



Title: Buying and Selling Derivatives (Episode 010)

0:00:18 Andy: Andy Tanner here, welcome to The Cash Flow Academy Show, it's great to have you. Congratulations for tuning in, rising on iTunes now man, The Cash Flow Academy Show. And when I say congratulations for being here, you know I mean it each and every time. You're investing time, time is money to get more insight, more financial education. Birds of a feather flock together and not everybody does what you and I do so I always feel a kinship, feel a resonance with people who wanna learn like I do.

And today's topic is a Warren Buffet topic and it just set me off. I tell you, I get, 99.9% of the mail get is positive, it really is and I should just let that be that way. I remember in my book 401 Chaos, I put it out there, it's a 5 star book, 4.9 star, whatever it is on Amazon and it's got lots of reviews. I remember my first 1 star review and this guy just ripped my, he wrote a book about my book on Amazon, bad book, ridiculous analogies, he went through like 7 points. And my great mentor, one of the great ones for me, Robert Kiyosaki, says, listen Andy, look, you're my paper assets advisor, you're gonna be writing books. He says, look, when you write a book, when you teach, when you put forth your education, there's gonna be people out there that throws stones, okay? Think Can Grow Rich has 1 star reviews, academy award winning best picture movies, someone's gonna go on Apple iTunes and give it a 1 star review and says, dude, look, well he didn't say dude, that's how I talk, he says, Andy look, and I never forget when he said this, this is one of my gems from Robert Kiyosaki and he said Andy, your critics won't change but your friends know who you are. And so here on The Cash Flow Radio Show, I consider you guys that listen my friends so I appreciate that.

So like I say, when I get critics and I get people that throw stones at what we teach and everything, most of the time I say, you know what Robert? Critics won't change but it was funny because on that 1 star review, the guy who listed these 7 points he said baloney. So I did a video and some floating out on YouTube probably somewhere out, I don't know where it is now, but I did a video and I put it out there to my database and I said, look at how backward this 1 star guy is, cow up in the 90 is and I backed up. So that's been a few years ago and since then, I just let it go. Well, I get email like I said, 99% of it is positive, 99.9% is positive but everyone smile.

I'll talk about Warren Buffet and I'll talk about the difference between what you and I do on The Cash Flow Academy Show, type of investing you and I look to do and the 401k guy or whoever you are in the world, the RSP guy, the Super in Australia, the 401k in Japan, wherever you are in the world, you and I do this different than other people and I said look, Warren Buffet doesn't do the 401k thing man, he does the derivative thing. And I get mail every time I do that and people try to set me straight and they say, Andy, Andy, Warren Buffet is a value



investor, he buys a stock and he holds it forever. And I've just got to tell you that nothing could be further from the truth, okay? We don't know his 2015 numbers yet, okay? I'm staring at an article here on my computer, let me bring it back up, make it bigger, and it talks about Berkshire Hathaway's annual report, okay? Let me bring this up here if I can find it again. It says, bring it up, where did it go? Okay, here it is. It says that he's got 7 billion dollars man, are you kidding me? 7 billion dollars from selling premiums, from collecting premiums to do this man, I mean, it's just absolutely not even close.

And so I wanna talk a little bit about Warren Buffet's strategy with derivatives, I wanna explain a little bit about what derivatives are and most of all that you can't listen to everything you hear, you've got to investigate things for yourself even things I say, educate yourself. There's a difference between education and advice, advice is when people tell you what to do, don't buy derivatives, don't sell derivatives, don't get in derivatives, that's advice. But do you know what you're saying no to? Do you know what you're saying yes to if you decide to do them?

