

# thinkMoney<sup>®</sup> 37

Random musings for traders at TD Ameritrade—FALL 2017

**YEEHAAHH!**  
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STOCKBROKERS.COM'S 2017  
ONLINE BROKER REVIEW.  
See page 7 for details

## FORGET WALL STREET. TRUST YOURSELF.

YOU'VE GOT THE TOOLS.  
ARE YOU USING THEM?

PAGE 16



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Cover Photograph by **Dan Saelinger**

# 16

COVER STORY

## Forget Wall Street. Trust Yourself.

Isn't this why you opened a self-directed account? You have the technology to overcome your fears. So, put the tools on your side and consider taking the plunge.

MISCELLANEOUS

## 11 In The Money

**Vol Whisperer** Understand the relationship between VIX futures and VIX options. Know all the details.

**Gear Head** Set up those alerts so you can be in the loop.

**Ask the Geek** About "the cloud" and the Home tab.

**Toys for Traders** Create custom candlestick patterns, add studies to indicators, and chart your portfolio.

**Capiche?** Part 4 of our series on portfolio margin covers position risk, margin requirements, and how to meet margin calls.

REGULAR COLUMNS

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Lorraine Gavican Kerr, Director, Trader Operations and Oversight at TD Ameritrade works hard and plays hard. Three words to describe her: "Bring it on."

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When the markets get topky, you need to be on the watch for the storm. Here are two chart patterns that could suggest a potential reversal signal.

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Can you remain safely oblivious to the world? Here are five ways traders can prepare for hibernation.



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## Your Portfolio Has a Job to Do. Put It to Work.

Investors think of core positions as a tool to ride out the good, the bad, and the sideways. Traders think about core positions as a way to store capital—do something to them and turn 'em into cash flow. Here are some ways you can make core positions potentially work for you.



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**All the World's a Trade.** You may not be able to trade directly in foreign markets. But you may be able to use international news to trade commodity swings. It's a savvy way to add international exposure to your portfolio.



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**Neutral Spreads Get Tasty.** When vol is low and you're scratching your head trying to decide whether to put on iron condors, consider diagonals. You'll be able to push your long options further out in expiration and get long vol exposure.

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**"As a self-directed investor,  
you always control when,  
what, and how you trade."**

Forget Wall Street. Trust Yourself. **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
- SEASONED
- PRO

## Trust In Me

• ACCESSIBILITY. HONESTY. RELIABILITY. In our “always on” world, these are all basic traits of humanity we’ve come to expect from the people we choose to interact with—be it in business or in life. Our thirst for knowledge is bigger than it’s ever been, and seeking out information is baked into our DNA. Instant, reliable answers to our questions are expected, and the same goes for our goods and services. If you want reassurance, our collective conscience of peers will happily tell you with up to five stars if any of it is BS.

But for all that, skepticism and cynicism still prevail when it comes to our money. As with everything else, we can learn what to do with money—how to buy, sell, trade, invest, plan, save, and protect—instantly, from credible people. Smart people. But the moment it’s time to pull the trigger, we hesitate. We doubt, we hem, we haw. Why?

Perhaps it’s because those of us who watched the global financial collapse in 2008, which took nearly every asset class down with it—well, our portfolios got walloped. And if you were too young to invest, you heard us talking about our portfolios getting walloped.

Yet, despite nearly every asset suddenly moving in the same direction (in this case, down), there was but one single, accessible, reliable, transparent asset class that remained “non-correlated” (didn’t follow the crowd)—listed options. If you were lucky enough to understand and know how to use them, you might have saved a lot of heartache and pain. Oh, what a small, yet powerful thing to have known more about and understood better. Right at our fingertips. Right in front of us.

Understandably, if you’re a millennial or a survivor of the Great Recession, you have questions about your money. You have fears. You want control. And you should expect to get answers to your questions to make informed decisions—quickly and reliably, while being able to take matters into your own hands.

That makes perfect sense. How about starting your journey now, on page 16.

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



**TAKE ACTION:**

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# 1

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• Transaction costs (commissions and other fees) are important factors and should be considered when evaluating any options trade. For simplicity, the examples in these articles do not include transaction costs. At TD Ameritrade, the standard commission for online equity orders is \$6.95; online option orders are \$6.95 + \$0.75 per contract. Orders placed by other means will have higher transaction costs. Options exercises and assignments will incur a \$19.99 commission.

# 4

• TD Ameritrade was ranked #1 overall out of 16 online brokers evaluated in the StockBrokers.com Online Broker Review 2017. We also rated #1 in several categories, including "Offering of Investments," "Platform & Tools," "Customer Service," "Education," "New Investors," and "Mobile Trading." Read the full article at [www.stockbrokers.com/annual-broker-review](http://www.stockbrokers.com/annual-broker-review).



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## LOVE NOTES

LITTLE QUIPS FROM YOU TO YOURS TRULY



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**thinkmoney@tdameritrade.com**



## Best In Show ... (To Our Inbox)

In 1984 we were pumped up about flying cars, but let's face it. Who's going to pay the bill when Harrison Ford bumps you? —**Ann**

If I had a crystal ball, I'd be at some quant fund and I'd be the one rubbing my temples saying, "It was my understanding there'd be no math." —**Jacob**

"Thank you for calling. We'd like to inform you that we've slashed earnings by 33% for next quarter. Please press nine to remove us from your BUY list." —**Pascal**

*The comments from Chat Room Pearls, right, are excerpts from chat rooms, emails, and tweets submitted by TD Ameritrade clients, and are their views and may not reflect those of TD Ameritrade. Testimonials may not be representative of the experience of other clients and are no guarantee of future performance or success. TD Ameritrade reserves the right to modify Love Notes for grammar, consistency, and similar purposes.*

## Chat Room Pearls...

*Cleaned my glasses. The monitor tab still doesn't look any better.*  
—MARC

*Now, if I can only figure out how to get my weight to drop as fast as my portfolio, I'd be thrilled to death.*  
—MIKE

*Better to be silent and be thought a fool than speak and remove all doubt.*  
—RON

*We ladies just sit back and laugh at you gents :)*  
—DONNA

*I've never puked over a trade, but my wall has a couple of patches from putting my head through it.*  
—KARL

*I don't know a stinkin' thing! I just trade.*  
—BOB

*A Regulation T call is when you're not wearing enough necklaces and Mr. T comes and whomps you.*  
—TRISH

*I can't trade naked puts any more. The image is disturbing.*  
—PAUL

*You don't have to beat the market. You just have to beat the guy on the other side of your trade.*  
—TODD

*Instead of trading, why don't you give me half of what you're going to trade.*  
—WILSON

*So what does unskilled labor do if they're replaced by robots?*  
—JESS

*I have special trading gloves for this type of market. They're 14 oz. boxing gloves. I can't seem to press the keys on my computer keyboard to make trades. Keeps me out of trouble!*  
—KEN

*Early to bed, early to rise, stay off the Internet ... it's full of lies.*  
—JAMES

*Why do therapists make good traders? Because they fade their patients.*  
—RAM

### GET CHATTING

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



Volatility is not to be feared. It is to be captured and turned to your advantage. Harnessed to seek diversification and hedge portfolio risk. Utilized to drive income generation. Volatility does more than create market uncertainty. It's the path to uncovering new and powerful outcomes.

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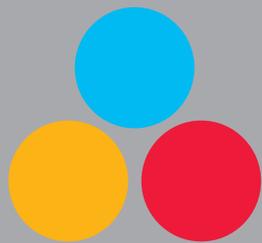
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## IN THE MONEY

A HODGEPODGE OF MARKET STUFF YOU SHOULD KNOW



**TRADER  
GLOSSARY**  
TURN TO  
PAGE 36

VOL WHISPERER ● SEASONED

## You're So VIXed

**BIG IDEA:** WHICH VIX FUTURES DO VIX OPTIONS FOLLOW?  
HOW DO YOU TRACK 'EM? KNOW THE DETAILS.

• WHO KNEW 20 years ago that volatility would become such a popular topic in market discussions? When the CBOE introduced the original **VIX** in 1993, it was an esoteric, “professionals-only” thing. Now we’re seeing the price of the VIX on our trading platforms and TV, we’re interpreting volatility’s impact on the markets, and yes, we’re trading it.

Trading activity in the VIX suite of products—/VX futures and VIX options—has exploded in recent years. Notably, in the past couple of years, /VX futures and VIX options with weekly expirations have been introduced. And different expirations offer more flexibility and strategies for speculating on volatility.

### Mix’n’ Match

But all those /VX and VIX expirations can spell trouble if you don’t understand the relationship between them. For example, looking at VIX options, you may see that a call in a further expiration has a lower price than a call at the same strike price at a closer expiration. Or you may want to trade a **synthetic covered call**—buy a /VX future and sell VIX calls against it. But you have multiple expirations in /VX and VIX options. Doing mix’n’ match with VIX products can expose you to risk you might not want to take. So how do you match up the /VX and VIX options so you can potentially avoid trouble ahead?

The short answer: when you’re looking at, or trading, VIX options in a particular expiration, you need to consider trading the /VX future in the same expiration. So, you match up September VIX options with the September /VX future. Or August weekly VIX options with the August weekly /VX future with the same number of days to expiration (DTE).

Make sure the VIX options have the same number of DTE as the /VX futures. This is important. The VIX options in a particular expiration are “priced” off their corresponding /VX future, and not the VIX index itself—because you can’t trade the VIX. You need to hedge with a /VX future. And /VX futures in different expirations move up and down independent of each other, according to the market’s expectation of what the VIX will be on those future dates.

There’s no arbitrage relationship that keeps /VX futures in a specific financial relationship to each other. This is why VIX options in further expirations can have lower prices than VIX options in closer expirations.



The /VX futures in those expirations are different, and the VIX options are priced off those different futures' prices. Also, if you trade VIX options in one expiration against /VX futures in another, both those positions can lose money if the /VX future that's pricing the VIX options you're trading moves higher or lower than the /VX future you're trading.

Say you sell 10 VIX calls in the Sep expiration, you buy a /VX future in the Dec expiration, and you think that's a hedged position. It's not. It's possible for the Sep /VX future that's pricing the Sep VIX options to spike higher and cause a loss on the short VIX call position, while the Dec /VX future may drop, causing a loss on the long Dec /VX future position.

