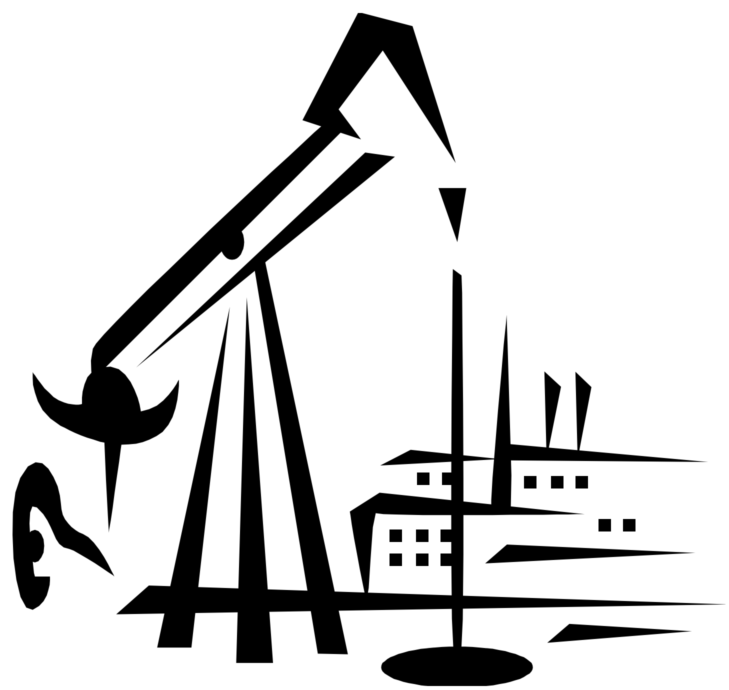
How To Be An Oil Speculator

Special Report



By John Roberts

LiveLearnAndProsper.com

How To Be An Oil Speculator by John D. Roberts

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How To Be An Oil Speculator

We hear about oil speculators quite often in the news these days, especially when the retail price of gasoline is going up.

Oil speculators are often portrayed as making a great deal of money in the oil markets. And they are often maligned for their profits by the mainstream news and Washington D. C. as well.

But we'll leave all of that judgment to the pundits.

Because all media reporting aside, what you may not know is that just about anyone can be an oil speculator if they choose. Certainly anyone who has a stock market account can do so.

So if we can't beat them, why not join them. Which is what we are going to do in this special Live, Learn and Prosper.com report.

We're going to look into this fascinating, and possibly lucrative subject of oil speculation. And I'm going to show you how you can do speculative oil trades yourself. Believe it or not, you can probably do this method I will show you in your IRA account.

And I'm going to show you the specific details of a profitable oil speculation trade I have on right now as I write this special report. The trade is up 49% in just eight weeks. Try getting that kind of a return in a savings account, or by buying bonds, or even stocks.

And I'm going to share with you the specific trade, the nitty gritty details, lifted right out of one of my personal trading accounts. And yes, it's an IRA account.

Furthermore, I'm going to share with you my special technique for putting this trade on, my rationale for doing it, and tips so you can trade this way too.

This little known technique is one of my favorites because, in theory, it can put me in the enviable position of 1) not losing or 2) winning, for a brief period of time. Compare that to the normal position of losing or winning and you see what I mean by "enviable position."

And as an added bonus, you will find you can apply this technique to other speculations besides oil in the right circumstances.

Now that's a pretty hefty list of advantages for this oil speculator technique, don't you think? So let's get into this thing and see how it works and how you can do it too.

Speculators

Believe it or not, many people are speculators. And a lot of them don't even know it. So I'm always amused when I watch the news and hear about all of those evil speculators out there.

Broadly speaking, there are speculators and investors. Speculators are primarily interested in the price action of some security like a stock or an option or a futures contract.

Investors, on the other hand are interested in the return that a business will give them. So if you invested in the stock of a business that you had thoroughly researched, and you are doing it for the dividends it will pay you, you are probably an investor.

If you didn't do this, and you bought shares of a stock because you were hoping the price of the shares would go up, well, oops, you sound like a speculator to me.

Since just about everyone that is contributing to their 401ks or IRA's has this speculator mentality, I think we can throw away the negative connotation of speculators at this point and move on, don't you?

Oil Speculators

Oil speculators are very much interested in price action – so they are aptly named speculators.

They are specifically interested in the price of crude oil in the open world markets. It's all about price and price movement to them.

Now the big hitters in oil speculation are probably doing a lot of that in the commodity futures market instead of the stock market. They are speculating on large futures contracts of oil, or options derived from these oil contracts.

