2012
ISSUE
08

Weekly Insight to the Options Market

PULSEOptions

For the Week of February 27th through March 2nd

In This Issue:

Event Calendar

Feb 26 - Mar 3									Filter On
Date	9:16pm	Currency	Impact		Detail	Actual	Forecast	Previous	Chart
Sun Feb 26	Day 2	ALL		G20 Meetings					
Mon Feb 27	10:00am	USD		Pending Home Sales m/m			1.1%	-3.5%	
Tue Feb 28	8:30am	USD		Core Durable Goods Orders m/m			0.0%	2.2%	
	8:30am	USD		Durable Goods Orders m/m					
	9:00am	USD		S&P/CS Composite-20 HPI y/y					
	10:00am	USD		CB Consumer Confidence					
	10:00am	USD		FOMC Member Duke Speaks					
	10:00am	USD		Richmond Manufacturing Index					
	7:15pm	USD		FOMC Member Pianalto Speaks					
Wed Feb 29	8:30am	USD		Prelim GDP q/q					
	8:30am	USD		Prelim GDP Price Index q/q					
	9:45am	USD		Chicago PMI					
	10:00am	USD		Fed Chairman Bernanke Testifies					
	10:30am	USD		Crude Oil Inventories					
	2:00pm	USD		Beige Book					
Thu Mar 1	8:30am	USD		Unemployment Claims					
	8:30am	USD		Core PCE Price Index m/m					
	8:30am	USD		Personal Spending m/m			0.4%	0.0%	
	8:30am	USD		Personal Income m/m			0.6%	0.5%	
	10:00am	USD		Fed Chairman Bernanke Testifies					
	10:00am	USD		ISM Manufacturing PMI			54.6	54.1	
	10:00am	USD		Construction Spending m/m			1.1%	1.5%	
	10:00am	USD		ISM Manufacturing Prices			57.2	55.5	
	10:30am	USD		FOMC Member Raskin Speaks					
	10:30am	USD		Natural Gas Storage				-166B	
	All Day	USD		Total Vehicle Sales				[illegible]	
	12:30pm	USD		FOMC Member Lockhart Speaks					
Fri Mar 2									
Sat Mar 3									

Reports Have More Leverage at the End of the Week.

This Friday is Void of Reports.

Thursday's Unemployment Numbers Maybe this Week's Big Report, but it Usually is not as Significant compared to Next Week's Non-Farm Payroll.

NOTHING !!!

Walking in the Middle of a Movie

This Sunday (February 26th) The Academy of Motion Picture Arts and Sciences will give away their annual awards for excellence in motion picture production. More commonly know as the Oscars, this event is a big deal in Hollywood.

Too bad we didn't have such a great event this past week in the stock market. And maybe more disappointing as far as scheduled reports go, we don't have much to look forward to this next week. Don't fret, because we have a major event / setup on the calendar for early March. This issue will have our short list to look at, but more than anything, we will take this lull in the action to teach.

This next paragraph talks about an Academy Award Winning Movie for best Picture. And if you're like me, you hate it when someone tells you about a movie you haven't seen yet. I just hate it when someone ruins the suspense. So if you're like me, skip the next paragraph so I don't ruin any thing for you.

My friend and I arrived early at the theater for our movie. We stuck our head in the back of a theater to catch a glimpse of the film that was currently playing. We wanted to take a quick glance to see how big the crowd was and to get a feel if we wanted to watch this movie or another. It was 1975 and the movie was "One Flew Over the Cuckoo's Nest." We were in the theater for less than 60 seconds. And as chance had it, those few brief seconds were when Jack Nicholson turns to the character known as "Chief" and offers him a stick of gum to which the "mute" reply's, "Juicy-Fruit my favorite." The packed theater erupts in laughter.

If you had watched the movie from the beginning, you would have known exactly what everyone else would have known. By walking in late, we hadn't a clue about the plot or the players.

If this is one of your first few issues of the Pulse Update, you may feel like you just walked into the middle of a movie. You may not have a great grasp of the plot or the players. And maybe most important of all, you may not fully appreciate your own role in this drama as it unfolds around you.

I have been teaching a small core group of students for years on Gamma Trading, the catching of 100% or more moves. It was only recently that I spent the first dime on advertising. Many of you are here now due to a direct mail piece.

Thank you for becoming a student. Notice how I didn't use the term subscriber. I think of you as students. But even more than a teacher/student relationship, I think of you as members of a larger community. Welcome to our club.

The goal of this club is to extract money out of the markets on a regular basis. And as you put in your time and study the market with me, you will see there are times when it's easier. And you will also see when it is tougher.

