thinkMoney®/49

Random musings for traders at TD Ameritrade—FALL 2020

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WHAT'S SHAKIN'?
VOLATILITY.
THAT'S WHAT.
PAGE 14

TD Ameritrade

ISSUE 49

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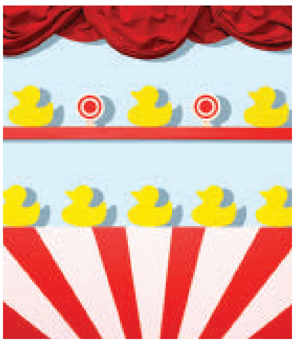
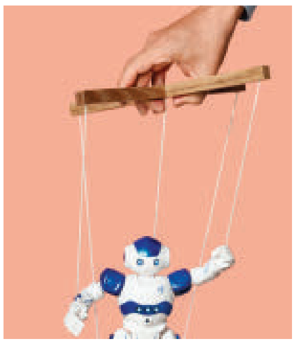
COVER STORY

What's Shakin'? Volatility. That's What.

To state the obvious, when volatility happens, things move. Sometimes a lot, which can be confusing for new option traders. So how do you trade "vol"? Consider three ways.

Cover photograph by **Dan Saelinger**





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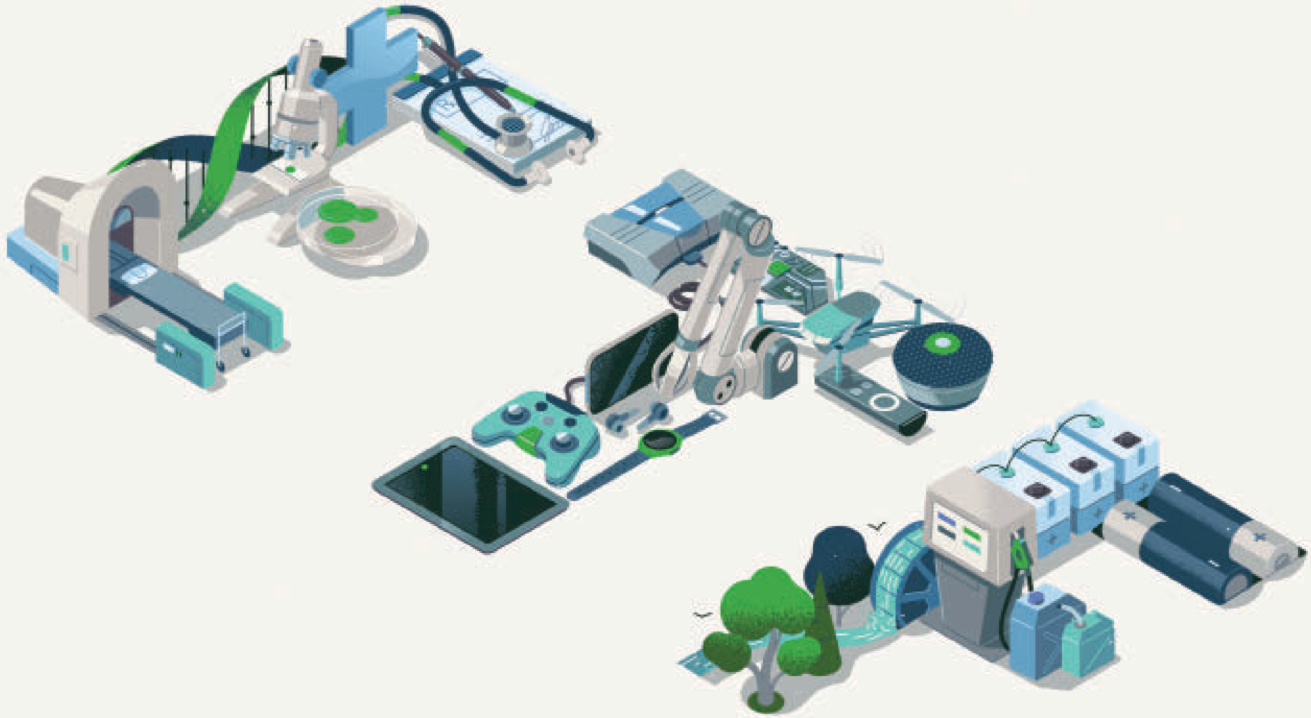
Calendar for Options Monkeys
All the important 2021 options trading days in one place. Pull it out and pin it up in front of your trading desk. Or take a picture so you have it on your phone.



SHARE THE LOVE—Give us your good and your bad, but save the ugly. We want to know if we're pushing all the right buttons. Write to us at **thinkmoney@tdameritrade.com**.

One Step at a Time

• THERE'S UNIVERSAL uncertainty in the air as we look to see what the end of 2020—and beyond—will bring. The pandemic, U.S. elections, and the civil unrest that erupted over the summer put forward more questions than we have answers. All of which leads to the biggest question of all: Where do we go from here?

In times of crisis, we often think about how to keep our financial lives healthy to provide for ourselves and our loved ones. Just because the stock markets recovered from the COVID crash doesn't mean we should be complacent. Markets eventually come down, and traders need to be prepared for all markets.

The market rally has been fueled by high volatility (vol). Higher vol means more uncertainty, but it also opens up potential trading opportunities. That said, traders should know how to navigate volatile markets. "What's Shakin'? Volatility. That's What" on page 14 explores different ways to analyze vol and strategies you could apply in different scenarios.

If there's one thing COVID-19 has taught us, it's to be ready for anything. It's a good idea to have checks and balances in place so you have a systematic way of tackling, not just the financial markets, but all aspects of life. It may be helpful to have a plan A, maybe something similar to what you'll find in "Black Box Trading for the Rest of Us (Sort Of)" on page 24. And if things don't work out like you thought, plan B kicks in.

No doubt 2020 has brought some tough challenges. But what makes this time in our history so appealing is the opportunity to come together, to make positive change, and to reset things when they become misaligned. It's in our nature. The capital markets are a tool to be used in that process, and wherever they go next will be a product of collective optimism and fear working at the same time. Optimism (and money) drove much of the incredible recovery from the bottom of the collapse in March. It was a clear sign that investors have been hopeful. But it's not a prediction of the future. Hope drives change as much as fear.

Be safe, and trade with caution.

Happy trading,
Kevin Lund
Editor-in-Chief, *thinkMoney*

PHOTOGRAPH: DAN SAELINGER | ILLUSTRATION: RANDALL WATSON

DISCLAIMERS

IMPORTANT INFORMATION YOU NEED TO KNOW

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The information presented in this publication does not consider your personal investment objectives or financial situation; therefore, this publication does not make personalized recommendations. This information should not be construed as an offer to sell or a solicitation to buy any security. The investment strategies or the securities may not be suitable for you. Any and all opinions expressed in this publication are subject to change without notice.

• Options transactions involve complex tax considerations that should be carefully reviewed prior to entering into any transaction.

• The risk of loss in trading securities, options, futures, and forex can be substantial. Clients must consider all relevant risk factors, including their own personal financial situations, before trading. Options involve risk and are not suitable for all investors. See the Options Disclosure Document: Characteristics and Risks of Standardized Options. *A copy accompanies this magazine if you have not previously received one. Additional copies can be obtained at tdameritrade.com or by contacting us.*

• Trading foreign exchange on margin carries a high level of risk, as well as its own unique risk factors. Before considering trading this product, please read the Forex Risk Disclosure, *available at http://www.nfa.futures.org/NFA-investor-information/publication-library/forex.pdf.*

• Supporting documentation for any claims, comparisons, statistics, or other technical data will be supplied upon request.

• A forex dealer can be compensated via commission and/or spread on forex trades. TD Ameritrade is subsequently compensated by the forex dealer.

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• Futures, futures options, and forex trading services are provided by TD Ameritrade Futures & Forex LLC. Trading privileges are subject to review and approval. Not all clients will qualify. Forex accounts are not available to residents of Ohio or Arizona.

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2

Transaction costs are important factors and should be considered when evaluating any options trade. For simplicity, the examples in these articles do not include transaction costs. At TD Ameritrade, online options orders are $0.65 per contract. Orders placed by other means will have higher transaction costs.

Cboe MINI VIX® Futures

Trade Your View on Equity Market Volatility

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Learn more at www.Cboe.com/MiniVIX

For more on election coverage, read "Republicrat or Democan? How to Manage an Election Trade": https://bit.ly/TTelect

INDUSTRY SPOTLIGHT

Election 2020: How Traders Can Rock the Vote

The 2020 presidential election will likely carry long-lasting implications for global markets. But before you vote with your capital, check the history books.

• U.S. PRESIDENTIAL ELECTIONS ROLL around every four years. But traders can cast a "vote" every trading day. And just like in politics, whether your financial vote winds up being a winner or a loser depends on many variables. One thing's for sure: whether it's the markets or politics, it helps to know your history.

BACK TO THE FUTURE

Some sectors tend to perform better, and display more volatility, in the wake of big national elections. Is it "better" or "worse" for certain stocks, or the market in general, if a Democrat or a Republican controls the White House, Congress, or a combination of the two? As election day nears, it's a good idea to set aside politics, study market history, and prepare for different potential scenarios and outcomes.

The coronavirus pandemic is likely to shake up traditional pre- and post-election dynamics, i.e., presidential election-cycle theory. A recessionary economy, high unemployment, and a bear market have historically meant trouble for incumbent presidents. But if the stock market continues to be strong and the economy recovers, even if it's modest, could it be favorable for the incumbent? We won't know for sure until Election Day.

So, even though this time could be different, it's still worth checking out some historical references.

Over the past three decades, the first year of a president's term (including the years following reelection) often coincided with a strong performance by the broader U.S. stock market, based on benchmarks like the S&P 500 Index (SPX). That said, over the last 70 years, the U.S. market's strongest periods have been when the two major parties split power in the capital.

PHOTOGRAPH: DAN SAELINGER

WHICH WAY FORWARD?
Republican leadership has often meant less regulation. This translates into "bullish and supportive" for industries like energy, financial services, and defense.

A Democratic agenda could mean more aggressive climate-change legislation, something like a "Green New Deal." In this scenario, alternative-energy stocks could become attractive, as opposed to oil-and-gas investment.

Again, keep in mind that preelection market conditions for 2020 are different than they've been in the past. How the pandemic will evolve, and how consumers and businesses will respond, remain wild cards. That makes it difficult to predict how market sectors will perform in 2021. Will there be a vaccine breakthrough by this November? Or will we see the number of cases continue to increase?

