







		Subject	Started by			Last post ▼
		Diamonetrics Chart for Dow & Trade Logic	janus			May 22, 2005, 08:18:36 PM by Ri\$k Doctor 
		Images and Text from 040405	Ri\$k Doctor			April 05, 2005, 09:04:47 AM by Ri\$k Doctor 

janus
Newbie
★
Posts: 12



Diamonetrics Chart for Dow & Trade Logic

« on: April 11, 2005, 01:46:07 PM »

Hi Charles,

Thanks for a great event on 4th. My question is regarding the DiamonetricGrid of the Dow that you discussed.



One questions I wanted to ask. You mentioned that you'd skip Apr trades as the range was too wide and there was no interesting play. But May could be a different matter.

Would you put on a May position given your analysis at that time or would you wait to see if the Dow followed you projection, nearer to Apr expiry?

Belinea03
Newbie
★
Posts: 9

Diamonetrics Chart for Dow & Trade Logic

« Reply #1 on: April 11, 2005, 01:55:09 PM »

Hmmm,

I thought Charles said he'd skip April because there were no premiums in the series?

janus

Newbie



Posts: 12



Ri\$K Doctor

Administrator

Hero Member



Posts: 3249



Diamonetrics Chart for Dow & Trade Logic

« Reply #2 on: April 12, 2005, 02:51:49 AM »

Belinea03, yes that was my understanding. What I mean is the Diamonetrics grid showed a target range for May that did offer some more interest. The question was about timing of taking the May position. Charles would you take the May position on 4apr given there is longer till expiry, or wait follow the market and look to open a position (assuming your option was unchanged) closer to May expiry (say 4 weeks before).

Diamonetrics Chart for Dow & Trade Logic

« Reply #3 on: April 13, 2005, 08:35:54 AM »

DJX		CBOE DJ INDL AVG INDEJX		Gamma		Impl Vol		7		
STOCK										
	LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW	
	105.04	-.04	0	0	0 x 0	0	105.07	105.21	104.65	
	YIELD	PE	EPS	DIV	DIV.FREQ	DIV.DATE	52HIGH	52LOW	BETA	SHARES
	0.00%	N/A	0	0	--	N/A	109.84	12.65	.98	0
OPTIONS					Single		Exchange Composite			
CALLS					PUTS					
GAMMA		IMPL VOL	BID X	ASK X	EXP	STRIKE	BID X	ASK X	GAMMA	IMPL VOL
APR 05 (1) 100										10.82%
MAY 05 (36) 100										10.50%
.07	10.54%	3.40 C	3.70 C	MAY 05	102	.45 C	.65 C	.07	12.87%	
.09	10.50%	2.65 C	2.90 C	MAY 05	103	.65 C	.85 C	.09	12.24%	
.11	10.18%	1.95 C	2.15 C	MAY 05	104	1.00 C	1.15 C	.10	12.06%	
.12	9.79%	1.35 C	1.50 C	MAY 05	105	1.30 C	1.50 C	.11	11.21%	
.12	9.48%	.85 C	1.00 C	MAY 05	106	1.85 C	2.00 C	.11	11.06%	
.11	9.65%	.50 C	.70 C	MAY 05	107	2.40 C	2.65 C	.10	10.68%	
.09	9.53%	.25 C	.45 C	MAY 05	108	3.10 C	3.40 C	.09	10.39%	

	SPREAD	SIDE	QTY	SYMBOL	SPC	EXP	STRIKE	TYPE	PRICE
▶ BUTTERFLY	BUY	BUY	+10	DJX	100	MAY 05	104	PUT	.40
	SELL	SELL	-20	DJX	100	MAY 05	106	PUT	
	BUY	BUY	+10	DJX	100	MAY 05	108	PUT	

We had to wait for the May options to come on board.

Based on the low implied volatility the MAY 104/106/108 butterfly is rater expensive at a .50ish fill. Even though I believe you can easily double or triple your money I might have a tendency to wait for an extreme (currently 104ish or 108ish to leg it vertical...wait a while... to vertical.

janus

Newbie



Posts: 12

Ri\$K Doctor

Administrator

Hero Member



Posts: 3249

Diamonetrics Chart for Dow & Trade Logic

« Reply #4 on: April 14, 2005, 02:10:15 PM »

Thanks I get the idea. Given Dow is down at 10279 today on the lower zone of the grid would you wait to see some signs of strength from here or be prepared to go ahead and buy the 104-106 vertical for 0.6 (mid =0.55)?

Diamonetrics Chart for Dow & Trade Logic

« Reply #5 on: April 14, 2005, 05:55:08 PM »

I would indeed. Let's paper trade it for the education of it. I will paste in the closing options chain and we will grab a screenshot on the open tomorrow to see where we would get filled.

▶ DJX		CBOE DJ INDL AVG INDEJX				Gamma		Impl Vol		11	
▼ STOCK											
▶		LAST X	NET CH...	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW	
		102.79	-1.25	0	0	0 x 0	0	104.03	104.18	102.73	
▼ OPTIONS											
▶ Single											
Exchange											
Composite											
CALLS											
PUTS											
GAMMA		IMPL V...		BID X		ASK X		EXP		ST...	
.11		11.13%		1.30 C		1.50 C		MAY 05		103	
.11		11.00%		.85 C		1.05 C		MAY 05		104	
.10		11.04%		.55 C		.70 C		MAY 05		105	
.08		11.13%		.35 C		.45 C		MAY 05		106	
.06		10.54%		.10 C		.30 C		MAY 05		107	
.04		10.90%		.05 C		.20 C		MAY 05		108	
BID X											
ASK X											
GAMMA											
IMPL V...											
.09											
15.06%											
.10											
12.98%											
.08											
14.67%											
.07											
15.45%											
.06											
16.84%											
.05											
15.42%											
POSITION AND ORDER ENTRY TOOLS											
DELTA											
GAMMA											
THETA											
VEGA											
P/L OPEN											
P/L DAY											
BF											
▶ DJX											
.00											
.00											
.00											
.00											
\$0.00											
\$0.00											
ORDER ENTRY AND ORDER QUEUE											
ORDER ENTRY											
ORDER QUEUE											
SPR...											
SIDE											
QTY											
SYMB...											
SPC											
EXP											
STRIKE											
TYPE											
PRICE											
LMT											
ORD...											
RU...											
▶ VER...											
... ▼											
+10											
DJX											
100											
MA...											
104											
CALL											
.55											
SELL											
-10											
DJX											
100											
MAY 05											
106											
CALL											

Ri\$k Doctor

Administrator
Hero Member
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Posts: 3249



Diamonetrics Chart for Dow & Trade Logic

« Reply #6 on: April 15, 2005, 06:26:35 AM »

Let's go for the 103/105 instead and take a fill at .75 on a .50 - .90 market quote.

