ETF
Game Changer

Wendy Kirkland

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By

Wendy Kirkland

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ETF Game Changer (EGC)

An opening comment to all aspiring and experienced traders.

What if the perfect trade strategy landed right in your lap …

With the plan, training and system you need to make it a consistent, repeatable, and long-lasting success?

Guess what? This is it, keep reading.

The trade strategy you want:

- The one with known trade candidates… eliminating hunt and peck…
- The one you wake up excited and enthused to put into effect …
- The one that's not only fulfilling to trade but that is rewarding …
- Is waiting for you to stop wishing and jump in.

I've been involved in trading for almost 15 years – and in that time, I've seen many trade ideas come and go. During that same time period, I've discovered two tried and true trade patterns that work in any trade atmosphere. Patterns that don't change over time or only work in one specific trade situation. Patterns that sustain and grow a thriving trade account and help people around the world live more fulfilling and abundant lives.

To me, there's nothing better in the world.

Here's where you come in – I will supply the plan, training, and trade candidates.

This is especially for you if you've ever had a desire to trade or have said anything like:

- *"I really wish I had the ability to trade."*
- *"Others can do it, but their circumstances must be different than mine."*
- *"I'm tired of just existing - I want to make a positive change to my finances."*
- *"I'm grateful for my paycheck, but what I really want is to do is control my own financial future."*

Now, I'm sure I don't have to tell you that learning to trade isn't something to take lightly, so - only if you're serious about this - I am excited to share this opportunity in more detail with you.

Let's get started.

Before we get into what type of equity we will trade, let's discuss the vehicle we will drive to reach our destination.

Calls and Puts - The Two Types of Options

There are two types of options (Calls and Puts). The official definition is outlined below. (Don't cringe just yet, I will explain in understandable terms).

- **Call Options** give the buyer (you) the right to require the grantor to sell the equity to them at the agreed price on or before an agreed-upon time. (If the grantor agrees to sell to you for $90, it doesn't matter that the equity is now worth $100, he must sell it to you for the agreed-upon price. This happens behind the scenes at the stock exchange - you buy from him for $90 and sell for $100 and earn the difference.)

- **Put Options** give the buyer (you) the right to require the grantor to buy the equity from them at the agreed price on or before an agreed-upon time. (If the grantor agrees to buy the equity from you for $90, it doesn't matter that the equity is now only worth $80, he must buy it from you at the agreed-upon price. This happens behind the scenes at the exchange - you buy it for $80 and sell to him for $90 and earn the difference.)

As mentioned, Call Options are contracts that give the owner (you) the right, but not the obligation, to buy a specified number of shares of an equity at a specified price, called the **strike price**, on or before a specified date, called the **expiration date**.

Call Options are purchased when you expect the price of the underlying equity to go up.

To clearly explain how options work and the benefits, I tossed around a lot of items I might use in my explanation - a new TV, a collector Wolverine comic book, a sold-out X-Box game, baseball card collection. I'm sure you get the idea. I decided on my dream car.

Let's say, I had a friend who was interested in selling a well-used 1966 first-generation Ford Mustang Fastback stored in a garage behind his house. He had begun restoring it, but lost interest along the way. He wasn't in any hurry to sell but wanted $20,000 for the car.

I was definitely interested but wasn't ready to come up with $20,000, so I proposed purchasing or paying for an option to buy the car at a later date.

The option was ... I would pay him $500 to let me purchase the car any time over the next 6 months for $20,000.

Four months later at a car show, I learned that the value of vintage Mustangs had gone up when I met a man, who desperately wanted to purchase a 1966 Mustang, and he was willing to pay $25,000 for a vehicle in any condition.

I was able to purchase my friend's car and sell it to the collector all in one transaction.

The end result was this. My friend was pleased to have received $20,000 for his car,

plus the $500 I paid for the option to buy the vehicle. The collector was excited to have bought a highly valued Mustang for $25,000, and I made $5,000, less the $500 I paid for the option and the $20 fee paid to transfer the title, on my option to buy and sell an equity that went up in value.

This simple illustration shows how I controlled what happened to the Mustang, a $20,000 equity for six months for a fraction of the cost ($500). In this case, the value went up, giving me the right to purchase it at the agreed-upon price and selling it for the increased value, pocketing the difference.

Put Options are contracts that give the owner (you) the right, but not the obligation, to sell a specified number of shares of an equity at a specified price, the *strike price*, on or before a specified date, the *expiration date*.

Put options are purchased when the price of the underlying equity is expected to go down.

When you decide to buy a Put option, you are betting that the value of the equity will go down. Put options can be hard to wrap your brain around because it is contrary to everything you have been taught. Why would anyone want to purchase something that is going to drop in value?

In a sense, a Put option is like owning insurance where you know that you will be paid the previous value of a lost or damaged item that you do not yet own.

Intrigued? Read on...

Imagine you are in a big-box electronics store, and they are offering an unusual guarantee. They are offering a manufacturer's contract that says, if you are not satisfied with a particular name-brand plasma TV for any reason, they will buy it back for $2,500. Even though you haven't yet bought the TV, this guarantee strikes you as a valuable offer, a type of insurance, since you are interested in that particular TV anyway. In a sense, it is like buying replacement insurance at a set price before the sale.

You pay $75 for the $2,500 purchase guarantee contract. Later that week, you see a commercial for the exact TV that has just gone on sale for $2,000.00 at another branch of the store across town.

So, what do you do? You go to the branch store and purchase the $2,000 TV and return it to the store where you purchased the price guarantee. The store manager gives you the difference between the price you paid and the sale price - $500.00.

Put options work in the same way, except that the purchase and sale happen at the brokerage and all you see is the addition of $500 in your account. Your net profit is $500, less the $75 you paid for the guarantee and the gas (fees), it took to make the exchange.

From an option trader's perspective, all of this happens behind the scenes. You just simply log on to your online brokerage account and click the "buy-to-open" button and you have just purchased the option (Call or Put). Actually, your broker buys the option from someone else. When you are ready to sell, you click the "sell-to-close" button and you're done. The broker sells your option, handling the details of the transaction for you.

Pretty simple, right? Not so fast.

There are other trading aspects that must be understood, like which equities to buy options on and how to determine when they will increase or decrease in value.

Trade the Trend - Up or Down?

The "bulls" and "bears" concept becomes relevant here. In a bull market, when the overall market is going up, successful bullish option traders buy and sell Call Options. It is counterproductive to go against the flow of the market, or, to express this concept another way, it doesn't make sense to ignore the upward bias of the market.

Likewise, in a bear market, when the overall market is trending to lower equity prices, then successful bearish option traders consider purchasing and selling Put Options.

I'll confine our discussion to Call Options and, other than general information, will save an in-depth look at Put Options for another time.

Remember: You are buying and selling options to buy and sell an equity, but you don't have to exercise that option. In other words, you will not own shares of the equities on which you purchase options unless that is what you choose. Most option traders buy and sell their option contracts without the intention of ever owning the equity itself. It is the option itself that has the most value. I'll explain this leverage more fully over the next few pages.

The **strike price** is the agreed-upon price for which the underlying equity will be sold or bought if the option is exercised.

(Keep reading, because the chart that appears soon will start to clarify this).

As said, you're purchasing options on what is called the **underlying instrument**, referred to as the **underlying equity**. In the context of this book, the underlying is an equity, an Exchange Traded Fund (ETF). These terms will be explained shortly. I refer to this group as equities.

The underlying is identified by its symbol. On the financial news crawls on the TV stations, such as CNBC, you see the symbols "crawling" past. Financial newspapers such as the *Wall Street Journal* or *Investor's Business Daily* also identify equities by their symbols. For example, MasterCard's symbol is MA, Apple's symbol is AAPL, Wal-Mart = WMT, Walgreens = WAG, Proctor & Gamble = PG, NFLX = Netflix, S = Sprint, and so on.

ETFs also have symbols - XLE = Energy sector ETF; XLK = Technology sector ETF; GLD = Gold ETF; SPY = S&P Index ETF.

Often the number of letters in the symbol tells you which exchange the equity trades on:

- One, two, or three letters usually means it is a Dow Jones stock, listed on either the New York Stock Exchange (NYSE) or the American Stock Exchange (AMEX).
- Four or five letters in its symbols usually means it is a NASDAQ stock.

There are a few exceptions to this rule. One of which is the QQQ (ETF for NASDAQ 100), which actually changed from 4 Q's in March of 2011. (I think they made the change just to confuse traders. What is a rule without an exception, right?)

By putting all the parts together, you complete the definition of an option.

So, let's look at XLE Oct 2017 64 Call:

This is a Call option to buy the XLE – S&P Energy Sector ETF (the underlying equity) at a price of $64 per contract (the strike price) at any time through the October expiration date in 2017. The monthly expiration date is always the third Friday of the expiration month.

Remember that, even though you have the right to exercise your option to buy the actual XLE equity, you don't have to. Most option traders simply trade on the options, not the equities themselves.

The Journey Begins

I know firsthand that the easiest way to begin the journey into option trading is to approach it as you would a world of its own that gives up its secrets one at a time. Many people, even those who trade stocks regularly, consider the stock market itself a big mystery, an enigma, which is why I think it's the best place to begin. What's actually behind the symbols and numbers you see on the crawls at the bottom of the TV screen or in the columns of fine print you see in the newspaper?

To reduce the stock market to its simplest terms, the best image I can come up with is our family's former gift store, a place where buyers and sellers come together to make exchanges. A shopping exchange—or transaction—where goods are offered at prices people are willing to pay and the stock exchange as a whole have much in common. The difference is that exchanges, or transactions, on the stock market are less tangible, and the perceived value of an equity often has little to do with actual worth. No matter, the concept of an exchange remains the same.

As you incorporate the aspects involved in the stock market one at a time, it starts to feel as familiar and comfortable as a retail gift store that you owned for 25 years. But, you don't have to leave the house to conduct your business. Your trading experiences

take place conveniently on the internet.

The Market - A Living Entity?

It is easy to feel overwhelmed if you allow yourself to think of the stock market as an abstract and baffling concept. I found it helpful to think of the market as a living being. Instead of thinking of it as being comprised of mathematical equations, it's made up of companies (including their stock and its products/services, employees and associates) that move around in groups. As a living entity, the market inhales, or contracts, and exhales, or expands, and at times it holds its breath. Said in other ways:

- During times of expansion, the market increases in value or "puts on weight" and prices go up.
- During times of contraction, its value (weight) goes down as if "losing weight" and prices drop.
- When the market holds its breath, it maintains its value or weight, and moves sideways.

You might wonder, what brings on fluctuations in the markets? Simply said, while buyers and sellers come to an agreement on price, they do not always agree on value. When it comes to equities, a trade takes place when one buyer is eager to sell an equity at the same time another buyer wants to make a purchase. Quite often, when or after an equity drops in price, a trader is anxious to get rid of the equity, while another trader sees the lower price as an opportunity to purchase an undervalued equity at a bargain price.

Value versus price is subjective. One company's stock price may trade at sixteen times its annual earnings and will be considered undervalued with room to grow. Another company's stock may trade at eight times its earnings and will be considered overpriced and at its peak. There are other influences that illustrate this difference in evaluation. An analyst group (Goldman Sachs, for example) may upgrade a stock based on their expectation of future earnings for that company and the next day, the stock's price will soar. Nothing has actually changed to bring about this increase in value, except an expectation, a belief that good things are apt to happen. If this hope is not realized, the stock will drop back to its actual worth, or even below that level for a time, until the next event. A company's reported earnings may disappoint analysts and traders, but, if the company's outlook for the coming quarter is encouraging, the stock may still rally into the next quarter. Value and price are separate concepts.

Trading options on ETFs eliminates some of the subjective value in stocks themselves, and this is one of their advantages that I will explain in a moment.

Stocks = A Share of the Action

Today's exchanges offer any number of investment choices—specific methods or vehicles through which you put money to use to make profits, earn interest, preserve

value, create portfolio growth, and so forth. Wall Street and the stock market is where individual investors (people and companies) own a share of the action and own a share of the risk, too. Ownership is measured in increments or units called *stocks*. When companies sell shares of stock, they are selling a small portion of ownership in that business or conglomerate of businesses.

Exchanged Traded Funds (ETFs), our preferred trading vehicle for this strategy, is the equity that purchases the stock or equity shares. We, the trader, by purchasing or trading based on the ETF are getting a basket of shares held by the ETF. In a sense, we are getting instant diversification.

The ETF might be comprised of a basket of health care stocks: medical providers, hospitals, medical supplies, billing companies, labs, insurance companies, research. Or the ETF might be a basket of building related companies, restaurant, biotech, retailers, precious metals, index-held companies, Big Caps, telecommunication companies, etc.

When you buy 100 shares of stock of one of the major U.S. corporations, such as Apple (AAPL) or Taco Bell (YUM) or Nike (NKE), you are a shareholder. For as long as you hold the stock, the value of your *portfolio*, defined as your investments, regardless of type, gains or loses value as the price of that stock or equity goes up and down. If you paid $25 per share and a year later, your stock traded at $35 per share, your portfolio value has increased by $1,000. If the stock is trading at $20 a share, then your portfolio is $500 lighter.

It is the same with ETFs. The equity will gain or lose value, but on a smaller scale because it is not comprised of just one company's earnings and growth, but many companies or equities. One company's loss may be offset by another company's gain.

Many well-established stocks pay their investors *dividends*, which is the way they distribute the profits. If your 100 shares of stock (which for discussion sake I'll say is priced at $50) pay a $2 dividend per share, then every quarter, you will receive $200, which you can reinvest or take as income.

ETFs do not pay dividends, but their value can be affected to a very small degree by the payment of dividends by the companies with which it is comprised.

Please understand these are basic definitions and provide the structure and function of stocks. The way stocks work in the everyday world of the stock exchange is a more complex issue. For example, if I'm limited to studying and choosing among, let's say, 50 companies, then I could keep track of what companies are profitable and which are going out of business, and who is merging with whom, and so forth. But, in the U.S. alone, thousands of companies sell shares of their stock, and the profitability of these companies is influenced by factors that no one individual or event can control. That's why financial services companies, including brokerage firms, hire analysts whose job involves watching trends and using complex formulas to determine short- and long-term profitability.

Before long, you will have the resources at your disposal to be able to determine these trends and evaluate the potential movement of specific stocks or other equities for yourself. Your short-list is made even easier by focusing your attention on prime, solid

ETFs versus the wide-world of thousands of stocks.

Bullish or Bearish

If Google or some other major industry comes to your town and brings new jobs and adds money to the economy, then, chances are, the other businesses in your area will experience an increase in business. If your town loses a major employer, the other local businesses may report a decrease in business because less money is circulating.

So, too, economic trends influence Wall Street, and stocks have a herd effect, so to speak. When economic trends are on the rise, and equities are increasing in value because investors are confident in the economic future of the market, then we're said to be in a **bull market**, or traders are said to be bullish.

On the other hand, in times of great economic distress or uncertainty, or a dramatic event makes the market "jittery," then stocks may decline in value and analysts say we're in a **bear market,** or traders are bearish.

Stocks rise and fall on a daily basis, and you don't assign the terms "bull" or "bear" based on one day or a week's performance. The terms are relative, as well. The market can be "bearish" for a period of time when other economic forecasts seem uncertain. Likewise, the market can turn "bullish" when certain indicators point to economic expansion. (These indicators and trends are a study in themselves, but for now, the general definitions will do).

A great many other terms are part of the language of the broad and specialized world of option trading and investing as a whole, but, for now, these basic definitions are enough "material" to begin understanding where option trading fits into the big picture.

ETFs function and flow from bullish to bearish and back again. Based on the unique advantage of ETFs, you will always find a number of ETFs moving in both directions at the same time. If, by the time you finish reading this manual, you feel more comfortable with long (Call) trades, you will be able to zero in on ETFs that are bullish and may have been bearish during the previous six months. This cyclical rotation of strength is a natural part of the market flow, similar to a tide. High tide and low tide come in routine flow, so that you will be able to trade Calls and Puts, or just concentrate on ETFs that are bullish in the current trading atmosphere or cycle.

Trade Expectations

I repeat, first and foremost, options are vehicles you buy and sell to take part in the exchange of equities. An option is defined as the right, but not the obligation, to buy or sell an "equity" at a certain price before a certain expiration date. (For our purpose, ETFs are the equities).

There are options in many different arenas where option trading is carried out, including exchange-traded funds (ETFs), stocks, indexes, future-contracts, commodities, securities, and so forth. However, you don't need to concern yourself with all the possible areas in which you can trade options. We'll keep the discussion to ETFs

(Exchange Traded Funds). In general, we refer to them as equities.

You can achieve significant short-term profits on the money you invest in option contracts. You profit by purchasing option contracts, Calls and Puts, with the express intention of selling the contract after the equity has moved in price, either up, as with Calls, or down, as with Puts, and you sell well before the option's expiration date.

When you purchase an unripe banana on the produce aisle of the grocery store, you know the banana still has time before it has to be eaten. In terms of options, the idea is to sell the banana before it becomes yellow with brown spots, soft and ready to expire.

By using most option trading strategies, you never exercise your option to buy the underlying equity. Your goal is to hold the option long enough for the price of the equity to increase in the case of a Call Option or decrease in price in the case of a Put Option. You don't intend to exercise the option to buy the underlying equity.

You never eat the ripening banana, but someone else will want to make banana nut bread, and that's its value.

Option Premiums

The **option premium** is the amount you pay to control the underlying equity. This option premium increases in a magnified way when compared with the underlying equity price. As the equity's price goes up, your option increases in value, and then you sell your option to someone else well before the expiration date. In that way, you trade the options, but never actually buy or sell the underlying ETF equity.

Try to remember these two crucial points:

1. As an option trader, you make money by purchasing the "right" to buy or sell a "thing," and that right in itself has value and gives you the trader, leveraging power.

2. You never need to worry about finding an interested buyer; through the option contract itself, the sale is guaranteed the moment that you decide to sell, providing you have purchased an option with a level of open interest. (This will be explained and covered in greater detail).

Most of us are accustomed to thinking of the stock market as an exchange, a "shopping mall," in which you buy and own actual shares of stock, and then decide to sell for various reasons. Therefore, it sometimes requires a new mindset to fully appreciate the value of an "option." The deal I managed on the Mustang— $5000 profit in four months—probably sounds pretty good. Let's see what it would look like with an ETF option.

The Power of Leverage: The Accelerated Growth Aspect of Option Trading

If you buy an option on an ETF, you can think of the option as a down payment on that equity. Imagine purchasing an option on 100 shares of the S&P Industrial Sector ETF

(XLI) to control the financial power of those 100 shares of the ETF, which is comprised of companies, like Deere & Co, Caterpillar, Boeing, and Lockheed Martin.

To make this even more clear, let's compare a stock purchase to an option purchase:

- If the Industrial Sector ETF (XLI) price is $75 per share, 100 shares of the actual ETF would cost $7,500. If next month, the price goes up $2, and you sell the shares, you have a profit of $200 on your 100 shares. Your profit is 2.7%.
- But, if you buy a Call Option on those same 100 shares of XLI ETF, you will pay approximately $3.10 per share, or $310 for 100 shares. (This is a good estimate, but the actual option prices vary greatly.) This $310 controls all 100 shares of XLI.
- If XLI's price goes up $2, your option may also go up $2. (This, too, varies according to the underlying option). This $2 increase, or $200 profit, is 67% of the initial $310 you paid for the option.
- Using the leverage of options, you've made 67% profit on the same underlying equity (ETF) that only realized (gained) a 2.7% profit when the actual ETF shares were sold.
- Owning the actual shares would cost you $7,500 for the 100 shares, and your gain would only be $200.
- In purchasing the option contract, you only spent $310 dollars buying the option and were still able to make a $200 dollar profit.

It is evident that options provide traders with two benefits:

1. You can begin trading with a small amount of money
2. You can turn a high percentage of profit.

It is unlikely that you would choose to invest $7,500 in an option trade, but to illustrate the leverage of options, let's pretend. At $310 per 100-share contract, you would have been able to purchase 24 option contracts for a total investment of $7,440, controlling 2,400 shares of XLI. Had the shares gone up the same $2 in our previous example, you would have gained $4,800. (2,400 shares x $2 = $4,800, or 24 contracts x $200 profit = $4,800)

This illustrates the Power of Options. For the same investment when compared to the purchase of stock, you are working with the leverage of options. You have an option gain of $4,800 (65%) versus a $200 stock gain (2.7%).

Without investing large amounts like $7,500, as you begin to practice trading, your confidence increases, and you can earn even greater profits. With careful, precise trading, a $200 profit can become $400, $400 can become $800 and before long a trading account will increase, showing exponential or "compounded" profit.

Which Option Should I Buy?

This is one of the first questions new option traders ask. Everyone wants to know how to decide what options to buy. The obvious answer is to only purchase options that are expected to achieve a substantial return on your investment.

And how do you know that? Once you understand the principles of option trading, then it's time to learn how to carefully consider the underlying equity upon which the option is based. I'll get to that a little later (I promise). I'll provide a complete discussion about a method to select great underlying ETF equities. Clearly, that's the heart of the matter.

Option Choices

Once you've decided to purchase a Call Option on an equity, you also have the choice to buy In-the-money (ITM), At-the-money (ATM), or Out-of-the-money (OTM) options. (You have these same choices on Put Options, and we'll discuss this later).

In-the-money is the amount by which the price of the underlying equity exceeds the strike price.

Let's say, S&P Cyclical Sector ETF (XLY)'s price is $96.04. You decide on a Strike Price of $95, with an October expiration date. The option contract would read: XLY Oct 2017 95 Call.

This October option is $1.04 "in-the-money", which is the difference between the equity price ($96.04) and the strike price ($95). The 95 in the contract name is the strike price of $95, and the expiration date is the third Friday in October 2017. Again, the expiration is always the third Friday of the expiration month.

At-the-money is the amount when the price of the underlying equity matches the strike price, or nearly so. For example, XLY's price is $94.98. You choose a Strike Price of $95. The option contract would read: XLY Oct 2017 95 Call

This October 2017 option is at-the-money, since the strike price ($95) nearly matches the equity price ($94.98).

Out-of-the-money is the amount by which the price of the underlying equity is below the strike price. For example, XLY's price is $88.43. You choose a Strike Price of $90, so the option contract would read: XLY Oct 2017 90 Call.

This option is $1.57 out-of-the-money, since the equity price ($88.43) is below the strike price ($90).

This terminology may seem to indicate that the strike price moves, but that's not so. When someone says the strike price has moved from out-of-the-money to in-the-money, it is actually the equity's price that has moved. The strike price remains constant, consistent with the price of the option purchased. The XLY Oct 2017 95 Call remains a $95 Call Option no matter if XLI's equity price moves above or below $95.

All options available to purchase, whether they are in-, at-, or out-of-the-money, are listed on an option chain.

Please don't worry about over-analyzing the option chain. I just want you to begin to grasp the terminology and to recognize the appearance of these tables and charts. I will cover the specifics and uses of this table as you go along.

The option chain below is for an earlier period in July 2017.

Last	Chg	Bid	Ask	Vol	OpInt	Action	Strike	Last	Chg	Bid	Ask	Vol	OpInt	Action
Aug17 Calls						(34 days to expiration)		XLY @ 90.19						Aug17 Puts
0	0	10.20	10.20	00	0	Trade | Detail	80.00	0.17	0	0.07	0.07	00	6	Trade | Detail
0	0	8.75	8.75	00	0	Trade | Detail	81.00	0.17	0	0.02	0.02	00	40	Trade | Detail
0	0	8.05	8.05	00	0	Trade | Detail	82.00	0.17	0	0.09	0.09	00	127	Trade | Detail
6.65	0	7.25	7.25	00	2	Trade | Detail	83.00	0.23	0	0.07	0.07	00	25	Trade | Detail
0	0	6.15	6.15	00	0	Trade | Detail	84.00	0.23	0	0.14	0.14	00	39	Trade | Detail
0	0	5.10	5.10	00	0	Trade | Detail	85.00	0.23	0	0.17	0.17	00	65	Trade | Detail
4.00	0	4.40	4.40	00	0	Trade | Detail	86.00	0.31	0	0.22	0.22	00	16	Trade | Detail
3.17	0	3.50	3.50	00	2	Trade | Detail	87.00	0.43	0	0.30	0.30	00	43	Trade | Detail
2.54	0	2.52	2.52	00	16	Trade | Detail	88.00	0.53	0	0.43	0.43	00	704	Trade | Detail
1.78	0	1.78	1.78	00	31	Trade | Detail	89.00	0.70	0	0.66	0.66	00	2,396	Trade | Detail
1.32	0	1.26	1.26	00	2,403	Trade | Detail	90.00	1.06	0	0.96	0.96	00	205	Trade | Detail
0.72	0	0.66	0.66	00	476	Trade | Detail	91.00	1.76	0	1.36	1.36	00	15	Trade | Detail
0.42	0	0.29	0.29	00	43	Trade | Detail	92.00	0	0	2.04	2.04	00	0	Trade | Detail
0.18	0	0.13	0.13	00	48	Trade | Detail	93.00	3.91	0	2.87	2.87	00	26	Trade | Detail
0.12	0	0.02	0.02	00	60	Trade | Detail	94.00	0	0	3.70	3.70	00	0	Trade | Detail
0.05	0	0.02	0.02	00	40	Trade | Detail	95.00	0	0	4.55	4.55	00	0	Trade | Detail
0.03	0	0	0	00	16	Trade | Detail	96.00	0	0	5.55	5.55	00	0	Trade | Detail
0.07	0	0	0	00	4	Trade | Detail	97.00	0	0	6.50	6.50	00	0	Trade | Detail
0	0	0	0	00	0	Trade | Detail	98.00	0	0	7.40	7.40	00	0	Trade | Detail

Courtesy of OptionsXpress.com *Fig. 1*

You can see that the strike price runs down through the middle of the chart. The 90.00 strike price would be in-the-money on this option chain chart by .19, since the last equity's price was 90.19 (shown at the top of the chart). And the 91.00 strike price is out of the money by .81. The shaded sections of the chain represent the strike prices that are in-the-money. Call options are listed on the left side of the chain, and Put options are on the right.

