TRANSCRIPT

OIC: Ready to trade options? Tips and tools

Andrew Rakowski: Hello. And good afternoon. Welcome to this session, Ready to Trade Options? Tips and Tools. My name is Andrew Rakowski. I am a regional brokerage consultant for Fidelity Investments. My region is southern New England. My role is a combination of education and support for representatives and clients to unlock the power of the Fidelity brokerage platform. We're going to talk today with Ed Modla. Ed is a director for retail education for the Options Industry Council. He oversees retail education programs, promotes the responsible use of listed options for individual retail clients, registered investment advisers, professional money managers. Guest speaker on panels. Creates content which we are going to review some of Ed's content. Before we get into it with Ed, a couple things from a housekeeping standpoint. How this session is set up is big picture overview, talk about -- conceptually -- things to think about when trading options with Ed. And then we'll get into primarily Fidelity.com to look through some real examples. What does it actually mean when we look at implied volatility of breakevens, etc.? Even just how do I mock up a trade, buy to open, sell to close, etc.? So with that, I'll let Ed take it. And then I think we're going to share some of the responsibility for talking through these things. And then we'll get into looking at all the great tools that are available for you on Fidelity.com.

Ed Modla: Yeah, thanks, Andrew. And welcome, everyone who's joining us here. Looking forward to this presentation. As Andrew said, we're going to talk a little bit about some tips and considerations that investors need to have as they're getting started with options, or even if you're already trading options there's going to be some interesting things that we talk about in this session. And then plenty of demo on Fidelity.com. First the disclaimer. Options involve risks and are not suitable for everyone. It is imperative to have a full understanding of the options product before using it in a live account. And while we are speaking together here for today there is no form of partnership between the Options Industry Council and Fidelity Investments. I did want to start today with a look at volumes because this year of 2020 has been one for the record books. Very quickly looking back to the start of the listed options industry, 1973, prior to that you had options trade for decades but in an over-the-counter fashion. An investor had to call their broker and say, "Here's what I want to do." And their broker had to go find a counterparty and negotiate terms and the buyer was then tied and attached to the seller. Seventy-three was the launch of the exchanges and the clearinghouse where you had listed options with standardized terms of strike price and expiration date, deliverable of 100 shares. You have cleared options, which meant they were fungible. One investor could buy them on one exchange, sell them on another. And made the options industry what it is today. Certainly the explosive growth here from the turn of the century was electronic trading, speed, and access to the markets. Two thousand eleven I always like to point out here the year of the European sovereign debt crisis. Elevated volatility. And then very encouraging years in the industry. There are billions of contracts here on the left, 4 billion contracts steady during periods when volatility was incredibly low. In fact I think it was 2017 I believe when the VIX did not close above its long-term average for the entire year. I believe that was the case 2017. Regardless, no volatility, no movement, strong options volume, and then some elevated volatility in '18 and '19. This 5 billion contract number comes out to about 19.8 million contracts traded each day on average. As we're closing Q3 in 2020, forecasting where this bar might be for 2020, we're on pace to be right about up here, just over 7 billion contracts, just shy of 29 million contracts traded per day this year. Markets are moving and investors are using options to both speculate and protect their position like never before. So we're going to talk about today some key considerations, tools, analytics. We'll walk through some things investors need to be aware of and need to consider as they're trading the options product. And then spend plenty of time on Fidelity.com looking at some examples and talking about as Andrew said order entry and some analytics that you can get through Fidelity. First of all, one of the key considerations always to remember is there isn't a trade without a thesis. There's got to be some sort of market plan or idea, bullish, bearish, neutral. What is it that you're expecting to happen? And then once that occurs or once that opinion is developed then you select your strategy. There are options strategies no matter what your outlook is. What's important is to keep adding these strategies to your toolbox. I often get asked, "What's the best strategy? What's the best options strategy? Which one works the best?" Well, the answer is they work as advertised. The key is develop your bias, select the correct strategy, have enough tools in your toolbox so that you can capitalize no matter what your market outlook is. And then manage it appropriately. Andrew, I don't know if I'd put this in the category of common mistakes, but maybe it is. Do you find investors often think that there's just a good trade and they forget about step one, you got to do your analysis first?

