		selling otm synthetic calls	newboyo			January 17, 2007, 06:38:11 AM by Ri$k Doctor
		Early Exercise / Assignment Strategy	rachalupa			January 04, 2007, 01:35:10 PM by rachalupa
		Entering After Hours Options Orders	rachalupa			January 02, 2007, 03:35:06 PM by rachalupa
		Market making, mean reversion, and profitability	trader56			December 27, 2006, 03:45:36 PM by trader56
		TELK	Ri$k Doctor			December 27, 2006, 09:47:08 AM by Ri$k Doctor
		trading an "Options Book" and stock tape reading	trader56			November 20, 2006, 08:43:06 AM by Ri$k Doctor
		can full service brokers give you a better price?	hissho			November 06, 2006, 09:15:46 AM by Ri$k Doctor
		put overwrite	hufra			October 31, 2006, 06:09:29 PM by Ri$k Doctor
		Butterflies Across Time	CoachPhil			October 26, 2006, 10:43:51 AM by Ri$k Doctor
		Double Diagonal	manojkagrawal			September 26, 2006, 07:50:43 AM by Ri$k Doctor
		Diagonal butterfly - crash safe position ?	alassio			September 17, 2006, 10:34:33 AM by Ri$k Doctor
		Welcome To The Ri$k Doctor's Forum	Admin			August 23, 2006, 09:57:31 PM by Ri$k Doctor
		Strange straddle prices	alassio			August 21, 2006, 11:48:16 AM by Ri$k Doctor
		no idea about US stock market	hissho			August 20, 2006, 02:28:41 PM by Ri$k Doctor
		Market Making vs Market Taking	trader56			July 28, 2006, 09:10:40 AM by Ri$k Doctor
		Pricing of Combos	ohlala			July 23, 2006, 03:01:22 PM by Ri$k Doctor
		Net credit OTM backspread	alassio			July 10, 2006, 06:34:36 PM by Ri$k Doctor
		conversion/reversals	samban			July 07, 2006, 07:30:26 AM by Ri$k Doctor

newboyo

selling otm synthetic calls
« **on:** January 07, 2007, 01:45:33 AM »

Hello,

am a newbie, and am selling otm synthetic calls and am protecting myself by placing stop limit orders on the short stock. the game plan is
1. sell the (say RIMM 170, mar strike) at 172, while spot is say 132.
2. let the value of the synth call reduce to 170
3. benefit from interest earned on the short sale proceeds.

Will appreciate your guidance on this game plan. Am I doing something crazy? Is there a better way for a low risk trade?

rgds,

new

Ri$k Doctor

selling otm synthetic calls
« **Reply #1 on:** January 17, 2007, 06:38:11 AM »

Sorry that I did not catch this earlier. I have clicked "Track this Topic" and will get an email when someone has posted to this topic. In future, please end and email to riskdoctor@riskdoctor.com with an initial post so I may have an opportunity to respond in a more timely fashion.

In response to your questions:

> **Quote**
> 1. sell the (say RIMM 170, mar strike) at 172, while spot is say 132.
> 2. let the value of the synth call reduce to 170
> 3. benefit from interest earned on the short sale proceeds.

I think this trade is a waste of time as the open interest is small and you will probably get assigned shortly. The cost of carry is greater than the call price (no dividend to pay). Also, I don't think that you could get a good value for the short 170P due to lack of liquidity making them .40 to .60 wide.

It is also a naked risk transaction which is not a good habbit to get into.

rachalupa

Early Exercise / Assignment Strategy
« **on:** January 02, 2007, 09:37:09 AM »

I wanted some expert opinion on this strategy if possible:

Proposed strategy: Sell ITM call/put calendar spreads in hopes of early assignment, exercise. The idea here is to prematurely collect the small to big time premiums on the short month. Then as you get assigned on each contract, buy more long ITM calendars. I am thinking this might enhance the rate of return by 30-50% in a given month due to all the exercises. Also this could be done with Debit ITM condors. Any thoughts on how much we would enhance a 20% ROI 30 day condor?

Also, I understand that expiring ITM calls/puts are auto exercised. If am short 20 ITM calls/puts, what is the chance of me getting assigned if I do not close out the positions? Is it close to 100%? I have heard that sometimes you get lucky and a short PUT is not assigned? This would only work on the calendar idea since you are still holding the long further out month.

Thanks,
Rob

Ri$k Doctor

Early Exercise / Assignment Strategy
« **Reply #1 on:** January 02, 2007, 10:03:59 AM »

Selling a calendar is selling the further dated option and buying the closer dated (expiring first*) option.
I don't see any enhancements you speak of.

Exercising your long deep ITM puts on a put Condor only gives you naked upside exposure even though you might earn a little bit on short stock rebate.

ITM calls should never be early exercised unless there is a dividend greater than the put of the same strike plus the remaing cost of carry on the stock.

100%. Until recently, all options ITM by .25 were auto-exercised but all equity options ITM by .05 are automatically exercised now.

*In certain Interest rate and implied volatility environments there may be instances when further dated puts would be attactive for early exercise sooner than closer dated puts.

rachalupa

Early Exercise / Assignment Strategy
« **Reply #2 on:** January 02, 2007, 10:24:42 AM »

I'm sorry maybe I wasn't clear on the idea, I didnt mean that I would exercise them, I meant that I wanted to write them and hope they get exercised/assigned early by the brokerage.

I do understand on the Call side this would be rare if the stock has no dividend so let me rewrite the idea for the put side only.

Buying a Calendar (shorting the ITM put in the current month and having a long ITM put in next month) and making sure there is some time premium left in the current months ITM Put. Hope they get assigned. When assigned you keep the entire premium you wrote of the short side.

Buy a long Debit ITM vertical put. Hope it gets assigned. You are left with the long put. When assigned you should keep the entire premium of the put you wrote on the debit vertical (prematurely getting the time value out of it).

Rob

Ri$k Doctor

Early Exercise / Assignment Strategy

« **Reply #3 on:** January 02, 2007, 12:21:06 PM »

> **Quote**
> Buy a long Debit ITM vertical put. Hope it gets assigned. You are left with the long put. When assigned you should keep the entire premium of the put you wrote on the debit vertical (prematurely getting the time value out of it).

It does not matter where you get the funds to invest in a strategy, the strategy has to be priced attractively and meet with your expectations of what the market will do.

The "hope they get assigned" aspect is inappropriate because perhaps you are forgetting that you will become long stock with carry costs or forgoing interest on the capital needed to purchase the stock.

The counterparty exercises because they wish save the remaining carry cost (when liquidating long stock upon exercise) or to profit by way of short stock rebate (when becoming short stock upon exercise).

More info:

Rent-A-Call

and:

Binomial Equity Reversal

rachalupa

Early Exercise / Assignment Strategy

« **Reply #4 on:** January 02, 2007, 03:38:29 PM »

Hi Charles,

Now for my twist: I have been fiddling with an early exercise calculator. My proposition is to sell 10 Jul IBM 100 puts, buy 10 jul IBM 95 Puts, (and to make the trade free on the call side as a condor optionally sell 10 IBM Jul 95 calls and buy 10 IBM Jul 100 calls). This puts me in a position with a $2.56 time value on all the short 100 puts. My hope is that they would get exercised early because at 5% interest, the cost of carry is $2.79 which is greater than the corresponding 100 Call (currently at $2.65). The idea would be to get assigned, and keep the $2.56 'free' premium I was paid on each put.

Let me spell out the exact proposal:

Sell (10) Jul 100 Put @ 5.40 (with exactly $2.56 time value per your graph: Strike 100 minus Stock @ 97.15 = $2.84 minus Option Premium of $5.40 = $2.56 time value)
Buy (10) Jul 95 Put @ 3.20
Sell (10) Jul 95 Call @ 7.50
Buy (10) Jul 100 Call @4.70
Note I am buying the Calls to create a box.
I am hoping for early assignment on 1-10 Short puts (The 100s).

What are your thoughts on that idea? BTW, even though the call Condor sounds crazy, it is more sound when you think of it as locking in the position for moves by IBM.

Also when I get assigned the stock, I do not intend to keep it, I sell the long Put that is left over and the assigned stock at market value. I should keep the $2.56 premium paid to me that was the time value.

Thanks,
Rob C.

Ri$k Doctor

Early Exercise / Assignment Strategy

« **Reply #5 on:** January 02, 2007, 08:24:04 PM »

The short answer is that this is a short box at 5.00, currently worth 4.86 (you'd have to catch some lucky legs) and you will not get assigned for a long while and if you did your position would be synthetically long the 100 calls. They won't be free and long calls are best when you think the stock will have a quick rally.
The long answer I hope to get to by tomorrow or Friday.

IBM | INTERNATIONAL BUSINE... | Easy to Borrow | Volume | Extrinsic | 7

UNDERLYING

LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW
97.15 N	+.18	97.15 P	97.30 P	1 x 10	4,455,900	97.00	97.88	96.83

YIELD	PE	EPS	DIV	DIV.FREQ	DIV.DATE	52HIGH	52LOW	BETA	SHARES
1.24%	16.75	5.8	.3	Q	11/8/06	97.40	72.73	1.729	1,506,35...

TRADE GRID | SYMBOLS

OPTIONS | Single | Composite

CALLS VOLUME	CALLS EXTRINSIC	CALLS BID X	CALLS ASK X	EXP	STRIKE	PUTS BID X	PUTS ASK X	PUTS VOLUME	PUTS EXTRINSIC
JAN 07 (17) 100									24.96%
FEB 07 (45) 100									19.81%
APR 07 (108) 100									19.02%
JUL 07 (199) 100									18.83%
20	2.30	19.30 X	19.60 X	JUL 07	80	.50 C	.60 X	0	.55
44	2.85	14.90 X	15.10 X	JUL 07	85	.95 C	1.05 I	0	1.00
0	3.80	10.80 I	11.10 C	JUL 07	90	1.80 I	1.90 I	40	1.85
50	5.25	7.30 I	7.50 I	JUL 07	95	3.20 I	3.30 I	20	3.25
82	4.60	4.50 I	4.70 I	JUL 07	100	5.40 C	5.60 I	18	2.65
605	2.60	2.55 B	2.65 I	JUL 07	105	8.60 I	8.80 P	1	.85
11	1.35	1.30 I	1.40 I	JUL 07	110	12.70 I	13.00 X	0	0

rachalupa
Newbie
Posts: 10

Early Exercise / Assignment Strategy

« **Reply #6 on:** January 03, 2007, 03:53:00 PM »

Charles, thanks for the answer so far. I paper traded this position using RUT instead, using a +10 ITM box (ie same exact IBM position, but starting at 800 with RUT stock at 794). I got in for a $1 debit. My theory is since RUT moves around so much, if it goes down around 10 to 20, you would get assigned and keep the $10 premium. If it goes up more than 15 you could sell off the call side and leave the put side open til expiry and keep the OTM expiring put.

Is this more sound, or are you against this entire idea?

Thanks in advance.

Rob

Ri$k Doctor
Administrator
Hero Member
Posts: 3249

Early Exercise / Assignment Strategy

« **Reply #7 on:** January 03, 2007, 04:27:56 PM »

Is there a RUT stock? I am aware of the index options but there would be no early assignment.

Even if it were a stock, the assignment process is random and to generate a bunch of commissions to play for it is a waste of time and money. That is even if this were a good strategy and it is NOT.

These ideas are a dead end.

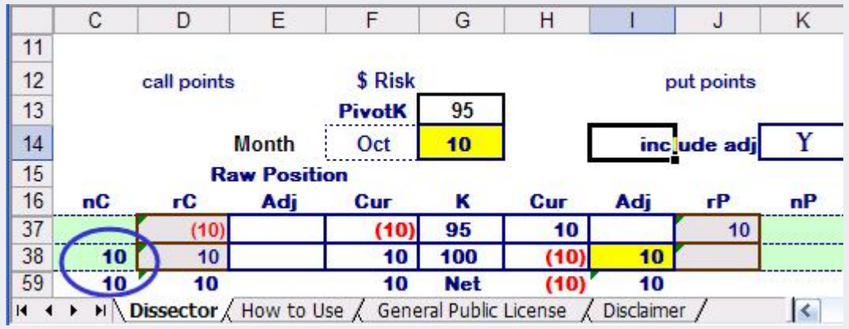
Ri$k Doctor

Early Exercise / Assignment Strategy

« **Reply #8 on:** January 04, 2007, 10:41:16 AM »

More on the early exercise expectation play:

The Yellow Cells are the effect of an assignment of the 100 puts (they go away and the stock replaces it).



	C	D	E	F	G	H	I	J	K
11									
12		call points			$ Risk			put points	
13					PivotK	95			
14				Month	Oct	10		include adj	Y
15				Raw Position					
16	nC	rC	Adj	Cur	K	Cur	Adj	rP	nP
37		(10)		(10)	95	10		10	
38	10	10		10	100	(10)	10		
59	10	10		10	Net	(10)	10		

Dissector | How to Use | General Public License | Disclaimer

You would be better off doing nothing than trying to short that box (saving transaction exposure and commissions). Wait for when the 100 puts to become a candidate for exercise (don't have to hope, pray or OD on HOPIUM) and buy the 100 calls. Question is, why would you? Would you be bullish?

The purchase of the calendar is a real cost and real risk and if your analysis says go for it, then go for it but don't think that somehow the carry cost stuff, you wrote about above, will pay for it (making it free).

rachalupa

Early Exercise / Assignment Strategy

« **Reply #9 on:** January 04, 2007, 12:14:36 PM »

Thank you Charles, will get back in the future if it is not worthless.

One note about the above assignment example:

When assigned you should have been forced to buy the stock at $100 equaling a debit of $10000 in the acct.
When closing out the trade, If the current price was still $97.15 the sale of stock would be a a credit of -$9715.
The exercised premium kept on the short put was $540.
Once you sell the long put at $320, you should be keeping the net of $256.

Example: Entry price of vertical: -$220(cr) + Loss on stock ($10000-$9715=-$285) + Long put sale of $320= $255.00 is what you keep.

A point well taken about waiting til it is assignable. No sense in entering a position and waiting around for something that may never happen. The strategy should be done during the last 30-45 days I am assuming. I don't know what the chances of getting assigned are on a far future Put.

My point is however that I realize you end up with a synthetic call after assignment, but after the sale of that assigned stock, you end up with a net credit of $256. Not bullish but instead being completely neutral on the play and ready to close it out.