But What If...

Wait, one more thing. On the thinkorswim® platform from TD Ameritrade, all VIX options have one day less to expiration than the futures. Yup, they don't match. The /VX futures will show one more DTE than the VIX options, and here's why.

The last trading time for a /VX futures contract is 8:00 a.m. Central on the contract's Wednesday settlement date. The last trading time for a VIX option is at 3:00 p.m. Central on the Tuesday the day before the Wednesday option's settlement. So, the /VX futures, and VIX options, settle on a Wednesday. But the VIX options stop trading one day before. That's why on the thinkorswim platform, the September /VX, for example, will show one more trading day than the September VIX options. But the Sep VIX options are still priced off of, and hedged by, the Sep /VX future.

So, while you have many choices to trade volatility, it pays to do your homework. Know how volatility products are priced, how they move, and how they trend.

—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.

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.

GEAR HEAD SEASONED

Create an Alert

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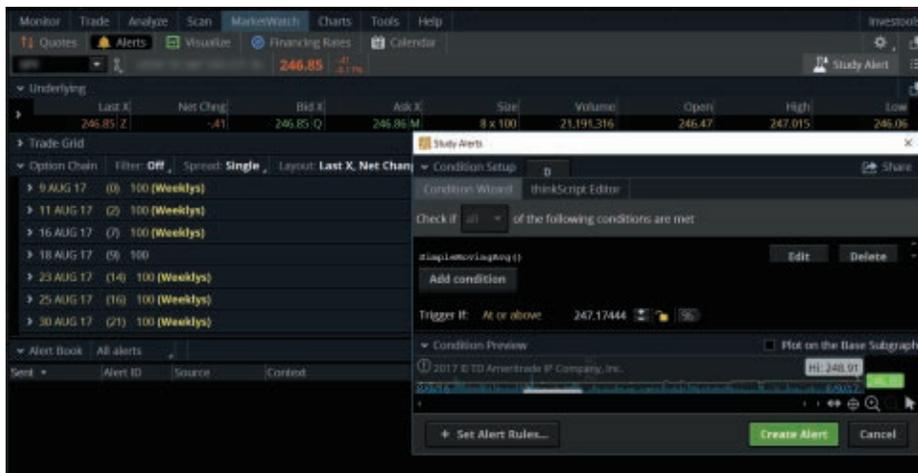
• Staying on top of your portfolio is important whether you're at an airport or waiting patiently at the dentist's office. That's why we want to make sure you have all the tools available on the TD Ameritrade Mobile Trader app. And not just to use your mobile device to check in, but to move on to the next level where you need to know exactly when the 50-day exponential moving average crosses the 117-day linear regression line. That's where the "Study Alerts" feature comes in handy.

Study Alerts generates a signal when a "study-based" condition is met. You can use predefined and custom studies to create your alerts. If you prefer to use a predefined (or previously created) study, then choose one from the Study list. The interface allows you to specify the study plot, input parameters, and aggregation period. Note that Look and Feel inputs (e.g., colors, painting strategies) are not available in Study Alerts, and constant plots are not included in the Plots list.

You can use a combination of studies or implement a new one by selecting Complex Formula from the Trigger Type list. This brings up the thinkScript editor.



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- 1 - Click the MarketWatch tab and select Alerts from the sub-tab row.
2 - Enter the ticker symbol you wish to issue alerts for.
3 - Click the Study Alert button. This'll bring up the Study Alerts window.
You have several options to choose from: You can set up your alert rules, set up your alert conditions, create your own alerts, and set trigger types, among other things.

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



## TOYS FOR TRADERS

FROM THINKORSWIM®

# Ask the Geek

**BIG IDEA:** A LITTLE Q&A WITH **JOHN HART**, MANAGING DIRECTOR,  
TRADER PRODUCT DEVELOPMENT AT TD AMERITRADE

• **Hey Geek, here's a two-part question:  
What's the cloud, and does thinkorswim®  
live in it?**

"The cloud" is one of many buzzwords in the industry that have come up over the last 10 years. What it means is non-local (not on your machine) storage and computing. It's like the mainframe processing of today, with no punch cards.

And part two's answer: Yes! For longer than the term "cloud" has been around, we've been storing settings, running thinkScripts, calculating implied volatility, and routing your orders on our own cloud.

We recently introduced cloud-hosted drawings. So, every time you add a drawing or modify it on any chart, it's instantly stored (well, nothing is instant, but it is super fast). If you close down thinkorswim at home and open it up at work, all those chart an-

**"We wanted to create a place where you can rest the software while you are between trades."**

—JOHN HART  
@JOHNHART\_TDA

notations you made at home will be on your charts. All the drawings are saved to a drawing set (you can have different drawing sets and quickly switch among them). And coming soon, we're going to tap in to the power of the thinkorswim cloud and add all of your drawings and annotations into thinkorswim Mobile, so all changes to your charts will be available quickly and everywhere.

It's not exactly related to the topic of the cloud, but another new feature of note is the new thinkorswim Home tab. This is a place on the platform that is uniquely yours. You can check in each time you log in and see portfolio performance, upcoming market events, orders status, and much more. We wanted to create a place where you can rest the software while you are between trades. We were also able to include features that help you react quickly to news or information.

The main part of the Home tab is made up of a group of customizable widgets. There are four categories: My Account & Portfolio, Market Data, Time & Calendar, and thinkorswim information. The widgets themselves are made of different monitoring tools. For example, you can bring up a chart of your account value versus a benchmark and next to that keep track of the current phase of the moon.

The other half of the Home tab is reserved for updates coming from social media, live news videos, and the thinkorswim Trade Desk. This is where you can stay in tune with the ever-updating news, wherever it may come from. This is also where you can check to see if there's a live education event in your neighborhood.

The main focus of the Home tab is that it is unique to you. You can customize this page to meet your needs. You can check in for a quick update, or spend most of your thinkorswim time here.

### **CUSTOM CANDELTICK PATTERNS**

Want to create patterns that include any number of up, down, or doji candles with any given relationship to one another? You can do that with a drag-and-drop interface. That's right, there's no need to write code or understand fancy thinkScript functions; just draw the pattern. From your Charts, choose "Patterns" and "Select Pattern." Once you're on the Candlestick tab, you'll see the Create button at the bottom, which will take you to the Candlestick Pattern Editor.

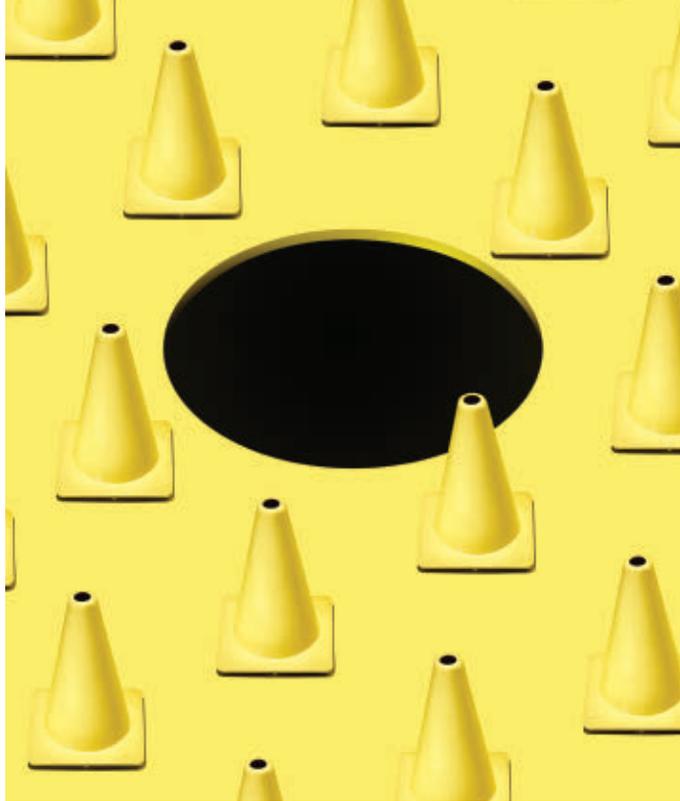
### **STUDIES ON ACTIVE TRADER LADDER**

Indicators of your studies are available on the Price column of the Active Trader ladder. To add the icons, right-click on any column header of your Active Trader ladder and check "Show studies from chart." This will add small indicators next to the price for any upper study that is plotted on the chart associated with your ladder. Hover over the indicator for details; simply click on the "Bid Size" or "Ask Size" price, just as you always have with the Active Trader ladder.

### **CHARTING YOUR PORTFOLIO**

You asked, we delivered: You have the ability to build your own portfolio analysis tools. Now you can use thinkScript to chart the historical performance of your portfolio. We get many different requests around charting this data, so we decided to start with thinkScript, as it's the best option to accommodate the diversity of requests.





CAPICHE ● PRO

## PORTFOLIO MARGIN PART 4: Risk Management

**BIG IDEA:** WHO'D WANT FORCED-POSITION LIQUIDATIONS? NO ONE. STAY ON THE BALL AND BETTER ESTIMATE POSITION RISK, MARGIN REQUIREMENTS, AND HOW TO MEET MARGIN CALLS.

• LET'S ASSUME you hold a portfolio margin (PM) account. The amount of capital required to open or hold a trade—its margin requirement—can be significantly lower than what's required for a regular margin account. That's because the margin requirement for a position in a PM account is based on a position's risk within a certain range of the underlying stock or index price.

### MAPPING IT OUT

For example, if the PM requirement for a long stock position is based on its max loss within a +15%/-15% price range, you can estimate the loss by multiplying the value of the stock position by 0.15 to arrive at the PM requirement.

Say you were long 1,000 shares of stock that had a price of \$75. The value of that stock position is \$75,000. Using a +15%/-15% PM test,  $\$75,000 \times 0.15 = \$11,250$ . That would be the PM requirement and the position loss if the stock price dropped 15%.

With options, the PM requirement tests theoretical values based on a range of the underlying prices and volatility. But the max loss of a long option position, for example, can be calculated with an option's prices. If you were, say, long 10 of 75 straddles, which would be long 10 of the 75 strike calls for \$3, and long 10 of the 75 strike puts for \$2.75, the value of that straddle position is  $\$5.75 \times \$100 \times 10 = \$5,750$ . You add up the options prices in the straddle, multiply that sum by the options' contract multiplier (usually 100 for standard options), then multiply that by the number of straddles.

