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Professional insights for options trading: Questions and Mistakes Options Panel

Presenters: Konstantin Vrandopulo, Colin Songer & Andrew Rakowski

Konstantin Vrandopulo: Hello, everyone. Welcome back. This is session three of the special February event. I'm Konstantin Vrandopulo of Fidelity's Trading Strategy Team. We are, of course, here with a panel. I have a few friends and colleagues with me or alongside me today. We're going to be covering some of the more commonly asked options related questions there will be questions that will be answered by, uh, some dedicated brokers in the background. So, utilize that. You obviously have a way to take a survey. We would appreciate it if you did that towards the end, towards the backend of the presentation. We love your feedback regardless of whether positive or negative. We want to get better going forward, we want to hear what it is that you're interested in learning more about. And of course, don't forget that the trading strategy team is a small group of dedicated brokers here who I'm a part of that focuses on client education. We spend a lot of time in live trading coaching sessions. You can find them by going to Fidelity.com/coaching as well as classroom-type sessions with dedicated material for four weeks out of every month, Fidelity.com/classroom. There is no way that we can learn all about options even in three hours that we've had today. We're just scratching the surface.

But if you want to learn more, you're always welcome in those additional sources that I just mentioned. So, without further ado, all of that out of the way, I am very excited. Colin and Andrew are friends and colleagues; we've known each other for many, many years. Guys, welcome in. How are you guys doing?

Andrew Rakowski: Good, thank you.

Konstantin: Excellent. Well, why don't we get this kicked off? So, the first most common questions, or I guess the worry, that I get asked quite a bit is Konstantin, what are some of the more common mistakes that traders tend to make? So, guys, what, in your experience working with clients throughout the years, throughout the many years that you've been in this business, what do you seem to learn towards as some of the common mistakes?

Colin Songer: I'll go first, I'll jump in, kind of break the ice here. So, thanks everyone for joining us here today. I really appreciate the opportunity to speak with everyone. That's a loaded question, most common mistakes. Here's a few, I just listed off the top of my head and from my experience of not only speaking with clients but doing it myself, I've done this, which is not having a game plan for each one of the trades. Now, when we mention game plan a lot of times people just think of one side of it: What do I need to get into and how do I make money? That's it; that's how they get focused on it. Which, okay, that's part of it, you know, finding the right security, finding the opportunities. Yeah, that's part of it, but that's not the essential part of it, right? Knowing where to get out, what vehicle am I going to use, when to get in. All of these are important pieces of that puzzle that you want to answer before you jump into any trade. Most importantly, where am I going to get out if I'm losing?

I want to, when I'm winning, because that's the answer that everyone wants to answer, not the one they don't want to answer, which is when I'm losing, when do I need to get out? I would say that's probably essentially the top one that comes to mind. But another piece of that puzzle — it goes hand in hand, granted — which is holding onto losing trades for too long. That happens so much. I've done it myself, but I've learned to stay away from doing that. And that's all about discipline; naming before I get into that trade. And for me, that's important for me, which is I need to know before I get into that trade, where am I getting out. I use this question, use it if it helps you: Where am I wrong? That's what I ask myself. I have to answer that before I get into a trade. So, with that, it helps me be disciplined and it keeps everything else in check. And when I say everything else in check, I'm talking about my emotions. That really gets to be a problem in my trading.

So, I use that discipline to make sure I keep everything in check. When I get that little pit in my stomach, especially on days like today if I'm bullish and it's going against me like today, I get that little thing in my stomach and then I look at my game plan. Yes, I write it down. I have a notebook. Yes, with paper, yeah. I know that's like artifacts, right? Etching in stone. But I will write it down and that way it holds me to it and that's how I keep myself disciplined. So, those are just some of the common mistakes that not only have I noticed, I've experienced myself. I don't want to cover all of them because, look, we have a whole webinar, one-hour webinar based on most common mistakes, so I don't want to cover them all. And I know Andrew's got a good list, so I'll pass it over to him.

Konstantin: So, Colin, you know, I have a trading journal as well. I talked about it in you know, the first session that we did with Ed today. It's so important, right? It helps you first of all, write down your thoughts, make sure that you have that trading plan and the structure for it. What is the criteria for entry and exit? It keeps you honest, helps you stick to that trading plan throughout, helps you evaluate the mistakes that you were going to make naturally, right? You will be making mistakes without a doubt. But it helps you go back and say, hey, what did I do wrong to make sure that maybe we won't do that same mistake or try not to do that same mistake again. But Andrew, I want to take your take on this. So, Colin alluded to the fact that we, as traders, especially in the options world, really need to be focused on the risk first, profit second type perspective. Thinking about limiting our risk and if we pick the right strategy to begin with, we most likely will get rewarded. What do we do if we're wrong? Do you help clients with that?

