

CANADIAN EQUITY DERIVATIVES

Quarterly Newsletter - January 2015

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COMMENTARY

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GENERAL INFORMATION



Patrick Ceresna

Patrick Ceresna is the Chief Derivative Market Strategist for Learn To Trade Global (LTTG) and optionsource.net and has been a content provider and speaker for the Montreal Exchange for over 5 years. Patrick is a Chartered Market Technician (CMT), Derivative Market Specialist (DMS) and Canadian Investment Manager (CIM) by designation. Prior to becoming a partner at LTTG, Patrick spent ten years working at key financial firms in numerous trading roles including the trading of a large fund dedicated exclusively to options writing. Patrick specializes in analyzing the intermarket relationships of the broader derivatives market and the impact those trends have on trading and investment decision making.



Martin Noël

Martin Noël holds an MBA in Financial Services from the Université du Québec à Montréal since 2003. The same year, he received his Fellow of the Institute of Canadian Bankers and was awarded the Silver Medal for his superior level of performance in the completion of the Professional Banking Program.

Martin began his career in the derivatives industry in 1983 as an options market maker for various brokerage firms on the floor of the Montréal Exchange. He later became an Options Specialist and ultimately an independent trader. In 1996, he joined the Montréal Exchange as Options Market Supervisor where he had the opportunity to contribute to the development of the Canadian options market. Since May 2009, he is President of Monetis Financial Corporation, which specializes in professional trading and financial communication.

2015 Trading Calendar

JANUARY							FEBRUARY							MARCH						
S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S
				1	2	3	1	2	3	4	5	6	7	1	2	3	4	5	6	7
4	5	6	7	8	9	10	8	9	10	11	12	13	14	8	9	10	11	12	13	14
11	12	13	14	15	16	17	15	16	17	18	19	20	21	15	16	17	18	19	20	21
18	19	20	21	22	23	24	22	23	24	25	26	27	28	22	23	24	25	26	27	28
25	26	27	28	29	30	31								29	30	31				

- Listing
- Last trading day
- Expiration
- Equity & ETFs options
- Weekly options
- S&P/TSX 60 Index Options (SXO)
- Options on the US Dollar (USX)

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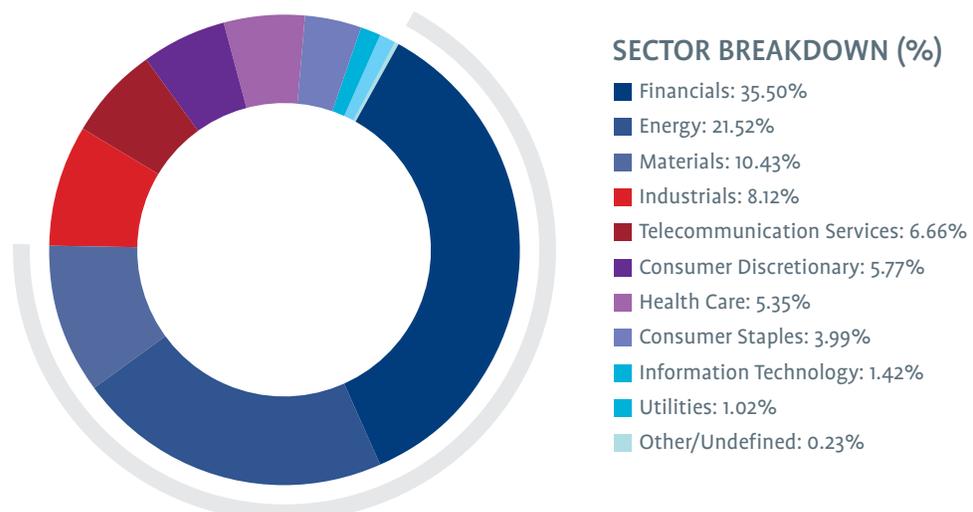
TURNING TIDES IN CANADA

By Patrick Ceresna

Reflecting on Canada from just a few years ago, global investors saw a country that seemed resilient to all external macroeconomic forces. Canada had a strong dollar and a very healthy consumer base. Real estate prices were strong, commodity prices were robust and our banking system was the envy of the world. Capital inflows were healthy and confidence level in investments was high. Most importantly, the credit worthiness of Canadian businesses and consumers was never in question.