So the total value of the straddle position is its max potential loss, as well as the traditional "non-PM" margin requirement. And the PM requirement for that long straddle may in fact be smaller.

### THE DREADED CALL

Margin calls in a PM account can be issued anytime the account has fallen below the

## IN THE MONEY



### COOL INFO:

Want to know more about portfolio margin? Visit [www.tdameritrade.com/account-types/margin-trading/portfolio-margin.page](http://www.tdameritrade.com/account-types/margin-trading/portfolio-margin.page)

firm's margin requirements. To meet margin requirements, you can deposit cash, close existing positions to reduce the overall margin requirements, or open trades that would create cash or reduce margin requirements.

If closing positions, you can choose which to close to reduce margin requirements, as long as they're done by the close of trading when the call is due. But if you're opening a trade, it would have to be in the same symbol as one of your current positions, in order to increase cash or reduce risk. For example, if you open a short call trade against a long stock position, it doesn't increase the position's risk (and so doesn't increase the margin requirement).

But it does increase the cash balance, so it's allowed. Opening a long put trade against a short naked put position decreases the risk of the position. And if it decreases the position's margin requirement, the

trade would be allowed. But if you're long 100 shares of stock XYZ, you could sell one call in XYZ if your account was subject to a margin call. You couldn't sell two calls, for example, because the risk of only one of the short calls is covered by the long 100 shares.

Also, if the net liquidating value of your account drops below minimum PM levels, the margin requirements may revert to regular margin requirements, which could be higher than PM margins, and thus result in a margin call.

### GET IN TOUCH

If your Position Statement on the thinkorswim® platform from TD Ameritrade shows negative buying power, your account may be in a margin call. In that case, call the Trade Desk at 866-839-1100 for assistance. They can clarify what is and isn't allowed in the account, and help possibly avoid forced-position liquidations.

*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 increases the risk of involuntary liquidation. Client, account, and position eligibility requirements exist and approval is not guaranteed.*

**TRADER  
JARGON**  
TURN TO  
PAGE 36

# Nasdaq-100<sup>®</sup> Index Options (NDX) At the Forefront of Tracking Innovation in Large-Cap Growth

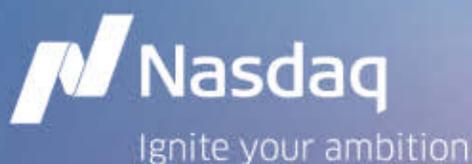
## Trade NDX on Nasdaq PHLX, Nasdaq ISE, and Nasdaq GEMX

Ambitious traders have done just that to execute valuable hedging and income generating strategies over the last two decades. Why?

- Global reach provides exposure to some of the most active non-financial issuers with large market capitalization listed on The Nasdaq Stock Market
- Cash settlement eliminates the need for delivery of underlying stock components
- Favorable 60/40 tax efficiencies impact your bottom line\*

For more information about NASDAQ-100 Index Options (NDX) and other Nasdaq options products, visit [business.nasdaq.com](http://business.nasdaq.com) or email [sales@nasdaq.com](mailto:sales@nasdaq.com).

\*Under section 1256 of the Tax Code, firms trading certain exchange-traded Index options, such as NDX, may receive favorable treatment. Investors should consult with their tax advisors for more information.



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# DO NOT FORGET WALL STREET. DO NOT TRUST YOURSELF.

WORDS BY **MARK AMBROSE**  
PHOTOGRAPHS BY **DAN SÄELINGER**

**BIG IDEA:** ISN'T THIS WHY YOU OPENED A SELF-DIRECTED ACCOUNT? YOU HAVE THE TECHNOLOGY TO OVERCOME YOUR FEARS. SO PUT THE TOOLS ON YOUR SIDE AND CONSIDER TAKING THE PLUNGE.



# If you're a MILLENNIAL,

you may not remember a world without computers, and maybe not even a world without cell phones or the Internet. You might take it for granted, but you certainly have faster access to more information than any generation in the history of humankind. And, at the risk of oversimplifying, you're also more aware of the larger world, and you like your own brains, researching everything you can to a fault—diet, fitness, work, finance, romance, and more. Wow. Considering your social creds, you could be the greatest investing generation ever. Or not.

Word has it millennials aren't investing like other generations for one simple reason: trust. In your lifetime, you've processed the crash and listened to your parents disseminate Wall Street horror stories. You may not trust others to manage your money. And you want to be sure you can put your hands on your cash when you need it.

## SLAY THE MONSTERS UNDER THE BED

Lots of folks who came before you have orchestrated a secure retirement—and many haven't. You'd prefer not to end up like the latter. So, you might skip the investing game altogether and take no chances. But you'll also reap no potential reward.

The fear factor aside, you have one gigantic advantage over previous generations—awesome technology, like the thinkorswim® platform from TD Ameritrade. When you engage tech wisely, while learning the investing ropes, over time you'll come to make informed decisions. And with much trial and error and trusting your own choices, you just might morph from cautious millennial to self-directed investor. Let's deconstruct the fear arguments one by one.

**TRADER  
GLOSSARY**  
TURN TO  
PAGE 36

## 1 You don't trust the "Street" and prefer to manage your own money.

The silver-screen version of Wall Street boils down to evildoers smoking cigars, bragging about huge kills, and fleecing the little guy out of hard-earned savings. But that's Hollywood.

In real life, online brokers may boast a few cigar smokers in their ranks. But in general, they don't trade your money, they don't speculate against you, and your financial success is naturally in their best interest. In point of fact, many online brokerage firms invest tremendous resources in support and education, plus technology upgrades to protect a quality investing experience.

What can you expect? With most online brokers, nearly every aspect of your account remains transparent so you can monitor activity details, large and small, in real time. At the least, profit/loss is calculated for every trade and investment to gauge performance. It's wise to log into your online brokerage account every day to review your account statement. There you'll find your various transactions—order history, trade history, commissions, fees, deposits, and withdrawals.

## 2 You're afraid of losing your money & fear it won't be there when you need it.

Naturally, there's no guarantee you won't lose money trading. But how big that loss might be is something you can often manage. "Defined risk" is a term we use to describe an options trade whose maximum potential loss can actually be known before you route the trade. No matter what the stock price does, an options trade with defined risk can't lose more than a precise amount. There are tools that can help you reduce the uncertainty of trading and calculate a trade's maximum loss. One is the Order Entry Tools function in thinkorswim. Fire up the platform, then:

1. From the **Trade** page, create an order by clicking on the bid price (to create a sell order), the ask price (to create a buy order), or right-click to create a spread order, like a **vertical** (Figure 1).

2. This loads up the options and/or stock in the **Order Entry Tools** on the lower part of the Trade page. If you click the "Confirm and Send" button—don't worry, you're not sending the order yet—you'll see details about the trade, including its max loss. (Only when you click on the "Send" button on the Order Confirmation Dialog box will you route it.)

As an experiment, create an order to **short** a naked call. The order confirmation box will show an "infinite" max loss. That's because a stock doesn't have an upper limit on how high its price might go. So, the loss on a short call has no upper limit, either. A naked short call, then, is not a defined-risk trade.

Next, create an order to short a naked put. The max loss might be fairly large because it's the strike price of the put, minus the credit you get for selling it short. The max loss occurs if the stock price goes to zero. Although the max loss on a short naked put can be identified, it may be too large for you to be comfortable calling it a defined-risk strategy.

Finally, right-click an option and select "Sell," then "Vertical." That creates an order for a short vertical spread. Note that its max loss is the difference between the strike prices, minus the credit for shorting the vertical (Figure 2). When you look at the max loss on the Order Confirmation Dialog box, it's not "infinite" like with a short call. And it might be much smaller than for a short put. Note that multi-leg strategies like this can entail substantial transaction costs (compared to single-leg strategies), in-

cluding multiple commissions, which may impact any potential return.

Using the order entry tool, you can see how different verticals at different strike prices have different max losses. Some might be bigger than others, but they're all defined. No matter whether the stock price goes infinitely high or to zero, a short vertical's loss won't exceed the max amount you see.

Above all, your risk tolerance is naturally your own decision. As a self-directed investor, you always control when, what, and how you trade. By controlling the max loss using defined-risk trades, you can be confident that even if all your trades are losers, your account might still have some value. For example, if your account is worth \$5,000, and you have three defined-risk trades each with a max loss of \$250, the worst-case scenario is each of them losing \$250 for a total loss of \$750, plus commissions. So your account would still be worth roughly \$4,250.

**B You're afraid to jump in (and jealous of those who are going for it).**

OK, maybe it's not exactly fear. But it stinks when you see people around you making money when you're not in the game, especially in bull markets. You know the threat of loss is real, despite your expectation that the market could move even higher. You're afraid of making a mistake, or getting in too late.

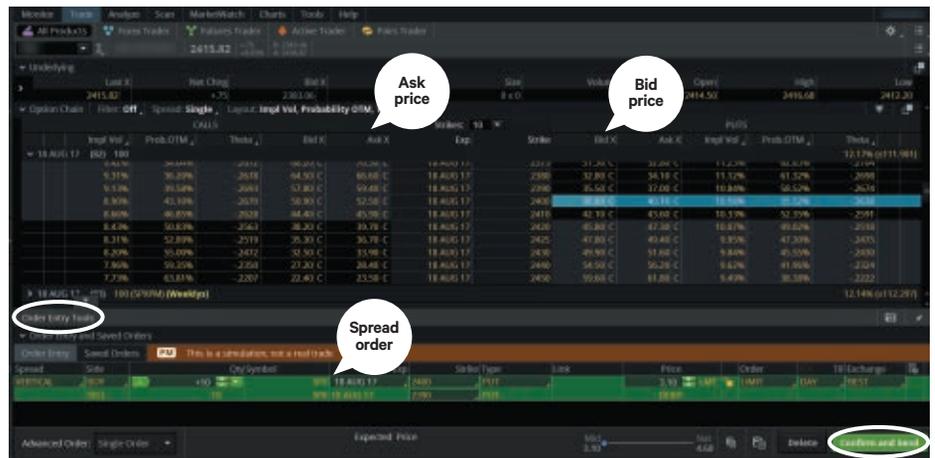
Of course, telling someone to "have no fear" is easier said than done. But it doesn't have to be all or nothing. You might convert your fear into thoughtful, informed trading strategies that don't break your bank in one day. Is risking, say, \$300 on a single trade acceptable if it means you slow things down a bit, participate in the growth of the market, and focus on strengthening your portfolio for the future? (Yes, trader—we do mean investing for the long term, here. But it's not what you think.)