Thanks,

Rob

Ri$k Doctor

Early Exercise / Assignment Strategy
« **Reply #10 on:** January 04, 2007, 01:14:33 PM »

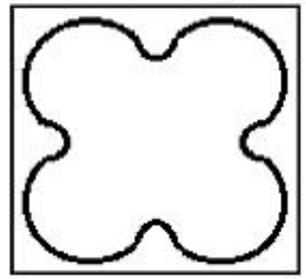
Why do you think you will get 3.20 for the 95 Puts? They could be worthless with the stock at 97.15 when the 100 put is parity.

The problem is that you are focusing on the 100 Put and don't realize that each option is a corner of a box with an interest rate component. While time is changing the value of your short 100 Puts it is also hurting you on the long 95 puts.

Warning: There is No Holy Grail Trade -- There is No Free Money in the Options Market!!

EXHIBIT 8 – 4

Box at Present Value and Maturity Value (Expiration)



Present value = 4.90 Interest = .10 Maturity value = 5.00

IMPLIED INTEREST RATE ON A BOX TRADE

The implied interest rate calculation on a box trade is very similar to that of the conversion/reversal. Take the discount on the box and divide it by the cost of the box, multiply the result times 365 days a year, and divide it by the numbers of days left to go.

$$\frac{\text{Box Discount}}{\text{Box Price}} \times \frac{365}{\text{Days left}} = \text{Implied interest rate}$$

If the box in the last example had had a market of 4.85–4.95 the trades would yield the implied interest rates as shown below.

Long Box:

$$\frac{0.15}{4.85} \times \frac{365}{146} =$$

Lending to the market place:
7.73%

Short Box:

$$\frac{0.05}{4.95} \times \frac{365}{146} =$$

Borrowing from the market place:
2.53%

rachalupa

Early Exercise / Assignment Strategy
« **Reply #11 on:** January 04, 2007, 01:35:10 PM »

Thank you sir,

So if I understand this correctly, in reality when we enter into a short box, we are at first locking in a premium of $2.56 ($255 of time value), initially. No matter what happens in the market, either the call side or put side will increase/decrease, there is a locked in premium of $2.56. But with time decay occurring at the risk free rate, each day that will decrease the available time premium. So if 30 days go by, my $2.56 is now $2.11 (minus all of the alligator trade commissions - 4 to enter, 5 to exit).

My slight point here is we are not losing the time decay while other corners would increase while others decrease? I realize the money isnt really free it is actually the entire premium paid for the short put is being forgone when the other party early exercises and delivers the stock.

Thank you for your detailed reply and excerpt from the book.

Rob

rachalupa

Entering After Hours Options Orders

« **on:** January 01, 2007, 08:14:29 AM »

I have an account with IB and have probed the advanced order parameters for Options, and found certain tags that supposedly allow execution after hours.

I am wondering if anyone knows or has experience in after hours trading or if it is even possible?

The theoretical idea is to have a daemon monitor after hours stock activity and place a long call or put on during the after hours session.

Thanks,
Rob C.

pjs

Entering After Hours Options Orders

« **Reply #1 on:** January 02, 2007, 12:57:42 PM »

Rob C.,
Since options don't trade in the after hours market there is no way to enter any kind of conditional order for an option. The only "exception" would be index options which trade for another 15 minutes after the market closes.
Event risk on individual stocks is quite real and little can be done to hedge that risk other than having your options (no pun intended) in place.

rachalupa

Entering After Hours Options Orders

« **Reply #2 on:** January 02, 2007, 03:35:06 PM »

Thanks pjs. I guess we need lots of capital available to buy the stock itself is the only hope

trader56

Market making, mean reversion, and profitability

« **on:** December 22, 2006, 09:51:45 AM »

Charles,

I'd be very interested in hearing your perspective on how market making works. Let me start by saying a bit about my meager knowledge:

I was an ag futures floor trader. I traded mainly momentum-type plays, and the intermonth spreads, like the Sept/Dec. One of the best floor traders was a guy who, when asked how he traded, said, "I make a market." He would almost always be willing to sell at the offer or buy at the bid. In addition, he almost always sold rallies once he sensed the buying slacken or end, and would buy breaks when the selling slackened or ended.

Now, here's what I'm interested in understanding better:
In making a market, this guy had to end up with long and short positions all up and down the price range. Every 1/2 hour we'd have to time-stamp our trading cards, hand them into the clearing firm, and we'd quickly get back a summary of our net position, long or short. So, how is this approach profitable?

In the options pit. the guys would do basically the same thing, as they'd just take the other side of the paper after quoting a two-sided market. So, again, you end up with positions all up and down the price range.

It was said when I started on the floor that one had to be able to "flat price," meaning trade the futures outright in order to be able to make a market, trade the spread (since you'd almost always leg into it), or trade the options (since these were derivatives of the underlying futures.

Anyway, sorry to make this so long, but I'd love to get some insight into how this approach (market making) works, since it seems like option market making would be closely related. Can you give a scenerio example perhaps?

Thanks, and Happy Holidays to you and yuors!

Ri$k Doctor

Market making, mean reversion, and profitability

« **Reply #1 on:** December 26, 2006, 10:01:17 AM »

Part 1:
Excerpt From Chapter 8 of "Options Trading: The Hidden Reality":

MARKET MAKER INSIGHTS

This chapter will let the reader into the world of the market maker and how he or she sees and uses customer order flow. This should shed a great amount of light on certain trades or spreads that are easy or impossible to get filled. I remember thinking at the beginning of my career, in 1981, that there must be something magical about options, because profits could be squeezed out with little or no risk. I came to discover that by understanding relationships better than my market maker competitors, I could pick their pockets on sizable trades. Those opportunities are now few and far between but the concepts remain.
The reader should build a foundation of knowledge about locks. A lock, as mentioned earlier, describes a position that has a locked-in profit or loss and theoretically cannot lose any money from that point forward. Spreads that are commonly referred to as locks are conversions/reversals, jelly rolls, and boxes and can and do lose money although they seem to be neutral. In the grand scheme of things, a lock does not make or lose much money by itself but market makers tend to have them on in huge sizes, turning molehills into mountains or cracks into canyons. Understanding the similarities and differences between the European-style options, American-style options, and options with futures-style margining help traders to make trading decisions even though they may only be trading one product. There will be a discussion about exercise features of the OEX and nuances that are caused when a stock is in a partial tender offer. This chapter does not place much emphasis on models except to explain some of the differences between them and to suggest how to enhance their usefulness. Does that mean that the models are useless for retail customers? No. The models are great. The problem is not the models, though some are better than others. For certain applications, a model is not the Holy Grail, but merely a tool. One can use a shoe to pound a nail into the wall just like this book will try to pound important concepts into its readers??heads. One can also dig a hole with a hammer easier than a trader can dig his way out of the hole that he got himself into because he tried to pay for a Mercedes with the anticipated profits that his options model projected.

THE EDGE

The most profitable players in the options game over time are traders who turn themselves into machines and churn out the money day in and day out simply by getting the edge. Edge is the trader??s markup or added premium when selling and markdown or discount when buying.
With this understanding, it is easy to see why some stock trading brokerage houses have commission-free trading. They provide free trades to customers who are willing to use market orders (i.e., trading at the market, which is taking the ask price or hitting the bid price) . There is no guarantee that the market maker will make a profit on the trade but he does have a head start in either spreading it off, or scalping out of the trade. It is a lot easier for banks and other traders who do have a wide client base to take advantage of a wide bid-ask spread differential. Generally, it is made wide so that the trader can lay off the risk for an automatic profit. Normally the bid-ask spreads widen out when markets are illiquid and the trader has fewer routes to go in spreading it off. This also occurs when the market gets choppy.

Story: Liquidity and the Bid/Ask Spread: In 1985, I wandered over to the CME from the CBOT. In the Treasury bond futures market at the CBOT, if the market was 20 bid / asking 21 (verbally: 20-21, complete price: 104.20-104.21)) I would be satisfied to get filled at 20 if I put in a market order to sell. If DM futures were 20-21 (33.20-33.21 at the time), I had to learn to be satisfied with a fill at 17 (33.17) on a sell at the market order. This can happen in any market on any exchange when moments of illiquidity create a vacuum. Take Eurodollars, also at the CME, a very thick market where at almost every price there are thousands of contracts to buy and to sell. Many times, if you try to sell at the market while it is 20-21 (94.20-94.21), the broker can get the edge and give you the fill at 21 because the market hardly moves. Do not hang your hat on that last sentence because for about a week in April 1989, while trading in Euro options, there were serious vacuums when certain numbers were announced. Before 7:30 A.M., for example, the market would be something like 90.50? ?90.51, and then in an instant, as the number was being announced, the market would widen to 90.40??90.60, then 90.80 bid. There were options traders in my pit waving orders to sell hundreds at the market when it was up there and getting filled at 90.20. Those who were trying to buy down there at the market hoping to get something close to 90.20, were getting filled at 91.00 (not 90.00). Eighty ticks ($25 per tick) on 100 Eurodollar futures is $200,000. Ouch! **End**

Fewer traders and customer orders create less liquidity, hence more risk. Market makers try to make wider markets but still close enough to compete with other exchanges and for customers to be attracted to the market. Customers hate the feeling of being ripped off. It is, however, unfair to state that customers think market makers are crooks just because they make wide markets. This is almost always a function of liquidity, often simply because it is lunchtime or a hot summer day when traders are not around to make markets. Fewer traders left to accommodate paper flow means added risk on the bigger orders when few are around to take down a sizable trade because they have fewer avenues on which to layoff the risk. The wide markets are a direct result of the fact that the trader expects a horrible fill price on his or her hedge. In effect, the trader is merely passing that hedge cost plus the negative-edge on to the customer.
It will soon become evident that options are a relationship game. If the relationships get stretched out far enough, they will eventually attract the attention of some great big force that will push them back into line. That force is the market as a whole, and it will do whatever it wants to do.

Part 2:

Ok, that may explain the bid/ask situation but what what about the inventory that a market maker accumulates by taking the otherside of the retail and institutional order flow?

Firts know that a MM's favorite position is No Position. Next favorite is to have a flat position with regard to delta, gama, vega, theta, other Greeks and to the effects of skew shifts.

Each options trade, therefore, is followed by an offsetting futures or stock trade to first achieve delta neutrality. That options versus underlying combination is a synthetic ratioed straddle long (or short) at that particular strike. that means it is long (or short) premium. Then the premium has to be neutralized:

Excerpt From Chapter 9 of "Options: Perception and Deception":

RISK REVERSALS / RISK CONVERSIONS

A risk reversal of sorts is the most common position for market makers, who are accommodating paper flow, in ??supply?? markets such as equities and fixed income products. In ??demand?? markets such as foreign currencies (foreign to the dollar), as well as in the grains and other commodities, market makers are generally carry risk conversions.

A Risk Reversal is defined as: long higher strike calls, short lower strike puts, and short the delta equivalent of underlying against it all. Essentially it is a reversal with the calls and puts at different strikes, hence the name ??risk? reversal, unlike a normal reversal where calls and puts are at the same strike and 1:1:1oo.

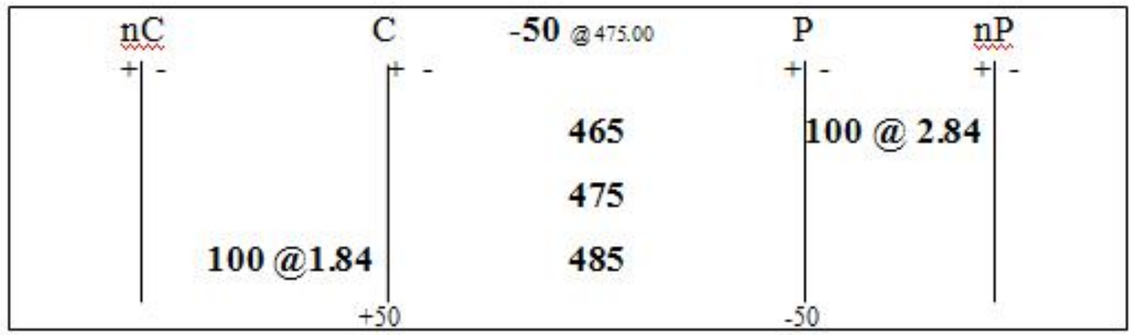
Risk Conversion is defined as: short higher strike calls, long lower strike puts, and long the delta equivalent of underlying against it all. Essentially it is a conversion with the calls and puts at different strikes, hence the name ??risk? conversion, unlike a normal conversion where calls and puts are at the same strike and 1:1:1oo.

There is good and bad news about these positions. First the good news: the position, as you can see in Exhibit 9-2, is delta, gamma, theta and vega neutral (all=0). The bad news is that usually these positions are huge in size because of the supposed neutrality and they are difficult to manage causing many traders to be wiped out. From this point forward the examples will be about risk reversals in particular for the sole purpose of having the reader follow a consistent path as we examine the nuances, trading procedures, philosophy, dissection and analysis. Use the same information, only apply it backwards, in order to understand risk conversions.

Remember that market makers facilitate trade. Customers either buy OTM puts for portfolio insurance, or sell OTM calls to enhance their rate of return, or do both, buy OTM puts and sell OTM calls to help defray the cost of the puts (fence off the underlying).

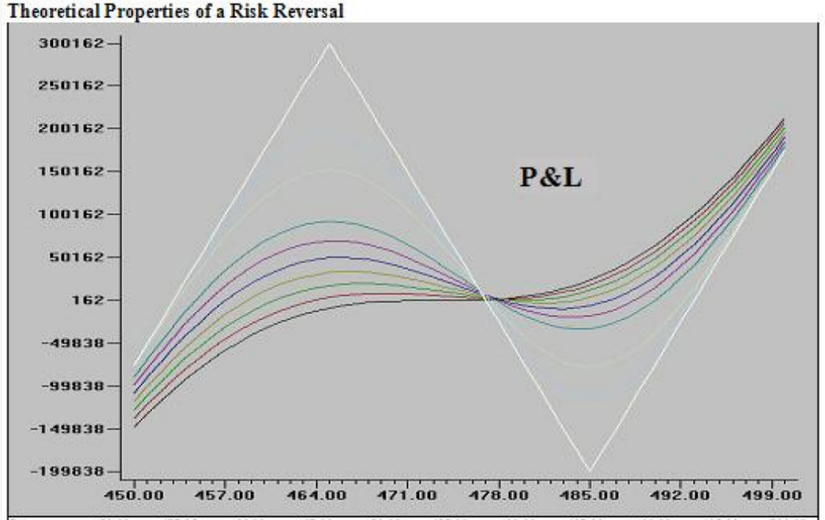
In the following example, the market maker is trading and trying to remain neutral (with 46 days to go). He has accumulated this position (carded-up in Figure 9-1) during the morning session: ??+100*485c @ 1.84 (Delta=.23) / -100*465p @ 2.84 (Delta=-.27) / selling 50f @ 475.00 area to offset the +50oo deltas??.

