

Guide #4: Covered Calls & Options Swing Guide

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COVERED CALLS & OPTIONS SWING GUIDE

Purpose

For traders looking to generate steady income, manage risk, and learn the foundational elements of options trading using a strategy designed for consistency—not gambling. Ideal for swing traders, cautious learners, and investors who want leverage with built-in downside protection.

Core Concept: Covered Calls

Definition

A covered call is an options strategy where you:

- Own 100 shares of a stock (or the equivalent exposure), and
- Sell (write) one call option contract against those shares, collecting premium.

Why It Works

- You collect option premium up front as income.
- The premium reduces your effective cost basis in the stock.
- You have defined upside (to the strike price plus premium) and defined downside (stock risk minus collected premium).

Target Stocks: “Mag Seven”

Focus on highly liquid, mega-cap tech stocks, often called the “Mag Seven”:

- Nvidia
- Microsoft
- Apple
- Amazon
- Meta
- Alphabet (Google)
- Tesla

Why These?

- Tight bid-ask spreads and deep liquidity.
- Weekly options (Friday expirations) for flexible income.
- Heavy institutional interest and news coverage.

Account and Timeframe

- Strategy type: Swing/position trading (days to weeks).
- Ideal account style: Cash or margin with sufficient capital for 100-share lots.
- Risk level: Lower than naked options, but still subject to stock price movement.

Basic Covered Call Workflow

Step 1: Choose the Underlying

- Pick one Mag Seven stock.
- Confirm:
 - High average daily volume.
 - Tight options spreads.
 - Weekly options available.

Step 2: Determine Bias and Support

- Use daily and 4-hour charts.
- Identify:
 - Strong support zones (previous lows, demand areas).
 - Overall trend direction.
- You want to own the stock near a logical support zone.

Step 3: Acquire the Shares (or Synthetic)

Option A: Buy 100 Shares

- Buy 100 shares outright at or near your chosen support zone.
- This is the simplest, most transparent approach.

Option B: Deep In-The-Money Call (Synthetic Stock)

- Buy a deep ITM call with:
 - Strike well below current price.
 - Expiration several months out (LEAP-style).
- This behaves similarly to owning shares but often uses less capital.
- For beginners, owning actual shares is simpler.

Step 4: Sell the Call

- For every 100 shares (or synthetic equivalent), sell 1 call contract.

- Strike selection:
 - Slightly out-of-the-money (OTM) for income plus some upside.
 - Typically near recent resistance or just above current price.
- Expiration selection:
 - Weekly calls (7–14 days out) for more frequent income.
 - Monthly calls for fewer decisions and potentially less micro-management.

Example

- Own 100 shares of a stock trading at \$100.
- Sell a 1-week \$105 call for \$1.50.
- You collect \$150 in premium.
- If price stays below \$105 at expiration:
 - You keep shares and the \$150.
- If price finishes above \$105:
 - Your shares are called away at \$105.
 - Profit: \$5 per share (\$500) plus \$150 premium = \$650 total (minus fees).

Step 5: Managing the Position

If Price Stays Flat or Slightly Up

- The call decays in value (time decay).
- You can:
 - Let it expire worthless and then sell another call, or
 - Buy it back early for a profit and roll to a new strike/expiration.

If Price Rips Higher

- Your stock may be called away:
 - You keep your premium plus stock gains up to the strike.
- If you really want to keep shares:
 - Consider rolling up and out:
 - Buy back the current call.
 - Sell a new call with higher strike and a later expiration.

If Price Drops

- The premium you collected softens the downside:
 - Your effective cost basis is reduced by the premium.
- Decide:
 - Hold shares and continue selling calls at lower strikes.
 - Or exit the stock and accept the loss, possibly after the call expires.

Risk Management for Covered Calls

Key Risks

- Stock can drop significantly in price:
 - You still own the shares and bear that risk.
- Opportunity cost:
 - If stock explodes higher, your upside is capped at the strike plus premium.

Risk Controls

- Only run covered calls on high-quality, liquid stocks.
- Avoid maxing out account in one position:
 - Use position sizing (e.g., 1–3 positions at a time).
- Avoid selling calls right before major earnings or big news unless this is deliberate.

Position Size Guidelines

- Decide an overall “stock income” sleeve of your portfolio (for example, 20–50%).
- Divide that sleeve across multiple tickers so no single name dominates your risk.
- Example:
 - Account: \$25,000.
 - Income sleeve: \$10,000.
 - Two positions of ~ \$5,000 each in different Mag Seven stocks.

Micro-Swing “Tap & Go” Version

For Smaller Accounts

- Buy smaller share blocks (e.g., 10–30 shares) where mini or micro options are available, or:
- Trade “cash-secured puts” as an alternative:
 - Sell a put at a strike where you’d be happy to own the stock.
 - If assigned, you buy shares at that price.
 - If not assigned, you keep the premium.

This creates a more flexible “income on training wheels” approach for smaller accounts.

Example Weekly Routine

Sunday / Pre-Market Prep

- Scan Mag Seven charts.
- Identify:
 - Stocks near support.

- Clean trends with manageable volatility.

Monday

- Enter or adjust stock positions.
- Sell covered calls for the current or next weekly expiration.

Midweek

- Monitor:
 - Is price nearing strike?
 - Is premium mostly decayed?
- You can roll early if profit is large (e.g., 70–90% of max).

Friday (Expiration Day)

- If price is below strike:
 - Options expire worthless; you keep shares and 100% premium.
- If price is above strike:
 - Decide to:
 - Let assignment occur (shares called away), or
 - Roll to a higher strike and later expiration.

Psychological and Practical Tips

- Treat covered calls as income, not lottery tickets.
- Accept that sometimes you will “leave money on the table” if price explodes higher.
- Focus on steady, repeatable premiums and reduced cost basis.
- Always know:
 - Your break-even.
 - Your max gain (premium + upside to strike).
 - Your risk (stock can still go to zero in theory, though unlikely with large caps).

Disclaimer-Style Note

Covered calls involve risk and are not suitable for all traders. This guide is for educational purposes only. Always understand the full options risk profile and consider consulting with a financial professional before using new options strategies.

Summary

Covered calls offer a practical path for traders and investors to generate income, manage risk, and build options experience without jumping into highly leveraged or complex structures. Focus on:

- Quality stocks (Mag Seven).
- Reasonable position sizes.
- Regular, rules-based call writing and review.

Trade slow, think in weeks and months, and let income accumulate quietly in the background.