

TRANSCRIPT

## Entry and Exit Strategy: What you need to consider

*Presenters: Konstantin Vrandopulo & Edward J. Modla*

**Konstantin Vrandopulo:** Hello and welcome, everybody. I'm Konstantin

Vrandopulo with Fidelity's Trading Strategy Desk. I want to welcome you into this second session of the day, of course. We are discussing entry and exit considerations for options strategies today with everybody. Session one flew by but we are continuing on today. I'm a part of the Trading Strategy Team of course. Just want to mention if you're interested in additional options trading and a technical analysis type education, feel free to join us by going to [fidelity.com/coaching](https://fidelity.com/coaching). And if you're newer to Fidelity and are interested in some of the more basic classroom type set ups where we are talking to a structured, proctored type material through four weeks every month, you can go to [fidelity.com/classroom](https://fidelity.com/classroom) and we'll gladly have you in there. Plenty of options education and technical analysis education out there that Fidelity provides, but today we are very excited to be spending some time with Ed Modla from the Options Clear Corporation. We have you for the next hour here and I just wanted to get the housekeeping items out of the way before we continue on. We have the live Q&A. You can ask those questions, of course, in the link to the right of the video player. We have some dedicated

brokers on the backend trying to answer as many of those as they possibly can. Of course you can download the presentation materials. The deck is available to download, the PDF that Ed is sharing with us today. And there will be a survey that we would ask you to fill out. It is completely anonymous but gives us a decent amount of feedback. We want to make sure that we keep getting better going forward and we want to hear what you are interested about learning in the days, weeks, and months to come. So Ed, hello. Back to you, sir. Thank you for spending this next hour with us. We're talking about entry and exit considerations today.

**Ed Modla** Sure. Thank you very much again, for the introduction. Hello everybody, great to be here. My name's Ed Modla from OCC. I've been in the options business in one way or another for about 24 years now, from being a market maker on the trading floor in the open outcry environment to being an electronic trader, a day trader in the futures space, a broker. I've seen different angles from this industry and now over seven years in direct education providing education and presentations just like this one to anyone who wants to listen and learn about options on all sorts of topics today. Entry and exit, specifically getting into and out of positions, positions that you open, the ones you close, and what factors do you need to consider to make those decisions, and some techniques that you might consider in managing the

position and closing when appropriate. Konstantin, we've got a lot to get through so we'll get right to it. But I'll say up top, a lot we're going to get to over the next hour is related to market psychology and once you have a position open it can be stressful to determine and try to figure out when do I get out of this position, when do I take profits, when do I take losses. And that's when investing gets stressful and having some understanding of those considerations, knowing your choices, is certainly helpful. Here's our disclaimer. Options are a complex tool, you should take the time to educate yourself and understand them well before including them into a live account. All the examples, all of the commentary we'll have today is for educational purposes only and should not be construed as advice. And here's our outline for today starting with entry considerations going to break that up into two pieces. First, strike selection and then, expiration selection. You have to choose those two pieces if you're going to enter a trade. What are the things that you're thinking about? And then exit considerations for buyers and for sellers. I feel like we're picking up on the previous session. What was your trading plan? How did you get there from, "I want to invest money," to "What trade, what strategy do I want?" There's market outlook, there's risk tolerance, there's confidence, there's all of these things you're going to consider until you select the strategy. Now we're picking up right there. What do you need to consider to put those details together on the strategy you've selected,

choose strike, choose expiration, open a position? And then once it's opened, what do you have to do with management of that position, monitoring things move forward? So these two sessions bleeding together in a nice progression. And we're going to start now with entry consideration. So, you've already done your homework, you've looked at some technicals, fundamentals. You've followed whatever guidance, whatever strategy you have for getting a market outlook and you've come to that point where you're going to utilize an options strategy. Strike and expiration, what kinds of things are you looking at? Well, before we look at strike more specifically we do have to remind ourselves of this term of moneyness, a very important definition and term to understand when you're using the options products for call options. Looking at this from a call holder, the call buyer's perspective, a call option is in-the-money when the call buyer owns the rights to buy shares of stock at a better price than the open market is providing. And for calls, this is when the strike price is below or better than the open market price from the perspective of the call buyer. Out-of-the-money is the opposite, when the call holder has the right to buy shares at a higher price -- strike price above the current price, a higher price or a worse price than the open market value of the shares. Puts have the same definition but from the opposite direction. A put holder has the right to sell shares of stock. Their put option is considered in-the-money when they have the right to sell shares at a strike price that is better than the open

