TRANSCRIPT

OCC: Getting started with options -- Strategies and ideas

Speakers: Allen Helm, Ed Modla,

Allen Helm: Well hello everybody, and welcome for the final session of our options series, Getting Started with Options: Strategies and Ideas. My name's Allen Helm, I'm the Regional Brokerage Consultant for Austin, North Texas, and Oklahoma. My group of about 65 of us nationwide of regional brokerage consultants and brokerage consultants work with clients that own individual securities, whether that's options, stocks, exchange-traded funds, mutual funds or fixed income, we're here to help you navigate our brokerage tools to meet goals and objectives, so, if you'd like to attend a session with us, reach out, just give us a call, either to your local financial consultant or call the 800 number and you can reach us there and just ask for some help with some of the tools that we have or what we're showing today. I've been in the brokerage industry now for roughly about 3+ decades. I'm a registered options principal license manager. I also have a money management license, so I have a myriad of different licenses and certifications, and have been in this space for a long, long time.

I'm honored to have Ed Modla with us today from the OCC or Option Clearing Corp. He's going to go over some of the different scenarios.

So let me kick it off to Ed, I'll let Ed introduce himself, and then we'll go ahead and get started with today's session. So Ed, take it away.

Ed Modla: Thanks, Allen. Welcome to everyone who's just joining us, and thank you to those who have stuck with us throughout the day. This session's going to be fun. We're going to talk about some hypothetical situations that might lead you to certain options and strategies, and then Allen will be showcasing maybe some order entry or looking at those strategies in the Fidelity platform, merging some of the things we've talked about today with respect to the different simple strategies available to you, and what market outlook or circumstance might lead you to that, so I'm looking forward to this session here with Allen. First of all, a little bit about myself. I got started in the business straight out of college, 1997, went to the trading floor in Chicago, and was trained as a professional options market maker. I was fortunate enough to be in the trading pits for about five years before that business started to die off. I made the transition to electronic trading, and now I have evolved to over six years with OCC now, presenting educational sessions just like this one online and in person, and there should be something in this presentation for everybody, because we're going to be looking at examples, we're going to be doing demonstrations, so hopefully this session will tie together some of the thoughts and concepts that we've been discussing throughout the day. First our disclaimer: options are not suitable for everyone. They are a rather complex tool that needs to be well-studied and understood before using them in a live account.

And let's get right to outlining sort of case study number one, and a certain perspective or situation that you might find yourself in, and then what do you do from that market direction, how do options come into play? So first of all, you have an opinion on the direction where a stock is headed, how can you capitalize on that move without trading shares. Well first of all, for many of you, if you're bearish, you might not be a short-seller; your account might not even let you do that. So when it comes to being bearish on a stock, what can you do, since you're not going to be selling short, and even if you're bullish, what if you just don't want to incur the cost of capital to buy the shares and have all of the risk associated with the downside of being wrong? Well in this circumstance, options could be considered. Now this is more on the speculative trade with options. When you're speculating, you certainly have a few strategies that you can choose from that would involve selling options. But in this case, we'll be more true to that speculative approach; if you're bullish, buying a call would be the way to go. If you're bearish, buying an outright put would be the bearish side. Remember buying a call gives you the right to purchase shares; if the share price moves higher, you would expect or hope that the value is moving in your favor. For put options, if you bought a put, you own the right to sell shares at a fixed price as the stock moves lower as your market outlook is telling you it's going to, you would hopefully be getting a positive influence on that put price. If you buy a call or if you buy a put, you do need to understand the stock price movement needs to overcome the element of time decay. At expiration, there will be no time value left in the option. You can expect to suffer time decay and have the entirety of the time premium you paid erode to zero. This means your market's thesis needs to be correct really on all three of these elements: the direction of the move, the magnitude of that move, and the timing of that move. If you can hit on all three of these, then you might be able to achieve a nice healthy return on your long call, or long put strategy.

One baby step further to make it a little bit more complex, an effort to reduce a little bit of the risk, or to reduce the cost of the trade, you can buy a vertical spread. More specifically, that's to purchase a call or put spread. If you're buying a call option, you are purchasing the more expensive call option and then selling the lower-priced, or higher-striked call option. So you're paying a debit, you're buying the more expensive option, but instead of leaving the trade there as an outright position, you're then reaching up and selling a cheaper option to reduce your cost and getting a different risk profile from doing the vertical spread.

