

Safety First  
Sunday May 8<sup>th</sup>, 2006

## Adjustments to your Positions Part 1

What a great experience! This week at I headed down to the Chicago Board of Options Exchange for a 'Mock Trading' event. We came into the lobby (after market hours) picked out our smocks, took our 4 different types of paper tickets (Sell Call, Buy Call, Sell Put, Buy Put) and our badges and ascended onto the floor. If you've never been, you have to orchestrate attending sessions sometime. The started a recorded 'tape' (ticker tape) and the 'market' began to move just like real time. There were several current floor brokers in the OEX pit that began to shout out orders, using the garb (hand signals / open outcry.) We saw several pits – each one was like a miniature theatre, with graduated levels of stairs – surround by more monitors, prices and electronics. I've been down to the floor quite a bit, but this time I came with students – some that have been able to quit their jobs and become full-time traders already, and to see the look in their eyes was worth it all.

Just so you know, the market makers are not scared of us (traders at home,) but I will say that most don't know many other ways to trade. Many only know floor trading. Amazing.

Well you all likely know by now that the jobs number on Friday created a massive short squeeze that pushed indexes up above their highs. Also bullishly enough they closed near their highs of the day.

This is a good time to give you a starting point of adjustments for our Iron Condors. What you as a trader must internalize and believe that you are mainly a risk manager. You are taking your hard-earned money from the safety of the money market into live trades, and as soon as you do, you need to believe that your main goal is to manage the risk. One 'arrow in your quiver' is to have a set exit strategy in place to deal with contingencies as they develop.

Let me take this time to give you a some benchmarks for your credit spread adjustments, now these are without the technical analysis that we use (Part 2) but a good start.

- >15 days from expiration, 10-15 (20) points from your short strike OR when delta of short strike hits 25-30, whichever comes first
- <15 days from expiration, 5-10 points from short strike or when the delta of short strike hits 25 whichever comes first.
- Close position (both legs) and move up your sold 'wings.' Increase position size by 50%

So let's say – like this month. The SPX is at 1326 and you are short the 1345 calls (on the SPX) and long the 1355 calls. (In this position you are also in a Bull Put Trade that is obviously already profitable and could be closed out for a profit.) This could be closed for a near debit of near \$1.60. So let's say your credit was \$1.00 and you've closed it for a debit of \$1.60. So far you are down 60 cents, but let's not forget about your already profitable Bull Put Spread. For example sake, let's say that you sold it for 75 cents (the spread) and can close it for 40 cents (net debit) netting out a credit of 40 cents. Read it again if you aren't with me. So in this trade, you are down 60 cents as your Bear Call position is getting into trouble and you are up 40 cents as your Bull Put is profitable, net down 20 cents. So far this isn't that bad.

I don't want to get too complex, but logically we'd 'move the goal posts' then. There is about 60 cents of credit in the 1355/1365 and 50 cents in the 1290/1280. This is net \$1.10 and if you are going to increase your position size by 50% you can see where this could work out quite nicely. The key is to adjust unemotionally. What do I mean by increasing position size? For example, if that initial position was a 10x10 Bear Call and 10x10 Bull Put, then the new position would be a 15x15 Bear Call and 15x15 Bull Put.

The wild card is the massive short covering and of course Uncle Ben Bernake speaking on Wednesday...(I think.)

Run the numbers yourself on this. Key is safety and defense. Your key roles are risk management. I'll be address this more as we delve deeper into adjustments next week but if done properly and your account is sized correctly, you can see where you could adjust a position, proactively, and have a harder time losing. We'll be talking more about this in our advanced column.

For nothing else, get out there and virtual trade these, get your credits and debits and feel it work for you.

Stay Disciplined,  
Michael Drew