market value of the shares or above where the stock price is currently trading. Those are in-the-money puts. Out-of-the-money puts are when the put holder has the right to sell stock at a strike price that is below the current level of the stock or sell stock at a worse price than where the stock is currently trading. In-the-money options have intrinsic and time value, this word time can be exchanged for extrinsic. That's extrinsic or time value. Out-of-the-money options are only time value. And here's this term at-the-money when the strike price equals the stock price. By definition, if the strike price is 75 that option will be at-the-money when the stock price is 75 even, 75 spot zero, zero. So yes, that is true. That is at-the-money. In practice when at-the-money options are referenced, it is generally understood that at-the-money options are strike prices that are close, relatively near where the stock price is currently trading. That's a bit of a cloudy definition but that's the way that term is used and there's a reason why I'm saying it here. It's going to come up a few slides later. At-the-money options, generally speaking, are when strike prices are very close to the strike price. Here's your moneyness: in-the-money, out-of-the-money, and at-the-money. And we're going to use this understanding, these definitions and terms, to then think about choosing our strike. If we are an option buyer – again, have a trading plan. We've got our market outlook, we know what we want to do, we know what our market thesis is -- bullish, bullish, bullish, bearish, neutral. We've selected our strategy, now we need to choose

a strike. If we're going to be an option buyer and we choose an in-the-money option, it's going to cost more. It's going to have intrinsic value. We already have the right to buy shares at a better price than the current market is offering. We already have the right to sell stock at a strike price that is better than the open market value of the shares. It's going to have intrinsic value there. So we're going to pay more but what we do get is greater sensitivity of the option premium to movements in the stock price. Greater potential here for monetary gain. The dollar value changes for in-the-money options will be greater than their out-of-the-money counterparts. Out-of-the-money options, by contrast, will cost less. We know that. They're going to be cheaper but they're going to be considered a more aggressive trade. They require a larger stock price move to achieve profitability. The potential for percentage gain is much greater because our cost is low and if we get that stock moving our direction, particularly if the magnitude is strong enough, the percentage gain could be very high here. For those of you that have bought calls or puts and have the trade work out, you probably have seen that those percentage gains can look awfully impressive. But just keep in mind, percentage gains can be attractive, they can be enticing, but remember it's not easy. I don't mind saying that when it comes to buying options and speculating it is not easy to consistently be profitable. So you just have to make sure you're doing your due diligence and your confidence level in the move you expect to occur --

that you're speculating on -- is high. Because you do need a larger stock price movement in either direction, whether its cause or puts, in order to capitalize and reach that level of profitability. Of course, there is a place for that.

Sometimes you do have high confidence, and that's where option buying could come in. Regardless, consistent theme you'll hear from Konstantin and myself throughout the conversation, market outlook and forecast might lead to your target strike price. You're incorporating that trading plan you started with. What's my outlook? What's the forecast? And this can lead you to target a certain strike price because your analysis and your thesis has taken you there. Option sellers are doing different things here. We're collecting premium, trying to capture and enhance our bottom line account balances through the sale of options. If an options seller choose an in-the-money contract of course there's going to be more premium. It's going to be a higher dollar amount into our account, but be careful that higher dollar amount does not mean that that option is going to decay to a greater extent or you're going to capture that natural decay of options, a premium, greater because you sold an option that is worth more. In-the-money options will have intrinsic value and a portion of that premium that you sold and received is going to be sensitive to stock price and will not decay. You might be okay with that but you do need to understand and be aware that when you sell an in-the-money option, in order for that premium to drop in your favor, you're looking for two

things to happen. The stock price to move in a certain direction to reduce the intrinsic value in addition to the day-to-day natural decay of the option contract. For options sellers who are selling in-the-money options they're looking at both of those pieces. Out-of-the-money options that are sold will generate less premium for sure. There's no intrinsic value, it's only extrinsic value. But the likelihood of being successful when selling out-of-the-money options increases and that's mathematically true because selling out-of-the-money options gives you room for the stock price to move particularly against you before you will start to suffer losses. One of the phrases that I've heard that I've used when it comes to choosing your strike price if you're an options seller is that sellers are selecting a strike price at a level which they believe the stock price might reach but not break through. And again, you're tying that back into your trading plan, having a plan and your market outlook. Where might this stock get to but not break through? And that can be a starting point for selecting the strike price when you're an options seller. Konstantin, I have this conversation a lot with investors who are selecting strike price and it's an interesting conversation and there's guidelines of course here but not an exact science. So maybe we should take a look at a few things and see what the options chain looks like and start to visualize that decision that investors are going to make when they select their strike.



