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# Investor Education Conference

A virtual experience

## Using Weekly Options to Unlock Trade Opportunities

**Mike Follett**
Education Coach

# How to Use This Guide

This reference guide is a tool to assist you in your learning during and after the Investor Education Conference.

## During the Conference

- Follow along with the presenter—the slides are in the guide.

## After the Conference

- Continue using the guide as a reference of all you've learned.
- Review reference guides and slides from presentations you couldn't attend.
- Complete the tasks on the Apply What You've Learned and Continue Your Education slides to keep developing your investing skills.

# Keep the Conversation Going

Make sure to follow TD Ameritrade on these social channels to stay connected with industry-thought leaders and fellow investors.

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# Important Information

Options are not suitable for all investors as the special risks inherent to options trading may expose investors to potentially rapid and substantial losses. Carefully read the previously provided copy of *Characteristics and Risks of Standardized Options*. Options trading privileges are subject to TD Ameritrade review and approval.

Options trades involving minimal potential benefit can also be significantly impacted by transaction costs.

**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.**

Supporting documentation for any claims, comparison, statistics, or other technical data will be supplied upon request.

Examples presented are provided for illustrative and educational use only and are not a recommendation or solicitation to purchase, sell, or hold any specific security or utilize any specific strategy.

Spreads, straddles, and other multiple-leg options strategies can entail substantial transaction costs, including multiple commissions, which may impact any potential return.

Advanced options strategies often involve greater and more complex risk than single-leg options trades. Investors should also consider contacting a tax adviser regarding the tax treatment applicable to spreads and other multiple-leg options transactions.

Educational Purposes: The following presentation is for educational purposes only and is not a recommendation or endorsement of any particular investment or investment strategy.

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

# Important Information

Discussion of returns are hypothetical and may not include the impact of commissions and fees. Returns will vary and all investments involve risks, including loss of principal.

Asset allocation and diversification do not eliminate the risk of experiencing investment losses.

In order to demonstrate the functionality of the platform, we need to use actual symbols. However, TD Ameritrade does not make recommendations or determine the suitability of any security or strategy for individual traders.

Any investment decision you make in your self-directed account is solely your responsibility.

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

Probability analysis results shown (such as the probability of an option expiring in the money) are theoretical in nature, not guaranteed, and do not reflect any degree of certainty of an event occurring.

All investing involves risks, including risk of loss.

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# Mike Follett

## Education Coach

- Former options principal and trade desk manager at Morgan Stanley Online
- Education coach since 2003
- Teaches in-person workshops and webcasts focused on advanced options strategies
- Co-creator of the options curriculum

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# Agenda

1. Weekly options
2. Implied volatility
3. Covered strangles
4. Butterfly spreads

# Weekly Options Background

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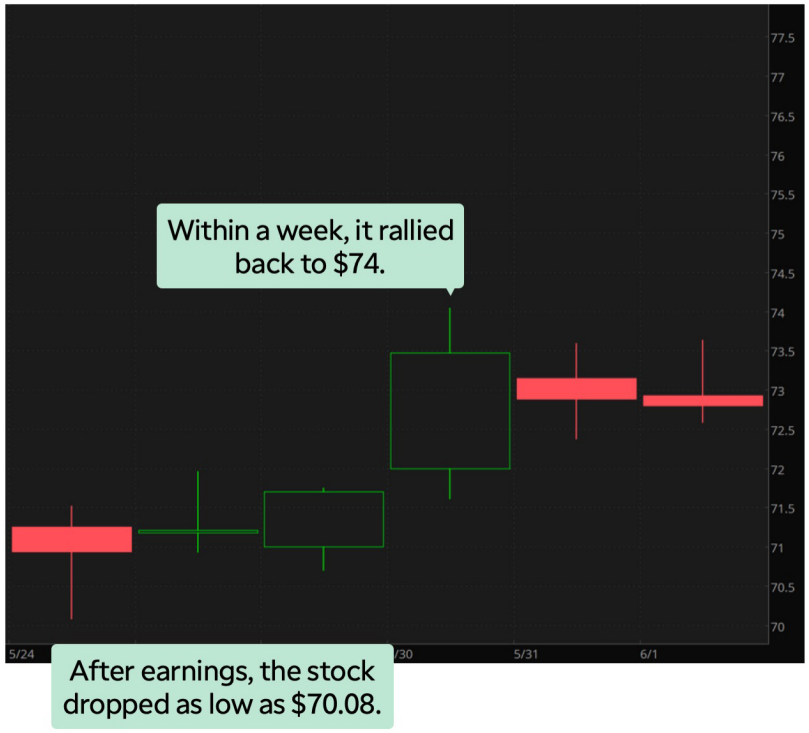
| Option Chain | Filter: **Off** | Spread: **Single** |
|---|---|---|
| APR1 16 | (1) | 100 **(Weeklys)** |
| APR2 16 | (8) | 100 **(Weeklys)** |
| APR 16 | (15) | 100 |
| APR4 16 | (22) | 100 **(Weeklys)** |
| APR5 16 | (29) | 100 **(Weeklys)** |
| MAY1 16 | (36) | 100 **(Weeklys)** |
| MAY2 16 | (43) | 100 **(Weeklys)** |
| MAY 16 | (50) | 100 |
| JUN 16 | (78) | 100 |
| JUL 16 | (106) | 100 |
| OCT 16 | (204) | 100 |

