UNDERSTANDING EARNINGS PLAYS

AION Trading Guide

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AION TRADING LLC

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Introduction to Quarterly Earnings

What is a Quarterly Earnings Report?

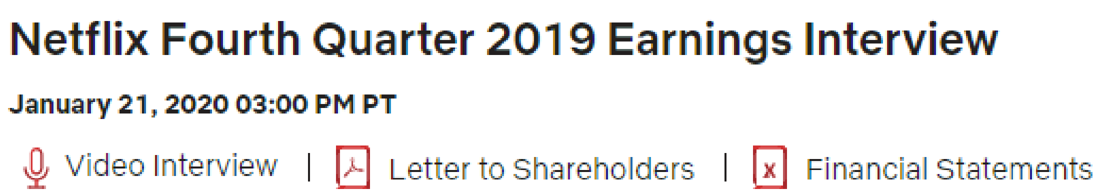
As the name suggests, a quarterly earnings report is filing made by publicly-traded companies to report their performance. Earnings report include information such as net income, earnings per share, earnings from continuing operations and net sales.

By analyzing quarterly earnings, investors can gauge the financial health of the company and determine if it's worth their investment.

How do we find a specific company's past earnings information?

Let's take Netflix Inc. [NASDAQ: NFLX] for example. You can google 'Netflix Investor Relations' in any search engine. You will be taken to https://www.netflixinvestor.com/financials/quarterly-earnings/default.aspx

1) You gain access to previous years' earnings since its initial public offering
2) You gain access to recorded interviews & letter to shareholders



How do we know which earnings is coming up?

1. https://www.earningswhispers.com/calendar
2. https://www.nasdaq.com/market-activity/earnings

Our two favorite sources to track upcoming earnings.

Trading Options During Earnings

Implied Volatility

Implied volatility[1] or IV is a metric that captures the market's view of the likelihood of changes in a given security's price. Investors can use it to project future moves and supply and demand, and often employ it to price options contracts. It shows how volatile the

[1] Investopedia. Implied Volatility https://www.investopedia.com/terms/i/iv.asp

market might be in the future, but it does not provide a forecast with respect to market direction.

Earnings IV Crush

Before a company announces earnings, you will generally see the implied volatility of its options increase as the one-time binary event [beating vs. missing] draws closer. After the earnings announcement, there is less fear or unknown in the market and therefore implied volatility will drop quickly for underlying options.

<u>Case Study</u>: BBBY [Bed Bath & Beyond]

In this case, the indicator being used is called IVR or Implied Volatility Rank indicator.

If the IVR is above 40%, then you should think about checking options premium. Over 40% is green and under 40% is red.

We can see that in this screenshot, the implied volatility *tends* to drop right after earnings. The green vertical lines highlight each earnings report. There was one instance on April 5, 2012 where the IV stayed relatively high. We will use this information later the guide to help with making trades.

