

thinkMoney/16

random musings for traders
at TD Ameritrade
Summer 2012

34/FUTURES SPECIAL

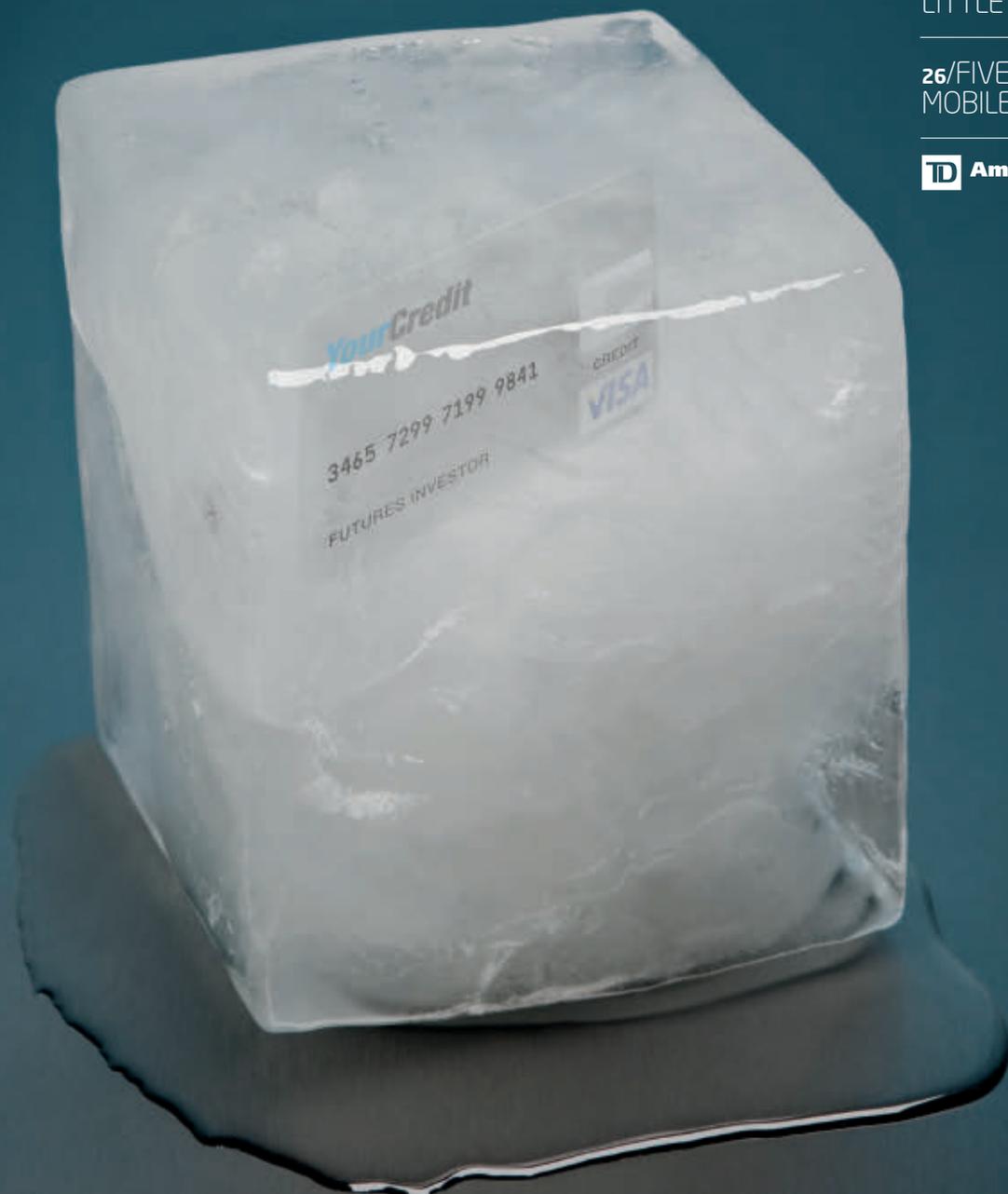
HEDGING YOUR
EVERYDAY
CONSUMPTION

10/A CHAT WITH
TOM SOSNOFF

18/SYNTHETICS
FOR THE
LITTLE GUY

26/FIVE TIPS FOR
MOBILE TRADING

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Fredrik Brodén

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Not Just for Farmers Anymore

Forget about inflation. There's probably a futures contract to hedge your everyday consumption. Let's start from the beginning with a little futures trading 101.





Synthetics for the Little Guy

If you're a market maker trading some size, putting on synthetic positions makes sense to optimize hedges. For you, the retail trader, synthetics may be helpful the next time you're sitting on a profit and don't want to leave money on the table.

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cont.

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Features



10/ Now Wall St. is Flipping Your Burger

Interviews. We don't usually do 'em. After all, why should someone else's instincts derail your own? But this one's different. Tom Sosnoff, CEO of tastytrade, Inc., helped pioneer modern-day option trading as we know it. And now he's got a few things to say about its future.

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If you're a market maker trading some size, putting on synthetic positions makes sense to optimize hedges. For you, the retail trader, synthetics may be helpful the next time you're sitting on a profit and don't want to leave money on the table.



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26/Go Outside and Trade!

Trading away from your desk can be liberating. Especially if it doesn't require talking to someone on the other end of the line as you rattle off orders. With mobile trading, since the rattling takes place between you and a touch screen, there's a few pointers to keep in mind.



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NOT JUST FOR FARMERS ANYMORE
Forget about inflation. There's probably a futures contract to hedge your everyday consumption. Let's start from the beginning with a little futures trading 101.

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How to trade futures step-by-step
FUTURES TRADING Q&A

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Double up on the CCI indicator for smoother performance and fewer whipsaws.



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41/Capiche?

Implied Order Functionality is here! Great. But what does it mean? It's all about the spread, baby.



32/The Spotlight

Meet the Professor—TD Ameritrade's Jeff Bierman. You may not have met him in the sandbox, but you've likely played with his toys.



33/Gear Head

Programming your trading software to find your ideal technical setup has never been easier—thanks to the Condition Wizard.

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A Quick Howdy

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Yup, Content is King...

• Sound like a cliché? Guilty as charged. But that’s because, at least from the perspective of you, the trader, it’s true. Why? Trading is largely a self-taught skill. There are no universities offering trading as a curriculum, and you’re not likely going to mentor under a famous billionaire trader anytime soon. But whenever you have an opportunity to get inside the mind of one of the greats, you take it.

In our first exclusive interview ever (it only took us five years), we dive inside the mind of Tom Sosnoff, CEO of tastytrade, Inc. You may know him as the guy who originally brought you thinkorswim, which revolutionized retail option trading. But what you might not know is that he’s now leading the charge in the content revolution that’s underway for traders. See page 10 for the interview.

Revolution, evolution, pick a volution, and we’re involved. In recent years, it’s all about mobile trading. You may already be trading mobile, maybe not. Whether you’re in



Got Feedback?

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the game, or thinking of getting started, we have a few tips for you in “Go Outside and Trade!” on page 26.

Of course, there’s the evolution of your own skill set, lest we forget the strategy addicts. For those who are thinking about dipping your feet in the water on futures, check out our special focus on futures trading, beginning on page 34. We’ll get right to the what, why, and how to get you started trading futures with TD Ameritrade.

Traders tend to be rule-breakers. Which means your reality is different from that of traditional investors. You rely on skills that have been honed over time. But again, where do you learn them? It starts with content—i.e. the spoken or written word. You might find those skills in a book, or maybe a video. At least for the moment, you may find them in an article or two in the pages of this issue of *thinkMoney*. That’s a promise.

Happy trading,
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INTERVIEWS.

WE DON'T USUALLY DO 'EM. AFTER ALL, WHY SHOULD SOMEONE ELSE'S INSTINCTS DERAIL YOUR OWN? BUT THIS ONE'S DIFFERENT.

TOM SOSNOFF, CEO OF TASTYTRADE, INC.—YOU KNOW, THE GUY THAT ORIGINALLY DEVELOPED THE THINKORSWIM PLATFORM—IS WELL KNOWN FOR PIONEERING THE RETAIL OPTION-TRADING TECHNOLOGY REVOLUTION (NOT TO MENTION A FEW EXCHANGE PRODUCTS AS WELL). AND HE'S GOT A FEW THINGS TO SAY ABOUT THE FUTURE OF OPTION TRADING. SO, YOU MIGHT WANT TO PUT DOWN THAT IPHONE AND PAY ATTENTION.

WORDS BY **THOMAS PRESTON**
PHOTOGRAPH BY **FREDRIK BRODÉN**

Interview

Photograph by
Fredrik Brodén
tdameritrade.com

TM: Aside from having been a market maker on the Chicago Board Options Exchange (CBOE), and now being a retail screen-based trader, are you trading differently than before?

Sos: Absolutely. And I know that I've become a better and more complete trader over the last decade, and over the last year in particular. That seems counterintuitive, I know. I was a market maker for almost twenty years, and have traded off the floor for nearly another twelve. Stocks, indices, options, futures, spreads—you name it, I traded it. But in the past year, I've devote more time to simplifying my approach and improving mechanics.

TM: Give us some examples.

Sos: First, I'm trading more liquid products, but in much smaller orders. Back in the day, I'd have thousands of contracts in index options tying up most of my capital. Most of my orders today are under 10 contracts, depending on the strategy.

But I have positions in 20 or 25 different underlying stocks or ETFs. That's to spread out the timing of my trades and have capital in reserve that I can use to put on new trades when price action or volatility presents an opportunity.

I use the example of a Las Vegas casino. Why do tables have maximum betting amounts? The casinos know that on any single hand in a single game, the probabilities may or may not work in their favor, and they don't want one enormous bet to wipe them out. Their probabilities work best over millions of smaller bets in games where the odds favor the casino. If the probabilities don't work out on a small bet, it's no big deal. Today, investors and traders have to think like casinos. Casinos don't gamble. They let the probabilities work for them over many small bets.

Secondly, I focus on what price and volatility are telling me about a stock or the market. Traditionally, investors and retail traders have read analyst reports or watched financial news on TV. That's what I would term "static" information—earnings, financial metrics, government data, etc. All the opinions about what any of that means don't help me identify an opportunity. The average investor or retail trader doesn't know what to do with that information, and neither do I. But people are beginning to move beyond that static data, and watch live prices and the relationships between various stocks, indices and volatility.

For example, **implied volatility** indices like the CBOE's VIX have been pretty low for most of the year. All the talking heads saying this or that about volatility didn't help me. But when I saw the "volatility of volatility" in the CBOE's new VVIX index drop sharply lower, that indicated to me a certain complacency or confidence in the market. I could use that information to create a trade—not just that the VIX was low, but so was the VVIX.

Thirdly, I use strategies where I can give a trade

time to work—what I call duration. During the life of any single trade, it can show a profit or a loss. If it's losing, I'd use a strategy that doesn't scare you out of the trade. Sometimes, if that losing trade has enough time, it can become profitable simply because of the volatile up/down behavior of the market.

Finally, when something happens that I've been waiting for, no matter when it happens, I have a plan in place and I act. If the stock reaches a certain point where I would **short** it, I do. If the stock drops to a point where I would **buy** it, I do.

TM: What wisdom do you like to share with small investors or new traders?

Sos: Stay small. Most individual investors trade too big. Second, diversify your strategies. Professional traders and money managers do it all the time. How they spread capital around between one or a hundred other positions is something smaller traders can learn.

The taboo topic? Everyone tells you to manage portfolio risk to be successful. Sounds great, but for some reason many investors still lose. So, stop focusing

TRADERS CAN'T TAKE THEMSELVES TOO SERIOUSLY. I CERTAINLY DON'T, BUT WE DO TAKE MONEY, RISK AND NUMBERS SERIOUSLY. THAT'S WHY WE CREATED THINKORSWIM—BECAUSE I LOVED TRADING AND LIVED THE TRADING CULTURE.





SEE TOM TRADE

So, do you wanna take a peek over Tom's shoulder during the trading day? Here's what you're likely to see.

