LIBERTY TRADING GROUP'S
OPTION Seller NEWSLETTER

James Cordier, President,
Liberty Trading Group/OptionSellers.com

Option Writing Insights and Education for the High Net Worth Investor JUNE 2012

THE BIG PICTURE

The Strategy Shift You Should be Making Now

It's been a pretty nice ride for everyone who has been long stock and commodity funds for the first part of 2012. Nice steady gains, more or less, for the better part of the year.

But alas, bull markets don't go up forever. China is showing signs of slowing. Europe, already in recession, now finds itself dealing (once again) with a new (old) crisis in Greece. The US is quickly approaching what is sure to be a nasty election season. And in late 2012, a lame duck, bickering congress will be tasked with dealing with one some of the most pressing financial legislation the country has ever faced.

Will stocks tip over? Will gas prices tank? Nobody knows. But the smooth easy ride that typified early 2012 is now giving way to choppier waters. And potentially darker clouds on the horizon indicate it may continue.

For traditional investors, this means heading back to the sidelines in cash. Or, it means resolving to "batton down the hatches" and hope for the best.

For option sellers, it means it's time to go shopping.

Premiums flow in bull or bear markets

I've said it a million times and I'll say it again here. I have no idea what stocks are going to do, now, this summer or after the election. Their price movements make no sense to me and I have no interest in trying to make money trying to guess what the value of a piece of paper will be tomorrow.

But for commodities, physical things that can be valued based on their quantifiable supply and end user demand, I think we have an opportunity on the table right now in several sectors.

The recent bull has run up call values in many markets - markets we may have been less willing to sell only a few months ago.

I am not predicting a bear market by any means. What we do see now are high commodity prices at a time when there appear to be many factors in place to undermine higher prices.

I realize that is a vague and general statement. But with option selling, it's often all that is needed.

Deja vu. Guess who's moving the markets again?

Crude prices hit $110 a barrel this Spring off of sharp demand and Iranian fears. Do you think the global economy is bullish enough right now to drive prices to $150 over the next 90 days? If not, then writing 150 calls in crude makes sense. It doesn't matter if prices go down or not. If you are selling options in these markets, that is all the "right" you need to be.

> **Quote *of* THE MONTH**
>
> "If the wind will not serve, take to the oars."
>
> - *Latin Proverb*

Vague, big economic pictures are sometimes all the raw material required to convert your observation to cash - at least in commodities where demand, not the media infused "knowledge" of the general public, is king.

In plain English, I feel the rosy economic outlook of the last 4-6 months is looking a little less rosey for the next 4-6 months. Which means the opportunity play on many commodities could be on the **call selling side**.

The easy money for traditional investors may have been made for the year. But for option sellers, we can roll up our sleeves and dig in for another round - it just requires a slight adjustment.

We hope this month's newsletter helps you make it - in spades.

FEATURE MARKET | SOYBEANS

Fast Start for 2012 Crop leaves Table Set for Call Sellers *continued*

What a bull market this has been. The Option Seller recommended put sales in the soybean market in both January and March. We hope you took advantage of the premiums.

For as we find ourselves on the brink of summer, it may finally be time to switch our focus in the soybean market to the **overpriced calls** now prevalent in this market. Not so much that soybean fundamentals have turned decidedly bearish. But more so because we seem to be in a bull market that has essentially "run it's course", especially in light of the outside "macro" factors now influencing many commodities prices.

Soybeans bull market this spring was due to a combination of tight near term supplies and voracious Chinese demand. Funds like trends. The trend in soybeans was clearly defined which brought more fund money, which in turn, drove prices higher. Fundamentals drive trends, for sure. But trends can also feed on themselves once they get going. The problem with this is that eventually, the music stops. And when it does, it often leaves the underlying commodity over (or under) priced, depending on the trend direction.

In this case, **soybean prices may have gotten a bit ahead of themselves**. The brisk pace of Chinese demand isn't going to go away. But at some point, it's priced into the market. And as summer growing season now begins in earnest, a number of factors are aligning which could hamper or even reverse the longer term uptrend in beans.

These include:

1. Exceptional planting weather in the US midwest. It has been warm and dry - ideal. Soybean plantings are already at 46% complete as of the 2nd week in May. This is compared to a 20 year average of 27%.