DJX	CBOE DJ INDL AVG INDEDJX										Gamma	Impl Vol
STOCK												
LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW				
102.18	-.61	0	0	0 x 0	0	102.77	102.78	102.76				
OPTIONS												
Single Exchange Comp												
CALLS						PUTS						
GAMMA	IMPL VOL	BID X	ASK X	EXP	ST...	BID X	ASK X	GAMMA	IMPL VOL			
.11	11.85%	1.10 C	1.30 C	MAY 05	103	2.00 C	2.15 C	.10	13.53%			
.10	11.59%	.70 C	.90 C	MAY 05	104	2.60 C	2.70 C	.09	13.14%			
.09	11.40%	.40 C	.60 C	MAY 05	105	3.20 C	3.50 C	.08	13.05%			
.07	11.88%	.25 C	.45 C	MAY 05	106	4.00 C	4.30 C	.07	13.18%			
.05	11.71%	.15 C	.25 C	MAY 05	107	4.90 C	5.20 C	.06	13.94%			
.04	11.38%	0 C	.20 C	MAY 05	108	5.70 C	6.10 C	.05	13.18%			
POSITION AND ORDER ENTRY TOOLS												
		DELTA	GAMMA	THETA	VEGA	P/L OPEN	P/L DAY					
DJX		.00	.00	.00	.00	\$0.00	\$0.00					
ORDER ENTRY AND ORDER QUEUE												
ORDER ENTRY ORDER QUEUE												
SPRE...	SIDE	QTY	SYMB...	SPC	EXP	STRIKE	TYPE	PRICE	LMT	ORDER	R	
VERTI...	...	+10	DJX	100	MA...	103	C...	.70	LMT	LI...		
	SELL	-10	DJX	100	MAY 05	105	CALL					

janus

Newbie
★
Posts: 12

Diamonetrics Chart for Dow & Trade Logic

« Reply #7 on: April 18, 2005, 01:23:42 AM »

Hi Charles, given the sell off at the end of last week would your opinion from the diamonetrics chart change or would you hold the vertical we now have in play?

Ri\$k Doctor

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Diamonetrics Chart for Dow & Trade Logic

« Reply #8 on: April 18, 2005, 06:10:21 AM »

Hold.
An affordable limited risk.



Need a more decisive breakdown and protracted move for me to change opinion and consider salvage value. The updated DiamonetricGrid shows that the move is within normal market behaviour and therefore has a reasonable chance of performing a normal retracement (trading within the purple oval) to where we can get out for even or still have a chance for profit. If it violates this normal downtrend channel at a greater velocity, then it would prove something more serious but the position has built in stops and even though it is doubtful that there would be any salvage value it was worth taking a stab at it in this limited fisk fashion.

Be mindful of an opportunity to get short (perhaps ignoring the initial position) but I like to get short on a rally to a resistance area rather than selling into a dip.

Ri\$k Doctor
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Diamonetrics Chart for Dow & Trade Logic
« Reply #9 on: May 02, 2005, 08:31:20 AM »

May 2nd:
Time for a repair strategy.



Does not look too likely that the DOW can muster much of a move above 104 by MAY expiration so we can sell 3 times as many 104/105 call vertical credit spreads and collect .25 per spread on what would be a ".20 bid at .45" market quote. It is possible to get .30 perhaps but to take a chance when there is a possible double top is too risky.

DJX		CBOE DJ INDL AVG INDEDJX				Delta		Open Interest		8		
STOCK												
LAST X		NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW			
102.50		+57	0	0	0 x 0	0	101.92	102.58	101.92			
OPTIONS												
Single												
Exchange Composite												
CALLS						PUTS						
DELTA	OPEN.INT	BID X	ASK X	EXP	STRIKE	BID X	ASK X	DELTA	OPEN.INT			
MAY 05 (18) 100												
.91	2,810	3.50 C	3.80 C	MAY 05	99	.25 C	.45 C	-.17	1,305			
.82	6,188	2.70 C	2.95 C	MAY 05	100	.45 C	.80 C	-.24	16,119			
.71	11,550	2.05 C	2.15 C	MAY 05	101	.65 C	.80 C	-.32	5,303			
.58	3,142	1.30 C	1.50 C	MAY 05	102	.90 C	1.10 C	-.43	6,435			
.44	3,931	.75 C	.95 C	MAY 05	103	1.40 C	1.60 C	-.56	4,765			
.29	9,358	.40 C	.55 C	MAY 05	104	2.00 C	2.25 C	-.68	15,975			
.15	10,436	.10 C	.20 C	MAY 05	105	2.70 C	2.95 C	-.80	12,304			
.10	4,160	.05 C	.15 C	MAY 05	106	3.60 C	3.90 C	-.85	3,929			
SPREAD	SIDE	QTY	SYMBOL	SPC	EXP	STRIKE	TYPE	PRICE	ORDER	RULES	EXCH	
VERTICAL	SELL	-30	DJX	100	MAY 05	104	CALL	.30	LMT	LIMIT	DAY	BEST
	BUY	+30	DJX	100	MAY 05	105	CALL					

