Picking The Option

1. Choose the DJX, SPX, VIX or ETF monthly option with a $2.50 average price.
    - Choose an option with a month that has at least 10 days left until expiry (third Friday of every month), or the following month.
    - Continue using this option, put and call, as long as they close no lower than $1.50, and no higher than $3.50. Remember to always look first for the put and call that has a closing price closest to $2.50
2. Find the Open/High/Low/Close (O/H/L/C). Analyze the O and the H price. Did the option go up in price at least 20%? Always round UP. Ex: Add 20% to the opening price and compute from there.
3. If the option did rise by 20%, the count is +2. If it did not, the count is 0. (Note: this is similar in count logic as the DJIA count averages used in our other example)
4. Next, analyze the L and C price. Did the option rise in price here by at least 20%? Again, round the number up for the calculation using the L first (Ex: 2.48 becomes 2.50). If it did, add +1 to the count. (2+1=3). If it did not, the count still remains 2. Important Note: Remember, you are choosing an option with this or next month expiry.
5. You use this month if there are 10 or more days left until expiry. If the price of the $2.50 average price put or call has a prior day closing price of over $2.50, you must change the option for calculation (put or call, but not necessarily both) to an option that does have a prior day closing price of $2.50 average.
6. Now, compare today's closing (c) price on the option to the prior day closing price. If the price today was higher than yesterday, add +3 to the count. If the same, add +2 to the count. If it was not higher, add 0 to the count.
7. If today's close was not higher than yesterdays, but not the same as yesterday, study if today's closing price was higher than the prior day close. Using the same 20% addition to the nearest equable price, and if it was, add +1 to the count; if not, add 0. With the above calculations made, the trader should now have a count from 0 to 6.
8. The trader should complete this calculation for both a put and a call. The count to the call can be identified as C+ the count, such as C5.
9. Once the count has been established for both put and call, analyze each count. If the put and call are not the same value, which is larger? Identify the difference as the final summation. Ex: If in the count the call is 3 and to the put is 1, the count is 2 to the call. If in the count the put is 4 and the call is 1, the count is 3 to the put. Important: If the count is both 0 for the put and the call, the count is 00. This will be used in our final analysis.
10. At the end of the first 10 steps you've identified which option, put or call, first shows more strength, and by how much. Remember, the count should now be 0 to 6.

Mechanized Formula/The Final Analysis

The trader now needs to analyze if the count strength has been taking place for some time, so we compare the closing price of today's session, and the prior two market days, for a total of three (3) sessions.

When an option changes, to keep with our rules, you do NOT need to go back and recalculate (change) the last three closing prices. Changes, for example, could come from three different strike points, but always compare today's close to yesterday's close of the same option.

- Did the call or put have at least 2 up closings in the last three days?
- If neither option had at least 2 up closings, the final count has already been established in the first 10 steps.
- If the put or call had 3 up closings in a row, add +4 to the count. If it had 2 up closings in a row, add +2 to the count.
- If the call or put had only 2 up closings in the past three days, with a down closing in between, only add +1 to the count.
- The final number you get from these calculations (Steps 1-10 and the final analysis) is the final Count, or directional strength bias indicator.

Important: If neither the call nor put had any strength in the first 10 steps, the count would have been 00. In this case, analyze again if there were up closings to the put or call in the last three days, and if the count was up in the first two of the last three days, add +2 to the count for either issue.

We want to define the strength to the bias. The simple count system we've shown above identifies classic O/H/L/C prices over a several day period in relation to one another for a high volatility OTM option.

The option itself is only the mathematical vehicle to provide the trader a starting signal to count from.

When the count is 5-9 there is continued strength, to the directional bias (meaning not too much overbought or oversold), and the definition to the count is most clear.

> Ex: If an Feb550C has a count of 6, its likely movement to the call will continue.
> If the same Feb550C has a count of 2, the directional bias is much less evident.

If the count to the put or call is 10 or greater, the count has established that the directional bias that direction may already be extended (overbought or oversold) and the risk to continued movement that direction is higher. If taking a position to an extended count, note that profit taking should be more modest in gains as it is more likely the direction could shift.

With a count of 5 to 9, it's likely the trend will continue.

When the count is 2-4, analyze again if in the first 10 steps if the count was ever figured at 00 (meaning there was no original bias to either the put or the call). If this is the case, analyze the count at 4 and review if 00 had occurred in the first 10 steps. If so, this does signal a count to the prevailing count; if not, do not trade counts 2-4.

Measuring Prime Around Average True Range

In addition to our standard methodologies of count and buy/sell, many index traders also use these additional calculations.

For example, in certain circumstances index options can rise dramatically the same day.
In situations that can be calculated to measure more of prime we find that traders can pay above prior day close (our rule of highest price to pay) to gain profits, and have found calculation models around Average True Range to do so.

As you'll remember, ATR (Average True Range) is a true range of movement:

1. H – L
2. Previous Close -Current High
3. Previous Close -Current Low

True Range (TR) is the greatest value derived from these calculations. The true Range is computed as the difference between the high and the low when the day's trading range is large.
If a large gap down: When the previous close is greater than the current day's high, the TR is the difference between the previous day close and the current day high.
If a big gap higher: When the previous close is lower than the current day's low, the TR is computed as the difference between the previous days close and the low of the current day.