Andrew: Yeah, absolutely. And I would say it definitely fits into what Colin said. It's all part of the strategy; what's my exit strategy if I'm wrong? What's my exit strategy if I'm right to some degree, too. When do I want to take some profits and then let the risk run? Play with quote unquote house money as they would call it. And with options, because of the leverage, you can really lever up. So, with options, it's a little different obviously. It's a time-based instrument that every day that nothing happens, it's working against you because of the time decay. It could hypothetically work for you if volatility increases due to the overall market or earnings that are coming up, but I caution most traders to say, hey, what's my exit point from a profit capture or limit my losses, but also a time-based strategy. If I'm buying those one-month options like Konstantin, you showed at the end of the last session, you showed two strategies, selling the puts to capture some of that time decay or buying calls for the unlimited upside, when am I going to review that strategy to say, hey, you know what? Two weeks have gone by and the stock or ETF that I'm looking at hasn't done anything. And I've lost a little bit of money because time decay has happened. So, I would say a common mistake is clients going out too far in expiration depending on what their outlook is because the longer you go, the less price-sensitive it's going to be. But also, then going out too far in price. I'm never going to tell someone not to buy a lottery ticket, but it's not a high probability practice.

And many clients that I talk to, and I fall into the same trap where I'm like, all right, you know, stock's trading at 20, I think it might go to 25 in the next three, six months. I'm going to load up on the 25, 27 and a half calls because it's a low volatility name. I could buy 50, 100 of them at 20 cents. What are the odds that you're going to see a 15- to 20-percent increase in that time and really hit your breakeven? So, that's another thing that I kind of coach people to think about, is hey, what's the price that you think that this stock could potentially go to either based on your technical analysis or fundamentals? That's probably not the strike price you want to be buying, right? Because if you think it's going to go to 25 in the space of a month, I'd probably think about buying something a little deeper in-the-money to get a little more bang for your buck or a little more delta exposure.

One other thing that just kind of comes to mind and it's pretty common is just following other people's plans without thinking about how does it fit into my risk tolerance. Really popular, there's numerous different option strategy kind of emails and newsletters. I would just say regardless of who the author is and what the history of performance has been, just take a step back and say, hey, is that the type of risk that I want to take for the potential reward? And that goes into strategy matching outlook.

Konstantin: So, Andrew, what I'm hearing from you, is this point which is very, very important, it's really crucial, is that if you are following someone else's plan, whether it's a newsletter or social media outlets of some sort, you've got to make sure that you make that trade your own. And making that trade your own means that you need to recognize what that trade is trying to accomplish, what the outlook is, is that trade structure appropriate for that outlook and only then place the trade if you actually are in agreement with all those things. Don't blindly follow anyone into dark tunnels, right? So, guys, there are I'm sure a lot of audience members today who are newer to options trading. And a common question that I get from our newer options traders is, what is the best strategy? And my answer on the trading desk usually is something that goes along the lines of, hey, if you can tell me exactly where something is going to be at the exact time in the future and not only where it will be, but how it will get there, I can give you an answer on what the best strategy will be. But nobody has a time machine, nobody knows exactly what the future is going to bring. We have to make some assumptions. So, for those newer members or newer traders who are either just starting out or thinking about starting out, what maybe are some of the common strategies that you guys feel people can actually start out with to dip their feet in the water?

Andrew: Yeah, I'll start, and we can kind of switch back and forth, Colin, I guess. I'll leave some ideas for you though, I promise. I would say start small if you're a beginning trader. There's no shame in buying one or two contracts and just kind of feeling it out. Directionally trading. I would look at minimizing perhaps that time value or premium over parity as it's called. So, you know, hey it's a 50-dollar stock, I don't want to put up five grand on 100 shares, why don't I maybe buy the 45 calls at five and a half or something like that, where you can quantify what your breakeven's going to be. Hey, I only need the stock to go up 50 cents to overcome that. That's an easy way to kind of dip your toe into how do options act. That's going to act very much like the stock; that is really a kind of stock replacement strategy. One other very common, I would say the most common, strategy for beginning options traders is the covered call. And I know that you guys covered it in your first two sessions, and that's just generating some income today for the potential obligation to sell your stock at a set price anytime between now and expiration. That's a good way to kind of get a feel for how options act when stocks move up and down on the short side.

The key with that is you have to know that you'd be potentially giving away some upside for that premium that you're paid today in the option. So, for some beginner clients, I'll say, hey, if you want to kind of jump into the covered call and you have 500 shares, maybe start with writing one covered call. If you own the extra 400 shares above that strike price, great. If not, you generated a little extra income. Those are two pretty basic I would say. You could use puts too, like you guys covered in the second session, but I'd love to hear what Colin's thoughts are around kind of beginner strategies, I guess, for lack of a better term.

