Size and Risk **3-10-20**

TRADE: We buy to open 6 XOM Apr 42.5 puts for $4, Sell to open 12 Apr 35 puts at $1.73, we buy 6 April 27.5 puts for $.70. Net we pay less than $1.30 for the Apr 42.5-35-27.5 Put fly.

The thing that puts people out of business is not the market, it is risk. All of my worst losses have not been because I had a bad trade. They have been because I had too much size on. My best trades have usually happened because I didn't have too much size on and I was in a position to profit. Let me tell you a story about risk.

In 2005, I was on the floor trading a small Irish drug stock called Elan (ELN). They were working on a drug to help with MS. The drug got approved and was working. The stock traded around 30-35 dollars a share, because they were selling A LOT of this drug AND there was speculation that the stock was going to get taken over by one of the big pharma companies.

On February 25th 2005, I looked over my position and saw a lot of inexpensive short puts, in the range of $.10-$.20. In total I was short about 800-1000 of them. This might sound like a lot, but to a market maker in a liquid stock, it's not. Well, even so, I thought to myself, why am I short these puts, they are a dime. I bought them all back.

I walked in on February 27th and the stock was down 80%. I made about 125,000 dollars that day. Mostly because I covered.

Before you go thinking I am some genius, I have another story. MICC was trading right around $35.00. I was short a bunch of upside calls. I was short so much that I had trouble sleeping one night. I came in the next morning intent to cover….it was too late, the stock was up 7 bucks and I was out 35k.

Fast forward to today. Andrew and I manage dollars at Karman Line Capital. With the market tanking we are both licking our lips at all the opportunity. Yet, are we going crazy slinging size trades left, right and up and down. NO.

For the month, my goal is to try to eek out 1% a day, using 1-2% of the fund's dollars. Might not sound like a lot and you might yell: MARK AND ANDREW WHY AREN'T YOU GUYS TRADING SIZE UP!!! YOU ARE EXPERTS!!!!

If we make 1% a day for the rest of the month we are going to do 20%, on a fund that has the S&P 500 as its tracking index. Our clients (and us for that matter) will be ecstatic.

So I want to yell this back at you: WE ARE EXPERTS!!! THAT IS WHY WE ARE NOT TRADING SIZE UP!!!!

Let's get to the markets...

This is not an investors' market, this is a traders' market. The S & P 500 opened up 100 points today, as I write this, it has given it all away into the European close. Yesterday's close was ugly and I know there was some stimulus suggested, but there is just too much uncertainty. Look at the size of candles the market is producing right now:

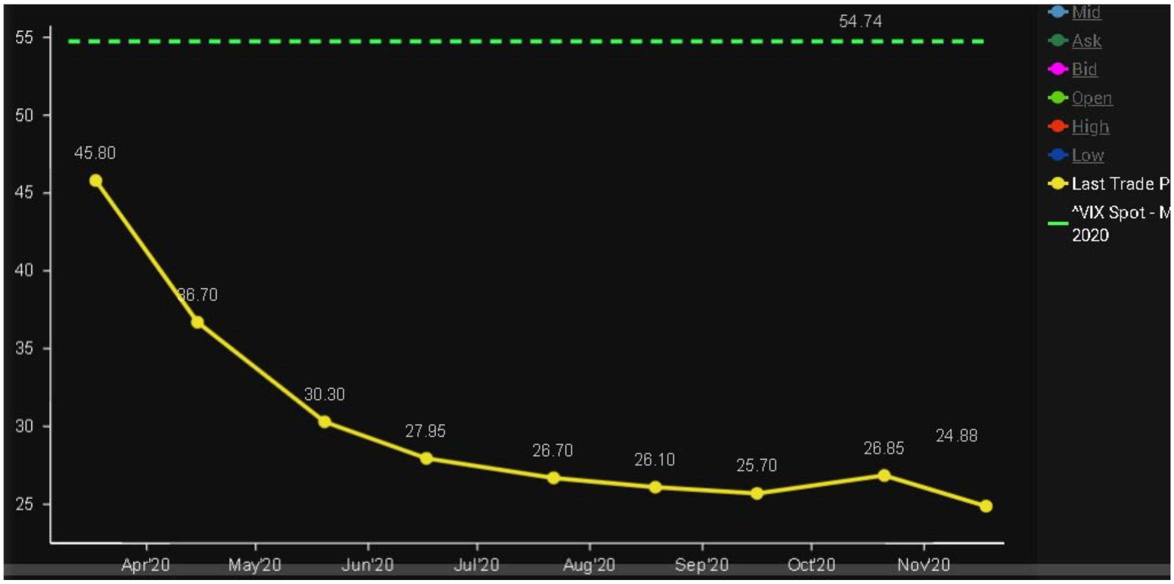
We have been moving at least 100 points in the S&P 500 every day. That is not an investable market, it's a tradable market. When there is a chance to take dollars, traders should take them.