Just a hypothetical example before we showcase this, and Allen's going to take the lead on that, you have a hypothetical stock here, JETX, you determine that shares have reached a strong support level, they're gonna balance, they're gonna due for a rally. But you're also thinking, well, it's expensive, I don't want to buy the shares, and if that support does not hold, if I'm wrong, the stock could crater and collapse. I don't like that risk profile. This could lead you to those strategies. Because of that downside risk, because of the cost of buying shares, you then look at your call options chains, up and down strike prices and decide, which call option do I want to buy based on an analysis of its cost, the call option itself, and where and when do I think this stock is going to move. And then also vertical call spread. This starts with buying a call, but instead of being done there, capped your upside potential by selling an upside call. So you buy a lower strike call, it's more expensive. You go up to a higher strike call and you sell that one. Think about what you've done there, you own a call option, giving you the right to buy shares at a certain price. You've now accepted the obligation to sell shares at that higher price, so you've capped or you've maximized that upside potential. This is focused on the bullish outlook on this particular stock. The same thing if you were bearish, you know, buying a put or buying a put vertical spread would be the way to go if you were bearish. Just two different simple ways. As I said, there's others to capitalize on this kind of market outlook, but a couple of simple ways to possibly implement your market outlook into an option strategy. And I think it's good time as we go through these case studies to look at this on the platform. So Allen, you can take the platform from here and showcase what this might look like if an investor had this opinion on a particular symbol, what would they be looking at? How do they get the chains going? And how might they enter these trades into their platform? And I can see your screen, it looks good.

Allen Helm: Looks good, okay. So a lot of moving parts here. We'll highlight, first of all, to Ed's point on the case study, you know, we've already got an idea, we want to take a look at the idea, and then we want to maybe determine which contracts or calls that we want to buy. We'll also then take a look at some of the benefits of a vertical spread, take a look at that, and run through some of those ideas. Then, Ed, if you don't mind, I'd like to also highlight some of the research capabilities where we do have research reports that, you know, clients can take a look at at some long call ideas. Like to highlight to Dan Nathan, also like to show folks how to screen stocks to look for options ideas based on some of the screeners, and then we can drop, or jump back into session 2 if that sounds okay to you, so.

Ed Modla: It's a great idea. Yeah, Allen I get asked the question sometimes from those new to options, they'll say, what's the best strategy? Which option strategy works the most? And I always have to tell them, take a step back. You've got to do some kind of market analytics first. So what you're doing here, looking at some research, looking up ideas, this is the first step, and Fidelity's got wonderful tools that lead you to that market thesis. It's a good idea to walk through that.

Allen Helm: Absolutely. And then the other thing, guys, this question comes up all the time, can I do these strategies in my retirement account? The answer's yes, you do have limited capabilities of what you can do in those retirement accounts, so you know, long calls, long puts, cash secured puts, covered call ideas, and then limited spreads, so you do have that capability. Once again, for those that maybe had missed the first two sessions to fill out an options application, each account would need to have an options application submitted. If I go to investment products right here, investment products options, this gives me apply to trade options. I can open a brokerage account, so if I need to open a brokerage account to do that. If I've got other accounts here and I want to apply for options, I just hit “apply options.” This is going to then take me to that area, and here’s where I can apply. It’s going to list your accounts and then say add options to that, and that’s where you would go. So if you do have an interest and you’re wanting to do that, that’s where you could go to do that.

So, for today’s purposes, I’m also going to introduce, because I don’t want people to leave the sessions not thinking that we do have streaming tools, those type of things, because we do. It’s a product called Active Trader, I might show that just a little bit. The majority of all the things that we’ve done so far have been on Fidelity.com, but I do want to show that platform just a little bit, because it is a very robust platform, so everything on that’s streaming. So we’ve got the benefit of seeing everything on Fidelity.com. We’ll show you just kind of where you can get that if you’re interested in getting the streaming platform. There’s not a cost to it, anything like that. But where you would do that, if you go inside accounts and go to Active Trader Pro, from here, you can actually download Active Trader Pro to either your PC or your Mac, and then it’s the same user ID and password. I’m running it in the background to kind of highlight that here in just a minute to show just a few things there on that platform.

But let's go back to Fidelity.com. Let's go back to the options, and then let's go in and say, okay, well we're interested in, we have an idea. You know, and let's say that idea, I don't know, is Microsoft or Qualcomm or whatever that is, and through that analysis and what we're looking for, we think that maybe Qualcomm is going to go up in value, and we think that's going to happen over a certain amount of time, and we want to determine, well what calls should we look for to take a look at, and how should we run the data or take a look at the data, and where would the potential contracts be if we were to buy different contracts, and how would they perform relative to whatever our expectation is on the price move.

So, the way we would do that is, you'll notice we have a quoting tab, a market overview tab, market overview tab here is going to give us kind of what's happening in the marketplace, some ideas, you know, that applied volatility stuff that we looked at, tips on what's going on in the market. And then we have a trade idea area that we're going to focus on right now. And so inside this trade idea tab, you'll notice, it has market scanners again, so we're scanning ideas here. We also have option expert analysis that you can take a look and read. We have intraday trade ideas, so these are specific ideas that you can take a look at. We have a report finder that takes us into specific covered call ideas and diagonal spreads that you can take a look at. And then we two buttons right here. One's called a strategy evaluator, and the other one's called a strategy idea area, and what that does is that lets you go into the different options strategies and maybe mine some ideas there.

