

ENHANCE[®]
YOUR OPTIONS
Add an extra dimension to your trading[®]



So What's Your Troubles with Options

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- Paul McLaren
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Session Outline



“If the key to developing a new skill follows successive stages of attitudes and perception, education and learning and finally action and implementation, then hurdles and obstacles at any stage will hinder, if not halt successful progression. These stumbling blocks will need to be overcome for advancement to be made.”



Why Options: Limited Risk



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Why Options: Leverage

	Shares		Options		
No Of Contracts			79.2		N.B. Not rounded for illustration purposes
Shares Per Contract			100		
No of Shares (Equivalent)		10129	7919		
Total Delta	100%	\$ 10,129	51%	\$4,038	
Strike Price			\$11.50		
Entry Price		\$ 11.50	\$ 0.43		
Opening Brokerage		\$ 35	\$ 35		
Total Outlay		\$116,514	\$3,475		
Closing Brokerage		\$ 35	\$ 35		
Closing Out Position (Stop Loss Level \$11.15)		\$ 11.15			
Option Premium At Stop Loss (After 5 Days)			\$ 0.25		= Original Premium - (Δ * Price Movement)
Total Loss At Stop Loss if Close Out Position		-\$ 3,475	-\$1,448		
Absolute Maximum At Risk		-\$116,514	-\$3,475		



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Session Outline

Options Perception - Dealing with the myths

- Most options expire worthless
- Options are risky
- Options are for expert traders
- Options are complicated

Options education – Dealing with the confusion

- Is there an inherent problem with the way options are taught?
- Do some who teach options suffer from the Curse of Knowledge?
- How well does Technical Analysis and Options Trading integrate?

Options trading – Dealing with the common mistakes

- The 8 most common mistakes of options trading.
- Cognitive biases with options trading



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The x Common Myths about Options



Friday, Ma

myths about options# - Google

The 10 Biggest Option Trading

7 Myths about Options Trading

https://www.google/ 80%

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Google myths about options# Sign in

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The 10 Biggest Option Trading Myths Debunked [Guestpost] - Tradeciety
<https://www.tradeciety.com/the-10-biggest-option-trading-myths-debunked-guestpost/>
 Nov 15, 2018 - There is more than one way to make money with options. Here are some of the common myths and misconceptions about options trading.

People also ask

- What is the riskiest option strategy?
- Can Option Trading make you rich?
- Is buying options a good idea?
- How much money do I need to sell options?

Feedback

7 Myths about Options Trading Debunked - FX Empire
<https://www.fxempire.com/Education/>
 There is more than one way to make money with options. Here are some of the common myths and misconceptions about options trading.

MYTHS ABOUT OPTIONS - MOMS WHO TRADE OPTIONS
<https://momswhotradeoptions.com/2018/09/17/myths-about-options/>
 Sep 17, 2018 - Here are the Answers to Fire Right Back to Every Myth. MYTH: Options are too risky. True ___ False ___ False: You are a thinking, educated ...

The Biggest Myths About Options - Wall Street Daily
<https://www.wallstreetdaily.com/2018/03/23/biggest-myths-options/>
 Mar 23, 2018 - I want to break down the biggest myths about options for you. You should NOT be afraid to use these investments... you should be embrace ...

10 Busted Myths About Options Trading - MoneyShow.com
<https://www.moneyshow.com/articles/optionsidea-28273/>
 May 14, 2015 - Common misconceptions often keep traders and investors out of the options markets, writes Ji.

Option Myths and Misconceptions - Option Matters
<https://www.optionmatters.ca/option-myths-misconceptions/>
 Mar 21, 2018 - For those readers who are just beginning their options education journey, I am sure you have been presented with many opinions from other ...

[PDF] 10 Common Myths About Options - Interactive Brokers
https://www.interactivebrokers.com/webinars/CBOE_Myths_About_Options.pdf



10 Common Myths About Options

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CBOE The Options Institute: 10 Common Myths About Options

Myth Number 1 – Options are only for speculators

- Reality – Many professionals use options for portfolio protection.
- Options may be used as insurance policies.
- Options make investors think differently.



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CBOE The Options Institute: 10 Common Myths About Options

Myth Number 2 – Options are risky because they use leverage

- Options may be used in non risky ways. The key is capital management.



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CBOE The Options Institute: 10 Common Myths About Options

Myth Number 3 – Options are only for short term trading.

- Options may be used with a long time horizon.
- Many stocks have options with well over a year until expiration.



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Myth Number 4 – 90% of options expire with no value

- The majority of option contracts are closed out before expiration.
 - Less than 10% of options assigned.
 - About 20% of options expire with no value.
 - About 70% of options positions are closed out before expiration.



**CBOE The Options
Institute:
10 Common Myths
About Options**

Myth Number 5 – Only sellers of options make money

- As noted in Number 4 more contracts are closed out before expiration.
 - The truth is option buyers and sellers can profit from option trading.
 - If only sellers made money, there would be no buyers.
 - With no buyers there would be no market.
-
- Buyer Strategy – Little loss, little loss, little loss, Big Gain!
 - Sellers Strategy - Little gain, little gain, little gain, Big Loss?



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CBOE The Options Institute: 10 Common Myths About Options

Myth Number 6 – The market makers can not be beat.

- Market makers trade as arbitrageurs.
- Their primary function is to provide liquidity to the marketplace (??)
- XYZ Apr 40.00 Call – Bid 0.90 Ask 1.00



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CBOE The Options Institute: 10 Common Myths About Options

Myth Number 6 – The market makers can not be beat.

Code	Name
ILU	ILUKA RESOURCES FPO
ILUN59	7.50 CALL OPTION EXPIRING 24-JAN-2019
ILUPS9	7.75 CALL OPTION EXPIRING 21-FEB-2019
ILUPX9	7.50 CALL OPTION EXPIRING 21-FEB-2019
ILUQ69	7.25 CALL OPTION EXPIRING 24-JAN-2019
ILUSQ9	7.00 CALL OPTION EXPIRING 24-JAN-2019

Options				
Edit Delete Download Refresh				
Code	Bid (\$)	Offer (\$)	Last (\$)	Change (\$)
▼ ILU	7.570	7.580	7.570	-0.010
■ ILUN59	0.240	0.315	0.150	0.000
■ ILUPS9	0.270	0.340	0.170	0.000
■ ILUPX9	0.390	0.470	0.000	0.000
■ ILUQ69	0.000	0.000	0.230	0.000
■ ILUSQ9	0.000	0.000	0.000	0.000

Bid	Ask	Spot	Spread	
\$0.900	\$1.000	\$40.00	0.25%	
\$0.240	\$0.315	\$7.50	1.00%	
Underlying Share Price	Delta	Price Movement	Underlying Share Price	Share Price Movement %
\$7.57	100%	\$0.15	\$7.72	1.98%
Ask			Sold	Option Price Movement
\$0.315	\$0.50	\$ -	\$0.315	0.00%



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Myth Number 7 – Covered calls force you to sell winners and hold losers.

- Stock may be called away if price is higher than strike.
- If called away shares may be repurchased.
- Short call option may be covered to avoid assignment



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Myth Number 8 – Trading options is a zero-sum game

- Options may be used as insurance policies.
- They are more like risk management tools than trading vehicles.
- Originally designed as insurance or portfolio protection.
- If you don't claim on your Life Insurance, did you lose and the Life Insurance underwrite win?
 - Hindsight Bias



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CBOE The Options Institute: 10 Common Myths About Options

Myth Number 9 – Selling puts is risky.

