OptionsTradingIQ

22 QUICKFIRE LESSONS IN TRADING OPTIONS

10 years of trading experience compacted into easy to digest lessons

By Gavin McMaster

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This ebook is dedicated to [].

www.optionstradingiq.com

1. VXX IS NOT FOR BUY AND HOLD

If you've read my book on option volatility [insert link], you'll be well aware of the historical performance of some of the volatility Exchange Traded Notes, including VXX.

VXX is not designed as a buy and hold investment, it's designed to be used as a very short-term volatility hedge. Anyone holding this ETN for more than a day or two needs to have their head examined.

Just take a look at the split adjusted performance of VXX since inception. Now that's a product that I wouldn't mind selling short!!

VXX has been split a number of times, it didn't actually start trading at 6693. However, any way you look at it the performance has been absolutely dire for anyone who has held this for the long term. From 6693, VXX has now dropped down to 42.70 for a fabulous return of -99.36%.

The reason VXX has performed so badly is due to the cost of rolling the futures to maintain a constant maturity date. To understand you need to understand a little about contango and backwardation. If you're interested in the details, you can read more here.

2. BE AWARE OF GAMMA RISK

Gamma is the ugly step child of option greeks. You know, the one that gets left in the corner and no one pays any attention to it? The problem is, that step child is going to cause you some real headaches unless you give it the attention it deserves and take the time to understand it.

Gamma represents the amount that an options delta will change given a 1 point move in the underlying. Trades with a high gamma will see rapid changes to their delta. Gamma is higher for shorter dated options which is why the last week of an options life is known as "gamma week"

Gamma is the reason so many novices get crushed when trading weekly options. They start out with a perfectly delta neutral iron condor, but then as soon as the price moves, their delta gets way out of line.

Trades like butterflies and
ars that have a steep point in the middle of their profit graph will have high gamma.

If you have negative gamma, you want the stock to not move around much and if you have positive gamma, you want large movements in the price of the stock.

Gamma scalping is a popular strategy with market makers, but it requires a lot of capital and a very good understanding of the options markets.

You can read more about gamma as well as follow along with my gamma scalping case study here.

3. COMMISSIONS ADD UP

How much you pay in commissions and trading fees are a major factor that impacts your bottom line as a trader. If you're not paying attention, these costs can quickly add up, especially if you are trading commission intensive strategies such as iron condors.

Iron condors are one of my favorite strategies and the fundamental building block for a lot of professional traders. However, each time you enter a trade, you are trading 4 separate option chains and most brokers will charge a trading fee for each. If you are trading a large number of contracts, those fees can be significant. Remember, that you will incur fees on entry, exit and any adjustments.

Assuming you are trading a 10 lot iron condor, that's 40 contracts on entry and exit, plus adjustments.

Every broker will have a different commission structure. You want to make sure you are getting a good deal. Interactive Brokers and Thinkorswim are the two best brokers and they provide great value for money. Optionshouse is a very cheap broker but they don't offer the same service as the other two and their platform is not as good.

If you are paying much more than $1 per contract you are getting ripped off.

4. BE AWARE OF EARLY ASSIGNMENT

If you've never had an option you are short exercised early, I can tell you it is not a fun experience. It has happened to me only once, thankfully it wasn't disastrous, but I had an email from a novice trader once who let a call credit spread get too close to the money. He ended up getting assigned on the short calls and lost around 90% of his account! Consider yourself warned!

My experience was with a butterfly trade on SPY. I should have been aware that the ETF was going ex-dividend shortly, but I ended up being assigned on the short calls which left me short 200 shares and long one in-the-money and one out-of-the-money option. Thankfully I only lost a few hundred dollars on that one, but it was still a painful lesson.

Just remember that **ANY** time you are short an American style option, you are at risk of being exercised. It is most likely to happen if your option is in-the-money. After all, why would a buyer exercise an option to buy a stock for more than they could buy it directly in the market.

