
www.StreetSmartOptions.com
How To Make
Quick Profits
From Falling Stocks
Learn To Spot
Great Opportunities Early
And Generate Huge Profits !
Ronald Lee

How To Make Quick Profits From Falling Stocks

By Ronald Lee

www.StreetSmartOptions.com

Learn To Spot Great Opportunities Early And Generate Consistent Profits Using This Incredibly Low-Risk and Time-Tested High Probability Trading Methodology

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"Everyone has the brainpower to follow the stock market. If you made it through fifth-grade math, you can do it"

- Peter Lynch, "Modern Maturity Magazine, Jan/Feb 1995"

Important Notice

Trading options can be very profitable but also comes with risks. You must be aware of the risks and willing to accept them in order to invest in the markets. Do not trade with money you cannot afford to lose. Past performance does not necessary indicate future success. Prior to buying options, read the Characteristics and Risks of Standardized Options. It can be viewed at www.cboe.com.

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Introduction

Knowing that you can make a lot of money from trading options can be very exciting. Many have the experience of jumping the gun and discovered painfully that they have lost all the money simply due to ignorance. The answer is patience and the discipline to follow through a simple trading plan.

My objective here is to share some thoughts with you so that you will not fall into some of the options trading traps in becoming a successful options trader and be financially well.

Before you begin trading options it's critical to have a clear idea of what you want to accomplish. Options can play a variety of roles in different portfolios.

This is a system I have created, tested and have been using regularly. It is highly effective in finding and identifying reversal trades which are of high probability of making profits. It is a very simple system which incorporates some technical indicators and some understanding of some basic Japanese Candlestick charting.

However I want you to remain as open minded as possible and not to let what you have learned before to judge the effectiveness of this system as some ideas may contradict to your trading philosophy.

Here are four rules that you are required to remember at all times in order to begin your journey in becoming a successful options trader.

My Trading Mantra

Rule #1: If you were not already making money in options trading or wanted to become a better trader, you must accept that what you are currently doing doesn't work or is limiting your progress.

Rule #2: Never turn the markets into the world's biggest casino.

Rule #3: Accept responsibility for all your losses. You made all the trading decisions, no one did. So, own up to it! Only then you will be ready to learn and start all over again.

Rule #4: Never, never take revenge on the markets!

Section 1

Trading Mindset

It is crucial for you as a trader to have the right mindset in order to be successful in your options trading and not to sabotage your trading account. Being aware of the common options trading traps are important so as to spot them early and not to fall deeper into it. Avoid them completely if possible in the first place.

Trading with a winning attitude

The goal of an options trader is to generate profits on a regular basis but only a small percentage of them are really consistent in making money. Most traders don't believe that their trading problems are the result of the way they think about trading. It is psychological, the consistent winners think differently from everyone else. They have winning attitudes.

We are not fund managers and we should not trade like one. Many traders think that if only they have a big account to trade, they will be able to bring in profits consistently. No, it will never work for us.

All the fund managers have to work within a very strict set of rules and they are under supervision. They are only allowed to risk a very small percentage of the entire portfolio account. If they are down by certain percentage they will have to stop trading for the entire month. Not abiding the trading rules will get them suspended. Anyone can do well when govern by these strict disciplinary rules. They are not trading with their own money. No matter how big is their account, there will be no emotions involved.

When you trade without any emotion, you are likely to do well but when you start trading with your own money, that's where all the emotions will come in, your fear and your greed. It doesn't matter whether you are just starting out or have been trading for sometime, it is the same, and every trader will have to take on the same emotional roller coaster ride in order to be good at it. It takes patience and time to master but it can be financially rewarding.

"The investor's chief problem and even his worst enemy is likely to be himself" – Benjamin Graham

Trading is a business

Trading should be treated as a business and that is the simple logical reason why it is called trading. Trading is just act of buying a product or merchandise then selling it and making a profit out from it. Isn't that's what we do as a trader? Most of us seem to forget our objective and become irrational when we trade. We become impatience and want to get rich very quickly.

It is important to state your trading objectives and goals to achieve. Have a simple plan and work on it, please do not try to complicate it by putting in some complex money management strategies. I am not saying that money management is not important. It is important but it has to be simple because the majorities of us do not have a PhD in finance to understand it. Simplicity is the key.

The Big Headed Syndrome

Many options trader have been misled into believing that they are able to achieve big winnings by the flexibility to leverage with options.

Most of these trading seminars are selling you a ticket in becoming a millionaire just by trading options. The highly motivated feeling gives you the false impression that you have finally found the easy way out. You just can't wait to fund your account and make your first trade. It can be done but it takes patient and it takes time.

It is sad to say that many options traders have lost their primary objective and become big time gamblers. They have fallen into the **"Big Headed Syndrome"**. To make big profit, you obsessed into look for the highest possible winnings and forget about the risk involved. Most of you will start betting and eventually got into addiction and blow up your account because of the excitements.

Please do not believe that you can make the same kind of a killing with consistency. It will eventually kill you, it is a delusion, it only happens at random and rarely. It is just like striking a first prized lottery ticket. Use your common sense. Don't believe everything you see.

"There are more fools in the world than there are people"
- Heinrich Heine

Think in probability and with accuracy

It is essential for you as an options trader to think in probability and with accuracy. Most of you started with just limited resources and begin to grow along with time learning from your mistakes.

It is common to see traders lose their minds taking extreme high risk and often chasing after the markets not knowing that the high slippage and commission can drain their trading account.

Not willing to accept defeat, quickly funded more money, blow up again. Beginning to doubt? How come what I have learned doesn't work? It looks like the market is always against me and not knowing that you have only let yourselves to be deceived. The market doesn't know who you are and it is only you who is taking it personal.

Perhaps you should wait like a sniper who always calculates his shot first. The target distance, it's moving speed and the wind direction. Even with all these calculations he still waits for the perfect timing to fire the shot. Why? Because he got to be right for he has only one shot and there is no room for mistake.

Don't you think that it is logical for you as novice, with such a small account to trade should to be sharp and be more careful with your trades? You must develop top priority in protecting your capital as there are full of crocodiles, sharks and piranhas waiting for you to get into the water. Your ignorance can lead you to be eaten alive.

"Investing without research is like playing stud poker without looking at the cards" – Peter Lynch

Trade for profits, not for excitement

It is not about what you trade but rather how you trade. By just selecting the appropriate strategies isn't good enough, what you need is a system that can produce consistent profit every month. It requires discipline to follow your trading plan and your trading objectives.

You must be able to differentiate between trading and gambling. Many will get carried with one strike of chance and take away a big prized money or being misled by others who post their winnings in some forum. If you feel excited when you are trading options, you are gambling.

