-GCRU-

Weekly Trading Service

"Change is the law of life. And those who look only to the past or present are certain to miss the future." – John F. Kennedy-

GCRU #720

●●● January 5, 2017 (in its 16th year)

KEY PRICES

Name/Symbol	JAN 4, 2017 price	Change	DEC 27, 2016 price
Gold (GCG17)	1165.30	26.50	1138.80
Silver (SIH17)	16.55	0.563	15.99
HUI (HUI)	192.28	19.14	173.14
Copper (HGH17)	2.557	0.0410	2.516
Crude Oil (CLG17)	53.26	-0.64	53.90
S&P500	2270.75	1.87	2268.88
U.S.Dollar (DXH17)	102.709	-0.298	103.007
30 Year T-Bond (ZBH17)	150 -22	2.04	148 - 18
10 Year T-Note Yield	2.450	-0.1130	2.563
13-week Treasury bill	0.518	0.0230	0.495

HAPPY NEW YEAR TO YOU ALL

Gold is starting the year on a positive note. It was up 6 out of the last 7 sessions, and it's looking eerily like last December's low and rise for the new year.

Gold ended up 8%+ for 2016; the first up year since 2012, and the best annual gain since 2011 when gold reached a record high. It's a good start on a big picture basis. Silver also gained, and it's better than gold; it's up 15%+ for 2016.

We sold our gold put spread at the right time, securing a 300% gain that helped to offset losses in gold during Q4-16.

Despite the Trump sell-off in gold during November and December, it ended on a positive note. This is good overall, especially since the U.S. dollar index has remained very strong, holding near 14 year highs.

It's saying the bull market is not dead. But it's wounded and we'll take advantage of ST moves.

The first half of the year was hot. A soaring rise that rose longer and faster than most anticipated. But then it fell, and fell more than most thought.

We're now in for a ST rise and trade. We'll take it from there, and be quick to take profits as they come up.

Gold shares are the most interesting market today.

Our **Chart of the Week** shows gold shares in an impressive situation. HUI is rising above its key 65-week MA as well as its 5-week MA. This shows gold shares gearing up for a rise. Once the 15-week MA is clearly broken above 194, a renewed rise will be underway. It's getting close.

HUI is also set to rise more than gold. Plus, junior mines are poised to rise more than seniors, as you can see on the chart. When this happens, it means gold shares and gold are both showing upside potential.

Our in-house gold share A/D Line, a leading indicator, has broken clearly above a downside wedge of its own and it's looking very strong with potential for more upside, see inside today's edition. We now recommend buying some GDXJ and AEM at mkt to take advantage of upside potential.

Wedges are breaking in many markets. This is also pointing to a change in trend. The changing parade continues…

For example, the Transportations peaked on Dec 8, followed by S&P500 on the 13th. Then gold, gold shares, the yen and bonds all reached a low on Dec 14-16. Silver and the Australian dollar finally reached a low on Dec 23, while the Dollar index has been resisting at the highs all December long.

If these highs/lows are not violated this month or next, then the changing parade is clearly here, and the breaking wedges are the early indication.

Our slate is essentially clean to add new positions.

We're still holding a small short on gold with GLL. We recommend selling half at mkt and keep the rest unless gold closes above $1200. We also have a put spread on the dollar index which is fine for now as it's been losing steam. Our put spread expires in Mar 2017.

Many of you have been asking us about our option strategy and options in general. **Matt Kerkhoff, from our sister letter "Dow Theory Letters",** recently published an excellent segment explaining option strategies and trading with great detail and precision. I've included this segment in today's issue at the end, after the "Open Positions" section for those of you who'd like to review it.

The gold chart shows a good reality.

Gold turned bearish when it closed below its 23-month MA in late November. A decline we call 'D' has been ongoing since August, and it tends to be sharp.... and it was. It's down 17 1/2% and it took over 4 months to decline to its December low.

The leading indicator then became extremely oversold which was saying the downside is limited and the lows are near, at least ST. We'll see how high this rebound rise will take gold, and if it'll rise back above its 23-month MA.

This new year rise is the start of a rise we call 'A'. An A rise tends to be moderate, and tends to be part of a consolidation period. If this is all we get for today's rise, then it won't necessarily be bad.

Bad would be a new low in the gold price below the December 2015 low ($1045).

Our outlook on today's purchases is precisely ST. That is, a ST position that we may end up holding longer than ST. We have several open orders to buy, and a few ones to "buy at market".

Interestingly, as powerful as the stock market has been this year, the Dow Industrials ended up gaining the same as silver did at over 15%. The bull market is clearly underway, but it's been consolidating and it still looks poised for more weakness ST.

The Transportation Average has been correcting and the Industrial Average looks toppy. We'll be looking to take advantage of weakness if and when it comes to secure positions.

We have open orders to buy into the strong sectors, banking, transportations, resource, energy and precious metals and their shares.

We've made some changes in the Chart Section below.

We've added a high-volume ETFs next to each of the commodities that make up our Market Leader Section. The idea is to provide an additional trading tool for those of you who would prefer to trade an ETF rather than the commodity itself or if your trading platform does not allow commodity trades.

In the case of gold and silver, we're recommending Sprott Physical Gold Trust and Sprott Physical Silver Trust. They're both trusts that follow the price of gold and silver accurately and are tradable in the NYSE and Toronto Exchange.

The main difference with GLD and SLV is that every share is backed by physical bullion and investors may, once a month and under certain conditions, take delivery of their gold and silver in exchange for the stock in the trust. Also, there are certain tax benefits, particularly for those of you who live in the U.S. and Canada. You can read more about it here: http://sprottphysicalbullion.com/sprott-physical-gold-trust/.

For Copper, Crude and the U.S. dollar, we've added JJC, DBO and UUP. For the 10 year yield we added TLT, which is a 20+ yr Bond ETF which moves inversely proportionate to interest rates.

It's important to understand that on any given trade, we don't recommend buying both the commodity and the ETF. It's two vehicles to choose from. Some prefer ETFs while others like the futures market.

Our strategy for this week is to pick up some gold shares and gold and silver. We have open orders to buy copper and other stocks. Keep a close eye and triggers ready as 2017 is shaping up to become a profitable year!

