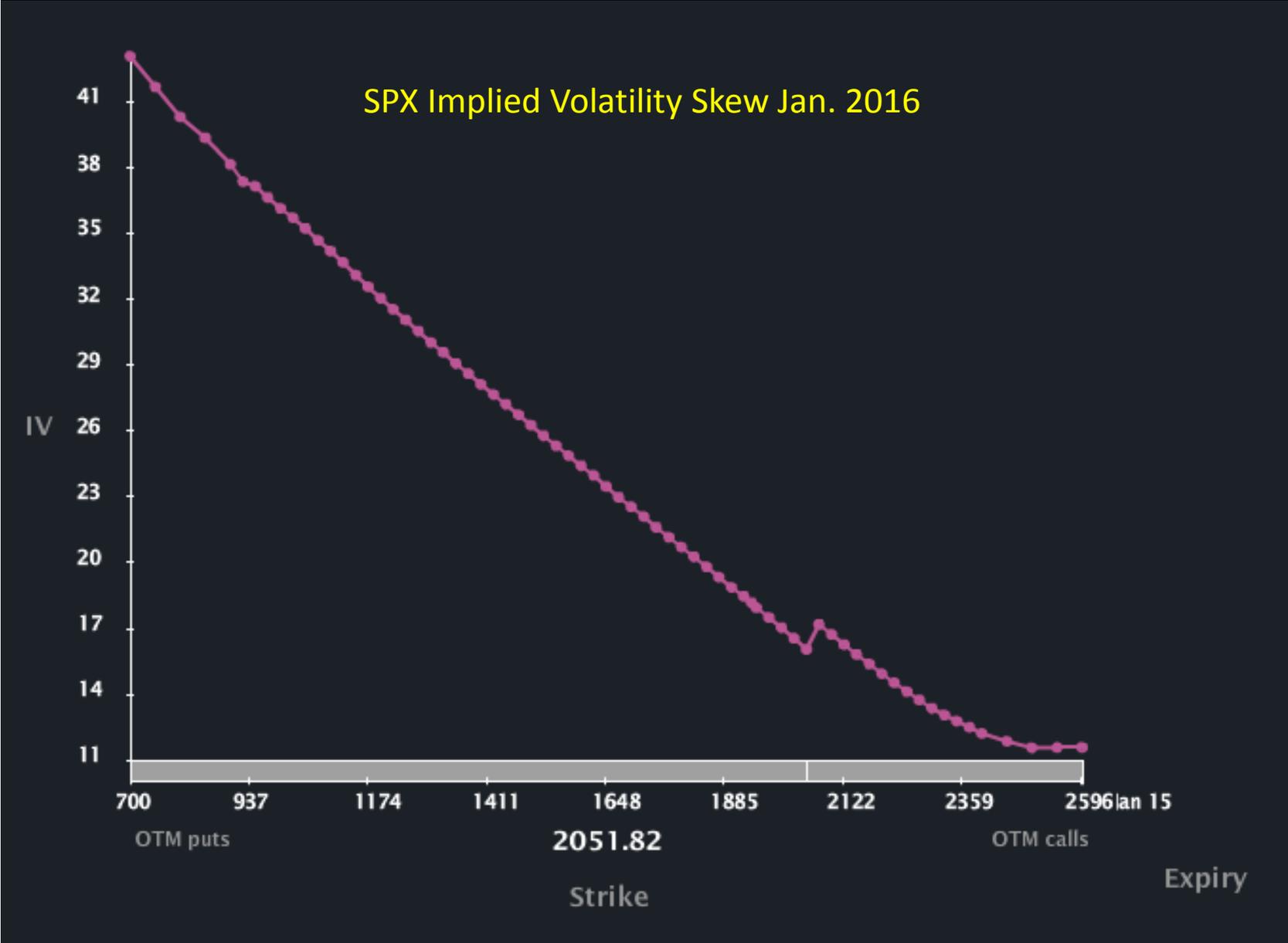




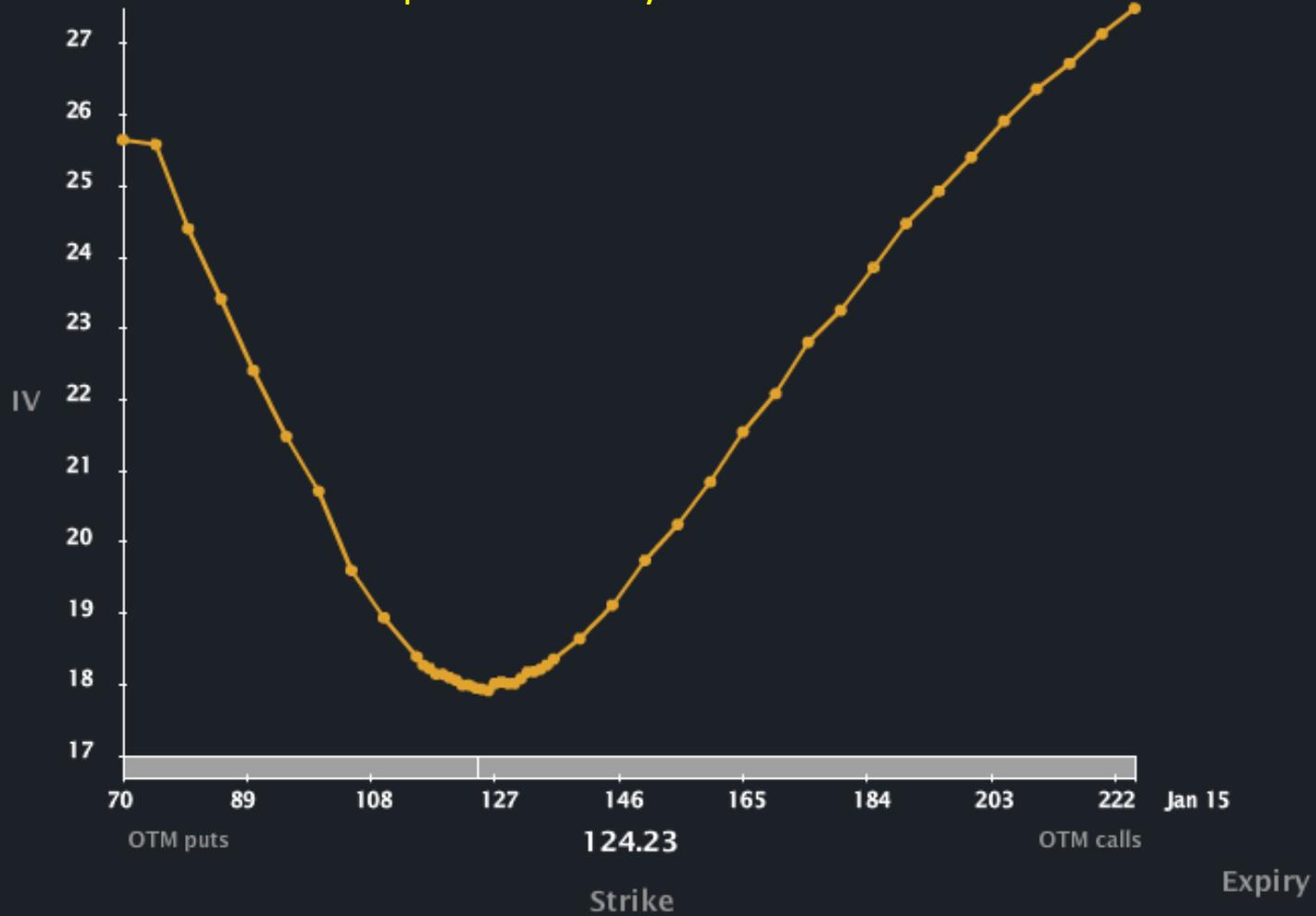
# PhaseTrader<sup>®</sup> Indicators

Market Insight 2015/01/26 - Long Term Gold

The collective intelligence of the market is represented in the implied volatility skew for options on a almost any financial instrument. Right now the skews are extremely negative for broad market indexes like the S&P (below), but strongly positive for gold (next slide).



