose to sell options with expirations ranging from a few hours (same-day expiry) to a few weeks or even months. A key consideration is the time value of the option, which is the extrinsic value that erodes as the option approaches expiry.

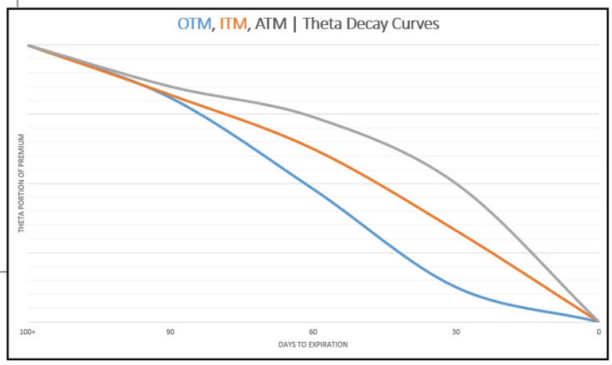
It is important to note that the intrinsic value of an option (the difference between the stock price and the strike price) does not decay; only the extrinsic or time value decreases as expiration nears. This time decay, represented by the Greek **theta**, is a central element of our cash flow strategy, as it allows us to take advantage of the diminishing value of the options we sell.

When selecting which options to sell, we typically focus on contracts with a lifespan of 3 to 6 weeks remaining until expiration. These options offer a balance between premium generation and time decay, making them ideal for our strategy. We generally avoid very short-term options, such as those with only a few days or hours left to expiry, as well as longer-term options with several months or more to go.

By targeting options with 3 to 6 weeks until expiration, we can optimize our approach to time decay, capturing consistent premium income while managing risk effectively.

Option Decay: The Path Depends a Little on How Far the Strike Is





✔ Those ATM (at-the-money) options will hold on for (seemingly) forever! But at 4pm they should be zero

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The Nuances of Short-Term Options: Understanding Risk and Time Decay

While some traders focus on very short-term options, spending their days grappling with minute price movements, we prefer to take a different approach. This strategy requires a distinct mindset, and honestly, it's not for everyone. The issue with very short-term options—especially those approaching expiration—is the increased risk due to **negative Gamma**, which escalates as expiration nears. Without diving too deep into the Greek letters, **Gamma** refers to the rate of change in an option's delta as the underlying asset's price changes. In simple terms, this means that as options approach expiration, particularly when they are near the strike price, they can become much more volatile, even with minimal price movement.

This heightened **Gamma risk** means you're facing significant price movement risk for very little remaining potential gain. The ratio of potential reward to risk becomes increasingly unbalanced as expiration approaches, especially when there's very little premium left to capture. As a result, in the final few days before expiration, you're not being compensated enough for the risk you're taking.

Even though our strategy is based on **covered calls** and **cash-secured puts**, we are still, in essence, managing "risk". The risk in a covered call is that we might have to give up upside potential, something we'd like to avoid. This is why we focus on **edge**—a concept we've discussed before—where we aim to extract premium from options that are priced higher than their fair value. We get deeper into this Volatility Risk Premium" concept in our Volatility Ninja Series. The key takeaway is that we want to avoid taking on risk unnecessarily.

It's possible to take a more passive approach to investing by simply buying stocks and holding them for the long term. However, our goal is to **harvest option premiums** in a consistent, calculated way that optimizes both risk and reward. We constantly assess whether the premium we're receiving justifies the risk we're taking, whether that's the risk of being called away on a covered call or the risk of owning stock at a lower price via a short put.

Risk-Reward: A Core Principle of Our Income Strategy

The concept of **risk-reward** is central to our income-generating strategy. While our approach to premium harvesting is largely systematic and automated, there are times when we introduce more sophisticated insights to increase our returns. As we continue through this course, we'll explore different ways to adjust and refine our strategy to move the needle on our income.

- **Deeper Dive:** The pure 1% and 2% methods in the Enhanced Wheel Program focus more on the cash-flow received, whereas the broader Crush the Premium Enhanced Wheel, and much more in-depth Cash Flow Insiders Live Mentoring programs apply a more holistic approach that aims to take as much value out of markets as possible. At times the traditional options income approach will take center-stage – at others we will let the market do more of the work for us and adjust the strategy to capitalize. As someone who managed a billion dollars in options-income funds I can attest that I am not happy with collecting $5 when I could have grabbed $15. But a recognition of environment, options pricing and many more factors will play into this opportunity.

So, for those who are part of our **Cash Flow Insiders Program**, we delve deeper into the intricacies of options trading, including volatility analysis, to uncover additional edges and optimize our strategies. This program is designed for traders who want to look beyond income generation alone and understand the broader dynamics of options trading and quality investing. It's an advanced course that provides a comprehensive view, offering value that is hard to find elsewhere.

Time Decay and Expiry Targeting

Time decay, or **theta**, accelerates as an option nears its expiration. The closer an option gets to expiry, the more rapidly its time value diminishes. This is where things get interesting. While there are typical decay charts you may have encountered, the most effective time to capitalize on theta decay falls between the 20 to 45-day window before expiration.

At this stage, options still have substantial time value left, but that value begins to decrease rapidly as we approach the final days. In contrast, once we move into the final 10 days or less, the time value rapidly disappears, and the rate of decay steepens. This can be both a benefit and a drawback: we get a sharp decline in time value, but there is very little premium left to capture by this point.

For example, options with **30 to 60 days** remaining to expiry tend to see a pronounced drop in time value, which is ideal for our strategy. Conversely, once the option nears expiry, the remaining time value shrinks dramatically, and there may not be enough premium left to justify the risk. That's why we prefer targeting options with around **30 to 60 days** remaining before expiration, where we see a favorable balance of time decay and premium capture.

The Impact of Moneyness on Time Decay

The concept of **moneyness**—whether an option is **in the money**, **at the money**, or **out of the money**—also affects how quickly time value decays. **Out-Of-The-Money (OTM) options** experience a steeper early decay, especially if the underlying stock is not moving towards the strike price. This rapid decay is a significant reason we tend to sell **OTM puts and calls**.

If the stock price remains relatively stable and doesn't approach the strike price of the OTM option, the time value collapses quickly. Once the option reaches the 15-day mark, the rate of decay flattens, and the option will continue to decay more slowly until expiration.

In contrast, **At-The-Money(ATM)** options tend to retain their time value longer, even as they approach expiration. These options are the most expensive in terms of premium because they are closest to the intrinsic value. As expiration draws near, ATM options will retain their time value and exhibit less steep decay than OTM options.

Deciding Whether to Roll or Let the Position Expire

For passive income traders who prefer a hands-off approach, such as those using the **wheel strategy** or the **covered call and cash-secured put strategies**, the goal is to let the time value decay naturally, without additional intervention. After the options expire, we simply repeat the process. The consistency of this approach is appealing, especially for those who prefer to focus on income generation while leaving the management of the options to a certain degree.