**Konstantin:** Absolutely, Ed. You know, an exact science is certainly not something that this is. There is a lot of art in it and obviously one of the common questions that I frequently get asked is, "Konstantin, what's the best strategy? What's the best options strategy? What's the best strike and what's the best expiration?" The reality is unless you can tell me exactly where something is going to be in the future, and not only where it's going to be but how it gets there, there's no way to know what the best strategy is. So, we have to make some assumptions. Let's take a look at a few tools that Fidelity provides. We found XME as our underlying of interest through our screener that we did in session one, so let's like, take a look at the board. So I've pulled up the options chain on XME and I'm just going to quickly look at the March 18th front monthly expiration right now. We have the February 18th, third Friday of the month expiring this week, and then the front monthly of course becomes March 18th. So what do I want to do here, Ed? Two things. Number one, does the computer do a lot of work for us? And the answer is absolutely. Is it in-the-money, is it out-of-the-money, how can I tell? So first things first, the options chain is presented to us from the perspective of a long option holder, or an option buyer, all right? So if we're looking at the call side of the option chain, we have this grayed out strikes below where the underlying is currently trading. These grayed out strikes are the in-the-money ones. The non-grayed out ones are out-of-the-money. Think about it, if the buying a call me the right

on buying a stock, if I can buy the stock right now at a lower price, right? And sell it in the open market for a higher price, then it should be worth something intrinsically, and it's therefore in-the-money. The computer also has two fields, intrinsic value and time value, that it's doing the calculations for you. Notice that the in-the-money strikes that are grayed out will have intrinsic value and the out-of-the-money will not. And all of their value will be based on extrinsic value. Okay? Now, the second thing is the put side. If you're looking at puts, remember option chain is presented to us from the perspective of a long option holder or a buyer of options. So, if I can short the stock or sell the stock at a higher price and buy it back in the open market for cheaper, then naturally the strikes above the current level of where the stock is trading would be the in-the-money ones. That's why they're shaded. The out-of-the-money ones will be the strikes that are lower than the current price. Therefore, they're unshaded. The computer, again, is doing all the math for us, in-the-money or intrinsic value versus time value. All those calculations are going through. Now, the way my options chain is set up in Active Trader Pro -- or if you are looking at Fidelity.com you might not have these columns padded in -- all you've got to do is right click on any one of these columns and add a column from the drop down list. There are plenty of things to add from but I think these two at the very least, when you're starting out, they could be extremely helpful to look at the board and say, "Okay, I understand what it's dealing

with. I might not have this moneyness, in-the-money, out-of-the-money down pat just yet." Let the computer do the work. Now Ed, in terms of strike selection, so let's look at XME and this is the underlying of interest to us right now. We're looking at this multi-year chart here and I get asked this question a lot, "Konstantin, this stock or the underlying exchange traded product is a new high. It might be down a little bit today but it's practically at a two year high, how do I figure where does it have the potential of going?" And that's where our technical analysis hats come on. And what I like to do is a few projections. So, if the underlying hasn't been at these levels of 49 dollars and 41 cents in the past two years or in the past five years or in the past 10 years, it's telling you that it hasn't been there in a while. So what could we do? Can we make some projections of where could potentially it might be going? There's this idea in technical analysis of, if we've identified a range where the underlying security has based, especially if it's based along this range for multiple months, maybe our initial target on the breakout would be doubling of that range. So, a type of a tool that you could use is called the Fibonacci Retracement Tool. So I'm going to go in here into draw, use the Fib Retracement Tool, grab the most recent high before the breakout, connect it to the lows of this range, click on the Fib Tool, and add some extensions to it. One twenty-three six. One thirty-eight two. One fifty. One sixty-one eight. And two-hundred. We're going to add these values in and now all of a sudden, Ed, we have some things

to be on the lookout for, maybe potentially for strikes. The security hasn't been there in the past two, five or maybe ten years, where could it possibly be going if this breakout was to extend itself? And if we were to retrace and maybe hold, what used to be resistance as support on the continuation of this preceding trend, where could it be going? Well, now you have some strikes above to be on the lookout for if you were to choose out-of-the-money (inaudible). All right? So Ed, back over to you, sir, for expiration selection.

**Ed:** Yeah, terrific demonstration to really tie in what, you know, the education we're providing, and also relate that to the chart and see visually what decision you're making, and how you might make that decision with strike. As you just say, Konstantin, that is tied into expiration. You have to choose both. So option buyers, thinking about expiration, they know they're paying for time. There's going to be an element to the option premium that accounts for places of value on the time between today and expiration during which the stock price has the potential to move. And technical analysis, as you're just showing, Konstantin, tends to lend itself a little bit more kindly to the decision on a target time frame. How long might the stock or how long might it take for the stock to reach the target price that I expect it has the potential to reach? That technical study, various types of technical studies can help lead you to that decision. Fundamental studies, and we're talking about things like say the