When an option holds time premium, it generally makes sense of the option owner to sell the option in the marketplace rather than exercise the option. The exception is when a stock is about to go ex-dividend. If the dividend is larger than the time premium left in the call, it may make sense for a call option owner to exercise the option, become the owner of the stock at records date and receive the dividend. Make sure you keep an eye on your dividend dates when trading American style options, particularly as you get close to expiry when time premium is diminishing.

5. KNOW YOUR VOLATILITY INDEXES

When people talk about market volatility, they are generally referring to the broader market and the most common measure is VIX. This is referred to as the Fear Index due its characteristic of gauging future price volatility (high volatility often signals financial crisis).

However, volatility of the instrument you are trading could be slightly different. For example, Nasdaq, Russell 200 and Dow Jones volatility will all be different to the S&P 500 (the index on which VIX is based).

Below is a list of some of the major volatility indexes provided by the CBOE. Note that they now have volatility indexes on some major stocks too!

- VIX – S&P 500 Volatility Index
- VXST – Short-term Volatility Index
- VXV – 3-Month Volatility Index
- VXAZN – Equity VIX on Amazon
- VXAPL – Equity VIX on Apple
- VXGS – Equity VIX on Goldman Sachs
- VXGOG – Equity VIX on Google
- VXIBM – Equity VIX on IBM
- EVZ – Euro Currency Volatility Index
- GVZ – Gold ETF Volatility Index
- OVX – Crude Oil ETF Volatility Index
- VXEEM – Emerging Markets ETF Volatility Index
- VXSLV – Silver ETF Volatility Index
- VXFXI – China ETF Volatility Index
- VXGDX – Gold Miners ETF Volatility Index
- VXEWZ – Brazil ETF Volatility Index
- VXXLE – Energy Sector Volatility Index
- VXD – Dow Jones Volatility Index
- RVX – Russell 200 Volatility Index
- VXN – Nasdaq 100 Volatility Index

6. LEARN THE MAJOR CANDLESTICK PATTERNS

Whether you put any trust in technical analysis or not, it can be worthwhile to at least be aware of some of the major candlestick patterns. Try not to become overwhelmed by the sheer number of patterns. With complicated names such as Harami, Doji and Shaven Bottom (really??) it's easy to become exhausted trying to master this subject.

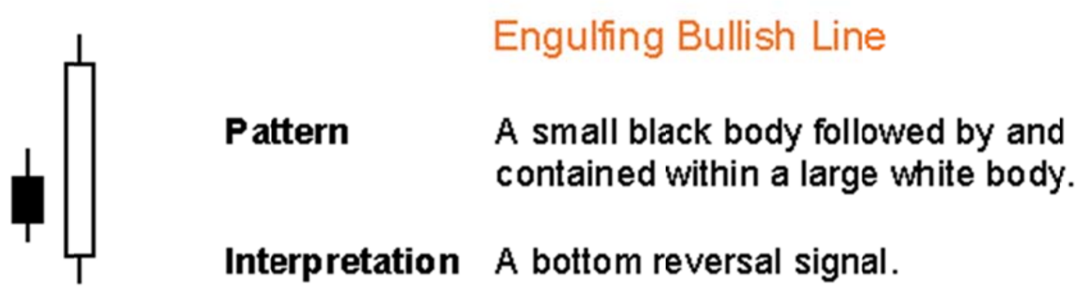
There are many candlestick patterns but only a few are actually worth knowing. Here are some of the most important candlestick patterns that will help you with your options trading.

It's important to note that you really need to use these candlestick patterns in conjunction with other forms of technical analysis. If you notice a bullish pattern, is the chart oversold on the daily timeframe? Where are the moving averages? When you spot a candlestick pattern, and 1-2 other forms of technical analysis agree with your hypothesis, you can give more weight to the pattern.

These are 7 patterns that I have found to be the most useful and reliable:

ENGULFING PATTERNS

This pattern consists of two candles. The first day is a narrow range candle that closes down for the day. The second day is a wide range candle that "engulfs" the body of the first candle and closes near the top of the range. The buyers have overwhelmed the sellers Buyers are ready to take control of this stock! The opposite is true for a bearish engulfing candle.



Engulfing Bearish Line

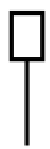
Pattern A small white body followed by and contained within a large black body.