- “Put selling has been shown to be an excellent method of owning stock”.
- Through selling puts an investor takes on the obligation to buy shares.



**CBOE The Options
Institute:
10 Common Myths
About Options**

Myth Number 10 – Option positions must be constantly monitored.

- Built in trading loss guarantee if net long.
- No need to worry about stop losses.



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Common Issues with Learning Options

- The complexities of options
- The curse of knowledge
- The way related concepts are presented in a disparate, counter-intuitive way
- The payoff diagram, what it tells you, what it doesn't, and how it misleads you
- The number of strategies
- When to use a Broken Wing Butterfly?



Common Issues with Learning Options: The Course of Knowledge Cognitive Bias

- The curse of knowledge or why so many university academics are bad lecturers.
- The more familiar people are with something, the harder it is to put themselves in the shoes of someone who's not familiar with that thing. They can't unlearn what they have learned, and can't see it with fresh eyes anymore.
- They have a much harder time explaining the basics to people who are new to the subject...
 - because you can't remember what questions you had when you were new to the subject.
 - Can't remember how difficult it was to grapple with some concepts



Common Issues with Learning Options: The Course of Knowledge Cognitive Bias

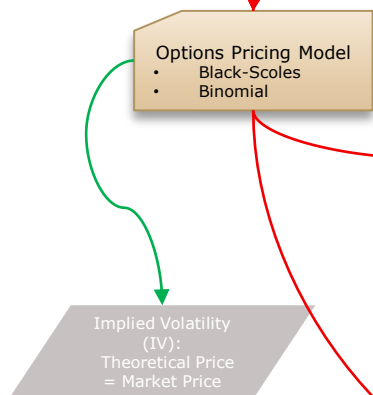
- In 1990, Elizabeth Newton, a Ph.D. candidate at Stanford University, conducted a study to see how people's confidence in their communication differed from reality.
- Participants were divided into two groups: tappers and listeners.
- Each tapper was partnered up with a listener.
- Tappers were told to pick a well-known song such as "Happy Birthday" and tap out the rhythm on the table.
- The listeners were asked to guess the name of the song.
- But first, the tappers were asked to predict how often the listeners would be able to guess the song.
- The tappers were confident. They expected the listeners would recognize the song about half of the time.
- Yet of the 120 songs tapped, the listeners only guessed 3 songs correctly.
- The tappers could hear the melody in their head, but the listeners could not.
- The tappers' knowledge of the song caused them to miscalculate the listeners' comprehension.



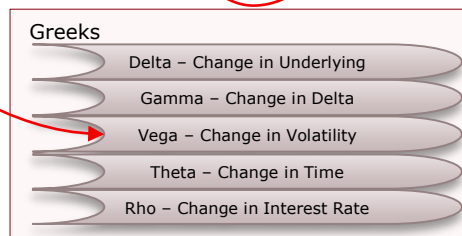
Theoretical

Practical

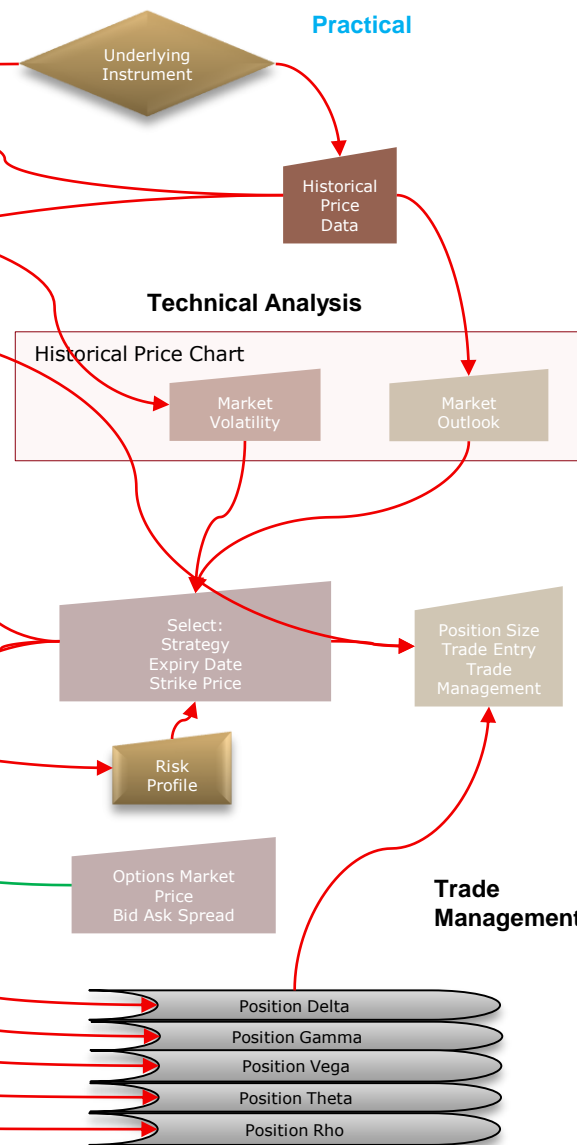
Option Valuation – Single Leg



Option Behaviour – Single Leg



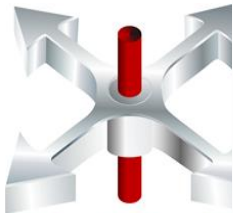
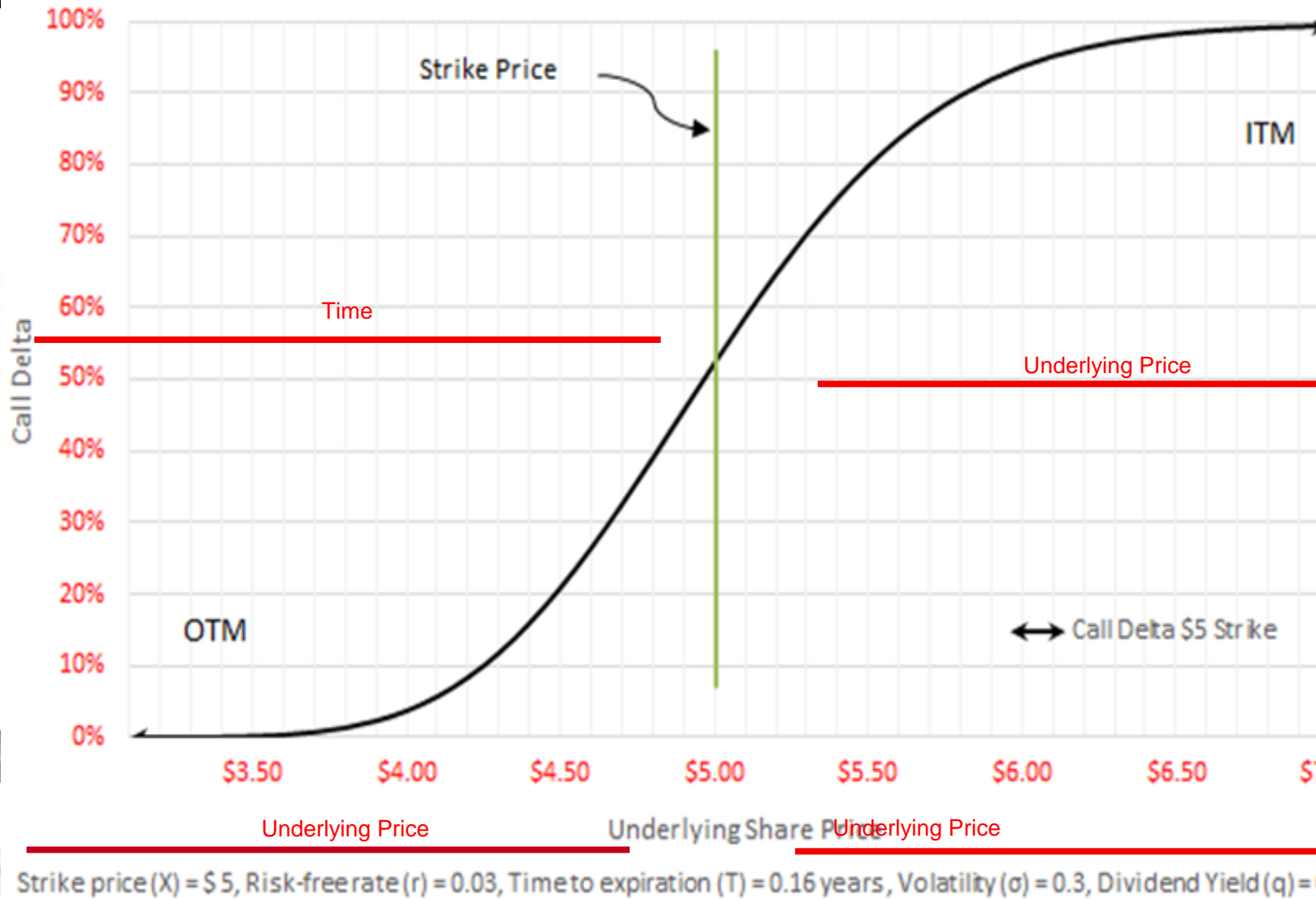
Option Trading – Multiple Leg



