Module 1 — Option-Selling Basics

The safest, most intelligent way to earn the maximum amount of income from the stock market.

I've personally used this and shown others how to earn thousands in extra income from stocks they would want to own anyway.

You can use these strategies to get paid as much as you want, whenever you want!

They revolve around selling options.

These are not complicated or inherently dangerous.

What are options?

Options are contracts between two parties:

- **The option holder** has the right — but not obligation — to buy or sell an underlying instrument at a specified price for a fixed time period.
- **The option seller** gives away that right for upfront income.

Each option contract specifies four important things:

1. Whether the option holder has the right to buy or the right to sell.
    a. **Call options** give the holder the right to buy the investment.
    b. **Put options** give the holder the right to sell the investment.
2. The class and quantity of the underlying asset.
    a. For American Options, this is usually for 100 shares of the underlying stock.
3. The price at which the underlying transaction will occur — known as the **strike price**.
4. The last date the option can be exercised — or **expiration date**.

Instead of buying options and becoming the option holders, we sell options.

Why sell options?

The vast majority of option contracts never get exercised. In fact, only 10% of contracts actually get exercised. Most expire worthless.

By selling, we collect income upfront. So, when our options become worthless at expiration, we keep 100% of that income.

Module 2 — Cash-Secured Puts

This is the first of two main strategies we use.

When selling put options, we are essentially offering "insurance" to other investors.

That's because we agree to buy their shares if they drop to a certain level.

But, if those shares don't fall to that level, they most likely won't want us to buy their shares.

Either way, we keep the cash we collected upfront for that "insurance." That's called the premium.

How do put options work?

There are four components:

1. Put sellers offer to buy shares of ...
2. The underlying asset, usually a stock or ETF at ...
3. The strike price before ...
4. The option contract expires.

We generally look to go a month to three months out. Meaning, if we are looking to sell a put option in January, we want an expiration date between February and April.

Example: Bob and Wendy

Bob owns 100 shares of Acme for $110 each. But he's worried they might fall to $100 in the next two months.

Wendy would love to own Acme at $100. So, she earns income by selling Bob the right to sell his shares for $100 at any point over the next two months.

In option language, Wendy is selling Bob a put option contract on Acme with a $100 strike price that is 60 days out in the future.

There are two ways to sell put options:

1. Have the full amount of the possible purchase price in your brokerage account. For the above example, Wendy would need $100 for every share of Acme she promised to buy. This is called "cash-secured" put selling. It's how I use this strategy and how I recommend others use it.

2. Use margin, which means you only have a percentage of the cash needed to make the possible stock purchase. It is more aggressive and can result in more income produced for each dollar of capital you hold. But it is much riskier.

Back to the example.

Bob is happy to pay Wendy $3 per share for the right to sell Acme at $100. Since each contract covers 100 shares, that works out to $300 for this put contract.

If he has 1,000 shares, he can buy 10 put contracts worth a total of $3,000. Wendy receives that $3,000 upfront.

From here, there are three possible outcomes.

1. **Acme stays above $100 per share.** The contract expires worthless. Wendy pockets the $3,000 premium and has no further obligation. She's free to start the process over again.

2. **Acme falls below $100 to, say, $98.** Bob sells Wendy his shares. But remember, she collected $3 per share right up front. So, her cost basis is really $97. She'd still be up on the trade.

3. **Acme drops well below $100 before expiration to, say, $95.** Bob sells Wendy his shares. But since they are below her cost basis of $97 per share, she'd be sitting on a small paper loss.

Scenario three is where the second part of our strategy comes in … Module 3 — Covered Calls.

But even before this second part of our strategy begins, Wendy is still sitting in great shape.

First, she wanted to buy Acme for $100 in the first place. Now, she owns shares that cost her just $97.

Second, if they pay dividends, she can begin collecting those as well.

Third, well, that's where Module 3 comes in …

Module 3 — Covered Calls

This can be used for any stock you already own at least 100 shares of that has options. But as part of our strategy, we use it on shares we receive if a put option we sold is exercised.

This part of our strategy is called "covered call writing." "Writing" and "selling" are basically interchangeable in options parlance.

How do call options work?

The same as a put, except instead of selling the holder the right to *sell us his shares*, we offer the holder the right to *buy our shares*.

It's covered because we own the shares when selling the call option.

Example: Wendy and Dave

Starting up from the third "worst-case scenario" from the previous module, we'll assume Wendy has 1,000 shares of Acme with a cost basis of $97 each. But they only trade at $95. So, Wendy is sitting on a $2,000 paper loss.