Many novices don't even read charts or relay on any technical indicators at all when buying the options. What they have in mind is the amount of money they can make if the stock makes a big move the next day. This is greed; too much is going to kill you. Be very careful as not to turn your computer screen into an online casino.

"If investing is entertaining, if you're having fun, you're probably not making any money. Good investing is boring" – George Soros

Section 2

The Bearish Reversal System

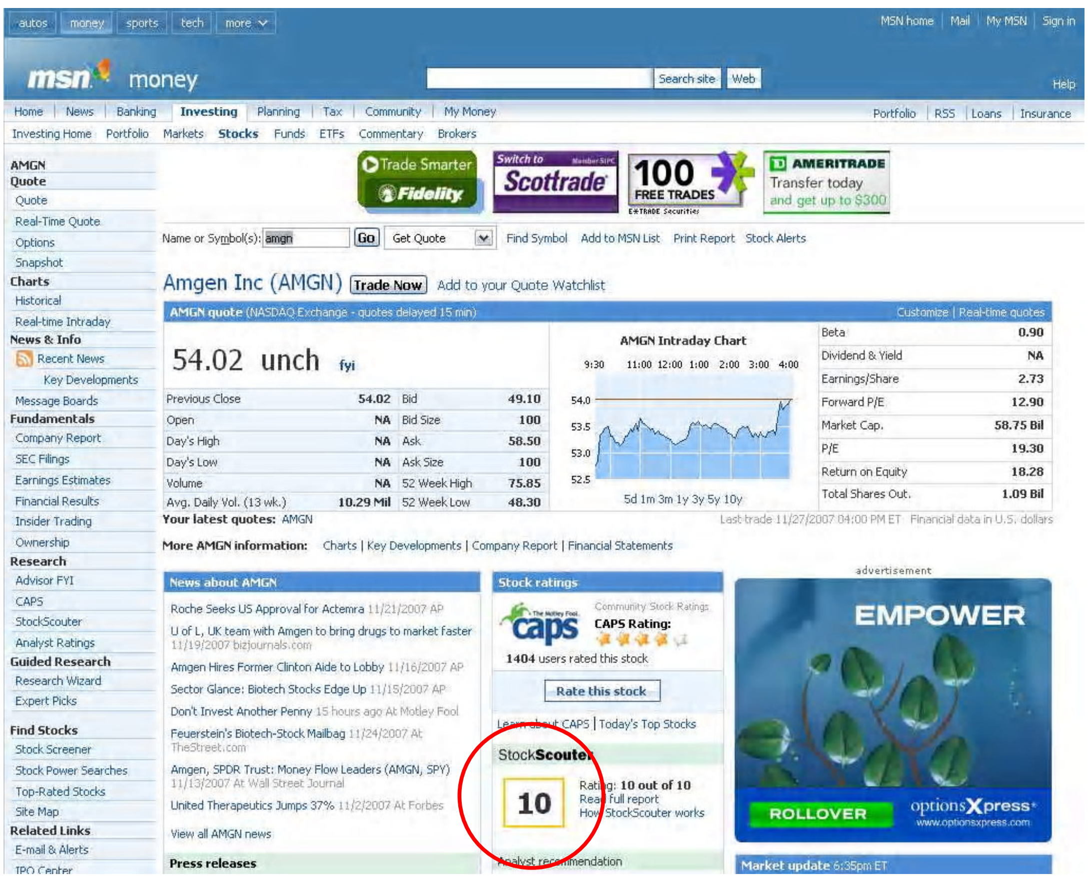
Making quick profits from falling stocks

A Bearish Reversal is a change against the prevailing upward trend. Technical analysts watch for these patterns because they can indicate the need for a different trading strategy. Early detection of a bearish reversal patterns can be very profitable for a Put Option purchase often resulting in more than a hundred percentages in gains. Mastering the ability to identify major Chart Patterns and Japanese Candlesticks formation are going to be of high benefits to you.

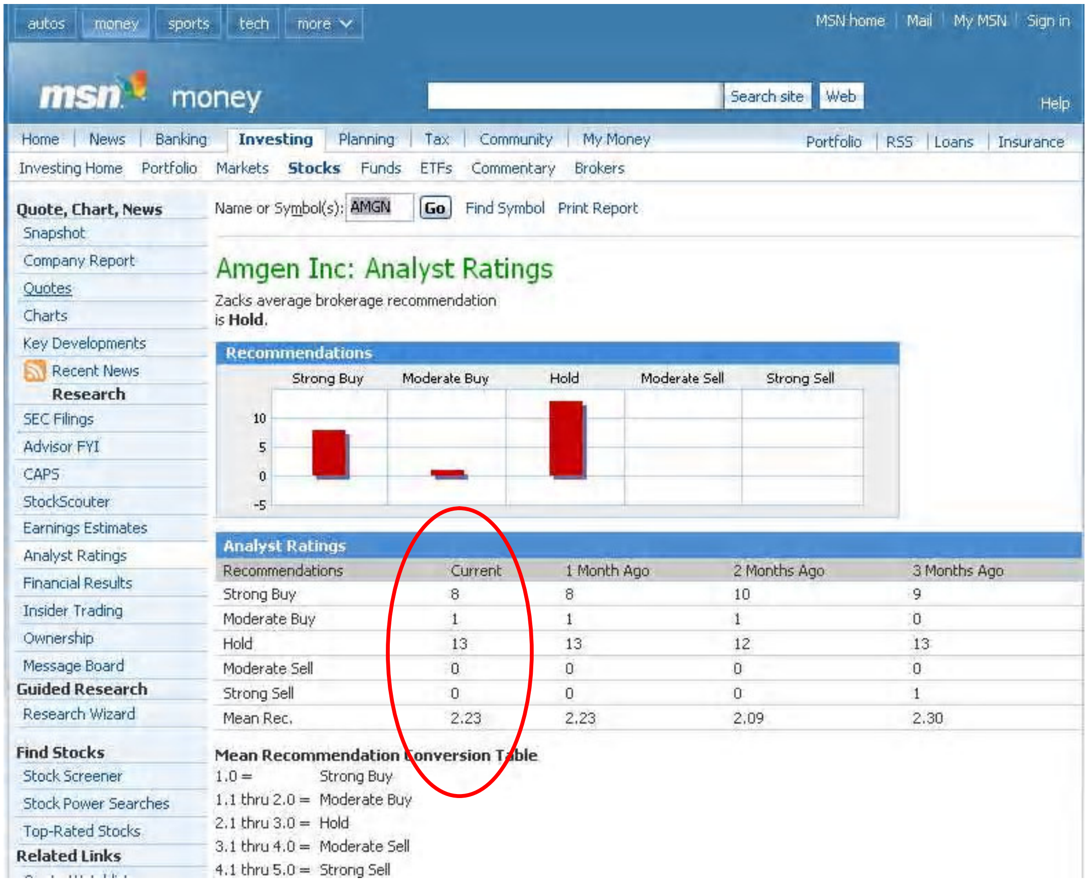
AMGEN INC. Bearish Reversal Signals

The art of contrary thinking

Sometimes it pays to be contrary. That is thinking differently from the investing crowd. When the crowd thinks the stock is bullish usually not many will pay attention to the Put Options and therefore it is usually cheap at least before everyone starts to buy Puts to hedge against their stock. Identifying the bearish reversal signal early is of utmost importance as stocks go down faster. "The Bull climbs the stairs but the Bear usually jumps off the window".



