TRANSCRIPT

Generating potential income with options: Selling puts

Presenters: Konstantin Vrandopulo and Nicholas Delisse

Konstantin Vrandopulo: Happy to be here, thank you everyone for signing up and of course planning on spending the next hour with us. Nick and I were preparing a few notes this morning and were talking amongst ourselves, and we were certainly excited, we got a few things in store for you. I wanted to introduce, of course, myself and Nick. I'm Konstantin, he's Nick Delisse. We're both trading strategy desk specialists here at Fidelity Investments. If you're not familiar with our group, it's really a small group of dedicated brokers that help self-directed clients here at Fidelity come up with a trading strategy, you know, sort of evaluate a strategy of interest for risk/reward, make sure that you have all of your blind spots covered. We focused on obviously investing education, including trading and we're discussing options here today as a topic, but we do, of course, cover technical analysis very in-depth as well in those sessions. So if you're interested in this sort of material, and you're curious about what else we do, please don't hesitate to go to fidelity.com/coaching. Everyone is welcome, if you're a Fidelity client, we'll be glad to have you in those.

Nick, wanted to jump in and of course, you know, kind of, a layout of the theme of today's hour that we're going to spend together. We have a presentation deck, and on the back end, we'll spend quite a bit of time on actually doing some screensharing for you to make sure that we are using the Fidelity tools and resources live as a professional investor would when you're coming up with trade ideas. So we're going to discuss of course what a put selling strategy entails. We're going to talk about making sure that we evaluate the strategy from this perspective in this particular order, risk versus reward, and of course how to use Fidelity tools in the screening space on fidelity.com, and then we'll build it out in Active Trader Pro to stress test whatever it is that we come up with.

So without further ado, Nick, it's great to see you today, sir. We're discussing cash-secured puts first. Mic is yours.

Nicholas Delisse: Appreciate that, Konstantin, and again, I want to thank everyone for joining us. One thing that kind of jumps out to me when it comes to, risk/reward, there's been a lot of study on that that, of course what's important first is to highlight and look at risk, how much risk are you willing to take, because there is no reward without risk. And to start everything off, you know, want to address what is selling a put, you know, what is selling a cash-backed

put, what are the risks, what's your obligation, because that's the important aspect first. Before you then look at really what your potential reward is. For those of you that have attended our other sessions we have, where we kind of introduce options, of course, an option is a contract between a buyer and a seller where the buyer has the right, the seller has the obligation. Specifically when it comes to puts, the buyer has the right to sell. The seller, the person that sells a cash-backed put, has the obligation to buy the stock. And this obligation, of course, goes through until expiration, and then it's of course terminated. And either at expiration, you'll line up with the option expires un-exercised. So, from the writer's perspective it expires unassigned, or they want it assigned shares of stock, and they have shares of stock.

Now, that's the risk. The profit potential, the upside is the premium you receive from selling the option to begin with. You know, if you sell an option for a dollar, and the option expires worthless, you're not going to magically receive three or four or five dollars. The most you can of course make is that premium received at the beginning. And that's what you're being paid in exchange for the risk you're taking of selling the put. Now, there is a lot of risk associated with this, and so security selection becomes important, and we'll talk a little bit about that at the end of the session on how to find different ideas and such to sell puts on. And with that substantial risk, if you're assigned

shares, you sell the option for a dollar, and you're assigned shares, you're called to fulfill your obligation. Well now you have a hundred shares of stock that it could go up, it could go down, it could stay flat. But there's a lot of risk there, especially if it happens to be a security that you're not a fan of. You might not want to take that risk associated with that. Now, what makes this cash secured is you've set aside enough cash that in case you're called on to fulfill your obligation, which with an American style option, it can occur at any time, it doesn't have to be at expiration, but it generally is at expiration, you have to be able to purchase those shares. That's the difference, of course, between it being task-secured and it not being cash secured where maybe you've set aside a margin requirement if it is not to cash secured.

So that kind of introduces everything when it comes to really what the put is, but we do want to talk about and address why traders might look to this particular strategy to begin with. You know, one of the big things that always jumps out of course is the ability to earn an income. You're selling these puts, you're able to bring in at premium, and maybe that cash that you set aside in case you were assigned, would have just been sitting in a money market account making whatever money market accounts are making these days, which you know, where the Federal Reserve has interest rates, isn't a whole lot. And of course, again that tradeoff with, a money market account has a lot

less risk, a lot lower reward. Puts have the potential for greater reward, but there's that risk associated with that, so you're bringing in an income.

Now that kind of covers of course, we've talked about on the slide with potential earned income two, you can earn interest, so to speak, on your cast, that premium, as opposed to, what the money market account is paying. But the other big reason, of course, why traders will sell puts, is the target that price they might be wanting to buy the stock at. Maybe a security is trading at $400 a share, and they look at it and go, well this drops to $350, I might be wanting to buy the shares at that particular price. In this scenario, you could put a limit order out there, limit to buy the shares at 350. But you know, what happens if the stock just goes sideways, drops to 375, then back to 400. And they never hit that, you never bought shares. Where it's selling a put, you can at least earn a little bit of income in that particular meantime. This does have a little bit of that tradeoff with that, that if the security drops to 350, a limit order would have been filled. And everything goes back up to 400. If it's 400 at expiration, you might not have been assigned. And so, there's, you're receiving that premium in exchange for, you might not buy the security if you so desire. But many traders will use this as a way to target a purchase price as opposed to having a limit order that sits out there and doesn't get filled for several months.