Let's take an example.



**TAKE ACTION:** To check your account status in thinkorswim, click the **Monitor** tab, then **Account Statement**.

Assume you're bullish on the market and you think it's going to move even higher. The "market" can mean a lot of things. But to many investors and traders, a good proxy is the S&P 500 Index (SPX). It tracks the value of the S&P 500, and it carries options. What does a defined-risk, bullish strategy on the S&P 500 look like?



**FIGURE 1: Get comfortable placing orders.** There are many different types of trades. It's worth your while to experiment with things like vertical spreads, naked calls, or naked puts. Source: thinkorswim from TD Ameritrade. For illustrative purposes only.



**FIGURE 2: Know your max loss before you trade.** In the Order Confirmation Dialog box, you can determine what your trade's max loss and max profit is likely to be. Source: thinkorswim from TD Ameritrade. For illustrative purposes only.

Maybe a **short put vertical** in SPX options. This would be short an **out-of-the-money** (OTM) put, and long a further OTM put. With the SPX at, say, \$2,410, a short put vertical could be short the SPX 2390 put, and long the SPX 2385 put. If that 2390/2385 put vertical is worth \$2, selling that put vertical generates a \$200 credit. That's your max potential profit (not including commissions), which you'd realize if the SPX price is anywhere above \$2,390 at the options' expiration.

The max potential loss on that short 2390/2385 put vertical is \$300, and that loss would happen if the SPX price is anywhere at, or below, \$2,385 at the options' expiration. Even if the market crashes badly and the SPX goes to zero, the most this trade will lose is \$300, not including commissions.

Only you can decide whether you think the SPX will go higher. There are lots of

other bullish strategies to choose from. But this example of a short put vertical should put at least some of your fears in context.

### SWIM WITH THE REST

Of course, no one wants to lose money, and options trading involves unique risks and isn't appropriate for everyone. But if you're looking to invest in your future and potentially realize better returns than from a savings account, you may have to engage some risk. Above all, the wealth of trading technology today means you're never alone. Once you get more comfortable with investment decisions and risk/reward equations, you'll likely trust yourself more, so that trading your own money starts to feel familiar and often worth it.

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

● SEASONED / TAKE AWAY: *How to work a core portfolio more like a trader.*

# YOUR PORTFOLIO HAS A

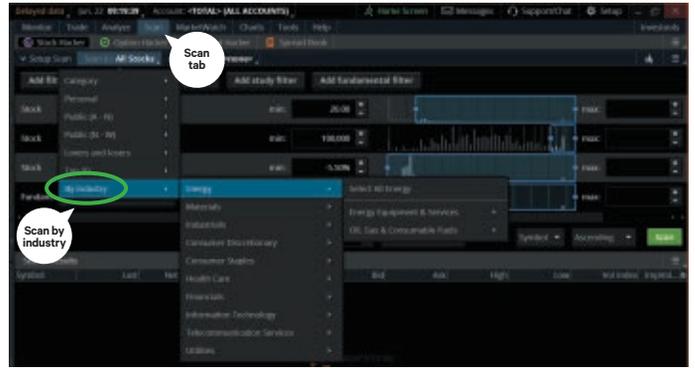
PHOTOGRAPHS BY DAN SAELINGER

# JOB TO DO.

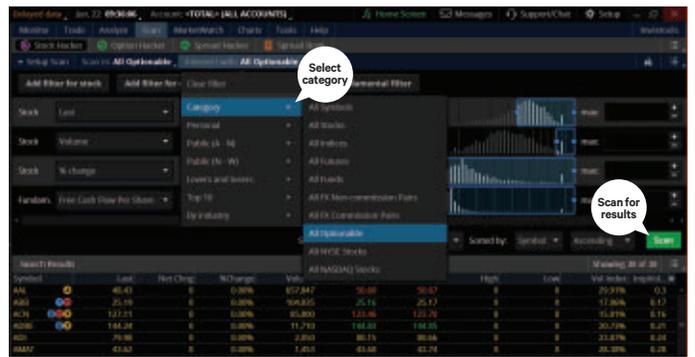
**BIG IDEA:** INVESTORS THINK OF CORE POSITIONS AS A TOOL TO RIDE OUT THE GOOD, THE BAD, AND THE SIDEWAYS. TRADERS THINK ABOUT CORE POSITIONS AS A WAY TO STORE CAPITAL—DO SOMETHING TO THEM AND TURN 'EM INTO CASH FLOW. HERE ARE DIFFERENT WAYS TO MAKE CORE POSITIONS POTENTIALLY WORK FOR YOU. WORDS BY **THOMAS PRESTON**

# PUT IT TO WORK.





**FIGURE 1A: What stocks to trade?** Narrow down your choices. Look for stocks within specific industry groups. Source: thinkorswim from TD Ameritrade. For illustrative purposes only.



**FIGURE 1B: What stocks to trade?** Use the scanning feature to help find optionable stocks that are highly correlated to the one you own. Source: thinkorswim from TD Ameritrade. For illustrative purposes only.

# WHEN

you fall in love with the markets and begin to stare endlessly at a trading screen, you're exercising your brain more than your muscles. And maybe you begin to notice some, well, "accumulations" and decide to hit the gym. What's the first thing your new trainer says? You've gotta work your core! You know, abs, back, middle. Without a strong core, the rest of you can't do much.

In market-speak, an investor might have a core portfolio composed of stocks that compel a long-term outlook. Investors passively hold on, enjoying the good times and riding out the bad. The research is done, and decisions are made. Investors hang in there, and believe returns will come eventually. Hopefully.

## CONSIDER THE POSSIBILITIES

For a trader, core positions can also do other things. Much like your body's core provides support for strong arms and legs, a trader's core position might be a single longer-term position based on a bullish or bearish bias that can support other positions and shape return and risk. In effect, a trader uses the core position as a tool to store capital, and trades around it.

What does that mean? The core position is a longer-term speculation that hopefully makes money in its own right, but it also supports other, short-term positions that may generate

cash flow and create returns on the overall portfolio. Basically, a trader tries to squeeze returns out of a core position by finding potential opportunities in varying market conditions.

Trading around core positions adds work, and often adds commissions. But even if you don't go all the way and treat your core positions like a trader might, there are things you can do that don't deviate too far from a passive approach.

## THE BENEFITS OF STAYING ACTIVE

For example, some traders may view a stock or future core position that lacks an option "overlay" as sitting idle. And they may look for ways to increase short-term returns on it.

Let's consider a bullish speculation in crude oil. A trader may put on crude oil futures in expectation of rising prices. The futures expire, so the trader may roll them from one month to the next to maintain this long-term, core bullish strategy. Does the trader know oil is going higher? Of course not, which is why the core position is speculative. But the trader also knows that adding certain option overlays, like a short call on a crude oil future, brings no additional margin requirement or risk to the core portfolio. In fact, the short call can add positive **theta**, which benefits the trader's daily profit/loss.

The short call also reduces the breakeven point of the long future. In exchange, the trader gives up some of the core position's upside potential.

In this scenario, the trader is often more confident in the option overlay than on the speculative bullish oil trade. She knows the theta of the short call is positive, and when the future's breakeven price is lower, the risk is lower, too.

Another trader might have a bearish core position and sell puts against it, with the same rationale as selling calls against a long future. The option overlays can get complex in response to different market scenarios, like hedging across markets and balancing notional values.

## INVESTING LIKE A TRADER

In some cases, an investor can use a trader's tricks. Of course, you know to sell calls against a long stock core portfolio. Say you're long shares of XYZ, ABCD, and GVRC, and you choose to sell calls in all three against their respective shares. Simple. But what if your core portfolio isn't so tidy? What if it has shares in a company that doesn't have

any options traded on it? Or what if your core portfolio contains a bunch of odd lots—150 shares here, 75 shares there? It takes 100 shares to cover the risk of most stock options. This is when thinking like a trader can help.

In *thinkMoney 33*, we discussed how to potentially generate income on a long stock position with covered calls. This is often handy for a single stock position. Let's extend that discussion to (1) a stock position that doesn't have options, and (2) a position in a stock basket that would require too many transactions or not qualify for a covered call.

### A long stock position in a small company with no calls to sell.

Maybe you have shares from an employee-stock program or inheritance. Or maybe it's a company you really like, but the stock doesn't have options, and you don't want to sell the stock and buy another. Let's call your stock XYZ. How can you sell calls against it?

To solve the problem, turn to the tools on the thinkorswim® platform from TD Ameritrade. Consider selling call **vertical spreads** in a stock that has options and a high correlation to XYZ. (Correlation is the numerical value that describes how closely XYZ moves with another stock or index.)

First, look at stocks in the same industry sector. Is XYZ a biotech company? An energy company? High tech? On the **Scan** tab, click on "Scan In" in the upper left-hand corner, and from the dropdown menu, click on "By Industry" at the bottom (Figure 1A). Here you can narrow the stocks into a specific industry. Next, click on "Intersect With" and select "Category," then "All Optionable" (Figure 1B). Then click on Scan.

This loads up a list of optionable stocks in the same industry as XYZ. Next, find one that has a high correlation to your stock. Go to the **Charts** page, click on **Studies** in the upper right-hand corner, select "Add Study," click on "All Studies," then "C-D" to find "Correlation" (Figure 2). This will display the correlation between XYZ and the SPX (by default) on the chart.

You can then edit the Correlation study, replace SPX with XYZ, and enter the symbol of an industry stock to see how it correlates with your stock. The closer the correlation is to 1.00 (max correlation value), the closer to perfect positive correlation. Keep in mind that correlations can change over time, and there's no guarantee the industry stock will move up and down at the same time as XYZ.