In this example, we already kind of know what it is we're wanting to do, so we're going to go to the strategy evaluator. And inside the strategy evaluator, we're going to put in our stock that we're interested in, so let's say Qualcomm, and to Ed's point, we're interested in purchasing a call. Okay, so we obviously think that Qualcomm is maybe going to go up, and we have an idea of maybe what we think that's going to look like as far as, you know, the increase in the value. And so, what we do is we're going to choose the strategy call, and then we're going to go out, and maybe we'll look at the May 21st 2021 calls. We're going to take a look at the strikes. We can say, okay, show us near the money, above the money, below the money, or we can do all, so we'll just say all for setting this up. And then the offset, when you think about the offset, we can also do a strategy like for example, a spread or a combo or a butterfly where we have multiple legs, and we want to offset those strikes by like five points, ten points, whatever that is. On our offset for this example, we're just going to use one. We're just looking at dollar-to-dollar increments. We'll adjust the volatility because, you know, Ed correct me if I'm wrong, but if I'm buying calls, I've probably taken a look at my implied volatility and my historic volatility tools, and I'm probably trying to take a look or take advantage of a call maybe when the volatility's a little lower than a little higher. Would you feel comfortable with that statement?

Ed Modla: Yeah, at the very least, you would want to lean your strategies towards the buy or sell side if you have some semblance of where is volatility today, compared to where it's been in the past. And I wouldn't go so far as saying that if volatility is high, you shouldn't be buying options, because as we know, if something is priced high, it can still go higher. So really, your opinion, your thesis in conjunction with some idea of where volatility sits today compared to its past, that's going to lean you one way or the other, and you're absolutely right, if we're going to be looking at buying options and buying calls in this example, our preference would be that volatility sits near its average or below the average. If it's higher, there would have to be a pretty good reason for it.

Allen Helm: Well, and probably our hope is that volatility is going to increase too if we're going long call, is that a fair assessment from --

Ed Modla: That absolutely is. You know, some investors will do that kind of analysis and form an opinion on volatility. You know, to be quite honest, Allen, most investors that I speak to that might be buying calls or buying puts, they know volatility levels, they can look at where volatility is today compared to its history, but they find it a little bit daunting to try and form an opinion on is it going higher? Certainly it will work in your benefit if you're buying calls and puts, just buying options for volatility to go up, but I wouldn't go so far as to say it's a prerequisite to have that opinion if you're going to go long options.

Allen Helm: Okay, so we're going to tweak the volatility a little bit as we run the data here, but we'll juice up the volatility just a little bit on this, but we'll make the assumption that volatility hasn't changed either way on our assessment. So, just a second. Let me see here. So, here's our target profit, it's default at 1%. What we're looking at is the overall investment, so what are we willing to risk in the contract. So, I don't know, let's say it's $2,000, okay. We have 58 days for these contracts to work, and maybe our thesis is that Qualcomm in this example's going to move 10% in value. Is that fair, Ed?

Ed Modla: Sure, and really, you know, all this is going to be useful, I think if you're looking at this you might think, well boy, do I really need to know all of these details? Well some of them certainly, the underlying move would be important, how many days to expiration important. But you can loosely fill in the rest, your target profit, your investment. What you're going to end up doing here, Allen, is taking a look at the chain, and then further scrutinizing from there.

Allen Helm: Oh, absolutely. So here, Ed, let's do we think maybe it'll go up 7%, maybe there's some sort of a, I don't know, earnings coming out, there's some sort of new product, I think Qualcomm's involved a little bit in 5G, so there's something working that space, whatever. So our thesis is we think that the stock could potentially go up. And then what we're going to do is we're going to search the first 50 ideas, hit search. What this tool does is this will actually run the contract for us all in May, and then what we can do is we can actually sort our P&L, and we can say, okay, well where would the move be, and let's say that that move happens, let's take 20 days off that. We have 30 days to expiration. And where would that put us as we go in as far as the data, and what this is doing is this is running a table for us, and it's showing us the different strikes. Okay, now keep in mind the stock's at 130; it's off $2.46 today. But it's running which contracts we might take a look at and based on our assessment, what we would put into the contracts and what we would potentially earn if this statement is a true statement, okay?

So, if we really got it right, and let's say this thing went up 12%, what we can do is then we can now rerun the data, take a look at it. We'll just sort the data real quick again. We want the highest P&Ls, and you can see without [juicing?] volatility up here, which we can do, we can see that hey, you know, based on the information we really get it right, we might want to take a look at the 130s, 125 and 135s based on the inputs that we put in, okay? So that's a way that you can actually run the data and take a look at maybe strategically looking at the different contracts. Now, when I use this tool, what I'll do is I'll take a look at, you know, if I'm buying something that's way out of the money, and let's say the estimated return is 120%, but I'm slightly in the money, and maybe the estimated return is 115%, I will tend to go with the ones that are maybe in the money slightly, depending on what I think, now your leverage is going to be course out of the moneys, if you really get a big move, so if you see a stock increase 25 or 30%, then that leverage because the number of contracts that you can buy, notice I can buy two contracts, this is the proceeds, this is the current market value and this is what's earned, and so I can go in and take a look at the different contracts and then see what that percentage move is on my scenario here, okay? So that's one tool that you can use as far as diagramming an idea.

