

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

MAY 2012

THE **BIG**
PICTURE

In Search for *Real* Profits, Look to the Mundane

I love trading agricultural markets. More specifically, I love selling options in Agricultural markets.

It reminds me of the story of two business owners in a small town where the mill that employed most everybody just closed. The jewelry store owner and the garbage dump owner. The jewelry store owner gets up, puts on his shiny new suit, gets in his Mercedes and drives to work. The garbage dump owner pulls on jeans and a T-Shirt and hops in an old pick up and goes to work. At the end of the day, they both leave their respective businesses and head home. The jewelry store owner pulls into his uncovered parking spot at his rented 2 bedroom apartment. The garbage dump owner pulls his old pickup into the garage of his mansion atop the hill.

Why?

Because people can do without jewelry if they have to. But they still need their garbage hauled away.

No offense if you own a jewelry store. I'm sure there are plenty that do quite well (I hear the mark ups are exceptional). The story is told to make a point.

The point is, **the real money is often made in the mundane, less glamorous businesses.**

The same is true in the Commodities Markets.

It's the "sexy" markets that get the headlines and cause John Q. Public to get fired up and buy some. Watch CNBC or leaf through your next edition of *The Wall Street Journal*. How many articles or reports do you see on Gold? How about Oil? I'll bet they outnumber what you read or watch on wheat or sugar by about 10 to 1. There are likely investors out there who think the commodities markets are gold and oil, and maybe silver as a "diversifier."



Spring Planting Underway in Iowa: While high profile commodities such as crude oil and gold get the glamour, there can often be better opportunities in lesser known, fundamentally traded commodities.

Don't believe it? How many ETF's do you see started for soybeans? How many new funds featured by Vanguard or T. Rowe Price are entitled "Diversified Cocoa - Admiral Shares?"

Quotes of THE MONTH

"A store of grain, Oh king,
is the best of treasures.
A gem put in your mouth
will not support life."
- Hitopadesa

"...you always want to
invest in things that
people can't do without."
- Kevin Costner
(Mr. Brooks, 2007)

Oil and gold can resemble equities movement at times because of the large public participation. That can make them more emotional and sensitive to factors outside of core fundamentals. This doesn't mean you shouldn't sell premium there. In fact, the large public participation means plenty of options to sell. But often, the glam, glitter and public participation can make them more difficult to analyze.

Continued on the next page

THE BIG PICTURE

by James Cordier, Michael Gross, OptionSellers.com

In Search for Real Profits, Look to the Mundane *continued*

However, **for pure fundamental trading, there is nothing better than trading agricultural markets, in my opinion.**

With less of the general public involved, these markets respond to pure supply and demand. At the same time, these are mostly indispensable products. Europe could implode today and guess what? We're still going to eat cornflakes for breakfast tomorrow. We may cut back our driving or hoard our gold, but when it comes time for mom to cook dinner for the kids, not much changes. This can make foods and other "indispensables" less price sensitive to international and geopolitical events - a trait less present in the more glamorous metal and energy sectors.

With Agricultural markets, you can worry less about Iran and Europe and instead focus on the time of year and cold, hard data from the USDA. And the even better news is: *Most people don't do this.*

"The real money is often made in the mundane, less glamorous businesses. The same is true in the Commodities Markets."

And that is where your opportunity is - especially if you're going to sell options.

This month marks the height of grain planting season here in the US and the peak of harvest season for many markets in South America. There are some abrupt fundamental shifts that tend to take place this time of year. As a

commodities investor, you should be aware of these. As an Option Seller, you should be getting ready to act on them, now. This month's issue will help get you started.

Talking about your corn or sugar options won't sound as exciting at your next cocktail party - especially when your buddy is explaining the oil fund he just bought into.

