

thinkMoney[®] 34

Random musings for traders at TD Ameritrade — WINTER 2017



WHAT I LEARNED **NOT TO DO**

SUCK IT UP AND
MOVE ON: YOU'VE GOT
LOTS OF LIFELINES.

PAGE 16

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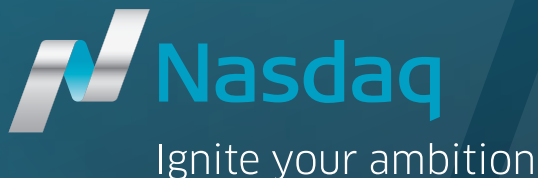
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Toys for Traders Watchlist alerts, trade flash, social sentiment.

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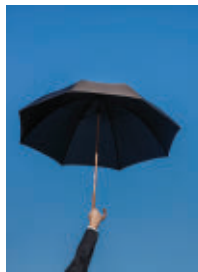
Shawn Cruz is your go-to guy for everything from gym tips to financial research.

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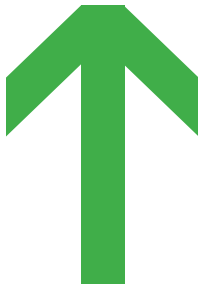


Cover Photograph by
Fredrik Brodén

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COVER STORY

What I Learned Not To Do What did 2016 teach me about direction, time, and vol, and how can I avoid making those same mistakes this year? Here's a rundown.



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**"Create smaller, short-term profits
to stay solvent and give your
longer-term positions time for
potentially larger profits."**

What I Learned Not To Do

Page 16



SKILLS BAROMETER: See a dot. Read or pass.
If you've ever been frustrated spending your precious
few minutes reading articles that aren't for you, these little
color dots at the beginning of each article will help you
skip to the stuff that matters most to you.

● EASY
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● PRO

Welcome, Change

• WELL, 2016 HAPPENED. With the election now a hazy memory, it's time to get back to business. If it feels uncertain, don't sweat it. After all, traders typically like uncertainty because uncertainty begets market volatility. And market volatility begets potential trading opportunities—quite often in places you might not expect.

So, despite your personal view of the world and where it sits right now in the political, social, and economic landscape, at least from a market perspective, new rounds of volatility are always welcome in our home.

Considering all the changes going on, we thought it was a good time to dust off some ideas that should get you thinking about doing things differently yourself, and see if you need to make tweaks to your own trading style.

Maybe you found yourself scratching your head at a flat P/L or watched a once-beloved trading strategy turn to dust and didn't know why. Our cover story, "What I Learned Not to Do" on page 16 might lend a clue as we dive into lessons learned in 2016 about the risks of direction, time, and volatility.

Then, we'll hand off the baton to "It's Not You, It's Me" on page 22 to give you some practical tips on what you might do when making some of those mistakes, and a map for how you might get back in the game.

And finally, stepping outside the comfort zone of traditional buying and selling, we'll throw you into the alt world of futures and pairs trading. The former could get you trading food and energy in ways you never imagined, while the latter could end your personal battle between two beverage giants without having to choose a side at all. If you're new to both types of trading, we'll help you dive under the hood first to see if it's something you want to drive.

So, bring it on, 2017! We'll gladly take your change.

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



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LOVE NOTES

LITTLE QUIPS FROM YOU TO YOURS TRULY



Best in Show ... (To Our Inbox)

Your hardware service guide:

- > Before servicing, disconnect all power and connection cords.
- > Grasp the computer firmly in both hands along the longitudinal axis.
- > With arms comfortably extended, lift the computer from its normal resting position.
- > While maintaining your balance, relocate the computer to the nearest recycle container and release your grasp.
- > Once computer has reached terminal descent, call the manufacturer. They'll instruct on how to proceed from here. —Mel

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Chat Room Pearls...

I tell my wife that I don't know what I'm doing but I'm sure getting better at it.
—BOB

I bought a gallon of ice cream over the weekend. It was only three quarts. I hate when that happens. It's hidden inflation.
—MIKE

Sitting on the fence gives you splinters where you don't really want splinters!
—FRED

They say water is the most precious resource required for living beings. If that's true you wish you get lots and lots of ice in your drink :-)
—GOWRI

WIFE:
Are you having an affair?
HUSBAND:
No, I'm just studying what options I have.

Time decay—I think my brain has decayed over time.
—KATE

If I went by my feelings I would blow my account.
—JIM

I would be screwed if I trade like I play golf.
—TOM

When in doubt, just keep your hands locked in your pocket :)
—DEB

Trickle-down economics works—when I have money I hire lawn guys, pool service, maids, re-model the house, etc. When I don't have money, I do it myself.
—EDDIE

I'm taking the night off work. My mouse finger is exhausted :)
—VINCE

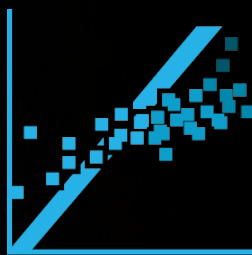
I'm so short, I could dance under Jimminy Cricket wearing a top hat.
—MARK

I get Botox for migraines. The back of my head is flawless.
—JAMES

I ain't wrong. I'm just early!
—MARC

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SPX

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IN THE MONEY

A HODGEPODGE OF MARKET STUFF YOU SHOULD KNOW



• WANT TO LEARN a funky twist on a traditional investment? If you have a futures account and understand what the **CBOE Volatility Index (VIX)** is, you might be ready for a covered call in volatility (“vol”). That’s long /VX futures and short VIX calls. This helps you think about vol as an asset class where you’re taking strategic positions.

Just like you might sell covered calls against your stocks, or even bonds, you can start to treat vol in a similar way. Note that I say “similar” because there are nuances that can make this strategy funky. Not harmful or scary or bad. Just funky. Stick with me. It gets clearer.

Nuance One: Same Expiration

You can’t trade the VIX itself. So VIX option market makers use /VX futures as a hedge. That’s the key to understanding this approach. The value of VIX options is determined by the price of the /VX future in the same expiration. The Feb VIX call options are priced off the Feb /VX future, Mar VIX call options are priced off the Mar /VX future, etc. You want to sell calls in the same expiration as the /VX future, so don’t mix them up. That could expose you to greater risk, because the /VX futures in different expirations don’t always move up and down at the same rate.

Nuance Two: Cash Settlement

At expiration, VIX options and their corresponding /VX futures are cash-settled according to VRO, which is the expiration settlement symbol for the VIX. If your short VIX call is **in the money** (ITM) at expiration, the difference between the option’s strike price and VRO will be deducted from the cash in your account. If the short VIX call is **out of the money** (OTM) at expiration, you keep the credit as cash. The /VX future will turn into a cash equivalent of \$1,000 x VRO.

VOL WHISPERER • PRO

Volatility Unleashed

BIG IDEA: CAN YOU TRADE COVERED CALLS ON VOL? SURE, BUT THERE ARE SOME KINKS TO IRON OUT.



COOL INFO: For more on trading covered calls in vol, see “**The Trader’s Cure For The Volatility Blues**” in *thinkMoney* 31, Spring 2016. Find more in our archive section online at tickertape.tdameritrade.com/thinkMoney



IN THE MONEY

With VIX options and /VX futures, the position disappears at expiration. You'll need to reestablish the position after expiration, and that means more commissions. Keep that in mind.

Nuance Three: Multiplier Sense

Finally, you sell 10 VIX calls against one long /VX future. That's because VIX options have a \$100 multiplier. If you sell a VIX call for \$1.50, you get a credit of \$150 in your account (not including commissions). The /VX future has a \$1,000 multiplier. If you buy a /VX future for \$13 and sell it at \$14, that's a \$1,000

profit. Because the /VX multiplier is 10 times bigger, you would sell 10 VIX calls against it. These subtleties are vitally important. As you gain more experience with these trades, you might sell fewer than 10 calls against

the long /VX to have more bullish exposure. But start with 10 short VIX calls versus one long /VX future.

Why Bother?

If you think vol might go up over time, this strategy lowers the breakeven point of a long /VX position, which could help weather the periods when vol is persistently low. Plus, it can add another level of portfolio diversification.

So study up and consider putting into play the various nuances, then wear a T-shirt boasting about your smarts as a vol-asset-class trader. You could be the first on the block. —Words by Thomas Preston

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 on the risks of trading, options, and futures see page 37, #1-3.

TRADER JARGON
TURN TO
PAGE 36

GEAR HEAD ● SEASONED

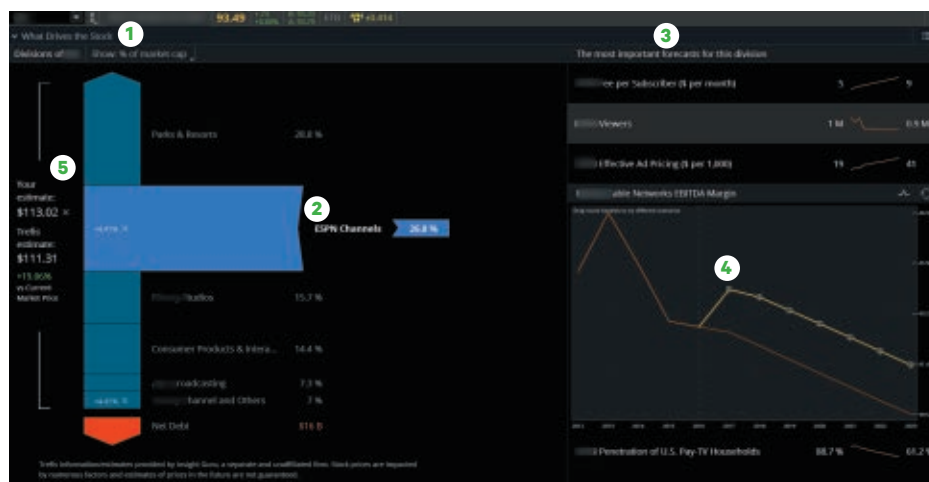
What's the Stock's "True" Value?

