Weekly Options Secrets Revealed: A Proven Options Trading Plan

When talking about stock options there are many common questions that come up. ***Which strike price should I trade? Should I buy or sell the options? Should I use weekly or monthly options?*** The reason these questions can be tricky is that there is no perfect answer that fits each situation. It all depends on your outlook and what you are looking to accomplish with that trade. Let's talk about the different expiration cycles in more detail.

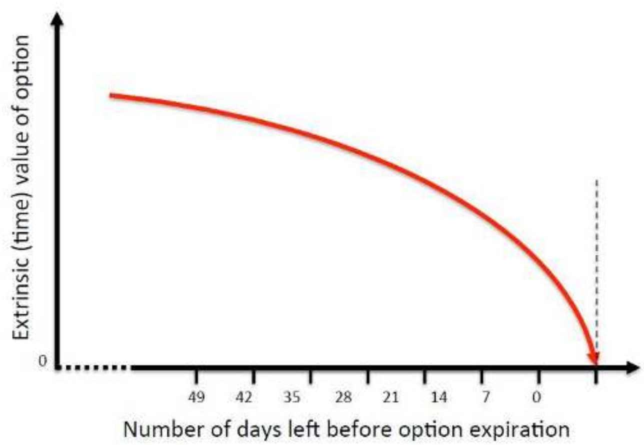
Over the past few years weekly options have become very popular with traders because in most cases they provide a cheap way for the retail trader to get into a trade. These options expire each Friday, which means they are great products for traders looking for quick movement in the stock or ETF. You can easily see 100-150% returns in a matter of hours or days with the weekly options. How can a trader not get excited about those types of returns? ***However, are they always the best products to use? When trading Weekly options is it best to buy or sell the options?*** Let's take a closer look.

Before we go any further with this discussion let's talk about the different factors that can influence the price of an option for a moment. While stock price will have a huge impact on the price of an option there are other factors at play that can impact your P/L. There are 6 different inputs that go into the pricing model of an option. We are going to focus on 3 of these inputs. The different inputs in the options pricing model can be tracked by using the Greeks. Options traders use the Greeks to track how the price of an option will change based on changing market conditions.

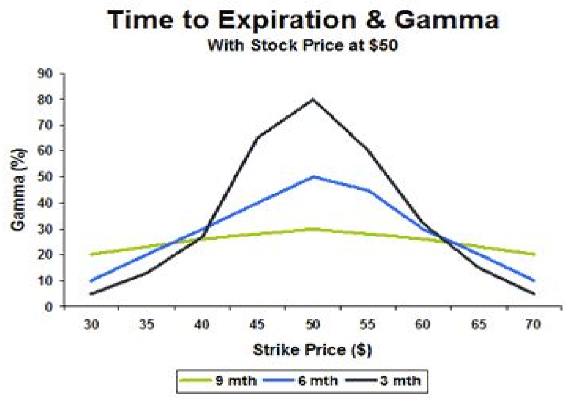
Take Delta for example. The ***Delta*** of an option tells a trader how much the price of an option will change for every $1 move in the stock. So if an Apple 95 call option has a delta of .50 that means for every $1 move that Apple stock makes the 95 call option will change by $.50. This can be helpful as traders try and plan out their trade.

The second greek that can be very helpful is called Gamma. The ***Gamma*** of an option tells the trader how much the Delta is going to change for every $1 move in the stock. So let's go back to our Apple 95 call that had a delta of .50. We know that if Apple moves from 95-96 the call option will increase in value by $.50. However, the Delta will also change as the price of the stock changes. Once Apple goes from $95 to $96 per share the Delta could then be at .75. This means the Delta has changed by .25 (from .50 - .75). The .25 change in the delta after Apple moved $1 is known as the Gamma. So if Apple continues to rally further from $96 to $97 the call option will increase in value by $.75 for that $1 move in Apple. In other words Gamma can be viewed as the fuel that is thrown on the fire. Gamma will also increase the closer we get to expiration. This can help or hurt depending on your position which we will talk more about later.

The third greek that is important to understand is ***Theta***. The Theta of an option tells the trader how much time impacts the value of the option. In other words, it tells us how much time decay there is for each day we hold the position. The key to Theta is knowing it will increase the closer you get to expiration. This can hurt an option's value if you have bought an option. On the flip side, if you have sold an option to open a position the time decay will help you.



