ASX200 INDEX (AP) Wheelhouse

Information Sheet

Introducing the "Wheelhouse" Strategy from AIE

With this strategy, you can sell options on the ASX 200 Cash Index (AP) and receive a weekly premium of around 0.5-1% on face value. We'll guide you through the concept of options selling and show you how to consistently receive a weekly premium throughout the year.

Understanding AP

The ASX 200 Cash Index (AP) is an options contract based on the S&P/ASX 200 Index, representing the top 200 companies listed on the Australian Securities Exchange (ASX). These options are European-style, meaning they can only be exercised at expiration, and they are cash-settled, meaning there is no delivery of the underlying asset upon expiration. Instead, the difference between the strike price and the final index value is settled in cash. These options have a face value of $10 per point and expire weekly, specifically at the open of trade on Thursday morning.

How Does the Wheelhouse Strategy Work?

The strategy involves the following steps:

1. **Selling Delta 0.5 Puts:**
   - Start by selling put options with a delta of approximately 0.5, for the next weekly expiry, or if the premium is to low the week following.
   - Delta measures the sensitivity of the option's price to the underlying asset's price movements. A delta of 0.5 indicates that the option has a roughly 50% chance of finishing in the money (ITM).
2. **Managing ITM Options:**
   - If these options expire out of the money (OTM), you keep the premium and start the process again.
   - If these options finish in the money (ITM), they are cash-settled, and you will receive a cash payout equal to the difference between the strike price and the settlement price.
3. **Transitioning to Delta 0.75 Puts:**
   - After an ITM settlement, start selling put options with a delta of approximately 0.75 on the same underlying index.
   - These options have a lower chance of expiring worthless because the strike price is ITM but provide a larger premium that will benefit in terms of recouping losses if the market rallies.
   - Selling ITM options following a dip in the price of the index will be advantageous if the market bounces back from a short term decline.
4. **Returning to Delta 0.5 Puts:**
   - Continue selling delta 0.75 puts until they expire worthless.

- Once the delta 0.75 puts expire worthless, resume selling delta 0.5 puts.

Benefits of the Wheelhouse Strategy

- **Weekly Premiums:**
  - Consistently receive premiums that can amount to 1% or more of the underlying value on a weekly basis.
- **No Assignment Risk:**
  - Since AP options are European-style and cash-settled, there is no risk of being assigned and having to manage the underlying asset.
  - This simplifies the strategy and focuses on cash management.
- **Downside Protection:**
  - Selling puts can provide some downside protection compared to outright ownership of the underlying asset by the amount of time value or extrinsic value received from selling the put.

Example Scenario: Bullish Market

1. **Initial Put Sale:**
   - Sell delta 0.5 puts on AP with a strike price close to the current market price. For example, if AP is trading at 7900, sell a put option with a strike price of 7900.
   - Collect a premium of approximately 40 points.
2. **Cash Settlement:**
   - If AP stays above 7900, the option expires worthless, and you keep the premium.
   - If AP drops below 7900, the option is cash-settled. For example, if AP settles at 7820, you pay 80 points (the difference between the strike price and the settlement price) but you keep the initial premium of 40 points.
3. **Selling Delta 0.75 Puts:**
   - After the cash settlement, start selling delta 0.75 puts, which have a higher premium. For example, sell a put option with a strike price of 7875 assuming AP closed below this level.
   - Collect a premium of 100 points.
   - Continue this until the options expire worthless.
4. **Returning to Delta 0.5 Puts:**
   - Once the delta 0.75 puts expire worthless, go back to selling delta 0.5 puts, resuming the cycle. For example, sell a put option with a strike price of 7900 again, if the current market price of AP is around 7900.

Detailed Steps and Considerations

1. **Selling Delta 0.5 Puts:**
   - Delta 0.5 puts are chosen because they have a balance between premium received and probability of expiring worthless. A delta of 0.5 means the option has an estimated 50% chance of being ITM at expiry, providing a good trade-off between risk and reward.

   - For example, with AP trading at 7900, you sell a put option with a strike price of 7900 and collect a premium of 40 points.
2. **Managing ITM Options:**
   - If the put expires OTM, you keep the entire premium (40 points in this example) and sell another delta 0.5 put for the next expiry.
   - If the put expires ITM, it is cash-settled. For example, if AP settles at 7820, you pay 80 points (the difference between the strike price of 7900 and the settlement price of 7820) but keep the initial premium received so the net loss is 40 points (80 points less 40 points).
3. **Transitioning to Delta 0.75 Puts:**
   - After an ITM settlement, switch to selling delta 0.75 puts, which have a larger premium and results in a more aggressive strategy following a dip in the AP price.
   - For example, sell a put option with a strike price of 7875 when AP is trading at 7800. The premium received will be higher due to the increased risk, around 100 points.
4. **Returning to Delta 0.5 Puts:**
   - Continue selling delta 0.75 puts until they expire worthless, at which point you resume selling delta 0.5 puts.
   - For example, once the 7875 put expires worthless, you go back to selling delta 0.5 puts, such as a put with a strike price of 7900 if AP is around 7900.