most prominent ones -- PE ratios and margins and such -- if you are in favor or bullish, say, on a particular stock because it's trading at a low multiple, you think it has the potential to appreciate in share price, the fundamental studies don't lend themselves as easily to choosing a time frame. So, those by themselves might lead you to longer expiration dates to make sure that you have enough time to capture the move you expect to occur, but you're not too sure or comfortable on the timing of that move. Many investors combine the two. They'll look at fundamentals and technicals to form an opinion or confirm it to make sure their bullish thesis is true on both sides, and then they'll focus a little more heavily on the technical side when they're trying to choose their expiration date as Konstantin is outlining or taking this the further and further steps. Option sellers are selling time. They're getting paid for the potential for that future stock price movement, taking on obligations, accepting the risk involved with such a decision. And here's where we have the selecting a time frame during which the stock price is not expected to threaten the strike price. This is similar to a comment I made about selecting strike. Where do you think the stock might go? What level of strike price might the stock reach but not threaten to break through? And here, options sellers are also looking for that time frame. If they think a certain resistance level is in place or if they're selling puts against a support level, what time frame do they feel a level of comfort that the share price will not threaten or possibly break through the selected

strike price? That can help lead to the expiration selection. All the while for options sellers, whether it's when you initiate the position or whether you have a short option position held in your account and you're just monitoring it, either way, options sellers are always making sure that the premium received or held with an open position is worth the obligations associated with it to have that short position open. If you're going to get paid and generate income up front, is the option premium worth that obligation in the first place? If you've sold an option and the premium has declined, is it worth holding that position and continue that open short with that lower premium level? We're starting to translate into the exit considerations which is coming up here shortly. These are the considerations for options sellers. Timeframe is a part of that. If you don't feel like you're getting enough premium you might need to look for further and further expiration dates. When you find premium that's worth it, you look at that expiration date, tie it in with the rest of your analysis to make sure that it's consistent with your market outlook. Both buyers and sellers need to be familiar with the time decay curve. Let's take a quick look at that and then Konstantin will walk us through -- again, translating this into the visuals which he's doing incredibly here. But let's look --at-the-money options will decay from one day to the next in a non-linear fashion. That natural day-to-day erosion is nonlinear. Remember I said at-the-money options are defined when the strike and the stock are exactly the same? Well in practice,

when someone says at-the-money options they're more or less being a little more loose with that definition. At-the-money options -- in this case as we're looking at here thinking about time decay our strike price that are close, relatively close but if you know Delta's 40, Delta's 45, Delta's close to where the stock is currently trading, the decay that you see in the extrinsic value is nonlinear. It starts to pick up right around that 40 day level and accelerates through and including expiration. And you're not going to get a faster rate of acceleration than expiration day when all options that are out-of-the-money expire with no value. But just keep in mind, a decay from a nickel at the opening bell is to no value at the closing bell is a 100 percent rate of decay. It doesn't get faster than that. Again that comment I just made a minute ago, is it worth selling an option for a nickel? Investors have to decide that for themselves and find the sweet spot. Where can you get, from a seller's perspective, an attractive rate of decay but also capture enough premium to make it worth your while? If you're buying options you are aware of this decay, you're aware of the rates of decay and you know you're going to suffer from it. But your market outlook and your target price, if you're correct on that, you're hoping to overcome any losses along this curve. Very quickly, just a few seconds, in-the-money and out-of-the-money options for that matter that have a much lower level of extrinsic value to begin with, they decay in a more linear fashion. This is not exactly linear but mostly linear fashion. Really,

where all the activity and actions taking place in the options space, at-the-money. Buyers and sellers both need to be aware of this curve and this decay. So Konstantin, take it away. Going back to the visuals as we're looking at expiration and now we know a little bit more about that decision. How are we now tying together -- again, what's our market outlook? What strategy do we use selecting strike? Now looking a little deeper in selecting expiration.

**Konstantin** Ah yeah, Ed. Perfect. If we could keep this slide up for just a moment.

So we have two axes, right? The y-axis is the time value or extrinsic of an option and we have time. Now, we know towards the end of the life there's no way to stop the clock. They will run out of life and they will expire. There is either going to be intrinsic value in them, and they're going to become long or short stock, or they will expire worthless. So this nonlinearity of time decay is an important thought because the in-the-money options seem to have a closer to a linear type decay line. What's that, a fancy way of saying what? Well, I can use a linear equation to solve for slope, all right? But the at-the-money and the out-of-the-money options have this curvilinear shape to them, where I cannot actually use a linear equation. I have to use the quadratic equation to solve for its slope, okay? So let me take this a little bit further into Active Trader Pro, back to Active Trader Pro we go. It's all about the examples at the end of the day to solidify them all. I'm going to go back to my options chain to