For those wondering where are the 'levels', I would argue we are at a key level right here as we are at the low from September of 2018. Next stop would be the low of that October. Final stop would be the December low (this is the biggest of the levels).

This gives the market the potential to drop another 500 points before there are a lot of true chart guys that would be willing to put a real leg out. If we get to December lows you will start to see some money managers get brave. As it is right now. One way I feel that we are going to keep going lower: my friends that are part time market experts are all saying they will 'ride this out' when they start selling, I want to start buying.

The only indicator better than our VIX indicator is the Doctor and Lawyer investment advice indicator. When they say sell, that's a really good buy signal.

The VIX curve is in a full on backwardation, and VIX is actually peppy relative to where the market is currently trading. With the curve the way it is there is NO way I would be looking to add dollars.



I would rather buy 3000 on the way up, than buy here and watch the market drop 500 more points. There will be a level where I am willing to put on S&P 500 short puts, but we are not there yet.

The VIX curve is saying this will be a GREAT trading market, dollars that are made should be taken, expectations should be that we turn around fast (like today). That being said, a VIX for 55 is high, if we get a couple of days of rallying it will fall fast.

Thus, VIX is a trade or a hedge, not a long investment here. I still see a ton of opportunity in the October-November time spread. But most importantly, with this structure long VXX and UVXY is going to have a bullish edge to it.

Option Pit Traffic Light

SPX: RED

SPX IV: YELLOW

VIX: YELLOW

VIX IV: RED

VXX: GREEN

Trade

Before the complete meltdown of oil XOM was already a disaster. The stock had fallen from nearly $80 to $60 over the last year. Management was underperforming names like CVX.

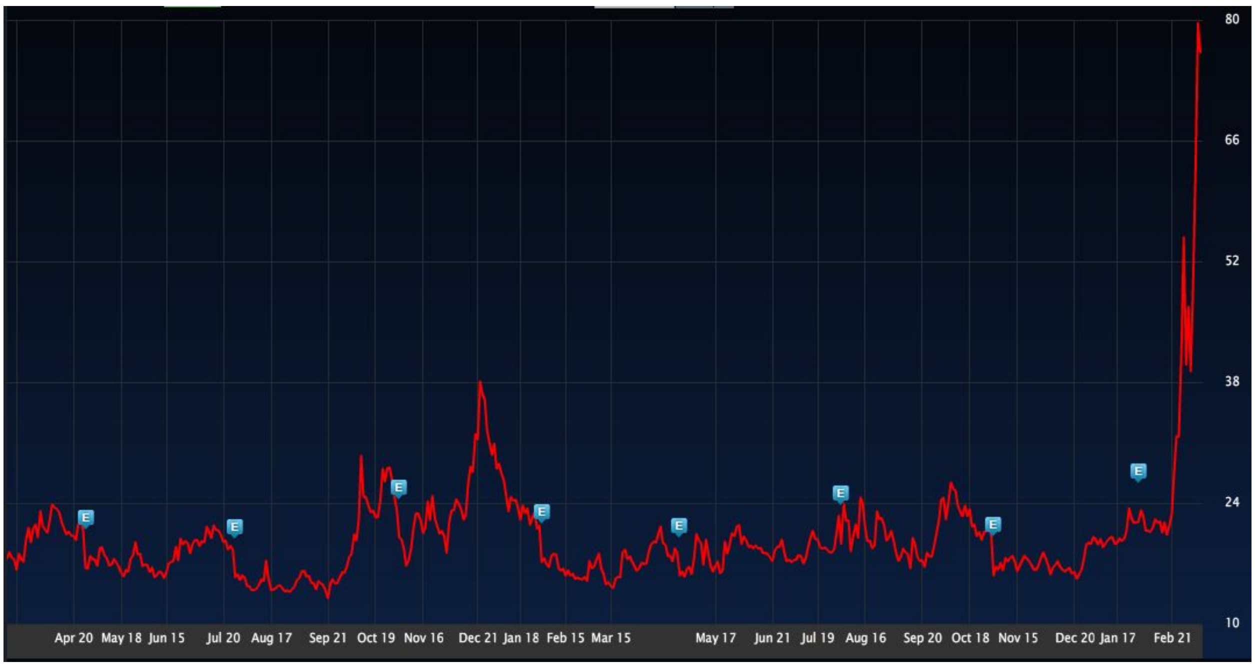
The stock was already down 25%. It is down nearly 50% now, and is probably going to get there. The pre-market low for XOM was sub $40. I think it has to test there at some point, the stock might go even lower from there.

If Oil is going to be in the toilet, which it appears to be heading to as we see a TON of production come online AND we see the world economy slow, XOM is going to have all kinds of problems.

