OMG Don't Trade This Way

[00:00:00] Oh, good. We're live. At least I'm alive. Are you doing friends Ernie here? See, get this thing to stop shaking. There we go. It is Friday and Friday is another zero DTE trading day. Of course, there are three. Such days every week, Monday, Wednesday, and Friday, unless there's a holiday, then Monday switches to Tuesday and Friday switches.

[00:00:29] And if the holiday falls on Friday, it switches to Thursday that happens several times a year. The holiday that we had today, didn't close the stock market closed the bond market. I'm talking about Columbus Day. And so the zero DTE was still on Monday. Just a little bit of trivia market trivia there for you.

[00:00:52] Today's episode on the zero DTE podcast is entitled. Oh my gosh. Don't trade zero DTE options this way, please. I beg of you. I just beg of you. Get yourself under control. And really what I'm going to tell you is I'm very similar to what. Follow through with no matter what type of strategy that you were doing, but there will be some very, very specific things here to zero DTE.

[00:01:28] Now, of course, trading zero DTE. What does that mean? Zero DTE, DTE stands for days to expiration. Zero means that there are no days or zero days left until expiration and put it another way. We trade the options on S and P. Now there are several ways that you can trade options on the S and P. There are number of ways you can trade the S and P you can trade.

[00:01:58] You can trade the] spy. Now we don't trade options on the spy. You can't trade the SPX because it's an index. It doesn't exist. It's a numerical calculation. However, you can trade options on the SPF. 'cause, you know, basically you can trade options on anything. I mean, you can trade options on the weather if you want to.

[00:02:23] And then the last thing is we trade the futures on the S and P. And what I'm talking about is the E-mini S&P futures. The S now we trade both the ES and the SPX options, and we. They have contracts, options, contracts for these. And they expire not just weekly, but inter weekly, Monday, Wednesday, and Friday.

[00:02:52] And that's the wonderful thing about them. It gives you three opportunities to take advantage of what happens on that last day of expiration. That is what is so important about this strategy. You're getting an opportunity that some trader. We're in options. First came out, only had this opportunity once a month.

[00:03:15] Now we get it three times a week, and that is the benefits that come with selling options of selling premium on that last day and with, and the reason why there's a benefit is a time benefit and what I call a convexity benefit, optionality convexity.

[00:03:38] And that is that as the seller of options on that very last day, because you are taking on an obligation for the people who buy that option from you, you get to collect the premium on that very last day. You're collecting it faster and at an ever increasing. Greater than any other time during the life of that option.

[00:04:08] As a matter of fact, it's almost uncanny and crazy. It's similar to falling into a black hole. You know, you get to a certain point and then you start accelerating and then you get over the event horizon and it goes so fast. That's what collecting the premium on these options and really what it does for you as the seller.

[00:04:31] As you're entering a trade. Unlike if you were a buyer of options, when you enter a trade as a buyer, you're constantly fighting the decay of premium as it is, sucking away the value of that option. And you're hoping that your option will go in the direction that you want it to. And if it doesn't, if you stay right where you are, or even if you move.

[00:04:56] Towards your direction, but not fast enough, then that premium decay can happen at such a rate that you're still a loser. Now it's exactly the opposite for the person selling as you're getting closer and closer to that expiration time. That last minute, that last day, that last hour, that last minute, that premium isn't going away from you.

[00:05:21] It's increasing the value of your position. That's a tremendous benefit. And so now not only do you not have to go towards your price, but you can do nothing, stay steady. In other words, your price could just stay right where it is and you still profit. And there are even cases where it could go against the direction that you intend, and you can still profit.

[00:05:46] And that's what this whole idea of convexity. Convexity is talking or a great analogy for this would be well, if you were ever into astronomy and if you weren't, I'll explain reflecting telescopes, have a mirror at the end of them and it gathers all the light, and that mirror has a very special property.

[00:06:08] It's a convex mirror, all the light that hits it reflects into a single point. That's like what's happening with options. Anything that you throw at this time and position and it, and that premium is reflected to you. That's I guess a rough way of looking at convexity. All right. Now let's get to how you can really screw things up.

