The Value Investing with Options Minifesto
A Brief Overview of the Best Way to Invest. Period.

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INTRODUCTION

Thank you for checking out this Value Investing with Options Minifesto!

I hope to achieve 3 objectives over the next 21 pages:

- Explain What a Value Investing with Options Approach Looks Like
- Demonstrate How and Why This Approach is Superior to All Other forms of Investing
- Have Some Fun Along the Way

Now, the first thing you’re probably wondering is, What the %$!# is a Minifesto?

We all know what a Manifesto is – it’s a 50,000 word rant penned by a frustrated and self-absorbed individual who wishes the world would change so he doesn’t have to.

Minifestos, however, are much different.

They’re (mercifully!) much shorter and, even more importantly, they contain information of actual use and interest to the reader. And they’re also fun and engaging to read.

(At least that’s all true of this Minifesto.)

So sit back and enjoy The Value Investing with Options Minifesto as I make the case for the best way to invest – period.
VALUE INVESTING vs. VALUE TRADING

The very first critical point we need to be clear on is that there are basically two very different approaches to value investing – and they both have serious flaws.

And those differences are what I call Value Trading and Value Investing.

#1 - Value Traders derive value from the price they pay for an asset. The quality of the asset is less important than the size of the discount at which they acquire it.

At some price, the idea is, any asset is a bargain.

Or said another way, even a bad business is worth something.

There are a couple of challenges with this approach – finding these opportunities, and actually being correct that what you find is, indeed, an opportunity and not one of Mr. Market’s many booby traps.

Because make no mistake about it – over time, bad businesses don’t create value, they destroy it.

And the longer you’re stuck owning a bad business and waiting for Mr. Market adjust his price on that bad business in your favor, the less likely you’re going to get all YOUR money back from the deal, let alone ANY of his.

#2 - Value Investors, in contrast, derive value from the quality of the underlying asset and, hopefully, not overpaying for it.

This is the Warren Buffett approach who famously said, "It is far better to buy a wonderful business at a fair price than it is to buy a fair business at a wonderful price."

At the end of the day, investing is about ownership, and ownership is powerful stuff.

Ownership means that other people work on YOUR behalf. They wake up every day, go to work, and spend their lives making YOUR company’s products, providing YOUR company’s services, managing the operations of YOUR business,
and persuading YOUR customers to purchase any or all of these products and services – and YOU receive a share of this production and wealth.

Of course, not all ownership is created equal – that’s where quality comes in.

Would you rather own a golden goose . . . or an albatross?

**So, again, the Value Investing (vs. the Value Trading) mindset is focused on getting fair deals on the highest quality businesses the investor can identify.**

That’s because this mindset understands that over the long term, wealth is built through the operations (i.e. growing profits) of the underlying business.

It’s a pretty safe and proven process, but they key phrase here is “long term.”

It WILL happen, but it’s not going to happen very quickly, and the more decades you can afford to invest this way, the more wealth you’re going to build.

**THE IDEAL SCENARIO**

The ideal scenario, of course, would be to acquire exceptional businesses at exceptional prices.

Unfortunately, Mr. Market rarely gives us those kind of no-brainer opportunities.

In fact, the only time a really great business goes on sale in Mr. Market’s world is when that business is struggling, or when the entire stock market and economy are on the skids.

So the only two realistic choices most conservative, value-oriented investors feel like they have are:

- Getting (hopefully) good deals on bad businesses; or
- Getting OK deals on great businesses
BUT what if we could bridge that gap?

What if, instead of waiting and hoping for Mr. Market to do the impossible, we could actually manufacture our own exceptional deals on exceptional businesses?

(And by exceptional deals, I don't mean small, one-time markdowns - I mean massive, impossible to get on the open market discounts.)

What if we didn’t have to choose between price and quality?

OPTIONS-BASED VALUE INVESTING – THE BEST OF BOTH WORLDS

The good news is that we can do just that.

I’ve been doing it myself and showing others how to do it for years.

So what’s the big secret?

How do you go about acquiring great businesses at seriously great prices?

To answer that, we need to take a step back and consider what we can learn from the most successful value investor of all time – Warren Buffett.

LESSONS FROM BUFFETT

Buffett is an intriguing figure.

He has his devoted followers who seem to hang on his every word.