However, there is also the option to **roll** positions earlier to capture additional theta decay. **Rolling** refers to closing out a current position and opening a new one with a later expiry. By doing so, we can continue to capture theta and optimize the amount of time value we extract from our options. If the stock hasn't moved significantly and the option hasn't reached the point where time decay is steepening, rolling out can help extend the opportunity for premium capture.

The "Sweet Spot" for Time Decay

As we've discussed, the ideal window for maximizing theta decay is typically between **20 to 45 days** to expiry. In this range, we see an optimal balance between the premium available and the speed of time decay. While the final few days before expiry may seem like they offer rapid decay, there's very little time value left at that point. That's why, in our strategy, we focus on options that still have significant time value, but are approaching that final period of decay.

In conclusion, managing time decay effectively is key to our options strategy. By focusing on the right timeframes and balancing risk-reward considerations, we can optimize the income we generate from our trades while keeping risks manageable.

✔ Typical target for our option write is 30 days. 25-40 days is ideal (use weekly for a 5-week position)

✔ At 10 days and below we get steep decay but relative diminishing returns to the overall position, there is less to capture

✔ Theta to gamma ratio less favorable: ie not making much but risking more movement, less hedge.

✔ Don't sell anything longer than 3 months. Movement risk outweighs theta benefit, which is slower. That's why longer-term options tend towards a 50 delta no matter the strike: because anything can happen over a longer period.

As we continue to refine our strategy, the **3/4 to 8-week** option timeframe often becomes the sweet spot for maximizing returns. This period allows us to take advantage of time decay while still capturing a meaningful amount of premium. Once we move to **10 days or less** before expiration, the time decay accelerates sharply, but we also begin to see **diminishing returns**. At this point, while we may experience rapid time value erosion, the remaining premium available to capture becomes very small, and the risk of giving up significant upside or potentially owning a stock at a much lower price becomes more pronounced.

This balance between risk and reward is something we must always consider. When there's little reward left for the risk we are accepting, it may be worth reconsidering our present position. If we're dealing with **At-The-Money** options, we may choose to simply wait until the premium is fully realized, which could result in a more passive income stream.

On the other hand, with **Out-Of-The-Money** options, rolling them into a new position might be more advantageous, allowing us to continue harvesting theta and extending the life of our premium capture campaign.

Duration and Premium Capture

One important guideline to keep in mind is that we should avoid selling options with expiration dates more than **three months** out. I would recommend limiting most sales to around **two months** out, as this ensures we are still within a period of significant time decay while avoiding the flat portion of the decay curve. By selling options with shorter durations, we are better positioned to harvest time decay and premium on a more frequent basis.

Selling options with longer expiration dates—such as those approaching three months or more—can still provide more premium up front. However, the return on that premium may not be as substantial once you account for the extended period of time you're holding the position. In contrast, by selling shorter-term options more frequently, we can capture **more premium overall** over time. Even though the individual premiums may be smaller, the frequency with which we can cycle through trades can result in a much higher total premium accumulation compared to holding long-term positions.

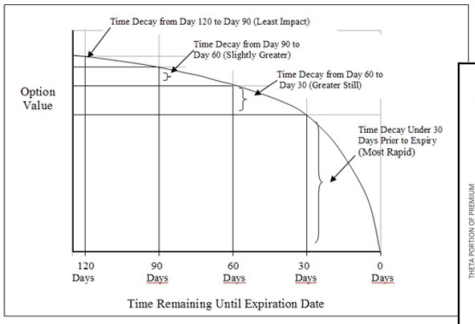
Ultimately, it's a balance between capturing premium more frequently and the length of time you're willing to hold each position. Shorter-term options give us more opportunities to adjust our strategy, roll positions, and optimize for theta decay. Longer-term options can offer higher premiums, but they also expose us to more risk, and the time decay tends to be more gradual.

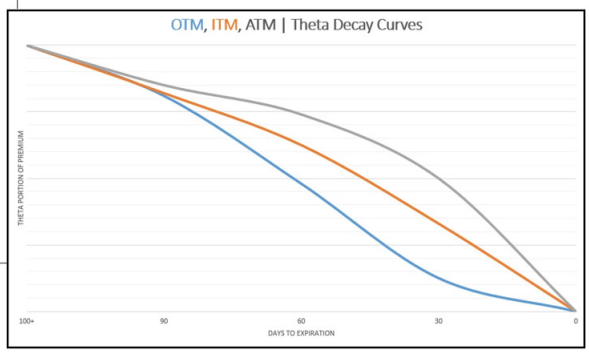
Key Considerations for Rolling

When we roll a position, we're essentially extending our opportunity to continue harvesting premium while mitigating some of the risk associated with imminent expiration. Rolling can be especially useful if we want to **maintain a position** or **avoid assignment** but still want to capture the benefits of time decay over a longer period. However, it's important to monitor the premium and the remaining time value when rolling. If the premium from rolling doesn't sufficiently outweigh the risk, it may not be worth continuing the trade.

In summary, while shorter-term options (in the **5-6 week range**) are typically more favorable for maximizing time decay, it's essential to keep an eye on the overall risk-reward balance. Selling options with **shorter durations** provides a more dynamic approach, enabling more frequent premium capture and the ability to adjust to market conditions. While **longer-term options** can offer larger premiums up front, they also come with a reduced rate of time decay, which may not align with our strategy of maximizing quick, consistent returns. By understanding these dynamics, we can adjust our trading to ensure we are making the most of both **time decay** and **premium capture**.

Option Decay: Positive Theta and the Steeper Crush





✔ Those ATM (at-the-money) options will hold on for (seemingly) forever! But at 4pm they should be zero.

Exactly, longer-term options tend to be much slower to decay, especially in the beginning, and only start to experience significant time erosion as they approach expiration. This can tie up capital for extended periods without delivering the kind of premium returns we're aiming for. By focusing our efforts on options with expiration dates between **30 and 60 days**, we're positioning ourselves in the **steeper part of the decay curve**, where the time value erodes at a much faster rate.

In practice, this means that if you were to sell **50 one-week length expiry options** versus selling **two six-month options**, the total premium you'd capture from those shorter-duration contracts would likely be much higher. This strategy allows for more frequent harvesting of premium, as you can cycle through trades more often, each time benefiting from the accelerated decay within that optimal 20-45 day window.

The key takeaway here is that the **steeper decay** period provides the greatest opportunity for consistent premium capture. Over time, the compound effect of harvesting from this part of the curve can significantly outperform the relatively flat, slow decay seen in longer-term options.

While this might be something you need to experience firsthand to truly appreciate, the results speak for themselves.

So, as we continue through the blueprint, keep this principle in mind: the more you focus on **options with 20-45 days to expiration**, the more you'll benefit from consistent time decay and premium capture. This approach not only helps optimize returns, but it also keeps you more actively engaged in your strategy.

Summary – Theta Decay and Expiry to Target

This chapter focuses on the critical concept of **time decay**, specifically **theta decay**, and how it impacts options trading strategies, particularly those focused on premium harvesting. The duration of options—ranging from very short-term options (0 DTE) to long-term options with several months to expiry—is essential to understand, as it directly affects the options' time value, which erodes over time as expiration approaches.

