

# **XSP – Mini SPX<sup>(TM)</sup> Options** **The Right Size Product** **w/Benefits of Index Options**

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- ❖ **1973:** Cboe first marketplace for trading listed equity options
- ❖ **1983:** Cboe creates options on broad-based stock indexes
  - S&P 100<sup>®</sup> (OEX) S&P 500<sup>®</sup> (SPX)
- ❖ Today SPX options are arguably the most liquid option product in the world
  - 2018 SPX ADV: 1.45 million
  - \$400 Billion in daily notional
- ❖ Accessible electronically w/Global Trading Hours

## ❖ Trading Index Options

- Index options may be deployed the same way as equity or ETF options
- Index options have some inherent benefits generally not associated with equity or ETF option

## ❖ **Directionally:** Bullish/Bearish/Range bound

- EX: Calls + Call Spreads/Puts + Put Spreads/Condors

## ❖ **Insurance:** Hedging/Tail Risk/Defensively

- EX: Puts + Put Spreads/Collars

## ❖ **Income Generation:** Yield Enhancement/Buy-Write/Portfolio Overlay

- EX: Own diversified portfolio + Write OTM Index Calls/Short Puts

## ❖ **Asset Allocation:** Targeted buying/selling/Efficient Rebalance

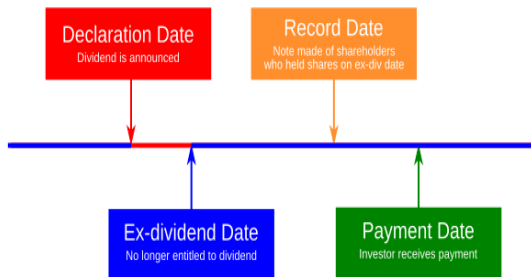
- EX: Buying/Selling Index options to increase/reduce exposure



## ❖ Unique Characteristics of Index Options

- European Style – NO early exercise
- Cash Settled – NO physical delivery of shares
- 1256 Contracts – Potentially favorable tax treatment\*

## What is the Ex-Dividend Date?



\*Section 1256 of the United States Tax Code – May not apply for non-domestic traders

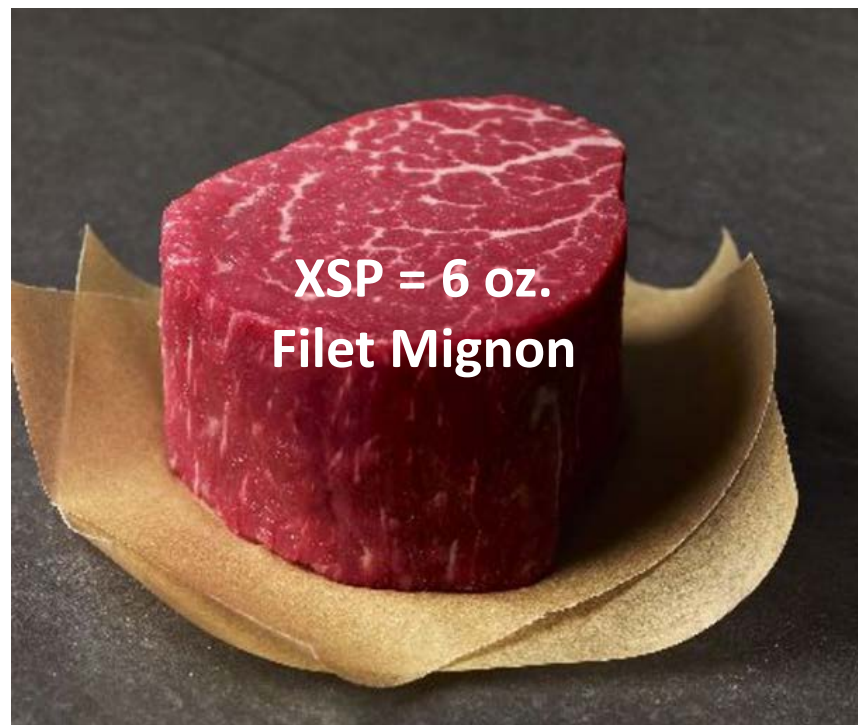
- ❖ XSP options are all PM settled
  - Including standard/weekly/EOM
- ❖ Early Trading Hours: 7:30am – 8:15am Chicago time
  - Accessible after release of economic data
- ❖ Expiring options stop trading at 3pm Chicago time

