

The Beginners Practical Guide to Options Investing

By Chuck Hughes

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HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

A Practical Guide to Understanding Option Investing

The focus of this Report is to provide you with the practical knowledge you need to understand in order to trade options. Learning the mechanics of option investing can be a bit overwhelming particularly if you have never invested in options before.

I use simple trend following systems to determine the price trend of a stock or ETF. When the price trend is up I buy call options which profit as the underlying stock increases in price. When the price trend is down I buy put options which profit as the underlying stock decreases in price. The other option strategy I use is selling options to generate cash income.

To be a successful options investor you don't need to know complicated mathematical formulas or Greek letters. You only need to know the basic mechanics of buying and selling options. In my 25 years of trading experience, option trading has been the most versatile and rewarding approach to profitable trading.

Option trading enables many different types of traders to achieve their specific investment goals. I have traded many types of option strategies with different investment goals. I favor the three limited risk option strategies listed below as I have had good success trading these strategies.

- Purchasing options to realize trading profits
- Trading option spreads that can profit during an up or down market
- Selling option premium to produce cash income

Successful Option Trading

The overall goal of my option investing is to achieve at least a 3 to 1 profit to loss ratio. To achieve this goal I must be ready to close out my losing trades before they develop into large losses and hold on to winning trades. I will normally sell an option before it incurs a 20 to 30% loss. Many option traders with good trading systems fail because they don't pay enough attention to risk. Maintaining a trading discipline that forces you to think in terms of reward versus risk can help you become a successful option trader.

If you are willing to risk 30% on an option trade, then you should be expecting a 90% profit on your winning trades in order to achieve a 3 to 1 profit to loss ratio. If you are willing to risk 50% on an option trade, then you should be expecting a 150% profit on your winning trades which is very difficult to achieve. I always think in terms of taking measured risks with every trade.

Also, if you have enough trading funds, don't risk more than 5 to 10% of your trading funds on any one trade. This helps prevent a large portfolio loss if one of your option trades experiences a big loss. This is especially important with options because they employ leverage.

Successful trade management can be summarized with three basic rules:

- Limit the size of your positions
- Close out your losing trades before they develop into large losses
- Don't limit your profits by selling winning trades with a small profit

There is no need to memorize all of the material presented in this Report. This Report can be used as a future reference when implementing an option strategy.

Option Basics

Options are also known as derivatives because the option contract derives its price and value from the underlying asset on which it is based. This value can fluctuate as the price of the underlying asset rises or falls in price. Option values are also affected by other market conditions. These conditions could be a change in volatility due to sudden fluctuations of price in the underlying asset, or interest rates, dividends and stock splits.

An option is the right, but not the obligation, to buy or sell a stock or index for a specified price on or before a specific date. A call option is the right to buy a stock/index, while a put option is the right to sell a stock/index. The investor who purchases an option, whether it is a put or call, is the option "*buyer*". Conversely, the investor who sells the put or call "to open" is the option "*seller*" or "*writer*".

Options are contracts in which the terms of the contract are standardized and give the buyer the right, but not the obligation, to buy or sell a particular stock/index at a fixed price (the strike price) for a specific period of time (until expiration). All option contracts traded on U.S. securities exchanges are issued, guaranteed and cleared by the Options Clearing Corporation (OCC). OCC is a registered clearing corporation with the SEC and has received 'AAA' credit rating from *Standard & Poor's Corporation*. The 'AAA' credit rating corresponds to OCC's ability to fulfill its obligations as counter-party for options trades.

The options markets provide a mechanism where many different types of investors can achieve their specific investment goals. An options investor may be looking for long term or short term profits, or they may be looking to hedge an existing stock or index position. Whatever your objectives may be, you need a thorough understanding of the markets you will be trading.

Options Share the Following General Characteristics:

- Options give you the right to buy or sell an underlying security or index
- If you buy an option, you are not obligated to buy the underlying security. You simply have the right to exercise the option
- If you sell an option, you are obligated to deliver the underlying security at the price at which the option was sold if the buyer exercises his/her right to take delivery

Option General Characteristics Continued . . .

- If you sell an option, you are obligated to deliver the underlying security at the price at which the option was sold if the buyer exercises his/her right to take delivery
- Options are good for a specified period of time after which they expire and you lose the right to buy or sell the underlying security
- When options are purchased the buyer incurs a debit
- When options are sold the seller receives a credit
- Options are available in various strike prices representing the price of the underlying security
- The cost of an option is referred to as the option premium. The premium is comprised of time value and intrinsic value
- There are two kinds of options: calls and puts. Calls give you the right to buy the underlying security and puts give you the right to sell the underlying security
- Options (put or call) which have the same underlying security are called a class of options. For example, all the calls for General Electric constitute an option class.
- All options which are in one class and have the same strike price are called an option series. For example, all the General Electric options with a strike price of 25 constitute an option series.
- Most options are never exercised and are closed out before option expiration

Buying Options

Any investor can buy options if they have the required account established with their broker. Buying options limits the investor's risk to the amount of capital invested in the option purchase. Therefore the only requirement is that the investor has enough funds in their account to purchase the options. Since the purchase of an option contract results in a long position, a cash debit is subtracted from the buyer's account.

Selling Options

For every option buyer there is a seller or writer. If an option is exercised, the option writer is obligated by the option contract to deliver the specified number of shares of the underlying security at the specific strike price. Anyone can write options if they have the required account established with their broker.

Selling “naked” options can involve large capital loss risk and is not a suitable investment for most investors. Writing an option results in cash being credited to the seller’s brokerage account. Since the writing of an option results in a short position, it requires that funds be held in margin to guarantee the writer’s obligation. Margin requirements for writing naked options vary for different markets, and sometimes even for different stocks.

Underlying Security

The underlying security in options trading is defined as the financial instrument on which an option contract is based or derived. It is a stock or Exchange Traded Fund (ETF) that you have the right to purchase or sell. The symbol used for the underlying security in options trading is usually the symbol used by the exchange on which the underlying security is traded. For example, GE is used for General Electric and SPY is used for the S&P 500 Index ETF.

Strike Price

The strike price is the actual price at which the option holder may buy or sell the underlying security as defined in the option contract. For example, a GE December 30-Strike call gives the buyer of the option the right to buy 100 shares of General Electric at \$30 per share between now and the December expiration (third Friday in December).

Expiration Date

The expiration date is the actual date that an option contract becomes void. Stock options normally expire on the third Friday of each month. This means if you have a December stock option, it will expire the third Friday of December. You should always check with the exchange or your brokerage firm for the exact times of expiration and the procedure they use. Be aware that in most cases, pending option contracts that are in-the-money at option expiration will be exercised automatically if the seller of that contract has not closed out (bought back) the short option prior to expiration or if the buyer of that contract has not closed out (sold) the long option prior to expiration.

Option Type

There are two types of options - call options and put options.

A call option *purchase* profits when the price of the underlying security moves higher.

A call option *short sale* profits when the price of the underlying security moves lower.

A put option *purchase* profits when the price of the underlying security moves lower.

A put option *short sale* profits when the price of the underlying security moves higher.

American Versus European Options

There are two types of option expirations: American and European. The American type expiration allows for the exercise of an option anytime prior to the expiration date. The European type expiration only allows for the exercise of an option on the expiration date. Most stocks and indexes are American type options but the S&P 500 index (SPX) options traded on the CBOE are an example of European type options.

How to Read Option Symbols

An option symbol is comprised of several components that define the underlying stock or ETF and information about the specific option contract. An option symbol consists of the stock or ETF trading symbol, year of expiration, expiration date, option type (call or put) and strike-price.

There are many financial websites available today that will give you option quotes. I like to use Yahoo Finance or the Chicago Board Options Exchange website at www.cboe.com to obtain option quotes.

The quote table below was downloaded from Yahoo. After logging on to the Yahoo Finance website type in the trading symbol and click 'Get Quotes'. When the quote summary appears, click 'Options' on the left column. The option webpage will give bid and ask quotes for all of the strike prices and expiration months available for that particular stock or ETF.

The table below contains an option quote for the Emerging Markets ETF (EEM) call options. Let's focus on the EEM January 2013 30-Strike call option which is circled. The symbol for this option is EEM130119C00030000.

EEM 13 0119 C 00030000

EEM is the trading symbol for the Emerging Markets ETF

13 is the expiration year 2013

0119 is the option settlement date January 19th

C designates a call option (put options are designated with a "P")

00030000 designates a 30-Strike price

iShares MSCI Emerging Markets Index (EEM) At 4:00PM EST: 46.03 ↑ 0.47 (1.03%)							
Call Options				Expire at close Friday, January 18, 2013			
Strike	Symbol	Last	Chg	Bid	Ask	Vol	Open Int
30.00	<u>EEM130119C00030000</u>	17.10	↓ 0.20	17.20	17.75	30	137
33.00	EEM130119C00033000	14.70	0.00	14.25	15.80	0	10
34.00	EEM130119C00034000	14.00	0.00	13.45	15.00	0	10
35.00	EEM130119C00035000	13.05	0.00	13.45	13.80	0	50

Option expiration day is normally the third Friday of the option expiration month. In this example, the January '13 call option would expire on Friday January 18th 2013.

Note: Option expiration is the last day options trade and is normally the third Friday of the month in this example Friday January 18th. The option settlement date is the Saturday after expiration day in this example Saturday January 19th. Put options use the same symbol designations except a put option is designated with a "P".

Stock Option Point Values

Normally, 1 stock option contract covers 100 hundred shares of the underlying stock. Therefore an option with a 3.5 point premium would cost \$350 (100 shares x \$3.5).

LEAPS

LEAPS (Long-term Equity Anticipation Securities) are long term options with expiration dates that can be up to 3 years away. Not all optionable stocks and ETFs have LEAPS available. With the existing product competition the exchanges only create LEAPS for a stock or indexes if they feel there is a demand for them. LEAPS can be used for long term investing or for hedging.

LEAPS option symbols differ from standard option symbols because they specify the year in which the option expires. Normally LEAPS option symbols begin with the letter V, W, X, Y or Z. For example, The Jan 10 Merck LEAPS option symbols begin with the letter W and the 2011 LEAPS begin with the letter V. LEAPS options expire the third Friday in January. The 2011 LEAPS would therefore expire on the third Friday in January 2011.

Exercise and Assignment

Exercise is the term used when the buyer of an option uses his/her right to purchase or sell the underlying security at the terms of the option contract. Assignment is the term used when the seller of an option is obligated to deliver the underlying security at the contract specification. When the option buyer exercises his/her option contract, the seller of that option contract receives a notice of assignment from their broker. The seller of the option contract must then deliver the underlying security at the specified price. Your broker handles the entire option exercise/assignment transaction, and the resulting cash profit/loss or stock position is transferred into or out of your account.

Section 1 Quiz

1. If you buy a Microsoft call option you are obligated to buy Microsoft stock.
A. True
B. False
2. If you sell an option, you are obligated to deliver the underlying security at the strike price at which the option was sold if the buyer exercises his/her right to take delivery.
A. True
B. False
3. When options are sold the seller receives a cash credit.
A. True
B. False
4. Call options give you the right to sell the underlying security and put options give you the right to buy the underlying security.
A. True
B. False
5. Stock options normally expire the _____ of the expiration month.
A. First Friday
B. Third Thursday
C. Third Friday
D. First Monday
6. European style options allow for the exercise of an option on the expiration date only.
A. True
B. False
7. MRK is the root symbol for Merck stock options. The symbol for the Merck January 2013 50-strike put option is _____.
A. MRK130119C00050000
B. MRK130119P00050000
C. MRK130119P00070000

8. The Merck December 80-strike call option is quoted at 4.25. It would cost _____ to purchase this option at the current quote.
 - A. \$425
 - B. \$4.25
 - C. \$42.50
 - D. \$4,250
9. Not all optionable stocks and ETFs have LEAPS options available.
 - A. True
 - B. False
10. Exercise is the term used when the buyer of an option uses his/her right to purchase or sell the underlying security at the terms of the option contract.
 - A. True
 - B. False
11. Most option contracts are never exercised.
 - A. True
 - B. False
12. Each stock option contract normally represents 100 shares of the underlying stock.
 - A. True
 - B. False

Section 1 Quiz Key

1. B, False
2. A, True
3. A, True
4. B, False
5. C, Third Friday
6. A, True
7. B, MRK130119P00050000
8. A, \$425
9. A, True
10. A, True
11. A, True
12. A, True

Option Characteristics

There are three major factors that determine the price of an option:

Strike Price in Relation to the Stock Price

The most important factor that determines the price of an option is the price of the underlying stock relative to the strike price. This determines whether an option is in-the-money or out-of-the-money and quantifies an option's intrinsic and time value. In-the-money options have more intrinsic value and are more expensive than out-of-the-money options. The deeper an option is in-the-money the more intrinsic value it will have and the more expensive it will be. In-the-money options are more expensive than at-the-money and out-of-the-money options.

Time Until Expiration

An option is considered a wasting asset, and as the option's expiration date gets closer, the value of the option decreases. The more time remaining until expiration, the more time value the option contract has. If the underlying security price falls far below or far above the strike price of the option, the underlying security becomes more dominant in determining the price of the option. On the day the option expires, the only value the option has is its intrinsic value, which is determined by the amount by which the option contract is in-the-money. If an option has no intrinsic value at expiration, it expires worthless.

The passage of time works against the options buyer, as the price of out-of-the-money options decreases at an accelerating rate as the expiration date approaches. This is called "time decay". The opposite is true for the option seller. The passage of time works for the option seller as time decay results in profits.

The longer an option has before expiration, the more expensive it will be. More time until expiration means more time value and a higher price.

Volatility

Volatility is the amount in annual percent terms that the underlying security has moved or is expected to move on an annual basis. This number can help predict short-term price ranges and also helps determine the relative value for an option price.

There are two types of volatility used in option analysis: The first is statistical volatility, which is volatility based on the historical price movement of the underlying security. This is sometimes referred to as historical volatility. This volatility number tells us what has happened in the past.

The second type of volatility is implied volatility, which is an implied value based on the current option prices for an underlying security. This kind of volatility can give insight into potential price movement.

When option prices rise because of increased trading volume or nervousness in the market this can signal a significant market event. When option prices rise, implied volatility rises as well. Therefore, implied volatility can be seen as a measurement of risk. Higher volatility means higher risk for the option seller and increased prices for option premiums.

The more volatile the stock, the more expensive the option will be. Because volatile stocks have larger price moves, there is a higher probability that an out-of-the-money option will become an in-the-money option with intrinsic value.

Option Pricing

Option premiums consist of intrinsic value and time value. At option expiration options lose all time value and consist of only intrinsic value. Intrinsic value is the difference between the option strike price and the current price of the underlying ETF. The intrinsic value of a *call* option is calculated by subtracting the strike price of the option from the current ETF price. For example, let's assume Apple stock is currently trading at 75.00 and the April 70-Strike call option is priced at 7.00 points. The intrinsic value of this option would be 5.00 points.

Current Stock Price of 75.00 Minus Strike Price of 70.00 = 5.00 Intrinsic Value

The time value of an option is calculated by subtracting the intrinsic value from the total value of the option. In this example the 70-Strike option priced at 7.00 would have 2.00 points of time value.

Option Price of 7.00 Minus Intrinsic Value of 5.00 = Time Value of 2.00

In this example, if the Apple April 80-Strike call option is priced at 3.00 then this call option would have no intrinsic value and would only contain time value.

Current Stock Price of 75.00 Minus Strike Price of 80.00 = 0.00 Intrinsic Value

Option Price of 3.00 Minus Intrinsic Value of 0.00 = Time Value of 3.00

The intrinsic value of a *put* option is calculated by subtracting the current price of the stock from the strike price of the put. Let's assume again that Apple stock is trading at 75.00 and the Apple April 80-Strike put option is priced at 8.00 points. The intrinsic value of this option would be 5.00 points and the time value would be 3.00 points.

Strike Price of 80.00 Minus Current Stock Price of 75.00 = 5.00 Intrinsic Value

Option Price of 8.00 Minus Intrinsic Value of 5.00 = Time Value of 3.00

In the above example, if the Apple April 70-Strike put option is priced at 2.00 then this put option would have no intrinsic value and would only contain time value.

Strike Price of 70.00 Minus ETF Price of 75.00 = 0.00 Intrinsic Value

Option Price of 2.00 Minus Intrinsic Value of 0.00 = Time Value of 2.00

When the price of a stock is below the strike price of a call option that option is said to be out-of-the-money. An option with a strike price equal to the price of the underlying security is at-the-money. A call option is in-the-money when the stock price is greater than the strike price. An in-the-money call option has intrinsic value equal to the amount the stock price exceeds the strike price.

A put option is just the opposite of a call option. A put option is out-of-the-money when the stock price is greater than the strike price. A put option is in-the-money when the stock is below the strike price. The intrinsic value of a put equals the amount by which the strike price exceeds the stock price. As with a call, a put will have value at expiration if the option is in-the-money. To clarify this concept, take a closer look at these terms:

	<u>Call</u>	<u>Put</u>
In the money	strike price < stock price	strike price > stock price
At the money	strike price = stock price	strike price = stock price
Out of the money	strike price > stock price	strike price < stock price

Time (or days remaining until expiration) and volatility are the main components of time value. Interest rates and stock dividends are smaller factors in the pricing of option premiums. The more time remaining until expiration, or the higher the stock volatility, the greater the risk to the option seller, and therefore the higher the option premium will be.

Dividends

Dividends reduce the value of call options and increase the value of put options. This is due to the fact that paying out a dividend normally reduces the stock price by the amount of the dividend. Dividends increase the attractiveness of holding stock compared to buying call options and holding cash. Conversely, short-sellers must pay out dividends so buying puts is more desirable than shorting stock.

Interest Rates

Rising interest rates increase the value of call premiums and decrease the value of put premiums. Higher rates increase the underlying security's forward price, which is the stock price plus the risk-free interest rate over the life of the option.

Advantages of Options Versus Stocks/Mutual Funds

When you purchase options you commit a limited amount of capital and thus have less total dollars at risk in the market compared to stocks and mutual funds. The surplus dollars can be placed in safe investments like a money market fund. Instead of buying stocks consider "leasing" them with options especially when your market expectations are likely to change more frequently with today's volatile markets. Set aside a small portion of your portfolio for options to benefit from the frequent market swings that can create big profit opportunities for traders positioned to capitalize on market swings.

Options offer profit potential not only when the market rallies, but also when it declines. With stocks and most mutual funds you can only benefit from bullish markets. If you are bearish on the stock market cash is usually your only alternative. With options you can profit from both bullish and bearish markets.

A Lower Risk Alternative to "Going Short"

Put options are normally a better choice than selling short a stock. Option purchases normally do not require a margin account, whereas short selling a stock does require a margin account. In addition, a short stock position has virtually unlimited loss potential if a stock continues to rally in price. Conversely, the maximum loss for a put option purchase is limited to the purchase price of the option.

Options offer greater leverage than stocks or mutual funds. A 10% move in a stock can easily translate into a 100% move in the related option. Purchasing options offers profit leverage if you are correct in your market view but also offers limited risk if your market view is incorrect.

Options can allow for stock or mutual fund portfolios to be hedged without losing long-term capital gain status. This results in a more favorable tax treatment. This can improve the after-tax returns on stock holdings while allowing you to protect those stocks during market volatility.

Risk Management

The first step toward intelligent risk management is to trade options only with that portion of your capital that can be comfortably devoted to speculation. This will permit you to trade rationally and to sleep soundly which is not possible if your 'Safe Money' is at risk. Never trade options with money needed to pay living expenses. Restrict your options trading to funds that can be lost without undue financial hardship.

Once you determine the amount of your available trading capital, allocate no more than 10% to any one trade. This should help mitigate losses when losing trades occur. This rule holds regardless of how successful you have been in the past and regardless of how attractive the next trade appears. There will always be losing trades. By compounding your capital after a few profitable trades, you are exposing yourself to potentially painful losses once that losing trade comes along.

Risk and Diversification

There are generally two types of portfolio risk: systematic and unsystematic.

Systematic Risk, also called non-diversifiable risk, is risk that cannot be eliminated. It arises from factors which cause the whole market to move up or down, and can not be eliminated by diversification because it affects all securities. Examples of systematic risk are political or sociological changes that affect all securities. Some of the most common forms of systematic risk are changes in interest rates or inflation.

Unsystematic Risk, also called diversifiable risk can be reduced or eliminated by diversifying your portfolio. Unsystematic risk is risk that is unique to a certain industry, firm, or company. Examples of unsystematic risk include: a company's financial structure, weather and natural disasters, labor strife and a shortage of raw materials. Since unsystematic risk affects a single company or industry, it can be mitigated by investing in many companies across a broad range of industries.

Option positions should be diversified. A major advantage of option purchases is 'truncated risk', whereby your loss is limited to your initial investment yet your profit is virtually unlimited. Diversification will allow you to use truncated risk to its maximum advantage. While some of your positions will inevitably be unprofitable, each profitable trade can offset several unprofitable trades. Option positions should be established among many underlying stocks and indexes in unrelated industries. This gives you diversification, which can help mitigate sector weakness.

In order to trade options, your broker must first approve your account for option trading. There are various levels of option trading and each level has financial requirements that differ from broker to broker:

Level 1 Covered call writing

Level 2 Call and put purchases and covered put writing

Level 3 Spreads (requires margin)

Level 4 Uncovered call and put writing (requires margin)

Level 5 Index option writing (requires margin)

Be sure to ask your broker about their requirements for the level of options you plan to trade. Lastly, before you trade options, regulations require that you read *Characteristics and Risks of Standardized Options* prepared by the Options Clearing Corporation (OCC) and available from your broker.

Order Types

Listed below are definitions for a variety of popular orders that may be helpful.

- **Market Order**

A market order is simply an order without restrictions or limits that guarantees execution but not price. Because it lacks restrictions, it takes precedence over all other types of orders. A market order to buy is executed at the lowest offering price available, which is also known as the "ask" price. A market order to sell is executed at the highest bid available known as the "bid" price.

- **Limit Order**

A limit order is an order in which an investor has placed a restriction or limit on the acceptable purchase or selling price. There are two types of limit orders: a buy limit order and sell limit order. A buy limit order sets the maximum amount an investor is willing to pay to purchase a security or option contract. A sell limit order sets the minimum price that an investor is willing to accept to sell their security or option contract.

- **Day Orders**

Day orders are only valid for one trading day. If you place the order during market hours, then it will expire at the end of the trading day if it is not executed. If you place a day order after the market close then it will be valid for the next trading day.

- **Good Until Canceled Orders (GTC)**

Normally each brokerage firm will establish time periods for which GTC orders are valid. Some brokers may allow a one month valid period while others may allow a six month valid period. Once a GTC order is placed, it will remain open until the option expires, the order itself expires, the order is filled, or the order is cancelled.

- **Stop Loss Orders**

A stop-loss order is normally used to protect a profit or prevent a further loss if you own a stock and the price of the stock starts to drop. Example: You purchase 100 shares of Microsoft stock at 25 and enter a GTC stop order to sell at 20. As long as Microsoft trades above 20 then the stop order will not be executed. If it trades at 20 or below, however, then the stop order automatically becomes a market order to sell 100 shares of Microsoft at the market. A stop order does not guarantee that you will be filled at the stop price. Using the above example, if Microsoft closes at 21 and opens the next trading day at 19 the stop order will be executed on the open at the best possible price but below the 20 stop-loss price.

Section 2 Quiz

1. Option premiums consist of intrinsic value and _____ value.
 - A. Dividend
 - B. Payout
 - C. Time
 - D. Cash
2. Exxon stock is trading at 70.00. The Exxon December 65-strike call option is priced at 8 points. The intrinsic value of this call option is ___ points.
 - A. 8
 - B. 3
 - C. 65
 - D. 5
3. The time value of the same Exxon 65-strike call option listed above is ___ points.
 - A. 8
 - B. 3
 - C. 65
 - D. 5
4. A call option is in-the-money when the strike price is _____ the current stock price.
 - A. Less than
 - B. Greater than
 - C. Equal to
5. A put option is out-of-the-money when the strike price is _____ the current stock price.
 - A. Less than
 - B. Greater than
 - C. Equal to
6. Time premium is normally the dollar amount the writer of an option is charging the buyer to assume the price movement risk of the option.
 - A. True
 - B. False

7. As an option's expiration date gets closer, the time value of an option increases.
 - A. True
 - B. False
8. On option expiration day, the only value an option has is its time value.
 - A. True
 - B. False
9. The most important factor that determines the price of an option is the price of the underlying security relative to the strike price of the option.
 - A. True
 - B. False
10. Higher volatility usually means higher risk for the option seller and increased prices for option premiums.
 - A. True
 - B. False
11. Dividends normally increase the value of call options and decrease the value of put options.
 - A. True
 - B. False
12. Rising interest rates normally decrease the value of call premiums and increase the value of put premiums.
 - A. True
 - B. False
13. Buying put options is normally a lower risk strategy than selling short stock.
 - A. True
 - B. False
14. Options offer greater leverage than buying stocks or mutual funds. A 10% move in a stock can translate into a 100% move in the related option.
 - A. True
 - B. False

15. One of the biggest differences between purchasing stock and purchasing short term options is the fact that short term options are time dependent.
 - A. True
 - B. False
16. Systematic risk normally can be eliminated with portfolio diversification.
 - A. True
 - B. False
17. A major advantage of option purchases is truncated risk, which limits your loss to your initial investment but allows for virtually unlimited profits.
 - A. True
 - B. False
18. Portfolio diversification will allow you to use truncated risk to its maximum advantage.
 - A. True
 - B. False
19. A market order is an order which an investor has placed a restriction or limit.
 - A. True
 - B. False
20. A limit order guarantees execution but not price.
 - A. True
 - B. False
21. A good until cancelled order remains in effect until the option expires, the order itself expires, the order is filled, or the order is cancelled.
 - A. True
 - B. False
22. A stop loss order guarantees that you will limit your loss to the stop loss price.
 - A. True
 - B. False

Section 2 Quiz Key

1. C, Time
2. D, 5
3. B, 3
4. A, Less than
5. A, Less than
6. A, True
7. B, False
8. B, False
9. A, True
10. A, True
11. B, False
12. B, False
13. A, True
14. A, True
15. A, True
16. B, False
17. A, True
18. A, True
19. B, False
20. B, False
21. A, True
22. B, False

Buying and Selling Calls and Puts

There are two ways to invest in options:

- **Buying options**
- **Selling short options**

Buying Options

The goal of buying an option is to 'Buy Low and Sell High'. Buying a call option is a bullish strategy as the value of a call option will increase as the price of the underlying stock increases. Conversely, if the price of the underlying stock decreases then the value of a call option also decreases. Buying calls is a strategy that can be used as an alternative to the outright purchase of the underlying security, giving the purchaser the added benefits of limited risk and increased leverage.