Now, look at the options on that industry

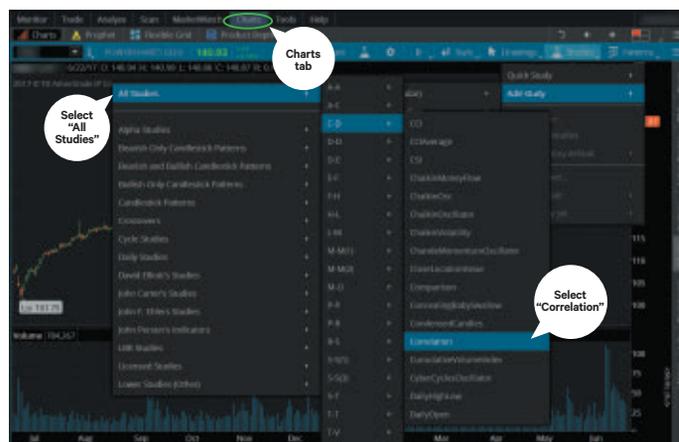
stock, and consider an **out-of-the-money** (OTM) call vertical to short. Why a call vertical? Selling a naked call in a stock you don't own has unlimited risk if that stock rallies and XYZ—the stock you own—doesn't. Because a call vertical has defined risk, even if the correlation breaks down, and the industry stock rallies while XYZ drops, the loss on the short call vertical won't exceed the maximum amount.

Finally, you need to figure out how many call verticals to sell in the industry stock. First determine the value of your XYZ shares. Then divide that value by the price of the industry stock to see roughly how many shares your position in XYZ represents. For example, if you have 1,000 shares of XYZ trading at \$25, the value of your XYZ position is \$25,000. If the industry stock is trading at \$75, then  $\$25,000/\$75 = 333$ . If the two are perfectly correlated, theoretically, your XYZ position has the same value as 333 shares of the industry stock. So, you may want to consider selling three call verticals in the industry stock.

Selling call verticals in a different stock from your core is a way to add theta to your portfolio. It adds a certain amount of defined upside risk, as well as commissions, but that positive theta is one way to potentially add a little extra return to an otherwise "lazy" core stock.

### Smaller odd-lot positions in stocks where selling calls is not possible.

Over time, perhaps by making smaller investments in individual stocks to diversify a portfolio, you may have acquired odd lots in 20, 30, or more stocks. An odd lot is a number of shares that isn't evenly divisible by 100. For example, 225 and 560 are odd lots. A single option represents 100 shares of stock. So, if you have 225 shares, you can't sell 2.25 calls. You could sell two calls against 225 shares, but that would mean 25 shares, or 11%, of that position isn't working as hard for you as you may want. Besides, you may not want to



**FIGURE 2: How well do they sync?** By charting the correlation between the stock you like and a related index or stock, you can visually see how the two move. Source: thinkorswim from TD Ameritrade. For illustrative purposes only.

look for calls to sell in 20 or 30 stocks.

You can apply the same process just discussed to selling a call vertical in an index that could be a benchmark for your portfolio. Let's say your core portfolio consists of 30 small-cap stocks. The NASDAQ 100 index could be a benchmark for your portfolio. The Mini NASDAQ-100 Index (MNX) is an index on the NASDAQ that also has options. The MNX has a contract multiplier of 100. So, if MNX is trading at \$550, it has a notional value of \$55,000. If your core small-cap portfolio is worth \$100,000, its value is nearly twice that of the MNX. So, you might consider selling two OTM call verticals in MNX options.

Again, the MNX call vertical offers your core small-cap portfolio defined risk and positive theta. It also offers the potential to increase returns over time in exchange for upside risk if MNX moves up more than your core portfolio and commissions.

### WORK THAT CORE

Selling call verticals against a core portfolio is just one strategy to consider, and it may or may not fit your objectives. But the larger goal is to review long-term positions you may be sitting on as assets that could be working even harder for you. You've worked diligently to construct a sensible portfolio. Make sure it's doing all it can.

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*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.*

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WORDS BY  
**JAYANTHI GOPALAKRISHNAN**

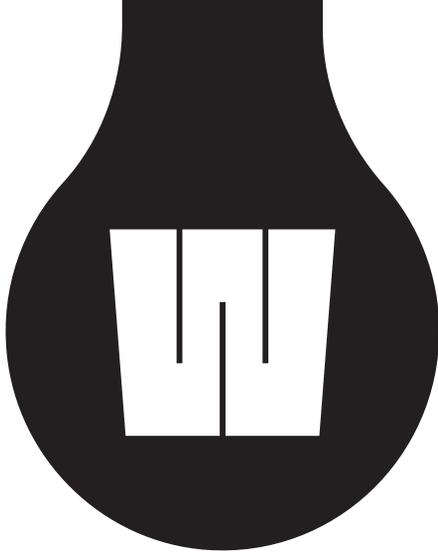
PHOTOGRAPHS BY DAN SAELINGER

# ALL THE WORLD'S A TRADE

**BIG IDEA:** YOU MAY NOT BE ABLE TO TRADE DIRECTLY IN FOREIGN MARKETS, BUT YOU MAY BE ABLE TO USE INTERNATIONAL NEWS TO TRADE COMMODITIES SWINGS. IT'S A SAVVY WAY TO ADD INTERNATIONAL EXPOSURE TO YOUR PORTFOLIO.

● SEASONED / TAKE AWAY: *Get a different market perspective through global events and their impact on futures prices.*





When a butterfly flaps its wings in Brazil ... you know how that story goes. But really? Can that butterfly set off a tornado in a far-away place? It'll remain one of life's mysteries, but for you, there's a deeper meaning. It may not be a butterfly that creates market volatility. But it might be political unrest, economic issues, or crazy weather patterns.

The thing is, if you've got a bit of tunnel vision, and you're stuck on trading your favorites, you may not be aware of China's Belt and Road initiative, or the date of the next OPEC meeting. And perhaps you should be. Because being aware of the world, and how markets interact, can open up possible trading opportunities.

Perhaps you can't directly access a specific international market. But you may be able to trade it indirectly. Let's look at how.

### IT WASN'T A BUTTERFLY IN BRAZIL

In May of 2017, corruption scandals in Brazil sent the Brazilian markets plunging. The country's currency (the real), Brazilian bonds, and the Brazilian Bovespa Index hit lows not seen in about 18 months. Many large investors were overweight in their Brazil holdings, and when the news broke, institutions didn't waste time unwinding their positions, as bonds, equities, currencies, and agricultural commodities were intimately connected.

What impact might a selloff in Brazil have on world markets? A first guess might suggest that ETFs with exposure to Brazil would tank, which they did. But think beyond equities—in emerging markets, Brazil is a dominant market and a large exporter of soybeans. So, when Brazil's markets tank, does it affect soybean markets?

To find out how prices reacted to the

headlines, fire up the thinkorswim® platform from TD Ameritrade and bring up a daily chart of soybean futures (Figure 1). Get a more detailed look by considering a shorter time frame, like one- or five-minute charts, to see how prices reacted when the news was released.

The U.S. is the world's largest soybean exporter, with Brazil coming in second. Agricultural commodities follow seasonal patterns, so you can at least know when crops are planted and harvested. The U.S. and Brazil are also in different hemispheres—meaning their seasonal patterns will be nearly opposite. In April/May, planting starts in the U.S., and that's when Brazil harvests soybeans. Soybean prices in Brazil can also influence global soybean prices. If the real depreciates, it will be cheaper to buy Brazilian soybeans, which in turn can impact U.S. export prices.

When it comes to trading agricultural commodities, traders often consider seasonal patterns. Soybean prices in general are based on speculation of future supply, and that becomes more certain toward the end of planting seasons. (Prices can hit a high after the end of planting, and then decline until the start of harvesting.) But other factors can play a role, too. Don't overlook geopolitical events, currency valuations, extreme weather conditions, and to some extent, crude oil prices.

In the one-year chart of soybean futures in Figure 1, notice that in 2016, prices rose from April to June (planting season), fell until August, and traded sideways until October, the start of harvest season. The low of this trading range suggests a strong support level for soybean prices. Prices bounced above the support level in April 2017, right at the beginning of planting season. But the selloff on May 18 threw traders a curveball. How might this action impact prices going forward, and how could soybean prices affect other markets?

### ON THE INDUSTRIAL ROAD TO CHINA

China is one of the world's largest soybean consumers, and it could take advantage of Brazil's low soybean prices. China is also the world's second largest economy, so it has a big impact on price movements in many commodities.

Let's move on from soybeans to copper. If you're aware of China's Belt and Road initiative, you'll know that China has plans to invest in more infrastructure and open up trade links globally. If all goes well, we can expect more demand for Chinese industrial

commodities. One industrial metal closely related to manufacturing, industrial production, and construction is copper. As long as China has the demand for that metal, copper prices might rise. Yet, any signs of a slower Chinese economy, or a tightening monetary policy, could send copper prices lower. So, copper could be a leading indicator of future economic activity.

Trading copper futures is considered difficult for self-directed traders. You have to know the market well before you can implement complex strategies. But you may want to consider using copper futures to trade other markets that may be correlated, such as gold or oil. The tools to find these markets are ready for you on thinkorswim.

To get started, pull up a long-term chart of copper. Go to **Studies**, select **Add Study**, then **Compare With** and overlay different charts to see the correlations. Figure 2 shows the copper chart overlaid with crude oil. The two often move closely together, and they tend to be affected by similar factors. But correlations can also change over time. Some markets may be correlated only at extreme highs and lows.

Explore the different overlays and see if you can find helpful or interesting relationships. As your awareness rises, you might find other potential trading opportunities and come to a trade through a whole new door. Even though you can't, say, directly trade the Shanghai Composite index, you can, in theory, indirectly trade China by knowing a bit more about copper futures.

### ONWARD TO RUSSIA

If you're watching the world, don't ignore Russia, which often has a dramatic impact on global markets and a strong relationship with the energy markets, especially oil. Yes, there's more to oil prices than driving to the gas pump and filling up your car's gas tank. Price movements in crude are often impacted by global events, especially geopolitical risk. Even a small conflict can spike oil prices. The biggest oil producers are Saudi Arabia, U.S., Russia, Iran, and China. The largest consumer is the U.S., with China coming in a close second. So keep an eye on the news for any hints and predictive headlines.

Crude oil futures are actively traded and can be volatile. Sure, certain variables like market demand, weather, and OPEC deci-

sions can have an impact. But price movements in crude oil may sometimes be based on emotions.

