

TRANSCRIPT

Options trade management

Brett Yoder: Thanks so much, and welcome, everyone. Thanks for joining us this afternoon. Pretty full hour that we have set up to go through this idea of how to manage your option trades once you've already gotten into them. Really, getting right into that fourth step here, as far as the Options 101 Webinar Series goes. Before we really get too far into this, I do want to just mention the Trading Strategy Desk. If this is your first exposure to the Strategy Desk, we're a small group of brokers here at Fidelity that's dedicated to your education. We're certainly focused on making sure that we do understand and can explain these complicated subjects, especially options, and we do that through these webinars, as well as those coaching sessions, which you can find at www.Fidelity.com/coaching, where we're teach to you options but then in addition to that, we'll also speak to technical analysis, overall trade management, and give you some great information on some of the tools that Fidelity offers to make this experience the best it can be for your investing.

That being said, here we are, we're in week 4. Now this is our agenda that we have as far as the next hour here. We're going to manage options prior to expiration. We're going to speak to position management, as well as manage

options at expiration. We're going to split it up in three different ways, and there's going to be a common theme that runs through all the decisions that you should make with options as you're in the trade and as you're analyzing new information as it's coming, and most certainly seeing your trade become profitable or possibly not at a loss, we'll talk about the idea of closing it out early as well as some of the other things that you will experience.

With that being said, Jacob, let's go over to you. Let's talk about managing options prior to expiration.

Jacob Ellis: Thank you, Brett. Welcome everybody here to our presentation. We'll be talking a lot about the various times in which we'll be managing our trade. So here, when we're talking about managing prior to expiration, this could be the very moment after you place your trade; it could be a few days down the road, weeks down the road, but we're some time prior to the end-all expiration date. As we work through that time frame, there's a lot of things that could occur. And one of the most crucial aspects of that is what has happened in your outlook on a trade after having placed it. You thought the stock was going to rise. You thought it was going to fall. You thought it might have stayed flat. You thought that would occur during a specific period of time. Maybe you had some expectations on the changes of relative levels of

volatility during that timeframe as well. Well, what has happened since then? After we place a trade, we should be continuing to manage our outlook, and determine do we still believe that the stock is rising? Do we still believe that it will go up during the timeframe of our trade? Are we still bullish, or neutral? Are we now bearish? Maybe we think that the time of our trade has changed; it happened faster than we thought, or slower than we thought, or maybe we think it's no longer going to occur at all.

But regardless, these two traders' viewpoints on the righthand side are of utmost importance. Number one, we want to be honest with ourselves as we reevaluate the trade to decide what type of management, if any, is necessary in making changes? That is so that we don't fall into the trap of making some adjustment without considering the end objective of the trade. The end objective of all trades is to make money. We should not be making a trade based on anything except the possibility and ability for our trade to net us greater profits from now forward.

And that is why there are three main factors that we need to think about in relation to an options premium. The three main aspects of the options premium can be broken down into the money-ness of the option, which of the various strikes you might select, the amount of time that you select in your

expiration, or the expiration selection, and finally, some expectation of the underlying and how volatile it may be into the future, during the lifespan of your trade, most specifically.

As we look at those different pieces of the overall option premium, we remember that the strike that we select, the expiration we select, and what side of implied volatility we are on are going to affect our gains or losses as the trade unfolds, and as we see things change. On the left-hand side, we see that out-of-the-money options are going to have lower premiums. We can get into the trade for cheaper. But maybe to have a lower probability of being in the money. At-the-money options are going to tend to have the most time value; we should be aware that if we choose those at-the-money options, we are paying extra in time value. Or if we choose to sell those options, we're getting extra in-time value.

Time to expiration, of course, is also going to affect how much time value is left in a specific contract. If we choose to favor the short-term, near-term expirations, then we have the possibility of the highest potential annualized return. We also have a lower upfront premium. Longer-dated options are going to decay much slower through time. Every day passing will eat up less of the actual overall premium. But you're going to have to pony up a little bit

extra if you're an option buyer to buy the high premium up front. So we need to be aware of that tradeoff on any one of these. We can choose the strike based off of the lowest cost, or the highest cost. We can look at the time until expiration. Do we want to have slow time decay, but high time premium overall by selecting those longer-date options, or do we want to err on the side of shorter-term options which will give us that higher potential return, but also require us to be right on the timing of our trade with much more exactness.

