PROBABILITY & CREDIT SPREADS
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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

100
Selling Out of the Money Options

If the stock expires below the short strike, you keep the credit.

Sell 110 call for 1.50 credit
Selling Out of the Money Options

If the stock expires below the short strike, you keep the credit.

- Sell 110 call for 1.50 credit
- Buy 115 call for .50 debit

Selling 110 call
Buying 115 call
Net Credit $1.00
Maximum Risk $4.00
Short Call Spread

Buy 225 Call
Sell 220 Call

Stock @ 200

+1.00 20% lose / 80% win

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

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

## Theo TRADE

### Short Vertical Spread Calculator

**Input Option Values in the Yellow Cells Below**

<table>
<thead>
<tr>
<th></th>
<th>SELL</th>
<th></th>
<th>Long Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bid</td>
<td>1.75</td>
<td></td>
<td>0.95</td>
</tr>
<tr>
<td>Ask</td>
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<td></td>
<td>1.55</td>
</tr>
<tr>
<td>Strike Price</td>
<td>2060</td>
<td>Strike Price</td>
<td>2050</td>
</tr>
<tr>
<td>Put/Call?</td>
<td>Put</td>
<td></td>
<td>Put</td>
</tr>
<tr>
<td>Mid</td>
<td>2.1</td>
<td></td>
<td>1.25</td>
</tr>
</tbody>
</table>

**Selling Spreads to Open the Trade**

Here are the characteristics of your vertical credit spread trade:

<table>
<thead>
<tr>
<th>Credit or Debit Spread?</th>
<th>Credit</th>
<th>Real Risk per Contract?</th>
<th>Max Profit per Contract?</th>
<th>Width of Spread</th>
<th>Probability of Success</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit</td>
<td>$0.85</td>
<td>$915.00</td>
<td>$85.00</td>
<td>$10.00</td>
<td>91.50%</td>
</tr>
</tbody>
</table>
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
We SELL the 765 Calls

We BUY the 765 Calls

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 is 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
TheoTrade.com/Trade

- 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 identify 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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