- 1) a list of futures quotes that are indicators for the whole market: S&P 500 (/ES), Nasdaq 100 (/NQ), 30-year U.S. Treasuries (/ZB), Crude Oil, (/CL), and Gold (/GC)
- 2) a watch list of stocks and ETFs with actively traded and liquid options
- 3) overall implied volatility levels for each of the symbols in 1 and 2
- 4) the thinkorswim Trade page set up with Implied Volatility, Probability of Out-of-the-Money, and Return on Capital columns loaded up

What this allows Tom to do is build a portfolio of positions that combine a certain level of probability of success and return on capital. Those are the core positions he'll hold for a few weeks. On top of that, he'll often day trade futures on intraday price moves. During earnings season, Tom will establish another layer of somewhat riskier option positions in stocks, with elevated implied volatility ahead of earnings announcements. These he'll typically hold for one or two days.

Throughout the day, Tom will check the P/I of his positions, as well as his available buying power, and overall net liquidating value on the Monitor page.

SEE
GLOSSARY
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on risk. Managing position risk as the core of a strategy is among the biggest mistakes any investor or trader can make. All risk mitigation needs to be done through smart order entry—selecting the right strategy, and trading the right size, so you can hold a trade until you're correct.

TM: You're doing a daily show at tastytrade.com, and I heard you say that if you can order a pizza, you can find a trade. Is that true?

Sos: Think about it. With pizza, you can mix and match 15 toppings. The problem is, some people like specific combos and hate others.

With trading, you check the liquidity of the stock and options you're looking at. You check the level of volatility—high or low. Then, you take a look at the probability numbers of certain options in a certain expiration month, to narrow down the options you're going to trade. Then you use maybe one of seven different strategies to express your bullish or bearish bias, based on potential returns on capital and margin requirements. With the right knowledge and tools, finding logical trading strategies doesn't have to be any more complex than ordering a pizza with the stuff on it you like.

TM: You're a veteran of not just trading, but of the financial industry broadly. Tell us about some of the things you've pioneered.

Sos: At thinkorswim (thinkorswim, Inc., the brokerage acquired in 2009 by TD Ameritrade), we mainstreamed tools by channeling the desires of our retail trading customers.

A million stories...an exchange official I had known for years at the CBOE once asked why thinkorswim was routing most of our orders to other exchanges. Two weeks later, the CBOE had the required technology built and was able to take thinkorswim customers' spread orders.

We were also instrumental in creating weekly options. Back in 2004 when thinkorswim was growing and teaching a lot of classes, we had a few customers that were doing most of their trading in the last week of expiration to try to take advantage of the higher **gamma** and time decay you get with options with only a few days to expiration. We sat down and hammered out the specifications for a new series of options that would only have a one-week life cycle. We sent that off to the CBOE, and a year later, weekly options were introduced.

We were the first to offer customers option **spreads** in their IRA accounts. At first, other brokers cried foul because they didn't have the technology to support this. Eventually, as the number of thinkorswim customers trading option spreads in IRAs grew, other brokers figured out ways to allow their customers to do it, too.

We took advantage of a simultaneous revolution of trading technology, and the increase in exchange products that thinkorswim helped facilitate. It's not that we're so much smarter than anyone else, but that innovations in the investment industry come from the brokers. The brokers need to be visionaries who have

very close relationships to their customers. They need to see what types of tools, support, and products customers need.

TM: What's the next revolution?

Sos: Content, content, content. Turn on traditional financial media and what do you hear? Noise. Talking heads repeating the same news, and industry "veterans" who don't actually trade. What I see is the same small group of people consistently making money on their trading and investments, and everybody else not. Why? That small group of people knows how to apply logic and probability to their trading decisions. What we're doing at tastytrade is trying to get "everybody else" profitable by showing them the logic and strategies that can lead to successful trading.

tastytrade is changing the face of content by making it fun and logical because we're talking about things like probabilities, capital requirements, and duration. If an analyst thinks a stock is going up 20%, who cares? What's the probability of that happening? That's more important.

Traders can't take themselves too seriously. We certainly don't. But we do take money, risk and numbers seriously. That's why we created thinkorswim—because we loved trading and lived the trading culture. tastytrade is the next step, with live programming. At tastytrade, we needed to figure out a way to deliver our content that mixes fun banter with trading to more people for less money to create truly consumer-oriented financial media. We think we've done it.

"Get tasted," and check out the tastytrade feed, live in the Trade page of the Trade Architect platform, or in the Trader TV Gadget within thinkorswim.

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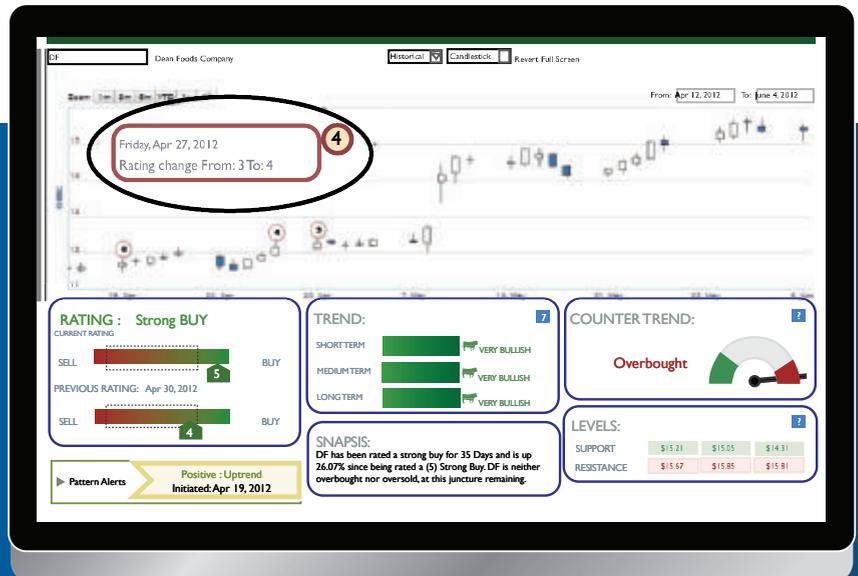
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- ◆ Bullish/Bearish Trends
- ◆ Pattern Recognition Alerts
- ◆ Discretionary Trade Commentary
- ◆ Market Internals
- ◆ Pair Trade Scans

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About Us

Greg Troccoli has been providing Technical Analysis to a Global audience for more than 20 years and was the Chief Technical Analyst for Prudential. In addition, Greg spent time at Deutsche Bank and Bear Stearns. Additionally, his research has been utilized by over 3,500 institutions worldwide, including eight central banks, proprietary trading desks, major oil companies and a large contingent of retail investors. Greg developed his own proprietary methodology that has benefitted many institutional investors. His process begins by a top down approach, he then applies technical studies to identify developing price trends. As trends are identified, he applies his screens for best risk/reward profiles.

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CAT	90.84	+4.12	+4.73%	+4.73%	+1.5	89		\$22.05	\$25.10	6	POSITIVE
DELL	14.98	+0.76	+5.34%	+5.34%	+1	90		\$22.05	\$25.10	3	
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Love Notes

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Hyperbole and Trading Pearls From ...You

Photograph by Fredrik Brodén

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• The best trade I made today was taking a loss.

Annie

• The market takes nothing. All trading tickets originate from the user.

Sam

• A big lesson for me has been that prayer is not a trading plan.

Josiah

• Does anyone know how to get more custom columns on watchlists? I've used the twenty that were initially given.

Roger

• Bond market from Mars. Stock market from Venus.

Jim

• I've always believed that lotteries are a tax on the mathematically naive, but I buy a ticket because black swan events happen.

Dexter

• If I tip over dead at my keyboard, could I ask you to flatten any open positions?

Russ

• Trading is 60% waiting, 25% nail-biting, and 92% thinking of clever things to say on your Facebook status.

Jessica

• The Fed's plan for a possible QE3: Not printing additional money, but rather photocopying it so the deficit doesn't increase.

Bob

• Damn, my coffee break just cost me a thousand bucks.

Frank

• A "contrarian" and a "contrarian with capital" are two different things.

Alyssa

• Always remember, if it looks like the platform has more features than you can comprehend, stick with the ones that work.

David



Got a quip, a poem or a pearl you'd like to share? Send your best prose to thinkmoney@tdameritrade.com.

• Bizarre economic indicators: —Skinny Tie Width Indicator: two indicators here. The first, men will buy ties to appear that they're working harder during difficult economic times. The second, ties get slimmer during bad times and brighter when the economy starts to recover. —High-Heel Index: Usually, in an economic downturn, heels go up and stay up, as consumers turn to more flamboyant fashions as a means of fantasy and escape.

Janie

• Eat meat. The West wasn't won on salad.

Griffin

• "It's not whether you're right or wrong that's important, but how much money you make when you're right and how much you lose when you're wrong."

George Soros



News+Views

A hodgepodge of stuff we thought you should know.

Photograph by Fredrik Brodén

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Ask The *Suit*

A little Q&A with **Nicole Sherrod**, Managing Director, Trader Group at TD Ameritrade



Q: What can you share about new enhancements we'll see in the platform over the course of the next year?

A: We can't spill all our secrets, but I can say that this year, more than any prior year, our development roadmap is packed with suggestions driven by client feedback. You may not know it, but every time you email us with a suggestion for how to improve the platform, we create a development ticket and we track how many other clients have the same demand. This year, we're focused on executing on that backlog, which we're sure will bring much delight to those who made requests. And, we've got a few other things in the works which you've never even dreamed of...

Q: With all the new features you folks roll out, sometimes the platform can get a little "heavy." Is there anything I can do to speed it up?

A: Once a year, in late summer when trading tends to slow down, we have an annual "maintenance release." This release is designed to enhance the core of the thinkorswim platform to address overall speed, bugs, and the nimbleness of the technology. It's not as sexy as releases with the latest toys, but as traders, we believe that speed and stability are priority one. There are other things you can do, though. Check out the FAQs in our Learning Center under "technical" to learn more.

Q: I want to learn how to trade options. What's the best way to get started?

A: You came to the right place. In Barron's Annual Broker survey for 2012 TD Ameritrade was recognized in the "Best for Options Traders" and "Best for Novices" categories. Over 60,000 clients have placed their first option trade with us. Also, check out our **Swim Lessons Chatroom**, and the platform **Learning Center** for helpful ways to maximize option trading tools in the platform.

Important Information

For more information on the 2012 Barron's Online-Broker review, see page 9.

Toys for Traders

Latest trading platform faves

thinkorswim:

LEARNING CENTER
As if *thinkMoney* wasn't enough! Now there's a massive new resource of trading videos, feature demos, archive of thinkorswim release notes, and schedule of live events. Just go to the Help tab and click on the orange Launch Learning Center button.

Trade Architect:

BETTER QUOTE DETAILS

Want more info in your quotes? You got it. We've added dividend yield, market cap, beta, and the previous day's closing prices to the Quote Detail feature. In the Today tab, enter a new quote in the Quote Detail feature in the upper right hand window, and have at it.

thinkorswim & Trade Architect:

tastytrade

Check out the new financial media network and brainchild of Tom Sosnoff, the guy that brought you the original thinkorswim platform (and focus of the feature on page 10). You'll laugh. You'll cry (not really). You'll be thoroughly edu-tained. Tom and his crew take trading seriously, just not themselves. Go to Gadgets in the left sidebar. Select Trader TV, then tastytrade.

**industry
spotlight**

All \$2 billion losses aren't equal

Words by
Thomas Preston
Illustration by
Joe Morse

This past May, international bank JP Morgan was in the news when it was revealed that its Chief Investment Office had lost \$2 billion on a credit-default swap position. If you heard CEO Jamie Dimon's explanation, he mumbled something about "marked to market" that may not have caught the media's attention, but it did mine. It signaled what might be a big change in institutional risk and transparency.

"Marked to market" means that every day, some verifiable price or "mark" needs to be attached, as it were, to a bank's positions, whether it's shares in IBM, or a credit-default swap. The bank, then, can calculate a daily



profit/loss number from that mark. The idea is that losses can be tracked daily and can be dealt with (i.e. closed), or made public (if required), before they get too big (like the giant losses banks took in 2008 and 2009).

