2012
ISSUE
09

Weekly Insight to
the Options
Market

PULSEOptions

For the Week of March 5th through March 9th

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Event Calendar

Mar 4 - Mar 10									Filter On
Date	12:59pm	Currency	Impact		Detail	Actual	Forecast	Previous	Chart
Sun Mar 4									
Mon Mar 5	10:00am	USD		ISM Non-Manufacturing PMI			56.2	56.8	
	10:00am	USD		Factory Orders m/m			-1.2%	1.1%	
Tue Mar 6									
Wed Mar 7	8:15am	USD		ADP Non-Farm Employment Change					
	8:30am	USD		Revised Nonfarm Productivity q/q					
	8:30am	USD		Revised Unit Labor Costs q/q					
	10:30am	USD		Crude Oil Inventories					
	3:00pm	USD		Consumer Credit m/m					
Thu Mar 8	7:30am	USD		Challenger Job Cuts y/y					
	8:30am	USD		Unemployment Claims					
	10:30am	USD		Natural Gas Storage					
Fri Mar 9	8:30am	USD		Non-Farm Employment Change					
	8:30am	USD		Trade Balance					
	8:30am	USD		Unemployment Rate					
	8:30am	USD		Average Hourly Earnings m/m			0.2%	0.2%	
	10:00am	USD		Wholesale Inventories m/m			0.7%	1.0%	
Sat Mar 10									

Super Tuesday Void of Gov't Reports.

Friday Has Multiple Reports Issued PRIOR to the Open of Trading.

How the World Turns

In last week's edition, I suggested following one stock and one stock only, GDX. Some might question why the "Top 5 Plus or Minus" was such a short list. In this week's edition we will look back at GDX and try to share some teachable moments, but the focus on this week's newsletter will be trading forward.

Coming off two slow weeks for reports, a question I often hear is, "Why do some weeks trade better than others?" Or the same basic question rephrased, "Why do some weekly reports offer greater opportunities for bigger profits in a short period of time than other reports?"

I think a brief explanation of what makes the market move after the release of these reports might help you to learn which weeks have greater opportunities. I believe if you can internalize these concepts, you will know when the potential is greatest. And once you know when the potential is greatest, then you know when to trade larger amounts of money.

The market hates not knowing what's going on. The purpose of these reports is to share data with the world so they can plan or adjust their plans. If the economy is expanding, businesses can spend into this expansion. If the economy is contracting, businesses need to tighten their belts. A very important concept to understand is the concept of uncertainty. The market hates uncertainty.

The market as a whole is basically looking for two points of insight from these reports: The Economy and Inflation. While some could argue some finer points, I say these two categories blanket all possibilities.

If the Fed announces they plan to fight a slowing economy with stimulus, the red flags are raised on both fronts. The market as a whole may drop as recession fears build. Inflation fears may send the precious metals (GLD & SLV) higher causing options on mining stocks (GDX) to increase dramatically.

What often confuses traders who come from an "Investing" background is why some news doesn't move the market as they perceived it would. Why does a stock stop moving in the direction one would have thought it should trend, only to reverse and go in the opposite direction? Or why does it go in the opposite direction right from the get go?

Investors like a calm march up in price: Day in day out, week after week; a steady climb to wealth. Investors want it easy to plan for retirement. This may or may not be news to you; investors don't often get what they want. That's why we're traders. That's why we take some time and effort to earn above-average returns on our money. Because we're above average!

As I mentioned, we are coming off two slow weeks of trading. Yet these slow weeks had numerous opportunities to double up on options. These last two weeks should be nothing compared to the upcoming few weeks. I hope you learned something so now you can earn something!

We have Non-Farm Payroll this Friday and FOMC Statement release the following week. Both of these reports historically have given us better than average results. But best of all both of these reports have their own simple to follow strategy.

After a few slow weeks, we finally have a report worthy of trading this week, Non-Farm Payroll (NFP). This report comes out only once a month (Usually a Friday, at least one full week after the close of the preceding month).

Unlike the weekly unemployment numbers, this is not about people losing jobs or unemployment benefits, but about the number of people working. Well working outside of the Agriculture Industry.

