

HOW TO TRADE PRESIDENTS

AVOID THE NOISE
AND FOCUS ON
WHAT THE ELECTION
REALLY MEANS

PAGE 16





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COVER STORY

How To Trade Presidents

Everyone is talking about the elections. But to what end? The economy is going to do its thing no matter who's in office. What should traders be looking at? Same thing they always have.

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Covered Calls in the Fast Lane

As a trader, have you shunned the covered call, declaring it a dull convention of traditional investors? Laddering price, volatility, and time can bring life to an old jalopy that even a trader could love.

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Cover Photograph by
Fredrik Brodén

MISCELLANEOUS

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"Trying to predict economic growth based on who's sleeping in the White House isn't necessarily more certain than the S&P 500's annual growth."

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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
● SEASONED
● PRO

Elephant or Donkey?

• IF YOU DON'T KNOW which party plan you're joining this year, you're not alone. The headlines and media coverage on the spectacle that is this year's Presidential election are giving the most hardline Dems and Reps pause, and the most aggressive traders the willies. But look closer, and what you have is, well, a lot of noise. That's not to say the outcome won't be important, and you shouldn't be paying attention. It will be, and you should be—for many reasons. But for investors and traders, financial Armageddon is more than likely much further out than November.

What does this mean for you? What makes for good headlines are jabs between candidates, and the occasional punch at the political status quo. And since there is no shortage of that this year, we have the potential for increased volatility going into the election. What comes next is anyone's guess. But our cover story, "How to Trade Presidents" (page 16), attempts to reveal some useful truths about trading elections—particularly this one.

Now, if you're really interested in trading the election right up to the eleventh hour, you could consider weekly options that expire—as their name implies—in seven

days. Whether it's an event like an election, earnings, or the next Trump gaffe, you can speculate on the market's next direction, or simply form a cheap hedge for a couple days at a time until the coast is clear. In "Life Is Short—Stretch It with Weekly Options" on page 26, we'll break down these short-term firecrackers to help you make sense of what they can do and just how to trade them.

Of course, it wouldn't be a November election without an October Halloween coming first. So don't be surprised this year if you see some scary Trump/Hillary costumes at your doorstep. And they won't likely be 10-to 12-year olds, either. But regardless of age be sure to read our recommendations on page 38 for trick or treats that are sure to make a grown trader cry or a young child run to mommy. And if you find yourself laughing at these suggestions, you'll know you're as twisted as we are.

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



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Best in Show ... (To Our Inbox)

Look at the big picture, watch the sentiment, and if your bartender is telling you to go long, best to go short ;) —**Ned**

One thing about probability % is if you're 10 feet from your front door you have a higher probability of getting to it than from a mile away. —**Vinnie**

Oil closing in on \$50 a barrel. Somebody better get his swimmies ready for a jump into the Chicago River. —**Seth**

Theta beats dividends any day! —**Jai**

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Chat Room Pearls...

I swear, all traders are gone for the weekend and their toddlers got loose on their trading desk and hit the buy button!
—LISA

CHAT SWIMMER #1:
I don't know how to swim.
CHAT SWIMMER #2:
You're a thinker then.
CHAT SWIMMER #3:
Swim Lessons instructors provide good life jackets.

When is Janet Yellen scheduled as a guest on Swim Lessons?
—JIM

When I went to the eye doctor the other day she said, "Read that lower line." I said, "E S E S E S." I knew at that point that I needed a rest from trading :) Then she looked at my retina and saw a chart of /ES on my optic nerve.
—VINCE

Four days without trading and I'm getting withdrawal pains.
—VAL

Silver is a great paperweight.
—CHRIS

These new "easy to use" dividend alerts are great! I know SPY div date now (tattooed on my arm) but great for next time to remind me (in case I get complacent).
—ZAI

My old trading machine was named Phoenix, in honor of the mythical bird in hopes my portfolio would raise from the ashes.
—DUANE

CHAT SWIMMER #1:
I plot the daily SMA study on my intraday charts (it shows as a horizontal line). Can someone tell me how to plot the line on the chart for tomorrow's daily SMA value at close of trading today?
CHAT SWIMMER #2:
If we could do that, none of us would be here. We'd all be on our private island.

Friends, don't let friends sell naked calls.
—JAKE

The Internet gods are trying to limit your consumption of cat videos.
—GREG

GET CHATTING

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IN THE MONEY

A HODGEPODGE OF MARKET STUFF YOU SHOULD KNOW



• **HOLIDAY SEASON** IS approaching and even though there are only a few days when the markets are closed, traders often take time off around them. This can lead to lower holiday trading activity, which can mean larger swings in stocks.

The more active traders there are in the markets, the more buyers are available when an institution needs to sell a large block of stock, or sellers available when a big hedge fund wants to buy. More traders can also mean a higher possibility of executing buy and sell orders closer to a listed price. With fewer buyers, fewer people are willing to trade at prevailing prices, may only sell at higher prices, or may buy at lower prices.

A large buy order, then, might drive the price of a stock or future up dramatically. That's why trading around the holidays can be tricky. But you can get some practice dealing with lower trading activity before the holidays.

Overnight markets often have similar liquidity and price-movement issues as holiday activity. Why? Fewer traders at their screens means overnight markets can have larger price movements than you might see during regular trading hours. The difference is big moves in low-activity holiday markets can likewise happen during regular trading hours.

Grab your coffee, log in to the thinkorswim® platform by TD Ameritrade, and go to the



COOL INFO: To view overnight trading in the futures markets, go to the Charts tab on the thinkorswim platform by TD Ameritrade and view intraday futures charts.

CAPICHE • EASY

Will Vol Show Up to Party?

BIG IDEA: TRADING LOW VOLUME, HIGH VOLATILITY SWINGS DURING THE YEAR-END HOLIDAYS TAKES PRACTICE. WHY NOT START WITH OVERNIGHT MARKETS?



Chart page. Watch the prices of stocks and futures change overnight. The trades are often more sporadic and have bigger jumps in price compared to the more continuous stream of trades under cover of daylight. You don't have to trade overnight to see that it can be a bit trickier when the moon rises and werewolves are shorting.

Drawing some insights from overnight trading, keep three things in mind that can help you manage the holiday swarm:

1. Keep positions small. A good idea any time of year. But around the holidays, it can mean the difference between a small loss and a huge one. If a stock drops \$2, the loss on long 100 shares is five times smaller than 500 shares. And smaller orders can mean faster executions and lower slippage when holiday trading volume is lighter.

2. Define your risk. Yes, light volume can drive larger price moves. But that doesn't mean the profit/loss caused by such a move isn't real. Defining your risk—using verticals instead of **naked short options**, or **iron condors** instead of **short strangles**—can mean you enjoy that bloated holiday party feeling without worrying about the market.

3. Monitor implied vol.

The holiday drops in stock liquidity and trading activity are exacerbated in the options markets. So keep an eye on implied volatility for signs the market may anticipate less activity, which can

drive implied vol lower. If nothing happens, lower implied vol is justified, and no one is surprised. But if something shocks the market and it springs to life, implied vol around options can spike higher, while the bid/ask spreads widen out. Even if you think higher implied vol presents a trading opportunity, you might have to work limit orders in between wider bid/ask spreads to reduce slippage.

—Words by thinkMoney Editors

TRADER JARGON
TURN TO
PAGE 36



COOL TOOLS
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GEAR HEAD ● SEASONED

How to See Contango

BIG IDEA: WITH THE PRODUCT DEPTH TOOL, PICKING THE RIGHT STRATEGY JUST GOT A LITTLE EASIER FOR FUTURES TRADERS.

• How much do you want to pay now for a futures contract with a delivery date sometime in the future? It's got everything to do with supply and demand but the nice thing is you don't need to figure it out. Just click your mouse a couple of times on the thinkorswim® trading platform and *poof!* There it is. Using the Product Depth tool gives you the ability to analyze futures curves to determine if the futures you are looking at are in **contango** (upward sloping) or normal **backwardation** (downward sloping). You can also compare the current futures curve to any curve on any date in the past. Knowing this could give you professional level insight into how to trade a particular futures contract.



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

BACKWARDATION OR CONTANGO?
Here's how you figure it out.

1 – Click the Charts tab, choose Product Depth, enter a futures symbol in the symbol box, and click on the futures button.

2 – You'll see the current futures curve for the contract you picked. To compare this curve to a date in the past click on Curve and then Add Curve. By default, the curve includes all of the futures series, and you can filter this out under the series shown.

3 – Once you've added your comparison curve and adjusted your series to show only the dates that fall in line with the current curve, you can align the points of the curve with the lock time button.

4 – Now you can easily see if your futures curve is in contango or backwardation and if it was that way in the past.



Ask the Suit

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



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"Ex-floor traders talk about the markets but blend their perspective to the tools in our platform."

—NICOLE "THE SUIT" SHERROD
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customized platform demo with one of our trading specialists.

In the past year, we've had a few days of volatile market drawdowns. What's the best way to prepare for those?

