



**This is just what I do.**

**I could be wrong.**



# MILLENNIOUS

## PERSONAL HEDGE FUND

### **The Disclaimer...**

I am not a broker/dealer, CFP, RIA or a licensed advisor of any kind. I cannot give you advice.

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 made.

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

So, please don't sue me.



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## PERSONAL HEDGE FUND

### **...a Personal Hedge Fund?**

#### **The Overview**

The personal situation

The investing thesis

The goals

#### **Equity Investing**

Entering long equity positions – Capital

#### **Income Trading**

Trades that generate predictable monthly income

#### **Portfolio Management**

Beta weighting the portfolio and managing by the numbers

#### **Hedging the Portfolio**

Strategies to reduce downside risk

#### **Tax Considerations**

Tax Loss Harvesting

#### **Portfolio Performance Measurement**

Report and manage like a hedge fund



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## PERSONAL HEDGE FUND - OVERVIEW

### **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.



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## PERSONAL HEDGE FUND - OVERVIEW

### I believe...The 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). 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.



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## PERSONAL HEDGE FUND - OVERVIEW

### The Investing Goals: Income first

**Capital:** Put capital to full use.

Manage 10 to 20 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.

**Income:** Use equity options for income.

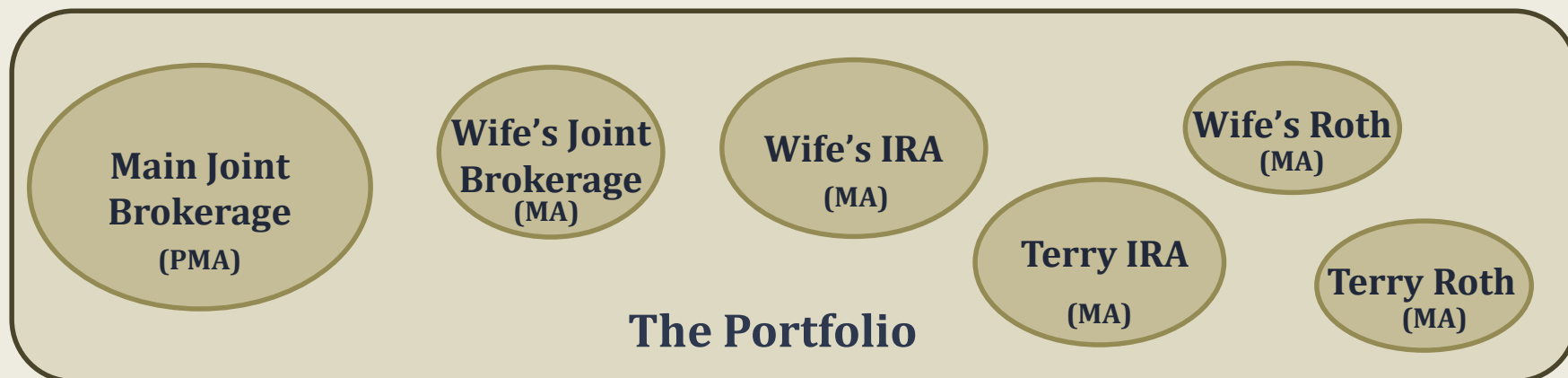
Sell covered calls against equity positions at 68% to 84% probabilities (.32 to .16 delta) at 25 to 45 Days To Expiration (DTE). Target total account theta to yield 0.05% to 0.1% of Net Liq. Trade front month; expire or roll to next month. Should yield better than 1% per month in premiums for all combined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

**Hedging:** Use index spreads to hedge off risk. Sell Out Of the Money (OTM) call spreads to finance long put spreads. Some people view covered calls as a hedge as well. Selectively use ratio put spreads. Occasionally sell /ES.



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## PERSONAL HEDGE FUND – EQUITY INVESTING



“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 20 positions.

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

Accounts are each 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.



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## PERSONAL HEDGE FUND - OVERVIEW

**What is “Portfolio Margin”?**





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## PERSONAL HEDGE FUND – EQUITY INVESTING

### **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 by expiration.**

Buy the highest strike Deep In the Money (DIM) call at 60 to 90 Days To Expiration (DTE) where the Extrinsic Value is less than 1% of the Intrinsic Value. This will likely be somewhere around .90 to .99 delta. Ideally, find an option whose price is 25% of the strike price. The Extrinsic value is the “premium” I pay above the stock price. Buying the DIM call puts far less capital at risk versus buying the stock. To maintain the position I will need to roll this DIM call out another 90 days or so in the week before expiration.

Allocation size, for the non-leveraged portfolio, will be the portfolio value divided by the number of equities (10 to 20). Contract quantity is the allocation divided by the share price divided by 100 rounded down to the nearest 100. I often buy nearly twice as many contracts to leverage the position.



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## PERSONAL HEDGE FUND – EQUITY INVESTING

### **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 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.

Buy the LEAPS call at .70 to .80 delta – Select the strike at about 25% of the price of the equivalent number of shares. I pay a “premium” over the stock price. Breakeven equals the strike plus the option price. The “premium” is the Breakeven minus the current underlying price.

Allocation size, for the non-leveraged portfolio, will be the portfolio value divided by the number of equities (10 to 20). Contract quantity is the allocation divided by the share price divided by 100 rounded down to the nearest 100. I often buy nearly twice as many contracts to leverage the position.



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## PERSONAL HEDGE FUND – EQUITY INVESTING

**Any hedge fund managers here?**

**Do you have a “go to” income trade?**

**Do you trade more than one of them monthly for income?**

**Is your income fairly consistent?**

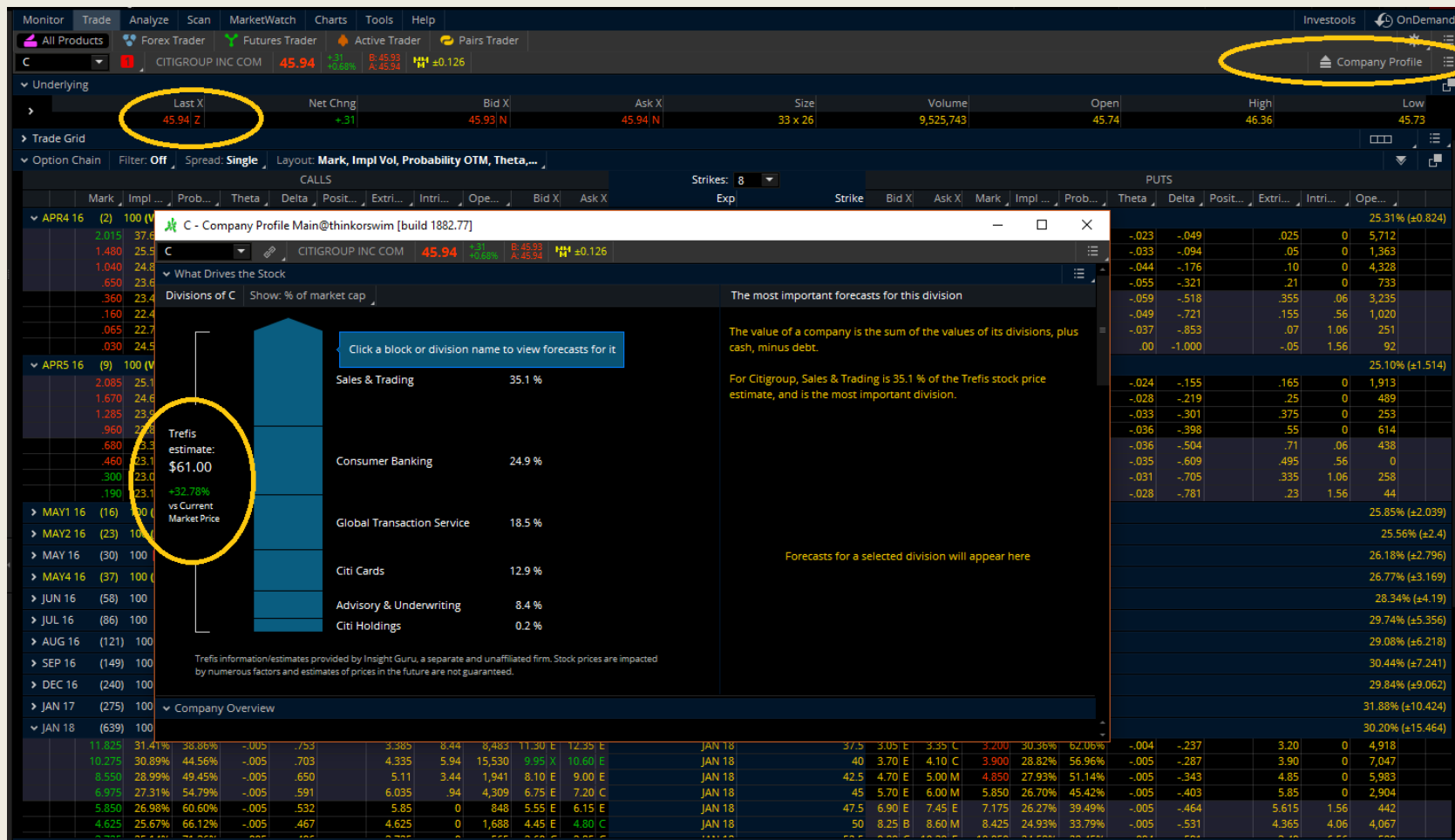
**Do you track your monthly results?**



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## PERSONAL HEDGE FUND – EQUITY INVESTING

Select an equity with a good Margin Of Safety:





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## PERSONAL HEDGE FUND – EQUITY INVESTING

### **Exiting the Equity position - When the 50 day EMA crosses below the 100 day EMA get out...maybe...**

In the short term, the market's impression determines the price of the equity. Do I really want to hold a long position in a down trending stock? If I have been in the position and following it upward while the price is below the FV, yet all of a sudden the equity begins to move downward, I need to consider that the market as a whole does not believe the earnings will continue to sustain the FV. I use the 50/100 EMA cross over as a guide to get out of the position. GILD is an example.

If I am in a position where the price is above the FV, then it is even more important to get out as the 50 crosses below the 100. By definition, when the price is above the FV the position is speculative and a quick exit is doubly important. NVDA is a good example.

There will be cases where the stock was recently beaten down and my entry decision was based on a turnaround situation where there is a good fundamental reason to be in the position yet the 50 day EMA is now below the 100 day EMA. In this case I am betting on the 50 day EMA crossing up soon. WFC is an example.



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## PERSONAL HEDGE FUND – EQUITY INVESTING

### **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. 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 are not a consideration in an IRA, I can exit at any time that I believe it is appropriate.



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## PERSONAL HEDGE FUND – INCOME TRADING

**Sell covered calls (calls covered with a stock replacement) for income:**

Select the front month 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 you will get a “feel” for how the underlying trades and how to manage your covered calls.





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## PERSONAL HEDGE FUND – EQUITY INVESTING

