

## RadioActive Trading Income Method Cheat Sheet

The goal of this Cheat Sheet is to give RadioActive Traders a quick review of the income methods, when they should be used, basic guidelines for each adjustment and some advantages and disadvantages.

*This Cheat Sheet in no way replaces or should be used in place of The Blueprint for decision making processes.*

Before trading an Income Method making an adjustment a RadioActive Trader should:

1. Consult this Cheat Sheet to get guidance for which adjustments might suit them.
2. Consult The Blueprint for further guidelines, basic rules and a more enhanced CEGA model.
3. Compare the before and after scenarios using the Simulate Trade feature on the PowerOptions Position Analysis – Roll Out Opportunities page, or manually view the new risk-reward profile using the Profit / Loss – Custom Spread tool on PowerOptions.
4. DON'T feel that you HAVE to trade an Income Method. Sometimes the best income method (what at times we refer to as Income Method #12) is to do nothing at all and allow the stock more time to move.
5. DON'T over trade. Don't feel forced to trade an Income Method every month or especially every week.

### Scenario #1: Stock rises 5-8% in the first 30 days or is trading at the put strike price:

Consider Bullish Income Methods: (#1, #3, #4, #5, #6)

**Income Method #1: Sell a Call to create a Collar**

#### CEGA Model

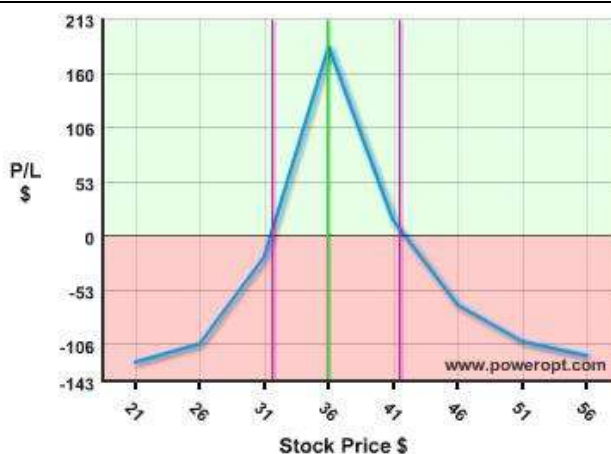
|                     |  |
|---------------------|--|
| <b>Conditions</b>   | Stock has moved up as expected.  |
| <b>Expectations</b> | Stock will be trading at or near the selected call strike price at expiration.   |
| <b>Actions</b>      | Sell a call with a strike price that is at or above the protective put strike price. (Refer to The Blueprint for other suggested guidelines on IM #1). |
| <b>Goals</b>        | Generate Income, Reduce Risk.  |

#### Advantages:

- Generates Income
- Reduces Risk
- If applied properly can be adjusted with Income Method #2

#### Disadvantages:

- Further gains on the stock may be capped
- If stock really takes off could have a small loss on the upside
- May increase risk if buy back cost is higher than initial premium sold



### Income Method #3: Roll Put Option Closer in Time

#### CEGA Model:

|                     |   |
|---------------------|---|
| <b>Conditions</b>   | Stock has moved up as expected.   |
| <b>Expectations</b> | Stock has risen, but may pull back. Or, chance to reduce risk or Bulletproof before an Earnings Event.  |
| <b>Actions</b>      | Sell to close existing put, buy to open a new put at same or different strike closer in time (only 30 days out from current date. Refer to your Blueprint for further guidelines).                      |
| <b>Goals</b>        | Drastically reduce risk or potentially bulletproof position prior to an earnings event, or if you feel the recent rise in the stock price has run its course and there may be a pull back on the stock. |

#### Advantages:

- Typically greatly reduces risk or bulletproofs RPM
- Can be done just prior to an earnings event
- Upside is still unlimited (gains are not capped)
- Done at a credit
- Can be applied with IM #1 after IM #3 adjustment has been made depending on your goals

#### Disadvantages:

- Shortens the time frame of the insurance policy
- If stock does not rise in the near term, may have locked yourself into a small gain
- If you wish to stay in the stock longer, a new put may have to be purchased thus taking the position out of bulletproof status