RAKOWSKI: Yeah, absolutely, and I think that's where a lot of beginning option traders for lack of a better term fall down. And it's what are my expectations for a move, what's the timeframe, more importantly what are my expectations from a profitability standpoint, what's my exit strategy. Because although we're talking about options today, planning the trade and trading the plan applies to any investment, or any speculative trade, or even hey, you know what, I'm building a portfolio, what's my plan now, how often do I rebalance, when do I make changes. It's really crucial for options because unlike other investments the clock is ticking. It may tick in your favor too. Which we can talk about different strategies to take advantage of that. But for the most part beginning traders as long-only option traders, just remember you own what's called a wasting asset. Every day that goes by and nothing happens it loses value.

MODLA: Yeah. You're absolutely right. This idea translates to any investment you have whether it's in the market or anywhere else, is to develop a plan and then select the right strategy and manage it. I think sometimes in the options space investors think there is a one best strategy because there's so many choices. They just think well, one of these has to be better than the other. But really it's a matter of knowing your strategies, understanding the product, and using the correct strategy at the right time. Now order types, very important to understand. We're going to spend possibly a little more time on this when we get to the demo in just a couple of minutes. But be familiar with the bid-ask spread, again more heightened in the options space. This is the same concepts as you would get with trading stocks except it's just more important to understand. Bid-ask spread. And when we do get to the demo, Andrew, I would expect we're going to put up the depth or the size of the bid-ask, that might be something investors never really looked at before if they were trading shares of stock. When you're trading options the width of the bid-ask and the size on the bid, size on the ask, these are all important. You need to be familiar with that concept. And then open versus close. Again when you're trading stocks you're not identifying opening versus closing orders. But in options that's exactly what you're doing. And you are frequently even in the most conservative risk-reducing strategies selling to open, initiating your position with sell orders. Most investors are not selling first when it comes to trading stocks. But in options that's exactly what they are doing. And Andrew, I guess we'll spend a lot more time on this in the demo when we get to it in a few seconds, would you agree?

RAKOWSKI: Yeah, and I think it takes a little getting used to. The opening versus closing positions. And it's a learning process. Definitely extremely important to look at the bid-ask spread. What the depth of the market is. Volume is a good indicator. It's not the only indicator though. Just because options haven't traded that day doesn't mean that there isn't a good amount of size posted. And that's just taking the additional peek underneath the hood as to how many can I buy at one and a half, etc.

MODLA: Yeah. And I'm glad you mention that. Volume and open interest are questions I get asked frequently. And very quickly the calculations are rather simple and volume is just executed transactions. That's all it is. Open interest will increase if the executed transaction is open versus open. Meaning the buyer and the seller are both opening a new position. That means open interest is going to go higher. If both sides are closing open interest goes lower. And when you have one side opening and one side closing, open interest doesn't do anything. It stays exactly where it was. So open interest and volume, two very different metrics that mean different things. Now we can't talk options without mentioning implied volatility and how it does have a significant effect on options prices. There is such thing as historic volatility which looks at the stock price movements in the past, looking backwards, and can calculate a volatility of what the stock has done. Options will consider that. But of course we're not going to price options based on what the stock has done. Options are forward-looking. And there will be a volatility level used to price the options contract that is an expected level between today and expiration date. That's known as implied volatility. It only exists in the options industry. And when you look forward the future might be very different than the past. There might be an earnings event coming up next week. Or earnings may have just occurred during the past week. And that forward-looking implied volatility could be very different from what we've seen in historic volatility. Or implied might gravitate towards historic. There is a level of analysis that would need to be done to form an opinion. But at the very least be familiar with changes in implied volatility, how they affect options prices, and the calendar of events. Because that is going to move implied volatility levels. Andrew, do you feel like options investors are in tune with the concept of volatility? Or is it something they need to be made more aware of?

RAKOWSKI: I would think there's probably room for improvement generally for just the understanding of how much am I paying, why are options so expensive now. Like you said calendar of events. Is it just because options as a -- volatility. Excuse me. Volatility as a whole may have risen. Or is it specific? It could be earnings. It could be a drug company that has third FDA announcement coming out. Those are all significant potential stock movers, i.e., potential volatility movers.

