

# CANADIAN EQUITY DERIVATIVES

Quarterly Newsletter - October 2016

**MANAGER'S  
COMMENTARY**

**TRADING THE  
CANADIAN OPTIONS  
MARKET**

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**THE OPTIONS PLAYBOOK**

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on Barrick Gold (ABX)

Covered Call on BCE (BCE)

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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.

## 2016 Trading Calendar

OCTOBER							NOVEMBER							DECEMBER						
S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S
						1			1	2	3	4	5					1	2	3
2	3	4	5	6	7	8	6	7	8	9	10	11	12	4	5	6	7	8	9	10
9	10	11	12	13	14	15	13	14	15	16	17	18	19	11	12	13	14	15	16	17
16	17	18	19	20	21	22	20	21	22	23	24	25	26	18	19	20	21	22	23	24
23	24	25	26	27	28	29	27	28	29	30				25	26	27	28	29	30	31
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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# TRADING THE CANADIAN OPTIONS MARKET

By Patrick Ceresna

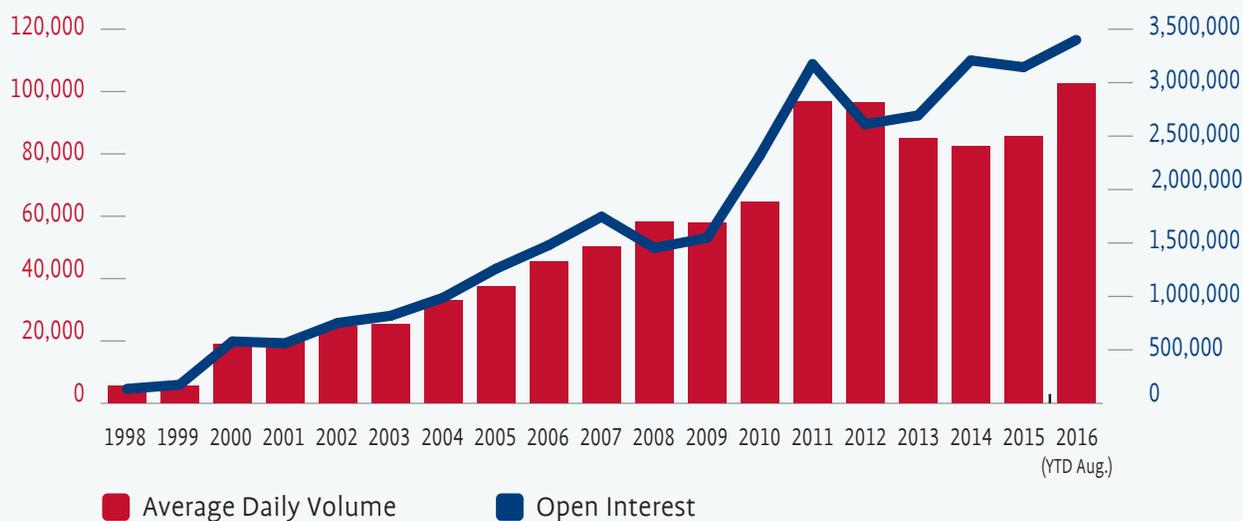
It is time to take a second look at Canadian options. Seasoned investment professionals who have been in the business for several decades remember the less liquid options market from a decade ago. Back then, ETF options had almost no volume and the equity options average daily volume averaged near 20,000 contracts. Back in those days, the liquidity was always an important consideration.

**But...**

Any money manager that still stereotypes today's options market to that of a decade ago should have a second look. Let's look at some data.

For standard equity options, the compounded annual growth rate of 18% has changed the landscape considerably. The average daily volume has rocketed higher from 20,000 contract in 2001 to over 100,000 contracts in 2016. At the same time, the open interest has increased 7 fold from 500,000 contracts back in 2001, to reaching 3,500,000 contracts this year.

