



## **Income Generation with Options in 2016**

December 8, 2015

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Founder & Managing Director

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A copy is also available at: <http://www.optionsclearing.com/publications/risks/riskstoc.pdf>

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# Host Profile (Gareth Ryan)

- Began his trading career at 19 years old in London
- Proprietary Spot FX Trader – EUR/USD, GBP/USD
- Went to work for a Wall Street Broker in Equities & Options
- Founded IUR in 2007 – registered with the Securities & Exchange Commission as an investment advisor firm and regulated by the UK Financial Conduct Authority.
- IUR Capital is an investment advisor for its clients on the Interactive Brokers TWS Advisor Platform.
- Specialising in options strategies for client portfolios
- Regular guest on Bloomberg/FOX TV

# Market Update

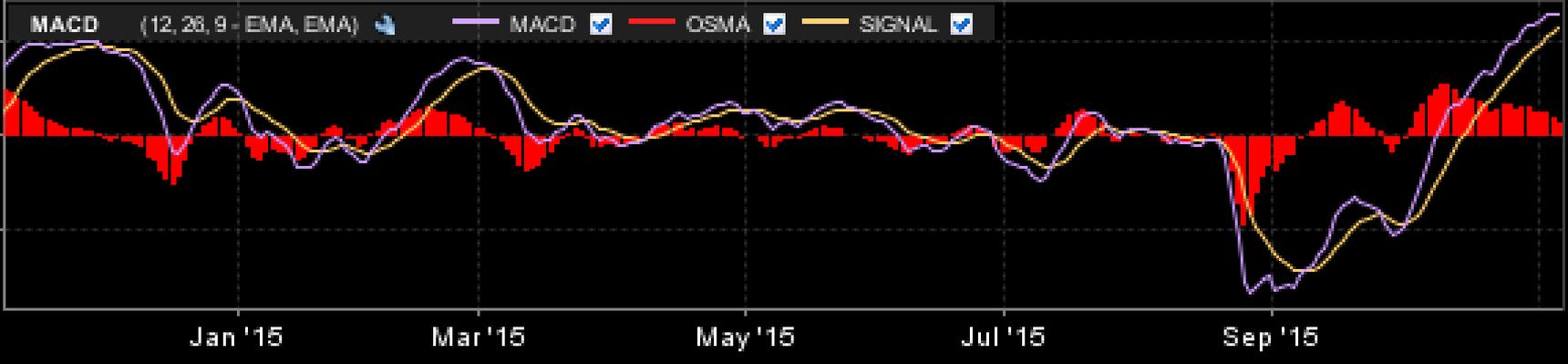
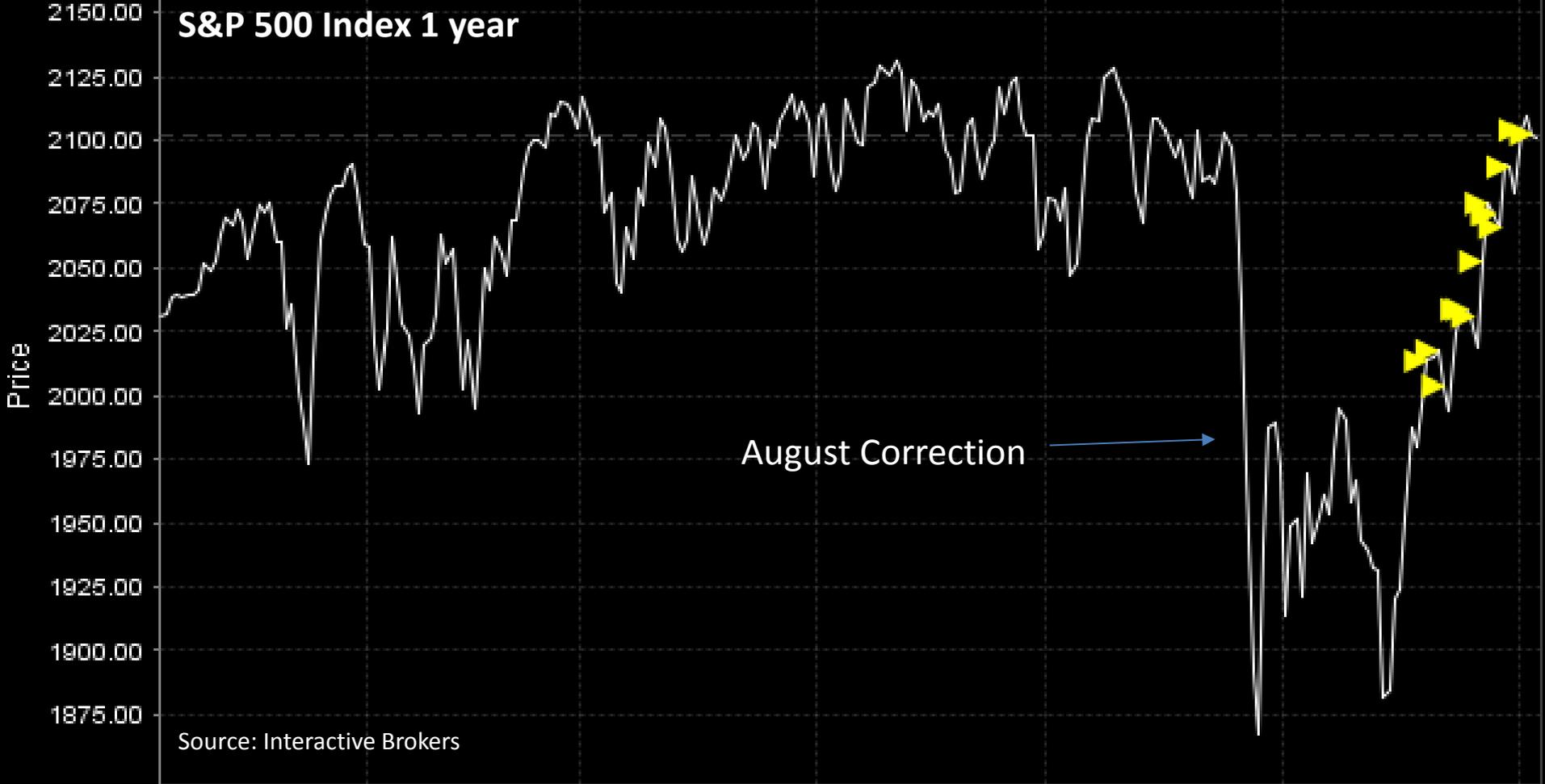
## December 8th

