

LIBERTY TRADING GROUP'S  
**OPTION** Seller  
NEWSLETTER



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Liberty Trading Group/OptionSellers.com

Option Writing Insights and Education for the High Net Worth Investor AUGUST/SEPTEMBER 2012

THE **BIG**  
PICTURE

## No Dog Days for Commodities

As this dry, hot summer works towards its inevitable conclusion, most equity traders will remember the month of August as a time of quiet markets, mild gains and a general break from the volatility seen earlier in the year. The calm before the storm? Perhaps.

Over in commodities, however, it's business as usual. Stock investors may take a summer vacation. Farmers, Distributors, Refiners and Importers have no such luxury. Price discovery continues on regardless of what the traders are doing. Commodities prices focus on fundamentals.

OK, ironic that this month's newsletter has a feature on gold, one of the only commodities more focused on what investors think. However, out in the fields, it's supply and demand that are calling the shots. And calling the shots they are.

Oil prices continue to drift higher off of continuing concerns in Iran. Softs prices have floundered as hefty supplies and waning European demand pressure the market. Corn prices spiked to a record high this summer as a result of the Midwestern drought. This will soon produce another fundamental shift in a related

market – one you will read about inside.

Dog days may winding down for stock traders as September begins, the kids go back to school and everyone starts focusing on their portfolio again. But for those of us who sell options in commodities, dog days are something we don't have to worry about. There is always a new premium to write!

Have a great September and I hope our special offer on the back page of the newsletter will help you do so.

-JC



### Quote of THE MONTH

"Investing should be more like watching paint dry or watching grass grow. If you want excitement, take \$800 and go to Las Vegas."

- Paul Samuelson

# FEATURE MARKET 1

by James Cordier, Michael Gross, OptionSellers.com

## FEATURE MARKET | LIVE CATTLE Herd Thinning Points to Longer Term Shortage

Labor Day weekend is fast approaching and stores are stocking their shelves with plenty of meat for holiday cookouts. The seasonal Labor Day increase in demand should reflect an increase in the price of live cattle through the month of August. However, a recent increase in supply of market ready cattle, due to the drought conditions across the US, could put pressure on live cattle futures in the near term.

Cattle producers breed cattle and raise them until they are about 700-800 lbs., which usually takes about 2 ½ years. The cattle are then sold to a feedlot where they become feeder cattle and are fattened up to about 1250 lbs. They are then sold to meat packing companies where they are slaughtered and then sold to your local grocery store.

The fastest way for the cattle producers and feedlots to get the cattle to 1250 lbs is to use corn in the feed. It is estimated that cattle will eat about 2.5% of their body weight in corn a day. So for a 1000lb cow that's 25 lbs of corn consumed a day! And with a bushel of corn about 56 lbs., cattle producers need a lot of corn to feed their herds. Over the years corn has been cheap for cattle producers until this year when the US was hit by a drought resulting in one of the worst corn crops in 50 years.



### DECEMBER 2012 CORN



Continued on the next page

# FEATURE MARKET 1

by James Cordier, Michael Gross, OptionSellers.com

## FEATURE MARKET | LIVE CATTLE

### Herd Thinning Points to Longer Term Shortage

The sharp dip in corn yields has caused corn prices to surge to over \$8.00 a bushel. Now cattle producers are running out of money to feed their cattle herds. Instead of feeding cattle to fatten them up, cattle producers are liquidating parts of their herds earlier than expected. This is causing a supply wave in market ready beef. Cattle producers are deciding that it is better to sell some of their herd now for a small loss, instead of continuing to feed cattle with expensive feed and incur a larger loss in the future. The extra supply of cattle being sold in the market now is supposed to be fed for 4-6 more months and then sold in the market when the cattle reach their full weight potential.

We think that the high feed costs are going to continue to force cattle producers to liquidate their herds causing an increase in the supply of cattle over the next 30-60 days. This could potentially pressure prices. However, this herd liquidation could likely result in cattle herd levels at their

