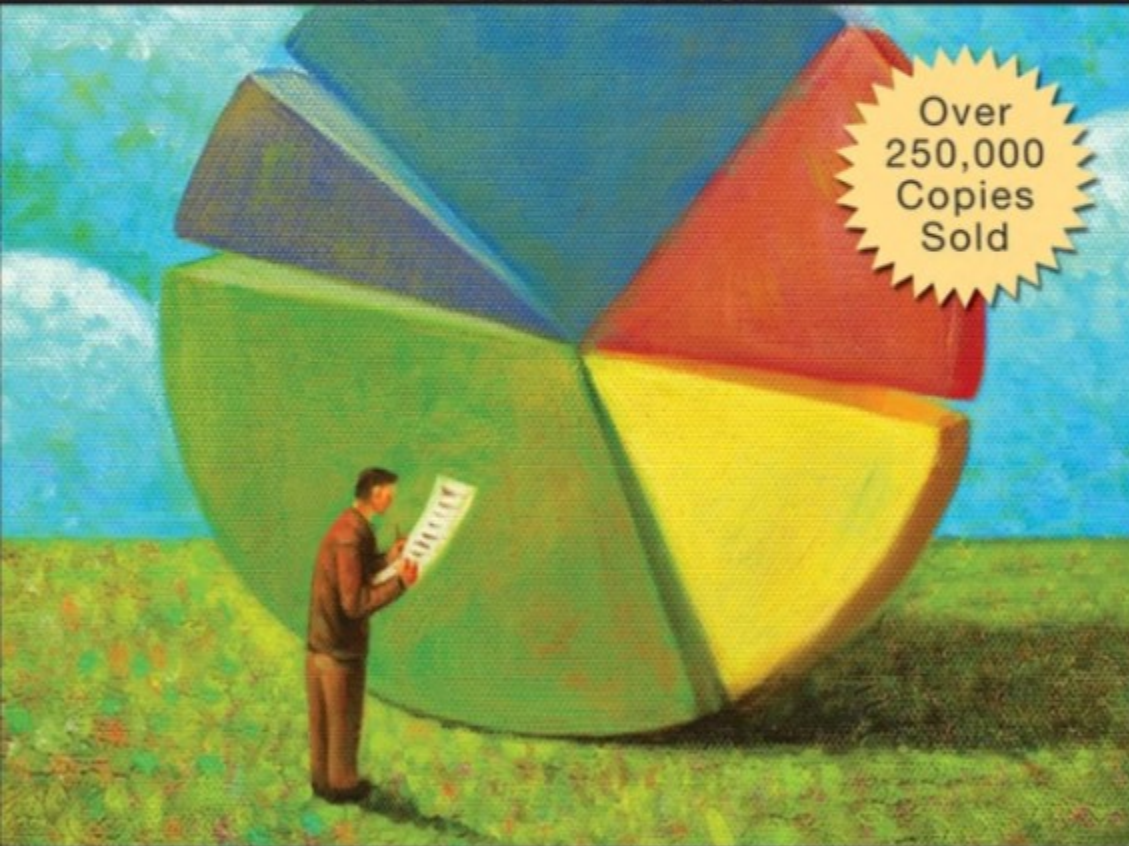


GETTING STARTED IN OPTIONS

SEVENTH EDITION



COMPLETELY REVISED AND UPDATED

MICHAEL C. THOMSETT

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SEVENTH EDITION

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qualification was enacted and applied to day traders. Anyone who trades on high volume (meaning moving in and out of the same positions four or more times within five consecutive trading days) is classified as a *pattern day trader*. Anyone meeting this standard is required to leave at least \$25,000 in their account. If they do not maintain the required level, they will not be allowed to execute further trades once the pattern day trader status is triggered.

Smart Investor Tip



Swing trading is the perfect solution for avoiding being classified as a pattern day trader. The typical entry and exit takes at least three days, so executing four trades within five days under these guidelines would be unlikely.

Swing- and Day-Trading Advanced Strategies

Most examples used in this book involve single option contracts, for the sake of clarity. However, swing and day trading do not necessarily have to be limited to single contracts to control 100 shares of stock. Especially when option premium levels are quite low, using multiple contracts saves on brokerage fees while increasing profit potential. In addition, using multiple contracts vastly expands your strategic potential for swing trading, including taking partial profits while keeping the remainder of a position open, and expanding swing trading into more advanced options strategies such as straddles and spreads.

For example, one popular online brokerage firm (Charles Schwab) charges \$9.95 for a single option trade, plus \$0.75 per contract. However, when multiple contracts are involved, the savings are substantial:

<i>Number of Options</i>	<i>Transaction Fee</i>
1	\$10.70
2	11.45
3	12.20
4	12.95
5	13.70

At five contracts, the cost per option is only \$2.74. So substantial transaction cost savings are going to be realized when trading in multiple option contracts. But there are other and more important reasons to use multiple

contracts. It adds flexibility to swing- and day-trading strategies. Example of how you can vary your strategies with multiple contracts include:

- *Take partial profits.* In many cases when swing trades are executed, you face a dilemma. Do you take your profits even when setup signals are not present or do you wait? Because no system is perfect, you will at times miss profit opportunities by waiting one day too long. But with the use of multiple contracts, you can sell part of your holdings and keep the balance in the position. When profits are exceptional, this enables you to make a profit on the entire position, while keeping a portion in play and awaiting the setup signal.
- *Partial exercise.* As a holder of a long call, you have the right to exercise or to sell. For example, if you are swing trading on a stock you might want to also own, multiple contracts open the possibility of combining strategies. You can sell part of the overall position to gain a profit on the swing trade and exercise the remainder. This strategy is valuable when you realize that the stock was selling at a great price a few days earlier. With a long call in hand, you can buy at the striking price and then hold the stock for the long term (or revert to a covered call strategy, for example).
- *Add more option contracts in times of price momentum.* From time to time, a stock's price not only moves in one direction, but gains momentum. For example, you might open a single-contract position only to later get a *second* setup signal going in the same direction. You can simply wait out the trend or buy additional option contracts based on the strong momentum of the stock's price.

Multiple contracts give you greater flexibility in a swing- or day-trading program, while also enabling you to execute trades for very little additional cost. Yet another interesting twist involves combining a swing-trading strategy with covered calls.

One of the great advantages in using options rather than stock is that you can use puts instead of the high-risk shorting of stock. But there is a mirror strategy of this, and it involves using covered calls instead of buying puts. If you do not own shares of stock and you reach a sell setup point, the obvious move is to buy puts. Then, when the stock declines, the put becomes profitable. However, if you also own stock, you can write covered calls rather than buying puts. This provides you with a double advantage.

First, the covered call is safer than the long put because time value is involved. As time value declines, your short call becomes less valuable and can be closed out (bought to close) at a profit. Second, you have to pay money for