Going back to our earlier question on whether we should buy or sell the weekly options, it all depends on market conditions. If we are expecting a quick move within the next few days, then the weekly options will give us the most bang for our buck. This is due to the fact that Gamma is higher the closer we get to expiration (see chart below). As a result of the higher gamma in the weekly options, the prices of those options will react quicker to movement in the stock. We will see more powerful moves as long as the move happens quick enough. Remember options are decaying assets, which means the longer we hold them the more time value comes out. As long as the move happens quick enough, then we can overcome the time decay.



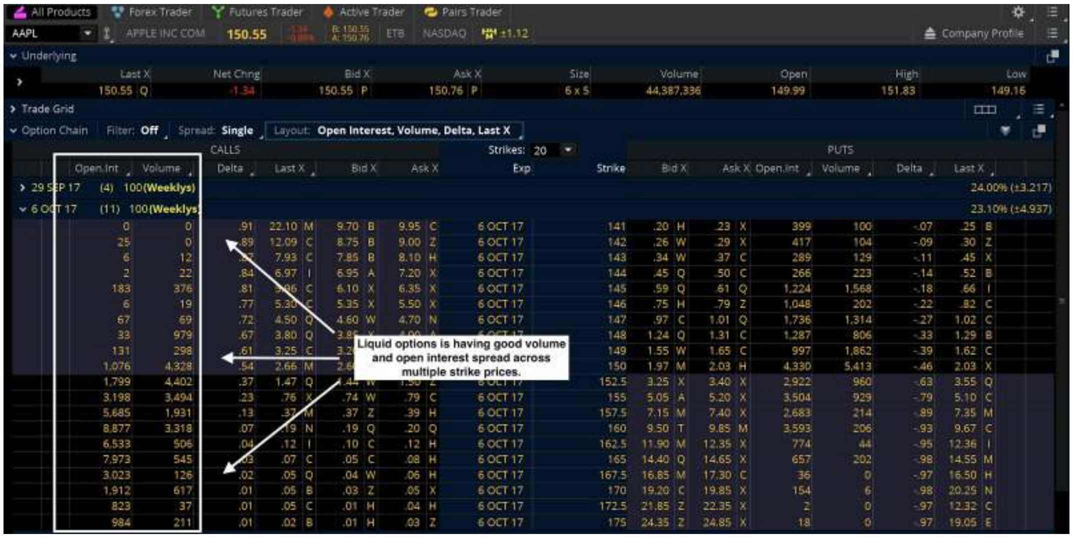
Buying Weekly Options - Strategy Criteria

Many newer traders get intrigued by weekly options because in many cases they are very cheap which is great for small account sizes. However, you don't want to back yourself into a corner by only buying weekly options. They are cheap for a reason. When buying a weekly option we only have one way of making money. They don't have much time left before expiration, which means the move in the stock has to happen quickly in order to make money. When buying weekly options you need everything to line up in your favor perfectly. When this happens the returns can be extremely large. The trade off here is that you will have a lower winning percentage when buying the weekly options. You will be banking on the fact that your winners will be large enough to offset the losing trades.