Buying a put option is a bearish strategy as the value of a put option will increase as the price of the underlying stock decreases. Conversely, if the price of the underlying stock increases then the value of a put option will decrease.

The risk for call or put option purchases is limited to the premium paid for the option. The profit potential is virtually unlimited.

The price you pay for an option is called the premium. When you buy an option, cash is deducted from your brokerage account to pay for the option premium. One option contract normally controls one hundred shares of the underlying stock. Purchasing an option with a 4.00 point premium would result in \$400 being deducted from your brokerage account to pay for the premium (4.00 x 100 shares = \$400). If you later sold this option for 6.00 points you would realize a \$200 profit.

Buy at 4.00 and sell at 6.00 = 2.00 Profit

Conversely, if you later sell this option for 3.00 points you would realize a \$100 loss.

Buy at 4.00 and sell at 3.00 = 1.00 Loss

Buyers of call options profit if the underlying stock increases in price

Buyers of put options profit if the underlying stock decreases in price

Selling Options

The goal of selling (to open) an option is to 'Sell High and Buy Low'. When you sell (to open) an option, cash is credited to your brokerage account. For example, if you sell an option for 6.00 points, \$600 will be credited to your account ($\$6.00 \times 100 \text{ shares} = \600). This is just the opposite of purchasing an option. As noted previously, buying an option for 6.00 points would result in \$600 being deducted from your account.

Selling (to open) a call option is a bearish strategy. An investor who sells a call option is also known as the 'writer'. Selling a call is also known as being 'short' a call. The value of a call option declines as the underlying stock decreases in price. Being 'short' a call option generates profits as the call option decreases in value.

If you sell (to open) a call option and the call option subsequently decreases in price then you can 'buy back' to close the short call at a lower price which will result in a profit for the call writer (Sell high and buy low). For example, if you sell (to open) a call option for 5.00 points and then later buy the call back to close for 3.00 points you would realize a 2.00 point profit.

Sell call at 5.00 and then buy back at 3.00 = 2.00 profit

This is a similar concept to 'shorting' a stock. If you short a stock that drops in price and then subsequently buy the stock back at a lower price to close you would realize a profit. For example, if you short Apple stock at 74.25 and subsequently buy the stock back to close at 70.00 you would realize a 4.25 point profit.

Short Apple at 74.25 and buy back at 70.00 = 4.25 profit

If you sell (to open) a call option for 5.00 points and then later buy the call back to close at a higher price let's say 7.00 points you would realize a 2.00 point loss.

Sell call at 5.00 and then buy back to close at 7.00 = 2.00 loss

Selling (to open) a put option is a bullish strategy. An investor who sells a put option is also known as the 'writer'. Selling a put is also known as being 'short' a put. The value of a put option declines as the underlying stock increases in price. If you sell (to open) a put option and the underlying stock subsequently increases in price then you can 'buy back' to close the short put at a lower price which will result in a profit for the put writer. For example, if you sell a put option for 5.00 points and then later buy the put back to close for 3.00 points you would realize a 2.00 point profit.

Sell put at 5.00 and then buy back to close at 3.00 = 2.00 profit.

If you sell (to open) a put option for 5.00 points and then later buy the put back to close at a higher price let's say 7.00 points you would realize a 2.00 point loss.

Sell put at 5.00 and then buy back to close at 7.00 = 2.00 loss

Selling a call option to open profits if the underlying stock decreases in price

Selling a put option to open profits if the underlying stock increases in price

Note: When you buy an option, you can sell the option any time prior to option expiration. When you sell to open an option you can buy to close the option any time prior to option expiration.

Let's review the types of option orders that you would give to your broker (or online) to make sure you understand this important concept.

Order		Result
Buy Call to Open		Establishes Long Call Position
Buy Put to Open		Establishes Long Put Position
Sell Call to Close		Closes Out Long Call Position
Sell Put to Close		Closes Out Long Put Position
Sell Call to Open		Establishes Short Call Position
Sell Put to Open		Establishes Short Put Position
Buy Call to Close		Closes Out Short Call Position
Buy Put to Close		Closes Out Short Put Position

Call Options versus Stock Ownership

It is important to understand the distinction between buying call options and owning stock. Unlike stocks, options have a limited life. If an investor purchases stock and the expected move does not occur with the stock he/she can continue to hold the stock indefinitely. This is not true with options as every option has an expiration date. At expiration a call option has only intrinsic value, which is the difference between its strike price and the current stock price. At expiration a call option is worthless if the stock closes at or below the strike price. Profiting from option purchases depends on your ability to predict both the direction and timing of a move in the price of the underlying stock.

Purchasing an in-the-money call has a higher probability of success than an out-of-the-money call, as there is a reduced requirement for the underlying stock to move in the right direction and a lower break even price. Sometimes new option traders will be tempted to buy short-term call options that are out-of-the-money because of the low cost. Everyone loves a bargain but these options are cheap for a reason: the option has little time left until expiration and the strike price and stock price are so far apart that it is highly unlikely that the option will be in the money before expiration day.

At-the-money and out-of-the-money calls have no intrinsic value; their entire price consists of time premium. At expiration, call buyers will lose their entire investment if the stock price is equal to or below the strike price.

If you choose to buy the cheapest options, you must be very precise in timing the move and calling the direction. You can also expect to have a higher percentage of losing trades when purchasing out-of-the money options.

In-the-Money Calls

Buying deep in-the-money call options offers a relatively conservative approach to options investing by giving an options trader more control over the time value and intrinsic value components of the option compared to at-the money and out-of-the-money options.

An important component of a deep in-the-money option is its substantial intrinsic value, which can comprise up to 90 to 95% or more of the total option premium. A major advantage of deep in-the-money options is the significantly lower level of time erosion of your option.

As options move deeper into the money, the amount by which an option's price will change for a one point move in the price of the underlying stock approaches 1.00 or 100% for a call option. This relationship between the price movement for an option compared to the price movement in the underlying security is referred to as an option's Delta. A deep in-the-money option behaves like the underlying stock by making a near point-for-point move with the price change in the underlying security. Therefore, these options are similar to owning the stock but with the advantages options provide:

- leverage resulting from a lower capital requirement
- limited risk
- higher percentage profit potential

LEAPS

As noted previously LEAPS are long-term options with expiration dates up to 3 years in the future. Purchasing a LEAPS call option can be an excellent profit vehicle for an investor who expects significant long term growth in an underlying stock but who does not want to make the substantial capital outlay required for entering a long term position in the stock. With expiration dates set years into the future, time decay occurs very slowly for LEAPS so buying LEAPS is an effective way to benefit from a stock's price movement without incurring the risk associated with an outright stock purchase.

LEAPS are an excellent option alternative that finds a happy medium between aggressive, short term option trading and an outright purchase of the stock. It is more profitable to use short-term trading strategies if a stock is expected to move in a short period of time. However, if your time horizon calls for a longer holding period and you want a leveraged way to profit from a stock without committing a lot of trading capital, LEAPS may offer an attractive alternative strategy.

There are three additional LEAPS strategies:

- Leveraged Trade
- Leveraged Trade with Diversification
- Conservative Trade

With a LEAPS leveraged trade, the dollar investment required to purchase a stock is redirected towards the purchase of an equivalent dollar amount of deep in-the-money LEAPS call options on the stock. This provides a leveraged portfolio with plenty of time for the underlying stock to move up in price.

Another variation of this technique would be to divide the total dollar amount available between several LEAPS options on different stocks. This has the dual effect of leveraging and diversifying the portfolio.

A third variation of the above LEAPS strategies is more conservative. An investor purchases LEAPS call options equivalent to the amount of shares they would purchase in a stock. For example, instead of purchasing 200 shares of a stock, 2 LEAPS call options would be purchased (assuming there are LEAPS options available for that stock). The remaining capital is then placed in a risk free investment such as US Treasury obligations.

Put Purchases

A put option purchase also known as being long a put is a bearish position. It gives the purchaser the right but not the obligation to sell the underlying security at a fixed price on or before the expiration. The risk for the purchaser is limited to the premium paid for the put option. The profit potential is not limited. The put purchase strategy benefits from a decrease in the price of the underlying security. Buying puts is a strategy that can be used as an alternative to short selling a stock, giving the purchaser the added benefits of limited risk and increased leverage.

A put purchase can also be used to hedge a long stock position. For example, let's assume you purchased a stock at 45 and the stock is currently trading at 80 and you have a substantial open trade profit. You are concerned that the stock has rallied a little too quickly and may be temporarily overvalued. You believe that the stock may be vulnerable to a decline over the next several months but the longer term outlook is favorable.

You would also like to hold the stock for at least a year to receive favorable capital gains treatment.

One possible solution for this situation would be to purchase a three-month 75-strike put option. This would protect most of your profits if the stock suffered a temporary price decline and would also allow you to benefit from the longer term potential price appreciation. Think of this put option hedge as an "insurance policy" for your stock position with the cost of the put as the policy premium.

I purchased a large number of shares of Provident Financial Services at \$10 per share in mutual savings bank conversion. With Provident trading at 20.50 I was able to purchase 200 Provident 17.5-Strike put options at .25 per option. This was like an insurance policy in that I was guaranteed to make a 7.50 profit per share or 75% return on Provident even if the price of Provident dropped below 17.50 (for each dollar the stock dropped below 17.50 the option gains in value a dollar).

Note: If you own a diversified stock portfolio and would like to hedge the portfolio against temporary price declines consider purchasing stock index puts.

Put Buying Advantages

- A put purchase is a limited risk alternative to shorting a stock which is a high-risk strategy
- Put purchases provide leverage without having to use margin
- Put purchases are limited risk but the profit potential is not limited
- Put purchasers do not have to pay dividends on the underlying stock, which is required of short sellers

Summary of Variables for Call and Put Purchases

Variable	Effect on a Call	Effect on a Put
Increase in Stock Price	Increases Call Value	Decreases Put Value
Decrease in Stock Price	Decreases Call Value	Increases Put Value
Higher Strike Price	Decreases Call Value	Increases Put Value
Lower Strike Price	Increases Call Value	Decreases Put Value
Longer Expiration	Increases Call Value	Increases Put Value
Shorter Expiration	Decreases Call Value	Decreases Put Value
Higher Interest Rate	Increases Call Value	Decreases Put Value
Lower Interest Rates	Decreases Call Value	Increases Put Value
Increased Dividends	Decreases Call Value	Increases Put Value
Decreased Dividends	Increases Call Value	Decreases Put Value
Increase in Volatility	Increases Call Value	Increases Put Value
Decrease in Volatility	Decreases Call Value	Decreases Put Value

Section 3 Quiz

1. Buying calls is a strategy that can be used as an alternative to the outright purchase of stock, giving the purchaser the added benefits of limited risk and increased leverage.
A. True
B. False
2. At expiration, call buyers will lose their entire investment if the underlying stock closes below the strike price of the call purchased.
A. True
B. False
3. The Apple 70-strike call option was purchased for 3 points. Apple stock would have to close at ___ at option expiration for this call purchase to breakeven.
A. 67
B. 70
C. 73
D. 76
4. In the above example if Apple stock closes at 80 at option expiration, a ___ point net profit (before commissions) would be realized on the call purchase.
A. 7
B. 3
C. 10
D. 8
5. Using the same Apple example, the maximum risk for purchasing the 70-strike call option for 3 points would be ___ points.
A. 7
B. 10
C. 3
D. 73
6. One advantage of purchasing deep in-the-money call options is the significantly lower level of time decay, as most of the option premium is composed of intrinsic value.
A. True
B. False

7. Apple stock is currently trading at 77. The Apple 55-strike in-the-money call option is priced at 22.75 points. This call option has ___ points of time value.
- A. 22
 - B. .75
 - C. 22.75
 - D. 21.25
8. Purchasing an in-the-money call option has a lower probability of profit than an out-of-the-money call as there is an increased requirement for the underlying stock to move in the right direction.
- A. True
 - B. False
9. As options move deeper in-the-money, the amount by which an option's price will change for a one point move in the price of the underlying stock approaches 1.00 or 100%. This is referred to as an option's Delta.
- A. True
 - B. False
10. Buying put options is strategy that can be used as an alternative to short selling a stock, giving the buyer the added benefits of limited risk and increased leverage.
- A. True
 - B. False
11. The Mastercard 120-strike put was purchased for 5 points. Mastercard stock would have to close at ___ at option expiration for this put purchase to breakeven.
- A. 120
 - B. 125
 - C. 130
 - D. 115
12. In the above example Mastercard stock closes at 130 at option expiration. This would result in a ___ point _____ for the put purchase.
- A. 10, profit
 - B. 10, loss
 - C. 5, profit
 - D. 5, loss

Section 3 Quiz Key

1. A, True
2. A, True
3. C, 73
4. A, 7 (10 point value - 3 point cost = 7 point profit)
5. C, 3
6. A, True
7. B, .75
8. B, False
9. A, True
10. A, True
11. D, 115
12. D, 5, loss



Your Best Opportunity For Investment \$UCCESS\$

By Chuck Hughes

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HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

Your Best Opportunity for Investment Success

Is your life filled with "if only"? If only, I had more education I would be making more income. If only, I didn't have this dead end job I could get out of debt. If only I could make some extra money life would be different for my family and me. The "if only" club can be a difficult and disappointing place. Members are often frustrated by their lot in life and see very few options for themselves and their loved ones. They have these amazing dreams and goals but very limited resources to turn their dreams into a reality. Their frustration is palpable, their disappointment overwhelming.

How do I know these feelings so well? I am successful. I am putting six kids through college, while having two wonderful homes. I play tennis almost every day. I am surrounded by friends and family, who are all eager to help me enjoy the spoils of my toils. How could I possibly know how it feels to be financially strapped? Here is a secret. I was once a member of the "if only" club. I had the "if only" syndrome and I know how it feels.

Here is another secret. You don't *have* to be part of the "if only" club. You can drop your membership today, because I have the opportunity of a lifetime for your investment success. I have the key to turn your financial life around. And the best part, it's not hard. Anyone can do what I have done!

First, I am going to teach you a method for selecting the most profitable stocks. Next, you are going to learn the most successful way to purchase options. My proven wealth building formula has the potential to bring you substantial and steady profits from stock market trading. Whether your goal is to use these profits to supplement your current income, or you wish to make enough money to live solely on your earnings, the techniques I am introducing in this Report can start you on the road to prosperity.

These two methods are my gold standard. They can be your foundation for building wealth and your best opportunity for investment success. Having knowledge of these two methods is the key to endless possibilities. I've already made my fortune. Now my greatest satisfaction lies in seeing you succeed. My methods are so simple, yet so effective! So, let's drop the "if only" and make it into a, "Yes, I can!" Let's keep it real and let's make it happen now.

Best Wishes for Success!

Chuck Hughes

First Steps to Running Your Own Wealth Building Business

To grow any kind of business, you need three things:

- A plan with goals
- An investment of time
- An investment of money

Developing your successful wealth building business is no exception. To make sure that your business has a good basis, right from the outset you must address each of these three issues.

A Plan with Goals

What is your intention for your home-based business? Do you intend for it to be a hobby that you'll pursue in your spare time to earn a little extra money? Or do you want to devote serious effort to it in order to make a substantial income? And how fast do you want your business to grow? The more specific your goals are in terms of how much you want to make and how quickly you want to make it, the more likely you are to achieve them.

So take a few minutes right now to write down your specific aims for the long-term and short-term. For example:

- "By one year from today, I plan to have mastered the principles of trading and be averaging \$1,000 in profits per month."
- "Over the next five years I plan to be earning \$3,000 per month in trading profits."
- "As I approach retirement, I plan to be earning between \$5,000 and \$10,000 per month in trading profits so that I can retire in comfort, travel, enjoy my hobbies, and provide generously for my family."

Determining these goals will guide you in planning how much time you will devote to your wealth building business, and how much money you will invest in it.

Investment of Time

The more ambitious your goals are in terms of how much money you plan to make, and how quickly you want to make it, the more time you must be willing to devote to learning the principles of trading, studying the markets to find opportunities, and following up on your trades. At the beginning you should plan to spend a certain number of concentrated hours learning the basics of trading. Then it would be a good idea to set aside time each day on a regular basis to go through your information sources to find promising markets, set up trades, and check on their progress.

At a minimum, plan half an hour each trading day. Some days will require more time if you have to research markets to find opportunities. If you have a number of trades already in place, it may only take a few minutes to check their current status.

Obviously, the more ambitious your goals, the more time you should plan to spend. The more time you give time to your wealth building business, the more likely it is to pay you back large dividends for your efforts.

Investment of Money

The life-blood of your wealth building business is your investment capital. On entering your new business venture, decide upon an amount of money you can SAFELY risk without endangering your present lifestyle. In fact, when you engage a brokerage to execute your trades, you will likely be required to enumerate your assets and confirm that you can afford to risk the amount needed to open your account.

If you select the right-priced stocks, you can start trading with only a few thousand dollars. Depending on how much money you have available, plan to start small and build up your account safely by reinvesting some of your profits.

Decide on how much money you can safely invest in your new business at the outset, and you will be able to trade confidently, knowing that you won't have to worry about over-extending yourself.

How to Learn Without Losing a Dime

The best way to learn any new skill, including stock trading, is to practice. And you will likely make mistakes at the beginning, perhaps by choosing wrong markets, not following the techniques correctly, failing to get out of trades at the right time – or maybe even giving the wrong instructions to your broker!

It's okay to make mistakes. That's the way we learn. But you don't want to make costly mistakes that could rip through your trading budget before you have the chance to really learn what you're doing and start making profits.

Fortunately there's an excellent way to learn every aspect of designing, following, and exiting a trade without risking any money at all. It's called "paper trading." The idea is that you conduct every stage of a trade – but only on paper. In effect, you are making hypothetical trades.

When paper trading, you select the stock you want to trade based on the criteria presented in this Report and "enter" the trade by noting down the price of the stock at the time you "make your purchase," you follow the price of the stock daily, and then note the price you "exit" the trade. The key to paper trading is that all the actions that I presented above in quotation marks are just notations you make on paper. You never actually place the trade or invest any real money in it.

Paper trading like this gives you the perfect setup to learn exactly how to run your business without risking a dime. You can practice all the details of selecting stocks, executing trading techniques, placing orders, and exiting trades until you feel completely comfortable with every step of the process. You can give this business a really good test to see whether you can make profits at it. And the more you see for yourself that the methods I teach you actually work, the more confidence you'll gain for making real money trades.

The main difference between paper trading and real money trading (other than the actual money profits or losses!) is that you will find that your emotions tend to come much more into play when real money is at stake. That's why it's so important to become completely comfortable with all the mechanics of trading by trading on paper first. The more automatic your actions can become through practice, the less likely you are to be thrown off course when emotions like fear or greed come in to muddle your thinking when you're in the middle of a real-money trade.

Here's your step-by-step guide for paper trading:

- Start by determining how much "money" you will place in your trading account.
- Using the criteria I provide, select a stock to trade.
- Plan how much to invest in this trade, which will determine how many stock shares you can purchase.
- Write down the order you would place, and the price of the stock (or option) at the time you would enter the market.

Determine the price of the stock or option at the time you would exit the trade. Use that, compared to the price when you entered the trade, to calculate your paper profit or loss. Add or subtract this amount from your trading account

The Wealth Building Formula

In this Report I would like to introduce you to a simple but effective method for identifying stocks with the greatest profit potential. I call this method the *Wealth Building Formula* as it is the single best way to build wealth. I discovered this unique method many years ago but as far as I know there is no other book or financial publication that uses this type of approach for selecting profitable stocks.

There are many ways to select profitable companies such as earnings growth, sales growth, cash flow, return on equity and low debt-to-equity ratios. The *Wealth Building Formula* takes all of these methods into account with one simple measurement. When we purchase stock in a public company we pay the current market price for a stock. For example United Healthcare symbol UNH is a major health care insurance company. United Healthcare stock is currently trading at 52.26 per share. Purchasing 100 shares of United Health at the current market price of 52.26 would cost \$5,226.

Once you purchase a stock you become a partial owner of the company and own a percentage of the company. The value of your percentage of ownership is known as 'stockholder's equity'. Stockholder's equity is essentially the net worth of a company and is calculated by subtracting the debt of a company from its assets. If a company is liquidated then stockholder's equity would equate to the break up or liquidated value of a company after all debt is paid.

The current stockholder's equity for United Healthcare stock is \$15.06 per share. If we own 100 shares of UNH then our stockholder's equity is worth \$1,506. If United Healthcare was liquidated then the value of our stockholder's equity would be approximately \$1,506 after all of the company's debt was paid. I like to refer to stockholder's equity as a stock's 'intrinsic' value as it represents the true worth of our shares of stock.

True Worth of Company Growing at a 31% Annual Compounded Growth Rate

United Health is a very profitable company with strong earnings growth and a low debt-to-equity ratio. Because United Health has no large capital expenditures and a low level of debt, it is able to retain a relatively high percentage of its earnings. Only a small portion of its earnings is required to service its debt.

Normally a company's retained earnings are the biggest component of stockholder's equity. Because United Health has a high rate of earnings growth and the ability to retain earnings it has been able to grow its stockholder's equity at a fast rate. Since 1990 United Health has maintained an annual compound growth rate in stockholder's equity of 31.1%.

\$1,506 Investment Grows to \$151,202

In the example just presented an investor who purchases 100 shares of United Health at today's prices receives \$1,506 in stockholder's equity. If we were to make that same \$1,506 investment in stockholder's equity in 1990 our \$1,506 investment would grow to \$151,202 by today. Our original investment would double more than 100 times. Regardless of stock market conditions our \$1,506 investment in United Health stockholder's equity in 1990 would have a 'true value' of more than \$150,000.

Market Price versus Intrinsic Value

The market price of United Health's stock has closely followed the growth of its intrinsic value. Purchasing 100 shares of United Health today would cost \$5,226. That same \$5,226 investment in United Health stock in 1990 grew to \$941,725 by today rewarding shareholders with a 35.7% annual compounded growth rate since 1990.

My actual trading experience and historical research demonstrates that there is a strong correlation between the movement of the intrinsic value of a stock and its market value. Historically with few exceptions the market price of a stock follows the increase or decrease in the intrinsic value of a stock. If a stock's intrinsic value is increasing then its market price is also increasing and if intrinsic value is decreasing then the market price is decreasing.

The market price of a profitable stock rarely ever trades below its intrinsic value even during bear markets. This stands to reason as intrinsic value creates a 'floor' under the market price of a stock. If the stock of a profitable company trades below its intrinsic value it could be liquidated at a greater value than its stock price or it could be bought out by another company at little or no cost by creating debt secured by the assets of the acquired company.

Ultimate Goal of Stock Investing

United Health's ability to grow and retain its earnings produced more than a 10,000% increase in the intrinsic value of its stock since 1990. This example demonstrates that a company's growth in intrinsic value creates economic value for its shareholders. As a company's intrinsic value grows the true value of your stock investment grows. Ultimately this is the reason why we invest in stocks and what separates stock investing from all other types of investments.

Growth in company intrinsic value has created trillions of dollars of economic value to shareholders and is the foundation of a capitalist economy. Stockholder's equity provides the capital that creates companies and allows them to grow.

As the intrinsic value of a company grows, the company can increase its production or services an insurance company can write more policies and a bank can create more loans. An increase in production or services can in turn create more income for a company.

I consider investing in a company that is growing its intrinsic value as a real investment. This is different than buying real estate, precious metals or commodities hoping that someone will pay you more than what you paid. This is price speculation. Real estate, commodities and precious metals do not have the potential for intrinsic value growth as stocks do.

The ability of companies to increase their intrinsic value has always allowed stocks to out perform all other types of investments.

Why Invest in Stocks?

Let's now take a look at the 'big picture' for investment returns for various asset classes versus inflation over the past 70 years. This can give us a broad perspective on how to best deploy our investment funds. I think it is prudent that every investor regardless of age or level of investment experience should diversify their investments between real estate, stocks and fixed income investments. The table below compares the long-term return performance for Treasury Bills, Gold, Treasury Bonds, corporate bonds, home prices and common stocks. The compounded growth of a \$1,000 investment in each asset class over the past 70 years is displayed.

70-Year Compounded Growth of \$1,000 Investment

Asset Class	Growth of \$1,000	Annual Return	Real Return
Inflation		4.0%	
Treasury Bills	\$16,817	4.1%	0.1%
Gold	\$31,595	5.1%	1.1%
Treasury Notes	\$42,573	5.5%	1.5%
Corporate Bonds	\$49,446	5.7%	1.7%
Home Prices	\$63,131	6.1%	2.1%
Common Stocks	\$1,287,957	10.8%	6.8%

Type of Asset Class:
 Treasury Bills: 30-Day Maturity
 Treasury Notes: 5-Year Maturity
 Home Prices: Home Price Appreciation (national average) *
 Common Stocks: S&P 500 Stock Index Total Return with dividends reinvested
 Corporate Bonds: 20-Year Corporate bonds
 Gold Price: London PM Fix

* Data Source: US Census Bureau and National Association of Realtors

This table reveals that the average annual inflation rate over the 70-Year period was 4.0%. Treasury Bills produced a 4.1% annual compounded return over the same period. After accounting for inflation, T-Bills only produced an annual 'real' return of 0.1%.

Despite the strong return performance for gold bullion over the last several years, over the long term gold only produced a 1.1% annual real return after accounting for inflation. Although gold is usually considered a hedge against inflation, the 1.1% annual real return does not provide much of a return beyond the inflation rate.

5-Year Treasury Notes produced a 1.5% annual real return, corporate bonds a 1.7% real return and home prices appreciated at an annual rate of 2.1% after accounting for inflation.

Only stocks provide a meaningful return after accounting for inflation. The S&P 500 Index with dividends reinvested produced an inflation adjusted compounded annual return of 6.8%. A \$1,000 investment in the S&P 500 Index grew to \$1,287,957 producing a 128,696% total return.

Based on this long term historical return data, only stocks provide a real rate of return after accounting for inflation. Home prices and gold are traditionally viewed as inflation hedges. However, the inflation adjusted annual return for stocks of 6.8% was actually more than three times greater than the inflation adjusted return of 2.1% for home prices.

This raises the question . . . why are stocks the real performance winner compared to other asset classes and why do stocks provide the only substantial real return after accounting for inflation? We will next discover why stocks provide the best real return compared to all other investments.

