Market Crash (July2007)

By ShareTradingSchool.com

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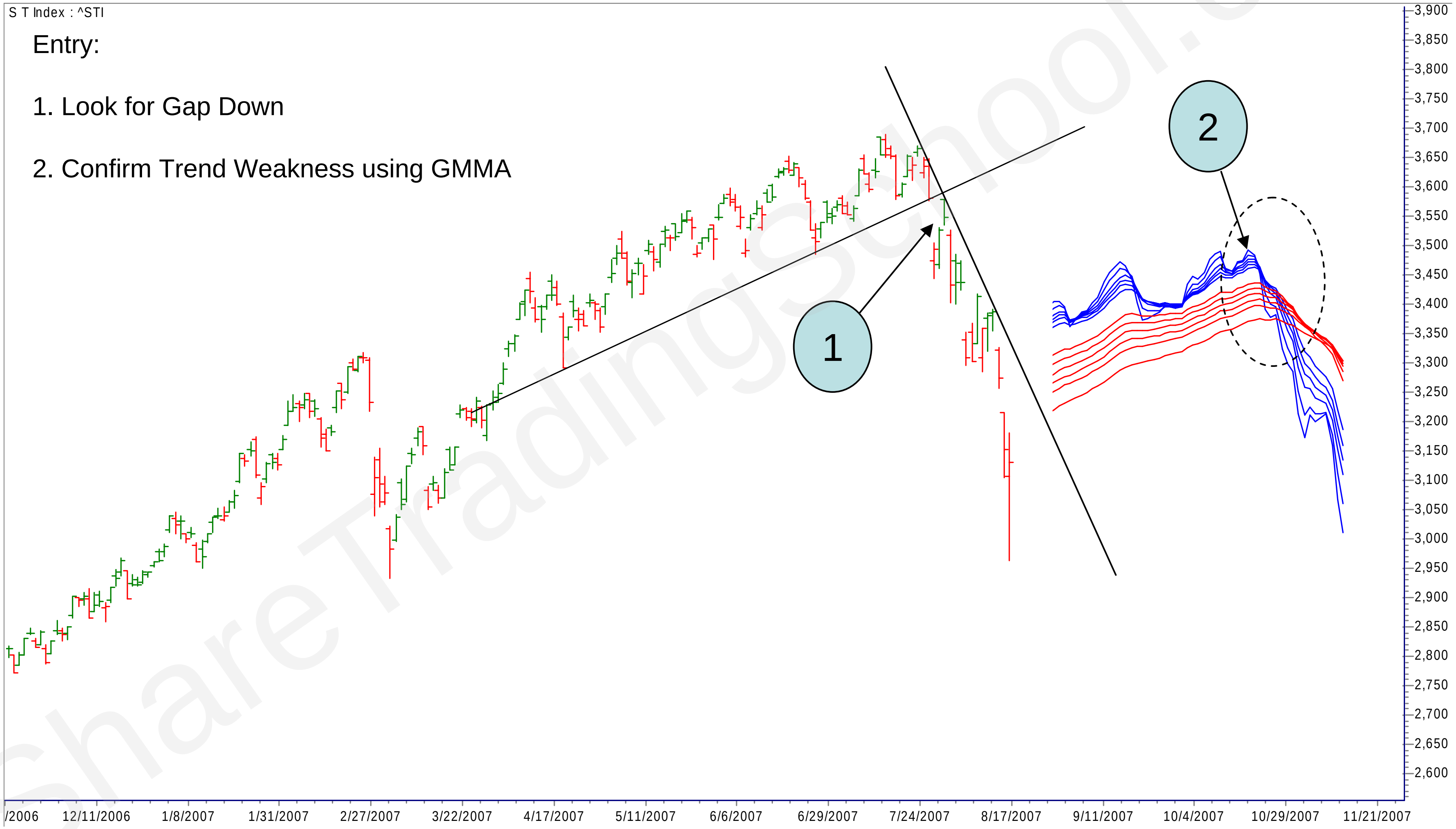
A Conservative "Put" Trading Strategy for EOD Traders