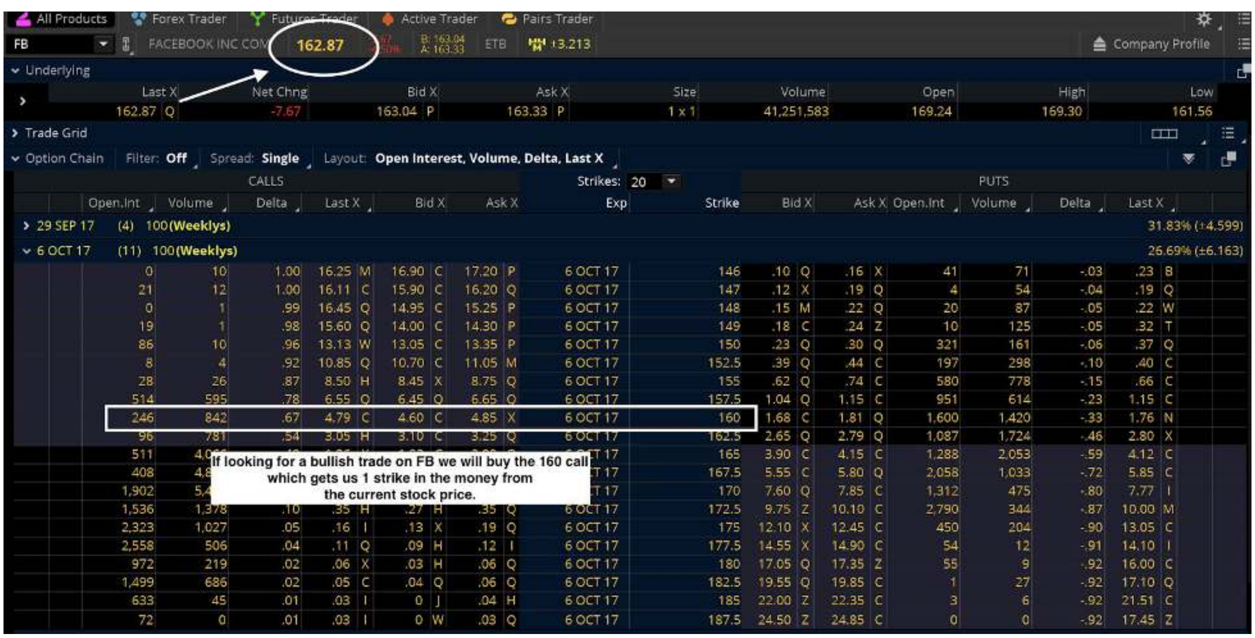
What can we do to increase our odds of success when buying weekly options?

I only like to buy weekly options in periods of high volatility. The market has to be showing consistent quick swings back and forth. ***We can't afford to hold long weekly options for very long so we need to make sure the market will allow us to get in and out in 1-3 days at the most.***

You will also want to make sure you are trading stocks and ETF's that have liquid options. While there are many products that offer weekly options that doesn't mean they are all equal. You want to focus in on stocks and ETF's that have good volume and open interest spread across numerous different strike prices. ***A good rule of thumb for me is to look for open interest on the option that I am trading of 25x the number of contracts I am looking to trade.*** So if I want to trade 1 contract then I want to see at least 25 contracts of open interest.



When choosing which option to buy I like to get 1-2 strikes in the money from the entry point on the chart. So if I'm looking to buy a weekly call option on FB with the stock price at $162.87, then I would look to buy the 160 call option. I leave myself a little wiggle room here by saying 1 or 2 strikes in the money to make sure I am trading an option with good volume and open interest.



Once you are in a position, make sure you are willing to book profits quickly. Remember time decay and gamma increase the closer you get to expiration. If you hold too long any little move in the stock can lead to instant losses. ***When buying weekly options I like to make sure I am in and out within 1-3 days.*** If the move in the stock doesn't happen inside of this window then it really is best to either close out of the position all together or roll the position farther out in time to give yourself more time to be right.

Buying Long Weekly Call and Put Strategy Criteria	
Time to Expiration:	7-20 Days
Strike Prices:	1-2 Strikes In the Money
Min Open Interest:	25x the number of contracts being traded.
Holding Time:	Need to be in and out of the trade in 1-3 days.

Selling Weekly Options - Strategy Criteria

We mentioned earlier that we like to take what the market is giving us when deciding which options strategy is best to trade. This will have us buying weekly options at times but there are also many times when selling the weekly options will increase our performance. Since time decay picks up the closer we get to expiration, there are strategies that will allow us to make more money from that time decay.

One of my favorite options strategies to use is selling vertical spreads with Weekly options. While I am willing to buy individual calls and puts, I don't like to sell the naked options as that comes with undefined risk which doesn't fit my risk tolerance. ***Selling vertical spreads is one of the simplest but powerful options strategies that you can use.***

When selling vertical spreads, I will sell a call spread when I'm bearish and sell a put spread when I'm bullish. ***Why would I use these instead of buying calls and puts?*** Earlier, we mentioned when buying a call or a put option you only have one way of making money. The stock has to move in your favor and it has to do so quickly. The problem here is in many cases the stock doesn't move quick enough and you are left with a position that is losing money every day that you hold it.

When selling a vertical spread to open a position we are actually getting paid to hold the trade each day. ***We can structure these trades in a way that we will have 5 different ways of making money.*** We can make money from a stock move higher, lower, or sideways and also from time decay adding up and volatility decreasing. In doing so we don't need everything to line up perfectly in our favor. We have multiple ways of making money which in turn will give us a higher winning percentage.

