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IUR Capital

Option Strategies for a Bear Market

Gareth Ryan

Founder & Managing Director
IUR Capital

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Option Strategies for a Bear Market



Gareth Ryan
Founder & Managing Director
gryan@iurcapital.com

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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)

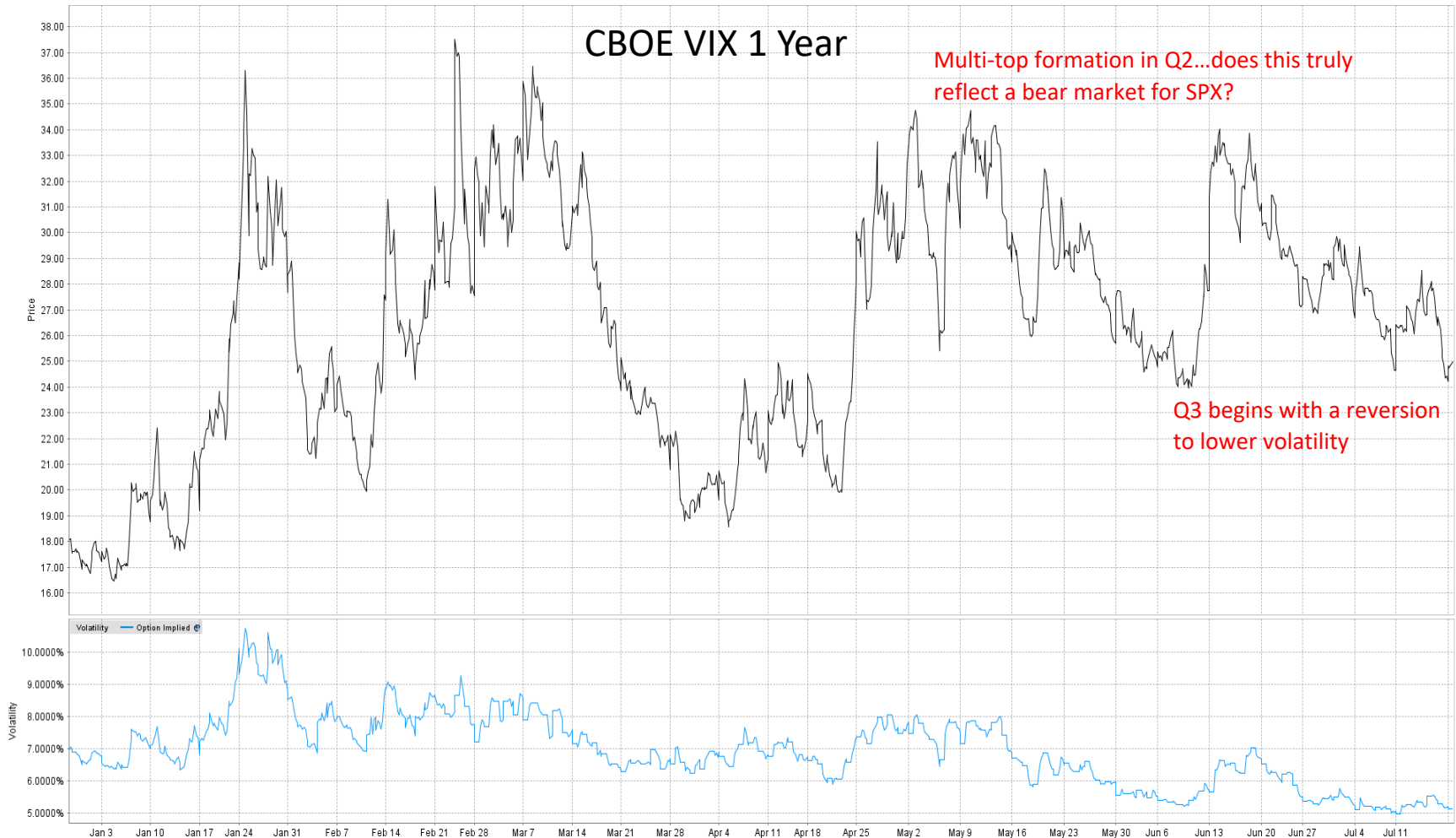
- Founded IUR Capital Ltd in 2007, IUR Capital LLC in 2010
- IUR Capital is an investment advisor for institutional and retail investors
- Focused in exchange-traded option strategies

How has your 2022 been so far?

