



TERRY WALTERS
TRADING OPTIONS IN AN IRA

Trading Options In An IRA Without Blowing Up The Account

May 19, 2018

Version 1



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.



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The Overview

The personal situation

The investing thesis

I am an investor not a “trader”

Investing in an IRA

How much should I risk?

Which underlying equities should I use?

Call Debit Spreads - Bull Call Spreads, Long Call Verticals, etc.

Synthetic Bonds – Collared Long Stock

Measuring Portfolio Risk & Hedging

Monthly Account Performance



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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.

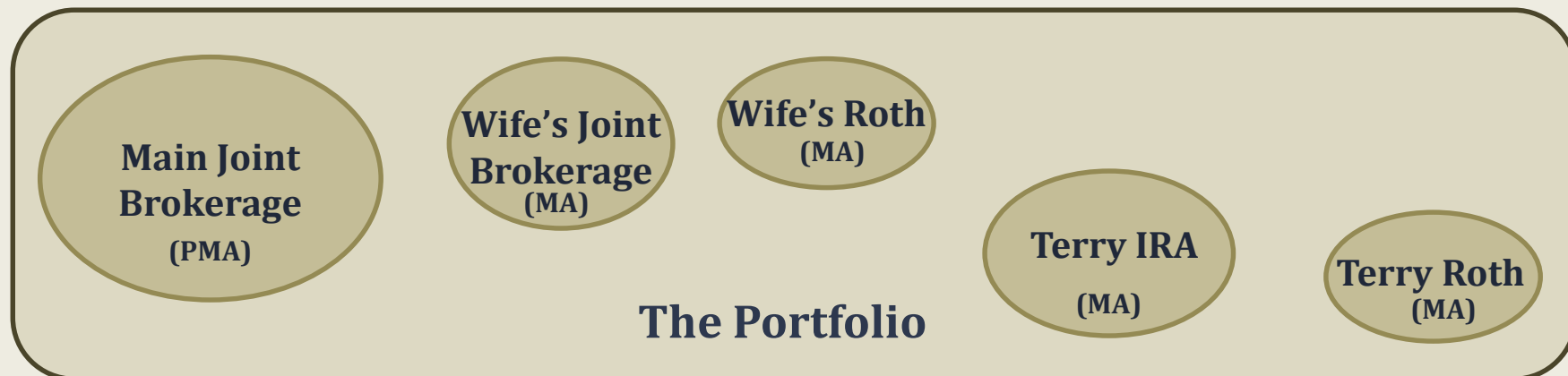
Options Investing: The options pricing model is a good predictor of the price of an equity option in the short term; that is 4 to 90 days. In the short term, markets themselves force individual equity prices to move out of sync with the Fair Value of future cash flows of the underlying equity.

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.



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“The Portfolio” consists of these five 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.

I am no longer tracking monthly premiums separately as income. I am simply tracking EOM brokerage statement balances.

IRAs are traded very differently from taxable accounts.



A “Campaign” of trades...

I am a directional trader.

Since I am an investor, my intention is to maintain my investment in the underlying equity over time.

