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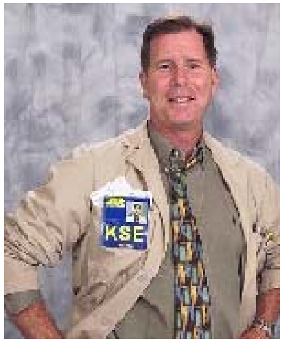


Short Spreads, Back Spreads and Time Spreads

Casey Platt

NOTE: The strategies within are for instructional purposes only and actual trades are the individuals responsibility to manage accordingly.

Front Spreads, Back Spreads and Time Spreads

SHORT PREMIUM	LONG PREMIUM

SHORT PREMIUM

- Short Gamma
- Collecting Decay
- Buy writes
- Condors
- Credit Spreads
- Short vega
- Needs a narrow price range
- Avoid earnings

LONG PREMIUM

- Long Gamma
- Long ratio spreads
- Need exaggerated price movement
- Big product or earning news
- Takeover stocks
- High flying SEXY names

Time Spreads — Combine Characteristics of Both Long and Short PREMIUM

TIME SPREADS HAVE BOTH SHORT AND LONG PREMIUM POSITIONS

- Sell a front-month-option to protect a back-month-option
- Great for an event coming in 2 or 3 months
- Long vega yet short premium
- Works with existing short premium positions to increase decay and neutralize vega
- Strategy for those who want to rent to own a stock