In weeks which have less clear cut opportunities to earn, we take it as an opportunity to learn. Don't be discouraged, I will present a trading plan for this week that is assured to have options double. But as far as I am concerned, this is more a learning week compared to an earning week.

Family Photos

In last week's edition I mentioned how a student let me know where he lived in his email. I shared that I liked helping individuals not numbers. More of you added your town to your emails this week, thank you. This week I received two emails with photos of their families. Wow, I am touched. Thank you.

Leap Day Memories

Do you have any Leap Day Memories? More than buying a carton of milk set to expire on February 29th? I want to share my favorite Leap Day Memory. It was February 29, 1968. My parents bought a brand new car. A 1968 Chevy Camaro. Cost them just under $3,000.

Because of weekly options, I have the opportunity to make enough money in a day to replicate this event. I hope to make enough money to buy a Camaro, 1968 or 2012, either works, but I will settle for $3,000.

Anatomy of Our Screenshots

Let's look at a typical screenshot and dissect all the information. Since the only clue to when the screenshot was taken is the time of day, I have added the date of the data in red. Everything else should be similar to what you might find on Yahoo. (When looking at a stock at Yahoo, look under Options Tab on left column. Should bring up a table listing all the Calls and Puts by expiration. Click on hyperlink under "Symbol" column immediately right of the desired strike price).


GLD Feb 2012 171.000 call (GLD120224C00171000) - OPR

2.25 ↑ 1.04(85.95%) 3:59PM EST

Prev Close:	1.21	Day's Range:	0.63 - 2.50
Open:	0.83	Contract Range:	N/A - N/A
Bid:	2.30	Volume:	5,057
Ask:	2.32	Open Interest:	4,601
Strike:	171.00		
Expire Date:	23-Feb-12		

2/22/12

This particular screenshot is for the $171 Call option on the Gold Tracking ETF (GLD). It will expire on Friday February 24, 2012. There maybe some confusion as to the exact expiration, but I will clear this up in the next few paragraphs.

The first two lines tell us exactly what the option is and how its price has changed from the day before. Let's start on the top line. This example reads "GLD Feb 2012 171.000 call (GLD120224C00171000) – OPR"

The first letters are the ticker symbol for the underlying stock. In this case GLD. Next it says month and year of expiration, "Feb 2012." This is followed by the strike price carried out three digits past the decimal. Then the type of option, in this case a Call option. Next it has a specific ticker symbol for this specific option. This code contains all the information you would need. As long as you know how to read it. Letters = underlying stock. Next two digits are year, 12 being the abbreviation for 2012. Next two digits are the month, 02 representing February. The last two of this group of six tell the actual date of expiration, this one being Friday the 24th.

Here is where some confusion develops, on the lower left it has, "Expire Date: 23-Feb-12." These don't match. In code it say's the 24th, but in plain old easy to read English it says the 23rd. You might be asking yourself, what's the deal here? Why does it show a Thursday as expiration? Or worse still, how can Chris show an option moving over 100% the day after in expires? I must first give you some background on options and weekly options and then make an assumption about the data source.

First, you must remember that regular options have existed for years. And the vast majority of stocks that have options available only have regular options. These expire once a month. Although many expirations might be available to trade at any one time; there are twelve total expirations in a year. Here is where it gets tricky. They expire on the Saturday following the third Friday. Not the third Saturday, not the third Friday, but the Saturday following the third Friday.

Next we have weekly options. Only a small fraction of the total stocks available have weekly options. Please understand there are 40 weekly option expirations in a year. You add them to the 12 monthly expirations for a total of 52. They expire on Fridays. Not on Saturday and not on the third Friday.

I believe the confusion on expiration comes less from the fact weekly options expire on Fridays than the fact monthly options expire on a Saturday. I believe a software coder years ago tried to remove the confusion of options expiring on a non-trading day by having the "Expire Date:" calculate the day before actual expiration. This error, of sorts, was never corrected or modified and therefore this source shows the incorrect date in the lower left corner.

Now that we spent a lot of time clarifying the expiration, let's look at the rest of the information. Starting with the second line: "2.25 ^ 1.04 (85.95%) 3:59 EST." The 2.25 and 1.04 are dollar amounts. The number on the left, in this example $2.25 represents the last actual trade. This particular trade was made at 3:59 Eastern time. Just a moment before the market closed for trading for the day. It is possible the last trade of the day might be hours before the close.

