Cherry Picks

tastytrade's Quantitative Newsletter for Traders

April 10, 2018

Analyzing Different Strategy Choices.

I'm partial to a good spreadsheet – keeps things clean and organized. I often start an analysis similar to what you see below – I figure out my theoretical return-on-capital (ROC) and balance that with the probability I'll actually make that return.

Below is my analysis of OIH – an oil services ETF. I've been taking a long position over the past few months. Since I've sold calls on my long stock and sold (and rolled) puts, my breakeven is slightly lower than the current price. Which is pretty cool considering I was wrong about the direction of the stock. It is one of the theoretical advantages of selling premium in an ETF that has higher than normal implied volatility (IV).

I do all of the following at different times. Right now, I like selling the *slightly in-the-money liquid puts since I want to take a long position anyway in the stock.* Why ITM as opposed to OTM puts? I want to get paid a bit more if the stock rallies. I generally avoid getting assigned by rolling out in time if the stock doesn't go above the strike price by expiration. When I am occasionally assigned, I sell out-of-the-money calls to lower my basis.

If you have a different way of analyzing, share it with us: research@tastytrade.com

	Long Stock	Long Stock with Short 26 Call (Covered Call)	Short 22 Put (OTM)	Short 25 Put (ITM)
Approximate Buying Power Required	$1,142	$1,143	$296	$477
Approximate Probability of Making $1 by Expiration	50%	52%	78%	55%
My Breakeven.	23.83 my bought price.	23.54 my bought price minus the amount from the sell of the 26 call.	21.60 the strike minus the amount I'd make on the put.	23.32 the current price minus the extrinsic value of the option sold.
Theoretical Max Profit	Technically it is "infinity". But realistically stocks never go up forever. So let's just say it is not out of the range of possibilities for the stock to double in price up to the expiration.	$246. Which is the amount I would make if the stock increased to, or above, the strike price along with the addition I'd be making on the call that I'd sell.	$40. Which is the amount for which I'd sell the put for.	$168. Which is the credit received which is the intrinsic and extrinsic value of the ITM option.
Theoretical Max Loss	Value of stock.	Value of stock minus money received from the sell of the call.	Value of stock minus value received from the sell of the OTM (all extrinsic) put.	Value of the stock minus extrinsic value received from the put.

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Lowering Taxes With An IRA?

Last Day is April 17.

How do you lower your taxes? One way is through lowering your earned income - **lower your taxable-income and you lower your taxes**. E.g. fund a Traditional IRA with $5,00 and your taxable earned income goes from $50,000 down to $45,000. A person in the 25% tax bracket might have saved $1,250 in taxes...or at least they put the taxes off until they retire. In effect their money is allowed to grow tax-free until they take the money out. Of course there are exceptions and rules to follow; it might be advantageous to see the IRS's definition here: https://www.irs.gov/retirement-plans/traditional-and-roth-iras

The government does make the whole process a bit difficult; deadlines and the choices between two different IRA classifications are challenging. We'll give you the low-down below – *tastytrade does not provide tax advice, always consult your tax professional*:

Traditional IRA
Funded with pre-tax dollars; pay no taxes now, pay taxes later. You basically have uncertainty of what future tax rates will be when you retire. But many investor's tax rates do go down, since their earned income is lower.
Deposit $5,500 or $6,500 if you're 50+ years old.
May lower your tax burden since you are lowering your earned income (if you qualify).

Roth IRA
Funded with post-tax dollars; pay taxes now, pay no taxes later. You let the account grow tax free since you've already paid taxes on it.
Deposit $5,500 or $6,500 if you're 50+ years old.
Does not lower your immediate tax burden since you're paying tax now. Your tax burden instead is lowered at the end since you won't pay taxes on the (fingers crossed) higher appreciated amount.

To open an IRA account with tastyworks, see the following:
https://tastyworks.com/accounts.html

Let us know if you have any questions, bigfoot sightings, conspiracy theories, etc.