Amgen Inc. high stock ratings



Amgen Inc. high analyst ratings

Going against the crowd

When riding a trend, you are asked to follow the crowd. Now you are to go against them. By looking at Amgen Inc, you can analyze the logic for going against them. Understanding the mechanics before placing your money on the table is going to prepare you from making unnecessary mistakes and be observant as which stock you should choose to trade.

High Stock Ratings and High Analyst Rating

Investors will naturally have high expatiations on the particular stock or company. The stock price will start to tumble down under the following conditions:

1. When the stock underperforms.
2. When the company or the management underperforms.
3. Any negative news related to the company or management or products or even the same related industry itself.
4. Analyst Downgrade, you only need one analyst to make that statement.

Short listing of reversal stocks

The selection of stocks is important step and must fulfill certain criteria before we even consider trading the stock. Strict rules of enforcement must be of top priority in achieving a high probability trade.

1. There must be a significant decrease in the stock's price during the last trading day – this will form a bearish candlestick in the chart.
2. The Market Capitalization of the stock should be above 50,000,000 – this indicates the liquidity of the stock.
3. The Last Volume traded should be above 1,000,000 – this indicates the demand of the stock.
4. The Rating of the stock should be high – this indicates the high Analysts expectation of the stock.
5. Last closing price must be above US$20.00 – sufficient amount for it to drop.

6. Mean Recommendation - Moderate Buy to Strong Buy.

Setting up for the play

Once a reversal candlestick is being spotted and the conditions are also fulfilled, you will need to do is to wait for the entry signal. It may be the next day or two to three days later, the moment you see the price is below the low of the reversal candlestick bar. It is your entry signal for this reversal system play.

Below is the illustration for qualifying and the entry to buy.

AMGEN INC, reversal candlestick chart.

Wait for the entry signal

When the price is 0.10 below the low of the reversal candlestick bar, it is your entry signal. Remember, you are not making the entry decision, the stock is making it for you and all you need to do is to act on it. If the price does not drop but goes up instead, it will be a "no go". This is supposed to be mechanical and no emotions are involved. Use a conditional order to automate the trigger to purchase so you don't have to wait all night. (Malaysia and Singapore trading hours, 12 to 13 hrs difference)

The Put option strategy

AMGEN INC. has been spotted a reversal candlestick bar formation and has fulfilled all the conditions as stated earlier. The stock price is 0.10 below the low of the reversal candlestick bar and you are ready to enter.

Buying a straight Put Option is the best strategy as the Implied Volatility is usually relatively low and since it is very short term, time decay is not going to affect much. As this is going to be a short play and the maximum holding period is two weeks and the target is about 50% to 100% profit on the put options.

Bearish Reversal candlesticks are found almost every time when you look at a chart. Remember what goes up must come down, even the most bullish in the world. They can also be seen repeating quite frequently in the same chart. All you have to do is to be observant enough to spot them early. Trading them with Put options can be very profitable. Remember not to be greedy, get out at the first exit signal. Money in your pocket is always better than in the markets.

It Pays To Be Contrary.

"As a general rule, it is foolish to do just what other people are doing, because there are almost sure to be too many people doing the same thing" - William Stanley Jeons

Section 3

Bearish Reversal System Case Studies

This is the system that I played most, the holding period is shorter and the profits are quicker. However, since the returns are greater and so are the risks because it involved the purchase of a straight put which is exposed to **Time Decay** and the **Implied Volatility** of the option. You must enforce strict risk management rules to protect and to preserve your capital as top priority.

I have been using and have taught my students to use conditional orders to minimize trading emotions and not to miss out on any trading opportunities that are available.

Conditional orders reduces emotional trading

A conditional order is a type of order that will be submitted or canceled if set criteria are met, which are set by the trader before entering the order. There is no doubt that emotions can be your worst enemy when you trade. Conditional order can help to reduce stress and emotions while trading.

Very often you missed a trading opportunity simply because you hesitated too long or watched your profits disappear when you become greedy to hang on for more profits, instead of sticking to your trading plan.

This allows for a greater customization of the order to meet the specific needs of the investor hence reducing emotional trading. The order just filled by itself when the conditions are fulfilled.

Eliminating the fear of missing opportunities

Many occasions trading opportunities are missed just because you wasn't at you computer staring at the chart when the entry signal was present. Conditional orders are used to place your orders before the market opens; defining a trigger price for your order makes you detachable from your computer.

Thanks to the advance trading platform available, trading has never been much easier. These automatic features allow you to separate trading from constant monitoring of the market, which is maintained even when you are away from your desk so you can have more freedom to do other things.

"Chance favors the prepared mind" – Louis Pasteur

Trading using conditional orders

Let me show you a classic example of how I used conditional orders to eliminate the abovementioned problems and profiting from it.

During the Chinese New Year, I want to detach myself from the markets so as to enjoy the celebrations. As a trader it is important to know when to take a break from trading if deem necessary.

The markets will always be there and there is no need to rush. Traders who can't just stop trading for even one day are addicted and if it is uncontrollable, it could be dangerous. Just like gambling.

After about a week absent from trading options I decided to do some screening and there were 13 possible counters to play.

	A	B	C	D	E
1	Symbol	Company I	Rank	Today's Hi	Last Price
2	FAF	First Amer	1	40.08	38.19
3	ANF	Abercromb	2	80.64	78.84
4	POT	POTASH (	3	152	147.69
5	MON	Monsanto	4	116.95	114.01
6	STR	Questar C	5	55	53.33
7	KSS	Kohl's Cor	6	47.93	46.27
8	PVH	Phillips-Va	7	43.45	41.65
9	MAR	Marriott Int	8	36.64	34.9
10	OMX	OfficeMax	9	24.64	23.48
11	LZ	Lubrizol C	10	60.3	58.54
12	WCG	WellCare H	11	49.99	48.59
13	GES	Guess? In	12	42.29	40.67
14	IGT	Internation	13	47.55	46.25

After going through the charts and the IV index, comparing the options premium and the slippage, only three were short listed. There were **STR**, **KSS** and **PVH** and the trading plan was set up.

Trading Plan for STR

Stock trading at $53.33 and when stock price is below $52.50, buy Apr 08 $50 Put.

