The Wheel Strategy

Options strategy for collecting low-risk premium or buying stocks at a discount

Ken Zill

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PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

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My Story

- I started trading in 1978 while in high school, just buying and selling stocks. My introduction to trading options began around 1989. I was buying puts and calls on commodities.
- Around 1990 brought the internet, charting software, and end of day data.
- In 1995, I learned about selling options and using probabilities from the book, “Trade Like a Bookie” by David Caplan. That lead me to developed my trading strategy based on selling puts and calls.

Option Statistics

- 60% of the time, markets have no trend
- 80% of all options expire worthless
- 100% of options lose all of their time value

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What is The Wheel?

The Wheel is a low-risk option selling strategy to collect premiums on a stock you don’t own, but wouldn’t mind owning at the right price. The goal of The Wheel Strategy is to collect premium and avoid being assigned. But if you are assigned, you understand that you will have to buy and hold the stock. From the collection of premium, the cost basis of the stock is lowered, giving you an increased probability of being profitable. If done correctly, it is difficult to ever have a loss, and monthly returns of 10+% are very possible.

Who should use The Wheel?

It is important to understand that you will be required to have the necessary buying power to buy the stock, in order to do this trade. In other words, you will need to have the cash or margin in the event you are assigned. For non-margin accounts, you will be required to have the full amount of cash to buy the stock. If the strike price of the stock is $200, and you sell one put contract, you will need to have $20,000 in your account. Margin accounts must be approved and usually require minimum balances. So, keep in mind your account size and cash or margin requirements when choosing a stock. The strategy can be done on lower priced stocks.

Who should use The Wheel? - Cont.

If you have used a buy and hold strategy in the past, you might be a candidate for The Wheel. If you have ever sold a covered call, The Wheel can take your returns to another level. If you plan to buy a stock, why not buy it at a discount? Each time you sell a put, you are lowering the cost basis until you get assigned the stock. It is not uncommon to have sold 3-4 puts before being assigned the stock. And then you are lowering it further by selling covered calls. In addition, you could be collecting a dividend, which lowers the cost basis even more.

Who should use The Wheel? - Cont.

If you don't have a lot of buying power, or you don't want to use a lot of your buying power, or if you don't want to be stuck holding a stock, then The Wheel strategy probably isn't for you. In this case, you may want to look into vertical spreads, or other option spread strategies.