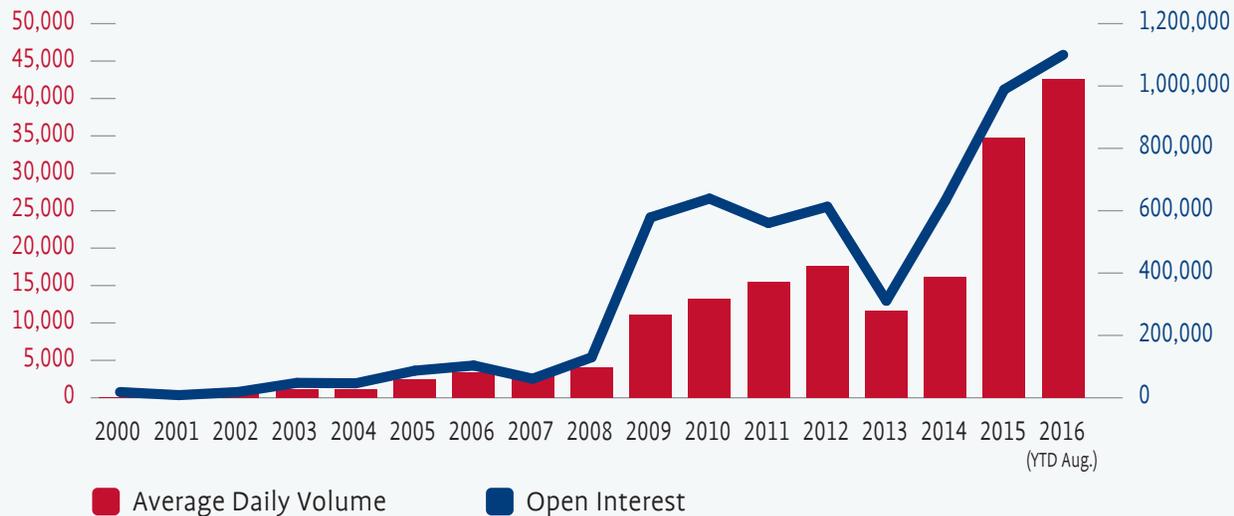
Equity options (1998-2016 YTD)



# THE MANAGER'S COMMENTARY

While that is solid growth, it is the 45% compounded annual growth rate of the ETF options that is most impressive. In the last decade, ETF options have seen a 10-fold increase in both average daily volume and open interest. This includes a 100% increase in open interest and average daily volume in just the last two years.

## ETF options (2000-2016 YTD)



### The Big Myth - Canadians will always find more liquidity in the U.S.

Yes, the American market is larger, that does not mean that Canadians will not find more liquidity in the Canadian market on interlisted names. A perfect example of this is an advisor friend of mine who stated that he always sells his naked puts on Royal Bank on the U.S. markets because they are more liquid. Really?

Here are some facts.

Back on August 24th, the open interest on NYSE:RY front month and next month options was under 4,000 contracts and the closest at-the-money September call had a \$0.70 spread (\$3.20-\$3.90). In addition to that, investors had options only available in \$5.00 strike price increments.

Alternatively, the open interest on the Canadian (TSX:RY) front month and next month options exceeded 27,000 contracts. The at-the-money September call had a \$0.09 spread (\$1.30-\$1.39). In addition to the substantially larger open interest and tighter spreads, the options offered strike price increments as frequent as \$0.50.

### Interlisted names trading more in Canada than in the U.S.

It is time for you to see if you can recognize stocks you own for your clients or in your portfolio.

#### Canadian Banks and Financials

Bank of Montreal, Bank of Nova Scotia, CIBC, Manulife, Royal Bank, Sunlife and TD Bank

## Energy and Pipeline

Advantage Oil&Gas, Baytex Energy, Cenovus Energy, Crescent Point Energy, Enbridge, Enerplus, Imperial Oil, Just Energy, Pembina Pipeline, Precision Drilling, TransCanada and Vermilion Energy

## Basic Materials and Mining

Asanko Gold, Bellatrix Exploration, Dominion Diamond, Hudbay Minerals and Tahoe Resources