MODLA: I was going to say we've got this election coming up on November 3rd and any options expiring right after that would likely be priced in with the possibility of large movements in the market. However, we might not know those results on November 3rd or November 4th or any time in November. So when is that volatility going to come out of those options? You don't know that part either. Same thing with earnings. You may know that earnings is coming out next week. And after earnings the expected volatility should drop. But what if earnings shocks the market participants and the stock is moving wildly? It might take some time for volatility to settle down. So that calendar of events very important to be aware of. We'll see some of that when we get to the demo in a few seconds on the pricing aspect of options. Now one other thing with respect to maybe holding options to expiration either from the long or short side is this idea of exercise by exception. Just going to walk through this by definition. Because investors really need to understand that when an option is held through expiration, if you're long an option and you hold it through the closing bell on expiration day, or if you're short an option, well, the industry has to have some default process by which how they handle these open options positions on expiration. Does the industry just let them all expire? Well, that's not the case. By far and away an option that has value at expiration is exercised. And by saying has value what I mean is that the call strike price is below where the current stock price has traded, that last print on expiration day. And for a put option if it's above that level. If it has value at expiration the industry is going to exercise that option on the holder's behalf but only if the holder does not communicate their instructions to the brokerage firm. An option holder, even if the option has value, can say, "Hey, look, I don't want to exercise this call or put option," for whatever reason. They may look at after-hours activity or they may be concerned about something that's on the macroeconomic calendar somewhere around the world over the weekend and might decide I don't want to exercise it. They have every right to do so. Also an option holder can choose to exercise if there's no value. They own that right. But if they don't do anything and they don't communicate any instructions the industry will default by calculating this value based on a comparison of strike price to the last traded price during regular trading hours on the national exchange of the shares, not taking into consideration any after-hours activity, and then will proceed with exercise by exception. Andrew, do investors get caught off guard by this from either the long or short side with exercise or getting assigned on something they didn't expect to?

RAKOWSKI: Yeah, sometimes it's on the assignment side I would say. Haven't really run into too many clients that are leaving money on the table or get a surprise where they own the stock. Usually trying to educate them about hey, you know what, you have a finite period of time to do something. And that's where hey, just even selling to close to recoup some of the investment and remove some of that uncertainty. And other times too it's some clients are on the receiving end of just someone making a bad exercise. They exercise it early, they receive the assignment, they say, "I don't understand why my stock was taken." And I'll say quite candidly, Ed, I don't understand either, because that was not an exercise of our option by everything that I'm looking at.

MODLA: I've heard that too. And you're right, an option holder has paid for the right to exercise even if it's not in their financial best interest. And I have had investors say that same thing to me. I got assigned on these calls. Stock was way below it. And my answer generally is well, congratulations, you sold stock above where the level was. I don't know why that would have been exercised. And you're right. I would agree. Most often if this really trips up an investor and takes them by surprise it's from the short side. Sometimes option sellers think that if the option expired with no value they're clear, they're good, they don't have to worry about anything because the option expired a penny out of the money or a nickel out of the money. They don't consider the fact that the option holder can then look at some after-hours movement and still exercise their options contract. Now monitoring and position management. This comes back to options in general are not set it and forget it type of trades and investment vehicles. Everything is changing all the time. Strike prices are going to be constant but your stock is going to move. The relationship between your strike and your stock is going to keep moving. Premiums are going to change. Volatility is going to change. At some point active management will be necessary. You might exit the position, take your profit or loss, that's a proactive closing transaction. Remember what we said earlier about order types. Close transaction to exit. You can let the option go ahead and expire. Or you can exercise it. These are choices that the option holder has. But position management. And Andrew, I think sometimes investors don't remember that. They maybe don't have the time. Or they're not used to tracking positions as closely as some options positions need to be tracked. Do you find that to be the case as well? And I find options investors are more in tune with the market. They're checking it every day. As compared to maybe someone who's more passive.