The core strategy revolves around **selling options** with a **3 to 6-week** time horizon, where the premium still holds substantial value, yet the time decay begins to accelerate. This period offers an ideal balance of time decay and premium capture, providing consistent returns while avoiding excessive risk. **Zero-day options (0 DTE)**, which are popular but highly risky, are not favored in this approach due to the increased volatility and diminished rewards as expiration nears.

Risk-reward is a central theme in our approach to income generation, as it helps to ensure that we are not exposing ourselves to unnecessary risks for minimal returns.

While the rewards from very short-term options decay are tempting, the risks of sudden volatility and the high likelihood of giving up potential upside (in the case of covered calls) or owning stock at a much lower price (in the case of cash-secured puts) are significant drawbacks.

For optimal results, the sweet spot for targeting time decay is typically **between 20 and 45 days** to expiration. In this timeframe, options still have enough time value left to capture meaningful premiums, while also benefiting from the accelerated decay. **At-The-Money(ATM)** options are a bit more stable but retain time value longer than **Out-Of-The-Money (OTM)** options, which decay quickly if the underlying stock does not move toward the strike price.

We also touched on the **rollover strategy**, where we can close out a position and open a new one with a later expiration date to extend the opportunity for harvesting time decay. Rolling positions can be effective when the stock price remains relatively stable and the time value is still significant. However, it's important to balance this strategy with an awareness of the premium and the risk involved.

In conclusion, understanding the nuances of **time decay**, **moneyness**, and the **expiry targeting window** is crucial for successful options trading. The **3 to 6-week** timeframe is the sweet spot for maximizing returns, with a focus on frequent premium capture while keeping the risks manageable. By balancing time decay with **risk-reward** considerations, we can continue to build a consistent, profitable income stream from options.

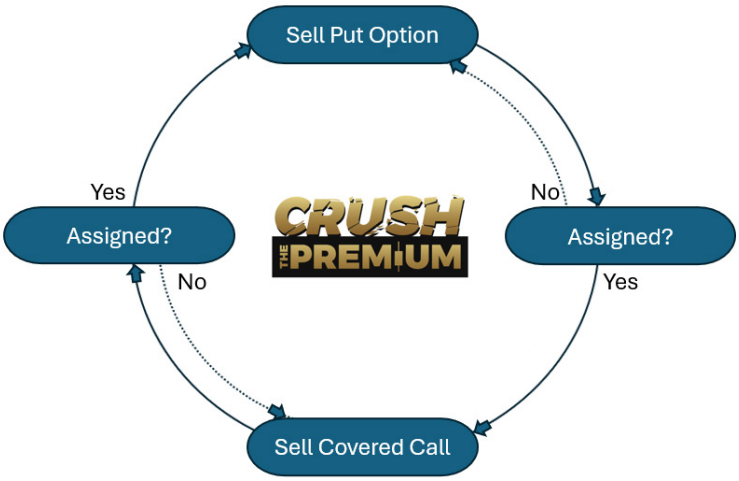
Chapter #10 Wheeling and Dealing

Let's take a visual approach to understand how this strategy functions. It operates much like a cycle, resembling a wheel. We generally begin by selling a **cash-secured put**. As we progress down the path, we ask ourselves:

Were we assigned?

- If the answer is **no**, we return to the starting point and sell another **cash-secured put once the previous one has expired or has been bought back**.
- If the answer is **yes**, meaning we were assigned and now own the stock, we move forward to the next step in the process: selling a **covered call**.

Wheeling and Dealing



At this stage, we again find ourselves at a decision point:

Were we assigned?

- If **no**, we return to selling another covered call and wait for the next expiry.
- If **yes**, we have been assigned on the call, meaning the stock has been called away since we were obligated to sell it as part of the covered call strategy.

Once the stock is called away, we return to square one and begin the process again by selling another **cash-secured put**. This cycle continues.

Now, when working with market makers, it's important to keep in mind that, based on my experience as a professional market maker for over 12 years, it's often necessary to "work the market." This is particularly true when the **bid-ask spreads** are wide—often 20, 30, or even 40 cents. In these cases, I recommend avoiding such options classes, as they can lead to higher transaction costs and less favorable trade execution.

Expiry Notables... Dealing with Market Makers for trades:

Buy back short option at:

Option under $1.00, buy back at intrinsic +0.02
Option over $1.00, buy back at intrinsic +0.05
Option over $5.00, buy back at intrinsic +0.10

Adjust these to get the trade done, but test the market if: you have time before the close, and there isn't much volatility in the stock.

**Close to the money options.... Buy them back to remove risk of after-hours news.

Trading options with wider bid-ask spreads, particularly those with lower liquidity, introduces significant risks, particularly the risk of slippage. A wide spread between the bid and the ask means that when you execute your trades, there's a possibility you won't be filled at the price you want. You could end up buying or selling within the spread, which increases the cost of executing the trade. For example, if you're dealing with a 50¢ spread, you're effectively losing that amount just to enter and exit the position.

So, how do we manage this risk? A good rule of thumb is to avoid options with wider spreads. If you find yourself dealing with options priced under $1, there are a few guidelines to consider. Based on my experience, if the option is under $1, you'll likely need to pay a small amount over intrinsic value to get filled. For instance, if you're buying back an option, say a **Tesla call** worth $5 in intrinsic value, you'll likely need to pay around $5.10 to close the position. In these cases, you can test the market by offering a bit above intrinsic value to see if you can get filled without overpaying.

Here's a process you can follow to execute efficiently:

- **Test the market:** If you have time before the close and volatility is low, try buying the option back at 5¢ over intrinsic. For example, if intrinsic is $5, offer $5.05.

- **Adjust quickly:** If you don't get filled in 10 seconds, raise your offer to $5.10.

- **Speed matters:** In a fast-moving market, especially if the spread is 10¢, don't wait too long. You might want to just get the trade done and pay the offered price (e.g., $5.10) to avoid any missed opportunity.

When dealing with options priced below $1, the difference is often just a few pennies. If it's a highly liquid stock like **Nvidia**, **Microsoft**, or **Apple**, you can often cover positions with minimal cost—sometimes just a penny over intrinsic value. This is one of the advantages of trading in these liquid markets, where the bid-ask spread is narrower.

For options priced between $1 and $5, you may need to pay around 5¢ over intrinsic value to execute. The exact amount will vary based on the popularity of the option class, but this is a typical guideline.

- **The key takeaway is this:** if you see a spread of 30-40¢, don't settle for paying 25¢ over intrinsic value with an hour left to expiration. That's generally a losing proposition. Over time, these small differences can add up, and saving that money by testing the market can make a significant impact, especially if you trade frequently.

One of my cardinal rules is to avoid letting options expire when they're near the money, particularly as expiration approaches. **Buy them back**. Pay a couple of pennies to remove the risk, especially the risk of unforeseen after-hours news.

