TRANSCRIPT

Interview with Glenn Neely
Trading Advisor & Founder of NEoWave, Inc.

The Benefits of Trading Options

This newly integrated feature of NEoWave's Trading service enables you to reduce risk and lock-in profits during sideways and choppy markets.

Announcer: Welcome to Glenn Neely's quarterly interview series. He is the founder NEoWave Incorporated, which provides money managers and traders worldwide with detailed market strategies to enhance their trading results. Now, here is your host, Brandon Clay.

Brandon Clay: Glenn, it's so good to chat with you again. Today, we're talking about Options. You recently started a new service related to Options. Talk to me.

Glenn Neely: Actually, it's not a new service. It's a newly integrated part of NEoWave's Trading service. In the past, I only followed 4 markets for equities trading: the S&P, Gold, T-Notes, and the Euro currency (SPY, GLD, TLT, and FXE). I've been doing this for most of my career, which is now 36 years. But for the last several years, 3 of those 4 markets were so dead that they stayed in the same range for 3 long years.

There were just no trading opportunities. I realized we were missing out a lot, even though I thought having 4 completely independent markets would be a good way to trade and track markets. Those 3 out of 4 were just doing nothing for so long that we hardly had any trading to do in those 3 markets. I got tired of waiting, and decided we had to expand into many more markets.

So, last year, I did an experiment. I actually traded or started analyzing all 8,600 stocks and ETFs on all the major exchanges. I had programmed scanning technology into TradeStation, and it would go through and apply all these different criteria, and try to find viable investments in over-sold or over-bought conditions for various ETFs and stocks. After doing that for a year and then surveying all my customers, most of them really didn't like the individual stock strategy. They wanted to stick to ETFs, and phase out all of our individual stock positions. So our NEoWave Trading service just kept our ETFs, and I'm now focused only on the top 50 to 100 most active ETFs on all the exchanges, and using those to trade directly or through Options.

The reason I began using Options is because, after doing research for a few years in preparation for this improvement to the NEoWave Trading service, I began to realize that it's possible to make money from markets when they aren't going anywhere. That was the biggest problem I had been experiencing, because 3 of the markets I had been following didn't go anywhere for 3 years. So, I realized that by selling Options premium on GLD, TLT, and FXE, we could actually make money if the market did absolutely nothing.

That's the reason I began researching and studying Options strategies and integrating them into the NEoWave Trading service. This way, we could start making money when the markets aren't going anywhere or if they're just chopping around, like they've been doing for the last 15 months.

Brandon: Okay. So, let me back up for just a second. There may be some listeners who aren't very familiar with Options. Could you give a real brief definition of what Options are and how you might use them?

Glenn Neely: Well, Options are a right to purchase an equity or an ETF at a particular price in the future, and they always have an expiration date. Most of them expire within three to six or nine months. Most people probably don't trade them much longer term than that, and a lot of people trade very short-term Options, looking for extreme leverage. Let's say you are buying Gold, which we did a few months ago right near the lows, and just recently – let me look up on my chart here – just recently we sold some GLD Options because I thought Gold was getting close to a short-term top. That means if it's going to go sideways, we could start losing money on the position if the market started to sell off, so we actually sold some Options.

Let me look up the exact details here. We sold the June 123 calls, so by doing that, we actually can bring in some money while this position, while this market goes sideways. The amount of money that was collected is called premium. When you write an Option, they give you the money instead of charging you for the position. So, if you were to buy an Option, you obviously pay the money and it's taken out of your account, and it's either gone – or when you sell the Option – you can get some or all or more than all of your money back.

When you sell it, you're limited to a specific amount of potential profit, but every single day that passes, the amount of value for that Option declines. It's a very small amount, and it gets much faster. The Option value decays much quicker the last month of the Option. But I sold some June contracts here and brought in $2,900 in premium. And if I can wait till the end of June and hold that position the entire time, then I'll automatically make $2,900 extra, even if the Gold market goes sideways for the next 4 months.

So, that's the benefit of Options. It allows you to be less specific and less accurate. It sort of allows a lot of fuzziness to your trading and analysis. You don't have to get the exact top or the exact bottom. You don't have to have precise stops. You can make money while the market goes sideways.

With this position – I'll pull up the analysis on it and can actually tell you exactly what happened – in this position, as long as Gold closes at 123, which was the strike price of that short call, as long as it closes at 123 or higher, I'll make the entire, full premium on that Option. Anything from 123 or higher, the amount that I'll make in the expiration will be the exact same amount, which will be $7,160.

If it sells off, as it sells off, the premium will decay faster, but the long position that I have will also start losing money. So, the point where the position breaks even won't occur until about 114, so we would have to drop approximately 7% to 8% from current levels to break even. If I hadn't sold that Option, then the breakeven point would be at 118. So, it gives me 4 additional points, a buffer, for the market to play around and for me to still make money. So the market can drop more, and I can still end up making money. If I hadn't sold that, then I would start losing money a lot sooner. So, that's one of the major benefits of writing Options premium. It does limit upside, like if it goes up a lot, I'm not going to make any more than the $7,600, but it also allows a lot of...more downside and still not losing money.