But he also has his detractors, some of whom seem to resent his success and some who forcefully disagree with his politics.

I prefer to take an objective view of Warren Buffett and focus on discovering what we can learn from his incredible success.

And more importantly, ask how we can apply his success to our lives?
Further, Buffett should be of particular interest to us, not just because of his success, but because he’s been both **Value Trader** and **Value Investor** himself.

When he was younger and didn’t have the massive amounts of capital to allocate that he does today, he was definitely more Value Trader looking to exploit inefficiencies in the market (i.e. finding arbitrage opportunities or undervalued situations regardless of the underlying quality of the asset or business).

But as he developed as an investor, and especially as he found that he had more and more capital to reinvest, he became much more focused on quality than price.

Fast forward to today.

When you have $30-$40 billion of cash to deploy, out of sheer necessity, you’re often forced to buy entire businesses – and not small ones either.

And when you buy an entire large business – like the Burlington Northern Railroad - there’s simply no way you’re going to get a screaming good deal on it. In fact, to acquire 100% of the shares, you’re actually going to have to pay a premium, or a price **above** the current share price.

Now, this is all interesting and everything, but why should we care? How does this impact us?

The key to our success is not in buying the same stocks that Buffett did.

**The key to our success is in understanding where all Buffett’s money came from to invest in the first place.**

**HOW BUFFETT BUILT BERKSHIRE**

So how did Buffett actually build Berkshire into what it is today, and in the process transform himself into one of the richest men in the world?

The very quick version is that he understood the tremendous power of compounding free cash flow.
And the foundation of that was with insurance.

Insurance companies produce large "floats" - funds generated from the natural lag time between when premiums are collected and when claims are paid out.

Those funds are investible.

While the insurance industry traditionally invests its float into liquid fixed income investments (think U.S. Treasuries), Buffett also invested his into the stocks of undervalued, high quality, high cash flow businesses.

**In effect, he invested lots of other people's money into assets that both produced lots of additional cash and were likely to further appreciate in value.**

All this served to further increase the cash flow and book value of Berkshire-Hathaway which he continued reinvesting and leveraging into more of the same until, over the decades, this brilliant formula compounded Berkshire-Hathaway into the cash cow behemoth it is to today.

**KEY CONCEPT – RESULTS vs. PROCESS**

As a detail-oriented individual, this was not an idea that came to me naturally.

But if we’re going to discover and develop better ways to do something – or at least better ways for us to do something - it’s a critical concept to recognize and embrace:

The process itself is not important – it’s the end result that matters.

Now, I’m not talking ethics here, about whether the ends justify the means. That’s not what I’m getting at all.

What I’m talking about is looking at an end result, seeing how someone else achieved that result, and then asking yourself a very powerful question:

Can I replicate that end result via another process? One that’s more practical and easier to implement for me?
Now, obviously, if you just arbitrarily invent a totally different and random process, the odds of replicating a similar end result are pretty low.

**INNOVATION AND RE-ENGINEERING A PROVEN PROCESS**

So here’s the key to innovating a process that will, in fact, replicate specific end results:

You simply ask yourself what the underlying principles of the proven process are.

If you can identify the principles that led to a certain result, then you can begin to study those principles and explore ways to rearrange and exploit those principles to build a new process that’s much more conducive to your own situation, abilities, resources, etc.

In the case of Buffett, yes, we first must understand how he built Berkshire, but it’s even more important to understand **WHY** the process he chose worked so well.

When we approach Buffett’s success from this angle, we realize that we don’t have to use the same process he did.

And in fact, we shouldn’t even try because it’s simply not practical.

We would first have to start our own investing partnership from amongst friends and family, build that up over several years, find a struggling textile operator that we can buy out and use as an investment vehicle, expand heavily into insurance, and invest, reinvest, and compound our float and cash flow from other businesses and investments over the next 5 decades into a hugely successful conglomerate.

The better question to ask ourselves then is whether it’s possible to build our own model that relies on the same **PRINCIPLES** that Buffett’s model does?