CHANGING DYNAMICS
Let's not forget the recent shift to "working from home." If that takes hold for the long term, products and services for millions of American home workers will be greatly in demand. Creative shopping alternatives are already part of an emerging delivery culture. And consider the potential for more market volatility in response to escalating tensions between the United States and China, or continued domestic unrest.

HOW THINGS WILL UNFOLD IS ANYONE'S guess. But you should be prepared with trading strategies you can apply to different scenarios as the nation barrels toward election season. And train a keen eye on those sectors likely to have a major influence on the global economy and the planet's future.
—Words by BRUCE BLYTHE

Bruce Blythe is not a representative of TD Ameritrade, Inc. The material, views, and opinions expressed in this article are solely those of the author and may not be reflective of those held by TD Ameritrade, Inc.

For more information on the risks of trading and trading options, see page 35, #1 & 2.

THINKTANK

Trading from Anywhere

There may be times when you're thinking about placing a trade but don't have access to your trading platform. Now you can use a web-based version and trade from any device when you're on the go.

The thought of taking a few days off from trading may seem refreshing. But it may be difficult to relax when you completely detach yourself from what you love doing. Maybe you hear something on the news about a stock you often trade. You want to place a trade, but without your trading platform within reach, you feel at a loss.

Good news! You can use the new web-based thinkorswim® platform from TD Ameritrade (thinkorswim Web) and sneak in a trade or two. thinkorswim Web may not have all the intricate bells and whistles of the parent thinkorswim desktop platform, but you can analyze stock, futures, forex, and options trades and place them if you think they have potential.

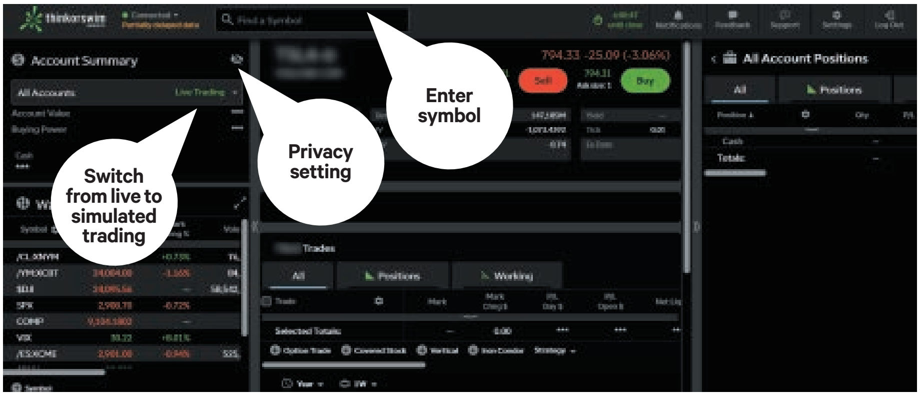
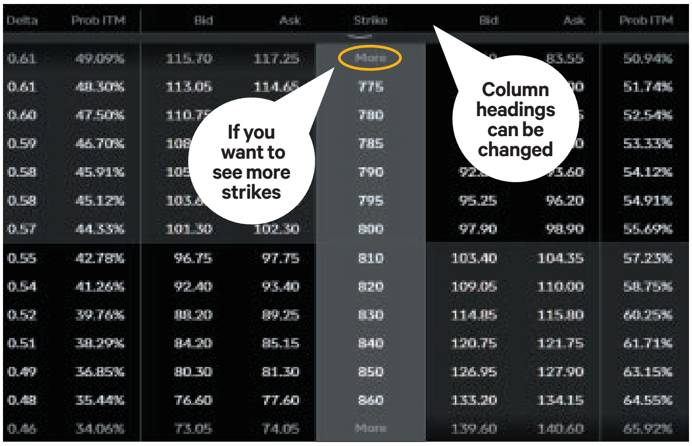


FIGURE 1: THINKORSWIM WEB DEFAULT SCREEN. **This streamlined version of the parent platform allows you to trade from anywhere. You have access to your watchlists and can trade individual stocks and their options.**
Source: thinkorswim Web. For illustrative purposes only.



Delta	Prob ITM	Bid	Ask	Strike	Bid	Ask	Prob ITM
0.61	49.09%	115.70	117.25	More	[illegible]	83.55	50.94%
0.61	48.30%	113.05	114.65	775	[illegible]	[illegible]	51.74%
0.60	47.50%	110.75	[illegible]	780	[illegible]	[illegible]	52.54%
0.59	46.70%	[illegible]	[illegible]	785	[illegible]	[illegible]	53.33%
0.58	45.91%	[illegible]	[illegible]	790	[illegible]	[illegible]	54.12%
0.58	45.12%	[illegible]	[illegible]	795	95.25	96.20	54.91%
0.57	44.33%	101.30	102.30	800	97.90	98.90	55.69%
0.55	42.78%	96.75	97.75	810	103.40	104.35	57.23%
0.54	41.26%	92.40	93.40	820	109.05	110.00	58.75%
0.52	39.76%	88.20	89.25	830	114.85	115.80	60.25%
0.51	38.29%	84.20	85.15	840	120.75	121.75	61.71%
0.49	36.85%	80.30	81.30	850	126.95	127.90	63.15%
0.48	35.44%	76.60	77.60	860	133.20	134.15	64.55%
0.46	34.06%	73.05	74.05	More	139.60	140.60	65.92%

FIGURE 2: OPTION CHAIN. Expand any option chain to see the details of different strikes. Columns can be changed to display whatever variable you want to analyze. *Source: thinkorswim Web. For illustrative purposes only.*

FIGURE 3: TRADING WITH THINKORSWIM WEB. You can either build a trade manually or select one of the provided strategies. Either way, the risk profile will be displayed next to the price chart. *Source: thinkorswim Web. For illustrative purposes only.*

TRADER JARGON
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Here's a taste of thinkorswim Web features. After you log in from thinkorswim.com, you'll see the default screen divided into three sections—**Account Summary**, **Watchlist**, and **All Account Positions**.

Let's say you're considering trading options on a specific stock. Enter the symbol in the symbol box (see Figure 1). A middle window opens up that displays quote details, the option chain, and a price chart.

It's simple to switch between your live and paperMoney® account; from the menu in **All Accounts** select the account you want to use. If you're trading from a public computer, you can hide your account value by selecting the eye icon next to **Account Summary**.

Expand any option chain, and you'll see the different strikes (see Figure 2). If you want to see more than what's displayed, select **More**. If you want to rearrange things a little, any column in thinkorswim Web can be customized by dragging and dropping the column headings.

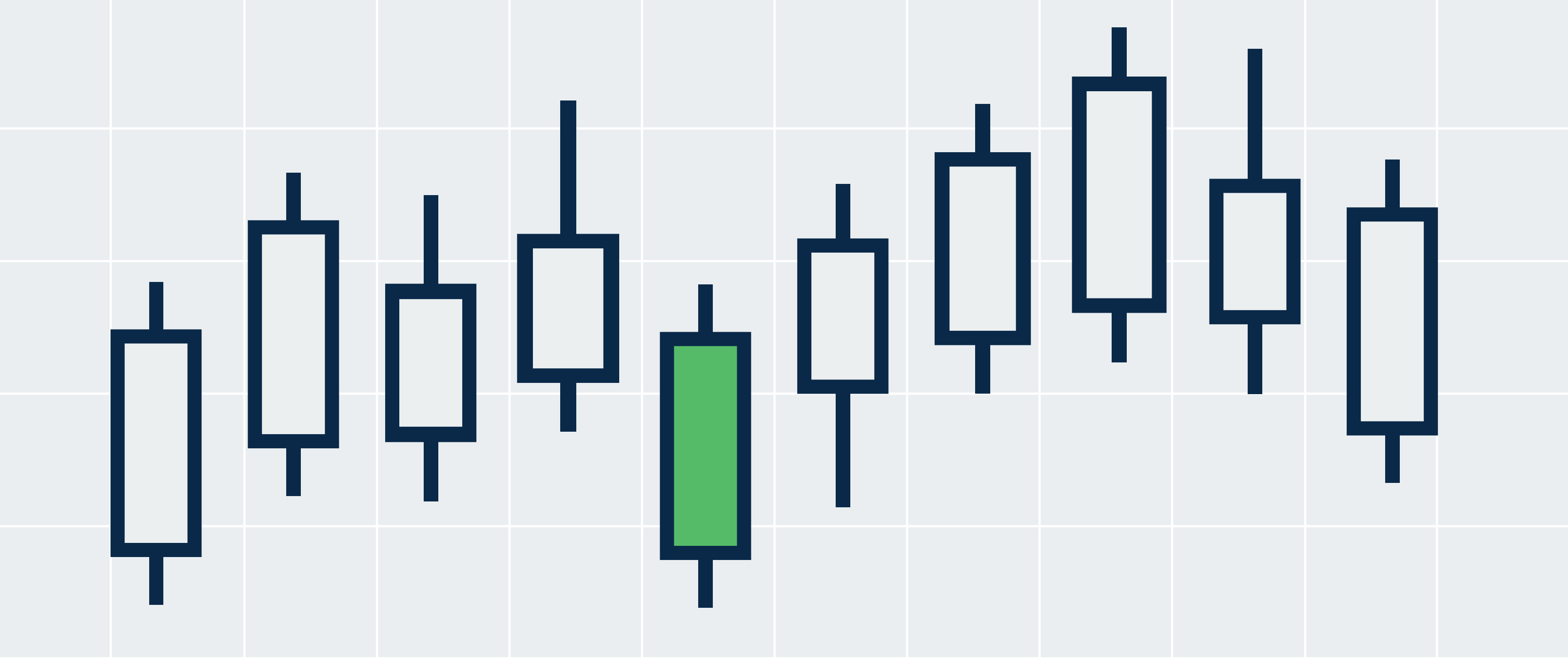
If you're considering a strategy that's listed below the **Trade** ticket window—you've got a few choices—select one, and thinkorswim Web will build the trade for you. But you can also build the trade manually if you prefer.

Suppose you're considering trading a calendar spread. Select it from the **Strategy** drop-down list, and thinkorswim Web will display the trade risk profile with its different legs (see Figure 3).