And finally, we should have some outlook on the implied volatility. Implied volatility is an interesting and option-specific characteristic helping us to quantify how much we expect as option traders for the underlying to move between now and the expiration date of the option. The higher the implied volatility, the more people are willing to pay for those options. If you think a stock will rise or fall substantially, then you become more and more willing to pay higher premiums. Lower implied volatility comes from lower premiums, so when we see options trading with very low implied volatility, it's saying that option traders currently think less about the upcoming volatility.

As we continue to think through that, that leads us now to the different types of management that we might execute prior to expiration. First, we could do nothing. We could leave the strategy alone, and that would make the most

sense if you would place that same trade today. Suppose you had cash in your pocket, and you had the option to place a trade. Would you hop into the same trade you're already in? In that scenario, we certainly should do nothing. We continue to stay in the trade if necessary, we actually go through exercise or assignment. It's all about lining up if we still think that the stock is rising or falling, and we're in a trade that stands to profit should those things occur, then we are ready to leave our trade as-is, and we should profit as the scenario unfolds if we are correct.

But we might err on the side of closing the strategy, in the moment that our strategy no longer aligns with our outlook, meaning that our outlook is wrong. Or, that the outlook has already occurred. Perhaps we thought the stock would rise. It did rise, but it happened so quickly that now we still have an option, and we don't think the stock is likely to rise any further. In any situation where we no longer have an outlook that lines up with the strategy that we are in, we need to close that strategy as soon as possible. Because if we do not, and we were correct in our outlook, then we will stand to lose money as our outlook unfolds. We could leave the strategy alone. We could close the strategy entirely, or perhaps some measure of tweaking the strategy might be necessary, and we would adjust the strategy in any situation in which our existing strategy doesn't quite align as well as it initially would, but by making

some alteration, we can line it up a little better. Maybe we can take some money off the table, as would be the case when we reduce our position size. Maybe we close out some of our contracts and leave others open. Maybe we utilize the strategies of rolling up, or down, or out to take some money off the table. Or add additional time to our trade, so it continues to work in our favor. Maybe we roll up or down because after additional analysis, we think there is different points of targets where we think the stock is likely to move. Regardless, it's one of these main three that are most commonly going to be employed as option traders: leaving the strategy alone, closing the strategy completely, which we should do with expedience in the moment we realize that our strategy no longer aligns with the outlook. Or, three, we should adjust the strategy when it can be tweaked to better align with it.

But these aren't in reality the only ways for us to manage options prior to expiration. In fact, it may, in some cases, Brett, make sense to actually exercise, correct?

Brett Yoder: You know, it absolutely might. There's a decent conversation that we should have around this, because your right as the buyer of that option, if you buy the call, you have the right to actually buy the shares at the strike price. Same thing with the put, if you buy the put, you have the right to exercise your

right to sell at the strike price, right? We need to talk a little bit about this idea of the ongoing management of your options. You'll see, you'll get into your option trade; it'll be in your position page, and from there, you'll see that marketplace for the option, you'll see the bid and you'll see the ask, as it continues to ebb and flow with the overall market.

And get used to the idea of maybe looking at an effective price. An effective price, what is that? Imagine your strike price, or take your strike price, and then let's say you're on a call, let's add to that the bid, right, on the put, and subtract a bid from your strike price, and see what that overall effective actual price is of where your contract is trading right now. We have this example over to the side. Because what'll end up happening is if your option gets fairly illiquid, or if you end up getting pretty deep in the money, you'll find the situation where that effective price is going to be less than the overall market price of the shares. And when that happens, it certainly makes more sense to exercise your right and then dispose of the shares in the marketplace.

Hopefully this is making sense. Let's look at the example, and let's walk through this.

