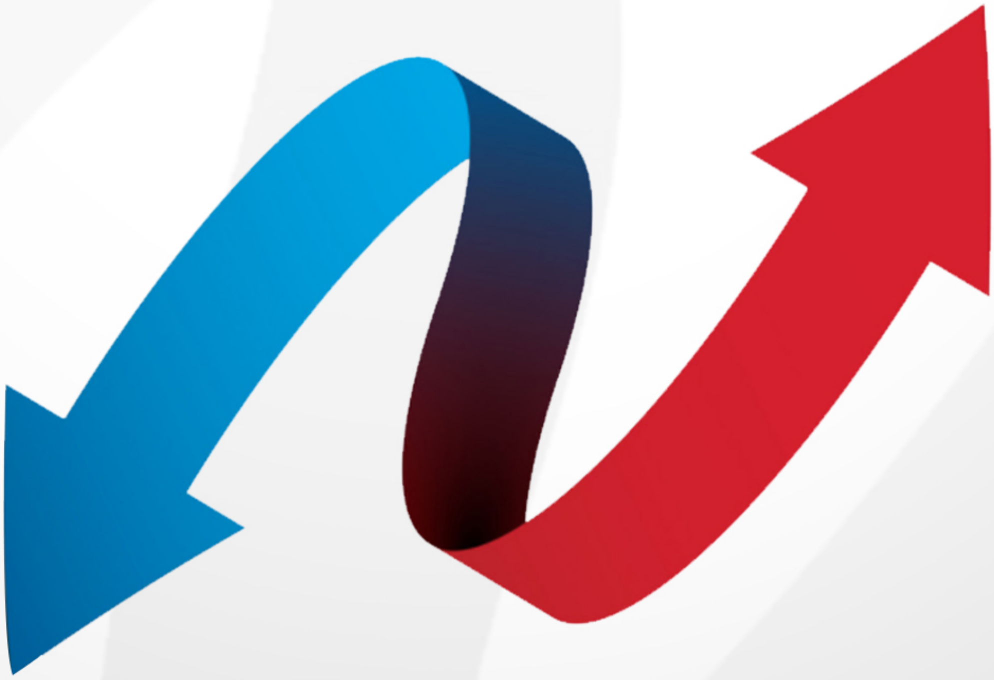
# THE RISK REVERSAL

# The Ultimate Options Strategy



Chris Douthit

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# Letter from Chris

Every investor's goal is to invest their money to make even more money. Ideally, we accomplish this while managing an acceptable level of risk. Most investors opt for the strategy of buying and selling stock.
The objective is to buy the stock low, then after it appreciates, sell the stock at a later date for a profit. For those who do their research, the majority of the time they will generate modest returns.

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However, markets OFTEN do not behave as expected. Even if every fundamental and technical factor indicates a stock should appreciate, a stock may trade lower due to other market variables. For this reason, it is paramount that the stock investor is right on nearly every trade. Keep in mind, if you're buying the stock, someone else is selling that stock. If they happen to be on the right side of the trade, and you are on wrong side of the trade, you lose money.

Everyone who has traded stocks knows that timing the market is extremely challenging, even for the top investors and trader. Since timing is so difficult, I often elect for an alternative option strategy instead of buying the stock long. This provides us with a significant advantage right out of the gate that is worthy of discussion.

# Moving to the Next Level

Upon asset research and selection, there are a myriad of securities from which an investor may invest. Some of the most common used are stocks, bonds, exchange-traded funds (ETFs), mutual funds, commodities, and options, to name a few.

It's not uncommon for investors to start with ETFs or mutual funds. Once they see a little success, they graduate to selecting individual companies through buying and selling stocks in an attempt to capture more significant returns.

ETFs and mutual funds have the advantage of diversification. If one of the fund's investments takes a nosedive, it modestly pulls the fund down, as a single stock only makes up a fraction of the total portfolio. This way, if a single company or industry sector starts to struggle, or has an unforeseen event, the loss is relatively easily absorbed by the other investments within the fund's portfolio.

On the other end of the spectrum, the same thing happens if one of the fund's stocks has a significant move higher. The fund will see a slight tick higher when any holdings have a significant move to the upside. With so much diversification (the good, the fair and the poor investments), gains are often slow and steady.

This is why investors who are more serious about their finances eventually leave funds behind in favor of a more proactive stock-picking approach. Those who are willing to dedicate the extra time into their research (in an effort to determine which companies are best suited for significant upside potential), can capitalize by holding the top performing companies while leaving the lagging companies behind.

Most investors who are pleased with their returns stop there. They managing individual names within their portfolio, and may trade in and around those positions to generate additional Alpha. Investors who have had consistent success selecting individual stocks, could easily enhance their returns, increase their purchasing power and mitigate considerable risk by employing a key options strategy that is ideal for the stock trader sizing up a longer-term investment.

# Are Options Too Risky?

For those who are new to options, or perhaps have never traded options at all, you have most likely been informed that options are risky investments ill-advised for the less experienced trader or investor. There is truth to that statement. If a trader implements an inappropriate strategy for his/her objective, or they use options irresponsibly, the problem that can arise may be extremely painful. For those who use options properly, the benefits will far outweigh the risks throughout the life of the trade. This is why the world's top money managers use options for hedging positions as well as for speculative investing. If options were too risky, investment professionals would avoid options and option strategies. This is hardly the case.

Warren Buffett, Jamie Dimon, George Soros, and nearly every other world-renowned investor use options as an investing tool to increase their rate of return.

Perhaps you're thinking these people are the best in the business, that they have been working in finance their whole lives, and naturally, they are going to use options in their investment arsenal. Yes, they do, and you can too! Although Warren, Jamie, and George are trading vast amounts of options contracts, you can do the same thing on a smaller scale to obtain a similar return rate. A rate that ideally will consistently generate above average returns.

Scaling large portfolios is one of the biggest issues large money managers face. When they want to buy or sell large or illiquid positions, they will leg into the position over several days, weeks, or even months, so that they can acquire the desired exposure without impacting the market price in a major way. For investors managing a smaller portfolio, we need not be so concerned about negatively impacting the price of a security while we build a position.

The fact remains, when options are appropriately used, they are actually one of the smartest and safest ways an investor can give their portfolio a boost.

Of course, there is an endless amount of option strategies, and knowing which option strategy should be applied in each case may be one of the greatest challenges new traders face. In this book we will discuss only one options strategy, the perfect time to use it, and why it is perfect for the stock trader!

# Understanding Options

Now, I know you're probably eager to get into it, but I want to make sure everybody understands the basics of options before we proceed. For those who are already familiar with the basic concepts of call options and put options, free to skip to the next section, which is for the benefit of those who are either new to options, or want a quick refresher on the subject.

So, what are options?

Options are investment contracts that give the buyer the right, but not the obligation, to buy or sell a particular stock. In essence, investors purchase options contracts to buy (or sell) stock at a specific price at a predefined future date.

There are two types of options: call options and put options. Call options are purchased when an investor wants to buy stock in the future. In contrast, put options are purchased to sell the stock in the future.

Of course, whenever there is a buyer, there must also be a seller. The seller of both call options and put options are obligated to take the other side of the trade in exchange for receiving a cash premium. An important note here: one contract, under normal circumstances, settles into 100 shares of stock for both calls and puts.

Let's work through an example…

Suppose you want to purchase 500 shares of stock ABC for $25 a share. However, you are worried about upcoming news that may either positively or negatively affect the stock. So instead of buying the stock itself, you purchase 5 ABC call options contracts (each contract represents 100 shares), giving you the right to buy the stock at $25 per share within the next two months. Because each contract costs $3, and you are buying 5 contracts, each controlling 100 shares, this will cost you $1500 ($3 x 5 x 100).

Now you have the right, but not the obligation, to buy the stock for $25 for the next two months.

At this point, you might be thinking, why would you pay $1500 for the right to buy a stock at $25 when you can go out in the open market and buy it for $25 right now?

Let me explain…

First, there is the obvious advantage - in buying the options, you are only required to outlay $1500. If you were to purchase the stock outright, this would cost you $12,500 ($25 x 500). This is clearly a much larger commitment of capital for the investment in 500 shares of ABC.

Furthermore, let's say ABC is expecting a decision from the FDA about their new drug, you know it's either going to be good news or bad news, but you don't know which.

Let's suppose the FDA rejects the drug, and the stock falls from $25 down the $15. Had we proceeded with the stock purchase, we would've lost $5000 ($10 X 500), but, because we invested with options, our loss would be limited to the $1500 we paid for the options contracts.

On the other hand, suppose the FDA approves the drug, and the stock shoots up to $55. Here you can exercise your call option contracts (buying the stock at $25 and simultaneously selling the stock in the open market for $55) resulting in a $15,000 profit. Had you purchased the stock, you would have had to pay $12,500 to make the equivalent profit. However, by using options, your entry price was only $1500, and you turned that into $15,000, resulting in a quick 1000% return!

**Options Trading Basics**

- **Buy a call option:** You have the right to purchase the stock at a predetermined price
- **Buy a put option:** You have the right to sell the stock at a predetermined price
- **Sell a call option:** You have the obligation to sell the stock at a predetermined price
- **Sell a put option:** You have the obligation to buy the stock at a predetermined price

Confused yet? If so, don't worry. It's confusing for most at first. If you're still trying to grasp the basic concepts, be sure to watch the free OptionStrategiesInsider.com animated options presentation that makes learning options easy and fun while significantly simplifying the process by clicking here.