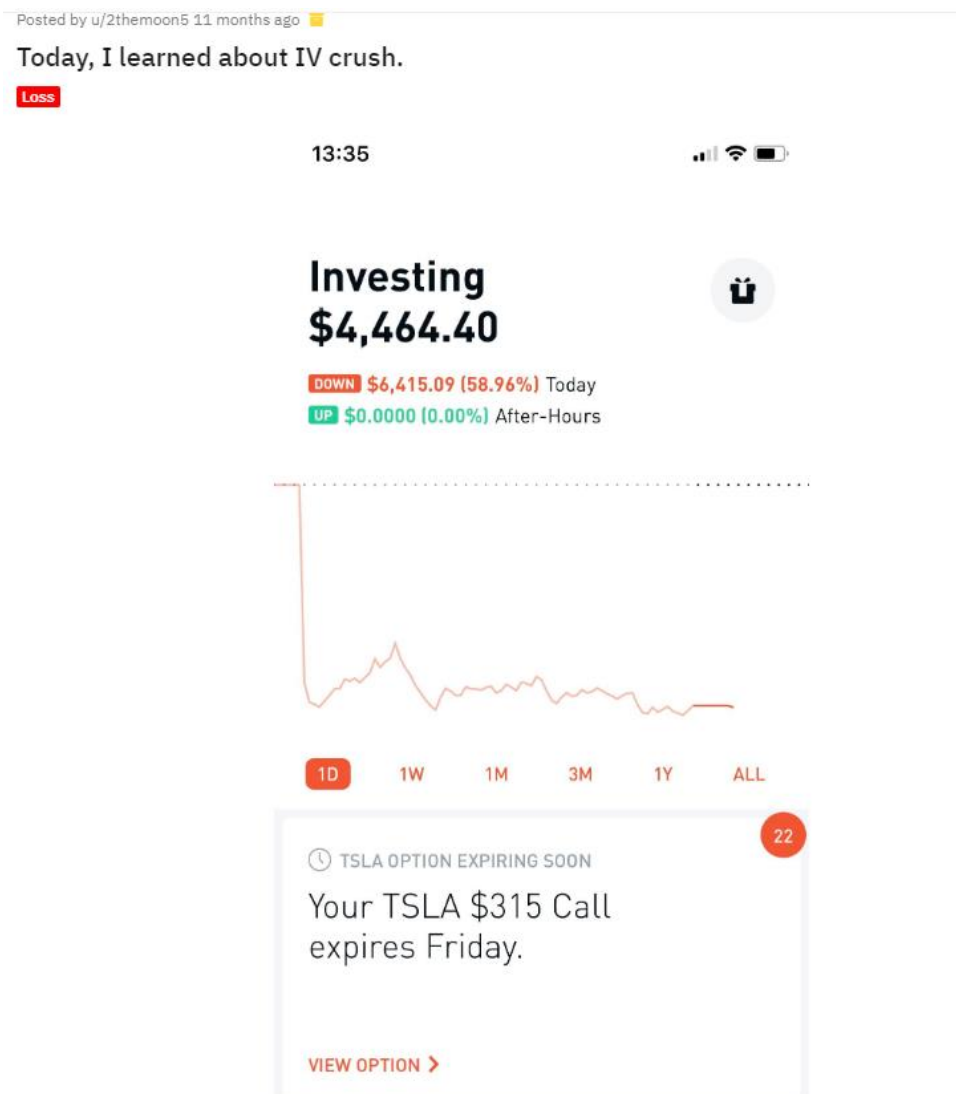
What are the implications of IV crush?

If you are entering in long or short positions during earnings reports, you are liable to IV crush. In general, IV up means the option contract prices are inflated. Let's say you bought a call contract when IV is high because you think stock XYZ is going to go up. Next day, ER comes out and XYZ beats earnings. But your call option contract *loses* premium or value, this is IV crush in action.

How to avoid IV crush in Earnings Plays

To minimalize IV crush, you should either buy while IV is low – so weeks before earnings – or be on the other side and *sell* options around earnings. You can sell options and still pick a direction: long, short, or neutral.

Most people with earnings try to play the market by entering a *long* position, so buying options on either end and assuming a huge move. But the better strategy, the more profitable strategy long-term, is to selling options the day before earnings and taking advantage of the implied volatility move. The IV has a higher percentage of dropping sharply than to move towards your long position, so it is worth it to sell option premiums take profits.



Options Strategies to profit off IV Crush

In this guide we want to focus and take advantage of IV crush. This would mean that we need to be seller of options whenever possible.

Short Straddles[2]

Example of short straddle	
Sell 1 XYZ 100 call at	3.30
Sell 1 XYZ 100 put at	3.20
Net credit =	6.50

Goal: To profit from little or no price movement in the underlying stock

Explanation:

A short straddle consists of one short call and one short put. Both options have the same underlying stock, the same strike price and the same expiration date. A short straddle is established for a net credit and profits if the underlying stock trades in a narrow range between the break-even points. Profit potential is limited to the total premiums received less commissions. Potential loss is unlimited if the stock price rises and substantial if the stock price falls.

Maximum profit:
Profit potential is limited to the total premiums received less commissions. The maximum profit is earned if the short straddle is held to expiration, the stock price closes exactly at the strike price and both options expire worthless.