This is a big report. I've been reading a number of articles discussing the stock market's run up towards the 2008 highs. A number of these articles are pointing to this report as confirmation the economy is improving.

We've had a "good" report the last two months. If this week's report shows strength the market should take this as proof the worst is past and expect the market to react. However, if the report has less than the anticipated numbers, well the market might sell off in disappointment. Add to this the general read between the lines ambiguousness often present in these reports and we should get some good price action Friday morning.

Non-Farm Payroll a Farmer's Perspective

I think sharing a story that recently happened to me might give you some perspective on this report. A little later in this week's edition I'll tell you how I plan on trading it.

One of my closest friends is in the Ag Industry. He's a Beekeeper. Not just a typical beekeeper, my friend's family farm owns tens of thousands of hives. They produce some of the finest honey in the world.

He basically runs his family business. He jokes, "My dad is too young to retire and too old to run a company in the 21st century." Unlike others in the family who majored in horticulture or other farming related coursework in school, my friend's college degree is in accounting.

Technically he's a farmer but in reality he's in farm services. A major portion of his business is contract pollination. His bees help grow much of what we eat. The size of his operation means he deals with some of the biggest corporate farms out there. He knows most major farmers and they know him. His keychain overflows with keys to countless gates on countless ranches. Farmers need bees and they give my friend access.

It might surprise you to know who owns vast amount of farmland. Without naming names, he often shares with me the concerns of people in his circle of influence. The economy and inflation.

I frequently visit him at his home base in South Dakota, but just a few weeks ago I drove with him through a myriad of Almond orchards in the southern end of California's San Joaquin Valley. For the uniformed, it's among the top agricultural producing regions in the world. It's often referred to as "the nation's salad bowl."

On this most recent visit we were walking out of an orchard at the extreme south end of the valley where we came across a man and a dog. The man, carrying a car battery, started talking to us in Spanish and my friend (who doesn't speak a word of Spanish) answered in English.

Yo Hablo Espanol malo. For those of you who don't understand Spanish I said I speak Spanish bad. For those who do speak Spanish, I badly said that I spoke Spanish bad.

There were no roads where we were walking, let alone any cars. I couldn't figure out from either of the two why he was carrying a car battery. When we got in our pickup I asked my friend who explained the man was charging the battery at an outlet near an electric water pump for the orchard.

The dog was the clue in this mystery. He was a sheep dog. The battery was for an electric fence. The gentleman was a Peruvian sheep herder. Here in the US on a work immigration visa. My friend shared how some of the ranchers get labor from outside of the US. I guess dogs and sheep speak better Spanish than I do.

My friend went on to share that the local farm labor's union was trying to stop the practice of bringing in foreign workers for this 'unskilled' position. I know enough about laws to know you have to pay everyone who works for you at least minimum wage, but I couldn't see the complete economic impact of what was going on until my friend shared the complete details.

He told me they have to pay the Peruvian man the prevailing wage. It's no cheaper to hire him than a local worker, with one exception; housing. The ranch was able to deduct the cost of the trailer the shepherd lived from his pay. He went on to say the net wages amounted to somewhere around $800 per month.

Let's assume there's 40 hours in a workweek. And assume there's four weeks in a month. This works out to be about $5.00 per working hour. It begs the question, where would the shepherd live if he wasn't living in the trailer near the sheep?

While it's arguably true this hardworking man is being paid a fraction of the true minimum wage. And while he may make only a small percentage of his true worth, one can make the argument he is making far more than he could in his native land.

Steinbeck's "The Grapes of Wrath" talks about migrant American farm workers of the depression era looking for jobs to earn enough to feed their families. These sharecroppers have been replaced by immigrants from south of the boarder, some of them illegal. In a case of irony some of these workers have been replaced by legal temporary foreign workers from further south.

You should have a few takeaway points from this story. First, the Non-Farm Payroll Report (NFP) is just that, payroll for everything but farm workers. And it's not this way because of foreign workers. It's this way because of seasonality. Workers are needed to harvest many of the crops, but are only needed to harvest the crops. There is no job growth when the job is growing food.

