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IUR Capital

Option Strategies for 2022

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Risk Disclosure

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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
- Specialising in exchange-traded option strategies

“Volatility evolves…..and in 2022, so should we.”

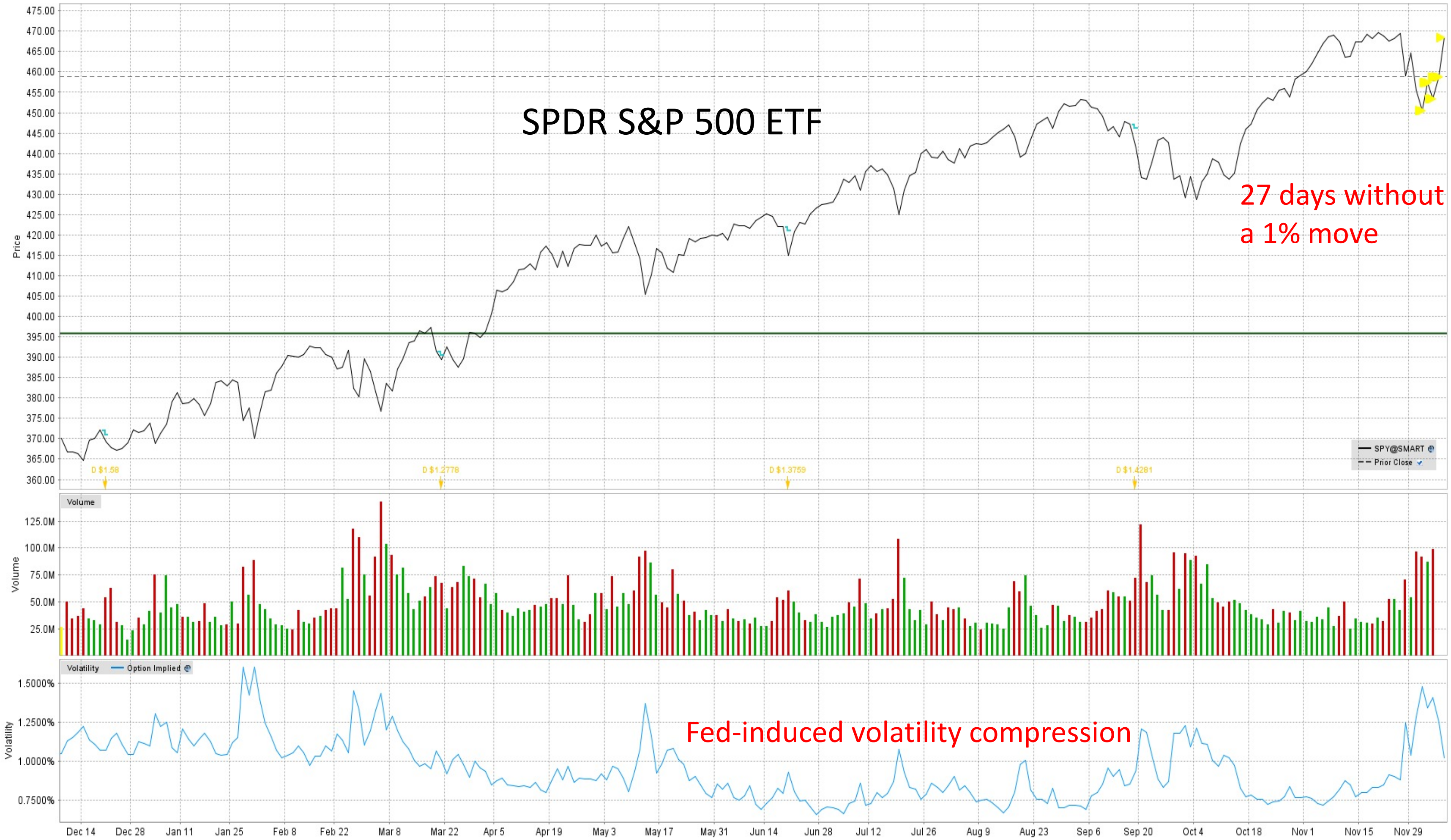
(Me. December 2021)

Market Update

- SPX +23% YTD / Nasdaq +27% YTD
- Q4 saw new highs for equity indexes
- VIX finds support at 15.00 handle during final few weeks of the year
- Risk assets continue to look past Covid into a "normalized" global economy
- Global markets prepare for a change in the rate environment
- But beware of tail risk in 2022….