Okay, now that we've covered the options basics, it's time to get into the fun stuff.

# The Risk Reversal

One of my favorite options strategies (and I would submit it is likely the one strategy that has generated the most profits for me of all options strategies), is the risk reversal. There's a good chance you're hearing about this powerful strategy for the first time in this book.

I use this strategy as a substitute for buying stock itself. When used appropriately, the returns from the risk reversal approach can become highly lucrative without a large commitment of capital to open the trade.

It baffles me that there is an endless amount of option trading experts out there and hardly anyone ever elaborates on the value of the risk reversal strategy. If you were to Google search a query on "the vertical spread", „the iron condor", or any of the other common option trading strategies, you will find a wide array of information on how to use those strategy effectively. The risk reversal, not so much…

Why is this so?

First, it is a slightly more advanced strategy, and thus, should only be applied if the company's long-term outlook is strong. Most self-proclaimed options gurus have a very narrow approach to trading. They base their trades strictly on technical analysis, volatility, and/or other short-term indicators.

There's nothing wrong with this approach. These tools are great indicators that can help the trader predict where a stock's price might be headed in the short term. However, most self-proclaimed options gurus don't have the education, professional experience, or simply don't want to spend time doing the deep-dive fundamental analysis that is critical before putting on a risk reversal options trade.

# How the Risk Reversal Works

The risk reversal options trading strategy consists of buying an “out of the money” call option and selling an “out of the money” put option in the same expiration month. This is a very bullish trade that can be executed for a net debit or a credit, depending on where the strikes are in relation to the current price of the underlying stock.

The investor who enters a risk reversal wants to benefit from being long the call options while paying for (most or all of) the call by selling the put. This trade setup eliminates the risk of the stock trading sideways, but is subjected to risk if the stock trades down.

The risk reversal is an aggressive bull trade, yet it is a less aggressive, and a safer strategy than buying the stock outright (this will be discussed further in the next section). Because the investor is buying a call option with a higher strike price, and financing the premium paid by selling an out-of-the-money put option, the investor is essentially putting on a bull trade for close to no cost, and in some instances even for a moderate credit.

If the investor is correct, and the stock continues to trade higher, the short put will then become worthless, and the long call will increase in value generating a considerable profit.

Conversely, if the investor is incorrect about the stock movement, they will be forced to buy the stock at strike price of the short put. This is where the risk comes in, which can result in significant losses. Although, being forced to buy the stock at a lower price than where the investor initially opened the risk reversal trade is still a better outcome than if the investor had just purchased the stock at a higher price from the start. We will explain in detail in the next section.

# Risk Reversal Example

Suppose we have been keeping a close eye on the stock XYZ over the last month. The online technology company has been in business for a few years, but the stock recently went public only a few months prior. We like the company because they have been consistently growing while trying to disrupt an industry that's been around for a long time.

After looking deeper into the company, we have discovered that XYZ has a competent management team. They're forming high-quality relationships within the industry, and their technology is loved by all those who use it.

We also like the fact that they have been very successful in their core business. Additionally, they have recently started to expand into another market segment where legalization of activity had been limited to a hand full of states, up until recently. Perception of this particular industry seems to be changing and now more than 20 states have voted to legalize this new segment of their business. If the trend continues over the next several years, more states are likely to follow in suit. That said, we have evaluated what seems to be a solid opportunity, and we are inclined to invest for the long-term.

One approach would be to buy the stock, which is currently trading at $35 per share. If we were to buy 100 shares, the cost is $3500 ($35 x 100).

A better approach to capitalize on this opportunity would be with a risk reversal options strategy. In doing so the investor will be in a better position to take advantage of an upside move while mitigating downside risk as well as the net cost of investment. Instead of buying the stock, I would open the following option contracts, which expire in 16 months:

- Sell 2 XYZ Jan 30 Puts for $9.50 Credit
- Buy 2 XYZ Jan 50 Calls for $9.00 Debit

With XYZ stock trading $35, we will be selling 30-strike price puts and buying 50-strike price calls that expire in nearly a year and a half. Options that go out this far are referred to as “leaps”. Since the puts have a higher value than the calls, we will receive a net credit of $.50 ($9.50 - $9.00) to open this trade. Because the transaction consists of 2 contracts, and we were paid $.50 per contract. Each contract controls 100 shares, we were paid a total of $100 (2 x $.50 x 100) to open this trade.

So how does our risk reversal approach compare to the investor going long stock itself?

Let’s compare…

## Risk

The first thing we ought to establish is the risk associated with these transactions.

If we were to buy the stock for $35 a share purchasing 100 shares for cash, we would be risking $3500. As a result, our investment bank would hold $3500 in reserve… just in case the stock went to zero.

The first thing you will likely notice is that with our risk reversal strategy, we purchased 2 contracts which together control 200 shares, versus our stock strategy where we purchased only 100 shares. Is this a fair comparison? Absolutely! Here’s why…

If the stock trades off, you won’t be forced to buy it, unless the price is under $30 upon expiration. If the stock you want to own is trading $35 today, and you had the opportunity to buy it for $30, would you want to do that? Most of us would, and if we could, we would likely buy more of the stock at that lower price. For this reason, I would at least want to double the number of shares I am purchasing. Typically, I will purchase a substantially higher number of contracts, but for this example let us stay at a conservative double.

Because we're only obligated to buy the stock at $30, our investment bank will simply hold $30 per share in reserve. By opening 2 contracts, which controls 200 shares, our investment bank will hold $6000 ($30 x 200). We received $100 for opening the risk reversal, so we are only risking $5900 ($6000 - $100), which works out to be a cost basis of $29.50 per share. This scenario is clearly more beneficial than paying $35 per share as stock trader.

Although we are risking $2400 ($5900 - $3500) more with our risk reversal approach (since we are controlling double the shares), our investment bank holds substantially less than twice the principle amount of the traditional stock trade. Thus, for this bullish investment, the risk reversal options strategy provides a significant edge over the traditional long stock trade in respect to cost and shares controlled.

In addition, if it turns out we're correct about our analysis, this $5900 that our investment bank holds in reserve will have little bearing on the long-term outlook of the trade or our account buying power. More on that later on…

## Worst Case Scenario

Although XYZ had tremendous promise, let us now assume instead the company underperforms, and as a result, the stock price is negatively impacted trading down from $35 to $25, losing $10 per share.

Fairly easy to calculate, had we purchased 100 shares, we would've lost $1000 ($10 x100).

We know from the previous section that if we opened a risk reversal we would be forced to buy the stock at $30, but, because we received a $.50 credit to open the trade, our overall cost basis amounts to $29.50 per share.

With our risk reversal approach, if the stock trades down to $25, we would incur a $4.50 ($29.50 - $25) loss, times 200 shares, equating to a total loss of $900. Note that this loss is 10% smaller than the loss of purchasing 100 shares at $35.

In this instance, we still fared better with the risk reversal approach - even with the price of stock trading off nearly 30%!

In fact, the stock trade doesn't turn out to be better on the downside until the stock reaches $24. Here the stock trade and the risk reversal trade would both be down $1,100. If the stock were to fall below $24, the risk reversal strategy would start taking losses at double the rate as a stock strategy.

So, from a downside perspective, if we believe XYZ won't trade below $24, the risk reversal approach is a far superior strategy.

## Average Case Scenario

There are many different average case scenarios that may result. XYZ could trade sideways, down slightly, or up slightly… all of which would have the same outcome for the risk reversal approach.

Since we received a $.50 credit for opening risk reversal, by selling the 30-strike price put and buying the 50-strike price call, the risk reversal approach will not require us to take any stock position unless the stock drops to below $30 or rises above $50. If neither of those events materialize, and XYZ stays between $30 and $50 over the next 16 months, then we will simply keep the $.50 credit per share received times 2 contracts… a total profit of $100.

So, at the end of the 16 months, if XYZ is priced at $31, $36, or $45, the risk reversal approach will have the same payout of $100.

However, the stock trade has dramatically different results under the same circumstances. I realize most readers are already familiar with the method of how to calculate the profit or loss for a stock trade, but let's work through a couple of examples just to be sure.

If we bought 100 shares of XYZ stock for $35 and the stock traded down to $31 over the next 16 months, we would have a net loss of $4 per share, times 100 shares, for a total loss of $400. With this scenario, our risk reversal strategy would prove to be the superior strategy, actually making $100, versus the stock trade that lost $400.

In our second scenario, let's pretend shares of XYZ traded slightly up to

$36. Because we purchased the stock for $35, we would have $1 of profit per share, for a total profit of $100. The risk reversal approach also had a total profit of $100, so here both the stock approach and the risk reversal options strategy would have the same profit.

Now let's assume the stock trades up to $45, giving the stock trade a profit of $10 per share, times 100 shares, for a total profit of $1,000. Because the stock did not go below $30 or above $50, our risk reversal strategy still profited that same $100. So, with this scenario, our stock trader did markedly better.

We've now established that if XYZ has a medium downward move, a slight downward move, or trade sideways, the risk reversal approach is the superior strategy. If XYZ has a substantial downward move, small upward move, or a medium upward move, the stock trading approach is a superior strategy.


In the next section, which is my favorite section, we will discuss what happens if XYZ has a substantial move higher.