Good luck and good trading,

Omar Ayales
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MARKET LEADERS

GCRU

GOLD FEBRUARY 2017(GCG17) 1/04/2017
CLOSE = 1165.3

Sprott Physical Gold Trust (PHYS) 1/04/2017
CLOSE = 9.52

GOLD Put Spread (Insurance)	Bought Feb 2017 1140/1100 gold put spread at $500 & $550 (Nov30 - 16). **Sold put spread at $1,550 for a 300% gain.**

New Recom	**Buy some at mkt. Place stops at 2dc below 1100. Profit targets at 1245, 1315 & 1380.**	New Recom	**Buy some at mkt. Place stops at 2dc below 9. Profit targets at 10, 10.75 & 11.50.**

Gold finished the year with an 8% + gain for the first time since 2012 bolstering the case for 2016 as a turn-around year. It broke above a bullish downside wedge with an upside target near 1245. Moreover, gold has broken above its 5wk MA and ST resistance showing another sign of strength. Gold's move is looking like the start of a rebound rise we call 'A'. Notice Spinner breaking above zero for the first time since Nov showing growing momentum. This tells us gold is poised to continue rising ST. Keep in mind, gold has strong resistance at its previous support near 1200 and remains vulnerable below this level. If gold breaks above 1200 on a 2dc, we could see it shoot up to the wedge target near 1245 or the Jul downtrend near 1335. A break above 1335 means gold could test 1372. Buy some gold at mkt. We also recommend keeping half of your position in GLL for now.

SILVER MARCH 2017 (SIH17) 1/04/2017
CLOSE= 16.552

New Recom	**Buy some at mkt. Place stops at 2dc below15.75. Profit targets at 17.75, 18.50 & 20.50.**

Sprott Physical Silver Trust (PSLV) 1/04/2017
CLOSE= 6.28

New Recom	**Buy some at mkt. Place stops at 2dc below 6. Profit target at 6.60, 7 & 7.75**

Although not as bold as gold, silver is also rising from the Dec lows, breaking above a bullish downside wedge of its own. Today silver broke above its 5wk MA showing a sign of strength. If silver can hold above its support at 15.75, it could rise to the wedge target near 17.75. A break above this level could propel silver to test its Aug downtrend near 18.75. Notice Spinner on the rise, breaking above its MT MA as it tests a downtrend of its own. This tells us momentum for silver is growing and it's now poised to rise to 17.75. On the downside, keep in mind silver remains vulnerable below the Aug downtrend. Until this level is surpassed, downside pressure will remain strong. We recommend buying some at mkt.

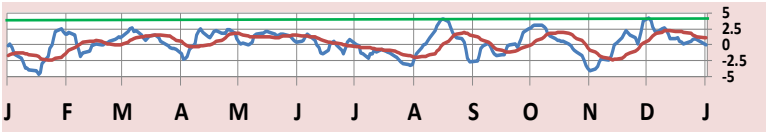
U.S. DOLLAR INDEX MARCH 2017 (DXH17) 1/04/2017
CLOSE= 102.709

PowerShares DB US Dollar Bullish ETF (UUP) 1/04/2017
CLOSE= 26.5

Bear Put Spread	Mar 2017 Dollar bear put spread at 99/97 at US$500 & US$550		
New Recom	**Keep your positions. Buy at 98. Place stops at 2dc below 96. Profit target at 103.**	New Recom:	**Buy at 25. Profit target at 26.50**

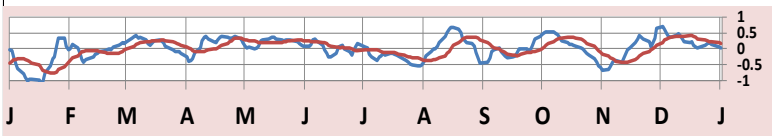
The U.S. dollar index is holding relentlessly near the highs. It's held above its very bullish Nov uptrend showing impressive strength and it has bull market support above the May uptrend near 98. A very solid look. However, the dollar index has also failed to rise to a new closing high since breaking to a 14 yr high on Dec 20 and as a result continues to form a bearish upside wedge with downside target at 98. A dollar break below 102 on a 2dc would confirm the ST bearish pattern and a decline to the wedge target would then be likely. Spinner continues to decline from overbought levels. We continue to hold on to our bear put spreads expiring in Mar. If the dollar declines to the wedge target, we recommend selling your put spreads for a profit and securing a long position.

LIGHT CRUDE OIL FEBRUARY 2017 (CLG17) 1/04/2017
CLOSE= 53.26



New Recom:	**Buy near 51 and again near 46. Place stops at 2dc below 45.**

POWERSHARES DB Oil ETF (DBO)1/04/2017
CLOSE= 9.57



New Recom:	**Buy near 9.25 and again near 8.50. Place stops at 2dc below 8.**

Crude inched higher, consolidating its rise since Nov and above its key break out level at 52. It's now very bullish above the Nov uptrend at 51 and has room to rise further if it holds above this level. Keep in mind, crude has bull market support at the 2016 uptrend near 46. On the downside, notice Spinner losing momentum quickly as it resists below its MT MA near the zero line. This tells us if crude slips below the bullish Nov uptrend on a 2dc below 51, it could then decline to the 2016 uptrend and support level near 46. We recommend buying some crude on dips to 51 and then again at 46.

CBOE Interest Rate 10 Year T No (^TNX)
1/04/2017 CLOSE= 2.45

CBOE Interest Rate 10 Year T No (^TNX) - Chicago options

iShares 20+ Year Treasury Bond (TLT) 1/04/2017
CLOSE= 120.1

iShares 20+ Year Treasury Bond (TLT) - Nasdaq

Taking a breather. The 10YY broke below a bearish upside wedge with downside target near 2.22. It's declining from the Dec peak and it's positioned to reach the wedge target and Sept uptrend near 2.22%. Spinner turned bearish and continues to fall confirming ST weakness. If the 10YY breaks below 2.22 on a 2dc, we could see an extended decline to the Jul uptrend near 1.80%. The chart to the right is TLT, a 20+ yr Bond ETF. Notice it has started to rise from the lows and bearish descending triangle, and testing the Sept downtrend. A break above 121 on a 2dc would undo the bearish pattern and could propel TLT to the Jul downtrend near 134. Keep in mind; TLT and the 10YY are inversely proportional. If TLT rises to the Jul downtrend it would coincide with a decline in the 10YY to its Jul uptrend. Stay out for now.