2. Recent concerns emerging of slowing in the Chinese economy with data to back it up.

3. A commitment of traders picture that shows funds still holding a near record long position in soybeans. If and when they begin to liquidate, the selling could quickly feed on itself.

4. The renewed and ongoing crisis in Greece which could continue to pressure the Euro and strengthen the dollar (bearish for commodities in general)

5. A seasonal tendency for soybean prices to decline once the crop is "in the ground" and planting fears subside. This typically begins sometime in early to mid June.

The Seasonal Play in Soybeans

Of the factors mentioned above, perhaps the most considerable is the seasonal tendency of **soybean prices to decline once the crop has been planted.**

With Old Crop US soybeans running low and Brazilian beans not widely available on the market, the northern hemisphere spring often sees low inventories of soybeans and thus, higher prices. This price strength can often be given additional fuel by any weather concerns that arise during US "new crop" planting in the Spring. However as June arrives, new Brazilian beans are typically flowing back onto world export markets (Brazil's harvest is in April and May) and the US crop is usually safely in the ground. In the past, this has often pressured soybean prices into the summer months (see chart below). With this year's US planting well ahead of schedule, price pressure could come sooner rather than later.

September Soybean 30 Year Seasonal Price Tendency

While there are no guarantees it will happen this year, in the past, the combination of fresh Brazilian supplies and the end of US planting season have tended to pressure soybean prices into the summer months. (Past performance is not indicative of future results).

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FEATURE MARKET | SOYBEANS

Fast Start for 2012 Crop leaves Table Set for Call Sellers *continued*

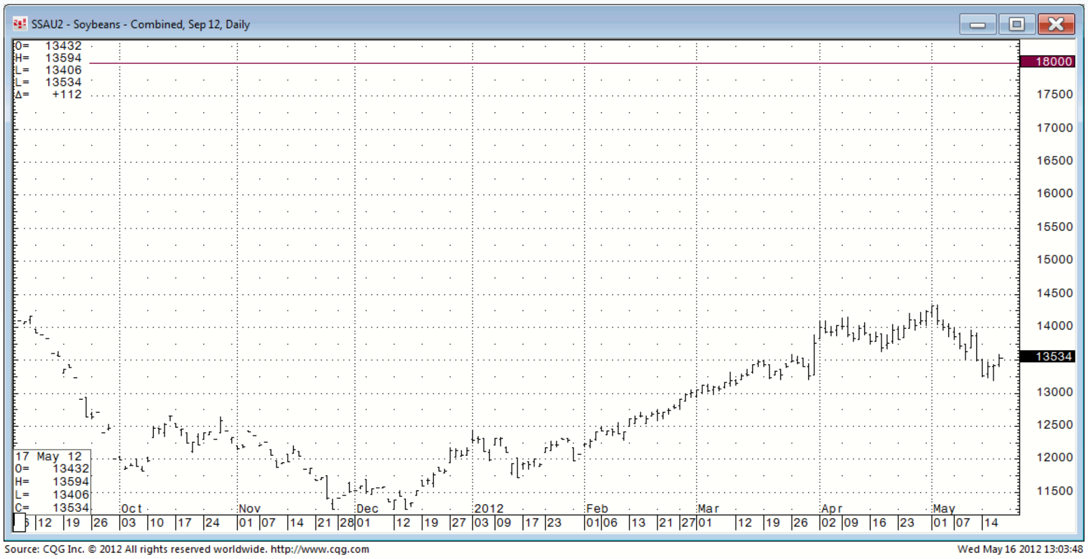
Higher Prices could help Call Sellers

For potential sellers of calls on these factors, it does not hurt that **soybeans are still within $2 of their all time historical highs** set back in 2008. This enables option sellers to target calls at strike levels this market has ***never*** attained - well above the all time soybean price highs.

MONTHLY SOYBEANS

While weakened as of late, soybeans remain close to the all time high price levels set back in 2008.

SEPTEMBER SOYBEANS



The relatively high price of beans prior to summer means call sellers can target strikes at levels the market has never seen.

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FEATURE MARKET | SOYBEANS

Fast Start for 2012 Crop leaves Table Set for Call Sellers *continued*

Conclusion and Strategy

While there could still be some sporadic bursts of strength over the next 2-3 weeks, it is our opinion that soybean prices will begin to weaken as the month of June progresses. The factors responsible for the rally this spring, while partially still in place, are being offset by both shifting soybean fundamentals and outside (Macro) market forces.

