thinkMoney/29
Random musings for traders at TD Ameritrade — FALL 2015

STOCK MARKET GRUDGE MATCH

IS PRICE OR VOLATILITY MORE IMPORTANT?

PAGE 16

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Cover Photograph by **Fredrik Brodén**

"Simply winning or losing doesn't mean you need to close your trade. When you have a reason to stay in, adjusting a trade can help you cut risk, take money off the table, and give you time to further plan."

How to Hold 'Em. How to Fold 'Em

Page 20

SKILLS THERMOMETER: See a dot. Read or pass. If you've ever been frustrated spending your precious few minutes reading articles that are too hot or too cold, these little color dots at the beginning of each article will help you skip to just the right temperature.

- EASY
- SEASONED
- PRO

PHOTOGRAPH: FREDRIK BRODÉN

Volatility or Bust

• TO SAY THE LAST quarter was a wee bit volatile is an understatement. If you woke up around 9:30 ET on August 24th and checked your TD Ameritrade Mobile Trader app before getting up (you know you do), you weren't the only thing falling out of bed. So did the market with a swoon not seen since 2008. But of course, as a trader, you didn't see fear, you saw an opportunity, right? After all, without a little movement, there's not much to trade. So selling volatility, without regard for stock prices when the CBOE VIX spiked over 50, would've likely been a good move for you if you bet to the upside.

This highlights an age-old argument about which is more important to get into a trade: stock price or volatility. In "Settling a Market Grudge Match" (Page 16) we'll discuss some strategy selection techniques that should make you think twice about ignoring volatility once and for all.

And should you have been lucky enough to make a profit that day, you might have been asking yourself, "Is there more?", or "Should I wait to sell?", turn to "How to Hold 'Em. How to Fold 'Em" on page 20. There's more to exiting a trade than merely getting out. In fact, you could say there's an art to it, whether you're in a winner or a loser, particularly if you want to try to squeeze more juice out of your winners. Or if you just want to fix your losers.

Speaking of selling volatility, if you're looking to maximize the potential of some defined-risk, short strategies, there's a little trick to turning their risk/reward profiles on their heads, without entering the world of unlimited risk. Turn to page 24 for more.

While the swoon of 2015 may have lasted a mere few days, it should serve as a not-so-gentle reminder that complacency has no business in the stock business. You never know when the next ball will drop, but by focusing on strategy selection, exit plans, and money management, you'll be ready for the next time you get kicked out of bed.

Happy Trading,
Kevin Lund
Editor-in-Chief, *thinkMoney*

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LOVE NOTES

LITTLE QUIPS FROM YOU TO YOURS TRULY

To Our Inbox...

TRADER JARGON—
WHAT IT REALLY MEANS...

Quantitative—Statistically losing money.
Algorithmic—Scientifically losing money.
Seasonal—Losing money rain or shine.
Cyclical—Losing money like clockwork.
Wave theory—Turning theory into the practice of losing money.
Trend—Losing money in one direction more than the other.
Contrarian—Losing money in the other direction, too.
Fundamental—Making a business out of losing money.
Technical—Losing money with precision.
—Joshua

JOIN THE FUN
Send us your best and brightest quips for a chance to get a seat next to the monkey (well, to get your quote in print, anyway). **thinkmoney@tdameritrade.com**

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Chat Room Pearls...

I should do a seminar about stubbornly staying in a trade. Hope is not a strategy.
—DENISE

I brought the Bourbon. When's lunch?
—ZACK

My wife wants to go out for dinner to Ruth's Chris Steakhouse. I told her not today, it's MCD.
—JOHN

Patience is a waste of time. What's the nanosecond chart showing?
—BRUCE

Everyone here tells me I'm not really good at trading and I'm just looking for attention.
—MIKE

You know the old saying—"You can lead a horse to water, but you can't force it to play canasta."
—GEORGE

All I want for Xmas is spell check.
—DIANE

Wow, that's what you call being taken to the woodshed. Let's do it again tomorrow.
—BILLY

I guess being long today was a bad idea. So we should wear garlic bulbs around our necks tomorrow?
—WENDY

CHAT DUDE 1:
Man what is causing this after hours selling?

CHAT DUDE 2:
Hell just rolled over.

As long as you're not on the wrong side of the trade, you'll be okay.
—JACK

"The hardest job is not lying to yourself. No one ever thinks they are doing a lousy job. Guess what, sometimes we all suck."
—MARK CUBAN

GET CHATTING
Head over to the thinkorswim® Chat Rooms for trading education or to cure boredom. In thinkorswim, at the top left select Support/Chat > Chat Rooms. Then join the party.

PHOTOGRAPH: FREDRIK BRODÉN

TRADER GLOSSARY TURN TO PAGE 36

INDUSTRY SPOTLIGHT ● EASY

VIX Options Go Weekly

BIG IDEA: TRADERS ARE DEMANDING MORE PRECISION FROM THEIR "FEAR GAUGE," BUT IS IT ENOUGH?

THE CBOE VOLATILITY INDEX (VIX) MAY have the best-worst nickname in trading. It's affectionately known as the "fear gauge," measuring broad stock market sentiment shifts. It's a mood thermometer for many market participants, but options and futures on VIX are tradable.

Now the suite is getting a revamp as the Chicago Board Options Exchange (CBOE) on October 8 launches a weekly options alternative in addition to traditional monthly expirations. It's a new spin on an old product (CBOE has this category locked up: Weeklys℠). The rollout will, quite literally, offer more options for traders who are looking for exposure to volatility.

In fact, VIX Weeklys launch in one of the most historically volatile months of the year for the S&P 500 (SPX). In October 2014, average daily swings for SPX were 95 points, according to Standard & Poors—the most volatile month of last year. We probably don't need to dust off the October history books otherwise. You get the idea.

Getting Closer?

VIX rises when traders buy up short-term hedging contracts to offset stock movement. It recedes when traders offload volatility hedging. But how precise is this play on vol? The nearer VIX options are to their expiration date, the more closely the contracts reflect the index's readings. At least, that's what the exchange is banking on with the weekly offering. Trader demand for these products could swell. But what are we talking about? It's still a guess about a guess: VIX tracks a measure of 30-day volatility expectations priced into short-term S&P 500 (SPX) options.

Keep in mind that options premiums are derived not from the index itself, but

Because they are short-lived instruments, weekly options positions require close monitoring, as they can be subject to significant volatility. Profits can disappear quickly and can even turn into losses with a very small movement of the underlying asset. For more on the risks of options, see page 37, #2.

PHOTOGRAPH: FREDRIK BRODÉN

(CONT. FROM PAGE 11)

from VIX futures themselves. That means because VIX itself isn't traded, VIX options track VIX futures. And those futures contracts have been known to reflect factors (institutional ebb and flow) outside what the pure index is doing on a given day. The launch announcement renewed a call from *Barron's* columnist Steve Sears for CBOE to quote VIX throughout a 24-hour cycle. He argues that would better reflect international market sentiment and in-the-moment U.S. sentiment.

Challenging the Formula?

What's more, VIX's stronghold may be challenged. BOX Options Exchange (BOX) and The VolX Group (VolX), architects of RealVol products, inked a licensing agreement earlier this year (it's not yet widely listed). BOX will list VOLS for trading, and the Securities and Exchange Commission gave its regulatory thumbs-up in May. VOLS more closely tracks the over-the-counter method based on a "variance swap" involving SPX exchange-traded funds. That's pretty wonky, we know. All you need to know is the volatility reading is tied to actual, not implied, movement in the underlying.

At the least, all this change pushes the market to take a hard look at the effectiveness and predictability of 30-day vol expectations, with the challenger saying there's a better way to read markets than assigning a number to what people think could happen next.

Now, no one denies VIX's long track record. It's not going anywhere. But will VIX have to scoot over for challengers? Will the CBOE have to return to the drawing board again and again to keep the vol crowd happy? Let's see. After all, competition is what drives all markets. Period.

—Words by RACHEL KONING-BEALS

GEAR HEAD ● SEASONED

Actively Trade Like an Active Trader

BIG IDEA: PRICE, VOLUME, AND DEPTH OF MARKET ARE STANDARD FARE. BUT THE ONE-CLICK ORDER CAPABILITIES OF THE ACTIVE TRADER LADDER? WHOA.