All was peachy in Canada until mid 2014, when Europe and many emerging markets started to show signs of recession and everything seemed to turn on a dime. It started with a flight to quality as the U.S. dollar broke out and began a very robust move higher. Global currencies started to tumble and the commodity bear market emerged in force. This macroeconomic tsunami hit all the commodity driven economies like a ton of bricks. When you compare the impacts to the relevant global stock markets, Canada has weathered the storm relatively well verses other commodity driven economies like Australia, Brazil and Russia, (its own basket case of geopolitical issues).

In its semi-annual Financial System Review, the Bank of Canada continues to view the level of household indebtedness and imbalances in the housing market as risks. When combined with the new stress on the commodity markets and net capital outflows from the Canadian equity markets, the concerns relative to the ability of Canadian banks to continue to grow has come to question. When one looks at the sector breakdown of the S&P/TSX index, one can quickly see where the stress resonates from. Financials make up more than one third (36.51%) of the index. When you add the 25.13% of energy exposure and 11.43% of basic materials exposure, one can see that over 73% of Canadian equity is weighted to what are the most heavily stressed sectors.



Source: **iShares**
January 26, 2015

If, as an advisor or investor, you feel this is just a cyclical market adjustment, then you do not need to do anything. But if you feel, like I feel, that this is a structural shift in the global markets, there are many headwinds that will take years to sort themselves out. This could lead to many more volatile months that may drive irrational emotions of many investors.

Hedging Psychology

One way to anchor those emotions is to utilize index put options to hedge outlier tail risk market drops. Now, I don't look at the puts just as a monetary portfolio hedge, but also a psychological hedge for clients and investors. It is much easier to keep investors calm and invested when they know that their portfolios have been, at least to one degree, hedged for the risk of a severe market decline. Therefore, it allows the advisor more room to manage money based on a long-term plan without clients and investors liquidating their holdings on emotional whims of fear, that often prove to be ill-founded.

2014 Review of the Canadian Options Market

One of the best ways to summarize the last year, in regards to options activity, is to define 2014 as the "Year of the ETF Investor". The move toward indexing by advisors and investors has seen an interesting shift in option trading volumes.

Although equity options still have almost three times the daily volume, the trend of growth in ETF options is evident. When compared to 2013, ETF options volumes increased by over 1 million contracts, which equates to a 39.86% increase. With there being modest decreases in both SXO index options and equity options, it is clear that more and more investors, advisors and institutions are turning to ETFs and options on ETFs.

Options on ETFs

With the rollout of the new CRM 2 rules, it will certainly be interesting to see if the trend continues through 2015. Will the upcoming year see more and more advisors and individual investors seek the more cost effective ETFs over that of the more fee heavy mutual fund market? It very well may. One thing is for certain, the landscape of the advisory business is in transition and ETFs are likely to play an ever increasing role in the years to come.

For those interested in identifying the highest option volume ETFs, the top 5 breakdown as follows:

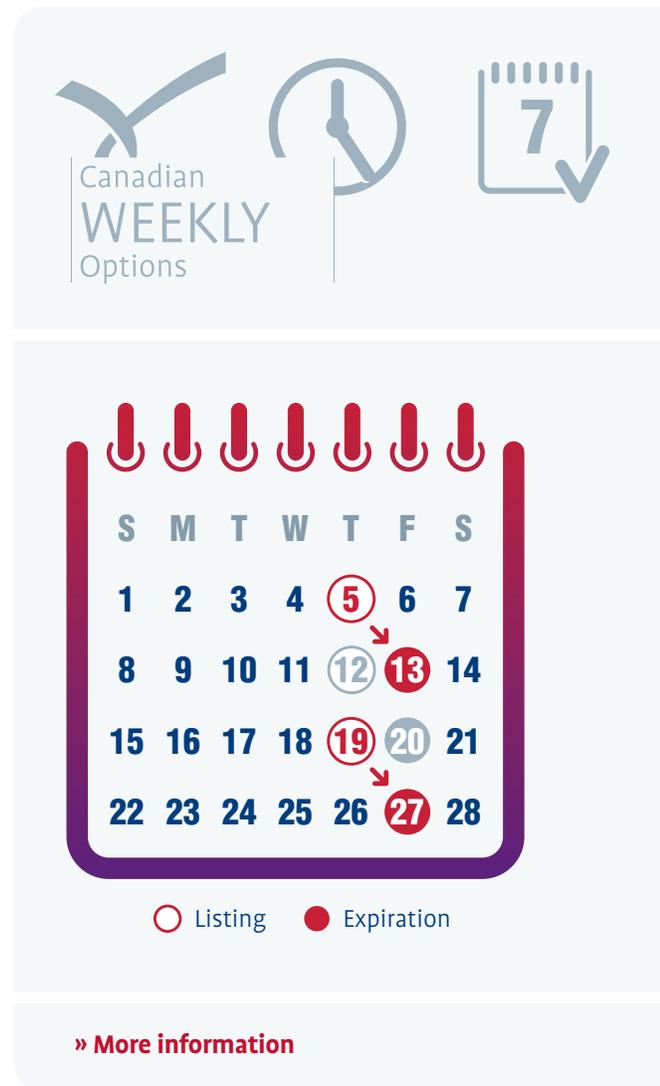
NAME	SYMBOL	2014 TOTAL OPTIONS VOLUME
iShares S&P/TSX 60 Index Fund	XIU	1,831,194
iShares S&P/TSX Capped Energy Index Fund	XEG	831,580
iShares S&P/TSX Capped Financials Index Fund	XFN	570,295
iShares S&P/TSX Global Gold Index Fund	XGD	310,180
BMO S&P/TSX Equal Weight Banks Index ETF	ZEB	301,857

Montréal Exchange introduces Canadian Weekly Options

Canadian weekly options have been in development throughout 2014 and have finally arrived. While the rollout will initially be on a limited number of the most actively traded classes, they are finally available. So what should you know?

How do weekly options differ from standard monthly options?

- Weekly options are listed to provide expiration possibilities every week. These opportunities may include taking advantage of market events or providing portfolio protection by specific buying, selling and spreading strategies.
- Weeklies have the same trading specifications as standardized monthly contracts except that new weekly contracts are listed on Thursdays and trade through to Friday's close of the following week.
- Standard options on equity and exchange-traded funds (ETFs) expire on the third Friday of the month; weekly options on equities and ETFs expire on the Friday of every week that is not a standard expiration week, because no weekly options will be listed for expiration on the third Friday of the month.
- They are available on equities and ETFs and are American style as well as physically settled.



This is what a standard and weekly option would look like at the Montréal Exchange on an equity class:

Standard	XYZ	14101860.00
Weekly	XYZ	14102460.00

My personal favorite use of weekly options is to buy call options as a stock entry strategy. In many cases, if the stock is beginning a proper breakout, it will follow through and I exercise and take ownership of the stock. Why do I use the option instead of just buying the stock outright? It is not uncommon to see the breakout turn into a fake out and reverse drastically. The option gives me a week to determine if I made the right investment decision or not. More often than not, my positions will be nicely profitable giving me confidence to exercise and buy the stock. Alternatively, when I realize that I was early to my entry and the stock has yet more selling to do, the call option expires for a modest loss, which was a predetermined risk at the time of entry. **I look at it like buying a mulligan on a stock.**