In most cases, unless you have a magic crystal ball, you won't know when they are going to happen. Order entry is a pillar of successful trading and can be used as a tool to manage risk in your account. We offer a variety of order types you can use to effectively enter and exit positions such as stop, limit, and stop-limit orders. Once again the Learning Center and Swim Lessons can be valuable resources in learning how to incorporate effective order placement into your trading plan. But there will be times when you may have a pretty good idea that major volatility is about to happen. Take the Brexit vote for example. When the decision was imminent, a lot of our traders took off their stop orders and instead set alerts. Why? Sometimes market conditions call for you to examine what's going on at the moment before making a decision. If you had stop orders on for Brexit, you might have exited at a low only to find that the markets not only rebounded but headed up to peak levels. Options can also provide the ability to hedge your positions to eliminate some of your directional risk, particularly for those of you who primarily have long only portfolios.

And finally, one of my favorite ways to manage risk is by beta weighting. If you don't know what I'm talking about, be sure to check out our Learning Center video or the many articles in the *thinkMoney* archives on the topic.

TOYS FOR TRADERS

FROM THINKORSWIM®

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Every good chartist can eyeball an inverse head-and-shoulders pattern forming from a quarter-mile away, but we wanted to help everyone—not just the graphically gifted—recognize all pattern types. We introduced the ability to automatically show any or all of our 16 predefined patterns. You can add and edit the parameters of these patterns simultaneously or tinker with each one individually.

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INDUSTRY SPOTLIGHT • EASY

Options in IRAs: The Final Word

BIG IDEA: THE LONG-AWAITED VERDICT ON OPTIONS IN IRAS IS IN. NOW WHAT?



• **HEY, TRADERS!** Remember when the Department of Labor (DOL) wanted to ban the trading of options in their IRAs? Well, good news. They decided against it. Thanks to a flood of letters and all the ranting, they realized that banning trading options in IRAs wasn't in the best interest of investors. And for good reason. A big chunk of options are traded in IRAs. So imagine the impact that could have had on not only the retail investor, but also on the entire industry.

As a self-directed investor, your goal is to manage your assets, right? The traditional model of asset management—based on the idea that investing for retirement is synonymous with long-term and slow growth—is slowly becoming a thing of the past. With the markets as volatile as they are today, all it takes is a big down day for some to lose faith in a buy-and-hold approach. For many traders, options are

now an integral part of their strategy to potentially generate income and manage risk. If you feel like options may be right for you, you should learn about their potential benefits and risks before you consider adding them to your portfolio. And then there are the potential tax advantages of trading options in your IRA such as deferring taxes that your financial advisor can tell you about. All in all, the point is, you're looking out for yourself and protecting your portfolio.

LOOK BOTH WAYS

As with anything you trade, be sure to be aware of the benefits, risks, and limitations of trading options within an IRA before you get started. Then you'll have to get approval to trade options in your IRA. In a nutshell, you can't sell stocks short, you can't leverage using margin, and you can't sell naked calls or puts. So no short straddles or strangles. But what you can do, with the appropriate approval, is trade covered calls, write cash-secured puts, purchase calls or puts, and create certain spreads. This can provide you with enough flexibility to come up with some pretty creative op-

tions strategies in your IRA where you can still manage risk and potentially generate income.

So, rest assured that you can continue working on growing your nest egg. Even with the limitations on trading options in an IRA, there are several strategies that can be used. Think **iron condors**, **calendar spreads**, **credit spreads**, **debit spreads**... get creative.

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

ASK THE TRADER GUY

Q: Hey, Trader! If I want to increase my trading size in short verticals, is it better to do a larger quantity of verticals, or do the same quantity, but widen out the strikes?

A: This question gets to width versus quantity, and a short vertical's max risk. All else being equal, the advantage of doing, say, one vertical whose strikes are 2 points wide is that the commissions will be lower than doing two verticals whose strikes are 1 point wide. The disadvantage is that sometimes the credit you get for one 2-point vertical is not equal to the total credit from two 1-point verticals, assuming the 2-point and 1-point verticals share the same short strike. In other words, the 2-point vertical can have a larger potential loss than the two 1-point verticals. So you need to factor that against commissions saved.

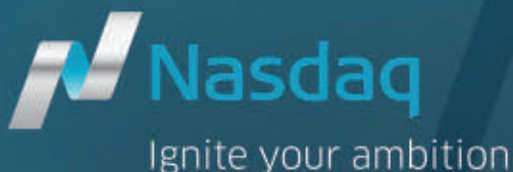
Q: I'm concerned about a massive power failure during trading hours. How can I keep on top of my positions and the markets if disaster strikes?

A: It's good to hear that you have your priorities straight in times of crisis. The most straightforward solution is a gas-powered generator that you can plug your computer into. But those can be a bit pricey. A more affordable option that doesn't rely on fossil fuels would be 10,000 gerbils in a turbine. Either way, it's smart to be prepared.

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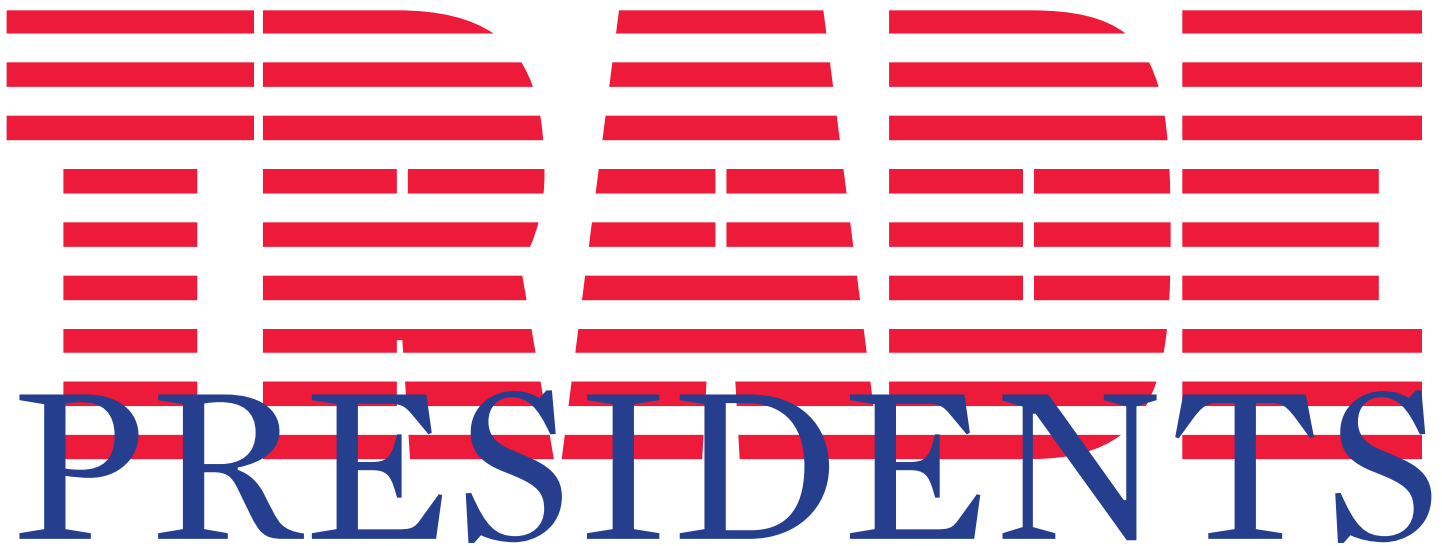
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HOW TO



PRESIDENTS

BIG IDEA: THE MARKET DOESN'T CARE WHO BECOMES PRESIDENT. THE PUNCHLINE OF AN ELECTION ISN'T WHAT A DEMOCRAT OR REPUBLICAN WILL DO ONCE IN OFFICE. IT'S WHAT YOU'LL TO DO PREPARE YOURSELF FOR EITHER SCENARIO. HERE ARE A FEW IDEAS.

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

● **EASY / TAKE AWAY:** *Everyone is talking about the elections. But savvy traders don't care about predictions—just results.*





UNLESS you've been hiding under a rock for the past year, you've probably heard, read, or participated in some heated discussions about the 2016 U.S. presidential elections. As an engaged trader or investor, you're naturally listening for cues about what the market might do in 2017.

People may argue up and down about policy, personality, and party, but markets are forward-looking and generally anticipate what might happen in the future. Washington is slow, while markets operate in real time. Just like traders. That's why we wanted to help you cut through some of the political noise and stay focused on your investment decisions and what really matters.

DATA MATTERS

Some people argue the Dems might be better for the market or the economy. Some argue it's the Republicans. So we wanted to take a look at the data to see if there is anything investors and traders could use from the two competing perspectives.

Since 1981, the average annual return (not including dividends) for the S&P 500 has been about 3.9% with a Republican in the Oval Office. When

a Democrat was president, the average annual return was about 12.8%. Wow! Seems like the S&P 500 loves Democrats.

Looking at a simple, average annual return, that's true. But does

that mean you should only buy stocks when a Democrat's in office?

Let's pose a second question: Why, in fact, does the S&P 500 have higher annual returns when a Democrat is in office? Over the past roughly 35 years, the market has seen some pretty big drops. After the 1987 crash, the S&P 500 rallied to end 1987 slightly higher.

And 2008 saw another big crash in the last quarter of the year—the final months of a Republican presidency. Now, you might argue that the Republican president was partly to blame for the crisis. But politics aside, who could have predicted with any certainty that the crash was coming? If it had happened a few months later when a Democrat was running things, the average annual returns under a Democrat would have dropped dramatically.

VISUALIZE A REPUBLI-CRAT

Historically, the standard deviation, or how spread apart prices are, for a series of annual returns indicates market volatility. When you look at the standard deviation of the S&P 500 annual returns since 1981, it's over 18% for Republicans and 12% for Democrats.

