A Fidelity Investments Webinar

Technical Analysis for Options Trading

BROKERAGE: OPTIONS

Using Technical Analysis to Plan Options Trades

Options Trade Management with Technical Analysis

Technical Analysis Concepts

Agenda

Using Technical Analysis to Plan Options Trades

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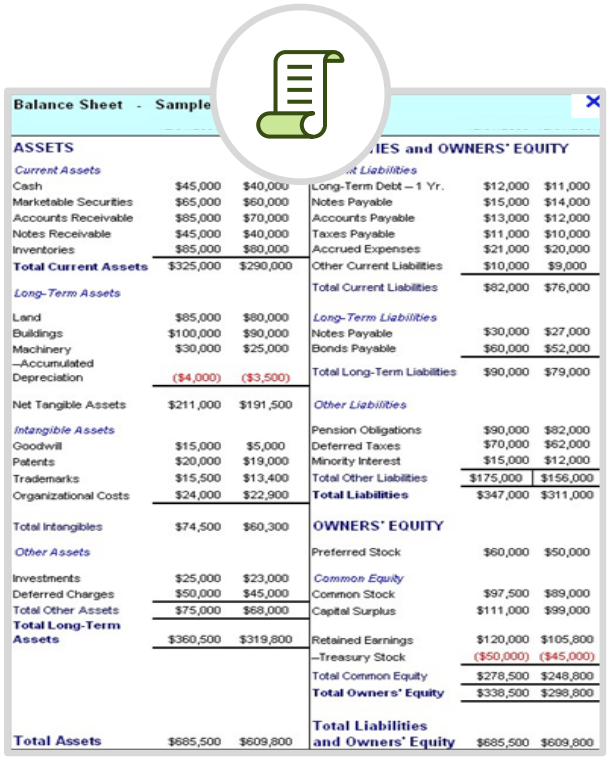
Fundamental Analysis and Technical Analysis

Two common types of analyses



Balance Sheet - Sample

ASSETS			LIES and OWNERS' EQUITY		
Current Assets			*t Liabilities*		
Cash	$45,000	$40,000	Long-Term Debt – 1 Yr.	$12,000	$11,000
Marketable Securities	$65,000	$60,000	Notes Payable	$15,000	$14,000
Accounts Receivable	$85,000	$70,000	Accounts Payable	$13,000	$12,000
Notes Receivable	$45,000	$40,000	Taxes Payable	$11,000	$10,000
Inventories	$85,000	$80,000	Accrued Expenses	$21,000	$20,000
Total Current Assets	$325,000	$290,000	Other Current Liabilities	$10,000	$9,000
			Total Current Liabilities	$82,000	$76,000
Long-Term Assets					
Land	$85,000	$80,000	*Long-Term Liabilities*		
Buildings	$100,000	$90,000	Notes Payable	$30,000	$27,000
Machinery	$30,000	$25,000	Bonds Payable	$60,000	$52,000
–Accumulated Depreciation	($4,000)	($3,500)	Total Long-Term Liabilities	$90,000	$79,000
Net Tangible Assets	$211,000	$191,500	*Other Liabilities*		
Intangible Assets			Pension Obligations	$90,000	$82,000
Goodwill	$15,000	$5,000	Deferred Taxes	$70,000	$62,000
Patents	$20,000	$19,000	Minority Interest	$15,000	$12,000
Trademarks	$15,500	$13,400	Total Other Liabilities	$175,000	$156,000
Organizational Costs	$24,000	$22,900	**Total Liabilities**	$347,000	$311,000
Total Intangibles	$74,500	$60,300	**OWNERS' EQUITY**		
Other Assets			Preferred Stock	$60,000	$50,000
Investments	$25,000	$23,000	*Common Equity*		
Deferred Charges	$50,000	$45,000	Common Stock	$97,500	$89,000
Total Other Assets	$75,000	$68,000	Capital Surplus	$111,000	$99,000
Total Long-Term Assets	$360,500	$319,800	Retained Earnings	$120,000	$105,800
			–Treasury Stock	($50,000)	($45,000)
			Total Common Equity	$278,500	$248,800
			Total Owners' Equity	$338,500	$298,800
Total Assets	$685,500	$609,800	**Total Liabilities and Owners' Equity**	$685,500	$609,800

Fundamental Analysis

Technical Analysis

Screenshots are for illustrative purposes only.

