AUTHORS NOTE: Due to Presidents Day expect the SB trade to be on WEDNESDAY Next week NOT on Tuesday.

Breaking Up With Your Trading Strategy

My senior year in college I had a pretty serious girlfriend. So serious that after I graduated rather than move back to Chicago, where I am from, I decided to move to the New York area to be close to her. I thought we were going to get married.

We continued to date in New York, but things did not go as planned. Over the course of the year, our relationship began to show its true face.

By the end of my first year in New York I loved everything about being there except one thing. That one thing made being there terrible for me.

I had to go hang out with her friends that I didn't like. We argued constantly and were constantly at each other's throats.

Basically, we did not like each other very much. Yet we stayed together. We stayed together for MONTHS.

In fact we stayed together so long that we probably could have EASILY gotten engaged. Why would something like this happen? Two people who clearly do not like eachother very much getting engaged?

The answer is inertia. We were both so comfortable being miserable, that we were almost afraid of being without each other, for fear that we would be even MORE miserable.

Eventually one of us (me) got up the courage to finally make the jump and end our relationship. While it was scary, it was the right thing to do for both myself AND her.

We both ended up getting married to other people and at least from my end, are MUCH happier.

What does this have to do with trading? The answer is inertia. So many of us fall in love with our terrible habits.

We know what we are doing is terrible and isn't making us money. Alternatively, we could be doing a lot of work for very little dollars. Worst case, we do A TON of work and LOSE Money.

Yet we keep doing what we are doing, because it is what we are used to. We don’t break up with our terrible habits for fear that what else is out there could be worse.

I can tell you this: it is not. If you are working too hard to not make money, what you need to do is take a hard look at what IS and IS NOT working for you. Spend some real time on 'trading self reflection' and ask yourself:
Why am I not making money? It could be:

Strategy

Risk Management

Bad Outside Influence (the CNBC effect)

Some combination of all three.

Inherently, people that hold on to bad trading STARTED OUT MAKING MONEY...SOMETIMES A LOT….OFTEN EASILY.

And the reason that person was making money no longer exists, maybe they found lighting in a bottle or markets changed. Regardless of the reason, the money is gone.

As we head into Valentines Day maybe ask yourself if you and the way you THINK you are going to make money need to get some 'space' and 'see other strategies'

That is probably why you are here, and let me tell you we are extremely happy that you have joined our ranks.

And now the market:

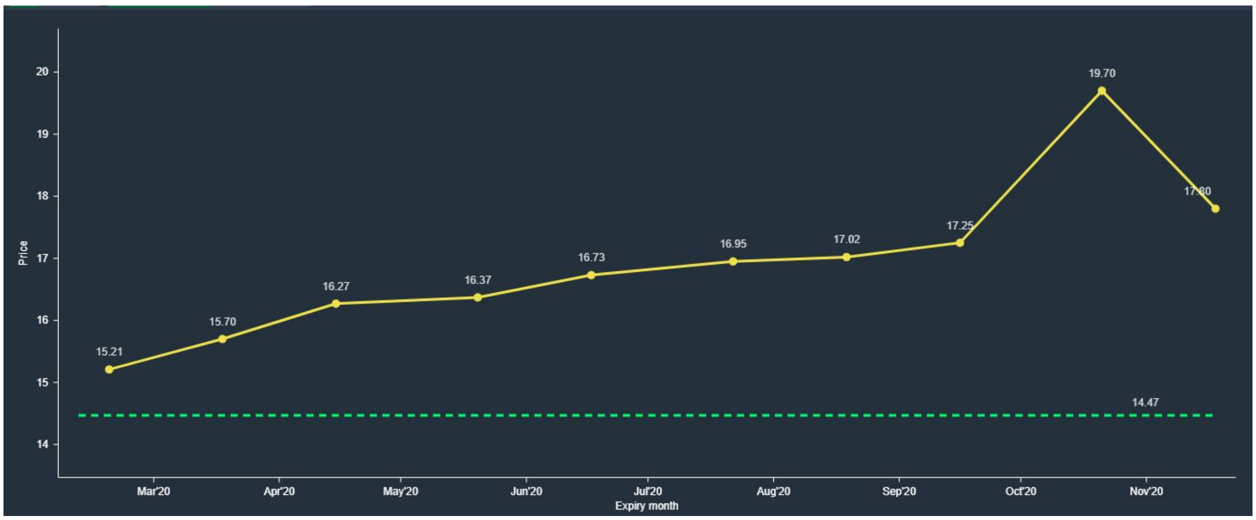
Another day another new all time high. I continue to be impressed that the market can move higher with the damage being done in China.

