The Sketch

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How to Limit Risk ~ But Leave Your Upside Open

Congratulations! You've reached The Sketch. This "Sketch" is a mini-version of a larger document called, The Blueprint (http://www.radioactivetrading.com/products.asp)

Question:

How do I get real, reliable growth and income from my stocks without risking devastating loss?

Answer:

By using a proven strategy for actually *controlling* losses in the single digits…
while letting your winners run.

Investors have attempted many different strategies for growing capital and generating income in the stock and options markets. Some popular strategies might be: buy and hold, dividend stocks, covered calls, vertical spreads, etc. In this pursuit, many investors have experienced large losses as a result of not being protected. If you haven't been hurt yet, good for you. But bookmark this page…the law of averages says you'll be back.

In theory, there's nothing wrong with the "buy-and-hold" investments or the various strategies for generating income except the fact that by themselves, these strategies are incomplete. In general, these strategies do not protect your investment if the stock loses value, which is not to the investor's (your) advantage.

THE TWO BIGGEST PROBLEMS WITH SELLING INCOME STRATEGIES

One glaring flaw of income generating strategies is that they do NOT cover you against loss beyond the initial premiums (income) received. Income generating strategies actually **limit** the amount that an investor can gain, while retaining **all the risk** of a slide in the price of the stock.

Think about it…in most income generating strategies, you only outperform the market if your stock stays flat. And flat stocks don't carry big premiums so you really don't do well trading those either. In case you do trade an issue that has the kind of volatility that makes income-generating strategies attractive, there are two scenarios in which you might lose:

1.- You own 100 shares of XYZ, currently trading at $50.00. You have $5,000 AT RISK. For income, let's say you sell a call at the $50 strike price, a month or two out for $1.50. This gives you a net income to the account of $150 less commissions.

Next..! XYZ shoots through the roof and goes to $100 a share…but you are **obligated** because of the short call to sell at $50 a share. Net gain if you bought your stock for $50 and sold a covered call: $150. This is a **3% gain** for a $5,000 investment…that actually **should** have DOUBLED your invested dollars (**100% gain**). Ouch.

2.- You own 100 shares of ABC, currently trading at $50.00 You have $5,000 AT RISK. For income, let's say you sell a call at the $50 strike price, a month or two out for $1.50. This gives you a net income to the account of $150 less commissions.

After trading hours, ABC comes out with news that it didn't get FDA approval. Didn't meet earnings expectations. Had "accounting discrepancies". Didn't get the big contract. Had SOME unexpected problem…fill in the blank. At the market open, ABC is valued at $25 and is going down HARD from there. All the institutional investors are forming a line to sell and you're at the end. Result? At least a 50% loss, offset by a meager 3% gain from selling a call option. Super-Ouch.

In the second scenario above, if you were trading on margin, you would have lost your ENTIRE account, or could even end up OWING money. I know this from personal experience…I was following a covered call trading guru's advice to the letter and ended up seeing all my savings dissolve within 15 minutes of the opening bell.

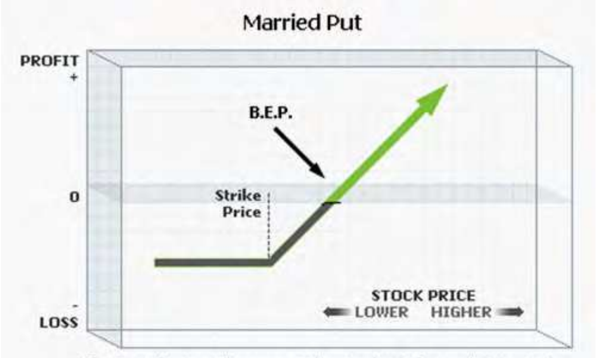
Income generating strategies are touted as some of the best ways to make money in the stock market, and yet it's only half (or less than half) of a complete plan. When you think about it, income generating strategies are actually efficient sorting machines…a mathematical algorithm that takes the winners OUT of your account, and places them in the hands of other investors…while leaving you with the losers to deal with in your account.

A good friend of mine runs a company that helps folks search the universe of stocks and options for the best trading candidates. He supports all kinds of option strategies, but out of the more than 120,000 investors, who have tried the tools, the majority of them are using income generating strategies…and MOST of them report having successfully sorted all the winning stocks OUT of their accounts and being stuck with losers…an inevitable effect of consistently trading income generating strategies.

