

# SPY Weekly Premium Selling Strategy

By: Ali Pashaei  
apashaei@gmail.com

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# My Background

- First Market Experience: 1987
- Active investing and trading with options since 2001
- Served as assistant coach for Charles Cottle "Risk Doctor"
- Trade my own accounts and manage family money
- Consulting & mentoring
- Online Private Google Group:  
<https://groups.google.com/forum/#!forum/active-options>

# Agenda

- SPY Weekly Strategy Overview & Objectives
- Covered Calls versus Short Puts
- SPY Weekly Strategy Edge
- Course Structure
- Course Topics
- Pricing
- Q & A

# Strategy Overview

## The Structure

1. **Short Put.** Sell near-expiration near-the-money puts in SPY
2. **Hedge.** Hedge the downside using structures that fits market conditions
3. **Optional Enhancer Structures.** Enhance returns during up trends and down trends.

## Management

1. **Adjustments.** Manage the position to minimize loses and increase profits.
2. **Risk Management.** Define risk.
3. **Position Sizing.** Proper position size & scaling techniques.

# Strategy Objective

- The objective IS:
  - Collect option premium in a systematic fashion
  - Minimize losses in unfavorable market conditions
  - Maximize returns in favorable market conditions
  - Adapt to market conditions
  - Long-term Positive Returns
- The object is NOT to:
  - Never lose money
  - Use the same structure to make money in all market conditions

# How I use this strategy?

1. **Retirement accounts.** In place of holding mutual or index funds
2. **Income Generation.** Collecting option income in a systematic way
3. **Opportunity Driven.** Active trading to take advantage of increased volatility



# Tactical vs Strategic Application

- Tactical Application

- You are in cash most of the time
- You enter and exit based on market and volatility conditions

- Strategic Application

- You are in a position most of the time
- You adapt the strategy to market conditions
- You increase / decrease size based on market and volatility conditions
- You are interested in continuously collecting option premium

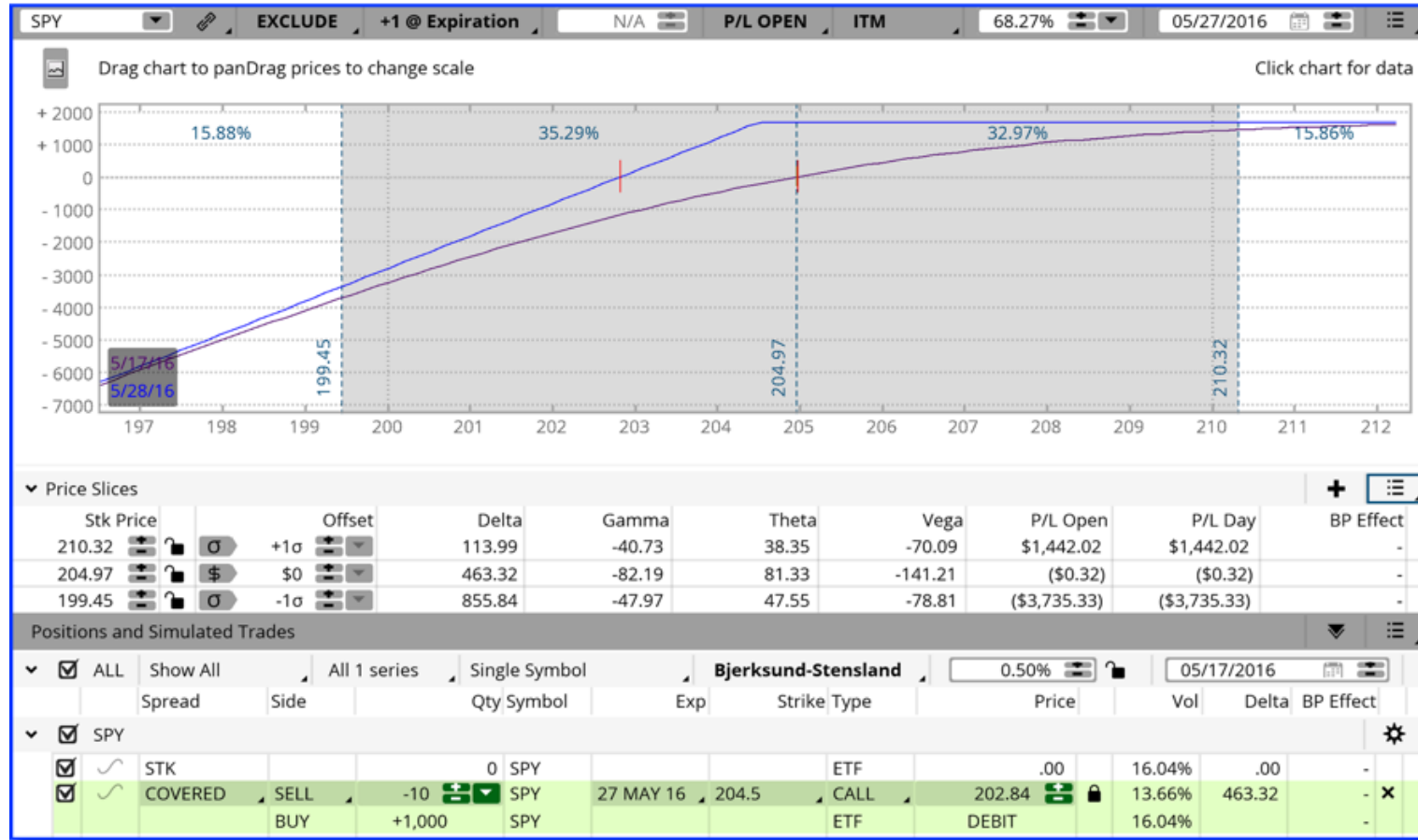
# Advantages over basic covered calls

- Better downside protection
  - Opportunity to make money or break-even if SPY falls by a normal amount
  - Opportunity to lose less if market goes down by more than a normal amount
- Better upside participation
  - Opportunity to make more in a strong up trend

