

2024 Automated Option Process Update

FIRST OF ALL:

I have nothing to sell. I just want to share a reliable income process I found that works for me and may be of help to you or someone you care about. It's all based on an investment strategy developed by Lee Finberg over his 30 years on Wall Street. If you would like to read Lee's book, The Monthly Income Stream, go to www.safertrader.com and order one there.

We maintain 3 short videos, Day to Day Process (4:14 min), Under the Hood (8:55 min), and OA Configuration (1:55 min) to help you understand our system.

To access these videos, go to www.GregAlanHoward.com/investinglp and click on ACCEPT to acknowledge the appropriate waiver.

The "Day to Day Process" is very simple and highly automated. How hard can it be if the training video is only 4 minutes long?

"Under the Hood" runs for about 8 minutes and details how we do what we do. Understanding all the details of what is under the hood is not necessary to be successful. It's much like driving a car. You don't need to know how an internal combustion engine works to drive the car and get where you are going. So the first video shows you how to drive the process, the second video tells you how the engine works.

The third video, "OA Configuration", is helpful after you have your own account set up with OptionAlpha.com.

SOME HISTORY:

The basis for our investment strategy can be found in Lee Finberg's book "The Monthly Income Machine". But a lot has changed since Lee wrote his book. The fundamental strategy is still sound, but the speed at which the market operates has changed significantly. Key developments are weekly/daily options, trading bots that automate the trading process and commission levels of \$0 to \$0.35 per contract. Add to that the availability of extensive back testing from 2006 to the present via TastyTrade's back testing software and you get to our current trading plan.

WHAT WE DO:

We sell XSP vertical PUT vertical spreads most trading days that expire the next trading day. (If I use terms that you are not familiar with, simply go to www.investopedia.com for good definitions.) Our goal is to take in premium from these sales and then wait for each spread to expire worthless the next day, allowing us to keep the premium. We created 2 bots, Investments and Notifications, to automate the process.

WHY PEOPLE BUY WHAT WE HAVE TO SELL:

When people buy something of value, they want to protect that value against loss. When you buy a car, you buy insurance. When you buy a house, you buy insurance. The same is true of investments in the stock market. When people buy 100 shares of the S&P at a total cost of \$550,000, they want to protect that investment as well from any substantial loss. That's where we come in. We insure stock investors against loss. We also do what insurance companies have been doing for several hundred years now, we buy re-insurance from someone else to limit our maximum loss and that's what is known as a put spread. In the small corner of the market that we play in, XSP trades on average 54,000 options on the S&P per day worldwide. But the reason why people buy what we sell is they want and need what we have, insurance.

SO HOW DID WE GET HERE?

It started with the Top Strategies tab at www.Optionalpha.com. Over the past 4 years, 14,000+ trades have been made selling SPY 2-day vertical put spreads with the short leg at $-.15$ delta and the long leg at $-.05$ delta. The documented actual win rate over those 14,000+ trades was **92.7%**. SPY is an ETF of the S&P 500.

We'll talk more about why we are looking at SPY and how we got from SPY to XSP in a moment.

Symbols ▾	☆	ETFs	Strategy ▾	DTE 2 days or less ✕	R/R ▾	POP 80% or higher ✕	PMP ▾	PML ▾	Trades 100 or more ✕	Live only	
SYMBOL	STRATEGY	DTE ①	AVG ROR ①	WIN RATE	AVG POP ①	AVG PMP ①	AVG PML ①	AVG R/R ①	MAX PROF... ①	MAX LOSS ①	TRADES ▾
SPY	Short Put Spread -.05, -.15	2 d	3.8%	92.7%	93%	92%	1%	8.5%	\$25	-\$312	14,272
QQQ	Short Put Spread -.05, -.15	2 d	3.4%	92.7%	90%	89%	3%	8.9%	\$26	-\$298	10,729

But being the skeptic that I am, after 30+ years of looking at various scenarios, I wanted independent confirmation of those results. I also wanted to know what would happen if the investment expired in 1 day rather than 2. After all, I'm not a patient man 😊 I turned to TastyTrade.com. It has an excellent back testing utility and it's free to the public. The results of testing the SPY scenario from 2006 to the present (18 years), confirmed the Option Alpha statistics and showed that over 1384 trades with a delta of -.10, the win rate for trades that were expiring in 1 day rather than 2 increased from **92.7% to 97%**.