- Both Nasdaq and S&P 500 retesting YTD lows
- S&P 500 index remains in bear market territory
- Commodities continue to see sharp daily swings
- VIX remains firmly above 2021 levels
- Talk of the next global recession lingering
- The next Fed meeting is on the horizon...

(As of July 7, 2022)

CBOE VIX....continues to do mostly what it is expected to do



Source: IBKR TWS (July 18, 2022)

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S&P 500 ETF...daily headlines driving daily swings



Source: IBKR TWS (July 18, 2022)

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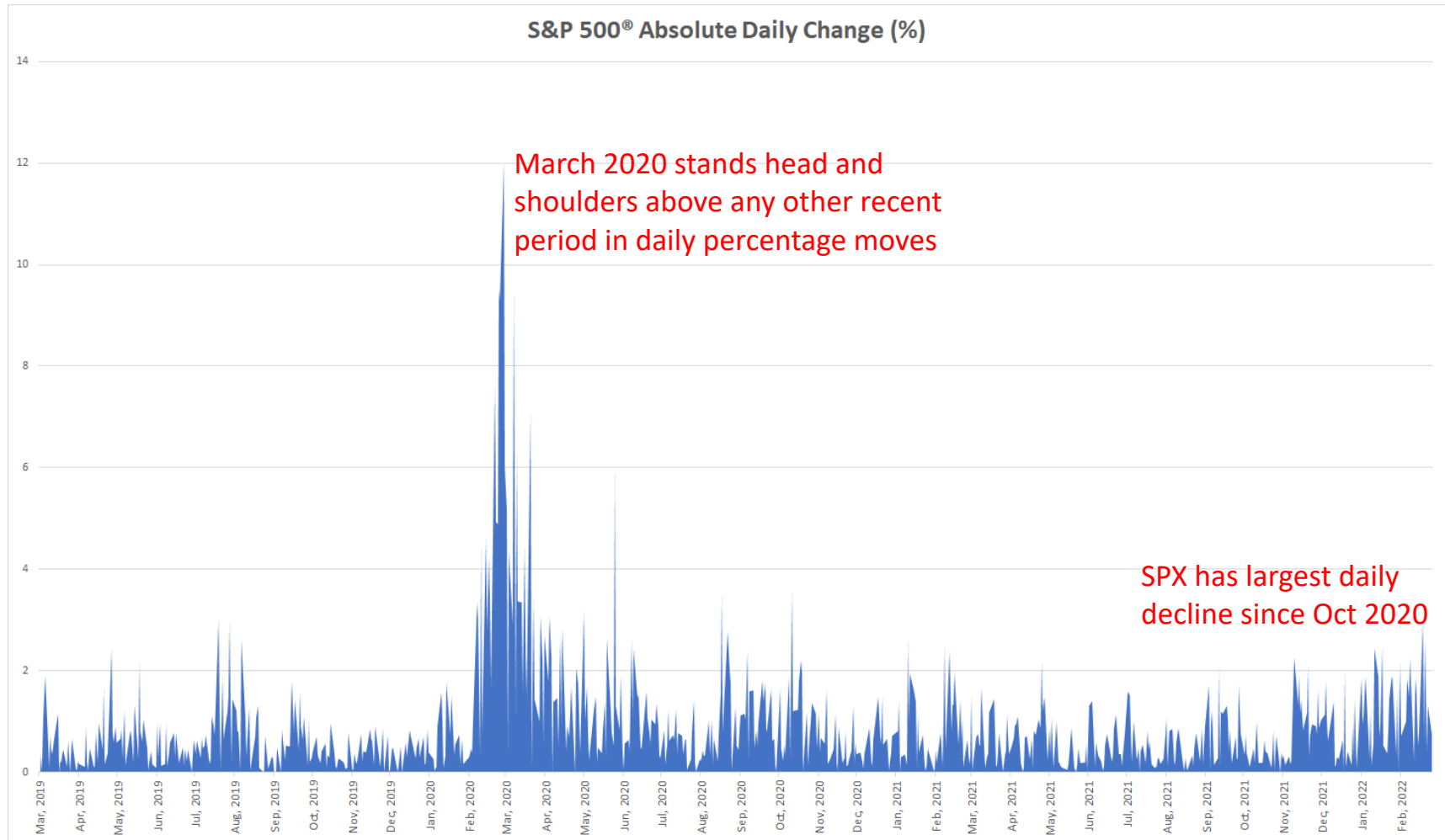
Powershares QQQ Trust.....epic declines in Q1