BIG IDEA: THE COMPANY PROFILE TOOL UNCOVERS WHAT DRIVES A COMPANY'S VALUE, TESTS DIFFERENT SCENARIOS, AND HELPS MAKE TRADING DECISIONS.

• It's a no-brainer: You're only going to put on a directional trade if you've got a hunch a stock's going to move in a particular direction. But to make that decision involves more than just guessing. You may have to look for things like—gasp—what drives a stock's value or price forecasts. They're not just for long-term investors. In fact, the Company Profile tool in the thinkorswim® platform by TD Ameritrade can help you as a trader drill down into the data and create your own short-term, "what-if" scenarios.



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



Source: thinkorswim by TD Ameritrade. For illustrative purposes only. The Company Profile is not available for every symbol. Data source: Trefis.

HOW DO YOU ACCESS COMPANY PROFILE?
There're more than one way. You can do it from the **Trade** tab, **Analyze** tab, or **View the News** gadget. Then select Company Profile.

1 – What drives the stock? That's what you'll see first. It's an interactive diagram of the revenue generating divisions of the company. Each division is represented as percent of market cap.
2 – Click on a division to view available forecasts related to it.

3 – Forecasts are displayed separately for each sub-division.
4 – When you click on a forecast it'll display a plot of the value you're analyzing. Its timespan normally includes five years before and seven years after the current date.

5 – You can modify the forecasts, which may affect the division diagram and estimated price. Compare your estimated price with the Trefis estimate and/or current market price to find potential directional trades.



Ask the Suit

BIG IDEA: A LITTLE Q&A WITH **NICOLE SHERROD**,
MANAGING DIRECTOR, ACTIVE TRADER, TD AMERITRADE



• **As we head into a new year, I hear a lot of talk about the Federal Reserve bank and interest rates. Is there any way to see and analyze the same data these 'Fed guys' use to make major decisions?**

Finally, someone asked! There is a great way and we have a tool that allows you to see all this data. I am referring to our Economic Data that is housed on the thinkorswim® platform under the Analyze tab. We encourage our clients to understand their portfolio using a top-down approach. By this I mean being aware of all factors that could affect a sector or specific company. Say that e-commerce is expected to take off in 2017 and you want to see if your portfolio is allocated to that sector. You can take a quick look to see if you have a good mix of retail stocks, specifically e-commerce retailers. Of course, you can chart the performance of these

"We encourage our clients to understand their portfolio using a top-down approach."

—NICOLE "THE SUIT" SHERROD
@TDANSHERROD

stocks, but now with Economic Data you can see how e-commerce is trending as a percent of Gross Domestic Product. This knowledge will give you a much higher level view of e-commerce and help you make better decisions about your retail stocks.

Back to the question, the goal of the 'Fed guys' is to control inflation, whether it be to speed it up or slow it down. Their most powerful weapon in this battle of inflation control is interest rates. For the past half-decade, these rates have been near zero. A rise in rates can have a big impact on the market and economy. The 'Fed guys' need to have a thorough understanding of the economy's health so they exhaustively look at many different economic indicators. To give you an idea of how deep they dig, let's use employment status as an example. The 'Fed guys' will analyze the difference between underemployment, unemployment, and long-term unemployment. Then, they compare this analysis with labor force participation rates and nonfarm payrolls. And to digress, yes, with thinkorswim all these data points (and about 400k more) are available for you to see.

My phone stores all my pictures and apps to the cloud. Does thinkorswim or thinkorswim mobile store anything in the cloud?

Great question. We don't refer to our storage system as a cloud, but the short answer is yes. If you assign a symbol link to a color, the setting is stored on the server side. This allows you to easily take your analysis from your desktop to your phone, as the same symbols linked from a watchlist on your desktop will pull up a chart on your phone. Most other settings that are applicable across mobile and desktop are stored on the server for this same reason. Spoiler alert: This same server side storage will be coming to your drawings soon.

TOYS FOR TRADERS

FROM THINKORSWIM®

DYNAMIC WATCHLIST ALERTS

Of course you want to be alerted when your dynamic watchlist (scan) updates its contents. From the Scan tab select "Scan" then "Alert" and choose the circumstances on which you want to be alerted, the way you want to receive a notification, and how often you want alerts to occur.

ANOTHER TRADE FLASH

The Trade Flash module, found under "Gadgets", is now more flexible and informative when it comes to notifying you of unusual trading activity in the marketplace. It can search for more computationally complex conditions and the option code is now automatically translated into a more human-readable format. Number formatting for large values is improved and you can now specifically identify unusual execution types such as intermarket sweeps, extended hour trades, and late reported trades.

SOCIAL SENTIMENT

How often is a product or service mentioned in social media? Are those mentions trending positively or negatively? And are they related to a specific division of the company? To enable Social Sentiment, bring up a chart for a company (symbols can be found under the Social Sentiment public watchlist), then click on Style, Settings, and enable Show Social Sentiment under the Equities tab.



INDUSTRY SPOTLIGHT • EASY

What's With Going Abroad?

BIG IDEA: ADD AN EXOTIC FLAIR TO YOUR PORTFOLIO WITH TIPS TO KEEP YOU FROM FLYING BLIND.

**COOL INFO:**

To find out more about international ETFs, go to tdameritrade.com. Follow the path: research & ideas > screeners > ETFs > create a screen > select ETF type and fund family.



• **TRADING FOREIGN STOCKS** sounds like a cool idea but can be tricky. Things can get expensive, there are lots of restrictions, and markets aren't always liquid enough. You're better off going to a local tapas joint to get a taste of something exotic.

But don't think of it as a dead end. There are ways to make diving into foreign markets less, well, foreign. But first, consider a few rules of thumb that don't necessarily follow a U.S.-based stock-picking approach. We leaned on the folks at BlackRock, purveyors of iShares ETFs, to discuss what they look for when investing in international stocks. Here's what we came up with:

Go deeper. In today's "flat" and connected world, it's increasingly hard to find markets that don't rise and fall together. Uncertainty or political unrest in one country could impact markets around the world. Do your homework and be choosy.

Diversification. Investors tend to view international markets as one big market, but the underlying economies could be vastly different. You may never have considered investing in China and Peru at the same time. What do the Great Wall and Machu Picchu have in common, after all? And in terms of size, they're apples and, well, lions. "China's GDP is roughly 60 times that of Peru's; conversely, Peru is 0.02% the size of China. Yet, the MSCI Emerging Markets Index includes both these nations and about 21 more," says Heidi Richardson, head of U.S. investment strategy at BlackRock.

Investing in one country. You could fine-tune your allocation strategy by zeroing in on a single country. "For the average investor, exposure to emerging markets means owning the broad universe represented by the MSCI EM index," says Richardson. "Given that China accounts for over a quarter of the index, those looking for select opportunities in areas like gold and silver miners may prefer single country exposures to Peru and India, respectively."

Smaller countries and/or emerging markets. Some countries may be experiencing staggering economic growth. But if those countries have stable political and economic foundations, their chances of maintaining that growth could be more likely than in countries with strong growth and volatile politics. Emerging markets could be candidates for short- to medium-term investments, which means your entry point is important. For most emerging markets, BlackRock examines cheap valuations relative to opportunity, overall trends, and if prices turn around, how much runway might be left.

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Emerging markets investments tend to be less liquid and more volatile and are subject to a number of additional risks, including but not limited to currency fluctuations and political instability.

ASK THE TRADER GUY

Q: Hey, Trader! I've never traded futures options. When I compare selling a strangle in SPX options for \$4, and a strangle in /ES options for \$4, I see the max profit on the order confirmation box as \$400 for the SPX strangle and \$200 for the /ES strangle. How come they're not the same?

A: What you're seeing is the effect of the contract multiplier. It's what you multiply the price of the option by to get the number of dollars you'd pay or receive for buying or selling the option. The multiplier for the SPX options is \$100, as it is for most U.S. stock options. The multiplier for /ES options is \$50. So, a \$4 strangle in SPX is $\$4 \times \$100 = \$400$, and a \$4 strangle in /ES is $\$4 \times \$50 = \$200$.

Q: Hey, Trader! Sometimes I look to roll a short vertical spread to a further-out expiration. Should I do the roll in one trade or buy back the short vertical and wait for a better price on the new vertical?