Colin: Andrew, that's why you're the expert, right? You hit it right on the head. It's really the most common that people come across is those covered calls. And they do. I love the idea. Hopefully everyone heard that because it's a wonderful idea of how to dip your toes in there. You don't have to cover all your shares to bring in that income. Just try one; see how that does, does it react as you expect it to? And that way, you still get the appreciation of remaining shares are out there. So, wonderful idea to do it. So, I'm going to take a step back, though. I am going to make a little difference here because yes, the most common is the covered call. Also, they will play that directional, usually buying calls, buying puts. But from my experience, usually when they go down that road, when they lose all that premium because they don't have that experience with them, it gives them a sour taste in their mouth and sometimes they don't go back. You've got to realize, losing's a part of trading. You're going to lose and there's that learning curve, right? When you lose that premium, you're like, okay, now I know how it reacts. So, that's going to lead me to my answer, is not really going to be strategy-based, so can that education. There's a boatload of education out there. And when I say a boatload of education, I'm talking already here available to you, the clients. We already have a built-out learning center, we have experts like Andrew here that we have the ability to get access, to learn from. We have the Trading Strategy Desk. I've been to their sessions; I love them. They have the daily market briefing, but they break down these strategies and they give you perspectives on how to view them. One of the things a lot of people go into these strategies and get that sour taste, they don't understand the options. They don't have a good grasp of how they work. So, as an example, with covered calls, some pieces of the puzzle that people aren't aware of, you can be assigned early. It doesn't have to go all the way to expiration. As soon as you can sell that, boom, you could be assigned.

It doesn't even have to be in-the-money. Now, even experienced people aren't aware of that. Does it happen? Hardly ever. But it does happen. And that's something to be aware of and we want to be cognizant of that when we go into these trades. I need to be willing to be able to let go of those shares. If I'm not willing to sell those shares, it might not be. I'm not saying it shouldn't be. It might not be the strategy for me. It might still be, right? I still might want to manage it and maybe close out the calls if it does go above the strike. But you're at a disadvantage because if it goes above that strike, guess what? Well, that's max gain on the strategy. That's what you want to happen. But now you're managing like it's a losing trade because it got above that strike. You want to set expectations of what that strategy does. Now, you're setting a foundation to put yourself in a better position. Now, one other aspect of this when we talk about the strategies and the education, Konstantin showed us a really important tool, is that profit/loss calculator. I can actually mimic some of these trades in there, see how they react. Now, I can say, okay, can I stomach that? When it moves and I bought, like Andrew said, a lot of calls, right, when I loaded up, I got 100 calls, how much would I have lost if this happened? This calculator's going to show you. And go with your gut. Because trust me, I can't trade all the approaches on there, can't trade them all. Why? Because I can't stomach the risk of some of the trades because the amount of capital I would be losing. I might not have that risk profile. If I can't stomach the risk, you're going to not be able to manage it in real life. In real life, it's going to be much worse. Because as much as I want to sit here and tell you, don't let your emotions get involved, they will, and they will steer you wrong. So, we want to make sure we put ourselves in the position that we can manage those trades and use strategies we are familiar with by leveraging the education that we have, the coaching sessions, leveraging representatives, and even experts like Andrew to be able to get a better understanding so when we do choose a strategy -- there is no such thing as the best strategy, everyone wants to believe that, I wanted to believe that when I first got involved, it just doesn't exist. Why? I don't have access to hindsight. If someone else does, that'd be great, you let me know, I'd love to chat with you. But the fact is, me as a trader, I don't have access to it. And I loved how Konstantin phrased that, is assumptions. We've got to use these assumptions and we have to create these assumptions based on what we're seeing. If I have a logical approach to creating these assumptions, I'm putting myself in a better position. And being honest with yourself. If I'm going to use a profit/loss calculator because it retains a position in Active Trader Pro, it will retain it in there until it expires, or you remove it. You can also put inputs in there to see how it reacts. These are giving you a way to be able to have a better understanding, see how they maneuver, and is this what you expected. I feel that that gives you some insight of, okay, can I use this as a vehicle for me?

Konstantin: Speaking of which, I guess it would be important of me to maybe screenshare that tool for those folks who did not attend the previous session. Where can you find this tool? Let me jump in there. Options at the top in Active Trader Pro, select the profit and loss calculator, and it brings up this tool, I'm just going to maximize it here. We were looking at XME in the earlier session and you can see that my simulated trades, they're built out still in here. We're thinking about maybe selling some March 47 strike puts or buying some 47 strike calls out in April. How do I add additional simulated positions?

Click on that simulated button and type it in as if you're filling out a trade ticket, all right? So, a very, very good tool; one of the most powerful ones out there. Guys, while I'm on this concept, this tool allows you to evaluate the trade before you place the trade in real terms. If you currently have a position on something, it will actually show up. If you have a position in your account already, it will know that you do, and it will help you evaluate what you've got. Can you add something else and evaluate that in context or in contrast with what you already have? Absolutely. Fantastic tool, one of the most powerful ones. I love it as well. Guys, while I'm on the screen share, what other tools do you find to be useful? What are some of the go-tos for you guys?