So that really kind of touches on some of the reasons why, but it still is important to evaluate that risk-to-reward aspect I was talking about beforehand.

So, some things to keep in mind with options. I mentioned, you know, that it's a standardized contract, there's an agreement between the buyer and the seller. The buyer has the right, the seller has the obligation. I'm going to talk a little bit about the obligation. The obligation covers 100 shares. So for every cash-backed put that you sell, a standardized, non-adjusted cash-back put, you're selling the equivalent to -- the obligation to be purchasing 100 shares of stock. If you do two, it's 200 shares of stock. And you have to keep that in mind that once own those number of shares, if you only want to own 50 shares, or you prefer to own 300 shares, keep that in mind with your math. That then breaks down to how much risk are you comfortable in taking? If you only want to risk $20,000 and you're looking at buying potentially 100 shares of stock at $350 a share, that's $35,000. Or if the stock is at $100 a share, and you're wanting to risk $20,000, well that could be 200 shares of stock. And so this builds into that, how much risk are you comfortable taking on, will help answer the question on how many contracts are you looking at. But everything, of course, builds into that management aspect on, keep aware

your size. And a lot of traders that Konstantin and I will work with, that maybe they look at selling puts that aren't cash-backed, sometimes can let that size get out of hand where they might sell more than they're comfortable with, and not realize it, because the numbers just look small, you know? I'm doing three contracts, I'm doing four contracts, I'm doing five, not realizing it's 300, 400, 500 shares. They have the obligation to purchase if called upon to fulfill that particular obligation. So these are just some important things to keep in mind before you look at selling a put. Keep in mind what the risks are before you necessarily dive too deep into that particular reward.

Konstantin Vrandopulo: You know, Nick, you bring up a very good point, right? Being aware of the position size, and how important it is, kind of forefront before you actually enter into a transaction, I am obviously a broker affiliated with Fidelity Investments and I am a Fidelity client, and I'm a trader as well, right? So if I'm thinking about my own personal trading, what usually keeps me in check is the tool that we will showcase a little bit later on in the presentation where when you do a particular size in the simulated trade, and you evaluate it for risk first, for what happens if I'm wrong, and you really can't stomach the red numbers that are associated with it, right, it kind of keeps you in check, and right away points to the fact that you should probably be

reducing the size of the position that you're planning on doing, as one potential adjustment, right?

So let's get into the strategy, break it down relatively simply here. We're looking at a stock QRS, a completely random symbol out there, right, and we're saying, we got $9,000 in cash in our account, and we are focusing on a cash-secured or cash covered put. Currently, the QRS stock is trading at $92, and I have $9,000 in my account, and I'm thinking about generating some income on the cash that I have available, but I'm not currently willing to pay $92 for the stock. I have a neutral to slightly bullish outlook. Now we emphasized that on the market forecast of why do we focus on neutral to slightly bullish, and not excessively bullish, right, or exuberantly bullish, is because, as Nick pointed out, the maximum amount that we can make on a short put strategy is the amount of premium we receive by selling, right, that obligation to the other side, to the put buyer. So, if the maximum amount that we can make is capped right at the beginning, we know that it's never going to be a home run unlimited profit potential type of a trade, right? So we have this neutral to slightly-bullish outlook, we might not be willing to pay $92 for the stock, but we would maybe want to, or would be interested in purchasing it, if the stock tucked in a little bit, between now and the expiration date. And if it didn't, you know, so be it, right? I'll utilize my cash, and whatever premium I

receive, I'll think about it as capital return on capital committed, right? So, particular point to the earlier side of generating potential interest, right?

So what are we doing here? We're selling 1 QRS 90 strike put. So notice that the stock is at 92, we're selling a slightly out-of-the-money put option below the market currently in QRS at 90, and we're receiving a dollar for it. Remember that each individual contract as Nick mentioned represents a hundred shares of stock, so the price or the premium of the contract has that hundred multiplier, most of the time, unless a contract has been adjusted, which happens sometimes, but it's usually very, very infrequent, all right?

So generally, each contract represents a hundred shares and I'm looking at a hundred bucks worth of premium. Now I am setting aside $9,000 to cover that obligation, from the perspective of the effect on your net cash position, well $8900 from cash, and I received $100 of premium, so net-net, I'm putting aside $9,000, very good. Now, that $100 by the way that I brought in, I can do whatever I want with right away, right? So that cash is a credit, and you know, you can purchase something with it, you can withdraw that money out of your account. You know, or put it aside for a rainy day, right? So essentially, that premium received becomes availability to you right away in your account.