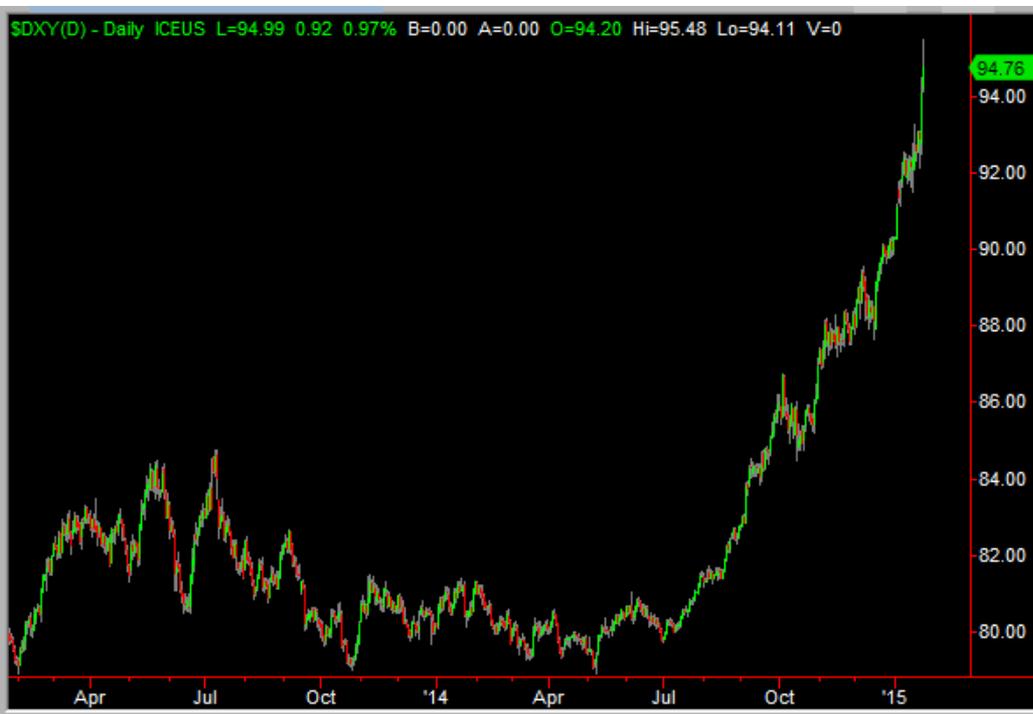
## GLD Implied Volatility Skew Jan. 2016





Last week's webinar (1/15) mentioned gold's breakout above the €1,000 mark that had become an important resistance level. Since then it has rallied more than 15%.

The chart on this page displays gold prices in dollars (top) and euros (bottom). It is tempting to assume that gold simply adjusted to the weakening euro, but that assumption is false. Between April and November, the euro fell from 1.39 USD to 1.24 USD and gold (priced in euros) oscillated in the trading range shown at the bottom of the chart between €920 and €970.

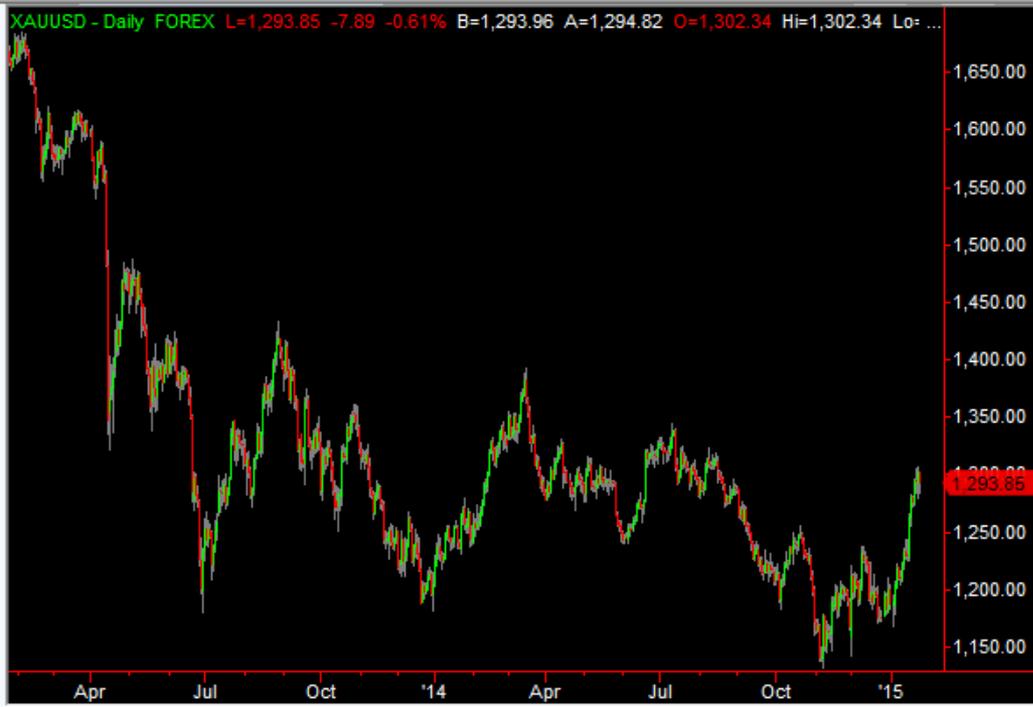


Gold priced in dollars has rallied 13% from its November 7 low even though the dollar index has climbed 8.4% - a total decoupling of more than 21%.