Interpretation A top reversal signal.

HAMMER PATTERNS

Bullish hammers are reversal patterns. If you see a bullish hammer in a downtrend, it is a sign that buyers have taken the momentum away from the sellers.

Hammer



Pattern A small body near the high with a long lower wick with little or no upper wick.

Interpretation A bullish pattern during a downtrend.

Inverted Hammer

Pattern An upside-down hammer with a white or black body.

Interpretation A bottom reversal signal with confirmation the next trading bar.

DOJI

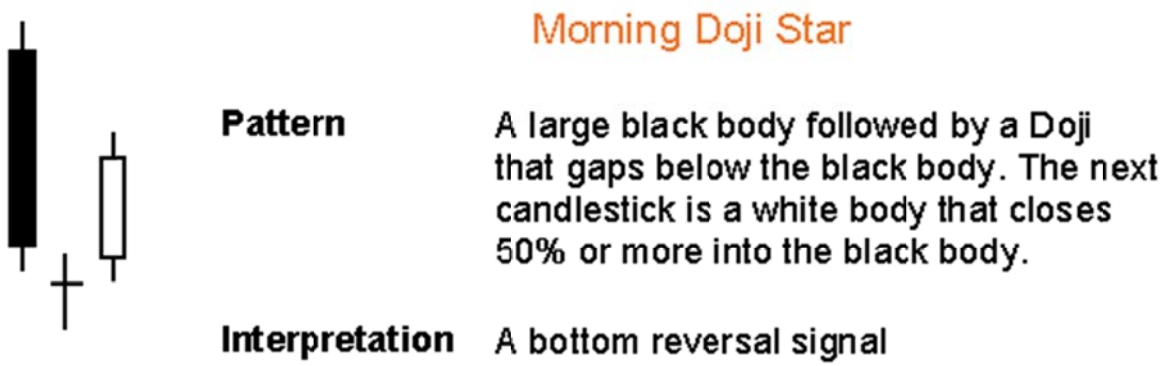
Doji’s are commonly referred to candlestick patterns. The stock opens up and goes nowhere throughout the day and closes right at or near the opening price. Quite simply, it represents indecision and causes traders to question the current trend. This can often trigger reversals in the opposite direction.

Doji Star

Pattern	A Doji which gaps above or below a white or black candlestick.
Interpretation	A reversal signal confirmed by the next candlestick (eg. a long white candlestick would confirm a reversal up).

Evening Doji Star

Pattern	A large white body followed by a Doji that gaps above the white body. The third candlestick is a black body that closes 50% or more into the white body.
Interpretation	A top reversal signal, more bearish than the regular evening star pattern.



You can download a useful resource that contains over 40 candlestick patterns from this link.

7. LEARN FIBONACCI RATIOS

The Fibonacci sequence is a series of numbers first identified by Leonardo Fibonacci in the thirteenth century. The actual numbers are not as important as the relationship between the numbers, or ratios between the numbers in the series.

The Fibonacci numbers are as follows:

0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144…. Etc.

Those that are mathematically minded, might have noticed that the sequence of numbers is simply the sum of the preceding two numbers.

A distinctive feature of the Fibonacci sequence is that each number is approximately 1.618 times more than the preceding number. This phenomenon continues no matter where on the sequence the number falls. This fact is one of the building blocks of the common ratios used in Fibonacci trading.

Fibonacci ratios have been seen to occur many times in nature. This video explains it better than I can in case you're interested.

In trading, Fibonacci ratios are used to identify potential reversal levels. The most popular Fibonacci Retracements are 61.8% and 38.2%, but others can be used as well. When used in conjunction with other technical indicators, they can provide powerful trade setups.

Whether you believe the mathematics behind it or not, the fact is that a lot of traders watch these ratios, so there is potential for the Fibonacci retracement levels to provide support on a pullback or resistance on a bounce.

Below you can see a one hour chart of AAPL. Notice how the stock briefly found support at each of the Fibonacci levels. The Golden Ratio of 61.8%, provided a good opportunity for a short term tradable bounce.