Trading Plan for KSS

Stock trading at $46.27 and when stock price is below $46.00, buy Apr 08 $45 Put.

Trading Plan for PVH

Stock trading at $41.65 and when stock price is below $40.50, buy Jun 08 $40 Put.

In the Asia Pacific region, the non daylight saving time difference here is 13 hrs, which mean the market starts at 10.30 pm local time and I have a Chinese New Year dinner with some of my business associates. I know that I can't possible be back to execute the trades and it won't be polite to bring my lap top along to work.

The only way possible to enjoy my dinner without any interruptions and not worrying that I'll miss the opportunity of a possible bearish reversal trade, I set all the three orders to **"conditional order"** that is to be triggered if only the stock price drop below the entry signals.

Here are the following orders I have set up on my Interactive Brokers trading platform.

1. **STR Apr08 $50 Put @ market, if stock price < $50.50**

2. **KSS Apr08 $45 Put @ market, if stock price < $46.00**

3. **PVH Jun08 $40 Put @ market, if stock price < $40.50**

The next morning when I switch on my computer to check on my trades, this is what happens last night when I was enjoying my dinner with my friends.

1. **STR not filled as the stock was bullish.**

2. **KSS Apr08 $45 Put filled at $3.20 and closed at $3.60, $0.40 or 12.5% profit.**

3. **PVH Jun08 $40 Put filled at $4.50 and closed at $5.00, $0.50 or 11.1% profit.**

All the three trades were set to trigger mechanically by the stock itself. I don't do the deciding, the stock does it for me. This eliminates the chance of emotional trading. For **STR**, the stock was bullish and it does not hit the entry point so the order was not triggered. There are no predictions involved; it's the stock that tells me what I should do and does it for me. I just set it on auto pilot mode so that I can enjoy my dinner.

You see that's the way how trading should be, it should not affect you and your social life. You do not have to be in front of your computer for 10 hours every trading day in order to make money. This is crazy, too much stress and it's ridiculous, it will only lead you into addiction and you will become a high flying gambler. Stop immediately if you are on the graveyard shift, it will affect your life and your family's life. You too can enjoy your life while trading options. Do it the smarter way.

"Those who have knowledge don't predict. Those who predict don't have knowledge" – Lao Tzu (604 BC - 531 BC)

Case Study #1 Phillips-Van Heusen Corp

PVH is an excellent example of a put options trading for profit that is signaled by the stocks itself. All you need to do is to follow the signals and set your orders on automation. This set up will removed your emotions and not to be taken over by your greed.

The bearish reversal candlestick formation was spotted on Feb 15 before market opens and the trading Plan for PVH entry was set up as follows.

PVH was trading at $41.65 and if stock price is below $40.50 which is the low of the reversal candlestick, then buy Jun 08 $40 puts.

A condition order was set up for PVH

Jun08 $40 Put @ market, if stock price < $40.50

The next morning when I switch on my computer to check on my trades, the order was triggered as the **stock plunge below $40.50** and **PVH Jun08 $40 Put filled at $4.50 and closed at $5.00, $0.50 or 11.1% profit** in the same day.

After three trading days the stock was down at $37.00, the option premium has increased to $5.80. Looking at the chart the **MACD histogram** is at about half way, still have room to drop but the **William %R** is at the bottom sending me a signal to exit.

The question is which indicator to depend on? If you are greedy you would have stay on, base on my experience it is better to get out even if there is a possibility to drop some more.

The stock open lower, many would have refused to get out, by then the options has gone up to $6.20. I set my stop to $6.10 to protect my profits if it turns around during half time which is common and I can sleep without any worries of my profits being wiped out.

The stock has indeed turn around and the stop was trigger at $6.00, giving me $1.50 profit which is about 25% profits in 4 trading days.

Many who take big risk on earnings will see it as small profit but I can sleep soundly without any stress. I obviously don't want to win big one day and get a heart attack the next day. Trading should be relaxed and it has to be consistent. It should not affect our life physically or emotionally.

Case Study #2 Foundation Coal Holdings Inc

FCL was spotted a bearish reversal candlestick formation on 29 Feb before market opens which fulfilled all the bearish reversal conditions coupled with a strong negative divergence present in the stock chart.

FCL was trading at $57.77 and the low was at $56.83 and the trading plan for **FCL** entry was set up using a conditional order.

If stock price < $56.60, buy Apr 08 $60.00 Puts

However the order was only triggered 4 days later @ $6.50 when the stock falls below the entry point. Having paid $3.10 for the time value leaving behind $3.40 in intrinsic value, I must bear in mind that if the stock moves sideways, time decay is going to be harmful to this trade.

A stop loss was then set at $4.50 giving enough room for the daily noises and a maximum of two weeks holding period.

By the 10 Mar 08, after eight trading days the stock is down to closed at $50.52, the option premium has increased to $10.30 giving me a **profit of $3.80, a 58% returns**.

Looking at the chart the **MACD histogram** is now at negative territory indicating a possible longer term bearish trend but **William %R** is at the bottom signaling me to get out.

Here comes the greed and the fear factor, greedy to want more profits and at the same time fear of losing out the profits if the stock turns around. In order not to be effected by this emotion a trailing stop of $0.40 was set. This means that if the stock keeps on falling the profits will be maximized and on the other hand if the stock reverses back up then it would trigger the trailing stop to exit the position.

Setting my trades on automated mode gives me plenty of time to blog (**www.StreetSmartOptions.com**) while I trade and I don't have to stare at the charts for opportunity.

Case Study #3 Goldcrop Inc

GG was spotted a bearish reversal candlestick formation on 17 Mar 08 after market closed which maybe due for a minor market correction as there was a negative divergence present in the stock chart. The stock rating was **8** and the analyst recommendation was **moderate buy** making this reversal play **contrary**.

GG was trading at $44.22 and the low was at $43.00 and the trading plan for **GG** entry was set up using a conditional order.

If stock price < $42.90, buy Jul 08 $45.00 Puts

However the order was triggered the next day on 18 Mar 08 @ $6.00 when the stock falls below the condition set. Having paid $3.90 for the time value leaving behind $2.10 in intrinsic value for a 120 days option, I guess it all right as the maximum holding period is only 2 weeks. The time decay effect is not so damaging to this position.

A stop loss was then set if stock price is > $46.40, which is the high of the reversal candlestick.

Yesterday 10 Mar 08, after only one day the stock is down to closed at $38.71, the option premium has increased to $7.90 giving me a **profit of $1.90, a 32% returns**.

Looking at the chart the **MACD histogram** is now at negative territory indicating a possible longer term bearish trend but **William %R** is at the bottom signaling me to get out.