	Mini SPX Index (XSP)	SPDR ETF (SPY)
Notional Value (SPX @ 3000)	\$30,000	\$30,000
Settlement AM or PM	PM-Settled	PM-Settled
Expirations	Mon., Wed. Fri., EOM, EOQ	Mon., Wed. Fri., EOM, EOQ
Settlement Type	Cash	Physical ETF
Exercise Style	European	American
GTH Available?	Early trade 7:30-8:15	No

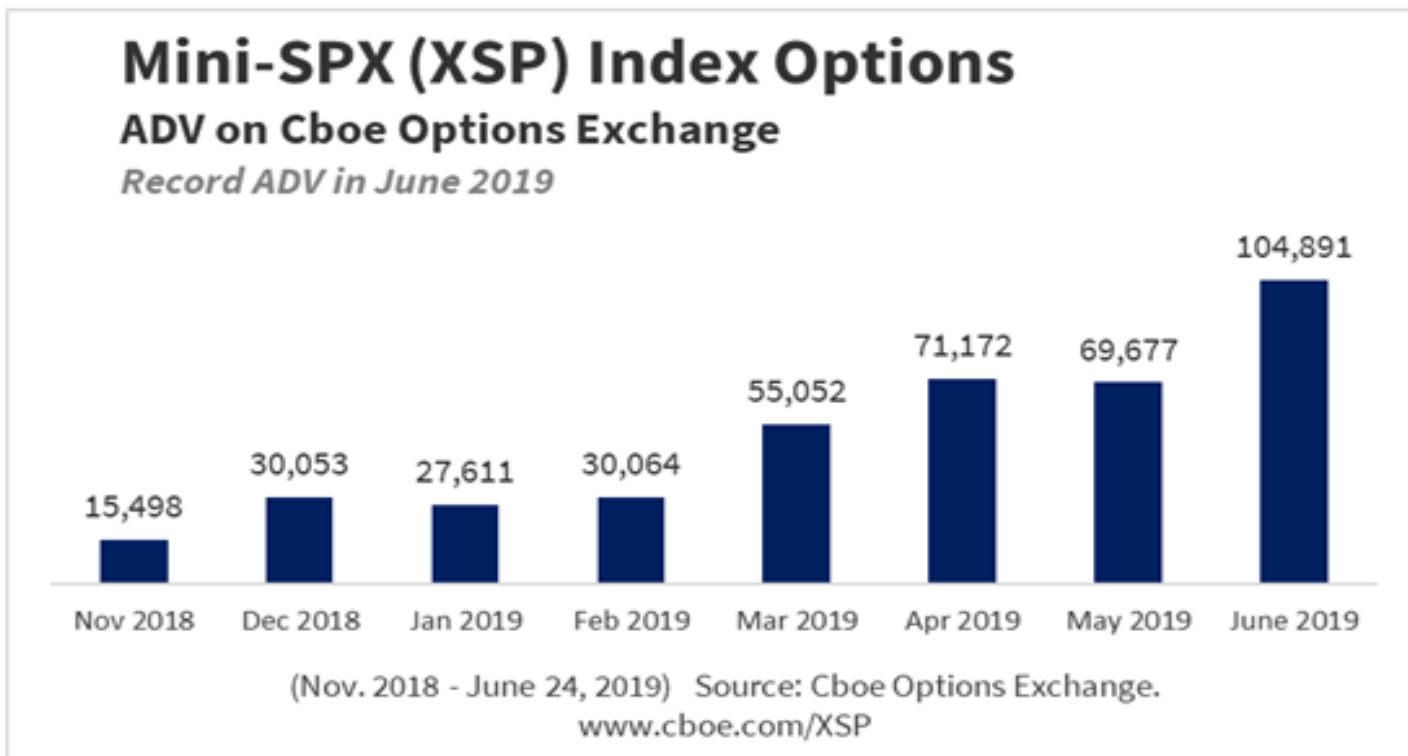


## ❖ Smaller size allows for flexibility

- XSP is **1/10<sup>th</sup>** the **NOTIONAL VALUE** of **SPX**
- XSP is the **SAME NOTIONAL VALUE** as **SPY**
- XSP is an **INDEX option** not an **ETF option**



- ❖ Average Daily Volume on XSP options growing exponentially
- ❖ XSP ADV +675% in last 7 months
- ❖ **More and more option SPY traders converting**





- ❖ Index Options\* like XSP – European style
- ❖ Equity & ETF Options like SPY – American style
- ❖ **One LESS RISK! (Early assignment: SPY dividend)**
  - **Average SPY dividend (Dec 16 – Jun 19)=\$1.263/Q**

Ex-Dividend Date	Type	Cash Amount
6/21/2019	Cash	1.432
3/15/2019	Cash	1.233
12/21/2018	Cash	1.435
9/21/2018	Cash	1.323
6/15/2018	Cash	1.246
3/16/2018	Cash	1.097
12/15/2017	Cash	1.351
9/15/2017	Cash	1.235
6/16/2017	Cash	1.183
3/17/2017	Cash	1.033
12/16/2016	Cash	1.329

\*Except OEX S&P 100 Options



- ❖ SPY approaching Ex-Div. Date (and dividend is uncertain)
- ❖ Trade short an ITM call with < month to expiration
- ❖ **Trader assigned on short call, now -100 SPY shares**
  - Trader would be responsible to pay dividend



❖ IRS Tax Code: 1256

❖ Broad-Based Index Funds:

- DJX/RUT/SPX/VIX/XSP
- **Representative, but MUST consult tax advisor**



Ordinary Tax Rate	60/40 Tax Rate
10%	4%
15%	6%
25%	19%
28%	20.2%
33%	22.2%
35%	23%
39.6%	28%