## Best Case Scenario

Good research will pay you in spades. There are an endless number of factors that can affect the value of a company. Traders that do their homework in fundamentals are looking at the firm's business model, their management team, their financial statements, international relations, marketplace positioning, industry competition, as well as several other possible price driving factors. They hope to identify similarities of the investment opportunity being researched to that of other companies that experienced incredible market execution, revenue growth and hopefully a dominant place in their industry. Identifying the stronger fundamental qualities of a prospective investment in a company will vastly improve the probability of selecting a highly profitable trade for the long term.

When traders combine strong fundamental research with short-term technical/ trading indicators, they more adept at determining the most optimal entry point to open the trade. From here, the positive results and beneficial returns can be dramatic.

Although there's always the possibility of an investment going sideways due to some unforeseen event. For those traders willing to put in the due diligence of fundamental research, patient enough wait for the positive (or divergent) signals from technical indicators and savvy enough to have adopted the risk reverse strategy, these stunted, underperforming trades will make up a small fraction of a trader's portfolio over time.

When we see that a company has many of these key important factors lining up, and a strong roadmap ahead, we realize that a best-case scenario for investing is not only possible, but more so, it is probable!

Great. now let's get back to our favorite disruptor, company XYZ, which we believe will go significantly higher over the next year.

For this scenario, let's say XYZ trades up the $55 per share.

We can quickly calculate that if we would've purchased 100 shares of stock, we would've made $20 per share for a total profit of $2,000.

Now let's compare that to our risk reversal approach. Here we can buy 200 shares at the price of $50, and with the stock now trading $55, we would have a gain of $5 per share, for a profit of $1,000 ($5 x 200). However, don't forget the $100 credit we received when we open the trade. So now our total profit would be $1,100.

What if the stock were to trade to $75 per share? Our stock trade would do quite well. Here they would have a total profit of $2,500 (100 x $25 per share). Not bad!

However, with our risk reversal trade, our call options allow us to buy the stock for $50, and because the value is $75, we would have a $25 gain per share, times 200 shares, for a total profit of $5,000… plus the premium received ($100), for a total profit of $5,100. More than double that of the stock trader!

Please take note: as the stock continues to trade higher our risk reversal trader makes double the profit of the stock investor since the trader now controls double the shares. In our XYZ example, both the stock strategy and the risk reversal strategy will produce a profit of $2,900 at the price level of $64. Once XYZ surpasses

$64, the risk reversal becomes dramatically more profitable, gaining value at double the rate as the stock trade.

# Actually, Trading the Risk Reversal

At this point, you might be thinking the stock approach and the risk reversal approach both have inherent advantages and disadvantages. And although this is true, the biggest advantage of purchasing stock outright over placing the risk reversal trade is that the stock method has a better outcome if XYZ has only a medium move higher. And perhaps this is the most likely outcome one might expect.

At this point, I want to show you why the risk reversal is actually the better under this scenario.

We don't actually open a risk reversal to hold the position until expiration, certainly not! This is especially true if the stock does what's expected, and moves higher. When it does, we adjust the position, lock in profits, then start turning our asset into a money generator.

In fact, at OptionStrategiesInsider.com, we've had one member so blown away by what comes next, he described the strategy as „printing money."

If you recall, we originally opened up our risk reversal in XYZ, expiring in 16 months, by performing the following trade:

- Sell 2 XYZ Jan 30 Puts for $9.50 Credit
- Buy 2 XYZ Jan 50 Calls for $9.00 Debit

This wasn't a trade we just jumped into on the fly. We had been tracking the stock on a technical basis for over a month. We liked everything the company was doing fundamentally and were patiently waiting to pick our entry point. We decided to jump in when the market sold off, and XYZ dropped down the $35 per share.

Let's pretend our research and technical analysis pays off, and the stock trades up the $55 over the next two weeks. This would be the perfect time for an adjustment!

# Adjusting the Risk Reversal

**Adjustment #1**

Once the stock reaches our call strike price, it's time to start thinking about an adjustment. In this case, the stock trades up to $55, and we decide to put on our first adjustment.

To accomplish this objective, we would first repurchase our puts (which we sold just two weeks earlier for $5.60). Since we originally sold the puts for $9.50, we would have $3.90 ($9.50 – $5.60) of profit per share, times 200 shares, for a total profit of $780. Not a bad profit! But there is another major advantage that happens at this juncture worth discussing.

Because we sold 2 puts with a cost basis of $29.50, our investment bank holds our maximum possible loss of $5,900 (2 x $29.50 x 100) in reserve. This is money that we cannot deploy for other investments because it's tied up in collateral for our XYZ trade. Once we repurchase the put position, this releases us of our downside risk, and our investment bank will add this money (no longer held in reserve) back into our account for a credit.

Keep in mind, we still own calls, and we have to pay for those calls. Now our risk is reduced to merely the cost of the call contracts. Since we purchased 2 call contracts paying $9 per contract, our investment bank will still hold $1,800 (2 x $9 x 100) in reserve. This is an excellent trade-off! We still control 200 shares; twice as many as if we would've just purchased the stock, but now we only have $1,800 invested. This represents just about half of what the stock strategy would require. In essence, the risk reversal strategy has double the profit-making potential as the stock strategy, while only requiring about half of the principal investment. Is that cool or what?

This may sound pretty good at this point, but the reality is… things get a lot better than that from here!

If you will recall, when we purchased the put position back, we made $780 of profit. This realized cash goes right back into our investment account. Now we will deduct the $780 profit from what our investment bank is holding in reserve. At this point, we still control 200 shares of stock, but the amount of cash tied up in this trade is only $1,020 ($1,800 - $720). This is important as it reduces our cost by nearly half which frees up decent capital from which we can invest in other investment opportunities.

But that's still too much… When executing a risk reversal, my goal is to ultimately pay myself back for the entire trade within the first few months of the trade's initiation. This accomplishes two major factors. First, if the investment ends up going sideways down the road, my savings won't take a major hit. Second, once I pay myself back in full for the initial trade, I can then deploy those funds previously held in reserve, to perform the same risk reverse strategy again in another opportunity. At this point, I can repeat this process all the while holding the initial investment of a single trade. This technique of adjusting allows the trader to yield a higher utility of capital committed. In principle, this principal (cash) is getting more investment bang for every investment buck put to work.

Things are off to a good start. So, let us now analyze an appropriate, second adjustment…

**Adjustment #2**
The next adjustment can be performed simultaneously as our first adjustment. We might execute both at the same time, or in close proximity, depending on the short-term analysis of where the stock is likely to go at this point in time.

Generally, stocks don't just continue to trade up forever. They move higher, frequently overshooting their current fair market value, then fall back in price and may even over-correct on the downside in doing so. Other times, they may move at a more gradual and even pace. It's up to us as traders to ferret out the current landscape. Even if we believe the company's long-term outlook is strong, we still do understanding those short-term pullback points are a normal part of the progress. This is price digestion.

In this case, XYZ had a swift move higher, trading from $35 to $55 over just a couple of weeks. Here it would be wise to start selling short-term upside premium with the expectation that the stock will pull back to lower levels, or at least flatten out.

To do so, we will sell calls expiring in about a month:

- Sell 2 XYZ Nov 55 Calls for $5.00 Credit

Because we are selling 2 contracts for $5, we will now receive an instant credit of $1,000 (2 x $5 x 100). As you recall, after the previous adjustment, we only had $1,020 remaining in the trade. Now that we've sold these additional calls for $1,000, we only have $20 left in this trade as a net cost.

Now we can start to see the magic really happening! We have incredible long-term upside potential trade on, and we are only at risk for a net cost of $20.

The current position we have on looks like this:

- Buy 2 XYZ Jan 50 Calls
- Sell 2 XYZ Nov 55 Calls
- Total money invested in the trade: $20

At this point, we've essentially turned our risk reversal into what is known as a diagonal spread. We want the stock to continue to trade higher, but slowly. Under these conditions, we can bank the $1,000 premium we received from selling November calls, while our January calls continue to increase in value.

Had we purchased the stock initially, instead of applying a risk reversal options trade, we could have sold the November 55 calls. This is known as a covered call. Yet our stock position only covers half as many shares. We would have only been able to sell a single contract for $500 instead of selling 2 contracts for a total of $1,000. Clearly, when it comes to generating income, the risk reversal approach also has more than double the potential working in its favor.

What happens once we convert our risk reversal trade into a diagonal spread?

If XYZ continues to trade higher, our January 50 calls will cover any losses incurred from selling the November 55 calls. For example, if XYZ shot up to $75, we would make $25 per share on our January 50 calls, we would then lose $20 per share on our November 55 calls. The net result would be another $1,000 ($25 - $20) x 2 x 100) in profit for us.

This is exactly what we don't want to happen! It's especially nice when you have a negative outcome; then, the result is making $1,000, clean and simple.

If the stock trades off to never see the $50 price point again, both of our call options would expire worthless. The net result would only be the loss of money we have left in the trade… $20.

That would be our worst-case scenario at this point, losing the $20 we still have committed. However, it won't be long until we get that $20 back… and then some. Once we do, there will be absolutely no way we can lose money on this trade. On top of this, we still have the opportunity for major long-term gains.

Being able to monetize our long-term calls at double the rate as the stock strategy, while at the same time, being able to pay ourselves back for the initial trade cost is what makes the risk reversal strategy so powerful and why it's even better than purchasing stock even on modest upward movements.