But still, who would go through all of this for \$5.76 per day.

TastyLive.com				View Backtest Results			
Early Exit at DTE? ☐ No Stop Loss? ☐ Never Take Profits? ☐ Never				Win Rate 97% Total Trades Examined 789 Largest Profit \$1,016.50 in March 2020 Largest Loss -\$694.00 in September 2020			
#	Type	Delta	DTE				
-1	Put ▾	10	1				
1	Put ▾	5	1				
+ -							
				Average	Median		
				Premium Collected \$5.76	\$0.00		
				Profit Per Trade \$22.27	\$0.00		

The answer is really no one or so it would seem. But there were a number of factors that we couldn't specify in the back testing. By optimizing some of these, we saw premiums that reached \$25 on a \$4 spread. Return on Risk was typically **5% to 10% PER DAY**. Yes you read that right, PER DAY. That translates to 25%+ per week and 100%+ per month. Now trade multiple option contracts per trade and real money results.

The chart below shows the impact on a \$5000 account over 1 year, of different spread sizes and number of contracts per trade. And remember, we are dealing with a process that has a win rate of 97%.

-.10 DELTA ANALYSIS - 200 Trades - 194 Winners - 6 Losers									
# Trades per Year	200	Account Balance	\$5,000	Position Size	20%				
Spread Size	Reserves Required Per Contract	Est. Premium Per Contract	Est. Premium Per Trade	# of Contracts per Trade	Win %	Return On Risk Per Trade Per Day	Total Gain Over 200 Trades	Maximum Loss Over 6 Trades	Net Gain
\$1	\$100	\$9	\$90	10	97%	10%	\$17,460	\$5,502	\$11,958
\$2	\$200	\$15	\$75	5	97%	8%	\$14,550	\$5,571	\$8,979
\$3	\$300	\$20	\$60	3	97%	7%	\$11,640	\$5,053	\$6,587
\$4	\$400	\$23	\$69	3	97%	6%	\$13,386	\$6,799	\$6,587

BUT WHAT ABOUT THOSE LOSSES:

The bots themselves have all kinds of checks and balances. We avoid having money in the market on days that we know the market is susceptible to high volatility. We block trading around the reporting days of the Federal Open Market Committee, the Consumer Price Index, Earnings Reports and Ex-dividend days. It's not important for you to know what each of those reports is, just that they can be bad for investing. All of that reduces the number of trading days by 44, but believe me when I say, we are safer and more profitable for it.

In addition to those 44 days, for those who are more conservative, we have a way to opt out of launching new trades on Fridays that expire on Mondays. Some folks don't want money tied up in the market over the weekend.

We monitor the movement of the market during the day. If XSP gaps open more than 1% in either direction or it drops more than 2% from its open, we suspend trading till the dust clears and sanity returns. If the market shows a definite down trend, we change short put leg deltas from -.10 to -.05 to provide more room for the market to move against our trade in an attempt to avoid a potential loss.

All of these are intended to reduce the 3% loss ratio. But when the eventual loss rears its ugly head, we have a loss mitigation process that offsets some or all of the money lost with a situation specific supplemental trade. It is automated as well with minor manual intervention required.

SO WHY PUT SPREADS INSTEAD OF IRON CONDORS?

Well that is the \$6 million question isn't it? After all, Lee was very high on the iron condor as an investment vehicle. But in the process of back testing, we discovered that Call spreads with the same delta values were not as successful as the puts and the resulting iron condor was only 86% successful.