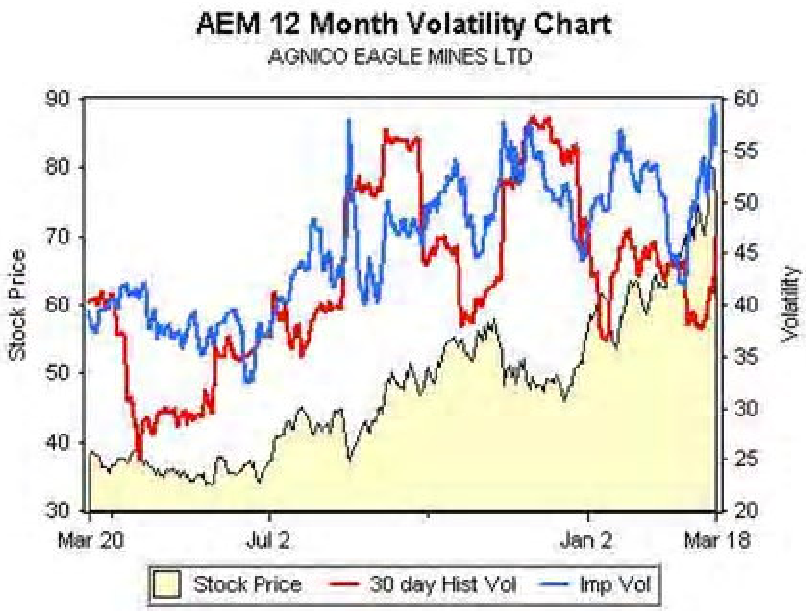
I took my profit when the market opens the next day and move on to the next trade, remember always take your profit, don't be greedy. Move on.

Case Study #4 Agnico-Eagle Mines Limited

AEM was spotted a **"Shooting Star"** bearish reversal candlestick formation yesterday on 19 Mar 08 before market opens which is due for a market correction as is was trending for some time. It was supported be a strong negative divergence present in the stock chart. **AEM** was trading at $74.10 and the low was at $73.50 and the trading plan for **AEM** entry was set up using a conditional order.

If stock price < $73.40, buy May 08 $75.00 Puts

However the order was triggered on the same day itself @ $8.40 when the stock falls below the condition set. Having paid $6.80 for the time value leaving behind $1.60 in intrinsic value for a 60 days option, is a very expansive premium to pay as the IV was very high.



I took this trade because the negative divergence was very strong bearing in mind that it is going to be a real short trade. Since only one day the stock is down to closed at $68.12, the option premium has increased to $10.30 giving me a **profit of $1.90, a 23% returns**.

The **William %R indicator** is at the bottom again sending me a signal to take my profit get out. Money in my pocket is always better than in the market.

Case Study #5 McKesson Corporation

MCK was the third bearish reversal trade I did together with ACOR and ABT. It is the most profitable one indeed; I managed to pocket a profit of **117%** in 10 trading days. Spotted a **"Dark Cloud Cover"** bearish reversal candlestick formation on my screener on 15 Jan 08 which have gapped up in the stock price three months ago and were making higher highs since then.

There was a strong negative divergence shown on the MACD Histogram, the strongest amount the three (ACOR, ABT and MCK) and the possibility of closing the gap.

MACD Histogram, the SMA 1 (green line) is about to cross the SMA 5 (pink line), a bearish reversal signal.

William %R is high in the over bought region, giving plenty of room to fall.

The stock price was at all time high at $68.50 acting as resistance, forming a possible double top.

The reversal candlestick was spotted on 15 Jan 08 before the market opens.

Trading plan set at if stock price **< $66.50**, the low of the bearish candlestick, buy **Mar 65 Put** and was filled @ **$2.30,** stop loss set at $1.20,

On the 28 Jan, Monday, after the stock has dropped $6.50, a "Doji" was seen in the chart. A "Doji" represents uncertainty, a possible turn around. William %R is touching the floor sending me a second exit signal.

Exit Plan is to get out immediately when the price is above Monday's high.

The stock rally on Monday's open and hit the exit signal at about 50 minutes after opens and I managed to get out at **$5.00** making a profit of **$2.70, 117% ROI**.

The problem with many traders is too much greed, always wanted more and not decisive when getting out. Discipline and following your trading plan is crucial in achieving consistence profits.

"The financial markets generally are unpredictable. So that one has to have different scenarios.. The idea that you can actually predict what's going to happen contradicts my way of looking at the market" – George Soros

Section 4

Be Proficient In Your Trading

To be proficient in trading options online, you need to master a few things. First you must learn to use a computer. This is the most basic requirement, then learning to use the trading platform.

You then set off to learn about stocks, the fundamentals and the technical. Since you have decided to trade options because it offers more flexibility, you need to learn about options, their strategies and their applications.

As a matter of fact the entry and exit signals are based on technical assessments of the charts. You don't make the decisions, the stocks do and it is supposed to remove the trading emotions from you when you trade. However there are some advices that I want you to remember as they can interfere and disrupt your trading decisions.

Do not listen to the experts

When you trade online, you are bound to surf the internet for information and tips. It is unavoidable to see lots of advertisements or sites that are offering free investing stuff just for signing up.

You are going to get quite a bit of email from these sites providing you with their expert recommendations for a small fee or even free. Think! This is their job and they are paid to bring in people to subscribe for their services. They will only show you the impressive winning trades just to get you to sign up. Some may claim to have "hot tips" or "insiders' information" and that they have a way to detect it before it move big time.

Subscribe to their services will probability get you some winners and some losers and you will be happy if your portfolio remain positive at the end of the month.

These experts probably know as little as you do about the markets and if they have known more, they would be making a lot more money trading on their own rather than to give recommendations services. It is all base on randomness and I recommend you to read "**Fooled by Randomness**" by Nassim Nicholas Taleb. It is about the hidden role of chance in life and in the markets. A must read book for those who are determined to be a successful trader.

Signing up for these services are going to make you lazy because you do not have to do your own research and finding them yourself. They will provide you with the recommendations and all you have to do is to follow their instructions. That it, so simple but it is going to hinder your growth from progressing as a trader.

Trading options can be more complex and thus requires more attentions as compare to trading stocks. If you can understand and master the knowledge of options, you would have acquired the unfair advantage as to how you can create profits on a consistent basis.

"I have probably purchased fifty 'hot tips' in my career, maybe even more. When I put them all together, I know I am a net loser" - Charles M. Schwab

Do not trade the news

Many options traders like to trade the news for quick profits. Can news releases be dependable to trade? First, let's take a look at the significance of the news being released.

Major news report like GDP, CPI, Interest rates or Unemployment can absolutely cause a stir in the markets. The question is that you have no idea whether it is going to go up or down. Trading the news is the same as playing earnings gapping, you are guessing and that is gambling.