Ask is the price market-makers are asking for the option when you buy, and **Bid** is the price they are offering when you are ready to sell.

Take a deep breath. This and the information that follows may seem like a lot to take in all at once, and it may even seem like a foreign language. In a sense, it is, but in a short time you will be able to appraise the information given in all these charts, tables, and graphs as quickly and easily as scanning the speedometer and other gauges on your car.

Remember, I'll always provide examples to illustrate, so read through the definitions, and don't be concerned if you don't yet grasp the full meaning.

An option's complete **price,** or **premium,** is comprised of two things - **intrinsic value** and **time value** - that are then shadowed by another aspect, **volatility**.

Intrinsic value is the in-the-money value, the price of the equity less its strike price. (Out-of-the-money options have an intrinsic value of zero.)

The **time value** of an option's price decreases as time passes. Out-of-the-money options are comprised entirely of time value, while a deeply in-the-money option is comprised almost entirely of intrinsic value. Another name for time value is **extrinsic value.**

Here's an example in easy to understand terms. Let's think of a quart of milk purchased from the grocery store.

- The milk itself has intrinsic value, and the longer the time left before it reaches its sell date, the more time value it has. The combination of these two factors make up an option's full value (intrinsic and extrinsic [time] value).
- As the milk closes in on its sell-by-date, its time value decreases, until at expiration, it has zero time value and maintains only the intrinsic value of the milk itself.

Here's a quick look at the math. For our purposes, I'll use numbers that are easy to add and subtract.

An option's premium - the amount needed to purchase it - is always comprised of its intrinsic value and its time value. If a $60 strike price for a Call on Consumer Staples (XLP) costs $10 when XLF's equity's price is at $68, the intrinsic value of the equity is $8; therefore, its time value must be $2.

Equity price of $68 – $60 (strike price) = $8 (intrinsic) + $2 (time value) = $10 (premium)

Time value represents the price charged for time from the present day of purchase to the date of the associated option's expiration. For example, the cost of an XLY's Dec 99 Call will be more than the cost of an XLY Oct 99 Call. In the case of the Dec 99 Call, the cost is more because of the added benefit of having two additional months until expiration. (Chart above was for October week 2 strike expirations.)

There are weekly expirations and monthly expirations.

As mentioned earlier, monthly expirations expire on the 3rd Friday of the expiration month. Weekly options expire on the Friday of the listed week. October week 2 would expire on the 2nd Friday in October. October week 4 would expire on the 4th Friday in October.

Why consider paying for two extra months? What are the probabilities involved in price changes in the underlying equity? Is it more likely that the equity's price will move $2 in one month or in three months?

Since an option premium's change is largely driven by the change in the underlying equity price (affecting an option's intrinsic value), having more time for the change to happen will be to your advantage, and you would expect to pay a higher premium for the benefit of added time.

Depending on the strategy that you choose to use in your trading will determine the proper expiration to choose for that strategy. A long-term strategy will require more time for a trade to play out, where a day-trading or short-term trading strategy will require less time for the trade to become profitable.

Volatility is a "shadowing effect" that is the historical and implied volatility of an equity. Volatility in the stock market refers to the overall movement in the exchanges and the price of an equity as a function of time as compared with other issues. Historical volatility refers to the actual price movement over time in the past. An estimation of future price movement is also taken into account in the volatility component of option premium pricing and is referred to as **implied volatility**.

This math is not something that you need to figure out. It is incorporated within option chain pricing, but a general understanding is advantageous. For example, if an equity moves $1.30 in one day, it is more volatile than a stock that typically moves $1.30 in a week.

Equity price movement benefits from this higher volatility, so you must pay a higher premium for the associated option. This is why an option contract on one particular $80 equity might cost $3 per share, while an option contract on another $80 equity might cost $5 per share to purchase. The price is higher because the probability of premium appreciation within the lifespan of the option for the faster-moving underlying equity is higher. Your chance of making more money faster grows with higher volatility.

Here is a simple principle. The optimum time to purchase an option contract occurs while an equity is in a time of calm (low volatility) when the option premium is lower than it might be at other times, and then sell when it has increased in value and moves into a more cost-raising, high volatility period.

Additional Helpful Terms

Before you move on, here are a few more terms to absorb:

Option Contracts: Option contracts are always sold in lots controlling 100 shares of an equity. Two option contracts would control 200 shares of an equity, ten option contracts 1,000 shares.

Option Contract Symbols: Each option contract or option is given a specific and individual symbol code identifying it:

> *Underlying Equity Symbol + Expiration Month and Year + Strike Price*
>
> QQQ October 2017 140 Call or QQQ October 2017 140 Put
>
> Usually, abbreviated as: QQQ Oct17 140 Call or QQQ Oct17 140 Put

Okay, let's move on to some additional discussion of the stock market. (And, please do move on, even if some concepts aren't yet clear to you. I promise they soon will be).

Exchange Traded Funds (ETFs)

To understand how ETFs work, the best place to start is with something familiar, like a traditional mutual fund.

Imagine half a dozen investors, sitting at home, each trying to figure out the best way to invest in the stock market. They could each go out and buy a few stocks on their own, but who has the time or resources to manage a portfolio of 50 or 100 stocks?

Instead, they decide to band together. They pool all of their money and hire a professional investment manager to invest it for them.

To keep track of who invested what, each investor receives "shares," representing their stake in the total investment.

Because it's your money, you want to know how much your investment is worth… every day. So, every day, the mutual fund tallies up the value of everything it owns and divides it by the number of shares that exist. Whammo-presto: You know exactly what each share is worth.

If you want to buy more shares, you know the amount of cash to send the mutual fund for each share. If you want to sell shares, you know exactly how much cash to expect in return.

It's an elegant system, and mutual funds have existed for close to 100 years. They currently provide exposure to stocks, bonds, commodities and other assets.

But what about ETFs?

So, what is an ETF? Well, it's a mutual fund too. It's a pooled investment vehicle that offers diversified exposure to a particular area of the market. As explained earlier, the basket of company stocks or commodities has a theme in common - technology, medical, healthcare, precious metals, sector bonds, currencies or an index. Investors buy shares, which represent a proportional interest in the pooled, or basketed, assets.

It's a mutual fund in every aspect … except one. And that's a big one, which is hinted at in its very name - *exchange-traded* funds.

Being Exchange-Traded

As an **exchange-traded fund**, you buy shares in an ETF directly from any brokerage account. Just like you buy shares in a stock, you can enter a buy order in your online brokerage or IRA account and buy any ETF you want.

You can also do it *whenever* you want. Whereas orders to buy or sell a traditional mutual fund can be processed only once per day after the close of trading, ETF trades can take place any time the market is open. Purchasing option contracts on ETFs can also be placed any time during the day form 9:30 AM ET to 4:15 PM ET.

You can also perform all sorts of stock-like option strategies with ETFs that you never could with mutual funds - placing stop-loss, profit target, or limit orders.

That's just the beginning. The fact that ETFs are "exchange-traded" and purchasing options on them creates a series of other benefits that, according to many market observers, makes them a better overall choice than traditional mutual funds for many reasons - lower costs, better tax efficiency and more. Of course, in other situations, they can be worse - commissions, trading spreads and other risks, like time expiration. So, it is important to understand and be aware of all the elements so that you incorporate them within your trade plan.

ETF Advantages

Trading ETFs gives instant diversification since the underlying is a basket of equities and not dependent on the performance of just one company.

ETFs are the vehicle of choice of many institutional traders and mutual funds. They also give you the benefit of participating in sector rotation. This gives traders the opportunity to trade where there is either strength or weakness, depending on the desire to enter Calls or Puts.

We want to focus on popular ETFs with lots of volume and option open interest. If the volume isn't there, you will have a very wide bid-ask spread…and a wide bid-ask spread leads to what's known as slippage.

Let's look at an example.

The SPDR S&P 500 ETF (SPY) is one of the most heavily traded ETFs in existence. It's also indicative of what I like to see in a bid-ask spread. As you can see below, at each strike for both the Calls and Puts the bid-ask spread is at most $0.03 wide. Ideally, that's what we want to see.

This is important because, if you buy at the ask and sell at the bid (or vice versa), you only have to make up at most $0.03, or 1.5%, on a $2.00 option.

Let's say that the bid-ask spread was $0.25 wide on that same $2.00 option. Even though I would suggest setting a limit price in between the bid-ask, you would still have to make up $0.25 or 12.5%…and that's the best-case scenario.

In many cases, the bid-ask spread is upwards of $0.50 or more. Just think if you started already down 25% on a trade due to the bid-ask spread. It doesn't make sense, yet I can't tell you how many traders fall into this trap, especially when they are new to the game.

This strategy will outline specific requirements that must be met to consider a trade entry. An explanation and recap of these requirements will follow. For now, let's take this step-by-step and add a few other levels to your basic trade education.

Chart Reading – Our Most Valuable Tool

For many people, this stage, chart reading—the nitty-gritty of learning to trade and interpreting the price movement of a company—is also a stage that may cause fear to surface, at least to some degree. Specifically, I've noticed that too many people become fearful about "messing up." They usually feel this way because all the pieces of this particular riddle aren't in place yet. Even so, most people can be very hard on themselves. They've become programmed to expect a great deal from themselves,

even instant understanding and immediate perfection. These high expectations can lead to fear of making a mistake.

Please understand that if you're afraid to make a mistake, you're destined to interfere with the process that will ultimately make you a successful trader. Blame it on conditioning or the pressure so many people feel to "do it all." It seems this is a tough lesson for many would-be traders. Yet, far from being the end of the world, mistakes are your ticket to new understanding.

I've told this story several times and still feel strongly about its significance. Some time ago, my ten-year-old granddaughter Lauren (she is now 21, another milestone) stayed overnight with me, and when she got into bed, I sat with her so we could have a good talk before saying goodnight. She was at a great age, a time when she was primed to receive information that would help her build a strong and powerful self-image (now she is a young adult and knows it all).

Anyway, that day I asked her to tell me about something that used to be hard for her to do, but is easy now.

"Cheerleading," she immediately said, followed by riding a bike.

I kept prompting her to think of more things, and we got to writing stories and making pancakes.

I watched her eyes widen in wonder when I told her all the things she learned that she couldn't remember—rolling over, sitting up, crawling, walking, talking, holding a fork, making her bed, and on and on. I told her how each of those things had been hard for her in the beginning. She'd struggled and made mistakes, yet now she can do all of them easily, without giving them much thought. Because she was still a child, Lauren could accept that the same rules apply to all the new things she's learning. She was open to the idea that mistakes are teachers. It's as simple as that. Unlike so many adults, she didn't spend much time complaining and whining about mistakes either!

We can all apply these same principles. So, don't fear mistakes. Use them as feedback. So many innovators credit mistakes as attributing to their most worthwhile successes. Mistakes lead to greatness, but only if we stop judging them as negative. By the end of these next chapters, you will be able to read and interpret stock charts. You'll be able to practice trading without actually losing a dime. Some of your choices will be winners and some losers, but each choice will be a teacher, putting you on the path to leveraging your wealth to a higher level.

Charts Create a Picture of Price

The charts I am talking about learning to read are images that show price movement of an equity in various time frames. For educational purposes, we will focus on the daily time frame, but will take a peek at others just so that you realize that chart reading on one particular time frame is the same for all time-frame charts.

Once you begin to focus on a specific option trade strategy, it will guide you as to which time-frame chart is appropriate for that particular strategy. If it is one of my strategies, I will lay out exactly how to set up the charts needed to successfully trade that strategy.

If you've invested in stocks or have traded options or futures contracts, you're probably familiar with looking at charts and applying technical indicators to those charts in order to form an opinion as to the possible direction of prices. This process is referred to as **technical analysis.**

Technical analysis is very popular among traders and investors today, but another type of analysis that is somewhat useful when trading options is **fundamental analysis**. Although fundamental analysis can cover a wide range of topics, I concern myself primarily with the release of important government economic reports and company earnings reports, upgrades, downgrades and news press releases. If you're interested in these reports, there are many free websites available today that list the date and time of upcoming reports.

Many news releases are made public. We all know well in advance when Apple is going to reveal a new iPhone or when the next Samsung Galaxy phone or notebook is going to be released, or the release date of the latest game for X-box or Wii. Mattel starts its promotional campaigns well in advance for the "must-have" toy for the upcoming holiday season.

One helpful site that lists government economic reports is http://www.forexfactory.com.

The site lists a calendar of news reports. There is a filter in the right-hand corner that allows you to select the countries' information that you would like to view.

Basically, any government report that has the possibility of moving the market is worth knowing about. If you're not in a trade and there's a chance that the release of a certain report might affect your trade, you may want to hold off. On the other hand, if you're in a trade and a report is going to be released, you may want to close your position or at least place your stop at a price that will provide you with some protection should the news cause the market to move against you.

Getting into a trade based on report information should be an intentional choice, where the risks are taken into consideration.

Okay, back to chart reading. The image below is a basic daily candlestick chart. Each of the marks from left to right reflect the price activity for a 7.5-hour day trading period from 9:30 AM ET to 4:00 PM ET.

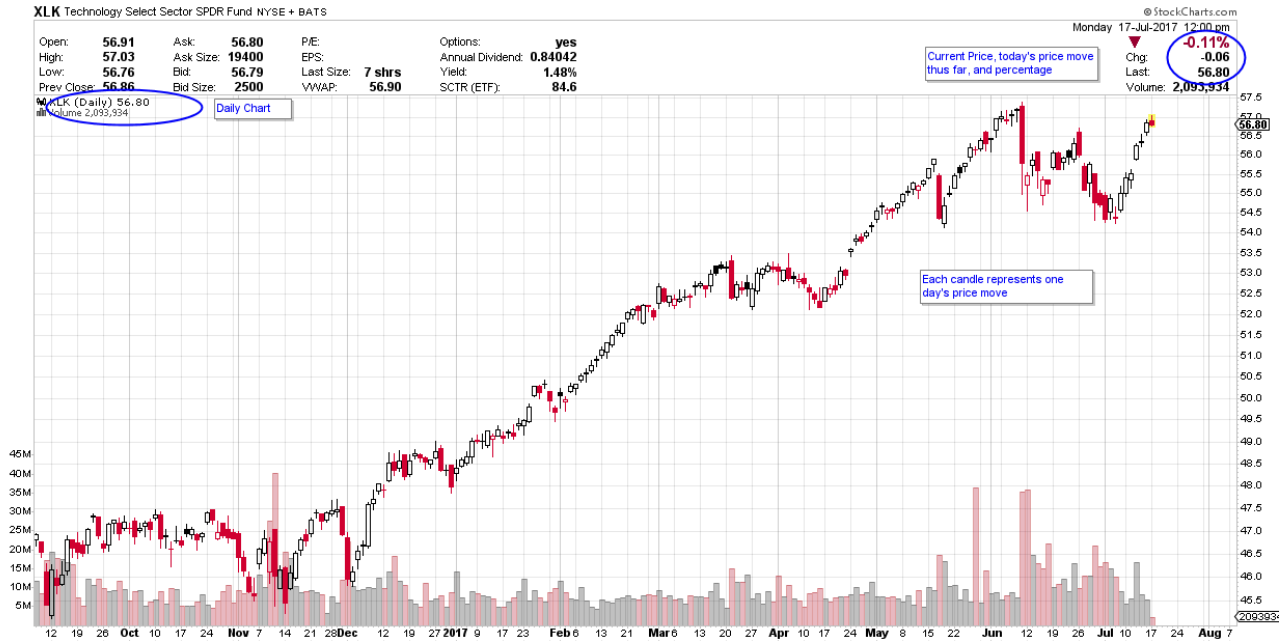


Chart Courtesy of Stockcharts.com *Fig. 2*

These technical indicators show where the equity is in its market cycle, and they explain what the chart says about the equity's price.

A chart is read from left to right. Furthest to the left goes back in time. The last candle on the right is the most current day's activity. The color and shape of the candles records what took place during the day. We will go over these details as we proceed.

Before we move on, allow your eyes to scan over the chart. Understanding that the numbers on the right side are prices, even a novice looking at a stock chart for the first time can pick out the times when XLP moved up in price and when it dropped or went sideways.

The point here is to ease your concern that this might be too complicated to learn. You have only studied the chart for a few minutes, and I have no doubt that you can see on the left side that XLF traded sideways from the middle of September to the middle of December. Then since December, it has risen approximately $10 in price from approximately 46 to 56, and then down a little to 55 and back up again.

Once I've explained the chart, gone over the details and individual indicators, you will put it all together, step by step. Try not to feel overwhelmed. I will explain and layer the information so that gradually it will begin to fall into place for you. Here are some facts to remember.

- As well as giving a picture of an individual equity, stock charts contain an abundance of information about what is happening in the overall market.
- Charts can be set up for a number of different time periods: daily, weekly, monthly, yearly, and much shorter periods of time, including hourly and minute-by-minute.
- Each chart creates a picture of the equity's position within the market as a whole, within sector ranking, and where it stands in its own life cycle.

Information that can be gleaned from the chart below includes the following:

- Daily highs and lows
- Open and closing prices
- Volume
- 9 months trading average
- Buying pressure and selling pressure

Additional information can be added to the chart. We will go slowly placing more and more detail on the chart.

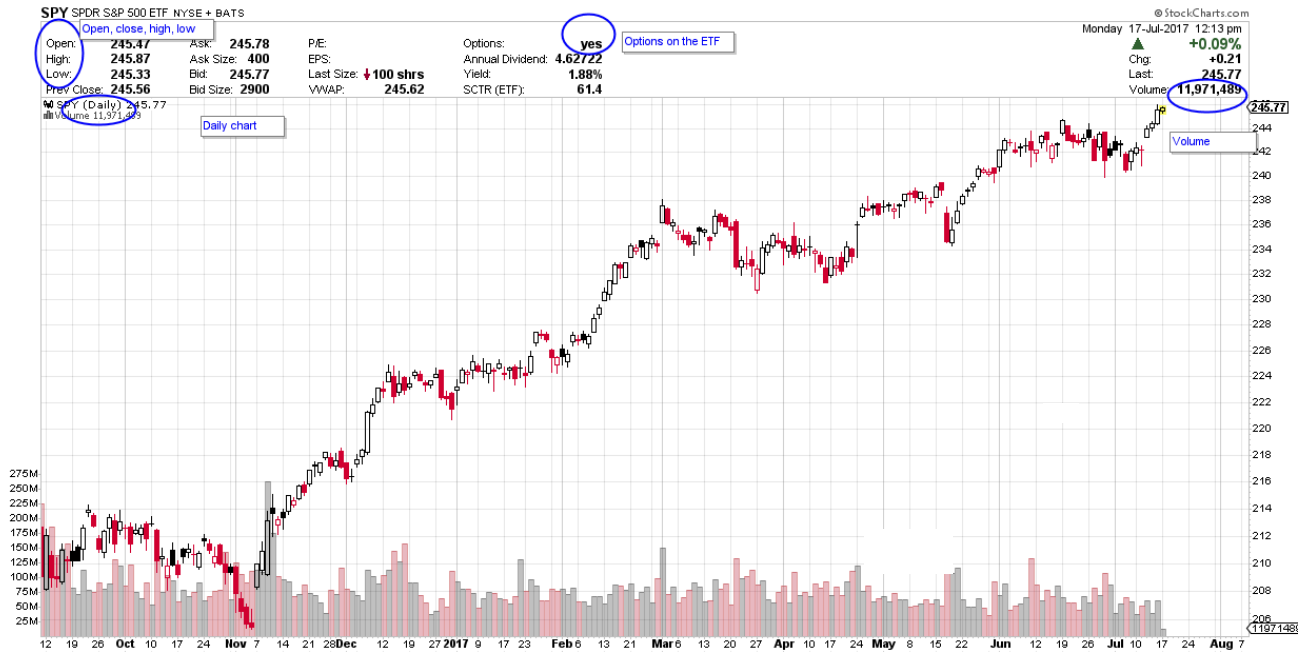


Chart Courtesy of Stockchart.com *Fig. 3*

As you read across the top of the Figure 3, it tells you to which ETF and exchange this chart refers. In this case, it is SPY, an ETF that holds shares of stock from companies within the S&P. Following the data across and then down on the left, you see the upper area also shows the date, the open, high, low, and closing price for the day, volume, and the change in dollars and percent that amount represents of the equity's total price.

There is additional information throughout the middle area that we won't address at the moment. No need to clutter our minds with details we won't be using.

Beneath this bar to the left, it tells you that this is a daily chart, and it repeats the closing price.

SPY's chart indicates that you are looking at a nine-month chart covering the ETF's price history over that period of time. The price scale is displayed on the right side of the chart. As you move your eye from right to left studying the candlesticks, you are moving from the most recent price information and journeying into the past.

Across the bottom of the main chart the bars show volume; usually two bars of different colors. In the chart you're studying, they are red and gray (though to you they are apt to be two shades of gray). Red (the lighter of the two) signifies the times when greater selling took place, while the gray (darker) bar shows a buying period, meaning more stock was bought than sold. Notice that the volume's color and size correspond to the candlesticks running through the middle of the chart that depict price.

You will also note that a large volume bar doesn't necessarily create a large price candle. If you look back and study the SPY's chart above for November 7th and 8th, there are two large buying volume candles where the 7th is a large candle with high volume, while on the 8th, there was a large range in price, up and down and seen in the long wicks at the top and bottom of the candle as the higher volume sent the ETF up and down in price.

Candlestick Stories

You will need to understand the **candlestick**, or **candle***,* which is an important technical symbol on charts in general. (See figure below.) They are designed to tell a concise story. You will see candles in red, black, and hollow.

- Candlesticks provide information about the average price of the underlying equity. They reflect the price action over the course of the market session for the time period selected (in our case, daily).
- If it is a daily chart, the candle reflects the movement that day from opening to closing bell.
- If the chart is a weekly chart, then the candle reflects an accumulation of the week's activity throughout that week.
- If the chart is an intraday chart, 60-minute, 30-minute, 15-minute, etc., the candle reflects the periods activity until the period completes and starts the next period.

The last candlestick (on right) can be a partial if you are viewing it before the closing bell, or day/intraday's period end. If you looked at the last candle on a daily chart, and it was noon, the candle would reflect the first two and a half hours of the trading day. If the last candle was on a weekly chart, and it was Tuesday at market close, the candle would reflect the activity for Monday and Tuesday. If it was a 60-minute chart, and it was 11:10, the candle would reflect the 10-minute period from 11:00 o'clock to 11:10. These candles are usually two colors, often red and black and are either solid or hollow (unfilled).

Thin lines above and below the body of the candle represent the high/low range of the session, and are called shadows (or sometimes are referred to as "wicks" and "tails").

How the price movement unfolded for the time period, or the relationship between the opening and closing price, is vital information and forms the essence of candlestick symbols.

- **Hollow candlesticks**, where the close price is greater than the open price, indicate buying took place.
- **Filled candlesticks**, where the close price is less than the open price (usually red), indicates a period of selling.

Candlestick's color and position on the chart reflect:

- whether the price closed higher or lower than the price at the opening of the day, and
- where it closed in comparison to the previous periods.

Generally speaking, the longer the body of the candlestick, the more intense the buying and selling was that took place during that time period.

There are whole books that are dedicated to candlesticks and the patterns they create by themselves and in groups when compared to the candles on either side. For this study and any of my strategies, we don't need that much detail. The more you look at charts, the more you will absorb about candlesticks as it comes naturally from exposure.

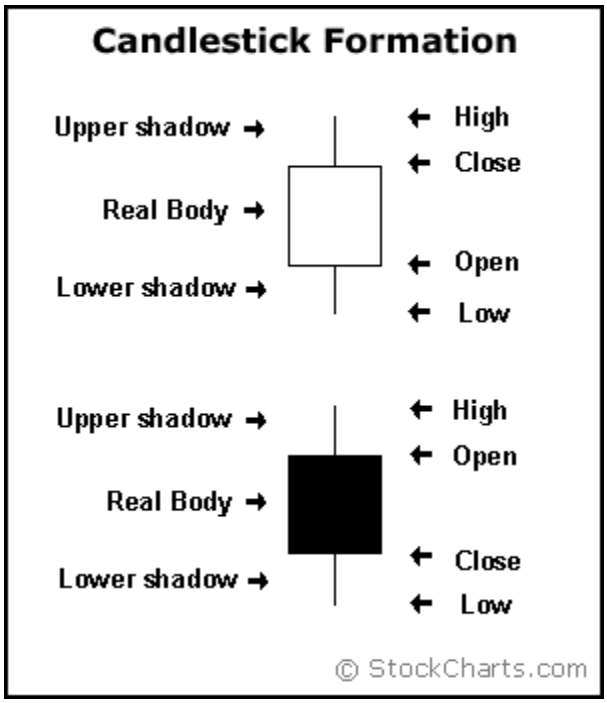


Image Courtesy of StockCharts.com *Fig. 4*

On the other hand, short candlestick bodies indicate little price movement and represents consolidation (tight price range).