Just remember the quality of your party conversations, like the outer appearance of a business, has little to do with where you park your car at night. -JC

MAY FEATURE MARKET

by James Cordier, Michael Gross, OptionSellers.com



FEATURE MARKET | SUGAR

Big Picture Fundamentals Should Help Market Pay off for Put Sellers

Have you ever picked out a basket of high quality, low risk stocks and tried to buy them on a "dip?" And if they did dip, you weren't afraid to buy, because you knew you were buying a high quality company that would be around for a long time. Solid balance sheet, strong demand for it's products, et, et, made you comfortable that even if your timing was not perfect, the stock would likely not fall too far. You were willing to buy and hold and felt real good doing it. Right?

That's how you could feel about the sugar market at it's current price levels. For as we plod through the month of May 2012, sugar finds itself the benefactor of two high quality price predictors that equate to the gold standard of commodity analysis: A favorable "big picture" fundamental outlook and a cyclical catalyst to help encourage a price move sooner rather than later.

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FEATURE MARKET | SUGAR

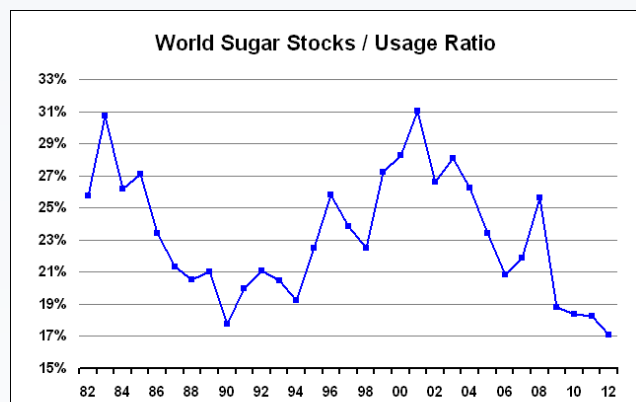
Big Picture Fundamentals Should Help Market Pay off for Put Sellers

continued

Supplies Hit Record Lows

By “big picture” fundamentals, we are typically referring to those 2 or 3 main figures that define a commodities supply/demand balance for the year. More often than not, these are Global Ending Stocks and even more specific, Global Stocks to Usage ratios. Ending stocks measure the amount of supply left over at the end of the crop year. Stocks to Usage ratio measures the Ending stocks as compared to the upcoming year's expected demand.

All of the news you may read if you do any sugar “research”, such as Indian demand or Chinese production or supply/demand surpluses or deficits, they all get thrown into a big pot and reduced to these two figures.



Sugar's 2012 Global Stocks to Usage ratio will hit the lowest level on record- leaving little room for shortfalls in 2012 production.

In 2012, global sugar stocks to usage ratio will hit **17%, the lowest levels on record**. This means that at the end of this crop year, leftover supplies will be able to meet 17% of next year's projected demand. While the reasons for this are complex, the short story is that emerging market demand from places like China, India, and even domestic demand from top producer Brazil are outpacing production as a longer term trend.

“Sugar finds itself the benefactor of two high quality price predictors that equate to the gold standard of commodity analysis”

While this figure is not necessarily useful in determining the short term direction of sugar, it sets the stage and provides a backdrop for everything else that happens in the market. In short, prices might not always be moving higher. But the market's “color” emits a bullish hue.



The 2012 Sugar Cane Harvest is well underway in Brazil.

This is **extremely** important to you as an Option Seller. Because you're not trying to guess market direction - only where prices are least likely to go.

Brazil, “Harvest Lows” and Higher Prices

The second ingredient to this trade is a seasonal catalyst. Big picture fundamentals are important. But knowing when potential causes of price moves will occur can be crucial in determining strike price and time selection of your options.

The chart below is a 15 year seasonal chart for sugar prices. Note that seasonal price chart reflect an average price pattern for 15 years. There is no guarantee prices will move like this in any given year. Past performance is not indicative of future results.