A: First off, a "roll" is when you buy back a short option in a spread and sell another option (usually the same strike) in a future expiration. If you do the roll as two separate trades, you're speculating the stock will move a certain way after you close your original position. You can do that, but the stock or index could move the opposite way, and you may get a worse price than if you had just rolled in one trade. The thinkorswim® platform lets you roll spreads in one transaction with only a few mouse clicks. Use the technology to simplify your trading.



GERMANY
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WHAT

I

LEARNED

NOT

TO DO

BIG IDEA: WHAT DID 2016 TEACH ME ABOUT DIRECTION, TIME, AND VOL, AND HOW CAN I AVOID MAKING THOSE SAME MISTAKES THIS YEAR? LET'S TAKE A LOOK.

WORDS BY **MARK AMBROSE**

PHOTOGRAPHS BY FREDRIK BRODÉN





ell, 2017 is here. And it's still

a never-leave-the-house world (worse, actually). Your cat litter comes from, well, the cat litter place. You can get pizza at 5 a.m. if the bourbon wears off. Your shaving cream comes from your fav online retailer. Who needs outside? When it comes to trading in your pajamas around the clock, pretty much no one.

Don't know about you, but for me, 2016 was at times a ride. Sometimes the market direction was confounding, or time went by too fast, or time drove me nuts and went too slow, or vol was in the basement for long periods but screamed higher often enough to keep me honest. Rather than being a deer in the headlights, I could often zero in on a platform to get some needed answers (the thinkorswim® platform was often a lifeline).

Here are three lessons for what not to do in 2017, courtesy of 2016 and some of the blunders and challenges the year delivered.

Lesson One:

DIRECTIONAL RISK

In 2016, the market rallied relentlessly for a while. But that rally was mixed with some sell-offs that, while you were living them, could have been the start of a crash. Remember Brexit? Whoever said hindsight is 20/20 must have been a trader. Because a crash can only be identified after the fact. But what's a "crash" anyway, besides being a big drop in the market? Is "big" a 5% drop? 10% drop? 20% drop?

Without getting too Zen, a big drop is one that creates losses on a long portfolio that are too large for your financial situation. A 10% drop in the \$100,000 portfolio of someone who is living off that money in retirement is \$10,000 that will be tough to replace. A 20% drop in the \$5,000 account of someone who has other assets and a good job is \$1,000 that could easily be replaced. So, a crash is in the eye (or account) of the beholder.

In practice, when the market is down for a given day, you don't want to be scared out of a position. If you need to close positions for risk or margin purposes, do so wisely and base it on logic. Every night, fire up thinkorswim, go to the Analyze tab, and beta-weight your portfolio to an index that you feel represents it best, like SPX, NDX, or RUT.

Look at the Risk Profile (see *Figure 1, page 20*) and explore the profit/loss line for the following day. It's there by default. Run your cursor over the live P/L line where the losses are. Look on the vertical axis to identify the loss that's too big for you, then look at the horizontal axis to identify the index price where that loss might occur.

Remember, the P/L numbers are theoretical values, so you may not see the exact same P/L if the index reaches that price in the future. But these numbers are a good estimate on which to base your risk management decisions. In a word, have your risk management plan in place. If you're holding mainly long stocks, then you could consider managing risk by buying index puts in a

quantity that could potentially create profit. This would reduce your theoretical loss to an acceptable level if the market does crash.

If your portfolio is composed of short strangles or short puts, the short **gamma** of those positions is going to "manufacture" positive **deltas** as the market sells off. That's not good. You may consider buying **out of the money** (OTM) puts against short options to reduce the short gamma and make a sell-off less scary. At what strikes, in what quantities, and at what index levels you'd buy those puts, is something you can simulate on the Analyze page. Use it. Make it yours.

Lesson Two:

TIME RISK

When you're long and you're wrong, every minute of a sell-off can bring a wave of self-doubt. And in 2016, bearish positions made you feel that way. Bullish or bearish, when a trade is losing money, you often contemplate how long to hold the position. More time can bring a favorable move in the stock



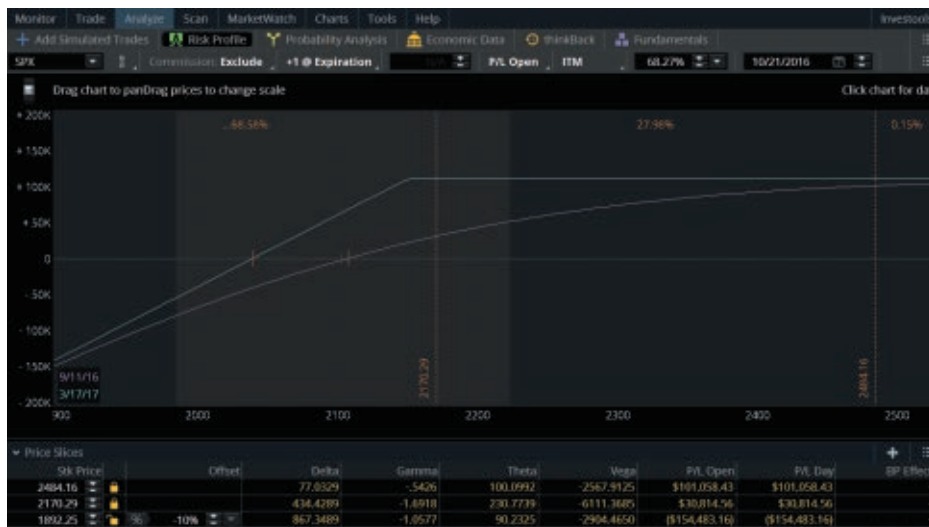


FIGURE 1: What's your risk profile? This graph helps you figure out how much loss you can expect in a trade. Below the horizontal zero line in the middle is your loss. Above the line is your profit. Is the loss too big for you to handle? If so, come up with strategies to better manage risk.

Source: thinkorswim by TD Ameritrade. For illustrative purposes only.

price, which could save you, or you might see a continued unfavorable move that could create bigger losses. You scratch your head. It's true, traders need to be proactive.

Yes, you could have exited a losing trade and moved on. No argument there. But what if your opinion of the long-term direction of a stock or the market hasn't changed? Think of having been bearish in 2016 as the market went higher. It hurt.

One way to reduce the pain would have been to finance that longer-term bearish position by selling OTM puts against negative **deltas**. If you were bearish, for example, and were long puts in a further expiration, selling OTM puts in a nearer expiration would have been one way to finance them. The short put with fewer days to expiration would have had higher positive theta, all things being equal, than the negative theta of the long put. If the short put expired worthless, it potentially improved the breakeven point of the long put. It let you hold that bearish position longer.

Traders pay their bills with trading profits. The bills come every month. A long-term directional strategy might take a long time to pay off. Attempt to create smaller, short-

term profits to stay solvent, and give your longer-term positions time for potentially larger profits.

Look on the Trade page to find options to sell. Drill down into the nearer-term expirations, and find the OTM options that have a good balance of premium versus theta. Compare the premium to the price you paid for the longer-term position. How much premium improves the breakeven point? The decision isn't whether to give a trade more time. It's whether you can collect enough premium to make a dent in the breakeven point. You want to still cover commissions by looking at further OTM options that have a higher probability of expiring worthless, than closer-to-the-money options that have higher premium but lower probability of expiring worthless. That's the decision a trader has to learn to make.

Lesson Three: VOLATILITY RISK

Yes, 2016 was a year when volatility imitated a whack-a-mole game. Look at the VIX. The times it stuck its head up, it was often knocked back down. The year was a good example of the inverse relationship between the market direction and volatility direction. The market dropped, and the VIX popped. The market rallied, and the VIX ... what rhymes with

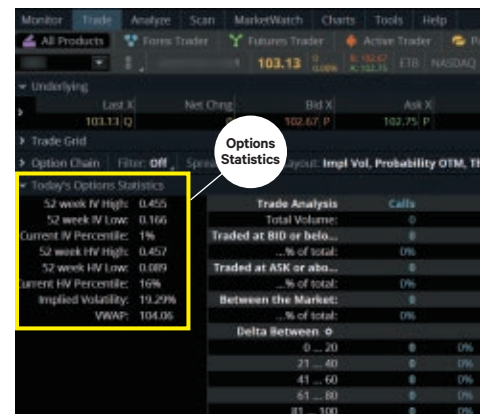


FIGURE 2: It's all relative. "Today's Options Statistics" displays all sorts of vol stats—52-week implied and historical vol highs and lows, IV percentile, HV percentile—all helpful for figuring out if vol is high or low.

Source: thinkorswim by TD Ameritrade. For illustrative purposes only.

"rallied"? Traders know higher vol isn't a bad thing. It raises option prices and can create more flexible strategies. Overall, for long stretches of 2016, that wasn't happening.

When vol is low, we might have a tendency to get bored and experiment with trading styles we haven't thought through. Like scalping futures or stocks. Unless you've proven to yourself you can be profitable scalping, it's not smart for an option trader to abandon those option skills just because vol is low. Instead, know what vol is. Adjust your strategy for a stock or index based on it, or find a different stock or index with a higher vol.

For example, are you bullish when vol is high? If so, a short put could be a possibility. Are you bullish when vol is low? In that case, a long call vertical might be worth considering. Alternatively, maybe you love trading ABC when its vol is high, but it's not high right now. Maybe XYZ has higher vol and you can trade your high-vol strategies in that stock. But what's high or low volatility? Funny you should ask.