Image Credit: http://niftychartsandpatterns.blogspot.in/

8. USE AN ECONOMIC CALENDAR

Every weekend I check an economic calendar that shows the important data releases over the next week. Bloomberg has a great calendar which is the one I use.

Checking the calendar allows me to plan out my trading for the next week. For example, if I see the Fed announcement is set for Wednesday, I might hold off on initiating any new trades until after then. The market can experience some pretty wild swings straight after Fed announcements.

There are also a lot of key data releases at the start of each month. Jobs data comes out on the first Friday of each month and ISM Manufacturing data is released on the first business day of the month.

Other important data releases that can move the market are GDP, weekly jobless claims and consumer sentiment. Here is an example of the weekly economic calendar from Bloomberg.

Monday Mar 3

Market Focus »

Motor Vehicle Sales
consensus

Gallup US Consumer Spending Measure
report 8:30 AM ET

Personal Income and Outlays
report 8:30 AM ET

PMI Manufacturing Index
report 8:58 AM ET

ISM Mfg Index
report 10:00 AM ET

Construction Spending
report 10:00 AM ET

4-Week Bill Announcement
report 11:00 AM ET

3-Month Bill Auction
report 11:30 AM ET

6-Month Bill Auction
report 11:30 AM ET

Tuesday Mar 4

ICSC-Goldman Store Sales
7:45 AM ET

Gallup US ECI
8:30 AM ET

Redbook
8:55 AM ET

4-Week Bill Auction
11:30 AM ET

52-Week Bill Auction
11:30 AM ET

Jeffrey Lacker Speaks
4:15 PM ET

Wednesday Mar 5

Bank Reserve Settlement

MBA Purchase Applications
7:00 AM ET

ADP Employment Report
consensus 8:15 AM ET

Gallup U.S. Job Creation Index
8:30 AM ET

PMI Services Index
8:58 AM ET

ISM Non-Mfg Index
consensus 10:00 AM ET

EIA Petroleum Status Report
10:30 AM ET

Beige Book
2:00 PM ET

Richard Fisher Speaks
7:00 PM ET

John Williams Speaks
8:30 PM ET

Thursday Mar 6

Weekly Bill Settlement

52-Week Bill Settlement

Chain Store Sales

Challenger Job-Cut Report
7:30 AM ET

Gallup US Payroll to Population
8:30 AM ET

Jobless Claims
consensus 8:30 AM ET

Productivity and Costs
consensus 8:30 AM ET

Bloomberg Consumer Comfort Index
9:45 AM ET

Factory Orders
consensus 10:00 AM ET

EIA Natural Gas Report
10:30 AM ET

Friday Mar 7

Employment Situation
consensus 8:30 AM ET

International Trade
consensus 8:30 AM ET

William Dudley Speaks
12:00 PM ET

Consumer Credit
consensus 3:00 PM ET

9. KNOW YOUR EARNINGS DATES

A quarterly earnings announcement is always a big deal for any stock. Quite often the stock will experience a huge movement after releasing earnings. It is very difficult to predict the direction and magnitude of the move that a stock will experience. You might get lucky occasionally, but over the long haul, it is very tough (unless you have inside information of course…).

Some options traders make their living around trading earnings results. Personally, I don’t like the volatility and risks associated with it.

In any case, no matter what type of option strategy you are trading, you should be aware of the earnings date of you stock. Realize that there will be the potential for a huge move and plan accordingly. Some people may prefer to close the trade out before earnings, other might choose to hedge some of the risk while others may decide to gamble on the result.

Here are some interesting stats on AAPL stock following earnings announcement since 2000:

- Maximum Gain % : 12.68
- Maximum Loss % : -13.26
- Average Gain % if Winner : 5.26
- Average Loss % if Loser : -5.19
- Average Gain % / Average Loss % : 1.01
- Average Absolute Change% : 5.23

As you can see, it is really important to know your earnings date and not get blindsided by a huge move.

10. DON'T OVER ADJUST

A term that gets thrown around a lot in option trading circles is “Adjustments”. When will you adjust? How will you adjust? What are your adjustment rules?

