DURVAN
Newbie

Skew
« **on:** June 17, 2007, 02:34:04 AM »

Hi Charles,
I enjoyed both Slinshot Strategy video presentations very much.
My question concerns your discussion in the early part of the first presentation where you pointed out that in demand type skew, verticals were disadvantaged because higher priced options were cheaper than they should be, and lower priced were dearer. You also mentioned that this was reversed in supply type markets and that this could be used to advantage to the downside. Would you be good enough to elaborate on this please?

Many thanks,
Peter

Ri$k Doctor
Administrator
Hero Member
Posts: 3247

Skew
« **Reply #1 on:** June 18, 2007, 02:53:33 PM »

As you can see from Chapter 10's Image of a Vertical that this implies that the same goes for Bull Collars. The upper right-hand corner is a stock skew where lower strikes have higher vols than upper strikes. This makes verticals expensive reletive to flat skew pricing showing also that there is more to lose ATM than can be gained. This does not suggest to avoid bull spreads or bull collars in stocks but just to understand the pricing nuances.

EXHIBIT 10-15A (comment and profile page 265)
Flat or No Skew

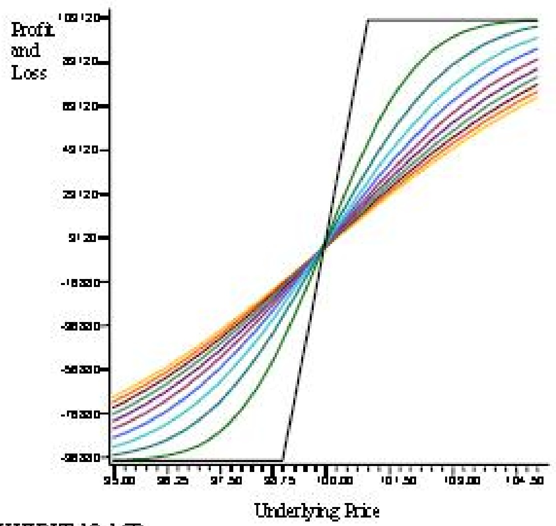


EXHIBIT 10-15C
Supply-Products Skew

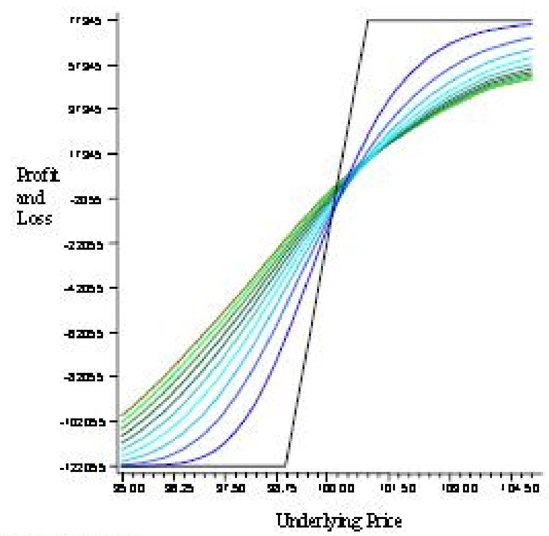


EXHIBIT 10-15B
Crash Skew

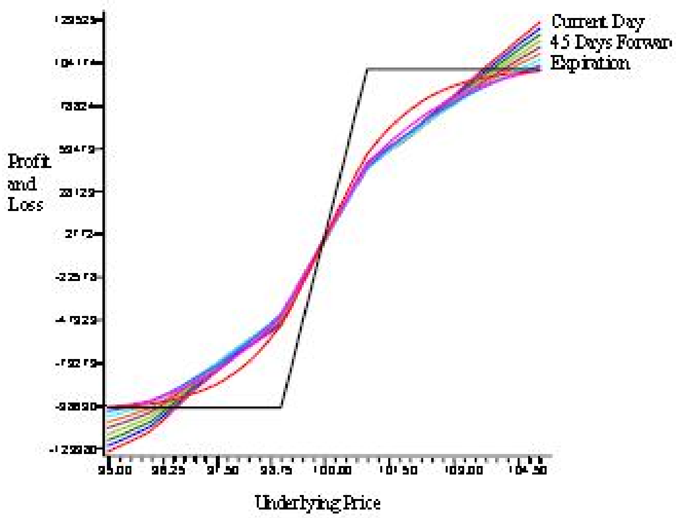
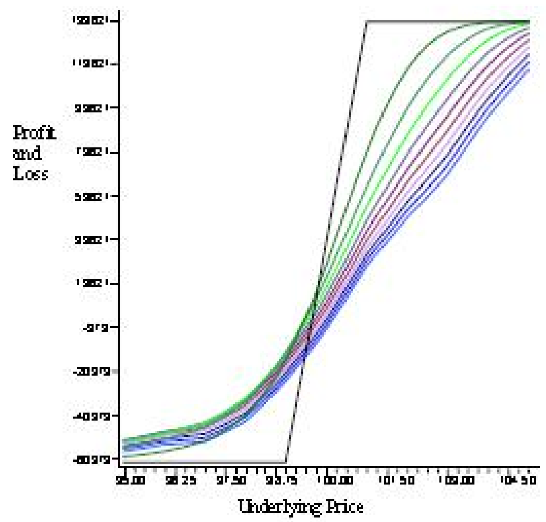


EXHIBIT 10-15D
Demand-Products Skew



DURVAN
Newbie
Posts: 4

Skew
« **Reply #2 on:** June 18, 2007, 09:48:04 PM »

Thanks Charles,
I guess what I was asking is does this mean that all verticals, (puts,calls, debit or credit) are too expensive relative to their probability. If so should this be considered when choosing between a vertical and a naked put?

Ri$k Doctor
Administrator
Hero Member
Posts: 3247

Skew
« **Reply #3 on:** June 19, 2007, 06:58:09 AM »

> **Quote**
> ...does this mean that all verticals, (puts, calls, debit or credit) are too expensive relative to their probability?

In the case of the Bull Spread;
If it is a call debit spread then the debit is expensive (more of a debit);
If it is a put credit spread then the credit is cheaper (less of a credit);
If it is a bull collar then there is a higher debit (put over call) or less of a credit (call over put).
The Box keeps it all in line owing to the reciprocal relationship between call vertical and put vertical.

> **Quote**
> ...
> If so should this be considered when choosing between a vertical and a naked put?