ANDREW: So, for one, I would say you're looking right at it. For position management I have another screen over to my left that I'm looking at. I have a position up that I own that has five different line items in it. What I like this for is, Konstantin, if you just click on summary right at the bottom of the two strategies, it's going to pull it all together. So, in this case you create a synthetic stock with a stagger of a month. But as you get into it and you have some covered calls and then maybe you sell some downside puts if the stock comes in or then you buy upside calls or you get into some funky straddles or different types of strategies, what I like to do is I'll look at the delta and be like, all these really smart trades, what have I accomplished? What's my exposure? What does this equal to if I owned that many shares of stock or what does it equal to in shares of stock? And then when you really get in, to Colin's point, around education and understanding options and the different aspects and implications, the gamma, the theta, I like to look at theta. So, how much am I paying for this position or how much am I earning? So, if I'm short premium, short options, what am I taking in on a daily basis, if I have the positive gamma, I bought some of the cheap upsides that I'm trying to really hit a homerun, how much is that costing me on a daily basis from a theta or a decay standpoint? So, that's one of my favorites. I also like to look at that options statistics within this option analytics just to get an idea of what's the market doing. So, XME, if we just looked at volume — and I don't think just volume calls outright versus puts is always the best way, you want to get into more detail, was it a spread, etcetera — but, I mean, this traded 20,000 options. Usually, it only trades 5600. In this case, it had a call-to-put ratio or a put/call ratio, one call to four put. This, at a first blush, would be a bearish put/call ratio. Four times the number of puts that are trading to calls. Traditionally, it trades about a one-to-one. So, I'd be like, all right, maybe I want to take a look at today's biggest trades and what actually happened. And in this case, I don't think it's all that incredibly bearish because like I said before, you can see 3500, so multiply that by two, 7,000 of those options that traded were really one trade. One person had an idea and put a bunch of money in it. For me, it would be much more bearish if it was 20s, 50s, 100s, 200s different people putting on trades. I mean, this one person may be a very good trader and may have made an excellent trade but it's not 7,000 puts because it's going to go to zero and they think it's going to go to zero; it's a put spread. Plain and simple. It's a very large one but being able to dive into the detail I find really helpful.

Konstantin: And Andrew, just to kind of reiterate for folks, remember that each one of these columns is sortable. So, what Andrew was just describing, there's a few things that you need to recognize here is that if you click on time, it timestamps all the trades together. So, this 3500-contract one obviously is a multi-leg execution so therefore it's a spread and both of the strikes, the 44s and the 49s, they executed somewhere in between the bid and ask. So, that's where you have to do a little more of forensic analysis and figure out is it somebody actually being bearish, or is it somebody being bullish neutral — are they buying this put/spread or selling it? Additionally, you could look at the options and sort them this way and say, well, it looks like there's a lot of activity in the 44s. If the color is red, that means it executed on the bid and if it's black, it means that it executed somewhere in between the bid/ask. Green would mean on the ask. So, are we buying these puts or are we primarily selling them or whoever is doing so in size? And it seems like they're closer to the bid than the offer. So, again, a lot of detail here. Fantastic tools, but there needs to be a much more forensic analysis and view; what's actually happening under the hood. Just a call/put ratio four-to-one doesn't tell you that it's excessively bearish or bullish.

Who were the initiating parties, what were they thinking? Were they selling those puts to initiate a transaction or were there buyers of those puts? A very important detail that gets lost quite a bit. Colin, I'm sure you've got a few things to say about this as well.

Andrew: Before he goes, though, I think that was probably at the end of the second session when you talked about selling those puts. Somebody might've logged and banged out 7,000 on you.

Konstantin: There you go.

Colin: Yeah, I mean, so, we started with some great tools already. I'm going to go a little bit more boring. I know, it's just my style. I'm going to go option chain. So, primarily when I'm breaking down or evaluating whether it's comparing expiration side-by-side or looking for events that are upcoming, if I want to plan out, if I want nothing to do with the volatility that comes along with an expiration, I can plan around that. And that's why I love how the option chain brings that all together and doing a side-by-side comparison of expiration. So, what does that do for me? That's probably what you're asking. Why would I do that? Well, one of the things that we've got to select is expirations. Andrew mentioned before, going too far out, this is a way for us to give a comparison. If I go out another month of time, how much more capital am I putting up for that amount of time? It's like shopping. That's what we're doing, right? We're shopping around, we're going to say, where am I getting the most bang for my buck? Yeah, all right, I'm paying X amount of dollars, I'm going out another buck to get 30 more days. But remember, that's more capital you can lose. Do you want to take that on? Those are important aspects to be keeping in mind when I'm doing this. So, the option chain on top of that, Andrew also mentioned about delta exposure. Really important to know that.

The option chain gives you that as well. So, when I'm looking, I can compare strikes — and yes, I do do this, I am guilty of this because I do it myself, that's why I love the option chain — I will go down saying, how much more am I paying, how much more delta exposure am I getting, at what strike? Side-by-side, right in front of me, I can do that. That's why I like to call the option chain almost like shopping. I'm shopping around, finding what's right for me. So, I would say if I had to choose my first tool would be the option chain because I use it all the time. I don't just bang in a trade on the trade ticket; I actually will launch a trade ticket right from the option chain. I click on the bid or ask, that's what I use. So, if I'm buying a buy-off, I click on the ask. If I am selling, I click off that bid. It fills it right in, and it does have that doc ticket feature right there so you can build out a trade. Or if you set up in customs and turn off the doc ticket, it will pop up a trade ticket for us. We have that ability to choose whatever's best for you and that's something everyone's got to figure out for themselves. But I know this is not a common option -- oh, Konstantin, you have something you want to add?

