TRANSCRIPT

One leg or two: Optimizing your options strategy

Presenters: Matt Davison and Konstantin Vrandopulo

Konstantin Vrandopulo: I'm Konstantin Vrandopulo, he's Matt Davison, we're both trading strategy desk specialists here at Fidelity Investments excited of course for today. Quickly, a few sentences about ourselves, if you are joining us for the first time and not familiar with our team, we are a small team of dedicated brokers here at Fidelity Investments focused on self-directed client education, and specifically, we're of course focused on options trading, equity trading, and in-depth technical analysis. If you're interested in additional education that we do that's virtual, you can find us by going to Fidelity.com/coaching, and if you're newer to Fidelity or newer to investing and you're interested in classroom-type setup sessions that expand out over the course of four weeks every single month, you can find us by going to fidelity.com/classroom. Of course today we have gathered here to discuss whether we're going to be trading a single leg or a multi-leg strategy, specifically we'll be focusing on buying calls or buying call spreads, I'll turn it over to Matt to get us kicked off with the presentation here today. Matt, please talk to us about why would somebody be thinking about a bullish strategy and thinking about using a call or call spread for it.

Matt Davison: Sure, yeah, absolutely. So the first thing that we're going to look at today is the idea of trading a breakout versus trading a longer-term trend. So those are the two different scenarios that we're going to be observing today. In both situations, we're going to be looking at a bullish outlook, right, so in both of these, we're going to be taking this from the point of view of we anticipate price going in the upward direction. Just keep in mind that even though we're considering the bullish side today for the purposes of the presentation, this can go in either direction. So breakouts can occur to the downside, longer-term trends can certainly be to the downside as well, but we're going to focus on the bullish side.

Some factors that we're going to consider throughout the day, so we're going to be looking at time horizon, you know with the breakout, we're going to be looking at something that's more on the shorter-term side, looking at that short burst to the upside looking to capture some of that impulsive movement. Then we're going to also look at the longer-term trend where maybe the time horizon's going to be a little bit more lengthy. Volatility outlook, so you know, we're going to touch on this today. It's a pretty involved concept obviously, right? It's something that we do whole classes on here at the trading strategy desk, and really the reason why is because it takes, you know, an hour

minimum to really just get the basics across, you could probably talk about this for hours on end. Talking about expectations of price movement as well, in this case, we're looking at the upside as we've mentioned. And then, kind of discussing what the tradeoffs are between the probabilities and the risk/reward, so what are we getting in terms of the likelihood of success, versus the leveraging effect, the return on capital that we're getting when we're putting on these different trades.

But certainly, we're going to be taking a look at trading the breakout first and foremost. And again, we're looking at the short-term time horizon here. So first of all, let's just kind of think about what a breakout is. Generally speaking, we're looking at something here that you know, maybe has gone up and touched a resistance point if we're looking at it from the bullish side, so we're going to be looking for that price to go up, and at least on, you know, a two-time basis, going up and maybe touching a certain line, that could be a horizontal line of resistance, could be some kind of trendline that we're drawing, you know, there's all sorts of patterns, rectangular patterns, falling wedges, ascending and descending triangles. These are just a couple of the different things that we have at our disposal in terms of the chart. We be looking for price to go and break out through that line.

Now when we're looking at something like this, really what we're looking for is that short burst to the upside, right? Breakouts can signal a longer-term trend, and you know, theoretically they could keep going forever and ever. But there's also this idea of throwback, right, where we have the breakout to the upside only for price to come back down and touch that original breakout point. So what we're using in this particular case is a long call strategy. And the reason we would do this is because we're looking at a single leg versus that double leg, because it's going to be more sensitive to that price movement. So we do see that burst to the upside, and we see a little bit of follow-through. Maybe, you know, we're looking at something like a momentum indicator, we're using some kind of timing filter, you know, a certain amount of days above the breakout line, whatever that may be, we're looking for that price to increase, and by using the single-leg strategy, what we're getting is a more sensitive option in response to that price.