Form **6781**

Department of the Treasury  
Internal Revenue Service

## Gains and Losses From Section 1256 Contracts and Straddles

▶ Go to [www.irs.gov/Form6781](http://www.irs.gov/Form6781) for the latest information.  
▶ Attach to your tax return.

OMB No. 1545-0644

**2018**

Attachment  
Sequence No. **82**

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Name(s) shown on tax return

Identifying number

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Check all applicable boxes (see instructions).

**A**  Mixed straddle election

**B**  Straddle-by-straddle identification election

**C**  Mixed straddle account election

**D**  Net section 1256 contracts loss election

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**Part I**
**Section 1256 Contracts Marked to Market**

- ❖ XSP option spreads continue to narrow
- ❖ +ADV and +OI --> Tight bid/ask spreads
- ❖ As with other products mid-market fills are typical

cBID	cASK	STRIKE	pBID	pASK
5.66	5.71	XSP Jul19 292.50	0.62	0.65
5.23	5.28	XSP Jul19 293.00	0.68	0.71
4.39	4.44	XSP Jul19 294.00	0.84	0.88
3.59	3.64	XSP Jul19 295.00	1.04	1.08
2.86	2.90	XSP Jul19 296.00	1.31	1.35
2.19	2.24	XSP Jul19 297.00	1.64	1.68
1.89	1.94	XSP Jul19 297.50	1.84	1.88
1.62	1.66	XSP Jul19 298.00	2.06	2.11
1.15	1.18	XSP Jul19 299.00	2.58	2.63

- ❖ Indexes TEND to move with less volatility than individual equities
  - NFLX 30 day HV = 27%
  - AAPL 30 day HV = 21%
  - FB 30 day HV = 33%
  - XSP 30 day HV = 10.5%
- ❖ Do NOT run the risk of ending up LONG stock/EFT (cash settled)
  - **Most option traders don't want stock positions**
  - Ever tell yourself I'll just "trade around" an assigned put?