Excellent, so we're looking at a profit-and-loss diagram, and this is something that's referred to as a hockey stick diagram in the business. It might look a little confusing, but I'll simplify it for everybody.

Now this yellow line here is an equivalent strategy to buying long stock. So if I wanted to buy a hundred shares of stock right now at $92, this is what my profit-and-loss diagram would look like is this yellow line. Now let's think about the axes. You have the x-axis here, which is the price of the underlying security, and the y-axis is going to be depicting our either potential profitability, or our risk, right, our potential losses. Let's think through this. If I'm buying the stock at $92, my cost basis is $92, that's my breakeven point. And the higher the stock goes, the more money I potentially stand to make. The lower the stock goes, the more money I potentially stand to lose.

Now the green line here is that hockey stick diagram that I mentioned a little earlier. That's the options trade. Now, that's quite a bit different from buying stock, as you can see. Why? Because the risk in the strategy looks similar. It is effectively substantial all the way down to zero, right, if the stock goes to zero, we have substantial risk on the downside. But on the upside, the profit potential is plateaued. And it has plateaued at what price, at what level? At

the price of the initial credit that we received. So in this case, one dollar, or a hundred dollars. That is the maximum that we can make.

So capped upside potential, substantial risk to the downside, right, is the difference between a cash-secured put versus buying the stock outright.

Okay, now you would say, well what about the profit-and-loss table, won't spend a whole lot of time on here, but essentially what we're trying to depict on this slide is the fact that the lower the stock goes, right, the greater the potential loss is going to be on the put strategy in relative terms. Because, it is offset only by how much, right? What is the buffer that I am bringing in for selling that put? How much of premium am I bringing in? What sort of a buffer am I creating, right, by how much am I decreasing my cost basis of a purchase of stock, if I was to be assigned, if the stock was to head south, by only a buck, right? So if I'm selling a put at 90, my breakeven point is $89. And anything below that, I'm actually starting to lose dollar-for-dollar effectively, okay?

Excellent, so we see that the maximum we can make again, very vividly displayed here is $100 or a dollar for every one lot that we do. We could of course make a little bit less than that, all the way down to our breakeven point

to $89, right, something between potentially zero and one hundred bucks. Or we could start losing dollar-for-dollar below our breakeven at $89.

All right, very good. Let's jump over into the importance of, when we're making a decision on strike selection, expiration selection, we know that there are plenty of different timeframes to choose from, right? Options in today's world are much more popular products than they were even just a couple of years ago. The growth in the options trading world has been exponential, very recently especially so, even though trading options has been a thing, right, since the early '80s.

So, we've come a long way, and what we need to recognize is that as the products, as the derivative products for options are becoming more and more popular, we're starting to see much more engagement in that market, and to accommodate that engagement, we're starting to see more and more expirations that are coming online, right? When the options first started trading, probably just had monthlies, quarterlies, and maybe LEAPs. Now we have, in some cases, right, intro week expirations and in many cases on many popular stocks especially in the large cap indices, they have weekly expirations, right, expanded weekly, which basically mean now five Friday expirations at any given one time when you're looking at the options board.

So how do you choose when you're deciding on how far out in time do you go? And so Nick, please talk to us about the non-linearity of time decay? This is a very important concept. Why, again, I want to underline, because the extrinsic value, or the amount of premium that we're bringing in, is our asset when we are trading a short put option.

Nicholas Delisse: Absolutely, Konstantin, and something I want to add on what you were just saying. And this is a very, very common question that we'll get on the strategy desk, is what about LEAP options? Should I do a LEAP option versus a regular option? This just builds into some of that old industry jargon kind of information. Just as you were saying, in the past it was just monthly options. And then due to increased activity, increased demand, traders wanted a longer-term option than what was available being this month, next month, next two in the cycle, you're only going out maybe seven, eight months practically. They wanted something that could go out a year, two years, or longer. That's where these long-term equity anticipation contracts came out of these LEAP contracts to offer something a little bit longer-term than what was originally created.

The flipside, as you mentioned, you have weeklies, which didn't really need something new to allow that extension beyond that original threshold, they

just started issuing some shorter-term ones on that. But the point I wanted to make on that is there's nothing really different about a LEAP contract other than a regular contract when it comes to looking at a chart like this. The big, big different with a LEAP contract is just, it's a fancy way of saying, I want to look at a contract that has more than nine months left to go. You know, it's a longer-term contract to get. So, there's not really anything else with that other than looking for extended time on that.

Now, when you're looking at a longer-term option, it's important to consider and remember that time decay isn't linear. So traders, they might look to sell an option 18 months out. But you know, going from 18 months out to 12 months out, it's going to decay a lot less than an option going eight months out to two months out, even though it's the same six months on that particular timeframe, just because of this non-linearity of time decay, and that's something to keep in mind, that's something to think about when you're trying to generate premium from this.