Konstantin: Oh, Colin, I love the fact that you took us back to the most basic thing. But the board is the most important thing. I just wanted to take a second here to say it's important to get rid of the information that does not give you value. Because there could be two dozen columns on here that you might not actually be interested in or need. How do you clean it up? Well, remember that it's all interchangeable; you can grab a column and move it around based on your own personal preference or right-click on that column, add and remove the fields of interest to you. So, cleaning it up a lot of times is important because you only want the data, the information that will lead to some sort of a decision that provides value. If it doesn't, get rid of it. It's not important.

Andrew: Can I just add one other thing? I think we're spending a lot of time on Active Trader Pro, too. All of this data's available on Fidelity.com for clients. I mean, one of my favorites still is the HV versus IV, the implied volatility versus historic volatility on a simple line graph because I'm a visual guy. We have that data available on Active Trader Pro through the option analytics. It just looks a little different on the slide bar. But you can look at a historic timeframe and I don't know if you want to just plug in an individual name or something that is really price sensitive. You can see what earning every three months you can see a spike in volatility. And you know, you just say, hey, I know that that's earnings related. So, that's something that I like to use, too, in addition to some of the other things. Just because I like the look of it. It's pretty cool.

Konstantin: Well, Andrew, to your point, I'm just going to bring Door Dash because their reported earnings yesterday, not for any other reason, stock was up around 10 percent sort of bucking the tape overall, a very big down day. But this is exactly what Andrew's alluding to. What is happening to implied volatility? So, shorter dated options versus intermediate- to long-term ones, comparatively speaking where they were a week ago, where they were a month ago. Then you can visualize it, scroll down and say hey, where were we in implied volatility versus historical volatility going into the event and what happened to it after?

Andrew: And I think that can lead into what type of strategy are you thinking about. Like, where is implied volatility now versus historic, and what am I trying to capture? Am I looking for a mean reversion type of trade where I think I'll get something back, do I want to make it directional or not? There's all sort of different strategies obviously with options to take advantage of different things. But I think that's a really good tool, too, to say, am I overpaying because the market is already anticipating it? So, that's what I'd like to do to kind of gut check myself to say, what am I buying versus what's the actual underlying stock or ETF moving at?

Colin: I couldn't have said it any better, Andrew. That's a great point right there, which is analyzing that volatility. How many times have we all spoken to a client and what do they overlook? Changing the implied volatility. Oh, yeah, just I'll buy an option right before earnings. It'll be fine. Do you think it's going to move X amount of dollars? It might. Okay, well that's going to make or break this trade because what's going to happen with volatility?

Having that outlook on volatility is so pivotal. I'm the very same way now. I want everyone to know, I didn't meet with Andrew before this panel right before to compare answers. I didn't. I'm a visual person as well and I'm the same way; I like that IV index. But I am getting better; I'm moderizing. But I'm going to take it one step further and say I actually like a regular price chart. I know it's not an option, people are going to say that's not an option tool. I actually disagree. It's helped me get an outlook on price, create the outlooks. And in the last session, yes, I, Konstantin, see, there it is, right? We're setting our spots of where to get with us, helping us with that timing. Does that mean it's always going to work out that way? No. Trust me. I have proven that it always doesn't work out that way. But you also have the ability to add IV and

HV, that same IV index, to the bottom of the chart as an indicator. So, I can do a volatility analysis and a price analysis and outlook on both of them. Because really when I go through the process of creating any kind of option trade, it's almost like a filtering system. Andrew's right: I need an outlook on the underlying. That makes sense, right? Bullish, bearish, or neutral? Options give you the ability, you could potentially make money in either of the three scenarios. Outlook on time, right? Theta, time decay. These are aspects. Now, whether it's working for me or against me, I need to be mindful of that, what type of strategy I'm going to be using. But it also helps me in the selection of that expiration. And then volatility. I need that outlook on volatility. I've got to know what it's doing because it could help me choose, do I want to sell an option, or do I want to buy an option? Now, the funny part is, and I'm going to throw out his name here, Mr. Kwan, who I respect very much, has always stated it this way, and it did help me reflect, it is, we've got to understand, is it expensive or inexpensive relative to how it's been moving? Absolutely. But also, we also want to ask ourselves, why is it getting expensive? It might actually mean it might move more than what the market's implying in there. That implied volatility, what the market's pricing in of what their expectation of move in that underlying. Historical volatility, what it actually has done in the past. And we're doing a comparison. So typically — not always, but typically — when IV's above HV, they'll consider it typically expensive. IV is less than HV, it would usually consider it inexpensive. There are new methodologies out there — it'd be good if I knew how to talk, that's something I apparently need to work on — but we also have the idea of percentiles. Now, this is a new wave that's going on of where is that IV within the range of its 52-week IV30 range. If it's below 50, usually considered inexpensive, usually above, usually considered expensive. But once again, that doesn't mean it is. Because if it moves more, guess what? It was inexpensive. Even though compared to the past, it was considered expensive. So, that's something you want to think through: why is it that way? And that way, it can still create that outlook. As Andrew pointed out with the IV index, and I think that was really important, hopefully everyone really grasped onto that idea, that IV index visualizes where it goes up but also we're talking about earnings, where it comes down, goes to that mean reversion of implied volatility. It can really help you understand that trade much better to know if I'm long options and volatility drops, that's working against me. If I'm short options and that volatility drops, that's working for me.