I would like to emphasize this again, as an options trader, it is crucial to understand about volatility. Any news that can cause the market to move will cause the markets volatility to increase at the same time. An increase in volatility means increase in fear which in turn means an increase in options premium.

The markets volatility would be so crazy that it would be dangerous to trade options. What has been affecting the market lately? Almost every major news or events has an effect on it and the market reactions are purely based on the masses psychology.

Very often, when we listen to the news, there are given by these so called 'experts' with questionable credentials, or limited resources. It could be that an inexperienced junior staff who is providing the piece of information.

Communications between news sources and brokerage houses are completely unregulated and unsupervised, therefore allowing the possibility of the news being diluted or altered and usually released to the public later in time.

However there are many who are willing to pay top dollars to get access to the news first. Use your intelligence, if the big boys would want to sell, they will tell you to buy and vice versa.

"The greater the uncertainty, the more people are influenced by the market trends; and the greater the influence of trend following speculation, the more uncertain the situation becomes" – George Soros

Do not tell others about what you trade

If you are trading on your own research and selections derived from facts and market data, be it on technical or fundamentals, then you are on the right track in becoming a better trader.

You are making trading decisions based on the data and information that you have gather from the markets. There is no right or wrong about the stock or market that you are going to trade, it is the actions that you take in making that profit or cutting those losses that matters.

Different people have different opinion, we all see things as things that we want to see, we have already form a mental perception about those things that we are about to see. Do not let others distract you from their opinions base on their perceptions. This will affect your judgments on the decision that you have already made earlier.

Many novices will join discussion forum on trading hoping to learn from the more experience traders. Their intentions are good but they did not know about the dangers that it can bring about.

I have come across an options trading forum offered by a trainer as a form of a support, but it turn out to be a forum for the students to post their winning trades. It becomes a platform for "showing off" rather than focusing and addressing on the trading and learning issues.

This is going to make you egoistic and this could be a trader's downfall. Beware of this kind of a forum, stay away if possible as you may get confuse over opinions and facts.

"Wisdom is what's left after we've run out of personal opinions" – Cullen Hightower

Do not predict, any thing can happen

Almost all options traders want to identify a trend early and accurately in order to achieve the maximum profit possible. Making prediction on stock price is very difficult and it is almost impossible to pick tops and bottoms. If anyone can tell you what's going to happen next then he must be GOD.

Even with the most advance technical indicators, it is still difficult to predict future outcome. It is believed that stock price movements are governed by the random walk hypothesis and thus are unpredictable.

Trading by predictions can cause mood swing, often leads to frustrations and disappointments. Traders who trade by intuition, tips or emotions are rarely successful and such methodology is the biggest downfall to trading success.

Trading In The Zone by Mark Douglas offers specific solutions to the "people factor", it is the culprit for lack of consistency, focus and self-confidence when it comes to stock picking.

It is important for traders to learn to think in probabilities, and adopt the specific beliefs necessary to developing a winner's mindset. Along the way, they'll gain valuable insights into their own entrenched misconceptions about the market.

"The market is like watching a drunk walk a tight rope. You never know what's going to happen next." – Arthur Cashin, CNBC Commentary

Be neutral when you are trading

Is there such thing as a bullish or a bearish consensus? It is a personal point of view, depending on what you are looking for. You open an intraday chart of a particular stock and it looks bullish, change it to a daily chart and it becomes bearish, change it to weekly and look at a 5 years time frame and it is bullish again.

It depends on what you want to see, the time frame that you are looking at and which time frame you want to play. Short, mid or longer term and you will find a correct time frame chart to support your thesis be it bullish or bearish.

You will find facts to support that you are right. Your ego can be your greatest enemy. When a trade goes wrong, you know that you should get out immediately without a second thought but your ego tells you to hang on. Many times you suffer even greater losses.

When you enter a trade, you enter with the intention to win and make money. No matter how good you are or how high the probability is, you will get some losers. You know after you have made that trade something is going to happen, either it is going in your direction or against your position.

As long as you understand this, accept the risk and willing to set a certain amount of losses if it moves against you, then you will be able to trade without any internal conflict, hesitation and doubt.

This way you'll know your limitations and when to cut your losses. Similarly when there are profits on the table you are not driven by greed to hang on for more. It will not create any emotional attachments when you lose money or make too little on a particular trade.

"He who lives by the crystal ball soon learns to eat ground glass" – Edgar R. Fiedler

Let the charts tell you what to do

Trading stocks and options in the market and achieving consistent returns can be relatively simple. As a matter of fact, in many other aspects trading can be very difficult as you try to find shortcuts to achieving unrealistic returns.

Many people have been misled into believing that it is possible to become a millionaire by trading options in a very short period of time. There are many unethical gurus out there who are only interested in making money by teaching and they'll try to impress you with their or their student's best trade which is probably a one in a life time thing. They will eventually turn you into gamblers.

It might be helpful to view options trading as a game where there are no rules, some certainties and probably works on randomness with repetitive frequencies. One of the most common situations when trading options is the necessity to make decisions despite of overwhelming ambiguity.

It is never an easy tusk, even the most experienced options traders will find difficulties and it can only become less difficult when you become a more experience trader. The key to successful options trading is the technical analysis know-how in reading and interpreting stock charts. Most of the time the charts will give signals to buy or to sell and all you need to do is just to act on the signals.

When you are starting out, a stock chart probably don't mean much to you. However, as you progress, you will discover that you can spot and determine in just a couple of seconds whether there are any opportunities in that particular stock just by looking at the chart.

Mastering the art of chart reading can help you to achieve handsome profits in your trading provided you are willing to put in the time and effort to learn the basics of charting. This ability will takes time to develop and is invaluable, but it doesn't happen overnight.

Most options trader won't be bothered; they only trade the news and wait for earnings announcements hopping to catch a wind fall. The road to success in options trading is not easy and there are no shortcuts, but it can be very rewarding for those who are determine to learn and put in the necessary effort to become a better options trader.

"The person that turns over the most rocks wins the game" – Peter Lynch

Be truthful to yourself

The main reason why so many options traders lose money is that they do not realize that their problems are internal. Trading is more psychology rather then methodology. The way you trade reflects on your personality and your beliefs which can surface to become your trading problem.

Making money is the main objective and reason for you to trade options, but when you become too obsessed in making money alone, the emotional implications and pressures from the money making part can very often will lead to losses.

All of us want to win and refuse to accept losses, avoiding the emotional pain if possible. As an options trader, you are constantly confronting with losing trades which creates an internal challenge of self esteem because it feels good when you are right.

When you are on a losing streak, you are putting yourself under pressure and you are psychologically in pain and the only way to remove it is to stop trading. Some may sabotage yourself by blowing out your trading account intentionally without even knowing it because when there is no more money in your trading account you will be forced to seize trading.