And I respectfully suggest that what I call **Leveraged Investing**, or Value Investing with Options, is a way for us to replicate our own personal version of Berkshire-Hathaway.
To Review:

1. We know Buffett is the most successful value investor – or any kind of investor – ever
2. We know how he did it
3. We can consider ways that we can use the same principles Buffett relied on to build something similar but smaller and easier and more practical for us as individual investors

BECOME YOUR OWN INSURANCE COMPANY

Now please bear with me – this first part may seem a bit generic if you’re already an experienced option trader, but it gets better and more profound as we go on . . .

As I see it, insurance, especially in the early years, was the key to Buffett’s success.

It gave him access to much larger sums of investible funds than he could get anywhere else.

Now, the stock market has its own form of insurance – put option contracts.

Puts are often compared to insurance policies for good reason. When you buy a put, you’re given the guarantee that you’ll be able to sell the shares of a stock at a certain price (strike price) by a certain date (expiration date).

If you buy a put at the $30 strike price, for example, and then the stock trades down to $25/share, you can exercise your put and sell the shares at a guaranteed $30/share price.

(You don’t have to own the underlying shares to buy a put either – you can also buy a put as general insurance or for speculative purposes, because all else being equal, a put increases in value as a stock decreases in price.)

But instead of buying puts, you can be on the other side of the equation and be the one selling puts, the insurance company as it were.
The big advantage here is that by selling insurance policies in the form of put option contracts to Mr. Market, you can generate a lot of cash (when you buy a put, the cash immediately comes out of your pocket – when you sell a put, you collect the “insurance premium” upfront as well).

**Now, when we sell a put, we want one of two things to happen:**

- For the put to expire worthless, or

- For the value of the put to at least decline over time so that we can buy it back (and close out the trade) for less than what we originally received to sell it.

**We want puts to lose value – and that can happen in three ways:**

- A Rising Stock Price

- The Passage of Time

- A Decline in Implied Volatility Levels

**BECOME YOUR OWN INSURANCE COMPANY**

Now, we’ll talk about risk and the potential downside in a moment, but what I really want you to understand is the structural nature of viewing yourself as the equivalent of a personal put writing Berkshire-Hathaway.

Writing or selling puts spins off a lot of cash (I personally target 15-25% annualized returns on all my trades).

Most people who sell puts – like those who write covered calls – do it primarily for the income (and there’s nothing wrong with that – as we’ll see in a moment, this is a viable choice as long as you adhere to a set of “strict underwriting standards”).
But what happens if we take the accumulated proceeds of our put writing operations and . . . reinvest those funds into open market stock purchases of high quality, reasonably or attractively valued stocks?

If, for example, I have a $100,000 portfolio that I use as cash-secured capital with which to write or sell puts, and over the course of one year, I end up booking, say, $15,000-$25,000 in option income, then that can become a separate high cash flow funding source for me to take and reinvest.

In the same way that Buffett takes the proceeds of his profits and cash flow and reinvests it into more of the same, you and I can sell puts, generate a lot of cash, and do the equivalent.

The high yield income produced by our put writing operations can be used as high yield income, of course.

Or it can be used as a separate funding source that we use to buy shares of our favorite stocks on the open market.

And, any stocks we purchase on the open market that are funded solely from the source of this reinvested income, in effect, will have a zero cost basis because the funds to purchase the shares didn’t come from our original capital – so, in effect, the shares, didn’t cost us anything.

Now, this sounds cool in theory, but if you’ve got your thinking cap on, you’ve probably got one really important question in mind . . .

**RISK . . . OR WHAT IF THE STOCK GOES DOWN?**

Any business model or investment strategy should be evaluated not based on what happens when everything goes right.

It’s far more important to understand what can go wrong, and what happens when it does?

Yes, we’re trying to replicate a miniature or personal version the Berkshire model through our own customized put writing operations.
But as beneficial as it is to understand the ways in which we’re similar to a traditional insurance company, it’s just as important to understand how we’re different.

**US vs. TRADITIONAL INSURANCE COMPANIES**

The real advantage of a traditional insurance company isn’t so much its profitability as much as its size.

In fact, a traditional insurance company’s scale means they don’t have to be all that profitable on an individual policy basis.

If, after paying out claims and covering all its administrative expenses, an insurance company can claim 10 cents of profit for every $1 in premium received, that’s an enormously successful company.

Sometimes, an insurance company will barely break even on its underwriting operations but make its primary profits from the income produced from investing the float.