Here we're on a call, remember that's our right to buy the shares. Okay, in this case, we're on an ABC Call expiring just this week on Friday, that has a strike

price of 100 and the ABC shares themselves are trading at 105. So now we know that 105 is our benchmark. That's where we need to, we're going to sell our contract, our call. We need to make sure that we're getting at least 105. That's the intrinsic value of your contract. As we look at the marketplace and we look to sell out of our ABC Call, we see that bid price is only \$4.50. As we look at the math on this, that means we would get an effective price of \$104.50 if we sold the contract, whereas if we exercise our right to buy at \$100, now we have shares of ABC, and then we sell the ABC shares at \$105, it puts an additional \$0.50 in our pocket. It's all about that effective price. The only thing I want to point out on this as well is we see the spread, spread referring to the difference between the bid and the ask. In this case, it was trading at \$4.50 bid by \$5.50 offer of the asking price. There's nothing that stops you from putting in a limit order in between the bid and the ask, making sure you're getting at least that \$105. Sometimes it might be a little bit of a hassle to actually exercise your right, get the shares, and then sell the shares. Sometimes you have to move around a couple of things to be able to facilitate that. If you want, make sure you throw in that limit order, limit to sell, at at least intrinsic value. Again, here's the example. The example's at effective price. Look at the bid. If you were to sell and get that bid price, what is the effective value of shares that you're trading? How does that line up with the

actual market? And on the same token, we can move forward with that kind of line of thinking, and talk about the obligation.

Now when we sell to open, our contract, we take on the obligation to fulfill the holder's right, the person that bought it, the right, we would have to facilitate that. Meaning in the other example, we bought to open the call. Well in this case, let's say we sold to open the call. Hopefully you're fairly familiar with the idea of a covered call. We went over that when we had the selling 101 session previous to this. The idea is we own 100 shares of stock and we sell to open a call. The obligation on that is we actually have to sell our shares at the strike price. In this case, early assignment, let's start to think about the idea of being assigned in the same sense as the holder's decision when they make their decision to exercise. It's still going to come down to that effective price. Your assignment risk will go up when that bid is less than intrinsic value.

And a little bit more commonly is this idea of dividends. So again we have this covered call example. We own 100 shares of the stock. With that, we sold a covered call. If the effective price of that call, remember that's the bid and the strike, is less than the shares and the dividend, we should assume, or it's very safe to assume that you may be assigned, or suffer this early assignment. In that case, the person has to exercise the right to buy the shares from you prior

to that ex-date, meaning you wouldn't get the dividend on the shares that you have.

Let's walk through the example. Again, when we pay the dividend, we're looking down here. The option may be at or slightly in the money and only trading for \$0.20, but the stock is paying a \$0.50 dividend. It's now \$0.30 in favor of the holder to exercise their right and get the dividend, then sell the shares, opposed to just getting rid of the option in and of itself. Therefore, your early assignment risk goes significantly up. Keep an eye on that; keep an eye on those dividend paying underlyings that you're trading and just make sure that we keep an eye on our positions and the overall value they're giving us.

Now Jacob had mentioned rolling back a few slides ago as a way to dispose of your strategy and really perpetuate your strategy, but just changing two main aspects, right? We're changing either the strike price, or the expiration date. And it's something we should certainly explore a little bit more. Jacob, why don't you talk to us a little bit more about this idea of rolling?

Jacob Ellis: Rolling is, exactly as you were saying, Brett, is the idea of simultaneously closing our old trade and opening a brand new one. If we're in a covered call

scenario that we just walked through, we own shares. We had sold a call, maybe we had sold the \$100 strike price call, but now we'd like to change the expiration date. Instead of the ones expiring this week, we want to expire next month. Or maybe we prefer to have a different strike price after further analysis. Well, based upon that alteration to our outlook, it would make sense to modify our trade and make an adjustment; in this case, rolling. We would close the current call by buying it to close, and then we would sell to open the other. Think about it: why would we want to do this? One would be just as I've outlined, to go ahead and move our expiration date from today further out 'til next month, giving us more time to play out. It could benefit us to change our strike price to lock-in gains that have already occurred. If we bought a call originally which benefits as the stock price rises, and then the stock does rise, well we could move our strike price up, taking some of our money off the table, locking in our gains, but still allowing ourselves the ability to continue to profit.

What about a lower potential of assignment? Well we've just seen several examples of when exercise and assignment are likely to occur. If we would like to mitigate that risk, we could roll our option to an option with greater time value than that of the dividend, or whose bid is greater than the intrinsic value

of the option, meaning it would be less likely for your option to be assigned early, if there's a reason that you specifically wanted to avoid that scenario.