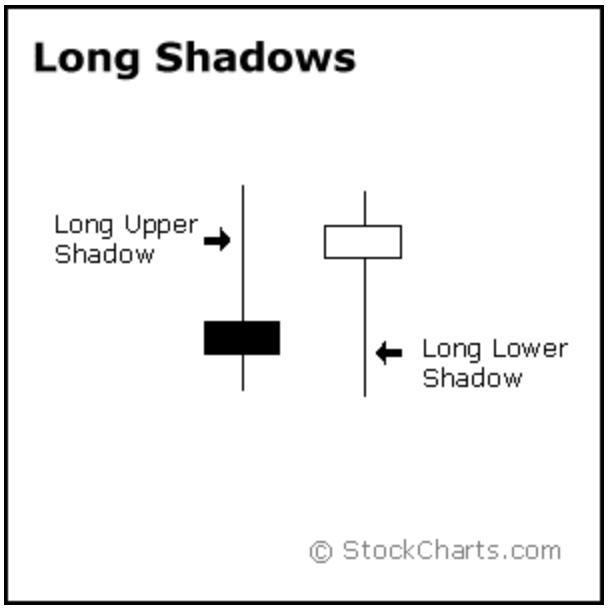


Image Courtesy of Stockcharts.com *Fig. 5*

This candle shape could be likened to the candle we discussed on the chart above for SPY on November 8th.

As you look at the candlestick on the left of the image above, first note where the solid candle opened and closed in relation to the high and low of the period. What does this relationship tell you?

This relationship indicates there was a great deal of (bullish) positive buying interest, which was barely overcome by the (bears) downward momentum selling. How do you know this? Look how far the equity's price went up after the market opened (represented by the topmost shadow or wick). Also note how little the downside was by comparison. Even though this reflects a down day for this equity (the candle opened higher than it closed), the size of the candle's body shows little selling (bearish) strength.

Conversely, hollow candlesticks with long lower shadows and short upper shadows or wicks indicate that sellers dominated during the session and drove prices lower. (See image above). However, buyers later rallied to push prices higher by the end of the session and the strong close into positive territory created a long lower shadow.

In addition, the shape and size of the candle tells you a great deal more.

You can imagine that a candlestick depicts a football game between the buyers (Bulls) and the sellers (Bears). The bottom of the candlestick (the session's low) represents the bears goal-line and the top is the bulls goal-line.

The harder the bears push the close to the low, the nearer they are to a touchdown. The harder the bulls push the close to the high, the nearer they are to a touchdown. The various sizes of the candlesticks indicate who controlled the ball for most of the game period.

Now consider the candlesticks in the figure below (Fig 6). What can you infer? Who ruled the day?

In the hollow candles to the left, the Bulls buying was very strong, with very little selling.

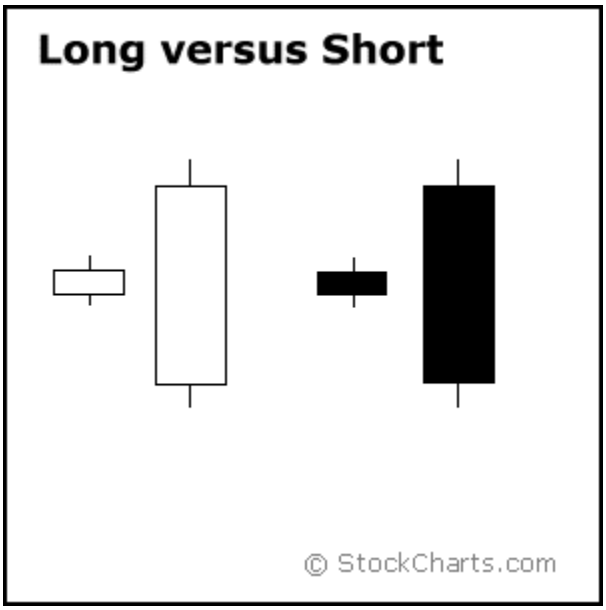


Image Courtesy of Stockcharts.com *Fig. 6*

- Long, hollow candles with "shortish" shadows (as shown above) show strong buying during the period.

- Long red (solid) candles show strong selling pressure. The longer the body, the more intense the buying or selling that took place.

- On the other hand, short candlesticks indicate little price movement and represent consolidation (tight price movement).

Even though much information can be gleaned from candlestick symbols, they don't represent the sequence of events between the open and close, only the ending relationship between the open and close. The high and low of the period are obvious (top and bottoms of the candlestick including wicks), but the candlesticks cannot tell you which came first. It's as if you took too long in the long line at the concession counter and you missed the 2nd and 3rd quarter of the game. You only know the final score. That means that this particular information doesn't mean as much in your decision to purchase an option as information about where the equity closed at the end of the period (knowing who won the game).

Trend Trading

Next, let's examine the **trend line**, a simple and useful technical tool. Literally, this line is drawn along and under the equity's price movement over time. Until you delve deeper

into creating your own charts, this trend line can be one drawn by the eye or by holding up a small piece of paper or business card under the lower portions of the candles.

For the moment in your study, you are first and foremost a trend trader. The trend is an accurate view of an equity's value. You generally do not trade options against the trend. If an equity is in an uptrend, you consider buying Calls. If an equity is in a downtrend, you consider purchasing Puts.

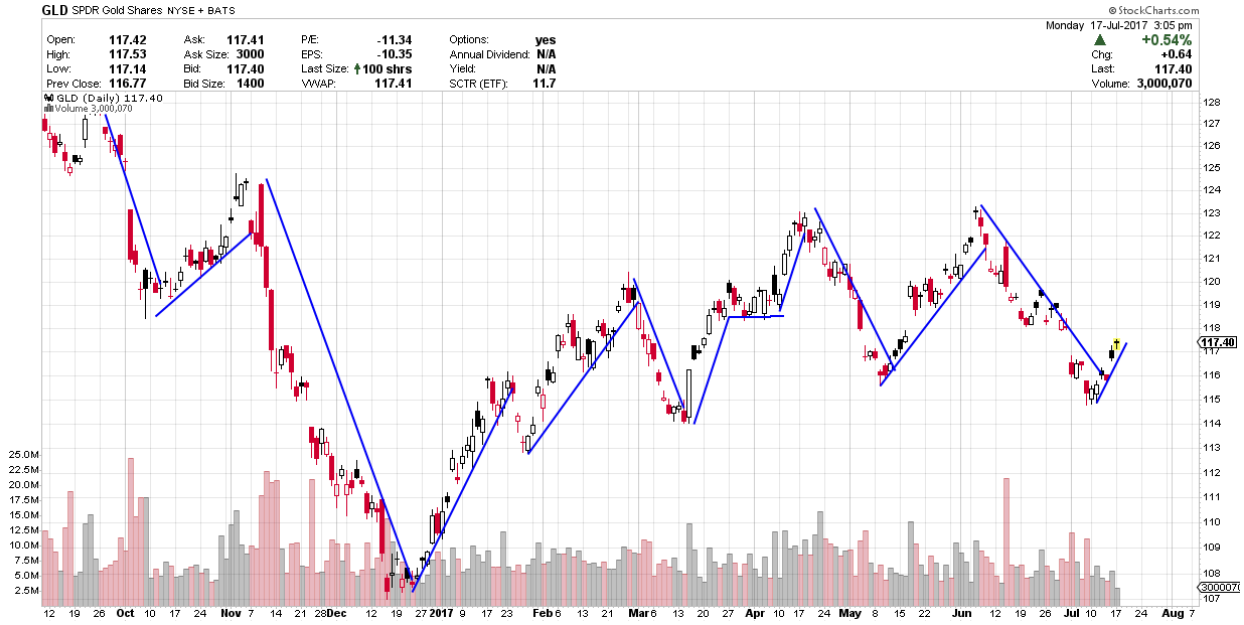


Chart Courtesy of Stockcharts.com *Fig. 7*

The downward sloping line indicates a downtrend where you could have purchased Put options. The upward inclining line depicts a strong uptrend, and using that trend, you would purchase and hold Call Options. if your other indicators have indicated that it is ripe. As you can see in figure 7 above, GLD's chart from March to July shows there were several down trends. The profit potential in a trending equity such as this is staggering. It is very clear on this chart that your potential for trading success would be enhanced by following the trend rather than swimming against the current.

If you step back and look at the big picture, GLD's chart has been in a down trend from mid-September on the left side of the chart until mid-December. Since then, price moved up and down several times in $8 moves, but notice the end result overall was that it traded flat, making little progress over those six months. Each of those swings was a tradeable move, trading a trend up and down.

This is a great example of how a trader who enjoys more action can take advantage of the breaks in the down trend and can open and close trades based on these up and down changes in price.

Trend Channels

Equity prices often reside within high and low limits, not only within the candlesticks, but also within their own performance. This range pattern can be very evident on a chart. To

draw a channel, simply draw or imagine a trend line along the lows of the candlesticks as shown in the Figure 8 below. Then draw a second line along the tops of the candlesticks. These two trend lines form a channel. Imagine now how it seems as if the candle hits the upper trend line like an invisible ceiling. Then it drops down only to bounce trampoline style off an imaginary floor.

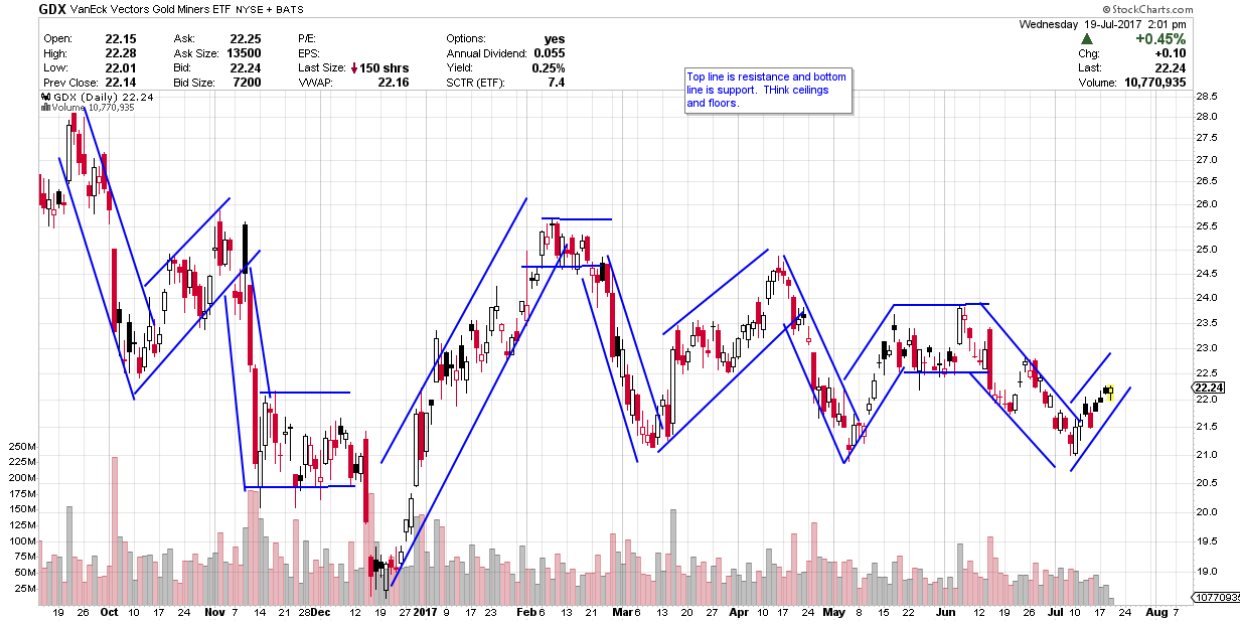


Chart Courtesy of Stockcharts.com *Fig. 8*

The bottom line or floor is called support, and the upper line or ceiling is called resistance. The support reflects the supply of this equity, and resistance reflects demand. You can easily think and remember this by thinking about gravity and the support needed to hold things up. Resistance is a barrier that prevents or inhibits something from going higher. (I'll discuss other types of support and resistance lines later).

Earlier we compared the market to a retail store. Supply would be the products available to customers, and demand would be the customer's interest in purchasing those products. There will be times that the stores will be loaded with products and other times that customer's demand makes for empty shelves and rising prices as scarcity raises value.

These are the two most important principles involved in understanding chart analysis, and subsequently profitable trading:

- Support is a price level at which prices tend to descend, but not break through.
- Resistance is a price level to which prices tend to ascend, but not pass through.

The key word here is "tend". These imagined lines of floors and ceilings hold through most price movement whether it is daily, weekly, monthly or yearly activity. A breakout takes something extraordinary to happen to pop through the support and resistance lines. These could include companies within the ETF reporting double earnings growth or a sizeable loss that disappoints analysts; a major product recall company; an equity,

sector, or overall market reversal; FDA decline of a drug approval; the end of an extended up/down trend or sector rotation. The effect of the individual company will have less impact on the ETF than the price change than that seen on the individual company's stock chart.

Support and resistance lines gain strength as the time frame lengthens. For example, support and resistance lines in a 60-minute chart might hold for a few days; in a daily chart, they might remain unbreakable for a number of weeks; a monthly chart's lines might be steadfast for years. Within a particular time frame, the number of touches or attempts to test the line without success multiplies this strength.

As you saw on the last chart in Figure 8, channels may be horizontal, upward, or downward. By watching for levels of support and resistance, you will find natural trade entry and exit points.

You would consider purchasing an option when an ETF starts to come up off the support floor, holding through the body of the channel. Then watch closely, being ready to sell as the equity's price comes close to the ceiling resistance, and if your purchased option is approaching its expiration date. It's entirely possible that an equity might break through resistance to then go higher, but you will stand ready to sell in case the equity doesn't have the thrust-power to do so. In other words, you'll be ready to sell once the equity hits resistance (perhaps bouncing off the ceiling), thus likely to descend back toward support.

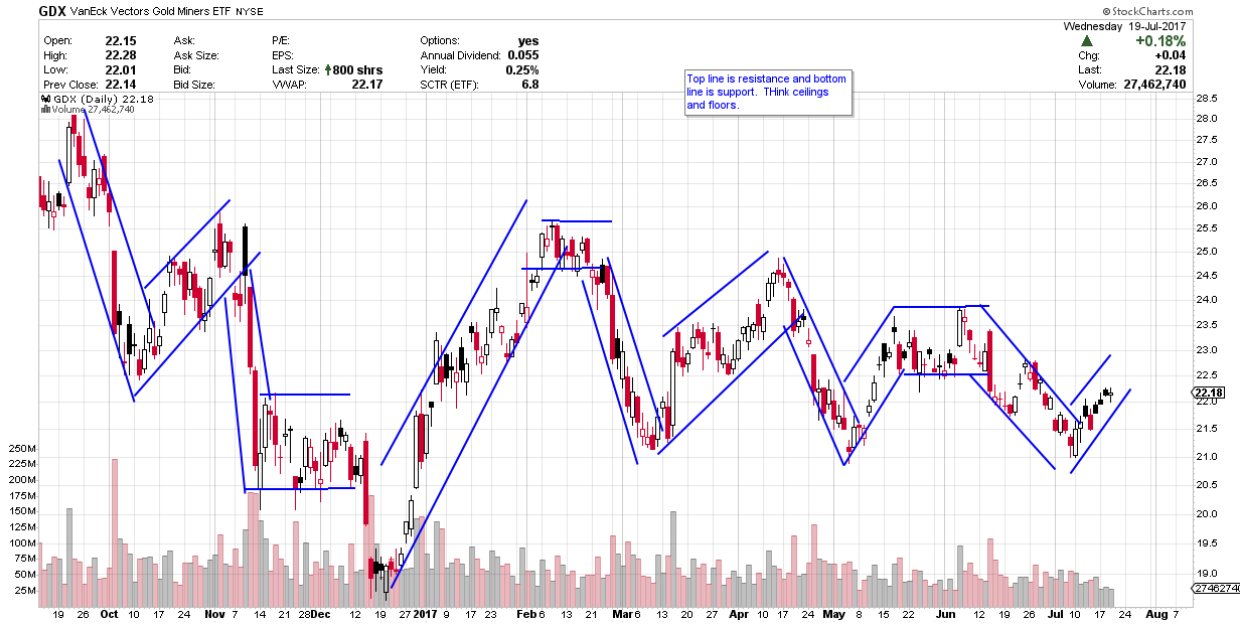


Chart Courtesy of Stockcharts.com *Fig. 9*

As you can see with another look at the chart above, the breakthrough of a support or resistance line can keep you in a trade for varying lengths of time. One trade may last a few days and another a few weeks. Other indicators will help you discover which breakthroughs will be worth trading.

Other Indicators

You can use other indicators to help anticipate a change in an ETF's direction before it happens.

- An equity's price that breaks out of a downward or horizontal channel with increased volume or other confirming indicators (heading upwards) is a possible trade signal.

- Volume is a sign that institutional buyers (Big Players) have taken notice of the equity. Volume is often heavy when things are about to change, signaling a breakout of support or resistance, and a possible change in trend.

- When an equity's price breaks support, dropping out of an upward channel, it is a possible sell signal. This breakdown and other confirming technical indicators are considered, along with general market conditions and harmony—agreement—with the equity's associated sector, and then you decide what action to take.

- Participating in a new uptrend or upside breakout, you go "long," meaning you buy Call options with the move out of the channel on higher volume. Participating in a new downtrend, downside breakout, or breakdown, you go "short," meaning you buy Put options with the move out of the channel on higher volume.

If the price drops back into the channel, then you can immediately sell the position. Channel breakouts occur in either direction, up or down.

You also need to watch and consider support and resistance lines once you've purchased an option. For example, if you bought an option on an equity at its bargain basement price, close to its support line (the bottom of the channel), then you'd watch it closely as it rises to the first level of resistance. You're paying close attention to see if the equity will go on to break through, or whether it is time to sell and take profits, because, once it hits this ceiling, it's apt to drop back down within the channel. And no one likes to give back profit.

So, as you can see, it's wise to watch activity taking place between these lines of support and resistance.

- At support, institutional buyers say, "What a bargain! I think I'll buy some of this ETF at this low price."
- At resistance, buyers begin to lose confidence in the ETF's direction and are no longer inclined to make equity purchases. Here, sellers begin to take profit, other traders seeing this move jump on the selling bandwagon, decreasing demand, and driving the price back down.

- Then, with the price low, buyers step back in, ready to purchase what again seems like an abundant supply at bargain prices, and that drives the prices back up.

The market dance of two-stepping—a number of steps up and a couple steps back, or a number of steps down and a couple steps up—continues until the price of the underlying equity finally builds the strength to break through resistance. Then, that old line of resistance becomes a line of support for the next leg up. Or, if the price drops through support, then that old support line becomes a new line of resistance for the next leg up. When I think of this, I recall the song with the line, “one man’s ceiling is another man’s floor.”

You will find that technical analysis is not an exact science, so you can never totally predict what is going to happen. That’s why it’s important to be aware of these lines and stay vigilant when the underlying equity gets near support and resistance. Your goal is to have time to react and avoid being caught unaware by a huge price move.

Exponential Moving Averages—EMAs

Another type of line of support and resistance lies with **moving averages (MA)**. There are two types of moving averages – simple and exponential. I prefer the Exponential Moving Averages. When you create a chart, you have the choice of time references to set for the **Exponential Moving Averages** (**EMAs**). For purposes in this book, I will be applying the 2, 13, 55 and 600 EMA over the top of the candlesticks on the chart.

We are keeping this basic chart simple and uncluttered. When you move on to other specific strategies, those books will direct you to a set of appropriate EMA lines that will work well with that strategy.

The middle left hand side of a chart shows the notation that will tell you which type of moving averages are used and the price that moving average reached.

When an equity is trading above any of the moving averages that are incorporated within the chart, watch what happens when the price reaches the support of the EMA. If it is trading below, watch what happens when it reaches the resistance of the EMA. (Fig. 10)

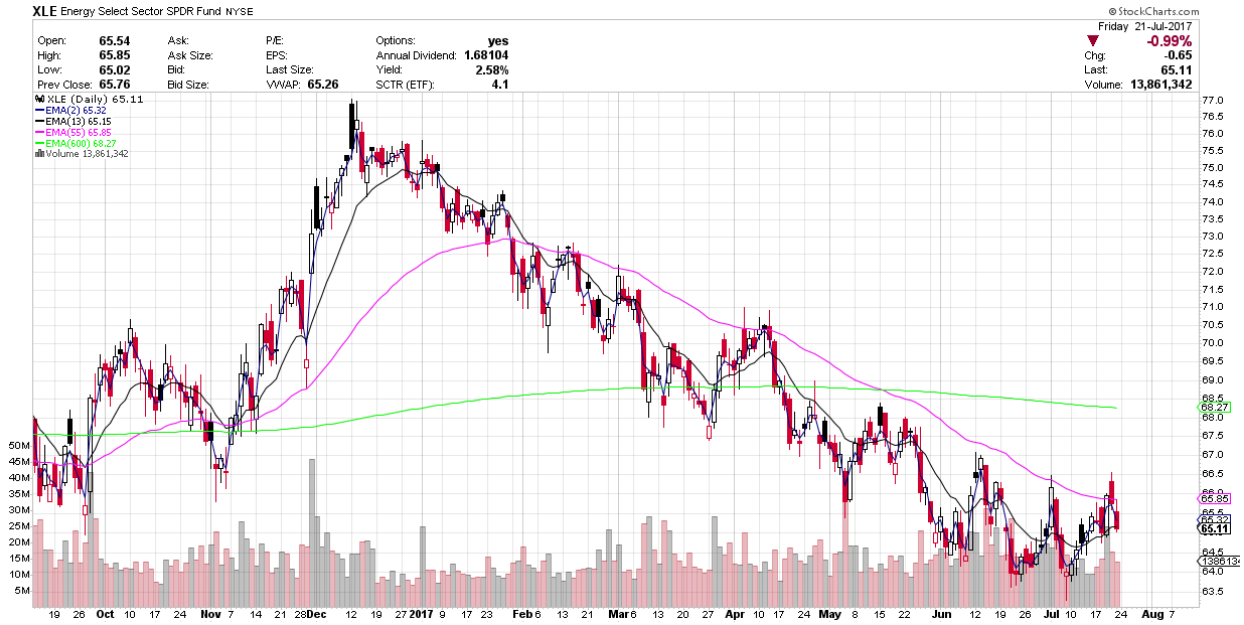


Chart Courtesy of Stockcharts.com *Fig. 10*

The colored lines are not seen in this book since it is printed in black and white, but if you set up your charts through Stockcharts.com or some other charting service, the EMA lines will be different colors. The posted Stockcharts.com's charts are blue, black, pink and lime green EMAs. They are more difficult to follow and identify in a black and white book. The shorter the EMA the more closely they follow the candlesticks. The 2 EMA runs through the middle of the candlesticks and the 13 EMA is often just above or below the candlesticks. Having a few lines of varying length gives you a comparison and points of reference. The EMA lines that have been added to XLE's nine-month candlestick chart depict the price movement for that period of time. These lines add additional information for your consideration.

The lines become areas of support and resistance. Ideally, in an uptrend, you want the 2-day EMA (blue line that closely follows the candlesticks, running through the middle of them) to be on top of the 13-day EMA (black line that more loosely represents trend)**.** The 55 EMA represents an even longer trend and the 600 EMA the longest of all.

When the 2, 13, and 55 EMA are above the 600 EMA, it points to a strong bullish trend and when the 2, 13, and 55 EMA are below the 600 EMA points to a strong bearish trend. This strong down-trending pattern is shown on the chart from mid-April through July shows such a bearish period.

Chart courtesy of Stockcharts.com *Fig. 11*

Viewing the charts in color creates a picture and makes them easier to read. The importance of the colored charts will become more evident as you proceed and more indicators are added.

Stockcharts.com is my favorite charting service. I have nothing to do with their company, but I really appreciate their charts and the clear pictures they depict when I evaluate a trade. I do a public chart list at Stockcharts.com Here is the link: http://stockcharts.com/public/1988469

It will give you a list of the indices and top-rated *Investor's Business Daily* stocks to look through until you decide on a charting service. If you choose to use Stockcharts.com, they have a free service that allows a couple indictors to be added to your chart template. If you decide to go for a paid subscription, their basic service is sufficient. It is approximately $15 a month. If you mention that I (Wendy Kirkland) recommended Stockcharts.com to you, it will help the ranking of the public chart list so other new traders can find it easily.

Before proceeding I would like you to notice how the 2-day moving average very closely follows the price of the candles. This stands to reason as it is based on only the average of two periods of time, whether it is 2 days or 2 hours or 2 5-minute periods.

Moving averages help to illuminate the current price positions as compared with the recent past. When you advance to creating your own charts, you will be able to choose how large a picture you'd like by selecting the number of calculation periods used in the construction of the moving averages. The determination of how many moving average periods to employ is based primarily on the expected duration of the option. Say you are planning to be in an option for 1-6 weeks for example, a 55-day moving average would be useful in determining the current trend. You can easily understand that a 233-day EMA would be too long and a 2-day would be too short to give a good picture of an ETF's trend. So, we use a combination of moving average information to form our chart picture.

When you study a chart, you will notice the shorter the periods used for calculating the average, the closer the line will follow the up and down movement of the candlesticks. In the case of the Dow Industrial Average (DIA) chart below (Fig 12), the 2-day moving average rides right through the line of candles. If you look more closely, during an uptrend the 2-day line runs through the top of the candles. In a sideways movement, the line cuts through the middle of the candles. In a downtrend, the line cuts through the lower half of the candlesticks.