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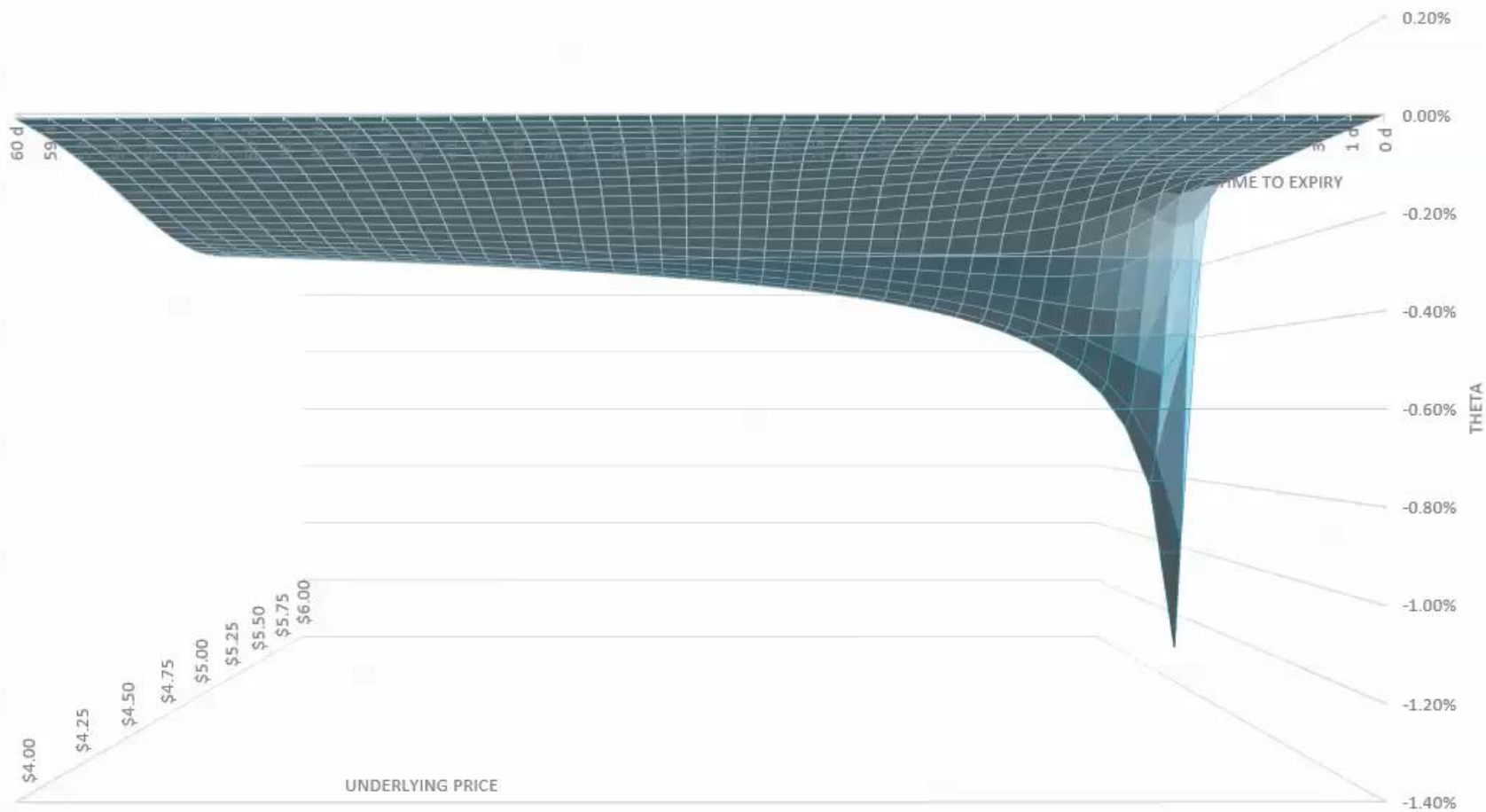
Add an extra dimension