EXHIBIT 9-1
Position as Carded

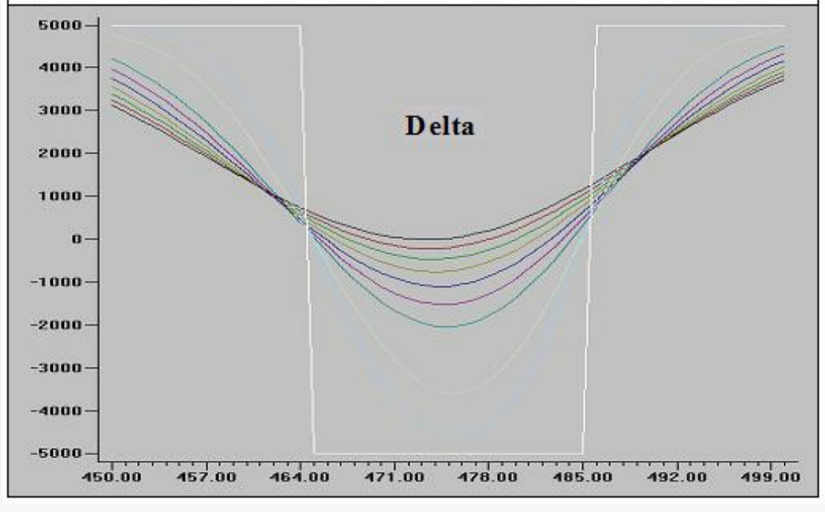


The position is approximately neutral with respect to the Greeks between the two strikes (actually it depends on the model). This is because the strikes are equal distances away from the money. As the underlying moves toward one of the strikes, the Greeks expand at that strike and dwindle at the further strike. The net Greeks will change as this happens. As we go lower toward 465 the gammas and vegas increase at the 465 strike and decrease at the 485. To determine how this effects the net units, simply multiply the corresponding Greek by each quantity of contracts (long or short), then tally them. The gammas for example @ 465 have increased while the gammas @ 485 strike have decreased, and since we are short 100 @ 465 vs. long 100 @ 485 the position has developed negative gamma on balance. It has also developed negative vega and positive theta. Since the gamma has turned negative and the market is moving lower, the positive deltas generated by the position are hurting us. In the other direction gamma and vega turn positive, theta turns negative and delta remains positive. The reason is that the market moves higher, the position develops positive gamma which in turn manufactures positive deltas with each subsequent up-tick. Many of my students naturally think that all the Greeks become opposite at each strike. Delta is the one that gets confusing. We will see in the sixth dissection (Exhibit 9-18) that this position resembles a long ratioed straddle at the 485 strike and a short ratioed straddle at the 465 strike. Remember from chapter 4 that a short straddle manufactures short deltas when the market moves up and long deltas when the market drops. The opposite is true when the market maker is long a straddle. Notice how a move in the underlying affects the Greeks and the P&L of a risk reversal in Exhibit 9-2.

EXHIBIT 9-2
Theoretical Properties of a Risk Reversal



Price:	450.00	455.00	460.00	465.00	470.00	475.00	480.00	485.00	490.00	495.00	500.00
P&L	-179474	-102877	-48411	-16588	-3268	0	4010	19049	52387	107076	182229
Delta	3462	2638	1714	859	264	71	320	933	1755	2614	3374
Gamma	-147	-179	-184	-151	-82	6	90	149	174	165	136
Theta	1505	1954	2090	1766	984	-78	-1131	-1901	-2234	-2140	-1748
Vega	-16950	-21195	-22266	-18645	-10345	813	11882	20054	23776	23140	19468



I hope that answers your question. There is a lot more in O:PD.

trader56
Guests
Newbie
Posts: 17

Market making, mean reversion, and profitability
« **Reply #2 on:** December 27, 2006, 03:45:36 PM »

Charles,

THANK YOU so much for such a detailed reply!

Best wishes for a Happy Holidays, and the best for the New Year!

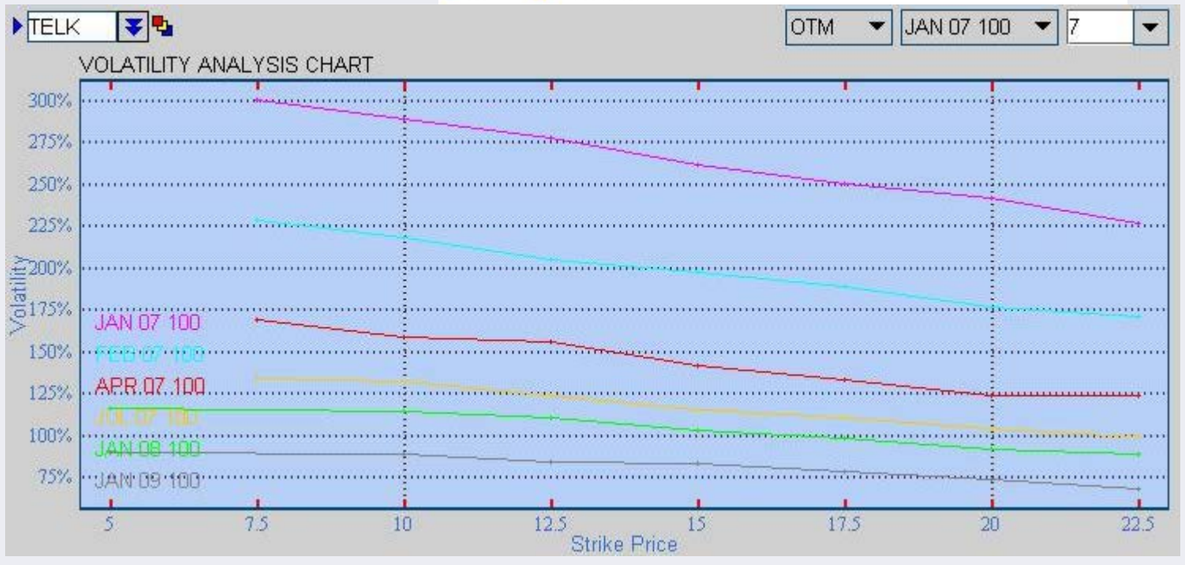
Ri$k Doctor

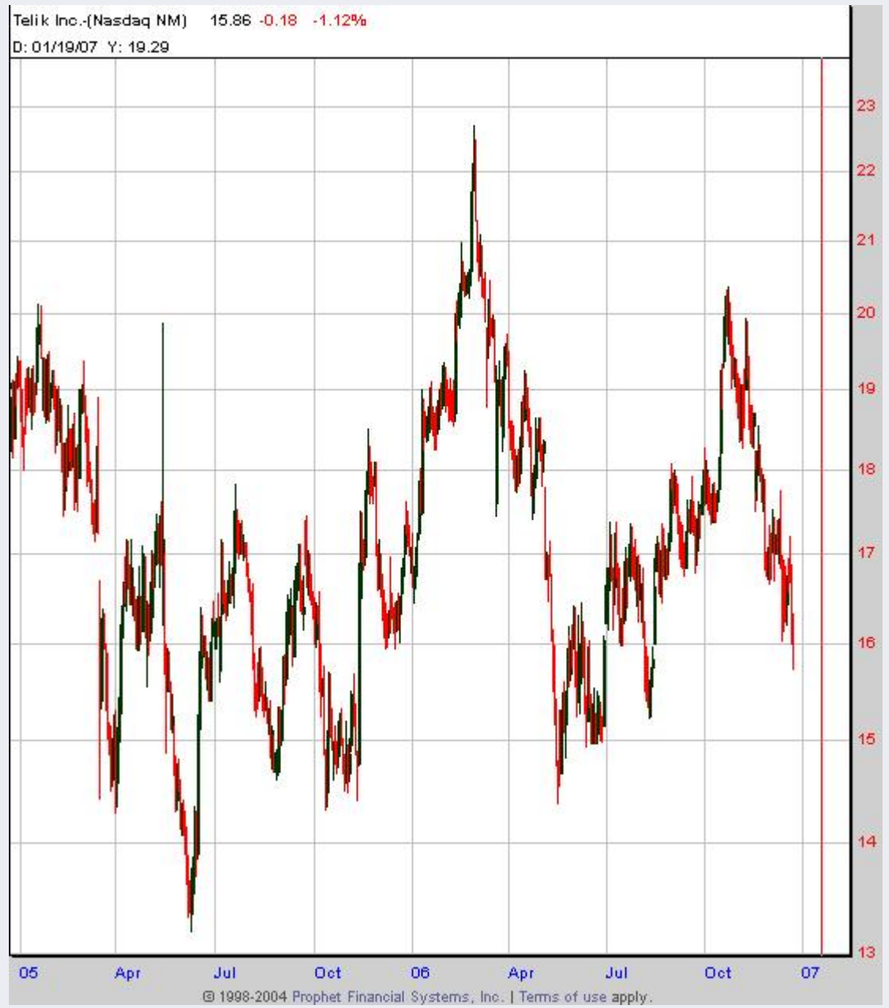
TELK

« **on:** December 27, 2006, 09:47:08 AM »

From an Email on 12/18/06:

What I really wanted to ask you, is if you think this is a pie in the sky trade: The TELK 15 Puts. I ran a profit loss analysis on it and show that buying the APR 15 Puts at $3.70 and selling the Jan 15 Puts at $3.20 for about a .60 cent debit, but the capability to make not only $370 per contract for January (as the Jan expires) (minus whatever decay happens to the April) but the capability to sell Feb at that point for almost a 100% profit. So the P&L shows a calendar spread profit as long as TELK doesn??t drop more than 50% or go up more than 100%. That??s the widest profit range I have ever seen for a calendar. Since I am more conservative now with my capital I only bought 25 of these contracts. I was wondering if your opinion is that is this safe and will it work? I can afford to stock up on 100 of them for $6k if they are really going to pay $35k (sounds too good to be true)?
Let's take a look of the measures:





TELK | TELIK INC | Hard to Borrow | NASDAQ | Vega | Theta | 4

UNDERLYING

LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW
15.86 Q	-.18	15.83 P	16.23 Q	1 x 10	1,639,767	16.105	16.3268	15.73

TRADE GRID | SYMBOLS

OPTIONS | Single | Composite

CALLS						PUTS				
VEGA	THETA	BID X	ASK X	EXP	STRIKE	BID X	ASK X	VEGA	THETA	
JAN 07 (29) 100										268.66%
.01	-.07	6.10 I	6.40 C	JAN 07	12.5	2.80 C	2.90 I	.01	-.06	
.02	-.07	4.70 C	5.10 C	JAN 07	15	4.00 I	4.20 C	.02	-.07	
.02	-.07	3.70 A	4.00 C	JAN 07	17.5	5.30 C	5.70 C	.02	-.07	
.02	-.07	3.00 C	3.10 C	JAN 07	20	7.00 A	7.40 C	.02	-.07	
FEB 07 (57) 100										143.76%
.02	-.04	6.20 P	6.50 C	FEB 07	12.5	2.85 C	3.00 A	.02	-.03	
.02	-.04	5.00 P	5.30 C	FEB 07	15	4.10 C	4.40 A	.02	-.04	
.02	-.04	3.90 P	4.20 C	FEB 07	17.5	5.50 C	5.90 C	.02	-.04	
.03	-.04	3.00 C	3.30 C	FEB 07	20	7.10 C	7.40 A	.02	-.04	
APR 07 (120) 100										145.96%
.03	-.02	6.30 C	6.70 P	APR 07	12.5	3.20 C	3.30 C	.03	-.02	
.03	-.02	5.20 I	5.50 A	APR 07	15	4.20 C	4.50 C	.03	-.02	
.04	-.02	4.00 C	4.30 P	APR 07	17.5	5.60 C	5.90 A	.03	-.02	
.04	-.02	3.10 A	3.40 P	APR 07	20	7.20 C	7.50 P	.04	-.02	
JUL 07 (211) 100										116.99%
.04	-.01	6.70 P	7.10 C	JUL 07	12.5	3.30 X	3.50 A	.04	-.01	
.04	-.01	5.50 P	5.90 A	JUL 07	15	4.50 P	4.80 C	.04	-.01	
.05	-.01	4.50 P	4.80 A	JUL 07	17.5	5.90 P	6.20 A	.04	-.01	
.05	-.01	3.60 P	4.00 C	JUL 07	20	7.50 P	7.90 C	.05	-.01	

TELK | TELIK INC | Hard to Borrow | NASDAQ | Volume | Open Interest | 4

UNDERLYING

LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW
15.86 Q	-.18	15.83 P	16.23 Q	1 x 10	1,639,767	16.105	16.3268	15.73

TRADE GRID | SYMBOLS

OPTIONS | Single | Composite

CALLS							PUTS				
VOLUME	OPEN.INT	BID X	ASK X	EXP	STRIKE	BID X	ASK X	VOLUME	OPEN.INT		
JAN 07 (29) 100											268.67%
126	2,510	6.10 I	6.40 C	JAN 07	12.5	2.80 C	2.90 I	2,693	18,724		
644	10,292	4.70 C	5.10 C	JAN 07	15	4.00 I	4.20 C	2,706	22,130		
914	19,453	3.70 A	4.00 C	JAN 07	17.5	5.30 C	5.70 C	3,640	11,821		
638	24,198	3.00 C	3.10 C	JAN 07	20	7.00 A	7.40 C	385	10,707		
FEB 07 (57) 100											143.76%
0	0	6.20 P	6.50 C	FEB 07	12.5	2.85 C	3.00 A	52	131		
9	25	5.00 P	5.30 C	FEB 07	15	4.10 C	4.40 A	348	709		
17	333	3.90 P	4.20 C	FEB 07	17.5	5.50 C	5.90 C	441	318		
41	365	3.00 C	3.30 C	FEB 07	20	7.10 C	7.40 A	50	73		
APR 07 (120) 100											145.96%
19	2,220	6.30 C	6.70 P	APR 07	12.5	3.20 C	3.30 C	164	1,800		
490	566	5.20 I	5.50 A	APR 07	15	4.20 C	4.50 C	474	4,859		
64	1,074	4.00 C	4.30 P	APR 07	17.5	5.60 C	5.90 A	766	1,359		
7	1,793	3.10 A	3.40 P	APR 07	20	7.20 C	7.50 P	251	983		
JUL 07 (211) 100											116.99%
0	20	6.70 P	7.10 C	JUL 07	12.5	3.30 X	3.50 A	1	112		
8	13	5.50 P	5.90 A	JUL 07	15	4.50 P	4.80 C	9	133		
34	77	4.50 P	4.80 A	JUL 07	17.5	5.90 P	6.20 A	0	120		
89	116	3.60 P	4.00 C	JUL 07	20	7.50 P	7.90 C	0	50		