So while we have a 97% success rate with Puts alone, combining them with Calls in an iron condor generated 28 losses in a full year of trading rather than 6. This had a significant impact on profits.

So bottom line is, we make and keep more money trading the puts only,

WHY XSP INSTEAD OF SPY? (this is a long-winded answer. You may want to just skip to [THE END.](#))

SPY is the ETF that tracks the S&P 500 at approximately 1/10 the value. So if the S&P 500 index is trading at \$5000 per share, SPY is trading at \$500. The same is true of XSP but XSP is not an ETF, it is a mini- index. The indexes typically trade using the European options trading model, which means that they settle in cash at the end of the day and that options can only be exercised at expiration. The ETFs operate on the American trading model that allows for early assignment of options and they settle in shares of stock. In addition, profits from the American style of trading are taxed as short term capital gains in the US, while profits from XSP are taxed 60% as long term capital gains and 40% as short term capital gains. So you pay less taxes trading XSP.

Trading XSP also avoids the possibility of early assignment. But what the heck is that?

Early assignment exists only in the American options model and means that your buyer can choose to exercise their option with you any time of the day or night on any day up to and including expiration day.

By way of an example, let's say that you have a SPY trade that has 10 contracts in it. Since each option contract controls 100 shares, those contracts control 1000 shares of SPY. If SPY is trading at \$500 per share, that's \$500,000 worth of stock. You have a short leg strike price of \$498 and sometime during the day, the price of SPY drops to \$496. Your buyer can choose to exercise the short leg of your vertical spread any time day or night, forcing you to buy 1000 shares of SPY at \$498 per share resulting in a debit to your account of \$498,000. Right now, you own 1000 shares that are really only worth \$496,000. You can then sell those shares and have a net loss of \$2000. That assumes that you are watching the market, and the market is still open. Are you sweating yet? God help you if SPY drops more overnight!!!

With XSP in the same scenario, XSP settles in cash at the end of each trading day and can only be exercised by your buyer on expiration day. Your account still experiences a loss of \$2000 but you don't have to be watching your account closely, nor do you have to worry about what is going to happen to XSP overnight.

"THE END"

The bottom line is, XSP lets us sleep at night and the tax consequences are better than SPY. I guess I could have just said that to being with. 😊

SO WHAT NOW:

Appendix A talks about how to get started.

Appendix B provides more details on the bot inputs and operational stuff. If you love the weeds, this is it.

Appendix C provides the required Federal Options Disclosure Statement

Legal disclaimer:

*I am not a certified financial planner. No guarantee of profit or return on investment is implied or intended. Investing is risky. People can and do lose money. Only invest money you can afford to lose. Seek advice from a certified financial planner. * Invest wisely.*

The information provided here is strictly for educational purposes and is confidential.

*Fair warning, most financial planners run screaming into the night when their clients bring up options, mostly because they were not taught how to safely do this while maximizing returns for themselves and their clients. Remember, this was all developed based on Lee Finberg's 30 years of experience on Wall Street as VP of investing at 2 major brokerages as well as historical data from OptionAlpha and back testing from 2006 to the present. If you want to read Lee's book, go to www.safetrader.com and purchase one for \$77.

APPENDIX A: Getting Started

OPTION 1:

www.OptionAlpha.com offers a free 30-day trial. You can register for that at <https://tinyurl.com/gahoarp>. After that, the standard plan runs \$79/mo. For our purposes, the standard plan works just fine. We'll provide free access to the bots and any additional training you need.

OPTION 2: Get OptionAlpha For \$10/Mo

Open a trading account on www.Tradier.com and fund the account with a minimum of \$2000. The monthly cost here is \$10. Note that you don't have to risk any of that money to paper trade the process. Simply by having this account open, you qualify for a free Pro+ membership with www.OptionAlpha.com that provides you free access to the 2 bots that execute the process.