You cannot really compare a short naked put to a short put vertical because of the unlimited risk aspect of the naked put.
If being naked short puts is of no concern then the skew would always favor naked short puts.

I think naked short puts should be a concern so it is better to realize that if a put credit spread is one of the ways you like to get long, the skew nuance works two ways.

When you get in, you might be getting .25 less than what could be gotten in a parallel universe (with no skew) but when you liquidate it (assuming you do not wait for worthless) it will also be discounted because of the skew (albeit less because time has gone by and skew has less of an effect on vega).

The fact that there is a skew in the pricing should not deter you from shorting a put vertical unless the skew is unusually pronounced. Simply get used to the concept and have the short put vertical strategy to pull out of your arsenal when an appropriate situation arises.

arp

OOs and AHHs
« **on:** March 03, 2007, 11:29:05 AM »

Charles,

First I wanted to thank you for the great presentation. I'm looking forward to the next one.

You mentioned something early on which caught my attention. Since I'm mainly in the OOs camp (Option Only Strategies), what did you mean by saying that the OOs should adopt the consciousness of the AHHs? I can think of a few things, but I wanted to hear your thoughts on that.

Thanks
Ali

Ri$k Doctor

OOs and AHHs
« **Reply #1 on:** March 03, 2007, 04:11:00 PM »

As an Options Only Strategist/Speculator (OOs), wouldn't you be curious to know what hedgers were up to? -- When they were motivated to lift hedges, roll hedges or what options they think are over valued or undervalued? In other words, if it is a good time for stockholders to bear collar their position, would it be a good time to initiate a bear spread? If they were going to calendar hedge (by selling a call and buying the same strike put in a deferred month) might it be a good time to put on the real calendar? The idea is to raise your consciousness to be aware of what all is going on in the market. So ask yourself, "if I owned the stock and the directions seemed iffy, what would I do to hedge given all the available data (IVs, time to go etc.) how would I hedge? -- What would I turn my long stock profile into?" A good hedger puts himself into the shoes (consciousness) of the OOs player.

OOs and AHHs
« **Reply #2 on:** March 04, 2007, 06:45:41 PM »

Thanks Charles.

