# P3 System

## Option Trading Basics and Putting Profit Probability Potential On Your Side

Many traders focus on trading stocks, indexes and ETFs on the stock market, using a cut and dry, buy and sell approach. While you could spend a lifetime learning about and perfecting these straight forward trading strategies on these assets, other traders are expanding their horizons. There is a unique trading opportunity for investors willing to put in the time to learn about a different trading vehicle and about a truly new and unique trading strategy…the P3 System.

Aspects of this opportunity offer huge gains…but the trading strategies can be a bit more complex when they are used to control risk. Therefore, sometime ago, I discovered, used and have since fine-tuned the P3 System, so that it controls risk, but is also easy to learn and to implement. Not only does the Strategy offer huge gains, but it also increases the probability of finding guaranteed winning trades. The best part is, just about anyone can use this proven system to score incredible gains on a majority of their trades.

Often I've been told that losses are part of the trading equation. That I only have to have a few large winning trades out of my total number of positions to make serious money. Well, I turned the tables and put Profit Probability Potential on my side, so I win BIG on most of my trades and lose only a little on very few trades.

I'm talking about trading options.

Options have never been for the faint-hearted.

Until now, because…

The P3 System not only increases the potential for profit, conversely, it deceases the chances of loss.

If a stock trades above the agreed upon sale price (strike price) of the underlying asset before the expiration date of the option, your "call" option becomes very valuable… and if it doesn't…well, the option could become worthless.

So why take the risk?

For the HUGE potential rewards…options can skyrocket in value… returning 300%, 400% or even more within a few short weeks.

Now obviously, when utilizing normal trading strategies, every trade doesn't work out like that… but what if you learn to have the probability potential on your side? Imagine turning a majority of your trades into BIG winners.

Once you understand how the P3 System works, it will become a very powerful weapon in your trading asenal.

## You Can Win in the Market, If You Put the Odds in Your Favor

Making money in the market can be extremely difficult. As you learn options and develop your trading plan, you will discover that you are putting the odds of winning in your favor. Investment gurus will tell you that you have to be invested in the stock market to truly strike it rich, but that doesn't protect you from declining markets. Options provide the trading vehicles for both uptrends and downtrends, but that volatility, the swings back and forth as the market settles on its direction, can quickly wipe out a trading account unless you consistently follow your plan.

Successful trading boils down to just one simple rule: Buy low and sell high. It doesn't matter whether you're trading stocks, mutual funds, real estate, collectables or options. It's just that simple. Therefore, as I unfold the P3 System, one of our major objectives will be to determine when a stock is low, finding those stocks that are on the sale rack in the stock market's bargain basement out of the thousands of stocks on sale.

Even though the Low/High concept is simple, the implementation has confounded novice investors, brokers and professional traders since the beginning of organized markets. That's because no one has been able to accurately figure out how high is high, and how low is low?

Sure you can either hear about or look at a chart of a stock that has fallen on hard times, perhaps they've reported poor earnings, or the FDA has turned down a patent request for a new drug, but is their stock at a low or is it just beginning a downward spiral? If finding highs and lows is such a dilemma that only 20-30% of professional money managers actually earn their management fees, then how can anyone expect to master any aspect of trading options from this simple book?

The key is that you're going to put Profit Probability Potential on your side. No longer will you simply buy and sell an option based on what you think is going to happen. Rather, you're going to learn to make an incredible prediction of future stock movement based on a picture found on a stock chart that will be as clear as an arrow pointing its intention to earn you profits.

This book will introduce you to a way to make money using the P3 System as it draws a picture to show you what will happen to the stock's price. You'll learn what indicators ( your paints) are needed to create this picture, how to recognize and interpret its visual message. You'll learn how this one simple strategy puts the odds in your favor every time you trade.

You'll also learn how to invest just a little to earn a tremendous amount of money if you are right, but lose just a little if the stock doesn't go up enough. (You'll note I didn't say you had made a mistake in the direction of the stock's movement, I said if it didn't go up enough to earn a big profit.) To be right all the time, you need a totally different set of rules that puts probability on the side of your investment.

The goal of this book is to introduce you to those tools, and show you how you can use them to make money far more consistently than you ever thought possible.

## The First Step in Putting Probability Potential on Your Side

As we noted earlier, trading options has its ups and downs. For most traders, the wild swings of market volatility can be just too much, mentally and financially. But there are some very attractive elements inherent in options that make learning the P3 System worth the effort.

First, the leverage that I mentioned earlier is enormous. The return you can make on your investment is huge whether you are a buyer or a seller. In the P3 System, we are going to concentrate on buying options, not selling them.

A second attractive aspect is buyers of options have limited risk and the amount of that risk is known right from the get-go.