And that's something learning those Greeks can help give you a better understanding to put yourself in a better position. It's not guaranteeing you're going to make money, that's not how it works, but it puts you in a better position to understand your trade and that way you can plan better. That's what we're looking to; we're always looking to improve as traders, and these are the steps that we can do it. So, I know that was very long-winded, but Andrew, I've got to say, those were great points so I'm glad you brought them up.

Andrew: Yeah, can I just do one last one too? Because we're talking about involved volatility, mean reversion, historic versus implied and if there's a lot of beginner traders, options traders, you're like, wow, what does that mean? And I'm not going to get into the formal definition of implied volatility for forward looking 12-month X percent of the occurrences are going to happen within one standard deviation, because that's what it means. That doesn't mean anything to me. If you look at an option chain and you add the price of the call to the price of the put at-the-money, that's how much the market is telling you they anticipate this stock to move in that timeframe. It's as simple as that. So, that, I think, is a way to conceptualize what we're talking about.

Konstantin: Andrew, you know, you make a fantastic point. It sounds very complicated, but at the end of the day, what does it really mean? How can I use it? I was doing the after-market briefing yesterday with Robert Kwan, actually, with a friend of mine, and we were looking at Nvidia because Nvidia reported earnings. We're not looking at this stock for any other reason than it moved a lot today, and it moved a lot in part because it reported earnings. Now, it's interesting, Andrew, that you point out the expected move and we're looking at this Friday's expected move in Nvidia, I was surprised to see it was around 24 bucks into Friday. It moved 20 dollars to the downside in a single day and we still got a trade though one day, a Friday. So, notice, right, everybody, that the expectations that you might be hearing, well, you know, post earnings implied volatility usually collapses, or it crashes. Well, it depends on what happens in the underlying. If it actually moves an excess of what was anticipated, then implied volatility stays fat. In fact, in Nvidia it seems like implied volatility actually increased. So, very interesting dynamic. Don't use common rules of thumb; it really is dependent on what the condition of the market is and what traders out there are doing. And we're just observing, we're observers of what's transpiring out there and we have to make those assumptions of what we think is going to occur in order to make our strategies successful. So, guys, a couple of additional questions coming from maybe beginner option traders out there — again, just intermediate, advanced, beginner trying to spruce it up a little bit for everybody if you got lost in the implied volatility discussion a moment ago — how about this idea well, if I come from the stock trading world, it's a common school of thought that I should be buying something if I have a long-term outlook and not doing a whole lot with the underlying because I believe that fundamentally the company is sound, it's valuation is sound and I think it's going to be worth more in the future. With options, they require a lot more attention. So, can I set it and forget it? Meaning, can I use the same approach? Is it a sound strategy to take? Your views on that, guys. I placed it, forgot about it, came back on the expiration day to check on it.

Andrew: I'll go first. And no, I would say that's not a good strategy. And I don't think it's a good strategy if you own the stock either. You should be what were the most recent earnings, what's changed, what's the news, what are the fundamentals, why did I buy it, etcetera. You should be constantly reevaluating what do I own and why do I own it, and for how long am I going to own it? And it really depends, like I think there's some questions around expiration cycles, etcetera. I prefer short-dated options, personally, if it comes to the end of the option or let's say I bought an option at three dollars, it's trading at six, I'm going to sell it and roll it if I'm still bullish on the company because why wouldn't I? I can bank 100 percent return, use some of that capital and maybe from a risk management standpoint roll it up. Depending on take a look at the option chain, where am I looking to roll. And then if I'm wrong and the stock turns and goes south, at least I banked some of that profit. I mean, those are my thoughts. I mean, sometimes clients get caught in a trap and just buying super long-terms. I think there is a place for that depending. Maybe it's coming now with a lot of volatility in the market where you're worried about potential downside and you're like, you know what? I want to express a longer-term view, but I don't want to commit all the capital and have 100 percent downside. Again, what's your exit? What's good enough for you? Is it 100 percent, is it 200 percent? And then know that you can adjust.