The commodities market is huge. It is sixteen times the size of the stock market. And to trade these futures contracts and options on them (and I've done it) you need a special commodity futures account and a whole new skill set.

So we aren't going to go there. Instead, we can do something similar in the stock market. And that's a market most people do have access to.

So what can we trade in the stock market, out of our stock accounts, that would involve oil? Glad you ask.

OIL Exchange Traded Funds

We are going to use a special technique with exchange traded funds to do our oil speculation. There are many exchange traded funds that you can trade out of your stock market account.

An exchange traded fund is a security that tracks some other securities or commodities or other things of value. And they trade just like stocks. So if you have ever bought or sold shares of stock, these work the same way.

They have a symbol, just like a stock does. And you can buy and sell shares of them just like a stock.

One of the most famous exchange traded funds (called ETF's) is the one that tracks the stocks of the top 500 corporations in America. It's called the S&P 500. You have probably heard about it. And its value literally goes up or down based on the changes in the value of the stocks of these top 500 companies.

And it has a symbol, just like a stock would. Its symbol is SPX. And you can look it up just like a stock, and see what its value is from minute to minute. And just like a stock you can buy and sell shares in it.

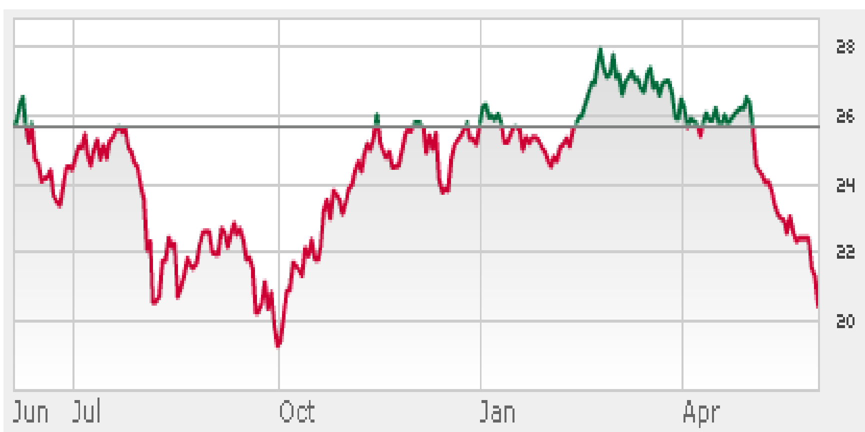
And there are many other ETF’s out there that you can buy. And some of them go up and down based on the market value of commodities, like corn, and wheat, ***and oil.***

Hmmm … I bet a light just went on in your head, didn’t it. Because I said there is an ETF for oil.

And your hunch is correct. We will do our oil speculation with the oil ETF. In fact, and how cool is this, the symbol for the oil ETF we are going to trade on is …OIL. Really.

You can go look up OIL in your stock market account and see how this ETF’s price goes up and down with the price of oil.

Here’s what that chart looked like on June 3, 2012. See how the price of oil has really been going down? That’s what’s made my oil speculator trade go up 49% -- but more on that in a minute.



Price chart – OIL ETF

So this is how we are going to trade oil out of a regular stock market account. But we’re going to do it in a special way.

We are going to use options.

Using Options On The Oil ETF

Now I'm not going into a full dissertation on options here because that would take be an entire book. But if you are really interested in them in detail, you might want to buy my book ***Stock Options For Beginners.***

What we are going to do here is give you just the bare basics on options so you can understand this trade.

Here they are.

You typically buy options because they give you leverage. Put another way, instead of buying a stock outright, you can pay much less for an option to buy the stock at a certain price by a future date.

And when you buy options, they are always for 100 shares of a stock, or 100 shares of an ETF in this case.

So our chart of the OIL ETF shows the price per share is about $20 a share. That means to buy 100 shares we would have to spend $2000. But right now in early June, if we buy options that are good through September, we probably only have to spend about $200 to control 100 shares.

We would pay $200 versus $2000. That's a big difference, yes?

So we use options for the leverage they give us with our money.

Or, said another way in options jargon, if we wanted to have the right to buy OIL shares at $20 a share from now until September, we would buy the "September $20 strike price" options.

Now here's the other thing about options. You can buy options that bet the price of the ETF will go up, or the price will go down. Options betting the price will go up are called "call" options. And if the price of oil, and the OIL ETF, does go up, your options go up in value.

As mentioned, you can also buy options that bet the price of oil, and the OIL ETF will go down. These options are called "put" options. And if the oil price really does go down, these options will become more valuable.