• Any trading style takes time to perfect. The best way to reduce your time investment is to practice your craft with exceptional tools. For more active trading styles, we have a tool that—through a single portal—gives you access to price movement, volume movement, and the depth of the market. Even with all that, the tool's most valuable asset is its ability to send, replace, and cancel multiple orders with a single click. Consider the thinkorswim® Active Trader ladder.

COOL TOOLS

For the latest release notes and thinkorswim how-to videos, go to **tlc.thinkorswim.com.**

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How To Do It

Streamline your Orders

Your road map to one-click order functionality in Active Trader on thinkorswim.

1 - Open the thinkorswim Charts tab and load up whatever symbol you'd like to actively trade (especially useful for fast-moving futures markets).

2 - From the right-hand menu, choose Active Trader (or AT in smaller views).

3 - To place a buy order, simply click on Bid Size next to the price you choose. For a sell order, you'll click on the Ask Size cell.

4 - Once orders are sent, drag them up and down on the price scale by clicking and dragging the order icon.

5 - You can click and drag orders on the chart, and do the same with linked orders, such as OCOs (one-cancels-other), by dragging the link.

Ask the Suit

A LITTLE Q&A WITH **NICOLE SHERROD,** MANAGING DIRECTOR, TRADER GROUP AT TD AMERITRADE

• How can I maintain a more global perspective with my trading?
I don't know. Like...travel more? Just kidding. Even though most of my trading is domestic, we all know how important it is to maintain an opinion about the state of the global economy. Without question, reverberations from markets abroad can be felt deeply in our own markets.

A few months ago when things started heating up in Greece and then China, we realized we had a huge gap to fill in our international data offering. So lately, we've started to roll out international exchange data on thinkorswim® and Mobile Trader so that you can stay more in tune with the global markets. And this was no small feat. We've been sending agreements back and forth to faraway exchanges like the Baltic exchange and Bovespa, where I'm pretty sure floor traders deal in wampum. You'll see more exchanges start to slowly be added. Just keep an eye on the International Indexes public watchlist. Ooh la la!

> **"When things started heating up in Greece and China, we realized we had a huge gap to fill in our international data offering."**
> —NICOLE SHERROD

WATCH THE SUIT
Skip the small print and let the Suit walk you through how to use Trade Finder.
http://tta.pe/nF/

Any new products I should be aware of?
New products are rolling out all the time. And most of them are total snoozers that traders have little interest in. Weekly VIX options is the latest product that's actually gaining traction. When you consider the fact that SPX Weeklys are responsible for about 30% of all SPX volume, you just know that VIX Weeklys will become a popular product.

For mobile, we now have in-app mobile chat. That's right. You can now message back and forth with service support representatives in TD Ameritrade Mobile Trader. In addition, you can even share your screen with them so they can teach you how to navigate the app.

I have friends who want to learn how to trade options. Any advice on the best way to get started?
For the better part of the past year, my team has worked tirelessly to build a tool that will help equity investors better understand how to trade options. It's called Trade Finder and it's located in Trade Architect. See "Toys for Traders," right for where to find it.

Trade Finder is to options trading what GPS is to a road trip. It helps you navigate a way to get from Point A to Point B. To get started, all you need to have is an opinion about an equity, optionable index, or optionable ETF. That opinion should be based on where you think it's headed and when you think it will get there. In addition, the tool allows you to pinpoint the probability of success that you are looking for. Obviously, the higher the likelihood of a successful trade, the lower the potential return on the trade. Trade Finder will take your opinions about the trade and return all of the relevant strategies ranked in order of probability of success. In addition, if you don't understand a particular strategy, Trade Finder even has descriptions of the trade to help you to understand what it's seeking to accomplish and the potential risk/reward.

TOYS FOR TRADERS
FROM THINKORSWIM®

MOBILE TRADER CHAT SUPPORT
In app customer support is now available in the TD Ameritrade Mobile Trader application. Chat directly with our support teams using a simple, easy-to-use texting style interface. Our associates can even guide you through the platform directly with our screen share technology, to set up your mobile trading experience exactly the way you want it. Available in the "Help/Support" menu within the app.

TRADE FINDER
The new Trade Finder tool in Trade Architect helps you find options trades that match your expectations on the performance of an equity. Identify the move in value a symbol is expected to make over a certain time frame, the probability of success you are looking for, and the amount of capital to risk. Simply click on the results to analyze the trade further and to place the trade. Check it out in Trade Architect on the "Trade" tab.

FULL DEPTH OF BOOK
thinkorswim now has the ability to show the entire depth of book for both NASDAQ and BATS/EDGE. See all open orders at every price level on each of these exchanges directly within the Level II gadget. To load these up, go to the Level II gadget and click the drop-down labeled "Level II" and select one of the full book options.

ASK THE TRADER
GUY

Q: Hey, Trader Guy! I know I can sell calls against long stock, but are there benefits to selling call verticals instead?
A: When you sell a call against long stock (a covered call), you give up some upside potential of the stock if the price rises above the strike of the short call. Your stock profit is offset by the loss on the short call. Yet, if you sell a call vertical, you preserve most of the upside. If the stock price rises above the long strike of the vertical, the long call offsets the loss on the short call, and the long stock makes money if it's over the strike of the long call. That may sound great. But you typically take in a smaller credit selling a call vertical than a short call. You have to decide if the upside potential is worth the vertical's smaller credit.

Q: Hey, Trader Guy! I'm entering a hot-dog eating contest next week and need to know the probability that my opponent will eat more than 50 in 10 minutes. Do you have the formula?
A: Divide your opponent's height by the circumference of his waist 6" above the hips. Divide that ratio by the square root of 1 over the minutes of the contest (in this example, 10). Next, divide the target number of hot dogs (50) by the minutes (10) and subtract 1. Then multiply the two numbers. Stick that on the standard normal distribution (normsdist in Excel) to see the probability of the opponent not eating the target number of hot dogs.

CAPICHE? EASY

Chasing Sector Momo With Fundamentals

BIG IDEA: BEFORE TURNING TO YOUR CHARTS TO FIND YOUR NEXT TRADE, CONSIDER A FEW FUNDAMENTAL FACTORS.

• IN A GENERAL SENSE, fundamental screens offer a top-down approach to help you identify presumably strong sectors that are geared for growth, versus those sectors that seem to be stuck in the mud.

We tapped the minds at BlackRock, parent company of iShares, for their thoughts on what they look for when evaluating sector strength. Heidi Richardson, head of investment strategy for U.S., said, "We always look at valuations, cyclicality of markets and balance sheets. Put these three together and you'll have a solid base for analyzing any sector or company."

BlackRock's investment professionals pay close attention to three main fundamentals when evaluating a sector's worthiness:

1. Valuations. What's cheap? What's expensive? How do price-to-book (P/B) and price-to-earnings (P/E) ratios compare with other sectors? These ratios might help you gauge what $1 in share price actually delivers. Keep in mind each sector has unique drivers. And you'll want to compare current numbers to history. Generally, P/B is a measure of how much investors are paying for each dollar of total assets, while P/E reveals what the company earns from business operations. For example, the S&P 500 trades at roughly 18 P/E and 3 P/B. A lower ratio could mean that the sector is undervalued compared to the broad market. However, it could also mean that something is fundamentally wrong. Ratios vary by sector, so be sure to consider other factors.

2. The market cycle. How's the economy? Is GDP growing? Is job creation healthy? During economic expansion, people spend more. So "cyclical" sectors like consumer discretionary, energy, financials, industrials, and information technology can benefit from increased activity.

During a recession, consider playing defense. Sectors that tend to outperform during slowdowns include healthcare, consumer staples, utilities, and telecommunications.

3. Balance sheets. Who's got cash on hand and who's servicing debt? As the Federal Reserve begins to normalize interest rates, monetary policy will continue to be influential.

Sectors with cash-heavy balance sheets, like technology, will be less vulnerable to rising rates than those carrying large amounts of debt, like utilities. What's more, cash will continue to benefit shareholder-friendly policies like rising dividends, share repurchases, and M&A activity. An asset-to-liability ratio can also help shine a light on a balance-sheet outlook. BlackRock professionals analyze this sector metric as an aggregate of all the companies within the sector. A ratio reading under 1 suggests a company has more liabilities than assets.

