

The image features a blue area chart with a white dotted grid background. The chart shows an overall upward trend with some fluctuations. The CBOE logo is positioned in the upper left corner.

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Technical Analysis and Option Strategies

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- Technical Analysis
 - Defined
 - Use for Trading
- Trend Following
 - Charting Example
 - Option Trade
- Overbought / Oversold
 - Charting Example
 - Option Trade
- Stops versus Option Trades
- Summary Q&A

- Study of how historical prices may be used to forecast future price movements
- Charts can give a picture of where the crowd has been aggressive buyers or sellers of a security
- Forward price projections combined with time periods may be extrapolated on charts

Uses –

- Determine outlook for stock prices
- Decide which option trading strategy best matches price action
- Develop exit plans relative to a trade

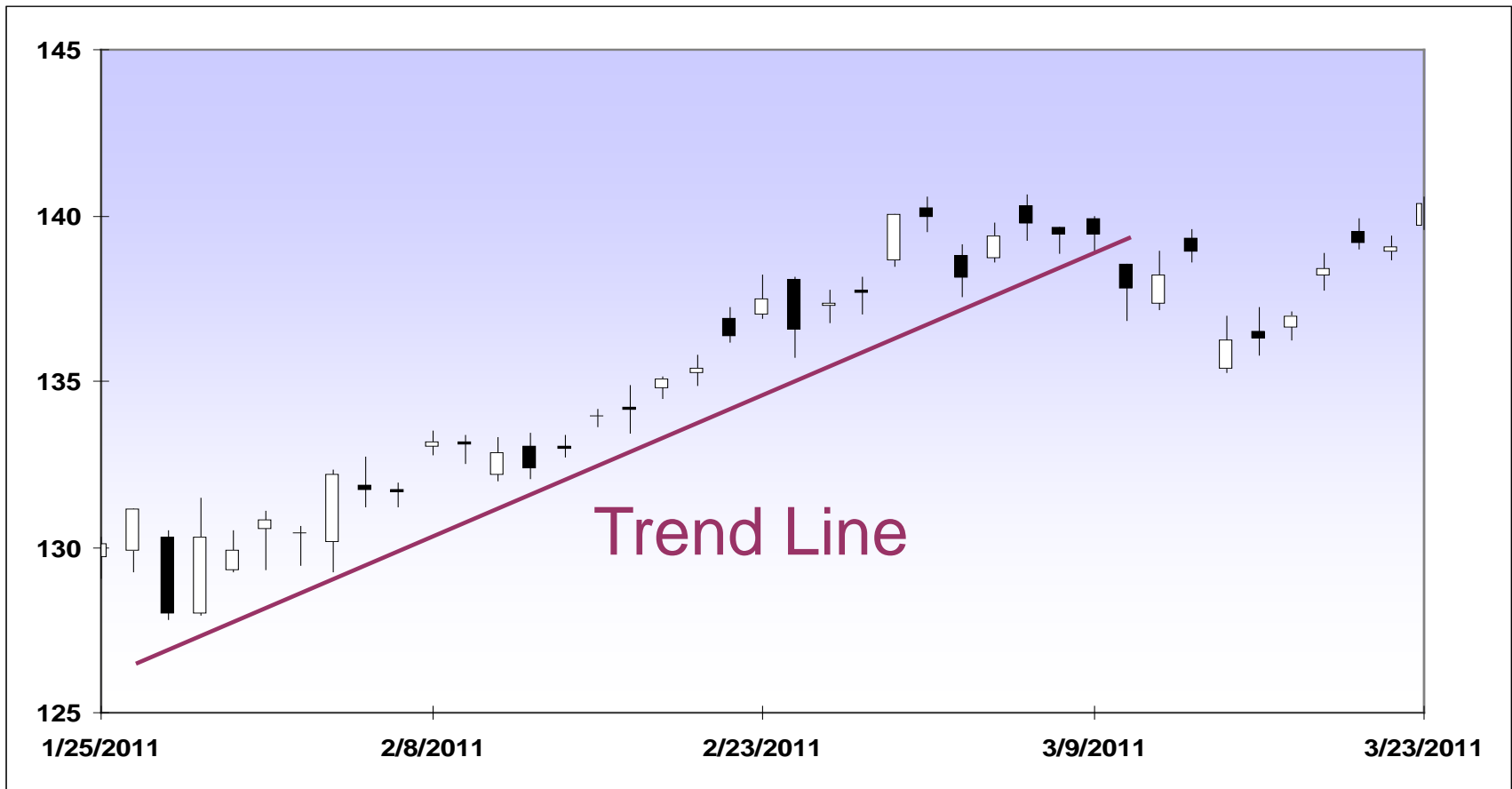
Trading Plan –

- Entry –
 - Limit Order
 - Based on a Break Out
- Exit –
 - Stop Loss Order
 - Target

