User Guide

How To Get The Most Out Of Your Subscription
Welcome!

Thank you for subscribing!

As chief options strategist of **Cabot Options Institute Earnings Trader**, I want to welcome you on board!

Whether you are just getting started with options or have traded them for years, it’s my goal to teach you my statistically driven, mechanical approach to trading options around earnings.

Simply stated, I’m a quantitative trader. I use math to make all my trading decisions. Probabilities are a key factor in each and every trading decision, not just with earnings trades, but with all my options trades. And my hope is that by learning my statistical approach to options trading, you will have the ability to use the strategies learned to not only take advantage of earnings trades, but also take advantage of other opportunities the market has to offer.

For **Cabot Options Institute Earnings Trader** subscribers, this guide will provide both beginner and advanced traders the step-by-step guidance for making the most of the advisory’s abundance of resources.

I hope that through weekly webinars, alerts and updates you will quickly learn from my 25 years of professionally trading options.

At any time, if you have questions or comments, please do not hesitate to email me at Andy@CabotWealth.com.

Once again, it's great to have you on board. And I hope you find the service helpful in all your trading endeavors. I look forward to a long and profitable relationship.

Kindest,

Andy Crowder
Chief Analyst
**Cabot Options Institute Earnings Trader**
# What’s in this guide...

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Weekly Issues
Every Friday during earnings season, except for major holidays, we will get together for a live webinar. In each webinar we will discuss the trades made the prior week and the trades we are looking at for the following week. I will also answer any pertinent questions you may have regarding past trades, future trades or just anything options. Each webinar will be recorded and archived just in case you are not able to attend the live webinar.

Moreover, every Monday I will publish a weekly issue (even if it’s not earning season) that covers companies that are due to announce the following week. There are a few major companies that announce outside of the typical earnings season (e.g., Nike, etc.) and we will trade them from time to time if the trade makes sense. Each weekly issue will include the companies that I plan to focus on plus several other trade ideas for those that wish to trade a bit more often on their own.

Alerts
You will receive email alerts when market or trade conditions warrant it; during each earnings season I will issue between 1-4 alerts per week. Typically, I average about 8-10 alerts per earnings season.

Special Reports
Our catalog of Special Reports provides further options analysis that provides a deeper dive into trading strategies and tactics. Here you will find all of my step-by-step strategy guides for the strategies we use most frequently during earnings season, plus the statistical approach I use around each and every earnings trade.

24/7 Archives
Your subscription gives you access to our vast online library of analysis, including past weekly updates, reports, related webinars, and other educational content published by Cabot Wealth Network.

Direct Contact
Outside of our weekly live webinars where you can ask as many questions as you would like, whenever you have an investment-related question, you can also email me directly at Andy@CabotWealth.com. You can also call our Cabot Investor Services desk at 800-326-8826 anytime during business hours to speak with someone about your subscription. Or you can email our subscription support staff at Support@CabotWealth.com.
Our Investment Strategies | How We’ll Make You Money

For years and years, clients of mine asked if I could teach them how to effectively trade around earnings announcements. And for years and years I stated, no!

At the time, there were only 12 expiration cycles per year. Each expiration occurred on the third Friday of the month, so it made it hard to trade earnings announcements with any real precision.

But oh, how things have changed. The advent of weekly options was a game changer. Now we have the ability to trade earnings announcements with far more precision as 52 weekly expirations are available to us.

This is not a homerun trading service. We aim for singles and doubles. Statistical laws lead the way. I’ll explain in greater detail below.

**Implied Volatility (IV)**

Professional and retail investors look to hedge and speculate around earnings. As a result, demand for options typically spikes. And with that spike in demand comes a spike in implied volatility in the expiration cycle that falls immediately after a company announces. But most important is the spike in options prices due to the heightened volatility.

It’s like clockwork. We know it’s going to happen; we just don’t know how high a company’s IV will be from one quarter to the next. This is where a mechanical approach is helpful. It gets you into trades that give you the best opportunity for profits and keeps you out of trades where the odds aren’t in your favor.

**The Law of Large Numbers**

Earnings season trades are binary trades that typically last from one to seven days, usually leaning towards the former. Either the price movement after an announcement stays within the expected range or pushes outside of the range.