## Telecoms

BCE Inc, Rogers Communications, Shaw Communications and Telus

## Other

Brookfield Asset Management, Brookfield Infrastructure, Brookfield Property, Canadian National Railway, Celestica, CGI Group, Cott Corp, Gildan Activewear, Magna, and Thomson Reuters

**The Bottom Line** - All of the companies above trade more in Canada. It may be time to take a second look.

## Currency Considerations

When an investment advisor or portfolio manager decides to trade the options exposure on the U.S. side, one of the key risks is currency. An example of this is observing the substantial price divergence in bank stock price moves, back in 2015. Using Royal Bank as an example, on the TSX (in Canadian Dollars), the share prices peaked at \$83.87 (November 2014) declined over 20% to a low of \$64.52 (February 2016). While that was a material bear market decline, it is quite notable the significance the currency influenced performance.

Alternatively, Royal Bank on the NYSE (in U.S. Dollars) peaked at \$76.07 (September 2014) and proceeded to decline to \$44.37 (January 2016), a staggering 41% lower.

Why was there such a surprising difference? It was all driven by the material rally in the U.S. Dollar over that time. If a portfolio manager or advisor was selling naked or cash covered puts on Royal Bank, the trade experience and trade management would have been completely different.

**The Bottom Line** - Currency matters and there are many cases that focusing on Canadian stocks in Canadian dollars will offer many strategic advantages.

## Putting it all together

With the material increases in liquidity in Canadian equity and ETF options, there are many times during which money managers would gain value in utilizing the Canadian markets. Whether to hedge currency risk or to find more liquidity, it is time Canadian professionals take a second look.

## Cash Covered Put on Barrick Gold (ABX)

Gold mining companies have been the single most volatile sector in the market throughout 2016. After a powerful rally in the first 6 months of the year, most gold miners have retraced half of their gains through the second half of the year. No better example of that is Barrick Gold. After trading below \$10.00 a share in 2015, the stock proceeded to rally to \$30.00 by July of 2016. Since then, the stock has given back half those gains. For those that view the stock pullback as an opportunity could use the put selling strategy to make income while attempting to accumulate the stock at more favourable levels. The put selling strategy is particularly effective if you are doing it on stocks you are willing to own and have the cash to undertake the obligation to buy the shares.

Here is the breakdown:

- Barrick Gold is trading a \$20.55 (October 11<sup>th</sup>, 2016)
- ABX had a 52wk range of \$9.18 - \$30.40
- The January 20<sup>th</sup>, 2017 \$17.00 call is \$0.57 bid

One can generate a 3.35% premium income for selling the January \$17.00 strike puts in just 3 months. If assigned, the investor would own the shares at an average price of \$16.43 when adjusting for the premium received.

## Covered Call on BCE (BCE)

BCE arguably remains the king of the Canadian telecom market. It's recent growth strategy has been through acquisitions, the most recent being its focus on Manitoba Telecom. This business model continues to deliver consistency to investors and driving the long standing view that BCE is Canada's premier dividend income stock. By purchasing the stock, one secures a 4.50% annual dividend. But with a covered call, one can secure a further income stream.

Here is the breakdown:

- The stock is trading a \$59.71 (October 11<sup>th</sup>, 2016)
- The next quarterly dividend is scheduled for December
- BCE had a 52wk range of \$52.38 - \$63.41
- The January 20<sup>th</sup>, 2017 \$60.00 call is \$1.20 bid

One can generate a 2.00% enhance income in addition to dividend stream in just 3 months. This is particularly effective in registered accounts like RRSPs where the need for tax considerations is unnecessary. The only thing that one must be aware of is that the stock could be called away prior to the December dividend. While that is a risk, the stock would have to be notably higher for that to occur.

**OPTION  
MATTERS**



## FOR ITS 10-YEAR ANNIVERSARY, THE MONTRÉAL EXCHANGE BLOG GETS A NEW LOOK!

- › New look
- › New contributors
- › New tips to profit from the use of options!

