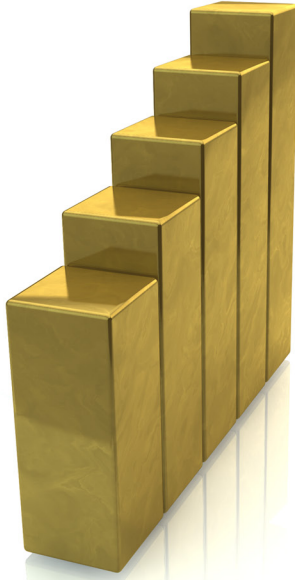


Pyramiding

Risky and Very Profitable Strategy

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This essay is not about ancient Egypt, nor about the great architectural creations of Central or South America. This article is dedicated to one of the riskiest and most lucrative strategies ever developed. It might be particularly useful for gold and silver speculators who dare to massively boost their profits.

In this essay the term ‘pyramiding’ refers to the strategy of purchasing OTM (out of the money) options, selling them when they are “in the money,” and using the proceeds from this transaction to quickly purchase another set of options – those, which would be out of the money at that time. This way you may increase your profits very substantially, given, of course, that your time and price predictions are correct. For example, if you gained 400% by purchasing an ATM (at the money) option and selling it when your predictions materialized, pyramiding might give you staggering 2000% and more. If the chance of realizing such a gain is only little smaller than profiting on ATM options, then you might want to seriously consider pyramiding.

Why are gold, and especially silver investors, interested in taking so much risk? Well, to put it simply, because we have the possibility of reaping more benefits using the pyramiding technique than people trading in other sectors. Pyramiding works best when a particular security moves in a given direction far and fast; and the precious metals market (including precious metals stocks) are known to be extremely volatile at times. Remember the rise in the precious metals in the second quarter

of 2006 and the consecutive fall, or 2008 plunge? At such volatile times, this strategy is superior to almost any other. Most of us agree that we have substantial part of this bull market still ahead of us, and that it will get more volatile during the final parabolic upswing. There will be times when the price of silver and gold is pretty stable and consolidates in a given trading range, and there will certainly be times when these prices rise at a great pace, outperforming any other asset class. This latter type of price action is just perfect for applying pyramiding! The higher (lower) and the faster gold or silver price rises (falls), the bigger the profits you might achieve.

What’s the catch? What do you bet on in pyramiding?

You bet on the fact that the move will be substantial.

The thing you should be aware of is that you need to be very accurate when it comes to your predictions, both in time and in the range of the particular rise or fall. For example, if you predicted that silver will go from \$40 to \$100 in six months or less, and it goes “only” to \$60 and then stabilizes at this price level for some time (so that the total time of the transaction exceeds six months), you will actually lose the capital that you used for this strategy. There are some ideas that might decrease the chance of such event taking place:

- make sure that your predictions are well founded,
- don’t use too much of your capital (you can use our Tools to check how much is “too much”),
- take some money off the table each time you sell one type of options and purchase another one.

Isn’t this way too risky for me? I don’t gamble with my money, you know.

Well, believe it or not, including risky strategies to your plans might help you to reduce the overall risk level. For example, say you have \$2 000 dedicated to your speculative portfolio for purchasing op-

tions or warrants. You expect that your ATM options will go up by 400%, but being conservative you attribute this rise a fifty-fifty (50%) chance of materializing. Realizing gains from the pyramid would amount to 2000%, but the chance is only one third (33%). Let’s see what would be a better decision for your portfolio in the long term. For this simulation we will use our Position Size Calculator (if you want more information about our methodology please refer to one of our other reports - [The Universal Investor](#)). We are going to check how much profit you would need to expect in order to justify taking higher risk. If the required profit is greater than 2000%, then pyramiding is useless here. However if it is smaller than 2000%, than it is possible to reduce your risk by using less money to this transaction and still expect higher gains!

Our calculations show that if buying ATM options is your only choice for \$2 000, long-term optimal fraction you should put in this strategy is 37%, which would effect in part of your portfolio increasing on average to about \$18600 after ten identical transaction. The pyramiding would work best in the long term if 30% was invested each time in such a transaction. Please note that the Calculator by itself suggests lowering your exposure! If you started with \$2 000, repeated this transaction 10 times and put 30% each time, then you would end up on average with ...\$112 750 (!). That absolutely does not guarantee you such a high rate of return, but it does give you the idea, just how powerful this strategy is. But – here’s the best part – if you invested only 7% of your capital each time in the pyramid, it would most likely still beat the result of buying simple ATM options. Actually 7% would (on average) cause this part of your portfolio to increase to \$22 100 after ten transactions.