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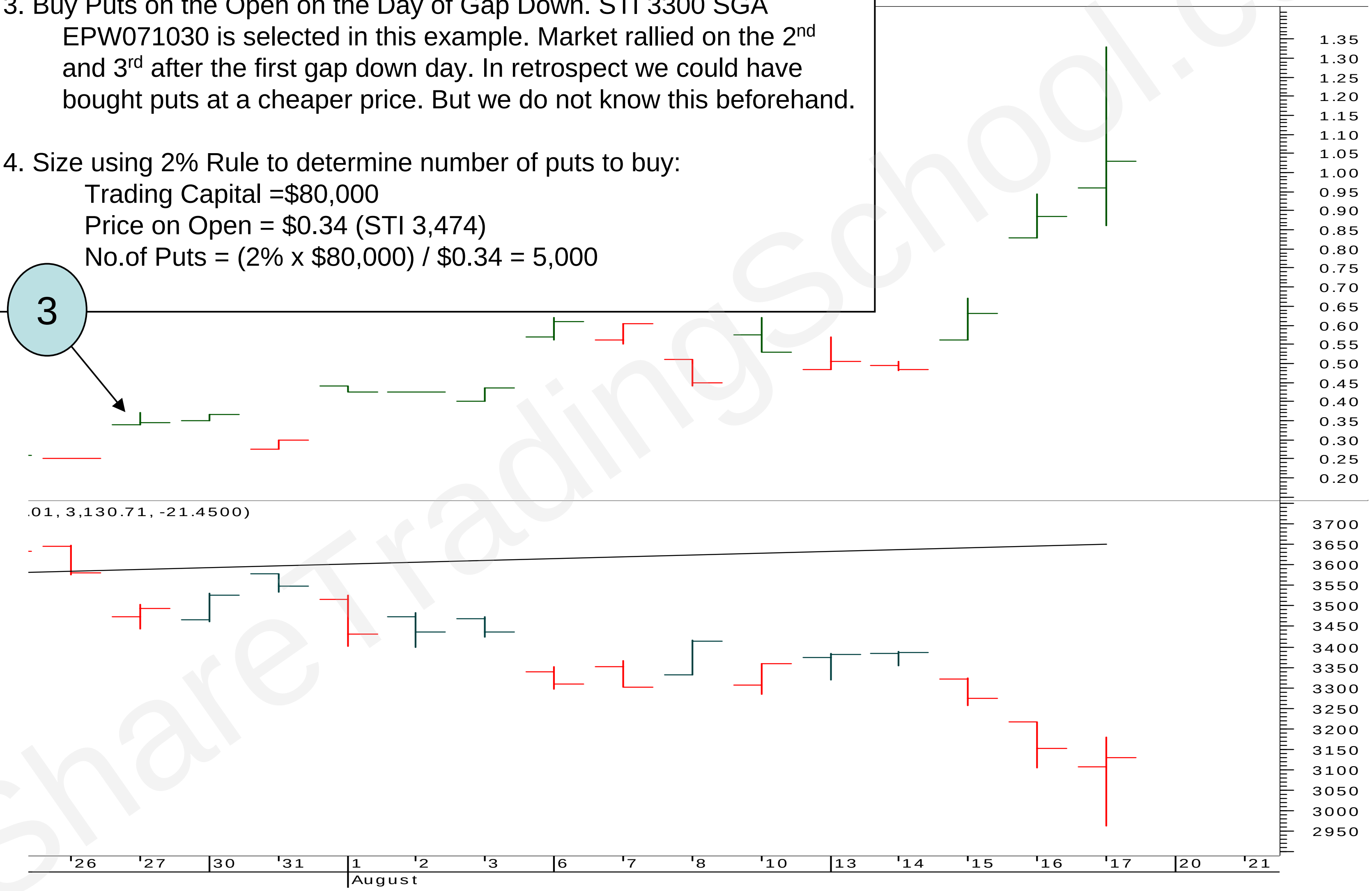
3. Buy Puts on the Open on the Day of Gap Down. STI 3300 SGA EPW071030 is selected in this example. Market rallied on the 2nd and 3rd after the first gap down day. In retrospect we could have bought puts at a cheaper price. But we do not know this beforehand.

