



TERRY WALTERS
OPTIONS MY WAY

Options My Way

October 22, 2017 – V6



The Disclaimer...

I am not a broker/dealer, CFP, RIA or a licensed advisor of any kind. I cannot give you advice. I have nothing to sell you.

Investing is risky. You could lose all of your money.

I am not giving advice; I am only telling you what I do.

I could be wrong.

If you do the things that I do, you could make some of the dumb trades that I have made.

Consider what you do carefully; you're on your own.

So, please don't sue me.



I am trying to get the “big picture” of investing.

The Overview

The personal situation

The investing thesis

The goals

Equity Trading

Entering long equity positions – Invested Capital

Leverage using options

Managing the portfolio

Income Trading

Trades that generate predictable monthly income

Hedge Trading

Strategies to reduce downside risk

Tax Trading

Tax-loss Harvesting

Portfolio Performance Measurement

Report and manage like a hedge fund



The Situation:

Husband and wife – retired

Have capital to invest

Have time the inclination to manage the investments

Not satisfied with professional money management

Need monthly income – Primary Goal

Monthly income should cover living expenses

Want capital appreciation – Secondary Goal

Capital appreciation should compound - the money you never spend.

Capital drawdowns are acceptable within limits

The Plan:

Study derivatives investing – get an equivalent ~~“Masters Degree”~~ “PHD”

Develop investing activities as one would for any world-class business.

Become the industry equal of any professional fund manager.



I believe...My Investing Thesis

Fundamental Investing: Discounted Cash Flow (DCF) analysis is a good predictor of the Fair Value (FV) of an equity in the long term; that is, one to two years. While there are many “fundamental” numbers, DCF is used because it causes the observer to have a deep understanding of how the underlying makes money in its markets and how its markets fit into the global economy. I take long positions when the current price is below the Fair Value by a reasonable Margin Of Safety (MOS) or my thesis indicates upside exists. The options pricing model is not a good predictor of the value of an equity one to two years out.

Options Investing: The options pricing model is a good predictor of the price of an equity option in the short term; that is 4 to 90 days. In the short term, markets themselves force individual equity prices to move out of sync with the Fair Value of future cash flows of the underlying equity.

Opportunity: There is an opportunity to invest for the long term, and trade against the long term equity with options. Capital appreciation can be gained from the long equity positions and current income can be had from the options.



The Investing Goals: Income first

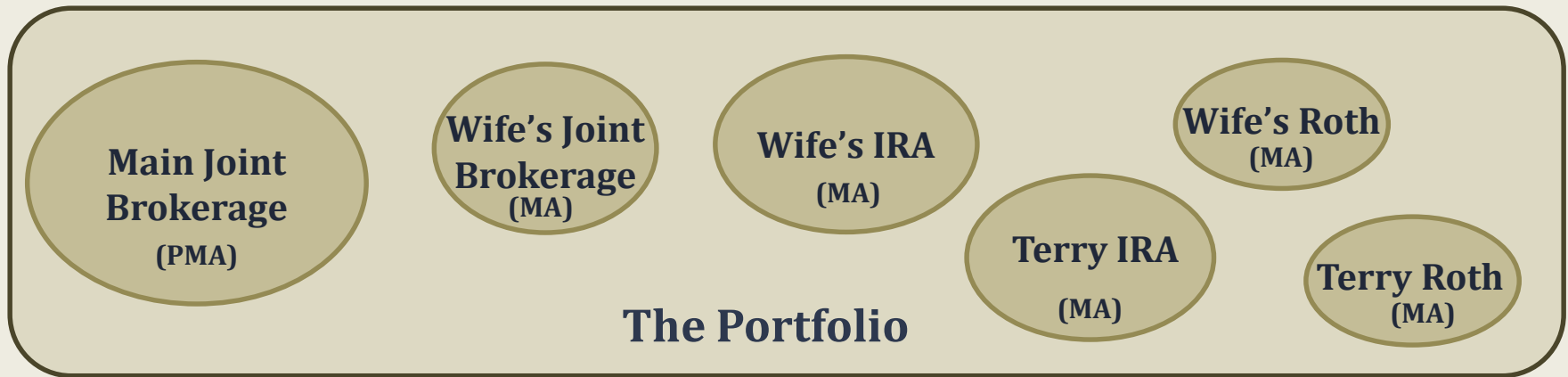
Capital: Put capital to full use.

Manage 10 to 40 diversified equity positions (may be 8 to 12 in small IRAs). Use synthetic stock and stock replacement to take long positions (.75 to .60 delta) in selected equities. Balance the portfolio between industries when appropriate. Prefer to select US equities rather than take currency risks. Drawdown is acceptable; expect to see 10% or more pull-backs during any twelve month cycle. I will use some options leverage.

Income: Use equity options for income.

Sell covered calls or strangles against equity positions at 68% to 84% probabilities (.32 to .16 delta) at 25 to 45 Days To Expiration (DTE). Target total account theta to yield 0.05% to 0.1% of Net Liq. Trade front month; expire or roll to next month. Should yield better than 1% per month in premiums for all combined accounts.

Hedging: Use index spreads to hedge off risk. Sell Out Of the Money (OTM) call spreads to finance long put spreads. Selectively use ratio put spreads. Implement the “Black Swan Hedge Campaign”. Occasionally sell /ES.



“The Portfolio” consists of these six accounts managed together.

Each account holds a minimum of about 8 equity positions.

Naturally, the PM account is the largest and holds 10 to 40 positions.

“Opportunity trades” are placed in the PM account – small lots.

Accounts can be hedged individually.

Options premiums received are booked as income for the current calendar month, even though some premium may be given up in following months.

Total income for the month is equal to net options income plus dividends plus interest. “Income Statement” items.

Gains in stocks or LEAPS are considered capital gains and are not viewed as part of monthly income. “Balance Sheet” items.



**How many of you are trading a Portfolio Margin
account?**



IRAs - Selecting the underlying equity:

Consult sources for Discounted Cash Flow (DCF) analysis.
Select candidate with reasonable Margin Of Safety (MOS) below Fair Value (FV).

I must be highly confident that the underlying will trade above its current price (or breakeven for DIM calls) by expiration. I am a directional trader.

Buy the highest strike Deep In the Money (DIM) call at 60 to 180 Days To Expiration (DTE) where the Extrinsic Value is about 1% per month of the stock price. This will likely be somewhere around .90 to .95 delta. Ideally, find an option whose price is less than 25% of the strike price. Buying the DIM calls is far less capital at risk versus buying the stock. The Extrinsic value is the “penalty” I pay above the stock price. To maintain the position I will need to roll this DIM call out another 90 days or so in the week before expiration.

Sell the At The Money call in the same month. This reduces the capital required and often provides some downside protection as well.



Taxable Accounts - Selecting the underlying equity:

Consult sources for Discounted Cash Flow (DCF) analysis.

Select candidate with reasonable Margin Of Safety (MOS) below Fair Value (FV).

I must be highly confident that the underlying will trade above its current price (or breakeven for LEAPS) by expiration - roughly one to two years from now.

Select the LEAPS expiration that will provide a holding period of more than one year to assure that I could get long term capital gains treatment. Ideally, I find an option whose price is 20% to 25%% of the stock price. Buying the DIM call puts far less capital at risk versus buying the stock. These accounts are double leveraged; i.e. the notional value of the LEAPS calls is twice the account Net Liq.

I sell the front month short calls at about .20 delta as covered calls for monthly income; I roll them out each month.

Both hedging and tax-loss harvesting are needed to make this trading style work effectively.



What trading platform do you use?

Interactive Brokers

TradeStation

Thinkorswim

optionseXpress

OptionsHouse

Livevol

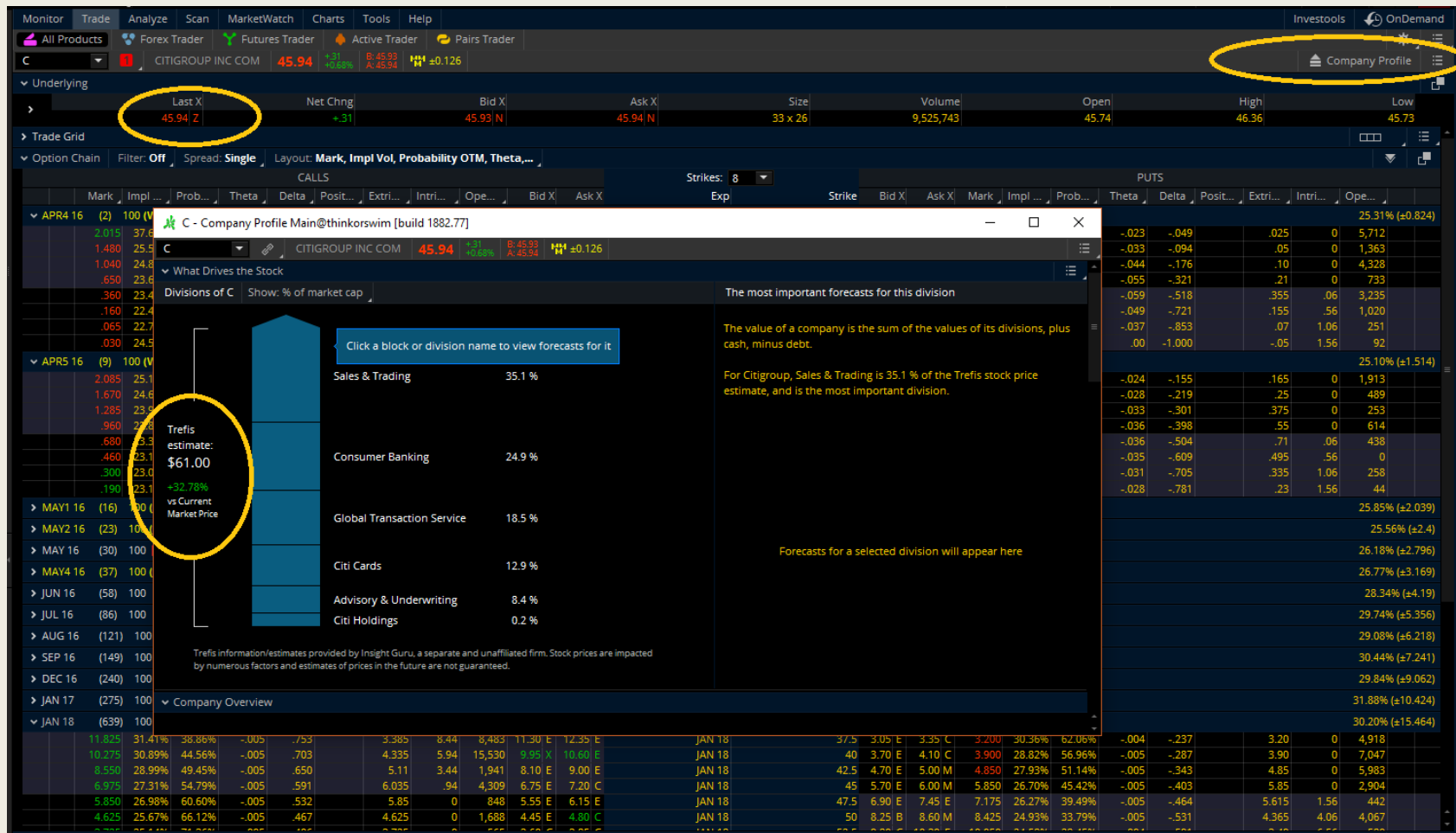
MerrillEdge

Fidelity

Tastyworks



Select an equity with a good Margin Of Safety:





Taxable Accounts - Exiting the Equity Position:

In a taxable account I have to consider the length of time I have held the equity position and how much time remains until Jan 1. I must make the trade-off between the pressure to exit now and the effect of a long-term or short-term capital gain in the current tax year. If I have held the position for eleven months, should I take the risk to hold the position for an additional month to get a long-term capital gain? Additionally, I need to determine, if I exit, should I exit now or wait until Jan 1 to force capital gains into the next tax year, payable 15 months hence.

IRAs – Exiting the Equity Position:

Since capital gains taxes are not a consideration in an IRA, I can exit at any time that I believe it is appropriate. I usually roll the spread trades at 4 to 10 DTE.



Capture Portfolio data at the end of each month.

- I create a Portfolio Performance spreadsheet monthly
- Use brokerage account end of month balances.
- Add back your withdrawals
- Subtract any deposits
- Calculate the Monthly Returns

Review the overall portfolio.

- Beta weight the entire portfolio – all accounts combined
 - (I track the Greeks for each account, probably don't need to.)
- Manage Portfolio Theta to equal approx. 0.1% of Net Liq, overall
- Portfolio Theta in IRAs will likely be lower, i.e. 0.05% to 0.06% of Net Liq
- I target the Leverage Ratio to be 150% to 200%
 - Notional value of all long LEAPS calls divided by Net Liq.
- Compare Equites Beta to the Beta of my hedge product.



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PORTFOLIO MANAGEMENT

Trading Journal separate tab for each ticker – data is copied directly from broker transactions site once a month.

Equity Purchases (includes shares and LEAPS)

Options Income (net purchases and sales, except LEAPS)

Dividend Income

Capital Gains Income

The only way to see the entire history as I go in and out of positions.

Answers the, “did I really make money in this product”, question.

Transaction Log - Downloaded from TDA Website										Manual Entry			
Date	ID	Description	Qty	Symbol	Price	Coms	Net Amount	Net Cash Balance	Reg Fee	Comment	Equivalent shares	Net Per Share	Cum
4/28/2015	1.32E+10	Sold 10 AAPL May 15 2015 137.0	10	AAPL May 15 2015 137.0 Call	0.86	5.5	854.21	---	0.29		1000	\$0.85	854.21
4/28/2015	1.32E+10	Bought 10 AAPL Jan 20 2017 105.0	10	AAPL Jan 20 2017 105.0 Call	32.79	11.5	-32801.77	---	0.27	Bought at the peak	1000	-\$32.80	-31947.6
5/6/2015	1.32E+10	Bought 10 AAPL May 15 2015 137.0	10	AAPL May 15 2015 137.0 Call	0.05	5.5	-55.77	---	0.27		1000	-\$0.06	-32003.3
5/6/2015	1.32E+10	Sold 10 AAPL May 15 2015 130.0	10	AAPL May 15 2015 130.0 Call	0.38	11.5	368.22	---	0.28		1000	\$0.37	-31635.1
5/14/2015	1.32E+10	Sold 10 AAPL Jun 19 2015 135.0	10	AAPL Jun 19 2015 135.0 Call	0.95	11.5	938.21	---	0.29		1000	\$0.94	-30696.9
5/14/2015	1.32E+10	Bought 10 AAPL May 15 2015 130.0	10	AAPL May 15 2015 130.0 Call	0.09	5.5	-95.77	---	0.27		1000	-\$0.10	-30792.7
6/9/2015	1.33E+10	Sold 10 AAPL Jun 19 2015 131.0	10	AAPL Jun 19 2015 131.0 Call	0.34	11.5	328.22	---	0.28		1000	\$0.33	-30464.5
6/9/2015	1.33E+10	Bought 10 AAPL Jun 19 2015 135.0	10	AAPL Jun 19 2015 135.0 Call	0.07	5.5	-75.77	---	0.27		1000	-\$0.08	-30540.2
6/22/2015	1.34E+10	REMOVAL OF OPTION DUE TO	10	AAPL Jun 19 2015 131.0 Call			0	---			1000	\$0.00	-30540.2
6/22/2015	1.34E+10	Sold 10 AAPL Jul 17 2015 132.0	10	AAPL Jul 17 2015 132.0 Call	0.78	11.5	768.21	---	0.29		1000	\$0.77	-29772
7/9/2015	1.35E+10	Bought 10 AAPL Jul 17 2015 132.0	10	AAPL Jul 17 2015 132.0 Call	0.04	5.5	-45.77	---	0.27		1000	-\$0.05	-29817.8
7/9/2015	1.35E+10	Sold 10 AAPL Aug 21 2015 135.0	10	AAPL Aug 21 2015 135.0 Call	0.86	11.5	848.21	---	0.29		1000	\$0.85	-28969.6
7/20/2015	1.35E+10	Bought 3 AAPL Jan 20 2017 105.0	3	AAPL Jan 20 2017 105.0 Call	32.34	7.65	-9709.74	---	0.09	Then got some more	300	-\$32.37	-38679.3
7/20/2015	1.35E+10	Sold 3 AAPL Aug 21 2015 140.0	3	AAPL Aug 21 2015 140.0 Call	1.45	1.65	433.25	---	0.1		300	\$1.44	-38246.1
7/22/2015	1.35E+10	Bought 3 AAPL Aug 21 2015 135.0	3	AAPL Aug 21 2015 135.0 Call	0.3	1.65	-91.74	---	0.09		300	-\$0.31	-38337.8



Equity Beta – Am I correlated to an index, i.e. SPX?