Without marked to market, positions could be valued, if at all, off of whatever price the individual trader at the bank thought it should be—making it easier to disguise or hide losses until it might be too late. That's one of the

big benefits of marked to market. It defines transparency. Bank CEOs might not be its biggest fans, but marked to market made JPM take a hard look at a losing position, and may have prevented that \$2 billion loss from becoming a \$20 billion loss. Back in 2008, for example, you didn't hear many banks talking about marked-to-market losses until they were forced to. That's why JPM's response now, owning up to a large losing position, makes me less concerned that the loss could snowball.

Of course,

marked to market has been the way retail accounts have been valued for years. Margin calls, risk analysis, net liquidating value, profit/loss—these are all based on marked to market, and updated in real time. Marked to market works for traders of all sizes, and unlike their institutional cousins, retail traders didn't, as a class, "blow up" in 2008, or require a government bailout.

**pit
talk**

Every vocation has its jargon. So if you want to be a real trader, you're gonna have to learn to speak like one

RUNAWAY TRAIN

A short squeeze.

Cherry picker

Only shows up when near certain winner is traded.

Carping a market

Letting the other market makers make a market and then improving one side only by a penny.

Backing the truck up

when a firm continues to buy aggressively.

CRYING ALL THE WAY TO THE BANK

A trader that makes a lot of money and only talks about how much he loses each day.

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- Push notifications
- Access multiple accounts with Combined Accounts
- Help menus and feature demos
- Complex order types

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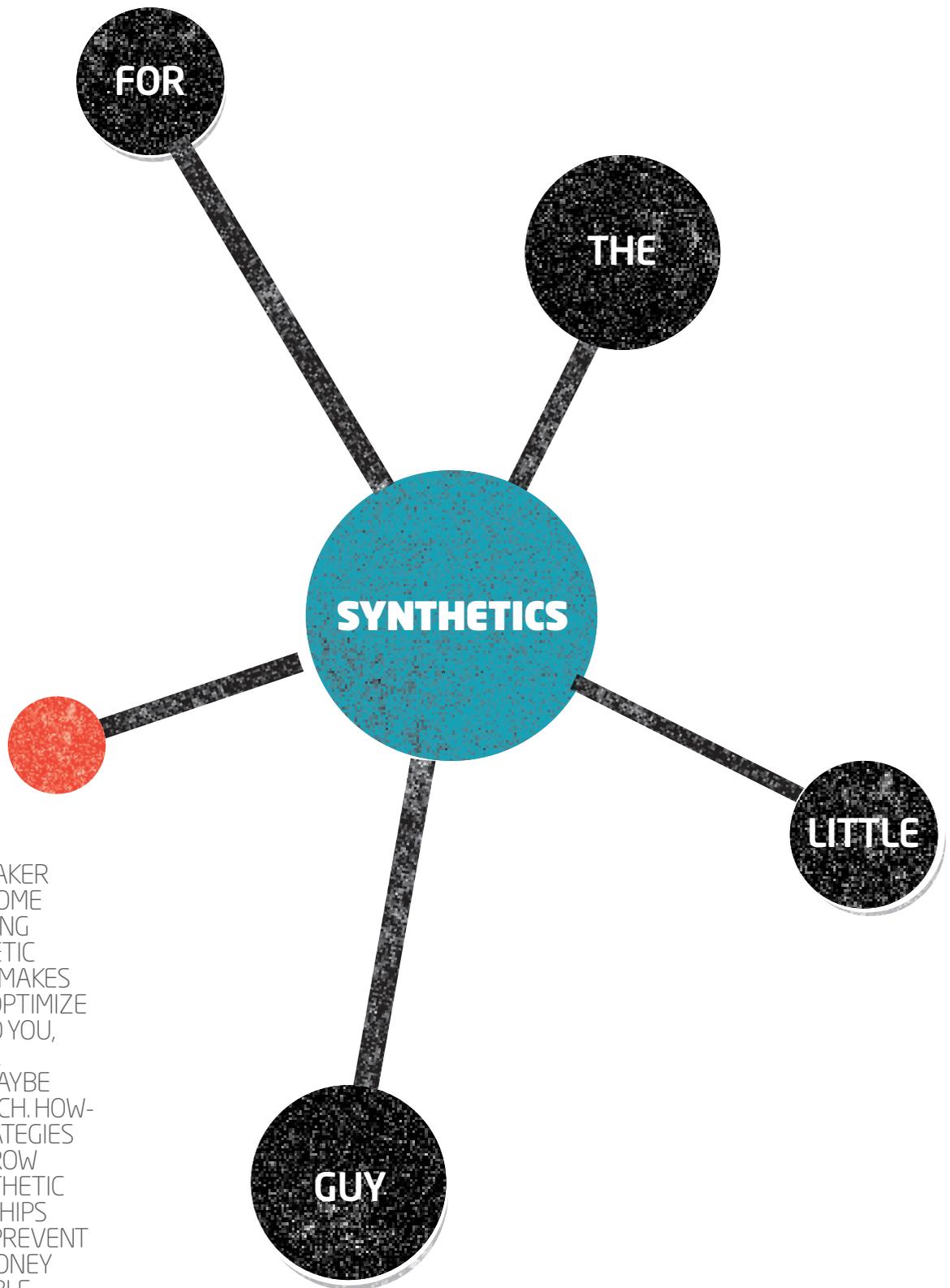
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Synthetics

Photograph by
Fredrik Brodén

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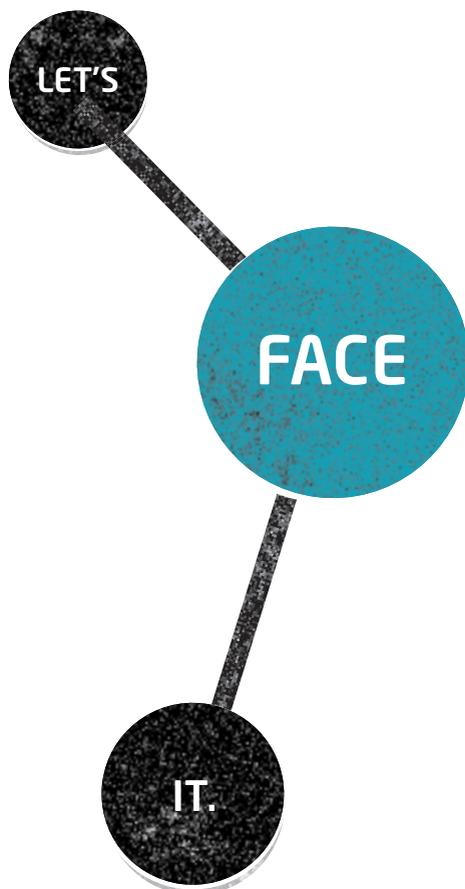
IF YOU'RE A MARKET MAKER TRADING SOME SIZE, PUTTING ON SYNTHETIC POSITIONS MAKES SENSE TO OPTIMIZE HEDGES. TO YOU, THE RETAIL TRADER, MAYBE NOT SO MUCH. HOWEVER, STRATEGIES THAT BORROW FROM SYNTHETIC RELATIONSHIPS CAN HELP PREVENT LEAVING MONEY ON THE TABLE NEXT TIME YOU EXIT A WINNING TRADE.

WORDS BY
ALEX MENDOZA

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Synthetics

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SYNTHETICS AREN'T SEXY.

And you're not going to win many friends talking about them at cocktail parties. There's even a good chance you've never used them—and for good reason. For one, they can be complex. And two, they're generally useless to the average retail trader.

So why talk about them at all? Because there are strategies that market makers use, based on synthetic relationships, to hedge positions or protect profits. But you're not a market maker, you say. Doesn't matter. It's important to understand synthetics in order to better understand the positions you're trading. Moreover, under certain circumstances, using techniques that originate in the world of synthetics can sometimes provide some measure of short-term protection or generate a profit, without leaving money on the table. On the other hand, despite their intended purpose, keep in mind that you can still lose money all the same.

SYNTHETICS...HUH?

When a position is referred to as "synthetic," it simply means it was put together from at least two other pieces, such as some combination of calls, puts, and stock, to emulate say, a single position in a call, put or stock. Most option strategies have a synthetic equivalent.

For example, to create a synthetic long call position, you could combine a long-put option with long stock. Why? Because during its lifetime a long call position has potentially unlimited reward for less risk than an equivalent stock position. The put in the synthetic can help protect the long stock position in case of a price

decline, for a limited period of time without suppressing the stock's unlimited upside potential. Therefore, the put/stock synthetic emulates the risk profile of the call.

Or there's the long-stock synthetic created by combining a short put with a long call, within the same strike and expiration. This position, known as a "combo," has the same risk profile as a long stock position, because the short premium collected on the short put can help pay for the long premium paid on the call. Since the time value in one option negates time value in the other options you're left with the same risk profile as that of a stock that can fall to zero, and that has unlimited upside potential. That is until the options expire, or you get assigned on the short put anyway.

Fortunately, with synthetics, you only have to deal with three pieces—calls, puts, and stock. Even better, in order to create a synthetic position, you only need to combine two of the three pieces.

A BETTER MOUSETRAP

Most of the common synthetic strategies are capital intensive, since they usually involve either the purchase, or sale, of stock. And many retail investors may not want to incur the expense of placing them, just to save a few pennies. However, there may come a time when you're in a trade—say, a long put position—that has gone deep **in the money**, and rather than simply exiting the trade, you might consider from adjusting the position using a strategy that borrows from synthetic relationships to maximize your profit potential. Without getting into the complicated math, consider the following examples of a long put and a long put spread, as well as their timelines.

LOCKING PROFITS ON A LONG PUT

Let's first look at how you might use a synthetic position to help protect a profit on a long put hedge on a high-priced stock.

April 25, 2012

Stock XYZ has just jumped nearly \$50 higher on the day, to close at \$610. Feeling like the stock is too rich, you buy a May 600 put for \$14. With nearly a month to expiration, you're feeling like there's a chance that XYZ could retrace some.

May 14, 2012

The stock falls to \$558, and your long put can now be sold at \$41.00.

With a potential profit on your hands, what do you do? That depends on how much of that profit you

want to keep. You could sell the put, take the money, and run. However, this is where some might consider synthetics in an attempt to pursue a bit more profit.

Let's look at several scenarios. Consider the following option chain at the current option prices:

CALLS		STOCK=\$558.00	PUTS	
Bid	Ask	Strike	Bid	Ask
.33	.35	590	31.50	32.50
.24	.26	595	31.50	32.50
.15	.19	600	41.00	42.50
.12	.15	605	46.00	47.50

SCENARIO 1: sell the put

This is the standard “take your ball and go home.” You bought the put and now you walk away with \$27 in profit, or \$2,700 per option contract (less commissions and fees).

SCENARIO 2: buy the stock, exercise the put

It may sound crazy, but by buying XYZ stock for \$558.00 per share and exercising your put, you can accomplish your goal of locking in your profits from the put purchase, but you're also potentially in a position to make additional money, should the stock rally over the next several days. Now, keep in mind, that in order for this scenario to work, you have to have \$55,800 per 100 shares + commission on hand to purchase the shares of stock—a significant capital commitment.

In fact, even if XYZ does not rally, you still bring home more money than if you had simply sold out your put. How?

First, remember that you started your position by purchasing the 600-strike put. This means you have the right to sell XYZ stock at \$600 per share. You have this right as long as you own the put. And because the put is an American-style option, you're allowed to exercise it, and hence, sell your stock at \$600 per share, at any time during the life of the option.

That said, if you buy stock for \$558.00 per share, and exercise your right to sell the stock at \$600, you end up with a net revenue of \$42.00 per share. If you then subtract the \$14 that you paid for the put, this would leave you with a profit of \$28.00, or \$2,800 per contract (less the commission on the purchase of stock and the fee to exercise the put). When you compare this to the first scenario, in which you simply sold your put option on the bid for \$41.00, you'll see that:

- You locked in your profit, just as you would have in the first scenario.
- You made more money—to the tune of an extra \$100 per contract. Less commissions and fees.

As an aside, if you decide to keep your long-put and long-stock combination through to option expiration, then, for the time being, you're long a 600-strike synthetic call.

LOCKING PROFITS ON A LONG PUT SPREAD

Using synthetic positions can also work well for the more budget-conscious trader. In fact, traders on a

budget tend to be more sympathetic to techniques that are designed to squeeze that little bit more out of each trade. Here's an alternative example using a long vertical put spread on the same stock and the same dates.