What it is –

- Direction of future price movements defined by chart or indicator
- Methods vary from drawing a line to complex indicators
- When trading a trend the entry and exit may be dynamic

Uptrend –



Downtrend –

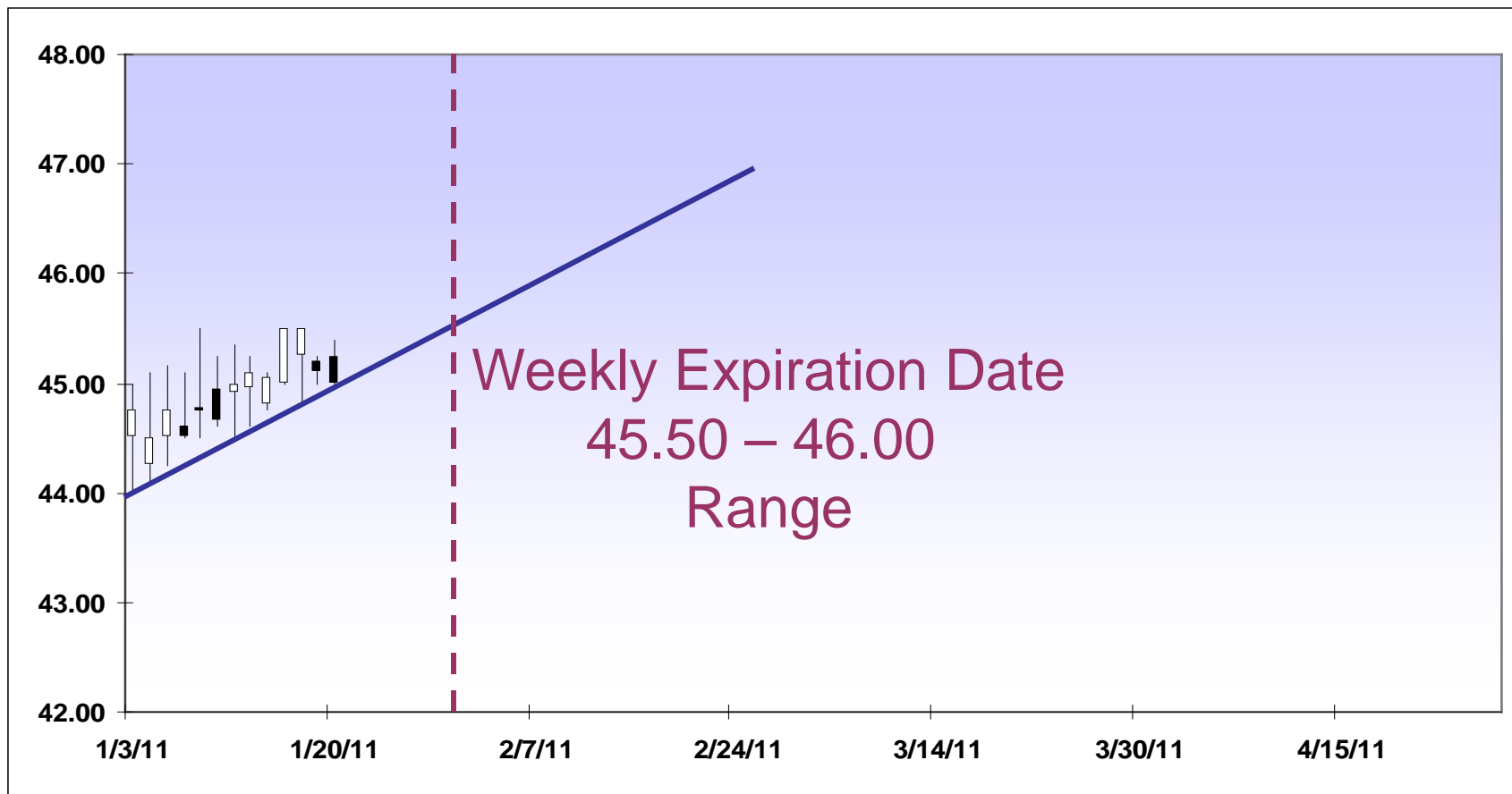


1/20/2011 – XYZ @ 45.00

- Stock in an uptrend
- XYZ has WeeklysSM options available
- Dollar strikes available
- Standard expirations available
 - Jan 29, 2011, Feb 2011, Mar 2011,
 - May 2011, Aug 2011, Nov 2011
 - LEAPS[®] – Jan 2012, Jan 2013
- Believe up trend will continue
- Decide to dynamically trade trend