Calculating the beta of my portfolio equities will give me a measure of its overall market risk. To do so, find the betas for all of the stocks. Each beta is then multiplied by the percentage of the total portfolio that stock represents (i.e., a stock with a beta of 1.2 that comprises 10% of my portfolio would have a weighted beta of 1.2 times 10% or .12). Add all the weighted betas together to arrive at the overall equity beta.

Symbol	Value	Percentage of Portfolio	Beta	Weighted
AAPL	\$ 15,306.00	3.9%	1.42	0.06
AMZN	\$ 95,984.00	24.5%	0.87	0.21
BABA	\$ 12,322.00	3.1%	1.33	0.04
C	\$ 6,110.00	1.6%	2.1	0.03
FB	\$ 14,806.00	3.8%	1.38	0.05
MA	\$ 11,758.00	3.0%	0.9	0.03
NFLX	\$ 15,702.00	4.0%	2.01	0.08
PCLN	\$ 180,828.00	46.1%	1.05	0.48
UNH	\$ 17,259.00	4.4%	0.32	0.01
V	\$ 9,248.00	2.4%	0.73	0.02
XLV	\$ 7,503.00	1.9%	0.75	0.01
YHOO	\$ 5,018.00	1.3%	1.2	0.02
Totals	\$ 391,844.00	100.0%		1.05
				Beta of the combined equities in the portfolio



Who is using Beta Weighting to analyze account or portfolio risk?



Beta Weighting - How much will my portfolio change for a one point move in the S&P?

Delta indicates the amount that a position will move for a one point move in the underlying. If I correlate the underlying to the S&P I could know how much the underlying will move for a one point move in the S&P. Beta is the correlation factor between underlying and the S&P.

Beta weighting is the process of adjusting the underlying Deltas to correlate to the index. The SPY is often used.

I can then add the beta weighted Deltas together to determine how much the account will change for a one point move in the index.

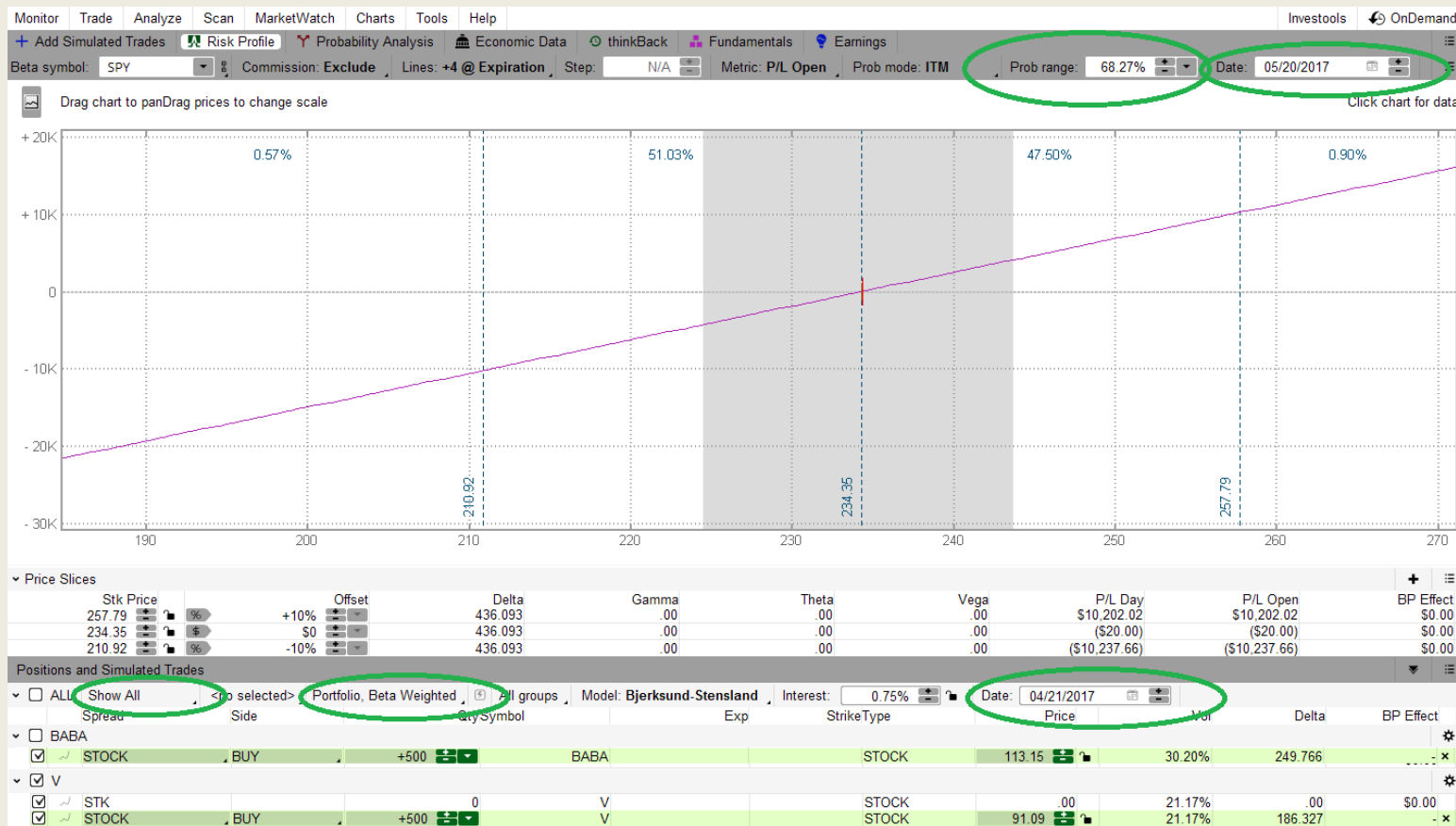
This is **THE** most important concept in portfolio management.



Equity Positions – Beta Weighted:

Bought 500 shares each of V and BABA in the account. The graph is up and to the right. As SPY moves up I make money, as it goes down I can lose. Long stock 436 delta in the account. Long stock has no other Greeks.

Note the parameters set up circled in green.



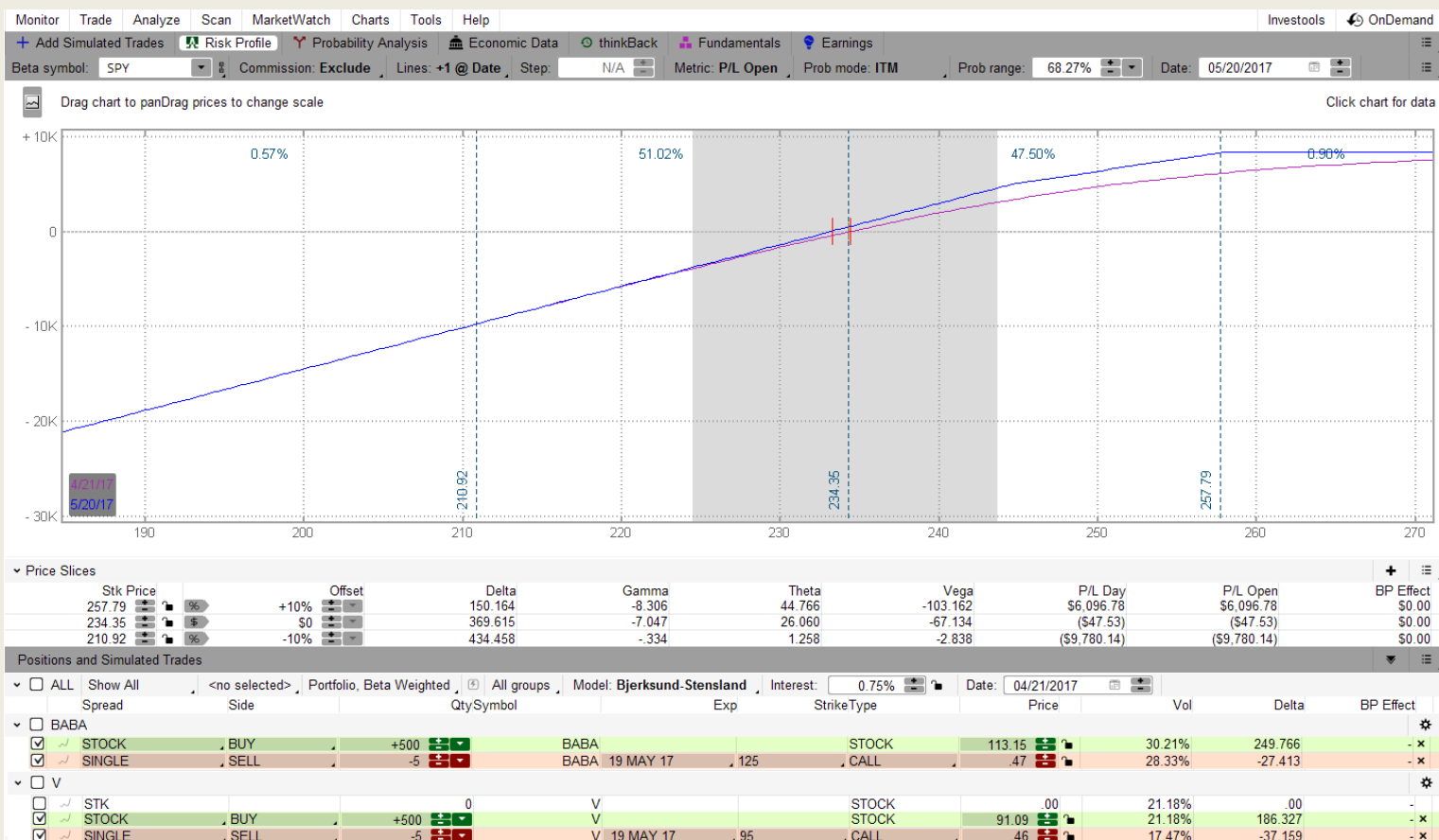


The Income Trades added to the portfolio:

Five covered calls are sold secured by the 500 shares of each equity.

I sell the call in the monthly series at 25 to 45 DTE.

Pick the strike – I usually go to about .20 delta calls, the BABA were .30.





Typical Long Stock Account – 52% Cash.

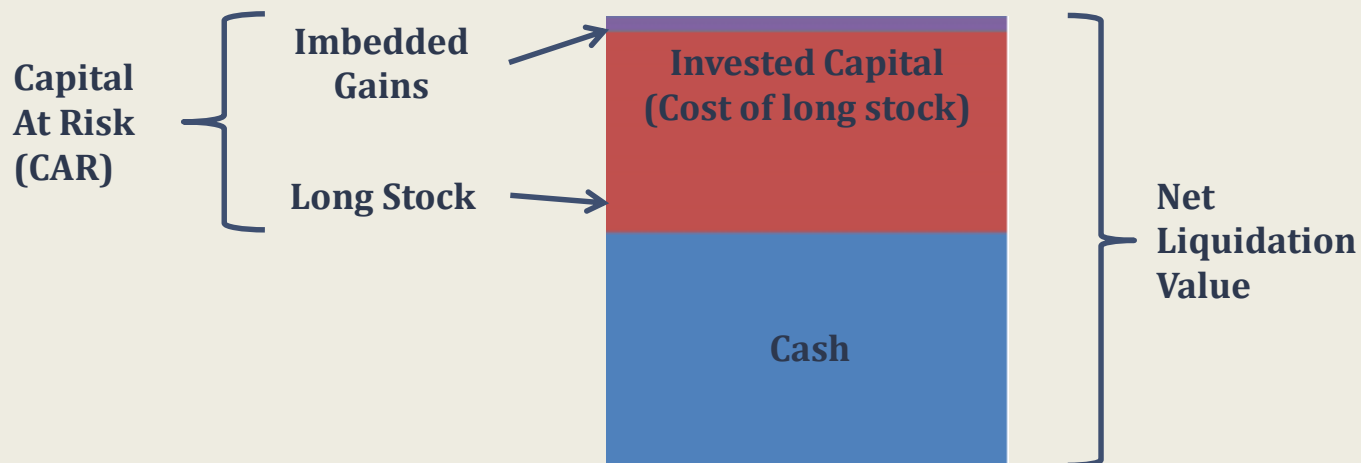
Upside – A 10% increase in market creates a 5% increase in Net Liq. (Only the Long Stock gains)

I can sell covered calls on the number of shares of stock I own, to the extent that I have round lots.

Capital At Risk is what I paid for the stock plus any unrealized or “Imbedded Gains”.

Can't lose more than the Capital At Risk, 48% of Net Liq.

Only need to hedge the CAR value.





One to one leverage:

Portfolio Net Liq \$100,000.00

Ten equity positions each allocated \$10,000.

AAPL trades at \$100.

Allocation for AAPL = \$10,000

Buy one Jan 18 LEAPS 80 strike call for \$25, total \$2500

Remaining cash allocated = \$7500

Notional value of the LEAPS calls = \$10,000

Sell one Front Month short call covered by the LEAPS.

Two to one leverage:

Portfolio Net Liq \$100,000.00

Ten equity positions each allocated \$10,000.

AAPL trades at \$100.

Allocation for AAPL = \$10,000

Buy TWO Jan 18 LEAPS 80 strike call for \$25, total \$5000

Remaining cash allocated = \$5000

Notional value of the LEAPS calls = \$20,000

Sell TWO Front Month short call covered by the LEAPS.



I use leverage when the market is down and I am bullish.

