

CALENDAR SPREADS

by

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WHAT IS A CALENDAR SPREAD

- AN OPTION STRATEGY THAT BENEFITS FROM TIME DECAY OF OPTION PREMIUMS
- BASICALLY, THE SELLING OF AN OPTION, AND THE BUYING OF ANOTHER, WITH THE SAME STRIKE PRICE, BUT A DIFFERENT EXPIRATION MONTH
- A NEUTRAL STRATEGY, BUT CAN ALSO BE USED AS A DIRECTIONAL ONE.
- WHEN A FRONT MONTH IS SOLD AND A BACK MONTH IS BOUGHT, A DEBIT SPREAD IS GENERATED. THIS IS A LONG CALENDAR SPREAD. A SHORT CALENDAR SPREAD IS THE OPPOSITE, AND IT IS A CREDIT SPREAD.
- FOCUS WILL BE ON LONG AND NEUTRAL CALENDAR SPREADS.

WHY IS THE STRATEGY ATTRACTIVE

- EXCELLENT ROR
- LIMITED RISK
- NO NEED TO SELECT MARKET DIRECTION
- “GET PAID WHILE YOU WAIT” AND ALSO ON WEEKENDS

SELECTING GOOD CANDIDATES FOR THE STRATEGY

- SELECT UNDERLYINGS THAT ARE TRENDING SIDEWAYS OR TRENDING SLOWLY IN EITHER DIRECTION
- PREFERENCE SHOULD BE FOR UNDERLYINGS ABOVE \$ 50. THIS WAY, LESS CONTRACTS ARE NEEDED, AND LESS BID/ASK COSTS. EXCEPTIONS CAN BE MADE WHEN ROR IS ATTRACTIVE.
- SELECT LIQUID UNDERLYINGS, WITH HIGH OPEN INTEREST ON THE OPTIONS SIDE (UNDERLYINGS TRADING MORE THAN 500,000 SHARES, AND \$2.5 B CAP)
- STOCKS THAT HAVE JUST ANNOUNCED QUARTERLY EARNINGS ARE ATTRACTIVE, AS THEY HAVE ALREADY MADE THEIR BIG MOVES. ALSO, THEIR FRONT IV IS USUALLY HIGHER THAN THEIR BACK IV, FOR FEW DAYS.
- SELECT UNDERLYINGS WITH IV'S BETWEEN 30-50%. TOO HIGH AN IV CAN CREATE A PROBLEM WITH ADJUSTMENTS OF POSITIONS, AS THE UNDERLYING TEND TO MOVE AROUND. ALSO, A LOW IV CAN MEAN A NARROW WINDOW OF PROFIT AND ANY BIG MOVE CAN CAUSE THE POSITION TO LOOSE. A HIGH IV SHOULD BE COMPARED TO THE HISTORICAL(STATISTICAL) VOLATILITY TO HAVE A CLUE ON THE FUTURE BEHAVIOUR OF THE UNDERLYING.
- SELECT UNDERLYINGS OF HIGHER FRONT IV'S THAN BACK IV'S. A DIFFERENCE OF .5 TO 3% IS DESIRABLE. TOO HIGH OF A DIFFERENCE CAN SIGNAL A BIG MOVE FROM AN EXPECTED EVENT, SUCH AS EARNINGS, MERGER, ETC...