TELK | TELIK INC | Hard to Borrow | NASDAQ | Vega | Theta | 4

UNDERLYING

LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW
15.86 Q	-.18	15.83 P	16.23 Q	1 x 10	1,639,767	16.105	16.3268	15.73

TRADE GRID | SYMBOLS

OPTIONS | Butterfly | Composite

CALLS				PUTS				
VEGA	THETA	BID X	ASK X	STRIKE	BID X	ASK X	VEGA	THETA
JAN 07 (29) 100								268.66%
.00	.01	-.70	.60	10 / 12.5 / 15	-.10	.45	.00	.00
.00	.00	-.40	1.00	12.5 / 15 / 17.5	-.30	.60	.00	.00
.00	.00	-.30	.80	15 / 17.5 / 20	-.40	1.00	.00	.00
.00	.01	-.35	.30	17.5 / 20 / 22.5	-.80	.80	.00	.00
FEB 07 (57) 100								143.76%
.00	.00	-.40	.80	10 / 12.5 / 15	-.05	.70	.00	.00
.00	.00	-.50	.70	12.5 / 15 / 17.5	-.45	.70	.00	.00
.00	.00	-.40	.80	15 / 17.5 / 20	-.60	.80	.00	.00
.00	.00	-.35	.75	17.5 / 20 / 22.5	-.40	.90	.00	.00
APR 07 (120) 100								145.96%
.00	.00	-.50	1.00	10 / 12.5 / 15	-.45	.25	.00	.00
.00	.00	-.70	.60	12.5 / 15 / 17.5	-.20	.80	.00	.00
.00	.00	-.30	.90	15 / 17.5 / 20	-.40	.80	.00	.00
.00	.00	-.15	.80	17.5 / 20 / 22.5	-.50	.70	.00	.00
JUL 07 (211) 100								116.99%
.00	.00	-.60	.90	10 / 12.5 / 15	-.25	.65	.00	.00
.00	.00	-.60	.90	12.5 / 15 / 17.5	-.40	.70	.00	.00
.00	.00	-.50	.90	15 / 17.5 / 20	-.40	.90	.00	.00
.00	.00	-.65	.70	17.5 / 20 / 22.5	-.60	.70	.00	.00

TELK | TELIK INC | Hard to Borrow | NASDAQ | Vega | Theta | 4

UNDERLYING

LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW
15.86 Q	-.18	15.83 P	16.23 Q	1 x 10	1,639,767	16.105	16.3268	15.73

TRADE GRID | SYMBOLS

OPTIONS | Calendar | Composite

CALLS				PUTS				
VEGA	THETA	BID X	ASK X	STRIKE	BID X	ASK X	VEGA	THETA
JAN 07/FEB 07 (29/57) 100								268.66%
.01	.03	-.20	.40	12.5 / 12.5	-.05	.20	.01	.03
.01	.03	-.10	.60	15 / 15	-.10	.40	.01	.03
.01	.03	-.10	.50	17.5 / 17.5	-.20	.60	.01	.03
.01	.03	-.10	.30	20 / 20	-.30	.40	.01	.03
FEB 07/APR 07 (57/120) 100								143.76%
.01	.02	-.20	.50	12.5 / 12.5	.20	.45	.01	.02
.01	.02	-.10	.50	15 / 15	-.20	.40	.01	.02
.01	.02	-.20	.40	17.5 / 17.5	-.30	.40	.01	.02
.01	.02	-.20	.40	20 / 20	-.20	.40	.01	.02
APR 07/JUL 07 (120/211) 100								145.96%
.01	.01	0	.80	12.5 / 12.5	0	.30	.01	.01
.01	.01	0	.70	15 / 15	0	.60	.01	.01
.01	.01	.20	.80	17.5 / 17.5	0	.60	.01	.01
.01	.01	.20	.90	20 / 20	0	.70	.01	.01
JUL 07/JAN 08 (211/393) 100								116.99%
.01	.00	.30	1.60	12.5 / 12.5	.40	1.20	.01	.00
.01	.00	.50	1.60	15 / 15	.50	1.20	.01	.00
.01	.00	.50	1.60	17.5 / 17.5	.40	1.40	.01	.00
.02	.00	.60	1.60	20 / 20	.30	1.40	.01	.00

News:
Zacks Buy List Highlights: Telik, Inc., Constellation Energy Group Inc., CTI Industries Corporation and Ares Capital Corporation

CHICAGO--(BUSINESS WIRE)--Oct. 13, 2006--Zacks.com releases the latest list of Zacks Rank Buy Stocks. Everyday on Zacks.com, four stocks are selected based on how well they match the criteria for the four main schools of investing:

Aggressive Growth, Growth & Income, Momentum and Value. The four Zacks Rank Buy stocks highlighted today are Telik, Inc. (Nasdaq: TELK) ?..

Aggressive Growth - Telik, Inc. (Nasdaq: TELK)

Telik, Inc. is a relatively early stage biotechnology company, so it doesn't have earnings yet. However, results thus far have been encouraging.
Second-quarter results exceeded estimates by almost 15%. In fact, the company has surpassed expectations in each of the past 10 quarters, with seven of them registering double-digit surprises. Seven analysts have raised their numbers
for this year, while four have done so for next year.

Telik announces financial results for 3Q 2006.
Telik Inc reported a net loss of $20.5 M for 3Q ended Sep 2006 (net loss of $17.9 M in 3Q ended Sep 2005). For nine months ended Sep 2006, Telik reported a net loss of $62 M (net loss of $59.3 M in nine months ended Sep 2005). Research and development expenses were $18.487 M for 3Q 2006 ($17.057 M for 3Q 2005) and $55.181 M for nine months of 2006 ($55.858 M in nine months of 2005). Telik Inc of Palo Alto, CA, is a biopharmaceutical company focused on discovering, developing and commercialising novel small molecule drugs to treat serious diseases. Details of unaudited statements of operations for three and nine months ended Sep 2005 and 2006, and, selected balance sheet data as on 31 Dec 2005 (audited) and 30 Sep 2006 (unaudited) are provided in two enclosed tables.

Yesterday

TELK | TELIK INC | Hard to Borrow | NASDAQ | Theta | Vega | 4

UNDERLYING

LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW
4.83 P	-11.43	4.83 Q	4.84 P	31 x 91	12,711,668	4.82	5.20	4.70

TRADE GRID | SYMBOLS

OPTIONS | Single | Composite

CALLS							PUTS				
THETA	VEGA	BID X		ASK X		EXP	STRIKE	BID X		ASK X		THETA	VEGA
JAN 07 (24) 100													119.51%
-.01	.01	.30	X	.40	I	JAN 07	5	.50	I	.55	I	-.01	.01
-.01	.00	.05	C	.10	I	JAN 07	7.5	2.70	I	2.75	X	-.01	.00
.00	.00	0	P	.05	I	JAN 07	10	5.10	I	5.30	C	-.01	.00
.00	.00	0	P	.05	I	JAN 07	12.5	7.60	I	7.70	I	.00	.00
FEB 07 (52) 100													92.81%
-.01	.01	.45	C	.55	C	FEB 07	5	.60	I	.70	C	-.01	.01
.00	.00	.05	C	.10	C	FEB 07	7.5	2.60	C	2.80	C	.00	.00
.00	.00	0	P	.05	C	FEB 07	10	5.10	C	5.30	C	-.01	.00
.00	.00	0	P	.05	C	FEB 07	12.5	7.40	C	7.80	C	.00	.00
APR 07 (115) 100													70.04%
.00	.01	.60	C	.65	I	APR 07	5	.75	I	.85	C	.00	.01
.00	.01	.10	X	.15	I	APR 07	7.5	2.65	I	2.80	I	.00	.01
.00	.00	0	P	.10	C	APR 07	10	5.00	X	5.30	C	.00	.00
.00	.00	0	P	.15	C	APR 07	12.5	7.50	I	7.80	C	.00	.00
JUL 07 (206) 100													65.15%
.00	.01	.85	I	.90	I	JUL 07	5	.90	I	1.10	C	.00	.01
.00	.01	.25	C	.40	C	JUL 07	7.5	2.80	I	2.95	P	.00	.01
.00	.01	.05	I	.15	I	JUL 07	10	5.10	I	5.30	I	.00	.01
.00	.01	.05	I	.10	C	JUL 07	12.5	7.50	I	7.90	C	.00	.01

12/26/06

Among Big Movers on Wall Street
Telik Inc., (TELK) down $11.52 at $4.75

The drug company said a late-stage trial of its cancer treatment Telcyta were "extremely disappointing."

trader56

trading an "Options Book" and stock tape reading
« **on:** November 09, 2006, 01:26:09 PM »

Forgive a foolish question, but what is meant by "learning to trade an options BOOK?"

Also, would the skills aquired in tape reading listed stock intraday be helpful in learning more about trading options?

If so, which skills in particular?

Thanks!

Ri$k Doctor

trading an "Options Book" and stock tape reading
« **Reply #1 on:** November 10, 2006, 05:31:23 AM »

Sorry, Trader56, I am a bit confused by your questions.
Are you referring to the Exchanges Order "Book" or my book?
What is the context in which you saw or heard this?
I would not advise to trade options as intraday trading vehicles.

trader56

trading an "Options Book" and stock tape reading
« **Reply #2 on:** November 10, 2006, 05:58:14 AM »

Hi Charles,

Here are the exact conments this person made:

"I also wanted to get back into options. It suited my personality more. So now I trade equity and index options in a haircut account in a JBO. Much more relaxing. LOL. And much more money. This business is a lot more scalable. And I don't have to go blind from staring at the screens all day. I enjoy my job more, have more upside, and it allows me to enjoy life more. Learning how to trade an options book is a great skill set. There are so many choices you have..."

This guy had come form a very successful background using tape reading to daytrade listed stocks, and moved form that to what he's doing now. This is an evolution I'd like to make as well. What's confusing my at tis early point is some of the lingo.

What's a "haircut account in a JBO?"
What's meant by "scalable?"
But the big one for me is, what's "an options book?"

I'm thinking it might be the book of standing orders, much like the NYSE OpenBook, or the futures broker's deck, but am not sure.

Finally, I completely agree with you that daytrading options is not the thing to attempt off the floor. The author of the quote defines tape reading as reading the bid/ask, reading the size on the bid/ask, reading the last price, and reading the size of the last print to asses potential stock movement. What I'm wondering is, would the tape reading skills from stock trading help in what this guy is doing now?

On the futures floor we used to feel that "flat pricing" (trading the order flow on a single month's contract) helped in trading the spreads as you could leg them more effectively.

I'd love to hear any and all comments you might have on this!

Thanks!

Ri$k Doctor

trading an "Options Book" and stock tape reading

« **Reply #3 on:** November 10, 2006, 06:48:40 AM »

"Haircut account in a JBO" refers to market maker margins in a Joint Back Office, like having a seat on the exchange that everyone shares in the JBO group shares.

Futures traders ususally trade a certain size. "Scalable" would mean that you can scale your sizes, either by delta or other Greek parameters or by margin required. For example one vertical in one underlying could have only 5 deltas and another in another underlying can have 20 deltas. That means, to be equivqlent to 1oo shares or 1 futures contract, you could have 20 verticals (.05 deltas each) or 5 verticals (.20 deltas each) to vary your sizes.

"An options book" here refers to his own "options portfolio" or what most Americans would call his "options positions".

---

trader56

trading an "Options Book" and stock tape reading

« **Reply #4 on:** November 10, 2006, 08:55:51 AM »

Thank you, Charles!

Ok, a few more to test your patience:
Is the JBO sort of the equivalent to "prop" type firms in stock trading?
How does one investigate these?

What's the "haircut account?"

Do you think the tape reading skills, as he's defined them, would be an advantage once one switches to trading options?

Thanks again!

Soft Delta

trading an "Options Book" and stock tape reading

« **Reply #5 on:** November 17, 2006, 12:27:32 PM »

A JBO is a joint back office. It allows the broker dealer to get better margin rates then Reg T. The buying power is passed on to the trader. A JBO allows for risk based haircuts that only require you to put up capital that is at "risk". not notional value like in a Reg T account.

This is especially advantageous for derivatives traders.

Tape reading and options trading are two seperate things entirely. Both require discpline though.

John (Maverick)

Ri$k Doctor

trading an "Options Book" and stock tape reading

« **Reply #6 on:** November 20, 2006, 08:40:58 AM »

A question from Tony, along the same subject:
Charles,

Have you ever heard of "echotrader"? A friend of mine who trades options full-time told me about them. Apparently, after you complete your Series-7, you can open up an account with them and receive margins that are very close
to market maker margins. If you take a peek below at my friend's correspondence with them, you can see that their margins are ten times better than my friend's current margins.

My question for you is this: What is the catch here? What are we missing?
Is having this kind of leverage a positive thing? When a 50% return can turn into 500% just because of the difference in the amount of money that you have to post, what can be wrong with that? I just feel I'm missing something here, a bigger picture perhaps, and that is the reason that I've
emailed you. As usual, thanks for your time.

Tony

Ri$k Doctor

trading an "Options Book" and stock tape reading

« **Reply #7 on:** November 20, 2006, 08:43:06 AM »

A resonse from Steve:
It's Echotrade, and I clear through them. They are an LLC, pooled accounting is the reason for the extra leverage. Yes, it is very legal, the risk being that if you don't trust the risk dept, or the management tools built into the system, then don't go there. I know the guys in risk and the system is very sound. This can be the place for wealth building if that is the desire.
A corporation cannot allow the same amount of leverage, such as a Schwab, or E-Trade. They cannot pool the resources.
Steve

hissho

can full service brokers give you a better price?

« **on:** November 04, 2006, 02:08:45 AM »

Hi Doctor,
Can full service brokers "look after" you and give you a better price than cheaper online brokers?

I very much doubt about that but I keep hearing some people claiming "although full service brokers cost a bit more, you'll be better off because they are able to get a better price for you" how? "they have the ability to go direct to their service desk and/or direct to a market maker on those occasions when no-one wants to play, and get it done at a fair price (as opposed to being screwed by the only market maker who may be only vaguely interested in your trade - if you pay dearly for it!)"

Is it true? I'd like to hear comments from you.
Thanks a lot
hissho

Ri$k Doctor

can full service brokers give you a better price?

« **Reply #1 on:** November 06, 2006, 09:15:46 AM »

There may be occasions in illiquid issues where the brokerage firm has a market maker operstion that will accommodate you better than the players out there. You really don't want to trade those underlyings if you can avoid it.