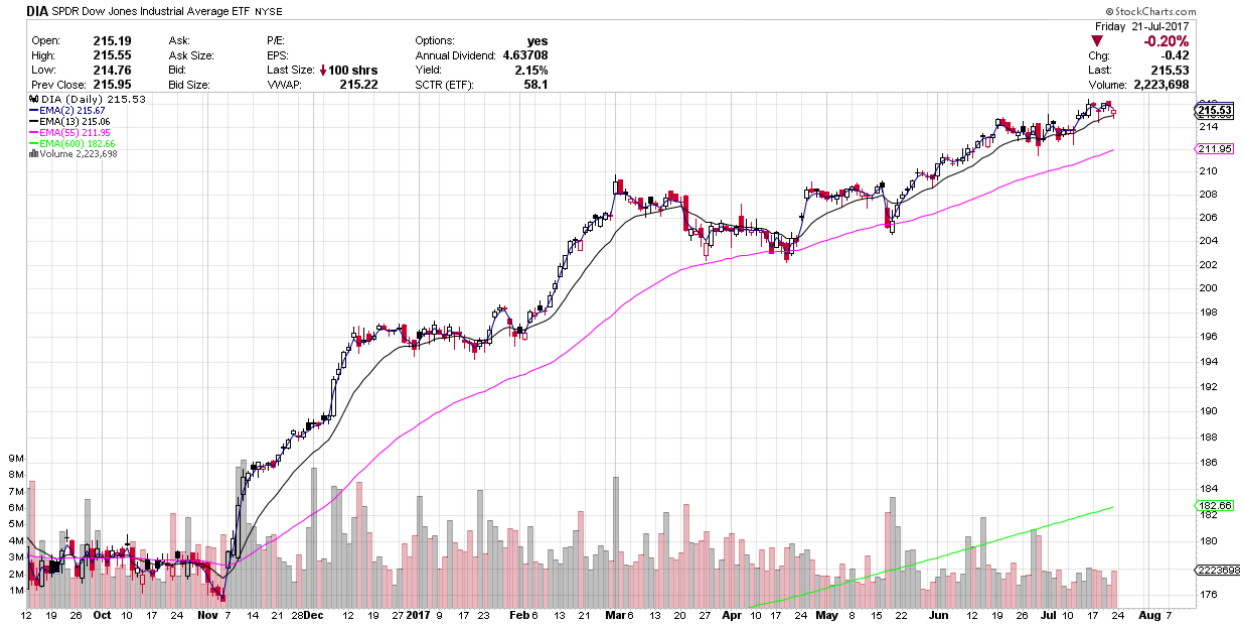


Chart Courtesy of Stockcharts.com *Fig. 12*

From mid-March through mid-April, on DIA's chart, the price is below the 13 EMA, and the two EMAs are in reverse order with the 13-day on the top and the 2-day on the bottom. This lineup corresponds to down-trending movement.

Also, begin to notice some of the other details like the way the candles used the 13 EMA as support to bounce up or down from it during January and February.

Notice how the EMA lines act as resistance. It took from September to November 7th for a price candle to have the momentum (buying volume) to break above the 13-day EMA line of resistance. It made an attempt to break through the EMA numerous times during that period, but there was enough selling pressure that the price couldn't hold, and it dropped back below through the line of resistance that, for only a day or so, had looked like it was ready to give way. On the November 7th, the bulls (buying pressure) broke through resistance. Like the opening of a Christmas present, this break starting a new uptrend.

Hungry bears challenged again on March 20th. On that day, selling pressure (the bears) pushed the price downward, and for the next two weeks, price sloped downwards and crossed up through the 13-day EMA again to start a new uptrend on March 24th that only lasted 3 weeks before the bears challenged again.

Trade signals are made in the direction of the shortest moving average (in our case, 2-day EMA) as it crosses the longer time frame moving average (13-day EMA).

Notice now how both the 2 and 13 EMAs, challenged the 55 EMA during this period, but the 55 EMA provided support and held on two different tests. When they held, it was then officially a new uptrend was underway.

Breaking up above the 55 EMA is a buy signal for a Call, and **Breaking down** below the 55 EMA is a buy signal for a Put.

Now, you could have purchased an option contract on November 7th, as the 2-day EMA crossed through the other EMAs. From here, you would have waited for exit signals, and this exit would also depend on how many months out the expiration date was on your option. If the expiration date was the month of March (because you always sell 30 days before expiration), the signal would have suggested selling anytime during February or 30 days (approximately) prior to March expiration when there would be the greatest time deterioration. (Remember this is like that milk carton in the store's refrigerator case coming close to it sell date).

I have spent a lot of time examining this chart in order to show that no hard and fast rules exist, except a full cross of the 2 and 13 EMAs over the 55 EMA line in either direction. The choices of when to buy and sell are up to you, but you must work with the tools and information at hand. You have just started this analysis process; you will be looking at many more charts until, by the end of this book, you will have a good foundation in chart reading and will be ready to really evaluate an ETF's chart.

Okay, for fun, let's throw in one more decision-making aspect into the mix. If you had a July option and were planning to take a vacation in May, sell the option, take your profit, relax, and never give another thought to what is happening to the market while you are away. That's the beauty of trading options. You are free to move in and out of the option market, based on what is most important to you at the time. Remember, this is all about quality of life, so you sell and take your profit and have a great time while you're away. The market will be there when you get back, and there will be many more opportunities.

We have now covered the most basic chart elements without going into a great deal of detail on the variety of available indicators. Before long you will be able to add and delete indicators from a chart easily and will be able to take in the story the chart is telling you.

Let's look at Pivot Points, and then I would like to quickly show you the indicators that create the chart pattern that started my career in option trading. It is the root of my trading success.

Pivot Points

Beyond visibly being able to see support and resistance areas, pivot points are a way to add specific lines of support and resistance to a chart. Stockcharts.com has a chart overlay that figures and draws pivot points on the chart, but if you use a charting site that does not offer this overlay, there are ways to manually determine these amounts

and levels. For Fibonacci Pivot Points at stockcharts.com, you add an "F" under parameters. Fibonacci Pivot Points are closely related to Standard Pivots, the main difference is that they calculate a third level. Fibonacci R2 and S2 match Standard Pivot Points R1 and S1.

Pivot points are determined by utilizing the previous day's open, high, low and close information. Online there are a variety of different calculators where you insert that information, and it does the calibrations for you. One such site on the web at the moment is http://www.pivotpointcalculator.com/. It is principally designed for Forex trading, but it works for option trading just as well. Also, there is http://www.forexabode.com/trading-tools/pivot-points/fibonacci-pivot-point-calculator/

On the calculator, you insert the open, high, low and close details of the equity you are interested in charting, and then note when the price hits those numbers and the amounts act as areas of support and resistance.

In the support and resistance section, I discussed visually seeing areas where traders bought (demand) and sold (supply) at certain price levels. These areas could be visually seen as peaks and troughs where an equity's price stopped and bounced or was repelled from going further.

By applying the Pivot Point overlay, you are now also turning those areas into prices as well as lines. On a chart, you will notice these areas from the top down are marked R3 (Resistance 3), R2 (Resistance 2), R1 (Resistance 1), P (Pivot Point) and S1 (Support 1), S2 (Support 2) and S3 (Support 3).

The Pivot Point can be a turning point, but it is also used as a reference point. If the equity's price is trading above the pivot point, it is said to be bullish. If it is trading below the pivot point, it is said to be bearish. The support and resistance lines respond to price in the same way as discussed earlier, meaning as ceilings and floors.

On the chart that follows, notice that not only are the current week's pivot points marked, but also the pivot point areas from the previous weeks. These lines are not as vital, but past price action affects current price based on market sentiment. If you compare this chart with Figure 11, you'll note that many of the areas marked that were visible to the eye are also the pivot point areas.

Chart courtesy of Stockcharts.com *Fig. 13*

Notice on XLE's chart above in the current week where the price touched R2 at 65.60 on the 26th and at R1 at 66.17 on the 25th. Once the price made it through the resistance level of R1, it then dropped back to test the resistance of the Pivot Point on the 26th. As it came back up through the Pivot Point, it popped up to R2 and then dropped back to test R1 for 3 candles on the 26th. R1 didn't hold, and it dropped lower to test the 55 EMA. Once a ceiling level is broken through on the way up, that level then becomes support on the way down.

The Pivot Points play a big role in the ETF Game Changer (EGC) strategy as other indicators are added, their importance will become evident.

Average Directional Index (ADX)

Okay here we go, hang on to the rails, the **Average Directional Index** (ADX) is one of the main elements to my P3 pattern. It determines the strength of a trend, whether it's trending up or down or trading sideways. As an oscillator, the ADX fluctuates between 0 and 100, but readings above 60 are relatively rare. Low readings below 20 indicate a weak trend, and high readings above 40 indicate a strong trend.

Studying the ADX, you'll note that the ADX indicator does not rate the trend as bullish or bearish, but merely assesses the strength of the current trend. In other words, a reading of 40 can indicate a strong down trend as well as a strong up trend.

To determine in which direction the trend is flowing or to indicate a change in direction, two other lines are added to the graph. Usually two different colors, green for bullish and red for bearish, they represent respectively a Positive Directional Index (+DI) or Negative Directional Index (-DI).

As these green and red lines cross each other and the ADX trend line, we are able to determine not only the strength of the trend, but in which direction it will head before it fully takes place.

- When the green +DI crosses upward over the red -DI and/or the black ADX trend strength line, we can expect the trend will be up.

- When the green +DI line, crosses downward and the red –DI moves upward and crosses over the black ADX trend strength line, we can expect the trend to fall.

- On occasion, it happens that the DI lines will touch each other prior to crossing, and they will act as resistance and will bounce off each other, resuming the previous trend direction.

- There are other times that the DI lines braid as they swim up and down struggling to be the dominant direction. When this happens, the price most often goes flat and trades in a tight range.

The ADX is special enough that it will be added twice to our chart. The full chart set up will be covered before long. We have one more indicator to cover, and then we will create our chart template.

As these indicators are applied to our charts, their movement and the information they impart will become crystal clear. Hang in there. These indicators are going to create a picture that you will be able to spot as it is forming.

The default is 14 periods, but I am going to tweak this to 13, which is one of our Fibonacci numbers.

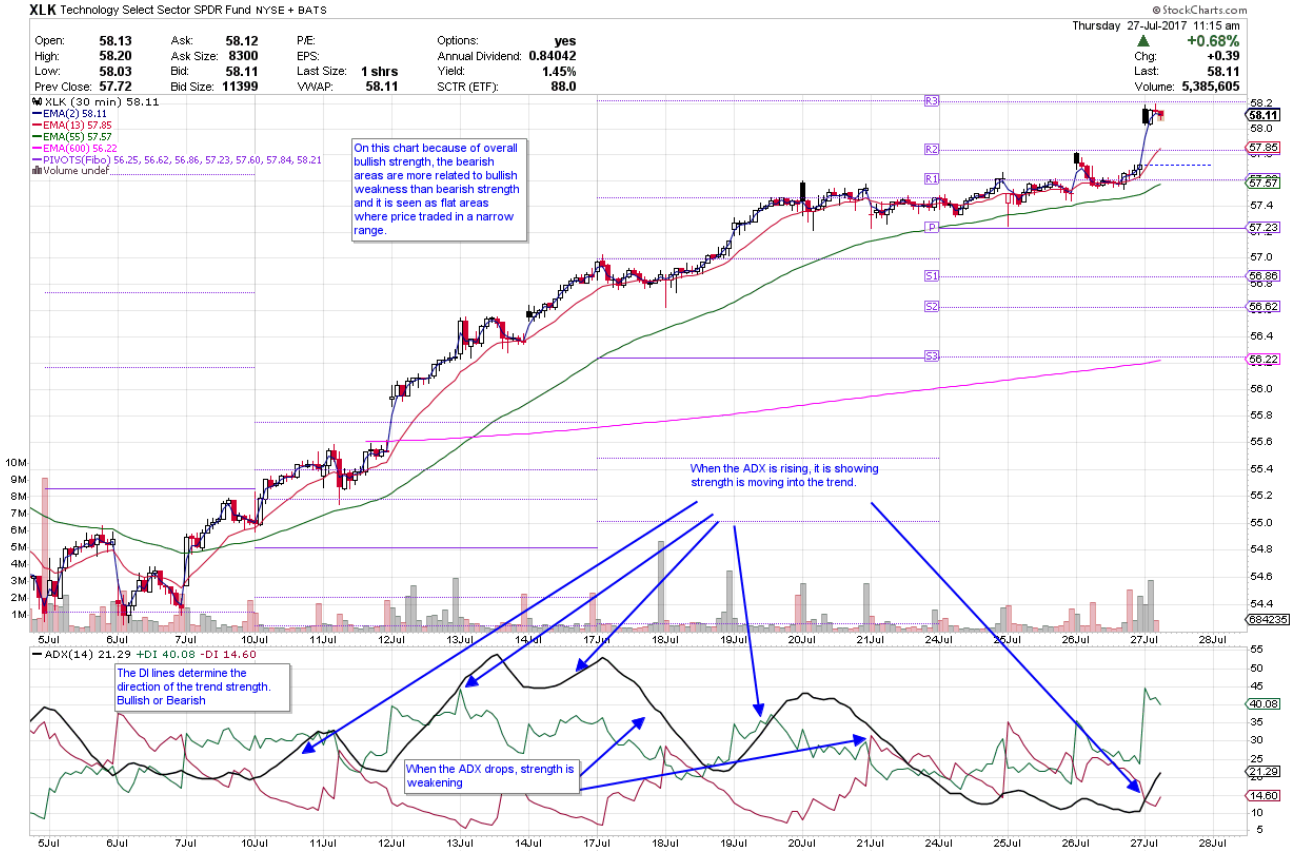


Chart courtesy of Stockcharts.com *Fig. 14*

I will post the chart again without all the big text boxes so you can get a better view of the information and how the different indicators work together. Notice that the DI lines foretell a change in direction before the actual change, but, on occasion, they can braid (swing back and forth), and the price goes flat because the two directions are battling it out.

Chart courtesy of Stockcharts.com *Fig. 15*

This might seem like a lot of information to absorb. Take it slow. Before you know it, your eyes will be circling around the chart in quick motions, gathering the information that your mind's eye will absorb and analyze instantly. Then, it will slow down and zero in on the important portions.

In the same way that your eye and mind work together to look at a Monet painting, your eyes swirl over the details, putting them together to take in the whole picture. It is only when your eyes settle on the small details of a ripple of water that the small dots and minute nuances become evident. This analyzing ability comes rather quickly when you spend just a little time looking at charts. One day they seem to be foreign and confusing and, within a short time, they become old friends that comfortably share their story. Hang in there. It will happen!

Okay, the PPO indicator is next, and then the ATR, and we are done with the elements of our chart. From there, we will tie all the pieces together.

Price Percentage Oscillator (PPO)

I present this oscillator as one of the main components of my P3 patterns for the EGC strategy. For traders who are familiar with the MACD and prefer to use that indicator instead of the PPO, they are welcome to do so. I prefer the PPO. The **PPO** is similar to the MACD, but uses a more complex, but more reliable formula; it's based on the percentage difference between two moving averages over a given period of time. It

uses two lines, one thicker and one thinner, to display its information as well as a series of blocks located beneath the lines called the histogram.

The PPO is an indicator that either confirms or contradicts the signals given by the special Fibonacci exponential moving averages that we have inserted into our charts. As a momentum indicator, it's one of the simplest and most reliable indicators available.

The PPO is a **lagging indicator**, meaning it uses information based on an equity's past performance. This lagging indicator turns into a momentum oscillator and functions by tracking the amount of difference between the short term moving averages and a longer term moving average, often the 12-day MA and the 26-day MA. The results form a line that oscillates above and below "zero," without any upper or lower limits.

This equation is represented by a thick line. The other time period is included as a reference point, seen as a thinner line. If the PPO is positive and rising, then the gap between the referenced time periods widens.

- When the thicker line moves up, positive (bullish) momentum is building for that underlying equity or index.

- When the thicker line moves downward, then the negative gap is widening, so we see negative price (bearish) momentum.

- When the thicker line crosses upward over the thinner line, we see that as a signal to buy. This buy signal will often confirm other buy signals depicted on the chart.

- But, when the thicker line crosses the thinner line in a downward slope, we see a signal to sell, depending on the option's expiration time frame.

You'll see two graphs within the PPO chart. One is formed by moving averages and the other is a **histogram**, which notes what has transpired previously on a shorter trigger exponential moving average (EMA).

The histogram is the bar chart along the bottom of the PPO graph. The size of the bars fluctuates above and below the "zero" line. These bars are another way of expressing the relationship between the PPO equation and an equation using a 9-day exponential moving average.

- If the shorter moving average (the thicker, dark line) is above the longer moving average (the thinner, lighter colored line), the PPO histogram will be above the "zero" line, or positive.

- If the shorter moving average is below the longer moving average, the PPO histogram will be below the "zero" line, or negative.

- The PPO histogram compares the PPO number equation with the 9-day EMA. If the value of the PPO is greater than the 9-day EMA, the histogram will be above the “zero,” or positive.

- If the value is less than the 9-day EMA, the histogram will be below the “zero,” or negative.

Signals in the histogram to watch

1. Positive divergence that precedes a Bullish Moving Average crossover on the PPO. A positive divergence (ever higher lows) in the histogram indicates that the PPO is strengthening and could be on the verge of a crossover.

2. Negative divergence (ever lower highs) that precedes a Bearish Moving Average crossover. A negative divergence in the histogram indicates that the PPO is weakening in momentum.

3. Broadly speaking, a widening gap indicates strengthening momentum and a shrinking gap indicates weakening momentum. Usually, a change in the histogram precedes any change in the PPO.

4. The main signal generated is a divergence on the histogram followed by a moving average crossover.

5. Keep in mind that a centerline crossover on the histogram represents a moving average crossover for the PPO.

The size of the histogram bars and the shape they create give visual clues, representing the expected movement of the moving averages. Divergence is a concept of differences or disagreement. An example would be if the PPO disagrees with what is happening in price movement. This divergence can give you a heads-up of something brewing under the surface - a warning signal. I will discuss divergence as it is seen on the charts.

If you are feeling overwhelmed, just let this basic indicator information settle in, we will get into the specifics and how to use the information when we apply the indicators to actual trade set ups. Once you begin to absorb the basic information, you can come back and reread the specifics. It is all part of the detail-layering process.

The drawbacks or down-side to PPO’s histogram is that it is a **second derivative**, based on the PPO’s equation of the price action of the underlying equity or index. The further removed an indicator is from the underlying price action, the greater chance of a false signal.

Because the histogram was designed to anticipate PPO’s signals, the temptation exists to paddle beyond the wave, getting in too soon. But, by acting only on short-time frame chart signals that are in agreement with the next time frame up, we are assured of trading *with* the longer trend and not against it. You will see this in action as we

proceed. But, please understand, the histogram signals need to be taken as part of a whole evaluation. Don't be tempted to plunge in on just the histogram information.

We are going to tweak the default numbers to 13, 21, 8 (Fib numbers). It is easy to understand that 13 is close enough to 12 and 21 close to 26, etc. so as not to make a significant difference in the results, but we are fine-tuning to our particular strategy.

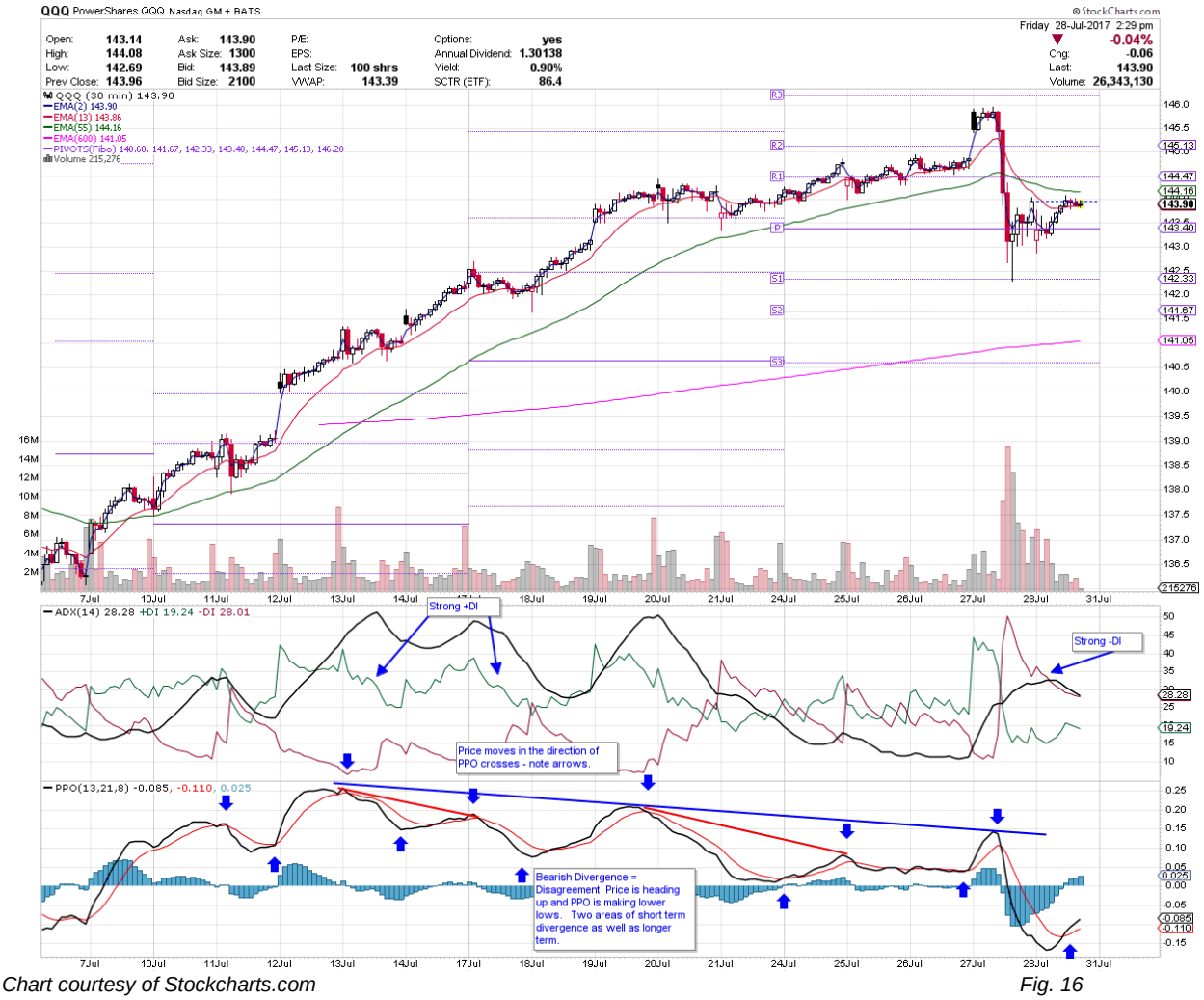


Chart courtesy of Stockcharts.com *Fig. 16*

As mentioned the histogram blocks within the PPO are a leading aspect of the indicator. Notice early on the 25th, 26th, 27th that the histogram suggested the drop experienced on the 27th was going to take place. The histogram blocks shortened and quickly crossed the zero line.

Study each indicator to see which one gave the first hint that a change was forming. Then which one happened next? Which one followed? How about the PPO and the EMAs? The 2 short-term EMAs crossed down and through, so they were in down-trending order in one quick burst, but are still above the 55 EMA.

Now that we have the PPO in place, we are going to add another ADX indicator. Yes, we want two of them, one above the PPO and one below. This will be explained further. But for now, just know that the line-up of indicators is an important element to the EGC strategy, allowing us to ride a wave up and down.