Defining Technical Analysis

Definition

Technical analysis primarily studies historical market data. It also:

- Focuses on the supply-and-demand dynamic expressed via stock prices
- Visualizes supply-and-demand shifts, which can be seen in chart patterns
- Accounts for the emotional aspects of the marketplace
- Quantifies the capital risk of trading and investing decisions
- Does not try to predict the future

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Defining Technical Analysis

Limits

Technical analysis is still not a perfect investing method and has limits:

- Patterns, trends, and indicators are never precise, and charts require human interpretation
- Technical traders are susceptible to the same emotions and cognitive biases as all other investors

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Defining Technical Analysis

Assumptions

- Prices in freely traded markets are determined by the economic principles of supply and demand.
- Price discounts everything.
- Prices are nonrandom but not necessarily predictable.
- Prices have direction and tend to travel in observable trends.
- Behavior and history in the marketplace will tend to repeat itself.
- Price patterns summarizing behavior are "fractal."

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Technical Analysis for Options Trades

Why should options traders leverage technical analysis?

Technical analysis and options trading can go hand in hand.

Many of the best practices for options trading come directly from technical analysis concepts.

Technical analysis focuses on price.

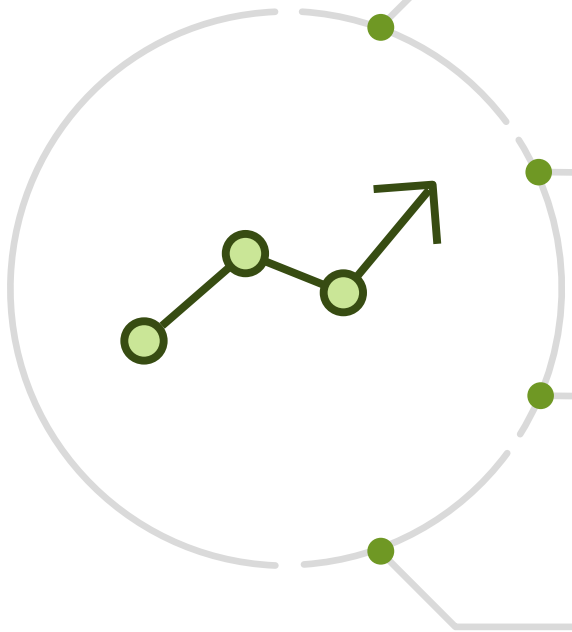
Fundamental analysis does not solely focus on price. When it comes to options, choosing a strike price is an important part of the trade process that technical analysis can help with.

Technical Analysis Concepts

Technical Analysis Concepts

Five key concepts to help you make smarter options trades

The Importance of Trend



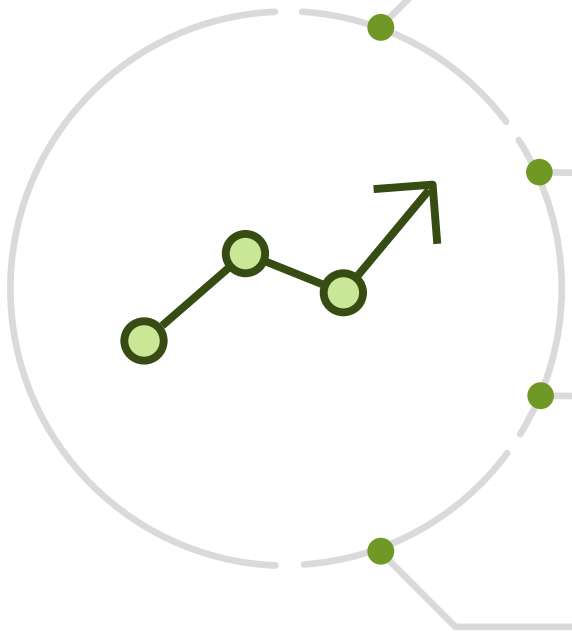
Technical analysis is based on the principles of trends

Trends arise from the interaction of buyers and sellers

Profit can be made from a trend in prices

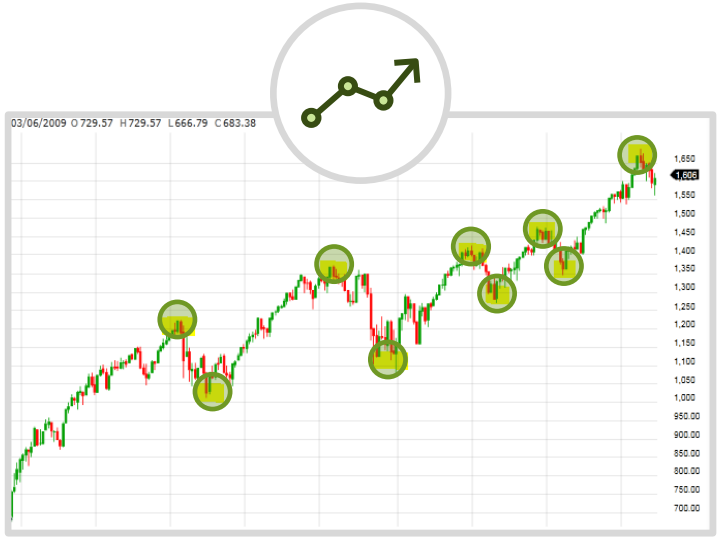
A trend's direction is described by the relative location of peaks and troughs