In the past, sugar prices have tended to establish lows in the heart of the Brazilian harvest, and then begin to strengthen into the second half of the year. (Past performance not indicative of future results)

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MAY FEATURE MARKET

by James Cordier, Michael Gross, OptionSellers.com

FEATURE MARKET | SUGAR

Big Picture Fundamentals Should Help Market Pay off for Put Sellers

continued

What a seasonal chart does is reflect a certain set of fundamentals that tend to occur about the same time each year. In this case, the price pattern reflects the beginning of the Brazilian sugar cane harvest.

Brazil is certainly not the only sugar producer in the world. But it accounts for roughly **25% of global production and nearly 50% of global sugar exports**. Therefore, harvest cycles in Brazilian sugar are a big deal for prices.

90% of this sugar is produced Brazil's center-south region. Harvest in this region begins in April and doesn't finish until November. However, May and June mark the meat of the harvest and the time when supplies are flowing most freely and rapidly to market. Thus, as is commodities rule #1, when supplies are highest, prices are often lowest. That is why sugar prices tend to establish lows in June.

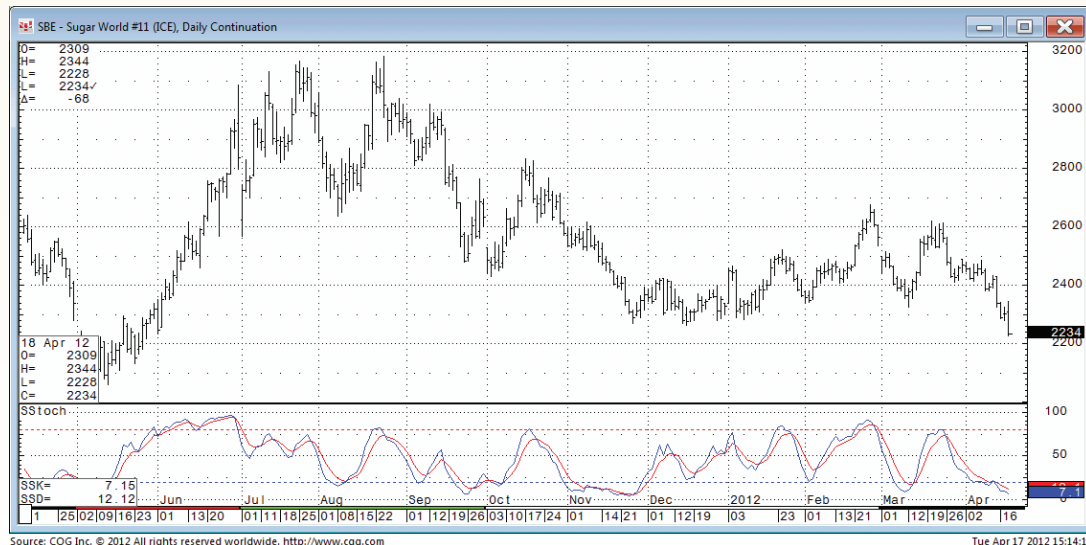
After that period when the 2012 crop is effectively "priced" and harvest pace begins to slow, the market turns attention to the northern hemisphere beet crops. As the Brazilian supply train begins to fade and uncertainty over the northern beet crop builds, prices have often responded in the positive as is evidenced by the chart.

We have every reason to believe that this pattern will repeat in 2012. Given the low ending stocks projected this year, the market will be particularly sensitive to northern hemisphere crop anxiety.

Conclusion and Strategy

With Brazilian harvest in full swing, we feel sugar prices will be at or near a low over the next several weeks. Reporters will love to tout the slight sugar "surplus" the market could enjoy in 2012. What they won't tell you is that annual production surplus's or deficits are highly irrelevant in regard to overall prices. It's what's left in the barn at the end of the year that counts. Ending stocks to usage ratios will be at the lowest level in recorded history this year. That should mean limited downside in sugar over the second half of 2012.

October 2012 Sugar



As the bulk of Brazilian harvest moves through the pipeline, the market will soon begin to turn it's attention the northern beet crop harvested in the fall. This could very well be a catalyst for higher prices.