Sale of covered call options on XFN

The shares of XFN (the exchange-traded fund replicating the return of the S&P/TSX Capped Financial Index) were trading at \$29.53 when the market closed on January 14, 2015, after reaching a peak of \$31.95 on December 29, 2014. The \$29 level could provide some support, whereas the price range between \$30 and \$31 may present some short-term resistance. In such a context, XFN could temporarily halt and remain relatively stable for a certain period of time. Investors with XFN stock in their portfolio could take advantage of this anticipated relative stability and get slight protection in case of a decline, while being able to profit from a possible upswing by selling covered call options on XFN shares. This strategy involves selling one call option contract for every block of 100 shares held. The strike price level for call options sold is a compromise between the desired capital gain, time value and degree of protection. In the current case, the sale of XFN 150320C29.00 call options at \$1.15 per share would generate a maximum profit of \$0.83 per share, including three dividends of \$0.07, by the March 2015 expiration month (strike price of \$29 - current price of \$29.53 + premium of \$1.15 + dividends of \$0.21), for a return of 2.9% (16.4% annualized). The breakeven point of \$28.17 provides protection against a decline of 4.6%. The sale of XFN 150320C30.00 call options at \$0.61 per share provides protection against a decline of 2.8%, with a breakeven point of \$28.71 and a potential maximum profit (with the three dividends) of 4.5% (25.1% annualized).

Purchase of call options to profit from a rise in XEG

The price of the shares of the Exchange-Traded Fund (ETF) iShares S&P/TSX Capped Energy Index Fund (XEG) took a 44% nosedive from its peak of \$21.50 last June to a low of \$12.01 on December 15, 2014, rebounding to \$14.50 at the close of markets on Friday, December 19, 2014. The market has since retreated and the recent slump may represent a major support level that could trigger a relatively long upturn. If this is the case, a rebound of nearly 20% from the closing price of \$12.90 on January 14, 2015 may be foreseeable over the next two months for a target price of \$15.48. Investors who would like to take advantage of such an increase could establish a limited risk strategy by purchasing call options offering the best leverage effect based on the \$15.48 target price. Among the call options expiring in March 2015 between the strike prices of \$10 and \$15 are XEG 150320C14.00 call options at \$0.43 per share, which offer the best return if the \$15.48 target price is reached before the March 2015 expiration month. In fact, these call options could have a minimum value of \$1.48 in case of success, (target price of \$15.48 minus strike price of \$14) for a risk/return ratio of more than 3 for 1 ($\$1.48 / \$0.43 = 3.48$). While this strategy makes it possible to establish a limited risk directional position, it is not actually risk-free, and investors are strongly advised not to invest more than the maximum loss they would be prepared to incur if XEG took another downturn.



OPTIONS CONFERENCE

for Investment Advisors and
Portfolio Managers

Event
hosted by



Montréal
Exchange

OIC The Options
Industry Council

MARK THE DATE

MONTRÉAL
April 8, 2015



TORONTO
April 9, 2015



VANCOUVER
May 28, 2015



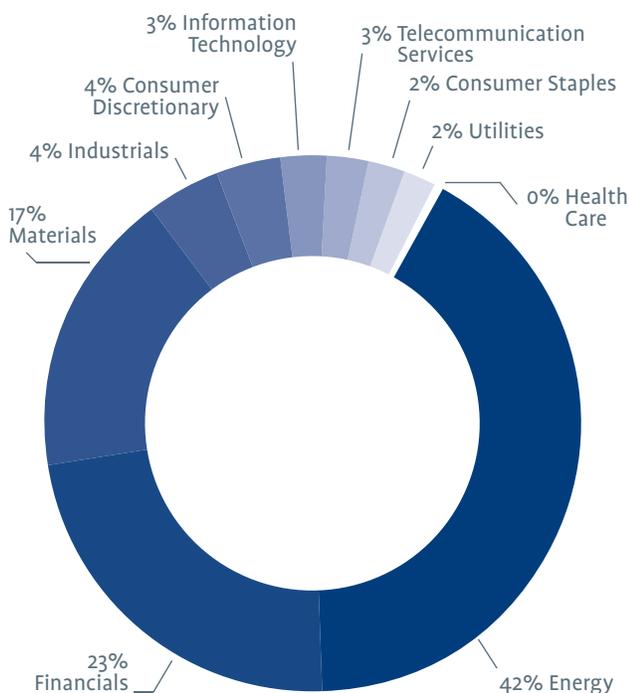
Attend and obtain
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Top 10 Most Active Option Classes (Q4 2014)