April 24, 2012

Rather than buying the 600-strike put, you buy something more affordable, such as the 600/590 put spread (buy the 600 put at \$14.20 and sell the 590 put at \$10.20) as indicated by the option chain below:

CALLS		STOCK=\$610.00	PUTS	
Bid	Ask	Strike	Bid	Ask
30.50	31.00	590	10.20	10.50
27.00	28.00	595	12.00	12.50
24.00	25.00	600	14.00	14.50
21.00	22.00	605	16.00	16.50

The spread can be picked up for \$4.00, or \$400 per contract. This is far less than the \$1400 needed to buy the 600 put outright. Of course, the drawback with buying a 10-point-wide put spread is that the most the spread can be worth is \$10—meaning that the maximum possible profit on this trade would be \$6, or \$600 (less commissions and fees), per contract.

Nevertheless, suppose you bought the 600/590 put spread for \$4.00. Let's fast forward to May 14. With the stock below \$560 per share, you have, in all likelihood, made some money. However let's take a closer look at the option chain to see what you might be able to do to maximize profits.

May 14, 2012

Once again, you see that XYZ is trading at a level of \$558.00. However, rather than being long the 600 strike puts, this time you're long the 600/590 put spread. You now have several scenarios to consider.

SCENARIO 1: do nothing, and carry the position to expiration

This decision involves the least amount of work. You do nothing, and provided that the stock remains below \$590 at option expiration, your long 600 puts will likely be assigned, making you a buyer of 100 shares of XYZ at \$590 per share. But now you can exercise your 600 strike put and sell XYZ stock at \$600 per share.

Of course, your short 590 puts are deep in the money and could be assigned at any time prior to expiration, thereby obligating you to buy 100 shares of XYZ stock for \$590 per share. The net result is you walk away with \$10, or \$1,000, per contract. Since you initially paid \$4 for the spread, this would give



Synthetically Confused?

Knowing at least the basic synthetics can be important to understanding how to adjust your trades. Very soon we'll be adding a synthetics tutorial video in the new **Learning Center**.

1 Log in to thinkorswim > Help tab > click the big orange “Launch Learning Center” button.

2 In the keyword search box in the upper right, type “synthetics” and push Go.



SEE
GLOSSARY
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Synthetics

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USING TECHNIQUES THAT ORIGINATE IN THE WORLD OF SYNTHETICS CAN SOMETIMES PROVIDE MARKET-MAKER-TYPE PROTECTION OR GENERATE A PROFIT, WITHOUT LEAVING MONEY ON THE TABLE.

you a net profit of \$6, or \$600, per spread (less commissions, contract and exercise/assignment fees).

The good news? This scenario could position you for maximum profit on the trade. The bad news? There's no way to guarantee the stock will remain below \$590 to expiration. Also, if you are assigned on the 590 put, you need to have funds on hand to purchase the 100 shares at \$590 per share.

SCENARIO 2: sell out the put spread

You can sell the put spread, close out the trade, and take your profits. As you may have learned in a basic options class, there's nothing wrong with taking a profit. One quick glance at the option chain shows you that you can sell the spread at a price of \$8.50. Since you paid \$4.00 for the spread, this would allow you to lock in a net profit of \$4.50, or \$450, per contract (less commissions and fees). You would have more than doubled your initial investment. The only thing better than locking in a profit would be a bigger profit. Interested?

SCENARIO 3: buy the 590/600 call spread ("box" off the trade)

Nope. That is not a typo. If you're long the 600/590 put spread, one potential way to lock in your profits is to buy the 590/600 call spread. To wit:

CALLS		STOCK=\$558.00	PUTS	
Bid	Ask	Strike	Bid	Ask
.33	.35	590	31.50	32.50
.24	.26	595	36.50	37.50
.15	.19	600	41.00	42.50
.12	.15	605	46.00	47.50

You can buy the 590/600 call spread for 20 cents (buy the 590 call at \$0.35 and sell the 600 call at \$0.15). If you do this, you will end up with the following position:

- Long the 590 call
- Short the 590 put
- Long the 600 put
- Short the 600 call

This is what's known in the option world as being "long the box." The difference in strikes is \$10. Therefore, the relationship you see is referred to as a 10-point box. The other way to think of the long box

is as synthetic long stock at the lower strike (long 590 call + short 590 put) and synthetic short stock at the higher strike (long 600 put + short 600 call). The beauty of the 10-point box is that barring unusual circumstances, it's worth \$10.

More importantly, that value doesn't change.

If you're having trouble remembering how to construct the box, it may be simpler to remember that given any two option strikes, buying the call spread and buying the put spread, equals buying the box.

So, how did you get to buying the box? Well, you started by buying the 600/590 put spread for \$4.00. Then, once the stock dropped, you bought the 590/600 call spread for 20 cents.

So, to wrap up, you paid \$4.00 for the put spread, and 20 cents for the call spread. Therefore, you paid a total of \$4.20 for a 10-point box. Since you know that the 10-point box has to be worth \$10 at expiration, using this synthetic relationship, you're able to take a profit of \$5.80, or \$580 per spread by selling *both* the call and the put spread on the day of expiration.. This is a whole \$130 per contract more, than if you had simply sold your existing put spread. So, what are the risks of the box? In short, pin risk, which is when the stock settles right at the strike price at expiration first, in which case, you could be unwillingly assigned an unhedged stock position. (See page 31, this issue, for more.)

SYNTHETICS AREN'T JUST FOR "MATHLETES," OR FOR sophisticated option professionals. These relationships represent position-management techniques are designed to help take back some of the money that others may leave on the table.

Important Information

Options are not suitable for all investors as the special risks inherent to options trading may expose investors to potentially rapid and substantial losses. Options trading privileges are subject to TD Ameritrade review and approval. Please see our website or contact TD Ameritrade at 800-669-3900 for options disclosure documents. Carefully read the Options Disclosure Documents before investing in options.

Spreads and other multiple-leg option strategies can entail substantial transaction costs, including multiple commissions, which may impact any potential return. These are advanced option strategies and often involve greater risk, and more complex risk, than basic options trades.

Transaction costs (commissions and other fees) are important factors and should be considered when evaluating any options trade. For simplicity, the examples above did not include transaction costs. At TD Ameritrade, the standard commission for online equity orders is \$9.99, online option orders are \$9.99 + \$0.75 per contract. Orders placed by other means will have higher transaction costs. Options exercises and assignments will incur a \$19.99 commission.

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Market volatility, volume, and system availability may delay account access and trade executions. Trading futures and forex involves speculation, and the risk of loss can be substantial.

Forex investments are subject to counter-party risk, as there is no central clearing organization for these transactions.

TD Ameritrade does not charge platform, maintenance, or inactivity fees. Commissions, service fees, and exception fees still apply. Please review our commission schedule and rates and fees schedule for details.

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TDA 1375 D 03/12



Coach's Corner

Pulling pearls from your favorite trading instructors.

Words by **Brandon Chapman**
Investools Instructor

Goldilocks and the Multiple CCI System

Using two indicators to make sense of one

Over the years, I've worked with a lot of investors trying to create technical trading systems. The Commodity Channel Index (CCI) is one that many try to incorporate into their trading. But as they change the indicator's settings, like Goldilocks's porridge, the experience feels either too hot or too cold. A lot of times "just right" occurs when two CCI's together are used to provide more trading signals with fewer whipsaws.

THE "WHAT"

CCI measures the distance between the stock price and its moving average. At first glance, you'll notice three horizontal lines—at -100, 0 and 100—that help signal changes in trend or extreme movements in the price. The setting used for the CCI sets the period length of the **moving average**—which reveals why it has trending properties. When you see it cross the zero line, it indicates a break of the moving average, or change of trend. A reading above or below +/- 100 could indicate a strong directional move.

THE "HOW"

For this bullish trend-trading system, I'm going to demonstrate, using both a 50-period and a 20-period CCI on the SPX.



FIGURE 2: CCI on the S&P 500 (SPX) Using two indicators together—such as a 50-period and a 20-period CCI—will often provide more trading signals with fewer whipsaws. **Chart from TD Ameritrade's thinkorswim.** For illustrative purpose only and is not a recommendation.



Set an alert

In thinkorswim, set complex alerts like the CCI system when they occur. Go to the MarketWatch > Alerts tab. Then:

- 1 Enter a symbol in the symbol box and select "Study Alert" in the upper right corner.
- 2 Click Edit. In new window, choose the studies you'd like to compare and adjust parameters. Click Save. Repeat for more conditions.
- 3 Set "Trigger If:" dropdown to "TRUE." Click Create Alert, and you're done.

The sheer frequency of signals may burn the roof of your mouth. So use a small spoon.

THE "WHY"

By combining both indicators, you're attempting to provide fewer indications of a

Important Information

The information contained in this article is not intended to be investment advice and is for illustrative purposes only. Past performance of a security does not guarantee future results or success. Be sure to understand all risks involved with each strategy, including commission costs, before attempting to place any trade. Clients must consider all relevant risk factors, including their own personal financial situations, before trading. Supporting documentation for any claims, comparisons, statistics, or other technical data will be supplied upon request. Investools® does not provide financial advice and is not in the business of transacting trades. Investools, Inc., and TD Ameritrade, Inc., are separate but affiliated companies that are not responsible for each other's services or policies. For details, please see disclaimer, page 9.

Using the 50-period CCI will give fewer, and more significant, signals than a shorter look-back period. However, this can also be frustrating, when watching a stock go up for weeks on end without receiving a bullish entry signal (based on the CCI crossing above 100). In this case, you'll probably find the porridge too cold. Conversely, a 20-period CCI gives more frequent indications of a trend change by crossing zero, and more bullish trading signals by crossing above 100.

trend change, but get more signals to enter a trade. The following table is a breakdown of two bullish entries using the CCI 20 and CCI 50, with the exit based on the CCI 50 crossing zero.

	ENTRY	EXIT
Entry #1	CSI 50 crossing above 100	CCI 50 crossing below 0
Entry #2	CSI 50 > 0 and CCI 20 crossing above 100	CCI 50 crossing below 0

Following is a graph of the SPX, and indicates the entry and exit signals provided by combining the CCI 20 & CCI 50. You'll notice that the CCI 50 only provided three entry opportunities during the uptrend in the SPX from Dec 27, 2011, to the eventual exit on April 10, 2012. At one point, there was over a 2-month span without a signal. By adding the CCI 20, you'll notice five additional signals as the SPX bounced off support along the way.

As a technician, you'll eventually find yourself in the Goldilocks position sampling different indicator combinations and settings. Ultimately, this simple system could be used to trade bullish or bearish trends depending on who's house you wander into.



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**Mobile
Trading Tips**

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GO
OUTSIDE
AND
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TRADING AWAY FROM YOUR DESK CAN BE LIBERATING, ESPECIALLY IF IT DOESN'T REQUIRE TALKING TO SOMEONE ON THE OTHER END OF THE LINE AS YOU RATTLE OFF ORDERS. WITH **MOBILE TRADING**, SINCE THE RATTLING TAKES PLACE BETWEEN YOU AND A TOUCH SCREEN, THERE'S A FEW POINTERS TO KEEP IN MIND.

WORDS BY **MARK AMBROSE** PHOTOGRAPHS BY **FREDRIK BRODÉN**

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Mobile Trading Tips

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SMART PHONES, IPHONES®, IPADS®, LAPTOPS WITH WIRELESS CARDS.



How Do I Get Mobile?

Simply download the TD Ameritrade Mobile Trader app at tdameritrade.com/mobileapp, right from your phone. Or search the storefront of your smartphone device or iPad and download from there. Just be sure to search for keywords "TD Ameritrade Mobile Trader."

Name your technology, and trading is one of the first applications to find a home on any mobile device. Only a few years ago, it seemed like I was the only one at the airport working orders and watching S&P futures on my iPhone. Now, I look around and I see people staring intently at watch lists, charts and p/l as we wait to board.

Mobile trading is one of the fastest growing segments of online brokerage. Heck, I'm waiting for a fill as I write this, at 37,000 feet. (Thank you, Uncle WiFi.) If you're not doing it, chances are your friends are. And you probably will, too.