Everyone in America should have some idea as to our jobs being sent to cheaper sources of labor. You just may not realize the extent to which some companies look for savings.

In America, we no longer have company towns where you're paid in company script and live in company housing and shop at the company store. Or do we?

This month the NFP comes out on a Friday one hour before the market opens. I can't imagine how the numbers are going to be exactly what everyone anticipates, because I think many are expecting different numbers. I believe good price movement will be the order of the day.

There are some constants in trading reports. We take these constants to create an attack plan. I like to think if we follow a specific system to trade, we can practice and perfect it as we go.

I have a formula to trade NFP. I want to teach you this formula in such a fashion you won't forget it. It can be used in almost every NFP release. I say "almost" every one because next month's NFP has a quirk to it that can only happen every few years. I tell you more in a month. But until then and after then, I want you to follow this formula.

Because it's Non-Farm Payroll I will call this formula, my "Farmula." Hopefully this play on words makes it more memorable. Hopefully following my "Farmula" you will have great success. Not just this month, but in the months to come.

NFP occurs before the market opens! We need to buy our options the day before! We should look to enter near the close of trading on Thursday! Advanced traders may look to buy near the open on Friday and try to catch a trend or play any whipsaw action. The rest of us are looking for a gap at open.

By buying near Thursday's close, we should not experience much time decay overnight to Friday's open. We hope the market reacts to the report by making movement above and beyond a "normal" trading day. Even though we are looking for a large move, we should not buy too far Out-of-the-Money (OTM) options unless we are skilled risk takers. If we don't get much movement at the open we can close our positions for close to what we have in the trade.

Super Duper Tuesday

This Tuesday, Mach 6th, is "Super Tuesday." This is the biggest day of the Presidential Primary season this year. While in fact, next Tuesday (FOMC Statement) may be more super when it comes to trading in the short term, this Tuesday should give us some insight into the year ahead.

As mentioned elsewhere is this newsletter, the biggest mover of the market in depth is the perception of the economic state and the anticipated future inflation. Nothing in any of the reports will compare to this years election.

As the Republican challenger becomes more set in stone, the battle lines will be drawn. Not by the political parties, but by those traders who expect the market to move based on the outcome of the election.

We will talk much about the election and its impact in the coming weeks and months ahead. It should provide us with great economic opportunities no matter who wins or loses.

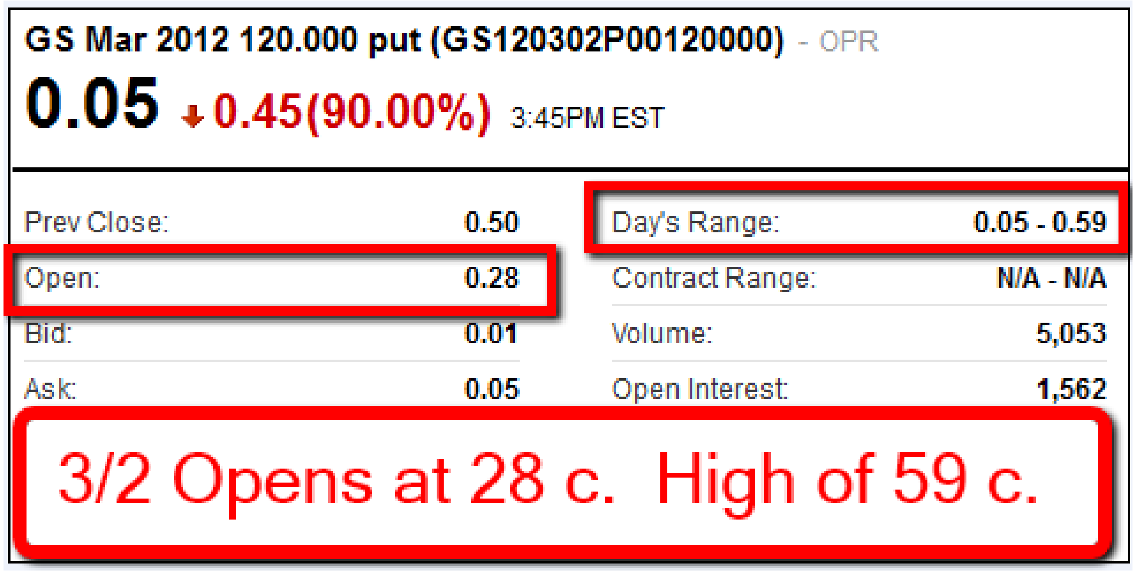
I don't anticipate a clear-cut winner in Tuesday's results. If however one candidate clearly wins, expect the market to embrace this fact. The market hates uncertainty. Having a known lone challenger allows the market to weigh the ramifications of a single opponent as opposed to the guessing game going on now.

