Learn to Trade Options

Presented by: T & K Futures and Options Inc.

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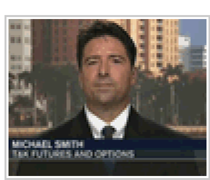
Forward

The author of this e book is the President of T & K Futures and Options Inc. and a series 3 registered commodity broker who has been trading these markets for nearly two decades. He has seen most option buyers lose money and wanted to create this e book to help option investors become more savvy and aware of the mechanics and strategies that may decrease the number of losing trades that occur in a speculator's portfolio.

Hopefully this e book will teach you at least one thing that you did not know before downloading it. It has been said that knowledge is priceless and if that one thing makes you money or saves you from losing money, then this e book has done its job. <u>This manual in no way should be considered as a guarantee that your trading results will improve.</u>



Visit www.tkfutures.com/biography.htm to learn more about the author.

Why do we need commodities markets in the first place?

To understand the importance of the futures markets one must envision an agricultural society that is dependent upon farming for its survival. During harvest time the abundance of the commodity is so high versus demand that the farmer is practically giving his crops away and much of the commodity goes bad and is wasted. Out of harvest the commodity's supply is low versus the demand so the prices become exorbitant. These huge price swings affect the producer as well as the consumer.

Before the industrial revolution, the cash markets could handle the supply and demand. But with a growing population and new technologies came the need for futures pricing. The advent of the futures markets allowed commodity producers to budget their money for input costs such as seeds, fertilizer, bank loan repayments, storage and distribution.

The consumers of commodities could also benefit by locking in the price they were willing to pay even before the crops were planted. The futures markets stabilize commodity prices helping both producers and consumers of commodities.

Visit www.tkfutures.com/basics.htm to learn more about futures.

Why do so many people lose money buying put and call options?

A put gives the purchaser the right but not the obligation to sell the underlying futures contract at a specified price (strike price) for a specified period of time. A call gives the purchaser the right but not the obligation to buy the underlying futures contract at the strike price for a specified period of time.

In my opinion, psychology plays a large part in the winning and losing process. People hate to lose and usually hold onto their losing trades instead of cutting losses and moving on. On the other side of the equation people love to win. It's fun to say that you made money in the markets. It makes you feel smart, lucky or whatever. This often makes investors take their profits too quickly. If most trades are losers, it makes mathematical sense to maximize your winners and minimize your losers or you will be out of money before you know it.

I believe that the two greatest enemies of option buyers, besides themselves, are time decay and volatility premium.

What is time decay?

Options are a wasting asset. Options lose money every day because of time decay. The only way for an option buyer to make money is for the value of the option premium to increase enough to offset the time decay of that option and the initial costs of the option. For instance a corn option that is 20 cents out of the money that has one week left until expiration will be worth less than the equivalent option that has 30 days until expiration.

What is volatility premium?

Volatility premium refers to the amount that the option grantor (the person who sells you the option you just bought) inflates the option premium to offset their risk associated with a volatile underlying commodity market. The option grantor collects the premium that you paid for the option. They hope that you lose because if that happens they win. In other words, the more volatile the price movement in the underlying futures market that you purchased your option in, the more risk the grantor is taking and therefore the more they will charge for that option.

Visit www.tkfutures.com/futures_options_trading.htm to learn more.

How much risk is there when buying options?

The short answer is a lot. The purchaser of an option can lose the option premium paid plus commissions and fees. I believe that the official numbers are somewhere around 80 to 85 percent of options expire worthless. Visit www.tkfutures.com/risk_disclosure.htm.

You have to keep in mind however that many huge corporations that need the commodity will often use options to hedge against higher prices by buying calls or using long futures. In the case of the calls, they hope those options expire worthless because that means the prices did not go up enough to really hurt their bottom line.

If you are producer of a commodity, you are worried about getting less for your product so you use puts or short futures to hedge your risk. Once again, expiring options are not necessarily a bad thing. It's like the premium that you pay for car insurance. It's a waste of money unless you get into an accident.

What are some other reasons options buyers lose money?

In my opinion, most speculators enter the markets without enough risk capital to withstand losing trades. Let's face it, with $5,000 you can only get into maybe 3 different markets and maybe afford 6-12 decent options. If 1 or 2 of those markets lose, you have a lot of ground to cover to make up with just one market because all of your risk capital is already invested. If you had $50,000 and buy the same 6-12 options in 3 different markets, you will have the capital to add to any winners and diversify into other markets……..

