ReadySetCrypto Options Masterclass

Module Eight: Using Fractal Energy Trading With Options

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By Doc Severson

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Introduction to Using Fractals With Options

To this point of the program, I've only made vague references to the charts, with suggestions such as "sell puts on the pullback." And quite frankly, that's more than enough for most to be able to leverage the power of Options.

But here you are, continuing to pull in Module eight. Is there a better way to apply the power of technical analysis and charting to the task at hand?

Yes. I call it "Fractal Energy Trading."

"Fractal" because all timeframes are interlaced like that of a family, with "parent" timeframes that do the heavy lifting, down to "child" timeframes that expend a lot of energy in a short period of time, but with little result.

"Energy" because every chart at every timeframe has a mix of "potential" energy caused by consolidation, merging with "kinetic" energy which is what we see when charts burn off the potential energy into a price trend. Charts just alternate between these two states, at every timeframe, and they do it continuously.

And of course the "Trading" part of it is there because we want to actually APPLY these concepts and not just talk about them in an academic setting.

Let me set the expectations here that I'm not going to be able to provide a comprehensive review on Fractal Energy Trading in this one module; I have a full fifteen-module program included in our course catalog to give it the proper treatment, which of course is available to our OMNIA members if you don't want to purchase it separately.

My goal with this module, therefore, is to provide an APPLICATION for how one could apply the principles of Fractal Energy Trading to the creation of income with Cash-Secured Puts and Covered Calls.

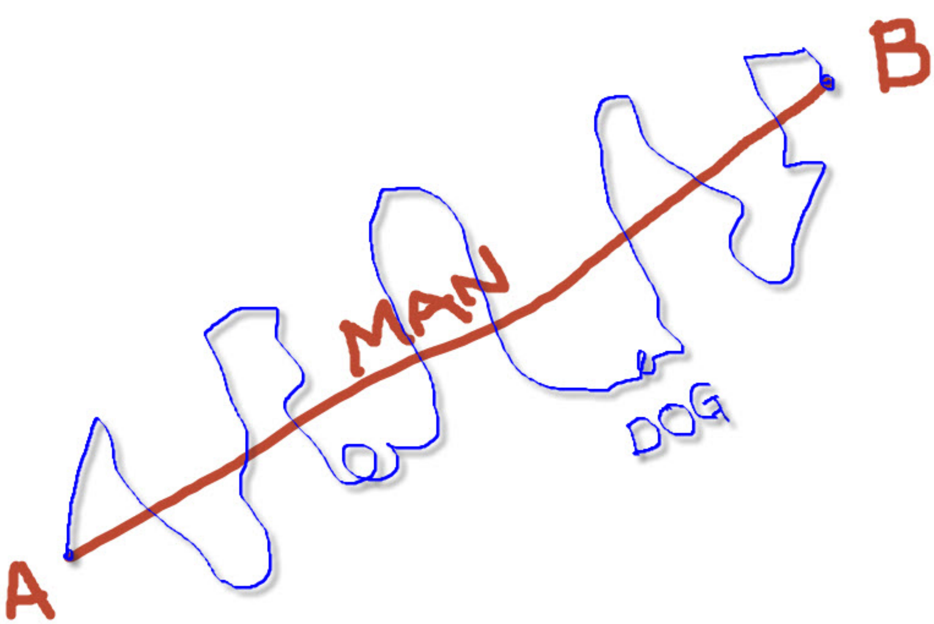
I break down the Fractal Energy Trading concepts into four main rules, so I'll show how to apply them to your income trades with the rest of this module, starting with Rule Number One.

Rule One - Larger Timeframes Dominate the Trend

If you've ever seen a 200 lb man walking a 10 lb dog, the man will generally walk from point "A" to point "B" with few interruptions. The dog, on the other hand, (depending on the level of obedience training) will explore to the limits of their leash and will generally create an "orbit" around the man, sniffing and marking this and that in a continual quest to discover and mark "their" territory. For every mile that the man walks, the dog probably puts in five.

But at the end of the walk, don't they arrive at the same exact spot?

Figure 1



This is how markets move; the larger underlying trend tends to persist in the same direction for a long time, while smaller timeframe moves occur "inside" of this trend.

Many of us assume the role of the dog and get caught up over-reacting to the small movements which are counter-trend to the larger move, so this rule is meant to help you understand and believe in following along with the larger trend, and not over-reacting to counter-trend pullbacks in a negative way, but rather to use them to accomplish our goals.