So, do the Dems really create less vol? Not so fast. Again, that difference in standard deviation would largely disappear if a catastrophic event happened a few months later.



Is there such a thing as the "Prez Spread"? No, but there is an iron condor. Learn more about spread-trading techniques in the *thinkMoney* archives at tickertape.tdameritrade.com, and search for the keywords "spread trading."



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In point of fact, the 2008 crash happened when it did. You can't change history. But be careful about assuming that under a Democratic president, the S&P 500 will have an annual return four times higher, and with lower vol, than a Republican administration. On the other hand, the S&P 500 has grown by a factor of 271 from 1981 to 2015, not including dividends. When a Democrat was in power during that time, it grew 185 times. So if you had only invested when a Democrat was running the show, you would have missed out on over 30% of the S&P 500's growth.

You could certainly run this sort of analysis over a longer time frame, and also factor in which party controls Congress, or any other interesting variable. But keep in mind that what happened in the past is no indication of what could happen in the future.

NOT WHO, WHAT

Perhaps the party that takes the White House isn't necessarily a great market indicator. But many assume one party would consistently have greater economic growth. Again, let's review the data.

U.S. gross domestic product (GDP) is a primary gauge of economic growth. Between 1981 and 2015, the U.S. GDP has grown about 5.31% annually. When a Republican was president during that period, the GDP grew on average about 5.87% annually. When a Democrat was president, it grew on average about 4.57% annually. Aha! So Republicans are better for the U.S. economy, right? Again, maybe not.

It's true that over the past 35 years, Republican administrations have seen higher GDP growth. But GDP has also seen some pretty big swings year to year. The GDP's standard deviation is a way to measure those swings. And under Republicans during that time, the GDP's standard deviation growth was 2.75%. Under Democrats, the GDP's

standard deviation growth was 0.75%. That could mean GDP growth during Republican administrations was more volatile—in other words, less predictable.

Like S&P 500 data, different time periods for GDP can yield different results. Also, Fed policy during those times could have been a bigger factor in GDP growth than, say, the presidency. So, trying to predict economic growth based on who's sleeping in the White House isn't necessarily more certain than the S&P 500's annual growth.

IT'S ALL IN THE VOL

Ultimately, taking a bullish or bearish market stance based on the outcome of an election might not be the soundest strategy. Overall, presidential elections often have little direct influence on all the things that can drive stocks higher or lower—earnings, interest rates, oil prices, the performance of the dollar, new technology, and so on. More to the point, Congress—which can change laws and strengthen or ease regulations—could in fact have a greater influence. But even there, the market might not interpret those changes in the way an investor might predict. So if presidents and political parties matter less than the market, what should you pay attention to?

Nothing's in stone. But in general, the market often cares about, and reacts to, the perceived uncertainty surrounding things like real economic data, the Fed, and earnings—not which way the market will go next. And that uncertainty gets expressed in the markets as **implied volatility**. The market, as you know, is in some sense a collective "opinion" of what might happen. So, if the market expects a particular administration to cause a lot of future uncertainty, implied vol will likely rise. If the market anticipates that a particular administration will "stay the course" without few surprises, implied vol will likely drop.

In the long run, it might be better to consider cues from the market (i.e., implied volatility) rather than from Washington. Traders and investors in general often don't care who gets elected (beyond personal preference). But they do care about what the market anticipates. If implied vol moves higher, option premiums tend to move higher, too, all other things being equal. And that can mean higher positive time decay for certain strategies.

GET PRACTICAL

Does all this mean you shouldn't keep an eye on Washington? Of course not. For example, is Congress going to vote on new regulations on fracking? Probably. In that case, take a look at the implied vol and/or prices of the stocks that have exposure to natural gas. That could be a potential trade opportunity.

How about a trade deal that increases technology exports? Take a look at the implied volatility for tech stocks and consider the following strategies that align with your inner charting genius. (See the Glossary on page 36 for more on these strategies.)

If implied vol is high:

- Bullish strategies = cash-secured short puts, short put verticals, and covered calls
- Bearish strategies = short call verticals
- Neutral strategies = iron condors (if you think a stock or index won't move either way)

If implied vol is low:

- Bullish strategies = long call verticals
- Bearish trades = long put verticals and long out-of-the-money put calendar spreads
- Neutral strategies = at-the-money calendar spreads

In a word, let implied vol help guide your strategy choice for the bullish, bearish, or neutral bias that you might get from the slugfest unfolding in our nation's capital.

WHEN IT COMES TO INVESTING, the reality is that politicians can have less impact on the market than they think they do. That's why it's less important to worry about which party will prevail, and more important to keep your eye on the market, because it's up to you—not Washington—to make informed trading decisions.

The cash secured put strategy risks purchasing the corresponding stock at the strike price when the market price of the stock will likely be lower. The 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 substantial stock price increase. For more on the risks of trading and options, see page 37, #1-2.

2017 WALL CALENDAR for Options Monkeys

WEDNESDAYS, FRIDAYS, MONDAYS, AND EVERY DAY IN BETWEEN: OPTIONS EXPIRATION COMES AT YOU FASTER THAN A FREIGHT TRAIN THESE DAYS. IT CAN BE HARD TO KEEP TRACK, BUT ALL THAT INFORMATION IS RIGHT HERE. JUST CAREFULLY PEEL THESE PAGES AWAY FROM THE STAPLES, PIN IT ABOVE YOUR DESKTOP, AND VOILA! YOU'RE READY TO ADD A LITTLE MONKEY LOVE INTO YOUR TRADING DAY.

LEGEND



Equity, index, and cash-settled currency options expire: Jan 20, Feb 17, March 17, April 21, May 19, June 16, July 21, Aug 18, Sept 15, Oct 20, Nov 17, Dec 15



Expiring equity and PM settled index options stop trading: Jan 20, Feb 17, March 17, April 21, May 19, June 16, July 21, Aug 18, Sept 15, Oct 20, Nov 17, Dec 15



Expiring cash-settled currency options stop trading at 12:00 pm: Jan 20, Feb 17, March 17, April 21, May 19, June 16, July 21, Aug 18, Sept 15, Oct 20, Nov 17, Dec 15



AM settled index options stop trading: Jan 19, Feb 16, March 16, April 20, May 18, June 15, July 20, Aug 17, Sept 14, Oct 19, Nov 16, Dec 14



VIX options expire: Jan 18, Feb 25, March 22, April 19, May 17, June 21, July 19, Aug 16, Sept 20, Oct 18, Nov 15, Dec 20



Quarterly options expire: March 31, June 30, Sept 29, Dec 29



Exchange takes day off: Jan 2, Jan 16, Feb 20, April 14, May 29, July 4, Sept 4, Nov 23, Dec 25

JANUARY

S	M	T	W	T	F	S
1		3	4	5	6	7
8	9	10	11	12	13	14
15		17	18	19	20	21
22	23	24	25	26	27	28
29	30	31	1	2	3	4
5	6	7	8	9	10	11

FEBRUARY

S	M	T	W	T	F	S
29	30	31	1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	21	22	23	24		
26	27	28	1	2	3	4
5	6	7	8	9	10	11

MAY

S	M	T	W	T	F	S
30	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31	1	2	3
4	5	6	7	8	9	10

JUNE

S	M	T	W	T	F	S
28	29	30	31	1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	22	23	24	
25	26	27	28	29		1
2	3	4	5	6	7	8

SEPTEMBER

S	M	T	W	T	F	S
27	28	29	30	31	1	2
3		5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	21	22	23	
24	25	26	27	28	30	
1	2	3	4	5	6	7

OCTOBER

S	M	T	W	T	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31	1	2	3	4
5	6	7	8	9	10	11

Word to the Wise: In a perfect world, all options would expire when you think they do. But when there's an exchange holiday on a normally scheduled options expiration, things can get a little wonky. For example, equity options normally expire each third Friday of the month. When there's an exchange holiday scheduled that day, expiration will be moved to the preceding Thursday. Confused? Just make sure you check this calendar!

MARCH

S	M	T	W	T	F	S
26	27	28	1	2	3	4
5	6	7	8	9	10	11
12	13	14	15			18
19	20	21		23	24	25
26	27	28	29	30		1
2	3	4	5	6	7	8

APRIL

S	M	T	W	T	F	S
26	27	28	29	30	31	1
2	3	4	5	5	6	7
9	10	11	12	13		15
16	17	18				22
23	24	25	26	27	28	29
30	1	2	3	4	5	6

January 18

Get invites out for Fed Party on Feb 1

February 14

Work up courage to confess undying love for the VIX

March 20

Wipe trading screen with spring's first dew for good luck

April 14

Panic when you realize you have the weekend to do taxes

JULY

S	M	T	W	T	F	S
25	26	27	28	29	30	1
2	3		5	5	6	7
9	10	11	12	13	14	15
16	17	18				22
23	24	25	26	27	28	29
30	31	1	2	3	4	5

AUGUST

S	M	T	W	T	F	S
30	31	1	2	3	4	5
6	7	8	9	10	11	12
13	14	15				19
20	21	22	23	24	25	26
27	28	29	30	31	1	2
3	4	5	6	7	8	9

May 1

Raise a glass to free markets on Int'l Workers Day

June 4

Order black out shades to keep sun from causing glare on trading screen

July 5

Practice creating orders with fingers burned by firecracker

August 16

Have moment of silence for whoever invented A/C

NOVEMBER

S	M	T	W	T	F	S
29	30	31	1	2	3	4
5	6	7	8	9	10	11
12	13	14				18
19	20	21	22		24	25
26	27	28	29	30	1	2
3	4	5	6	7	8	9

DECEMBER

S	M	T	W	T	F	S
26	27	28	29	30	1	2
3	4	5	6	7	8	9
10	11	12	13			16
17	18	19		21	22	23
24		26	27	28		30
31	1	2	3	4	5	6

September 7

Realize how quiet house is with kids in school

October 24

Start work on iron condor Halloween costume

November 23

Annoy Thanksgiving Day company by trading futures during dessert

December 31

Resolve to avoid early exercise in trading and at gym

COVERED CALLS IN THE FAST LANE

BIG IDEA: AS A TRADER, HAVE YOU SHUNNED THE COVERED CALL? DECLARED IT A DULL CONVENTION OF BUY-AND-HOLD INVESTORS? WHAT IF YOU COULD TAKE COVERED CALLS TO A NEW LEVEL? LADDERING PRICE, VOLATILITY, AND TIME CAN BRING LIFE TO AN OLD JALOPY THAT EVEN A TRADER COULD LOVE.

