thinkMoney®/54

Random musings for traders at TD Ameritrade—WINTER 2022

DETAILS
ON PAGE 5

FAREWELL!

AFTER 15 YEARS,
WE'RE SAYING
GOODBYE.

TRADING LONG OPTIONS

WITHOUT SHORT-CHANGING YOURSELF

PAGE 16

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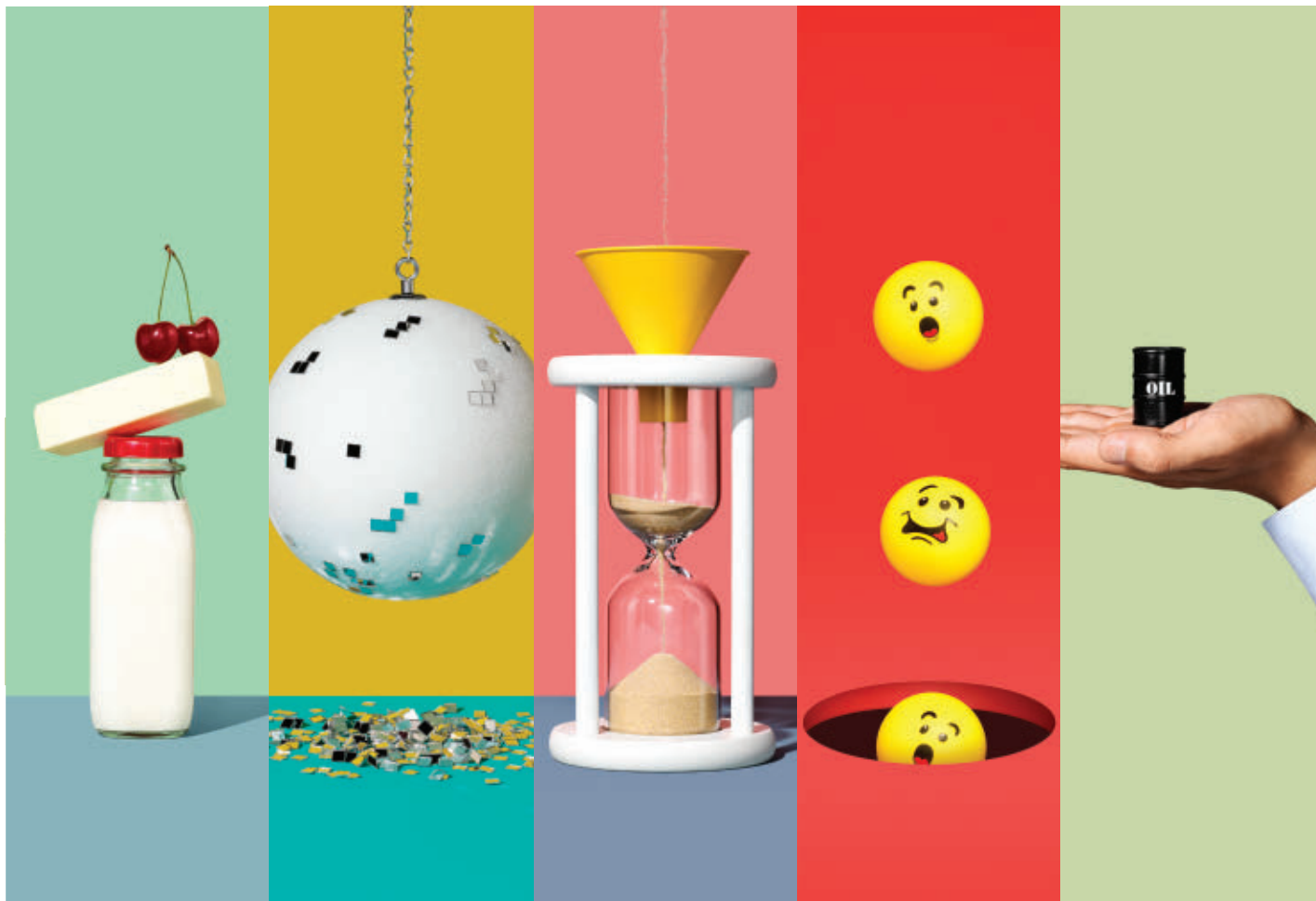
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Farewell, *thinkMoney*

• SINCE WE STARTED *thinkMoney* back in 2008, the world has evolved. The industry has evolved. You as traders have evolved. The way you get your market news, trade on our platforms, and educate yourself has taken a digital shift. The market is constantly changing, and you need to always have the most up-to-date info on hand. Simply put, that pace is faster than a quarterly magazine. By the time you open the cover, the content is already old news.

In the spirit of this digital age and delivering resources that keep up with this fast-changing market, we're saying "so long" to *thinkMoney* magazine. However, just because this is your last issue and thinkMoney is going away, doesn't mean the great insights you get from it are too. We have other ways for you to keep up with the market, track trends, and help master thinkorswim®.

Let's start with one of our favorites (and the closest thing to an online version of *thinkMoney* magazine), The *Ticker Tape*®. Here, you can peruse a library of educational articles at your leisure, read *thinkMoney* archives for some nostalgia, and get daily market commentary from JJ Kinahan. Plus, with a fast and easy subscription, you can get the timely market info that matters most to you, delivered right to your inbox. Just choose the topics you want to know more about and boom—you've got mail. Visit tickertape.tdameritrade.com/subscribe to sign up today.

If learning about thinkorswim is your focus, you don't have to go far. Just click the **Education** tab in the platform to see available webcasts and tutorials—or go to tdameritrade.com/webcasts to view our webcast calendar. You can also check out the Learning Center for more info.

Last, but not least, you also have our media affiliate, TD Ameritrade Network*. With more than nine hours of live broadcasts every market day, this programming doesn't just bring you the news but interprets it, so you understand how to confidently apply what's going on in the markets to your strategies.

So, even though we'll all miss *thinkMoney*, you have many options to help you stay innovative, relevant, and informed.

As we sign off for the last time, we leave you with this: The best asset any trader can have is knowledge. So, keep exploring, keep learning, keep trading. After all, there's a reason why TD Ameritrade is where smart investors go to get smarter.

Happy trading,
thinkMoney
Editors, Contributors, and Staff

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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.

Micro WTI Crude Oil futures

Micro-sized Crude Oil contracts Major market opportunity

Micro WTI Crude Oil futures from CME Group are live, giving traders of all sizes a more precise way to manage crude oil price exposure. Now you can get all the benefits of trading this global benchmark at 1/10 the size.

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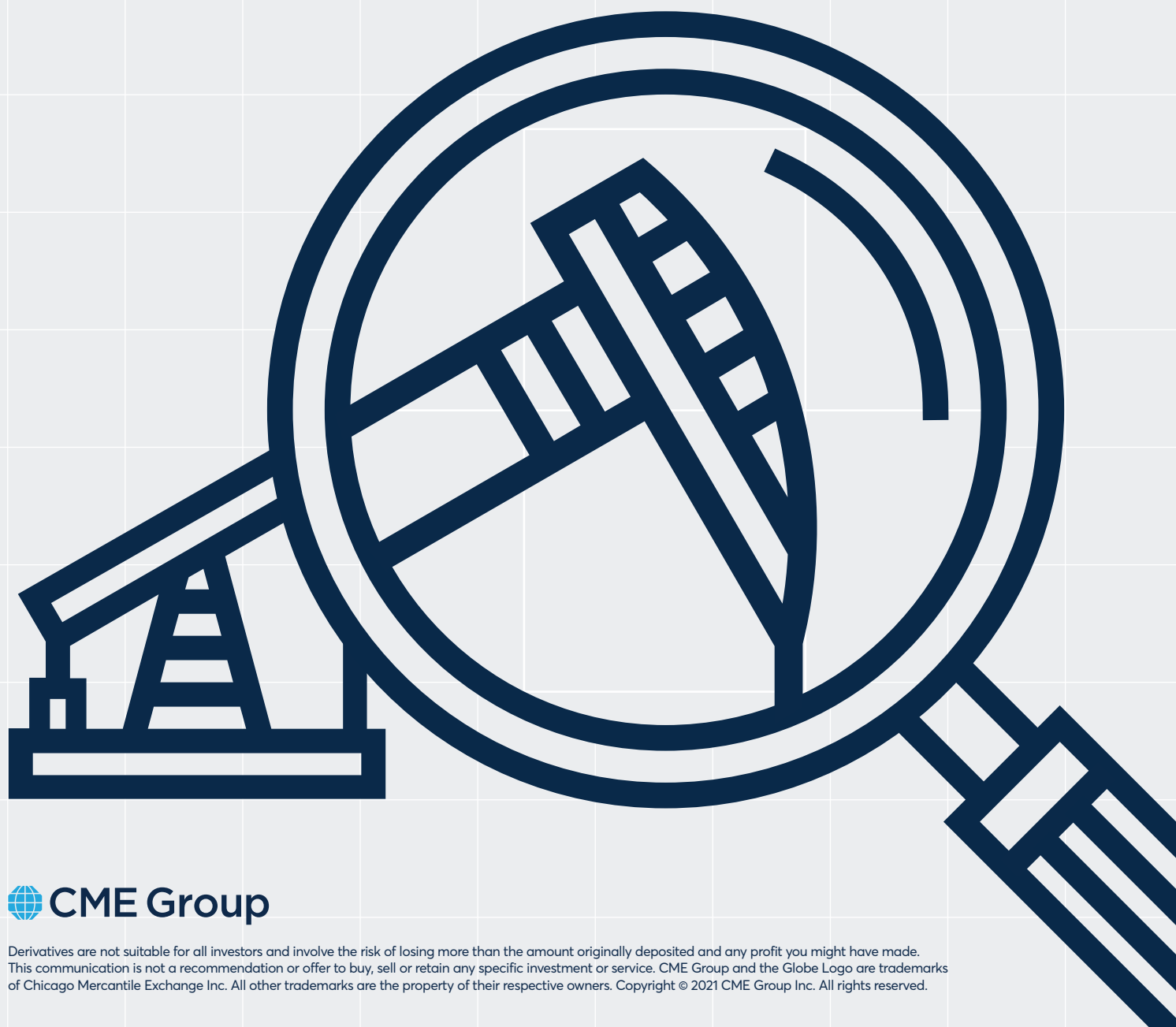
🌐 CME Group

