



TERRY WALTERS  
TRADING OPTIONS IN AN IRA

# Trading Options In An IRA Without Blowing Up The Account

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## 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.



## **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?

## **Synthetic Bonds – Collared Long Stock**

## **Bull Call Spreads and Bull Put Spreads**

## **Monthly Account Performance**



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## TRADING OPTIONS IN AN IRA

### **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.

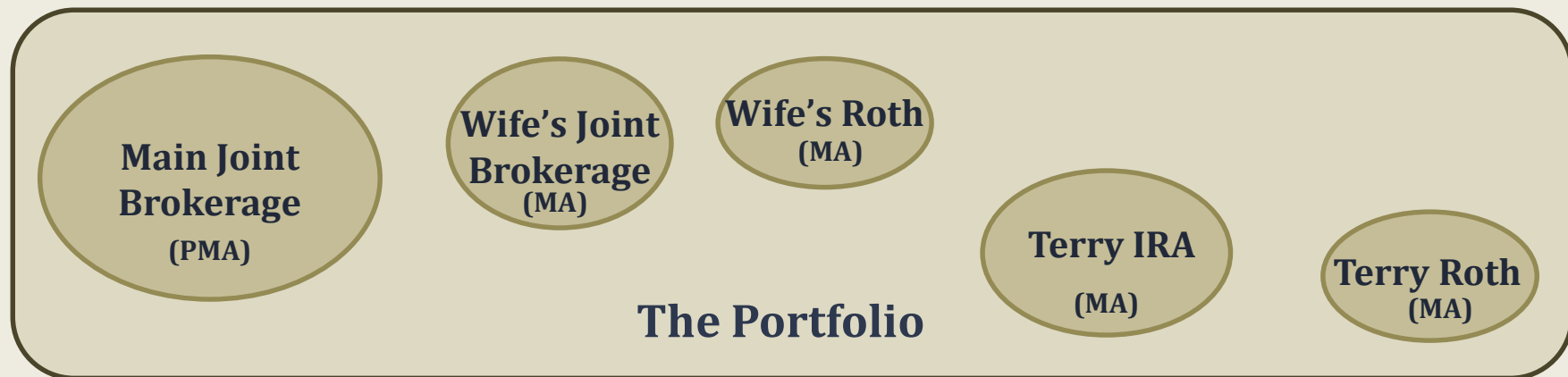
**Options Investing:** The options pricing model is a good predictor of the price of an equity option in the short term; that is 4 to 90 days. In the short term, markets themselves force individual equity prices to move out of sync with the Fair Value of future cash flows of the underlying equity.

**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.



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### **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.