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James Blakeway
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Trade Focus

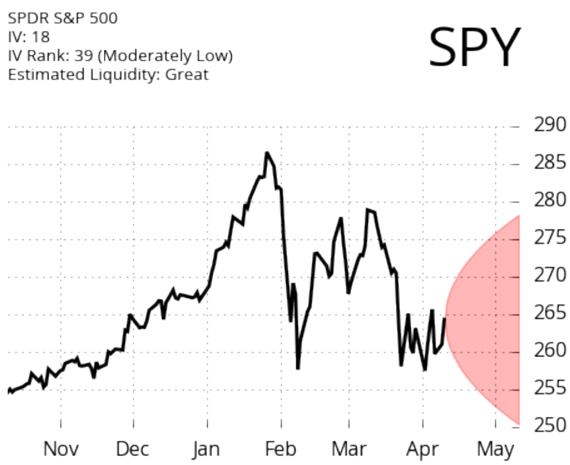
	Trade	What I'm Thinking	Statistics
	**INTC Ratio Spread 0.25 Cr** Buy 1x 50 Call MAY Sell 2x 52.5 Call MAY	Neutral to Bearish in INTC, fits my current position; can still profit even if INTC moves up a little more. Keep the credit if INTC is below 50 at expiration. INTC currently has an IVR of 92.	POP of 76%, max profit of $275. Breakeven is 55.25
	**ORCL Laddered Puts 4.13 Cr** Sell 2x 44 Put MAY Sell 3x 43 Put JUN	ORCL has been beaten up recently. IVR is 51, while earnings are after JUN expiration. Laddering puts across 2 cycles, creating a long position.	Breakeven around 42.60
	**COST Straddle 10.15 Cr.** Sell 1x 185 Call MAY Sell 1x 185 Put MAY	COST has an IVR over 50 with Earnings after May Expiration. A credit over $10 means we need COST to stay within the same range it's exhibited in the last 2 months. We would look to manage this aggressively at 25%, hoping to keep $250 of the $1,015 in premium.	Theoretical probability around 50% at expiration, hoping to manage before then which should have a higher probability. Upside Breakeven is 195.15, downside is 174.85
	**SLV Back Ratio 0.01 Db.** Buy 2x 16 Call MAY Sell 1x 15.5 Call MAY	Looking to participate in any large up move in silver.	Max Loss $51. Breakeven is 16.51, need SLV above this price to profit. Only lose $1 with SLV below 15.50

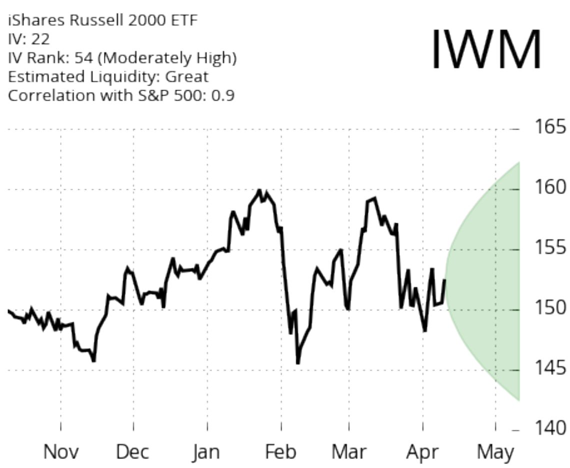
Upcoming Earnings

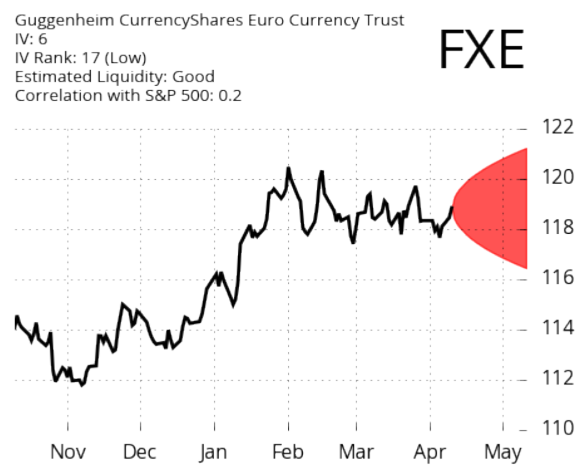
With high than normal volatility across the board, we generally avoid earnings plays – that and the market doesn't have many earnings upcoming in the next week.

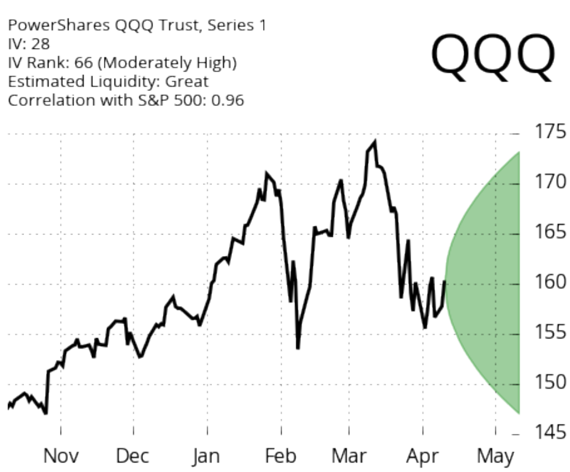
Be on the look though – we'll release an Cherry Picks "Earnings Edition" shortly since earnings season is coming up soon.