For the highly liquid stocks, if you're experienced and have a good 'clicker' you can get as good a price as anyone. Otherwise you can easily learn to incentivise counterparties with techniques covered in my books and webinars.

hufra

put overwrite
« **on:** September 15, 2006, 10:27:02 AM »

I came across the term "put/overwrite". What kind of position is this?

Ri$k Doctor

put overwrite
« **Reply #1 on:** September 15, 2006, 03:11:44 PM »

Sorry, never heard of it.

hufra

put overwrite
« **Reply #2 on:** October 06, 2006, 09:52:32 AM »

Thanks for the quick answer risdoc!! Here is the "complete" description of the strategy.

"I've traded 20% of my portfolio in put/overwrite since 1999... it's dramatically outperformed the other 3 short-gamma methdologies I trade: (-)dispersion, ETF basket overwrite and pitchfork. Caveat: the portfolio always positions in long DOTM puts (replicating a synth. long fly)."

does this help to clarify this mysteriuous strategy?

Ri$k Doctor

put overwrite
« **Reply #3 on:** October 06, 2006, 10:32:58 AM »

Still cannot make any sense of this. I have forwarded this to a Professor friend of mine who uses my book in his class. Watch this space.

Ri$k Doctor

put overwrite
« **Reply #4 on:** October 20, 2006, 05:41:24 AM »

My Professor friend thinks it is a ratio write but in this day and age when so many people are implying that they have the Holy Grail trade, there are a lot of new names to old concepts created for the purpose of hype.

If you submit to me what the actual position is, I can show you how to dissect it and really find the strategy's true essence.

rmi

put overwrite
« **Reply #5 on:** October 24, 2006, 01:23:49 PM »

Yes it is a ratio write. The term is used in some limited option trading circles. Basically it is a ratioed synthetic straddle. For example. Short the ES, short ES OTM puts on a ratio that meets your delta preference. Usually done 1X2 or 1x3 futs/options. It's a short gamma trade which is relatively vega neutral except +skew and gains on theta and delta with a trade towards your sold strikes.
The name comes from the covered write i can imagine. Long spot-short more calls or short spot-short more puts, therefore the overwrite term. Hope this was helpful.

Ri$k Doctor

put overwrite
« **Reply #6 on:** October 24, 2006, 03:51:06 PM »

Right, I mean Write...I'm so confused. Seriously, I think you have it...basically a (short) ratioed straddle or what's know as a "covered put trade, delta neutral".

rmi

put overwrite
« **Reply #7 on:** October 25, 2006, 10:35:12 AM »

> **Quote** (Ri$k Doctor @ Oct. 24 2006,19:51)
> Right, I mean Write...I'm so confused. Seriously, I think you have it...basically a (short) ratioed straddle or what's know as a "covered put trade, delta neutral".

delta neutral covered put or covered call sounds better.

I've mostly seen put overwrites on -skew instruments and call overwrites on +skew instruments with slight delta preference. Goal is delta gains and skew gains during a favorable move and not so pretty losses from all the unbounded -gamma with an adverse move.

hufra

put overwrite
« **Reply #8 on:** October 26, 2006, 11:45:45 AM »

rmi´s explanation makes sense. But the how do you get the "put/overwrite" = syn. straddle in line with this:

"Caveat: the portfolio always positions in long DOTM puts (replicating a synth. long fly)" Or does this last sentence refer to the whole portfolio, that is described? There aren´t any long DOTM puts in this "1X2 or 1x3 futs/options" positions.

btw, thanks for your efforts, rd and rmi!

rmi

put overwrite
« **Reply #9 on:** October 26, 2006, 01:07:09 PM »

hufra,

who knows what they mean. It is difficult to interpret something out of context. Perhaps they mean the port needs to be ALWAYS traded with some long wings around your short synthetic straddles/overwrites into the direction of your short gamma risk as to not be wiped out when the instrument makes a 2 sigma move.

Ri$k Doctor

put overwrite
« **Reply #10 on:** October 31, 2006, 06:09:29 PM »

Good Point. I always need to see the exact, months, strikes and quantities in order to give you an answer. If you can get me that, we can save a lot of confusion and guess work.

CoachPhil

Butterflies Across Time

« **on:** October 23, 2006, 11:59:33 AM »

Charles:

Here is the follow up discussion from what I sent you.

The scenario is this:
GOOG @ ~$480.
I have been experimenting with Short Butters across time as opposed to within the same month. So instead of a short -40/+$50/-$60 hypothetical Fly in NOV, I am looking at a -NOV/+DEC/-JAN FLY using the $50 strike, for example.

Another way to look at this is a long calendar financed by a short calendar further out in time. So looking at it this way and focusing on the first months expiration as a target you want the underlying to be at the strike at expiration (i.e. in this case at the NOV expiration, holding it past until DEC expiration has a horrible profit graph and could lead to big losses).

Actuals	GOOG Common		Legend		
	477.15	+17.48	Last	Chg	Trade
	477.70	460.37	High	Low	Ex.Pos

Options	NOV <26>			DEC <54>			JAN <89>			MAR <145>		
570 calls	MktPr	MIV	Ex.Pos	MktPr	MIV	Ex.Pos	MktPr	MIV	Ex.Pos	MktPr	MIV	Ex.Pos
560 calls	1.07	36.1%		2.98	31.2%		6.05	29.5%		14.10	31.3%	
550 calls	1.50	35.3%		3.80	30.7%		7.50	29.4%		16.26	31.3%	
540 calls	2.07	34.4%	-40	5.10	30.7%	+80	9.19	29.4%	-40	18.67	31.2%	
530 calls	2.92	33.6%	+10	6.60	30.5%		11.33	29.3%		21.33	31.1%	
520 calls	4.15	33.1%	-30	8.51	30.1%	+60	13.89	29.3%	-30	24.70	31.5%	
510 calls	5.85	32.5%		11.05	30.1%		16.95	29.4%		28.20	31.5%	
500 calls	8.10	31.9%	-20	14.10	30.0%	+40	20.43	29.3%	-20	32.10	31.6%	
490 calls	11.34	31.8%		17.81	30.0%		24.56	29.5%		36.26	31.6%	
480 calls>	15.50	31.7%	-10	22.34	30.1%	+20	29.31	29.8%	-10	41.40	32.1%	
470 calls	20.85	32.0%		27.50	30.1%		34.69	30.1%		46.62	32.2%	
420 puts	1.72	35.8%	-40	3.93	32.0%	+80	7.11	31.3%	-40	13.19	32.5%	
430 puts	2.50	34.3%		5.43	31.4%		9.10	30.8%		15.69	32.1%	
440 puts	3.80	33.4%	-30	7.27	30.7%	+60	11.53	30.4%	-30	18.74	31.9%	
450 puts	5.65	32.5%	+10	9.80	30.3%		14.34	29.9%		22.19	31.7%	
460 puts	8.30	31.8%	-20	13.00	30.0%	+40	17.79	29.6%	-20	25.90	31.3%	
470 puts	11.94	31.6%		16.98	29.8%		21.86	29.3%		30.22	31.1%	
480 puts>	16.64	31.4%	-10	21.60	29.5%	+20	26.58	29.2%	-10	35.07	31.1%	

Summary

	Net Reqmts	Gross Reqmts	Cash Flow	+$5,970	Delta	-107.1	Avg.IV	31.9%
Init	$1,392,665	$1,398,635	Cur. Value	-$17,280	Gamma	17.14	Calls.IV	31.5%
Maint	$1,392,665	$1,398,635	Gain/Loss	(unknown)	Theta	53.97	Puts.IV	32.4%
Cash/Init	0.00	0.00	Commis	$0.00	Vega	858.6	P/C (Vol)	0.30

My theory is that I can spread out these FLYs across the current stock price above and below using puts and calls and create an "umbrella" of profits. The position in GOOG I sent you uses slightly OTM strikes and moves further OTM, increasing the number of spreads with each step OTM.

To deal with the losses if the stock moves outside of the umbrella I also buy a strangle to profit from large moves.

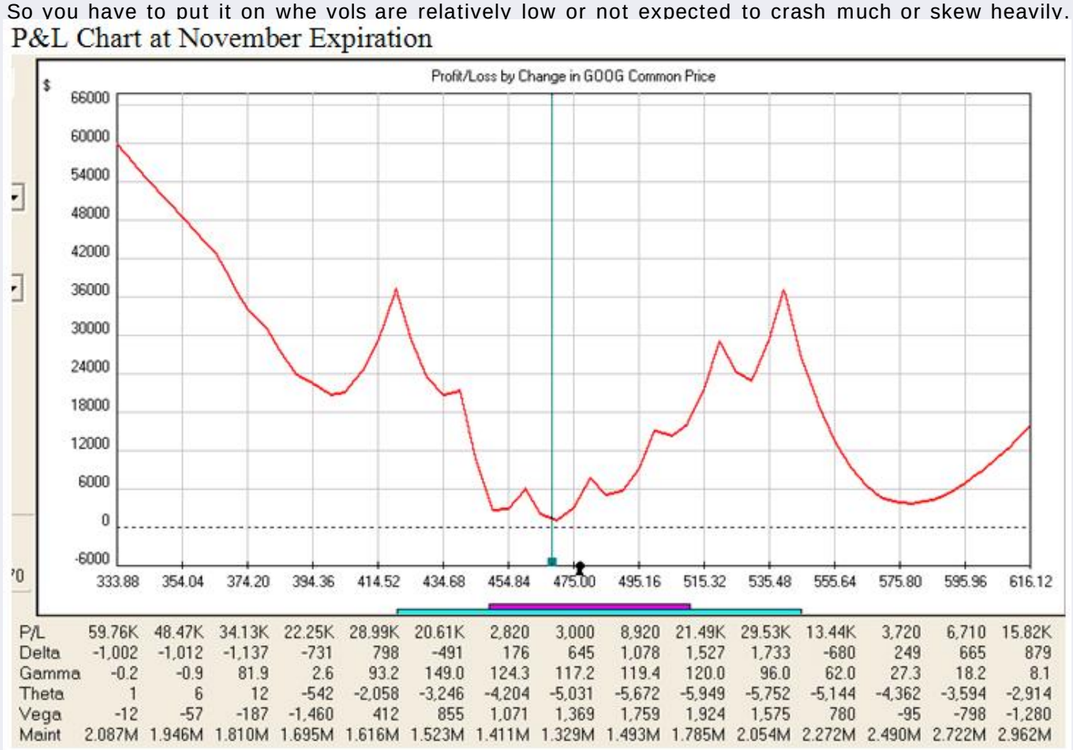
The combination of these options and number of spreads is the shown on the profit graph I sent you (I wil try and attach the document if I can). By selecting the right strikes and right number of spreads at each strike I can create a wide profit zone with very little risk and high probability of success.

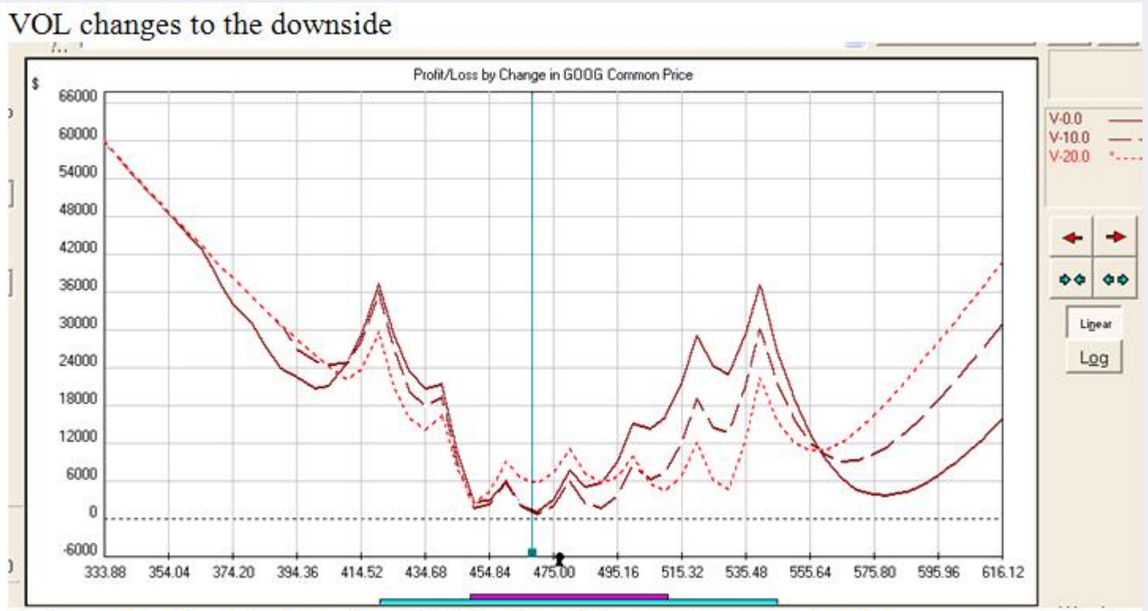
An example of one FLY would be

-20 NOV GOOG $490 CALL
+40 DEC GOOG $490 CALL
-20 JAN GOOG $490 CALL

Here are some caveats:

1. The position is vega sensitive so if there is a vol crush or huge skew you are in trouble. I chose GOOG because vols have collapsed near 52-week lows and should stay stable or move higher by NOV expiration. So you have to put it on whe vols are relatively low or not expected to crash much or skew heavily.





2. If I put this on in a prop account with a risk based haircut, the margin is minimal since the position is pretty much delta neutral. I will also get out by NOV expiration so no worries about huge losses at DEC expriation. Reg T margin would be huge as JAN options are considered naked. So this is not doable in an average Reg T account.

3. Commission intensive to open and close so discount or prop rates only lol.

Charles, I stress tested this on vols and it holds up pretty well since GOOG is at around 30/40% vols, and never has gone below 25% in the past year. I tested up to 20% drops in vols and any loss is still quite limited. If this is a viable strategy I should keep it quiet lol but I wanted to make sure I am modelling it correctly.