Now let's say I'm bullish on a stock, and I think it will move its way up from $20 to $40 over the next 6 to 12 months. I'm <u>not</u> expecting a straight up move. I think it will most likely oscillate there, with periodic pullback and consolidation periods, some last as long as month or two. A pure stock trader might just buy the stock and hold it until then; or at most use some sort of a trailing stop to protect gains.

Since we want to take advantage of options, what strategy would you say would work best for an Options Only Strategist/Speculator (OOs)? Specially if we were interested in:
a) Locking in profits as the stock moved higher to protect gains,
b) Keeping short-term directional speculations to the minimum, and
c) Maintaining a limited risk configuration & not increasing risk during the whole process

Here are some ideas running around in my head. Please let me know what you think.

1. Use front month bull verticals & continue to roll them higher as stock advances and verticals get nearly maximized. Nice and simple, but I would have to switch to neutral or short premium verticals during consolidation to hedge or benefit from time decay. And doing that, I'll end up increase possible downside risk, while limiting upside, & end up regretting it if the stock takes off North. It also causes me to 'speculate' about short-term market moves, which I'm trying to avoid.

2. Use a near-term (30-45 day) slingshot and adjust as stock moves higher to lock in gains. This is better. I'm good with theta, and not limiting upside. But I'm not expecting the stock to make explosive moves up past my kicker call either. It could happen, but low probability of happening. How would I manage such 'slow' advances in stock, which end up killing the kicker call? One solution is to roll the short call verticals to the next month. Is this the best way to deal with slow movers?

3. Use a Slingshot with say 6 to 12 months to expiration. Relax & make fewer adjustments, let the trade do the work. Only adjust where there is enough profits to protect. If I use this approach, what if implied volatility is high and I expecting a drop in IV, so I'm not happy about the amount of long vega I have?

4. How about front-month butterfly, with kicker call being the longer-term options? Or the other way: buy an ITM longer-term option and selling 2 x near-month ATM/OTM call verticals? This will reduce my long vega, (still long vega however), but does it make adjustments more complicated (slippage and commission becoming issues)?