- Not available for all stocks
- Cease trading Friday every week
  - Index options are an exception because they have some shorter expirations
- Most eligible stocks have five weeks available
- For an updated list of stocks/indices with weekly options, go to: http://www.cboe.com/micro/weeklys/availableweeklys.aspx

# Weekly Options: The Good, the Bad, ...

- Benefits:
  - Rapid time decay (income)
  - Short-term volatility events
  - Short-term portfolio protection
- Risks:
  - Increased commissions as you can trade more frequently
  - Additional complexity like higher gamma risk
  - Require more active monitoring

# … and the Ugly: Market Cyclicality

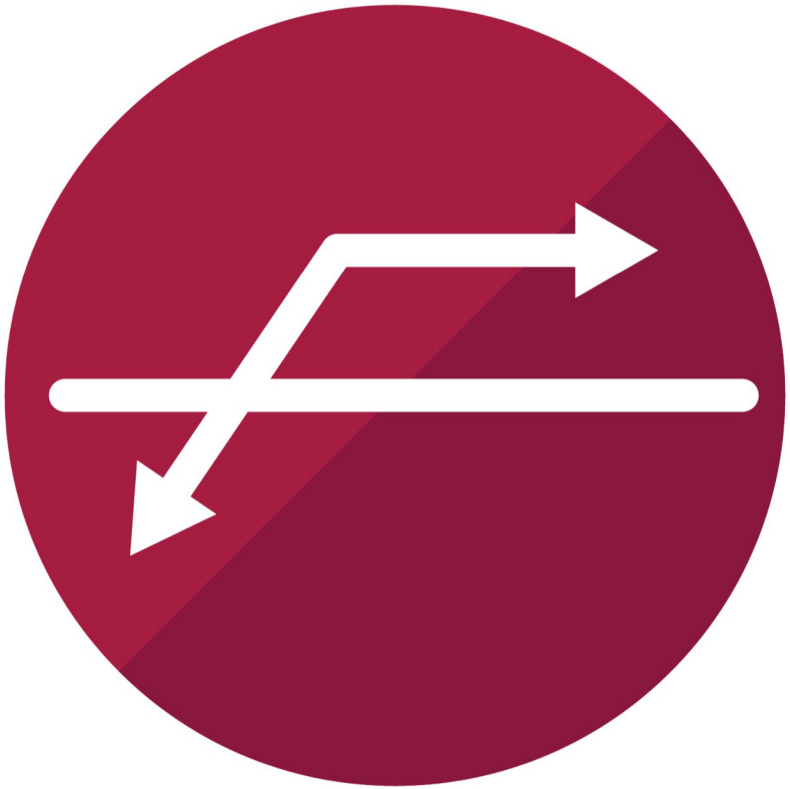



- A short time frame can be a help or a hindrance.
- Weekly options don't allow for "normal" market cyclicality.
- Sometimes even an extra week of time can make a big difference.