Unpredictable news can come in many forms—**micro** news related to the underlying stock, like a new announcement about **Apple**, or **macro** news that affects the broader market. For example, positive earnings for a company like **Nvidia** can cause a ripple effect, making stocks like **Apple** move unexpectedly. By letting options expire near the money, you're leaving yourself open to potential risks that can arise after the market closes.

It's always better to close those positions, even if it means rolling them over to a later date, rather than risk unexpected price movements due to news you can't predict. Closing out those cheap, near-expiry options can save you from significant risk, and paying a small amount above intrinsic value is usually worth it to ensure you're not caught off guard.

This approach not only mitigates risk but also helps you maintain control over your positions, ensuring more consistent and predictable returns in the long run.

Part of Hans's Volatility Ninja Series:

Understanding where the Edge can be in trading Options.

https://youtu.be/qVKA03S0b7g

More Insight from Hans's Favorite Articles and Videos:

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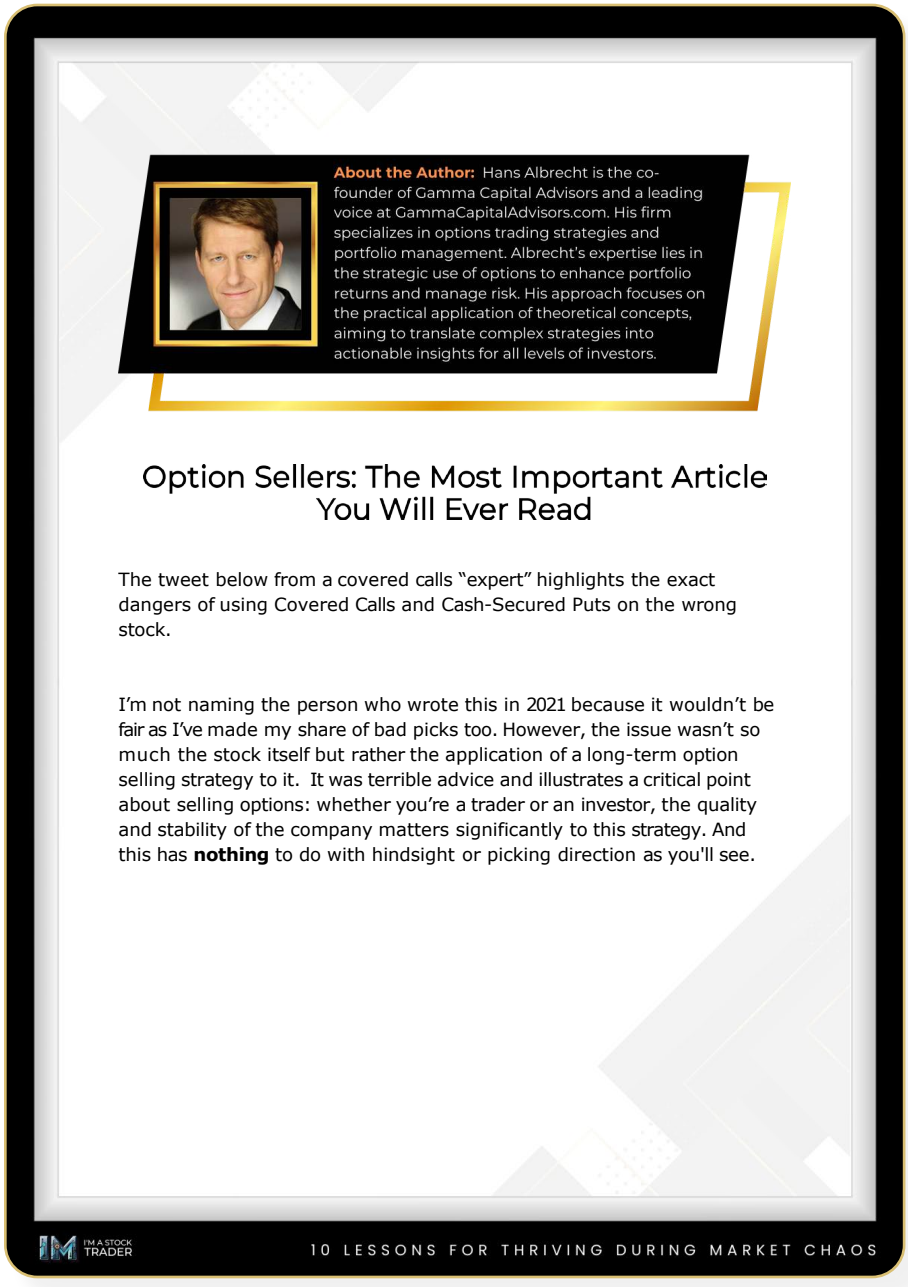

About the Author: Hans Albrecht is the co-founder of Gamma Capital Advisors and a leading voice at GammaCapitalAdvisors.com. His firm specializes in options trading strategies and portfolio management. Albrecht's expertise lies in the strategic use of options to enhance portfolio returns and manage risk. His approach focuses on the practical application of theoretical concepts, aiming to translate complex strategies into actionable insights for all levels of investors.

Option Sellers: The Most Important Article You Will Ever Read

The tweet below from a covered calls "expert" highlights the exact dangers of using Covered Calls and Cash-Secured Puts on the wrong stock.

I'm not naming the person who wrote this in 2021 because it wouldn't be fair as I've made my share of bad picks too. However, the issue wasn't so much the stock itself but rather the application of a long-term option selling strategy to it. It was terrible advice and illustrates a critical point about selling options: whether you're a trader or an investor, the quality and stability of the company matters significantly to this strategy. And this has **nothing** to do with hindsight or picking direction as you'll see.

To live a normal existence off of dividends alone, I think $3 million or so is a good target. You'd be yielding about $100k initially (assuming your portfolio mirrors the yield of the Vanguard High Yield ETF, VYM) and your dividends and capital would grow each year.

But there's a strategy that could make you financially independent with less money: **Writing Covered Calls.**

Say you own 100 shares of Square (SQ). In my opinion, it would be a great long-term hold considering the growth of online payment processing.

Your 100 shares would be worth about $23,360 as of today at $233.60 per share.

You could sell the July 16th, 2021 $260 calls for $2.10 per share right now, or $210 per contract (one contract represents 100 shares).

The calls are about 11.3% out of the money and have 24 days until expiration.

Now let's say you have $1 million in your portfolio and repeat this process with your available capital. Of course you wouldn't only do this with one stock, but let's you pick 10 stocks that average out to the same situation as Square just for simplicity.

You'd be able to purchase 42 lots of 100 shares (4,200 shares) and still have about $19,000 left over.

Let's say you sell those covered calls on all your shares: $210 x 42 contracts = $8,820.

The author described Square (SQ) as a promising company in digital payments. True then as it probably is now. It may have had strong prospects, but in 2021, it had surged by hundreds of percent to a P/E ratio of over 400.

Despite rising earnings during the pandemic, its cash flow was highly erratic, and it was undeniably a high-flyer with a nosebleed valuation.