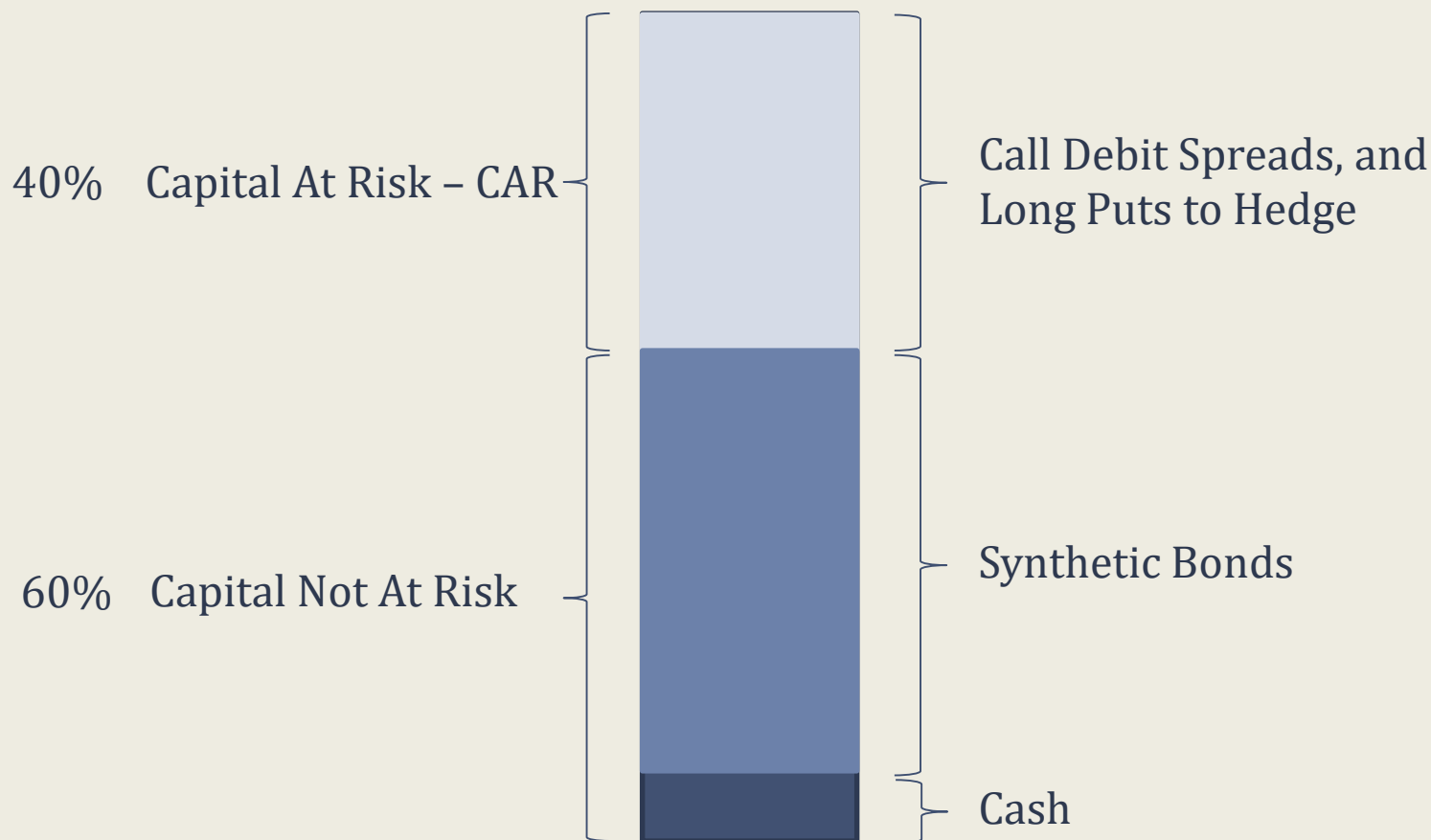
My trading is not a group of “one off” trades.

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?

