THE WAGON WHEEL INCOME GENERATOR

BRUCE MARSHALL

SIMPLER OPTIONS

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The Wagon Wheel Income Generator

Cover by Sarah Durkee.

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When you evaluate investment strategies, it's always a good idea to remember the Buffett rule…

"Rule No.1: Never lose money. Rule No.2: Never forget rule No.1."
— Warren Buffett

That's easier said than done for most people not named Buffett. Finding undervalued stocks can be daunting, and traditional 'safe' investments offer anemic single digit returns.

Most financial experts insist that higher returns come with higher risk. Investors happily roll the dice with their savings in bull markets. And they feel like geniuses until a 'Black Swan' downturn wipes out years of gains in a matter of months. Anyone burned by the 2008 financial crisis remains painfully aware of this inconvenient truth.

So, you can imagine my reaction when I met Bruce Marshall a few years back and discovered he's cranked out consistent double digit returns throughout his 27-year career. Most would willingly donate precious body parts to enjoy steady annual returns of 10% or more. And yet Bruce is renowned for generating 15% or more in a MONTH with strictly limited risk.

To be clear, Bruce is not an adrenaline junkie. Nor does he claim to have invented anything new. Instead, he follows ultra-conservative systems he learned from mentors while managing funds for some of Wall Street's biggest institutions.

In this book, Bruce reveals one of his favorite 'bread and butter' trades, called The Wagon Wheel Strategy. It's a low maintenance approach, ideal for those who don't want to actively watch the market, and short-term traders looking to diversify into longer-term gains.

I've learned a lot of what I know about advanced option strategies from Bruce Marshall, and I'm confident you'll be very glad you got your hands on The Wagon Wheel Strategy.

John F. Carter
Simpler Trading

CONTENTS

INTRODUCTION

STRATEGY OVERVIEW

Thanks for picking up this book.

This is a variation of one of the oldest options trading strategies, but that's what makes it great. It's tried and true. It's very consistent, and it works. This one won't keep you up at night. There's really no other strategy that you can walk away from, turn off your computer, and not open your account for long periods of time, like this one.

Many years ago, one of my first mentors taught me this system. I ran this strategy for about ten years for a large equity firm, and for many years after that and I still use it today. If you've taken a class with me before, you know that I also use weekly trades and trades that need adjustments: butterflies, iron condors, calendars, and diagonals. You've got to keep a close watch on those, unlike the Wagon Wheel strategy we will cover in this book. Another aspect that you must take into account when trading is commission. On more complex trades, the commissions can really add up. Not so with the Wagon Wheel Strategy. It has a very low cost on commissions, which makes a big difference.

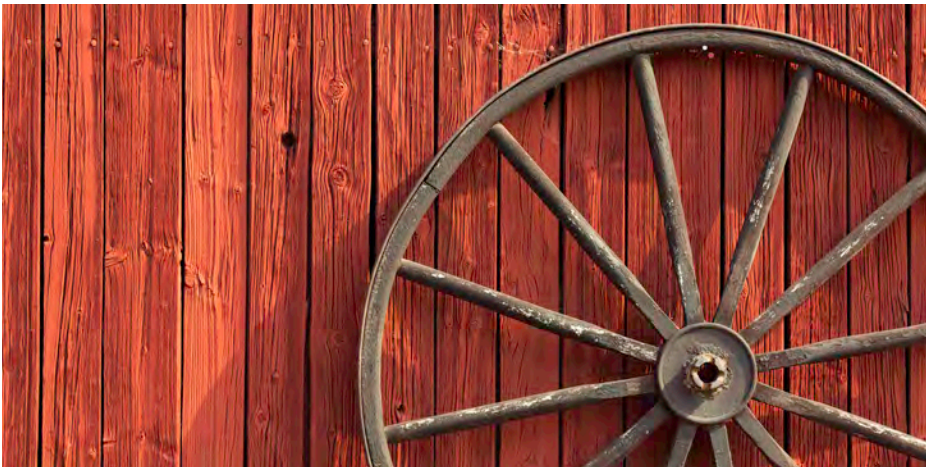
First, the obligatory disclaimer: You can lose money trading options. As with any trade, be aware that there are risks.

We'll go over how to set it up, how it works, why it works, common mistakes, and some tricks of the strategy. As with most trades, it's very important to find the right candidate to trade, and to use time on your side.

Bruce Marshall

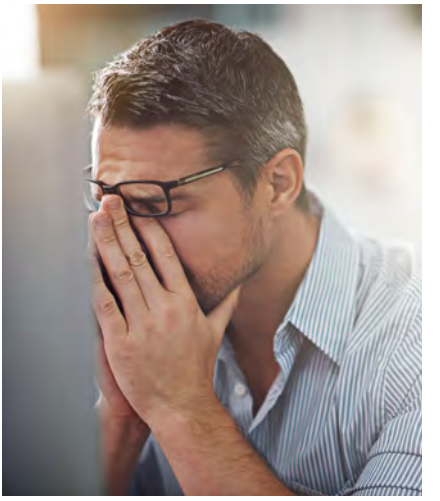
Simpler Trading

HOW DO YOU ROLL?



The reason I call this strategy "The Wagon Wheel" is because it is a circular trade. Once we start the trades, we will restart and restart it over and over. It will "roll" from month to month, and from expiration to expiration. This is ideal for traders who work full time, have limited time, hobbies or commitments that don't allow them to sit at a desk all day. If you are on the road, or in meetings, or simply can't check your trades every day, this is the trade for you.

Other non-directional options trades include iron condors, butterflies, and calendars. Adjustment is key on most of them, but there's no adjustment to do on this trade. It's low stress, and it's largely hands-off. It typically lasts for three months, sometimes less, but it's a cycle that "rolls", or starts again, so it's about four trades per year. It's pretty consistent and very low maintenance. So you don't have to be this guy.



We have all been here, and no matter what you do, and no matter how great you are, you will be there again. I will be there again. Everybody has trades where things look perfect, and it seems like the best trade you ever put on, and then it blows up on you. That does not tend to happen with this trade.

The Wagon Wheel is designed to be a compliment to your overall portfolio. The more that I can take pressure off of watching and adjusting trades, the more time I have to focus on other more aggressive trades that I need to watch, or more importantly, to focus on my family, my life, and my golf game. How much you use it depends on your personal temperament, your level of aggressiveness, and your personal situation. How much can you make, and what do you risk? A lot will depend on whether you're using a margin account or a cash account.

What do you want to accomplish with your account? Think of your portfolio as pieces of a pie. Do you want this piece to be small or large? I prefer to have it pretty large, myself. You can run this as a complete portfolio, and I'll get into that towards the end of this book. I did that for a long time, as a 100% income, non-directional type of portfolio.

It's a very straightforward way to bring in incremental cash on an ongoing basis. It's a simple trade, and it tends to be profitable, consistent, and it's a great additional trade to your overall portfolio.

CASH COVERED PUTS

SELL A CASH COVERED PUT

So let's start with the first part of the Wagon Wheel, the art of the put sale.

The market mainly goes up, but on an individual basis, stocks might go sideways. You're sitting on a stock for months and months, and it goes down a little, up a little, but ultimately, it doesn't go anywhere. So traders ask, "Is there any way I can make money on a stock if it doesn't go up?" Or, "Is there a way to buy a stock cheaper than the current market price?"

Absolutely. Even if you don't already own the stock, you can sell cash covered puts.

I'll use Johnson & Johnson (JNJ) as an example of a conservative stock that most people wouldn't mind owning. Say you were trying to buy JNJ stock, and you wanted to buy when it crossed the 20 day moving average. You wish you'd bought it there, but it kept going. You wish you would have bought it on this pullback or that pullback, but it kept going. The market rolled over and you wished you would have bought it before it shot straight up again. You're now coming up on 200 day moving average, and maybe you should buy it here, if only it was cheaper. So, what do you do?

You sell a cash covered put.

When you sell (or sometimes called write) puts, they are considered cash covered, or sold against the cash or the margin in your account. All this means is that cash or margin is deducted or set aside, for the sale of the option.

When you sell the put, you collect a premium, which comes with an obligation. If the put is in-the-money at the expiration, you will be assigned. You will be obligated to BUY the shares of the underlying stock at the price you agreed to. Don't get hung up on the lingo, we will go into detail.

In this strategy, you already have enough cash, or margin, set aside, so the obligation of selling that put is covered. Again, that's where they come up with the name "cash covered put."

When you sell puts on a stock, you'll profit if it goes sideways or it goes up, because the put can expire for its full profit. So in this way, when you sell puts, you've got two out of three scenarios for this trade to work, regardless of what the underlying stock does. That is the beauty of the trade.

PUT SALE RISK/REWARD

What's the Risk?

The risk of this strategy comes into play if the stock you choose moves sharply lower. In that scenario, you will get put to, meaning that you have to buy the stock at the predetermined price. But remember, the predetermined price is the price that you agreed to. If the stock is at $100, and you say, "If it ever dropped back to $90, I would buy." Well, okay. Now it's at $90.