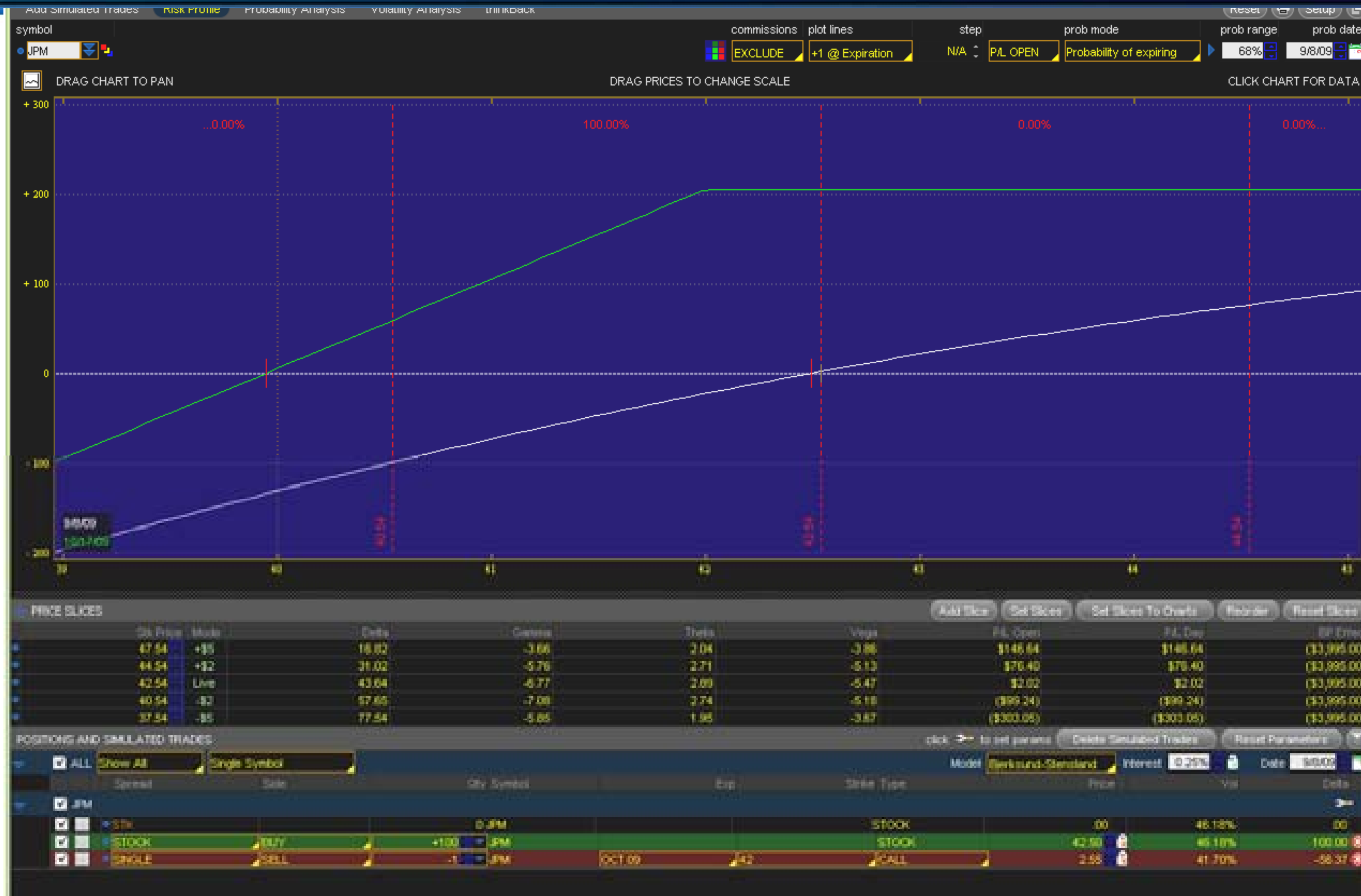
A Front Spread Is the Buy Write

BUY and Stock and sell option premium against to lock in and protect profits

BUY 100 JPM common pay 42.50

Sell (Write) a Oct 42 call @4.20

Profit and Loss Graph for JPM October 42 Buy/Write



Characteristics of the JPM Buy/Write

BUY 100 JPM common pay 42.50 Sell (Write)
a June 32.50 call @4.20

- Option premium protects equity investment
- Limited upside appreciation
- A means to value the overall position and creating a dividend
- Reduces the cost of outright stock ownership
- Similar to rent to own strategy

Front Spreads are Credit Spreads

- Collect premium selling a nearer the money and buying a further out option
- Directional and diametrically, algebraically opposite to the debit spread
- Can be used as a means to buy a stock at a discount
- Risk is limited to the difference between the strikes less the premium collected