In reality, when you compare the risk reversal strategy to simply buying stock, the comparison chart is actually more like the following:


**Adjustment #3**
If we were correct, and XYZ doesn't break $55 by November expiration, the $1,000 premium we received will be added to our account, and the November 55 calls will disappear. Now we are in a position where we can do it again.

For example, if XYZ is still trading about $50, we can then sell the December 55 calls. Here, because the stock has become substantially less volatile, not having any large price swings over the last month, the options will be much less expensive. Being so, we can sell 2 December 55 call contracts for $2 each, giving us a total credit of $400.

If you recall, after selling the November 55 calls, we only had $20 of our own money left in the trade. Now that we've taken an additional $400, we've paid ourselves back 100% of our initial investment, plus we have another $380 ($400 - $20) of cash in the bank.

That means we have zero risk left in this trade! If we woke up tomorrow and found out company XYZ was operating some sort of fraudulent operation and the stock went to zero, we would still have a $380 profit… And that's the worst-case scenario!

In addition, we also have on the following position:

- Buy 2 XYZ Jan 50 Calls
- Sell 2 XYZ Dec 55 Calls
- Total money invested in the trade: $380 credit

Our January 50 calls, which we originally paid $9.00 for now, have a value of $15.90. So, in addition to paying ourselves back 100% of our initial investment, plus another $380 of cash, we also have another $1,380 (($15.90 -$9.00) x 2 x 100) worth of profit in our January 50 calls.

You can see how this strategy can become highly profitable very quickly.

## Trade Breakdown Thus Far

Our January 50 calls, which we originally paid $9.00 for now, have a value of $15.90. So, in addition to paying ourselves back 100% of our initial investment, plus another $380 of cash, we also have another $1,380 (($15.90 -$9.00) x 2 x 100) worth of profit in our January 50 calls.

You can see how this strategy can become highly profitable very quickly.

**Opened Position**

- Sell 2 XYZ Jan 30 Puts for $9.50 Credit
- Buy 2 XYZ Jan 50 Calls for $9.00 Debit
- $5,900 reserve requirement

**Adjustment #1**

- Buy 2 XYZ Jan 30 Puts for $5.60 Debit

Remaining position:

- Buy 2 XYZ Jan 50 Calls for $9.00 Debit
- $780 cash profit
- $1,800 reserve requirement

**Adjustment #2**

- Sell 2 XYZ Nov 55 Calls for $5.00 Credit

Remaining position:

- Buy 2 XYZ Jan 50 Calls for $9.00 Debit
- Sell 2 XYZ Nov 55 Calls for $5.00 Credit
- $1,780 cash profit
- $1,800 reserve requirement

**Adjustment #3**

- Sell 2 XYZ Dec 55 Calls for $2.00 Credit

Remaining position:

- Buy 2 XYZ Jan 50 Calls for $9.00 Debit
- Sell 2 XYZ Dec 55 Calls for $2.00 Credit
- $2,180 cash profit
- $1,380 open position profits
- $1,800 reserve requirement

As we can see, the amount of cash we have generated is $380 more than what our investment bank holds in reserve, plus we have another $1,380 worth of profit in our January calls if we want to close the position today.

We could continue to execute this strategy month after month, selling short-term upside calls against our long-term premium, generating safe, reliable income month after month. At the same time, our original asset continues to increase in value.

Once our original investment pays us back in cash, we then have capital to fund a new opportunity. An investor who only has enough money to open one position could continue this process, opening up several income-generating positions within a year.

Imagine if you are trading more than 2 contracts. If you have four, five or even more risk reversal trades going at once, you can increase your revenue generation considerably.

# Does it Really Work?

Now you know the power of the risk reversal options strategy; But does this strategy really work?

For investors who find the right opportunities, the risk reversal strategy is a very powerful method of trading. In my experience, one of the most significant risks with this strategy is having the stock make a massive move to the upside, causing your short-term calls to go in the money.

When this happens, it forces a trader to sell the whole position, knocking them out of their long-term endeavor. Although this is not ideal, if it does, the result is still making a lot of money! Remember, whatever you lost by selling short-term premium, you made substantially more from owning long-term calls. That's why there's zero risk when the stock goes higher as was anticipated.

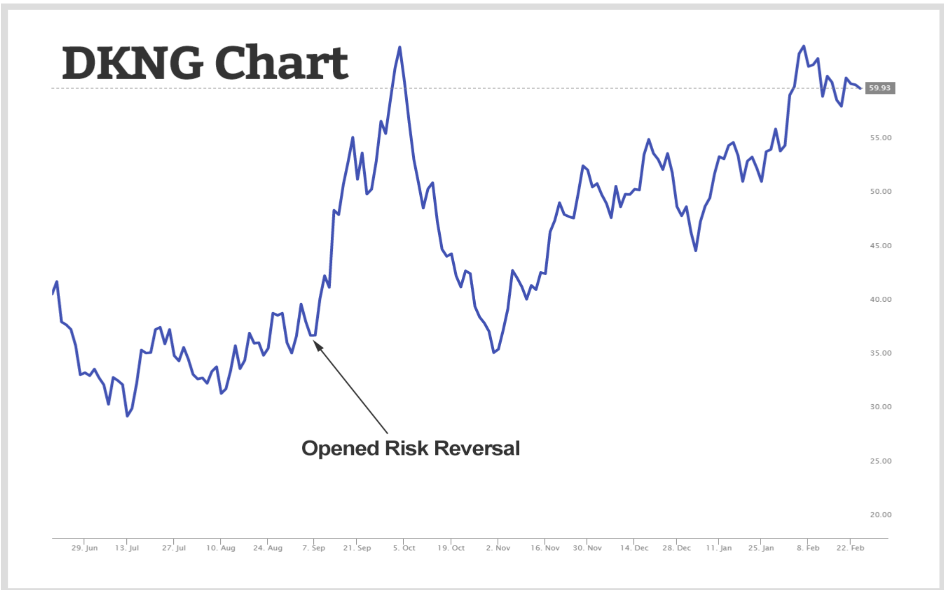
There also may be times when a stock continues to trade down after opening the risk reversal. However, if the original investment premise is still intact (even though your options may have lost value), it is important to realize you won't be forced to buy the stock unless it's price drops beneath your short put strike price. That being said, I am not that concerned about my P&L if the stock trades down. The main thing I care about is: at what price I will be forced to buy the stock? If I'm still comfortable with purchasing the stock at that price, I need not worry.

# Real-Life Examples

## Example #1

Thus far in this book, we have been working with our favorite company XYZ. If you recall, we had very high hopes for this company, which is why we decided to execute the risk reversal strategy. However, XYZ and the trade we worked through is not a fictitious trade. This is a trade was actually executed at OptionStrategiesInsider.com.

Our prospect, XYZ, is really the sports betting firm **DraftKings (DKNG)**. We open this trade in September 2020 after watching the stock for over a month. We had been waiting for the perfect time to strike, and after the stock dropped from $40 per share to $35 per share on the market pullback, we pounced on our risk reversal approach.



The example we worked on above depicts the exact P&L from our trading strategy in action. However, we did not stop after the third adjustment. As the stock slowly made its way higher, we continued to sell upside premiums on DKNG. On our fourth adjustment, we brought in another $520. n our fifth adjustment, we brought in another $510. Then, on our seventh adjustment, we brought in another $580. All the while our long-term calls increased in value.

We will continue with the strategy of monetizing our long-term calls by selling a short-term premium, month after month, generating risk-free income.

And this isn't just a one-time deal. Within the OptionStrategiesInsider.com Ultra portfolio, we repeatedly executed this strategy. Our research identifies companies that are well positioned for a strong price movement higher. These companies are the best candidates for applying the risk reversal approach.

Just two months after we opened up our DraftKings risk reversal, we open another risk reversal on a company that's has been even more successful than DraftKings in recent months.

In total, we have 5 risk reversal strategies all working simultaneously at the time of this writing. 4 out of 5 trades are currently very profitable. 1 of the 5 is still in neutral territory. So, the risk reversal trade not only works in theory, but is an extremely valuable options strategy we utilize frequently because of its consistent reliable success and profit generating capability.

## Example #2

Even though we will have high hopes for any company we execute a risk reversal on, sometimes things don't always go as planned. We haven't had any risk reversal strategies go sideways within our Ultra portfolio at OptionStrategiesInsider.com. Even still, I have been trading this strategy since 2005 in my personal account, I can tell you that even when things seem to go wrong out the gate, they may still be profitable if your analysis is correct.

In December of 2018, I was looking to execute a risk reversal in **Roku (ROKU)**, the media hardware company that allows its users to access streaming media content directly to their TV. This firm is highly innovative, and with the release of the Roku Channel, the firm had a number of interesting opportunities percolating in the marketplace.

The stock was then trading around $70. I wasn't looking to execute the risk reversal strategy at that level, but if the stock were to pullback somewhat, I would be looking to execute the strategy as the price became more attractive.