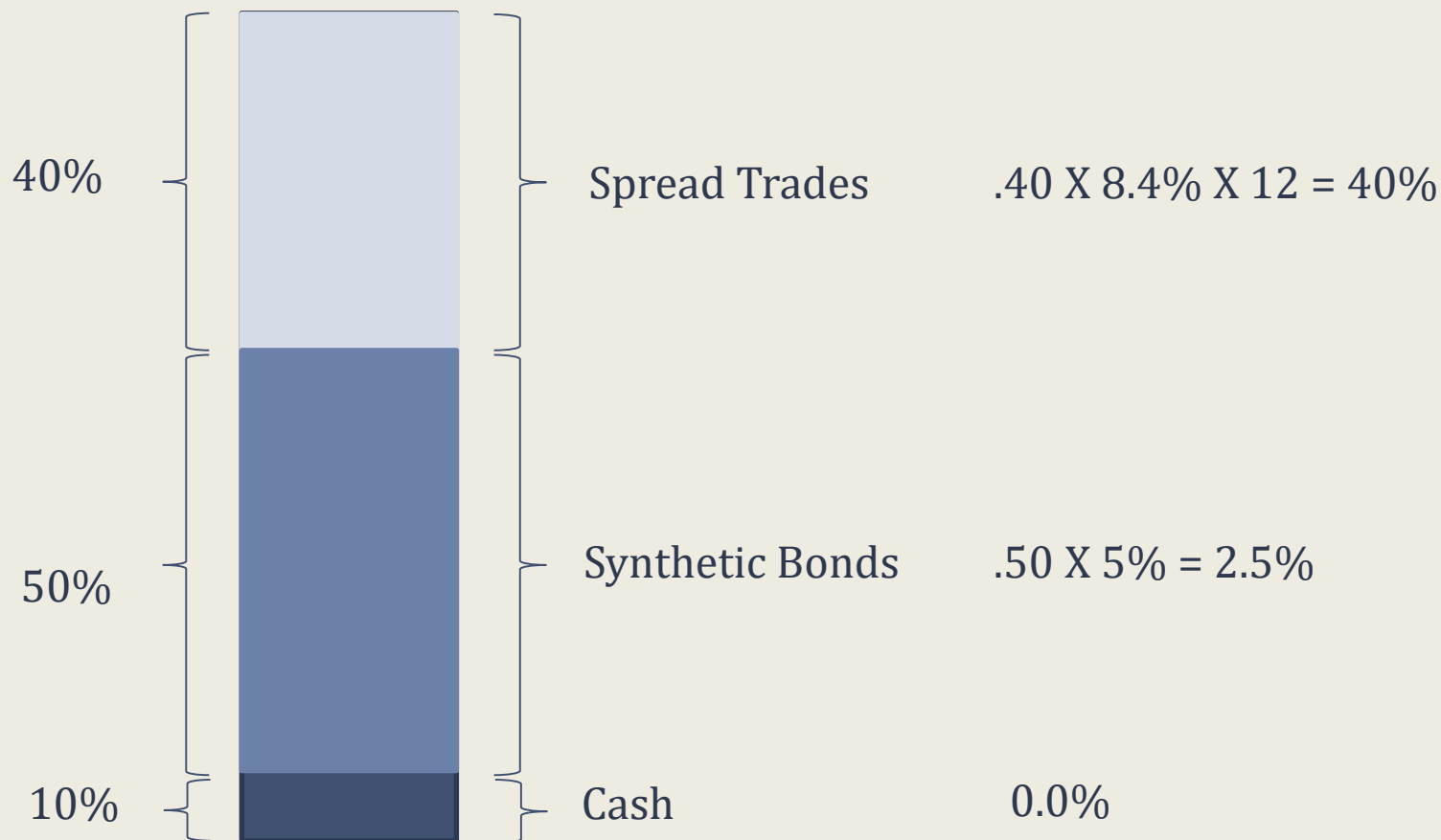
Net Liquidation Value = 100% of the account







## IRAs – How much could I make?



Possible, but not likely = 42.5% Some trades will lose.  
Could lose 100% of the spread trades, but not likely.

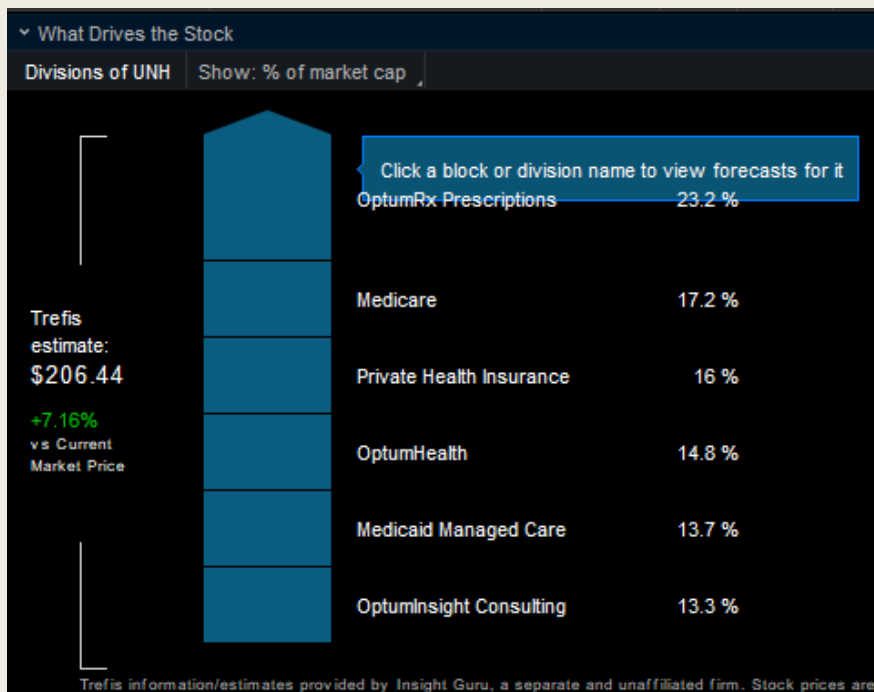


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### Selecting the Equity - Discounted Cash Flow Analysis:

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 software interface with a table of stock data. The table has columns for Symbol, Last, Delta, Strike, Theta, Mark, Intrinsic, and Extrinsic. The 'Export' menu is open, showing options like 'To file...', 'To Microsoft Excel', and 'To Calc'.