So call options mean you are betting the price of oil (and the OIL ETF) will go up, and put options mean you are betting oil (and the ETF) will go down.

So that's it for options for now. Now to our strategy.

Our Trading Strategy

So if we thought the price of oil was going to go up, we would buy call options on the OIL ETF. And when the price went up, our options would be worth more and we would make money.

Okay – that has a nice ring to it.

But what if the price of oil went down, and we had bought call options – meaning we were betting the price would go up? Hmmm … bad news – our options would lose value and we would lose money.

So instead, and this is our big strategy, we are going to bet oil will go up, and we are also going to bet oil will go down. That way we are sure to win on one of our bets, right?

Of course we will lose on the other bet, but doing this crazy thing actually does give us a chance to make money, as you will see in a minute. Even though we are literally straddling the fence with this trade.

And that is exactly what this technique is called. It's called a straddle.

Which is our next topic.

Doing A Straddle

Straddles are one of my favorite stock options trades, as well as a related trade called a strangle.

When we do a straddle we are buying call options AND put options on the same stock or ETF at the same strike price. In other words, we aren't choosing if the stock or ETF will go up or down, we are choosing both directions. We are straddling the fence, so to speak.

Let's just talk about stocks for a minute to get the basic straddle concept down. We'll use Microsoft stock as a straddle example.

So if the stock goes up, our call makes money but our put loses money. If the stock goes down our put makes money but our call loses money.

When you net this out it sounds like we will never make money, right? So why would we do a crazy thing like this?

Because if the stock moves enough in one direction, the profit will outweigh the loss and we will make money.

Look at this list of options (called an option chain) for Microsoft stock where the $32 strike price is highlighted. Using the Ask Price, if we buy a 32 strike price call for $74 and a 32 strike put for $95, then our trade cost us $169 (the prices are for one share, so 0.74 X 100 = $74, etc.).

MSFT Jun 19 2012 47 Days To Expiration										
Calls	Bid	Ask	Last	Op Int	Strike	**Puts**	Bid	Ask	Last	Op Int
29.0	3.00	3.10	2.97	1973	29.0	29.0	0.15	0.16	0.16	5232
30.0	2.12	2.14	2.16	2266	30.0	30.0	0.28	0.29	0.28	11712
31.0	1.33	1.34	1.35	4849	31.0	31.0	0.52	0.53	0.52	9735
32.0	***0.73***	***0.74***	***0.73***	***14462***	***32.0***	***32.0***	***0.94***	***0.95***	***0.93***	***5828***
33.0	0.35	0.36	0.35	45816	33.0	33.0	1.56	1.58	1.59	2169
34.0	0.15	0.17	0.17	13397	34.0	34.0	2.37	2.38	2.36	2102

Now if the stock price moves enough, one of the options will probably become worthless, but the other may increase in value beyond our original cost of $169. And that would make us money.

Or if the stock just moved a little bit, we would make a little bit on one option and lose about the same amount on the other. So theoretically we would not lose money.

And if the stock did not move at all, our option's value would stay about the same and we would not lose money.

Sounds interesting, doesn't it? There are only three things the stock can do – go up, stay the same or go down. But the only thing (again, theoretically) that can happen to us is 1) make money or 2) not lose money.

I like the sound of that, don't you?

Now we don't want to have this trade on for too long, because as time passes both options will start to lose money.

Now we don't want to have this trade on for too long, because as time passes both options will start to lose money. That's because of something known as time decay.

But if you know of a big event coming up, like a company is going to announce earnings in the next week or so, you can put a trade like this on. And if the earnings announcement is big news (good or bad, we don't care because we are proud fence straddlers) the stock will make a big move and you could make money.

And you didn't even have to pick the direction of the move!

Many times you will start making money before the announcement because other options traders will be eager to buy call or put options. They are making a direction bet. But you may benefit because they may be driving the option prices up, they are so eager to get in the game before earnings.

So sometimes I have seen both the calls AND the puts increase in value at the same time. And yes, sometimes they can both decrease in value. So when I say theoretically you can only win or not lose, you can actually lose, but typically just a little bit.

But overall, the thing plays out like we've described.

Now I mentioned a strangle as a related type of options trade earlier. So what's a strangle? A strangle in our example would be if I had bought a 31 call and a 33 put. I'm still betting on both directions, just out of the money on both sides.

Put another way, the options I buy are both further away from the actual stock price. That's what "out of the money" means.

So that's all you need to know about straddles – and strangles, as the case may be. To do them, you buy calls and puts on the same stock or ETF.

So let's see this in action, with a real OIL ETF trade.