So let me tell you that you can learn about this in some of the things that we teach and we do this in the Mentor Club every week but let me see if I can give it a crack, it's a little bit tougher environment. Let me give it a crack on The Radio Show, I think it's worth giving a crack to. A derivative most of the time is just a contract so I want you to think about the insurance that you buy. It's a contract, you went to GEICO maybe or some company and you bought some insurance on your car for 6 months so you have a premium that you pay, that's what the insurance company collects, and you've got a period of time where they've made you a promise. So basically, Warren Buffet's company GEICO makes money for making promises and exchange for those promise, people pay a premium. So let's get that in our heads, let's repeat that several times 'til we get it. Warren Buffet, what he does is he makes someone a promise, I promise you that if you wreck your car, I'll pay for it. In order for that promise, you've got to give me a premium. Oh, and by the way, the promise is good for 6 months or a year or however long it is. And that's a derivative, it's a contract. Think about those of us that have rental properties, right? So I have a rental property let's say and it's a single family home maybe and I make someone a promise, I say look, this is my house, okay? This belongs to me and my trust, it belongs to my LLC. I'm gonna promise you that you can live here, that's my promise, I'll let you live here, I promise you I won't bother you, you can have use of my house, that's my guarantee to you, that's my promise, that's my obligation, whatever word you wanna use, promise, obligation, guarantee. You're gonna stay in this house and you're gonna be able to use it at your will and just keep it nice. But in exchange for that promise, you've got to give me a premium called rent, you've got to give me some money and we're gonna just do this month to month or 6 month lease or whatever.



So derivatives have an element of time, they have an element of time and that's how you make the money is off the time decay, right? The time will go away. Look, I don't know if the stock market will go up tomorrow or down tomorrow but I know that Monday turns in to Tuesday and I know that January turns to February, I could even do this long term if you're impressed, I can say that 2015 is gonna turn in 2016 regardless of what all this end of the world people think, it is going to move forward and it's predictable and even the pace, as sure as the sun rises and sets. So one of the cool things about derivatives is they're linked to time, rental agreements, insurance agreements.

Well, as you increase your financial education, as you increase your knowledge, your jargon, your vocabulary, you'll begin to learn that there are insurance contracts for paper assets for financial assets. A great example of this is something called a credit default swap, holy cow, we don't wanna get complicated on The Cash Flow Academy Show so we better simplify that. There's a country called Greece, that's pretty simple to understand, and Greece, they have credit and they might default on that credit hence the word credit default, right? And there's a contract that says, look, it's called a credit default swap says if Greece issues some bonds, they go in to debt and Greece defaults on this, we as your insurance company will pay you for this. And so it's a great thing to learn as an investor coz you can get a gauge at risk. Think about insurance, if someone's paying a lot higher insurance premium than you are, they're probably a speeder, they're probably speeding like crazy. I bet they've got tickets, maybe even accidents. And so I look at how much premium someone pays, I know how much risk there is in that market so when paying a lot of premium for the health insurance, hey, maybe I have cancer like I did. I'll tell you, until they did the Obama Care thing and I'm not for against any of that stuff, I'll just say though man, my insurance premiums, they wouldn't even insure me because the risk of cancer was too high, right? I'm a cancer survivor. And so I look at Greece and if the credit default swap premiums spreads are huge, I know Greece might default on that debt. So it's a wonderful thing to learn even if you don't invest in derivatives, they can be a great measure of risk.

So probably the derivative that I work in the most is the options market and you'll learn there's different types of options. If people are suspecting the market's going up, they'll buy call options, if they suspect it's going down, they'll buy put options. Just by looking at how many people are buying calls and puts, a ratio between the two, I can get an idea of how people feel about the market. Just by looking at how much people are paying for options, even if you don't wanna buy them, even if you don't wanna play that game, you wanna see how much volatility investors, the big boys think in the market? Just look at how much they're paying premium for these things.



There's a lot of money to be made in making promises. Think about GEICO again, what's their manufacturing cost? Nothing. What's their raw materials? Nothing. Assembling? Nothing. Distribution, they're putting those things on as railroads, no. You're making a promise, it's air baby and that's why insurance companies are some of the richest in the world, that's a clue. My friend Bryan Thayer wrote a book called Life Leaves Clues, there's one right there. The richest companies anywhere are insurance companies, that's a clue. So if you wanna get rich, what business would you wanna be in? People are scared of risk, those guys analyze risk, those guys embrace risks, those guys make money on taking risk. Think about it, the moment you pay them for that car insurance, they're taking the risk now not you and they're willing to take it because there's big money in it. I'll tell you, people run from risk, no, no, no, analyze it, learn it, study it, learn the tables, learn the actuarial tables, sell premium.