Now that might be a more important characteristic that it decays less if you're looking to take the other side of the contract, you're looking to buy the option. With that, because this non-linearity of time decay, many option traders will look to generate premium, they might go 30 to 60 days out. Because as we

can kind of see in this diagram we have, time decay increases in that 30 to 60-day timeframe. And that can be a little bit of a sweet spot that traders will look at, going less, going 30 days or 21 days or less, we would have even faster time decay. But again that tradeoff with risk to reward, where there's then other aspects like gamma risk that comes into play, where you start to look at the Greeks, the importance of some of these other things.

Now we don't really have the Greeks mentioned on this slide. But I would encourage everyone to learn more about those, take a look at some of the other sessions we have, because looking at the Greeks can really illustrate a lot of these concepts where you see how the option might lose more value on a 30-day option versus a 60-day options versus a six-month option out. And it can be a very, very valuable tool to help you with that expiration selection.

Now, something to keep in mind of course is the difference in that red line versus the blue line, when you're looking at selecting an expiration. At-the-money options have the greatest amount of time premium. And so, they have the greatest amount of premium to decay. If you're then selling an option that is out of the money, or maybe it's in the money, where a greater portion of the option is intrinsic value, when it's in the money, the smaller portion is extrinsic time value, then if it's decaying, then you have only ten cents of time premium

compared to the dollar that Konstantin was talking about on the previous slides, well, they can't decay at five cents a day for a week; there's only ten cents left. Where, on option trading at a dollar, it can decay at five cents, because there's enough premium there left to decay. And so, that's a little bit on why this kind of flattens out there, the further away you get because there's less premium, it's already kind of approached zero on this, and it's an important consideration, that if you look at it going too far away from the money, you might look at going a little bit further out, your expiration selection, so there's that premium associated there. With this, though, this can really help with that selection, you're looking at that 30 to 60 days out, as opposed to one week out with the weeklies, as opposed to LEAPs might go too far out. And really, then once you've selected an expiration, you can make it easier to select a strike. And, you know, with that, Konstantin, why don't you kind of talk with us then about strike selection?

Konstantin Vrandopulo: Sure Nick, again, you're making great points here, options price being the vertical axis here, the y-axis and the x-axis having, you know, the different expirations availability. You know, we wanted to depict this, and this is not anything scientific, right, from the perspective of the actual rate of change. But what we wanted to showcase on the slide is the non-linearity of time decay, and the acceleration, right, of time decay in an option towards the

end of its life. You kind of start seeing that the slope of especially at-the-money options, starts to become curvilinear, right, so the nonlinearity, you're almost having to use a quadratic equation, you know, to solve for a slope of this line and the way it is curving over towards the end of its life. So, we'll focus on that when we're looking at the options chain to kind of visualize it and illustrate it, but this is a good graph to remember. Again, nothing scientific specifically, but just a great illustration there.

So Nick, moneyness. So we talked about, you know, OTM, ATM, in-the-M, (laughs) ITM. ATM is not to be confused with the ATM where you get your cash from, right? It's the at-the-money option. So let's talk about the moneyness factor and the common use of it. So let's discuss the strategy from the perspective of neutrality with a bullish bias.

So if I use an in-the-money option, what does that mean? Well we know that an in-the-money option with puts is going to have a strike that is above the current price of where the stock is trading. Okay, so if I am selling something with a strike that's above the current price of the underlying security in the open market, does that make me more bullish, or more aggressively bullish? And the answer is yes, right? Remember I'm selling to somebody the

obligation to buy the stock at a higher price than what it's trading for in the open market right now.

So what would be my thesis for doing that? Well my thesis for doing that would be the fact that I actually think that the stock has the potential to rally from here, preferably above the strike that I sold so that I can expire worthless at expiration, right? So part of the in-the-money option, or its value, is going to be intrinsic, and part is going to be that extrinsic, or time value, depending on how deep in-the-money you go. Again, in-the-money strike, or a put option, is going to have a strike above where a current underlying is trading, so you're becoming more aggressively bullish, you would need and hope for the stock to rally in order to keep above the strike price that you selected, in order to keep all of that premium that you received up front, for a maximal profitability potential in the strategy.

Now if I compare that to an at-the-money option, well an at-the-money option is going to be essentially at par of where the stock is currently trading. Nick alluded to the fact that that has that option usually has, right, across the different expirations, at-the-money options will have the most amount of extrinsic value, of time value. And that is certainly true.

So it has all of the value of where the stock is currently trading where that strike is being extrinsic value, all right? Now I have become a little bit less bullish, or less aggressively bullish. Why? Well because, now in order for me to potentially make money on the strategy, right, all I need are the stock to either stay exactly where it is, or go higher, but preferably not go down by a whole lot. Okay, so to keep the premium that I have brought in for selling an at-the-money option, I need the stock just to stay above the strike that I chose, in order for me to potentially keep all of the premium received. So less bullish than an in-the-money from that perspective.