ENTERING AND STRUCTURING THE SPREADS

- ENTER SPREADS WITH THREE TO SIX WEEKS TO EXPIRATION AND A MAXIMUM OF TWO MONTHS OF SEPARATION. ONE MONTH SEPARATION IS BEST IN A HIGH VOLATILITY ENVIRONMENT, AND TWO MONTHS FOR LOW VOLATILITY ONE.
- USE CALLS OR PUTS, WHICHEVER CHEAPER, AS LONG AS LIQUIDITY IS GOOD.
- USE TWO OR THREE STRIKE SPREADS, TO ENHANCE THE PROBABILITY OF SUCCESS. REMEMBER THAT AN INCREASE IN THE PROBABILITY OF SUCCESS WILL REDUCE THE POTENTIAL ROR. THE ADVANTAGE IS THAT LESS ADJUSTMENTS ARE NEEDED, AND THE WINDOW OF SUCCESS CAN ACCOMMODATE BIGGER MOVES.
- SIMULATE THE DESIRED POSITION ON THE ANALYSER PAGE IN TOS. MAKE SURE YOU HAVE A WINDOW THAT CAN TOLERATE MOVES OF 7% UP/DOWN FROM WHERE THE UNDERLYING IS. CHECK TO MAKE SURE THAT THE PROBABILITY OF SUCCESS EXCEEDS 45%. IT MIGHT NOT BE POSSIBLE TO ACHIEVE THIS WITH ONE SPREAD.
- LEGG INTO THE DESIRED POSITION SLOWLY, ESPECIALLY WHEN THERE IS MORE THAN FOUR WEEKS TO EXPIRATION. PLACE THE SPREADS ATM AS THE UNDERLYING MOVES, AND THUS CAPTURE THE HIGHEST PREMIUMS.
- ENTER SPREADS THAT SHOW ROR'S OF BETTER THAN 80% AT EXPIRATION. SPREADS WHICH HAVE MORE THAN FOUR WEEKS OF EXPIRATION, SHOULD HAVE ROR'S OF MORE THAN 80%.

FACTORS ESSENTIAL FOR SUCCESS

- BUILD A PORTFOLIO OF 8 TO 12 POSITIONS, AND ALOCATE CAPITAL/RISK EQUALLY TO ALL POSITIONS. OVERWEIGHT ON SOME POSITIONS SHOULD BE EXCEPTIONAL.
- COMMIT A MAXIMUM OF 50% OF AVAILABLE CASH TO ALL THE PORTFOLIO. TRADERS WITH LIMITED EXPERIENCE SHOULD START WITH LESS AND INCREASE THE COMMITMENT AFTER GAINING EXPERIENCE WITH THE STRATEGY. USING HALF THE CAPITAL WILL GUARANTEE THAT THE TRADER WILL ALWAYS BE ABLE TO STAY IN THE GAME.
- USE TWO EXPIRATION CYCLES WITHIN THE PORTFOLIO, SO THAT WHEN AN EXPIRATION IS APPROACHING, YOU ARE ENTERING NEW SPREADS WHILE EXITING OTHERS.
- DIVERSIFY THE PORTFOLIO, SO THAT SEVERAL SECTORS ARE REPRESENTED, THUS AVOIDING HIGHLY CORRELATED UNDERLYINGS.
- DIVERSIFYING AND HAVING SEVERAL POSITIONS AT ONE TIME, GUARANTEES “STATISTICALLY”, THE CHANCES OF SUCCESS ARE HIGHER.
- HEGDE THE PORTFOLIO AGAINST MARKET DECLINES. TOS PROVIDES FACILITIES TO ESTIMATE THE BETA-WEIGHTED NEEDS.