# Income with Covered Strangles

- Seek to generate income from existing stock positions.
- Use long-term stocks.
- Be willing to increase the position on a pullback.

# Covered Strangle



- Own stock (but willing to buy more or sell shares)
- Sell an out-of-the-money (OTM) call and an OTM put

# Sample Covered Strangle Entry

- Consider selling options one to three weeks to expiration
- Begin strike selection process around .30 delta
- Lower delta = Lower premium, but more freedom for stock movement
- Higher delta = Greater income, but less range for stock movement

# Follow Along

## Which options would you consider selling for a covered strangle?

| Last X | Net Chng | Bid X | Ask X | Size | Volume | Open | High | Low |
|---|---|---|---|---|---|---|---|---|
| 106.72 Q | +.81 | 106.62 P | 106.65 Q | 3 x 4 | 32,126,723 | 105.25 | 107.29 | 105.21 |

Option Chain | Filter: **Off** | Spread: **Single** | Layout: **Delta**

Strikes: 12

| CALLS | | | | | | PUTS | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Delta | Bid X | Ask X | Exp | Strike | Bid X | Ask X | Delta | |
| APR5 16 (38) 100 **(Weeklys)** | | | | | | | | 26.70% (±7.423) | |
| | .72 | 7.10 X | 7.60 X | APR5 16 | 101 | 1.41 X | 1.49 X | -.25 | |
| | .70 | 6.35 A | 6.65 X | APR5 16 | 102 | 1.69 Q | 1.73 Q | -.29 | |
| | .66 | 5.70 X | 5.85 X | APR5 16 | 103 | 1.94 X | 2.03 T | -.33 | |
| | .62 | 5.05 X | 5.20 A | APR5 16 | 104 | 2.27 X | 2.35 T | -.37 | |
| | .58 | 4.40 X | 4.60 X | APR5 16 | 105 | 2.65 Z | 2.72 T | -.41 | |
| | .54 | 3.85 X | 4.00 X | APR5 16 | 106 | 3.05 E | 3.15 A | -.46 | |
| | .49 | 3.30 X | 3.45 M | APR5 16 | 107 | 3.50 X | 3.60 M | -.51 | |
| | .45 | 2.83 E | 2.95 M | APR5 16 | 108 | 3.75 X | 4.15 X | -.56 | |
| | .41 | 2.39 X | 2.51 X | APR5 16 | 109 | 4.25 X | 4.75 A | -.61 | |
| | .36 | 2.01 X | 2.10 X | APR5 16 | 110 | 4.85 X | 5.40 X | -.66 | |
| | .32 | 1.67 M | 1.78 X | APR5 16 | 111 | 5.45 X | 6.15 X | -.71 | |
| | .28 | 1.37 X | 1.47 M | APR5 16 | 112 | 6.05 X | 7.10 X | -.75 | |

# Comparing Strike Selection

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**For this example, the current stock price is near $107.**

| Strike Prices | Approximate Credit | Potential Risks |
|---|---|---|
| $109 call, $105 put (~.40 delta) | $5.05 | Buy additional shares at $105; Sell owned shares at $109 |
| $111 call, $102 put (~.30 delta) | $3.60 | Buy additional shares at $102; Sell owned shares at $111 |
| $112 call, $101 put (~.25 delta) | $2.68 | Buy additional shares at $101; Sell owned shares at $112 |

# Sample Covered Strangle Active Exit

- Near expiration, close options:
  - Buy to close the current position
- Near expiration, roll options*:
  - Buy to close the current position
  - Sell again using the same, or possibly adjusted, delta

*Rolling strategies can entail substantial transaction costs, including multiple commissions, which may impact any potential return.