The other thing that we may be expecting to see in this particular situation is an increase in volatility, and we're going to talk more about that later on throughout the presentation. But effectively, what we'd also be trading here is an increase in volatility, if this is expanding, if volatility is expanding, it is actually helping our trade, it's going to make the price of the premium that we're able to sell more expensive. On the flipside of that, of course a

contraction in volatility is also going to decrease our premium, so we have to be cognizant of what our expectations are for volatility as well, because this can certainly affect the trade.

Now on the next slide here, we're going to be looking at, you know, kind of what the strategy is, give us a breakdown of what the profit-loss diagram is looking like, as well as what our maximum gain stands to be versus things like our maximum loss. So first of all, when we're looking at the long call, it's a single-leg strategy. You know, in this particular example, we're going to be thinking about buying the 100 strike call at a price of $3.30. Now the thing that's not really mentioned anywhere on this slide is what the call gives us the ability to do, and effectively what it's giving us the ability to do is buy 100 shares at our strike price. So in this case it's going to be $100. So this makes it pretty clear, right, it's the concept, the age-old concept of buying los and selling high. So what are we looking for? Well we're looking for that price to explode as quickly as possible to the upside, and the higher and the quicker the better. That's in effect what we're looking for when we're buying this long call. So obviously, our outlook here is going to be bullish. That's pretty clear, we want everything to the upside and in terms of the price action, as far as the construction of the trade, Konstatin's going to show us a little bit more about this here in just a moment as we go through and do some demonstration in

Active Trade Pro. But effectively, we're just buying to open the contract for however many we're looking for.

Now as we can kind of see from the profit and loss diagram, as we're going further and further to the right, this is going to be represented on the X-axis, this is the underlying prices of the security. As this goes higher and higher, this is going to increase our profit. And we can see right there, you know, if this were to keep going, we stop it at 105, we could get to 110, 115, 120, our profit wouldn't stop, it would continue to go up as long as the price continues to go up as well.

Now, on the downside, kind of the beauty of the strategy, right, is we know right from the onset how much we stand to lose, and that is simply the amount that we paid for the premium here. In this case, it's $3.30 per share. We're buying 100 shares, that's $330. That's what we stand to lose, and that's from any point at expiration beneath at 100, or beneath 100. And then we can kind of see there's this range where we're not quite at maximum loss, but we're not really at a profit either, and eventually it's going to cross that x-axis right there at 103.30. The way that we're constructing that, all we're trying to figure out is the strike price, which is 100, plus the premium that we paid, so it's $3.30,

that's how we're determining the breakeven. So that's the basics, as far as the construction of the trade and what the strategy is.

And just keep in mind, you know, as we're going through this, there's a bunch of different approaches that we can kind to kind of tailor a trade depending on how bullish we want to be. So you know, a lot of times we're going to be looking at something and maybe that's at the money, slightly in the money, maybe out of the money, we can do different things depending on how much we want to leverage ourselves, how much do we want to expose ourselves to in terms of maximum loss, going up or down the option chain is going to determine some of those characteristics of our trade. Also the timeframe of the breakout. As I mentioned, you know, a breakout can occur and it can just keep going. We've seen it on several stocks thus far this year, and you know, they've been quite forceful to the upside. However, there's also the possibility of that idea of throwback, which is where we have an initial breakout, maybe it proceeds to do this for a couple days, only for it to come back and test that level that we broke out from.

Now why is this important? You're seeing it right there on your screen. The reason it's important is because with a long call option, we have something known as option-centric risk, right? This is risk that isn't inherent to us if we're

simply buying or selling the stock. If we buy a stock at a certain level, it goes up, and then it comes back down to that level, well we haven't lost anything if we're able to sell it at the exact same price. Maybe the opportunity cost of doing something else with their money that was maybe a little bit better off.

However with an option, there's this concept of time decay. Now what is time decay really talking about here? Ultimately it's simply talking about, as the option moves further and further along on the calendar, if the price is staying the same, if the volatility is staying the same, if everything else is staying the same, the only thing that's changed is we're just moving along in time, well this is going to decrease the value of our option, and we can kind of see some of these Greeks here. We probably won't get, you know, too deep into that, but you can notice that theta which is representing this time decay, it's negative. This is representing the amount that we're losing from our option contract as each day goes by, so we just have to be cognizant of that when we're looking at a long call is it sensitive to that time decay, so if we have it in initial move and it starts to come back on us, it could possibly present a situation where we're at a loss, whereas this would not be the case if we were just buying the stock.