While it’s important to have a plan and know in advance how to adjust a trade, it is equally important not to over adjust. As mentioned earlier, commissions add up, which is one reason why over adjusting is a bad idea.

The other reason is that if you adjust too often, you are likely to be subjected to the dreaded whipsaw. Let’s say you have a delta neutral iron condor and the market starts dropping. Your delta is getting out of line so you adjust and bring it back to delta neutral. Now, as soon as you’ve adjusted, the market turns right back around and starts rallying again. By adjusting and getting back to delta neutral, you have effectively locked in a loss and now the market is moving back against you the other way.

It's important not to let a position get out of control and you need to adhere to solid risk management principles, but sometimes you need the market to move against your position before it will start coming back your way.

When adjusting, don't completely cut your exposure. Reducing it by 25-50% can be a good way to cut your risk while still maintaining exposure in case the market comes back your way.

11. SLIPPAGE ADDS UP

Following on from the previous topic is the concept of slippage. Whenever you enter an option trade, there is a bid /ask spread that you need to be aware of. For some stocks this is very high, for others it is low.

When trading SPY for example, there is a very low spread between the bid price (the price at which market makers are willing to buy) and the ask price (the price at which market makers are willing to sell) as it is the most liquid instrument in the market.

Spreads on SPY are typically only $0.01 so you are not giving up much to get into a trade on SPY.

SPX on the other hand, has spreads that can run as high as $1.00 to $1.50. Keep in mind though that a $0.01 spread on SPY is equivalent to $0.10 on SPX.

Chances are you are not going to get filled at the exact mid-point. This is known as slippage and is a cost that can really start to add up, particularly if you are adjusting too often.

Every time you enter, exit or adjust a position, you will suffer from slippage to some degree. It's important to minimize that slippage as much as possible. If you are trading complex option spreads, you may have multiple legs and will be suffering slippage on each one every time you trade.

Take an iron condor trader who is trading 40 lots spreads. E.g.

Date: July 31st 2013,

Current Price: $1052

Trade Details: Iron Condor

Buy 40 RUT Aug 15th $980 puts @ $1.45
Sell 40 RUT Aug 15th $1000 puts @ $2.45
Sell 40 RUT Aug 15th $1090 calls @ $1.25
Buy 40 RUT Aug 15th $1110 calls @ $0.35

Premium: $1,900 Net Credit

Let’s say this trader enters this as two trades, a bull put spread and a bear call spread. Due to the bid / ask spread, he suffers $0.10 slippage on each trade. Multiply that by 40 contracts and the trader is starting off $800 behind the 8-ball from the word go! Don’t forget he will suffer slippage any time he adjusts or when he exits as well and you can see how slippage can quickly add up!

In order to reduce slippage, trade instruments with tight bid / ask spreads and don’t force trades. Put in your order around the mid-point and then wait for 15 minutes or so to see if it gets filled. Rushing trades is a sure fire way to suffer from slippage.

12. HIGH VOL STOCKS ARE HIGH VOL FOR A REASON

Novice option traders can be sometimes succumb to getting sucked in to trading high volatility stocks. After all, if a stock like TSLA is trading with implied volatility of 80%, you can place an iron condor on the stock and place your short strikes a significant distance from the current price. This look attractive at first, but you should be aware that high volatility stocks, have high volatility for a reason.

Stocks like TSLA and TWTR can have massive daily moves, and it’s not uncommon for them to move 4-5% in a day. That sort of move can wreak havoc on a delta neutral income trade.

By all means trade these stocks as they can provide some fantastic opportunities, just be aware that your daily P&L might also fluctuate wildly.

If you are new to option trading, then the safer choice is to stick to indexes like SPX, RUT and NDX or slightly less volatile stocks. Trust me, you’ll sleep better at night.

To learn more about trading volatility, you can check out my ebook Bullsh*t Free Guide to Option Volatility. [insert link]

13. USE THE RIGHT BROKER

You can't expect to succeed at option trading if you don't use the right broker. As option traders, we need to have an option friendly broker. This is a broker than either specializes in options, or considers option traders a very important customer base.