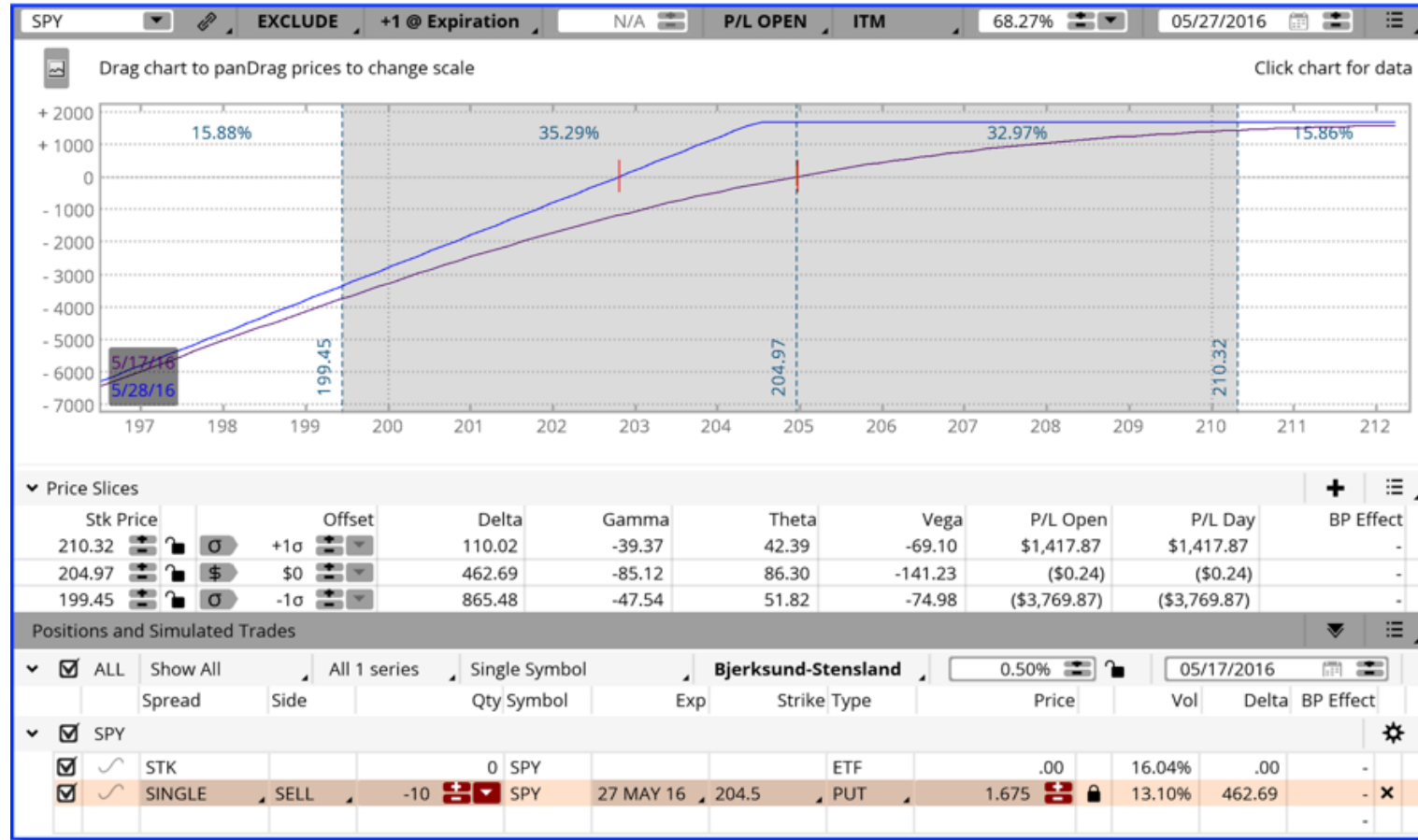
# Is this a holy grail strategy ?

- NO.
- Why not create a strategy that always makes money?
  - Markets change
  - We don't know what we don't know (future)
  - An all-weather strategy has to be curve fitted, therefore becomes fragile
  - This is not how trading or investing works

# Covered Call



# Short Put



# Covered Call = Short Put

- Put-Call Parity Formula:

- $k + c = u + p + i - d$

- $k$  = the strike
    - $c$  = call
    - $u$  = underlying price
    - $p$  = put
    - $i$  = interest
    - $d$  = dividend

- Therefore:

- $u - c = -p$  (underlying & short call = short put)

# Same Position – Different Psychology

- You sold a put:
  - Market goes up. How does that make you feel?
  - Market goes down. How does that make you feel?
- You bought a covered call:
  - Market goes up. How does that make you feel?
  - Market goes down. How does that make you feel?

# Importance of knowing your **EDGE**

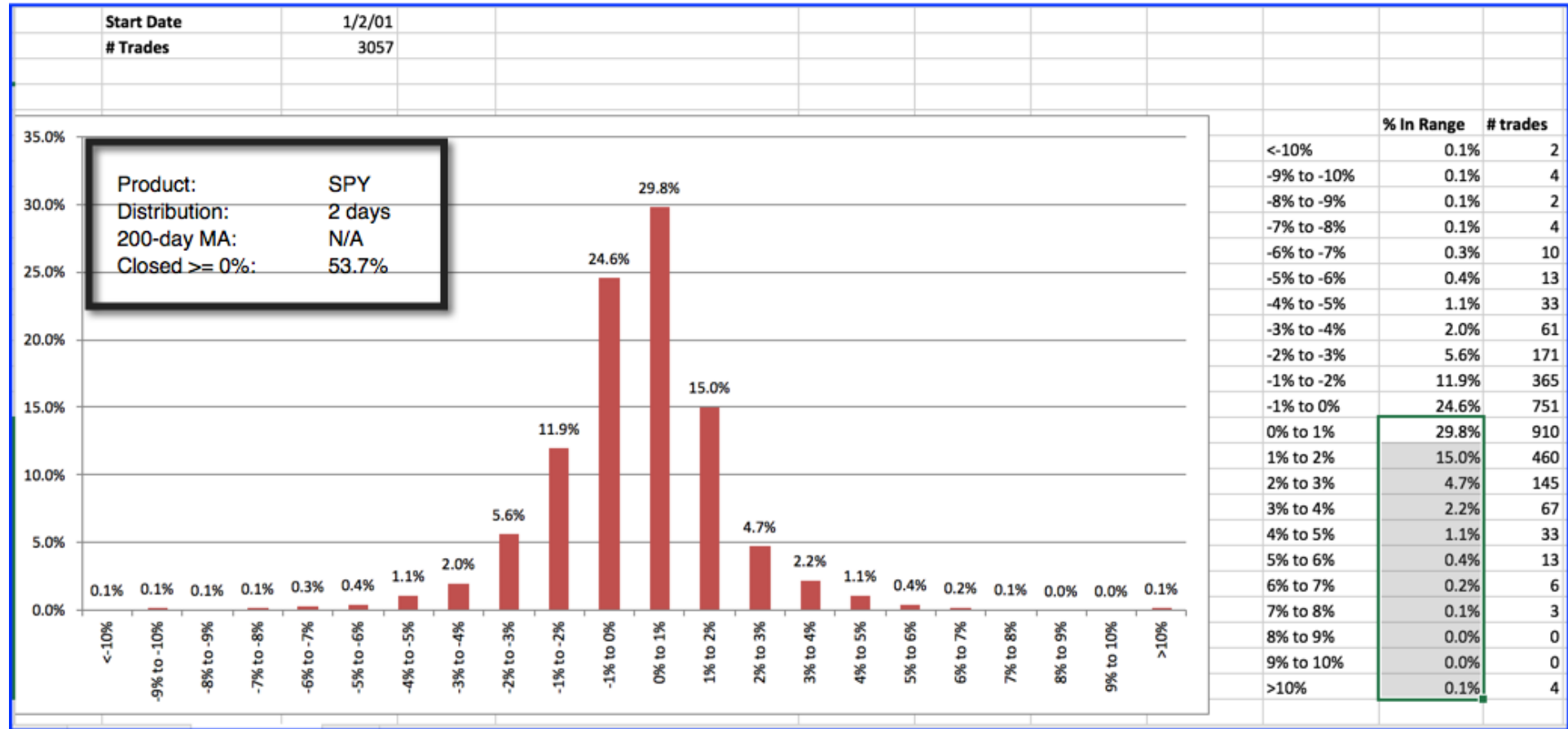
- If there is no edge, you should not trade
- Most people abandon a perfectly good strategy after couple of losses. That is human nature, and that is why trading is not 'natural'
- Knowing what the edge is will help you stay with a good strategy
  - Example: A value investor
- How do casinos make money?