Assumptions about Trends



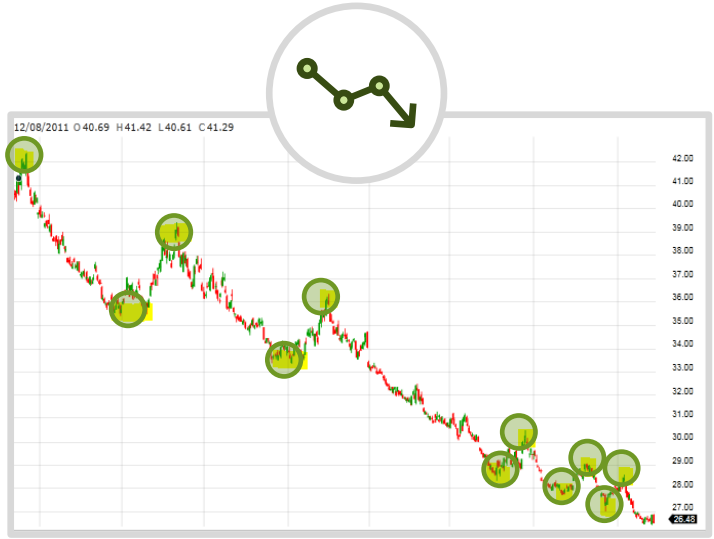
- Trends continue rather than reverse
- Trends are influenced by the next longer and the next shorter trend
- Trends are fractal, meaning that although they occur over different time periods, their behavior is the same
- Trends are not mechanical methods that can easily be programmed and tested on computers

Uptrend, Downtrend, and Sideways Trend



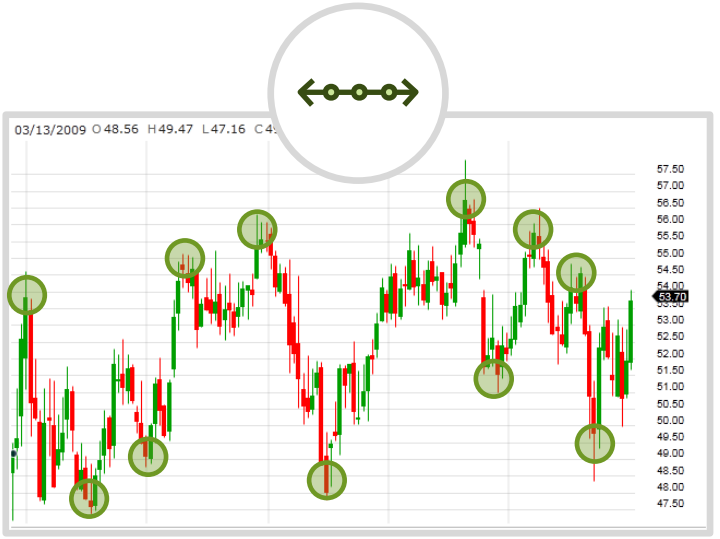
Uptrend

An uptrend has successively higher peaks and higher troughs.



Downtrend

A downtrend has successively lower peaks and lower troughs.



Sideways trend

A sideways trend is a period with no clear direction in prices.

 Screenshots are for illustrative purposes only.

Use Trend for Options Trades

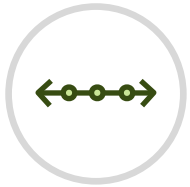
Use trend to form your price outlook for options trades

If the underlying is in an **uptrend**

Consider bullish options strategies i.e., buy calls or sell puts.

If the underlying is in a **downtrend**

Consider bearish options strategies i.e., buy puts or sell calls.



If the underlying is trading **sideways**

Consider options strategies that favor range-bound securities i.e., condors, butterflies, strangles, or straddles.

From Trend to Trend Line

Definition

A trend is a direction; a trend line is an attempt to define and use that direction.

How do we draw trend lines?