Ri$k Doctor

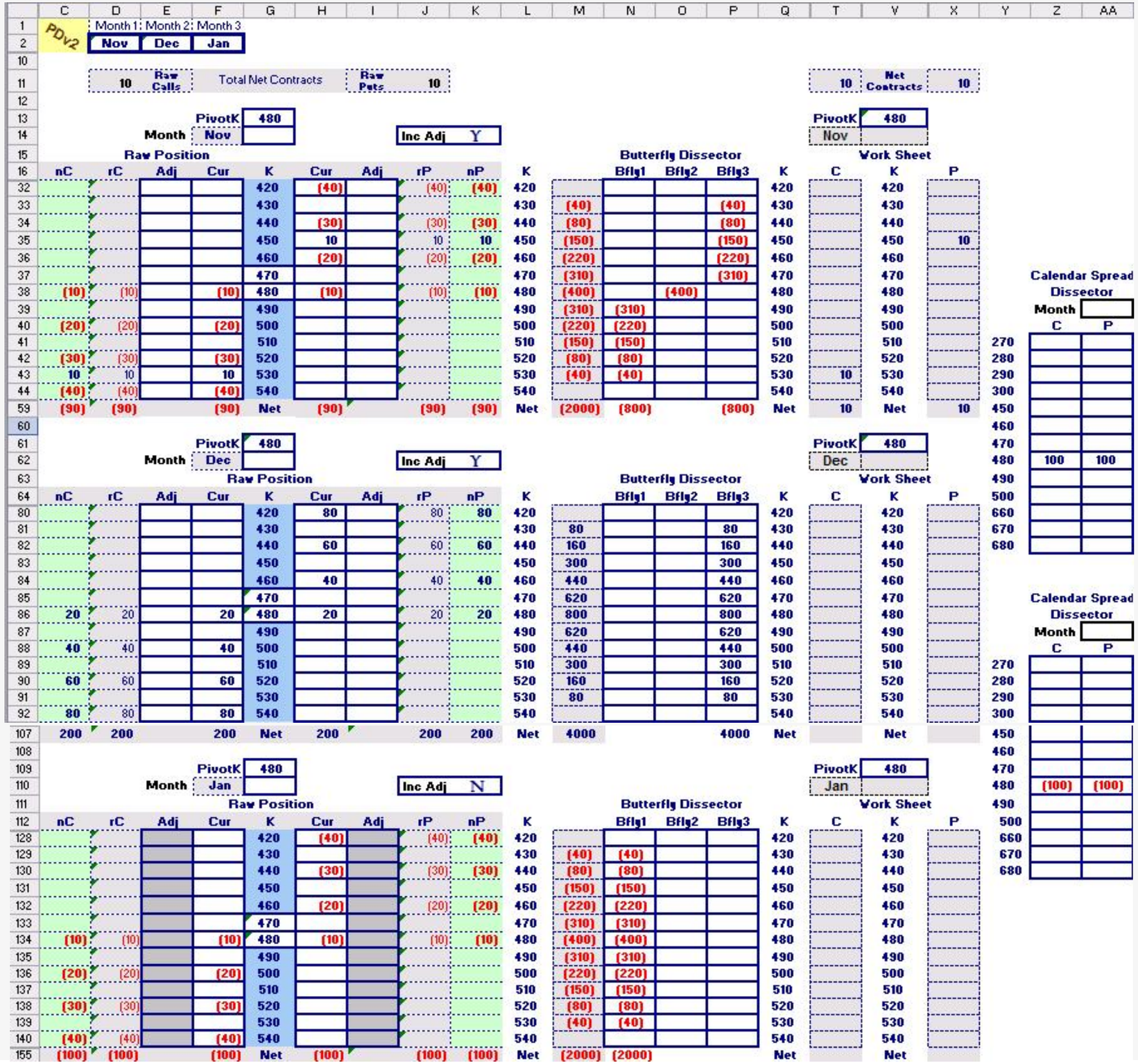
Butterflies Across Time

« **Reply #1 on:** October 25, 2006, 05:43:56 AM »

Comment to follow:

Also I used large numbers to magnify the profile, you can do this starting out with 5/10/5 and increase each step by 5. Also I am experimenting with just using a 3 or 4 strikes overall and not 3 or 4 on each side.

Phil



CoachPhil

Butterflies Across Time

« **Reply #2 on:** October 25, 2006, 06:56:19 AM »

Thanks Charles, looking forward to it.

For others reading, ignore the REG T margin requirement. The haircut for this is closer to $15,000.

Ri$k Doctor

Butterflies Across Time

« **Reply #3 on:** October 25, 2006, 01:02:37 PM »

See what your analyzer shows with this position set at $477. Your massive configuration is mostly flat except for basically what my smaller position that replicates the P&L and Greeks fairly well.

☑	•	STRANGLE	BUY	+35	GOOG	100	JAN 07	560	CA...	10.35	28.94%	410.14
			BUY	+35	GOOG	100	JAN 07	400	PUT	DEBIT	32.48%	
☑	•	STRANGLE	S...	-41	GOOG	100	DEC 06	540	CA...	8.30	28.89%	-452.44
			SELL	-41	GOOG	100	DEC 06	420	PUT	CREDIT	31.97%	
☑	•	STRANGLE	BUY	+12	GOOG	100	NOV 06	480	CA...	29.85	29.36%	243.90
			BUY	+12	GOOG	100	NOV 06	480	PUT	DEBIT	29.44%	

You sited that the commissions would be huge so these fewer contracts should help a lot but also the edge given up. Just to give up .02 negative edge per contract means $1600 each way. .02 would be a dream because in GOOG bid ask spreads are wide. If it were .10 then it would be $8000 each way, not to mention all the rolling.

Your butterfly and calendar configurations are relatively flat. The following two images from my book show the theory of butterflies and calendars with kind of a rough micro look at where your positions lie.

EXHIBIT 6–1

Theoretical Risk P&L Profile of a **(Long the Wings)** 99/**100**/101 Butterfly—View over Underlying Price Movement. Futures-Style Margining, 57 Days, 10% Flat Volatility and .01% Interest

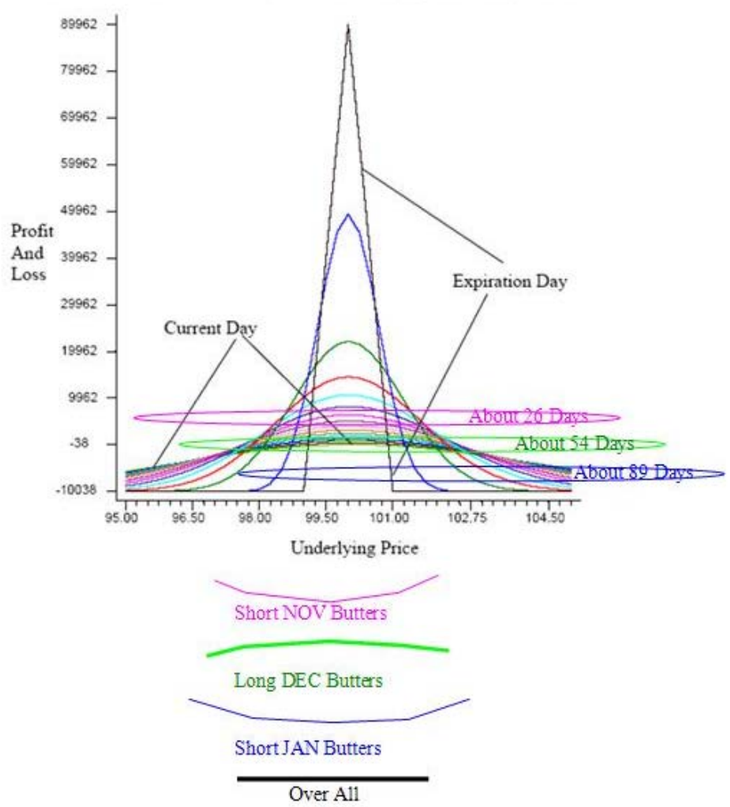
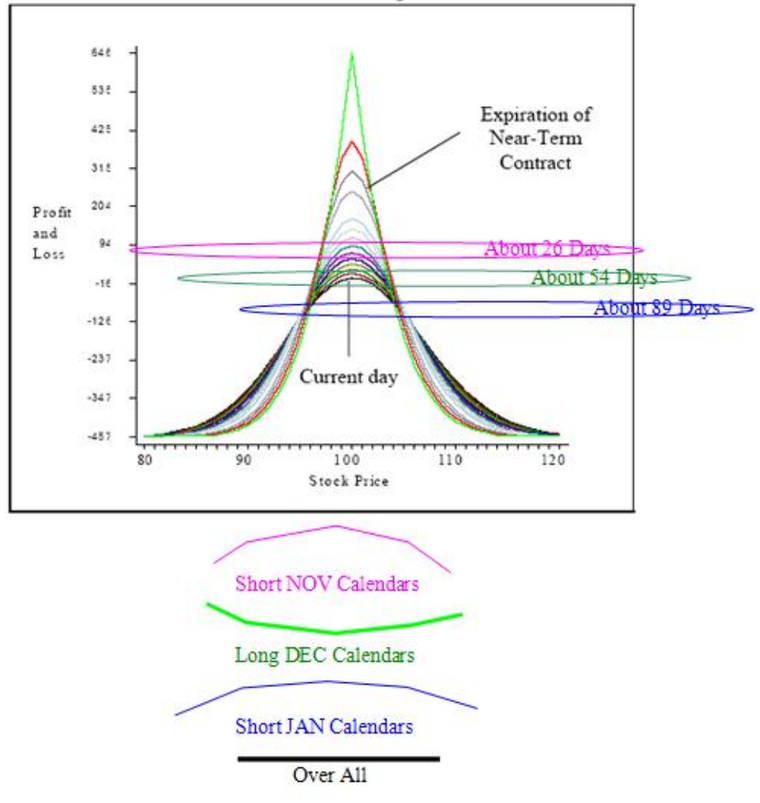


EXHIBIT 7–8

Theoretical Risk Profile of a Long 100 Strike Time Spread
View over Price Movement Using 0% Interest



CoachPhil

Butterflies Across Time

« **Reply #4 on:** October 26, 2006, 05:52:01 AM »

Charles:

As usual thanks for the quick and detailed response. Some comments:

1. I plugged in the position you gave me and got more of a short straddle risk chart.

2. The position does not come out as flat when I model it. As the p&l chart shows above the different strikes in the cross month FLYs act as tent poles propping up the profit chart. Basically here is how the profit develops. The entire position is put on for a net credit. At NOV expiration:

- The OTM strikes cost a small debit to purchase back the DEC/JAN portion as the NOV expires worthless.
- The deep ITM strikes are usually flat to slighlt debit to close out all 3 expiration months.
- THe ATM and slightly OTM strikes have a sizeable profit since the NOV months have no time or little intrinsic value while the DEC/JAN combination is closed for a large net credit. So basically I am looking for a profit anywhere along the zone where I have strikes.

The end of the wings turn negative if the underlying falls or moves too high. To avoid this risk I added the deep OTM strangle which lift the wings up.
This position I showed you has many strikes but you can achieve the same general shape if you pick one or two call strikes and one or two put strikes OTM. I am still playing around with this.
On less volatile stocks you will only need like 2 strikes on either side perhaps.

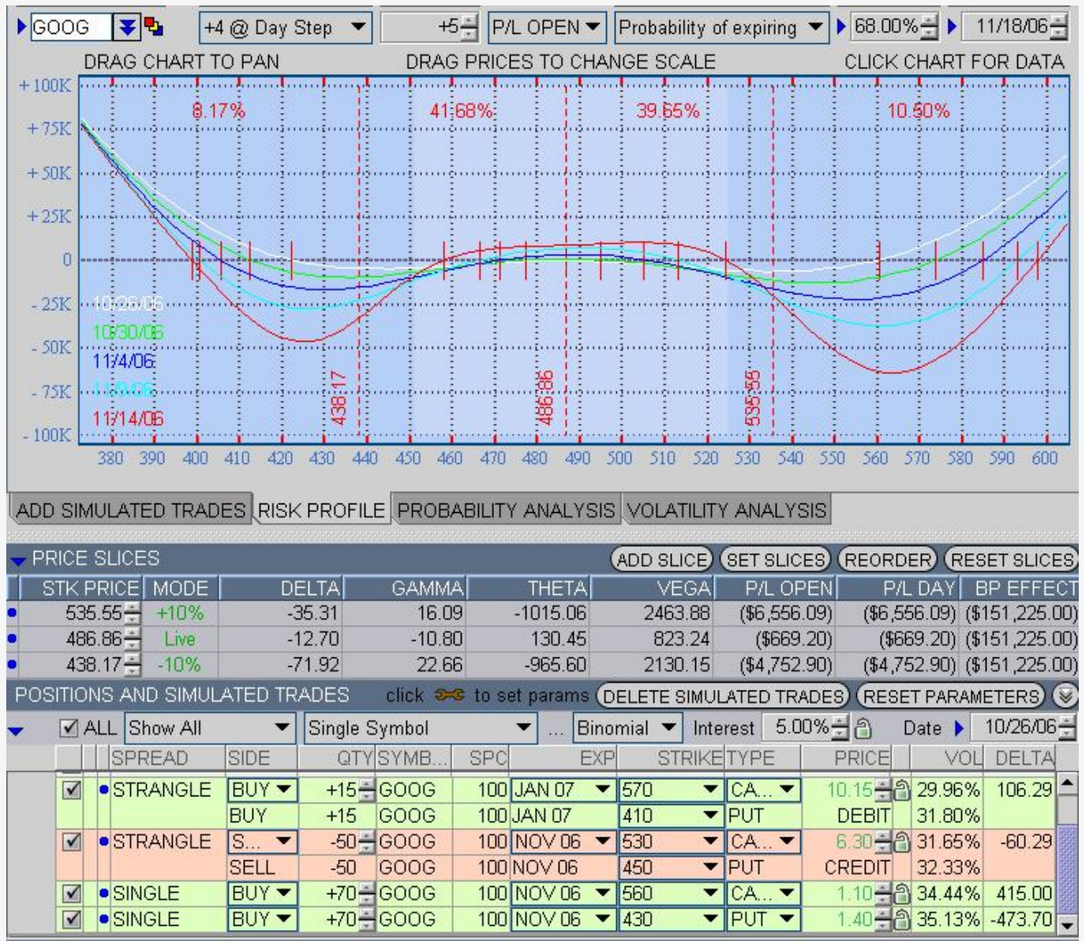
Commissions exist obviously but with even most retail brokers it is not too much of a problem. The real issue is that you cannot do this under Reg T since the back months are treated as naked. I put one on the other day in GOOG to test out and will update the results here as we go along -P

Ri$k Doctor

Butterflies Across Time

« **Reply #5 on:** October 26, 2006, 10:43:51 AM »

Please send me your imagery to examine and post and in the meantime, how's this?



manojkagrawal

Double Diagonal

« **on:** September 17, 2006, 06:42:59 AM »

Hi,

I recently placed a Double diagonal on IWM as per follows:
Sold Oct 67put/74 call
Bot Nov 65put/76 call

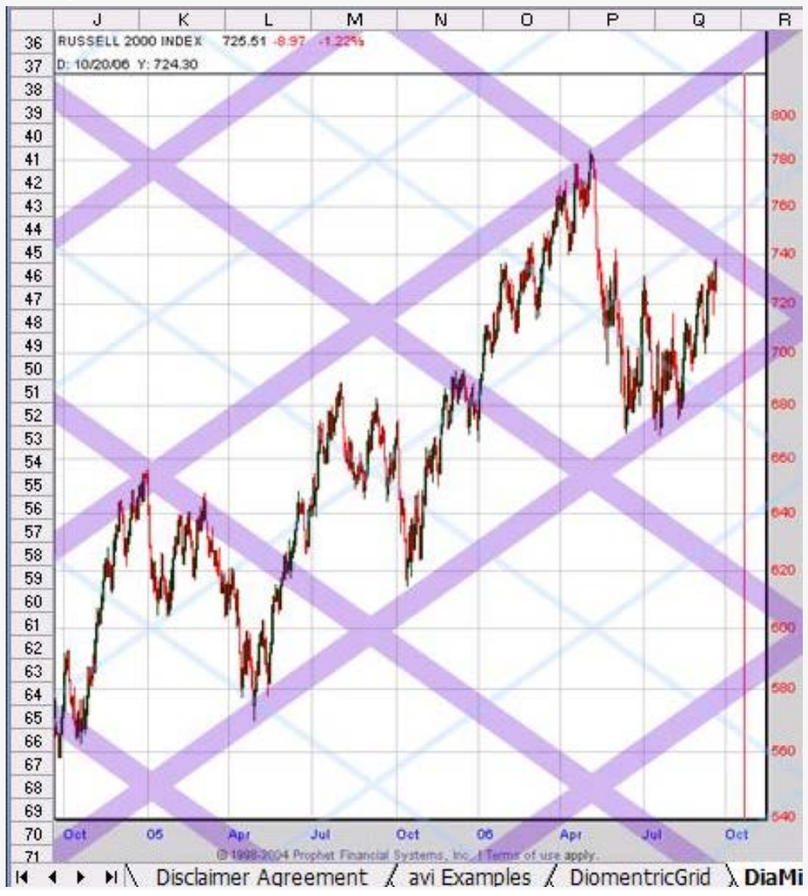
Would appreciate comments perspective on the trade.

