



Theo**TRADE**

SURVIVE AND THRIVE IN EXTREME VOLATILITY

WITH DON KAUFMAN



Theo**TRADE**

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Don Kaufman

- Co-Founder TheoTrade
- Industry-leading options strategist
- Derivatives Risk Manager
- 19 year trading career
- 17 years of thinkorswim® platform experience

About TheoTrade

- TheoTrade Specializes in education for options, futures, and stocks.
- Founded by professional traders and trading educators each with a minimum of 15 years experience, several with many decades
- TheoTrade is here to help you mitigate the risks in the market, while learning a skill set that can last a lifetime.

Who is TheoTrade

- Doc Severson – Stocks, Options and Technicals
- Jeff Bierman – Stock trader & Former CMT for TD Ameritrade
- Steve “Slim” Miller - 43 year veteran stock, futures trader
- Tony Rago - Nasdaq Futures and Intraday Strategist

Risk and Success

- How you handle your risk is directly correlated to your success in the markets.
- Too much risk and you will panic and close positions continuously at the worst possible time.
- At least you're consistent with your panic 😊



In the Throws of Volatility?

- What works in volatility?
- What is high risk in Volatility?

Are we Volatile?

- Let's not put the cart before the volatility horse.
- First we have to define what we believe to be a more volatile market.

What is Volatility?

- Before we forge forward let's take time to understand options volatility and how markets determine risk and price.

Risk = Volatility

- Options markets can be thought of as putting a price tag on risk.
- Pricing in markets is determined via market participants.
- Ultimately, options pricing comes down to supply and demand.
- Competition breeds efficiency in pricing.

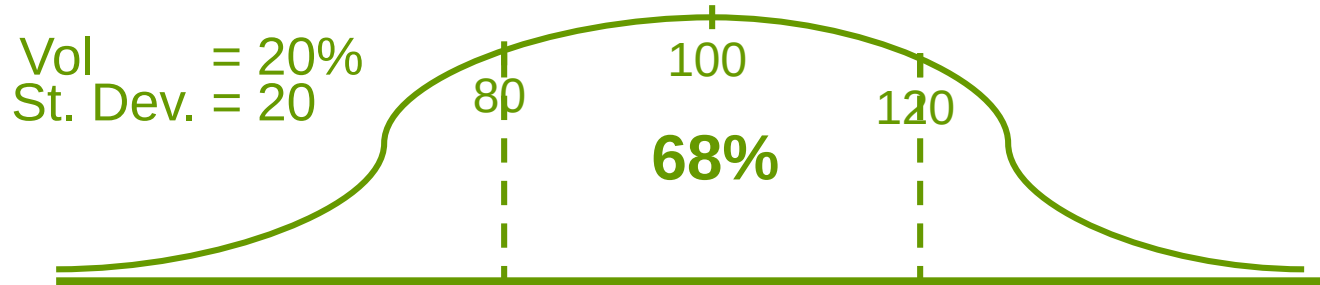
Implied Volatility

Historical

- the annualized standard deviation of the past stock price movement

Implied

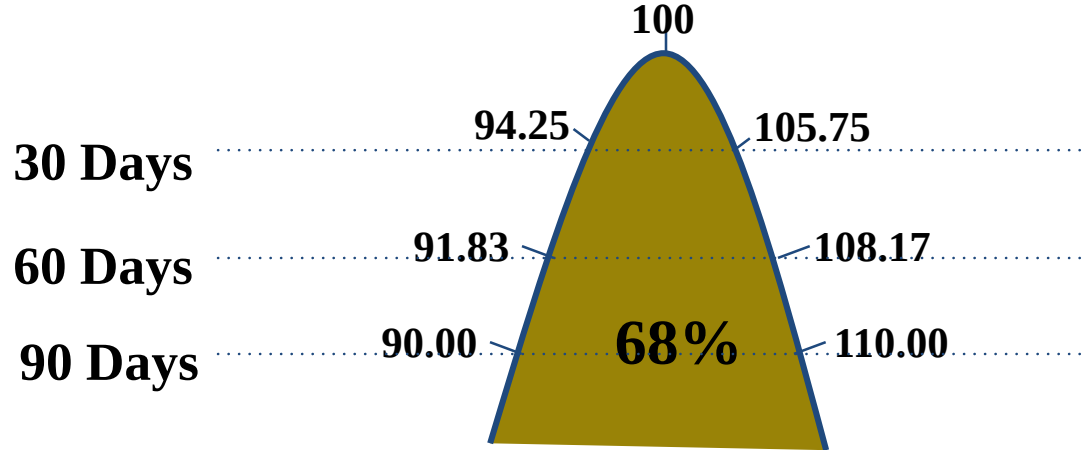
- volatility that justifies an option's current market price
- is found using an option pricing calculator



Implied Volatility and Expected Price Moves

- What Does Implied Volatility delineate?
 - Implied volatility is the volatility that justifies an option's current price.
- How can I use implied volatility in my day to day trading?
 - Implied volatility can be extrapolated into stock price movement or what is termed "Expected Move".