Presently



RoToR
PAYOFF DIAGRAMS

Call Theta versus Underlying Price versus Time to Expiry

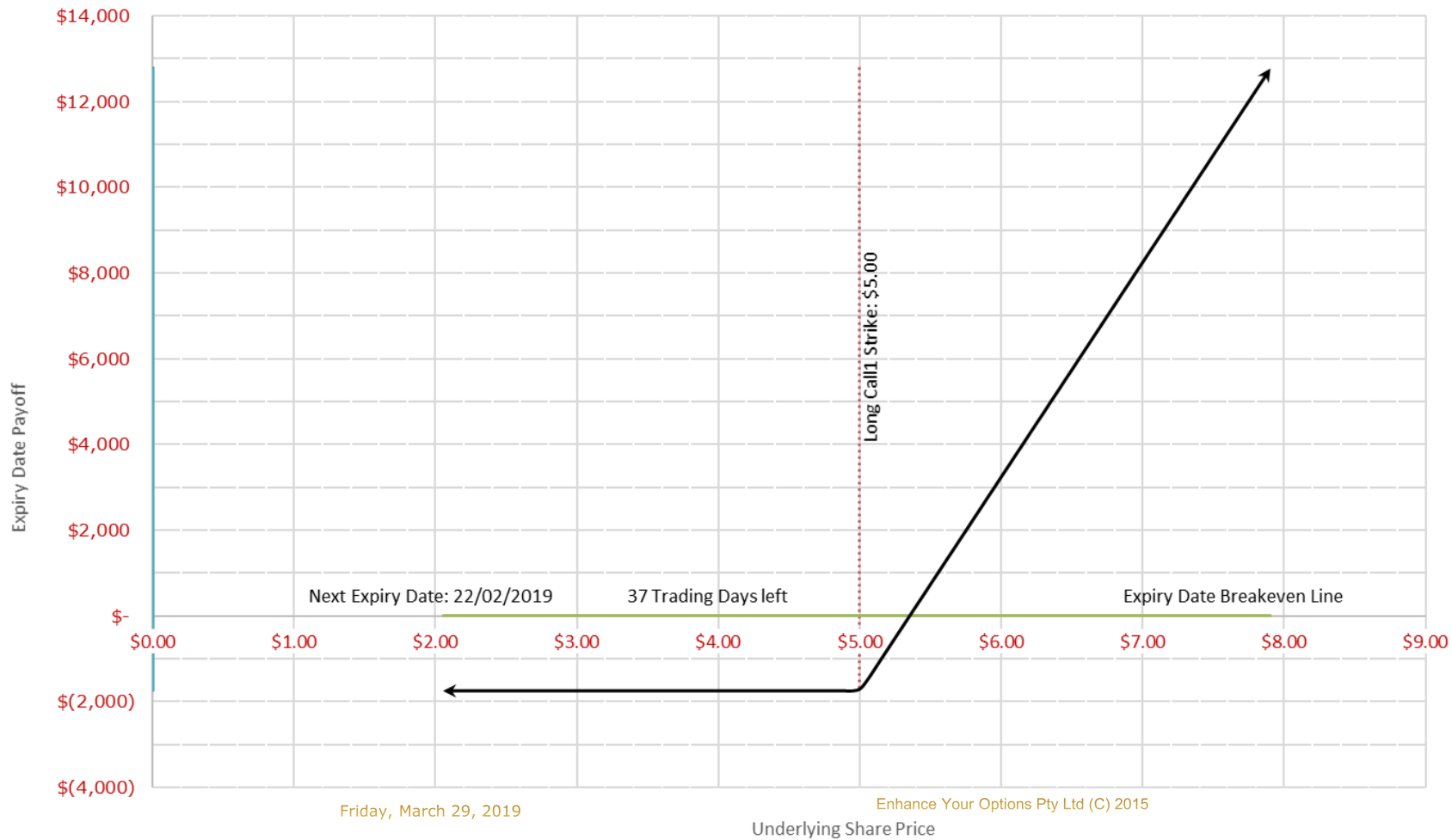


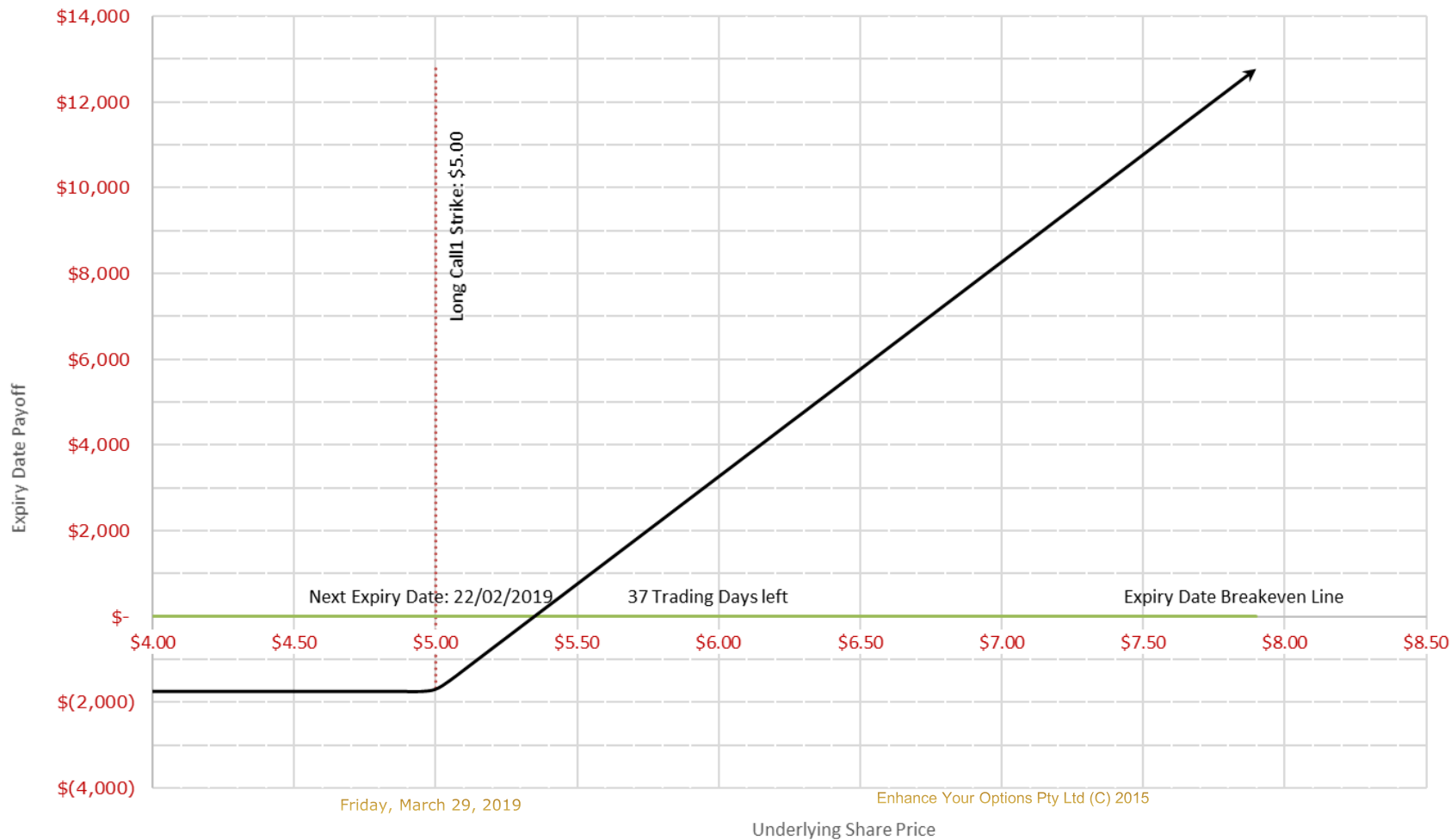
Common Issues with Learning Options: Problems with payoff diagrams