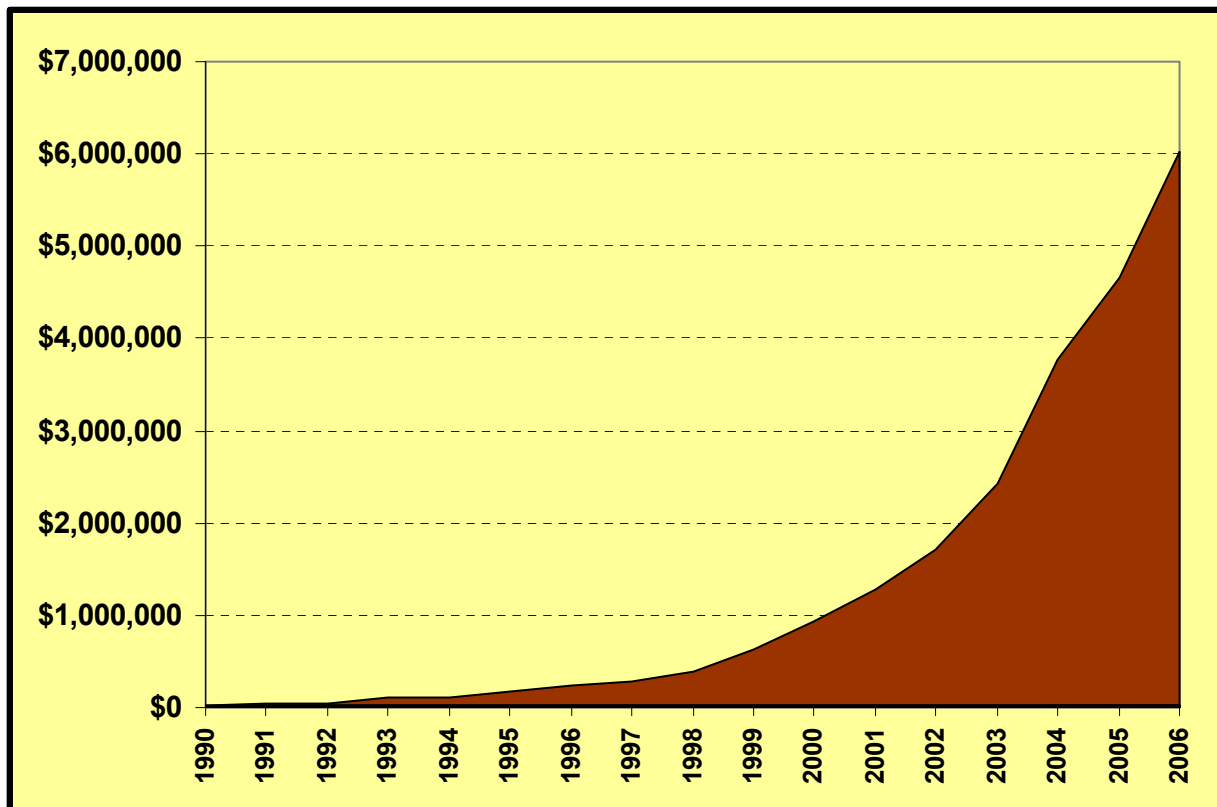
“Shallow men believe in luck. Strong men believe in cause and effect.”

-Ralph Waldo Emerson

My *Wealth Building Formula System* invests in stocks that grow their intrinsic value at a 10% or higher annual rate. Let's examine some historical profit results for a sampling of 10 *Wealth Building Formula* stocks to give you a feel for the powerful profit potential of this system. Investing \$1,000 in 1990 in each of the 10 *Wealth Building* stocks listed below grew to an incredible \$6,018,045 over the following 17 year period. Results include dividends but not commissions. These 10 stocks represent a broad cross section of different industries from biotechnology to coffee houses.

Stock	Industry		Stock	Industry
United Healthcare	Health Care Plans		Starbucks	Coffee Houses
Markel Corp.	Insurance		Merrill Lynch	Brokerage
Immucor	Diagnostic Products		Stryker	Medical Instruments
NVR Inc.	Home Builder		Expeditors	Air Freight
Energen	Energy		Celgene	Biotechnology

\$10,000 Investment in Wealth Building Stocks in 1990 Grows to Over 6 Million Dollars



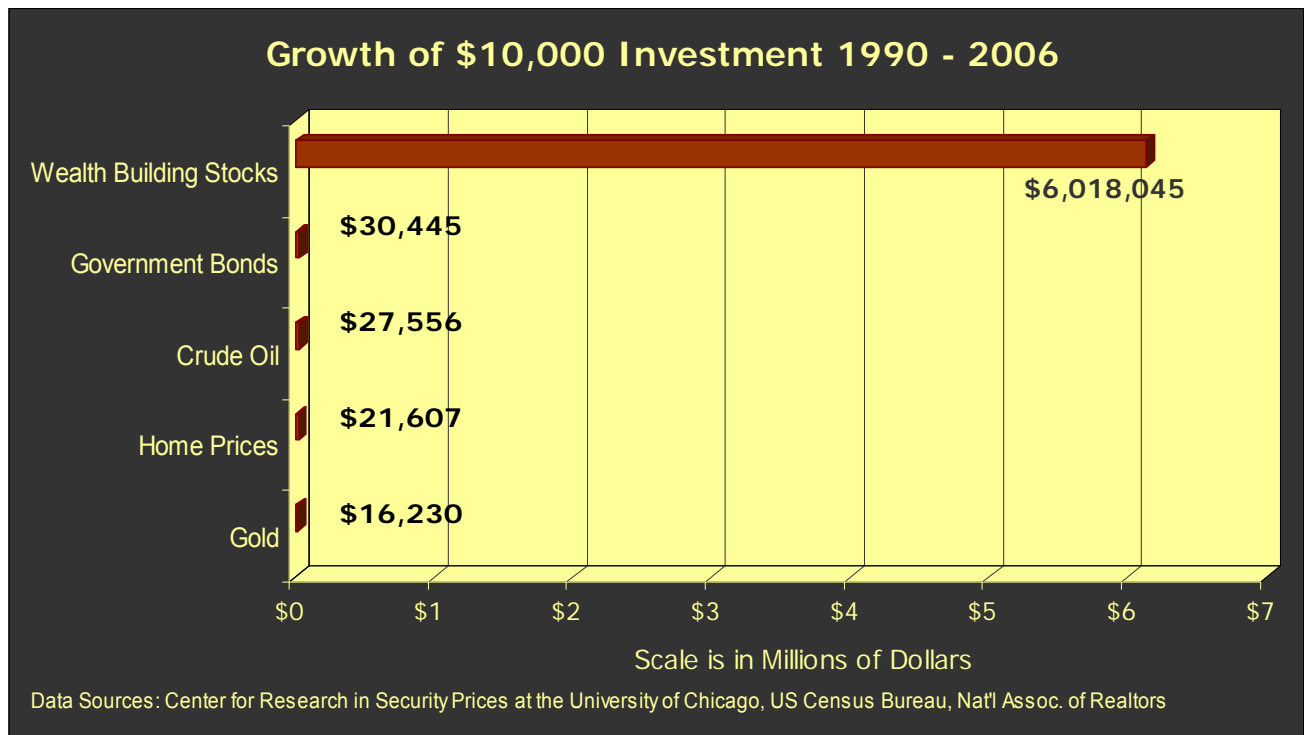
60,080% Return versus a 139% Return

The sample portfolio of 10 *Wealth Building Formula Stocks* just presented handily outperformed all other types of investments over the same time period. The table below compares the growth of a \$10,000 investment for various types of investments. Over the same time period the *Wealth Building Stock Portfolio* had a total return of 60,080% compared to an average total return of 139% for US Government Bonds, crude oil prices, home price appreciation and gold bullion prices.

Growth in intrinsic value allows Wealth Building Stocks to clearly outperform investments that have no growth in intrinsic value.

Investment Return Comparisons

Investment Type	\$10,000	Percent
	Grows To	Return
Wealth Building Stocks	\$6,018,045	60,080%
US Government Bonds	\$30,445	204%
Crude Oil	\$27,556	176%
Home Prices	\$21,607	116%
Gold	\$16,230	62%



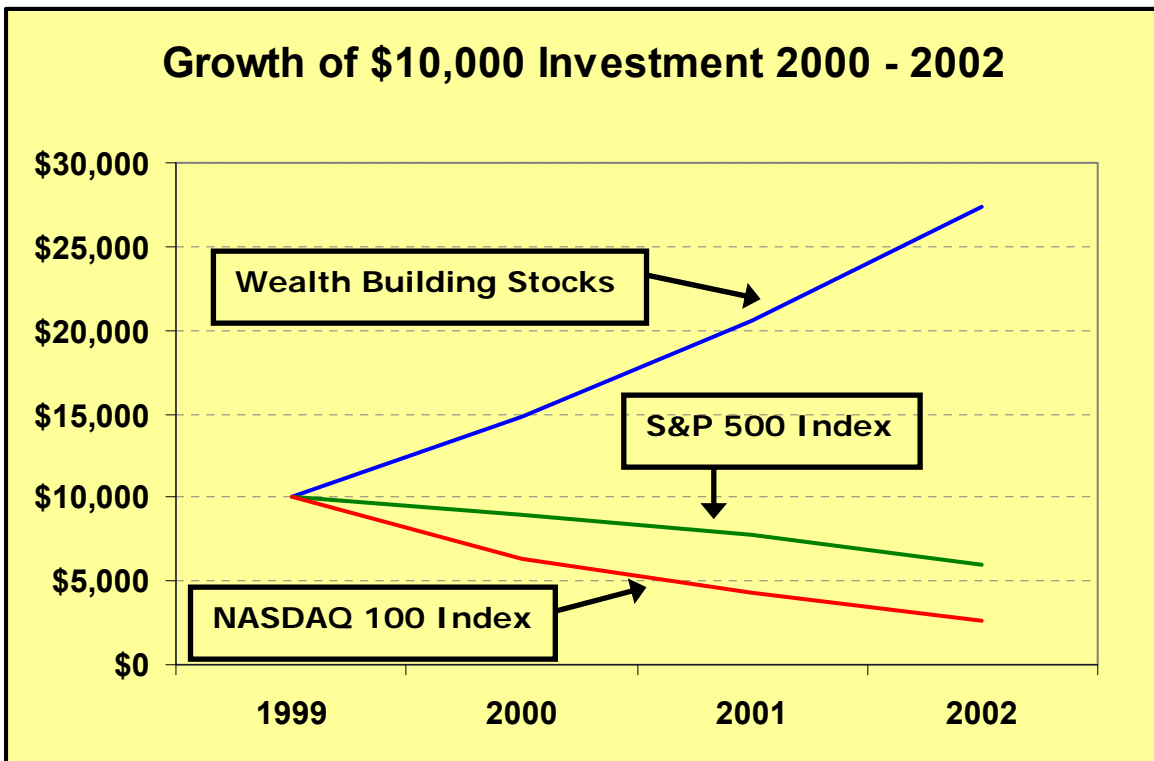
Wealth Building Stocks Profitable During Bear Market Years

Although individual stocks in our sample portfolio of 10 *Wealth Building* stocks had unprofitable years, the portfolio as a whole had no losing years during the bear market years of 1990, 2000, 2001 and 2002. During the 1990 bear market year the *Wealth Building Stock* portfolio produced a healthy 39% return. During the severe 2000 – 2002 bear market the S&P 500 Index suffered a 40% decline and the NASDAQ 100 Index lost 73% of its value. But the sample portfolio of 10 *Wealth Building Stocks* produced a positive 173% return during the same three year bear market period.

Remember that intrinsic value creates a 'floor' under the market price of a stock even during bear markets. The graph below depicts the growth of a \$10,000 investment in our sample portfolio of 10 *Wealth Building Formula Stocks* versus the S&P 500 and NASDAQ 100 Index during the three year bear market period from December 31st 1999 through December 31st 2002.

Investment Returns During 2000 – 2002 Bear Market

Investment	\$10,000	Percent
	Grows To	Return
Wealth Building Stocks	\$27,361	173%
S&P 500 Index	\$5,991	-40%
NASDAQ 100 Index	\$2,654	-73%



The preceding historical profit results demonstrate that stocks and in particular *Wealth Building Stocks* have provided superior returns compared to all other types of investments. Growth in intrinsic value creates economic value for shareholders and separates stock investments from other types of investments that have no growth in intrinsic value. Intrinsic value growth is the best overall measurement of the soundness of a company's balance sheet and its profitability and financial health. Companies with high intrinsic value growth rates share common characteristics listed below.

General Characteristics of Companies with High Intrinsic Value Growth Rates:

- **Successful Business Models**
- **High Earnings and Sales Growth Rates**
- **High Profitability Allows Company to Retain Earnings**
- **High Profit Margins**
- **High Cash Flow Levels**
- **Low Debt Levels**
- **Are Not Capital Intensive Businesses**

General Characteristics of Companies with Low or Negative Intrinsic Value Growth Rates:

- **Mediocre or Poor Business Models**
- **Low or Negative Earnings and Sales Growth Rates**
- **Low Profitability Does not Allow Company to Retain Earnings**
- **Low Profit Margins**
- **Low Cash Flow Levels**
- **High Debt Levels**
- **Are Capital Intensive Businesses and Have Difficulty Retaining Earnings Due to High Capital Expenditures**

Our previous United Healthcare analysis was a good example of how shareholders are rewarded when a successful company is able to grow its intrinsic value. United Health's business model enables the company to grow its earnings quickly and more importantly the company is able to retain its earnings and grow its intrinsic value. Retained earnings are the biggest component of United Health's intrinsic value. The company's low debt level and low level of capital expenditures also enhance its ability to retain earnings. United Health's stock price has closely followed its growth in intrinsic value and as a result a \$10,000 investment in United Health stock in 1990 grew to \$1,852,758.

Sirius Satellite Radio (SIRI) on the other hand would be an example of a company with a struggling business model. The company's subscription and advertisement revenue do not cover its expenses and as a result the company is losing money and has no earnings. It is spending its available cash and borrowing money just to stay in business. As a result its stockholder's equity has been declining at a 38% annual rate. Over the past year its stock price has dropped 54% (see Sirius stock price chart below courtesy of Yahoo Finance). Investors who track intrinsic value growth would know that this stock is not a good investment.

Sirius Satellite Radio

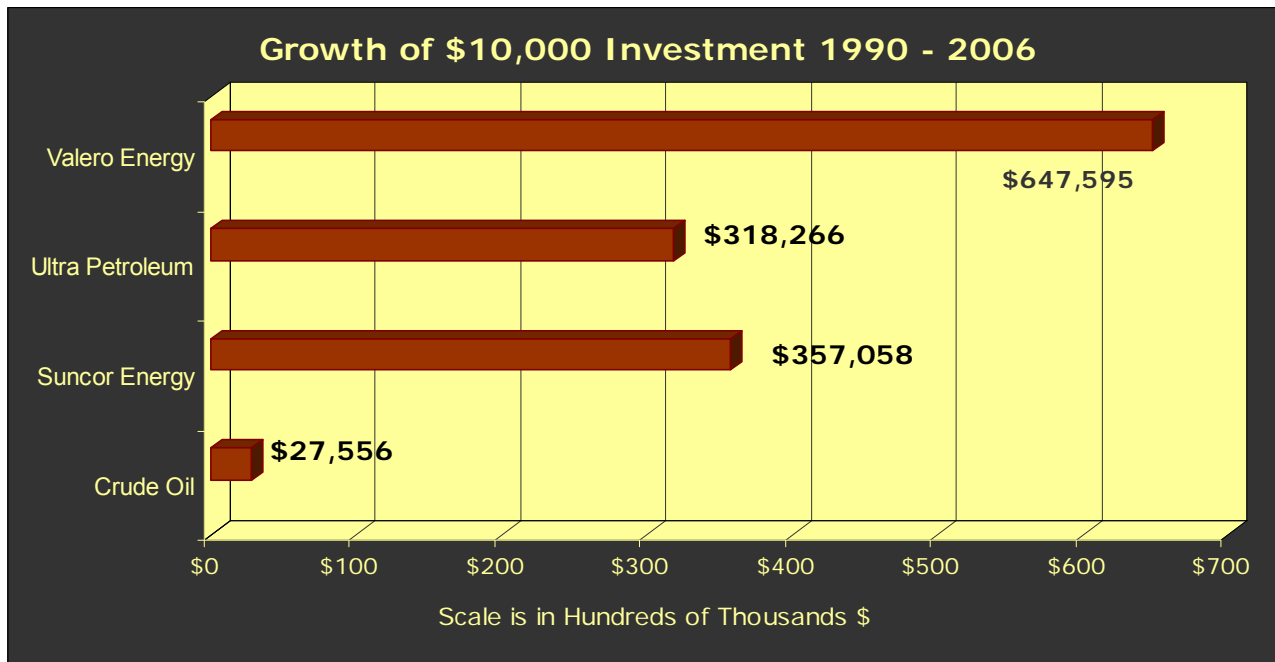


It is far more profitable to invest in Wealth Building Stocks of companies that produce commodities than the commodities they produce.

For example, the three oil producing companies listed below each have an annual intrinsic value growth rate of 10% or higher which qualifies them as *Wealth Building Stocks*. A \$10,000 investment in these three companies in 1990 produced an average return of 4,309%. In comparison, a \$10,000 investment in crude oil over the same period produced a 175% return demonstrating that the growth of intrinsic value for these three companies enables them to deliver a far superior investment return than the commodity that they produce.

Investment Return Comparisons

Investment	\$10,000	Percent
	Grows To	Return
Valero Energy	\$647,595	6,376%
Ultra Petroleum	\$318,266	3,082%
Suncor Energy	\$357,058	3,470%
Crude Oil	\$27,556	175%



In the preceding example an investment in *Wealth Building* oil producing stocks produced a much greater return than an investment in crude oil itself. A similar comparison can be made for investing in *Wealth Building* home building stocks and gold producing stocks.

The three home building companies listed below each have an annual intrinsic value growth rate of 10% or higher which qualifies them as *Wealth Building Stocks*. The average annual intrinsic value growth rate for these three companies is 30%. A \$10,000 investment in these three companies in 1990 produced an average return of 7,786%. In comparison, a \$10,000 investment in homes over the same period produced a 116% return demonstrating once again that the growth of intrinsic value for these three companies enables them to deliver a far superior investment return than the homes they build.

7,786% Average Return versus 116% Return

Investment Return Comparisons

Investment	\$10,000	Percent
	Grows To	Return
Lennar Home Builders	\$581,000	5,710%
NVR Homes	\$1,387,000	13,770%
Toll Brothers Homes	\$398,000	3,880%
Home Prices	\$21,607	116%

The three *Wealth Building* gold producing stocks listed below produced an average return of 1,373% versus a 62% return for the precious metal itself.

Investment Return Comparisons

Investment	\$10,000	Percent
	Grows To	Return
Goldcorp	\$118,870	1,088%
Royal Gold	\$251,250	2,412%
Randgold	\$71,975	619%
Gold Bullion	\$16,230	62%

Long-Term versus Short-Term Investing

The preceding profit results demonstrate that *Wealth Building Formula Strategy* provides superior investment returns compared to all other types of investment strategies. 'Buying and holding' a diversified portfolio of stocks with strong intrinsic value growth is a great long term strategy for building your wealth.

Investors with a short to intermediate term time horizon, however, incur more investment risk than long term investors. The timing of when you buy and sell stocks becomes more important with shorter term investing. Short term investors with less than a three to five year time horizon run the risk of buying when stock prices are high and selling when prices are low.

'Investing with the trend' is an important requirement for profitable stock investing for investors with a short term time horizon. *Timing is everything*. If you are a short term investor 'Investing with the Trend' should be your investing mantra. Regardless of which investment strategy you use to buy and sell stocks there is always 'entry and exit' timing risk for short term investors.

If you have investment funds that you would like to commit to invest in stocks you run the risk that when you buy your stocks you may be buying at a time when stock prices are high. Similarly when you decide to sell your stocks you may be selling at a time when stock prices are low. There is a direct correlation between your investment time horizon and entry and exit timing risk. Investors with the shortest time horizon face the greatest risk of timing risk. This timing risk is less important to long term investors that plan to be invested for three to five years or longer.

Investing with the trend can help reduce this timing risk for shorter term investors. If you limit your stock purchases to stocks that are in a price up trend and sell a stock if it enters a price down trend you can eliminate much of the entry and exit timing risk associated with short term investing. Investing with the trend reduces the risk of having to be 'right' about the short term price direction of a stock. The best time to buy a stock is when its upward price trend has already been established.

I like to use moving average 'cross-overs' to define the short term price trend. For example, my *EMA System* uses 50-Day (fast) and 100-Day (slow) Exponential Moving Average (EMA) 'cross-overs' to define a trend. A price up trend exists when a stock's 50-Day Exponential Moving Average (EMA) line is above the 100-Day Exponential Moving Average line and the stock should be bought. A price down trend exists when the 50-Day EMA is below the 100-Day EMA and a stock should be sold. This is a simple but effective system for buying stocks when they are in a price up trend and selling stocks when they are in a price down trend. The system allows us to know in advance the most likely future price direction of a stock. Let's take a look at some actual examples of this trend following system so you can fully understand this important concept.

"Every moment is a golden one for him who has the vision to recognize it as such."

- Henry Miller

The daily price chart below reflects the daily price movement and the 50-Day and 100-Day EMA lines for Coach (COH) stock a leather goods retail company. This chart reveals that in May the Coach 50-Day EMA line crossed below the 100-Day EMA resulting in an *EMA System* 'sell' signal for short term investors who own Coach stock. At that point short term investors should sell Coach stock as the length and severity of the price decline is still unknown. In September the price trend reverses as the 50-Day EMA line crosses above the 100-Day EMA at around the 34.0 price level signaling a 'buy' for Coach stock. Coach is currently trading at 49.97 and this buy signal currently has about a 47% return. The 50-Day EMA line remains above the 100-Day EMA line and Coach stock is still in a 'buy' mode. (Chart courtesy of Yahoo Finance)

Coach Inc



Follow the Trend Instead of Trying to Predict It

**"Prediction is very difficult, especially if it's about the future."
 - Niels Bohr**

The *EMA System* allows us to 'invest with the trend' instead of trying to predict the short term price direction of a stock. The historical studies that follow demonstrate that price trends tend to continue in the same direction and can continue on longer than one may initially expect. My investing experience confirms that this simple but effective system allows the short term investor to reduce the timing risk of when to buy and sell stocks. *The position of a stock's 50-Day EMA line in relation to its 100-Day EMA line allows us to know in advance the most likely future price direction of a stock.*

Investing using a trend following system is critical to the success of short term investors.

Wealth Building Formula Stock Examples

The stock price graphs that follow are examples of stocks that qualify as *Wealth Building Formula* stocks and are in a price up trend. Each company's annual Stockholder's Equity growth rate is listed along with the one year return for the stock. Note: These examples of *Wealth Building Formula* stocks in an *EMA System* 'buy' mode may change by the time you read this Chapter. Charts courtesy of Yahoo Finance

Nat'l Oilwell **Equity Growth Rate 148%** **One Year Return 181%**



Apple Inc **Equity Growth Rate 48%** **One Year Return 123%**



Cameron Int'l Equity Growth Rate 21% One Year Return 113%



Precision Equity Growth Rate 30% One Year Return 115%



Performance Examples of Companies with Low or Negative Equity Growth Rates

Charts courtesy of Yahoo Finance

Tenet Healthcare Equity Growth Rate -42% One Year Return -63%



STAAR Surgical Equity Growth Rate -8% One Year Return -62%



Krispy Kreme Doughnt Equity Growth Rate -34% 1 Year Return -62%



Midway Games Equity Growth Rate -36% One Year Return -66%



Recent Wealth Building Profit Results

My online brokerage account portfolio Profit/Loss Reports that follow show recent real time profit results of \$472,065.39 for my *Wealth Building Formula* portfolios of stocks on a 50/100-Day EMA "buy" signal.