You can make adjustments to any of the trade parameters, either manually or by using the menus. Below the **Trade** ticket window, you'll see the price chart and risk profile. If you hover over a price bar, you'll see the estimated profit and loss (P&L) on the risk profile (and vice versa). And if you roll positions, you'll see the P&L profile after rolling the position. If all looks good, you can review the trade before sending it. When a trade is executed, it will populate in the **Account Position** window. You can keep track of open positions on any device; your account stays synced.

Isn't it comforting to know that you can always peek at your account and maybe even place a few trades using thinkorswim Web?

The paperMoney software application is for educational purposes only. Successful virtual trading during one time period does not guarantee successful investing of actual funds during a later time period, as market conditions change continuously.



Following the Info Flow with Futures

You don't have to be a futures trader to benefit from futures info. There's a ton of fundamental data waiting to be tapped.

STEPHANIE LEWICKY
SENIOR MANAGER
Trader Education, TD Ameritrade

• If you've ever traded futures, you know the spiel: You can speculate on the price of crude oil, gold, and other commodities. And you can hedge some of the risk in your portfolio with stock index and interest rate futures. Futures can be an efficient way to allocate your capital through margin, but that margin can exacerbate your losses as well as your gains.

Even if you're not a futures trader, you can still use futures info to help guide you. Fire up the thinkorswim® platform from TD Ameritrade and check out this sampling.

Cost of raw materials. If you trade or invest in oil services companies—or the Energy sector in general—you know how closely their profitability is tied to crude oil prices now and in the future. Pull up a chart of NYMEX WTI Crude Oil futures (/CL) and select **Product Depth** to see where futures contracts for delivery next month, next year, and several years from now are trading. The same goes for that burger joint on your watchlist—there are futures contracts on corn (/ZC), soybeans (/ZS), cattle (/LE), and hogs (/HE). And, of course, industrial metals such as copper (/HG) and platinum (/PL) can offer a glimpse into the construction and manufacturing outlook.

Price volatility. It's not just the cost structure of raw materials that can impact profitability; it's also their volatility (vol). Vol is uncertainty, and uncertainty can cloud a company's forecasting and make it skittish about deploying capital for improvements, growth, or strategic acquisition. Want to follow the vol? Punch in a futures symbol and hit the **Trade** tab. The futures contract option chain shows an implied vol reading for each listed series. Now open up a chain and check the vol skew—are vols higher to the upside or downside, and if so, by how much? This might give you an indication of where the uncertainty lies. And if there's an outsize move being priced in, you'll see a Market Maker Move (MMM) indicator at the upper right (see page 32 for more on MMM).

Interest rates and the yield curve. The cost of money is one driver of the economy. Plus, Treasury yields and the yield curve can be key determinants of bank profitability. From the 30-day Fed funds futures (/ZQ) to the 30-year Treasury bond (/ZB), the info is there. Just remember that Treasury prices move inversely to yields.

Foreign exchange. For companies you invest in, how big are their overseas operations? Or, how much do the tech names in your portfolio rely on foreign goods and manufacturing? With thinkorswim, you can track futures on individual currencies and also track a basket of currencies against the U.S. dollar.

Who knows? Once you're comfortable with the dynamics of the futures market, you might decide to add futures to your arsenal.

FOR A DEEPER DIVE into different futures contract specs, check out https://bit.ly/TTspecs

For more on the risks of trading and trading futures, see page 35, #1 & 3.

PHOTOGRAPH: DAN SAELINGER

SKILL LEVEL SAVVY

TAKE AWAY:
How to trade volatility on the long side, short side, and when it's elevated.

WORDS BY **KEVIN LUND**

WHAT'S SHAKIN'?

SPECIAL FOCUS **VOLATILITY PRIMER**

BIG IDEA:
TRADERS OFTEN EQUATE HIGH VOLATILITY WITH FEAR. BUT VOLATILITY CAN ALSO MEAN POSSIBLE TRADING OPPORTUNITIES. SO INSTEAD OF RUNNING AWAY FROM VOL, LEARN TO EMBRACE IT.

PHOTOGRAPHS BY **DAN SAELINGER**

THAT'S WHAT

Volatility happens. Sometimes it's big. Sometimes it's small. In the midst of a global economic meltdown, it gets pretty big. When a pandemic erupts, volatility (vol) can rise to levels most traders have never seen in their lifetimes, just as it did in March 2020, when the Cboe Volatility Index (VIX) hit 85. That's a level seen only once before in the past 20 years, back in 2008.

But what exactly is vol, and why is everyone talking about it every time the market plunges?

In a word, vol is the movement of a stock or index—or more specifically, the magnitude of its movement. When vol is low, there may not be much movement from one day to the next. Price moves are relatively small and orderly relative to the stock's price. On the flip side, when vol is high, there's a lot of movement, and the size of price moves can be quick, fierce, and wildly unpredictable. Investors usually don't love it when the market is unpredictable. So, when there's too much vol, they might run for the hills.

But for a trader, vol can mean potential opportunity. That's because traders typically look for short-term price fluctuations and aren't married to a particular direction. They're focused on what they're trading at the moment. They trade what the market gives them. And if you're an option "volatility" trader, a world of possibilities opens up.

VOLATILITY: REARVIEW MIRROR OR CRYSTAL BALL?

It doesn't help that vol is used in different ways. Headlines may exclaim, "The market is volatile!" Traders talk about "implied volatility" and "historical volatility."

When talking about options, vol simply means implied volatility, or IV. It's derived from options prices, and it "implies" what a stock might do in the future. You can enter prevailing options prices into a theoretical pricing model, which will spit out the IV. Or, enter an IV to get your options prices. When you freeze all other inputs in the pricing model—interest rates, time to expiration, strike prices, etc.—options prices and IV are different sides of the same coin, and one can be translated into the other.

TRADER JARGON
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Either way, stock options prices and IV can often give you an idea of the expected movement range of the underlying stock—helpful info for setting up trades.

Keep in mind that when IV increases, it's an indication the market expects the stock price to move more than it did before. When IV falls, it's an indication of potentially less price movement.

Instead of trying to keep track of the IVs for every stock, wouldn't it be great if there was one IV number that covers everything?

This is where the VIX comes in. The VIX measures the IV from a mix of S&P 500 Index options that have expirations close to 30 days. Although it doesn't reflect every stock and exchange-traded fund, it's a pretty good indication of overall market vol at any given moment.

Despite what you may hear, vol and VIX don't trend like stocks. Rather, they're "mean-reverting," which means they tend to hang out at certain average levels and trade in particular "regimes," or ranges, around these levels. Although vol can move in and out of these regimes, it typically reverts to those average levels sooner or later. Of course, there are always exceptions. The idea is to understand when a new regime is in place. Spikes in volatility are typically temporary, because they tend to revert back to the mean, historically speaking.

Take VIX, for instance. Before the pandemic in the first two months of 2020, the VIX typically traded, on average, below 15. Sometimes, it would slump to 10; other times, it would spike to 30 or 40. But then it would generally go back to its "typical" range.

But that was pre-pandemic. As fears of a slowing global economy grew, so did vol. The higher IV moves beyond a normal range of between 12 and 20, and the longer it stays there, the longer it may take for it to return to anything closely resembling a previous norm.

TOOLS OF THE TRADE

Now that you have a better understanding of vol, how do you make sense of it?

Volatility charts. First, determine whether the current IV is high or low, because that might help when choosing which options strategy to use. One way to compare vol levels is to add the **ImpVolatility** study to your charts on the thinkorswim® platform from TD Ameritrade.

1 – Fire up the thinkorswim platform.
2 – Select the **Charts** tab.
3 – In the upper right of the default chart, select **Studies** > **Quick Study** > **Volatility Studies** > **ImpVolatility**.

Today's options statistics. This is found under the **Analyze** or **Trade** tab, below the **Option Chain**. Note the prevailing IV level and compare it the high and low IV levels over the past 52 weeks.

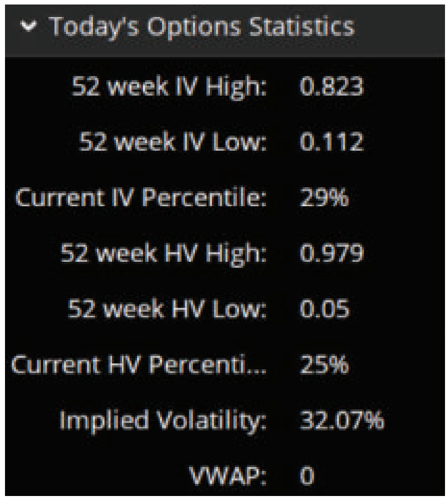

FIGURE 1: WHERE IS IV? Compare IV with its 52-week high and low in Today's Options Statistics, found below the Option Chain in the Analyze tab on thinkorswim. *Source: thinkorswim from TD Ameritrade. For illustrative purposes only.*

In Figure 1, the highest level IV reached over the previous year was 82.3%. The lowest level was 11.2%. Prevailing IV is at 32.07%, which puts it in the 29th percentile. That means it's a little closer to the lower midrange than the high end. Yet, it's still much higher than what used to be considered the "normal range" of 12% to 20%, and there's still room to move. This doesn't typically bode well if you're buying options because vol premiums will be higher. You could potentially offset some of that vol risk by buying in-the-money (ITM) options, vertical spreads, or straight stock.

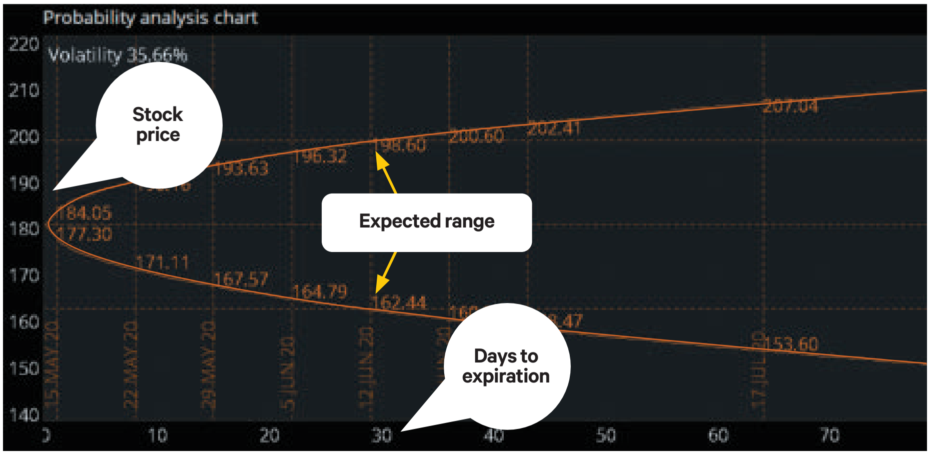

FIGURE 2: PROBABILITY ANALYSIS. **This tool shows the expected price range, based on the current stock price and implied volatility, at various expirations.** *Source: thinkorswim from TD Ameritrade. For illustrative purposes only.*

FIGURE 3: MARKET MAKER MOVE. **The MMM calculation gives you the expected one-day range of the stock.** *Source: thinkorswim from TD Ameritrade. For illustrative purposes only.*

If IV were closer to the top end of the range, you might view it as "high." Then you may consider strategies that have short vega profiles (geek-speak for strategies that should profit if vol drops) like short iron condors, short verticals, and long butterflies. Yet, even if vol is at the high end of the range, it doesn't mean it can't go higher.