If only there were a way to do the exact OPPOSITE of this process…to guarantee that a stock's sell price could never go below a certain amount, but also "leave the lid off" – that is, ALLOW the stock to grow and even take income without obligating ourselves to sell…

Enter the Married Put Strategy

This graph is a visual representation of a Married Put position. As the stock falls, the value of the position hits a "floor" – an absolute limit to how much you can lose. This amount can be adjusted for your comfort level… **even as low as 5% or less…** That's MUCH tighter and safer than the traditional "stop-loss" order, which you might use for protection. On the other hand, there is NO limit to how high the combined value of a stock and put option may go. Where traditional income generating strategies offer little income and no protection, a Married Put offers absolute protection for a small price…*a cost, which may even be erased* as the stock moves. **Can you imagine having no way to lose, but STILL be able to gain more?**



The Married Put is the only long stock investing method that bets on the sure thing: Setting up a stock and option configuration whose value is secured with a definite selling price. This absolutely defines your maximum possible loss…it's why mutual fund managers and other institutional traders – men and women entrusted to stewarding millions, sometimes BILLIONS of dollars – use the Married Put strategy and its cousin, the Collar – all the time.

A Married Put position executed correctly includes the choice, but not the obligation to sell at the exit price YOU choose. Meanwhile there are several different Income Methods and growth strategies that can be applied as the market unfolds. A trader that sets up a Married Put can define the MAXIMUM POSSIBLE LOSS and control it, yet retain unlimited gain/profit potential.

THE SKETCH: HOW TO (REALLY!) TREAT YOUR TRADING ACCOUNT LIKE A BUSINESS

In general, income-generating strategies involve taking on a certain amount of risk. If the underlying stock goes against your expectation, you're on the hook. But if these same cash-capturing strategies are executed *within the context* of the Married Put, they can be implemented *after* the fact, *after* a stock has chosen a direction…usually adding no additional risk to the trade.

In other words, you might wait to execute one of ten Income Methods against a stock that you own, that's insured by a put...until AFTER the market makes a move. This way, ALL of your risk can be erased to the point that the stock and option combination become "bulletproof". In this Sketch we'll investigate one of ten different ways that this can happen. After reading this Sketch, you might consider attending a free webinar that details two of the other ten Income Methods we teach. Go to http://www.poweropt.com/webinars.asp to get signed up for a free live web-seminar. All ten Income Methods are described and illustrated in The Blueprint.

OPERATING (AND PROTECTING) YOUR INVESTMENT LIKE A SMALL BUSINESS

To set up a Married Put, all you must do is own an optionable stock and choose a date by which you are willing to sell. The "put" option grants you the right, but not the obligation, to sell your stock at a preset price up until the expiration date. Depending on risk tolerance, you can secure the exit at 10%, 5% or even 2% loss NO MATTER WHAT. That's right…With a Married Put, even if the stock pulls an Enron, the sell price is guaranteed no matter what the stock does before expiration.

When you insure the value of your stock with a Married Put, you can still use covered calls and other option strategies to take in income. In fact, it may be possible to take in MORE income before expiration than is AT RISK, making an investment "bulletproof". This means that even though a stock can bring in MORE money in terms of growth or income, it's IMPOSSIBLE for you to lose even a DIME. How much more you make depends on the stock's performance, but you've effectively made a situation like this: Heads you win, Tails you don't lose. An example of an actual trade in this situation follows.

Here's how a specific kind of Married Put arrangement can be turned into an income-producing asset: VERY limited risk, UN-limited potential. The following example is taken from an actual trade, one of many documented in real time with real money and explained in great detail in The Blueprint.

FEBRUARY 11, 2008

1) Buy 100 shares SWN(Southwestern Energy)	$60.95
2) Buy to Open 1 Sep 08 $70 put option	+ $13.00
3) Total Amount of Investment	$73.95
4) Level at which Investment is Insured	- $70.00
5) Total Amount AT RISK	$ 3.95 or 5.3%

Now, let's look at what this setup means to you. Say you had only bought the stock in this situation. You'd then have your whole investment of $6,095 (the cost per share times 100 shares) AT RISK. If SWN happens to go down, you bear ALL the risk.

Instead, however, you used a Married Put. You may have paid a little more, but now own an investment with a guaranteed minimum value of $7,000 for the next seven months. It cost $7,395 total to set up (see line three, multiplied by 100 shares), but its value is GUARANTEED to be at least $7,000 because of the put option.