Now, there’s obviously no way we can compete with traditional insurance companies when it comes to scale. We don’t have billions of dollars of capital to work with.

But that’s OK, because we have our own set of advantages.

Our lack of size can actually work in our favor – as well as the different nature of what we’re actually insuring along with the incredible flexibility of stock options themselves.

**BECOMING THE INSURANCE COMPANY FROM HELL**

I don’t consider my own put writing insurance operations merely as a retail investor’s equivalent of a personal Berkshire-Hathaway, I go one better.

I view my model as “The Insurance Company from Hell.”

And what exactly is that?
In a nutshell, my objective is to collect lots of premium and never pay out a claim.

If I can do that, profitability becomes such a huge advantage that scale begins to become irrelevant.

And the good news?

My personal stock insurance operations have two powerful advantages over traditional insurance companies:

- Selectivity
- The Ability to “Renegotiate”

**Selectivity** means I don’t have to insure just anyone who walks into the office. I can be highly selective of who I insure, when I insure, and at what rates I insure.

And secondly, when I insure a stock and it goes down such that Mr. Market is within his rights to file a claim (which I define as me being forced to either buy the shares at the agreed upon strike, or insured, price or buy back the put option contract for a loss), I can “renegotiate” the contract.

A car in an accident or a home that catches fire aren’t simply going to fix themselves – if it’s covered in or by the policy, an insurance company has no real choice but pay out the claim.

Selling puts is a very different reality.

A stock can repair itself by trading higher once again.

And unlike a traditional insurance company, we can “renegotiate” or replace the original contract with a new contract with better terms for us.
RENEGOTIATION EXAMPLE

For example, if we insure a stock at $40/share but then as expiration nears, the stock is trading at $39/share, we can buy back the put perhaps for a loss or perhaps for a small overall gain.

Or we can also do nothing and simply allow ourselves to be assigned the shares.

Either way, we’re probably not coming out ahead and we’ve also managed to waste our time.

But we can also “renegotiate” our situation.

We can exchange the expiring contract and replace it with one that’s better for us.

For instance, in this example, we might be able to make a counter offer to Mr. Market – “Instead of me insuring 100 shares of Stock X at $40/share by this date, how about I instead insure 200 shares of Stock X @ $39/share by a later date? And also, I would like more money if I’m going to extend my coverage like this.”

Now that’s something of an oversimplification of the process, but this is a minifesto after all and not a full blown training module.

But the underlying concept and rationale is rock solid:

1. I write puts under very strict conditions when I identify multiple reasons why a stock is unlikely to trade lower or lower by much in the short term

2. When I’m right, I make great annualized returns over that holding or “coverage” period

3. When I’m wrong, I’m not usually wrong by much and I can pretty easily repair or renegotiate the trade so that, over time, I not only don’t lose money, but I still walk away with decent to good returns
4. On the rare occasion when I’m really wrong – no guarantees, of course – while the repair and renegotiation process may be a little more involved, providing I’ve adhered to my strict underwriting standards, I’m still likely going to be in a solid position at the end of the day to still walk away with a decent gain.

Heads I win, Tails I don’t lose.

[And to illustrate this concept in the real world, here’s the complete documented trading history of the model Warren Buffett Zero Cost Basis Portfolio I maintain.]

Still, I understand this concept sounds WAY too good to be true, so let me take a moment and cover scenarios where you can really get hurt.

HOW TO SELL PUTS THE WRONG WAY

My customized put writing strategy can be summed up in a single sentence:

Write near dated, at the money, cash-secured puts on high quality stocks when they’re trading at fundamentally and technically attractive prices.

You do that and 90% of your problems writing puts will instantly disappear.

But if you overleverage, or lower you quality standards, or choose a stock that’s overvalued, or ignore basic technical analysis, then you may be setting yourself up for a situation that goes against you and isn’t repairable.

And if you try to repair a short put trade on a stock that doesn’t stop going down, or if the floor on the stock is ridiculously far away, what you’re more likely going to end up doing is expanding your losses.

If, for example, you wrote puts on Enron and kept doubling down as the stock imploded, you would’ve lost every penny of your capital at risk.

But that’s also the case if you’d owned the shares as well.
SELLING PUTS TO REDUCE RISK

And here’s the key concept to understand – selling cash-secured puts is ALWAYS safer than owning the stock.