see if we can view that and see that on the board through different expirations. Linearity, non-linearity. So let me look at February 25th weekly expiration. That's available and, by the way, XME does obviously have weeklys as you can see here. It has monthlies and it has some leaps out there. So let's compare February 25th expiration to March 18th to April 14th. So, let's look at the board and compare the first two. Number one, if at-the-money option time decay was linear, then what would have to be expected? Well, eight days to go, February 25th, 29 days to go, March 18th. So that's what, roughly eight into 29 is around 3.6 times, okay? So what is an at-the-money option currently worth in time value terms for eight days out? Well, it's a dollar 20. So I have to multiple that by 3.6 to get my at-the-money option value for the same strike going out 29 days. And the reality is it's nowhere near 3.6 times the same. It's less than two times the amount. Now, how about extrapolate that further. If I'm at 29 days and I'm looking at something that's about twice the amount of time until expiration at-the-money. Well again, 49 has a two dollar and seven cent time value in March and double that would be over four in April, but yet it is not. It is only two dollars and 70 cents. So therefore, there's that nonlinearity of time decay. Just because you go further out, it should be obvious to everybody that options are going to be more expensive in dollar terms but not in sort of linear fashion decay terms potentially, all right? So that's my point number one. How about the in-the-

money ones? Let's look at a 45 strike. Is there more linearity to the time decay on something that's in-the-money. Forty-five days out, 18 cents. Twenty-nine days out is 83 cents. Okay, how about we compare this 83 cents of an in-the-money call to double that of the time. Is there roughly around a buck 60? Closer to it, right? So there you have this function to where it's decaying more linearly. If it's an in-the-money option it is more expensive because it's in-the-money and it has intrinsic value and it has less time value. Think about that curve, take a screenshot of it. Ed did a great job of showcasing it. I just wanted to depict it or display it on an options chain because it's a very valuable piece of information. Just because I'm going out further in time -- think about those of you who are thinking long option buying versus short option selling. Just because I go out further in time does that mean that I'm paying way more in excess or I'm receiving way more than I should be? The lesson is on the board. So Ed, back over to you.

**Ed:** Great -- again, great explanation and it's really helpful to see it on the screen as displayed through the chains and actual option prices. And just remember, all of this gets tied into your decision including your market outlook, your strike selection. This is all part of the process in putting together your approach, your strategy, and your trading plan. A lot of pieces. And we're just moving from one piece to the next to the next, ultimately getting towards the end of

the line. So we've talked about all these things -- market outlook, citing a strategy, citing a strike and expiration, how do you do that. So now we have a position, and let's talk about what do you need to think about as the stock price is moving, as your option premium is moving. What are your considerations and thoughts? Now we're going to look at this first from the perspective of option buyers and then option sellers and then look at another demonstration that Konstantin is going to showcase for us. I can say this little segment here, the next several slides, this could be an entire presentation all by itself. There's going to be a lot of bullet points that you see here. I wouldn't expect those new to options to remember every single piece of this. If nothing else you're taking away some of the things that you're thinking about and of course the reference of the slides will be helpful, but I'm going to just walk through these just so you can start to get a feel for what are you thinking about when that trade is open and you have a position to manage. We'll look at long calls and then long puts. I'll say, if you're an options user and maybe doing spreads, these considerations can also translate into more complex strategies. If you're net long calls let's say, for example, and you're buying a vertical call spread or such, the same types of things can be considered. You've got a long call position as a result of all the things we've talked about today. Now you're long call and the stock moves higher, what do you do? I said this when we did the introduction, this is where investing can

get stressful. All of this can be fun and we're all trying to make money here, but when you have a position open and you're trying to decide what should I do now while your profit loss is fluctuating, this is when it can be stressful. So understanding your choices and getting a comfort level here is very important to control your emotions and make sure that you're making the right decision.

Stocks higher, we'll say this call option has gained for us. We know we're suffering from some time decay but that move higher in the shares has worked out to a net gain so if you hold for further gains there's a couple of things you're doing here. One is you're managing the position against your market outlook. Be true, be honest with yourself that you're not just holding it because it's working, that you do believe the stock price is going to appreciate further and you want to hold for further gains to capitalize on that. The other thing that you're managing here that I hope investors don't forget is you're managing an account balance. You're here and you're trying to learn about options because you want your bottom line to have the positive impact through the use of options, so in addition to managing your position against your market outlook, you're also managing money. You're managing your position against your money. Maybe you've had a few losing trades and you need a winning trade. So do you want to risk holding it for further gains? Maybe you've had a few nice gainers recently and this one you're going to let go a little bit. You can possibly or potentially change your risk tolerance a bit