# Sample Covered Strangle Passive Exit

- Do nothing:
  - OTM options expire worthless
  - In-the-money (ITM) options assigned:
    - Calls result in selling stock at strike
    - Puts result in buying stock at strike

# Other Opportunities with Weekly Options

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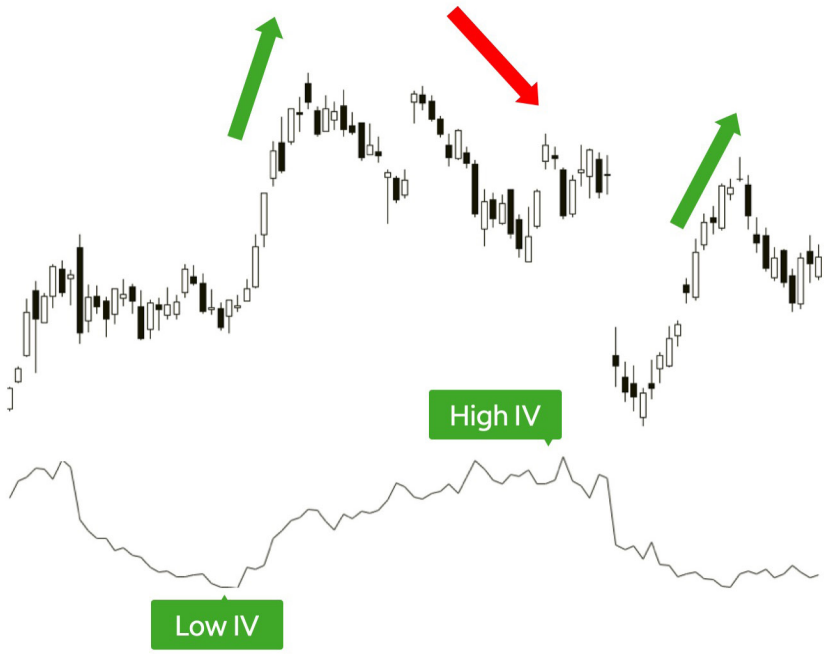
- Most trade decisions tend to revolve around price.
- However, some opportunities can be based more on implied volatility (IV).