Look to take advantage of the relatively high price of beans while the volatility remains in the market. We like **selling call premium** well above the all time highs set in 2008. September calls are still viable. November will allow you to sell deeper out of the money strikes.

Example (This is *not* a recommendation)

Trade:	**Selling November Soybean 18.00 call**
Premium:	**$700**
Margin Requirement:	**$1155**
Expiration:	**10/26/12**

We will be working closely with our private client group this month in selecting the optimum strikes and risk parameters for this market.

JUNE CLIENT FOCUS | Spotlight on a Liberty Trading Group Client/Investor

Kerry and Carol O'Hallaron

Valrico, FL

Kerry – Insurance Broker and Risk Management Consultant

Carol – Retired Classroom Teacher

Why I got started Selling Commodities Options:

(answers provided by Kerry) About 18 years ago, before online trading existed, I had an account with a broker who specialized in writing naked stock options. The concept absolutely fascinated me. Before options could be traded, they had to originate somewhere – and I was the one who originated them. As a math geek, I was able to fairly well quantify the risk and reward of each trade. Unfortunately, the deck was stacked against the individual trader because of high maintenance requirements. It seemed to me that you should be able to go ridiculously far out of the money and accept a small premium but also have a maintenance requirement that corresponded to the extremely low risk. Unfortunately, you couldn't actually get very far out of the money except on volatile stocks, and the maintenance was very high no matter what the strike was. So, the profitability of trades, measured as return on cash tied up (or return on equity) was really not good. Plus, we were selling puts on profitable companies in good times – meaning we profited as long as the stock was stable or went up – but the catastrophic potential was enormous. A sudden "Black Tuesday" could have killed my account!

I later gravitated to credit spreads on indexes such as the S&P 500. Both the principle and the inherent challenges were pretty much the same – pretty good rewards, but potentially catastrophic risk. I did very well for a while, but the extreme exposure bothered me. Ironically, while I feared market crashes wiping me out, it was actually significant upward moves that cost me my profits and caused me to lose interest in this process.

A couple of years later, by way of Google, I stumbled across this broker (Liberty) in my own back yard that specialized in selling options on commodity futures. I looked at their web site, and even though I knew zero about futures, I understood the basic concept right away because of my prior experience selling premium. But I knew the numbers did not work for the small seller of equity options; would they somehow be any different in commodity options? Plus, would I somehow end up with 80,000 head of cattle in my front yard if something

Spotlight on a Liberty Trading Group Client/Investor *continued*

went wrong on a trade? Our homeowners association would frown on this.

So I read the book, and enjoyed it immensely (and also realized I would never, ever actually own cattle or oil unless I wanted to). For a book on trading, it was extremely user friendly and easy to understand. However, the big "aha" for me was the reasonableness of margin requirements – the notion that the exchanges required enough margin to cover the immediate risk, but no more. In addition, the SPAN margin concept seemed to apply a common sense approach to a portfolio of short futures options. What a concept – letting small investors take prudent risks in a "big boy" game!

My next step – which I wholeheartedly do not recommend, was to open my own (personally traded) account. I took a couple of small positions, and a few weeks later found myself with a profit that was not huge dollar-wise, but the annualized return on equity that it represented was phenomenal. I kept taking more and more positions, increasing them in size and diversity – and my profits grew consistently larger. I never really intended to trade long term on my – the goal was always to join Liberty after I really had an understanding of the process. And did I gain an understanding! Back when margin requirements were smaller than they are now, I found myself taking massively large positions in the same commodity. When the market moved against me, even though the positions really weren't at high risk (in my opinion), the broker made me close out most of them at a huge loss – wiping out most of my gains to date. Over the next six months, I made the same mistakes several more times, giving back my very substantial profits and then some.

At that point, Carol and I were ready to meet with Liberty, and gain a clear understanding of what they would do differently. They didn't tell us anything that wasn't in the book – small position sizes, a mix of non-correlated underlying commodities, far out of the money, keep some cash available, etc. – but it was somehow comforting to hear James say in person that we have to be willing to let him follow his own risk management rules if he were to manage our funds. Now, as we get our daily statements, I look each trade and can quickly get a good feel for both the market strategy and the risk management thought processes that likely were used in the decision. I am convinced that the value of a well managed account consists of both of these elements – portfolio development and risk management - not just one or the other.