This means you can sleep right through quaking financial markets, or a bad earnings announcement, or any number of events that might result in a sudden gap down. Out of your $7,395 invested, you cannot possibly lose any more than $395, or about 5% of your invested dollars, no matter what happens.

Hold on because this gets interesting rather quickly. Most investors, even those experienced with options, would think that your stock would have to go waaay over $73.95 a share before you begin making any money. **That simply is not true**. Sure, when you drive a new car off the lot its value instantly goes down by 20%, but in the case of a Married Put, especially one done this specific way, the value of both the put option and the stock are added together and there are ten different ways to take Income out, without selling the stock. Compare this with just ONE way to take money out of a stock alone: the covered call.

While the put option's value does drop in response to the stock going up, it does so at a distinctly different rate. Truth is, you can make LOTS of money…safely…doing other trades within the context of this structure. The structure becomes a platform for launching other trades that capture income and put it into your account, with no risk at all. I call this specific arrangement a RadioActive Profit Machine (RPM).

INCOME GENERATING STRATEGIES CAN STILL BE USED WITH MARRIED PUT

You now own an income-producing asset, protected by "stock insurance". Most folks that invest in real estate or in small businesses would never consider picking up an asset whose value was not insured. Just like a small business that's insured by the owner in case the building burns down, your RadioActive Profit

Machine has the potential to make money. It also has the potential to lose, but not much. In the case above, your max loss is about 5%.

Your RadioActive Profit Machine's value is guaranteed…and it has several "products" for sale. ONE of those products is a covered call, a call sold against the shares of stock that you have in inventory. We'll call THIS way of using the RadioActive Profit Machine to generate money: Income Method #1. I give this Income Method away for free…because many folks with a weekend to kill and $3,000 to burn have already learned it…Sorry to poke fun but it's an awful lot to charge for just one Income Method and NO protection.

INCOME METHOD #1: SELLING A CALL OPTION

In this real life, real money trade example, SWN made a climb, had a sudden downturn, and then began to climb again. In this example we'll look at how it could have made a **short term, 7.36% return…**

…though in truth the SWN RadioActive Profit Machine (my specific kind of Married Put structure) made about a **two month, 16.2% profit** after commissions.

THAT's not remarkable though…what's important is that, if the trade had gone sour, there's no way that I could have lost more than 5.3% of my capital. Here's how the story begins:

About two weeks after assembling the SWN RPM (**R**adioActive **P**rofit **M**achine), SWN went up enough that it was possible to sell the April $70 call for $3.90 premium. Now, let's recall the setup:

FEBRUARY 26, 2008 SWN STOCK PRICE: $68.13

1) Own 100 shares SWN(Southwestern Energy)	$60.95	
2) Own 1 Sep 08 $70 put option	+$13.00	
3) Total Amount of Investment	$73.95	
4) Level at which Investment is Insured	-$70.00	
5) Total Amount **AT RISK**	**$ 3.95**	(5.34%)
6) Sold to Open April $70 call	**-$ 3.90**	
7) **New AT RISK Picture**	**$ .05**	**(0.07%)**

Since there was only $3.95 AT RISK, taking in $3.90 premium for selling the April $70 call made this trade virtually risk-free…a situation we call "bulletproof". Since October 2002, RadioActive Trading has used this term to describe a situation in which it's impossible to lose, but possible to gain.

Now, some might argue that 1) there's still a NICKEL (.05 a share) AT RISK, which technically there is, and 2) that if the stock goes up above $70, you would lose that nickel because you would be forced to deliver the stock at $70 a share.

Well, okay…but let's not forget that you still own a $70 put option, and that option doesn't expire for another 7 months.

If you were forced to sell your 100 shares of SWN at $70 a share, because of the obligation that you took on by selling the April $70 call…The September put would still be worth *something*. On April 18, 2008, you could have gotten out of your September put for $5.50.

IF all you did was Income Method #1: Selling a call option…here would be the Profit and Loss Statement:

APRIL 18,2008 SWN STOCK (PRICE ADJUSTED FOR SPLIT): $80.84

Income from selling the April 2008 $70 call	$ 3.90
Proceeds from selling stock at $70	$70.00
Proceeds from selling the September $70 put	+ $ 5.50
Total IN	$79.40
Total OUT Original Investment	- $73.95
Profit (in 52 days)	$ 5.45 or 7.36%

So truly…you are BULLETPROOF the moment you decide to sell a call option whose premium cancels the AT RISK amount in this trade. If you are called out, so what? Your put option still has enough value to have made your time worthwhile. In this case, you would be balancing a maximum $0.05 loss per share against a $5.45 gain. Not shabby.