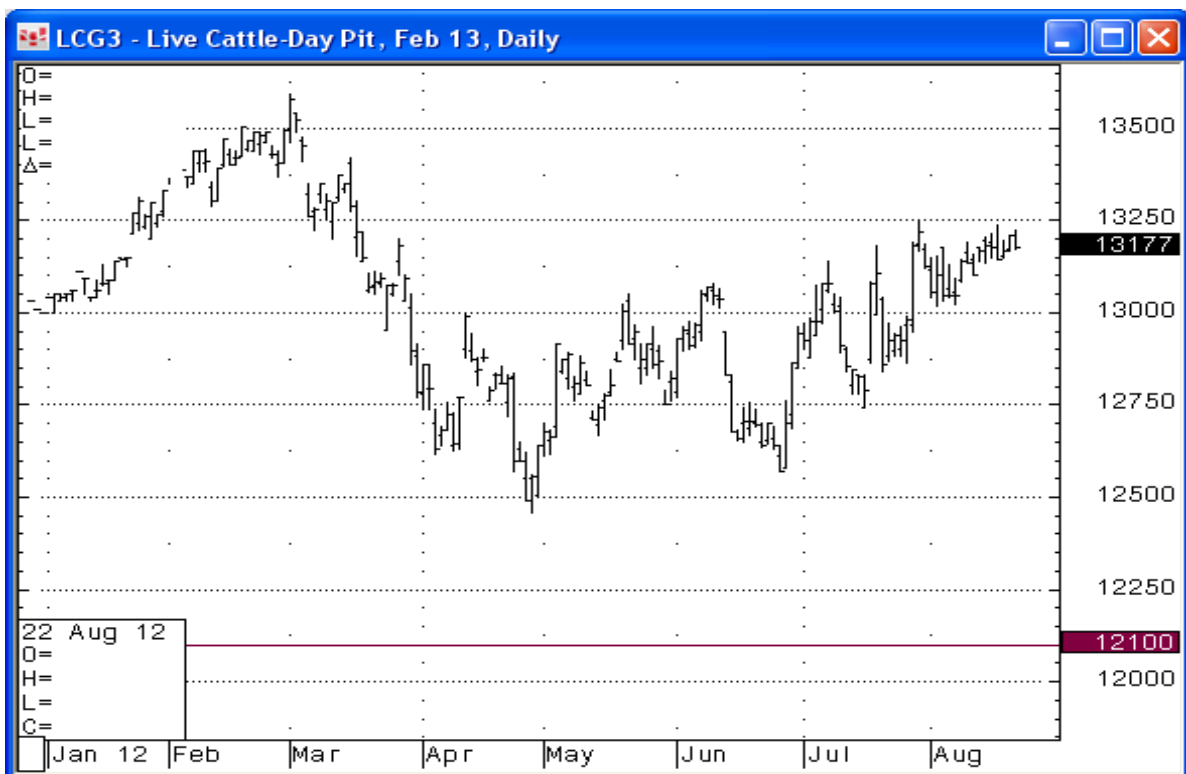
lowest levels since 1973. The ultimate result is likely a shortage of live cattle in 5 to 7 months. The shortage in supply could hit the market during the holiday season when demand for beef begins to rise. Long term – Bullish.

#### Conclusion and Strategy

It is possible that cattle prices could break over the next 7-30 days as a result of the short term herd liquidation. But traders are well aware of the herd liquidation in process and appear eager to buy. Look at moderate breaks over the next 4 weeks as opportunities for selling puts well below current market prices.

Look to target the February puts around the \$121.00 level for between \$600-\$800 a contract over the next 1-2 months.

#### FEBRUARY 2013 LIVE CATTLE



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## FEATURE MARKET 2

by James Cordier, Michael Gross, OptionSellers.com

### FEATURE MARKET | GOLD

## GOLD: To QE3, or not to QE3? Either could favor Put Sellers

The media has been all over QE3 the last month and has speculators trying to figure out whether the Fed is going to pull the trigger or not. While investors continue to sit tight and wait for Fed Chairman Ben Bernanke to make a decision, gold has fallen into a trading range between \$1,537 and \$1,646 over the last 3 months. In August this range has tightened up even more to a range between \$1,580 and \$1,630. We think that this shows that the Fed has a strong influence on where the price of gold will trade over the next 3 to 6 months.

With the Fed having a strong influence on the price of gold at the moment we think that gold will continue to trade in a tight range between \$1,550 and \$1,650 until September 12-13, when the Fed meets to talk about QE3. Notice I said "talk" and not "decide". We point this out because fortunately for us, as out-of-the-money option sellers, it does not matter whether Bernanke will decide to launch QE3 or not. We are most concerned with making sure that Bernanke continues to keep QE3 on the table as a possibility and with unemployment at 8.3%, we think that is a very likely scenario. As long as QE3 continues to be a possibility we think that it will provide support for gold because investors will continue to keep gold in their portfolios as a hedge against inflation and speculators will continue to place long bets on the possibility of a QE3 announcement.

If Bernanke decides that it is not time for QE3 just yet, but says that the Fed is ready to take action if needed. Then with another Fed meeting right around the corner on October 23-24, we think

investors will continue to keep their current gold positions in their portfolios until they see some improvements in the economy, while speculators will look to the next meeting for a QE3 possibility.



This is the luxury of being an out-of-the money option seller as we do not have to worry about trying to pick where gold will be in 3 to 6 months. We have to pick where gold is most likely not going to go. And with the economy still sluggish we feel that the possibility of QE3 is not going away anytime soon. The "possibility" keeps investors in the market and speculators trying to guess when QE3 will happen.

### Conclusion and Strategy

To take advantage of this situation we are looking at selling the \$1,400 December Gold Puts for \$600 a contract. We feel that gold should maintain a trading range between \$1,580 and \$1,630 until a decision is made by the Fed. Remember we just want for Bernanke to continue to push the possibility of QE3. If Bernanke does decide on QE3, then gold should rally and our put options would almost certainly expire worthless.