[00:06:36] Well, first. Not playing that convexity, not putting it into your favor is probably one of the worst ways that you could approach zero DTE trading, because you are no longer taking advantage of that convexity principle. Now you might be taking advantage if you're able to maintain a price in a very, very specific range for that options premium and collect it.

[00:07:08] If you're not in that very tiny range and let's face it. When you enter a position, your stock price, the S and P price is going to move. And if you don't maintain perfect centering, in certain ways that people trade the S and P using 32, and you're going to be a loser. And that is probably the principal way that you can be.

[00:07:36] Uh, loser trading options on the S and P and that's not taking advantage of that convexity principle. So, for example, many people are trading the zero DTE strategy using an iron condor, and they create a very, very wide iron condor that supposedly is supposed to have high probability of profit. But when you spread the wings of the condor very wide, it also.

[00:08:03] Minimizes the total amount of premium that you can collect. So, the wider you spread them, the less premium you have, the less, the spread, the more premium the ultimate non spreading would be one where it meets right in the center, where there is no spread between the short strikes and that's called the butterfly.

[00:08:27] And there you're maximizing the amount of premium that you can get. So that's one step towards and I in condos would be the step away from what you would want to do. Now, what most people do is they create these very, very wide iron Condors. They claim that it has a high probability of profit because they will profit.

[00:08:49] If price ends at expiration, somewhere in between there. However, this is what happens. Because they are not taking advantage of the convexity principle when they first entered that trade, the PNL, the shape of the PNL on that trade that they put on is like a big bell, bell shaped. And when they put the trade on at first, they're sitting at the very top of that bell.

[00:09:17] Now this is a very narrow bell. So, if you can imagine being, or standing at the top of a bell shape. And then you start walking towards the perimeter of the bell. The slope is going to fall off very quickly and you're going to be in danger. If it's a very large bell of sliding down that bell into and off of the Spire or the steeple that you're on in and die, you know, and you don't want to do that.

[00:09:46] That's what happens figuratively when you're a. And you place an iron condor and you're positioned right at the top of that bell curve. And then as soon as price moves, which would simulate you walking to the perimeter of that bell, your trade starts to go into an unrealized loss very quickly. I might add, and a big loss.

[00:10:15] And that's because when you create a very wide iron condor, you're what you're doing is you're creating very large amounts of risk. So, the risk to the potential profit becomes extremely exaggerated asymmetric in the wrong sense of the word. So, for example, if you created a five Delta. Iron condor. What that means is that you would approximately have about a 95% probability of profit.

[00:10:50] That also means that the risk is about 20 times the size of the potential profit. Now, when you get into that iron condor and you're right at the top of that bell, if price starts moving to the left to the right, your account starts going into this almost immediate unrealized law. And this can be extremely disconcerting.

[00:11:11] And if it continues to go towards the wing of this iron condor, you start building up this incredible anxiety because you know that if now the probability that you will end up somewhere inside of that bell has diminished dramatically. Now it may come back. It might regress to the mean maybe all the while you're sitting there.

[00:11:38] Literally weeks of profit in the red unrealized loss, mind you. So, in other words, you haven't lost yet until you exit the trade. However, time is ticking away and you're sitting there with hundreds or thousands of dollars of losses, hoping that the market will close, and the profit curve will rise up in your favor and give you profit.

[00:12:04] But in the meantime, you are going nuts. That is one way not to trade the zero DTE. Well, what would be an alternative way or any? There are lots of alternatives, but the, probably the best is one where you can take that bell curve and flatten it out. Now, the way you would do that is you would use a butterfly that would flatten it out dramatic.

[00:12:31] However, you still have that steepness of the bell and you still have a lesser probability of profit. So, it's not entirely the best, a better way would be to have it slightly offset. So, in other words, anticipate where price is going to go and then put the short strike towards that direction. So now you, when you put the trade on, you're not sitting in the middle of the.

[00:12:58] Butterfly you're sitting on the side of it now. Here's and you can even be outside of that butterfly. Now, why would you do that? The reason why you would do that is that when you're outside there, you are now experiencing the properties of convexity because the prophet in the early parts of that strategy extends well beyond.