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Portfolios		Performance & Value		Positions		Gains & Losses		Risk Analyzer		Portfolio Analyzer		Income Estimator	
<input type="checkbox"/> Symbol	Buy / Sell	Last Trade	Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit		
			\$	%				\$	%				
<input type="checkbox"/> BUCY	Buy / Sell	30.256	1.58	5.50%	\$3,467.20	2,200	\$19.02	\$24,677.26	58.92%	\$86,563.20	Edit		
<input type="checkbox"/> CHK	Buy / Sell	24.05	1.39	6.13%	\$1,946.00	1,400	\$20.40	\$5,081.36	17.77%	\$33,670.00	Edit		
<input type="checkbox"/> CLF	Buy / Sell	29.13	1.68	6.90%	\$4,136.00	2,200	\$20.64	\$18,641.06	41.02%	\$64,086.00	Edit		
<input type="checkbox"/> FCX	Buy / Sell	58.57	4.14	7.61%	\$4,140.00	1,000	\$43.90	\$14,632.05	33.30%	\$58,570.00	Edit		
<input type="checkbox"/> FWLT	Buy / Sell	28.20	1.68	6.33%	\$2,520.00	1,500	\$24.07	\$6,176.03	17.10%	\$42,300.00	Edit		
<input type="checkbox"/> JPM	Buy / Sell	37.48	0.58	1.57%	\$696.00	1,200	\$33.24	\$5,052.05	12.65%	\$44,976.00	Edit		
<input type="checkbox"/> MDR	Buy / Sell	22.80	0.83	3.78%	\$2,158.00	2,600	\$15.58	\$18,732.08	46.20%	\$59,280.00	Edit		
<input type="checkbox"/> MOS	Buy / Sell	56.06	1.36	2.48%	\$544.00	400	\$45.60	\$4,170.02	22.84%	\$22,424.00	Edit		
<input type="checkbox"/> MS	Buy / Sell	30.64	0.32	1.06%	\$256.00	800	\$23.50	\$5,696.02	30.27%	\$24,512.00	Edit		
<input type="checkbox"/> NOV	Buy / Sell	40.28	1.66	4.30%	\$2,324.00	1,400	\$32.19	\$11,279.06	25.00%	\$56,392.00	Edit		
<input type="checkbox"/> NYX	Buy / Sell	31.60	1.80	5.33%	\$1,440.00	900	\$28.57	\$2,706.03	10.52%	\$28,440.00	Edit		
<input type="checkbox"/> PBR	Buy / Sell	45.585	1.56	3.53%	\$1,244.00	800	\$34.80	\$8,594.04	30.63%	\$36,468.00	Edit		
<input type="checkbox"/> SQM	Buy / Sell	37.38	1.02	2.81%	\$612.00	600	\$35.89	\$878.32	4.08%	\$22,428.00	Edit		
<input type="checkbox"/> STT	Buy / Sell	47.23	0.78	1.66%	\$936.00	1,200	\$32.68	\$17,428.04	44.40%	\$58,676.00	Edit		

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Portfolios		Performance & Value		Positions		Gains & Losses		Risk Analyzer		Portfolio Analyzer		Income Estimator	
<input type="checkbox"/> Symbol	Buy / Sell	Last Trade	Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit		
			\$	%				\$	%				
<input type="checkbox"/> AAPL	Buy / Sell	210.732	-0.91	-0.43%	-\$1,089.60	1,200	\$198.32	\$14,851.52	6.24%	\$252,878.40	Edit		
<input type="checkbox"/> EEM	Buy / Sell	41.50	0.14	0.34%	\$560.00	4,000	\$39.38	\$8,465.02	5.37%	\$166,000.00	Edit		
<input type="checkbox"/> GOOG	Buy / Sell	619.98	-2.75	-0.44%	-\$1,100.00	400	\$560.50	\$23,759.04	10.60%	\$247,992.00	Edit		
<input type="checkbox"/> V	Buy / Sell	87.46	-0.68	-0.77%	-\$1,020.00	1,500	\$65.97	\$2,216.03	1.72%	\$131,190.00	Edit		

Portfolios

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Portfolios Performance & Value Positions Gains & Losses Risk Analyzer Portfolio Analyzer Income Estimator

Symbol	Last Trade	Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit
		\$	%				\$	%		
AOD	Buy / Sell 9.25	0.17	1.87%	\$2,040.00	12,000	\$8.565	\$8,188.04	7.96%	\$111,000.00	Edit
BCUY	Buy / Sell 34.6104	1.34	4.03%	\$2,412.72	1,800	\$31.92	\$4,798.77	8.35%	\$62,298.72	Edit
HIG	Buy / Sell 27.0801	1.64	6.45%	\$3,936.24	2,400	\$23.44	\$8,710.28	15.48%	\$64,992.24	Edit
JPM	Buy / Sell 44.01	0.82	1.90%	\$984.00	1,200	\$42.63	\$1,628.03	3.18%	\$52,812.00	Edit
MDR	Buy / Sell 27.65	0.21	0.77%	\$441.00	2,100	\$24.46	\$6,684.03	13.01%	\$58,065.00	Edit
MET	Buy / Sell 40.83	1.47	3.73%	\$2,056.00	1,400	\$37.62	\$4,195.03	7.92%	\$57,162.00	Edit
MLY	Buy / Sell 18.38	0.11	0.60%	\$880.00	8,000	\$17.19	\$9,414.10	6.84%	\$147,040.00	Edit
NOV	Buy / Sell 44.06	1.23	2.87%	\$1,230.00	1,000	\$38.94	\$5,109.02	13.12%	\$44,060.00	Edit
STT	Buy / Sell 53.82	0.64	1.20%	\$704.00	1,100	\$50.00	\$4,159.06	7.56%	\$59,202.00	Edit
TXT	Buy / Sell 20.525	-0.02	-0.12%	-\$25.00	1,000	\$20.16	\$357.01	1.77%	\$20,525.00	Edit
WDC	Buy / Sell 36.735	0.30	0.81%	\$560.50	1,900	\$31.13	\$10,604.58	17.92%	\$69,796.50	Edit
X	Buy / Sell 50.20	1.22	2.49%	\$1,464.00	1,200	\$45.23	\$5,936.03	10.93%	\$60,240.00	Edit
Totals				\$7,260.00		\$724,734.88			\$563,380.65	

Account Equity	DTBP	ONBP	Non-Margin BP
405,148.64	1,232,326.36	404,120.68	202,060.34
Open P/L	Closed P/L	Commission	Total P/L
24,162.10	24,162.10

Positions		Open Orders	Activity	Summary	Trade Journal	Balances
Type	A Sy...	Last	Change	Qty	Avg Price	Profit/Loss
2	ATI	\$38.3298	\$2.9198	1500	38.0293	\$450.75
2	BCUY	\$30.26	\$1.58	3000	21.3533	\$26720.10
2	CAT	\$37.26	\$1.80	1500	28.7083	\$12827.55
2	CLF	\$29.03	\$1.78	3000	21.9788	\$21153.60
2	FwLT	\$28.24	\$1.72	3000	23.7293	\$13532.10
2	MDR	\$22.80	\$0.83	3000	17.0217	\$17334.90
2	NYX	\$31.575	\$1.575	1000	28.436	\$3139.00
2	SII	\$30.82	\$1.63	1000	25.736	\$5084.00
2	SQM	\$37.38	\$1.02	1000	36.036	\$1344.00
2	STT	\$47.14	\$0.69	1500	32.7483	\$21587.55

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Symbol	Buy / Sell	Last Trade	Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit
			\$	%				\$	%		
BUY	Buy / Sell	35.55	2.28	6.85%	\$1,824.00	800	\$31.00	\$3,632.01	14.64%	\$28,440.00	Edit
CHK	Buy / Sell	28.92	0.61	2.15%	\$427.00	700	\$19.81	\$6,351.03	45.71%	\$20,244.00	Edit
CLF	Buy / Sell	33.90	1.95	6.10%	\$2,535.00	1,300	\$25.60	\$10,747.46	32.25%	\$44,070.00	Edit
FCX	Buy / Sell	72.15	0.63	1.16%	\$166.00	200	\$52.30	\$3,962.01	37.85%	\$14,430.00	Edit
FWLT	Buy / Sell	32.99	0.69	2.14%	\$1,035.00	1,500	\$24.07	\$13,361.03	36.99%	\$49,485.00	Edit
HIG	Buy / Sell	28.16	2.72	10.69%	\$4,896.00	1,800	\$23.62	\$8,155.03	19.17%	\$50,688.00	Edit
JPM	Buy / Sell	44.65	1.46	3.38%	\$1,168.00	800	\$33.08	\$9,228.03	34.83%	\$35,720.00	Edit
MDR	Buy / Sell	27.46	0.02	0.07%	\$22.00	1,100	\$25.43	\$2,220.02	7.93%	\$30,206.00	Edit
MET	Buy / Sell	40.83	1.47	3.73%	\$1,323.00	900	\$37.62	\$2,671.02	6.48%	\$36,747.00	Edit
MQS	Buy / Sell	53.04	-0.63	-1.17%	-\$378.00	600	\$48.33	\$2,794.04	9.62%	\$31,824.00	Edit
MS	Buy / Sell	30.15	1.41	4.91%	\$1,128.00	800	\$28.84	\$1,027.03	4.45%	\$24,120.00	Edit
NOV	Buy / Sell	44.38	1.55	3.62%	\$1,395.00	900	\$33.57	\$9,690.05	32.03%	\$39,942.00	Edit
PBR	Buy / Sell	45.42	0.94	2.11%	\$658.00	700	\$42.24	\$2,196.04	7.42%	\$31,794.00	Edit
STT	Buy / Sell	54.70	1.52	2.86%	\$912.00	600	\$51.44	\$1,930.03	6.25%	\$32,820.00	Edit
WDC	Buy / Sell	36.85	0.41	1.13%	\$410.00	1,000	\$33.43	\$3,404.02	10.18%	\$36,850.00	Edit
X	Buy / Sell	49.81	0.83	1.69%	\$664.00	800	\$44.16	\$4,508.02	12.76%	\$39,846.00	Edit
Totals					\$5,150.00		\$405,682.96			\$335,293.40	

The Wealth Building Option Strategy

The historical and actual trading results just presented demonstrate that the *Wealth Building Formula* when combined with the 50/100 Day EMA trend following system produces a powerful investing force that identifies stocks with the greatest profit potential. I also use the *Wealth Building Formula* to select call options on stocks that qualify as *Wealth Building Formula* stocks.

Stocks of companies that are growing their stockholder's equity at a 10% annual rate or higher and are in a price uptrend with the 50-Day EMA above the 100-Day EMA are excellent candidates for call option purchases. Purchasing call options is a bullish strategy as the value of a call option increases as the price of the underlying stock increases. If you are new to option investing please refer to my "Beginners Practical Guide to Option Investing" Report which explains in detail the basics of option investing.

When I compare investing using the *Wealth Building Formula* to other traditional stock strategies, the *Wealth Building Formula* walks away as the clear winner! But trading call options using the *Wealth Building Formula* can be even more profitable.

The greater return potential associated with options is due to the leverage that options provide. Let's take a look at some actual option examples so that you can understand the important concept of leverage and how leverage can provide a high rate of return. The option quote table that follows contains actual call option prices (courtesy of Yahoo Finance) for Hewlett Packard (HPQ). Buying call options is a bullish strategy as the value of a call option will increase as the price of the underlying stock increases. Hewlett Packard stock is currently trading at 32.78. Let's focus on the March 35-Strike call option (circled).

Hewlett-Packard Co. (HPQ) At 3:49PM ET: 32.78 ↓ 0.18 (0.55%)						
CALL OPTIONS		Expire at close Fri, Mar 17, 2006				
Strike	Symbol	Last	Chg	Bid	Ask	Open Int
<u>25.00</u>	HPQCE.X	7.90	0.00	7.60	7.80	303
<u>27.50</u>	HPQCY.X	5.40	↓1.00	5.10	5.30	479
<u>30.00</u>	HPQCF.X	2.80	↓0.15	2.65	2.75	4,797
<u>32.50</u>	HPQCZ.X	0.70	↓0.15	0.65	0.70	38,350
<u>35.00</u>	HPQCG.X	0.05	↓0.05	0.05	0.10	30,226

10% Stock Price Increase = 950% Option Return

Buying the 35-Strike call option gives us the right to buy 100 shares of HPQ at 35.00. If we were to purchase the 35-Strike call option we would expect to pay the 'ask' price of .10 cents or \$10 per option (.10 x 100 shares = \$10). Let's assume HPQ stock increases 10% in price from the current price of 32.78 to 36.05 (not an unusual assumption as HPQ stock has increased more than 60% over the past year). With a stock price of 36.05 the 35-Strike call option would be worth 1.05 points or \$105 (stock price of 36.05 minus 35-Strike price = 1.05 option value). When you purchase options you can sell them anytime prior to option expiration. So the option we purchased for .10 points could be sold for 1.05 points. Selling the 35-Strike call at 1.05 would produce a 950% return (1.05 sale price minus .10 cost = .95 profit divided by .10 cost = 950% return).

9.5 to 1 Leverage = Profit Opportunity

Options Are Highly Leveraged and Can Provide a High Rate of Return

Stock Investor

- Buys HPQ Stock at 32.78
- Stock Increases 10% to 36.05

Results:

- Big Investment \$3,278
- Small Profit 10%

Option Investor

- Buys 35-Strike Call Option for \$10
- Stock Increases 10% to 36.05
- Call Option is Worth \$105 (Stock Price of 36.05 minus 35.0 Strike = 1.05 Option Value)

\$105 Option Value Minus \$10 Cost = \$95 Profit
\$95 Profit Divided by \$10 Cost = 950% Return

Results:

- Small Investment \$10
- Big Profit 950%

**A 10% Price Increase in Stock = 950% Call Option Return
Which Allows Us to Achieve a High Rate of Return**

The Power of Leverage

The table below compares the profit potential of purchasing Hewlett Packard stock at today's price of 32.78 versus the HPQ March 35-strike call option at .10 points. If HPQ stock increases to 38.00 stock investors realize a 15.9% return but option investors realize a 2900% return. If HPQ stock increases to 40 stock investors realize a 22% return but option investors realize a 4900% return.

"Progress always involves risks. You can't steal second base and keep your foot on first."

- Frederick B. Wilcox

15.9% Stock Return = 2,900% Option Return = 29 to 1 Leverage

22% Stock Return = 4,900% Option Return = 49 to 1 Leverage

Hewlett Packard	35.00	36.00	37.00	38.00	39.00	40.00
Stock Price						
Stock Profit	2.22	3.22	4.22	5.22	6.22	7.22
Stock % Return	6.8%	9.8%	12.9%	15.9%	19.0%	22.0%
Value of 35-Strike Call Option	0.00	1.00	2.00	3.00	4.00	5.00
Option Profit	0.00	0.90	1.90	2.90	3.90	4.90
Option % Return	0.00	900%	1900%	2900%	3900%	4900%

Prudent Speculation

I would like to make one important distinction between the leveraged investments we use with the *Wealth Building Formula Option Strategy* versus 'high risk' leveraged investments. The *Wealth Building Formula Option Strategy* uses 'limited risk' leverage. This means that the most you can lose is your initial investment. Regardless of adverse market moves you can't lose more than your initial investment. You won't receive a 'margin call' from your broker or be asked to add funds to your brokerage account to avoid the forced liquidation of your positions.

Limited Risk Strategy

Strategy
Wealth Building Formula Option Strategy

High Risk Investments

The investments listed in the table that follows are what I categorize as 'high risk' investments because you can lose more than your initial investment. An adverse market move could wipe out your initial investment and could trigger a margin call that would require you to add funds to your account. You would be legally liable to pay back any and all losses that are sustained in your brokerage account. It only takes one unexpected overnight world event to wipe out a highly leveraged trading account. Recently some hedge funds which are highly leveraged have been incurring massive losses due to unexpected adverse market moves.

High Risk Investments

Investment
Futures Trading
Forex Trading
Shorting Stocks
Selling Uncovered or 'Naked' Options

"Luck never gives, it only lends."

- Swedish Proverb

Option Profits Are Derived From Stock Price Movement

Options are 'derivatives' that derive their value from the price of the underlying stock. The intrinsic value of a call option will increase one point for each point its underlying stock increases above the strike price.

Intrinsic Value of Call Option Increases One Point for Each Point Its Stock Increases above the Strike Price

A lot has been published about option strategies that invest in options based on whether an option is under valued or over valued according to the Black-Scholes Pricing Model. These option strategies are very complex and require high-level mathematical calculations to compute an option's Alpha, Beta, Delta, Gamma, Theta etc. I never understood the logic of investing in an option because it was slightly under valued at the time of purchase. Under valued options can become more under valued. ***The price movement of the underlying stock determines an option's value and the resulting profit/loss.*** When you purchase a call option your profits are determined by the price movement of the underlying stock.

Let's refer again to the example for the Hewlett Packard 35-Strike call purchased at .10 points so that you fully understand this important concept. The table below clearly demonstrates that the price of HPQ stock determines the profit/loss of the 35-Strike call option. If we can select a stock moving up in price, purchasing a call option on that stock can produce enormous profits and will allow us to harness the tremendous leverage provided from option investing.

Option intrinsic value increases 'dollar for dollar' once the stock price moves above the strike price of the option purchased

HPQ Stock Price	35.00	36.00	37.00	38.00	39.00	40.00
Value of 35-Strike Call Option	0.00	1.00	2.00	3.00	4.00	5.00
Option Profit/Loss	0.00	0.90	1.90	2.90	3.90	4.90
Option % Return	0.00	900%	1,900%	2,900%	3,900%	4,900%

If we can select a stock moving up in price, purchasing a call option on that stock can produce enormous profits and will allow us to harness the tremendous leverage provided from option investing.

Recent Wealth Building Call Option Purchase Example

Let's take a look at a recent *Wealth Building Formula* call option purchase example. Research in Motion (RIMM) is growing its stockholder's equity at a 24% annual rate and is in a 50/100-Day EMA system price uptrend which qualifies RIMM as a *Wealth Building Formula* stock.

My online brokerage account Portfolio Report that below shows that I purchased 12 Research in Motion January 70-Strike call options symbol RFYAN at an average price of 19.00. These options expire in about four months. Research in Motion stock was trading at 87.10 points.

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Symbol	Last Trade	Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit	
		\$	%				\$	%			
NOVKJ	Trade	23.20	0.00	0.00%	\$6,960.00*	24	\$12.08	\$27,859.04*	96.00%*	\$56,880.00*	Edit
QAAAD	Trade	69.05	-1.05	-1.50%	-\$150.00*	10	\$23.79	\$45,210.04	189.75%	\$69,050.00	Edit
RFYAN	Trade	55.30	1.95	3.66%	\$4,920.00*	12	\$19.00	\$46,099.04*	201.83%*	\$68,940.00*	Edit
Cash					23,332.74				\$23,332.74		
Totals					\$5,460.00	\$230,233.40	\$201,896.60	87.69%	\$455,462.74		

LEGEND: collapsed (click to expand) expanded (click to collapse) Real-time quotes

Research in Motion stock has continued to move up in price as well as the RIMM call options I purchased which are currently priced at 57.45. I have a \$3,845 open trade profit per contract which translates to a 201.8% return after commissions.

WBF Stock - Research in Motion



When I purchased the RIMM 70-Strike calls Research in Motion stock was trading at 87.10. RIMM is currently trading at 126.95. Purchasing RIMM stock would have produced a 45.7% return compared to the 201.8% return for the RIMM 70-Strike call options over the same six week period. The option return out-performance is due to the leverage options provide. A small increase in the price of a stock can translate to a large increase in the price of an option. The table below compares the return for the RIMM stock purchase at 87.10 to my RIMM 70-Strike option purchase at 19.00.

RIMM Stock Purchase versus RIMM Option Purchase

RIMM Stock Price	100	110	120	130	140	150
Stock Profit	12.90	22.90	32.90	42.90	52.90	62.90
Stock % Return	15%	26%	38%	49%	61%	72%
Value of 70-Strike Call	30.00	40.00	50.00	60.00	70.00	80.00
Option Profit	11.00	21.00	31.00	41.00	51.00	61.00
Option % Return	58%	110%	190%	216%	268%	321%

At current prices my RIMM 70-Strike call option percentage return is more than 4 times greater than the return for purchasing RIMM stock over the same period. While my option return is greater than the stock return I actually have fewer dollars at risk. With option purchases your risk is limited to the purchase price of the option.

In this example my risk for the RIMM 70-Strike call option purchase is limited to the 19.00 point purchase price or \$1,900 per option contract. Option contracts are based on 100 shares of stock so my dollar risk for an equivalent purchase of 100 shares of RIMM stock at 87.10 is \$8,710 which is considerably greater than my \$1,900 risk for my option purchase. So option investing has the double advantage of providing a higher potential return with less dollar risk than stock investing.

Double Advantage of Option Investing

RIMM Option Purchase - 440% Higher Return than Stock Return

RIMM Option Purchase – Only 22% of the Dollar Risk Compared to RIMM Stock Purchase

The *Wealth Building Formula Option Strategy* has been very successful in selecting call options on *Wealth Building Formula* stocks that are moving up in price. Recent real time option trading results follow.

\$1,483,988.61 In Actual Profits

The copies of my brokerage account Profit/Loss Reports that follow show \$1,483,988.61 in recent profits I generated using the *Wealth Building Formula Option Strategy* over the last several years.

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Portfolios Performance & Value Positions Gains & Losses Risk Analyzer Portfolio Analyzer **NETD** Income Estimator

Market Value: \$317,913.22 (\$154,821.03 / 95.89%)

REFRESH STREAMING QUOTES EXPORT TO EXCEL Results per Page: 200

Symbol	Last Trade	Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit
		\$	%				\$	%		
AXVAU	Trade 74.50	2.50	3.47%	\$560.00*	2	\$44.50	\$6,042.52*	67.76%*	\$14,860.00*	Edit
CAMAM	Trade 39.30	0.00	0.00%	-\$800.00*	8	\$18.31	\$16,757.78	114.14%	\$31,440.00	Edit
FCXAO	Trade 36.10	0.00	0.00%	\$2,925.00*	9	\$20.60	\$19,184.28*	103.30%*	\$37,755.00*	Edit
FLBAA	Trade 49.90	0.00	0.00%	-\$540.00*	6	\$27.00	\$21,751.53*	134.03%*	\$37,980.00*	Edit
GOQAF	Trade 66.30	2.30	3.59%	\$690.00	3	\$64.27	\$583.78	3.02%	\$19,890.00	Edit
GQPAY	Trade 132.50	1.50	1.15%	\$680.00*	2	\$60.75	\$14,412.52*	118.45%*	\$26,580.00*	Edit
LQHAK	Trade 12.10	1.11	10.10%	\$440.00*	4	\$12.00	\$69.01*	1.43%*	\$4,880.00*	Edit
NOVKJ	Trade 22.20	-1.40	-5.93%	-\$3,240.00*	18	\$12.62	\$17,579.28*	77.30%*	\$40,320.00*	Edit
QAAAD	Trade 66.57	1.76	2.72%	\$1,020.00*	6	\$24.47	\$25,191.53*	171.27%*	\$39,900.00*	Edit
RFYAN	Trade 49.15	-1.25	-2.48%	\$540.00*	9	\$19.83	\$28,019.28*	156.70%*	\$45,900.00*	Edit
RIGAR	Trade 28.20	0.00	0.00%	-\$240.00*	6	\$19.05	\$5,229.52*	45.67%*	\$16,680.00*	Edit
Cash					1,626.22				\$1,626.22	
Totals				\$2,035.00		\$161,463.97	\$154,821.03	95.89%	\$317,913.22	

LEGEND: collapsed (click to expand) expanded (click to collapse) Real-time quotes

Portfolios

Portfolios Performance & Value Positions Gains & Losses Risk Analyzer Portfolio Analyzer Income Estimator

Account/Watch List: 559 Defined Benefit Plan Create / Edit List

View: Performance Customize

Market Value: \$678,220.28 (\$315,756.53 / 87.64%)

DJIA 13,970.17 ▲ +62.92 Nasdaq 2,708.73 ▲ +1.73

REFRESH STREAMING QUOTES EXPORT TO EXCEL

Results per Page: 200

Symbol	Current Price	Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit
		\$	%				\$	%		
BGCGL	Trade 22.30	0.00	0.00%	\$0.00	10	\$8.20	\$14,084.51	171.44%	\$22,300.00	Edit
BGCGM	Trade 16.70	0.00	0.00%	-\$0.00	-10	\$7.20	-\$9,515.49	-131.88%	-\$16,700.00	Edit
BGCHL	Trade 22.30	0.00	0.00%	\$0.00	5	\$17.00	\$2,638.26	31.00%	\$11,150.00	Edit
BGCHN	Trade 14.40	1.10	8.27%	\$990.00	9	\$10.79	\$3,227.27	33.16%	\$12,960.00	Edit
COPGN	Trade 18.10	-2.30	-11.27%	-\$3,220.00	14	\$8,5429	\$13,353.52	111.40%	\$25,340.00	Edit
DEGB	Trade 19.00	0.00	0.00%	\$0.00	12	\$10.90	\$9,695.02	73.98%	\$22,800.00	Edit
EMCHQ	Trade 3.40	0.00	0.00%	\$0.00	22	\$3.50	-\$244.49	-3.17%	\$7,480.00	Edit
FCXGM	Trade 25.90	0.00	0.00%	\$0.00	10	\$12.12	\$13,748.53	113.14%	\$25,900.00	Edit
FCXHO	Trade 19.60	-0.30	-1.51%	-\$210.00	7	\$11.00	\$6,006.76	77.88%	\$13,720.00	Edit
FLRGS	Trade 25.41	0.00	0.00%	\$0.00	12	\$10.00	\$18,467.02	153.57%	\$30,492.00	Edit
FLRHT	Trade 20.82	0.00	0.00%	-\$0.00	6	\$5.00	\$9,479.51	314.67%	\$12,492.00	Edit
GOPHO	Trade 61.50	4.00	6.96%	\$1,600.00	4	\$49.60	\$4,749.01	23.92%	\$24,600.00	Edit
IHHHJ	Trade 25.50	4.00	18.60%	\$1,600.00	4	\$23.50	\$789.01	8.38%	\$10,200.00	Edit
JECGJ	Trade 13.50	0.00	0.00%	\$0.00	18	\$3.75	\$17,535.26	259.22%	\$24,300.00	Edit
JECHJ	Trade 15.10	0.00	0.00%	\$0.00	8	\$9.00	\$4,866.01	67.45%	\$12,080.00	Edit
JECHK	Trade 9.80	-0.75	-7.11%	-\$675.00	9	\$5.70	\$3,675.26	71.44%	\$8,820.00	Edit
MALGG	Trade 39.00	0.00	0.00%	\$0.00	9	\$12.43	\$23,887.27	213.04%	\$35,100.00	Edit

<input checked="" type="checkbox"/>	MALHJ	Trade	24.30	1.60	7.05%	\$480.00	3	\$17.40	\$2,059.76	39.38%	\$7,290.00	Edit
<input checked="" type="checkbox"/>	MDRGN	Trade	17.07	0.00	0.00%	\$0.00	13	\$9.6231	\$9,655.27	77.02%	\$22,191.00	Edit
<input checked="" type="checkbox"/>	MDRHN	Trade	23.65	1.15	5.11%	\$890.00	6	\$13.60	\$6,017.51	73.63%	\$14,190.00	Edit
<input checked="" type="checkbox"/>	NOVGQ	Trade	22.70	0.00	0.00%	\$0.00	10	\$12.12	\$10,548.53	86.81%	\$22,700.00	Edit
<input checked="" type="checkbox"/>	NOVHS	Trade	18.10	0.00	0.00%	\$0.00	6	\$13.50	\$2,747.51	33.87%	\$10,860.00	Edit
<input checked="" type="checkbox"/>	PCPGC	Trade	16.64	0.44	2.72%	\$792.00	18	\$6.65	\$17,952.52	149.61%	\$29,952.00	Edit
	PCPHB	Trade	17.70	0.00	0.00%	\$0.00	10	\$9.00	\$8,684.51	96.33%	\$17,700.00	Edit
<input checked="" type="checkbox"/>	PCUGP	Trade	30.10	0.00	0.00%	\$0.00	9	\$13.20	\$15,195.26	127.75%	\$27,090.00	Edit
	PCUHQ	Trade	24.00	0.00	0.00%	\$0.00	10	\$10.00	\$13,984.51	139.63%	\$24,000.00	Edit
<input checked="" type="checkbox"/>	QAAGA	Trade	34.30	1.60	4.89%	\$1,440.00	9	\$14.88	\$17,457.27	130.15%	\$30,870.00	Edit
	QAAHB	Trade	29.90	1.27	4.44%	\$889.00	7	\$14.20	\$10,976.76	110.28%	\$20,930.00	Edit
<input checked="" type="checkbox"/>	REYHT	Trade	32.99	2.39	7.81%	\$3,346.00	14	\$22.41	\$14,779.52	47.06%	\$46,186.00	Edit
<input checked="" type="checkbox"/>	RIGGR	Trade	19.10	0.00	0.00%	\$0.00	11	\$11.38	\$8,465.77	67.49%	\$21,010.00	Edit
	RIGHR	Trade	18.70	-0.80	-4.10%	-\$480.00	6	\$13.70	\$2,987.51	36.29%	\$11,220.00	Edit
<input checked="" type="checkbox"/>	UEBGR	Trade	29.80	0.00	0.00%	\$0.00	8	\$12.89	\$13,508.02	130.74%	\$23,840.00	Edit
	UEBHS	Trade	26.90	0.00	0.00%	\$0.00	6	\$14.00	\$7,727.51	91.86%	\$16,140.00	Edit
<input checked="" type="checkbox"/>	UVAHH	Trade	7.40	0.90	13.85%	\$1,260.00	14	\$6.80	\$821.51	8.61%	\$10,360.00	Edit
<input checked="" type="checkbox"/>	XTQGI	Trade	9.16	0.66	7.76%	\$1,716.00	26	\$4.8077	\$11,290.27	90.14%	\$23,816.00	Edit
<input checked="" type="checkbox"/>	XTQHI	Trade	9.04	-0.06	-0.66%	-\$84.00	14	\$5.8429	\$4,454.77	54.32%	\$12,656.00	Edit
	Cash						2,185.28				\$2,185.28	
	Totals				\$10,134.00		\$360,278.47	\$315,756.53	87.64%		\$678,220.28	