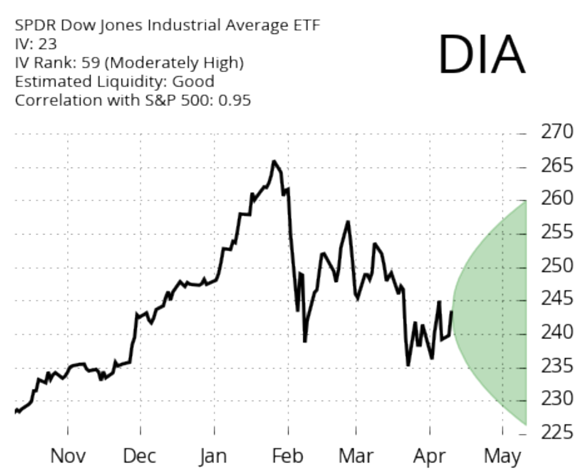
30-Day Expected Range Plots – The colored cone represents a 30-day expected theoretical price range that is calculated from the options' implied volatilities. In theory, we expect that prices will stay, with a 68% probability, within the boundary of the cone.











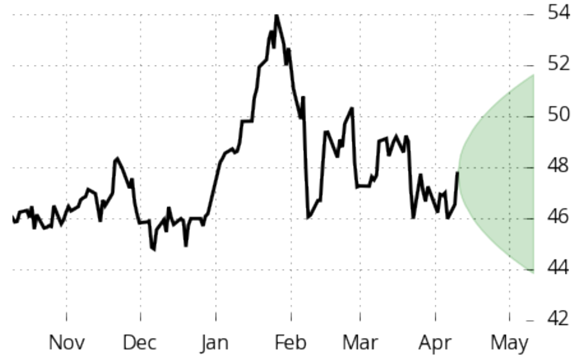
30-Day Expected Range Plots – The colored cone represents a 30-day expected theoretical price range that is calculated from the options' implied volatilities. In theory, we expect that prices will stay, with a 68% probability, within the boundary of the cone.

SPDR S&P Metals & Mining ETF
IV: 34
IV Rank: 38 (Moderately Low)
Estimated Liquidity: Good
Correlation with S&P 500: 0.67

XME

iShares China Large-Cap ETF
IV: 28
IV Rank: 55 (Moderately High)
Estimated Liquidity: Great
Correlation with S&P 500: 0.8

FXI



SPDR Select Sector Fund Technology
IV: 26
IV Rank: 65 (Moderately High)
Estimated Liquidity: Great
Correlation with S&P 500: 0.96

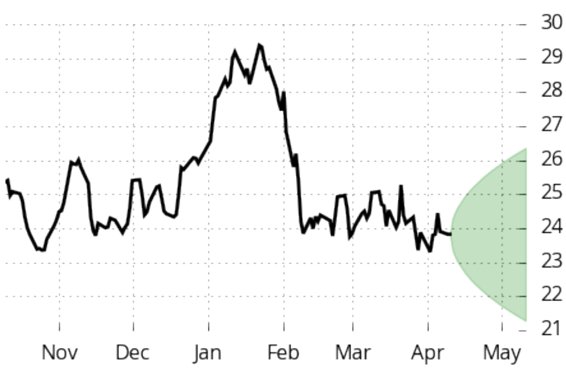
XLK

iShares MSCI Emerging Index Fund
IV: 25
IV Rank: 63 (Moderately High)
Estimated Liquidity: Great
Correlation with S&P 500: 0.91

EEM

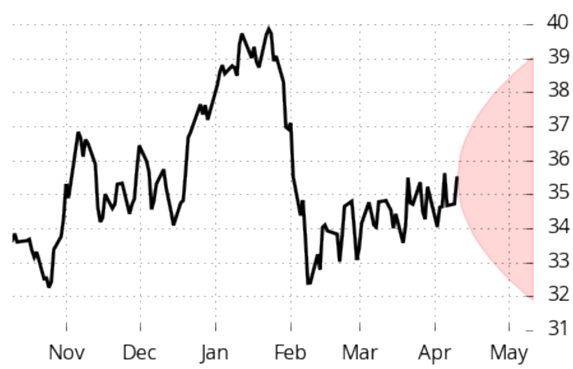
VanEck Vectors Oil Services ETF
IV: 36
IV Rank: 57 (Moderately High)
Estimated Liquidity: Great
Correlation with S&P 500: 0.73