Brandon: Just to confirm with you related to writing and selling, this is one of the things that if... You were going back and forth between writing an Option and selling an option. That is the same thing.

Glenn Neely: They're synonymous.

Brandon: Yeah, okay. I just want to make sure for people who may not be familiar with it. And also to confirm, the way you've been talking about it, the strategy that you're employing seems to be a writing or a selling strategy, not a purchasing or a buying strategy of Options. Is that correct?

Glenn Neely: No. I buy calls or I buy long stocks, and then I'll generally, if you're in an uptrend, then I'll sell premium on those positions at the point where it looks like the market is reaching resistance, or might go through a correction. So, whenever it's at a point where you think it might stop advancing for a while and/or start declining, that's when you can write Options against the position. Generally, I prefer to get in what's called a naked Option or a naked stock position at some oversold condition, then let the market bounce. And during the bounce is when you want to sell the premium. And when you do it this way, your profit potential is greater, you can lock in more profit. If you sell the Option at the same time you buy the stock or the long call, then your profit potential is less, but it still gives you much more buffer on the downside. So, the kind of purpose of selling premium is to increase the amount the market can drop and you'll still make money.

So, a lot of people make the mistake when they're trading, they're trying to make as much money as possible, and they forget about the risks they're taking. So, they may buy an Option with 1 or 2 weeks, they'll spend $1,000 and hope to make 10 times their money or 20 times their money, but in that situation, the odds of losing are probably 95% out of 100. So, my goal, and which should be the goal of any professional trader is return of your capital is more important than return on your capital. So, you always want to try to get your money back first, and then everything else is just, what they say in Louisiana, lagniappe, it's extra. So, you want to try to always get your money back, and writing premium increases your chances of getting your money back.

Brandon: Excellent. You also brought up this subject and the answer there that it's not just a writing of the option. Sometimes you're going along the stock, and maybe writing an Option on top of that position. So, some of the strategy you employ, and presumably is integrated into the service, involves multiple positions. Is that correct?

Glenn Neely: Oh, yes, absolutely. Right now, for our customer account, I have to look it up real quick, we currently have about almost 20 positions in all ETFs. And some of those are singles, which means they're just a call or long a put because these are bullish or bearish. And let me just check, so I can give you a percentage here. I would say about half of them, maybe a little bit more than half, are covered positions where we have a long stock and a short call, or a long call and a short call, so you know, a coverage. It's called a covered position where you're limiting your potential, but also limiting your risk. And then about a little bit less than half of them are directional trades.

And most of these are very recent, new directional trades. So, my hope, of course, is that the market will move somewhat in our favor. And then, after it does, if it's moved 20%, 30%, 40% in our favor for the Options, then I'll write some Options on those positions to bring in an extra amount of money, reduce the overall risk of the position, and allow us to make money if the market goes sideways.

Brandon: Okay. And do you view your positions as sort of like a portfolio of positions, you're not betting on any one particular...

Glenn Neely: Yes, that's another important criteria that a lot of people, when they trade are looking for that one great trade, and they want to focus on that situation, but then, of course, if your analysis is wrong, or your timing is off, you may buy an Option that expired before the move happens. So, it's a good idea to spread your probabilities around, spread your risk around. So, a lot of times things will just happen you don't expect. Like, I'm sure many of you have seen crazy stuff happen with Tesla, where all of a sudden, now the blue, it's zooming way up, or zooming way down. And these kinds of events are mostly unpredictable and you want to be there when it happens, but you don't necessarily know when it's going to happen.

So, by spreading your risk around, and then only focusing on positions that are making money and losing money, significant amount, not things that are just barely making or losing money, then you can actually take strategies that address the good positions and the bad positions. So, for example, in TradeStation, there's the ability to export all of your positions into an Excel spreadsheet. And I've paid my programmer to design this very sophisticated exporting process that organizes all my positions based on whether they're puts or calls, whether they're single positions, or whether they're covered positions, whether they're making money or losing money and how much and what percentage, and all of these details, and then it highlights the positions that are at risk, and highlights the positions that are making a lot of money.

So, if a position is, say, making more than 30%, 40%, then that's one that'll be highlighted and we can use a protective strategy such as writing premium to enhance the profit potential of that position. If a position is losing 20% to 30%, that position will be highlighted in red, and then I can address that by starting to scale out. That's another thing that most people don't do when they trade. They don't want to pay attention to the stuff that's losing money because they don't want to be wrong. So, they just sort of ignore the bad stuff, hoping it's going to get better, and the good stuff, they tend to want to get out very quickly because they're all excited, they're making money. But they're doing exactly the opposite of what really creates a profitable long-term portfolio. You want to let your profits run, and cut your losses short.