[00:13:23] What some people think is the extent of the profit. In other words, if you were to look at the strategy risk graph, it looks like a pyramid, right? With wings, but that's at expiration. That's the PNL at expiration. When you first get into the trade, the P and L is actually quite rounded at the top and very wide on a butterfly on an iron condor.

[00:13:48] It is also rounded, but it looks more like that bell with very, very steep sides. So, two very different things. The butterfly looks like maybe the shape of a pitcher's mound, maybe even shallower. And the iron condor looks a lot like a very tall bell or maybe an ant amount in Africa.

[00:14:12] Imagine that you're sitting on top of an ant mound. That would be a, that would be an appropriate thing. Okay. So, there was the first thing that you should not do, do not do this in zero DTE, do not use iron Condors, however, universally people who are trading the dirty tea using iron Condors, except for what we do.

[00:14:34] We are using the butterfly and using it so that we take advantage of the convexity principle. In other words, we make profit on the outer edges of that bell curve, where even if you move, if price moves to the left or to the right, you're still maintaining profitability in. Your Delta is very small. So, any change in price does not put you deep into the red, right?

[00:15:06] And all the while time is working on your side because that, profit curve is moving up into you and increasing your profitability instead of decreasing.

[00:15:19] That's the thing to do. And the other thing that I had already mentioned is not to do now. We'll talk about some other things that are more mainstream in terms of your trading. And I'm sure this is one that most people are familiar with, and you hear it from all the gurus, and they'll tell you not to trade without.

[00:15:40] Now, this doesn't mean that you must have this elaborate document that specifies every aspect of your trade. In fact, it could be something that just is hand scratch on a single page, but you still must have a plan and you plan doesn't necessarily have to be static throughout all your trading history.

[00:16:00] There are certain rules and guidelines that you should follow trading decorum, the way you would act during as a trader, but every trade that you take on, you should have some sort of idea of what you want to get out of that trade. Now, all the trades, if you're trading a particular strategy, like say our strategy, you want to have a, an expectation of, or a long-term expectation of what that strategy will do.

[00:16:37] So that's one thing that you shouldn't do if I took the inverse of that. If you do not have a long-term expectation and a knowledgeable expectation of what that strategy might do for you, then each individual trade that you take is going to be a new experience and not in a good way.] You're going to be discovering things without the expectation of what would happen if you did this trade 10 times or a hundred times or 500 times.

[00:17:11] And having that expectation is very important and having it footed in reality. And understanding what is the implication of trading something a certain way? And that's why I brought up the iron condor at first, because most people that are introduced to this strategy are led to believe that it is somehow a high probability trade.

[00:17:31] Now there were other things that they do in that strategy that I would say don't do the way other people trade the zero DTE strategy because they have this. Immense problem of the bell falling off the edge of that bell, instead of allowing them to, if price were to move towards the wings and, and get that unrealized loss, they instead will put stops to ensure that they get a realized loss.

[00:18:08] I swear to God, that's what they do. They put stops on their strategy in order to prevent them from falling off the edge of that event, horizon that would put them into an untenable position. So instead, they are more willing to take a substantial loss rather than a catastrophic loss. Now why they would want to take a substantial loss at all is beyond me.

[00:18:35] But I guess that is better than a catastrophic loss, but that's another thing to do or not to do when you're trading options. Why, why would you trade with stops? That's a very simple question. We're not talking about. Yeah, stocks or futures or any other simple type of contract that either it goes up or down and has no other properties other than it ticks up when the price goes up or it ticks down when the price goes down, simple options or simple stocks or assets, that's their property.

[00:19:20] And so you have no other behavior, no other way to control the price of the value of that contract or that stock or that asset, other than you're held captive by whether the price goes up or down, it's binary with options, you do not have that problem. You can create strategies that will define your risk.

[00:19:45] Stocks and futures. You have virtual unlimited risk with options. You can fashion trades where you have very well-defined risk. And this is with strategies like the iron condor or the, um, the butterfly, the differences. With the iron condor, when you attempt to create a very high probability trade, you also at the same time, take on huge potential risk with the butterfly.