Probability cone. Use this tool to help position your strikes. Select the **Analyze** tab > **Probability Analysis**, and you'll see a chart that looks like a bell curve on its side. The probability cone helps you visualize vol because it maps the expected range of the stock based on the current IV level and number of days until expiration for each option.

In Figure 2, the current stock price is around $180. Yet, over the next 30 days, the probability cone pegs the expected range (based on current IV) from $162.44 to $198.60 with a 68% probability (the expected price move is one standard deviation). The actual range could be greater or smaller, and you could use this information to consider selling vertical spreads with the short strike just outside the range with a theoretical success probability of 68%. Or, you could use this tool to tweak other options strategies by changing strike prices or expirations to see how your break-even levels might compare with the expected stock price range.

LOOKING INTO THE FUTURE FOR EXPECTED PRICE MOVES

Nothing is certain, but the probability cone gives you some idea of potential price changes. Find out more at https://bit.ly/TTninja

Market makers. Another tool to help figure out expected movement is the Market Maker Move (MMM) indicator.

It's based on formulas used by market makers to calculate how much a stock is expected to move in a single day. In Figure 3, for example, the MMM is $2.30, and yes, this number is based on prevailing IV. It doesn't always show up for every stock, but it's usually triggered when an event is near, such as earnings. All things being equal, this number gets bigger when IV goes up and shrinks when IV goes down.

Bear in mind, however, that the actual range can be larger or smaller, and it also doesn't suggest the stock direction. But this number can be helpful in many ways, such as when you're deciding to make adjustments to existing trades going into an earnings event. Likewise, if the daily moves keep exceeding the MMM, it might be an indication that IV is on the rise.

THESE ARE JUST A FEW TOOLS AVAILABLE ON the thinkorswim platform to help a vol trader analyze IV. Armed with all this information, you're on your way to learning how to trade vol—or at least becoming someone who doesn't need to fear it.

HOW TO CHOOSE A TRADE

Trying to figure out why a stock's IV is high or low is an important factor, but so is trying to determine the strategy to apply based on prevailing volatility levels. This table can be a handy reference.

	Bull	Neutral	Bear
High volatility	Short put vertical	Calendar, butterfly, iron condor	Short call vertical
Low volatility	Long call vertical	Calendar, butterfly, iron condor	Long put vertical

For illustrative and educational purposes only. Not a recommendation.

Kevin Lund is not a representative of TD Ameritrade, Inc. The material, views, and opinions expressed in this article are solely those of the author and may not be reflective of those held by TD Ameritrade, Inc.

Probability analysis results from the Market Maker Move indicator are theoretical in nature, not guaranteed, and do not reflect any degree of certainty of an event occurring.

For more information on the risks of trading and trading options, see page 35, #1 & 2.

2021 WALL CALENDAR

for Options Monkeys

Different types of options have different expiration dates, and keeping track of it all can get tricky. But it's all right here on this calendar. So go ahead and peel these pages away from the staples and pin them above your desktop. Now you've got your expirations right in front of you. So just sit back and add some monkey love to your trading day.

Jan

S	M	T	W	T	F	S
					1	2
3	4	5	6	7	8	9
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31	1	2	3	4	5	6

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OPTIONS EXPIRATION DAYS

Equity, index, ETF & ETN options, and cash-settled currency options expiration dates. Expiring cash-settled currency options cease trading at 12:00 p.m. ET. *January 15, February 19, March 19, April 16, May 21, June 18, July 16, August 20, September 17, October 15, November 19, December 17*

Last day to trade monthly a.m.-settled index options. *January 14, February 18, March 18, April 15, May 20, June 17, July 15, August 19, September 16, October 14, November 18, December 16*

VIX expiration dates. *January 20, February 17, March 17, April 21, May 19, June 16, July 21, August 18, September 15, October 20, November 17, December 22*

Exchange holidays. *January 1, January 18, February 15, April 2, May 31, July 5, September 6, November 25, December 24*

Quarterly expiration dates. *March 31, June 30, September 30, December 31*

2024 Equity LEAPS® added. *September 13*

NOTE:

- Weekly product expirations happen on Mondays, Wednesdays, and Fridays.
- On an exchange holiday, the expiration and expiration processing of standard weekly, monthly, or quarterly expiration will be moved to the preceding OCC business day.
- Equity LEAPS® expire in January. Index LEAPS expire in December, January, and June.

Apr

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Nov

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26	27	28	29	30	**31**	1
2	3	4	5	6	7	8

SKILL LEVEL PRO

TAKE AWAY:
Understanding how to use probabilities to manage trades.

WORDS BY **DOUG ASHBURN**

THE WIN/LOSS CONUNDRUM

PHOTOGRAPHS BY **DAN SAELINGER**

UNDERSTANDING THE ODDS

BIG IDEA:
WHEN YOU'VE GOT TRADES ON, YOU TYPICALLY FOCUS ON HOW MUCH YOU'RE MAKING OR LOSING. BUT IT'S POSSIBLE TO LOSE MORE TIMES THAN YOU WIN AND STILL COME OUT AHEAD. SAY WHAT? THAT'S RIGHT. IT HAS TO DO WITH USING PROBABILITIES TO MANAGE YOUR POSITIONS.

There's an old joke among traders: What do you call a scalp gone bad? An investment.

It's not just a bad joke; it's a bad idea. And it's not just the money, although that's a big part of it. Hanging onto a loser is mentally draining, and it ties up capital that could be better allocated elsewhere. Plus, you're supposed to ride your winners and cut your losers. That scalp-turned-investment is the exact opposite—it's riding a loser because you're too stubborn to take your lumps and move on.

Part of the issue is understanding your objectives—targets, goals, and pain points. And let's not forget the importance of discipline in sticking with a strategy once your objective is hit (for better or worse).

IT'S LIKE OTHER THINGS IN LIFE

In the 1960 World Series, the New York Yankees dominated the Pittsburgh Pirates in pretty much every category. Over seven games, the Yankees outscored the Pirates 55 to 27. The Yankees also led the series in the number of hits, batting average, and pitching.

But on October 13, 1960, the Pirates were crowned national champs. Because in the World Series, there's only one category that matters—the number of games you win—and the Pirates won four out of seven.

Here's another one. Since the start of this nation, five presidents have been elected without having won the popular vote. Unless the Constitution is amended, the objective is to win 270 electoral votes. The popular vote is mostly a related statistic.

What do the 1960 World Series and the U.S. Electoral College have to do with trading? They underscore the importance of objectives. Place too much importance on the wrong objective and you run the risk of falling short of the underlying goal, which, as a trader, is to keep account values moving in the right direction.

Here's a common sentiment among new traders: "Of my last 50 trades, 35 were winners, and 15 were losers. Yet, I broke even."

Has that ever been your trading pattern? You have confidence in your overall strategy, except when a trade goes south. You get stubborn. You believe you're right, so you hang on, or even double down. Next thing you know, that one loser has wiped out your last six winners. It's not just a rookie mistake; even veteran traders have fallen victim to the forces of stubbornness and misguided conviction.

Remember the first rule of trading: Profitability is about total dollars and cents, not about win/loss percentages.

LOOKING FOR GOOD ODDS

One way to keep an eye on goals? Instead of focusing on percentages, consider whether the odds are in your favor. In other words, consider looking for so-called "high-probability" trades with defined risk parameters and a risk/return profile in keeping with your tolerance. (For more on setting these guidelines, see "Black Box Trading for the Rest of Us," page 24.)

Good odds are also about cutting your losses but letting your winners run their course. That's the exact opposite of the trader who lets one pig of a trade wipe out the previous six winners. Say you've got a $10,000 account and you target 5% of risk per trade, with a risk/return of 2:1. In dollar terms, that equals a max risk of $500 and a max return of $1,000 per trade. Suppose you made 16 trades last month following these targets, with the following results:

6 Winning Trades	x $1,000	$6,000
10 Losing Trades	x $500	$5,000
Net Gain/Loss		**$1,000**

Nearly two out of three trades were losers. But because the winners ran twice as long, the account saw a net gain. Granted, this example is oversimplified. Yet, it speaks to the power of sound money management.

Merging the two—high-probability trade selection and prudent money management—is one way to look for better odds. And remember: as markets move and time passes, odds change. And whenever those odds change, it's time to reassess whether your goals and targets are still on point.

MANAGING YOUR ODDS

Whether you're a stock trader, active option trader, or somewhere in between, the thinkorswim® platform from TD Ameritrade has the tools you need to assess the odds and help keep your eye on your objectives. Ready to put your good-odds system to work? Fire up the thinkorswim platform and follow along.

IF YOU'RE A STOCK TRADER...

Brackets. Placing "bracket orders" along with your entry orders may be the simplest way to set your max-risk and max-loss points. The bracket is essentially two orders—a profit target and a stop order. When one order fills, the other is immediately canceled (called a "one-cancels-other," or OCO, order). The bracket order allows you to set your targets just where you want them.

Trailing stops. Want to take your trade management a step further? Consider a trailing stop. It's like a regular stop order, only more dynamic. It automatically adjusts the stop price at a fixed percent or dollar amount below or above the prevailing market price. So, if you're long a stock and it starts rallying, the activation price increases to "trail" the new value. If the stock price drops, the activation price doesn't change. If the stock price drops to an amount equal to or less than the current activation price, the order is activated and becomes a market order. This is one way to manage trades—by letting your winners run in a trending market (see Figure 1).