If you sold a put, you don't have to decide. So this actually forces you to stick to your own criteria and be more disciplined with your trading plan. As we know, any stock can move lower at any time, which makes choosing the right underlying stock a key factor in this strategy.

How Much Can You Expect to Make?

The cash covered put is just the first part of the trade, and overall, it's a slow and steady process. This is a singles and doubles strategy, and more of a singles strategy. Because it's not directional, you don't have a lot of Delta risk.

I mentioned commission earlier. One of the best parts of this trade is that it's probably the lowest commission options trade available. In the majority of times that you use it, you will only sell one to five, maybe up to ten contracts, which means minimal commission compared to multi-leg complex trades. Your plan is also to let it go to expiration and have no "closing cost" commission on the back end. Your whole trade might cost you $5 or $10 in commission. It's very cheap.

What's the Catch?

There's no catch to this trade. Just be aware that you have sold an obligation to buy the stock at the price you agreed to upon that sale.

So, this question always comes up. "What if I change my mind?"

Although you are obligated to a set price over a period of time—until the expiration—you can always close it if something happens and you change your mind. You can buy the put back, although you may have to pay more. If you sold it for $1, you may have to buy it back for $2. Is that the end of the world? No, of course not. It's a whole lot better than if a big Iron Condor goes against you and you lose $5,000—$10,000 or more.

GOAL OF THIS TRADE

Two things can happen with a put sale:

1. The puts expire for a full profit. Everything is great, you make money, sell another one and bring in more profit.

2. Or the puts are in-the-money, and you get put to.

If that happens, remember, you're able to buy the stock at a cheaper price—and now you own the stock so you get to keep the dividends. The dividend is a big component of the trade and can tack on incremental profits for you. It is one of the bigger benefits when it comes to the risk/reward element of this trade.

It is possible to write puts over and over and not get put to. I did this all through the late 1990s. Granted, the market was going up for years and years, and I was selling, selling, selling. I usually didn't get put.

You can make good money without getting put to, if you choose the right vehicle. You don't even have to monitor them much. Just note the price at which you sell the put, and every now and then check the price to make sure it's not down $20 or had a crazy move. This gives you a big buffer zone.

Michael Dell used to sell puts against Dell stock. I read that he was making $50,000 per month, selling puts against Dell stock. He was using open market transaction, nothing hidden, but he didn't mind owning more stock. If it pulled back, he'd buy it cheaper. That always stuck in my mind.

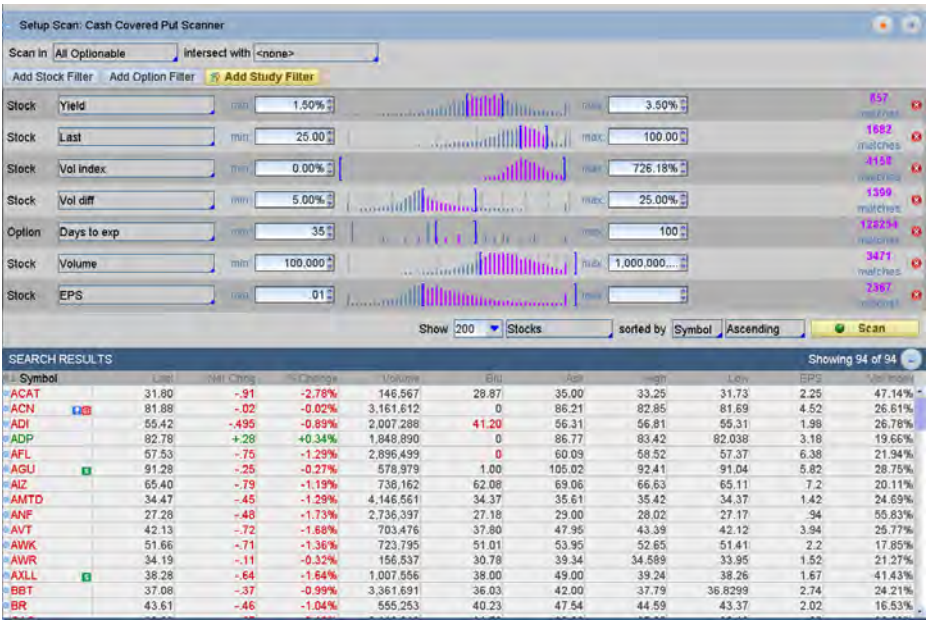
STOCK SCANNER

Our goal is to make 1%—5% on our margin per trade. It can be a lot more than that, depending on the stock and other factors.

To start with, you need a well-chosen stock or ETF. Then you need to choose your strikes, and your expiration. The next few chapters go over each component in detail.

So, where do you start? There are thousands and thousands of stocks. How do you narrow them down?

I've tweaked a Thinkorswim stock scanner to sort and grind out all of the different stocks, getting it to show about 100 stocks or less. The scanner considers yield, price, vol index, vol difference, days until expiration, the volume, and earnings. We want enough volume in the stock to make a difference—stock volume, not option volume, as option volume really doesn't matter.



The next thing I do is go to the charts. You want TRIN to be lower-left to upper-right.

Awareness of earnings is not critical to the trade. You just don't want to step on a landmine. You don't want to sell your put right in the face of an earnings announcement. In other words, if your put expires two days after earnings are announced, and earnings are bad, and you get put to, it can turn into a not so fun day.

In general, you're looking to go out three months, not three weeks. This is not a weekly trade. There's just not enough premium there to do shorter time frames.

So what am I looking for in a stock? I want:

1. A stable stock
2. Stable industry
3. $25 to $100 price range
4. Calm or bottoming reversal
5. Mid-range implied volatility
6. A decent dividend

I'll go over each of these criteria.

ETFS

What about ETFs? For example, Regional Bank, KRE, looks pretty interesting. At the time I wrote this, the stock was at $39.

Again, you have to be comfortable with it. I would personally avoid FXY, FXI—China, South Korea, Brazil. I'd expect too much craziness with that. But something like Regional Bank? Sure.

And you don't have to worry about earnings with ETFs. The only thing you have to be concerned about is it staying the same, or going higher.

CRITERIA

Stable Stock

Stock selection is a key to this trade. You must be comfortable owning the underlying, since that will happen in a worst case scenario. Choose a stock that you'd feel at ease with in a portfolio for your mother or grandchildren for example.

You might take into account moving averages, fibonacci, retracements, extensions, or other criteria. You may already be familiar with a stock and just want to look at it and say, "I like this. This is good. It looks like this is going to go higher. It looks like its found support."

Stock Price

There is a reason that some stocks trade for $15 a share, and some stocks trades for $500 a share. I like to use $25 to $100 stocks. Below that, and there's more risk. Above $100, and it's just going to tie up too much margin or cash. I typically don't want to do this on a $500 or $600 stock. There are always exceptions, but the $25 to $100 range gives you a great place to start, as that is where the vast majority of candidate stocks will be.

You might find it easier to start with a range between $25 to $50, or $25 to $75, and expand your range as you get more comfortable with this strategy. If you have a stock you love and it's $125, do it. It's fine. I've just found that a price lower than $100 is ideal.

Implied Volatility

Be aware of earnings and dividends, and be cautious. You'll want to be aware of the implied volatility and historic volatility. I like to sell mid-range implied volatility.

High I.V. (implied volatility) means high risk. When I started this strategy years ago, I scanned for—and I had to do it manually back then—the highest volatility I could, and I would sell it. Then I would be running around the office, high-fiving my buddies, because six or seven out of ten trades would work, and it would be great. Then, you guessed it, I would get smacked in the face by three or four. Eventually I learned that if volatility is too high, there's reason to investigate the stock. Maybe there's an event

coming up, such as earnings, dividends, unexpected news on the stock, takeover rumors, etc. If you go out and sell high volatility, it will come back to bite you.

Option volume can make more complex options trades very frustrating getting in and frustrating getting out. That's not as important with this strategy. You're going to sell one to five contracts, or maybe up to ten contracts in larger accounts. You're not going to sell 100 or 200 contracts on this strategy, unless you're trading an institutional size account.

Dividends

Maybe I should have put this higher on the list of criteria. The dividend is very important to this trade. If you get put to, which is always a possibility, you get to keep the dividend. More saliently, if the stock goes down, the dividend goes up. That's key. Let's go back to our JNJ example.

So, JNJ offers a 2.69% dividend, which is pretty good. There's a drop-down menu on Thinkorswim, showing a $0.70 dividend, and the next dividend date. It pays quarterly, so we get $0.70 per quarter, at 2.69%. That's pretty good. What happens if the stock goes down?

The stock was at $103.96. Just as an example, if JNJ

stock goes down, the yield goes up. The more the stock goes down, the more the yield goes up. We start at 2.69%. If the stock sold off to $97.50, we're at 2.87%. If it dropped to $87.50, the yield goes to 3.21%.

The point is that if you get put to, you're locking in that higher dividend. That is one of the components of this strategy, and how it can benefit you.

So we need a vehicle (stock, ETF) where there's a decent dividend. I consider a decent dividend to be 1.5% to 3.5%. Once you get above that—4.5%, 5.5%—you start to get into utility stocks and other things which are not desirable for this trade.