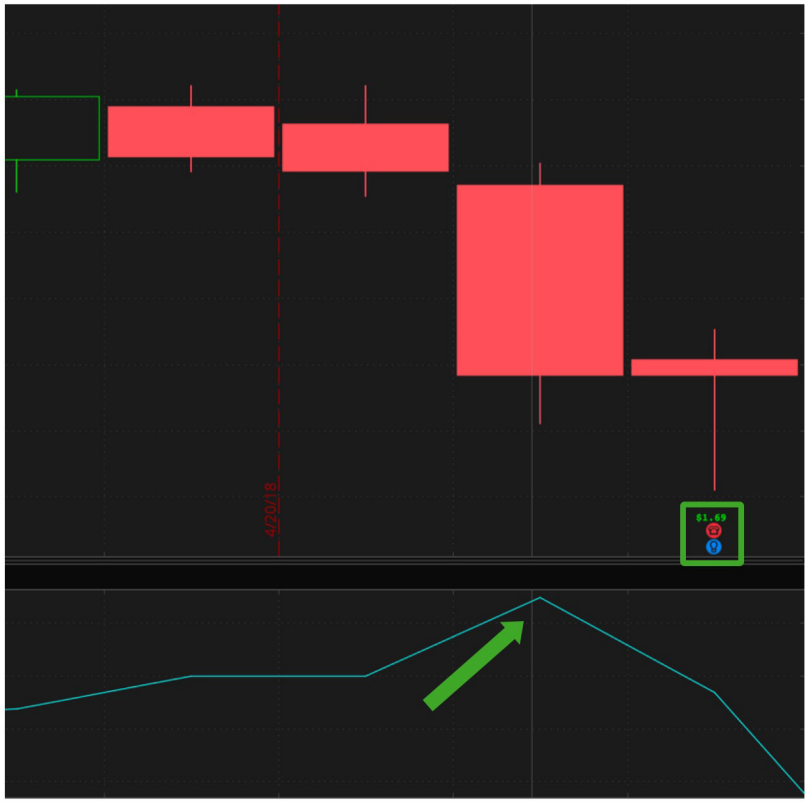
# Normal Volatility Skew

| | | | |
|---|---|---|---|
| › APR1 16 | (10) | 100 **(Weeklys)** | 16.59% (±2.477) |
| › APR2 16 | (17) | 100 **(Weeklys)** | 17.39% (±3.34) |
| › APR 16 | (24) | 100 POS | 17.89% (±4.06) |
| › APR4 16 | (31) | 100 **(Weeklys)** | 18.20% (±4.679) |
| › APR5 16 | (38) | 100 **(Weeklys)** | 18.86% (±5.359) |
| › MAY 16 | (59) | 100 | 20.04% (±7.079) |
| › JUN 16 | (87) | 100 | 20.93% (±8.973) |
| › JUN5 16 | (100) | 100 **(Quarterlys)** | 21.30% (±9.791) |
| › JUL 16 | (115) | 100 | 21.68% (±10.691) |
| › AUG 16 | (150) | 100 | 21.95% (±12.373) |
| › SEP 16 | (178) | 100 | 22.06% (±13.559) |
| › SEP5 16 | (192) | 100 **(Quarterlys)** | 22.23% (±14.199) |

- Implied volatility (IV) is usually similar across different expirations (normal or flat skew).
- This can change when large price moves are anticipated.

# Event Risk Volatility Skew

- Events like earnings announcements cause IV to skew.
- IV typically normalizes after the announcement.
- Weekly options strategies can be used to play the “IV crush.”



# Event Risk Volatility Skew (Cont.)

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| | | | |
|---|---|---|---|
| MAR4 16 | (2) | 100 **(Weeklys)** | 79.11% (±3.535) |
| APR1 16 | (10) | 100 **(Weeklys)** | 48.11% (±4.277) |
| APR2 16 | (17) | 100 **(Weeklys)** | 41.63% (±4.762) |
| APR 16 | (24) | 100 | 37.40% (±5.055) |
| APR4 16 | (31) | 100 **(Weeklys)** | 34.53% (±5.288) |
| APR5 16 | (38) | 100 **(Weeklys)** | 33.06% (±5.597) |
| MAY 16 | (59) | 100 | 31.35% (±6.601) |
| JUL 16 | (115) | 100 | 30.04% (±8.842) |
| OCT 16 | (213) | 100 | 29.53% (±11.902) |
| JAN 17 | (304) | 100 | 30.12% (±14.617) |
| JAN 18 | (668) | 100 | 28.26% (±20.803) |

- Events like earnings skew front-month IV higher.
- Further out expirations are relatively unaffected.

# Expected Move

- The stock's expected range over the time frame
- Based on current IV, stock price, etc.
- With IV skew, Market Maker Move (MMM) will show expected move through the event

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| B: 63.32 A: 63.44 | ETB | ±3.246 | | |
|---|---|---|---|---|
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| APR2 16 | (17) | 100 **(Weeklys)** | 41.63% | (±4.762) |
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# The Weekly Butterfly