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



## **The Synthetic Bond – Conversion Arbitrage or Collared Stock**

Trade Structure – Buy stock - sell a call - buy a put

Effect of Dividends on Returns – Get a boost.

Effect of Implied Vol on the call side – May help.

Getting Filled – Bid/Ask spreads will be wide; be careful.

Assignment Risk - Knowing a good trade entry position.

Exiting the Trade – I am waiting until expiration; but...

Splitting the Strikes – Collared Stock

Rolling the Short Call – More gains, but added risk.



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## TRADING OPTIONS IN AN IRA

### The Synthetic Bond – Conversion Arbitrage or Collared Stock

This spreadsheet and explanation are available at [www.terrywalters.com/tools.html](http://www.terrywalters.com/tools.html)

Conversion Arbitrage - Synthetic Bond Analysis				Rolling the Short Call	
<b>Trade Setup</b>	<b>Simulated Trade</b>		<b>Actual Trade</b>		
Stock Ticker	GE		GE		
Expiration Date	1/17/2020		1/17/2020		
ATM Put Strike (Buy to Open)	5.00		5.00		
OTM Call Strike (Sell to Open)	5.00		5.00		
Trade Date	6/22/2018		6/22/2018		
Current Stock Price	\$12.87		12.88		
ATM Put Price - Mark	\$0.08		\$0.09		
OTM Call Price - Mark	\$8.08		\$7.97		
Lot Size	1		100		
Dividend Cycles	6		6		
Dividend - Quarterly Amount	0.12		0.12		
Sumulate the trade at the Mid and the Natural					
	<b>Mid</b>	<b>Nat</b>			
DTE	574	574	574		
Total Dividends per share for the trade	0.77	0.77	0.72		
Total Potential Dividend Dollars	76.53	76.53	7200.00		
Buy Shares - Capital Required	\$1,286.50	\$1,286.50	\$128,750.00		
Buy Put - Dollars Spent	(\$7.50)	(\$10.00)	(\$900.00)		
Sell Call - Dollars Received	\$807.50	\$800.00	\$79,700.00		
Option Trade - Credit (Debit) at Time of Trade	\$800.00	\$790.00	\$78,800.00	Rolling Trade Credit (Debit)	\$0.00
Max Loss at Expiration (stock cost minus put notional plus credit)	\$13.50	\$3.50	\$50.00	Additional Gain at Expiration	(\$50,000.00)
Max Gain at Expiration (call notional minus stock cost plus credit)	\$13.50	\$3.50	\$50.00	Rolling Ratio	0%
Total Cost of Trade	\$486.50	\$496.50	\$49,950.00		
Notional Long Put - the "Cash"	\$500.00	\$500.00	\$50,000.00	New Total Cost of Trade	\$49,950.00
Notional Long Call- the "Cap"	\$500.00	\$500.00	\$50,000.00	New Notional Long Call	\$0.00
<b>Trade At Expiration</b>				<b>Trade At Expiration</b>	
Gain - Underlying trades above Call Strike (includes dividends)	\$90.03	\$80.03	\$7,250.00	Max Gain	(\$42,750.00)
Total Return On Capital	18.51%	16.12%	14.51%	Total ROC	0.00%
Rreturn On Capital Annualized	11.77%	10.25%	9.23%	ROC Annualized	0.00%
Gain - Underlying is below Put Strike (includes dividends)	\$90.03	\$80.03	\$7,250.00	Max Loss	\$7,250.00
Total Return On Capital	18.51%	16.12%	14.51%	Total ROC	0.00%
Rreturn On Capital Annualized	11.77%	10.25%	9.23%	ROC Annualized	0.00%
Max Value - Includes Dividends	\$576.53	\$576.53	\$57,200.00		
Min Value - Cash Substitute - Can't go below this value.	\$500.00	\$500.00	\$50,000.00		
Min Value - Cash Substitute with dividends	\$576.53	\$576.53	\$57,200.00		



## **Bull Call Spread, Call Debit Spread, Long Call Vertical, etc.**

Trade Structure – Buy a deep in the money call - sell a call near the money.