And then the other thing I'll mention here as well briefly is just the delta. And this is kind of the concept of, you know, moving up or down the option chain in terms of the strike price. So, the delta, you know, there's a couple different things that it represents. You know, in the basic sense, it's just representing, if the stock were to go up by one dollar, well how much should the option go up by, that's the first thing. The second thing that we're going to use it for in this particular example is we're using it to measure the share equivalency. So if we're looking at a delta here of 71.443, if that's what our option is saying and we can view this on the option chain, we'll see it in just a moment, this is trying to tell us approximately how many shares this is comparable to if we were to go out and buy the shares, and this is what I mean, we can become more or less bullish, we can spend more capital at the outset of the trade depending on where we're landing on that option chain.

With that being said, we'll probably circle back here to the management of the trade in just a moment. Konstantin, I'll turn it over to you here to take us through some of the things that, you know, we need to look out for in Active Trader Pro, and kind of getting a real-time example of how we might be using some of these concepts.

Konstantin Vrandopulo: Yeah Matt, of course, for those of you who are newer, you probably are hearing a lot of, you know, verbiage that you've never heard before, and you might be feeling a little overwhelmed. Well it's a good thing that this session is recorded so you'll be able to replay it for yourself. But let's start going through a few of the terms, and of course, a few of the tools that are going to help you analyze where you stand and where something might be making sense.

So we're looking, we're going to be looking at the S&P 500 SPX as an example for today's purposes. And so, you know, imagine a scenario where you are looking at the price action, of course today being a down day, you know, you might be looking at something like, okay, where do we pop out, you know, in the most recent history here in the S&P 500, maybe somewhere along the lines of 4700, 4710, and right now we have a couple of down days in a row, so what would you be looking for, right, if you were looking for breakout, well a breakout above this area where we have found some supply against and continuation of course to the upside past that level.

So let's take a look at an options chain here and you can see to Matt's point a little bit earlier why a call option is a bullish strategy. Well in order for you to be making money on the call, you need for the underlying security to be up in

price. Okay, so what I'm displaying here for you today is the SPX options chain, and I'm just going out to the December 31st quarterly expiration here. So we're saying 38 days out, imagine a scenario where maybe the stock market stabilized here, went back up, knocked on that door of prior resistance, was able to see price acceptance above, and we were to see a Christmas rally, right, or a rally into the holiday. So you would notice that on my options chain there's some red numbers on here today, and then red numbers of course are associated with the fact that when the actual price of the underlying is down, you are going to be losing value on the call options that are displayed on the board.

Now Matt mentioned that there are several Greeks, and they're option-centric and non-option-centric risks. So let's talk about that. First things first, I'm displaying options that go from 45.60 all the way out to 47.40 in strike prices. And you would notice on my scree that some of these strike prices are grayed out, and others are not on this black background. That effectively shows us the line, right, the grayed outline versus the non-grayed outline shows us the area where there are options that are in the money versus the ones that are out of the money. That's something that Matt mentioned. So, how do we look at call options from the top down? Well, the lower the strike of a call, the more in the money it's going to be. The further away from the current price of the

underlying security we're looking at a call strike, the further out of the money we'll be. And of course, the ones that are very near or close to right at the money is effectively where the underlying security is currently trading.

Okay, now we're going to take a peek at this delta value. So Matt mentioned that delta, one of the uses of it is to define how much directional exposure do you have in a given moment in time to the underlying securities price. So delta being the derivative of price action, what we're recognizing is that the deeper in the money we go, the more like stock it starts to behave, okay, from the perspective of dollars gained or dollars lost. So if I am looking at a 65 delta option, okay, and I am paying for it $163, I'm having to pay more for that option to gain more directional exposure to the underlying security. And if the S&P 500 was to go up by one point, I would be making 65 cents on this option, all other things held equal.