APPENDIX B: Bot Inputs and Operational Details

Shown below are the Bot Inputs that control the entire process. To see a detailed explanation of each category, simply click on the underlined links.

*POWER SWITCH ⓘ ☒		1st TRADE CONFIG
*FRIDAY TRADES ⓘ ☒		
*SYMBOL XSP		
*POSITION SIZE 15% of net liquid		2ND TRADE CONFIG
*EXPIRATION 1 to 4 days		
*PRICE GAP % ⓘ 1%		
MARKET CRASH TRIGGER % 2%		DOWNTURN CONFIG
*VIX TRIGGER POINT ⓘ 30		
SHORT PUT DELTA -.10 delta		
LONG PUT \$ ⓘ \$1.00 below short p		
SHORT CALL DELTA .10 delta		
LONG CALL \$ \$1.00 above short call leg		
SLIPPAGE → \$.02 from mid price		

Bot Input Label	Nominal & Default Values	Details
Power Switch	On/Off	Default value is "On". In the "Off" position, new trading will be suspended in the scanner as well as any loss mitigation. All other automations will continue to operate.
Friday Trades	On/Off	Default value is "On". Authorizes Friday trades that expire on Monday. You'll have money in the market over the weekend.
Symbol	XSP	Mini index of SPX – Settles at expiration in cash. Taxed at 60% long term capital gains 40% short term capital gains rates. Avoids possibility of assignment of underlying asset's stock.
Position Size	5% to 25% of Net Liquidity	This definition of position size opens the possibility of compounding our investments by way of multiple contracts in one trade as the account grows. In a \$5000 account, with the spread size set to \$2.00 (Long Put \$), and a 10% position size, 2 contracts are selected. This puts approx. \$200 per week into the account. As the account balance grows, you can lower the % or keep it there and have additional contracts added to each trade. I use 10% because out of a \$5000 account, I am willing to risk about \$400 per trade. When the account reaches \$6000, the system automatically sets the number of contracts per trade to 3 and the risk goes up to \$600 per trade. Want to be more aggressive and put more money in the account quicker? Set the Long Put and the Long Call size to \$1 and the Position Size to 20%. This will use 10 contracts per trade and put approx. \$350 to \$400/wk. in the account on a \$5000 account. As of R(17), we have gone to issuing 2 trades per day, the first at 10:00 and the second at 3:00. So when you pick a position size, it applies independently to each trade. If you want to limit your risk to 20% per day, you would set the position size at 10%.
Expiration	1 to 4 days	Finds the soonest viable trade allowing for Friday/Monday trades and Friday/Tuesday trades when needed.
Price Gap %	1%	If the opening price gaps either plus or minus this percentage from the close the day before, the system suspends trading for the day. It resets each day prior to opening and can be overridden by selecting the Reset Price Gap button on the dashboard.
Market Crash Trigger	2%	If the current price of the underlying asset is 2% or more below the opening value on any given day, the system thinks the market is crashing and suspends all new trades.
VIX Trigger Point	30	If VIX goes above 30, the market is experiencing volatility that is too high for us to operate profitably. We get a heads-up notification if the VIX goes over its annual average of 21.