In most cases, each trade I place has, at least, an 80% probability of success. As a result, we know that as trade occurrences increase our win ratio should fall right around 80%. I’ve traded this strategy successfully for years with over 1000 trades and guess what my win ratio is … yep just over 80%. There is a reason why the Law of Large Numbers is, well, a statistical law, right?

But, just because you have a high win ratio doesn’t mean that you are going to be successful over the long term. I’ve known plenty of traders with high win ratios that still lose money hand over fist.

**Risk Management**

Risk management, as with any investment strategy, is a necessity. And because these are one-to-seven-day trades, the only true way to manage risk is through using a disciplined and consistent approach to position size. Every trader will have different levels of risk when using the strategy; I try to keep my position size between 1% and 5% per trade. By keeping my position size at reasonable levels, I am able to endure sequencing risk and can focus solely on the end goal … allowing the number of my trades to increase so the Law of Large Numbers has the ability to play out.

I discuss the importance of risk management in every single webinar. We must allow the statistics (Law of Large Numbers) to work itself out and the only way to do that is through a strict and disciplined approach to risk management.
Mechanics of the Trade

Before I place a trade, I must go through the mechanics of the screening process to make sure a trade makes sense. Once I go through each of these steps, I then have a clear picture of whether a trade makes sense. If it doesn’t, no worries, opportunities will always present themselves. Again, this is about pouncing on the best trades the market has to offer. Patience pays!

Step 1

The first aspect of placing a trade is knowing if the underlying of your choice has adequate liquidity.

Most traders don’t realize, but there are only 3,200 tradable stocks with options. Only 11% out of the 3,200 stocks have medium liquidity and only 3% of are considered highly liquid.

With just a few exceptions, I only focus on the 3% of highly liquid stocks.

As I stated above, at the end of each week during earnings season, I prepare a list of the upcoming earnings announcements for the week.

Step 2

The next step includes looking at the IV rank and IV percentile.

*IV Rank – tells us if current implied volatility (IV) is considered high or low on an underlying security in comparison to all other IV readings over the past 12 months.

IV rank is calculated by taking the highest IV reading and lowest IV reading over the past 12 months.

\[
\text{IV Rank} = \frac{\text{Current IV} - \text{1 Year IV Low}}{\text{1 Year IV High} - \text{1 Year IV Low}}
\]

For example, if a stock has an IV range between 40 and 80 over the past 12 months and the IV is currently 60, the stock would have an IV rank of 50%.

*IV Percentile – tells us the percentage of days that implied volatility (IV) has been below the current level of IV over the past 12 months.

IV percentile is a ranking system from 0-100.

For example, if a stock has a current IV percentile of 80%, it simply means that the current level of IV is higher than 80% of all IV readings over the past 12 months.

Understanding the difference between the two and how to effectively use each measure is important, not only during earnings season, but also outside of earnings season.

When I am trading around earnings, I use both measures and typically want to see a reading around 50%, if not higher.
Step 3

Once I’ve found a candidate with an acceptable IV rank and IV percentile, I then move over to my platform to take a look at the expected move for the stock.

What is the expected move? The expected move, otherwise known as the expected range, is the amount a stock is predicted to advance or decline from its current share price, based on the security’s current level of implied volatility and days to expiration. Additionally, the expected move fluctuates, in real time, based on changes in a security’s price and its implied volatility.

Simply stated, the expected move shows us the future expected range of a security over a specific time frame.

For the most accurate reading I look at the nearest-term expiration cycle. I include an image of the expected move with each and every trade placed.

For example, if a stock is due to announce earnings after the close on a Tuesday, I want to look at the expected move for the expiration cycle that Friday.

There is one exception, if a stock is due to announce on a Wednesday through Friday, I will take a look at the expiration cycle one week out.

Step 4

After I know the expected move, I move on to the historic price movements around the last 12 earnings cycles and compare it to the current percentage of the expected move. I also look at the Earnings Volatility Ranking (EVR).

EVR is ranked from 1 to 10 with one being the least volatile around earnings and 10 being the most volatile around earnings. Knowing if the EVR reading is high or low gives me insight into which strategy I will use.