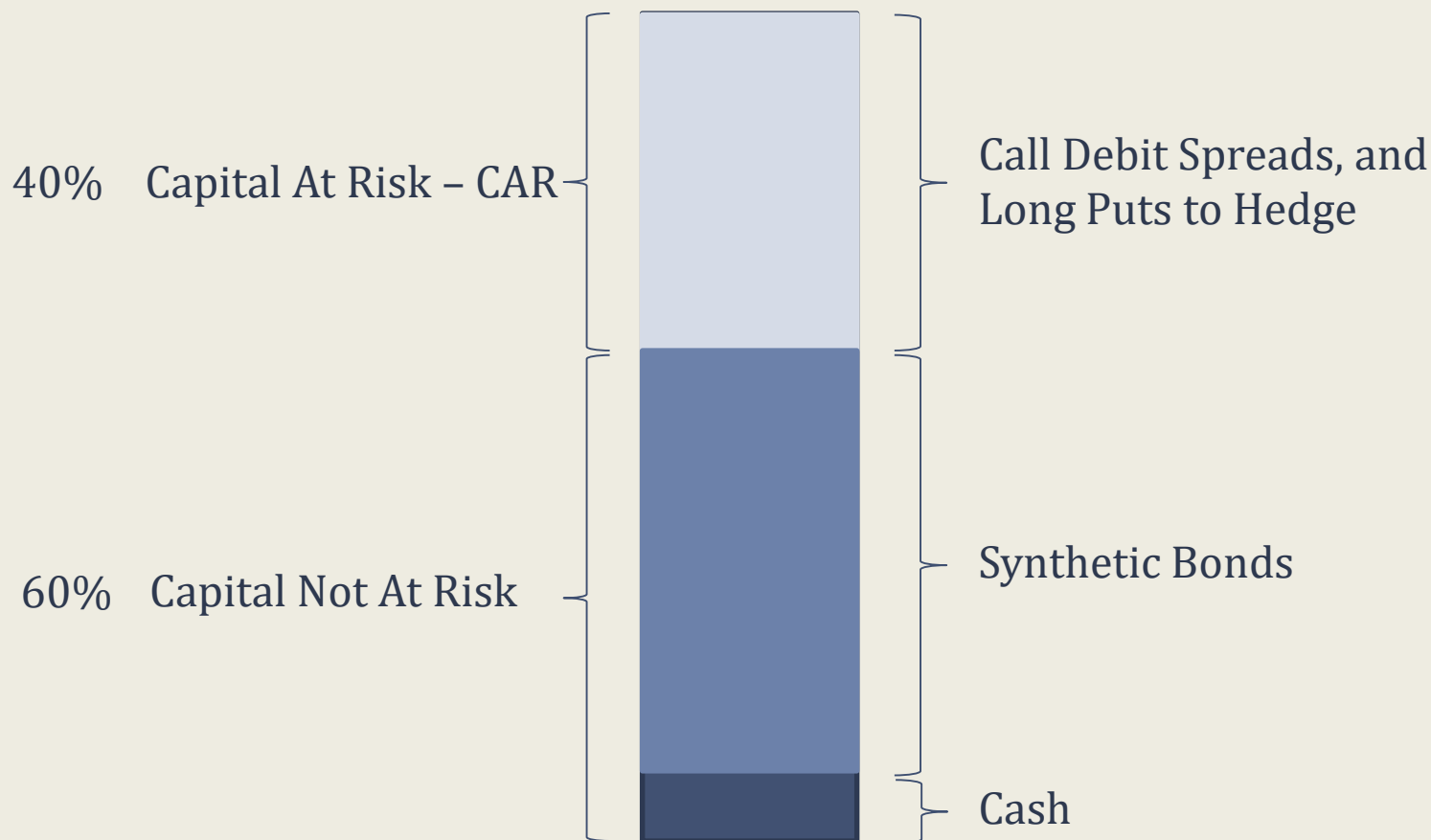
My trading is not a group of “one off” trades.

I see my trading as a campaign. A series of trades. Each trade rolls to the next month as long as I believe that institutional investors will continue their support of the underlying business.



IRAs – How much capital am I willing to risk?