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Short Put Delta	-.10	Based on historical data since 2006, put spreads with a -.10 delta short leg are 97% profitable.
Short Call Delta	.10	This only comes into play in Put Loss Mitigation and is again optimized to maximize the win rate.
Long Put \$ Long Call \$	\$1.00 - \$4.00	Defines the spread size. We typically use \$1.00
Slippage	.02	Tells the OA Smart Pricing to start at the mid-price and move down in pricing by .01 for 2 lower prices. (i.e. if mid-price is .13, it will try to fill at .13, .12, and .11.
1 st Trade Start Time	9:45	Defines the trading window for the 1 st trade of the day.
1 st Trade End Time	11:45	Defines the trading window for the 1 st trade of the day.
1 st Trade Mid Price Target	.07	Target mid-price premium for 1 st Trade
2 nd Trade Start Time	2:45	Defines the trading window for the 2 nd trade of the day.
2 nd Trade End Time	3:45	Defines the trading window for the 2 nd trade of the day.
2 nd Trade Mid Price Target	.04	Target mid-price premium for 2 nd Trade
Contraction Trigger	35	MFI is used in conjunction with MACD to determine the market direction. MFI rankings of 35 or less indicate that smart money is moving out of our market.
DM Short Put Delta	-.05	The short put delta for situations where we are convinced that our market is trending downward. We are trying to give ourselves more room on the bottom.
DM 2 nd Trade Mid Price Target	.01	With a lower delta of -.05, we expect the premiums to be lower as well. This number is typically the 1 st trade mid price divided by 2.
DM 2 nd Trade Mid Price Target	.01	With a lower delta of -.05, we expect the premiums to be lower as well. This number is typically the 2 nd trade mid price divided by 2.

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Appendix C:

OPTIONS DISCLOSURE STATEMENT

BECAUSE OF THE VOLATILE NATURE OF THE COMMODITIES MARKETS, THE PURCHASE AND GRANTING OF COMMODITY OPTIONS INVOLVE A HIGH DEGREE OF RISK. COMMODITY OPTION TRANSACTIONS ARE NOT SUITABLE FOR MANY MEMBERS OF THE PUBLIC. SUCH TRANSACTIONS SHOULD BE ENTERED INTO ONLY BY PERSONS WHO HAVE READ AND UNDERSTOOD THIS DISCLOSURE STATEMENT AND WHO UNDERSTAND THE NATURE AND EXTENT OF THEIR RIGHTS AND OBLIGATIONS AND OF THE RISKS INVOLVED IN THE OPTION TRANSACTIONS COVERED BY THIS DISCLOSURE STATEMENT.

BOTH THE PURCHASER AND THE GRANTOR SHOULD KNOW THAT THE OPTION IF EXERCISED, RESULTS IN THE ESTABLISHMENT OF A FUTURES CONTRACT (AN "OPTION ON A FUTURES CONTRACT").

BOTH THE PURCHASER AND THE GRANTOR SHOULD KNOW WHETHER THE PARTICULAR OPTION IN WHICH THEY CONTEMPLATE TRADING IS SUBJECT TO A "STOCK-STYLE" OR "FUTURES-STYLE" SYSTEM OF MARGINING. UNDER A STOCK-STYLE MARGINING SYSTEM, A PURCHASER IS REQUIRED TO PAY THE FULL PURCHASE PRICE OF THE OPTION AT THE INITIATION OF THE TRANSACTION. THE PURCHASER HAS NO FURTHER OBLIGATION ON THE OPTION POSITION. UNDER A FUTURES-STYLE MARGINING SYSTEM, THE PURCHASER DEPOSITS INITIAL MARGIN AND MAY BE REQUIRED TO DEPOSIT ADDITIONAL MARGIN IF THE MARKET MOVES AGAINST THE OPTION POSITION. THE PURCHASER'S TOTAL SETTLEMENT VARIATION MARGIN OBLIGATION OVER THE LIFE OF THE OPTION, HOWEVER, WILL NOT EXCEED THE ORIGINAL OPTION PREMIUM, ALTHOUGH SOME INDIVIDUAL PAYMENT OBLIGATIONS AND/OR RISK MARGIN REQUIREMENTS MAY AT TIMES EXCEED THE ORIGINAL OPTION PREMIUM. IF THE PURCHASER OR GRANTOR DOES NOT UNDERSTAND HOW OPTIONS ARE MARGINED UNDER A STOCK-STYLE OR FUTURES-STYLE MARGINING SYSTEM, HE OR SHE SHOULD REQUEST AN EXPLANATION FROM THE FUTURES COMMISSION MERCHANT ("FCM") OR INTRODUCING BROKER ("IB").

