"Last Week's Trades" - A Resource for Leveraged Investors

Description	Closed	Opened	Days Held	Premium Booked	Annualized Rate (projected if still open)	Daily Income	Share Price When Position Initiated or Rolled	Ending Price (or Previous Friday Close if Trade is Still Open)
TOTAL BOOKED INCOME MAY 2012				**$1,289.42**				
TOTAL BOOKED INCOME JUNE 2012				**$755.13**				
2 PG JULY 21 2012 65 PUTS	7/12/2012	5/15/2012	58	$89.33	4.32%	$1.54	$63.50 - $64.22	$63.76
7 JPM JULY 21 2012 38 PUTS	7/11/2012	5/29/2012	43	$265.74	8.48%	$6.18	$33.36 - $34.00	$34.54
1 JPM JULY 21 2012 34 LEAPS Cvrd Call	7/2/2012	6/12/2012	20	$106.23	63.10%	$5.31	$33.22	$36.30
1 JPM JULY 21 2012 37 LEAPS Cvrd Call	7/17/2012	6/22/2012	25	$72.21	34.32%	$2.89	$36.19	$34.60
5 LINE AUGUST 18 2012 38 PUTS	7/19/2012	6/29/2012	20	$305.85	29.38%	$15.29	$38.08	$40.12
JULY BOOKED				**$839.36**				
1 ALL AUG 18 2012 34 PUT	8/3/2012	7/6/2012	28	$63.21	24.23%	$2.26	$34.61	$37.10
3 LINE AUGUST 18 2012 40 PUTS	8/8/2012	7/19/2012	20	$210.42	32.00%	$10.52	$40.12	$39.08
1 JPM AUGUST 18 2012 35 LEAPS Cvrd Call	8/6/2012	7/25/2012	12	$82.23	81.41%	$6.85	$34.92	$36.77
1 JPM AUGUST 18 2012 36 LEAPS Cvrd Call	**8/13/2012**	7/25/2012	19	$39.23	24.53%	$2.06	$34.93	$36.99
1 NTRS SEP 22 2012 45 PUT	**8/16/2012**	7/31/2012	16	$68.47	34.71%	$4.28	$45.56	$47.19
2 PG OCTOBER 20 2012 65 PUTS	**8/17/2012**	7/12/2012	36	$78.40	6.11%	$2.18	$63.76	$67.10
AUGUST BOOKED - TO DATE				**$541.96**				
1 BWP SEP 22 2012 30 PUT	9/22/2012	2/29/2012	206	$67.20	3.97%	$0.33	$27.08 - $27.59	$27.00
1 JPM SEP 22 2012 35 LEAPS Cvrd Call	9/22/2012	7/2/2012	82	$13.46	1.95%	$0.16	$36.30	$36.98
3 KIM SEP 22 2012 20 PUT	9/22/2012	8/6/2012	47	$137.69	17.82%	$2.93	$19.87	$20.31
7 JPM OCTOBER 20 2012 38 PUTS	10/20/2012	7/11/2012	101	$714.25	9.70%	$7.07	$34.54	$36.98
1 JPM OCT 20 2012 36 LEAPS Cvrd Call	10/20/2012	8/6/2012	75	$9.46	1.50%	$0.13	$36.77	$36.98
3 LINE OCTOBER 20 2012 40 PUTS	10/20/2012	8/8/2012	73	$240.37	10.02%	$3.29	$39.08	$39.48
1 JPM OCT 20 2012 37 LEAPS Cvrd Call	10/20/2012	**8/13/2012**	68	$36.46	6.37%	$0.54	$36.99	$36.98
3 Long JPM JAN 18 2014 25 LEAPS Call (Cost = $3072.28) (Adj Cost = $2772.38)	1/18/2014	6/12/2012	585	N/A	N/A		$33.22	$36.98

Disclaimer: I include this section of the weekly letter as an additional resource for owners of ***The Essential Leveraged Investing Guide*** *package. Any information and commentary detailed below should not be construed as a recommendation to enter into any specific trade. The purpose here is to simply provide owners of* ***The Essential Leveraged Investing Guide*** *the additional resource of seeing how I personally apply the principles spelled out in the Leveraged Investing Guide to initiate and adjust my own trades.*

FYI - All "Put" positions are naked, or short, puts. Grayed out fields indicate a position has been closed. Accumulated booked income for the month is reflected in appropriate row.