Net Liquidation Value = 100% of the account



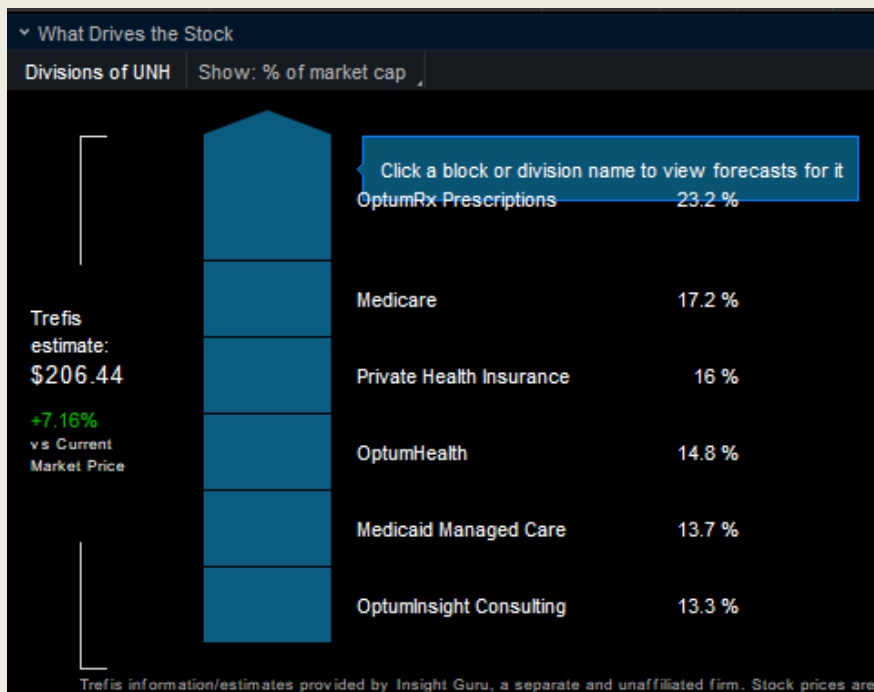


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Selecting the Equity - Discounted Cash Flow Analysis:

I will trade an equity if it trades above the FV if the business case is sound, management is in control and institutional investors have supported the price. But, if the underlying is trading above its Fair Value it is by definition “speculative”. I need watch for any change in the fundamental business case and always be prepared to exit.



I watch for “value traps” - GE, GILD, IBM, etc.

I don't trade “turn around stories”.

I don't trade drug developers.



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Selecting the Equity - Moving Averages:

I trade trending stocks. I want to trade a stock that has been trending up-n-to the right for a year or more.

I use the 50/100 EMA. I stay in products that are trending upward. I consider exiting when the 50 day crosses below the 100 day on a 2Yr chart.





Real Time Data (RTD) functions in Microsoft Office Excel

The spreadsheets depend on TOS and Excel on Windows

Thinkorswim supports the RTD function allowing me to create Excel spreadsheets using live data from the TOS streams.

Export data from a TOS window To Microsoft Excel

Paste the data into a Worksheet to invoke the function in Excel

As long as TOS is running the workbook will pull live data from TOS

The screenshot shows the Thinkorswim 'MarketWatch' window. The table displays the following data:

Symbol	Last	Delta	Strike	Theta	Mark	Intrinsic	Extrinsic
AABA	70.39	1.000	N/A	.00	70.390	N/A	N/A
AAPL	166.01	1.000	N/A	.00	166.010	N/A	N/A
AMAT	51.08	1.000	N/A	.00	51.080	N/A	N/A
ANET	257.10	1.000	N/A	.00	257.100	N/A	N/A
C	70.00	1.000	N/A	.00	70.000	N/A	N/A
CAT	154.29	1.000	N/A	.00	154.280	N/A	N/A
CRM	123.18	1.000	N/A	.00	123.180	N/A	N/A
FB	166.00	1.000	N/A	.00	166.010	N/A	N/A
GE	14.575	1.000	N/A	.00	14.575	N/A	N/A
IPIX	.43000	1.000	N/A	.00	.43000	N/A	N/A
MA	177.255	1.000	N/A	.00	177.255	N/A	N/A
RHT	161.86	1.000	N/A	.00	161.860	N/A	N/A
UNH	234.83	1.000	N/A	.00	234.830	N/A	N/A
V	124.585	1.000	N/A	.00	124.585	N/A	N/A

An 'Export' menu is open over the table, with the following options:

- Reset
- Detach
- Show in sidebar
- Print now!
- Print preview...
- Page setup...
- Export
 - To file...
 - To Microsoft Excel
 - To Calc
 - Help on data export
- Take screenshot...



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The Call Debit Spread – Bull Call Spread, Long Call Vertical, etc.