Another one you can use, let's do the spread idea. We can go to strategy ideas and we can say, okay I want to do a long call spread, and I want to do that long call spread. By the way, when I click that, it's going to take me to this page, it's going to run ideas and show me some call spreads down here. Be careful, cause these ideas aren't necessarily buy-rated stocks; it's the computers just screening ideas looking for total returns on those ideas. What you'll notice right here, it'll tell me what a long vertical spread is, and then I can input the symbol that I'm interested in, Qualcomm, and I can say, okay, do I want that vertical spread to be less than 60 days, between 60 days and 100 days, whatever that is, I can default that. From here, I can hit "apply," and this will actually run some ideas for you, and then once again, on those ideas, I'm going to take a look at probably where the stock price is, so Qualcomm is roughly about 130, and I'm going to go with my long strike and start looking at that. And then I'm going to take a look at, well what's my net debit on the idea and what's my payout ratio. From here, I can actually go in to analyze and I can go to a probability, or a profit/loss calculator, and I can actually analyze this data and see, well what would the outcome look like as far as this idea if I did that, what's my breakeven on the idea? And then, this goes on for eight days, but this shows me my risk, so I'm risking roughly $115 to try to make $194. If I think that stock can at least maybe get to 135, it's defaulting to one contract, but this allows you then to look at or run ideas. So that would be if we had a specific idea, Ed. You know, we were using Qualcomm's both on a long call, we could do it on a long put, or we could do it of course on a vertical spread.

Now if I'm looking for ideas, or I haven't generated those ideas, or I want to see, well are there some tools that will generate these type of ideas, there are. So, there's a weekly report that comes out on Fidelity.com, and it's under actually the news research tab, and it goes into stocks. When we go into the stock area, by the way, this will show you if you want to know, what are the most actively traded stocks here in Fidelity.com for retail clients. So these are retail customers. I can view the orders and what's being traded the most here at Fidelity, and I can go see more. And this will show me the 30 most active stocks that are currently being traded, stocks, exchange-traded funds that are being traded here at Fidelity by retail customers. Okay, so you can go in and kind of see what's going on here. And you'll see some of the same suspects, right, you'll see Apple, Amazon, and then you might see some names in here that you're not familiar with, but this will show you where the current activity is as far as what retail customers are buying and selling here at Fidelity, okay?

Now, to archive the options research report, I'm going to research firms right here, so research firms. This list, all the research providers, Fidelity gives you more research than anybody out there. This is third-party research, they don't have any relationships with the company, they just strictly do research. Got names like Argus, Zacks, different companies that you can go in and take a look at. Argus so, just so happens, actually writes a weekly options report. So let's go to that. So it comes out every Monday at about 11 o'clock Central Standard Time here in Texas, and you can read their ideas. And a lot of times, what they'll do, is they look at two major areas. They look at covered calls, and then they look at long call ideas. Every now and again, you will get a cash-secured put idea on there sometimes they'll run, but if I scroll all the way to the bottom of the page, this gives me a weekly options watch. And then what this does is this will give you kind of an overall market view of what's going on. They give you some CBOE data on what's going on on put-call ratios, do a little bit of information there. They go through their Argus covered call strategies right here, so these are some of the names that they like, that they're doing covered calls on. And then here are some of their earnings plays or long call ideas that you can track and take a look at on a weekly basis. Okay, so they're giving you, and they're telling you specifically, what it is they're looking at, what, you know, the share price is, the options that they're trading, what the current price of those options contracts are on the specific ideas, so you can read these reports on a weekly basis. Okay, so they're right here. And the way we found those, once again, I know this may be new to a lot of folks, so I'll just go ahead and kill that. And we went into, just so you know, news and research, stocks. We got to the home stock page, okay. We went over here to news, and, news and research, research firms. We selected the Argus research report. Inside the report, we have various things, market digest, whatever. You can read those, a lot of great materials here. In fact, if you were to pay for this, we've had one of the Argue representatives on our call, it would be roughly about $120, $130 a month to get that we're giving you here for free, as a client. And if you scroll down, we go all the way down, here is that weekly options research report. And then once again you can go through that report, comes out every Monday, okay?

The next place that you can do if you're looking for ideas or want to screen ideas, I'm going to stay on this page right here, is I can go to stock screeners, and I can actually go in and I can screen ideas from roughly 6500 stocks, okay. And I can be very strategic on how I screen this and choose different things that might interest me, when I'm looking for ideas. So, notice, it's defaulted to a stock screen here. We could also do the same thing with exchange traded funds, if they wanted to trade options ideas on those. The default here is stock, I'm going to start a stock screener. I'm going to go into the screener. Inside this screener, you'll notice that we have different strategies that are already set up, okay. And so, you can go in and take a look at value ideas, growth ideas, whatever these are set up by the different research providers. You can also look for specific themes, so if you were interested in cloud computing, whatever, you can go in. But you could set up your own personalized screen and start looking for ideas.