In combing the three factors, areas like financials and technology, for example, may offer interesting opportunities in an environment of economic recovery and as we enter a new era of rising rates. The point is, traders have a wealth of fundamental data at their disposal, which can tell you things about sector strength your charts might not be able to. —Words by KIRA BRECHT

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SETTLING A MARKET

SEASONED / **TAKE AWAY:** *Choosing an options strategy is about volatility, not price.*

MATCH

BIG IDEA: WHAT DO YOU THINK IS MORE IMPORTANT WHEN GETTING INTO AN OPTIONS TRADE—STOCK PRICE OR VOLATILITY? WHILE WE'RE NOT SUGGESTING YOU GET RID OF YOUR CHARTS, IF YOU'RE IGNORING VOLATILITY, YOU'RE MISSING A CRITICAL COMPONENT: STRATEGY SELECTION.

WORDS BY
MARK AMBROSE

PHOTOGRAPHS BY
FREDRIK BRODÉN

WHEN TRADERS LOOK AT volatility, they often mine it for clues as to potential stock price or market direction. Kind of like a counter indicator with the idea that when prices rise, volatility goes down. And when prices drop, volatility goes up. So, if volatility (vol) is low, maybe stocks have been overbought and could drop. And when volatility is up, maybe stocks have been oversold and could rally. Sometimes that works, and sometimes not. For instance, we saw consistently higher stock prices in 2014 and 2015, despite persistently low volatility. If you can't rely on volatility regarding the direction of stock prices, what good is it?

It's potentially a useful guide, but in context. At the beginning of a trade, volatility is best used to pick the trading strategy for a given opinion regarding what the price of a stock or index might do. Rather than using it to replace your fundamental analysis, charts, or technical studies to determine the potential direction of a stock or index, use it to pick a strategy to speculate on a given direction. During an option strategy's life, volatility typically impacts a trade's p/l. However, it's at the end of the trade where the profit or loss on most options trading strategies depends a lot more on where the stock price goes and not on volatility.

THE MYTH OF VOLATILITY

All things being equal, options values increase when implied vol rises, and decrease when implied vol drops. So, a short option typically loses money when implied vol rises, and makes money when implied vol drops. But the "other things"—like time and stock price—are always changing, too. Let's examine how those other things can matter more than volatility when it comes to profit and loss.

When vol drops. Say a stock is $100 and your 90 put is worth $1 when the stock's implied volatility is 35% with 30 days to expiration. You short the put, expecting the stock to either rise or not drop much, as well as the implied vol possibly dropping. Fast-forward to expiration, and the implied volatility of that 90 put is now 0%. You sold the put when its volatility was 35%. So, the short put should be profitable, right? Actually, if the stock is $85 at expiration and your short 90 put is five points in the money, it's losing money. You sold it for $1, less transaction costs, and now it's worth $5. With the stock price at $85, and the 90 put trading for $5 at expiration, the put's implied volatility is 0% because it doesn't have any extrinsic value. It's worth only its intrinsic value (90 – 85) and no more. In this case, the change in vol doesn't tell the whole story. The price of the stock determined the profit or loss of the short put—not volatility.

When vol rises. Let's look at that same short put, but assume the stock is still $100 at expiration. That 90 put might be 0.00 bid/0.05 ask. Not completely worthless, but close. So, the 90 put is assumed to have value somewhere between the bid and ask, even at expiration. That would make its implied vol 90% or higher. Say you sold the 90 put at $1, less transaction costs, and it's now worth $0.025 at expiration. It's profitable. But the 90 put's implied volatility rose from 35% to 90%. How can that be?

First, because external factors (time, stock price, etc.) are at work as well, there's nothing that states a short option loses just because implied volatility rises—no more than it profits when it goes down. In fact, in the last two examples, the change in implied volatility is not what determined the short put's profit or loss. What did? The stock price. It depended on whether the short put was in or out of the money at expiration.

For example, a butterfly spread makes its max profit if the stock is at the short middle-strike price at expiration, regardless of whether volatility is higher or lower. A short strangle makes its max profit if the stock is in between the short strike prices at expiration, because volatility premium ceases to exist when there is no time left.

Now, if we were to look at the profit or loss on that short put before expiration, a big change in volatility could have had a larger influence because the option's vega—an option's sensitivity to changes in implied volatility—fluctuates over time. It's higher with more time to expiration, and lower with less. Remember, vega is how much the theoretical value of an option can change if its implied vol moves up or down 1%. And implied volatility is a measure of the option's extrinsic (time) value. When an option has even a little extrinsic value, and a low vega close to expiration, its implied vol can be high. Take a look at the Trade page on thinkorswim®—with the "Impl Volatility" column loaded up. Find a far out-of-the-money option's implied vol close to expiration, and it will likely be high.

TRADER GLOSSARY
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VOLATILITY = STRATEGY

So when does a trade have the most time to expiration? When you put it on. And that's the time its vega will be highest due to the longer time to expiration. With this in mind, you might take your stock directional cues from charts or technical or fundamental analysis. However, the strategy you use to implement a bullish, bearish, or neutral position should depend on the volatility of the options for the stock or index when you initiate the trade.

For example, if you think the price of a stock will go up, you have some choices on how to trade it. You could buy it. You could buy a call or a call vertical spread. You could short a put or a put vertical spread. Those are all bullish strategies, but they all have different vega. A long call or long call vertical have positive vega. A short put or short put vertical have negative vega. And stock has zero vega.

When you use volatility to determine strategy, not direction, you're potentially putting its real influence on your side. That might mean shorting options when they're a bit higher, and buying options when they're a bit lower.

TAKE ACTION:
For more on the volatility tools like Options Statistics in thinkorswim, go to the thinkorswim Learning Center at: **tlc.thinkorswim.com.**

When vol is high. Again, if volatility is high when you open a trade, options premiums will likely be high, too. Thus, the credits you get for bullish short put or short put vertical trades would likely be higher, too—which translates to a larger potential profit.

When vol is low. When you initiate a trade, low volatility typically means options premiums are relatively low. The debits you pay for bullish long calls or long call verticals are a bit lower—all things being equal—because vol is lower. Buying options for lower debits means your potential risk is lower.

WHAT'S HIGH? WHAT'S LOW?

So how do you determine when volatility is high or low? thinkorswim has a proprietary number—the IV Percentile—available for any stock or index with options. Find it in the Today's Options Statistics section on the Trade page. (See "Three Steps to Gauging Volatility, below.)

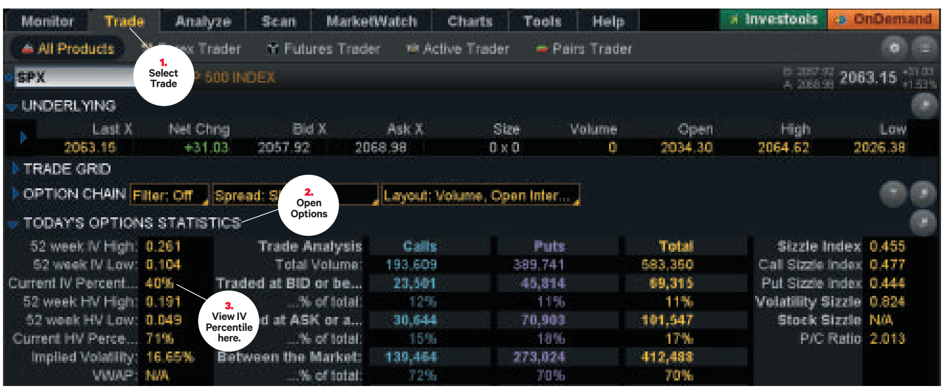
The IV Percentile compares the current implied volatility to its 52-week high and low. An IV Percentile at 100% means the current implied volatility is at its 52-week high. An IV Percentile at 0% means the current implied volatility is at its 52-week low. Now, there's no guarantee that high vol won't go higher, or low volatility lower. But when you see the IV Percentile over 80%, for example, it means implied vol is higher than it has been over the past year, and options prices are relatively high. When the IV Percentile is under 20%, for example, options prices are relatively low.

Say you're bearish on a stock. Take a look at the IV Percentile. Over 80%? Consider a bearish short call vertical that has negative vega. Under 20%? Consider a long put vertical that has positive vega. Near 50%? You might sell an out-of-the-money call vertical if you're feeling less confident about your opinion on direction, or buy an at-the-money put vertical if you're feeling more confident.

Basing strategy on IV Percentile or a judgment on volatility doesn't guarantee your trading decisions will be profitable. But it does potentially give your actions a fighting chance by having volatility work for, rather than against, your chosen strategy. And once you put the trade on, focus on where the stock price actually is, while tracking implied vol changes as icing on the cake.

