Contents

Introduction to the Second Edition: Managing and Exploiting Volatility —— 1

1	The Flexible Nature of Options: Risks for All Levels —— 3
	Terms of Options —— 4
	Type of Option —— 4
	Underlying Security —— 6
	Strike Price —— 6
	Expiration Date —— 7
	Valuation of Options —— 8
	Intrinsic Value —— 8
	Time Value —— 9
	Extrinsic Value —— 9
	Dividends and Puts —— 10
	Comparing Risk Levels —— 12
2	Puts, the Other Options: The Overlooked Risk Hedge —— 15
	Puts as Insurance for Paper Profits —— 15
	Selecting the Best Long Put —— 18
	Long Puts to Hedge Covered Calls —— 20
	Risk Considerations: Type of Risks —— 23
	Inflation and Tax Risk —— 24
	Market Availability/Trade Disruption Risks —— 27
	Portfolio and Knowledge/Experience Risks —— 28
	Diversification and Asset Allocation Risk —— 29
	Leverage Risk —— 31
	Liquidity Risk (Lost Opportunity Risk) —— 32
	Goal-based Risks —— 32
	Error Risks —— 32
3	Profit-taking Without Selling Stock: An Elegant Solution —— 34
	The Insurance Put —— 34
	Picking the Best Long Put: Time, Proximity, and Cost —— 36
	Buying Puts versus Short Selling Stock —— 38
	Rolling into Spreads to Offset Put Losses —— 39
	Buying Puts to Protect Covered Calls —— 42
	Tax Problems with Long Puts —— 45
4	Swing Trading with Puts: Long and Short or Combined with Calls —— 47
	Basics of Swing Trading —— 48
	A Swing Trading Method: Long and Short Stock —— 52

	The Alternative: Using Options —— 53
	Long Options —— 54
	Variations on the Options Swing Trading Method —— 56
	Short Options — 56
	Calls Only —— 58
	Puts Only —— 58
	Multiple Contract Strategies —— 59
	Multiple Contracts —— 59
	Multiple Strikes —— 60
	Spread or Straddle Conversion —— 60
	Covered Ratio Write Swing —— 60
	Long and Short Combination —— 61
5	Put Strategies for Spreads: Hedging for Profit —— 63
	Bear Spreads —— 63
	Bull Spreads —— 65
	Calendar Spreads —— 67
	Diagonal Spread Strategies —— 71
	Combination Put Spreads —— 75
	call bull spread and call bear spread (call-call) — 77
	call bull spread and put bear spread (call-put) 79
	put bull spread and call bear spread (put-call) —— 82
	put bull spread and put bear spread (put-put) —— 84
	The Diagonal Butterfly Spread —— 86
6	Put Strategies for Straddles: Profits in Either Direction —— 90
	The Long Straddle —— 90
	The Short Straddle —— 93
	Strangle Strategies —— 97
	Calendar Straddles —— 102
7	Puts in the Ratio Spread: Altering the Balance —— 106
	Ratio Put Spreads —— 106
	Ratio Put Calendar Spreads —— 108
	The Backspread (Reverse Ratio) —— 110
	Ratio Calendar Combinations —— 113
	The Diagonal Backspread —— 116
	Short Ratio Puts —— 118

8 Puts as Part of Synthetic Strategies: Playing Stocks Without the Risk —— 122

Synthetic Stock Strategies —— 122

Synthetic Strike Splits — 125

The Synthetic Put —— 126

9 Puts in Contrary Price Run-Ups: Safe Counter-plays During

Bear Markets —— 129

Option Valuation and Volatility ---- 129

Volatility Trading — 131

Factors Affecting Option Value —— 132

Stock Price Movement —— 133

Stock Market Volatility and Trend —— 133

The Time Element —— 134

The Proximity Element —— 134

Dividend Yield and Changes --- 135

Interest Rates —— 135

Perceptions —— 135

Spotting the Overall Trend — 136

Reliance on Stock-based Technical Analysis —— 137

Support and Resistance — 137

Gaps and Breakouts —— 138

Double Tops and Bottoms —— 141

Head and Shoulders —— 141 Volatility Trends —— 145

10 Uncovered Puts to Create Cash Flow: Rising Markets

and Reversal Patterns ---- 146

The Uncovered Short Put — 146

Evaluating Your Rate of Return from Selling Puts --- 149

Covered Short Straddles —— 151

Covered Short Spreads ---- 154

Recovery Strategies for Exercised Covered Straddles and Spreads —— 158

Short Puts in Rising Markets—One-sided Swing Trading —— 160

11 Uncovered Puts in Recovery: An Essential Strategy to Offset Loss —— 162

When Recovery Does Not Make Sense —— 162

Recovery as a Conservative Decision — 164

Recovery with Secondary Options — 165

12 Puts and Risk: A Range of Risk Levels and a Conservative Trading Goal —— 167

Risk as a Range of Exposure —— 167
Less Obvious Risks —— 169
The Oddity of Pattern Day Trading Risk —— 170

Glossary —— 172

Index —— 178