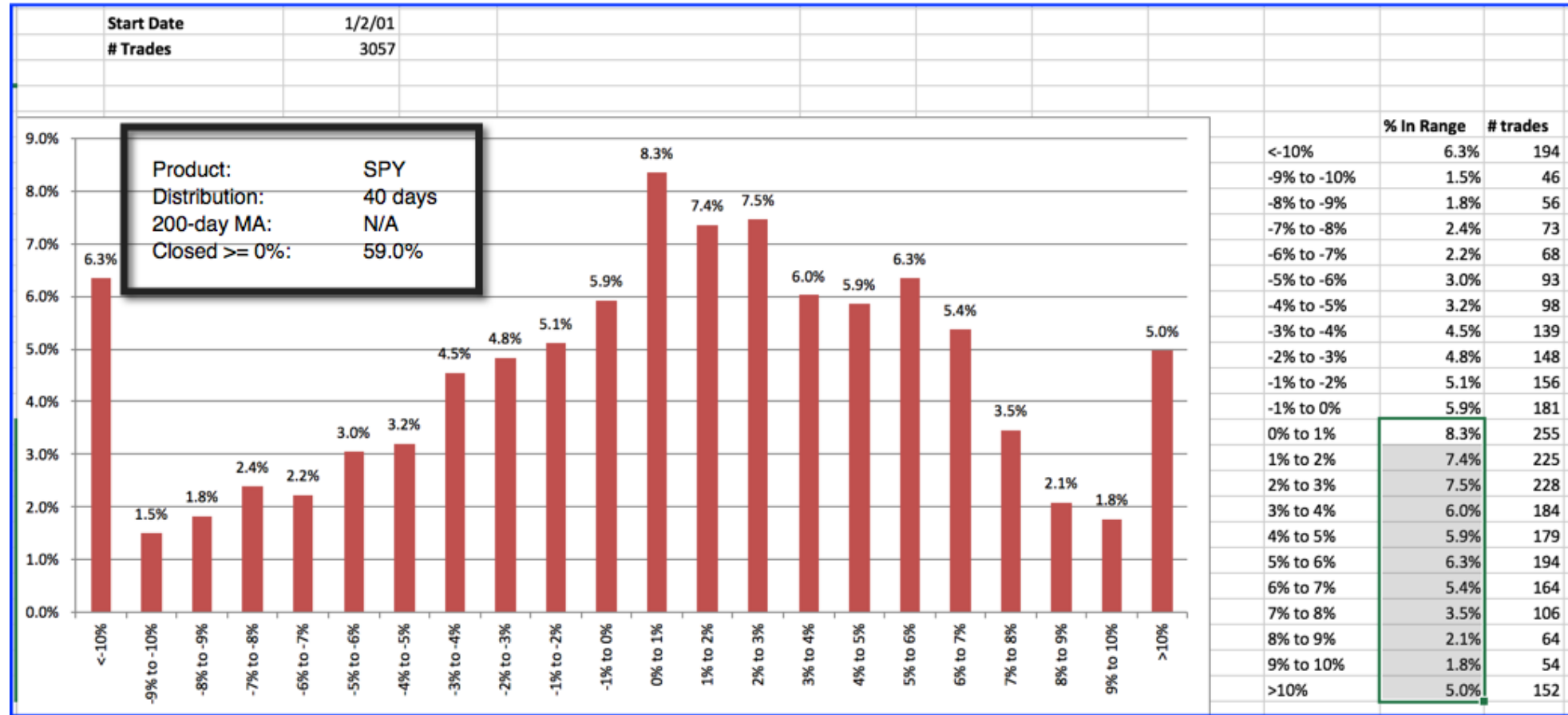
# Edge: SPY

- No Company Specific Risk
- No need to search/scan for stocks
- Diversified
- It is THE fund to beat, by all money managers. And how well does that work out on the long-run?
- Upward Drift
- Highly mean-reverting – what we want for short gamma