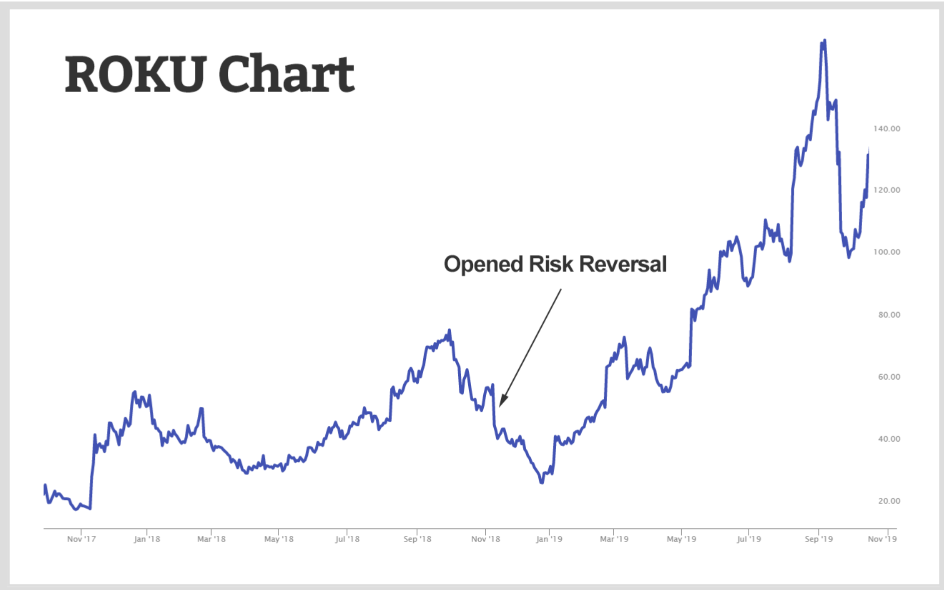
Shortly thereafter, the entire equity market started to sell-off. This was the opportunity I was hoping would come to fruition. ROKU traded down to the $65 level, then down to $60. Now in a downward trend, the price of ROKU continued to deteriorate to $55, and then $50. I had no idea how far the market might continue drop at this point in time, but, if you would've told me just a few weeks earlier I could buy Roku $50, I would have backed up the truck!

Under these circumstances and price action, I had little interest in buying the stock outright. Instead, I elected to execute a risk reversal trade. Because the market was currently dropping, and it's always risky attempting to catch that falling knife… the risk reversal made for a much safer approach. I executed a 45/60 risk reversal by selling the 45 puts and buying the 60 calls; all for a net credit of $3.

This means that if ROKU were still trading below $45 at time of expiration, I would be forced to buy the stock at the strike price of $45. However, since I received a $3 credit upon executed this trade, my cost basis now equated to $42. If Roku were to begin to trade higher, profits could be extraordinary. I felt confident knowing that the stock was trading significantly higher just a few weeks prior to the initiation of this trade.

As it turns out, I didn't time this trade very effectively. ROKU traded down to $45, then $40, $35, and eventually settled in around $30. Oy vey!  As you can guess, my P&L was down thousands of dollars. I knew my research was spot on, as nothing fundamental had changed within the company or the industry sector. The market, as a whole, was experiencing a massive pullback. Although this was somewhat comforting, I still started the second guess the trade.

Was I wrong? Was it time to pull the plug? How much pain would I be able tolerate?




ROKU eventually hit a low of $26. Because my options were so deep in the money, I got the stock assigned to me from the put, which forced me to buy the stock for $45 when the fair market value of the stock is $26. This is not how this trade was supposed to go being the stock price went south right out the gate!

Fortunately, I was able to hold in there (all the while staring a massive loss in the face). Being a disciplined trader does require a fair amount of market experience and intestinal fortitude. Getting back my floundering ROKU risk reversal trade…

if there was no fundamental reason for the stock to trade down as hard as it did, I knew I needed to trust my judgment, my research and remain patient. And wouldn't you know it, things started to turn around for the better, and then some!

Over the next 10 weeks, the stock traded back up to $78 a share. Not only did I own stock at $45, but my 60-strike price calls were now also in the money, and I was paid a $30 premium to put on this trade. I held on for about another 10 weeks, until I was finally knocked out when ROKU blasted over $100.

This trade, shortly after initiation only seemed to provide me with stress. Soon after, it turned out to be one of my most profitable trades ever! As it turns out, ROKU ended up trading to $175 in the following months. I was a little salty getting knocked out of the trade when the stock hit $100. My goal was to hold for the long run. This is simply a part of the game. As long as we made money, great!

My point is, if you believe you got into the stock for the right reasons, yet the stock still trades down, you should still be happy that you can pick it up at a discount. Getting assigned the stock at your put strike price may hurt at the time, but, if there's no fundamental change in reasoning for owning the stock from the onset, this short-term drifting downward in price can still turn into a big win in the longer run. It is certainly a better scenario than if you would've bought the stock itself originally given the factors mentioned earlier in this book.

This is why I love the risk reversal strategy so much!

If I have chosen to invest in a high-quality opportunity, and the stock trades higher from the start, I win. If the stock trades down and I'm forced to buy it at a discount, I should still win if my fundamental research is solid. When I execute the risk reversal for a net credit, and the stock continues to trade sideways, I win albeit modestly. As long as there is no surprising news specific to the company or the sector that would compel me to change my mind about the existing fundamentals, the risk reversal options strategy is a win, win, win scenario!

# When to Open a Risk Reversal?

The risk reversal originated as a strategy to protect short investors from a rising stock price. If an investor is worried about the price of a stock trading higher when they are short the position, they may be inclined to buy an upside call, and pay for the premium by selling a downside put. The trade is being executed on a one-to-one basis; for every 100 shares the investor is short, they would execute one risk reversal option contract.

If the stock moves higher, the investor would be protected by the upside long call options. If the stock traded lower, the investor would be forced to buy the stock at the short put's lower price point.

However, it wasn't long before investors started to realize they could use the risk reversal as an aggressive bull options strategy with extremely high profit potential when executed prudently.

Due to the aggressiveness of the risk reversal strategy, before applying, the investors should consider the following criteria:

**You've done your research, and you have high confidence the stock will move higher:** There is an endless number of reasons why a stock could move to the upside. If you feel, for whatever reason, the company you've researched is about to climb higher, a risk reversal could be a great approach.

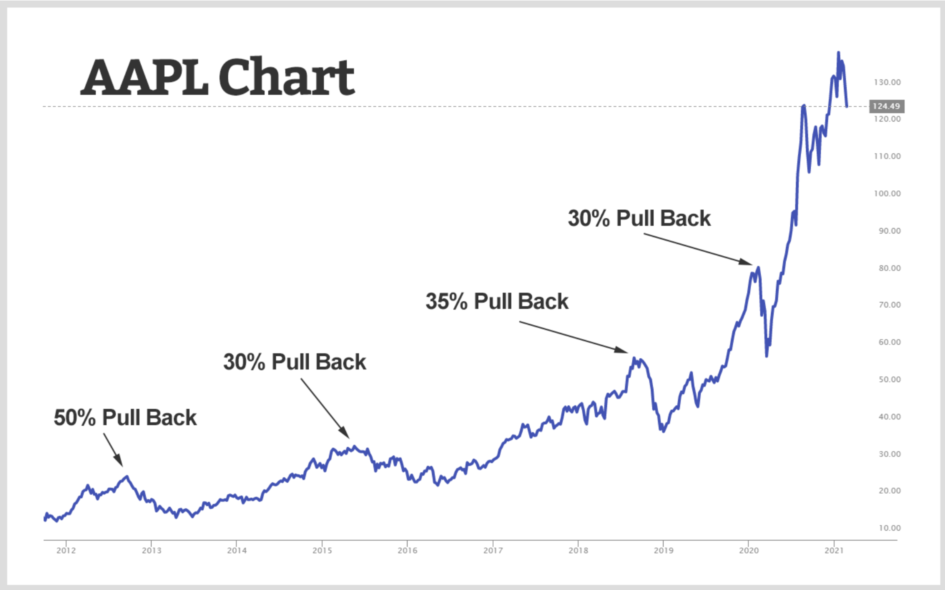
**The stock is currently trading under $50:** Technically, you can execute a risk reversal at any price point, but the larger the share price, the more your investment bank will hold in reserve. If you were to apply a risk reversal on a $200 stock and plan on buying double or triple the number of shares versus just buying the stock, that could get expensive quite fast. For this reason, I generally like to apply the risk reversal with stocks trading under $50 and preferably, substantially lower than that.

**Prior to the stock attempting a bull run:** Once the investor's research concludes that a particular equity is currently undervalued, the stock price itself may have already started to make a serious surge higher. Conceivably, you are not the only investor to make this fundamental assessment. For the risk reward strategy to be most effective, you will want to pick your entry price point fairly conservatively. So, if the price action has already moved north ahead of you, then this may not be the most optimal time to put on the trade. If the price takes off too high, too fast, we may have missed this boat for now, or for good.

Don't fret. Commonly, a stock's strong price move to the upside will soon later be accompanied by a retracement due to the market's momentum overshooting the mark in regard to the stock price/firm valuation. A consolidation of the stock's share price is what you are banking on at this point. We want to avoid at all cost putting on our risk reversal trade just before a potential pullback. The moral here is: don't chase!! Lean into your technical analysis to find a recent support level to the stock that is in line with a favorable entry point for the trade. In timing a pullback correctly, the risk reversal will still prove to be a viable strategy.

**When good companies fall out of favor:** Stocks move up and down, that's just the nature of the game. Company leaders may lose their place for any number of reasons and become followers. Sometimes everything culminates positively for a company and their stock accordingly trends higher. Other times a company misses their revenue expectations, subscriber projections or have misjudged barriers to entry, competitive forces or even the regulatory landscape of their industry. The stock would most likely trade lower barring any other counteracting positive events for the company.