IN THE MONEY

INDUSTRY SPOTLIGHT

Micro Crude Futures: A Lower-Cost Ticket to Oil

Ever thought about trading oil futures? Consider micro crude oil futures. At 1/10th the notional value of full-size WTI crude oil futures contracts, they could be within reach.

• CRUDE OIL FUTURES ARE VOLATILE and yet versatile, which is why they're one of the world's most actively traded commodities. Crude oil futures can be used to hedge anything from the cost of airline fuel to plastic shampoo bottles. Many traders closely watch the price of crude oil, mainly because it's the most consumed type of energy.

You can trade crude oil indirectly using stocks or exchange-traded funds. But, they don't necessarily correlate perfectly with crude oil price movement. If you want to gain exposure to crude oil, futures might be the ideal vehicle. But for many it can be cost prohibitive.

That may have changed when CME Group launched Micro WTI Crude Oil futures. They're linked to the exchange's benchmark—West Texas Intermediate (WTI) Crude Oil futures contracts—but require less money up front because they're one-tenth the size.

Of course, micro futures aren't suitable for everyone, and they carry the same risks as full-size contracts. But the hurdles to enter the market are lower, and as a result, they offer benefits not always available when using bigger contracts.

ADVANTAGES OF A SMALLER CONTRACT
Up-front cost. Micro crude oil futures can be used to gain exposure to the crude oil market for hedging or speculation at a fraction of the cost of full-size futures contracts.

Flexibility. The standard benchmark WTI crude oil contract represents 1,000 barrels of physically delivered WTI crude oil. The micro contract size is 100 barrels, so trading strategies can be tailored or granular for risk management needs.

Capital efficiency. The micro contract has a smaller margin requirement. Traders can establish market exposure at a fraction of the cost of the standard benchmark crude oil contract. Plus, micro contracts offer the same benefits and risks as the benchmark contract.

KNOW ABOUT MARGIN

Futures contracts are highly leveraged—you need a relatively small amount of initial capital to participate in a relatively large amount of underlying, or notional, value. And that means gains and losses are magnified: A small amount of market movement can have a large impact on your profit or loss. Oil futures are traded by using a margin requirement, which is cash that's set aside as a good-faith deposit.

Because the Micro WTI Crude Oil is one-tenth the standard WTI Crude Oil futures contract, the micro contract's margin requirement is also one-tenth that of its larger counterpart.

If you're considering trading futures, make sure you understand the basics of futures margin. Regardless of how large your position, leverage can magnify profit and loss, which means you could lose much more than the initial amount deposited.

MICRO CRUDE STRATEGIES

There are several ways to use Micro WTI Crude Oil futures contracts.

Hedging. Suppose your portfolio holds shares of major oil and gas exploration companies or of oil-field service providers. Yet, you have concerns about short-term events, like a drop in oil prices, that might hurt the value of those stocks. A hedging strategy using Micro WTI Crude Oil futures may offer the potential to ride out such events without having to part with those shares.

Supply/demand dynamics. Oil prices are known to be volatile. Shares in various types of energy-industry stocks are one way to gain exposure to the market, yet other factors can move energy-industry stocks. Using futures can be a way to establish a position that's closely tied to product supply or demand fundamentals. So, plug in the ticker symbol /MCL on the thinkorswim® platform and watch how the micro crude contract moves. —Words by MARY HAFFENBERG

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

THINKTANK
Need Speed?

If you trade actively, one important consideration is getting your orders in quickly. Find out how Active Trader on the thinkorswim® platform can help.

If you've been trading awhile and are used to placing orders, you may be ready to consider the Active Trader feature on thinkorswim. With Active Trader, you can enter orders with one click and move them to different price points by dragging your mouse. You can also cancel and replace working orders the same way. Keep in mind that any open orders could get filled while you're in the process of modifying or canceling them. So, to use these features well, you should be an experienced trader and have confidence in your decisions. Even if you don't fit this bill, you can still try out Active Trader using paperMoney® on thinkorswim without putting real money at risk while learning or just to get a deeper understanding of how the features might help. Consider a couple different ways to access Active Trader. Select the subtab in the **Trade** tab, or access it from any of the control bars on the right side of a chart.
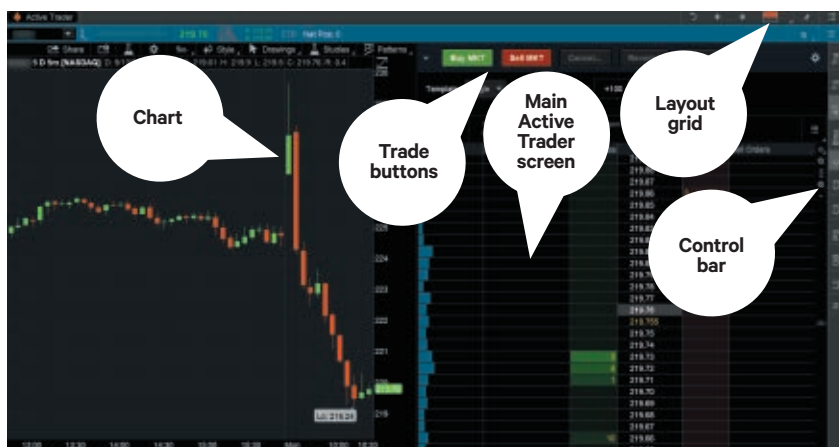
FIGURE 1: ACTIVE TRADER LAYOUT. Customize your layout in different ways. Consider familiarizing yourself with this feature even if you're not an active trader. *Source: thinkorswim. For illustrative purposes only.*
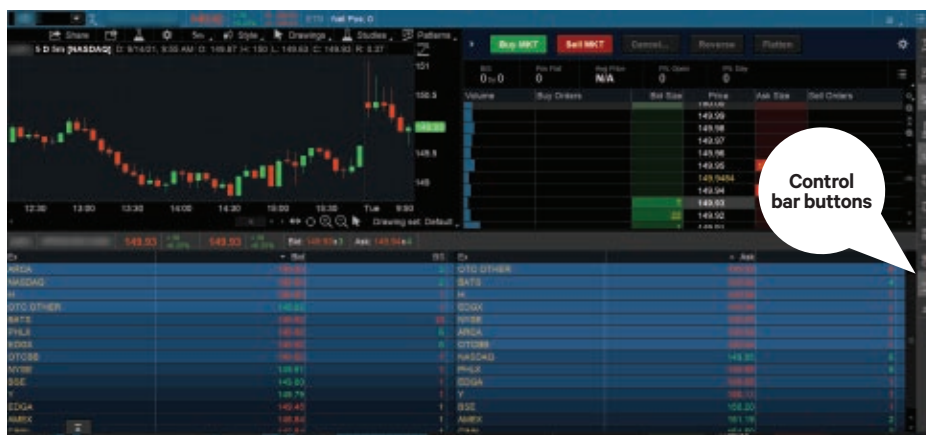
FIGURE 2: THE CONTROL BAR. Try the different buttons. There may be a layout you like to use to get a better understanding of price movement. *Source: thinkorswim. For illustrative purposes only.*
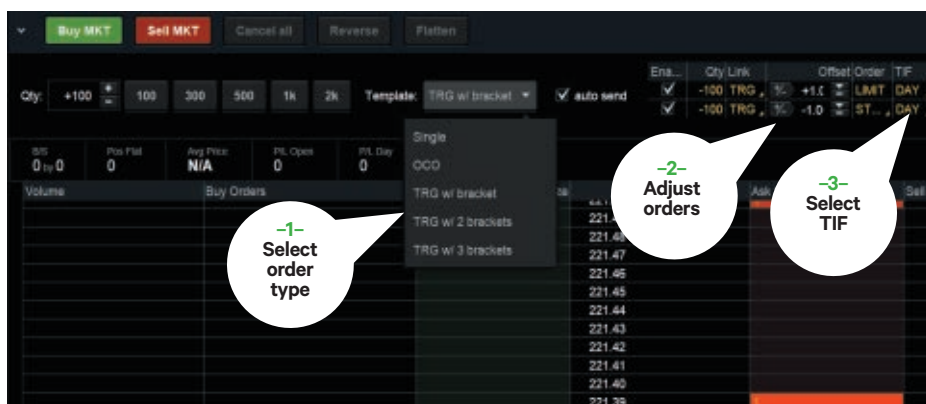
FIGURE 3: PLACING ORDERS WITH ACTIVE TRADER. For some traders, price fills and speed are important, and using the Active Trader could shave a few seconds off the process of placing orders.
Source: thinkorswim. For illustrative purposes only.