Log on to thinkorswim and check out the "Today's Options Statistics" at the bottom of the Trade page (Figure 2). Open it up and

Symbol	Size	Volume	Open	High	Low
1 x 1	225,819	0	0	0	0

Parts	Total	Size Index	Volatility Index	Stock Size	PVC Ratio
0	0	0.895	1.183	0.829	1.325
0%	0%	0	0	0	0
0%	0%	0	0	0	0
0%	0%	0	0	0	0
0%	0%	0	0	0	0
0%	0%	0	0	0	0
0%	0%	0	0	0	0
0%	0%	0	0	0	0

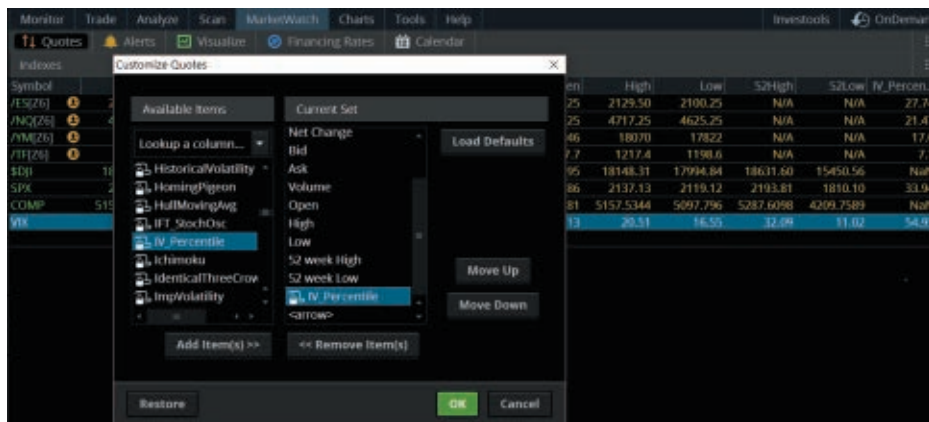


FIGURE 3: Want to trade something with a higher IV percentile? You can sort your symbols in a watchlist by IV percentile and identify those symbols that have the higher values.

Source: thinkorswim by TD Ameritrade. For illustrative purposes only.

you'll find all sorts of volatility goodness. Look at the "Current IV Percentile." That compares the current overall implied volatility (IV), which you can also see, to the 52-week high and low IV numbers. IV percentile would be 100% if the prevailing IV were at its 52-week high, and would be 0% if the prevailing IV were at its 52-week low.

So the IV percentile can tell you if the prevailing IV is high or low for a specific symbol, and that can tell you whether you should consider adjusting your strategy. But what if you want to find another symbol with a higher IV percentile?

If you go to the MarketWatch tab and load up a watchlist of symbols, you can change one of the columns to IV Percentile (Figure 3). Then you can sort the list by ascending or descending IV percentiles. To find it, click on the little gear icon in the upper right-hand corner of the MarketWatch tab and select "Customize." Then scroll down the list of metrics, find "IV Percentile," and add it as a column for MarketWatch. You can then click on the top of that column to sort it. This makes finding symbols with relatively high or low IV faster.

WHY BETA-WEIGHT YOUR PORTFOLIO?

MOST TRADERS KNOW WHAT THEIR PORTFOLIO IS MADE UP OF, BUT OFTEN DON'T SEE IT FROM A "BIG PICTURE" VIEW. THIS IS WHERE BETA-WEIGHTING COMES INTO PLAY.

1. How do each of your positions move with relation to the market?

Look at each component of your portfolio and see how you can standardize it by relating it to a benchmark index. For example, if you have a tech-heavy portfolio, you may want to standardize it against a tech-heavy index like the NASDAQ composite.

2. How much do you want your portfolio to move with the market? That's really up to you, but if the beta of your portfolio is positive, it means that if the market moves up, your portfolio will likely also move up. A negative beta means if the market moves up, your portfolio will likely move in the opposite direction. A smaller beta value means that if the market has a large move, your portfolio—you guessed it—likely won't move much.

3. Does your portfolio have a bullish or bearish tilt? If you look at the individual components of your portfolio, you may not be able to tell if your portfolio is bullish or bearish. But if you beta-weight it against a benchmark index like the S&P 500 on the thinkorswim platform, you'll see what the total weighted delta is, and that could tell you if your portfolio is bullish or bearish.

Now, IV and IV percentile are just tools. You'll need to drill down into the options of whichever symbols have the IV percentile you're looking for to evaluate different strategies. Use this information to change what you trade, not how you trade.

Try and Try Again

The most important lesson of 2016, which encapsulates all other lessons, is to be proactive with your portfolio. Stay engaged with the market, analyze mistakes, test your approach, and push yourself to learn more. How do you aggregate enough profit to have the pizza made right inside your house? When it comes to trading, practice, practice, practice.



WATCH THE VIDEO:

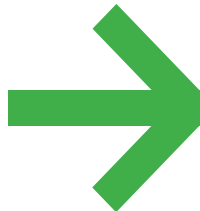
What's beta-weighting? Watch the video at <http://the.thinkorswim.com/center/video/videos/Beta-Weighting>

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

MISTAKE

1

ASSUMING YOU'RE SMARTER THAN THE MARKET



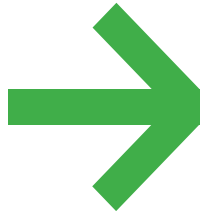
You're smart, but not smarter than the cumulative wisdom of a million other traders. As soon as you think you've discovered the secret to successful trading, you get complacent. But complacency kills.

Solution: See each losing trade as a chance to learn. What caused your loss? Was it a wrong assumption about market direction, volatility, or risk? What can you do differently in the future? Trading is a never-ending cognitive loop. See, evaluate, learn, improve.

MISTAKE

2

SEEKING VENGEANCE



They say revenge is a dish best served cold, but markets are always moving. So you think the market had it in for you and caused your losing trade. Your next trade will strike a blow to restore your honor.

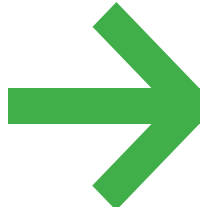
"Vengeance" trading says you don't care about losing more money when you're making poor trades.

Solution: Detach yourself emotionally from each trade. It's tough, but it'll help you see problems more clearly and possibly fix them faster.

MISTAKE

3

DOUBLING DOWN AFTER LOSSES



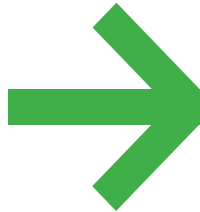
This is the kissing cousin of mistake two. You try to make a loss back by increasing the risk. But if you're not using logic when adding to risk, you're tossing strategy out the window. You're increasing risk on gut instinct rather than strategy. And gut isn't always right.

Solution: Devise other ways to salvage losing trades, but allocate additional capital to new trades that conform to a defined strategy.

MISTAKE

4

LOOKING FOR THE MAGIC BULLET



Losing money on a trade makes you question your strategy. You think there's a "next big idea," since you have a string of losers after learning all you can about volatility, probability, and options. You hear traders talk about big profits with some sexy new approach. There's nothing wrong with learning something new (see mistake one), but don't forget everything you've already integrated.

Solution: Fusing new information with existing strategies can be effective and profitable.

EASY / TAKE AWAY: If you've got a losing trade, deal with it and move on.

IT'S NOT YOU, IT'S THE

BIG IDEA:

IF YOU MAKE ANY ONE OF FOUR BIG MISTAKES, REST ASSURED THERE'S A RECOVERY PROCESS DESIGNED TO GET YOU OUT OF YOUR HEAD FAST AND BACK ON TRACK.

WORDS BY **THOMAS PRESTON**

LET'S FACE IT. We're living (surviving) the era of "all about me." We post pictures of our gourmet scrambled eggs. We tweet urgent thoughts about the perfect dog groomer. Yup. Narcissism on steroids. Except in one area.

When veteran traders lose money on a trade, that self-involved bullhorn is nowhere in sight. A trader might celebrate or blame the market or the news or timing or strategy or even aliens. Whatever his analysis,

If you've identified making one of the mistakes at the top, consider the five-step assessment process below to kick emotion to the curb and apply the balm of logic.

STEP

1

**ASSESS HOW MUCH MORE YOU CAN LOSE ON THE TRADE.**

Say you bought a call for \$1 and now it's worth \$0.05. You lost \$95 plus commissions. You can only lose another \$5. If you try to sell it for \$0.05, you'll pay another commission. The trade only presents an additional \$5 of risk, so is it worth hanging onto?

You shorted a call for \$1 and now it's worth \$50? You lost \$400 plus commissions. Can you afford to lose more?

If your answer is

yes?

Hang onto the trade.

no?

Close the trade, take the loss like the skilled trader you are, and move on to the next trade.

STEP

2

**HAS MY OPINION ABOUT THIS STOCK CHANGED?**

You put the trade up and now it's losing money. With the stock at its current price, and everything you know about its fundamentals, charts, whatever, do you still feel the same way about the stock?

yes?

Keep the trade and consider attempting to improve its breakeven point by selling an option against it. Sell the option that meets your criteria for credit, theta, probability of expiring out of the money, (OTM), etc.

no?

