

The Upside of Market Volatility

My *GPS Advisory Service* took full advantage of the market crash we experienced this month. The **Global PowerTrend System** shorted most global currencies, commodities and equities last summer and rode the wave down producing nice profits from short positions. But what now? How can investors who were not short during the crash profit now?

The upside of the increased market volatility is that option premiums have become very rich. If you purchase options you will pay a high premium due to the high market volatility. But if you are an option seller, you will receive high premiums in the form of cash credited to your brokerage account when you sell options. A great way to collect option premium is to purchase stock and sell a call option to create a covered call. Selling rich option premiums allows you to:

- 1) Collect cash income in your brokerage account
- 2) Buy stocks at a discount
- 3) Realize a good return on your discounted stock purchase
- 4) Provide downside protection in case your underlying stock declines in price

Let's take a look at a covered call trade I initiated this week. My brokerage confirmation below shows that I purchased 300 shares of Chesapeake Energy (CHK) at 20.16 and simultaneously sold 3 CHK Jan 10 25-Strike call options symbol WZYAE at 5.60 which expire in about 15 months. Selling the 25-Strike call at 5.60 results in \$560 cash per contract being credited to my brokerage account. This reduces the cost of purchasing Chesapeake stock to 14.56 per share ($20.16 - 5.60 = 14.56$).

The call option sale enabled me to purchase Chesapeake stock at a big discount and provides substantial downside protection. Chesapeake stock would have to decline below 14.56 at option expiration before this trade would incur a loss.

USD - US DOLLAR						
Trades						
Trade Date	Settlement Date	Trade Time	Action	Quantity	Symbol	Price
10/23/2008	10/28/2008	3:04:29 pm	Buy	300	CHK	20.160000
10/23/2008	10/24/2008	3:16:44 pm	Sell to Open	-3	+WZYAE	5.600000

The covered call analysis that follows displays the risk/reward profile for buying Chesapeake stock at 20.16 and selling the CHK 25-Strike call at 5.60. The table displays profit results for various price changes for CHK stock at option expiration from a 25% increase to a 25% decline.

Covered Call Analysis

Stock Name	Current Stock Price	Call Strike	Call Price	Break Even
Chesapeake Energy	20.16	25	5.60	14.56

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% Change in stock	25.0%	20.0%	10.0%	0.0%	-10.0%	-20.0%	-25.0%
Stock Price	25.20	24.19	22.18	20.16	18.14	16.13	15.12
Stock Profit/Loss	504	403	202	0	-202	-403	-504
Call Value	0.20	0.00	0.00	0.00	0.00	0.00	0.00
Call Profit/Loss	540	560	560	560	560	560	560
Net Profit/Loss	1,044	963	762	560	358	157	56
% Return	71.7%	66.2%	52.3%	38.5%	24.6%	10.8%	3.8%

The cost of this covered call is \$1,456 and is calculated by subtracting the 5.60 points I received from the sale of the 25-strike call from the 20.16 cost of CHK stock. The most we could lose on this covered call trade is the \$1,456 cost of the trade.

The Covered Call Analysis table above shows that a 10% increase in the price of CHK stock to 22.18 at option expiration would result in a 52.3% return for this trade. A 25% increase in CHK stock results in a 71.7% return. If CHK stock remains flat at 20.16 a 38.5% will be realized. This is a great return for such a low risk trade.

A 10% decrease in the price of CHK stock to 18.14 at option expiration would result in a 24.6% return for this trade and a 25% decrease in CHK stock results in a 3.8% return.

CHK Stock Goes **Up** 25% = 71.7% Covered Call Return

CHK Stock Goes **Up** 10% = 52.3% Covered Call Return

CHK Stock Stays **Flat** = 38.5% Covered Call Return

CHK Stock Goes **Down** 10% = 24.6% Covered Call Return

CHK Stock Goes **Down** 25% = 3.8% Covered Call Return

Average Return Potential of 57.7%

My brokerage account Profit/Loss Report below displays the covered call trades I initiated over the past week. I collected \$30,853.12 in cash income from the sale of these call options over the past week. This covered call portfolio has an average return potential of 57.7% demonstrating the substantial returns available from covered call trading and the upside of selling option premium during volatile markets.