Expected Moves



Expected Move and Probability

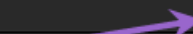
- Expected move defines a one standard deviation move (68.3%) in a given underlying.
- Therefore, there is a 68.3% probability of and underlying closing inside of the expected move by the designated expiration.
- Expected Move is a probability of expiring inside a given range by a specified date.

Expected Move and You

- Not every trading application has expected move.
- You can use the “At The Money Straddle” as an alternative to the expected move.
- Add the ATM call and the ATM put for any selected expiration cycle.

> JAN5 16	(3)	100 (Weeklys)	49.67% (±7.587)
> FEB1 16	(10)	100 (Weeklys)	47.03% (±12.383)
> FEB2 16	(17)	100 (Weeklys)	63.93% (±21.801)
> FEB 16	(24)	100	59.02% (±23.832)
> FEB4 16	(31)	100 (Weeklys)	57.55% (±26.388)
> MAR1 16	(38)	100 (Weeklys)	56.88% (±28.881)

expected move



- At the Money Straddle can suffice for expected move.

Order Entry Tools

Order Entry and Saved Orders

Order Entry Saved Orders

Spread	Side	Qty	Symbol	Exp	Strike	Type	Link	Price	Order	TIF	Exchange
STRADDLE	BUY	+1	AAPL	JAN5 16	100	CALL		6.08 LMT	LIMIT	DAY	BEST
	BUY	+1	AAPL	JAN5 16	100	PUT		DEBIT			

EM = Expected Move

- Expected Move has NO directional bias.
- EM's are based purely on an implied volatility model.
- However, recognize the implied volatility is based on live markets whereby, there are often 100s of millions of dollars setting the volatility in options and expected move.

Cement Boots

- Math Geeks and Engineers here you go.
- I am sworn to secrecy regarding how thinkorswim derives the Expected Move.
- That and the Chicago River is cold this time of year.
- Roughly this is how you solve for Expected Move.

$$\text{ONE STANDARD DEVIATION MOVE} = \frac{\text{STOCK PRICE} \times \text{IMPLIED VOLATILITY} \times \sqrt{\text{DAYS TO EXPIRATION}}}{\sqrt{365}}$$

Implied Volatility Opportunities

- Understanding volatility and expected move is a step in the right direction.
- Our understanding of these metrics can take our risk management to the next level.
- Let's explore implied volatility and expected moves on various products.

Using Expected Move

- Expected move can be a phenomenal resource.
- Selling Options outside of the expected move can help instantly create viable trade candidates.

Strategies Surrounding EM

- Iron Condors outside EM
- Vertical Spreads outside EM
- B-Fly's on the edge of the EM
- These are ALL practical trading strategies

Risk Management and EM

- Another area to consider when evaluating EM is how you manage risk.
- View an EM on a given underlying for a period of time you are considering holding a particular position.
- For example; you would like to buy and hold or trade MSFT sometime in the next 30 days?

Example: how many shares of COSTCO can you hold for the next 30 days?

MSFT

MICROSOFT CORP COM

94.06

+2.33

+2.54%

B: 93.98

A: 94.06

NASDAQ

±0.089

Company Profile

Underlying

Last X

Net Chng

Bid X

Ask X

Size

Volume

Open

High

Low

94.06 Q

+2.33

93.98 P

94.06 P

5 x 6

26,329,226

92.75

94.07

92.36

Trade Grid

Option Chain

Filter: Off

Spread: Single

Layout: Delta, Open Interest

Strikes: 12

CALLS

PUTS

Delta

Open.Int

Bid X

Ask X

Exp

Strike

Bid X

Ask X

Delta

Open.Int

> 2 MAR 18

(6)

100 (Weeklys)

20.56% (±2.05)

> 9 MAR 18

(13)

100 (Weeklys)

20.55% (±2.961)

> 16 MAR 18

(20)

100

21.01% (±3.731)

> 23 MAR 18

20.51% (±4.222)

> 29 MAR 18

20.87% (±4.744)

1.19 X

-31

144

1.33 H

-34

53

1.49 X

-38

50

1.66 Q

-41

86

1.85 N

-45

160

2.06 Q

-49

68

2.30 Q

-53

95

2.55 Q

-57

53

2.84 N

-61

36

3.15 X

-65

57

3.55 X

-68

4

3.85 X

-72

141

How many share of MSFT are you willing to be LONG or SHORT in the next 30 days when the expected move is \$4.75? Normal volatility should see a \$4.75 swing up or down, more extreme volatility could bring moves 2 or 3 times this amount!

Size Matters

- If you are used to trading in a 12% VIX what is the first thing you should consider when volatility spikes?
- Higher volatility directly implies you are getting more movement in individual stocks or the overall market.
- The bright side is you get more bang for your buck.
- Cut your trading size in accordance with increased movement in the markets.
- If volatility doubles you can literally trade HALF the size and still maintain the same profit and loss swings.

Probability of Touching

- Expected Move is a probability of expiring within a range between now and a specific date.
- Probability of Touching is roughly double the expected move or probability of expiring.
- Probability of Touching is the probability ANYTIME between now and expiration of the stock touching or exceeding a specific options strike price.