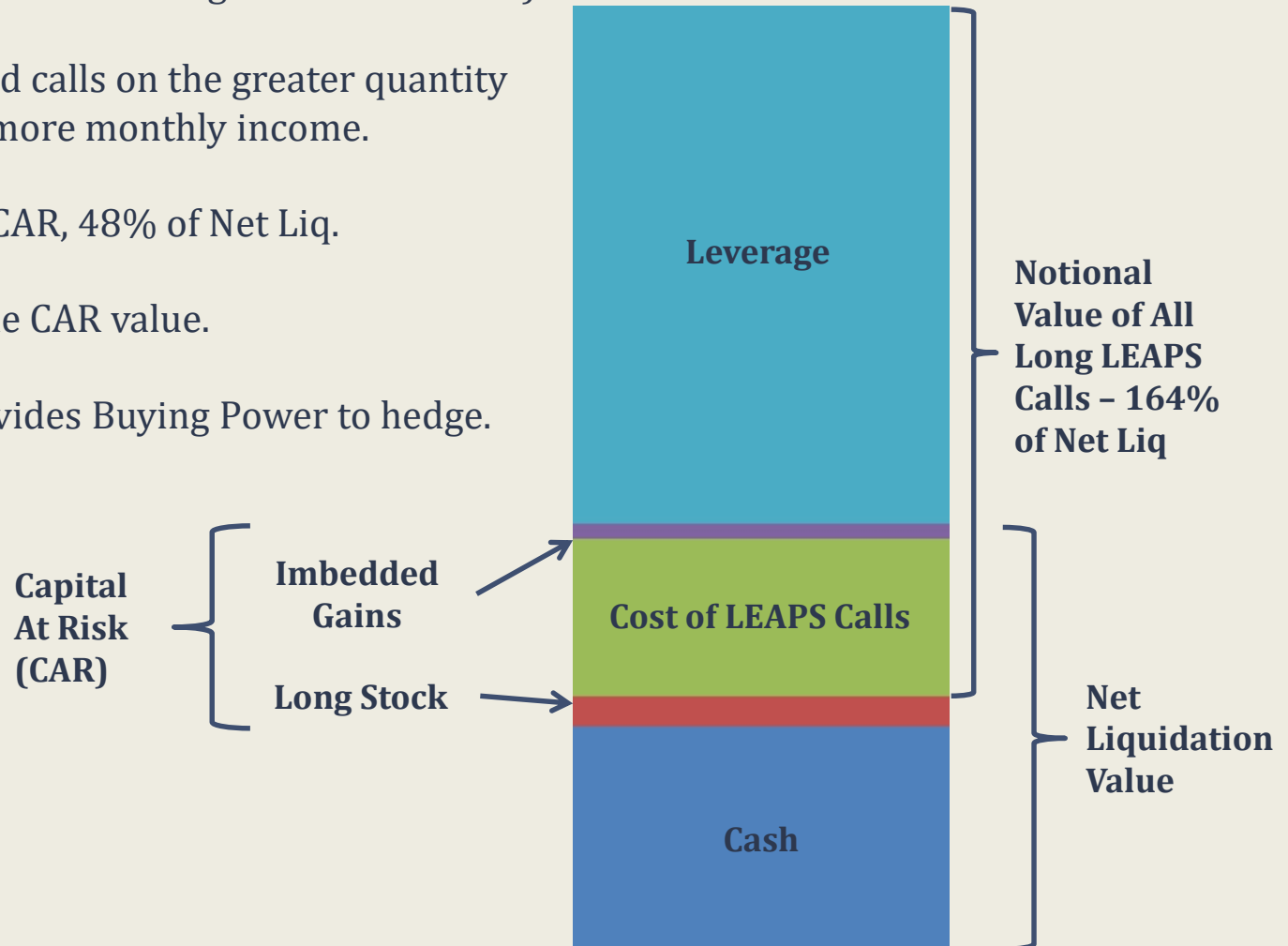
Upside – A 10% increase in market creates a 17.2% increase in Net Liq. (Includes Long Stock and LEAPS)

I can sell more covered calls on the greater quantity of LEAPS generating more monthly income.

Can't lose more than CAR, 48% of Net Liq.

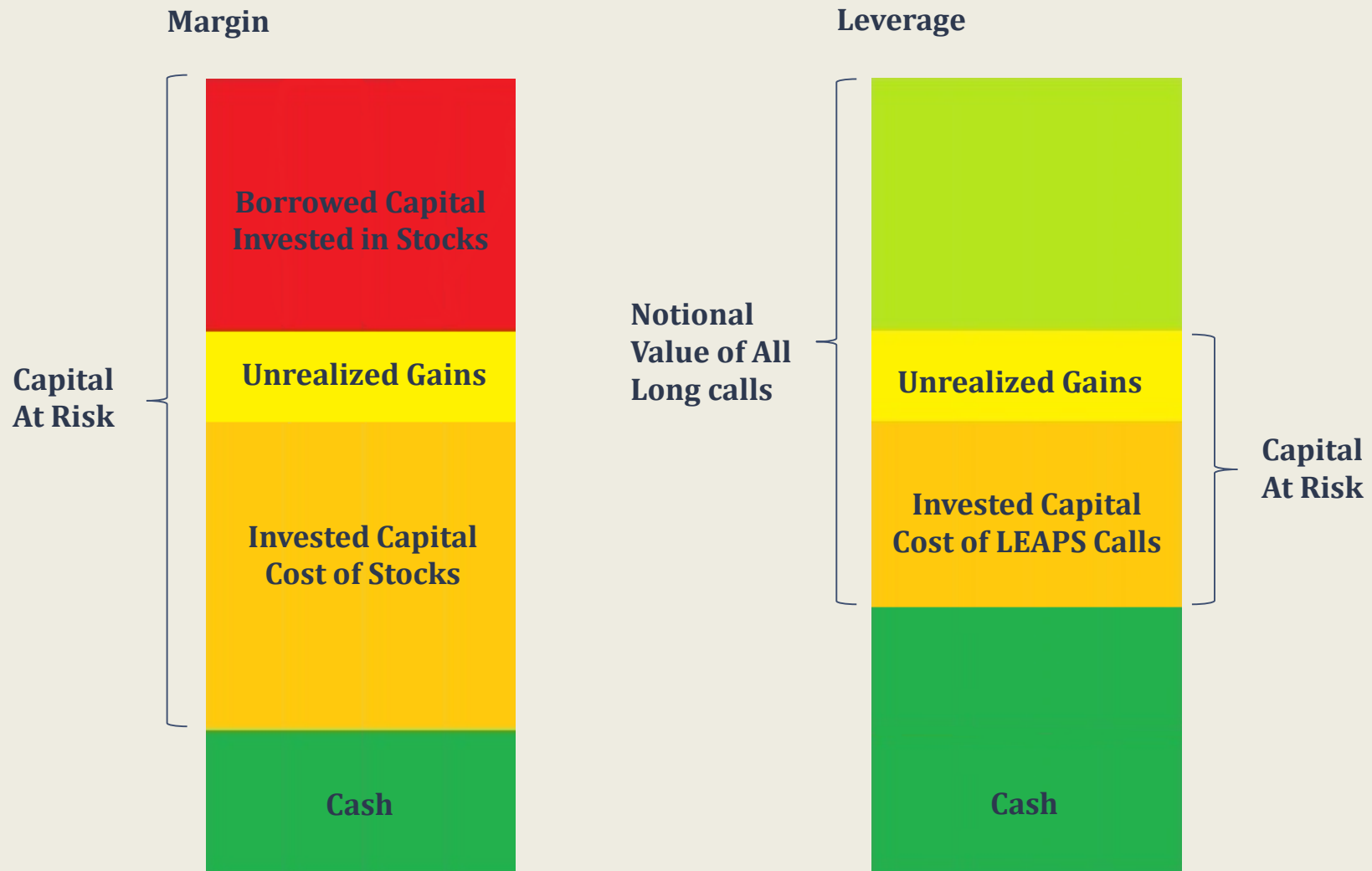
Only need to hedge the CAR value.

The value of cash provides Buying Power to hedge.





Leverage and Margin are not the same thing...





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INCOME TRADING

What's your "go to" income trade?



I sell covered calls (calls covered by a stock replacement) for income:

Select the monthly series at about 45 DTE with a strike near .20 to .25 delta.

Sell the number of contracts equal to the number of LEAPS or DIM calls I own.

Expect to receive about 0.5% to 1% of the strike price. Return On Capital for the month will be the total short call premium divided by the total cost of the long call. Expect this to be 1% to 3%.

Monitor the short call preparing to roll the short call to the next month.

Yes, this is the hard part.

Know the underlying. Monitor news, global market effects, earnings announcements and ex-dividend dates. Over time I will get a “feel” for how the underlying trades and how to manage your covered calls.



The Law Of Large Numbers:

Sell short calls at approximately .20 delta each month against equity positions.
The probability of expiring as income is approx. 80%

Alternative A:

Sell one covered call each month – 100 contracts, one product only.
One out of five months, twenty percent, might not have income.
I might take a loss one out of five months.

Alternative B:

Sell twenty covered calls each month – 5 contracts each on 20 products.
There will likely be 16 winners and 4 losers.
I should have steady income each month.
Careful management of the positions will result in better performance.

I'll take B. This is not gambling. This is running a business.



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INCOME TRADING

Monitor Trade Analyze Scan MarketWatch Charts Tools Help															Investools OnDemand	
All Products Forex Trader Futures Trader Active Trader Pairs Trader															Company Profile	
CITIGROUP INC COM 45.92 0.001																
Underlying																
Last X: 45.92 N Net Chg: +.29 Bid X: 45.92 N Ask X: 45.93 N Size: 33 x 12 Volume: 9,577,319 Open: 45.74 High: 46.36 Low: 45.73																
Option Chain Filter: Off Spread: Single Layout: Mark, Impl Vol, Probability OTM, Theta, ...																
CALLS																
Strikes: 16 PUTS																
MAY 16 (30) 100															26.21% (±2.798)	
4.150 27.32% 13.96% -0.12 .877 .23 3.92 52 4.10 C 4.20 C																
3.725 27.20% 17.41% -0.14 .845 .305 3.42 27,555 3.70 M 3.75 C																
3.300 26.58% 20.89% -0.15 .813 .38 2.92 68 3.25 C 3.35 C																
2.890 25.94% 24.85% -0.17 .775 .47 2.42 65 2.87 C 2.91 N																
2.515 25.68% 29.66% -0.18 .729 .595 1.92 290 2.50 C 2.53 X																
2.155 25.22% 34.77% -0.19 .679 .735 1.42 395 2.14 X 2.17 X																
1.825 24.86% 40.36% -0.20 .624 .905 .92 27,673 1.81 X 1.84 M																
1.525 24.55% 46.28% -0.21 .566 1.105 .42 2,015 1.51 X 1.54 C																
1.250 24.13% 52.36% -0.21 .505 1.25 0 1,367 1.24 C 1.26 Z																
1.010 23.82% 58.50% -0.20 .443 1.01 0 282 1.00 C 1.02 Z																
.810 23.66% 64.46% -0.19 .382 .81 0 7,033 .80 C .82 X																
.640 23.53% 70.09% -0.18 .324 .64 0 8,679 .63 Z .65 X																
.495 23.35% 75.32% -0.17 .264 .495 0 1,324 .49 Z .50 Z																
.380 23.26% 80.40% -0.15 .220 .38 0 112 .37 M .39 C																
.290 23.26% 83.92% -0.13 .170 .29 0 83 .28 Z .29 Z																
.220 23.31% 87.25% -0.11 .143 .22 0 115 .21 N .23 M																
MAY 16 (37) 100 (Weekly)															26.79% (±3.17)	
JUN 16 (58) 100															28.34% (±4.188)	
JUL 16 (86) 100															29.75% (±5.355)	
AUG 16 (121) 100															29.08% (±6.215)	
SEP 16 (149) 100															30.43% (±7.236)	
DEC 16 (240) 100															29.84% (±9.058)	
JAN 17 (275) 100															31.91% (±10.43)	
JAN 18 (639) 100															30.20% (±15.457)	
20.225 42.87% 26.70% -0.04 .871 1.805 18.42 16 19.25 E 21.20 E																
17.625 36.33% 25.87% -0.03 .863 1.705 15.92 3,173 17.15 E 18.10 Z																
15.650 34.91% 30.17% -0.04 .831 2.23 13.42 1,000 15.15 E 16.15 E																
13.750 33.49% 34.70% -0.04 .793 2.83 10.92 5,786 13.15 E 14.35 E																
11.825 31.49% 38.97% -0.05 .754 3.46 8.43 7,743 11.00 E 12.35 E																
10.275 30.96% 44.00% -0.05 .703 4.355 5.92 15,530 9.95 X 10.60 E																
8.550 29.05% 49.53% -0.05 .650 5.73 5.42 15,717 8.75 E 9.60 E																
6.975 27.36% 54.86% -0.05 .591 6.055 .92 4,309 6.75 E 7.20 C																
5.850 27.03% 60.65% -0.05 .531 5.85 0 848 5.55 E 6.15 E																
4.625 25.71% 66.16% -0.05 .466 4.625 0 1,688 4.45 E 4.80 C																
3.725 25.18% 71.40% -0.05 .406 3.725 0 565 3.60 C 3.85 C																
2.905 24.43% 76.31% -0.04 .345 2.905 0 3,046 2.81 C 3.00 N																
2.210 23.66% 80.81% -0.04 .286 2.21 0 1,182 2.10 C 2.32 M																

Buy to Open, Jan 18, 40 Call AND Sell to Open May 16 48.5 Call - \$9.92 DEBIT
Diagonal Call spread...but to me it is a “covered call”.

This requires \$989.00 of Invested Capital vs \$4592.10 for equivalent stock
Breakeven on the Covered Stock Replacement is (40 plus 9.92) \$49.92.
Received \$0.39 Credit for May short Call covering the Stock Replacement



Equity:

If C declines dramatically over the next 22 months, the most that can be lost is \$989.00 for a one lot trade vs \$4592.10 at risk for equivalent stock.

C must be trading over the \$49.92 breakeven at expiration to make money dollar for dollar on the Stock Replacement.

C will have to move \$4.00 (\$49.92 - \$45.92) from its current price over the next 22 months to breakeven; a 8.7% increase. This is my premium/penalty over the current stock price.

C's Fair Value today is \$61.00 providing a Margin Of Safety of \$11.08 over the breakeven price.

If C moves to it's FV at expiration, the trade makes over 112% Return On Capital At Risk; 24% return on allocated capital.

Income:

The short call paid \$0.39 which is 3.9% Return On Capital ($\$0.39 / \9.89) for the front month trade with 30 Days To Expiration (DTE). Return on allocated capital is 0.085% ($0.39/45.92$), 10.3% annualized with VIX at 12.74.

The short call has a 77% chance of expiring as income. It will either be rolled or a new short call will be placed in the following month for income.



Rolling the covered calls out each month:

I make every effort to avoid rolling for a debit; credits are my monthly income. Generally I roll when the theta of the back month .20 delta option is greater than or equal to the theta of my current option – theta parity.

If my covered call goes in the money, i.e. “gets run over”:

- If the underlying is not likely to decline, roll early in the cycle; 10 to 24 DTE.

- Roll to the next month, one strike or more higher still in the money.

- Sell a put (a strangle) to get enough premium to roll up and out for a scratch.

- Roll to a weekly option one strike up for a scratch.

- Roll out two months if I have to in order to get a credit or a scratch.

- Roll as a calendar if I must, but I likely will have to close the trade later.

- If the underlying trades in a channel, wait until 4 to 10 DTE to roll.

- Worst case; buy my short call and sell the LEAPS call – close the trade

Consider the tax consequences of closing the trade for tax harvesting; attempt to keep the LEAPS position for greater than one year if taxable.