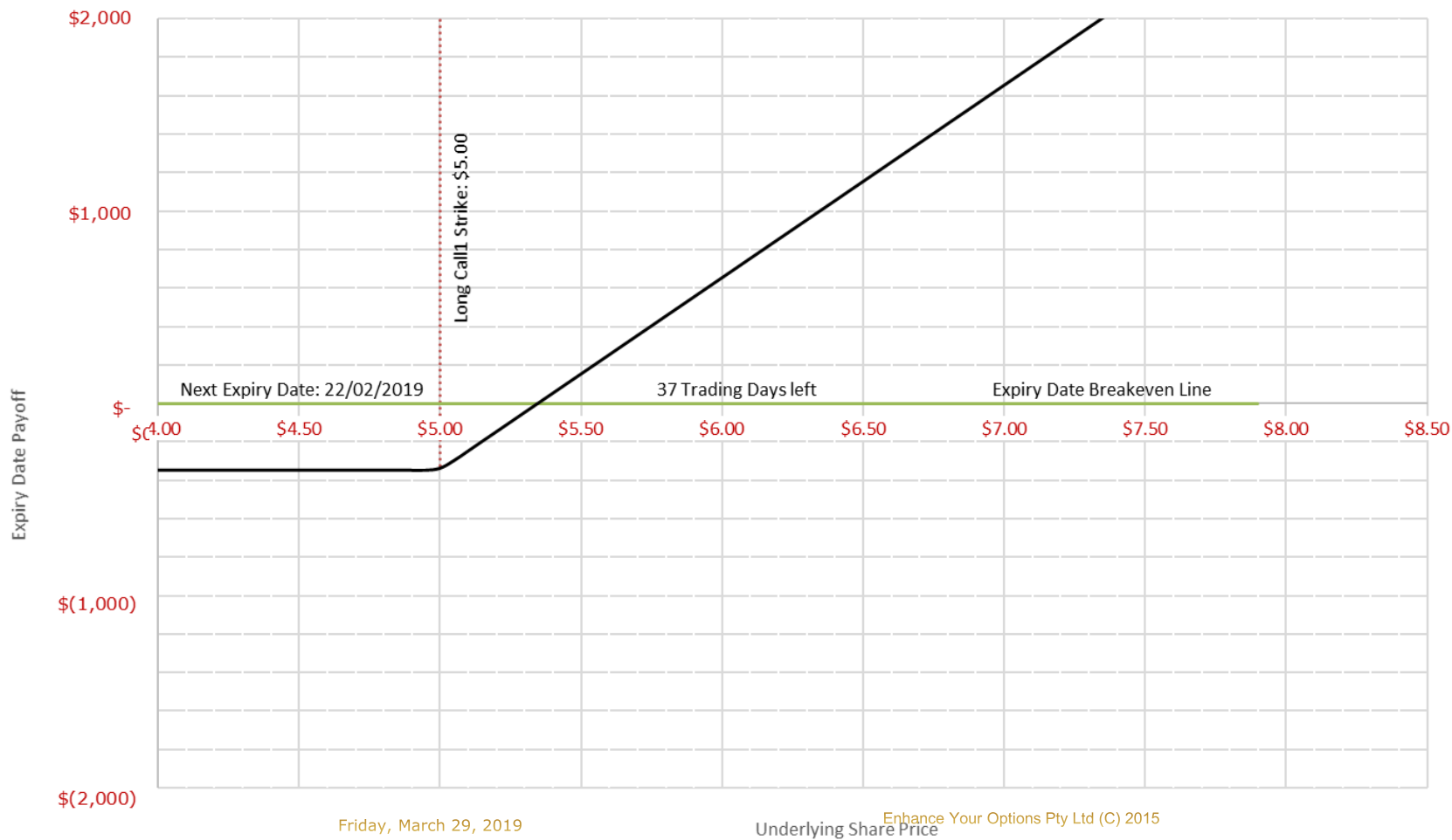
1. Framing effect – scaling of payoff diagram affects risk-reward perception
2. Key determinant of a profitable options trade is the instrument
 - Market Outlook – Bullish, Bearish or Neutral
 - Volatility – High or Low
3. Shows only possible outcomes, not probable outcomes
4. Implies in the absence of other information, that all outcomes are equally

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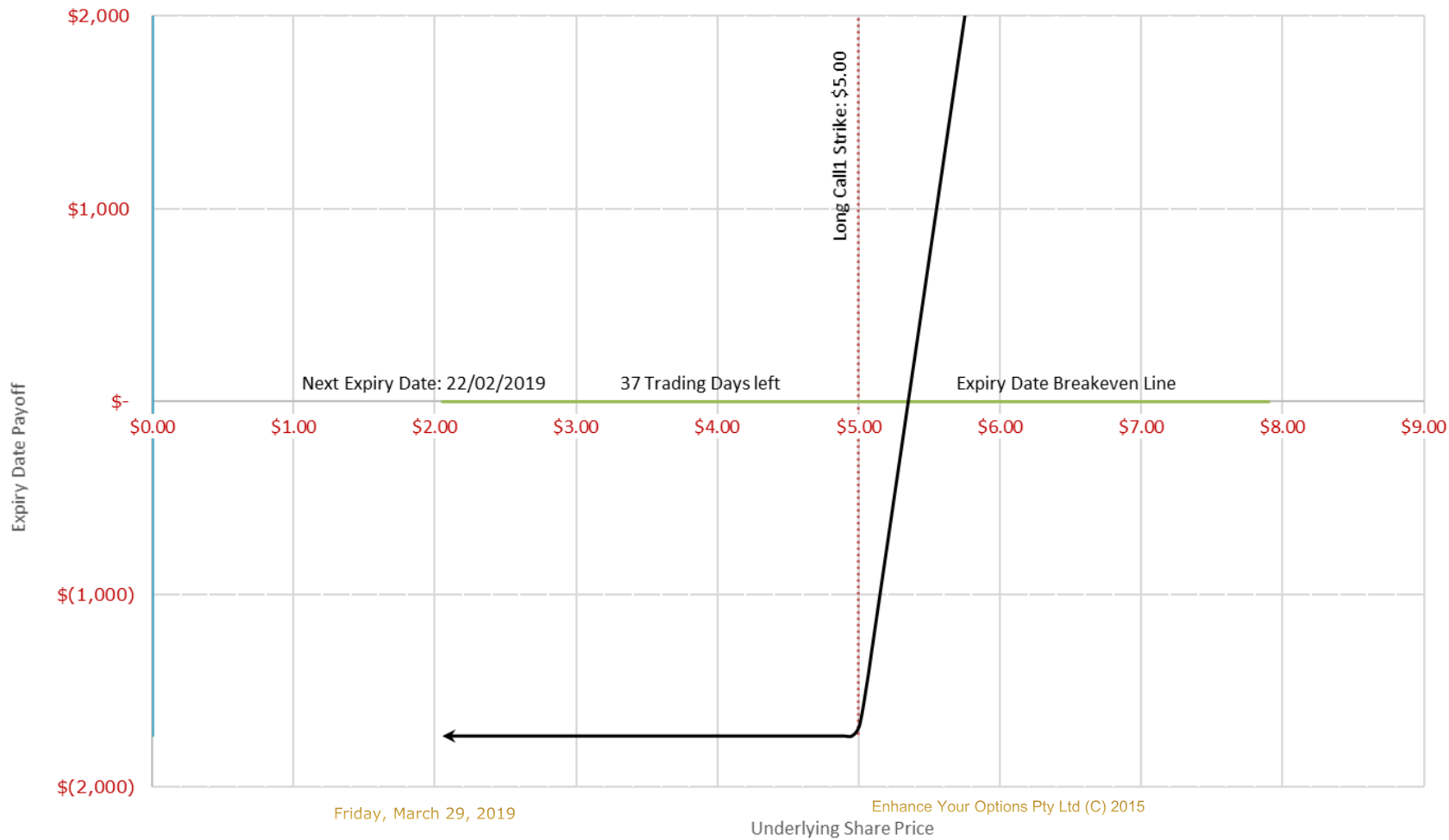






