7 Step Trade Entry Checklist
About the Author

Kirk Du Plessis is a full-time options trader, real estate investor and entrepreneur.

Before launching Option Alpha more than 8 years ago, he was an Investment Banker for Deutsche Bank in NY with the Mergers & Acquisitions group, a Capital Markets Analyst for BB&T in DC covering REITs and a Senior Loan Officer in the mortgage industry.

His training courses and coaching programs have helped thousands of traders from around the world learn how to make smarter options trades. He was recently featured in Barron’s Magazine as a contributor to the Annual Broker’s Review and is the head trader here at Option Alpha.

Though a long-time resident of Virginia, he currently lives in Pennsylvania with his beautiful wife and daughter.
7 Step Entry Checklist:

This is your step-by-step guide to the top 7 things you should check before you make another trade.

And this isn’t some quickly thrown together list; these are strategic steps that will help you take more decisive action when it comes to filtering and picking great trades.

Each item is placed in perfect order so that you can quickly figure out if a trade is worth your time analyzing.

1. Portfolio Fit

The first thing you need to ask yourself before even looking for a new trade is, “Do I need this trade? Does this trade fit within my current portfolio?” If you already have 10 bullish trades do you really need another bullish trade - probably not right.

The key here is to look for trades that add balance or reduce risk. If you already have 10 bullish trades you need to look for some bearish trades to help re-balance. Just knowing what to look for from the start helps you focus only on the setups you need for your portfolio.
2. Liquidity

Checking for liquidity is a very quick way to distinguish between great, tradable stocks and everything else. Our general rule of thumb is that the underlying stock needs to trade approx. 100k shares per day.

With markets this big and efficient we can confident that probability calculations will be more accurate over time.

For the underlying options, we prefer the strikes we are trading to have at least 1k contracts of open interest. This minimizes the bid/ask spread and ensures the markets are liquid enough to quickly get in and out of a trade fast.

3. IV Percentile

Once we’ve narrowed down possible setups that fit our portfolio and stocks that have great options liquidity it’s time to see if IV is relatively high or low. We can measures this relative ranking with IV percentiles.

For example, if AAPL has IV currently of 45% but an IV percentile of 85% then that means that more than 85% of the time over the last year, volatility will be lower than it is right now at it’s current actual IV (45%).
This type of IV percentile suggest that AAPL implied volatility is relatively high and we should focus on premium selling strategies.

Likewise, if GOOG has IV of 45% but an IV rank of 25% then only 25% of the time over the last year IV was lower than it’s current actual IV (45%).

This also means that we have a 75% chance that IV will increase on average so we consider GOOG to have relatively low implied volatility and would prefer to be net buyers of options.

4. Option Strategy

The process of selecting the best strategy is a process of elimination not selection. With a solid understanding of where implied volatility is for the stock relative to it’s historical past (IV Percentile) we can now eliminate all the strategies that “don’t make sense” for this setup.

For example, if IV is high and option pricing is rich we can eliminate all option buying strategies like debit spreads, calendars, long single options etc. From the short list left; credit spreads, iron condors, strangles etc we can then choose the strategy that best fits our risk tolerance and account size.
5. Strikes & Month

Having finally selected the appropriate strategy to fit the market situation we can now place trades at whatever probability level we feel comfortable at. One of our favorite strategy is to sell credit spreads below the market.

We could sell them at strike prices that give us a 90% chance of success or we could sell them at strike prices that give us a 70% chance of success. In either case we are making high probability trades but one is slightly more aggressive than the other.

Just be sure to pick strikes that fit your style and goals.

At this stage we also want to make sure we are giving ourselves enough time to let the trade work for us. Our general rule is to place high IV strategies between 30-60 days out and to place low IV strategies between 60-90 days out.

The longer timeline on the low IV strategies gives us more theta value to counter-balance low volatility.
6. Position Size

Position sizing is one of the most pivotal areas that many traders (both new and experienced) fail to get right. After you have gone through steps 1-5 of this checklist and are ready to actually place a trade you need to make sure that you are doing so with a small position.

Countless studies have proven that trading big positions will exponentially increase your risk of blowing up your account and losing all your money. For this reason we suggest that you place trades on a sliding risk scale from 1-5% of your account balance per trade.

Risk by our definition is measured in cash or margin put up to cover the trade. For example, if you sold a $1 wide credit put spread for 0.30 the broker would require you to put up $70 in margin to cover the trade.

Now, if you are trading a $5,000 account and want to allocate 3% of your account to each trade you would base that off the $70 of margin required to cover the trade. Taking at most $150 of risk (or 3% of $5,000) divided by the $70 per contract would mean you could at most sell 2.14 spreads.

Play it safe and always round down okay?
7. Future Moves

As the saying goes, “A great chess player is always thinking a couple moves ahead.” Well the same applies to trading options. This is where your “Plan B” scenarios start to get thought out in advance.

And this shouldn’t necessarily apply to just thinking about how to protect yourself from a losing trade, though important.

But rather, what if the stock just stays in the same range, could I roll it to the next contract month? Are there even options at the next contract month? Does the stock having earnings coming up? Is there a divided being paid in the future?

Asking these questions helps your brain strategically prepare for adjustments when things go wrong (because some trades undoubtedly will).
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We help educate and coach options traders on all levels: from people just starting out to advanced traders with multi-million dollar portfolios (and everyone in between).

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We believe that there is a huge lack of financial literacy and a gap that we aim to close by delivering the best possible content in multiple formats for you to consume: blog posts, video tutorials, webinars, podcasts, case studies, live events, etc.

Our goal is to pull back the curtain and give you the best online courses and training possible in all the right areas so that you can learn to make decisions for yourself. Because at the end of the day, making smarter trades isn't just our tagline - it's our mission for you.