

PROBABILITY & CREDIT SPREADS



Theo**TRADE**

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Don Kaufman

- Co-Founder TheoTrade
- Industry-leading options strategist
- Derivatives Risk Manager
- 18 year trading career
- 16 years of thinkorswim[®] platform experience

Shorted AAPL @ \$130.07



Learning to SELL Options

- Many have heard through the grapevine “selling options” is the way to make money...
- Well if you have experimented with selling options you know full well there is definitely RISK involved.
- Today’s session will separate the myths from the real risks and the fact from the fiction in selling options premium.

Don't Panic, You Can Do This

- You may know NOTHING about options and that is ok for today's session!
- For starters, look to grasp the big concepts regarding probability and risk. So let's dive right in...



Probability and Profitability

- Your trading is based on probability.
- You and I can create trades all day long with a 90% probability of success and still lose money.
- Probability alone does NOT make you profitable.

Remember that!

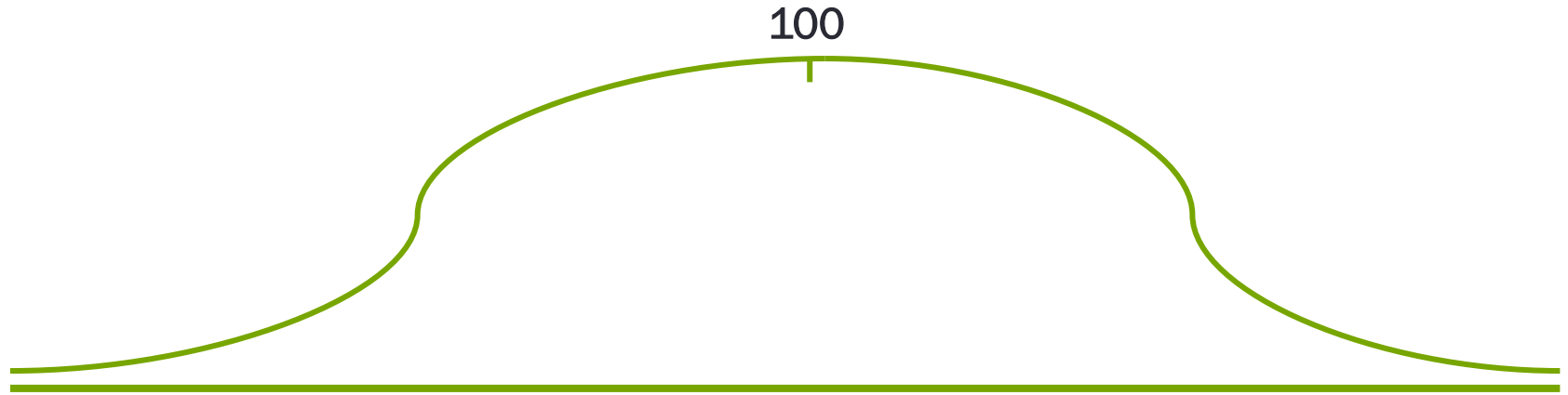
Markets Are a Trade Off

- Markets are a series of trade offs.
- Higher probability equals Higher RISK!
- You can be right 90% of the time and still lose money!