Continuing on this second line we see an up arrow followed by 1.04. This refers to the change in this option's price since the last trade of the preceding trading day. In this instance, when this option last traded at $2.25 it was $1.04 higher than the day before. This gain was an 85.95% increase over the previous close. Also notice it's in green ink. It is color coordinated to match the value change. Green symbolizes increasing in value, red for dropping in value.

Looking at the data with titles to their left we see the first entry as "Prev Close." While this should be obvious to some, I want to make sure you know exactly what this means. Prev is an abbreviation for previous. It is the last trade from the trading day immediately prior. Here is an important fact. The last trade may have been well before the close.

"Open" is the first trade of the day. While many options trade right away, sometimes this trade will be minutes or even hours into the day. The important fact is that a trade took place at this price. It's not a theoretical value. Money exchanged hands.

"Bid" represents the price an actual buyer is willing to pay for this option at the time the screenshot was taken. If the market is closed when the screenshot is taken, it represents what the last bid was at the time of the close.

"Ask" represents the price an actual seller is willing to sell this option at the time the screenshot was taken. If the market is closed when the screenshot is taken, it represents what the last ask was at the time of the close.

It is VERY Important to understand the following concept: Stocks trade all day long. As stocks move in price, the value for its option change, BUT options don't always trade. There could be a willing buyer willing to pay less than a willing seller will take. The two might not meet. The bid / ask prices may move up or down without a trade taking place.

It's important to understand, I won't count it as a double unless it trades. But if the bid/ask is at level higher than the high, it is possible to have a trade. This will happen more than you may realize and now that you know about it, you may see it in real life.

"Strike" is short for strike price. This is the price the stock would trade at if the option were exercised. Our system is not meant to exercise options, we buy them and we sell them.

"Expire Date" is suppose to represent the expiration date, but currently an error exists that shows the day before.

"Day's Range" shows the lowest and highest prices at which the option actually traded. Key word here is actually. Again please understand the bid and or ask could be lower than the low or higher than the high. Options trade only a fraction of the time compared to its actual stock. This range changes during the day.

"Contract Range" will show, in the cases where the information is posted, the lowest low and highest high that option has traded for in its lifespan. Regular monthly options may have a lifespan of many months. Weekly options are only in existence for a maximum of seven trading days. While these numbers are capable of changing during the day, I don't see the results being updated by the data provider until the option opens the following day.

"Volume" is the total number of contracts traded that day. This number should start at zero each day and increase as trading takes place.

"Open Interest" represents the total number of contracts in existence at the open of the trading day. This number will not change during the day. It only changes at night. The volume traded may far exceed the open interest. Please do not confuse open interest with liquidity. It only represents how many contracts exist so far, it's not a limit of how many are available to trade.

Now that I've shown you what the lines mean, let me tell you how to read between the lines. Using logic we can be assured of a few facts and we can avoid some misconceptions.

While it is often true the low came before the high, we can NOT assume that it happens this way. We would need to look at a history of actual trades. We never want to assume. But we can know certain things without any doubt.

We know the "Open" is the first trade of the day. We know the last trade (line two) had to come after the open. Unless the open is the low or the high of the day, we can assume they came after the open. Also, unless the last trade is the low or the high of the day, we can assume they came before the last.

So looking at the screenshot of the GLD $171 Call, we know it opened at 83 cents. We know it went down to 63 cents sometime later. We know it went to $2.50 after it opened. We do NOT know if the 63 cents came before or after the $2.50. we do know it closed at $2.25. And we know the last of $2.25 came after every other trade, including the 63 cents.

So here is what can be said with certainty: The stock tripled from open to high (83 cents to $2.50). It also more than tripled from low to last (63 cents to $2.25). It was certainly worthy of our time and attention.

And the Winner is…

Most weeks, but not all, we will be awarding the "Sloppy Slop Award." This mark of distinction is presented to the member of our community who makes a profit on a trade but doesn't capture the entire move. This honor is not meant in any derogative sense. It is only given if a lesson can be shared with the entire group that benefits both the recipient and the audience.

It is with great privilege and reverence that I present this week's honor to none other than my very self. Yes that's right, I won the award. And if there were an award for missing a good trade all together, I would have won it as well. I am not sure which trade I am more embarrassed; about the one I made or the one I missed.

I have to start somewhere, so let me start with last week's "Top 5 Plus or Minus." If you're new to our group each week I share a short list of stocks which I predict will have options that double at a minimum. Sometimes the list is as long as eight to ten stocks. Other times the list is as short as two or three. It averages five +/- hence the name.