I believe that another reason investors lose money is because they listen to various news sources and base their trading on the so called experts. You have to understand that gold prices at $260 an ounce is not a good story. Who cares? But when gold is at all time highs, everyone wants to talk about it. "You better buy it before it goes any higher." *Isn't the idea to buy low and sell high?* Visit www.tkfutures.com/startegies.htm to learn more.

When do you think most speculators decided to buy gold? Near the top. There is even an indicator called bullish consensus that is based on surveying so called market experts and small speculators about where a particular market is heading. When 75% of the experts and small speculators are bullish it gives a sell signal. When 25% or less are bullish it gives a buy signal. That's right. The so called experts and small speculators have such a bad investment track record that other investors use their opinions as a contrarian indicator.

Like Warren Buffet says, "When everyone is brave, be afraid and when everyone is afraid, be brave." I'm tempted to listen to him since he made his billions investing in out of favor companies and commodities.

Visit www.tkfutures.com/research.htm to learn more.

Which markets usually have liquid (fair) option markets?

You are going to have to look at the volume and open interest in the particular commodity and month that you want to trade. Usually, the more liquid the underlying futures contract the more liquid options will be. Visit www.tkfutures.com/education.htm to learn more.

I like the **grain options** markets the best. There are still pit traded commodities right alongside the electronic markets for corn, soybeans and wheat. The contract size is 5,000 bushels and therefore a one cent move in your option premium = $50. Visit www.tkfutures.com/corn.htm .

The **energy options** that are liquid enough to trade are crude oil, natural gas, heating oil and RBOB unleaded gasoline. Crude oil is a 1,000 barrel contract and each dollar move in your premium = $1,000.

Natural gas is a 10,000 mmBTU contract and a one cent move in your option premium = $100. Visit www.tkfutures.com/natural_gas.htm .

Heating oil and unleaded gasoline are both 42,000 gallon contracts and each one cent move in your option premium = $420.

The liquid **metals options** markets include gold, silver and copper.

The gold option contract size is 100 ounces so each $1 move in your option premium=$100. Visit www.tkfutures.com/gold.htm .

Silver has a 5,000 ounce contract size so each one cent move in your option premium=$50. Visit www.tkfutures.com/silver.htm .

Copper has a 25,000 pound contract size so each one cent move in your option premium=$250. Visit www.tkfutures.com/copper.htm .

The **soft markets** with the most liquid options are sugar, coffee, cotton, cocoa and orange juice.

The sugar contract size is 112,000 pounds and each one cent move in your option premium=$1,120. Visit www.tkfutures.com/sugar.htm to learn more.

The coffee contract size is 37,500 pounds and each one cent move in your option premium=$375. Visit www.tkfutures.com/coffee.htm to learn more.

The cotton contract size is 50,000 pounds and each one cent move in your option premium=$500. Visit www.tkfutures.com/cotton.htm to learn more.

The cocoa contract size is 10 metric tons and each one dollar move in your option premium=$10. Visit www.tkfutures.com/cocoa.htm

The orange juice contract size is 15,000 pounds and each one cent move in your option premium=$150. Visit www.tkfutures.com/orange_juice.htm

The liquid **meat options** are live cattle, feeder cattle and lean hogs.

The live cattle contract size is 40,000 pounds so each one cent move in your option premium= $400. Visit www.tkfutures.com/live_cattle.htm

The feeder cattle contract size is 50,000 pounds so each one cent move in your option premium= $500. Visit www.tkfutures.com/feeder_cattle.htm

The lean hog contract size is 40,000 pounds so each one cent move in your option premium= $400. Visit www.tkfutures.com/lean-hogs.htm

Account Choices

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1) Self Direct Online Account- This account is for investors who wish to trade without the help of a broker. Visit www.tkfutures.com/online-trading-platform.htm to see our platforms.
2) Broker Assisted Account- This account is for investors who wish to trade with the help of a broker. A broker will give you recommendations and assist you with entering and exiting your trades. They will also monitor your account and keep you informed.
3) Managed Account- This account is for investors who wish to take a hands off approach to commodity investing. A commodity trading advisor (CTA) will make trades for your account at their discretion. We have dozens of CTAs to choose from. Visit www.tkfutures.com/managed-futures-trading.htm to learn more.

Visit www.tkfutures.com/open_account.htm when you are ready to begin trading.

We hope that you have enjoyed this e book. Feel free to pass it on to your friends and family that might have an interest in futures and options.

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Contact us today for more information.