Exit the trade.

STEP

3

**IF YOU DIDN'T HAVE THIS POSITION ON NOW, WOULD YOU HAVE PUT IT ON TODAY?**

You were bullish and shorted an OTM put 30 days ago and it's now in the money after the stock dropped. Would you sell that same put today?

yes?

Keep it.

no?

Close the trade, take the loss, and move on. Don't second-guess your logic when thinking about closing the trade. On the other hand, consider mitigating the loss by improving the breakeven point with offsetting delta trades.

STEP

4

**IS THERE SOMETHING YOU CAN DO WITH THIS STOCK TO REDUCE THE LOSS OR IMPROVE THE BREAKEVEN POINT?**

You have a bullish trade, like a short put or long stock. Is there a call, or call spread, you can sell to take in some credit and improve the trade's breakeven point? Is volatility relatively high?

yes?

Credits for short calls or call spreads might be a good choice if the stock's price has dropped.

no?

If vol is low (or high), consider rolling the position to a different strike in a different expiration that has price and greeks closer to your original logic.

it's kept absolutely private. How is that possible in a "look at me" world?

Unlike newbies, veteran traders have a game plan. It might not be perfect. But it's defined, it's something they can execute decisively. A solid plan can keep an investment strategy steady over time. No threat of losses turning this trader into a preening, bellyaching goofball. What helps our humble trader look in, not out? Two things: attitude and technique, which immediately undercut "emotional trading." Above all, our trader has a healthy relationship to the market and keeps her head.

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 on the risks of trading and options, see page 37, #1-2



STEP

5

MAKE YOUR TRADING CHECKLIST.

Write out a checklist for your trading game plan. Review it before you do any trade. The guidelines we just reviewed are a good starting point. Commit to the checklist. Use thinkLog (Figure 1) as a convenient way to take notes on a particular trade, or even create a checklist. If you follow a plan and still lose money on a trade, you have the consolation that you were guided by logic, not ego or emotion. But if you don't follow a plan... well, let's just say your trader gold star simply won't come in the mail as fast. And your dog may love you less. Huge stakes.

FIGURE 1: Keep Good Notes. From your watchlist, open thinkLog and jot down whatever will be important in making a trading decision. You can access the notes from the Tools tab.

Source: thinkorswim by TD Ameritrade. For illustrative purposes only.

● SEASONED / **TAKE AWAY:** *Using your capital efficiently, speculating, and hedging with futures.*



BIG IDEA:

DON'T LET HIGH
LEVERAGE OR
SCARY WAR
STORIES FRIGHTEN
YOU AWAY FROM
POTENTIALLY
TRADING FUTURES.
THINK OF THEM
AS JUST ANOTHER
ASSET CLASS. AS
WITH ANY NEW
ASSET, START
WITH THE BASICS.
WORDS BY

JACKIE MUNRO

PHOTOGRAPH BY
FREDRIK BRODÉN



You

finally gave up the mini van, and you're cruising along Tuscany's winding roads in your flashy red sports car, testing the handsome machine's powerful capabilities. You're completely lost in the moment when you hear it—the closing bell. Jolted out of this gorgeous reverie, you realize you'd fallen asleep at your trading desk. The culprit? Dampened vol can strike at any time. • If you've been trading equities and options for a while, you might be looking for something new. If you're already cozy with option strategies and how to use them, maybe some new tools and instruments can give you more alternatives with which to manage positions, especially if you're in a slump. Explore the idea of adding new trading vehicles to your existing fleet.

WHAT'S THE SPEED LIMIT?

For instance, say oil is on a tear and you want a piece of the action. You might first turn to equities of oil drilling companies, or to exchange-traded funds (ETFs) whose underlying assets are oil companies. But did you consider trading oil futures?

We like what we know. And new things can feel mysterious. Maybe you think crude oil futures (/CL) are too rich or too risky or too scary. Before embracing different asset classes, it's best to drill down and know the nuts and bolts of the new product.

Consider the breakdown of oil's contract specs. The contract size is 1,000 barrels, with a tick size of \$0.01, or \$100 per contract. Say the price of oil is \$45. The notional value of one oil futures contract would be \$45,000. That may feel too rich. So one option is to look at the e-mini crude futures (/QM) contract with a multiplier of 500 barrels. The notional in this case would be \$22,500, or half the big contract. It may still be too much for one trade, but think of what you're getting. When you buy a futures contract, you're getting exposure to 1,000, or 500, barrels of oil.

HIGHWAYS AND BYWAYS

Let's talk margin. Don't think of futures margin in the same way as equity margin, which functions as a down payment. In other words, with equities you have to put down 50% of the total cost before you can buy or sell on margin. With futures, the margin is more of a good faith deposit on the contract's performance—more like leasing versus buying. You'll discover different margins across commodities, but they're standardized within a specific futures contract. Margin requirements for futures is a small percentage of the notional value, which may range anywhere from 1% to 15%. So in a word, you've got leverage, and with leverage comes the potential for greater profits but also greater losses.

There are also two types of margin—initial and maintenance. The initial margin for a futures contract is the amount you'll need to open a position. Once you open a position, your account must have a maintenance margin while the position is open. Again, that maintenance margin varies across commodities. But it's usually about 80% to 90% of the initial margin. It's something you will

need to monitor closely when you have a trade open. And if the maintenance margin requirements change, you may have to deposit more or could even be closed by TDAFF (TD Ameritrade Futures & Forex LLC).

Let's look at the E-Mini S&P (/ES) contract and make a comparison with an ETF that tracks the S&P index. Say /ES is trading at \$2,167. That makes the notional value of one /ES contract \$108,350 (price multiplied by multiplier of 50). Your initial margin may be \$5,500, with a maintenance margin of \$4,500.

Say the corresponding ETF is trading at \$215 per share. To get the equivalent exposure of one /ES contract, you'd have to buy about 500 ETF shares. That would cost you \$107,500, and with the Regulation T margin requirement, you'd have to put down \$53,750 (50% of total cost). Compare this to the initial margin of \$5,500 for one /ES contract. Of course, you don't have to buy 500 shares. Yet, even if you settled for 100, which would only give you one-fifth of the exposure of an /ES contract, you'd still need to have \$10,750 in margin.

This is how futures expand your leverage and can give you greater capital efficiency. The expanded leverage makes them riskier, but it's the reduction in buying power effect that can make trading futures attractive to self-directed traders. Think about your trading preferences and how all this fits into your strategy toolbox.

OPTIONS LIKE LEATHER SEATS ...

Compared to equities, futures contracts are more correlated with **spot price** movement. At the same time, you have overnight access to a liquid electronic market. This lets you

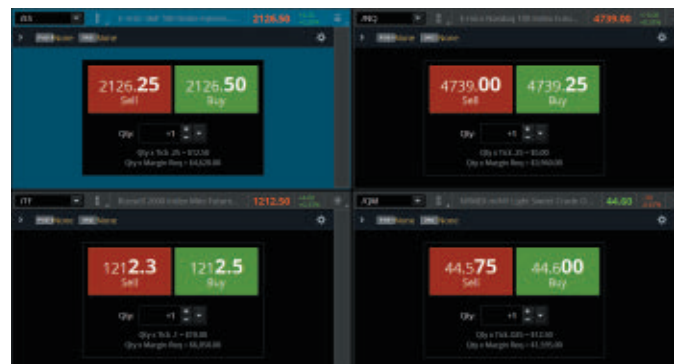


FIGURE 1: Futures trading screen.

From the Trade page, select Futures Trader to be able to place futures orders.

Source: thinkorswim by TD Ameritrade. For illustrative purposes only.

Position Statement <input checked="" type="checkbox"/> Beta Weighting <input checked="" type="checkbox"/> /ES										
▼ None										
	Instrument	Qty	Days	Mark	Mkt Chng	% Change	Delta	P/L Open	P/L Day	BP Effect
FUTURES >	* /GE					0.00%	.00	\$62.50	(\$37.50)	(\$517.00)
	/GEH7 Futures,Mar-2017,ETH	+2	180	99.0300	+02		1.3785	\$75.00	\$100.00	
	/GEU7 Futures,Sep-2017,ETH	-1	369	98.9550	+025		-.6893	(\$25.00)	(\$62.50)	
	/GEH8 Futures,Mar-2018,ETH	-1	551	98.8800	+03		-.6893	\$12.50	(\$75.00)	
	Selected Totals									
STOCKS >	* /ES					+0.69%	24.2344	(\$870.00)	\$255.00	\$0.00
	100 (Weeklys) 30 SEP 16 130 CALL	0		128.088	+878		.00	\$0.00	\$0.00	
	Selected Totals	+10	16	1.450	+2549994		24.2344	(\$870.00)	\$255.00	
	* /ES					-0.73%	6.1105	(\$235.00)	(\$65.00)	(\$11,809.00)
	100 21 OCT 16 55 PUT	0		56.120	-.41		.00	\$0.00	\$0.00	
	100 21 OCT 16 55 PUT	-10	37	1.320	+14		11.2656	(\$450.00)	(\$140.00)	
	100 21 OCT 16 60 CALL	-10	37	.385	-.075		-5.1551	\$215.00	\$75.00	
	Selected Totals									
	* /ES					+0.14%	.4226	(\$607.38)	\$59.72	(\$12,043.38)
	100 21 OCT 16 52.5 PUT	0		51.330	+07		.00	\$0.00	\$0.00	
	100 21 OCT 16 52.5 PUT	-10	37	1.777	-.059716		.4226	(\$607.38)	\$59.72	
	Selected Totals									
	Wtd (/ES) Subtotals						30.7675	(\$1,649.88)	\$212.22	(\$24,369.38)
Wtd (/ES) Totals								(\$1,649.88)	\$212.22	(\$24,369.38)

FIGURE 2: Futures and stocks seen together. If your portfolio is made up of stocks and futures, you can view them together in your position statement from the Monitor tab and view your beta-weighted delta equivalents (pictured here using /ES). Source: thinkorswim by TD Ameritrade. For illustrative purposes only.

directly speculate in different markets. Let's look at the "ags" (agriculture commodities) as examples. Keep in mind that liquidity in futures contracts tends to vary, especially for seasonals like ags. Weather, seasonal planting and harvesting patterns, whether crops are old or new—all these variables can impact a given yield, which ultimately affects a contract's price.