For more information on the general risks for trading and options, see page 37, #1-2.

Three Steps to Gauging Volatility



For illustrative purposes only.

BIG IDEA: YOU ENTERED THE TRADE FOR A REASON. NOW YOU HAVE A HEALTHY PROFIT OR A FAT LOSS STARING YOU IN THE FACE AND **IT'S TIME TO EXIT**. BUT ISN'T THERE A BETTER WAY OF GETTING OUT, RATHER THAN SIMPLY BOLTING FROM THE TRADE? SOMETIMES THERE IS.

WORDS BY **GREG LOEHR**

PHOTOGRAPHS BY FREDRIK BRODÉN

1

HOW TO HOLD 'EM.

2

HOW TO FOLD 'EM.

PRO / **TAKE AWAY:** *Ideas on how to exit trades, without leaving money on the table.*


EXIT

For all the lessons learned

how to get into a trade, not as much focus is on how to get out. Whether you're winning or losing, at some point, you need to exit in order to take a profit or chalk up a loss. There a number of options strategies to cover on the subject, but let's focus on three of the most popular—long options, vertical spreads, and calendar spreads.

EXITING WINNERS

THE WINNING LONG CALL OR LONG PUT

You're a believer in XYZ Corp. and you bought the September 50 calls for $1. Now those calls have doubled to $2. You can't be blamed for wanting to take the money and run, but you're as bullish as ever and don't want to miss out. Here are three potential ideas.

1/Sell part of your position

Although this is a potential adjustment almost every time, be smart about it. Sell at least enough contracts to bring in more money than your initial debit. For instance, selling 60% of the calls that now trade for $2 nets a credit of $1.20, minus transaction costs. This way you're guaranteeing yourself a profit, even if the remaining part of the trade fizzles.

2/Adjust into a vertical

Turn your long call into a vertical call spread by selling a call with a higher strike. For example, sell the 55 calls for $0.80, less transaction costs. Even though this adds a second trade to your account, you now own the 50–55 call spread, which now has a total risk of only $0.20. That's calculated by taking the initial $1 cost of the 50 calls, less the $0.80 credit from selling the 55s.

TRADER GLOSSARY

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If this spread finishes fully in-the-money (ITM), then you'll realize the $500 max value per spread. Yet, if XYZ drops below $50, and the spread expires worthless, the loss is limited to only $0.20 rather than your full $1.

3/Roll up

Cash out the long call that's made money, but stay in the game by "rolling" up using a "sell vertical spread" order to buy another call that's further out-of-the-money (OTM). This nets you a credit that reduces the overall risk. Bonus: if the credit's more than you originally paid, you've locked in profit.

THE WINNING LONG VERTICAL SPREAD

Sticking with XYZ, now assume you originally bought the 50 call, and sold the 55 call, as a spread for $0.80, less transaction costs. The first adjustment above—selling part of the position—is still viable. But, so are the ideas of spreading off the trade or rolling it up.

1/Spread the spread

Butterflies and condors are nothing more than combinations of vertical spreads. Create your own combination by selling the 55–60 call spread, and you end up with a butterfly, with the 55 strike as the body. (See Table A, below.) Calculate your new risk by subtracting the credit from this adjustment from the initial debit.

2/Rolling a vertical

The idea behind rolling up a vertical is the same as rolling up a single option: take profits on the original trade, then do it again. There are more moving parts, but all you need is a "sell butterfly" order ticket.

For example, turn your long 50–55 call spread into the 55–60 call spread by selling the 50–55–60 call butterfly. Subtracting the butterfly credit from the original debit leaves you with the remaining net risk of your new 55–60 spread position; see table B.

Which adjustment do you make? Ask yourself what position you'd enter if this were

A

CALL OPTION STRIKE PRICES	ORIGINAL POSITION	ADJUSTMENTS	NEW POSITION
50	+1	—	+1
55	-1	-1 (TO OPEN)	-2
60	—	+1 (TO OPEN)	+1

TABLE A: LONG VERTICAL EXIT #1. Add a short vertical at the short strike of the long vertical to create a butterfly to lock in some profit and possibly squeeze out a bit more. *For illustrative purposes only.*

B

CALL OPTION STRIKE PRICES	ORIGINAL POSITION	ADJUSTMENTS	NEW POSITION
50	+1	-1 (TO CLOSE)	
55	-1	+1 (TO CLOSE) +1 (TO OPEN)	+1
60	—	+1 (TO OPEN)	-1

TABLE B: LONG VERTICAL EXIT #2. Roll a vertical spread to higher strikes to take profits on the original trade and use those profits to try it again. *For illustrative purposes only.*

a new trade. Why? Because it is a new trade. The first rule of adjusting a trade is to treat the adjustment as a new position. Have profit and loss exits mapped out like you would for any new trade.

THE WINNING LONG CALENDAR SPREAD

Rolling the calendar

There's nothing better than making money when a stock does nothing, which is what calendar spreads are designed to do.

Constructing a calendar with a little time between the long and short options lets you roll the short option. Once the short option's evaporated, use a "sell calendar" order ticket to bring in a credit by closing the short option and selling the same strike option in the next expiration. As long as the stock cooperates, you can attempt to do this every expiration.

EXITING LOSERS

Losing trades are an expected part of trading. Sometimes, simply closing the trade is the right decision. Other times, it might be appropriate to do something else. The assumption here, though, is that you're managing this losing trade before it's gotten out of hand.

THE BROKEN LONG CALL (OR PUT)

Your long call is a relative mess because XYZ stock hasn't budged. But you still believe the stock is poised to move. In the meantime, to salvage some of what's left while still leaving yourself a chance for some profit, consider converting your call to a spread.

1/Spreading to a vertical

Just like with the winning trade, sell a higher strike call in the same month. Deduct the credit from the original cost of your long call to arrive at the net debit of your trade.

This second rule for adjusting a trade says to match your new position with your market outlook. Since you're still bullish on XYZ, it only makes sense to maintain a bullish trade.

For instance, initially buying the September 50 call for $7, then adjusting by selling the 55 call for $1, nets you a $5 wide call spread for $6, not including transaction costs. That's a guaranteed loss of at least $1, if not the whole $6. If the math doesn't make sense, it's probably best just to close the trade.

2/Spreading to a calendar

If there's enough time left in your long call, another idea might be to convert it into a calendar by selling a shorter-term call with the same strike. This "buys" you some time for the stock to get going. And while you're waiting, you'll hedge time-decay risk as well as some of the downside risk. When XYZ comes back to life, buy back the short option and you're back to your original trade.

THE BROKEN LONG VERTICAL

Obviously, converting to a vertical spread isn't a choice if that's what you started with. But all is not lost. One possibility is to roll the entire spread further out in time using a "vertical roll" order. Don't pay money to make this trade. That violates the third rule: don't make any adjustments that add risk to your trade.

To avoid adding risk, you'll have to roll up the spread to strikes that are further out of the money than the current spread. This may not be ideal, but the longer time frame gives your trade time to work.

THE BROKEN LONG CALENDAR

Similar to winning calendars, rolling out the short strike reduces the risk in the trade. But, since calendars work best when at the money, if the market moves, you might have to move with it. Rolling a calendar that's gone in the money, though, will cost you. But here's how you might get around that.

Roll the long option up/down in the same month to the at-the-money strike. Then, roll the short option up/down to the same strike, going one expiration out in time. If the net cost of both trades is a credit, it might be a worthwhile adjustment. If it's a net debit, it might be best just to close.

Simply winning or losing doesn't mean you need to close your trade, although that'll sometimes be the best choice. When you have a reason to stay in, adjusting a trade can help you cut risk, take money off the table, and give you time to further plan.

THE GOLDEN RULES OF "FIXING" TRADES

First off, there's no such thing as "fixing" a broken trade. Whatever your reason for needing to make an adjustment—exiting at a profit or a loss—realize that the trade isn't the same one you put on. To wit:

1

Treat any adjustment as a new position. Have P/L exits mapped like you would for any new trade.

2

Match your new position with your market outlookand volatility backdrop.

3

Don't make any adjustments that add risk to your trade.

For more information on the general risks of trading and options, see page 37, #1-2.