The sellers of options automatically put the probability of profit in their favor when they implement a position, so by utililizing the P3 System, you are going to turn the tables and put the probability of winning profit on your side.

My goal in this book is to show you the "hows" and "whys" of option trading, and then I will focus on the P3 System itself. As you learn and utilize the principles of this strategy in trading options, you will be in a position to capitalize on the Probability Potential.

Okay, let's start zeroing in on putting the trade potential on your side. During a recent six year period, the DOW and other indices have gone up or down more than 5% in a month (measuring from one expiration to the next expiration month) only 11 times or 15%. That is 11 times in 72 months. This percentage is even in the shadow of the volatility surrounding the severe market corrections of 2008-2009.

In other words, if the S&P 500 was up at 1,100 at the beginning of the month,  in order to incorporate a 5% move, it would have to be above 1155 or below 1045. Of the 72 months during this 6-year time period, such a move above or below that 5% range only happened 11 times! Or as mentioned, 15% of the time. That means the S & P 500 stayed within a 5% range 85% of the time.

This final figure is critical. It means that since the S&P 500 and other indices consist of a composite of stocks whose average price movement makes up that 5% move, it can be nearly impossible to locate a stock that will guarantee a profitable trade. An average of all the stocks within those indices, those that move more than 5% and those that move less than 5%, create the monthly total that is (as stated) most often less than 5%. And from that mix of stocks, we must somehow find the stocks that will move more than 5%, or we can expect that our option candidates are going to move within that 5% range 85% of the time. In most cases, a 5% gain a month, minus the costs involved in a trade, is not going to give you the winning results that you want to achieve. If only 15% of the trades give you the percentages you need to win big, you will either lose your portfolio quickly or you need to discover a way to increase the winning percentages. In comes the P3 System.

By using a strategy that helps you to locate option candidates that have the potential to move more than 5% before their expiration dates, changes the rules of the game.

To implement the P3 System that profits from the stock's magnitude rather than and indices' movement, you first need to undertsand how options work, and second, to find a tool that will locate and pinpoint stocks that are apt to experience large moves. This then, boils down to the purpose of this book, to: understand options, learn how to locate stocks ready to move, and come up with a solid plan to trade them so your accumulated profits bring you financial independence.

That's where we begin our next chapter.

## Understanding Options

In this chapter, I will briefly skim over the definition of an option and how it functions within the overall market. My plan in this book is to build on the aspects of option trading, like applying layers of paint, until I have covered the basic concepts and details needed to trade the P3 System. I will mention aspects several times adding another layer of information each time. You don't have to be an expert in financial fields to trade options, but it helps to demystify the terms used, so let's start with the option itself.

What is an option? In its simpliest definition an option is a choice. In the financial world, options give the owner of the option the right to buy or the right to sell the underlying asset at a pre-determined price, during a pre-set time period. As the owner of the option, you have the choice of actually buying, or selling, or doing nothing! You pay someone for these rights or choices.

Each option contract is based upon the price movement of 100 shares of the underlying asset. If you own 2 contracts, you then control 200 shares of the underlying asset.

Since an option contract is not something that you will be able to physically hold in your hand to look at and study, allow me to explain how they work by telling you a story that will help you understanding their value.

As I have mentioned, there are two types of options: calls and puts. This first story example will relate to a call option.

Let's say you have a friend who wants to sell her house for $200,000. You know the neighborhood and like the fact that it is well-established and can be reached from two major highways, which makes the area desireable, but you don't have $200,000 to purchase the house as an investment, so you offer another proposal. “If you’ll give me a piece of paper saying I can purchase your house for $200,000 anytime over the next twelve months,” you say to your firend, “I will give you an extra $10,000.” Your friend agrees to your proposal, because it’s not important that she sells today. In essence, you have bought a call option based on your expectation that the property will appreciate in value.

Six months later, a shopping center is under construction a half-mile away, making the properties in the area in hot demand. Now the house has gone up in price to $230,000. You hold up your paper – the option- and wave it in front of interested buyers. “I’ll sell you this paper for $$20,000. It states that you can purchase this $230,000 house for only $200,000.”

A young couple takes you up on your offer, and the trade is made. Here’s what happened.

- Your friend receives the $200,000 she wanted for her house, in addition to the $10,000 you paid for the option to purchase her property for a total of $210,000.
- The young couple purchases the house valued at $230,000 for $200,000 plus the $20,000 they paid you for the paper option. They pay a total of $220,000, a savings to them of $10,000.
- And, you received $20,000 for the option (paper) you purchased for $10,000 six months ago, so you made a $10,000 profit (100%) on your $10,000 investment.