4. Size using 2% Rule to determine number of puts to buy:

   Trading Capital =$80,000

   Price on Open = $0.34 (STI 3,474)

   No.of Puts = (2% x $80,000) / $0.34 = 5,000



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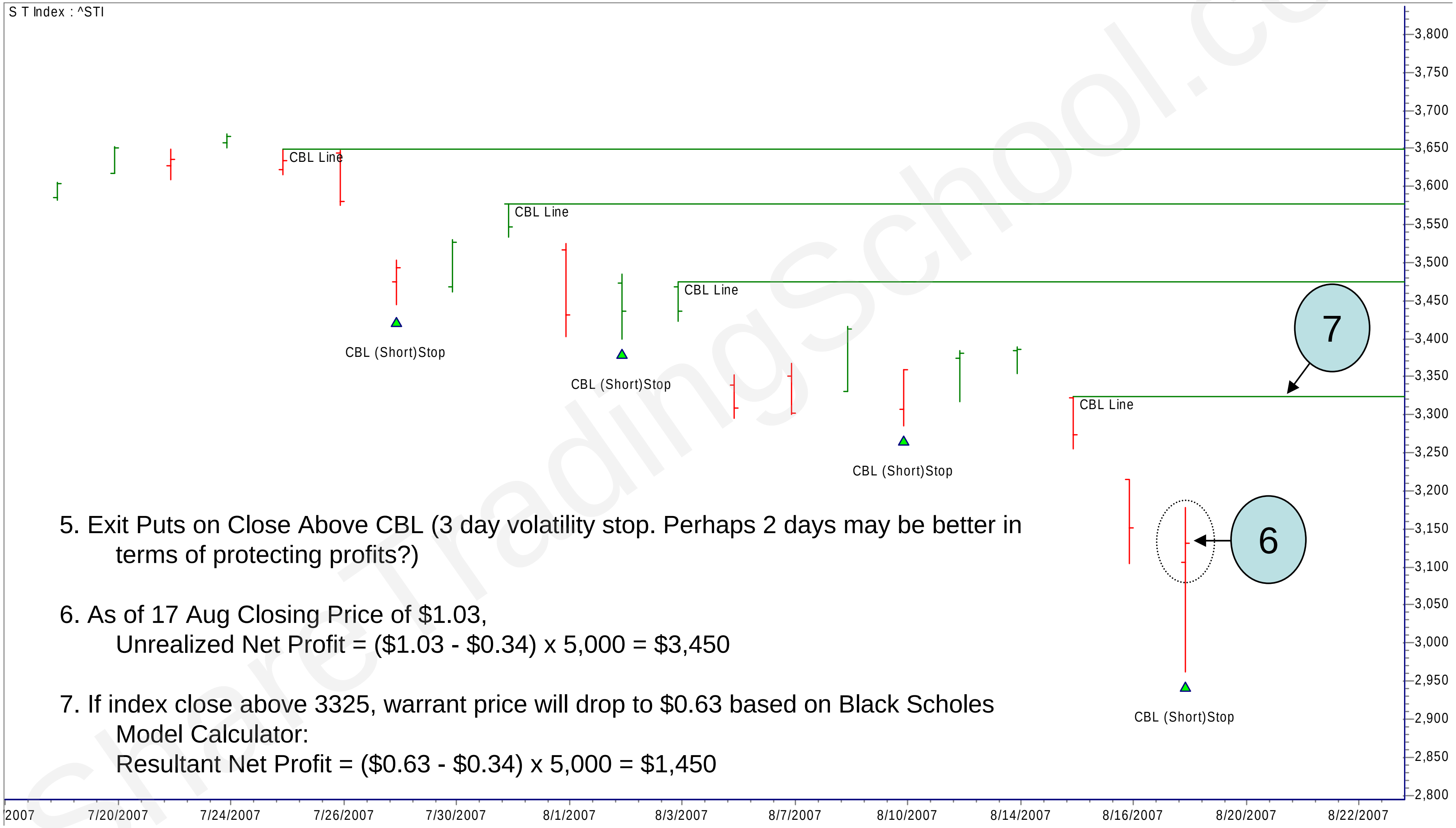

5. Exit Puts on Close Above CBL (3 day volatility stop. Perhaps 2 days may be better in terms of protecting profits?)

6. As of 17 Aug Closing Price of $1.03,
   Unrealized Net Profit = ($1.03 - $0.34) x 5,000 = $3,450

7. If index close above 3325, warrant price will drop to $0.63 based on Black Scholes Model Calculator:
   Resultant Net Profit = ($0.63 - $0.34) x 5,000 = $1,450