So, we're looking for options ideas. So obviously, one of the things that we want is we want to build a screen. We could go to basic facts, and we're going to look at ideas where they do have options, and securities without options, securities with options, so there's roughly 7,383 ideas. A lot of ideas to take a look at, Ed. So we're going to take a look at securities with options. We have 3,697 ideas. Okay, so that's our first filter. Do these ideas have options? The answer is yes. We have 3,697 ideas, and we're going to take a look at weeding those down. So the next thing we're going to take a look at is, we can be strategic. We could choose a certain sector, so maybe we think that the economy's coming out, and we think certain sectors will do better than others. We can be specific and strategic on that, on how we take a look at that. I'm going to leave my filter fairly open. And what I'm going to do is I'm going to take a look at, on these companies that we're screening for as an example, they've had a positive earnings surprise. That positive earnings surprise has happened over the last 90 days, and man, they've been great earnings surprises. They were at least 33.87 or more on the surprise. Maybe the idea there is that a body in motion stays in motion, and maybe we're seeing a trend of earnings increases and maybe that's something that we might want to take a look at, just an idea, okay.

So we've now whittled this down to 624 ideas, okay. It's going to show us those biggest earnings increases, okay. So now we can go down and filter and take a look at ideas that maybe have a technical buy rating from the different research providers that we give you, and what we do is we wait and rank these research providers, and then we do a blended score. And we call that our Starmine equity score, and from there, we're going to go in and we're going to take a look at those Starmine equity score stocks that are rated at least very bullish, so they have a 9.1 rating to a 10 rating. That leaves us 122 ideas.

Okay, now the final thing maybe on our screen that we're taking a look at is just for fun. Part of the analyst opinions. We can go in here and we can actually take a look at a service called Trading Central, and from there we can go into Trading Central, and we can say, okay this is just on a technical analysis rating, so we've got the fundamental piece of it that we're looking at through the different research providers. Now we're looking at a technical piece, and from here, we're going to add in a rating that's just a technical analysis rating. So, from technical analysis, they think that the stock's a buy. From a fundamental analysis, we have that overwritten on our ideas, and so we've very quickly built an idea or a stock generation idea as far as maybe companies that we want to check out, that trade options, okay, and that have a technical both buy rating from our research providers, and then also a buy rating based on technical analysis. If it's a screen that you like, you can always go to Save My Screens, name the screen, and you can always go back, take a look at that, and add additional filters or things as far as looking for options ideas, okay?

All right, the final thing that we'll take a look at real quick is, we can go right here guys, to the options page. Right here is our CNBC contributor Dan Nathan. You haven't watched this, you can take a look at what Dan's saying. He gives typically one or two ideas every week. It comes out, you can actually go back and take a look at the past videos, but he'll give you an idea, one or two, typically. He'll tell you why he likes the idea, what the thought process is. He'll do typically long calls, long puts, or a vertical spread, Ed, and he'll go in and he'll follow the trade, and they do updates from there and that's something that you can look at, and watch, it comes out on a weekly basis, so. So there's a few ideas for you. Ed, I'm going to turn this back over to you, and let's take a look at scenario 2.

Ed Modla: Yeah, let's do it. That was a wonderful walkthrough, Allen. The research and the screening is such a critical piece. Options operate as advertised. You do have to have that first piece of the puzzle in place, and the screening technique that you walked through is a great way to do it. Those resources at Fidelity are going to be really helpful, especially the way you can filter things down.

So yeah, let's look at another case study, and do something similar on the platform here. We've changed the perspective of the investor, they're in a situation now where they own shares. They've rallied, some of you may find yourself in this position today, and now you are sitting on a profitable position. How do you protect those gains against the downside? This comes back to a little bit of that psychology of trading when you have a nice big green number and a strong performer, you might want to let that ride. You might want to let that continue to go, especially if you continue to be bullish, but you have these conflicting thoughts that you need to start to peel off and protect that position, one of the most difficult situations to deal with is seeing a green number turn red, and in order to avoid that, options can help.

And there's a few strategies you can consider: the protective put, holds your long stock position, and involves adding a long put. When you buy this put option, you are taking on an expense, you are paying for the right to sell stock at a particular strike price, and you're paying for that right, hopefully the strike price that you purchase the right to exit your position at is higher than your original entry point, if you've got a big enough move in the shares, then you can actually buy a put option protecting the position in a profitable situation.

The collar is very close to that. You still have your long stock, you're going to hold the shares, but instead of holding them for a larger gain to the upside, you're thinking maybe there's just a little bit more room to the upside before I'm willing to scale out of this position. I'm looking for prices a bit higher than here. I'm willing to sell, so I'm going to sell a call option to start scaling out of this position, but I'm also going to protect the downside at the same time. You're kind of doing things on either side of where your stock is. Ultimately, this is a protective strategy to protect against a pullback and lock in gains or protect against losses, but instead of paying for the put option, you have this other element where you're selling a call to mitigate, maybe even eliminate the entire cost of that put option while you know you're taking on obligations here. Long stock, short call. If the stock does really through the strike price of the call option, your shares are going to get called away.

Let's look at a hypothetical example here. We have a soft drink company, ticker symbol BUBL, and you've had the shares for many months, they've performed well. And one common result of having a strong performer in your portfolio is that you have a position that's a little bit too much of your portfolio. It's now taking up a larger percentage of your overall capital than you're comfortable with. So your thesis may still remain bullish, but you're concerned about giving up healthy gains that are unrealized. You could use a stop-loss to the downside, you can use a limit order to the upside and just strictly trade the shares. That's a choice, that's an alternative. Or, you can reach into your toolbox of options strategies and implement a few different strategies which include the protective put. This would be buying a put option on the stock at a strike price you would like to exit this position at if things go the wrong way. Whatever that put costs, you know that's going to be a sunk cost, so you have to evaluate that as well. The lower you go in your strike price selection, the less it's going to cost you, but the more you stand to give up before that protection starts to kick in.