So with 5 different ways of making money when selling spreads why wouldn't use these trades all the time?

The trade off to having so many ways of making money is that we will have a bad risk to reward scenario. Following our trade criteria, we are looking for trades that will give us a risk 2 or 3 to make 1 scenario. While this doesn't look attractive at first glance, we are willing to accept these ratios because of the 5 different ways we have of making money.

Before we get into the criteria that we look for when structuring these trades let me point out that when selling spreads we will be in positions that have defined risk. I talk to many newer traders on a regular basis that get intimidated by selling options due to thinking they have large risk. When selling a spread we are always buying an out of the money option as part of the spread to define our risk. This way we know our worst case scenario right up front which also makes it easier for us to manage our risk.

When selling vertical spreads, I like to use a few rules to make sure we are in trades that will both give use the best performance long term while also controlling our risk. To start, we need to decide if we are bullish or bearish on the stock or ETF that we are looking to trade. If bearish you will look to sell a call spread. If bullish you will look to sell a put spread.

Short Call Spread - Bearish Trade

Let's take a look at a short call spread first. We will always sell a call spread when we want to be in a bearish position. ***In most cases, I will sell spreads on weekly options that have between 7 and 20 days left to expiration.*** In doing so I take advantage of the increased time decay that occurs the closer we get to expiration. With time decay working in our favor we can afford to hold these trades a little longer when compared to buying the weekly options. Each day that we hold these spreads we are going to be making money from the time decay.

When selecting the best strike prices for the trade I like to use the Delta of an option. Most options brokers show you the Delta of an option right on the trade page of their platform. ***When deciding on which option to sell I will go to the option that has a Delta closest to .35.*** This will typically get us 1-3 strikes out of the money. To make sure we are in a risk defined trade we will also buy an option farther out of the money. ***To do this I like to go out 2 additional strikes from the option that I sold*** (we will take a closer look at this in Case Study #1 below).

When selling weekly spreads it's very important to make sure you are trading liquid stocks/ETF's. Where we get in and out of these trades can make a huge impact on our profitability. ***I want to make sure that the options I'm looking to trade have an open interest of 25x the number of contracts I'm looking to trade.*** So if I want to sell 5 spreads then I'm looking for 125 contracts of open interest on the options that I'm looking to trade.

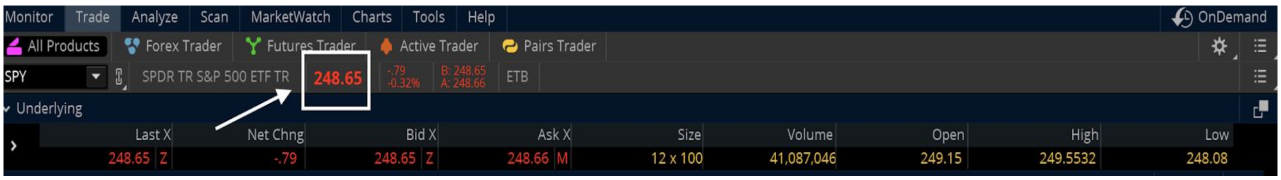
The price that we collect when selling the spread is our maximum profit potential. Regardless of what the stock does, the premium that collect for selling the spread is the most we can make on that trade. ***Our risk is limited to the difference between the strikes minus the credit that we received for placing the trade.*** When selling spreads our breakeven point is always our short strike plus/minus the credit that we received for opening the trade. We don't care it the stock goes higher, lower, or sideways as long as price stays below our breakeven price we can make money. We also make money from time decay adding up and from volatility decreasing.

We look to take these trades off when we can keep 50-75% of the premium that we collected when putting on the trade. For example, if we collected $1.00 to put the trade on, we will close the trade when we can buy it back for $.25 - $.50. This would give us $.50-$.75 of profit per spread.