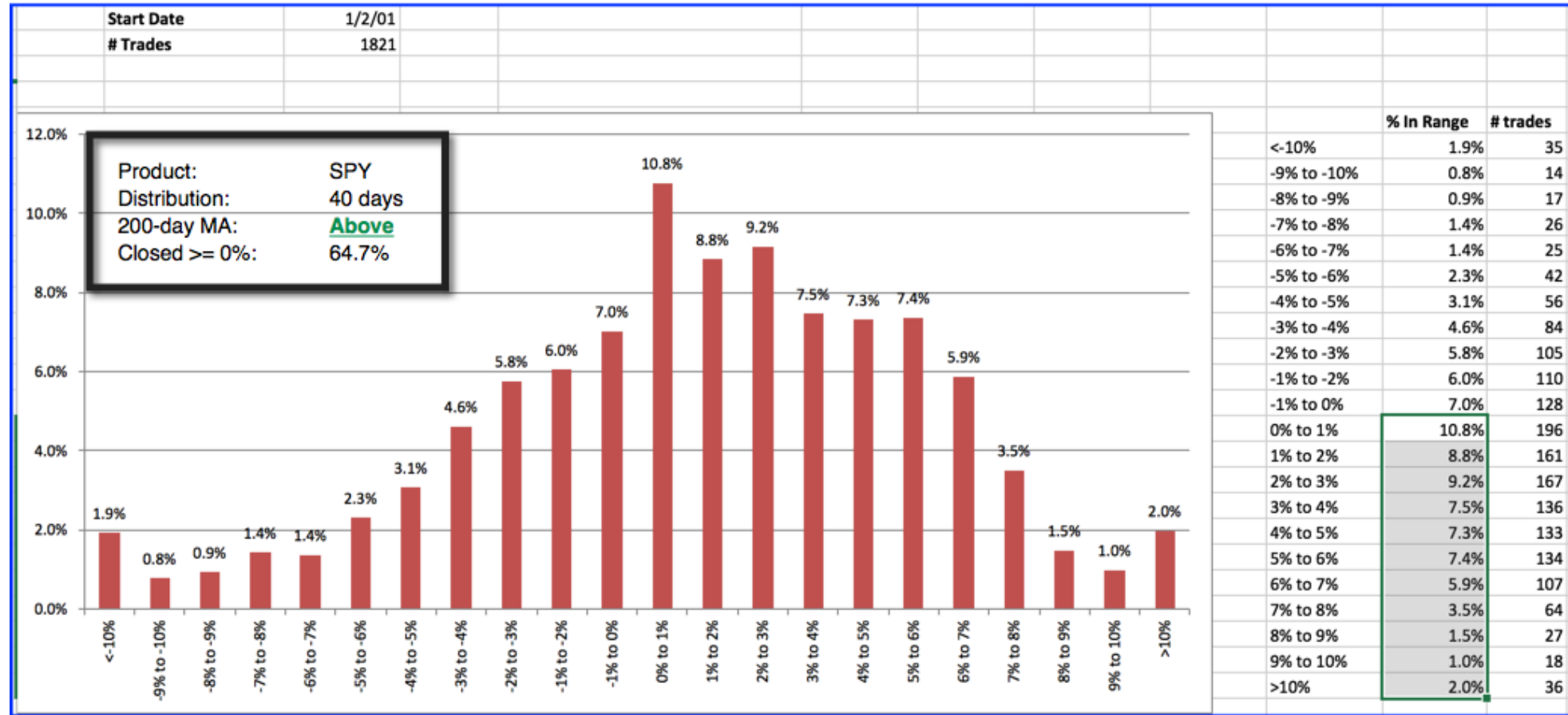
# SPY Upward Drift – 2 Days



# SPY Upward Drift – 40 Days



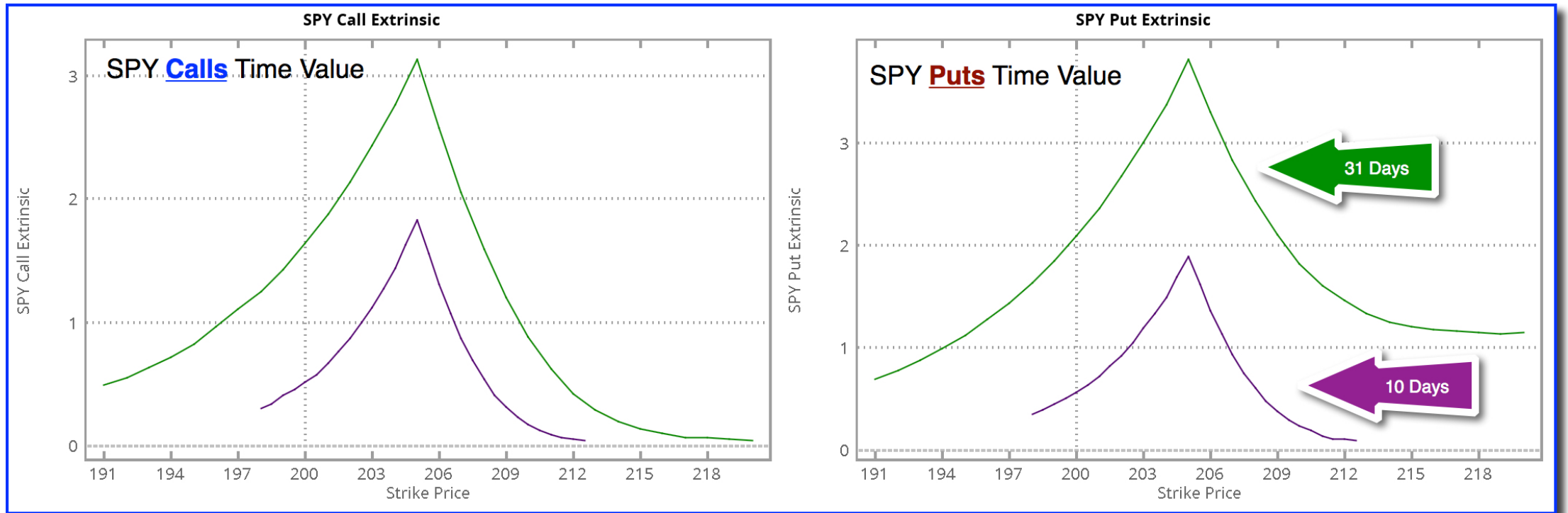
# SPY Upward Drift – 40 Days (in bull markets)



# Edge: Short Puts

- Risk Premium :
  - Put options in S&P are chronically over priced
  - OTM puts have high demand for hedgers
  - Better risk-adjusted returns than the index (CBOE studies)
  - See WPUT, PUT, & BXM index studies by CBOE  
<http://www.cboe.com/micro/buywrite/>

# SPY Options Extrinsic Value Curve



# Edge: Weekly Puts

- Higher Premiums
  - Weeklies generate higher income premium over time
  - Paper: <https://www.cboe.com/micro/buywrite/put-oleg.pdf>
- Let's look at the 'Covered Return' calculation in TOS