A Conservative Strategy – Comparing Performance Using Different Puts

Trading Capital	$ 80,000.00	
% Risk	2.00%	
Dollar Risk	$ 1,600.00	
Entry Date	27-Jul-07	First Gap Down Day
STI Index Open on Entry Date	3,474	

Reward vs Risk > 3

Puts	Entry Price	Position Size	Last Close	Un-Realized Profit	Reward/Max Risk	Time to Expiry (mths)	ITM/OTM	Comments
STI 3500BNPePW070830	-	-	-	-	-	1	ITM	No Volume. Need to trade with Market Maker
STI 3300BNPePW071030	-	-	-	-	-	3	OTM	Not Yet Listed on 27Jul07
STI 3300BNPePW071129	-	-	-	-	-	4	OTM	Not Yet Listed on 27Jul07
STI 3300DBePW070831	$ 0.050	32000	$ 0.430	$ 12,160.00	7.60	1	OTM	
STI 3450SGAePW070830	$ 0.250	6400	$ 1.580	$ 8,512.00	5.32	1	OTM	
STI 3300SGAePW070830	$ 0.160	10000	$ 0.965	$ 8,050.00	5.03	1	OTM	
STI 3000DBePW070928	$ 0.035	45714	$ 0.205	$ 7,771.43	4.86	2	OTM	
STI 3400SGAePW071030	$ 0.295	5424	$ 1.520	$ 6,644.07	4.15	3	OTM	No Vol on 27Jul07. Trade with Market Maker
STI 3500SGAePW70927	$ 0.405	3951	$ 1.530	$ 4,444.44	2.78	2	ITM	
STI 3600BNPePW070830	$ 0.275	5818	$ 0.980	$ 4,101.82	2.56	1	ITM	
STI 3600SGAePW70830	$ 0.450	3556	$ 1.460	$ 3,591.11	2.24	1	ITM	
STI 3300SGAePW071030	$ 0.340	4706	$ 1.030	$ 3,247.06	2.03	2	OTM	
STI 3400SGAePW070927	$ 0.370	4324	$ 1.080	$ 3,070.27	1.92	2	OTM	
STI 3500BNPePW071030	$ 0.315	5079	$ 0.900	$ 2,971.43	1.86	3	ITM	No Volume. Need to trade with Market Maker
STI 3600SGAePW70927	$ 0.660	2424	$ 1.830	$ 2,836.36	1.77	2	ITM	
STI 3500SGAePW71030	$ 0.560	2857	$ 1.530	$ 2,771.43	1.73	3	ITM	
STI 3400BNPePW071030	$ 0.230	6957	$ 0.610	$ 2,643.48	1.65	3	OTM	Not Yet Listed on 27Jul07
STI 3400 DBePW071031	$ 0.285	5614	$ 0.720	$ 2,442.11	1.53	3	OTM	No Vol on 27Jul07. Trade with Market Maker
STI 3500BNPePW070927	$ 0.305	5246	$ 0.680	$ 1,967.21	1.23	2	ITM	
STI 3700BNPePW070830	$ 0.480	3333	$ 1.070	$ 1,966.67	1.23	1	ITM	
STI 3600SGAePW71030	$ 0.785	2038	$ 1.590	$ 1,640.76	1.03	3	ITM	
STI 3600BNPePW071030	$ 0.500	3200	$ 0.785	$ 912.00	0.57	3	ITM	
STI 3320BNPePW070927	$ 0.430	3721	$ 0.620	$ 706.98	0.44	2	OTM	

Put warrant as per example in the slides

OTM – Out of the Money
ITM – In the Money

Conclusion

- Puts that offer price leverage provided the best returns as well as reward vs risk. Max risk is limited to 2% of total trading capital. This means even if the warrant prices expire only 2% of total trading capital would be lost.
- However puts that offer the biggest price leverage could be closer to their expiry dates.
- These puts are also not in the money when the market crash started. This means warrants that are out of the money and offer price leverage should be considered when deciding which puts to buy.
- Puts that are in the money during the initial gap-down does not necessarily give you the best returns.
- Warrant performance varies depending on who is the warrant issuer. Example: SGA warrants are more reactive as compared to BNP warrants with the same expiry date hence able to provide better returns (STI3400 BNP vs SGA).