When we think through rolling, we want to be conscious of the human desire to place these trades at a credit. In fact, much options literature will speak and recommend that you only roll options at a credit. But I would starkly and steeply disagree. Our goal, as we stated at the beginning of this session, is to end up with a trade that aligns with our outlook, because then if our outlook is correct, we stand to profit. Rolling at a credit is not as important as rolling to a trade that we expect to be profitable. And for that reason, when we take a look at different trades, we can identify good or bad, not based off of paying a net debit or net credit, but rather based on the closer alignment with our outlook at the end of the trade.

As we see here in the slide, "rolling out" is the term for buying to close the option we have currently, and changing expiration dates. In general, if we're rolling out, we likely will keep our strike price the same. If you look real close here on the right-hand side you can see that we are buying to close one of the December 18th 120 strike price calls, and selling to open one of the January 15th 120 strike price calls. All that will change is the expiration date, adding an extra month onto the timeframe of our trade. And a little lower, we see the

order type has filled out at a net credit of \$1.59. Where does that \$1.59 come from? We need to buy to close the \$120 strike price call for December, and sell to open the January 120 call. Well the difference between those prices is getting us to that \$1.59. If we look over on the right-hand side, we can see a net bid, a midpoint, and a net ask. The \$1.59 net bid is saying, the natural pricing of this trade would be \$1.59. It would be likely for a trade to execute right away if we were to put our trade in for \$1.59 credit. But we could aim instead to look for \$1.63, that midpoint, asking somebody to meet us in the middle. And that is a common tactic in options trading, especially dealing with multi-leg trades. Or, if we're willing to give the other people a harder bargain, drive a hard bargain and look for the best price for ourselves, we could go for that net ask in this case, the higher, farther one away from zero. Regardless of which we choose to aim for, we place our order as a limit; this is a limit asking for a net cred of \$1.59. When we place any multi-leg option like this, our trade will execute only if the difference between those prices comes to be that \$1.59 if we were to place this trade as it. That could be because the January prices go up, allowing us to sell for more and bring in a greater premium. It could be because the December price goes down. It doesn't matter so long as our net price is \$1.59 of credit to us. That's why we see that example there, for example, closing one call at \$0.91 and selling the other for \$2.50. That would be our overall net credit of \$1.59. When we roll out an option, because we

keep the strike price the same, we usually would do this trade at a net credit; it is common for this trade to be a net credit. We would expect that, in fact. But there are other scenarios, like rolling up or down, in which instead, we would be looking at a net debit.

Here, we still have a similar scenario. The top of our trade ticket looks pretty similar. We're still buying to close one option and selling another, but notice that both of them are dated for December. 115 strike price is the one we'll buy to close. The 120 is the one we will sell to open. Next between them, we are moving the strike price by \$5. But, we are doing so at a net debit of \$3.13. In essence, as we take a look at that difference, we see the stock having risen up. If this is a covered call scenario which we had previously sold the 115 strike price, well what does that mean for us now to sell to open instead of the 120? That means that if the stock rises up to 120, we will be able to sell for 120 instead of 115. We have the benefit of selling for \$5 more. And it's only costing us \$3.13 in order for that to happen. So this would make sense if we do think that the stock is likely to rise up to and around 120 and stay there through December. Whereas previously, we thought it might only get up to around 115. Sure, we're going to have to pay a net debit. We're going to pay to get this trade in place. But that does not make it a bad trade. In fact, it gives us the ability to profit that difference, that \$5 of higher strike price, minus

our \$3.13 of cost, we have the ability to continue to profit an additional \$1.87 if the stock ends at 120 or higher, given this trade. So we have the ability for us to see a change in price. And here we can see that indeed a net debit trade can be quite reasonable if it aligns with our outlook. And that always will be the end-all and be-all of our trade management, whether that's prior to expiration, or even if our trade takes us right up until expiration, at which point there are also several ways for us to manage our ongoing trade, is there not, Brett?

