

Third Edition

The background of the book cover is a collage of financial-themed images. It includes a close-up of a US dollar bill with the word 'STOCK' and 'Leader' visible. A gold-colored pen lies diagonally across the center. Below the pen is a line graph showing an upward trend, with a red arrow pointing to a specific point on the line. The graph is labeled 'FTSE All-Share Index' and has a timeline from 'Dec 1998' to 'Feb' and 'Close'.

Options *made* Easy

Your Guide to Profitable Trading

Guy Cohen

Praise for *Options Made Easy*

“This is one of the best books on option strategies I have ever read.”

—Daniel J. Zanger, President, Chartpattern.com

“Guy Cohen builds a foundation for the reader with simple definitions and clear mechanics on what can be a complicated topic. He then approaches each strategy with a context of fundamental and technical analysis and sets the stage for a solid understanding of risk, reward, and probability.”

—Dave Whitmore, Senior Strategist, Investor Education, E*Trade Financial

“Guy Cohen really does make options easy. Each options strategy has both a visual diagram of the risk and reward, as well as a logical explanation of how the strategy works. Combined with primers on fundamental and technical analysis, Guy shows you how to put the odds in your favor in today’s options markets.”

—Price Headley, Founder of BigTrends.com and author of *Big Trends in Trading*

“Guy Cohen has put together a comprehensive, easy to understand, must-read on options for investors of all levels. Practical in its approach, the graphics bring clarity to what beginning investors might consider complicated strategies.”

—Joseph Sellitto, CEO, Global Execution Brokers

“The best book on options I have ever come across.”

—Alpesh B. Patel, bestselling author of *Trading Online* and *Mind of a Trader*

“Guy Cohen cuts through the fog and helps all levels of investors grasp the most intricate concepts. He does so with great clarity and brevity despite covering such a broad set of topics. His is an invaluable guide for the interested beginner and the most advanced trader.”

—Ned Bennett, former CEO, optionsXpress, Inc.

Chart 4.2.3 ● Double top and trend break and reversal for PCLN (April–May 2012).

Source: OVI Charts. Courtesy of FlagTrader.com. Go to www.theinsideredge.com for more information.

The Rule for Double Tops

So, now we have three criteria fulfilled:

- (a) A double top
- (b) An uptrend broken and reversal to the downside (mid-May)
- (c) The last significant bottom breached to the downside (mid-May)

You can do one of the following:

- Exit your long position when the trendline is broken.
- Exit your long position when the bottom is breached.

Recap:

Diagram 4.2.1 ● Double top with trend break and reversal.

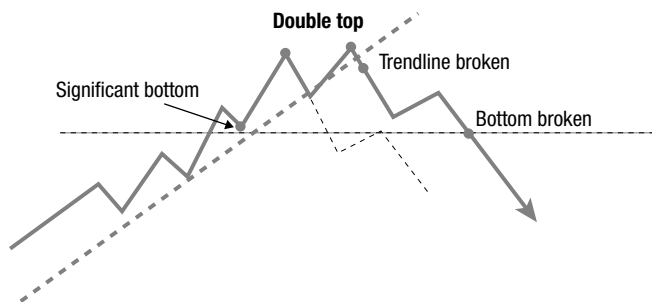
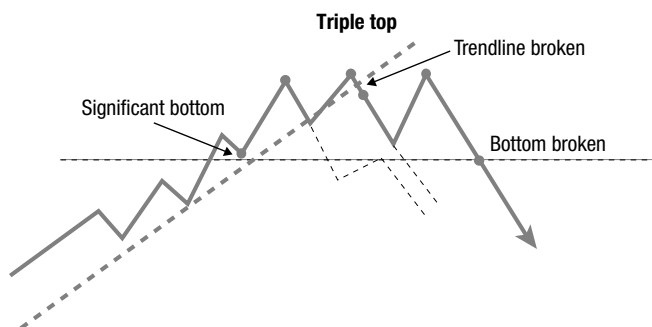


Diagram 4.2.2 ● Triple top with trend break and reversal.



The rule for triple tops is the same as for double tops. Look for one of the following:

- (a) A triple top
- (b) An up-trend broken and reversal to the downside (usually after the second top)
- (c) The last significant bottom breached to the downside

You can do one of the following:

- Exit your long position when the trendline is broken.
- Exit your long position when the bottom is breached and enter into a short position.

Double tops and triple tops summary

What the patterns mean.	<ul style="list-style-type: none"> • Weakness in the stock if it breaks down through the trendline after the second or third top.
What to do.	<ul style="list-style-type: none"> • Sell all holdings on breakdown through trendline. • Consider buying puts and/or selling the stock short.
How to identify the pattern.	<ul style="list-style-type: none"> • Two or three peaks (tops). • Broken upward trendline. • Reversal breaking down through latest significant bottom.
What is the cause?	<ul style="list-style-type: none"> • Lack of conviction in stock price appreciating beyond previous high.

Double Bottoms and Triple Bottoms

These work in the opposite way as double tops and triple tops.

In logical terms, the chart tells us that the (stock) price wasn't weak enough to fall through a previous low. Furthermore, it has the strength to break upward through the previous peak. This is interpreted as strength, and imminent price appreciation is likely.