AAPL Credit Spread Short Jan 150 / 145 put at 1.07$ perhaps buy AAPL at 148.93

BACK SPREAD or Long Premium Characteristics

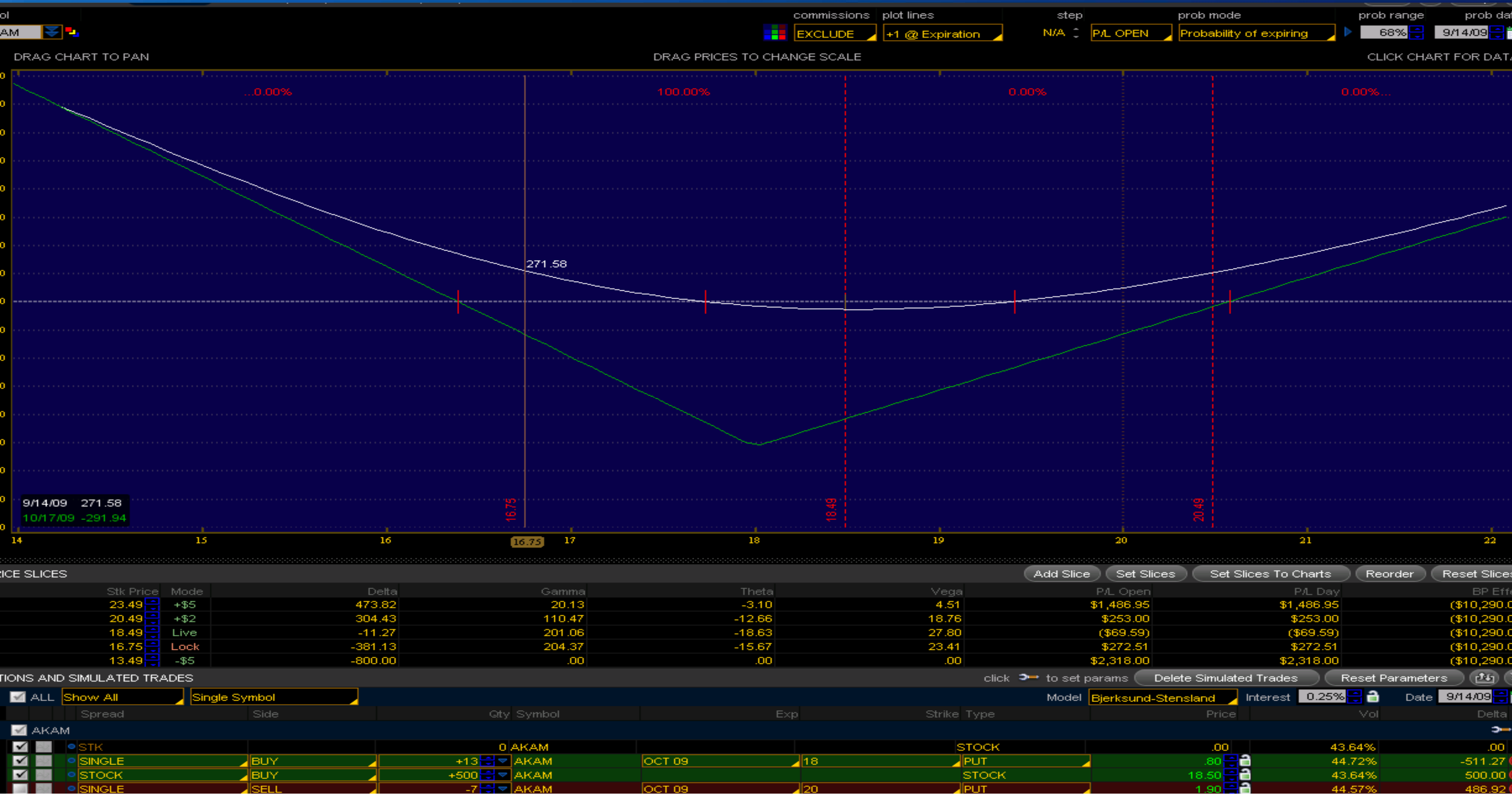
- Buy calls or puts in anticipation of price movement from earnings product new or potential takeover activity
- Negative theta is the daily cost of a decaying option position and long premium needs to work with in7 business days or it will never work
- Back spreading can be a ratio spread with extra unites
- Long straddles, puts and stock, and unlimited profit potential with limited risk are indicative of long premium
- A back spread can use an underlying or calls and puts
- Only back spread when you have a quality gamma to theta ratio

Ratio Back Spread

Gamma / Theta Ratio must at the very least BE IN YOUR FAVOR

- Ratio of gamma vs. theta must be greater than 1:1
- 3, 5 and 10:1 ratios are possible
- Stock price 15 to 50
- Volatility from 20 to 75 and up to 100

LONG STRADDLE



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Back Spreading or Long Gamma Trading Rules

Managing, Planning, Anticipating

A. Flatten Your Delta When Equal to or Greater Than Your Gamma

- Sell options on inventory and reduce your back spread
- Sell other options in other cycles against the position; track what and where you traded it
- Trade stock or single stock futures to flatten the delta of the position
- Remember if your not selling an existing position your adding to the overall position

B. Stick to Your Plan

- Know and Track the price of the implied volatility the volatility you bought and what the underlying price was when you executed the position
- Target the volatility you anticipate before the upcoming event
- Portion out the position as the event nears, volatility will peak close to the announcement

C. Anticipate Your Big Day

- Anticipate following the implied volatility as the big day nears and sell out portions of the spread as volatility increases.
- Multiply the percent increase in your volatility by the long premium dollar amount for volatility risk
- Track where your event date is option earnings cycle and how time will be left when the events over