This spreadsheet and explanation are available at www.terrywalters.com/tools.html

New / Existing Call Debit Spread		Exit Analysis		Rolling trade	
Enter these values:				Today is: 4/24/2018	
Stock Ticker.....	AAPL			Enter these values:	
Entry Date.....	4/12/2018 Trade Date			Expiration Date (Friday)	6/15/2018 Pick about 45 - 90 DTE.
Expiration Date (Friday).....	5/18/2018 Expiration Friday			Long Strike (Buy To Open)	\$100.00 Pick about .90 to .95 Delta.
Stock Price - Mark.....	\$174.79 Stock Price on Trade Date			Short Strike (Sell To Open)	\$115.00 Pick a call just below the ATM strike.
Long Strike (Buy To Open).....	\$155.00 Pick about .90 to .95 Delta.				
Short Strike (Sell To Open).....	\$170.00 Pick a call just below the ATM strike.				
Long Strike Premium - Mark.....	\$20.78 Price paid for this option				
Short Strike Premium - Mark.....	\$8.69 Price paid for this option				
		Current Stock Price - Mark	\$162.94	Long Call Mark	\$63.10
Days To expiration	36	Long Call Mark	\$10.400	Short Call Mark	\$48.00
Long Strike Option Code	.AAPL180518C155	Short Call Mark	\$2.400	Days To expiration	52
Short Strike Option Code	.AAPL180518C170	Days Remaining	24	Long Strike Option Code	.AAPL180615C100
Capital At Risk per 1 Lot	\$1,209.00 I can't lose more than this.			Short Strike Option Code	.AAPL180615C115
Breakeven Stock Price	\$167.09 Trade breakeven at expiration.	Current Short Prem vs Trade Pre	28%	Capital At Risk per 1 Lot	\$1,510.00 I can't lose more than this.
Probability of Breakeven or Better	39% 86.4% would be great.	Current Price - Credit (Debit)	\$8.00	Breakeven Stock Price	\$115.10 Trade breakeven at expiration.
Long Extrinsic as % of Strike/Mo	0.5% Adjust long strike to keep below 1%.	Gain (loss)	(\$4.09)	Probability of Breakeven or Better	100% 86.4% would be great.
Trade Cost vs Stock Price	6.9% Shoot for less than 15% or so.	Gain (Loss) Total Dollars	(\$409.00)	Long Extrinsic \$ as % of Strike/Mo	0.1% Adjust long strike to keep below 1%.
Max Gain	\$2.91	Gain -Loss Return On Capital	-33.8%	Max Return On Capital Per Month	9.3% Shoot for less than 15% or so.
Equity Decline % at Breakeven	4.4% Is 10% too much to ask?	Current % of Max Gain -Loss	0.0%	Max Gain	-\$0.10
Downside 5% Return On Capital	-8.6% I'd like a positive number here.	Remaining Potential Gain \$	\$700.00	Equity Decline % at Breakeven	29.4% Is 10% too much to ask?
Max Return On Capital Per Month	20.1% I'd like better than about 8%.	Totals \$ Remaining vs Rolling	\$704.62	Downside 5% Return On Capital	-0.7% I'd like a positive number here.
Max Annual Return On Capital	240.7%	Potential Profits Per Day	\$29.17	Max Return On Capital Per Month	-0.4% I'd like better than about 8%.
Potential Profits Per Day	\$8.08			Max Annual Return On Capital	-4.6%
				Potential Profits Per Day	-\$0.19
Account Management - New / Existing trade		Progress		Account Management - Rolling Trade	
Net Liquidation Value	\$540,339.00 Total value of the account	Total Gain (loss) To Date	(\$2,045.00)	Lot Size	5
Portion of the Account to Trade	40% This is the Capital At Risk	Total \$ Remaining vs Rolling	\$3,523.08	Account Allocation Size	\$31,784.65
Number of Positions	17 How many positions to trade	Rolling Cash Credit (Debit)	-\$3,550.00	Capital At Risk / BP Reduction	\$7,550.00
Account Allocation Size	\$31,784.65	Total Remaining Theta \$	-\$24.00	Total Max Gain Potential \$	-\$50.00
Lot Size Computed	10.5 Estimated Qty for Allocation	Total Position Theta	(1.0)		
Lot Size Actually Placed	5 Round up or down from computed	Total Position Vega	(5.5)		
Capital At Risk	\$6,045.00				



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The Synthetic Bond – Long-dated Collared Stock

This spreadsheet and explanation are available at www.terrywalters.com/tools.html