EXITING POSITIONS

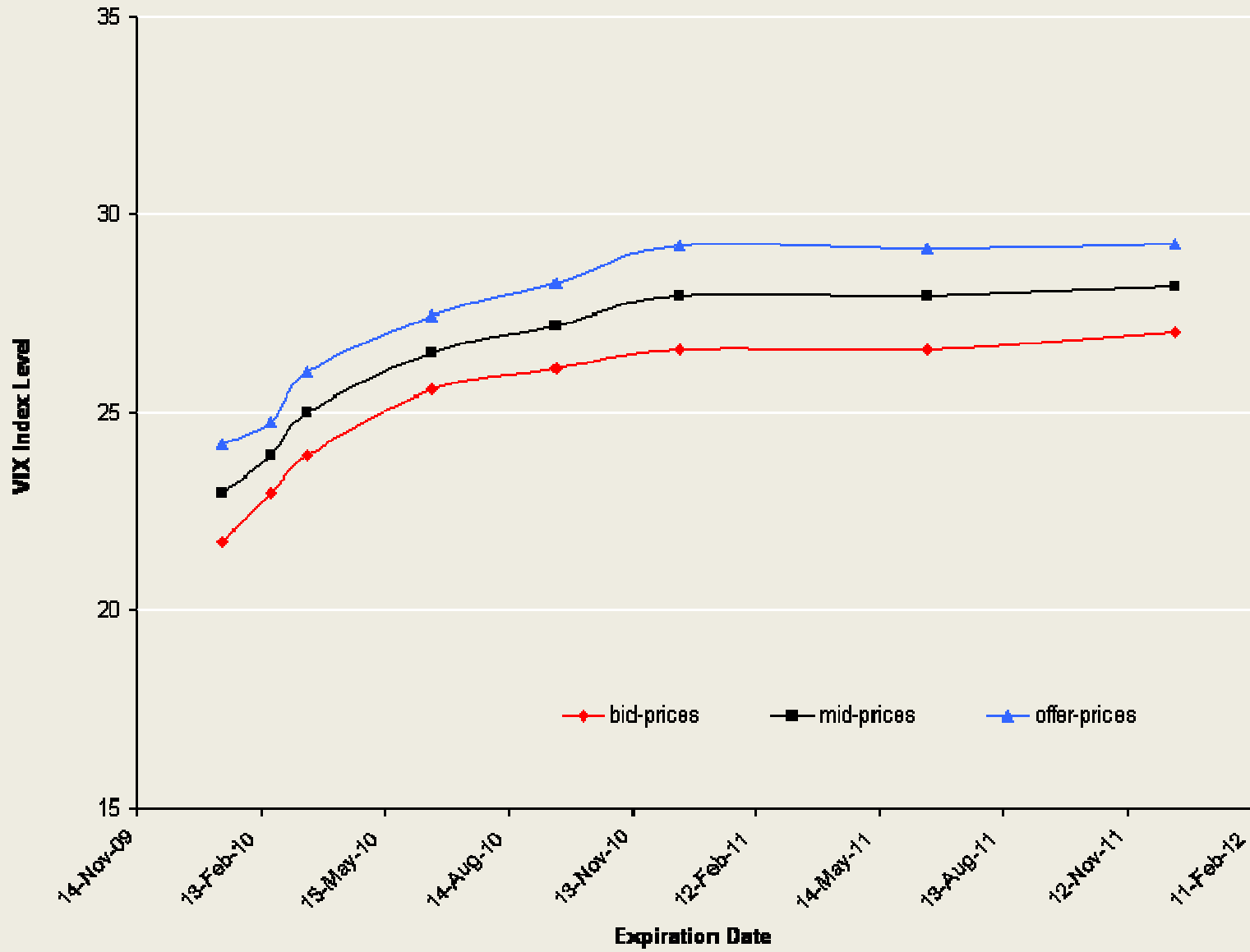
- EXIT POSITIONS WHEN THEY HAVE MADE 40 TO 60% PROFIT
- EXIT ALL POSITIONS ON FRIDAY OR MONDAY OF EXPIRATION WEEK. THE ONLY EXCEPTION IS WHEN THE UNDERLYING HAS MADE AN UNFAVOURABLE MOVE AND IT IS IN AN OVERSOLD/OVERBOUGHT CONDITION, AND A CORRECTION OF THIS CONDITION IS VERY FAVOURABLE.
- EXIT AT ANY TIME WHEN A POSITION IS OUTSIDE IT'S WINDOW OF PROFIT, AND THERE IS NO SENSE IN ADJUSTING IT, SIMPLY TAKE THE LOSS.