Now if I was looking at an at-the-money option that roughly has a delta of 50, then it would cost me less, right, $88-89 instead of $163. But for every one point of increase in the underlying security, I'll be making 50 cents. Okay, so less directional exposure with at the money, and the further out of the money you go, more directional exposure, the deeper in the money you go.

Now delta has some other uses, but recognize the fact that the deeper in the money you go, the more directional exposure we gain, part of it being from the fact that that option is probably worth something intrinsically, or it should be worth something intrinsically, if we are in the money. The in-the-money factor tells you that besides the extrinsic or time value in the option, there's something else that we can count on. And so the computer is doing the math for you. So we got intrinsic value column here, and the time value column. And you would notice that the largest amount of time value is actually allocated right at the money for options. The deeper in the money we go, the lower the time value gets, and the further out of the money we go, the lower the time value gets. The deeper in the money we go, the more and more intrinsically that option is worth, which is basically taking the strike price, right, and subtracting out the current price, or subtracting the strike price out of the current price of the underlying, to give us that intrinsic value that we can actually count on. It's either there, right, or it isn't. Towards the end of an option's life of course, it is either going to become stock, right, or it's going to transform and paid out in cash of whatever it's worth intrinsically, or it'll expire worthless. Because there are only two things that could happen effectively, right, towards -- or at the end of an option's life.

So talked a lot about analyzing this kind of hypothetically and how to read the options chain from the perspective of your exposure to direction, how much in premium you're paying for it, how much intrinsic value there is, versus extrinsic value. How about a tool that is going to help me analyze all of this, all right? Let's imagine that I did pick an in-the-money option, right, to go along with maybe an example that we used in the long call scenario. And I said, what if the time came and there was a breakout in the S&P 500 and I wanted to participate in that breakout once I got a confirmation above, right, the price acceptance above a certain level. Maybe I'm going to utilize the options chain in the profit-and-loss calculator to evaluate a few scenarios.

So let's say that I did go down to the 65 delta option. I'm going to click on this little menu button here, I'm going to pull up the options analytics field, and I'm going to go to the profit-and-loss calculator. Now notice what happens when the tool is brought up. Well we're building out a hypothetical transaction. I'm buying one call to open the 31st of December strike, $45.60, and I am paying, let's say a midpoint price of $162.75 for it. All right, so I went ahead and built this out, and what we're going to do is utilize this tool to evaluate what our potential scenarios are going to be, right, play the wizard with it. Meaning, what if the underlying security goes up in value, but what if it goes down in value, and what if a few things happen to implied volatility, to the supply-and-

demand equation. I'm going to bring back the chart, and I'm going to apply a volatility indicator onto this chart and show you, volatility, HVs, IVs, VOL. So you would notice that there is a dynamic between price action generally speaking in the S&P 500, and this could be unique, right, to this underlying. You know, so you have to kind of observe it through history and see if you could see, you know correlations of any sort, right, what happens to implied volatility, this orange line, when prices go up, versus what happens to implied volatility when price of the underlying security actually goes down. So in the S&P 500, it seems like there's an inverse relationship here based on the most recent history. When the price is down, implied volatility expands, and when price actually goes higher, implied volatility tends to contract.

So remember that we are, from the profit-and-loss calculator perspective, we are actually long volatility. Remember that we would prefer volatility to expand. So Matt made a point a little bit earlier: what if I'm actually bullish and I am buying expanded volatility, and the underlying security does go up in value as I expect it to, but at the same time, volatility contracts, right? Could I still make money? Well potentially, right, but it's gonna depend on how much that volatility contraction is going to dull the effect of the expansion of your delta in that option.

So let's take a look at this 4560, and I'm just going to play the wizard and say, you know what, what if we go to 4740, and it's going to happen by the second week of December. Okay, let's say December 8th. And by that time, implied volatility from its current value of 18 or so, is going to come down relative 10%. And I'm just using random numbers here, markets break out to brand-new all-time highs, a few weeks pass, and implied volatility contracts a little bit from its current value. Let's go ahead and hit enter. Okay, well it looks like I will still be making money on that day, $3,553 to be exact, right, versus how much I will be making at each individual level the higher it goes, and you can see that propensity of a call to continue to make money the higher the expectations for the S&P 500, essentially to brand-new all-time highs, into unchartered territory.