WORDS BY **THOMAS PRESTON**
PHOTOGRAPH BY GRAPHICDESIGNMACHINE



● SEASONED / TAKE AWAY: *To resuscitate a stodgy covered call strategy, look to collect more premium and diversify across vol and time.*

net when you have 200, 300, or more stock shares.

CLIMBING LADDERS

Laddering means selling covered calls at different strike prices, or expirations, or both—against more than 100 shares of long stock. For example, if you're long 300 shares of XYZ at \$75, laddered covered calls could be short one December 76 call, short one December 77 call, and short one December 78 call. That means you're short a total of three calls covered by the long 300 shares.

On the other hand, laddered covered calls could be short one 77 call in a December expiration, short one 77 call in a January expiration, and short one 77 call in a February expiration. Again, you're short a total of three calls covered by the long 300 shares.

Let's break down a few different ways to ladder the covered call.

LADDER ACROSS STRIKES

The first approach for ladderding covered calls means you sell them at different strike prices. Consider the basic properties of a covered call. A short call limits the upside profit potential of the long stock to the call's strike price. If you buy, say, XYZ at \$75 and sell the 77 strike call (for \$0.75), the long stock makes money when the stock's price goes up. But over \$77, the profits on the stock are offset by losses on the short 77 call when in exchange

\$77, but reduces the breakeven point for those 100 shares to \$74.25. Selling one 78 call for \$0.50 limits the profits on the final 100 shares up to \$78, but reduces the breakeven point for those shares to $\$75 - \$0.50 = \$74.50$.

To calculate the net effect of ladderding, take the averages. You sold three calls for a total \$2.50 credit. So, each call was sold for an average of \$0.833. The average breakeven point for the stock is $\$75 - \$0.833 = \$74.167$. And the average stock price above which the long 300 shares won't make money is \$77. In this example, ladderding across the 76, 77, and 78 calls took in a larger credit and created a lower breakeven point than just selling three 77 calls for \$0.75.

That won't always be the case, as the prices of OTM calls will vary with differences in the implied volatility skew. But ladderding lets you adjust the breakeven and max-profit point for a covered call strategy to match your outlook for the stock.

How? Are you more aggressively bullish? Ladderding to further OTM calls gives the covered call strategy more upside potential, but a higher breakeven point. Are you more concerned about the downside? Ladderding to calls closer to the money can reduce the stock's breakeven point, in exchange for less upside potential.

You could roll three calls at a single strike to a higher strike in the same, or different,

WHAT'S COOLER THAN LEASING your stock to someone while giving them the option to buy it at a higher price? Not much if you're a buy-and-hold investor. But if you're a trader, you probably already know that this is nothing more than a covered call—and that might put you to sleep at the wheel, if you're looking for excitement. So what makes covered calls—a combination of long stock and a short call—swerve left and get in the fast lane? Buckle up and let's find out.

Most U.S. equity options control 100 shares of stock, which is another way of saying that they deliver 100 shares at expiration. So, if you're short a call at its expiration and you're assigned, you have to deliver 100 shares of the underlying stock. This will happen if your short call is **in the money** (ITM), and in all likelihood, **at the money** (ATM) since a short contract can be assigned at any time regardless of its ITM or **out of the money** (OTM) amount. If you don't deliver 100 shares, you'll be short 100 shares of the stock the day after expiration—which may or may not be what you want.

In a covered call, the long stock leg is the hedge that offsets the delivery on the short call. If one short call is covered by long 100 stock shares, two short calls are covered by 200 stock shares.

So, having 100 stock shares means you can only sell one call, and that one call has to be at one strike and one expiration. But “ladderding” is a technique you can use to cast a wider

➤ 19 AUG 16	(52)	100	41.83% (+1.585)
➤ 16 SEP 16	(80)	100	38.67% (+1.824)
➤ 21 OCT 16	(115)	100	38.23% (+2.171)
➤ 18 NOV 16	(143)	100	38.64% (+2.455)
➤ 20 JAN 17	(206)	100	38.95% (+2.995)
➤ 17 FEB 17	(234)	100	38.37% (+3.151)
➤ 19 JAN 18	(570)	100	40.03% (+5.404)

FIGURE 1: Implied volatility at a glance. Select the Trade tab and you'll see the overall implied vol for the options contracts listed on the right-hand side. Source: thinkorswim by TD Ameritrade. For illustrative purposes only.

for limiting the stock's upside, the covered call reduces the stock's breakeven point by \$0.75 to \$74.25.

Ladderding the strikes of short calls adds more flexibility. Against 300 shares of XYZ, selling one 76 call for \$1.25 limits the profits on 100 shares up to \$76, but reduces the breakeven point for those 100 shares to \$73.75. Likewise, selling one 77 call for \$0.75 limits the profits on another 100 shares up to

expirations in one spread transaction. For example, buying three 77/78 call verticals could roll short three 77 calls to short three 78 calls. Rolling ladderded calls would involve more transactions, e.g., rolling the short 76 call, rolling the 77 call, and rolling the 78 call, which means additional execution risk and potentially higher commissions.

What's the downside? First, it can be harder to execute ladderded covered calls than to sell covered calls at the same strike. Unless you sell the calls at the bid price, you would be, in our example, working limit orders on three different calls. Further, you might not

get filled on all three at the prices you want. That's also true for buying the calls back, if you wish to do so. Second, the commissions may be higher when executing three separate orders versus a single order for three calls. And third, rolling and managing three calls at different strikes can be trickier than for three calls at one strike.

LADDERING ACROSS EXPIRATIONS

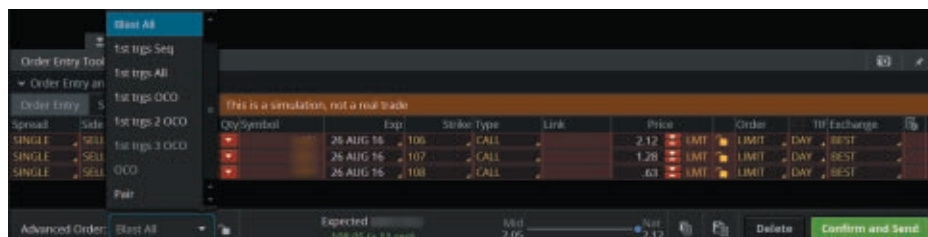
Another approach involves selling covered calls at different expirations, which can add an element of time to the covered call strategy and be useful when important events rise, such as earnings. Earnings can elevate the implied volatility of options in the expiration following the announcement because earnings uncertainty can make traders think a stock price might have bigger moves, which drives implied volatility higher. Look on the right-hand side of the Trade page of the thinkorswim® trading platform by TD Ameritrade to review implied vol.

For each expiration, there's a single, overall implied vol metric for the options in that expiration (Figure 1). If you see one expiration's implied vol is higher than the ones before it, there's a good chance earnings are expected shortly before that expiration.

All things being equal, when implied vol is higher, an option's price is often higher, too. The same goes for longer time to expiration. Laddering covered calls across expirations can mean you're capturing higher premiums because of higher volatility around earnings, as well as higher premiums because of more days to expiration.

Why wouldn't you just sell the covered calls in that expiration if the implied vol is higher? Because you're risking the stock having a large move from that earnings event, which will affect your covered calls adversely.

Think about laddering across expirations to diversify around the event. Let's say XYZ (still at \$75) has earnings just before a January expiration. Laddering covered calls against 300 shares of XYZ might be selling one December 76 call, selling one January 77 call, and selling one February 78 call. The premium you get for selling the calls in the January and February expirations is higher for two reasons. One, you have more days to expiration over the December ones. Two,



BLAST ALL ORDER

- Locate the “Blast All” order type in the Advanced Order section of the Trade page. Click on “Single Order,” then choose “Blast All.” Once selected, you can click the bid prices of different calls to create laddered covered calls, or the bid prices of puts to create laddered puts.

When you send the Blast All order, each option is sent as an individual order and treated individually by the exchange. That's why one order of the Blast All might get filled, but another might not.

you have increased implied vol in the January options because of the earnings.

Additionally, laddering across expirations is a way to balance short calls that have higher positive time decay (the ones at the nearest expiration) with those that have more time premium (the ones at further expirations).