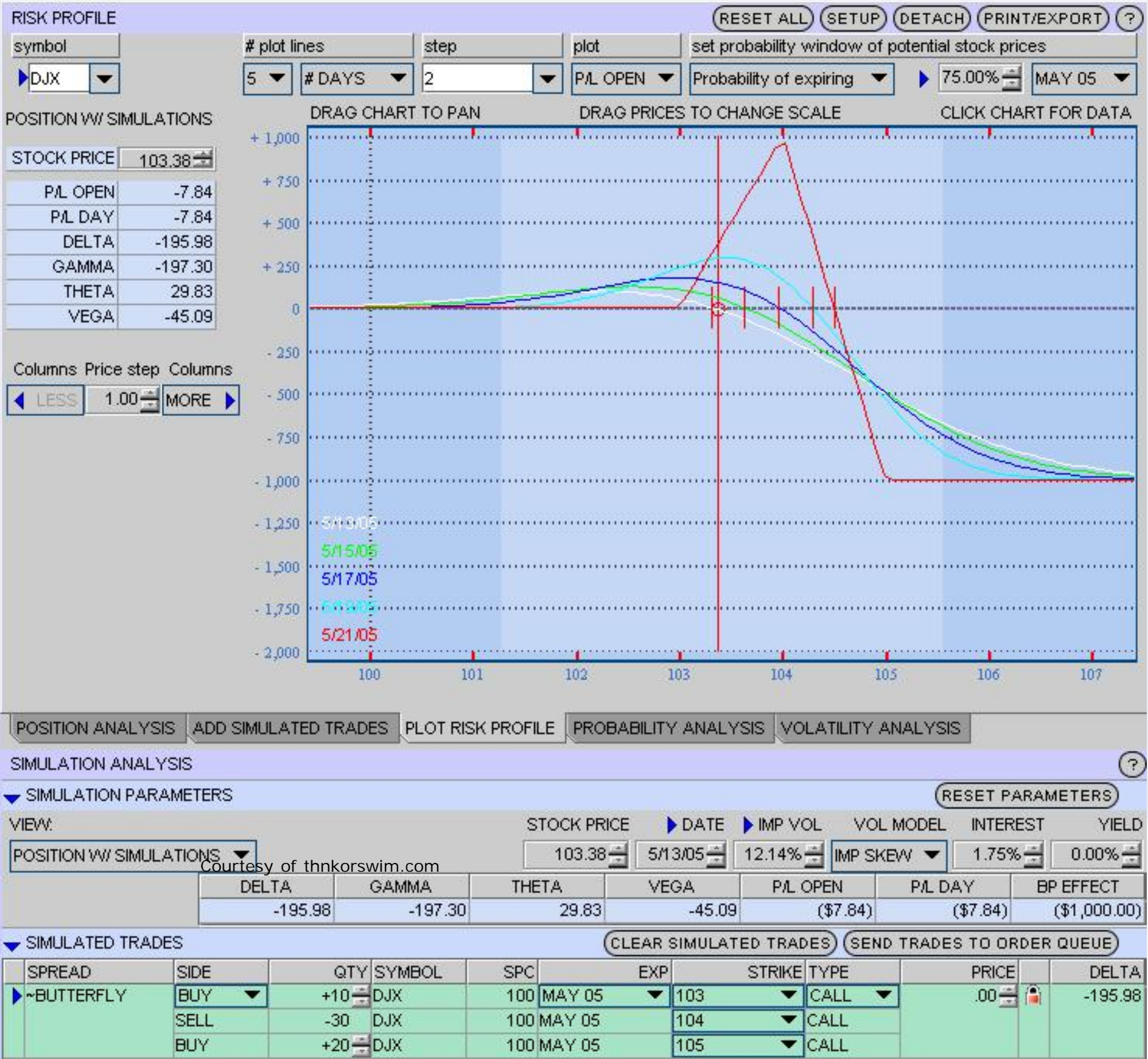
The results would be a butterfly and a short call vertical, all for even money, taking our money (.75 debit) off the table. Let see what happens. Just walk away from this for now.

Extra Calls	Bfly Calls	Net Calls	Raw Calls	Strikes
				102
	10	10	10a	103
10	20	30	30b	104
10	10	20	30b 10a	105
				106
Trade a: Bought 10*MAY 103/105 Call Verticals @.75				\$750 Debit
Trade b: Shorted 30*MAY 104/105 Call Verticals @.25				\$750 Credit
Result: Long 10*103/104/105 Butterfly				\$0 Even Money
Short 10*104/105 Call Verticals				
Max Gain:				\$1,000
Max Loss				\$1,000

Diamonetrics Chart for Dow & Trade Logic

« Reply #10 on: May 03, 2005, 09:05:05 AM »

The current value of the spread is equal to the value that we legged into it at (.05 credit).



Ri\$k Doctor

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Posts: 3249

Diamonetrics Chart for Dow & Trade Logic

« Reply #11 on: May 09, 2005, 07:01:11 AM »
Currently the spread is .10 against us but I would put the trade on at these prices so I will remain in the trade.