The Fed keeps talking about rates going up. But if you put money in the bank right now, what are they going to pay you; a tenth of 1%? If you get 1.5%, 2.5%, 3.5%, on a dividend of a stock, that's pretty good.

WHICH STRIKES TO USE?

What strikes do I sell?

Unlike a lot of other options strategies, I really don't use Delta value for this strategy set up. I use a percentage value. I like to come in at 5% lower than the current stock price, which gives me a buffer of safety. If you go more than 5%, it's really hard to get paid much. Less than 5%, and you're getting too close to the fire. It's not an exact science, but it's worked for me for a long time. That 5% gets you to the closest strike that you need to be, and it should give you somewhere between 1% and 5% return on margin.

If my stock is at $103.96, I'm going to look at 5% less than $103.96. If I calculate $103.96 x 5%, that's $5.19, which puts me at $98 or so, closest to the $97.50 strike. So that's the one I sell. We could sell that put for $1.10, which, on 10 contracts is $1,100 profit on $15,000. This is a margin account, so that's 7%. That's pretty good.

We're going out 35 to 90 days. I would rather go a little bit further out than a little bit closer in, just because of the length of time that we're going out.

JNJ JOHNSON & JOHNSON COM Company Profile ±1.373 ETB 103.96

UNDERLYING

Last X	Net Chng	Bid X	Ask X	Size	Volume	Open	High	Low
103.96 N	-.47	103.30 K	104.28 K	1 x 5	12,110,559	104.77	105.06	103.63

Yield	PE	EPS	Div	Div Freq	Ex Div Date	52High	52Low	Shares	Beta
2.69%	17.21	6.04	.7	Q	11/21/14	109.49	86.09	2,799,110,000	.5339

TRADE GRID

OPTION CHAIN Filter: Off Spread: Single Layout: Volume, Open Interest, Delta, Impl ... Strikes: 14

CALLS Volume	Open Int	Delta	Impl Vol	Bid X	Ask X	Exp	Strike	Bid X	Ask X	PUTS Volume	Open Int	Delta	Impl Vol
DEC 14 (4) 100													21.04% (±1.925)
DEC4 14 (11) 100 (Weeklys)													17.46% (±2.565)
JAN1 15 (10) 100 (Weeklys)													16.12% (±3.007)
JAN2 15 (25) 100 (Weeklys)													16.79% (±3.679)
JAN 15 (32) 100													18.76% (±4.644)
JAN4 15 (39) 100 (Weeklys)													18.58% (±5.072)
JAN5 15 (46) 100 (Weeklys)													17.91% (±5.306)
FEB 15 (66) 100													19.08% (±6.767)
0	633	.91	37.74%	18.75 M	20.10 M	FEB 15	85	.25 A	.32 A	2	197	-.05	29.11%
0	499	.88	31.08%	13.95 M	15.20 M	FEB 15	90	.41 A	.47 A	94	61	-.08	24.64%
109	135	.82	23.92%	9.35 A	10.10 A	FEB 15	95	.72 A	.91 A	53	130	-.16	21.03%
0	178	.76	22.07%	7.15 A	8.00 A	FEB 15	97.5	1.04 A	1.15 A	55	286	-.22	18.95%
0	543	.67	20.72%	5.15 A	6.15 A	FEB 15	100	1.54 A	1.70 M	41	560	-.31	17.58%
121	553	.44	17.21%	2.27 A	2.49 A	FEB 15	105	3.45 A	3.80 A	14	1,420	-.57	15.78%
82	2,428	.20	16.21%	.72 M	.83 A	FEB 15	110	6.65 A	7.35 Q	101	959	-.84	13.83%
2	670	.08	16.97%	.23 Q	.29 A	FEB 15	115	10.75 A	12.20 A	54	1,006	-1.00	0.02%
22	92	.04	18.76%	.08 X	.15 M	FEB 15	120	15.70 X	17.10 A	155	344	-1.00	0.03%
2	0	.02	20.95%	.03 X	.10 X	FEB 15	125	20.70 X	21.95 W	1	220	-1.00	0.02%
APR 15 (122) 100													19.29% (±9.304)
JUL 15 (213) 100													18.87% (±12.052)
JAN 16 (395) 100													21.67% (±19.03)
JAN 17 (766) 100													21.34% (±26.484)

TODAY'S OPTIONS STATISTICS

OPTIONS TIME & SALES

PRODUCT DEPTH

ENTRY TIME FRAME

Once you have a stock or ETF in mind, start watching the implied volatility in the days or the weeks before you want to put the trade on. I like to enter on a down day if possible as this gives you a little more premium to sell. I don't like to enter on a strong up day because we're trying to sell the volatility and it typically drops when the stock goes up. Every penny counts here. If we can get 5 cents, 7 cents, 10 cents more for the trade, over that long period of time, it will make a difference.

Keep an eye on your days till expiration. You don't need to worry too much about it once you set it up. If your trade expires in 60 to 90 days, that's the next time you really need to worry about this trade. You should obviously have a general idea of what the overall market

is doing and occasionally look at your stock price, but that's about all you need to do until the expiration of the trade.

As I mentioned, although I like to enter when the vols are elevated, too much volatility is not a good thing. It means something's coming up; a takeover, earnings, etc. Always investigate to see if you have a big vol spike.

So, those are our three entry steps:

1. **Choose the vehicle—section:** Criteria to Choose your Vehicle
2. **Choose the strikes—section:** Which Strikes to Use?
3. **Choose our entry time frame—section:** Entry Time Frame

RATE OF RETURN

The way this works, you can use one, or two, or ten. It doesn't matter. If you use only 1 contract, $110 doesn't sound like a lot, but you've only got $1,500 tied up here. You still have a 7.4% rate of return, which is pretty good. Be aware, if you got put to, you've got to come up with $97.50 to cover it.

What if you're not using a margin account? What if you have an IRA or other non-margin account? Well, then these numbers change a lot. We still got $1.10 credit, but your margin is $97,500, so you're making $1,100 on $97,500. That's a 1.13% return. That's not as good, but it is still okay, considering the stocks we will be using. You're not really worried about JNJ going bankrupt.

But keep in mind, this is only step 1 of the whole wagon wheel process.

What if you don't have $97,500 in your non-margin account? Well, you can do one contract, $110 on $9,750.

GETTING PUT TO

So, let's review from the beginning. The price was $103.96. If the stock goes down and you were put to, you are obligated to buy the stock at $97.50, as you agreed to. But you also have the premium you collected. You made $1.10 at the beginning of the trade. So your actual cost, in essence, is $97.50 minus $1.10, because $1.10 went into your account.

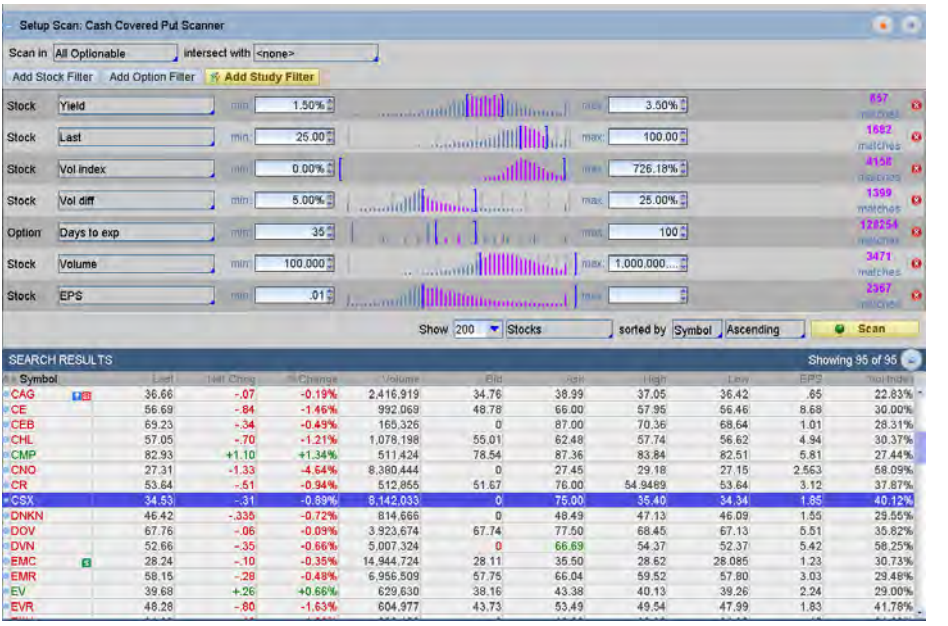
So your cost basis is actually $96.40. It's $7.56 lower than the original price. At $97.50, what's the dividend? It's 2.69%, right? At $97.50, the price where you would get put to, it's higher, 2.87%. So the dividend is 6.5% higher, and the purchase price is 7.2% lower. That's not too bad. And your plan is to keep the upfront money (premium), and not get put to.

TWO MORE EXAMPLES

Example: CSX

The JNJ example might not have you fired up. This one will.

I was pleasantly surprised when CSX came up on the scanner. It's around a $34 stock, and it looks like a good candidate. Lower left to upper right. It's going in the right direction.