(As of November 30, 2021)

So….how was your 2021?



Source: IBKR TWS (12/08/2021)

Another solid year for technology…
the digital working era is upon us

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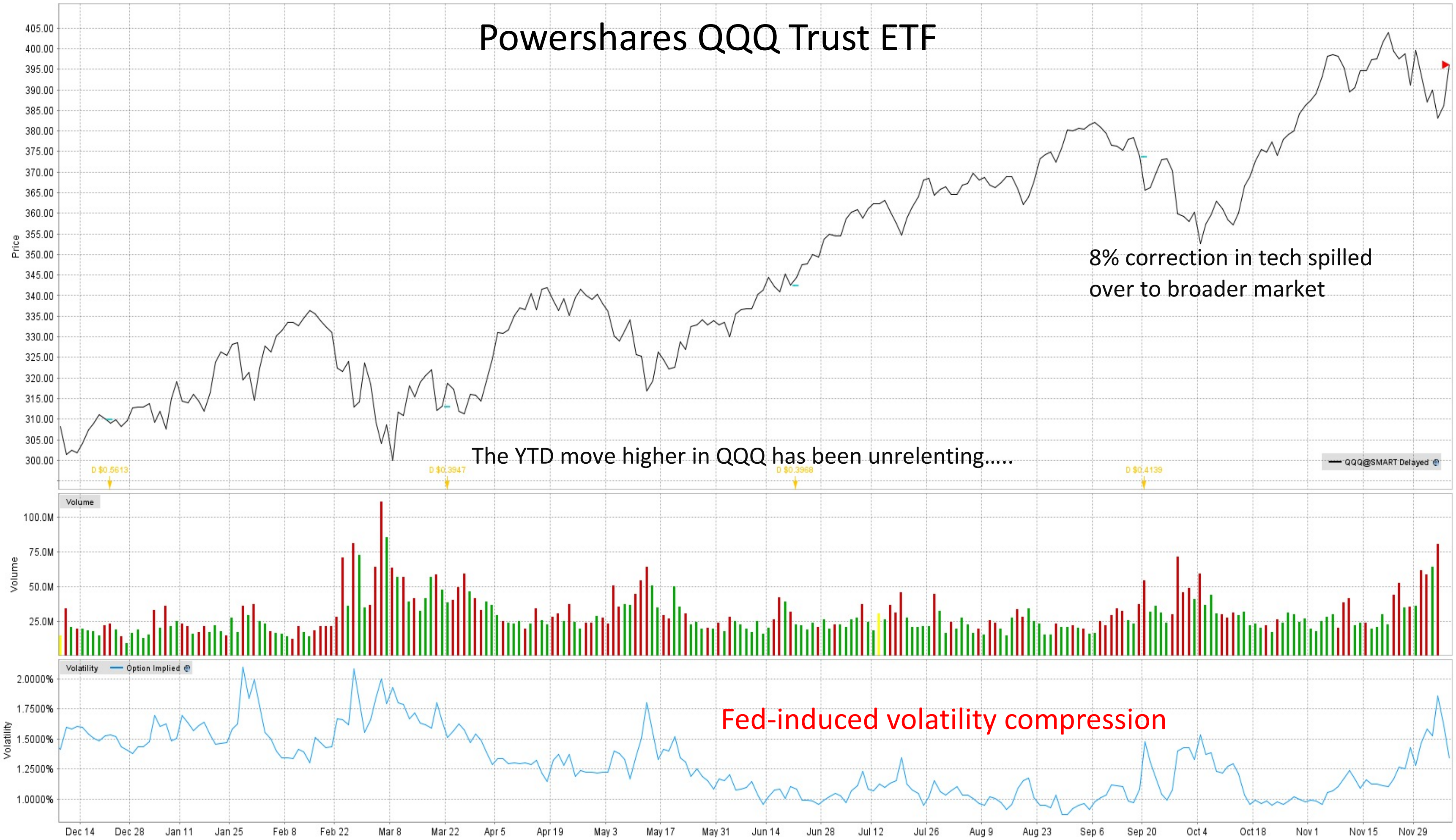
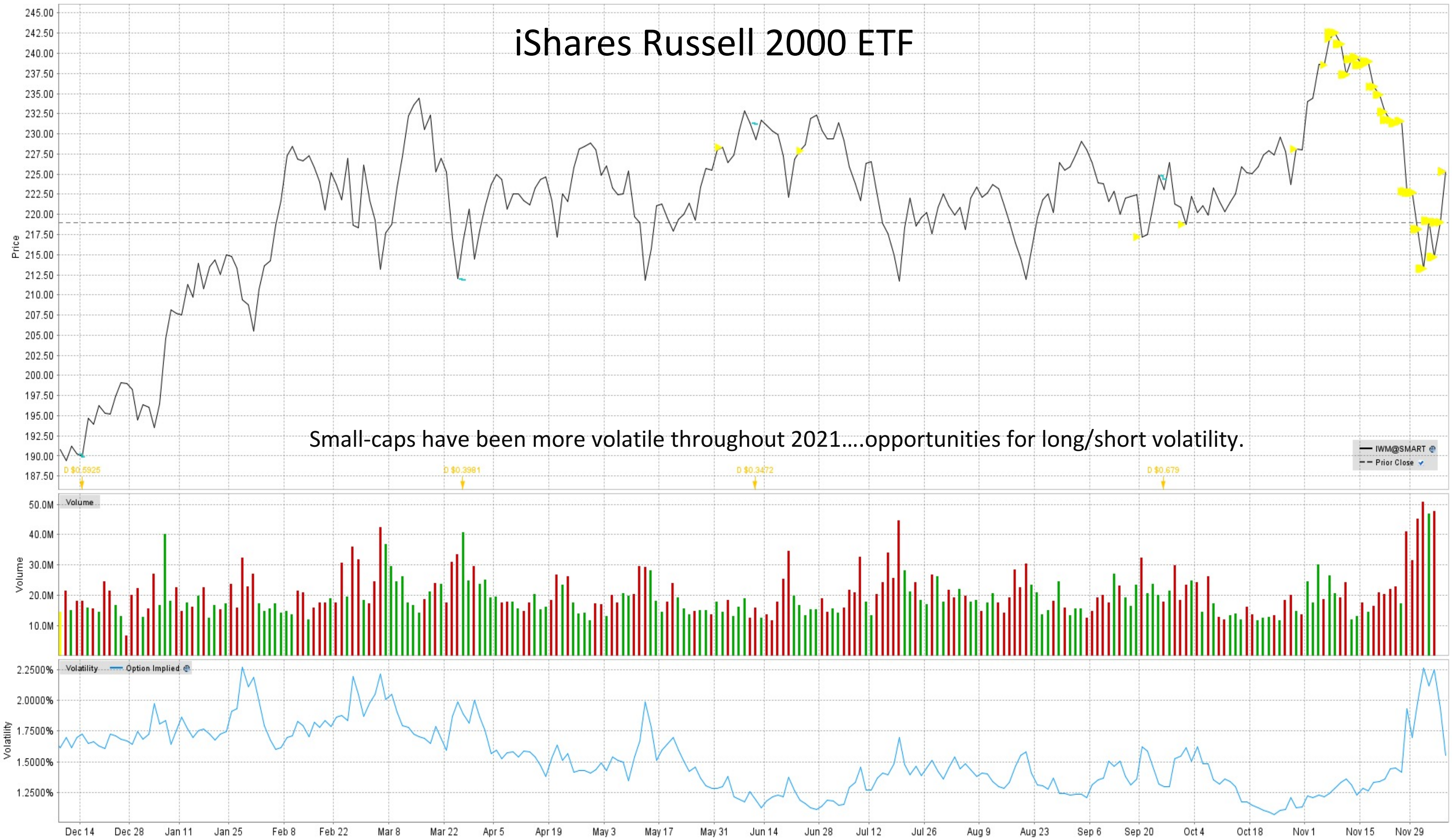


Source: IBKR TWS (12/08/2021)

Small-caps are ending the year on a softer note…



Source: IBKR TWS (12/08/2021)

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

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Source: IBKR TWS (12/08/2021)

What causes volatility, and why is volatility important?