Typically, ags contracts with higher liquidity include corn (/ZC), soybeans (/ZS), and wheat (/ZW). If you have a directional bias on any of these, and you choose to speculate using underlying futures contracts, one way to get a smaller piece but still maintain some exposure is to trade the "mini" con-

tracts. You'll have an advantage with a smaller piece of the pie because you may see that large price moves in commodities occur quickly, especially following crop reports. When trading a smaller contract, although the move would

hold the same, because your exposure is less, the impact will be reduced.

HEDGE THE DREAM

Say you have a portfolio of stocks. If there's something like a Brexit vote looming, you may want to reduce portfolio risk. Adding futures contracts may help. You can use

futures to reduce risk on your equity portfolio by adding non-correlated products—those that tend to move opposite to

equities, such as /ZC, /ZS, and /ZW—to your portfolio. And these don't have to be big contracts. You can go smaller by adding the available minis—they're a fraction of the size of the customary larger contracts. But keep in mind that smaller contracts may not be as liquid.

Another way to reduce portfolio risk is by reducing total delta, which can be accomplished by adding futures. Remember that deltas in futures are not exactly like deltas of equities. Futures deltas are based on contract multipliers, so they don't change. In other words, delta for /CL contracts will be 1,000, for the /ES it will be 50, for the /NQ it'll be 20, and so on.

Say you have an equity portfolio of 10 stocks drawn from the S&P 500. So you beta-weight your portfolio (see page 21 on how to beta-weight your portfolio) against the S&P, and the total delta is about +80. That means a one-dollar move in the S&P 500 will increase or decrease the value of your portfolio by \$80. Now, if you sell one /ES contract in your portfolio (/ES has a delta of 50), it will reduce your portfolio delta by 50, giving it a total delta of 30. Of course, it will reduce the value of your portfolio by \$5,500 (if we used the previous example, that would be your margin). But your delta exposure is reduced, along with the stress. In the example portfolio in Figure 2, total delta was 1,297, but it reduced to 30 after beta-weighting

against the /ES. For your convenience, in the thinkorswim® platform, you can view your futures and equity accounts side by side.

TEST-DRIVE A NEW TRADING LIFE

As we've seen, futures are more accessible than you might think. They may help you engage capital more efficiently, and directly speculate in your preferred markets while giving you a hedge in your portfolio. Are futures the path before you?

While you're putting on a racing helmet, get a feel for the instrument through a simulated futures account. Monitor them in overnight sessions, and as you get familiar and comfortable with how they move, you may find a whole new world open up for you. Who knows. You just might enjoy the ride.

Symbols are for educational purposes only and not a recommendation to buy or sell.

Carefully consider the investment objectives, risks, charges, and expenses before investing. A prospectus, obtained by calling 800-669-3900, contains this and other important information about an investment company. Read carefully before investing.

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.

Futures accounts are not protected by the Securities Investor Protection Corporation (SIPC). Futures and futures options trading services provided by TD Ameritrade Futures & Forex LLC. Trading privileges subject to review and approval. Not all clients will qualify.



HOW TO:

Open a futures account. For qualified accounts, you'll need Tier 2 options approval to trade futures and Tier 3 to trade options on futures. Log in to your account at tdameritrade.com. Under the Trade tab, select **Futures Trader** to access charts, quotes, and more.

BIG IDEA: IT TAKES TWO TO MAKE EVERYTHING GO RIGHT, OR DOES IT? IT DEPENDS ON IF IT'S THE RIGHT PAIR. THERE ARE MANY COMBINATIONS OF BULLISH AND BEARISH POSITIONS YOU CAN USE. LET'S NARROW DOWN YOUR CHOICES.
WORDS BY **THOMAS PRESTON**
PHOTOGRAPHS BY FREDRIK BRODÉN

PAIRS TRADING: YOUR YUMMY NEW SNACK

● **PRO / TAKE AWAY:** *In a low-vol environment, pairs trades may offer some unexpected opportunities.*

Where would we be without the ham-and-cheese sandwich? Or chicken noodle soup? Would peanut butter even exist without jelly? Sure, you can eat any of those things without the other while sitting at your desk trading. But if staring long and hard at an individual stock or index to figure out a strategy is yesterday's lunch, maybe that stock or index could be paired with another to make a delicious new strategy. So, what's a "pair"? • Think of pairs trading as a bullish position in one stock or index, combined with a bearish position in another. You might consider a pairs trade for the same reason you eat peanut butter with jelly. The constituent parts are fine on their own. But when you combine them, things can get interesting.



YOUR INGREDIENTS LIST

For pairs trading to make any sense, you need to understand a few concepts.

Correlation. This is more or less how two stocks move in the same or different directions at the same time. Statistically, correlation is measured from -1.00 (perfect negative correlation, where one stock goes up and the other goes down) to +1.00 (perfect positive correlation, where two stocks always go up and down together). Most of the time, the correlation between two U.S. equities or equity indices is usually positive, from 0.01 to 1.00.

When you look at two stocks or indices to comprise a pair, a positive 0.60 or higher correlation is a good place to start. Higher than that is good. Lower than that, and the relationship between the two stocks can become weak. And when the long stock in the pair goes down and the short stock in the pair either goes up or doesn't drop, it can lead to unappetizing surprises.

To find correlation values, go to the Charts page on the thinkorswim® platform by TD Ameritrade. Then:

1. Type in "SPX-NDX" in the symbol field as an example of a pairs chart.
2. Click on the Studies button, then Add Study, then All Studies, then click on "O-P" in the list of studies and select PairCorrelation. It'll load up the correlation between the two symbols that you entered, in this case the SPX and NDX.
3. Enter any two symbols in the same way "ABCD-XYZ" and you can see the correlation between them. (See Figure 1.)

Selection. This is figuring out when you use stock or options, or both. A long stock/short stock pairs trade can use up a lot of trading capital and have a large amount of risk if the pair moves against you. Options, particularly option spreads like **verticals**, can have lower capital requirements and defined risk. A lower capital requirement means that if you want

to trade pairs, you can allocate a relatively small amount of capital to a bullish vertical in one symbol, and a bearish vertical in another. With defined risk, even if the pair's correlation collapses, your bullish stock crashes, and your bearish stock rallies, the verticals have a defined max potential loss. The loss still hurts. But it doesn't have to be fatal.

The main downside to options is commissions. Two verticals for a pairs trade has a commission on four legs. Also, the max potential profit on verticals in a pairs trade

If both stocks drop, but stock A drops 5% to \$95, and stock B drops 6% to \$47, stock A has indeed performed better than stock B. It's dropped less. But how's your P/L? Long 100 shares of stock A have lost \$500. Short 100 shares of stock B have made \$300. You were right on your assessment of the pairs



FIGURE 1: How correlated is a pair?
How well do these two get along? The Pair Correlation study at the bottom of the price chart shows if the pair is going strong, or not.
Source: thinkorswim by TD Ameritrade. For illustrative purposes only. Past performance is no guarantee of future results.

is limited, making the commissions a larger factor in doing the trade.

Notional Value. Think about a pairs trade that buys 100 shares of stock A for \$100 and shorts 100 shares of stock B at \$50. They're highly correlated, they move up and down together most of the time, and you think stock A will outperform stock B by rising more or dropping less.

trade, but it lost money. Why?

The notional value of the long shares of stock A was $100 \times \$100 = \$10,000$. The notional value of the short shares of stock B was $100 \times \$50 = \$5,000$. Stock A had 2x the notional value of stock B, so the pairs trade was weighted heavily toward stock A.

If the notional values were equalized by shorting 200 shares of stock B, the pairs trade would be profitable if stock A dropped \$5 and stock B dropped \$3. One hundred shares of stock A would lose \$500, but short 200 shares of stock B would make \$600. The difference in notional values might not be a big deal in two stocks that have roughly the same price. But it becomes a bigger deal if you pairs trade with futures or index products.

A SPLASH OF SECTORS

The first pairs trade to consider is an intra-sector trade between two stocks in a partic-

ular industry like technology, health care, or energy, where correlation is often high. Consider two hypothetical large oil companies, GTPO and MNAL. Say you chart the “price” of the pair GTPO–MNAL.