### Income Method #4: Roll Put Option Up in Strike Price

#### CEGA Model

|                     |  |
|---------------------|--|
| <b>Conditions</b>   | Stock has moved up as expected.  |
| <b>Expectations</b> | Stock has risen and you feel there is more growth potential.   |
| <b>Actions</b>      | Sell to close existing put, buy to open a new put at a higher strike price (usually only one or two strikes higher) in the same expiration month. Try to make sure that the net debit you pay is around 50% of the strike price difference. (Refer to your Blueprint for further guidelines) |
| <b>Goals</b>        | Reduce the risk by at least 50%, or bulletproof position while leaving the upside open.  |

#### Advantages:

- Typically greatly reduces risk or bulletproofs RPM
- Upside is still unlimited (gains are not capped)
- May be combined with an IM #6 trade to help reduce cost of adjustment

#### Disadvantages:

- This is one of the only adjustments done at a net debit
- Total Risk is reduced, but capital invested is increased
- May be harder to apply other income methods if stock does not continue to rise

## Income Method #5: 2:1 Ratio Call Spread

### CEGA Model

|                     |  |
|---------------------|--|
| <b>Conditions</b>   | Stock has moved up as expected.  |
| <b>Expectations</b> | Stock may continue to rise slightly over the next 30 days, trading close to or near a certain strike price.  |
| <b>Actions</b>      | Sell two calls and buy 1, relative to your shares. Bought call is typically ATM, with two short calls OTM. Position should always be entered at a credit (two calls pay for the one long call). This essentially creates a bull call spread with an IM #1 against your married put.<br><b>True Ratio:</b> If you have 200 shares, sell 4 OTM calls and buy 2 ATM calls<br><b>Adjusted Ratio:</b> If you have 200 shares, sell 2 OTM calls and buy 1 ATM call<br>Generally, calls are bought and sold only 30 days out. Refer to your Blueprint for further guidelines. |
| <b>Goals</b>        | Only generates a small credit, but the benefit comes from the Bull Call Spread if the stock performs as expected down the road. Outpace gains of IM #1 if stock is trading just at or near the short call strike price at expiration.  |

### Advantages:

- Opportunity for accelerated gains, and to get paid twice with adjustments (consult The Blueprint)
- Adjusted Ratio can be done in an IRA or restricted account (True Ratio may not be)
- Upside is still unlimited if the adjusted ratio is used

### Disadvantages:

- If True Ratio is used, upside profit will be capped if stock takes off
- May have to enter position as different legs increasing commissions
- If stock pulls back and calls expire worthless, only a small premium was generated to offset the initial at risk.

## Income Method #6: Bear Call Spread

### CEGA Model

|                     |   |
|---------------------|---|
| <b>Conditions</b>   | Stock has moved up as expected  |
| <b>Expectations</b> | Unsure of stock movement going forward, could rise, fall or stagnate  |
| <b>Actions</b>      | Sell to open a call with a strike price at or just below put strike price, buy to open a call with the same expiration month at a higher strike price (typically one or two strikes above sold call – refer to The Blueprint for more guidelines) |
| <b>Goals</b>        | Generate income, leave upside open  |

### Advantages:

- Generates a good income, not as much as #1 but greater than #5
- Upside is still unlimited (gains are not capped)
- Very flexible, can be used if stock has moved up, has stagnated, or declined in price
- Potential to increase returns with management techniques

### Disadvantages:

- If stock is trading between the strike prices at expiration you may actually increase your risk if the buy-back cost of the short call is higher than initial net credit (but, IM #2 could be used in this case)
  - May have to leg into the spread if you are trading in a restricted account, thus increasing commissions
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## Scenario #2: Stock has stagnated in the first 20-30 days, and you feel the stock may continue to stagnate

Consider Neutral Income Methods: (#7, #8, #6)

Income Method #7: Sell to Close stock, sell a near term put

### CEGA Model

|                     |   |
|---------------------|---|
| <b>Conditions</b>   | Stock has stagnated in the first 20-30 days of trading  |
| <b>Expectations</b> | Stock may continue to stagnate over the next 30 days.   |
| <b>Actions</b>      | Sell to close your stock for a small gain or loss, leave long put in place, and sell a put option with 30 to 45 days to expiration. Effectively creates a Calendar Put spread (Consult The Blueprint for additional guidelines) |
| <b>Goals</b>        | Generate income, potentially repurchase stock if stock is trading below put strike price at short term expiration   |