However, futures prices remain flat or slightly down from spot gold and that distortion must unwind before a stable gold rally can materialize. The first part of the unwinding will occur when the spot price rises high enough to encourage investors to stop hoarding gold. The initial selloff that follows will allow futures to rise above the spot price creating a normal "carrying cost" for futures traders who hold far-dated contracts.

While these dynamics play out, the underlying forces driving investors out of currencies and into gold are likely to remain intact.

It makes sense, therefore, to create trades that are bullish in the long-term but not sensitive to interim reversals.



One way to trade with the skew is to structure a long-term option trade using a forward ratio that bets on a modest rise 1-2 standard deviations. Current volatility for GLD is 17%. We can calculate the value of a 1 Stdev move over the next year:  $\$124 \times 0.17 = \$21$ .

Open interest remains high across the far strike zone for options expiring in January 2016 (below).

Using our calculation we can structure a delta-neutral, forward ratio where the near strike is 1 Stdev out-of-the-money and the midpoint is 2 Stdev away:

**1 long \$145 call / 2 short \$165 calls = \$0.32 debit**

The trade will only lose money if gold rallies more than 3 Stdev to a point above \$185 – essentially a “crash up.” However, interim sharp rallies have the potential to place gold on a trajectory to climb above this level creating a “paper loss.” The risk is an event that creates a “crash up” scenario – a terrorist attack, major bond default, collapse of the U.S. dollar, etc. The trade is unusual because prevailing macroeconomic forces (like a strong dollar) tend to prevent a sustained sharp increase while general uncertainty in financial markets continues to create demand for gold.

Finally, market intelligence tends to cause complex option trades to be correctly priced according to risk. Short straddles and strangles pay a credit because they are dangerous. Conversely, this trade costs \$0.32 - \$320 per 10 contracts - because it is a quality long-term investment in gold in a bullish gold market. The trade also has a margin requirement because the ratio is naked short 1 contract. The account must have the equivalent of 10% the value of the underlying stock – approximately \$1,240 for every long 1/short 2 contract pair.

CALLS										
Symbol	Open Int	Volume	Gamma	Theta	Delta	Imp Volati...	Mid	Bid	Ask	Strike
GLD 160115C145	31,662	1	0.0130	-0.0105	0.2411	19.51 %	3.10	3.00	3.20	145
GLD 160115C150	46,585	54	0.0113	-0.0097	0.1990	20.15 %	2.50	2.43	2.57	150
GLD 160115C155	2,727	5	0.0097	-0.0088	0.1634	20.66 %	2.00	1.93	2.07	155
GLD 160115C160	6,895	140	0.0084	-0.0080	0.1360	21.26 %	1.64	1.57	1.71	160
GLD 160115C165	3,133	20	0.0072	-0.0074	0.1153	21.97 %	1.39	1.33	1.44	165
GLD 160115C170	3,775	0	0.0062	-0.0067	0.0969	22.50 %	1.15	1.07	1.23	170
GLD 160115C175	6,336	13	0.0054	-0.0062	0.0840	23.23 %	1.00	0.92	1.08	175
GLD 160115C180	7,253	0	0.0047	-0.0056	0.0709	23.68 %	0.84	0.75	0.92	180
GLD 160115C185	2,121	0	0.0041	-0.0051	0.0616	24.27 %	0.73	0.65	0.80	185
GLD 160115C190	1,610	0	0.0036	-0.0047	0.0542	24.90 %	0.64	0.58	0.70	190
GLD 160115C195	465	0	0.0032	-0.0043	0.0468	25.35 %	0.55	0.49	0.61	195
GLD 160115C200	19,666	0	0.0028	-0.0039	0.0409	25.83 %	0.48	0.42	0.54	200
GLD 160115C205	567	0	0.0025	-0.0036	0.0362	26.34 %	0.43	0.36	0.49	205
GLD 160115C210	106	0	0.0022	-0.0033	0.0320	26.80 %	0.38	0.31	0.44	210
GLD 160115C215	656	10	0.0019	-0.0030	0.0279	27.15 %	0.33	0.26	0.39	215
GLD 160115C220	2,719	0	0.0017	-0.0028	0.0249	27.60 %	0.29	0.22	0.36	220
GLD 160115C225	10,343	0	0.0015	-0.0025	0.0219	27.96 %	0.26	0.18	0.33	225