LEGEND: collapsed (click to expand) expanded (click to collapse)

Real-time quotes

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Market Value: \$452,033.80 (\$121,132.76 / 36.61%)

DJIA 10,864.86 ▼ -35.06 Nasdaq 2,305.82 ▼ -0.96

REFRESH STREAMING QUOTES EXPORT TO EXCEL

Symbol	Trade	Current Price		Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit	
		\$	%	\$	%				\$	%			
QQDAJ	Trade	125.70	3.40	2.78%		-\$341.48	3	\$129.33	-\$1,122.22	-2.89%	\$37,710.00	Edit	
QIHDB	Trade	46.50	0.00	0.00%		\$0.00	2	\$26.00	\$4,088.51	78.45%	\$9,300.00	Edit	
RTPDL	Trade	46.20	0.00	0.00%		\$0.00	2	\$25.50	\$4,128.51	80.77%	\$9,240.00	Edit	
RTPGN	Trade	46.00	0.00	0.00%		\$0.00	2	\$46.00	-\$11.49	-0.12%	\$9,200.00	Edit	
VHEAT	Trade	44.30	0.00	0.00%		\$0.00	6	\$42.70	\$925.53	3.61%	\$26,580.00	Edit	
TSIF	Trade	39.30	0.00	0.00%		\$0.00	4	\$35.50	\$1,497.02	10.53%	\$15,720.00	Edit	
AAQDH	Trade	36.50	3.90	11.96%		\$3,120.00	8	\$20.10	\$13,094.02	81.30%	\$29,200.00	Edit	
ZZTAN	Trade	36.10	2.20	6.49%		\$768.51	4	\$32.20	\$1,537.02	11.91%	\$14,440.00	Edit	
CCJCI	Trade	32.40	0.00	0.00%		\$0.00	12	\$15.47	\$20,281.03	109.04%	\$38,880.00	Edit	
TIECI	Trade	32.40	0.00	0.00%		\$0.00	12	\$17.90	\$17,361.03	80.68%	\$38,880.00	Edit	
ZBKAJ	Trade	32.30	0.00	0.00%		\$0.00	3	\$22.60	\$2,897.76	42.66%	\$9,690.00	Edit	
VTWAL	Trade	31.00	-3.99	-11.40%		-\$1,197.00	3	\$30.70	\$77.76	0.84%	\$9,300.00	Edit	
Cash						2,028.80						\$2,028.80	
Totals						\$5,195.03		\$330,901.00	\$121,132.76	36.61%	\$452,033.80		

LEGEND: collapsed (click to expand) expanded (click to collapse)

Real-time quotes

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Portfolios Performance & Value Positions Gains & Losses Risk Analyzer Portfolio Analyzer **BETA** Income Estimator

Market Value: \$477,662.79 **(\$254,006.83 / 114.95%)**

REFRESH STREAMING QUOTES EXPORT TO EXCEL

Results per Page: 200

Symbol	Last Trade	Change		Day's Gain	Qty	Price Paid	Total Gain		Market Val	Edit
		\$	%				\$	%		
AXVAU	Trade	74.50	2.50 3.47%	\$560.00*	2	\$43.85	\$6,172.52*	70.24%*	\$14,960.00*	Edit
CAMAM	Trade	39.30	0.00 0.00%	-\$1,260.00*	14	\$18.06	\$29,834.76*	117.81%*	\$55,160.00*	Edit
FCXAO	Trade	36.10	0.00 0.00%	\$5,200.00*	16	\$19.38	\$36,076.04*	116.21%*	\$67,120.00*	Edit
FLRAA	Trade	49.90	0.00 0.00%	-\$1,080.00*	12	\$25.62	\$45,169.04*	146.70%*	\$75,960.00*	Edit
GOOAF	Trade	62.70	-1.30 -2.03%	\$480.00*	2	\$64.85	\$292.52*	2.25%*	\$13,280.00*	Edit
GOPAY	Trade	132.50	1.50 1.15%	\$760.00*	2	\$60.50	\$14,542.52*	120.01%*	\$26,660.00*	Edit
LQHAK	Trade	12.10	1.11 10.10%	\$400.00*	4	\$12.00	\$29.01	0.60%	\$4,840.00	Edit
NOVKJ	Trade	22.20	-1.40 -5.93%	-\$4,560.00*	24	\$12.08	\$24,499.04*	84.42%*	\$53,520.00*	Edit
QAAAD	Trade	66.57	1.76 2.72%	\$2,124.00*	12	\$23.52	\$51,613.04	182.57%	\$79,884.00	Edit
REYAH	Trade	49.15	-1.25 -2.48%	\$720.00*	12	\$19.00	\$38,359.04*	167.94%*	\$61,200.00*	Edit
RIGAR	Trade	28.20	0.00 0.00%	-\$160.00*	8	\$18.69	\$7,419.26*	49.53%*	\$22,400.00*	Edit
Cash					2,678.79				\$2,678.79	
Totals				\$3,184.00		\$220,977.11	\$254,006.83	114.95%	\$477,662.79	

LEGEND: collapsed (click to expand) expanded (click to collapse)

Real-time quotes

Account Reports: Profit/Loss Report



Give your accountant a break. View profits/losses for all trades executed on one specific date or during a range of dates. Track by position, whether it's closed, or still opened. Download to a spreadsheet for easy manipulation, processing and tax reporting.

Unrealized P&L on Open Positions

Symbol	Description	Position	Avg Price	Cost Basis	Market Value	Type	Unrealized Val.
+APVAJ	Apple Inc Jan 2008 150.00 Call	18	\$20.0594	\$36,107.00	\$48,960.00	Stock Option	\$12,853.00
+PCXAO	Freeport-Mcmoran Copper & Gold Jan 2008 75.00 Call	18	\$21.8789	\$39,382.00	\$76,860.00	Stock Option	\$37,478.00
+FLRVH	Fluor Corp New Nov 2007 140.00 Call	18	\$15.6928	\$28,247.00	\$42,480.00	Stock Option	\$14,233.00
+GOPYQ	Google Inc Cl A Nov 2007 570.00 Call	18	\$37.3983	\$67,317.00	\$138,960.00	Stock Option	\$71,643.00
+NOVKJ	National Oilwell Varco Inc Nov 2007 90.00 Call	18	\$0.0000	\$0.00	\$50,940.00	Stock Option	\$50,940.00
+RFYAN	Research In Motion Ltd Jan 2008 70.00 Call	18	\$23.4178	\$42,152.00	\$80,730.00	Stock Option	\$38,578.00
+RIGAR	Transocean Inc Ord Jan 2008 90.00 Call	18	\$18.8233	\$33,882.00	\$48,960.00	Stock Option	\$15,078.00

Total Unrealized Gain-Loss:

\$240,803.00

Account Reports: Profit/Loss Report



Give your accountant a break. View profits/losses for all trades executed on one specific date or during a range of dates. Track by position, whether it's closed, or still opened. Download to a spreadsheet for easy manipulation, processing and tax reporting.

Unrealized P&L on Open Positions

Symbol	Description	Position	Avg Price	Cost Basis	Market Value	Type	Unrealized Val.
+APVKJ	Apple Inc Nov 2007 150.00 Call	20	\$15.3450	\$30,690.00	\$44,100.00	Stock Option	\$13,410.00
+PCXKO	Freeport-Mcmoran Copper & Gold Cl B Nov 2007 75.00 Call	20	\$24.6700	\$49,340.00	\$75,800.00	Stock Option	\$26,460.00
+FLRIH	Fluor Corp New Nov 2007 140.00 Call	20	\$15.3250	\$30,650.00	\$37,400.00	Stock Option	\$6,750.00
+NOVKT	National Oilwell Varco Inc Nov 2007 52.50 Call	20	\$0.0000	\$0.00	\$46,800.00	Stock Option	\$46,800.00
+RIGKR	Transocean Inc Ord Nov 2007 90.00 Call	20	\$18.1000	\$36,200.00	\$43,200.00	Stock Option	\$7,000.00

Total Unrealized Gain-Loss:

\$100,420.00

Account Reports: Profit/Loss Report



Give your accountant a break. View profits/losses for all trades executed on one specific date or during a range of dates. Track by position, whether it's closed, or still opened. Download to a spreadsheet for easy manipulation, processing and tax reporting.

Trade date: = SELECT DATE

Trade date: = SELECT DATE

Symbol: SUBMIT

Show detailed unrealized positions

*To see all transactions within specified date range leave symbol blank.

[Guide to the Profit/Loss Report](#)

Unrealized P&L on Open Positions on 9/25/2007

Symbol	Description	Position	Avg Price	Cost Basis	Market Value	Type	Unrealized Val.
+PCXAO	Freeport-Mcmoran Copper & Gold Jan 2008 75.00 Call	15	\$19.2983	\$28,947.50	\$48,600.00	Stock Option	\$19,652.50
+FLRJB	Fluor Corp New Oct 2007 110.00 Call	15	\$18.3583	\$27,537.50	\$49,200.00	Stock Option	\$21,662.50
+GQRJA	Garmin Ltd Ord Oct 2007 90.00 Call	15	\$16.6117	\$24,917.50	\$43,800.00	Stock Option	\$18,882.50
+NOVKT	National Oilwell Varco Inc Nov 2007 100.00 Call	15	\$25.3717	\$38,057.50	\$64,950.00	Stock Option	\$26,892.50
+QAAJD	Apple Inc Oct 2007 120.00 Call	15	\$18.5650	\$27,847.50	\$50,550.00	Stock Option	\$22,702.50
+RFYAN	Research In Motion Ltd Jan 2008 70.00 Call	15	\$18.7250	\$28,087.50	\$44,850.00	Stock Option	\$16,762.50
+RIGAR	Transocean Inc Ord Jan 2008 90.00 Call	15	\$18.0317	\$27,047.50	\$36,450.00	Stock Option	\$9,402.50
+ZQNR	Amazon Com Inc Oct 2007 90.00 Call	15	\$6.0283	\$9,042.50	\$8,850.00	Stock Option	-\$192.50

Total Unrealized Gain-Loss:

\$135,765.00

Portfolios

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Portfolios Performance & Value Positions Gains & Losses Risk Analyzer

Account/Watch List: LEGACY PUBLISHING LLC Create / Edit List

View: Performance Customize

Market Value: \$563,590.7 (\$161,283.56 / 40.09%)

DJIA 11,531.95 -110.70 Nasdaq 2,284.05 -36.69

REFRESH STREAMING QUOTES EXPORT TO EXCEL

Symbol	Current Price	Change \$	Change %	Day's Gain	Qty	Price Paid	Total Gain \$	Total Gain %	Market Val	Edit
BHPAH	Trade 12.40	1.00	8.77%	\$1,200.00	12	\$9.60	\$3,335.02	28.89%	\$14,880.00	Edit
BHPKH	Trade 11.60	0.80	5.45%	\$360.00	6	\$8.40	\$1,907.51	37.75%	\$6,960.00	Edit
CBGIK	Trade 31.90	0.00	0.00%	\$0.00	8	\$18.70	\$10,538.02	70.34%	\$25,520.00	Edit
CBGIL	Trade 27.30	0.00	0.00%	\$0.00	4	\$18.00	\$3,709.01	51.44%	\$10,920.00	Edit
CBGIM	Trade 24.50	0.00	0.00%	\$0.00	4	\$19.00	\$2,189.01	28.76%	\$9,800.00	Edit
CRSLB	Trade 38.20	0.00	0.00%	\$0.00	2	\$33.50	\$930.51	13.87%	\$7,640.00	Edit
EEMIR	Trade 22.50	0.00	0.00%	\$0.00	6	\$17.95	\$2,709.52	25.11%	\$13,500.00	Edit
EEMLR	Trade 21.50	-1.40	-6.11%	-\$420.00	3	\$20.20	\$379.76	6.26%	\$6,450.00	Edit
EWCIQ	Trade 4.80	0.00	0.00%	\$0.00	36	\$4.40	\$1,389.03	8.74%	\$17,280.00	Edit
FTIJJ	Trade 20.90	0.00	0.00%	\$0.00	13	\$13.89	\$9,076.28	50.16%	\$27,170.00	Edit
IOKIZ	Trade 30.50	0.00	0.00%	\$0.00	4	\$29.80	\$261.02	2.19%	\$12,200.00	Edit
OIIJJ	Trade 27.60	0.00	0.00%	\$0.00	6	\$22.35	\$3,129.52	23.30%	\$16,560.00	Edit
OMUAE	Trade 13.00	0.28	2.20%	\$336.00	12	\$11.80	\$1,415.02	9.98%	\$15,600.00	Edit
OPQAN	Trade 29.80	0.00	0.00%	\$0.00	6	\$27.75	\$1,205.52	7.23%	\$17,880.00	Edit
OPQAQ	Trade 26.10	0.00	0.00%	\$0.00	3	\$28.50	-\$730.24	-8.53%	\$7,830.00	Edit
OYGAE	Trade 49.00	0.00	0.00%	\$0.00	6	\$13.30	\$21,405.51	267.75%	\$29,400.00	Edit
OYGAG	Trade 41.00	0.00	0.00%	\$0.00	12	\$19.97	\$25,205.03	105.04%	\$49,200.00	Edit
OYZAJ	Trade 26.00	0.10	0.39%	\$90.00	9	\$22.00	\$3,569.28	18.00%	\$23,400.00	Edit
RTILL	Trade 25.60	2.20	9.40%	-\$10.24	3	\$25.60	-\$10.24	-0.13%	\$7,680.00	Edit

<input type="checkbox"/>	Symbol		Current Price	Change \$ %	Day's Gain	Qty	Price Paid	Total Gain \$ %	Market Val	Edit
<input type="checkbox"/>	RTPJB	Trade	43.50	0.00 0.00%	\$0.00	2	\$42.75	\$132.52 1.55%	\$8,700.00	Edit
<input type="checkbox"/>	TIEIG	Trade	47.50	0.00 0.00%	\$0.00	10	\$15.40	\$32,076.52 207.97%	\$47,500.00	Edit
<input type="checkbox"/>	TNBIH	Trade	13.00	0.00 0.00%	\$0.00	15	\$11.97	\$1,514.78 8.42%	\$19,500.00	Edit
<input type="checkbox"/>	VHEAL	Trade	23.80	0.00 0.00%	\$0.00	6	\$22.40	\$819.52 6.09%	\$14,280.00	Edit
	VOHAI	Trade	14.90	-0.10 -0.67%	-\$10.99	4	\$14.90	-\$10.99 -0.18%	\$5,960.00	Edit
<input type="checkbox"/>	VOIAK	Trade	35.70	0.00 0.00%	\$0.00	4	\$22.60	\$5,227.01 57.74%	\$14,280.00	Edit
<input type="checkbox"/>	VOIAM	Trade	26.10	-0.60 -2.25%	-\$480.00	8	\$20.35	\$4,578.02 28.08%	\$20,880.00	Edit
<input type="checkbox"/>	ZAMAJ	Trade	5.50	-0.20 -3.51%	-\$400.00	20	\$5.30	\$369.02 3.47%	\$11,000.00	Edit
	ZBKAE	Trade	19.90	-0.70 -3.40%	-\$420.00	6	\$11.30	\$5,147.76 75.79%	\$11,940.00	Edit
	ZBKAX	Trade	21.80	0.10 0.46%	\$240.00	24	\$14.70	\$17,021.01 48.22%	\$52,320.00	Edit
<input type="checkbox"/>	ZSTAH	Trade	11.90	0.00 0.00%	\$0.00	15	\$10.60	\$1,914.78 12.02%	\$17,850.00	Edit
<input type="checkbox"/>	ZZTAK	Trade	24.70	3.10 14.35%	\$919.76	6	\$23.20	\$879.52 6.31%	\$14,820.00	Edit
	Cash					4,690.74			\$4,690.74	
	Totals				\$1,404.53		\$402,307.18	\$161,283.56 40.09%	\$563,590.74	

LEGEND: collapsed (click to expand) expanded (click to collapse)

Real-time quotes

Inner Circle Advisory Service

My *Inner Circle Advisory Service* provides research and makes stock, ETF and option trade recommendations. Members receive email alerts whenever there is a new trading recommendation or a change to an existing recommendation. If you are interested in becoming a member of the *Inner Circle Advisory Service* please call our support staff at 856-325-6013 or log on to www.ChuckHughesIC.com for more information.

Membership Benefits:

- Personal consultation with Chuck via Chuck's personal email address
- Receive full support from our experienced staff to help you implement the *Wealth Building Formula Trading Strategies*
- Receive clear and concise 'buy', 'sell' or 'hold' signals that eliminate guesswork
- Frees up your time spent on research
- Receive access to actual open trade and closed trade profit results that give you an instant 'picture' of how a strategy is performing

Inner Circle Advisory Service

Trade Selection Process Produces Average Return of 86.3% with 99% Winning Trades

I use a 3-Step trade selection process to make stock, ETF and option trade recommendations for my *Inner Circle Advisory Service*. Currently the *Inner Circle Advisory* has \$1,075,981.83 in open trade profits and an average return of 86.3%. There are currently 138 winning trades and one losing trade resulting in 99% winning trades.

Inner Circle Advisory Current Open Trade Profit Results

138 Winning Trades, 1 Losing Trade = 99% Accuracy

Portfolio	Profit/Loss	Percent Return	Winning Trades	Losing Trades
Stock Portfolio	\$191,397.40	78.6%	24	1
Dividend Portfolio	\$161,344.80	72.0%	24	0
Option Portfolio	\$104,315.00	95.5%	14	0
Option Spread Portfolio	\$62,238.00	45.8%	17	0
Buy Write Portfolio	\$150,739.27	63.8%	25	0
MHC Strategy	\$56,462.90	30.2%	17	0
Micro Cap Portfolio	\$349,484.46	218.0%	17	0
Total Profits/ Avg Return	\$1,075,981.83	86.3%	138	1

My trade selection process continues to produce excellent returns for my advisory service members. In January 2011 we closed out record monthly profits of \$107,318.00 with an average closed trade return of 45.2%. Over the past 18 months the advisory service has produced \$614,974.62 in closed trade profits with an average monthly return of 42.0%

Inner Circle Advisory Closed Trade Profit Results

Monthly	Profit	Percent
Profits	Loss	Return
January-2010	\$54,080.00	37.2%
February-2010	\$22,854.00	32.9%
March-2010	\$24,875.00	52.7%
April-2010	\$33,010.00	45.7%
May-2010	\$7,750.00	26.5%
June-2010	\$12,665.00	67.2%
July-2010	\$7,970.30	50.8%
August-2010	\$12,681.18	29.4%
September-2010	\$12,540.00	34.2%
October-2010	\$31,044.05	39.6%
November-2010	\$53,983.36	69.1%
December-2010	\$67,039.00	51.4%
January-2011	\$107,318.00	45.2%
February-2011	\$20,812.75	19.8%
March-2011	\$40,238.25	33.4%
April-2011	\$45,023.60	77.2%
May-2011	\$26,603.61	20.2%
June-2011	\$34,486.10	22.8%
Total Profits/ Avg Return	\$614,974.62	42.0%

If you would like more information on becoming a member of the *Inner Circle Advisory Service* please call Brad toll free at 866-661-5664 (310-647-5664) or log on to www.ChuckHughesIC.com

Option and stock investing involves risk and is not suitable for all investors. Only invest money you can afford to lose in stocks and options. Past performance does not guarantee future results. The trade entry and exit prices represent the price of the security at the time the recommendation was made. The Inner Circle Advisory trade record does not represent actual investment results. Trade examples are simulated and have certain limitations. Simulated results do not represent actual trading. Since the trades have not been executed, the results may have under or over compensated for the impact, if any, of certain market factors such as lack of liquidity. No representation is being made that any account will or is likely to achieve profit or losses similar to those shown.

**For Updated Profit Results Log On to
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Chuck Hughes *INNER CIRCLE* ADVISORY

Welcome to Chuck Hughes Inner Circle Advisory

Greetings and welcome to the Chuck Hughes Inner Circle Advisory website! I want to take this opportunity to introduce myself and tell you a little bit about my trading programs. I have been trading stocks, options, currencies and commodities for more than 25 years.

I developed simple trend following systems that trade with the trend. When the price trend is up we buy and when the price trend is down we sell short. Now even though this concept sounds very simple it really works. My trend following and option strategies produced \$4,569,797.88 in actual profits providing my family and I with financial security and allowed me to retire from my job at age 48.

Now we all know that the markets have been very volatile lately but this increased volatility has created some great trading opportunities. My trend following programs have been taking full advantage of this increased volatility and have been on the right side of the trend in global markets. In my 25 years of trading experience there has never been a better time to profit from market trends than now.

Members of Chuck Hughes Inner Circle receive access to an exclusive advisory service which provides trading recommendations for my trend following and option strategies. All recommended trading signals are posted on a 'Members Only' proprietary web page enabling members to benefit from the continued success of my trend following and option strategies.

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The Key To Profits in Tough Times



By Chuck Hughes

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HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

Short Trades Reduce Risk and Increase Profit Opportunities

We don't often think of short trades as a way of reducing portfolio risk. Normally short trades are considered high risk but in this Report we are going to demonstrate that short trades not only reduce portfolio risk but can also dramatically increase the profit potential of your portfolio. In my experience the two keys to a successful short program is to only take short positions in stocks or ETFs when the major price trend is down and only take limited risk short trades.

Two Keys to Successful Short Trades

- **Only Short Markets When Major Price Trend is Down**
- **Take Only Limited Risk Trades**

My trading career started more than 25 years ago. I started out attending seminar that taught students how to trade stock and options using trading systems. I didn't know much about trading but I did realize system trading was something that I could learn at my own pace and the time involved was totally flexible. It was something I could do with my free time. Trading seemed to be the perfect means to supplement my income. I went to more seminars and read every book I could find concerning system trading. My goal was to develop a systematic, business-like approach to trading stocks, options and futures.

I started out 'paper trading' and tried many different types of trading methods with great hypothetical profit results. I then graduated to real time trading but quickly discovered that I could never come close to achieving the advertised profit results. This led to the realization that just about anyone with a computer and historical price data could optimize the system parameters and massage the price data to the point that the profit results always looked fantastic. But these great trading programs never seemed to hold up in actual trading. I then developed my own trend following systems that gave me a rule-based systematic approach to trading. I also developed money management systems that allowed me to control risk and manage losses and profits.

I quickly learned that following the trend was the simplest and most effective way to produce consistent trading profits. When the price trend is up I buy and when the price trend is down I sell short. This concept sounds simplistic but it really works. It is much better to follow the trend than trying to predict it. In my experience trading based on predicting the future is the biggest mistake beginning traders make. The truth is that no one can consistently predict the future. It is better to let the price trend of the market tell you when you should buy or sell.

A trend following system is your road map to trading success. Trend following combined with money management discipline is a powerful, systematic approach that allows you to manage risk and produce consistent returns. It allowed me to turn my trading into a business.

Let Price Movement Determine When You Should Buy or Sell

Through experience I learned that you want to purchase a stock or ETF only if the price trend is up. Buying a stock in a price down trend is risky as it requires you to correctly predict when the stock will 'bottom out' and resume a price up trend.

Buying a stock because it is cheap and predicting that the price has bottomed out can be nearly impossible to forecast correctly on a regular basis. This 'crystal ball' type of approach is risky as you must correctly predict the future price movement. A safer approach would be to wait until a stock is in a price up trend before buying. A stock's price reflects all of the known information about a company so let the price movement of the stock tell you when you should buy and sell.

Similarly, you don't want to take a short position in a stock unless the stock is in a price down trend. Taking a short position in a stock in a price up trend requires you to correctly predict when a stock will top out and start a price down trend.

Short Positions

I learned the hard way that you only want to take short positions when the major or long term price trend for a stock or ETF is down. There are many variations of technical indicators that can be used to determine the long term price trend.

In my experience, the 1-Month Price of a stock in relation to its 20-Month Exponential Moving Average (EMA) is an excellent way to identify the major or long term price trend of a stock. If the 1-Month Price is below the 20-Month EMA a bearish major price trend is indicated. This simple system has been very effective in correctly identifying the long term or major price trend.

Major Trend System 'Short' Signal

- 1-Month Price is Below 20-Month EMA

Added Dimension

Short positions profit when a stock or index declines in price. Most trading programs only trade from the long side because of the high risk associated with shorting a stock. You will discover in this book, however, that it is possible to take short positions with limited risk which adds a whole new dimension to wealth creation. The historical and actual profit results presented in this book will demonstrate that trading from the short side dramatically increases your profit opportunities. Let's next take a look at an example of how short trades can increase profit opportunities.