Colin: Yeah, I know this is going to sound like an echo chamber, but I don't think that's a good strategy to set it and forget it. And I would agree, from whether it's an option trader or a stock trade, having a game plan going into either one of those is just one of those things you need to do to put yourself in the best possible position. You will find yourself to be -- I know when you're starting out, I know when I started out, I struggled with confidence in pulling the trigger. That was the toughest thing for me. I would kind of create this trade, I had a rough idea of what it was, but I was like, I just don't want to risk it because I'm not exactly sure, I'm really not familiar. I noticed that it became easier when I started, once again, writing down my ideas. And anytime that you create a game plan, this is going to hold you to the idea of it's not a set-it-forget-it because I know I need to get out if it gets down to here and I'm losing money. The idea is I don't want to lose all my money. That's not the idea. I want to come back to trade another day, that's the whole concept that we're trying to get across. And eventually, we're going to hopefully come away making money. That's our overall goal. But you can't do that if you lose it all. And some of the most famous traders have gone bankrupt over the years. So, our goal is, for me, to create that game plan, hold myself to that game plan. And that requires not to set it and forget it, but monitor it. Put it on. Yes, patience is part of it and that's where that emotional rollercoaster's really going to be playing a role. We don't want it to. We want to make sure that we are analyzing our trades, monitoring our trades. That's why you have all of these different tools to help us monitor our trades. You can even set those price alerts. I know with option trades, I know I've heard this over the years about stop orders and people use them, they have their place, absolutely. Me personally, I do like to also implement things like alerts. I don't think stop orders are necessarily going to be my go-to in managing my option trades. I personally like alerts, and here's the reason why: changes in volatility can make it an opportunity for you to close it out on the losing side even though your set up and the reason why you got in the trade are still in place. You still haven't gotten to that area where you say, oh, I'm wrong on the trade. And that's why I switch it up to, where am I wrong on the trade? And a lot of this is based on, and I used to sit next to Brian, and I would bounce just about every trade idea off of Brian and he would say the same thing to me, well, where are you getting out? Where are you looking on the chart? And that's why I, me personally, I've always been reliant on that chart to help me pick my points of getting out and then it's suited for my style. It allows me to be able to, and here's the thing, be specific about where to get in and where to get out. And to me, that was really valuable. And I was able to incorporate that even with my option trading, which is why I use those alerts. Those can tell me if it gets to this price point, okay, I'm at that area where I need to look at it, am I closing these out? Yes, it got to that area. Okay, time for me to walk away from the trade. And that's kind of the approach that I like to do, and it helped me when I first began. So, from that particular aspect, when I'm starting out going down that path, setting up that game plan and being specific with those details helped me to manage the trades more effectively.

Konstantin: You know, Colin, my motto has always been options trades require adjustments when they're called for. And that could happen at any point in the trading day. So, they're certainly important. You need to be paying attention. They need more handholding. I definitely agree with both of you guys that even if you are a long-term investor, you should be acutely aware of where that underlying security is relative to where it has been in the past and the reason of why you are still in it, so you constantly have to reevaluate. You just have to continuously do that, probably much more of it, if you are an options trader for sure. A couple of points that you guys hit on —

and we'll maybe take your views on that and then answer some real-time questions that are coming through in the past few minutes that we have together — but you alluded to the fact, maybe stops are not the best idea for when you're trading options. So, this concept of options liquidity and the spread between the bid/ask, can you guys elaborate a little more on that and what types of orders are appropriate generally?

Andrew: Yeah, I'll take it and then Colin, you can come over the top. I mean, there's a lack of liquidity sometimes. I trade a lot and I mean, Fidelity probably doesn't want me trading as much as I do but I got an exception and they allow me to do it. So, I have a couple options right now that are post-split options, I'm not going to tell you the symbol, but a couple names did some reverse splits and now I own weird options that they're two-dollars wide. And they're only two dollars. So, one bid at three, it's criminal in my opinion. So, that's where there's a danger that I put a market order in or I have an order that's triggered because of a certain price or a stock.

I think potentially using stocks, but a stop limit makes sense where you're like, hey, you know what? Stop limit at two is my trigger and I'll sell it all the way down to a dollar 75. But I don't want to put in an option order that's going to trigger at two and they spread the market just because the reason it's trading at two is maybe the stock gapped down or the market gapped and I get filled at a dollar because I don't have an argument to make with the market and Fidelity's just executing the order as per my orders: sell at the next best price. But you hit other names up like these really liquid ETFs like SPY an example. It's a penny wide and you do a half a penny better sometimes. I personally would always like to just put a limit order in. If I want to own it, it's trading at 28 cents, I'll buy it up to 30 instead of the potential danger of a market order. That's my personal opinion.

I'd rather pay an extra two cents than God forbid with my luck, the second I hit it, some type of weird news comes out and it gaps up or down. So, that's kind of my take on it. I almost want the market to give me a better price by making the limit above what they're willing to do, if I really want to execute that badly.

Colin: Yeah, that's a great point. And I'll be honest, with the majority of my option orders, are just that. They're limit orders whenever I'm looking to execute. When I utilize any kind of market order, it's going to be with something that is going to be the most liquid of options that are out there because they have to be tight spreads to make it even me feel comfortable of putting in any kind of market order. I would say make sure you're evaluating those quotes, the difference between that bid and ask.

That really is going to dictate whether or not I would feel comfortable in using that. I'm on the same train. I already use limit orders probably with the majority of my trades just to be safe, just so I have more confidence of I at least know the very minimum I'm going to get. Stop orders, I just typically will rather get that alert and that way -- I mean, I have access now through my phone, my computer. I always have access to it so where I can go in and I can put it any orders that I see fit. It does make me a little nervous, stop limit order certainly is another avenue to go down. For me personally, and it's just a personal opinion, it's a preference for everyone, what works for them, it's going to be different for everyone, I will leverage those alerts instead.