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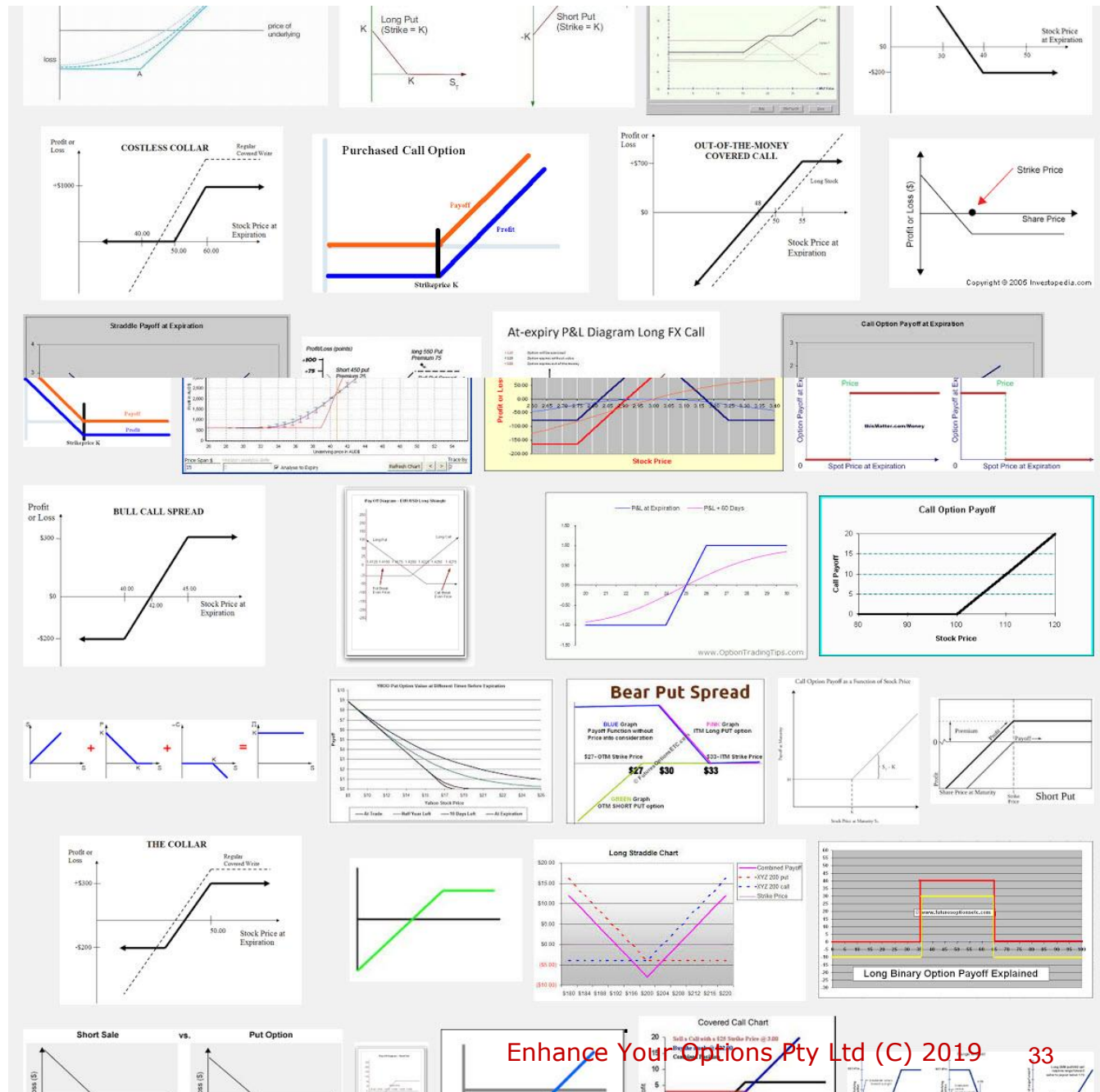
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The Traditional Options Payoff Diagram



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RoToR Payoff Diagrams[®]



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Option Strategies



Instrument: Citigroup, Inc.

Selected Strategy:

Long Underlying

Date / Price Selection:

EMV: \$ 505

Last Date / Last Price

-17,920 -8,960 Expiry Date Payoff 8,960 17,920

Net Cr/Db (Incl Comm): \$ -143,480

Debit

Net Cr/Db/Cntrct (Ex Comm): \$ -71.740 Debit

Volatility (Historical) 19.6 %

Maximum At Risk: \$ -14,720

Maximum Gain: \$ 17,920

BreakEven: \$ 71.740

Long Underlying

AMIBROKER
PAYOFF DIAGRAMS

C0
C1
C2
C3
P3

72.50
72.00
71.50
71.00

71.74

Next Expiry: 25/10/2018 - 18.375 trading days until: Expiry Date (breakdown)

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Instrument: Citigroup, Inc.	Date / Price Selection:	Last Date / Last Price	-17,920	-8,960	Expiry Date Payoff	8,960	17,920
Selected Strategy:	Short Underlying	EMV: \$ -505					
Net Cr/Db (Incl Comm):	\$ 143,480	Credit	Net Cr/Db/Cntrct (Ex Comm):	\$ 71.740	Credit		
Volatility (Historical)	19.6 %		Maximum Gain:	\$ 14,720			
Maximum At Risk:	\$ -17,920	BreakEven: \$ 71.740					

Short Underlying

C0
C1
C2
C3
P3



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Instrument: Citigroup, Inc. Date / Price Selection: Last Date / Last Price -14,616 -7,308 Expiry Date Payoff 7,308 14,616
Selected Strategy: Long Call EMV: \$ -9

Net Cr/Db (Incl Comm): \$ -2,784 Debit
Volatility (Historical) 19.6 %
Maximum At Risk: \$ -2,784
BreakEven: \$ 73.392
Net Cr/Db/Cntrct (Ex Comm): \$ -1.392 Debit
Maximum Gain: \$ 14,616

