



# Enhancing your Retirement Portfolio

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The thinkorswim guide to using options  
in an IRA account



This three-hour class will focus exclusively on option strategies that enhance retirement portfolio returns.

Because of the 3-hour time constraint, we will not cover hedging, speculating or other option strategies like collars, although they are permissible for IRA accounts at TOS.

This class was designed to teach TOS clients a variety of professional option strategies for adding incremental returns to “long” or bullish-biased retirement portfolios.



We will concentrate on:

1. Defined-risk option strategies
2. Premium selling techniques that will add between .25% to .45% to your portfolio on a monthly basis
3. Trade entry and exit criteria

We believe it's important to focus on long-term returns as you learn to be your own money manager. Our objective is to improve your ability to build wealth and eliminate management fees by adding a few extra percentage points of total return year after year by making your own trading decisions.



Enhancing your retirement portfolio is a powerful financial journey on which we are about to embark. Here are the key points so far:

1. Self-directed money management provides significant cost savings
2. Learning to add incremental returns on a monthly basis is simple and rewarding
3. It's not cost-effective to hedge tax-advantaged portfolios with long puts (too expensive) or with collars (why own the underlying?)



Since the IRS does not allow you to be short stock in an IRA, we will make the basic assumption that everyone here holds a long stock and mutual fund portfolio. We also would like to strongly suggest that clients focus on trying to maintain a consistent portfolio weighting of different asset classes. For example, everyone should have an understanding of a balanced "model allocation". Even something as simple as 50% stocks, 30% cash, 20% "other" will keep you focused and somewhat protected to market swings.



Be consistent with that allocation over time and do not try and test your market timing skills to add performance. Here are some of the key points:

1. Market timing strategies historically lead to emotional, negative adjustments
2. Learning consistent portfolio allocation is a positive tool



## **Strategy lesson #1:**

Selling cash-secured puts to establish long stock positions.

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Although we will discuss the covered call shortly, selling cash-secured puts in an IRA is synthetically similar to selling covered calls. The execution of this strategy is simple but it's important to follow our basic trading criteria. Understanding the strategy is 10% of the battle. 90% of success is knowing the correct options to trade.



## **Strategy lesson #1:**

Selling cash-secured puts to establish long stock positions.

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First, find a stock that you like. Next, find the nearest available expiration that has at least 23 calendar days to go. Then find the put that is one strike OTM in equities or 2% OTM in indexes. Selling that put short will provide you with the quickest rate of decay relative to the highest probability of success.

The cash-secured put strategy assumes that you want to own the stock at a lower price. Your effective purchase price of the stock, should you be assigned on the short put, is the strike price minus the premium received.



## **Strategy lesson #1:**

Selling cash-secured puts to establish long stock positions.

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The upside of this strategy is that there is a high probability of success. The downside is that it has limited profit potential. You can make a losing stock selection but the enhancement itself can never be a losing trade.

Depending on account size, using an index-based ETF such as QQQQ, IWM, DIA or SPY will allow you to implement the cash-secured put strategy to maintain your target portfolio allocation while offering the diversification of various broad-based indexes.



## **Strategy lesson #1:**

Selling cash-secured puts to establish long stock positions.

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Consider this, when viewing the current implied volatility for any index, if you sell the front-month put every expiration cycle, the implied volatility is the discounted price that you will pay for the long ETF. It's like buying an index mutual fund with a 15% (average current index implied volatility) discount to the current NAV. Here are the key points:

1. Using cash-secured short puts is a risk-free method of acquiring long stock
2. Selling index ETF puts is another method to maintain consistent equity portfolio allocation



## **Strategy lesson #2:**

Selling calls against long stock to enhance your returns.

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Using a blanket generalization, selling calls (covered) will add approximately  $\frac{1}{3}$  of one percentage point per month to your total return. For consistent results, find the nearest expiration month with at least 23 days to go and sell the nearest strike OTM call. Since there is no tax consequence to re-establish a long stock position if the short call is assigned, there is zero risk to selling an OTM call to cover any stock position.



## **Strategy lesson #2:**

Selling calls against long stock to enhance your returns.

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### Key Points:

1. No tax consequences for stock being called away from assignment
2. Selling index ETF puts is another method to maintain consistent equity portfolio allocation
3. No risk whatsoever of selling calls
4. No additional margin required
5. Blended enhancement adds approximately 1/3 of a percent per month



### **Strategy lesson #3:**

Selling index call spreads to enhance mutual fund returns.

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Many investors own some type of a mutual fund. Over the last 50 years, no-load index funds have outperformed 96% of all active money managers.

Because IRS regulations do not permit the sale of naked calls against long mutual funds, we recommend that you learn how to sell index credit spreads to enhance mutual fund performance.



### **Strategy lesson #3:**

Selling index call spreads to enhance mutual fund returns.

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We suggest that you take the dollar amount that you have invested in equity mutual funds and offset that dollar value against the notional value of a specific listed index product. For example, if you own \$60K of stock mutual funds, you could sell 10 call vertical (credit) spreads in a \$60 index like the IWM or 5 call vertical spreads in a \$120 index like the SPY or XSP.



### **Strategy lesson #3:**

Selling index call spreads to enhance mutual fund returns.

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You should pick an index product that you believe will have the closest correlation to your portfolio and then sell a very tight (narrow strikes) vertical credit spread in the near month (23 days to expiration) and approximately 2% above the current underlying price.



### **Strategy lesson #3:**

Selling index call spreads to enhance mutual fund returns.

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By going 2% above the market, you will have approximately a 60%+ chance of keeping the premium. The premium added from even a very small notional dollar trade could enhance your portfolio by approximately .33% per month. You would also look to exit the vertical when its value drops to 10% of the width of the strikes. For example, .10 for 1.00 wide vertical, or .50 for a 5.00 wide vertical.



### **Strategy lesson #3:**

Selling index call spreads to enhance mutual fund returns.

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#### Key Points:

1. Simple to execute
2. Same criteria as covered calls
3. All the upside is still available without the cap of the covered call
4. You must be consistent on a monthly basis in order to reap the statistical benefits



## **Strategy lesson #4:**

Beta weighting the portfolio and selling index credit spreads.

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Selecting the types of option strategies that could be used to enhance a bullish portfolio is pretty straightforward. Most professionals stick with liquid index options and use short call verticals.

But the question is, how many index option spreads do I need to enhance my IRA portfolio?



## **Strategy lesson #4:**

Beta weighting the portfolio and selling index credit spreads.

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You can't just add up the individual deltas of your positions because IBM deltas don't necessarily have the same risk as, say, GOOG deltas. What you need to do is convert individual deltas into a common metric. That is, you need to convert oranges and bananas into apples and apples.

The way to do that is to beta-weight the individual position deltas against an index. Beta is a measure of how much a stock might move if the S&P 500 moves up 1%. It can be used to convert deltas such that they can be added together to generate an overall portfolio delta.



## **Strategy lesson #4:**

Beta weighting the portfolio and selling index credit spreads.

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The thinkorswim software calculates the beta-weighted deltas for you, and you can see your overall portfolio delta on the Position Statement and the Analyze page. You can then see how many short call spreads you might need to sell to enhance your portfolio. Professional traders most often use SPX, SPY, XEO, MNX , IWM and QQQQ options to add value to portfolio returns.



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