COPPER MARCH 2017 (HGH17) 1/04/2017 CLOSE= 2.5565

iPath Bloomberg Copper SubTR ETN (JJC)1/04/2017 CLOSE= 29.4

Copper completed a full 50% retracement from its highs during Dec. A normal pull back within a bull mkt. Copper has since rebounded as Spinner rises from extreme oversold levels. This tells us copper is poised to continue rising and re-test the Nov highs near 2.75. On the downside, a break below the Dec lows on a 2dc below 2.45 may expose additional weakness that could push copper back to its 2016 uptrend near 2.15. Overall, copper is poised to have a good year if the world economy continues to tick upward. The chart to the right is a high volume ETF that tracks copper (JJC). We recommend buying copper at 2.50. Place stops at 2 dc below 2.40. Profit targets at 2.75 & 3. Or buy JJC below 29. Place stops at 2dc below 27.50. Profit targets at 31 & 33.

SPDR DOW JONES INDUSTRIAL (DIA) 1/04/2017
CLOSE= 199.15

Shares Transportation Average (^IYT) 1/04/2017
CLOSE= 163.93

New Recom	**Buy IYT on a dip below 155. Place profit targets at 176 and 190. Place stops at 2dc below 147.**

The stock market continues to show signs of a ST top. The Industrials have failed to break clearly above 20000 and the Transports continue to decline after breaking below their upside wedge with downside target near 155. Spinner for both averages have sunk below zero showing momentum waning. This tells us the stock market could pull back from its highs within a healthy ST correction. Keep in mind, however, the stock market remains bullish, especially if both averages hold above their Jun uptrends near 18200 (DIA) (DIA:183) and 8400 (DJT) (IYT:153). We recommend taking advantage of a deeper pull back to buy stocks.

Breaking out! In similar fashion to the start of 2016, gold shares are rising from their Dec lows. The A/D Line, a leading indicator, has broken above a bullish downside wedge with upside target near 4550. It has also broken above its 75 day MA showing the move is bold. Notice A/D Line's Spinner is also rising, breaking above a downtrend of its own. Although at first glance Spinner might appear to be fast approaching an overbought level, it really has lots of room to rise. This is a very strong indication that a rebound rise in gold shares has begun. HUI is also breaking above the Aug downtrend showing signs of rebounding strength for the first time since the decline began. HUI also broke above both its 5wk and 65wk MAs as Spinner rises above a downtrend of its own. This confirms a strong ST outlook for gold shares. We are securing positions in some gold shares to take advantage of growing strength.

STOCKS

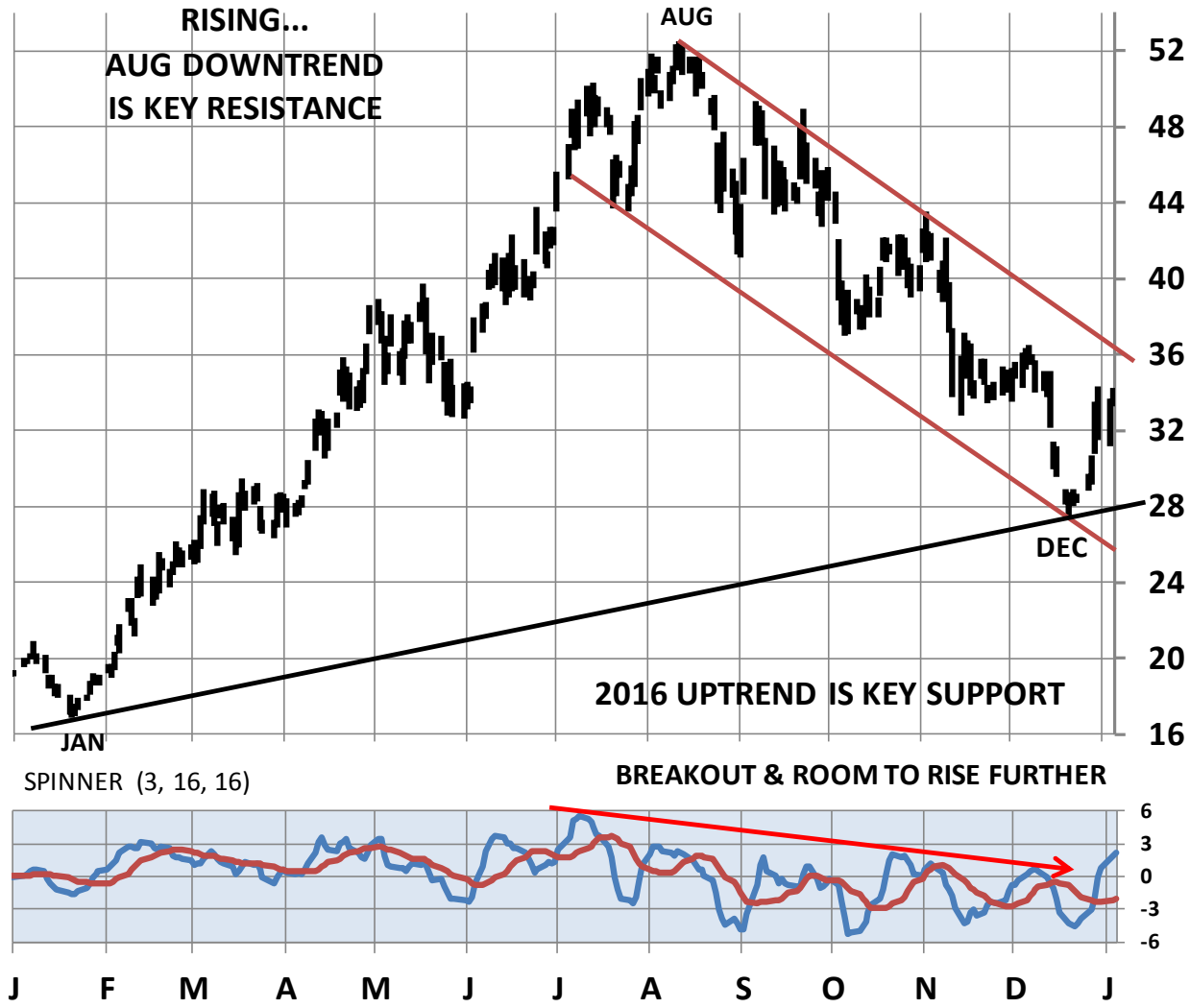
Silver Wheaton Corp. (SLW) 1/04/2017 CLOSE= 19.94

Silver Wheaton Corp. (SLW)

New Recom:	**Buy below 19. Place stops at 2dc below 17.50. Profit targets at 24 & 28.**

SLW held at the Nov lows showing good ST support. It has started to rebound as Spinner crosses into bullish territory telling us momentum may be shifting. If SLW can now stay above 18.50, we could see a rise to the Aug downtrend near 24.50. A break above the Aug downtrend would be bullish and could then open the door for a rise to the Aug highs.