THAT FIVE-LETTER WORD: TRUST

If you're hesitant to start trading mobile, think ATMs and email. The idea of pulling money—your money—out of a machine, or trusting the Internet to deliver an important message without fail, wasn't something a lot of folks jumped on immediately. There were early adopters. Then the rest of us recognized the incredible convenience these two game-changing innovations gave us.

Mobile trading takes some getting used to. Are the fast quotes accurate? How does my order actually get sent from my iPhone on an airplane to the exchange? The short answer is really, really smart developers built the technology to be able to place a trade reliably and confidently from anywhere you can get a connection. I'm not a technology geek. But I don't hesitate to travel during trading hours, because I know I can stay on top of the markets and my positions. Okay, maybe I don't travel on expiration, but that's mainly because I don't want too many people to hear me yelling.

TIPS OF THE TRADE

If you're already trading mobile or about to, there are a few things you need to manage. First, the obvious. You probably know you can't guarantee a mobile connection in the middle of the trading day. And you also know you don't have as much screen real estate as you do when sitting at home in front of your 27" flat panel. As for the not-so-obvious, here are four more tips to get the most out of your mobile trading.

Tip 1: Trading never sleeps

Whether you're a soccer dad in the grocery line, or an executive mom on a plane to Tokyo, trading is now 24/7, and everywhere.

Do you trade stocks? Options and **spreads**? How about futures and forex? TD Ameritrade's Mobile Trader let you route orders and monitor positions in all these products. But it's tougher to integrate the sophisticated screening, back-testing, and analytical tools into mobile apps. That's partly because of the limitations of the processors on the phones and tablets, and partly because it's tough to fit all the controls, and a complete interface, into a much smaller screen. So, if you need to figure out your trading strategy, you might have an easier time with the full functionality of the

FIGURE 1: iPad Trading

is one way to place a trade at a park bench. The new interface is slick, and so is the feature set. From your iPad, go to the App Store and search for "TD Ameritrade Mobile Trader."

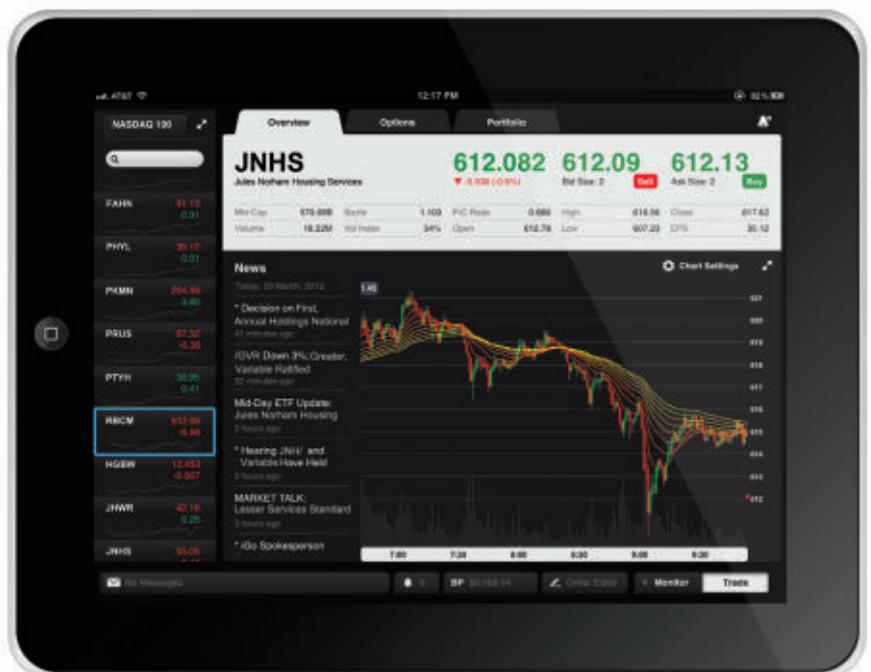




FIGURE 2: Smartphone trading is here to stay. If you're using an iPhone, Android, Blackberry or other mobile phone device, jump on board. Stocks, options, futures, and forex are now tradeable from grandma's house.

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TD Ameritrade's flagship thinkor-swim trading platform.

Tip 2: Serious toys only

Sometimes the reason you're trading while flying, waiting for a meeting, or sitting in a doctor's office, is because you may not think you have much time to trade. So, you end up logging in to TD Ameritrade Mobile

Trader, and watching the streaming CNBC feed, or reading the Dow Jones news service.

But have no fear. The layouts of the mobile trading interfaces are designed to maximize trading functionality on limited screen space, without crowding them. Entering complex option-spread orders with two, three, or four legs, or placing conditional orders on your mobile device, is fast and fairly easy—with practice. And you don't need to spend a lot of time implementing your trading strategy. You can take advantage of the time away from home during market hours and trade!

Tip 3: Stay engaged—really engaged

This happens to me frequently when I'm trading mobile: I'm watching the SPUs and they're up 5.00 points. I look away at something. I look back a few seconds later, and they're still up 5.00 points. A few minutes later, same thing—which now seems fishy. How long do the SPUs stay unchanged in the middle of the trading day? So, I check my connection and I see it's dead. Gulp. I re-establish the connection and the quotes refresh. SPUs down 2.00? Oh, and my emails finally get sent.

Losing your wireless connection happens. That's a fact of our mobile age. But when you're talking to someone on your mobile phone, and the conversation suddenly ends, it's pretty obvious you lost the call. And emails you try to send stacking up in your outbox is a sign you need to reboot your wireless card.

But calls and emails don't demand the immediacy of trading. Trading with old prices can mean you're either losing money when you think you're not, or maybe even missing opportunities you don't realize you may have. That's why you should get a sense of how often prices of certain stocks, futures, or indices change intraday. SPUs change a lot. T-bills not so much. Practice by using a symbol whose price changes a lot as your connection indicator. The SPUs are handy

for this. If they've been sitting at the same price with no change for more than 30 seconds, you've probably lost your Internet connection. Get it restarted pronto.

Tip 4: Think Alternative

Trading stocks or simple option buy strategies is one thing that most mobile trading platforms can handle. But if you need to roll a calendar spread on expiration Friday while sitting on a park bench, or you realize as you're filling your tank with \$5-per gallon gas that it might be time to consider crude oil (see page 34), you'll require a platform that can handle your needs. Complex spreads, futures, and forex—TD Ameritrade

Mobile Trader's got you covered.

Important Information

Market volatility, volume and system availability may delay account access and trade executions.

Options are not suitable for all investors as the special risks inherent to options trading may expose investors to potentially rapid and substantial losses.

Spreads, Straddles, and other multiple-leg option strategies can entail substantial transaction costs, including multiple commissions, which may impact any potential return. These are advanced option strategies and often involve greater risk, and more complex risk, than basic options trades. Investors should also consider contacting a tax advisor regarding the tax treatment applicable to multiple-leg transactions.

The paperMoney® Trading software application is for educational purposes only. Successful virtual trading during one time period does not guarantee successful investing of actual funds during a later time period as market conditions change continuously.

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Tip 5: Spread the word to Junior

Math underlies not only trading strategies, but also a lot of online games as well. Now, I'm not going to say that trading and managing your money is a game, but I will say it can often be fun.

So the next time your 'tween or teen is begging to play a game on your mobile phone while you're on a road trip or waiting in line, show her a chart on your trading app instead. Explain what the S&P 500 is, and see if she can guess whether the next price will be an up tick or down tick. Show her the price of the stocks of some of her favorite products or stores. Heck, log in to the paper-trading mobile app (paperMoney) instead of your "real account found on the log in screen of Mobile Trader. Let her put on a position and watch it. And maybe by the time she's ready to start trading her own money, she'll have the knowledge and tools she needs. Isn't that what parents, strategy, excellent tools, and waiting rooms are for?

THE MARKET MOVES FAST. STAY AHEAD OF THE CURRENT.

Swim Lessons gives you tips and techniques
for using the thinkorswim platform.



SWIM LESSONS IS A **FREE** AND **DAILY** WEBCAST
THAT WILL SHOW YOU:

- How, when, and why to use thinkorswim
 - Tools to implement your strategies in any market
 - The possible impact of current events on your portfolio
- ▶ **Log on to thinkorswim** to get Swim Lessons every weekday from 10:30 a.m. to 1:30 p.m. CT. Support/Chat > Chat Rooms > Swim Lessons

Market volatility, volume, and system availability may delay account access and trade executions.

In order to demonstrate the functionality of the platform, we need to use actual symbols. However, use of actual symbols should not be inferred to be a recommendation to trade specific securities.

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Ask the Trader Guy

Saving traders, one question at a time.

Photograph by
Fredrik Brodén

Q: Hey, Trader!
What does it mean when a stock pins to a strike?

A: “Pinning” refers to a scenario where the price of a stock is right at, or a couple pennies away from, an option’s strike price at expiration. “Pin risk” refers to a scenario where the stock price is “pinning” to the strike price of a **short** option position. When the stock is exactly at the strike price, you don’t know if that short option is going to be assigned or not. If it is, you’ll have short stock (if you have a short call), or long stock (if you have a short put), in your account the day after expiration. If the short option isn’t assigned, you won’t have any stock position. That uncertainty is “pin risk.” Some stocks do seem to pin to

certain strikes at expiration, but you shouldn’t count on it as a trading strategy.

Q: Hey, Trader!
I’ve been trading option spreads in a smaller trading account, but I’m wondering if those same strategies can work in a larger account, like an IRA?

A: If you’re seeing positive results in a smaller active trading account using various option strategies, you can certainly expand that to a larger account, except IRAs. Certain option strategies, no matter their size, can never be carried out in an IRA. For instance, naked short calls or short stock in an IRA are not allowed. Consider the amount of capital and your risk tolerance. The more capital you allocate to options and to advanced complex options strategies, the greater the risk. With a larger non-IRA account, where you may have long stocks, or funds, and bonds, you may only want to use a



certain percent of your capital, say, 15% or 20%, to risk with option strategies, and leave the rest in money markets or T-bills. In this case, it’s possible to get similar risk/reward exposure as those long stock, fund, and bond positions with a smaller amount of capital using certain option-spread strategies. You may not want to add extra risk to your portfolio, so if you are thinking about taking some of the strategies you have used in smaller accounts to a larger account, consider using those option strategies as a way to allocate capital, not increase market exposure.

Q: Hey, Trader!
I’ve heard some people refer to a position that is shorting an XYZ 50 call, and buying an XYZ 51 call, as “selling the XYZ 50/51 call spread,” and others referring to it as “selling the 51/50 call spread.” Who’s right?

A: The convention among option traders is to work from the lowest strike to the highest strike. So, you can refer to the 50/51 **call spread**, or the 50/51 **put spread**. Whether you’re buying or selling

the spread, the order of the strikes is the same, and is understood by experienced traders. That is, if I tell you I’m short the 50/51 call spread, you would understand that to mean I’m short the 50 call and long the 51 call. Alternatively, I can say I’m long the 50/51 call spread, meaning I’m long the 50 call, and short the 51 call.

Q: Hey Trader. I eat nachos while I trade, but my screens and keyboard get all greasy. My fingers slipped the other day and I nearly sent an order for 500 S&P futures! How can I clean it up?

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A: Get a clean (no used napkins), lint-free cloth lightly dampened with water only and carefully dab and wipe away the offending nacho residue. Please, no sprays or abrasives! If that fails, have your dog lick it clean.

Important Information

The information contained in this article is not intended to be investment advice and is for illustrative purposes only. Be sure to understand all risks involved with each strategy, including commission costs, before attempting to place any trade. Clients must consider all relevant risk factors, including their own personal financial situations, before trading. Options involve risk and are not suitable for all investors. Supporting documentation for any claims, comparisons, statistics, or other technical data will be supplied upon request.

Associate Spotlight

A chat with a TD Ameritrade VIP making things happen

Illustration by
Joe Morse

• Jeff Bierman is one of the most almost-famous guys in TD Ameritrade's "Trader Group"—the team responsible for bringing you all the cool toys and trading platforms at TD Ameritrade. Most likely, you've never met Jeff in person. But, you're probably either using a tool on your trading platform he conjured up in his head, or maybe you've heard him in Swim Lessons.