# Edge: Higher Annualized Returns

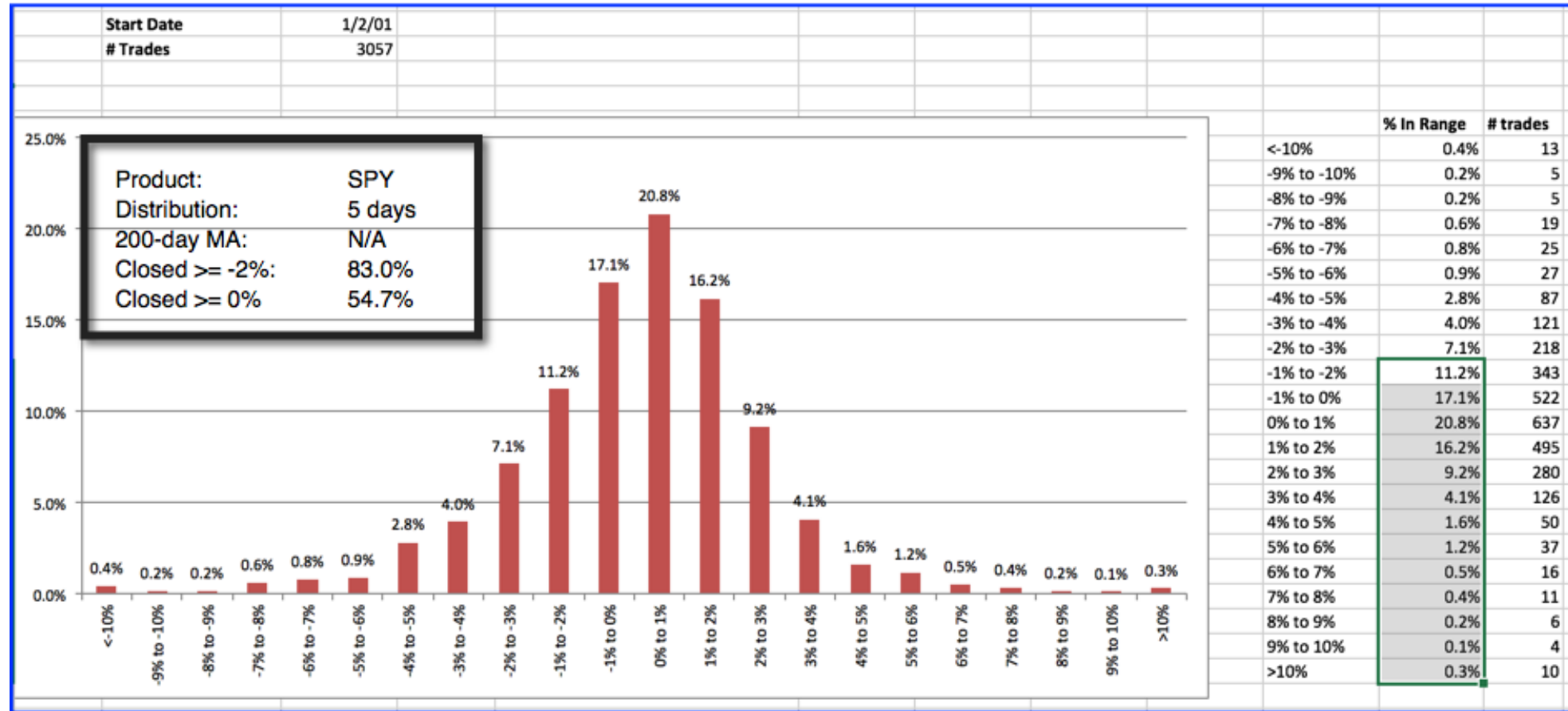
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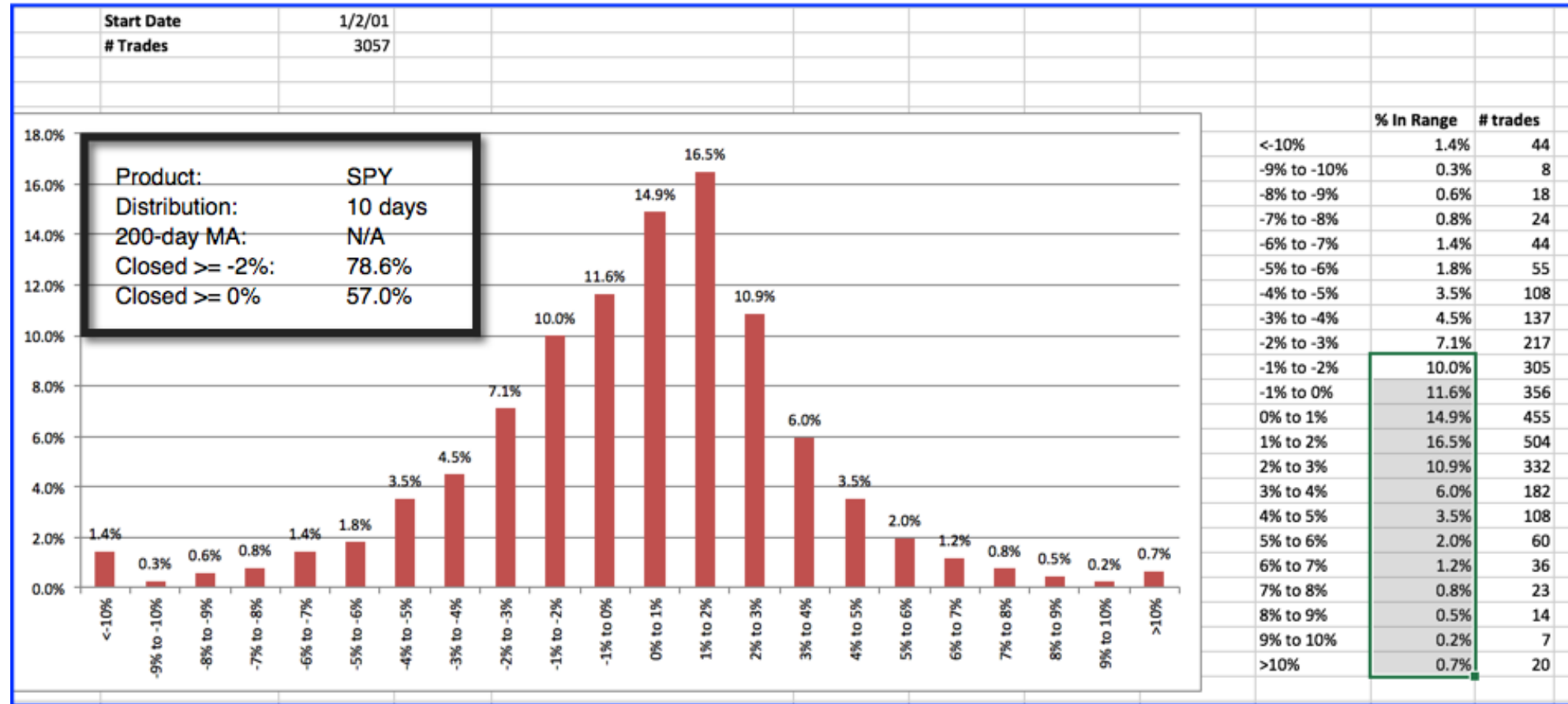
# Edge: Short-term Price Distribution

- Price distribution over a week versus a month
- How much does SPY move over a week versus a month?