MKT VECTORS JR. GOLD MINERS (GDXJ) 1/04/2017 CLOSE= 34.2



Junior Gold Miners ETF (GDXJ) - NYSEArca

New Recom:	**Buy some at mkt and more below 31. Place stops at 2dc below 28. Profit targets at 40, 44 and 50.**

GDXJ has formed a bottom near 28 exposing a new uptrend since Jan 2016. It's now approaching its first key resistance at the Aug downtrend near 36 as Spinner rises above zero and a downtrend of its own. This tells us GDXJ is poised to rise ST as momentum picks up. Keep in mind, downside pressure remains strong and volatility high. Be quick to take partial profits if targets are reached.

Agnico Eagle Mines Limited (AEM) 1/04/2017 CLOSE= 43.27

Agnico Eagle Mines Limited (AEM) -NYSEArca

New Recom:	**Buy some at mkt and more near 40. Place stops at 2dc below 38. Profit targets at 50 & 55.**

AEM is forming a bullish ascending triangle between the Dec uptrend and the Dec highs near 45. A break above 45 on a 2dc would be bullish and could then push AEM above the Aug downtrend. Spinner is at overbought levels but showing impressive strength. We recommend buying some at mkt and more on weakness near 40.

Freeport-McMoRan Inc. (FCX)1/04/2017 CLOSE= 14.83

Freeport-McMoRan Inc. (FCX) -NYSEArca

New Recom:	**Buy some at 14 and more near 12. Place stops at 2dc below 11.50. Profit targets at 17 & 19.**

FCX is a U.S. based natural resource company and among the largest global copper producers. FCX is a solid bet on resources for 2017. It has solid support at the 2016 uptrend near 11. Spinner is on the rise from an extreme oversold level. It's now testing the zero line telling us more upside is likely. FCX's next key resistance is at the Nov downtrend near 15.50. A break above this level would be very bullish and a rise, initially, to the Nov highs near 17 would be likely. We recommend buying some near the Oct uptrend (14) and more on a decline near the Jan uptrend (12).

Energy Select Sector SPDR ETF (XLE) 1/04/2017 CLOSE= 76.01

Energy Select Sector SPDR ETF (XLE)

XLE is an ETF made up of several solid energy companies, including Chevron and Exxon. It's solid and not subject to a company's individual liability. The trade is designed to perform on crude strength. Notice Spinner is near the lows telling downside is limited. However, as seen with crude, we could see some additional downside pressure ST which could drag XLE down. We recommend buying on a dip near 74 and again on a decline near 70. Place stops at 2dc below 68. Profit targets at 78 and 85.

UNITED STATES STEEL Corp. (X) 1/04/2017 CLOSE= 37.33

United States Steel Corp. (X)-NYSEArca

New Recom:	**Buy near 31.**

X tested its ST support at 34 and quickly jumped above it showing impressive strength. However, X also has ST resistance below the Dec highs. Notice Spinner below zero showing signs of ST weakness. This tells us X must now rise above the Dec high on a 2dc above 40 to show renewed strength. Otherwise, we could see X pull back ST before resuming its rise. We recommend waiting for a deeper pull back to buy.

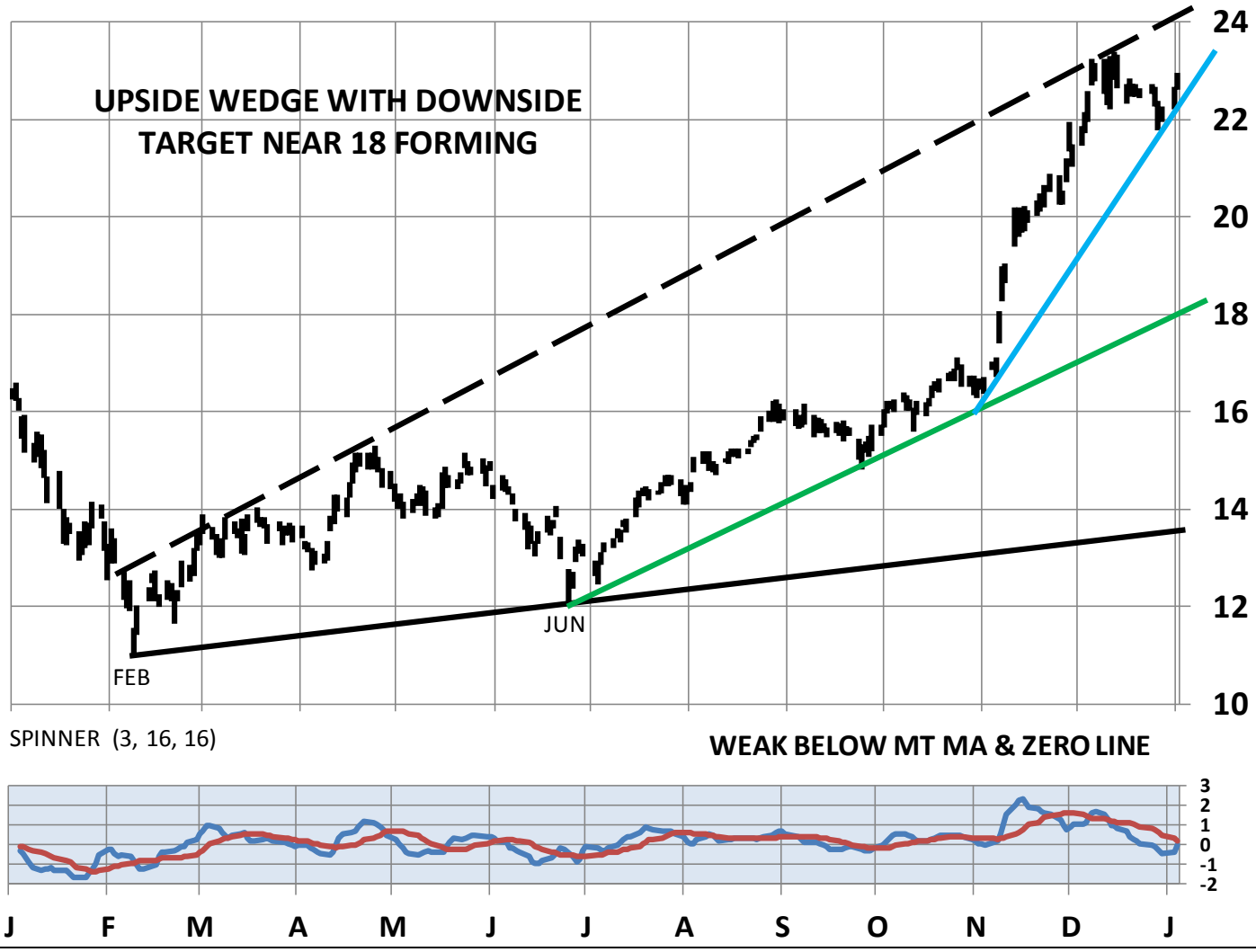
ProShares UltraShort Gold (GLL) 1/04/2017 CLOSE= 88.48