Diagram 4.2.3 ● Double bottom with trend break and reversal.

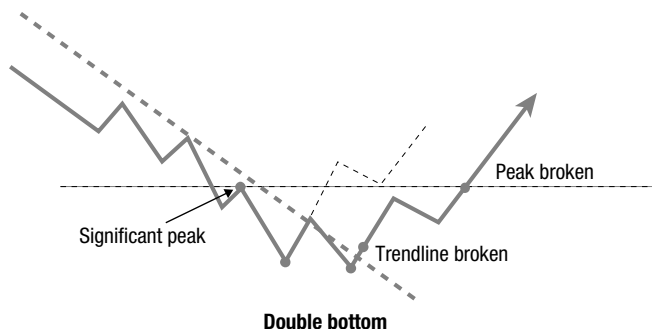
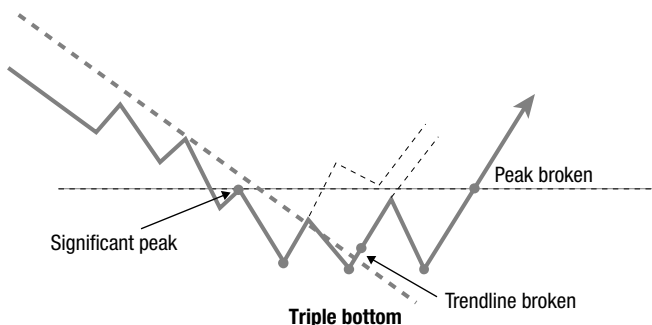


Diagram 4.2.4 • Triple bottom with trend break and reversal.

The Rule for Double Bottoms

- (a) A double bottom
- (b) A downtrend broken and reversal to the upside
- (c) The last significant peak breached to the upside

You can do either of the following:

- Enter your long position when the trendline is broken.
- Enter your long position when the peak is breached.

The rule for triple bottoms is the same as for double bottoms. Look for one of the following:

- (a) A triple bottom
- (b) A downtrend broken and reversal to the upside (usually after the second bottom)
- (c) The last significant peak breached to the upside.

You can do either of the following:

- Enter your long position when the trendline is broken.
- Enter your long position when the peak is breached.

Double bottoms and triple bottoms summary

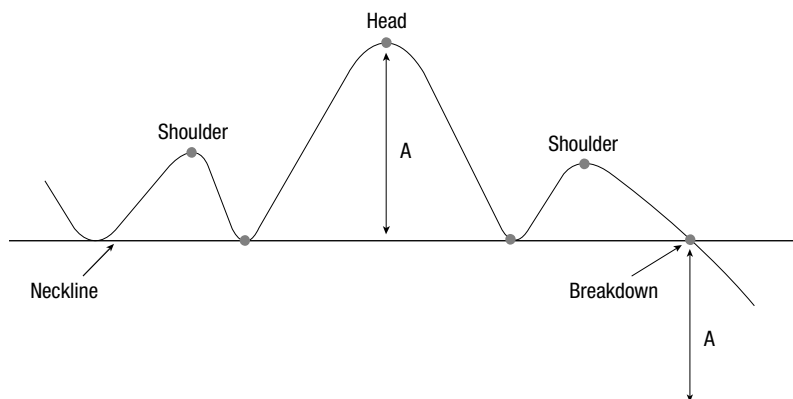
What the patterns mean.	<ul style="list-style-type: none"> • Strength in the stock if it continues up through the trendline after the second or third top.
What to do.	<ul style="list-style-type: none"> • Consider entering into a bullish position by buying the stock or calls.
How to identify the pattern.	<ul style="list-style-type: none"> • Two or three bottoms. • Broken downward trendline. • Reversal breaking up through latest significant peak.
What is the cause?	<ul style="list-style-type: none"> • Conviction in stock price appreciating beyond previous highs.

Time Tip

The longer the time period, the stronger the pattern becomes. A two-month double top (or double bottom) is a more powerful indicator than a ten-minute double top (or double bottom).

Head and Shoulders

Diagram 4.3.1 ● Head and shoulders.



A head and shoulders pattern occurs when a peak (head) is sandwiched between two lower peaks (shoulders). In logical terms, the chart is telling us that the (stock) price did not have the strength to rise through either preceding highs. This is interpreted as weakness, and imminent decline in the price is likely at

least the amount of distance (A) between the neckline and the middle (head) high.

Head and shoulders summary

- | | |
|-------------------------------------|--|
| What the pattern means. | <ul style="list-style-type: none"> • Possible weakness in the stock if it breaks the support line (neckline). |
| What to do. | <ul style="list-style-type: none"> • Sell all holdings on breakdown and consider buying puts and/or selling the stock short. |
| How to identify the pattern. | <ul style="list-style-type: none"> • From the neckline, a pattern develops as shown here. • First shoulder, head, second shoulder, followed by breakdown below the neckline. |
| What is the cause? | <ul style="list-style-type: none"> • A breakdown below the support line (neckline) of the stock. • One of the most reliable of the major reversal patterns. |

Chart 4.3.1 ● Head and shoulders for GS (February–May 2012).



Source: OVI Charts. Courtesy of FlagTrader.com. Go to www.theinsideredge.com for more information.