Maximum risk:

Potential loss is unlimited on the upside, because the stock price can rise indefinitely. On the downside, potential loss is substantial, because the stock price can fall to zero.

Breakeven stock price at expiration:

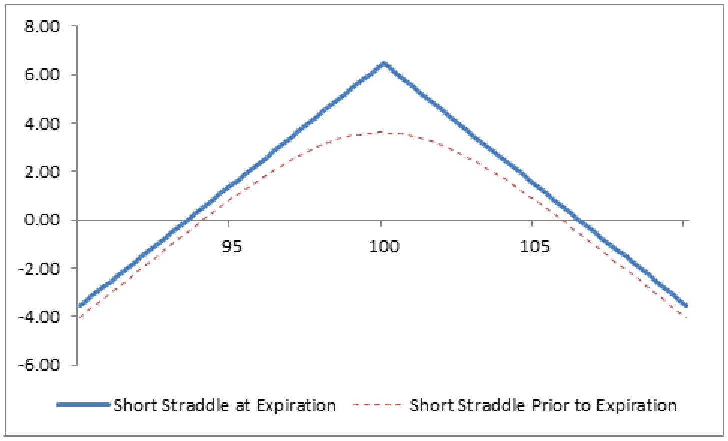
There are two potential break-even points:

1. Strike price plus total premium: $100 + $6.50 = $106.50
2. Strike price minus total premium: $100 - $6.50 = $93.50

[2] Short Straddle: https://www.fidelity.com/learning-center/investment-products/options/options-strategy-guide/short-straddle

<u>Table</u>: Short Straddle

Short 1 $100 Call	$3.30 or $330 (Covers 100 Shares)
Short 1 $100 Put	$3.20 or $320 (Covers 100 Shares)
Total Credit:	$6.50 or $650



P&L Diagram:

Stock Price at Expiration	Short 100 Call Profit/(Loss) at Expiration	Short 100 Put Profit/(Loss) at Expiration	Short Straddle Profit / (Loss) at Expiration
110	(6.70)	+3.20	(3.50)
109	(5.70)	+3.20	(2.50)
108	(4.70)	+3.20	(1.50)
107	(3.70)	+3.20	(0.50)
106	(2.70)	+3.20	+0.50)
105	(1.70)	+3.20	+1.50
104	(0.70)	+3.20	+2.50
103	+0.30	+3.20	+3.50
102	+1.30	+3.20	+4.50
101	+2.30	+3.20	+5.50
100	+3.30	+3.20	+6.50
99	+3.30	+2.20	+5.50
98	+3.30	+1.20	+4.50
97	+3.30	+0.20	+3.50
96	+3.30	(0.80)	+2.50
95	+3.30	(1.80)	+1.50
94	+3.30	(2.80)	+0.50
93	+3.30	(3.80)	(0.50)
92	+3.30	(4.80)	(1.50)
91	+3.30	(5.80)	(2.50)
90	+3.30	(6.80)	(3.50)

Short Strangle[3]

Example of short strangle	
Sell 1 XYZ 105 call at	1.50
Sell 1 XYZ 95 put at	1.30
Net credit =	2.80

Goal: To profit from little or no price movement in the underlying stock

Explanation:

A short strangle consists of one short call with a higher strike price and one short put with a lower strike. Both options have the same underlying stock and the same expiration date, but they have different strike prices. A short strangle is established for a net credit (or net receipt) and profits if the underlying stock trades in a narrow range between the break-even points. Profit potential is limited to the total premiums received less commissions. Potential loss is unlimited if the stock price rises and substantial if the stock price falls.

Maximum profit:

Profit potential is limited to the total premiums received less commissions. The maximum profit is earned if the short strangle is held to expiration, the stock price closes at or between the strike prices and both options expire worthless.

Maximum risk:

Potential loss is unlimited on the upside, because the stock price can rise indefinitely. On the downside, potential loss is substantial, because the stock price can fall to zero.