ProShares UltraShort Gold (GLL) -NYSEArca

Long:	94.20 (Dec-15-16), 89.75 (Dec-29-16).
Stop:	2dc below 85
Profit Target:	102 & 112.
New Recom:	**Sell half at mkt. Keep the rest until gold breaks above 1200.**

GLL declined from its recent high in Dec, allowing us to pick up some more below 90. Spinner is declining from the highs and has room to fall further. However, gold remains vulnerable below 1200. We recommend holding on to GLL until gold breaks clearly above its first key resistance. A gold breakout would coincide with GLL's stop at 85.

Bank of America Corporation (BAC) 1/04/2017 CLOSE= 22.95



Bank of America Corporation (BAC) -NYSEArca

New Recom:	**Buy at 18. Place stops at 2dc below 16.**

The financial sector is shaping to be among the best performers for 2017. BAC poses a great opportunity and in the past has fared well in times of financial turbulence. The chart above shows BAC forming an upside wedge with downside target near 18. A break below 22 on a 2dc would confirm the pattern and a decline to the wedge target would likely ensue. Spinner slipped below zero and its MT MA showing ST weakness. This could coincide with a pullback in interest rates and stock market. We recommend buying some at or near the wedge target, near 18.

Delta Air Lines, Inc. (DAL) 1/04/2017 CLOSE= 50.7

Delta Air Lines, Inc. (DAL) - NYSEArca

New Recom:	**Buy some below 49 and more near 44. Place stops on 2dc below 42. Profit target at 55 & 60.**

DAL is among the leading transportation companies globally, a consumer favorite and a part of the Dow Transportation Average. The chart above shows DAL breaking above the Mar 2016 highs showing impressive strength. It has since pulled back to its breakout level. However ST weakness in the Transportation Average tells us we could see some additional downtime ST before a continued rise. We recommend taking advantage of ST weakness to buy.

OPEN POSITIONS

Symbol	Trade Update &/or Current Position	Status (L=Long, S= Short, O= Out P= Put C= Call)	Initial Entry Date	Initial Entry Price	Traders re-bot/ -sold at	Last Closing Price	Stops	Target #1	Target #2
SHARES									
SLW	Buy below 19. Place stops at 2dc below 17.50. Profit targets at 24 & 28.	O				19.94	2dc below 17.50	24.00	28.00
GDXJ	Buy some at mkt and more below 31. Place stops at 2dc below 28. Profit targets at 40, 44 and 50.	O				34.20	2dc below 28	40.00	44.00
AEM	Buy some at mkt and more near 40. Place stops at 2dc below 38. Profit targets at 50 & 55.	O				43.27	2dc below 38	50.00	55.00
FCX	Buy some at 14 and more near 12. Place stops at 2dc below 11.50. Profit targets at 17 & 19.	O				14.83	2dc below 11.50	17.00	19.00
XLE	Buy on a dip near 74 and again on a decline near 70. Place stops at 2dc below 68. Profit targets at 78 and 85.	O				76.01	2dc below 68	78.00	85.00
X	Buy near 31.	O				37.33			
GLL	Sell half at mkt. Keep the rest until gold breaks above 1200.	L	Dec-15-16	94.20	89.75	88.48	2dc below 85	102.00	112.00
BAC	Buy at 18. Place stops at 2dc below 16.	O				22.95	2dc below 16		
DAL	Buy some below 49 and more near 44. Place stops on 2dc below 42. Profit target at 55 & 60.	O				50.70	2dc below 42	55.00	60.00
MARKET LEADERS									
Gold - GCG17	Buy some at mkt. Place stops at 2dc below 1100. Profit targets at 1245, 1315 & 1380.	O				1165.30			
Crude-CLG17	Buy near 51 and again near 46. Place stops at 2dc below 45.	O				53.26			
Silver SIH17	Buy some at mkt. Place stops at 2dc below15.75. Profit targets at 17.75, 18.50 & 20.50.	O				16.55			
US Dollar DXH17	Keep your positions. Buy at 98. Place stops at 2dc below 96. Profit target at 103.	P				102.71			
COPPER HGH17	Buy copper at 2.50.	O				2.56	2dc below 2.40	2.75	3.00

INTRODUCTION TO OPTIONS

By Matthew Kerkhoff

Dow Theory Letters

Introduction to Calls and Puts

When it comes to using options, there are many strategies, but there are only two types of options: calls and puts. Every position that is built using options is comprised of either calls, puts, or a combination of the two.

Thus, if you can understand calls and puts at their fundamental level, then adapting them to strategies as we move forward will be much easier.

Before we get into the specifics of calls and puts, it's important to understand that options are a direct form of investment. As we'll see later, an investor can achieve everything they want in terms of positioning just by using calls and puts. In fact, nearly every position you could ever want to take in stocks, bonds or ETFs can be replicated using options, often with a better risk/reward profile.

For our purposes, most of our attention will focus on using options in conjunction with regular stock or ETF positions we own. We'll also discuss using options to get better pricing on stocks and ETFs that we *would like* to own.