TAKING A DIVE INTO THE NOT-SO-DEEP END

PRO / **TAKE AWAY:** *Maximizing the risk/reward of a defined-risk trade*

BIG IDEA:

WANT TO GET MORE JUICE FROM YOUR SHORT VERTICAL SPREADS? THERE'S A LITTLE TRICK THAT COULD INCREASE YOUR OPPORTUNITY WITHOUT JUMPING OFF A CLIFF.

WORDS BY
THOMAS PRESTON
PHOTOGRAPHS BY FREDRIK BRODEN

Option trade examples presented here are for illustrative purposes only and, for the sake of simplicity, don't include transaction costs. Please see page 37 for more information.

WHEN

you ride a bike you know your limits. Pedaling down a quiet street? No problem. Racing down the Alps in the Tour de France? Maybe not. And while a ride down a quiet street is nice, the Alps are more exciting. The question is, can you get some of the fun of the Alps without the risk of broken bones and an expensive trip to France? While I can't comment on cycling, there is a middle ground between the "quiet street" in trading and the "Alps." And it uses strategies with which you're probably already familiar.

When it comes to using short spread strategies, positive time decay (or positive theta) is a good thing to have. All other things being equal, positive time decay can help create profits as time passes. But it always means being short an option. Long options have negative time decay. So, to generate positive time decay, the strategy needs to include a short option. There are different ways to be short an option, however. The riskiest of them all is a short naked option, which generally has very large or unlimited risk. These are the "Alps." Short option spreads, on the other hand, which have both a long and short option in them, have "defined risk"—meaning the max loss on the spread is limited, no matter where the stock or index price goes. These are the "quiet streets."

When you add a long option to a short option and create a spread, the negative time decay from the long option reduces the positive time decay from the short option. This might be great for risk management. But with the lower risk-to-reward profiles, you might wonder if it's possible to bike a little closer to the Alps while remaining on the quiet streets.

SQUEEZING MORE FROM YOUR SPREADS

There is a way to increase the risk-to-reward profile in some spreads and stay within their defined-risk world. The idea here would be to capture the most time decay in the short option and reduce the time decay in the long option. You just have to get creative. Let's look at both the vertical spread and the iron condor.

IF HIGHER RISK-TO-REWARD IS WHAT YOU'RE LOOKING FOR, YOU DON'T NEED TO GO FURTHER THAN DEFINED-RISK TRADES LIKE VERTICALS AND IRON CONDORS. IN SOME CASES, JUST BY WIDENING THE STRIKES OF THE SPREAD, YOU CAN TAILOR THESE STRATEGIES TO LOOK MORE LIKE THEIR UNLIMITED-RISK COUSINS.

THE SHORT VERTICAL DILEMMA

The margin requirement on a short put vertical is the difference between the long and short strikes, minus the credit received. Now, many traders place short put verticals using adjacent strikes—such as the short 97/98 put vertical for, say, $0.25 credit. This trade has a max risk of $75 if the stock is below $97 at expiration and a theta of $0.50 per day.

An Alternative: The Super-Wide Vertical

Just because you prefer defined risk doesn't mean you're limited to verticals with adjacent strikes. Say you bought the 88 put instead of the 97 put, to create a short 88/98 put vertical. By widening the short strike from 97 to 88, you've increased your risk-to-reward substantially. (See Figure 1.)

If you shorted that put vertical for $1.60 credit, its max potential profit of $160 is larger than the $25 of the 97/98 put spread. Its max potential loss is larger, too—$840 if the stock is below $88 at expiration versus $75 for the 97/98 put spread. That $840 is also the margin requirement for the short 88/98 put vertical. And because there are 10 points between the long and short strikes, the theta of the vertical will be higher, too, because the 98 put can have a much higher theta than the 88 put.

THE IRON CONDOR DILEMMA

The iron condor is a common spread combining two short vertical spreads—a short put vertical combined with a short call vertical. Suppose you have a stock at $100. Like a short vertical, most think of an iron condor as having the long and short call and put strikes adjacent—for example, long a 97 put, short a 98 put, short a 102 call, and long a 103 call. Let's also say theta for the position is $0.75 per day.

The requirement on a short iron condor is the difference between either the long and short call or put strikes (97 to 98, or 102 to 103), minus the credit for which you sell the iron condor. If you sell it for a $0.40 credit (the iron's max potential profit), the requirement would be $100 minus $40 = $60. That $60 is also the max potential loss if the stock goes below $97 or above $103 at expiration.

An Alternative: The Super-Wide Iron Condor

If you are looking to increase the risk/reward profile of your plain-vanilla iron condor, like the short vertical, you can widen out an iron condor's long and short strikes. This keeps its defined-risk characteristics intact, but you'll squeeze more juice from the strategy.

TRADER GLOSSARY
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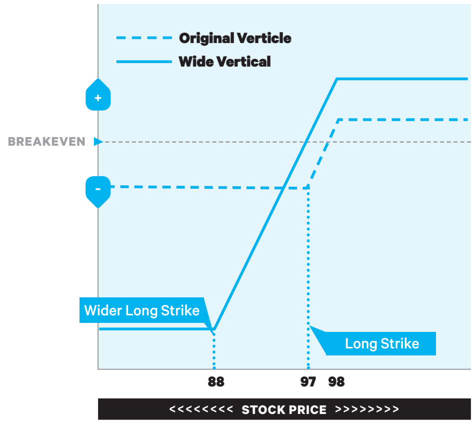
Widening out the iron condor by buying the 88 put and the 112 call, instead of the 97 put and 103 call, could increase its credit to $3.00 and its positive theta to $2.00. The 88/98/102/112 iron condor would have a max risk of $700 if the stock is below $88 or above $112 at expiration, with a margin requirement of $700. In risk, profit, and theta, that wider iron condor is similar to the short 98/102 strangle, but still has defined risk.

THE SUPER-WIDE ALTERNATIVE

IF YOU'RE FEELING IS THAT CERTAIN SHORT SPREADS ARE TOO LIMITING IN THEIR RISK-TO-REWARD, CONSIDER WIDENING THE SHORT STRIKES.



For illustrative purposes only.

FIGURE 1: SHORT PUT VERTICAL vs WIDE SHORT PUT VERTICAL.

"Widening" the long strikes further away from the short strikes of a short vertical spread will increase the trade's risk-to-reward ratio.

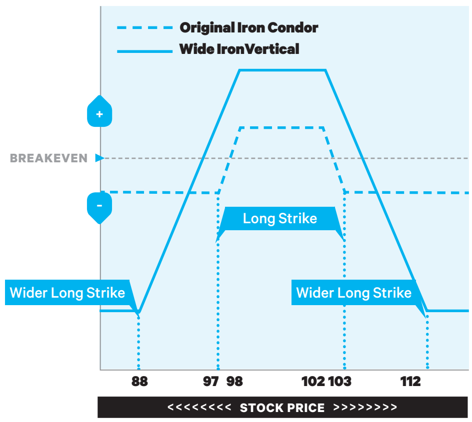


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FIGURE 2: IRON CONDOR vs SUPER WIDE IRON CONDOR.

"Widening" the long strikes further away from the short strikes of an iron condor will increase the trade's risk-to-reward ratio.

THE WIDE-SPREAD CAVEAT

Although short verticals and iron condors still have defined risk even when you widen out the strikes, it doesn't mean the risk is small. If our stock went from $100 to $90, the loss on the short put vertical could be about as big as that of a short naked put, and the iron condor's loss about as big as a short strangle.

IF HIGHER RISK-TO-REWARD IS WHAT you're looking for, you don't need to go further than defined-risk trades like verticals and iron condors. In some cases, just by widening the strikes of the spread, you can tailor defined-risk strategies to look more like their unlimited-risk cousins.

Short equity options can be assigned at any time up to expiration regardless of the in-the-money amount. Spreads and other multiple-leg option strategies can entail substantial transaction costs, including multiple commissions, which may impact any potential return. Thomas Preston is not a representative of TD Ameritrade, Inc. The material, views and opinions expressed in this article are solely those of the author and may not be reflective of those held by TD Ameritrade, Inc.

For more information on the general risks of trading and options, see page 37, #1-2.

HOW TO PULL UP A RISK CURVE ON THE ANALYZE PAGE

You can use the Analyze page on TD Ameritrade's thinkorswim® trading platform to simulate the P/L and theta of verticals and iron condors of varying widths until you find one with a comfortable risk-to-reward ratio.