As an ex-floor trader, ex-hedge-fund manager, and ex-prop-desk manager, he's got a few things to say to traders new and used. So we thought we'd unleash a few pearls by sitting down for a chat.

Okay, "Professor" Jeff, your name pops up all the time on thinkorswim alerts. What's your role in the madness that is the Trader Group?

I'm the face you don't get to see. But, I oversee much of what comes out of the thinkorswim trading platform. One of the things I do is figure out tools to add. But no single person makes a decision. The core spirit in the Trader Group is to give you the tools to set you free to do what you do best.

I'm also an educator with my shows on Swim Lessons, and the Trade Architect webcasts which are a little edgier (See sidebar). I like to teach things you can't get from a textbook. It has to be a real-world perspective if it's going to mean something to traders. You have to keep people interested when times are tough.

So, how do you keep people interested when the market—or their trading account—is behaving badly?

Everyone has something to learn. Just because you're trading on the thinkorswim platform, doesn't mean you know everything. And the market is just one part of



Hear Jeff dole out his own pearls at TD Ameritrade:

1/Trade Architect Chat—Every Monday/Wednesday/Friday, learn how to use the Trade Architect platform, discover tools to help you manage risk, and learn how to read charts.. He picks the subjects—always relevant, always timely.

2/ Swim Lessons—Daily between 10:30 a.m. – 1:30p.m. CT.

1) Adapt or die. The market is not a conspiracy. It's not fixed. It's a bunch of electronic computers matching trades made by many people. It doesn't care about you, and it's not personal. Seriously. **2) Think risk first, reward second.**

Every trade you take should be treated like any of life's important decisions.

Meet the Professor

• TD Ameritrade's Jeff Bierman is part trader, part mad scientist. And he wants to change the way you trade.

your life. My job is to help you understand there's always more to learn. It's best to stay hungry for knowledge. When you stop craving knowledge, you stop living.

We educate them most when things are uncertain. We help traders from turning their backs on trading when times are tough. As a real-time commentator on Swim Lessons, I can talk about today's color of the markets, and how to troubleshoot problems because chances are, problems are shared.

Give the readers something they can sink their teeth into. Name the top 3 things to keep in mind when trading.

Think about what can happen first—i.e., what can go wrong. Don't assume you've made the right choice just because you've pulled the trigger. Have a back up plan in case it turns out you've made the wrong decision. You need to know ahead of time what you're going to do if the trade fails.

3) Don't brag to your neighbor. Trading is humbling. If you make a lot today, you could lose it all tomorrow—just about the time you think you have it figured out. Don't get cocky or emotional. Also, don't pick up nickels in front of a bull dozer. Also, going for grand slams all the time will likely lead to disappointment. Shoot for singles.

Important Information

TD Ameritrade does not make recommendations or determine the suitability of any security, strategy or course of action, for you through your use of its trading tools. Any investment decision you make in your self-directed account is solely your responsibility. All investments involve risk, including loss of principal. The content presented in the Trade Architect and Swim Lessons chat sessions are provided for educational purposes only and should not be considered recommendations to trade any specific security or utilize any specific trading strategy. TD Ameritrade, Inc., member FINRA/SIPC/NFA.

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Gear Head

Our favorite gadgets you may not have heard of

Words by
Editorial Staff

gear

When I was little I once saw a friend's mother struggling to open a big can of fruit with a manual can opener. After much twisting and grinding, the can opener finally got stuck. She tore it from the can, cursed, and lobbed it across the kitchen with palpable frustration. She then used an electric can opener, and happily popped the lid right off. I wondered why she didn't spare herself all that time and frustration by using the electric one in the first place.

Welcome to the trading world of most investors, who work hard to spend time efficiently and manage their emotions. If that includes you, then perhaps it's time to take a technological leap forward by automating some of the harder parts of trading. Automation reduces the need for work. This tends to lower frustrations and time spent. And you don't have to be a programmer to do it. The Condition Wizard on thinkorswim does the hard stuff for you.

CANNED PEACHES, FASTER

Traditionally, automated investing involved lots of programming, and led to searching for the nefarious Holy Grail—which doesn't exist. Then and now, we just want what works best. When programming every little detail it's remarkably easy to fall into never-ending analysis paralysis. Condition Wizard opens cans, as it were, for you. It's a smart little program with a drop-down interface. It's like a file cabinet with three folders:

The Condition Wizard

Cut the work (and stress) by automating your scans on thinkorswim

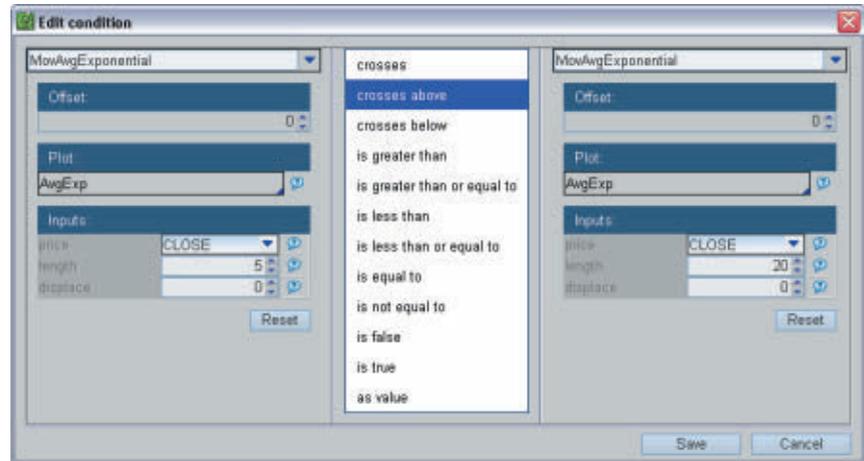


FIGURE 1: The Condition Wizard in thinkorswim makes it easier to automate your trading and dial in on searching for the exact setup you're looking for. *For illustrative purposes only.*

- 1) Find what you want in the first drop-down menu (i.e. "price")
- 2) Pick what you want it to do in the middle drop-down menu (i.e. "greater than")
- 3) Select what it compares to in the last drop-down (i.e. "\$10")

This literally writes the programming for your rules. It's simple, and typically requires little practice to learn where to find everything.

PEACHES BECOME COBBLER

Say you want to create a large watch list to alert you each time a buy signal triggers on a stock using a triple-moving average crossover. Look at Figure 1. Using Condition Wizard, first make a moving average cross another longer-term moving average. Second, have the longer-term moving average cross a third. And finally, apply it to a watch list. Instead of writing code, this tool can do all this and more in a few quick steps. Each signal now streams to you on your watch list.

WARM THE COBBLER AND ADD ICE CREAM

Let's up the ante. That blasted triple moving average crossover seems to never give signals when you want it to. So, you might be inclined to toss the rules out the win-

dow for the sake of getting into a trade—any trade.

Going too large on a single trade, or stubbornly clinging to a losing one, can bring ruin. Aside from chasing your tail—how do you become confident and proficient in an active skill you don't stick with? Perhaps automation is the answer. Remove yourself from emotional decision-making and consider applying the Condition Wizard rule to trade orders. Now when buy signals occur, the trade has the ability to automatically fire for you, potentially instilling trader discipline.

Condition Wizard doesn't replace your brain. You don't want to give up the human advantage of picking watch-list stocks, deciding when to sit out the market, or, over time, optimizing your rules. But you can leap forward in your trading by considering automating some functions, leaving you enough time to grow the peaches yourself.

Important Information

Market volatility, volume and system availability may delay account access and trade executions.

Past performance of a security or strategy does not guarantee future results or success.

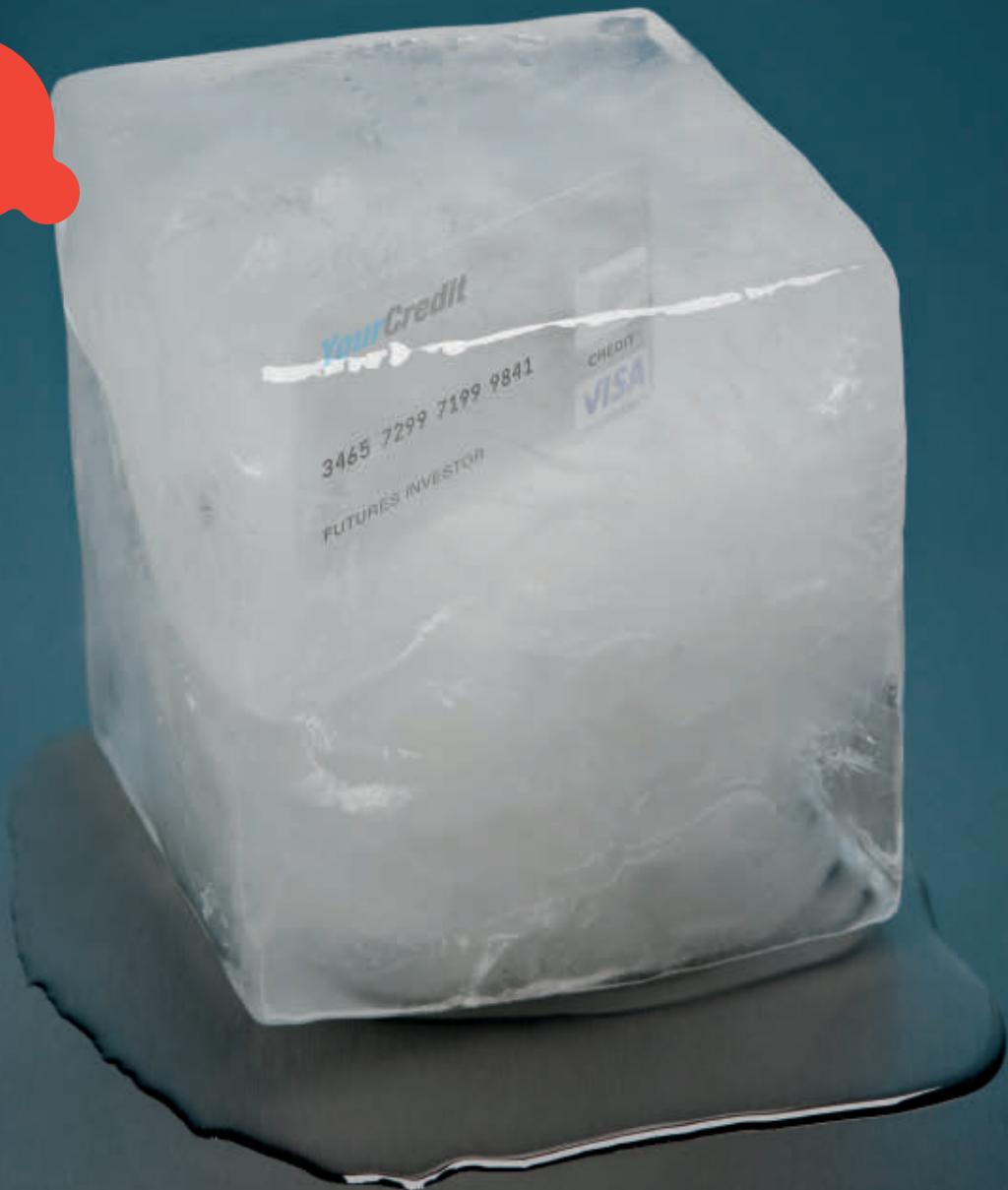
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**Special Focus:
Future Trading**

Photograph by
Fredrik Brodén

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FUTURES: NOT JUST FOR FARMERS ANYMORE

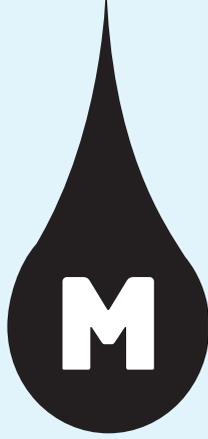
FORGET ABOUT INFLATION. THERE'S PROBABLY A FUTURES CONTRACT TO HEDGE YOUR EVERYDAY CONSUMPTION. LET'S START FROM THE BEGINNING WITH A LITTLE FUTURES TRADING 101.