By having multiple positions, 10 to 20, maybe even 30, I usually have about 30 generally, where you spread all of your risks out, and you only risk 2% or 3% per position so your total risk is maybe pushing 100% but there are all kinds of different strategies: long, short, hedged, not hedged, covered, and so forth. And then you have the spreadsheet that I print out, and it just tells me which ones to focus on, the ones that are starting to lose too much, I start scaling out of them in thirds, you know, a third each day until the position either improves or until I'm completely out.

And the positions that are doing really well, I'll start writing premium on so that I enhance their profit potential and protect some of the profits. And then if it really starts making a lot of money, then I'll start scaling out of the profitable positions also in stages. So, if they're up like 60%, I might get off a third. This is for Options, by the way. So, maybe another third. And if they're up 120 or more, maybe get the whole position off. So, you're always wanting to scale out or your losers quicker, and hold your winners longer and protect them over longer periods of time.

Brandon: So, it's helpful to hear the philosophy behind what you're doing and why you're doing what you're doing. I'm thinking about the trader on the other side though. And they're not going to have all this information that's in your head and what you're doing. Of course, they want to know why you're doing it. But are you telling them? Are you saying, "Okay, it looks like this position isn't working out as well as we'd like it to. I want you to go ahead and scale out"?

Glenn Neely: Absolutely. We do it all the time. In fact, we just did that today. I can read you what I said in my Trading service email today.

Brandon: Yeah, let's do it. Yeah, I'm curious.

Glenn Neely: I have a position in the IWM which is the Russell 2000. And so I said, "This market continues to rally against our position. If you have more than one put spread open, exit half of all remaining positions and keep the other half. If this position continues to move against us later this week, we will probably exit the remainder." So, that's an example of getting out of a position. We'd already taken off a third of that position earlier in the week. And let me see if there's another example here where we hedged a position.

Brandon: And by hedging, it's going in your direction but you want to make sure that you're protecting your profits?

Glenn Neely: Yeah, when I say hedge, I'm saying that we're looking to write premium on a position that's already making money and doing well. So, let's see. GLD – here's a perfect example. I mentioned that to you earlier, and that's with the June contracts. I got to pull up my June. Okay. So, I said on December 26th, "This long position is making more than 35%, which gives us a chance to reduce the cost and risk of this position. Neely River and my MOAT Index tell us this market is getting close to resistance. And if you look up the 25th of December, let's see what that looks like. The correction started. It peaked four days later, and then it went sideways for three weeks. So, that allowed us to collect some premium while the market went sideways. That's a perfect example of using Options – you're not just waiting and not making money, you're actually making money while you're waiting.

Brandon: Perfect. And I'm trying to put myself in the other trader's shoes. As they're looking at these updates that are coming out, about how many trade adjustments, new trades, are happening each month?

Glenn Neely: It's hard to say. I mean, it depends on how active the markets are. Probably one to three a week. That's the total number of trades or adjustments. So, one to three updates per week approximately. It just really depends on how active the markets are.

Brandon: Okay. Well, that sounds pretty reasonable, because if you're doing 1 to 3 a week, you're looking at 4 to 12 per month. That's not a lot of activity for the trader.

Glenn Neely: And a lot of these, they're not new positions. They're just protecting old ones or scaling out of ones that are making money, or scaling out of ones that are already being held, so that's including everything. It's not new positions.

Brandon: Got it. And, of course, this is the only Options service that's out there that's following the NEoWave strategy. Is that correct?

Glenn Neely: Right. Well, it's a combination of NEoWave for forecasting and what I call Neely River, which is a trading technology. So, Neely River helps me to fine-tune entries a lot better than Wave theory can. Wave theory is a great at the extremes and it's great at telling you the direction or trend of a market, but it's not so great at telling you exactly how to enter a position, exactly where to put your stops, especially when you're far from the beginning or end of a trend. It's not going to tell you what kind of Options to buy. It's not going to tell you time frames necessarily. So, I use it more for direction, and I use River theory for specific entry points, and stop placement, and targets, and so forth.

Brandon: Okay. Well, so let me kind of wrap it up. As we're thinking about this Options service, if somebody is interested in trading Options, if somebody is interested in following an Elliott Wave strategy specifically, an enhanced Elliott Wave strategy like NEoWave, and if somebody wants a simple sort of strategy with not very many updates throughout the month, it doesn't take a whole long time to trade this, we're only talking about ETFs, not individual stocks, worrying about earnings reports, this is the kind of service they'd be interested in. Is that right?

Glenn Neely: Yeah, I mean, they also can pick which categories they want. We have four major categories. We have ETFs and World Equities, so we're trading equities and Options along all of the major ETFs in the U.S. that represent world economies and different categories of the U.S. economy. Then we have a Real Estate and Fixed Income category, which is a lot less active than our World Equities category. We have a commodity category, which include Gold, and Silver, and different commodity ETFs. And then we have a currency ETF, which also includes Bitcoin, Euro, and many different currencies.

Brandon: Awesome. Super helpful, Glenn. Thank you so much for your time going over this awesome service, and we really appreciate it.

Glenn Neely: Thanks Brandon.