

TRANSCRIPT

OIC: How do options fit into my portfolio? Strategies and ideas

Allen Helm: Hello everybody, and welcome to our last and final event today, "Can options fit into an investor's portfolio?" I've got Ed Modla with me from the Options Industry Council. My name is Allen Helm. I'm a regional brokerage consultant for the Austin/North Texas/Oklahoma. I have over three-plus decades of experience. I'm a Registered Options Principal-licensed manager, also an ex-commodities guy. I have Ed joining us today with, if not more experience than I do, from the Options Industry Council and the Options Clearing Corps. We will have slides. Ed and I will be going through both slides and then also a live demo. If you would like to sit down with myself or one of my colleagues, there's 26 regional brokerage consultants nationwide, and we help our clients navigate Fidelity's award-winning brokerage tools to meet their goals and objectives. So if you own individual securities, we have folks that focus on equities on the brokerage side, and then we also have fixed income regional brokerage consultants that also work with clients that have outside, or have fixed income investments and what kind of things that they can do to help you with those aspects of your business.

So, without further delay, Ed if you want to go ahead and introduce yourself to our viewers, we'll go ahead and get started: "Can options fit into an investor's portfolio?" and take it away.

Ed Modla: Sure, thanks Allen. You mentioned 23 years for yourself. Same here. I got my start in the business in 1997, and ever since have been using options in one way or another. It started out in the trading pits on the trading floors in Chicago and New York. I was also an independent trader after working for some large firms. Was a broker for a little while also with Allen in the commodity space trading futures with clients and for myself. For the past six-plus years, I've been in education, teaching market participants, those are individual investors, financial advisors, money managers, how to use options, and I'm looking forward to this session with you, Allen. We're going to walk through some different hypothetical situations that investors might find themselves in, take that and translate it into an options trade and then we'll take a look at some things on the Fidelity platform, pull up some quotes and chains and see how things might work as the investors actually executing a trade and some things they need to consider.

First, our disclaimer. Options are a complex tool that needs to be studied and understood before using them in a live account. Since we're gonna walk

through so many strategies and examples today, I should say those are for educational and illustrative purposes only and should not be interpreted as an endorsement or recommendation. Also, there is no form of direct partnership or affiliation between the Options Industry Council and Fidelity Investments. While we're partnering here, we are completely separate entities.

So, let's just get right into it. We're going to go through three case studies today. I'll walk through that hypothetical circumstance, and then, me and Allen will walk through some of the details on the Fidelity platform. Hopefully, this will help those who are beginners take that basic-level foundation of knowledge and understand a little bit more about what it means to actually implement a particular market outlook into your options strategy. Let's look at this first one. You had an opinion on the direction the stock is headed. That means it's not going sideways; it's not consolidating; it's not trading in between support and resistance. It's going somewhere. Higher or lower, you're bullish or you're bearish. If you're a stock trader, and you only trade shares, you can only buy or sell stock. That is what you are limited to. Options give you alternatives, or things you might consider. For example, buying a call or put, or buying a vertical spread.

Certainly, if you have a directional outlook on where the stock is headed, it doesn't mean you're going to buy options. There are selling strategies that would also have some level of a directional move incorporated into them. However, buying options requires you to have that directional outlook, particularly if you are very bullish, or very bearish, and you're expecting a rather large move over a certain length of time. Buying a call or put would of course suffer from time decay. You know that options naturally decay over time, and you need profitability to be derived from the movement in the stock.

Particularly, you have to be correct on the direction, the magnitude of that move, and the timing of that move in order to be profitable. It's not easy to get all that right, and if you miss one, it's tough to make money buying a call or a put. I always say, there's a time and a place; there's a certain condition where buying options, particularly this way, might yield some good returns, but it is not easy to do this consistently profitable over time, you more or less have to pick your stocks, buying a call or a put. They can also be somewhat expensive. Many investors don't like the fact that you had time decay working against them, so in order to mitigate that, you can implement a spread.

Buying a vertical spread, either for calls or puts. You could purchase a call or put, and then simultaneously sell a lower-priced option of the same kind; if you bought a call here, you're selling a call here. If you bought a put, you're

selling a put. A sold option is lower-priced; it's further out of the money, and what this does is it provides a benefit and it also, it comes with a cost.

The benefit is you are into this trade at a lower price point. Your risk is lower, your cost is lower, and what you give up in exchange for that is the potential for big gains should the stock move outside of the strike price of the option you sold. That leads me to one, I would say is a general rule of thumb in this case: when you're selecting the short option, it would be the level you think the stock is going to possibly get to, but it's not going to go through. That's where you're looking to select that short strike price. Further from there, you would then look at the premium and decide is it worth it to sell the option for the premium I can get for it. If it's not worth it, maybe you go back and just do a long option. Or you start to investigate by bringing your strike price in and look at options with a little bit higher premium levels.