| 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   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 42 .25 C .27 C .260 28.43% 85.01% -0.13 -131 .26 0 120               |  |
| 3.725 27.20% 17.41% -0.14 .845 .305 3.42 27,555 3.70 M 3.75 C  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 42.5 .31 X .33 X .320 27.69% 82.11% -0.14 -158 .32 0 13,945          |  |
| 3.300 26.58% 20.89% -0.15 .813 .38 2.92 68 3.25 C 3.35 C   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 43 .39 Z .40 N .395 27.03% 78.69% -0.16 -191 .395 0 120              |  |
| 2.890 25.94% 24.85% -0.17 .775 .47 2.42 65 2.87 C 2.91 N   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 43.5 .49 A .50 I .495 26.61% 74.55% -0.17 -230 .495 0 82             |  |
| 2.515 25.68% 29.66% -0.18 .729 .595 1.92 290 2.50 C 2.53 X   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 44 .60 C .62 X .610 26.06% 70.03% -0.19 -273 .61 0 1,462             |  |
| 2.155 25.22% 34.77% -0.19 .679 .735 1.42 395 2.14 X 2.17 X   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 44.5 .74 C .76 X .750 25.58% 64.99% -0.20 -322 .75 0 1,236           |  |
| 1.825 24.86% 40.36% -0.20 .624 .905 .92 27,673 1.81 X 1.84 M   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 45 .91 C .93 I .920 25.20% 59.47% -0.20 -376 .92 0 6,692             |  |
| 1.525 24.55% 46.28% -0.21 .566 1,105 .42 2,015 1.51 X 1.54 C   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 45.5 1.11 C 1.13 C 1,120 24.88% 53.64% -0.21 -434 1.12 0 140         |  |
| 1.250 24.13% 52.36% -0.21 .505 1.25 0 1,367 1.24 C 1.26 Z  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 46 1.34 H 1.36 A 1,350 24.55% 47.63% -0.21 -494 1.27 0 360           |  |
| 1.010 23.82% 58.50% -0.20 .443 1.01 0 282 1.00 C 1.02 Z  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 46.5 1.59 C 1.62 H 1,605 24.15% 41.58% -0.20 -556 1,025 58 80        |  |
| .810 23.66% 64.46% -0.19 .382 .81 0 7,033 .80 C 82 C   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 47 1.89 C 1.92 M 1,905 24.02% 35.70% -0.20 -616 .825 1.08 79         |  |
| .640 23.53% 70.09% -0.18 .324 .64 0 8,679 .63 Z .65 C  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 47.5 2.22 H 2.24 N 2,230 23.81% 30.10% -0.18 -673 .65 1.58 617       |  |
| .495 23.35% 75.32% -0.17 .264 .495 0 1,324 .49 Z .50 Z   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 48 .45 H .46 M .461 M 2,595 23.89% 25.12% -0.17 -725 .515 2.08 38    |  |
| .380 23.26% 79.40% -0.15 .220 .38 0 112 .37 M .39 C  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 48.5 2.85 Y 2.87 C 2,980 23.88% 20.62% -0.15 -771 .40 2.58 0         |  |
| .290 23.26% 83.92% -0.13 .170 .29 0 83 .28 Z .29 Z   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 49 3.35 C 3.45 C 3,400 24.26% 17.03% -0.14 -808 .32 3.08 0           |  |
| .220 23.31% 87.25% -0.11 .143 .22 0 115 .21 N .23 M  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | MAY 16 49.5 3.70 C 3.95 C 3,825 24.35% 13.72% -0.12 -842 .245 3.58 0        |  |
| 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   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 27.5 1.10 E 1.72 E 1,410 38.19% 77.75% -0.03 -101 1.41 0 1,074       |  |
| 17.625 36.33% 25.87% -0.03 .863 1,705 15.92 3,173 17.15 E 18.10 Z  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 30 1.50 E 1.63 Q 1,565 34.55% 75.95% -0.03 -122 1,565 0 2,172        |  |
| 15.650 34.91% 30.17% -0.04 .831 2,23 13.42 1,000 15.15 E 16.15 E   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 32.5 1.89 E 2.13 M 2,010 33.03% 71.72% -0.04 -155 2,01 0 950         |  |
| 13.750 33.49% 34.70% -0.04 .793 2,83 10.92 5,786 13.15 E 14.35 E   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 35 2.42 E 2.65 C 2,535 31.53% 67.17% -0.04 -193 2,535 0 5,267        |  |
| 11.825 31.49% 38.97% -0.05 .754 3,167 8.43 7,473 11.00 E 12.35 E   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 37.5 3.05 E 3.35 C 3,200 30.33% 62.04% -0.04 -238 3,20 0 4,918       |  |
| 10.275 30.96% 44.00% -0.05 .703 4,355 5.92 15,530 9.95 X 10.60 E   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 40 3.70 E 4.10 C 3,900 28.79% 56.93% -0.05 -287 3,90 0 7,047         |  |
| 8.550 29.05% 49.53% -0.05 .650 5,713 3.42 15,717 6.15 E 7.00 E   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 42.5 4.70 E 5.00 M 4,850 27.90% 51.11% -0.05 -343 4,85 0 5,983       |  |
| 6.975 27.36% 54.86% -0.05 .591 6,055 .92 4,309 6.75 E 7.20 C   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 45 5.70 E 6.00 C 5,850 26.66% 45.39% -0.05 -403 5,85 0 2,904         |  |
| 5.850 27.03% 60.65% -0.05 .531 5,85 0 848 5.55 E 6.15 E  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 47.5 6.90 E 7.45 E 7,175 26.23% 39.44% -0.05 -465 5,595 1.58 442     |  |
| 4.625 25.71% 66.16% -0.05 .466 4,625 0 1,688 4.45 E 4.80 C   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 50 8.25 B 8.60 M 8,425 24.89% 33.74% -0.05 -532 4,345 4.08 4,067     |  |
| 3.725 25.18% 71.40% -0.05 .406 3,725 0 565 3.60 C 3.85 C   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 52.5 9.80 C 10.30 10,050 24.53% 28.39% -0.04 -582 3,47 6.58 580      |  |
| 2.905 24.43% 76.31% -0.04 .345 2,905 0 3,046 2.81 C 3.00 N   |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 55 11.55 C 12.00 E 11,775 24.06% 23.51% -0.04 -650 2,695 9.08 1,073  |  |
| 2.210 23.66% 80.81% -0.04 .286 2,21 0 1,182 2.10 C 2.32 M  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | JAN 18 57.5 13.25 C 13.80 E 13,525 23.12% 18.83% -0.03 -709 1,945 11.58 177 |  |

Buy to Open, Jan 18, 40 Call AND Sell to Open May 16 48.5 Call - \$9.92 DEBIT Diagonal Call spread.

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





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## PERSONAL HEDGE FUND – EQUITY INVESTING

### **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 over the current 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.



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## PERSONAL HEDGE FUND – INCOME TRADING

### **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, may 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 will 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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## PERSONAL HEDGE FUND – INCOME TRADING

### **Rolling the covered calls out each month:**

I make every effort to avoid rolling for a debit; credits are my monthly income.

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 you have to in order to get a credit or a scratch.

  - Roll as a calendar if you must, but you 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 your 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.

Watch for ex-dividend dates. If the corresponding strike put sells for more than the dividend you must roll out before the ex-dividend date. You might just want to roll well ahead of the ex-dividend date to be safe.



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## INVESTING METHOD – PORTFOLIO MANAGEMENT

### **Capture Portfolio data at the end of each month.**

Keep a Trading Journal – A copy of brokerage account transactions

Use brokerage account end of month balances.

Add back your withdrawals

Subtract any deposits

Monthly Return

### **Create an overall view of the portfolio.**

Beta weight the entire portfolio

I track the Greeks

### **Management**

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

Target Leverage Ratio to be 150% to 200%

Notional value of all long LEAPS calls divided by Net Liq.

Compare Equity Beta to the Beta of your hedge product.



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## INVESTING METHOD – PORTFOLIO MANAGEMENT

Trading Journal separate tab for each position – copied directly from broker transactions site.

- 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”, question.

| BLANK Analysis                             |    |             |     |        |       |      |              |                  |         |                      |                  |
|--|----|-------------|-----|--------|-------|------|--------------|------------------|---------|----------------------|------------------|
| Fair Value                                 |    |             |     |        |       |      |              |                  |         |                      |                  |
| Consider Adding More                       |    |             |     |        |       |      |              |                  |         |                      |                  |
| Equity Purchases                           |    |             |     |        |       |      |              |                  |         |                      |                  |
| Date                                       | ID | Description | Qty | Symbol | Price | Coms | Net Amount   | Net Cash Balance | Reg Fee | Net Per Share to Buy |                  |
|  |    |             |     |        |       |      |              |                  |         |                      |                  |
| Totals                                     |    |             | -   |        |       |      | \$0.00       |                  |         | #DIV/0!              |                  |
| Options Income                             |    |             |     |        |       |      |              |                  |         |                      |                  |
| Date                                       | ID | Description | Qty | Symbol | Price | Coms | Net Amount   | Net Cash Balance | Reg Fee | Comment              | Break Even Price |
|  |    |             |     |        |       |      |              |                  |         |                      | Buying Power     |
|  |    |             |     |        |       |      |              |                  |         |                      |                  |
| Dividend Income                            |    |             |     |        |       |      |              |                  |         |                      |                  |
| Date                                       | ID | Description | Qty | Symbol |       |      | Net Amount   | Net Cash Balance |         |                      |                  |
|  |    |             |     |        |       |      | 0 ---        |                  |         |                      |                  |
| Capital Gains Income                       |    |             |     |        |       |      |              |                  |         |                      |                  |
| (These cells require shuffling some data.) |    |             |     |        |       |      |              |                  |         |                      |                  |
| Date                                       | ID | Description | Qty | Symbol | Price | Coms | Capital Gain | Net Cash Balance | Reg Fee | Net Per Share to Buy | Net Amount       |
|  |    |             | 0   |        | 0     | 0    | \$0.00       | 0                | 0       | \$0.00               | \$0.00           |
|  |    |             |     |        |       |      |              |                  |         |                      |                  |
| Income minus cost of active LEAPS calls    |    |             |     |        |       |      | \$0.00       |                  |         |                      |                  |



# MILLENNIOUS

## INVESTING METHOD – PORTFOLIO MANAGEMENT

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

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

| Ticker        | Value              | Percent of Portfolio | Beta | Weighted Share                 |
|---------------|--------------------|----------------------|------|--------------------------------|
| PCLN          | \$13,362.40        | 28%                  | 1.56 | 0.43                           |
| V             | \$3,148.80         | 7%                   | 0.84 | 0.06                           |
| BABA          | \$4,138.50         | 9%                   | 1.03 | 0.09                           |
| AAPL          | \$3,992.00         | 8%                   | 1.00 | 0.08                           |
| C             | \$2,220.50         | 5%                   | 2.00 | 0.09                           |
| AMT           | \$2,338.40         | 5%                   | 0.53 | 0.03                           |
| ORCL          | \$1,643.40         | 3%                   | 1.12 | 0.04                           |
| XLE           | \$2,066.10         | 4%                   | 1.34 | 0.06                           |
| GILD          | \$6,863.20         | 14%                  | 1.10 | 0.16                           |
| FB            | \$8,411.90         | 17%                  | 1.06 | 0.19                           |
| <b>TOTALS</b> | <b>\$48,185.20</b> | <b>100%</b>          |      | <b>1.21</b>                    |
|               |                    |                      |      | Beta of the combined portfolio |



# MILLENNIOUS

## INVESTING METHOD – PORTFOLIO MANAGEMENT

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



# MILLENNIOUS

## INVESTING METHOD – PORTFOLIO MANAGEMENT

### **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.





# MILLENNIOUS

## INVESTING METHOD – PORTFOLIO MANAGEMENT

A Beta Weighted (SPY) view of an account:

Maintain theta – try manage theta to about 0.1% of Net Liq

Keep vega manageable – don't collect too much negative vega in a bull market

Note the effect of selling short front month calls for income in this unhedged account. Delta is 691. Theta is 70.





# MILLENNIOUS

## INVESTING METHOD – PORTFOLIO MANAGEMENT

Transactions are copied and pasted from the brokerage account.  
Each account is beta weighted and greeks are recorded.  
The following are calculated:

Return on capital (ROC) for the month and annualized.

Delta as a % of Net Liq for the month.

Income is categorized and totaled from the transaction log.

Theta as a % of Net Liq for the month and annualized.