Enter the covered call strategy. The author suggested that while dividend stocks are fine, covered calls are a better path to financial independence, especially for those without enough savings to rely on traditional dividends. Option premiums on stocks can indeed exceed traditional dividends. He says that covered calls are 4 times better than dividend growth investing. Ok. Houston, we have a problem.

A few key points to remember:

1. This advice risked pushing people out on the risk spectrum without acknowledging (or being aware of) the dangers of doing so.

2. Yes, options can create yield on high implied volatility (high pricing) stocks that don't otherwise provide yield. However, many no-yield stocks are more speculative and prone to volatility. Selling calls simply doesn't transform these stocks into better companies and comparing them to dividend payers is misguided.

3. Dividend stocks offer yield while allowing investors full upside in the stock. With covered calls, you retain much of the downside but only some of the upside. The performance profile is drastically different.

You might argue that even quality stocks can get hit hard, as seen in 2022. True, but quality companies typically recover. The market will do market things: multiples will expand and contract, we can't control that. But great companies have a better chance of stability and recovery, while speculative, cash-flow companies may plummet to zero or languish in dead money purgatory for years.

For instance, SQ fell over 80% following this recommendation and has only slightly recovered, still around 70% below his recommended level and roughly the same price it was at over two years ago. In contrast, quality balance sheet, high cash-flow, wide moat and higher margin companies have generally recovered and thrived since 2021.

You might think you can sell premium on the way down to defend, but selling calls on a rapidly declining stock often still results in poor capture. You also risk losing your position below your cost basis, and the absolute yields you harvest may not be as lucrative as before.

This is crucial and often overlooked. If SQ options yield, say, 30% a year in the at-the-money options: 30% on $70 is much less than 30% on $233, assuming implied volatility remains similar. Your income drops to a third of what it was, and your principal has been decimated. How's that retirement plan going so far on SQ?

This underscores a significant issue with covered calls, and the crux of the takeaway today: you're creating a bond proxy on a product that has full principal risk. Unlike a bond, which guarantees your principal at maturity, a covered call on a stock has no such guarantee.

Your principal can drop to near zero in theory. This strategy is not to be looked at as a kind of secure bond, as I fear so many do. But it can be approximated to a bond-like approach if certain strict conditions are met, and certain limitations are accepted.

We must strive to ensure our principal is preserved long-term. But that means prioritizing quality is paramount. Quality companies should endure and bounce back, though we can never be 100% certain. There is however a great deal of evidence that higher profit and and high free cash flow companies outperform over time by a significant margin. For example, high FCF companies tend to outperform the rest by around 18% **per year**. High gross margin companies tend to outperform by 3-4%. Selling puts in quality names has outperformed by a wide margin – because of stability and premium capture over time.

Will you get less premium for those names? For many, yes. But are you in the business of trading for excitement or are you in the business of actually retaining premium and making money over time? You decide.

The dangers of following ill-informed advice, especially on social media, are very real. Make sure you're following the right people. People with almost 30 years of having done this professionally, managing a $billion in options strategies and having generated $750 million in options cash flow for investors. That's me. And the best part? You can learn to do this...

Like and follow and check out our Cash Flow Insiders Program. It covers topics discussed here: rules, guardrails, gauging market and stock sentiment and quality, using option deltas as a tool to trade reality rather than hope, nding edge, and avoiding pitfalls. It offers frameworks for handling volatility, managing options, retaining upside, and more— in other words.. how to trade and manage like a professional.

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Article Hans Wrote for The Globe & Mail Newspaper

Markets aren't nearly as complacent as you may think

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HANS ALBRECHT
Special to The Globe and Mail
Published Wednesday, May 10, 2017 11:57AM EDT
Last updated Wednesday, May 10, 2017 12:14PM EDT

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The VIX, an index that shows the market's expectation of volatility, has spent the past five months trading between 10 and 13.

I've been fielding many questions about why the VIX is so low and whether that signifies "complacency."

I don't think "complacency" and the VIX should be used in the same sentence. VIX merely takes a snapshot of current sentiment – and market sentiment is calm and subdued.

Investors tend to focus too much on the VIX average. While most people refer to the VIX as a mean-reverting product, it actually isn't – at least not in any useful sense of the term. As always with derivatives, it's wise to not necessarily take things at face value.

Let's revisit some high school math: The mean is the average, and the average of the VIX over the last 20 years is just under 20. The median is the very middle sample of observations, so in this case, it's about 18. The "mode" is where the most observations are found, and in this case, it is about 13.

So "normal" isn't, in fact, anything close to 20. Over the last 20 years, the majority of VIX observations have been in the low teens. That is something we should be very aware of. When we are looking to buy or sell volatility, we must be cognizant of the fact that option prices can stay low for a very long time – the mode tells us so. It doesn't mean that the VIX can't go up, because it absolutely can – but I prefer to see this low range of VIX as muted and approaching normal, rather than complacent.

If the market were swinging around and the VIX was whipping from 11 to 18 and back again – then yes, I would say 11 is cheap. Right now, however, actual market movement is hitting record lows. A "low" VIX is warranted.

Remember how averages work: Large VIX spikes, such as the ones in 2008 and 2009, can skew the mean number drastically upwards. Think of it this way: Imagine you're walking across the Sahara and the sand is mostly flat. Suddenly, you come across a great pyramid. What will stand out in your mind forever is the magnificent sight of the pyramid, and not necessarily the mass of level sand around it. When the VIX is at 40, it is the pyramid, but most of the time it's just flat terrain. Watching the VIX can useful and even fun, but be careful with how you interpret the level.