11 Days to Go. The Resistance should help our spread.



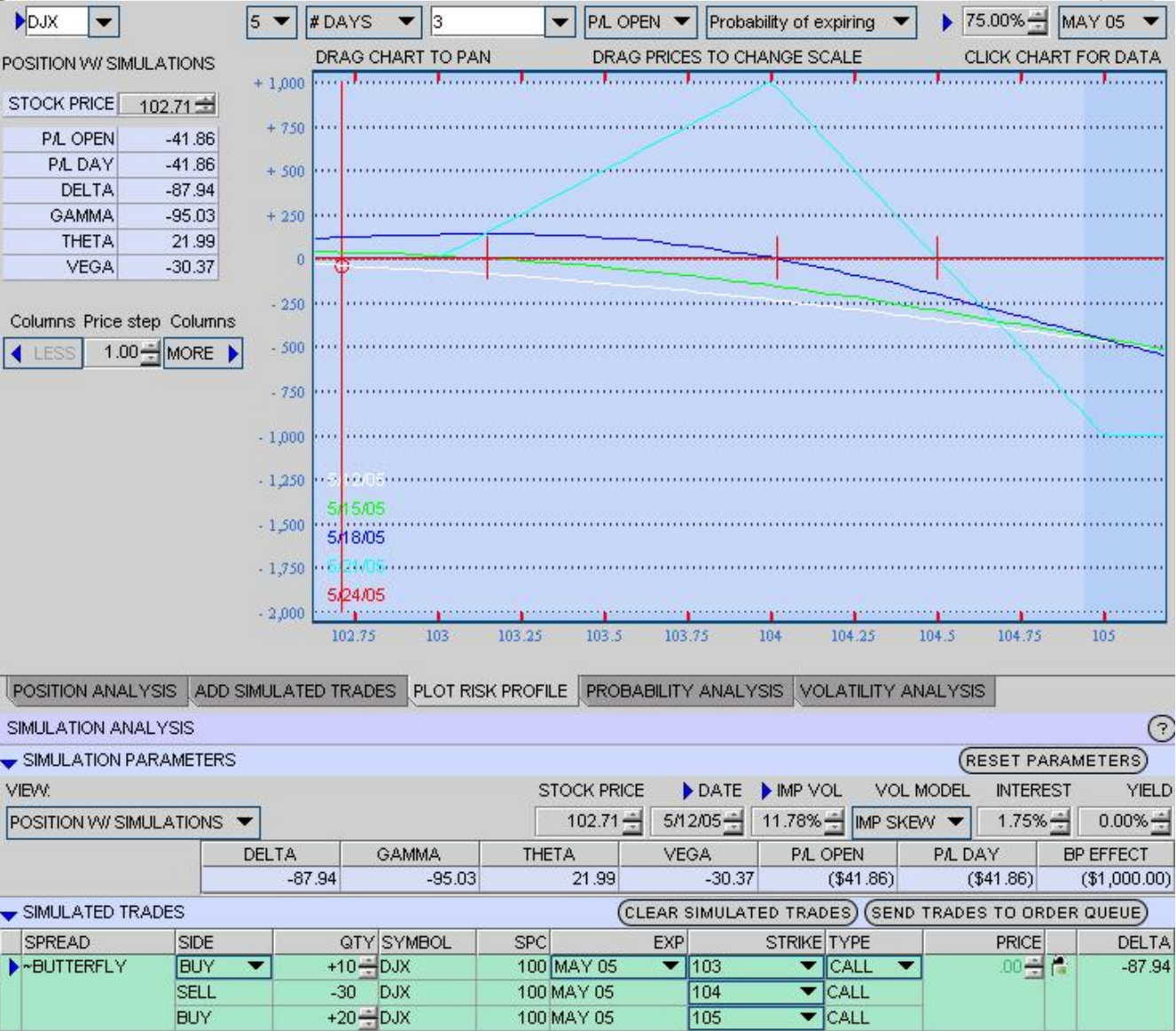
Ri\$k Doctor

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Hero Member
★★★★★
Posts: 3249

Diamonetrics Chart for Dow & Trade Logic

« Reply #12 on: May 10, 2005, 12:33:10 PM »
Currently the spread is .05 against us but I would put the trade on at these prices so I will remain in the trade

10 Days to Go. Looking Good.





Diamonetrics Chart for Dow & Trade Logic

« Reply #13 on: May 18, 2005, 07:20:27 AM »

We are on the dance floor. Hold on tight it is getting exciting. The DJX expires to cash on Friday's open. For this one, we will close our eyes now and open them then.

▶DJX		CBOE DJ INDL AVG INDEDJX				Volume		Opra		4	
▼ STOCK											
▶		LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW	
		104.13	+.81	0	0	0 x 0	0	103.23	104.13	103.23	
▼ OPTIONS											
Single Exchange Composite ▼											
CALLS											
		VOLUME	OPRA	BID X	ASK X	EXP	STRIKE	BID X	ASK X	VOLUME	OPRA
		1,603	DJVEY	1.10 C	1.20 C	MAY 05	103	.10 C	.20 C	845	DJVQY
		1,209	DJVEZ	.30 C	.50 C	MAY 05	104	.35 C	.40 C	3,239	DJVQZ
		129	DJVEA	0 C	.10 C	MAY 05	105	.80 C	1.00 C	2	DJVQA



Diamonetrics Chart for Dow & Trade Logic

« Reply #14 on: May 19, 2005, 07:32:37 AM »

I peaked. Did you? I will still gut it out for the opening settlement prices tomorrow. Clearly this is a case of Coulda Woulda Shoulda. A few days ago the 104s were 0 bid and offered at .10 and perhaps a .05 bid could have scooped them up. Buying all 30 would have made this trade golden. Bying 20 would have been great too. Even buying 10 would have turned this into a 122 Slingshot (+10*103c/-20*104c/+20*105c).

DJX		CBOE DJ INDL AVG INDEDJX				Vega		Opra		4		
STOCK												
	LAST X	NET CHNG	BID X	ASK X	SIZE	VOLUME	OPEN	HIGH	LOW			
	104.55	-.09	0	0	0 x 0	0	104.64	104.82	104.50			
OPTIONS												
Single										Exchange Composite		
CALLS						PUTS						
	VEGA	OPRA	BID X	ASK X	EXP	STRIKE	BID X	ASK X	VEGA	OPRA		
MAY 05 (1) 100											8.14%	
	.01	DJVEY	1.50 C	1.70 C	MAY 05	103	0 C	.05 C	.01	DJVQY		
	.02	DJVEZ	.60 C	.75 C	MAY 05	104	.05 C	.20 C	.02	DJVQZ		
	.02	DJVEA	.05 C	.10 C	MAY 05	105	.45 C	.65 C	.02	DJVQA		
POSITION AND ORDER ENTRY TOOLS												
		DELTA	GAMMA	THETA	VEGA	P/L OPEN	P/L DAY	BP EFFECT				
DJX		.00	.00	.00	.00	\$0.00	\$0.00	\$0.00				
ORDER ENTRY AND ORDER QUEUE												
ORDER ENTRY		ORDER QUEUE										
	SPREAD	SIDE	QTY	SYMBOL	SPC	EXP	STRIKE	TYPE	PRICE	ORDER	RULES	EXCHAN.
	~BUTTERF...	BUY	+10	DJX	100	MAY 05	103	CALL	-.25 LMT	LIMIT	DAY	BEST
		SELL	-30	DJX	100	MAY 05	104	CALL				
		BUY	+20	DJX	100	MAY 05	105	CALL				

I hope that this has been a useful learning experience. It was a pleasure to Visit the OptionsTradersClub in London. It does not even matter at this point whether the DOW breaks and settles right at the sweet spot of 104 by tomorrow morning giving us all the glory of the full 1.00 profit. All of us would have played it differently anyway, don't you think? I'd like to know what you think.

Please let me know and everyone else who might benefit from how this landed in your court. Simply replying to this post and continue the conversation.

All the Best,

Charles

Diamonetrics Chart for Dow & Trade Logic

« Reply #15 on: May 22, 2005, 08:18:36 PM »

Settlement 105.03. Lost the total 1.00. OUCH! A lesson for life! Better to have gotten out. Even though it costs, it is the cheapest you will almost ever pay for an option.

Ri\$k Doctor
Administrator
Hero Member
★★★★★
Posts: 3249



Images and Text from 040405
« on: April 05, 2005, 09:04:47 AM »

This will be edited soon but I wanted to start everything off. Uploading images will be done when I have a chance and perhaps better to do when I am back in the States and can again enjoy a faster connection. Thanks for your patience.

Why Options? - Why Synthetics? Options can be very deceiving at first glance.