OIH



SPDR S&P Oil & Gas Explor & Product
IV: 34
IV Rank: 46 (Moderately Low)
Estimated Liquidity: Great
Correlation with S&P 500: 0.77

XOP



Current Stock Watchlist

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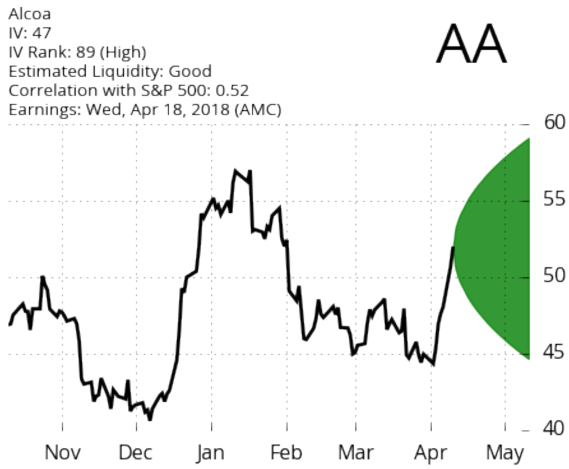
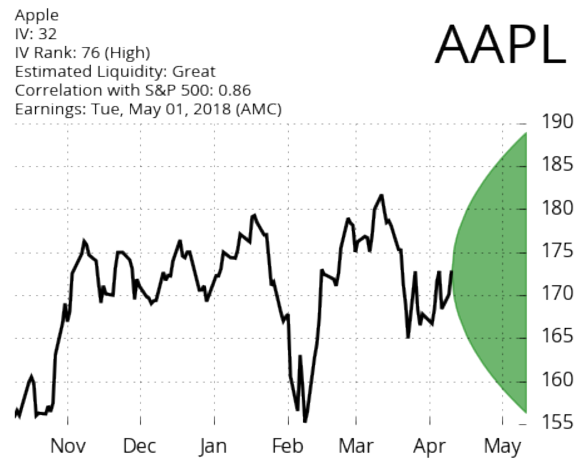
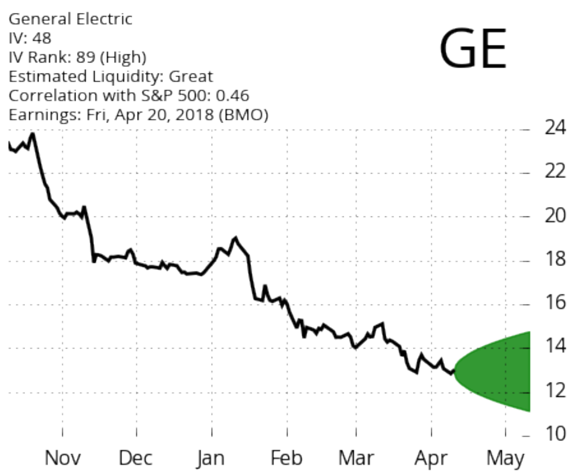
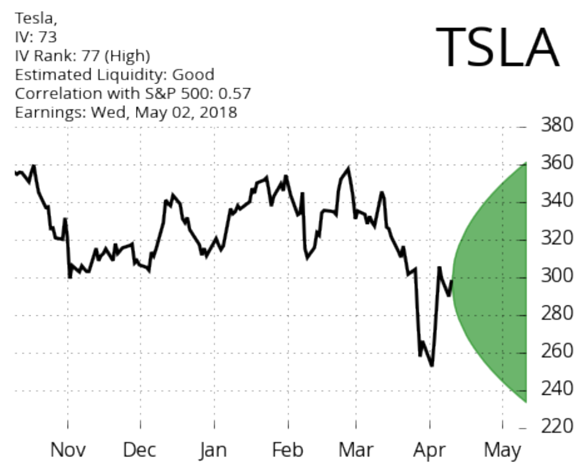
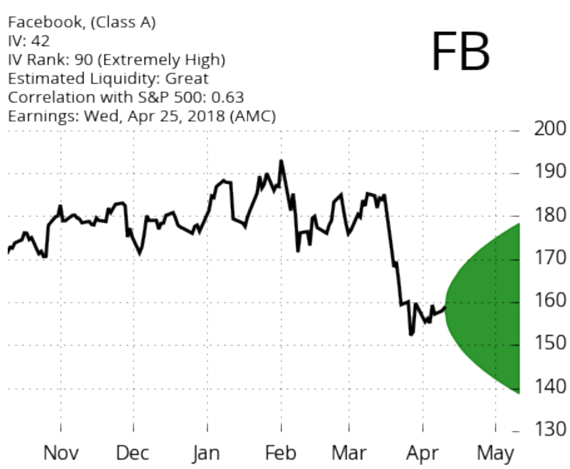
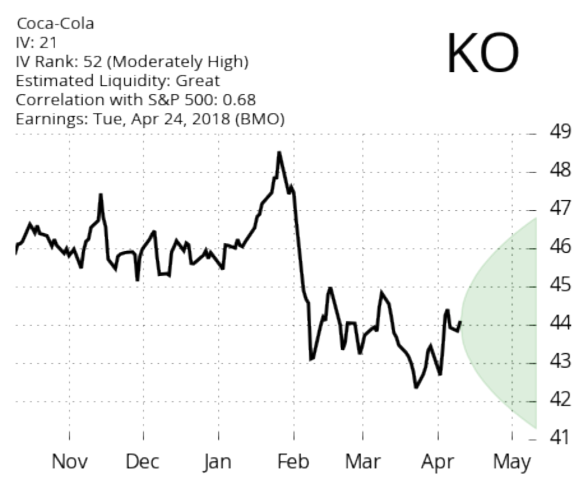