- ❖ Trader believes the early June lows will hold, but wants cushion in case level is tested (6/3 lows XSP: 272.88)
  - 8/26: Trader sells 10 Sept30(Q) 2265 puts @ 1.75/each (7.2% OTM)
  - Collects \$1750 in short option premium (Max potential profit)
- ❖ Typically margined by brokerage firm
  - U.S broker may require ~\$3000/put in this example\*
    - » Total Margin Requirement = \$30,000
  - Potential return on margin capital ~5.8%
  - 35 calendar days until expiration
- ❖ Trade still has SIGNIFICANT RISK
  - **IF XSP settled at 260.00 on Sept 30<sup>th</sup> (9% decline) position loses**
  - **5.00-1.75 = 3.25\*100\*10 = \$3250 (Not Long Index at Expiration)**

\*Understand how brokerage firm margins short Index puts



PUT (7.6%) v. (10.2%) SPX Q1 & (15.5%) v. (20%) SPX in Q4



# Cboe's S&P 500® Strategy Benchmark Indexes



## BuyWrite Indexes

Ticker	Index	Sym
BXM	Cboe S&P 500 BuyWrite Index®	BXM
BXD	Cboe DJIA BuyWrite Index	BXD
BXMC	Cboe S&P 500 Conditional BuyWrite Index	BXMC
BXMD	Cboe S&P 500 30-Delta BuyWrite Index	BXMD
BXMW	Cboe S&P 500 Multi-Week BuyWrite Index	BXMW

## PutWrite Indexes

Ticker	Index	Sym
PUT	Cboe S&P 500 PutWrite Index	PUT

## Combo Index

Ticker	Index	Sym
CMBO	Cboe S&P 500 Covered Combo Index	CMBO

## Butterfly and Condor Indexes

Ticker	Index	Sym
BFLY	Cboe S&P 500 Iron Butterfly Index	BFLY
CNDR	Cboe S&P 500 Iron Condor Index	CNDR

## Collar Indexes

Ticker	Index	Sym
CLL	Cboe S&P 500 95-110 Collar Index	CLL
CLLR	Cboe Russell 2000 Zero-Cost Put Spread Collar Index	CLLR
CLLZ	Cboe S&P 500 Zero-Cost Put Spread Collar	CLLZ

## Put Protection Index

Ticker	Index	Sym
PPUT	Cboe S&P 500 5% Put Protection Index	PPUT

## VIX-related Benchmark Indexes

Ticker	Index	Sym
VPD	Cboe VIX Premium Strategy Index	VPD
VPN	Cboe Capped VIX Premium Strategy Index	VPN
VXTH	Cboe VIX Tail Hedge Index	VXTH
LOVOL	Cboe Low Volatility Index	LOVOL
VSTG	Cboe VIX Strangle Index	VSTG

❖ XSP's size (1/10<sup>th</sup> SPX) is very attractive to individual traders looking to express a market sentiment via options

- 8/26: S&Ps volatile after weekend Trade War rhetoric (G7)