I start with the stock, and then I overlay that with fundamentals, to see what the big guys, like Goldman Sachs, are thinking. So, to me, this looks pretty good, especially when the stock pulls back a little bit, and I find a good place to enter.

CSX CSX CORP COM Company Profile ±0.777 ETB 34.53

UNDERLYING

Last X	Net Chng	Bid X	Ask X	Size	Volume	Open	High	Low
34.53 N	-.31	0 Q	75.00 Q	0 x 1	8,142,033	35.09	35.40	34.34

Yield	PE	EPS	Div	Div Freq	Ex Div Date	52-High	52-Low	Shares	Beta
1.85%	18.66	1.85	.16	Q	11/25/14	37.99	25.84	995,397,000	1.322

TRADE GRID

OPTION CHAIN Filter: Off Spread: Single Layout: Volume, Open Interest, Delta, Impl Vol

Strikes: 14

CALLS Volume	Open Int	Delta	Implied	Bid X	Ask X	Exp	Strike	Bid X	Ask X	PUTS Volume	Open Int	Delta	Impl Vol
DEC 14 (4) 100													46.04% (±1.402)
JAN 15 (32) 100													39.46% (±3.257)
FEB 15 (66) 100													35.06% (±4.152)
0	0	.90	52.14%	8.60 X	8.90 X	FEB 15	26	.14 A	.16 Q	5	305	-.05	42.88%
0	28	.89	46.33%	7.15 X	7.50 X	FEB 15	27.5	.17 X	.29 X	0	781	-.08	39.84%
0	2	.85	41.89%	5.80 X	6.10 X	FEB 15	29	.32 X	.41 C	0	1,585	-.12	37.35%
1	1,373	.81	40.78%	5.00 A	5.25 X	FEB 15	30	.47 A	.53 C	7	556	-.16	35.92%
0	516	.77	38.13%	4.15 X	4.40 X	FEB 15	31	.64 X	.70 N	0	711	-.21	34.34%
43	1,855	.68	35.19%	3.05 A	3.20 X	FEB 15	32.5	1.02 N	1.07 N	0	647	-.31	32.43%
87	1,164	.56	32.88%	2.08 X	2.21 A	FEB 15	34	1.53 X	1.63 C	1	452	-.43	30.59%
11	2,382	.48	32.07%	1.59 Q	1.67 C	FEB 15	35	1.99 X	2.08 M	1	564	-.53	29.28%
56	572	.39	31.30%	1.16 A	1.24 A	FEB 15	36	2.55 X	2.68 A	0	370	-.62	28.56%
21	2,594	.28	30.63%	.70 N	.76 C	FEB 15	37.5	3.55 X	3.80 X	9	338	-.74	28.07%
79	3,020	.18	30.14%	.40 A	.44 Q	FEB 15	39	4.75 X	4.95 X	0	130	-.85	26.35%
21	413	.14	30.30%	.25 C	.34 C	FEB 15	40	5.55 X	5.85 X	0	108	-.91	24.39%
0	101	.11	31.39%	.16 C	.30 X	FEB 15	41	6.50 X	6.75 X	0	61	-.95	23.03%
0	149	.06	30.91%	.07 A	.17 X	FEB 15	42.5	7.90 X	8.15 X	0	0	-1.00	0.03%
MAY 15 (150) 100													31.41% (±5.631)
JAN 16 (395) 100													31.10% (±9.237)
JAN 17 (766) 100													28.98% (±12.275)

TODAY'S OPTIONS STATISTICS

OPTIONS TIME & SALES

PRODUCT DEPTH

Its current price is $34.53. Remember my criteria is 5%, because I want to buy this 5% lower, right? So, $34.53 x 5% = $1.72. That puts me at $32.81. Well, there's no $32.81 strike, but there's a $32.50. That's the one I choose.

I sell this put, and I get paid $1.05. Now it starts to get a little more interesting. I'm using a $32.50 strike, and I'm going out 66 days. I got $1.05, which may not seem like much, but it's $1,050 on $5,000 of margin. That's a 17% rate of return. I profited by 17% in 66 days on $5,000 of risk. The best part is that I did this by setting it up and forgetting about it until expiration.

What if you only use one contract? Well, everything is relative. If you use one contract, you're going to make $105. On one contract, your commission is something like $1.00. You've got $500 of margin, or cash, tied up, and you still have a 17% return. You can do as many or as few contracts as you want.

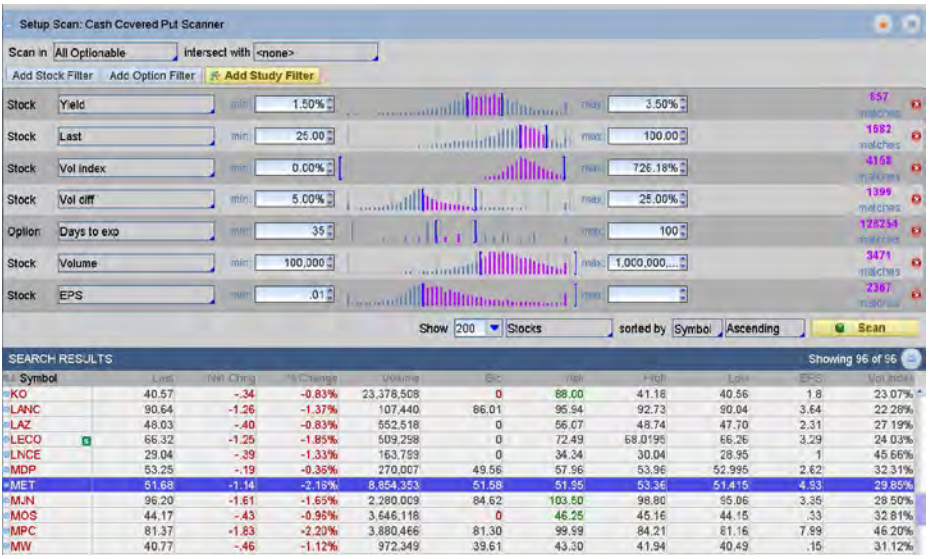
What about in a non-margin, or an IRA, account? Does it really change things? In the JNJ example, which wasn't as good in a non-margin account, you'd have to tie up a large chunk of your account. In this CSX example, you'd make $1,050, on $32,500. That's a 3.23% return, in 66 days, without a lot of risk.

And again, you don't have to do ten contracts. You can do one contract. So you're going to make $105. That doesn't sound like a lot of profit, but you're tying up $3,200, and this is not a speculative trade. Again, keep everything in perspective. This is just the beginning—one half—of the wagon wheel process.

Example: MET

I'll go through one more example, and then we'll get into the other side of the trade.

So first, I ran the scanner again, and I saw a lot of energy stocks in here. Mosaic, Noble, etc. There's 96 stocks, narrowed down from 8,000 and more. MetLife (MET), the insurance company, looks like a good candidate. Lower left to slightly higher right.



At the time I wrote this, the overall market was in a big V pattern. It has a tendency to hit the 200 day and bounce, hit the 200 day and bounce. What does this tell me? Well, if we hit the 200 day again, we're probably going higher.

So, unlike a lot of the other trades, where I want a calm, steady chart, I don't mind this action so much, because I'm thinking, "Well, if I get put to, that's fine, but ultimately, I'm looking for this thing to go higher." I like a calm chart, but I like a stock that I'm comfortable with. And you should too, when looking for ideas, and the scanner is a great place to start.

What strike to sell on MetLife? Well, the stock is at $51.68. Minus 5% is going to put me at $49.09. So, boom, the $49 strike. That gives me a 5% buffer zone on the downside.

Now, it also gives me a 2.71% dividend, or $0.35 per quarter. So $1.73 is what I can sell that option for. If I do ten contracts in a margin account, I make $1,730 on $9,300 of margin. That is an 18% rate of return.

In an IRA, you'd gain $1,730, with $49,000 of cash tied up. This is using a strike price of $49, so for ten contracts, you make $1,730 on $49,000, which is 3.53% on your money in 94 days. So over the course of a quarter, even in a non-margin account, this is very good.

GETTING ASSIGNED EARLY

Here's another really important point: If you sell the $49 strike price, and the stock goes down to $45 tomorrow, will you get put to? Not likely. Could you get put to? Yes, absolutely, you could. But there is no mathematical reason for anyone to put it to you early, because they would have to buy the put and assign it. You sold it—they would have to buy it. And if there is a $2.58 spread differential there, and it cost them $2.58 to buy that put on the other side. There's no reason for them to do it. Just because it goes under $49, if it goes to $48.50, doesn't mean anything, initially. This is probably one of the biggest misconceptions that people have.

So when would they do it? Typically, they'd do it at expiration, or very close to expiration. That's about 90 days from now.

There is always the remote possibility you could get assigned early, but again, mathematically, there's no reason for anyone to assign it to you early. So, 94 days out, I can make 18%, very low stress, and in this case, not a lot of margin.

LONG TIME FRAMES

I went to March on the JNJ example, 94 days out. If the March expiration was 108 days out, that would be fine. I'm not a stickler. But if it's 135 days? Nah. I'm just not going to go out that far. I just don't get paid that much more. So, you have some flexibility, and sometimes you may not have the exact expiration you want. You just choose what you're comfortable with and mathematically what makes the most sense.