TRADING HABITS

WORDS BY
Thomas Preston

PHOTOGRAPHS BY
Fredrik Brodén

EASY / **TAKE AWAY:**
To understand trading, turn conventional wisdom on its head.

TRADING TIPS FOR YOUR NON-TRADING MILLENNIAL FRIENDS

BIG IDEA: HOW YOU TRADE AT 25 MAY NOT BE THAT MUCH DIFFERENT FROM WHEN YOU'RE 75. BUT WHILE YOU MAY LEARN AND PRACTICE THE MOST BASIC TRADING TENETS NOW AND INTO THE FUTURE, IT'S JUST AS IMPORTANT TO LEARN WHAT NOT TO DO.

HEY,

WE KNOW YOU TRADE. You're reading this magazine. But what about your millennial friends who are landing their first jobs and starting to save a little? How many of them trade? Or invest? Do any of you talk or text or chat or tweet about the market? Ever? The fact is, trading today isn't some super-esoteric lifestyle that means you become a math nerd who talks exclusively in market-speak and kinda never gets invited to parties. Do your friends want to learn? What may be missing from all that when you're starting out is the wisdom of experience that dictates what not to do, which can be as crucial as what you actually do. Were I talking to my 25-year-old self, here are the two cents I'd give.

TRADER GLOSSARY TURN TO PAGE 36

1.

FORGET BALANCE SHEETS AND ANALYST REPORTS. LEARN THE STRATEGIES.

Even if someone's interested in the market, people are busy. They only have so much time to learn about trading and would have to make that time count. Be honest—if you spent six hours perusing research reports and company financials, what could you possibly learn that 1,000 market analysts don't know already? But if you spent six hours studying vertical options spreads, and learning how to estimate potential profit, you'd start to learn something a lot of analysts don't fully grasp. (Starting out your education with options would be ambitious but might be well worth it.)

Once you got verticals down, for example, you'd own that knowledge for the rest of your life. The fundamentals of verticals—buying one option and selling another option at different strikes in the same expiration—don't change. Yet, company financials do. Knowing how options make and lose money, where they're profitable, what's at risk, how they respond to time and volatility, and how to apply it all for a particular directional speculation may not only be more practical than knowing what the company financials tell you; it could be critical.

And there arejust a handful of strategies you'd need to be competent: short puts and covered calls, vertical spreads, iron condors, butterflies, and calendar spreads, to name a few. That's pretty much it. You can employ an options strategy for just about any market condition over the next 60 years—high volatility or low, market rallies or black Fridays. Even for a beginning trader (for all options traders, really), it's never about perfectly predicting the next big market move or hot stock. It's about learning, absorbing, and applying the right strategy.

2.

DON'T MYTHOLOGIZE RISK. QUANTIFY IT.

A first instinct when we earn money is not to lose it. In the world of trading, naturally we hate seeing a winning trade turn into a loser. Seeing our investment go up in flames. And as hearty traders, we have to train our hearts and minds to fear less and trade more confidently.

If we teach our friends fear, we keep them from potentially earning a better return on their money. Risk often presents itself as a scary monster under the bed to the uninitiated. It can make otherwise skilled traders resist, back off, back out, and more. Those kinds of traders and investors have mythologized risk. They hold onto images from the 2008 crisis and market meltdown. More recently, they tremble in the face of the Greek economic crisis. China, Iran, Russia. After all, they worry they could lose their money because of events out of their control. Events out of everyone's control.

Perhaps the antidote for trembling is science. Teach your friends how to quantify risk. "Implied volatility" (vol) is the market's way of informing us of how much risk is built into a given trading move. In our less-fear science experiment, for instance, vol times a stock price gives you a one-standard-deviation price change for a year out. And plus-and-minus that standard deviation change suggests a range where, theoretically, a given stock or index will land 68% of the time at the end of a given trading year.

EXAMPLE:
Stock at $50; vol at 30%. (0.30 X 50 = 15)
$50 – $15 = $35
$50 + $15 = $65

So, 68% of the time (one standard deviation) over the next year, the stock will theoretically trade between $35 and $65 per share. That means a lot fewer sweaty palms. A lot more sensible evaluation using the market's own data. (Of course, it's entirely possible it could trade more than what the standard deviation suggests, which could also increase your risk.)

ANY SINGLE TRADE CAN BE A WINNER OR A LOSER. JUST MAKE SURE THE LOSER CAN'T TAKE ALL THE OTHERS DOWN WITH IT.

Converting volatility this way starts to effectively quantify the risk for newbie traders. Instead of managing their money in a world of absolute uncertainty, they can start to manage their money based on numbers.

And while you're at it, show them which options strategies have "defined risk." What's that, now? No matter where a stock price or index lands over time, it's possible to estimate and predict the maximum possible loss if a trade has some defined risk built in. Quantifying and defining risk is how traders sleep at night.

3.

KEEP YOUR HEAD AFTER YOUR FIRST KILLER TRADE.

Equipped with your trading wisdom, your friends may start to see potential opportunities. Some will seem so good, and a big win could impart so much confidence to the new trader, it might create some early reckless behavior.

Quick success has its dark side. Top of the list: stop your friends from trading too big, no matter how good an opportunity seems. Larger trade sizes naturally mean more risk. And if a single trade moves against them, their small accounts could be wiped out. Distributing risk equally across all trades by limiting the size of any one trade is one way to survive.

Any single trade can be a winner or a loser. Make sure the loser doesn't happen on a trade that has outsized risk—a trade that could take all the others down with it. And because you can't predict which trades will be successful, modulating position size may help avoid early catastrophic losses.

All traders have losing trades. It's part of the business. Your friends will learn all about that just like you did: the hard way. Through a lot of trial and error and honing instincts. For your part, you have to help make sure a losing trade doesn't end their career.

COLLECTIVELY, ALL THIS ADVICE IS timeless. These ideas and recommendations will be true for just about every earnings cycle and Fed announcement for years to come. The goal of the young trader should be to build a healthy trading account and a foundation of knowledge and good habits. That's what they can rely on through many cycles of fear, hope, hard work, and patience as they become the successful math and strategy nerds who are the envy of all.

For more information on the general risks of trading and options, see page 37, #1–2.

Tom Preston is not a representative of TD Ameritrade, Inc. The material, views and opinions expressed in this article are solely those of the author and may not be reflective of those held by TD Ameritrade, Inc.

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Parlez-Vous Trading?

FRENCH-SPEAKING, TENNIS-PRO-TURNED-MASTER-OPTIONS-TRADER SCOTT CONNOR TAKES SWIM LESSONS℠ TO A WHOLE NEW LEVEL.

Interview by Kira Brecht / Illustration by Joe Morse

• HOW DID A FRENCH-SPEAKING college tennis star end up teaching Swim Lessons? Easy. The lure of the financial markets. We've all felt it. After college in 1980, Scott Connor was working on his tan and teaching tennis at Club Med Tahiti. His best buddy from college visited with stories of his internship on the Chicago Board Options Exchange (CBOE) trading floor. Armed with an undergrad degree in economics, Connor didn't need much convincing. He moved to Chicago and spent the next 25 years on the CBOE floor.

Now an eight-year veteran at TD Ameritrade, Connor is Director of Trader Education. Recently back from a stint with TD Ameritrade in Singapore, Connor is busy putting his unique stamp on trader education just for you. And the French stuff? Well, that's how he got the girl—his wife, a French native—while in Tahiti. She didn't speak any English, so he learned French. The rest is history.

1

Scott, tell me about your time in Singapore. For 3 years I headed up thinkorswim Singapore's education team. Until 10 years ago, they never had the opportunity to trade U.S. markets. In Singapore, 54% of our clients fall into the active-trading category, even though they don't have much experience. We spearheaded an education program with in-person seminars, then took it online and started adding countries and targeting traders at every level, from beginning to advanced.

2

What makes education from TD Ameritrade so special? The people behind it. I worked in a trading pit for 25 years. Many people in the Active Trader Group at TD Ameritrade likewise came from the CBOE trading floor. We're all people who had the creds. Many of us have professional floor trading experience and were members of the exchange for many years.

TAKE ACTION: Tune in to Swim Lessons℠ with Scott Monday through Friday 10:30 a.m.–12:00 p.m. CT

3

What's new now that you're running the show? Clients can find a progressive series of educational trading seminars. The first hour is geared toward beginning traders. The topics become more complex as we drill down into strategy and software. Traders can become more confident if they practice in their paperMoney® virtual trading accounts.

