Three Secrets For Profitable Straddle Trading

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Introduction…

Welcome to our free report, "The Three Secrets To Profitable Straddle Trading".

It's no secret that options have exploded in popularity over the years. The reason is simple. No other investment offers the broad range of benefits to investors that options do.

For instance, for the cost of an option premium, you control 100 shares of stock. That means, you can control huge amounts of assets with a relatively small amount of money.

What's more, options make top-notch risk management tools. Options are one of, if not the top financial instruments used to reduce portfolio risk among professionals and casual traders alike.

And don't forget flexibility…

There are literally hundreds of strategies you can create with options. You can use options to design strategies to profit from just about any scenario you can envision…

We're going to look at one of these strategies up close in just a minute. This strategy is one of the most popular out there for all types of traders. And, it can result in huge profits… *if done correctly*.

First off, after reading this report, be sure to check your email inbox each day for our free e-letter, *Options Trading Research*. This newsletter is one of the best ways to not only learn more about options, but also how to use them effectively.

Now, let's take an in-depth look at the options straddle.

Introducing The Options Straddle

One of the many popular options spreads commonly used by expert traders is the options straddle. If you've traded options for any length of time, you are familiar with the straddle. You may have even traded a straddle once or twice.

By definition, a straddle is a strategy where the investor has a position in both a call and a put at the same strike and expiration date for an underlying instrument.

So far example, if **Microsoft** (MSFT) is trading at $32 per share, then buying an at-the-money (ATM) straddle would consist of buying the 32 call and 32 put for the same expiration month.

Now, a straddle doesn't always have to be an ATM straddle. But more often than not, that's what traders are talking about when they refer to a straddle trade.

For our purposes, I'm only going to be discussing ATM straddles in this report. Anytime I mention a straddle from here on out, assume it's an ATM trade.

Okay, now that you know what a straddle is, let's talk about why it's such a popular trade.

Actually, it's really quite simple. **The straddle is so popular because it can make you so much money**. <u>The upside is unlimited.</u>

What's more, you don't have to pick a direction for the underlying to move! Because you own both a call and a put, either direction can make you money. All you need is for the underlying instrument to move.

On the surface, it seems incredibly simple. It's true, a straddle is an easy trade to understand and execute. Unfortunately, reality is a different story. And often times, uninformed investors lose lots of money trading straddles.

You see, there's a problem with much of today's options literature concerning straddles.

On one hand, you have the books/websites that tell you how easy a straddle can be to trade and how you can make unlimited profits. But, they also fail to tell you how easy it can be to lose money on straddles... **<u>if you don't know what you're getting into</u>**.

And then you have the literature that tells you to flat-out avoid straddles because they're too risky. The problem is, if you listen to this advice, you'll be missing out on an incredible opportunity.

As always, the answer lies somewhere in between.

Straddles can be risky and they can make you lots of money. **You just have to know the rules of straddle trading.**

Understanding the rules of straddle trading can unlock the strategy's unbelievable upside potential. Following the three rules I'm about to explain can make all the difference between being an expert straddle trader and an options tourist.

Just keep reading and you'll know the same three secrets to straddle trading that the pros use in their own trading.

The Three Secrets To Successful Straddle Trading

Okay, so you know what a straddle is. But on its own, understanding the definition of a straddle is no way to make money.

Straddles can be very risky if not traded properly. The experts don't just jump in and starting slinging straddles all over the place.

In order to minimize your risks and maximize your return potential, it's important to follow three key rules of trading straddles. These aren't rules you're going to find in your typical options literature.

Pros like to keep the best trading secrets to themselves.

Not anymore! Let me introduce to you the three secrets to successful straddle trading.

Straddle Secret #1: Base Your Straddle Trade On An Event

The biggest risk to trading straddles – and the reason investors often lose money on them – is the cost.

Straddles can be really expensive.

It can get to the point where the underlying instrument (a stock, ETF, or whatever) has to make a huge move just to make your money back.

Don't get me wrong, you're expecting a big move. After all, that's the point of trading a straddle. But you don't want to the underlying (let's say it's a stock) to have to move 20% in order to just break even. That's a highly improbable event.

As with any other trade, you want probability on your side as much as possible. Now, strategies with big return potential have bigger risks involved – but that doesn't mean you throw probability out the window.