Brett Yoder: Oh, there certainly is. The big change here, when we actually get to expiration, your hand is forced. The contract is about to expire, there is no anything else that can happen; you're at the end of the road. The trade worked, or it didn't, but we're faced really with the same decisions. We can close the trade; that's selling to close or buying to close, but closing out of the option contract, so it's gone. We can go through exercise would be a sign, or if it is out of the money, the option ultimately will expire worthless.

The big thing that we want to point out on this, with the idea of exercise and assignment, there's a default. The default is, if the contract is one penny in the money, the contract will be exercised. So if I hold my contract, right, I bought to open, call or put, if I do have that one cent of intrinsic value as of the close

at expiration, your broker, we will certainly go in and exercise your right. It's important to know that, because if you don't want that to happen, you either need to close the trade prior to the market close, or you need to call in to us and say don't exercise this, for whatever reason. The majority of times, there is intrinsic values, there is some sort of value to your contract, you're going to want that. You'll end up with the shares or end up selling shares, and you know, manage that as the weekend passes, and we go into the next trading week. But if your contract is one cent in the money, it will automatically be exercised. Which means, if I sold to open, sold to open my contract, and I'm carrying that obligation of being assigned, if my contract is a cent in the money, I should absolutely assume I'm going to be assigned. Again, looking on the day of expiration, it's Friday, you're looking at your account, looking at the market on these options, if you think there's this risk that you're going to end in the money, certainly close out the trade, get rid of the trade so that you don't have to go through that, if that's not what is desired. Because it's interesting when we start to think about that, especially when you get to expiration, because there's the idea sometimes of trying to just squeeze out every possible cent of premium from some of these options that you sell.

So going back to this covered call. Actually, we'll continue the covered call example even through the screenshare which is coming up here momentarily.

But with a covered call, the most money you can make from that call is when that contract expires worthless. Or you get assigned, but where you can keep all of the premium. That's the prospect of the covered call, is that premium that you sold. You get it up front, but you're not able to truly take it all in, or just accept it as a full win until you dispose of the option. It expires, or you close it, or you get assigned. At that point, you can look at the overall prospect and realize how much you made. If I sold a contract for \$5, that's the full prospect, but what if we get to expiration date, and it's Friday, and that \$5, now the premium has just dwindled the whole way down to \$0.20? What are you going to do? Are you going to chase the rest of that \$0.20, or would you rather buy to close and spent the \$0.20, switching your prospect from the \$5 in total, well now you've captured almost all of it, but you didn't capture the full \$5, something very important to think of. Remember, stocks gap in price. Sometimes they can open drastically higher. Then the next day, look at what's happening in the broad market today. Fortunately, (inaudible) a little bit lower here, and at the beginning of this webinar, the S&P 500 was down over 2% on the S&P 500. Typically, it doesn't move around that much as far as intraday. We've had a pretty tumultuous few months as far as trading goes, but in general, that's a very large move. Your stocks can do that as well. So as you go into expiration, it's very important for you to weigh out how much premium is left, and is it worth the chance that the stock could change drastically in

price? Look over there to the right side here, remember, that second paragraph here, we say picking up pennies in front of the steamroller.

There are many different ways that you can gauge whether it's worth it to you or not, one of which is the idea of probability, how far away from the money are you? If it's drastically far away from the money, maybe you'd be more inclined to keep your sold contract through expiration, because it's very low probability, but what if you're closer to the money? Start to weigh that out, you'll have to come up with that rule yourself, and that's certainly something that we can help you with. Right, but make sure that you have that good gauge as far as what you were trying to actually capture; your capture rate is what it'll be referred to in many different texts.

But with that, we slide over to the idea that just overall position management, how does it look? So there's a few guiding factors we want to talk to you about with managing your positions, but then certainly, we'll show you fidelity.com and then managing your account. Jacob, over to you.

Jacob Ellis: When we think about position management, what we're talking about is really some measure of having a plan. What are we going to do to minimize the emotional types of decisions that we tend towards if we don't have a plan?