Watch for ex-dividend dates. If the extrinsic value of the option is greater than the dividend I must roll out before the ex-dividend date. I might just want to roll well ahead of the ex-dividend date to be safe.

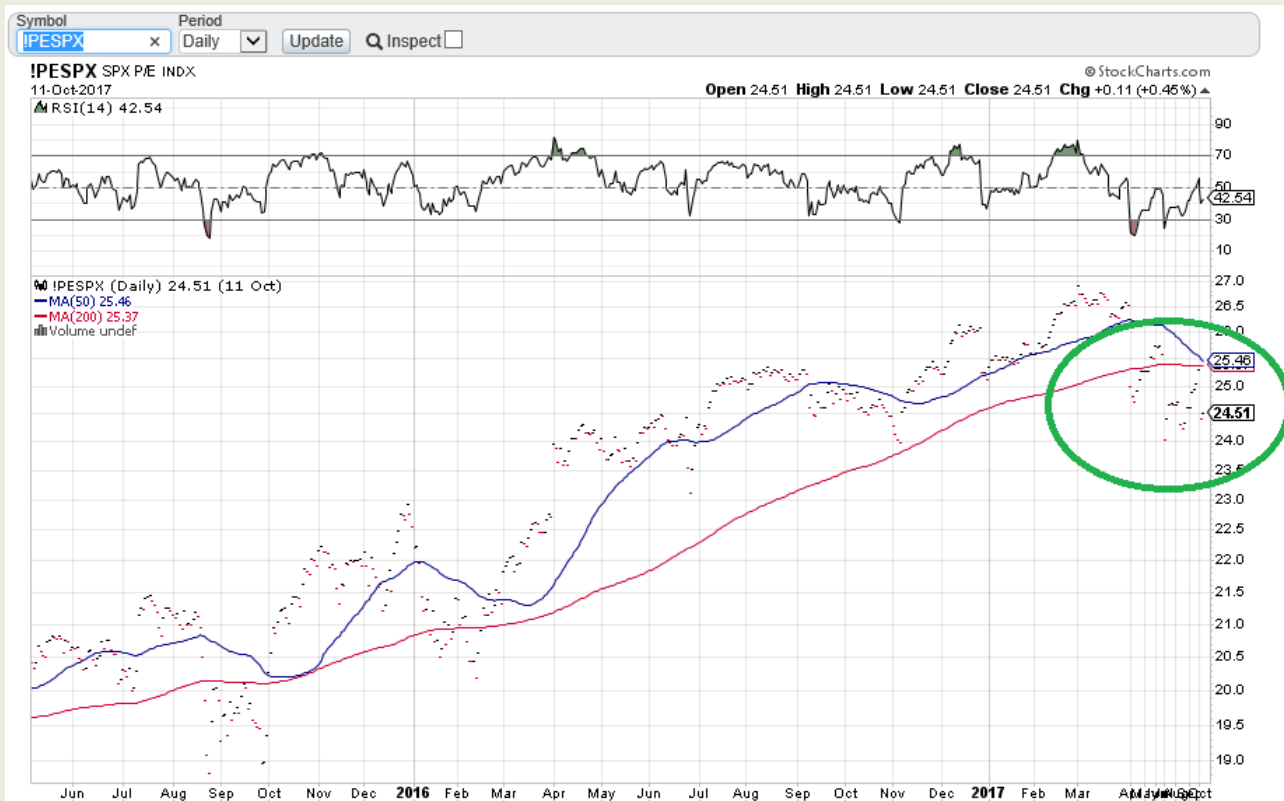


What percentage of days over the past 20 years or so has the market closed up from the prior trading day's close?



Are We Near The Market Top?

I believe that institutional investors will have a harder time paying high multiples to push the market even higher. Note how in the most recent earnings season P/E multiples finally declined a little. Is this the top of the market? I don't know.



Daily
S&P 500,
Actual
P/E,
1 Yr,
rolling
chart.

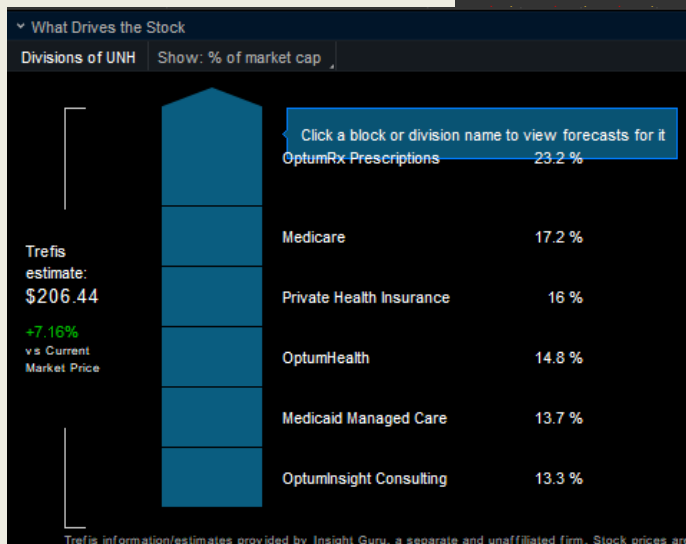


Fundamental View:

If the underlying is trading above its Fair Value it is by definition “speculative”. I need to consider carefully why I am still in this equity position. Start looking for an exit.

Moving Averages:

Pick your favorite MA – be consistent. I use the 50/100 EMA. I tend to stay in products that are trending upward. I consider exiting when the 50 day crosses below the 100 day, 2Yr chart.





The LEAPS Call Rollup - Taking Profits But Remaining Invested:

When the underlying is making new highs and the Mark of the LEAPS call is trading for about double the Trade Price – consider taking profits.

Choose a new LEAPS strike that you believe the underlying will trade above by expiration.
Sell the long LEAPS call and buy a LEAPS call in the same month at roughly 0.60 delta as a vertical spread.

This has the effect of reducing the Imbedded Gains portion of the Capital At Risk and moving it to Cash.

Taxable versus Non-taxable accounts:

I take profits anytime in the IRAs, etc. when there has been a significant increase in the underlying.

I am careful to trade off the tax implications of taking profits versus the risk of a market decline. Generally I favor the safety of profit taking over the pain of paying taxes.

3/2/2017	AAPL
Quantity	1
Market	\$139.80
Strike	\$115.00
Trade Price	\$13.07
Mark	\$28.27
DTE	323
BE Expiration	\$128.07
Gain Option	\$15.20
Roll to	\$130.00
Mark	\$17.60
Credit	\$10.67
New BE Expiration	\$147.60
Trade BE Expiration	\$136.93
LEAPS Cost Basis	\$2.40
Notional Value	\$13,000.00

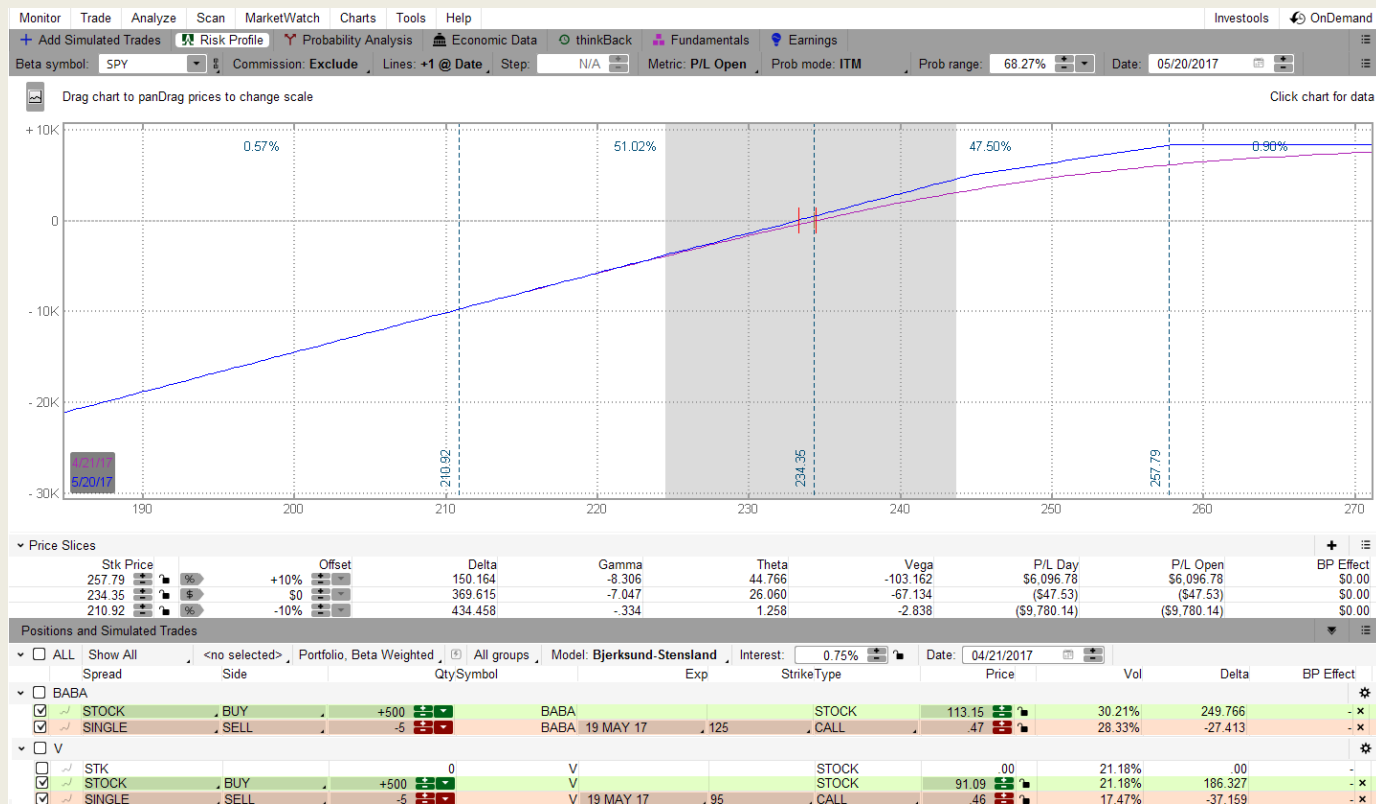


A beta weighted portfolio:

Note that the account flattens out at the short call strikes. I have traded upside potential for current income this month.

The account is generating \$26.06 of theta decay per day to the 5/20 expiration.

This is the account I will hedge.



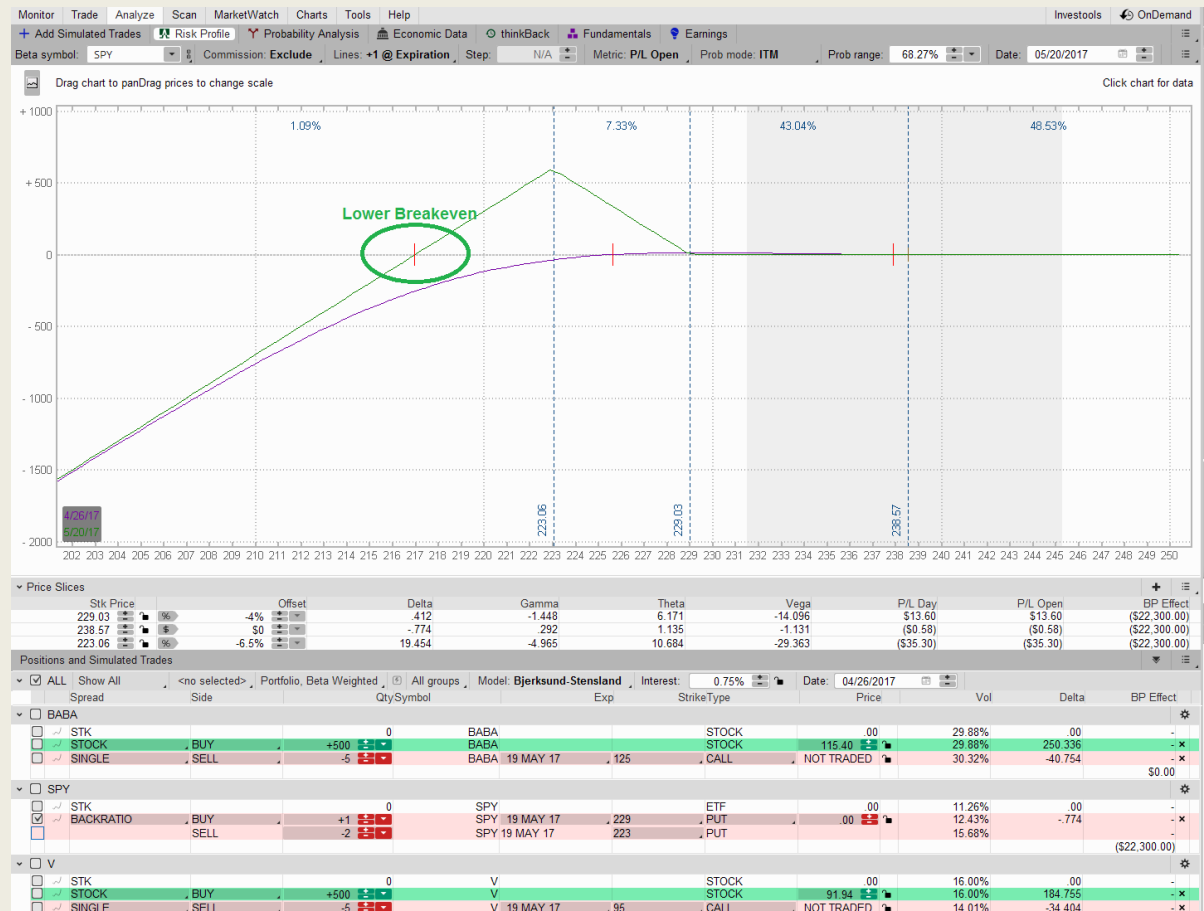


The Backratio Put Spread Hedge:

Place the long strike of the put spread at about 4% below market. Select the short put strike whose premium is equal to or greater than 50% of the premium of the long strike. Sell two of the short puts for every one of the long puts.

Note the Lower Breakeven point, about 217.

