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IUR Capital

Earnings Season – Managing Risk

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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)

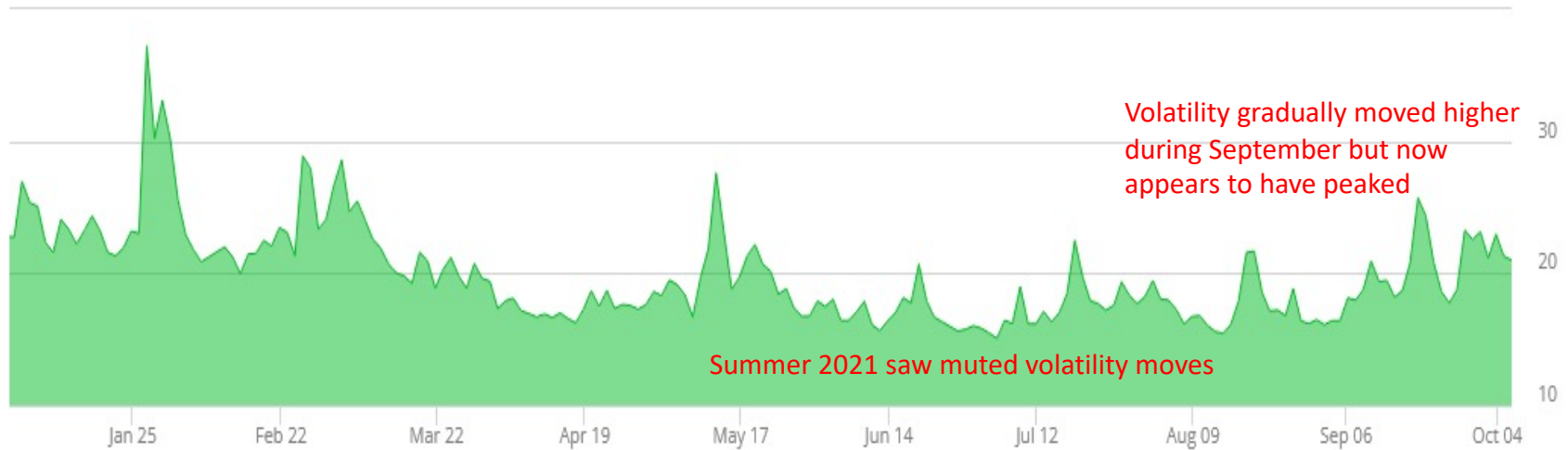
- Founded IUR Capital Ltd in 2007, IUR Capital LLC in 2010
- IUR Capital is an investment advisor for institutional and retail investors
- Focusing on exchange-traded options

- SPX +16% / Nasdaq 16% YTD
- Recent volatility saw tech correction of almost 10%
- Broader S&P 500 correction limited to 5%...for now
- Cyclical / Defensives have outperformed during September declines
- Retail, banks, airlines all +40% YTD
- Equity market volatility also driven by continued moves in treasury yields
- Fed meetings aside, the next major market event is Q4 earnings

Recent volatility moves have been short and sharp...will we see this continue in Q4?