Covered Call Trade Portfolio

Account Reports: Profit/Loss Report		PRINT					
<p>Give your accountant a break. View profits/losses for all trades executed on one specific date or during a range of dates. Track by position, whether it's closed, or still opened. Download to a spreadsheet for easy manipulation, processing and tax reporting.</p>							
Trade date:	<< [] >>	SELECT DATE					
Trade date:	<< [] >>	SELECT DATE					
Symbol:	[]	Submit	<input type="checkbox"/> Show detailed unrealized positions				
* To see all transactions within specified date range leave symbol blank			Guide to the Profit/Loss Report				
Unrealized P&L on Open Positions							
Symbol	Description	Position	Avg Price	Cost Basis	Market Value	Type	Unrealized Val.
+FCXEG	Freeport-Mcmoran Copper & Gold May 2009 35.00 Call	-3	-\$4.7183	\$1,415.48	-\$1,485.00	Stock Option	-\$69.52
+LLWAG	Peabody Energy Corp Jan 2010 35.00 Call	-3	-\$9.9782	\$2,993.47	-\$3,390.00	Stock Option	-\$396.53
+LVXAF	Southwestern Energy Co Jan 2010 30.00 Call	-3	-\$7.2782	\$2,183.47	-\$3,960.00	Stock Option	-\$1,776.53
+WBAAE	Bank Of America Corporation Jan 2010 25.00 Call	-3	-\$4.7683	\$1,430.48	-\$1,530.00	Stock Option	-\$99.52
+WKBAZ	Ishares Inc Msci Brazil Jan 2010 40.00 Call	-3	-\$4.9183	\$1,475.48	-\$2,580.00	Stock Option	-\$1,104.52
+WWRAG	Wells Fargo & Co New Jan 2010 35.00 Call	-3	-\$4.5283	\$1,358.48	-\$2,010.00	Stock Option	-\$651.52
+WYSAH	United States Stl Corp New Jan 2010 40.00 Call	-3	-\$10.8882	\$3,266.47	-\$3,390.00	Stock Option	-\$123.53
+WZYAE	Chesapeake Energy Corp Jan 2010 25.00 Call	-3	-\$5.5183	\$1,655.48	-\$1,830.00	Stock Option	-\$174.52
+YCPAZ	Cleveland Cliffs Inc Jan 2010 140.00 Call	-3	-\$7.3182	\$2,195.47	-\$2,070.00	Stock Option	\$125.47
+YHBAE	Bucyrus Intl Inc New Jan 2010 125.00 Call	-3	-\$5.2783	\$1,583.48	-\$2,190.00	Stock Option	-\$606.52
+YKYAG	Prudential Finl Inc Jan 2010 35.00 Call	-3	-\$10.6182	\$3,185.47	-\$2,550.00	Stock Option	\$635.47
+YMOAE	Petroleo Brasileiro Sa Petrobr Sponsored Adr Jan 2010 25.00 Call	-3	-\$6.4982	\$1,949.47	-\$2,640.00	Stock Option	-\$690.53
+YPXAF	Freeport-Mcmoran Copper & Gold Jan 2010 30.00 Call	-3	-\$6.7282	\$2,018.47	-\$2,520.00	Stock Option	-\$501.53
+YVKAE	Ishares Tr Msci Emerg Mkt Jan 2010 25.00 Call	-3	-\$2.6583	\$797.48	-\$1,800.00	Stock Option	-\$1,002.52
+YZGAG	Walter Inds Inc Jan 2010 35.00 Call	-3	-\$11.1482	\$3,344.47	-\$4,260.00	Stock Option	-\$915.53
BAC	Bank Of America Corporation	300	\$22.6888	\$6,806.63	\$7,251.00	Equities	\$444.37
BTU	Peabody Energy Corp	300	\$33.7417	\$10,122.50	\$10,353.00	Equities	\$230.50
BUCY	Bucyrus Intl Inc New	300	\$20.1417	\$6,042.50	\$7,239.00	Equities	\$1,196.50
CHK	Chesapeake Energy Corp	300	\$20.2417	\$6,072.50	\$6,591.00	Equities	\$518.50
CLF	Cliffs Natural Resources Inc	300	\$27.2646	\$8,179.37	\$8,097.00	Equities	-\$82.37
EEM	Ishares Tr Msci Emerg Mkt	300	\$19.4270	\$5,828.09	\$7,629.00	Equities	\$1,800.91
EWZ	Ishares Inc Msci Brazil	300	\$29.0117	\$8,703.50	\$11,298.00	Equities	\$2,594.50
FCX	Freeport-Mcmoran Copper & Gold	600	\$27.4367	\$16,462.00	\$17,436.00	Equities	\$974.00
PBR	Petroleo Brasileiro Sa Petrobr Sponsored Adr	300	\$23.1617	\$6,948.50	\$8,067.00	Equities	\$1,118.50
PRU	Prudential Finl Inc	300	\$32.5217	\$9,756.50	\$9,000.00	Equities	-\$756.50
SWN	Southwestern Energy Co	300	\$26.2417	\$7,872.50	\$10,686.00	Equities	\$2,813.50
WFC	Wells Fargo & Co New	300	\$30.0817	\$9,024.50	\$10,215.00	Equities	\$1,190.50
WLT	Walter Inds Inc	300	\$33.7117	\$10,113.50	\$11,625.00	Equities	\$1,511.50
X	United States Stl Corp New	300	\$35.5517	\$10,665.50	\$11,064.00	Equities	\$398.50
Total Unrealized Gain-Loss:							\$6,601.03