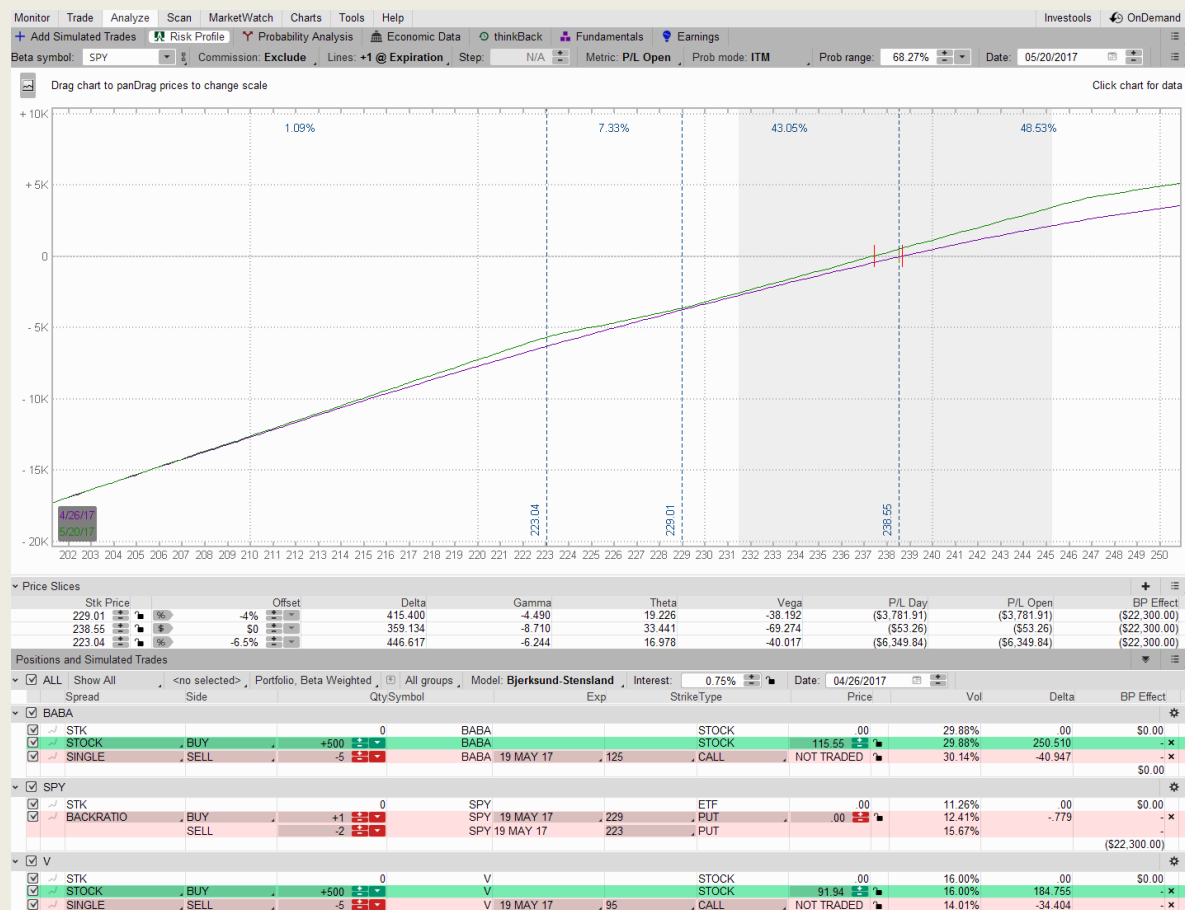
All of the contents of this account are unchecked in the Positions and Simulated Trades Section except for the hedge trade.





Combining the Account and the Backratio Put Spread Hedge:

Now look at the entire account beta weighted – all items checked. It does not look like much yet. Note the quantity of the hedge trade is 1.



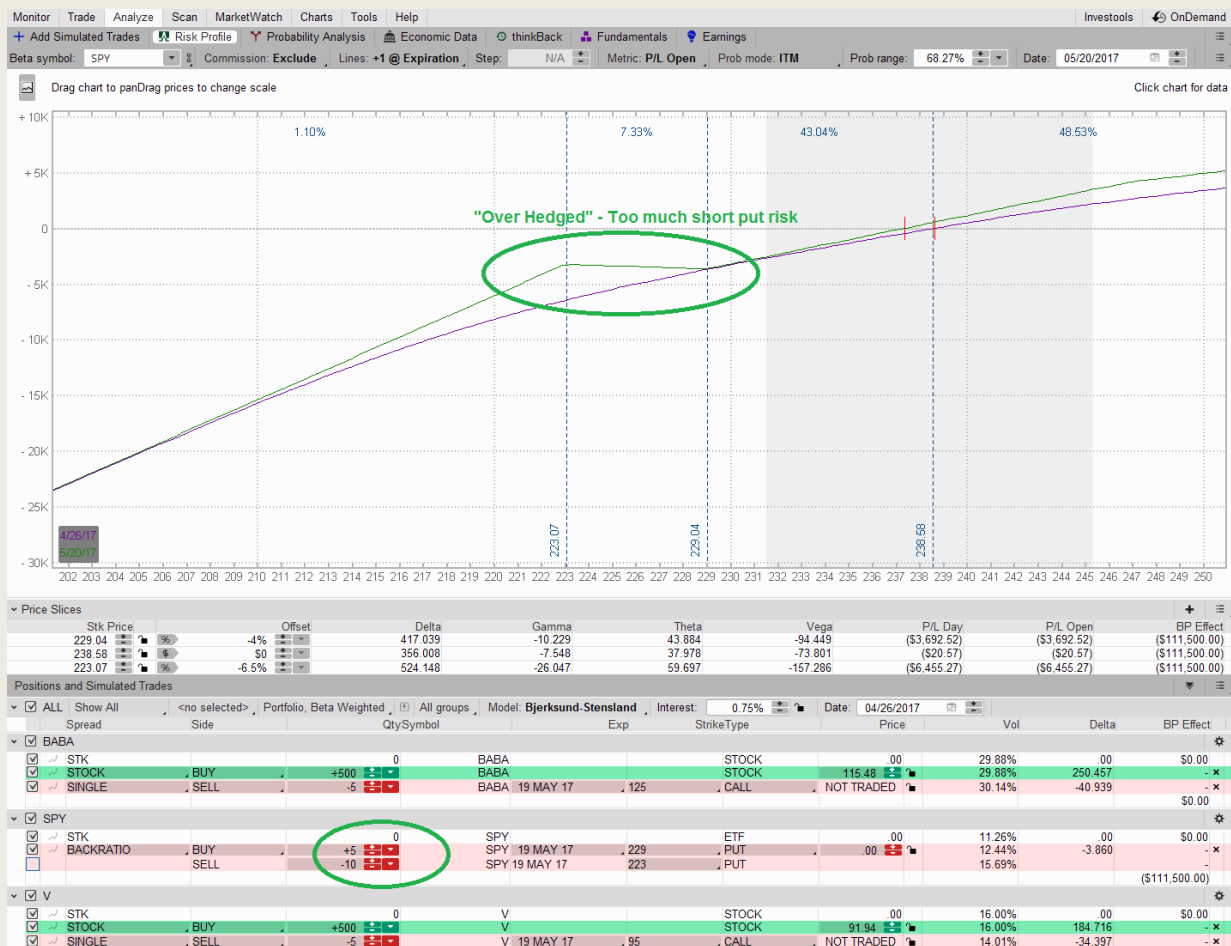
All of the contents of this account are checked in the Positions and Simulated Trades Section.



Adjust the size of the Backratio Put Spread Hedge:

Now I adjust the Qty of the hedge until the Risk Profile “flat lines” below the long put strike, 229 in this case. Thus, if the market goes down 4% the account will drop but remain at that level until the market drops below 223 by expiration.

Note this example is slightly over hedged. The circled area is sloping up to the left. There is a little too much risk in the quantity of short puts in this hedge.

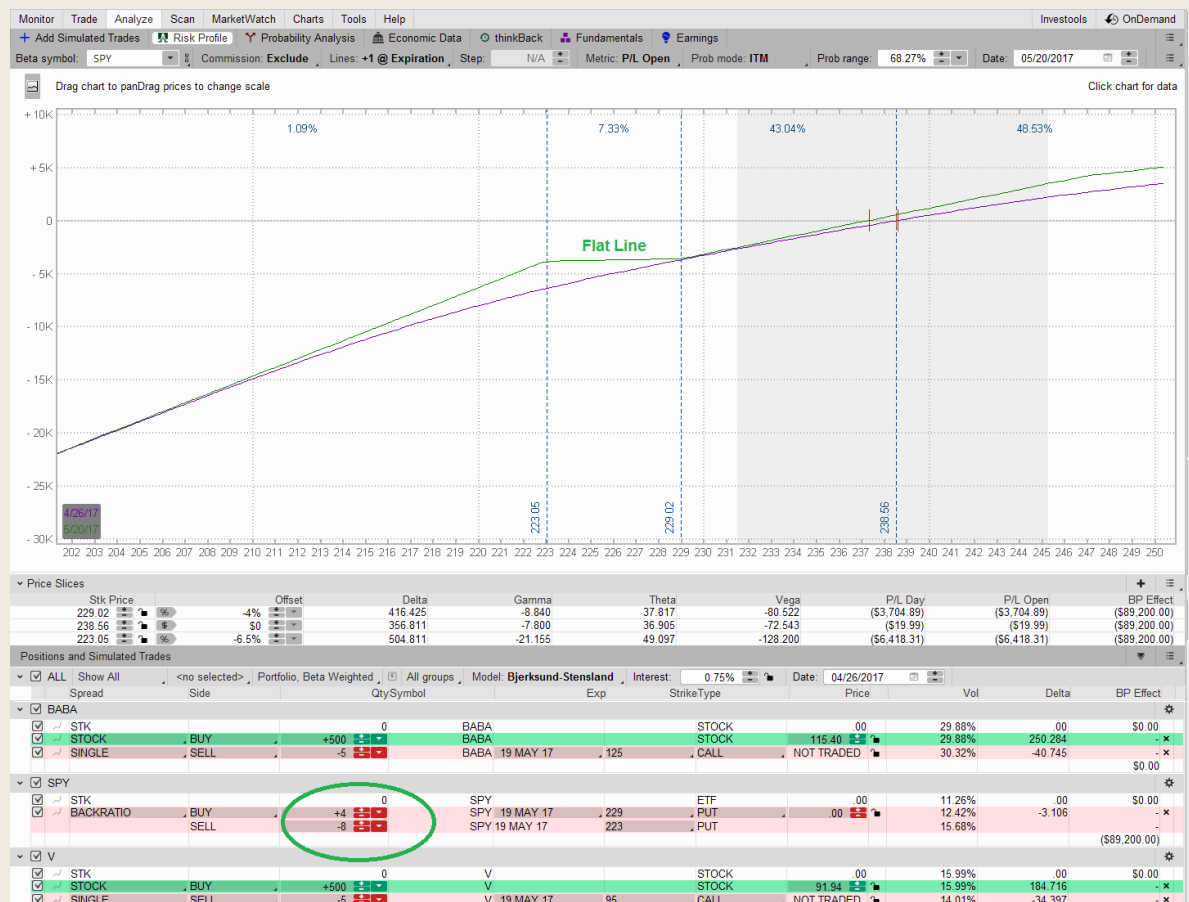




Adjust the size of the Backratio Put Spread Hedge:

The Flat Line – Just the right number of Back Ratio Put Spreads to protect the account but not to many to add too much short put risk below the short strike.

Note that the Risk Profile “Flat Lines” from the long put to the short put. ‘Good match of hedge spreads to the overall account.





Combined Account and Hedge Notes:

Protection begins at the 229 long put strike which is 4% below today's market. The short put strike at 223 is about 6.5% below the market. So the hedge protects from about minus 4% to minus 6.5%. If I am more bearish I might pick a lower long put strike to be able to buy the short puts at much lower strikes and reduce the short put risk.

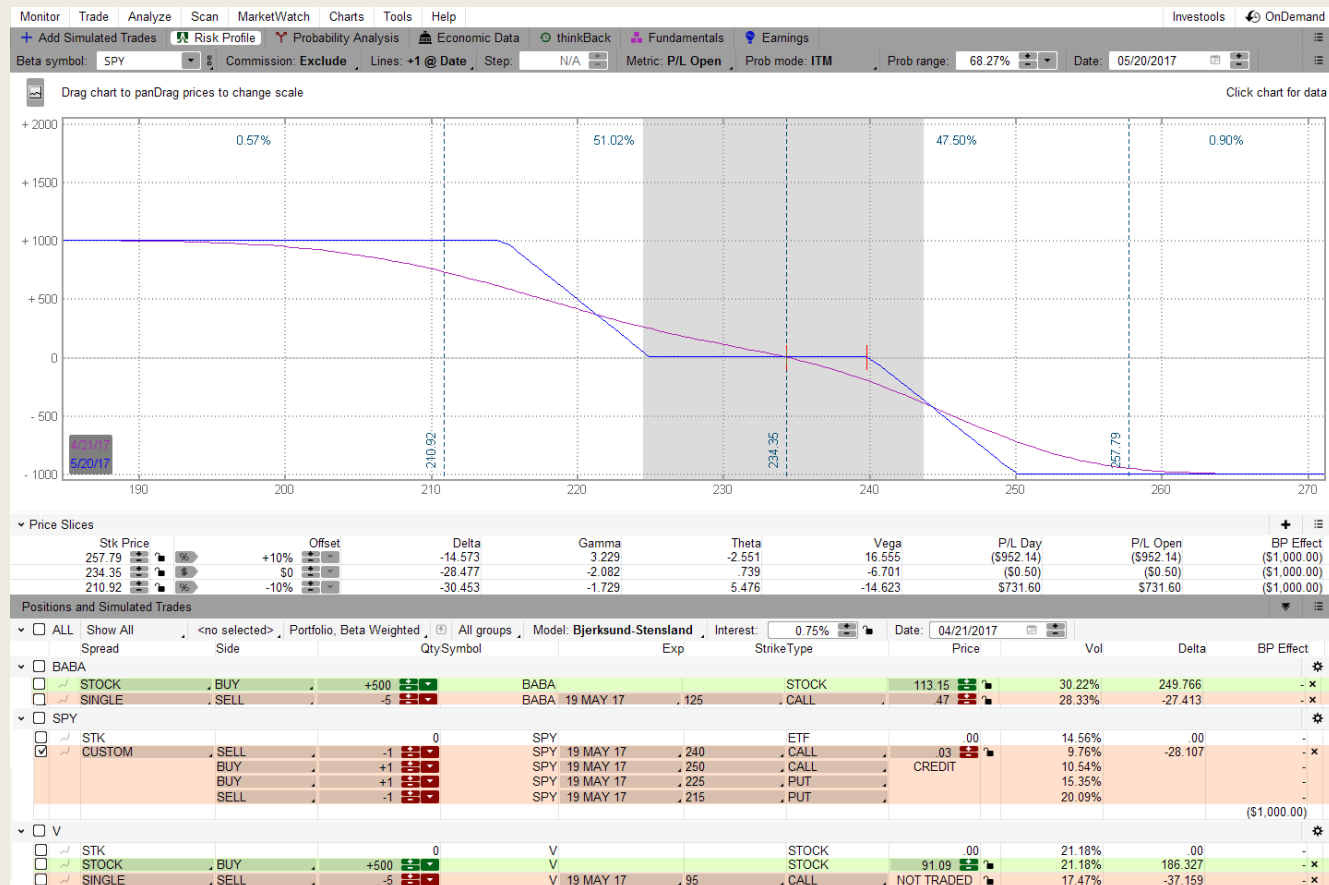
The P/L Open of the "today line" in purple at the mark or "0 Offset" is (\$20.58). If the market declines by 4%, the account drops by (\$3632.34) at expiration (where the green line intersects the 4% line) which is a 2.9% decline in the portfolio value. If the market declines by 6.5%, the portfolio declines by only (\$3839.66) or 2.9%. I am hedged.

DANGER – The problem with Ratio Put Spread Hedges is that if the market declines below the Lower Breakeven point (217) noted on an earlier slide, the value of the portfolio **declines more rapidly than if there was no hedge at all**. This is why I must be very careful in my estimation of the market. This is not a good hedge if the market is making new highs and may rapidly decline in a short time. This is also why I do not place these out more than about 25 DTE; the further out the harder it is to estimate market movement.



The Collar Hedge:

Short strike of the call spread at 2% above market. Place the long strike of the put spread at about 4% below market. The lower put strike is adjusted to achieve a small credit for the trade. This trade is built as a one lot. Note the other positions are not checked on the left; we see only the hedge trade.