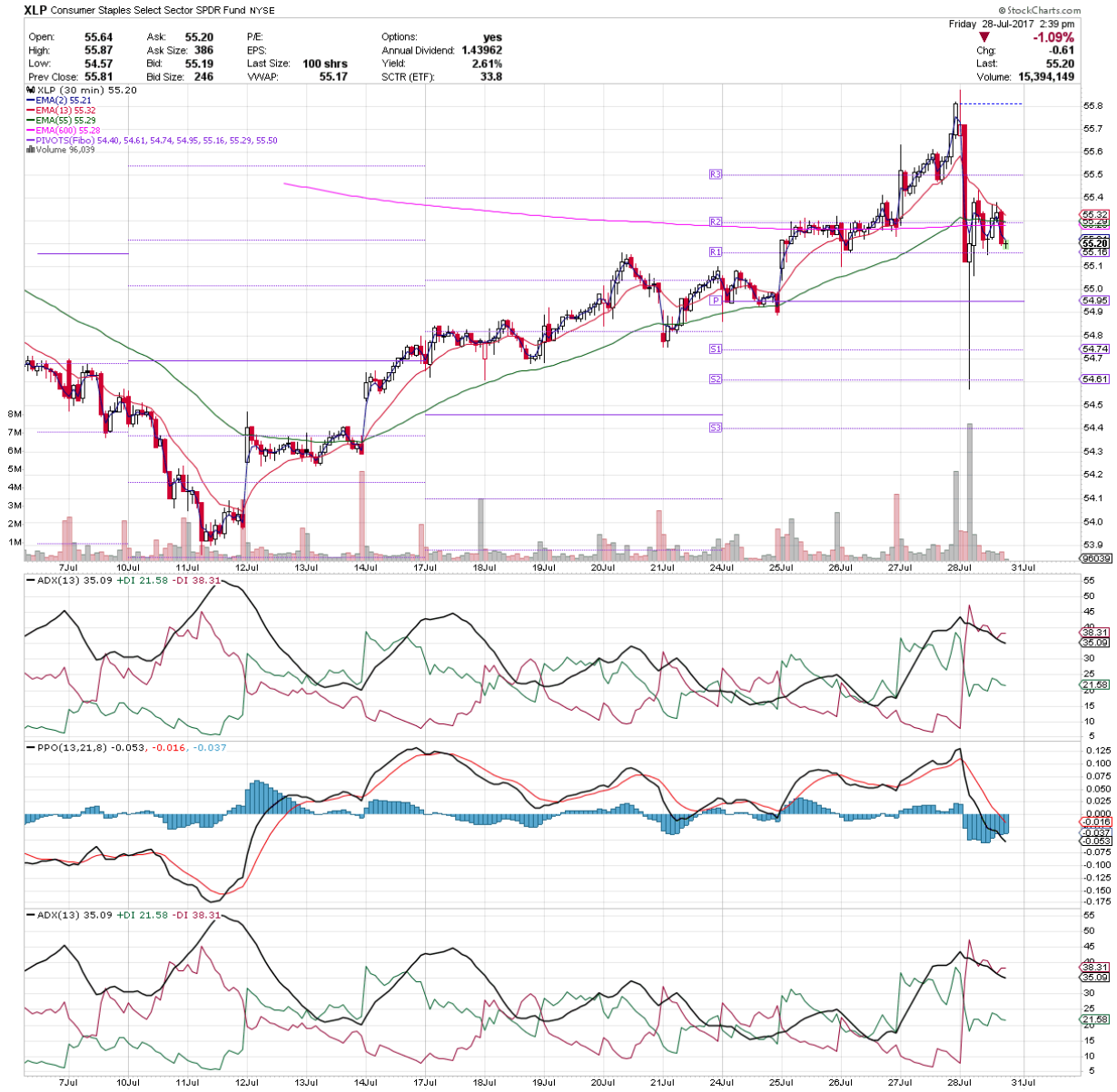


Chart courtesy of Stockcharts.com *Fig. 17*

The last indicator is the Average True Range (ATR).

Average True Range (ATR)

The Average True Range indicator is a means to discover the average price movement of an underlying equity. The concept starts with **True Range (TR)**, which is defined as the greatest of the following over a period of 14 days:

- Current High less the current Low
- Current High less the previous Close (absolute value)
- Current Low less the previous Close (absolute value)

Typically, the Average True Range (ATR) is based on 14 periods and can be calculated on an intraday, daily, weekly or monthly basis. For this strategy, the ATR will be based on daily data. Because there must be a beginning, the first TR value in a series is simply the High minus the Low, and the first 14-day ATR is the average of the daily TR values for the last 14 days. We will be investing in weekly options, so having a higher than 1% Average True Range means that the equity's price movement is apt to fulfill your price goal more quickly than an equity that swings back and forth in penny movements.

On the chart below, notice it is a daily chart set up with the chart indicators we've discussed. The ATR indicator has been added. It reflects that the daily ATR for QQQ is $1.50. A one percent move on price would be approximately $1.42, so QQQ would be a good candidate for our trades since it moves on average $1.50.

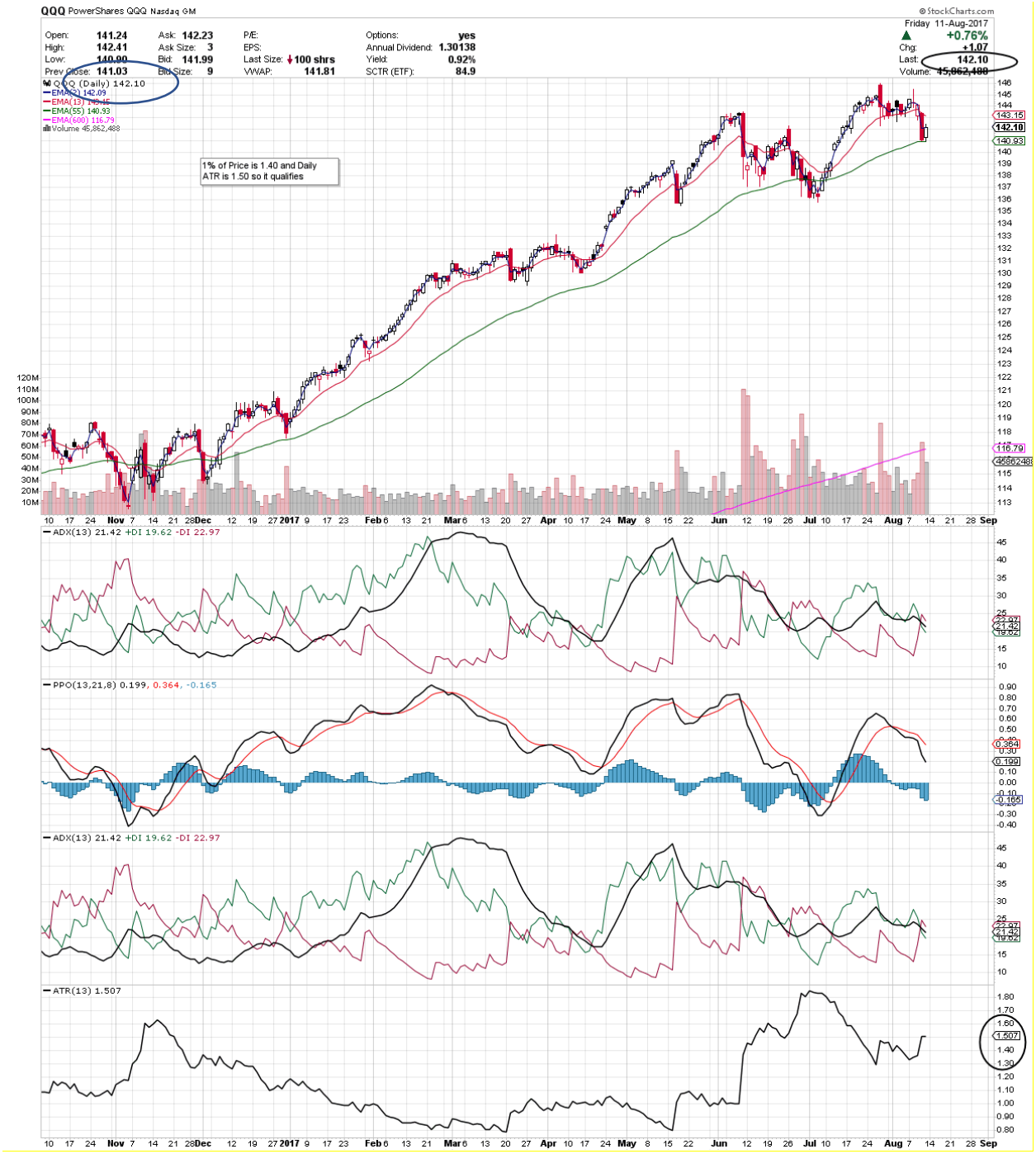


Chart Courtesy of Stockcharts.com *Fig. 18*

In this study and strategy development process, I have discovered that a 2-4% move in price equates to a double in an option's premium. This is our goal; we want to trade ETFs with large, quick moves, weaving in and out of trades.

Now you can keep the ATR on your chart for convenience, but the information you are going to use from it is not needed for your everyday chart analysis. Beyond this, there are times when the ATR range has increased to a high point that it indicates a bearish

environment is brewing (brought on by erratic price swings), but aside from the daily information as to price movement, the other indicators give us what we need to know on the intraday charts. We will use the ATR on the daily chart to see if an ETF qualifies, but we will not leave it on our everyday charts.

Using the ATR information, you can create a list of qualifying chart candidates from which to check for the patterns we will be trading (discussed below). Before we jump into the patterns, let's take a quick peek at how to set up the indicators and overlays on Stockcharts.com. This will also recap the parameters.

Chart Set-up

The image below shows the set-up for the indicators and chart overlays used in this strategy. It also shows the tweaked parameters.

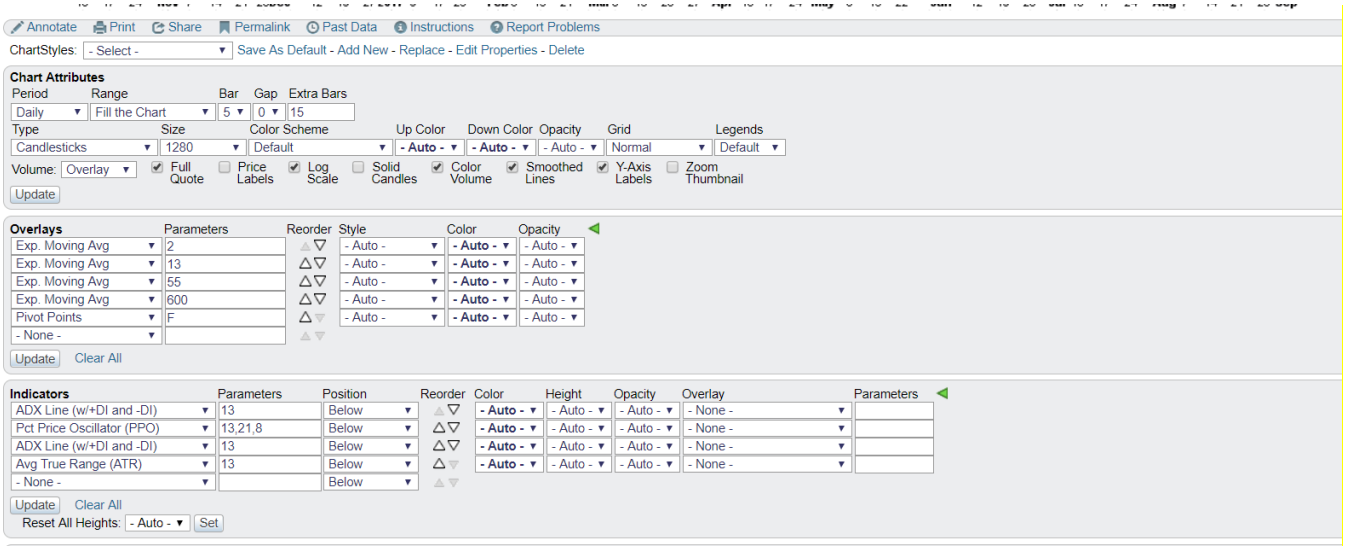


Image Courtesy of Stockcharts.com *Fig. 19*

P3 Squeeze Pattern

I am going to point out two different patterns that will be visible on the 30 and 60-minute charts. Let's start with the P3 squeeze pattern that will be used for Call (long) trades. Some of you may be familiar with this pattern, so this section will act as a review. Then, we will discuss the pattern that will be used to initiate Put trades.

We have our chart set-up established, so now I want to draw your attention to a pattern that often forms. I will annotate a chart where I circle the pattern - the Squeeze Pattern – this picture on the chart is as close to a guarantee as you can find in the stock market.

It's interesting, the PPO indicator and the ADX indicator have no connection to each other. They are separate indicators, yet when they are set-up as you have done with the PPO on top of the ADX, a pattern is formed, and, when this picture is created, the equity will ALWAYS go up. Oh, there are times when it takes a few days, and other times

when the price pops up like a dolphin fin breaking the surface, and then drops back down for a short period, but in the end, it always comes back up.

I will list a few charts so that you can see the accuracy in what I am showing you. Also, I will point out on a chart or two what happens when this pattern fails after it gets started. When it does fail, the pattern forms again, tightens, and then pops up with even more gusto, like a geyser that has built up steam.

There are times that the lines of the PPO and ADX squeeze together so tightly they almost touch and other times there is a larger bit of space between them. The indicators create their patterns separately, yet together they tell a story about the ETF's past and its future. The P3 Squeeze picture is created when an equity has not just dropped, but dropped drastically. The PPO black line reflects this extreme drop, and the ADX black line reflects the strength behind the drop. The pattern combination of these two indicators draws this unique picture that guarantees upward movement.

After we look at this pattern picture on a few charts, I will show you the second Put pattern, the P3½ . Then, we'll address what you need to look for on the indicators that will pinpoint exactly when to enter a trade. Also, we'll review an option chain so you can see how to select the option you wish to purchase once you've located an equity that has drawn the picture of an equity that is getting ready to explode.

On the chart below, notice the circle drawn over an area on both the PPO and ADX indicator. Once you study this area, look up on the candlestick portion of the chart and see the uptrend that happens after this picture is formed.

Both the P3 Squeeze and the P3½ pattern go through specific stages. We will cover those stages after you look at a few charts to get the basics.

Chart Courtesy of Stockcharts.com *Fig. 20*

Chart Courtesy of Stockcharts.com *Fig. 21*

Chart Courtesy of Stockcharts.com *Fig. 22*

Chart Courtesy of Stockcharts.com *Fig. 23*

Chart Courtesy of Stockcharts.com *Fig. 24*

Chart Courtesy of Stockcharts.com *Fig. 25*

Chart Courtesy of Stockcharts.com *Fig. 26*

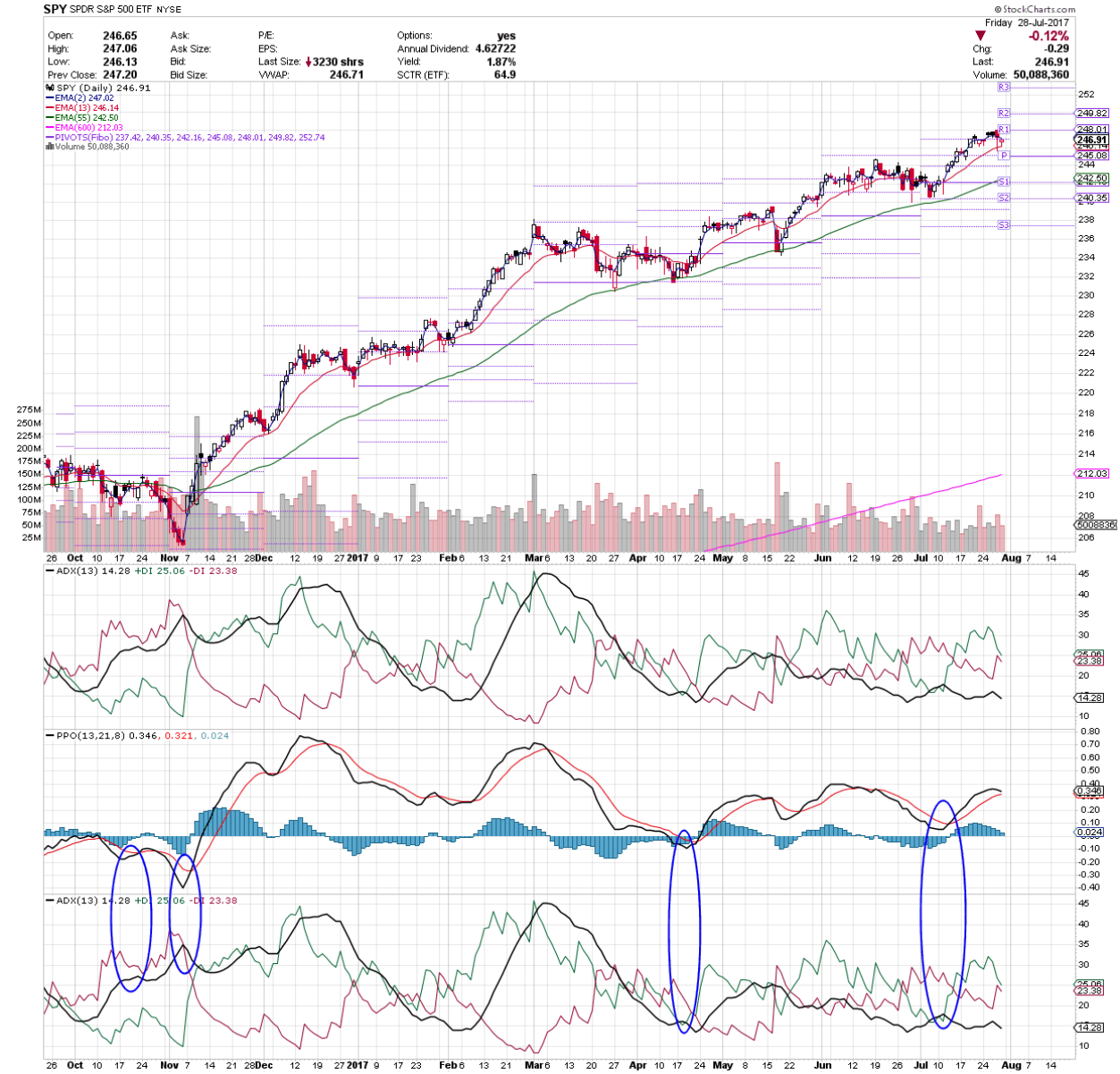


Chart Courtesy of Stockcharts.com *Fig. 27*

Chart Courtesy of Stockcharts.com *Fig. 28*

These were 30-, 60-minute and daily charts. The pattern as it unfolds is the same in every time frame. You have seen sometimes the lines come very close together, and at other times, there is more white space between the lines. As we proceed, I will cover all the indicator details and what part they play in the unfolding process as the price goes up.

As we proceed, I will go through the process of how this pattern is formed, the entry confirmations and the stages that it flows through.

I'm sure the point has been made with the charts listed above. Any time the PPO and ADX line come together to form a squeeze on the chart, the equity's price goes up when the lines eventually push away from each other. Sometimes, the movement lasts for a few hours, and other times it continues and strengthens to start an uptrend that can last

several days based on the 60-minute charts and weeks, maybe months, if is is daily chart.

It can be difficult to take this one step at a time because it is a final stage of the P3½ (short pattern) that needs to take place on the upper two indicators for a P3 pattern to form. Looking at all the charts above, it is only when the PPO has crossed down, -DI of the ADX has crossed up and the ADX line itself rises (on the upper two indicators) that a new P3 pattern forms. These three actions have to all be taking place at the same time for a new P3 squeeze pattern to be created. We will dig deep into the P3½ pattern and all its stages, but for now, let's just accept that these 3 events are what has to take place for a P3 pattern to form.

Confirming indicators are going to help us determine which of the P3 squeeze patterns are going to develop into profitable trades.

Time is very relevent. With 30-minute charts, the patterns form more quickly, and there are often more of them because they pick up the smaller moves. This is one of the reasons you'll need to determine how much time you have to devote to trading and watching your trade during the day. Trades on a 30-minute chart that unfold over a period of hours to a day or two must be watched much more closely than a daily chart that unfolds over a period of a few weeks.

On the 60-minute charts, patterns can last for days, so this puts it more in the swing trade catagory, which is perfect if that is your style. In the EGC strategy, you have a choice to select a time frame that suits your particular trade style.

If there is a squeeze pattern on all three time frames, then, as the 30-minute chart pattern unfolds, it prompts the 60-minute to do the same, and, as the 60-minute unfolds, it triggers the daily chart to kick into gear. Even though you may not be trading the higher time frame, you can use its information to know the squeeze on the 30-minute chart is on sound footing and is apt to go through all its stages and hit your profit target.

If on the other hand, the 60-minute chart doesn't have a squeeze pattern forming like the 30-minute chart, you might use this information to determine that the pattern formed on the 30-minute chart will likely fail and perhaps drop further before it is ready to unfold into an explosive move upward.

Please skim through the charts above again and note the squeezes that had profitable moves and those that didn't. Note where the squeeze was only a shallow advance and then perhaps reformed. Notice particularly the strength of the DI lines of the ADX.

It doesn't matter what the time frame; the "Squeeze" pattern reacts the same.

Let's put all the P3 squeeze pieces together before we move on to the P3½ Put pattern. By then, maybe you will understand my terms and references for what is taking place, making it easier to apply the terminology to the P3½ Put Squeeze.

This is a description of what has been taking place on the charts so you will more easily recognize the actions. During the learning process, it might be helpful to write these stages down on a sticky note as a cheat sheet. You will soon have the stages memorized and will easily recognize the stages.

P3 Squeeze Stages

1. The PPO and ADX black (thick) lines come close together to form the squeeze pattern.

2. The PPO line crosses up over its signal line, and the ADX black (thick) line pushes away from the PPO line as if it is repulsed by it.

3. As the Squeeze continues to unfold, the PPO and ADX lines will move further and further away from each other

4. It is only when the +DI line turns up and eventually crosses over the –DI line that the price will "really" move upwards. The PPO line cross itself can only take the price so far. If the +DI falters and doesn't continue by taking control, the squeeze is likely to fail and resqueeze because the price will go flat or head back down. A PPO cross down over the signal line can be the stop or exit for the trade, or at least a place to pay attention and consider taking your profit. If the ADX starts to head up while the PPO is down and -DI is up and over the +DI, exit quickly, and loses will be cut short.

   You can always reenter when you are given the confirmation signals again.

5. Quite often as the PPO line is moving upward, it will weaken for a period of time, drop back, and test the PPO signal line. The signal line will then act as a trampoline, and the PPO line will bounce up from there. There are times that it will do this twice during the climb up. I call this a wobble. The lines/direction are weak as if on wobbly legs and can fall before picking itself up again to proceed. In actuality, these are tests of support.

   Wobbles can be used at times for second entries if you missed a trade or if you want to add to a trade.

6. While the PPO line advances upward and the +DI line has crossed up and over the –DI line, the ADX Strength line will turn up to support the new uptrend. I call this the sweet spot, or in the *Life Cycle of a Squeeze* DVD, it is called the adult stage of the squeeze pattern.

   In this stage of the pattern, the PPO and ADX thick lines run parallel to each other. They almost look like railroad tracks. As long as the lines remain in this formation, the price will continue up.

This is the strongest stage of the pattern. Think about what it is telling you. The direction has been declared in the DI, PPO, and the ADX line, which is the strength, momentum or energy, is heading up and putting its muscle behind the move.

7. The last stage and exit is when the PPO and ADX line turn and start heading down or the PPO rolls over the signal line. This is a final signal to exit.

8. #8 is an additonal stage that has been happening on some charts during the most recent super strong market uptrend. A fun way to think it of this stage is to think of a B-rate movie where the hero acts out a death scene. Imagine him dying and finally falling to the floor. Maybe he flops around for a few seconds, and then is quiet and you think he is gone. After a short time, he rises as if breath has come back into his body, and after a brief effort he falls back to the floor. You breath a sigh of relief that the scene is over, and you can now have closure and move on to the next scene and our hero gets up again for a final display of will.

   This is what stage #8 looks like. Stage 6, the sweet spot stage forms, maybe has a nice run. Then stage 7, the PPO crosses over its signal line and, for a good while, the +DI line still remains in control. After a good rest below the PPO signal line, the PPO heads up again for one more leg-up of the sweet spot stage.

   Then, there is another stage 7 and the PPO crosses down again, and eventually, even the +DI gives up, drops, and, for a brief period, the -DI takes over by crossing up and over the +DI, but then suddenly, there is another burst of energy, and the pattern, which we thought had died, is rising and heading up again - and doing so before a new P3 squeeze pattern has had a chance to form.

Earlier, I mentioned that there has to be three elements for a new P3 squeeze pattern to form: PPO cross down, -DI cross up, and a rising ADX strength line. These three elements have to happen all at the same time, and there will then be a new P3 squeeze pattern. These three elements are part of the end stages of the short P3½ Put pattern.

Otherwise, if you only have two elements, PPO cross down with or without the -DI cross, there is a good likelihood that like the B-Movie, the hero-pattern is likely to pop up for one more act to show it isn't dead yet.

On the next few charts, I will annotate the chart with numbers that tie in to the descriptions above so that you begin to recognize each stage.

The first chart is for the XLP ETF. Its 30-minute chart is a great example of three P3 patterns in a row that went through all the squeeze stages. The last pattern (furthest to the right) had an additional sweet spot stage (#8) The 1st squeeze started to unfold on July 12th when the PPO line crossed its signal line, and the ADX line started to push away from the PPO. Then the +DI crossed up later in the day. On the 13th, there were two wobbles where the PPO dripped down to test its signal line. This is a test of past support to see if it has the strength to continue the upward move. After these tests, the ADX line started to head upward. Wobbles (tests) can happen prior to stage 6 or during stage 6. In this case, we had one of each.

On July 19th, we had another P3 squeeze pattern form. It isn't a beauty and can be hard to see because the drop that created this squeeze pattern wasn't deep where the PPO and the ADX came super close together. That said, take a moment to check, and you will see that it had the three P3½ sweet spot elements needed to create a new P3 squeeze long pattern. The PPO crossed down, thought just for a short while, -DI crossed up, and, for a couple candles, the ADX line rose while the other two elements were in place. Therefore, it isn't a classic beauty, but the need to go through all the stages of a P3 pattern to complete.

Once the PPO crossed up and the lines pushed away from each other, things got going quickly, and it went through all the stages fast. There was a little wobble on the 20th, but, for the most part, it got right down to the business of going up.

On the 21st, there was another drop and again, there were all 3 of the needed elements to create a new P3 squeeze pattern. Later in the day on the 21st, the PPO crossed up, and the lines pushed away from each other.