Now an out-of-the-money option, ad I think that's the one that we did in an example, right, where we're looking at a QRS stock with $92 per share in the open market, and we're doing a 90 strike put for a buck. So that would be an example of an out-of-the-money option, a circumstance where it is truly may be regarded as an income-generating premium-selling strategy where you are not willing to buy the stock right away, but you are willing to buy the stock if it actually comes in, right, or it pulls back a bit, and if it does, then you get assigned. So of course, naturally for an out-of-the-money option, having that buffer to the downside, in addition to the premium that I am bringing in, I'm decreasing effectively my cost basis, right, and our previous example was sold in 90 strike for a dollar. So my breakeven point was 89. So I'm having a buffer

of around $3 between 92 and 89, between now and expiration, for me to potentially keep all that premium, right, or most of it up until $89, some of it through that expiration date, right? So the stock has the potential to even come down a bit, not only stay pat of where it's currently trading, it'll go higher. In both of those circumstances, I'll keep the premium received, but I even can come down a little bit, right, and I could still make the money, and have my capital work for me for that timeframe. So that's sort of the breakdown of the moneyness factor.

Now the probabilities are interesting as well, cause they're very correlated, you know? The in-the-money option obviously is going to have the highest probability of being assigned. Remember that the probability is generally very closely correlated to an options Greek that I will showcase on an options chain in a little bit here that we can kind of use as a gauge to figure out what our potential probability of assignment is going to be. But the in-the-money option is going to have the highest probability, and the out-of-the-money options is going to have the lowest probability of assignment, with, right, the current market participant's outlook on the underlying security. Now, we're evaluating that stock for where it is right now, and the stock has the potential of going up, down, or staying sideways, right, or trading sideways. The premium or risk that we're taking on, everything is going to be correlated to

these points, right? If I'm bringing in more premium, if I'm taking on more risk by being more aggressively bullish for an in-the-money strike, well, I'm going to get the highest amount of premium, part of which is going to be intrinsic value and part extrinsic. If I'm looking at something that's out of the money, I'm going to have the lowest, right, amount of premium received, relatively speaking, for the amount of risk that I'm taking on. Why, because the risk is still substantial, the stock can still go down, but I have that buffer. I sold an out-of-the-money options, therefore the probability of assignment is lower, my perceived risk in relative terms to an in-the-money options is lower. Right, therefore I'm bringing in the less money, or the least amount of premium.

Then finally, you know, to the position management piece, Nick, this is very important because if we understand from the onset with our strike selection and the expiration selection of our choosing that we are more aggressive with one strategy and less aggressive with the other, we right away recognize that probably our risk management is going to have to be appropriate as well, right? Based on our position size, do we have to be paying attention to what the stock is doing tick-by-tick, or do we have some sort of a buffer zone that stock can meander with that, right? So we are recognizing on the forefront that we have a relatively balanced exposure with an at-the-money option, a more conservative, or less bullish outlook on the underlying security with an

out-of-the-money option, and a more aggressive, more bullish outlook, if we're picking an in the money. Remember the risk and reward, right, is parallel to what we're taking on. If we are more aggressively bullish with an in-the-money options, we're obviously going to have to most likely be more aggressive about managing risk in that strategy if the stock is not doing what we were expecting to do, i.e. trading sideways or going higher, right? If it heads south, we're going to have to do something most likely a lot quicker than we would with a strategy that has more tolerance for risk.

All right, Nick, let's jump into, you know, managing the strategy prior to expiration.

Nicholas Delisse: With this, looking at managing it prior to expiration, this is of course continuing on past the point where, you know, you've selected your security that you want to trade. You've selected the timeframe, and based on that, risk/reward with the time decay that you want to trade. You've then narrowed it down looking at that expiration. You've selected your strike; you've placed your trade, awesome. Well now what? Now, how do you manage the trade? There are really only three things that you can do to manage your trade, so to speak. You know, you can leave your trade alone, you can close your trade out, or you can adjust your trade. Now the ways you

can adjust your trade can be very, very, very complex, you know, whether you're changing strikes, changing expirations, changing number of contracts. Didn't get quite complex, but it boils down to really these three things. And so, what you have to do is you of course have to be honest with yourself, with your particular expectations. And you chose a strike price because you were neutral to bullish on the security. Maybe you went a little bit more in the money, because you were more strongly bullish, like Konstantin was saying, or you went a little bit further out of the money because you were a little bit more neutral. Well, if your outlook hasn't changed, you picked an in-the-money one, because you were more bullish, and the stock has kind of gone sideways, but you still, you're expecting it to still move up. If your outlook hasn't changed, might leave your trade alone, make no adjustments.

But what happens if your outlook has changed? You sold a slightly out-of-the-money, or maybe a little bit further out-of-the-money option, and your strike started to be tested, starting to drop down to your strike. Now in the QRS example, with selling at 90, stock was at 92 or 95, well since dropped down to 90, and you're looking at it going, well I'm no longer neutral to bullish, I'm now slightly bearish. Well now's when it might make sense to close this strategy. And what you really want to do is look at and analyze, and maybe as yourself, would I place the same trade today? And if the answer is, yeah, I'd still sell

that particular contract today, leave it alone. If the outlook is, I don't like the stock, I wouldn't place the trade on the stock today, you close it out. Or, or, or, if it's still like the stock, but I'd rather a different strike price. This is where that adjustment comes into play where maybe you then adjust it to the strike price that you'd want to be trading now as opposed to one that you initially did, or if you were neutral to bullish, and the stock went sideways and you're still bullish, you can roll it out to get more time.