You can set your trailing stops manually (if, for example, you're tracking specific technical trend levels). Or, if you want to be more mechanical, pull up an order ticket in thinkorswim. Under **Order**, select **TRAILSTOP**, and under Price, set your trailing parameters. As

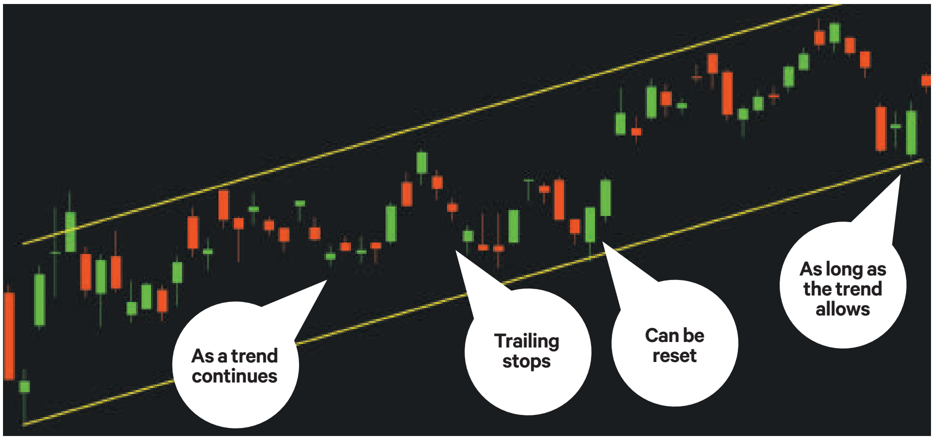

FIGURE 1: TRAILING THE TREND. From the **Charts** tab on thinkorswim, select the drawing tool and insert trendlines on your chart. Then consider adjusting your stops as the trend continues.

Source: thinkorswim from TD Ameritrade. For illustrative purposes only.

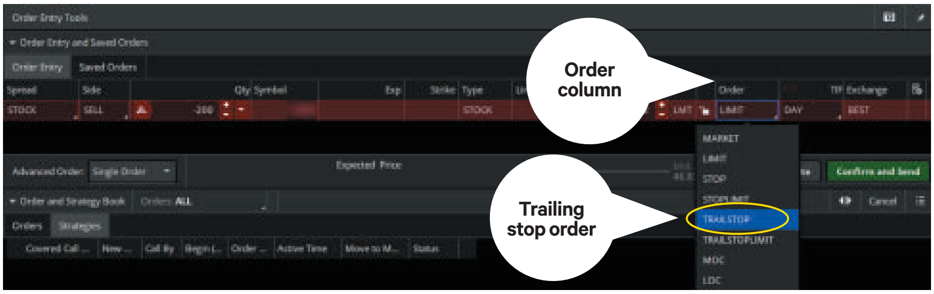

FIGURE 2: SETTING A TRAILING STOP. **To place a trade on thinkorswim, head over to the Trade tab and on Order Entry Tools under Order, select TRAILSTOP to set the different price levels.**

Source: thinkorswim® from TD Ameritrade. For illustrative purposes only.

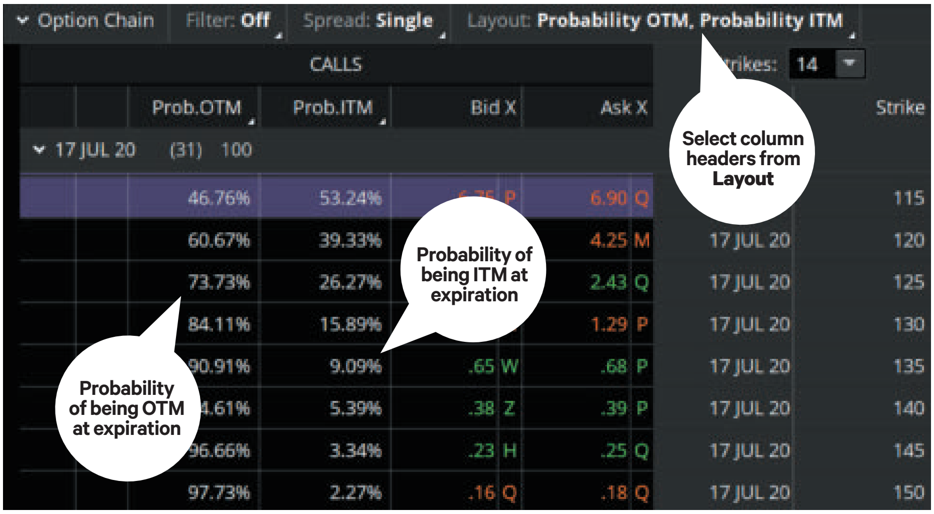

FIGURE 3: OPTION CHAIN WITH PROB OTM AND PROB ITM. **On thinkorswim, adding Prob OTM and Prob ITM to the Option Chain column headers from Layout can help you assess and manage a position while looking for high-probability trades.**

Source: thinkorswim from TD Ameritrade. For illustrative purposes only.

the stock rallies, the stop will reset automatically. It will get triggered if or when the price slips back to the stop level (see Figure 2). But keep in mind, once a stop order is activated, it competes with other market orders and the price isn't guaranteed.

Laddering entries and exits. You know the frustration when you're a hair too early on an entry point, just missed a profit target, or got stopped out on what turned out to be a head fake. To try and avoid these headaches, consider scaling in and out by laddering your prices above and below your targets. Just because you've set your risk parameters doesn't mean you have to go all in, or all out, at one price. And remember, laddering into and out of positions may incur additional transaction costs.

IF YOU'RE AN OPTION TRADER …

Although brackets, trailing stops, and order laddering can be just as effective for options positions as for stocks and exchange-traded funds, there are even more ways to manage your options trades.

Prob OTM/Prob ITM. One key to looking for trades with odds in your favor is seeking high-probability trades. You can manage the trades with the Probability OTM (an estimate of the probability of an option being out of the money at expiration) tool on thinkorswim and its inverse, Probability ITM, which estimates the probability of being in the money at expiration. You can add one, or both, of these tools to any option chain by clicking a column header, then selecting **Option Theoreticals and Greeks** and finally **Probability OTM** (or **Probability ITM**).

Say you're looking at the option chain of a stock that's trading at around $115 (see Figure 3). You're thinking about selling the 125 calls and buying the 135 calls (that is, selling the 125/135 call vertical). The Prob OTM and ITM suggest that the 125 calls have almost a 74% probability of being OTM at expiration, and the 135 calls have a 9% chance of being ITM at expiration. This is an example of a high-probability trade. Granted, you'll need a full analysis of the points of max gain and max risk before deciding if this trade is for you. Yet, from a good-odds standpoint, there's a high probability that both legs will be OTM at expiration (max gain), and a low probability that both legs will be ITM (max loss).

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Risk profile. As any option trader will tell you, the first rule of managing positions is knowing that the odds are always in motion. Each tick in the stock price, each tick of the clock, and each shift in implied volatility affects the odds. The **Risk Profile** tool (available on thinkorswim under the **Analyze** tab) can help you examine your positions in real time but also fast-forward to what your positions my look like at expiration—or any point between now and then. You can look at different volatility scenarios and their possible effect, not only on your profit and loss, but also on your positions' gamma, theta, and other greeks.

LET'S FACE IT: YOU CAN'T CONTROL stock prices. You can't control direction, magnitude, or timing. But you can assess the odds and work to control your objectives—entry and exit points, profit and loss targets, and scenarios by which you change those objectives. Will you win more often than you lose? Maybe. But who cares? It's not the win/loss percentage that counts; it's long-term profitability. Diligent trade management and keeping a firm grip on the odds may just help you get there.

Doug Ashburn is not a representative of TD Ameritrade, Inc. The material, views, and opinions expressed in this article are solely those of the author and may not be reflective of those held by TD Ameritrade, Inc.

For more information on the risks of trading and trading options, see page 35, #1 & 2.

SKILL LEVEL **EASY**

TAKE AWAY:
Learn how to create a pre-trading checklist.

BIG IDEA:
NO MATTER WHAT YOU TRADE, OR WHAT THE MARKET IS DOING, YOU NEED TO HAVE A GAME PLAN. AND IT DOESN'T HAVE TO BE COMPLICATED. IT CAN BE A SIMPLE CHECKLIST YOU CAN FOLLOW EVERY DAY.