Options (calls and puts), are called "derivatives" because they derive their value from some other investment. This is called the "underlying" security. Examples would include Apple stock (AAPL), the S&P 500 ETF (SPY) or even a bond fund like the iShares US Aggregate Bond Fund (AGG). If a stock or ETF has an "options market" it means that calls and puts can be traded on that underlying security.

Nearly all large cap stocks and popular ETFs have options markets. This makes our life pretty easy as most of these markets are highly liquid and allow investors to build and liquidate positions with ease.

Calls and puts can both be bought and sold, just like any other security. One especially nice aspect of options is that you don't necessarily have to own a call or put to sell one. As we'll see over the course of the next few months, some situations will warrant buying calls and puts, and others will warrant selling calls and puts.

When determining which side to be on (buying vs. selling), it's important to remember this general rule of thumb: *Option buyers have rights; option sellers have obligations.*

The implications of this statement will become more clear as we progress, but this is a fundamental truth and one that will affect every decision regarding the use of options.

Okay, enough beating around the bush. Let me explain exactly what calls and puts are, and then we'll wrap up with a brief summary.

A **call option** is the option to *buy* an asset at an agreed upon price on or before a particular date. Calls are similar to having a long position on a stock. Byers of calls hope that the stock will increase substantially before the option expires.

A **put option**, on the other hand, is the option to *sell* an asset at an agreed upon price on or before a particular date. Puts are very similar to having a short position on a stock. Buyers of puts hope that the price of the stock will fall before the option expires.

Again, keep in mind that both call options and put options can be bought and sold. If you're the buyer of a call option, it means you have the right to buy the underlying asset. If you're the seller of a call option, it means you have conveyed to someone else the right to buy the underlying asset from you (recall our general rule of thumb above).

Conversely, if you're the buyer of a put option, it means you have the right to sell the underlying asset. And if you're the seller of a put option, you have conveyed to some else the right to sell you the underlying asset.

If that doesn't make sense right off the bat, don't worry. Things will become more clear as we progress and go through examples. In the meantime, just understand that there are two types of options (calls and puts) and each one can be bought and/or sold.

We've already discussed the "underlying asset," which is the asset that the call or put option derives its value from. The two other important aspects that we need to be aware of with options are the "strike price" and the "expiration date."

As mentioned earlier, call and put options convey the right (but not the obligation) to buy or sell assets at an agreed upon price. That price is known as the strike price. As we'll see moving forward, choosing the right strike price is an integral part of using options to your advantage.

Next, all options have an end date, or expiration date. When an option is traded, the rights and obligations of that option (whether it be a put or a call) only last until a certain point in time. This could be anywhere from a day or two in the future, up to many years from now. Here as well, choosing the right expiration date is a very important factor.

Buying Calls (or Puts)

The best place to start when it comes to understanding how option contracts work is to look at buying calls (or puts). This is because call (or put) buying is one of the simplest ways of trading options, and it positions the buyer to benefit from a rise (or fall) in the underlying stock or ETF.

As we walk through these examples, we're going to use hypothetical pricing to understand various payoff scenarios. Therefore, it's important that you understand two crucial aspects of option pricing right off the bat:

1. Every option contract, whether a call or put, represents 100 shares of the underlying security.

2. Option prices are shown and quoted on a "per share" basis.

Here's what that means. If you were to look up the price of a call option, and your screen showed that option trading at $2, it would cost you $200 (plus any commission) to execute the trade. This is because one option contract represents 100 shares, and the price of that option is $2 *per share*. Make sense?

If not, it'll probably become more clear as we walk through some examples, which we'll do right now.

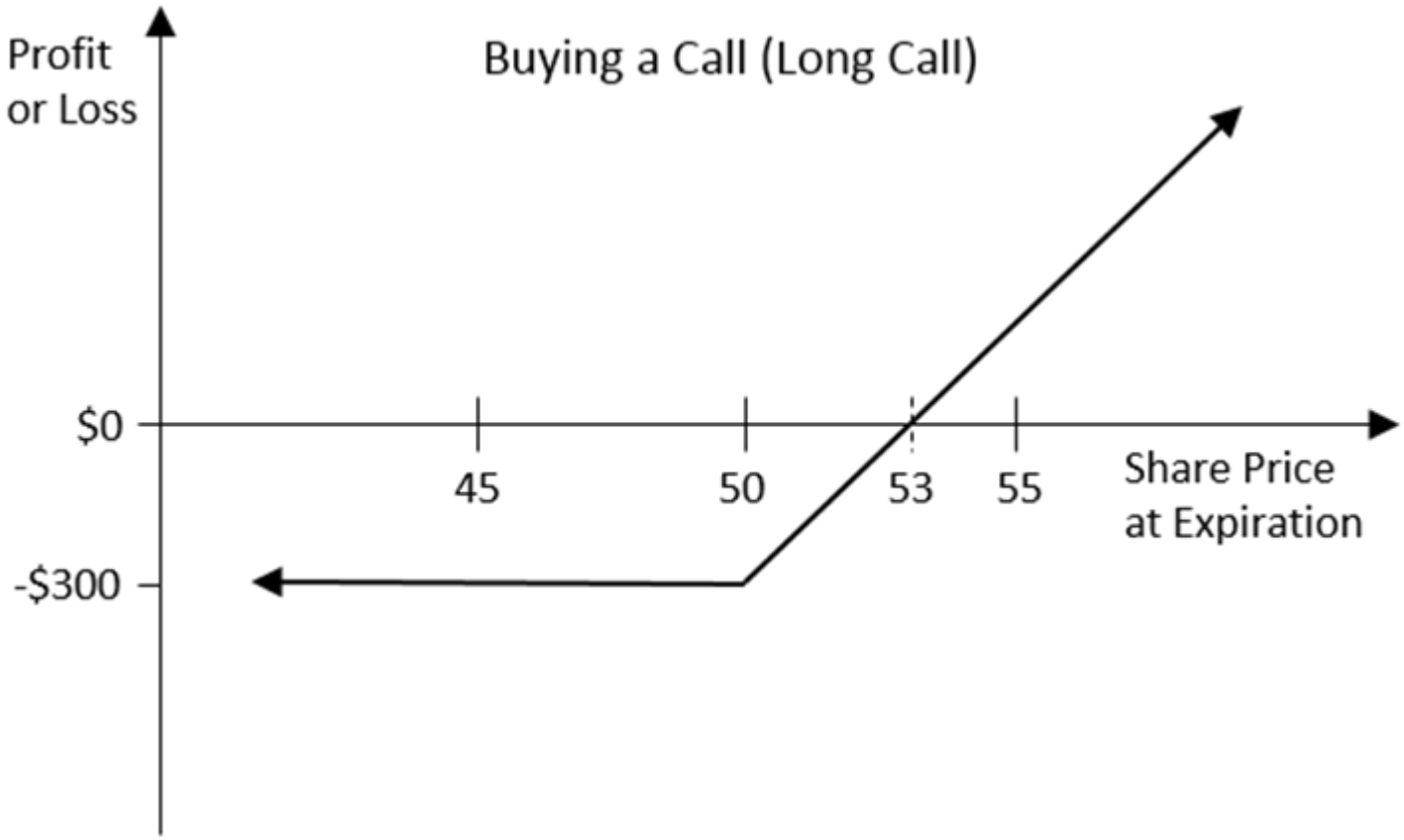
To visualize the payoff scenarios of buying and selling options, we use handy little profit and loss charts like the one below. If you can get in the habit of viewing option trades visually like this, it will go a long way in helping you select the right trade at the right time.