A PERSON SHOULD NOT PURCHASE ANY COMMODITY OPTION UNLESS HE OR SHE IS ABLE TO SUSTAIN A TOTAL LOSS OF THE PREMIUM AND TRANSACTION COSTS OF PURCHASING THE OPTION. A PERSON SHOULD NOT GRANT ANY COMMODITY OPTION UNLESS HE OR SHE IS ABLE TO MEET ADDITIONAL CALLS FOR MARGIN WHEN THE MARKET MOVES AGAINST HIS OR HER POSITION AND, IN SUCH CIRCUMSTANCES, TO SUSTAIN A VERY LARGE FINANCIAL LOSS.

A PERSON WHO PURCHASES AN OPTION SUBJECT TO STOCK-STYLE MARGINING SHOULD BE AWARE THAT, IN ORDER TO REALIZE ANY VALUE FROM THE OPTION, IT WILL BE NECESSARY EITHER TO OFFSET THE OPTION POSITION OR TO EXERCISE THE OPTION. OPTIONS SUBJECT TO FUTURES-STYLE MARGINING ARE MARKED TO MARKET, AND GAINS AND LOSSES ARE PAID AND COLLECTED DAILY. IF AN OPTION PURCHASER DOES NOT UNDERSTAND HOW TO OFFSET OR EXERCISE AN OPTION, THE PURCHASER SHOULD REQUEST AN EXPLANATION FROM THE FCM OR IB. CUSTOMERS SHOULD BE AWARE THAT IN A NUMBER OF CIRCUMSTANCES, SOME OF WHICH WILL BE DESCRIBED IN THIS DISCLOSURE STATEMENT, IT MAY BE DIFFICULT OR IMPOSSIBLE TO OFFSET AN EXISTING OPTION POSITION ON AN EXCHANGE.

THE GRANTOR OF AN OPTION SHOULD BE AWARE THAT, IN MOST CASES, A COMMODITY OPTION MAY BE EXERCISED AT ANY TIME FROM THE TIME IT IS GRANTED UNTIL IT EXPIRES. THE PURCHASER OF AN OPTION SHOULD BE AWARE THAT SOME OPTION CONTRACTS MAY PROVIDE ONLY A LIMITED PERIOD OF TIME FOR EXERCISE OF THE OPTION.

THE PURCHASER OF A PUT OR CALL SUBJECT TO STOCK-STYLE OR FUTURES-STYLE MARGINING IS SUBJECT TO THE RISK OF LOSING THE ENTIRE PURCHASE PRICE OF THE OPTION—THAT IS, THE PREMIUM CHARGED FOR THE OPTION PLUS ALL TRANSACTION COSTS.

THE COMMODITY FUTURES TRADING COMMISSION REQUIRES THAT ALL CUSTOMERS RECEIVE AND ACKNOWLEDGE RECEIPT OF A COPY OF THIS DISCLOSURE STATEMENT BUT DOES NOT INTEND THIS STATEMENT AS A RECOMMENDATION OR ENDORSEMENT OF EXCHANGE-TRADED COMMODITY OPTIONS.

1. SOME OF THE RISKS OF OPTION TRADING.

Specific market movements of the underlying future cannot be predicted accurately.

The grantor of a call option who does not have a long position in the underlying futures contract is subject to risk of loss should the price of the underlying futures contract be higher than the strike price upon exercise or expiration of the option by an amount greater than the premium received for granting the call option.

The grantor of a call option who has a long position in the underlying futures contract is subject to the full risk of a decline in price of the underlying position reduced by the premium received for granting the call.

In exchange for the premium received for granting a call option, the option grantor gives up all of the potential gain resulting from an increase in the price of the underlying futures contract above the option strike price upon exercise or expiration of the option.