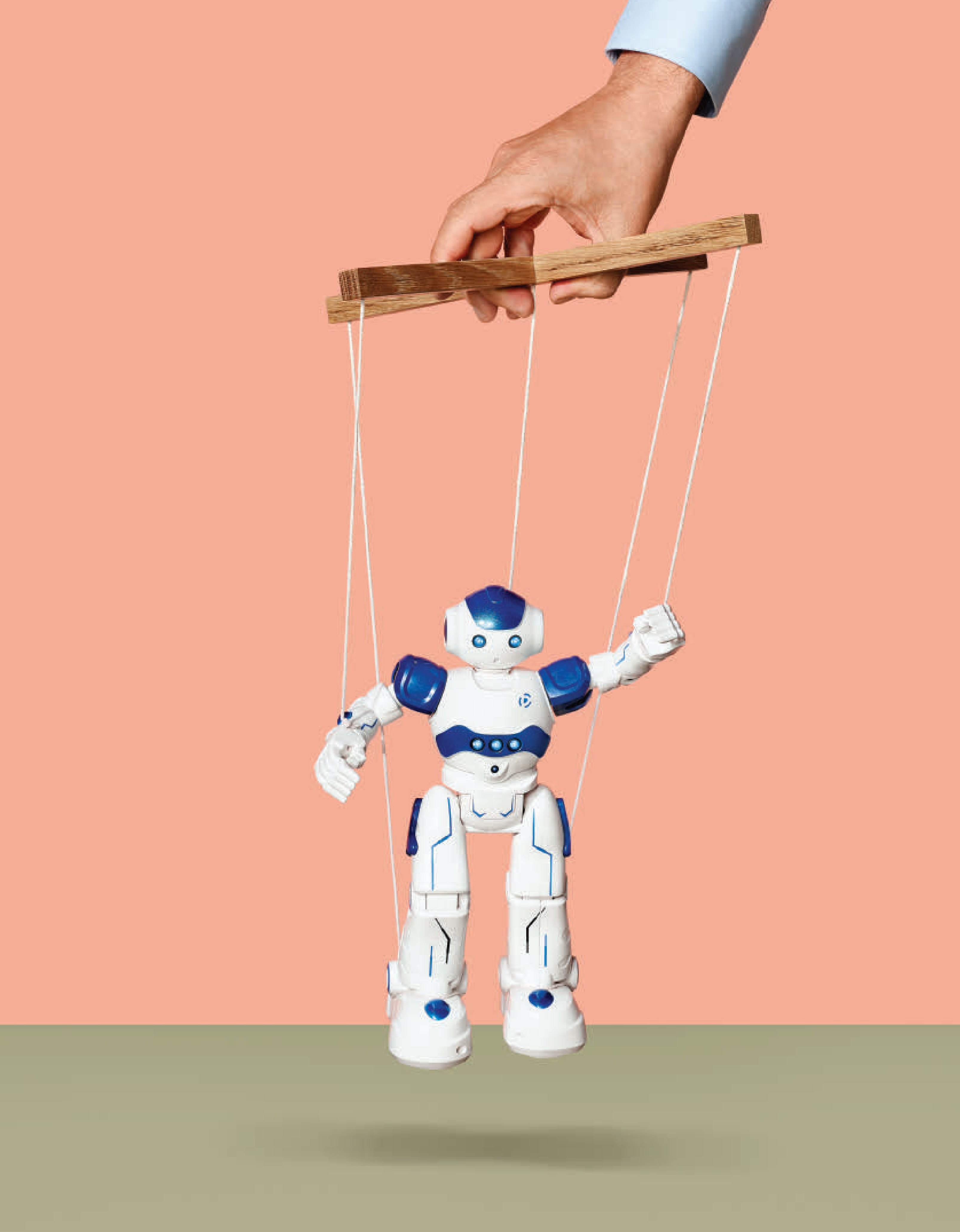
WORDS BY
JAYANTHI GOPALAKRISHNAN

PHOTOGRAPHS BY
DAN SAELINGER

black box trading

FOR THE REST OF US

SORT OF



you may not be wired to build automated trading systems that require endless code. But that doesn't mean you can't trade systematically. Yours may be a different kind of system—one with no math—but you can still develop and follow a set of rules to help you decide what and when to trade.

As a trader, you've likely come across countless typical trading "rules": don't trade based on emotions, make a plan, be disciplined, stick to your plans, and so on. But be honest: do you follow these rules each trading day, or do you still make certain trades based on instinct? Creating a system and a set of rules that works for you is a strong first step. To take it further, you'll want to be consistent in how you engage your system each trading day. This next step requires more thought.

One idea is to keep it simple and limit the number of rules. Trading involves quick decisions. The more checks and balances you have, and the more complicated your strategy, the more your stress levels can rise. And that's when things could start to fall apart. So, don't get fancy. You may want to stick to three important factors when trading options:

- Defined risk
- Positive time decay
- High probability of success

LESS IS MORE

Defined risk. Whether the stock, index, or exchange-traded fund goes up, down, or sideways, you should know what your max potential loss is before you place the trade. For example, if you trade a short call vertical, your max loss would be the difference between the two strikes, minus any premium you may have received, minus transaction costs. If you were to sell a naked short call*, you don't know what your max loss could be because the risk with this strategy is unlimited.

***SHORT CALL**
A bearish, directional strategy with unlimited risk in which an unhedged call option with a strike that is typically higher than the current stock price is sold for a credit. The strategy assumes that the stock will stay below the strike sold; in which case, as time passes and/or volatility drops, the call option can be bought back cheaper or expire worthless, resulting in a profit.

Positive time decay. You may want your options positions to have positive time decay. Meaning: all things being equal, as each day passes, your options position may be worth a little bit more. But don't all options lose value as each day passes? Yes, but if you put on a spread such as a short vertical, long calendar, or short iron condor, the short option puts time on your side.

High probability. The chance of a stock going up or down is like a coin flip (50/50). But those aren't good odds. You want better odds of success. One way to increase your probability is to look for an option chain with a shorter-term expiration and a higher probability of expiring out of the money (OTM).

Get to know these parameters. They could become your new best friends.

PUTTING THEM TO WORK

When you consider trading anything, you're going to have some directional bias. It could be based on technical or fundamental analysis, or maybe something you heard from a friend. This isn't exactly systematic, but hey, trading is a little bit art and a little bit science. Which means it's also subjective. And remember—just because you have a directional bias doesn't mean price is going to move in the direction you expect it to.

Once you've figured out what to trade, you'll need to pick strategies and strikes.

Let's walk through a short vertical spread, which is a defined-risk trade. If you have a bearish bias for a stock you want to trade, you'd create a short call vertical. If you have a bullish bias, you'd create a short put vertical. As a starting point, you may look for options that have somewhere between 25 to 45 days to expiration, since this gives you enough time to see the effect of time decay on your positions and also if your directional bias works in your favor. If you have a bearish bias, consider an OTM short call with say a 60% to 75% chance of expiring worthless, since that's what you ideally want your options to do. If you have a bullish bias, consider an OTM short put with a relatively high probability of expiring worthless.

Next, select the options strikes. If you're going to create a short call vertical, to limit your risk, consider buying the call option that's at least one strike further OTM than your short call. And if you're going to create a short put vertical, consider buying the put option that's at least one strike further OTM than your short put.

Consider these scenarios:

- With the short OTM call vertical, if the stock moves down by expiration, you'll likely make money.
- If the stock moves up past the short strike of the short call vertical, you'll probably lose money.
- If the stock goes up some, but not as high as the short strike of the short call vertical, you may still make money.

Now you have the lay of the land. Let's put a plan into action.

A DAY IN THE LIFE OF A TRADE

Naturally, the starting point is to establish a directional bias. And this isn't based on a coin toss if you make sure there's some amount of objectivity involved. First, get an idea of overall market performance. Luckily, you have tools available to help. Fire up the thinkorswim® platform from TD Ameritrade and select the **MarketWatch** tab. Then look to see which S&P 500 sectors are outperforming or underperforming. You can also visualize how each stock within the sectors is performing to help get an understanding of which direction a stock might move. Identify what you may want to trade and add those stocks to your **Watchlist**.

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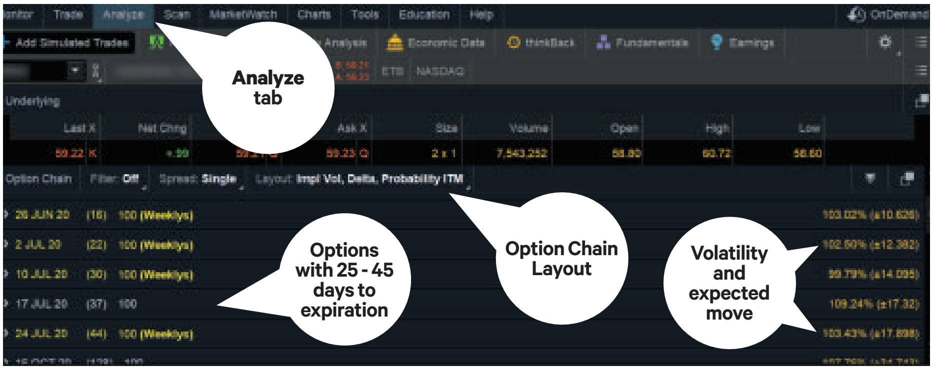

FIGURE 1: WHICH OPTIONS SHOULD YOU TRADE? From the **Analyze** tab on thinkorswim, bring up each option chain and consider looking at the volatility and expected move of options that expire in 25 to 45 days.

Source: thinkorswim from TD Ameritrade. For illustrative purposes only.

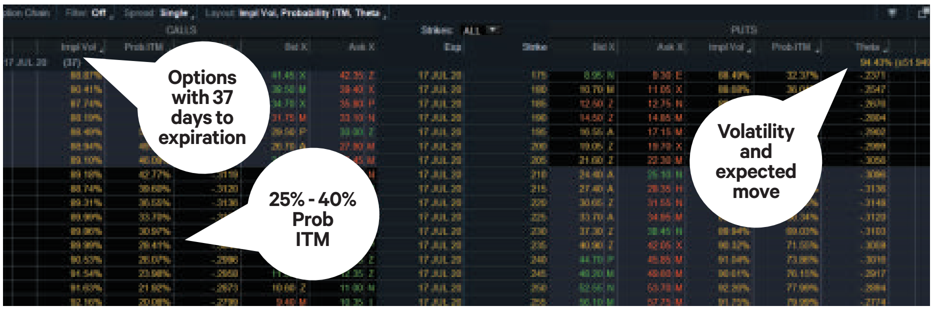

FIGURE 2: MASSAGING THE ODDS. You want your trades to have a high probability of success. For a short call vertical, a lower probability of the option expiring in the money can help improve your odds.

Source: thinkorswim from TD Ameritrade. For illustrative purposes only.

Then select the **Analyze** tab. Enter a symbol from your watchlist into the symbol box and review the different option chains (see Figure 1). Set up your layout so it displays **Probability ITM** in one of the columns.

For starters, you might want to look for options with expiration dates that are 25 to 45 days out. On the far right of the row, notice the volatility (vol) and the expected move (the number in parentheses next to vol) for each option. If the stock is volatile and you're comfortable with the expected move, go to the next step. Otherwise, it's back to the drawing board.

Say you have a bearish bias and want to sell a short call vertical. Because Prob ITM + Prob OTM = 100, a lower Prob ITM suggests a higher probability of expiring OTM.

Looking at the option chains, you could pick OTM call strikes that have about a 25% to 40% probability of expiring ITM (see Figure 2). So, you'd sell one call, and buy one that's one strike further OTM. You know what your credit is. Now select **Risk Profile** to visualize the potential risks and returns associated with this trade. You can go back and try other strikes, keeping that $1 width between the two, and analyze the different risk/return scenarios.

LET'S CREATE A USEFUL CHECKLIST

[ ] **Defined risk.** You know your max loss (width of strikes minus premium and transaction costs), and you know how much you could potentially make on this trade.

[ ] **Probability.** The options have about a 70% probability of expiring worthless.

[ ] **Positive time decay.** Because you're selling a call in your spread trade, you've got time on your side.

Even if you check off everything on the above list, it doesn't always mean your system will go as planned, or that you'll make money. Bottom line? Find and execute trades that make sense instead of shooting from the hip.

Still hesitant to jump into a trade? Try placing some trades in your paperMoney® account to see how this "trading system" works.

THERE'S NO GUARANTEED PROFIT when trading. But creating a system and following a checklist can give you the satisfaction of having made a sensible trade. You're not going to win them all. But with a method of analysis and a trading system, you'll have critical data for understanding what happens and why.

