

# Using Options to Set Up Huge Profitability Ranges in SPY with Jade Lizard Strategy

Many of you reading this have probably never sold or traded an option in your entire investing tenure. And most probably are still fighting the dogma you have been force fed about options being weapons of mass destruction. Or that options are much more risky than stock. Or that options are purely for speculation and offer huge amounts of leverage.

When in fact the original creation of the options market was for that of risk transfer and mitigation. Meaning you can and in my opinion should be using options to reduce your risk in the financial markets. My favorite two strategies for beginners are the [short cash secured put and the covered call](#) (link to a guest post I wrote for Financial Samurai). You can also read about a post I wrote on the [covered call here](#). The reason I love these two strategies is that they give you the ability to reduce your cost basis, increase your probability of profit, and give you more than one way to profit.

There is another type of option selling combination that I am very fond of in higher volatility environments. I actually wrote about this for the first time [here](#). Until recently I didn't really have a name for this strategy. But recently I saw the guys over at [TastyTrade](#) calling this a "**Jade Lizard**." A Jade Lizard is an option strategy established by combining a short call spread with the sale of a naked put.

The reason I love this strategy is due to the fact that it is neither bullish nor bearish, but instead creates a huge range of profitability, while at the same time giving you zero to very little risk to the upside (beyond your breakeven). And as a kicker, should the market correct really hard you are locking in a price that you would not mind getting long well below the current price of the market, as you will see in a moment.

According to TastyTrade, a Jade Lizard should be constructed to have zero upside risk. In this instance I had that opportunity but decided to take on a little risk to the upside for a bit more downside protection, as I am personally bearish 2016 price

action.

## Details & Visuals of the Option Strategy

**The Trade:** Sold 1 January 2017 195/225 callspread @ \$11.74 & Sold 1 January 2017 \$194 put @ \$16.60 for a total credit of \$28.34 (\$2,834 in total premium collected). When I placed the order the SPY was trading at \$194.44.

Below you can visually see the area of profitability as well as both the upside and downside break even points (makes money anywhere between the yellow lines):



**Break-even Points:** \$165.66 & \$223.38 (includes commissions). This represents a +/- 15% range from the market price at the time of the order of \$194.44 (or almost a \$58 price range)

Based on the break-even point to the upside that still allows the SPY to finish up approximately 9.5% on the year (based on a 2015 closing price of \$203.87), the risk to the upside is capped due to the purchase of the \$225 call (within the callspread).

**Upside Max Loss:** The max loss is \$166 to the upside (includes commissions). I was willing to take a little risk to the upside in order to get more downside protection. This position starts to lose money at \$223.39 (9.5% higher than 2015

closing price of \$203.87), but is capped at \$225.

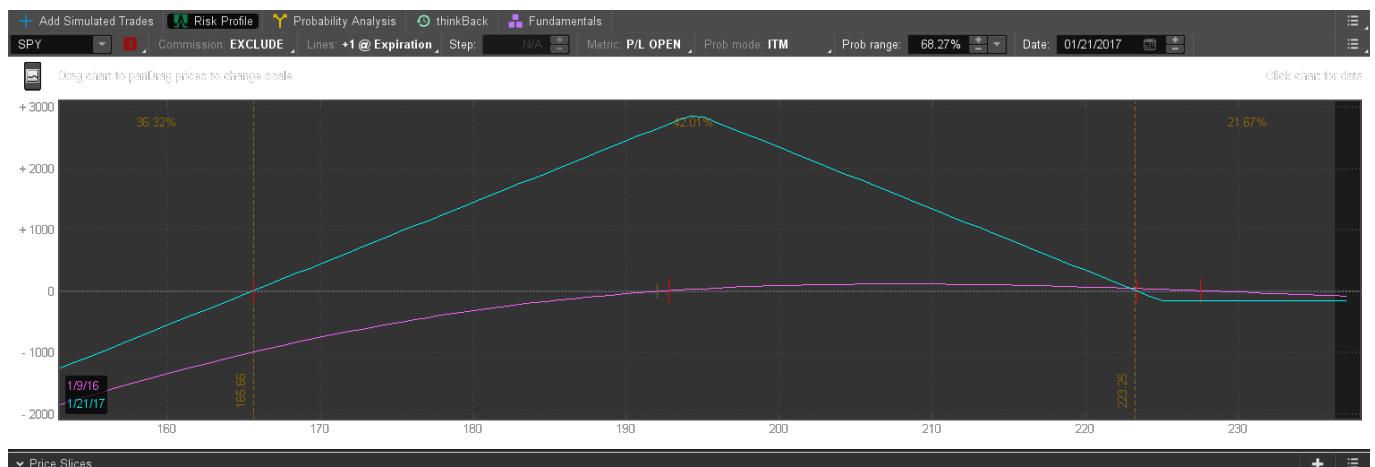
**Downside Max Loss:** The max loss to the downside is theoretically \$16,566, but that would mean the ETF goes to zero. I am not concerned with the downside on this, because I am comfortable owning the ETF at \$165.66 if exercised and forced to take possession (this price reflects a 23% correction from the all-time high of \$213.78 set on 5/18/15).

**Profit Zone:** Anything Greater than \$165.66 and Less Than \$223.38.

**Max Profit:** \$2,834 with SPY @ ~\$194.50

[Let's take a look at the risk profile of this particular trade set up:](#)

The blue line below represents the risk profile of this position and you can see the profit based at different closing prices for SPY at expiration.



## Conclusion

I think 2016 is going to be flat at the **BEAR (play on words)** minimum to down 10% or more. Obviously no one actually knows when the market will finally correct, but we are going on 7 years now and signs from all over the place are pointing to weakness, at least from my vantage point.

This type of strategy allows you the ability to eliminate FOMO (fear of missing out), but still giving you a large margin of safety. I think it would be a surprise to most if 2016 went on to make new all-time highs...and even more surprising if it moves up double digits in percentage terms. If the bull market was just getting started I likely

would not be putting this trade on, instead I would just be selling naked puts.

In all honesty I hope the market not only touches my downside breakeven of \$165.66, but I hope it goes on to trade even lower than that. This will only present way more opportunities to sell inflated option premium and get long equities at bargain prices. Until the next cycle I will be hoarding cash and using this strategy as a way to get paid while we wait for the market to resolve itself.

This position does the best if the market stays flat.

The reality of this strategy is that it makes money whether the market goes up, down, or trades sideways (**and that is a beautiful thing**).

And before I sign off I would like to provide a little more context and support coming from the options market that the expectation is for a down year. The probability of the SPY touching \$165 is 60%, where the probability currently priced into the options market for the SPY to touch \$225 is only 26%.

Some people paint by numbers, I prefer to trade by numbers (i.e. probabilities).

-Gen Y Finance Guy



## Gen Y Finance Guy

**Hey, I'm Dom** - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own [financial stats](#). I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a

beacon of hope, motivation, and inspiration for *you*, the reader, by living life by example and sharing it **all** here on the blog. My sincere hope is that you will be able to learn from me - both from my successes and my failures! [Read More](#)