That's why the first rule of straddle trading is to base your trade around an event.

That event can be earnings, a conference, a product unveiling, or something else entirely. *But, it needs to have a known date.* A potential event is not the same as a scheduled event. Don't bet on potential in this case – bet on certainty.

Too often, investors are told to trade straddles in volatile stocks. But, volatile stocks are unpredictable. So, you'll be paying a lot for the straddle due to volatility, but with no clear end in sight. That's pure gambling.

Instead, pick an event which you believe may cause a stock to move. Quarterly earnings are typically the way to go. They happen four times a year guaranteed – and you know exactly when they'll be released.

Here's the thing…

Earnings in a utility stock will do no good. A utility is not likely going to tell the market anything it doesn't already know. As such, the shares probably won't move very much.

That goes for any "boring" or predictable stock. If there's not expected catalyst for a big move, there's no point in trading a straddle on earnings.

On the other hand, earnings in a tech stock that recently launched a new product could be the perfect candidate. There's really no way to know what the impact will be of a new product on the bottom line until the company releases numbers. And, that typically happens at earnings.

The most obvious example of this is **Apple** (AAPL).

Let's say Apple has recently released the next version of its iPhone. Until the quarterly earnings, there's really no way to know for sure how many of the new phones the company has sold.

The potential for a huge earnings miss or beat is pretty big. In general, that makes for an excellent straddle opportunity. Your straddle theory is centered on upcoming earnings after the release of a major product.

Okay, so this theoretical Apple trade follows rule #1 perfectly. However, Apple is not a good choice for a straddle. In fact, it's the exact opposite. That's where rule #2 comes in.

Straddle Secret #2: Avoid Expensive Stocks

I just mentioned an Apple earnings release after an iPhone launch as the perfect opportunity to trade a straddle. But then I said Apple was a terrible company to trade straddles on. So what gives?

The event itself is a nearly ideal event to trade on - *but Apple is way too expensive of a company to buy straddles in*.

By expensive I'm talking about a flat-out high stock price. (For options straddle trading purposes, I'm not concerned about AAPL's value - just the actual price.)

You see, the higher the stock price, by definition, the higher the straddle is going to cost.

Just think of this quick example. Let's say the market has priced in a 10% move into a stock for an upcoming earnings release. (In other words, the current straddle price reflects a 10% move in either direction in the expiration month the earnings occur in.)

For instance, a 10% percent move in a $40 stock is $4 - so the straddle might trade for $8 ($4 in each direction). Okay, if you agree a 10% move is probable after earnings come out, that's a reasonable price to pay... $800 per straddle.

But what if it's a $400 stock? Then, in the same scenario, we're talking about an $80 straddle or $8,000 per straddle. That's just too much to pay for the average person.

Here's an important thing to understand...

The likelihood of a 10% move in either of these stocks is the same in the scenario I just described. It's not like you have a better chance to make money because one stock is more or less expensive.

The key point to understand is if you're wrong and the straddle doesn't work, you're out $8,000 on one trade or $800 on the other. *That's a huge difference in cost.* And, it significantly impacts your personal risk equation.

So really, this straddle rule is all about risk management. **And the bottom line is, there's no reason to take unnecessary risks on straddles by picking high-priced stocks**. There will be enough opportunities in cheaper stocks to avoid the really expensive straddles.

As a rule of thumb, I'd ignore stocks trading above roughly $75 per share. Obviously exceptions can and do occur, but generally once you get to that price level straddles get to be too expensive.

Remember, winning straddle traders understand and embrace risk management. The single best way to keep your risk low is to keep your overall cost low.

Straddle Secret #3 – Buy The Straddle Two Weeks Before The Event

Alright, I just talked about not spending too much on straddles because of a high stock price. But how do you know if the straddle itself is too expensive? Is a 10% move too much to expect? What about a 20% move?

First off, this is a far more difficult question to answer. That's because there's not necessarily a right answer.

Depending on the stock, a host of different variables come into play. There are technical and fundamental factors to consider. How much has the stock moved on past earnings?

Is the stock significantly overvalued? Are Rumors already swirling about this news event? That's just a sample of the many variables you need to consider.

Here's the thing...