Thanks

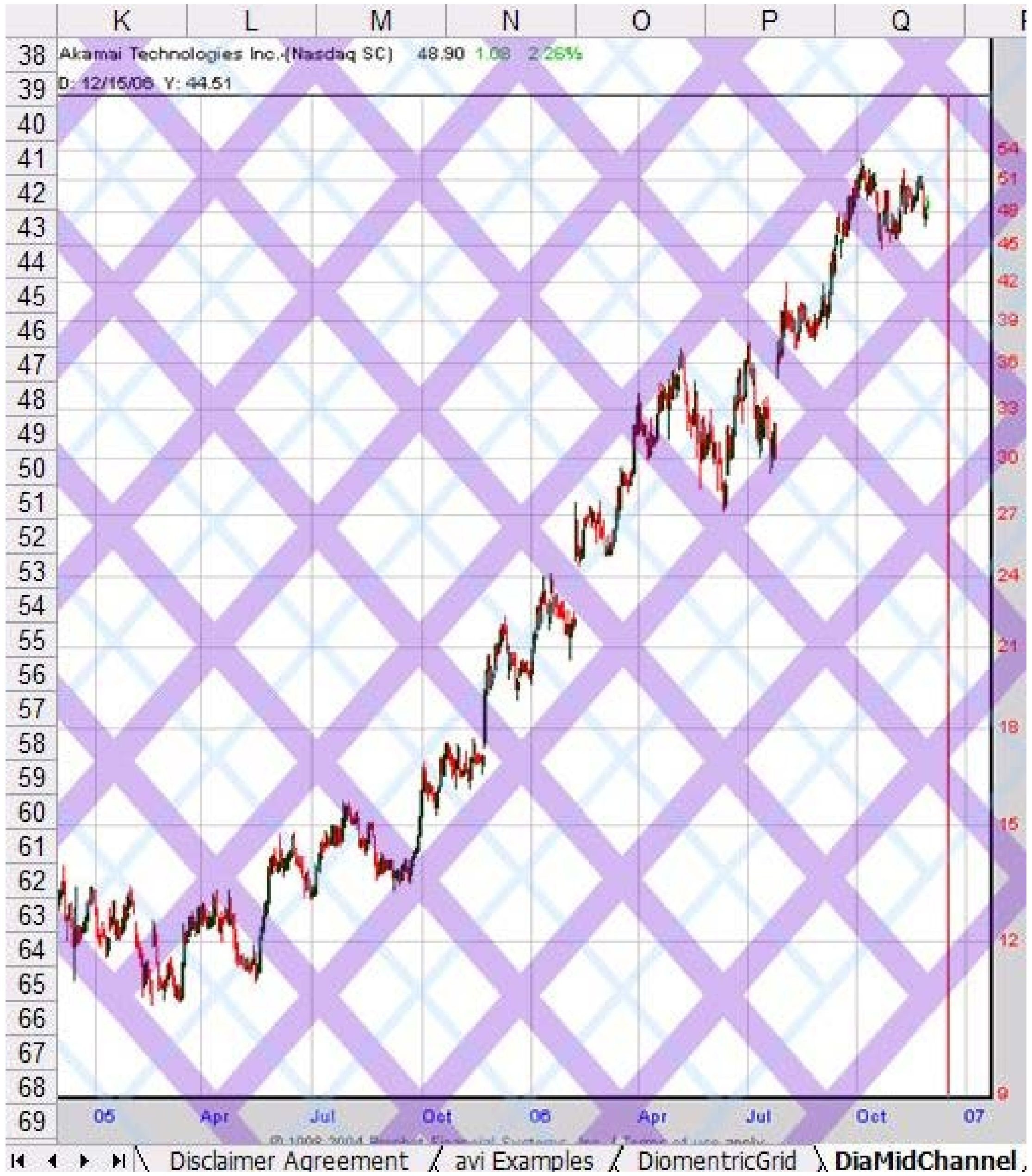
Ri$k Doctor

OOs and AHHs
« **Reply #3 on:** March 05, 2007, 02:01:50 PM »

Below is a chart of AKAM and in a similar period the stock did just that (went from 20 to 40).

Obviously, the stock is going to zig zag on its way. For the purpose of this discussion, let's call the up moves the "zigs" and the retracement corrections along the way, the "zags".

Certainly it would be advantageous to identify the trend channel, like I attempted with Diamonetrics:



You can see in hind site that there were places that bull spreads would have taken advantage to the Zigs as long as they were rolled up (protecting gains) before the Zags. There was the period between April and July that was sideways that calendars or butterflies would have been profitable. Kickers would have also come in handy at the points where the stocked gapped higher. It is simple to maintain a limited risk profile throughout the process but I think there are opportunities for short-term speculations within the bigger picture for optimizing profits.

Quote

1. Use front month bull verticals & continue to roll them higher as stock advances and verticals get nearly maximized. Nice and simple, but I would have to switch to neutral or short premium verticals during consolidation to hedge or benefit from time decay. And doing that, I'll end up increase possible downside risk, while limiting upside, & end up regretting it if the stock takes off north. It also cause me to 'speculate' about short-term market moves, which I'm trying to avoid.

Depending on IV levels;

and where the underlying is in the channel (Bottom of channel -- bullish...Top of the channel -- temporarily bearish in the bull trend) at any given time will determine whether it is worth speculating with other than an ATM bull spread (ATM Bull Collar if own stock) that is premium neutral. If IV low then calendarize the long option. If consolidating and IV is low -- straight ATM calendar or lean toward the next higher strike to maintain bullish delta.

Quote

2. Use a near-term (30-45 day) slingshot and adjust as stock moves higher to lock gains. This is better. I'm good with theta, and not limiting upside. But I'm not expecting the stock to make explosive moves up past my kicker call either. It could happen, but low probability of happening. How would I manage such 'slow' advances in stock, which end up killing the kicker call? One solution is to roll the short call verticals to the next month. Is this the best way to deal with slow movers?

Best chance for the kicker is at the low end of the channel for big bounce possibilities. At the upper end of the channel there is less of a chance for the kicker to kick in (unless the underlying starts to have a hyperbolic move). Rolling the vertical becomes necessary when the stock lingers for too long between the upper two strikes and time is running out.