Combining the Account and the Collar Hedge:

Call Side Setup:

First locate the short call strike about 2% above the current market. This will be about .20 delta. Ideally this would be just above the all-time market high. Buy the “wing” - pick the long strike of the call spread far out of the money where it is very cheap and yet there is large Open Interest.

Put Side Setup:

Pick a strike about 4% below the market for the long put strike. As you build the trade note the credit/debit of the entire trade.

Pick the short put strike as low as possible to still receive a credit on this four leg trade.

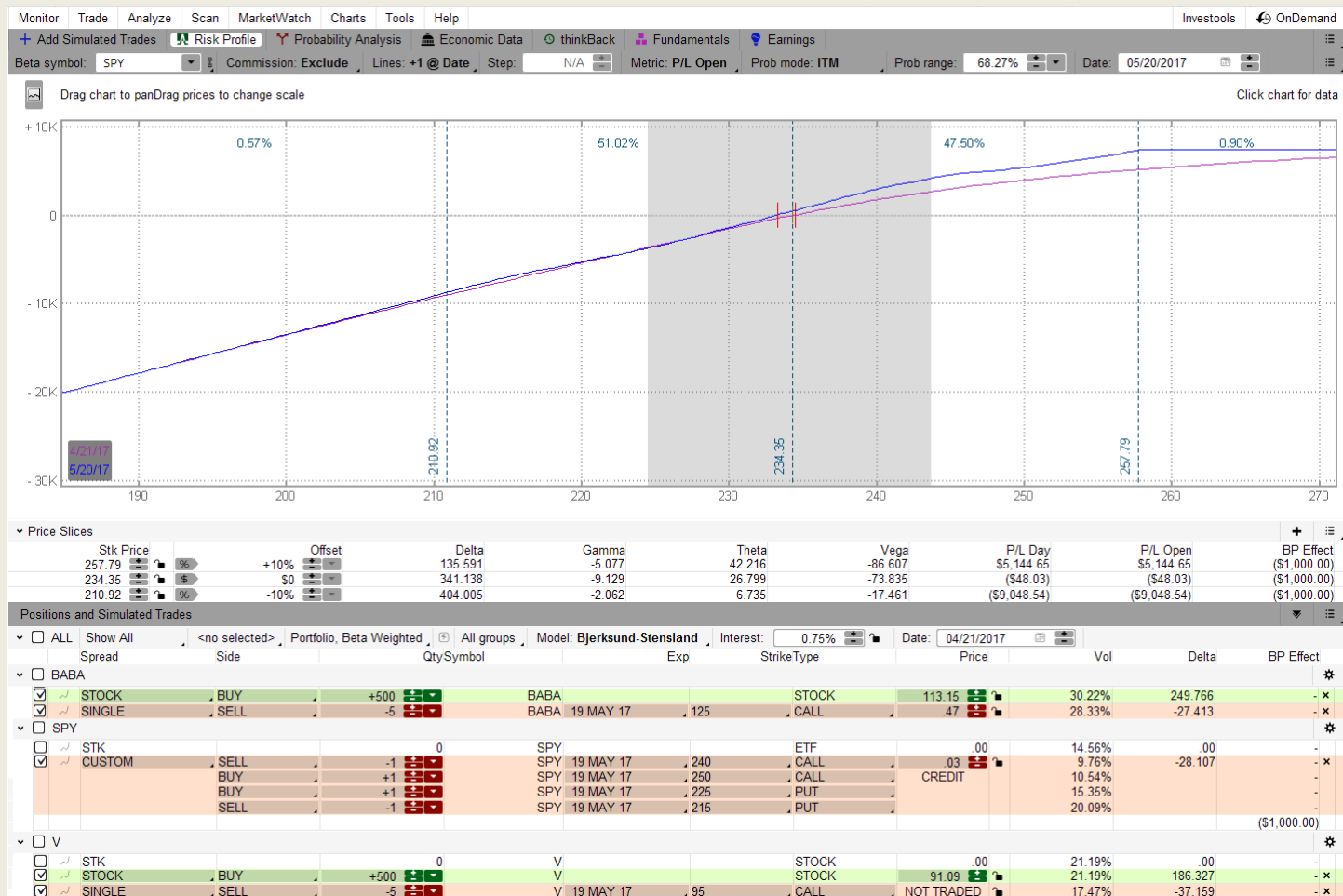
Quantity of Contracts:

I start with one contract in each of the four legs. I will adjust the size of the hedge trade later.



Combining the Account and Collar Hedge:

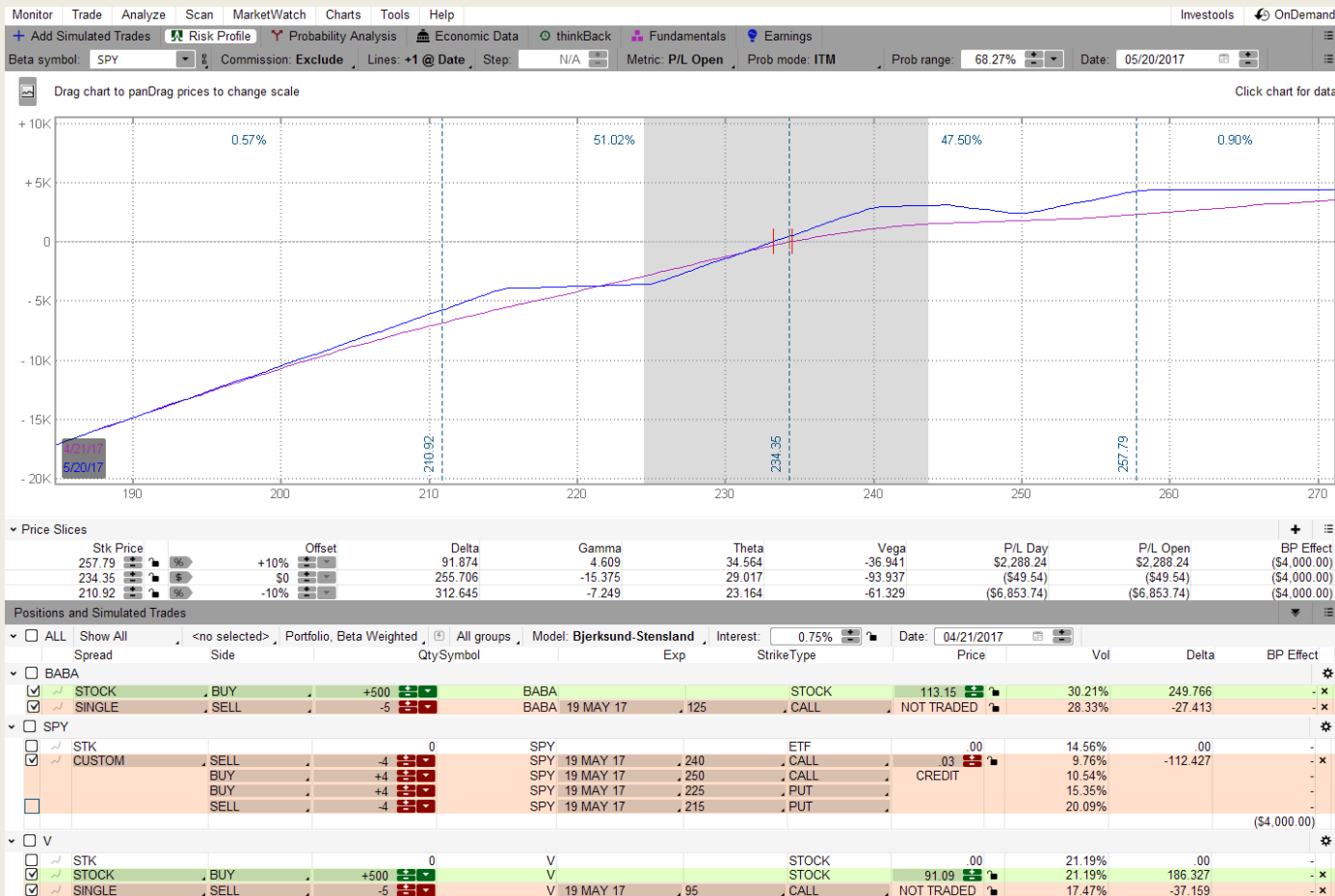
Now look at the entire account beta weighted – all items checked. It does not look like much yet. Note the quantity of the hedge trade is 1.





Combining the Account and Collar Hedge:

Now I adjust the Qty of the hedge until the Risk Profile “flat lines” below the long put strike, 225 in this case. Thus, if the market goes down 4% the account will drop but remain at that level until the market drops below 215 by expiration.





Combined Account and Collar Hedge Notes:

The shaded area in the graph on the previous page represents the one sigma spread; the 225 long put strike is just above this point. Thus, if the market dropped by one sigma the hedge would kick in. The short put strike at 215 is about 8.5% below the market. So the hedge protects from about minus 4% to minus 8.5%.

The P/L Open of the “today line” in purple at the mark or “0 Offset” is (\$112.13). If the market declines by 4%, the account drops to (\$3617.09) at expiration - where the blue line intersects the 225 strike – about 4% below market, which is a 2.9% decline in the portfolio value. If the market declines by 8.5%, the portfolio declines by only 3.4%. I am hedged.



The Black Swan Hedge - Requirements for Professional Grade Trading

High Capital Requirement - Portfolio margin account required

This Process is Complex – Requires time and attention

A “Risk Profile” Graph Is Required – I have only done this with TOS Risk Profile

More Than A Single Trade – This is a campaign that must be managed

Build a ladder of Black Swan Hedge trades.

The initial setup requires placing the BSH trades in each month in the monthly SPX series beginning with placing the short puts at about 120 DTE. Place a BSH in each monthly series that is available out to about 180 DTE. Thus. there would be three to five trades on at any one time forming the ladder.

Create GTC orders.

Create a GCT order to buy the short puts for the credit received when the BSH was placed. If the total credit received is \$3000.00 then divide this credit by the number of short puts times 100. In this case assuming 10 shorts the GTC order would be to close the 10 short puts for \$3.00.



The Black Swan Hedge – Basic Trade





The Black Swan Hedge – Basic Trade

The basic trade is a “Back-ratio Put Buy-more”

Use the monthly SPX series. That is where the most open interest is. Use the strikes that are multiples of 25 to get the most open interest; i. e. 2125, 2150, 2175, etc.

Place the first trade short puts at about 120 DTE at the -.10 delta or lower strike; sell a 10 lot. Go to the series one or two months earlier and buy puts at the same strike or even 25 points higher. If selling the DEC 2100 then buy the NOV 2100 or 2125. Adjust the quantity of long puts to achieve a credit of about \$2000 to \$3500. The ratio will be something like 10 short to 13 long puts.

On the Risk Profile the trade will display a “Valley Of Death” at the long put strike. Place a GTC order to buy back the 10 short puts for the whole credit received when initiating the trade. As time passes these short puts values will decay and thus if the market remains constant or upward moving, the short puts will be bought back and leaving only the long puts in the front month. This strategy eventually eliminates the Valley Of Death in the front month.



The Black Swan Hedge – Ladder of Four Trades in the Campaign

Long puts are in the front two months (green text)

Short puts are in the back months (red text)

There are no short puts until the third month.

Blue and purple text represents long and short puts either expired or bought back.





The Black Swan Hedge – Risk Profile, 5% Vol Steps

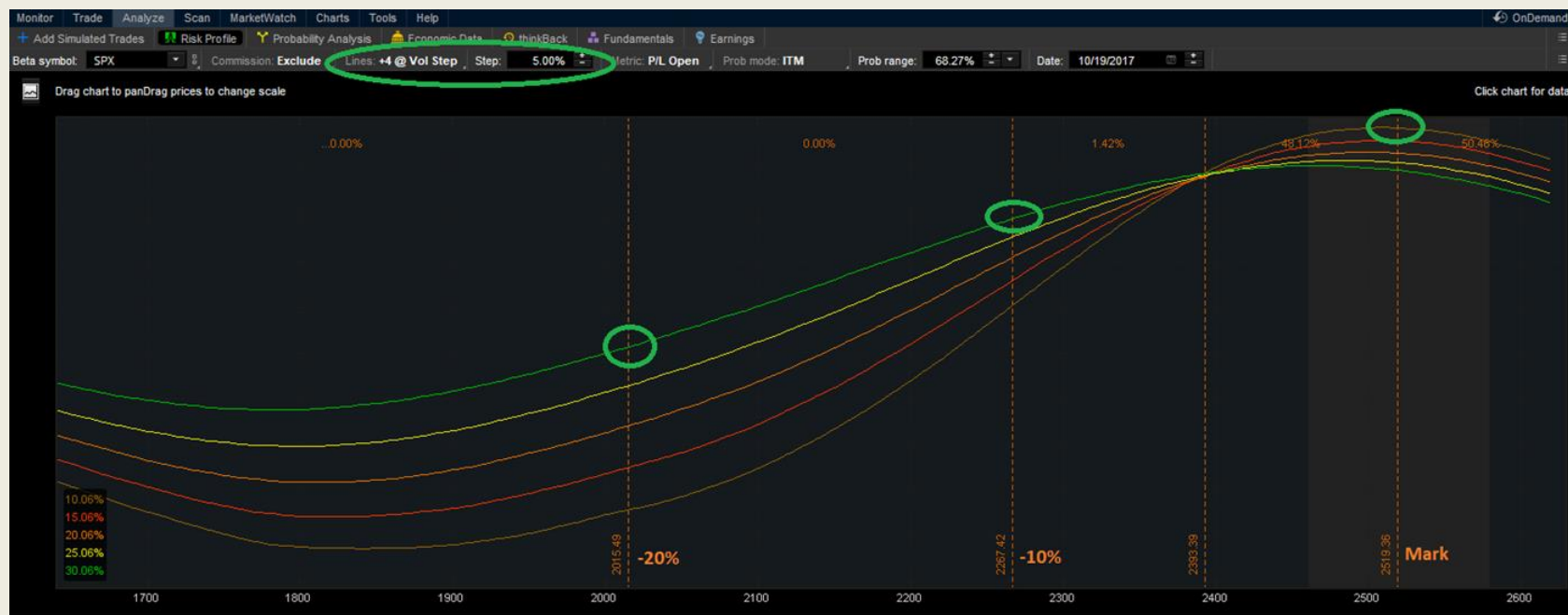
At no point does the account lose all of its profits, not even any Invested Capital and the portfolio is double leveraged.

Note the effect of VIX rising in a down market.

Assuming that VIX spikes from 10 to 30...

For a 10% market decline the portfolio declines by 4.2%.

For a 20% market decline the portfolio declines by 9.8%.





The Long-dated High Collar Hedge – “Synthetic Bond”

Synthetic Bond	
Trade Entry	
Stock Ticker	AMZN
LEAPS JAN Year	2020
Current Stock Price	\$992.19
ATM Put Strike - Ideally Above Stock Price	\$990.00
ATM Put Price	\$136.05
OTM Call	\$1,100.00
OTM Call Price - Ideally Same as Put Price	\$135.30
DTE	820
Lot Size	2
Dividend - Quarterly Amount	\$0.00
Dividend Cycles	9
Total Dividends per share for the period	\$0.00
Total Potential Dividend Dollars	\$0.00
Buy Shares - Capital Required	\$198,437.94
Buy Put - Dollars	-\$27,210.00
Sell Call - Dollars	\$27,060.00
Cost of Option Trade (Debit)	-\$150.00
Max Loss - Not considering Dividends	\$587.94
Total Cost of Trade	\$198,587.94
Trade At Expiration	
Underlying trades above Call Strike	\$21,562.06
Return On Capital	10.86%
Rreturn On Capital Annualized	4.83%

Terry Walters 10/19/2017 V2

Pick and equity good for two years.