- SPX +2% YTD....VIX back to summer 2014 levels
- August / September global correction was sharp and painful
- October rally was the best in 4 years
- Central banks globally continue to provide support to financial markets via stimulus
- European markets continue to see inflows on ECB stimulus + weaker euro. DAX index is 11% YTD
- Manage your Risk! Avoiding the storm by raising cash levels and/or making the necessary adjustments to options strategies in your portfolio.
- Most obvious adjustment during Aug/Sep correction for bullish options positions was to roll down strikes; i.e., bull put spreads to recover premium.

# S&P 500 Index 1 year

12:37:15

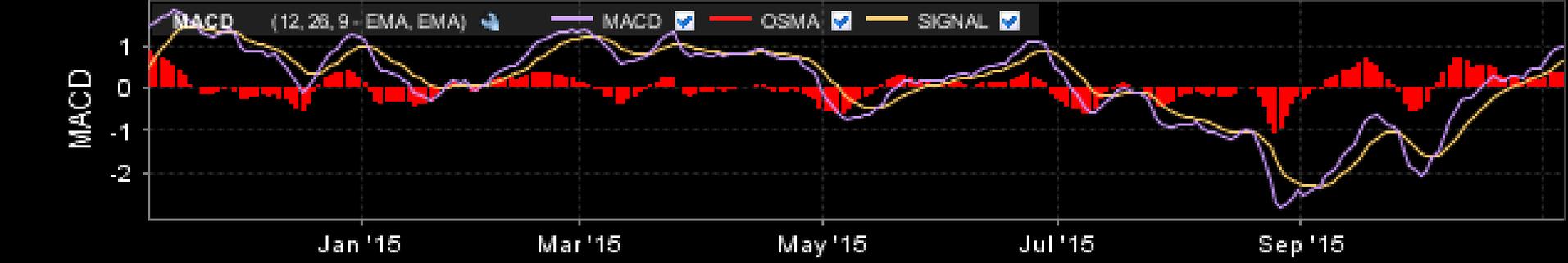
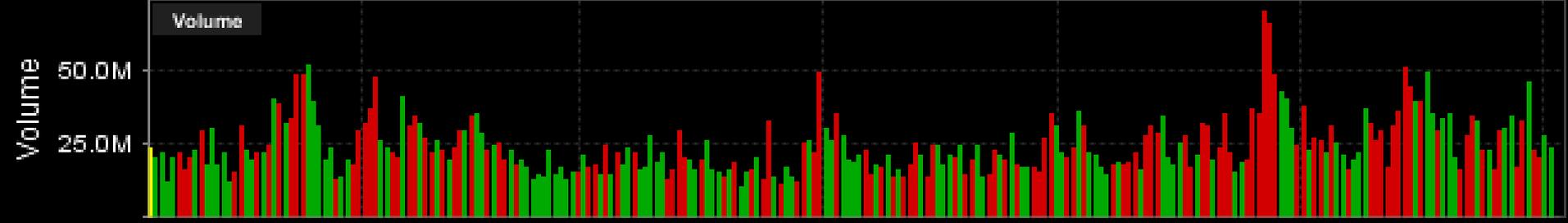
L: 2100.90 CH: -1.41 CH%: -0.07%



# IWM ETF 1 year

13:37:38

L: D118.27 CH: -0.02 CH%: -0.02%



# CBOE Volatility Index 1 year

12:38:00

L: 15.55 CH: +0.04 CH%: 0.26%



MACD (12, 26, 9 - EMA, EMA) MACD OSMA SIGNAL

MACD



Jan '15

Mar '15

May '15

Jul '15

Sep '15

# What lessons have Retail investors learned from 2015?

- Retail investors appear to have a habit of being overactive
- Income generation strategies using options should have had a solid year, unless they were sailing too close to the wind with strike selection
- What about your approach to risk? Sufficient hedging in place to protect bullish strategies?
- Call buyers in many cases saw their asset wasting in value without the upward move in the underlying... an alternative strategy may be worth considering

## A Possible Recovery Strategy...

- If the August / September correction was painful for you in a stock portfolio, then you may need to devise a plan to recover through the rest of 2015 and going into 2016
- Income-seeking strategies
- Leave out directional strategies for now
- Credit spreads – far OTM put spreads being sold for premium
- Allow plenty of room for more volatility with your strike selections.

*Option strategies involve risk and are not suitable for all investors.*

*Multiple leg strategies, including spreads, will incur multiple commission charges.*

# Scenario 1: \$500k portfolio

- You are in the 40-60 age range, married with 0 / 1 dependent
- You are looking to supplement income from employment through your current portfolio
- Currently invested in bonds, mutual fund, dividend-paying stocks
- You need to generate consistent income in the portfolio BUT with a focus on capital preservation
- You are willing to allocate 15-20% of the overall portfolio to a conservative options strategy to generate regular premium
- You want to achieve regular premium even if the market remains flat through the rest of 2015

## Scenario 2: \$100k retirement account

- You are nearing retirement or already retired, with no dependents
- Your income has dropped, but you are wary that you will still have living costs for you and your spouse
- Mostly invested in bonds with a small element of stocks, but your dividend income is not sufficient for regular drawdowns
- Preserving your capital in your retirement accounts is a priority
- But you are willing to look at an income strategy using options that does not require a rising market
- You want to achieve regular premium even if the market remains flat through the rest of 2015

# Possible Strategy using SPY ETF options as a vehicle for income

- Vertical Spreads
- Creates defined-risk, defined-reward scenario
- Buy one option, sell another
- Same underlying
- Same expiration
- Different strike prices
- Established as a credit spread (premium received on opening transaction)

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# How do I position myself with strike selection on SPY ETF?

- Strike selection ultimately depends on what your monthly income target will be and how sensitive you are to daily price moves on the S&P 500 index.
- If you want to set a monthly target of 5% on capital, consider where you can position your strikes for the OTM put spread below the market and with the OTM call spread above the market.
- Think about **STAYING AWAY** from ATM options on the SPY. You may want to focus on what premiums are available between 5 – 10% OTM strikes on SPY (below and above the current market).