If the pair price on the chart has been moving up, it means GTPO has been outperforming, either rising more or dropping less than MNAL. If the pair price has been moving lower, the opposite is true. If you believe that the pair price will continue to go higher, and GTPO will continue to outperform MNAL, you could buy shares of GTPO and sell shares of MNAL. If you believe the pair price will go lower, you could sell GTPO and buy MNAL.

Why don't you just buy MNAL, if you think the pair price will go lower? Or buy GTPO if you think the pair price will go higher? In fact, the price of the pair could go up even when prices of both stocks are going lower. Picking one of the stocks isn't a pairs trade. You're just making a directional bet on that stock.

Now, you're making a directional bet on the pair, but the pair may have a couple of advantages. First, you may think a pair is mean reverting. That is, the pair price might oscillate above and below some average level on a regular basis. Let's say you think the average pair price of the two stocks is \$12. If the current pair price is \$15, and you think it might revert to \$12, you could short GTPO and buy MNAL. If the current pair price is \$9, you might buy GTPO and short MNAL. You might be able to evaluate the chart of the

pair price more easily than one of the component stocks.

Second, the pair may have less risk than either of the component stocks. If the stocks are highly correlated, and in the same in-

dustry, the long and short shares in the pairs trade offset each other to a certain degree. They act as a hedge for one another.

A PINCH OF INDICES

Another type of pairs trade is interindex, like SPX versus NDX. Think big cap versus

small cap. Correlations between the major U.S. equity indices tend to be pretty high, which make them interesting pairs candidates. You can approach them like a stock versus stock pair trade. Yet keep in mind that SPX and NDX don't have underlying shares, so you'd need to trade that pair using options.

With options, think about positive (bullish) **deltas** in one symbol, and negative (bearish) deltas in the other. You'll also need to think about volatility (vol). SPX typically has a lower **implied volatility** than NDX because SPX's large-cap stocks are somewhat less volatile than NDX's small-cap stocks. But if the implied vol was the same for both, it might suggest SPX's implied vol was high relative to NDX.

If you looked at a chart of SPX versus NDX and thought that the pair price might go higher, you could consider putting on bullish deltas in SPX and bearish deltas in NDX. Given the relatively high implied vol in SPX, you might sell a put vertical, for example, in SPX to generate positive deltas because the higher implied vol would mean credit spreads have higher prices. And you might buy a put vertical in NDX to generate negative deltas, because lower implied vol would mean debit spreads have lower prices.

A DASH OF MARKETS

A third avenue is an intermarket pairs trade, like S&P 500 versus Treasury bonds. Get your big kid pants on for this. Recently, threats of higher rates have pushed both Treasuries and U.S. stocks lower, at least in the short term. Maybe you think that Treasuries have sold off a bit much, and the S&P 500 hasn't caught up to the downside. You may consider a pairs trade that's long deltas in Treasury futures (/ZB) and short deltas in S&P 500 futures (/ES). Notional value here is critical.

At \$1,000 per point, /ZB at \$170 has a notional value of \$170,000. At \$50 per point, /ES at \$2,200 has a notional value of \$110,000. /ZB is about 50% larger. To get the risk between the /ZB and /ES positions more equal, you might consider two positive deltas in /ZB for every three negative deltas in /ES. With implied vol in /ZB at

11%, and in /ES at 13%, you may want to consider sticking with the 2:3 ratio. But if they were different, say /ZB at 11% and /ES at 17%, that would make /ES vol 50% larger than /ZB vol. If you factor that in, the 2:3 ratio would now be one /ZB to one /ES because the 50% smaller notional value of /ES is offset by the 50% larger volatility.

Intermarket pairs trades have the most moving parts, and require the most confidence, experience, and account size. Even if you're not quite ready for those, the concepts discussed here can be applied to any pairs trade.

WATCH CELEBRITY CHEFS AT THE CLOSING BELL

This article just scratched the surface of pairs trading, a part of the market that's often both demanding and rewarding. Pairs trades can be complex, have high commissions, and carry a lot of risk. But they also make you push the boundaries of your trading knowledge. And that's a good idea for all of us. Because really, who wants just jelly?

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.

Pairs trading requires active monitoring and management and is not suitable for all investors.

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



TAKE ACTION:

To find out more about pairs trading, see “**Opposites Attract**” in *thinkMoney* 15, Spring 2012.



WHEN THE MARKET CALLS, ANSWER IT.

The best things in life don't happen behind a desk. And with the #1 trading app in the App Store, your portfolio can go wherever you're going.

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The best returns aren't just measured in dollars.



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Research—All Buffed Up

EVER WONDER WHO'S BEHIND THE REPORTS THAT SHAPE YOUR TRADING DECISIONS? WE SPEAK WITH RESEARCH WHIZ SHAWN CRUZ—THE GUY WHO DIGS FOR MARKET NUGGETS.

Illustration by Joe Morse

• **SOME GOOD QUALITIES**—hard work, loyalty, and accountability—never go out of style, which is why Shawn Cruz, Trader Content Specialist at TD Ameritrade, will always be trendy. He joined the TD Ameritrade client services team straight out of college. He moved on to TradeWise (formerly RED OptionSM), and from there went to Swim LessonsSM. He then lent his insights to product development and became a key player in the economic and market research team. Despite a demanding work life, he still manages to find time to study for his MBA, run, play golf, and share videos that'll make you head to the gym and show off your six pack abs.

1

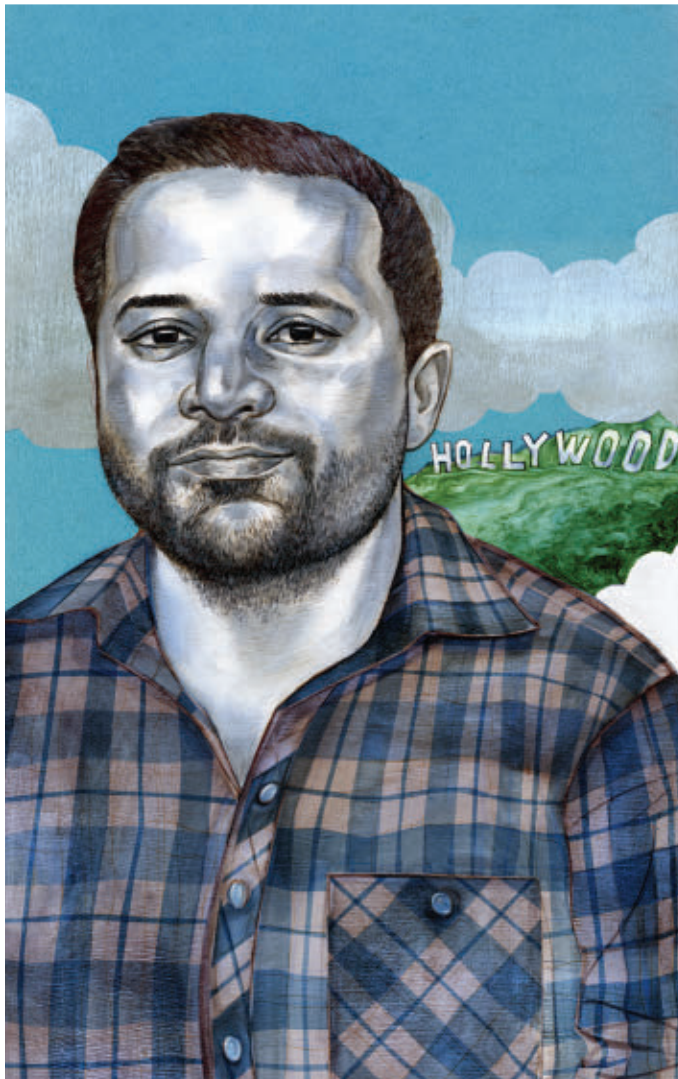
Describe a day in the life of Shawn.

I'm in the Active Trader group. So the focus of my job is to assist JJ Kinahan with any research that needs to be done around market structure and trading. The pace around the office can be quick, with a lot of projects in the works. There're lots of moving parts, so you have to stay on schedule, especially in product development. When there's an overload, I help out to avoid any setbacks.



TAKE ACTION:

Access FRED from the Economic Data tab on the thinkorswim platform to view the massive number of data points.



Why is TD Ameritrade research so valuable?

We always make sure the tools we provide clients are functional and useful. We want our technology to be accurate, and naturally backed by relevant data and research. We don't want to randomly put things out there. We make sure our products help clients make the best use of company resources when we develop something.

3

What are some projects you're working on for the future?

One big release that has come up is the addition of economic data to the platform. On thinkorswim[®] we've added the Federal Reserve Economic Database ("FRED"), a massive database with lots of different economic data points used by economists, researchers, and traders. And there are markets that are driven by fundamental and economic data.

4

What are your golden trading rules?

I like to make sure I know the products I'm trading, especially when it comes to futures. I want to know how the contracts settle. I also have a top-down approach. I start with a high-level economic picture, then drill down into what I think is specific to the particular instrument I'm trading. I don't want to miss anything when I make a trading decision. Finally, I manage my open positions well, which is something that should be part of any successful trading plan.