[00:20:16] You can control that to a much better degree. And if your strategy is such where you offset it, you can almost eliminate the. And in fact, the butterfly is a very flexible strategy because you're not bound by, it's symmetry. You can create an asymmetrical or what's called a broken wing butterfly and further define your risk and sometimes eliminate it or bring it down to such a small amount versus the potential profit.

[00:20:46] So now you can create a strategy where you don't need stock. And you don't have to worry about that risk. So why would you create a strategy where you have to put in a stop that virtually guarantees and unrealized loss?

[00:21:05] It's a rhetorical question. Of course. So that would be another thing that I wouldn't do. And that is specific to zero T. But that also comes into play with trading with a plan and understanding what your expectations are over the long run. If you were to look at anybody, that's done longer-term studies and I've seen at least three or four of these on YouTube people who have done year-long studies with zero DTE.

[00:21:32] Following this iron condor strategy, all. Have either lost or have broken even after a year. Why would you do a strategy where you lose after a year's worth of trading after 150 instances and you're down the one that was broke even it was broke even in terms of profit, but if you considered the commissions and the fees, it was also a loser.

[00:22:00] So I don't understand why you would do. So that's another thing don't do that have a long-term expectation of what, where are you going to be?

[00:22:09] Now? There are certain things that you can do to assure that you will not get into that problem. And one of them is employ principles such as convexity put on asymmetric trades take on very well defined. Low probability risks.

[00:22:30] And those only seem to make sense, especially if you have the tools available to you, why not fashion a trade that way you can do whatever, almost anything that you want with options and model them to virtually any kind of situation that you want, whatever your mind can conjure up, then why not conjure up a trade that has very little risk and very large.

[00:22:55] Potential profit and does not give you any anxiety and has a positive future outcome.

[00:23:02] Again, a rhetorical question, but trying to illustrate the difference between what you shouldn't do and what you probably should do now, trading with a plan is so important when you get into any.

[00:23:21] Now knowing the outcome of a trade is, well, you can't say I know the outcome of a trade it's unknowable. However, you can with reasonable certainty, come up with enough scenarios that would cover all the possible outcomes. And in most cases, the possible outcomes are either it's a winner or loser or flat.

[00:23:49] In other words, it didn't, it neither one nor loss, or it could be maybe a small winner or a large winner or a small loser or a large loser and with enough knowledge of market structure and volume profile. You could probably come up with two or three very likely scenarios of which, if you were to look at it over time that you could have a positive outcome or expectation that you would choose at least 50% of the time, with your three scenarios have covered one of the possible ways.

[00:24:26] Then, what you could do is you could use the flexibility of options and particularly the flexibility of the butterfly strategy to model a strategy that has all the properties that you want. Convexity, asymmetry, high expectation of gain over a long period of time, the ability to accurately model.

[00:24:53] The scenarios that you have conjured up where you think market the market might go. So having a plan and planning those things out, and then spending a little time to model your plan and then put a trade on. Now that has a very high level of expectation, minimal risk, minimal anxiety, and very good.

[00:25:17] Future expectation, positive outcome.

[00:25:20] So here's another thing that a lot of people, probably the number one reason why most people fail and that is trading too big. When you trade too big, when your position size is too big, you most certainly are going to. Regardless of what the strategy is, you are most certainly going to fail.

[00:25:46] And the reason for this is that when you trade too big, there's when I talk about the long-term expectations, you also must have short term and medium-term expectations. You could look at a strategy and say over the long-term, I'm going to win. It's going to be a 50 50 proposition. I'll win 50% of the time lose 50% of the time.

[00:26:12] As long as my losers are very small, and my winners are very large. That's good with me. I might even be able to win say, 30% of the time and lose 70% of the time and still have a positive expectation if the asymmetry is big enough. So that's another thing that we're talking about here by creating.

[00:26:33] Asymmetric trades you can build in that future positive outcome. If you trade too large, there are some cases where if you, for instance, had only a 30 or a 50% probability of winning there's a reasonable expectation that you're going to lose multiple times in a row at some point. It might not be this week or this month or even this year, but at some point, you're going to have 3, 10, 15 losses in a row.