Closely related there is that collar trade. We're still, you're holding shares, you're still bullish, you think the stock's going higher. You want to protect the downside, so you buy this protective put at a lower strike, and instead of paying for the put, you then reach up to the upside and sell the call option. That is going to offset some of your cost here, put you in a better position as far as your cost to capital on the options piece, and in doing so, you've accepted the obligation to start letting your shares go in their entirety, or maybe just in pieces at the strike price, to the call options that you sold. Allen, I'll let you take it from here so we can showcase this. I'll also, while you do that, I'll just say, options are flexible. You can choose, if you have multiple shares, you can choose to buy a different quantity of puts or calls than are necessary to fully protect or fully call away your position. Totally up to you, you can choose different strike prices, but the classic construction, the foundation of your knowledge of the collar starts this way, and then you can take it from there. Allen, your screen looks good. Go ahead.

Allen Helm: So protective collars and protective puts, we'll get to that real quick, but let's answer just a few questions that we got. So, for a novice Ed, would you say it's easier to do calls and puts, or what's your thoughts there? Have you worked, if you were fairly new to it, what do you think the answer is, on what strategy to do? I thin it's probably a little easier to do calls initially to kind of grasp at, maybe if you were starting, what's your thought on that?

Ed Modla: You know, I'm going to answer this in the way that I believe an educator should answer this question, and I would say that if you're not fully comfortable with your understanding on what it means to do all four sides, buy call, sell call, buy put, sell put, take your time. The market is not going away tomorrow. You may think you've got a great idea and a great trade you want to capitalize on, but don't rush into things, don't over-trade. Now I speak to investors that spend many weeks and months studying options. Their first trade might be selling a put, because that's the trade they've learned, they've understood, they feel most comfortable with it. They understand the obligations, they understand what assignment means, and that's the trade they like best. So yeah, I would agree with you, that calls would be easier because they're easier to understand. But as a teacher, I'd say listen, let's understand everything, and then we'll implement what looks best.

Allen Helm: So Ed, you're leading me into the second question that we got, is well how do we learn more about options? Of course, downloading the material that we provided here, revisiting the material, particularly if you were able to attend all three sessions. Go back over that, you know, read that information. But you know, once again, you can go into investment products, you can go directly to options, if you scroll down the page here, this takes us into the strategy desk, you can make an appointment with them for a coaching session. You know, they normally ask, well what is it you're taking a look at? I'm wanting to learn more about options, understand more about these type of strategies, so that's something you can do. You can also contact Fidelity and reach out to one of the brokerage consultants, or regional brokerage consultants to help you with these. We do virtual sessions where we can do both Zoom, or we do Glance sessions where we can actually come onto your computer with you while you're logged in and point different areas to go, and talk you through it, so that's where you'd want to go there. The other place if you want more content, more help, and you want to look at, you know, different things, you can go into News and Research, right here from news and research, go into Learning Center, then inside this learning center, you can actually go in and type in the topic that you're interested in, so options, let's say, hit enter, and then this is going to pull up a menu of items that we can go in, as far as the different topics and things for options, so you can kind of pick and choose what it is you're interested in learning, and different topics from here, so you know, you've started down a road or a pathway. We're giving you a lot of information out of the firehouse, I mean just, you know, so much we're throwing at you, maybe different ideas and concepts, to Ed's point, take your time, go through the material. You know, stick with the old Warren Buffet thought processes, don't invest in stuff you don't understand, so you know, get a good knowledge on what it is you're looking at doing, making sure you understand, and then you don't have to trade big. You know, you can always start with one contract. They'll have a lot in it, and you know, from that vantage point you can kind of take a look at it. If you have questions, you can always call us, we can go over that, but that would be some of the things that I have to take a look at.

All right, protected puts, let's take a look at it. So, we're going to go to News and Research, go to options. I'll pick on Boeing this time so if we do Boeing, we're going to put it in. Once again, to keep from getting confused on my strategies, I'm going to go into strategies, and I'm going to say puts. I'm going to set it up for just puts so I know that's what I'm looking at, so you know, if I buy the wrong thing, darn it, I mean tot buy puts, but I bought calls, well guess what, now all I'm doing is looking at puts. Once again guys, you can customize this data, so for example, if you want to show different months, you can go in and actually customize and set it up on time to show those different months, okay. And you can also go in and go into the settings piece, and then add in the different things that you want to see as far as the call or put default so we can default that to just calls only. The number of strikes that we want to display whether that's ten strikes, five strikes, 20 strikes or a certain range, maybe you trade the same thing over and over. Default expirations, and then you can put in the different things here as far as you know, what it is you want to look at, whether that's bid, ask, last, open interest, implied vol. So that's where you would go in and kind of customize the data that you're looking at.