After what I would call a bit of a market sneeze in late January, the S&P 500 has been moving straight up. Mostly on the backs of the 'MAGA" names and Facebook. We now have 4 trillion dollar companies, 3 of which are making new all time highs, and one is within a few points of its all time high. Facebook (the junior member) is the only name that is not within basis points of its all time high.

This is part of the reason VIX has remained firm. While the S&P is at an all time high, VIX is still 14.5, a strong VIX and a strong Market can be dangerous. That said VIX MIGHT be tailing off.

It looks like it could be heading back to test at least 14, and maybe 13. Which in turn would pull the future lower. If the market is going to really make a serious run higher, in a healthy way, the VIX needs to back off here, and it would be nice to see at least SOME sort of rest near 3400 of the S&P 500 as a whole.

In terms of the VIX futures they are back in a full contango, generally speaking this means the market is going to be moving higher:



Logically, I keep asking myself WHY IS THIS MARKET GOING UP. The fundamentals say we have to have a sell off. I say the same thing in individual names like TSLA.

This is where getting away from my logic and simply looking at the numbers matters and right now, without any changes, the S&P 500, and more importantly the VIX, points to the S&P 500 going to 3400.

Option Pit Traffic LIght

SPX: Green (to 3400)

SPX IV: Red

VIX: Red

VIX IV: Red

VXX: RED

Of all of these I feel the strongest about VIX dropping. The S&P 500 is likely to slow down and these openings are probably fades.

Speaking of Fades, let's talk my trade:

As a long term buy and hold AAPL is the best stock in the last 15 years. Prior to 2005, AAPL was under 10 dollars (split adjusted). It's really an incredible recovery. Yet even the best investments have periods where they can get overbought (or oversold). In the last year AAPL has been both.

It was WAY over sold in May-June of last year, and it's currently way over bought. I want to remind you of it being oversold then, because like the current price action almost ALL of that selling was momentum driven NOT fundamental driven.

This rally in AAPL has been driven by fundamentals, but THAT piece got baked in prior to earnings. At this point, the stock has become ‘choppy and sloppy’ which tells me there is a lot of trading and not so much investing.

One thing from a ‘stock perspective’ I do not like is that it has HUGE down candles and soft small up candles. Down moves are violent, up moves are not. This is why we have an ‘Option Pit Cross’ in volatility with realized volatility crossing implied.

If you think this is earnings related you are wrong, AAPL has been moving A LOT. THe IV of the options is actually backwardated. And 10 day and 20 day HV are WAY higher than IV. They are higher than IV has been all YEAR at this point.

What does this mean...I want to OWN options in AAPL that are At the Money (plus or minus 2% of the value of the stock). The cheapest contract to own is Feb28 which has almost 3 weeks to expire:

Expiry	Feb14(W)	Feb21	Feb28(W)	Mar06(W)	Mar13(W)	Mar20
Sigma	27.44	23.59	23.67	24.68	24.88	24.92
Sigma Chg	0.10	-0.83	-0.72	-0.62	-0.21	0.04

I am also going to talk about ‘skew’ which is the cost of out of the money puts. It is SKY HIGH. IV is already elevated from movement in AAPL, out of the money puts are seeing ALOT of interest from traders. Options that are close to 10% out of the money, with 14 trading days left, are pricing over $1.00 a contract. That is high from a price perspective.

When I have an expensive premium in a cost sense (price), but cheap from a vol perspective I cannot in good conscious simply go out and buy a put or call. That said, if I was to simply want to play AAPL short, the Feb28 312.5 puts for less than 3.00 are a decent value.
I am going to do a slightly more complex trade to keep cost down and protect the position from any near term price push higher. With skew expensive, I like buying ATM puts and selling OTM puts in AAPL in the Feb 28 contract.