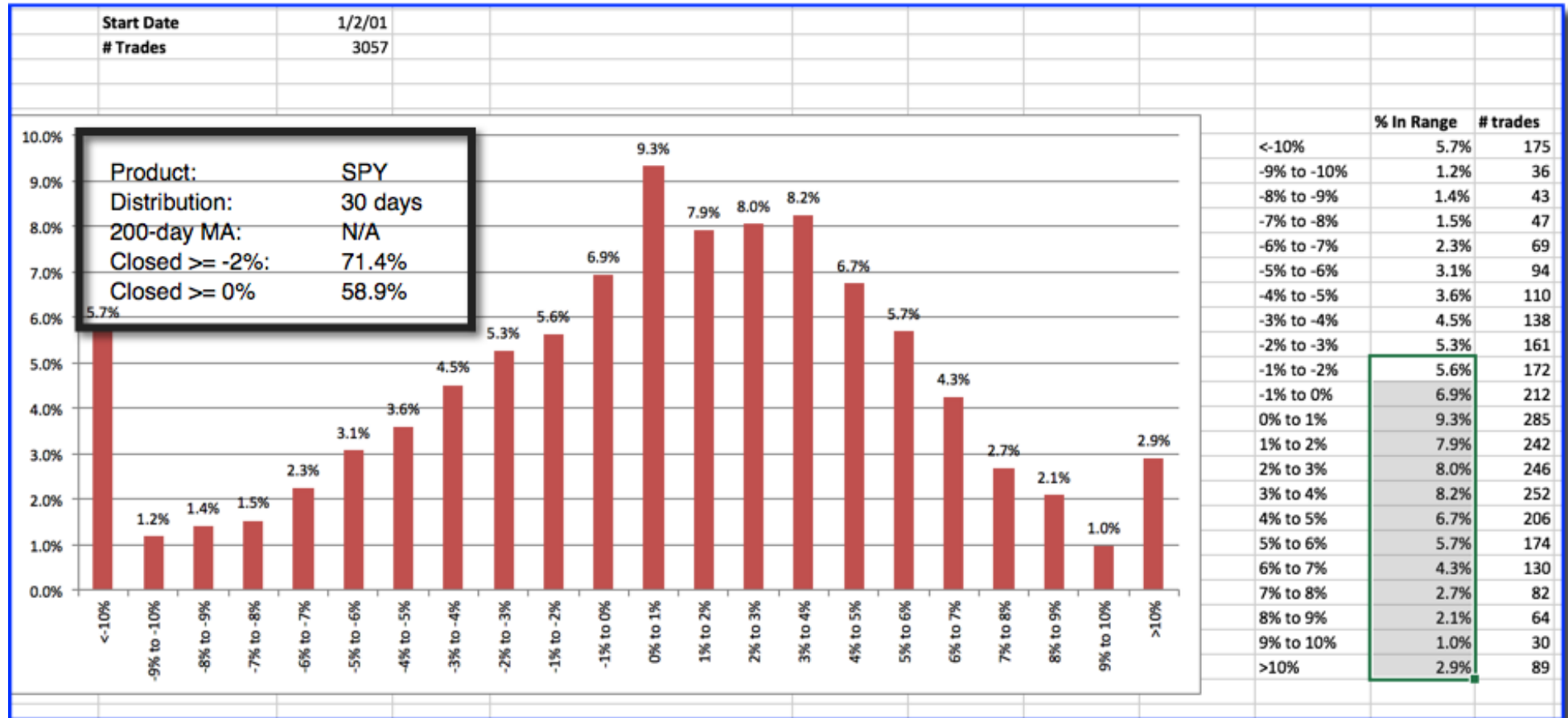
# SPY Actual Price Distribution – 5 Days



# SPY Actual Price Distribution – 10 Days



# SPY Actual Price Distribution – 30 Days



# Edge: Hedge Selection

- Focus on hedge structures that take advantage of market conditions and volatility
- Is there a high degree of price movement?
- Is volatility low?