Some of you have probably never gone out this far out on an option. It really puts the trade in slow motion, from a risk standpoint. If MetLife drops sharply tomorrow, I've got almost 100 days on the trade. There's no reason to panic.

FOUR TRADES PER YEAR

Let's do the math on this. In an IRA we make $173 on a one lot on MET … times four. If we do it once per quarter, at about 94 days, we can get four trades in a year, $692. We use $4,900 in margin the whole time, which is 14.2% on an annual basis.

That's not too bad for something kept in the back of your mind. You didn't sweat any of this. You didn't lose any sleep. Did you have major margin at risk? No, you had $4,900. Did you spend a ton of time and effort? You looked at it four times during the whole year. Did you spend a ton of commission? No, you had four trades. You spent about four dollars per trade on commission. That's the beauty of these types of trades—and remember, this is just half of the wagon wheel process.

MARGIN CAUTION

Using margin can give you a lot different outcome. On a one lot, in a margin account, on four trades per year, your margin would be $937. That's a 73% annual return. Now, don't assume that you'll make 73% a year on your account. It's possible. As long as the underlying stock doesn't go down, and you sell and you sell, and you never get put to, then it's possible. The stock could even be flat-lined. I used to do this on Exxon, for years and years, and I never got put to. I know somebody who did this for upwards of twenty years on KSU. You can do it over and over, as long as the stock is in a gradual uptrend.

You've seen the huge difference in returns, using margin as opposed to non-margin. That's great. You can use that to your advantage. But BE CAREFUL using margin. The returns are real, but they do not show you all the risk that you're taking. If you take on thirty contracts, you're obligating yourself to those thirty contracts … times a hundred, so 3,000 shares of the stock. You always have the potential to get put to, so don't sell more than you can afford to lose. You might be able to psychologically handle it, while your account might not. Or your account might handle it, while you cannot.

Always size according to what you can afford to lose. That goes double for anyone who is new to this trade strategy, or relatively new to trading.

A SHARP GAP UP

If you've taken classes with me before, you're probably aware of my "Gift Guide." That means, essentially, that if you sell puts on a stock that then gaps quickly, you might be able to buy it back for a nickel. Do it. Buy your shorts back for a nickel or a dime. If you don't understand this concept yet, don't worry, you will over time.

For example, if you sell a put for $1.50, and the stock jumps higher the next day, you might be able to buy it back for $0.20. It depends on how long you're in the trade, and how much you sold it for.

Personally, if I make 75% of my goal within half the length of time in the trade, I take the win. For example, if I start a trade with 66 days to expiration, and by day 33 I've got 75% of my max profit—I'd buy back the put and take the win. Quick profit over shorter time frames are always better.

What does buying it back allow you to do?

1. You lock in a profit. Woohoo! You made money. Done deal.
2. It takes your 66 day trade and it turns it into a 33 day trade. You can start over and do it again.

A stock can always retrace, and go back. Take the profit if you have enough. That's easy money. And if you buy it back, it will be cheap, and you can do it again.

AT EXPIRATION

One of two things can happen at expiration.

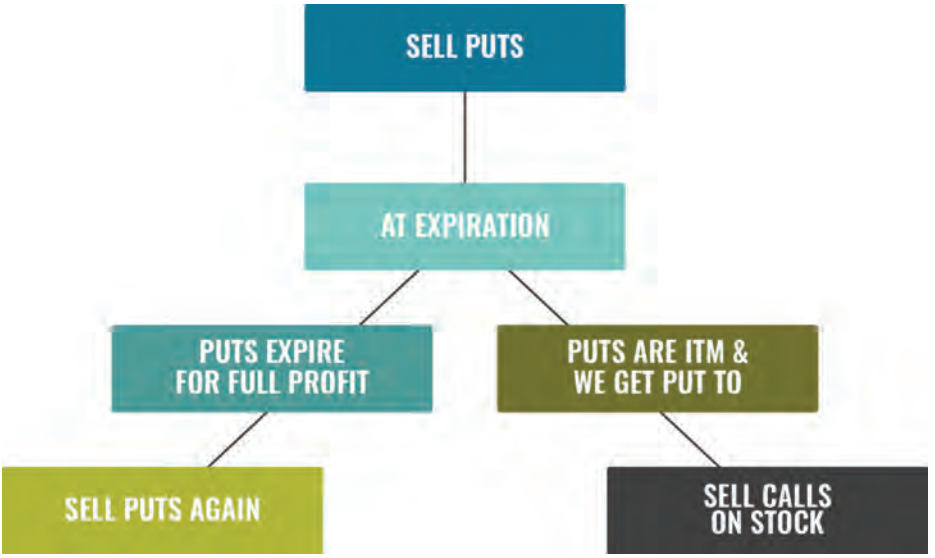
Ideally our puts expire worthless, and we keep the full credit. Then we sell puts again and jump back in. We do it again, and again, tying up the same margin over and over, and continue to make money

on the same margin. The life cycle of a put is about selling them, and letting them expire for a profit. It's a great way to make some profit.

Or, at expiration, our puts are in the money, and we get put to.

When that happens, there's no action required on your part. Your broker will automatically exercise your put, and you'll open your account the next day, and say, "Wow, I've got stock." You got assigned.

LIFE CYCLE OF A PUT AT EXPIRATION



Sooner or later, you will get put to. You might have the best stock in the world, but it will happen eventually. And that's a good thing!

You can make more money in Part 2 of the wagon wheel strategy. You'll sell Covered Calls on the stock.

COVERED CALLS

SELLING COVERED CALLS

Congratulations. This is where the fun starts. This is where the math starts to get a little bit better. After you get put to, this is where the Wagon Wheel actually starts rolling.

We've all had stocks that just sit there. They go up a little, down a little, and a year later, the stock hasn't gone anywhere. That's frustrating. If the stock doesn't have a dividend, and you don't sell calls against it, you've got money tied up … and NOTHING HAPPENS. So you may ask, is there any way to make money on this flat stock? Can I set a sale price ahead of time?

You could set a limit order, but you don't get paid for a limit order. You do get paid for selling covered calls. That brings us to the art of the Covered Call.

Let's say I have a stock currently at $100, and I decide to sell it at $105. So I sell a $105 (covered) call, and get $2 (premium) for the call. When you sell the call, you collect the premium and it goes into your account right then. Don't forget, the premium comes with an obligation. If your option or stock is in-the-money, you're obligated to SELL the stock at your pre-determined price. That's it. And since you already own the underlying stock, the potential obligation is "covered". That's why it's a Covered Call. There are no moving parts. It's profitable, it's consistent, and it's a great additional trade to a portfolio.

What about the dividend? You continue to receive the dividend as long as you have the stock. Selling the call has no bearing whatsoever on the dividend.

Years ago, my thought on this was, "I'm only going to make $500 on this. I'm making $300, $200, $100 on it. Eh."

I was going to lunch with an older trader one day, and he said, "If we were walking down the sidewalk and you saw a $100 bill, would you bend down and pick up?"

"Absolutely!" I said. "Well," he said, "that's what you're doing with this strategy."

CALL SALE RISK/REWARD

There are two risks. The stock might drop dramatically, or it might gap up dramatically.

Say you've got Tesla (TSLA) stock. You're thinking, "This stock's great!" Then the price drops. That's just the way it is with any stock. Or what if Tesla jumps higher? That doesn't make a hill of beans in this strategy, because if you own the stock, you've got the same risk whether you sell a call or not. The option doesn't change anything. Selling the call on it doesn't increase or decrease that risk. It has no effect on the stock going up or down dramatically.

That's why it is important to choose a stable stock that you feel pretty comfortable with.

How much can you make? This is another singles and doubles strategy. It's a very methodical, slow process—but we're going to add to the singles and doubles from the first part.

What about commission? Same thing. If you've got 100 shares, and you sell one contract, that's about $1.50 commission. It's very cheap. There's no catch to the trade. The only obligation is that you have to SELL your stock at the price you originally agreed to when you agreed to sell the call. That's it.

If you change your mind? Say a month has gone by and you don't really want to lose your stock. You decide that you don't want to sell.

Well, you can always buy the call back. In rare instances, I will buy a call back to close the trade, but that's unnecessary in most cases. You may have to pay more, or you may have to pay less, depending on the stock price.

It's exactly the same as the put sale, in that if you sell a $100 call, and the stock goes to $101, you're not always going to come in the next day and be assigned. There is a potential, but mathematically, it doesn't make sense for anybody to "call you out" or assign you, until expiration. It's advantageous for somebody on the other side to wait as long as they can to exercise options against you. The main reason for exercising the option early is so that the person on the other side can take your dividend from you. This is why you should be aware of your stocks dividend dates. Even so, your stock has to be in-the-money and the math has to work for someone to benefit from exercising a call option prior to expiration. It's very rare that I ever get called out early and remember that any time you are called out, you are selling at a higher price and making a profit.

