THE Wizard OF OPS

FUNDAMENTAL TRADER
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Welcome to the first edition of The Wizard of Ops fundamental newsletter! This is an exciting endeavor for me, and I hope you find the ideas useful.

Before you read this newsletter, please read the introduction section since that will give you an idea of what this newsletter will provide. I recommend just sitting on the sidelines a month or two to see the flow of the newsletter and if the options strategies provided match your risk profile.

Please let me know what you think! Submit feedback to manager@addeumfunds.com.

Introduction to The Wizard of Ops Fundamental Trader

● This newsletter delivers ideas that identify undervalued businesses to invest in and buy when they reach a certain value.
● This trading style requires more capital to start, but it is less volatile.
● This newsletter will only offer long trades, which means your positions in this portfolio will produce returns that correlate with the overall market.

The fundamental trader is an investor in businesses, their models, and their management. He/she looks at a business's market capitalization, trends in revenues, growth prospects, dividends, profits, book value, and other business-related statistics. Because these positions are buying businesses, they are susceptible to market risk because they are always long businesses, never short. These investment decisions are based on business statistics and the stock price usually follows those statistics, so **the successful fundamental trader will realize consistent gains**.

From an options standpoint, there are several different strategies that the fundamental trader uses. The most popular is a put hedge. The manager buys a stock, then buys a put to hedge that investment. This is not a strategy you will find in this newsletter because the fundamental analysis needs to be so good that it not only must be correct, but must also outperform the hedge.

The strategies you will see here are:

● **Cash-Secured Puts**: When an undervalued stock is identified, a put is sold at the price you would have purchased your stock anyway. This allows you to collect premium on the money you have held aside to purchase this stock even if the stock never reaches your target price. If your stock reaches your target price, the option is exercised, and you get the stock at the price you wanted.

● **Covered Call**: When you own a stock, and want to sell it at a certain price, you sell a call at that price. This gives premium in exchange for the guarantee you will sell at that price. Again, this outperforms your typical stock purchase by the premium collected every month.

● **Bullish Credit Vertical**: This has the same effect as the Cash-Secured Put, except you purchase a put at your stop price. This strategy is ideal if there are **(continued on page 2)**

(Introduction Continued) earnings or a catalyst that introduces a measure of risk that you are not comfortable with, or your value price is far enough away from the current price that you are sure the option will not be exercised. This strategy also lowers the amount of capital required to do a trade, so you need to remain disciplined to keep the appropriate capital on the side for your trade.

Fundamental Trade #1

Image Source: Value Line® Institutional Services Website.

Analyst: Arnold Bernhard founded Value Line in 1931 after spending several years on Wall Street as an employee of Moody's Investors Service. When the crash of 1929 and subsequent bear market wiped out what little savings his mother had, he determined that the then-current practice of analyzing stocks was woefully inadequate. He set out to develop a set of objective measures that would signal when a stock was overvalued and when it was undervalued – measures that would not yield to emotions. What followed revolutionized the practice of securities analysis and sent Value Line on its path to being one of the nation's largest independent investment research services as well as a major money management institution.

Accounting: $40,000 starting capital
Trade Idea: SLM Corp. (Sallie Mae)

Thesis: "SLM's favorable prospects have not gone unnoticed by the investment community, and the stock price has advanced more than 10% over the past three months. That said, the stock still trades at a reasonable price-to-earnings multiple, and we think that the equity has plenty of upward mobility. In fact, the issue offers wide appreciation potential to the 2020-2022 time frame." – Value Line. If you wish to see further company information about the recommendation from Value Line, please email manager@addeumfunds.com.

Wizard of Ops Commentary: I wanted to start with a company that hasn't participated in the massive run-up, so that it could still be a value. When I look for good fundamental names, I look to the analysis first. Value Line put up TXT and SLM, and SLM had the higher implied volatility, which means the options are more expensive relative to the underlying price. We are selling options, so we want the options to be more expensive.