Last Week's Trades - August 13 - August 17, 2012 (August Expiration Week)

1 Adjustment/Roll + 2 Closed Early

#1 - Rolled 1 Aug 2012 JPM $36 Short Call to 1 Oct 2012 JPM $37 Short Call

On Monday, August 13, 2012 (Expiration Week), with JPM (JP Morgan) trading at $36.99/share, I rolled one of my JPM LEAPS Covered Calls from August out to October, and increased the strike price from $36 to $37. The trade also produced a modest net credit of $36.46 over an expected holding period of 68 days (i.e. the October expiration).

Actually, the net premium received wasn't all that modest. As I've pointed out before, I tend to "under calculate" the returns on these LEAPS Covered Calls/calendar spreads in that I take the premium income from an individual short call and divide it by the entire purchase price of all 3 long January 2014 JPM LEAPS calls (this probably made more sense when I was adhering to the 1/3 approach and hadn't initiated short calls against all 3 long LEAPS).

So on this roll, the $36.46 net premium income is equivalent to a 6.37% annualized rate when calculated on the entire LEAPS position (even though I currently have short calls written against all 3 of the LEAPS). In actuality then, this new October short $37 call, based on just the one long LEAPS that it's written against, has an annualized return of around 19% (the net premium in terms of total dollars may not be much, but each one of these long LEAPS calls originally cost just a little over a thousand bucks - as I've said before (I think), it's not the total dollars that's important, but rather the principles and rates of return.

Of course, the primary objective here was to increase the strike price on the roll - the net premiun and solid annualized returns was a nice little extra. I was fortunate enough to achieve all this because (A) the implied volatility on JPM is pretty high so there is nice amount of premium available and (B) the roll to the $37 October strike was pretty much at the money, which is always going to be where the highest amount of time value is.

So why did I roll the position so early in the week? It goes back to that delta issue we've been talking about the last couple of weeks (delta = the amount an option's value is expected to move for each dollar move in the underlying). Basically, the short August $36 call had a higher delta than the long January 2014 $25 call (LEAPS) - meaning that if JPM continued its uptrend, my short call would increase in value at a faster rate than my long LEAPS call.

Reminder - the deeper in the money and the closer you get to expiration, the higher the delta. In this case, even though the short August 2012 $36 call was nowhere close to being as deep in the money as the January 2014 $25 call, its expiration was a whole lot nearer (imminent, in fact) whic was enough for the August call to pull ahead in the delta race.

Finally, a quick recap and current overview of the trade for those new to the conversation or for those who've forgotten since the conversation has seemingly gone on for so long . . .

Back in June (2012), I purchased 3 long JPM $25 calls (LEAPS) expiring in January 2014 for $3072.28 in order to employ the LEAPS Covered Call Writing strategy. I initially went the 1/3 route, only writing a minimal number of calls against the LEAPS (limiting the number of calls you write against your long position, whether we're talking about LEAPS or the actual underlying shares, helps protect you from moves higher in the stock).

But with JPM as the underlying, my confidence levels are not the highest, and I don't mind being forced out of the trade early if the stock moves sharply higher. So I've been more aggressive on the # of calls I've written - in fact, as I alluded to above, I currently have short calls written against all 3 of the long LEAPS. And with JPM closing on Friday @ 36.98, all but one of them are currenly in the money (and the third is only 3 cents away):

September 22 2012 - $35 strike
October 20 2012 - $36 strike
October 20 2012 - $37 strike

To date, I've booked $299.90 in premium income with another $50-$60 of net premium in the 3 current open positions - as JPM itself rises, the emphasis is less on maximizing option income and more on trying to keep pace with the share price by increasing the strike prices on the short calls with each new roll (the long LEAPS have increased in value from my original $10.20/contract purchase price to a bid of $12.65 as of last Friday's close).

#2 - Closed Early - 1 NTRS September $45 Short/Naked Put

On Thursday, August 16, 2012, with NTRS (Northern Trust Corporation) trading @ 47.19, I closed my single September $45 short put position. The underlying stock had risen from $45.56 to $47.19 in the 16 days since I'd initiated the trade.

We discussed this issue in greater detail in Q&A Session #5 - Buying Back Short Puts Early, but basically, following the move higher in the stock, I saw that I could close out the trade and lock in more than 50% of the trade's potential gains in less than a third of the original holding period.

Or to compare the numbers more explicitly:

Original Trade - $124.23 over 58 days = 19.01% annualized rate

Closed Early - $68.47 over 16 days = 34.71% annualized rate

On the flip side, what was left on the trade (basically about $44, or the $55.76 it cost me to close it out less my commission), factoring in the 46 days remaining on the trade represented only a 7.76% annualized rate

But it wasn't just the accelerated partial returns - I also looked at the NTRS chart which suggested (to me) that the stock appeared to be bumping up against resistance. Here it is after Friday's close (I closed the position on Thursday):

This is also the part where I remind you that I don’t consider myself particlularly adept in deciphering the dark art that is technical analysis. Even if you're proficient with technical analysis, it's as much art as it is science. And the way I approach it, I'd throw in a fair amount of guesswork, too.