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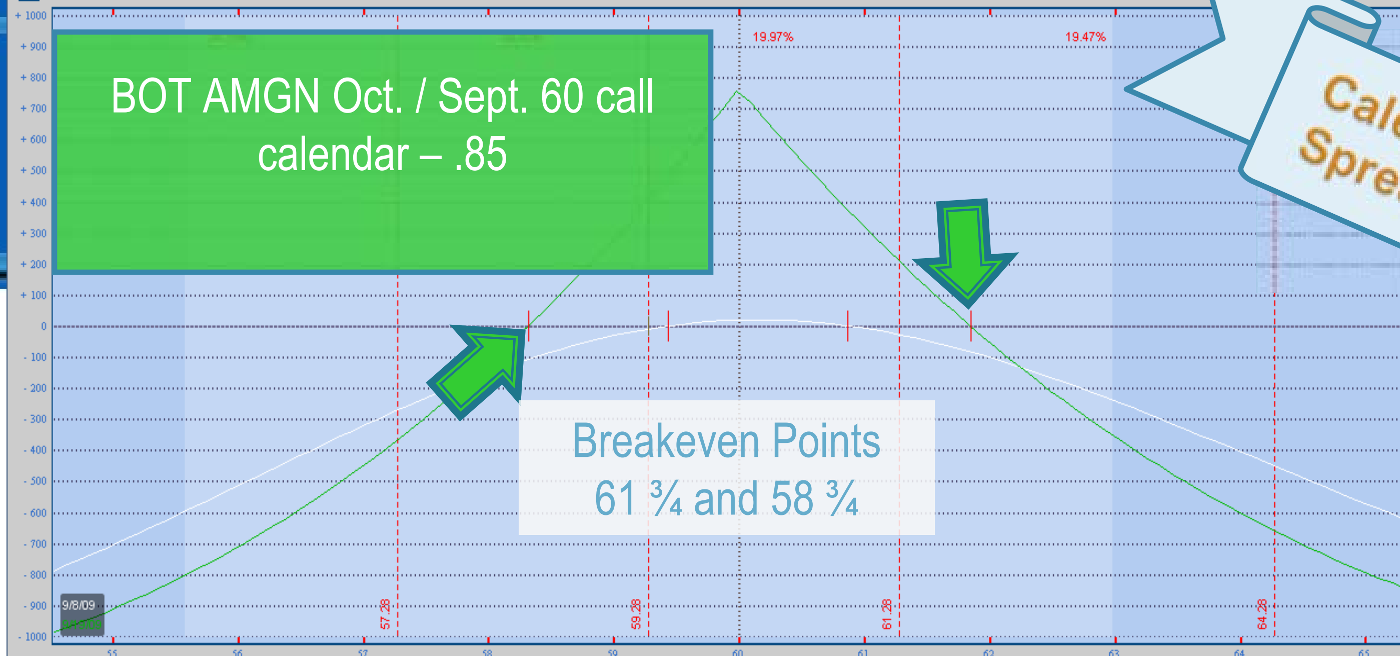
Calendar or Time Spreads

- Two Month calendar
  - Pay less than .90 cents
  - Usually 2 front months
  - Short term play anticipating a quick price increase
- Long Term calendar
  - Short option at least half the value of long options
  - Quality name with a stable history
  - Use more as a direction play