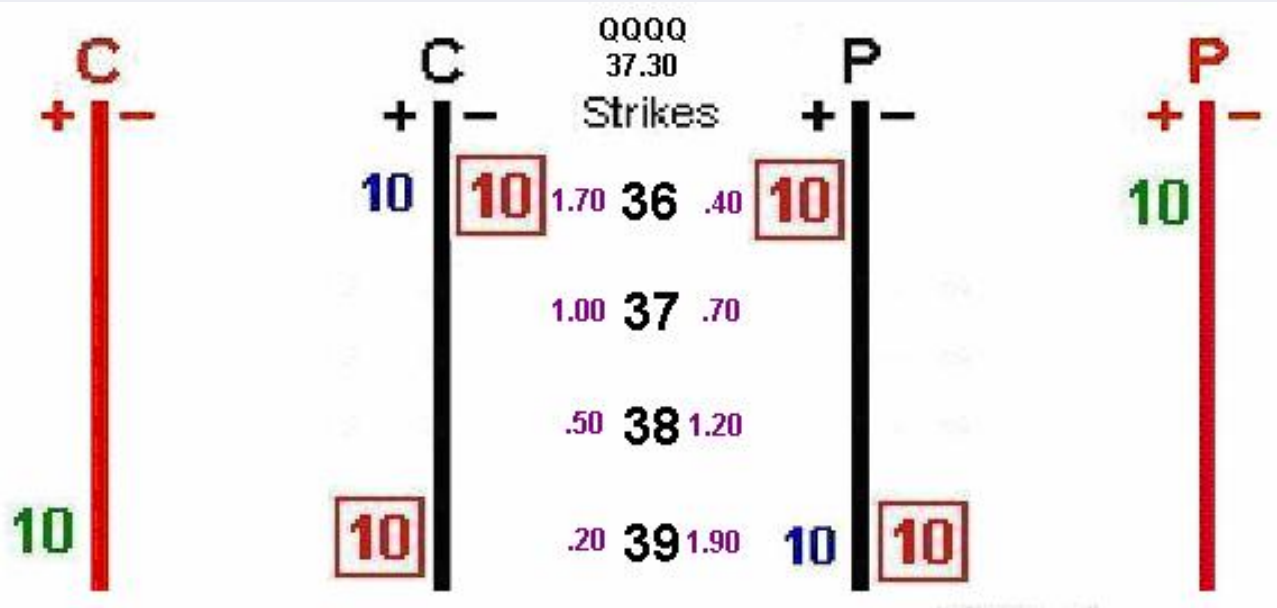
Format of Carding from Page 11 in Chapter 1 of "[Options Trading: The Hidden Reality](#)".

EXHIBIT 1 – 3

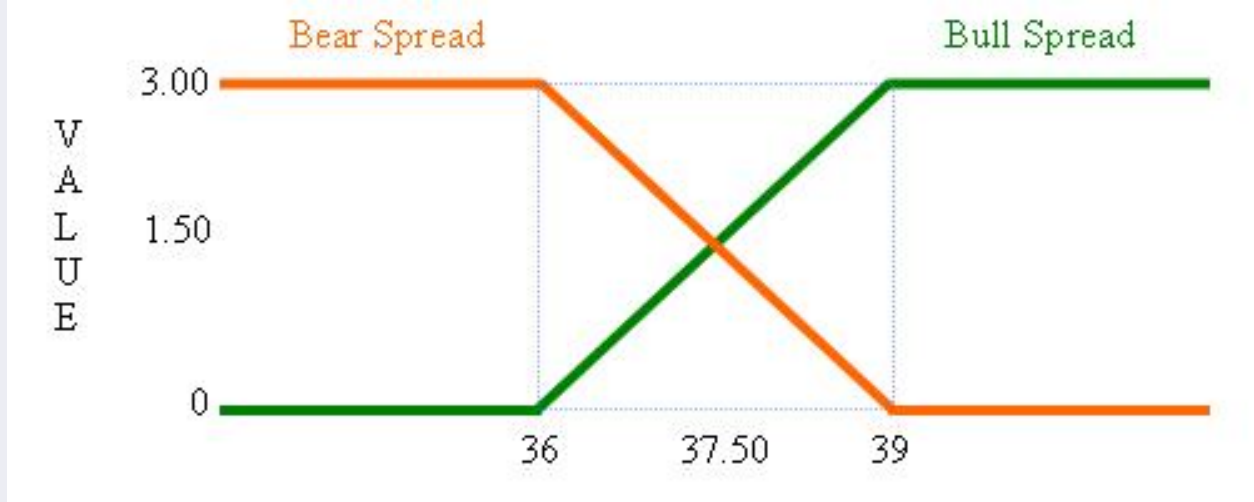
Format for Displaying Positions

Underlying (u)								
Net Calls		Raw Calls		(+/-)	Raw Puts		Net Puts	
(nc)		(rc)			(rp)		(np)	
long	short	long	short		long	short	long	short
(+)	(-)	(+)	(-)		(+)	(-)	(+)	(-)
				Strike 1				
				Strike 2				
				Strike 3				
				etc.				
(ncc)		net call contracts			net put contracts		(npc)	
(+/-)		(+/-)			(+/-)		(+/-)	

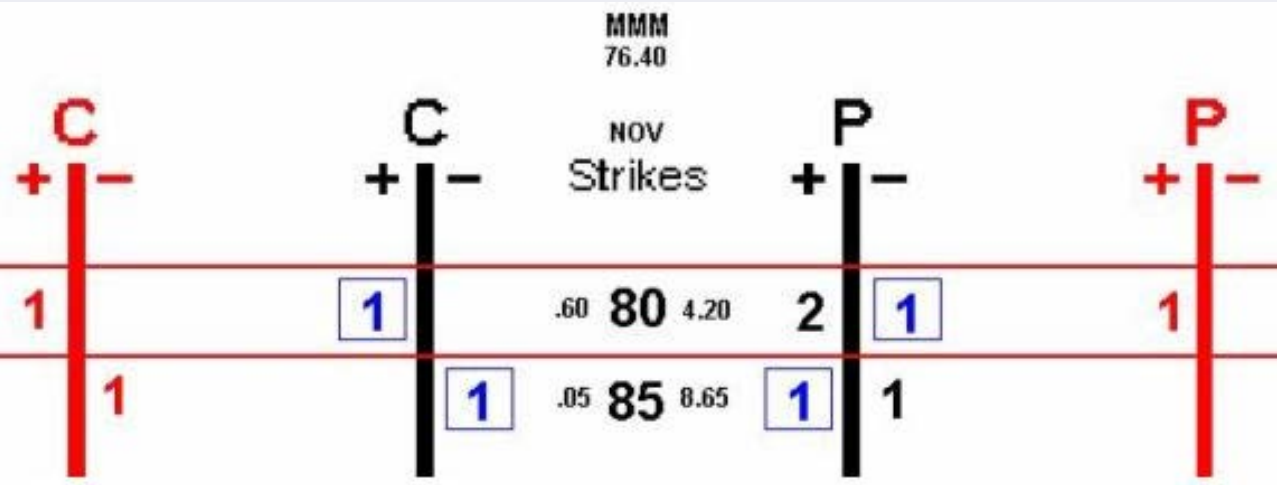
To demonstrate the answer, alter the view of the Raw Position: 10*36C/39P Guts Strangles going for 3.60 by applying -10*3.00 BoxTools (+10 36/39 Boxes are embedded in the position). One can much more easily answer a new question, and this time get it right: What amount of money is the most one can lose with 10*36 Puts bought at .40 and 10*39 Calls bought at .200, making a total investment of \$600 (10 x (.40 + .20) x 100 shares)?