Trend Following

1/20/2011 – XYZ @ 45.00



1/20/2011 – XYZ @ 45.00

Buy 1 XYZ Nov 35 Call @ 10.75

Sell 1 XYZ Jan Weekly 46 Call @ 0.40

Net Cost = 10.35

1/28/2011 – XYZ @ 45.75 (up 0.75)

Long 1 XYZ Nov 35 Call @ 11.40 (+0.65)

Short 1 XYZ Jan Weekly 46 Call @ 0.00 (+0.40)

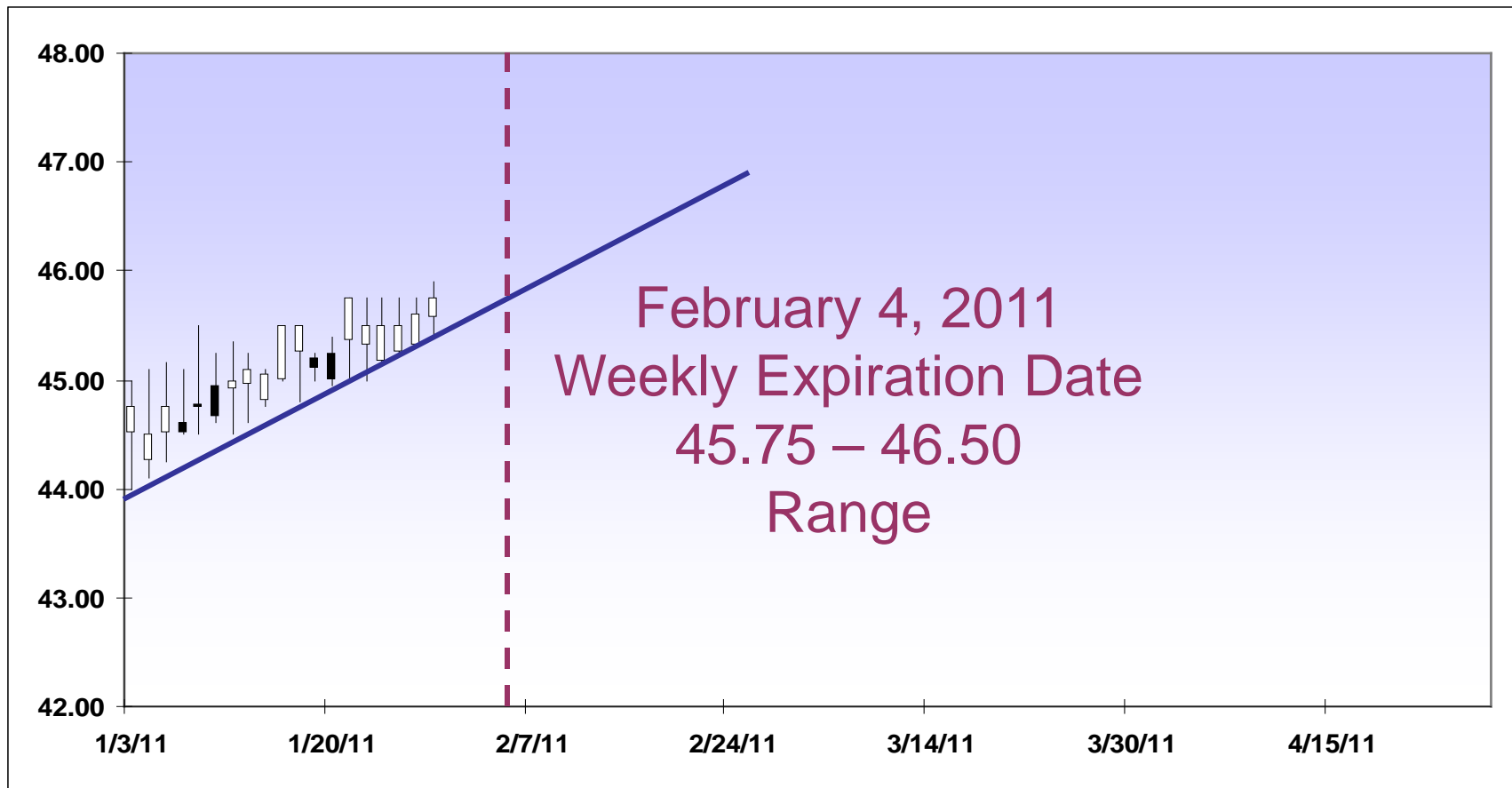