CBOE Volatility Index

Intraday 5D 1M 3M 6M YTD 1Y 5Y All

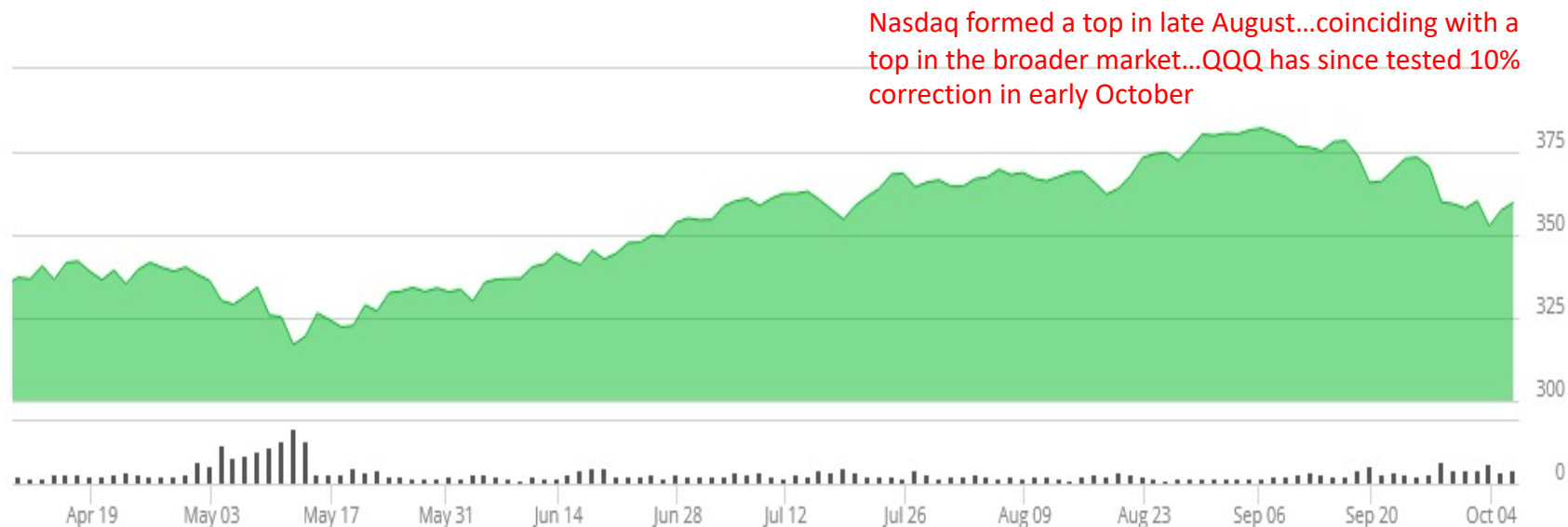


Source: CBOE

Technology stocks are interest-rate sensitive and are more widely impacted during a shift in the rate outlook

PowerShares QQQ Trust, Series 1 (ETF)

Intraday 5D 1M 3M 6M YTD 1Y 5Y All



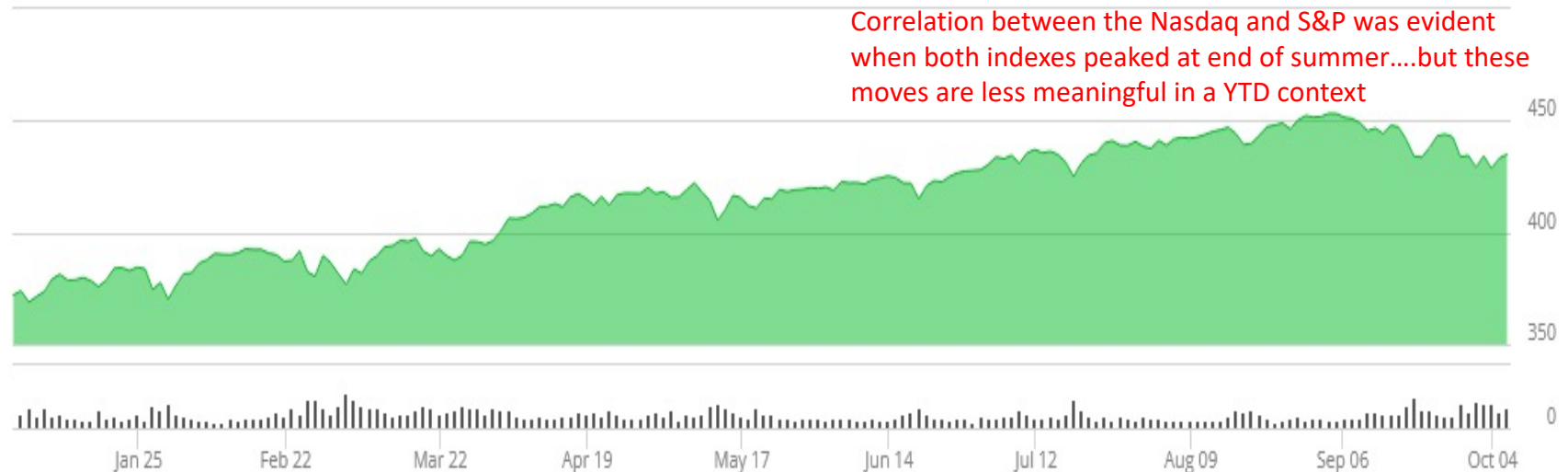
Source: CBOE

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SPDR remains solidly in the green YTD... despite the recent 5% correction