By using an option friendly broker you will get:

- Better commissions
- Better margin requirements
- Better prices on your orders
- Better software/platforms to trade on
- And better education

The only two brokers I recommend are Thinkorswim and Interactive Brokers. I definitely advise against using E-Trade.

There are a lot of brokers out there these days, so there is no excuse for not having a good options broker. As you've seen already, getting good fill prices and good commission rates are a really important factor that will help you succeed.

Here are some other important considerations when choosing a broker:

- You should be paying close to $1 per contract, anything more than that and you are getting ripped off.
- Can you trade from your smartphone?
- Does the broker offer seminars or classes on how to use their software and how to trade various option strategies?

With huge technological advances in recent years, there really is no excuse for using a substandard broker.

14. LEARN GREEK

An understanding of the greeks is essential for successful option trading. The five main greeks are Delta, Vega, Theta, Gamma and Rho.

Delta is the amount an option price is expected to move based on a $1 change in the underlying stock.

Calls have positive delta meaning theywill increase in value if the stock rises. Puts will decrease in value if the stock rises. Calls will have a delta between 0 and 100 and puts will have a delta between 0 and -100. Deep out-of-the-money options have a delta near zero, at-the-money options have a delta around 50 and deep in-the-money options have a delta near 100 or -100.

Vega is the amount call and put prices will change, in theory, for a corresponding one-point change in implied volatility.

As implied volatility increases, the value of options will increase. This is good for option buyers and bad for option sellers. An increase in implied volatility suggests an increased range of potential movement for the stock. If your Vega exposure is +200, you position will increase in value by approximately $200 for each 1% rise in implied volatility.

Theta is the amount the price of calls and puts will decrease (at least in theory) for a one-day change in the time to expiration.

Theta is also referred to as time decay. Options are a decaying assets and each day that passes will see an option’s price decrease (all other things being equal). Options sellers try to take advantage of this time decay whereas time decay works against option buyers.

The rate of time decay speeds up as an option approaches expiry. For this reason, selling weekly options has become a popular strategy, just be aware of the risks!

Gamma is the rate that delta will change based on a $1 change in the stock price. So if delta is the “speed” at which option prices change, you can think of gamma as the “acceleration.”

Gamma is sometimes difficult for beginner traders to understand, but in short if you’re a buyer of options you are long gamma and you want the stock to make a big move. If you’re a seller of options, you are short gamma and you want the stock to stay steady.

Rho is the amount an option value will change in theory based on a one percentage-point change in interest rates.

Rho is the least important of the five greeks. You really only need to think about Rho if your are trading longer term options like LEAPS. If interest rates go up, option prices will go up due to the new higher cost of carry.

15. PAY ATTENTION TO GREEK RATIOS

Now that you know how important the Greeks are in options trading, you should start monitoring them on every trade.

Each option strategy will have different Greek characteristics. For example, one on my bread and butter trades is a 30 day iron condor on RUT. Usually I set my short strikes around delta 10.

Without even looking, I know that my delta will be roughly neutral, my Vega will be around -400 and my theta will be around +100.

Once you start trading a strategy consistently like I have with the 30 day RUT condor, you start to notice that certain relationships hold true.

In my example above, you can see that my Vega / Theta ratio is around 4 to 1. This is around the maximum ratio I want to take on an iron condor trade otherwise the Vega begins to be the dominant factor in the trade.

This Vega / Theta ratio is a pretty good rule of thumb for any income trade.

The other ratio I like to keep a close eye on is the Delta / Theta ratio. Option income trades are typically delta neutral, as such; you do not want your delta to become too high as a percentage of theta. Otherwise, you are taking on too much of a directional exposure.

Once you delta reaches greater than 25% of your Theta, it's time to think about adjusting the position.

Keep an eye on your Greek ratios and I guarantee your trading will improve.

16. NEVER USE MARKET ORDERS

Never, ever use a market order. It’s like taking money from your wallet and just handing it over to the market makers. There really isn’t any easier money for them. The only time I would ever consider using a market order is if I was trading SPY where the bid/ask spread is $0.01.