And we want to look at this as an example. So, before we get to the platform, let's just walk through a hypothetical example, and then Allen's going to take us through something a little more realistic. Let's just walk through what you might be faced with, after analyzing, say the technical chart on a fictitious airline stock, a JETX, you determine that shares have reached a strong support level and might be due for a rally. A stock trader is going to look to buy shares

at this level. But oftentimes, if it's a strong support level, and it's broken, the shares can collapse pretty quickly, particularly if the stock happens to open up below that support level at the opening bell. This is where stop-losses might not help your long stock position. If this is concerning to you, and you think, well this support level doesn't hold, my long stock position could really collapse, that's where looking at these alternatives of options can come into play. Alternative to buying shares would then be buying a call, lowering your cost. It could be, concern of knowing, buying shares doesn't have time decay. Buying options does. That's what you have to be concerned about. But you're controlling your risk, you're controlling your cost upfront, and if you wanted to then further look and take that long call to reduce it even further in cost and risk, you can investigate vertical spreads.

Allen, as we take a look at the hypothetical, and then maybe translate that into a realistic look with some tickers, and of course you can do this with the put and the put spread as well, if you were bearish, but we're focused on the call side here. So, let's take a look at an example and see how this might be implemented by the investor who wants to use these strategies.

HELM: A couple things real quick. If you need to set up an options count, just if you go to investment products, go to options right here. Here's where you would

go in and apply for options. There's also some idea generation here. For buying puts or calls or doing vertical spreads, from the research standpoint, I'll focus in on Fidelity.com, but I'll also introduce a new platform or product that clients can use, and that's our Active Trader Pro platform. You know, where I found that once again, if I just go to our account here, you could go to Accounts and Trade, go to Active Trader, you could download that product on both a Mac or a PC. If you need help with that, we have an 800 number. It's 800-564-0211. I'll be showing a little bit of both of these, both at fidelity.com and Active Trader Pro in today's demonstration.

So, let's go back and just to fidelity.com. You'll notice I'm running Active Trader Pro in the background, so we can run them both at the same time. But if we just go to fidelity.com and go to options, once again, we can take a look at a live example. You know, let's make it QQQ, so we'll do an exchange-traded fund as an example. So QQQ, the Nasdaq 100 Trust, if I just type that in, you'll notice on my chains, it will give me the months that I can look at. It will put the strikes here in the center. I've got puts on this side, calls on this side. I can actually go in and customize this window, so if I go to settings right here, so once again we shut that down, but if we go to settings, this will allow us to take a look at how we want to default data, so if we wanted to have that set up to where we're just looking at calls or puts, we can do that.

So, we can also default a number of strikes, so the different contracts. We can actually even go in and custom, so if we wanted to look at let's say strikes from 300 to 310, we can actually go in and customize the strikes that we want to do. We can also default it to three months or further out. And then you can choose or customize what columns you want to put in here -- some of the Greeks like delta, theta, some of those type of things that are available, so you can go in and customize this.

And then once you've done that, you can just hit "save" on the screen to go into what it is you want to do, and so I think the first example is we were looking at buying a call. We could go in; of course, we've got the different months that we can take a look at, if I wanted to turn these weeklies off. So, I've got both the months and the weeklies, I could just go in there, and instead of having the weeklies on, I've got them turned off, and then off and hit apply.

And so then, this is just going to display the contracts that I want to see. I'm going to remove the December so these expire tomorrow, and let's just focus on the Januarys and Februarys, and then this will give you the dates of the contract you'll notice, so these expire one day from now. We hit apply here. There we go. These expire 29 days from now. In the notice, we color-code,

we have our history-gram off, but we color-code the different contracts here as far as the open interest, and then the volume that's traded on the different contracts. If I wanted to buy these contracts, so we're at the money, we've got 310.67, we're looking at the 310s, I would just go in here and say buy-to-open. That's going to take me into a page where then I can run an actual trade so it would show, we would put in the number of contracts that we want, whether that's in a margin account or cash account, would get that. Of course, it gives me a current bid-ask, and then the size, so one contract bid 25 ask. So, and I don't know if you want to add a little color on maybe bid-ask or any of the Greeks like delta-theta real quick.

MODLA: Well, bid ask certainly, yes. I think it's really important that investors are looking at the bid-ask size. And what Allen's showing here is, this option is \$8.33 bid, and there is one contract bid for at that price. It's offered at \$8.35, and there's 25 offered there. Beyond the \$8.33, \$8.35, we're not really sure where those next levels are. Now in the Qs, there probably is an \$8.32/\$8.31 bid, but let's just say you were a seller of this option and you went in and wanted to sell five contracts at a market order, well you can only be certain to get one at \$8.33; the other four are going to get filled at wherever the next best bid is. So, some familiarity with your ticker symbol certainly is advisable, but at least tracking the size. We were looking at buying this option. Well

there's 25 offered there, so that's pretty comfortable if we're going to be buying less than 25. I would always be looking at that bid-ask size, and then generally tweaking my limit orders a little bit based on what I might see there, particularly if it's a low number like we just saw with one.