What's the downside? In addition to the execution risk, potential higher commissions, and management issues, another risk of laddering across expirations is that you have to hold until the expiration of the furthest short call, unless you close the position by buying the short call back and selling the stock. You could choose to maintain your long position. Either way, the extra time you'd hold the stock can increase the risk of the stock dropping sharply below the breakeven point.

IF LADDERING SOUNDS GOOD, but you're trying to wrap your head around how to get all those trades executed at the same time, thinkorswim has a tool that lets you send orders for laddered options simultaneously—the “Blast All” order type (see the sidebar).

Ultimately, laddering means using the same old strategies like a covered call with more flexibility. That's why the fast lane could turn out to be a pretty familiar road.

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. 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 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.)

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

LIFE IS SHORT—

STRETCH IT

WITH WEEKLY OPTIONS

BIG IDEA: WEEKLY OPTIONS ARE EXACTLY WHAT YOU THINK. THEY MOVE QUICKLY AND LIVE FOR ABOUT A WEEK. CURIOUS ABOUT THE WHAT, WHY, AND HOW OF TRADING THEM? READ ON.

● **PRO / TAKE AWAY:** *Increase the flexibility of existing options strategies with weeklys.*



WORDS BY **THOMAS PRESTON** PHOTOGRAPHS BY **MAXWELL BRODÉN**

IN JUST A DECADE, it seems weekly options have become one of the most actively traded products out there. Introduced in 2005 by the CBOE for S&P 500 options as “SPX Weeklys,” the number of stocks and exchange-traded funds (ETFs) with weekly options has since expanded dramatically.

At first, weekly options were listed by the exchange on Thursdays, a week before the following Friday, so they’d have a full week of trading days. Now, some stocks have options that expire at the end of each week going out several months. That’s financial innovation in action. The exception is when the following Friday is the expiration of the “regular” options—generally the third Friday of the month.

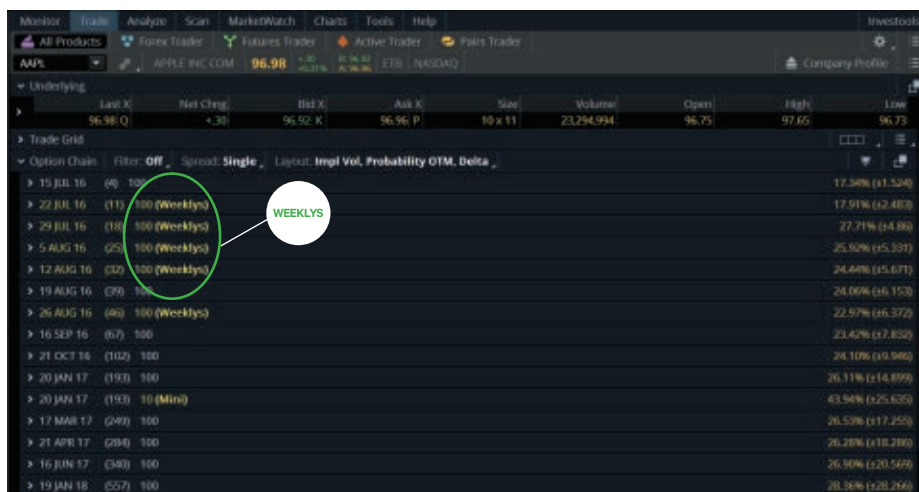


FIGURE 1: Weekly options available for trading. Can't miss 'em. They're listed on your screen as soon as they're available for trading.
Source: thinkorswim by TD Ameritrade. For illustrative purposes only.



FIGURE 2: Delta, gamma, theta. These greeks values are different in a weekly option with fewer days to expiration than one with more days to expiration.
Source: thinkorswim by TD Ameritrade. For illustrative purposes only.

You can see the weekly options a stock, index, or ETF might have under the Trade tab of the thinkorswim® platform by TD Ameritrade. Type in the stock symbol and look for the weekly expirations in the Option Chain. You'll see the word “Weeklys” on the left-hand side (Figure 1).

SO WHY TRADE WEEKLYS?

Consider options that have a few days to expiration. When the number of days drops, and the option price also drops the option's **theta** and **gamma** will change.

As you can see in Figure 2, on the Trade page of thinkorswim, the prices of options with five days to expiration are lower than the options at the same strike with 33 days left. Also, the gamma of the weekly option with five days to expiration is larger than the gamma of the weekly option at the same strike price with 33 days. (Remember, gamma is how much the **delta** of an option changes when the underlying stock moves up or down \$1.)

What's the real impact of all this?

Look at the deltas of the 97.5 call and 98.5 call in the options with five and 33 days to expiration (DTE). If the stock price moves up \$1, you could estimate that the 98.5 call could have the delta of the 97.5 call. In the five DTE calls, the 97.5 call has a 0.57 delta, and the 98.5 call has a 0.40 delta. That's a 0.17 difference (just what the gamma suggests). In the 33 DTE calls, the 97.5 call has a 0.54 delta, and the 98.5 call has a 0.47 delta. That's only a 0.07 difference. This means the delta of the five DTE call is

more sensitive to a change in the stock price. So, if you're making a short-term speculation that the stock's price might go up, the call with fewer DTE could respond to that rally more strongly than the call with more DTE. In other words, it's a more aggressive bet.

In exchange for that high gamma, take a look at the theta (time decay). The theta of the option with five DTE is more than twice the theta of the option with 33 DTE. That means each day the stock doesn't move the way you want it to, it'll cost that option with fewer DTE a lot more in decay.

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HOW TO TRADE 'EM

Earnings trade. The first possible use of weekly options with fewer DTE is as a market-neutral trade ahead of an earnings announcement. A weekly option's high theta (time decay) with fewer DTE, which can work against a trader buying that option, can work in favor of a trader who's selling that option short. Of course, with fewer DTE, an option's price is lower than an option with more DTE, all things being equal. But that option's **implied volatility** could be higher ahead of an earnings announcement. That higher implied vol can push up the weekly option's price.

Rather than make a bullish or bearish speculation on a stock price after earnings, consider a neutral strategy, like a **short strangle** (short out-of-the-money put and short out-of-the-money call) in weekly options that expire just past the announcement. The short strangle could take advantage of higher option prices and theta, and is a speculation that the stock's price won't move below the short put's strike, or above the short call's strike.

On the other hand, a short strangle has unlimited risk regardless of which way the stock ends up moving, and you may not want to take that risk ahead of a big announcement. Along with high positive theta, a short strangle's high negative gamma means the position's delta risk could grow quickly if the stock either rallies or drops. But don't give up on the weekly option just yet.

if the stock either rallies or drops. But don't give up on the weekly option just yet.

Instead of using a naked short strangle, you could consider an **iron condor** in the weekly options. The iron condor has defined risk, but still has positive time decay, and is a speculation that the stock price will

stay between the options' strike prices, just like the short strangle.

Say XYZ is at \$75 and has an earnings announcement three days out on the upcoming Friday. You think it might not move below \$72 or above \$78. Here, a short strangle with undefined risk would be short the 72 put and short the 78 call in the weekly options that expire that same Friday. But a defined-risk iron condor would be long the 70 put, short the 72 put, short the 78 call, and long the 80 call in the weeklys. If you sold the iron condor for an \$0.80 credit, its max risk would be \$120, and would occur if XYZ either went below \$70 or above \$80 at the options' expiration.

Short-term protection. A second possible application of weekly options is a short-term hedge—think buying a put to hedge long stock—against upcoming news. Here, buying a weekly option with an expiration just after the news takes advantage of a lower price and higher gamma.

Look again at the options in Figure 2. You might estimate that the 97.5 put will have a price close to the current price of the 98.5 put if the stock drops \$1. Let's say you bought the 97.5 put with 33 DTE for \$2.05. Then news came out, the stock dropped \$1, and the 97.5 put was worth \$2.53 (the current price of the 98.5 put with 33 DTE). That's about a 23% increase.

But now let's assume you bought the 97.5 put with five DTE for \$0.69, the stock fell \$1, and the 97.5 put was worth \$1.17 (the listed price of the 98.5 put). That's a 69.5% increase. If you're protecting long shares of stock against a price drop, the weekly with fewer DTE may have a larger percent increase for a given investment in the hedge. The downside, of course, is that time decay is working against the long put with five DTE. And if the stock doesn't drop in five days, your hedge could expire worthless, and you'd have to buy another put in the next weekly, or further expiration. That drives up costs and commissions. But weekly options can be effective short-term hedges.

Trading time, not direction. A third application is a long **calendar spread**, where you're shorting a weekly option with fewer DTE, and buying an option at a further expiration at the same strike. The speculation is that the stock price will be close to the strike

price of the calendar spread at the expiration of the short option, where the long calendar can maximize its profit. The max risk of a long calendar is the debit paid.

Selling a weekly option as part of a long calendar takes advantage of potentially higher positive time decay than an option with more DTE. Now, you can see that the actual premium you're selling that weekly option for is lower than an option with more DTE. But here's where the weekly options that have more than seven DTE come in handy when they're available. Because time decay isn't linear—it gets higher faster as expiration approaches—you could choose one of the weekly options that might not have the highest time decay, but has a higher premium.

Because rolling the short option is a key part of the long calendar strategy, there could be a lot more rolling of trades with weekly options. Yes, that can increase the total potential credit from the rolls. But it could also increase commissions.