The Winning OIL ETF Trade

You remember we said that if the price of a stock, or the OIL ETF, moved enough, that even though we lost on one bet, we made more money than we lost on the other bet.

So we were in profits.

This is exactly what happened to my OIL ETF trade. I put this trade on eight weeks ago as a strangle, and it is currently sitting at a 49% net profit.

Here are the specifics of that trade, lifted straight out of my trading account.

The price of the OIL ETF was about $25 dollars per share when I put this trade on in April. So technically I did a strangle since both the put and call options are a few dollars per share away from the $25 strike price.

Symbol	Qty	Cost	Mkt Val	Purchase Price	Last	Gain $	Gain %	Bid	Ask	Delta	Open Interest
OIL Sep 22 2012 30.0 **Call**	3	375.00	30.00	1.25	0.15	-345.00	-92.00	0.10	0.15	0.06	3690
OIL Sep 22 2012 27.0 **Put**	2	530.00	1320.00	2.65	5.75	790.00	149.06	6.60	7.00	-0.87	95
		905.00				445.00	49.17				

You can see that I bought three $30 Calls for $375. This was my bet that the oil price would go up.

And at the same time, I bought two $27 Puts for $530. This was my bet that the price of oil would go down.

Note that since a put cost more than twice what a call did, I bought three calls but only two puts to make my dollar exposure more even. To get even more precise about this, you can also consider something called the delta, which just shows how much the option price moves in relation to the ETF share price. But that discussion is beyond the scope of this report. You can learn more about deltas in my book ***Stock Options For Beginners***.

Now here's the thing. There was a lot of talk eight weeks ago that the price of oil was going to go up soon. One expert was even saying it was going to go way up, maybe over $180 a barrel – and very soon.

And this was quite plausible. There was a lot of tension in the Middle East at that time over the Iran nuclear enrichment issue. There was a lot of war talk going on.

But here's the thing about experts and reality. Sometimes the experts are wrong because reality doesn't play their game. Like what actually happened on this trade.

Instead of oil going way up, as predicted, it went way down. Oops.

Had I just bought the three calls, I would be sitting on a $345 loss. See, it's showing there in bright red type, just like it shows in my account.

But knowing oil can be a crazy thing to trade, I also bought those two $27 puts I mentioned.

And look at them. They have gone up in value by $790. So for the total trade, that's 49% higher than my $345 loss on the calls.

See what happened? By doing a strangle and playing it safe, instead of just going for the calls like the experts were saying to do, I've made a profit of $445 instead of a loss of $345.

I did this by simply hedging my bets. That's what straddles and strangles do for you.

Are you starting to see how oil speculators make money?

Now let's look at another scenario. Had the oil price actually moved upward like the experts were saying, I would have made a nice profit on the calls, and lost money on the puts. If oil had gone up significantly, I would have made much more money on the calls than I lost on the puts.

So that just leaves one other scenario, right? And that is if oil didn't move much at all after I put this trade on.

You'll like this. Because all of the options would have stayed at about the same value I bought them for. So I wouldn't have lost money.

That's why I said at the beginning of this special report that this technique puts you in a position, for a time, to either 1) not lose, or 2) to win.

So as crazy as it seems, there can be some extra safety built into straddles and strangles.

But not total safety, right? Because, all other things being equal, options, both the puts and calls, lose some value every day with the passing of time.

So this is not a long term play. You can't fall asleep on this trade like you might on stocks. Because all of your options will eventually go totally worthless on expiration date.

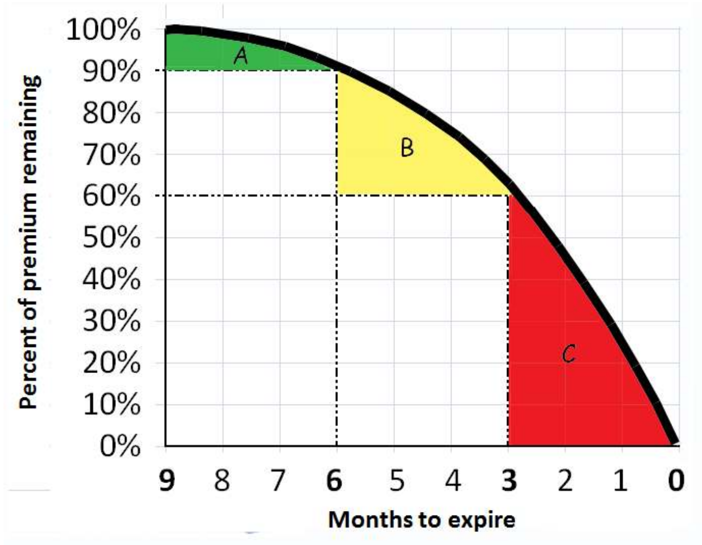
Which leads us to our tips and cautions for this kind of trade.