Initial Cost = 10.35

Current Value = 11.40

Running Profit = 1.05

Trend Following

1/28/2011 – XYZ @ 45.75



1/28/2011 – XYZ @ 45.75

Long 1 XYZ Nov 35 Call @ 11.40

Sell 1 XYZ Feb Weekly 47 Call @ 0.35

2/4/2011 – XYZ @ 46.00 (+0.25)

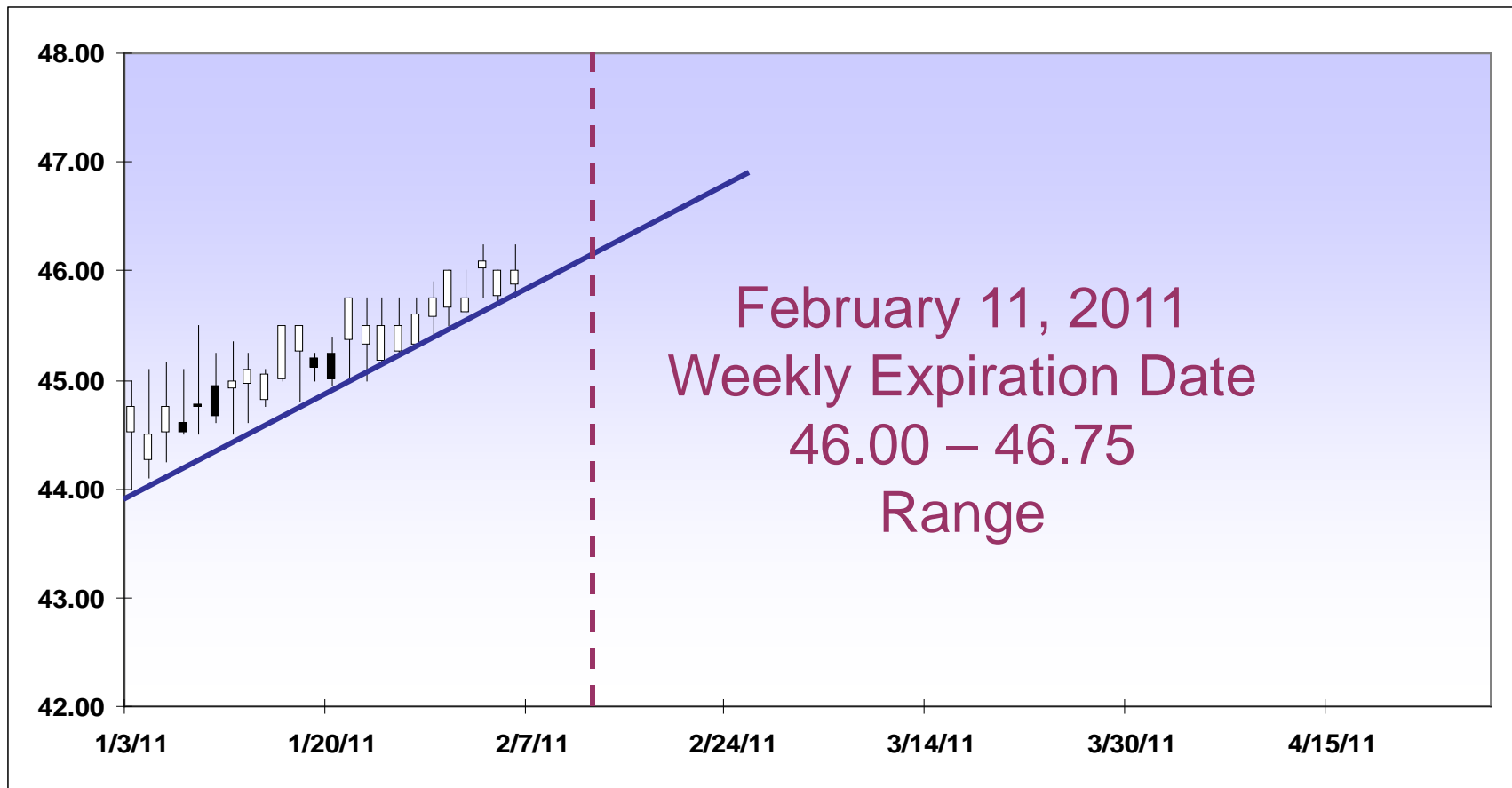
Long 1 XYZ Nov 35 Call @ 11.60 (+0.95)