because not just your market outlook is there, but you're managing your funds, you're managing your account, and you're managing your emotions as well. But certainly holding on for further gains is a possibility. Closing the position, scaling down the position, you've had enough. This could be from either direction. Again, your market outlook has changed, you have less confidence, you think this stock might be moving in the other direction so close the position, get out wherever that stands. Or scale it down, take some risk off the table. That can be because your market outlook has changed, that could be because you need to take a winner in your account or a mixture of both. So winding things down, taking some money off the table. Of course this is a lot easier if you have 5 or 8 or 10 contracts as opposed to 1 or 2. But scaling down, certainly a possibility. I'll say closing is also easier when you have that larger position and get to scale out of it rather than taking everything off the table. Rolling up to a higher strike, I think this is something investors might forget about. This is specific to the situation when you have a call option, stock has moved in your favor to a great extent. It's now an in-the-money option by a significant margin, you still think the stock's going higher, you've got plenty of time left in your trade. But if you don't do anything you're risking giving back all of that premium, all of those gains if the stock moves in the other direction. One of your choices here, sell the option that you own, capture all of that premium and buy a higher strike price. You're not going to

be able to do that for what we'd say is even money, the distance between the strikes, but roll up, sell the more expensive option that you own that you've gained on, buy a higher strike, a less expensive option. Maintain that bullish position to capitalize on further gains but receive premium for doing that.

Take some money off the table. Rolling -- you'll see a few times here -- rolling just means you're closing one position and opening another. That's all it is, that's all rolling refers to when you see it referenced on the slides here.

Exercise -- if you're willing to buy the shares of course this could be before or after before our expiration if your long calls, you might want to capture a dividend. Remember, call holders are not entitled to a dividend but shareholders are, so you might want to capture that. If the stock consolidates and goes nowhere, this is rather simple. You suffer from time decay, you know that that day-to-day decay is going to be there on your calls. You could close the position if that's starting to reach a point where you don't want to risk further losses. You can hold that position, risk continued losses if you're confident that the stocks going to move in your favor and start to turn around and go higher. If your long calls and the stock moves lower, consider your risk tolerance. What's your pain point, when do you need to get out, do you have strong confidence? You can just hold that position or close it before you experience a total loss on your investment in the calls. Now long puts, and I really want to get to the demo since on the long puts, I'm not going to walk

through this just a couple seconds here because it looks exactly the same as long calls but it's the opposite direction. So really quickly here, remember long puts -- if the stock moves higher that's not good for us. Long puts, we own the right to sell stock, we want the shares to go lower. So if the stock moves higher this is the losing position for us. Consider that risk tolerance, maybe hold it if you think the stock is going to turn around and move lower, or close it before giving back all that premium you spent up front. Stock goes nowhere, it's exactly the same considerations as the long call holder. You're suffering from time decay, do you close and get out before you avoid further losses? Do you hold the position because you're willing to risk the rest of that premium and you're confident in the share price decline? You make the decision there and then as the stock moves in your favor, hold it. Maybe your market outlook is still confident in lower further downside, maybe you're in a position financially to try and extend your gains so you can hold for further profits. Close it, scale it down, start to sell off some of your position, roll -- in this case -- down to a lower strike price. The one big difference here is exercise is unlikely. There is one circumstance when exercising early might come in to fruition that's particularly -- we won't get into it here -- but that's deep in-the-money options when the strike price is far above the stock, that's the situation where early exercise for puts starts to rear itself. But for equity investors it's highly unlikely that you will exercise your long put option.

Instead, you would likely just close that out, sell to close your put option, and move on to the next trade. Exit considerations for options. Sellers now -- we've talked about buyers, let's look at sellers. I mentioned before we're not going to look at naked call options but covered calls, sure. What do you do if the covered calls moving in your favor, it's working out well, stock's higher? Maybe you hold and just wait for assignment. You just let it get assigned. If you do, you will have achieved your maximum gain on your position and your capital will be freed up to move to a new position. You could monitor how close you are to maximum gain with the covered call. You can calculate what's my maximum gain, and when you're really close to that number you can proactively go ahead and close out the position because you're at mostly all risk with very little left potential reward. That's when you can start to do the calculations and maybe close out or rolling up. Again, rolling. Closing one position, opening another. Buy back the short call that you sold, roll up and sell at a higher strike price giving that stock more room to run. You can consider that as well. As stock consolidates, of course, you can always close the position. Buy back the short call, go back to just a long stock position, profiting off that short call. Roll down, buy to close that short call you originally sold, sell a lower strike option. Bring in more premium, more capital that way. That's a consideration with the stock moving nowhere. With the stock lower this is where you're in a losing position, so this is where that stress level might