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- The March 2020 market meltdown saw historic moves in x-asset volatility:
- *1: Fastest ever correction for S&P 500*
  2: Fastest ever bear market for S&P 500
  3: Record VIX print of 84
  4: Dow has two of its largest ever daily points declines in the same week
  5: US equity options volume breaks new daily records

- High volatility = High option pricing
- Fed talk / lack of Fed action
- Economic reports (jobs reports / inflation data / manufacturing data)
- Investor sentiment
- Will the Omicron variant become a tail-risk event in 2022?

Scenario 1:
$5m portfolio

- You are in the 40-60 age range, married with 0 / 1 dependent
- You are looking to supplement income from employment through your current portfolio
- Currently invested in bonds, mutual fund, dividend-paying stocks
- You need to generate consistent income in the portfolio BUT with a focus on capital preservation
- You are willing to allocate 15-20% of the overall portfolio to a conservative options strategy to generate regular premium
- You want to achieve regular premium even if the market remains flat

Scenario 2:
$500k retirement account

- You are nearing retirement or already retired, with no dependents
- Your income has dropped, but you are wary that you will still have living costs for you and your spouse
- Mostly invested in bonds with a small element of stocks, but your dividend income is not sufficient for regular drawdowns
- Preserving your capital in your retirement accounts is a priority
- But you are willing to look at an income strategy using options that does not require a rising market
- You want to achieve regular premium even if the market remains flat

Questions to ask about option strategies for 2022:

- 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?

Strategy Suite for 2022

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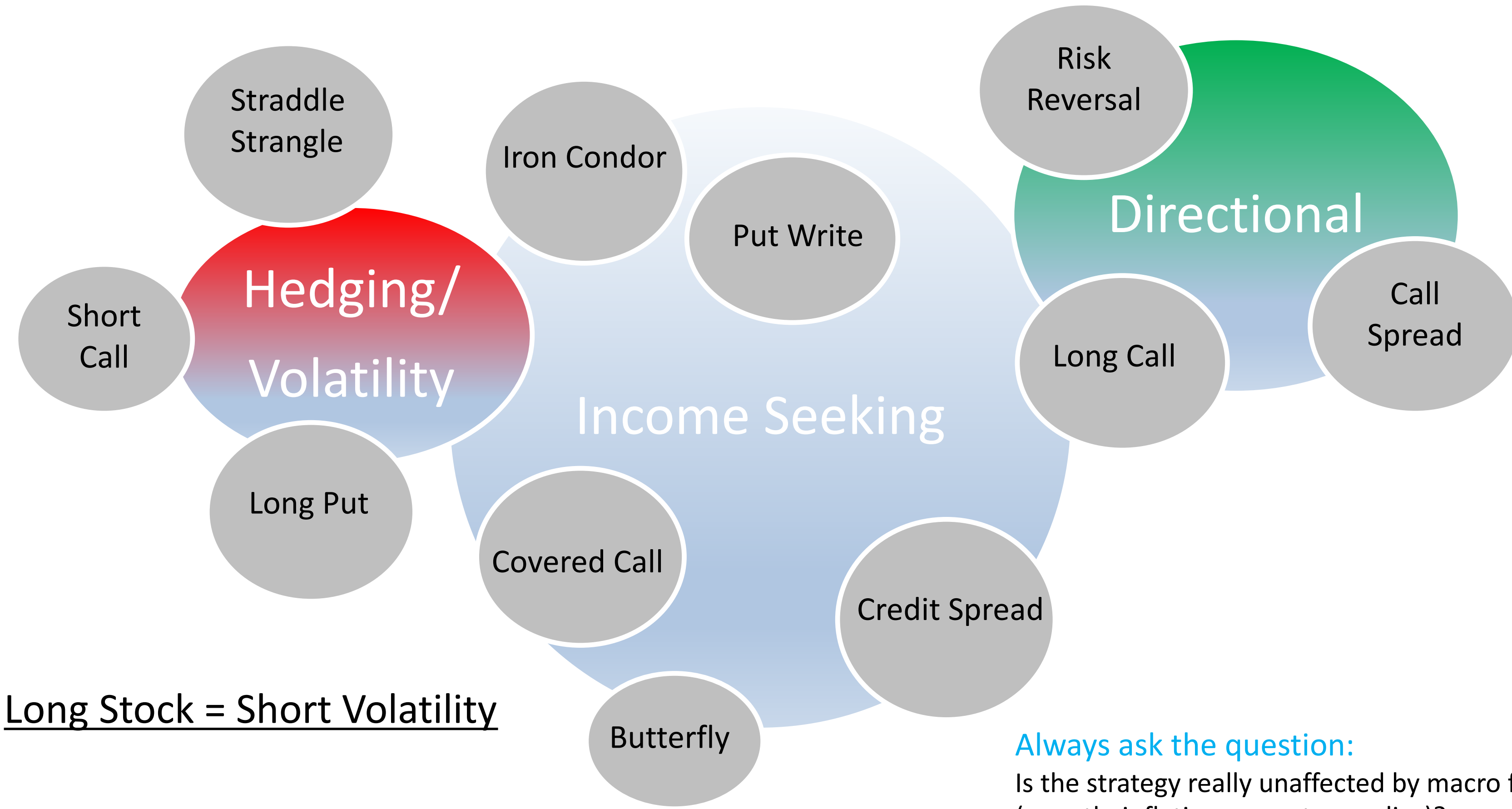