The minimum value for this position is not ??zero? as human nature forces us to believe. Rather it is \$3000 (10x 3.00 x 100 shares). The 3.00 Box will hold that value all the way to expiration. Exhibit 1-10 shows the conventional approach to demonstrating the expiration value of a box.



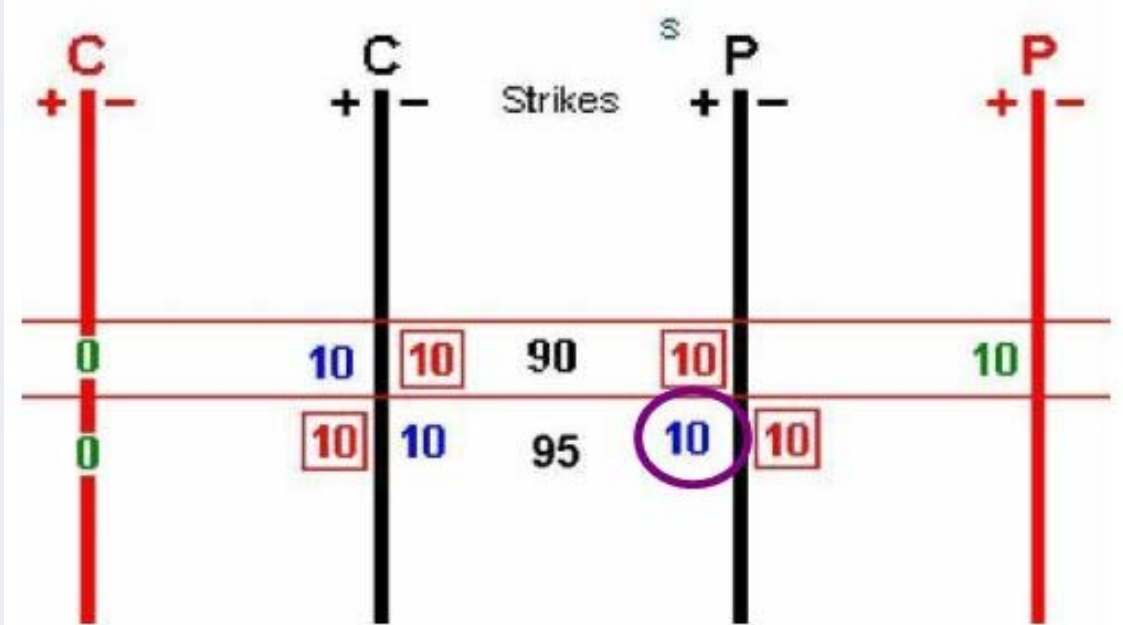
This particular example, taught by a particular seminar company, shows the recommended trade in the black font: In-the-money (-1 by +2) NOV 80/85 Put Back Spread for a .25 credit (paid 4.20*2, receive 8.65).



Unfortunately, they teach, and actually think, that some how there is something special about this sort of a credit when in fact it is nothing less than a 4.75 Debit in disguise. That would be OK if you understood that and still wanted it but if you look at the red font you will see some glaring realities that perhaps you would realize, are undesirable. The position displayed in the red font (long a NOV 80 P for 4.20 and a Call Bull spread for .55 is equal to a debit of 4.75) is a result of the Imaginary Box Trade in the blue font (Box relationship pretty solid* until expiration).

*For exceptions to the solidity of a box read Coulda Woulda Shoulda, Chapter 8.

This is the image that I was looking for, and could not find and you had to endure the first few measures of "Come Hedge with Me". Sorry, I do get carried away on occasion. For those interested, the rest of the words are posted somewhere at www.RiskDoctor.com.



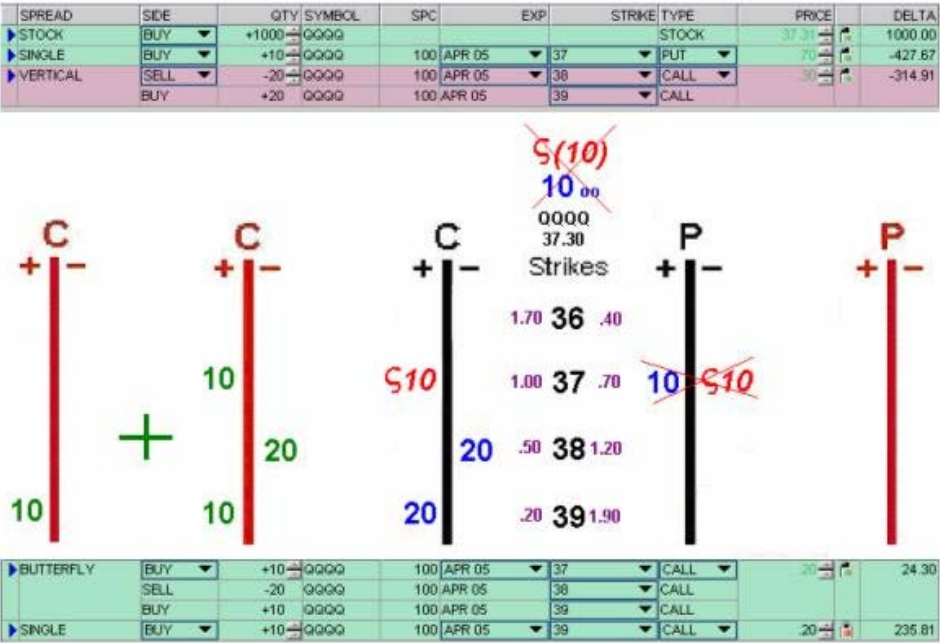
Exhibited below is the (10*90/95) Call Vertical Spread discussed in "Caught Naked Between Spread Legs" that is pasted starting on the next page of this PDF. What I wanted to add was that if one purchased the ten 95 Puts (10 in the Purple Circle) in order to capture most of the profit from this trade then the remaining position would be the Green 10*90 Puts, which becomes evident once the four 10 lots removed with the imaginary Box Trade in the red font.