Step 5

If my potential candidate meets all the aforementioned criteria, I swiftly move over to my strategy. I almost always use risk-defined options strategies like bear call spreads, bull put spreads and iron condors when I place earnings season trades. However, in addition, I will use an undefined-risk strategy like a short strangle from time to time. This is a more advanced approach and should only be used by traders who understand the risks involved and have a disciplined approach to risk management.

Overall, I would say iron condors are my favorite strategy to use and will be the strategy of choice for well over 90% of the trade alerts you will receive. Again, for more advanced traders that prefer to use short strangles, I will also send an associated short strangle alert as well. If you are not familiar with the iron condor strategy or short strangle, please make sure to read the associated reports on both strategies.
The Strategies    Iron Condor

Focus on the mechanics of the strategy. Timeframes will vary from trade to trade.

The basic premise of an iron condor is simple. I place the range of my iron condor outside the range of the expected move.

Moreover, I want my probability of success to be greater than 80% on both the call side and put side of my iron condor. I aim to make a return anywhere from 10% to 35% per trade.

Let’s go through an example using Nike (NKE).

The company was due to announce after the closing bell on March 21.

Here is how Nike had performed immediately following earnings dating all the way back to March 21, 2007.

As you can see, Nike has a recent history of being volatile from time to time when its earnings are released. But that’s OK—it’s always good to see what a trade is offering us, particularly one that might seem a bit more aggressive given Nike’s history around earnings. But if the premium and probabilities make sense, well, we might have a nice opportunity at hand.

But we have no idea until we take a closer look.

**Iron Condor Earnings Trade in Nike (NKE)**

Nike (NKE) was due to announce after the close March 21. So again, let’s take a look at a potential trade using a risk-defined options strategy like an iron condor.

At the time we looked to place a trade the stock was trading for 126.33.
The next item is to look at NKE’s expected move for the expiration cycle that I’m interested in.

The expected move or expected range over the next eight days can be seen in the pale, orange-colored bar below. The expected move is from 116 to roughly 137, for a range of $21.

Knowing the expected range, I want to, in most cases, place the short call strike and short put strike of my iron condor outside of the expected range, in this case outside of 116 to 137.

This is my preference most of the time when using iron condors, or short strangles for that matter.
If we look at the call side of NKE below for the March 25, 2022, expiration, we can see that the 140 call strike offers an 85.70% probability of success. So, for this example, we sold the short call at the 140 call strike and defined our risk with the 145 call strike. By choosing the 145 call strike to define our risk, we know that there less than 10% chance that NKE will push above 145 prior to or at expiration. We know this by taking the probability of success of the 145 strike which is 91.94% and subtract it from 100%.

Now let us move to the put side.

Same process as the call side. But now we want to find a suitable strike below the low side of our expected move, or 116. The 111 put strike, with an 85.27% probability of success, works as our short put strike. I'm going to stick with a 5-wide spread on the put side as well so the 106 put strike will define our probability of success on the downside. The 106 put strike has an 91.47% probability of success. This means there is less than a 9% chance of taking a max loss on the downside portion of the trade.

Overall, we can create a trade with a nice probability of success if NKE stays between our 29-point range, or between the 140 short call strike and the 111 short put strike. Our probability of success on the trade is 85.70% on the upside and 85.27% on the downside.

Here is what the actual trade looks like:

Simultaneously:

**Sell to open NKE March 25, 2022, 140 calls**

**Buy to open NKE March 25, 2022, 145 calls**

**Sell to open NKE March 25, 2022, 111 puts**

**Buy to open NKE March 25, 2022, 106 for roughly $0.95 or $0.95 per iron condor**

Our margin requirement is $405 per iron condor.
Return on the trade is 23.5%.

Again, the goal of selling the NKE iron condor is to have the underlying stock stay below the 140 call strike and above the 111 put strike immediately after NKE earnings are announced.

Here are the parameters for this trade:

- The Probability of Success – 85.70% (call side) and 85.27% (put side)
- The maximum return on the trade is the credit of $0.95, or $95 per iron condor; that’s a 28.2% return per iron condor
- Break-even level: 140.95 – 110.05
- The maximum loss on the trade is $405 per iron condor. We always adjust if necessary, and always stick to our stop-loss guidelines. Position size, as always, is key.