RAKOWSKI: I do. And I think it goes back to your first point. What's your plan when you enter the trade? Too many times I've heard of -- and again it's hey, you have a finite period of time to be correct. And many times clients have the correct investment thesis, the stock moves in their direction, they didn't take advantage of I bought the calls at two, I could have sold them at three, that's a pretty nice return. And by the time that expiration came they expired worthless. Or something like that. Or along those lines. I would just say, "Hey, you know what, because of the leverage and the timeframe, think about where your exit is going to be. Doesn't have to be 100 percent of the trade. If you have a longer-term timeframe." And like you said you can always be adjusting.

MODLA: Yeah. You can always be adjusting and options investors are frequently doing just that. The last thing. We're going to put up the demo here in just a minute. The last thing is really a warning for investors that if something looks too good to be true it probably is. And I can recall a number of times speaking to not just individual investors but sometimes professionals, money managers, who will think they got this incredible price on an option. And it just isn't the case. Standard options contracts deliver 100 shares of stock. But when there's a corporate action of some kind and the shares themselves are exchanged for something else, then the options might need to be adjusted. We're talking about things like splits, mergers, maybe spin-offs. The terms of the option might need to be changed. And when that happens the option becomes what's referred to as nonstandard or an adjusted contract. It will be identified with a numeric suffix. So XYZ, that symbol, is a standard option. But XYZ1 or XYZ2 or XYZ3 would indicate that something is different about this options contract. And you better do some homework and look up what has happened to the shares. It is possible for maybe a reverse split for example to result in an option appearing to be in the money by a significant amount but trading for a very small amount. And this is most often when I've seen money managers, investors get into trouble thinking hey, the stock is trading up at $15 a share. I just bought the 10 strike calls for a nickel or a dime. And they're thinking I just got free money. Well, not so. If that stock had undergone a reverse split you may have an adjusted contract. You may have bought an option that delivers 5 shares and not 100. And that's when you can get tripped up. Be aware of those symbols. Andrew, doesn't come up too often I wouldn't say, but it's just something to keep your eyes open for. If you think you're getting a really good deal you're probably not.

RAKOWSKI: Yeah, I would agree, I don't think it comes up that often. Comes up often for me because I end up owning a bunch of stocks that reverse split if you know what I mean. So I have adjusted options. But no, it's just hey, like I think you said, if it appears too good to be true, it probably is. Go under the assumption of the efficient market theory. There's no way that an efficient market is going to allow you to buy something at five cents that intrinsically is worth $5. Take an additional step to do the homework. Why would the market be pricing it like that? And I'll give you an example of how you can see what those adjustments represent.

MODLA: Yeah, and as we go to the demo here right now, I'll just say most recently where this came across, without naming symbols, was when oil really got hammered earlier this year and you had some of those ETFs that did reverse splits, that traded high volume, significant amount of volume, but their terms changed and they didn't deliver 100 shares anymore. And that confused a lot of investors that were seeing prices that just didn't make sense on those underlyings. You just have to be aware of that. But I think now it's time to take a look at some things on Fidelity.com.