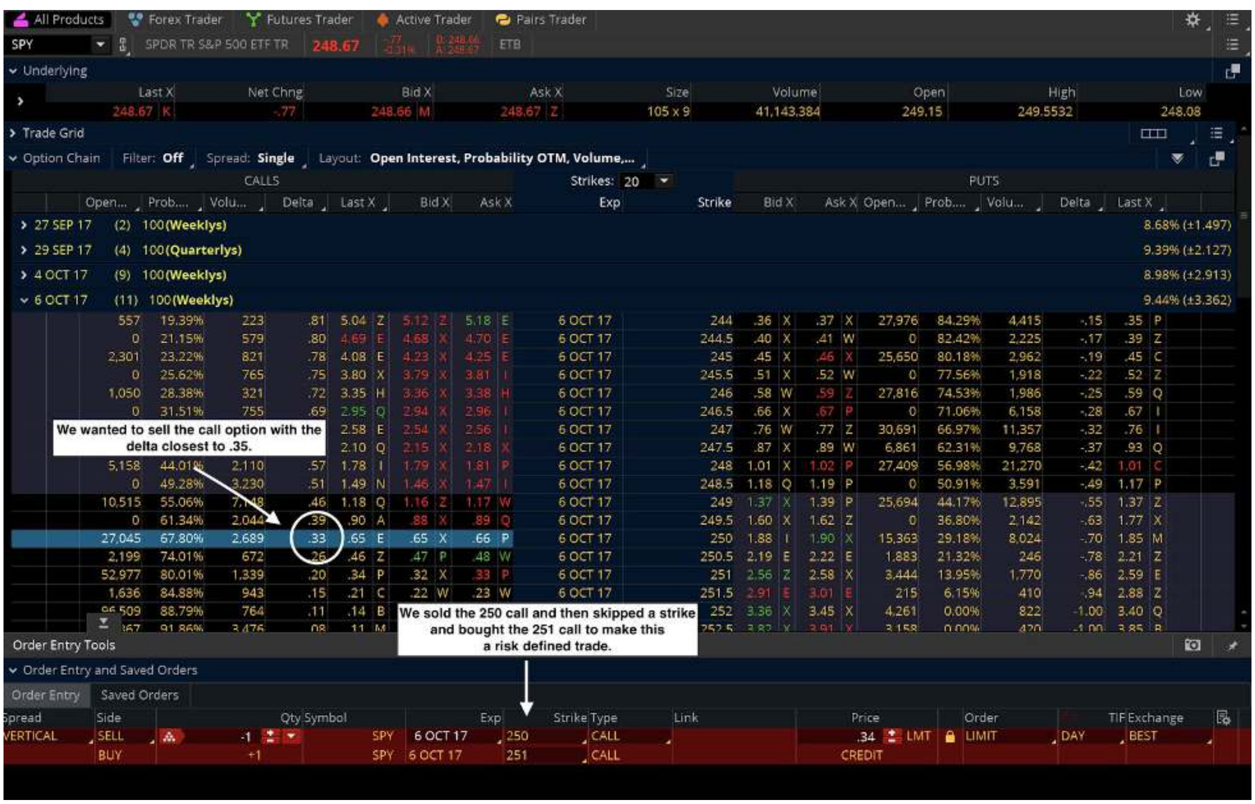
Let's put this all together by looking at an example on an SPY trade.

<u>Case Study #1 - Short SPY Call Spread</u>

For example, with SPY trading at 248.65, if I was looking to put on a bearish position I would look to sell a call spread.