If you’re trading popular vehicles such as RUT, SPX, AAPL and GOOG the bid / ask spread can be as high as $1.50. Always use a limit order somewhere near the mid-point of the spread and see if the market comes to you. If not, slowly increase your order by $0.05 at a time until you are filled.

Sometimes it pays to place your limit order just below the mid-point and leave it there for five to ten minutes. With regular market gyrations, you will usually get filled.

When markets are fast moving, you occasionally need to get out of a bad position quickly. I would still never use a market order. Let's say there is a spread of $4.00 - $5.00. You could enter a sell order at $4.20 and likely be filled instantly. It may be $0.30 below the mid-point, but you are still $0.20 per contract better off than if you used a market order.

17. CHECK YOUR ORDER BEFORE HITTING TRANSMIT

It may seem obvious, but I bet most traders have entered a sell order when they meant to do a buy order. I'll admit that I have done it a couple of times. The first time, I realized pretty quickly and was able to reverse the position with only minimal impact. The second time, it actually worked in my favor to the tune of about $400!

However, since making those errors, I am now extra careful and double check everything before I hit submit. When I am trading a large number of contracts, I also like to put in a test order of one or two contracts, to see where the fill prices are and just to make sure everything goes as expected.

Especially when markets are moving fast, make sure you double check your orders before hitting submit.

18. USE DAY ORDERS RATHER THAN GTC ORDER

Occasionally, you might look at an option trade and think, "if only that were trading $0.50 lower, I would get in". You then set up a good till cancelled (GTC) order and leave it hoping that over the next few days, your order might get filled.

A few days pass and you forget about your order that is still live in the market. Next thing you know you company reports a terrible earnings number and the stock tanks.

All of a sudden, that put option that you wanted to sell for $1.50 doesn't look so attractive. You check your account and see that you were filled at $1.50 and the put is now trading at $4.50 leaving you with a whopping great loss.

It's always safer to use day orders, you can always input the same order again the next day.

19. UNDERSTAND THE LIMITATIONS OF STOP LIMIT ORDERS

Stop losses order are a great idea. They work quite well for stocks when there is a tight bid / ask spread. However, it gets a little trickier with options.

Using a standard stop loss order, can see you get filled at well off your “trigger” price. This is where a stop-limit order comes in.

The idea is that your order goes live once a certain condition is met, but you determine a limit price that you are willing to close it out at. You stop order can now only be filled at the trigger price or better. Fantastic, right? No more slippage.

The issue here is that if the market is plunging, there may not be enough demand at your stop trigger price. The market then continues to fall with you still in your position. Your stop limit order is still live, but it’s unlikely to get filled now that the market has moved beyond your limit price.

This is not to say you cannot use stop-limit orders, but be aware that in situations where the market makes a sudden big move, you may not be filled on your protective stop if you specified stop-limit rather than the plain vanilla stop order.

20. KNOW WHEN YOUR OPTIONS EXPIRE AND HOW SETTLEMENT WORKS

The last day for trading American style options is Friday at 4:15pm. These options then settle on Saturday and any stocks that have been assigned to you will be placed into your account.

The last day for trading European style options is Thursday at 4:15pm. These options then settle on Friday morning and are cash settled.

Even though European options settle on Friday morning, the settlement price is not based on the opening price of the index. The calculation for the index is based on the of each individual component of the index. Most stocks open at the bell but there will always be lagers based on a number of reasons. For example if specific news on a security is pending the stock prices opening will be delayed.

Therefore, there can be a large variance in the settlement value to the closing index value on the Thursday.

The below table illustrates this point:

NDX Settlement Details			
	Close	Settlement Value	Variance
November-13	3,415.70	3,415.14	0.56
October-13	3,332.23	3,301.28	30.95
September-13	3,245.97	3,237.61	8.36
August-13	3,075.84	3,076.23	(0.39)
July-13	3,053.26	3,077.82	(24.56)
June-13	2,895.50	2,890.33	5.17
May-13	3,017.36	2,999.34	18.02
April-13	2,741.72	2,741.95	(0.23)
March-13	2,803.36	2,807.30	(3.94)
February-13	2,772.26	2,771.43	0.83
January-13	2,734.67	2,747.15	(12.48)

You can see that if you were short the 3060 July calls in NDX, you might have been forgiven for thinking these options were fine and about to expire worthless. However, as you can see, the index settlement value was 3077.82, so if you have been in for a very nasty surprise if you were not aware of how and when the settlement value is calculated.