ACTIVE TRADER LAYOUT

When you first view Active Trader, the layout includes a chart on the left and prices displayed vertically on the right (see Figure 1). You can change the layout to display the number of charts you like to review, similar to what you'd do in the **Charts** tab. You can also use the grid presets to quickly access a layout.

Let's take a closer look at the Active Trader screen. It's like a level 2 of the market displayed vertically. You see the bid and ask size—bid side representing buyers, and ask side representing sellers. Customize the columns by selecting the settings gear icon, and then save the layout so you can use it later.

THE CONTROL BAR

On the right side of the Active Trader panel are several buttons (see Figure 2). Select these to add or delete features. It may be worth your while to try each one—news screen, Level 2 quotes, dashboard, charts, time, and sales—displaying a set of order buttons between the chart and other market boxes or above your chart. You may find one you like.

ENTERING ORDERS

If you want to place a market order, adjust the quantity by selecting the arrow next to the **Buy MKT** button, then select **DB** (or dashboard) from the control bar so you

can see the current market price. When you're ready to place the trade, select the **Buy MKT** button. An order confirmation dialog box will pop up, and you can choose to send the order. But if you want faster order entry, skip the confirmation screen by checking the **auto send** box on the dashboard (see Figure 3). If you don't want to place a market order, place your cursor on your desired price and select it. Please understand if you enable the **auto-send** feature, you will not be able to view the order in the confirmation screen prior to its final submission. You're responsible for all orders placed in your account—another reason to use paperMoney before putting real money at risk.

Once the trade is filled, if you wanted to, you could scale out of your position by "bracketing" your order using the one-cancels-other (OCO) order type.

1 – Select order type from the **Template** menu.
2 – Adjust the OCO "offset" using the +/- to the right of the **Link** input for value, percentage, or tick.
3 – Select **TIF** (time in force). Select your exit levels using specific prices, a dollar-amount change, or percentage change.

If you want a different perspective, you may want to give Active Trader a try. Sometimes a change in your screen layout could improve your trading experience.

The paperMoney® trading 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.

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To Leg or Not to Leg: When Does It Make Sense?

If you're thinking of participating in the world of "legging," there are some things to consider. James Boyd, Education Coach at TD Ameritrade, explains the good and the bad.

Q: **When you trade a multi-leg options spread, do you need to enter and exit the legs in the same transaction, or can they be done separately?**

That's a great question. When you're thinking of creating an options spread position, you don't necessarily have to buy or sell the different legs simulta-

neously. For example, if you're creating a put vertical spread, you could leg in to the trade—enter an order for the long put, wait till the order gets filled, then enter an order to sell the short put.

It's the same with the exit. You could exit both in the same transaction, or leg out of each one in separate transactions. For

example, if you set a predefined place to exit your trade—a support area or a price target—you could plan to exit one of the legs when it reaches your target. Say your order to sell the long put gets filled. The short put will still be remaining. And if that short put could benefit from time decay and volatility contraction, you might decide to stay in that short put a little longer. But, a short position can be assigned at any time regardless of in-the-money amount. Plus, you're likely leaving the short put naked, which could result in a hit to your available capital because of the margin requirement on the naked option.

Q: **What are the pros and cons of legging in to trades?**

Getting a good fill is important for a trader. Stocks with higher volume are likely to have higher options volume. And higher volume could mean better fills. Of course, month and strike selection and other factors can affect volume as well.

The reason you might consider legging in to a trade is to potentially get a better fill. But after that first leg is filled, you're taking a chance with the price of the second leg. Things could go your way, and you may end up getting filled at a better price. But there's also the likelihood things may not go your way. In that case, you may not be able to get in to the second leg at the price you want. That could even discourage you from getting in

to the second leg, leaving you placing only one leg of the trade. That could mess up your original trading strategy.

Legging in and out of trades also requires discipline. Say you were selling a call vertical spread. You entered the short call first, and the price of the underlying shot up. You'd be losing on that short call option, and you'd have to try to buy the long call at a higher price. On top of that, you may have a margin call because the system won't know you have plans to buy an option against that short call. It will look at that order as a naked one, which has unlimited risk.

So, legging in to trades can work if you get the timing right, but there's a chance that things may not go your way. Before deciding whether or not to leg in, think hard about the reason you want to place the trade in the first place. If you do decide to leg in to the trade, always have a plan B.

Tracking Market Activity, Visually

If you've been trying hard to understand what goes on beneath the price bars on a chart, this colorful feature could be the ticket.

• In *thinkMoney 53*, we introduced you to Bookmap. Now that more traders are using this tool, it may be worth diving into a bit more.

You may have to contact TD Ameritrade to request Bookmap on thinkorswim®. Once you're set up, the first thing you'll notice are a lot of dynamic colors, dots, and lines. It may be a little overwhelming at first, but once you figure out what they mean, it'll open you up to a whole new world of trading.

All that movement is real-time market action, and the heat-map-style visualization helps you see a number of things: all transactions that have taken place on the bid/ask prices, the number of buyers and sellers, the stocks moving up and down through their support and resistance levels, whether spreads are tight or wide, whether orders are getting filled or just sitting there, and so on. Basically, you get a deeper look at price action, especially order flow and liquidity. And for a trader, order flow and liquidity are two key data points.

Another cool Bookmap feature is that you get an "inside" view of a candlestick bar. When you overlay the candlesticks on the heat map, you see the candlestick bar forming. And as the candlesticks are forming, you may see the red and green dots on the charts—red dots representing sells and green ones representing buys. The green dots are connected by a green line and the red dots are connected by a red line, so by looking at these lines, you can see if the spread between the bid and ask is tight or wide. You can also see when a stock gets volatile and starts to move.

The colored horizontal bars represent pending orders, and each color matches up with the liquidity of the different price slices. You can also zero in and view order flow in smaller time frames—we're talking seconds.

You'll also get an inside view of volume bars. Traditional volume bars display a cumulative total. You don't know how many trades were buy and sells. But the Bookmap volume bars separate them, with red and green bars representing sells and buys, respectively. And those dots are volume dots, so a bigger dot represents higher volume. There are many other ways to view the number of buyers and sellers. Whichever way you choose to view the data, seeing if there are more buyers than sellers (or vice versa) can be helpful in determining potential price movement.

Another useful piece of data you can get from Bookmap is whether orders are getting filled or if traders are just keeping them there to move the price—you can see if the orders are removed before getting filled.

If you've wondered what goes on beneath the price bars you see on a chart, Bookmap takes you there. And there are many ways to use it. You can join the user community to see what other users are talking about. It's a great way to learn about new features or new ways to use features. But it's not free—you do have to pay $39.99 per month for it.

How is **futures** margin different from equities margin?

When you trade futures, you often wind up with a lot of questions. That's why, at TD Ameritrade, we have on-demand education, futures specialists ready to talk day and night, and an intuitive trading platform. So whatever the question, you'll have all the answers you need.

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TRADING LONG OPTIONS

WITHOUT SHORT-CHANGING YOURSELF

WORDS BY **JOHN MANLEY**

PHOTOGRAPH BY **DAN SAELINGER**

BIG IDEA:
SOME OPTION TRADERS STICK TO SELLING STRATEGIES ONLY. BUT BUYING CALLS AND PUTS HAVE THEIR PLACE TOO. YOU JUST HAVE TO CREATE A RECIPE AND STICK TO A FEW KEY INGREDIENTS.