[Using Rule Number One with Income Trades]()

The first concept that we need to apply is that the overall asset that we want to apply Cash-Secured Puts and Covered Call income trades to should be in a primary uptrend! We can define this a couple of different ways, such as using a Weekly "Anchor Chart" uptrend, (figure 2 below) or an indicator-based strategy such as the 50 sma "Golden Cross" above the 200 sma on the daily chart.

Figure 2

This rule is more applicable to the Cash-Secured Put strategy, since we can also sell Covered Calls against assets in a downtrend. But in general, creating income from a crypto asset will be much, much easier if you wait on a primary uptrend, and look for pullbacks against that main trend with which you establish the short put positions.

Rule Two - Reversals Start From the Inside Out

Everything changes from the “inside-out” and then propagates higher. You can get infected from one virus, which finds a host cell and multiplies from there, with each new virus finds its own host cell, replicating in an exponential manner until your immune system becomes swamped. A building decays from simple cracks in the foundation which allows shifts through the entire structure until it becomes unstable. Rust can start in one spot of a car until it becomes like a cancer which eats the car from the inside-out.

Markets move in the same manner. Reversals start at the smallest timeframes which most do not even notice. The reversal gains momentum when it “propagates” to the next order of timeframe, which reverses polarity as well. Reversals don’t just start at the monthly timeframe; by the time the monthly chart starts to reverse its trend, a reversal process has been occurring for *several months* by that point, and it all started with the reversal at the smallest timeframes.

It stands to reason, therefore, that if we track this reversal process on some standard timeframes, we can actually watch and monitor this reversal process. And in doing so, can give us a potential edge for entry.

Notice how the reversal on the five-hour chart back to an uptrend….(right pane figure 3) led to the larger daily timeframe (left pane) reversing as well.

Figure 3

Using Rule Number Two With Income Trades

We can use this rule to help us determine when a pullback against the main trend has finished, and is likely to revert back to the major uptrend again, as Figure 3 shows.

Another application for Rule Number Two is when we're trading Covered Calls. If we don't want to get "called out" and exercised on our short call/underlying coin, then we generally want to be selling near the peak of a rally so that we don't get "run over." A way to do this with price action is to look for an uptrend to throw off a "lower high" such as the process that we see happening on the five hour chart first (right pane figure 4) before that propagates to the daily chart (left pane). Any short call sold above that level would be considered "safe" at that point as the larger chart transitions into "range contraction" which we'll cover in Rule Four.

Figure 4

Rule Three - Descending Patterns Break to the Upside

This is only half of Rule Three; descending patterns will ALWAYS break to the upside, and ascending patterns will ALWAYS break to the downside. (eventually) It's a matter of physics…charts cannot and will not trend forever in one direction.

And trends tend to form "trendlines" which connect with support or resistance points on the way up or the way down, depending on the slope of the trend.

Let's bring up the daily/five hour chart again:

Figure 5

Notice that the five hour chart had a decent downtrend going which was bounded by the solid red line, connecting all of the recent "lower highs" on the way down. That trend line was ultimately broken "to the upside" which also coincided with the change in polarity to the new uptrend. We will also see the same effects with uptrends that are bounded by a lower ascending trend line connecting all of the "higher lows" that ultimately will get broken to the downside when the polarity changes.

Using Rule Number Three With Income Trades

I will usually use Rule Three in conjunction with Rule Two to help me spot a bottom reversal, indicating that it's a high-probability entry for a Cash-Secured Put trade. As the price prints a "higher low" on the smaller timeframe and starts to change polarity to the upside, it will also break the descending trend line. This is normally a very high-probability entry point, and is illustrated above in Figures 3 & 5.

We can also use the same methodology to help us get a "safer" entry on the short call for a Covered Call position. As the child timeframe starts to reverse lower, the price will break the ascending trend line and help identify a better entry for the short call option.