So notice on Boeing, we have an earnings event. We'll post both dividends and earnings events up here for you, so you can see those. We've got expected earnings coming out on 4/27, so you know, if we're looking at puts, we might be worried about the earnings event, or we want to maybe want to buy protection. But you know, this goes back to Ed's point, that the stock is currently at 241.79. Well if I want immediate protection at roughly the 240 range, and let me just switch this back here to just call or puts only, so here we go, puts, I did the settings piece and I didn't save anything that I did there. So if I go back to puts, and I look at the May puts, notice that the 240s for me to buy protection is going to cost me roughly $15.35 bid to $15.80, okay? Well that gives me the right to potentially either put the stock to somebody at 240, or get the ability to protect myself from downside if that stock continues to go down. But notice, the more risk I take, if I'm willing to take on ten more points in risk, maybe I own Boeing at $100, right? I'm willing to assume 10 points of risk, that premium that I paid, just like a deductible on an interest policy, you know, if you're willing to assume $1000 deductible versus a $250 deductible, typically that's going to be less on the cost. Same thing, I'm willing to take 10 points of risk. For doing that, the difference in the premiums are a little bit, right, about 35-40%. I'm willing to take on even more risk and do the 20s, the 220s, notice those contracts cost me $7.60.

So Ed, a question that I always get, and I always tell clients, I think it's a preference, it's a factor of, you know, how much risk you want to take on, what's your cost basis on the stock. But what are the right strikes to buy here?

Ed Modla: Tough call. Yeah, as you're looking at it, puts can look expensive, particularly in this case. You know, you always want to know where earnings is; it's great that you pointed that out, April 27th. So certainly if you want to protect earnings, and you're going to buy puts in May, they're going to be elevated in price. And when you look at this, it might look expensive, which is what might lead you to another alternative like the collar, or we didn't talk about possibly doing a put spread to protect some of the position. So what's this -- the correct strike? Well you've identified it. How much are you willing to give back, and then how much are you willing to pay for that, right? It's a simple analysis, the way you would evaluate any other policy you were going to purchase that was going to provide you for protection. But then to further add some detail to your question, one of the situations, as we identified in sort of the case study, is when you are in a very profitable position, your stock is looking good, you've got a nice big, green number, you're not buying after earnings, you know, the premiums aren't juiced -- you're actually buying protection, when this situation is rather calm and looking good, and everyone's comfortable, and the stock looks like it's going nowhere but higher, put options in this way, the protective put outright, seems to me to be more frequently traded when the situation is calm, and you're buying protection against something you do not see coming, and you don't want to be blindsided. Those are the situations, and the premiums might be more reasonable.

Allen Helm: And probably the process of thinking about puts is when the market's up and trending up, than rather when we have a scare in the market and the market has maybe sold off. Is that a fair assessment?

Ed Modla: Yeah, with respect to earnings, it's that potential scare, because earnings is dangling out there, and these options expire right after that. The market is expecting the possibility of a major selloff or a major scare. That's why those premiums are there. You can still look at buying puts in that situation; I don't want to discourage that, but it is going to cost a lot, and that's where those alternatives may come in to do something else to offset that cost.

Allen Helm: And the other thought process to buying the put is you know, maybe you think this stock is going to really run, and the $7, $8 or $10 in premium that you pay for the protection you think would be offset by 40 or 50 points in upside. And so you're like, you know, I'll give up some of that potential upside just to know that I can protect the position, or move the position at a later time that's more strategic for me.

Now, the other side of that coin is, you could simply reduce the position and sell the position, pay the gain if it's in a taxable account, or harvest some of the gain on some of the position. Doesn't cost anything to do that, right? This does cost something to do. You can also put on a stop, or a trailing stop, or something like that. Once again, doesn't cost anything to do, but it won't necessarily, you know, protect you from after-hour events or things that happen. You know, if something really bad happened overnight, you know, you're not going to be able to get out of the position. The stock is already reacting and would be down. So while that doesn't cost anything, it doesn't necessarily protect you from unforeseen events, or that, where the put option gives you a price certain and you have that capability.

Now the other solution to this is taking a look at a collar, and I've used to do this in a past life for a lot of executives where, you know they've worked at a company for the last 20 years. They're going to retire in six months, and they want to know that when they walk out the door, we'll use Boeing as the example here, they have a $2 million position in Boeing, they want to know that when they step out the door on their day of retirement, that that stock is worth $2 million, and how do we do it? So you can use a collar as a strategy to protect the gain, and really the thought process on that is to use a covered call to pay for the premiums to buy the protection, and then put in a floor. Normally when I was building these and Ed, tell me your thoughts on this, but normally when I was building these for clients, we always looked at a collar that was either net zero or would typically have a little bit of a credit. So, I'm always the kind of guy that like, man, I love to get paid to do stuff. So if I could squeeze out maybe 50 cents or a buck on the collar, and then give myself maybe 10% downside and 10% up on that collar, I would take a look at those. So what's your thought process on that?

