

While looking at the broader index (SPX) you can see that the market is “overbought” and that gives way to caution. We must also recognize that in the past the market has been oversold and overbought and remained in that state for some time. We never want to base the trade on one indicator or one piece of data. Rather, we want to incorporate multiple indicators and data that allow an informed decision to be made.



One other piece of important data to consider is that we are in the summer months and the old adage of sell in May and go away has merit. Volume is waning in the markets and volatility is at multi-month lows. In fact, with the volatility being so low it is almost seen as a contrarian indicator that complacency is in the market.

Remember, VIX is calculated directly from the price quotations of nearby and second nearby S&P 500 Index options spanning a wide range of strike prices. The VIX calculation is independent of any theoretical pricing model, using a formula that averages the weighted prices of at-the-money and out-of-the-money puts and calls to derive expected volatility. The goal is to estimate the implied volatility of the S&P 500 index over the next 30 days.

With the current reading of 24 on the VIX we can assume that there is a 68% likelihood (one standard deviation) that the magnitude of the S&P 500's 30-day return will be less than 6.92% (up or down).

One might be greedy and try to sell options within the volatility range but we do not want to fall victim to that zero sum game.

Our recommendation for the strikes to focus on for August expiry are as follows:

RWO Model Portfolio Trade		
Sell the August 1020/1030 calls and the August 850/840 puts for a net credit of \$1.90 or better		
Parameter	Calls	Puts
Break-even levels	\$1021.90	\$848.10
Probability of touching	27.40%	17.82%
Probability of expiring	85.36%	91.63%
Net Delta is -12.41		
Theta is 63.76		
Max risk is \$8.10 per contract with an estimated 81% probability of the whole trade expiring within our safe-zone.		

