Tuesday's Trade 11-5-19 IBM: We buy 5 Jan 135 puts pay $3.40 and sell 5 Jan 125 puts at $1.05

A Change is Going to Come

Overtime things change, yet sometimes our thinking doesn't'....that is when we find ourselves in trouble. Whether in life or in trading, if you can't change you are going to be done for.

There is an old saying: those that do not learn from the past are doomed to repeat it. I would add this: If you are stuck in the past you are history. Every trading cycle has a period of time that is just like it. The year 2017 was a lot like 2007 and 2018 was a lot like 2011. Yet there are instances where this type of thinking doesn't fit, most recently, all of the hand wringing about the yield curve inversion. Traders and more notably reporters were OBSESSED with the yield curve over the summer. Yet that yield curve is so different from times in the past because current circumstances are so different than in times past.

My point is that history can tell us things, but it does not tell us the future, nothing does. Things change, even history repeating itself does; in fact, it changes every time. Thus, it is SO important not to become married to a stock, a trade, or an approach to trading and/or investing. At one point in time, the subject of this paper, IBM, had been just like every other major stock. It's been a growth high multiple stock, it's been a cash cow, it's been a reclamation project, it's been a fallen angel. Owning and trading IBM like its 2005, or 2015, or 2017 is going to backfire.

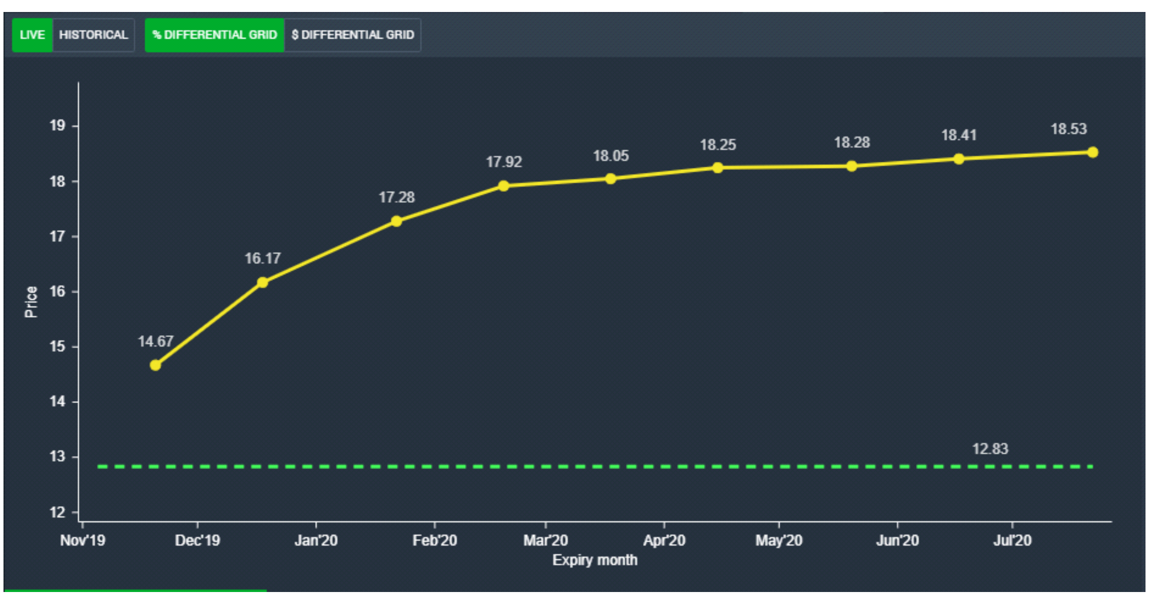
Companies and small business are also similar. Over the next few months, there are going to be a lot of changes here, (at OP), changes for the better. This letter you are reading is the first example of the type of initiatives we are taking to make this company easier to navigate for the customer while upholding our standards for delivering the best trading content in the world. As we make our changes, be sure to let us know how we are doing. Speaking of changes....

Markets:

The S&P 500 is at an all-time high, yet again. Looking at the past, this upside move in the S&P 500 does have some similarities in movement that rings of January 2018; notice how strong the up move in the SPX has been in the last couple of weeks.

The chart of the S&P 500 looks like a selloff, not a rally; the move has been so dramatic. About the only thing different is that the candles on this rally are smaller than on a normal sell off. The fact is, we are up about 200 points in the S&P 500 in about a month; that is incredible movement. An upside run like the above stinks of algo pump and dump. It does not have to be though: fundamentally, earnings have been 'meh,' economic data is okay, trade is calm and the FOMC is out of the way. This could be a reset of pricing that leads to us sitting around for a while. My point is, there is enough there to get worried about some sort of sell off in the near term. VIX seems to be just a hair worried as well:

VIX structure might actually make some sense when we take the above movement in context:



With 15 days to go, VIX Nov is almost two points more than the cash. December, typically one of the slower periods, is trading at a three and half point premium and January is close to five points. THIS IS A MASSIVE contango priced in the market. This type of contango is when a lot of short vol traders lick their lips. This is when THIS short vol trader starts to get nervous.