Cheers,
Manoj

Ri$k Doctor

Double Diagonal

« **Reply #1 on:** September 26, 2006, 07:50:43 AM »



This Diamonetric Grid suggest that that strategy will win but in the event it bust out, what is your game plan?

BTW: When initiating a new topic, please email me the first time and I will click "Track this Topic" to get follow-up emails when new post are made to the existing topic.

alassio

Diagonal butterfly - crash safe position ?

« **on:** September 01, 2006, 07:04:40 AM »

As I am still searching for better (safer) ways of shorting premium than with iron condors I have setup the following calendarized/diagonalized butterfly position:

DAX was at 5800 when the position was setup (Aug 17):
Short 2 DAX Calls Oct06 at 5800 for 193.9
Short 2 DAX Puts Oct06 at 5800 for 147.3
Long 3 DAX Calls Sep06 at 6150 for 9.8
Long 3 DAX Puts Sep06 at 5450 for 18.5

The position was setup for a credit of 597.5,
in the mean time (Sep 1 with DAX at 5875) a profit of 19.7 has accumulated.

The reasoning behind the position is the following:
The DAX is trading near resistance area, where it should stay for a while. However, the additional long calls and puts serve as protection, should we have large breakouts on either side.

As the title suggests, I also expect the position to be robust in case of a large downside move.
Do you agree or will the volatility changes and skew break down the additional protection?

Thanks for your advice, alassio

							ImpF	Fut					
						DEC		5938.00					
						OCT	5802.80						
						SEP	5887.00	5892.50					
	Calls						Strike					Puts	
OCT CBfly	OCT C¥ert	OCT Prices	SEP CBfly	SEP C¥ert	SEP Prices			SEP Prices	SEP P¥ert	SEP PBfly	OCT Prices	OCT P¥ert	OCT PBfly
							5450	2.60			28.00		
									1.40			6.50	
							5500	4.00		(0.20)	34.50		(0.80)
									1.20			5.70	
							5550	5.20		0.70	40.20		2.60
									1.90			8.30	
						293.50	5600	7.10		2.60	48.50		(2.30)
					46.50				4.50			6.00	
			4.50		247.00		5650	11.60		(0.10)	54.50		35.50
					42.00				4.40			41.50	
		268.10	(2.60)		205.00		5700	16.00		1.70	96.00		(24.50)
	98.80				44.60				6.10			17.00	
64.50		169.30	0.60		160.40		5750	22.10		6.00	113.00		2.20
	34.30				44.00				12.10			19.20	
7.30		135.00	14.60		116.40		5800	34.20		3.70	132.20		4.60
	27.00				29.40				15.80			23.80	
3.00		108.00	(3.10)		87.00		5850	50.00		6.20	156.00		0.20
	24.00				32.50				22.00			24.00	
11.70		84.00	12.00		54.50		5900	72.00		2.40	180.00		26.40
	12.30				20.50				24.40			50.40	
(12.40)		71.70	6.00		34.00		5950	96.40		6.70	230.40		
	24.70				14.50				31.10				
13.90		47.00	4.90		19.50		6000	127.50		(2.60)			
	10.80				9.60				28.50				
(2.40)		36.20	4.20		9.90		6050	156.00					
	13.20				5.40								
9.20		23.00	3.20		4.50		6100						
	4.00				2.20								
(4.90)		19.00	0.90		2.30		6150						
	8.90				1.30								
7.20		10.10			1.00		6200						
	1.70												
(1.10)		8.40					6250						
	2.80												
0.90		5.60					6300						
	1.90												

I need better data but have no access.

Ri$k Doctor

Diagonal butterfly - crash safe position ?

« **Reply #1 on:** September 03, 2006, 08:41:28 PM »

It could be a real concern. I would prefer to ratio analysis but Eurexchange.com has stale data showing butterflies for credits. This distorst the ability to see how skew might affect your positions.

alassio

Diagonal butterfly - crash safe position ?

« **Reply #2 on:** September 04, 2006, 12:55:58 AM »

Here is the data for close of Sep 1 with DAX at 5876.54:
Strike Sep06P Sep06C Oct06P Oct06C
5450 3.1 435 29.4 478
5500 4.1 386.1 34.9 433.7
5550 5.6 337.7 41.4 390.4
5600 7.8 289.9 49.1 348.3
5650 11 243.2 58.1 307.6
5700 15.9 198.2 68.8 268.4 5750 23.3 155.6 81.4 231.2
5800 34.2 116.6 96.1 196.1 5850 50 82.4 113.2 163.4
5900 71.9 54.4 133 133.5 5950 100.6 33.2 155.8 106.5
6000 135.9 18.6 181.9 82.8 6050 176.8 9.5 211.5 62.6
6100 221.9 4.6 244.6 45.9 6150 269.5 2.3 281.2 32.8

Sorry, but this forum doesn't provide a file upload feature. Otherwise I would have attached an Excel file ...
Concerning variants of this strategy, it may be better to switch months and short the front month and buy protection in the back month?Or what do you think of the position in Allen H. Baird's book with a front month butterfly and a back month wrangle?

Thanks for your advice, alassio

Ri$k Doctor

Diagonal butterfly - crash safe position ?

« **Reply #3 on:** September 06, 2006, 03:45:32 AM »

I can do it if you email the file to riskdoctor@riskdoctor.com. That would help.

Ri$k Doctor

Diagonal butterfly - crash safe position ?

« **Reply #4 on:** September 07, 2006, 11:04:37 AM »

Thank you for your prices:

	A	B	C	D	E	F
1	Closing option quotes from September, 1 with DAX at 5876.54					
2	Strike	Sep06P	Sep06C	Oct06P	Oct06C	
3	5450	3.1	435	29.4	478	
4	5500	4.1	386.1	34.9	433.7	
5	5550	5.6	337.7	41.4	390.4	
6	5600	7.8	289.9	49.1	348.3	
7	5650	11	243.2	58.1	307.6	
8	5700	15.9	198.2	68.8	268.4	
9	5750	23.3	155.6	81.4	231.2	
10	5800	34.2	116.6	96.1	196.1	
11	5850	50	82.4	113.2	163.4	
12	5900	71.9	54.4	133	133.5	
13	5950	100.6	33.2	155.8	106.5	
14	6000	135.9	18.6	181.9	82.8	
15	6050	176.8	9.5	211.5	62.6	
16	6100	221.9	4.6	244.6	45.9	
17	6150	269.5	2.3	281.2	32.8	

As you can see, the prices are much more in line. You can tell because the butterflies make sense in the the SEPs are greatest near the money and get cheaper away from the money. That does not work for the OCTs because of the skew; lower ones cheap because of high vols and higher ones more expensive that ATMs because of lower vols.

Closing option quotes from September, 1 with DAX Cash at 5876.54

SynFutures Price
SEP 5882.40
OCT 5900.20

=(3*F56)+(3*H28)-(2*C46)-(2*K46)

	Oct06C Verticals	Oct06C Price	Sep06C Butterflies	Sep06C Verticals	Sep06C Price	Strike	Sep06P Price	Sep06P Verticals	Sep06P Butterflies	Oct06P Price	Oct06P Verticals	Oct06P Butterflies	Your Spread
28		478.00			435.00	5450	3.10			29.40			(420.20)
29	44.30			48.90				1.00			5.50		
30		433.70	0.50		386.10	5500	4.10		0.50	34.90		1.00	(470.40)
31	43.30			48.40				1.50			6.50		
32		390.40	0.60		337.70	5550	5.60		0.70	41.40		1.20	(513.80)
33	42.10			47.80				2.20			7.70		
34		348.30	1.10		289.90	5600	7.80		1.00	49.10		1.30	(547.60)
35	40.70			46.70				3.20			9.00		
36		307.60	1.70		243.20	5650	11.00		1.70	58.10		1.70	(568.20)
37	39.20			45.00				4.90			10.70		
38		268.40	2.40		198.20	5700	15.90		2.50	68.80		1.90	(574.80)
39	37.20			42.60				7.40			12.60		
40		231.20	3.60		155.60	5750	23.30		3.50	81.40		2.10	(569.40)
41	35.10			39.00				10.90			14.70		
42		196.10	4.80		116.60	5800	34.20		4.90	96.10		2.40	(555.90)
43	32.70			34.20				15.80			17.10		
44		163.40	6.20		82.40	5850	50.00		6.10	113.20		2.70	(539.40)
45	29.90			28.00				21.90			19.80		
46		133.50	6.80		54.40	5900	71.90		6.80	133.00		3.00	(516.80)
47	27.00			21.20				28.70			22.80		
48		106.50	6.60		33.20	5950	100.60		6.60	155.80		3.30	(512.30)
49	23.70			14.60				35.30			26.10		
50		82.80	5.50		18.60	6000	135.90		5.60	181.90		3.50	(512.60)
51	20.20			9.10				40.90			29.60		
52		62.60	4.20		9.50	6050	176.80		4.20	211.50		3.50	(524.80)
53	16.70			4.90				45.10			33.10		
54		45.90	2.60		4.60	6100	221.90		2.50	244.60		3.50	(548.00)
55	13.10			2.30				47.60			36.60		
56		32.80			2.30	6150	269.50			281.20			(580.30)

In analyzing your 3 by 2 configuration, there are not enough strike prices to include the value of what the SEP 6150 calls would be worth if the market dropped each 50 point increment or what the 5450 puts would be worth if the market rallied each 50 point increment (as the equation displayed in the upper right hand corner of the image is trying to do. Currently you have a value of 516.80 credit. That gets worse for a decrease in the DAX for the next 300 points lower and OK for the next 150 points higher only because your long OCT 5800 straddle is currently ITM.

If you have can send me what the Greeks up and down with multiple time horizons then perhaps I can give you more insight.

alassio

Diagonal butterfly - crash safe position ?

« **Reply #5 on:** September 08, 2006, 12:04:19 AM »

Thanks for the analysis

It tells me that I should more thoroughly analyze the shape of the volatility curves in the different months to select strikes in order to start with the intended deltas. I should also have a closer look at the synthetic futures to see where the underlying is really trading, since the cash index is misleading.

Currently the position has a nice profit with the Oct06 5800 straddle trading for 272 (DAX at 5790). I will hold it at least until over the weekend.

My only concern with this type of position is the negative vega in case of a strong sell-off, where the additional protection may not be enough to compensate the vol increase. So I would like to be delta neutral with positive vega, positive theta and long wings for breakout protection (I know that is a bit too much). One type of position with these characteristics has been shown in Allan Jan Baird's book "Option Market Making" (front month butterfly with back month wrangle). However, this position seems infeasible with the current volatility surfaces. I simply can't manage to maintain positive theta (back month is too expensive).
Any alternatives with similar characteristics?
Thanks, alassio

alassio

Diagonal butterfly - crash safe position ?

« **Reply #6 on:** September 11, 2006, 02:03:33 AM »

Position was closed today for 272 with a total profit of 28
(decay was minimal over weekend, volatility starts rising, profit was taken because of negative vega)

Ri$k Doctor

Diagonal butterfly - crash safe position ?

« **Reply #7 on:** September 15, 2006, 03:12:31 PM »

Well done.

alassio

Diagonal butterfly - crash safe position ?

« **Reply #8 on:** September 17, 2006, 04:54:51 AM »

In retrospect I could have easily waited until front month expiration ...
However, I want to switch into long vega positions now.

Ri$k Doctor

Diagonal butterfly - crash safe position ?

« **Reply #9 on:** September 17, 2006, 10:34:33 AM »

Please keep us posted.

Admin

Welcome To The Ri$k Doctor's Forum
« **on:** March 02, 2005, 12:09:49 AM »

Welcome to the Ri$k Doctor's Forum.

"Tell me and I will forget. Show me and I will remember. Involve me and I will understand."
Aristotle

Comments, notices, and pontifications from The Ri$k Doctor. This forum will be used for notifications concerning changes in Webinars and schedules. Have a comment or question concerning the Ri$k Doctors books or webinars, this is the forum to use.

Be sure to read and follow the rules of the forum you were given when you signed up to use the forum. Report any abuse in the forums to the Admin of the forum.

Enjoy!