The bottom line? Weekly options have a short life span that can bring flexibility to your existing strategies.



HOW TO Find Weeklys

If you don't see weekly options listed in the Option Chain under the Trade tab of thinkorswim, try the following:

1. Click on the gear icon in the upper right-hand corner of the software and select Application Settings from the drop-down menu.

2. Click on Display from the menu choice in Application Settings. Make sure that "Non-standard Option Types: Weeklys and Quarterly" is checked.

3. Click on the Apply Settings button.

Look on the Market Watch tab for a list of symbols that have weekly options. The "Weeklys" list is under the "Public" watchlists.

Disclaimer: 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.

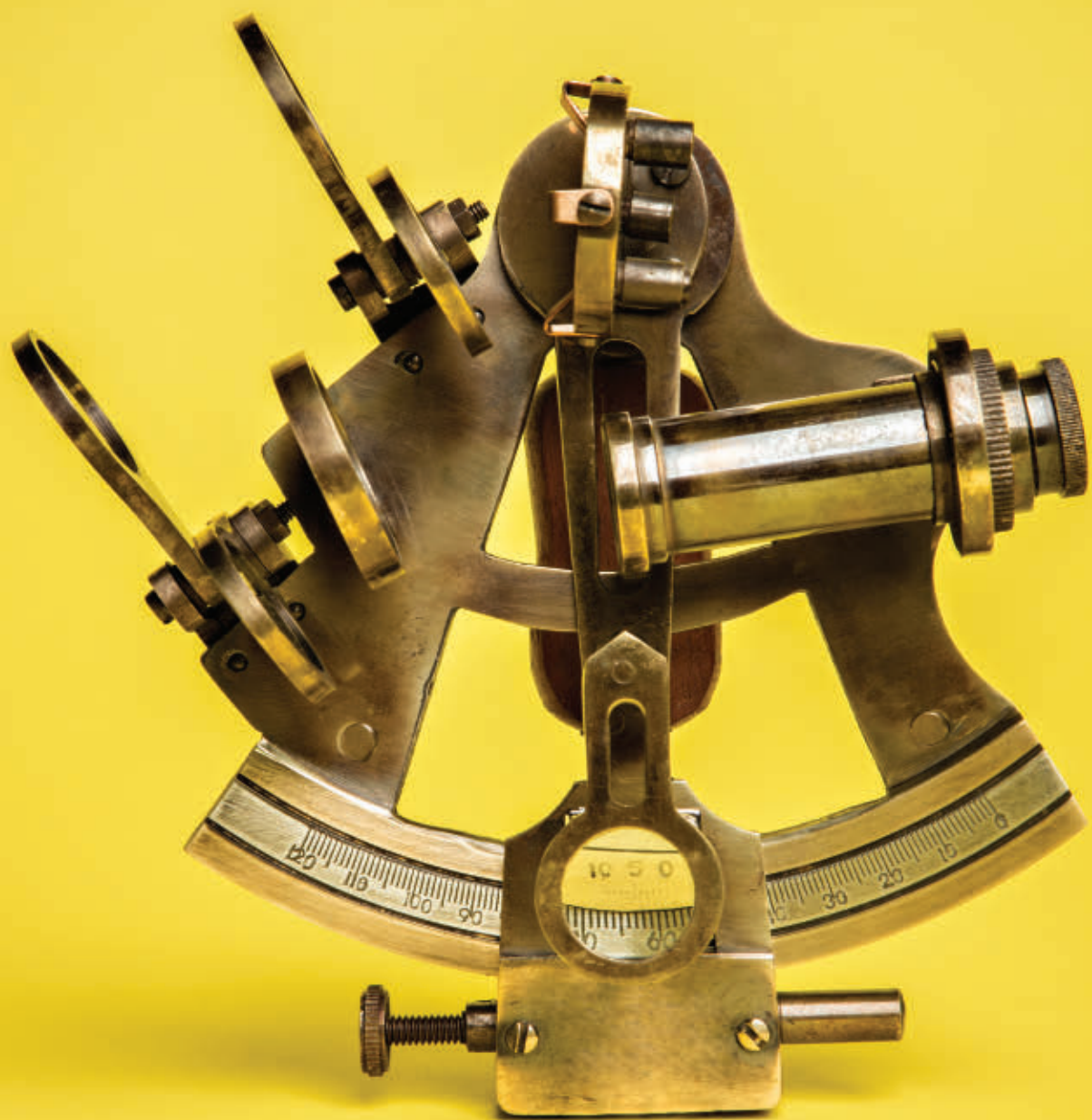
Tom Preston is not a representative of TD Ameritrade, Inc. The material, views and opinions expressed in this article are solely those of the author and may not be reflective of those held by TD Ameritrade, Inc.

Naked option strategies involve the highest amount of risk and are only appropriate for traders with the highest risk tolerance. For more information on the risks of trading and options, see page 37, #1-2.

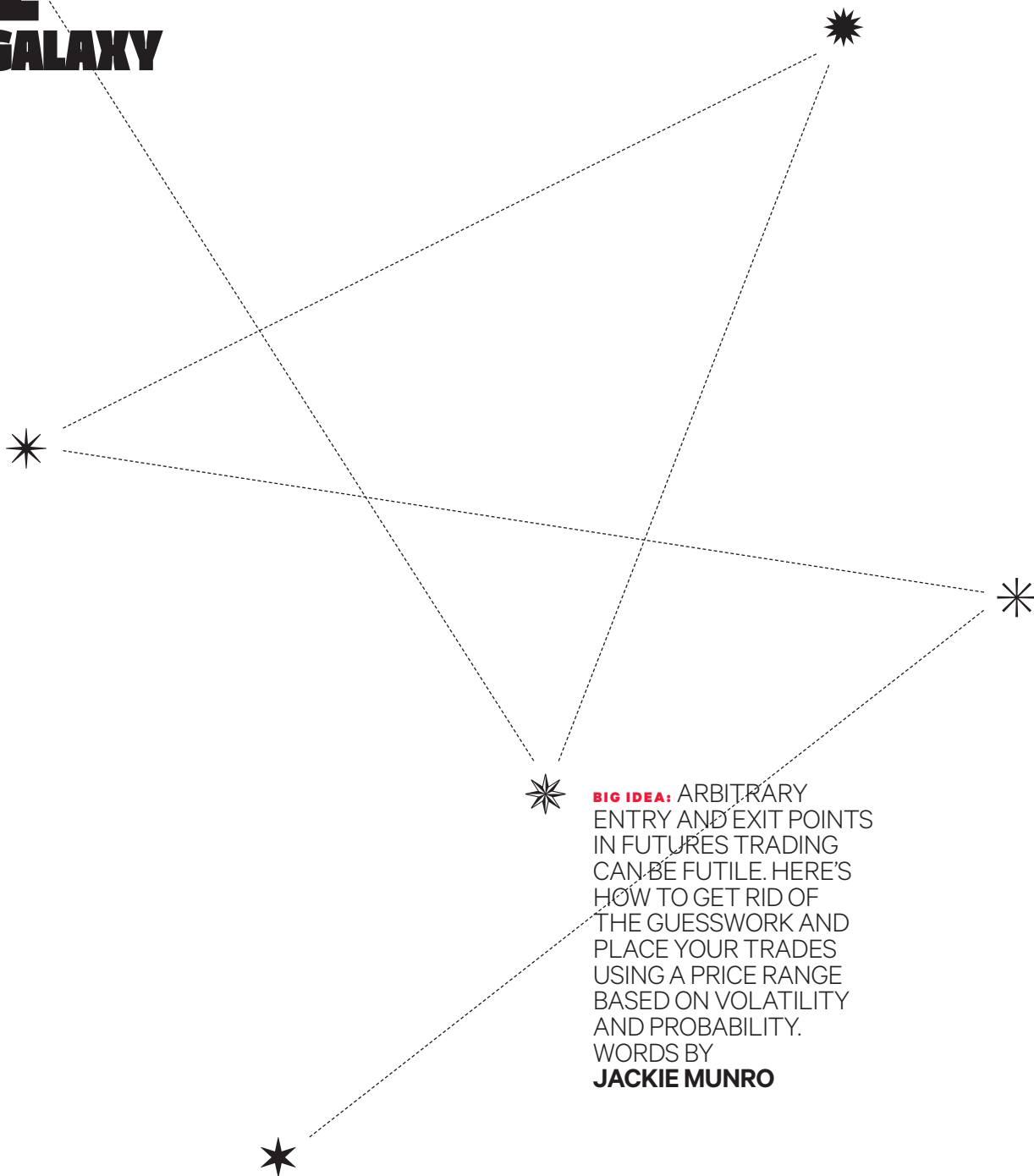


COOL INFO:

Wanna know more about these shorter-term contracts? With SPX weeklys expiring on Fridays, Wednesdays, and now Mondays, it brings more choices to the table. To find available Weeklys go to www.cboe.com/micro/weeklys/availableweeklys.aspx. Catch a replay of the Using Weekly Options During Earnings Events webcast at tdameritrade.com/learn.