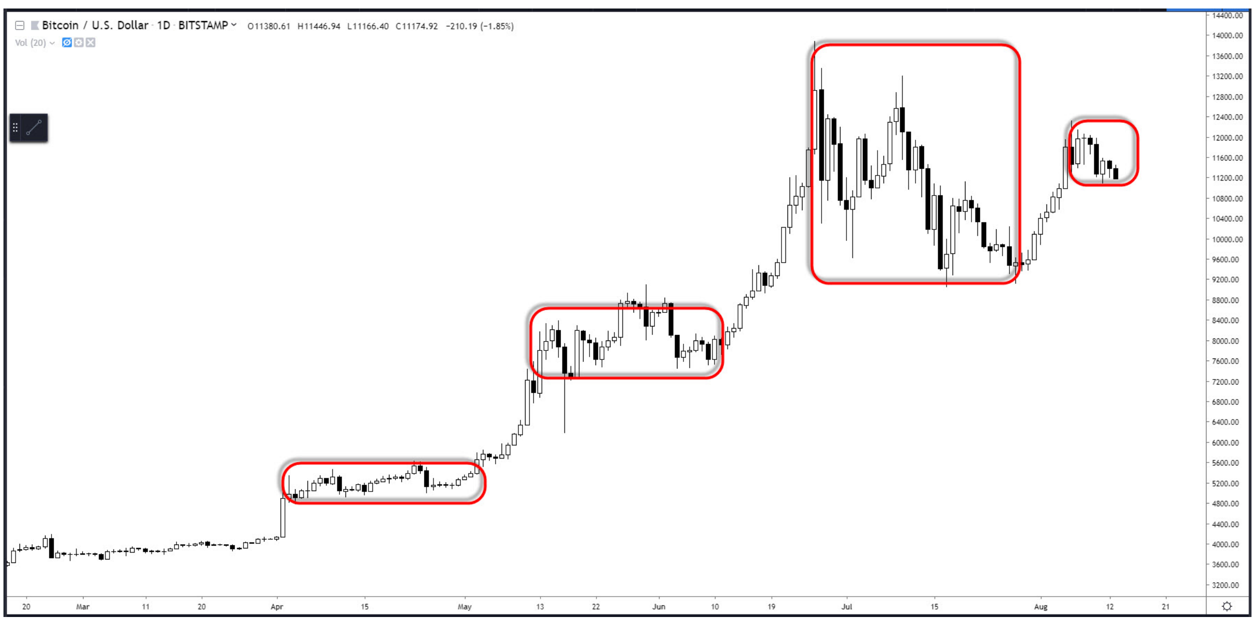
Rule Four - Range Contraction Leads to Range Expansion

Can you run up the side of a mountain and summit in one continuous sprint? Some can, but for us mere mortals, we have to “pace” ourselves. This usually means that we go as hard as we can for some distance, and then “pause” to recharge ourselves for a few minutes before continuing the assault. We move, then we rest, then we move again. This continuous cycle is seen everywhere you look.

And it’s also seen in financial markets.

Markets will trend as far as they possibly can at that timeframe, and then rest or “consolidate.” We can see an example of this in the Bitcoin daily chart, as every significant trend “range expansion” is met with a correspondingly-sized “range contraction.”