The long call acts as a “stock replacement”, about 90 delta.

I think of the short call as a “covered call”.

I enter a profitable but “safe” trade

Max Return On Capital per Month – Greater than 8.4%

Probability of Breakeven or Better – Approx. 80%

Equity Decline % at Breakeven – Greater than 5%

I will need to trade “Trader Stocks”:

Lot Size % of Open Interest – Greater than 10%

Fill Risk – Prefer below 20%, or hold out for a fill very close to the Mid

Rolling the trade is an important part of the strategy.



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### Bull Call Spread, Call Debit Spread, Long Call Vertical, etc.

This spreadsheet and explanation are available at

[www.terrywalters.com/tools.html](http://www.terrywalters.com/tools.html)

New / Existing Bull Call Spread				Exit Analysis		Rolling trade	
Stock Ticker.....	AMZN					Today is: 6/21/2018	
Entry Date.....	6/13/2018	Trade Date				Expiration Date (Friday)	7/20/2018
Expiration Date (Friday).....	7/20/2018					Long Strike (Buy To Open)	\$1,530.00 Pick about .90 to .95 Delta
Stock Price - Mark.....	\$1,704.86	Stock Price on Trade Date				Short Strike (Sell To Open)	\$1,630.00 Pick a call just below the ATM strike.
Long Strike (Buy To Open).....	\$1,520.00	Pick about .90 to .95 Delta					
Short Strike (Sell To Open).....	\$1,620.00	Pick a call just below the ATM strike.					
Long Strike Premium - Mark.....	\$201.08	Price paid for this option					
Short Strike Premium - Mark.....	\$110.43	Credit received for this option					
Long Strike Open Interest	246			Current Stock Price - Mark	\$1,754.80	Long Strike Open Interest	246
Lot Size % of Open Interest	1%	Prefer less than 10%		Long Call Mark	\$235.725	Lot Size % of Open Interest	1% Prefer less than 10%
Fill Risk	40.9%	(Nat-Mid)/Max Gain		Short Call Mark	\$140.700	Fill Risk	62.2% (Nat-Mid)/Max Gain
Long Strike Delta	1.00					Long Strike Delta	1.00
Short Strike Delta	0.92					Short Strike Delta	0.90
Probability of Breakeven or Better	90%	Prefer greater than 80%		Short Call % of Max Gain		Probability of Breakeven or Better	91% Prefer greater than 80%
Days To Expiration	37			Days To Expiration	29	Days To Expiration	29
Capital At Risk per 1 Lot	\$9,065.00	Equal to Max Loss		Current Price - Credit (Debit)	\$95.03	Capital At Risk per 1 Lot	\$9,457.50 Equal to Max Loss
Breakeven Stock Price	\$1,610.65	Trade breakeven at expiration.		Gain (Loss)	\$4.38	Breakeven Stock Price	\$1,624.58 Trade breakeven at expiration.
Max Gain, Total \$ per 1 Lot	\$935.00			Gain (Loss) Total Dollars	\$437.50	Max Gain, Total \$ per 1 Lot	\$542.50
Equity Decline % at Max Loss	10.8%			Gain (Loss) Return On Capital	4.8%	Equity Decline % at Max Loss	12.8%
Equity Decline % at Breakeven	5.5%	Prefer greater than 5%		Current % of Max Gain - Loss	46.8%	Equity Decline % at Breakeven	7.4% Prefer greater than 5%
Max Return On Capital Per Month	8.4%	Prefer greater than 8.4%.		Remaining Potential Gain \$	\$930.62	Max Return On Buying Power	5.9% Prefer greater than 8.4%.
Max Annual Return On Capital	100.4%			Totsl \$ Remaining vs Rolling	-\$45.00	Max Annual Return On Capital	71.2%
Potential Profits Per Day	\$25.27			Potential Profits Per Day	\$17.16	Potential Profits Per Day	\$18.71
<b>Account Management</b>				<b>Progress</b>		<b>New Trade - Rolling Trade</b>	
Account Net Liquidation Value	Percent to Trade	No. of Positions	Lot Size Placed			Lot Size of New Trade	
\$600,000.00	40%	16	2	Total CDS Gain (loss) To Date	\$875.00	2	
Lot Size Computed: 2				Rolling Cash Credit (Debit)	\$90.00	Account Allocation Size: \$37,500.00	
Account Allocation Size: \$37,500.00				Total Gain - CDS Plus Roll	\$965.00	Total Max Gain Potential Dollars: \$1,085.00	
Total Max Gain Potential Dollars: \$1,870.00				Total Return On Capital At Risk	5%	Total Capital at Risk: \$18,915.00	
Total Capital At Risk: \$18,130.00						Spreadsheet Version 23	