Consider the chart of crude oil futures in Figure 3. On May 4, 2017, crude oil dropped to below \$46 a barrel. If you go back to November 29, 2016, you'll see a price of \$44.82, which was the low for that day, and a strong support level for crude prices. After the fact, you can see that crude's price almost reached that support before bouncing back.

**WATCH IT:** Stay in tune with breaking news through your CNBC widget. Fire up your thinkorswim platform and you'll see it right on the home page that pops up, or access it from the left sidebar by selecting Trader TV.

When you see something drastic on a chart, it may be a good time to explore some fundamental research. Pull up your favorite news source—for example, you have access to the CNBC widget on thinkorswim—and look under the energy section to see what may have triggered a particular day's sell-off. It could have been

caused by a slump in demand, uncertainty about oil's future, or an excess in supply.

More to the point, that activity happened after OPEC's decision to cut production to control supply. Could it be that traders weren't convinced Russia was on the "supply-cutting" board? Or was it because U.S. oil inventories were higher? Turns out, none of the above. It could have been emotion triggered by forced selling.

Since then, oil prices have rebounded as traders await the oil producers' meeting in late May 2017. The chart points to the next resistance level at \$54. Will prices break out, or resume their trading range?

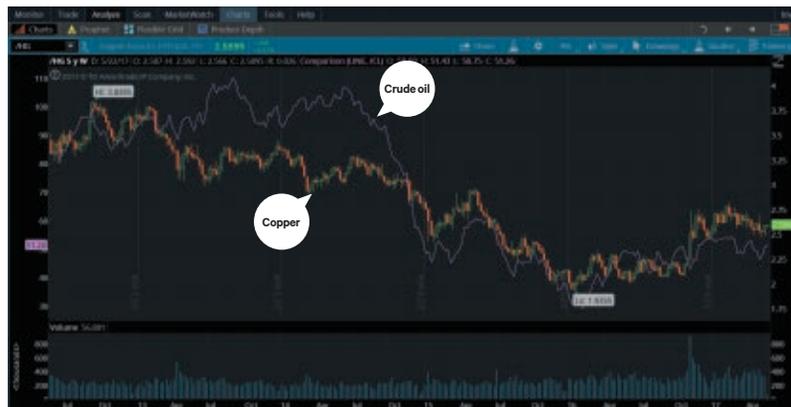
## MORE OPPORTUNITIES

The scenarios presented here just scratch the surface. There are countless countries you can explore to determine how they relate to and shape other markets. You may even surprise yourself and find relationships you never thought existed. Start with the fundamentals, then narrow down to the technicals.

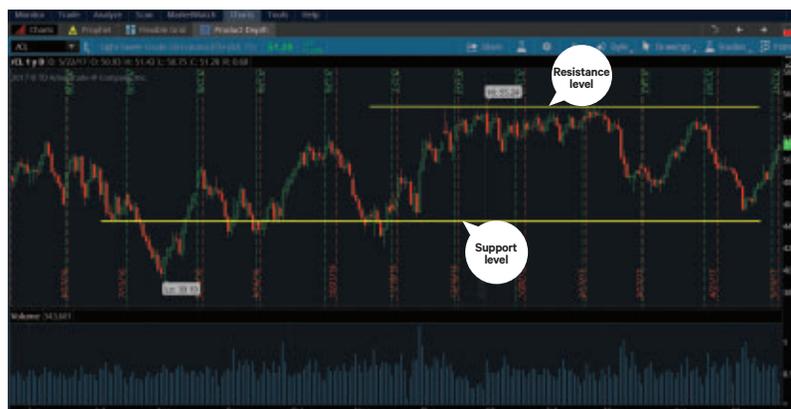
Train your brain to think differently. When you hear of a cyclone brewing in the Pacific, or a change in leadership in a European nation, think about how those events might hit the global markets. Which futures will be impacted, and how will those futures affect other sectors? Last but not least, figure out what new potential trading opportunities may come knocking. All you have to do is turn on your smartphone.



**FIGURE 1: What's with the selloff during planting season? Geopolitical events can throw you a curveball, so pay attention to other parts of the world.** Source: thinkorswim from TD Ameritrade. For illustrative purposes only. Past performance is no guarantee of future results.



**FIGURE 2: How correlated are they? When you overlay two charts, the answer becomes clearer. Copper and oil, for the most part, move together in this chart. Knowing this can help you create possible trading strategies.** Source: thinkorswim from TD Ameritrade. For illustrative purposes only. Past performance is no guarantee of future results.



**FIGURE 3: Keep an eye on resistance. A breakout above the resistance level could mean further upside in crude oil. And if prices slide lower, watch that support.** Source: thinkorswim from TD Ameritrade. For illustrative purposes only. Past performance is no guarantee of future results.

Jayanthi Gopalakrishnan 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.

International investment and investments in commodities are not suitable for all investors as they can be extremely volatile and can be significantly affected by world events, import controls, worldwide competition, government regulations, currency fluctuations, and economic conditions.

● PRO / TAKE AWAY: Use diagonals to stretch out your iron condors. Pick up credit by rolling them.

# PLUS NEUTRAL IRON CONDORS GET FASSTY

**BIG IDEA:** WHEN VOL IS LOW AND YOU'RE SCRATCHING YOUR HEAD TRYING TO DECIDE WHETHER TO PUT ON IRON CONDORS, CONSIDER DIAGONALS. YOU'LL BE ABLE TO PUSH YOUR LONG OPTIONS FURTHER OUT IN EXPIRATION AND GET LONG VOL EXPOSURE.

WORDS BY **THOMAS PRESTON**  
PHOTOGRAPHS BY **DAN SÆLINGER**

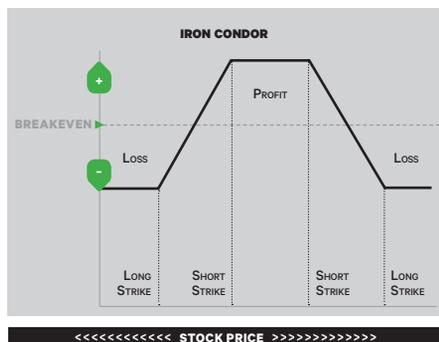


**B**read 'n' butter. Meat 'n' potatoes. Rice 'n' beans. When you're hungry, you may rely on combinations of staple foods to deliver satisfying deliciousness. There're some slight variations on the basic recipe. But when you see them on a menu, you can usually be fairly certain you'll get a reliable, hearty meal to keep body and soul humming.

#### ORDER THE TRADER'S COMBO

Some traders rely on strategies that combine positive time decay (**theta**) and defined risk. Positive theta might be beneficial in that time is on your side, all else being equal, and defined risk might deliver the confidence that no matter what a stock, index, or market does, a trading loss won't exceed a size you can know when you enter the trade.

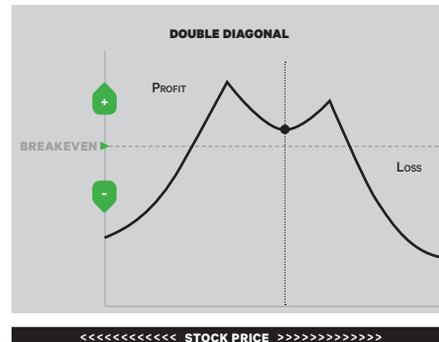
One typical trader's combo is the **iron condor**. (See Figure 1.) It has positive theta, defined risk, and limited **deltas**, as long as options are far enough **out of the money** (OTM). It's a market-neutral strategy you can use when you expect a stock or index price to stay in a range—specifically, between the strike prices of a short call and short put of an iron condor.



**FIGURE 1: Profit curve of the iron condor.**  
For illustrative purposes only.

Now, the credit you receive when you sell an iron condor can be higher when volatility (**vol**) is higher, all things being equal. And that credit is the max potential profit of the iron condor, which impacts how much positive theta it has. This can make the credit important. Yet, when **VIX** is under 20, and the implied vol of individual stocks is low, iron condors might not deliver the credits you hunger for.

It's kind of like seeing meat and potatoes on the menu, but in appetizer-sized portions that won't fill you up. But never fear. When your meat-and-potatoes iron condor needs to be more filling in a low-vol market, you can stretch it out by tweaking the strategy in a way that still maintains positive time decay and defined risk. On to the next dish: double diagonals.



**FIGURE 2: Profit curve of the double diagonal.**  
For illustrative purposes only.

#### DOUBLE OR NOTHING

The double diagonal (Figure 2) is an iron condor stretched across two expirations. It's short an OTM call and OTM put within the same expiration, and long a further OTM call and OTM put.

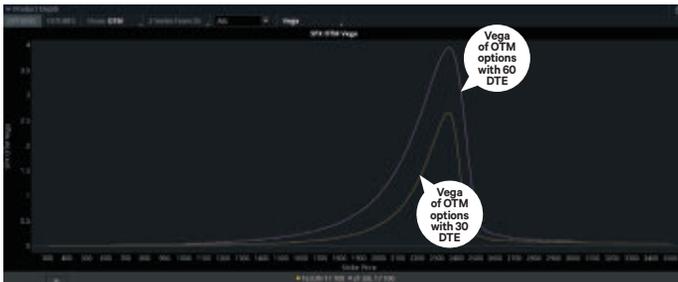
The double diagonal takes those long OTM calls and puts to a further expiration. So, the double diagonal's short call and put are in an expiration with fewer days to expiry (DTE), and its long call and put are in an expiration with more DTE.

For example, with XYZ at \$40 per share, an iron condor could be a long 37 put, a short 38 put, a short 42 call, and a long 43 call, with 30 DTE. A double diagonal would be short the 38 put and 42 call with 30 DTE, and long the 37 put and 43 call, with 60 DTE. Like the iron condor, the double diagonal is designed to profit if the stock price stays in a range between the strike prices of the short call and put, which in this example would be between \$38 and \$42. The double diagonal also has positive theta and defined risk.