# Potential 5% monthly income in 2016... the specifics

- Sell 5% SPY OTM Put Spread
- \$2 maximum spread value
- With a net credit above \$0.20, your premium received generally equates to 10% of maximum value (before commissions)
- Your price range will be a maximum 5% decline in the SPY ETF
- You are neutral to modestly bullish.
- Understand that the margin required for this should be the maximum spread value of \$2

# What is the risk/return profile?

- Receiving a credit of \$0.20 means you have significant risk if the S&P 500 index declines by more than 5% during the period for which you hold your position.
- HOWEVER,  
We manage downside risk using protection (i.e., put debit spreads closer to ATM)
- This requires active management of the position... which is what we do everyday for clients (advisory and managed accounts)

# An alternative vehicle to SPY... IWM ETF

- IWM ETF – Russell 2000 index ETF, represents the small-cap index.
- Similar structure to SPY ETF but with a smaller percentage of household names comprising the index.
- 2015 range on IWM is currently \$107 – \$126
- Can you run a 3% monthly income strategy with this price range?
- Think about strike selection to achieve your monthly income target.

## Notes on credit spreads

- The credit spread strategy can generate income if the underlying security price is above the higher strike of an OTM Put Spread at expiry.
- Can be established in one transaction, but always at a credit (net cash inflow).
- Maximum loss generally occurs where underlying security price moves in the direction that makes both strikes of the credit spread ITM at expiry.
- If both legs of the put spread expire out-of-the-money with no value, the entire premium received on the opening transaction is retained.

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## Key points to consider for risk/return in 2016

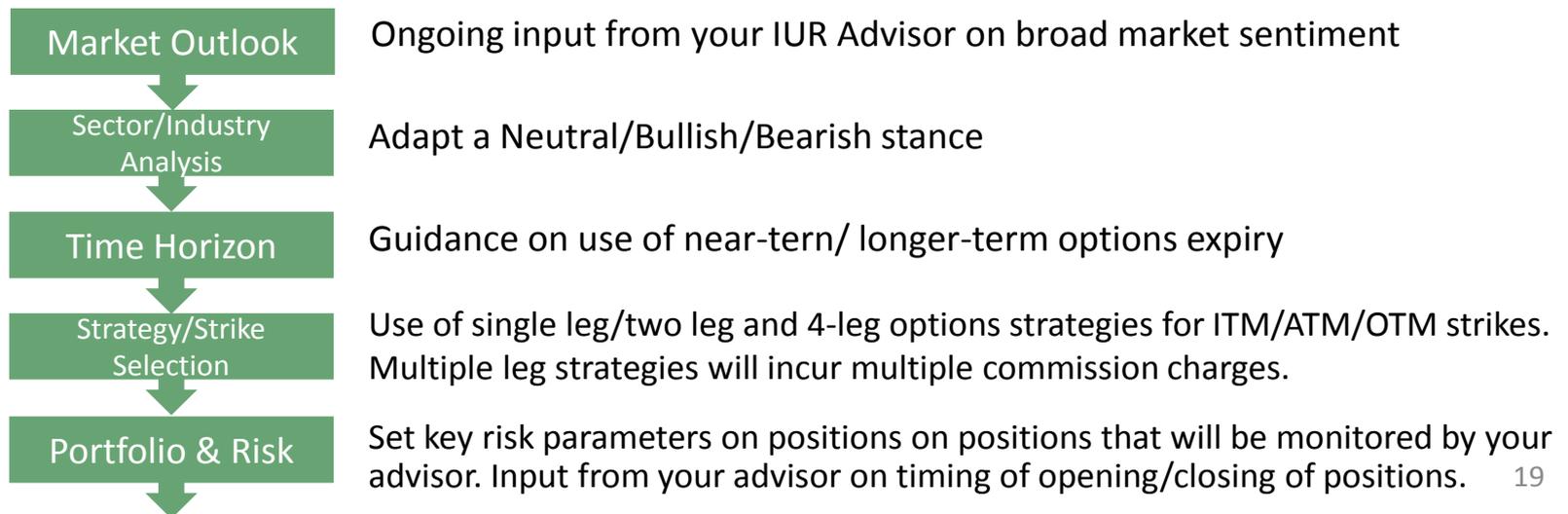
- Don't allow one specific event or price move to seriously affect your options portfolio!
- Avoid company-specific risk particularly on earnings reports.
- Look at what your monthly objectives are for returns. Is your strike selection and strategy still going to allow you to achieve that?
- Keep a small basket of underlying securities on the book... we are not here to be stock-pickers.
- There is nothing wrong with working with a professional, particularly on risk.