[optionmatters.ca](http://optionmatters.ca)

A Montréal Exchange initiative

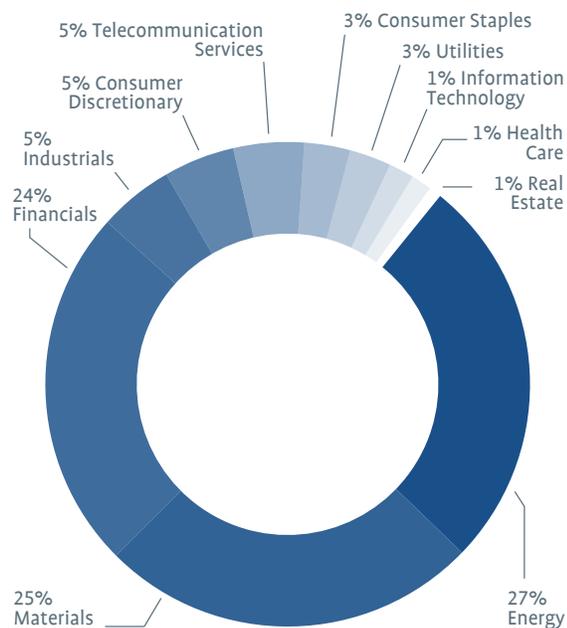


## Top 10 Most Active Option Classes (Q3 2016)

RANK	SYMBOL	VOLUME	INSTITUTIONAL	RETAIL	INSTITUTIONAL %	RETAIL %
1	XIU	1,755,760	1,625,585	130,175	93%	7%
2	XGD	208,041	157,924	50,117	76%	24%
3	RY	192,090	65,656	126,434	34%	66%
4	ABX	179,201	36,688	142,513	20%	80%
5	BNS	153,203	59,385	93,818	39%	61%
6	CM	150,923	73,034	77,889	48%	52%
7	XEG	149,392	121,376	28,016	81%	19%
8	NA	146,495	98,307	48,188	67%	33%
9	TD	143,689	48,362	95,327	34%	66%
10	TCK.B	141,452	29,841	111,611	21%	79%

## Options Trading Volume by Sector

Q3 2016



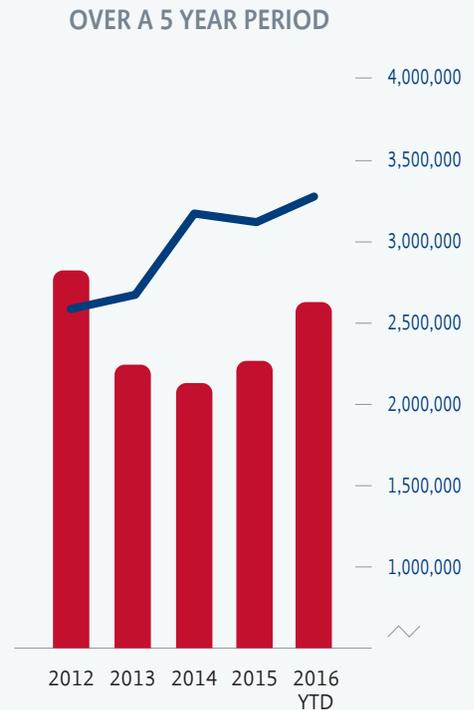
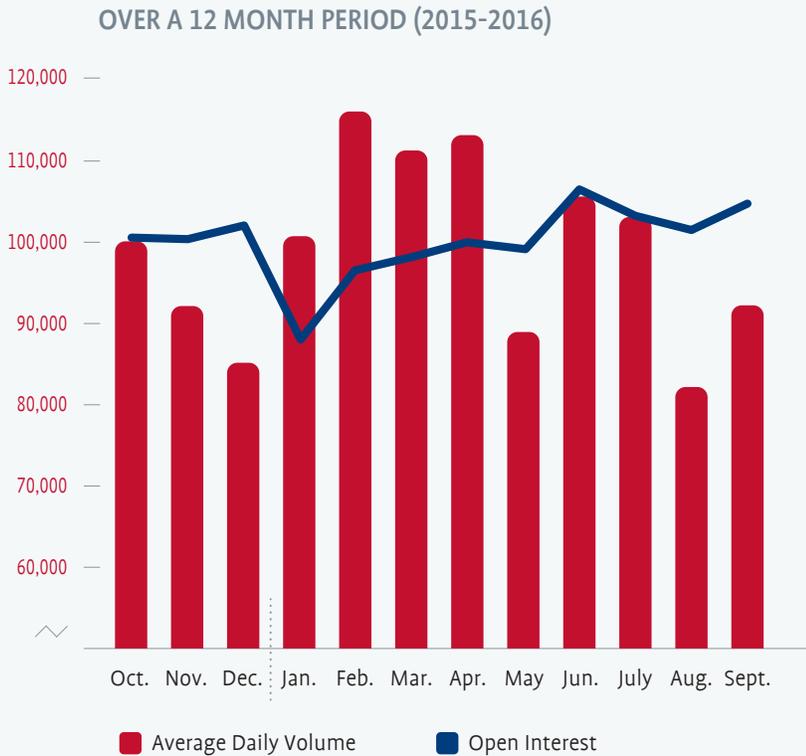
Source: Bloomberg