WORDS BY **THOMAS PRESTON**

•
**Special Focus:
 Futures Trading**
 •

Photograph by
Fredrik Brodén
 •

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ENTION FUTURES trading at a party and your friends will likely think of farmers and pork bellies. Then there's Hollywood, which often tells the story of the little guy making fortunes, while the bad guys go broke. That's what trading futures is all about, right? Well, not exactly. At least not if you ask smart investors and traders.

Futures trading is certainly not appropriate for everyone. Trading futures does involve speculation and the risk of loss can be substantial. But, the idea that futures are for professionals only—industrial-sized users, or farmers of some commodity, or some big financial institution, or central bank looking to hedge, ganged with fire-breathing speculators taking the other side of the risk—is Hollywood. It's a fun story, but not practical.

In fact, futures trading can be boringly practical. The concepts of hedging and speculation are still true, but it's how you hedge or speculate with futures that can make all the difference. You can use the same strategies as the pros, but on a much smaller, and less leveraged scale. Here's how.

PUTTING THE DRINK DOWN

Let's start with a sober discussion of what a future is by talking about the E-mini S&P 500 future, the electronically traded little brother, of the S&P 500 future (SPU). You're probably familiar with the S&P 500 index, calculated off the prices of 500 large-cap U.S. stocks, and which has a price. The E-mini S&P 500 future is a contract that that would deliver the cash equivalent of \$50 times the price of the S&P 500 index, at the expiration of the future.

So, if you thought the S&P 500 might go higher, you could go to the trouble of buying all the 500 component stocks in the same weighting method that the index uses. Or, you could just buy an E-mini future. You would put up some cash to cover the initial requirement for the futures contract. You'd profit if the E-mini future went higher, and lose if it went lower. Now, you may have mutual funds that track the S&P 500, so you may be asking, why all the fuss about futures?

When you multiply the price of the S&P 500 future by \$50, you get the value of that future. With the S&P 500 future at 1,300, it has a value of \$65,000. The initial margin requirement, or the amount of cash you need in your account to buy that future, is about \$4,400. Using only \$4,400 to establish a position worth \$65,000 is known as leverage. And some say it's both a good and bad thing about futures. Good in the sense you don't need the full value of the contract to buy it. Bad in the sense you don't need the full value of the contract to buy it.

If the SPU moves up 50.00 points in a week—not a huge move for the S&P 500 future—you'd make \$2,500. But if it drops 50.00 points, the loss would be \$2,500, and you'd have lost over 50% of your initial investment. You may also have to put up more cash to maintain the position. That's called a margin call, which must be satisfied immediately. In that sense,

leverage is kind of scary. But what if you actually had a portfolio of S&P 500 stocks worth \$65,000? That doesn't have any more risk than the S&P future. Finally, what if your stock portfolio is smaller? Are there any advantages to buying an E-mini future than a basket of the S&P 500 stocks?

SMALL SHOTS CAN WORK, TOO

Let's say you'd like to invest in an S&P 500 portfolio with a value of \$65,000. What are your choices?

- 1/ You could buy \$65,000 worth of an S&P 500-tracking mutual fund.
- 2/ Alternatively, you could buy \$65,000 worth of an exchange-traded fund that tracks the S&P 500, and if you chose to use margin, you'd only need to put up \$32,500 to do that (remembering the cost of margin interest also, when borrowing from your broker).
- 3/ Or you could buy 1 E-mini S&P future, and put up about \$4,400 in margin.

Note that in scenario 3 you have not bought any actual securities like you did in the first two scenarios, but you've bought a product where the risk/reward profile is similar. And if you had remaining capital (since you did not have to spend \$32,500 or \$65,000), you could conceivably invest that in an interest earning product. That could help diversify your overall portfolio, or even enhance your potential return.

Rather than leveraging up to take more risk, you'd be using leverage in an attempt to enhance returns. Fire breathing? Not so much. Unlocking some capital? Yes. Time for that martini.

Many futures—like the E-mini S&P 500—are traded nearly twenty-four hours a day, making real-time information available in the middle of the night. You can even trade futures on a mobile platform, such as TD Ameritrade Mobile Trader. (See "Go Outside and Trade!" page 26 of this issue for more.) And you can trade a wide variety of markets with futures—from commodities like corn, soybeans and crude oil, to financial instruments like Treasury bonds and currencies. Futures can be a way of speculating or hedging these products because of several things—liquidity, electronic quoting and order routing, and availability of futures accounts (have you ever tried to buy 1,000 barrels of crude oil?).

Those S&P 500 futures are also frequently viewed as a heads up on what might be happening in the market. Ask any active trader what things she checks daily, and you're likely to hear "the SPUs." That's because the speed and efficiency of the futures markets helps professional traders make either bullish or bearish speculative trades on futures faster than buying or selling entire portfolios of stock. When some news or event hits the wires, generally the product that reacts first is the S&P 500 future. Often, you might see the S&P 500 futures rally before you see the component stocks of the index rally. There's no guarantee that individual stocks will follow the futures, but the futures can give you an indication of how market participants might be interpreting a news



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Wanna Trade Futures?

Opening an account is easy for qualified traders. See sidebar, page 38 for a step by step on how to do so.

event as either bullish or bearish on the overall market. To check it out yourself, put the symbol /ES in a watch list.

BACKYARD HEDGES

Speculating with futures is one way to use them. But, what if you want to reduce the risk of adverse price movements on everyday things like gas prices at the pump, heating oil, your stocks, or even your adjustable mortgage against rising interest rates? Now, this isn't the traditional hedging strategy of the futures market, and the same pros and cons of leverage apply. But the tricky part is contract size. Remember the part about the price of the S&P 500 times \$250 for the "big" SPU contract, and times \$50 for the E-mini? Those are contract sizes. And they affect how much of an underlying position a future can hedge.

Using even an E-mini S&P future to hedge a \$10,000 stock portfolio would be overkill. You need to be familiar with the mechanics of futures contracts in order to use them as a hedge. Let's look at a few examples.

Portfolio Protection. It doesn't take a rocket scientist to understand that oil stocks are affected by rising oil prices. Or that metal miners might be affected by the rising price of gold. If you had a portfolio of stocks or funds as a long-term investment that broadly tracks

Contango & Backwardation

Two cool-sounding words you'll hear when learning about futures. They refer to the relative prices of futures in different expirations, as they relate to an expected futures price or spot price. They're related to the **cost of carrying** the underlying product of the future—whether it's a basket of the S&P 500 stocks, a barrel of crude oil, or bars of gold. At the futures expiration, the futures price converges with the spot price.

Contango refers to futures prices in further expirations being higher than a current spot price. If spot crude oil is trading at \$80, and the December crude future is trading at \$82, the crude futures are in contango.

Backwardation refers to futures prices in further expirations being lower than a current spot price. If the S&P 500 index is at 1,300, and the December S&P 500 is at 1,298, the S&P 500 futures are in backwardation.

Do contango and/or backwardation give any indication of the potential price movement of a given future? Not necessarily. While contango prevails when the cost of carry is positive, severe contango—where the futures price is much higher than the cost of carry would suggest—can indicate either an excess of supply in the spot market, or a potential shortage in the futures market. A severe contango is often perceived as a bearish signal for the market, because a trader can buy the product at the spot price, short the future, and make the difference between the future and spot price, minus carrying costs. That can put downward pressure on the futures price. But is that enough to overcome the natural ups and downs of a future itself? That's not certain, which is why speculating using contango alone is not necessarily a sound strategy.

the S&P 500, and that you don't want to liquidate, the E-mini S&P future could be used as a "hedge."

Let's say the value of your portfolio is \$100,000 and you're concerned that the market might drop 10%. You could consider **shorting** E-Mini S&P 500 futures as a hedge. But how many? If the market drops 10%, your portfolio would theoretically lose \$10,000 in value. If the E-mini is at 1,300.00, a 10% drop would mean 130 points. Each point in the E-mini is worth \$50. So 130 points times \$50 equals \$6,500. So, if you shorted an E-mini future, and the market dropped 10%, theoretically your portfolio, in conjunction with the short future, would lose about \$3,500 of value. The strategy isn't perfect—your portfolio still loses money if the market drops—but the intention would be to lose less than if it were unhedged. And remember, the risk associated with the futures position doesn't change. If the market rises suddenly instead of dropping you need to be aware of your exposure.

Lock in on your adjustable home loan.

Let's consider a scenario where you're borrowing \$500,000, with an adjustable rate tied to 10-year bonds. (Or if you don't have a home loan, think high-balance, floating-rate credit card here.) If you believe interest rates might rise by 1.00 (100 basis points), you'd have to pay an extra \$5,000 in interest per year if that happens. A possible strategy to reduce the risk

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**Special Focus:
Futures Trading**

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of adverse price movements would be a short 10-year Treasury bond future (symbol: /ZN). If interest rates rise, bond prices drop. But how much does a 10-year bond future change when interest rates change 1%? According to the Chicago Mercantile Exchange, nearly 8 points. Each point in a bond future is worth \$1,000, and 8 points would be worth \$8,000. If rates do rise by 1%, you'd have to pay \$5,000 more on your loan. But, theoretically you'd earn \$8,000 on your 10-year bond future hedge. Again, this is a case where the hedge isn't perfect, but the point is to understand how to apply futures point values as a strategy to offset risk.

Home economics and the heating bill.

Using the same principles as interest rates, how about offsetting your heating bill against rising energy costs? Only this time, you might use natural gas futures (symbol: /NG), the primary source of residential heat. Want to hedge against a rise in prices at the pump? Consider futures on crude oil (symbol: /CL). Just remember the risks involved in futures trading, and the ever present effect of leverage. These days, there's likely a future that you have access to for just about any bill or expense that's tied to a commodity of some sort.

TO TRADE FUTURES EITHER FOR PURE speculation or in an attempt to reduce the risk of adverse price movements, you need to do that in a futures account. You can't trade futures in an equities account. But you don't need a futures account to see futures quotes on the TD Ameritrade platforms, and opening a futures account with TD Ameritrade is very straightforward. Just follow the steps in the sidebar, next article ("Wait, you don't have a futures account?").

How to Trade Futures at TD Ameritrade

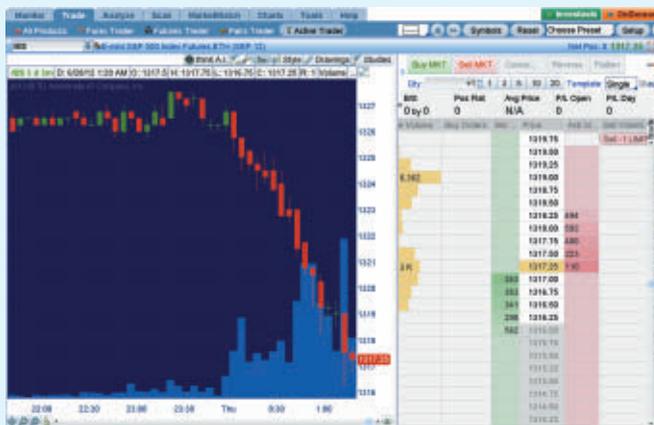


FIGURE 1: With the Active Trader screen on thinkorswim, you get a real-time view the depth of the market and multiple charts from one place. *For illustrative purposes only.*

fut.

After opening a futures account, you won't move mountains, but you will be able to trade both futures and forex from the **thinkorswim** platform. One way to view and execute a futures contract, such as the E-mini S&P (/ES), is from Active Trader under the main Trade tab. Active Trader allows you to view multiple charts on multiple markets alongside a real-time view of the depth of market.

1—CUSTOMIZE Customize the chart to the futures symbol you want to view, such as /ES. No need to enter the month symbol or year, as the platform will default to the contract's front month, or month with the most volume. The chart's time frame can be customized to display one minute bars to view short term moves, all the way monthly bars to view long term trends.

2—ANALYZE Analyze the futures market by adding a study to a thinkorswim chart in the Charts page. Hundreds of studies can be added to thinkorswim charts under Edit Studies and Strategies. Bollinger Bands, for one, can help you chart a trend and gauge volatility levels all in one. This indicator is comprised of curved lines overlaying the futures price chart. The middle curve or "band" is a moving average, while the upper and lower bands are formulated from volatility.