Source: IBKR TWS (March 21, 2022)

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Let's put this bear market in perspective....



Source: Bloomberg (March 15, 2022)

What's driving x-asset volatility?



Question of the day....

Will the S&P 500 end 2022 in bear market or correction?

Answers please in the Q&A Panel

Correction territory = 10%
decline from recent high

Bear market territory = 20%
decline from recent high

Questions to ask about option strategies during market corrections:

- 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

Scenario: Tech-focused equity portfolio

- 2020 / 2021 posted significant gains
- Exposure to both mega-cap tech names and growth-oriented software/internet stocks
- 1H'2022 has saw a sizeable impact to 2021 unrealized gains in portfolio
- Some single names down >50% YTD
- How can we mitigate our downside for these beaten up names?

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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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?

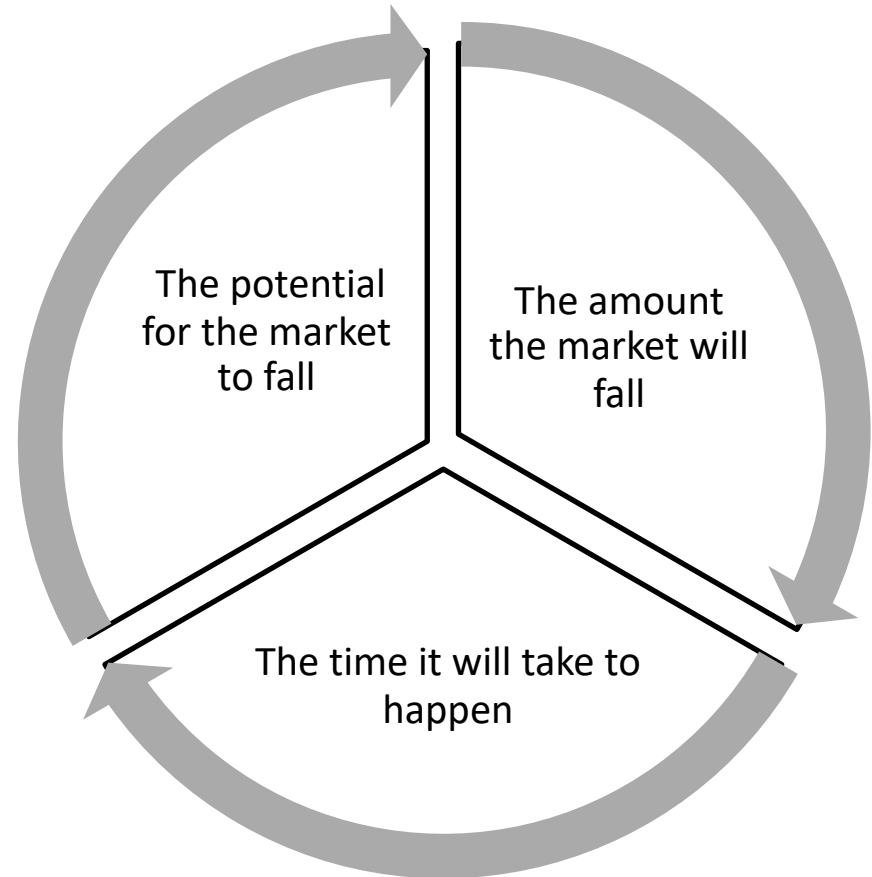
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- **By having an explicit approach to hedging in place, we can more accurately determine the “lay of the land” during sharp market selloffs**
- We planned for this
- We hedged in anticipation
- We are better positioned for this situation than we were previously
- If the portfolio is heavily exposed to tech, the recent 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?