But before I pull the trigger, let’s take a look what our margin of error is on the upside and downside.

With NKE trading for roughly 126.33, our short 140 call strike is roughly 14 points away for an 11% margin of error.

On the downside, our short 111 put strike is also roughly 15 points away, for a 12% margin of error.

As you can see in the image below, the following day after the earnings announcement the iron condor could be closed for $0.16, for an 18.8% return, based on our trading guidelines.
Short Strangle

Remember, focus on the mechanics of the trade. Timesframes will vary.

A short strangle is a neutral, range-bound options strategy (short call and short put) that has undefined risk and limited profit potential. Typically, a short strangle has little to no directional bias. And, like most options selling strategies, short strangles benefit from a decline in implied volatility (IV) and passage of time (time decay).

Strangles require more capital. The reason is because we are selling naked options on both sides. But don’t let that scare you.

In return for the larger capital outlay, an options trader is rewarded with one of the highest-probability options strategies in the investment universe. I’m talking an 85% probability of success. But hey, that’s one of the great things about selling options, using defined or undefined options strategies: you get to choose your probability of success on every trade you place.

But there is one important caveat when trading short strangles.

Short strangles only work for the disciplined options trader. If you are not disciplined when it comes to risk management, naked options aren’t for you. I would suggest looking at iron condors. Iron condors are risk-defined.

That said, I would question why bother trading options or stocks if risk management isn’t your #1 priority, regardless of the strategy you choose. Just go to the casino. Use the numbers in front of you to make sound decisions. Allow the probabilities to lead the way ... all you need to do is create a disciplined risk-management approach and the Law of Large Numbers will take over. You will hear me say this repeatedly—all successful options traders have a rigid risk-management plan. Without it, failure is inevitable.

But I can’t emphasize enough: If you have the capital (taking position size into account) and look at yourself as a risk manager first and options trader second, well, this could be your new favorite strategy. There is a reason short strangles are the bread-and-butter options strategy for most professional options traders.

Let’s look at an example on how a short strangle works around an earnings announcement.

As I said before, strangles, like all options selling strategies, benefit from a decline in implied volatility (IV) and passage of time (time decay). Our steps are the same as with the iron condor example mentioned above.

So, the first step is finding a highly liquid stock or ETF that has a heightened level of implied volatility.

Look no further than the current IV rank and IV percentile of the stock.

IV rank tells us if the current level of volatility in a stock is higher comparable to the levels over the past year. Since we are selling options in the form of a short strangle, we prefer options prices to be inflated.

IV percentile tells us the percentage of days that implied volatility has traded below its current level of implied volatility over the past year.

So, let’s take a look at a sample trade to understand the mechanics of the strategy better.
At the time of the trade Intel was trading for 55.96.

The next item is to look at INTC's expected move for the expiration cycle that I'm interested in.

The expected move or expected range over the next 7 days can be seen in the pale, orange-colored bar below. The expected move is from 51.50 to roughly 60.50, for a range of $9.00.

Knowing the expected range, I want to, in most cases, place the short call strike and short put strike of my short strangle outside of the expected range, in this case outside of 51.50 to 60.50.

This is my preference most of the time when using strangles. I want my short strangle to have a high probability of success.
If we look at the put side of INTC for August expiration, we can see that the 51 strike offers a 75.48% probability of success and the 50 put strike offers us an 80.75% probability of success. And hey, I might even consider the 49 put strike, with better than an 85% probability of success. All three are below the lower edge of INTC’s expected move, or 51.50.

Now it’s just a matter of what kind of return we are looking for on the trade. In this example, I’m going with the 50 put strike.

Now let us move to the call side. Same process as the put side. But now we want to find a suitable strike above the high side of our expected move, or 60.50. The 61, with an 85.60% probability of success, works.

We can create a trade with a nice probability of success if INTC stays between our 11-point range, or the 61 call strike and the 50 put strike. Our probability of success on the trade is 85.60% on the upside and 80.75% on the downside.

Here is an example of what the trade looks like:

Simultaneously:

Sell to open INTC August 21, 2021, 61 calls

Sell to open INTC August 21, 2021, 50 puts for roughly $1.01
Our margin requirement is $751.74 per short strangle.