On the 24th, there were two wobble tests. Both had a PPO line that crossed down below its signal line, not just a touch. Not only that, but the -DI crossed up and over the signal line. Now for traders who do not understand the stages of the P3 pattern, they may have closed their trades, figuring the equity was failing, and it was time to jump ship. P3 traders would have known that wobbles are part of the unfolding process, and, if the ADX wasn't rising then this minor pullback would likely be a wobble and not a stage 7 exit after a stage 6 sweet spot stage. So far in the unfolding process on the 24th, this P3 pattern hasn't had a stage 6 sweet spot, and it should because that is the normal order of things. On the 25th soon after open, it went into the stage 6 sweet spot stage.

On the 26th, that pattern moved into stage 7, and still the ADX did not rise to support the -DI and, on the 27th, it added a stage 8 additional sweet spot leg up.

I also want to draw your attention to the chart on the 28th-31st. At first glance, you may think this is a new P3 squeeze pattern. Notice that the dip down of the PPO isn't directly above the rising area of the ADX. You want the dips to look like the indents of a guitar. The dents/dips of the 28th are offset.

Chart Courtesy of Stockcharts.com *Fig. 29*

Now if you apply what you know about the three elements needed to create a P3 squeeze pattern, you will see that you have only two of the elements needed on the 28th of July, and this is really important. From here, the PPO has crossed back up as has the +DI line, so in all likelihood, the ADX line will flip up, and there will be another stage 8 – add-on sweet spot leg up. Seeing this and recognizing the possibility of it moving into another strong ADX support move, gives insight and a trading advantage.

Really study this chart; it is a great example no matter what time frame you are looking at. It is a classic image of all the P3 squeeze stages.

Stages of the P3 Squeeze

1. The PPO and ADX lines come close together
2. PPO lines cross and ADX line pushes away from PPO

3. The lines move further away
4. +DI crosses –DI line and then the ADX line itself
5. PPO line wobbles- maybe once, maybe twice. If PPO fails and crosses back down, this is a stop exit.
6. PPO and ADX move into the sweet spot - railroad tracks where lines run parallel.
7. Time to exit with PPO rollover.
8. Add-on Sweet spot leg

I cannot stress strongly enough how important the +DI is to this P3 pattern. It truly reflects the direction of the trend and whether the price has a chance of moving up into a new uptrend, or if it will drop back to then have to try to break out again.

Let's study another example.

Notice on SLVs chart below at the area where the PPO line and the ADX both headed up 3 times from July 11th to the 21st. These were extra add-on on bonus stage 8 stages.

I will get into the specifics of exact entry and exits as we proceed, but for now, I want you to focus on the stages of the pattern. As I mentioned before, the P3 squeeze pattern reacts the same no matter what time frame it is seen in. The difference is the time it takes for it to unfold.

Chart Courtesy of Stockcharts.com *Fig. 30*

The next chart is for QQQ. It is an example of the pattern that failed to go through all the stages of the squeeze on the left side of the chart. It reformed 3 times. On the first effort, the +DI did cross up but couldn't hold its ground. On the second pattern attempt, the +DI didn't cross, and the PPO only touched the signal line at about the same time. The 3rd pattern was the charm, and its pattern unfolded over a period of months.

Note how many times that the PPO crossed down (stage 7) after a stage 6 sweet spot. I count 4 PPO crosses before a new P3 pattern formed in July.

Every squeeze pattern must go through the unfolding process, end up in the sweet spot, and then conclude by a PPO cross back down. There are times that an equity will make it through stage 5 where the PPO and ADX lines have spread apart and the PPO wobbles, and then the squeeze fails and resqueezes. You know this has happened if

the PPO crosses down through the signal line before the ADX strength line has headed up into the sweet spot where the PPO and ADX line run parallel to each other.

Sometimes a squeeze pattern will resqueeze several times as we saw in this chart, but, eventually, it will unfold completely. All squeezes will finally go through all the stages, and this then ends the original squeeze. At some point, another one will form.

Understanding this squeeze process and the stages will help you analyze where the pattern is along its way as it moves through its stages. You will be able to spot if the squeeze is weakening and likely to resqueeze or if it is showing strength and is apt to move through the stages #1- 7.

If the +DI seems to be regaining strength at the first wobble, this can be a second entry point. If the ADX line has headed up and is in the sweet spot, the next PPO wobble is quite likely to be the exit time, not another opportunity to enter.

From here on out as you spot a squeeze on a chart, follow the stages and analyze where it is in the unfolding process. Create a cheat sheet until you have the stages memorized. The more you do this, the faster you will train your eyes and mind to digest the information, recognize the stage and interpret its message.

When I first began, I made a little cheat sheet on a yellow sticky note and kept it near my computer with the stages numbered and a short description. This helped to keep me straight and is still a quick reference.

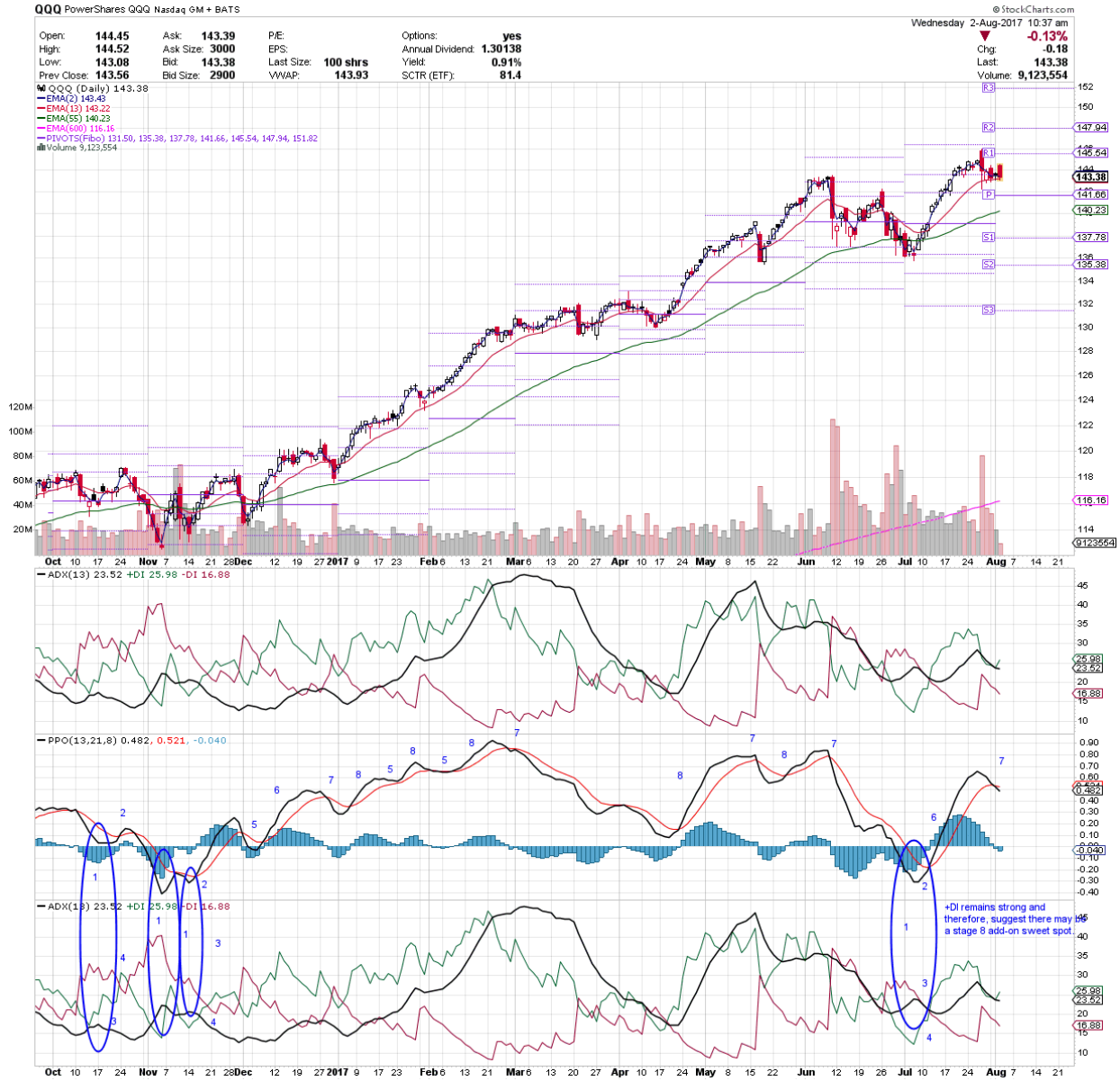


Chart Courtesy of Stockcharts.com *Fig. 31*

One more chart and we will move on.

As wonderful as the P3 squeeze is, there are times (few) that trading it can be tough. The next chart is an example of one of the challenging squeezes.

EEM squeezed and resqueezed 4 times before it went through all the stages. Each time the PPO crossed up, the price went up, but the +DI lagged. And then, PPO quickly failed, and the price dropped. It stayed down only a short time, short enough that it became hard to spot the areas where the PPO and ADX lines came together. Finally, on the last squeeze, there was a sweet spot area where the PPO and ADX lines went parallel for nearly 2 months, and then the PPO crossed down to end the pattern.

Before the PPO cross down in March, whatever happened, it was something that went beyond just the energy of the squeeze. Maybe all the squeezes and resqueezes pushed all the bears out.

Each time the PPO crossed its signal line, and the +DI failed to move up, the possibility of a viable trade was negated. Eventually, on the 4th attempt, there was a great deal of pent up energy, and the stage 6 sweet spot was solid and long lasting.

So much so, that in March when the PPO did cross down, and price touched the 55 EMA, it triggered a series of stage 8 add-on sweet spot stages that played out before another new P3 squeeze was able to form. Each time the PPO crossed down, it did so and rested during that time, caught its breath, and then popped up again before any ADX strength came in to support the -DI line.

The chart below is the last example of the P3 squeeze pattern that provides information for trades going to the upside – Calls. Next, we will look at the Squeeze Put pattern. It's a tweak on the P3 squeeze. A P3½ . Once you become familiar with this pattern, I will move on to the charts as a whole and apply what you have learned to the strategy – entries and exits.

Chart Courtesy of Stockcharts.com *Fig. 32*

P3½ Put Squeeze Pattern

For the P3½ adapted pattern for Puts, we will be using the PPO indicator and the ADX that is on top of the PPO on the chart, the upper two indicators.

In some ways, the squeezing portion of the pattern is not quite as obvious as the P3, but you can train your eyes to pick it out. More obvious is the P3½'s sweet spot. During this stage, the equity's price drop is a certainty, and we have already had a preview of this stage in that there must be a P3½ sweet spot for a new P3 squeeze pattern to form.

On the EEM's chart below, you will see that the ADX line has dropped to come closer to the high PPO line. The PPO line is high because there has been a recent uptrend, yet

now because the uptrend is weakening, the ADX line has dropped as energy comes out of the uptrend and the +DI.

The uptrend weakened to the point that the PPO line crossed down and over its signal line. At the same time, the –DI of the ADX is beginning to show strength by heading up to cross over the +DI line.

Before we get into further details of the P3½ pattern, in addition to EEM's, I will post a few other charts so you can start to recognize this variation of the squeeze.

Chart Courtesy of Stockcharts.com *Fig. 33*

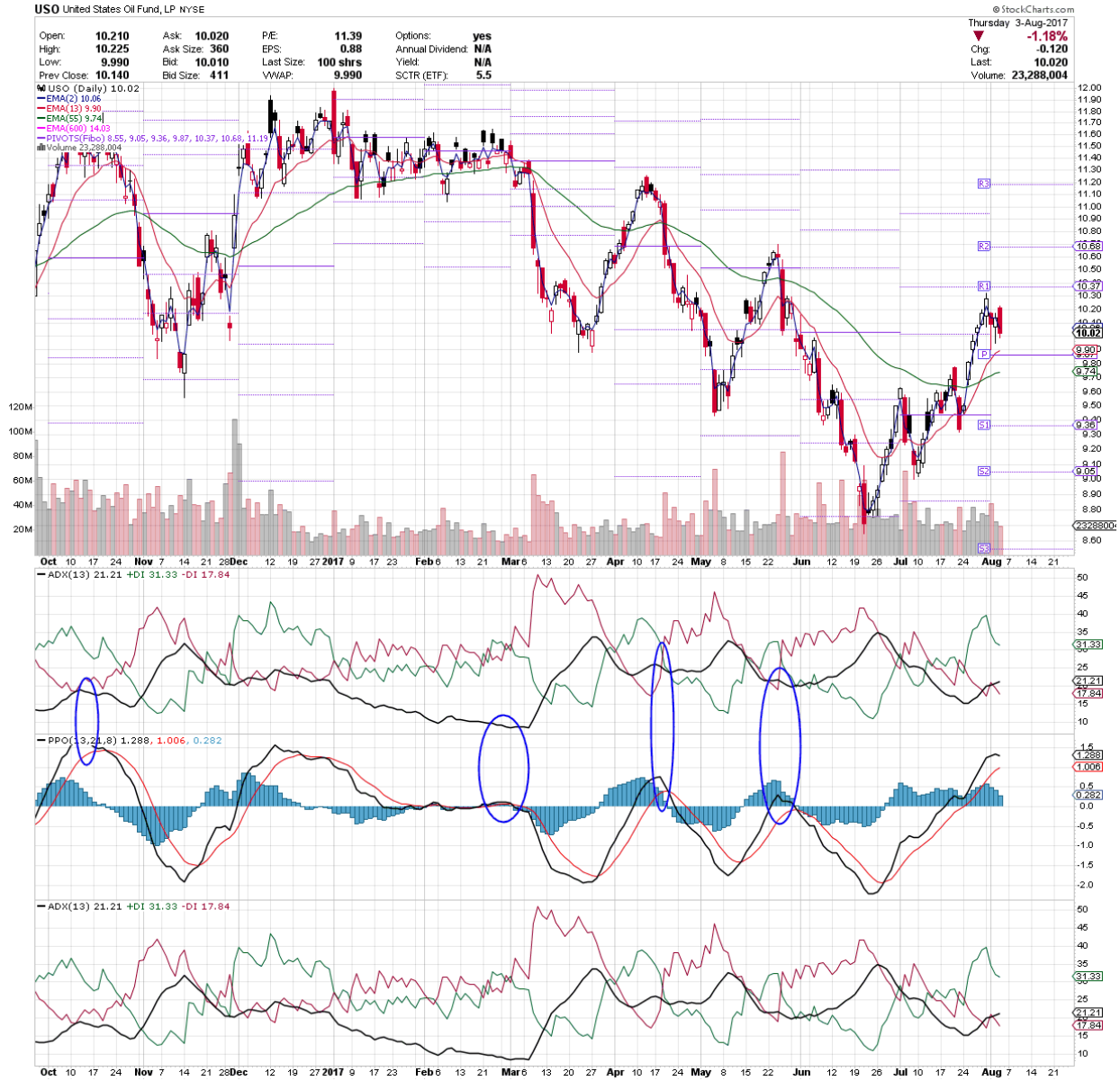


Chart Courtesy of Stockcharts.com *Fig. 34*

Chart Courtesy of Stockcharts.com *Fig. 35*

Chart Courtesy of Stockcharts.com *Fig. 36*

Chart Courtesy of Stockcharts.com *Fig. 37*

Perhaps, after looking at these charts, you have realized why the P3½ pattern is harder to spot than the P3. The secret is in the ADX indicator. For the P3 and the "creation" of the squeeze pattern, the PPO and ADX indicators are the reverse image of each other. The PPO is down, and ADX strength line is up. It is this reverse pattern that creates the P3 squeeze pattern, and, when the indicators run in the same direction, the sweet spot is formed. The stage following the P3 sweet spot – stage 7 is the beginning of the P3½ pattern.

So how is the P3½ different, making it tougher to spot? The ADX strength line placed above the PPO support it and makes the pattern harder to see. If the PPO is up, so is the ADX line in most cases as both indicators reflect the movement of price going up. As the price goes up, the PPO and ADX lines follows the same path, it is when the uptrend starts to weaken that the P3½ starts to form.

The PPO and ADX lines are relatively close as the PPO line curls over and prepares to cross down over its signal line. Then, the –DI moves up to cross the +DI line, so the trend is changing to the downside. The PPO crosses its signal line. Then as the P3.5 moves through its early stages it is preparing for the PPO line and ADX line spread apart and push away from each other to create the P3.5 sweet spot. The P3.5 pattern, in a sense, is the complete reverse of the P3.

The beauty of it all is that one pattern flows into the other. This creates the wave that can be ridden up and down. As the P3.3 pattern unfolds and plays out, the chart starts to form the P3 squeeze pattern. As the P3 squeeze pattern forms and plays out, the P3.5 pattern is forming.

Let me make a list of the stages for the P3.5 and mark a few charts, so that you can tie in this information. Let's use the same charts posted above with the close areas circled.

We are getting closer to having all the elements for our squeeze patterns in place. Let's look at a few more P3.5 charts where the stages are marked, and then we will move on to tie everything together.

Stages of P3½ Put Pattern

1. ADX and PPO come close together as they mimic each other
2. –DI Rising
3. PPO crosses down and over its signal line
4. –DI crosses +DI and eventually, the ADX line
5. PPO wobbles against the signal line
6. Spread apart of PPO and ADX lines creates the sweet spot
7. Exit - Rollover of ADX line and drop of –DI
8. Bonus - in a strong downtrend there can be an add-on sweet spot stage

I will apply these reference numbers to the charts.

Chart Courtesy of Stockcharts.com *Fig. 38*

Chart Courtesy of Stockcharts.com *Fig. 39*

Chart Courtesy of Stockcharts.com *Fig. 40*

Chart Courtesy of Stockcharts.com *Fig. 41*

I marked the last chart a little differently to illustrate how the P3½ stage 6 sweet spot is needed to form a new P3 sweet spot stage and a similar chart could be drawn to show that there has to be a P3 sweet spot stage for the P3½ pattern to form. It is when both the PPO and ADX line are heading straight up that a P3½ stage 1 pattern is formed.

So now you understand the stages of both the P3 Squeeze and the P3½ Squeeze patterns. As the P3½ forms and plays out, the P3 is forming. As the P3 unfolds and it is time to exit, the P3½ is taking shape.

One pattern flows into and forms the other.

I will move on now, and we will delve into the strategy itself, tying in the other indicators as confirmations. I suggest during this learning process that you do a lot of chart gazing. Like walking the beach at night and looking skyward, the more often you can

pick out and identify the Little Dipper and Orion's Belt, the easier it is to zero in and identify those patterns no matter how cluttered the night sky. It is the same with the charts. The more you skim through charts and locate the patterns, the easier it is to spot them amongst all the other information on the chart.

I am and will be eternally grateful for the circumstances that brought these patterns to my attention. They have been at the root of changing my life for the better.

Next, let's tackle the requirements for the strategy and then, we'll jump into specific entry and exit signals based on the patterns you just learned.

Do We Select In, At or Out-of-the-Money Strike Priced Options?

When you decide to purchase a Call or Put option on an ETF, you also have the choice to buy in-the-money, out-of-the-money, or at-the-money options as we discussed earlier.

For our review, let's say you decided on a Call purchase:

- **In-the-money** (ITM) is the amount by which the price of the equity exceeds the strike price. For example, EEM's (Emerging Market ETF) equity price is $42.20. You decide on a strike price of 40, with an April weekly expiration date. The option contract would read EEM Aprwk2 17 40 Call. (17 is the year) This April option is $2.20 *in-the-money,* which is the difference between the equity's price and the strike price. The 40 is the strike price of $40, and the expiration date is the second Friday after the weekly is listed or its birth date.

- **At-the-money** (ATM) is the amount when the price of the equity matches the strike price, or nearly so. For example, EEM's (Emerging Market ETF) equity price is $42.20. You decide on a strike price of 42, with an April weekly expiration date. The options contract would read EEM Aprwk2 17 42 Call. (17 is the year) This April weekly option is *at-the-money* since the strike price nearly matches the equity's price.

- **Out-of-the-money** (OTM) is the amount by which the price of the equity is below the strike price. For example, EEM's (Emerging Market ETF) equity price is $42.20. You decide on a strike price of 44, with an April weekly expiration date. The option contract would read EEM Aprwk2 17 44 Call. (17 is the year) This option is $1.80 *out-of-the-money* since the equity's price is below the strike price.

As I stated earlier, this terminology may seem to indicate that the strike price moves, but this is not the case. I may say the strike price has moved from out-of-the-money to in-the-money, but it is actually the underlying equity's price that has moved. The strike remains constant, consistent with the price of the option purchased. The EEM Aprwk2 17 42 Call remains a $42 call option no matter if EEM's equity price moves above or below $42.

All options available for purchase, whether they are in-, at-, or out-of–the-money, are listed on a option chain. Not all equities offer weeklys, but each week more and more do. If weeklys are available, they are the first ones listed on the chain. Option chains can be found on your option trading platform and online at numerous sites, such as BigCharts.com, CBOE.com, or OptionsClearing.com.

The chains provided by your trading platform will show premiums that are current, second by second. The online chains available at the sites mentioned above are usually delayed by 15 minutes or so. They are good for after-market hour reference or for times when you are studying and don't need up to the moment information.

The screen shot below is for JPM (JP Morgan), a bank stock include in XLF (Financial Sector ETF). The Calls are listed on the left side of the chart; the Puts are on the right side. The strike prices run down the middle. The current stock price for JPM is $44.84. Therefore, any of the Call strike prices that are in the darker shaded area in the upper left hand corner will be in-the-money since the strikes are lower than the stock price. The strike prices below the current stock price (below the dark line) will be out-of-the-money since they are higher than the stock price. The 45 strike price could be considered at-the-money since it is near the stock price of $44.84, but it is actually out-of-the-money by $.16.

No matter which ETF or stock you look up, the option chain set-up will be the same.

For comparison, Put options are listed on the right side of the chain, the strike prices that are higher than the equity's price and are in the darker shaded box in lower right corner are in-the-money Put strike prices (below the dark line). The strikes that are lower than the equity's price (above the black line) and are in the upper right hand corner are out-of-the-money strike prices. The 45 strike would be considered to be at-the-money, even though it is $.16 in-the-money for a Put.

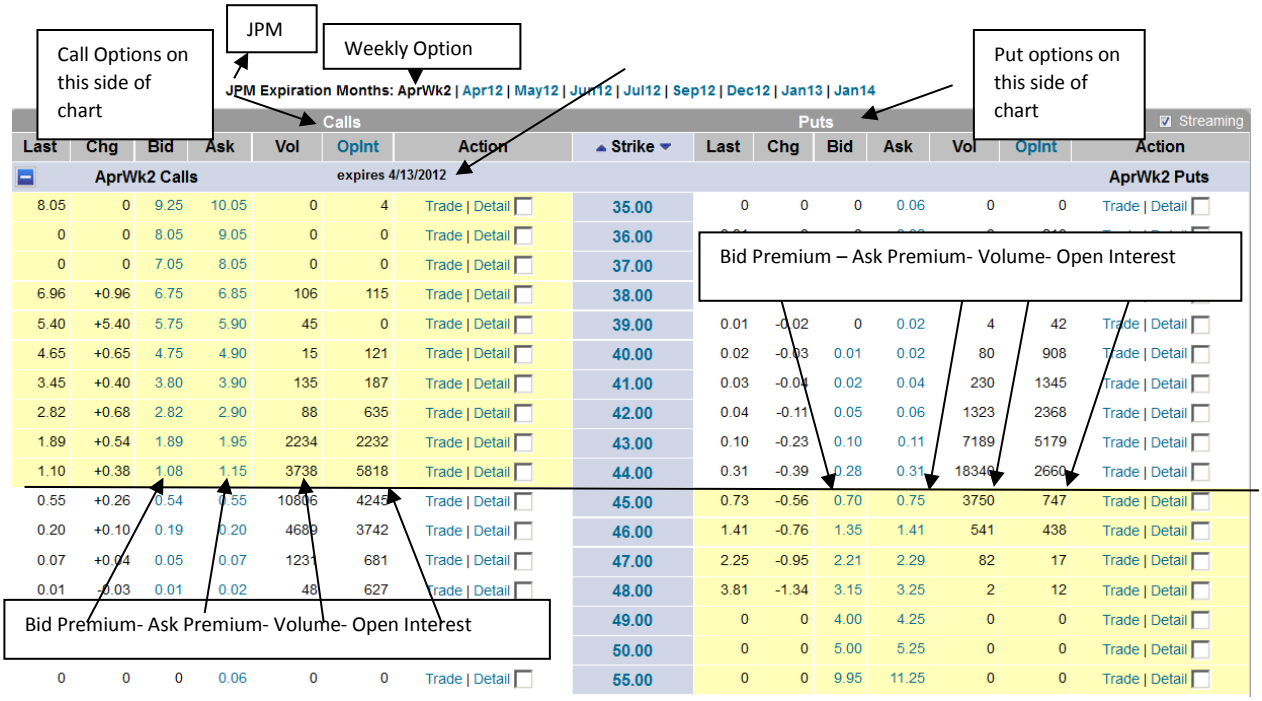


Image Courtesy of OptionsXpress *Fig. 42*

An ask premium is the amount the market-makers are asking per share for each of the 100 shares in an option contract. The bid premium is the amount that the market-makers are willing to pay to buy back the shares in the contract. The difference between the ask and the bid can be considered a commission charged by the market-maker to participate in the trade.

For the EGC strategy, we will be concentrating on the strike price that is one out-of-the-money, providing it meets the other criteria covered in the next section. In this strategy, it fits into and has the most benefits as it relates to the quick movement we are looking for in our trades.

How Do I Find ETFs to Trade?