SPDR S&P 500 ETF Trust

Intraday 5D 1M 3M 6M YTD 1Y 5Y All

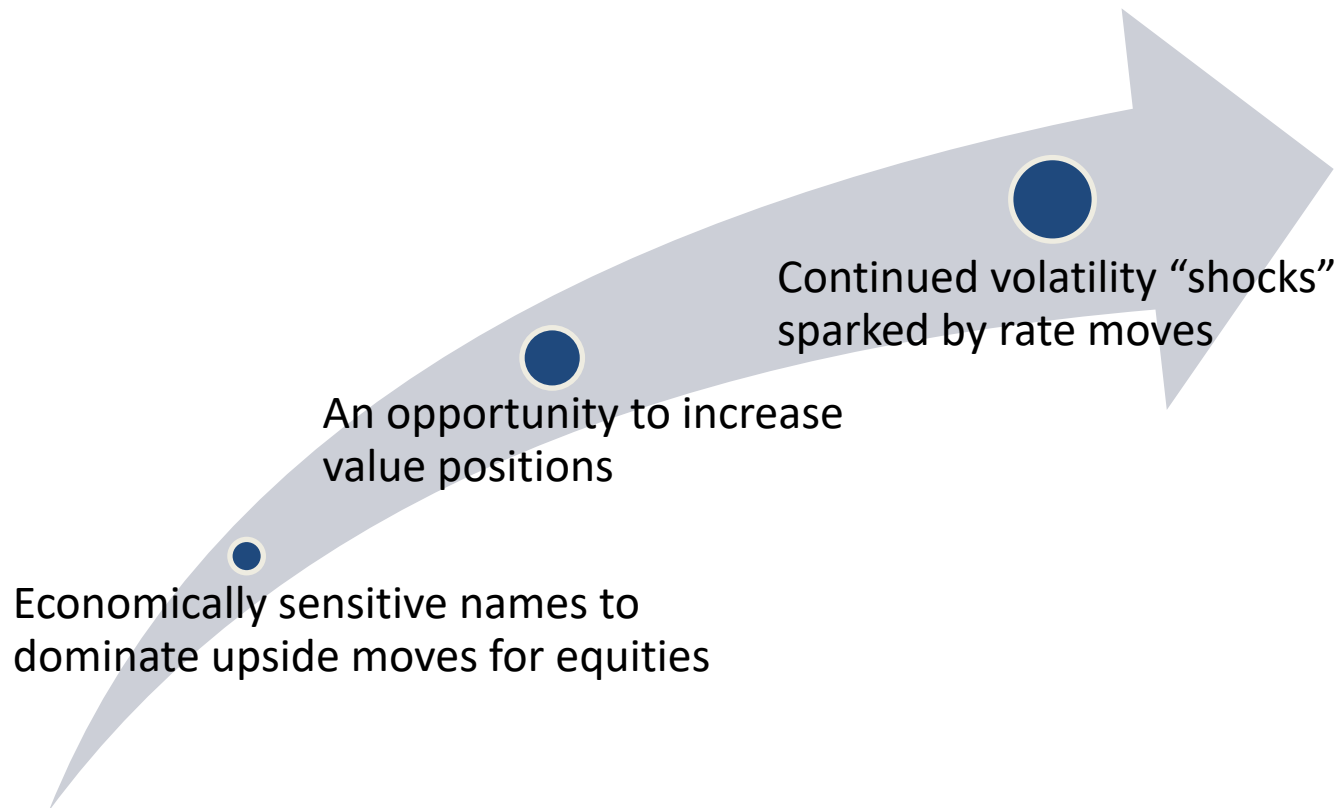


Source: CBOE

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What to watch in Q4

- **Interest rates** – Equity markets will continue to react to rate moves
- **Inflation** – Markets continue to fret over the commodities story of 2021
- **Quarterly Earnings** – Expectations of some surprises on EPS



- Set to get under way mid-October, with publicly-traded companies reporting financials for Q3 (before or after the bell)
- Earnings announcements typically see near term price moves of individual names that is greater than historical norm
- Equity options help us determine what the implied move is for the underlying security after the announcement

Will you hedge your equity portfolio with options during earnings season?