It’s a mathematical fact.

For example, say I buy an $80 stock. Quite simply, excluding commissions, my cost basis on the stock is $80/share.

I can also write an $80 put against the stock expiring in 1-2 months.

Maybe I generate $1.50/contract in premium (or $150 since each contract represents 100 shares of the underlying stock).

Now, let’s assume the stock is trading at $75/share as the put you sold expires and you do nothing and simply allow the put to be exercised against you.

You buy the $75 stock for $80/share, but after you factor in the $150 in premium you already received, your effective cost basis on the 100 shares is $78.50, not $80.

Or . . .

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<th>STOCK INVESTOR</th>
<th>OPTION INVESTOR</th>
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<td>Buy @ $80</td>
<td>Sell $80 Put (And Get Assigned)</td>
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<td>Receive Nada</td>
<td>Receive $1.50/contract</td>
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<td><strong>Cost Basis = $80/share</strong></td>
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Understand this – when you write a cash-secured put on a stock, it’s impossible to buy that stock at a market top. You will always be getting a better deal than your stock only counterparts.

Writing or selling a put enables you to ALWAYS have a lower cost basis than the stock only investor who makes a comparable purchase at the same time.
If you think selling puts is too risky – then you should definitely avoid owning shares of any stock because you will ALWAYS pay more for those shares by buying them on the open market rather than getting paid to make an offer on them ahead of time (simply another way of conceiving of the insurance process).

My point is don’t fall for the knee-jerk reaction that a lot of people have and just assume that options are the stock market equivalent of carrying around unstable sticks of dynamite in your back pocket.

With the right training – think clarity and common sense rather than a full regimen with Pei Mei from Kill Bill – you will understand the enormous flexibility and structurally advantages of writing puts in this manner.

THE FORMULA

Due to time and space constraints, I obviously haven’t provided you with full training on the options-based value investing approach I’ve developed from years of personal experience (and a lot of trial and error).

But I’m not hiding anything either.

In fact, I already spelled out the formula earlier, and I’ll repeat it again:

Write near dated, at the money, cash-secured puts on high quality stocks when they’re trading at technically and fundamentally attractive prices.

That’s the secret sauce.

If you do that, I firmly believe you’re going to find a success and consistency in the stock market that will make you stand out from the crowd of mediocre investors who largely invest just like everyone else.

ARE YOU AVERAGE?

Another truth I’ve learned – if you want average investing results, continue investing as average people do.
But this is crucial for you to understand – average is not a gene we’re born with. It’s a choice.

Of course the choice to be average is understandable when you realize that there’s an entire industry that spends millions of dollars every year trying to disempower you so you’ll outsource your investment decisions to them.

It’s no accident that the managed money industry inundates us all with messages of mediocrity because they make their money not from their own investing results but from siphoning off a portion of yours.

**If mediocrity is a choice, so is excellence.**

But here’s the deal – excellence is not always graceful.

Excellence is not about already being excellent and proficient at something.

- Excellence is about wanting something you don’t have yet and believing you can attain it even if you don’t exactly know how you’re going to do it.

- Excellence is about being smart enough and open-minded enough to recognize the next area of your life that’s best for you to grow into – and then identifying the path that’s most likely going to get you there.

- Excellence is, ultimately, about growth, and sad to say, most people don’t want to grow – because they fear that it will be too hard or too complicated or too confusing. Of course, nothing could be further from the truth. We’re happiest and most fulfilled when we’re growing, and it’s only when we stop growing, that we start dying.

**THE LEVERAGED INVESTING CLUB**

Others believe in value investing, dividend growth investing, and high yield income investing.

**I believe in options-based value investing because it takes every one of these approaches and seriously improves it.**
And if you’re a seriously motivated individual with lots of time on your hands, what I’ve shared with you in this “minifesto” is everything you need to begin to develop your own methodology and processes to do exactly what I’ve been doing (and teaching) for years.

But if you’re like most people who are serious about improving your skills and understanding in a certain area of your life, you’re also realistic in the benefits of having someone who’s been exactly where you are guide you along in the process.

And that’s exactly why I founded The Leveraged Investing Club, the very headquarters, if you will, of options-based value investing.

