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Options Earnings Primer

Author: Steven Place
Contact:
steven@stocktwits.com
[@stevenplace](#) on twitter

Why Follow Earnings?

When a stock reports earnings, there is risk that there will be a structural change in the underlying stock, whether it be fundamental or sentimental. The options market tries to price in this risk into the event. By measuring options premium, we can gauge how large of a move the market is expecting.

About InvestingWithOptions

IWO is an options trading service that offers fresh ideas and setups to traders and investors. We take advantage of market volatility and technical structure to gain an edge in the market.

IWO offers a live chat room during trading hours, detailed video setups every weeknight, and fresh setups for both swing and intraday traders. There is also an educational component that offers an in depth look into how to better trade stock options.

About EarningsTrades.com

EarningsTrades.com is an online video course that will teach you how to profitably trade options around a corporate earnings event. The 6-hour course goes deep into detail about what to look for and exactly what situations can be exploited in the market. Risk management is discussed in detail, as well as tradeoffs between strategies.



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Introduction

As the market continues to run higher (and volatility lower) into October, investors are looking forward to earnings season as to determine whether the global growth story rings true on the corporate side. The liquidity based rally, highly correlated in the dollar, has left many wondering whether there has been a divergence in the markets and economy or whether this quarter will confirm expectations.

Alcoa officially ushered in earnings season last week with a beat and a strong upside move, and materials stocks have been rewarded in kind. This week we will see other sectors weigh in, including rail, semis, financials, and tech. This week is especially important as INTC has been a major bellwether in the markets, as the gap up from July of 2009 helped to accelerate the market to fresh 52 week highs. It was also the reversal in April 2010 that has marked the highs of this year.

There may be dark clouds on the horizon. This past week EQIX warned on a drop in revenue that cut the stock by a third and caused the rest of the cloud space to suffer. This point alone shows that if crowded, high momentum names do not satisfy investors, a positive feedback loop could occur as selling begets selling.

This week offers special opportunities to specific names. Options expiration comes this week, which makes analyzing expected moves much easier. Furthermore, large differences can occur in front month premiums compared to back month premiums, which is exploitable by the advanced options trader.

How to Use this Table

The table indicates the day of the report, the current trends, and two data points: the average gap and the expected move. These are in absolute numbers, but be aware that certain stocks will be more volatile on a relative basis. Generally, if the expected move is higher than the average gap, the options market is pricing in a move larger than historically. The opposite can happen. This table is one piece of data in a very large puzzle needed to create an earnings trade thesis.

Table Legend

A trading system based solely off these readings does not make sense. The best way to use this table is to synthesize your current views of the stock and structure option trades around that thesis.

Ticker

The ticker symbol of the underlying company.

Time

Whether earnings are released after market close (AMC) or before market open (BMO).

Trend

Simple technical analysis to determine where the trend currently sits on two different timeframes.

Avg Gap

The average gap that the stock has after it reports earnings.

Ex Move

The expected move as indicated by the options market. This is derived from examining past earnings events as well as current implied volatility on near term options.

Date	Ticker	Time	LT Trend	IT Trend	Avg Gap	Ex Move
12-Oct	CSX	AMC	Neutral	Up	1.5	2.2
	INTC	AMC	Neutral	Down	0.65	1
13-Oct	APOL	AMC	Down	Neutral	4.81	3
	ELN	BMO	Neutral	Up	N/A	N/A
	JPM	BMO	Neutral	Neutral	0.93	1.5
14-Oct	GOOG	AMC	Neutral	Up	23.2	23.65
	AMD	AMC	Neutral	Neutral	0.47	0.44
	MTG	BMO	Neutral	Up	0.4	0.8
	SWY	BMO	Neutral	Neutral	0.53	1

Comments

APOL will be an interesting event. The stock has suffered from legislative changes in the for-profit education sector, but many stocks in that area have seen a strong short squeeze as of late. The options market could be undervaluing this move.

ELN was included but there are other risks besides earnings. There are corporate governance issues, as well as risk on Novartis pricing. Friday saw over 2800 Oct 6 call options traded, many of them bought. There was enough open interest to indicate that this was potentially a closing order, but it was very bullish action in the short term.

There is always an opportunity in trading **GOOG** earnings. The front month volatility into the event always is elevated relative to the back month options, so double calendars may be a good trade going into Thursday's close.

Final Notes

This is the first issue of EarningsPrimer, and feedback is very welcome. Any comments, criticisms, or suggestions can be emailed to steven@stocktwits.com

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The photo "New York at Night" was taken by Rafakoy and can be viewed here: <http://www.flickr.com/photos/altamiranopics/4549751630>