# Options Advisor Account

2016

- Highlights
  - Dedicated IUR Options Advisor allocated to your portfolio from day one.
  - Work with your advisor 1-to-1. Discuss your objectives, risk tolerance and time horizon.
  - Direct Advisor input on option strategy setup for the underlying security, strike selection, position sizing. Strong emphasis on risk management.
  - Your Advisor will advise, undertake and monitor all positions
  - Focus on consistent P&L for your options account

## Our Options Advisory Process

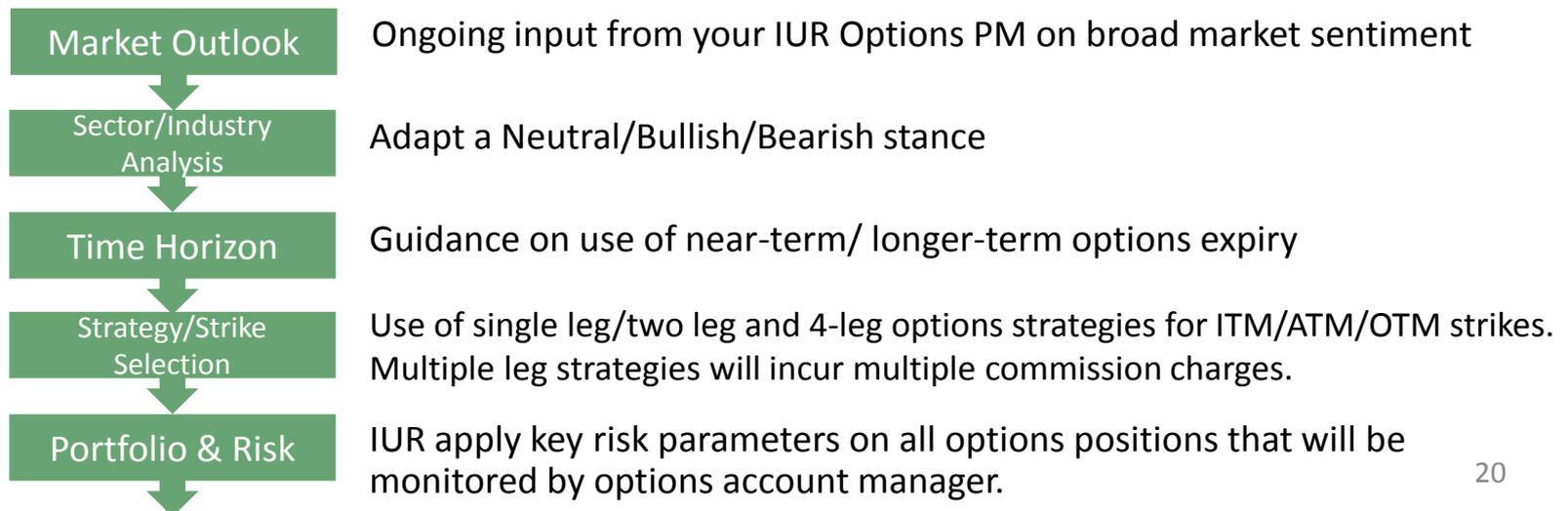


# Managed Options Account

2016

- Highlights
  - Dedicated IUR Options Portfolio Manager allocated to your options account.
  - Work with your advisor 1-to-1. Discuss your objectives, risk tolerance and time horizon.
  - Direct input on option strategy setup for the underlying security, strike selection, position sizing. Strong emphasis on risk management.
  - Your options portfolio manager will undertake and monitor option positions.
  - Option account updates available daily via account management
  - Focus on consistent growth for your options account

## Our Options Advisory Process



# Let's talk...

Email us at [gryan@iurcapital.com](mailto:gryan@iurcapital.com) to arrange a 1-to-1 call and to request the slides for this webinar.

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