❖ XSP Index @ 286.50

- **Trader +100 Oct 300/305 call spreads**

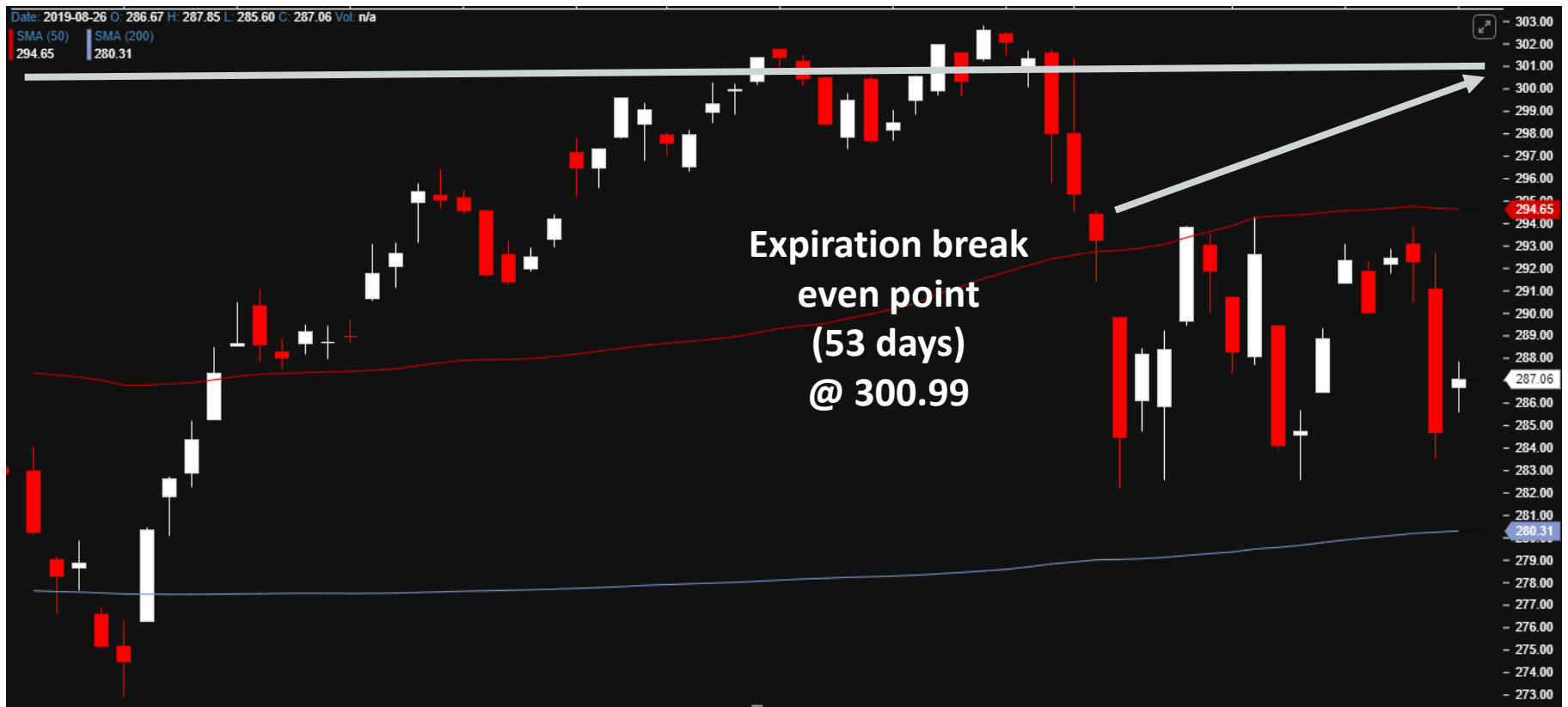
SYMBOL	OPTION	QTY	PRICE	EXCHANGE	CONDITION	MARKET
^XSP	XSP Oct18 300.00 C	100	1.77	CBOE	Spread	1.75 x 1.80
^XSP	XSP Oct18 305.00 C	100	0.78	CBOE	Spread	0.75 x 0.80

- Paid \$0.99/spread; Max spread value 5.00
- Long ~9,900 in total premium



# P&L at Expiration

- ❖ XSP all time highs (7/26) 302.80
- ❖ Assume acct value of \$250k
  - After trade: Cash Balance of \$240,100