I am not saying that the market is going to have a huge sell off, but I would pay close attention to VXX negative 'roll yield.' It continues to remain stable or even expand. If roll yield starts to tighten up and become less negative, take heed, it might be a time to take dollars off the table. Need to brush up on VIX and VXX? Check this out!

Option Pit Signal

SPX: GREEN

VIX: yellow

SPX IV: yellow

VIX IV: yellow

VXX: RED

Speaking of dollars off the table:

To paraphrase OP client Tim B: IBM's problems are the result of leadership, listening to outside consultants, advising them to get rid of low margin businesses. However, they failed to see how all the pieces of IBM fit together, and did not realize that people tend to want 'tech consulting' from the people they are buying the equipment from.

To paraphrase myself: I can't believe the leadership team is still employed after all the stock buy backs above $200 and how little they are buying back now. They are THE case against stock buy backs as a way of returning shareholder value.

The point is IBM is to tech what Sears or Macy's is to retail. They are potentially the next GE. They might not be out of business in 10 years, but they are on the way down and maybe on the way out. The dividend is not safe and the earnings are not safe. Most people do not even know what IBM does anymore, heck, I am not sure they know where they are going.

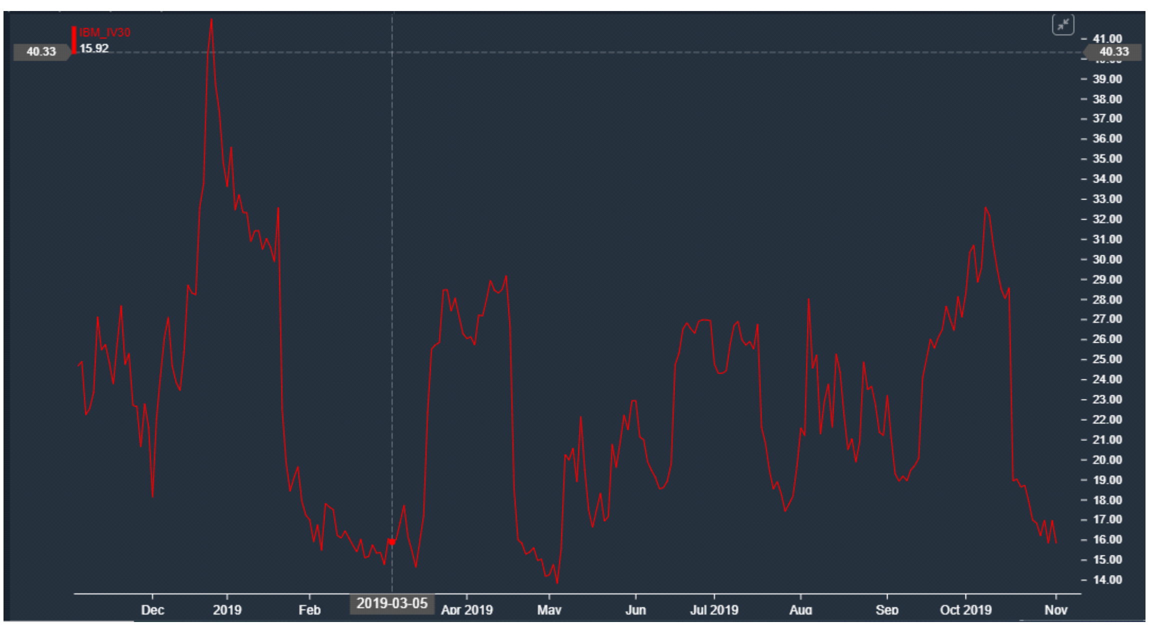
They are an AI company; they are a cloud company; they are a who knows what company. I mean, on their 'our services' page, they highlight a relationship with KRAFT. That is like bragging about being the GM for the New York Jets.

Earnings stink and revenue growth is non-existent. They are losing the cloud business to AAPL, MSFT, and AMAZON (what do you know, companies that deliver an actual front facing product to their clients and the general public). They have had exactly two good earnings cycles in the last two years and even those were not WOW.

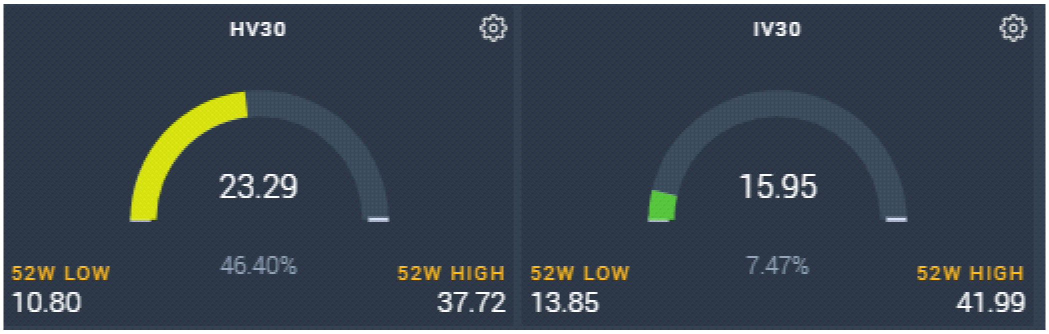
The all-time low for this name is around $105; I think it ends up going there again, probably next year. Ahead of the next earnings, and into the end of the year, I think the stock is heading lower. It does go ex-div this week; I think that the stock goes off a cliff once the dividend is paid.