start to tick up a little higher. What's your risk tolerance? Do you hold in anticipation of the share price moving higher? That has to be true to your market thesis. Do you roll down to that lower strike? Same kind of analysis here. We roll down, collect some more premium, accept the obligation to sell shares at that lower price or just get out. Get out and reallocate your capital altogether. Selling puts, if the stock moves higher this is a good thing for that particular position. You can close when the premium nears zero. Along this mindset we mentioned earlier, is it worth it to hold an options short position for the premium that you're seeing on your screen? If it gets near zero, maybe not. Maybe it's not worth it. Or if you do want to squeeze every single penny out of that, you can hold it in anticipation of worthless expiration. Stock consolidates, almost the same thing. Close when the position nears zero, hold in anticipation of capturing all of that value and expiring worthless. Or possible roll up. Buy to close the strike you sold, roll it up to another strike price, capture more premium, and accepting the obligation to sell shares at a higher level than you originally obligated yourself to. A stock moving lower, if this is cash secured and you want the shares you might be okay with this. So hold in anticipation of assignment, take the shares where you want them. Roll down to a lower strike if you've changed your mind. I don't really want shares here, I'd like them a little lower. Buy to close the put you sold, roll down to a lower strike. Or, if you've changed your perspective altogether, you don't

want shares, you don't like that long share position stock starting. Maybe there's new news out, it's broken support, something may have happened, close the position. Reallocate capital. There's a lot there that I just went through and I realize if you're newer to options you won't be able to repeat most of anything I just said. But hopefully there's at least an idea or some level of comfort that as a stock moves up down or sideways based on the position or strategy you've implemented, there are certain things you consider, all mostly boiling down to hold and do nothing, get out or scale down, or roll the position in some way. Close what you've got, reopen something new. That's what it all boils down to. Konstantin, I think this is another good time to bring up the tools and maybe look at some interesting things like volatility, but key takeaways from the conversation: buyers need price movement in their favor because they're always suffering from time decay, sellers have that advantage of a stagnant or consolidating price being profitable for them. And that's part of what those obligations, taking on obligations in order to have that benefit, come from. And buyers and sellers both monitoring always the consistency of their position against the market outlook and the amount of time or value remaining in the option. That can help determine how you manage your position. So, Konstantin, let's take a look for one last time at the demo and see some live prices in action so we can look at the tools.

**Konstantin** For sure, Ed. It's a good thing that we have plenty of options and technical analysis education out there on display for everybody. So, you know, there was a lot to take in in the last couple of slides. If you want to dive in further into it, of course visit us at [Fidelity.com/coaching](https://www.fidelity.com/coaching). We'll be glad to have you. Ed, a few questions that I'm already seeing that are very popular here on the board that I'm going to answer as I'm demoing. The first question is how do I -- I'm newer to options, how do I place trades? How do I maybe evaluate them if I have never done it before? Is there a way to do that? So, first things first, let's go back to the chart of XME that we have here. This is just going to be my take from the technical standpoint of view and perspective. Do you have to rush out there right now and do something with a bullish view on XME? And the answer, to me, is no. What's the reason? Why? Well, it's come a really long way very, very quickly and so what the preferred thing to do would be -- and this is again, based on personal experience trading is that normally I'm a little early with a call. So it's better to be late in a breakout than to be early. So what you would prefer to see is that the stock consolidates sort of sideways, maybe print something like a bull-flag type of a formation, retest its breakout area to around 47 and a half, 48. And then balances from there, breaks through and continues on its trend. So I want to make sure that this is not a false breakout because if it fails back into the pattern there's nothing bullish about it. In fact, it invalidates the whole thesis. If it fails back into the

pattern it most likely -- out of failed moves come fast moves in the other direction. So, the preferred situation would be retest, maybe consolidate if the broader market is really weak, if it's weaker over the next couple of days but finds a balance and breaks out and continues eventually. So with that thesis, what are we thinking about? What would happen? Well, momentum will cool off in our side terms. Hopefully we'll consolidate on lower volume and then when the breakout actually continues, volume will kick back in or kick back up. Great, so how about the options chain and the types of tools that could help, that we could use to help evaluate what would we be doing. There's some of you probably itching saying, "I've got to put something on today." Let's evaluate it through the prism of the hypothetical options trading tool. Options from the dropdown profit and loss calculator brings you to this tool where you can type in XME, and if you currently do not have any positions on XME it will tell you that you do not. What can I do? Well, I can click this magic button that says, "Add simulated trade." And so let's evaluate it. Let's say that I was thinking about maybe putting something on today, it said 49 dollars and 80 cents, down 40 basis points on the day. Broader market is down big, over two percent, it is continuing to outperform even on the down day. They're both down but down less than the broader market, so continuing to perform. Maybe I'll think about selling a put down below at the levels of where it broke out from if I can't wait to do something right now, to say if it does come in I