5

Hey, rumor has it you have ties to Hollywood?

My great grandmother was an actress who played roles in a number of popular TV shows and movies. She was Mrs. Philbert in *The Wonder Years* and Dorothy in *Sixteen Candles*.

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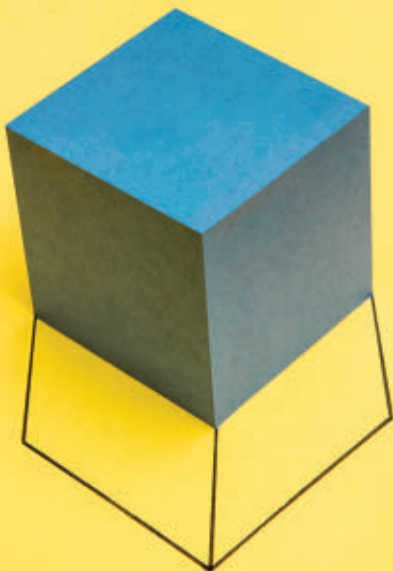
Options involve risk and are not suitable for all investors. Every investor who uses options should read and understand the publication Characteristics and Risks of Standardized Options. You can obtain a copy from the Chicago Board Options Exchange® (800-OPTIONS) or from your broker.

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Leverage Into A Margin World

WANT TO UPGRADE YOUR TRADER STATUS? PORTFOLIO MARGIN IS ONE WAY TO GO. BUT YOU'VE GOT TO EARN IT.

● PRO / TAKE AWAY: *Knowing synthetic equivalents is critical to understanding portfolio margin.*



COOL INFO:
To find out more about portfolio margin, go to tdameritrade.com. Then follow the path to tools & platforms > trader offerings > portfolio margin.

AP—Actual Position
SE—Synthetic Equivalent

AP	Long call
SE	Long stock + long put
AP	Short call
SE	Short stock + short put
AP	Short put
SE	Long stock + short call
AP	Long put
SE	Short stock + long call
AP	Long stock
SE	Long call + short put
AP	Short stock
SE	Short call + long put

• **WANT UP TO 10 times normal margin?** Portfolio margin might be your solution. But you have to qualify. Portfolio margin expands your leverage and enhances your trading capabilities. But it carries significant risk.

This article, first in a series of four, can help you understand what portfolio margin is and how it works.

FIRST UP: SYNTHETICS

Think of synthetics this way: You have a call, a put, and stock. Synthetics take any two of those to make the third. It kinda sounds like a parlor trick. So why is this important enough to have on the portfolio margin test?

You may have a position, like a vertical or

calendar, that has a particular risk profile. If one of the options is exercised or assigned—either early or at expiration—the resulting position can be a synthetic with a different risk profile. And knowing the synthetic equivalent position will help you understand the risk.

Before we get to how to quickly determine a synthetic equivalent, let's first get the lay of the land.

To be clear, the call or put in the actual position and the synthetic equivalent are at the same strike price and at the same expiration. A long 60-strike put has a synthetic equivalent that's **short** stock and long the 60-strike call.

With **American-style options**, if you have a **short call vertical** that's short the 70 call and long the 75 call, they can be exercised or assigned before expiration. Let's also say the stock price is \$74, and your short 70 call gets assigned. Overnight, the short 70 call disappears, and in the morning when you look at your account you'll find you're short 100 shares and long the 75 call, instead of having that nice short vertical. Yikes! But if you know synthetic equivalents, you can understand the risk of your new position.

Short stock, plus a long 75 call, is equivalent to a long 75 put. If you have enough capital in your account to cover the margin requirement of the short stock, and if it's not an IRA account (you can't short stock in an IRA), this position will act like a long put.

SO, WHAT'S THE TRICK?

In the synthetic equivalent position, the option will be long if the actual option is long, and short if the actual option is short. Likewise, if the synthetic equivalent position is bullish, the actual stock will be long. If the synthetic equivalent position is bearish, the actual stock position will be short.

So what's the synthetic equivalent of a long call? The call is long, so the synthetic equivalent will contain a long put. A long call is also bullish, so the synthetic equivalent will contain long stock. A long put plus long stock is synthetically equivalent to a long call.

Most likely you're not going to run into synthetics every day. But they're handy to know if you have **in the money** options that might be exercised or assigned. Knowing what they are can help you gain a better-than-average understanding of options.

—Words by THOMAS PRESTON

Use of portfolio margin involves unique and significant risks, including increased leverage, which increases the amount of potential loss, and shortened and stricter time frames for meeting deficiencies, which increase the risk of involuntary liquidation. Client, account, and position eligibility requirements exist and approval is not guaranteed. 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.

Short Option

PAGE 14

A high-risk, directional strategy in which an unhedged option is sold for a credit. The strategy assumes that the stock will stay above the strike sold if a put, or below the strike sold if a call. As time passes and/or volatility drops, the option can be bought back cheaper or expire worthless, resulting in a profit.

Spot Price

PAGE 26

The price where a security, commodity, or currency can be purchased or sold for immediate delivery.

Short Vertical

PAGE 14, 35

A defined-risk, directional spread strategy, composed of an equal number of short (sold) and long (bought) calls or puts in which the credit from the short strike is greater than the debit of the long strike, resulting in a net credit taken into the trader's account at the onset. Short call verticals are bearish while short put verticals are bullish. The risk in this strategy is typically limited to the difference between the strikes less the received credit. The trade is profitable when it can be closed at a debit for less than the credit received. Breakeven is calculated in a short put vertical by subtracting the credit received from the higher (short) put strike, or in the case of a short call vertical, adding the credit received to the lower (short) call strike.

CBOE Volatility Index

PAGE 11

The de facto market volatility index used to measure the implied volatility of S&P 500 index options. Otherwise known to the public as the "fear index," it is most often used to gauge the level of fear or complacency in a market over a specified period of time. Typically, as the VIX rises, option buying activity increases, and option premiums on the S&P 500 index increase as well. As the VIX declines, option buying activity decreases. The assumption is that greater option activity means the market is buying up hedges in anticipation of a correction. However, the market can move higher or lower, despite a rising VIX.

WHAT

I

LEARNED

NOT

TO DO

ALL RIGHT, WHAT DID 2016 TEACH ME ABOUT DIRECTION, TIME AND VOLATILITY? I'VE BEEN THINKING ABOUT THOSE SAME QUESTIONS IN MY HEAD AS I TAKE A LOOK.
WORDS BY MARK AMBROSIO
PHOTOGRAPH BY PHILIP BROWN



Delta

PAGE 18, 21, 27, 31

• A measure of an option's sensitivity to a \$1 change in the underlying asset. All else being equal, an option with a 0.50 delta (for example) would gain 50 cents per \$1 move up in the underlying. Long calls and short puts have positive (+) deltas, meaning they gain as the underlying gains in value. Long puts and short calls have negative (−) deltas, meaning they gain as the underlying drops in value.

American-Style Options

PAGE 35

An option contract that can be exercised at any time between when you purchase it and when the contract expires.

Call Spread

PAGE 23

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

Implied Volatility

PAGE 21, 31

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

Gamma

PAGE 18

A measure of what an option's delta is expected to change per \$1 move in the underlying.

In the Money (ITM)

PAGE 11, 23, 35

An option whose premium contains "real" value, i.e., not just time value. For calls, it's any strike lower than the price of the underlying equity. For puts, it's any strike that's higher.

Out of the Money (OTM)

PAGE 11, 18, 23

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.

Short

PAGE 35

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 is that if you believe the price of the asset will decline, you can "borrow" the stock from your broker at a certain price, and buy back ("cover") to close the position 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.

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 accounts are not protected by the Securities Investor Protection Corporation (SIPC). Futures and futures options trading services provided by TD Ameritrade Futures & Forex LLC. Trading privileges subject to review and approval. Not all clients will qualify.

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>).

*2017 Personal Predictions

- I'll have weekly options that expire sooner than the cottage cheese in my fridge.
- My mother still won't understand what I do for a living.
- I'll attempt to create an implied vol meme that will take the Internet by storm. It will fail.
- Janet Yellen will finally return my calls in the third quarter after she sees my number on her caller ID for the ten thousandth time.
- I'll trade to avoid uncomfortable social situations.
- The growth of my waistline will increase faster than the S&P 500.
- I'll take no more risk on any trade than I would eating undercooked chicken.
- The thinkorswim® platform by TD Ameritrade will have more upgrades than I have trips to the gym.
- I will mistakenly call my significant other "VIX" in intimate conversation.
- The frequency of my dog's tail wags when he's presented with a pork chop will be slower than the ticks in AES ahead of FOMC meetings.



SHIFT YOUR TRADING INTO HYPER-DRIVE.

Buckle your chin strap and get ready for cutting-edge insights and new strategies from pro speakers and fellow traders. No matter your skill level, this free event gives you everything you need to boost your trader know-how.

- Test-drive revolutionary trading platforms and learn new skills
- Get answers and insights from our TD Ameritrade platform experts
- Interact with industry visionary and veteran Tom Sosnoff, CEO of tastytrade[®],* Inc. and co-founder of thinkorswim[®]
- Bring a friend, because your friends are our friends



Visit tdameritrade.com/marketdrive to see the current schedule.

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