FUTURES SCALPER'S GUIDE TO THE GALAXY



BIG IDEA: ARBITRARY
ENTRY AND EXIT POINTS
IN FUTURES TRADING
CAN BE FUTILE. HERE'S
HOW TO GET RID OF
THE GUESSWORK AND
PLACE YOUR TRADES
USING A PRICE RANGE
BASED ON VOLATILITY
AND PROBABILITY.
WORDS BY
JACKIE MUNRO

PHOTOGRAPH BY FREDRIK BRODÉN

● SEASONED / **TAKE AWAY:** Turn your gut feelings into hard numbers. Then do a little exploring.

If you're going to scalp futures—meaning, try to profit from very small movements—you want to find the times when products are moving fast so you can move in and out quickly and close positions before retiring for the day. And that's easier said than done. Some days may be great scalping days, with a lot of market whip. Others may be quieter with less movement. You could decide to limit your scalping to traditionally liquid products such as crude oil (/CL), S&P futures (/ES), the euro (/6E), bonds (/ZB), and notes (/ZN). But even in these products, at different times you'll find different levels of liquidity.

HOME IN ON THE EXTRA-TERRESTRIAL RANGE

In the strange world of futures trading, it's all about the price range. You're better off not chasing a market that's moving in a clear up or down direction. That would be tough to scalp. You want to look for two-way action. In other words, you want a market that's moving in a trading range.

In some ways, it's a no-brainer—products with larger daily price ranges are going to be better scalping candidates. If you keep your trades within that price range, you'll be able to better manage risk. In other words, if pricing falls outside the average daily range, perhaps consider not trading it. Look elsewhere for better possible choices.

Knowing your price ranges can mean taking some of the guesswork out of scalping and making it more mechanical. But figuring out price ranges could also involve complex math. It can be a lot more sophisticated than merely looking at past data to determine the average intraday range. Let's see what's involved.

LET PROBABILITY BE YOUR GRAVITY

Say you want to trade the /ES. Assume there's a 50% chance they could go up or down. Your gut instinct suggests they're going down, so you want to sell them on the close. But they could also go back up. Do you place your trades on what your instinct says, or do you consider the probability of /ES going down before deciding?

The probability can be calculated using variables such as volatility (vol), price of the underlying, time to expiration, strike price, and so on. As a scalper, your best bet is to identify a likely price range based on current vol and use that to set profit and stop loss targets.

Think about trading futures based on expectations regarding vol and probability. That may feel daunting and out of reach. But if you don't want to spend time calculating probabilities and trying to spot likely price ranges, one option is to use the probability analysis tool in the thinkorswim® platform from TD Ameritrade. It's visual, clear, and promises to text you photos of your favorite planets three galaxies out.

For example, say you start your trading day and for whatever reason, /CL is up. You look at the day's vol, and see it's at 37%. You

know that /CL is extremely liquid, which may make it a scalping candidate. Further, the high vol might already give you a clue that the day's trading range could be wide. Going further, say /CL is trading at \$49. How should you trade it? What's your entry point, profit target, and where will you place stops?

Pull up the probability analysis from the Analyze tab in thinkorswim to see the probability cone (Figure 1). This probability is calculated using the underlying's current price, strike price, implied vol, and time to expiration. The calculations are all done for you in a way that's easy to interpret.

The probability cone shows the price range for future dates within ± 1 standard deviation by default. This means 68% of the time, the price of the underlying will be within the price range shown on the cone. If desired, you can change the settings to ± 2 or ± 3 standard deviations. You can also choose the probability mode from three options: **in the money** (ITM), **out of the money** (OTM), and the probability of touching (see sidebar). That's about as complicated as it gets.

Here's how it works. The upper and lower boundaries of the probability cone show a theoretical price range over time. Time is displayed along the bottom, with prices along the left side of the chart. Say you look at a specific contract expiration date and see that 68% of the time (one standard deviation), under the probability of expiring OTM, the price range will be 40.87 to 57.33. That's quite a range, and maybe you don't want to trade such a wide range. Don't worry: there's more.

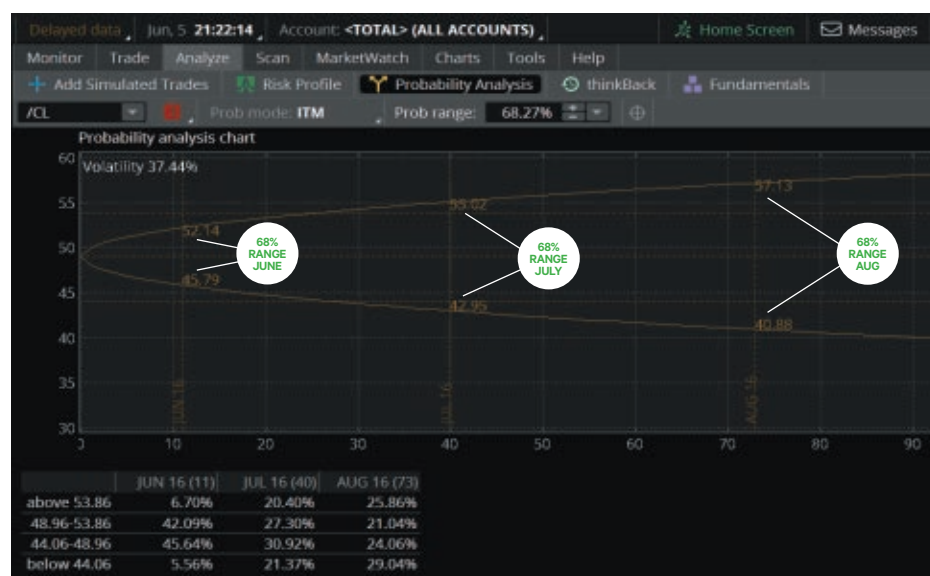


FIGURE 1: Determining probability. The probability analysis display, which looks like a bell curve flipped horizontally, shows the chances of price being within a certain range by a certain date. Source: thinkorswim by TD Ameritrade. For illustrative purposes only. Past performance is no guarantee of future results.

Hover your mouse over the chart and you'll see gray crosshairs that display a percentage above and below. At that price on that specific date, the percentage above the crosshairs tells you the probability of a price being above the price you're seeing, and the percentage below the crosshairs tells you the probability of price being below the price you're seeing. You can position the crosshairs at a specific point of your choosing.

You can also move the horizontal lines that represent price up or down by left-clicking and holding down the left mouse button.

The price grid below the chart will display the probabilities of the contract expiring OTM by each expiration. You can change things to view the probability of ITM, or the probability of touching. Play around with it.

The ability to view these probabilities could bring a new perspective to your trading. And the best thing? There's no guesswork. It's like a three-headed alien creature arrived with maps 100 light-years out. Super helpful.

Your best chance is to enter at a price that has a higher probability of occurring, and set your stops at a price with a lower probability. There are different ways to use this information. You may be able to see if you're better off being long or short crude oil based on where price is, with respect to the price range on the probability cone. If you like to trade off of price charts, you can look for things like support and resistance levels, or pivot points, and see where those price levels fall within your probability cone.

Say you pull up a long-term chart of /CL and you discover a clear resistance level at 50. From the probability cone, you notice that the likelihood of /CL moving above 50 is low. Say /CL is trading just below 50. Put the two together—that'll help you decide which direction to trade /CL.

POSTSCRIPT FOR OPTIONS TRADERS

If you've never traded futures, but you trade equity options, and you think you have what it takes, cool. Just make sure you understand some important differences between the two just so you're aware.

First, a futures contract buyer is taking on the obligation to purchase the underlying

Probability-Speak in thinkorswim

1

Probability of ITM:

The chance the price of the underlying will be above the strike price for calls, at expiration. For puts, it's the chance the price of the underlying will be below the strike price at expiration.

2

Probability of OTM:

The chance the price of underlying will be below the strike price for calls, and above the strike price for puts, at expiration.

3

Probability of touching:

The chance of the underlying touching the strike price of your contract between the current time and expiration. The probability cone when viewed in probability-of-touching mode will be wider than the probability of ITM or OTM.



TAKE ACTION:

For more on the probability analysis tool in thinkorswim, view the tutorial in the thinkorswim Learning Center at tlc.thinkorswim.com.

asset, whereas an options owner has the right, but not the obligation, to purchase (call option) or sell (put option) the underlying. But if you put the two together—that is, own an option on a futures contract—you have the right, but not the obligation, to purchase or

sell a futures contract.

Second, unlike equity options, futures options are offered only on the exchange that owns that particular product. This may affect things like volume and the bid-ask spread of the options.

Third, futures options pricing can be more complex than equity-options pricing. That's because the pricing is based off the spot or cash price by the cost of holding that spot until expiration. Futures options are priced off the future that corresponds to that option's expiration and delivers that specific futures contract. Futures prices are non-standard and have larger notional values. The multiplier likewise varies among the different contracts, and it's not always multiplied by 100, as with equity options.

For example, an E-mini S&P 500 Index Futures (/ES) contract unit is \$50 per point and trades in quarter ticks (\$12.50), and a Light Sweet Crude Oil Futures contract (/CL) contract consists of 1,000 barrels, meaning a \$0.01 move equates to a \$10.00 move. For the Euro FX Futures Contract, it's 125,000 euros per contract, trading in \$0.00005 increments (\$6.25/contract). No doubt, these are large products. But don't let that scare you. Trading options on these big contracts could reduce your cash outlay.

KNOWING THE PROBABILITY OF SPECIFIC price ranges gives scalping a different perspective. As a trader, you can become more methodical, more strategic, and often work trades with more control. Ranges help you say goodbye to arbitrary entry and exit points (unless you like those funky black holes). You now have a smarter way to travel the galaxies and touch the future.