Breakeven stock price at expiration:

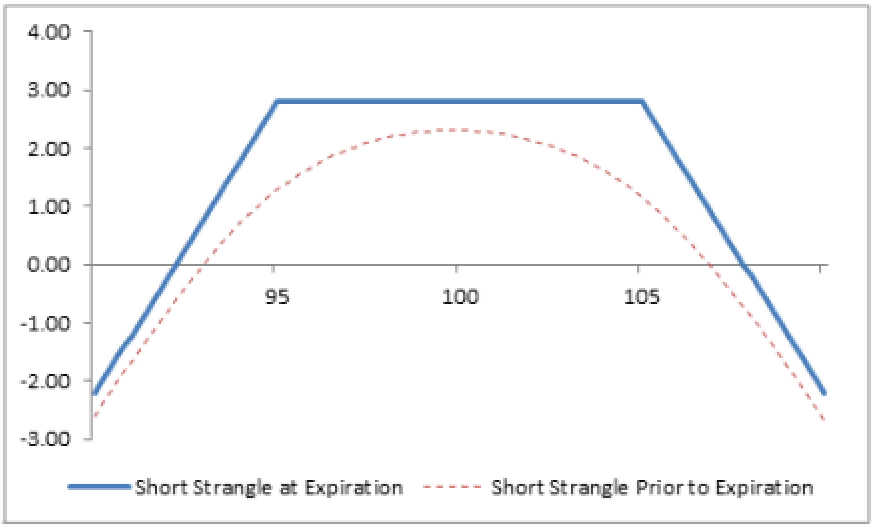
There are two potential break-even points:

1. Higher strike price plus total premium: $105 + $2.80 = $107.80
2. Strike price minus total premium: $95 - $2.80 = $92.20

Table: Short Strangle

Short 1 $105 Call	$1.50 or $150 (Covers 100 Shares)
Short 1 $95 Put	$1.30 or $130 (Covers 100 Shares)
Total Credit:	$2.80 or $280

[3] Short Strangle: https://www.fidelity.com/learning-center/investment-products/options/options-strategy-guide/short-strangle



P&L Diagram:

Stock Price at Expiration	Short 105 Call Profit/(Loss) at Expiration	Short 95 Put Profit/(Loss) at Expiration	Short Strangle Profit / (Loss) at Expiration
110	(3.50)	+1.30	(2.20)
109	(2.50)	+1.30	(1.20)
108	(1.50)	+1.30	(0.20)
107	(0.50)	+1.30	+0.80
106	+0.50	+1.30	+1.80
105	+1.50	+1.30	+2.80
104	+1.50	+1.30	+2.80
103	+1.50	+1.30	+2.80
102	+1.50	+1.30	+2.80
101	+1.50	+1.30	+2.80
100	+1.50	+1.30	+2.80
99	+1.50	+1.30	+2.80
98	+1.50	+1.30	+2.80
97	+1.50	+1.30	+2.80
96	+1.50	+1.30	+2.80
95	+1.50	+1.30	+2.80
94	+1.50	+0.30	+1.80
93	+1.50	(0.70)	+0.80
92	+1.50	(1.70)	(0.20)
91	+1.50	(2.70)	(1.20)
90	+1.50	(3.70)	(2.20)

One difference between a short strangle and a short straddle is that strangles allow a wider range for you to be profitable but will deliver less credit as a trade-off.

Short Iron Condor[4]

The two previous examples of strangle or a straddle are undefined risk trades meaning you must carry the margins to hold the positions. For smaller accounts, the next best thing to do is iron condors. It the same concept as the other two but you buy "protection" which caps your profits, but you are putting up less capital as a result of adding those legs.

Example of short iron condor spread	
Buy 1 XYZ 95 Put at 0.70	(0.70)
Sell 1 XYZ 100 Put at 2.10	2.10
Sell 1 XYZ 105 Call at 2.35	2.35
Buy 1 XYZ 110 Call at 0.95	(0.95)
Net Credit =	2.80

Goal: To profit from neutral stock price action between the strike price of the short options with limited risk.

