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Prepare your Portfolio for the next Market Correction

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A copy is also available at: http://www.optionsclearing.com/publications/risks/riskstoc.pdf

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Host Profile (Gareth Ryan)

- Founded IUR Capital Ltd in 2007, IUR Capital LLC in 2010
- IUR Capital is an investment advisor for institutional and retail investors
- Focused in exchange-traded option strategies

Market Update

- SPX +13% YTD / Nasdaq +7% YTD
- Russell 2000 continues to see upside…+18% YTD
- First half of 2021 saw continuous new highs for equity indexes
- VIX continues it's downward trend, but with some blips
- Retail, banks, airlines all now significantly higher YTD
- Surge in commodities reflective of the recovery in global demand
- What's on the horizon that could negatively impact risk sentiment?

(As of June 29, 2021)

Potential catalysts for a market correction…

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The Fed	Inflation

Recent change in Fed language indicates a shift in tone from dovish to hawkish...expect this to to continue through the rest of 2021

Inflation data continues to show the economic recovery gathering pace…inflation can only go so far before being brought into check with rate hikes

Where are we on the Volatility Landscape?

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- The events of early 2020 have set a permanent mark on cross-asset volatility and how it is priced
- High volatility = High option pricing
- Volatility has made only cameo appearances during 1H 2021
- Implied volatility tells us what the options market is *implying* in terms of market moves
- For as long as volatility continues to decline, the cost of insurance (puts) will be significantly lower than March 2020
- Opportunities within both long volatility and short volatility option strategies in 2021…

Question of the day….

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Should we be a BUYER or SELLER of volatility at current levels?

Answers please in the Q&A Panel

Buying Puts =
Buying Volatility

Selling Puts =
Selling Volatility

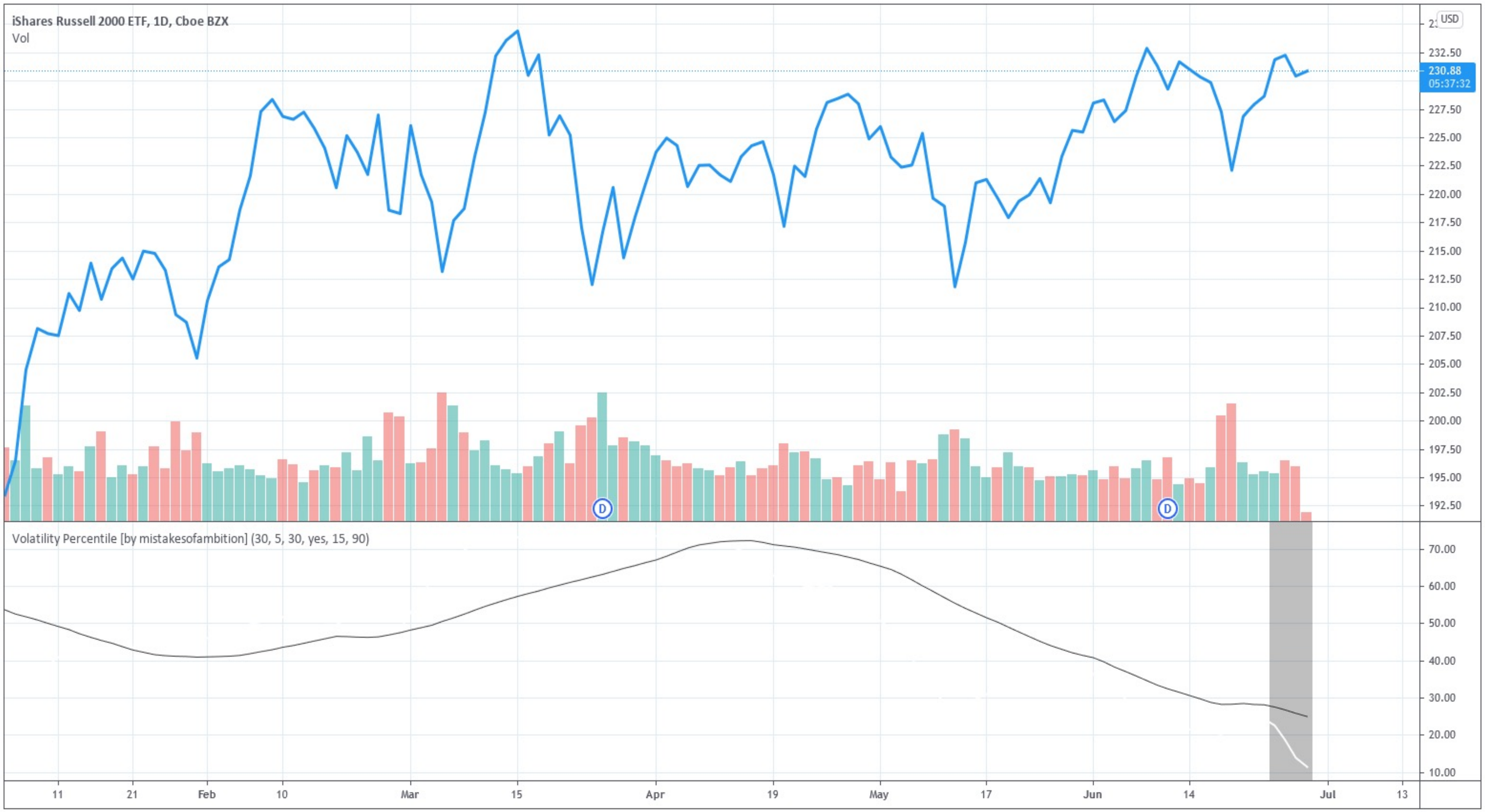
Everyone becomes concerned about the VIX during market sell-offs…..