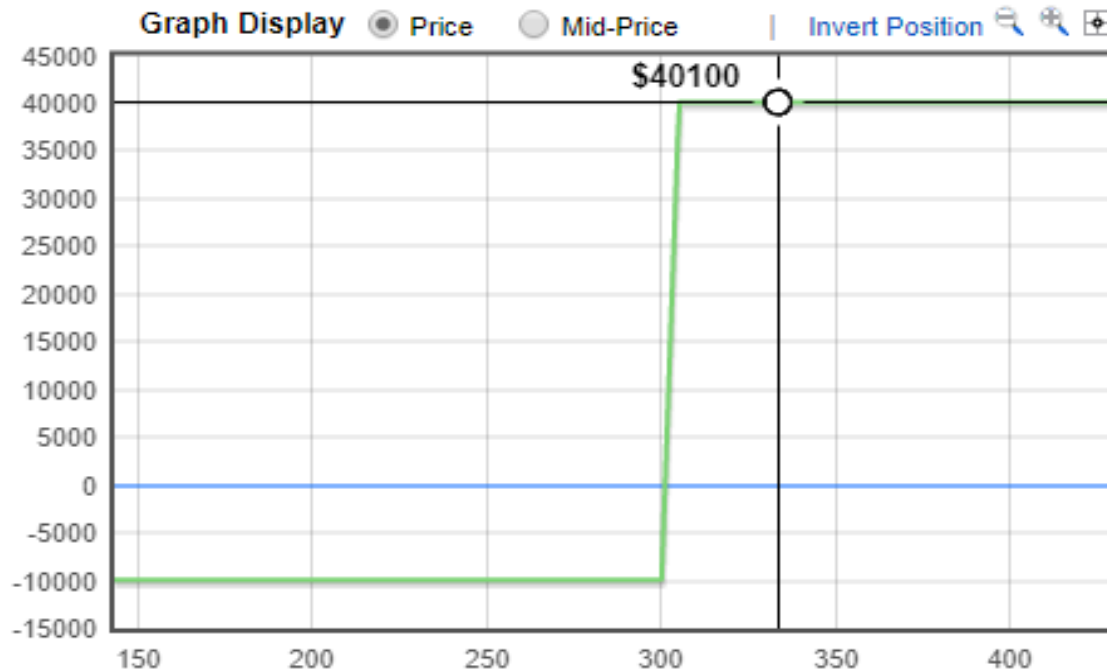
# P&L at Expiration

- ❖ (If held) Trader needs XSP to settle above 300.99 at expiration in order to breakeven
- ❖ Position reaches max profit potential anywhere >305.00
  - The spread would cash settle at \$500 each

## XSP - Mini-SPX Inde...

Last: 286.51 | Change: 1.80

Price Points	P/L
150.00	-\$9,900.00
300.00	-\$9,870.59
300.99	\$0.00
305.17	\$40,100.00
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- ❖ The Account had \$250,000 to begin
  - The trader bought XSP spread for \$0.99 each
  - Paid out \$9,900 in premium
    - Cash Balance \$240,100
    - Long option premium \$9,900
- ❖ Assume XSP settles at 305.00 on August 30<sup>th</sup>
  - The spread cash settles worth \$500 each
  - $5.00 - 0.99 = 4.01 * 100 * 100 = \$40,100$  (Profit from options)
    - Account's Cash Balance: \$290,100\*
    - NO UNDERLYING POSITION