There are many ETFs from which to select and to review as you look for trade patterns to develop. New ETFs are created on almost a daily basis. Of course, you are going to want to place trades on ETFs that are tried and true and have a solid trade history.

A starting place is the ETFs based on the market indices - DIA, SPY, QQQ, IWM. Then you can add the 9 sectors of the S&P. A good place to find a list of the sector ETFs, as well as others like the precious metals, is located on Stockstarts.com free summary - https://stockcharts.com/freecharts/marketsummary.html

You can also do a Google search for top-traded ETFs.

In the next section, you will find criteria that will help qualify these ETFs further.

Trade Requirements (Open Interest, Volume, Delta and Spread): EGC Option Guidelines

In the EGC option strategy, we will be selecting options from an option chain, considering the following criteria:

First Guideline: The first consideration will be Open Interest of at least 50. **Open interest** is the number of open contracts at the current moment, whether they are long or short positions (Calls or Puts). I use the 50 requirement for a specific reason. If you purchase an option with open interest of less than 50, you may experience difficulty selling the option when you are ready if there aren't enough interested traders wanting to buy it from you.

To fine tune this even further, *don't buy more than 10% of the open interest*. Therefore, if the open interest is 250, then don't buy more than 25 contracts.

On the option chain featured above, notice how the open interest is listed for each strike option whether it is a Call or Put option. Also, please note that some of the strikes have zero open interest, and others have less than the required 50, while still others have plenty of interested traders.

I want to add an exception to the 50 OI requirement. If a weekly option is born on a Thursday and you are considering a purchase that morning, it may not have had time for other traders to make purchases. In this case, you should take into consideration what is normal for this equity.

Does it usually have adequate OI for most strikes? Is it likely to accrue OI quickly over the next few hours?

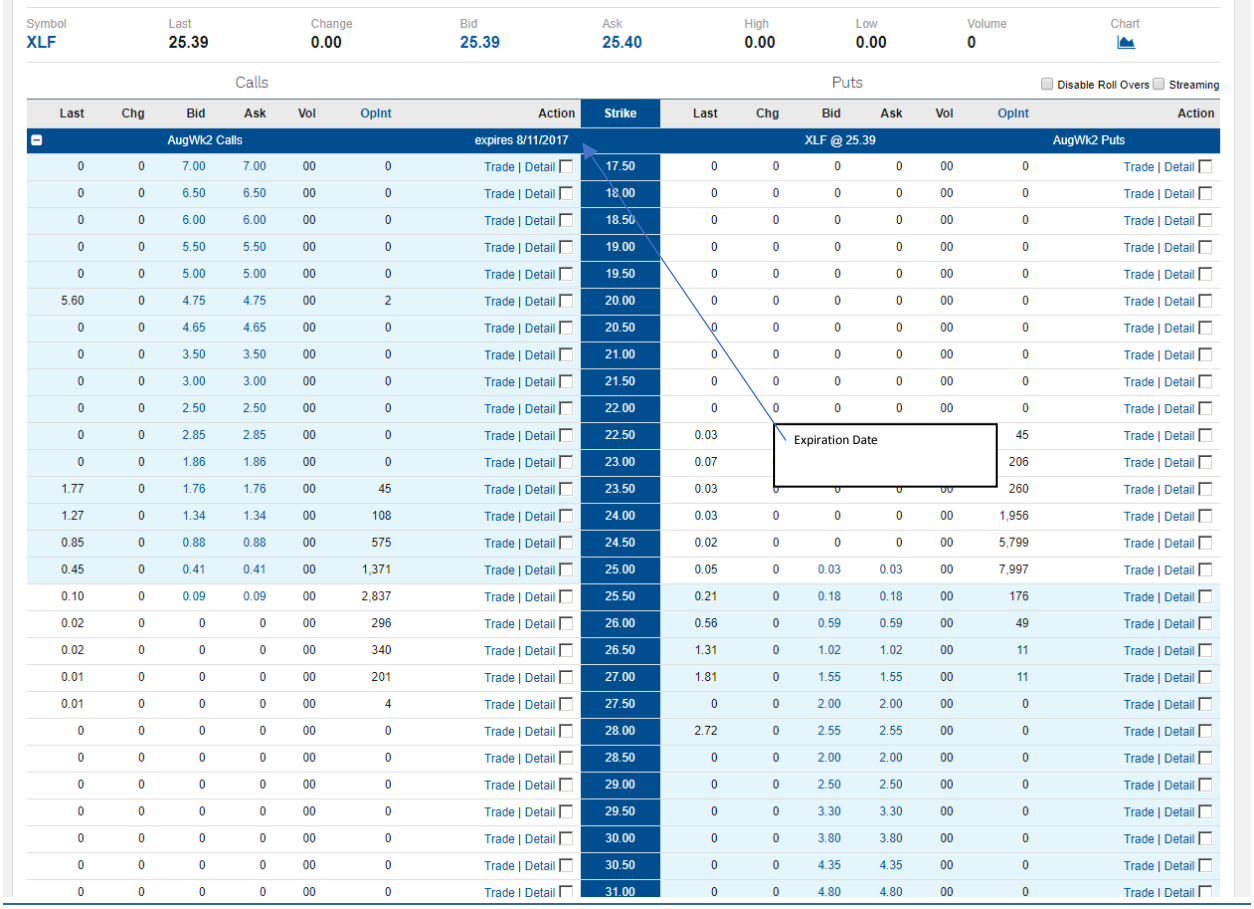
I want to add one more element to this guideline. On the chain, you will note the volume column. You want to see some volume. There is no set volume number to keep in mind, but there should be *some* volume. This is an ambiguous phrase. The **volume** is the number of contracts bought and sold during the current day, where open interest is the number of accumulated open contracts. There is no specific number for volume, but it stands to reason that you would want to see some daily activity or trader interest taking place.

Now there may be the unusual circumstance where you are considering entering a trade, the market has been heading down, and you see that a change is imminent, and you decide to enter a Call position, yet there is no volume on the strike for the current day.

Your online brokerage should offer you historical information, covering the activity on the strike you are considering. If you cannot locate the historical information on your brokerage's website, call or use the online chat option that most online brokers offer to ask where you can access this information.

The chart below will illustrate why this is an important step. It may be that there is plenty of open interest to fulfill the 50 OI guideline on a strike price, and if there is no volume, it may be just one of those fluky days. On the other hand, it could be that all the contracts (open interest) are owned by market-makers and the premiums are sitting stagnant until naive traders get lured in.

On the image below for XLF (S&P Financial ETF), there is 1,371 open interest, or 1,371 open contracts for the 25 strike price, which is at-the-money or in-the-money by .39 cents depending on how you want to look at it. This figure meets the 50 open interest guideline, but there is no volume on this day because, as I capture the image, it is a weekend.



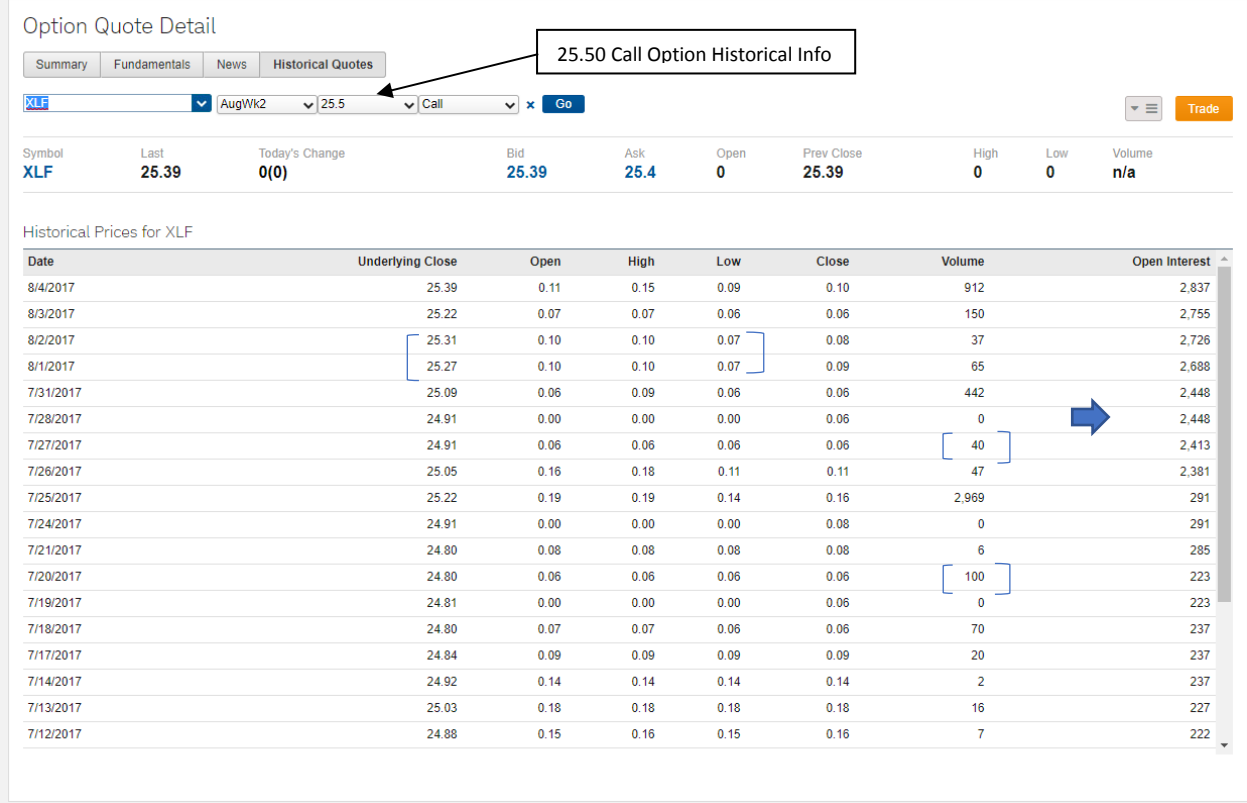
Symbol	Last	Change	Bid	Ask	High	Low	Volume	Chart
XLF	25.39	0.00	25.39	25.40	0.00	0.00	0	

Calls | Puts | Disable Roll Overs | Streaming

Last	Chg	Bid	Ask	Vol	OpInt	Action	Strike	Last	Chg	Bid	Ask	Vol	OpInt	Action
AugWk2 Calls						expires 8/11/2017		XLF @ 25.39						AugWk2 Puts
0	0	7.00	7.00	00	0	Trade | Detail	17.50	0	0	0	0	00	0	Trade | Detail
0	0	6.50	6.50	00	0	Trade | Detail	18.00	0	0	0	0	00	0	Trade | Detail
0	0	6.00	6.00	00	0	Trade | Detail	18.50	0	0	0	0	00	0	Trade | Detail
0	0	5.50	5.50	00	0	Trade | Detail	19.00	0	0	0	0	00	0	Trade | Detail
0	0	5.00	5.00	00	0	Trade | Detail	19.50	0	0	0	0	00	0	Trade | Detail
5.60	0	4.75	4.75	00	2	Trade | Detail	20.00	0	0	0	0	00	0	Trade | Detail
0	0	4.65	4.65	00	0	Trade | Detail	20.50	0	0	0	0	00	0	Trade | Detail
0	0	3.50	3.50	00	0	Trade | Detail	21.00	0	0	0	0	00	0	Trade | Detail
0	0	3.00	3.00	00	0	Trade | Detail	21.50	0	0	0	0	00	0	Trade | Detail
0	0	2.50	2.50	00	0	Trade | Detail	22.00	0	0	0	0	00	0	Trade | Detail
0	0	2.85	2.85	00	0	Trade | Detail	22.50	0.03					45	Trade | Detail
0	0	1.86	1.86	00	0	Trade | Detail	23.00	0.07					206	Trade | Detail
1.77	0	1.76	1.76	00	45	Trade | Detail	23.50	0.03					260	Trade | Detail
1.27	0	1.34	1.34	00	108	Trade | Detail	24.00	0.03	0	0	0	00	1,956	Trade | Detail
0.85	0	0.88	0.88	00	575	Trade | Detail	24.50	0.02	0	0	0	00	5,799	Trade | Detail
0.45	0	0.41	0.41	00	1,371	Trade | Detail	25.00	0.05	0	0.03	0.03	00	7,997	Trade | Detail
0.10	0	0.09	0.09	00	2,837	Trade | Detail	25.50	0.21	0	0.18	0.18	00	176	Trade | Detail
0.02	0	0	0	00	296	Trade | Detail	26.00	0.56	0	0.59	0.59	00	49	Trade | Detail
0.02	0	0	0	00	340	Trade | Detail	26.50	1.31	0	1.02	1.02	00	11	Trade | Detail
0.01	0	0	0	00	201	Trade | Detail	27.00	1.81	0	1.55	1.55	00	11	Trade | Detail
0.01	0	0	0	00	4	Trade | Detail	27.50	0	0	2.00	2.00	00	0	Trade | Detail
0	0	0	0	00	0	Trade | Detail	28.00	2.72	0	2.55	2.55	00	0	Trade | Detail
0	0	0	0	00	0	Trade | Detail	28.50	0	0	2.00	2.00	00	0	Trade | Detail
0	0	0	0	00	0	Trade | Detail	29.00	0	0	2.50	2.50	00	0	Trade | Detail
0	0	0	0	00	0	Trade | Detail	29.50	0	0	3.30	3.30	00	0	Trade | Detail
0	0	0	0	00	0	Trade | Detail	30.00	0	0	3.80	3.80	00	0	Trade | Detail
0	0	0	0	00	0	Trade | Detail	30.50	0	0	4.35	4.35	00	0	Trade | Detail
0	0	0	0	00	0	Trade | Detail	31.00	0	0	4.80	4.80	00	0	Trade | Detail

Image Courtesy of OptionsXpress *Fig. 43*

The image below shows the historical activity for the 25.50 strike price option (one strike out of the money from the chart above for XLF (S&P Financial ETF).



Date	Underlying Close	Open	High	Low	Close	Volume	Open Interest
8/4/2017	25.39	0.11	0.15	0.09	0.10	912	2,837
8/3/2017	25.22	0.07	0.07	0.06	0.06	150	2,755
8/2/2017	25.31	0.10	0.10	0.07	0.08	37	2,726
8/1/2017	25.27	0.10	0.10	0.07	0.09	65	2,688
7/31/2017	25.09	0.06	0.09	0.06	0.06	442	2,448
7/28/2017	24.91	0.00	0.00	0.00	0.06	0	2,448
7/27/2017	24.91	0.06	0.06	0.06	0.06	40	2,413
7/26/2017	25.05	0.16	0.18	0.11	0.11	47	2,381
7/25/2017	25.22	0.19	0.19	0.14	0.16	2,969	291
7/24/2017	24.91	0.00	0.00	0.00	0.08	0	291
7/21/2017	24.80	0.08	0.08	0.08	0.08	6	285
7/20/2017	24.80	0.06	0.06	0.06	0.06	100	223
7/19/2017	24.81	0.00	0.00	0.00	0.06	0	223
7/18/2017	24.80	0.07	0.07	0.06	0.06	70	237
7/17/2017	24.84	0.09	0.09	0.09	0.09	20	237
7/14/2017	24.92	0.14	0.14	0.14	0.14	2	237
7/13/2017	25.03	0.18	0.18	0.18	0.18	16	227
7/12/2017	24.88	0.15	0.16	0.15	0.16	7	222

Image Courtesy of OptionsXpress *Fig. 44*

Notice that there is zero volume for 7/28 and the open, high, low premium information shows no change despite the fact that the equity had open interest of 2,448 contracts. The premium price should have changed with the drop in the price of the equity, but it didn't change at all. Even the day before the 27th when 40 contracts were bought, price remained at .06 for the high, low, close. This is suspicious as it suggests that only the market-makers are involved, and, since no other traders are in the trades, there is no need to adjust the price.

If you skim though the other days' activities on the chain, you will note that several of the amounts look suspicious. There should have been changes in relationship to the intrinsic value of the option and the rise and fall in the equity's price. On XLF's chain, there were a few days that it actually met the "some" volume guideline and still the premium didn't change an appropriate amount until August 4th.

As you become more familiar with option chains, these suspicious strikes will jump out at you. You will note it is unusual for a strike that is in or at-the-money to have no or super low volume, or the strikes above or below to have zero volume. This should raise the hair on the back of your neck. It is time to investigate by checking out the historical activity of the option.

So, what does it all mean?

You will find, on occasion, a strike that is in or at-the-money option that isn't being bought by traders. When this happens, the market-makers will buy a few contracts themselves to entice traders, and then, if no other traders are drawn in to make purchases, there is no reason to adjust the option premium. Why raise the price when no one is involved but the market-maker himself?

So, what happens if you purchase one of the options being manipulated by a market-maker? Nothing disastrous. Once you make a purchase, the market-maker will have to adjust the premium according to trading regulations. The option premium will be calculated based on equity's price movement, volatility, and time value. However, it may be that you are the only trader involved in the trade. When you decide to exit the trade, it could be that there is no one but the market-maker to purchase it back from you. He may or may not be interested in that side of the transaction.

Or it could be that soon after you enter the trade, other traders will be drawn into the trade as well. Perhaps, they too saw the same opportunity you recognized. If this happens, the trade and premium pricing will proceed under normal conditions. When you are ready to exit the trade, there will be traders willing to participate.

When the volume looks light on the option chain, it pays to check the historical information. It is much more productive to take part in a trade that other traders are participating in.

Second Guideline: The second consideration in the EGC option strategy is to purchase only weekly options or front month (if there is at least 3 weeks left until expiration) if you are trading 30 or 60-minute charts and 3-4 months out if trading a daily chart. We will cover the specifics shortly.

There are some very attractive elements inherent in option trading that are not available to stock or longer term option traders that make learning options and particularly weekly options worth the effort.

The first is leverage. The leverage you can achieve in options is incredible. This leverage is like controlling a multi-million-dollar project by investing only a small down payment. For each $0.25 this project generates, your investment can increase by $1 or more, a four-fold increase.

Weeklys compound this option leverage even further, many times by ten-fold.

Now that is what dreams are made of!

Another overshadowing consideration is the atmosphere of the stock market as a whole. Is it in a solid uptrend? Is it going into a correction? Is there a sector rotation taking place? The answer to any of these questions could influence the amount of time that it could take your trade to develop. We will be trading particular patterns, but still the unfolding of these patterns can be influenced by overall market conditions. It would be a shame to plan for a long Call trade lasting a few hours, while the indices pullback

in a major correction, or it changes course to a down trend that stifles the direction of your long trade.

Next, you will want to evaluate the index that the equity is associated with. Is the NYSE or NASDAQ moving in the same direction as your trade? If so, then the time to profit may be extended by the support of the index. If the index is going in the opposite direction, then the movement is apt to be based on the equity's momentum alone, unless there is some other influence like the equity's sector deteriorating. Has the equity's sector fallen into disfavor? Is there a cyclical change happening? If so, the equity is likely to climb or drop for a longer period of time. There is no sense leaving money on the table.

These are all considerations in the option evaluation process.

You will want to sell your position before expiration to avoid having the option exercised, meaning that you will be asked to purchase the shares of an equity covered by the option if you don't sell your option contracts before market close on expiration Friday.

Weekly Option Selection Example: Imagine there are 2 days left of the current weekly option, which we will say is an April 2nd week, and the average pattern pullback for XLF's 30-minute chart is 3 days. Therefore, even if the pullback happened immediately, the pullback would run into the next week or a day after expiration. The trade could run out of time before it has time to complete. If the pullback doesn't get started on the first day, it could go even deeper into the next week.

In this case, it would pay to purchase the April 3rd week option, which would be the April Monthly expiration (which expires on the 3rd Friday) while there was still 2 days left on the current weekly option, giving your trade the benefit of the extra time needed to make sure the pattern develops.

After answering the questions about index and sector support, you will decide if there is enough time for the trade to develop to its full potential in the current weekly option or if you need even more time by waiting for the following week's option to be listed. Always err on the side of extra time, giving the trade plenty of time for the unexpected.

As a general rule, it is suggested that you select an option that is out about two weeks in time if you are trading a 30-minute pattern. This gives the trade plenty of time to develop if it is slow to get started, to play out and sell before time decay escalates days before expiration.

If you are trading a 60-minute chart, give the trade 3 or 4 weeks, which allows time for the trade to develop and then sell to close the trade the week before expiration to avoid escalating time decay.

When trading a daily chart pattern, buy an expiration that is 3 or 4 months out in time, and then close the trade approximately 30 days before expiration to avoid the escalating time decay that happens as the month closes in on it expiration date.

Third Guideline: A third, yet major, consideration has to be available funds. Since extra time will be available at an increased premium, you can only work with the funds you have on hand to invest. Don't be tempted to cut the time a third week option covers because of a shortage of funds! Find another ETF to invest in that's creating a tradeable pattern, one that has a lower premium.

For our weekly option trades, set an average total investment for each trade at about $600. Then this is the total amount at risk for the trade. You can't lose more than $600, and you know the full amount that is at risk before you ever enter the trade.

If you are purchasing monthly options for a trade based on a daily chart, you can increase the trade amount to $1,200 on average.

The main reason for setting a $600 to $1,200 limit is that trading fees or commissions need to be taken into account when trading multiple contracts that are inexpensive. One broker might charge $12.95 for 1 to10 contracts and $1.25 for each contract thereafter. Other brokers may have slightly higher or lower commission fees. If possible, you want to purchase a few contracts so the fees are paid for by the profit of a few contracts.

Let's use the $1.25 broker as an example. If you are considering purchasing low cost weekly options with a cost of .05 per contract (not advisable) or $5 for the 100 shares, and perhaps, allocating $1,000 for the trade. You would be purchasing 200 contracts. The commission or trade fees would be $250.45 to get into the trade and $250.45 to close the trade. A total of $500.90 in fees is quite likely to wipe out or put a big dent in the trade's profits.

By limiting each trade to an average of $600 to $1,200, you are limiting the risk on each trade and also controlling the costs to place the trade.

This brings up the importance of finding an online broker with reasonable fees. I will cover this again when I get into the section about opening a trading account

Now that we have established the $600-$1,200 guideline, let's fine tune this even further. Premiums vary depending on many influencing factors. For this EGC strategy, target equities offering .45 premiums or higher. Most of the popular ETFs are likely to be more than .45, but I want to set a limit so that you aren't tempted to trade an obscure ETF with a low premium.

This restriction limits the number of contracts to approximately 10. In our example, $0.45 times 100 shares = $45, $45 divided into $600 = 13 contracts. Limiting the number of contracts to approximately 10 helps control the brokerage fees. As explained earlier, if a trader is tempted to buy 100's of contracts based on a cheap premium, he may be hit by HUGE brokerage costs that more than wipe of the profit earned.

Fourth Guideline: The next weekly option consideration is strike price. The option we select for the EGC strategy should be at or slightly out-of-the-money.

The agreed-upon price at which the option can be exercised is the strike price; therefore, that price is a factor in the selection for the following reasons:

Let's say you want to purchase a Put option to sell S&P Health Care ETF (XLV). Its current price is $79.34 a share. You can agree to sell shares of XLV equity for $80, or you can agree to sell XLV equity for $85. If both options cost the same, which one would you choose to sell? The options with the $85 exercise or strike price. That's a no-brainer.

Now let's assume S&P Health Care ETF (XLV) decreases in value to $75. If you had the right to sell the equity for $85, you could "exercise" your right, purchase the equity for $75, and then sell it for the strike price of $85, thus earning a profit of $10 per share, or $1,000 for your 100-share option contract. Needless to say, you would not "exercise" your right to buy, if you owned the option with a $72.50 strike price. You would choose to do nothing because there would be no profit in it, and no reason to pay the fee to close the trade.

The fact that there would be a $1,000 profit on the option with a $85 strike price and no profit on an option with an $72.50 strike price illustrates how an option's value should increase or decrease, depending upon the agreed-upon price at which the equity can be purchased.

The $10 per share you earned, if you exercised your option, is called the "intrinsic value" of the option. Depending on whether you are purchasing a Call or Put option, you want the intrinsic value to accrue quickly as the equity value rises or drops. Therefore, you want to buy your Put option at or slightly out-of-the-money.

To determine the intrinsic value of the option, subtract the current price of the equity from the Put strike price.

Example: For a Put option an $80 strike price minus $78 equity price equals $2 intrinsic value in-the-money. (This is the opposite of a Call option; an $80 strike Call option on a $78-dollar equity price would be $2 out-of-the-money).

Another example: $75 strike price Put option minus $78 equity price equals -$3 (negative $3) or $3 out-of-the-money. The equity's price will have to drop $3 before a $75 strike will be at-the-money.

To take this pricing example one step further, let's say the premium for the $80 strike Put option for our expiration was $2.38. If we deduct the $2 intrinsic value from the premium, the balance is its time value ($0.38). This time value dissipates each day as the expiration date nears. It is also replaced by additional intrinsic value if the equity's price moves in the direction of our option position. In the case of our Put option, as the equity's price goes down, our Put option's intrinsic value goes up.

To conclude our Put option example, the $75 strike has no intrinsic value since it had a negative number. Therefore, there is nothing to deduct from the premium (the premium for the $75 strike, 2 strikes below the 80 strike, is considerably lower $0.46). The entire amount of the premium is time value ($0.46 minus .00 equals $0.46 time value.) If the equity's price does drop and continues to do so, the option will eventually gain intrinsic value.

For this strategy, we are going to select options that are at or slightly out-of-the-money, meaning they will have little or no intrinsic value. Patterns unfold quickly, so we are taking the greatest advantage of premium leverage through low premiums and an increased number of contracts.