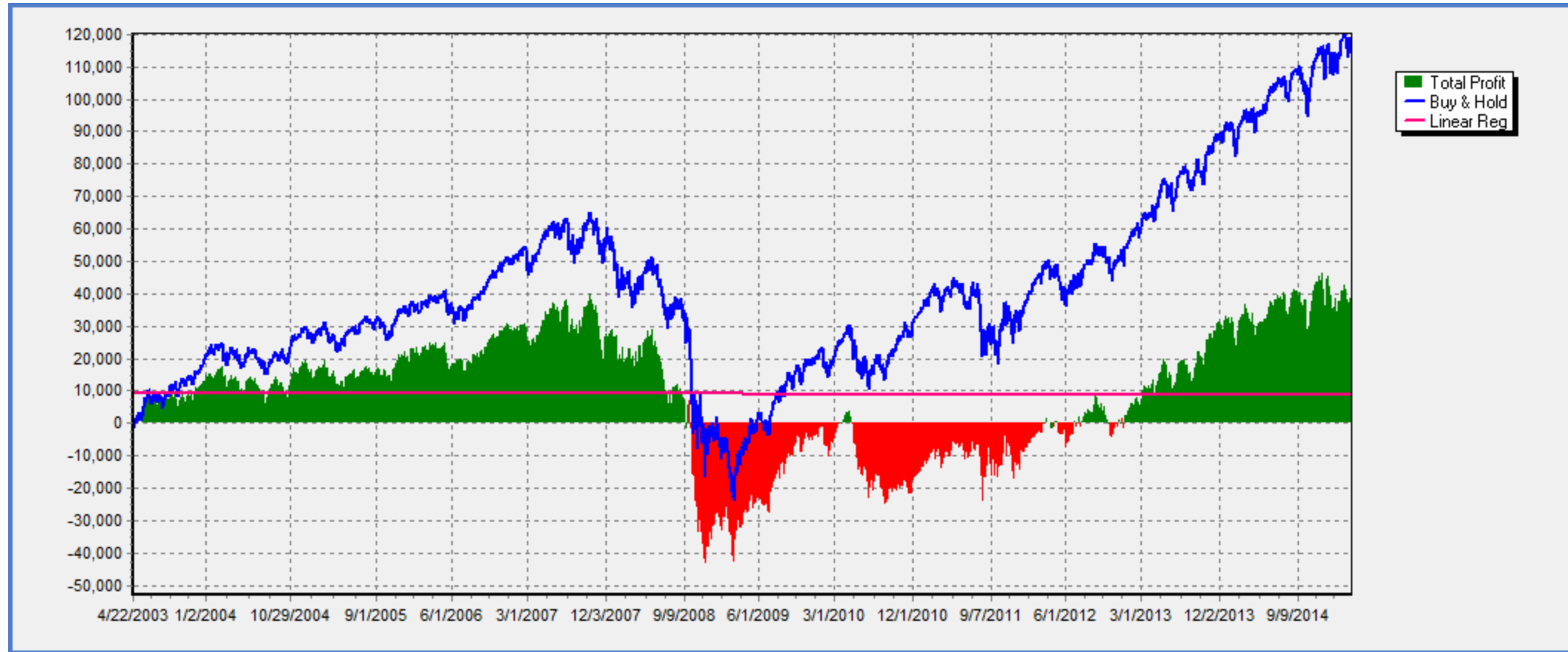
# Edge: Management & Position Sizing

- Entry & management techniques aligned with market behavior
- Minimize whipsaws adjustments
- Defense-first Approach
- Proper Position Sizing
- Use of scale-in models

# Edge: Entry Timing

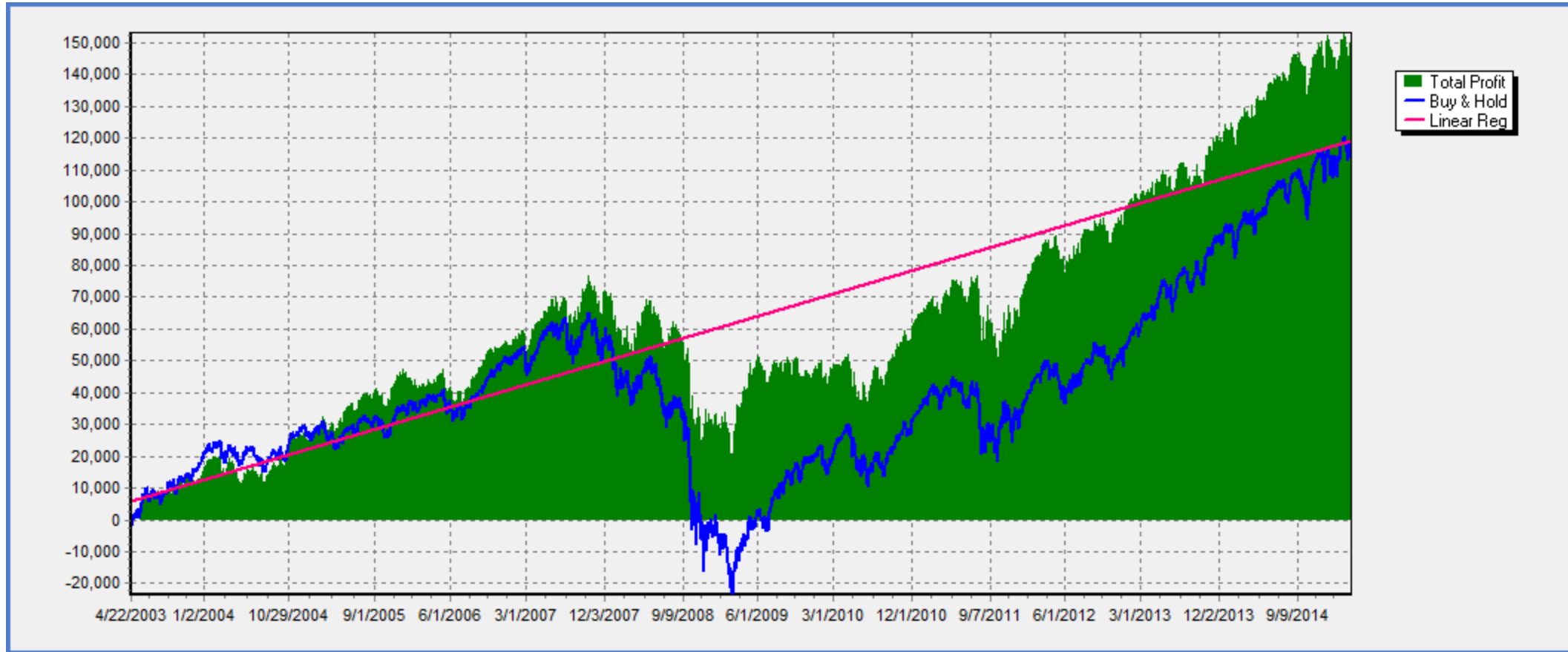
- No magic or crystal ball needed
- Some basic entry & exit techniques have historically improved results, when used systematically

# Bad Entry Example





# Good Entry Example



# Course Structure

- Three Classes – each building on the knowledge gained from the prior class
- Class 1 can stand on it's own
- Classes 2 & 3 go deeper and cover more variations for different market conditions
- Each class goes over a step-by-step process
- The logic (why) behind each step is explained
- Instead of hard rules to follow, a template format is provided to allow each person to customize and create a plan that fits their objectives
- For example:
  - Are you good with market direction?
  - OR do you prefer to be neutral all the time?
  - Are you conservative or aggressive?
  - How much to you wish to invest?
  - How much time do you have to allocate to managing this strategy?

# Class 1 – The Building Blocks

- **The Building Block Template**
  - A Template for trading the basic variation of the strategy
  - Step-by-step guide to:
    - When to entry – a basic timing model
    - Entry Structure
    - Management
    - Exit
- **Two management variations**
  - How to handle down moves
- **Customization Guidelines**
  - How to customize to fit your objectives
- **The logic behind each step**
  - Explaining the ‘why’ behind each step
- **Risk Management Guidelines**
  - How to minimize risk
- **Position sizing guidelines**
  - How to determine the number of contracts

# Class 2 – Timing and Adapting

- **Timing model**

- Mechanical trading systems to provide entry/exit signals
- To be used as a guide (not rigid rule) for better entry/exit timing
- Can be adapted to one's objectives

- **Scale-in Models & Techniques**

- **Hedging in Different Volatility Condition**

- Hedging in low volatility market conditions: Multiple variations
- Hedging in high volatility market conditions : Multiple variations

- **Management Techniques in Different Volatility Conditions**

- Handling low volatility market conditions
- Handling higher volatility market conditions