\*NOT INCLUDING COMMISSIONS/FEEES

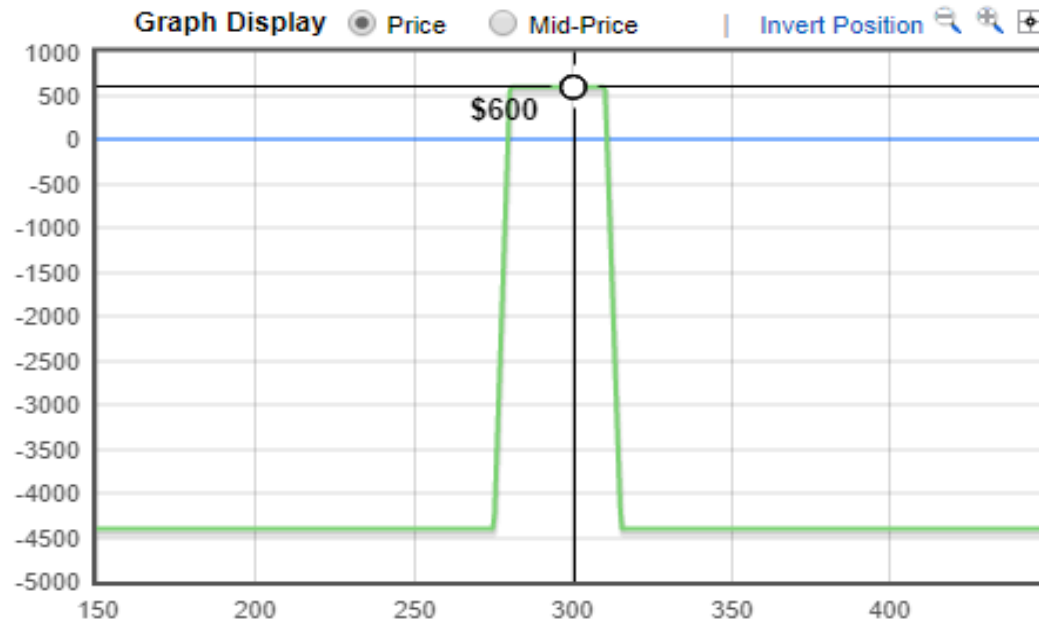


- ❖ The same SPY strategies translate in XSP
- ❖ Many traders use Iron Condors
  - Non-directional trading
  - Potential to benefit for time decay & VRP
  - Short an OTM (4%) call spread & OTM (6%) put spread

