



STOCK SPIN-OFF
I N V E S T I N G

Ultra Options Advisory

Ratings Guide

About the Author

Bruce Harper, CFA, earned his undergraduate degree in Econometrics from Stanford University and MBA from UCLA.

His experience with options goes back almost 30 years, even prior to beginning his career in the treasury department of a Forbes 100 company. He went on to senior positions in treasury, including managing the company's investment portfolios, where he used options not only for hedging corporate currency and interest rate risk exposure, but also while running top decile and quartile ranked institutional fixed income and balanced investment portfolios respectively.



Guide to Stock Spinoff Investing: Ultra Options Advisory

Welcome! This document is intended to serve as the official guide to the rating system that we use in developing the trade profile that we put together for every recommendation that we make in the Stock Spinoff Investing: Ultra Options Advisory.

The purpose of these trade profiles is to allow subscribers to quickly grasp the nature of the trade that we are writing up, and see where it rates across 7 critical dimensions, and therefore determine, at a glance, whether the trade is one that fits their individual criteria for a suitable options trade.

There are two main reasons that we do this:

- Knowing that no two investors have the same trading criteria, and wanting a convenient way for all subscribers to rapidly evaluate a recommendation's suitability for them
- To hold ourselves accountable, by making sure that trades play out like we think they will at the outset, and to learn and grow from our mistakes when they do not

We hope that you find them of value!

Let's dig in...

Near the top of every official Trade Recommendation write-up, you will see a box with icons that looks like this:



Each icon represents 1 of the 7 critical dimensions of the trade that we evaluate prior to releasing a recommendation. Below is a brief explanation of each icon and what the rating numbers mean:



INCOME POTENTIAL – represents the approximate percentage of the returns from the trade that we think will come from income (as opposed to appreciation of the underlying asset). Corresponding ratings and percentages are as follows:

- 5 = 100%**
- 4 = 60 – 99%**
- 3 = 40 – 60%**
- 2 = 1 – 40%**
- 1 = 0%**

Examples of options trades that will earn scores of 5 for Income Potential could be short puts or bull put spreads, where the entirety of our return depends on keeping as much of the initial premium earned as possible. Conversely, examples of option trades that will earn scores of 1 are Naked Calls, or OTM Bull Call Spreads, where our returns are entirely dependent on the appreciation or depreciation in the value of the underlying positions.



CAPITAL APPRECIATION POTENTIAL – this measure represents the approximate percentage of the returns from the trade that we think will come from appreciation (or depreciation, in rare cases) of the underlying stock price. This factor is the mirror image of the Income Potential since option returns are composed of the combination of these two. Corresponding ratings and percentages are, therefore, identical:

- 5 = 85 – 100%**
- 4 = 61 – 85%**
- 3 = 40 – 60%**
- 2 = 15 – 39%**
- 1 = <14%**

Other examples of option trades that will score 5 on Capital Appreciation Potential include Synthetic Longs and Call Ratios. Among those that have the potential to garner returns from a combination of both Income and Capital Gains include Covered Calls, or Diagonal Call Spreads.



TOTAL RETURN POTENTIAL – this factor represents a measure of how much TOTAL potential return we think the proposed trade has, considering both the income and capital appreciation components. This is going to be highly correlated with the degree of our conviction in the current level of undervaluation in the stock price and the strength of impending catalysts, as well as the availability and current pricing of options. We plan on using the following scale of potential returns for the ratings:

5 = 100% or higher

4 = 70 – 90%

3 = 20 – 70%

2 = 10 – 20% (likely reserved for income only plays)

1 = N/A



TRADE COMPLEXITY – this factor is a subjective measure of how easy or difficult the trade will be to understand and execute. Education about the uses of different option strategies is a big part of the reason that Rich and I launched The Options Advisory and we expect that, over time, using these strategies will become a lot more routine and comfortable trades for all subscribers. Our hope and expectation is that subscribers will be able to apply these strategies to other stocks they find that would be good candidates for options trading. We are defining “Average Complexity” as being able to execute a basic spread trade – simultaneously buying one call or put and selling another call or put, while a High Complexity trade might be an Iron Condor, which requires at least 4 call and put contracts at different strike prices.

5 = Very Simple

4 = Below Average Complexity

3 = Average Complexity

2 = Above Average Complexity

1 = High Complexity



MARGIN IMPACT – this concept is likely to be very familiar to seasoned options traders, but less so for those with lighter experience. Basically, whenever you **sell** a put or a call, your brokerage will expect that you have the cash to execute the trade, or sufficient margin credit in your account to “cover” entire amount of the potential loss. The simplest way to understand the concept: If I sell 1 put on XYZ stock at \$50, my brokerage will expect that I can cover the potential losses of \$5,000 (100 shares x \$50) if the stock declines all the way to \$0. If I happen to have \$5,000 in cash in my account not allocated to other trades, then this is what’s known as a “cash secured short put.” If I do not have the \$5,000 in cash, my brokerage will only allow me to make the trade if I have sufficient margin credit in my account. Selling puts and calls without sufficient cash to complete the trade in a worse case scenario is a surefire way to receive a dreaded margin call, where the brokerage force liquidates your holdings at their discretion until the account has enough cash to cover the actual losses. **YOU SHOULD SEEK TO AVOID THIS SITUATION AT ALL COSTS – NEVER RISK MORE THAN YOU ARE ABLE TO AFFORD TO LOSE, NO MATTER HOW FAVORABLE THE TRADE DYNAMICS APPEAR.**

To ensure that you are aware of the potential impact of a recommended trade on the cash or margin credit balance in your account, we will provide a margin impact rating that **reflects how much unallocated cash you should have on hand in your account in order to cover the potential worst case losses from 1 contract/position of the recommended trade.**

5 = \$0 - \$1000

4 = \$1000 - 2000

3 = \$2000 - \$5000

2 = \$5000 - \$7500

1 = >\$7500



RISK – this measure represents the subjective relative riskiness of the trade under proposal, with the 3 or Average score assigned to trades that are equivalent in risk to holding a long position in the stock.

5 = Extremely Low/No Risk – Arbitrage Opportunities

4 = Somewhat Lower Risk – Covered Calls, Cash Secured Puts

3 = Average Risk – Equivalent to Long Exposure to the Stock – Synthetic Longs

2 = Above Average Risk – Most Option Trades

1 = High Risk – Extremely Low Probability of Success – Naked Puts and Calls



TIME – this measure represents the approximate maximum length of time that we see holding the trade in our accounts. Keep in mind, if the catalysts for stock price appreciation take place, we will have no issues liquidating our positions and taking profits, so this meant to be a conservative estimate. If some of these time frames seem on the long side for option trades, keep in mind that we also foresee using LEAPS in situations where they are available and allow us to gain exposure to the stock at highly favorable costs relative to the underlying fundamental value of the company.

5 = 0 – 1 Month

4 = 1 – 3 Months

3 = 3 – 6 Months

2 = 6 Months – 1 Year

1 = >1 Year