My outlook on the overall markets: I may have a more educated opinion on the equity markets than I do on the commodity markets. My opinion on the equity markets is that they tend to be cyclical, whether your time frame is days or decades. A person can certainly do well following Warren Buffett's lead – buy solid, profitable companies with some growth potential and hold them until they no longer fit that model. But from a perspective of trading rather than investing, markets go up, and markets go down. I've never mastered market timing except on the occasional trade, and I don't really care to keep trying. The only thing that really counts is the liquidated value of your portfolio. Everything else is just conversation. So when people ask me what I think the market is going to do this week, this month, or this year, I voice an opinion for the sake of conversation – but I won't bet my future on it.

My outlook on the general economy: I happen to work in the financial services arena, and am employed by one of the largest bank holding companies in the country. My outlook in late 2008 and early 2009 was that the world narrowly avoided a cataclysmic financial meltdown and global depression. How's that for sounding negative? But I believe we came closer to that than we'll ever know.

Advice to New Commodity Option Sellers: In the book, James and Michael liken option selling to being the casino rather than playing at the casino – it moves the odds consistently to your favor. It's a good analogy, though it takes anywhere from a few million to a few hundred million to open a casino, and much less to sell options. If you're new to the concept, the first thing you absolutely must do is read the book. If the strategy sounds completely comfortable and logical, then you can move to the next step; if not, you should not even pursue it.

Most of us could gain a solid understanding of how to make money selling options without ever doing it. I believe, though, that learning how to lose money selling options is just as important as learning how to make it. You really need to understand that before you can fully appreciate the value of the risk management component of the Liberty managed account. The guys at Liberty know far more than I do about selecting the trades and building the portfolio – but I think it's impossible to overstate the value of their risk management efforts.

If you would like to submit your own entry to Client Focus, simply email us at Office@libertytradinggroup and you will be sent an entry form. You must be a client of Liberty Trading Group to participate.)

by James Cordier, OptionSellers.com

Q: Dear James, Presently, I have an active trading account ... with a broker using ADM for clearing. While the young man seems to be helpful in many ways he just doesn't seem interested enough in your approach to even read your book. I meet a lot of resistance at times when I want to apply things I've learned from your writings. For example, your current article about margin management strikes me in particular. Some time back when I inquired about my margin stats he basically brushed me off. Like, "Don't worry about that...I'll take care of it...!"

As you must know, searching for the right broker is not a pleasant job. Just getting an application finalized is a pain and I don't want to just be throwing applications around in hopes of one day getting lucky and finding the right broker. Frankly, I'm new enough at this that I'm not always real sure I'm doing things the way you might advocate. My broker certainly didn't help much while I took my lumps!

Do you possibly know of a broker who might work with a smaller account like me, who you know has read your book more than once, and believes in the principles you advocate?

Thanks for your consideration!

Ron Fredricks,
Redding, CA

A: Dear Ron, I'm glad you wrote to us as this is a question that we get over and over again. I feel for you. I really do. I wish we could help each and every investor out there who wanted to sell options for income. That would, however, require me to vastly expand my staff, hire new traders, train and supervise them in a way that was not only compliant but congruent with our core methods. At this point in my career, I have no interest in doing that. I love what I do and am quite sure that Michael does too. However, limiting the number of new clients we accept allows us to give our full attention and focus to the investors that are accepted. They expect and deserve this attention to their portfolio.

While we realize that many investors will not qualify to join our client family, we do try to help educate the overall investment community as a way of giving back to the industry. However, I will have to stop short of recommending a specific broker.

I know there are many brokers out there that have read our book. I know there are some even attempting to simulate our methods. That is fine with me. For you, however, finding the one of them that is both competent and has your best interest in mind will be the challenge.

The "young man" you describe sounds like he has his own agenda with little interest in yours. Unfortunately, this can be true for many a "young man" that enters this industry. Did you know that the average career span of a futures broker is two years? The salesman looking for a new product to peddle will be out quickly. The ones with a passion for the markets, a commitment to constant learning and a true concern for their client's best interest will be the ones that last.

The good news is, there are still plenty of good, qualified people in this business.