<u>Long Stock = Short Volatility</u>

Always ask the question:

Is the strategy really unaffected by macro forces (growth, inflation, monetary policy)?

How to react if the sensitivity changes over time?

Adapt the strategy / Lower expected potential

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

Systematic vs Discretionary….

Systematic

Creates an "auto-pilot"

Options rolled at expiry each month

Strike selection pre-defined

Fixed time horizon

Minimal variation in market timing

Involves continuous market exposure

Seeks to perform consistently in low volatility

Avoid over-trading

Discretionary/Opportunistic

Option Strategy / Market Bias can vary

Positions rolled only when appropriate

Strike selection may change each month

Time horizon to vary based on market conditions

Does not seek on-going exposure to volatility / market moves

Seeks to benefit from extreme market moves

Avoid missing opportunities

Question of the day….

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Should we be a BUYER or SELLER of volatility going into 2022?

Answers please in the Q&A Panel

Buying Puts = Buying Volatility

Selling Puts = Selling Volatility

Income-seeking strategies… an overview

Objective	To generate regular premium to portfolio / generate income	
Setup	Selling of put / call options for premium on underlying security Carries inherent market exposure	
Covered Call	Credit Spread	Iron Condor / Iron Butterfly
When it works:	Moderately trending market Sideways market	
Risks:	Sharp market moves with no hedge Realized volatility is higher than implied volatility	

Use of index/index ETF products as underlying vehicles

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

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

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Using SPY ETF options as a vehicle for income

- Vertical Spreads
- Creates defined-risk, defined-reward scenario
- Buy one option, sell another
- <u>Same</u> underlying
- <u>Same</u> expiration
- <u>Different</u> strike prices
- Established as a credit spread
  (premium received on opening transaction)

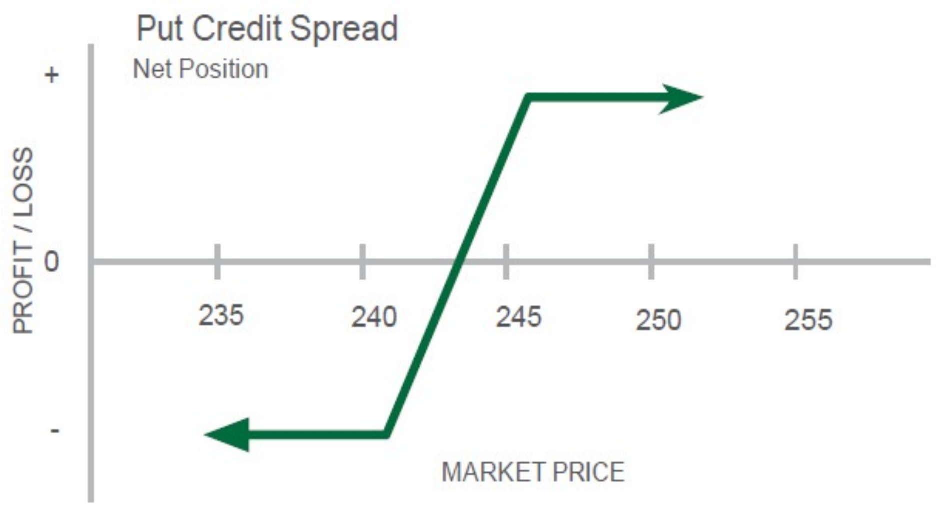
SPDR ® S&P 500
Credit Spread Strategy

- Seeks to harvest premium on a continuous basis to the portfolio using both put spread and call spread premium on SPY ETF.
- Makes use of short-dated and long-dated options
- Seeks to outperform the underlying benchmark index net of fees.
- Can be used on any equity index or index ETF.