WHAT REALLY HAPPENED

Truth is, I actually did every single thing that I've documented here…but I'm leaving out two details that I'll call Income Method #3 and Income Method #6. Neither one added ANY risk to the overall position…

…but those other Income Methods squeezed enough out of this position (with no added risk) to take total profits up to just over $1,200.00 after commissions. I actually ended the position on May 16, 2008…That's about a **three month return of 16.2%.**

Again, though…It's NOT the fact that I had a decent return that makes this form of trading unique. What makes it unique is the fact that I never had more AT RISK than 5.3%...and after a certain point it was BULLETPROOF, meaning that I could gain more, but could not possibly lose ANYTHING.

Here's a revealing poll that I do in my free webinar, which you can attend by the way by clicking: http://www.poweropt.com/webinars.asp. If you could keep your wins from last year, but go back and change your losses from whatever they were to 3-6%, would that have made you more successful? Almost EVERYBODY says yes. Listen: when I began trading this way, it was October 1, 2002. I picked up AMZN, then YHOO, then EBAY. At the time, all I knew was how to assemble a Married Put and sell calls against them to accomplish bulletproofing.

NOW I'm able to assemble and take money out of my RadioActive Profit Machines ten ways from Sunday. The best thing about the RPM is that it skews your Risk/Reward picture in a positive way… which can be statistically shown to WIN over the long haul. This means that whether you pick more winners than losers, or even if you actually LOSE more often than you WIN… you can still profit.

CONCLUSION

With stock ownership alone, ESPECIALLY with stock that you have entered an income generating strategy, you have no protection whatsoever against a sudden drop. This is because you have to hold the stock until expiration, OR roll the position. This can often be expensive and stressful.

A “stop” order will do you no good either; “stop” does not mean, “stop and sell exactly at this price”. That is, when you place a stop order, your broker will sell at whatever the market price is when the order is triggered, not necessarily at the price you set. I went to sleep one night with a —stop order to sell my $18 stock if it fell below $15. When it opened one morning at $9, I was out of my highly margined account with a devastating (complete) loss. To add insult to injury, my stock climbed back up past $20 four months later.

The income generating strategy known as covered call selling can be compared to —renting out one’s stock - like with a rental home property. If selling a covered call equals collecting a rent payment, and the stock is the house, and I’ve heard the put option be compared to the fire insurance. In truth, however, the put is MUCH more powerful… it is another tool for generating income.

The best thing about trading this way is knowing your exit on the way in. Rather than spending hours glued to the computer like a day trader, or sweating out the “overnights” with other position traders, I prefer to be in total control of the cash out while only looking at the stock one or two times a week.

Time invested: I used to take an hour on the front end to determine what stock/option combination to buy. NOW I use the services of PowerOptions (http://www.poweropt.com/RAT/) to instantly sort and report…which gives me the best candidates in seconds. You can get a free two-week trial subscription, no credit card required, by clicking the link above.

The Married Put strategy is used by almost all huge slow-moving behemoth institutional investors and yet is virtually unknown to who it can benefit the most: The nimble, small investor with $5,000 - $1,000,000 to allocate. I want to make it common knowledge as the ONLY strategy that guarantees a preset sell price, while still leaving the upside wide open for gains.

Intrigued? Or should you dismiss the idea of healthy gains without the risk of any serious loss? Look over an investor’s shoulder that does this kind of strategy. Better yet, send this page to a friend (could be your broker) with options trading experience and see what he or she thinks. The information contained on this page is going to shake up the world for small investors everywhere if the secret gets out.

OTHER EDUCATIONAL RESOURCES ON THE WEB:

For a free & live webinar that covers all of this material and more Income Methods
http://www.radioactivetrading.com/webinars.asp

For a definition of covered calls, visit
http://www.poweropt.com/cchelp.asp

For a definition of the Married Put strategy, visit
http://www.poweropt.com/marriedputhelp.asp

Free Trial to do a real time search of the best candidates for this strategy, visit
http://www.poweropt.com/RAT/

The Blueprint details 11 Income Methods to manage and earn income from a married put setup:
http://www.radioactivetrading.com/products.asp