HELM: Well, to Ed's point, you know right here we can go through the chains and look at the specific bid size, ask size on the different contracts, and then go in and you can always put in an order as a market order, but you can also put those in as a limit order. So, we would go in, you would select the order type right here limit, and then you can specify what it is you're willing to pay for that contract. So you know, if we didn't want to pay more than \$8.47 or maybe we were happy to try to get it at \$8.45, we can actually put in that price and just specify well we're willing to buy that at \$8.45 or less on the price. And then once again you would choose whether you wanted that to go into a margin account or a cash account. A lot of times if you're in a retirement account you would select, you know, that cash piece of it, and place the trade if you had a market account under brokerage, you would go in and probably use that margin account and place the trade over there. So that's how we would initially place that trade.

Now, Ed, a lot of clients asked me for, what kind of ideas does Fidelity have potentially to show us on, you know, long calls, or long puts, or are there any

resources that are available to give me different ideas. You know, unfortunately, no one at Fidelity's going to tell you, well you need to buy XYZ calls, you know, because we think that it's going to go here. However, we do have some resources where you can go in and they do have actionable trading ideas and things that you can read. So let me go into that real quick, and then we'll cover the spread idea and I'll run that on Active Trader Pro and kind of start giving our clients and people watching a little flavor of Active Trader Pro and some other resources that are there.

The Dan Nathan report, I mentioned that just a little bit on the first presentation. If you go to this Dan Nathan report right above this is going to take you in and this is a weekly series that comes out. Actually, Dan Nathan who's a CNBC commentator, he does different ideas. He looks at long calls, long puts, spreads, different things that you might take a look at, and then he follows those trades with you. This is something that comes out weekly. This is my colleague, Heather Knight out in Florida. She's a regional brokerage consultant, but she's narrating that with Dan. And so, they're weekly ideas that customers can go in and take a look at, and follow the commentary, and also take a look at different investing ideas. Another place that you can go, there is actually a research report that's put out by Argus on a weekly basis that comes out Mondays typically around 11 o'clock Eastern Standard Time,

and it's a weekly report, and it's actually an options report, that will give you both cover call ideas and long call ideas, so a lot of times they're doing earnings plays and things on individual stocks. So, if you have an interest in looking at those ideas, you can go in right here.

So, I went to News & Research; once again I'm just in Fidelity.com, News & Research, I go to stocks. When I go into that stock page right here, you'll notice this is showing you kind of what's going on as far as market movers. You can also track orders by Fidelity customers. So this is showing you the most popular stocks from an order standpoint going across the Fidelity platform here, so we go in and take a look, see more, so this is going to list those stocks, show you the buy orders and sell orders what's coming in, and then those different stocks here.

But if you go into Research Firms, so if we just select Research Firms, there's two sets of model portfolios that you could get from both Argus and Zacks. Argus has that options report, but if I select the Argus Analyst, this is a list of research reports, and this is why we feel Fidelity is superior to all our competitors by the way, because we give the most research of anybody out there. And quite frankly, we've had the Argus representative on our regional calls, and if you were to purchase this offline and you're getting this service for

free through Fidelity, he told us it would be about \$120, \$130 cost on a monthly basis to get all these different reports. So, you can look through the different reports, but that options research report is here at the bottom of the page. It'll give you a weekly options watch report. You pull that report up, and then inside this report, you can actually find some actionable items. And so, you'll see kind of their trade of the week, what they're looking at. You'll notice as you scroll down the report, so that's the week of December 14th, they have both a covered call list here that they're looking at ideas on their model portfolios, and then they also have pre-earnings calls or call buy-in strategies where they're looking at specific ideas that you can take a look at and read. And once again, that comes out every Monday at around 11 o'clock, Eastern Standard Time. So, there are some of the research pieces.

I would encourage you, want to show you the best tools that we have both from a research standpoint, and taking a look at options. I would say that if you're going to do some options, it's definitely worthwhile to go into Fidelity, and then go ahead and download Active Trader Pro. Once again, Active Trader Pro can be downloaded both on a Mac and a PC. We have layouts that are already created for you that you can use. You can create your own layouts, once again there's 26 regional brokerage consultants nationwide that are here to help. We have a strategy desk which you can talk with that are here to help,

but these are the tools maybe that you might want to take a look at, because they are streaming tick-by-tick data, and when it comes to options, that's probably something that you're going to want to see. When you have that downloaded, it's going to come in right here and look similar to this. What I've done here is I've just created a layout, but you'll notice that I've got a daily dashboard showing me what's going on in the marketplace, S&P's up 20, NASDAQ's up 91, and 133 on the Dow. And then what I've created is just a streaming list of stocks in the portfolio. Once again, this is just a demo account, so don't read anything into the stocks.