FROM TROUGH TO TROUGH

FROM PEAK TO PEAK

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Support and Resistance

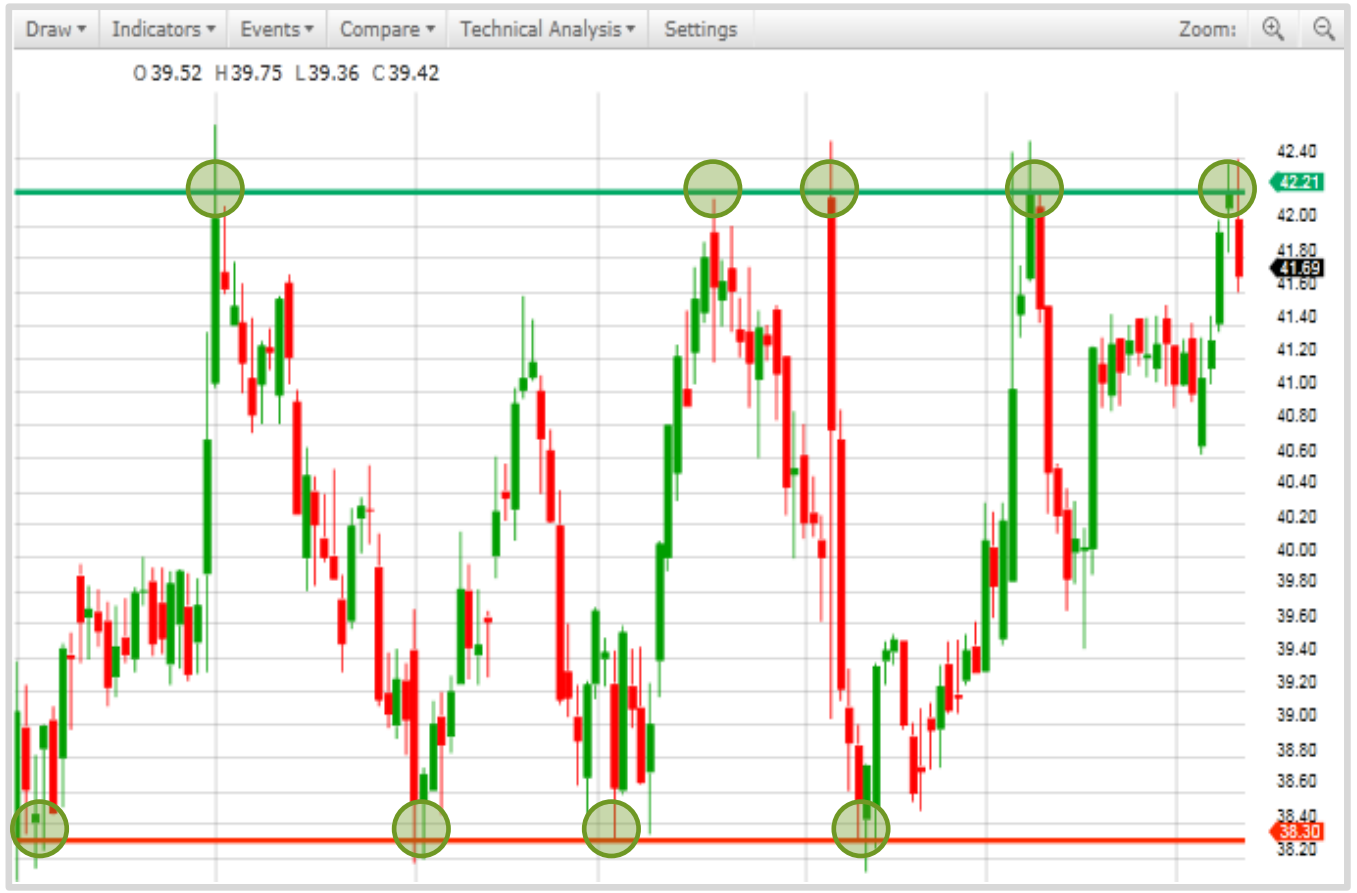
Support

Horizontal line drawn through troughs at the same price level

Resistance

Horizontal line drawn through peaks at the same price level

Support and resistance can be horizontal, diagonal, or even curved lines



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Use Support and Resistance for Options Trades

Use trend to form your price outlook for options trades

- Choose strike prices for calls and puts.
- Determine an entry point for a directional trade.
- Determine the legs of multi-leg trades.
- Identify a range-bound security, and determine where the range has been.
- Support and resistance levels can be stronger or weaker depending on the time period they're based on.

What Are Moving Averages?