RANK	SYMBOL	Q4 2014 VOLUME	INSTITUTIONAL	RETAIL	INSTITUTIONAL %	RETAIL %
1	XIU	692,767	502,654	190,113	73%	27%
2	XEG	541,110	473,167	67,943	87%	13%
3	ATH	41,754	18,818	22,936	45%	55%
4	TD	152,008	40,598	111,410	27%	73%
5	BNS	174,820	68,803	106,017	39%	61%
6	MFC	219,777	157,278	62,499	72%	28%
7	RY	131,718	34,059	97,659	26%	74%
8	XFN	233,944	214,088	19,856	92%	8%
9	BMO	108,477	41,910	66,567	39%	61%
10	CNQ	152,196	69,340	82,856	46%	54%

Options Trading Volume by Sector

Q4 2014



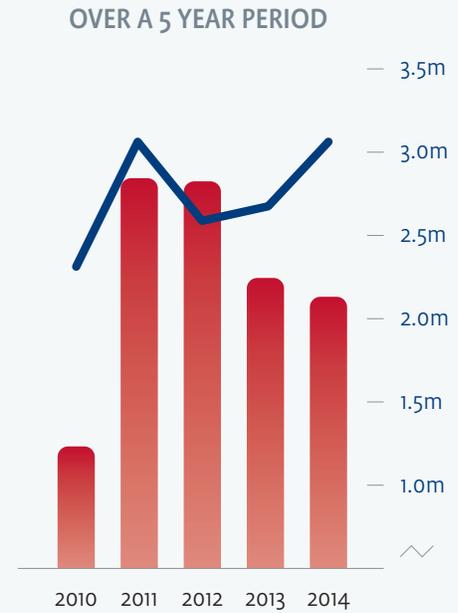
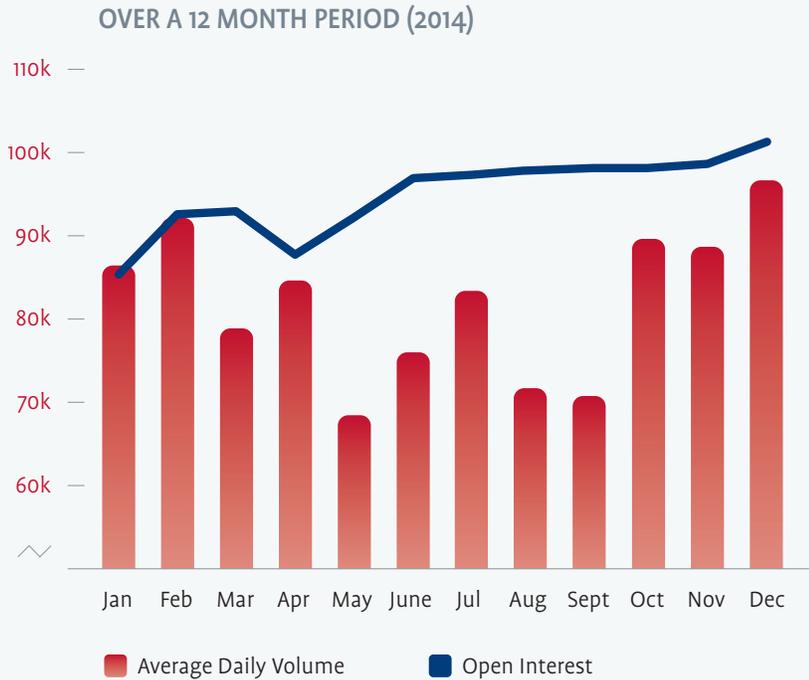
Source: Bloomberg

Note: Options volume from delisted or acquired companies are excluded.

