

Trading Equity Options Week 4

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Topic Summary

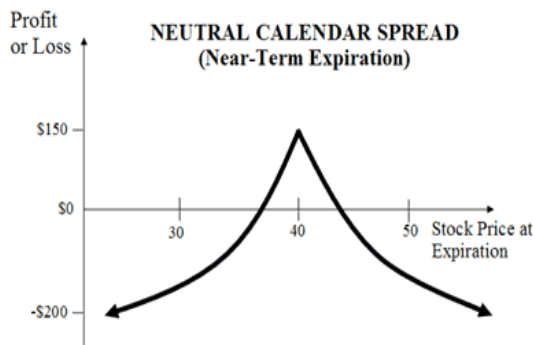
- Durational Calendars
- Straddles and Strangles
- Butterflies
- Continuing your Education

Durational Calendars (not for earnings)

- Sell a near dated option and buy a longer dated option at same strike.
- Keep the time frames ~ equal between them; i.e. if short option is 30 DTE, long is 60.
- Use for products that have low IV rank; calendars are long Vega.
- Calendars make money when IV rises because the further dated option has much higher Vega than the near option, so an increase in IV will help the position.
- If you lean bullish, place the strikes slightly OOM to the upside and use calls.
- If you lean bearish, place the strikes slightly OOM to the downside and use puts.
- The short option has higher theta and will decay faster than the long option.
- When you price the calendar, make sure you do not pay more for the calendar spread than you collect from the short option.
- With different expiries, we cannot calculate max profit on this trade, but we can estimate it. Max profit occurs if price goes to the front month short strike at expiry.
- Calendars are pretty forgiving, but will lose if price gets far away from strike.
- **Max loss is debit paid; look to take profit at 25% return on debit paid.**

Durational Calendars P/L Diagram

- The P/L diagram is always done at expiration of the near term strike.
- The peak of the P/L graph is always at the short strike (closest in time).
- There are two breakevens for the calendar, and max loss is debit paid to place trade.
- Calendar max profit is only an **estimate** because when the front month option expires we do not know what the IV of the back month option is (we can only estimate it).



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Straddles and Strangles - Neutral

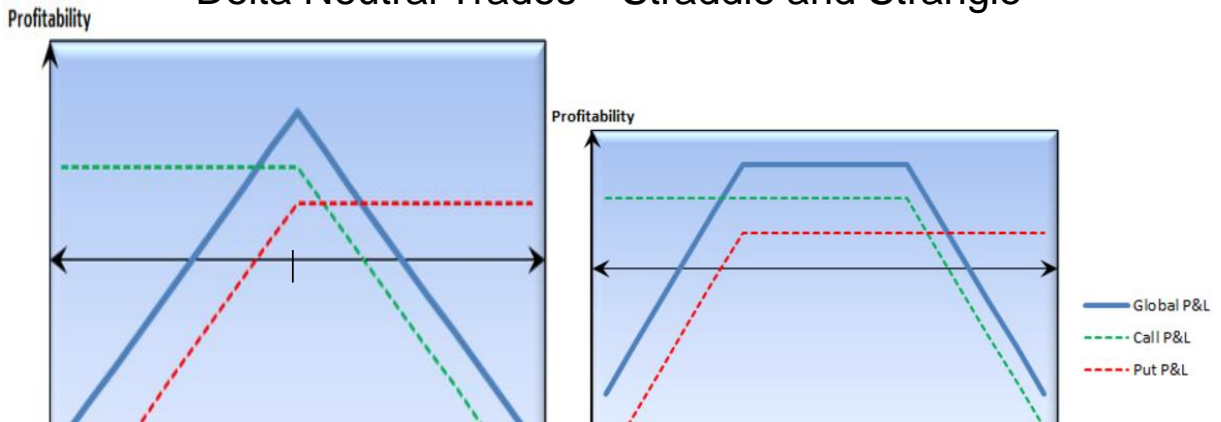
- The straddle and strangle are similar trades that are usually delta neutral but can be skewed for a little upside or downside bias.
- These use naked options so they have a lot of risk and use a lot of BPR.
- The straddle sells a put and call at the same strike, usually close to ATM.
- The strangle sells an OOM put and an OOM call (different strikes).
- These trades are placed for a credit, and max profit = credit received.
- For these trades, you want the stock to stay in a narrow range.
- These trades will be winners if the stock moves less than expected.
- Since the straddle sells ATM options, theta decay is much higher, so the credit received is much higher than the strangle; take profits earlier.
- Max loss is undefined, so implement a strategy to close or adjust if loss exceeds your limits (i.e. twice what you received as a credit).