In general, I wouldn't expect a move of more than 10% in either direction – typically it will be less. Of course that's a ballpark estimate, but it's a good general guideline.

For further guidance, you can always look at a longer-term chart of the stock in question and see how much it's moved on past earnings announcements. (You can also use important technical support/resistance levels to help you make the decision.)

Of course, past performance doesn't guarantee a thing. However, it's a good place to get general guidelines.

Now, I'm not listing the "10% guideline" as a straddle trading rule. A guideline is all it is. The situation is too variable between stocks. Historical performance is important. The type of stock is important too. (You can't compare a biotech with a retail stock, for instance.)

Basically, you'll have to do a little research and come up with some general expectations of how far a stock could move given the coming event.

So, instead, we need to focus on the best time to purchase your straddle in order to maximize its potential. That is something we have some control over.

Most importantly, you want to try to buy your straddle before other investors bid up the price.

Let's say you have a stock in your price range with an event coming up you believe will move the shares. When should you buy the straddle?

You want to get in before other investors, as I just mentioned. But, you don't want to overpay by spending too much on time premium. Keep in mind, we're trying to find straddles that price in less than a 10% move in either direction.

In my experience, the cutoff for straddle investing occurs approximately two weeks before the event is supposed to happen. Many investors only look about two weeks ahead. And plenty of people will start jumping into a trade those last couple weeks.

Now, those late comers are also trying to minimize spending on time value. But, we're willing to pay a little more for time in order to avoid buying at the peak of demand.

That being said, we don't want to buy too early. Around two weeks is pretty much ideal. Over three weeks is too long. Under two weeks is not long enough. So roughly 14-21 days before the event is generally speaking, the best time to buy.

Putting It All Together

Now it's time to put all three trading secrets together. If a straddle meets all three rules above, it's going to maximize your potential for a big win.

So, first off, find a scheduled event you believe is going to move a certain stock. Earnings are the easiest choice. We have plenty of advanced notice for when earnings are going to be released.

Don't forget, you should expect this event to really move the stock. Earnings with no reasonable expectation of a catalyst won't do you any good. Make sure you can justify why a big move is expected to occur.

Then, make sure this event will impact a stock that isn't too expensive. I gave a $75 per share max, but under $50 would be even better.

Then, check the price of the ATM straddle for the earnings month and make sure it's not pricing in more than a 10% move. If it's cheap enough, add it to your watch list until 14-21 days before the event. And, if it still meets the criteria during the trading period, buy it.

Remember, the ATM straddle can and will change with the stock price. What you're looking to buy is the ATM straddle *at the time of the ideal trading period* (2-3 weeks before the event).

But even though the ATM straddle may change, the three rules won't. So, as long as you're following the rules, you have nothing to worry about.

That's the beauty of these trading secrets. **You can use them in virtually every straddle trading scenario.** As long as your potential trade passes the criteria, it's worth seriously considering.

A Final Word

By following my advice above, and paying close attention to the three secrets of successful straddle trading, you're putting your straddles in the best possible position to profit.

Basically, you're combing elements of risk management and probability in order to give your trades a stronger likelihood to succeed.

Just following the rules I laid out above will allow you trade on the same level as the pros. This is how they do it! **Professional options traders follow these exact same rules**. That's why I call them secrets – the pros don't want you to know their secrets to success!

After all, straddles can make you a ton of money. And you don't even need to know what direction your stock is headed in!

The straddle strategy can be so powerful – it just needs to be used properly. And now, you have all the information you need to become a successful straddle trader.

Where To Get More Options Trading Ideas On These Strategies And Many More…

One of the additional benefits you'll receive along with this report is a free subscription to our *Options Trading Research* newsletter (delivered straight to the email address you provided).

Published several times a week, *Options Trading Research* will give you professional options trading ideas, market commentary and analysis all designed to make you a better options trader!

Authored by my expert team and me, we'll show you what's working in the options market and what you need to know to generate the biggest returns.

To make it as useful as possible, we've also tailored it so both beginners and advanced traders can profit immediately from what they read...

So if you're serious about making money and securing your retirement using options--welcome aboard!

I promise that you won't find a better source of proven, useful options trading ideas anywhere on the web!

Sincerely,

Gordon Lewis,
Chief Options Strategist
Options Trading Research