### DECEMBER 2012 GOLD



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08/17/2012



## BACK TO BASICS

### Picking the Right Option to Sell

Deciding to allocate capital to an option selling portfolio can create a maze of questions. When you are initially learning about selling options, especially if you are considering going it on your own, one of the first questions that probably enters your mind is “How do I know the best options to sell?”

This is a broad subject simply too complex to answer completely in a single email seminar. In reality, there probably isn't any one “best” option to sell. If it expires

before hitting your risk parameter, you sold the right option. However, there are a few guidelines you can gain here that will get you started in the right direction.

Ideally, you want to pick options that not only expire worthless, but quietly decay to zero – preferably well before expiration. At least, that is the objective of the [premium collection program](#) that I recommend. Some options that expire worthless can also have “interesting” swings in value prior to expiration. While these can ultimately provide profits, they don't work so well for the investor's state of mind!

Your objective is to select the former, avoid the latter.

Therefore, while there are no hard and fast rules for selecting the “best” options to write for your commodities portfolio, here are presented some general guidelines that may help you. These are the same guidelines discussed in more detail in [The Complete Guide to Option Selling](#).

The recommendations below are recommendations based on my 25 years of experience trading options. These are the distilled, street tested ideas as to what makes money consistently, and what doesn't. Before the option geniuses out there write in to argue with me, let me preface these suggestions. There are many ways to trade options and many number crunching gurus out there willing to show you their way. Great. The suggestions below are simply what I have found to produce most consistently in the real world, (and with the least trading “excitement”) in the [portfolios I manage](#).

### Three Guidelines for Successfully Selling Commodity Options Consistently

**1. Know your Fundamentals.** Unlike equities, commodities are almost always dependant on their physical supply/demand fundamentals for their ultimate price direction. While institutional money or public sentiment can still play a role in commodities in the short term, a massive list of commercial players are buying and selling the futures contracts to hedge actual usage or production of the commodity.



Supply/Demand fundamentals play a sizable role in determining future commodity prices

These commercial traders are keenly aware of the actual supply and demand for these products. You should be too. Fundamentals can give you a fairly clear idea of where prices *will not go* and provide you with an advantage over the average commodity investor who is simply following a chart. Combining this knowledge with a high percentage strategy such as option selling can be a potent combination. There are many good sources of fundamental data for investors such as the USDA, the EIA, news wire services or private sources such as [The Option Seller Newsletter](#).

**2. Sell Deep out of the Money.** Select markets where premium is available 50-100% out of the money. Rarely possible in stocks. Quite feasible in commodities. This forces the market to make an extreme move against your position to put the option in the money. It also allows you to manage your risk based on the option value – not on the price of the underlying or it's proximity to your strike.

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## BACK TO BASICS

### Picking the Right Option to Sell *continued*

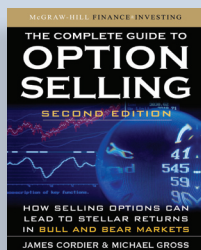
#### DECEMBER 2012 SILVER



Selling Deep out of the money means seeking strike prices 50% away from the current price of the commodity. In mid 2012, silver bulls could still sell 14.00 put options for high premiums - nearly 50% below the current price of silver.

**3. Trade Time for Distance:** This is the cornerstone of the entire [investment plan](#) we recommend for high net worth individuals. Many books and courses that address selling options will advise selling options within 30 days of expiration to gain the fastest time decay. While this may make sense for option sellers collecting premium on open stock positions, I couldn't disagree more when it comes to selling options for income in commodities. Getting any significant premium with this little time means selling close to the money – too close for a person that enjoys their sleep as much as I do. Close to the money strikes may decay quickly if you are right the market. But even a temporary fluctuation can put your option in the money. **Guessing short term market direction is exactly what we are trying to avoid by selling options.** Be willing to sell options with more time (2-4 months) and much further out of the money. If your fundamental synopsis is even close to being right, these trades should work well for you.

Of course, selecting the right strategy, managing risk and structuring your portfolio are all important too. But selecting the right options to sell is where you start. Getting that part right makes the rest of managing a portfolio quite a bit easier.



#### **The Complete Guide To Option Selling** Revised, Updated 2nd Edition on Sale Now

*Learn How to Excel in Bull OR Bear Markets*

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In honor of our New Partnership with Clearing Firm FC Stone, Liberty Trading Group is temporarily waiving our Minimum Account Requirement of \$250,000 and **for a limited time, will be allowing new accounts to open for as little as \$100,000.** If you have ever wanted to have **options written and managed for you** by the authors of *The Complete Guide to Option Selling* but were not in position to commit \$250K,  
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This is a Limited Time Offer and No Accounts will be accepted under the minimum after expiration.

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