Most often the strike you will select is the one that is one strike out-of-the-money.

Fifth Guideline: The next aspect to consider is the price of the underlying asset.

Many, but not all, of the ETFs trading on the major indices have weekly options associated with their equities. More and more weekly option tradeable equities are added to the chains every month. Likewise, new weekly optionable ETFs are created to cover a myriad of sectors, industries, or combination of companies.

It stands to reason that higher price ETFs and indexes have larger price movements. Greater price moves give an increased advantage in meeting our profit goals.

For this, we will focus on underlying equities in the $25 plus price range. That doesn't mean on occasion, if your due diligence brings up an equity that experiences higher volume and regular price moves, that you can't make an exception. Yet, for the most part, target $25 plus priced equities.

Sixth Guideline: The cost of purchasing an option is another consideration. The difference between the bid price and the ask price on an option chain is the amount that goes to the market-makers. As mentioned before, you might think of it as a commission paid for handling the in and out transactions of the sale.

For example, if the bid is $0.95 and the ask is $1.10 at the time you purchase your option, you would most likely pay $1.10 for the 100 share-option or $110. If at the time you wanted to close the option, the bid was $2.45 and the ask was $2.60, you would receive $2.45 for each of your 100 share options, or $245 per contract. The market-maker, or the person on the other buying/selling end of the transaction, receives the $.15 per share or $15 (the difference between the bid and the ask) for the 100-share contract as their commission for handling the transaction.

This explains why when you purchase an option contract your account starts off with a deficit. You are down the amount of the spread.

Often the spread between the ask and the bid in weekly options is pennies. With this in mind, you don't want to pay a fee that is too high. If the spread is greater than $.30, don't purchase that particular option, or else place a limit purchase order for a price that

is between the bid and the ask price, bringing the spread into the $0.30 or less range. Market-makers will sometimes trim their commission if they are interested in taking part in the trade. Also, the various exchanges don't always maintain the same bid and ask premiums, so what seems to be a low commission for market-makers at one exchange might be within range at another exchange. The broker will check the various exchanges in their effort to fill your limit order.

A trick that often works for bid/ask spreads that are too large and are divisible by 3 is to divide by 3 and subtract that amount from the ask premium, then insert that amount in your limit order. This trading secret then works even for the $.30 spread. Submit your limit order for $0.20 instead of $0.30. The $0.10 you save per share per contract is $10 and is apt to pay the broker's trading fee for one side of the trade.

Now that I have established a $0.30 guideline for the spread, you must realize there is likely to be times that you decide that you'd like to trade an option on a more expensive ETF and, because these ETFs have higher prices, the bid/ask spread is likely to be more than $0.30.

This being the case, you must use your own discretion as to what is acceptable, knowing that the difference in the bid/ask spread is going to be the amount that your account will be down right from the get-go. If the spread is $1.05, your account will be down $105 until the premium increases beyond that amount.

You should also realize that the higher price ETFs can have a large amount of volatility, and they will often realize a large price move every day in one direction or the other.

Earlier, I mentioned brokerage costs. Every few months of trading, contact your broker (especially online brokers) and ask if you are getting their best deal. You can mention that you want to make sure you are paying a fee commensurate to other brokerage firms. Often you will find they will drop you from $14.95 per side of a trade to $12.50, then to $9.95 for 1 to 10 contracts the next time you call, etc. Eventually, you will hit a limit, but it still doesn't hurt to ask.

Seventh Guideline: This strategy guideline suggests that you focus on ETFs that have significant price movements. In every day trading where there is no event to increase volatility, an ETF moves up and down a predicable amount. This amount can be determined by an indicator that can be applied to a chart called **Average True Range** (ATR). Let's discuss the information it can provide.

Because we want to realize a profit quickly, it stands to reason to want to own an option on an equity that is going to move quickly. For the greatest leverage and profit advantage, you want an ETF that is likely to move up further in-the-money one or two strikes during the time of the trade.

You want an ATR of approximately 1% a day. This way, if a trade last 2 or 3 days, you are likely to reach your profit goals based on a 30- or 60-minute chart. Of course, it

takes longer for a daily chart to move through its pattern and it does cost more, so you want the ETF to have consistent steady moves from which to benefit.

A 2.5% - 4% price move will often equate to a double in premium. So, our goal is to trade high ATR equities, reach our profit goals quickly, close the trade, and move on to the next candidate.

The Average True Range indicator provides this qualifying information. The indicator gives a numerical average of price movement over a given period of time. Using this average, you can look up the price information on a chart or the option chain of a particular ETF and compare the average price movement. You want them to be nearly the same.

If an ETF moves $0.26 a day as an average, yet 1% is $1.50, it will take an average of 5 days for it to move up to reach 1%. It is unlikely that this equity will reach its profit goals before its expiration date.

One the other hand, if 1% ATR is $1.00 and the ATR is $1.26, it would be quite likely that the ETF would move up and into profit during the duration of a 1 or 2-day trade.

EGC Option Guideline Recap

Let's recap the basic weekly option guidelines before we move on to study the charts.

Recap – Option guidelines – the first 7 aspects of the EGC strategy:

> **#1** - Options must have open interest of at least 50. Don't buy more than 10% of the open contracts. Also, make sure there is "some" daily volume activity taking place in the strike you are considering. If the volume looks suspicious, check out the historical information on that strike option.
>
> **#2** – Buy the weekly option that is about 2 weeks out in time when trading a 30-minute chart, 3-4 weeks for 60-minute charts, and 3 to 4 months out for daily chart pattern trades.
>
> Options are born on Thursday and expire the second Friday (7 days). If the time left in the current weekly option isn't enough time to add to the next weekly expiration to give you 8 to 10 days, then either wait for Thursday and purchase the 3rd weekly option, giving you a full 14+ days for the trade, or move on to another trade that will work within the time left in the option.
>
> If your option has intrinsic money value at expiration, close the trade so it is not exercised where you need to actually purchase the equity. In this strategy, we are trading the options with no intent to purchase the underlying equity.
>
> **#3** – Buy at- or slightly out-the-money options that fit your available funds, and use the total trade dollar limit of approximately $600 for 30 and 60-minute trades and up to $1,200 for daily chart trades. Don't be tempted to buy beyond your

means by accessing margin funds. This consideration ties in with Guideline 2 and 4. Don't be tempted to go cheap by buying way out-of-the-money options. Margin accounts, unless you maintain a balance of $25,000 at all times, can trip you up on day-trading regulations. Cutting corners sets up a trader for failure and the inevitability of facing unforeseen market eventualities.

Focus on premiums of .45 or more so that the brokerage fees are reasonable in relation to the size of the overall trade profit.

#4 – Always buy options when trading the EGC strategy that are near (at-the-money) or slightly below (out-of-the-money) the current price of the underlying equity.

#5 – Concentrate on and purchase options on ETFs that trade in a price range of $25 or up. You want equity price action that moves quickly, and this is more likely to happen in equities with a higher price.

#6 – Don't enter an option where the spread between the bid and ask is more than $.30 or else enter a limit order that is less the amount needed to bring it in line with the $.30 requirement.

The exceptions to this rule are the higher priced equities. Trader's discretion is then used as to what is a suitable spread.

#7 – Focus on equities with a daily price movement that is near or more than a 1% ATR.

I have already explained several unique chart indicators and patterns that create our trade signals as we develop a clear trading plan. My goal is to bridge the gap and to create a book for beginners who want to profit while they continue their option education and a strategy that will intrigue experienced option traders with a trading system that accurately predicts and precisely times bursts of quick price movement.

If you feel overwhelmed already, hang in there! I have tried to slowly build one principle or one indicator upon another until the layered information fits together to create a clear trading pattern.

You will always have the opportunity to review the information, and you will be surprised how many more of the details will fit into a comfortable place and become clear as you read through the information a second and third time.

I'm sure you are excited to get started so off we go with the final concepts and then we will look at some trade examples, putting all the elements in place.

Stops Against Losses

Fixed, Mental, or Trailing Stops

You can arrange with most online brokers to receive email “price alerts” once you incur a certain percentage of profit or loss. These alerts can signal times to buy or sell. This helps when you are not able to sit in front of the computer to monitor your trade.

It is advisable to have a profit goal and stop loss established at the time you enter a trade. The profit goal can be a percentage above the premium paid, or it can be an amount just under a resistance or support level, pivot point or EMA.

Traders often feel like they must gain the highest profit possible, yet some of the most successful traders are those who establish profit targets based on their strategy and trading plan, stick to them, and close out the day with CONSISTENT profits no matter the percentage. A trader who earns 25%, 17%, 157%, 82%, 45% and 350%, comes out much further ahead than the trader who earns 550%, -100%, 12%, -95%, 27% and -32%.

See if this sounds familiar.

A trade will earn a nice profit, maybe it even breaks through a resistance line, yet the trader doesn’t take profits because he decides he is going to hold out for even more gains. Then the trade drops, so he feels like he lost money even though he still has a profit. The price drops further, and the trader stubbornly holds as his profits diminish. He holds because he just knows it will go back to its earlier high, and he doesn’t want to give up on it. Giving up would be like turning his back on an old friend.

He holds until the profit becomes a loss, and his stubbornness strengthens. How can he sell for a loss when it once had such a nice profit? He’ll give it more time. He will “one-more-day-it” until all the value is gone, and expiration day is at hand. This whole process happens quickly with weekly options.

Often traders do not learn from this experience. After all, they had a loss on the last trade, so the next trade needs to earn double. The negative trade results get repeated over and over again out of greed.

Again, it is time to consider your stops. Have a **fixed stop** established at the time of entry and stick to it. Make it a part of your plan.

Traders need to change their thinking. Each trade should be looked at as a fresh start, a new event that has been evaluated and is being traded based on what is happening in the market at that moment. It should not be based on trade results from the past, whether those trade results were positive or negative. Trade-actions should be based on what is happening “now”.

You can determine a **"mental" stop**. You know the stop amount and will close the trade when it hits this amount, but you don't actually set a stop with your broker. A trader might choose to set a mental stop when there are occasions of market-makers playing games and manipulating an ETF's price by selling their shares so that the price hits your stop, but it quickly recovers to its higher price when the market-maker buys the equity back. If this happens, it is usually when the stop is placed very close to the equity's current price. They see the stop as a quick way to make money.

Traders can set a sell-stop with their broker who will close the trade when it crosses that amount. This provides protection against the position that turns against the trade's direction. This amount can be an acceptable percentage loss or an amount that is beyond a line of support/resistance, pivot point or the break of an EMA.

A tool called **trailing stops** allows the broker to automatically close your position when a certain dollar amount or percentage loss has occurred. These are safeguards to protect you from unexpected circumstances, especially if you are expecting to be away from the computer for an extended period. Trailing stops are used to protect profits. As the equity's price rises, the trailing stop rises proportionately (ex: as the price rises, the stop rises as well, but consistently stays 15% below the equity's price), then if the equity's price turns, the position will be closed when it reaches the trailing stop amount.

Now we have discussed profit targets and stops in a general sense. Let's apply these principles to the trades analyzed below. We will work through a trade, starting with the 30-minute chart as a trade progresses. Once we have located trades and covered possible entries, stop, profit targets, and exits, we will move on to discuss actual trade results, including option strikes and expiration choices.

As we proceed and cover trading our patterns, including the P3 and P3½ patterns, I will point out appropriate stops and profit targets for each type of pattern.

I will mention again that a stop for P3 and P3½ pattern is often a cross down of the PPO against the direction of your trade. There can be times that the PPO will test the signal line in a wobble and slip a little below as if it couldn't press the brakes fast enough, so you want to allow for a little white space between the PPO and signal line. You also want to look at the other indicators, such as the DI lines, which will help clarify direction.

Of course, there is an exit/profit stop when the pattern has reached a high/low and is ready to rollover (stage 7). Again, a full rollover is when the PPO line crosses over the signal line in a direction against your trade.

Do keep in mind there is nothing wrong with taking profit along the way, especially if price hits your profit targets. Taking profit when it accrues is much better than watching

it slip away the next day as the market changes direction based on some unexpected news event.

Sample Trades

Chart Courtesy of Stockcharts.com *Fig. 45*

You have been keeping your eye on GDXJ, you feel it may be getting close to setting up a quick trade on its 30-minute chart. There was a P3½ sweet spot that formed on the 24th that created a new long squeeze pattern. On the 25th, the bulls tried to make a move, but failed, there was no +DI cross on the ADX indicator.

S3 pivot point seems to be holding, but the 2 EMAs haven't yet started to curl up to cross over the 13 EMA.

When the PPO starts putting some white space between the lines, the +DI crosses, and the 2 EMA crosses the 13 EMA, you will be ready then enter a trade.

The 26th is a Wednesday, and, if the pattern confirms an entry, you will purchase August week 2 weekly option expiration, which gives the pattern 13 days to develop with the plan of sell 5 trading days before expiration to avoid escalating time decay.

Chart Courtesy of Stockcharts.com *Fig. 46*

Price started to move, and the pattern unfolded on open. You were prepared and entered a trade by purchasing the 33 strike for August 11th expiration, paying $0.69 per share or $69 per contract, and you purchased 9 contracts for $621.

The pattern got right down to business and started to play out quickly. Your profit target was R3, while your stop was a 2 EMA cross back down over the 13 EMA. Toward the end of the day, price reached R3 and started pulling back.

Even though the trade had lots of time left until expiration and had only been opened a day, you chose to close the trade since it had hit your profit target. You were aware that the P3 squeeze pattern was in the sweet spot stage, which is the last stage before stage 7 and a rollover. Time to take profit and be thankful for a quick gain.

The premium for the 33 strike toward the end of the day when you closed it was 1.28 per share or $128 per contract, or a value of $1,152 for your nine contracts. This is a gain of $531 or 86%. Not bad for a trade that was open just one day.

As a side note and a reminder, your expiration gave you the opportunity to control the trade until August 11th, but you are not obliged to hold it that long. You can sell at any time before the expiration date. Just to see what happened, let's glance at a chart that covers the next day.

The chart below shows that it was wise to take profit. As a general rule, it is never wrong to take profit, especially when you know the pattern stages, and the strongest part of the pattern has already happened.

In this case, price dropped the next day, and the PPO crossed down. Price dropped down through the pivot point, which should have been a strong area of support. It dropped down to the 600 EMA, and then bounced back up above the pivot in a quick move, but by the end of the day, it was slipping below the pivot point again.

The only bullish sign was that the +DI was still in control and showing some strength and could possibly bounce into a stage 8 add-on sweet spot. However, holding out for that possibility gave up more than half the gains of your trade.

In this case, a bird-in-the-hand paid off. That said, you always have the opportunity to reenter at a stage 8 sweet spot and trade it should it happen.

After reviewing the next chart, we will move on to a Put trade, and then I'll list the entry and exit criteria.

Chart Courtesy of Stockcharts.com *Fig. 47*

The chart below is also for GDXJ, but it is a 60-minute chart and is for a different time period. On the 12th price popped up, not quite getting to R3, but close, which was a new recent high. On the 13th, price dropped below all the EMAs. The 2 EMA cross down through all the higher EMAs shows building weakness. The last level of support in this area is the pivot point. The 13th is a Thursday, and Friday is a holiday, so you decide to wait to see what Monday brings, but you will be prepared to enter a trade if the -DI crosses up taking price lower.

Chart Courtesy of Stockcharts.com *Fig. 48*

On the 17th, price dropped further, and the -DI crossed up. You opened the May monthly expiration, giving the trade plenty of time to unfold, but again it got down to business quickly.

The premium for the May 36 strike Put monthly option was 2.05. You purchased 3 contracts for a total investment of $615. By midday, the pattern started creating the sweet spot. You considered selling after just this one day of trade, but the -DI was still strong and in control, and the ADX and PPO were still spreading apart. The last candle was bullish, but decide to hold since you had a full month of time left, and weakness hadn't yet stepped up.

Chart Courtesy of Stockcharts.com *Fig. 49*

You have a mental stop in place if the 2 EMA crossed above the 13 EMA soon after you enter the trade, and a profit target of 50% or higher if price keeps dropping. You will keep a close eye on building bullishness.

The strength of the -DI lasts for 8 days. There were a couple nervous moments as the PPO wobbled on the underside of the PPO signal line. Once it actually crossed up, but you watched not only the PPO and the -DI line, but also the combination of the 2 and 13 EMAs. You could see a pattern forming where the 2 EMA would come up to the 13 EMA from underneath, and the 13 EMA held the 2 EMA down, and it would drop to a lower level.

On the 26th, the bullish indicators were building. The PPO had crossed up again, the +DI was coming closer to crossing the -DI line, and, most importantly, the 2 EMA was right at a cross of the 13 EMA. All of these strengthening bullish signals and weakening bearish indicators suggested that it was time to take profit off the table. There is no sense in being greedy.

Chart Courtesy of Stockcharts.com *Fig. 50*

On the 26th of April, the bid premium for the 36 strike had increased to $3.90. You paid $2.05. This is an increase of 1.85, or a gain of $555, which is a 90% increase. Another nice trade.

I am sure you are already getting an idea of which time frame upon which to place your trades. You no doubt will be determining how much time you have to devote to trading

and watching the charts as the pattern plays out. If you want to remain actively involved in the market, then the 30-minute trades could be a good fit. If on the other hand, you have less time, but still want to be really connected, the 60-minute may be just right. Or if you have less time and only want to briefly check in on the charts at the end of the day, then the day trades could be a good choice.

Listed below are the signals you will look for entries and exits.

Recap of Entry and Exit Alerts and Confirmations

P3 Alert Signals that a new trade is forming

1. Bullish divergence signals an undercurrent of change brewing (seen on PPO)
2. P3½ Sweet spot has taken place
3. Positive candle on the chart, and the 2 EMA moving up and toward the 13 EMA
4. Black PPO and ADX lines have come close to each other.
5. PPO histogram blocks are narrowing and heading upward
6. ADX line begins pushing away from black PPO line and +DI (green) line is pointing and moving up, while the –DI (red) line points and heads down.

P3 Confirmation Buy Signal

These buy signals should be applied to the chart.

Earliest pattern entry - P3 Squeeze Pattern entry:

1. The PPO lines crosses up over its signal line and +DI crosses the -DI (earliest entry)
2. The 2 EMA crossed up and over the 13 EMA (a second confirmation- less risk)

(There can be supplemental entries at pullbacks or stage 5 wobbles but the initial Pattern entry and Sweet Spot entry are usually the best and offer plenty of trade opportunities.)

Second pattern entry - P3 Squeeze Sweet Spot entry:

1. PPO and ADX are heading up and running parallel to each other, creating the stage 6 stage of the squeeze pattern. These are quicker trades as they incorporate just the last strong stage. They should be entered quickly just as the ADX line starts to turn up.

Exit Rules

Remember there is often a wobble on the PPO that will produce some of these alerts, so look at the PPO to see if that is what it appears to be. A second or third area of weakness (wobble) is likely to be the true exit.

Alert that weakness is developing

1. 8 EMA drops closer to 13 EMA, appears as if it might cross
2. Negative candles (in conjunction with other alert indicators)
3. PPO histogram blocks begin to narrow downward
4. Black ADX line flattens or curls downward, and +DI (green) starts to head down and –DI (red) starts to head upward
5. A cross of the +DI line down and through the ADX line

Confirm Sell Signals:

Many times, it is better to take gains once your trade reaches its profit target rather than wait for a confirmed signal that gives back a portion of your profit. The signals below are the line-in-the-sand exit signals, other than the price hitting your stop.

1. Crossover of the PPO over its signal line. This can be used as a stop when you first enter the trade. A PPO cross is also an exit signal if it happens during the course the pattern unfolding and is stage 7, the final stage of the squeeze pattern. So, no matter when the PPO crosses down against your trade, it is time to pay attention and exit, or at least evaluate what is taking place. Once the PPO crosses down, profits will begin to slip and are likely to turn into losses.

2. As noted previously, there are times that the PPO will wobble against the signal line and not apply the brakes quick hard enough before there is a PPO cross. It is important to watch as the wobble is taking place and evaluate the strength of the +DI line.

P3½ Entry Alert Signals that a trade is forming

1. Bearish divergence to signal an undercurrent of change brewing (seen on the PPO)
2. Negative candle on the chart, and the 2 EMA moving down and below the 13 EMA
3. Black PPO and ADX lines have been both been heading up and running parallel for a while.
4. PPO histogram blocks to be narrowing downward
5. ADX line pushing away from black PPO line and -DI (red) line to be pointing and moving up, while the +DI (green) line points and heads down.

Confirmed Buy Signal

Earliest Pattern entry signal – P3½ Pattern Entry

1. The PPO line crosses down over its signal line and –DI crosses up and over the +D up (earliest entry)
2. The 2 EMA crosses down and over the 13 EMA (less risk)

Second Pattern entry – P3½ Pattern – Sweet Spot entry

1. PPO and ADX lines spread away from each other, creating the P3½ stage sweet spot pattern. These pattern often play out quickly. Try to enter as soon as the ADX line starts heading up.

After entering a trade, watch for the P3½ pattern to go through the stages as it unfolds. Look for weakness to develop, signaling a time to exit.

Exit Rules

Remember there is often a wobble on the PPO that will produce some of these alerts, so look at the PPO to see if that is what it appears to be. A second or third area of weakness is likely to be the true exit.

Alert that weakness is developing

1. 2 EMA rises closer to 13 EMA, appears as if it might cross
2. Positive candles (in conjunction with other alert indicators)
3. PPO histogram blocks begin to narrow upward
4. Black ADX line flattens or curls downward, and +DI (green) starts to head up and –DI (red) starts to head downward
5. The -DI line crossed down and through the ADX line

Confirm Sell Signals

Many times, it is better to take gains once your trade reaches its profit target rather than wait for a confirmed signal that gives back a portion of your profit. The signals below are the line-in-the-sand exit signals, other than the price hitting your stop.

1. Crossover of the PPO line over its signal line. A PPO cross can be used as your stop early in the trade if it crosses up against the direction of your trade. A PPO cross up any time during the course of the trade is a time to pay attention and exit, or at least evaluate what is going on. A PPO cross ties in to stage 7, the final stage of the P3½ pattern. Once the PPO crosses up, profits will diminish and soon losses will be incurred.

2. A cross of the 2 EMA up and over the 13 EMA.

How to Start Trading

Now that we have covered the option basics, the details of the strategy, the trade guidelines, and chart reading, it is important to apply what you have learned and practice. You can practice by paper-trading and writing down the details of the trade as you make decisions as to date, time, expiration, strike, premium, and chart signals, or you can open an account through a broker who offers a virtual trading platform.

Virtual trading offers the opportunity of utilizing option chains and trade orders that are identical to real forms, but you a trading with pretend funds. This is a great way to build confidence in the strategy and your understanding of the patterns.

I am restricted from recommending any one broker as they all offer a variety of services, tools, rates and minimum funds needed to open an account. I will share general information that will help smooth the way.

Brokerage Accounts

We have covered the basics of the stock market, option trading and chart reading, so let's discuss how you place your trades and where you will find the option chains that show premium costs.

Some of you may already have brokerage accounts set up from which you will be able to trade. Others can choose to set up an online brokerage account. There are many, and all you need to do is search in your browser, and a large number of companies will come up.

I am restricted by SEC rules from making a specific recommendation, but I will list a few: optionsXpress.com, ThinkorSwim.com, TradeKing.com, OptionsHouse.com, MoneyBlock.com, OptionMonster.com, eOption.com.

Each of these offer different tools, such as charting, various news services, etc. I feel that a virtual trade platform is important. Virtual trading gives you the opportunity to practice setting up the order forms, pushing all the buttons, but never risking a penny until you have the confidence to trade for real.

Fees vary depending on the services these brokers provide.

You will have the choice of opening a cash or a margin account. The broker is likely to hope you open a margin account, which allows you to trade with funds beyond what you deposit (for an interest charge, of course). One advantage to a cash account is that it is not subject to day-trading rules, which only allow three round-trip trades (in and out of a trade in the same day) within five consecutive trading days. In a cash account, you can open and close trades as often as you like with cleared funds within your account. The funds from a trade closed today will be available for use tomorrow.

Margin accounts are subject to day-trading rules. If you open a margin account, you must have $25K+ in your account to actively day-trade, defined as more than three round trip trades within five consecutive trade days. Most of the trades made using the EGC strategy will last longer than a day, but then again, as you saw in our sample trades, we closed a 30-minute trade the same day as we opened it because price moved quickly.

As a trader, there are some decisions you have to make on your own based on your experience, available funds for trading, and the amount of time you have to devote.

Another consideration is the minimum deposit required by each broker to open an account. Some require as little as $500 and others might require a $2,500 deposit to open an account.

Once you have opened an online account, then PRACTICE, PRACTICE, PRACTICE!

Welcome to the Elite Club of Option Traders

You have read through the basics needed to understand and trade options. I suggest you read through this information again. Each time you review the information, more will settle into a comfortable place, and you will build up layers of understanding and confidence in that knowledge.

When you are ready, you can move on by applying the information, first in practice trades, and eventually using real money. Don't rush the process. I want you to be successful, and it takes a little time to fully understand all the aspects of trading and the P3 patterns.

That said, you can do this! I know you can. It just takes a willingness to put in the time needed to understand the process, especially if it is new information. Practice. Learn from decisions made, that in chart study could have been changed, and before you know it, you will gain confidence in the strategy and in yourself, and you'll start realizing the leverage of option trading.

Again, welcome and I wish you great trading success.