One Trick Pony

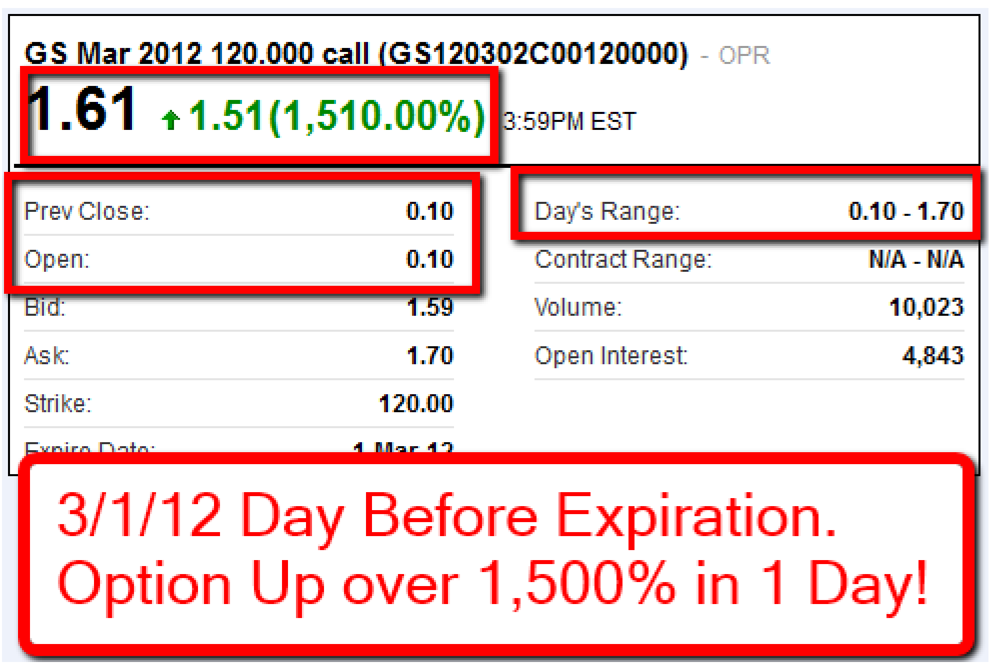
Since last week was a slow week for reports, I didn't want to go too far out on a limb. So besides mentioning Goldman Sachs (GS) I slashed our "Top 5 Plus or Minus" to one stock and one stock only, GDX.

And before I go into great depth on GDX, I feel compelled to show two screenshots of GS. First the $120 Put from Friday March 2nd, a day GS opened at $121.41 and closed at $119.96 after making a low of $119.86. This stock moved nicely, except it just barely crossed the $120 strike price.

This continues our streak on GS having an option double week after week on expiration day. But once again, the stock barely crossed a strike price and so while the gain was triple digit; it is nowhere near Goldman's potential. Having said that, GS crossed above the $120 strike on Thursday March 1st, and in so doing it had a resounding winner. Albeit a day after I like to trade it.



This next screenshot shows the movement we've come to expect in GS.



No Sloppy Slop Award this week. But we all know who would have won, me. I have this love hate relationship with GS. It should play out well this next week with the reports scheduled.

But before we get any closer to this week's "Top 5 Plus or Minus" we still need to look at GDX in depth. I've made a table showing how GDX and many of its options moved in price this past week. Let me show it to you, and then we will dissect it in great detail.