Quote

3. Use a Slingshot with say 6 to 12 months to expiration. Relax & make fewer adjustments, let the trade do the work. Only adjust where there is enough profits to protect. If I use this approach, what if implied volatility is high and I expecting a drop in IV, so I'm not happy about the amount of long vega I have?

Long dated Slingshots can be costly for the extra kicker especially when the IV is high, however, the butterfly part is cheap. You may prefer to have the kickers be shorter dated and acquire new ones as the old ones expire.

Quote

4. How about front-month butterfly, with kicker call being the longer-term options? Or the other way: buy an ITM longer-term option and selling 2 x near-month ATM/OTM call verticals? This will reduce my long vega, (still long vega however), but does it make adjustments more complicated (slippage and commission becoming issues)?

It simply means that you have a calendar embedded at the lower strike which is not a "bullish" thing to have. It may be better (if IV is low) to have the longer dated options at the 'kicker' strike. [/color]

Slippage can be reduced by trading in liquid OTM options as much as possible. Commissions are becoming less and less of a factor but even so you want to identify the easiest way to get from your existing position to the desired adjusted position with the fewest amount of contracts.

Ri$k Doctor

OOs and AHHs
« **Reply #4 on:** March 06, 2007, 07:57:18 PM »

A question was asked after the recording: **"What adjustment or rolling can I do if the stock goes up high enough that my "Kicker" goes ITM while I am still bullish and I want to protect some of my gains?"**
Here is one answer and it is a follow on from the CSCO discussion http://www.riskdoctor.com/cgi-bin/forum/ikonboard.cgi?act=ST;f=1;t=576 where a guy originally did the 20/22.5/25 Slingshot and the stock rallied big (went over 29). The call 'kicker' was the 25 strike that went ITM. So why not sell the 27.50/30 call vertical spread 20 times (i.e. Slingshot the extra 25 call).
That creates another butterfly and a new kicker at 30.

I am often asked, what do you do with the nearly worthless butterfly? Leave it alone, probably, if it is too cheap to sell. It could come back to some descent value to salvage later.
Here is the dissection of the new trades and dissections with the yellow highlight:

	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	T	V	X
11		10	Raw Calls	Total Net Contracts			Raw Puts									10	Net Contracts	
12																		
13				PivotK	2500											PivotK	2500	
14			Month	JAN	10			Inc Adj	Y							JAN		
15			Raw Position										Butterfly Dissector				Work Sheet	
16	nC	rC	Adj	Cur	K	Cur	Adj	rP	nP	K		Bfly1	Bfly2	Bfly3	K	C	K	P
36					1750					1750					1750		1750	
37					2000	10		10	10	2000					2000		2000	
38		(20)		(20)	2250				(20)	2250	10		10		2250		2250	
39	10	20		20	2500				10	2500					2500	~~10~~	2500	
40	(20)	(20)	(20)		2750					2750	10		10		2750		2750	
41	20	20	20		3000					3000					3000	10	3000	
59	10	10		10	Net					Net	20				Net	10	Net	

arp

OOs and AHHs
« **Reply #5 on:** March 08, 2007, 07:49:38 PM »

Thanks for the reply Charles. It makes a lot of sense. It's a very "clean" way of locking-in profit while maintaining the bullish bias, and having the benefit of an ATM fly, just in case market goes sideways. It's beautiful.

> **Quote**
> It is simple to maintain a limited risk profile throughout the process but I think there are opportunities for short-term speculations within the bigger picture for optimizing profits.

I just wanted to clarify that I'm not against short-term speculation. I do it all the time. However, I like to diversify my trades across various timeframes. Therefore I like to have long-term trades as well as short-term ones.

In the above case, I was giving an example of a trading system that gives me buy and sell signals based on weekly charts. It may be in the market for months, attempting to catch the longer-term trends. So I'm willing to sacrifice additional potential profits from short-term speculation in-order to stay true to my long-term system; and at the same time, do better than the stock trader.

I know that short-term speculation can enhance the returns, but as you know, the flip-side is that if you're wrong a couple of times, you can damage the eventual long-term result that you were after in the first place.

- Ali

Ri$k Doctor

OOs and AHHs
« **Reply #6 on:** March 09, 2007, 03:35:36 PM »

OK Ali. When you are considering a trade (long-term or otherwise) try running it by me and I will give you a second opinion to see if the strategy is consistent with your opinion, or perhaps a better alternative.