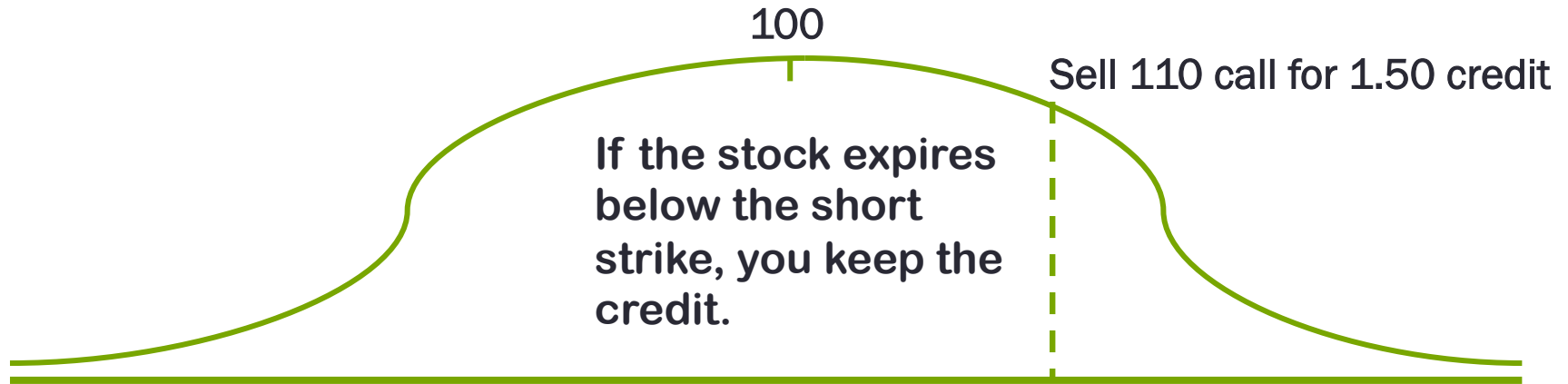
- So where can I find an edge?

- That's what you here for right? Great, then get ready because I'm about to show you something very important:

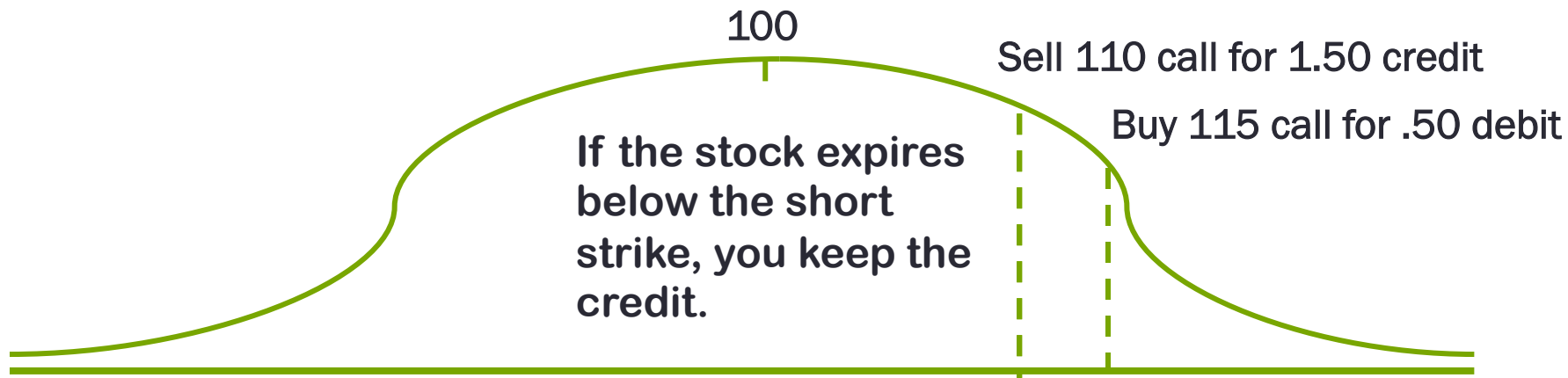
Discovering Probability: The Curve



Selling Out of the Money Options



Selling Out of the Money Options



Selling	110 call
Buying	115 call
Net Credit	\$1.00
Maximum Risk	\$4.00

Short Call Spread

Buy 225 Call	+1.00	20% lose / 80% win
Sell 220 Call		

Stock @ 200

Probability of Success? 1.00 credit

Risk = 4.00 --- $4.00 / 5.00 = 80\%$

Break-Even Point up is 221

Probability of Success

- Calculating YOUR Spread's Probability of Success - Take the real risk in the Spread divided by the Total Width of the Spread.
- Probability calculation details are as follows...
- Check out our TheoTrade Short Spreads Calculator!!