Some of the key points here on the right hand side are that we can reduce our concentration in just one position or sector. This is that timeless and age-old phrase of don't put all your eggs in one basket. If you put all of your money into one trade, that tends to have a high impact on your emotional state. If it goes well, you will be elated. But if it goes poorly, it can quite literally put you into the poorhouse. We want to make sure that you are able to make decisions that are wise, and not react in a knee-jerk fashion when something happens, instead first pausing to reevaluation our outlook. If our outlook still is maintained, then we keep the current trade. If our outlook no longer aligns with the stock and our trade, we close our trade out right away. Or, if an alteration needs to be made, then we will modify our trade as necessary to better align with our outlook. With smaller position size, smaller pieces, smaller trades, we're able to step back and remember that this is only one piece of our overall portfolio. And sure, it was a winner; it was a loser. It was a draw, just a waste of our time. Well regardless, we can then move forward and make the next decision in a way that we are happy with and proud of as we continue to move forward. We go into each trade knowing what you might, and are willing to lose. And finally, we need to be flexible, in the moment that our outlook has opinion has changed, we need to be ready to adjust fire, make the necessary adjustment to our trade.

That's going to wrap up what we're going to go over in great detail on the slides, but we are going to move into now a period of screenshare where we will look together on Fidelity.com, and actually the types of tools available on the website that will help you with managing your trade throughout its lifespan. One of the first cases that we will come to, is that very one that you see when you sign into Fidelity.com, and that is your portfolio summary, which you can see in front of you now. We can very easily navigate to the positions page by clicking on the Prospective tab, and I imagine that many of you, if not all, are very familiar with those two spots.

But this next page that you will see, is one that perhaps you have not seen before. We come up here to the top of our screen under "Related Links," give it a click, and then select from the list "Options Summary," which as the name implies, summarizes all option-related trades. We see a number of filtering criteria up here at the top, including how these are going to be grouped, whether by underlying or by strategy, or by the expiration date of the options. We can also choose what to show. Do we want to include these unpaired positions like this Bank of America, which only entails five shares that are owned in this test account? Or would we prefer instead to see only those trades which include options? By unchecking the box we see that the several that were unpaired are gone, and now we're looking exclusively at a Zynga

covered call trade, in which we own 100 shares of the stock, and have a covered call sold against it, specifically a December 18 call with a \$10 strike price. We can also show the previous closing price of this security for the stock at \$8.46, and the option at \$0.31. And as we take a look at the current price, Zynga has gone up by \$0.10 today, a profit for our trade.

But if we come over past this upright line, we start to see things about both historic and our current pricing. We see the average cost, how much did it cost us to acquire this 100 shares? Overall, \$628. How much did we sell the call for? \$56. We can see CR for credit, DR for debt. Debits were paid; credits were paid to us. Our overall strategy then was one of \$572 of debit. It cost us \$628. We brought in \$56. Net cost overall is \$572. If it is worth at any point anything greater than \$572, then this trade is at a profit. And we see over here to the right that indeed currently, we're looking at a \$250 profit because the market value of the trade as a whole is currently \$823. That difference is our current profit. We already can see, I hope that you agree, a lot of information summarized here at a glance that helps us to understand what has happened since the onset of our trade. We now know that this trade has worked in our favor, whereas we bought it for about \$6.28 a piece for the 100 shares, it's now worth \$8.46. We've made a good deal on the underlying shares themselves. But the call happens also to have been profitable in this case. Well, what type

of management might we take on here? If after additional analysis, we've taken a look and decide that this is still the trade we like, I still think Zynga will go up, I think it will be somewhere near \$10, but not much beyond, by December. Well this trade would stand and no additional management will be needed.

But what if we came to this situation and we thought, you know what? This is as high as I think Zynga was ever going to get. Now, it may actually be headed downwards. Well then we need to think about closing our strategy and doing so with the utmost of expedience. Click here on "Covered Call" and you will see several management techniques prebuilt for us, specifically close strategy, and roll, we'll be looking at in-depth today. If we click "Close Strategy," we are brought quickly to a prebuilt, preloaded trade ticket with all pieces of the strategy ready to be closed out. Notice that on this screen, it is expecting us both to sell the shares of the stock and to close the option, buy to close the one December 10 strike price call, closing out all pieces of the overall strategy. And it's build that up for us at the natural pricing of a net credit of \$8.23. We see here again where those numbers are coming from. If we were to sell the stock at the bid of \$8.56 and had to buy back the option at the ask of \$0.33, well \$8.56 minus \$0.33 gives our \$8.23 difference. Perhaps we'd prefer to aim for that midpoint price, and ask for \$8.24, for somebody to meet us in the

middle. Regardless of what price we decide, since our outlook has changed, we are ready to close out all pieces of the strategy. Closing out at this overall net price. If we're ready to close it out right now, we can probably leave this time-in-force as day. But perhaps instead, if we place this order in advance, then we might choose "good 'til canceled," saying that we'd like this order to stay around, and as soon as we can get \$8.50 for the trade, we could be out of the trade in that moment.