IT'S NOT UNUSUAL FOR OPTION TRADERS

to begin their journey by buying calls and puts. Armed with a fearless attitude, they often don't put much thought into their actions and end up with losses in their trading account after a few trades—not exactly a success story.

Many experienced traders use a clearly defined set of rules and money management principles. They enter trades for a valid reason, try to put the probabilities on their side, and apply smart money management principles before, during, and after a trade. And they do this over and over again.

If you're thinking of buying options—puts or calls—keep in mind that trade decisions are often deeply rooted in understanding volatility, time, and price. Success in options trading isn't always about gut feel. It's about careful analysis, structuring your trades, and managing risk.

How can you strive to get consistent results from a simple options-buying strategy? Consider these five elements to help get you started on a smarter path.

1 PICK AND CHOOSE: SELECTING OPTIONS

Too many choices can be overwhelming and challenging. But you can probably strike many off your list due to lack of volume, low open interest, and wide bid-ask spreads.

Some options have a large pool of buyers and sellers, whereas others sit idle with little or no activity. The lack of liquidity could end up being costly and even potentially turn a winning trade into a losing one. That's because of the potential for price slippage, or the difference between the price at which you expect to get filled and the actual executed price of an entry or exit order. So, how can you size up options liquidity? Two important indicators can help—volume and open interest. Taken together, they can give a sense of whether

an options contract is very liquid, sort of liquid, or gathering dust.

More liquid options contracts tend to have more strikes and expirations to choose from. They also typically have narrower bid/ask spreads. Liquidity is important for active traders in fast markets and/or near expiration dates—that's when opening or closing a position might be a more pressing issue (see the sidebar: "Taking Stock of Liquidity").

2 ANALYZE MOMENTUM AND TREND

Once you've selected an underlying instrument based on liquidity thresholds, your next step is to consider assessing momentum and trend. When you're buying an option, you want it to move fast in your desired direction. Options are decaying assets that are headed toward expiration. With each passing day, the option will lose a little bit of value based on time decay, or theta. A stock could be moving in the right direction, yet if it doesn't move fast or far enough, it could become a losing position.

So, how can you attempt to put the probabilities in your favor around momentum and trend? Looking at a price chart could help. There are many ways to analyze a price chart, but let's start with identifying a possible trend. A stock can do one of three things at a time—trend up, consolidate sideways, or trend down.

From the **Charts** tab on thinkorswim, bring up a price chart and determine if the stock is in a clear uptrend (see Figure 1).

But direction isn't enough. The trend has to have momentum. A slow grind can make you right directionally, but theta could drag you down. So, consider adding volume and some momentum indicators such as the Relative Strength Index (RSI) and stochastic oscillators into the mix. If the trend is up and the additional indicators suggest strong momentum, there's a chance the stock has the strength it needs for the trend to continue.

As a long option trader, you could consider buying calls in a dip in the longer-term upward trend. Puts work similarly but in reverse. You want to look for short-term strength in a longer-term downtrend.

3 ASSESS IMPLIED VOLATILITY

As long option traders, you want to be on the right side of implied volatility (IV). If IV is too high, options are considered expensive. That's because of the extra premium built into the option to mitigate the risk of the market maker who's selling it to you. For example, IV will often rise before an earnings report because traders anticipate a possible big move based on the event. After the event, IV could drop. As a result, a call option could potentially decline in value even if the underlying goes up.

TAKING STOCK OF LIQUIDITY

How do you identify daily volume, open interest, and bid/ask spreads? You could customize your Option Chain layout on the thinkorswim® platform.

- From the **Analyze** tab, select **Add Simulated Trades** to bring up the **Option Chain** of a stock.
- Then, from the **Layout** menu, select a layout with **Volume** and **Open Interest** (or **Customize** and create a chain with these two parameters).

Source: thinkorswim. For illustrative purposes only.

How can you tell if IV is expensive or cheap? Look at its current value in relation to how it's moved over the previous 52 weeks. You can do this using the Current IV Percentile in the **Today's Options Statistics** section of the thinkorswim platform.

The IV percentile over the last 52 weeks oscillates between 1% and 100%. As an option buyer, you may want to see this reading as low as possible in relation to where it's been over the previous 52 weeks.

4 SELECT STRIKE AND EXPIRATION DATES

One of the biggest enemies of long options is time. So, you want to consider an expiration that gives you enough time for your forecasted price move to work. The intention usually isn't to hold the position for that long. Instead, you want to try to minimize the negative effects of theta while you're in the trade. Theta tends to be smaller in the early days.

You also want to factor in any anticipated major news announcements or earnings reports that might come up while you're holding the position.

The strike you select can have a lot to do with how much you pay for the option. In-the-money (ITM) strikes tend to be more expensive than out-of-the-money (OTM) strikes. How do you pick a strike? This is where delta comes in. Delta rises in a "convex" (accelerated) manner until it gets just past the at-the-money (ATM) point, and then it begins to slow down. It's like a gas pedal in a car. You increase the pressure on the pedal until you reach a certain speed, then gradually reduce pressure on the pedal. You're still going but at a reduced rate of speed.

Each trade is different, but generally delta acceleration kicks in at the 30–40 range. And if the underlying goes in your direction, you could get the most delta benefit. Because these options are slightly OTM, they will likely be a little cheaper but also carry a little more risk because they don't have any intrinsic value and therefore have a higher probability of expiring worthless versus ITM options. And if the trade goes against you, that delta convexity could also slow down.

5 POSITION SIZING: NOT TOO SMALL, NOT TOO BIG

Position sizes play a big role when buying options. Trade too big and you can wipe out

FIGURE 1: TREND AND MOMENTUM. Even if a stock is trending up, it may be a good idea to add a momentum indicator such as relative strength index (RSI) to determine if the potential trend has enough strength.
Source: thinkorswim. For illustrative purposes only.

your account. Trade too small and you may not be using your capital efficiently.

How much should you risk? This is where trader discretion kicks in. You may not want to risk more than an actual dollar amount or percentage of your account value on a single trade. That may help keep your "risk of ruin" at bay if you're following a disciplined, rules-based system.

Consider two risks when figuring out position size:

• **Portfolio risk.** How much of your total portfolio are you going to risk on one trade?
• **Trade risk.** The risk of an options contract is the entire premium you pay. That premium will be your trade risk and could determine how many contracts to buy.

Let's look at an example:
• Account size = $50,000
• Risk per trade at 1% = $500 (portfolio risk)
• Premium on ATM call option = $2.50
• Total premium per contract ($2.50 x 100) = $250 (trade risk)
• Number of contracts to buy = portfolio risk ($500) divided by trade risk ($250)
$500 / $250 = two contracts

Your intention may not be to risk the entire premium, but it makes sense to use the entire premium when calculating your risk.

Just because the calculation shows you can trade two contracts doesn't mean you can "set it and forget it." Once your trade is executed and you have the position in your account, there are at least three ways to help manage risk:

1 - Maximum premium loss. Set a dollar amount of premium lost as your trigger to exit the trade. For example, this could be $250—and because you're trading two contracts, it would be $125 per contract.
2 - Technical stop loss. If you have a long call position and the uptrend of the underlying reverses and takes out the most recent low, it could be your trigger to manage risk and recognize something has changed.
3 - Time. As time passes, theta increases. If the trade isn't doing what it's supposed to be doing, you might want to exit the trade after a certain number of days.

ONCE YOU'VE BOUGHT AN OPTION (or two, or three), watch and manage your position. There are no guarantees, regardless of how well you follow a plan. Win or lose, you should consider exiting at a predetermined price. Hopefully you'll win more than you lose, and then start the process over again—rinse and repeat.

John Manley 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.

A trailing stop or stop order will not guarantee an execution at or near the activation price. Once activated, they compete with other incoming market orders.