MONITORING AND ADJUSTING THE PORTFOLIO

- POSITIONS MUST BE MONITORED DAILY, TO MAKE SURE THAT THEY ARE WITHIN THE PROFIT WINDOW, AND THE TOTAL PORTFOLIO WINDOW IS ACCEPTABLE. SUPPORT AND RESISTANCE OF THE INDIVIDUAL POSITIONS MUST BE WATCHED AS THE UNDERLYING MOVES AND ADJUSTMENTS COULD BE NECESSARY.
- IN A TWO STRIKE POSITION, IF THE UNDERLYING MOVES ABOVE THE UPPER STRIKE, SELL THE LOWER SPREADS AND ADD A NEW SPREADS WHERE THE UNDERLYING IS OR SLIGHTLY ABOVE IT. THE SAME THING CAN BE DONE WHEN THE UNDERLYING MOVES BELOW THE LOWER STRIKE. THE IDEA IN ADJUSTING IS TO STAY NEUTRAL AND MAXIMIZE THE PREMIUM/PROFIT.
- IN A ONE STRIKE POSITION, ADJUST BY ADDING TO THE POSITION A NEW STRIKE SPREAD, PLACED AT WHERE THE UNDERLYING IS.
- NO ADJUSTMENT SHOULD BE MADE IN THE LAST TWO WEEKS BEFORE EXPIRATION. THERE IS NO SUFFICIENT PREMIUMS LEFT, AND MORE RISK WOULD BE ADDED TO THE POSITION. ADJUSTMENTS CAN BE MADE BY SELLING SOME OF THE SPREADS AND TRYING TO BE DELTA NEUTRAL.
- MONITOR DELTA , GAMMA, AND THETA OF YOUR PORTFOLIO. IT IS LIKE X-RAYS OF YOUR POSITIONS.

RATES OF RETURN

- RATES OF RETURN VARY DEPENDING ON THE MARKET ENVIRONMENT
- OBSERVING THE VIX TERM STRUCTURE CAN GIVE SOME INSIGHT INTO THIS ENVIRONMENT, AS IT REFLECTS THE IV'S OF THE MARKET(SEE GRAPH)
- ONE CAN EXPECT RETURNS OF 100 TO 200% IN LOW/MIDIUM VOLATLITY ENVIRONMENTS
- MUCH LOWER RETURNS OR EVEN LOSSES WOULD BE EXPECTED IN A HIGH VOLTLITY ENVIRONMENTS. IT IS NOT A STRATEGY TO BE USED IN VOLATILE MARKETS.