We also have the ability to make a change and perhaps the alteration to our strategy doesn't require closing it entirely, but rather, we think that now the upside in the stock is substantial. Previously we sold a 10 strike price call, but after further analysis, we realize you know what, Zynga's going to \$12, or \$13 or \$15, or \$20. We no longer want to be tied together to this covered call. Well, by simply changing our strategy up here from buy, right, which implies a stock and an options strategy simultaneously, we will click and change it to calls and puts. It will conveniently keep for us the buying-to-close part of that trade, saying we will still be closing out our short call, but now instead we're ready to place just that trade which would leave us with the resultant shares uncovered in our account, ready to profit from our expected meteoric rise in the stock. These tools will allow us to quickly navigate through a trade.

But we also notice here on the right-hand side under a similar title, "Related Links," a link straight back to the options summary where we can continue to look through our trade. If we hit back here to "Options Summary," we'll be presented with that same screen we were on before. We notice we have the unpaired and the paired physicians. But this time when we click on "covered call," we're going to evaluate what happens and how we can walk through the strategy of rolling our option, and Brett was prepared to do that.

Brett Yoder: Absolutely, Jacob. Thanks so much. The mechanics here, very similar.

When you go from the "Options Summary" page, it does preload for you, and it's wonderful; it saves you a decent amount of time. That being said, with this rolling idea, going back to our terms, that means we're either going to be changing the strike price, the expiration date, or even both. Now because we're deciding what this new trade is going to be, we see all of that is left open there in Lake 1. So here we have Lake 1 and Lake 2. Lake 1 is our buy-to-close. We need to get out of the current contract, and it's important to point out on this rolling, reiterating something Jacob had said earlier, we are closing the 10 strike. You can't just change an option. Options are fixed. What we have currently is the December 18th, 10 strike, that's what it is. If we want a different expiration or a different strike, we have to close out that trade. Now that could create a capital gain in this case, or loss. It's a gain simply

because we sold at the higher level, 50. We're buying at this lower level 30, that'll be a gain to our account. So we're closing out Lake 1, and now we're opening and creating our new Lake, Lake 2, sell-to-open.

So let's talk about rolling up or down first. So first, let's put our quantity in. We want to make sure that we match the same quantity there, as one. And we'll stick just with that same December expiration date. But as Jacob mentioned, let's say our outlook is that the price will actually go up significantly more. Instead of 10, our new target will be 15. So if we switch from the 10 strike to the 15 strike, and make sure to select call there at the end, we'll be able to see the overall prospect, what is going to change? What sort of opportunity are we getting? In this case, we can see that for the 10 contract, we have a bid and ask. But that 15 contract, we're lacking a bid. There's no one actually to sell that contract (inaudible), but if we think the price is going up to 15, we would just be buying-to-close with 10 allowing the shares to go up by themselves to make the appreciation that way.

So let's switch it, Jacob. Instead of the 15, let's just go down to the, I believe there's a 12. Okay, so now we're on the 12 strike. Now there is a bid, \$0.11. This is one of those situations where we're going to pay money to have this opportunity. We're picking up two additional dollars going from 10 the whole

way up to \$12, but it's going to cost us \$0.22 to do so. Now, that's cheaper than buying the \$10 back by itself, spending the \$0.33; there's your benefit to doing it. But in this case, we're picking up \$2 worth of opportunity, right, getting that net debit, spending \$0.22 on that. We have to weigh out, is that worth it?