Okay, let's dive right in.

In this first example, we're going to look at the profit and loss scenario of buying a call option.

Suppose ABC stock is trading at $50 per share. We are bullish on the stock and believe it will trade higher in the months ahead. Therefore, we purchase a call option priced at $3, that has a strike price of $50.

The chart below shows the payoff scenario from buying that call option. The first thing to observe is that this trade cost us $300 (plus any commission) to execute. As described above, this is because while the call option was priced at $3, it represents 100 shares, so our total outlay is $300.



In exchange for this $300, we have purchased the right (remember our rule of thumb) to purchase 100 shares of XYZ, on or before expiration, for $50 per share. In effect, we get to "control" 100 shares of XYZ stock until expiration.

One nice thing about buying options is that your potential downside is limited. In this case, as buyers of the call option, the most we can lose is our $300. We have the right to buy 100 shares of ABC stock at $50 per share, but *we are not obligated* to make that purchase. If ABC stock isn't trading above $50 at expiration, our call option will simply expire worthless.

As you can see in the chart above, at a share price of $50 or less, we sustain our maximum loss, which is $300. But if ABC rallies, as we think it will, then our gains with this call option are potentially unlimited. As ABC trades above $50 per share, our call option gains value quickly.

One of the most important aspects of assessing an options trade is to look at the breakeven point. This is the share price at which the underlying stock (in this case ABC) must trade for the option to be worth what you initially paid for it at expiration.

In this example, that share price is $53. The math here should be straightforward. Our call options gives us the right to buy 100 shares of ABC at $50 per share. If ABC is trading at $53 per share at expiration, then it means our call option gives us the right to buy 100 shares at $50, which we could theoretically then sell right back into the market at $53 per share. Our profit from that would be $300, which is exactly what we paid for the option in the first place.

If ABC trades between $50-$53 at expiration, then we know we will suffer a loss of somewhere between $0 - $300. But if we're right, and ABC does move higher, anything above $53 becomes profit.

For the sake of the example, let's say ABC is trading at $56 at expiration. This means that our call option would be worth $600 [($56 - $50) x 100]. Since the call option cost us $300 initially, it means we have a profit of $300, or 100%.

And if ABC trades even higher than $56, we get to capture all the upside in the stock until the expiration date. Not bad, right?

To summarize, here is what we need to remember about *buying call (or put) options*:

- It's a strategy for when we are bullish (bearish) on a stock, ETF or commodity.

- There is limited downside (the price or "premium" that we paid)

- There is unlimited upside

Now, let's flip the script and see what the trade above would look like if we were on the opposite side, as the *seller* of the call option.

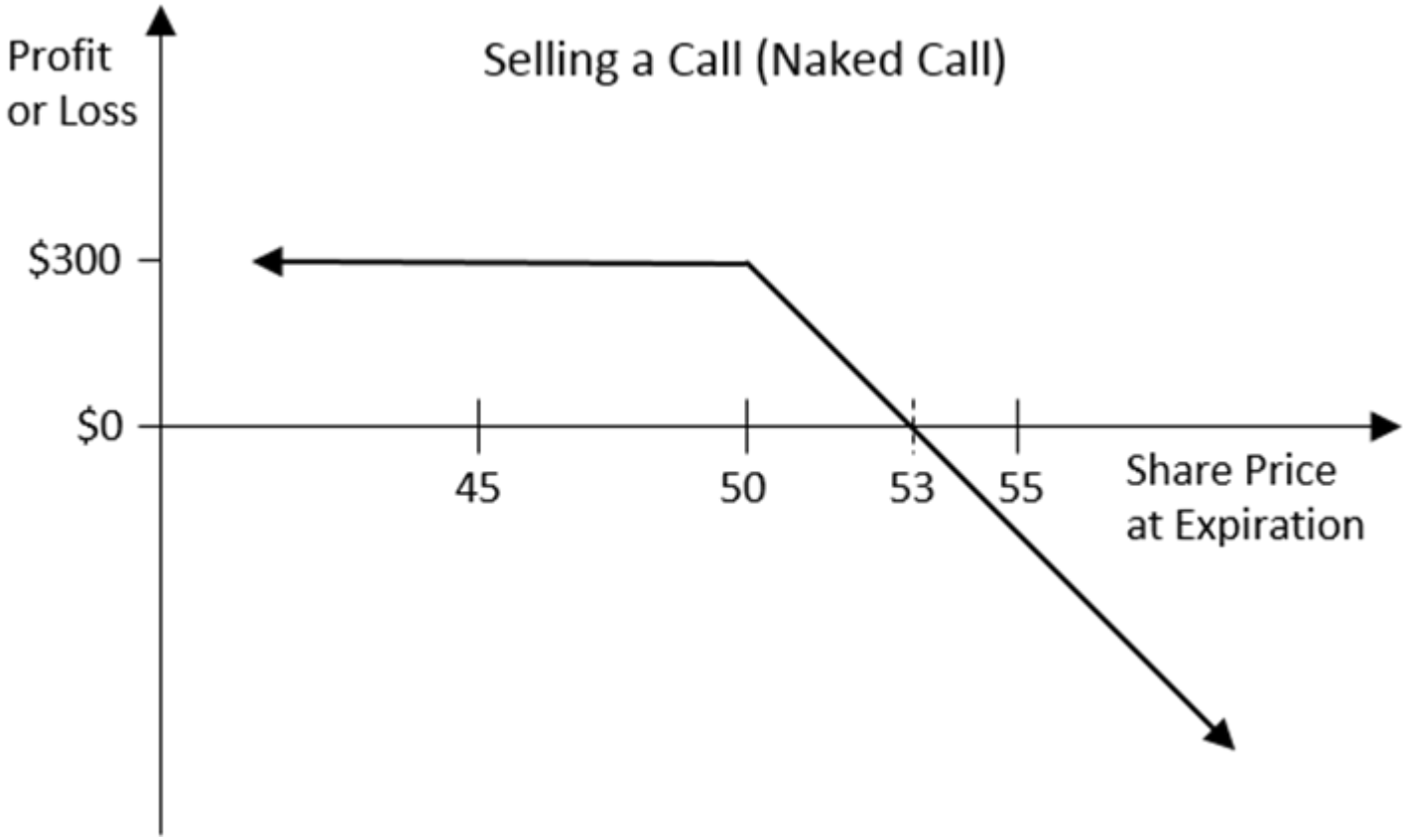
Selling Calls (or Puts).