So don't read too much into my potential support and resitance lines. But still, my working assumption here is that there's a decent possibility that NTRS could face a little difficulty in moving much higher in the near term.

So why not close it early and then keep an eye on it? I could have probably drawn another potential support line around the $44 level - so maybe if the shares pull back to around $45, I might consider selling the $45 put again. There's still plenty of time on the September put, after all - it's a 5 week cycle this time around and I actually closed out the September put before the August cycle had expired.

#3 - Closed Early - 2 PG October $65 Short/Naked Puts

Finally!

I'm claiming victory here, although I'm not going to pretend that it's a major, important, or impressive victory, or that the end result is going to be a parade in my honor.

First the details - on Friday, August 18, 2012, with PG (Procter & Gamble) trading @ $67.10/share, I closed my 2 short October $65 puts position. With commissions, it cost a total of $178.53 to buy back the puts. There had been a $256.93 net credit on the trade when I previously rolled it from July to October. So that net credit less the $178.53 cost to close the trade resulted in a final booked income/profit of $78.40.

Closing the trade early reduced the holding period from the original expected period of 100 days to just 36 days. But even with that reduction in the holding period, the annualized rate of return actually decreased moderately, from 7.21% to 6.11%.

But that's OK - I don't consider either one of those rates to be very impressive, and I'd rather only be subjected to low returns for 1 month rather than 3 months.

But to understand more fully my desire to close this trade early, you need to recall the history of this trade.

It started long ago . . .

Actually, it only began back in April with PG trading in the $65-$66 level and I'd just read a bearish article on Seeking Alpha on the company based on its technicals (and on a fundamental basis, the company's anemic earnings growth, especially in North America, had been well documented over the previous couple of years).

The author of the bearish article wasn't predicting that the stock would crash, but as I recall, he thought the stock was likely to trade down to at least the low $60s (and he was right, it turned out).

I, on the other hand, was eager to test out a new hypothesis - I was curious (and obviously biased) whether the company's imminent dividend announcement/declaration for the quarter would raise the floor on the stock. This was the quarter, after all, that PG was expected to announce that it was increasing its dividend for something like the 54th consecutive year. And that announcement, I estimated, was likely to come my the middle of May.

I actually thought the shares might trade higher on the news, and even if they didn't surely the floor on the stock would be moving higher by roughly the same amount as the dividend increase. So I very nonchallantly wrote a single out of the money $67.50 put for the May expiration.

The announcement did come, but unfortunately, it didn't come, as I recall, until after the market close on the Friday of expiration week for May. So by the time the dividend was increased as I'd anticipated, I'd already been force to roll the position out a comple of months to July.

And what was also unfortunate is that instead of the share price rising following the news, it continued to drop. When I rolled to July, the shares were in the $63-$64 range, and they weren't done falling yet. So on that first roll, I expanded the trade in order to lower the strike price.

I rolled the single May short $67.50 put to 2 July short $65 puts for a small net credit that would result in a 4.32% annualized return over the 58 days it was held until I rolled again to the October expiration cycle (the one I just closed out).

So what were the lessons learned?

I was clearly wrong on the direction and the near term behavior of the stock. And I demonstrated an obvious lack of respect for the opposing viewpoint. At the very least, the article raised red flags that I shouldn't have been so quick to disregard.

But in my defense, this was at some level an experiment (although one I arrogantly assumed I already knew the outcome of).

I also very deliberately initiated this position by writing only a single put. I was smart enough not to test my hypothesis with a larger position.

And ultimately, where I was right was in my belief that there was an extremely low probability that I would actually lose any money on the position when all the dust settled. I may have had to expand the trade (in order to both lower the strike price and generate net credits on the rolls), but PG, in spite of certain headwinds the company is facing, is still a world class, low risk business.

Still this example does illustrate an important point about risk - it's not always downside risk you have to be concerned about. There's also the risk and cost associated with missing out on better opportunities. For instance, this trade used up $6750-$13000 of implied capital over a 4 month period and produced annualized returns that ranged from 4.32% to 13.93%.

I think I may have contrasted this trade in past commentary with my overlapping series of ALL (Allstate) short puts that had a much better looking chart, produced annualized returns ranging from 19.20% to 30.68%, offered zero drama, and actually made me look kind of smart.