Cash as a percentage of Net Liq

### TDA Monthly Transaction Log & Account Analysis

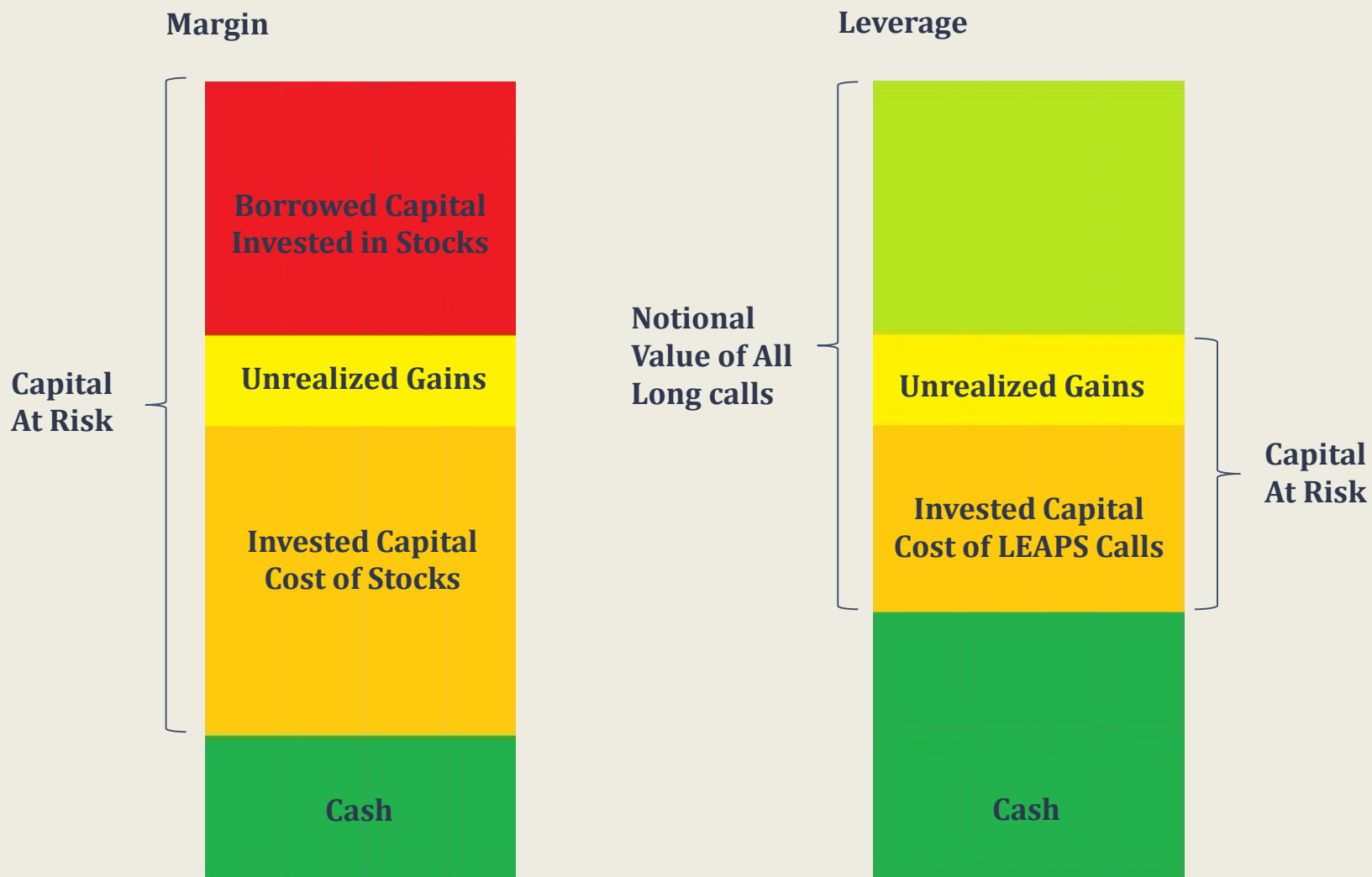
| Feb             |               |                       | Options      | Return On Capital (ROC) | Annual (ROC) | Delta/Net Liq | SPY            | SPY              | SPY            | SPY                | Interest Earned | Dividend Income       | Options Income | Total Income   | Theta % of Portfolio | Theta (Annual) | Cash % of Net Liq |
|-----------------|---------------|-----------------------|--------------|-------------------------|--------------|---------------|----------------|------------------|----------------|--------------------|-----------------|-----------------------|----------------|----------------|----------------------|----------------|-------------------|
|                 | Net Liq. EOM  | Cash                  | Buying Power |                         |              |               | Weighted Delta | Weighted Gamma   | Weighted Theta | Weighted Vega      |                 |                       |                |                |                      |                |                   |
| Roth            | \$ 152,000.00 | \$ 22,256.00          | \$ 20,000.00 | 0.36%                   | 4.26%        | 0.31%         | 464            | 1                | 38             | 294                | \$0.00          | \$0.00                | \$539.86       | \$539.86       | 0.03%                | 9%             | 14.6%             |
| Carol           | \$ 144,554.78 | \$ 74,174.00          | \$ 60.94     | 2.49%                   | 29.89%       | 0.48%         | 689            | -43              | 160            | 1,535              | \$0.00          | \$ -                  | \$ 3,600.54    | \$ 3,600.54    | 0.11%                | 40%            | 51.3%             |
| Totals          | \$ 296,554.78 | \$ 96,430.00          | \$ 20,060.94 | 1.40%                   | 16.75%       | 0.39%         | 1153           | -42              | 198            | 1,829              | \$0.00          | \$ -                  | \$ 4,140.40    | \$4,140.40     | 0.07%                | 24%            | 33%               |
|                 |               |                       |              |                         |              |               |                |                  |                |                    | 0.0000%         | 0.00%                 | 1.40%          |                |                      |                |                   |
| TRANSACTION LOG |               |                       |              |                         |              |               |                |                  |                |                    |                 |                       |                |                |                      |                |                   |
| DATE            | ID            | DESCRIPTION           | QUANTITY     | SYMBOL                  | PRICE        | COMS          | AMOUNT         | NET CASH BALANCE | REG FEE        | SHORT-TERM RDM FEE | FUND RDM FEE    | DEFERRED SALES CHARGE | DIVIDENDS      | OPTIONS INCOME |                      |                |                   |
| 2/1/2016        | 14457769793   | MONEY MARKET PURCHASE | 61.74        | MMDA10                  |              |               | 0              | 61.74            |                |                    |                 |                       |                |                |                      |                |                   |
| 2/1/2016        | 14457769637   | MONEY MARKET PURCHASE |              |                         |              |               | -61.74         | 0                |                |                    |                 |                       |                |                |                      |                |                   |
| 2/3/2016        | 14475025264   | Sold 1 GILD Feb 19    | 1            | GILD Feb 19 2016        | 0.58         | 6.55          | 51.41          | 51.41            | 0.04           |                    |                 |                       |                | 51.41          |                      |                |                   |
| 2/3/2016        | 14475025272   | Bought 1 GILD Feb     | 1            | GILD Feb 19 2016        | 0.03         | 0.55          | -3.58          | 47.83            | 0.03           |                    |                 |                       |                | -3.58          |                      |                |                   |
| 2/3/2016        | 14475238097   | Sold 3 BABA Mar 18    | 3            | BABA Mar 18 2016        | 1.04         | 7.65          | 304.26         | 352.09           | 0.09           |                    |                 |                       |                | 304.26         |                      |                |                   |
| 2/3/2016        | 14475238108   | Bought 3 BABA Feb     | 3            | BABA Feb 19 2016        | 0.09         | 1.65          | -28.73         | 323.36           | 0.08           |                    |                 |                       |                | -28.73         |                      |                |                   |
| 2/4/2016        | 14477789382   | MONEY MARKET PURCHASE | 73.36        | MMDA10                  |              |               | 0              | 323.36           |                |                    |                 |                       |                |                |                      |                |                   |
| 2/4/2016        | 14477789352   | MONEY MARKET PURCHASE |              |                         |              |               | -73.36         | 250              |                |                    |                 |                       |                |                |                      |                |                   |
| 2/10/2016       | 14540569965   | Bought 2 FB Feb 19    | 2            | FB Feb 19 2016 11       | 0.05         | 1.1           | -11.16         | 238.84           | 0.06           |                    |                 |                       |                | -11.16         |                      |                |                   |
| 2/10/2016       | 14540569969   | Sold 2 FB Mar 18 20   | 2            | FB Mar 18 2016 11       | 0.87         | 7.1           | 166.83         | 405.67           | 0.07           |                    |                 |                       |                | 166.83         |                      |                |                   |
| 2/10/2016       | 14540900498   | Sold 1 GILD Mar 18    | 1            | GILD Mar 18 2016        | 1.73         | 6.55          | 166.41         | 572.08           | 0.04           |                    |                 |                       |                | 166.41         |                      |                |                   |
| 2/10/2016       | 14540900506   | Bought 1 GILD Feb     | 1            | GILD Feb 19 2016        | 1.05         | 0.55          | -105.58        | 466.5            | 0.03           |                    |                 |                       |                | -105.58        |                      |                |                   |
| 2/11/2016       | 14543321724   | MONEY MARKET PURCHASE |              |                         |              |               | -216.5         | 250              |                |                    |                 |                       |                |                |                      |                |                   |
| 2/11/2016       | 14543321771   | MONEY MARKET PURCHASE | 216.5        | MMDA10                  |              |               | 0              | 250              |                |                    |                 |                       |                |                |                      |                |                   |



# MILLENNIOUS

## PERSONAL HEDGE FUND – LEVERAGE

**Leverage and Margin are not the same thing...**





# MILLENNIOUS

## PERSONAL HEDGE FUND – LEVERAGE

### **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 85 strike call for \$25, total \$2500

Remaining cash allocated = \$7500

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 85 strike call for \$25, total \$5000

Remaining cash allocated = \$5000

Sell TWO Front Month short call covered by the LEAPS.



# MILLENNIOUS

## PERSONAL HEDGE FUND – LEVERAGE

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

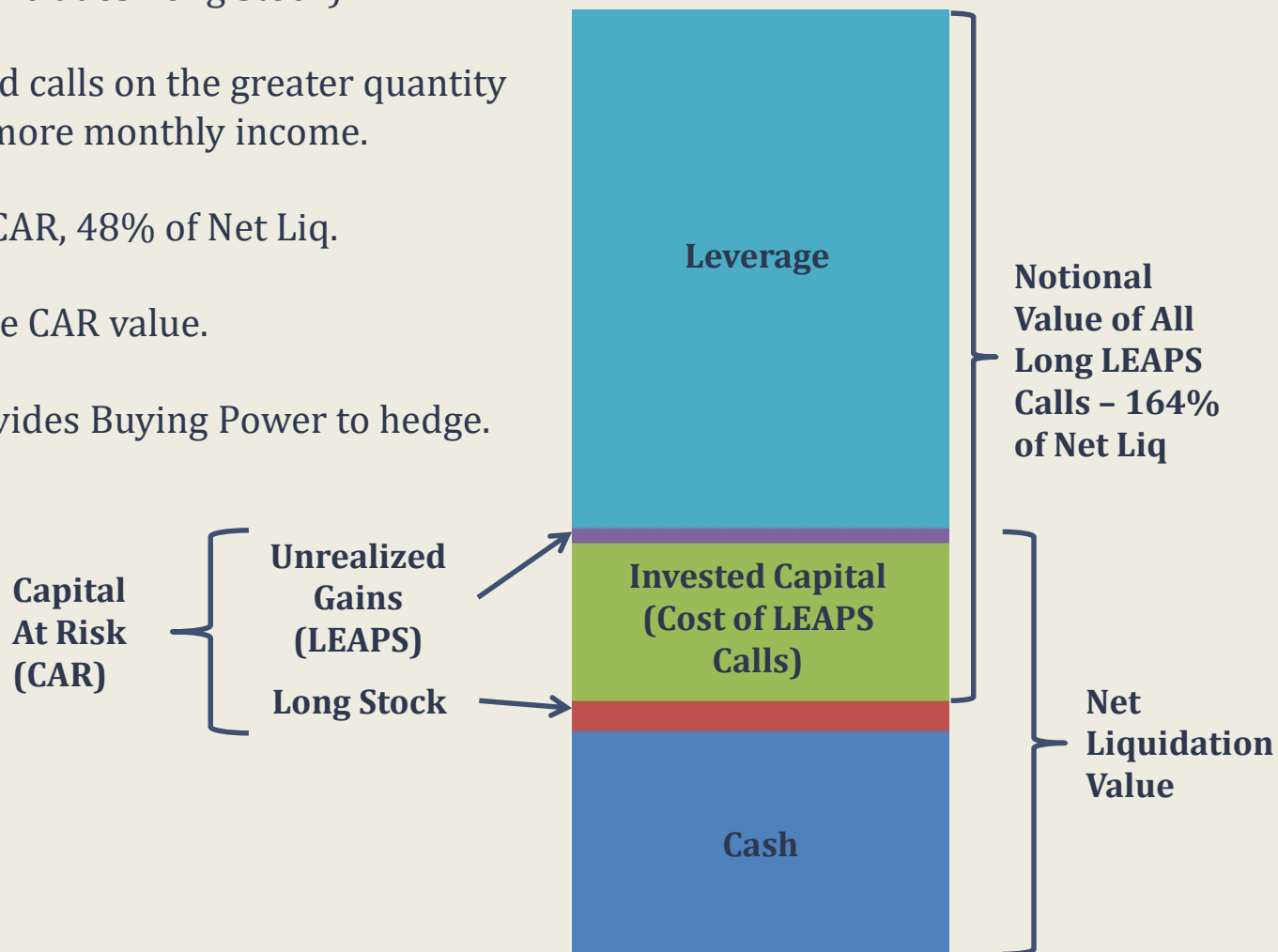
Upside – A 10% increase in market creates a 17.2% increase in Net Liq. (Includes Long Stock)

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.