RAKOWSKI: Let's take a look at a few things. Yeah. I would say one other thing about the adjusted option too. Typically after that happens then some of the liquidity seems to dry up too. Because it is a little more complicated might entail a second or third calculation in the case of a corporate reorganization or spin-off. I would probably suggest you look at the standard versus the adjusted to open. Then if you already own an option that was adjusted, might be worth considering exiting before the liquidity completely dries up. Just a thought. So I am sharing my screen now. Ed, just confirm with me that we're looking at Fidelity.com. And a couple different things. I wrote down some things when Ed was talking. And we're going to go back to that news and research, that options home page. I really like that idea of planning the trade and trading the plan. But it's a pretty deep toolbox, the option toolbox. So Fidelity does provide some help in that area to learn more and also potentially suggest some strategies. And I'm just going to click on trading strategies. And I'm going to go to strategy ideas right here. And what this is is a collection of simple to more complex strategies that if I know exactly what I'm looking for I can use this to evaluate and generate ideas. If I don't I can simply say, "Hey, Ed, I've done some homework." And I'm going to use an airline stock as an example. Let's say I'm an optimist that there will be a vaccine. I think that is going to be favorable for travel and leisure stocks. And I've done some research on an individual airline stock. So I'm bullish. But even though I'm an optimist I'm also a realist that if I get my trade wrong I want to be able to limit some of my risk potential. So show me strategies where I can express a bullish opinion and limit my downside. Because A, I don't want to buy the stock because I'm worried about the downside in general. And B, I want to be able to participate if I am correct on the homework that I've done. So the tool will show me some highlighted strategies that I can take a closer look at. I'm going to choose the long vertical spread. And just to give you an idea I'm going to expand this here. And this is going to explain to me what it is. So it's a great opportunity to learn more even if I don't choose to execute the strategy. In this case I am buying the lower strike and selling the higher strike. So it's the 120, 125 call spread. So I own the right to buy the stock at 120. At the same time I'm obligated to sell it at 125. I'm hoping to sell it at 125 or above because I own the right to buy it at 120. That's if the spread hits its maximum profit potential. This will show me the top 50 results across the market for payout ratios. So the payout ratio is what is that debit that I paid and what do I get paid out if the spread hits that maximum widening. In my hypothetical example the stock that I was talking about is United Airlines. Let's say that I've done some research and this is just an example, it's not a recommendation by myself or Fidelity or Ed Modla to buy United Airlines, we're just using it as an example. And let's say that I want to express my bullish opinion but I want to be able to quantify what my downside is without buying a $34 stock roughly. We'll round it up by six cents. So what's neat about this is I know that if I buy the lower strike I have a higher probability of my spread being in the money. We'll choose this one, the top one, it's a very short-dated strategy. I chose up here 60 days or less. Really depends on what my investment thesis is and timeframe. We'll just stay with that. So first things to consider. I'd say, "Hey, do I think that this potential move that I'm modeling will happen in a week and a half?" So that's very short-dated. You know what, let's switch to the one below it. So we'll give ourselves an extra week. It's a 5.319 payout ratio to 1. This is where I can get into some of the other tools to do some analysis. And Ed, I would love your comments on the payout ratio and why you would look at a strategy like this aside from what I laid out.

MODLA: Yeah. Certainly the payout ratio is a great starting point for evaluating your potential return on the trade. And again that's going to be in direct correlation to your cost of the trade involving both options. So as Andrew has been pointing out when you're browsing through those lower strikes you're going to have the more likelihood of this trade working out. Your breakeven and your profitable range will be a bit lower. And as far as tying this into market thesis, Andrew, that you've been pointing out, what I would say is the higher strikes you go, in my opinion that means you're more bullish and you're being more aggressive. Those payout ratios are going to look better because the cost will be less. Your potential for gains are greater. The likelihood of those gains is lower. But if your bullish thesis over the next two to three weeks is very strong, that is when you start to raise those strike prices. Because your return is going to be much greater if you go up above say to the high 30 strikes for your long. The lower you go, maybe a little more conservative. But that payout ratio is still going to help you evaluate the trade, whether you want to take it or not.