Synthetic Bond Analysis		Rolling the Short Call	
Entered Values:			
Stock Ticker	AMZN	Existing OTM Call Strike	1100
Expiration Date	1/17/2020	Lot Size of Active Trade	1
Trade Date	10/20/2017	Date	1/7/2018
Current Stock Price	\$992.19	Stock Price	\$1,229.14
ATM Put Strike	990	Existing OTM Current Call Price	\$284.75
ATM Put Price	\$136.05	Strike at the premium shown below...	1200
OTM Call Strike	1100	New Call's Premium - Check below...	\$231.75
OTM Call Price - Ideally Same as Put Price	\$135.30		
Lot Size	1		
Dividend Cycles			
Dividend - Quarterly Amount			
Calculated Values:			
DTE	819		
Total Dividends per share for the trade	\$0.00		
Total Potential Dividend Dollars	\$0.00		
Buy Shares - Capital Required	\$99,219.00		
Buy Put - Dollars	(\$13,605.00)	Rolling Trade Credit (Debit)	(\$5,300.00)
Sell Call - Dollars	\$13,530.00	Additional Gain at Expiration	\$10,000.00
Option Trade - Credit (Debit)	(\$75.00)	Rolling Ratio	53%
Max Loss - Not considering Dividends	\$294.00		
Total Cost of Trade	\$99,294.00	New Total Cost of Trade	\$104,594.00
Notional Long Put - the "Cash"	\$99,000.00	New Notional Long Call- the "Cap"	\$120,000.00
Notional Long Call- the "Cap"	\$110,000.00		
Trade At Expiration		Trade At Expiration	
Gain - Underlying trades above Call Strike (includes dividends)	\$10,706.00	Max Gain	\$15,406.00
Total Return On Capital	10.78%	Total ROC	14.73%
Rreturn On Capital Annualized	4.81%	ROC Annualized	6.56%
Gain - Underlying is below Put Strike (includes dividends)	(\$294.00)	Max Loss	(\$5,594.00)
Total Return On Capital	-0.30%	Total ROC	-5.35%
Rreturn On Capital Annualized	-0.13%	ROC Annualized	-2.38%



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The Long Put – A Simple Hedge Trade

This spreadsheet and explanation are available at www.terrywalters.com/tools.html

Portfolio Risk Measurement and Hedge Trade Evaluation							
Date	4/29/2018	Delta	348	Hedge	SPX	Hedge Cost	\$1,740.00
Acct.	Sample	Gamma	-1	Strike	2425	% of Portfolio	0.35%
Net Liq	\$498,490.00	Theta	294	Paid	\$17.40	Cost Per Mo.	0.22%
VIX	15.41	Vega	-558	Delta	-18.69	Annualized	2.23%
SPX	2669			DTE	47		
				20% Below the Mark	10% Below the Mark	5% Below the Mark	At the Mark
		SPX	2135.2	2402.1	2535.55	2669	
Base Case	Account Without Hedge Trades	P/L Open on the Day Line	-\$153,858.00	-\$102,694.00	-\$57,148.00	-\$11,618.00	
		Portfolio	\$356,250.00	\$407,414.00	\$452,960.00		
		Percent Decline	-28.5%	-18.3%	-9.1%		
Hedge only		P/L Open on the Day Line	\$55,853.00	\$14,789.00	\$4,537.00	\$104.00	
		Percent of Portfolio	11.2%	3.0%	0.9%		
Hedge only 30 at IV		P/L Open on the Day Line	\$60,405.00	\$25,031.00	\$13,989.00	\$6,849.00	
		Percent of Portfolio	12.1%	5.0%	2.8%		
Case Two	Account With Hedge Trades	P/L Open on the Day Line	-\$98,004.00	-\$87,905.00	-\$52,610.00	-\$11,514.00	
		Portfolio	\$412,000.00	\$422,099.00	\$457,394.00		
		Percent Decline	-17.4%	-15.3%	-8.2%		
Case Three	Account With Hedge Trades at the 30 IV Line	P/L Open on the 30 IV line	-\$85,505.00	-\$73,266.00	-\$46,044.00	-\$11,514.00	
		Portfolio	\$424,499.00	\$436,738.00	\$463,960.00		
		Percent Decline	-14.8%	-12.4%	-6.9%		