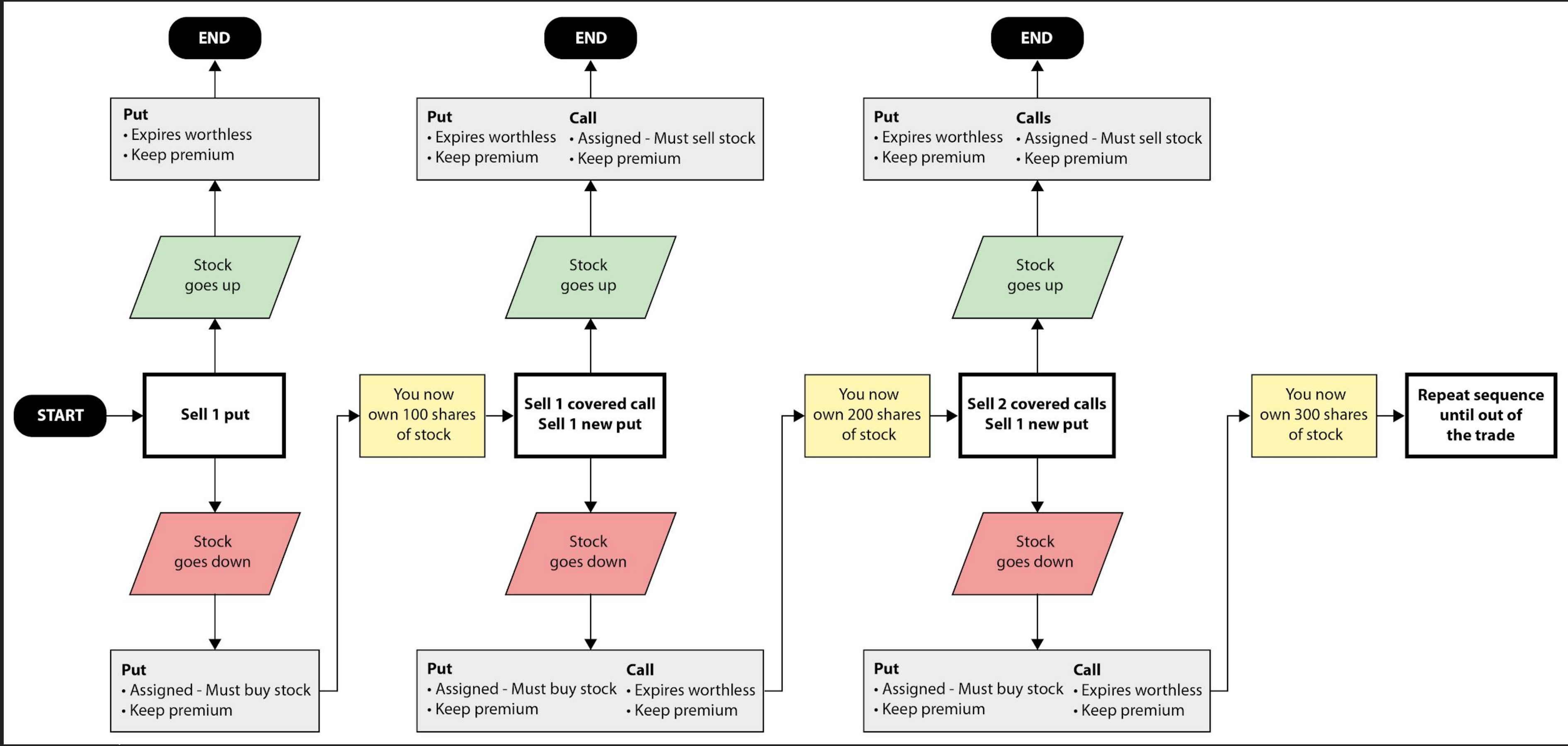
How it works

1. Sell a naked put, out of the money, at a strike price where you don't think the price will go in the next 30 to 45 days.
2. If it expires out of the money, you keep the premium and sell another put.
3. If the stock price is below the put strike price on expiration, you must buy the stock at the strike price. You then sell a covered call and also sell a new put. You will want to sell your covered call at a strike price that is above your cost basis.

How it works - Continued

4. If the stock price goes above your covered call strike price, you must sell your stock at the strike price, and you keep all the premium.
5. If the stock price stays below your covered call strike price, the call expires worthless and you keep the premium. You sell another covered call, and you sell another put. You repeat this sequence until your stock is assigned.

The Process



END
Put
• Expires worthless
• Keep premium
Stock goes up
START
Sell 1 put
Stock goes down
Put
• Assigned - Must buy stock
• Keep premium
You now own 100 shares of stock
END
Put
• Expires worthless
• Keep premium
Call
• Assigned - Must sell stock
• Keep premium
Stock goes up
Sell 1 covered call
Sell 1 new put
Stock goes down
Put
• Assigned - Must buy stock
• Keep premium
Call
• Expires worthless
• Keep premium
You now own 200 shares of stock
END
Put
• Expires worthless
• Keep premium
Calls
• Assigned - Must sell stock
• Keep premium
Stock goes up
Sell 2 covered calls
Sell 1 new put
Stock goes down
Put
• Assigned - Must buy stock
• Keep premium
Call
• Expires worthless
• Keep premium
You now own 300 shares of stock
Repeat sequence until out of the trade

Cost Basis

Keep records of each iteration of The Wheel, to always know your cost basis.

1st iteration
Cost basis = (Strike price from sold put) - (Premium collected from sold put)

2nd iteration
Cost basis = (Previous cost basis) - (Strike price from new sold put) - (Premium collected from new sold put) - (Premium collected from sold call)

3rd iteration
Cost basis = (Previous cost basis) - (Strike price from new sold put) - (Premium collected from new sold put) - (Premium collected from 2 sold calls)

And so on. Repeat sequence until out of trade.

Cost Basis Example

Action	Date	# of Shares	Premium Collected	Cost	Total	Status
Sold put	6/14/19	100	$5.52		$552.00	Closed
Assigned from sold put	7/22/19	100		-$65.00	-$6,500.00	Closed
Sold put	8/5/19	100	$1.02		$102.00	Expired
Bought put	8/6/19	100	-$0.15		-$15.00	Closed
Sold put	8/7/19	100	$0.95		$95.00	Expired
Sold calls	8/22/19	100	$1.65		$165.00	Expired
Sold puts	10/15/19	100	$1.10		$110.00	Expired
Sold calls	11/26/19	100	$1.85		$185.00	Expired
Bought calls	12/6/19	100	-$0.10		-$10.00	Closed
Sold calls	12/26/19	100	$1.00		$100.00	Closed
Called away from sold call	1/21/20	100		$66.00	$6,600.00	Closed
Total premium collected			$12.84			
Total profit					$1,384.00	
Running cost basis	-$77.84					
Return on investment	21.29%					
Annualized ROI	37.22%					

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Wheel Trade Example

6/14/2019 — TNDM had a big drop. When it was around 63, I sold 1 put. I sold the July 19, 2019 65 strike put for $5.52 of premium, for a total of $552.

My cost basis = (Strike price) - (Premium collected)

Cost basis: $65 - $5.52 = $59.48

I won't lose money unless it drops below $59.48

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Red line is put strike price

Green line is call strike price

Blue line is cost basis, or break even

Wheel Trade Example - continued

7/19/2019 — On expiration day, TNDM closed below the 65 strike price and I was assigned 100 shares of the stock.