The grantor of a put option who does not have a short position in the underlying futures contract is subject to risk of loss should the price of the underlying futures contract decrease below the strike price upon exercise or expiration of the option by an amount in excess of the premium received for granting the put option.

The grantor of a put option on a futures contract who has a short position in the underlying futures contract is subject to the full risk of a rise in the price in the underlying position reduced by the premium received for granting the put. In exchange for the premium received for granting a put option on a futures contract, the option grantor gives up all of the potential gain resulting from a decrease in the price of the underlying futures contract below the option strike price upon exercise or expiration of the option.

2. DESCRIPTION OF COMMODITY OPTIONS.

Prior to entering into any transaction involving a commodity option, an individual should thoroughly understand the nature and type of option involved and the underlying futures contract. The futures commission merchant or introducing broker is required to provide, and the individual contemplating an option transaction should obtain:

- (i) An identification of the futures contract underlying the option and which may be purchased or sold upon exercise of the option or, if applicable, whether exercise of the option will be settled in cash;
- (ii) The procedure for exercise of the option contract, including the expiration date and latest time on that date for exercise. (The latest time on an expiration date when an option may be exercised may vary; therefore, option market participants should ascertain from their futures commission merchant or their introducing broker the latest time the firm accepts exercise instructions with respect to a particular option.);
- (iii) A description of the purchase price of the option including the premium, commissions, costs, fees and other charges. (Since commissions and other charges may vary widely among futures commission merchants and among introducing brokers, option customers may find it advisable to consult more than one firm when opening an option account.);
- (iv) A description of all costs in addition to the purchase price which may be incurred if the commodity option is exercised, including the amount of commissions (whether termed sales commissions or otherwise), storage, interest, and all similar fees and charges which may be incurred;
- (v) An explanation and understanding of the option margining system;
- (vi) A clear explanation and understanding of any clauses in the option contract and of any items included in the option contract explicitly or by reference which might affect the customer's obligations under the contract. This would include any policy of the futures commission merchant or the introducing broker or rule of the exchange on which the option is traded that might affect the customer's ability to fulfill the option contract or to offset the option position in a closing purchase or closing sale transaction (for example, due to unforeseen circumstances that require suspension or termination of trading); and
- (vii) If applicable, a description of the effect upon the value of the option position that could result from limit moves in the underlying futures contract.

3. THE MECHANICS OF OPTION TRADING.

Before entering into any exchange-traded option transaction, an individual should obtain a description of how commodity options are traded.

Option customers should clearly understand that there is no guarantee that option positions may be offset by either a closing purchase or closing sale transaction on an exchange. In this circumstance, option grantors could be subject to the full risk of their positions until the option position expires, and the purchaser of a profitable option might have to exercise the option to realize a profit.

For an option on a futures contract, an individual should clearly understand the relationship between exchange rules governing option transactions and exchange rules governing the underlying futures contract. For example, an individual should understand what action, if any, the exchange will take in the option market if trading in the underlying futures market is restricted or the futures prices have made a "limit move."

The individual should understand that the option may not be subject to daily price fluctuation limits while the underlying futures may have such limits, and, as a result, normal pricing relationships between options and the underlying future may not exist when the future is trading at its price limit. Also, underlying futures positions resulting from exercise of options may not be capable of being offset if the underlying future is at a price limit.

4. MARGIN REQUIREMENTS.

An individual should know and understand whether the option he or she is contemplating trading is subject to a stock-style or futures-style system of margining. Stock-style margining requires the purchaser to pay the full option premium at the time of purchase. The purchaser has no further financial obligations, and the risk of loss is limited to the purchase price and transaction costs. Futures-style margining requires the purchaser to pay initial margin only at the time of purchase. The option position is marked to market, and gains and losses are collected and paid daily. The purchaser's risk of loss is limited to the initial option premium and transaction costs.

