

Some Option Trading Myths

By Robert C. Miner

In the past few years, promoters have jumped on the bandwagon of heavily promoting options on futures trading as the quick and easy road to trading wealth. We've all seen the ads for option books, newsletters, software and workshops that go something like this: *Low Risk, High Profit Option Trades Every Time! Make 432% In Just Two Weeks! Never Risk More Than The Cost Of The Option! Option Trading Money Machine - Make Hundreds of Percent Every Month!*

Sounds too good to be true, doesn't it? That's because it is. As usual, these aggressive promoters fail to tell you the whole story about options trading. They try to perpetuate the senseless myth that option traders don't have to be as smart or as good a trader as a futures trader in order to make big money.

Why has option trading been so heavily promoted in recent years? Because the public has bought into several of the option myths including the myths that options are less risky with more profit potential.

Option trading is probably one of the most misunderstood and mispromoted trading techniques for futures traders. Options are often promoted by everyone from legitimate brokers to scam option selling companies not necessarily because options are a better trading vehicle for their customers, but because they can sell the idea of option trading to the public easier than selling the idea of futures trading.

Let's take a closer look at the real business of trading options on futures and some of the myths that have been promoted.

Myth #1. Options are less risky than futures trading. All you can lose is the premium paid for the option.

Like many myths, there is a little truth and a little lie to this myth. It is true if you purchase a put or call option, the option can expire worthless and the most money you can lose is the premium paid. But it is definitely not true that option trading is less risky. On the contrary, options are more risky than futures trading.

Risk is the probability of an event occurring. With options, the trader must not only determine the position of the market and the most likely direction (same as a futures trader) but also choose which option strategy is most appropriate and which options are most appropriate for the trading strategy. The futures trader has one decision to make. The options trader has three. The risk (probability of being wrong) is much greater with the option trader.

It is true that the most you can lose with a long option position is the price of the option. It is also true that the odds of making a profitable trade with an option are probably less than with a futures trade. There are many more variables that go into the option trade decision than the futures trade decision. The more variables in the decision making process, the greater the probability of making a mistake.

Myth #2: *You don't have to make a decision what the market direction should be to make money with options.*

80% or 90% of options expire worthless. All you have to do is be the bookie or the casino and take all of the sucker bets by selling naked options to the suckers! Wouldn't it be nice if it were so easy. We could just calculate the price range of the futures contract for the past 6 months, sell a call above the range and sell a put below the range and collect those premiums, month after month, under the illusion that in the next few months the market will not exceed the range of the past six months. This would be the ultimate, option money-machine strategy if the futures contract remained within the range of the past 6 months and the volatility remained low so the premium didn't increase. You of course know the premium can increase even if the market does not reach the strike price?

This strategy can be a real money maker until a market has a fast move out of the expected range. Ask Victor Niederhof (author of the *Education of a Speculator*) whose multi-million dollar fund that had sold S&P puts went bust in the violent down-move last Oct. If you hold "naked" options, you are effectively holding a futures position with about the same margin required and the same risks and capital exposure of a futures trade. You had better have a carved-in-stone exit plan and hope a fast market gives you the time to implement the exit plan if you have sold puts and/or calls. Ask Victor who wiped out 30 years of reputation and an entire multi-million dollar trading fund in about three days. Are you smarter than someone who has 30 years of experience and used to be the chief trader for George Soros' billion dollar funds? What's your exit plan?

Myth #3: *Buy cheap, far out of the money options. The home run trades will more than make up for the multitude of losers.*

Buying far out-of-the-money options is strictly a game for amateurs. These are the options that the professional option traders love to sell because the odds of them every increasing in value are minuscule. If your analysis techniques of the futures market are so well-developed and so right-on to be able to predict a major move (the only kind that will make a profit on a far out-of-the-money option), you would be a fool to buy the option instead of a futures contract. Unless your name is Nostradamus, don't even consider far out-of-the-money options.

The far-out-of-the-money option strategy is the same idea that is sold to the suckers who will bet a trifecta of the three longest shots in the last race of a county fair, harness race simply because the payoff odds could be enormous if the three nags happen to come in 1-2-3. The pay-off odds are enormous because the odds of being paid off are even more enormous!

Successful Option Traders

These are just three of the option myths and their reality. Each of these option strategies has the potential to be profitable. Each of these strategies is used by professional option traders who have a great deal of knowledge and experience with both the futures and options markets. That knowledge and experience does not come quickly, easily and cheaply. The professional option traders know intimately the downside potential to each option strategy and how to protect against violent moves. They trade options just like we trade futures.

In my opinion, you must first gain the expertise to analyze the futures position and then gain the expertise of option strategies. Your success with options trading is directly contingent on your success with correctly analyzing the position of the underlying futures contract. My recommendation is to take it one step at a time. Don't consider option trading until you are first consistently profitable trading the futures markets. Keep in mind that it is the underlying futures contract that influences the option value. The tail doesn't wag the dog. The dog wags the tail.

When you feel you are ready to try options trading, only consider buying in, at or very near the money options. That way your risk will be much less. The probability of profit will usually be greater. It will only take a relatively small move for the option to be in-the-money. Once you have mastered the simple, low-risk option buy strategies, then you will be ready to expand into the more complex option strategies.

There is a lot more to successful option trading than the aggressive, get-rich-quick-and-easy promoters want you to believe. We each have the choice to make decisions based on reality or on myth. Which do you choose?

How can Dynamic Trader help you succeed with options trading?

Dynamic Trader has several analysis routines that project the high probability price and time targets when a trend will begin and the highest probability time and price objectives for each trend. This is the information that can make the difference between option trading success and failure when deciding which option strategy has the greatest probability of success for any market position.

The **Dynamic Trader Trading Course** that is included at no additional charge with the Dynamic Trader Software includes a chapter on options trading. It is critical that traders interested in options understand which strategies have the greatest chance of success for any given market position. Futures and option trading success require the proper tools and the proper knowledge. That is what the **Dynamic Trader Software and Trading Course** is all about. We provide the proper tools and knowledge for traders to increase their level of success.

If you are ready to deal with reality, not promotional myths, and ready to make the effort to learn how to improve your trading, Version 2 of the Dynamic Trader Software and Trading Course is now available to you.

The following resources for option traders provide useful information and good value for the cost:

The New Options Advantage (book) - David Caplan

The Option Advisor (book) - Bernie Schaeffer

Opportunities In Options (newsletter) - David Caplan

McMillan on Options (book) - Lawrence McMillan

The Option Strategist (newsletter) - Lawrence McMillan

Futures Options Weekly (chart service) - Commodity Trend Service