Short 1 XYZ Feb Weekly 47 Call @ 0.00 (+0.35)

$$\begin{aligned} \text{Running Profit} &= \\ &+ 0.95 + 0.40 + 0.35 = +1.70 \end{aligned}$$

Trend Following

2/4/2011 – XYZ @ 46.00



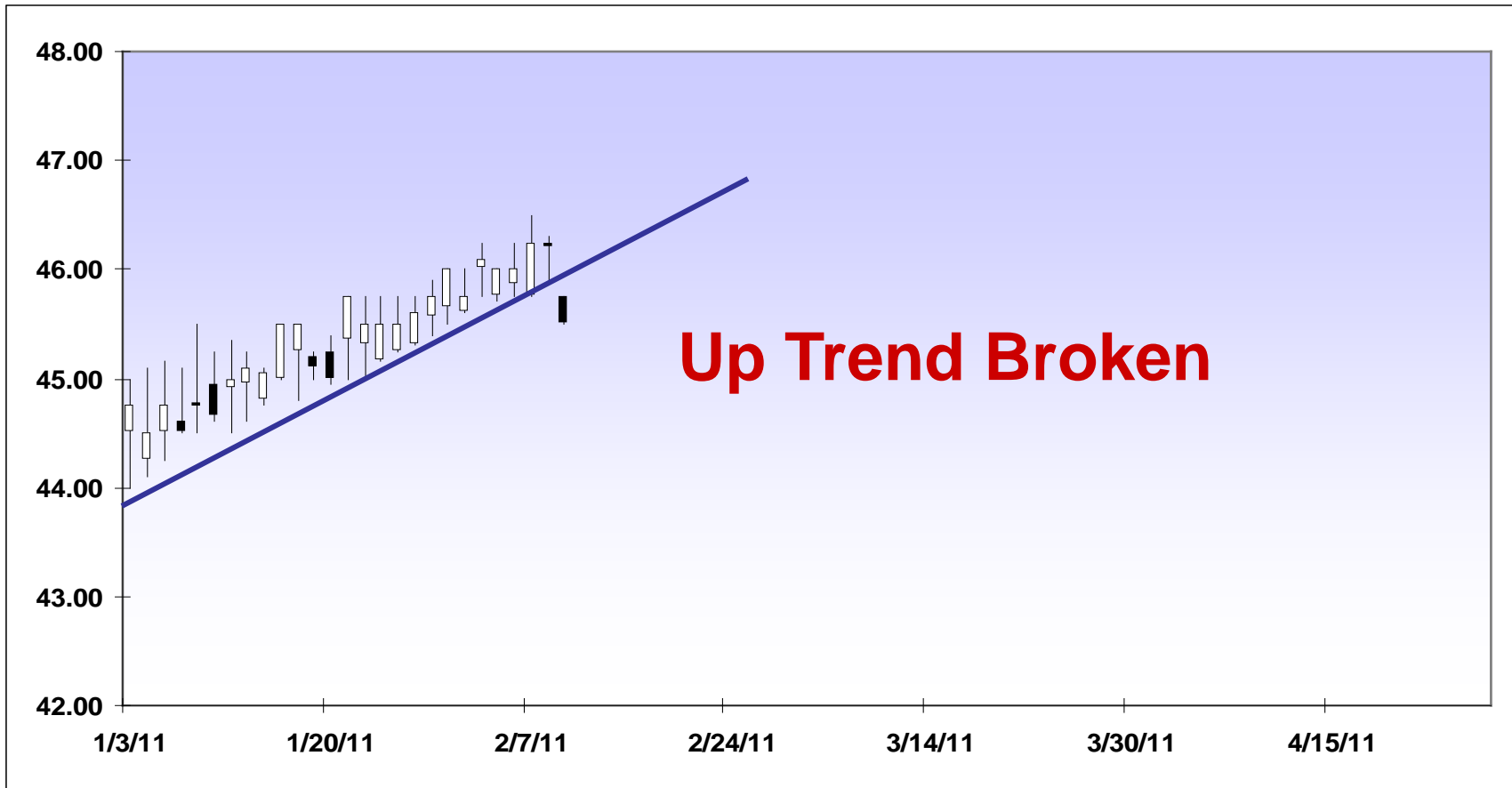
2/4/2011 – XYZ @ 46.00

Long 1 XYZ Nov 35 Call @ 11.60

Sell 1 XYZ Feb Weekly 47 Call @ 0.35

Trend Following

2/9/2011 – XYZ @ 45.75 (-0.25)