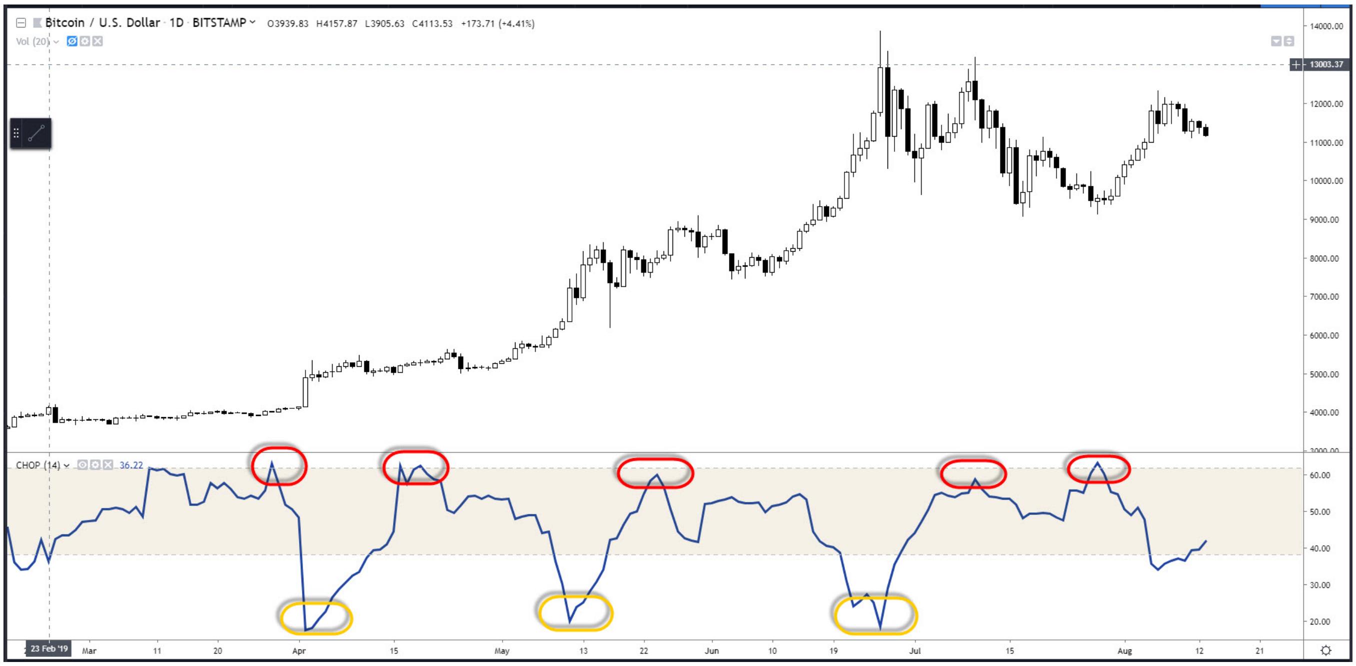
Figure 6



The bigger the breakout, the larger/longer the consolidation. And if you’ve taken the time to absorb the Fractal Energy Trading program, you’ll know that we can approximate the “energy” present as either “potential energy” created by a consolidation, or the lack of it as this potential energy is turned into “kinetic energy” through a trend. We use the Choppiness Index to measure and analyze the energy, as it measures the linearity of the current trend. The more linear the move, the more energy subtracted by it. The choppier the move, the more potential energy added to it.

We can see how the addition of the Choppiness Index adds this dimension of "energy" to the chart in Figure 7:

Figure 7



The red circles show a "high energy" condition which consistently warns of an impending move, either up or down. The orange circles represent an "exhaustion" condition from which a transition to "consolidation" typically occurs.

Markets will just oscillate back and forth between these two states of "range expansion" and "range contraction," literally forever.

Using Rule Number Four With Income Trades

There are a couple of different ways that we can add increased "edge" through the use of Fractal Energy Trading techniques, depending on the setup:

- If we want to ensure that we do everything possible to keep the underlying coin and not get "called out" by settlement, then we should wait until we see exhaustion signals on at least the daily, and optionally the Weekly chart as well. This might prevent a monthly application of covered calls, but we will reduce the probability of being "run through" by the price above your short strike.

- During a primary uptrend, we will rarely ever see the daily chart sell down hard enough during the pullback to create an "exhaustion" signal which would be a great short put entry (normally). During a primary bull market, we might go down to the chart which is 5x faster than the daily chart, such as the 5 hour chart, and look for downtrend/pullback exhaustion signals on this timeframe as a potential trigger for the short put entry.

- We generally want to look for the larger timeframes (weekly/daily) to be supportive of the next trend with relative high energies when we are selling puts. We are hoping that the next move higher will be explosive.

- We look for the exact opposite of that with the short call setups; we want the price to be "flaming out" on the uptrend and just about to move into consolidation when we sell a call against our inventory.

Summary - Using Fractal Energy Trading Concepts

I would once again encourage you to use your OMNIA privileges to access the Fractal Energy Trading course material so that you can take the time to get a better understanding of how you can use these principles to not only understand what price is actually “doing,” but also to use this knowledge to create better edge for your trades.

In this module we saw that we could:

- Use Rules 1, 2, and 3 to give us a better read on the price action to create entries with more edge.
- Using a smaller-timeframe reversal on the pullback gave us better edge on the short put entry.
- Using a smaller timeframe reversal on the ensuing rally gave us better edge on the short call entries.
- Trading in the direction of the larger weekly trend gave us the best chance of success for a short put entry.
- Understanding the cycles of “range expansion” and “range contraction” gave us a much better read on how to set up the short put/short call trades.

Homework and Next Steps

Please complete the following tasks before moving to the next module:

- [ ] Watch the associated video for this module.
- [ ] Take the module quiz.
- [ ] Look at a daily chart of Bitcoin; can you spot any of the four rules explained in this text that could have been applied towards a short put or covered call trade?