RAKOWSKI: Yeah, that's a good point as far as the degree of bullishness. So I'm just going to use the analyze tool here to then get into some additional screens to then talk about things. I want to look at the P&L calculator because I want to be able to evaluate on a more quantitative basis what this strategy will do for me if I execute it. And I'm just going to scroll down here. And it's going to default to one contract. Let's say that hypothetically I'm willing to buy 10 and 10. Buy 10, sell 10. To make it simple I'm going to change this to 30 cents, just to make it $1. Now what I can do with this tool is I can model in what I think my potential price target is. And let's say that it's 39 bucks. I only have 17 days until expiration. Can say, "What happens if that happens in the next week or so?" And then I can also make changes to volatility. Actually I'd have to change the price. It went back to 33.99. I was wondering why my bullish trade was looking negative. So if now we change it to $39 you can see in the chart I didn't model in any changes to volatility but based on what the anticipated changes in each side of my spread will be, I can anticipate a profit of $1,523 roughly not including the pennies. And I can model in some different things. Different timeframes. Back to Ed's point. Planning the trade and then trading the plan. What are the timeframes? This is a little more complicated because it's a multileg strategy. But I want to just show you the simplicity of trading. So let's go to trade strategy. It'll take me into a multileg strategy or a multileg ticket I should say. Mocked up the 36, 41 call spread. I'm buying 10 of the 36s. I'd be selling 10 of the 41s. And I'm going to change it to -- actually it came up at 95 cents. I think I modeled it in in the wrong way before. But we'll leave it at 95 because that's going to price it off the ask and to the bid. My maximum loss is $950. That's just the math of 10 contracts times 95 cents. My maximum gain is $4,050. So that's that pretty impressive payout ratio that was displayed on the previous page. So I could enter this trade if I wanted to, again to Ed's point, we're opening on both sides of this trade. But I also am afforded my breakeven point. For me if I hold this strategy until expiration my breakeven is 36.95. So that goes back to planning my trade and trading my plan. Does that fit the parameters of what my investment thesis is for United Airlines if I hold it until expiration? If I want to see whether or not this actual trade makes sense for me I can go to probability calculator. And this isn't only for options by the way. You can model in probabilities of future price expectations for stocks you may own. And what this is going to do, as Ed touched on volatility, it's going to show me what are the odds of the stock I'm looking at, United Airlines, hitting 36.95 between now and that expiration, and I'm going to model it right till expiration, based on the trailing three-month volatility. In this case if I model it down I really only have a one-in-four chance of just breaking even with this particular trade for that breakeven price, which I could back into. It's roughly $3 higher than where the stock is trading right now. To give you an idea of how volatility influences option prices, if I change this volatility from 90 days to 180 days, that has changed, because this is going to be backward-looking to capture the historic volatility of the March meltdown in the market. So a couple things to think about when you look at volatility. What is the timeframe for the trade? What's the timeframe that you're evaluating it on? And then how is it in the context of what you're looking at? So I'm going to go to trading ideas. Because I like the idea of looking at implied volatility. And this is a great resource. I'm not going to have time to go through every single scan. But this is where you can build customizable scans, etc. I'm going to go to this imploding IV30s which is implied volatilities that have decreased substantially. And I'm going to choose FedEx. It's a pretty well-known name. It's not a super high volatile stock. And if I go to action analyze and go to the IV index, this is going to show me. And let's go back. If I were looking at today maybe I want to express either a bullish or bearish opinion, 30-day volatility roughly at 38.80. A week ago it was around 50. The front week was 38 versus 62. Ed, why do you think that is?

MODLA: Good question. Well, the current level of 39 versus 63. Did they have earnings announcement?