2/9/2011 – XYZ @ 45.75

Sell 1 XYZ Nov 35 Call @ 11.40 (+0.65)

Buy 1 XYZ Feb Weekly 47 Call @ 0.10 (+0.25)

Net Trading Profits –

$$+ 0.65 + 0.40 + 0.35 + 0.25 = +1.65$$

Summary –

- Bullish diagonal spread traded based on an uptrend in the underlying
- When trend was broken, trade was exited
- Although trend was broken cumulative profit was made on overall trade

Overbought / Oversold –

- Can be the result of a variety of technical indicators
- Also may be a stock that is trading in a defined range
- Involves buying and selling against the trend

Overbought / Oversold (Range) –



Overbought / Oversold (Range) –

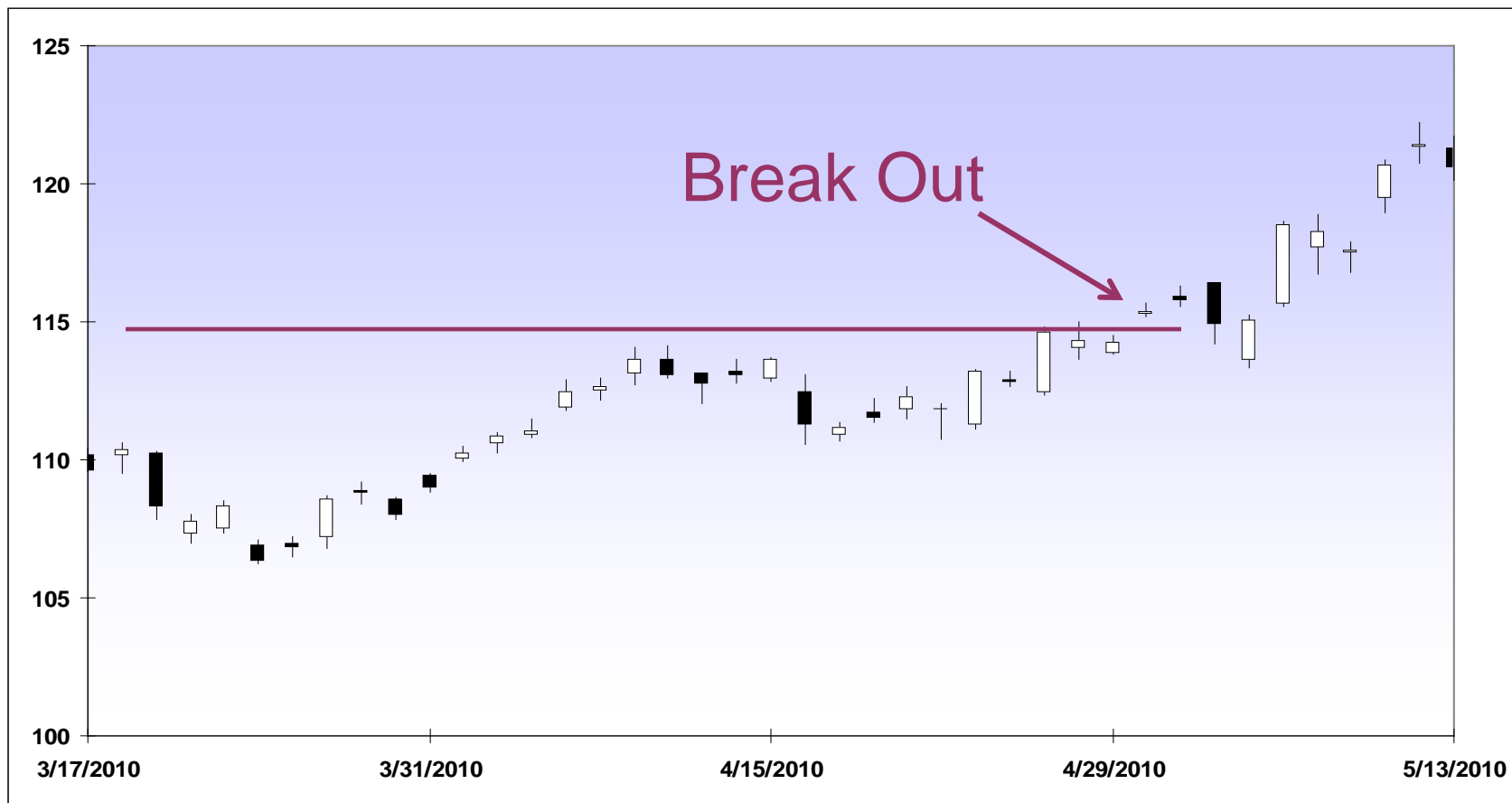


What can go wrong....a Break Out –

- When a stock makes a new high or low relative to a certain period
- Upside – break out
- Downside – break down
- Some traders consider this the beginning of a trend and try to capitalize on these price moves