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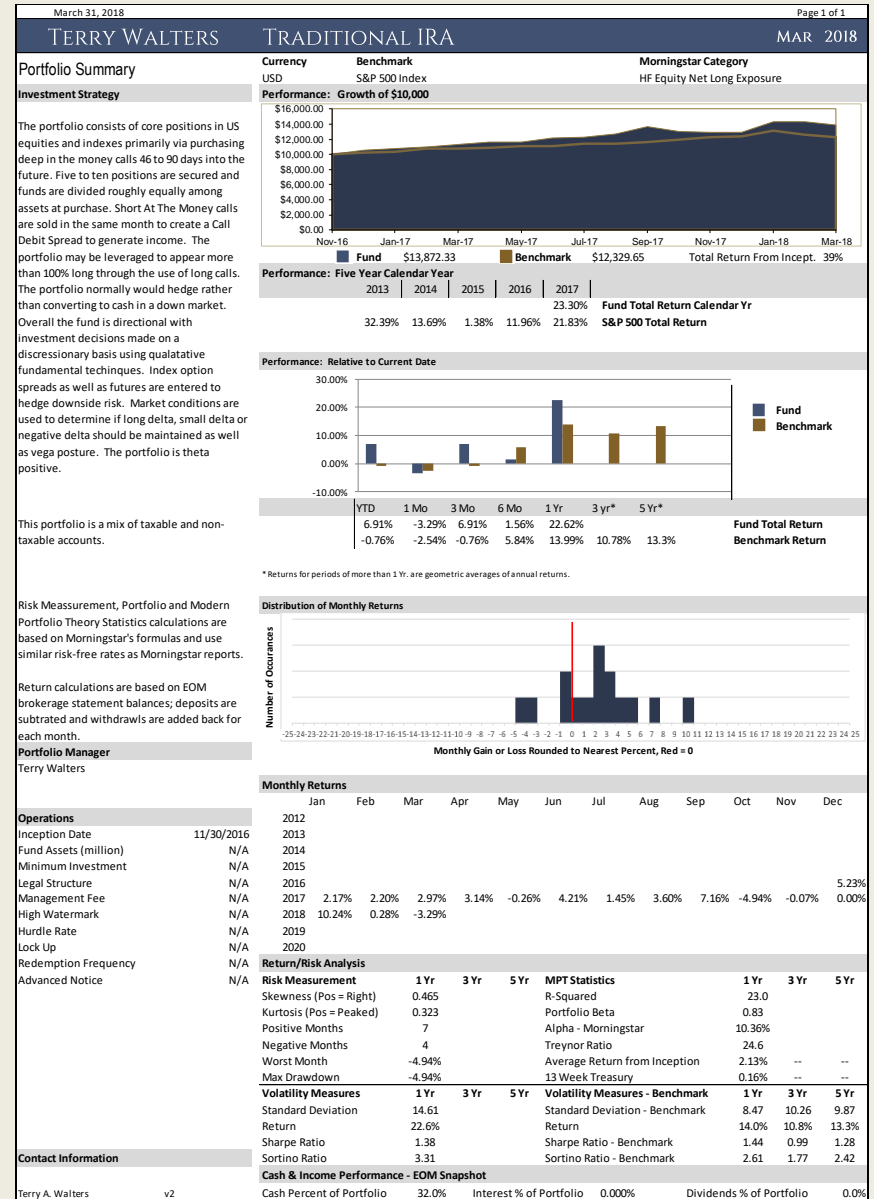
## TRADING OPTIONS IN AN IRA

Yes, another spreadsheet...  
[www.terrywalters.com/tools.html](http://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**