In 2007, I have an article where Warren Buffet sold options, derivative contracts on stock index, it's like the SNP500 and he's saying, look, you guys are scared it's going down? I think it's going up, I'll sell you these contracts. He made 2.5 billion dollars that year. Now look, 2.5 billion dollars, at that time I think he's worth maybe 40 billion, maybe 40 billion. Last year, Warren Buffet, last year, he made promises, he says, look, I'm gonna make you a promise to buy some things from you cheaper than they are today, I'll lock in your price. If you get scared and wanna sell, I'll be your buyer. He wants to buy this stock anyway, they paid him 7 billion dollars last year, 7 billion dollars in 2014, Berkshire Hathaway, Warren Buffet's holding company brings in. He's only worth 60 billion, that's like 10%, 7 billion dollars the guy brings in by doing nothing more than making promises that he knows how to keep and he may wanna keep these promises. Let's say that oil, I'm doing it on oil right now, let's say the USO, it matches oil goes up and oil goes up, the USO is the oil funds, it's an ETF. Right now it's sitting about 14, I wanna pick it about 13, I can't because it's at 14 but maybe these guys holding at 14 think it may go down, I say I tell you what, I'll lock in your price at 13, you wanna drop that thing off at 13 to me, I promise you, I'll buy it at 13. That waiver goes down further than that, you know you got a buyer at 13. I wanna buy it anyway, I think it's gonna go up, I don't think we're gonna have the USO sit there, it was at 30 something a year ago, it may not hit 30 again but I'm willing to hold on to that for few months and I don't think oil is gonna be free, I don't think it'd go down that much further. Pay me some premium, pay me some premium, I'll take the premium, that's cash flow. That's not something that happens in a 401k.

Now let's say you're driving along or you're exercising or you're kicking back like I am right now listening to Cash Flow Academy Show and you say, Andy, I don't know what a derivative is or put option, hey, it's alright, hang out man, hang out. You'll be fine my good friend, you have something to study, you have something to you know what? I'm gonna Google derivative, what does it mean. Start educating yourself. We live in such a great time, you can learn anything, you really can and so start learning about what a derivative is, start learning about why



insurance companies are the richest companies in the world. Look, life leaves clues just like my friend Bryan Thayer says, life leaves clues. If the richest people are selling premium and the richest companies, insurance companies are selling premium and they are the ones coming ahead of the game in every market and they're getting that premium up, down and sideways, wouldn't I wanna learn just exactly how to sell premium? And man, if I could do it without having to start home insurance company by just having a stock account and an options account, hey, there's risk involved, there's no question, there's always risk involved, how do you manage risk, by avoiding it? Do you avoid risk to learn about it? No, you manage risk by managing it. Don't buy a house, it might burn down. No, buy the house but manage the risk with insurance, right? Manage the risk.

So a lot of people will be surprised, Warren Buffet said that derivatives were weapons of mass destruction and he scared everyone, well look, he also said that the guys that are borrowing money to buy these might end up losing so what did he do? Turned around with the seller and that's how he makes billions, by selling these. He's used them opportunistically, he's bought a few in his day to hedge and so have I and you'll learn your lessons and you got to start out small in paper trade and a fake account so you'd learn how to sell these the right way but you'd be surprised that if you go in, you walk in to your financial advisor's office, one of the ways you can do this is something called a covered call, you don't even know what that means. But if you go in to your financial advisor, your broker, you say I wanna start selling some covered calls, is that aggressive or conservative? They'll tell you, they look at that on the conservative side, they'll say why don't you ever tell me about this, they'll say because you never asked. As long as you never ask, you don't take up my time and I have time to go sell more people more financial mutual funds and financial products. But I did that with my advisor 20 years ago, I learned about what's selling a call option was on stock that I owned and I thought it was the coolest thing I've ever seen like that looks conservative to me, looks way conservative, more conservative maybe than just owning a stock, I'm gonna hold it anyway long term. And I went in there to him and said, hey, I was a little embarrassed, I thought, I'm probably went to some ???[0:16:58] seminar that was blowing stuff up and I probably just got taken in by it so I was a little bit worried when I walked in to the broker's office and I walked in, I sat down with him and I said, I went to this thing, it may be ???[0:17:13] but it sure looked good to me so I hope I didn't get taken in, I'm interested in writing covered calls. He goes, why don't you ever told me? I says, how could you never told me, he said, you never asked. He says, I've got 3 or 4 in my own account right now, you wanna see what I do? The guy was writing covered calls in his own account, he was doing what they thought in the seminar in his own account, you never told me about it, why? I never asked and he's busy getting more clients which I understand, cash flow for him.