Jayanthi Gopalakrishnan is not a representative of TD Ameritrade, Inc. The material, views, and opinions expressed in this article are solely those of the author and may not be reflective of those held by TD Ameritrade, Inc.

For more information on the risks of trading and trading options, see page 35, #1 & 2.

The paperMoney® software application is for educational purposes only. Successful virtual trading during one time period does not guarantee successful investing of actual funds during a later time period, as market conditions change continuously.

PRACTICE WITH FUNNY MONEY.

On the **Log-in** screen of thinkorswim, move the slider to **paperMoney** and log in with your credentials.

SKILL
LEVEL
SAVVY

TAKE AWAY:
How to ladder puts to better manage risks.

PUTS & LADDERS

FOR YOUR IRA

BIG IDEA:
BUY AND HOLD IS A FINE STRATEGY FOR MANY LONG-TERM INVESTORS. BUT IT MAY NOT BE FLEXIBLE ENOUGH WHEN THINGS TURN UGLY. IF YOU WANT TO MORE ACTIVELY MANAGE YOUR IRA, LADDERING PUTS ACROSS PRICE AND TIME COULD HELP PROVIDE THE SUPPORT YOU NEED IN VOLATILE TIMES.

WORDS BY
JAYANTHI GOPALAKRISHNAN

PHOTOGRAPHS BY
DAN SAELINGER

WHAT'S EXCITING

about buying and holding for the long term, regularly investing a certain amount, and periodically checking your balance? Not much. In fact, many investors and traders consider their retirement accounts to be in that "traditional buy-and-hold" category. And although slow and steady may win the race, markets aren't always slow and steady.

KNOW WHAT YOU CAN AND CAN'T DO IN AN IRA.

https://bit.ly/TTira-trad

You can never predict when a market might turn south, so even in an IRA, you might consider managing entry points through the laddered selling of puts as opposed to buying the stock outright. And yes, this does fall under the "can-do" list for an IRA. But you'll need to be qualified to trade options in your account. And you'll need to have enough cash available in the account to buy the stock should you be assigned on a short put. That's why this strategy is described as selling "cash-secured" puts.

THE PUTS-FOR-ACCUMULATION STRATEGY IN A NUTSHELL

Suppose you're eyeing a purchase of 300 shares of FAHN—a high-flying stock you want to add to your retirement portfolio that's trading at $174 per share. You expect the stock price to move up based on your "go-to" technical or fundamental indicators, or anything else you rely on. But as a highflier, FAHN is quite volatile, and you're not sure you want to go all in at that one price.

When you sell a put option (and remember one options contract usually controls 100 shares of stock), that put has one strike and one expiration date. If the stock price stays above the strike price through expiration, you'll likely get to keep the premium you collected when you sold the option. If stock price goes below the strike price prior to or at expiration, and you don't close the position or roll it to another expiration date, you'll likely be assigned and end up purchasing shares of the stock at the strike price when the market price of the stock is probably lower. Remember: a short option can be assigned at any time prior to or at expiration, regardless of the in-the-money (ITM) amount.

But if your strategy is to accumulate shares of FAHN (or make a little money from a rally in the shares), you meet your objective either way by selling a cash-secured put.

Laddering takes the cash-secured put strategy and spreads it over different strikes and/or expiration dates. So, if your target is 300 shares of FAHN, you could build a ladder made up of three options contracts.

BUT FIRST, THE ASTERISKS

Before getting into building the ladder, there are a few things to note about this strategy. First, although a short put is technically a bullish strategy, there's a limit to your upside exposure. You keep the premium (minus transaction costs), and that's it. It doesn't matter how high FAHN might rally. Plus, because you don't own the shares, you have no voting rights, nor are you entitled to any dividends FAHN might pay.

There's also downside risk. If FAHN gets hammered, the meter keeps running on your exposure. Once a put is deep ITM, it essentially moves one-to-one with the stock—all the way to zero, if that should happen.

BUILDING THE LADDER

There are different ways to ladder puts in your portfolio. You could sell puts across different time frames and strikes at the same time. Or, you could scale in by selling one, and then—depending on how things go—before the first contract expires, you could add more. Anytime an option expires out of the money (OTM), you could add another.

Let's review how you could ladder three puts on your stock. Suppose the stock you're considering has been in a trading range for some time. It starts trending higher and moves above an exponential moving average (EMA) you follow (see Figure 1).

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On the thinkorswim® platform from TD Ameritrade, select the **Analyze** tab and look at the different option chains (see Figure 2).

FIGURE 1: MAKING A MOVE? After hanging out in a trading range for a few months, the price looks like it may break out above that range. *Source: thinkorswim from TD Ameritrade. For illustrative purposes only.*

FIGURE 2: THE THREE RUNGS. From the **Analyze** tab on thinkorswim, look up OTM puts in the **Option Chain.** Select puts that have a risk/return you're comfortable with and a relatively high probability of expiring OTM. *Source: thinkorswim from TD Ameritrade. For illustrative purposes only.*

FIGURE 3: VISUALIZING THE LADDER. Marking the levels of the different puts on a price chart could help you monitor and manage your positions. *Source: thinkorswim from TD Ameritrade. For illustrative purposes only.*

Say the stock is trading at $144 and the EMA is at around 139. From the **Option Chain**, based on the expected move and a relatively high probability of the options expiring OTM, you decide to sell the Dec 135 puts with 51 days to expiration. The credit for this trade minus transaction costs is $1.11.

The stock price continues moving up, so a couple of weeks later when the stock is trading at $150 with its EMA at 139, you decide to look at the deferred expiration dates. Once again, based on the EMA, expected move, and relatively high probability of expiring OTM, you decide to sell the Jan 140 puts with 63 days to expiration. You collect $1.20 for selling the puts.

A few weeks later, the stock pulls back to its EMA at around 146, but then continues moving up. With the stock trading at around $152 and EMA at 147, you decide to go out further to the February contracts. Analyzing the data, you decide to sell the Feb 140 puts for a $1.83 credit. These puts have 77 days to expiration.

Figure 3 shows the three trades that make up the put ladder in this example.

If the stock price remains above the strike prices through expiration, the puts expire worthless. You keep the credit, minus any transaction costs. At that point, depending on conditions, you could consider selling another put. If the stock price falls below the strike price before the put expires, you'll likely get assigned.

By spreading out your puts over price and expiration, you have more time to manage the puts that have more days to expiration. Things can, and do, naturally change as time passes. Volatility could increase, prices could fall, and the options that made sense at the time you opened the position may no longer meet your criteria. That's why it's important to monitor your positions often, especially in a retirement account.

THERE'S NO ONE "RIGHT WAY"

So, you could sell three puts across different strikes and expirations at the same time. You could also ladder based solely on prices or time frames. Another choice is laddering put spreads, where the long-leg strike price is lower than the short leg.

Looking at the same example, you could trade the Dec 135/130, Jan 140/135, and Feb 140/135 put spreads. Because these are spreads, you'd be collecting less premium, so your potential profits would be reduced. But your risk would also be limited. The max loss in these put spreads would be the width of the strikes, minus the credit received. Because these are $5 wide spreads, that would be a max loss of $500 (5x100), minus the premium and transaction costs for each spread.

If the stock price goes below the strike price of both puts in the spread and the puts get exercised, you'd lose the $500 (minus the credit received). You can decide if you want to buy the stock at the lower price or sell another put spread. The basic premise of laddering puts is the same as selling puts or put spreads. Yet, the laddered approach has a benefit: You diversify your risk by price, time, or both. And that helps you better manage your positions.

BECAUSE YOU'VE GOT PUTS WITH different expirations—and you could keep adding puts as time passes—it creates the opportunity to actively manage your IRA. After all, your retirement account is just as important as a short-term trading account. There's no requirement to think of it as a traditional buy-and-holder.

Jayanthi Gopalakrishnan is not a representative of TD Ameritrade, Inc. The material, views, and opinions expressed in this article are solely those of the author and may not be reflective of those held by TD Ameritrade, Inc.

For more information on the risks of trading and trading options, see page 35, #1 & 2.

Market Maker Magic Move

Now you see it; now you don't. It's not magic. It's math. And when you see MMM, it can provide some useful info.

Hey, Coach May! On the symbol bar of the thinkorswim® platform from TD Ameritrade, I saw a yellow MMM followed by a +/- number. But it's not always there. Is this some hocus-pocus magic, or is that how it's designed?

The three Ms stand for the Market Maker Move (MMM) indicator. It's not magic, but you can do some cool tricks with it.

Here's the gist. When the market prices excess volatility into the next options expiration date (typically on a Friday), MMM pops up and shows the expected magnitude of an upcoming move, expressed in dollar terms. So, an MMM of +/-4.50 would mean that, based on implied volatility (IV), the market is expecting a move—up or down—of $4.50 over and above the usual price variability.

Let me unpack that a little more.

In normal markets, IV is lower for the front-month options contract than for deferred months. But when a potentially outsize move—such as an earnings release or company announcement—is expected, you may see that yellow MMM. When there's no MMM, the options market isn't pricing in any excess volatility. But during especially volatile times, you might see MMMs for many stocks.

So how do I use the MMM?

There are different ways to potentially incorporate MMM into your trading strategies. Here are a few:

1 – Setting entry/exit points. Implied volatility is exactly that—volatility implied by the market based on options prices. That makes it an equilibrium spot, at least from a wisdom-of-the-crowd perspective. So, you could add MMM to your list of points to watch—as a possible profit target, stop level, or both.

2 – Strike selection for options spreads. If you plan to trade based on earnings reports, you could consider using the MMM to help structure a trade. What you choose depends on your risk tolerance and trade objectives. As an example, some traders set the strikes of a short strangle one or two MMMs wide.

Another tactic is to sell an iron condor with the short legs one MMM around the at-the-money strike and the long legs two MMMs apart. This would put your area of profit within the MMM reading, but if it happens to be a mega-surprise, you hit your max loss in two MMMs.

3 – Long options plays. Pre-earnings, IVs tend to be elevated (which is why the MMM shows up), and that means options can be relatively expensive. But you might find a bargain in a strike price that's outside the MMM range. Scan the MMMs of your favorite stocks and compare them to the wing strikes in the option chain to see if something strikes your fancy.