TAKE AWAY:
Know risk management and the variables you can control.
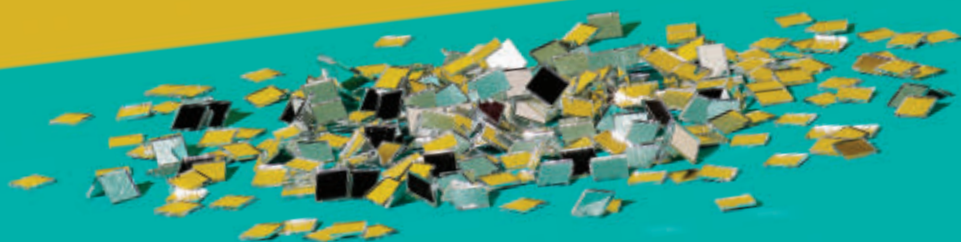
PHOTOGRAPH BY **DAN SAELINGER**

RISK MANAGEMENT

BIG IDEA:
YOU'VE HEARD WHAT MAY HAPPEN IF YOU DON'T FOLLOW A TRADING PLAN. LIKE IT OR NOT, YOUR RISK-MANAGEMENT STRATEGY COULD DECIDE WHETHER YOU SURVIVE THE NEXT MARKET TURN. IF YOU DON'T HAVE A LIST OF RULES, CONSIDER THESE IDEAS TO GET YOU STARTED. WORDS BY **KEVIN LUND**

The Un-Fun, Must-Know Part of Trading

YOU CAN

read thick books on risk management, write algorithms as long as your arm, and test strategies till you turn blue. But none of that guarantees you earn money or guarantee against losses. After all, look at how much the big financial institutions lost during the Great Recession.

Managing the risk of your positions doesn't have to be tedious. Most of it is common sense—with the goal being to make sure that one trade, or a series of trades in a month, quarter, or year, doesn't have the potential to create a loss so great that you can't continue to trade. Consider it the financial equivalent of getting hit by a tricycle, not a bus, should you cross the street.

Risk Is Relative—Sort Of

So, what constitutes getting hit by a bus? That's different things for different traders. For example, with $10,000 in your trading account, how would you feel if you lost $8,000 in a month? Would it prevent you from continuing to trade? It could, especially if that $8,000 can only be replaced by making winning trades with the remaining $2,000. But if that $8,000 represents a small percentage of your resources, then the loss may not be a big deal.

Let's look at the coin-flip game. You can guess heads or tails, and if you're right, you win $1. If you're wrong, you win nothing. You're more interested in how much you're likely to walk away with after tossing the coin

several times. In this case, you could take $0.50 (the expected value of that coin-flip game) and walk away. Most of you would probably choose to flip the coin. Why? Whether you make $1, $0.50, or nothing would hardly make a material difference to most people. But if the amount you win or lose is higher, then you'll have to decide how much of a loss is too great to bear. That can be tough for some people, but it'll make the rest of your risk-management decisions easier.

Defined Risk (Made Simpler)

As a general rule, traders should decide how much they're willing to risk. For example, say you decide you don't want to risk more than 20% of your trading capital. That leaves you with 80% of your base to continue trading to attempt to make up any losses. But how much should you risk on each trade? That's another point to think about. Say you decide not to risk more than 5% of your trading capital on any one trade. That means you could do about four trades, each risking 5% of your capital, and have a max overall risk of 20%.

Of course, setting a max loss for your account assumes you can identify the max loss of your trade. For defined-risk trades like verticals, iron condors, butterflies, calendar spreads, and so on, you could visualize the potential max loss. Fire up the thinkorswim® platform, select the **Analyze** tab, load up the different strategies, and review the potential max loss before you place the trade. One approach to consider would be to take 5% of your trading capital and divide it by the max loss of the position. That would give you a target number of spreads.

Trading Odds? Use 'Em

If you're trading uncovered positions like stocks, mutual funds, or naked short puts, it's a little trickier to figure out how much you can risk with any one trade. You might think using stops defines your risk. But once the stop is activated, it becomes a market order seeking execution at the next available price. If the stock or index moves up or down significantly once the stop is activated, you might not exit your position at a price anywhere near your stop. A more conservative approach would be to look at a likely move in the stock or index over a time period like a day or a week.

One way to do that is with the probability cone on thinkorswim. That helps you see what a 68.27% (one standard deviation), 95.45% (two standard deviations), or 99.73% (three standard deviations) range is likely for a stock or index (see Figure 1). You may not think a three-standard-deviation move is likely while you're holding your position, but those "black swan" moves can come out of nowhere. (COVID-19 crash, anyone?)

Your time frame when looking at the potential loss on a trade with undefined risk should match the time you expect to hold the position. If you think you might hold positions for a week or month, you need to account for greater risk. With more time, there's risk of a bigger price move.

If you factor in the potential loss of the underlying stock or index making a large move against you, keeping the total risk of all your positions under a maximum risk ceiling might help prevent catastrophic losses.

How Much Can You Lose?

When you risk a smaller percentage of your trading capital, you tend not to have big winners or losers relative to your total trading account. One trade may have a max profit or loss, but when combined with other trades that might make or lose a

smaller amount, the effect on your account is reduced. That's bad if you put up nothing but winning trades, but who does that? Sometimes it may be smarter to minimize the effects of losing trades rather than maximizing the winners. Plus, you may want to consider keeping the risk of all positions basically equal. One trade shouldn't represent dramatically more risk than the others. If you're using a set of criteria to identify the trades you want to place, whether they're based on probabilities, volatility, technical analysis, or fundamental analysis, each trade has about the same potential to make or lose money as the others. If you start to have a "favorite" and decide to risk twice as much money on that trade as the others, that favorite can end up breaking your heart (and trading account) if it turns out to be a loser. In general, you don't want one position carrying disproportionate risk.

The 20% rule is handy if you tend to put on positions and not pay much attention after that. But if you monitor your positions through the trading day and have the discipline to exit or hedge positions going against you, it might make sense to increase the percentage of trading capital to risk. How much you want to increase depends on if you'll have the discipline to exit a trade if it goes bad. Instead of looking at the max loss of a position, you might consider the max loss you're willing to take

TRADER GLOSSARY
TURN TO
PAGE 33

when you figure in the number of contracts you trade. For example, you may consider selling straddles or strangles ahead of an earnings or news announcement when implied volatilities have been pushed higher. A short straddle has a potentially unlimited loss on the short call side and the potential for significant loss on the short put side. But that occurs if the stock goes very high, or goes to zero, respectively, and both those events are often unlikely, but it's always a possibility. So, you may look at the volatility, determine a likely price range, and see what your losses could be at certain prices (the **Analyze** tab is useful here). If you have enough experience trading these scenarios, and you're sure you'll exit trades when you have to, you could do a larger trade than the max-loss method would indicate. Because you're watching what the stock is doing tick by tick, if that position reaches a loss you've determined is too much, under normal market conditions you could attempt to exit the entire position or parts of it.

RISK MANAGEMENT IS NEW AGAIN. Failure to manage risk is possibly the single most important aspect of trading that retail traders and investors often overlook. It's not necessarily fun, and it certainly isn't the first thing that springs to mind when you think about trading. But when you realize why you're trading—to make money—then you need to make sure you don't get knocked out of the game before you even learn how to play. Employing risk management techniques, like those

Cool Tips for Portfolio Management

A tip for assessing and managing portfolio risk is counting deltas. Use the beta weighting portfolio tool on thinkorswim by measuring the delta risk of your entire portfolio in a single underlying index's terms, such as the S&P 500 Index (SPX) or another index that resembles the securities in your portfolio. This is useful if you tend to hold a lot of stock positions for longer periods of time. You can see what your portfolio loss might be if your reference index makes a large move in a short time frame. If that risk puts you outside your comfort zone, you can reduce your portfolio's deltas by reducing your index exposure, or even doing short delta options spreads like short call verticals or long put verticals.

detailed here, could work for different market conditions. It's safer than having no risk strategies at all.
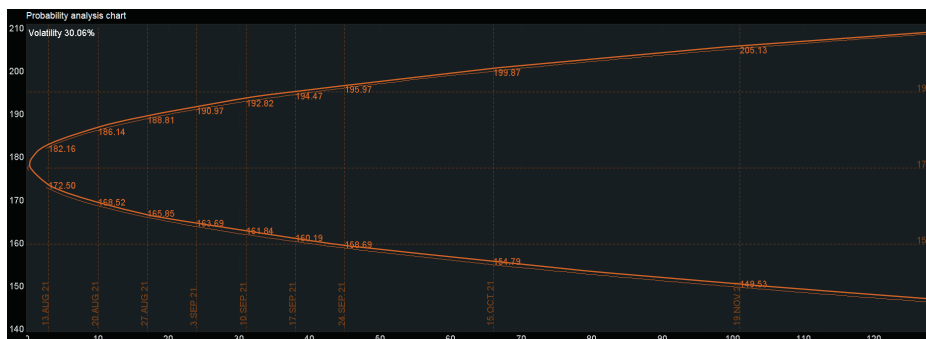
FIGURE 1: PROBABILITY CONE. On thinkorswim, select the **Analyze** tab and then the **Probability Analysis** subtab to view the likely price ranges. *Source: thinkorswim. For illustrative purposes only.*

TAKE AWAY:
Understanding when it may be better to set up a double calendar.