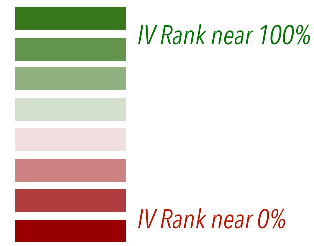




Reading this Report

Expected Range Cone. The colored cone represents a 30-day expected theoretical price range that is calculated from the options' implied volatilities. If the implied volatility is relatively high, then the market is expecting a larger price change in the underlying stock or ETF. From this we can derive the market's 1 standard deviation theoretical expectation of where prices might be in the future. In other words, the market is expecting, with a 68% theoretical probability, that prices will fall within the boundary of the cone at the end of 30 days.

Cone Color. The color of the cone is significant. The darker the color, the more "extreme" the implied volatility (IV) which is represented by implied volatility rank (IV Rank). This information can help you decide on a trading strategy.



Glossary

IV. Implied Volatility is the estimated volatility of a security's price derived from its option price; the higher the IV, the more expensive the option and therefore the larger the expected price move. IV is an annualized number of volatility, e.g. a IV of 27 means the option's market is pricing in an annualized price range, either plus or minus, of 27%.

IV Rank. IV by itself doesn't tell us if if the volatility is high or low - but IV Rank does. An IV Rank of 70 means that the IV is 70% between its low and high IV over the past year. The higher the IV Rank, the higher the security's IV is compared to its past year. We provide six levels to make evaluating easier:

- **Extremely High:** IV Rank between 90 and 100
- **High:** IV Rank between 75 and 90
- **Moderately High:** IV Rank between 50 and 75
- **Moderately Low:** IV Rank between 25 and 50
- **Low:** IV Rank between 10 and 25
- **Extremely Low:** IV Rank between 0 and 10

Option Liquidity. At tastytrade we have our own theoretical measure of option liquidity, Poor, Moderate, Good, or Great. It examines the options' bid/ask spread, open interest, and the number of strikes with non-zero bids.

Correlation with S&P 500. Correlation is a statistical measure of how strong a relationship two securities have with one another. A correlation of -1 means the stocks are perfectly negatively correlated (they move in opposite directions), while a correlation of +1 means the stocks are perfectly positively correlated (they move in the same direction). A correlation of 0 means there exist little relationship.

Earnings. The earnings date of the security. In practice we tend to see stocks have a larger amount of implied volatility (IV) nearer to earnings as the market is pricing in the fear of the upcoming earnings announcement. In parenthesis, is BTO or AMC; "Before the Open" or "After Market Closes", respectively. Upcoming earnings dates do sometimes change.

Disclosures

Options involve risk and are not suitable for all investors. Please read Characteristics and Risks of Standardized Options before deciding to invest in options: https://www.theocc.com/components/docs/riskstoc.pdf

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