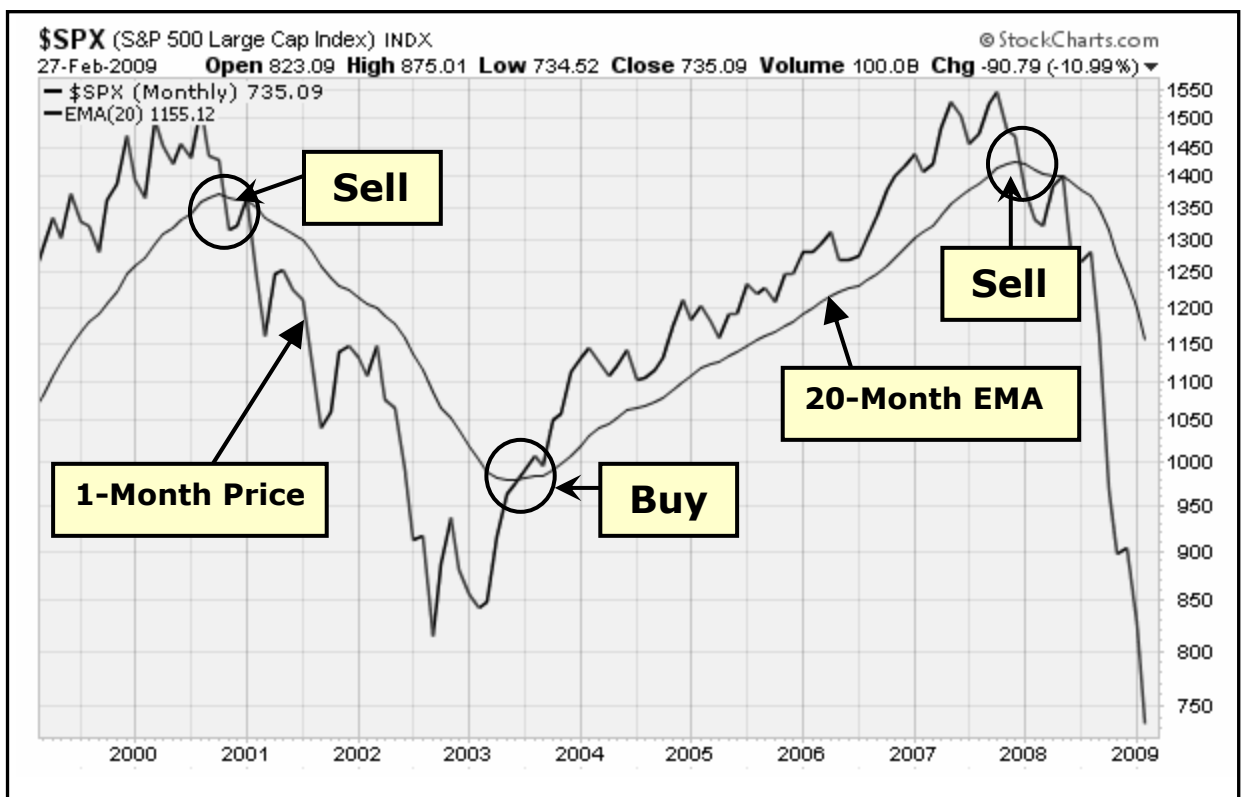
The chart below displays a longer term 1-Month/20-Month EMA price chart for the S&P 500 Index over a ten year period.

The price chart shows that the major price trend for the S&P 500 was bullish during the late 1990s, and then turned bearish in October 2000 when the 1-Month price crossed below the 20-Month EMA and bearish positions should be taken.

In May of 2003 the major trend turned bullish when the 1-Month price crossed above the 20-Month EMA. Bullish S&P 500 Index positions should be established and short positions should be exited (chart courtesy of stockcharts.com).

In December of 2007 the 1-Month price crossed below the 20-Month EMA indicating a major price down trend. Long positions should be exited and short positions should be initiated.

S&P 500 Index 1-Month/20-Month EMA Price Chart



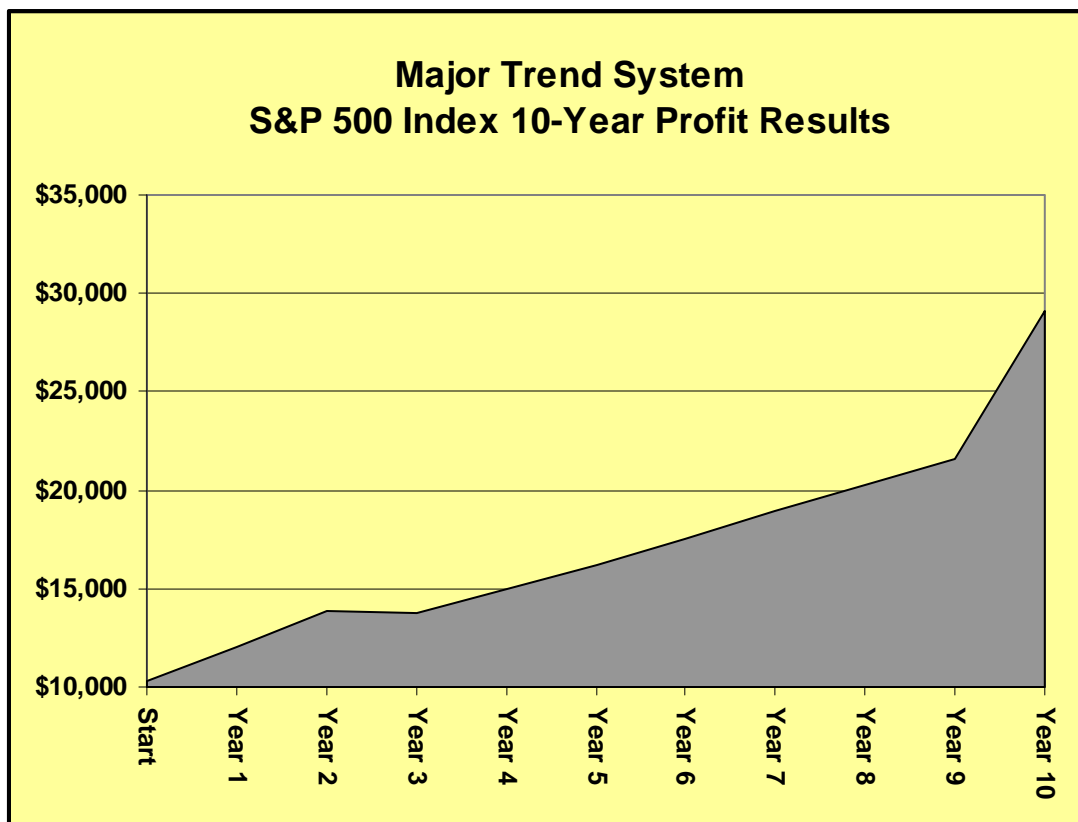
14% Loss versus 191% Profit

The S&P 500 Index incurred a 14% decline over the 10 year period just presented. Long term "buy and hold" investors would have incurred a 14% loss investing in the S&P 500 Index over this ten year period. Now let's take a look at investing in the S&P 500 Index using the *Major Trend System* which takes both long and short trades.

The *Major Trend System* is a simple trend following system that buys when a stock's one month price is above its 20-Month Exponential Moving Average and sells short when a stock's one month price drops below its 20-Month Exponential Moving Average. Short positions profit as a stock or index declines in price. The system produced a 191% profit over the same ten year period demonstrating the versatility of a system that takes short trades.

The profit graph below displays the profit growth from trading the S&P 500 Index over the same ten year period using the *Major Trend System*. Over the ten year period, a \$10,000 investment grew to \$29,139 using the system resulting in a \$19,139 profit and a 191% return. So taking both long and short trades allowed investors to realize a 191% return and avoid the 14% loss incurred from a buy and hold approach. This demonstrates the ability of short trades to reduce risk and increase profits.

Major Trend System Produces 191% Return Over 10 Year Period



Short Trades

- **Reduce Risk**
- **Increase Profit Potential**

Using The Major Trend Indicator as a Filter

Regardless of which trend following system you use to generate buy and sell signals, I learned through experience that you don't want to short a market unless the major price trend is also down. I use the 50/100-Day EMA trend following system to generate buy and sell signals for short to intermediate term trading.

The longer-term 1-Month/20-Month EMA Major Trend System can be used as an entry filter for the shorter-term 50-Day/100-Day EMA System by only allowing trades in the direction of the major trend.

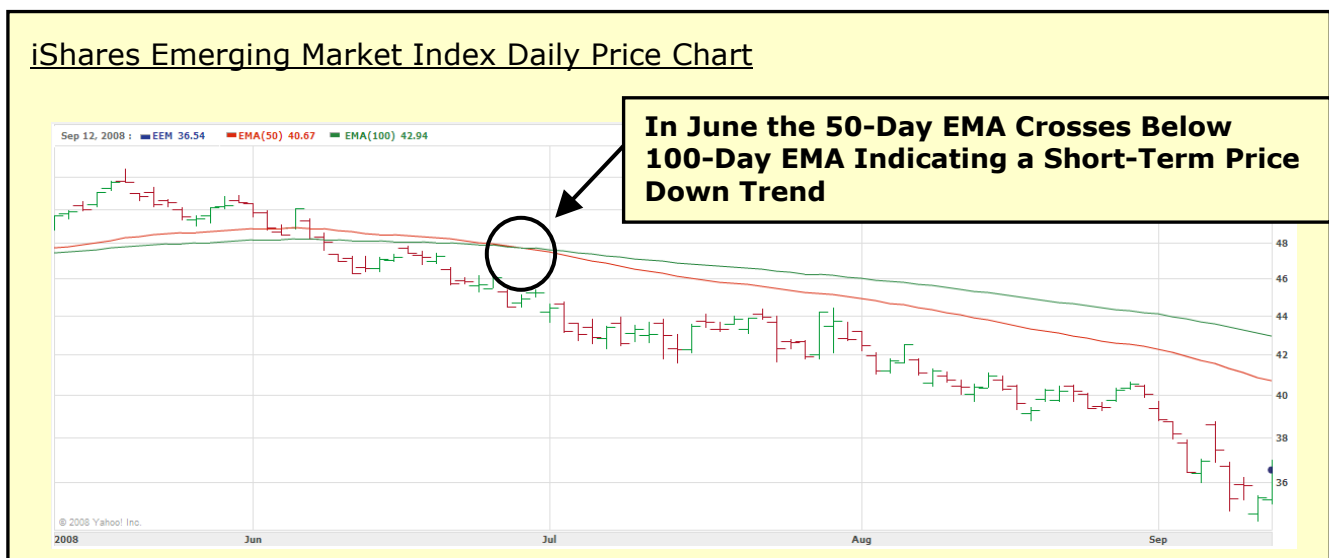
As we learned previously, the major trend is bullish when the 1-Month price bar is above the 20-Month EMA and the major trend is bearish when the 1-Month price bar is below the 20-Month EMA.

The Major Trend can be used as a filter by only allowing the shorter term 50/100-Day EMA buy signals when the Major Trend is bullish. And only allowing 50/100-Day EMA sell signals when the Major Trend is bearish.

The filter can improve the profit performance and reduce the risk of the shorter-term 50-Day/100-Day EMA System. The *Major Trend System* "confirms" the trend indicated by the shorter-term 50-Day/100-Day EMA System.

In my experience I have found the 1-Month/20-Month EMA Major Trend System entry filter to be particularly useful when taking short positions.

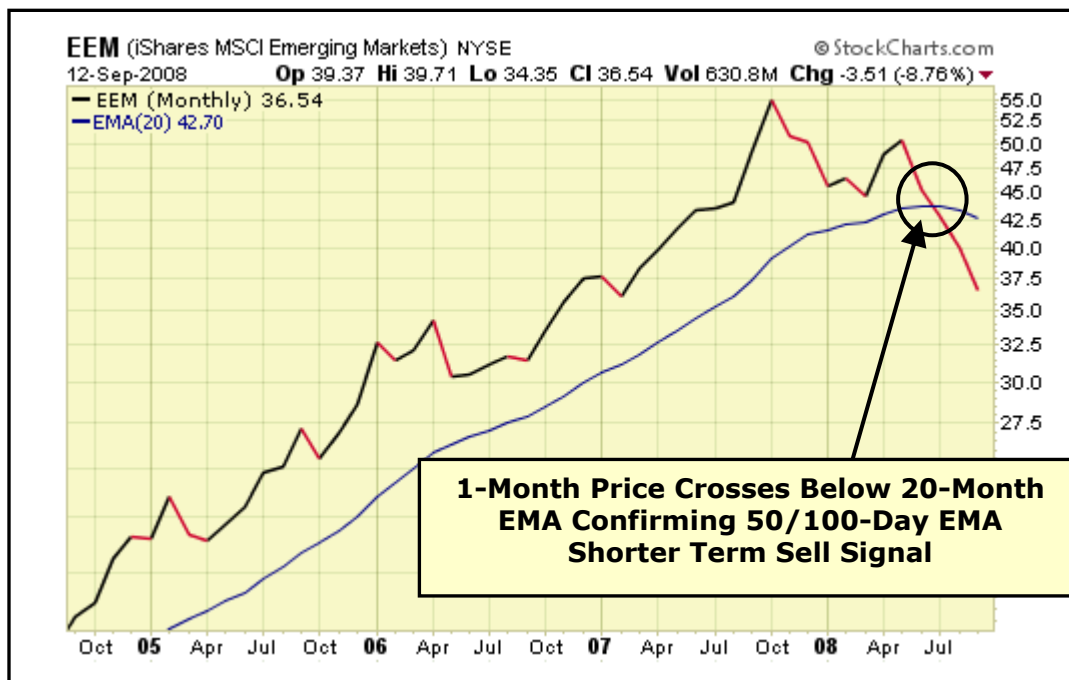
The *50/100-Day EMA Trend System* allows us to instantly see the 'Big Picture' when trading ETFs. The iShares Emerging Market Index ETF (EEM) daily price chart below shows the 50-Day EMA line crossing below the 100-Day EMA line in June indicating that this ETF is in a short-term price down trend (chart courtesy of Yahoo Finance).



Trend Confirmation

The iShares Emerging Markets (EEM) monthly price chart below shows the 1-Month price crossing below the 20-Month EMA in June indicating a major price down trend.

The *Major Trend System* confirms the shorter term 50/100-Day EMA sell signal. Both the 50-Day/100-Day EMA and Major Trend systems turned bearish in June and short positions can be initiated (chart courtesy of stockcharts.com).



Trend Confirmation Reduces Losses

The 1-Month/20-Month EMA filter only allows us to trade in the direction of the major trend. This helps prevent "whipsaw" trades when counter-trend rallies or sell offs occur. Preventing whipsaw trades can increase profits, reduce losses and increase the percentage of winning trades.

For example, the 1-Month/20-Month EMA price chart below for the Emerging Markets ETF (EEM) shows that the major price trend for EEM was bullish from 2004 until June of 2008. In June of 2008 the 1-Month price crossed below the 20-Month EMA indicating a major price down trend (chart courtesy of stockcharts.com).

During the 4 year period from 2004 until 2008 when EEM was in a major price up trend, the shorter-term 50-Day/100-Day EMA system issued three counter-trend "sell" signals all of which turned out to be losing trades. Using the 1-Month/20-Month EMA as a filter for the 50-Day/100-Day EMA System would have avoided these three losing whipsaw trades.

50-Day/100-Day EMA System Issued 3 Counter-Trend "Sell" Signals During Bullish 2004 - 2008 Period



The 1-Month/20-Month EMA price chart below for the S&P 500 Index is another example of how the system helps prevent whipsaw trades.

The 1-Month/20-Month EMA price chart below indicates the major price trend for S&P 500 Index was bullish from mid-2003 until December of 2007. In December of 2007 the 1-Month price crossed below the 20-Month EMA indicating a major price down trend.

During the 4½ year period the S&P 500 was in a major price up trend, the shorter-term 50-Day/100-Day EMA system issued five counter-trend "sell" signals all of which turned out to be losing trades. This is another example of how the 1-Month/20-Month EMA filter helps prevent whipsaw trades (chart courtesy of stockcharts.com).

50-Day/100-Day EMA System Issued 5 Counter-Trend "Sell" Signals During Bullish 2003 - 2007 Period



50-Day/100-Day EMA System Issued Five S&P 500 Index 'Sell' Signals During Bullish 2003 - 2008 Period

All Five Sell Signals Were Losing Trades

Limited Risk Trades

As noted previously shorting stocks can be high risk unless you take short positions that are limited risk trades. There are four types of short trades that are limited risk:

- 1) **Purchasing Short or Inverse Exchange Traded Funds (ETFs)**
- 2) **Purchasing Put Options**
- 3) **Buy Write Trades Using Short or Inverse Exchange Traded Funds (ETFs)**
- 4) **Bearish Option Spreads**

With limited risk trades the most you can lose is your initial investment regardless of adverse market moves. Limited risk trading is absolutely essential when trading volatile and unpredictable markets. You won't receive a 'margin call' from your broker or be asked to add funds to your brokerage account to avoid the forced liquidation of your positions.

High Risk Investments

The investments listed in the table that follows are what I categorize as "high risk" investments because you can lose more than your initial investment. An adverse market move could wipe out your initial investment and could trigger a margin call that would require you to add funds to your account. You would be legally liable to pay back any and all losses that are sustained in your brokerage account. It only takes one unexpected overnight world event to wipe out a highly leveraged trading account.

High Risk Investments

Investment
Futures Trading
Shorting Stocks
Selling Uncovered or 'Naked' Options

Futures trading usually involves 10 to 1 or even 20 to 1 leverage. It doesn't take much of an adverse market move for you to lose all of the cash in your account and worse yet owe your broker money in a margin call. You may think the odds are low that this could happen to you but as we used to say in the Air Force "Sierra Hotel"! It can happen. It only has to happen once and you are out of the game.

The # 1 Rule of Trading

Never Put Yourself in a Position to Lose More Money than You Invest

Lehman Brothers, Bear Sterns and AIG did not go bankrupt because there was a 5% default rate in mortgages. A 5% default rate could easily be absorbed with 1 to 1 leverage. They went bankrupt because they were highly leveraged and risked more money than they invested. The world financial system almost collapsed because the # 1 Rule of Trading was violated. Limited risk trading is essential for your trading success.

“If you must play, decide upon three things at the start: the rules of the game, the stakes and the quitting time.”

Chinese Proverb

Surviving the Financial Armageddon

By John Weston

There are times in your life that you will never forget. Dates that you know exactly where you were and what you were doing. In our family we have this thing about remembering where you were on significant events in history. My Grandfather would always say that he was out looking for his kids the day Pearl Harbor was attacked. My Dad was collecting glass bottles for money on the beach the day that the stock market crashed in 1929. My Mom was home watching TV the day President Kennedy was assassinated. I was at the office during the terrorist attack on September 11th. I remember sitting there watching the TV with utter disbelief and terror.

Unfortunately, I now have another unpleasant day to remember. I am thankful that no one has injured or killed. But the loss of people's dreams and financial security has become palpable. That day would be September 15, 2008. This day will go down in history as the beginning of the worst financial crisis in the United States since the Great Depression. Due to the Lehman Brothers and Fannie Mae bankruptcy, the Merrill Lynch buyout and the AIG insurance company insolvency, today could be considered one of the worst global financial storms in history. Some call it a 'Financial Armageddon'. Over thirty trillion dollars of highly leveraged mortgage securities that went bad have caused a financial meltdown that has frozen global credit.

The day of September 15, 2008 started out no different than most. I was cruising into my desk that morning nursing my second cup of coffee, entertaining thoughts of when the market volatility is going to give us a decisive trend. Well, be careful what you wish for . . . the market was about to show us and the rest of the world a very decisive trend. The market began a precipitous sell off. Of course, Chuck Hughes was already on top of it . . . in the early AM hours he knew the Asian markets were selling off. He had a feeling already that things were going south and the ride was going to be a rough one.

Fortunately, Chuck's *Major Trend System* had already positioned us on the right side of the trend in the global currency, commodity and equity markets. In Chuck Hughes' August blog he recommended that readers take short positions in the global markets just as he had done over the summer. The *Major Trend System* issued "go short" signals for most foreign currencies, commodities and equity markets in the June - July time frame.

By the end of the day the Dow Jones Industrial Average had lost over 500 points in ONE day. But Chuck's ETF trading accounts **had a positive return for the day**. The copy of his brokerage account Profit/Loss Report that follows shows \$14,987.22 in closed trade profits on September 15th and his open trades had a 14.5% return for the day. His other three global ETF trading accounts had similar returns.

Chuck Hughes locked in solid profits today and also created spread trades that help preserve existing profits. Trade management and creating spread trades to help protect profits. Protecting profits is a very important requirement for profitable trading during volatile markets.

14.5% Return in One Day While Dow Dropped 504 Points

Account Reports: Profit/Loss Report PRINT

Give your accountant a break. View profits/losses for all trades executed on one specific date or during a range of dates. Track by position, whether it's closed, or still opened. Download to a spreadsheet for easy manipulation, processing and tax reporting.

Trade date: << >>

Trade date: << >>

Symbol: Show detailed unrealized positions

* To see all transactions within specified date range leave symbol blank

[Click here](#) to download data

Sept 15th Closed Trades

Realized P&L on Closed Positions

Symbol	Date Bought	Date Sold	Shares	Cost Basis	Sales Price	Gain-loss
+EWYMH	8/27/2008 3:35:11 PM	9/15/2008 10:52:32 AM	4	\$6,302.00	\$7,093.95	\$791.95
+EWYMH	8/27/2008 3:35:11 PM	9/15/2008 10:52:41 AM	1	\$1,575.50	\$1,778.49	\$202.99
+FLNOD	9/8/2008 2:57:00 PM	9/15/2008 10:51:53 AM	5	\$10,727.50	\$10,032.43	-\$695.07
+FLNOD	9/11/2008 11:38:18 AM	9/15/2008 10:51:53 AM	5	\$11,227.50	\$10,032.43	-\$1,195.07
+JIKOH	9/3/2008 3:27:07 PM	9/15/2008 10:34:02 AM	5	\$9,827.50	\$11,622.42	\$1,794.92
+RSXWX	8/26/2008 3:51:00 PM	9/15/2008 9:58:34 AM	5	\$6,527.50	\$9,572.43	\$3,044.93
EEV	8/26/2008 2:39:36 PM	9/15/2008 9:46:40 AM	100	\$9,681.50	\$11,910.13	\$2,228.63
EEV	8/26/2008 2:39:36 PM	9/15/2008 9:46:40 AM	100	\$9,701.50	\$11,910.13	\$2,208.63
EEV	8/26/2008 2:39:36 PM	9/15/2008 9:46:40 AM	100	\$9,681.50	\$11,920.13	\$2,238.63
EFU	8/26/2008 2:32:13 PM	9/15/2008 9:44:26 AM	236	\$25,458.42	\$28,890.29	\$3,431.87
EFU	8/26/2008 2:32:13 PM	9/15/2008 9:44:26 AM	64	\$6,903.98	\$7,838.80	\$934.82
Total Realized Gain-Loss:						\$14,987.22

Open Trade Profit

Unrealized P&L on Open Positions

Symbol	Description	Position	Avg Price	Cost Basis	Market Value	Type	Unrealized Val.
+EEVLD	Proshares Tr Ultr Shrt Msci Dec 2008 120.00 Call	-3	-\$19.9182	\$5,975.45	-\$10,080.00	Stock Option	-\$4,104.55
+EWYMH	Ishares Inc Msci S Korea Jan 2009 60.00 Put	5	\$17.5550	\$8,777.50	\$9,800.00	Stock Option	\$1,022.50
+JIKOH	Claymore Exchange Traded Fd Tr Bny Bri&c Ptf Mar 2009 60.00 Put	5	\$21.4550	\$10,727.50	\$12,650.00	Stock Option	\$1,922.50
+RSXWX	Market Vectors Etf Tr Russia Etf Nov 2008 50.00 Put	5	\$16.0550	\$8,027.50	\$11,500.00	Stock Option	\$3,472.50
EEV	Proshares Tr Ultr Shrt Msci	300	\$107.0817	\$32,124.50	\$42,240.00	Equities	\$10,115.50
EFU	Proshares Tr Ultr Shrt Msci	300	\$114.0817	\$34,224.50	\$40,059.00	Equities	\$5,834.50
Total Unrealized Gain-Loss:							\$18,262.95

Major Trend System Historical Results

Let's now take a look at profit results using the Major Trend system to trade stocks. I conducted 10 years of historical testing on a diversified portfolio of eight stocks in a broad cross section of industries. Industries in this portfolio include: construction, computers, agriculture, steel, oil and gas, iron ore and coal, savings bank and metal fabrication.

Major Trend System Diversified Stock Portfolio

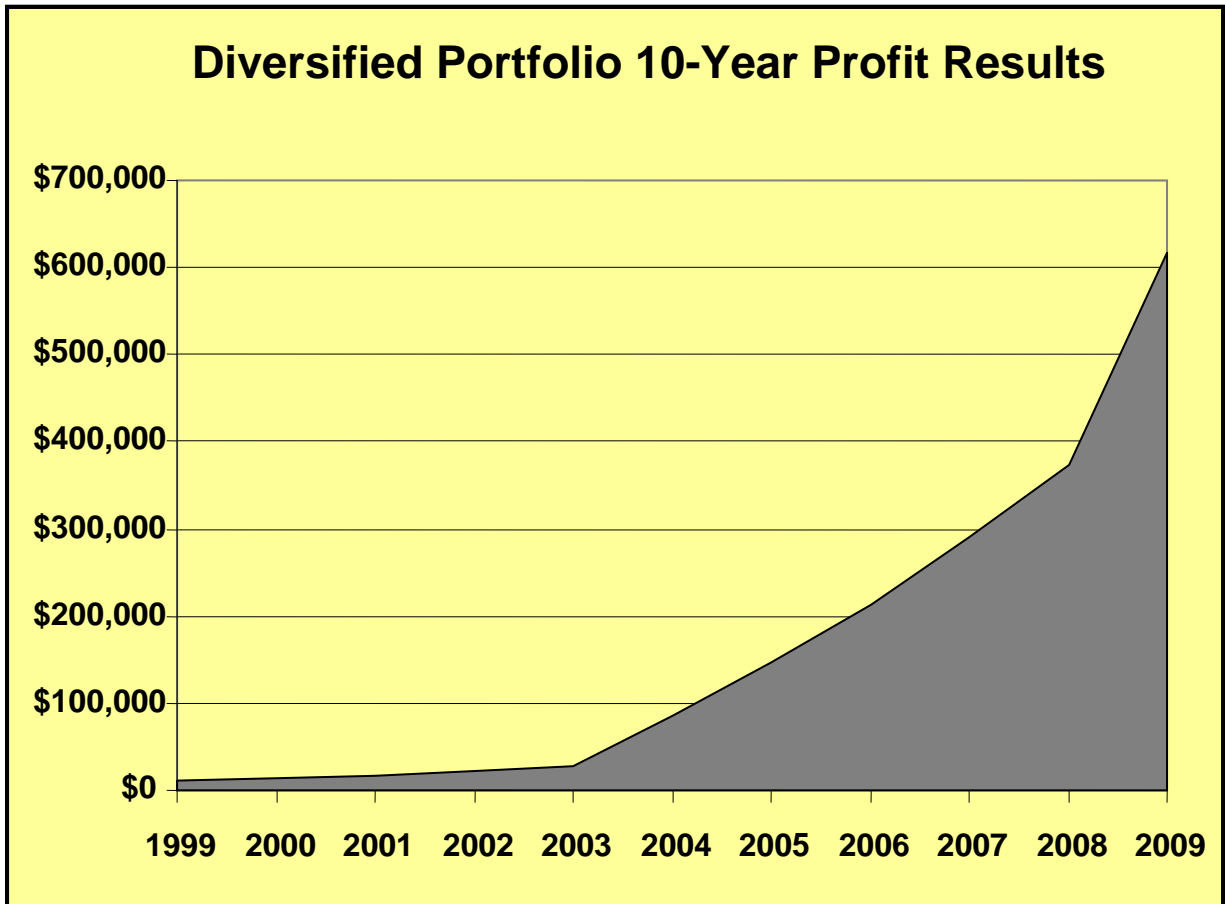
Foster Wheeler (construction)		Petrobras (oil and gas)
Apple (computers)		Cliffs Natural (iron ore & coal)
Monsanto (agriculture)		Precision Cast (metal fabrication)
Arcelor Mittal (steel)		Hudson City Bancorp (savings bank)

The historical profit results are based on an initial investment of \$10,000 divided equally among the eight stocks over a recent 10-Year period (or when stock first traded) and compounding the results and do not include commissions. The historical results do not reflect the use of leverage or margin.