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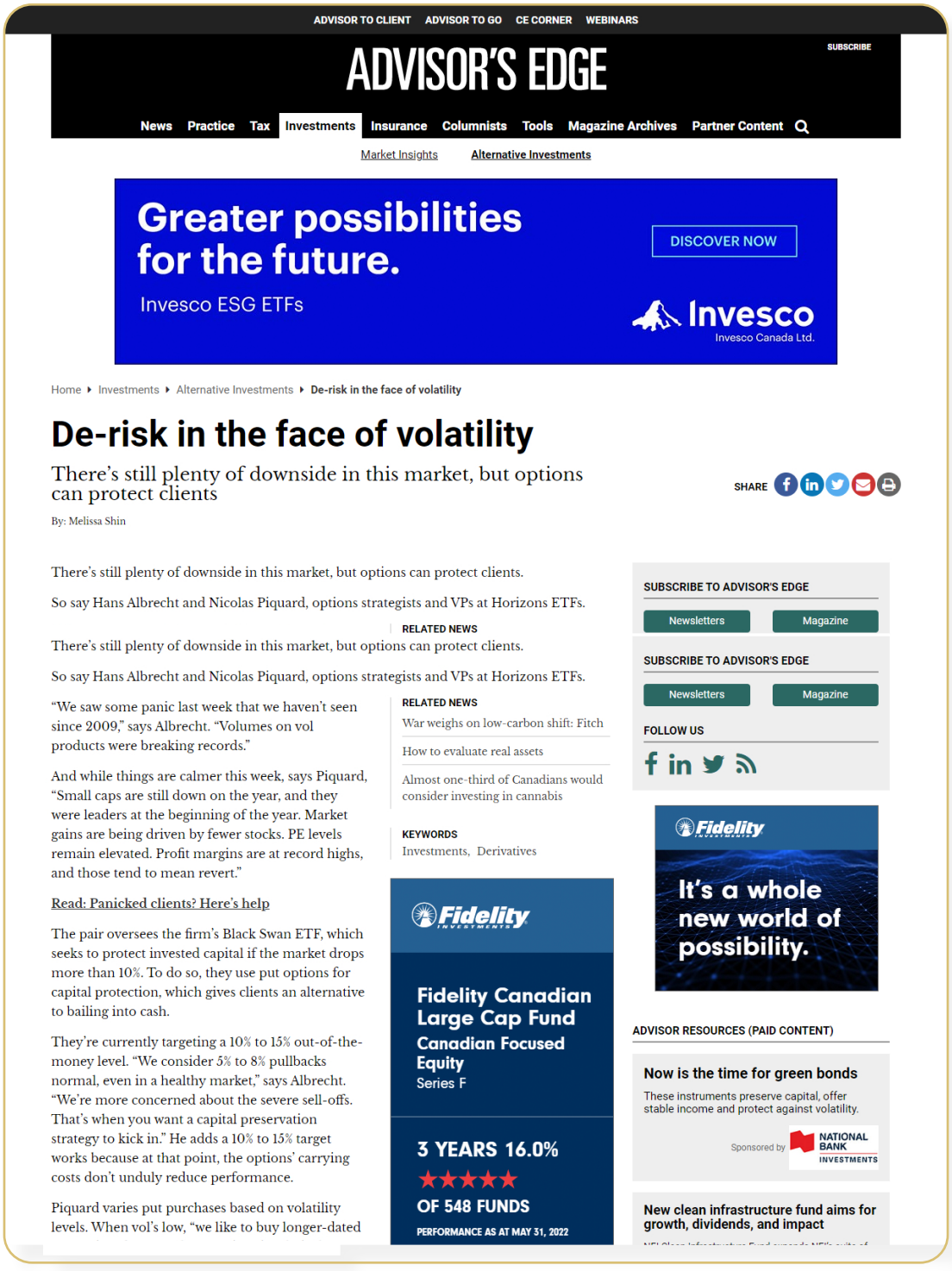

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De-risk in the face of volatility

There's still plenty of downside in this market, but options can protect clients

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By: Melissa Shin

There's still plenty of downside in this market, but options can protect clients.

So say Hans Albrecht and Nicolas Piquard, options strategists and VPs at Horizons ETFs.

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There's still plenty of downside in this market, but options can protect clients.

So say Hans Albrecht and Nicolas Piquard, options strategists and VPs at Horizons ETFs.

"We saw some panic last week that we haven't seen since 2009," says Albrecht. "Volumes on vol products were breaking records."

And while things are calmer this week, says Piquard, "Small caps are still down on the year, and they were leaders at the beginning of the year. Market gains are being driven by fewer stocks. PE levels remain elevated. Profit margins are at record highs, and those tend to mean revert."

Read: Panicked clients? Here's help

The pair oversees the firm's Black Swan ETF, which seeks to protect invested capital if the market drops more than 10%. To do so, they use put options for capital protection, which gives clients an alternative to bailing into cash.

They're currently targeting a 10% to 15% out-of-the-money level. "We consider 5% to 8% pullbacks normal, even in a healthy market," says Albrecht. "We're more concerned about the severe sell-offs. That's when you want a capital preservation strategy to kick in." He adds a 10% to 15% target works because at that point, the options' carrying costs don't unduly reduce performance.

Piquard varies put purchases based on volatility levels. When vol's low, "we like to buy longer-dated

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How to use the measures when trading

By Melissa Shin | April 21, 2017 | Last updated on September 21, 2023

12 MIN READ

How fast am I driving? And, when I press the gas pedal, how quickly will I speed up?

These questions have nothing to do with investment, but they're helpful analogies for understanding risk when trading options. That's because "options are a multi-dimensional asset," says Hans Albrecht, portfolio manager and options strategist at Horizons ETFs Management (Canada) Inc. in Toronto. Options pricing depends on several factors. Since options give you the right to buy or sell an underlying asset at a certain price on a certain day, their value depends on things like how far you are from the expiration date (time value) and the strike price (intrinsic value). These and other factors are quantified using measures known as the Greeks.

"Greeks are handy because they tell us what happens when certain market conditions change," says Ioulia Tretiakova, vice-president and director of quantitative strategies at PUR Investing in Toronto. How will an option's price change if implied volatility rises? "Greeks give us those handy answers."

Common Greeks include delta, gamma, theta and vega. Their formulas aren't for the faint of heart but, fortunately, software can calculate them for you (results varies by model). So what does each measure mean, and how can they help you become a better investor?

Delta symbol We asked Albrecht and Tretiakova to walk us through the most common Greeks.

Delta

Technical definition

Delta measures the rate of change in an option's value for every one-point increase in the underlying asset. A delta of 50, for instance, means that for every dollar the price of the underlying asset (a.k.a. the "underlying") goes up, a call will gain by $0.50. A delta of -20 means that for every dollar the underlying goes up, a put will go down by $0.20.

Range

0 to 1 or -1. Put options have negative delta, whereas call options have positive delta. People will often say "50" or "25," which actually means a delta of 0.5 or 0.25, respectively; they also tend to omit the sign because call deltas are always positive, whereas put deltas are always negative.

Everyday analogy

Delta is like speed, says Albrecht, because the measure tells you whether you're driving 20 kilometres per hour or 50 kilometres per hour. But, in trading terms, speed is measured per dollar.

Delta shows how much your position will gain or lose for every $1 move in the underlying—in other words, how quickly you'll gain or lose money.

Pricing examples

Assume:

- You own five call options trading at $10, with a strike price of $202
- Delta is 50 (or 0.5)
- Underlying stock is trading at $200

If the stock rises to $201, the call option trades at $10.50. How did we calculate that? Since delta is 0.5, for every $1 increase, the call goes up by $0.50. Since you bought five call options, you've just made $2.50.

Now assume:

- You own five call options trading at $10, with a strike price of $210
- Delta is 30 (or 0.3)
- Underlying stock is trading at $200

If the stock rises to $201, the call option would trade at $10.30, since, for every $1 increase, the call goes up by $0.30. You've gained $1.50 on the five call options.

Now assume:

- You own five call options trading at $10, with a strike price of $202
- Delta is 50 (or 0.5)
- Underlying stock is trading at $200

The stock rises to $201.50, so the call option would trade at $10.75 ($10 + [$1.50*0.5]). You've earned $3.75 on the five options.

Why it matters

Since delta "helps describe how something is going to behave, it gives you an idea of risk," says Albrecht.