Explanation:

A short iron condor spread is a four-part strategy. A short iron condor spread is established for a net credit, and both the potential profit and maximum risk are limited. The maximum profit is realized if the stock price is equal to or between the strike prices of the short options on the expiration date. The maximum risk is the difference between the prices of the bull put spread (or the bear call spread) less the net credit received. The maximum risk is realized if the stock price is above the highest strike price or below the lowest strike price at expiration.

Maximum profit:

The maximum profit potential is equal to the net credit received less commissions, and this profit is realized if the stock price is equal to or between the strike prices of the short options at expiration. In this outcome, all options expire worthless and the net credit is kept as income.

Maximum risk:

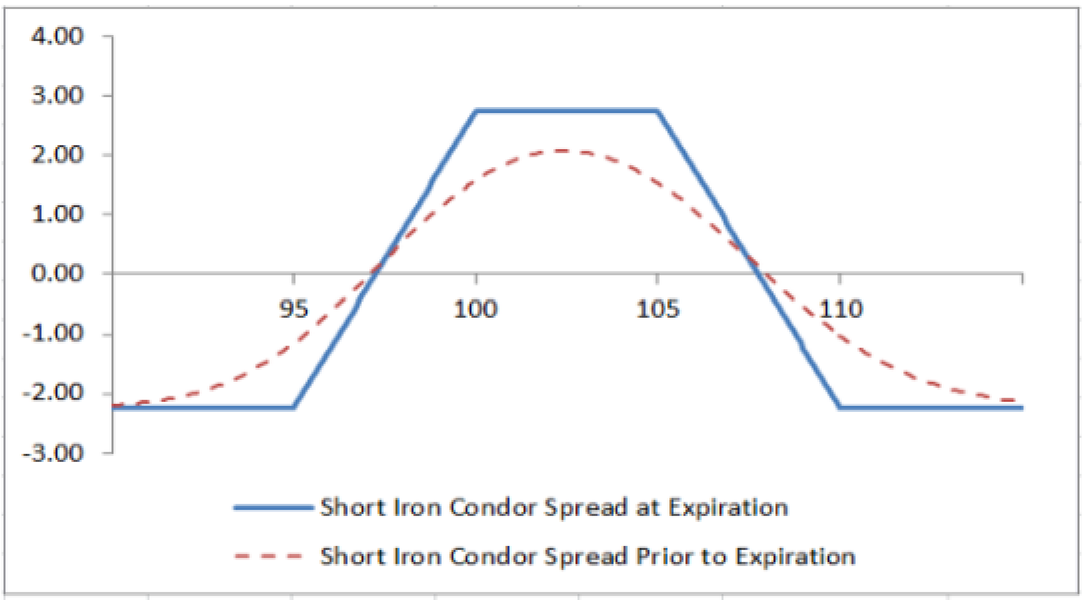
The maximum risk is equal to the difference between the strike prices of the bull put spread less the net credit received. In the example above, the difference between the strike

[4] https://www.fidelity.com/learning-center/investment-products/options/options-strategy-guide/short-iron-condor-spread

prices of the bull put spread is 5.00, and the net credit received is 2.80, not including commissions. The maximum risk, therefore, is 2.20.

Table: Short Iron Condors

Buy 1 $95 Put	($0.70) or $70 cost
Sell 1 $100 Put	$2.10 or $210
Sell 1 $105 Call	$2.35 or $235
Buy 1 $110 Call	($0.95) or $95 cost
Total Credit:	$280



Stock Price at Expiration	Long 1 95 Put Profit/(Loss) at Expiration	Short 1 100 Put Profit/(Loss) at Expiration	Short 1 105 Call Profit/(Loss)at Expiration	Long 1 110 Call Profit/(Loss) at Expiration	Net Profit/(Loss) at Expiration
115	(0.70)	+2.10	(7.65)	+4.05	(2.20)
110	(0.70)	+2.10	(2.65)	(0.95)	(2.20)
105	(0.70)	+2.10	+2.35	(0.95)	+2.80
100	(0.70)	+2.10	+2.35	(0.95)	+2.80
95	(0.70)	(2.90)	+2.35	(0.95)	(2.20)
90	+4.30	(7.90)	+2.35	(0.95)	(2.20)

Analysis:
We can see that because there are "legs" on this trade, you're capping maximum gains but also reduce risk because they offer protection outside of your range. Your maximum gains would be within the $100-105 range where you will be credited a total of $280.