Moving averages (MAs)

Are indicators designed to detect the start, continuation, and reversal of a trend

Simple moving averages (SMAs)

Give equal weight to each period to help identify a trend

Simple Moving Average

Simple moving average (SMA)

An SMA is the easiest MA to construct. It is calculated as the average price over the specified period. The average is called "moving" because it is plotted on the chart bar by bar, forming a line that moves along the chart as the average value changes.

How It Works

DETERMINE TREND DIRECTION

- If the SMA is positively sloping, the trend is up.
- If the SMA is negatively sloping, the trend is down.

DETERMINE TREND DURATION

- 200-bar SMAs are common proxies for long-term trends.
- 50-bar SMAs are typically used to gauge intermediate trends.
- Shorter-period SMAs can be used to determine short-term trends.

DETERMINE TRADING SIGNALS VIA PRICE CROSSES

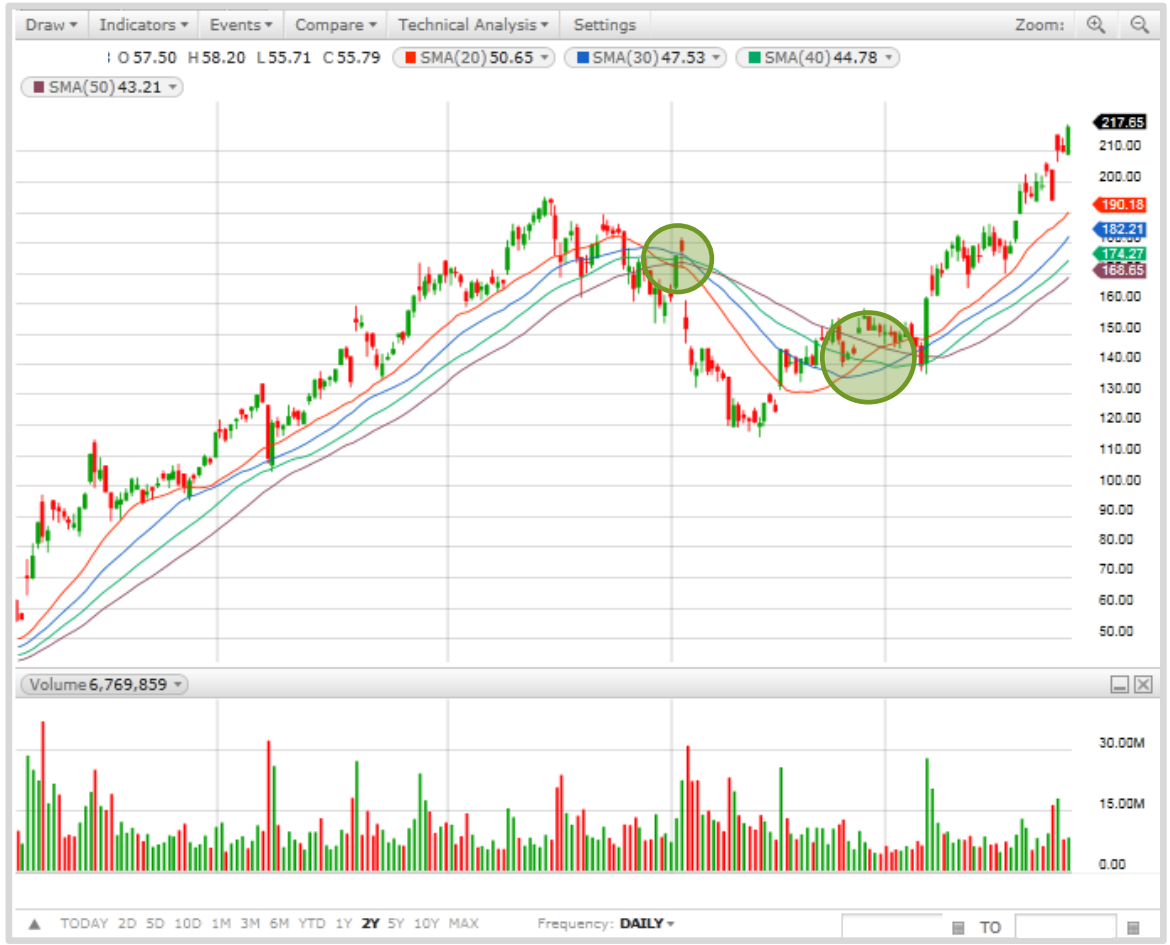
- When prices cross above the SMA, you may want to go long or cover short.
- When prices cross below the SMA, you may want to go short or exit long.