Now, it does come with a caveat that we could be wrong about direction, and we could be wrong about implied volatility assumption, right? What if the underlying security actually goes down in value? So let's go ahead and, you know, maybe suggest, it's currently at 4460, how about it loses 60 points from this current level, 4600 by the same date, and maybe implied volatility instead of going down 10% actually expands 10%. How bad of a loser will we be looking at if that was to happen? So essentially we know that we will be making money, or we'd prefer for the underlying security to be going up, and

for it to be going up by a certain amount over what the dulling of implied volatility contract would do to it. In that case, it would be making money. And if the underlying security goes down, of course, we'd be losing money, and remember that this is the S&P 500, you know, CBOE proprietary contract, each contract represents $466,000 worth of notional value, therefore the contracts are expensive in premium terms relative to that notional that they represent, right? We're talking about $164 for each one lot, which equates to around $16,400 in individual dollar terms per contract, all right?

So Matt, utility of the options chain recognition, how much exposure am I getting through the prism of my delta maybe, right, on the onset? Recognition of the fact that time only goes in one direction, and this option is never going to be the same, each day that passes is going to be changing its characteristics, because, right, we cannot stop time. Implied volatility is changing based on the supply and demand equation in the marketplace. And the price of the underlying is moving around. And so this tool allows us to look at the potential scenarios of profitability as well as where our risk is going to be, right, given those changing parameters and factors to help you evaluate the trade based on its risk/reward to help you maybe evaluate the trade on its risk/reward according to the size of the trade that you were thinking about, before you actually place it or put it on, okay?

So we're going to hop back over into the screenshare portion here, jump back over into the PowerPoint. And you know, remember that again, placing the trade is probably one of the easiest things, and I'm going to show you how we're going to place the trades once we discuss the spreads, as a secondary strategy in our case here.

Matt Davison: Exactly, and yeah, we're going to jump right in and talk about, you know maybe, what if we're looking now instead of that shorter-term breakout where, you know, we had that burst to the upside, maybe you know, we're still expecting bullish potential, but it's going to keep going forward on a more longer-term basis. Well, the main that we're thinking about here if we're doing this, maybe it's because we want to buy a longer-term option. Naturally if we're buying an option that's further out in expiration, this is going to cost more money. Well what naturally is happening when we're buying an option that costs more money? We're expanding our maximum risk, right? We said that at the beginning when we're buying the single leg, whatever we pay for the trade, this is our maximum risk. Well if we're going out further and having to pay more, that is now increasing.

So what we can do potentially if we want that longer-term options, we want that exposure, but maybe we're not willing to pay that price. Maybe there's some other way that we could do this, and this is where the second leg comes into play, right? This is where we're going to go in and potentially sell an option against the long leg that we're buying. So the setup here as we can see, our outlook is still very much bullish. However, we're buying a certain leg at a lower strike price and then selling another leg at a higher strike price. And in this case, we're typically looking at the same date. You don't necessarily have to do that, but for the simplicity of the example today, we're just looking at a similar dated option.

Now, what's happening here? Right, the net cost of the trade has been reduced. So initially in this case, we were buying that 3.30. Well now let's say we're selling a 105 strike call against that $100 strike option that we're buying. In this case, we're able to do that for $150, so that's going to actually reduce the cost of our trade. And we can see that this is still going to be the maximum we can lose in the trade. We can see on the left-hand side no matter how far we keep going down in terms of the price, our maximum loss in this particular case is only that $180. Now this is where it gets a little different than what we formerly had. By selling this leg against our long leg, what have we also done? Well we've capped our upside, and we can see that now on the right-hand

side. In the first example, and what Constantine was just showing us there, I mean you could see the exorbitant numbers that started to exist as it goes up to, you know, $5,000, $550, all this stuff on the S&P 500. The numbers got pretty extreme, and you participate all the way up there when you're in the single leg. In the two-legged strategy, this is not the case. You are capping your upside, so there's going to be a certain point where this trade is no longer helping you. And in this case, it's going to be wherever that strike price is at expiration, whatever the strike price of the leg that you're selling, this is where you cap yourself, right? So you know, typically you're going to buy this in the money and sell the out of the money, but just like with anything else, there's different ways to move up and down the option chain to make yourself more bullish, less bullish, increase your probability of profit, just like with the single leg, you can adjust this to tailor to your specific strategy. But the main thing that we're giving up here is that upside.