I briefly mentioned that there is the synthetic aspect of a position that should always be considered. The actual trade consisted of all Puts, displayed on the right. But when the stock, JNPR came down to perceived support, the trader was encouraged to cover (buy back) the cheap APR 22.50 Call as can be understood by having the consciousness that the center position (viewed as an "Iron Butterfly")

All Calls				As an Iron						All Puts			
Net Calls		Raw Calls	JNPR MAR Strikes	Net Calls	Raw Calls	JNPR MAR Strikes	Raw Puts	Net Puts		JNPR MAR Strikes	Raw Puts	Net Puts	
			20			20				20			
			22.5			22.5				22.5			
			25			25				25			
			APR			APR				APR			
			20			20	5	5		20	5	5	
			22.5			22.5				22.5	5	10	
			25			25				25	5	5	

Options Only Strategies (OOs) & Alternative Hedging Strategies (AHs)

The Slingshot and its variations - How to capitalize on sideways with unlimited upside.



Rolling Opportunity for Even Money Right between the two strikes in the vertical. Time and Volatility Proof ATM Verticals (right between the strikes) trade around half price (when not too steep of skew).

EBAY		EBAY INC		NASDAQ		Impl Vol		Opra													
STOCK																					
LAST X		NET CHNG		BID X		ASK X		SIZE		VOLUME		OPEN		HIGH							
38.79 P		-.07		38.79 Q		38.80 C		14 x 31		6,904,655		39.10		39.30							
YIELD		PE		EPS		DIV		DIV FREQ		DIV DATE		52HIGH		52LOW		BETA		SH			
0.00%		68.05		.57		0		--		N/A		59.21		32.395		2.058		1,344.8			
OPTIONS											Single		Exchange		Cc						
CALLS											PUTS										
DELTA		VEGA		BID X		ASK X		EXP		STRIKE		BID X		ASK X		DELTA		VEGA			
MAR 05 (7) 100											33.28%										
.76		.02		1.55 I		1.80 X		MAR 05		37.5		.25 I		.30 I		-.23		.02			
.26		.02		.25 I		.30 C		MAR 05		40		1.45 I		1.55 I		-.73		.02			
APR 05 (35) 100											36.34%										
.65		.05		2.40 I		2.50 B		APR 05		37.5		1.05 I		1.15 I		-.35		.05			
.42		.05		1.15 I		1.20 C		APR 05		40		2.25 I		2.35 I		-.59		.05			
JUL 05 (126) 100											37.20%										
.62		.09		4.10 I		4.30 I		JUL 05		37.5		2.50 I		2.60 I		-.39		.09			
.50		.09		2.90 I		3.00 I		JUL 05		40		3.70 I		3.90 I		-.51		.09			
OCT 05 (224) 100											36.25%										
.70		.11		6.90 B		7.00 I		OCT 05		35		2.45 C		2.55 I		-.30		.11			
.53		.12		4.10 I		4.30 I		OCT 05		40		4.70 I		4.85 I		-.49		.12			
JAN 06 (315) 100											37.04%										
.62		.14		6.30 I		6.50 I		JAN 06		37.5		4.10 I		4.20 I		-.38		.14			
.55		.14		5.10 I		5.30 I		JAN 06		40		5.30 I		5.50 I		-.46		.14			
JAN 07 (679) 100											37.21%										
.65		.20		9.40 I		9.60 A		JAN 07		37.5		5.80 I		6.00 C		-.36		.20			
.61		.20		8.30 I		8.50 I		JAN 07		40		7.10 I		7.30 I		-.42		.20			

*No 37.5s in October

Legging Options in an Electronic World OR Caught Naked Between Spread Legs

It was once considered sound advice not to leg into and/or out of an options spread. Most investors still shy away from doing this and put all their orders in as spreads (see last page). It was good advice when orders were physically handled in the pits on the options floors around the country and one had very little control when transacting. Levels of frustration run high when people are waiting for information about impending fills, canceled orders or even a simple quote. The world has changed and immediate gratification has become more attainable. Options can be clicked into and out of in a matter of seconds and therefore the transaction risk has been greatly diminished. There are a couple of nuances of the options market that we advise to keep in mind when legging, especially when 'caught naked between spread legs'.

Bottom Line:

- 1. In an electronic world, one gains control by legging spreads, avoiding floor procedures at all costs.**
- 2. One needs to understand synthetic relationship in order to have other ways in or out of a position.**
- 3. Save money while still motivating market makers to take the other side of your orders.**
- 4. One should not be afraid to use stock to 'stop the bleeding' (or at least change the flow of blood).**

Which Side First?

From a margin and risk standpoint it is prudent to leg the buy side first but if you have the wherewithal, by all means, go ahead and leg from the short side. Having said that, it may be inconsistent with your market opinion and you might want to consider executing the synthetic equivalent position as an alternative, i.e. when bearish buy a put vertical (bear spread) instead of selling a call vertical (also bear spread). When at the same strikes, the synthetic equivalents move at about the same rate and maintain a fairly constant relationship (called the "box"). It's also wise to consider that the out-of-the-money synthetic equivalent options' bid/ask spreads can be considerably narrower reducing the cost of doing business.

Hard Side First

Do the hard side first. One leg of the spread can be considered harder than the other side when there is lower liquidity in one of the components. To help determine the level of liquidity, check the volume and open interest (under information layout in the upper right-hand corner of the thinkorswim platform) and make sure that there is some trading going on in those options. Note the widths of the individual markets in order to indicate what you might be faced with when trying to make subsequent adjustments or liquidating the trade.

For calendar spreads (also known as time spreads) the hard side would almost certainly mean trading the deferred month first and then the closer dated month. The front month moves faster (higher gamma) but the options are usually more liquid. There are those, more experienced 'leggers', who prefer to enter their buys and sells to work at the same

time but that is not recommended for everyone. Either way one may prepare orders and store them in the “Order Queue” ready for sending.

For a Ratio/Back (ShortMore/LongMore) spread, I like to grab the greater quantity side first. It is easier to pull the trigger on the smaller quantity especially if it starts to get away.

Risk and Money Management

Let's say that you have Long 10 March 90/95 call spreads (bull spreads), when you are long 10 Mar 90C and short 10 Mar 95C and want to liquidate it (with a bear spread). On the natural markets, the spread is 3.60 (bid) – (at) 4.00 which is 40 cents wide. It's a pretty good bet that the spread is worth about 3.80 when 3.80 is the current average between bid and offer. The inside or actual market would be something like 3.70 – 3.90 or possibly even 3.75 – 3.85 if the crowd felt that they had to be a bit more competitive with one another or the other exchanges. By the way, the 3.60 bid is derived from 8.60, the bid price of the 90s, minus 5.00, the offer price of the 95s).