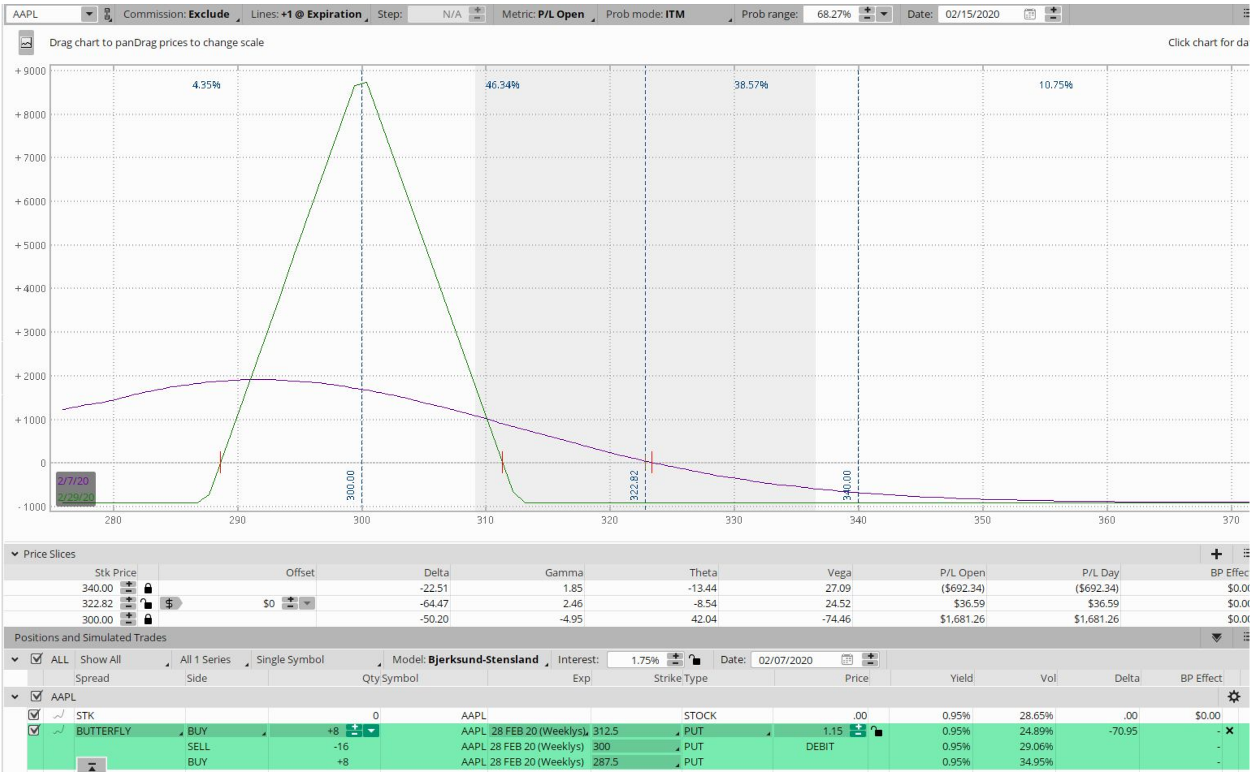
I can buy the 312.5-300-287.5 put butterfly for less than $1.20, that is better than 10 to 1 payout. With a long strike near the money that is only 3% out of the money. We have seen AAPL make those types of moves in a day, and I expect my exit will happen in a similar manner.

I buy 8 AAPL Feb28 312.5 put for $2.93, I sell 16 AAPL FEB28 300 puts at $1.24, I buy 8 AAPL Feb28 287.5. puts for $.69. Net I pay $1.15 on the 312.5/300/287.5 put fly.

		Ratio	Qty		Expiry	Strike		Size	Bid	Theo	Ask	Size	Delta
X	Open	1	8	AAPL	(W)Feb28	287.5	P	6	0.69	0.70	0.71	123	-6
X	Open	-2	-16	AAPL	(W)Feb28	300	P	5	1.26	1.26	1.28	46	24
X	Open	1	8	AAPL	(W)Feb28	312.5	P	12	2.97	2.98	3.00	1	-27
Options total								6	1.10	1.15	1.19	1	-9

I am targeting $1.75-$2.00 on this butterfly which would mean a 5-10 point drop in AAPL from here, which is completely reasonable. What is interesting is that with a few days lower we could actually see IV DROP and SKEW flatten as traders take hedges off, and big dollars become less terrified of holding AAPL at a slightly lower level.

Looking at risk if AAPL DOES make a run higher, I will buy back the 300 puts on the cheap, and sit on a few of the 312.5 puts. I am outlaying about 900 bucks with a target of making 400-500 dollars on this trade. If we do get a quick move we may take dollars early.



Your Only Option,

Mark Sebastian