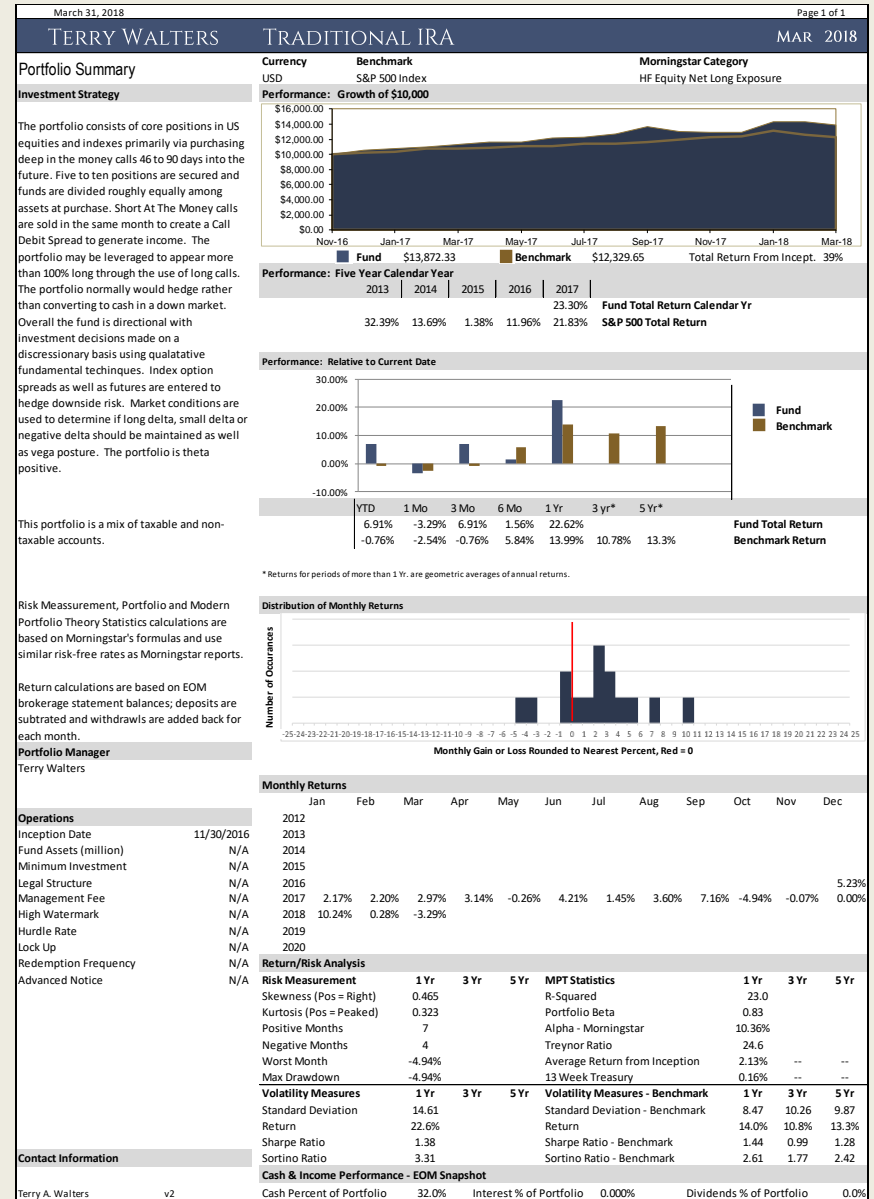
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Yes, another spreadsheet...
www.terrywalters.com/tools.html

Used the Morningstar hedge fund example report as a template

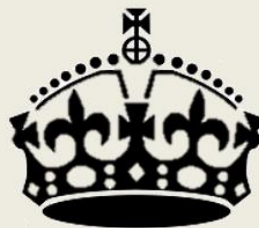
Developed Excel spreadsheet to track data and fill in the template

Simply enter data from monthly brokerage statements in the Source Data Tab.





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**KEEP
CALM
AND
TRADE
ON**