Major Trend System Diversified Portfolio Historical Results

Initial Investment	\$10,000
Number Years	10
Profit	\$608,337
Total Return	6,083%
Average Annual Return	608.3%
Percent Winning Trades	94.5%
Total Profits	\$609,025
Total Losses	\$688
Profit:Loss Ratio	885 to 1
Largest Losing Trade	-1.9%

Growth of \$10,000 Investment Using the Major Trend System



Historical results reveal that the *Major Trend System* produced impressive profits with very low risk. A \$10,000 investment grew to \$618,337 over the ten year period. After deducting the initial \$10,000 investment, the total profits were \$608,337 (before commissions) which equates to a 6,083% return on the initial \$10,000 investment.

Over the ten year test period this translates to a 608% average annual return. This is an excellent annual return for a system that does not use leverage or margin! Ninety-four percent of trades were profitable and all years were profitable.

\$885 of Profit for Each 1 Dollar of Loss

The system produced \$609,025 in total profits and only \$688 in total losses. Dividing the total profits by the total losses results in a Profit to Loss Ratio of 885 to 1. This translates to 885 dollars of profit for each 1 dollar of loss. The Profit to Loss Ratio is a good measure of risk. A high Profit to Loss Ratio indicates that the *Major Trend System* keeps losses to a minimum by exiting losing trades before they develop into a large loss. The largest losing trade over the 10-Year test period was a -1.9%

The *Major Trend System* almost always exits a trade before a big loss occurs and provides you with the discipline necessary to become a successful trader. Keep in mind that two bear markets occurred during this period including the worst bear market since 1932 during which the S&P 500 Index lost 50% of its value and the NASDAQ suffered a 76% loss.

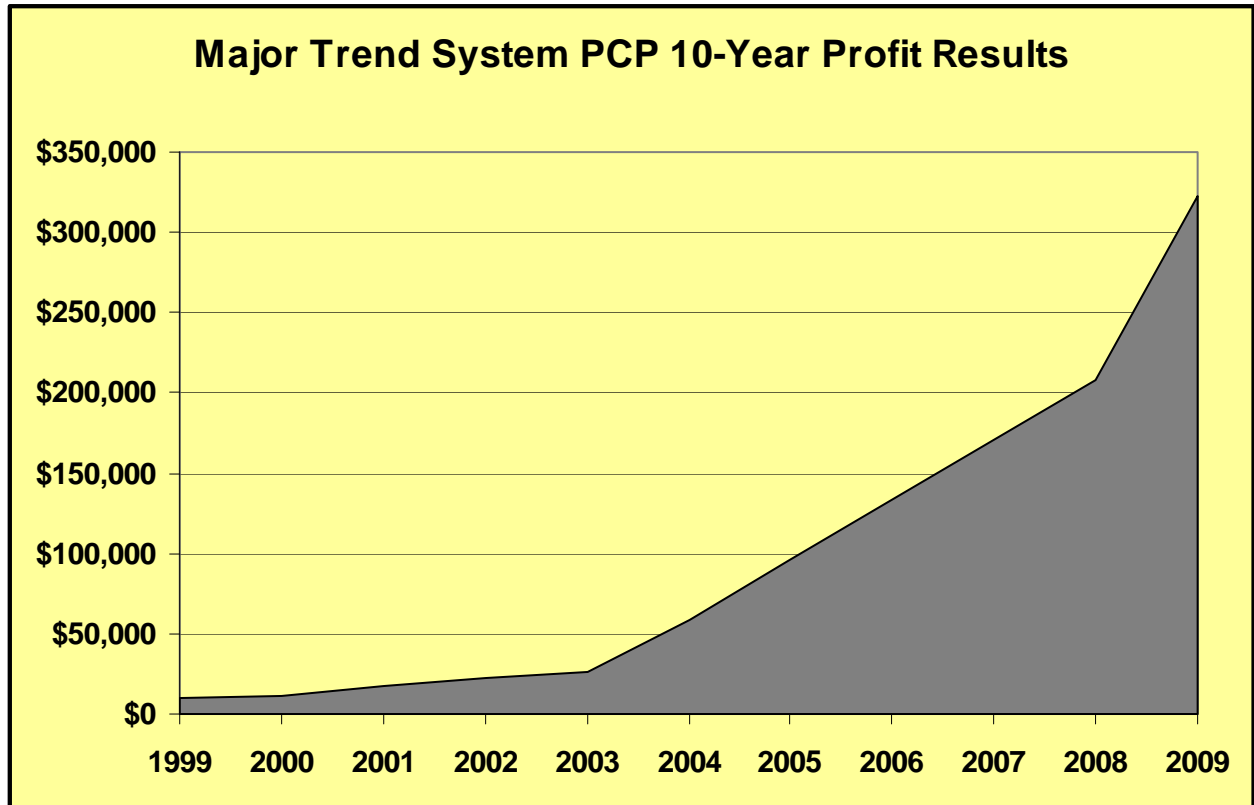
These profit results demonstrate that the *Major Trend System* is a versatile, effective method for profiting from long or short trades in any type of market.

Most investment programs recommend diversifying your portfolio across different industry groups. One of the great advantages of the *Major Trend System* is that it allows you to further diversify your portfolio by taking both long and short trades which increases the diversity and profit opportunities of the system. Let's next take a look at profit results for some of the individual stocks in the diversified portfolio just mentioned.

Major Trend System Individual Market Profit Results

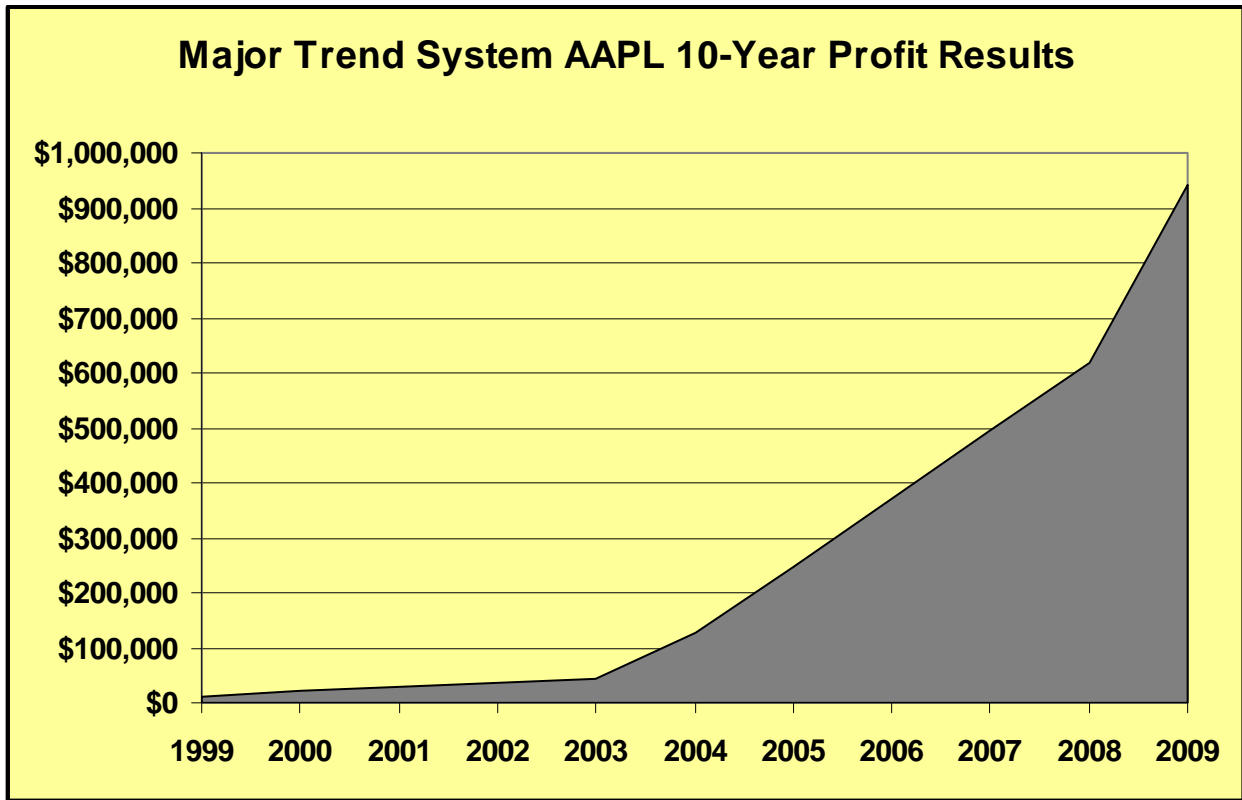
The historical profit results that follow are based on trading the *Major Trend System* with an initial investment of \$10,000 in a stock and compounding the results thereafter and do not include commissions. The historical results do not reflect the use of leverage or margin.

Precision Castparts Profit Results



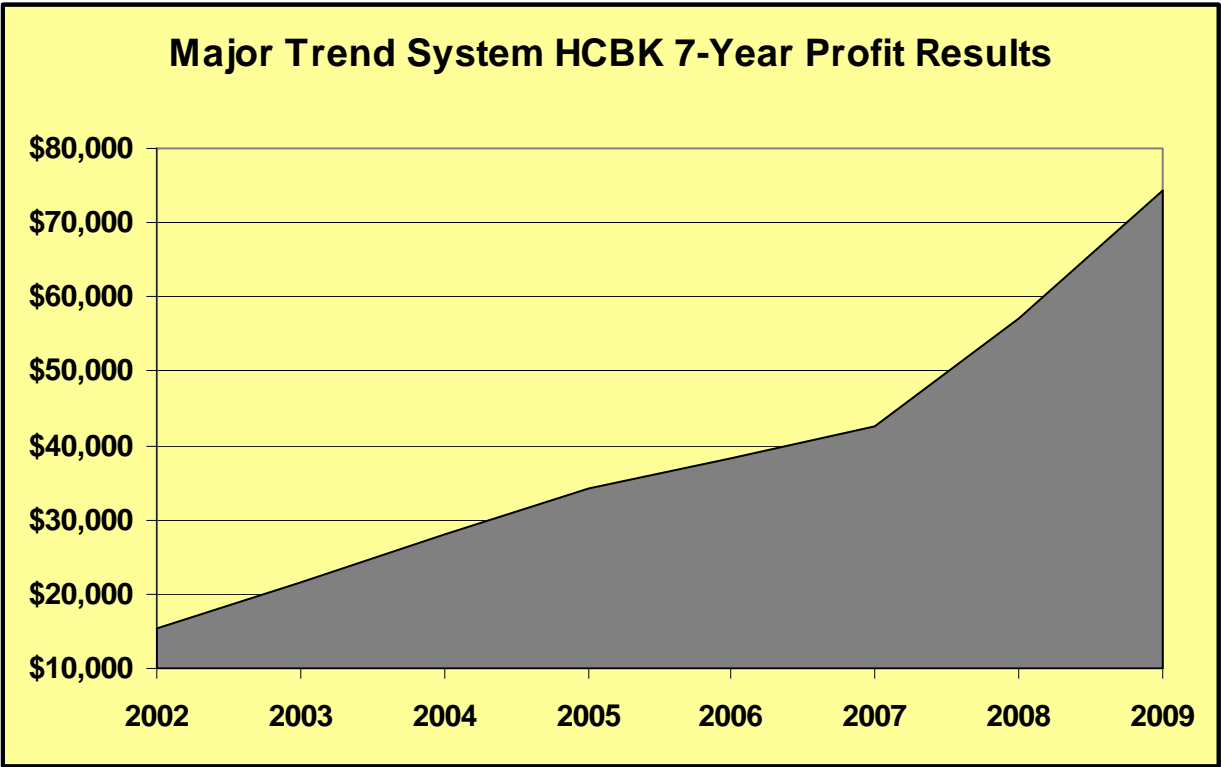
Initial Investment	\$10,000
Number Years	10
Profit	\$312,645
Total Return	3,126%
Avg Annual Return	312%
% Winning Trades	100%
Profit/Loss Ratio	No Losses

Apple Profit Results



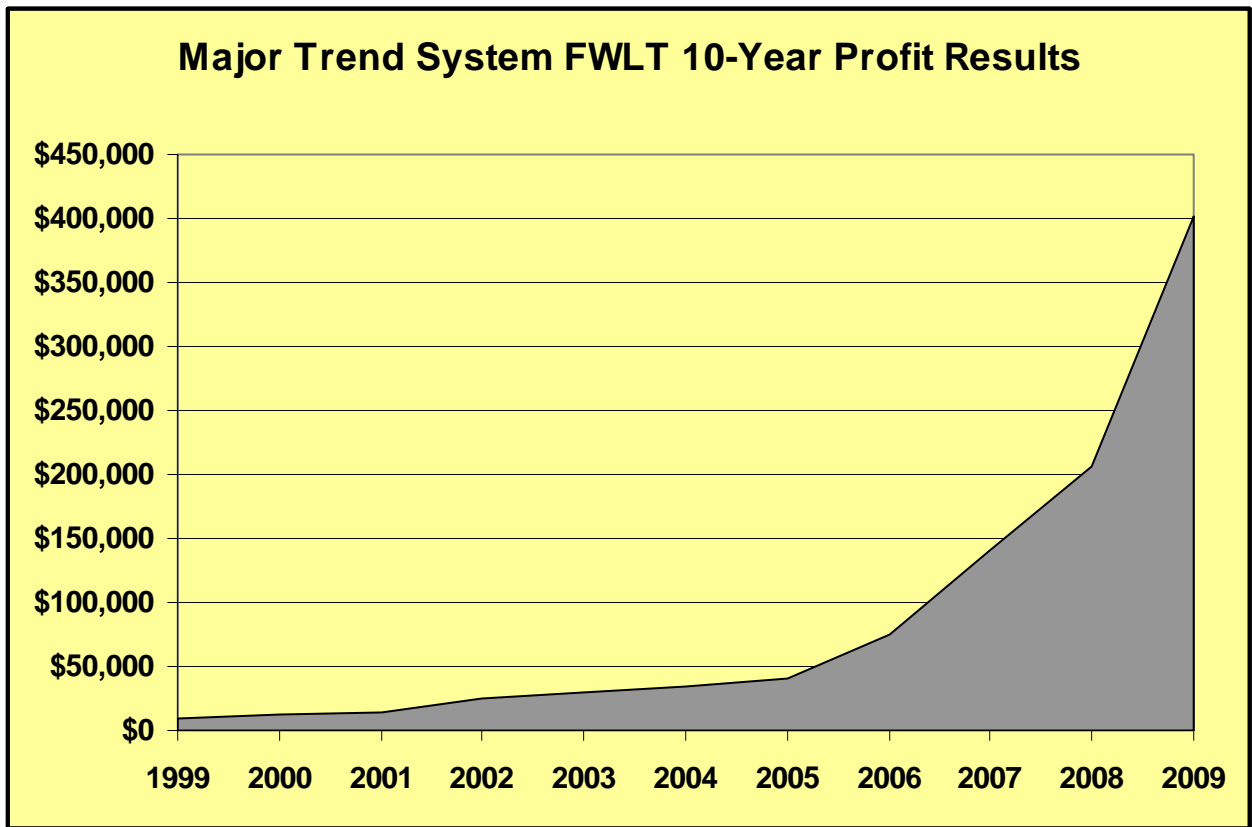
Initial Investment	\$10,000
Number Years	10
Profit	\$933,885
Total Return	9,338%
Avg Annual Return	933%
% Winning Trades	100%
Profit/Loss Ratio	No Losses

Hudson City Bancorp Profit Results



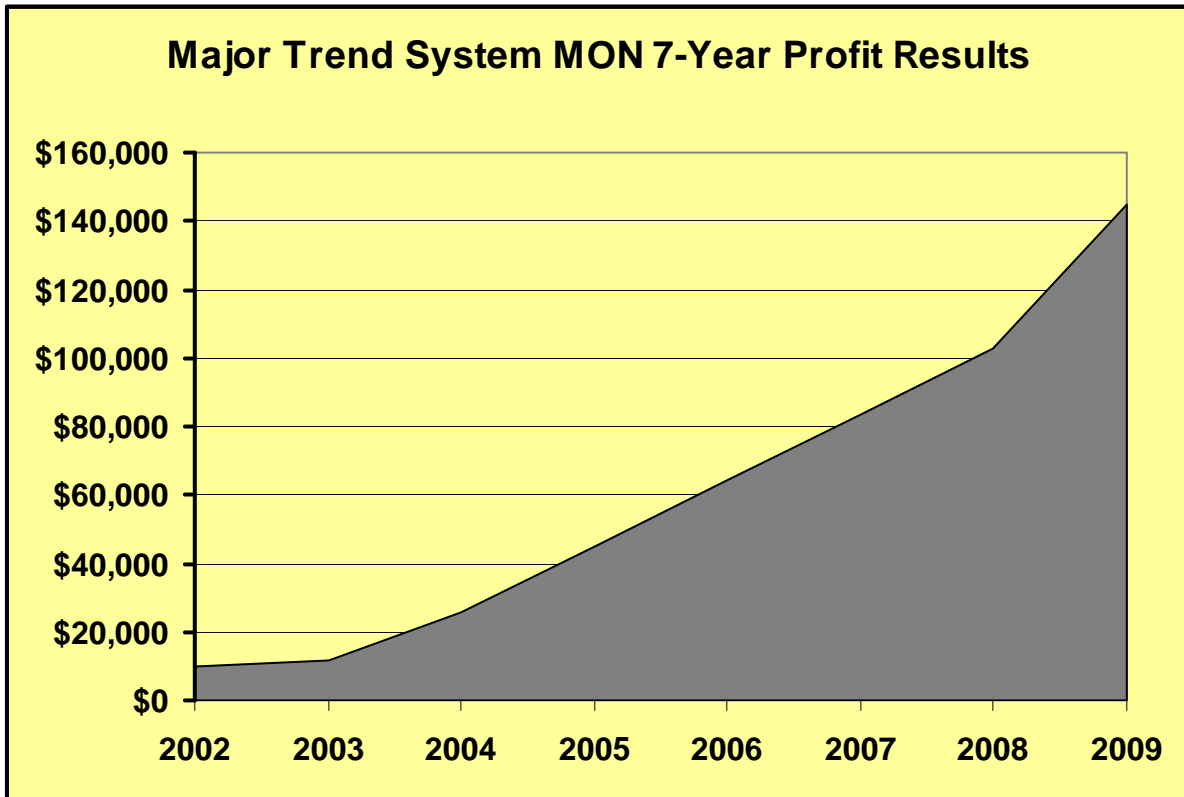
Initial Investment	\$10,000
Number Years	7
Profit	\$64,440
Total Return	644%
Avg Annual Return	92%
% Winning Trades	80%
Profit/Loss Ratio	131 to 1

Foster Wheeler Profit Results



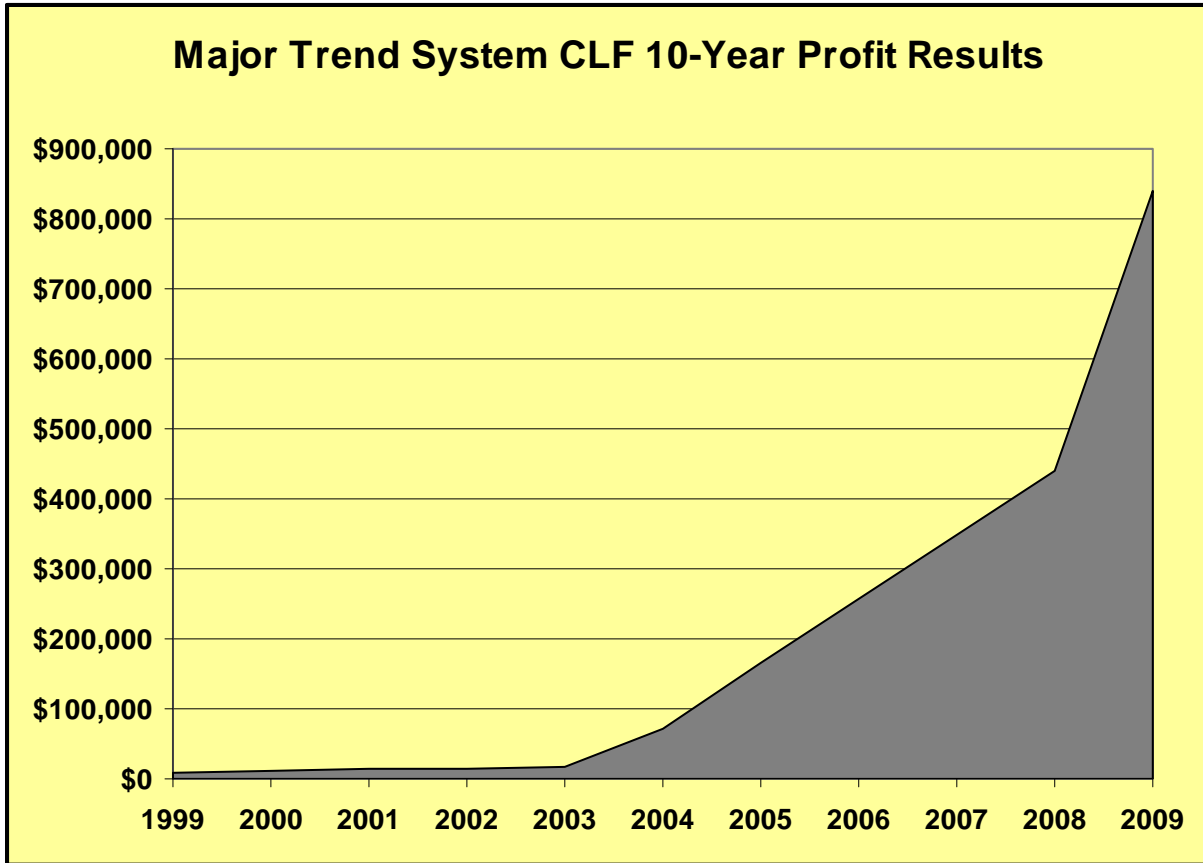
Initial Investment	\$10,000
Number Years	10
Profit	\$391,544
Total Return	3,915%
Avg Annual Return	391%
% Winning Trades	100%
Profit/Loss Ratio	No Losses

Monsanto Profit Results



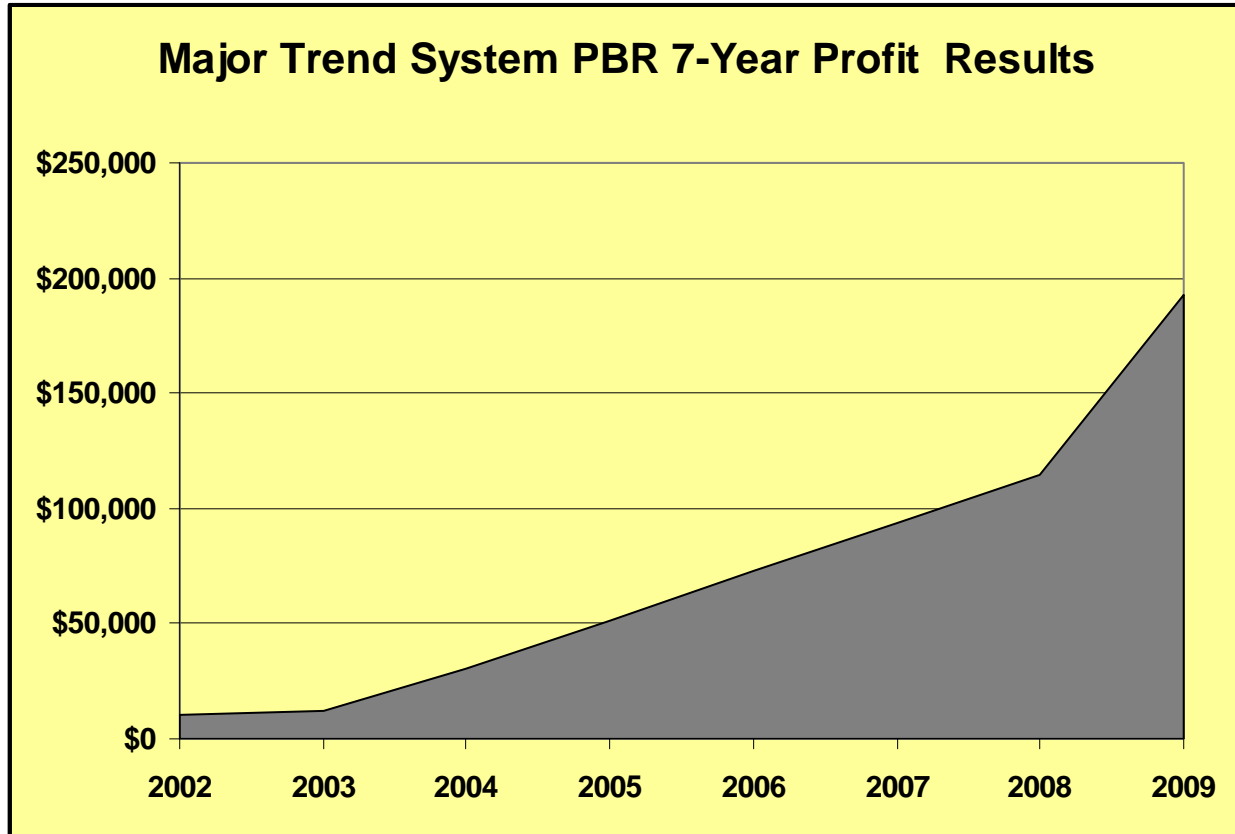
Initial Investment	\$10,000
Number Years	7
Profit	\$134,822
Total Return	1,348%
Avg Annual Return	192%
% Winning Trades	100%
Profit/Loss Ratio	No Losses