RAKOWSKI: They did. They did. I knew the question before I asked you but I had confidence that you would get it right. So if we scroll down to the actual chart, this is where if I was looking at this trade a week ago I might say, "Hey, why is volatility so elevated? I may have to do some additional research on FedEx." Or maybe I know that the earnings are coming out and I want to make a more speculative risky trade before earnings. Do I really want to buy volatility when it's trading at 60 when the stock only merits 40? It's obviously pricing in uncertainty of the earnings. In this case being the long volatility trade was a loser. We may have been correct in direction. And I'm not exactly sure what FedEx did subsequent to earnings. But this is where hey, knowing that it's a pretty deep toolbox of trading options, what's a strategy that -- and we just looked at one. Maybe it's a call spread where you're buying and selling volatility so you're not just loading up on that breakeven price. If that makes sense. I'm just going to go back and to highlight depth and market types that Ed talked about. And I'm just using all these symbols as examples, it's not a recommendation to buy or sell. I'm going to plug in SPY. And I'm going to go to option chain. To give you a great example of a very liquid option. I'm going to choose the October 9 expiration. I go to settings here. I customize how it comes up for me. So I choose no expirations as my default. So I can pick and choose as I go through. That also shows you the different column headers and information that is available on the option chain. But if I just click apply we can look at the five strikes around where SPY is trading. This is a really tight option market, 6.31 bid at 6.34, 800 contracts have traded, 1,300 open interest, what actually for SPY isn't even all that much. I can get into more detail by viewing the detailed quote. And now if I scroll down this is where to Ed's point I can see the depth. There's 196 wanted. There's 93 offered. So even though it's only traded 799 today I can easily move some inventory based on the posted liquidity. So something like that, I may feel comfortable just buying it at the market. I usually don't suggest buying options at the market. For me I like to use limit orders. I may just put in the limit right at the offer price because it's a very efficient market. To give you a different example, I'm going to change the symbol to TM. And this is where it does make a difference as to what type of order that you use. In that previous example if you used a market order you probably wouldn't get crushed on your execution. So TM is Toyota Motor. On any given day it's either the world's largest or second largest car company. It's not based in the United States. So the options are on the ADR, the American depositary receipt. So if we were to look at these November options and if I click apply, and I'm going to scroll down, this is a little different picture. It's a little wider. It's 3.10 bid offered at 3.50. The whole spread is 10 percent of the option value. This is one where I may want to put a limit order in. It's only traded one contract. The open interest is only one. That may also be a potential red flag where I say, "Hey, do I really want to trade this option based on what the potential liquidity may be?" But let's say if I'm only going to buy two contracts anyway. Buy to open two. My limit price, again a fairly wide spread. I may want to say, "I'm going to put my limit in at 3.20, maybe 3.30 depending on how aggressive I want to be." And I know that I am going to pay no more than $3.30, the maximum I'm going to pay on this trade is 661. So I like to use that as an example because it's a pretty well recognized name but it's not a great option to trade per se. I don't know if you have any thoughts. Obviously there's a couple issues when I looked at volume and open interest. But I think it's interesting. The liquidity really depends on the individual name.

MODLA: Yeah, certainly it deserves some level of analysis. Of course there are some stock symbols that don't have any options at all. The exchanges don't list options because they don't anticipate a demand being there for options. Maybe the stock doesn't trade that much. There are other symbols that do have options but they might not trade too often. And this is one of those. Now the bid-ask here, 3.10 at 3.50, and there were a few other markets I looked at. It didn't look too bad if I did really want to take this trade. It didn't look too bad. But certainly using a limit order somewhere in the middle towards the midpoint or more aggressively just either side of the midpoint would likely be the best way to go here. But all of this is really powerful. All these analytics. Looking at the bid-ask, the size on the bid-ask matters. Especially for symbols like this. If you did want to trade a 10 lot of options you would want to know is the ask good for 10 or is it just good for 2, and what's that bid-ask size there for. I can see on the screen it looks like 8 by 12. Well, if you're selling these options, you want to sell 10 of them, and you put in a market order to sell 10 options at the market, you would get 8 of them at 3.10, where's the other 2 going to get filled? I don't know. Maybe 3.10, maybe $3, maybe 2.90. So you got to be really careful if you're doing those higher volume numbers what the size is. And then use your best discretion on choosing your price and entering your order.

RAKOWSKI: Yeah, I would agree, especially if we looked back a few months ago when the markets were really volatile and there was very wide spreads in a lot of names, and you see a lot of bad prints. Bad print meaning in Ed's example yeah, eight trade at 3.10 and then two trade at 2.50. And then two minutes later it's three bid again and it's like oh my God, they just totally jammed a market order. So just be very careful. You can be aggressive with limit orders. You can just price it right to the bid. And force someone to buy it from you.

MODLA: You could even go through the bid if you wanted to get really aggressive. You can say, "Look, I'm going to sell 10 of these options at a limit order of $3," and now you're hoping or expecting to get all 10 at 3.10. But you're making sure it doesn't get any worse than three. And you could still effectively be using that limit order like a market order by even going through the bid or through the offer. But just protecting yourself against that bad print.