MMM uses some market dynamics that market makers use to set their bid/ask spreads (hence the name). It's reverse-engineered math—no secrets there. Don't expect MMM to give you clairvoyance on how far, or in which direction, a stock will move. But it could be a welcome addition to your bag of cool trading tools.

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HOW TO FIND MMM

To learn more about how to find and use MMM, read https://bit.ly/TTmktmkr

Probability analysis results from the Market Maker Move indicator are theoretical in nature, not guaranteed, and do not reflect any degree of certainty of an event occurring.

PHOTOGRAPH: DAN SAELINGER

FIGURE 1: IDENTIFYING SUPPORT AND RESISTANCE LEVELS. From the Charts tab on the thinkorswim® platform from TD Ameritrade, select the Drawings button. Then, from the Drawing Tools menu, select Fibonacci Retracements (%). *Source: thinkorswim from TD Ameritrade. For illustrative purposes only.*

Charting and Strike Selection: Together at Last

Trying to figure out what strikes to use for different options strategies? Try some good old-fashioned charting.

• Sure, option traders can choose their strategies by looking at probability, volatility, and the options greeks. But some traders like to visualize a trade before jumping in.

Looking at price charts has its benefits. First, you get an idea of the overall direction—has price been trending up, down, or sideways? With that info, you can identify potential levels of support and resistance, breakouts, and reversals. Then you can use those points to decide on your options strategies and strike prices.

Let's walk through one charting approach that might help you make more informed options trading decisions: using Fibonacci (Fib) retracement levels.

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Figure 1 displays Fib retracement levels on a chart of the E-Mini S&P futures (/ES), which is trading around $2,810. That's close to its 50% retracement level at $2,788. Note that the retracement levels between 50% and 61.8% have acted as relatively strong support and resistance levels. Based on that information, /ES could trade within that range, but there's also a chance it could head lower and go below the 50% retracement level or higher above the 61.8% level.

Say you're considering selling out-of-the-money (OTM) vertical put spreads. The price needs to remain above the options strike prices if you hope to keep the full premium. So, one idea may be to consider selecting strikes below the next support level, or 38.2% retracement. That could mean giving up some premium, so weigh your risks against potential returns. And consider options with a high probability of being OTM at expiration.

Say you sell to open the put spread position and then /ES moves above the 61.8% retracement level. You could then add a call spread with strikes that are higher than the put spread.

STRIKE SELECTION

From the chart, let's assume you determine that if /ES trades below the 50% retracement level, then $2,643 could be a possible support level. On thinkorswim, select the **Analyze** tab, and review the puts with strike prices below that price level.

As an example, for the put spread, you could sell the 2640 put and buy the 2635 put. And if /ES starts to move above the 61.8% retracement level, you could add a call spread with strikes closer to the 78.6% retracement level. You could consider selling the 2950 call and buying the 2955 call. It really depends on which options have a high probability of expiring OTM, and how much credit you receive versus your max loss.

The worst-case scenario? When either the two calls, or the two puts, are in the money (ITM). Remember that both spreads can't be ITM at the same time. So, you can only lose money on one. In this case, either the calls are above $2,955 or the puts are below $2,635. Your max loss would be the difference in the strikes of the ITM puts or calls, i.e., 100 x $5 = $500, minus any collected premium and transaction costs.

Consider assignment risks too. You've got two spreads, and the short options can be assigned at any time.

CHARTS CAN BE A GREAT STARTING POINT for making trading decisions. They offer drawing tools and indicators you can apply to see the bigger picture. From there, narrow things down to specific strategies and strike prices. After that, it's about how well you manage your trades. —Words by JAYANTHI GOPALAKRISHNAN

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In the money (ITM)—An option whose premium contains "real" value, i.e., not just time value. For calls, it's any strike lower than the price of the underlying equity. For puts, it's any strike that's higher.

Butterfly—Typically a market-neutral, defined-risk strategy composed of selling two options at one strike and buying one each of both higher- and lower-strike options of the same type (either all calls or puts). The strategy assumes the underlying will remain relatively unchanged during the life of the trade, in which case, as time passes and/or volatility drops, the combined short options premiums exhibit more decay than the combined long options premiums; resulting in a profit when the spread can be sold for more than its original debit (which is its maximum loss).

Calendar spread (long)—A defined-risk spread strategy constructed by selling a short-term option and buying a longer-term option of the same type (i.e., calls or puts). The goal: as time passes, the shorter-term options typically decay faster than the longer-term options and profit when the spread can be sold for more than you paid for it. The risk is typically limited to the debit incurred.

Gamma—A measure of what an options contract's delta is expected to change per $1 move in the underlying.

Iron condor —A defined-risk, short spread strategy constructed of a short put vertical and a short call vertical. You assume the underlying will stay within a certain range (between the strikes of the short options). The goal: as time passes and/or volatility drops, the spreads can be bought back for less than the credit taken in or expire worthless, resulting in a profit. The risk is typically limited to the largest difference between the adjacent and long strikes minus the total credit received.

Out of the money (OTM)—An option whose premium is not only all "time" value, but its strike is away from the underlying equity. For calls, it's any strike higher than the underlying. For puts, it's any strike that's lower.

Put spreads—A put options spread strategy involves buying and selling equal numbers of put contracts simultaneously. Spread strategies can also entail substantial transaction costs, including multiple commissions, which may impact any potential return.

Short vertical—A defined-risk, directional spread strategy composed of an equal number of short (sold) and long (bought) calls or puts with the same expiration in which the credit from the short strike is greater than the debit of the long strike, resulting in a net credit taken into the trader's account at the onset. Short call verticals are bearish, while short put verticals are bullish. The risk in this strategy is typically limited to the difference between the strikes minus the received credit. The trade is profitable when it can be closed at a debit for less than the credit received. Breakeven is calculated in a short put vertical by subtracting the credit received from the higher (short) put strike, or in the case of a short call vertical, adding the credit received to the lower (short) call strike.

Theta—A measure of the sensitivity of options to time passing one calendar day. For example, if a long put has a theta of -0.02, the options premium will decrease by $2 per contract.

Vega—A measure of the sensitivity of options to a one-percentage-point change in implied volatility. For example, if a long option has a vega of 0.04, a one-percentage-point increase in implied volatility will increase the options premium by $4 per contract.

Vertical spread—A defined-risk, directional spread strategy composed of a long and a short option of the same type (that is, calls or puts). Long verticals are purchased for a debit, while short verticals are sold for a credit at the onset of the trade. Long call and short put verticals are bullish, whereas long put and short call verticals are bearish. The risk of a long vertical is typically limited to the debit of the trade, while the risk in the short vertical is typically limited to the difference between the short and long strikes, minus the credit.

Cboe Volatility Index (VIX)—This index is the de facto market volatility index investors use to measure the implied volatility of S&P 500 Index options. Otherwise known to the public as the "fear index," it's most often used to gauge the level of fear or complacency in a market over a specified period of time. Typically, as the VIX rises, options buying activity increases, and options premiums on the S&P 500 Index increase as well. As the VIX declines, options buying activity decreases. The assumption is that greater options activity means the market is buying up hedges in anticipation of a correction. However, the market can move higher or lower, despite a rising VIX.

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GENERAL DISCLAIMER

The information contained in this article is not intended to be investment advice and is for illustrative purposes only. Be sure to understand all risks involved with each strategy, including commission costs, before attempting to place any trade. Clients must consider all relevant risk factors, including their own personal financial situations, before trading. Past performance of a security or strategy does not guarantee future results or success.

Transaction costs (commissions and other fees) are important factors and should be considered when evaluating any options trade. Options are not suitable for all investors as the special risks inherent to options trading may expose investors to potentially rapid and substantial losses. Options trading is subject to TD Ameritrade review and approval. Please read Characteristics and Risks of Standardized Options *(http://www.optionsclearing.com/about/publications/character-risks.jsp) before investing in options.*

It is not possible to invest directly in an index.

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OPTIONS STRATEGIES

Trading options involves unique risks and is not suitable for all investors.

Spreads, condors, butterflies, straddles, and other complex, multiple-leg options strategies can entail substantial transaction costs, including multiple commissions, which may impact any potential return. These are advanced options strategies and often involve greater risk, and more complex risk, than basic options trades. Be aware that assignment on short options strategies discussed in this article could lead to unwanted long or short positions on the underlying security.

The maximum potential reward for a long put is limited by the amount that the underlying stock can fall. Should the long put position expire worthless, the entire cost of the put position would be lost.

When trading short options strategies, there is a risk of getting assigned early on the options sold, even if they go in the money by $0.01, obligating you to deliver shares you don't own (in the case of a short call) or purchase shares (in the case of a short put).

The risk of loss on an uncovered short call options position is potentially unlimited because there is no limit to the price increase of the underlying security. Option writing as an investment strategy is absolutely inappropriate for anyone who does not fully understand the nature and extent of the risks involved.

Short naked put and cash-secured put strategies include a high risk of purchasing the corresponding stock at the strike price when the market price of the stock will likely be lower.

Short naked options strategies involve the highest amount of risk and are only appropriate for traders with the highest risk tolerance.

A covered call strategy can limit the upside potential of the underlying stock position, as the stock would likely be called away in the event of a substantial stock price increase. Additionally, any downside protection provided to the related stock position is limited to the premium received. (Short options can be assigned at any time up to expiration regardless of the in-the-money amount.)

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FUTURES

Futures trading is not suitable for all investors, as the risk of loss in trading futures is substantial. Futures accounts are not protected by the Securities Investor Protection Corporation (SIPC). Futures and futures options trading services are provided by TD Ameritrade Futures & Forex LLC. Trading privileges are subject to review and approval. Not all clients will qualify.

Futures and futures options trading are speculative and are not suitable for all investors. Please read the Risk Disclosure for Futures and Options *prior to trading futures products (https://www.tdameritrade.com/retail-en_us/resources/pdf/TDA631.pdf).*

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SPREAD DISCLOSURES

Options collar: *The collar position involves the risks of both covered calls and protective puts.*

Options covered call: *The covered call strategy can limit the upside potential of the underlying stock position, as the stock would likely be called away in the event of a substantial stock price increase. Additionally, any downside protection provided to the related stock position is limited to the premium received. (Short options can be assigned at any time up to expiration regardless of the in-the-money amount.)*

Options long put: *The maximum potential reward for a long put is limited by the amount that the underlying stock can fall. This strategy provides only temporary protection from a decline in the price of the corresponding stock. Should the long put position expire worthless, the entire cost of the put position would be lost.*

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