Puts – a quick review of the basics...

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

*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 a substantial decrease in the price of the underlying stock for you to break even or realise gain.

The potential for a stock to fall

The amount that the stock will fall

The time will take to happen

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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

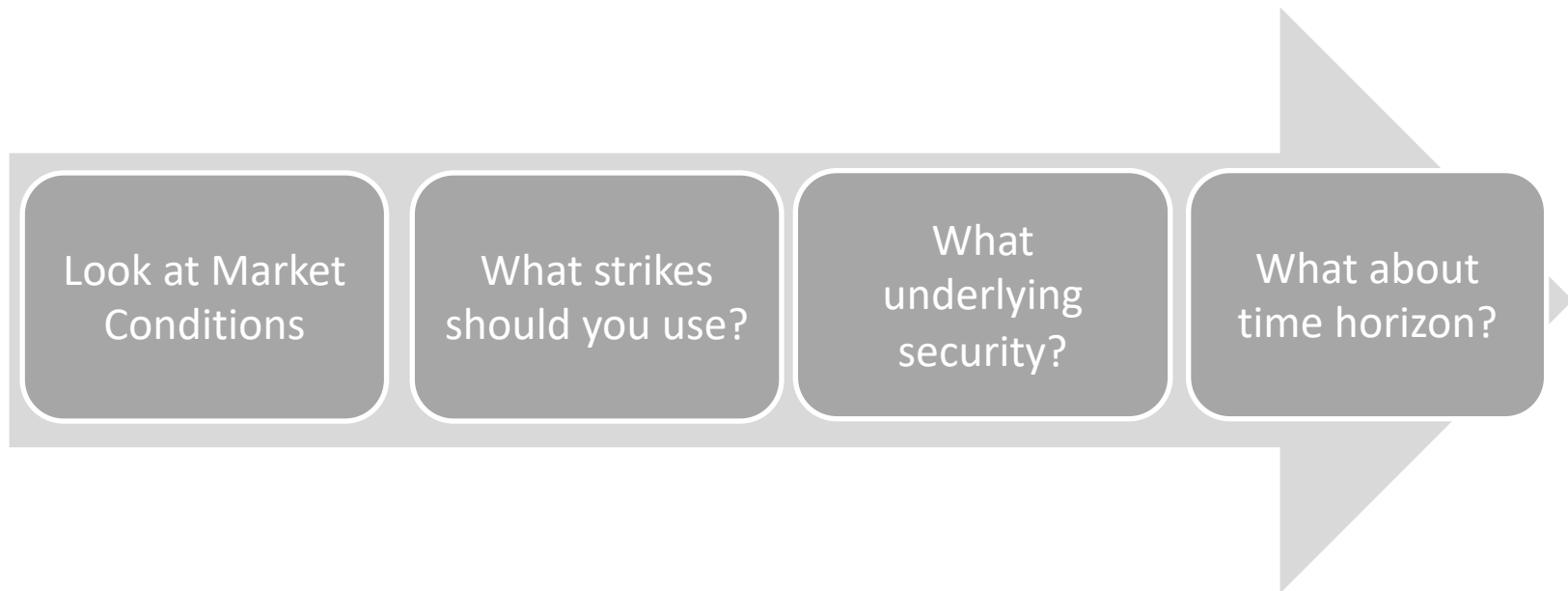
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Am I long vol or short vol? (Spreads)

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



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Let's talk...about your portfolio

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