Long Call

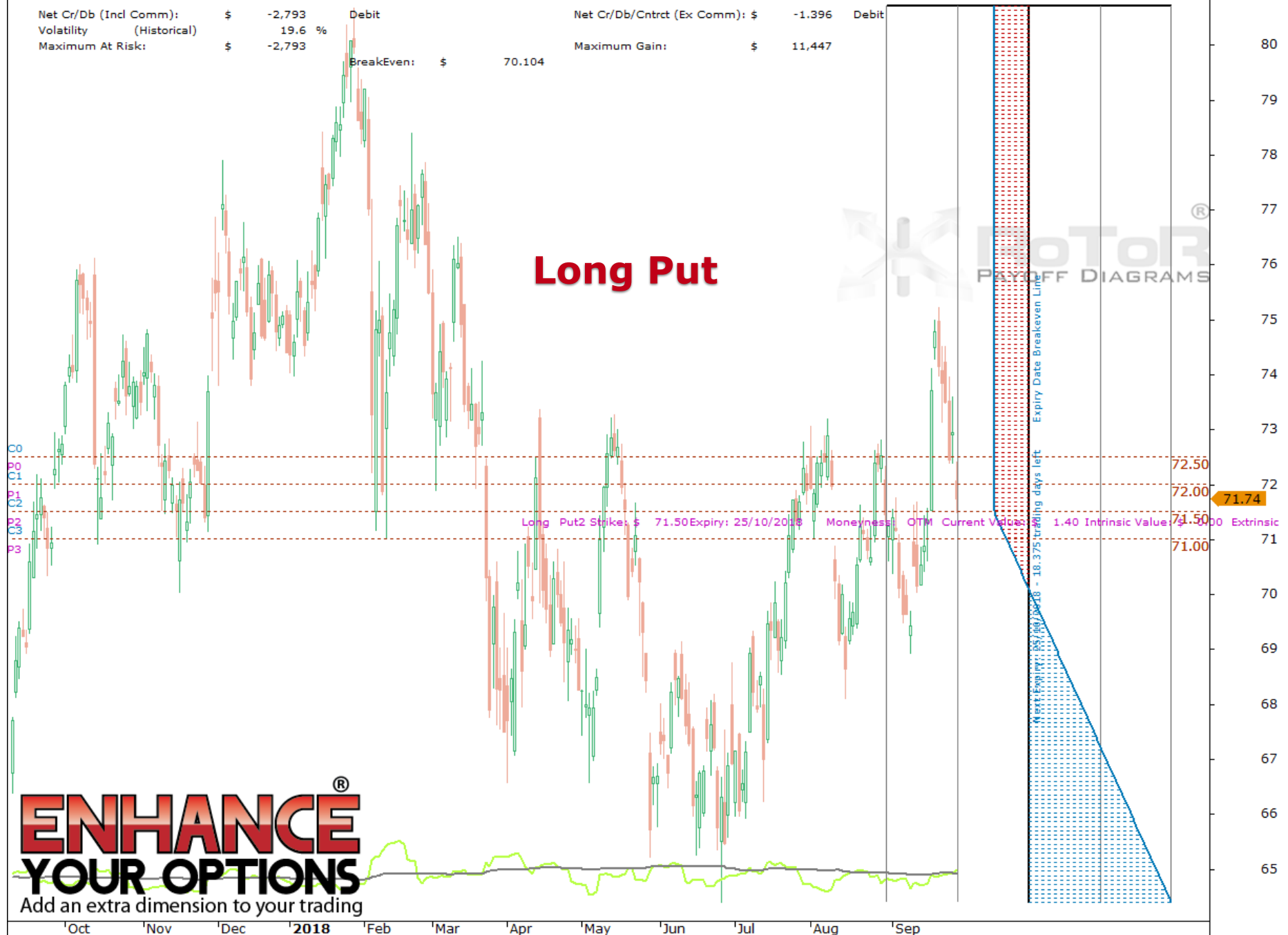


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Instrument: Citigroup, Inc. Date / Price Selection: Last Date / Last Price -11,447 -5,724 Expiry Date Payoff 5,724 11,447

Selected Strategy: Long Put
 Net Cr/Db (Incl Comm): \$ -2,793 Debit
 Volatility (Historical) 19.6 %
 Maximum At Risk: \$ -2,793
 BreakEven: \$ 70.104

Net Cr/Db/Cntrct (Ex Comm): \$ -1.396 Debit
 Maximum Gain: \$ 11,447



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Instrument: Citigroup, Inc.

Selected Strategy:

Long Straddle/Strangle

Date / Price Selection:

EMV: \$ -486

Last Date / Last Price

-11,823

-5,911

Expiry Date Payoff

5,911

11,823

Net Cr/Db (Incl Comm):

\$ -5,577

Debit

Volatility (Historical)

19.6 %

Maximum At Risk:

\$ -5,577

BreakEven (Upper):

\$4.789

BreakEven (Lower):

\$8.711

Net Cr/Db/Cntrct (Ex Comm): \$

-2.789

Debit

Maximum Gain:

\$

11,823

Long Straddle

C0
P0
C1
P1
C2
P2
C3
P3

Long Call1 Strike: \$ 72.00 Expiry: 25/10/2018

Moneyiness: OTM Current Value: 1.39 Intrinsic Value: \$ 0.00 Extrinsic

Long Put2 Strike: \$ 71.50 Expiry: 25/10/2018

Moneyiness: OTM Current Value: 1.40 Intrinsic Value: \$ 0.00 Extrinsic

Expiry Date Breakeven Line

Next Expiry: 25/10/2018 - 18.375 trading days left

72.50
72.00
71.50
71.00

71.74

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Instrument: Citigroup, Inc. Date / Price Selection: Last Date / Last Price -11,823 -5,911 Expiry Date Payoff 5,911 11,823

Selected Strategy: Short Straddle/Strangle EMV: \$ 486

Net Cr/Db (Incl Comm): \$ 5,577 Credit

Volatility (Historical) 19.6 %

Maximum At Risk: \$ -11,823

BreakEven (Upper): \$4.789

BreakEven (Lower): \$8.711

Net Cr/Db/Cntrct (Ex Comm): \$ 2.789 Credit

Maximum Gain: \$ 5,577



C0

P0

C1

P1

C2

P2

C3

P3

Short Call1 Strike: \$ 72.00Expiry: 25/10/2018 Moneyness: OTM Current Value: \$ 1.39: Intrinsic Value: \$ 0.00 Extrinsic

Short Put2 Strike: \$ 71.50Expiry: 25/10/2018 Moneyness: OTM Current Value: \$ 1.40: Intrinsic Value: \$ 0.00 Extrinsic

72.50

72.00

71.50

71.00

71.74

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Instrument: Citigroup, Inc.

Selected Strategy:

Bull Call Spread

Date / Price Selection:

EMV: \$ 38

Last Date / Last Price

-514

-257

Expiry Date Payoff

257

514

Net Cr/Db (Incl Comm):

\$ -486

Debit

Net Cr/Db/Cntrct (Ex Comm): \$

-0.243

Debit

Volatility (Historical)

19.6 %

Maximum Gain:

\$

514

Maximum At Risk:

\$ -486

BreakEven:

\$

71.743

Bull Call Spread



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Instrument: Citigroup, Inc.

Selected Strategy:

Bear Put Spread

Date / Price Selection:

EMV: \$ -34

Last Date / Last Price

-509

Expiry Date Payoff

-255

255

509

Net Cr/Db (Incl Comm):

\$ -509

Debit

Net Cr/Db/Cntrct (Ex Comm): \$

-0.255

Debit

Volatility (Historical)

19.6 %

Maximum Gain:

\$

491

Maximum At Risk:

\$ -509

BreakEven:

\$

71.745

Bear Put Spread

C0
P0
C1
P1
C2
P2
C3
P3

Long Put1 Strike: \$ 72.00 Expiry: 25/10/2018

Moneyness: ITM Current Value: 1.65 Intrinsic Value: 0.25

Short Put2 Strike: \$ 71.50 Expiry: 25/10/2018

Moneyness: OTM Current Value: 1.40 Intrinsic Value: 0.00 Extrinsic

Expiry Date Breakeven Line

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**The x Most
Common
mistakes
with options**



The screenshot shows a Google search for "top options mistakes". The results list several articles from various websites:

- The Top 10 Mistakes Made by Options Traders | Top Ten Topia**
<https://www.toptentopia.com/the-top-10-mistakes-made-by-options-traders/>
 The following mistakes are not unique to newcomers to options trading. Untrained investors may be more likely to fall into the patterns discussed below, but ...
- Top 10 Option Trading Mistakes: Watch How to Trade Smarter Now | Ally**
<https://www.ally.com/do-it-right/investing/top-10-option-trading-mistakes/>
 Jan 25, 2019 - How to Avoid the Top 10 Mistakes in Option Trading. Top 10 Mistakes Beginner Option Traders Make (Click to watch how to trade smarter now!): #1 Option Trading Mistake: Buying Out-of-the-Money (OTM) Call Options. #2 Option Trading Mistake: Misunderstanding Leverage. #3 Options Trading Mistake: Having No Exit Plan.
- 7 common options trading mistakes - Fidelity**
<https://www.fidelity.com/learning-center/investment-products/options>
 Learn about some of the most common options trading mistakes so you can make ... One way to help you choose the best expiration for your outlook is to have a ...
- Top 11 Mistakes When Trading in Cheap Options - Investopedia**
<https://www.investopedia.com/investing/options>
 Feb 1, 2019 - Cheap options can be very risky, but here's how to reduce your risk by avoiding these 11 common mistakes when trading in cheap options.
- 7 Options Trading Mistakes Beginners Can Avoid - TraderHQ.com**
<https://traderhq.com/options-trading-mistakes-beginners-can-avoid/>
 Jul 14, 2014 - Here are seven mistakes beginner options traders make, and how to avoid them. ... What Is a Rounded Top and Bottom? Justin KuepperJan 23 ...
- Are You Making These 11 Common Options Strategy Mistakes?**
<https://optionalpha.com/options-strategy-mistakes-137003.html>
 Oct 17, 2018 - See if you are making these 11 common options strategy mistakes. ... ultimate guide to earnings trades including the top things to look for when ...
- The 15 1/2 "Avoidable" Option Trading Mistakes You're Making Right ...**
<https://optionalpha.com/options-trading-mistakes-20586.html>
 Oct 3, 2016 - Learn to recognize these 15 1/2 "avoidable" option trading mistakes ... I know are the top 15 1/2 options trading mistakes people are making ...
- 10 Options Trading Mistakes Every Beginner Makes - CreditDonkey**
<https://www.creditdonkey.com/options-trading-mistakes.html>
 Sep 26, 2017 - 10 Options Trading Mistakes Every Beginner Makes ... Even the best-laid strategy can fail, but the odds are in your favor when you plan.

Most Common Mistakes:

- Overcomplicating Trades with too many legs – sometimes same risk reward ratio can be obtained with less (long) legs.
- Ignoring the greeks
- Ignoring volatility
- Incorrectly selecting the expiration date
 - Share prices go up the stairs
 - Down the elevator
- Overleveraging your trades
- Buying options because they are "cheap"
 - Delta is the probability of a trade finishing in the money
- Endowment Effect – Covered Calls – being happy to sell a stock at a price and then changing your mind.
- Not legging in complex trades
- Being net short
- Staying in a written option that is a loss
- Holding on to a short trade till expiry



Strategies for Market Direction, Volatility and Time

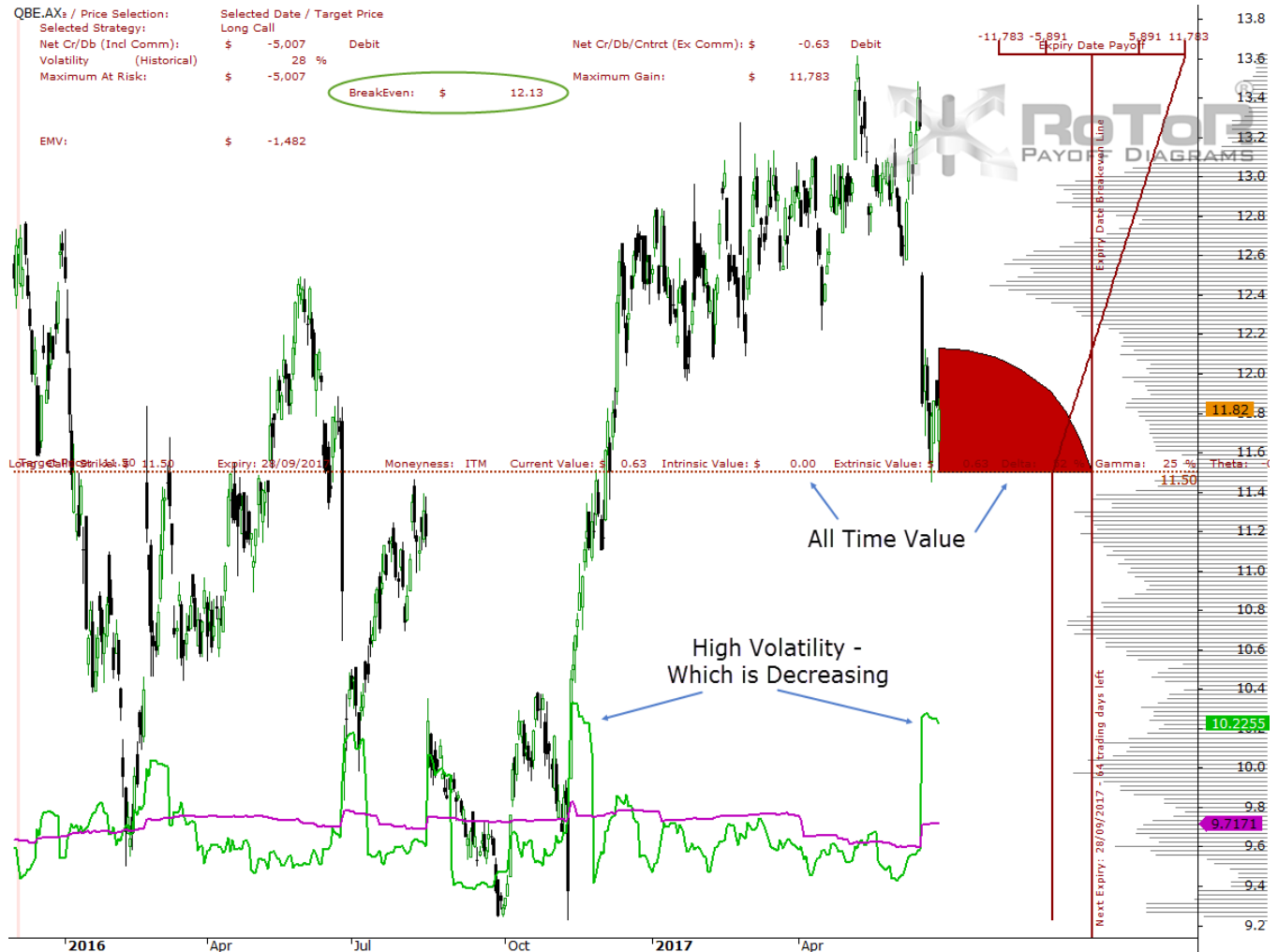
**Common Mistake:
Overcomplicating
Trades**

Market Outlook	Low Volatility	High Volatility
Bullish	<p>Long Calls</p> <p>Long Underlying</p>	<p>Short Puts</p> <p>Bull Call Spread</p> <p>Bull Put Spread</p>
Neutral / Birdirectional	<p>Long Straddle</p>	<p>Short Straddle</p>
Bearish	<p>Long Puts</p> <p>Short Underlying</p>	<p>Short Calls</p> <p>Bear Call Spread</p> <p>Bear Put Spread</p>

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Common Mistake: Buying on the first bounce



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Local Issues

- Local Laws and Customs - Shariah Law
- Local Trading Restrictions
- Illiquid, unsophisticated exchanges



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Research on Options

- Looking for participants



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Thank You