<http://www.cboe.com/micro/vix/vixtermstructure.aspx>

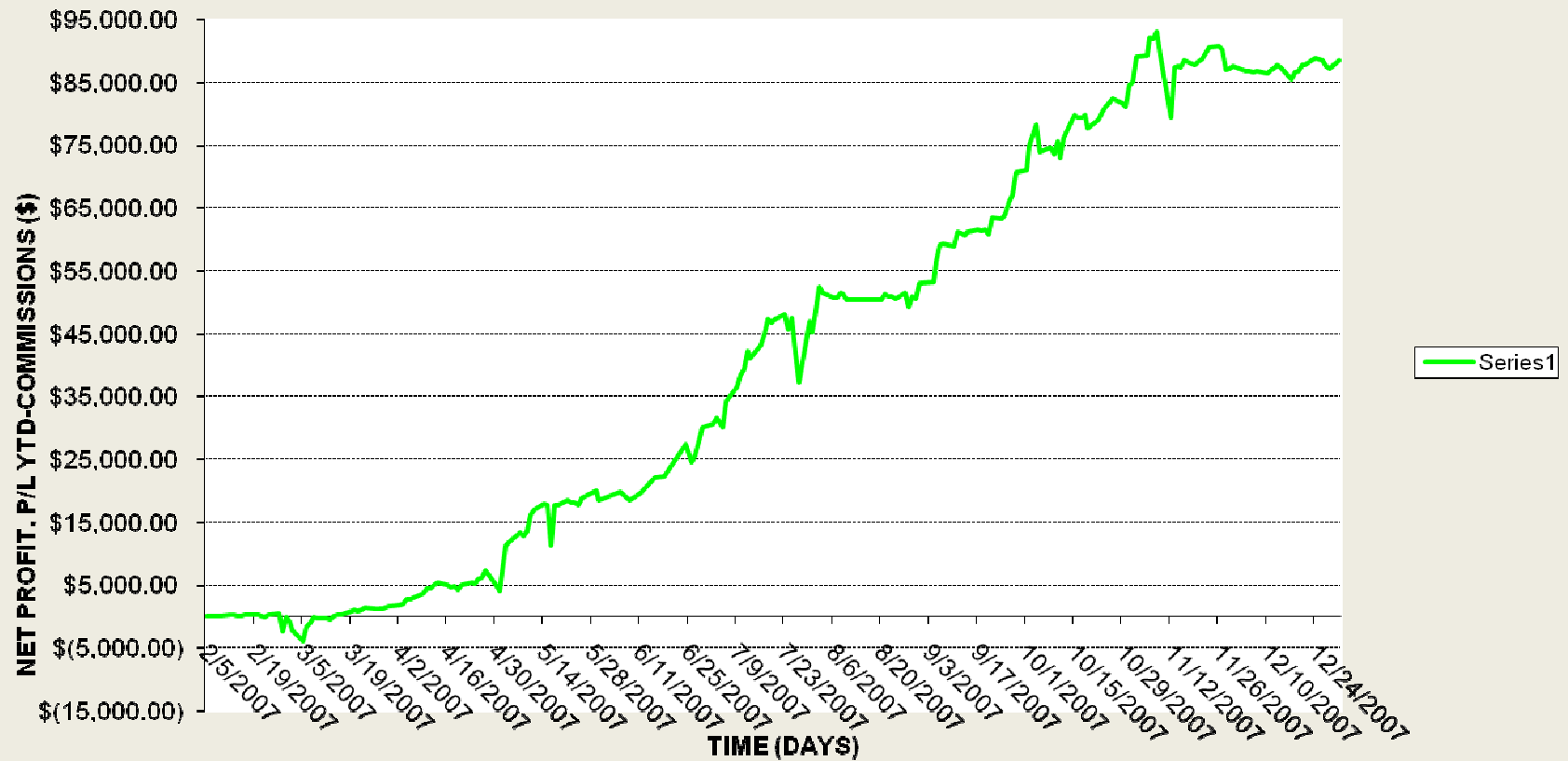
VOLATILITY FUTURES



<http://cfe.cboe.com/>

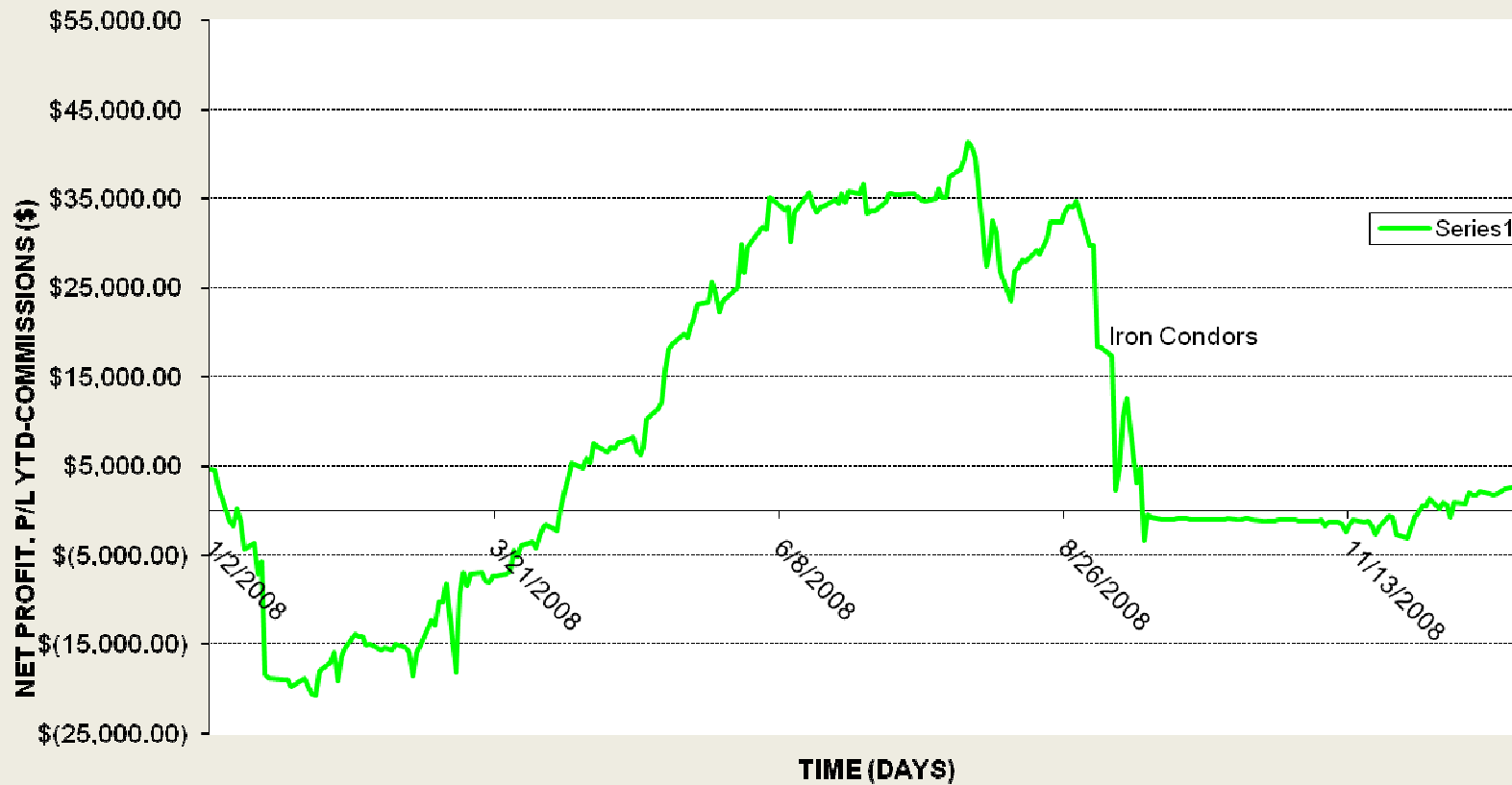
RESULTS IN 2007

NET PROFIT USING CALENDAR SPREADS 2007

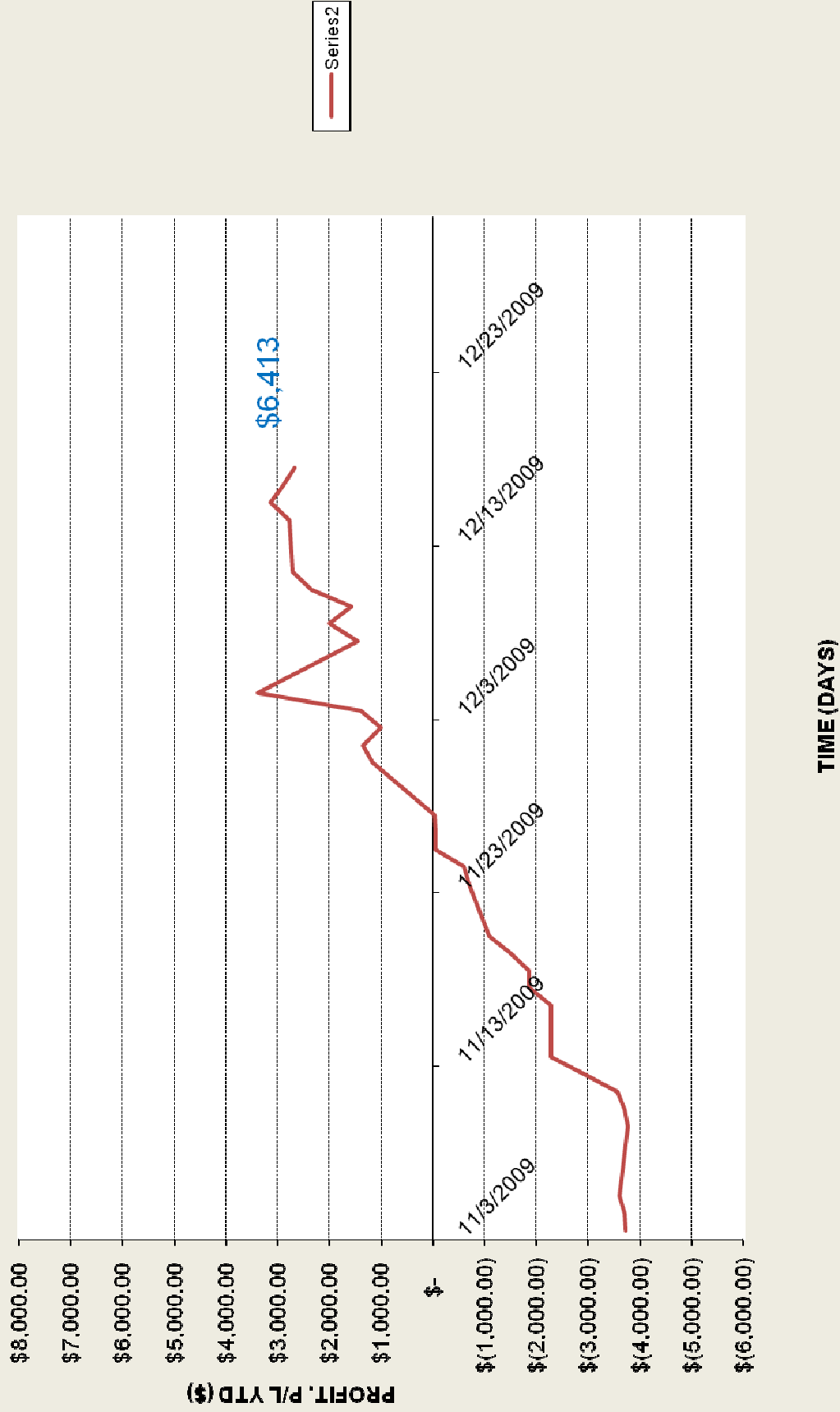


RESULTS IN 2008

NET PROFIT USING CALENDAR SPREADS + IRON CONDORS 2008



PROFIT WITH CALENDAR SPREADS 2009



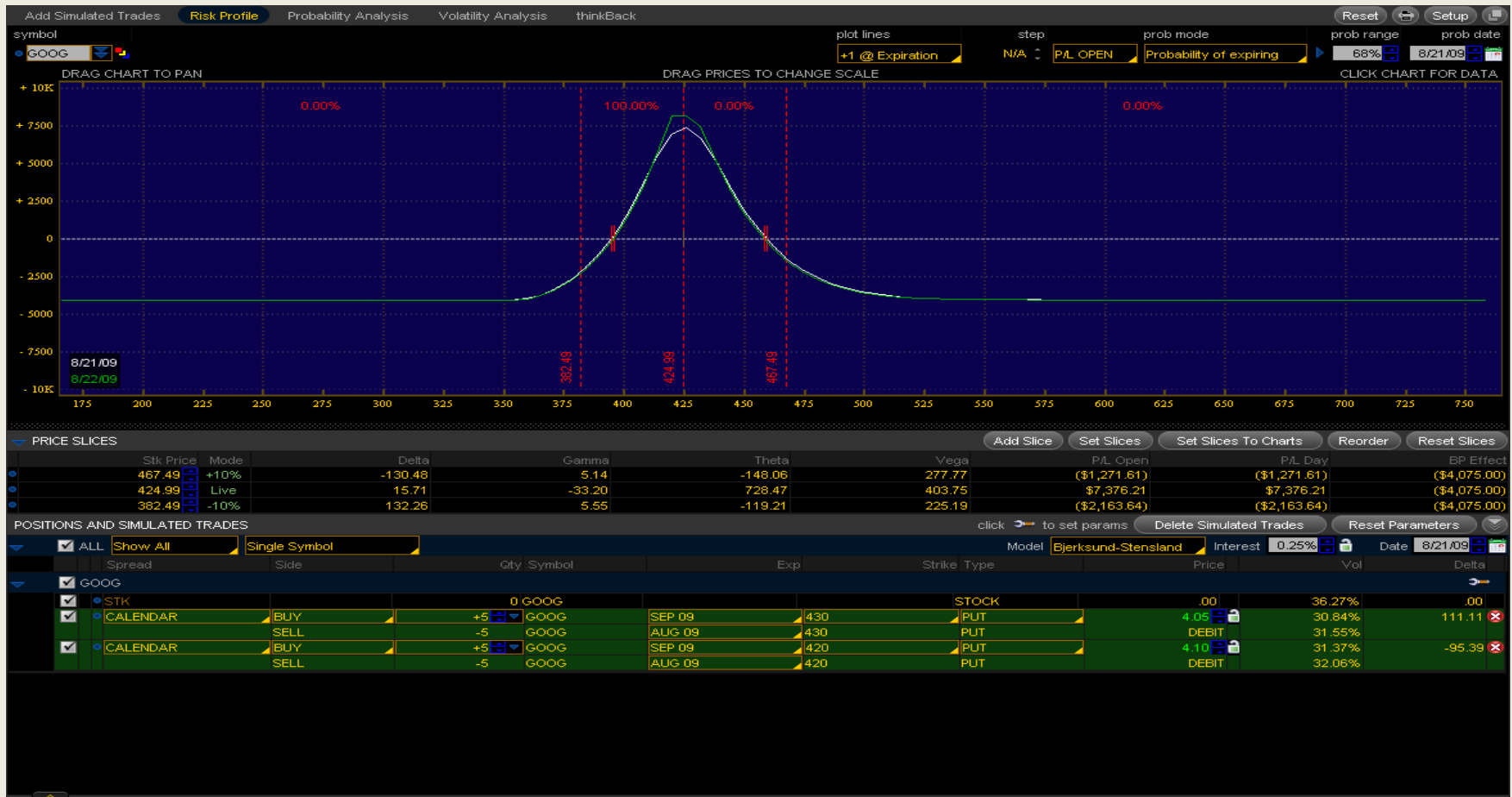