4

Give me three trading rules you live by. First, define your risk. Know how much you can make or lose no matter what happens. Second, focus on high-probability trades. Third, understand decaying assets. Time decay is a critical factor.

5

Tennis—do you still play? I now focus my competitive energies on golf. It's different from tennis. Every time you play, it's a new course—like the markets. Some courses are flat, some change in elevation. You know how to hit the ball. But how will it land? Same with trading. You put a trade on but have to learn different conditions and how new strategies will react.

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.

GLOSSARY OF TRADER JARGON
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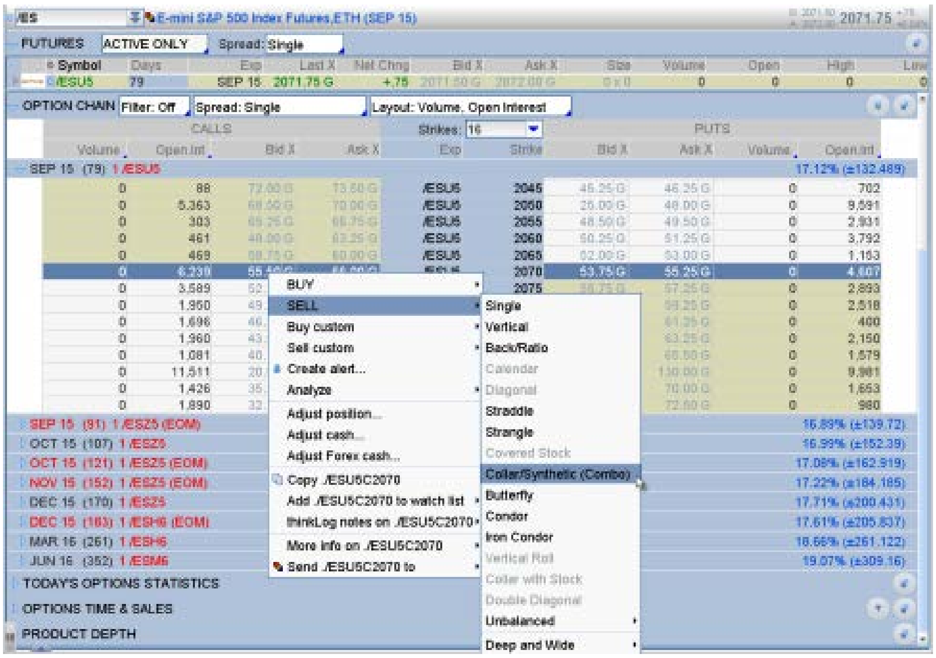
Survival Guide for Locked-Limit Futures

IF YOU'RE IN A POSITION YOU CAN'T ACCESS WHILE "LOCKED LIMIT," CONSIDER SYNTHETIC FUTURES TO STOP THE BLEEDING.

● PRO / **TAKEAWAY:** *Using a band-aid fix for locked-limit positions.*



For illustrative purposes only.

Figure 1:
A synthetic futures position can be created in TD Ameritrade's thinkorswim® trading platform by right-clicking an at-the-money option, hovering over buy or sell, then selecting Collar/Synthetic (Combo).

• RISK HAPPENS. So prudent traders define their loss ahead of time and use stop orders to get out when they need to, right? Maybe not. There's one scenario in the futures market that won't let you out at any price. That's when the market is "locked limit." No safe stops here.

Locked limits, either up or down, occasionally occur when a futures contract exceeds its daily maximum price move. Trading is suspended for the day, sometimes multiple days, until a price is found that attracts both buyers and sellers. "Locked-limit down" means you won't be able to sell during the locked period. "Locked-limit up" means you won't be able to buy (or cover a short position) during the locked period. Such a move might go against you, and right past your stop, with no way to exit your position. What's a trader to do?

CREATING SYNTHETIC FUTURES

While an underlying futures contract is inaccessible in a locked-limit scenario, typically you can still trade futures options. You're probably not the first person to think of this, so you'll have to act fast. Your main concern is to contain your loss as much as possible by constructing a synthetic futures contract to offset your position.

If you're long in a limit-down situation: You'll need to construct a synthetic short by simultaneously buying an at-the-money (ATM) put and selling an ATM call. This options strategy simulates the payoff of a short futures contract, thereby offsetting your long contract and in theory preventing further loss.

If you're short in a limit-up situation: You'll need to construct a synthetic long by doing the opposite—simultaneously buying an ATM call and selling an ATM put. This strategy simulates the payoff for a long futures contract, thereby offsetting your short contract and in theory preventing further loss.

CALCULATING IMPLIED FUTURES

During a locked-limit period, traders might not know the exact implied ATM price. Fortunately, you can also use options to estimate the market's perception of the price of underlying futures with this formula:

Implied futures price =
strike price + call price – put price

For example, suppose you're long a contract of the September E-mini S&P 500 futures at $2,100. The Sep 2100 call is priced at $35, and the Sep 2100 put is priced at $75. Applying the formula, you get:

2,060 = 2,100 + 35 – 75

The market is implying a current price of $2,060. If you construct your offsetting synthetic contract at or near this price, you'll potentially be locking in a $40 loss ($2,100 – $2,060). For the E-mini S&P 500, this equates to a potential loss of $1,750 per contract.

Locked-limit moves are rare, but are known to happen as a result of a news event or drastic change in a commodity's supply. It only takes one of these events to wipe out a whole year of profits (or worse). Using synthetic futures as a backup plan could mean surviving to trade another day.

—Words by DEVIN EKBERG, INVESTOOLS®

For information on the general risks of trading and futures, see page 37, #1,3.

Iron Condors

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• A defined-risk, short spread strategy, constructed of a short put vertical and a short call vertical. You assume the underlying will stay within a certain range (between the strikes of the short options). The goal: As time passes and/or volatility drops, the spreads can be bought back for less than the credit taken in or expire worthless, resulting in a profit. The risk is typically limited to the largest difference between the adjacent and long strikes minus the total credit received.

Calendar Spread

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A defined-risk spread strategy, constructed by selling a short-term option and buying a longer-term option of the same type (i.e. calls or puts). The goal: as time passes, the shorter-term option typically decays faster than the longer-term option, and profits when the spread can be sold for more than you paid for it. The risk is typically limited to the debit incurred.

Covered Calls

PAGE 30

A limited-reward strategy constructed of long stock and a short call. Ideally, you want the stock to finish at or above the call strike at expiration, in which case, you'd have your stock "called away" at the short call strike. In this case, you would keep your original credit from the sale of the call as well as any gain in the stock up to the strike. Breakeven on the trade is the stock price you paid minus the credit from the call.

CBOE VIX

PAGE 11

The VIX is a proprietary index of the Chicago Board Options Exchange, which measures the implied volatility ("vol") of the S&P 500 Index (SPX) options.

Butterfly Spread

PAGE 19, 30

Typically a market-neutral, defined-risk strategy, composed of selling two options at one strike and buying one each of both a higher and lower strike option of the same type (either all calls or puts). The strategy assumes the underlying will remain relatively unchanged during the life of the trade, in which case, as time passes, and/or volatility drops, the combined short option premiums exhibit more decay than the combined long option premiums; resulting in a profit when the spread can be sold for more than its original debit (which is its maximum loss).

Short Put

PAGE 30

A bullish, directional strategy with limited risk in which an unhedged put option with a strike that is lower than the current stock price is sold for a credit. The strategy assumes that the stock will stay above the strike sold; in which case, as time passes and/or volatility drops, the put option can be bought back cheaper or expire worthless, resulting in a profit.

Short Strangle

PAGE 19

A market-neutral strategy with unlimited risk, composed of an equal number of short calls and puts of two different strike prices (strangle), resulting in a credit taken in at the onset of the trade. The strategy assumes the underlying will stay within a certain range, in which case, as time passes and/or volatility drops, the options can be bought back cheaper than the credit taken in, or expire worthless; resulting in a profit. Breakeven points are calculated by adding the total credit received to the call strike and subtracting the total credit received from the put strike.

Out-of-the-money

PAGE 21, 22

An option whose premium is not only all "time" value, but the strike is away from the underlying equity. For calls, it's any strike higher than the underlying. For puts, it's any strike that's lower.

At-the-money

PAGE 35

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.