Simple Moving Average

Using moving average crossovers to generate trading signals

When a more sensitive (faster) SMA crosses above a less sensitive (slower) SMA from below, it is considered bullish.

When a more sensitive (faster) SMA crosses below a less sensitive (slower) SMA from above, it is considered bearish.



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Use Moving Averages for Options Trades

- MAs do not anticipate reversals. They merely confirm that a reversal has taken place.
- Shorter-term MAs are more sensitive to changes in price and indicate trend reversals more quickly. They can generate more false signals.
- Technical analysis traders often use combinations of MAs to help manage false signals and to confirm reversals through one or more crossovers.
- Consider matching the time frame for your options trade with your MA.

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What Is a Breakout?

- A breakout occurs when a trend line or support or resistance, level or zone, is exceeded up or down.
- Trend line breakouts usually signal trend endings.
- Support or resistance breakouts usually signal trend beginnings.

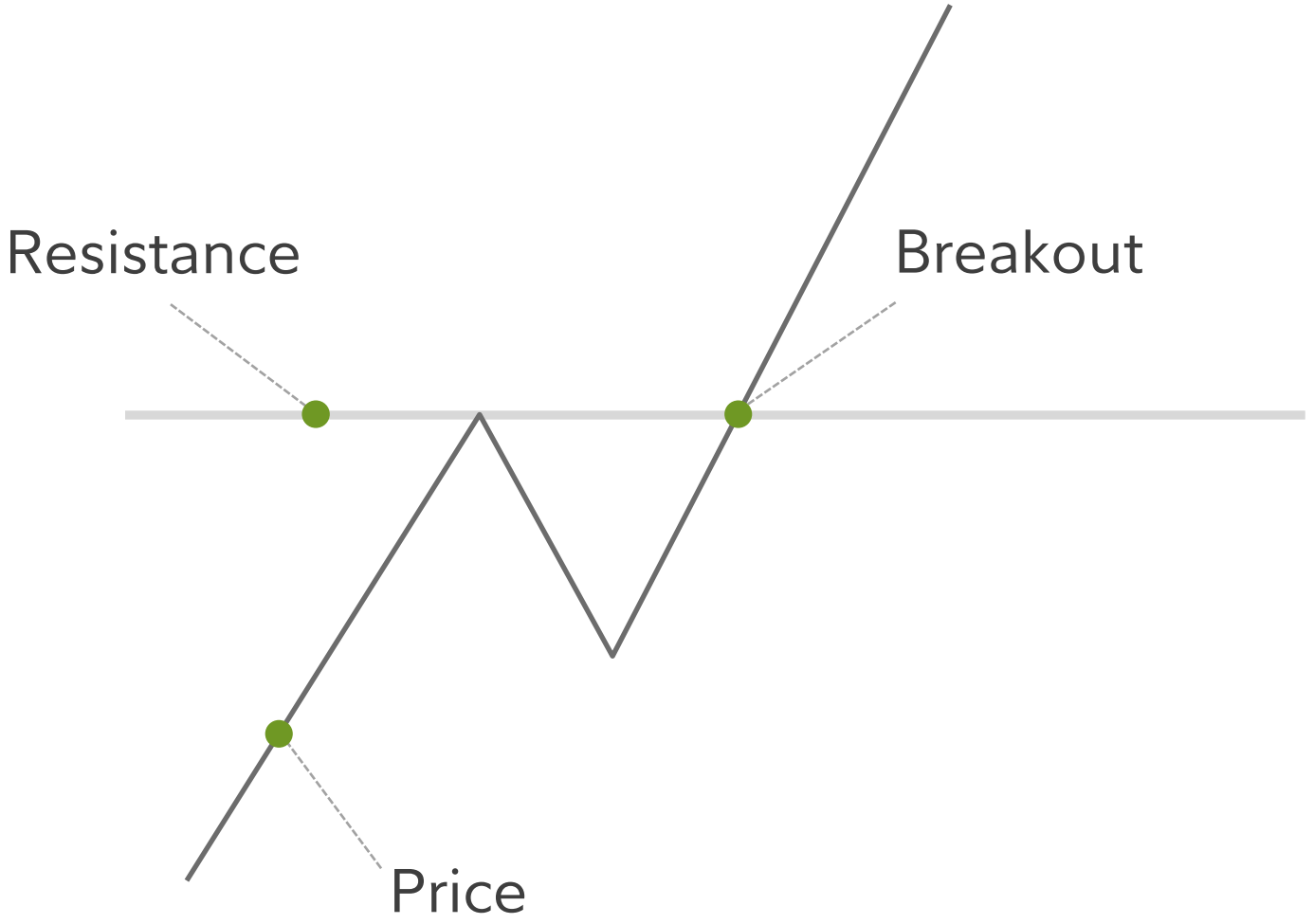
Remember

Many successful trading systems depend on a breakout strategy.