The ATR is simply the average of the true ranges over a period of days. As each day of new data is calculated, the last is dropped. The ATR calculation is the number of days divided by the sum of the number of TR. Typically chart services begin with an ATR of 14.

Higher ATR valuations often occur at market bottoms. Low ATR values are often found also during sideways periods, such as those found at tops, and after consolidation periods.

When movement around prior day data is a "higher count" index options often can return greater short term returns of up to 40 to 60%, and moves often take place same day or in just a few days.

Here's what we do:

Using how ATR is calculated we assign "numbers" to the strength of a movement:

- **Take the Prior Day High minus the Prior Day Close. If this equals 95 or greater, signal strength is being defined. If it calculates below 95 take a reading of the Prior Day High minus the Prior Day Low. If this calculates 95 or greater, trade. We recommend taking reading on both put and call only if the primary measurement (the "count" position) does not calculate to 95 or greater.**

- **Measure this based on our existing 15 point Bell Curve Count using 2.50 averaged cost front month out of the money options (Ex: in January 2007 use January 07 out of the money options).**
  Ex: On January 3rd we recommend a count to the call of 3. Take your reading first to the call, using our calculation model on the website, to see if its prime measurement will be over 95.

Prime Measurements:

If the count is 4, 5, 6 and the ATR Prime Measurement is over 95, buy the option at opening price and look for 40% up returns.

If the count is 4, 5, 6 and the ATR Prime Measurement is under 95, buy the opposing option.

If the count is 1, 2, 3 and the ATR Prime Measurement is over 95, buy the option at opening, but the risk is higher, take potential tighter profits.

Prime Measurement - Option Value Changes

This is a variation on our standard bell curve count, based on the use of the Average True Range, and closing prices of OTM options. Using a higher volatility out of the money (OTM) option helps define the interest and value to the bias.

Take all information on all options shown, regardless of count, and calculate after the close

ATR/Prime Measurement buying is based on PM being between 75 and 250 and SM between 27 and 60. All initial buying should be done on the day following the signal based on the signal day's close (buy 0-20% below signal day close). If PM is 90 or more and the count is a signal in the opposite direction, trade the normal count bias direction with 30-45% profit goal

PM Measure the drop in cents, high to close
If 75 to 250 half the requirement is met

SM Measure the drop in %, high to close
If 27 to 60 the other half of the requirement is met

- ▲ If on the day the system trades an option the difference between the open and the close is $.90 or greater, this is a bargain buy indicator. Add 2 to the normal bell curve count for the put or the call

Unlike our normal count, if moving to a new option expiration if the old option traded at $1.25 or higher, trade the old option for this prime measurement

- ▲ Remember, you <u>do not</u> need to change the call and put option every night. Once you've made your choices you stay with them unless they close outside the $1.50 to $3.50 range, or if there is less than two weeks to the option expiration.
- ▲ At the close of each trading day you calculate the count using the options you were following that day. This gives you the count for the next day's trading signal. You then check to see whether either or both options closed outside the $1.50 to $3.50 range.

- ▲ If either option closed outside the range change only that option(s) to one that has closed closest to $2.50 for use on the next day, both for trading (if appropriate) and calculations at the end of that next business day.
- ▲ You do not have to change them in pairs, unless both closed outside the range. Also, you do not need to go back and recalculate/change the last three closing changes. Those changes can come from 3 different strike prices, but make sure you compare today's close to yesterday's close of the same option.

Prime Measurement Reversal Logic: When studying this count of prime measurement and there is no signal, but the Bell Curve Count does show one, check the PM. If it is 100 or larger, and the initial count bias is to the opposing count, trade the Bell Curve count directionally.

Prime Measurement by Way of Option Value-Secondary Measurement

- ▲ When the PM is less than 75:

1. If PM = 70, SM must be at least 25
   If PM= 60 to 65, SM must be at least 30

2. If SM does support the decision, then measure High to Low
3. PM and sometimes SM must now be:
   PM of 75 plus
   SM of 27, if original value was 25 or 26
   SM of 29 or greater, SM value must be greater by 4 or more

If the low was the same as the close, no re-measurement needed, unless there is an option change by our primary OTM option measurement. (Remember, this can be done with any index, or commodity, and shifted to an ATM or ITM option using proportional count measurements for the changes in value) Then replace the PM and SM values by measuring with the signal day prices of the new option, using High to Close

Buying Secondary Prime Measurement Options: The next day opening is the highest safe buy, but the buy price may not exceed the signal close by more than 25%. Do not pay more than $3.00 per contract.

The best available safe buy is to subtract 10% from the signal close, and try to buy within 10 cents of this, unless buy at market overrides this. (Again note that if ATM or ITM options are used proportionally change the values to reflect the type of option)

Rule of Thumb: *When targeting mark up profit goals, add the profit goal to the best available buy price of the range, even if you bought higher in the range.*