Buy the ATM LEAPS put two years out.

Sell the OTM call trading at the same price.

Buy the stock.

The option trade should be done for a scratch.

At expiration you cannot lose principal below the long call strike. Zero risk.

If the underlying rises above the short call strike you will harvest that gain at expiration.

Use when you have cash to park for about two years – a bond substitute.



What a is key characteristic of index options and futures?



Section 1256, IRS Publication 550

There are special cases of tax treatment for certain investment products:

Futures: i.e. /ES and /ZB

Cash-settled Options: i.e. SPX and VIX

These fall under Section 1256 of the IRS Code:

60% of gains are treated as long-term capital gains.

40% are treated as short-term capital gains.

30.12% blended federal rate at top marginal tax bracket (47.22% CA)

Both are subject to the Tax-loss Carry Forward offset rules.

Consult IRS Publication 550 for details

When creating hedges or trading index products, I give favor to products that qualify for Section 1256 treatment.

Remember there is no special capital gains treatment in CA – Long Term gains max rate is 37.1%



What is the maximum percentage marginal tax rate for combined California and federal income taxes?



Should I create a legal entity and trade within it?

Problem – For an individual filer, capital losses are limited to \$3000 per year when passed to the 1040 form.

Benefit – All losses in the legal entity can pass from the legal entity to the tax payer in the form of business losses.

Qualify for Trader Tax Status, file form ..., elect 475 mark to market accounting and create legal structures/corporate entities. File corporate taxes and personal taxes. Keep careful records, comply with regulations to avoid the corporation being set aside as a “sham”.

Another option – create a registered hedge fund. Receive income as “carried interest”. ‘Really expensive and I don’t want to manage OPM.

My decision – too expensive, too complex, I don’t have trading losses and have no other income which would be offset by losses anyway. I am not going there.



Capital Gains In Option Trading

Long Calls and Long Puts held for more than one year, and “sold to close”, qualify for long-term capital gains treatment.

ALL other option trades are treated as short term capital gains.

Thus, only Long Calls and Long Puts require special attention in taxable accounts.

Short-term capital losses offset short term capital gains dollar-for-dollar.
Long-term capital losses offset long-term capital gains dollar-for-dollar.

Assignment of option trades involving long or short stock can affect the stock holding period and/or cost basis. One must be very careful where assignment risks exist.

Consult IRS Publication 550 each year for changes.



Tax Loss Harvesting – Knowing your current position...

Your brokerage firm must provide cost basis information to the IRS. Thus, you can now check your gains and losses YTD. Periodically check GainsKeeper “YTD with wash sale adjustments” at your broker’s website.

Print Cancel

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For best results, choose the landscape setting when printing.

TD Ameritrade

Account Name: Sample

Account Taxability: TAXABLE

Realized Capital Gain/Loss Report 01/01/2016 to 03/21/2016 Monday, March 21, 2016

Short-term gain	20,569.78	Long-term gain	4,939.95
Short-term loss	-44,769.17	Long-term loss	-1,413.41
Short-term net	-24,199.39	Long-term net	3,526.54
Short-term proceeds	87,425.01	Long-term proceeds	14,526.41
Short-term cost	111,544.48	Long-term cost	10,879.97
Short-term gain or loss adj	-79.92	Long-term gain or loss adj	-119.90
Gain	65.00	Loss	-22.00
Short-term gain or loss(40%)	17.20	Long-term gain or loss(60%)	25.80
Gain or loss total	43.00		
Realized gain or loss	242.82		
Unrealized gain or loss	199.82		
Section 1256 sales	313.41		
Section 1256 cost	70.59		

Security	Trans type	Qty	Open date	Adj cost	Close date	Adj proceeds	Gain adj	Adj ST gain(\$)	Adj LT gain(\$)
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Tax Loss Harvesting – DO NOT MISS THESE OPPORTUNITIES

I carefully track the length of time I hold a LEAPS call and its covered calls looking for opportunities in a market correction. Take losses early; postpone gains. There is no change to the Net Liq.

In a market correction a LEAPS long call may be trading for a loss. It is important to take the loss by rolling that call either up or down in the same expiration or to move it to the following January expiration.

When the market goes up quickly the covered call may be trading for a loss. It is important to take that loss by rolling the call to the next month for a scratch or a very small debit.

If you do not take these losses and the market returns to its previous position, the opportunity will have been lost to “harvest” the loss. I must keep in mind that losses are used to offset gains elsewhere in the account. Thus, losses can be a huge benefit to reduce taxes incurred in the current year. Losses can be harvested all year long to create a tax-loss carry forward position.

How to trade for improvements?

September 30, 2017

TERRY WALTERS

ALL ACCOUNTS PORTFOLIO

SEP 2017

Portfolio Summary

Investment Strategy

The portfolio creates core positions in US equities and indexes primarily via purchasing deep in the money LEAPS calls one to two years into the future. Ten to twenty positions are secured and funds are divided roughly equally among assets at purchase. Covered calls and covered strangles are sold monthly to generate income. The portfolio may be leveraged to appear more than 100% long through the use of long LEAPS calls. Small "opportunity" option trades are entered if the positions set themselves up. The portfolio normally would hedge rather than converting to cash in a down market. Overall the fund is directional with investment decisions made on a discretionary basis using qualitative fundamental techniques. Index option spreads as well as futures are entered to hedge downside risk. Market conditions are used to determine if long delta, small delta or negative delta should be maintained as well as vega posture. The portfolio is theta positive.

Income tax is withdrawn primarily in April. Roughly 67% of the portfolio is taxable. Tax loss harvesting is done throughout the year.

Risk Measurement, Portfolio and Market Statistics calculations are based on Morningstar's formulas and use the same risk free rates as Morningstar reports.

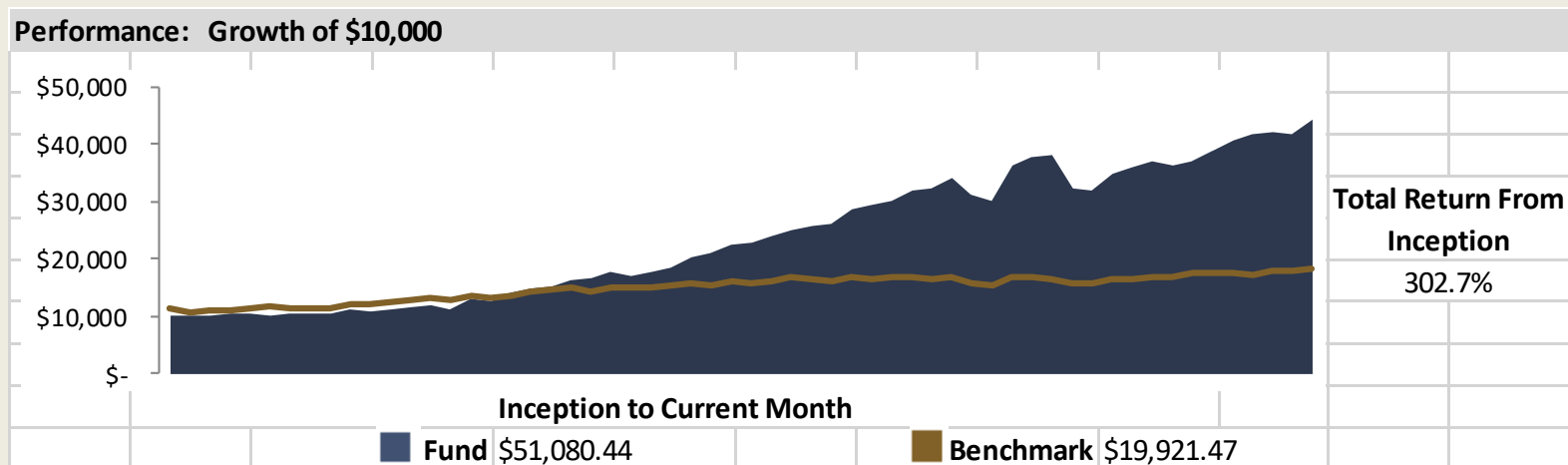
Return calculations are based on EOM brokerage statement balances; deposits are subtracted and withdrawals are added back for each month.

Portfolio Manager
Terry Walters



Growth of \$10,000 since inception

This is the graph that all of the mutual funds and hedge fund managers use. Getting all of the funds placed and making progress in the first year was difficult. It just takes time.



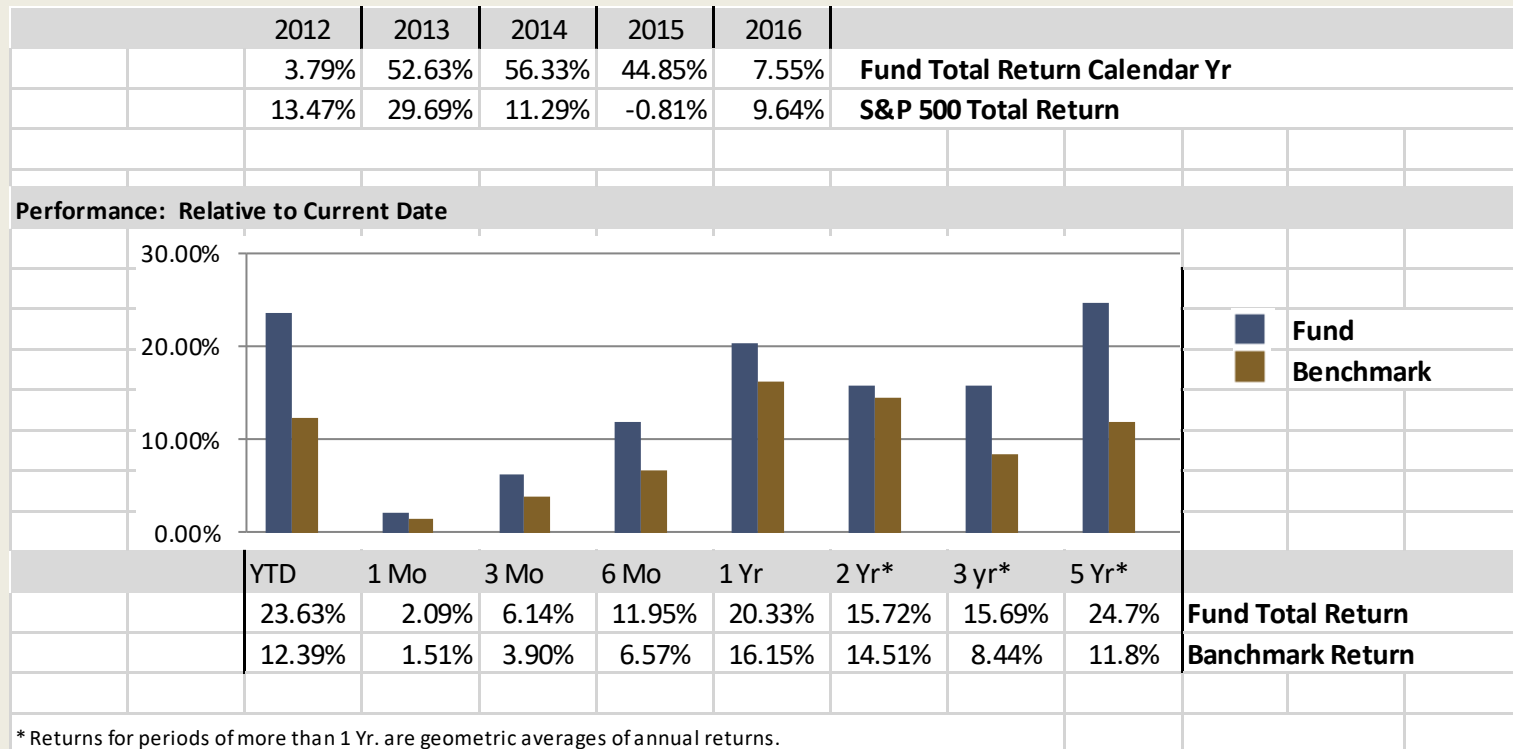


The Total Returns Graphs

2012 – the startup year.

Three very good years.

2016 – a very bad year.



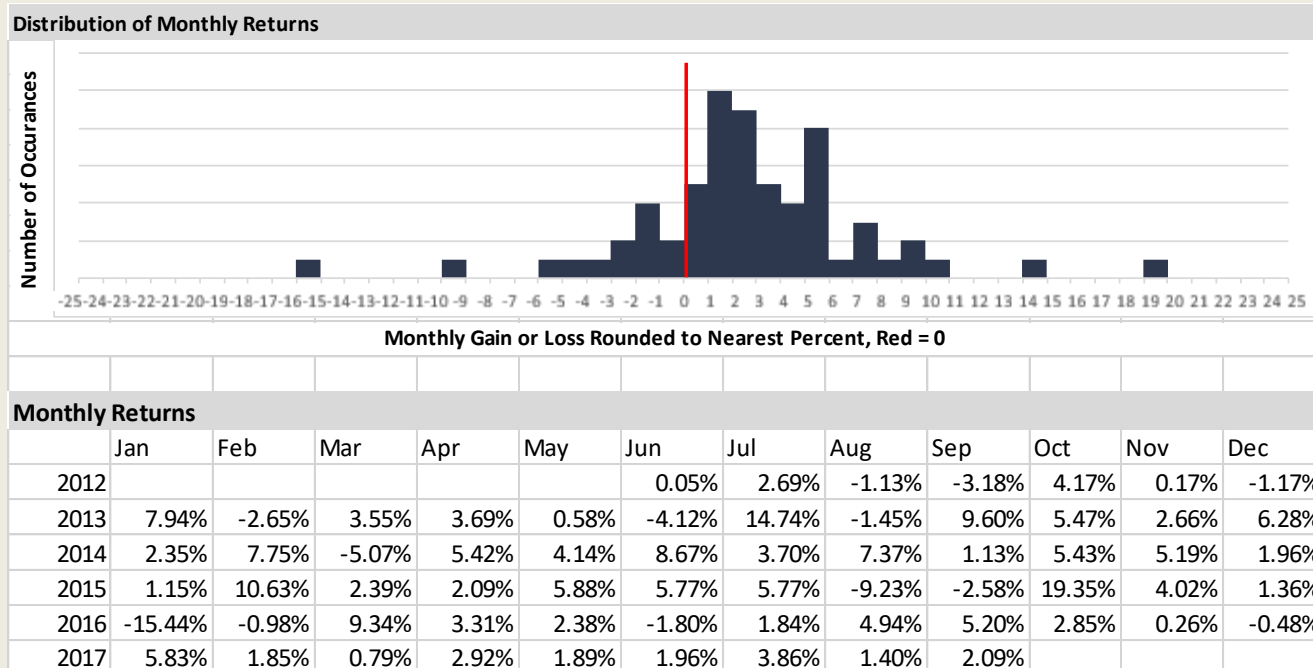


Distribution of Monthly Returns

The returns are mostly positive and skewing to the right. More winners than losers.