Risks and Considerations

- **Market Volatility:**
  - The strategy can be affected by sudden market movements and volatility.
  - Proper risk management is crucial to handle potential losses and maximise gains.
- **Cash Settlement Risk:**
  - Cash settlement at a lower price than the strike can result in temporary losses.
  - The strategy involves managing these settlements effectively.

Leverage

Leverage in the context of selling put options on the ASX200 Index (AP) in the cash-settled options market refers to the use of borrowed capital to increase the potential return on an investment. Here's a detailed explanation of how leverage works in this scenario:

Selling Put Options

When you sell (write) a put option, you are agreeing to buy the underlying asset (in this case, the ASX200 Index) at a specified price (strike price) if the option expires in the money at the expiration date. As the ASX200 Index is a European style option, this can only happen at the expiration date.

Weekly Options

Weekly options have a short expiration period, typically one week, which means they expire every Thursday morning. This short time frame can affect the option's price and the potential risk/reward profile.

Cash Settled

Since the ASX200 Index is cash-settled, you won't actually be buying or selling the underlying index. Instead, the difference between the option's strike price and the index's closing price at expiration will be settled in cash.

Leverage Mechanism

1. **Initial Margin Requirements:**
    - When selling put options, you must post margin, which is a percentage of the potential obligation. The margin required is often a fraction of the total notional value of the underlying index.
    - For example, if you sell a put option with a strike price of 7,000 on the ASX200 Index, and the margin requirement is 10%, you might only need to post $7000 in margin for each contract, despite the notional value being much higher (Index value * 10).
2. **Exposure:**
    - By selling put options, you gain exposure to the movement of the ASX200 Index without having to invest the full value of the index.
    - This exposure allows you to potentially earn a higher return on the margin posted compared to investing directly in stocks that make up the index.
3. **Premium Collection:**
    - When you sell a put option, you receive a premium from the buyer. This premium is income that you can keep if the option expires worthless (i.e., the index stays above the strike price).
    - The premium collected can provide a significant return on the margin posted, enhancing leverage.
4. **Risk:**
    - The primary risk is that the ASX200 Index falls below the strike price, and you have to settle the difference in cash.
    - The potential loss can be substantial if the index declines significantly, and you may need to post additional margin if the value of the option increases as the index drops.

Example Scenario

Suppose the ASX200 Index is currently at 7,100, and you sell a weekly put option with a strike price of 7,100 for a premium of $400 per contract. The margin requirement is ~10% of the notional value.

- **Premium Received:** $400
- **Margin Posted:** $7100 (~10% of 71,000)

- **Potential Return:** If the index stays above 7,100, you keep the $400 premium, which is a 5.6% return on the $7100 margin in one week.
- **Potential Loss:** If the index falls to 7,100, you would need to pay the difference between the strike price and the index level at expiration (7,100 - 6,900 = 200), resulting in a loss of $2000. This loss would be offset by the $400 premium, resulting in a net loss of $1600, or a 22.5% loss on the initial margin.

Leverage Impact

The leverage effect arises because the margin required is only a fraction of the potential exposure, allowing you to control a large notional amount with a relatively small investment. This can amplify both potential gains and losses.

Key Points to Remember

- **Leverage Magnifies Results:** Both gains and losses are amplified due to the lower margin requirement.
- **Premium Income:** Selling put options can generate regular income, but this comes with the risk of substantial losses if the index falls significantly.
- **Risk Management:** It's crucial to manage risk carefully, including monitoring margin requirements and being prepared to post additional margin if needed.

By understanding these concepts, you can better navigate the use of leverage in selling put options on the ASX200 Index in the cash-settled European style options market.

Conclusion

The "Wheelhouse" strategy from AIE offers a systematic approach to options trading on the ASX 200 Cash Index (AP). By following the structured process of selling delta 0.5 and delta 0.75 puts, you can generate consistent weekly income while managing risks effectively. If you're ready to learn and earn more from this strategy and start generating weekly income, then read the information above and start implementing the "Wheelhouse" strategy today.

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