The 4.00 offer price is derived from 8.80, the offer price of the 90s, minus 4.80, the bid price of the 95s. Incidentally, one should always consider the corresponding put spread and in this case the Mar 90/95 put spread is 1.05 – 1.35, only 30 cents wide on the naturals and most likely something like 1.15 – 1.25 when the fair value is 1.20. The 1.05 bid is derived from 2.20, the bid price of the 95s, minus 1.15, the offer price of the 90s. The 1.35 offer is derived from 2.35, the offer price of the 95s, minus 1.00, the bid price of the 90s.

Very seldom does one have to “pay up” to “take” the natural offer or “sell down” to “hit” the natural bid. Often traders like to middle the market in hopes that the market will move to their price. The market would almost certainly have to move because there is little incentive for market makers to meet in the middle unless the trade happens to fit their position. It is rare, indeed, that a market maker meets in the middle since the reason they come to work is to buy under-value and sell over-value. **Note:** When a spread is invoked in the thinkorswim trading platform (see last page), the middle or average price between bid and ask (offer) is displayed but is not the price at which one can instantly be filled. The number floats around until the little padlock is clicked and locked (click again to unlock) and again this price represents an estimate of what the theoretical or fair value is on a collective basis, at any given moment in time. A current offer at the middle, i.e. 3.80 would prove fruitless temporarily but could get bought in the event of a market rally enough to motivate a market maker to buy it. The spread happens to have a delta of

about .20 so a 50-cent rally in the stock may increase the spread's value by about 10 cents meaning that it would then be worth 3.90 making the 3.80 a better buy so the offer may be scooped up.

Back to the trade....remember, we are through with being bullish, or we are now bearish, or we have enough profit, and now we want out. From a market opinion standpoint it doesn't make sense to leg by buying our short 95 calls back first. It may also be prohibitive from a risk and margin standpoint to sell out our long 90 calls because that would leave us naked short the 95s. What oh what can we do? Buy the 90/95 put spread (some call it the 95/90 put spread) instead. If we get filled, we will be long the 90/95 box. It may be necessary to sell the box later due to the pin risk¹ potentially involved (don't worry, the box can usually be sold just prior to expiration for a nickel or two less than the 5.00 value). It is reasonable to assume that if we bid 2.30 for the 95 puts (just a nickel away from the ask of 2.35), we would get filled then by offering the 90 puts at 1.05 (only a nickel away from the 1.00 bid). The net price of 1.25 for the spread is synthetically equivalent to selling the call spread for 3.75 when the box is worth around 5.00². Not bad.

Adjust the Leg Size

What if you wanted to just get long 10 put spreads, and you intended to buy it at about 1.25. That would be \$1250 of risk. Therefore, when legging you should not risk more than that amount (assume the worst). This means that you buy about 5 contracts at a price of 2.30 on the first leg, get filled and get filled on the other side's sale before going for the next set of fives. Legging 5 at a time instead of legging all 10 at once (\$2300) will end up costing a bit more in commissions on this size, but would not cost any more with a size of 3 spreads or less with thinkorswim's current pricing structure³. The immediate accomplishment, along with the fact that you are more assured of getting in or out of the market, will make it well worthwhile. Remember also that the reason you are legging in the first place is to get a fill at possibly a better price. Better prices for your spreads will save more than the extra commissions spent.

Remember: The biggest problem with legging is stubbornness. Be disciplined and pull the trigger. Don't be greedy. When you mess up, spread off, and move on.

Leg with a coach the first time – (no phone charge). If you want to have a thinkorswim representative coach you while you try this, please call toll free 1 866 839 1100. Once you've done it once you will feel empowered.

¹ Pin Risk is discussed in *Coulda Woulda Shoulda* starting on page 75.

² Actually a box is worth the present value between the strikes with some exceptions. See more about boxes in Chapter 8 of *Coulda Woulda Shoulda*, starting on page 169.

³ Comparison of commissions on 20 spreads vs. legging two 10 lot spreads. The 20 lot is \$70 (40 options X 1.50 plus \$10 ticket charge). Four 10 lot legs will cost \$100 (10 options X 1.50 plus \$10 ticket charge 4 times). Take the \$30 and divide by 20 spreads equals 1.5 cents more for the spread when buying or 1.5 cents less when selling. That is if we bought the spread for 1.25 it translates to 1.265. .015 is much less than the .05, .10 or more saved through legging.

Entering a Spread Order on the Thinkorswim Trading Platform

For spread orders, it's the only "Right" click (for Macs: "Command" click) in the whole system. From the "TRADE" page, right-click right on the "Bid" or "Offer" of an option in the spread (the spread below is for a butterfly so right-click on the body strike) and a tiny submenu will appear: "Buy" or "Sell". Roll your cursor over one or the other and a bigger menu of spreads will appear. Click one (butterfly in this case) and the trading ticket will show at the bottom of the screen displaying your default quantity(ies). The price displayed will be calculated using the middles of each option involved. Then by clicking any of the "Blue Arrows", you can modify the quantity(ies) and depending on the spread selected, changing one quantity changes them all. Then adjust the price (the price lock will lock when the user changes the price). From this order ticket you may modify; buy vs. sell, months, strikes, exchange routing or call vs. put. (See more in two tutorials at www.thinkorswim.com and clicking "DEMO"). While at the web site change, if you desire, your size defaults under "thinkClients".

Right click on a price to invoke a Spread



Select (roll cursor over) Buy or Sell, then Select (left click) a spread listed.

After the click, look at the trading ticket below:

The default limit price is calculated using each option's average price. That is the middle price between the bid and offer price of each option involved in the spread:

.80 is equal to $5.05 - (2 * 2.85) + 1.45$

	STRIKE	TYPE	PRICE
▼	590	CALL	.80
	595	CALL	
	600	CALL	

To help get filled, one should try to motivate the market makers by adjusting your limit price up when buying or down when selling by .05 to .20, or more depending on that particular market's liquidity and competition. Market makers usually want about .05 per option so if you are buying this butterfly, bid between .90 and 1.00. If selling, offer it at a price between .60 and .70. For a quick reference on the value check the corresponding "PUT" butterfly by clicking on the "Blue Arrow" under "TYPE" to see if the spread is of similar value.

Good Trading and Best of Luck – thinkorswim support