Andrew: Can I just add one thing before we get off the topic? That should be part of your pre-trade evaluation. What's the liquidity of what I'm looking at? Even if it's the best idea, if you've got to pay an extra 20 cents to get in and you don't know if you can get out, that may not be the best trade. Maybe you just buy a little less of the underlying stock or ETF, whatever it is. I've fallen into that trap a number of times. Hey, I made a great trade and it's like, they're going to make me sell it at parity to get out and that doesn't make me happy.

Konstantin: Guys, these are fantastic points. Remember to option traders, each penny means a buck. So, what's really the cost of doing business? Is it paying 65 cents a contract to Fidelity to execute the order, or is the spread and the difference between the bid/ask? To Andrew's point, what is going to be the time when you're going to be probably forced to make a trade or a transaction or take a trade is when you're on the defensive. And so, if you're having a tough time getting into something, thinking that it's going to work out and the strategy that you picked is correct and then it goes against you, you're going to have a much tougher time getting out at a fair value as well. So, Andrew, great point there, sir. So, we've got about five minutes left. Let's go through a couple of questions that were live that came through the audience here. One of the most asked ones was, best option strategies that you guys can think of for income generation. We're in a very volatile market dynamic and environment right now. Your thoughts on that, income generation in this environment, guys.

Andrew: You can go first.

Colin: All right. I'll fire away on this one. So, it's a great question and once again, I'm going to stress this from the onset, is there is no such thing as a best strategy. If we are worried about selling options, things like selling puts or selling calls or even covered calls because you still have that downside risk. Stock is still going to have that substantial risk to the downside. If you're not comfortable with that substantial risk to the downside, there are things like selling spreads where you're defining your risks. Now, I would caution, be comfortable with knowing what spreads are. They're more complex. Why? There's more legs involved. But selling spreads, the advantage? Define your risk. That's really what you're looking at, is you define your risk. The disadvantage, which, you also have got to consider, is you're going to take in less premium. And it's also going to be a slower trade because you're offsetting one with the other. So, yeah, what I'm going to get from time decay from selling just the put, it's going to be a slower trade than the time decay I'm going to get with selling a put spread. Why? Because you also have a long leg with the put spread, which is going to lower down the amount of time decay I earn with each passing day. So, spreads can define that, but it does come with its disadvantages. So, it's all about making sure you're aware of it and does it fit what you're trying to accomplish.

Andrew: I have nothing to add to that. That's exactly what I was going to say. In today's environment, like you said, Konstantin, you want to limit some of the downside. Yeah, do spreads. Why not? Or do calendar spreads. If you can do a little stock replacement out six months, keep writing the three-week or one-month options, you could do that. I mean, you're going to need the appropriate option level to do so. You could do it in an IRA if you have the spread agreement, etcetera. But it's going to be a lot less capital outlay than a covered call and a lot less risk. And think about it, we "nerded" out a little bit with the Greeks, that's ROE, that's interest rate risk of options. The less money it costs me to put up on a trade that has a similar risk profile, guess what? Now I'm actually getting a little bit of money in the bank as money market rates move up. So, that would be my thought on that.

Konstantin: Efficient use of capital, right, Andrew, in this environment. So important. It will only become more important if interest rates actually do rise at some point, which maybe they will in the near future. We'll have to wait and see. You guys, a common question that came through, very popular as well, elaborate a little bit on the collar strategy if you will. Your thoughts on that, whether it's the current environment that we're in or just generally.

Andrew: Yeah, so just real quick, I'll just give the definition of a collar for those of you who aren't aware. You own the stock, you're looking to protect the downside to buy those protected puts, that costs you money. So, you're then trying to finance that downside put by selling an upside call. So, it's basically a covered call with a downside put as protection.

I think it really depends. The way options are priced, you're going to give up some hypothetical edge because of skew. So, an option, a 20-percent out-of-the-money call is less expensive than a 20-percent out-of-the-money put. Hypothetically, it shouldn't be if you think about it because a stock can only go to zero, but a stock can go to infinity. But that's supply and demand of options. The average investor, his long stocks, they're looking to generate income, they sell calls that pushes the price down, people are looking to buy puts for insurance. But if I'm long a stock that I bought at 20 and now it's trading at 100 and I don't want to sell it for whatever reason and I'm willing to give up some of that upside by selling that call and it can finance that put, I think it's a great idea.

Konstantin: Perfect. Guys, we are right at time at five o'clock. An hour flew by. I mean, we could talk about this stuff for hours, but we have a limited amount of time. I wanted to thank everybody for showing up. This is going to conclude today's three-part event. We would encourage you, though, for all those questions that came through on option Greeks and how to use them, how to manage individual strategies once you're in them, things of that nature, please join us by going to Fidelity.com/coaching, find the appropriate session, sign up. It doesn't cost you anything, you're a Fidelity client, we'll be glad to have you in there. Take care. Guys, thank you so much for joining me, it was a pleasure.

Andrew: Yeah, thanks everybody for showing up, too. It was my pleasure.

Colin: Thank you, everyone.

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