# MILLENNIOUS

## PERSONAL HEDGE FUND – TAKING PROFITS

### Taking Profits & Removing Risk – Rolling up the LEAPS Calls:

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     |
| Gain Expiration     | \$11.73     |
|                     |             |
| 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 |
| Cash                | \$1,760.00  |



# MILLENNIOUS

## INVESTING METHOD - HEDGE

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





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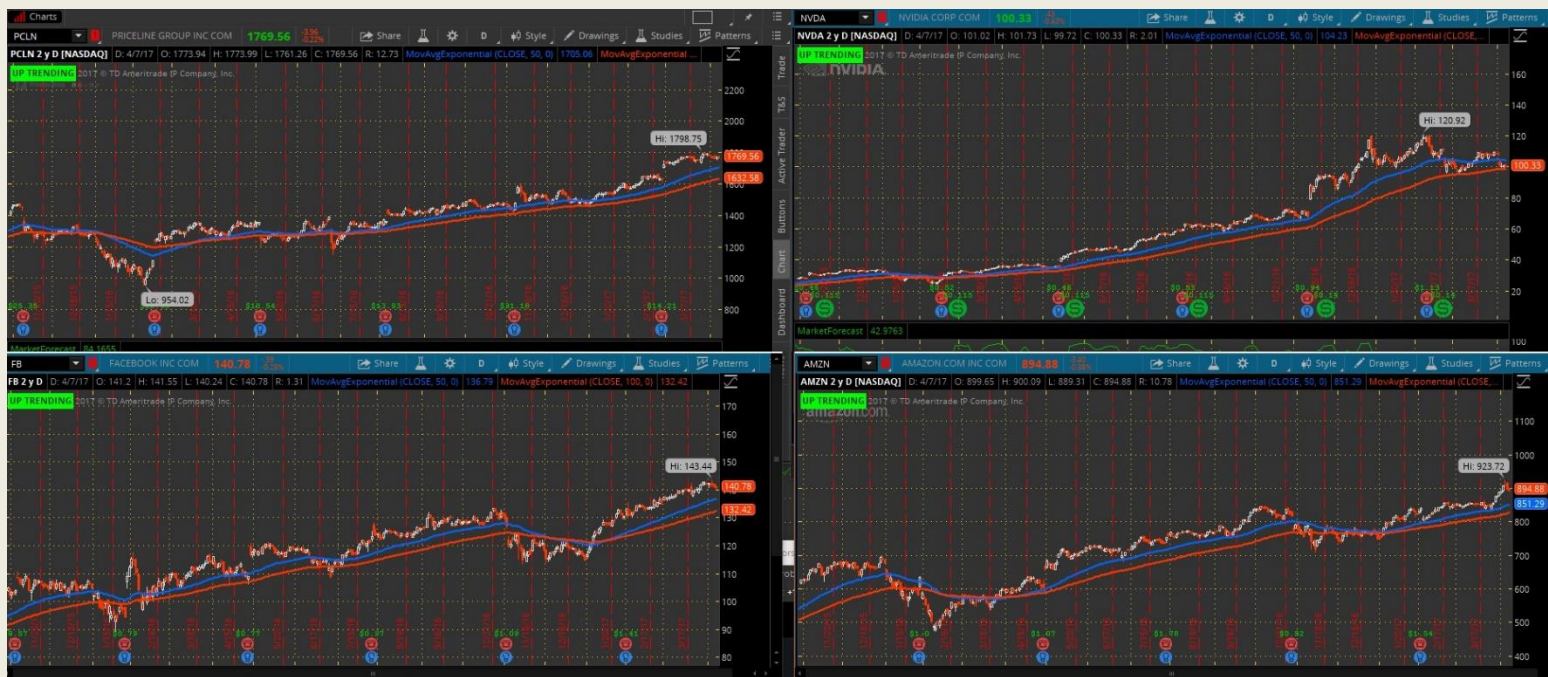
## PERSONAL HEDGE FUND – WHEN TO EXIT

### 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.





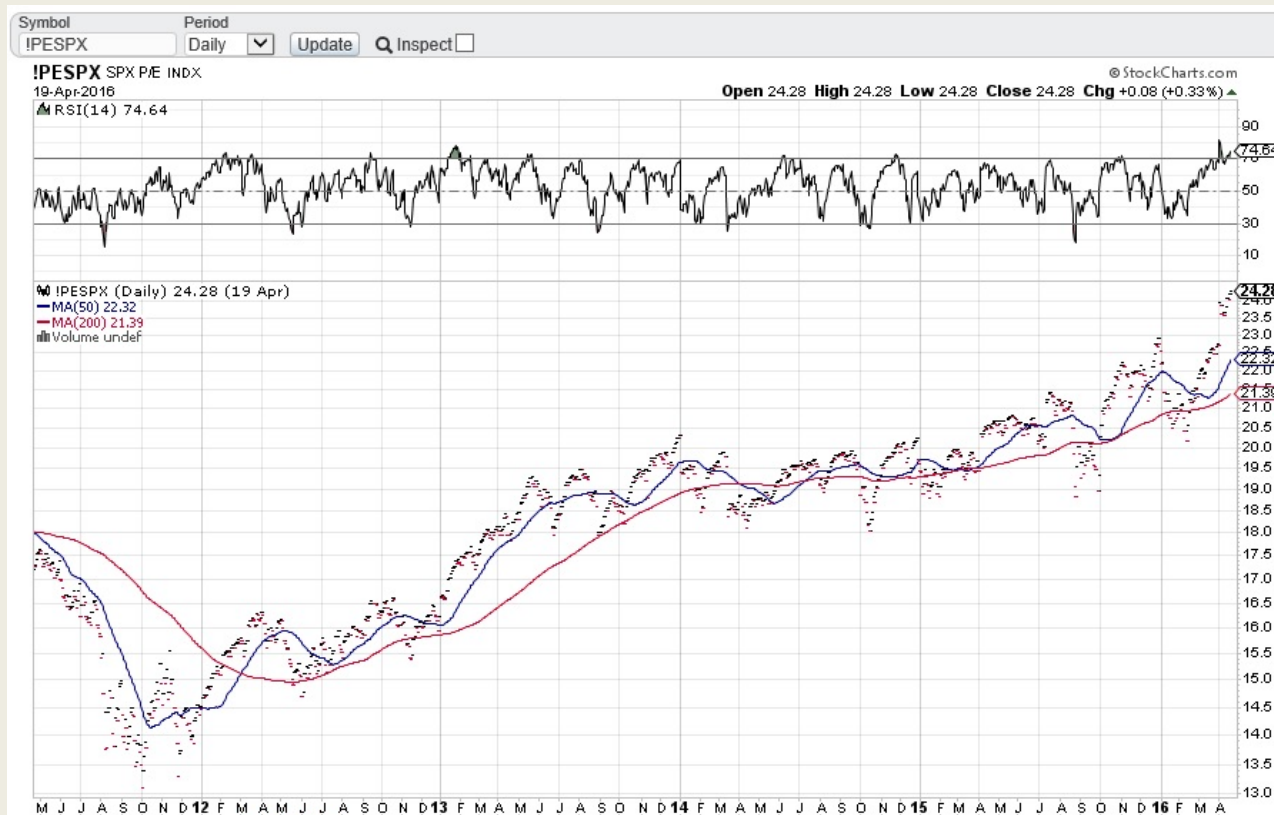


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## INVESTING METHOD - HEDGE

### 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 took a big jump....again. Is this the top of the market. I don't know, but I believe I should hedge just in case.



**Daily**  
S&P 500,  
1 Yr,  
rolling  
chart.



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## INVESTING METHOD - HEDGE

Nearing a new high and highly “overbought”:





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## INVESTING METHOD - HEDGE

### When I Hedge and How Much:

Waiting for the “Death Cross”; I have to hedge BEFORE disaster happens. The five year chart showing the 200 and 40 day MA helps. Will the market go up or down; I don’t know but I believe I should be hedged just in case.

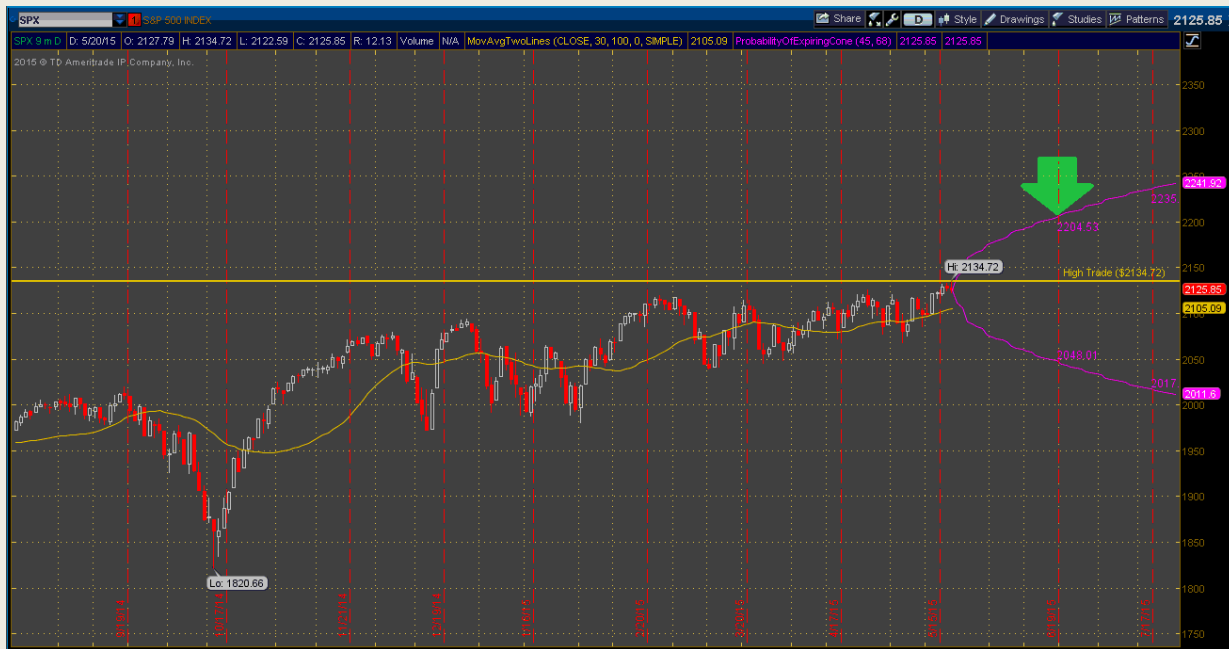




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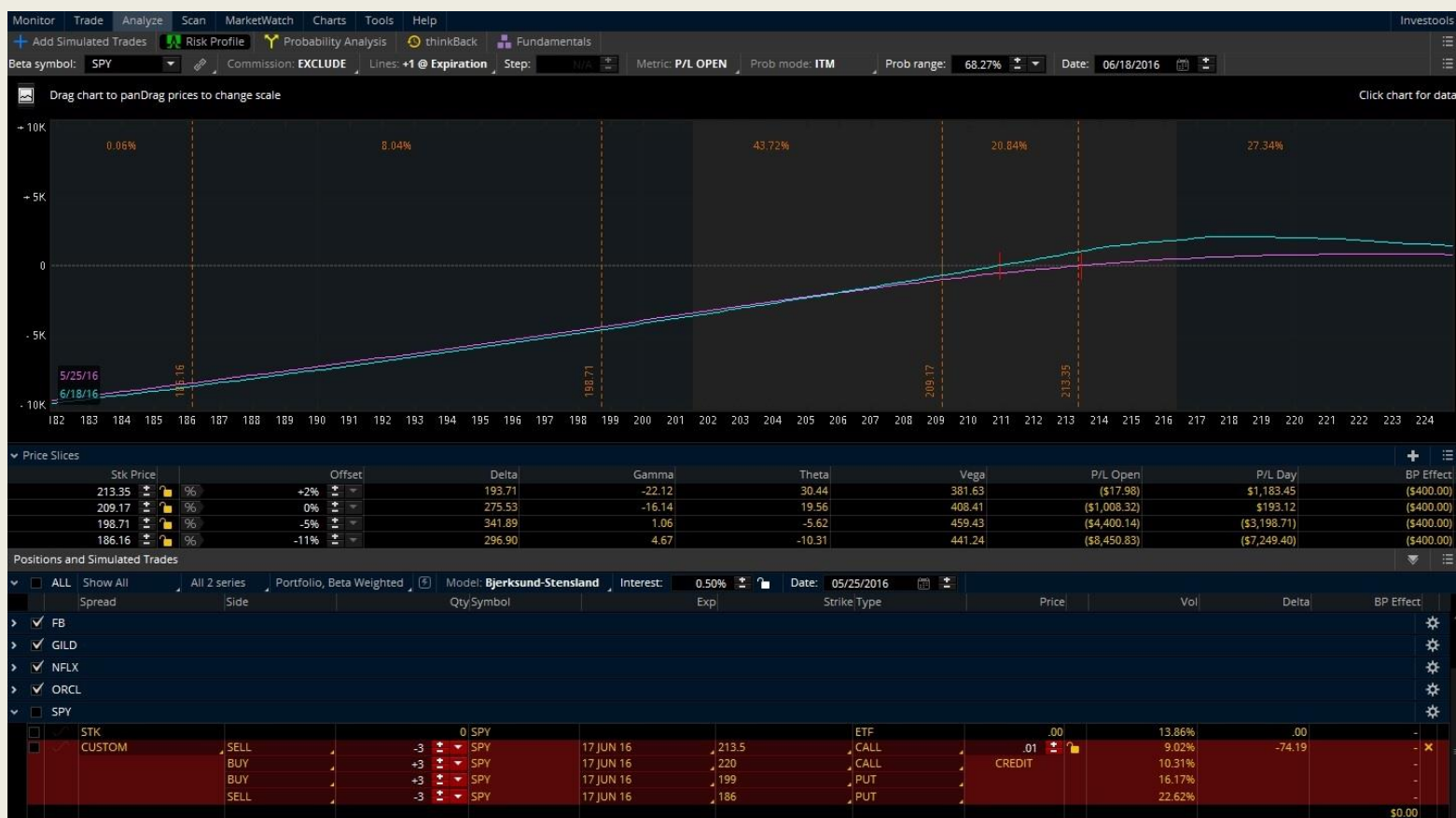
## INVESTING METHOD - HEDGE

**Short Call Hedge Risk:** When the market makes new highs, the probabilities of the short call options expiring OTM will be misleading. At the market high, the P/E ratios for the aggregate S&P will be stretched and institutions will not want to push the market upward. Fundamentals are important at market extremes. When S&P P/E is already 21, is there really a 16% probability that the SPX will go to 2204 from 2134 in 29 days? I believe these short calls are not nearly as risky as the option probabilities indicate in bull market extremes. That is why the short calls are so cheap, although they still are needed to hedge.