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

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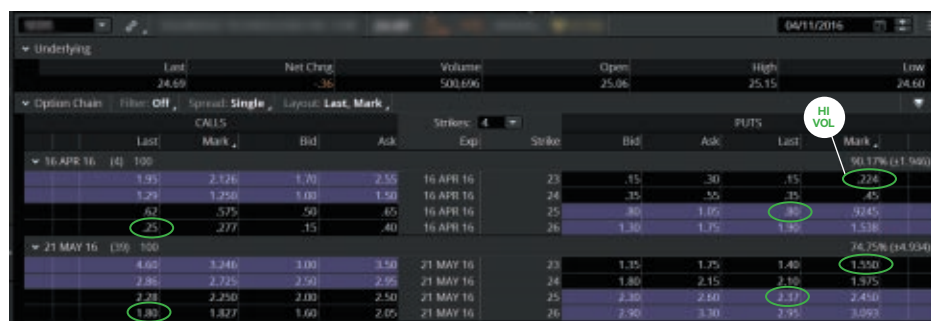
1. Morningstar as of 6/27/16, based on 64 US-domiciled single country ETFs and 41 individual country exposures. Visit www.iShares.com or www.BlackRock.com to view a prospectus, which includes investment objectives, risks, fees, expenses and other information that you should read and consider carefully before investing. Investing involves risk, including possible loss of principal.

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High Vol Doesn't Mean High Prices

DON'T IGNORE THE VARIABLES. DIG DEEP INTO IMPLIED VOLATILITY TO SEE WHAT ELSE IS GOING ON BEFORE YOU DECIDE TO SELL.

● PRO / TAKE AWAY: The amount of time left on a contract can have a substantial impact on price.



• HERE'S A LITTLE DIRT on volatility ("vol"). Just as love can be blind, so can friendship with this invisible force. It can pull a fast one, leaving you helpless, miserable, and eating dinner alone.

As options traders, we focus a lot on **implied volatility (IV)**. That's because, all other things aside, higher vol means higher options prices. So when vol is high, we may look at short option strategies that take advantage of higher option prices, such as **short naked options** and **short vertical spreads**. But in practice, it's not enough to look at high vol and execute the strategy.

LOOKS CAN BE DECEIVING

Take a look at Figure 1. Options with four days to expiration had a vol of 90.17%—enough to make premium sellers salivate. But before you rush to judgment, take a look at the options in the next expiration. The contracts with 39 days to expiration had vol of 74.75%—not exactly low, but certainly less than 90.17%.

Now look at the prices of the out-of-the-money (OTM) calls and puts. The contracts with fewer days to expiration had lower prices than those with more days to expiration, even though the IV of contracts that were close to expiration was higher.

WHAT GIVES?

Remember that vol is one input into an option pricing model that makes the theoretical price of the option equal to its market price. It's related to an option's **vega**, or how much its price changes when IV changes one percentage point.

Here's what happens: the vol calculation indirectly incorporates the option's vega to see what the vol input into the model needs to be to make the theoretical ("theo") option price equal to its market price. If the theo price needs to be a little higher to match the market price, the vol calculation bumps the vol input up a little if the option's vega is high. This small increase in vol translates into a proportional small increase

in the option's price through the high vega. If the option's vega is low, the vol calculation needs to bump up the vol input more for the option's price to increase by that amount.

But vega isn't constant. It's different across strikes and expirations over time. All other things equal, an option with more days to expiration will have a higher vega than an option with fewer days to expiration. If the theo price is lower than the current market

value of the option, the vol increases by a larger amount to make the theo value equal to the market price when the option's vega is low. In other words, lower vega requires a larger change in vol input and higher vega requires a

smaller change in vol input to move the theo option price a given amount.

This is why you can see some really high vol numbers for OTM options close to expiration. That's when an option's vega is lowest—close to expiration and far OTM. An OTM option that's close to expiration may have a low market price, say 0.01 or 0.02. But using a vol of the **at-the-money (ATM)** option, for example, might make the theo value of that OTM option worth less than 0.01. So, because the OTM option's vega is so low, the IV calculation has to increase the vol input much higher than the ATM vol to give that OTM option a theo value of 0.01.

If your strategy involves selling options that have a high IV, you might find the highest vols for OTM options close to expiration. But if you sell them, the credit you can get might not even cover the commission expense, which would make it impossible to make money on the trade.

Don't let high IV fool you into thinking you can make a quick buck. You may consider vol your friend. But vol's larger circle of friends may include ones you don't know so well, like vega. —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 information on the risks of trading and options, see page 37, #1-2.

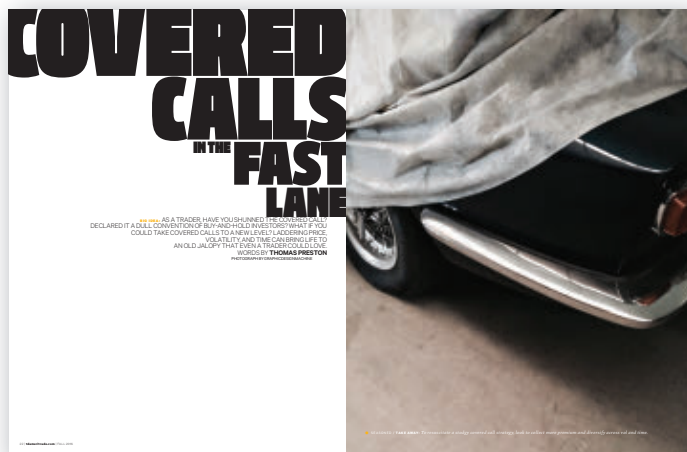
FIGURE 1:
It's not all about vol.
How much time is left
on the contract can
determine price.

Source: thinkorswim® from TD Ameritrade. For illustrative purposes only.



COOL TOOLS

The Trade page can be configured to display the implied vol for each option in addition to its current price.



Implied volatility

PAGE 19, 24, 29, 35

• 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 in percent (such as 25%), is forward-looking, and can change.

Short Naked Options

PAGE 12, 35

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.

Short Straddle/Strangle

PAGE 12, 29

A market-neutral strategy with unlimited risk, composed of an equal number of short calls and puts of the same strike price (straddle) or 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 of either strategy at expiration is calculated by adding the total credit received to the call strike and subtracting the total credit received from the put strike.

Short Vertical Spreads

PAGE 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.

Credit Spread

PAGE 14

A spread strategy that increases the account's cash balance when established. A bull spread with puts and a bear spread with calls are examples of credit spreads.

Debit Spread

PAGE 14

A spread strategy that decreases the account's cash value when established. A bull spread with calls and a bear spread with puts are examples of debit spreads.

In the Money (ITM)

PAGE 24, 32

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 24, 32

An option whose premium consists of all "time" value, and 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 (ATM)

PAGE 24, 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.

Iron Condor

PAGE 12, 14, 29

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.

Theta

PAGE 28

A measure of an option's sensitivity to time passing one calendar day. For example, if a long put has a theta of -.02, the option premium will decrease by \$.2.

Calendar Spread

PAGE 14, 29

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.

Vega

PAGE 35

A measure of an option's sensitivity to a one percentage point change in implied volatility. For example, if a long option has a vega of .04, a 1% increase in implied volatility will increase the option premium by \$.4.

Gamma

PAGE 28

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

Delta

PAGE 28

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.

Contango

PAGE 12

When the price of the further expiration futures contracts is higher than nearer expiration futures contracts.

Backwardation

PAGE 12

When the price of the further expiration futures contracts is lower than the price of the nearer expiration futures contracts

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>).

Trader's Guide to Last-Minute Halloween Treats

• Forget the bowls of candy for the kiddos. Leave that to those on your block who have time to go to the store and don't have to watch /ES moving 20 handles and /ZB crashing. But hey, traders love Halloween, too. So, in lieu of candy, here are some treats (and one trick) that the busy trader can happily hand out to spooky visitors.

TREAT 1:

DVD compilation of Janet Yellen's 2016 speeches.

Kids can play these in a darkened room, and hold a quasi-séance trying to interpret the Fed Chair's ruminations. Soon they'll be able to answer the question, "will she or won't she raise rates?"

TREAT 2:

Risk profile of unbalanced iron butterfly.

True horror is created by twisting friendly things in strange ways. What's friendlier than a butterfly? And what's more twisted than making it "unbalanced" and "iron"? Kids will love you showing them how to create the creepy figure on the Analyze page of the thinkorswim® trading platform by TD Ameritrade. It kind of looks like a witch's hat.

TREAT 3:

Formula for a leptokurtic distribution.

You have to say it with a Transylvanian accent, but "leptokurtosis" sounds sufficiently like a skin disease to qualify for Halloween. Plus, the fourth moment of the normal distribution is not only good for creating shapes of ghosts, but also for market-neutral trades.

TREAT 4:

Autographed copies of your trade confirmations.

That's right, you're a trader. People, and especially children, look up to you. A piece of paper that you signed with the symbol, transaction price, and time stamp of one of your trades is something they can hold onto for the rest of their lives, and hand down to their children. Let's see them do that with candy.

TRICK:

Tell the snarky kid how to calculate the conditional probability of barfing after eating a fistful of candy corn, then the caramel apple, then the popcorn ball. When he struggles with the math, tell him it's over 90% and watch him run home.





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
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