Many new investors will trade the exact opposite way they should by buying into higher prices when stocks are on a roll, only to end up selling once stocks have rolled. My friends, the best time to apply an aggressive bull strategy is after a strong chart demonstrating gradual growth experiences a consolidation in and around a technical support level. If the long-term outlook of the company is still strong, then a bull strategy should be applied despite the current downside move. Even Apple, one of the world's strongest companies, has a history of seeing its shares fall by 30% every three years give or take.




For some reason, the majority of investors prefer to buy Apple when it's at all-time highs versus when it is experiencing a massive pullback. Apple isn't going away anytime soon, same with many other companies. If you see short-term volatility, this may be a solid indicator of a good opportunity to strike.

# Conclusion

The risk reversal options strategy has an extremely high payoff potential when:

- We have done our proper fundamental research on a potential investment (bottoms up)
- We have observed the appropriate signals from technical indicators (setting our sites on entry)
- We are patient and prudent to executed our trades at or near to our conservative price point.

An investor who applies this options strategy has the opportunity to make substantial money on the upside, while monetizing their long-term calls to bring in short-term premium as income. Absolutely beautiful! On the downside, the strategy allows investors to acquire the stock long at a discount, compared to where they originally desired to open the trade.

Be warned! The risk reversal strategy is generally not recommended for beginning investors. Losses can be substantial if a risk reversal is applied in the wrong situation or at too high of a price if/when the stock (or even the market as a whole) trades against the investor. But for those investors who understand what drives price movement and apply the strategy appropriately, gains can be quite substantial given a smaller commitment of capital, a mitigation of some risk and a leveraging quantifier in the number of contracts acquired.

Traders new to the risk reversal strategy should follow the guidance of an experienced financial coach familiar with the options strategy and the appropriate situations in which to apply it. Once the novice trader has executed a number of risk reversal trades under some level of supervision, they will begin to understand the strategy's full depth, power, folly and profitability. Only then should they attempt to apply it on their own.

# Example Risk Reversal Trade

Here is the exact DraftKings trade that we published on OptionStrateglesinsider.com

### Opening Trade: Getting In While It's Still Cheap


There have been several regulation and deregulation changes historically that have set the stage for certain businesses to thrive. Getting in early, before the company has already started to flourish is a major benefit to the investor.

Some of the more obvious examples might include: changes to state sales tax, tariffs & trade policies, general data protection regulations (GDPR), new laws repealing old (the legalization of cannabis). When laws that prevent business from thriving are amended, abolished or overwritten, there is a unique opportunity for companies in various industries to experience massive rapid growth.

Today we have a company that is in a perfect position for long-term growth, but is currently being stifled by both the coronavirus and regulations. Soon, both of these constraints are likely to change for the better. How long COVID-19 last is anyone's guess, but this is one company we don't want to see slip away.

The simple fact is companies continue to grow over time. Look at the long-term chart of any major index or industry. This is something that should be quite obvious to anyone with even a casual understanding of how the stock markets work. Stock prices go up over time to match the company's growth. Some companies just grow faster than others, resulting in accelerated stock gains relative to the underperformance of their peers.

One of the best situations for a firm where we might witness an immediate acceleration of a company's growth rate is "the right product at the right time." This marketplace advantage, coupled with a favorable regulation change in its industry may instantly cause a product or service to explode virtually overnight in what were previously untapped markets.

There are a few companies today heading straight out onto this fortunate path.

### Sports Betting

On May 14, 2018, the United States Supreme Court found the Professional and Amateur Sports Protection Act (PASPA), the federal law prohibiting states from authorizing sports betting, to be unconstitutional. It is now up to individual states to decide if they want to authorize and regulate sports betting in their state. Congress can also take action on the authorization and regulation of sports betting, but thus far, representatives have left it up to the individual states. Could that change? Yes, but in light of states now adopting legalization of sports betting (and are bringing in additional tax revenues), it seems unlikely.

One of the top players in the space that we have been keeping a close eye on over the last several months is **DraftKings (DKNG)**, an American daily fantasy sports contest and sports betting operator. The company allows users to enter daily and weekly fantasy sports-related contests. Users have the opportunity to win money based on individual player performances in major sports leagues (i.e. MLB, the NHL, the NFL, the NBA, and the PGA, Premier League and UEFA Champions League soccer, NASCAR auto racing, Canadian Football League, the XFL, the MMA, and also Tennis.

In August 2018, DraftKings launched DraftKings Sportsbook in New Jersey, becoming the state's first legal mobile sports betting operator. Since then, DraftKings has opened mobile sports betting operations in Indiana, Pennsylvania, West Virginia, and New Hampshire.

Retail sports betting is available in Iowa, Mississippi, and New York. DraftKings Sportsbook mobile and retail sports betting products allow bettors in each state to engage in betting for most major US and international sports. In total, DraftKings currently operates in 20 states that allow sports gambling in some form or another. This means that there are still 30 states where they don't operate.

We particularly have our eye on the California sports betting bill on the November ballot. If it passes, the California sports betting market would undoubtedly become the country's biggest and fast.

Chris Grove of the research firm Eilers and Krejcik Gaming said that the market could be worth $2.5 billion per year in California alone.

There is no guarantee that the bill will pass. It needs a two-thirds supermajority to pass, yet they are continually moving closer and closer in that direction.

If DraftKings were able to land California, the stock would go on a tear. Even if it doesn't, the opportunities ahead for this company looks fantastic. They will continue to grow in the states that they are currently operating, and once they start acquiring more and more states, their potential is even more compelling. During the pandemic with league sports so limited, many people still sought this product. In fact, New Jersey's year-over-year sports betting in June of 2020 exceeded June of 2019.

In addition, Michael Jordan recently took an equity stake in DraftKings in exchange for providing guidance and strategic advice to the company's board of directors. He will also join the e-sports and gambling company as a special adviser.

### Risks

Although the possibilities are quite favorable over the long-term, there are some risks associated with this trade. Most sports are on hiatus due to the pandemic. However, as COVID-19 cases continue to decline in February, and there is certainly optimism on the horizon. Additional vaccine candidates are currently in stage II or stage III trials and could be approved shortly.

Even though limited sports are happening at the moment, the stock has been holding its own. This mostly is because markets are forward-looking. Most all agree at some point, sports will be on again.

The NFL is the most popular sport in the US. If the NFL season kicks off or gets put on hold due to increased COVID-19 cases, it will affect DraftKings stock price one way or another.

Currently, the stay at home orders of the previous months has spurred pent up demand for sports, and along with sports… betting. This will play nicely into the hands of DraftKings when sports reopen.

### The Market

It has been some time since we have seen a significant down day in the markets, but yesterday was the first since June, especially in the tech sector.

Although buying on pullbacks can undoubtedly be scary, it's a strategy that consistently pays off in the long run. There's no doubt the stock could pull back into the lower $30s over the short term. That aside, we would rather open the trade now rather than risk a sharp run up in the price of the stock.

### Trade

The fact is we don't know for sure when sports will come back, but we know for sure that at some point they will. When they do, DraftKings will be in a perfect position to capitalize.

A risk reversal strategy will work perfectly for a trade with a lot of potential, but also a lot of uncertainty.

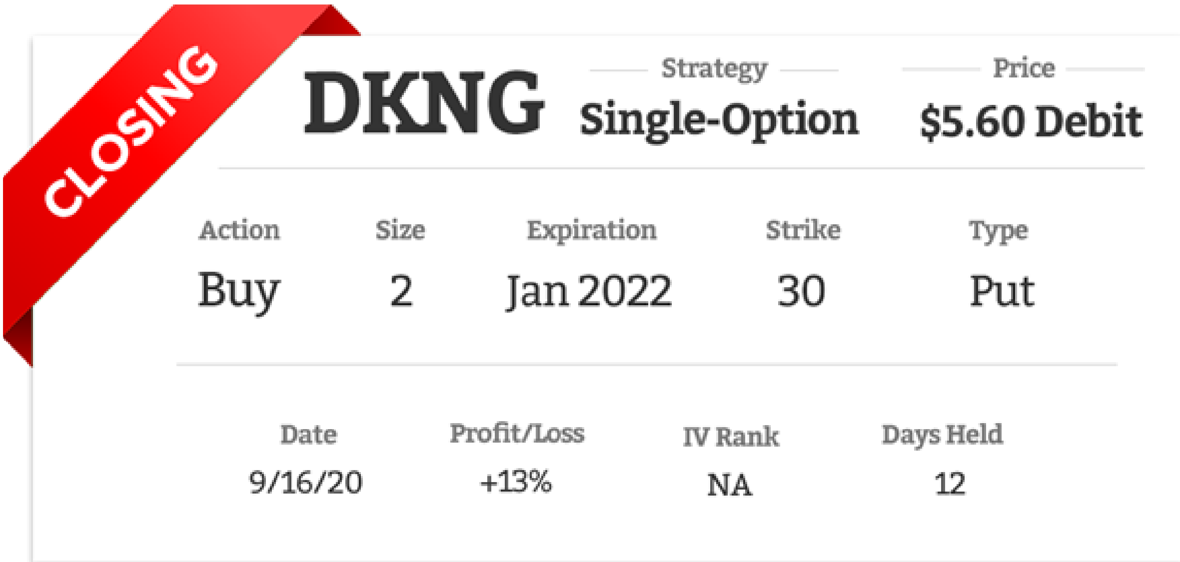
Here I want to sell the DKNG January 2022 30-strike price puts and then buy the January 2022 50-strike price calls, and for this, I will receive a credit of $0.50.