### Advantages:

- Generates Income
- Reduces Risk
- Frees up capital, but you will still need to have it on hold if you are put the stock at near term expiration

### Disadvantages:

- Upside gains are capped. You may have to scramble to buy the stock if it takes off after IM #7
- Does create a leveraged spread trade which may not be allowed in a restricted account
- Although a spread is created, capital still should be on hold in case stock is put to you

Income Method #8: RadioActive Iron Condor (Type A and Type B)

### CEGA Model

|                     |  |
|---------------------|--|
| <b>Conditions</b>   | Stock has stagnated in the first 20-30 days of trading   |
| <b>Expectations</b> | Stock may continue to stagnate over the next 30 days.  |
| <b>Actions</b>      | <b>IM #8a</b> Apply IM #1 (sell a call) even though the stock has not moved up, and enter into a bull put credit spread. Sell an OTM put for near term expiration, buy a lower strike put with the same expiration.<br><b>IM #8b</b> Apply IM #6 (Bear Call Spread) even though the stock has not moved up, and enter into a bull put credit spread as above.<br>(Consult your Blueprint for further guidelines for IM #8a and IM #8b) |
| <b>Goals</b>        | Generate income, stock will remain between the strike prices so all options expire worthless.  |

### Advantages:

- Generates Income
- Credit received reduces risk, but extra capital may need to be put on hold for bull put
- Good combination for a neutral stock, if no events (earnings) are coming up

### Disadvantages:

- Upside gains are capped.
- If stock falls, bull put will have to be closed which will increase risk

- Extra capital needs to be on hand to place bull put spread (adds to risk)
- Complex strategy with multiple legs, may be commission intensive

### **Income Method #6: Bear Call Spread**

Refer to the guidelines in the Bullish section for CEGA model. Always make sure you graph the IM #6 position if you plan on entering it on a neutral stock, using strike prices that are below the protective put strike price. The effect may not match your Goals for the RPM trade.

## **Scenario #3: Stock has fallen by 5% or more in the first 20-30 days of the trade**

**Consider Bearish Income Methods: (#9, combo of #9 and #1, #6)**

### **Income Method #9: Rolling down the put option**

#### **CEGA Model**

|                     |  |
|---------------------|--|
| <b>Conditions</b>   | Stock has declined in price against initial expectation.   |
| <b>Expectations</b> | Stock may recover in the following 30-60 days  |
| <b>Actions</b>      | Sell to close your existing put, buy to open a lower strike put with the same expiration month. This will result in a credit thus lowering the cost basis. Only roll down one strike at a time. (Consult your Blueprint for further guidelines and warnings with IM#9) |
| <b>Goals</b>        | Generate income, reposition RPM position with a lower break-even.  |

#### **Advantages:**

- Generates income, lowering cost basis
- Upside is unlimited
- Cost into RPM is lowered
- Can result in higher profits if stock recovers and rises in the future
- Positive premium generated can be used to buy more shares or calls to further increase profits if stock does rise as expected (review the content in The Blueprint for further guidelines)

#### **Disadvantages:**

- The at-risk amount and percentage at risk will increase. This is due to the lower guaranteed exit price
- Can lock in higher losses from initial position if stock continues to fall
- Should be really confident that the stock will recover over time to use IM #9

### **Combination of Income Method #9 and #1: Rolling down the put option, selling a call**

Once you have rolled down the put using IM #9, you may have an opportunity to sell a call at the new put strike price to help alleviate some of the new adjusted at-risk amount. The disadvantage here is that the gains will now be capped if the stock recovers quickly.

### **Income Method #6: Bear Call Spread**

Again, refer to the guidelines for IM #6 in the Bullish Income Methods discussion. This technique is not regularly used after the stock has fallen more than 5%, but it can be applied. As always, graph any potential adjustment prior to making a choice as the outcome may not match your goals or risk-reward profile.

Feel free to contact the RadioActive Trading support team if you have any questions.

Email: [support@radioactivetrading.com](mailto:support@radioactivetrading.com) Phone: (302) 992-7971