Again, the goal of selling the INTC short strangle is to have the underlying stock, in this case INTC, stay below the 61 call strike and above the 50 put strike through expiration in 7 days. Although, in most cases I will look to take the trade off immediately after earnings are announced.

Here are the parameters for this trade:

- The Probability of Success – 85.60% (call side) and 80.75% (put side)
- The max return on the trade is the credit of $1.00, or 13.3%
- Break-even level: 49 – 62
- The maximum loss on the trade is in theory unlimited.

Remember, we will adjust if necessary and always stick to our stop-loss guidelines. Position size, as always, is key.

As you can see in the image below, the following day after the earnings announcement the iron condor could be closed for $0.57, for an 5.9% return on capital ($751.74 per short strangle), based on our trading guidelines.

Short strangles offer options traders one the highest probability strategies out there. And that’s why they are one of the strategies of choice amongst professional options traders. Undefined risks strategies can be scary for the uninitiated. But if you understand the risk of the strategy and are diligent with your risk management a whole new world of trading has just opened up.
Frequently Asked Questions

Can you recommend options brokers?
I use Tastyworks and Thinkorswim, although you will find that there is a plethora of good brokers out there that offer excellent platforms, I have found these to be the best in the business. That said, I have no additional relationship with them, nor is this an endorsement. Whatever broker you choose, make sure you are paying a competitive rate on commissions. You also want a broker that offers a good trading platform and the ability to speak with someone on the trading desk. All of this will be helpful in your future trading endeavors.

How much capital should I start with?
The beautiful thing about options is it doesn't take much capital to gain large market leverage. You certainly don't need more than $500 to put on many of the trades I suggest, though many of my readers trade much higher amounts.

I missed your recommended price. Should I trade at the current price?
With each trade recommendation, I lay out my thesis. It's then up to you to decide if it's a good enough idea for you to make the trade. And if you like the thesis, you need to decide how much capital to allocate to the trade, and at what price, based on your feel for the market and your investment goals.

Because earnings season trades are timely, it is important not to chase trades. There will be trades where you get a better price and some where the price isn't as good as stated in the alert. That is the nature of trading. Ultimately, it is up to you to decide what price you are willing to take. This is something that we will go over each week in our live webinars, not just for price entry, but for exit price as well.

How long do you hold your trades after earnings are announced?
In most cases I get out of my trade shortly after the opening bell. Earnings are either reported after the closing bell the day before or prior to the opening bell. Again, it is my goal to send out an alert shortly after the opening bell. Prices will move quickly so it is imperative that you have the ability to place the trade once the alert is sent either through email, text, or both.

How much should I allocate to each trade?
This is an incredibly important question and one that I must take some time to answer. Please don't take position size lightly if you plan on being a successful trader over the long term.

It doesn't matter if you are just starting or have an advanced grasp of all things options, if you don’t think of yourself as a risk manager first, you will fail, it's just a matter of time.

Proper risk management is what separates those that succeed from those that continually struggle or simply just give up.

What people continue to struggle with is trying to find the latest and greatest strategy, constantly hopping from one strategy to the next. Strategy is far less important, than proper risk management.

Placing trades, well, it's the easiest part of the trading process. Anyone can place a trade. It’s how you handle the trade that allows you to be profitable over the long term.
Which is why you MUST think of yourself as a risk manager first, especially if you are taking a truly quant-based approach. The law of large numbers is your foundation but managing sequence risk is the obstacle that most traders just can’t overcome.

Sequence risk is the inherent risk that a trader could suffer multiple losses in a row. The best way to combat sequence risk is through proper position sizing. Position sizing mitigates the impact of consecutive losses. The lower the capital risked per trade, the lower the probability that a sequence of losing trades will cause a significant drawdown.

The table below shows how sequence risk can impact your overall account and why it is imperative that you use proper position size when investing/trading.