Cliffs Natural Profit Results



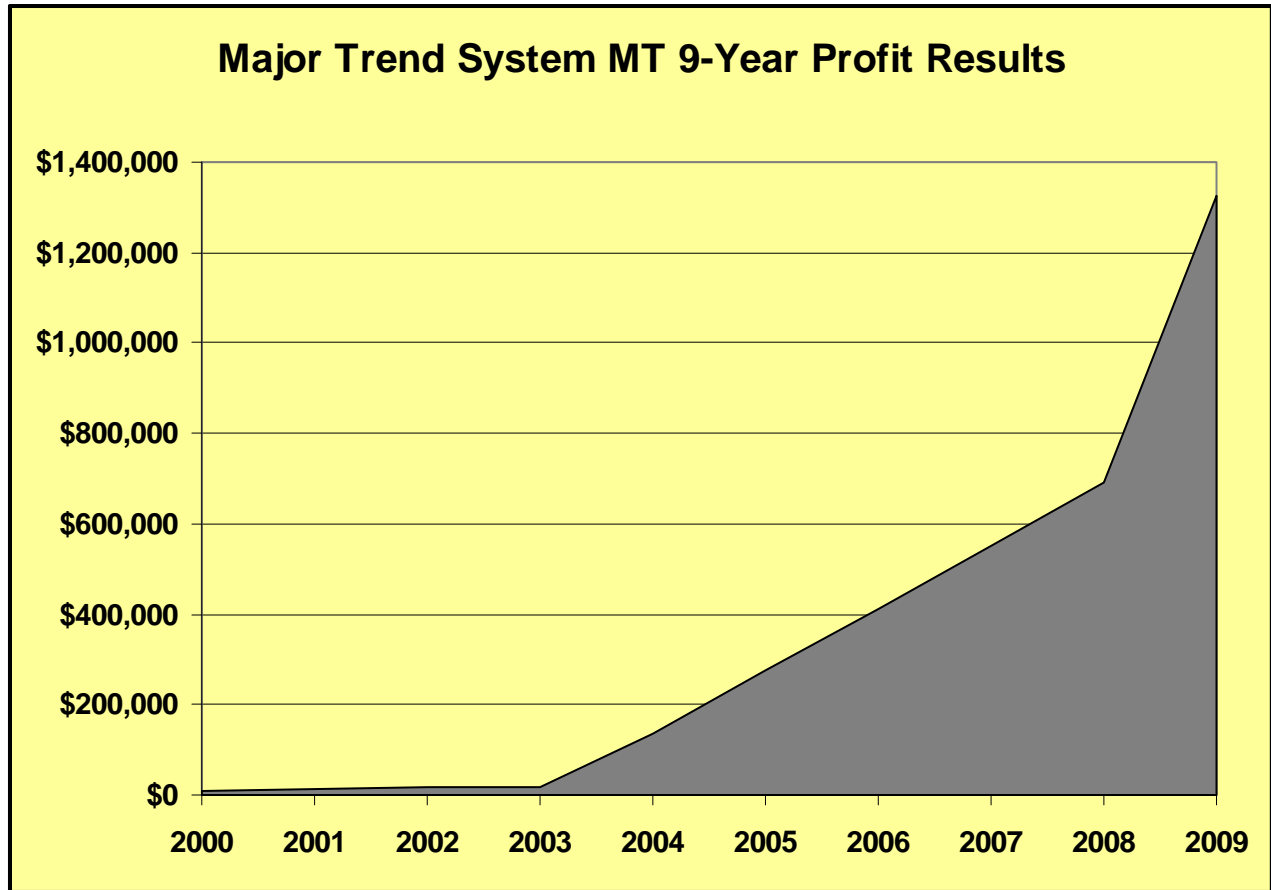
Initial Investment	\$10,000
Number Years	10
Profit	\$829,430
Total Return	8,294%
Avg Annual Return	829%
% Winning Trades	100%
Profit/Loss Ratio	No Losses

Petrobras Profit Results



Initial Investment	\$10,000
Number Years	7
Profit	\$182,501
Total Return	1,825%
Avg Annual Return	260%
% Winning Trades	100%
Profit/Loss Ratio	No Losses

Arcelor Mittal Profit Results



Initial Investment	\$10,000
Number Years	9
Profit	\$1,315,802
Total Return	13,158%
Avg Annual Return	1462%
% Winning Trades	80%
Profit/Loss Ratio	6,818 to 1

Major Trend System is Universal in Nature

Regardless of which indicator or methodology you use to trade, the *Major Trend System* can be a valuable trading tool for virtually any market. Before I take a long or short position I normally check to make sure I am trading in the direction of the major trend. Trading in the direction of the major trend helps prevent whipsaw trades which can increase profits and reduce risk. The *Major Trend System* has been profitable across a wide range of markets including energy, fixed income, commodities and currencies.

I conducted historical testing using Exchange Traded Funds (ETFs) on a diversified portfolio of eight global markets listed below including crude oil, the Euro currency, bonds and equities.

Diversified Global Portfolio

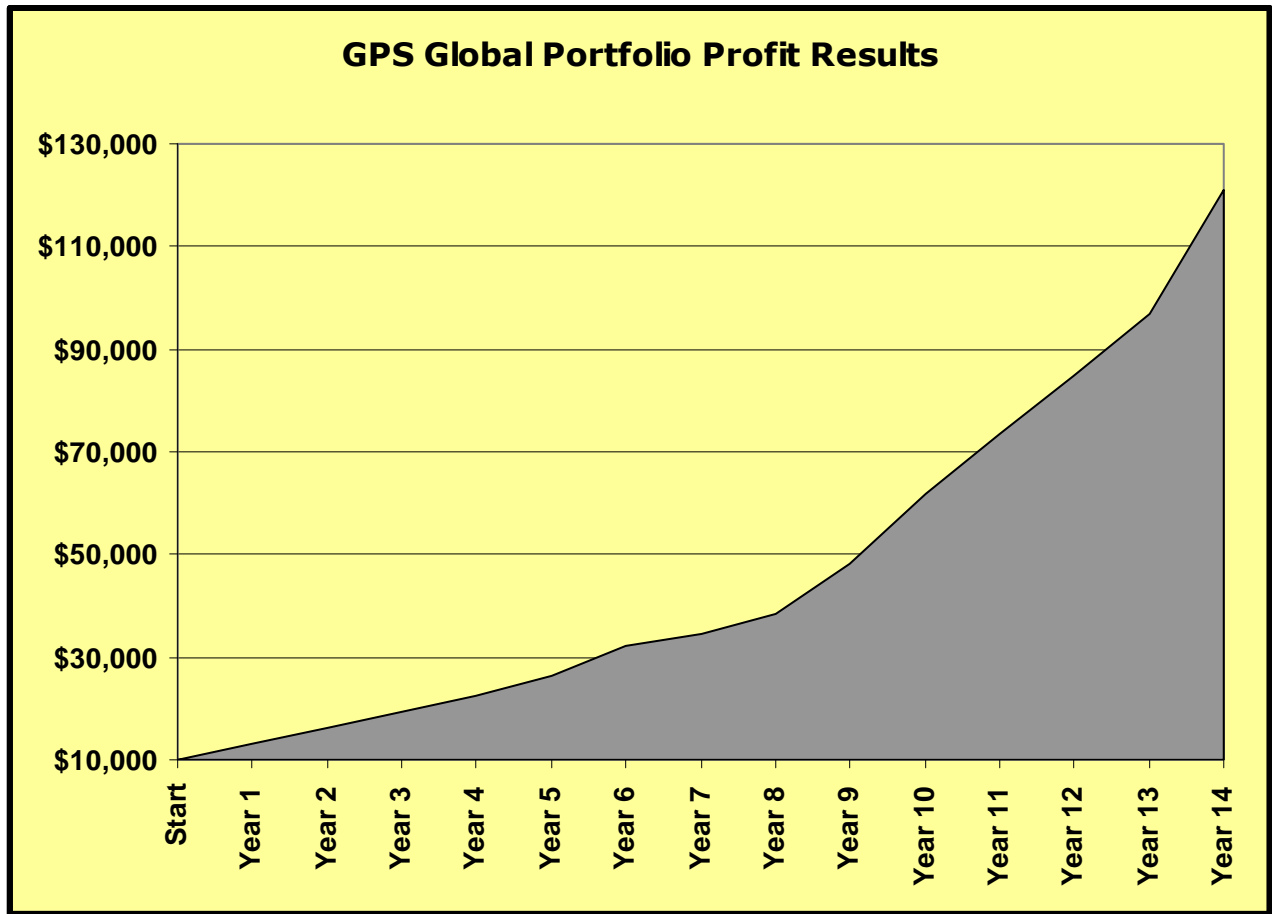
Crude Oil		Euro Currency
MSCI Emerging Market Index		20-Year Treasury Bonds
iShares Latin America		MSCI Brazil
iShares Europe		S&P 500 Index

The historical profit results that follow were conducted over a recent 14 year period (or ETF inception). Results are based on an initial investment of \$10,000 divided equally among the eight global markets and compounding the results thereafter and do not include commissions. The historical results do not reflect the use leverage or margin.

Major Trend System Global Portfolio Historical Results

Initial Investment	\$10,000
Number Years	13³/₄
Profit	\$111,031
Total Return	1,110%
Average Annual Return	80.7%
Percent Winning Trades	81.0%
Total Profits	\$113,549
Total Losses	\$2,518
Profit:Loss Ratio	45.1 to 1
Largest Losing Trade	-9.2%
Average Losing Trade	-3.2%

Major Trend System Global Portfolio Profit Results



Historical results reveal that the *GPS Major Trend System* produced impressive profits with very low risk. A \$10,000 investment grew to \$121,031 and after deducting the initial \$10,000 investment, the total profits were \$111,031 (before commissions) which equates to a 1,110% return on the initial \$10,000 investment.

Over the almost fourteen year test period this translates to an 80.7% average annual return. This is an excellent annual return for a system that does not use leverage or margin! Eighty-one percent of trades were profitable and all years were profitable.

\$45 of Profit for Each 1 Dollar of Loss

The system produced \$113,549 in total profits and only \$2,518 in total losses. Dividing the total profits by the total losses results in a Profit to Loss Ratio of 45.1 to 1. This translates to more than 45 dollars of profit for each 1 dollar of loss. As noted previously, the *Major Trend System* almost always exits a trade before a big loss occurs and provides you with the discipline necessary to become a successful trader.

These profit results demonstrate that the *Major Trend System* is a versatile, effective method for profiting from long or short trades in any type of market.

How a Market Crash Can Make You a Millionaire!

It could start with a terrorist attack or the collapse of a major bank or government-sponsored entity like Fannie Mae. Investors panic and start to sell from the opening bell.

By mid-morning, the NYSE has broken all records for volume as prices continue a downward spiral. Shortly after noon, hedge funds and money center banks start snapping up shares at what appears to be bargain prices.

But the respite is short lived. The selling continues and then intensifies as mutual funds dump stocks to meet redemption demands.

What started as a frenzy turns to a panic in the final hour of trading as investors rush to dump everything from blue chips to speculative small caps. The Dow ends the day down a wealth-shattering 3,289 points as investors lick their wounds and worry that this is just the start of something much bigger and more destabilizing than anything the country has ever seen.

For most investors it's the ultimate nightmare. . . But not for you . . . In fact, such a scenario could open the door to undreamed of riches. The key is to make use of the incredible leverage and limited risk of options.

The *GPS Option Strategy* allows you to make gigantic profits using a small amount of capital when prices rise. There's another strategy that could allow you to make more – much more – when prices fall.

This scenario may seem unlikely or remote but let's not forget that after the terrorist attacks of 9/11 and the ensuing bear market, the broad-based S&P 500 Stock Index lost 50% of its value. Then NASDAQ 100 Index lost a crushing 76% of its value. In the event of a national crisis the last thing you want to worry about is your (and your family's) financial security. Defending your portfolio and increasing your net worth at the same time can be accomplished by using what I call the 'Ideal Investment'.

'The Ideal Investment'

In my experience I have found option investing to be the most versatile and profitable way to invest today. You may think investing in options is too risky or too complicated but I am going to ask you to put aside all preconceived notions or opinions on option investing for a minute and let me demonstrate the benefits of option investing. When you purchase options there is no limit on your profit potential and at the same time your risk is limited to the purchase price of the option making options the 'ideal' investment. Many of you may be unfamiliar with option investing but you are about to learn that option investing provides big profit potential with limited risk.

Call Options

Buying a call option is a bullish strategy. If you buy a call option, the value of the call option will increase as the price of the underlying stock increases. Conversely, if the price of the underlying stock decreases then the value of the call option also decreases.

Value of Call Option Increases as the Price of Underlying Stock Increases

Once a call option is purchased it can be sold at any time prior to option expiration. When you purchase a call option the most you can lose is the purchase price of the option or premium regardless of how far the underlying stock drops in price.

Risk Is Limited to Purchase Price of Option

A major advantage of option purchases is 'truncated risk' whereby your loss is limited to your initial investment yet your profit potential is not limited.

Profit Potential of Call Option Purchases

The table on the following page lists actual call option prices in the Column labeled 'Option Price'. In order to demonstrate the profit potential of call option purchases let's assume we purchase the call options at the listed prices. The initial investment to purchase the call options for each example ranges between \$250 and \$625 with an average initial investment of \$497. Five to six months later this \$497 initial investment grows to an average of \$20,459 based on current prices which demonstrates the tremendous profit potential of option investing. Remember we are using actual option prices in our assumptions of the buy price and the current price. Let's take a closer look at the first example in the table on the following page which is Genentech a biotech company.

In this example, we will assume that 8 of the Genentech September 60-Strike call options were purchased. Purchasing the 60-Strike call option gives you the right to purchase 100 shares of Genentech stock at 60.00. The purchase price for this option was \$75 per contract on March 14th so the total cost to purchase 8 of the 60-Strike options was \$600 plus commission (8 X \$75 = \$600). One call option normally covers one hundred shares of stock so the 8 Genentech options controlled 800 shares of Genentech stock. Today is August 1st and Genentech stock has moved up in price to 91.09. As a result of the price increase in Genentech stock, the value of the 60-Strike option increased to 31.50 points or \$3,150. The total value for the 8 options purchased for \$600 increased to \$25,200 (8 X \$3,150 = \$25,200). In this example our initial \$600 investment grows to \$25,200 resulting in a \$24,600 open trade profit. Remember that our total risk to achieve this \$24,600 profit was only \$600 so I think you can start to understand why I think options are the ideal investment!

\$497 Grows to \$20,459 on Average

Underlying Stock	Option Strike	Number Contracts	Number Shares	Option Price	Total Cost	Grows To
Genentech	Sep 60.0	8	800	\$75	\$600	\$25,200
Ameritrade	Aug 12.5	15	1500	\$20	\$300	\$11,700
Valero Energy	Sep 70.0	7	700	\$70	\$490	\$16,940
Canadian Nat Res	Sep 60.0	6	600	\$75	\$450	\$11,400
Genentech	Sep 55.0	3	300	\$140	\$420	\$10,890
Google	Jan 300.0	5	500	\$125	\$625	\$62,750
Netflix	Sep 15.0	25	2500	\$20	\$500	\$18,500
Corning	Aug 12.5	20	2000	\$25	\$500	\$15,600
Southwest Enrg	Sep 35.0	7	700	\$80	\$560	\$15,330
KOS Pharma	Aug 50.0	8	800	\$75	\$600	\$22,320
Legg Mason	Nov 90.0	7	700	\$85	\$595	\$19,110
Google	Jan 290.0	3	300	\$170	\$510	\$40,590
Viropharma	Aug 7.5	10	1000	\$25	\$250	\$5,700
Great Atlantic Pac	Aug 17.5	8	800	\$70	\$560	\$10,400
Averages					\$497	\$20,459

Options Work Just as Well in a Down Market

Another way to harness the tremendous leverage available with option investing would be to purchase index or sector put options on your stock portfolio. Buying an index put option can help protect your stocks in the event of a price decline. For example, if you own large cap stocks buying an S&P 500 Index put option can help protect your large cap stocks in the event of a price decline. The value of the put option will increase as the price of the S&P 500 Index declines. If you own a portfolio of tech stocks, buying a NASDAQ 100 Index put option can help protect your tech stocks in the event of a price decline in the tech sector. Buying index put options on your stock is the equivalent of purchasing 'insurance' to help protect the value of your stocks.

What is a Put Option?

Simply stated a put option is a contract that gives you the right to sell a stock at a specified price which is called the 'strike price' on or before the expiration date of the option. The price you pay for an option is called the premium. Buying a put option is a bearish strategy. If you buy a put option, the value of the put option will increase as the price of the underlying stock decreases. Conversely, if the price of the underlying stock increases then the value of the put option decreases. Once a put option is purchased it can be sold at any time prior to option expiration. When you purchase a put option the most you can lose is the purchase price of the option or premium regardless of how far the underlying stock increases in price.

Buying a put option would produce results similar to 'shorting' a stock except for one important difference. When you buy a put option your risk is limited to the premium paid for the option. When you borrow stock and 'short' the stock your risk is not limited if the stock continues to increase in price. This can result in a 'margin call' that would require you to immediately add cash to your account or could result in your broker covering the short stock by buying the stock back at a loss. Also, when you borrow stock to short you must continue to pay the owner of the stock any dividends that are paid while you borrow the stock.

Recent Example

I own approximately \$596,000 of energy stocks such as Valero Energy, Encana, Tenaris, Marathon Oil, Peabody Energy and Southwestern Energy. I want to hedge my energy stock portfolio in the event the price of oil declines resulting in a price decrease in my energy stocks. I created a 'hedge' for a price decline in my energy stocks by purchasing a total of 117 XLE Energy Sector 51-Strike put options for .30 or \$30 each (see brokerage confirmations below). The XLE stock is an Exchange Traded Fund comprised of energy stocks. If the price of XLE stock declines then the value of the put options I purchased will increase thereby creating a profit for my put options. A profit in my put options can help offset losses in my energy stocks in the event of a price decline.

Activity	Quantity	Security Description	Price	Principal
You Bought	67.000	SPDR ENERGY SELECT SECTOR FUND OCT (2005) 51- PUT	0.30000	\$2,010.00
Account Type: Margin		XBTVY	Commission	60.25
			NET AMOUNT	\$2,070.25
ADDITIONAL INFORMATION		OPENING TRANSACTION As Agent for you we have sold or bought this security.		
BOUGHT PUT ENERGY SECTOR SPDR \$51 EXP 10/22/05 LONG TERM OPTION****	QUANTITY 50.00000		PRICE 0.30000	PRINCIPAL 1,500.00
SYMBOL	XBTVY	ACCOUNT TYPE	MARGIN	CHARGE/COMMISSION
SECURITY NUMBER	4085-987	TRADE DATE	09/30/05	72.50
UNSOLICITED		SETTLEMENT DATE	10/03/05	NET AMOUNT
MARKET PHILADELPHIA STOCK EXCHANGE				\$1,572.50
TRADE INFORMATION: OPENING TRANSACTION.				

Let me explain why I purchased 117 51-Strike put options. Buying a XLE 51-Strike put option gives me the right to sell 100 shares of XLE stock at 51.00. The value of 100 shares of XLE stock at 51.00 is \$5,100 ($51.00 \times 100 = 5,100$). If I own 117 51-Strike puts then the value of the underlying stock if I exercise the put options would be \$596,700 ($\$5,100 \times 117 = \$596,700$) and my energy stock portfolio would be hedged against a potential price decline in energy stocks. The \$596,700 value of this put option hedge is an approximation because the energy stocks I own do not exactly match the energy stocks that comprise the XLE Exchange Traded Fund. You can see from the preceding brokerage confirmations that the total cost to purchase the 117 put options was \$3,642.75 and includes commissions.

Using Leverage to Its Maximum Advantage

The XLE stock was trading at 53.60 when I purchased the 117 51-Strike put options. Let's assume XLE stock subsequently declines 20% to 42.88 after the purchase of the protective put options. The value of the 51-Strike put option would be 8.12 as the 51-Strike put would be 'in the money' with a stock price of 42.88 (51.00 strike minus 42.88 stock price = option value of 8.12). The value of the 117 put options would grow to \$95,004 (117 put options \times $\$812 = \$95,004$).

\$3,643 Investment Grows to \$95,004 with a 20% Price Decline

If XLE stock declines 30% to 37.52 then the value of the 51-Strike put option would be 13.48 and my 117 put options would have a value of \$157,716 (117 put options \times $\$1,348 = \$157,716$).

\$3,643 Investment Grows to \$157,716 with a 30% Price Decline

A 50% decline in XLE stock to 26.8 would increase the value of the 51-Strike put option to 24.20 points and my 117 put options would increase in value to \$283,140 (117 put options \times $\$2,420 = \$283,140$).

\$3,643 Investment Grows to \$283,140 with a 50% Price Decline

Keep in mind that regardless of the price movement of XLE stock my maximum risk for this trade is the \$3,643 cost of the put options. The \$3,643 cost to provide an 'insurance policy' to help protect against a price decline for a \$596,000 portfolio is very reasonable and demonstrates the versatility and practicality of option investing.

Buying stock index put options can produce enormous profits as was demonstrated in the previous example of my XLE put option purchase. Let's take a look at another example of purchasing index put options this time on the S&P 500 Index. The option table below contains actual S&P 500 Index option prices I downloaded from the CBOE website. The SPY SPDR is an ETF stock that tracks the S&P 500 Index. The SPY stock is currently trading at 126.09

SPY		126.09 -0.14			
Nov 29 (Data 20 Minutes Delayed)		Bid N/A	Ask N/A	Size N/AxN/A	Vol 51814300
Puts		Bid	Ask	Open Int	
06 Jan 108.0 (SWG MD-E)		0	0.10	1531	
06 Jan 109.0 (SWG ME-E)		0.05	0.10	488	
06 Jan 110.0 (SPY MF-E)		0.05	0.10	1524	
06 Jan 111.0 (SPY MG-E)		0.05	0.15	551	
06 Jan 112.0 (SPY MH-E)		0.10	0.15	670	
06 Jan 113.0 (SPY MI-E)		0.10	0.15	1565	

Let's focus on the Jan 110.0-Strike put option symbol SPY MF (circled). This option has an 'ask' price of .10 and a 'bid' price of .05. When purchasing an option we can expect to pay the ask price so this option could be purchased for .10 or \$10. If we were to invest \$5,000 in the SPY 110-Strike put option we could purchase 500 contracts ($\$5,000/\$10 = 500$).

\$5,000 Investment Produces \$1,082,000 Profit

Let's assume that due to a terror attack or a collapse of a major bank or similar incident there is a major stock market sell-off. As a result let's assume the S&P 500 Index drops 30% in value and the SPY ETF stock is trading at 88.26 after a 30% price decline. The value of the SPY 110-Put option would increase to 21.74 points or \$2,174 per contract (110-Strike minus current price of 88.26 = 21.74). The total value of the 500 put options we purchased would increase to \$1,087,000. Subtracting the \$5,000 cost to purchase the options from the current value of \$1,087,000 produces more than a one million dollar profit.

30% Decline = \$1,082,000 Profit on a \$5,000 Investment

If the SPY ETF dropped 50% in price to 63.04 the value of the 110-Strike put option would increase to 46.96 or \$4,696 (110-Strike - 63.04 = 46.96). The total value of the 500 put options we purchased would increase to \$2,348,000. This would produce a \$2,343,000 profit after subtracting the \$5,000 cost to purchase the options.

50% Decline = 2.3 Million Dollar Profit On a \$5,000 Investment

The Safest Way to Use Leverage

The preceding examples demonstrate the awesome profit potential made possible through the use of leverage. Purchasing options is the best way to multiply your profits. The preceding put option example using actual option prices demonstrated that a \$5,000 investment can produce more than a one million dollar profit.

Option purchases are also the safest way to use leverage. Your only risk is the price you paid for the options. In the event you experience adverse market moves you don't have to worry about receiving margin calls or the possibility that your broker will be forced to liquidate your investments at a loss. I think the preceding trade examples demonstrate once again that options are the ideal investment!

Inner Circle Advisory Service

Trade Selection Process Produces Average Return of 86.3% with 99% Winning Trades

I use a 3-Step trade selection process to make stock, ETF and option trade recommendations for my *Inner Circle Advisory Service*. Currently the *Inner Circle Advisory* has \$1,075,981.83 in open trade profits and an average return of 86.3%. There are currently 138 winning trades and one losing trade resulting in 99% winning trades.

Inner Circle Advisory Current Open Trade Profit Results

138 Winning Trades, 1 Losing Trade = 99% Accuracy

Portfolio	Profit/Loss	Percent	Winning	Losing
		Return	Trades	Trades
Stock Portfolio	\$191,397.40	78.6%	24	1
Dividend Portfolio	\$161,344.80	72.0%	24	0
Option Portfolio	\$104,315.00	95.5%	14	0
Option Spread Portfolio	\$62,238.00	45.8%	17	0
Buy Write Portfolio	\$150,739.27	63.8%	25	0
MHC Strategy	\$56,462.90	30.2%	17	0
Micro Cap Portfolio	\$349,484.46	218.0%	17	0
Total Profits/ Avg Return	\$1,075,981.83	86.3%	138	1

My trade selection process continues to produce excellent returns for my advisory service members. In January 2011 we closed out record monthly profits of \$107,318.00 with an average closed trade return of 45.2%. Over the past 18 months the advisory service has produced \$614,974.62 in closed trade profits with an average monthly return of 42.0%

Inner Circle Advisory Closed Trade Profit Results

Monthly	Profit	Percent
Profits	Loss	Return
January-2010	\$54,080.00	37.2%
February-2010	\$22,854.00	32.9%
March-2010	\$24,875.00	52.7%
April-2010	\$33,010.00	45.7%
May-2010	\$7,750.00	26.5%
June-2010	\$12,665.00	67.2%
July-2010	\$7,970.30	50.8%
August-2010	\$12,681.18	29.4%
September-2010	\$12,540.00	34.2%
October-2010	\$31,044.05	39.6%
November-2010	\$53,983.36	69.1%
December-2010	\$67,039.00	51.4%
January-2011	\$107,318.00	45.2%
February-2011	\$20,812.75	19.8%
March-2011	\$40,238.25	33.4%
April-2011	\$45,023.60	77.2%
May-2011	\$26,603.61	20.2%
June-2011	\$34,486.10	22.8%
Total Profits/ Avg Return	\$614,974.62	42.0%

If you would like more information on becoming a member of the *Inner Circle Advisory Service* please call Brad toll free at 866-661-5664 (310-647-5664) or log on to www.ChuckHughesIC.com

Option and stock investing involves risk and is not suitable for all investors. Only invest money you can afford to lose in stocks and options. Past performance does not guarantee future results. The trade entry and exit prices represent the price of the security at the time the recommendation was made. The Inner Circle Advisory trade record does not represent actual investment results. Trade examples are simulated and have certain limitations. Simulated results do not represent actual trading. Since the trades have not been executed, the results may have under or over compensated for the impact, if any, of certain market factors such as lack of liquidity. No representation is being made that any account will or is likely to achieve profit or losses similar to those shown.