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Important Factors for Managing Option Trades

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Presentation Outline

- Monitoring and Managing
  - Dynamic nature of marketplace
  - Holding vs. Closing vs. Rolling
- Implied Volatility (IV)
  - Definition
  - Changing IV
- Dividends
  - Early exercise considerations

Monitoring and Management

Importance of Monitoring Positions

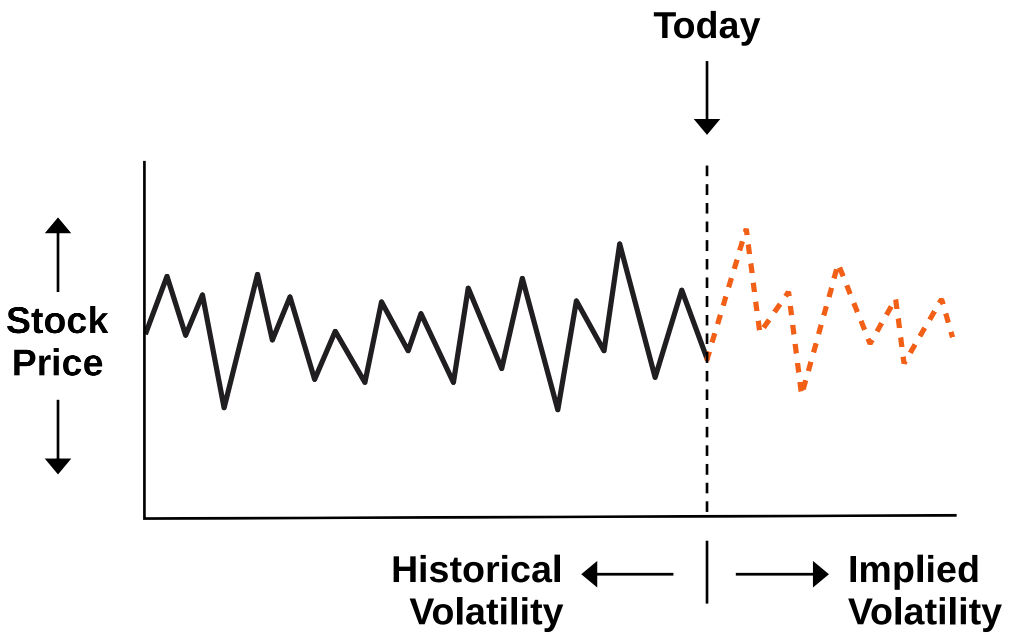
- **Plan the Trade**
  - The first step is developing a market forecast
  - Select a strategy to fit this forecast while considering risk tolerance and efficiency of capital allocation
  - Adding new strategies may help keep an investor prepared for an evolving market landscape
- **Monitoring and Position Management**
  - Market dynamics are constantly changing
  - Tracking positions is critical, active management may be necessary, especially in times of excessive volatility
  - Be aware of announcements (company specific or broad market dynamics such as shifts in the geo-political landscape)

Managing Long or Short Positions

- Holding
  - Compare current forecast vs. exposure of the open position
  - Consider time decay and how it affects the price of options
- Closing
  - Risk and reward tolerance
  - What does it cost to cross the bid/ask spread to close the position
- Rolling
  - Involves closing the existing position and opening a new position (possible simultaneous execution)
  - Can improve the net credit or debit of the overall position
  - Can provide more time for market forecast to come to fruition
  - Market forecast likely unchanged

Implied Volatility (IV)

Implied Volatility (IV) Represents the Future



- Option implied volatility reflects current expectations of future stock volatility
- Only options have implied volatility

Implied Volatility: Definition

- Option implied volatility
  - volatility assumption at which option is currently priced in market
  - can be determined via option pricing model
  - volatility input resulting in value same as current market price
- Reflects <u>underlying stock's</u> volatility expected by marketplace
  - consensus of all market participants
- Who ultimately determines option market prices?
  - <u>everybody</u> who makes a bid/ask price and trades an option
  - professionals and individual investors alike

Implied Volatility in Action

Pre-Earnings

- Stock: $100
- DTE: 13
- IV: 50%

	105 Call
Value	**$1.85**
Delta	**.30**
Gamma	**.05**
Theta	**.15**
Vega	**.10**
Rho	**.01**

Post-Earnings

- Stock: $105
- DTE: 6
- IV: 22%

	105 Call
Value	**$1.20**
Delta	**.50**
Gamma	**.15**
Theta	**.20**
Vega	**.05**
Rho	**.01**

Even with a $5 increase in share price, these calls lost value due to time decay and decreasing IV

Dividends

Dividends

- A dividend is generally a cash payment, typically paid quarterly to shareholders on company profits
- A call holder generally isn't entitled to the dividend unless they exercise their contract(s) in advance of the ex-date
- When dividends are paid the stock price is usually reduced by the amount of the dividend
- The price of a stock and the price of its options are connected

Dividend Dates and the General Timeline

Dividend Timeline

Declaration Date

- On the declaration date, the Board of Directors announces the dividend, the size of the dividend, the record date, and the payment date

Ex-Div Date

- The date when new shareholders are disqualified from earning the dividend
- Investors who buy shares on or after the ex-dividend date will NOT earn a dividend
- The shares trade "ex-dividend" (without a dividend) on this date

Record Date

- The date the company takes a snapshot of its books to record who is a shareholder of record, and thus will receive the dividend
- In most cases, the record date is 2 days after the Ex-div date

Payable Date

- The date that the dividend is paid out to shareholders of record, as determined on the record date
- This is the date that a shareholder can expect to see a dividend payment hit their account

Assignment Risk Regarding Dividends

- Early assignment may occur in the event of a dividend, and generally occurs prior to the ex-dividend date (Calls)

- Analysis:
  - For In-the-Money (ITM) call options that have no time value that can be captured through a closing transaction, the call option could be a strong candidate for early exercise if the value of the corresponding put (same strike) is less than the amount of the dividend
  - ❖ Synthetic Relationship:
    - Long Call = Long Stock + Long Put

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