Now, that's of course prior to expiration. What about at expiration? Options going to expire in an hour, or three hours, what are your choices? Well really, your choices are the same as prior to expiration, but there no longer is any time left to make a decision. You can't really adjust anything because there's no time left, and so you're really then left with the first two, leave it alone, close your trade out. Closing the trade is the first listed here for ways to manage it at expiration. You know, if it's going to be in the money, out of the money, in the money, out of the money, you're not sure, you don't really want to be assigned shares, you're okay, but you prefer not to close the trade, remove the risk. If you're looking at it, that you, okay, still taking that risk, might be in the money, you might be assigned at expiration. Leave the trade on, take assignment. Or, leave the trade on, and maybe it balance up, and it expires worthless. There could even be a situation where the option is in the

money and you're not assigned, that can't happen. Just like there could be the situation of where the option is not in the money at expiration, and you could still be assigned, because it's up to the hold of the contract on whether or not they want to exercise their particular option.

Now, that said, maybe you might ask, well what about adjusting? Coming to at expiration, keep them on, of course, adjustments, you know, a roll, for example, you're closing one trade, you're opening a new trade. And now that you're at expiration, that's really more what you're doing is you made the decision to close the old trade, and then you're looking at everything, and you're placing a new trade. You can't quite make the decision, well I'm going to roll it up, because, well there's no time left, or I'm going to roll it down, because there's no time left. Or I'm going to reduce my position from ten contracts to five because, there's no time left. And so, you know, again, if your choice is at expiration, but it's really those same types of choices.

Konstantin Vrandopulo: Nick, you're making very good points here from the perspective of the fact that you always want to try to be in control, right? You don't want to leave anything to chance. We have the obligation, and the other side, the counterparty that we sold this contract to has the right, they can do whatever they want. And we have the obligation, right, and we're at risk of

potential assignment at any time, not only throughout the options live, but at expiration, so we can't be really counting on the other side potentially making a mistake of some sort. What we need to be doing is being, we need to make sure that we're in control. So taking action based on what our thesis is from here on out needs to be appropriate.

Let's jump in, Nick, into a couple of things. I'm going to wrap this up, I just, you know, stress-testing, right, what we have been focusing on primarily. You have the obligation to buy the stock at the strike price until expiration, for an American-style option, all the way throughout its life, right? The profit potential is limited to how much, the amount of premium received up front. We have substantial downside risk, if the stock tumbles and continues to go lower, as depicted in our profit-and-loss diagram there, we saw that the risk is substantial. And just to nicely wrap it up, if we are selling puts, we're generally thinking about income-generating strategies on the underlying security, and we do have that neutral-to-bullish outlook, so we want to make sure that when we're coming up with trade ideas, we're not selling puts on stocks that we think are headed south, okay? Making sure that we're being honest with ourselves and keeping ourselves in check, right, we are our own biggest judges. And so, just making sure that you're not, you can't obviously lie to yourself, so making sure that we're keeping ourselves in check, and managing

our expectations accordingly, before we place the trade, and once we've placed the trade and market-generated information is sending us certain signals, right?

So Nick, what I'm going to do from here is I'm going to jump over into the stock screener, and spend just a quick minute here on an idea-generating strategy. And again, we want to emphasize the fact that Nick and I are not solicitors of buy, sell short, or buy to cover recommendations of any sort, right? We're here to kind of show you how the tools work and help you through the process. You have to make your own determination as to whether it makes sense for you, and you know, evaluate it for your own personal financial tolerances and financial situations, okay? So, let's do this, let's start with News and Research, Stocks from the dropdown, and then click on Start a Screen, which will bring us to the stock screener. So what I'm going to do is, Nick, I'm going to jump in, and I'm going to say, you know, I'm interested in securities that have large market capitalization sizes. And the last time I checked, probably the lowest market cap in the S&P 500 was roughly around $6 billion mark, maybe $6.5 billion, right? So we'll eliminate basically the universe of stocks that make up, that are outside of the S&P 500 by selecting market capitalization of $8 billion-plus, okay? I'm going to jump down a little bit lower, and we're going to say, what's the second-most important thing?

Well we need to make sure that the security is going to be optionable, right? So I can actually trade an option on that security. So currently I have 1,028 underlyings in my selection. I'm going to go ahead and click on Optionable to make sure that they are.

Now what might be the next thing that we're interested in? Let me jump in into trading characteristics and let's say that the 90-day average volume for the underlying security is maybe high or very high, right, 300,000-plus, or 218,000-plus. So I have a lot of securities basically that trade with lower volume, so I want something that the underlying security is liquid to make sure that the options potentially have decent markets as well and have some liquidity there.

