

Title: Risk = Reap or Rip

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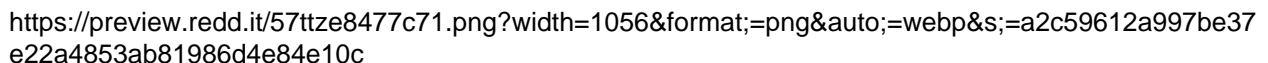
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Hi everyone,

I wanted to share with you my process of choosing which options to trade around earnings. I am mainly on the buy side here, so very risky with time decay and iv playing against you, but the hope is to catch tail events that are outside the market expectation already priced in.

I pick the stocks from the recommendations of my ML model ([this](https://www.reddit.com/r/EarningsWatcher/comments/om71bf/biggest\_expected\_moves\_this\_week\_after\_earnings/) post). This used to be a model trying to predict high movement (more than +/-5%) and I refined it to actually predict when the movement is more than "what the market expects". This is usually derived from the break even of the options prices, and that I approximate to be the average of the movements around the last five releases plus 1.95 times std (basically miming a gaussian if you're familiar with that). The model outputs a list of stocks that should outperform this value and so beat the market (update coming soon on this btw). For this week, we have \$AAL \$HON and \$NEE. Let's continue with AAL.

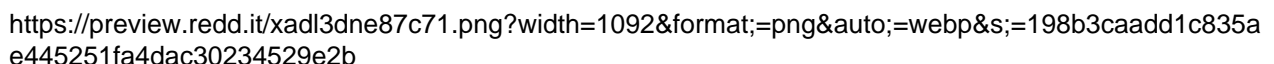
Then I use [earnings-watcher.tech](https://earnings-watcher.tech) (hosted version of my model) to make some projections. The average historic movement of 6% with a distribution of movements (absolute value) that looks like this

https://preview.redd.it/57ttze8477c71.png?width=1056&format;=png&auto;=webp&s;=a2c59612a997be37e22a4853ab81986d4e84e10c

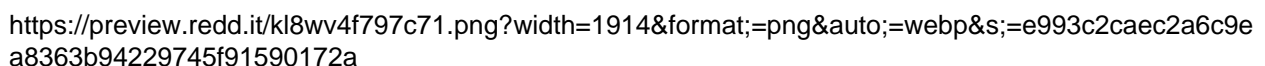
We actually like this type of histogram because of the fat tail we see on the right, and that's what we will be betting on. Lets make some projections about the expected movement based on this

conservative = +/-4%	ideal = +/-10%	wow = +/-20%
range = (19.2\$, 20.8\$)	range = (18\$, 22\$)	range = (16\$, 24\$)

Now, let's look at different options combinations. We are mostly interested in the movement of the stock, with no preference for direction, so we will be choosing strangles. I automated scrapping options prices to get this summary

https://preview.redd.it/xadl3dne87c71.png?width=1092&format;=png&auto;=webp&s;=198b3caadd1c835ae445251fa4dac30234529e2b

We see that the price per contract decreases a lot as we go further in the money, but so does the break even. Using [optionstrat.com](https://optionstrat.com), we can estimate gains and losses from these plays. We have to account for the severe IV crush that happens after the release, and that will make our options loose most of their value if they're not in the money. The closer to the money the strangle is, the higher your chances of recouping some of what you payed for, but then your gains are also lower in case of a tail event (same for further expirations). We can see this in the next graph

https://preview.redd.it/kl8wv4f797c71.png?width=1914&format;=png&auto;=webp&s;=e993c2caec2a6c9ea8363b94229745f91590172a

Based on this, I made this recap of gains/loss estimates

strangle	price / 1 contract	break even	gains at +/-20% move
19p / 20c	70\$	+/-8%	+300%

|18p / 22c|25\$|\+/-12%|\+600% |

My strategy here is to pick the riskiest play for each of the recommended stocks, and usually one tail event makes enough profits to compensate for the other losses, so I picked the 18p/22c and fingers crossed for at least a +/-11% move. Basically if no tail I lose small, if tail I win big, sort of like a vc investing in start ups.

Hope this helps and happy to discuss more!