3—EXECUTE Execute your trade directly from the Active Trader window. Just like everything else on the thinkorswim platform, the choice is yours. You can place an order directly from a chart or



Wait, you don't have a futures account?

The process is completed in three easy steps.

1 You need to have Level 2 options approval prior to filling out the futures application. To apply for Level 2 options, login to the TD Ameritrade website, click on My Profile and click Edit Option Trading. Complete and submit the Upgrade form.

2 After receiving your approval, log back in. Under My Profile, click on Upgrade your futures account for futures and forex. Complete the "Upgrade Agreement for Futures and Forex."

3 Once your account has been upgraded, (which may take about a day or two) go back under My Profile and click the Futures Apply button. Fill out the online futures application and you're on your way to trading futures.

Contact us at support@thinkorswim.com, or call 866-839-1100.

FUTURES TRADING CAN BE BORINGLY PRACTICAL. THE CONCEPTS OF HEDGING AND SPECULATION ARE STILL TRUE, BUT IT'S HOW YOU HEDGE OR SPECULATE WITH FUTURES THAT CAN MAKE ALL THE DIFFERENCE.

from the Active Trader window while viewing the order book depth. The buttons on the right hand side of the Active Trader page let you add or remove the tools. The T&S tool lets you see time and sales of futures trades with a time stamp, trade price, and trade size, with data colored green or red to indicate an up or down tick. The AT tool displays prices vertically and centers itself on the current futures price. It indicates the number of contracts on the bid and ask, and volume on the left hand side. You can also customize the trading buttons at the top to enter buy or sell market orders, or limit orders to buy on the bid price or sell on the ask price with a single click.

Important Information

Past performance of a security does not guarantee future results or success. The information contained in this article is not intended to be investment advice and is for illustrative purposes only. Clients must consider all relevant risk factors, including their own personal financial situations, before trading. The risk of loss in trading futures and Forex can be substantial. Trading foreign exchange on margin carries a high level of risk as well as its own unique risk factors. Please read the National Futures Association Understanding the Risks of Trading in the Retail Off-Exchange Foreign Currency Market risk disclosure before considering the trading of this product. Supporting documentation for any claims, comparisons, statistics, or other technical data, will be supplied upon request.



Q: Can I set up a futures account that I can access with my current log in?

A: Yes!

Q: What Futures markets can be traded?

A: Not only can you hedge your stock portfolio though futures stock indices like the E-Mini S&P (/ES), E-Mini Nasdaq (/NQ) and Mini Russell (/TF), but you can speculate on the global economy by trading Ten Year Treasury Notes (/ZN), Gold (/GC), Crude oil (/CL), Wheat (/ZW) and Euro Currencies (/6E). These are just a few examples of the various products and market sectors that you can access via the Futures markets.

Q: When do Futures trade?

A: Just because the stock market is closed doesn't mean you can't trade. You have the ability to be responsive to changing market conditions and economic events knowing that Futures trading is available almost 24 hours per day, 5 ½ days per week. You can view the trading hours for each product at the TD Ameritrade website tdameritrade.com/trade/futures.html.

Q: Which products can I trade futures on at TD Ameritrade?

A: Thinkorswim, webBased trading, and TD Ameritrade Mobile Trader. Or you could always call our trade desk to place your order.

Q: How much is the margin in futures trading?

A: Margins are based on the likely dollar value that futures contract may change in a single day, and vary with each product. More volatile products have higher margins. The system that clearing houses and clearing firms use to determine the margin on an account's overall futures position is called SPAN (Standardized Portfolio Analysis of Risk) and is standard in the industry.

Q: How can I see the symbols for the different futures available on thinkorswim?

A: You can access the list of futures by clicking on the double drop down arrows on any symbol entry field. That opens up the Symbol Table, and you can click on the Futures tab. That will list all the futures we support and their root symbol. If you type that root symbol into a quote page or chart, you'll see the price of the current most active expiration month for that

future. The platform automatically switches to the new most active future when the futures are rolled from one expiration to the next.

Q: Do futures expire on the same date as equity options?

A: Not necessarily. The expiration date of a future is set by the exchange and often conforms to the needs of people that use that product as a hedge. The e-Mini S&P future has quarterly expirations that match the March, June, September and December expirations of equity options. Corn futures, on the other hand, have many more contract months available that usually expire in the middle of the month. The specific expiration dates are available on the exchange websites.

Awarded 5 stars from Stockbrokers.com* ★★★★★

Trade with your finger on the market.

Explore futures and forex trading with thinkorswim®, our award-winning, feature-packed trading platform. Use Monkey Bars, Pairs Trading, and the Active Trader Ladder to help make your strategy even stronger. Access all your trading, data, and idea-generation tools in one slick, customizable window. Or take your trading on the go with TD Ameritrade Mobile Trader.

Both platforms are free to download. And they'll change the way you trade.



TD Ameritrade

Find out more at tdameritrade.com/futuresforex

*The thinkorswim trading platform received 5 stars overall in the 2011 Stockbrokers.com Forex Broker Review (sharing the highest score with one other broker), as well as 5 stars in the categories of "platforms and tools" (sharing the highest score with one other broker), "investment offerings" (sharing the highest score with three other brokers), and "customer support" (sharing the highest score with one other broker). thinkorswim was evaluated among a total of 16 forex brokers and trading platforms reviewed.

Access to real-time market data is conditioned on acceptance of the exchange agreements. Professional access differs and subscription fees may apply.

Market volatility, volume, and system availability may delay account access and trade executions.

Trading futures and forex involves speculation, and the risk of loss can be substantial.

Forex investments are subject to counter-party risk, as there is no central clearing organization for these transactions.

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TDA 1377 D 03/12



Capiche?

Lessons from a veteran floor trader

Words by **Alex Mendoza**

A Cheaper Way to Spread

Implied Order Functionality is here! Great. But what does it mean?

- The language of trading can be technical and weird. Outer-space talk. Think “implied order functionality”...did we lose you? Deep breath. Consider trusting the countdown because the orbit is often majestic.

In early May, the International Securities Exchange (ISE) became the first exchange to offer something called “implied order functionality.” The motivation? To help you with tighter bid-ask spreads, of course.

Some home-planet background

Single-order improvements have been around since the early days of option exchanges. Any unrestricted limit order that improves the current market quotes must be represented, typically causing a tightening of the normal bid-ask spread.

To illustrate: suppose that the market on the 55-strike calls is 0.90 – 1.10. For a prospective option seller, it means that the most someone is willing to pay for an option is 90 cents. Conversely, for the buyer, the lowest advertised selling price is \$1.10. So far, everything looks normal.

Now, suppose a retail customer enters the marketplace looking to sell the 55-strike calls. If he places a limit order to sell his calls at 90 cents, he’s likely to obtain a fill. However, the customer wants to try to get a better price for himself. So rather than

entering a limit price at 90 cents, he offers them at \$1.00.

And because the retail customer is willing to sell the 55-strike calls at a lower price than what is indicated by the current market quote, his \$1.00 offer is now the best offer and must be represented. The new market on the 55-strike calls is now updated to reflect the new offer—that is, 0.90 – 1.00.

Moving on, the \$1.00 offer belongs to the retail customer. And since it now represents the best offer price, it’s reflected in the exchange’s listed quotes. This additional exposure not only tightens the overall market, but increases the customer’s chances of finding a counterparty willing to fill the limit order.

That’s how market improvement works for single orders. No alien crossfire. Until now, this type of improvement was not available anywhere for spread orders.

Star power: spread-order improvements

Suppose you have the following markets in the 50 and 55 call-option strikes:

BID	ASK	STRIKE
1.90	2.10	50
0.90	1.10	55

The natural market for the 50/55 call spread would be 0.80 – 1.20. Now, suppose an order enters the marketplace seeking to buy the 50/55 call spread for \$1.10. The natural offer is currently \$1.20, so the 1.10-bid is 10 cents away from the best-displayed market offer.

The ISE can now do the following: Knowing there is a real market maker who is willing to sell the 50 calls at \$2.10, the ISE will create an “implied” offer of \$1.00 on the 55 calls. This will make the quoted market look like this:

Important Information

Options are not suitable for all investors as the special risks inherent to options trading may expose investors to potentially rapid and substantial losses. Options trading is subject to TD Ameritrade review and approval. Please see our website or contact TD Ameritrade at 800-669-3900 for options disclosure documents. Carefully read the Options Disclosure Documents before investing in options.

Price improvement is not guaranteed and will not occur in all situations. TD Ameritrade acts as agent. Orders are filled by independent third parties.

Spreads, Straddles, and other multiple-leg option strategies can entail substantial transaction costs, including multiple commissions, which may impact any potential return. These are advanced option strategies and often involve greater risk, and more complex risk, than basic options trades.

BID	ASK	STRIKE
1.90	2.10	50
0.90	1.00	55

Note the \$1.00 offer on the 55 calls. This is the implied quote.

If an order enters the market to pay \$2.10 for the 50 calls, the market maker will sell the calls at \$2.10, and it’s business as usual.

Yet, if an order enters the market to pay \$1.00 for the 55 calls, the ISE will sell the 55 calls at \$1.00, and buy them from the spread customer for \$1.00, thereby scratching on the trade.

The spread customer, having sold the 55 calls at \$1.00, will now pay \$2.10 to the market maker to complete the spread.

Turn meteor showers into pet rocks

The beauty of the process is that up til now, while the \$1.00 offer was implied by the marketplace due to a spread order on the order book, there was no way to use that information to improve overall market quotes.

The ISE has found a way to turn the implied quote into a tangible market that can be traded by anyone. This is good news for traders everywhere, since the ability to create these implied quotes can dramatically reduce the possibility of trade-throughs, by allowing traders across different strategies to find each other on a given exchange.

42 **gls**

The Token Glossary

• Terms you might stumble across in this issue.

• tdameritrade.com

found on pages: **12, 31 & 37**

SHORTING

• To short is to sell an asset, such as an option or stock that you don't own in order to collect a premium. The idea being that if you believe the price of the asset will decline, you can buy back (or "cover") your short at a lower price later. Your potential profit would be the difference between the higher price you shorted at and the lower price you covered.

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Implied Volatility

• The implied volatility is the market's perception of the future volatility of the underlying security, and is directly reflected in an option's premium. Implied volatility, expressed as an annualized number (such as 25% implied volatility), is forward-looking and can change.

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In the money

• An option whose strike is "at" the price of the underlying equity. Like out of the money options, the premium of an at the money option is all "time" value.

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COST OF CARRY

• The cost to you to hold an asset, such as an option or futures contract. In the case of options, the cost of carry relates to dividends paid out by the underlying asset and the prevailing interest rates.

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Call or put spread

• ALSO KNOWN AS "VERTICAL" SPREADS, THESE ARE DEFINED-RISK, DIRECTIONAL SPREAD STRATEGIES, COMPOSED OF A LONG AND A SHORT OPTION OF THE SAME TYPE (I.E. CALLS OR PUTS). LONG VERTICALS ARE PURCHASED FOR A DEBIT, WHILE SHORT VERTICALS ARE SOLD FOR A CREDIT AT THE ONSET OF THE TRADE. LONG CALL AND SHORT PUT VERTICALS ARE BULLISH, WHEREAS LONG PUT AND SHORT CALL VERTICALS ARE BEARISH. THE RISK OF A LONG VERTICAL IS TYPICALLY LIMITED TO THE DEBIT OF THE TRADE, WHILE THE RISK IN THE SHORT VERTICAL IS TYPICALLY LIMITED TO THE DIFFERENCE BETWEEN THE SHORT AND LONG STRIKES, LESS THE CREDIT.

13

found on page:

Gamma

• A measure of what an option's delta is expected to change per \$1 change in the underlying asset. Delta is the measure of an option's sensitivity to a \$1 change in the underlying asset. All else being equal, an option with a .50 delta and a .05 gamma for example, would gain or lose \$0.50 per \$1 move up in the underlying. The new delta would then be .55 (.50 delta + .05 gamma).

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13 & 28

Spread

• An option position or order that contains two or more option "legs," which typically includes at least one short and one long position.

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Moving Average

• A charting indicator used to gauge momentum of an asset's price, such as stock or a future. The moving average typically computes an average closing price over a specified period of time, such as 50 or 200 days.



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