The quest in becoming a successful options trader requires you to know and understand the method of trading options that are being taught to you. Its strengths and weaknesses, what are the limitations and if it is really so easy to get rich by trading options then every trader can be as rich as Warren Buffett or George Soros.

Statistics have shown that 90% of options traders lose money. Why? They probably share the same thoughts, same misconceptions or even make the same mistakes. Logically speaking, we all must aim to be the 10% traders who make money consistently in trading.

These 10% winners don't compete with the markets, whether they win or lose money, they are honest and truthful to themselves and accepting all the responsibilities of their actions. They know that losing is part of the process in the course of doing business and they do not make it personal.

They are not controlled by the money emotions and they only respond and react to the market conditions as it is. They do not predict the future and will not try to beat the markets, accepting the fact that anything can happen.

You are fully responsible for all your actions as no one force you into it and all the trades are entered by you. You must understand that only when you are truthful to yourself and accept the responsibility of all your losses then you are ready to learn from your mistakes.

"Your ultimate success or failure will depend on your ability to ignore the worries of the world long enough to allow your investments to succeed. It isn't the head but the stomach that determines the fate of the stock-picker" – Peter Lynch

You don't need to prove that you are right

Traders who think that they have developed outstanding abilities, knowledge, and skill in options trading are often egoistic in their personality. They usually brag about their superficial abilities in trading options and they will display their best winnings to boast about how great they are.

It is sad to say that they have been misled by many of the so called "Gurus" out there claiming that they have the abilities or secrets in doing so. Don't fall into this trap for it can turn out to be a financial disaster that can ruin your life. It is just too painful for one to bear.

The problem with most of us is that at the very first glimpse of what we see or hear, we often find reasons to substantiate the information that we want to believe. We tend to be bias and become one sided thus anchoring our subsequent thoughts.

Trader wannabes must learn to seek and develop the ability to analyze information given to them even though they have paid for it. One way is to seek information from a few more sources so that you'll have a clearer perspective before making any major decisions.

The only way is to paper trade and test it out first to see whether what have been taught is credible. You must stay within your level of competence and be questionable of everything you see or learn. It is your money that is at risk not the person who is teaching you to trade. It is better to be safe than sorry.

Your ego can be your greatest enemy. Over confidence in your ability to make forecast and profit from it can be a setup for your downfall as an options trader. This can cause you to be irrational when your emotions take custody over your thinking and you'll lose your ability to trade properly. You begin to make stupid mistakes and lose badly. To break the spell, you'll have to take a break to detach and unlearn of what that have been taught to you.

Many times you know that when a trade goes wrong, you should get out immediately without having any second thought but your ego tell you to hang on. Maybe you are able to recover your losing trades and turn it into winners most of the time. You average down and buy more to support your theory of being right, it is only going to heat up your over confidence level and one day the market is going to break you for that.

Respect your trading rules, admit your mistakes, learn from them and you can be sure that you are on the right track in becoming a better options trader.

"The market does not beat them. They beat themselves, because though they have brains they cannot sit tight" – Jesse Livermore

Section 5

Becoming a Better Trader

The choice to trade online instead of seeking the help or advice of the traditional stock broker has become popular. Most people are attracted into online trading because it offers outstanding opportunities to enjoy unlimited freedom. However unlimited freedom also comes with unlimited self-sabotage, there are several options trading traps that you should be aware and not to fall into them if possible.

The No.1 deadly options trading trap

Leverage using options on the earnings announcement hoping for a big catch when the stock gaps is the **No.1 Options Trading Trap** that most options traders fall into and are unaware of.

Many naive options traders and wannabes who have been misled into playing earnings don't know the dangers that they are facing. It is a real killer. Next time you hear this, you better run fast.

These people don't know that the very occasional big win traps them into believing they can make money doing it again and again. It can ruin their lives as they are gambling their life savings away.

It is my duty as a trainer myself to expose the hidden dangers to the public and alert them of the consequences.

1. **High Risk Exposure** - after the earnings are released, the Implied Volatility will immediately shrink often know as **"volatility crash"**. The options premium will lose its value so much that if there is no substantial movement in the stock price to push the option deep in-the-money to cover the losses, even it gapped in your favour, and you can still lose money.
2. **Gambling** – betting on earnings is all based on **predictions** just like playing baccarat, you bet on either banker or player base on intuition or gut feeling. Even with positive earnings the stock still can go down, past earnings does not guarantee that the same outcome the next round.
3. **Addictions** –You will be **obsessed** in finding jackpot trades. The amount of excitements you get out of the one strike of a chance winner can get you addicted. Just like drugs, addicts are after the "high" effect.
4. **Mood Swings –** the emotional implications are just too dangerous for anyone to handle. It can affect your life and family. The amount of stress can be damaging to your health as it screws up your mind. You will develop an **"irritability"** personality and become an angry or impatient person.

The truth about earnings is that they are very difficult to predict. Even companies themselves often are unable to forecast their future accurately. They take measures to ensure their earnings are right on target. What most investors don't know is that companies sometimes "manage" their earnings to meet analysts' expectations and we should not give them more respect than they deserve when assessing their estimates. Past earnings records do not guarantees future performances. Very unfavourable risk / reward ratio. All the odds are against you.

"An important key to investing is to remember that stocks are not lottery tickets" – Peter Lynch

Completing your learning curve

There are definitely advantages to online trading, but as an individual trader you will have your learning curve in becoming an online trader. You'll need more than basic computer skills if you want to excel in your trading as some of the online trading software may be quite complicated if you only have basic computer knowledge.

When a trader is trading online, he makes choices based on his own research and there is no broker to advice and confirm his order. Consequently, it is extremely important that online traders competency in operating their online stock trading software as it is common for traders to have pressed the buy button instead of the sell on their online trading software by mistake.

Try out the online trading system first before choosing your online broker; I am sure that you can find one that you are comfortable with before starting out to trade with your money. Most online brokers offer the use of a virtual account where you can practice and sharpen you trading skills.

When you begin to learn more and become more experience in your trading, you may become curious and want to try out different strategies or approach to reach your desired goals faster. As it is important to learn new strategies, remember never try it out with real money as you may suffer financial losses, speaking from an experienced point of view. Always use your virtual account to try out your new stuff. It requires time and money, save your money invest only your time.

"Don't limit investing to the financial world. Invest something of yourself, and you will be richly rewarded"
– Charles R. Schwab

Know your risk tolerance

This is also the number reasons why people lose money is they get carried away easily and take unnecessary risk. It is estimated that 90% of the traders lose money in the long run. It is also important to know what type of financial instruments suits you, your personality and risk tolerance.