Breakouts

Violation of trend line, support or resistance, or previous reversal point

A violation signifies a change in buyer and seller behavior and signals the beginning or end of a trend.



Why use breakouts in options trades?

Trading options with breakouts is no different from trading stock ETF breakouts.

Traders will look for a confirmed breakout and use an appropriate options strategy for the direction of the break.

BREAKOUT TO THE UPSIDE?	**BREAKOUT TO THE DOWNSIDE?**
Consider a bullish strategy, such as buying calls or selling puts.	Consider a bearish strategy, such as buying puts or selling calls.

Bollinger Bands®

Bollinger Bands

Bollinger Bands are a type of price envelope plotted at a standard deviation level above and below an SMA of the price. Bollinger Bands help determine whether prices are high or low on a relative basis.

How It Works

DETERMINE RELATIVE PRICE

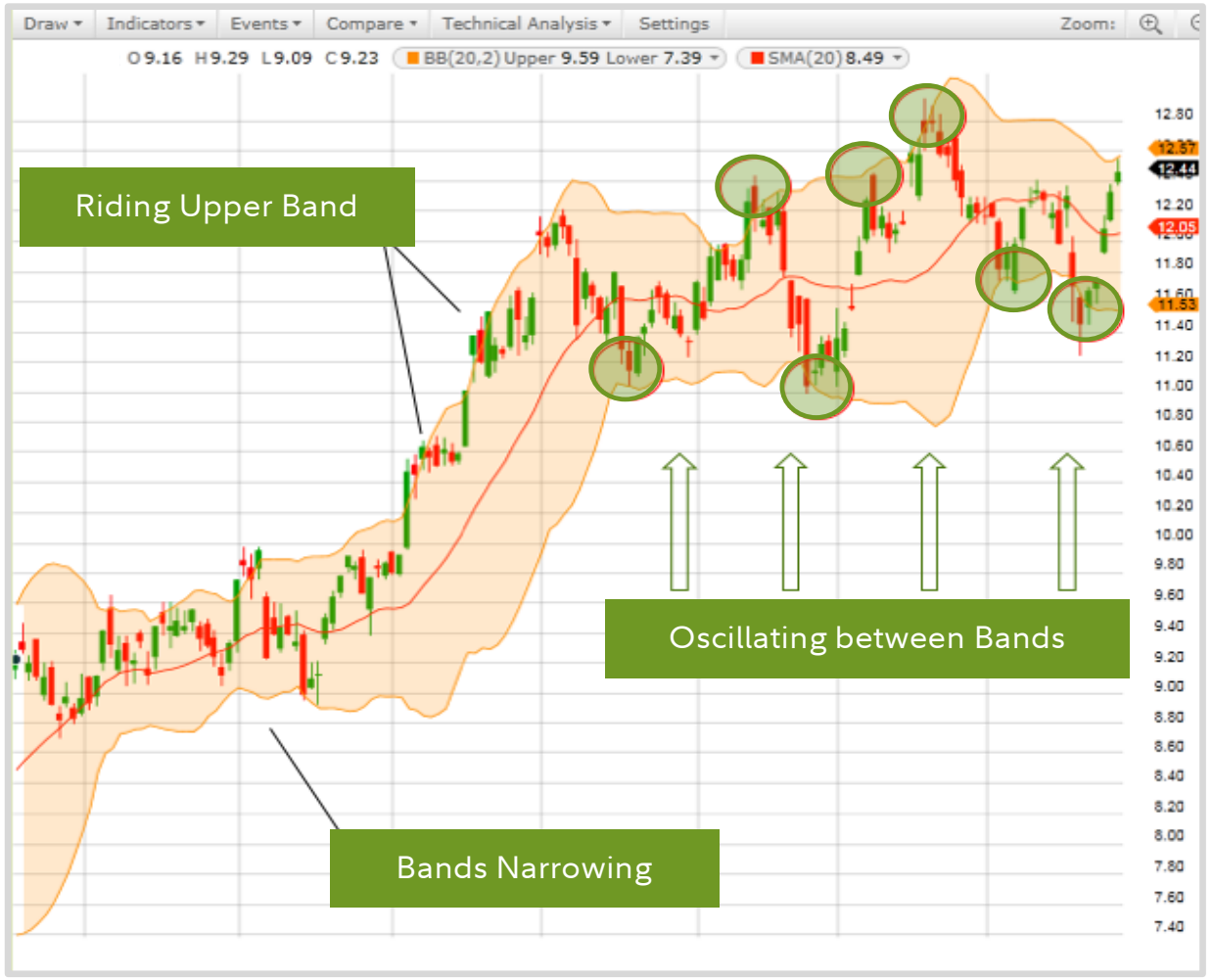
- When the bands tighten during a period of low volatility, it raises the likelihood of a sharp price move in either direction.
- When the bands separate by an unusually large amount, volatility increases, and any existing trend may be ending.
- Use swings within the band's envelopes to help identify potential profit targets.