But you'll see, here is a live options page. It looks very similar to the one on Fidelity.com. Once again, you could put in the symbol that you want to see. So, let's say, Facebook as an example, we could put whatever, Google. And then from here, we can, in a similar fashion, we can go in and just display calls. You can set up by just right-clicking into the options chain. You can set up the settings of what it is you want to see so you can add in the different things in. On that first session that Ed and I did on the options, Ed mentioned intrinsic and time values. You can actually display that as part of the chain, so if you wanted to see what the intrinsic value is, how much it's in the money, and then the time value or volatility, you can actually add those components in and

display that, and then what we can do is just choose a specific call that we want to look at, and then we can go in and take a look at the data.

So, let's do a quick spread, because Ed had mentioned a directional or vertical spread that we were taking a look at. Inside this options chain right here, you can go in and pull in what's called an options statistic window. That's this window right here, so options statistic. It's going to open up, and then we can just put in, let's say SPY, whatever that is, we'll do an ETF here. So, SPY. As we'll go through and show us as far implied volatilities, the implied volatility currently on the S&P 500 or SPY is the exchange-traded fund. And then that historical volatility that we've seen over that 52-week period, so you know, once again, volatility's going to drive a function of the pricing. Then you'll notice right here, there is a probability calculator that we can take a look at where we can model trades here. And then there's a profit/loss calculator that we can use.

So, Ed had mentioned on doing the calendar spread, right here we can actually add a simulated trade. We can also do this on Fidelity.com. But we can go into the spread and then we can go in and say, okay, we're looking at buying let's say five contracts of the SPY. Let's go out to the January 15th. We'll choose a strike, so we'll do, currently it's at 160 or 372. Let's go to the

370s, and we'll buy to open a call, and then we'll go in and we'll take a look at selling five, an exact amount. And once again, just do the January 15s, and we'll take a look at maybe selling the 380s as a call. And then if we hit "apply," what this does is this diagrams that trade for us. And it shows us, to Ed's point, we do pay out from premium, but we do take in some premium on that short leg. But it does cap the upside potential on the trade. So, those are just some of the tools on that first examples that we can do to look for ideas, where we can place trades if you're more comfortable on Fidelity.com, how you would place those trades. And then also using Active Trader Pro potentially to place those trades.

Once we have it in a simulated position, we can go down here so we've got a spread. We can always tweak the spread. But from here, you could go to play strat, place the trade. This will take us into that spread strategy and from here, we could go in and set up a limit price maybe at the bid. So, our net debit on that would be \$4.91, but we could always set that as a limit order, so.

So, I will let you go ahead, Ed, with the next scenario, and we'll push along.

MODLA: Yeah, and that piece was wonderful, Allen. That analytics part before you get to the trade is so important, and you have to keep that in mind. The

options strategy is going to work as advertised. You have to have that market thesis down, and then the strategy follows. We know the covered call. This is our second example. We know the covered call is one of the most popular strategies that investors like to use when they trade options.

So, let's look at a couple of different ways to use covered call strategy here in this example. We're going to start by saying the investor has some different stock positions in their portfolio, and maybe they're comfortable with how they've performed over time and starting to top out a little bit. That extremely bullish outlook might not be there, and the investor decides, I want to bring some cash into the account without necessarily selling any of my positions at these levels. Maybe I'll sell some of these positions if I can get another 1.5, 2, 3% out of them.

Instead of throwing out limit orders to sell your positions in stocks, you can consider the options piece, and this is where covered calls can come in. First of all, maybe, selling slightly out-of-the-money calls, for those of you familiar with deltas vis-à-vis your 40-50 delta call options; if you're not familiar with delta, that just means strike prices that are slightly higher than where the stock currently is, slightly out-of-the-money calls. You do want to keep in mind that your strike price selection would ideally be consistent with a level that you've

determined to be resistance for the shares, a level that the stock is not going to break through, or at least a level you're comfortable selling some shares at, selecting the strike price as low as possible given those motivations. Where is that stock going, and where am I comfortable getting rid of some shares?

Just take it one step further, you could also stagger your strike price selection, and/or sell fewer calls than shares owned. This would mean, if you had 500 shares of stock, instead of selecting your strike price and selling five calls, you can select a strike to sell two of them, go up a little bit higher than strike, sell two more, go higher and sell another one, and this would be similar to working different limit orders to scale out of the position as the stock rallies, receiving premium for all of those options that you sold. Or, if you wanted to sell, say, four or three calls, even though you had 500 shares, maybe then you can be more aggressive, capture premium, and if the stock rallies a significant amount, you still have 100-200 shares to capitalize on that move.