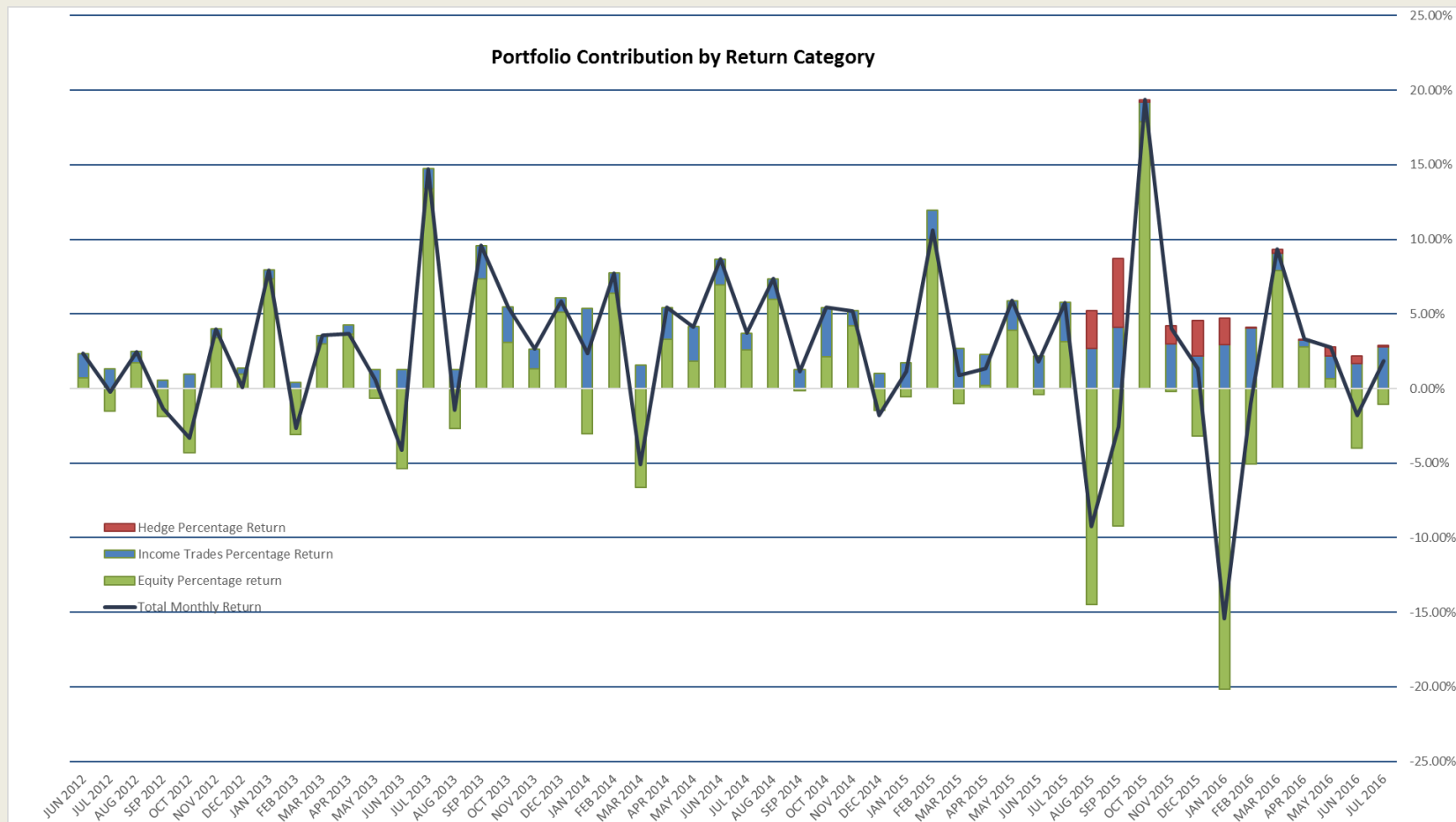
The Avg. 1 Yr return was 2.1% with Std. Dev. of 1.6.

Improved hedging will keep the returns skewed to the right.



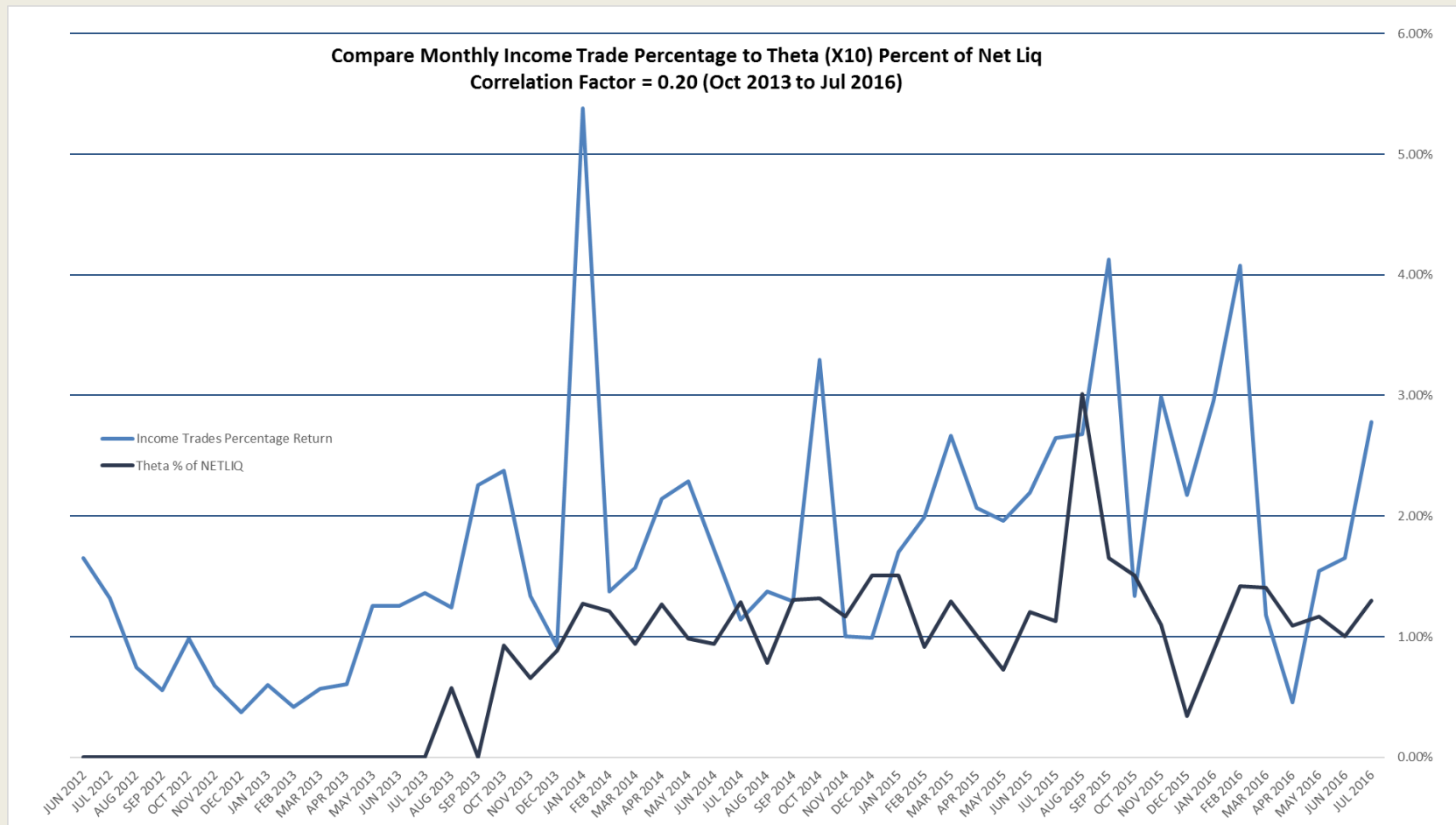


Large market moves dramatically affect this portfolio although the combination of hedging and premium income mitigates the down side. Better hedging techniques and quickly exiting down-trending stocks should help.



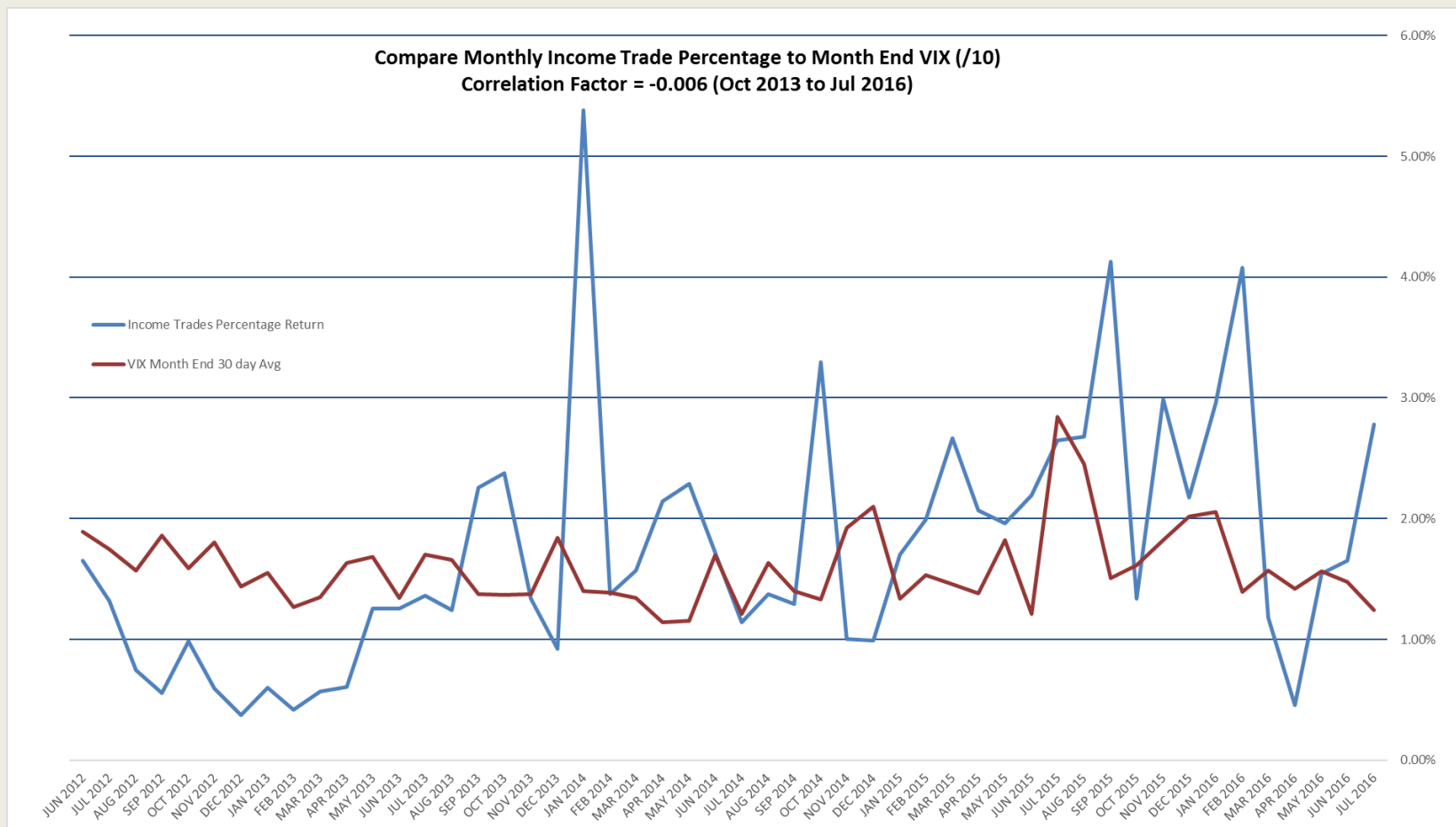


It appears that managing to keep theta above 0.1% of Net Liq is a key to generating good income, though they are not as highly correlated as I would have thought.





Monthly income percentage is not correlated to the VIX. It appears that managing theta to 0.1% of Net Liq is mitigating the problems of getting higher premiums in low VIX environments. 'Not what I thought.





“Fund Speak”

Risk-Free Rate = Average Three Month Treasury Yield – nearly nothing.

Jensen’s Alpha = Your portfolio return minus Portfolio Beta times the market return with the risk free rate factored out, expressed annually.

Portfolio Beta = Beta calculated based on monthly portfolio returns.

Treynor Ratio = $(\text{Portfolio Return} - \text{Risk Free Return}) / \text{Portfolio Beta}$

Sharpe Ratio = $\text{Mean of Excess Returns} / \text{Standard Deviation of Excess Returns}$

Sortino Ratio = $(\text{Avg. Portfolio Return} - \text{Minimum Acceptable Rate}) / \text{Standard Deviation of Negative Returns}$

Portfolio Leverage = $\text{Notional Value of LEAPS Calls} / \text{Portfolio Net Liq}$



Risk Analysis and Options Performance

Very useful information to compare how much risk my strategies are incurring versus other managers and their techniques. There is a lot to learn here.

Return/Risk Analysis									
Risk Measurement	1 Yr	3 Yr	5 Yr	Portfolio and Market Statistics			1 Yr	3 Yr	5 Yr
Treynor Ratio	-208.7%	9.57%	16.91%	Jensen's Alpha			20.3%	4.1%	0.09
Skewness (Pos = Right)	0.756	-0.352	-0.231	Portfolio Beta			(0.06)	1.42	1.33
Kurtosis (Pos = Peaked)	1.305	5.441	3.840	R-Squared			0.00	0.62	0.53
Positive Months	11	30	49	Average Return from Inception			2.54%		
Negative Months	1	6	11	VIX Current Month End			9.51		
Worst Month	-0.48%	-15.44%	-15.44%	10 Year Treasury Bills 1 Yr Avg			2.28%		
Max Drawdown	-0.48%	-15.44%	-15.44%	Risk Free Rate 1 Yr Avg			0.79%		
Portfolio Risk	1 Yr	3 Yr	5 Yr	Market Risk - Benchmark			1 Yr	3 Yr	5 Yr
Mean (Avg) Return	2.10%	2.48%	2.90%	Mean (Avg) Return - Benchmark			1.27%	0.72%	0.97%
Standard Deviation	1.60%	5.28%	5.04%	Standard Deviation - Benchmark			1.52%	2.91%	2.77%
Sharpe Ratio	4.42	1.61	1.98	Sharpe Ratio - Benchmark			2.73	0.82	1.19
Sortino Ratio	47.11	2.78	3.92	Sortino Ratio - Benchmark			7.95	1.43	2.21
Cash & Income Performance - EOM Snapshot									
Cash Percent of Portfolio	53.3%		Interest % of Cash	0.000%		Dividends % of Net Liq		0.001%	



Next - Never assume I know it all yet...

Very concerned about possible pullback. Learn more about hedging. Get more experience with the Black Swan Hedge Campaign.

Continue to convert traditional IRAs to Roth IRAs.

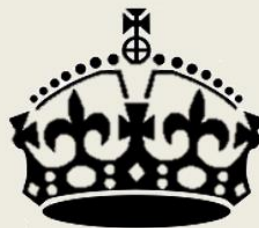
Watch carefully for tax-loss harvesting opportunities.

Continue attending workshops, investor conferences, read investment books, monitor investor subscription services, etc. to get exposure to different styles.

Am I missing some opportunity because I don't know it exists?



TERRY WALTERS
OPTIONS MY WAY



**KEEP
CALM
AND
TRADE
ON**