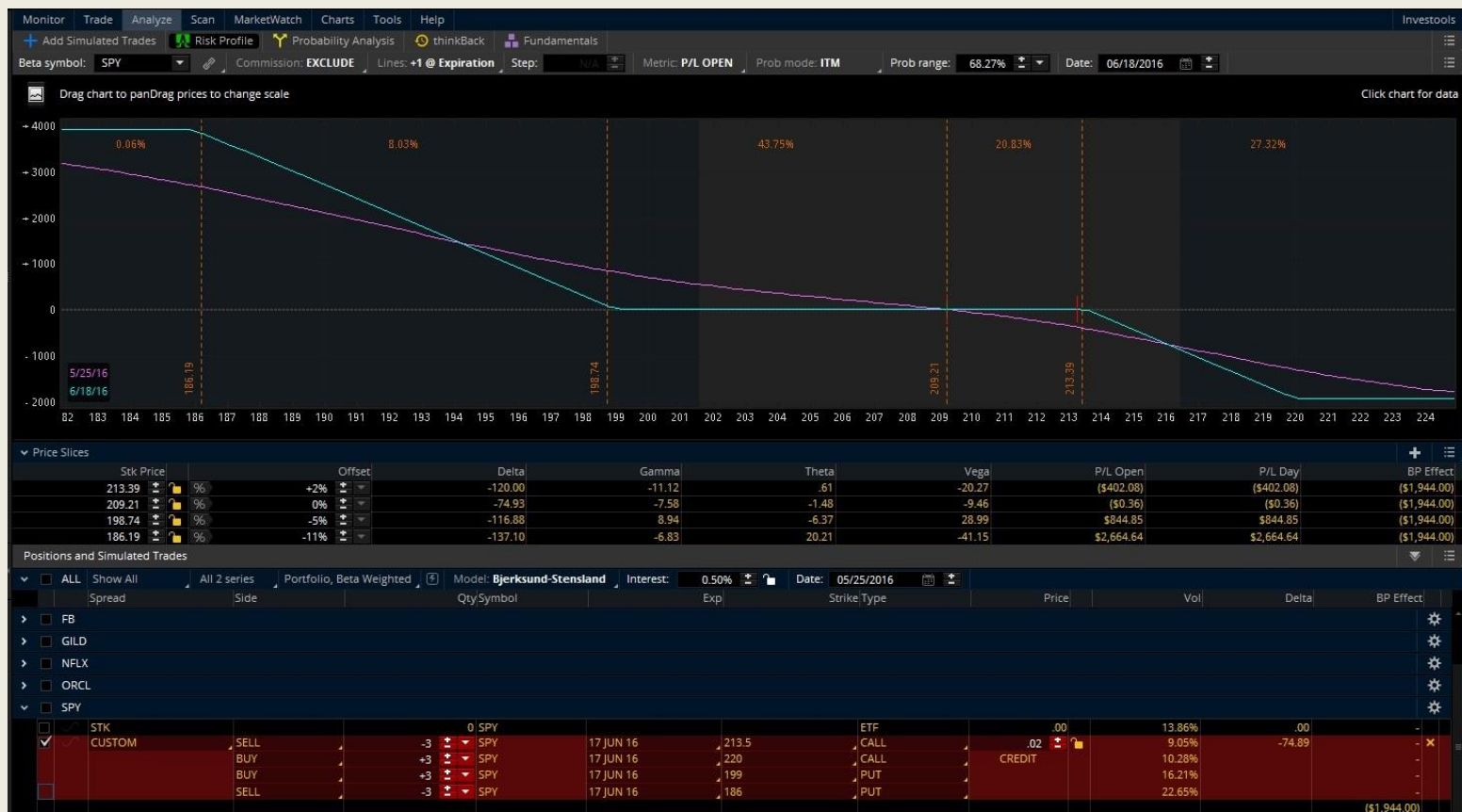
This account consists of long LEAPS stock replacements with covered calls.  
275 positive delta; 19.56 positive theta







Short strike of the call spread at 2% above market. Place the long strike of the put spread at about 5% below market. Position the short put about 10% below market. 74 negative delta; 1.48 negative theta.



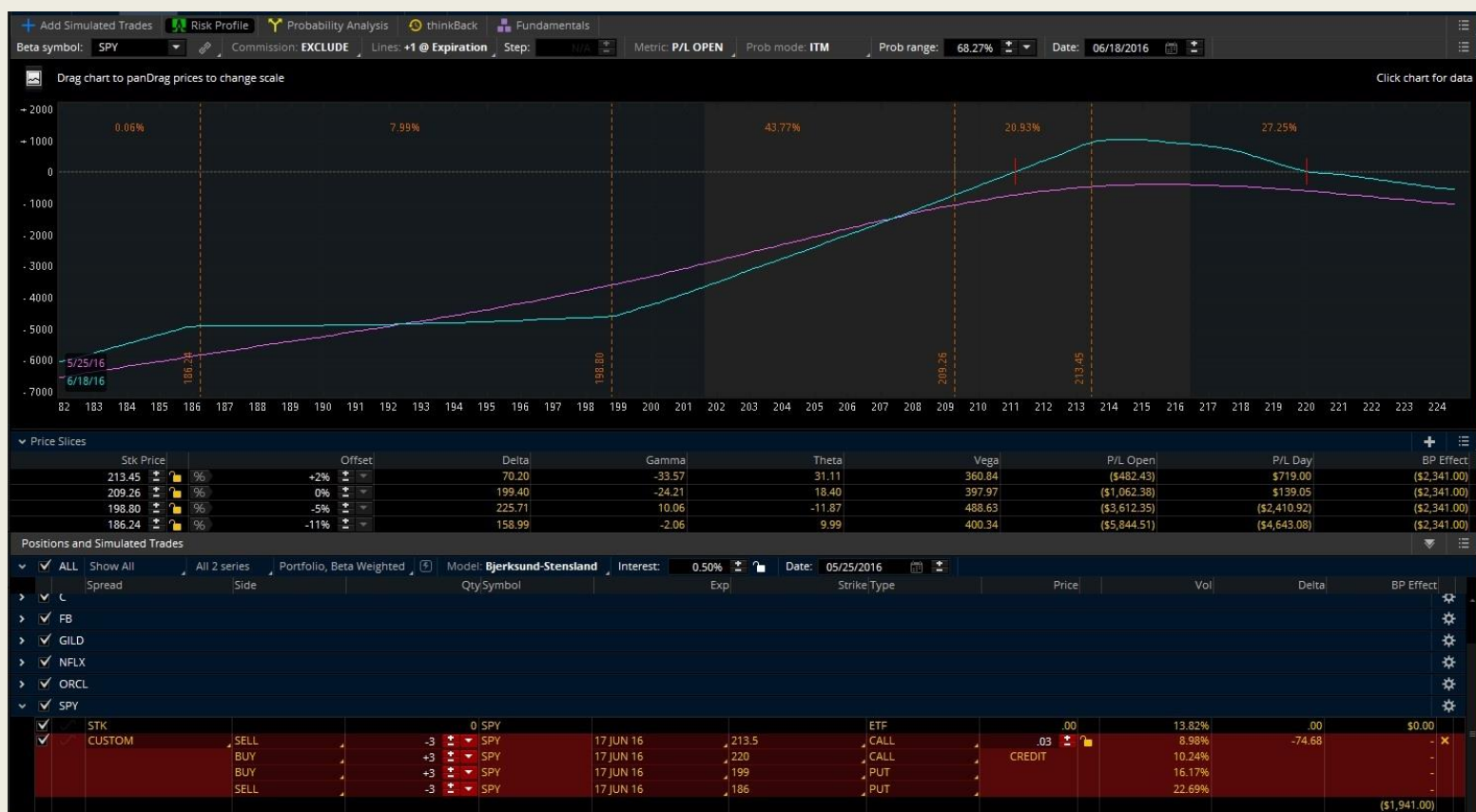


# MILLENNIOUS

## INVESTING METHOD - HEDGE

### Combined account and hedge:

Delta is now 199 with theta of 18.4. When the market declines we get partial compensation for the decline. Markets don't crash up...usually.





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## INVESTING METHOD - HEDGE

### **Hedging notes:**

Hedges have to be managed just like all option trades. As the market moves more contracts may need to be sold or some taken off to keep the Greeks in alignment.

As the month progresses I take off/roll my short income calls thus reducing much of the risk of short income calls, leaving the hedge short calls to manage. If the market declines further, I may be rolling the front month short calls down for additional credits in the month.

In a market correction, the long puts will ease the pain of the decline. This is not a perfect 100% hedge. I need to decide when or if to sell the long put spreads to capture the hedge as cash.

The upside has been sold to protect the downside since I do not expect large swings to the upside in the short term. A fast upward movement in the market creates management problems for the short SPX calls.





# MILLENNIOUS

## PERSONAL HEDGE FUND – TAX CONSIDERATIONS

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



# MILLENNIOUS

## PERSONAL HEDGE FUND – TAX CONSIDERATIONS

Tax treatment seems complicated, but it pays to know a few simple concepts.

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

Consult IRS Publication 550 each year for changes.

| Tax Treatment of Equity Options |                             |  |                                      |   |  |  | Terry A. Walters 9/15/2013  | Version 2.0 |
|---------------------------------|-----------------------------|--|--------------------------------------|---|--|--|---|-------------|
| Case:                           | Type of Option              | Outcome  | Optio Holding Period - Open to Close | Cost Basis  | Tax Treatment of the Options   | Tax Treatment of the resulting stock   | Uses or Examples  |             |
| 1                               | Short Put (Sold the Put)    | The Option expired or was bought back before expiration        | Less than 12 Months                  | Sale price or the difference between original sale and buy-back price.  | If your obligation expires, the amount you received for writing the call or put is short-term capital gain. If you enter into a closing transaction by paying an amount equal to the value of the put or call at the time of the payment, the difference between the amount you pay and the amount you receive for the put or call is a short-term capital gain or loss. | Not Applicable   | Short term income strategies  |             |
| 2                               | Short Put (Sold the Put)    | Shares Assigned  | Less than 12 Months                  | Reduce your basis in the stock you buy by the amount you received for the put.  | Nothing to report for taxes until you sell the stock.  | If a put you write is exercised and you buy the underlying stock, decrease your basis in the stock by the amount you received for the put. Your holding period for the stock begins on the date you buy it, not on the date you wrote the put.   | Short term income strategies  |             |
| 3                               | Short Put (Sold the Put)    | The Option expired or was bought back before expiration        | Greater than 12 Months               | Sale price or the difference between original sale and buy-back price.  | If your obligation expires, the amount you received for writing the call or put is short-term capital gain. If you enter into a closing transaction by paying an amount equal to the value of the put or call at the time of the payment, the difference between the amount you pay and the amount you receive for the put or call is a short-term capital gain or loss. | Not Applicable   | Sale of LEAPS Puts in synthetic long positions  |             |
| 4                               | Short Put (Sold the Put)    | Shares Assigned  | Greater than 12 Months               | Reduce your basis in the stock you buy by the amount you received for the put.  | Nothing to report for taxes until you sell the stock. The holding period of the option of greater than twelve months has no bearing on the transaction.  | If a put you write is exercised and you buy the underlying stock, decrease your basis in the stock by the amount you received for the put. Your holding period for the stock begins on the date you buy it, not on the date you wrote the put.   | Sale of LEAPS Puts in synthetic long positions  |             |
| 5                               | Long Put (Bought the Put)   | The Option expired or was sold before expiration               | Less than 12 Months                  | Report the cost of the put as a capital loss on the date it expires. Report the difference between the cost of the put and the amount you receive for it as a capital gain or loss.                 | Short-term Gain (Loss)   | Not Applicable   | Purchased as a hedge or protection in vertical spread                                   |             |
| 6                               | Long Put (Bought the Put)   | Exercise the Option (Sold the stock to someone else.)          | Less than 12 Months                  | Reduce your amount realized from sale of the underlying stock by the cost of the put.   | Not Applicable   | Any gain or loss on the sale of the underlying stock is long term or short term depending on your holding period for the underlying stock.   | Purchased as a hedge or protection in vertical spread                                   |             |
| 7                               | Long Put (Bought the Put)   | The Option expired or was sold before expiration               | Greater than 12 Months               | Report the cost of the put as a capital loss on the date it expires. Report the difference between the cost of the put and the amount you receive for it as a capital gain or loss.                 | Long-term Capital Gain (Loss)  | Not Applicable   | Purchased as a hedge  |             |
| 8                               | Long Put (Bought the Put)   | Exercise the Option (Sold the stock to someone else.)          | Greater than 12 Months               | Reduce your amount realized from sale of the underlying stock by the cost of the put.   | Not Applicable   | Any gain or loss on the sale of the underlying stock is long term or short term depending on your holding period for the underlying stock.   | Purchased as a hedge  |             |
| 9                               | Short Call (Sold the Call)  | The Option expired or was bought back before expiration        | Less than 12 Months                  | Sale price or the difference between original sale and buy-back price   | If your obligation expires, the amount you received for writing the call or put is short-term capital gain. If you enter into a closing transaction by paying an amount equal to the value of the put or call at the time of the payment, the difference between the amount you pay and the amount you receive for the put or call is a short-term capital gain or loss. | Not Applicable   | Short term income strategies  |             |
| 10                              | Short Call (Sold the Call)  | Shares Called Away   | Less than 12 Months                  | If a call you write is exercised and you sell the underlying stock, increase your amount realized on the sale of the stock by the amount you received for the call when figuring your gain or loss. | Not Applicable   | If a call you write is exercised and you sell the underlying stock, increase your amount realized on the sale of the stock by the amount you received for the call when figuring your gain or loss. The gain or loss is long term or short term depending on your holding period of the stock. | Assuming sale of covered calls. Short term income strategies                            |             |
| 11                              | Short Call (Sold the Call)  | The Option expired or was bought back before expiration        | Greater than 12 Months               | Sale price or the difference between original sale and buy-back price   | If your obligation expires, the amount you received for writing the call or put is short-term capital gain. If you enter into a closing transaction by paying an amount equal to the value of the put or call at the time of the payment, the difference between the amount you pay and the amount you receive for the put or call is a short-term capital gain or loss. | Not Applicable   | Not likely to do this. Synthetic short positions  |             |
| 12                              | Short Call (Sold the Call)  | Shares Called Away   | Options > 12 Months                  | If a call you write is exercised and you sell the underlying stock, increase your amount realized on the sale of the stock by the amount you received for the call when figuring your gain or loss. | Not Applicable   | If a call you write is exercised and you sell the underlying stock, increase your amount realized on the sale of the stock by the amount you received for the call when figuring your gain or loss. The gain or loss is long term or short term depending on your holding period of the stock. | Not likely to do this. Assume only with covered calls.                                  |             |
| 13                              | Long Call (Bought the Call) | The Option expired or was sold before expiration               | Less than 12 Months                  | Report the cost of the call as a capital loss on the date it expires. Or The difference between its cost and the amount you receive for it  | Short-term Gain (Loss)   | Not Applicable   | Short term income strategies  |             |
| 14                              | Long Call (Bought the Call) | Exercise the Option (Purchased the stock at the strike price.) | Less than 12 Months                  | Add call premium you originally paid to your new stock cost (nothing to report for taxes until you sell the stock).   | Not Applicable   | Any gain or loss on the sale of the underlying stock is long term or short term depending on your holding period for the underlying stock.   | Short term income strategies Not likely to exercise a long call.                        |             |
| 15                              | Long Call (Bought the Call) | The Option expired or was sold before expiration               | Greater than 12 Months               | Report the cost of the call as a capital loss on the date it expires. Or The difference between its cost and the amount you receive for it.   | If you sell the put or the call before you exercise it, the difference between its cost and the amount you receive for it is either a long-term or short-term capital gain or loss, depending on how long you held it.   | Not Applicable   | Sale of LEAPS Calls in synthetic long positions   |             |
| 16                              | Long Call (Bought the Call) | Exercise the Option (Purchased the stock at the strike price.) | Greater than 12 Months               | Add call premium you originally paid to your new stock cost (nothing to report for taxes until you sell the stock).   | Nothing to report for taxes until you sell the stock. The holding period of the option of greater than twelve months has no bearing on the transaction.  | Any gain or loss on the sale of the underlying stock is long term or short term depending on your holding period for the underlying stock.   | Sale of LEAPS Calls in synthetic long positions. Not likely to do exercise a long call. |             |