Being on the the wrong side of a breakout
can be painful.

Break Out –



- XYZ Overbought according to the YFI
- YFI = Your Favorite Indicator
- Stock currently trading at 39.75
- August expiration in 20 days
- Thinking about a Bear Call Spread
- Want maximum profit under 40.00
- XYZ has dollar strikes!

XYZ August Call Quotes –

| Strike | Bid | Ask |
|--------|------|------|
| 40 | 1.20 | 1.25 |
| 41 | 0.75 | 0.80 |
| 42 | 0.50 | 0.55 |
| 43 | 0.30 | 0.35 |
| 44 | 0.20 | 0.25 |
| 45 | 0.10 | 0.15 |

Potential Vertical Spreads –

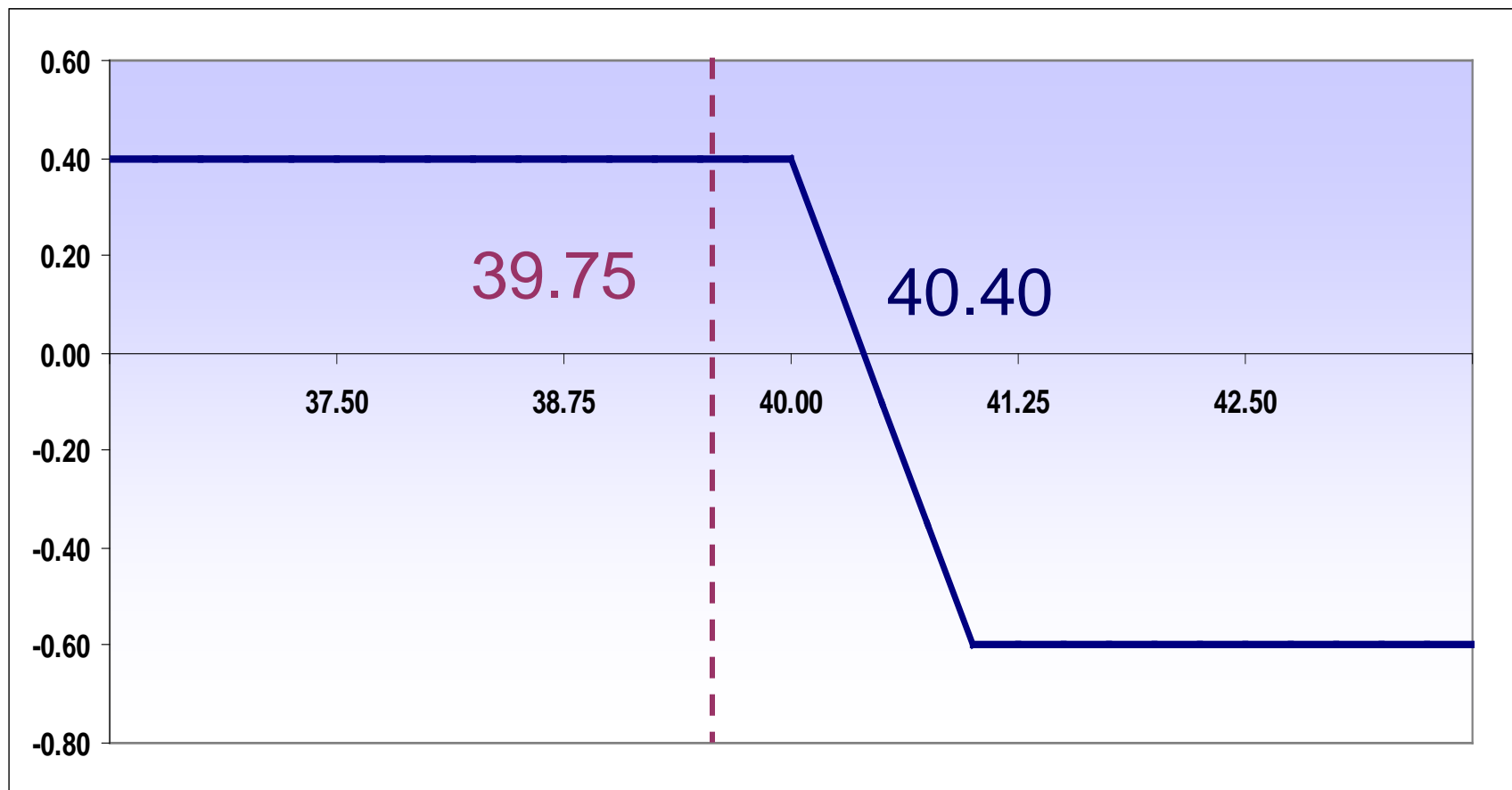
| Short | Long | Credit | Max Loss | Credit / Max Loss | Break Even |
|---------|---------|--------|----------|-------------------|------------|
| 40 Call | 41 Call | 0.40 | 0.60 | 66.67% | 40.40 |
| 40 Call | 42 Call | 0.65 | 1.35 | 48.15% | 40.65 |
| 40 Call | 43 Call | 0.85 | 2.15 | 39.53% | 40.85 |
| 40 Call | 44 Call | 0.95 | 3.05 | 31.15% | 40.95 |
| 40 Call | 45 Call | 1.05 | 3.95 | 26.58% | 41.05 |