DISCLAIMERS

IMPORTANT INFORMATION YOU NEED TO KNOW

1

GENERAL DISCLAIMER

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

Transaction costs (commissions and other fees) are important factors and should be considered when evaluating any options trade. 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 subject to TD Ameritrade review and approval. Please read Characteristics and Risks of Standardized Options (http://www.optionsclearing.com/about/publications/character-risks.jsp) before investing in options.

It is not possible to invest directly in an index.

2

OPTION STRATEGIES

Trading options involves unique risks and is not suitable for all investors.

Spreads, condors, butterflies, straddles, and other complex, 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. Be aware that assignment on short option strategies discussed in this article could lead to unwanted long or short positions on the underlying security.

Maximum potential reward for a long put is limited by the amount that the underlying stock can fall. Should the long put position expire worthless, the entire cost of the put position would be lost.

When trading short option strategies, there is a risk in getting assigned early on the options sold, even if they go in the money by $0.01, obligating you to deliver shares you don't own (in the case of a short call) or purchase shares (in the case of a short put).

The risk of loss on an uncovered short call option position is potentially unlimited since there is no limit to the price increase of the underlying security. Option writing as an investment strategy is absolutely inappropriate for anyone who does not fully understand the nature and extent of the risks involved.

The short naked put and cash-secured put strategies include a high risk of purchasing the corresponding stock at the strike price when the market price of the stock will likely be lower.

Short naked option strategies involve the highest amount of risk and are only appropriate for traders with the highest risk tolerance.

A covered call strategy can limit the upside potential of the underlying stock position, as the stock would likely be called away in the event of a substantial stock price increase. Additionally, any downside protection provided to the related stock position is limited to the premium received. (Short options can be assigned at any time up to expiration regardless of the in-the-money amount.)

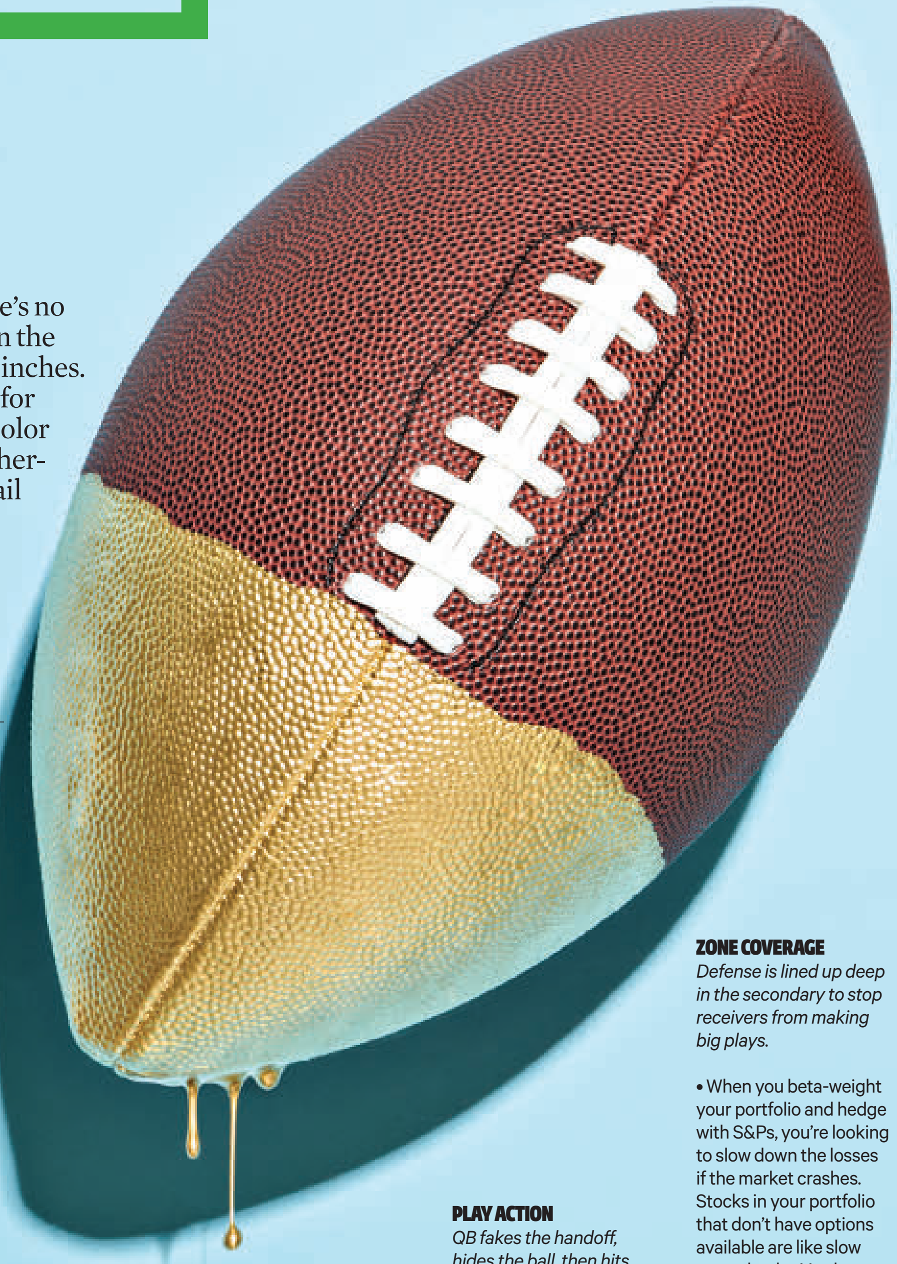
3

FUTURES

Futures trading is not suitable for all investors as the risk of loss in trading futures is substantial. Futures trading privileges are subject to TD Ameritrade review and approval. Not all account owners will qualify. Futures accounts are not protected by the Securities Investor Protection Corporation (SIPC). Equity options trading involves risks and is not suitable for all investors. Spreads and other multiple-leg option strategies can entail substantial transaction costs, including multiple commissions, which may impact any potential return.

Futures and futures options trading is speculative, and is not suitable for all investors. Please read the Risk Disclosure for Futures and Options prior to trading futures products (https://www.tdameritrade.com/retail-en_us/resources/pdf/TDA631.pdf).

The Trader's Guide to the GRIDIRON



• With football season in full swing, there's no reason to be glum on the weekends when the markets are closed. Football is a game of inches. So, it's a natural fit for traders, who fight for ticks. In fact, you can provide welcome color commentary at any football-focused gathering. Postprandial Thanksgiving game. Tail gate party. Sports bar. In the neighbor's living room. Why? For every big play in the game, there's a trading analogy. Your friends will be so amazed, maybe they'll set aside their quarterbacking and start trading on Monday morning. Sweet.

FOURTH AND GOAL

It's fourth down, and the team is within 10 yards of the goal.

• This is a binary event like trading bonds ahead of a Fed announcement or unemployment number. It's a winner or loser with no second chances. Field goals are failures. Statistically, aggressive play is the better choice on the field, but can wipe out a trader. If the team goes for it and scores, nod and knowingly say, "Thank you, Janet Yellen."

PASSING ON THIRD AND LONG

This is all about field position, getting a few more yards before a punt.

• That's your short in-the-money put that's about to be, or has been, assigned. You short some calls against it to reduce the long stock's cost basis and give it a better chance to make money. Like its football counterpart, it doesn't wow the crowd, but it's solid strategy.

PASS RUSH

Defense reads the play and comes at the QB with 1,000 pounds of linemen.

• You're trying to close out a winning trade, but you can't get your limit order filled. The stock starts moving against you too fast for you to respond, and the winner turns into a scratch at best, or even a loser. Hey, it happens. But trust me, it's not personal. The market, like the defense, is just doing its job.

PLAY ACTION

QB fakes the handoff, hides the ball, then hits the receivers on their routes.

• This is like legging into a spread. When the ball is snapped, or an order is routed, there's risk. You put on half of a spread in expectation that the market will move your way and surprise them by putting on the other half at better prices. Of course, if the other half of the spread doesn't get filled and the market moves against you, you can get stuffed like the QB.

ZONE COVERAGE

Defense is lined up deep in the secondary to stop receivers from making big plays.

• When you beta-weight your portfolio and hedge with S&Ps, you're looking to slow down the losses if the market crashes. Stocks in your portfolio that don't have options available are like slow cornerbacks: You have to use a strategy that works with the resources you have. Maybe not the most precise way to manage a portfolio, but lets you focus on new opportunities (interceptions) with protection in place.

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