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Red line is put strike price
Green line is call strike price
Blue line is cost basis, or break even

Wheel Trade Example - continued

8/05/2019 — I sold 1 August 16, 2019 55 Put for $1.02

My cost basis = (Previous cost basis) - (Premium from new sold put)

Cost basis: $59.48 - $1.02 = $58.46

I won’t lose money unless it drops below $58.46

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Red line is put strike price

Green line is call strike price

Blue line is cost basis, or break even

Wheel Trade Example - continued

8/07/2019 — I sold another 1 August 16, 2019 55 Put for $0.95

My cost basis = (Previous cost basis) - (Premium from new sold put)

Cost basis: $58.46 - $0.95 = $57.51

I won’t lose money unless it drops below $57.51

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Red line is put strike price

Green line is call strike price

Blue line is cost basis, or break even

Wheel Trade Example - continued

8/09/2019 — I waited for a bounce and sold 1 August 16, 2019 69 Call for $0.40

My cost basis = (Previous cost basis) - (Premium from new sold call)

Cost basis: $57.51 - $0.40 = $57.11

I won’t lose money unless it drops below $57.11

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Red line is put strike price

Green line is call strike price

Blue line is cost basis, or break even

Wheel Trade Example - continued

8/16/2019 — Even though TNDM dropped considerably, I had picked a low enough strike price that both puts (55 strike) expired worthless. Also, the 69 Call expired worthless.

Red line is put strike price
Green line is call strike price
Blue line is cost basis, or break even

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Wheel Trade Example - continued

8/22/2019 — This looked like the top of a trading range so I sold 1 September 20, 2019 70 Call for $1.65

My cost basis = (Previous cost basis) - (Premium from new sold call)

Cost basis: $57.51 - $1.65 = $55.46

I won't lose money unless it drops below $55.46

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Red line is put strike price

Green line is call strike price

Blue line is cost basis, or break even

Wheel Trade Example - continued

9/20/2019 — The 70 Call expired worthless.

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Red line is put strike price
Green line is call strike price
Blue line is cost basis, or break even

Wheel Trade Example - continued

10/15/2019 — I sold 1 November 15, 2019 50 Put for $1.10

My cost basis = (Previous cost basis) - (Premium from new sold put)

Cost basis: $55.46 - $1.10 = $54.36

I won't lose money unless it drops below $54.36

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Red line is put strike price

Green line is call strike price

Blue line is cost basis, or break even

Wheel Trade Example - continued

11/15/2019 — The 50 Put expired worthless.

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Red line is put strike price
Green line is call strike price
Blue line is cost basis, or break even

Wheel Trade Example - continued

11/26/2019 — I sold 1 December 15, 2019 75 Call for $1.85

My cost basis = (Previous cost basis) - (Premium from new sold put)

Cost basis: $55.46 - $1.85 = $52.51

I won't lose money unless it drops below $52.51

I got lucky with this one and picked the top.

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Red line is put strike price

Green line is call strike price

Blue line is cost basis, or break even

Wheel Trade Example - continued

12/06/2019 — I bought the call back after 7 days for $0.10.
My cost basis = (Previous cost basis) - (Premium from new bought call)
Cost basis: $55.46 + $0.10 = $52.61
I won’t lose money unless it drops below $52.61

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Red line is put strike price
Green line is call strike price
Blue line is cost basis, or break even

Wheel Trade Example - continued

12/26/2019 — I sold 1 January 17, 2020 66 Call for $1.00

My cost basis = (Previous cost basis) - (Premium from new sold put)

Cost basis: $55.46 - $1.00 = $51.51

I won’t lose money unless it drops below $51.51

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Red line is put strike price

Green line is call strike price

Blue line is cost basis, or break even

Wheel Trade Example - continued

01/17/2020 — The 66 Call was assigned and I had to sell the stock.
I was originally assigned the stock at $65 and sold it at $66 for a profit of $1.
Throughout the trade, I made $13.49 in premium. All together I made a total of $1449.00 (minus commissions) in a little over 7 months. This comes out to 22.29% ROI, and 39.08% Annualized ROI.

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Red line is put strike price
Green line is call strike price
Blue line is cost basis, or break even

Finding stocks to trade

1. Start with good profitable companies that you would own as an investor.
2. Find stocks that are becoming oversold.
3. Stock prices between $30 to $80
4. High volatility
5. Big drops for no logical reason
6. Rolling stocks
7. Dividend stocks

Choosing a Strike Price

1. Probability of 75% to 80% out of the money
2. Delta of -.20 to -.25
3. Desired return

Choosing an Expiration

1. 30 to 45 days
2. If theta is good, up to 60 days
3. Under 30 days if volatility is high

Managing Trades

1. Don’t be greedy. Buy back your put when it reaches 75% of the total premium.
2. Stagger your position. Enter with half or less of your position and add to your position if the stock continues down.
3. Stock should be moving down when you sell your put
4. Stock should be moving up when you sell your call. Don’t necessarily sell your call immediately after getting assigned. Wait for a bounce.

Pros/Cons

Pros

- Simple, repeatable strategy
- Relatively safe and reliable
- Don’t need to be exact on entry
- Buy stocks at a discount
- Almost can’t lose
- Reliable monthly returns

Cons

- Need a lot of capital
- May have to hold stock for a long time
- Not huge returns

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Thank You!

Contact Info:

Ken Zill

ken@doorwaytothesun.com

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