Now we're also getting something else in return, and that something else is going to be the fact that the spread is going to move slower. This is a good and a bad thing, right? It's not going to be as sensitive to the price action, and the reason why is because we're offsetting some of that option-centric risk. We're also offsetting some of our delta. We talked about that delta, well now we're putting negative delta into our trade so it's not going to be as reactive.

So if we do happen to get it correct and it starts just absolutely going higher and higher, it's still going to help our trade, but not quite as much. This is also a good thing on the downside, however. So if we start to see the price go down and down and down, this is inherently a bad thing for a bullish outlook trade. However with the spread, it's not going to quite hurt quite so bad, whereas with the single leg, it's going to be much more sensitive. So that's kind of the tradeoff between, you know, the one- versus the two-legged strategy is this idea of, you know how much am I paying for my trade, how fast is it going to move, you know, am I limiting my max loss, but I'm also giving up some of the maximum gain. So these are just some of the thoughts that we need to think about when we're considering the one leg versus the second leg strategy. And Konstantin, I know you probably want to jump in here and throw in some thoughts as we move to the next slide on the double-legged strategy. Take us away.

Konstantin Vrandopulo: Absolutely, Matt. Look, you know, you're making some great points here. There is, if we're selling an option against the one that we're buying, there's something that we're gaining and there's something we're giving up. So the best way to evaluate it or to compare the two strategies is to build them out side by side, right, instead of hypothesizing about it verbally, looking at what actually transpires in your account, if certain

scenarios were to occur. So first things first, we talked about the fact that we chose an in-the-money option, in this case, a 65 delta option at 4560 while the underlying is trading at 4660. So this option is intrinsically worth 100 points right now, and we have to overcome the $66 of time value or extrinsic value, synonymous terms, right, in order for us to make money. So notice that our breakeven point is highlighted here by the computer right away, it's effectively the difference, right, of that extrinsic value on top of where the underlying is currently trading, that's where we break even, and the higher we go at expiration, the more money we'll potentially stand to make.

So let's build something out that might move a little bit slower than a single leg. So, I'm going to do a spread, and I'm just going to be clicking on the buttons here from the dropdowns, the computer is smart enough of course to recognize that you'll be buying one option, selling another. I'm going to keep it in the same expiration cycle, so we're going to click on the December 31st expiry. And you know, what we're going to go is we're going to say, what if I believed that the market before the year end is actually going to top out somewhere around the 4800 level, and I am just picking a random price because we have never been trading there before, the top in the market just yesterday was 4740, or thereabouts, right? And we've never been as high as 4800. So let's say that we thought that the market will go to 4800 and it will

stall from the current level. Could a spread strategy work in that situation? So, 4560 is my long strike, and 4800 is going to be my short strike. By buying one and selling another, I am reducing the cost that I am paying. So let's build this out. I'm buying the one that is worth $166.80 right now, and I am selling the 4800 for $26.30 at the midpoint. I get the net debit, now my price was reduced to $140.80, I'm going to go ahead and apply it. And we have two trades built out. As you can see, that our profit and loss diagram is essentially equivalent through the way it's constructed, right, to what you saw on the previous slide. There's a cap at the top, and there's a cap at the bottom. The maximum amount that we could lose is what, the premium that we paid for the spread, which is $14,000. No matter how low the underlying security goes from this point, that's the maximum that we could lose. What do we also do, however? We also capped our upside potential. Where do we cap it? Well, we have a spread that is $45.60 by 4800. And we paid $140 for it. So we're capping our upside potential at around 10 grand. So whatever I am paying in debit plus the long strike that I have, okay, is what I need to overcome. Once I have overcome that at 4700, up to 4800 is the additional profitability on this trade through expiration. So 100 points is the maximum that I can make. I capped my upside potential, but what I also do, I reduced my cost by around $22 versus a single leg.