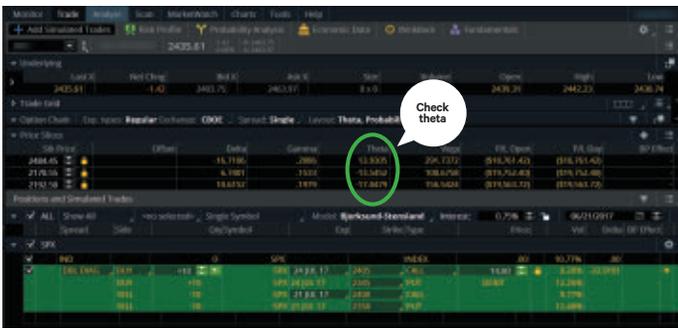
All things being equal, the positive theta of the short 38 put and 42 call with 30 DTE will be greater than the negative theta of the long 37 put and 43 call with 60 DTE. Here, theta grows as the option approaches expiration. Theta is also higher when the option is closer to the money. In this case, the 38 put and 42 call with 30 DTE have higher theta than the 37 put and 43 call with 60 DTE, and the short 38 put and 42 call give the double diagonal net positive theta.

The double diagonal also has defined risk. No matter how high or low the stock price, the double diagonal's max risk is the difference between the long and short strikes (either calls or puts), minus any credit received, or plus any debit paid, including transaction costs. If you created the double diagonal in XYZ for a \$0.20 credit, the max risk would be  $\$38 - \$37 - \$0.20$ , or \$0.80, or \$80 per double diagonal. If you paid a \$0.30 debit for the double diagonal, the max risk would be  $\$38 - \$37 + \$0.30 = \$1.30$ , or \$130 per double diagonal, plus transaction costs. Those max losses happen if the stock falls below the long put strike, or sits above the long call strike (\$37 or \$42 in this example) at the long options' expiration.

So, what does the double diagonal do that the iron condor doesn't? By pushing the long options to a further expiration, the double diagonal can have positive vega, meaning an increase in implied vol can benefit it. An iron condor has negative vega, so an increase in implied vol can hurt an iron condor position, all things being equal.



**FIGURE 3: Visualize vega.** When there are more days to expiration, vega is higher. Source: thinkorswim from TD Ameritrade. For illustrative purposes only.



**FIGURE 4: Explore the double diagonal.** Put in your simulated trades and see if vega is positive. Change the strike prices and see how vega changes. Source: thinkorswim from TD Ameritrade. For illustrative purposes only.

### ADD A LITTLE VEGA

Remember some hard facts about vega. First, it's highest for **at-the-money** (ATM) strikes, and gets progressively lower as a strike moves further OTM. Second, it's higher when an option has more time to expiration, all else being equal. With an iron condor, the short options are closer to the money and have higher vega than the further OTM long options. So, the iron condor is net short vega. With the double diagonal, even though long options are further OTM than short options, they can have higher vega because they have more time to expiration.

You can visualize vega at different strikes for multiple expirations on the thinkorswim® platform from TD Ameritrade. On the **Trade** page, go to the

**Product Depth** section near

the bottom. Select vega from the dropdown menu, then choose two expirations from the "Series" dropdown menu. In Figure 3, the magenta line shows the vega of OTM options with 60 DTE, and the yellow line shows the vega of OTM options with 30 DTE.

Really, a double diagonal is an iron condor, plus a put calendar and a call calendar.

- Start with a 37/38/42/43 iron condor, which is long the 37 put, short the 38 put, short the 42 call, and long the 43 call with 30 DTE.

- Add in a long 37 put calendar that's short a 37 put with 30 DTE, and long the 37 put with 60 DTE.

- Add a long 43 call calendar that's short the 43 call with 30 DTE, and long the 43 call with 60 DTE.

The long 37 puts with 30 DTE of the iron condor are offset by the short 37 puts with 30 DTE of the put calendar spread, while the long 43 calls with 30 DTE are offset by the short 43 calls with 30 DTE of the call calendar spread.

Keep in mind that **calendar spreads**

have positive vega. Adding them to a negative iron condor can create a positive-vega double diagonal. The level of a double diagonal's positive vega depends on which strikes you select for long options. If long options are closer to the money, like the 37 puts and 43 calls are in this example, it could have a higher vega than if the long options are further OTM, such as the 35 puts and 45 calls. If the long options are far OTM, they could have lower vega than the short options, and give the double diagonal negative vega.

You can use the **Analyze** page on the thinkorswim platform to see if a prospective double diagonal has positive vega, and even test how that vega changes as you use different strikes (Figure 4).

Strike selection in double diagonals also determines position risk. The wider the distance between the strikes of the short and long options, the larger the risk. That's the same as with an iron condor.

When vol is low, consider the double diagonal's long vega strategy. If you think implied vols might go higher, but you still like the market-neutral, positive-theta, defined-risk strategy, the double diagonal could be a suitable alternative.

### ROLL WITH IT

Double diagonals have another unique feature: opportunities to get credits from rolls. Think of it as the gravy with your tasty meat

and potatoes. Because a double diagonal's long options are in a further expiration than the short options, you can try to roll the short options to a further expiration and collect a credit. As long as the short options you roll to don't expire after the long options, you can keep a double diagonal alive long after an iron condor expires.

Just like rolling the short option of a long calendar spread, the credits received through rolling a double diagonal's short options can reduce the risk of the position while potentially increasing its profit. Given the available stocks and indices with weekly options, this increases the number of possible rolls.

For example, if you paid \$0.30 debit for that XYZ double diagonal, the max risk is \$130. But if you roll the short 38 put and 42 call to a further expiration and collect \$0.30 in credit, you've reduced the double diagonal's risk to \$100. If you can roll them again for, say, \$0.40, you've reduced the risk down to \$60. The last action is rolling the short options to the expiration of the long options, and you have—drum roll, please—the iron condor. The total roll credit on the double diagonal is the total for the resulting iron condor. Ideally, those rolling credits are higher than what you'd get from selling the iron condor in the first place.

Credits earned for rolls depend on where the stock price is at the time of the roll, as well as implied vol. When implied vol is higher, credits can be higher, too. So, if you think implied vols will rise, you could potentially collect more. That's an additional benefit to a double diagonal's long vega.

Keep in mind that rolls will increase commission costs, which means the double-diagonal strategy may carry more commissions than the iron condor.

### FILL UP ON STRATEGY

Don't go hungry when vol is low. And don't toss out your market-neutral, positive-theta, defined-risk style for potentially riskier directional trades. Consider double diagonals as an alternative to iron condors in low-vol market conditions. Then buy a stationary bike and snack to your heart's content.

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*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 trading options, see page 37, #1–2.*

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## Run Lola Run

SHE JUST KEEPS GOING AND GOING AND GOING. THERE'S NOT A WHOLE LOT THAT CAN STOP THIS GAL.

*Illustration by Joe Morse*

• HAILING FROM THE emerald isle, Lorraine Gavican Kerr—LGK, Lola, or Spud—works hard and plays hard. Independent and strong, she'll do everything and anything on her own, including taking a cab to the hospital as she's about to give birth to her third child. She'll squeeze as much into her day as she can and after her tasks are done, she'll often go for a run, even if it's midnight. Three words tell Kerr's complete story: "Bring it on."

**1** **You have a degree in education. How did you end up in the financial industry?** It wasn't the career path my parents thought I'd follow. I was educated in Ireland. I taught native Irish language, history, and geography. I worked in business for some time and eventually got connected to TD Ameritrade.

**2** **Your title is Director, Trader Operations and Oversight. What does that mean?** It sounds way fancier than it is. We're responsible for making sure we perform the best for our customers and shareholders. We care about the

client experience. My job is to make sure those things happen—putting out the right information, ensuring that teams are appropriately supervised, making sure our operations are running properly, ensuring regulatory inquiries or customer problems get resolved quickly. Luckily, our team is made up of old-school traders who have a sensitive palate when it comes to exceptional client service at every level. I'm a behind-the-scenes kind of gal. I work to make sure our back-end operations are nurturing the end goal, which is to make clients happy. I also support our business operations in Singapore and Hong Kong.



**3** **You're afraid of flying. Do you ever travel to those places?** Not afraid, petrified. All of my family live in Ireland, so I endure that flight, often with gritted teeth. I'm one of those crazy Irish Catholic girls who blesses the plane and prays the rosary the whole way. After seven years of supporting our Asia business, I finally

got the guts to travel to Singapore and Hong Kong. The flight was nerve wrecking and yes, I did bless the plane!

**4** **Does this fear have anything to do with your trading style?** I'm afraid of flying mostly due to lack of control. When I trade I like to feel in control and don't like to lose money. I have a risk-averse personality. When it comes to trading, I create a plan and stick to it. I keep my emotional attachment to a minimum. My golden rule of thumb is simple: if you invest and put your money out there, be prepared for the trade to go against you.

**5** **You may have some fears, but you're not afraid of the dark. Who jogs at midnight?** Running for me is relaxing. When I'm finished with work I like to spend time with my family. I run when my three little kids are sleeping, maybe not quite midnight but close.

**I find that running is more productive than, say, watching TV or going to the pub. Well, sometimes.**



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## Storm Watching: Chart Patterns That Portend a Storm

GETTING INTO A TRADE WHEN MARKETS ARE IN A STRONG RALLY CAN BE EASY. BUT HOW DO YOU KNOW WHEN THINGS MAY CHANGE?

● EASY / TAKE AWAY: Use charts as a weather map to potentially alert you to changes.



**FIGURE 1: Double top up ahead?** Could be, given that the second top didn't quite reach as high as the first top after the pullback and prices look like they may be breaking below the neckline.

Source: TD Ameritrade. For illustrative purposes only.

• WHEN TIMES ARE GOOD, don't get caught up in thinking it'll be that way forever. At some point, you need to turn on your alerts just so you don't get caught unawares. And in the markets, those alerts could come in the form of chart patterns. Have you ever looked at a chart and thought to yourself that something just isn't right? Perhaps it's looking too topy, or maybe its behavior has changed, or maybe you see a classic topping pattern begin to appear. And then it happens ... the fear factor ... you're now moving into the domain of the chart pattern nerd. Hey, you know what? There are worse things to fear. So, take a page out of the chartists' book and give charts a chance.

### DOUBLE OR NOTHING

There're many chart patterns that identify a topping pattern such as head and shoulders, triple tops, or double tops. We'll focus our at-



**FIGURE 2: After the storm.** Things seemed to follow the theoretical definition of a double top. After the pullback, prices dropped to around where they should have. Recognizing the pattern ahead of time could have helped to make entry and exit decisions.