Investors look at delta when they want to know how much the options will return relative to the underlying. "If I own 100 shares of Barrick Gold, I know that, if it goes up a dollar, I'm going to make $100." But a 100-share call on Barrick with 50 delta would make $50, says Albrecht, since a 50-delta call goes up $0.50 for every dollar the stock goes up.

If the investor wants her 50-delta call to behave as if she owned 100 shares of Barrick, she must buy two calls. "Now, each one is moving up $50, and therefore I've made my $100," Albrecht explains.

Delta also tells you about "moneyness," or how close a strike price is to the actual price of the underlying. A 50 delta is considered "at the money": it's when the option's strike price is identical to the price of the underlying security. At that point "it's a coin flip," says Albrecht: the delta indicates a 50% chance the asset goes either up or down. As a result, delta tells you the current probability of an option being in the money by expiry.

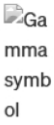
A call option with a 70 delta is in the money, and has about a 70% chance of still being in the money by expiry. "For example, if Barrick was trading at $100, maybe I'm owning a $96 strike. So it's already in the money by $4."

A 20-delta call, however, is "quite a ways out of the money," he says, and has about a 20% chance of being in the money by expiry.

What "quite a ways" means can differ by type of stock.

"If you're trading Tesla, which is a volatile stock, a 20 delta might be 15% out of the money," he says. "If you're trading [a blue chip like] Royal Bank, a 20 delta might [only] be 4% out of the money." In this example, the chances of a blue chip jumping 4% are about the same as a tech stock jumping 15%. "So implied volatility has a direct effect on your delta," Albrecht says.

Another point about delta and probability: time matters, too. If you're two weeks into a one-month call option that had a 20 delta, and the underlying hasn't moved, the delta and the probability of meeting the strike price by deadline would then be lower. "We had a 20% chance of that option being in the money. If we only have two weeks left, we [no longer have] a 20% chance of that being in the money, even though the stock hasn't moved," Albrecht says. Instead, the option might have fallen to 10 delta—that is, there's only a 10% chance of being at the money. "The stock is still the same price," Albrecht notes. "Nothing's changed except we only have two weeks left in that option."



Gamma

Technical definition

Gamma is related to delta. It measures the rate of change in an option's delta for every one-point move in the underlying asset's price. If a call on Barrick has 30 delta and 5 gamma, for instance, and Barrick goes from $100 to $101, the call's new delta is 35.

Range

0 to 1, with the same caveat about decimal places (e.g., 20 gamma is technically 0.2 gamma). Gamma is highest when the underlying is at the option's strike price (at the money), and decreases as the underlying moves away from the strike price in either direction.

Everyday analogy

Gamma is like acceleration, says Albrecht. It tells you how quickly delta will change as the stock moves around. "With a $1 move in the stock, will I go from 20 kilometres per hour to 40 kilometers per hour, or 20 kilometres per hour to 100 kilometres per hour? There's a big difference," he explains. "The latter has larger gamma."

Pricing example

Assume:

- You own a call option trading at $10, with a $202 strike price
- Delta is 50 (or 0.5)
- Gamma is 10 (or 0.1)
- Underlying stock is trading at $200

If the stock rises to $201, the call option would trade at $10.50, and the new delta would be 60 (since for every $1 increase in the stock, delta goes up by gamma, which is 10).

If the stock rises to $203, the call option would trade at $11.50, and the new delta would be 80.

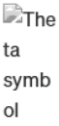
Why it matters

There's a big difference between accelerating gradually and accelerating quickly. To avoid (or benefit from) investment whiplash, you need to understand how fast your positions will change.

"Gamma is something that gives you warnings as to where something might start to hurt or help you," says Albrecht.

Gamma is highest when an option is near the money and close to expiry, says Albrecht, because a jump in the underlying is likely to cause the option to expire in the money (a drop would cause the option to expire worthless). Bill Feingold, an American options trader, has explained this using a basketball analogy: if the game is tied in the last minute, each team's delta is 50. "When Team A scores right before the end of the game, its delta goes up from 50 to 98, a much higher rate of increase, or gamma, than when it scored the first basket of the game," he writes in Forbes. Albrecht agrees with this analogy. "With two minutes left on Friday of expiry, an option becomes very binary," he says. "It could close 5 cents in money, or 5 cents out of the money. That's why binary options are so dangerous."

And don't be fooled by options on low-volatility stocks, which people rarely expect to move by much. They can still have a lot of gamma, because "when there's [even a small] move, you can get hurt." He adds that "gamma is important if you're short options. If there's a big move in the stock, they can start to hurt you exponentially."



Theta

Technical definition

Theta measures how much an option's value decreases over the course of a day.

Generally, as time passes, an option's value falls because there is more certainty about whether it will be in the money. That value is typically stable at the beginning of an option's life. But, says Tretiakova, as an at-the-money option approaches expiration, "the value will take a fast dive." Theta therefore increases as an option closes in on its expiry.

Range

Since theta always subtracts from an option's value, it is always negative for long options and measured in units of value (e.g., cents). It starts at zero and its magnitude cannot exceed the value of the option premium. For a short call or put, theta is said to be positive, since you gain value through time.

Everyday analogy

According to CARFAX, a new car will lose 60% of its total value over the first five years of its life (10% when driven out of the dealership). Theta behaviour is the inverse of that: for an at-the-money option, the time value of an option is stable until it gets close to the expiration, when it drops precipitously. (In-the-money options lose value more linearly.)

Pricing example

Source: The Options Industry Council

Why it matters

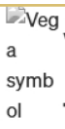
Traders need to know the point at which an option's time value starts to nosedive, explains Tretiakova. Traditionally, the sweet spot of maximum value prior to the drop "is about a month."

When Tretiakova is writing covered calls on stocks owned in a taxable account, and the stock has a low cost base, she usually wants to avoid having to sell the stock (being called) because that would trigger unwanted capital gains taxes. Instead, "If the option gets in the money or at the money [before expiry], we might want to close out our option position." She would do this by buying back the option (so she's relieved of the obligation to sell her shares). If possible, she'll wait until theta peaks (and the option's value is low) so she can get the option at a cheaper price. But that's not always possible, and she may lose money when buying back the option.

Time decay can also work in your favour if you're short options, since that decay turns into value accumulation: you're earning theta. But there's also a higher likelihood of those options becoming in the money, which is generally not what someone short a call option wants.

When he's short, Albrecht monitors the theta-to-gamma ratio to ensure his theta accumulation compensates for his gamma risk. "Once there's almost no theta left, why would I want to carry a lot of gamma risk? The Fed [could] come out and say something, and the market jumps up 3% tomorrow.

"I thought I was going to collect all this money, and now my calls are in the money and I'm going to get killed."



Vega

Technical definition

"Vega describes how much you can make or lose from a 1% move in implied volatility," says Albrecht. "Vega becomes more pronounced as an option has a longer lifespan." That's because the longer the lifespan, the more chances for volatility to affect the option.

Range

Vega is positive when you buy options and negative when you sell them. Commonly, vega moves between 0 and +/-1.