2022 Approach

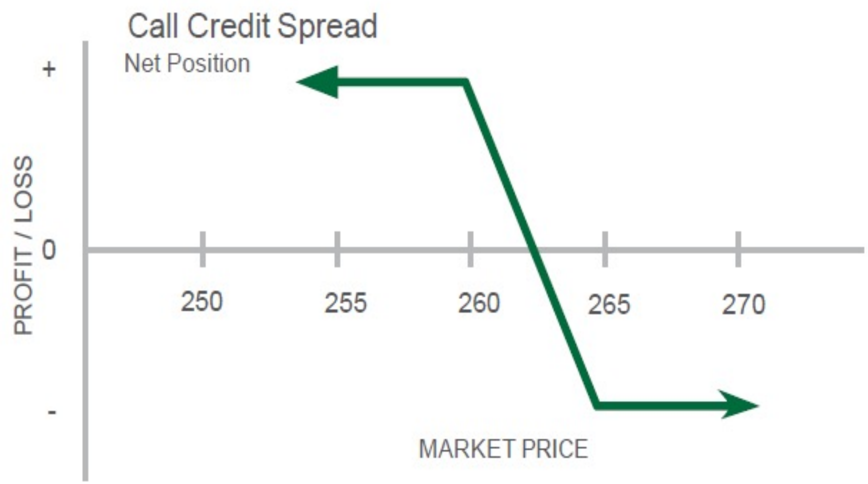
- Combine weeklies and traditional monthlies to harvest premium
- Weeklies setup could be as short as 14 days
- Use of at least 2 weeklies and the traditional monthly in any given month
- Consider an outright hedge

Credit Spread Strategy for income



Defined risk

Defined return



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Risk Management

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- Both maximum gain and maximum loss are defined
- Best case scenario is both legs of the credit spread expire OTM at zero
- Worst case scenario is for SPY to fall below the lower strike at expiry (put credit spread) or above the higher strike (call credit spread)
- Adjustment points determined at the outset to avoid assignment
- Credit Spread Strategy can also be hedged to reduce directional exposure
- **<u>This requires active management of the position…</u>**

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?

Reasons to hedge with options…cont'd

- **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 correction necessitates at least partially reducing your risk with puts