We certainly want to look at covered calls on the demo, but let's do another hypothetical example with a fictitious company, a financial services company, DOLR. You've owned this for many months, and it's performed well. Now you may find yourself in this position with some of your current holdings, where the stock has done really well, and now all of a sudden, when you're looking at

your entire portfolio, this one position that's performed incredibly well, is now a bit too much. Its allocation is a bit higher than your comfort level for your entire portfolio, and now you're ready to maybe scale that down a little bit. It can be difficult when a stock's done really well for you to go ahead and sell stock right where it is. Options may help with that discipline that puts you in a position to get out where you need to.

So, an alternative that is going in and selling shares and reducing your positions there, is to sell covered calls against slightly out-of-the-money calls would generate income through premium. You're going to sell the number of calls equal to the number of shares you're willing to sell. If you have a thousand shares, and you're willing to depart with 400 of them, then you're looking to potentially sell four call options. You can also stagger those strike prices, sell a few that are more expensive calls, sell a few others that are cheaper calls. You can also stagger the expiration dates, sell two calls at a strike price that expires in the near-term, sell two calls that expire a little bit longer-term, and do different things. This is all simply the covered call strategy, but done in ways that are a bit flexible, as we mentioned in session one.

That's one of the main features of using options is the flexibility of the product. Allen, I know you talk a lot about covered calls and you use them a lot when you're trading options for yourself and your clients. So, let's just take a look at what putting together the covered call trade might look like. Take a look at some quotes, and then what it might look like to execute these transactions and put them in our portfolio.

HELM: Sure. And let me know Ed, can you see my screen?

MODLA: Yes, I can.

HELM: Okay, so there's some tools; there's some wonderful tools both on fidelity.com and Active Trader Pro that you can use to model and run some covered call analysis. There's also some wonderful tools that you can use to look for specifically covered call ideas where you can screen those type of ideas. So, let's go into an example where maybe we had a stock that we're taking a look at, and we wanted to maybe model some of the covered call strategies as far as rates of returns. We're going to look at maybe at-the-moneys and out-of-the-moneys on the different covered calls.

The place you would find that, and this is a tool that I highlight with a lot of clients that are first starting out, or looking for ideas, or how do I model some of these trades, if you go to just directly to fidelity.com and just go into News & Research, and we go once again back into options, it's a little bit hidden in here, but if you go to the trade ideas tab, you'll notice that there's a report finder, a strategy evaluator, and then strategy ideas. Now what we're going to look at initially here is that strategy ideas area, and once again, just from muscle memory, we went into News & Research on Fidelity.com. We went into Options, so News & Research, Options. I know a lot of people are following at home on the pathway. We go to trading ideas right here, and then we're going to look at strategy ideas. And so, this applies to the different strategies that we've talked about in a lot of examples today.

But notice, and we'll talk about cash-secured puts a little later in collars. But notice we have a covered call strategy as far as an available strategy. You can also filter your thoughts. So, if you thought the market was bullish, neutral, or bearish, you can select these, and it'll tell you which strategies you might want to look at based on your thought process here. But we're going to look at covered calls, so I select covered calls. Notice it populates right here, covered call, it's going to go through and explain the strategy that we can go in, and you can click those little icons and read the different strategy. It's going to pull

up a list of covered call ideas. Real important on this, so there is no analysis going on. The only thing that the computer's looking at is what is the best if call rates of return? If we ride a covered call on these ideas, what's that rate of return over time? So, it doesn't look, is that a buy-rated stock, a sell-rated stock, what is that? It just is scanning the marketplace to look for a covered call idea and what that best rate of return is.

From here, you would actually type in the symbol of the stock you're interested in. So, let's say it was Boeing. We could go in here and choose the timeframe that we're interested in, 60 days or less, 60-180 days, 180 days or more. Ed, I don't know if you have a thought process on timeframe that you might want to share, just out of curiosity?

MODLA: Well, sure. And now we're looking at selling options here. The idea is to generate income, capture some time decay. We know decay starts to accelerate around that 40-day level. I'll just say it's less often you'll see investors go too far beyond that, as far as how long they'll go to select their call strike. More often than not, I hear investors trying to select the shortest time duration they can, capture the fastest time decay they can, but also making sure, and I've said this a few times, they're getting enough premium to make that obligation worthwhile. You have to go out far enough to get

premium, but you want to keep it as short as possible to capture that time decay.

HELM: So, we set that default for 60 days or less. You could always go and look at maybe 60 days and a little further out. I'm running the data for Boeing on anything that's 60 days or less. Notice that it gives me the expiration. I can sort all of these different columns, so if I wanted to look at, you know, the further out expirations or the closer-ins, I can sort that data if I want to. And notice here, it's running, it's showing me what the current price is of the stock, and then it's showing me the current strike. So, you know, if I wanted to sort these by strikes, I can sort them from higher to lower, or lower to higher, whatever it is I want to do from there. And then it's giving me a standstill rate of return that call delta that Ed had mentioned right here, and then an if-called rate of return. So, we can once again sort that call data if we wanted to from higher to lower, and so you know, depending on what it is we're looking at, we can go in.