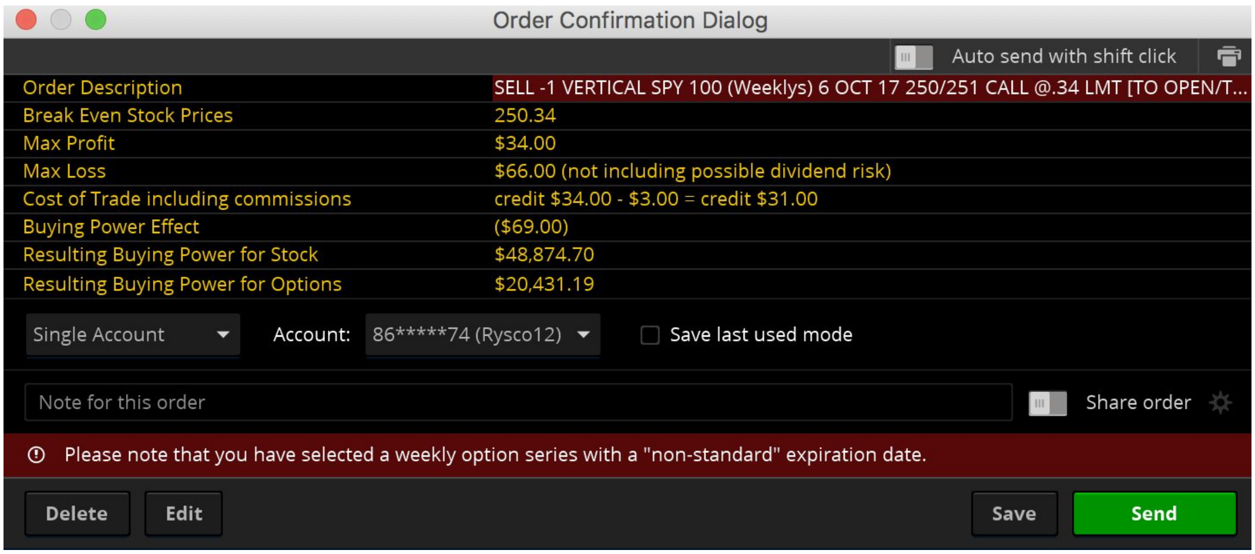


By going to the trade page of my brokers platform I can see that the October 6 Weekly 250 call has a delta of .33. This is very close to the .35 number that I am looking for. I would sell this option. I also need to buy the out of the money option so I also take a look at the available strike prices to see that they are .50 wide. I need to go out an additional 2 strikes to buy the call option which would have me looking at the 251 call (skipping the 250.5 call). I can sell the 250 call for .66 and buy the 251 call for .32. ***This means I can sell the whole spread for $.34 or $34 per spread.***



If I collect the $34 per spread that is the most I can make on the trade. The capital required to put this trade on would be $66 per spread ($1 difference between the strikes minus the $.34 that

I collected to put the trade on). The $66 is the most I can lose on the trade. With us risking $66 to make $34 it will leave us with a 2:1 risk to reward scenario. We are ok with this ratio because we have 5 different ways of making money. As you can see, this is a very reasonable trade that can be used regardless of account size. You can sell this spread 10 times and still only have $660 of risk.



When selling the 250/251 call spread for $.34 our breakeven point would be at $250.34 (The short 250 call plus the $.34 that we collected to sell the spread). We don't care if SPY moves higher, lower, or sideways as long as it stays below $250.34. We also make money if time decay adds up and if volatility decreases. ***This means we have 5 different ways of making money.***

The beauty of this trade is all the different ways we have of making money while in a risk defined trade. Many would actually argue that this is actually safer than just buying a call or a put which is what most traders limit themselves to.

Short Put Spread - Bullish Trade

Let's move on to a short put spread. We will always sell a put spread when we want to be in a bullish position. ***In most cases, I will sell spreads on weekly options that have between 7 and 20 days left to expiration.*** In doing so, we will take advantage of the increased time decay that occurs the closer we get to expiration. With time decay working in our favor, we can afford to hold these trades a little longer when compared to buying the weekly options. Each day that we hold these spreads we are going to be making money from the time decay.

When selecting the best strike prices for the trade I like to use the Delta of an option. Most options brokers show you the Delta of an option right on the trade page of their platform. ***When deciding on which option to sell I will go to the option that has a Delta closest to .35.*** This will typically get us 1-3 strikes out of the money. To make sure we are in a risk defined trade we will also buy an option farther out of the money. ***To do this I like to go out 2 additional strikes from the option that I sold*** (we will take a closer look at this in Case Study #2 below).

When selling weekly spreads it's very important to make sure you are trading liquid stocks/ETF's. Where we get in and out of these trades can make a huge impact on our profitability. ***I want to make sure that the options I'm looking to trade have an open interest of 25x the number of contracts I'm looking to trade.*** So if I want to sell 5 spreads then I'm looking for 125 contracts of open interest on the options that I'm looking to trade.