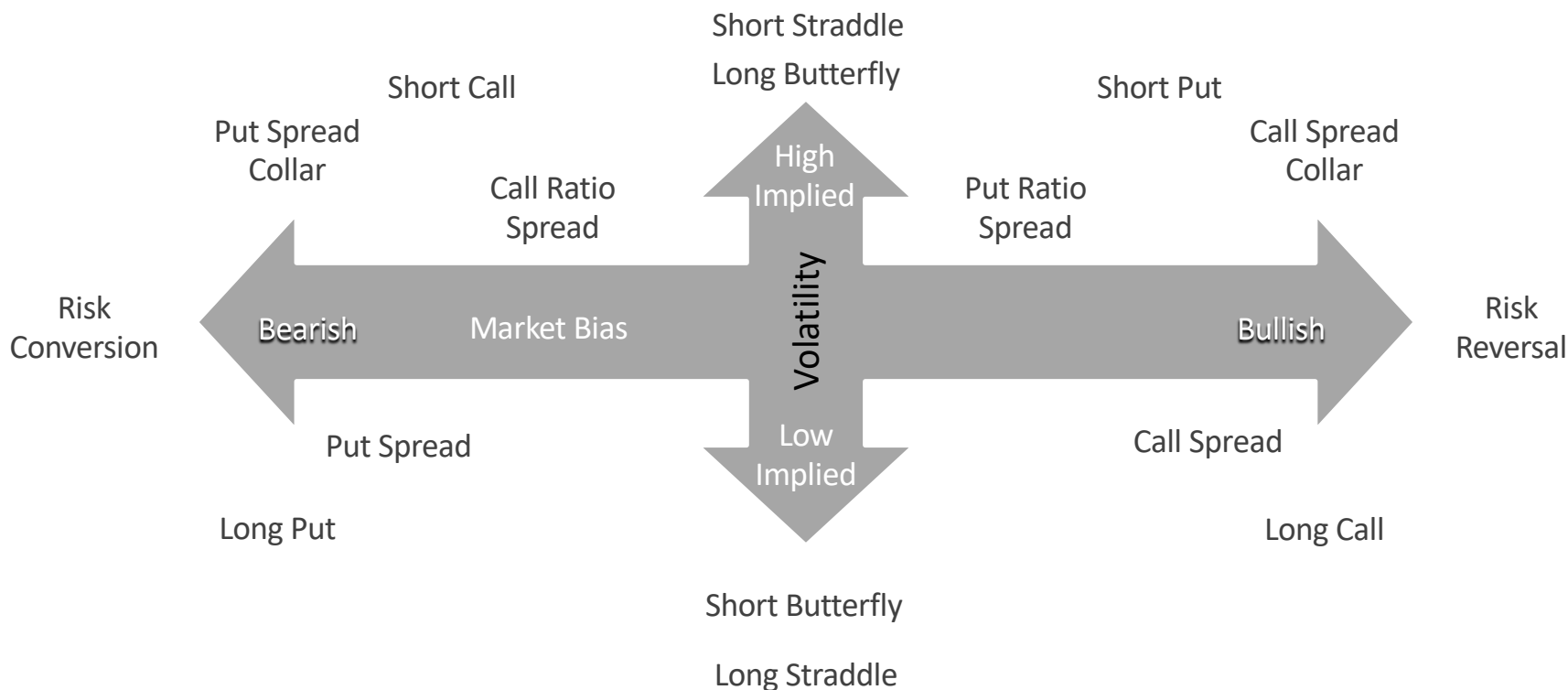
Answers please in the Q&A Panel

Buying Puts = Buying Volatility

Selling Puts = Selling Volatility

Let's revisit our strategy suite for earnings...