Calendar Spread

BOT AMGN Oct. / Sept. 60 call calendar – .85

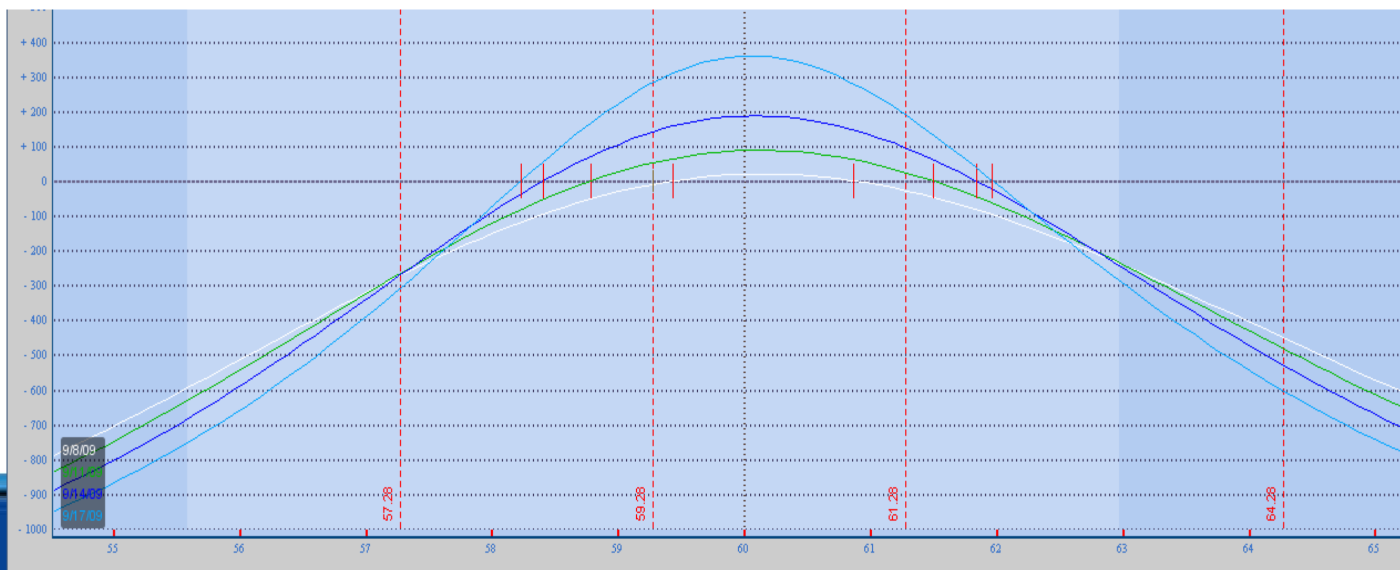


Breakeven Points 61 ¾ and 58 ¾

PRICE SLICES

Add Slice | Set Slices | Set Slices T

Stk Price	Mode	Delta	Gamma	Theta	Vega	P/L Open
64.28	+$5	-168.07	2.90	-8.24	50.07	($452.00)
61.28	+$2	-80.65	-63.09	15.26	39.36	($27.43)
59.28	Live	66.96	-74.69	17.77	37.18	($9.72)
57.28	-$2	179.18	-31.03	2.52	44.17	($270.77)
54.28	-$5	163.02	29.86	-14.00	42.56	($830.83)



Why Time Spreads Work

- Time is on your side
- Usually front 2 months options have the greatest liquidity
- Inexpensive dollar value options make this strategy almost “renting to own” instead of outright ownership
- Can be used in a variety of price movement of situations
- Buying and selling an option makes the spread order more marketable, tradable and liquid than an outright purchase or sale of an option.

Calendars as Directional Plays

- Efficient use of your money
- Fallen names, or quality stocks yet somewhat out of favor currently, are good candidates for long term calendar spreads, which give you a long time to be wrong or RITE
- Lower entry cost than an outright call purchase and less dollars at risk
- Careful for takeovers and momentum names where the movement is….."to far to fast"
- Limits risk to the debit paid for the spread
- Downside volatility protection with an inventory of short premium index premium

Example of a Long Term Time Spread

HUM Buy the March / August 45 Call Spread Pay -1.85 or 185 dollars each spread

HUM=26.50
3.17.09

Strategy is to roll the short calls each month to defray the cost of the August option

Example of a Short Term Calendar as a Directional Play

Buy the Apr / Mar 19 call Spread - .33 cents or 33 dollars per spread

MSFT=16.71
3.07.09

Maximum profit 98 $ per spread at expiration MSFT = 19 $

Warning Signs for Time Spreads

- Huge volatility skews
- Special Dividends
- One-time events
- Potential take-over candidates
- Newer or volatile industries

Be Sure of Your “Trade Set Up”

- Time spreads are long “vega” so carefully study the stocks historic volatility range
- Track the fundamentals of a stock so the original premise for the spread remains
- Index calendars work best as part of an overall index position and as downside protection

Know Your Exit Point

- MSFT example -.33 cents: Down or up 20% is .07 cents; Need to know exits Approx. = to .25 and .45 cents
- HUM example $1.85: Dow and up 20 % Approx.= 1.45 downside and 2.25 upside

Trade your Plan and Plan your trade.

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