Bollinger Bands®

Riding upper band

Oscillating between bands

Bands narrowing



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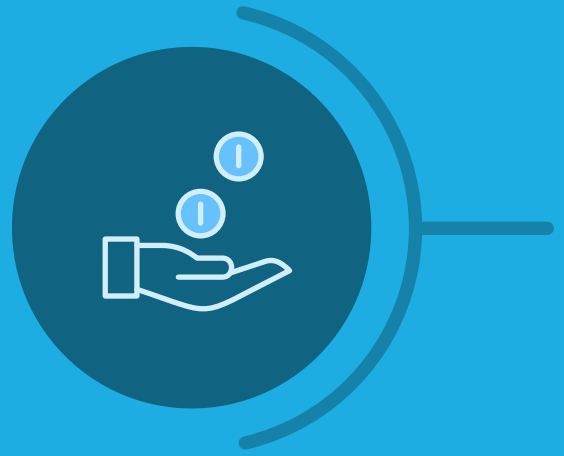
Why use Bollinger Bands for options trades?

Use to form an outlook on an underlying's historical volatility

Use to help with directional trades

- Identify when the price has been riding along the band for an extended period of time, which can indicate a strong trend in that direction
- Use to identify a range-bound security and determine where the range has been



Options Trade Management with Technical Analysis

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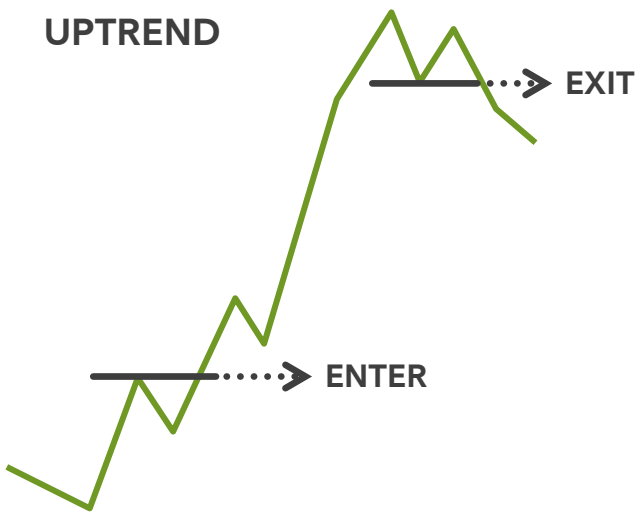
Trend trading

Best practices

Determine:

- Outlook on price, volatility, and time
- Determine entry and exit strategy
- Need for confirmation
- Size of trade and specific risk involved

Strategies for Trend Investors



Entry and Exit Strategies

ENTRY STRATEGY	EXIT STRATEGY
Consider entering strategy based on outlooks on price, volatility, and time	Consider closing when trader gets pre-determined technical signal to exit the trade or desired profit target hit

When investors using technical analysis execute these two strategies successfully, they may make a profit. The entry and exit should be decided prior to entering the trade.

Position Management

Have a plan!
Minimize emotional decisions through risk and position-size management

- Reduce concentrations in individual positions and sectors.
- Keep it small and in proportion to your portfolio.
- Go into each trade knowing what you can and are willing to lose.
- Be flexible; if your opinion has changed, then adjust your strategy.

Let Your Outlook Define the Options Strategy

Key takeaways

- Know what you are trying to trade.
- Consider your risk-reward balance.
- Use volatility analysis to select an options strategy.
- Consider the effect of time on the strategy.
- Establish an exit strategy before entering a trade.
- Reassess your strategy if your outlook changes.

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There are additional costs associated with option strategies that call for multiple purchases and sales of options, such as spreads, straddles, and collars, as compared with a single option trade. Examples in this presentation do not include transaction costs (commissions, margin interest, fees) or tax implications, but they should be considered prior to entering into any transactions.

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