Using Probability of Touching

- Let us look at a live example in AMZN!

Touch Me? Probably!

- So why does probability of touching matter to me?
- Prepare yourself to take pain when selling Out of the Money Options.
- Have you ever bailed out only to watch the trade thereafter be widely successful?
- Have you been stopped out only to watch minutes later the markets turn around?
- Get the point? You puked out of the trade too early!

It Touched Me!

- I am not asking you to look at Probability of Touching constantly.
- Rather understand if and when you SELL Out of the Money Options, the short strike has a high probability of being breached at some point between now and expiration.
- Prepare yourself to take pain when selling Out of the Money Options--it's part of the program!

Overcome the Touch

- In order to be more effective in roughly ANY strategy, you need to overcome the need to exit trades early or when “touched”.
- In every strategy you embark upon ask “What is the likelihood of the underlying touching a given point within a given time frame?”



I Got Stopped Out

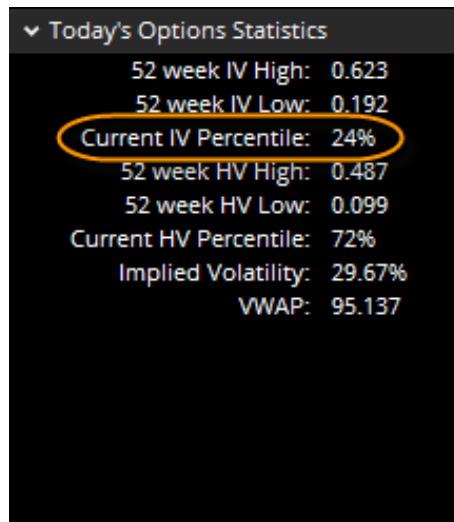
- Yes stop orders work but maybe a little too well. In periods of heavier volatility you MUST consider the probability of being stopped out has greatly increased.
- Stop orders (if utilized) must be placed further away from the underlying instrument.
- Use expected move and probability of touching to help you determine viable placement for stop orders.
- As the stop order is placed further away from the underlying price you are left with more risk. You MUST cut your trading size in a more volatile marketplace.

Implied Volatility Percentiles

- Implied Volatility Percentiles rank implied volatility over the past 52 weeks in optionable securities.
- Ranking volatility over 52 weeks can help us determine if volatility is at an extreme, high or low.
- Implied Volatility can move to extremes exceeding 100% +
- IV percentiles are bounded from 0% to 100%.
- Determining Your Products IV percentile.

IV Percentile

- IV Percentile is found on the thinkorswim Trade Tab under Options Statistics.



▼ Today's Options Statistics

52 week IV High:	0.623
52 week IV Low:	0.192
Current IV Percentile:	24%
52 week HV High:	0.487
52 week HV Low:	0.099
Current HV Percentile:	72%
Implied Volatility:	29.67%
VWAP:	95.137

Implied Vol Percentiles Continued

- Extreme high readings (80%+) on IV percentiles can offer opportunities to sell options premium at historically high levels.
- However, larger options premium is a definitive indication of higher risk and should be approached with defined risk strategies.
- Allow me to emphasize, IV percentiles can shoot to 100% and remain elevated for extended periods of time.

I'm Wrong, But I'm Consistent

- Volatile markets can be unpredictable leaving traders second guessing every decision they make.
- When heavy volatility kicks in you are going to feel like every move you make is precisely the wrong thing at the wrong time.
- After all, volatility equates to unpredictability and RISK.

Liquidity Matters

- Trade liquid markets
- Liquidity tends to concentrate in limited products during episodes of intense volatility.
- Bid / Offer Spreads will widen out even in the most liquid products
- You may not be able to “get out” when you absolutely need to get out.
- Never place yourself in the position of needing to get out. And yes I’m talking to YOU Iron Condor Sellers!

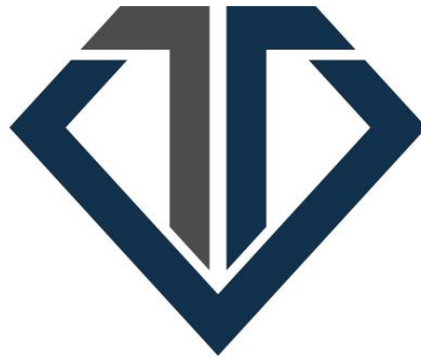
Volatility Crush

- In the midst of volatility you may be so inclined as to want to purchase a call option thinking the market may rally.
- The markets may indeed rally however, you may not profit due to the impending volatility crush.
- As markets rally volatility gets crushed (especially after large down moves).
- Buying at the money or out of the money calls is a serious mistake as it leaves you exposed to significantly volatility risk.
- If you are intent on buying options use a .80 delta or higher in order to avoid volatility risk on the option.
- Don't get VOL CRUSHED.. you have been warned.

Vertical Spreads Mitigate Vol Risk

- Volatility Risk can be considerable in being long or short options.
- Buying or selling vertical spreads will mitigate volatility exposure in the event you want to go long or short the markets.
- SPREADS offset volatility risk via buying volatility and selling volatility.

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