Selling a put, cash covered put, what a great way to acquire stock, could be a great way for you, maybe it is, maybe it isn't but wouldn't we all like the choice? I get the email, it says, Andy, you're up in the night, Warren Buffet does not sell derivatives, he's a value investor, he has nothing to do with derivatives, he call them weapons of mass destruction. That's just really a superficial knowledge of what Warren Buffet does, it's not even a superficial knowledge, it's just an incorrect knowledge. Okay, yeah, people that misuse anything can turn it in to a weapon of mass destruction but I'll tell you, don't bring a knife to a gunfight. If you're gonna get in financial war with someone, would you want a knife, gunfight or nuke, a weapon of mass destruction? I wanna go to war with a weapon of mass destruction, man, I want power on my side. Just coz it's a weapon of mass destruction, does that mean it's a bad thing? Well, it's a bad thing if you're on the other side of it, right? If you're looking up and it's coming down on you but boy, if you're using it as your weapon on your favor then that's better than a knife, that's better than a sword.

So yeah, your critics won't change but your friends know who you are. So I just have to remember when I get these emails, most of them I don't see but I have to confess, one of the guys on my team, he and I were talking and I brought up Warren Buffet, he says, man, you got to see some of the mail you got on this. I go, what do you mean? He told me about one of them and the guy just chewed me out, told me I was up in the night, told me that Warren Buffet has never touched derivatives. It's like never touched him, it's 7 billion, his net worth is 60 plus billion, 60 billion in the net worth column, cash flow from derivatives? Over 7 billion dollars, 10% of his net worth. Can you believe that? And the guy says, Andy, he doesn't touched derivatives. I'll tell you, he touches them and he sells them and he puts that premium right in the bank.

So, do you need to know everything about derivatives from one episode of The Cash Flow Academy Show? No you don't, no you don't, but let's review. What is a derivative? It's an agreement, it's contract. It has a time period to it. One party usually makes a promise, hey LeBron James, come out and play for my team, okay? Play for my team, if you'll promise me that you'll play for my team, I'll give you a contract, you promise me, you make a promise, man, I'll give you 10 million a year, 20 million a year, whatever he makes, he's worth it. It's a contract but it's only a 5 year contract or 2 year contract, right? You're making money on time. LeBron James collects a paycheck in the form of a contract. He's gonna collect that for a certain amount of time if he keeps his promises, same thing with insurance, same thing with rent.

Contracts are the coolest thing, ask yourself, if I am going to be in financial education, if I wanna learn more and become more wealthy and elevate my wellbeing as a part of humanity with financial education, is contracts part of that? Is learning about what a contract is part of that? Yeah it is, yeah it is, premium, making promises, obligations, guarantees, whatever you



wanna call it. Do I wanna know about credit default swaps? Do I wanna know what they are? Hey, you know what? Even if I don't know the details of credit default swap, if I know that there are measurement of risk, if I know that the price, the spread on a credit default swap is massive for a company like Greece, does that tell me Greece is in trouble? Sure does, it tells me there's a lot of risk there anyway. If someone's paying lots of money for insurance, for their health insurance, I'm concerned about their health is, I hope they're okay if they're a friend. Even if they're not a friend I hope they're okay.