An individual granting options under either a stock-style or futures-style system of margining should understand that he or she may be required to pay additional margin in the case of adverse market movements.

5. PROFIT POTENTIAL OF AN OPTION POSITION.

An option customer should carefully calculate the price which the underlying futures contract would have to reach for the option position to become profitable. Under a stock-style margining system, this price would include the amount by which the underlying futures contract would have to rise above or fall below the strike price to cover the sum of the premium and all other costs incurred in entering into and exercising or closing (offsetting) the commodity option position. Under a future-style margining system, option positions would be marked to market, and gains and losses would be paid and collected daily, and an option position would become profitable once the variation margin collected exceeded the cost of entering the contract position.

Also, an option customer should be aware of the risk that the futures price prevailing at the opening of the next trading day may be substantially different from the futures price which prevailed when the option was exercised.

6. DEEP-OUT-OF-THE-MONEY OPTIONS.

A person contemplating purchasing a deep-out-of-the-money option (that is, an option with a strike price significantly above, in the case of a call, or significantly below, in the case of a put, the current price of the underlying futures contract) should be aware that the chance of such an option becoming profitable is ordinarily remote.

On the other hand, a potential grantor of a deep-out-of-the-money option should be aware that such options normally provide small premiums while exposing the grantor to all of the potential losses described in section (1) of this disclosure statement.

7. GLOSSARY OF TERMS.

- (i) **Contract market.** Any board of trade (exchange) located in the United States which has been designated by the Commodity Futures Trading Commission to list a futures contract or commodity option for trading.
- (ii) **Exchange-traded option; put option; call option.** The options discussed in this disclosure statement are limited to those which may be traded on a contract market. These options (subject to certain exceptions) give an option purchaser the right to buy in the case of a call option, or to sell in the case of a put option, a futures contract underlying the option at the stated strike price prior to the expiration date of the option.

Each exchange-traded option is distinguished by the underlying futures contract, strike price, expiration date, and whether the option is a put or a call.
- (iii) **Underlying futures contract.** The futures contract which may be purchased or sold upon the exercise of an option on a futures contract.
- (iv) **[Reserved]**
- (v) **Class of options.** A put or a call covering the same underlying futures contract.
- (vi) **Series of options.** Options of the same class having the same strike price and expiration date.
- (vii) **Exercise price.** See strike price.
- (viii) **Expiration date.** The last day when an option may be exercised.
- (ix) **Premium.** The amount agreed upon between the purchaser and seller for the purchase or sale of a commodity option.
- (x) **Strike price.** The price at which a person may purchase or sell the underlying futures contract upon exercise of a commodity option. This term has the same meaning as the term “exercise price.”
- (xi) **Short option position.** See opening sale transaction.
- (xii) **Long option position.** See opening purchase transaction.
- (xiii) **Types of options transactions—**
 - (A) **Opening purchase transaction.** A transaction in which an individual purchases an option and thereby obtains a long option position.
 - (B) **Opening sale transaction.** A transaction in which an individual grants an option and thereby obtains a short option position.
 - (C) **Closing purchase transaction.** A transaction in which an individual with a short option position liquidates the position. This is accomplished by a closing purchase transaction for an option of the same series as the option previously granted. Such a transaction may be referred to as an offset transaction.
 - (D) **Closing sale transaction.** A transaction in which an individual with a long option position liquidates the position. This is accomplished by a closing sale transaction for an option of the same series as the option previously purchased. Such a transaction may be referred to as an offset transaction.
- (xiv) **Purchase price.** The total actual cost paid or to be paid, directly or indirectly, by a person to acquire a commodity option. This price includes all commissions and other fees, in addition to the option premium.
- (xv) **Grantor, writer, seller.** An individual who sells an option. Such a person is said to have a short position.
- (xvi) **Purchaser.** An individual who buys an option. Such a person is said to have a long position.

Investment Products: Not FDIC Insured * No Bank Guarantee * May Lose Value