The other thing we can do is roll out, right, roll further out. Remember those longer-dated options carry more time premium. So there's the chance that we could still have our \$12 target, but let's go out a month or two. Let's roll out, so we click our expiration dates, and we'll take a look at the January contract. As Jacob selects that, we'll see the new pricing. Here, very small improvement. We went from spending \$0.22 down to \$0.20. If we go further out in time, there's the chance that we could roll this for a credit. That being said, we warned about this. The idea of always rolling for a credit is, I mean, it sounds pretty fantastic, right? You're always paid additional money in additional money. But our outlook was by December, price is going to up; in this case, we'll say it's 12. Now we've gone out an extra month of obligation to get to 12, and it's still a net debit.

Jacob, let's go and let's check something months out. Let's see if we have those even further out. So we have July's, in this case. So looking at July, now

we can get a credit, but for that price outlook that we expect by December, we're now taking on months of obligation. This is where we don't want to be fixated on rolling forward credit. This is where we want to let our strategy determine if it was worth it. In that sense, we look to that \$0.22 opportunity to get that extra \$1.78 in our underlying if the price does go, in fact, up to \$12.

So, that being said, familiarize yourself with this option summary page. Really work out, and work out before you trade, work out the idea of what are you trying to capitalize on, what is the actual strategy? It needs to be articulate. I'm going to sell this call for this particular reason. Right, and this is going to be my covered call strategy. This is the prospect; I'm always looking for, I always want a certain amount of premium. I only ever want to be obligated for a certain amount of time. Being flexible on your underlying will make sure that you get the strategy right. Being rigid on your underlying may get you into a situation where the call shouldn't be traded; the covered call shouldn't be traded. The only way you'll know and be able to navigate that is if you set those rules up at the beginning before you actually start trading.

Jacob, let's show one more thing. We have a few more minutes here. We talked briefly about probabilities, and we just want to showcase the probability calculator. To do that, we'll go up to news and research. Excuse me, as

Jacob's pointing out, related links, we have the probability calculator right there to the side. If you did want to go the other way, it's News & Research, and then Options, and then the probability calculator. Here we're jumping right to it. And just familiarize yourself with this page, you're trading options now, we should definitely be familiar with the quotes and tools tab, as well as the market overview and the trading ideas. In the quotes and tools, here's our probability calculator. Jacob, why don't you just walk over this probability calculator here for us)?

Jacob Ellis: The probability calculator is a fantastic tool that's going to help us understand how probable it is for the stock to be able to wiggle high enough or low enough to get to a specific price by a certain date. But it runs all of this through a filter of how volatile the stock has been recently. Okay, Zynga over the last 90 days of traded information has had about a 32% annualized volatility. Well, between you and me, that's not too informative. But if we then plug it into our calculator, that tells us that if we want to know the likelihood of the stock rising to \$10 by December, our expiration date, assuming that volatility stays consistent, well this is what it means. It means that there's about a 15% chance that the stocks could rise high enough to get there. And an 85% chance that it would be below. Now, that is based on that historic volatility. Maybe we're under the impression though that the last 90

days is not representative of the future, from now until December. Maybe we think that it's likely to be more similar to the last 180 days, which we see has a higher volatility figure. We went from 32 to 40. And notice that even though everything else is the same, looking for the probability by December of it rising to 10, we now have a 20%, almost 19.25% probability of the stock rising above. It was 15% below, versus 80% below. As we take a look at that difference, we can see that the higher the volatility we expect, the more possibility for the stock to move in extreme ranges up or down, and this probability calculator can very quickly give us a gut-check idea of how likely it is for the stock to move. We also can see these different rings, if you will, or curves. These bell curves are the first, second, and third standard deviations away from the current stock price. For every day that passes, we see that those curves move up and down further away from the current price. This tool is not biased in saying that it thinks the stock is moving down, or up. Rather, it is looking exclusively at the amount of volatility that has occurred to determine the likelihood, the possibility that those types of swings ended up above a certain level by that ending time frame. So that probability tool can really help you with your decision as we evaluate, is it worth it to stick with our trade? Now we know that if we really think that the stock is going to come all the way up here to 12, well we are predicting a very large swing, only a three in 100 chances that that occurs. Now we might be so sure of our analysis, that we're

ready to place this trade. But now we know we are shooting for the stars; this is an extreme value, and would require some extreme move in Zynga, a change from history for it to occur. So use that tool as you evaluate along through this.

END OF AUDIO FILE

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