You may have guessed that intra-day trading is best for you in pursuing your goals quickly and aggressively, never to realize that you are not mentally prepared to take that kind of a stress yet. We are situated in this part of the world, 12 hours different which means that you'll have to stay awake through out the night to trade. All of this requires a willingness to not only take risks, but also make scarifies to your family as they will be sleeping when you are awake. Be wise, making money is important but striking a balance is even more important especially where your family is concern.

If you are trading options do not misunderstand the word “Limited Risk” thinking that you are not going to lose a lot of money because the risks are limited. “Limited Risk” is not to be interpreted as it is, what it actual means is that as compared to buying or shorting a stock, the risk is limited. If you buy a particular stock for $50, you risk is $50 because the company can go bust which is most unlikely to happen but it can go down. Buying the stock option instead will limit your loses for you may only pay $5 for it. And comparing both, buy option seems to be a logical choice because you only have to pay 10% of the stock’s price; so naturally, you don’t mind risking it all. It is this mentality that most options trader loses money.

Understanding the market

Sometimes you think that the market is against you. Well, the market doesn’t know you at all and it is not against you personally. It was you who interpreted the market the way you want the out come to be and if it does not go your way, you get disappointed. Don’t try to read the markets, let it tell you what you should do instead. Put the systems to work, test it out, virtual trade of course to see whether it works or not. Maybe it will help.

Rules to follow in becoming a better trader

Mastering a trading system alone would not however automatically insulate you from losses. It must always be remembered that the overriding rule is for one to exercise the required discipline every time, without compromise. Self-governing rules and regulations must be strictly enforced via self-discipline, so that you will not break any of the trading rules laid down and you will not be reckless in your trade and go into the punter’s mode. Having a system to trade can develop winning habit and the incisiveness to be committed to trade only if you are able to find high probability trades and become a better trader. Here are some of the trading rules that I have set up as my trading parameters.

1. Start to paper trade first to be familiarized with the trading platform.
2. Trade less and be more selective per trade.
3. Do not over trade, maximum trades – 70% of funds.
4. Start with 1 contract size and increase slowly.
5. Do not trade during the 1st trading hour.
6. Do not chase, be patient – Wait.
7. Make sure all the signals are in line before executing the trade.
8. Don’t trade the news.
9. Never average down your losing position.
10. Cut you losses quick and without hesitation.
11. Always use protective stops.
12. When losing bad, stop trading, take a small break or back to paper trade.

13. Stay away from stocks that hurt you.
14. Don't be a gambler.
15. Do not try anything new with real money.
16. Do not make stupid mistake, think like a pro.
17. After the trade is done, off your computer and go to bed.
18. Follow the system and your trading plan.

"Habits are safer than rules; you don't have to watch them. And you don't have to keep them either. They keep you." - Frank Crane

About The Author

Ronald Lee is a Malaysian street smart entrepreneur, a professional investor/trader, a trainer and author. He provides contact coaching lessons on US stock options trading; sharing his trading experiences and how to achieve consistent profits systematically with his low risk, proven high probability trading methodology.

He is widely known for his blog, **www.StreetSmartOptions.com**, which is devoted to sharing his effective emotion-free trading psychology on reversal-driven quick profits and trading traps to avoid.

Recommended Readings

Options As A Strategic Investment

By Lawrence G. McMillan

Reflecting today's market realities and the new innovative options products available, this book features an in-depth analysis of volatility and volatility trading; updated information on all stock option strategies, reflecting recent market conditions; buy and sell strategies for Long Term Equity Anticipation Securities (LEAPs); detailed guidance for investing in the growing field of structured products; the latest developments in futures and futures options; and the market impact of the most recent changes in the margin rules. Read More…

High Probability Trading

By Marcel Link

A common denominator among most new traders is that, within six months of launching their new pursuit, they are out of money and out of trading. *High-Probability Trading* softens the impact of this "trader's tuition," detailing a comprehensive program for weathering those perilous first months and becoming a profitable trader. This no-nonsense book takes a uniquely blunt look at the realities of trading. Filled with real-life examples and intended for use by both short- and long-term traders, it explores each aspect of successful trading. Read More…

Trading In The Zone

By Mark Douglas

Maximizing the trader's state of mind is the key to successful results. Conflicts, contradictions and paradoxes in thinking can spell disaster for even a highly motivated, astute and well grounded trader. Mark Douglas, a trader, personal trading coach, and industry consultant since 1982, sends the message that "thinking strategy" will profoundly influence a trader's success rate. Douglas addresses five very specific issues to give traders the insight and understanding about themselves that will make them consistent winners in the market. Read More…

The Disciplined Trader: Developing Winning Attitudes

By Mark Douglas

Douglas starts the book out from a perspective that many traders can identify with- crushing defeat. Humbling himself to the higher power that the market is and analyzing the formula for defeat, Douglas shows how he was able to reverse-engineer it to find the formula for success that many of the book's readers over the years have found useful in exorcising their own psychological demons. Read More…

Mind Over Markets
By James F. Dalton

The key element that has long separated tremendously successful traders from all others is their intuitive understanding that time regulates all financial opportunities. In 1984, J. Peter Steidlmayer formally introduced the Market Profile as a way to graphically depict the acceptance or rejection of price over time. For the first time, what had once been the domain of the intuitive trader was not accessible to all traders. Read More…

High Performance Options Trading
By Leonard Yates

High Performance Options Trading offers a fresh perspective on trading options from a seasoned options trader programmer/engineer, Leonard Yates. Drawing on twenty-five years of experience as an options trader and software programmer, Yates has written this straightforward guide. First he provides readers with a solid foundation to trading options, including an introduction to basic options terminology, a thorough explanation on how options are traded, and specific trading strategies. Read More…

Trading For A Living: Psychology, Trading Tactics, Money Management
By Alexander Elder

Soviet-born author and practicing psychiatrist Elder shares his learning over the years as a professional trader and expert in technical analysis and his principle of understanding the three Ms (Mind, Method, Money), which will strengthen the discipline required to be successful in trading. He explores crucial factors in the markets that most experts overlook, including time, volume, and open interest, and describes little-known indicators to track them profitably. Read More…

Come Into My Trading Room
By Alexander Elder

Come Into My Trading Room educates the novice and fortifies the professional through expert advice and proven trading methodologies. This comprehensive trading guide provides a complete introduction to the essentials of successful trading; a fresh look at the three M's, including a proven, step-by-step money management strategy; and an in-depth look at organizing your trading time. It reviews the basics of trading stocks, futures, and options as well as crucial psychological tactics for discipline and organization—with the goal of turning anyone into a complete and successful trader. Read More…

Fooled By Randomness
By Nassim Nicholas Taleb

In this look at financial luck, hedge fund manager Taleb addresses the apparently irrational movement of money markets around the world. Using his own investing experience and examples of others' successes and disappointments, he discusses theories like Monte Carlo math and the concept of Russian roulette. Read More…