The Ri$k Doctor

KB0EBG

Welcome To The Ri$k Doctor's Forum
« **Reply #1 on:** March 02, 2005, 02:08:32 PM »

It is nice being a charter member.
I hope we will learn from each other.
Carl

RiskDoctor

Welcome To The Ri$k Doctor's Forum
« **Reply #2 on:** March 02, 2005, 03:25:48 PM »

Thanks Carl

---

trader56

Welcome To The Ri$k Doctor's Forum
« **Reply #3 on:** July 14, 2006, 08:04:33 PM »

New to the forum, but learned my inital options lessons from the course Charles put together for ITI!
Looking forward to getting re-acquainted with options, and learning more!
Dave

Ri$k Doctor

Welcome To The Ri$k Doctor's Forum
« **Reply #4 on:** August 23, 2006, 09:57:31 PM »

Cool!

alassio

Strange straddle prices
« **on:** August 16, 2006, 12:11:23 AM »

Today I notice some strange option prices of Oct06 straddles:
Oct06 SMI Call 8100 is 182.5
Oct06 SMI Put 8100 is 198.2 -> 8100 straddle is 380.5

Oct06 SMI Call 8150 is 156.4
Oct06 SMI Put 8150 is 221 -> 8150 straddle is 377.4

Note that the SMI index is currently at 8069.
=> The 8150 straddle should be more expensive than the 8100 straddle, since the SMI is farer away from the strike!

Can the volatility skew be the reason for this price distortion? Is there a way to profit from this apparent anomaly?

I have noticed already at different occasions that straddles with higher strikes are not necessarily much more expensive than a closer straddle when the underlying dives. The call seems to lose value more quickly than the put increases.

Thanks for your clarification

Ri$k Doctor

Strange straddle prices
« **Reply #1 on:** August 20, 2006, 02:35:52 PM »

Wild Guess (I don't have access to SMI): The 8069 is the cash index and the calculating the carry cost* until October expiry at 5% (but it could be higher) gives you 66 or so. Add that 66 to 8069 and you get 8132 (closer to 81.50) for a synthetic futures price that the options are actually priced off of.

*If there are dividends paid during the period then that would reduce the carry cost.

---

alassio

Strange straddle prices
« **Reply #2 on:** August 20, 2006, 11:49:30 PM »

> **Quote** (Ri$k Doctor @ Aug. 21 2006,02:35)
> Wild Guess (I don't have access to SMI): The 8069 is the cash index and the calculating the carry cost* until October expiry at 5% (but it could be higher) gives you 66 or so. Add that 66 to 8069 and you get 8132 (closer to 81.50) for a synthetic futures price that the options are actually priced off of.
>
> *If there are dividends paid during the period then that would reduce the carry cost.

Well, the carry cost shouldn't be that high (annual interest rate is at about 1.8% with no dividends).
However I understand that since the synthetic futures price may be closer to the 8150 strike than the 8100, the seemingly odd straddle prices can be explained.

Thanks for the explanation

Ri$k Doctor

Strange straddle prices
« **Reply #3 on:** August 21, 2006, 08:52:15 AM »

OK, the carry at 1.8% would be 24 added to 8069 to get 8093 (still south of 8100) the skew might be pumping up the 8150s, but not likely in an index. Question: Where did you get the 1.8%?

alassio

Strange straddle prices
« **Reply #4 on:** August 21, 2006, 09:49:28 AM »

I got the 1.8% from the option modelling parameters used by InteractiveBrokers. They adapt these parameters themselves. I don't know how reliable they are, however. Any way, 5% is too much, since we still have a low interest environment here below Euro levels.

Ri$k Doctor

Strange straddle prices
« **Reply #5 on:** August 21, 2006, 11:48:16 AM »

IB may be setting it to the interest rate they pay on customer accounts but in actuality if you get a quote on an ATM box and take the middle between the market makers' bid and ask then you can crunch out the rate you should use and see that it is perhaps higher than 1.8%.

hissho

no idea about US stock market
« **on:** August 09, 2006, 04:23:58 AM »

Hi Doctor
Greetings.
I live in Oz and apart from a few household names like Coke, Intel, Yahoo, google, GM etc i have no idea about the US market.....

Do i need a solid understanding of US stock market before trading US options?

how can i get started? what's a good resource of US stock market?

Your reply would be much appreciated,
hissho

Ri$k Doctor

no idea about US stock market
« **Reply #1 on:** August 20, 2006, 02:28:41 PM »

Options are Options and you do not necessarily need to know the fundamentals of the underlying company. Charting helps and you need to have a basis for becoming bullish or bearish or non-trendish or break-outish.

I would stick with the bigger names that have high enough volume and players to provide relatively tight bid / ask spread quotes.

trader56

Market Making vs Market Taking

« **on:** July 24, 2006, 04:41:24 PM »

Hi Charles,

In the "A Very Good Trader Makes 6% Per Month" thread below, you said:

"A very good market maker can make 10% to 30% pr month but that is a totally different game.

For the retail investor, a realistic goal should be about 2%-3% per month realizing that there may be drawdowns of 8% in some months and gains of 10% or more in others."

Is it possible for a trader who's not on, say, the floor of the CBOE or other exchange to act as a market maker?

If not, what are the factors that prevent a trader from assumming this role, rather than that of a market taker?

Thanks!

Ri$k Doctor

Market Making vs Market Taking

« **Reply #1 on:** July 28, 2006, 09:10:40 AM »

You could be a totally electronic market maker on the ISE but it takes a certain amount of capital (you could partner with a JBO (Joint Back Office) and go through the necessary registrations.

The main thing is having an understanding of risk management and being to take on and manage all the trades that give you an inventory decided by the market place.

ohlala

Pricing of Combos
« **on:** July 06, 2006, 06:24:52 PM »

Hi Charles,
I've got a question regarding the pricing of Index Options. In your book, you say: The options are priced off a non-transparent synthetic contract in the way of the same strike combos.
Now, the query is if the options are priced of the synthetic futures which are themselves priced off the combos, where are the prices for the combos (calls, puts) derived from in the first instance?
Sathya

Ri$k Doctor

Pricing of Combos
« **Reply #1 on:** July 06, 2006, 06:52:57 PM »

Take the strike and add the call and subtract the put and what do you get?

The Synthetic Future.

Now, why is it priced at that particular level?

The carry cost of the basket of stocks is added to the cash price less the present value of the dividend stream during the period.

Why is it like that?

Think, if you were a market maker and were going to sell someone the combo at theoretical value plus your market maker edge (profit whether it be .10 or ,20 etc.).

At fair value, when I, the MM, sells you the combo, I then need to buy the basket of stocks. Right?

What does that cost? Tons plus the interest on all the money I have to borrow to buy it or the interest I would have received on the money I spent (implicit interest). But, I get the dividends on all the stocks in the basket during the expiration cycle. Don't I?

There you have it.

You hear about the cash versus the theoretical value of the futures. You don't hear much about synthetic futures where there are no real futures like the OEX and XEO.

ohlala

Pricing of Combos
« **Reply #2 on:** July 06, 2006, 07:21:12 PM »

Hi Charles,
This is my interpretation, Correct me if I??m wrong;
Looks like the pricing of the Index options is a two tier system, first level, options prices derived from the current index value (no interest or dividend streams considered), Next a synthetic futures price is derived from the combos + interest less dividend streams, finally the ??displayed? options prices are priced off the synthetic futures so there??s no arbitrage opportunity between the index and options prices.
Also, the index value is different for different months due to
effects of the dividend payments, which could result in calendar risk on a calendar on an index?

Sathya

Ri$k Doctor

Pricing of Combos

« **Reply #3 on:** July 07, 2006, 07:29:22 AM »

Starting at the bottom of your last post and working up:

Each month is different, yes because of the dividends during the period but also because of the time differences to carry (interest) the basket of stocks.

There are indeed arbitrage opportunities (for market makers) but it is based upon either buying below the "fair value' or selling above it while locking in those better valued trades against other relatively good valued trades (basket, other combos or other safe configurations).

As far as what valuation comes first, the tail wags the dog often times. The lead trades sometimes happen at a put strike or a call strike or combination of strikes, or in the cash or futures market (even though the correlation may not be that high).

Bottom line: There is a fair value equation that identifies where the components belong in relationship to one another. The dynamics of the market cause temporary aberations (opportunities) that may or may not be able to be taken advantage of (locked in).

The more you can trade and the better your cost stucture (margin treatment, commissions and money & banking arrangements) will determine whether you can compete in that game.

Market maker groups are set up for that game but it is highly competitive and by no means always a cash cow.

xyzt13

Pricing of Combos

« **Reply #4 on:** July 21, 2006, 11:51:26 AM »

Hello Ri$k Doctor-
Thanks for sharing your knowledge. Can you an example of a synthetic future?

Ri$k Doctor

Pricing of Combos

« **Reply #5 on:** July 23, 2006, 03:01:22 PM »

For The SEP 470 OEX Synthetic Future would be 574.15:

S&P 100 INDEX 800-895 (OEX: CME:Index and Options Market)

Last Price	Today's Change	Bid size	Ask size	Volume	Trade
572.50	-2.47 (-0.43%)	572.29 x0	572.65 x0	1,344,458,800	BU

CME:Index and Options Market Delayed Quote: 4:59 PM ET 7/21/06

Enter Symbol: Select Chain: Calls & Puts

Month: Sept-2006 Strikes: At and Near Money Include Adjusted/Non-standard Options

Education and Strategies: Get started with options | Learn about buying a call | Learn about buying a put

Options Expiration: September 16, 2006

Calls									Puts						
	Symbol	Open Interest	Volume	Net Change	Last	Bid	Ask	Strike Price	Bid	Ask	Last	Net Change	Volume	Open Interest	
Trade	OEBIL	33	0	0.00	28.70	21.30	23.10	560.0	7.60	8.40	7.40	0.80	419	2,117	
Trade	OEBIN	269	142	-3.80	15.40	15.00	15.90	570.0	10.80	11.80	10.20	0.40	30	3,953	
Trade	OEBIP	1,766	24	-0.20	10.00	9.00	10.00	580.0	15.20	16.20	14.80	1.30	157	2,046	
Trade	OEBIR	879	216	-0.80	5.10	4.50	5.20	590.0	20.90	22.70	20.00	-6.70	1	113	

Strike plus call average minus put average.
570 + 15.45 - 11.30

alassio

Net credit OTM backspread

« **on:** July 03, 2006, 05:59:16 AM »

Currently I observe a rather steep volatility curve in DAX index options, which allows me to put on the following position for a net credit:
Short 1 July06 5850 DAX option for 22.1
Long 2 July06 5950 DAX options for 6.6
=> net credit 8.9
(DAX is currently at 5700 with 25% vol and 3 weeks to go)

My analysis suggests that this position should win if the DAX stays, falls or advances quickly. It will loose if it slowly creeps up into the loss region 5850-5950.

However I am not quite sure, how the position will behave with regard to the steep volatility curve. I consider it a well protected short premium position. Is this true?

Regards, alassio

Ri$k Doctor

Net credit OTM backspread

« **Reply #1 on:** July 03, 2006, 07:31:36 AM »

Just looking at the 5800/5900 spread, 1 by 2, it is showing a value of about a 10 credit, meaning if the DAX rallies today and vols at your strikes assume the the volls at those strikes, as the skew slides, you will be losing about 1 point. A sloww move up is worse. Your deltas must be showing that you are short at the moment.

Strike Price	Vers. Num.	Opening Price	High	Low	Last Price	Date	Time	Daily Settlem. Price	Traded Contr.	Open Interest (adj.)	Open Interest Date
6000.00	0	4.00	4.00	2.80	3.30	03.07.2006	13:00:44	4.30	1,162	25,417	30.06.2006
5950.00	0	7.20	7.20	5.50	6.00	03.07.2006	15:59:00	8.00	169	13,993	30.06.2006
5900.00	0	13.30	14.00	11.00	11.70	03.07.2006	15:56:55	14.50	1,461	20,728	30.06.2006
5850.00	0	24.00	25.00	18.50	19.80	03.07.2006	16:08:10	25.00	1,447	11,056	30.06.2006
5800.00	0	41.00	41.80	32.00	33.60	03.07.2006	16:05:08	40.40	1,453	48,085	30.06.2006
5750.00	0	62.00	63.80	51.50	55.50	03.07.2006	16:10:47	61.30	4,520	15,977	30.06.2006
5700.00	0	88.90	91.50	76.10	80.70	03.07.2006	16:11:08	87.50	4,535	25,875	30.06.2006

alassio

Net credit OTM backspread

« **Reply #2 on:** July 03, 2006, 08:19:57 AM »

Yes, my deltas are negative up to about the 5800 strike, where the delta starts going positive (in the short term)
So, the main idea behind the position is a short call credit spread where I afford the additional call for added short term protection.

Ri$k Doctor

Net credit OTM backspread

« **Reply #3 on:** July 03, 2006, 11:58:55 AM »

Assuming it is a supply shaped skew (meaning that the OTM calls have successively lower implied volatilituies and the lower strike puts get higher and higher), the vols will work in your favor because you will have two oprions going up the skew curve favorably versus only one unfavorably.

ashoo

Net credit OTM backspread
« **Reply #4 on:** July 08, 2006, 10:25:55 AM »

This post caused previous post's typo to be corrected.

Ri$k Doctor

Net credit OTM backspread
« **Reply #5 on:** July 08, 2006, 09:32:26 PM »

Thank you ashoo, for pointing out previous post's typo.

alassio

Net credit OTM backspread
« **Reply #6 on:** July 09, 2006, 05:46:20 AM »

Yes, you are confirming my expectation that the skew shape should help me in case the underlying goes against me.
So I consider this a relatively high probability trade.

I am still looking for a similar way to exploit the skew shape on the put side. The put ratio spread without additional protection is too risky and the higher vol. of further OTM puts make protection so expensive that the slight advantage of the sold puts disappears.
I guess I will have a look at some "hockey-stick" positions.
Some alternative ideas?

Ri$k Doctor

Net credit OTM backspread
« **Reply #7 on:** July 10, 2006, 06:34:36 PM »

I like a strategy that meets my market expectations. What do you expect?

samban

conversion / reversals
« **on:** July 03, 2006, 06:18:58 AM »

hello,
i am a newbie and have a question on conversions/reversals.

if i buy a conversion/reversal, the cost to me is at times 50 to 60 cents less than the corresponding strike price. this seems to be an arb opportunity.

my question - is'nt it too good to be true, or am i (which may be more likely) missing something?

much appreciate any advice.

rgds

Ri$k Doctor

conversion / reversals
« **Reply #1 on:** July 03, 2006, 07:05:26 AM »

Yes, you are missing that there is a cost to carry the stock* and perhaps that will cost 1.00. the carry cost is the present value of the strike less any dividend you might receive during the period.
How much time is left?
What is the strike price?
Is there a dividend?

*If you have the cash you would miss out on the interest that you would have received.

---

samban

conversion / reversals
« **Reply #2 on:** July 03, 2006, 07:54:09 AM »

thank you vm for your calrifications

much appreciate your advise

Ri$k Doctor

conversion / reversals
« **Reply #3 on:** July 07, 2006, 07:30:26 AM »

You're welcome.