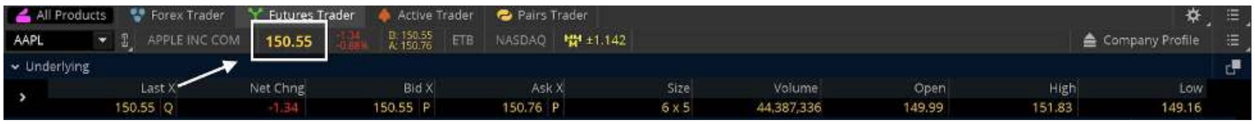
The price that we collect when selling the spread is our maximum profit potential. Regardless of what the stock does the premium that collect for selling the spread is the most we can make on that trade. ***Our risk is limited to the difference between the strikes minus the credit that we received for placing the trade.*** When selling spreads our breakeven point is always our short strike plus/minus the credit that we received for opening the trade. We don't care it the stock goes higher, lower, or sideways as long as price stays below our breakeven price we can make money. We also make money from time decay adding up and from volatility decreasing.

We look to take these trades off when we can keep 50-75% of the premium that we collected when putting on the trade. For example, if we collected $1.00 to put the trade on, we will close the trade when we can buy it back for $.25 - $.50. This would give us $.50-$.75 of profit per spread.

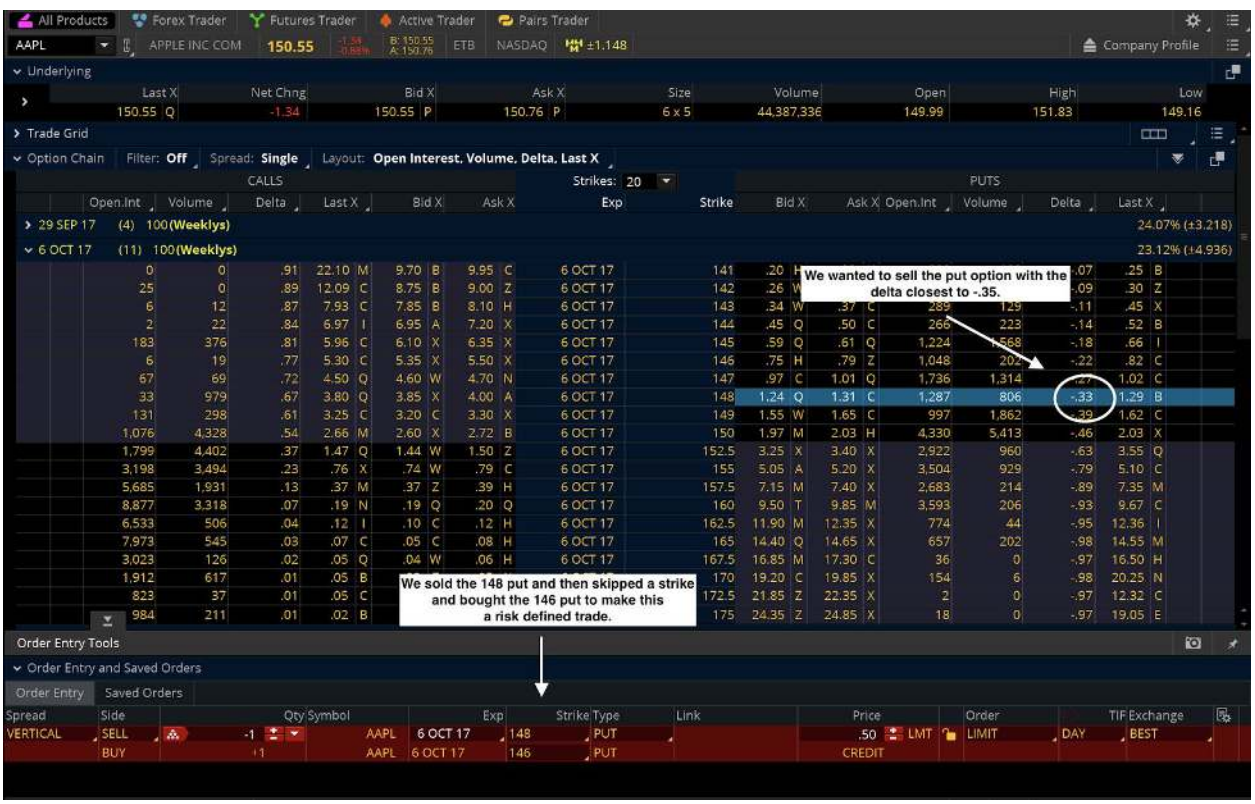
Let's put this all together by looking at an example on an AAPL trade.

Case Study #2 - Short AAPL Put Spread

For example, with AAPL trading at 150.55, if I was looking to put on a bullish position I would sell a put spread.