CALENDAR SPREADS DECEMBER 2009

Stock	Before Commissions Net Gain/loss	After Commissions Net Gain/loss	Total Cost	Risk in trade	ROR %	ROR% (risk)	Commissions
AMZN	\$ 319.00	\$ 246.25	\$ 6,786.00	\$ 2,900.00	4.7%	8.5%	\$ 72.75
FSLR	\$ (77.00)	\$ (38.00)	\$ 3,965.00	\$ 3,000.00	-1.9%	-1.3%	\$ 39.00
OIH	\$ 85.00	\$ 34.00	\$ 3,567.00	\$ 3,000.00	2.4%	1.1%	\$ 51.00
PCLN	\$ 763.00	\$ 718.00	\$ 5,642.00	\$ 3,000.00	13.5%	23.9%	\$ 45.00
POT	\$ 1,240.00	\$ 1,114.00	\$ 8,661.00	\$ 3,000.00	14.3%	37.1%	\$ 126.00
WYNN	\$ (48.00)	\$ (93.00)	\$ 2,051.00	\$ 1,200.00	-2.3%	-7.8%	\$ 45.00
RIMM	\$ 810.00	\$ 723.00	\$ 3,711.00	\$ 2,900.00	21.8%	24.9%	\$ 87.00
EEM	\$ 265.00	\$ 190.00	\$ 1,560.00	\$ 1,300.00	17.0%	14.6%	\$ 75.00
IYR	\$ 337.00	\$ 274.00	\$ 1,363.00	\$ 1,000.00	24.7%	27.4%	\$ 63.00
Total	\$ 3,694.00	\$ 3,168.25	\$ 37,306.00	\$ 21,300.00	8.5%	14.9%	\$ 603.75

CALENDAR SPREADS NOVEMBER 2009

Stock	Before Commissions Net Gain/loss	After Commissions Net Gain/loss	Cost	ROR %	Commissions
FCX	\$ 544.00	\$ 490.00	\$ 3,810.00	12.90%	\$ 54.00
OIH	\$ 794.00	\$ 758.00	\$ 3,010.00	25.20%	\$ 36.00
JPM	\$ 428.00	\$ 365.00	\$ 1,961.00	18.60%	\$ 63.00
Total	\$ 1,766.00	\$ 1,613.00	\$ 8,781.00	20.11%	\$ 153.00

LET'S ANALYZE AN EXAMPLE



BREAK EVEN POINTS-WINDOW



GO TO TODAY IN THE CALENDAR...



PROBABILITY TO EXPIRATION