PROS	CONS
You can write these for months and months and months, over and over, and not ever get called away.	Stock can always go lower, and selling a call has no influence on whether the price of the stock moves up or down.
You get to keep the dividend as long as you have the stock.	The stock CAN be taken any time that you're in the money. Always be aware of that. But I've done this for many years, and I rarely get assigned early.
You choose the price that you're willing to sell.	
It's an easy set-and-forget strategy.	

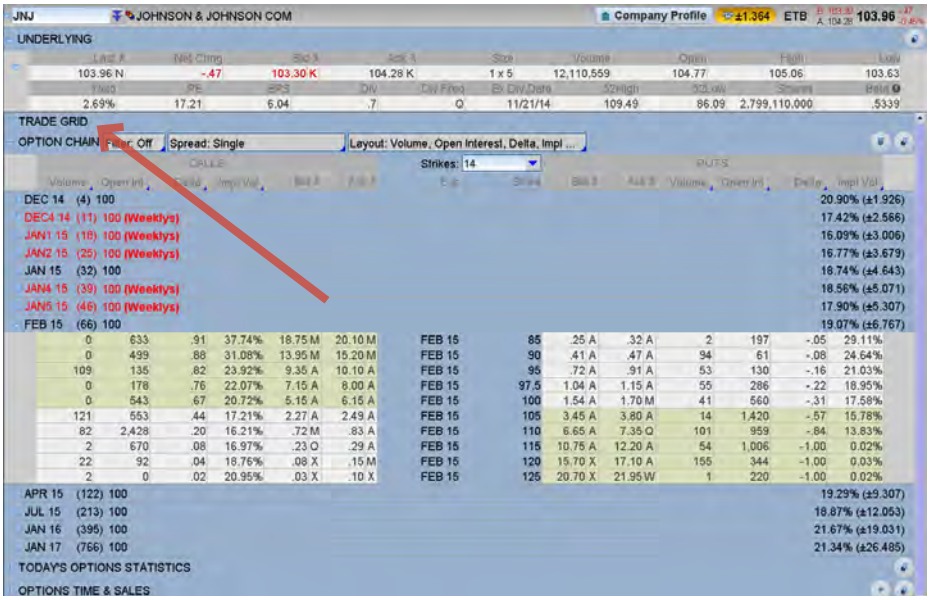
TRADE CRITERIA

This trade is very similar to the put sale cycle. Not exactly the same, but it's a very quick, easy process.

First, we check the dividend date. The dividend is a nice part of this trade, and we want to sell PAST the dividend date, in order to catch that upcoming dividend. It enhances the trade. In other words, we own the stock, so if our dividend date is here, we want to make sure our call is out here past it.

Volume is not important to these trades, because we'll do very few contracts. It's not an earnings play, either, but be careful. Be aware of earnings. I always watch earnings, because I don't want to have an expiration that's ahead of a big move in the stock, or behind it. You only need to check one earnings date, then check your option expiration, and consider whether you'd be able to handle being called out there.

Back to the Johnson & Johnson (JNJ) example. On Thinkorswim, I'll check the yield, the dividend, the frequency, and the expiration date.



This shows you the next dividend. So, match up this ex-date, and all you have to do is add +3 months. So, this is November 21, December, January, February. Line that up with your expiration, and just be aware of when your dividend is when you sell your call.

ENTRY TIME FRAME

Next, choose your entry time frame. We want to go out far enough to give ourselves enough time for it to work; 35 to 90 days. That's a big, wide window. You will have a better understanding of this once you get into the trade. Maybe you go out 40 days, maybe you have to go out 80. Just see what you get paid, because if you get paid $1.00 for going out 50 days, and then you look at going out 90 days, and you get paid $1.10 … eh. It's not worth it.

Let's think from the beginning of the trade and selling the puts. The mechanical process of being put to is that option expiration is always on Friday, you technically then get put to the next day, Saturday, and when you come in on Monday morning, the stock will be in your account. Then we start with the call side.

Once you get PUT to and I have stock on Monday, I like to go ahead and sell the CALLs that Monday. Sometimes I'll wait, if the market's up 300 points and the vol has dropped. But I don't want to sit there. You may feel a strong urge to wait for the stock to go up. I used to do that. I'd say, "I'm going to wait until the stock goes up $10 before I sell my call." In theory, that sounds great … but what happens if the stock goes down $10 while you're waiting for it to go up? Well, now you blew your whole trade, because you're not going to be able to get any premium at the levels that you wanted, and now you're just in limbo, waiting.

So I like to sell within a week. It's not critical, but it's important to get the second part of this wagon wheel strategy working within a day, or two, or three. I might say a week if the market is calm.

It's the worst when you get put to and, you're ready to write that call, and then the stock gaps down another $5 or $10. You were going to be able to get $1 to sell that call, but now you can only get $0.20, so it's not worth it. You see the point.

STRIKES

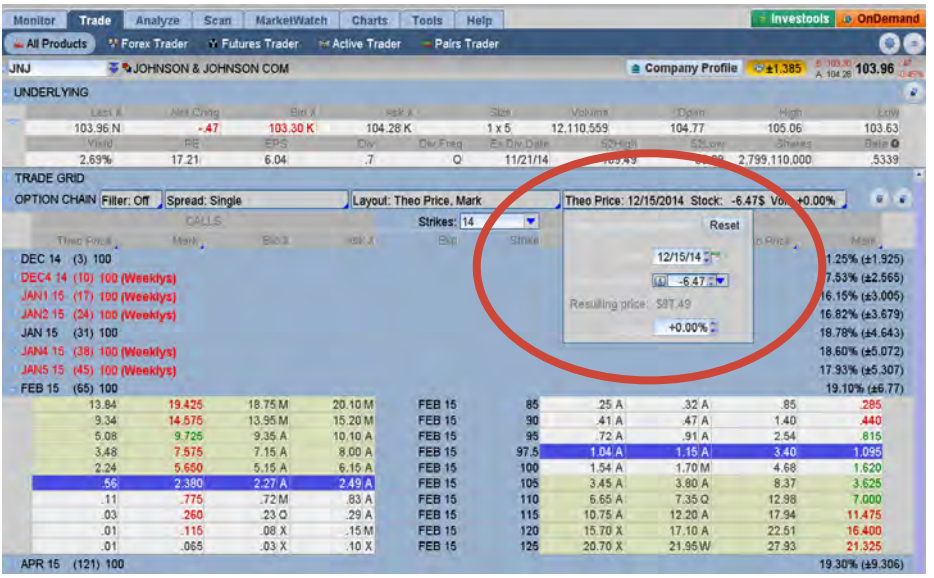
What strike do I use? Well, it's the opposite of the put side. I like to go 5% higher than the current stock price. That gives me a range, back and forth, work with.

Overall, this is going to give me roughly 1% to 5% return—or more—over the life of the call sale trade. So… check the dividend date, because you want to catch that dividend, choose your entry time frame, and choose the correct strike.

THEORETICAL PRICING

Example: JNJ

Thinkorswim has a feature called theoretical pricing. If you don't use Thinkorswim, most other platforms will have a similar feature.



We can dial our price up or down. Back to the JNJ example: I set the price at $97.50, which is where we got put to. Then I dialed it down, assuming we got put to yesterday, which is theoretical. We came in today, and the stock is at $97.50. So what do we do?

Well, we consider: $97.50 x 5% = $4.87 + $97.50, which puts us roughly at $103.

There's a $100 strike, and there's a $105 strike. When I'm selling puts, I like to go further down, if I can. On the calls, I like to go further up, if I can. In this case, we'll use the $105. Under the theoretical pricing, where we would be, we're going to get $0.56 for that, and we're going to go out 65 days.

You might not think that's much money, $0.56, but I'm going to show you why that's nice.

So, we sold these calls for $0.56. We got put to at $97.50, so that's our cost of the stock. We also received the put premium. This is on 1,000 shares of JNJ, which is a big position. Again, you can do this on any sized account. In this case, if we're called away, we did the February $105's. So all of this is profit: $8,060. That's on 1,000 shares of stock.

But are we forgetting something? Our original price was $103.96. We got $1.10 for the put sale. Our put to price was $97.50. We pay $97.50, which is what we got put to at … minus $1.10. Our actual cost basis is $96.40.

Now, for those who are accountants, I'm aware that this is not how it will show up on your brokerage statement, tax-wise. But that $1.10 does go into your account. In reality, your cost basis drops by the amount of that put premium. We had put premium on the bottom, and call premium on the top, so we get a little bit of extra on each side.

On the call side, we sold the $105 strike for $0.56 + $105, which is $105.56. Our cost was $96.40, so overall, our return is 9.5%. That's not bad for a low cost, low stress trade.

And are we forgetting something? Yes, we are. What about the dividend that we receive while we're holding the stock? We got $0.70 for the quarter. We held the trade for approximately 3 months for the put, but since we didn't own the stock yet, we don't get a dividend for that period of time. Once we get put to, then we actually own the stock, and we get the dividend. This is approximately 3 months for the call. Add that dividend, and our return goes up to 10.23%.