With last week's trading Holiday on Monday and the lack of any great reports being released, the short list was short. Three stocks to be exact (FAS, GDX & GS). With 20/20 hindsight we can see the list could have been longer. But that's not where my Sloppiness took place. It was in my prediction of the likelihood of doubling. I moved FAS to the front of the list.

And while all three stocks had options that doubled, I should have kept GDX at the front of the list. Not because of actual probability, but because of ease to trade.

In last week's edition I shared how FAS had a higher probability to cross strike prices than FAZ and because of this I removed FAZ from the "Top 5 +/-" list. Looking back it was a good decision to remove FAZ from the list, but I should NOT have moved FAS to the front of the list.

I am going to keep it simpler this week. It will be detailed, but simpler. But before we get into this week's predictions and action plan, I need to share the trade I missed this week.

The bad part of missing this trade, is the FACT this stock has been on our list just recently. And to make matters worse, I had been talking with longer term students about it outside this newsletter environment. But the WORST part is it hit big. Really big!

The underlying stock was VXX. This is an ETF that represents short term S&P 500 Option Volatility. It's a somewhat complex stock. It's mentioned in the DVD's in the section on "Thermometer Trading."

I think I mentioned it as a "New Best Friend." I let my friend down. I ignored him when he wanted to give me money. Lots and lots of money.

Below is a line chart showing how for four hours on Friday it stayed under $24 only to blast past it in the last 2 ½ hours.

When the stock rocketed through $24 on its way to over $25 it literally sent two options into outer-space when it came to return on investment. Please understand I didn't make either trade so we can throw Sloppy Slop out the window. Since we're pretending, let's pretend I bought the low of the day as a "Risk Worthy Trade" and let's continue the "what-if" game to its extreme. Let's say I sold the high of the day.

Before showing you the screenshots, I must follow the Sloppy Slop Award Procedure. I must make sure there is a lesson to be learned. (My lesson was take my own advice). The lesson I want to share here for everyone else is watch what happens when an option that is Out-of-the-Money (OTM) moves In-the-Money (ITM). Stock was under $24 goes over $25. It crossed two strike prices with little time and little time value in the option.

Here is the $24 Call. With 2 ½ hours to go the stock was under $24. This option was just OTM. It dropped in price to a dime. Ten contracts would have cost exactly $100. I think you would agree, a reasonable amount to risk.

Look how it rose to $1.13 and closed at $1.06. Normally I would take it to the close. Normally I would show how this $100 became $1,060 in a few hours. But since I missed it, we might as well show the $100 climbing to $1,130.

VXX Feb 2012 24.000 call (VXX120224C00024000) - OPR

1.06 ↑0.71(202.86%) 4:02PM EST

Prev Close:	0.35	Day's Range:	0.10 - 1.13
Open:	0.20	Contract Range:	N/A - N/A
Bid:	1.00	Volume:	9,521
Ask:	1.13	Open Interest:	3,011
Strike:	24.00		
Expire Date:	23-Feb-12		

2/24/12

Open to Close 5x. Low to High 11x

This next screenshot is of the $25 Call. I didn't annotate it in red. If you could use the information shown earlier in this week's edition, you should be able to see what this option closed at on Thursday. What it opened at on Friday, how low it went, how high it went and what it closed at. Unless you knew or were told, you could only assume the low came before the high. (It DID!). See if you can calculate the results.

VXX Feb 2012 25.000 call (VXX120224C00025000) - OPR

0.07 ↓0.03(30.00%) 4:02PM EST

Prev Close:	0.10	Day's Range:	0.01 - 0.31
Open:	0.08	Contract Range:	N/A - N/A
Bid:	0.07	Volume:	13,109
Ask:	0.10	Open Interest:	5,115
Strike:	25.00		
Expire Date:	23-Feb-12		

What you should have seen is as follows: It closed on Thursday at a dime. It opened Friday at two cents lower, 8 cents. It then traded down to a penny, before making a high of 31 cents. This equates to $100 becoming $3,100. (It took about 90 minutes by the way). The option then sold off closing at 7 cents, down 30% from the previous.

I hope this last paragraph matched your math. I hope you were able to learn from my Sloppiness. Learning to trade is more like an education than a journey. If you can accept the fact that these weekly Pulse Updates are more like a classroom than a vacation, you'll be better able to profit from them for your lifetime. We all need to think of this as a One-Room Schoolhouse. Some of you are graduate students, while others are just starting out.

Speaking of lessons; let me share an important one here. If you are new at this, or nervous putting real money at risk, pay close attention: Follow one stock and one stock only. Have GDX become your friend. A friend that will give you money that you won't have to give back. All your friend asks for is for you to spend some quality time and attention with them.