As an option seller, you don't necessarily need higher prices to be successful. But the number of factors in sugars favor for Q3 and Q4 2012 should keep prices at least well supported.

As a put seller, that is your recipe for success.

Look to **sell Sugar puts** at strikes **below the 20 cent level** on any additional weakness this month. Margins are typically low on sugar options which can mean a higher ROI on successful trades.

Note: If you have an interest in investing using seasonality, we'll be positioning clients in a number of new option trades that take seasonal factors into account this month. Feel free to see the back of the newsletter for new account info. Also be sure to check the blog for more updates on seasonality in individual markets.

Spotlight on a Liberty Trading Group Client/Investor



Dr. Niall O'Dwyer

British Columbia, Canada
Medical Director

Why I got started Selling Commodities Options:

I'm primarily a real estate based investor having been unimpressed with mutual funds for years. That said I've kept an open mind about unconventional investing strategies so when a friend of mine was making high returns trading options on commodity futures I wanted to learn more. At his recommendation I read The Complete Guide to Option Selling by James Cordier and Michael Gross. I feel didn't confident enough to start trading options myself so I enlisted the services of Liberty Trading to manage my margin account. This started in the fall of 2011 and it's been an interesting and lucrative process so far.

My outlook on the overall markets:

I believe that history will repeat itself and over the long term stock markets will continue to rise at a pace that outstrips inflation; this will happen with volatility that many people find difficult to bear. Commodity markets will continue to fluctuate but in many instances this will happen with a seasonal predictability that creates profitable opportunities for commodity option sellers. A good thing about selling commodity options is that you don't have to know where the market is going.

Using fundamental analysis, seasonal tendencies and an understanding of current events you make an educated prediction of where the markets won't go. Then you place your trades and monitor your positions knowing that 80% of the time your options will expire worthless. I like these odds better than trying to pick the next hot mutual fund that is trying to outperform its own MER.

My outlook on the general economy:

Canada has weathered the worldwide economic wows better than many countries have. It is a country rich in natural resources and I think the world will continue to want what Canada has to offer. This coupled with a federal government that seems intent on a balanced budget makes me hopeful that Canadian economy will see modest growth over the long run.

Advice to New Commodity Option Sellers:

I would advise any new commodity option seller to read The Complete Guide to Option Selling by James Cordier and Michael Gross. Be sure to have a well capitalized account with money that you can afford to put at risk, but be optimistic as this is one of the few investment strategies where the odds are in your favor.

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You've Got Questions - We've got Answers

Q: I've seen in past newsletters where you suggest certain options to sell. However, when I go to review the option, there doesn't appear to be enough liquidity. Do you recommend selling options in markets with low liquidity?

-Hank Summers, Erie, PA

A: Dear Hank,

We do not recommend selling options in illiquid markets. That being said, liquidity can be a subjective term. If an option has a few hundred open contracts, a big trader might think twice about putting an order up to sell 1,000. He might still get filled, but he would likely have to pay up if he wanted out. If you went into the same option and sold 5 contracts, you would likely have no trouble at all. Liquidity is in the eye of the beholder.

But let's get to the bigger point. Our newsletter is meant to suggest a certain category of options you might do well with. Researching the individual strikes, margins and months is up to you (unless, of course, you are a client). My recommendation is to use the information you read here to identify the market and the strategy, then do your own analysis on the individual strikes. Don't like the open interest in one? Then look at other strikes (whole numbers will tend to have higher open interest over fractional strikes). You can also look at other contract months. Some have higher Open Interest than others. We only cover markets here with adequate liquidity so you should have no problem finding an option or group of options with good liquidity.

Q: I have sold options on the S&P for years and just recently started following commodities after reading your book. One question: It seems like commodities can be more volatile than stock indexes. Do you find that to be the case?