# Class 3 – Advanced Methods

- **Bullish Variations – for strong up trends**
  - How to identify and take advantage of strong up trends
  - Different variations for the bullish market
- **Bearish Variations – for down trends**
  - How to sell puts in down trends
  - Different variations for the bearish market
- **Advanced hedging**
  - Adding hedge layers
  - Hedging with SPX
- **Legging techniques**
  - How to correctly leg in intra-day or over multiple days to improve results
- **Using leverage**
  - Tips for using leverage – i.e. trading bigger

# Class Prerequisites

- Class 1 – The Building Blocks
  - Option Basics
  - Vertical Spread
  - Delta
  - Butterfly spread (not required, but helps)
- Class 2 – Timing and Adapting
  - Basic technical analysis tools
  - Butterfly and condor spread
  - Time spread
- Class 3 – Advanced Methods
  - Good understanding of above concepts
  - Willingness to go deeper

# The Goal for the Course

Instead Of	Do
Just explaining the rules without the reasons	Explain the 'why' and the logic to help you stay with the plan instead of abandoning it after the first lose
Providing 2-page trade rules	Provide a template that can be customized to allow you to create your OWN trade plan that fits your objectives
Teaching A trade	Teach about the trading process, and the decision making process
Showing you a trade that didn't lose money in the last 2 market crashes if you just did the XYZ adjustment	Show what to focus on and how to approach the strategy in order to minimize losses and create great returns over the long run
Teaching one strategy	Teach concepts that can applied to other strategies

# The Evolution of an Options Trader

- We all start by learning about puts and calls first





# The Evolution of an Options Trader

- Then we learn about spreads, extrinsic value, intrinsic value, and the greeks.



# The Evolution of an Options Trader

- Then we learn about a few trade strategies, how to follow a trading plan, learn trades developed by others, maybe modify them a little.



# The Evolution of an Options Trader

- Eventually those of us that stick with it, learn to become independent traders who understand how the game works.



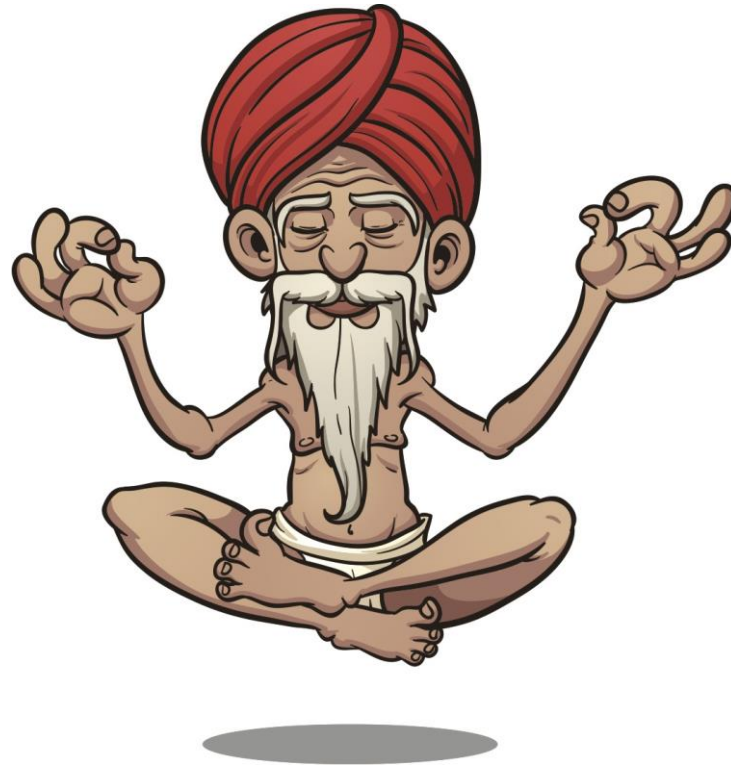
# The Evolution of an Options Trader

- Some of us eventually get real good at the game.



# The Evolution of an Options Trader

- And some eventually move to a different level, but that's a different story 😊



# Pricing – Option 1 : Pay as you go

Each session            **\$140** (individually)

Session 1:            ~~\$140~~ --> **\$95** (special pricing)

Session 2:            \$140

Session 3:            \$140

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Total:                **\$375**

**Start:** <http://paypal.me/AliPashaei/95>

# Pricing – Option 2 : Buy 1, Add 2

Buy Session 1 to try things out, then later add sessions 2 & 3:

Session 1:	<b>\$95</b>
Sessions 2 + 3:	<b>\$250</b>
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Total:	<b>\$345</b> (\$30 discount)

**Start:** <http://paypal.me/AliPashaei/95>

**Later:** <http://paypal.me/AliPashaei/250>

# Pricing – Option 3: Buy All 3

Buy all 3 session at one time:

Sessions 1 + 2 + 3: \$315

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Total: **\$315** (\$60 discount)

**Full Course:** <http://paypal.me/AliPashaei/315>



# Tentative Class Schedule

- Class 1: Saturday June 4<sup>th</sup>, Time: 1:00 PM
- Class 2: Saturday June 11<sup>th</sup>, Time: 1:00 PM
- Class 3: Saturday June 18<sup>th</sup>, Time: 1:00 PM

# Q & A

- **Q:** I'm not an advanced trader, I understand covered calls and cash secured puts, and vertical spreads. There seems to be some complicated adjustments in this strategy. Will it be too advanced for me?
- **A:** Parts of the strategy, specially when we get to advanced rolling, will be complicated for you. Many parts of it will not be. You can also apply the simple variations, which are taught in class 1, until you get good at the other variations.
- **Q:** What is the minimum amount needed to trade this strategy?
- **A:** You will not need more than 1 SPY contract, for the most basic variation. 2 to 3, for the more involved variations that require scale-in and adjustment techniques.
- **Q:** Can it be applied to other underlying products?
- **A:** Yes, but you need to understand the risks of that, which will be explained. As you have seen, SPY has unique properties that make it an ideal product.

# Q & A

- **Q:** How much money can I make with this?
- **A:** This depends on you: (1) The skills you develop as a trader and (2) your psychology.

**Q:** What kind of time commitment does one need to dedicate to trading this strategy?

- **A:** If you trade small, once a day for few minutes is sufficient. For the simply variations with a small position size, every couple of days is sufficient. Parts of the strategy can be managed via GTC orders. If you want less active approach, you can use slightly longer-term options. The same set of guidelines can be applied to slightly longer-term options (3-5 weeks out). As you go further out however, some of the benefits of the strategy that add to it's edge start diminishing, but it's still tradeable.