Source: TD Ameritrade. For illustrative purposes only.

tention on the double top and see how it may have alerted you to a possible top. A double top is a bearish pattern, and the name is a dead giveaway. You see two tops forming on a chart, and what usually happens—although not all the time—is that when that first top forms, it will be the prevailing trend's highest point. Chances are you're not going to think anything is out of the ordinary. It's just part of the normal trend. After that peak, you could see a price pullback—again, nothing unusual. There won't be an increase in volume during the pullback. It looks like nothing more than a regular pullback.

After the pullback, you'll see prices move back up as far as the previous high (or the first top of the double top). Here's where you look at the price to see if there're any signs of resistance at that first top. You may have to exercise some patience, because it could take a few months before a double top can be confirmed. The pattern can only be confirmed if prices decline from this second top with increased volume. When you see prices fall with higher volume and

quickly, that should alert you that something isn't right. The next point to watch is that low between the two peaks. Will price break this support, and do so with increased volume? If it does, you could expect price to fall as much as the distance between the support level and the peak of the double top. This may sound pretty clear-cut (and in reality, of course, things are rarely so clear), but it gets you thinking that there may be some kind of a shift between supply and demand, which should be enough to put you on alert.

Take a look at the chart of the double top in Figure 1. The first top formed at around 3737. Prices then pulled back to around 3625 and then went back up to 3717, which is not as high as the first top. If you draw a line connecting that pullback point to a previous low, you'll get what's called a "neckline." This gives you some idea as to how low prices could get if, after that second top, prices go down and break below that neckline. In this case, the distance between the first top and pullback is about 112 points. This suggests that when prices break below the neckline, you could potentially expect prices to drop by about 112 points below that break point.

You can see from the chart that price did break below the neckline at around the 3620 level. From a theoretical point of view, that would mean that prices should decline to around 3508. Let's see what happened (Figure 2). Price did fall steeply after it broke below the neckline, but didn't quite reach 3508. In fact, it went back up above the neckline but didn't make it to the second top. Instead, it did a quick turnaround and again broke below the neckline. This time, the decline was drastic.

### KEEP AN EYE ON IT

Here's what's interesting—the price bar after the long breakout bar went as low as 3482 but closed for the day at 3507. How's that for coincidence? Another point to note here is the neckline. Notice how it first acts as a support level, and once prices break below it, that neckline becomes a resistance level.

These are the types of things any trader could pick up from looking at charts—without becoming a chart pattern nerd. You've got the tools, so why not use them to alert you to possible stormy weather, even if it's for the short term?

## TRADER JARGON GLOSSARY



### At the money (ATM)

• 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.

**Calendar spread**—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.

**Delta**—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.

**Iron condor**—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.

**Margin call**—A margin call is issued when your account value drops below the maintenance requirements on a security or securities due to a drop in the market value of a security or when you exceed your buying power. Margin calls may be met by depositing funds, selling stock, or depositing securities. TD Ameritrade may forcibly liquidate all or part of your account without prior notice, regardless of your intent to satisfy a margin call, in the interests of both parties.

**Out of the money (OTM)**—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**—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.

**Short put vertical**—A defined-risk, directional spread strategy, composed of an equal number of short (sold) and long (bought) 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 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 by subtracting the credit received from the higher (short) put strike.

**Straddle**—A trading position involving puts and calls on a one-to-one basis in which the puts and calls have the same strike price, expiration, and underlying asset. When both options are owned, it’s a long straddle. When both options are written, it’s a short straddle.

**Synthetic covered call**—A position composed of long stock and a long put. The number of long puts multiplied by 100 equals the number of long stock shares. For example, long five synthetic 70 calls can be created by being long five 70 puts and long 500 shares of stock.

**Vega**—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 0.04, a one percentage point increase in implied volatility will increase the option premium by \$4.

**Verticals/vertical spreads**—An option position composed of either all calls or all puts, with long options and short options at two different strikes. The options are all on the same stock and of the same expiration, with the quantity of long options and the quantity of short options netting to zero.

**Theta**—A measure of an option’s sensitivity to time passing one calendar day. For example, if a long put has a theta of -0.02, the option premium will decrease by \$2 per option contract.

**CBOE Volatility Index (VIX)**—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.

## 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.*

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# Five ways traders can prepare for HIBERNATION

•As a trader, you have the ghost thing down pat. You're good at disappearing. You go into your office with every intention of coming out for dinner, but somehow, days and weeks pass. You beg forgiveness from friends and family, but know in your soul you'll never change (hey, the price of genius). But there's hope from an unlikely source—bears—who, during hibernation, remain safely oblivious to the world. And so can you. With a little preparation.



## 1. STORE FAT

• Bears can lose 30% of their body weight during hibernation and you might, too, should you forget to eat during prolonged trading sessions. That means you must stockpile industrial portions of potato chips, candy bars, gourmet coffees, and those strange protein drinks in your office—quick calories that make you feel young at heart and always at the ready.

## 2. REDUCE YOUR BODY TEMPERATURE

• A lower body temperature will slow your metabolism, making the fun calories just listed last longer. Multiple air conditioners aimed at your head, combined with misted air blown across your body, should do the trick and reduce your body temp a couple of degrees. This way you don't have to resort to an ice bath, which could take you away from your trading screen (not advised).

## 3. SLOW YOUR HEART RATE

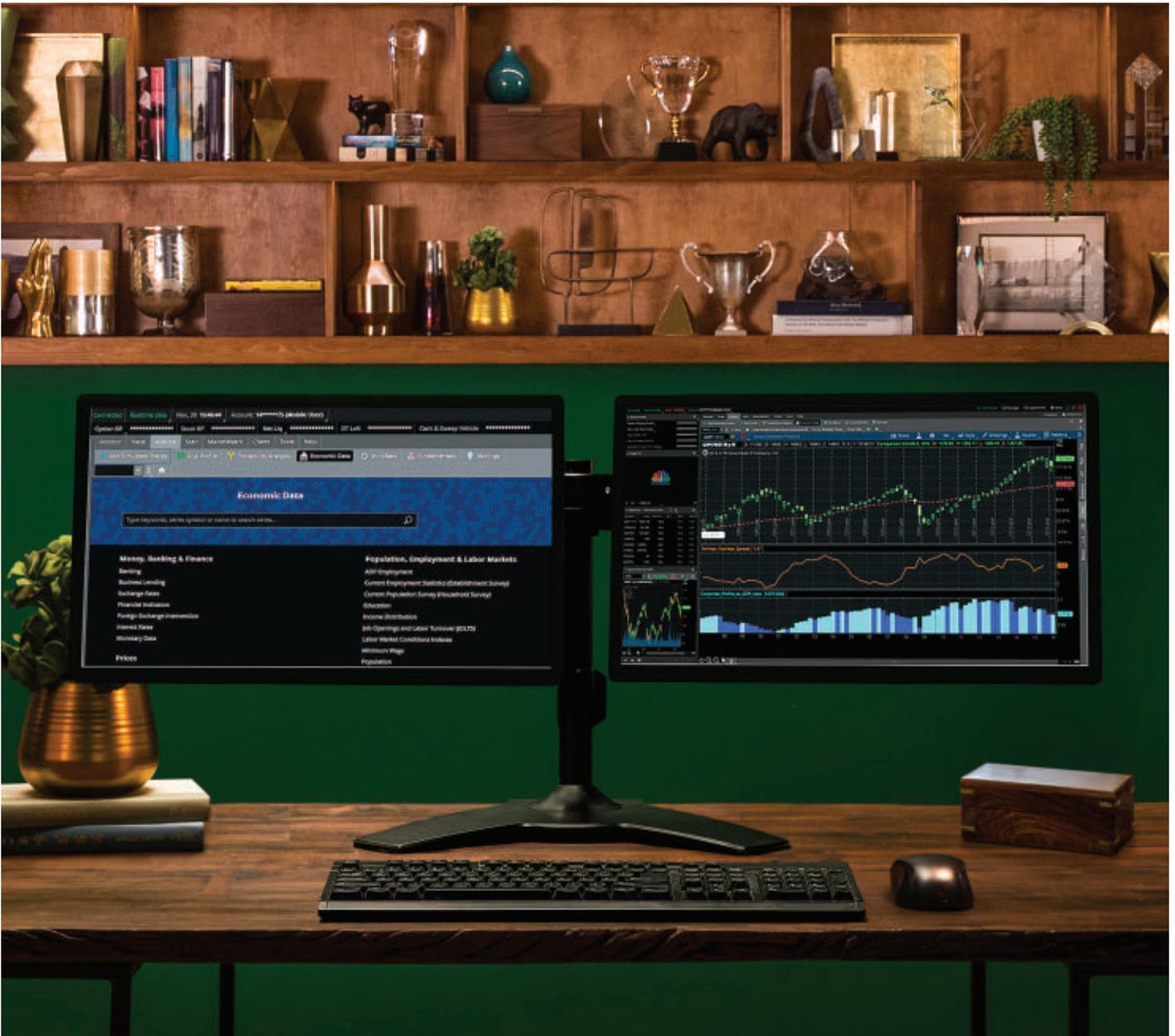
• In winter months, bears exist in a den of immobilized zen. For you, a slower heart rate can surely bring relaxation to even the most stressful trading days. To enter that mindful state, focus on up - and down - ticks in the /ES futures. The colored numbers will surely be hypnotic and help you feel truly at one with the global markets. If that doesn't work, hold your breath right before earnings announcements.

## 4. CREATE A SAFE PLACE

• Hibernating bears never want to feel vulnerable, so they secure a comfortable, safe spot. You, too, can get your trading area just right. Invest in padded chair cushions and neck pillows. Most of all, make sure the risk of your trading positions is manageable. You don't want to be roused by a big loss that causes you to actually leave the room, disrupt the hibernation, and seek the company of real people.

## 5. AVOID DISTRACTIONS

• With the help of bear assistants, these majestic creatures make sure their affairs are in order prior to bedding down. As a trader, you may want to prepay utilities bills to ensure uninterrupted service so your trading platform runs smoothly. Also, politely request that friends and family don't call or text, lest human contact ruin a blissful contemplation of positive theta and the Black-Scholes formula.



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