Short Spread Probability Calculation

Spread	Side	Qty	Symbol	Exp	Strike	Type	Link	Price	Order
VERTICAL	SELL	-1	GOOGL	15 JUL 16	790	CALL		1.00	LMT
	BUY	+1	GOOGL	15 JUL 16	795	CALL		CREDIT	LIMIT

Width of Spread **Credit Received**

TOTAL RISK= \$5.00 (width of spread)

REAL RISK= \$4.00 (total you can lose)

real risk is the width of the spread minus the credit received.

PROBABILITY= real risk/width of spread

Calculation= \$4.00/\$5.00 = 80%

Probability Calculator



TheoTRADE

Short Vertical Spread Calculator

Input Option Values in the Yellow Cells Below

SELL	Short Option				
	Bid	Ask	Strike Price	Put/Call?	Mid
	1.75	2.45	2060	Put	2.1

BUY	Long Option				
	Bid	Ask	Strike Price	Put/Call?	Mid
	0.95	1.55	2050	Put	1.25

Selling Spreads to Open the Trade

Here are the characteristics of your vertical credit spread trade:

Credit or Debit Spread?	Credit	Real Risk per Contract?	Max Profit per Contract?	Width of Spread	Probability of Success
Credit	\$0.85	\$915.00	\$85.00	\$10.00	91.50%

Let's Do Another Trade in AMZN!

- AMZN trading in and around all-time highs!
- Let's Sell an Out of the Money Spread.

AMZN @ \$724



Underlying

Last X	Net Chng	Bid X	Ask X	Size	Volume	Open	High	Low
724.5701 D	-3.6699	724.57 P	724.73 Q	1 x 2	2,461,956	726.74	727.00	718.43

Option Chain | Filter: Off | Spread: Single | Layout: Volume, Open Interest

CALLS						Strikes: 20		PUTS			
	Volume	Open.Int	Bid X	Ask X	Exp	Strike	Bid X	Ask X	Volume	Open.Int	
15 JUL 16	(42)	100								24.18% (±47.992)	
	1	480	56.05 C	57.10 A	15 JUL 16	675	6.50 A	6.75 C	67	494	
	18	559	52.00 C	53.00 A	15 JUL 16	680	7.40 C	7.65 C	53	482	
	0	566	48.05 C	49.05 A	15 JUL 16	685	8.45 A	8.75 C	18	608	
	33	690	44.20 C	45.30 C	15 JUL 16	690	9.65 C	9.90 C	48	414	
	28	267	40.60 C	41.55 A	15 JUL 16	695	10.95 A	11.20 C	21	289	
	155	2,832	37.30 A	37.85 Z	15 JUL 16	700	12.40 A	12.70 C	86	1,644	
	15	687	33.95 C	34.65 C	15 JUL 16	705	14.00 A	14.25 A	44	251	
	50	558	30.80 C	31.45 C	15 JUL 16	710	15.70 A	16.00 C	69	477	
	50	710	27.80 C	28.35 X	15 JUL 16	715	17.65 A	17.95 C	29	219	
	274	2,057	24.95 A	25.35 A	15 JUL 16	720	19.75 A	20.05 C	37	467	
	128	670	22.20 C	22.65 C	15 JUL 16	725	22.05 A	22.35 A	92	261	
	51	491	19.75 C	20.05 C	15 JUL 16	730	24.50 C	25.25 C	16	86	
	52	417	17.35 C	17.75 C	15 JUL 16	735	27.15 C	27.95 C	0	20	
	54	623	15.25 C	15.60 C	15 JUL 16	740	30.00 A			52	
	54	684	13.30 C	13.60 C	15 JUL 16	745	33.00 A			10	
	150	1,583	11.45 C	11.80 A	15 JUL 16	750	36.20 C	37.15 C	0	51	
	16	242	9.90 C	10.20 C	15 JUL 16	755	39.55 C	40.55 C	2	4	
	194	402	8.45 C	8.75 C	15 JUL 16	760	43.10 C	44.15 A	0	10	
	5	346	7.25 A	7.45 A	15 JUL 16	765	46.80 C	47.95 C			
	21	317	6.15 C	6.30 C	15 JUL 16	770	51.60 C	51.80 C			

We SELL the 765 Calls

We BUY the 765 Calls

Spread	Side	Qty	Symbol	Exp	Strike	Type	Link	Price	Order	TIF	Exchange
VERTICAL	SELL	-1	AMZN	15 JUL 16	765	CALL		1.12	LIMIT	DAY	BEST
	BUY	+1	AMZN	15 JUL 16	770	CALL		CREDIT			

Width of Spread

Credit Received

Probability Solved!