RAKOWSKI: Yeah. So just a couple other things I wanted to think about. Trading that plan. This isn't even option-related. It's just hey, what's my price expectation. How am I going to know when that happens? Why don't I just set myself an alert? I made that trade in UAL. Maybe I ended up just buying calls outright. Or if I have the spread on be like, "You know what, I want to be alerted when it trades up to $38." And then when it happens send it to Active

Trader Pro. Send it to my e-mail. Send it to my phone, etc. Personally I like to trade options based on the underlying stock and technicals and that sort of thing. So I like to trigger trades off of if a stock hits a certain price. Either to enter or to exit. And that could be the idea of a conditional trade. So let's say that my condition would be a contingency. And the contingency is -- we'll go back to SPY. And we can think about it a couple ways. We can say, "Hey, we bought that call." Or we looked at a chart and we think there's a technical breakout above a certain level. And let's see what's SPY trading at, 3.29. I'm just making up these numbers too. But let's say we've done some analysis and we say, "In the short term above 3.38 I think it's going to be at breakout." If that happens -- I kind of cheated. I copied and pasted that S&P. The SPY option call that we were looking at before. If this event happens then I want to buy five contracts. In this case they're the 3.27s. Probably be trading around at least $11 is the intrinsic value. Maybe I want to use it as a stock replacement. Hey, trigger a limit order to buy five contracts at $12. Maybe not the best example. I like to do it sometimes to enter trades on breakouts. I always do it to trigger a limit order. To Ed's point I'm always kind of a little nervous about the market order. I do have one other thing that I did do a little bit of homework when I saw Ed's slides about the adjusted contracts. And this is a company that recently went through a reorg or a spin-off, SunPower. Again this is just an example. I'm using it because it's a great example. And if we're looking at the October 16, if I didn't know that options had the ability to be adjusted I'd be like, "Which October do I want to buy?" Here if I do a little digging I can see the ADJ for adjustment. But this is where without knowing the full picture I'd say, "Why would I pay $2 for these 10 calls when these 10 calls are trading for 90 cents?" And the answer is right here. Because they're an adjusted option. When you purchase that contract you own the right to buy 100 shares of SunPower but also you get 12 shares of Maxeon MAXN. And then any shares less than a half you get cash in lieu. So they spun off this particular stock. That corporate action happened in the past. The options exist until their expiration. We have to adjust, or the options industry has to adjust to account for that. Because what 100 shares of SunPower did qualify for also equaled 12 shares of Maxeon. That's just an interesting example. When you're looking at option chains in specific months, if you see multiple listing for the same months and same strike price, that's a yellow flag or maybe red flag to be like, "Let me dig a little deeper why would these be one price versus the other." And this is a pretty good example of that lack of liquidity. Nobody wants to trade these complicated options to open because every time that I want to figure out what it's worth I got to take out my calculator and multiply 12 shares of Maxeon by every 100 shares of SunPower that I own. So I don't know if you have thoughts on that, Ed. That's pretty straightforward, what you had talked about. But a real example of it.

MODLA: Yeah, and I would just emphasize. You said this before as well. It is very unlikely that investors or market participants are opening new positions in these adjusted contracts. They don't trade as much. The markets tend to get wider. And in fact sometimes the exchanges might not allow it. The exchanges could decide that they are only going to accept closing orders. And then once those orders get executed and open interest disappears they just delist the options. They're not going to list new options. And they may only accept closing orders. Without providing advice, it's generally best to stay away from these options. Or as you said earlier, Andrew, work your way out of them if you happen to have an option that becomes adjusted.

RAKOWSKI: Yeah. Great point. I could go for hours in some of the different tools and talk about some things on Fidelity.com. But we want to be tight to our promises like we said to stay within 50 minutes for the presentation part. So is there anything else that I left out, Ed, that you think that we should touch on?

MODLA: I don't think you left anything out but I do just want to say again that everything you went through is incredibly powerful. I found it extremely interesting. The analytics. The calculators. Options investors might be thinking well, if the stock moves 4 percent and I still got three weeks left what's my option going to be worth. Andrew, you walked through a calculator that can help an investor forecast what it might be worth. And it can actually toggle changes in implied volatility to see how that has an effect. All of those analytics are very powerful when you're trying to forecast the price movements in options, whether or not you want to make a trade. And then order entry, position management, all of it comes together. It might seem like a lot for anyone out there who hasn't traded options before. It might seem like there's a lot here to do. But again none of it is too complicated. It's just a matter of doing it over and over. Seeing it time and time again and getting more comfortable with it.

END OF AUDIO FILE

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