Of course, there is no free lunch in the economy and especially in trading, and this situation is no different. It is possible to achieve such high gains because you would ‘bet’ on a different scenario than in the case of purchasing single options of

security and the forecasted price. You might wish to use three or more different strike prices if you predict a really large and fast move in a stock, metal or index. In that case, the strike prices should still be between actual price and the forecasted one, but the differences between them and the starting and final price should be close to being equal. The Pyramid Optimizer, available on our website, can calculate these strike prices for you.

This kind of trade is wonderful for one's account balance, if it is successfully executed. Yet, there have really been only a few times during the last couple of years when it was rational to use them. At times, precious metals move in a fast manner, but as we all know too well, we sometimes have long consolidation periods, during which pyramiding really doesn't make much sense. To achieve very high rate of return you would ideally want a stable market, which starts to move in a given (most likely up) direction and it rises very far. For example, take a look at the magnificent run-up silver had back in the 2005/2006, or the very recent surge that drove the price from \$14 to \$21. These are the moments you might seriously consider pyramiding. It is also possible to profit on the falling prices, but conducting such a transaction is really challenging.

So – what's a precious metals investor or speculator to do to take the full advantage of the outstanding opportunities that pyramiding has to offer?

Firstly, don't get too greedy. Gold and silver markets are very volatile at times, but that doesn't mean that they will be volatile each time you make a prediction. In fact – if they were so volatile all the time, the overall profitability of this strategy would decrease – but we don't want to go into details in this essay. Sometimes it's best not to take any action and see how things unfold. Be sure to take your position when the chance of winning far outpaces the risk you take on. You may use our tools to help you with this comparison. Either way, we suggest waiting for clear signals before getting involved in this strategy. This could be gold breaking out of some chart pattern, particular positions taken by Commercials or Large Speculators, as indicated in the CoT Report, witnessing excessive fear on the precious metals market, or anything else that would convince you that "the move" is imminent. Let this opportunity come to you. Don't look at every market action trying to figure out

whether that was it or not. Following these rules should make your portfolio safe and more sizeable.


At the end of the 1970 – 80 bull market in the precious metals the price of both gold and silver went parabolic and allowed investors to achieve astonishing rates of return. Now imagine that these profits could have been increased at least ten-fold thanks to pyramiding... Another interesting thing is the junior mining sector. Juniors tend to rise very fast at times, especially during the final stage of particular upleg. This applies also to the whole bull market meaning that juniors absolutely thrive in the speculative frenzy when prices of precious metals rise in a parabolic fashion. When precious metals were rising very fast, most juniors were skyrocketing! Now imagine what could have been achieved if you had a portfolio of warrants and used pyramiding on them.

That's right – you could apply this strategy to precious metals warrants. This is more complicated than using it with options, as there usually is not that many different types of warrants for a given company. You would need to check particular juniors' correlation etc. to successfully execute this strategy with warrants. We will get back to this issue in our future essays.

The conclusion is that pyramiding is another strategy that gold or silver speculators could use to maximize their profits. If used wisely, it can also decrease overall risk exposure. Like all tools, pyramiding is not good nor bad in itself – it can only be used in a good or bad way. This strategy gives you the ability to achieve enormous gains under particular circumstances, but you need to be careful not to overuse it.

The main point is to use pyramiding only for the most volatile and most probable upswings or downswings. This means that most of the time, it should not be used. However, when circumstances are favorable, it is absolutely crucial to take action very fast as the opportunity may soon be over due to the rapidness of the move.

That's where the Pyramid Optimizer comes in handy. It helps you quickly find out which options are likely to provide you the highest profit for a given move, as well as when might you expect to switch from one option type to another. It also compares the profitability of pyramiding with the one of ATM options, options with the best strike price (yes, it will tell you which one it is), and the underlying asset itself.

See how it works for yourself now [on this page](#) so that you will already be familiar with this tool when the right time comes to use it 



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