Strategy Suite Income-seeking / Directional / **Hedging**



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

Reasons to hedge with options...

"Everybody's got plans...until they get hit."

Mike Tyson

- **Economic**
- Correct for “wrong-way market bias”
- Reduce portfolio volatility at appropriate cost

- **Behavioural**
- Hedging should be a mouthguard, helps to avoid big psychological hits during major market events...like earnings
- Also helps us to stay the course...are you short-term or long-term with your horizon?

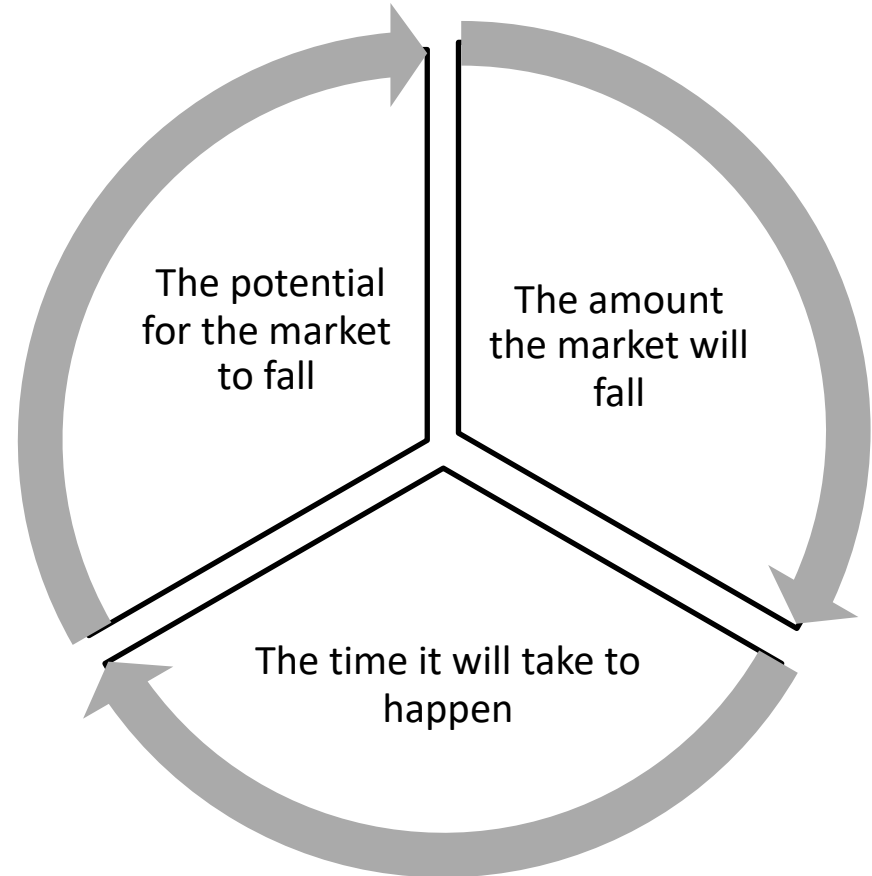
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- **By having an explicit approach to hedging in place, we can more accurately determine the “lay of the land” during sharp market selloffs**
- We planned for this
- We hedged in anticipation
- We are better positioned for this situation than we were previously
- If the portfolio is heavily exposed to tech, the recent 10% correction necessitates at least partially reducing your risk with puts

Protection is cheaper than you think...

To be successful with hedging using put options, we need to be right about three things:

- **Fixed costs** – what will we spend on premium?
- **Standalone** – expected return of the protection element of the portfolio?
- **Portfolio cost** – What is the marginal effect on the portfolio from continually hedging with puts?



- 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

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

- 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

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.

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	<u>\$300</u>	<u>\$15</u>	(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.

TSLA Earnings...should we hedge with puts?

- Earnings date 10/22
- Consensus EPS estimate \$1.56
- TSLA options are widely traded
- Implied vol on <30 day options elevated before ER
- Let's look at a potential hedge with "What-if" scenarios in TWS

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Let's talk...

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