One major difference from our story and how a real call option works, is, if after a period of time, you decide you are no longer interested in buying the property, you can sell the option for the time value that is left. If our story had a different ending and the property had not appreciated in value and, if you had sold the option back to your friend (the issuer), it would still have half it’s time value (6 months). Your friend will be in a position to sell that option to purchase his house within the next six months to another option buyer. Therefore, rather than lose your total investment, you will receive a portion of your investment back when you sell the option to close your position.

This story illustrates in a concrete manner the crux of trading options. In our story, you see the house, the owner, and the buyer. They are tangible to you. In the world of stocks, it’s all like pieces of paper so to speak, and truthfully even more vague because most traders handle their trades over the internet, you never actually hold that piece of paper. However, the principle is the same. *You control enough of a great stock, index or ETF to make a great deal of money with essentially only a down payment.*

Most of us can’t go out and simply plunk down $200,000 to invest in an *underlying instrument* or *asset,* like a second house or a block of stocks. But we can benefit from the leverage of controlling the *underlying* with a fraction of the house or stock cost by using options.

Earlier I mentioned there were two types of options – calls and puts. We have looked at an example of call options to be used when you expect the underlying to go up in value, so let’s take a moment to tell a story about puts, even though they will not be utilized in our P3 trading plan. Puts are purchased when you expect the underlying to go down in value.

Traders sometimes have trouble making sense of puts because they go contrary to what we have been taught. Who in their right mind will pay for something they expect to go down in value. Puts are considered a short position because it benefits from a decline in the security's price.

In this story, let's say you and your neighbor, Fred, are in your front yard discussing the new golf store opening in the shopping center about a half mile away. You both agree that the new store will be convenient, will attract other quality stores and will add value to your already appreciating properties. While you're talking, a real estate agent walks up to you. He explains that he's selling pieces of paper that guarantee that if you decide to sell your home anytime over the next year, he will pay you $200,000 for the house, no more, no less, but the $200,000 is guaranteed. This guarantee will cost $5,000.

Bob isn't impressed. "Why the heck would I consider paying $5,000 to let you buy my property for $200,000? It's worth that now and it's been appreciating 10% every year for several years. With the new golf store coming in, who knows? By the time that contract runs out, my house will be worth $230,000 or more."

On the other hand, you take a minute to mull over the agent's offer, which he has explained is a transferable contract, meaning that it can be sold to someone else under the same terms. As it happens, you've been thinking about moving closer to your work, but haven't found a new house yet. You know your house might go up in value before you actually want to sell, but the guarantee feels like insurance. You tell the agent to get the paperwork ready while you get your checkbook. So, you pay the real estate agent $5,000 for the paper guarantee (put option).

Two months later, you find the perfect house across town, and quickly find a buyer willing to pay $202,000 for your old house. Of course, you now feel a little foolish for purchasing the contract to sell at the lower fixed price. Nevertheless, you hang on to the contract.

Six months later, still four months before the contract is due to expire, an article in your local newspaper reports that many years ago, toxic waste material was buried beneath the ground in your old neighborhood. This news has an immediate effect on the housing market in your town. Within days, you learn that the house you recently sold is now worth only $75,000. At that point, you remember the paper that you hold, guaranteeing a price of $200,000.

You entertain the thought of going to your neighbor Fred, but he heckled you so badly when you purchased the contract in the first place that you go to the young family who purchased your home. "I'm sorry this happened," you say, "but there was no way of knowing about this toxic waste. But, I have this paper and I'm willing to sell it to you for $10,000. The paper says that a particular real estate agent is obligated to purchase the house for $200,000."

No doubt, the young family is ecstatic. They will be out from under the poor investment at a loss of only $12,000 – the extra $2,000 they paid you for the house, plus the $10,000 for the paper guarantee.

You're happy to have sold the house and the paper. In the eight months since you purchased that contract, you doubled the $5,000 you paid for it, so you have 100% profit.

In our story, I point out that no one could have anticipated the toxic waste catastrophe, but that would not be entirely true with a put purchase. You purchase puts with the same care and consideration that you put into our call option choices. You are drawn to a security by its chart (I will go over examples) and then you do our homework. You know its earnings history, it next earnings date, what sector it trades in and whether or not that sector is gaining or losing strength.

In order to tell my story, I made it sound as if you are actively involved in finding a buyer for your contract (option), and that is not the case with trading option contracts. Selling option contracts, if there is open interest, is part of the option contract itself. It happens within seconds if the price is agreed upon. You set the price at the time that you push the button to sell to close the position. All this will be explained in more detail as we proceed, I just want to clear the impression that you might need to become a salesperson searching for a customer to sell your option to. This is not the case.

As I stated earlier, you will not be utilizing put options in the P3 strategy, but I want you to have a clear idea of the difference between the two types of contracts. Understanding the difference is part of your basic option education.