[00:27:08] Those are the odds. That's what the universe deals us. There's no escaping it now. Will that happen today? This week, this month, this year? Probably not, but eventually. And when you trade too large, if you have too many of those consecutive losers, you can downdraft or draw down an account enough so that it makes it almost impossible for you to reasonably expect to regain that last high watermark that you had.

[00:27:44] This is the number one reason why people blow up accounts. That's the market. It is the number one reason why people blow up accounts because they don't have a good sense for how big they should make their accounts. So there's another thing don't trade too large. And here's another emotional. And that is usually born out of not planning and not having an expectation of long-term or medium term or short-term expectation of what your strategy will provide for you.

[00:28:20] And when we don't have a strong expectation and then we're confronted with anxious times unexpected events, then we become emotional. If we have a string of winners and we allow ourselves to get steeped in that whole thing, that joy and allow it to distort our plan, then certain emotions will take over whether it's fear, greed, avarice, whatever it is.

[00:28:55] And it will cause you to make bad decisions when you're trading. No matter what the strategy is, the strategy itself will not save you from mistakes. The only thing that will save you from mistakes is your ability to approach trading in a calm, rational, logical way.

[00:29:14] That is so important. So, maintaining your composure is very, very important. And there are ways that you can ensure that you can create strategies and methodologies and process around all of that. That will keep you in the right mindset. And in fact, that is something that you should be practicing.

[00:29:38] So allowing yourself. To become emotional in your trading or allowing yourself to become attached to a particular position or an idea will be the source of your suffering. There's a little Buddhist philosophy there. Those attachments that we create are what will eventually cause you to fail.

[00:30:03] Let's see what other I could. There are probably 20 or 30 different things that I could talk about and go on and on. And I don't want it to sound like I'm lecturing or anything, but those are probably the biggest things right there. Trading too large, allowing yourself. To get involved or attached to ideas or bad or good situations that will compromise your thinking, your ability to make decisions, rational decisions, good decisions, trading the wrong strategy without understanding the future outcome of that.

[00:30:39] Getting drawn into the lore of high probability trades with not understanding the reciprocal risk that's involved there. Trading stops in an environment that doesn't need you to trade stops, that they are put in there as a fail-safe measure for an inadequate strategy. Use the right tool for the right job.

[00:31:06] If you have the right tool, then you don't have to throw band-aids and bailing wire and duct tape. To make it work, make it clean, simple, elegant, the simpler things are the more straightforward they are, the easier they are to understand and execute the better off you're going to be. So, let's see what else.

[00:31:32] We had a pretty good week this week. We had a nice winter today. We had a nice winter on Wednesday. We had no trade on Monday. Last week was, eh, not so great. We had one, one day where we didn't trade two days where we lost the two weeks prior to that.

[00:31:51] We're all good. Three wins out of three, three wins out of three. So overall the last four weeks have been very good. And even as good as they have been, they have not met our positive expectation or are our longer-term expectation because this past month has probably been one of our poorest months, even though it was a winning month.

[00:32:12] Now, some people have not yet been able to master all that. Various items that I was talking about. And even if you had a strategy that puts you in the right position, , in order to make profit, they may not have acted on those things or acted with one of the attachments that they have that prevent them from making the right decision.

[00:32:36] So even with perfect trade. You can still lose because it all comes down to when you push the button, when you decide to make that decision to the push, push the button. And if you're not in the right mindset, if you're not attuned to what is in front of you, if you're not aware you can be a loser and that same set of circumstances with just a clear mind and understanding what you're doing with the right place.

[00:33:10] Then you will be a winner if you'd like to try out our strategy for all the wonderful reasons that I told you about before, why it works and why it does have a positive future outcome, then go to zero-dte.com/try. You'll get a four-week trial and you'll become. A full-fledged member for four weeks and you will get a fantastic education, not only on our strategy, but on, on technique and process, that will make you a better trader.

[00:33:45] So regardless of what happens, whether you decide to come on and be a long-term member or not, you're going to benefit from those four weeks.

[00:33:56] All right. That's all I've got to say. I hope you all have a great weekend. I know I will get a lot planned, peace

[00:34:07] Can never find that button. We've got to move those windows out of the way.