OptionProfessor.com Alert
October 21st, 2021

THE REPLACEMENT TRADE

BY THE OPTION PROFESSOR

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OptionProfessor Alert:
Time to Reduce Risk--Replace Long Stocks with Long Calls??
October 21th, 2021

As regular readers now; we have been very BULLISH since we held the SPX 4300 area and closed above 4450 in the last couple of weeks. We felt earnings would be dynamite and positioning seemed to indicate a lot of money could come back into stocks the last 90 days of the year (Oct Nov Dec). Since then; we have gone up to the highs on SPX and the VIX has dropped to a 15 handle the lowest reading since mid-August. This indicates a short term sanguine and complacent market potentially...a potential set up for something that instigates repricing. Could it be an earnings surprise? Inflation & interest rates effects? Geo-political?.....who knows what if any will occur but we do know history and sometimes it can rhyme.

In mid-August: SPX had rallied from a selloff low in July (4233) to a high point August 16th (4480) or about 247 points. The VIX dropped to a low level and complacency was present. The SPX subsequently fell to 4368 or about 120 points quickly. We have just seen a move on SPX from 4278 to about 4550 in a matter of weeks and the VIX has moved to lower levels. We see companies are earning and raising prices and shorts have covered and sideline money is repositioning...all bullish.

There may be a continuation of the Pamplona Bull Run we alluded to 2 weeks ago or a pause to refresh may be close. We are seeing a bit of divergence in our RSI work and we are looking at the end of the month next week. We see short term technical support above 4400-4450 SPX. Should we fail from this neighborhood by the end of the month and the VIX were to spike; a move of 100- to 150 SPX point would mirror what occurred in August however then we did not have the flood of earnings reports engine behind us. Short term traders can evaluate replacing positions with limited risk option strategies.

Send us an email at optionprofessor@gmail.com with your contact info and we will be happy to share our information.

- The Option Professor, 10/21/21, 3:21 PM ET

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The following is an excerpt from the eBook "7 Best Ways to Trade Options" by The Option Professor, download the full PDF eBook HERE.

#3. How Does Implied Volatility Affect Options?

Implied Volatility is the market's forecast of a likely movement in a price of an underlying market. It is a metric used by investors to estimate future fluctuations (volatility) of a price based on certain predictive factors. Implied Volatility denoted by the symbol (sigma) can often be thought to be a proxy of market risk. It is commonly expressed using percentages as standard deviations over a specified time horizon. When use in the stock market; implied volatility generally (but not always) increases in bearish markets when investors believe prices will decline over time. Implied Volatility will generally (but not always) decrease when the market is bullish and investors believe the market will rise over time. Implied Volatility does not predict the direction that the price change will continue.

Implied Volatility is one of the deciding factors in the pricing of options. Buying options contracts lets the holder buy or sell an asset at a specific price for a specific period of time. Implied Volatility approximates the future value of the option and the current option value is also considered. It is important to note that implied volatility is based on probability. It is only an estimate of future prices rather than an indication of them. There is no guarantee that an option price will follow a predicted pattern. However; when considering an option, it may be worthwhile to consider the actions of others activity in the option so implied volatility is directly correlated with market opinion which of course affects option pricing

CONCLUSION-OPINION...Our opinion with Implied Volatility is that it tells us what has happened but not will happen. Just like the point spread in a football game is indicative of how teams have been playing to some degree. It is important you remember that options have intrinsic value (the amount it is in the money-higher than the strike price on calls & lower than the strike price on puts) AND time value/implied volatility which is a discounting mechanism to some degree of future price movements. EXAMPLE if the underlying market has been 40-45 (flat) for the last year; the Implied Volatility would be lower and the option price generally lower. Conversely; if a market has been 100-200 (volatile) for the last 2 months; the Implied Volatility will generally be high. In some respects option trading is volatility trading and if you enter calls after a volatile move to the upside where implied volatility is high; the market will have to keep that pace and then some to overcome the premium. The direct opposite with entering puts after a big decline. Of course; there are a variety of option trading tactics buying/selling/spreading and Implied Volatility measures are an important consideration. Our opinion is that generally low volatility can present an opportunity for buyers to use longer dated options and high implied volatility options can present an opportunity to use as a hedge in a number of strategies or a means to contract to buy the market at a discounted price.

-7 Best Ways to Trade Options" download the full PDF HERE.

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