The commodity and energy guys I talk to expect oil to get to 26 bucks a barrel or maybe cheaper. That is going to put a lot of pressure on oil producers. While XOM as a LONG term investment is probably a huge win at 40 bucks a share, in the near term it is likely to be a loser.

Warren Buffet usually wins when he buys a stock, however, normally the trade needs to go in his face for a bit first. XOM is probably going to dip before it rallies.

Look at the IV, it is SKY HIGH.



Notably out of the money puts are incredibly expensive. ATM implied vol of 70 is high, getting to sell Out of the Money puts at 90-100 IV makes it totally worth it. We never see these types of IVs in blue chips like XOM.

XOM could obviously flop around which is why I do not want to sit here and trade 1 week options. Thus I am using April options which are short enough in time to still react, but have enough time to expiration that I can wait on any dead cat bounce (which might already be over).

At $1.20 for the April 42.5-35-27.5 put fly I am getting short at an INCREDIBLY inexpensive level. I love this spread. I will target my 1st sale at $1.50-$1.80 to lock in some gains (we are not shooting for the moon here). But hopefully I can close this trade with my last sale of a put fly being over $3.00.

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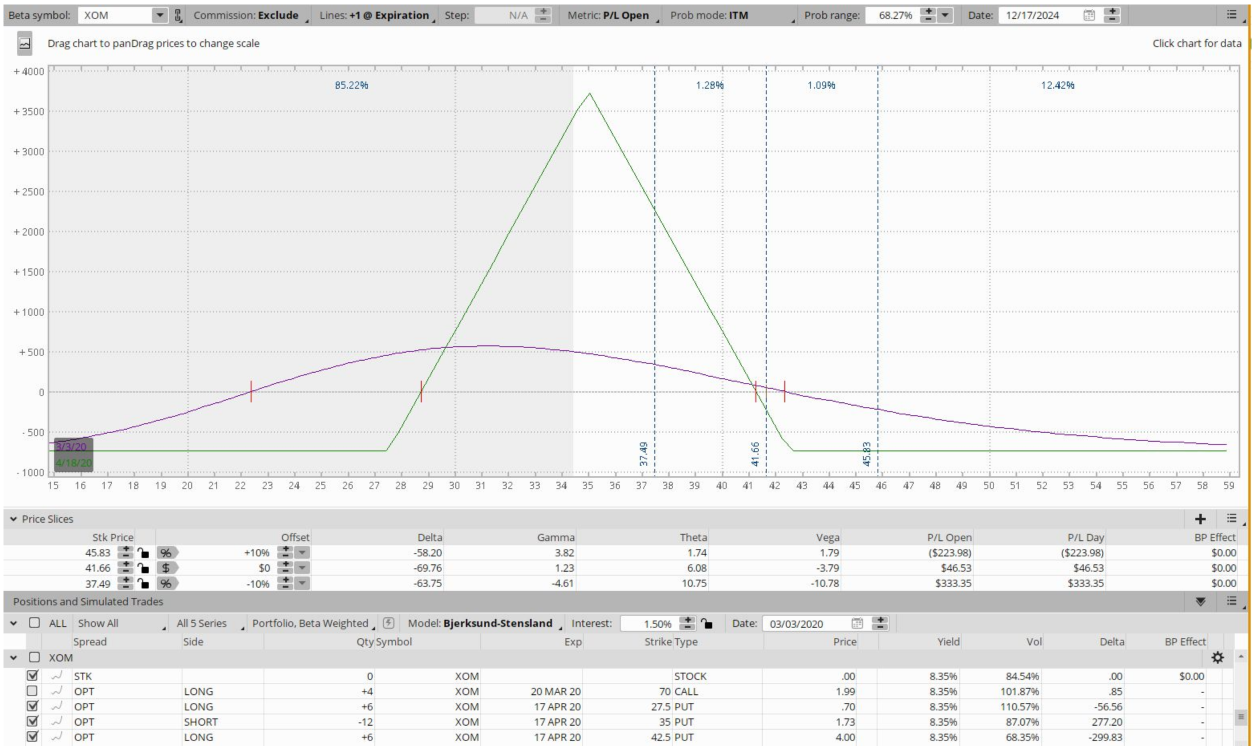
RISK:



This is so cheap and has so much time, that as long as XOM does not go completely vertical it is going to be hard for us to lose if we manage it properly. I want to make sales at $1.60, $1.80, $2.00, and then hang on to the last couple to see if I can squeeze $3.00-$3.50 out of them.

My goal is to own 1-2 put flies for a credit when I am done trading. If I wanted only the SIMPLE version of this trade, I would be a buyer of the March 42.5 puts to get short, but I see that as HIGHLY Risky.

Your Only Option

Mark Sebastian