Consult IRS Publication 550 <http://www.irs.gov/publications/p550/ch04.html> for current regulations. There may be changes from year to year.

Cells colored white; this text was copied directly from IRS Publication 550 for the 2013 tax year.

Darker colored cells are the author's interpretation and may not be correct. This is not tax advice.



# MILLENNIOUS

## PERSONAL HEDGE FUND – TAX CONSIDERATIONS

**What is the key characteristic of “European Style” options?**



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## PERSONAL HEDGE FUND – TAX CONSIDERATIONS

### 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% - Short Term gains max rate is 56.7%



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## PERSONAL HEDGE FUND – TAX CONSIDERATIONS

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.



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## PERSONAL HEDGE FUND – TAX CONSIDERATIONS

### Tax Loss Harvesting

Your Schedule D from last year's return will show you if you have any tax loss carry forward to offset gains this year.

#### Part I Short-Term Capital Gains and Losses – Assets Held One Year or Less

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

|   | (d)<br>Proceeds<br>(sales price) | (e)<br>Cost<br>(or other basis) | (g)<br>Adjustments to<br>gain or loss<br>from Form(s)<br>8949, Part I,<br>line 2, col (g) | (h)<br>Gain or (loss)<br>Subtract col (e)<br>from col (d) and<br>combine the<br>result with col (g) |
|---|----------------------------------|---------------------------------|---|---|
| <b>1a</b> Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank.   |                                  |                                 |   |   |
| <b>1b</b> Short-term totals from all Form(s) 8949 with <b>box A</b> checked.  | \$10,000.00                      | \$6,000.00                      |   | \$4,000.00  |
| <b>2</b> Short-term totals from all Form(s) 8949 with <b>box B</b> checked.   |                                  |                                 |   |   |
| <b>3</b> Short-term totals from all Form(s) 8949 with <b>box C</b> checked.   |                                  |                                 |   |   |
| <b>4</b> Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824:<br><b>A</b> Form(s) 6252, Installment Sale Income.....<br><b>B</b> Form(s) 4684, Casualties and Thefts.....<br><b>C</b> Form(s) 6781, Gains and Losses from Section 1256 Contracts and Straddles.....<br><b>D</b> Form(s) 8824, Like-Kind Exchanges..... |                                  |                                 | \$4,000.00  |   |
| Total.....  |                                  |                                 |   | 4 \$4,000.00  |
| <b>5</b> Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1.....   |                                  |                                 |   | 5   |
| <b>6</b> Short-term capital loss carryover. Enter the amount, if any, from line 8 of your <b>Capital Loss Carryover Worksheet</b> .   |                                  |                                 |   | 6 -\$10,000.00  |
| <b>7</b> <b>Net short-term capital gain or (loss).</b> Combine lines 1 through 6 in column (h)....  |                                  |                                 |   | 7 -\$2,000.00   |

#### Part II Long-Term Capital Gains and Losses – Assets Held More Than One Year

See instructions for how to figure the amounts to enter on the lines below. to complete if you round off cents to

This form may be easier to complete if you round off cents to whole dollars.

|  | (d)<br>Proceeds<br>(sales price) | (e)<br>Cost or other<br>basis from | (g)<br>Adjustments to<br>gain or loss<br>from Form(s)<br>8949, Part II,<br>line 4, col (g) | (h)<br>Gain or (loss)<br>Subtract col (e)<br>from col (d) and<br>combine the<br>result with col (g) |
|--|----------------------------------|------------------------------------|--|---|
| <b>8a</b> Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank.   |                                  |                                    |  |   |
| <b>8b</b> Long-term totals from all Form(s) 8949 with <b>box D</b> checked.  | \$5,000.00                       | \$2,000.00                         |  | \$3,000.00  |
| <b>9</b> Long-term totals from all Form(s) 8949 with <b>box E</b> checked.   |                                  |                                    |  |   |
| <b>10</b> Long-term totals from all Form(s) 8949 with <b>box F</b> checked.  |                                  |                                    |  |   |
| <b>11</b> Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824:<br><b>A</b> Form 4797, Sales of Business Property (Gain from Part I).....<br><b>B</b> Form(s) 6252, Installment Sale Income.....<br><b>C</b> Form(s) 4684, Casualties and Thefts.....<br><b>D</b> Form(s) 6781, Gains and Losses from Section 1256 Contracts and Straddles.....<br><b>E</b> Form(s) 8824, Like-Kind Exchanges.....<br><b>F</b> Form(s) 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains..... |                                  |                                    | \$6,000.00   |   |
| Total.....   |                                  |                                    |  | 11 \$6,000.00   |
| <b>12</b> Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1.....  |                                  |                                    |  | 12  |
| <b>13</b> Capital gain distributions.....  |                                  |                                    |  | 13  |
| <b>14</b> Long-term capital loss carryover. Enter the amount, if any, from line 13 of your <b>Capital Loss Carryover Worksheet</b> .   |                                  |                                    |  | 14 -\$8,000.00  |
| <b>15</b> <b>Net long-term capital gain or (loss).</b> Combine lines 8 through 14 in column (h)....  |                                  |                                    |  | 15 \$1,000.00   |



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## PERSONAL HEDGE FUND – TAX CONSIDERATIONS

### Tax Loss Harvesting

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

Download: PDF

Export: XLS

TXF

TXT

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(\$) |
|----------|------------|-----|-----------|----------|------------|--------------|----------|-----------------|-----------------|
|----------|------------|-----|-----------|----------|------------|--------------|----------|-----------------|-----------------|



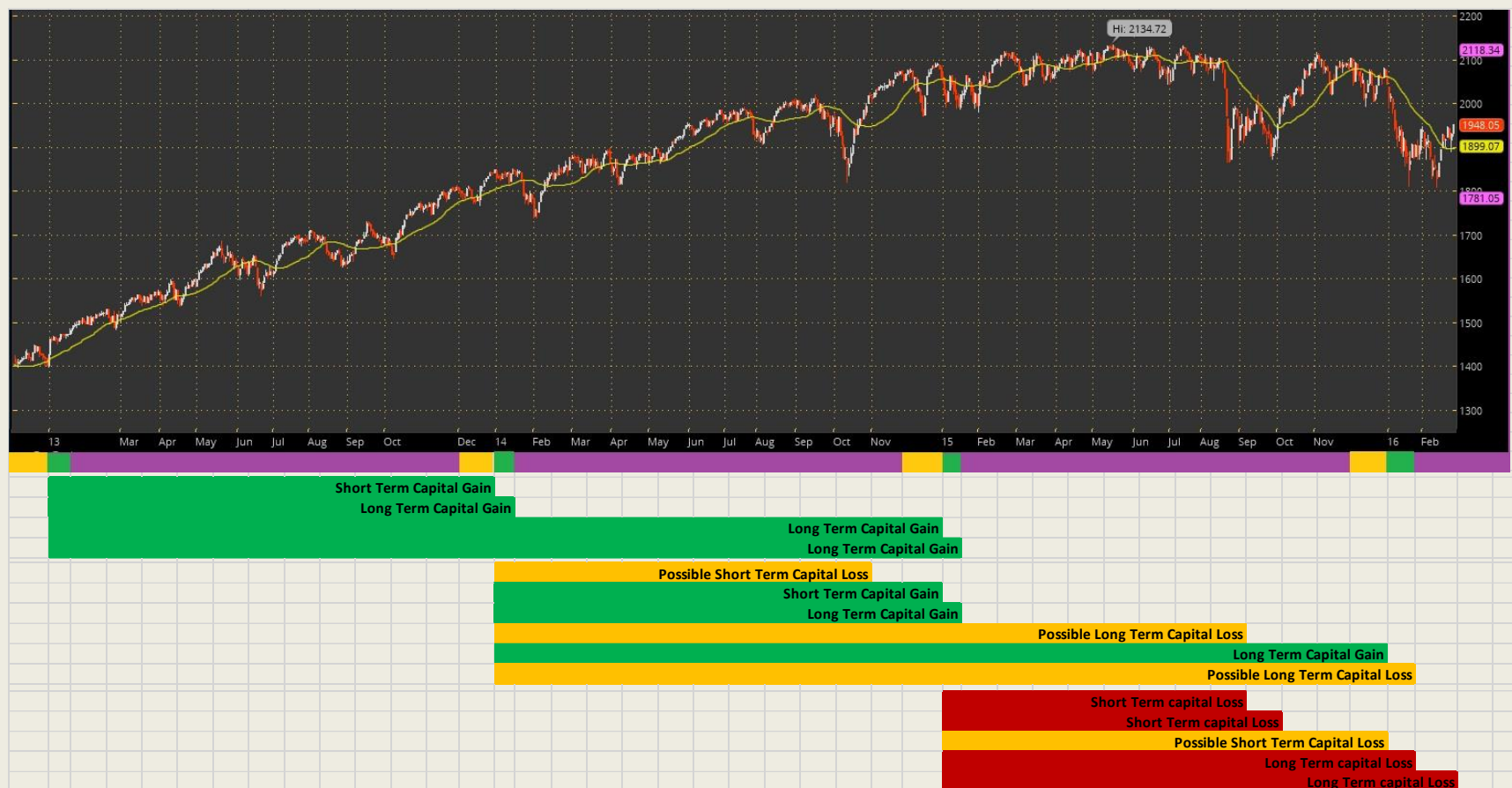


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## PERSONAL HEDGE FUND – TAX CONSIDERATIONS

Tax Loss Harvesting - Making the best of a bad situation...