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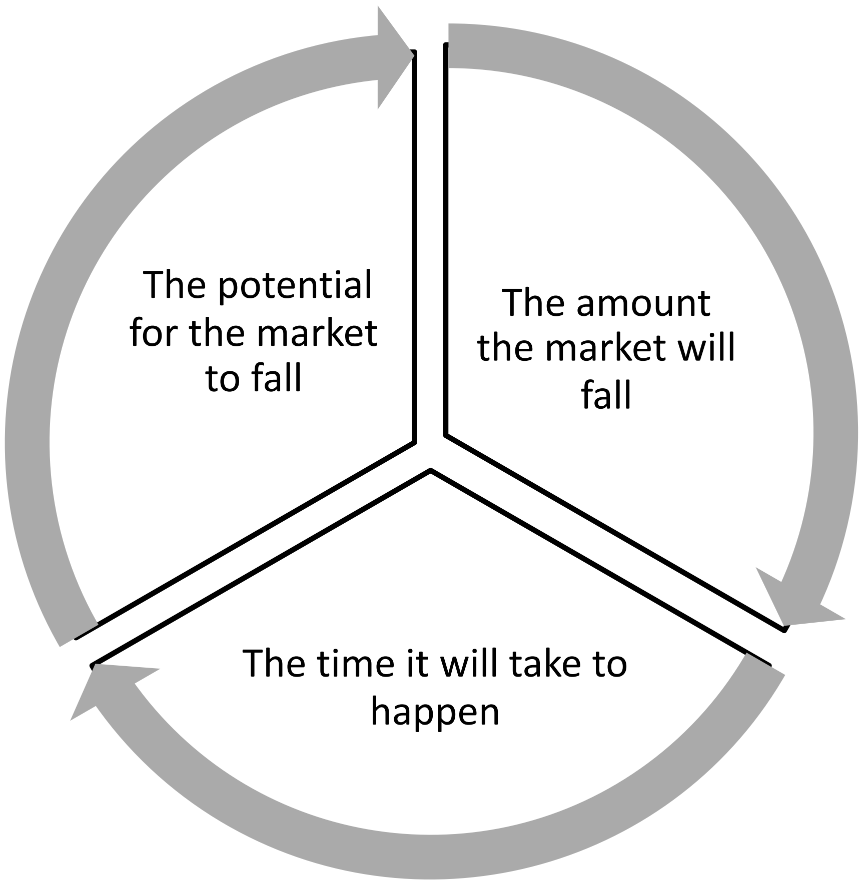
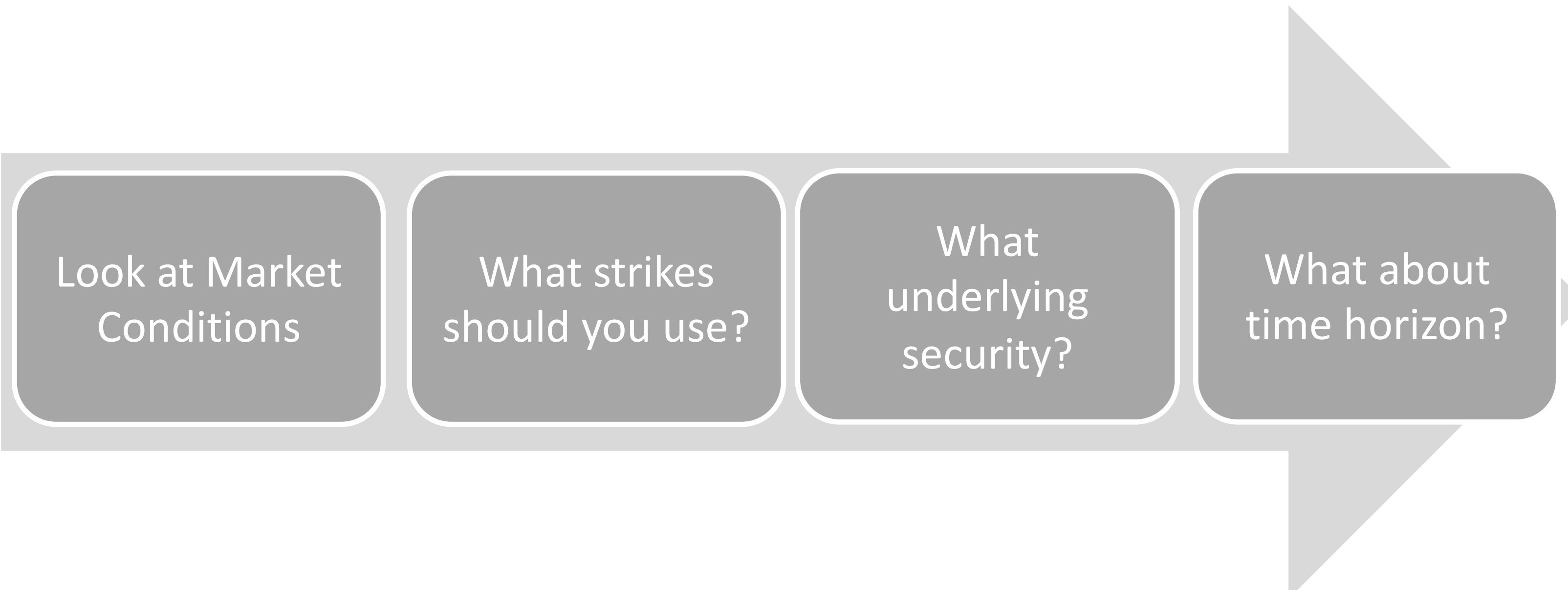
Protection is cheaper than you think…

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?



Making option-based strategies work in a portfolio…..



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Let's talk…

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