Keep in mind that with playing any of these three options, make sure you have "Spreads" enabled on Robinhood, or make sure you're eligible to sell calls or puts in your current Level on any other trading platform.

Playing Naked Contracts on Earnings

This portion of the guide is where gambling addicts get excited. When playing earnings with naked calls or puts, you can either make a ton of money or lose your entire contract premium. Keep in mind that it is not recommended to play earnings with naked contracts if you don't know what you're doing or if you want to steadily build a portfolio.

This section is for those who are willing to risk their money on options plays.

Let's say you make a prediction on a play of a stock going up or down after earnings. If you were to do this, it would be a smarter move to buy an ITM contract weeks before earnings so you can collect premium leading up to its earnings report. You can sell right before the ER so you can take profits.

If anything, we will list a couple of things that one should <u>not</u> do when playing earnings.

1) **Buying out-of-the-money naked contracts with same week expiration**
2) **Holding contracts through earnings if you have a weak heart**
3) **Ignoring risk management**
4) **Don't gamble if you aren't willing to take the loss**

#1: Most contracts expire worthless, while there is a chance you might profit from #1, it is highly not recommended due to theta & IV working against you.

#2: There's no point in risking your profits if you have a low tolerance for risk. There's a chance you might profit but when things do go bad, there's nobody else to blame but yourself.

#3: Just because its earnings and you're feeling lucky does not mean you should throw your principles out the window, proceed with caution and remain on high alert even if you are in a winning position. Things can hit the fan real fast if you aren't careful

#4: Similar to number two. Maybe you've been on a winning streak and you think playing earnings will 200% your portfolio. You can go right ahead but you should also consider the consequences.

When to Exit Earnings Trades

Let's say that the stock does open in your favor (whether you are longing or shorting it). Its right after earnings and your P&L is **+65%.** What should you do?

The short answer is "take profits" if your trade hit your target. Whether your target is; % profits, % loss, a certain price level, or even one of the Fibonacci levels, you need to be comfortable with exiting.

Like always, have an exit plan ready before you enter in a trade. One of the most disappointing things a person can experience in trading options is exiting too early. Keep in mind that it is nearly impossible to enter in and exit at the perfect times, so selling early may feel bad but money is money.

Earnings Adjustments [Post-Earnings]

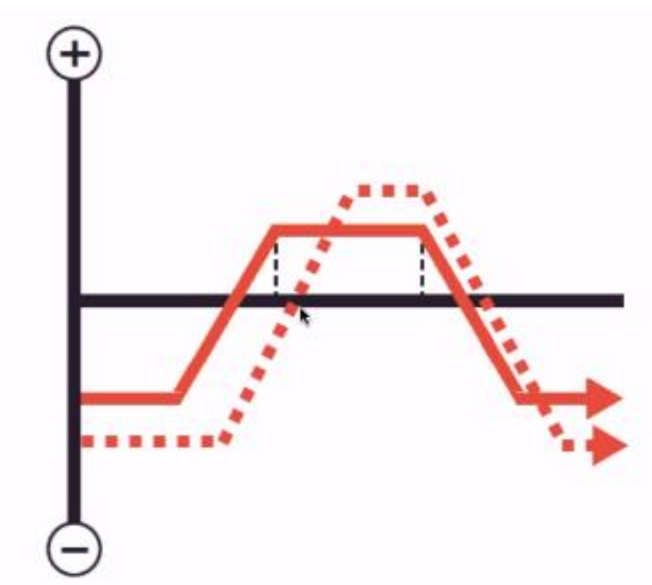
You've made a great earnings trade but what happens if the company gaps much higher or lower than the expected move that you planned for?

Unfortunately, stocks will inevitable move outside the "expected range" and we must be smart about how we adjust or hedge these positions post-earnings. When this eventually happens (and it well many times over the course of your career) you need to have a game plan in place to adjust the trade and reduce risk.