So how is this going to play out, right, if the underlying, again in a similar scenario, goes to 4740, as we managed it in the previous example there, and it happens by that second week of December, and implied volatility maybe subsides by 10%. So bringing back up our profitability graphs. Well if that was to occur and I was in the spread instead of a call, I'll be making approximately $2800 in profit. How much would a call alone be making? $3300, so it's doling your appreciation to the upside if the underlying does in fact go up. But what is it also doing? What if it goes down, right, from the current level to maybe, you know, a few points lower. So we said, 4600 or so. And in that timeframe, the implied volatility maybe rises by 10% instead. Our long call option is losing $5200, but our spread is losing only $3700. So it's slowing down, right, your losses, if the underlying was to go down, and volatility was to expand, and it's also slowing down your gains if the underlying went up and volatility contracted. So you get a decision, you have a decision to make, look, which one is a better strategy? Well we would only know that with the benefit of the hindsight, there is something that we gain versus something that we give up. There is obviously, you know, more risk from the perspective from the net outlay of capital in a call option versus a call spread, because we're reducing our cost by the amount of premium that we're bringing in for selling that cap away, right, but it's not going to be a strategy that will do well in the down

market environment either way, because we are still bullish, we still have bullish deltas, we have, you know, long exposure, there's just less in some.

And what is also true is that we have lessened our option-centric risks, things like time decay, we have slowed it down a bit, because if time was to pass, we would be losing some time value in the long leg, but we will be gaining some time value in the short one. In the long leg alone, we are losing time value, essentially for what it's worth, right, in theta terms. So we're decreasing our option-centric risks, we're giving up some directional exposure for that, we're paying less in capital, compare and contrast the two and decide which strategy fits your investment objective, your risk tolerance, your financial situation, which one makes sense, okay?

So back over to the slides here, Matt. Before I actually do that, I just want to make sure that everyone is aware, you can very simply trade these strategies as well. I wanted to put on the spread, I built this out in the profit-and-loss calculator, look, I want to buy this, click on the ask price. The tool prebuilds the spread strategy, all you've got to tell it is how much in debit you're willing to pay for it, you're buying one option, you're selling another, preview place, just a couple of clicks, all right? You could do the same thing of course by hitting the "offer" button here on the calls, and that is going to pre-build a

single-legged trade ticket, right, so I'm buying to open just the one call by itself. Got to tell it how much you're willing to pay for it, preview place. So very simple, and remember that you could also trade these strategies directly from an options chain as well. Hey, these buttons are active. I'm going to click on the offer price here, same thing is going to pop up, the trade ticket. What if I wanted to trade the spread instead? Well maybe I'm buying this one, and I'm clicking on trade and chain, and maybe I'm going down instead of selling the 4800, I'm going to be a little bit more aggressive and sell the 4740 against it. Well here's the spread down below, trade in the options chain by clicking the offer or the bid, offer for the one you're buying, bid for the one that you were selling.

All right, excellent. Matt, back over to the slides as we have just a couple of minutes left here to wrap this up. Let's talk about the key takeaways, right, that we're learning here. What's important? Well, we need to make sure that we're not utilizing a strategy just because we've been doing it over and over, and that's the one that we're gravitating towards. We're going to make sure that we're choosing the strategy that fits the outlook that we have. That outlook has to be bullish, right, a little bit maybe more bullish-neutral in the bull whole vertical, all right, than it is for an individual call by itself. Some of the common pitfalls that we're seeing, well not having an exit strategy, that's

so important. Not having an exit strategy means what, you did not utilize the profit-and-loss calculator, and you did not stress-test yourself for the scenario where you were wrong. Hey, what if this thing goes down, do I have to lose a hundred percent of what I paid? No, there has to be a point at which I will be planning on taking losses off the table because market-generated information is telling me that I was wrong for picking either a full outright bullish, or maybe a bullish with slight neutrality strategy for it, all right?