Since Value Line does not give price targets, I will sell the 30-delta put every time, and the number of options will be based on 25% of the portfolio. Again, we are building a portfolio, so I want to start with one play for this first month.

The Trade: Sell 9 Feb. $11 SLM Puts @ $.24. ***This trade uses $1,430 capital.***

The Plan: Keep this on through expiration. If the options are exercised (SLM closes below $11 at February expiration), that is what we want. We have the shares at a price reasonable to buy them anyway, technically at $10.76. If you execute at $.24, you will realize a 2.2% return on this trade if the price never drops below $11. If it drops below $10.76, you will realize a small loss to begin. This is fundamentally an underpriced stock, so you wouldn't mind owning this stock at that low price.

Fundamental Trade #2

Image Source: [Chimera Research Group website](#).

Analyst: David "Dave" Sobek is a disciplined value investor. Using models, research, and fundamental data, Dave devises a value for biotech stocks, buys when significantly undervalued, and sells when significantly overvalued.

Accounting: $50,000 starting capital
Trade Idea: Neurocrine Biosciences, Inc. (NBIX)

Thesis: "NBIX has gotten cheaper. The $75 level is close to the moving average is a good level with $70 as the stop loss."

Sobek Commentary: "Is there any name out there that is a screaming buy coming out of JPM and heading into 2018? Not really. The stock that I think is really set up well is NBIX. If I did not already own it that is the one I would be buying. Going through their presentation, I think the weakness came from management talking down 1Q18 sales as there are still some more patients that need to switch over to the 80 mg dose. Remember that originally only the 40 mg dose was approved and since most patients take 80 mg/day they had to double up on the dose. The double 40 mg price was higher than a single 80 mg pill, so revenues per patient were higher than they will ultimately settle. The 80 mg was approved late third quarter and using that dose was cheaper for patients, so the revenue per patient would go down. Apparently not all made the switch in the fourth quarter so there will be some headwinds remaining.

"I get that but it completely ignores that there was still massive growth even though the majority already made the switch. So is it really worth selling when scripts are growing this fast. The other caution that management noted was that this will be the first year they go through the donut hole and it is unclear how much that will impact sales in 1Q. Again, this is a well-known cycle and a very temporary slowdown in growth that might happen in 1Q. The safety of this drug is great and these patients are going to be on it a long time and so it is going to be a blockbuster. I will happily hold through a potential explainable 1Q slow down knowing why it is happening.

"The other thing I like about NBIX is its pipeline. Elagolix will be approved this year and those royalties and milestones go straight to the bottom line. In addition, we have a call option with opi in that they will find out soon whether or not they need to run a trial in the US for approval. My expectation is they would need a new trial (being cautious in expectations) but with upside potential, especially given its approved in the EU and the more open FDA. Finally, you have NBI-74788 phase II data this year with the potential initiation of a phase III. Even with all of that going on it is still trading at $8B market cap which is less than NKTR. So it is hitting on all cylinders and will be a long term winner and it is not crazy to think it is also a take-out target if M&A heats up."

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The Trade: Sell NBIX 3 Feb $75 puts, Buy NBIX 3 Feb $70 puts @ $.85. Hold $3,750 on the side per spread for ***$11,250 in total capital used.***

The Plan: Set an alert on your brokerage platform for when NBIX hits $76. When it does, hold the full amount of capital on the side and sell the $70 put, hopefully at a gain. If this happens close to the February expiration date, do not bother selling the put as it won't have a bid for you to sell it at. Remember, in the fundamental portfolio, you WANT to own the stock. You are hoping for NBIX to dip.

(Fundamental Trade #2 Continued)
Wizard of Ops Commentary: NBIX is selling at $81.37, 7.8% away from the strike price of $75. This is one standard deviation away. Normally when this is the case, I do a vertical and hold only half of the capital on the side. This is because of the low probability that the options will be exercised.