TWIN TOPS

CONSIDERATIONS ON＿HOW AND＿WHEN＿TO SET＿UP＿A DOUBLE＿CALENDAR

BIG IDEA:
LOOKING TO GET LONG VOLATILITY WITH A THETA KICKER? CONSIDER A CALENDAR SPREAD. BUT IF YOU ALSO WANT TO SPREAD YOUR RISK ACROSS A STOCK'S RANGE, YOU MIGHT SCALE THE TWIN PEAKS OF A DOUBLE CALENDAR. WORDS BY **DOUG ASHBURN**

PHOTOGRAPH BY **DAN SAELINGER**

WHEN

you trade basic options strategies—individual calls and puts, vertical spreads, and even straddles and strangles—volatility (vol) and time decay (theta) are locked in a tug of war. Got a long position? Even as vol ticks higher, theta is constantly pulling the other way. And if you're short, you like that theta tailwind, but you know that a rise in vol could act as a counterforce.
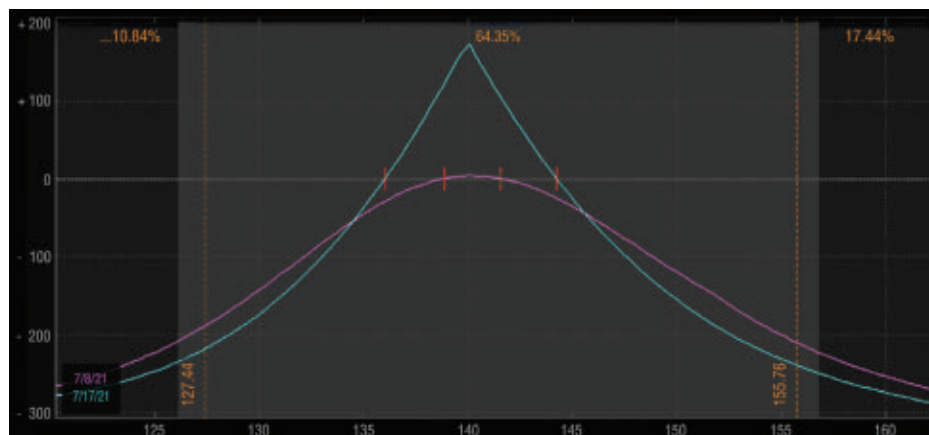
Want to burn some theta while maintaining long vol exposure (vega)? That's where time spreads come in. And they come in a couple varieties: There's the basic calendar spread and its more exotic cousin, the double-calendar spread. These are debit spreads. Premium is paid up front, and your max loss is that premium, assuming you close it out on time (more on that later).
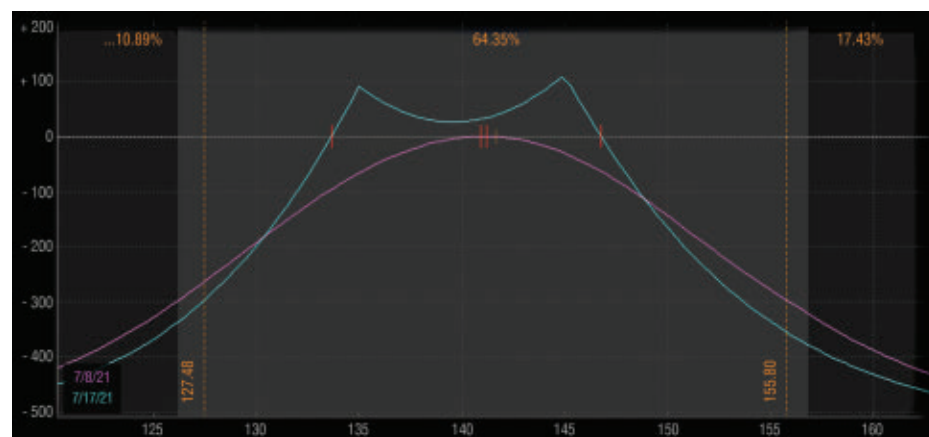
HOW MANY PEAKS—ONE OR TWO?

Think of a calendar spread as the sale of a short-term option with the purchase of a longer-term option of the same type and strike, say the FAHN Jul–Aug 140 call calendar spread. As time passes, the shorter-term July option you sold should decay faster than the longer-dated August call you bought. Assuming FAHN stays within a range around 140, as expiration of the front leg approaches, the risk profile begins to form a peak centered at the 140 strike (see the risk profile in Figure 1).

The 140 is the high watermark, and the profit potential begins to fade as soon as FAHN deviates from 140. By the time it's moved $5 one way or the other, you're below the break-even point. If that's your objective, great. But if you're looking to spread out that risk, you might consider a double calendar.

So, instead of a single calendar at the 140 strike, say you set up two calendars—one using the Jul and Aug 135 put strikes, another using the Jul and Aug 145 call strikes. That's a double calendar (see Figure 2).

Whether you choose a single or double calendar, your objective is the same. If FAHN stays in a range, the accelerated theta of the front-month strike should work in your favor. But if you think an outsize move in FAHN could pull vol out of the doldrums, the long vega of calendars and double calendars might give your profit and loss a boost, or at least a head start, even if FAHN moves away from the peaks.

Want to check the potential effects of a vol move? Fire up the **thinkorswim**® platform. After loading up your trade under the **Analyze** tab > **Risk Profile**, switch the simulator from +1 @ **Expiration** to +1 @ **Vol**

Step. You can check the possible effects of one (or several) up (or down) move in vol (see Figure 3).

If you're having trouble visualizing the dynamics of a double calendar, think of it this way: It's the combination of two strangles—a short-dated short strangle and a longer-dated long strangle. The short one aims to maximize theta while the long one aims to give you long vega exposure.

The two-strangle view should help punctuate the number one rule of double calendars: Decide your next move—and act on it—before the front legs expire. Otherwise, you're left with just a long strangle—long vega, but no theta tailwind behind you. That would run counter to your initial objective of

FIGURE 1: SEE THE POINT? As expiration of the July option approaches, the risk profile goes from a smooth mound (purple line) to a pointed peak centered at the strike price. *Source: thinkorswim. For illustrative purposes only.*

FIGURE 2 : DOUBLE POINTS. Compared to the single calendar, a double calendar has wider break-even points to the upside and downside. But as the front leg's expiration date approaches, the risk profile forms a dip between two peaks. *Source: thinkorswim. For illustrative purposes only.*

FIGURE 3: HOW COULD VOL MOVES IMPACT YOUR STRATEGY? Select **Vol Step** from the menu in the **Risk Profile** simulator and select how much of a vol move to analyze. *Source: thinkorswim. For illustrative purposes only*

burning theta while you waited for that vega pop. Once the theta stops burning, it's time to assess.

STRATEGY AND RISK WITH DOUBLE CALENDARS

With four legs spread over two expiration dates, you'll encounter more moving parts versus your typical options strategy. Keep all this in mind as you set and monitor the double calendar.

Strike selection. If you've ever spent an afternoon in the orange juice aisle, you know a wide set of choices can be daunting. With double calendars, there's really just one rule: The further apart you set your strikes, the wider you spread out your risk. Yet, in so doing, you also deepen the valley between peaks, sometimes to the point the position behaves like two separate calendars. So, it really depends on how much you expect FAHN to wiggle. Remember: If you think FAHN is set to stay put, the single calendar (with a single peak) might be a better choice.

Pre-expiration tickler. When an out-of-the-money option expires, aside from that line item on your statement, it goes away with little fanfare. But with calendars, double calendars, and other time spreads, you need to decide what to do with the long leg(s). With a double calendar, once the short options

expire, you're left with a long strangle—and that's a different risk profile. Actually, once the front legs approach zero, there's little theta left in the spread. You might even have more daily theta in the back legs. That's when you know it's time to move on.

The roll decision. Do you close out the long legs as the shorts expire, or do you roll the position to another spread? And if FAHN has moved a bit during the life of the spread, do you reset the strikes around the current price? Depending on your current outlook—including vol—you might do that. Some traders like to set the long legs a couple months beyond the expiration of the short legs. When the front month expires, assuming FAHN is still within the strike range, they'll sell another short-term strangle and repeat the process. Keep in mind that multi-leg and rolling options strategies can entail additional transaction costs, including multiple commissions and contract fees, which may impact any potential return.

One final note: Vol can drift lower even while FAHN makes an outsize move beyond your strikes. Though it's a worst-case scenario, your loss is still limited to the price you paid for the spread (plus transaction costs). It's about giving yourself good odds and keeping within your risk parameters.

If you like the idea of spreading out your risk and think vol could be on the upswing but you like the idea of a theta tailwind, you might want the double.

LIKE AN IRON CONDOR? SORTA.