"If we're selling an option, we want higher sensitivity to volatility, so we would be looking for a higher number—it means we'll get more premium up front," says Tretiakova. "We would look for lower vega if we're buying an option."

Everyday analogy

While there's no easy analogy for vega, there is a good one that illustrates implied volatility: car insurance pricing. Let's say there's a rash of car thefts in your area and your premiums go from $300 a year to $500 a year, even though your car is worth the same. That's purely a response to the increased risk (volatility).

Pricing example

Assume:

- You own a call option trading at $10, with a $210 strike price
- Vega is 10 (or 0.1)
- Underlying volatility is 14%

If the underlying volatility increased by a percentage point to 15%, the option price would be $10.10. On the other hand, if the underlying volatility decreased by three percentage points to 11%, the option price would be $9.70.

Why it matters

"Vega is one of the most important Greeks to options traders, especially as you start to trade longer-term options," explains Albrecht.

Traders typically look at implied volatility for a given option relative to where it's been over the past year. "If it tends to be in the higher end of the range, what you're risking is that the prices will come down. If implied volatility comes down, you could lose money, all else being equal."

Volatility tied to an expected event—for instance, an election or referendum—is particularly concerning. "You're at risk that after the event, implied volatility comes down a lot. So vega is going to give you an idea of how much you're going to get hurt." He adds a tech stock like Tesla tends to have a higher vega than a blue-chip financial, for instance.

Traders need to know their risk if volatility changes. "If I want to buy a six-month option, and Barrick volatility is in its 80th percentile for the year, I'm taking on a lot of vega risk," he says, because that volatility is more likely to fall. "If that volatility drops ten points, I'm going to get very hurt. Let's say my vega is $500 per point of implied volatility. I could lose $5,000, and the stock doesn't even have to move." Another example: "If an option typically trades at a 30 vol, and it's trading at a 40, you've got about 10 vol points of vega exposure," says Albrecht. "What if vol goes back to 30? I could lose 10 vol points times the vega."

On the flipside, Tretiakova says traders can use vega to find stocks that will make outsized moves on positive news. "If you expect volatility in a stock to pick up—so an earnings announcement, or ideally something you know that the market doesn't—you would want an option with the highest sensitivity to that (i.e., with the highest vega), because it means you'll make the most money." But she cautions this would be a specific, speculative bet.

Albrecht adds that the relationship between implied volatility and options pricing isn't linear. Triple the implied volatility can push up an out-of-the-money put by 15 times, he says.

Beta

Beta is the sensitivity of the investment relative to the benchmark, and ranges from 0 to 1, with 1 meaning the investment mimics the benchmark perfectly. But Ioulia Tretiakova, director of quantitative strategies at PUR Investing, says people have incorrectly conflated volatility and beta. "A beta of zero does not mean that the investment has no volatility. It can have very high volatility, but [that volatility] is completely unrelated to the benchmark."

Short versus long

- When you're trading short-term options, focus on delta and gamma.
- When you're trading long-term options, focus more on vega.

Moneyness

In-the-money options have intrinsic value as well as time value (e.g., an option that's $4 in the money has an intrinsic value of $4, plus time value). Out-of-the-money options, however, have only time value and no intrinsic value.

In-the-money options react more to moves in the underlying stock. Hans Albrecht of Horizons says that calls with at least 70 delta work well in stock replacement strategies, since those calls behave almost like the stock itself.

Melissa Shin
Melissa worked with Advisor.ca from 2011 to 2024, most recently as the editorial director.

Options Trading: Life in the Fast Lane has Gotten FASTER!

CHAPTER 7 - Hans Albrecht of CashFlowInsiders.com

ABOUT THE AUTHOR

Hans Albrecht is the co-founder of Gamma Capital Advisors and a leading voice at GammaCapitalAdvisors.com. His firm specializes in options trading strategies and portfolio management. Albrecht's expertise lies in the strategic use of options to enhance portfolio returns and manage risk. His approach focuses on the practical application of theoretical concepts, aiming to translate complex strategies into actionable insights for all levels of investors.

Options Trading: Life in the Fast Lane Has Gotten Even Faster

In recent years, the surge in interest in options trading has raised concerns among some participants in capital markets. Particularly, there has been a noticeable uptick in the utilization of very short-term options, commonly referred to as "zero-day-to-expiration" (0DTE) contracts, which could be contributing to increased volatility in products such as the SPY (SPDR S&P500 ETF).

Zero-day options are contracts set to expire within the current trading day. This means that time is of the essence when dealing with these short-lifespan options – they may involve only a matter of hours or even minutes before they hold some remaining value, or none at all.

Think of these contracts as becoming very binary, particularly as the trading day draws to a close. For the option buyer, an advantage for their use could be in being able to make directional bets for relatively little cost. The ability to hedge a portfolio only on the day of an important economic release has some alure to it. For the option seller, these contracts may be enticing as option premium decay is very rapid with so little time remaining. The phrase "making a quick buck" comes to mind. The problem is it could very well mean losing a quick buck. Simply put, only experienced options traders should wade into this hornet's nest of speculative activity. Traders haven't heeded any such warning, however, as 0DTE trading now accounts for around 50% of S&P500 options traded in 2023 according to the CBOE.

From a broader market perspective, there is reason to believe that these 0DTE contracts are contributing to volatility due to something called a “gamma squeeze”. This squeeze comes about as a result of a feedback loop that, if persistent enough, could potentially exacerbate a particularly strong directional move up or down in the Index. Think of popular meme-stock GameStop in 2021 and more recently in 2024, but with the effect being felt multidirectionally.

As an example, if a hedger has sold put options and the underlying stock goes down through the option’s strike price, the gamma squeeze effect could require the seller to sell more shares to remain hedged against those options contracts. Then, like dominos, as equity prices are pushed further still towards lower strike prices, more selling is required to hedge subsequent strike exposures. Effectively, sellers of options can potentially be forced to chase stocks both up and down in order to maintain the hedge, which creates more volatility in equity markets. This is the “gamma squeeze”, a directional move that can potentially be made worse as the volume of short-term 0DTE options rises, thus increasing the likelihood of frenzied stock buying into a rising close, or a cascade of stock selling into a weakening tape.

Further, there are some market experts who believe the increase in the use of 0DTE options could end up causing a volatility “dislocation”, something akin to what we witnessed in early 2018 when an overcrowding in the short volatility trade led to the CBOE Volatility Index (VIX) doubling in a single day. While we don’t believe that this is highly likely, we also believe that under certain kinds of conditions, if the planets align just so, a strong selloff could set in motion the kind of move required to make an event like this a reality. Indeed, JP Morgan noted in 2023 that these options could turn a 5% intraday market decline into a 25% rout. It’s certainly possible that as selling begets selling, a strong intraday rout begins to trigger more and more of the downward squeezes we illustrated earlier.

Changes in the options and volatility space can have an impact on portfolios, making it crucial to stay informed about them. The recent surge in 0DTE activity is definitely a trend investors should keep a close eye on.

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