Ed Modla: Totally agree; that's exactly where I would start as well, and I would further state that normally when I would look at developing what strike prices, I'll start with the put strike first, because I do consider it a protective strategy more than anything else. So I'll look at, what would I like to buy, what amount am I willing to give up on the stock. I won't care too much about the premium yet. I won't evaluate that. I'll just decide, how much am I willing to give back on the stock before I want the protection, and then you can see what premium is that going to cost me, and then start to look at the cost, and figure out, as you were saying, for starters, which call would I have to sell to give me even money or a little credit, and then you can tweak your strikes from there as necessary.

Allen Helm: So Ed, so I'm running these guys all over the board, I'm showing tools, so I'm trying to stay in one area with them, because I know we're not going to get everything that we're showing here. But the way we can run this collar is we can go to trading ideas here. And remember, we were in here kind of looking at the strategy evaluator, and then also the strategy ideas. So if I go to the strategy ideas, notice in the available strategies that I'm looking at right here, I do have a collar selection, okay? So I'm going to select a collar, maybe this is a new concept and what did Allen and Ed say about a collar, you know, gosh I can't find my information, if I just click this, this is going to show us what a collar is, okay? So it's going to kind of diagram it for us, similar to what you've got, Ed, and you know, that type of information. Then I'm going to put in the underlying stock that I want to do a collar on. We'll go ahead and leave it at Boeing to protect the innocent here. We'll just go ahead and use that one. And then I choose the timeframe that I'm looking at. So is that collar going to be 60 days or less? Is it going to be 60-180 days, whatever that is, I hit "apply," and then computer will actually run me collar ideas, to your point, Ed. And it's showing me the strikes, along with the puts, and then it's showing me if I'm going to have a net debit or credit, and then it shows me what my downside floor is, my upside cap.

And so, I can go out. You know, this was showing 618 as a choice, or 820, 21 as a choice, and I can say, oh, okay, so for a 50 cent credit, I know that I've got a hedge on my put side at 215. I've also put a call on at 270, and I'm getting a 50-cent credit on that, and that's going to be my collar that maybe I take a look at. Now, we don't have to go this route; we can always jump in on the options page, take a look at both the puts and calls and match that up, maybe that's not the solution. But the computer will run some of this data for us automatically and kind of give us a suggestion. So that's a collar idea that you can take a look at. And then once again for folks that this is all brand new, I just went into news and research options, we have the three tabs where we put in our stock symbol, so we're using Boeing as the example. We went over to the trade idea tab and then from here we went to strategy ideas, and then notice we could choose the strategy, whether that was a vertical spread or a collar whatever that was, we could go in. So those were things that we could take a look at, so anyways.

So I think we have time for a few more questions, Ed. So let's see. Here's one that came up. So, what is the difference between implied volatility and imploding volatility and how would that effect on the option? So, on some of the screens, I showed ideas of applied volatility that was exploding. So if we remember from Ed's presentation, applied volatility is what the market thinks is going to happen, how it's going to react so maybe there's something going on with a biotech company that has a new drug that's awaiting FDA approval, and if they get the approval, it's going to be a huge, huge move for the company. So maybe the market's anticipating that. Once that news is out, maybe the news isn't good, that implied volatility implodes and it goes out. So Ed, I don't know if you want to add to that, but why people would look between the implied volatility and exploding volatility, but that's in essence what happens is we can look at that, and typically when you're looking for that kind of volatility, you're selling volatility.

Ed Modla: Yeah, and I would say certainly if you can quantify changes in the current level of implied volatility to have exploded or imploded without question, make sure you know why that happened. There's going to be a reason, whether it's an announcement or something unexpected that occurred, or something unexpected that's about to occur. There's going to be a reason for that, and you can then further evaluate whether or not that explosion or implosion was justified. Implied volatility might then gravitate back in the direction of its average, or if that news was significant enough, maybe it doesn't. But that further analysis would be required.

Allen Helm: Another question, Ed, is is it better to sell weekly calls and puts on the close of Friday trading for the next week, or early on Monday morning?

Ed Modla: It's a good question. So first of all, time decay does occur over the weekend. It is true that on Friday afternoon, you are selling, in theory at least, time decay that includes Saturday and Sunday. I've spoken to investors who say that they do implement that technique where they're selling on Fridays to capture a quick three days of time decay, and they claim that it works. My response is, maybe it does, maybe it doesn't. Sometimes it will, sometimes it won't. If there is nothing that occurs, no big headlines come out, then certainly, selling options on Friday might work in favor to get the quick reduction in days to expiration. But you really are taking a full weekend worth of risk that something can happen from an economic or maybe even a military perspective anywhere around the world, over the course of those three days, that forces the market to then open up on Monday morning with a big change, and that's when you get caught off-guard.

Last thing I'll say about that, Allen, brings me back to my trading floor days. When I was on the trading floor on Friday, I didn't want to be buying options all day. If I was getting sell orders, guess what happened to my bids, they came down fast and quickly. And if you wanted to sell me options on Friday afternoon, I was going to be paying basement-level prices, so keep that in mind too. The professionals also know what's going on.

Allen Helm: It's always fun doing these with you, I wish we had more time together. Thanks again for all the material and your expertise in this.

END OF AUDIO FILE

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