When you look at the risk profile of a double calendar, you might see a twin-peaked version of an iron condor (IC)—that four-strike, single expiration, long-short-short-long strategy that also spreads your risk across a price range. Sure, it's more of a flat-topped mesa than a double-peaked mountain range. And unlike the double calendar, the IC is a credit spread—premium is collected up front. And there's one more key difference: vol exposure.

With an IC, rising vol can eat into the potential profit from your theta, and a vol spike can blow it up entirely. If you're torn between strategies, you might look at current vol relative to a benchmark such as the Cboe Volatility Index (VIX). Then look at today's vol in FAHN relative to its 52-week history. You can find that on **thinkorswim** under the **Trade** tab > **Today's Options Statistics** > **Current HV Percentile**. Is vol on the high side? The IC might be your "go-to" choice. If it's one of those watching-paint-dry low-vol markets, consider double calendars.

SKILL
LEVEL
SAVVY

TAKE AWAY:
Get to know the
VIX and how traders
might trade it.

TAKING THE FEAR OUT OF THE FEAR INDEX:

TRADING VIX OPTIONS

PHOTOGRAPHS BY
DAN SAELINGER

BIG IDEA:
THE CBOE VOLATILITY INDEX (VIX) IS OFTEN THOUGHT OF AS A GAUGE OF INVESTOR UNCERTAINTY. BUT BEFORE TRADING VIX OPTIONS, THERE ARE A FEW THINGS YOU SHOULD KNOW. WORDS BY **JAYANTHI GOPALAKRISHNAN**

MARKETS CRASH.

And when they do, it can be fast. So, it's a good idea to study the Cboe Volatility Index—or more affectionately, the VIX—to help you guess when that next market sell-off might happen.

Often, the VIX is inversely correlated with the S&P 500 Index (SPX). When the SPX goes up, the VIX typically goes down. But there's more to the VIX than this relationship. In addition to it being the market's "fear gauge"—investors tend to be more fearful when market volatility (vol) is high, and less so when vol is low—the VIX measures the market's expectation of future volatility implied by SPX options prices.

WATCH VOLATILITY CLOSELY

The VIX measures implied volatility. But what does that mean, and how is it different from other types of vol measures? There are two general types of vol: historical and implied. Historical vol is measured by what a stock or market has done in the past. If you're looking at, say, a 20-day historical vol of the SPX, it indicates the movement of the SPX over the previous 20 days. Implied vol is a snapshot of SPX options and indicates what traders believe the future market vol may hold. Generally, as vol increases, the demand for options increases, as does trading volume. As a result, implied vol increases.

TRADER GLOSSARY

Generally, vol rises when traders perceive higher risk in equities. So, if vol is rising, how can you trade it? Although investors can't directly trade the VIX, they can trade VIX futures and options with the appropriate account approvals.

VIX OPTIONS: WHAT YOU NEED TO KNOW

Before trading VIX options, you should familiarize yourself with their pricing, expiration dates, and how they're settled. Remember: Futures and futures options trading involves substantial risk and is not appropriate for everyone.

Pricing. Most indices use the underlying index level to value corresponding options. However, for VIX options, the underlying is the corresponding VIX futures contract (/VX).

VIX options and futures are priced based on forward-looking market activity. Sometimes /VX may trade at a premium to the VIX Index, and other times, the futures may trade at a discount. Basically, the level of /VX reflects where traders believe the VIX Index will be at some date in the future. When futures are valued at a premium, this indicates traders believe the VIX Index will move higher by a certain date. When futures are at a discount, the marketplace often anticipates a drop in the VIX. This is another reason futures are used as the underlying pricing instrument for VIX puts and calls.

To see where /VX is trading, fire up your thinkorswim® platform, select the **Analyze** tab, and punch /**VX** into the symbol box (see Figure 1).

Say the VIX is trading at 16.15, and the VIX Aug 15 call is priced at 4.90. The minimum intrinsic value should be 1.15 (16.15 – 15). You may think there's some mispricing. This is where looking at the /VX helps.

Looking at the August /VX contracts, you see they're trading at 19.85. Perhaps the calls are more reasonably priced because the August /VX contracts look to be anticipating a higher VIX than the current level.

Expiration and settlement. VIX options, like index options, are cash-settled. That means, upon exercise, there's a cash transfer from the seller of an in-the-money (ITM) option to the option owner. In the case of VIX options, this involves $100 for each point an option is ITM at expiration. For example, the holder of a 15 call would receive $500 at expiration from the holder of a short position in the 15 call, if the settlement value for VIX options is 20 [(20 – 15) * $100 = $500].

VIX options are European style, so they can be exercised only at expiration. Keep in mind that holding VIX options through expiration can be tricky. VIX options officially expire on the Wednesday 30 days (or closest to 30 days) prior to the third Friday of the next calendar month. Although expiration is on a Wednesday, the options stop trading at the close of the Tuesday before Wednesday's settlement. The settlement level of the VIX is a special calculation based on the opening prices of all SPX options that contribute to the VIX calculation the following day.

Keep in mind, the VIX level that results from the opening SPX options prices may differ from the closing VIX Index level the evening before (see Figure 2). This is partly because of normal overnight activity in the global equity markets, but a number of
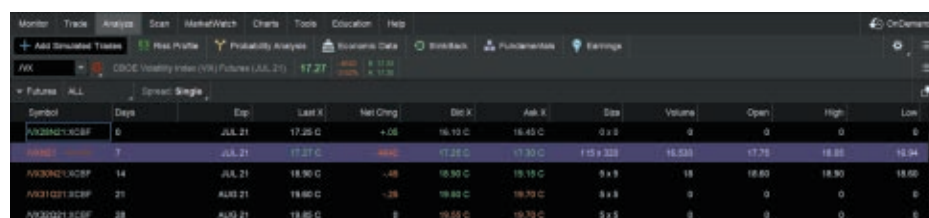
FIGURE 1: FOLLOW /VX FUTURES. Because VIX options are priced off /VX, it's a good idea to see where /VX is trading before deciding which options to trade. *Source: thinkorswim. For illustrative purposes only.*

FIGURE 2: VIX OPTIONS CHAIN. Bring up the **Option Chain** of VIX options from the **Analyze** tab on **thinkorswim** the day before expiration Wednesday. Then compare it to how VIX options opened on Wednesday.

Source: thinkorswim. For illustrative purposes only.

factors may influence the actual settlement price. Also, because the VIX settlement level is determined with opening prices, it could take a few hours for the actual settlement level of the VIX to be determined. VRO is the ticker symbol for the VIX settlement price.

The final trade for /VX the Tuesday before a.m. settlement on Wednesday was 19.95. The final VIX spot index print was 19.73. The following morning, the July VIX settlement value for options positions was 18.90—0.83 lower than the index close Tuesday evening.

For context, a trader holding an August 20 call likely would've expected the call to expire worthless based on the VIX Index closing at 19.73 on Tuesday afternoon. But if the August VIX settlement for futures and options was priced higher on Wednesday morning, the holder of the 20 call would now receive cash for the option. That would be a nice surprise. But there's another side— if the trader had held a short position, that option wouldn't have expired worthless. Instead, the result of the settlement print for this trader would be a debit.

If you have a profit in a VIX options position going into expiration, based on market conditions, the wisest choice may be to attempt to close the position and take the profit. There may be some risk involved in holding VIX options until the settlement price is determined. Be warned.

BEARISH STRATEGY: BUYING VIX CALLS

Because of the inverse relationship between the SPX and VIX—especially in times of extreme negative moves in the SPX—VIX options may be used especially if you believe a downturn in SPX is likely. If you're bullish on stocks, consider a bearish strategy with VIX options, although more bang for the buck typically comes when the SPX experiences a hard, fast fall. Let's look at an example of trading VIX options with a goal to benefit from a quick pullback in the SPX.

Suppose it's July 27, and you think the SPX is overbought at 4,400. You think there could be a dramatic pullback soon. While the SPX was rising, the VIX dropped from 41 to 19. In your opinion, stocks will fall in the next 45 days and the VIX should move to at least 25. September expiration for VIX options is 49 days off. You also note the September VIX futures are trading at 22.35—at a premium to the underlying VIX Index. Because you're trading the September VIX options, you might use the September /VX contract as the underlying for valuation purposes. The VIX Sept 21 call is trading at $4.10 (or $410 per contract, which is also your maximum risk).

Fast-forward 49 days. Your market

scenario turns out to be correct, and the SPX drops more than 15% to 3,740. As predicted, the VIX climbs, and VIX settlement for September comes in at 26.50. As a holder of the Sept 21 call, you receive a credit to your account of $550 [($26.50 – $21.00) * $100]. Subtracting the options cost of $410 nets you a profit of $140. But there's a chance the SPX may begin to rise and the VIX calls will likely decline in value.