Source: Tradingview.com

SPDR S&P 500 ETF

Source: Tradingview.com

IWM (iShares Russell 2000 ETF)



Source: Tradingview.com

Questions to ask about option strategies:

- What are the objectives for an equity/fixed income portfolio?
- How can option strategies achieve a "*net benefit*"?
- If seeking income with options, what risk/return profile is appropriate?
- If taking directional positioning with options, what strategies can we use?
- For hedging an equity position with options, how can we justify costs?
- Do we have sufficient knowledge of the various strategies available?

Options involve risk and are not suitable for all investors. Multiple leg strategies, including spreads, will incur multiple transaction costs

What should be my approach during an equity market correction?

1. What is your risk tolerance?
2. How deep / how long could a correction last?
3. Rebalancing of of portfolio from risk/safe haven assets
4. Market corrections as opportunities?

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Puts – a quick review of the basics…

To be successful in buying put options, we need to be right about three things:

- **The potential for a stock to fall**
- **The amount that the stock will fall**
- **The time will take to happen**

*The more bearish you are, the more willing you may be to purchase options that are far out-of-the money. That means there might have to be substantial decrease in the price of the underlying stock for you to break even or realise gain.

*The more Bear you are, the more willing you may be to purchase options that significantly out-of-the money. That means there might have to be substantial decrease in the price of the underlying stock for you to break even or realise gain.

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Why use Puts as Insurance….

- Hedging a long equity portfolio
- Protection before a key event, which may significantly move your underlying
- If your underlying does have a near-term sell-off, puts will gain to mitigate unrealized loss on the equity portfolio
- How much protection are you seeking to hold? 50% of your portfolio

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Am I long vol or short vol?

Strategy	Vega	Rise in IV	Fall in IV
Long Call	Positive/Long	Gain	Loss
Short Call	Negative/Short	Loss	Gain
Long Put	Positive/Long	Gain	Loss
Short Put	Negative/Short	Loss	Gain

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Am I long vol or short vol? (Spreads)

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Strategy	Vega	Rise in IV	Fall in IV
Long Strangle	Positive / Long	Gain	Loss
Long Straddle	Positive / Long	Gain	Loss
Credit Spread	Negative / Short	Loss	Gain
Debit Spread	Positive / Long	Gain	Loss
Butterfly Spread	Negative / Short	Loss	Gain
Calendar Spread	Positive / Long	Loss	Gain

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Potential Volatility Strategies

- Why the straddle or strangle?
- Speculating volatility of the stock
- Straddle BUYERS expect higher volatility
- Straddle SELLERS expect lower volatility
- Stranglers expect a similar movement, BUT with a different risk/return scenario

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The Long Straddle

- Purchase of one call
- Purchase of one put
- Same strike price, underlying and expiry date.
- Risk Profile
- Maximum Risk – Net Debit
- Maximum Reward – Unlimited
- Downside Breakeven – Strike less net debit
- Upside Breakeven – Strike plus net debit

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The Long Straddle Example

- With XYZ stock trading at $50.00
- Buy 1 XYZ 50 Call at $3.20
- Buy 1 XYZ 50 Put at $3.00
- Net Cost $6.20 * 100 = $620.00
- The “50 straddle” is purchased for a total cost of $620 plus commissions.

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Long Straddle P&L

Stock price	50 Call Profit/Loss	50 Put Profit/Loss	Net Profit/Loss
$60.00	$680	($300)	$380
$55.00	$180	($300)	($120)
$50.00	($320)	($300)	($620)
$45.00	($320)	$200	($120)
$40.00	($320)	$700	$380

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Long Straddle P&L

	50 Call Profit/Loss	50 Put Profit/Loss	Net Profit/Loss
Stock Price	$50.00	$60.00	20%
Days to Expiration	60	32	
50 Call	$320	$1020	220%
50 Put	$300	$15	(95%)
50 Straddle	$620	$1035	67%

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The Long Strangle Example

- XYZ stock trading at $50.00
- Buy 1 XYZ 55 Call at $1.40
- Buy 1 XYZ 45 Put for $1.05
- Net Cost $2.45
- The “45-55 Strangle” is purchased for a total of $245 plus commissions.

Long Strangle P&L

Stock price	55 Call Profit/Loss	45 Put Profit/Loss	Net Profit/Loss
$60.00	$360	($105)	$255
$55.00	($140)	($105)	($245)
$50.00	($140)	($105)	($245)
$45.00	($140)	($105)	($245)
$40.00	($140)	$395	$255

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Straddles vs Strangles

- Strangle – Maximum loss possible over wider range than straddle
- Straddle – Maximum loss only if stock = strike price at expiry
- Combination (strangle) – Maximum loss anywhere between two strikes at expiry

Use of index/index ETF products as underlying vehicles

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Ticker	Instrument	Style	Settlement
SPY	SPDR S&P 500 ETF	American	Physical
SPX	Credit Spread	European	Cash
IWM	Russell 2000 Index ETF	American	Physical
RUT	Russell 2000 Index	European	Cash

*Note that SPY / IWM ETF products have quarterly dividends.

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Let's talk…

Email me gryan@iurcapital.com to request the slides or just to have a chat….