I carefully track the length of time I hold a LEAPS call and look for opportunities in a market correction. It's complicated.







Used the Morningstar hedge fund example report as a template

Developed Excel spreadsheet to track data and fill in the template

Used results to determine how to manage the portfolio

## How to interpret results?

## What do I want to change?

## How to trade for improvements?

12/31/2015

Page 1 of 1

TERRY WALTERS - PERSONAL HEDGE FUND

DEC 2015

Hedge Fund Summary

Investment Strategy

The fund invests in US equities and indexes primarily via purchasing deep in the money LEAPS calls one to two years into the future. Twenty to forty positions are secured and funds are divided roughly equally among assets at purchase. Covered calls and covered strategies are sold monthly to generate income. The fund 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 fund 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 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.

Currency

Benchmark 1

Benchmark 2

Morningstar Category

USD

S&P 500 (SP500TR)

N/A

HF Equity Net Long Exposure

Performance: Growth of \$10,000

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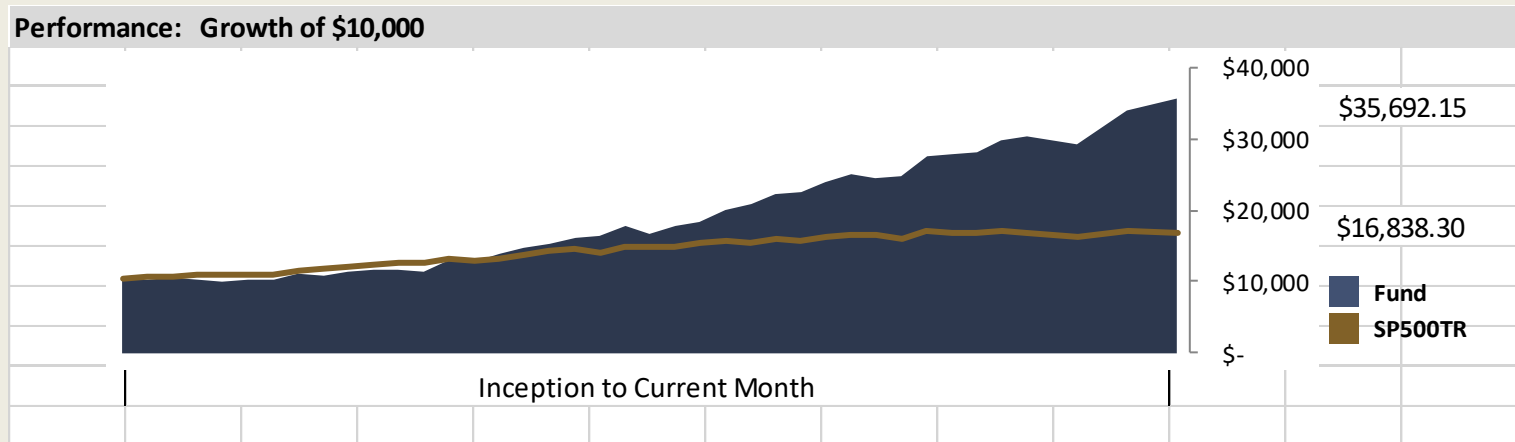


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## PERSONAL HEDGE FUND – PORTFOLIO PERFORMANCE MEASUREMENT

Growth of \$10,000 since inception

This is the graph that all of the mutual funds and hedge fund managers use. Real “Feel Good” stuff.



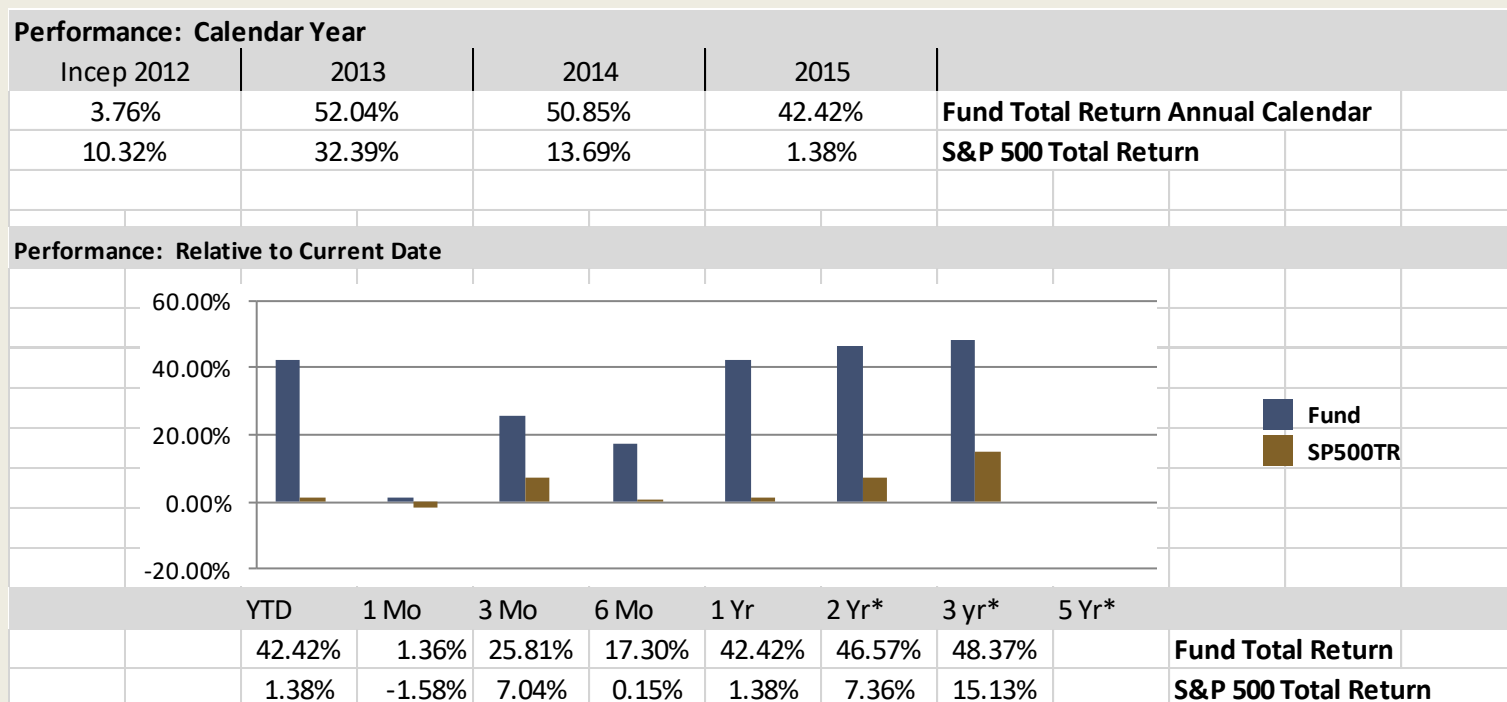


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## PERSONAL HEDGE FUND – PORTFOLIO PERFORMANCE MEASUREMENT

### The Total Returns Graphs

More “Feel Good” stuff.



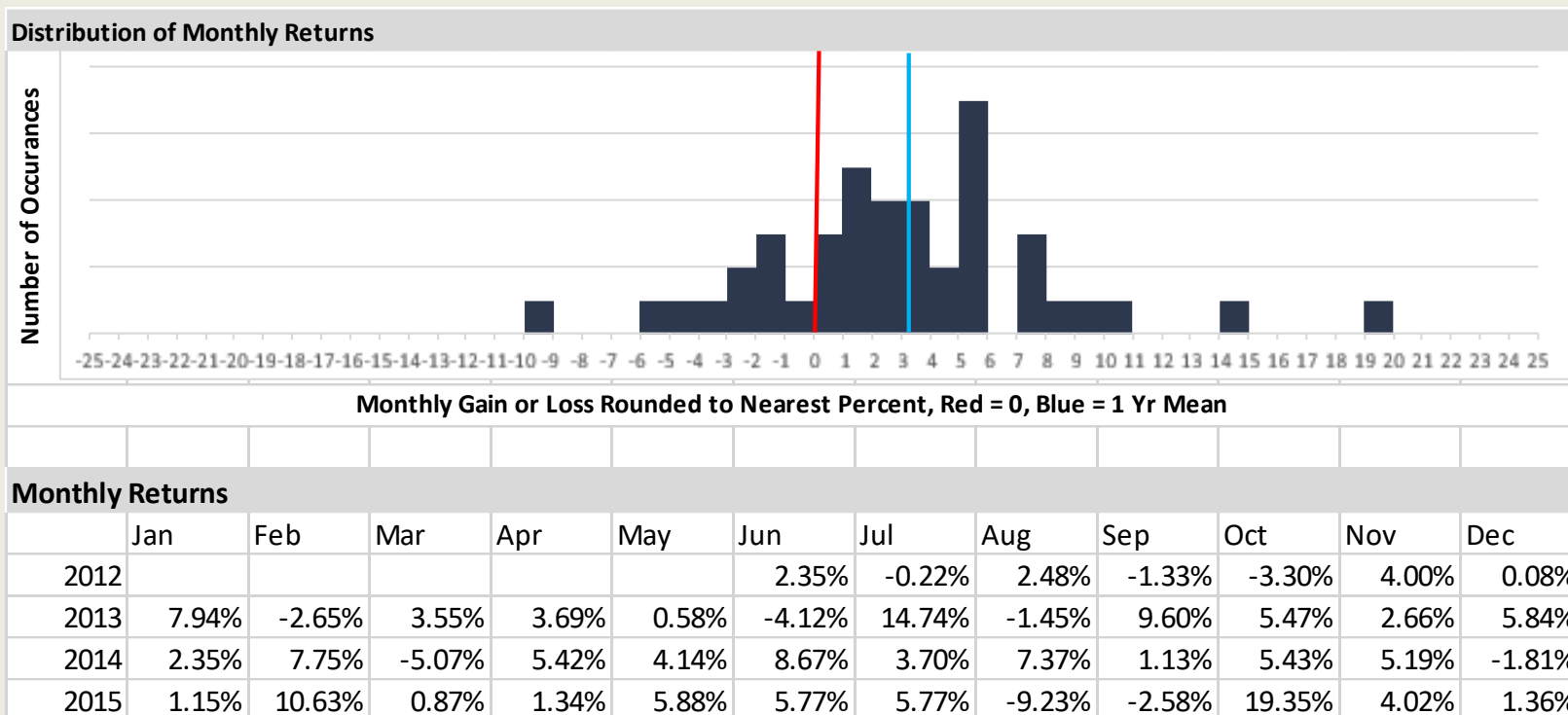


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## PERSONAL HEDGE FUND – PORTFOLIO PERFORMANCE MEASUREMENT

### Distribution of Monthly Returns

This is much more useful to see how I am doing.

