Yield Cashflows on your portfolios, without selling out.

An options writing strategy, to generate an additional cash-flow of 5-9% per annum on existing Stocks / Bonds / Mutual Funds Portfolios / Fixed-Deposits.

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Process

You shall keep your Shares/Mutual Funds/Fixed Deposits as collateral against which a margin amount of upto 80% of the value of your portfolio shall be released for trading in the Derivatives Segment. This margin released will be used for writing index options (Nifty options) & taking hedging positions. The writing of options aims at yielding cashflows out of the time-value decay & mis-pricing due to shorter term volatility & hedging positions are taken to control risks of writing options. The extent of cash-flows can be expected to be in the range of 5-9% per-annum on the margin amount.

Principles of writing options

The principle thought supporting this cash-flow generation strategy is to assess what is not likely to happen in a given time period, and monetise by selling the probabilities of unlikely events. To put it simply, This strategy of writing options is akin to working of an Insurance company. It collects small premiums to compensate for few but much larger payouts towards uncertain events. These Insurance companies are profitable because of statistical probabilities, likewise is the case for options writing.

Methodology

Writing of options is based on the phenomenon of higher occurrences of smaller profits & extremely low occurrences of larger losses. This makes it extremely crucial to manage your risk rightly in order to minimise the extent of losses when they occur. In order to manage risks we implement a very methodical approach to build an options writing position. Also, this methodology has an open ended ability for the client to choose his risk preference and accordingly try to achieve a Risk/Return matrix.

3 crucial components of this options writing strategy's methodology are as below:

1. Position Sizing
2. Option Type, Contract Expiry & Strike Price
3. Risk Management

1) Position Sizing

Based on the margins available the maximum number of options contracts that can be written are ascertained. After which, this is divided into 4-6 equal sets of positions that are taken spanned across a months time frame, this enables time-scape diversification. 3 major factors that are taken into consideration for deciding the size of each set of quantity are as follows:

a. Implied Volatility
b. Impending global news
c. Upcoming economic events

2) Option Type, Contract Expiry & Strike Price

This strategy consists of writing both the call and puts of near and further months, of strike prices mandatorily beyond 5% from the spot in any case. However, the decisions to choose the right strike prices (beyond 5% distance from spot), option type, strike price & contract expiry are based on a proprietary 4 factor quantitative model that uses Trend (Direction/Strength & Age) , Standard Deviations, Option Greeks & Implied Volatility. To quote an example of the usage of these decision principles, we would sell further off strikes with a certain degree of increase in IV's (Implied Volatility) and if the IV expands beyond a threshold shift to the next months contract expiry in anticipation of reduction in IV.

3) Risk Management

During trading sessions, losses are manageable. However one risk that we are assuming while adopting this strategy is the over-night gaps risk. We've believe that heavy weighing has to be done on risk control to ensure capital safety from Extreme Loss scenarios. Efficient risk avoidance, control & management towards this risk exposure is achieved as follows:

a. Diversification: Time Diversification & Value Diversification form an integral part of organic risk control. Option Writing Positions are taken over a period of time in varied instruments with different contract expires.

b. Deep OTM Writing: This strategy consists of writing both the call and puts of near and further months, of strike prices mandatorily beyond 5% from the spot in any case. However, the writing may happen of strikes that are further OTM (Beyond 5%) but in no case < 5%. This is a risk avoidance strategy based on the historic gap ups/downs in nifty the highest of them had been ~6%. Nonetheless, we believe that historic events do not guarantee the occurrences of future events & so opt to implement prudent hedging as per point (c). Also, in case of such extreme loss scenarios, operational aspects don't allow squaring off of positions and hence, hedge becomes an essential aspect.

c. Natural & Synthetic Hedge: Positions are opened over a period of time as per the position sizing methodology described above, this helps to leverage the profits of the first set of position as a natural hedge to compensate for the risk assumed in every following set of position opened. However, this natural hedge mechanism shall only be viable until partial positions have been opened. Once, we are in the 3rd week of the month and approaching a significant position built up we may hedge the positions by one of the 3 methods as required:

ii. Buying options that are further OTM then the written options
iii. Taking Contra positions in the weekly contract expires.
iv. Taking position in futures (Here the quantity required is < 1/5 of 1 set of the options)

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