FEAR ISN'T ALWAYS BAD. The VIX reflects the overall market's opinion of how stock prices may move in the future. Often dubbed the investor's "fear gauge," it's more accurate to think of the VIX as a yardstick of investor uncertainty, which at times may equal fear—but not always.

The VIX wasn't designed to predict stock prices, market direction, or market highs and lows. Instead, the VIX was created to predict the market's expectation of future fluctuation. And for the most part, the VIX continues to measure anticipated future volatility as designed.

FIGURE 1: FIBONACCI PRICE AND TIME. Adding both drawing tools on your price chart can help identify potential trend reversals and when those reversals could take place. *Source: thinkorswim platform.. For illustrative purposes only.*

Price and Time: It's a Match

When trading options, you'll need to look at price and time. Consider applying Fibonacci Time Series and retracement levels.

• Life often happens when you're at the right place at the right time—the dream home you find, the life-changing gig you land, the winning lottery ticket you buy. In a way, nailing a trade is similar. Except it's more about getting in at the right *price* at the right time.

There's no doubt luck can play a role. Yet, more often than not, it's your analysis that can bring more potential trading opportunities.

PRICE AND TIME

You're probably familiar with Fibonacci (Fib) retracement and extension levels. Traders often use them to help identify potential trend reversals. These retracements and extensions typically measure changes in price and are displayed as horizontal lines at different levels on the y-axis.

There are several other ways to apply Fib numbers—arcs, spirals, fans, and more. One that might help spotting pivoting price trends is Fibonacci Time Series. Think of it as adding another dimension to retracement levels. Fib Time Series measures change in time along the x-axis—vertical bands with days or periods equal to numbers in the Fibonacci sequence.

So, when you combine Fib retracements with Fib Time Series, you can examine price movement through the lens of time and price.

HOW DOES THIS WORK?

When you only look at Fib retracements, your focus tends to be on a price bounce either above or below different levels. Sometimes price can bounce around these levels several times before making a directional move. And that can be frustrating for an

option trader who's trying to decide which strike price and expiration to use.

Now, when you add in the time series, you might get a better idea of when price trends could potentially reverse.

Let's see how this works.

Fire up your thinkorswim® platform and enter the symbol of a stock you'd like to follow. Next, find a low and high point on the chart (see Figure 1). Select the **Fibonacci Time Series** icon. Use the low or high as a starting point and the corresponding high or low as an end point. Remember to go from left to right.

Notice that the Fib Time Series doesn't necessarily identify every price reversal. But if you isolate the areas when price and time came together, price bounced off a retracement level, revisited it (sometimes more than once), and the revisit took place at one of the vertical lines, and often, the trend reversed (see labels 1, 2, and 3 on Figure 1).

AS WITH ALL THINGS TRADING AND chart analysis, there are no guarantees. Yet, using Fibonacci Time Series and retracement levels may be able to help you simplify your options strike-and-expiration decisions. Consider these drawing tools as one of many guides. An earnings report, economic data, or a news event could naturally throw prices out of whack. Which is why, even when a trading setup looks ideal, it's important to have money-management strategies in place.
—Words by JAYANTHI GOPALAKRISHNAN

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.
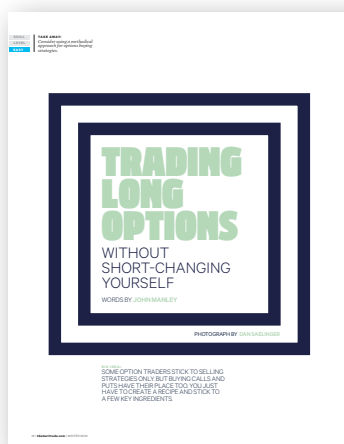
Out of the money (OTM)

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.

At the money (ATM)— An option whose strike is "at" the price of the underlying equity. Like out-of-the-money options, the premium of an at-the-money option is all "time" value.

Butterfly spread— 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.

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.

Delta— A measure of the sensitivity of an option to a $1 change in the underlying asset. All else being equal, an option with a 0.50 delta (for example) would gain $0.50 per $1 move up in the underlying. Long calls and short puts have positive (+) deltas, meaning they gain as the underlying gains in value. Long puts and short calls have negative (–) deltas, meaning they gain as the underlying drops in value.

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

Implied volatility— This is the market's perception of the future volatility of the underlying security and is directly reflected in the premium of an option. Implied volatility is an annualized number expressed as a percentage (such as 25%), is forward-looking, and can change.

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.

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.

Short straddle/strangle— A market-neutral strategy with unlimited risk composed of an equal number of short calls and puts of the same strike price (straddle) or two different strike prices (strangle), resulting in a credit taken in at the onset of the trade. The strategy assumes the underlying will stay within a certain range, in which case, as time passes and/or volatility drops, the options can be bought back cheaper than the credit taken in or expire worthless, resulting in a profit. Break-even points of either strategy at expiration are calculated by adding the total credit received to the call strike and subtracting the total credit received from the put strike.

Standard deviation— A statistical measurement of the distribution of a set of data from its mean. For price charts, this is the historical volatility, or the average distance that the price of an asset moves away (deviates) from its mean.

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 (long and short)— 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.

OK, BOOMER

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Three Lessons from a Meme-Stock Boomer

Tempted by the rocket ship emoji?
Just keep your wits about you.

• You've been eyeing that meme stock. You're eager to jump in, join the crowd, and ride it to infinity. Understandable? Yes. Sensible? Not always. This tale has played out before, and for many traders, it hasn't been the happiest of endings.

Should you focus your attention on those meme stocks or look the other way? That's up to you. But remember: Some lessons need to be learned the hard way. As with all trading, starting small may be the way to go.

COUNT TO THREE
On the surface, that latest meme stock has all the makings of a trade candidate—volatility, momentum, buzz. That's all you need, right?

Not so fast. You also need liquidity. Plus, smart traders will try to anchor their decisions to at least one or more fundamental and/or technical points. There should be a reason to get in when and where you do, and the exit target should be something other than zero or infinity.

1 – There's no chart. With your typical meme stock, it's about the narrative. You're not likely to find support and resistance levels, and a moving average crossover isn't necessarily bullish or bearish. It could just be that a trader's rolling out of a midsize position with no liquidity to absorb it. From a fundamental standpoint, there's also often little to go on. There's no such thing as a price-to-buzz ratio.

2 – Volatility is smarter than your account. Ever buy a call option ahead of an earnings report, see the company beat consensus by a wide margin, the stock rallies, and you lose money because implied volatility gets slammed along with the value of the option? That can happen. If you plan to use long options as part of a meme play, make sure you understand the dynamics of vega, gamma, theta, and the rest of those greeks.

3 – It's not different this time.
Mark Twain is widely credited as saying, "History doesn't repeat, but it often rhymes." Meme stocks may look like a shiny new toy, but there's nothing new here. Every once in a while, conditions align for a perfect storm of unbridled animal spirits, excess money sloshing about, and a narrative that explains away those out-of-whack fundamentals. Once upon a time, it was tulip bulbs, then railroads, then the Roaring Twenties. A generation ago, it was Y2K and the internet. Now it's the late-pandemic economy. Every cycle has its ups and downs.

ESSENTIAL TRADING RULES
Have you decided to forge ahead despite the clear cautions? Heed the lessons from those who've been there.

1 – Get a second opinion. Old-time journalists have a saying: "If your mother says she loves you, check it out." In other words, nothing is certain, especially if based on one metric. Look around. An anonymous post in an internet thread shouldn't count as due diligence.

2 – Detach from the noise. It's easy to get caught up in the hoopla. In the dot-com bubble, the old rules and metrics didn't apply to the so-called "new economy" stocks, as the payoff would be big, someday. After the dust settled, though, for every "Amazon" that eventually made it through, there were countless others that fizzled out.

3 – Create an exit strategy. Set your game plan and stick to it, for better or worse. You don't need to go all in (or all out) at one price. And when it's time to take profits (or losses), do it and don't look back. No one goes broke taking a profit too soon. It may hurt sometimes, but it can help keep you in the game for the long haul.

THERE'S AN OLD ADAGE about knowledge and wisdom. Knowledge is learning from your mistakes, but wisdom is learning from other people's mistakes. Most of us would choose wisdom. It's often cheaper. —Words by DOUG ASHBURN

1

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.

2

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.)

3

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 Charles Schwab Futures and Forex LLC, a CFTC-registered Futures Commission Merchant and NFA Forex Dealer Member. Trading privileges are subject to review and approval. Not all clients will qualify.

Futures and futures options trading involves substantial risk, and is not suitable for all investors. Please read the Risk Disclosure Statement *(available at https://www.tdameritrade.com/retail-en_us/resources/pdf/TDA611.pdf) prior to trading futures products.*

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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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