The next thing, and the most important thing I think from this list, and that I'm going to select, Nick, are going to be our bullish potential criteria, right? So I'm going to click on Technicals, and I'm going to hop over into the indicator technical events, and I'm going to select all bullish criteria, and I'm going to select the ones that have happened within the past couple of days. Right, so we have a very big down-tape, I would say to the downside right now, I mean, you know, it's a lousy market condition currently, so finding out securities that are doing relatively well maybe in this sort of a market is going to be of interest to us.

Now, I just clicked on the market capitalization to display the largest market cap stocks on top, and I'm going to just scroll down here and see maybe what catches my eye, again, not for any particular reason, but let's look at Boeing, since it has two of these bullish indicators here. So let's take a look at what Boeing is telling me. Price crossed above the 200-day moving average, price crossed above the 50 as well, happened on one day on the 14th last week at some point.

All right, so we're going to jump over into Active Trader Pro and break down Boeing a little bit closer, all right? Let's make sure that we do that, and I'm going to look at a chart of Boeing, and of course, as we traders like to call it, the board, the options chain, right? So first things first, from the perspective of a chart, I have a couple of things on my chart currently. This is a one-year view of Boeing. It looks like it's clearly been, you know, in a relatively speaking intermediate-term downtrend for a while, had a nice start in January of 2021, topped out around 275, most recently bottomed out right up against 190, 185, and is now trying to stage a little bit of a recovery rally. Is it trading above those moving averages that we depicted on the technical indicator screener? And the answer is yes, right? I have the 20-day, I have the 50-day, and I have the 200 on my chart, and clearly, the stock is currently contending with a 200-

day, and is sitting right on top of it. It has been above the 50-day for quite some time, for a few days. So it's sitting above all of the moving averages that I have displayed on my chart, and right, it's trying to content maybe from the technical stand point of view, again, for more of this type of information, don't hesitate to show up in our coaching sessions that we do quite frequently, and often, fidelity.com/coaching. But after this small break to the upside post the downtrend line, right, lower lows and lower highs along the way, contended with that 200-day here, last time failed, found a floor, most recently right up against, let's call it 185 to 190 range, and has had some lows in this relative area most recently as well, right? So from the potential of areas of interest of the battles between the bulls and the bears that have been fought, these are some of the areas that catch my eye, right? What are we seeing from the momentum standpoint of view? Well, momentum picking up pace, a little bit of a positive divergence here in RSI terms versus price, price staged a lower low, RSI did not. Momentum actually printed a higher low, positive divergence, and now we're potentially breaking this downtrend line. Again, not out of the woods yet, right, anything is possible. The last time I tried to do that, it failed. But maybe it's trying to get out of its funk.

What about, in terms of implied volatility, or the market's expectation for movement of the stock based on what participants are doing right now and

how they're trading it, well it looks like we had a couple of quarters' worth of earnings, and the reaction wasn't exactly stellar to those earnings reports. Where were option premiums going into those events? Well around here, implied volatility out 30 days was around 32%. Around here, it was around 33, 34. Where is it right now? It's at 38.50. So market expectations for future movement in the stock right now are higher than they were going into the prior earnings announcements.

Now we are of course in the earnings cycle. So we know that there is potential for this stock to maybe be reporting soon. I'm bringing up the board, I'm looking at the puts, looking at 20 strikes, and I know right away that earnings signage or symbol is telling me that Boeing's expected to report on the 26th of January, right? So in about two trading weeks or so, right? Or excuse me, ten calendar days.

What do I have on my options chain? Now this is not, you know, the best layout of an options chain; it's just one of them. What do we have here? We have our strike, last, change, bid/ask, volume, open interest, implied volatility, the cheapness or expensiveness of options, again, for another session, we want to make sure that we're inviting you back, right, for sessions on implied volatility and the importance of it. But it is the creator and destroyer of

extrinsic value, and therefore, it is a part of our evaluation here. It's currently higher than it has been before going into earnings cycle, so that's of interest to us. What else do we have? We have our delta, we have our theta, and we have these two columns of intrinsic and time value. Now you would notice that the shaded areas are going to be our in-the-money options, and the unshaded areas are the out-of-the-money options. Strikes above the current price versus the strikes below the current price.

Now Nick, we identified some areas of interest going back to the chart. You know, the depiction of the fact that at-the-money options have the most amount of time value is very visible if you lay out your options chain this way, 225s have around $10 worth of time value, and if you go out 60 days, they have around $13 worth of time value. So that brings us back to that non-linearity of time, the way to display, $10 worth of time value for an at-the-money option with 30 days to go, versus double that, and we only get an extra $3 worth of time value or time premium built into it, right? So very important point.

Now Nick, I have alluded to some levels, maybe of interest from a technical standpoint of view. Why don't we build out a few strikes into the profit and loss calculator and see how they look?

Nicholas Delisse: Absolutely, and another tool to look at, of course you were talking about implied volatility. Take a look at the options statistics up here to see kind of what that range was in the past, in addition to the chart. But pulling back up the profit and loss calculator, while you're going along, while you're mentioning those particular strikes, I was following along with the profit-and-loss calculator on Boeing. I have three separate strikes up here, the 225, the at-the-money you mentioned, 205, about that support level that you were mentioning on your chart. But from a statistical standpoint, this is about --

Konstantin Vrandopulo: Potential support, right, Nick?