I put the needs of the members first.

That’s why there’s only one membership status – lifetime – and that’s why it’s never been set up on a recurring, fee based subscription.

You join The Leveraged Investing Club one time, you become a lifetime member, and I never ask you to buy or join anything else ever again.

And you get as little or as much instruction as you want, when you want it.

When you join, you begin with the 5 week/module Sleep at Night High Yield Option Income Course which is the foundation that everything else is built on.

The course covers every aspect of the customized put writing strategy I use in more than 90% of my own personal trades to safely and consistently generate high yield income so you’ll know exactly what kind of stocks to insure, when to insure them, under what conditions, for how long, and for what amount of compensation.

Once you complete the foundational course, you then receive access to everything else included in your membership – all designed with your long term success in mind.

That includes the two follow up courses – Super Value Investing with Options and The Dividend Accelerator.
These courses include advanced tricks, tips, and techniques on how to most effectively incorporate the Sleep at Night Strategy into your own personal portfolio – how best to acquire shares of high quality stocks at extremely low cost basis prices as well as how to dramatically accelerate your portfolio’s dividend income, dividend yield, and future dividend growth rates.

That also includes the model Warren Buffett Zero Cost Basis Portfolio that I maintain inside the Club and provide comprehensive weekly trade analysis and trade management updates on.

As Leveraged Investor Nathan K. of Portland Oregon put it, “One of the best ways to learn is the ‘apprenticeship’ model – thinking alongside someone who already knows what they are doing.”

Week in and week out, I provide comprehensive commentary on new and updated trades in the Warren Buffett Zero Cost Basis Portfolio.

As you follow along with these trades each week, it’s like you’re watching over my shoulder as I explain all the factors that go into the trade selection and management process.

I confide in you my exact thought process and why I make certain decisions or adjustments.

The cool thing is after a while, you won’t be watching me as a student but rather as a colleague.

When you begin to consider how you might have done the trade differently or why you agree with how I did it, that’s when you really know you’ve reached the next level.

That also includes weekly trade ideas. Each weekend I post a Limited Downside Letter inside the Club where I provide a fully researched and comprehensive written trade idea for you to consider.

This is very different from the standard trade picking services that are out there where you pay someone a lot of money every month to blindly send out emails telling you what to trade and when but never why.

The why is essential.
My ultimate goal is for you to be able to consistently find great trade ideas on your own. I don’t want you to have to rely on others and be at their mercy (and hope they never have a couple of bad months).

So, yes, the ideas themselves are solid and sound, but just as important, I share everything that goes into their selection and different ways they could be traded so that you’ll learn this process much more quickly and then be able to find additional opportunities on your own.

This service is included in the price of your one-time membership – it’s not an additional service you need to subscribe to or pay for.

**That also includes ongoing support and encouragement.** As I say, when you join the Leveraged Investing Club, it’s not the end of our relationship – it’s just the beginning.

I stay in contact with you via our official weekly Club newsletter, *The Weekly Compounder*. No upsells here – this is how I communicate updates and announcements to the Leveraged Investing Community each week.

And The Leveraged Investing Club private membership platform is set up for maximum interaction.

You are free – and encouraged – to leave comments, ask questions, and post observations throughout the Club. I read and respond personally to those comments.

**We also have a forum where members can discuss specific trade ideas or anything else related to value investing with options.**

And when you join, I also give you access to my personal email address in the event that you ever want to discuss a trading or training issue more privately.

(Yes, I’m crazy – but I’d rather work with 10 individuals who I can actually help than take money from – and then blow off - 100 individuals and not help anyone.)

**That also includes a bunch of other resources and materials** – including a ton of archived real world trading examples (engaging and fun to read, of course), case
studies, detailed member Q&A sessions, and other resources designed to further bolster your success.

And finally, that also includes offering all this for a fraction of its true value.

No doubt, you’re aware that there are plenty of option training programs that run in the thousands of dollars.

All too frequently, that training is for high risk trading or, unfortunately, even just for generic option training.

And if you want ongoing support or to be part of a community afterwards?

Plan on paying for the privilege – and not one time, either.

**Bottom line – The Leveraged Investing Club** would love to have you as a member and to be a pivotal part of your continuing development as an investor and an individual.