One quick terminology note before we get started -- when you sell an option (either a call or put) that you do not already own (and you do not have a position in the underlying stock), it's called a "naked" call or put. This term comes from the unlimited risk nature of the trade.

Before you start to worry, know that there are very few instances in which it is advisable to do this. In most cases, when we sell options we will have a position in the underlying stock or ETF; thus these will be considered "covered" options. Or we'll be using a different option to hedge out the risk that selling a naked option creates.

For now, it's important to understand how these options work on their own before we start combining them with other positions.

In the previous example, when we bought our call option for $300, someone was on the other end of the trade selling us that call option. The chart below shows the payoff scenario from that person's point of view.



In this case, the $300 is actually revenue to the call seller, and this represents the most that the call seller can possibly earn on the trade. As long as ABC trades at $50 or less by expiration, the call seller will have made $300 on the trade. Why is this?

Because if ABC is trading at less than $50 at expiration, then the call option that we purchased will be worthless. After all, why would we exercise our option to buy shares at $50 if we can buy them in the market for cheaper?

In this scenario, the call option is said to have expired worthless, and the option seller gets to keep all of the premium he or she received.

But in exchange for this $300, the option seller has *obligated* himself to sell us 100 shares of ABC stock for $50 per share, *if we so desire*.

This means that from the option seller's perspective, his payoff begins to decline as the share price of ABC rises. At the breakeven price of $53 (at expiration), the option seller has received $300 in revenue, but is obligated to sell us 100 shares at $50 per share. If this truly was a naked call on his behalf, then he would have to go into the market and buy 100 shares of ABC at $53 per share, which he would then turn around and sell to us for $50 per share. This would result in him losing $300, which would offset the premium he earned, causing him to break even.

As the share price rises above $53, making good on the obligation the option seller committed himself to becomes more difficult. Since stocks have no upper bound, the price at which the option seller must buy shares at in order to sell to us has no limit. If the stock soared to $100 by expiration, the option seller could lose $4,700 [(($100 - $50) x 100) – 300].

This is why, generally speaking, an option seller would want to hedge or cover that unlimited risk somehow. We'll get into how to do that later.

For now, let's summarize what we need to remember about *selling call (put) options*:

- It's a strategy for when we are neutral to slightly bearish (bullish) on a stock or ETF

- There is limited upside (the premium collected)

- There is unlimited downside (unless the position is hedged some way or another)

OPTION STRATEGY AT GCRU

By Omar Ayales

Having understood the basic concept of options, I will go on to explain the option strategy we typically use at GCRU called an "option spread". Although spreads may be construed in different ways, we try to keep it simple by buying and selling calls (or puts) simultaneously, using different out of the money strike prices but with the same expiration date.

Any spread that is construed using calls can be referred to as a "call spread" and any spread construed using puts can be referred to as a "put spread".

If an option spread is designed to profit from a rise in the price of a stock, ETF or commodity, it is a "bull spread". Conversely, if the option spread is designed to profit from the fall in the price of a stock, ETF of commodity, it is a "bear spread".

Spreads can be used to:

- Reduce the net cost of entering a trade.

- Limit risk of loss when selling naked options.

Here's an example.

Suppose we have a stock XYZ currently trading at $500; a $550 call for XYZ expiring in Jul is priced at $2, and a $600 call expiring on the same month is priced at $1. The cost of our bull call spread would be $100.

Let's take a minute to dissect that…

Remember that when you sell a “naked” call, you are receiving the value of the call and when you buy a call you are paying the value of the call. Moreover, even though the price point for both calls in this scenario are worth $2 and $1, respectively, they represent the purchase of 100 shares.

So, going back to the example above, in selling the $600 call expiring in Jul you will receive $100 [$1 (price point of call) x 100 shares = $100]. And in buying the $550 call expiring in Jul you must pay $200 [$2 (price point of call) x $100 shares = $200]. The total cost of the operation will be $100 ($200 to be paid for the call being bought less $100 to be received for the call being sold).

If prior to expiration the price of the stock falls, the call that you sold will be worth more, but the call that you purchased will be worth less thereby cancelling each other out. The maximum amount of your loss will be $100 as the loss of the call being sold will not be worth more than the value of the call purchased.

Conversely, if prior to expiration the price of the stock rises, the call that you sold will be worth less, but the call that you purchased will be worth more. The difference in the price point will allow for a profit. The maximum amount that you can make on this example will be defined by the difference in value of both options times 100 shares [(600 – 550) x 100 = $5000].

It is important to note that the value of a spread will also be affected by price volatility, time value decay exposure and price movement exposure.

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ABBREVIATIONS	
1dc	1-day close (the share price must close above or below the indicated price level, before our recommendation is activated)
2dc	2-day close (consecutive)
bot	bought
CAD$	Canadian dollar
H&S	head & shoulder
LOC	line on close
LT	long term
MT	medium term
NL	neckline
PF	portfolio
PO	price objective
Recom	recommended
RH&S	reverse head & shoulder
RS	relative strength
ST	short term
Sym/tri	symmetrical triangle
Tgt	target
Unch	unchanged
Vol	volume
Wk	week
Ystdy	yesterday
C	close

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