Again, she wanted to own them anyway. So, this "worst-case scenario" isn't so bad. She expects them to grow over time.

Meanwhile, she can immediately turn around and generate more income from her shares right now by selling covered calls.

In this case, since she still expects shares to rise, she sells covered calls with a strike price of $110 — the same price they were originally trading for when Bob first had them in the previous module.

Enter Dave — someone even more bullish on Acme than Wendy. He believes they will go higher than $120 over the next 60 days.

So, Dave decides to pay Wendy $5 per share for the right to buy her shares at $110 in the next 60 days. After all, he would still make a minimum of $10 per share if they do indeed go over $120 ($120-$110), his speculation.

This is how the trade works. Wendy sells Dave 10 covered call contracts worth $5 per share with a strike price of $110 and an expiration that is 60 days out.

Here's how the math works. Wendy receives $500 per contract ($5 per share x 100 shares per contract), or $5,000 for all 10 contracts.

She keeps that $5,000 no matter what.

She can also keep collecting dividends that are paid to Acme shareholders.

And if shares don't go above $110, she will keep her shares, too.

BUT if shares do go above $110, Dave will use his right to buy her shares at that price.

What if shares DO go to $120?

Well, they are both winners. Dave bought shares at $110. So, he profits from this deal. But remember, Wendy bought shares much cheaper than that.

So, while she gives up some of the upside (from $110 to $120), she still profits.

She still earns all the capital gains from her $97 cost basis to her sell price of $110.

What is her gain?

Her capital gain ends up being $13 per share or $13,000 plus any dividends she collected.

That's on top of the $5 per share or $5,000 in premiums from selling the covered calls.

So, she missed out on $10,000 in capital gains that Dave, instead, collected. But she still walks away with $18,000 from this trade.

But she did all of that inside of 120 days (60 for the original put option plus 60 for the covered call).

So, when you annualize her gain, she made a 54% annualized gain on the $100,000 in capital she originally set aside.

Good luck finding that kind of return for anything with as much safety as this strategy.

In fact, this strategy is actually *safer* than just buying stocks or ETFs. After all, if you only sell covered calls with strike prices higher than your cost basis, you don't add any more risk than you'd have already.

Meanwhile, the income you generate actually improves your guaranteed returns.

Put it all together

With the full strategy — from selling cash-secured puts to selling covered calls — we have a full lifecycle of an investment … one that pays us in four ways:

1. Income from selling the cash-secured puts.

2. Pocketing dividends.

3. Selling covered calls.

4. Banking capital gains upon exit.

That's everything you *need to know* to sell options like a pro. But we have a few more tips and pointers to do it even better …

Module 4 — How to Use This System

A few more topics worth covering …

How are options valued?

Entire books have been written about this topic. And most of it is far beyond what anyone needs to know to use options properly.

There are a few major factors that are worth knowing that affect option prices …

The first involves price movements in the underlying security. The option price goes up when the underlying gets closer to and even above the strike price of that option.

Using a call option as an example, if you have one with a strike price of $100, it becomes more valuable as the underlying shares move from $90 to $110.

That's called **intrinsic value**.

The second major factor is **extrinsic value**. These are more nebulous, but amount to a few smaller factors.

Let's start with **time decay**. That involves how much time is left on the contract. The more time left, the higher the option premium.

Next is **volatility**. This involves both markets at large and volatility in the underlying security of the option contract.

You can measure the market's overall volatility by the VIX. When the VIX is higher, option prices are usually higher, too.

Volatility on the underlying security is called **implied volatility**, or IV. It's basically how much the market expects prices will fluctuate in the next year in a particular investment.

How to further limit your risk with option selling strategies

The first, is by using **limit orders —** only execute a trade if the price is at or better than a certain number.

You can also **"buy to close"** a trade before expiration day. This is as simple as buying the same options contract you originally sold.

You might want to do this for two reasons:

1. To lock in the vast majority of the premium you collected without waiting the whole way until expiration.

2. To prevent an outcome you don't want. Say, your opinion changed on the underlying stock … or you want to move into a different strike price.

That brings me to something else you can do …

Sometimes when you buy to close a contract, you may immediately want to sell a new contract with a different strike price, a different expiration date or both.

This is called rolling a position forward.

What about brokers?

Most major brokers let you sell options easily. You likely won't have to switch brokers to do this.

However, you need to be set up for options trading, which takes approval from your brokerage. Again, this is easy and painless.

It involves filling out a form that asks about things like your occupation and annual income.

It will also ask which level of options selling you want to use. Each broker is a bit different. But you'll need at least "Level 1" to sell cash-secured puts.

And that's it! You're ready to start collecting income from option selling right away.