So derivative contracts, so a couple of things. When people, they'll do the same thing to you that they'll do to me. I'm grateful for my opportunity to write books because you're gonna get some 5 stars, you're gonna get some 4 stars, you'll get a couple of 3s and you'll get some 1s and that's part of life is dealing with the 1 star people in your life. You probably don't do a rant like I did, you probably don't fight and most of the time, we don't but just know that if you're gonna pursue a different path, the road less traveled as Robert Frost said, look, the things Buffet does certainly in off the beaten path, Steve Jobs, certainly off the beaten path. The people that are on the beaten path are never wealthy, it's the people that are off the beaten path that are always wealthy. So when your family members see you reading a book on real estate from Kenny McElroy, the ABCs of Real Estate Investing or they see you reading Second Chance from Robert Kiyosaki or maybe you got a free one, maybe you're starting out with free and you're reading my book which I make available now for free, 401 Chaos, and you say, I'm not so sure 401k is the best thing, they will throw stones at you, oh yeah, yeah, my employer said I had to. You know what? Your critics won't change but your friends know who you are. Your critics, they won't change, they won't but your friends, they know who you are. And so just remember, when people criticize you, they're not gonna change, critic, criticize, they're not gonna change. You hold strong of what you believe, you start that business, join that, who cares what they say, join it, it will be a great experience even if you don't make money, you learn how to sell and you'll meet great people. Start that new business venture, hey, you know what? Invest in that real estate. Go out and improve that property, get some cash flow. They'll say you're crazy, your critics won't change, your friends know who you are. You'll make mistakes, when you do, they'll be there to show you and say I told you so but see, mistakes are how we learn, mistakes are how we learn. And when you're at the top of the man, how many friends you think Steve Jobs has? How many friends you think I have? Shoot, I got friends on, thousands of friends, I don't even know who most of them are, they wanna be my friend on Facebook now but your friends know who you are that's why they're your friends, critics won't change, that's the first lesson.

Second, derivatives, derivatives, learn about derivatives, Warren Buffet uses them, George Soros uses them, are they using your 401k? Nope, that's just a mutual fund. So think about it, most successful investor ever, Warren Buffet. You wanna copy him? Don't listen to old people



say, Warren Buffet is a value investor, he just buy stocks, holds until he die. Baloney, he's selling derivatives. 7 billion dollars this year selling derivatives. 7 billion dollars. Started at the first time I saw it, that's how he bought his Coca Cola, 1993, sold a bunch of promises, say hey, hey, Coke's at 39 dollars, I like to buy at 35, if anyone's nervous about it going down, I'll make you a promise, I will buy at 35 no matter what happens to the price if you give me a dollar 50 premium, that's exactly what he did. Now, he's owns that Coke and it's worth billions of dollars, one of the best moves he ever made. How did he get Coke? By selling derivatives.

My 401k guy, your 401k guy, he's not talking about that with you, you're not copying Warren Buffet. Doesn't it make sense? If Warren Buffet is using derivatives, do we learn about them? If Warren Buffet is selling derivatives, do we wanna learn about how to sell them? And if our 401k is not copying the most successful people, wouldn't we wanna shift or at least think or at least learn a little more but just remember, when you're reading that book, when you're reading the 1 Minute Networker by my friend Bryan Thayer, when you're reading 401 Chaos which is free, when you're reading Second Chance by Robert Kiyosaki, when you're reading How to Start Your Own Corporation by Garret Sutton, when you're reading one of the best books ever, Tax Free Wealth by Tom Wheelwright, right? When you're reading these books and people make fun of you for trying to learn more about financial education, just remember, critics won't change, your friends know who you are.

Awesome to be with you, we've talked about derivatives, we've talked about people that throw stones. Take a learn about derivatives, great way to manage risk, great way to learn about how contracts works, great way to learn about measurements of risk with high premiums or low premiums. Great way to learn about puts and calls and new words, new language. If you don't know what a put is, well hang out in The Cash Flow Academy Show, we'll talk about it again. If you don't know what a derivative is, I'm sure this isn't the last time we'll talk about it again but a derivative is a contract where someone makes a promise in exchange for premium and Warren Buffet has collected a lot of premiums in billions of dollars.

Hey, awesome to be with you, great, I just love everyone that listens to The Cash Flow Academy Show, I love your mail coz 99.99% of it is good and the 1% of it, hey, boy, we'll even read yours too once in a while, we might even do that. So awesome stuff, love having you and next time, we'll be talking more about all things cash flow. Our mission is to raise the financial wellbeing of humanity by giving them all the opportunities we know how, Facebook, the internet, The Cash Flow Academy Show, podcasts, by give you chances to learn more about financial education. I'm out.

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