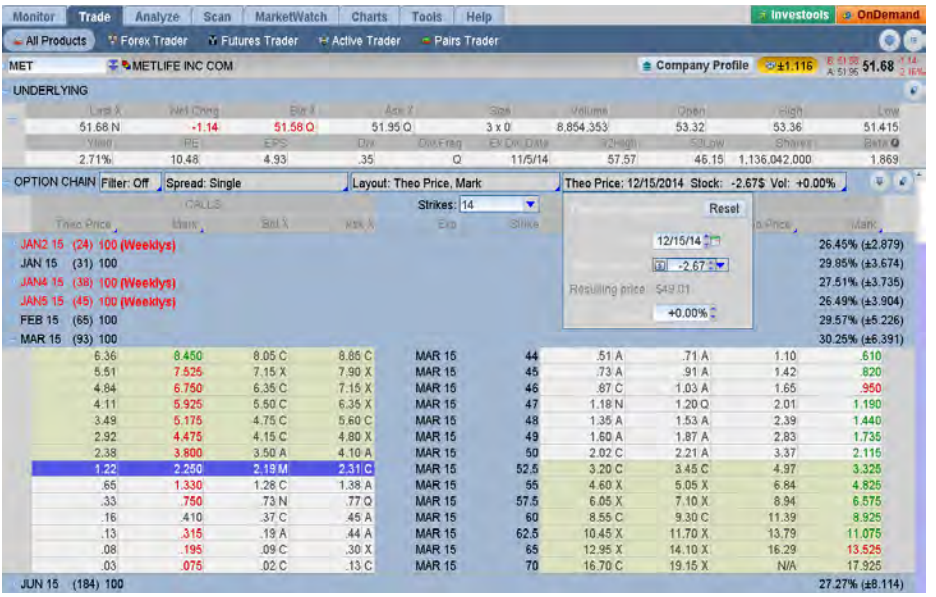
This trade earned a return of 10.23% for approximately 6 months. Annualizing, that's 20% a year, since it's on the same tied-up cash. That starts to sound pretty interesting, right? It doesn't matter if you do one hundred contracts or one contract. The percentage is the same.

What are the four profit components of the wagon wheel strategy?

1. The put premium
2. The call premium
3. The dividend
4. The difference in the strike price, from the put price to the call price depending on what the stock does.

In the JNJ example, we got put to at $97.50, and we got called out at $105. All of that is profit, and it works like that on all of these trades.

Example: MET



I did a theoretical pricing on the MetLife example, also. Here, we got put to at $49. That price x 5% = $2.45 + $49 puts us at near $51.50. There's no $51.50 strike, and I would rather go up further when selling the calls, if I can, so we're going to $52.50.

These choices will be pretty obvious to you once you're in the trade, so there's no need to get hung up on calculations. Just 5% lower for puts, 5% higher for calls.

Anyway, $49 is our put to price, $52.50 is our called out price. We get $1.22 for selling this call, and we're going to go to $52.50 if the stock cooperates. We made money on the put on the downside. We can make money on the call, on the upside. So you can get a little bit extra on both ends. Plus you get the dividend. So here is our profit: $4,720 on 1,000 shares.

Example: CSX

The CSX Corporation trade is another great example. I moved the put price to about $32.50 here, under theoretical pricing. We would be able to get $1.17 for going up 5% higher.

With CSX, we'll go out 66 days, and we get $1.17. Once we sell that call, if we got put to on 1,000 shares, we make $2,670 of profit. But don't forget, we're selling at $34, and we bought it at $32.50. So we get the incremental profit, the call profit and the put profit.

Let's review this trade from the beginning. Original price: $34.53. Sold a put for $1.05, so dollar-wise, our put price is $32.50 minus $1.05, because you pocket the $1.05. It's in your account.

So the effective stock purchase price is $31.45. What about the call side? We sold the $34 call for $1.17, so we're selling it for $34 + $1.17 = $35.17.

Our cost is $31.45, and we're selling for $35.17. That's an 11.82% rate of return. And we have the dividend. It only adds $0.16. Our return goes up to 12.23%. If I can make 12.23% in 6 months, well, that's 24.46% per year if you can repeat the process.

THE ROLLING WHEEL

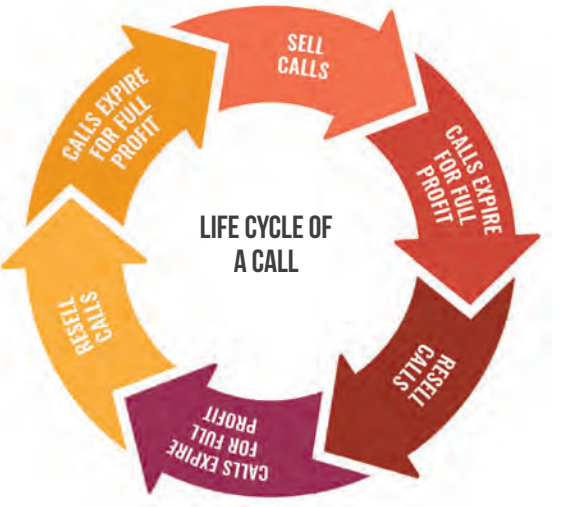
Ideally, we want these calls to expire for a full profit. Then we sell more premium, bringing in more profit. If the calls are in-the-money, and we get called out at expiration, we sell our stock at the price we agreed upon.

Our goal is ideally to let the call go to expiration, and expire worthless, and make 1% to 5% on the stock. Loss only occurs if the stock drops substantially. If it gaps up and we get called out at expiration, the trade is over and we lock in a profit.

Let's look back at the beginning of the MET trade. On the put side, our stock was at $51.68, the first put sale was $1.73, so we got put to at $49. Our true cost basis is $47.27. On the call side, we sold the call for $1.22, the call price was $52.50, so we're actually selling it for $53.72.

That means our cost was $47.27, and if we get called, we're selling it for $53.72. That's a 13.65% rate of return. Pretty good, right? Now add in the dividend we received, $0.35, which adds to our sale price. The rate of return goes up to 14.38% for approximately six months. You're annualizing a return of about 28% if you can repeat this process.

If you can do this for six months, times 2, you can get nice returns. And it may not be six months. It may be four months or it may be seven months, depending on how far out you go on your expiration. This is very systematic procedure, but it is not an exact science and you have to be a little flexible.



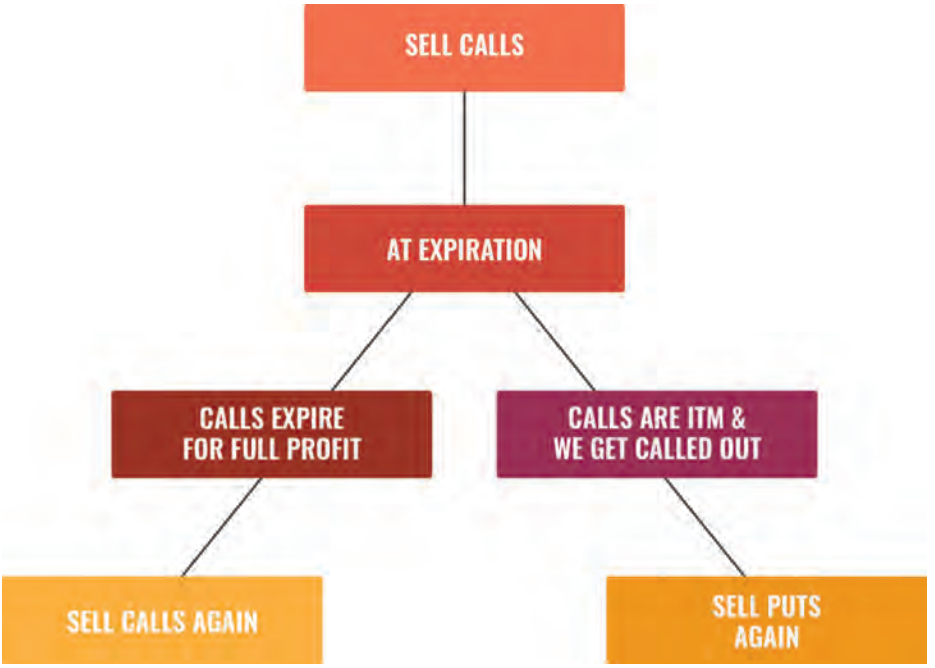
In any scenario, you get four components of profit. You get the put premium initially, you get the call premium, you get the dividend, and you can get the difference in the strike price from the put to the call.

So, that sounds great. We sold puts until you were put to. We sell calls, they expire, resell them, they expire, etc. You can do this over and over and over. At some point, you'll get called out. But sometimes, you will get onboard with a stock that's slowly grinding higher, and it's just beautiful when that happens.

GETTING CALLED AWAY

Sooner or later, you will get called away. That takes us back to the first part of the strategy: Sell more puts. That's where the wagon wheel really accelerates and starts rolling.

LIFE CYCLE OF A CALL AT EXPIRATION



CALLED EARLY?

It doesn't happen too often, but if you were to get called early, that's a great thing. If you sell a call for $2, and you go out 90 days in time, what happens if you get called out only 30 days into it? Hooray! You're high-fiving, because you made the same exact return in one month that you would have made in three months.

When you get put to, it's not a bad thing. When you get called out, it's not a bad thing. It means the process is working, and you just pull out your notebook and move on to the next step.