.XSP - .XSP

Last: 299.45 | Change: 1.49

Price Points	P/L
150.00	-\$4,400.00
279.40	\$0.00
280.55	\$600.00
310.60	\$0.00
315.35	-\$4,400.00
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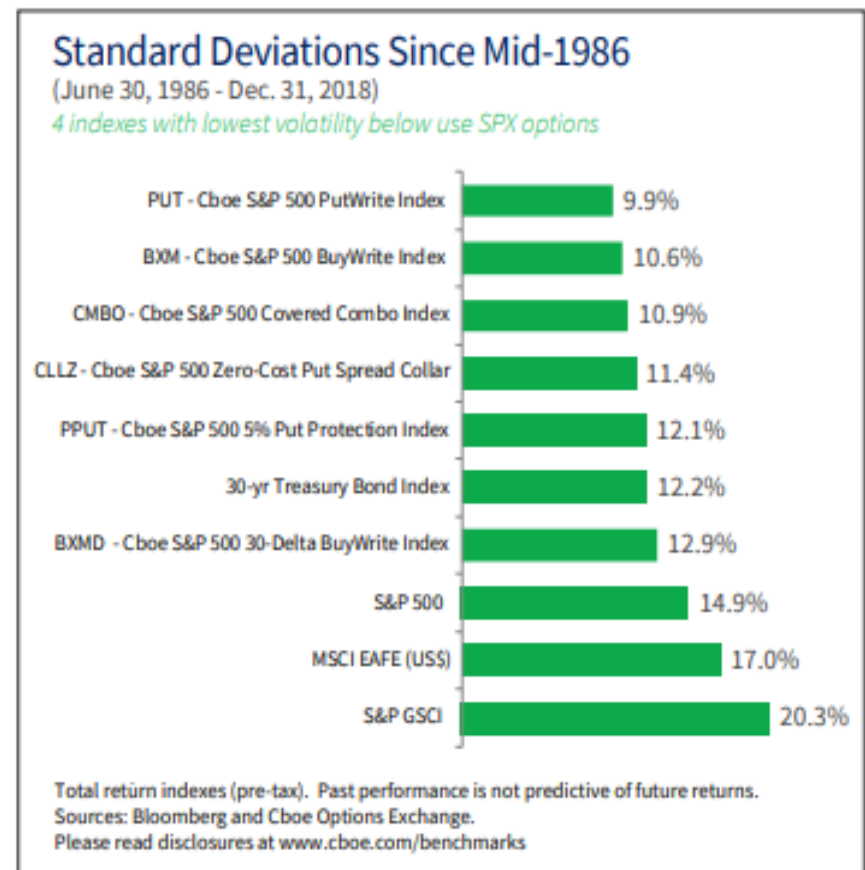
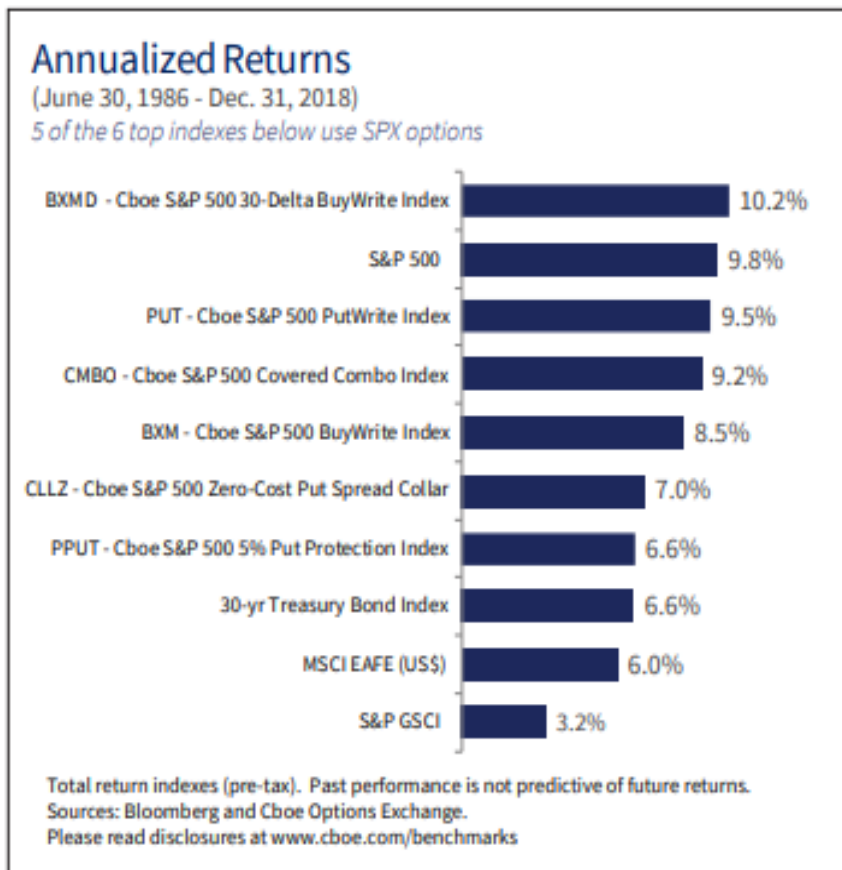
- ❖ Volatility Risk Premium (VRP) is a potential source of alpha & better risk adjusted returns

**EXHIBIT 12 – VIX INDEX MINUS SUBSEQUENT S&P 500 1-MONTH REALIZED VOLATILITY ANNUAL AVERAGES (1990-2018)**





## ❖ Index Option Strategies often reduce risk and potentially enhance portfolio returns



- ❖ XSP is an Index Option product
  - Very similar to SPY options – Equivalent Notional Value
  - Meaningful benefits associated with Index Options
    - Cash Settled (no shares)
    - Euro Style (one less risk; dividend assignment)
    - Potentially favorable tax treatment
- ❖ Trading strategies associated with SPY are interchangeable
- ❖ XSP options market is deep/liquid
  - Available before U.S. cash open
- ❖ Index option strategies often yield better risk adjusted returns



Questions?