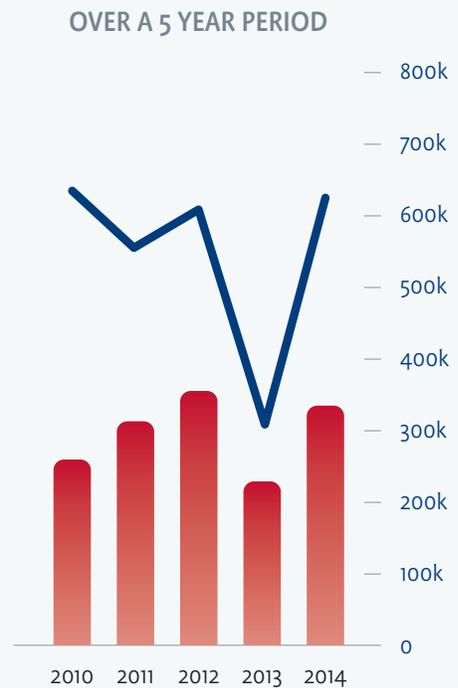
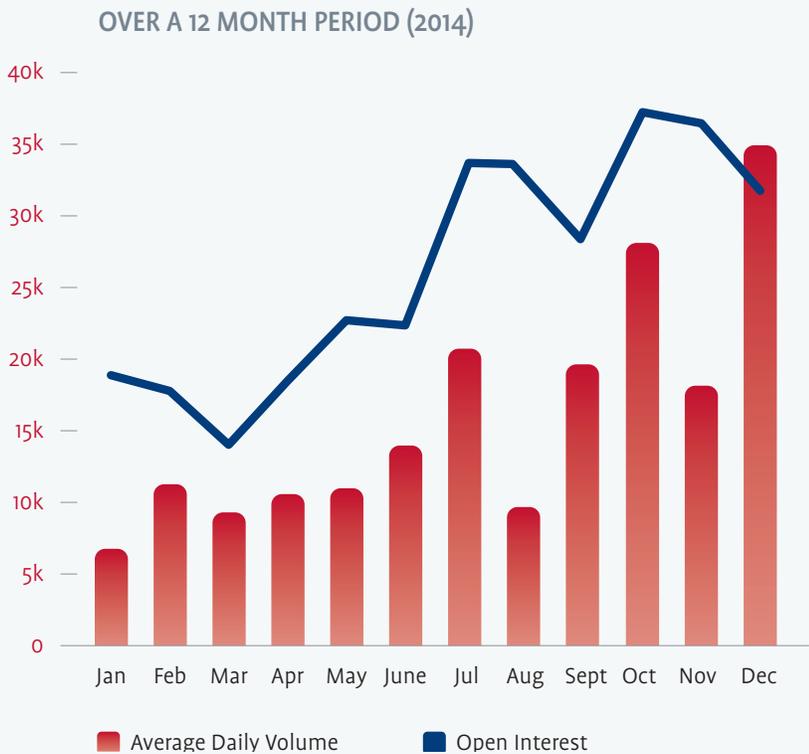
Most Crossed Option Classes

RANK	SYMBOL	CROSS VOLUME
1	XIU	502,654
2	XEG	473,167
3	XFN	214,088
4	MFC	157,278
5	COS	108,919
6	PRE	93,937
7	NA	92,623
8	XGD	85,637
9	TRP	83,342
10	CNQ	69,340
11	BNS	68,803
12	ZEB	60,000
13	DGC	54,339
14	TCK.B	53,242
15	TX60	51,388
16	SLF	48,538
17	ATD.B	47,669
18	BTE	46,105
19	MEG	46,072
20	TA	44,490

Equity Average Daily Volume and Open Interest



ETF Average Daily Volume and Open Interest



Trading Tools



Useful Links

GUIDES

- » [Equity derivatives](#)
- » [Index derivatives](#)
- » [Currency derivatives](#)
- » [Equity options tax regime](#)

MX INDICES

- » [S&P/TSX 60 VIX Index \(VIXC\)](#)
- » [MX Covered Straddle Writers' Index \(MPCX\)](#)
- » [MX Covered Call Writers' Index \(MCWX\)](#)

OTHERS

- » [Options List](#)
- » [Put/Call Ratios](#)



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