If the stock finished below $30 in January 2022, which is our worst-case scenario, we would be forced to buy the stock at that price, but because we received a $0.50 credit when we executed this trade, our adjusted cost basis would be $29.50. That is 16% lower than where the stock is right now.

If the stock finished between $30 and $50, we would keep the $0.50 as profit, and we would have no position in the stock.

If the stock finished above $50, we would be able to buy the stock for that price and retain it or sell it in the open market at the current market price, but we would also keep the $0.50 credit received.

**Adjustment #1**




**DraftKings (DKNG)** has a lot of amazing opportunities on the horizon. Sport-entertainment company ESPN is integrating with the sports-betting company into its platform, which has caused the stock to break out almost immediately after he got into it.

We think the skies the limit for DraftKings, but with this massive upside movement, we want to take profits on our put position so we can release our reserve requirement.

We sold the puts for $9.50, today we can buy them back today for $5.60. This equals a 13% return over 12 days (400% annualized) and a $780 profit on a minimum order.

As a result, we will still be long calls, which we paid $9 for. This will drop our reserve requirement from $5,900 down to $1,800.

We will continue to hold onto the calls, which we are currently up 128% on or

$2,050 on a minimum order. We will look the sell upside calls against our current position in the future.

**Adjustment #2**


Sports betting firm **DraftKings (DKNG)** has jumped significantly higher since we got into it a month ago. We've already sold our put position for a nice profit, but today I'd also like to leverage our calls for additional income.

Although we believe the sky is the limit for DraftKings, the company supports a robust market cap, which now stands at $18 billion. In comparison, **Caesars Entertainment Inc. (CZR)** only supports a market cap of $11 billion.

With the NBA season coming to an end and with the NFL dealing with coronavirus issues, we want to limit our downside risk, take advantage of elevated volatility, and add additional guaranteed income to our portfolio.

If DKNG stays under $55 by November expiration, we will bank an extra $1,000. If DKNG goes over $55 by November expiration, we will still keep that $1,000, while adding roughly another $700 due to the stock movement.

We will give up another massive uptick in momentum by selling the calls, but we already had a huge move last month, and I think we need some time to let the fundamentals catch up with the momentum.

This trade should only be executed if you are long the January 2022 call position from last month.

**Adjustment #3**


Today's recommendation is only for members who are in our September Ultra trade for **DraftKings (DKNG)**. We initially open the risk reversal strategy with 2-contracts on September 4 with the stock trading $34.50, by selling the January 2022 30-puts for $9.50, and then buying the January 2022 50-calls for $9.00, for a total credit of $.50.

Shortly thereafter, the stock immediately popped higher, allowing us to sell our put position on September 16 for a quick $780 profit.

Then on October 12, with the stock indicating it would likely to fall over the short term, we sold 2 November 55-calls for $5.00, giving us another $1,000 credit.

Last week, our November 55 calls expired worthless…

In total, we've already pocketed $1,780 on the trade, and we are still holding the January 2022 50-calls, which we paid $1,800 for initially. However, these calls now have a value of $3,180. So, our total profit on the trade thus far is $3,160. Not bad on trade for which we currently only have $1,800 invested.

However, today with DraftKings moving higher, we want to monetize that position by generating additional income off the asset we already own.

We can do this by selling the December 55-calls for $2.00 per contract. This will put another $400 on our side while giving us complete protection if the stock runs higher. Because we own January 2022 50-calls, if the December 55-calls go into the money by December expiration, it would still be a profitable sale as long as a stock is under $57 (55+2).

Now, if DraftKings were to run over $57, whatever we lost on the December position, we would more than make for with our January 2022 position. This is important, because there's no way we could lose money by entering the trade.

If DraftKings stays under $55 by December expiration, we will pocket the $400. If DraftKings goes over $55, we will make even more money from the combined position.

Let's be smart and hedge our position while adding additional income to our portfolio by selling short-term upside premium against our long-term position.

**Adjustment #4**

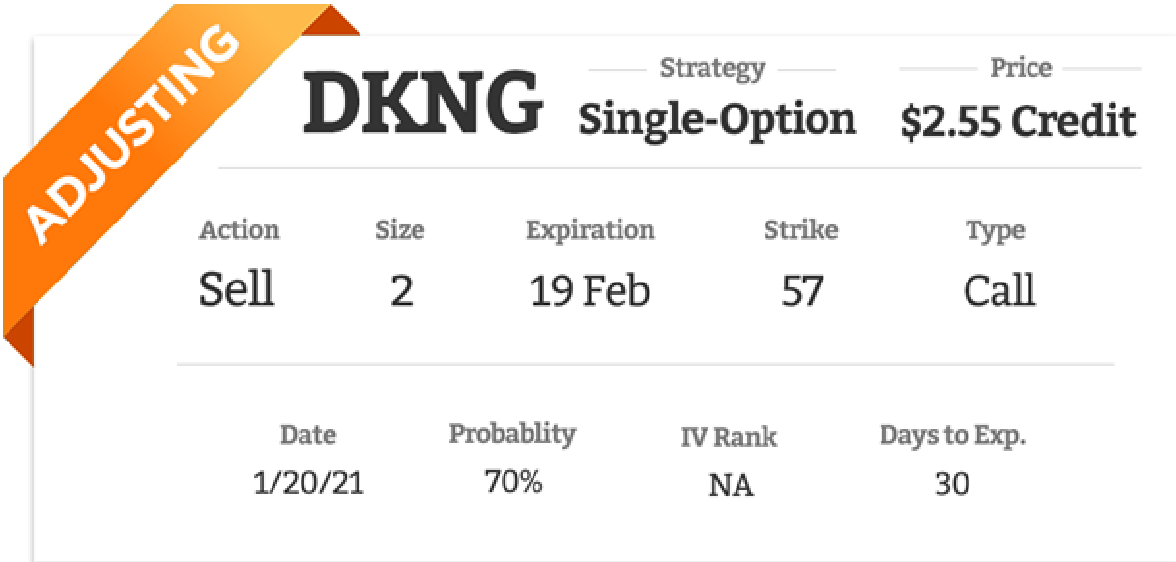

Today's recommendation is only for members who are in our September Ultra trade for **DraftKings** (DKNG).

We are currently up over $4,000 on the position and want to continue to monetize our long-term calls to add additional income to our portfolio.

Here we are going to sell the January 57.5 calls for a price of $2.60, which will add another $520 to our account. Because we own long-term calls, we are able to sell short-term premium with zero risk.

Let's capitalize on the opportunity and continue to profit!

**Adjustment #5**




Today's recommendation is only for members who are in our September Ultra trade for **DraftKings (DKNG)**.

Sports betting stocks continue to be one of the hottest sectors in the market today, and many industry experts expect the sector to continue its growth throughout 2021. Michigan is just days away from launching its legalized sports betting operations. Simultaneously, the Texas governor has reportedly reached out to regulators and other states on advice for the best path forward to legalized sports betting gambling. New York will also soon decide if it wants a single operator or work a multi-sports gambling system.

Although we generally don't put too much weight on what analysts think, the range of perspective targets spans $39-$100 per share. The question for us is, does DraftKings warrant its current valuation? We believe the company is trading close to fair market value based on the company's execution and the sector's growth potential. That said, the company has a propensity to rally with any positive news…

Fortunately, everything is gone picture-perfect thus far in the trade. In just a few short months, we've already paid ourselves back 100% of our initial investment, plus another 50% of profits on top of that in cash. Even if DraftKings were to go to zero tomorrow, we would still have a 50% return on capital.

In addition, we also still hold the calls, which we are up another $1,000 on top of that.

So, where do we go from here?

We will continue with the current strategy of selling short-term upside premium against our long-term position. We will do this by selling the DKNG February 57 calls for $2.55, adding another $510 worth of cash to our account. We were hoping to execute this trade yesterday, but the stock saw short-term selling pressure at the start of the week. This is not surprising after the stock enjoyed a short-term rally.

We will continue to capitalize and profit in this name.

**Adjustment #6**

If you took our advice and opened up a position in DraftKings (DKNG) back in September, then you've done quite well, we are currently up over $5,000 on the trade! However, this month, our short calls have gone into the money…

Nothing wrong with that, it just means we would be forced out of the position for $59.55 ($57 strike price + $2.55 option credit). There's nothing wrong with being forced out of position if the end result is big profits in your pocket!

Today we would like to make an adjustment to help keep the position alive or get paid more to exit. To do so, we want to buyback our 19-February 57 strike price calls and then sell 26-February 62 strike price calls. Here we will extend the options expiration one week and raise our strike price by $5.

Because we were paid $2.55 for our original February covered calls, and we are adjusting today by paying $1.20, we still have a credit of $1.35 on our side.

Earnings are on 26 February, so we can collect a higher premium for these calls. If DraftKings turns out a positive earnings number, we will almost certainly lose the position. However, we will get paid an extra $5.00 for the sale. Because we own two contracts, this means an extra $1000 of profit, less adjustment cost of $240, so in total, this adjustment will net us an extra $760 of profit with a DraftKings beat.