Tips And Cautions

Remember that you typically put this straddle trade on because you think there could be a big price movement in the NEAR future. **This is not a long-term type of trade.**

No matter how short term you think you are going to be in the trade, I would buy at least four months worth of time. For example, if the current date is June 1st, I would not buy options that expired any earlier than sometime in September.

Why? Because options start losing value very quickly in the last 90 days. And I mean both your calls and your puts. Just look at the chart below, and the red section, to burn this into your mind. See how options lose 60% of their value in the last 90 days of their life.



So if you think you are going to be in the trade longer than a few weeks, buy even more time. If you look at my trade, I thought it might take a few months to develop. So back in the beginning of April, I bought options that would expire in mid-September. That's six and a half months of time.

And as of this writing, on June 7, those September options are starting to look a bit long short-dated to me. So I will be out of this trade very soon. I seriously doubt if it will go more than another week or so before I pull the trigger and cash out.

And you can believe I already have a stop loss order set for the winning puts so if the market starts turning the other way on me I get out at a profit.

On the other hand, I'm not nearly as edgy and anxious on my losing calls. They are already paid for, and then some, by the winning puts.

And if the market turns around, they may start going up in value and I'll get some of that money back. If the oil price moves enough, I could even make a profit on them too.

If not, well, like I said, they are already paid for by the wins on the puts.

Summary

So that's how you can become an oil speculator. You play smart by playing on both sides of the fence. And we showed you a real, live trade where this actually works.

And as we said, you can do this in your regular stock trading account. And most IRA accounts will let you buy options in them (you may need to call your broker to set up options capability). And our live trade was done in an IRA account.

You use the OIL ETF as the basis for you oil speculation. And you buy put and call options on that ETF. This special trading technique is known as a straddle or strangle.

You do this because it gives you a chance to make money while hedging your bets.

And it puts you in a position, theoretically, to not lose (or just a little) or to win.

And that's a much better place than most traders position themselves, wouldn't you say?

To your health and prosperity - John

ABOUT THE AUTHOR

"It's not the years in your life that count, but the life in your years"

John Roberts is the Founder and CEO of Live Learn And Prosper.com, a leading newsletter and website where informed living meets success. His books and articles are known for their easy to understand writing style explaining complex things.

He's been a life-long investor and prior to founding LLAP, was a Financial Consultant and Stockbroker (formerly licensed with the New York Stock Exchange) and Senior Business Analyst. Before that, he managed the Corporate IT Department of a Fortune 500 Corporation, and earlier in his career, he served as the Senior Programmer/Designer for May Department Stores International, spending time in London, England designing and programming a large scale international foreign buying system. He also served in the United States Marine Corps.

But all is not work and investments in John's life. Called a renaissance man by his friends, he is also an award winning photographer, cartoonist, published author and avid sailor, believing that life should be an adventure.

He recalls one Thanksgiving finding himself single-handedly sailing his boat the ***Saline Solution*** in the Florida Keys — on the far edge of tropical storm Keith. He says when he finally made it back safely to port; it was the most thankful Thanksgiving of his life. He also allows this may have been a bit too much adventure.

John's had a lifelong commitment to self-improvement and achieving goals — for himself and teaching others. He had an early start in life achieving higher goals as a "lettered" fiberglass pole-vaulter in high school, clearing 12' when the world record was 17'. And still earlier, as a big brother teaching his younger twin sisters how to read before kindergarten.

John currently resides in Miami, Orlando or St. Louis — depending on when you ask him. When he's not too busy writing in Florida you can often find him soaking up sun at the beach.

Thanks for buying the How To Be An Oil Speculator Special Report.

Could you do me a favor and tell me what you thought of it, so I can write even better things for you in the future? I know you are busy, so just six little questions …

1) Did the report help you understand stock investing?

No ____ A little ____ Some _____ Quite a bit ____ A lot ____

2) Would you recommend it to a friend? __ Yes __ No

3) What are some things you liked about it?

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4) What could I have done better? Don't hold back here—I asked for it :-).

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5) How much did you know about the stock market before reading this book?

Not much ____ A little ____ Some _____ Quite a bit ____ A lot ____

6) Would you be willing to write your name and a testimonial below that I could use. **I protect your privacy by just using an initial and name, like J. Smith or Jane S.**

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Continue on the next page if you need room. ***And thank you so much for that.***

To your health and prosperity—John