-Tim Cole, Watsonville, CA

A: Dear Tim,

I am so glad you asked that question! The answer is no. In a study performed a few years back, stocks were shown to actually be more volatile than commodities as a whole. While I'm sure there are individual markets that will be more volatile than the indexes at times, it is the leverage that gives commodities the false reputation of being more volatile. However, if you are trading the S&P futures, you are trading the same leveraged vehicle. A futures contract is a futures contract.

Incidentally, if you are selling options on the S&P futures, you already have more leverage than if you were trading commodities. I am scared to death to trade the S&P. It's a huge contract, the margins are gigantic and the public opinion driven price swings don't make sense to me. I would much rather trade a market who's price moves at least have some kind of rationality to them. However, I realize there are many traders out there who make their livings selling S&P premium. I still think it's a riskier way to fill your option selling cup. But, to each his own.

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

BACK TO BASICS

Getting your Option Exercised (Or Not)

I am often asked by stock option sellers who are novices at commodities "What happens when we get assigned?"

The answer is, you don't get assigned.

The investor who sells a stock option may have different objectives than one who sells a futures option.

To sellers of stock options, getting "assigned" (also known as getting "put to" or having your option exercised) is often a part of the game. Sometimes, getting assigned can even be an objective. Getting assigned or exercised simply means that somebody on the other side of the market that bought the option has decided to exercise his right to convert it into shares of stock (or in our case, a futures contract).

Stock option sellers typically practice one or both of two basic strategies. Selling a "covered" call on a stock they already own, or selling "cash backed" puts on stocks they hope to own at a lower price. These are both solid strategies. But if you want to diversify into commodities, your objectives are going to be different.

In commodities options, unless you want to be a futures trader, which we would not recommend, you have no interest in owning the underlying futures contract. You are simply selling calls above the market and/or selling puts beneath the market. You are doing this for one reason: You do not think that prices are going to these levels and you are purely interested in getting the premiums. Period.

Since you have no interest in owning the futures contracts, you will only want to **sell deep out of**

the money strikes - strikes that will most likely never be reached, even in an adverse market event.

Fortunately, unlike in stocks, strikes are available at these levels in commodities. Some of them offer large premiums. These are the strikes you will be selling in your account.

Investors who pose the "assigned" question to me often do so with a tone of anxiety in their voice. But there is little reason to fear being exercised in these types of



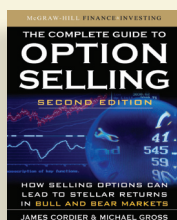
Stock option sellers are often accustomed to having options exercised. As a commodity option seller, this isn't part of the strategy.

"While these tactics sound simple and self evident, you'd be surprised as to how many new option sellers don't practice them."

options. First of all, in almost every case, your option would only be exercised if you allow it to go in the money. It makes little sense for an option buyer to exercise otherwise. Secondly, and more importantly, you can close out your option (buy it back) at any time. Thus, if you don't want it to go in the money, buy it back before it goes in the money.

While these tactics sound simple and self evident, you'd be surprised as to how many new option sellers don't practice them. In my experience, keeping it simple has always been the best policy. In regard to commodities, that means not bothering with the futures contracts. Stick to the options and close them out long before they come anywhere near to getting exercised. If you practice the rule of only selling deep out of the money, this is fairly easy to do.

Have a great month of premium collection.
- James



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ANNOUNCEMENTS

The options expiring this month are options you could have written 90 days ago.

Will you be saying the same thing 90 days from now?

The Options decaying this month are options that could be decaying for **you**. If you are ready to start applying fundamental information like you read in this newsletter to its most efficient use, **Professionally Directed Option Selling Accounts** with Liberty Trading Group are available this month on a **limited basis**.

Call us below for questions and availability

New Accounts US **800-346-1949**

International **813-472-5760**

Recommended Initial Investment: \$1M

Minimum Initial Investment: \$250,000

Past performance is not necessarily indicative of future results. Futures and options trading involves risk of loss. Only risk capital should be used.

LIBERTY TRADING GROUP

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

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