Date	Open	High	Low	Last	Range
24-Feb				$56.46	
27-Feb	$ 56.27	$56.64	$55.73	$56.06	$ 0.91
28-Feb	$ 56.55	$57.44	$56.20	$57.33	$ 1.24
29-Feb	$ 57.51	$57.91	$54.87	$55.40	$ 3.04
1-Mar	$ 55.54	$56.38	$55.21	$55.89	$ 1.17
2-Mar	$ 55.39	$55.53	$54.51	$54.79	$ 1.02

27-Feb		Open	High	Low	Last
Stock	Previous	$56.27	$56.64	$55.73	$56.06
$54 Call					
$55 Call	$ 1.75	$ 1.71	$ 1.77	$ 1.22	$ 1.45
$56 Call	$ 1.11	$ 0.86	$ 1.16	$ 0.66	$ 0.77
$57 Call	$ 0.61	$ 0.49	$ 0.63	$ 0.32	$ 0.36
$58 Call					
$54 Put					
$55 Put	$ 0.27	$ 0.32	$ 0.46	$ 0.26	$ 0.33
$56 Put	$ 1.26	$ 1.33	$ 1.56	$ 1.16	$ 1.36
$57 Put	$ 1.09	$ 1.22	$ 1.50	$ 1.02	$ 1.30
$58 Put					

28-Feb		Open	High	Low	Last
Stock	Previous	$56.55	$57.44	$56.20	$57.33
$54 Call					
$55 Call	$ 1.45	$ 1.71	$ 1.77	$ 1.22	$ 1.45
$56 Call	$ 0.77	$ 1.02	$ 1.58	$ 0.89	$ 1.53
$57 Call	$ 0.36	$ 0.45	$ 0.90	$ 0.40	$ 0.81
$58 Call	$ 0.16	$ 0.20	$ 0.41	$ 0.14	$ 0.41
$54 Put					
$55 Put	$ 0.33	$ 0.20	$ 0.25	$ 0.07	$ 0.11
$56 Put	$ 1.36	$ 0.49	$ 0.61	$ 0.19	$ 0.26
$57 Put	$ 1.30	$ 1.07	$ 1.07	$ 0.49	$ 0.57
$58 Put	$ 1.99	$ 1.34	$ 1.34	$ 1.06	$ 1.11

29-Feb		Open	High	Low	Last
Stock	Previous	$57.51	$57.91	$54.87	$55.40
$54 Call					
$55 Call	$ 1.45	$ 2.74	$ 2.74	$ 0.60	$ 0.80
$56 Call	$ 1.53	$ 1.58	$ 1.97	$ 0.22	$ 0.34
$57 Call	$ 0.81	$ 0.88	$ 1.15	$ 0.07	$ 0.12
$58 Call	$ 0.41	$ 0.43	$ 0.53	$ 0.02	$ 0.04
$54 Put	$ 0.04	$ 0.01	$ 0.27	$ 0.01	$ 0.17
$55 Put	$ 0.11	$ 0.04	$ 0.67	$ 0.04	$ 0.46
$56 Put	$ 0.26	$ 0.17	$ 1.30	$ 0.09	$ 0.96
$57 Put	$ 0.57	$ 0.40	$ 2.11	$ 0.28	$ 1.78
$58 Put	$ 1.11	$ 0.80	$ 2.82	$ 0.72	$ 2.80

1-Mar		Open	High	Low	Last
Stock	Previous	$55.54	$56.38	$55.21	$55.89
$54 Call	$ 1.56	$ 2.00	$ 2.20	$ 1.86	$ 2.09
$55 Call	$ 0.80	$ 0.96	$ 1.40	$ 0.67	$ 0.94
$56 Call	$ 0.34	$ 0.35	$ 0.71	$ 0.22	$ 0.31
$57 Call	$ 0.12	$ 0.12	$ 0.25	$ 0.07	$ 0.07
$58 Call	$ 0.04	$ 0.05	$ 0.08	$ 0.02	$ 0.02
$54 Put	$ 0.17	$ 0.15	$ 0.15	$ 0.02	$ 0.03
$55 Put	$ 0.46	$ 0.31	$ 0.42	$ 0.08	$ 0.10
$56 Put	$ 0.96	$ 0.95	$ 0.96	$ 0.33	$ 0.45
$57 Put	$ 1.78	$ 1.50	$ 1.65	$ 0.95	$ 1.06
$58 Put	$ 2.80	$ 1.80	$ 2.15	$ 1.80	$ 2.02