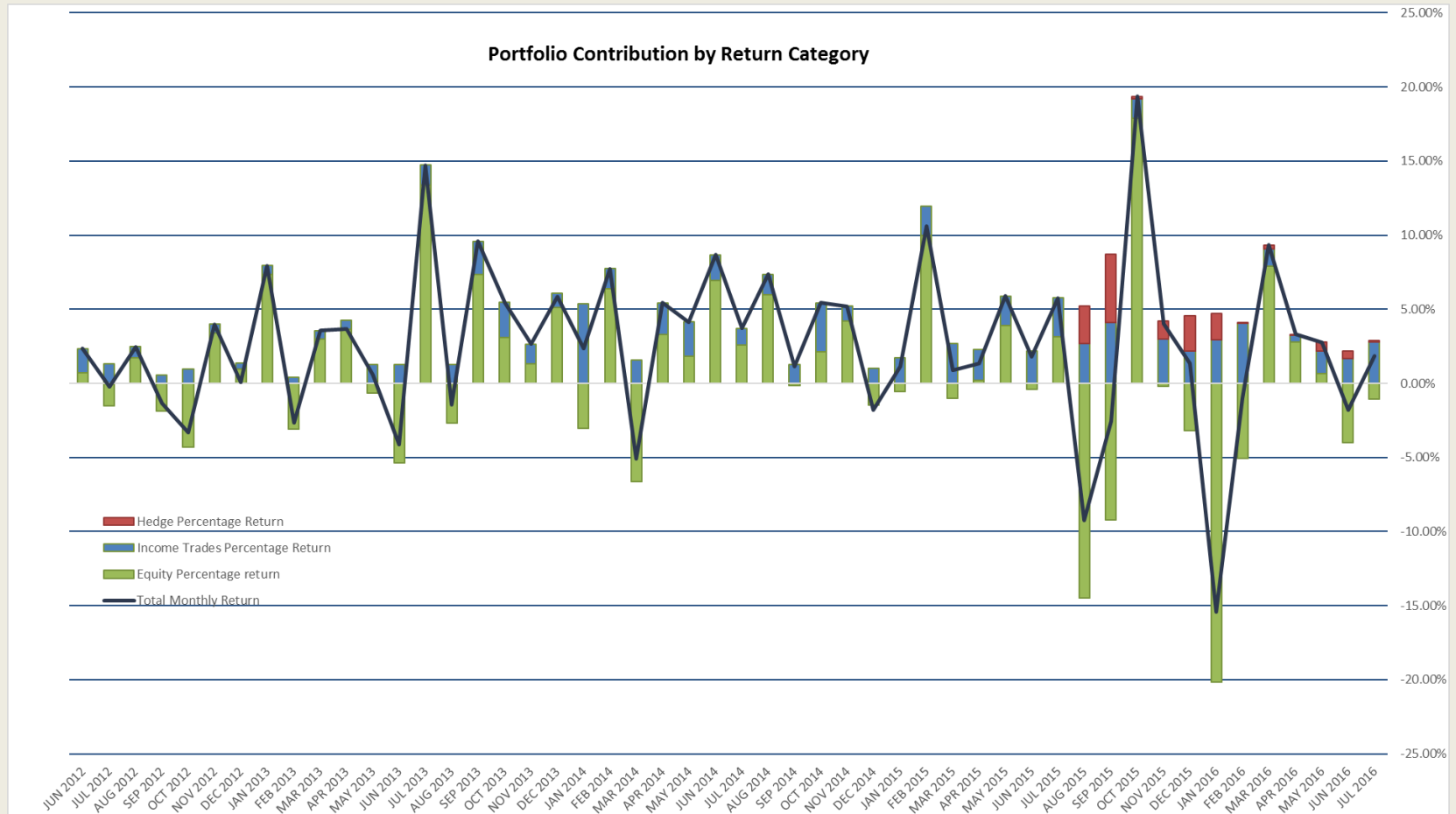




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## PERSONAL HEDGE FUND

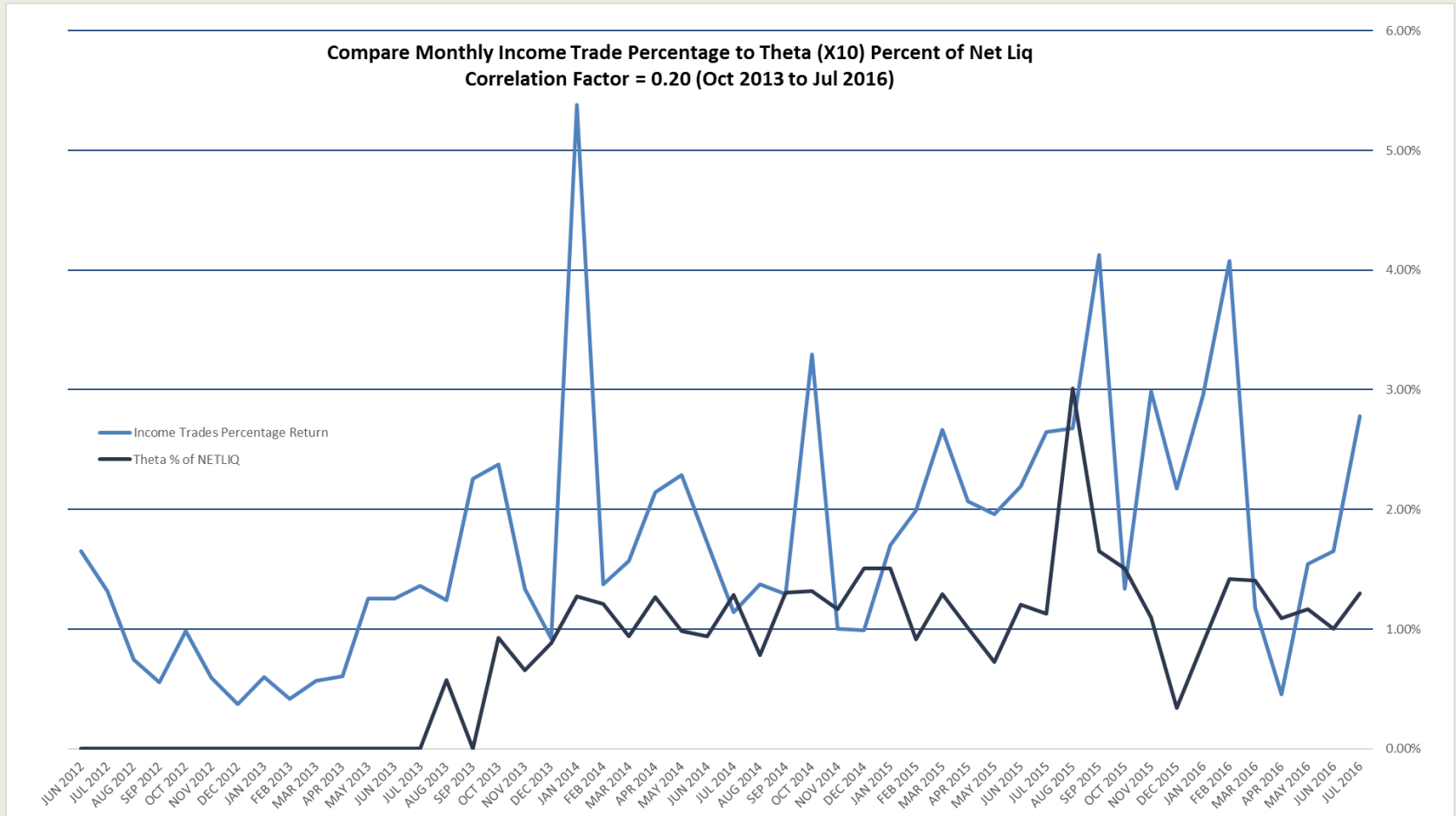
Large market moves dramatically affect this portfolio although the combination of hedging and premium income mitigates the down side. Better hedging techniques and quickly exiting down-trending stocks should help.





# MILLENNIOUS PERSONAL HEDGE FUND

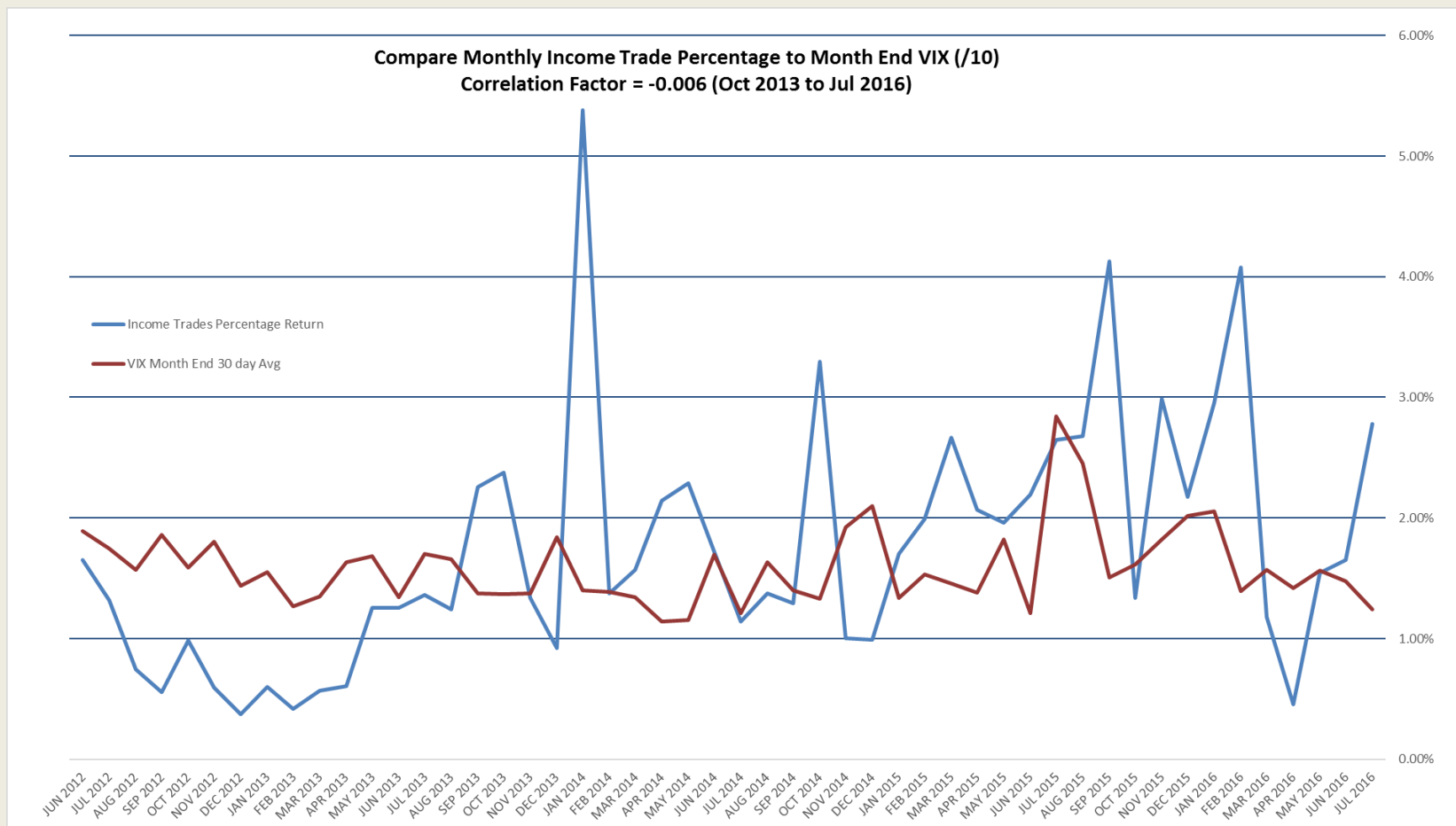
It appears that managing to keep theta above 0.1% of Net Liq is a key to generating good income, though they are not as highly correlated as I would have thought.





# MILLENNIOUS PERSONAL HEDGE FUND

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.





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## PERSONAL HEDGE FUND – PORTFOLIO PERFORMANCE MEASUREMENT

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





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## PERSONAL HEDGE FUND – PORTFOLIO PERFORMANCE MEASUREMENT

### 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   | 2 Yr   | 3 Yr   |                           | Portfolio and Market Statistics |      |        |  |  |
| Mean (Avg) Return   | 3.36%  | 3.53%  | 3.62%  |                           | Alpha* 1 Yr                     |      | 15.2%  |  |  |
| Standard Deviation  | 6.69%  | 5.46%  | 5.37%  |                           | Beta 1 Yr                       |      | 1.70   |  |  |
| Skewness (Pos = Right)  | 0.720  | 0.401  | 0.388  |                           | R-Squared (Portfolio)           |      | 92.0%  |  |  |
| Kurtosis (Pos = Peaked)   | 2.240  | 2.448  | 1.480  |                           | Average Return from Incep       |      | 3.13%  |  |  |
| Positive Months   | 10     | 20     | 29     |                           | Treynor Ratio* 3 Yr             |      | 27.1%  |  |  |
| Negative Months   | 2      | 4      | 7      |                           | VIX                             |      | 18.21% |  |  |
| Worst Month   | -9.23% | -9.23% | -9.23% |                           | 10 Year Treasury Bills          |      | 2.27%  |  |  |
| Max Drawdown  | 10.28% | 10.28% | 10.28% |                           | Risk Free Rate*                 |      | 0.02%  |  |  |
| Portfolio Risk  | 1 Yr   | 2 Yr   | 3 Yr   | Market Risk (SP500TR)     | 1 Yr                            | 2 Yr | 3 Yr   |  |  |
| Sharpe Ratio *  | 1.67   | 2.19   | 2.30   | Sharpe Ratio * (SP500TR)  | 0.16                            | 0.69 | 1.38   |  |  |
| Sortino Ratio *   | 4.20   | 5.44   | 6.20   | Sortino Ratio * (SP500TR) | 0.28                            | 1.25 | 2.74   |  |  |
| * Risk Free Rate is the USTREAS Treasury Bill Auction Average 3 Month |        |        |        |                           |                                 |      |        |  |  |
|   |        |        |        |                           |                                 |      |        |  |  |
| Cash & Options Performance - EOM Snapshot & Full Month Totals         |        |        |        |                           |                                 |      |        |  |  |
| Cash Percent of Portfolio   | 31.4%  |        |        | Interest % of Cash        | 0.000%                          |      |        |  |  |
| Delta % of Net Liq  | 0.61%  |        |        | Dividends % of Net Liq    | 0.000%                          |      |        |  |  |
| Theta % of Net Liq  | 0.034% |        |        | Premium % of Net Liq      | 4.64%                           |      |        |  |  |



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## PERSONAL HEDGE FUND – PORTFOLIO PERFORMANCE MEASUREMENT

**Yesterday: 4/12/2017**

**Theta/Net Liq    0.14%    Relative to front month expiration**

**Delta/Net Liq    0.04%    SPX weighted**

**Cash/Net Liq    66.7%**



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## PERSONAL HEDGE FUND

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

Very concerned about possible pullback – lots of long deltas.  
Need more hedging experience; up and down markets.  
Continuing to investigate more hedging techniques.

Continue to convert traditional IRAs to Roth IRAs.

Get a better understanding of risk measurements –  
interpretation of the data and actions to take as a result.

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