Back when I was running that large portfolio, around 1994, I used to go around and do seminars on trading. We would have a ballroom in some hotel, and I would explain this whole strategy. Somebody in the audience would always say, "Well, if I get called away, and the stock is 25 points higher because the company is getting bought out, just look at all the money that I left on the table."

My answer is always the same. "When you entered the trade three months ago, if you'd known that the company was going to get taken over, you would have bought all the calls that you could. You don't know what's going to happen three months from now. Hindsight is always 20/20 and 'shoulda, woulda, coulda' is not a valid argument."

Are you comfortable making a good consistent return? Yes? Okay, that's the end of the discussion. I've had this conversation many times. People always want to second-guess any kind of trade strategy, so keep everything in perspective. You won't make 1000% per year like some strategies promise, but you won't get destroyed either. Slow and steady wins the race in trading.

REVIEW AND TIPS

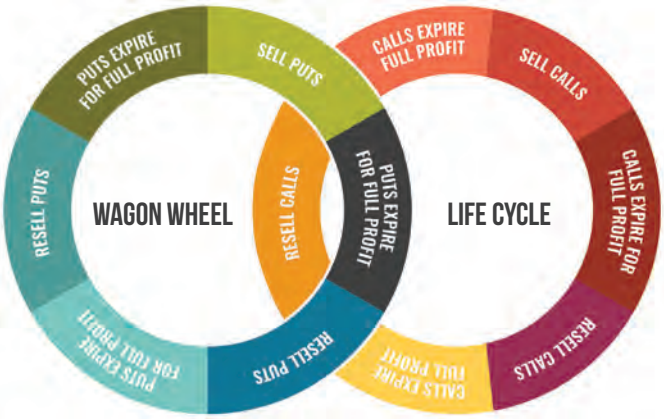
THE WAGON WHEEL

The Wagon Wheel Strategy is a slow and steady process compared to almost every other options strategy. You can say it's nickel and dime, but they add up.

You can bring in your expirations a little bit closer, or extend them out a little further. You don't need to get hung up on account size. You can do whatever size you want. You can make this just one of the twenty trades that you do, or maybe you'd rather have it be ten out of twelve of your trades. It's up to you.

Dial it up or dial it down, depending on how you want to position it. Think of it in terms of risk for your account, and margin for your account, and also your mental capacity to handle loss. No matter how much money I'm trading, I don't think I could sleep at night doing this trade on Priceline, or some other super volatile stock. If you do this on volatile stocks, you will be watching it every day, and it would turn into a whole different ball game.

I have an engineering background, so breaking strategies down into smaller components helps me. Round and round until you get put to, and then round and round until you get called out.



Now that we know how the individual parts work, let's look at the ongoing plan as a strategy.

1. Select a solid stock. That's vital to making this thing work. As we discussed, you can get in trouble if you just throw this on any stock, so choose something that you've followed for a long time, or that you're familiar with in some way. It should be a stock that you are happy to own.

   I'm looking for stocks between $25 and $100, in a slow and steady uptrend. Use a scanner. I keep a short, separate list on my Thinkorswim platform just for this. You can make as many watch lists as you want.

2. Factor in earnings, volatility, and dividends. Choose your strike price, and sell the puts.

3. The puts expire worthless. You high-five your friends, sell more puts, make more profit, and keep going. Or…

4. If your puts are in the money, you get put to and you now own the stock. Next you sell the calls. We review the process of selecting expiration and strikes, sell the calls and don't panic. Also, now that you own the stock, you will collect the dividends. The Wagon Wheel continues.

5. If calls expire worthless, what do you do? Well, you're still collecting dividends. Sell more calls. The Wagon Wheel continues, round and round. You do it over and over and keep it going.

6. Or your calls are in the money, and you get called away. What do you do? High-five, you're back in cash. You have a profit. You go back to Step 1 and start all over again. Round and round and round.

COMMON MISTAKES

Poor Selection

1. Starting with the wrong vehicle, or stock.

2. Using a volatile stock. You will be tempted to choose a volatile stock, because there will be a lot more premium there. You will say, "instead of getting $1.20, I can get $4 if I sell this on Biogen!" Don't do it. You're turning a calm baby into a crazy animal when you do that.

Misjudging Volatility

3. Selling super high volatility. That goes hand-in-hand with choosing a volatile stock.

4. Not understanding the I.V. (Implied Volatility). Say you've got a stock that you love. You say, "my brother works for Home Depot! I want that stock!" but the I.V. is in the tank. You can only get $0.30 for the put, or $0.30 for the call. You may love the stock, but the math is more important here. If it won't pay enough to give you a decent rate of return, then don't tie the money up.

Poor Timing

5. Entering the trade around earnings. Generally, earnings won't make much difference, because when you look three months out, the implied volatility on the stock is not going to reflect the earnings. This is not an earnings set-up. The more important thing is, do you want to be in or out, near an earnings announcement, in case of a big gap up or a big gap down?

6. Using the wrong expiration. You can go in too soon, or go out too far. If you do the math, and your option premium for going out 50 days is $1.00, and for 90 days it's $1.10, don't go out 90 days. You're not getting compensated for the difference in going out further.

Other Errors

7. Not following your trading plan. If earnings are eight weeks out, and you want to sell a call to be ahead of that, that's one thing. But if you get put to, and you decide to wait until earnings to see whether it will gap up before you sell the call, and earnings are in six weeks … well, you've just taken this complete turn-key trading plan and turned it into something completely different. Now you're at the whim of the market.

8. Not taking profit when you can. Although this is a hands-off strategy, if you sell a put on a stock, and the stock gaps up, go ahead and buy back the put early. Don't wait three months, because it's going to expire worthless anyway, even if you've only got a nickel left in it. It is the same on the call side. If you sell a call, and the stock sells off enough that you can buy the call back cheap, do it.

9. Too large a position size. In a margin account, be aware that when you sell ten or twenty contracts, you have an obligation if you get put to.

Don't wing it. Follow the strategy. It's a tried and true process. It works.

A SHARP MOVE DOWN

I've already told you the good, the bad, the ugly. What happens if the stock continues to slide down? What if it falls off a cliff?

Back to the JNJ example: When we started, it was at $103. We sold at $97.50, we got put to. We're getting a good yield, we sold some calls, and it sits fine. We made a little money on the calls. Now, what happens if the stock goes down, or if it really sells off and goes to $50 share?

This happened to me a couple of times. I sat on a stock for six months, or a year, waiting for it to come back. There are a couple of things you can do.

1. Continue to write your calls, and it will lower your cost basis over time. You're getting paid, right? You're not getting paid much, but you are getting paid while you wait on that. I'd rather be making 2.87% on my tied up money, than making 0.015% in a bank somewhere.

2. If you truly get down to $50, and you still like the stock, you can sell another put at that price. Your cost basis just got cut in half, didn't it? Think if it this way, if you had never heard of puts or calls, and you just bought JNJ stock at $100 and it dropped to $50, you would be in the same shape. Also, in that scenario, wouldn't you consider doubling up and reducing your cost basis if you still liked the stock?

You keep selling calls, keep selling calls. The stock price should come up over time, and your cost basis should come down over time, and you will intersect at a happy median. While this may take a while, this doesn't happen often. Choose the right stock, and it's less likely.

What happens if your stock goes to zero and completely goes out of business and de-lists? That's your ultimate worst case! But that has never happened to me, because we're just not playing in that playground with those kind of companies. Think Fortune 500 vs. start-ups.

A SHARP MOVE UP

Any move to the upside doesn't hurt you. At all. Both a short put and a covered call take a full profit with a big move higher.

So, we've talked about the ins and outs, the ups and downs, of this trade. It's very straightforward. No moving parts, no adjustment.

CONTACT ME

Through SimplerTrading.com, I offer a service for active traders, called Bruce's Income Advisory Service or BIAS. That's where I share my daily and weekly trades live, including iron condors, butterflies, calendars, diagonals, and more.

The Wagon Wheel strategy is a more relaxed style of options trading. The team at Simpler Trading has been talking about making a service like BIAS for these types of trades. I would trade it as a portfolio, maybe ten stocks, and you can follow along, and size it according to what you're comfortable with, or choose one or two of the stocks.

It would be updated once or twice a week. If you're interested, there's no obligation. Just let me know what you think. If you enter your email address at the link below, you'll be notified once it's available.

http://Products.SimplerOptions.com/wagon-wheel-invitation

I may send promotions for occasional webinars that may interest you, but you can easily opt out of those.

You might have a stock scanner set up on your own charting software, or you can use the scanner that I use on Thinkorswim. If you don't have Thinkorswim, you can get a demo account for free.

If you have any questions regarding this strategy, you can reach me, or any member of the Simpler Options team, at:

support@SimplerTrading.com

FINAL THOUGHTS

Many traders have tried this strategy, or variations of it, or parts of it. Maybe you've sold calls, maybe you've sold puts. The key to having this work on a consistent basis is to just keep it going. If you get put to, or if you get called out, that's a good thing. You grab the dividend, and you just keep it going, keep it going, keep it going.

I hope this was helpful. As always, I appreciate your time.

Bruce Marshall

Simpler Trading