21. BE CONSISTENT

They say consistency is the key to success and that is true of options trading as well. When you figure out the type of trader you want to be, it's important to stick to your game plan.

If you decide you want to trade iron condors, then stick to it. Don't chop and change strategies. Trade your iron condor every month. Also try and trade a select group of stocks or indexes. After a while you will start to know how they behave and how their options behave.

My bread and butter trade is a 10 delta iron condor on RUT. I know it like the back of my hand and I know how it performs in almost any market environment. I know exactly how I am going to adjust the trade given certain circumstances.

This gives me an advantage over traders who have to sit there for an hour while trying to figure out what they are going to do while their trade moves against them.

How else can you apply consistency to your trading? Here are some examples:

- Set aside 30 minutes each week to write in your trading journal. Note down your trades for the week, how the market behaved and how that affected your positions AND your emotions.
- You can apply consistency to your trading decisions. I.e. Follow your trading plan at all times!
- Set aside certain times each day / week to perform certain tasks related to your trading.

Those are just a few ideas, but I'm sure you can think of some more.

22. HAVE A PLAN

My mantra is "Have a plan, trade your plan and review your plan". Many traders think they don't need a formal trading plan. Even worse, some just have one in their head rather than writing it down.

Having a written down trading plan takes the emotion out of the decision making process and always you to act rationally, even when the market is behaving irrationally. A good trading plan will contain entry, exit and adjustment rules as well as risk management guidelines. The trading plan can also list out the types of stocks you will be trading.

A trading plan is a constantly evolving thing, as you continue to learn and test new ideas. You should review your trading plan at least quarterly, and look at what worked and what didn't and then adjust it accordingly.

The markets are also constantly evolving, so what worked in the past my not work in the future.

If you would like to see a sample trading plan, you can download one here.

FINAL WORDS FROM GAV

Congratulations! If you've made it this far, you're well on your way to becoming a successful butterfly spread trader. I put a lot of work into the book, and I REALLY hope it helps you in some way. Here are a few final thoughts to leave I would like to share with you.

YOU CAN DO THIS

Trading iron condors is not rocket science. You don't have to be some whiz at math, or technical analysis. Just start out by sticking to the basics and taking things slowly. Even the greatest traders had to start at the beginning.

EVERYONE MAKES MISTAKES

There's an old proverb (I think it's Japanese, but don't quote me) that says, "fall down seven times, stand up eight". You will make mistakes along the way, I guarantee it. I've made plenty. I've been trading for over 10 years and recently I entered a spread order as a **Buy** to Open rather than **Sell** to Open, before I realized my mistake I was down $600, then had to pay commissions and slippage just to get the positions back to what I wanted. All up it cost me nearly $1,000. So if you make a mistake, don't fret about it. Get back up, brush yourself off, and don't make the same mistake again.

KISS – KEEP IT SIMPLE STUPID

Honestly, don't try to overcomplicate or overthink things. Just keep it simple; sometimes the simplest things are the ones that work the best.

DON'T BE AFRAID TO ASK FOR HELP

It's a fabulous time to be alive; never in the history of mankind has communication been so instantaneous and information so easily accessible. There are loads of traders out there who are willing to help you. I'm more than happy to help, so if you have any questions, please don't hesitate to drop me a line.

OTHER RECOMMENDED READING

There are a couple of books that I recommend, but it depends on what stage of you development you are at. For beginners, who still feel they need to learn some of the basics of options trading, check out the following books:

The Bible of Options Strategies – Guy Cohen
Options Made Easy – Guy Cohen

For those who have a good knowledge of options, and want to take things to the next level, check out these books:

Options As A Strategic Investment – Lawrence McMillan
Option Volatility and Pricing – Sheldon Natenberg
Trade Your Way to Financial Freedom – Van Tharp

Definitely check out some of the above books - I guarantee you will not be disappointed.