If DraftKings doesn't put up a good earnings number, we will retain our original position and add the $1.35 premium we collected for February to our profit. So here, we will bank $270 from selling February upside calls versus our original $510.

This adjustment makes a lot of sense. We are happy to pay $240 for the opportunity to make $760 extra with upbeat earnings or keep the position where we'll be able to re-monetize our long-term calls next month, easily making that $240 back.

**DKNG Expiration**
The continued legalization of sports betting continues to push the industry forward, and **DraftKings (DKNG)** is reaping the rewards.

It's looking like we picked the perfect strike price as our DKNG February 62 calls will expire at the end of the day. The stock is currently trading $61.75, which means the probability is high that these calls will expire worthless when the market closes. However, if the stock is over $62 within the last 15 minutes of the day, we will repurchase the expiring calls for likely just a few cents.

We will have to act quickly if that's the case, so everyone in this trade should pay attention to the stock price as we go into the close.

As we predicted in our original report, the sports betting disruptor continues to thrive, posting fourth-quarter revenue of $322 million versus the Street estimate of $233 million. That's a whopping 146% revenue growth compared to a year ago.

DraftKings also reported monthly unique players of 1.5 million in the previous quarter. This represents 44% growth versus the same time last year. Average revenue growth per user is also up 55% over the last quarter.

The company raised its revenue guidance for 2021, increasing its original estimates of $750 million-$850 million to $900 million-$1 billion. This also exceeds the Street's estimate of $872 million.

DraftKings cited mobile sports betting now being legalized in Michigan and Virginia for their increased expectations.

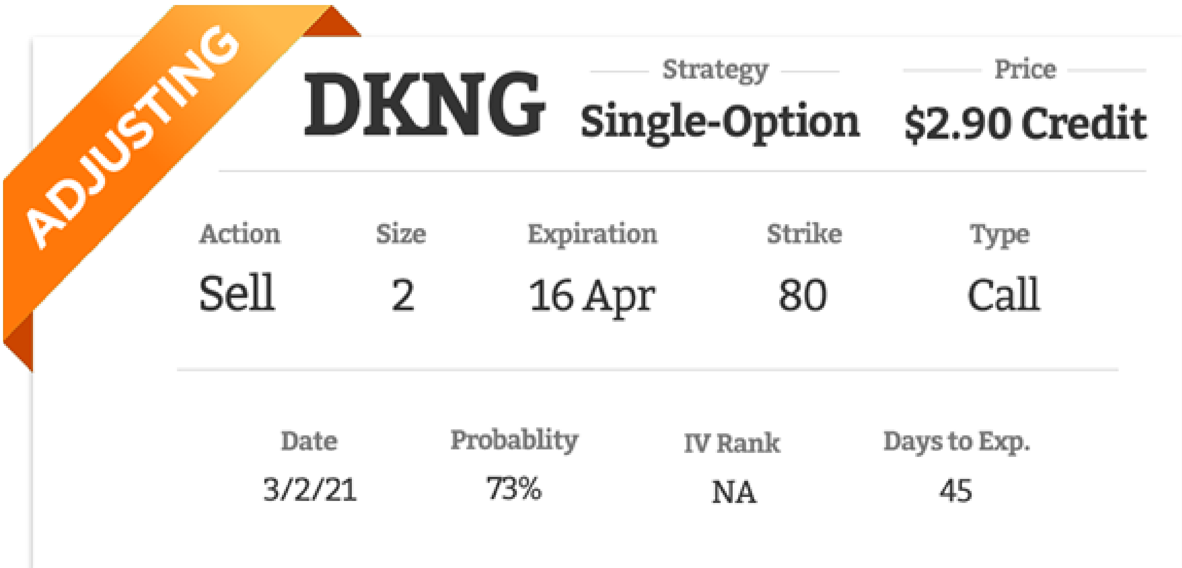
As states continue to need more tax dollars, their stance on legalizing sports betting will continue to move the needle in DraftKing's favor. Even states such as New York, which has frowned upon sports betting in the past, are starting to rethink their approach to the industry.

We see continued growth for DraftKings as they establish themselves as the leader in a rapidly growing industry.

As the position currently stands, we will head into next week still being long 2 January 2022 50-strike price calls, which we paid $9.00 for. These calls currently sport a value of $20.70, so we are up $2340 on the calls. In addition, from all the extra premium we sold, we generated another $2230 of cash.

This means we are up over $4500 on the trade on a minimum order. Because we've generated more cash than the calls originally cost, we have zero risk if the stock did have a pullback, yet have the potential for massive gains if the stock continues to accelerate forward, which we feel is the most likely outcome for the remainder of the year.

**Adjustment #7**



DraftKings (DKNG) has continued to move to the upside. People are now starting to realize the potential of the sports betting disruptor. The stock has jumped higher off the upgrade from Loop Ventures, which has referred back to its previous earnings report to increase confidence in the stock.

ARK Fintech Innovation ETF (ARKF) also help the cause by purchasing 173,800 shares for its fund.

With DraftKings smashing fourth-quarter earnings and raising guidance, there isn't anywhere for this one to hide… Investors are now starting to notice. We could see several more funds jumping on the bandwagon over the next several months.

For this reason, we only want to sell upside calls after the stock has already had a substantial move to the upside. This will not only give us a better entry point, but it will allow us to sell premium at higher volatility levels, giving us the ability to sell further out of the money strike prices. This approach will give us more room to profit as the stock continues to move to the upside.

With DraftKings currently trading over $70 and being up $12 over the last two trading sessions, I feel comfortable selling the April 80-strike price calls for a price of $2.90. This will bring in another $580 worth of income to the position. We've already banked $2230 of short premium, so this will bring our total short premium intake up to $2810.

This would be in addition to our long-term calls which we are currently showing a profit of $3600. This means our cash premium intake plus profit from a long-term calls now totals over $6400!

We expect continued profits in the name…

# Final Thought

I hope you found our risk reversal approach to trading entertaining and enlightening! It is not a commonly used strategy by most trading coaches or research centers as it is a more advanced trading setup usually only employed by true industry experts. However, at OptionStrategiesInsider.com, we continue to use the risk reversal strategy repeatedly within our Ultra portfolio with great success as demonstrated with our DraftKings example!

Our DraftKings saga continues to move forward, but serves as a great example of what can be accomplished with the strategy. At the time of this writing, we still own our long-term calls, and we will continue to monetize the position by selling short-term upside premium against our long-term options. This way, we will not only profit as the calls trade higher, but we will turn those calls into a monthly income-generating asset as well.

# About Option Strategies Insider

At OptionStrategiesInsider.com, we analyze hundreds of stocks monthly, running through all of the parameters above to determine which companies are cheap, allowing us to get in and scoop up value in front of the herd.

We scan the market, looking for companies that have been pushed down below their true and actual value. We then analyze their balance sheet to ensure they're their current trading price is below market value, and based on their future growth expectations will likely rebound in the months to come.

One of the main reasons why we have such a high winning percentage is because we do all the hard work to find the situations that have the best chance of success and then apply the appropriate option strategy, allowing us to achieve the maximum benefit from each trading scenario.

# Letters and Testimonials

*"I have been working with options for nearly 30 years, I was a portfolio manager and an options education instructor for Bear Stearns before finally retiring. Let me just tell you, I was fully impressed with your services. Your videos are clean, easy to follow, and paint the perfect picture for trading options the right way. But what I really found valuable was your trading analysis. Your ability to find trades and then take the time to write a full report puts you one step above. You're a true professional who cares about his clients."*

*-James G.*

*"You guys really know the market, after reading one of your reports I thought, "wow, I'm getting in on this." And I am glad I did. You guys look at the market with a microscope and find the tiniest details that end up having a massive effect on value. I'm excited every time I see a new trade has posted and look forward to reading each trade reports. I am so much more confident in my trading now that I have found you!"*

*-Sam C.*

*"This class was great! Chris's approach to teaching is very engaging and his passion really shows. He explains everything in great details, so everything is easy to understand. I recommend Option Strategies Insider to anyone that is serious about learning to trade the markets."*

*-Mark S.*

*"I have been on a mission to learn options, it started a few years ago when I bought a book off Amazon, but soon found it to be too confusing to continue. Then about six months ago I watched one of your competitors' courses and it wasn't much better, it was just a lot of talk and words on the screen. I then somehow found Option Strategies Insider, and am I glad I did. You did an excellent job of taking a complicated topic and making it easy for anyone to understand. Amazing presentation, I am so glad I found your site."*

*-Harold B.*

"Learning how to trade options property can lead to more wealth than any other form of investment. I am not going to tell you it's easy, because it's not But once learned, you will have a viable skill that can lead to great wealth that no one can take away from you.

The best part about options is that it never changes, unlike other online businesses that get disrupted or cease to exist over time, options trading knowledge is a viable skill that can be applied forever. Once you have the skill it's yours to use for your entire life!

This is why I am such a proponent for learning how to trade options the right way from the start."

— Chris Douthit - OptionStrategiesInsider.com Founder

## Chris Douthit

Chris has a long history with options and an extensive education in finance. Holding an MBA and multiple finance degrees, Chris has put in the time and effort to learning the market fundamentals. As a professional trader for TFM, Spear, Leads & Kellogg and Goldman Sachs, Chris was fortunate to be trained by the top companies in the world and to work alongside some of the best options traders in the business.



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