With trading tools at tradingoptionslikethepros.com

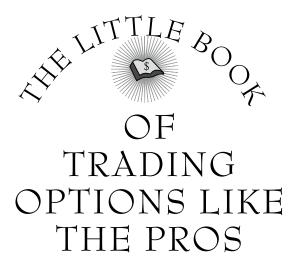
THELITTLE

# TRADING OPTIONS LIKE THE PROS

Learn How to Become the House

DAVID BERNS MICHAEL GREEN

BOOKOr



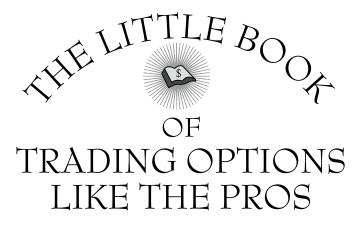
### Little Book Big Profits Series



In the Little Book series, the brightest icons in the financial world write on topics that range from tried-and-true investment strategies to tomorrow's new trends. Each book offers a unique perspective on investing, allowing the reader to pick and choose from the very best in investment advice today.

Books in the Little Book series include:

The Little Book of Investing Like the Pros by Pearl and Rosenbaum The Little Book That Still Beats the Market by Joel Greenblatt The Little Book That Saves Your Assets by David M. Darst The Little Book That Builds Wealth by Pat Dorsey The Little Book That Makes You Rich by Louis Navellier The Little Book of Common Sense Investing by John C. Bogle The Little Book of Value Investing by Christopher Browne The Little Book of Big Dividends by Charles B. Carlson The Little Book of Main Street Money by Jonathan Clements The Little Book of Trading by Michael W. Covel The Little Book of Valuation by Aswath Damodaran The Little Book of Economics by Greg Ip The Little Book of Sideways Markets by Vitaliy N. Katsenelson The Little Book of Big Profits from Small Stocks by Hilary Kramer The Little Book of Currency Trading by Kathy Lien The Little Book of Bull's Eye Investing by John Mauldin The Little Book of Emerging Markets by Mark Mobius The Little Book of Behavioral Investing by James Montier The Little Book of Hedge Funds by Anthony Scaramucci The Little Book of Bull Moves by Peter D. Schiff The Little Book of Alternative Investments by Stein and DeMuth The Little Book of Bulletproof Investing by Ben Stein and Phil DeMuth The Little Book of Commodity Investing by John R. Stephenson The Little Book of the Shrinking Dollar by Addison Wiggin The Little Book of Stock Market Profits by Mitch Zacks The Little Book of Safe Money by Jason Zweig The Little Book of Zen Money by The Seven Dollar Millionaire The Little Book of Picking Top Stocks by Martin S. Fridson The Little Book of Robo Investing by Elizabeth MacBride and Quian Liu



### Learn How to Become the House

DAVID BERNS

MICHAEL GREEN

WILEY

Copyright © 2024 by David Berns and Michael Green. All rights reserved.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey. Published simultaneously in Canada.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 750-4470, or on the web at www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at http://www.wiley.com/go/ permission.

Trademarks: Wiley and the Wiley logo are trademarks or registered trademarks of John Wiley & Sons, Inc. and/or its affiliates in the United States and other countries and may not be used without written permission. All other trademarks are the property of their respective owners. John Wiley & Sons, Inc. is not associated with any product or vendor mentioned in this book.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Further, readers should be aware that websites listed in this work may have changed or disappeared between when this work was written and when it is read. Neither the publisher nor authors shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information on our other products and services or for technical support, please contact our Customer Care Department within the United States at (800) 762-2974, outside the United States at (317) 572-3993 or fax (317) 572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic formats. For more information about Wiley products, visit our web site at www.wiley.com.

#### Library of Congress Cataloging-in-Publication Data:

ISBN 9781394238958 (Cloth) ISBN 9781394238965 (ePub) ISBN 9781394238972 (ePDF)

Cover Design: Paul McCarthy

#### For my Carolee & Henry, who bring magic to us all. —DB

To Jennifer, Ryan, Ella & Gavin. The journey has been the reward. —MG

# Contents

Preface	xi
Acknowledgments	xvi
Chapter One	
Trading Options: Allure vs. Reality	1
The Retail Option Explosion	2
The Natural Biases of New Traders	7
The Amateur Trap	10
An Intuitive Conclusion	12
Chapter Two	
The Barebones Option Primer	15
Option Basics	17
Options in Time	20
Breaking Down the Option Premium	23
Combining Options	31
Real-World Examples	35

[viii] Contents

Chapter Three	
Become the House	39
The Broader Option Ecosystem	40
Our Core Trade	45
Strike Selection	47
Expiry Selection	51
Equity ETF Puts for the Win	55
Chapter Four	
Risk Management	57
Moving Beyond "Sell and Hold"	59
Stop Losses	60
Profit Taking	64
Rolling Positions	67
Chapter Five	
Building a Portfolio	73
Motivation	75
Expanding Our Universe	77
A "Commonsense" Portfolio	84
Optimized Portfolios	89
Setting Risk Exposures	96

Chapter Six	
From Theory to Practice	101
Option Screener	103
Trading	108
The First Six Months	119
Beware Assignment	122
Behavioral Biases of Sellers	123
Parting Words	125

Bibliography	127
Bibliography	12

## Preface

RETAIL OPTIONS TRADING HAS exploded in popularity over the past few years. But options are complex, and trading options can quickly become a black hole of losses. The goal of this book is to show new options traders how to quickly pivot from naïve strategies with a high probability of loss to a winning strategy deployed by professional options traders. After a quick review of the option ecosystem and the basics of options, we spend most of the book presenting a proven options trading strategy. This strategy is a breadand-butter trade from the institutional world of hedge funds and market makers, and we show you how to execute it at home. We have also decided to support readers of this book beyond just the words found here, by making the option screener reviewed in this book available for free at www .tradingoptionslikethepros.com. This book is intended for nonfinance professionals. We have avoided the use of advanced mathematics to keep this accessible for all. We have thrown in a few "Adult Swim" sections for those who want to go a bit deeper on topics, but these are not required reading, so feel free to skip these if you want to keep things light.

Let's now quickly review what will be covered in each chapter.

Chapter 1. Trading Options: Allure vs. Reality. We review the recent rise of retail options trading, which has boomed on the heels of easy access to trading and an expansive social media ecosystem for amateur traders. We then illustrate how the combined human biases of loss aversion and overestimation of low-probability events leads novice traders into buying cheap options. We then show that most cheap options expire worthless, leaving amateur traders destined to perform poorly. This discussion lays the groundwork for the winning option strategy we will cover in this book: selling cheap options for small yet consistent wins.

**Chapter 2. The Barebones Option Primer.** We begin with a review of the defining characteristics of an option: calls versus puts, the underlying asset, strike, and expiry. We review the basic payoff structure of an option as a function of the underlying price at contract expiry. We bring time into the equation, showing how the value of an option contract evolves into expiry, which then forces us to break