The first thing we must recognize is that when this happens, we are now playing *defense* and the goal is to <u>reduce risk</u> **FIRST**.

2-Step Process:

1) Roll the challenged side to the next monthly contract (keeping the strikes the same)
2) Move un-challenged side close to the new stock price and take in a big credit.



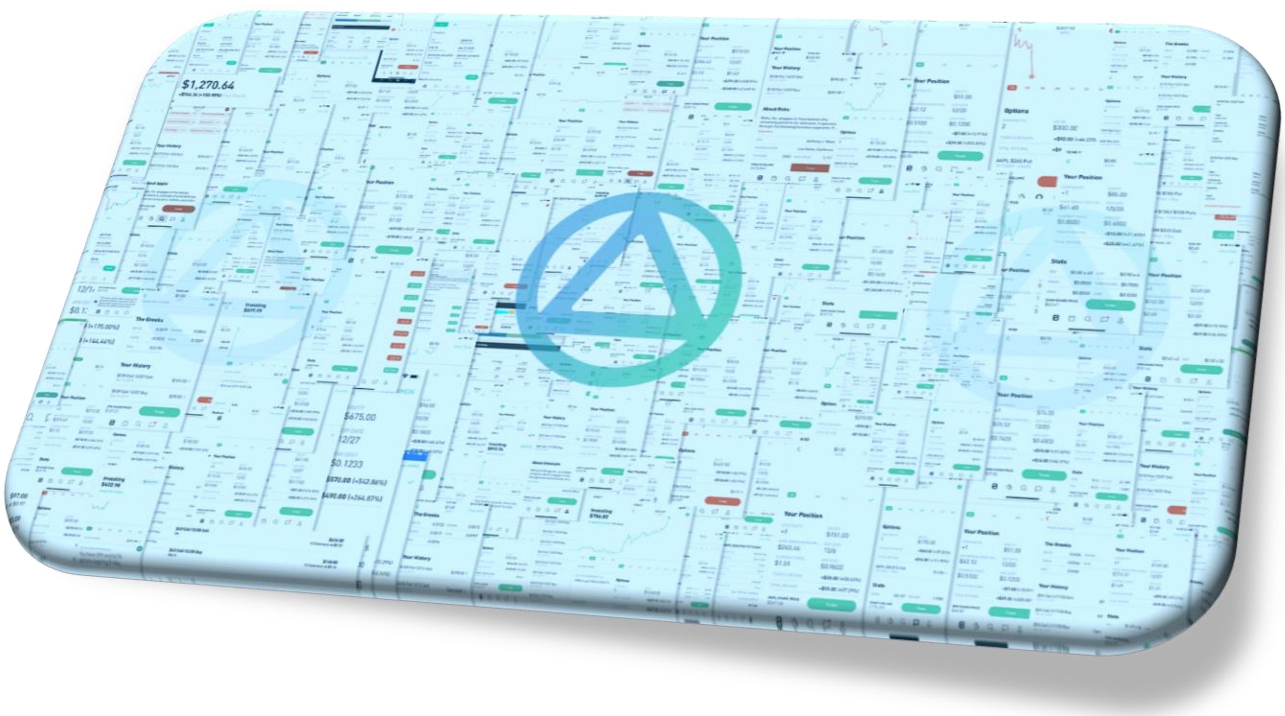
This is for plays that expected maybe a 3-7% move but actually moved an substantial amount like 8-15% after earnings.

Hopefully, by rolling over to the new stock strike price, you allow yourself more room to play with and take in more credit. We don't want to change the strike price in case the stock price moves back closer to your original strike.

Conclusion

This PDF may seem very confusing for newer members, but the end goal for AION Trading is to advance people from playing basic naked contracts to playing strategies. Over the long run, it is essential to learn and develop more skillsets in options because you might be able to sell premiums and make "passive" money while using most of your portfolio for active investing. If anyone has any questions, feel free to reach out to any of the admins or mods for help.

Anyone interested in more guides? Feel free to ask in #suggestions channel. We can include specialized guides for beginners as well. (How to trade spreads on Robinhood, etc…)



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