<table>
<thead>
<tr>
<th>Probability of Success</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>50%</td>
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<td>1:4</td>
<td>1:32</td>
<td>1:1024</td>
<td>1:10.4M</td>
</tr>
<tr>
<td>60%</td>
<td>1:3</td>
<td>1:7</td>
<td>1:98</td>
<td>1:9537</td>
<td>90.9M</td>
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<tr>
<td>70%</td>
<td>1:4</td>
<td>1:11</td>
<td>1:412</td>
<td>1:169350</td>
<td>1:28T</td>
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<tr>
<td>80%</td>
<td>1:5</td>
<td>1:25</td>
<td>1:3125</td>
<td>1:9.7M</td>
<td>1:100T</td>
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<td>90%</td>
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<td>1:10000</td>
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Again, we know losing trades are going to occur. It’s a hard fact that we must accept. So, trades must be managed appropriately. And the first step is proper position size.

The most important decision you will make as a successful options trader is how much to allocate per trade. From a risk-management standpoint, maintaining a consistent position size among your trades is of the utmost importance. We want to limit the havoc that one trade could have on our portfolio.

<table>
<thead>
<tr>
<th>Account Balance</th>
<th>1%</th>
<th>2%</th>
<th>3%</th>
<th>4%</th>
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</tr>
</tbody>
</table>

For simplicity’s sake, let’s say our trading account stands at $10,000 in this example.

In one case, we have allocated 50% per trade. In the other, we have allocated 5% per trade.
$10,000 Account (50% allocated per trade):

One position, equally weighted at $5,000. So, with each trade, a 10% drop will cause a 5% drop in our overall portfolio. A 20% drop will cause a 10% drop, 30% would be 15% . . . you get the picture.

Just knowing this gives every options trader the insight necessary to shape a position size and stop-loss strategy for maximum effectiveness.

Let's say with each trade we set our stop-loss order at 50% of our allocated amount. For example, with 50% allocated to each trade, our stop loss would be set at $2,500.

Two trades would only allow us to diversify among two positions with 50% of our overall portfolio value at risk.

$10,000 Account (5% allocated per trade):

One position, equally weighted at $500. So, with each trade, a 10% drop will cause a 0.5% drop in our overall portfolio. A 20% drop will cause a 1% drop, 30% would be 1.5% . . . again, you get the picture.

Our stop-loss with 5% allocated per trade is $250.

For example, if we had four iron condor trades open simultaneously, we would have $2,000 in play with only $1,000 or 10% of our overall portfolio at risk.

Worst-Case Scenario

If we assume our position size of $500 per trade and had four trades going at one time, our maximum loss is 10% or $1,000 of our overall portfolio (barring a catastrophic gap up or down that bypasses stop-loss levels).

A 10% loss in the portfolio would need a 11.11% overall gain to make up for the loss.

Summary

I realize the prior exercise is fairly simplistic. Again, it only begins the important discussion of money management. Without some form of money management, emotions take over.

And emotions are the enemy. Hindsight never exists in the present. We must realize that we will be wrong on occasion.

Being privy to this allows us to prepare accordingly. We know over the long term that having a defined stop loss will only serve to benefit the performance of our respective portfolios. More importantly, we always know when to sell. Of course, all of the above assumes that we prefer the straight percentage stop-loss.

If you want to be a successful trader/investor over the long term, then taking the time to figure out an appropriate position-sizing plan is imperative. Please, please, please do not overlook this important concept.

You will not regret it.
Options jargon and terminology can sometimes sound like a foreign language. Here are a few terms that are commonly used in the investment methods discussed in *Cabot Options Institute Earnings Trader*.

**Call Option**

A call option gives its holder the right to buy 100 shares of the underlying security at the strike price, any time prior to the option's expiration date. The seller of the option has the obligation to sell the shares.

**Exercise**

Exercise is the process by which an option holder invokes the terms of the option contract. If exercising a call, the holder will buy the underlying stock, while the put owner will sell the stock under the terms set by the option contract. All option contracts that are in-the-money by at least one cent at expiration will be automatically exercised.

**Expected Move or Expected Range**

The expected move, otherwise known as the expected range, is the amount a stock is predicted to advance or decline from its current share price, based on the security's current level of implied volatility and days to expiration. Additionally, the expected move fluctuates, in real time, based on changes in a security's price and its implied volatility.

Simply stated, the expected move shows us the future expected range of a security over a specific time frame.

