High Probability Trades with the SPX Weekly Option

An article for Traders World Magazine, by Dale Brethauer

This article will take an honest look at why most traders lose and how to flip the script. The three main reasons why traders lose are 1.) investing too much of their portfolio on trades, 2.) using poor entry techniques and 3.) poor exit techniques. Here you will learn a high probability short-term income generating trading strategy that you can use right away on both large and small “starter” accounts, and how to apply these techniques while leveraging with SPX weekly options.

Hi, my name is Dale Brethauer. I have been trading stocks and options for 35+ years. I run my own hedge fund, Options Infinity Growth Fund, and have been a keynote speaker with Money Block, Investor Inspiration, MetaStock, The Money Show, Value Charts and MicroQuant. I have also written three financial books and am the founder and head trader at what I believe to be the very best stock option educational website www.optionsinfinity.com. I trade for a living. I also teach and educate. I don’t teach because I can’t do, I do and love to show others how to make money in the stock market. If you have realistic goals, financial freedom is possible once you’ve laid the right foundation. The right foundation is finding a rock-solid trading strategy (like the one I will share with you here) and sticking with it. It might take hundreds, or even thousands, of hours building the foundation but it is possible. Consider any professional. They have spent thousands of hours perfecting their craft and when they execute it looks easy.

Are weekly options your best path? Consider:

Futures: Trading Futures can provide quick profits because of the large leverage, but 95% of all retail accounts not only lose money but a lot lose their whole trading account.

Stocks: Trading Stocks is good for extremely large accounts where you are fine compounding wealth at a small percent per year.

Selling Monthly Options: This is a good strategy for all size accounts that target ~20% returns per year.

Weekly Options: This is the best strategy for both smaller and large accounts looking to make sizable consistent income.
Weekly Options are rigged against you with explosive gamma and high premiums. This is by design. Market makers pocket this money by taking it right out of your account during times of rapid price movement at key strikes. This article will show you how to join the market makers by selling options on the SPX. By selling options the hyper-fast time decay works in your favor. Figure 1 depicts the rapid premium decay of options. But, we never want to sell “naked”, and will always have protection by using vertical credit spreads (Bull Puts or Bear Calls). If you are unfamiliar with Bear Calls and Bull Put I would suggest www.wikipedia.org.

The SPX, or Standard and Poor’s 500 Indices, is the best weekly option to trade. Over 1/3 of all SPX volume is now in the weeklys creating a fantastic opportunity. Large funds and Institutions use the SPX the hedge their portfolio’s. This leads to high liquidity and tight bid/ask spreads. The SPX is priced for a 1% move – but it doesn’t move 1% very much. This creates a win ratio of 68.2% for moves at the 1 standard deviation reverting back to the mean and 95% for moves at the 2 standard deviation reverting back to the mean. Figure 2 show the standard deviation bell curve.

How I trade the SPX weekly option is very simple.

Step One: Place a directional credit spread trade when the SPX is overbought/oversold.

Step Two: Exit a profitable trade on a Fibonacci extension, or a losing trade on a reverse measured move.

The exit is where a lot of money can be given back if you are not careful. You also want to have an idea of when you will exit even before putting on the trade. This allows you to calculate your risk/reward for the trade. My exit strategy relies solely on the Fibonacci extension.

Fibonacci ratios may be seen throughout nature. As you go up the stem of a flower the leaves grow at a proportional distance of the ratio. The spirals of a conch shell are proportional to the ratio. The distance of the human forearm to the hand is proportional to the ratio, etc., etc., etc. Therefore, doesn’t it make perfect sense that the stock market, which is fueled by human fear and greed, would move in perfect harmony with nature?

The Fibonacci ratio comes from a number sequence that is derived by adding the current number to the previous number to get the next number in the sequence. It is: 0,1,1,2,3,5,8,21,34…….

The Root Fibonacci ratio is calculated by taking any number in the sequence and dividing it into the previous number. In other words 18/34 = .618 or the Root Fibonacci ratio. If you take the square root of the Root it is .786 and the Root squared us .382. By taking the reciprocal of these numbers you get 1.272, 1,618 and 2.618. These are the numbers which I use to determine the extent of the stock move after a measured move occurs. A measured move to the up side is when a new high happens after a previous high and a pullback to a higher low or a measured move to the downside is when a new low happens after a previous low and a pullback to a lower high.
Usually at 127%, 161% and 261% a stock price advance or decline will stop, consolidate, retrace or completely turn around. The more you use Fibonacci extensions to time your exits the better your trading will become.

Now for an actual trade, refer to Figure 3, entered on Tuesday 7/11 - selling an SPX Bull Put – by selling the 21 Jul 2405 put and buying a put option further out-of-the-money for protection at 2400. This Bull Put gave a credit of $1.00. Six trading days later this Bull Put was bought back for a debit of $0.05 for a 95% return.

The left hand side of the chart in figure 3 is a 90 day 1 hour chart. This is a screenshot from my Think or Swim account. I use this to review the larger picture for support or resistance and where the SPX is trading versus the regression line in black. The regression line is an excellent trend line as it is calculated by taking 50% of the price above and 50% of the price below at a given date. Notice on 7/11 the SPX price was at a support level and oversold at the -1 standard deviation line (green line).

I trade from the right-hand chart, which is the 10 day 15 minute chart. Notice on 7/11 the SPX price was at the extreme oversold condition at the -2 standard deviation (gold line) @ $2412. This has a high probability it will revert back to the mean price, which it did and went to the 261% Fibonacci extension at $2474 for the 95% return. Pretty simple strategy, easy and profitable.

Lastly, I’d like to invite you to become one of my >7,000 FREE members of my website www.optionsinfinity.com. Just go there and click on the Free Membership button and enter your email address. This will allow you to view all the free content, i.e., option leverage, chart setup, proper trade size for a given account, the regression channel, Fibonacci’s and measured moves to name a few. If you like what you see and feel comfortable with my style and strategies you may choose to become a member of one or both of my trading systems – credit spread trading short-term using the SPX (SPX_WOR) and credit spread trading longer-term using the big five: AMZN, GOOGL, PCLN, SPX and RUT (Option PRO).

I hope you enjoyed this article. Any questions you may contact me directly at dbrethauer@comcast.net.
Figure 1: By selling options the rapid time decay, especially in the last week, work in our favor.
Figure 2: The Standard Deviation Bell Curve.
Figure 3: 95% Return Trade made 7/11/17