

2-25-20

Your Diner Might Suck

**We buy 2 VXX March 18 calls for \$2.00 or less and We buy 2 UVXY Jan 2021 14 puts for \$5.50**

Just outside of the suburb I live in is a Diner called PJ Klems.

It is literally 20 feet outside of my town. I drive by the place at least 10 times a week.

The diner has a great reputation for the food it serves. They make a good breakfast (honestly how crappy of a restaurant do you have to be to screw up breakfast).

They make great soups and burgers and also have a bakery on site (the bread is really good).

Yet, until last week, I had never been there in my life. I have lived in my town since 2013.

The food lived up to the reputation. I had a patty melt and it was better than any of the other diners I have been to. I will be back.

This got me asking myself "why had I not been to this restaurant before?"

The only answer was that I was in a routine with my restaurants. I have a diner I go to that is good. I saw no reason to change it up.

Yet I was missing out, because this place makes great burgers and is cleaner inside (restaurant tip: lose the carpet).

I don't just get into these habits with food. I do the same thing with where I shop, where I buy clothes, almost everything I do. It HAS to break into my trading.

This motivated me to go back and look at what type of trading I am doing right now. Am I falling into silly traps and habits?

The answer was of course, yes. Sure, I was making money, but does that mean I was maximizing my trading?

By not looking around, I trap myself in the same trades. So, this week make it a point to try something new, be it food, drink, or at least, trading.

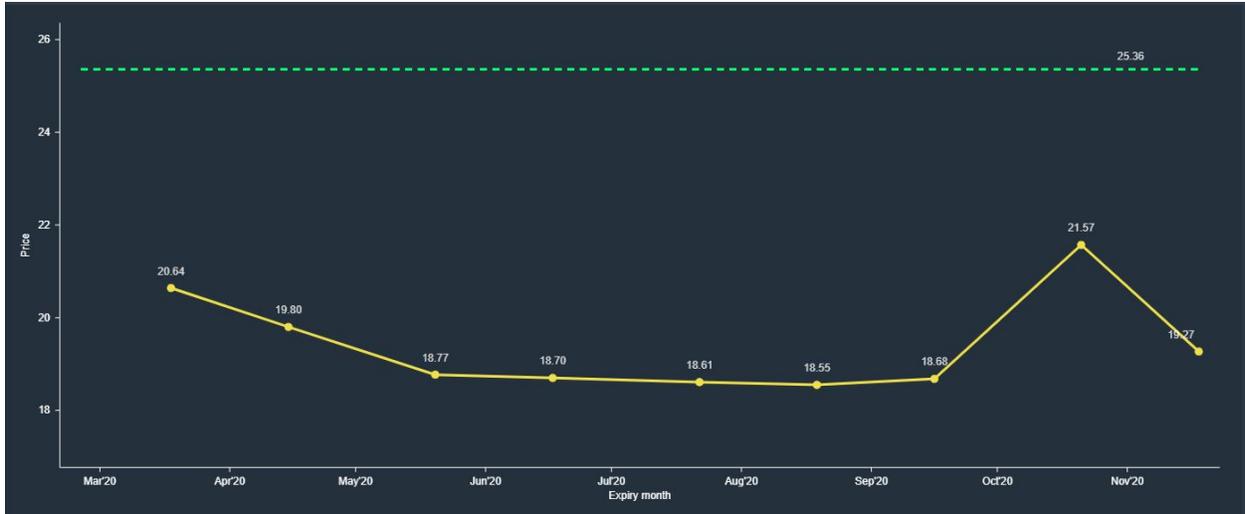
ESPECIALLY given the market we had on Monday.

The market is red, and oh boy is it RED. Monday's price action sets up as a somewhat classical move. This should sound familiar: weird down day on Thursday, ugly sell off on Friday, low liquidity tank job on Monday.



We saw this set up in August of 2015, and most famously October of 1987. What makes this one different is that it took place 3 days off an all time high. We would typically expect to see some fighting around the index BEFORE a market beating. That did not happen.

That said we were yellow on the S&P 500 for a reason, VIX and VIX future were tight signaling the market was on edge. VIX is now fully backward, meaning that VIX is trading above the futures, and the futures are trading above one another as we move back in duration.



We are now in a situation where premiums are all the way back to August. This is the market signaling that we are going to be volatile for a while. I would expect 1-3% moves for the next few weeks and there is potential for a serious sell off on a single day.

For us to have another OUTSIZED day I think we are going to need a catalyst. This means a serious sell off will need one more big news event. It could be Virus related or tangentially related to the virus.

What I will say is that the market is set up for selling for a while, and this was done WITHOUT a panic. I can see that in the VVIX which did NOT spike with the VIX pop.



115 might seem high, but in a normal 30 VIX environment, VVIX is going to go to 140 or 150. I think we have another leg lower.

Option Pit Traffic Light

SPX: RED

SPX IV: YELLOW

VIX: YELLOW

VIX IV: GREEN

VXX: GREEN

I think we are going to see the VXX run to 20 before all is said and done. In the short term I think the ETN has a lot of bullish upside.

Which brings us to our trade:

I am going to give you a preview of a trade on our upcoming VIX trading service because, frankly that is the only trade that I see that I really like right now (I still have TSN on my radar). VXX and UVXY

There are two things we know, in the near term the VXX is pressured to go higher. This is caused by the VIX future being in backwardation. In that type of environment I want to be long VXX calls and typically slightly in the month.

If you look at the historical performance, when the VIX is backward that is when VXX makes almost ALL of its gains.



The last time VXX had any kind of run was when the VIX was backward in early October. That coincided with a run of VXX from the low 20s to about 27. A nice 20% gain. That market did not have 100 point S&P 500 sell offs.

Thus we like being Long the VXX March 18 calls 2 times spending \$400.00

Against that we want to use the other thing we know about VXX: in the end it will decay to nothingness and have all kinds of problems. The long term chart of VXX is TERRIBLE. If you have not seen it, VXX has had a GREAT run of the last 2 years, seriously, yet here is its performance:



Thus we are going to use VXX's ugly stupid little brother UVXY to accomplish being short and trying to capture contango. As bad as VXX is, UVXY is WAY worse. Here is its performance POST reverse split which was in September of 2018:



UVXY has rallied from 12 to about 16.5 in the last couple of days. It could go higher, but in the long run, it will drop as well, just like VXX. In fact, I think UVXY has a reverse split coming by the middle of the year. You will be shocked at the speed with which this thing drops once the VIX flips toward a red traffic light.

I can buy 2 of the Jan 14 puts for about \$5.50. In the near term the VXX, will outperform my UVXY position. In the long term, my UVXY will pay us lots of \$\$\$.

Trade: buy to open 2 UVXY Jan 2021 14 puts for \$5.50

The basic principle of risk management here is to take off the VXX as it rallies, or if VIX starts to go really red. At that point, we let the UVXY run. IF the VXX keeps running, we will roll the calls as they double in value, which is ENTIRELY possible if we have 1 more catalyst.

**We buy 2 VXX March 18 calls for \$2.00 or less and We buy 2 UVXY Jan 2021 14 puts for \$5.50**

If I was NOT going to do both trades I would be a buyer of the Jan 2021 10 puts in UVXY for less than \$3.00 2 times.

Your Only Option,

Mark

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