2-Mar		Open	High	Low	Last
Stock	Previous	$55.39	$55.53	$54.51	$54.79
$54 Call	$ 2.09	$ 1.43	$ 1.43	$ 0.70	$ 0.70
$55 Call	$ 0.94	$ 0.45	$ 0.57	$ 0.01	$ 0.03
$56 Call	$ 0.31	$ 0.11	$ 0.11	$ 0.01	$ 0.01
$57 Call	$ 0.07	$ 0.07	$ 0.07	$ 0.01	$ 0.01
$58 Call	$ 0.02	$ 0.02	$ 0.02	$ 0.01	$ 0.01
$54 Put	$ 0.03	$ 0.02	$ 0.05	$ 0.01	$ 0.02
$55 Put	$ 0.10	$ 0.15	$ 0.50	$ 0.08	$ 0.17
$56 Put	$ 0.45	$ 0.63	$ 1.45	$ 0.56	$ 1.17
$57 Put	$ 1.06	$ 1.63	$ 2.39	$ 1.50	$ 2.34
$58 Put	$ 2.02	$ 3.15	$ 3.50	$ 3.11	$ 3.40

There are basically six tables on the graphic above. (All the above numbers are courtesy of Yahoo.com) The upper left table (table #1) shows the closing price on Friday February 24th and then the Open / High / Low / Close for each day, followed by the range of that day.

The next five tables show the movement of GDX and some of its options by date. The middle left table (table #2) shows the results from Monday February 27th. The lower left (table #3) shows Tuesday the 28th. Leap day is represented by the table in the upper right (table # 4), followed by March 1st and 2nd (tables #5 & 6).

Each of the tables for the five days of last week show the prices for various options one may have considered trading during that week. You will notice some blank spots early in the week. The accompanying options didn't fit our criteria at that time.

These tables almost give me enough information to write an entire book. But I'll spare you my verbosity. Let me focus on what I believe is the most important data. Feel free to ask any question you may have. I hope to answer any question with multiple requests in upcoming editions.

First thing you should look at are GDX's raw price data in table #1. Notice where the stock traded. But please notice the daily range. With 20/20 hindsight, we can see the best day to trade was Wednesday the 29th. Largest range. But notice the range on Tuesday was the second largest. Close examination should revel you could have out traded Tuesday on either Thursday or Friday.

Average Range Last 10	Average Range Last 50	Average Range Last 100	Average Range Last 300
$ 1.36	$ 1.26	$ 1.48	$ 1.53

I've also copied some of the statistical data I have gathered on GDX by doing the P.U.L. calculations of the PULSE System. As you can see, only Wednesday of this week had a range bigger than any of our stats. This was not a surprise to me as I knew the reports would generate a slow week this past week.

I would like to think this next week should give us some bigger ranges and some bigger profits. And if not this week, then certainly the following week (FOMC).

Back to the price data tables from last week, again with 20/20 hindsight, you should have seen the best trade was the $54 Put on Wednesday. It opened at 1 cent then traded to 27 cents closing at 17 cents. Massive gain, but only a lucky or skilled trader could have gotten that one.

A better trade to look at would have been on Wednesday as well. Here you can see the stock opened almost exactly between strike prices, $57.51. Without using any techniques to buy a Put as a directional trade (we will teach these advanced rules in future editions) one was left to simply buy the Strangle.

The Rules to buy a Strangle are fairly simple. When the stock trades right between strike prices we buy the Call option one strike Out-of-the-Money (OTM) and the Put one strike OTM. This would have had us buying the $58 Call at 43 cents and the $57 put for 40 cents. Notice the options are priced almost identical, just a few cents apart. This is part of the law of option pricing our system is based on.