Sell 1 Aug 40 Call @ 1.20
Buy 1 Aug 41 Call @ 0.80

Profit / Loss Table –

| XYZ | Short 40 Call | Long 41 Call | Credit | Profit / Loss |
|-----|------------------|-----------------|--------|------------------|
| 37 | 0.00 | 0.00 | 0.40 | 0.40 |
| 38 | 0.00 | 0.00 | 0.40 | 0.40 |
| 39 | 0.00 | 0.00 | 0.40 | 0.40 |
| 40 | 0.00 | 0.00 | 0.40 | 0.40 |
| 41 | (1.00) | 0.00 | 0.40 | (0.60) |
| 42 | (2.00) | 1.00 | 0.40 | (0.60) |
| 43 | (3.00) | 2.00 | 0.40 | (0.60) |

Profit / Loss Diagram –



Early Exit #1 –

- Hold to August expiration
- Mental stop if XYZ above 40.25

2 Days Later

XYZ Opens @ 40.40

Stock Gapped Up

XYZ @ 40.40

August expiration in 18 Days –

| Strike | Bid | Ask |
|--------|------|------|
| 40 | 1.45 | 1.50 |
| 41 | 0.95 | 1.00 |

Buy to Close 1 XYZ 40 Call @ 1.50 (0.30 loss)

Sell to Close 1 XYZ 41 Call @ 0.95 (0.15 gain)

Net Loss = 0.15

Early Exit #2 –

- Hold to August expiration
- Mental stop if XYZ above 40.25

5 Days Later

XYZ Opens @ 41.00

Again Stock Gapped Up

XYZ @ 41.00

August expiration in 15 Days –

| Strike | Bid | Ask |
|--------|------|------|
| 40 | 1.80 | 1.85 |
| 41 | 1.30 | 1.35 |

Buy to Close 1 XYZ 40 Call @ 1.85 (0.65 loss)

Sell to Close 1 XYZ 41 Call @ 1.30 (0.50 gain)

Net Loss = 0.15

Summary –

- Taking the other side of a price move that is considered 'overdone' is a risky strategy
- This is also known as counter trend trading
- Taking the other side of a trending security

Two types of stop loss orders

- Market stop – price hit or violated – result is a market order
- Stop limit – price hit or violated – result is a limit order

Stop Market Order –

- Price hit / violated result is an exit trade
- Trade is a market order
- Execution is certain
- Price of execution is uncertain

Stop Limit Order –

- Price hit / violated result is an exit order
- Trade entered as a limit order
- Execution uncertain
- If executed price is certain

Previous Example #1 –

- Short XYZ @ 39.75
- Stop price = 40.25
- XYZ Opened at 40.40

Buy stop order executed @ 40.40
0.15 worse than planned for stop price.

Previous Example #2 –

- Short XYZ @ 39.75
- Stop price = 40.25
- XYZ Opened at 41.00

Buy stop order executed @ 41.00
0.75 worse than planned for stop price

- All option trades should begin with a price outlook
- Additionally an option trade should have an exit plan that involves a target and stop loss
- The target may involve either time or price with options

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