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Straddles and Strangles – P/L diagrams

Delta Neutral Trades – Straddle and Strangle



Short Straddle

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Short Strangle

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Butterfly - Neutral

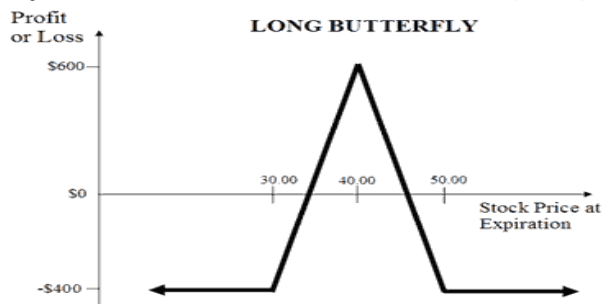
- The butterfly is 3-legged spread that is usually delta neutral but can be skewed for a little upside or downside bias. Put on for a debit.
- The butterfly uses 3 put or 3 call options in a 1-2-1 ratio.
- You sell the 2 options in the middle (the body), and you buy the wings.
- This is called “buying the butterfly”; you put it on for a debit.
- A butterfly is a relatively low cost, low probability, high ROC trade.
- Max profit is achieved if the stock expires exactly at the short strike, and is equal to the width between the body and the wings less the debit paid.
- Max loss is the debit paid, so this is a risk defined trade.
- Loss occurs if the stock expires too far away from the center strike.
- Best to put on with high volatility. Full profit cannot be realistically achieved.
- Making the wings wider increases cost, but you will have a higher POP.

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Butterfly – P/L Diagram

- Butterflies tend to expand near the expiration, so don't go out too far in time
- Variations are the Broken Wing Butterfly, Unbalanced butterfly, and some can be entered for a credit.
- The peak of the P/L graph is always at the short strike.
- The butterfly can be done using two credit spreads, this is called an "Iron Butterfly" or "Iron Fly". Similar to Iron Condor except squished together.



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Continuing Your Education

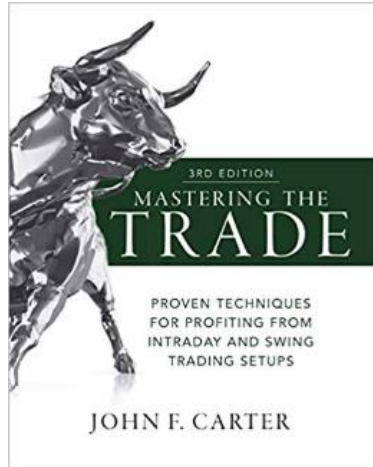
- Continue your learning. You can take away something new from any free webinar that is offered. Don't commit to paying a lot for education unless you are sure that it answers your needs. Look for sites which teach you HOW TO TRADE.
- Markets are not static; they change. So your trading must change also. Don't trade last month's chart.
- Find a trading buddy. Find a coach or a mentor that has more experience than you.
- Don't be afraid to continue to invest in your education. It doesn't take more than a couple of winning trades to pay for a course or mentorship that costs you a few hundred dollars. Be careful about putting thousands of dollars into training.

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Books

- There are many popular books on trading derivatives. Here is my favorite:
 - *Mastering the Trade*, 3rd Edition, John Carter (a pretty easy read)



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Free Videos and Training

Many educators put out free nightly videos, and then offer you a more detailed video each night if you pay a monthly fee. Try the free videos, and buy a subscription only if you really think it adds value:

- www.stockmarketmentor.com Dan Fitzpatrick (a great technical analyst), will teach you how to read charts.
- <https://theotrade.com> Nightly videos featuring Don Kaufman, uses TOS.
- www.simplertrading.com John Carter (author, trades stocks, options, and futures)
- The ShadowTraders put out an excellent free video every Sunday evening, about 20 minutes long, summarizing the state of the market. Sign up at: www.shadowtrader.net
- www.thetraderisk.com Evan Medeiros puts out an excellent weekly summary on Friday evening which looks at major markets and indices from the recent week.
- The education tab on TOS has lots of videos to teach you about the platform.
- TD Ameritrade webcasts have hundreds of archived training videos.

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Karen the Supertrader

Karen the Supertrader (these segments are much longer than 15 minutes)

Karen is a retail trader that started trading on TOS, and eventually managed over \$300 million (of hers and other people's money). Her story is very inspirational. Unfortunately, she became a target of investigation by the SEC, but the story remains compelling. These videos have been removed from the tastytrade network, but the videos can still be found on YouTube. Search for "karen the supertrader tastytrade interview" on GOOGLE (not on tastytrade) to see the following four videos, and watch them in order to understand her development as a trader. You can also find them on my website www.tradercoaching.net under the "Best of tastytrade" tab at the very end.

May 30, 2012	<i>Karen's First Interview</i>
Oct 16, 2012	<i>Karen's Second Interview</i>
Feb 12, 2014	<i>Karen's Third Interview</i>
Aug 21, 2014	<i>Karen's Fourth Interview</i>

Homework

•Watch these episodes:

Best Practices	4/27/15	<i>Calendar Spreads</i>
Know Your Options	4/20/15	<i>Durational Calendars</i>
Mike and his White Board	8/11/15	<i>Trading Strategy Long Butterfly Spread</i>
Market Measures	10/30/14	<i>Premium Buying Butterfly Spreads</i>

- In the tastytrade Beginners Course do Section 4: **Basic Options Strategies Part 2**
- Practice your trading using Paper Money.

Class Feedback

- The school will give you or send you a request for feedback. Please completed it because it helps me and it helps the school.
- You are always free to provide any personal feedback (good or bad) to me at craig@tradercoaching.net. All feedback is welcomed.
- I am happy to answer questions on anything as you continue your quest to become a successful personal portfolio manager.
- I also offer coaching and mentoring on one-on-one basis. Your first hour is free if you have taken my class. Email me if interested at craig@tradercoaching.net .

GOOD LUCK IN TRADING !