My advice to you would be to spend more time interviewing prospective candidates up front, before submitting any paperwork. Seek someone with at least 5 years in the industry, preferably 10 or more. The person you are looking for may not necessarily be familiar with our work (then again, he very well could be. I've personally autographed umpteen copies of our book for floor traders at the CME. I was literally stunned (and flattered) by the number that recognized me when I visited. So, you never know.) But he should have some knowledge and experience in selling options. If he does not, I would <u>not</u> recommend trying to "teach" him.

Most of all, he should have your best interest at heart. He should be willing to build a relationship with you over the longer term. When he recommends a course of action, you should be able to trust that he is speaking in your best interest alone, at all times.

I wish you the best in your search.
-JC

If you would like to submit a question for "Q&A" feel free to email your question to office@libertytradinggroup.com.

BACK TO BASICS
The Triangle Formula for Option Selling Success

It is likely that if you are reading this, you are already successful in at least one field or discipline. In achieving this success, you are probably already aware that your success can likely be reduced to a simplified formula.

Donald Trump (and many other real estate investors bigger than Trump) achieved their wealth by repeating a few simple formulas for profit, over and over again. They built their fortunes by applying the same proven formulas on bigger and bigger scales.

Likewise Warren Buffet. In his autobiography, *The Snowball*, he describes using formulas for picking winning stocks. The same ones, in the early years, right up through today.

Likewise almost anyone who has ever achieved success in anything, there was a formula, however simple, to their success.

So why should selling options be any different?

It isn't.

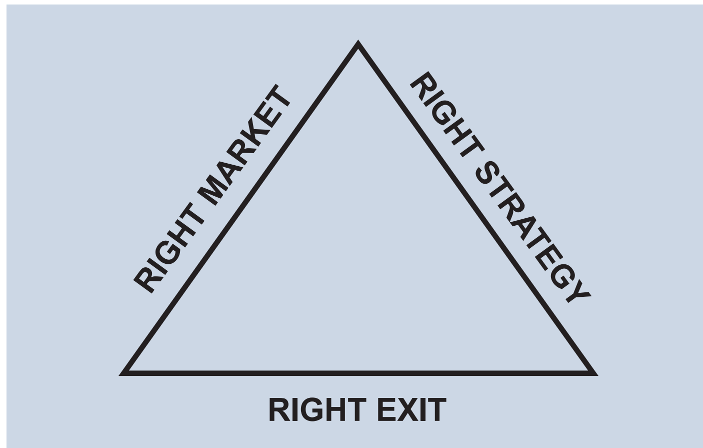
If you want to be successful in selling options, you have to first begin with a winning formula.

As I mentioned in the Intro, it took me nearly 20 years of hard knocks and gradual, begrudging victories in the options arena before I was finally able to put a formula on paper that I could fully believe in and use confidently. I spent the better part of the most recent 10 years in implementing that formula.

> **If you want to be successful in selling options, you have to first begin with a winning formula.**

It is presented here for your review. The formula itself is simple. The following of it, a bit more complex. But most everything you read in these guides, our newsletters, blog, website, new account materials or even our book is based on this simple formula.

We have entitled it the *Triangle Formula for Option Selling Success*



Notice the three components of the Triangle formula are all equal in length. Your correct formula for selling options is reliant on these three aspects, each equally important. You get the **right market** with the **right strategy** and then the **right exit** - you have profits.

It's not as easy, or hard as it sounds. But you should always focus on trying to get all three right. Option selling is a forgiving strategy and you can still win sometimes if you get one or even two of them wrong. But doing so could mean your odds of success begin to fall or your risk could begin to rise.

The more you get right on every single trade will mean the higher your winning percentage and likely the higher your profits.

Have a great month of premium collection. - James

A N N O U N C E M E N T S

The Smart and Easy Way to Sell Options

James Cordier and Michael Gross will be accepting new members to their private client group during the month of June. This is your chance to have **options written and managed for you** by the authors of *The Complete Guide to Option Selling.*

For inquiries or to see if you qualify, call the Liberty Trading Group main office to schedule a confidential consultation. Written inquiries can be sent to office@libertytradinggroup.com.

New Accounts US **800-346-1949** International **813-472-5760**

Recommended Initial Investment: $1M
Minimum Initial Investment: $250,000

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* Seasonal Charts courtesy of Moore Research Center **Fundamental Charts Courtesy of Hightower Research ***Price charts courtesy of CQG, Inc.

THIS MONTH'S FEATURES INSIDE

The Option Seller Newsletter
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