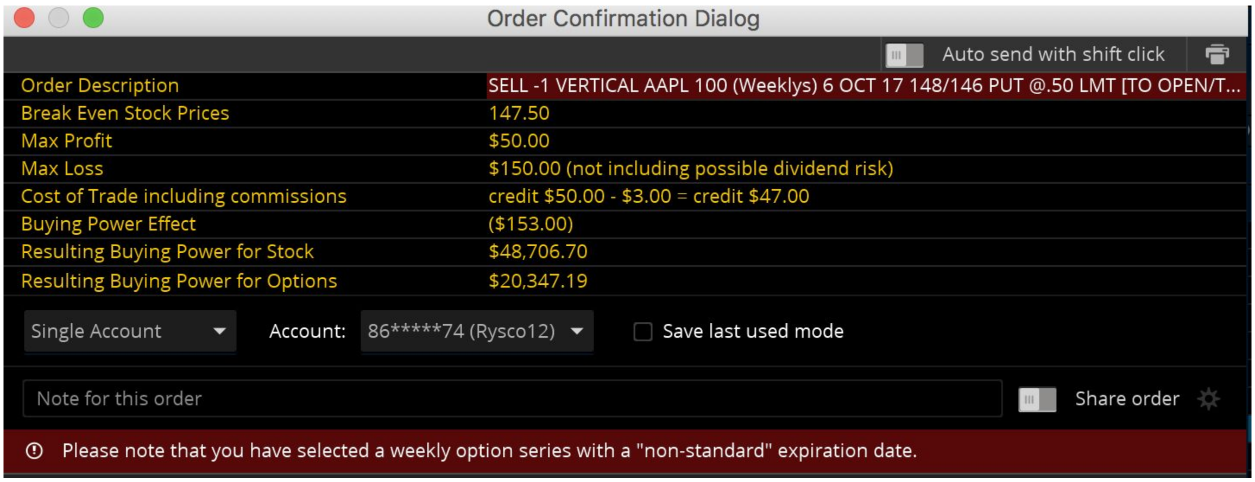


By going to the trade page of my brokers platform I can see that the October 6 Weekly 148 put has a delta of .33. This is very close to the .35 number that I am looking for. I would sell this option. I also need to buy the out of the money option so I also take a look at the available strike prices to see that they are $1.00 wide. I need to go out an additional 2 strikes to buy the call option which would have me looking at the 146 put (skipping the 147 put). I can sell the 148 put for $1.27 and buy the 146 put for $.77. ***This means I can sell the whole spread for $.50 or $50 per spread.***



If I collect the $50 per spread that is the most I can make on the trade. The capital required to put this trade on would be $150 per spread ($2 difference between the strikes minus the $.50

that I collected to put the trade on). The $150 is the most I can lose on the trade. With us risking $150 to make $50 it will leave us with a 3:1 risk to reward scenario. We are ok with this ratio because we have 5 different ways of making money. As you can see this is a very reasonable trade that can be used regardless of account size. You can sell this spread 10 times and still only have $1500 of risk.



When selling the 148/146 put spread for $.50 our breakeven point would be at $147.50 (The short 148 put minus the $.50 that we collected to sell the spread). We don't care if AAPL moves higher, lower, or sideways as long as it stays above $147.50. We also make money if time decay adds up and if volatility decreases. ***This means we have 5 different ways of making money.***

The beauty of this trade is all the different ways we have of making money while in a risk defined trade. Many would actually argue that this is actually safer than just buying a call or a put which is what most traders limit themselves to.

Selling Weekly Vertical Spread Strategy Criteria	
Time to Expiration:	**7-20 Days**
Option to Sell:	**Delta closest to .35**
Option to Buy:	**Buy the option 2 strikes away from option sold.**
Min Open Interest:	**25x the number of contracts being traded.**
Profit Target:	**50-75% of the Premium Collected when opening trade.**

Conclusion:

The biggest piece of advice that I can give options traders is to make sure you have a toolbox of trades that you can use to take advantage of any different type of market condition. Don't limit yourself to only trading one type of options strategy. You will see far better results long term if you have a good mix of different trade types. Mix up the weekly and monthly options. Use a mix of long calls and puts along with vertical spreads. If you do so you will see a better overall equity curve in your account. You now have a set of mechanics that you can use for the different trade types outlined in this book. Now it's time to get your trades on and watch your account size grow.