Nicholas Delisse: Yeah.

Konstantin Vrandopulo: We will only know if it's support if the stock gets there, potential support.

Nicholas Delisse: If it holds, if it bounces, yeah, exactly, exactly. And so, I used a 205 as also, it's about one standard deviation down from being at the money. Looking at delta, delta was about 18 on the option chain. And we can talk

about that in some of our other sessions on the Greeks. But to be even, if we're going to 20 down, I want 20 up, the 245.

Now with this on these evaluation prices we have here, it's, I picked the midpoint. We can see of course the theoretical price is about the same as the evaluation price. And I haven't really changed anything in this tool. Now, this evaluation price is one of the most important columns within this tool, because this can show things like, well what if time goes by? Then we can fast forward and say, what if we're looking at next Friday, about a week-and-a-half of time has gone by. How is that going to impact this option? Well, we can see, difference between evaluation price and well, we can see, difference between evaluation price and theoretical price, we have time decay impacting here, where these options are going to decay a little bit in value. But what if movement in the security happens? Konstantin, you're talking about an earnings event that was coming up. And of course, that's also going to change implied volatility, but let's just take a look at what happens if price changes, what happens if, maybe it drops back down to that potential support area we're looking at in the chart? It drops down to $210 a share. Just change that up here at the top left-hand corner, we can see what this has done to the theoretical price of the option. You see almost across the board almost 50% increase in the theoretical value of what the option would be. And as we then

look farther, let's say that area was broken that you were looking at, Konstantin, on the chart. And it goes back to that even lower area down here, you know, about that 191-85 where it had the other lows. Well what happens if that occurs? Well we'll shift over, we'll do 190, here, and we can start to see that dollar-for-dollar decrease as we go 190, 150, adjusting this, these theoretical prices start to get very, very high, and we can see at 150, 205, we bought in a $3 premium, and that's $55, the value on this, over a $50 loss. 225, $65 loss at this particular time because it's worth about $75. It's the money by $75--

Konstantin Vrandopulo: So Nick, what you're trying to point out here is the fact that we do have, right, that substantial loss potential to the downside if the stock was to tank from here. And we're spending some time here focusing on the bad scenario first, because that will help you determine maybe what strike you should do based on your outlook, and how many contracts you should do relative to those numbers. Now what about the good side, right Nick, and I know that we're running out of time, what about the good side? So the theoretical profit and loss is going to be evaluating how much you could potentially make. We know it's limited, but how much of it, Nick?

Nicholas Delisse: Exactly, so haven't changed the date, still a week-and-a-half, but now, Boeing moves up 15 points. Well, with a very large percentage gain here on the 205, same thing, you know, close to 70% gain on the 225, but maybe only closer to 50% gain on the 245. So, our profit potential is limited. Raw gains, and we're of course making quite a bit more on the 225 than we did on the 205 simply because of that initial premium we brought in. Same thing on the 245, if we place this trade, and this had happened, we would have made more on the 245 and the 225 on that.

Now, one thing I'd like to kind of compare with, I'm just going to add an additional simulated position. And as opposed to calls and puts, I'm going to do a buy-right. What we'll do, 100 shares, sell-to-open one contract, we'll keep the same February 18th expiration. We'll look at that 245 strike, and we'll select about that midpoint of the 335 here, and we'll then hit Apply. And this kind of touches on that we always get asked a question on, well what about the tradeoffs between this trade, and if I'd done a covered call? Generally traders that are doing covered calls will look to doing covered calls at or above the money. So let's compare 245 put with the 245 strike on this buy-right, this covered call. Well look at this theoretical profit and loss here, on the put versus the call. 245 put, we would theoretically have made $1197, or $11.97 on that contract. On the covered call, right about the same. And really the

difference can be attributed to this bid-ask spread right here in where you'd entered the trade. And this highlights, we see this going up, plateauing on the buy-right, going up, plateauing. We're seeing the trades, they're identical on that.

Konstantin Vrandopulo: Synthetically equivalent, right as professionals would say here, Nick?

Nicholas Delisse: Exactly, exactly.

Konstantin Vrandopulo: So essentially what we're saying in anticipation of the question I think that was the most asked one, kind of jumping a little bit here for Trey, but based on what we're seeing, is just a short put strategy is equivalent, synthetic equivalent to a covered call strategy done at the same strikes, right?

Nicholas Delisse: Exactly.

Konstantin Vrandopulo: And Nick, as you know, evaluated and exhibited that very well using the profit-and-loss calculator showing you that it's the same trade

with the same risk-reward, and the same effective capital requirements if you were thinking about the cash covered put as a cash-secured strategy.

Nick, this was great. I can't speak, you know, enough about this tool. It's probably one of the most powerful things that we offer, having the ability to simulate/evaluate for risk versus reward, decide what to do before you place the trade.

END OF AUDIO FILE

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