**Expiration Date**

The expiration date is the last day an option exists. Monthly options cease trading on the third Friday of each month and expire the next day. Weekly options cease trading on the Friday of the week they are due to expire.

**IV Percentile**

IV Percentile – tells us the percentage of days that implied volatility (IV) has been below the current level of IV over the past 12 months. IV percentile is a ranking system from 0-100. For example, if a stock has a current IV percentile of 80%, it simply means that the current level of IV is higher than 80% of all IV readings over the past 12 months.

**IV Rank**

IV Rank – tells us if current implied volatility (IV) is considered high or low on an underlying security in comparison to all other IV readings over the past 12 months. IV rank is calculated by taking the highest IV reading and lowest IV reading over the past 12 months.

**Law of Large Numbers**

The foundation of all quantitative or statistically-based options traders rests on one statistical law – The Law of Large Numbers. The Law of Large Numbers states that as you increase your sample size, in our case number of trades, our expected value or probability of success will come to fruition. This is because the Central Limit Theorem shows us that actual values will converge on expected values. But, in order for the Central Limit Theorem to work, we need a large enough sample size or number of observations—in our case, trades. This is where the Law of Large Numbers comes in.
Option

An option is a contract that conveys to its holder the right, but not the obligation, to buy (in the case of a call) or sell (in the case of a put) shares of the underlying security at a specified price (the strike price) on or before a given date (expiration day). After this given date, the option ceases to exist. Equity option contracts usually represent 100 shares of the underlying stock.

Options Premium

An options price is called the “premium.” The potential loss for the holder of an option is limited to the initial premium paid for the contract. On the other hand, the seller of the option has unlimited potential loss that is somewhat offset by the initial premium received for the contract.

Probability of Success or Probability of Profit?

When selling options, we have the ability to choose our own probability of success on every trade we place. The probability of success simply means the probability of our chosen call or put strike, or both, to close at expiration, out-of-the-money.

Probability of Touch

The probability of touch may be a new concept to some investors/traders, but it certainly isn't to those that trade options. The probability of touch tells us the probability of an underlying stock touching a specific price over a specific timeframe.

Put Option

A put option gives its holder the right to sell 100 shares of the underlying security at the strike price, at any time prior to the option’s expiration date. The seller of the option has the obligation to buy the shares.

Strike Prices

Strike Prices (or exercise prices) are the stated price per share for which the underlying security may be purchased (in the case of a call) or sold (in the case of a put) by the option holder upon exercise of the option contract.

Time Decay

All options are a wasting asset whose time value erodes to zero by expiration. This erosion is known as time decay. Generally, the longer the time remaining until an option’s expiration, the higher the premium will be. This is because the longer an option’s lifetime, the greater the possibility that the underlying share price might move so as to make the option in-the-money. This time decay increases rapidly in the last several weeks of an option’s life as the likelihood of it finishing in the money declines.
About the Expert

Andy Crowder is a professional options trader, researcher and chief options strategist of Cabot Options Institute Earnings Trader. Formerly with Oppenheimer & Co. in New York, Andy has leveraged his investment experience to develop his statistically based options trading strategy which applies probability theory to option valuations in order to execute risk-controlled trades.

His proprietary strategies have been refined through two decades of research and real-world experience and have been featured in the Wall Street Journal, Seeking Alpha, and numerous other financial publications.

As a professional options trader, Andy has helped thousands of option traders learn and implement his meticulous rules-driven options trading strategies through highly attended conferences, one-on-one coaching, webinars, and his work as a financial columnist.

He currently resides in Bolton Valley, Vermont and when he’s not trading, teaching and writing about options, he enjoys spending time with his wife and two daughters, backcountry skiing, biking, running and enjoying all things outdoors.
About Cabot Wealth Network

Cabot Wealth Network, established in 1970, is a trusted independent source of advice for individuals striving to take control of their investments and find the best stocks. Its investment advisory services deliver high-quality advice to more than 200,000 individual investors and investment professionals in 141 countries. Headquartered in historic Salem, Mass., Cabot Wealth employees take great pride in providing intelligent investment advice and timely, personal service without the hype and fabricated claims. Cabot is a member of the American Association of Individual Investors, Better Business Bureau, Specialized Information Publishers Association, and the Salem Chamber of Commerce.