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

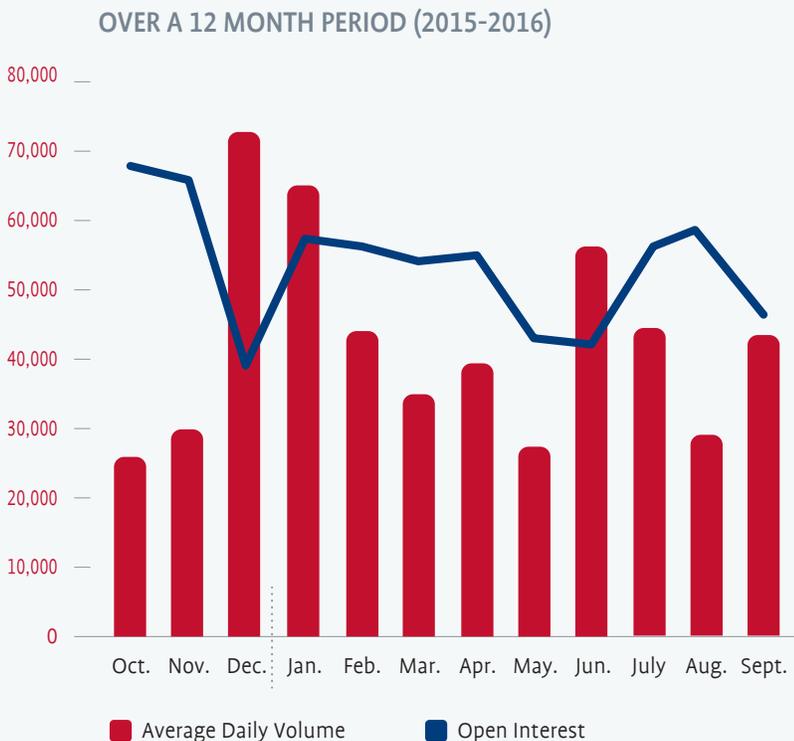
## Most Crossed Option Classes

RANK	SYMBOL	CROSS VOLUME
1	XIU	1,625,585
2	XGD	157,924
3	XEG	121,376
4	ZEB	110,380
5	NA	98,307
6	SXO	92,530
7	BCE	82,806
8	ZSP	79,622
9	CM	73,034
10	EFN	70,158
11	TCW	67,400
12	RY	65,656
13	PD	65,260
14	RCI.B	62,035
15	ECA	60,474
16	ENB	59,840
17	BNS	59,385
18	G	59,325
19	MFC	55,605
20	SU	53,348

## Equity Average Daily Volume and Open Interest



## ETF Average Daily Volume and Open Interest



# Trading Tools

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**COVERED CALL**  
Calculator

**OPTIONS**  
Calculator

**TMX Trading**  
**SIMULATOR**

## Useful Links

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### 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](#)



[m-x.tv](http://m-x.tv)



[OptionMatters.ca](http://OptionMatters.ca)



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