When the stock sold off, the Put jumped dramatically in price. It rose to over $2.00, more than doubling the cost of the pair. Doubling a Strangle on a Wednesday is a pretty good feat. We normally get greater leverage on a Friday than a Wednesday.

Because of the extra time to expiration a Wednesday offers, we have Special Strangle Rules. I ask only experienced traders implement these rules. (Understand, if you let me, I will teach you to the point of being comfortable with these upper level trades and beyond). With three or more days to expiration, these rules allow us to buy further OTM options.

We could have bought the $59 Call and the $56 Put. You will notice I don't have the $59 Call as part of the table. If you are able to follow the Laws of Option Pricing, you would know they would cost within pennies of each other. Also you would know that we would have lost 100% of the money paid for the $59 Call.

Let's simply double the cost of the $56 Put from 17 cents to 34 cents. Add a few more cents so no one could argue and we have a cost of let's say 40 cents. Notice the $56 Put went to a high of $1.30. This move more than tripled the cost of the pair.

These are all fun and good. It was a lousy week to trade. Knew that in advance. We had a short list for our "T5+/-." That's not the bad news, that's just the reality. But this is also the reality and the good news; the next few weeks have a much higher statistical probability of great setups. Let me tell you about them.

"Top 5 Plus or Minus"

In alphabetical order: FAS, GDX, GS, SLV, TLT & VXX.

Two trading opportunities: Both of them buying our options near the close for the next trading day's movement. First, near the close on Tuesday expecting some shock value in that day's primary election results to affect the market Wednesday. The other event is Friday before the opening bell.

My "Farmula" to trade NFP this month is pretty simple. Look to buy our options close to Thursday's close. Hope for a report that sends the market moving.

All stocks in play. Let me tell you their pluses and their minuses. While we generally want to trade Non-Directional, I will give some insight into directional plays on a few of the stocks.

FAS: The stock has great stats for price movement. Problem is, its options are likely near a dollar. Making contracts expensive compared to the others. Consider short term Deep-Out-of-the-Money (DOTM) options at your own risk. Speaking of risk, if the market falters, FAS Puts have the added advantage of gaining Implied Volatility in the event of a sell off. Risk Takers ONLY – look to trade Puts on FAS. While you are truly risking 100% of your money. If right, the returns should be many multiples of your risk.

GDX: No reason to not have doubles this week. While I do think next week's FOMC might be a better play, this week is a lock. The half dollar strikes are back in play. These allow for more entry opportunities. Sometimes more can overwhelm a newer trader. If this is you, stick to even dollar strikes.

GS: 75 to 80% of Fridays GS crosses a strike price. Because of the distance between strike prices, we never trade Strangles on GS. I know you can have success trading Straddles, but I feel the simpler trade is to buy the option closest to crossing a strike and cross your fingers. When we get a slow week again in the future I will take the down time as an opportunity to teach more on this trade. Until then, treat this as a "Risk Worthy" trade. Trail a stop underneath your price and look forward to for a good ride.

SLV: I might not have SLV in this short list except for the half dollar strikes. The math just says double. You can trade this like GDX, but why bother, just trade GDX instead. I have this on my speculative list. I want to find an option that is under a dime that I trust can go up four to five times in prices. It's a function of where the stock is in relation to a strike price and its ability to cross that strike. Should / could be good practice for GS traders.

TLT: This stock has pretty good stats, especially if you hold overnight from a close to an open. It tends to gap a bunch right now. Not ready to pick a direction so sticking with Non-Directional trades.

VXX: Last but not least. I want to trade this directionally on Friday. But since that's almost a week away, I don't want to commit 100% to the specific direction at this time. Allow me to wish out loud. I hope this stock makes a new low Thursday. I would then buy Call options wishing the trend reverses. If I am right, I may be looking at a 1,000% one day move. A lot of "ifs" need to take place for the setup to be just right. I feel I am somewhat skilled, I hope to get lucky.

I hope this information increases your skill level, so you can amaze your friends and family with your new found luck.

As always Good Trading,
Chris