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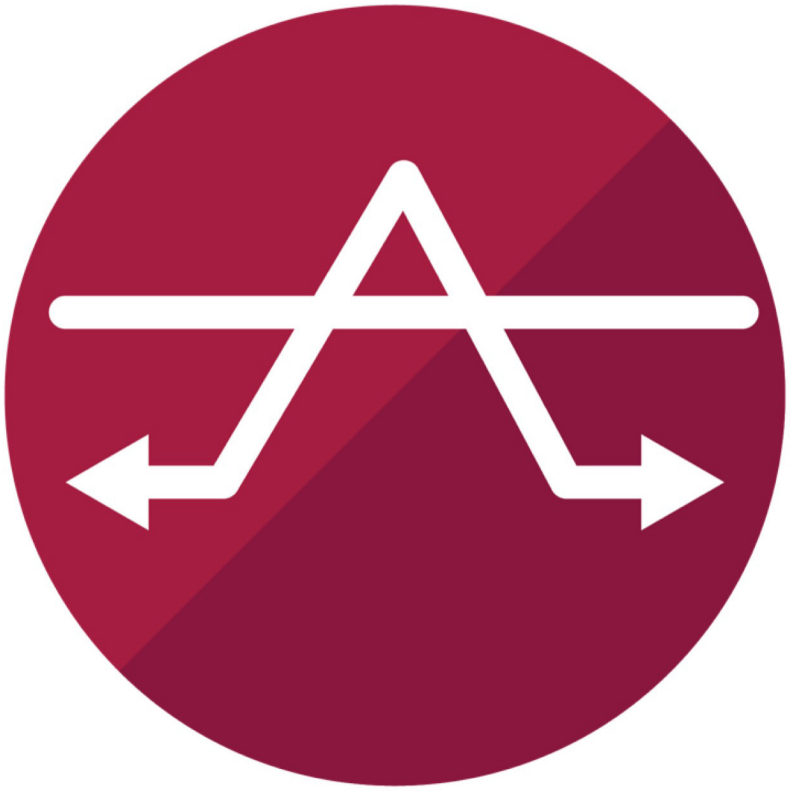
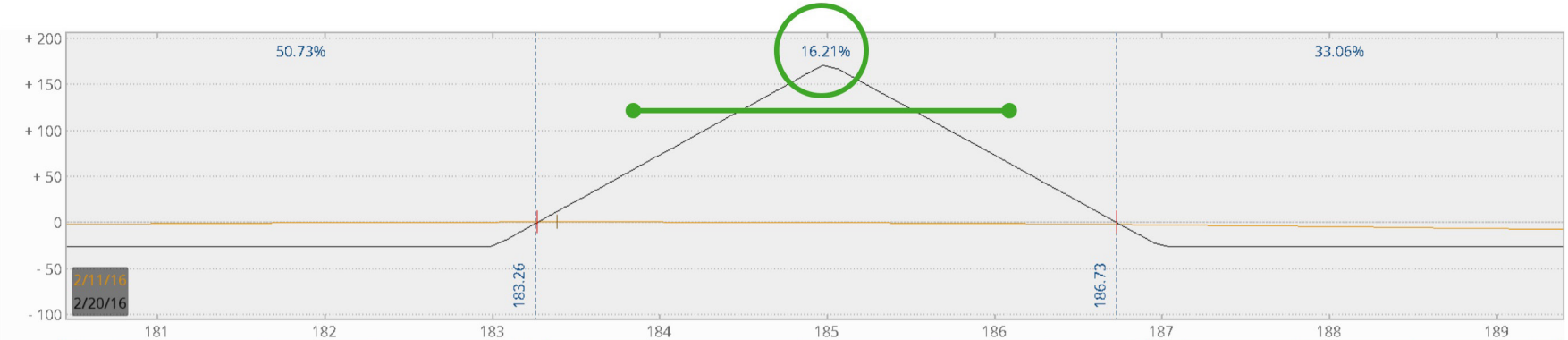


- Features:
  - The price of butterfly spreads moves most quickly near expiration
  - Falling volatility helps
  - Favorable pricing when volatility is high potentially creates a lower max loss
  - Small investment
- Risks:
  - Higher probability of max loss
  - Lower probability of price hitting max gain
  - Low or declining liquidity especially near expiration

# A Quick Butterfly Reminder




| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| BUTTERFLY | BUY | +1 | FEB 16 | 183 | CALL | .27 | 24.84% | .10 | - | ✕ |
| | SELL | -2 | FEB 16 | 185 | CALL | DEBIT | 23.70% | | - | |
| | BUY | +1 | FEB 16 | 187 | CALL | | 22.87% | | - | |
| VERTICAL | BUY | +1 | FEB 16 | 183 | CALL | 1.04 | 24.24% | 11.78 | - | ✕ |
| | SELL | -1 | FEB 16 | 185 | CALL | DEBIT | 23.22% | | - | |
| VERTICAL | SELL | -1 | FEB 16 | 185 | CALL | .77 | 23.22% | -11.65 | - | ✕ |
| | BUY | +1 | FEB 16 | 187 | CALL | CREDIT | 22.48% | | - | |