Selling the additional leg to stop the losses on the long leg, so this one is interesting, Matt. This one is something that's called, legging into a spread, right, so I bought a call, I guessed the direction incorrectly, the price of the underlying actually started coming down, and maybe as it's coming down, I am not really getting the benefit of implied volatility expansion along the way with it. And so what I'm going to do is I'm going to leg into a spread now, right? So if it wasn't a part of the original plan, and you were changing the structure of that trade, understand that if the market was to turn around or the security of your choosing was to turn around and actually go back up, you now have a very differently-structured strategy on than you started with, right, when you were doing a call by itself. So it's important to be adjusting the strategy based on your new outlook with the realization that if your original outlook was to still play out in the timeframe of your choosing, you're going to

be faced with other decisions, right, or other circumstances that you would need to making decisions on. It's all about effective and efficient decision-making, it's all about doing the analysis and making sure that whatever steps you're taking, you're not taking them to just click a button, right, not trading for the sake of trading, but trading for the sake of adjusting your outlook.

Matt, a few key takeaways for you sir, some other thoughts that you want to share?

Matt Davison: Yeah, absolutely. So I mean, as far as what we covered today, hopefully we started to introduce these concepts of the option-centric risk, so some of these things were the time decay or outlook on implied volatility. And then there's still, you know, regular risk that's involved, such as what's the actual price going to do. So we need to be analyzing each of these things. You know, if you were attend our options four-week class that we do, we talk about this in the risk management, we talk about the three-pronged approach, well those are the three things that we're talking about. So we need to have outlooks, not just for price, that's a very important one, no doubt about it, but we need a time horizon, we also need implied volatility outlook. And then we need to use all of these things to generate the reason for our trade and try to justify if our risk is worth the reward that we're getting, or vice versa.

All right, so looking at single-leg versus two-legged option strategy, you know, there's -- the circle's on the same thing. There are different tradeoffs for both. We talked about the fact that if you're rewarded for the price action being correct, this can be really nice, it can very enticing on the single-legged side, because it's going to go faster. But at the same time, it can hurt just as fast, right? On the double-legged strategy, well we're not going to get that benefit of it moving quite so strongly to our direction if we're right, but it also doesn't hurt as bad, and these are the things that we need to be evaluating, is the reward versus the risk.

And finally, you know, we have all these tools. Konstantin did a great job of taking us through the profit-and-loss calculator. I know personally for myself whenever I'm putting on an option trade, it's something that I'm utilizing, not just when I'm in the trade but actually prior to going into the trade, because this is how we're determining if our risk-reward balance is correct, and this helps us decide what the actual trade is what we want to do, we can compare different strikes up and down the chain. What happens if you know, price does this and volatility does this by this certain date? Well that's not going to be something we just know offhand. But the tool can help us understand what it might look like, and what it'll be. And then once we're in the trade as well,

we can actually take a look and see what all these different outcomes are. So that's one of the tools. There's many others that we have available on Active Trader Pro, so make sure that we're utilizing these are we're going through planning our trades and once we're in them for risk management tactics.

Konstantin, I know we're at time here. Any final thoughts that you wanted to leave us with before we go out?

Konstantin Vrandopulo: Certainly, Matt. You know, this risk/reward balance is going to be my last comment and my last thought. What does it really mean, right, this risk/reward balance? Well, I want to make sure that everyone is taking away a point that we were trying to make or trying to allude to throughout the presentation is that there's no silver bullet here. It's all about not only knowing where the underlying is going to be, but how effectively is it going to get there, how much time it's going to take, and how market participants are going to be reacting, what sort of actions are they going to be taking, right? Is implied volatility going to be expanding, or is it going to be contracting throughout? So the only way to know what the best strategy is is with the benefit of hindsight, or if somebody invented a time machine, right, so we can move into the future and figure all these things out, neither one of which obviously exists at this current moment. So what I would engage you in

is by evaluating risk/reward, what you want to be thinking about is if you are right on the outlooks that you have, direction, volatility, time, are you actually getting paid enough for you to take on the risk that you're taking on? And if the answer is no, then you probably want to be adjusting the construction of the trade somehow, whether it's picking a different delta option, moneyness, right, for an individual single leg, or constructing a spread, right, with the appropriate approach as well. Take care everybody, thank you so much for attending. We hope to see you again in our upcoming sessions and webinars.

END OF AUDIO FILE