And then we can take a look at the different contracts and the timeframes. So, once again, Boeing is currently at \$222 roughly. We're looking at maybe the 225s if we were interested maybe in possibly getting out of some of this stock. These are the 12921 contracts. We would collect roughly \$11.35 of premium.

That gives us a 5.39% downside protection on that, and an if/call rate of return at 9.26. Now none of these numbers are annualized. The other thing the computer does, and now maybe you own that stock at \$150 a share, this is just showing you what the current price is, what the strike price is, and then what that if-call rate of return would be, and then what that downside or standstill protection would be. That's how you can go in, you know, and take a look at an individual idea. You know, once again you can plug in let's say Visa or whatever. You can run those, you can run as far out, or as close in as you want to. You can sort these different columns here and go and take a look at the shorter-term contracts, or the longer-term contracts, depending on what it is you're looking at, and what the thought process is. So that's one tool.

The other tool, if you're just looking for ideas, so you're interested in ideas, and you want to generate a report on that idea, if you go back up here to the tools, the report finder right here, this is going to take you into an area where you can actually screen Argus research reports that are in-the-money, out-of-the-money, or both. You can plug in your own stock specifically that you're interested right here. And so, we could put in Visa, Boeing, and get an actual report, so let's do that; we'll plug in Visa, kick it in. And then from right here, we can actually get a covered call research report, and then go from there, and go down and take a look at that overall report. And so, what this is doing is

this is showing us a suggested covered call with a target price, and then they're giving you the idea from right here if that's something you want to do. Or you can go in and just simply screen ideas. So, a lot of our customers don't realize this is here.

So, Ed was talking about out-of-the-moneys, in-, and at-the-moneys. We can do both if we want to, or we can just take a look at out-of-the-moneys only. So, let's do both. We can take a look at the Argus-rated stocks that are either buy or hold, so let's take the hold off, and we'll look at specifically just covered call ideas, although we can run some spreads if we wanted to do that. And then days from expiration, you know Ed was saying probably 45-60-some-odd days, maybe around there, so let's set this up and we'll look at contracts anywhere from, I don't know, one day out to maybe no more than 90 days. And we can set up a model and say okay, of those ideas we want to see strategies that at least give us maybe 3% in downside protection; we're hunting and looking for ideas. If we go in and load this up, this is actually going to give us a list of those ideas. And then from here, what you can do is you can sort the different categories that you want to see. So, from expirations to annualized rate of returns, whatever that is, and so you could go in and actually sort that data and take a look at the different annualized rate of

returns, or the assigned rate of return. Of course, this is on an annualized basis. And then a downside protection that you get.

Now, you know the one that came up here is actually Tesla. They're looking at a December 31 \$6.50 call as an example. They're going 15 days out and they're collecting a \$31.80 to do that. Now Ed, I don't know about you, but Tesla could move 25, 30 points pretty easily in a day, don't you think?

MODLA: I was just going to say, these annualized returns, they can be eye-popping.

I think it's wonderful analytics that you're showing, because I think looking at those annualized returns are very important. It allows you to compare one trade to another, particularly if they're completely different industries, different expirations. Look at the annualized return and see what's there. But be careful, because the higher the annualized rate of return, what that's telling you is it's a riskier trade as well. So, while you can make money, you also have to be concerned about that downside.

HELM: Absolutely. And you can go in and read the actual report here, take a look at that report, they'll once again get specific on the covered call ideas, and you know, go from there. Hey Ed, on delta, how would you explain delta to our

audience as far as that there are a few questions on that as far as delta, what would you say?

MODLA: I'd say a few different things. First of all, by straight definition, the delta number is trying to forecast how much the option value is going to change with each one-point move in the stock. And you can have a delta per-option. You can also calculate deltas for spreads if you had more than one option, you simply net out the number, and that net delta again is, how much is the expected change in value given a one-point move in the stock price?

There's also another well-accepted definition of delta which is the percentage likelihood that the option will finish in the money. That's not a precise mathematical definition, but it's accepted in our industry. And I mention that because that sometimes helps investors select strike prices. You'll hear investors, and I've heard them say, I like to sell 30-delta calls, I like to sell 40-delta calls. And I always as an educator will say, it's fine to have rules and say this is what I do, but it's also reasonable to treat every circumstance a little bit differently. If you want to be aggressive, and you be more bullish, then maybe you're going higher on your delta and selling 30, 25, 20 deltas. If you want to be more aggressive collecting premium and you're not as bullish on the share price, those circumstance lend themselves to 40-, 45-delta trades. So, there

could be differences case-by-case, but if you have a strategy, and you have rules, nothing wrong with that either.