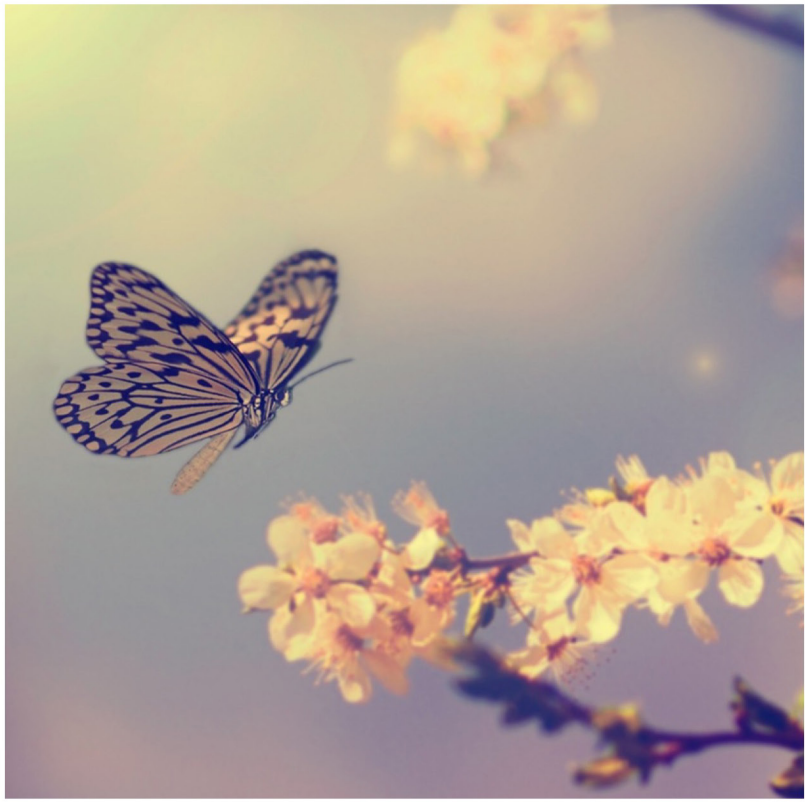
# Planning the Trade

- Consider buying the butterfly where you think the stock will most likely go (possibly support or resistance levels).
- If you have no idea, place the butterfly at strikes with highest levels of open interest (could be an area of pinning due to large amount of hedging near those spots).

| | Volume | Open.Int | Bid X | Ask X | Exp | Strike | Bid X | Ask X | Volume | Open.Int |
|---|---|---|---|---|---|---|---|---|---|---|
| FEB 16 (8) 100 POS | | | | | | | | | | 27.51% (±6.172) |
| | 21,217 | 6,926 | 2.98 M | 3.07 Q | FEB 16 | 183 | 2.90 Q | 2.96 M | 26,784 | 98,851 |
| | 8,542 | 6,009 | 2.70 Z | 2.79 C | FEB 16 | 183.5 | 3.08 M | 3.19 M | 7,381 | 13,679 |
| | 25,890 | 10,327 | 2.44 M | 2.53 Q | FEB 16 | 184 | 3.32 M | 3.40 N | 18,632 | 70,083 |
| | 6,412 | 6,372 | 2.20 Z | 2.28 M | FEB 16 | 184.5 | 3.58 Q | 3.70 N | 2,672 | 11,155 |
| | 40,069 | 21,811 | 1.97 M | 2.00 Q | FEB 16 | 185 | 3.84 M | 3.95 M | 35,419 | 164,126 |
| | 7,028 | 12,998 | 1.75 M | 1.83 Q | FEB 16 | 185.5 | 4.12 Q | 4.26 M | 3,672 | 17,282 |

# Sample Weekly Butterfly Entry & Exit Considerations

- Entry:
  - Typically eight to 10 days before expiration
- Exit:
  - If butterfly becomes worth ½ strike width
  - Mid-expiration week when stock price moves closer to short strikes
  - Wednesday or Thursday of expiration week for whatever it's worth



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# Summary

1. Weekly options
2. Implied volatility
3. Covered strangles
4. Butterfly spreads

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# Apply What You've Learned

- Look at your favorite stock that has weekly options:
  - Evaluate potential trades by analyzing premiums for short strangles using weekly options.
- Attend webcasts focused on weekly options for application ideas.

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# Continue Your Education

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