would expect it to be support and I would expect a balance there. Sell a put, select a little bit of premium to be brought in to begin with. That breakout area was 47, 48. Hypothetical transaction, let's look at that put going out about a month. Why? Well, because the whole up and down that it did, it took about a month to get to where it is today. So we're looking at a month. I can bring in about a buck 30 in credit for a midpoint price for that put. Sell a put, apply. Now I have my profit and loss diagram and I recognize that the most that I can make to Ed's point is a hundred and 30 bucks. How much can I lose? Well, I can lose all the way down to zero if the stock continues to go down through my strike and lower. So I know where I would have to potentially manage my position if I was wrong directionally. So long as the stock is above 47 bucks at expiration I am keeping all the credit that I received and so long as it's above around 45.50 I'm breaking even. The breakeven point is highlighted here on this chart right away. So great, this is a put option and what I could do is evaluate. Ed, if the price of this stock went up instead of going down, what if it went up to 51 and that happened by two weeks from now by March 4th? What would be the theoretical price of this option that I sold? It is working through a binomial option pricing model and it's telling you that based on these assumptions, the stock went to 51 in a couple of weeks, this option would be worth 40 cents and I sold it for a buck 30. So a nice profit that I'm looking at. So the tool is fantastic, it allows you to play certain

scenarios through. Remember that with calls you would do the same thing. Well, what if I'm buying a call? How about I just do one right now, roughly at-the-money or out-of-the-money. Maybe I'll go out to April instead, and I picked a slightly in-the-money strike to do so, to gain advantage of that nonlinearity of time decay. And I paid a midpoint price so 4.65 for it. A call option, how would it behave? Where is my breakeven point? What would happen if the stock was at 51? What if it was at 53? So forth and so on in terms of gains and losses. A fantastic tool that allows you to simulate a trade, stress test the trade, project winnings, project potential losses, identify if you're comfortable with those losses or not, and that usually leads me to, "Hey, do I have too big of a position size if I'm not comfortable with the losses?" The first thing you do is usually start lowering the position sides instead of -- well, you can't do lower than one contract can you, Ed? But if you were starting with a ten lot and you're not comfortable with the losses that appear on the board in a potential drawdown scenario, maybe the first thing to do is to just take a smaller position size or reevaluate your strike and expiration selection. So we've talked about a lot there. Ed, couple of questions I want to ask you as a pro, as a seasoned pro. Specifically, if I am thinking about the entry and exit strategies, is there a difference in considerations that I am thinking about when trading weekly options versus monthly options? We know that the sensitivity of shorter term options is much

more to the directional movement in the underlying security. So to me, Ed, I think the answer is absolutely considerations should be different. What is your take on that?

**Ed:** There is no doubt about it. Yeah, the attractiveness to weekly options for option buyers is sometimes that they expect short, quick moves and they can pay very little for options. If you're thinking at-the-money versus out-of-the-money options, the premiums drop off so quickly when it's weekly options. For sellers who are thinking weekly options, they're more or less confined to those at-the-money strikes, which is perfectly fine. Those weekly options decay very quickly so sellers are attracted to weeklys for that reason. When you go out, as you just said Konstantin, when you go out further in time you change the dynamics. The premiums of options across the spectrum of strikes tends to spread out more. The element of decay is different, you have that accelerated decay but not the fastest rate just yet. The premiums go up, so yes, the considerations for weekly's are a bit unique for those two reasons. The extremely fast rate of decay but also the fact that premiums as you drop away from at-the-money strikes tend to decline very quickly. Ed, and a couple of other questions that I want to answer quickly, can you trade options and IRAs here at Fidelity? And the answer is absolutely you can. You have to apply for that feature, of course. The highest level of options trading that you

can do in an IRA would be spread trading and, I've got to say this, in terms of management of trades -- in terms of, "How do I utilize option Greeks like Delta and Vega and Theta in my strategy?" Please join us for additional sessions and those coachings that I mentioned. We talk about this stuff every single day, we'll be glad to have you. There's plenty more to this but remember, don't be too quick to press the trigger. Do the evaluation, fill out that trading journal, have a plan, figure out where do you want the underlying to get to before you might enter something, use the simulator, evaluate both the risk as well as the rewards, start with the risk part first. If you pick the right strategy you will be rewarded, but the risk is the thing that we have to be focused on managing at all times, all right? Ed, thank you so much, sir. I really enjoyed this past couple hours. We're going to do, obviously, session three with a couple of option experts and answer questions both throughout the next hour. Very excited for that. Ed, we'll hope to see you again soon.

**Ed:** Yeah, my pleasure to be here and I'm looking forward to attending the next session coming up in a few minutes.

END OF AUDIO FILE



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