HELM: And with that definition, so if we were maybe looking at selling some of the appreciated stocks that we had in the portfolio, we were looking at choosing different possible strikes, we would probably want to stick with the least deltas at .50 or 50%, with the likelihood that we have a 50/50 chance of potentially delivering those stocks, and/or maybe going a little higher on delta. Would that be a safe assessment in your mind?

MODLA: Yes. You're going to get the most time value; again, you're trying to capture time value when you're selling options doing covered calls. The most time value is going to be right there at 50 delta, exactly when your strike price and stock price line up. If you want to potentially capture a little bit of upside in the stock before shares get called away, that's when you start moving your strike price up. With good starting .50 deltas, the most time value is right there.

HELM: That you can get right there, okay. So, let's jump back into another scenario here, and we'll go through some of the tools on that.

MODLA: Sure. Let's look at one other hypothetical and this will be our case number

3. Shares have recently rallied and are sitting in a profitable position. We kind of walked through that with the covered call as well, but instead of feeling like you're just ready to scale down on your position, you want to protect it. And this is something often I always say. Trading and investing is also managing emotions, and when you have a nice winning trade, the worst thing is to see that turn red, and it's also very difficult when you've seen how good your trade can be, or high levels in the stock price. Just when it starts to retrace and pull back lower, it can be hard to pull the trigger and exit as the stock starts to move down. That's a discipline that's hard to incorporate every single time you know you should. Options can help with that by forcing that discipline. If you want to protect your gains and make sure you're getting out of this position if something bad happens, here's a couple choices for you instead of stop losses, a protective put. This includes your long stock position. Now you add the purpose of a put option. You're going to have to pay for that. That's an upfront cost; you're never going to see that money again. But now you own the right to sell shares at the strike price of the put option. No matter how low the stock goes, you can get out at the strike price. That's why you're buying this option, and that's why it's protective.

You also could buy a put option on a portfolio if you had many stocks in a portfolio, and you wanted to protect the whole thing against a broad market downturn, you could look and find an index or an ETF option that would track that broad market move and buy a put to protect all of your positions.

Another possibility is to implement a collar, which is a variation, like an extension of the protective put. You still have your long stock. You're going to buy the put as protection, just as you did before, starts the same way. But you're not comfortable spending all of that money to buy the put option.

Looks a little too expensive for you, so instead you decide, I will sell a call and accept the obligations of possibly lightening up on this position, but I'm okay with that because it's going to reduce the cost of the downside protection.

This is still a risk-reducing strategy. Because of this short-call obligation, you would not be doing in a collar on a portfolio. You would have to potentially deliver shares of a particular stock. So it's very stock-specific, and it's a strategy that money managers seem to use often when they or their clients have a consolidated position in a particular stock and they're ready to get out at a little bit higher level, but along the way, they want to protect against something that goes against them.

Hypothetical example, we have a soft drink company, Bubble, that you've had for many months. Shares have performed well. You think there's still more room to the upside, but you really don't want to give up all the gains you have. Oftentimes, this may come from history of yourself, knowing, and I've been there, watching a good trade get worse and worse, and watching it go negative. That can be very emotionally disturbing, and that's something you want to avoid.

So, an alternative to entering a stop order would be to use the options, the benefit here with the options is round-the-clock, 24/7 coverage, so overnight, over the weekend, you don't have to worry about it. Stop-orders don't give you that. So protective puts can be a choice to buy or spend some money, get the protection to the down side and sleep easier at night. The collar would be an extension of the protective put, particularly if you've had really nice gains and you're willing to start selling shares if they continue their modest rally, sell a call option in addition to the other two pieces. Now you have three moving parts, long stock, long put, and short call, but they all work together to protect the downside, to start scaling out to the upside, and to be at relatively low cost. Of course, that cost is going to depend on your strike price selection between the call and the put.

Allen, a couple different things to walk through here, as we're going to walk through an example and look at the platform again. I've certainly already seen with the first two case studies, the analytics are wonderful, they're showing, and that is the most critical piece, but once you have that thesis, then implementing the strategy comes next, and let's take a look.

HELM: A couple of the things to think about. So really, if you're buying a protective put, you're having somebody assume the risk of the stock over a specified time or the index. A lot of folks may be worried that that markets might pull back, or we might have some retracement with profit taking here of the last six months, whatever that is. So, you know, what are some of the strategies that we can do, to hedge that risk or protect potentially if that outcome should happen.