It is sitting right where the 50 and 200 DMA touch. I think this is a spot where IBM fails considerably, and the stock, at a minimum, heads to the post earnings low and maybe the low for the year. I do not know if we get to the 2018 low without S&P 500 help. If we get help from the S&P 500 (namely a sell off) we could see IBM break $100.

At the same time, and this is NOT a good thing, the IV of IBM options are in the toilet

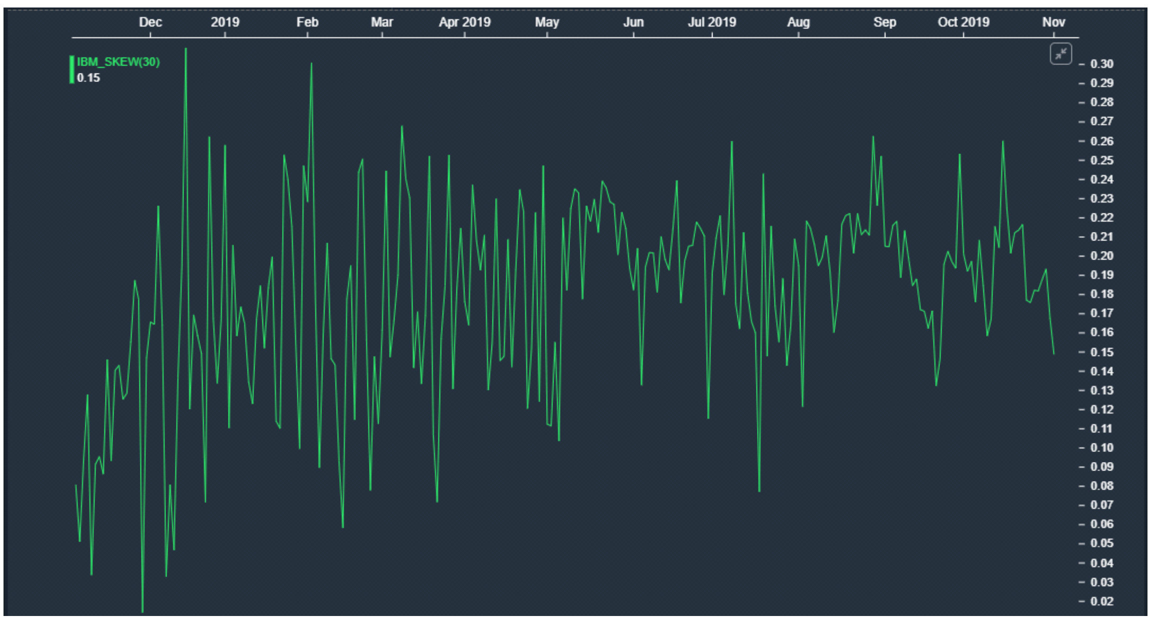


When a stock is soft and IV is low, that means customers are dumping the stock instead of buying puts. It tends to mean the stock heads lower over time. It also means that I want to buy options in this name. To further the case for an option purchase, take a look at the HV30 vs the IV30. HV (past movement) is around the 50th percentile, IV (implied volatility) is in the bottom 10th.



The amount of movement I am getting, relative to my cost, is appetizing.

Skew, the cost of out of the money puts relative OTM calls, is also appetizing; this is because puts, near 25-40 deltas are inexpensive. Yet the cheap puts, that might not show up on a skew chart, have some surprising juice.



I would be a buyer of OTM puts and a seller of puts that are further out of the money. I would like to have as much time to sit on my short play as I can get. I want to be long through the New Year, but maybe not through the next earnings cycle. This puts me in January instead of April options.

Nov08(W)	Nov15	Nov22(W)	Nov29(W)	Dec06(W)	Dec13(W)	Dec20	Jan17'20	Apr17'20
18.69	16.73	16.19	15.55	16.12	16.27	17.33	17.50	21.04
5.80	2.10	0.80	-0.10	-0.30	0.00	0.30	-0.50	0.20

January is not as cheap as December, but it's pretty darn cheap given the time to expiration. If I was going to look at more complex trades, I would probably set up a bearish January butterfly. However, for the purposes of this newsletter, I am going to set up a bear put spread in IBM. I can buy the IBM

Jan 135 puts and sell the 125 puts and pay less than $2.50 a spread.   That is an INCREDIBLE value, given the time to expiration and proximity to the money, that I get from the 135 puts.

Trade: We buy to open 5 IBM Jan 135 puts for $3.40 and sell to open 5 IBM Jan 125 puts at $1.05

From a risk perspective, I would like to make at least $1.00 plus a spread before I take profits.   I will begin pairing back if this spread gets to $1.75 or less.   My target P&L would be to make at least $500 on the position, preferably closer to $1000 if I can play my cards right.

Mark Sebastian