- AMZN is @ 724.57
- We are selling the 765 calls and buying the 770 calls.

- Net Credit +1.12
- Maximum Risk = - 3.88
- Width of Spread= \$5.00

- Probability is $3.88/5.00 = 78\%$

78% probability and the 22% hammer

- 78% sounds great but 22% of the time the market “rips your face off”.
 - When you trade high probability strategies and your wrong, you get hammered.
 - And the market is just evil enough to allow you to make money 3 or 4 times, you increase contract size... then...
 - Train wreck! Your losses exceed the gains on the previous 3 trades.
-
- I know...I know it's like I can see your account. Well for the previous 15 years, I could 😊

I Can Fix It, I Know I Can Fix It..

- Fix is a really dirty word in trading.
- 15 years in the brokerage business has made me a bit syndical regarding good trades gone bad.
- Any time you are fixing a trade you are adding more risk to an already losing trade and racking up transaction costs.
- Yes some “fixes” may work but the very notion of fixing a trade throws good capital after bad.

Yesterday's Trash

- Take a car drive it off a cliff and bring it to a body shop. The body shop will tell you the same thing about the car that I am going to say about your losing trade. It's a piece of junk, let it go.
- Do it right... learn how to correct good trades gone bad!



**Would You Like to Learn How to Sell
Spreads and how to Control Your Risks the
Right Way?**

Let's Discuss Criteria!

THEOTRADE RECIPES IN TRADING

Criteria... it's what we at TheoTrade do!

Trading is about Answering the What Ifs

- What might be a good stock or ETF candidate for me to sell a spread ?
- What is the correct options expiration cycle to sell my spread?
- How much capital do I commit to generating short spread premium?
- What Strike Price Options do I sell?
- What Strike Price Options do I buy?

TheoTrade is the Answer to Your Questions

- What is the right probability for my trade?
- How many options contracts do I trade in for my account size?
- When do I close my Short Spreads?
- What if the stock sells off big? Do I bail-out of the Short Spread?
- What if the stock rallies massively?
- Can I fix a losing trade?

TheoTrade Has Your Answers

- TheoTrade has the answer to your trade related questions!
- We Build Recipes with definitive criteria and checklists for each strategy and each unique variable you will encounter.

How, When, Why, at What Price?

- Earnings are approaching what steps do I take?
- Can I sell options without ever owning the stock?
- This is just the beginning of the many variables you will face while selling a Spread!

Guide to Selling High Probability Spreads

- Saturday June 18th 9am – 1pm Central Time
- Trade Instructor: Don Kaufman
- Class is archived immediately and available indefinitely.
- Slides with detailed entry and exit criteria to be made available immediately following the course.

- As an added bonus
- BONUS #1: Options 101: The Basics and Beyond - 5 Part Series (a \$150 Class)
- BONUS #2: Options 201: Vertical & Calendar Spreads Essentials Class (a \$150 Class)

\$297 TheoTrade.com/Trade

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- Guide to Selling High Probability Spreads Curriculum
- How to sell the correct spreads to maximize the benefits of time decay while you minimize your risk
- Why entry and exit criteria is the key to consistent returns so you're never left guessing what options to trade
- How to identify favorable short spread candidates so you know precisely what stocks to trade
- How to Identity your risk and rewards like never before so you will know exactly how your spread will perform in all market conditions.

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- Guide to Selling High Probability Spreads Curriculum
- The powerful strategies used by the insiders to generate consistent returns in their portfolio over the duration
- How so many experienced traders sell spreads to reap the benefits of option decay
- Which stocks and indexes make the best candidates for selling spreads
- What strikes and what expiration period to select to give you the highest probability of success
- When to open and when is the best time to close the spread
- Probability of Touching and how this calculation can be the defining factor in ALL of your trading strategies.

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