Here is an excerpt from an email I received on 2/22 from an existing student. She and her husband were quoted on my marketing brochure. They really exist and they're really earning and learning. Their complete story includes the fact they never traded an option before becoming my student. And the Slop is coming out of their trading. As yours will be as well.

"…traded GDX today ... bought a 56 call and I usually let Doug do the trades but today I thought that I might try. I bought the call at .37 and sold it at 1.01. For me that was exciting!
Thank you,

Christy"

As you just read, they almost tripled on an option in one day. A Wednesday. A less than perfect leverage day.

Below I have the screenshot for the particular option they traded. You should be able to analyze their trade as it compares to this option's movement through the day. Please see they did not buy the low, nor sell the high. They traded Sloppy. But again I say, the Slop is coming out of their trading as it will yours.

As you see below they caught most of the move. Not all of it.

GDX Feb 2012 56.000 call (GDX120224C00056000) - OPR

0.99 ↑ 0.49(98.00%) 3:57PM EST

Prev Close:	0.50	Day's Range:	0.33 - 1.15
Open:	0.42	Contract Range:	N/A - N/A
Bid:	1.01	Volume:	1,537
Ask:	1.05	Open Interest:	1,321
Strike:	56.00		
Expire Date:	23-Feb-12		

2/22/12 Taking the Slop Out
Doug & Christy's 37 c to $1.01

Here's the beauty of GDX. It's the gift that keeps giving. Two days later the stock reverses and the Put on Friday out moves the Call from Wednesday.

GDX Feb 2012 57.000 put (GDX120224P00057000) - OPR

0.51 ↑ 0.21(70.00%) 3:59PM EST

Prev Close:	0.30	Day's Range:	0.15 - 0.82
Open:	0.17	Contract Range:	N/A - N/A
Bid:	0.51	Volume:	2,503
Ask:	0.52	Open Interest:	3,104
Strike:	57.00		
Expire Date:	23-Feb-12		

2/24 Triples from Open to Close.

"Top 5 Plus or Minus"

This week's "Top 5 Plus or Minus" will be a "Top 1 Plus & Minus." Since this is a slow week for reports, I am going to focus on one stock and one stock only, therefore it will be the "Top 1."

Before I give you the list of one for the week (try and guess), I want to tell you the stock that made the list and then got cut off. It's Goldman Sachs (GS). Here's why I want it on the list. It has a history of crossing strike prices and having options double. Here's why I want it off the list. We don't trade Strangles on it and we only occasionally trade Straddles on it. I want to focus on these two strategies this week.

Having said that, if you have been a student for a while, if you have traded GS before, if you know what you're doing, just do it. If you're new, GS will be there later for you.

As you can see below GS moved up and down on Friday. What you may not realize is that it never cross a strike price during the day. It sold off towards $115, but rallied higher, only to sell off again.

Here is a chart of the weekly $115 Put on GS. See you had two opportunities to double. I want to reiterate, it didn't cross below $115. If it had, this option would have tripled or better.

Unless you have traded GS before, skip it. Your list is one stock and one stock only. GDX.

Here's the plan. Let's watch this stock at the beginning and end of five straight days. Let's see how it moves from previous close to open then to close then to open so on and so on.

If you take the close this past Friday ($56.46) and watch it forward for the week you'll have five opens and five closes. (We won't need to see where it closes next Friday for this lesson).

Follow my logic. You will watch our number one stock. You will become friends with it. You will see how it moves in a ho-hum week for reports. You will observe it and its options. This is meant as a paper trading lesson. We will go over the results in next week's edition and we will tie your new experiences together to be set up to trade the following week. Did I mention Non-Farm Payrolls (NFP) is coming up?

Follow these rules:

Observe the stock price.

We want it right at an even dollar to buy a Straddle. This would cause the At-the-Money (ATM) Call and Put to be priced about the same. No bias up or down. We have some play in this, but if it trades at $56.25, it's too far away.

If it happens to be at $56.50 or close (like how it closed on Friday) we would buy a Strangle. In this situation we would look at the $56 Put and the $57 Call. If you were adventurous, you could go further OTM. Say the $55 Put and $58 Call. Again this is for learning. Next week is for earning.

Understand, if the stock is a dollar or two higher or lower, adjust your strike selection. We want ATM options in the case of a Straddle. We want OTM for Strangles.

We will zone in on this stock. We will have it become an income source for you as it has countless other students before you. If we pick up new students along the way, well they have to deal with the fact they're walking into the middle of a movie. And the movie stars GDX and you are also a player in this drama. Let's write the script together.

As always Good Trading,
Chris