The simplest method is of course, you can just go in and put in a stop order of your stock. The risk of that is, I don't know, something happens overnight, you wake up the morning, and the market's down 800 points. You wanted to stock your stock out at 60 bucks, but you know, we wake up at 55 or whatever, and you have that market risk. I didn't cost you anything to do that, but you've had that market risk. The other solution is to just buy a protective put. On the first session, we also talked about using puts maybe, also that you could speculate on the downside, so those are the two ways that you could use a put. For this

one, we're just hedging the risk. And for that method, we're just going in and taking one, head of staff. Let's go back. We'll use some SQ as an example. When we go in, we'll just type that in, hit enter. And so, stock's up three bucks today. We're going to just go in and change this and take a look at puts on this and then we do have an earnings event coming out here on the company on 2/24/21. Let's say we were interested in possibly hedging some of that risk, wanted to go out maybe to March or June. We can put in the March and Junes, and then now we're looking at that put. Well once again, we provide projection, and the more risk we're willing to assume, the cheaper those contracts go.

So, I don't know, let's just say we bought this stock and we own it at \$100. And so, we've got a really nice gain in this. You know, I could buy protection at 190, okay, so if the stock were the drop below 190, I've got some protection. Here's what the cost would be, \$8.10, \$8.30 to buy that protection. As I get closer to the actual strike price, the \$2.30s, I'm going to pay \$24.75 of contracts (inaudible), so for everyone contract times 100 shares times \$24.75, I'm paying \$2,470 bucks to buy that protection. So that's one strategy.

Now the other is that collar strategy and what we're combining there is we're combining both puts and calls. You can actually build the collars directly in the

platform right here, so you can go in and choose a collar. Ed, what's your thought on collars? I've always tried to do them at a net zero cost or a slight cost. What's your thought on that?

MODLA: I start the same way as you. I look for zero cost. I'm actually really curious to see how this is going to look in SQ. I know the stock was trading I think around \$40 sometime this year. So when moves like that happen, sometimes you can see the premiums really shift in favor of calls, and we've seen a lot of that in symbols this year where the call premiums are really high, and in this case, if you're sitting on a really big gain and you want to buy some protection, but you're willing to sell at a higher-level strike price, you may actually be able to pull that off for a credit, but I'm not sure; I'm waiting to see.

HELM: Yeah, and just looking at the 230s as an example, we're getting \$25.70 to sell the call on the 230s, and where paying \$24.70 to buy the puts on the 230, so we would actually have a credit. We can run that same model in here by just doing a collar, and then we can tell the computer to take a look at the different collars that we have here. So, let's go to maybe the Febs. Let me see if that'll run for me... my demos. Let's do all strikes, and then we'll run it that way. And so, what we can do is actually go and let's see if we could get it at-the-money here. It doesn't like that. Then we'll see above-the-money, so we'll do at.

A lot of people that are really doing collars, maybe they've worked at SQ for the last five years, and they're going to retire whenever, they want to know when they retire or walk out the door that they're going to get X number of dollars for their stock position. That's why they would go in and actually do a call. So, Ed, let me kick it back to you, Ed. Didn't know if you had anything else on your side as far as any other feedback or anything from the side that we had today.

MODLA: I just want offer a final comment on this. I look at the collar as a risk reduction strategy, so when it comes to selecting strikes, what I find investors most often tell me is they determine what put they want to buy as protection first. They ignore the price of the put. They find what put do I want, and then they look and see what's that going to cost me, and then the second part of that puzzle is to take a look at which call option can I sell to cover that premium amount. From there, you can move either strike price either way you want to get a little bit of a credit, maybe incur a little bit of a debit. But I find most often it starts with selecting the put and then looking at the calls. In the case of SQ, you might be able to go \$30 out of the money either way, maybe even get a credit doing something like that, but that would be a bit rare. I always think, starting with the put strike selection is first, and then looking at the calls after that is the best way to put it together.

HELM: Yes, I've built these in my career for clients, and the goal really is if you can get to maybe a sliding credit, like I'm talking a nickel, that's really happy times, and if it costs you maybe a nickel or dime to do it, that's probably more realistic on looking at these. Wouldn't you say that that was kind of the case?

MODLA: For sure. My old eyes are trying to look at these premiums. I actually think if you do go, say \$30 each way, I think you're getting credits to do SQ, but that would be rare, and that's those circumstances where the stock has been so strong, the demand in the calls starts to outweigh the demand in puts. It's abnormal; you won't find it too often, but it can happen, and I think this is an example of that.

HELM: Sure. Well guys, that takes us right to the time. Ed, once again, thank you for joining, and giving us your insight as far as the knowledge and skillsets that you bring to the table. It's always a pleasure to do events with you guys. Once again, my name's Allen Helm. I'm the regional brokerage consultant for the Dallas/Fort Worth/Austin/Oklahoma markets. There's 26 other regional brokerage consultants both in the fixed income and brokerage space that are here to help you navigate Fidelity's ordering tools. So, thanks again, everybody, have a great rest of your week.

END OF AUDIO FILE

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