Understanding Options Gamma to Boost Returns

Maximizing Gamma

The Optimum Options for Accelerated Growth

For more information on our Options Shark Advisory Service, click here.
Enhance Your Option Trading Returns by Maximizing Gamma

Select the Optimum Options for Accelerated Growth

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Options Shark is one of the flagship recommendation programs at BigTrends.com. Run by Hall-of-Fame trader Price Headley, Options Shark offers short-term, aggressive, real-time option trade recommendations. Price utilizes a proven and unique technical analysis method for finding the best breakout opportunities that can last from one day to several weeks.

Just how do we utilize the leverage of options to best garner profits on these big breakout signals? Well, this is the latest innovation to our option trading selection process – we call it Gamma Booster.

**What is Gamma?**

As you may know, Gamma is one of the “Option Greeks” - mathematical functions that are part of the option pricing formula. Specifically, Gamma refers to the rate of change in Delta in the option per each $1.00 move in the underlying security.

Gamma has many uses outside of options trading. This ancient Greek symbol is used in probability, engineering, physics and many other sciences. The way we utilize Gamma in our option selection is designed to accelerate the leverage with as little cash outlay as possible.

**What is the technique we utilize in Options Shark in order to maximize profits with our aggressive directional trade recommendations?**

As mentioned, we’re looking for power breakouts. The success profile of the best trade signals indicate we’ll know quickly if we are correct. If we are, we can ride the trade much higher to big profits. If not, we bail out quickly for a minimal drawdown.

The option selection itself has been tested and tweaked by Price and the BigTrends team of analysts for Options Shark. Basically, we’re focused on the “high Gamma” options in the 1 week to 1.5 month expiration area. These offer the biggest ‘bang for the buck’ with a relatively small cash outlay. This provides a great risk/reward package for our subscribers.

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Normally, the Gamma Booster options that we choose are near-the-money, usually a bit out-of-the-money (OTM) - although they can also be at-the-money (ATM) or even in-the-money (ITM). We’re finding that the optimal ‘sweet spot’ between Delta, Gamma, Theta and Vega is often 1 or 2 strikes OTM in the front month options.

Let’s take a look at a theoretical example based on real-life prices.

The Nasdaq 100 tracker (QQQ) has 16 trading days left until the next expiration and is at 53.36. If we have a bullish Options Shark trading signal, we may be targeting a quick run to the 57 level or higher. The QQQ next month options with the highest Gamma are the 53, 54, and 55 strikes. The highest is the next OTM strike 54 with a Gamma of 0.10.

This means that the Delta will rise 0.10 for each $1 move in the underlying. Of course the Gamma is dynamically changing as the price moves. The Delta on this 54 option is 0.47 currently - meaning the option price will go up 0.47 approx. with each $1 move in the underlying.
The Theta (time decay) on this option is about 0.046, or 4.6 cents per day. The Vega is also 0.046. But Vega (and implied volatility) risk is not as much of a concern for us because we are buying options, generally, in the 1 week to 1.5 month expiration range. The further-out options have much higher Vega, and so are much more influenced by changes in implied volatility.

The front-month and close options that we like to purchase have much bigger Gamma and much less Vega. We are getting a Delta boost (and an option price boost) when they move quickly in our favor. This, of course, is what our tested trade signals are designed to find.

Going back to that QQQ 54 Call example (with underlying at 53.36), this option is priced at 1.38 offer. **Low priced options:** yet another reason we like our Gamma Booster strategy for options selection. This equates to less cash outlay for you (or more contracts if you choose) and, in effect, less maximum risk because the most you can lose on an option purchase is your $ outlay.

This QQQ 54 Call has a 0.46 Delta but a 0.10 Gamma kicker. On a $1 move in the underlying the next day, it should rise by 0.46. Plus, the Delta will rise to 0.55 or so. The time decay Theta is 0.046 cents currently. So, in 1 day a $1 move theoretically will make the option worth somewhere around 1.79 (0.46 gain from Delta minus 0.05 time decay). If we paid 1.38, that’s about a 30% gain in 1 day on a 1.8% gain in the stock!

**Talk about leverage!**

Now, let’s assume it moves up another $1 on the underlying for a 2nd day. The Gamma is now a bit lower, but probably will be in the 0.09 area. The Delta will be around 0.55 as we mentioned. Let’s assume that Theta has risen to 0.08 just to be fair (with the days...
elapsed and possible volatility drop). This means our position will now be worth, roughly, $2.26 (0.55 Delta gain minus 0.08 time decay). Because of the big Gamma value, the Delta has now raised to roughly 0.64. You can see the acceleration or booster effect that we like.

On the $2 move in 2 days, this option we bought for $1.38 ($138 each) is now likely worth around $2.26 ($226). That’s a 64% gain in 2 days on a 3.7% move in the underlying security. That equates to 17x leverage on utilizing the option versus the stock!

Following is a representation of how the actual Gamma and Option Price have behaved on this option over the past month. This is *not* a projection of future data. You can see that the Gamma Effect is gaining. We utilize similar time frames in our Options Shark trade recommendations in order to hit the ‘sweet spot’.

With the power breakouts our system finds, we can outpace the potential time decay and find the super-charged Gamma options to get the best risk/reward ratio. As we
mentioned, the Options Shark system will exit the non-producing trades quickly, thereby minimizing losses.

Option Market Makers clearly recognize the value and importance of Gamma. They often have a large ‘long’ or ‘short’ Gamma position based on customer and institutional order flow. When they are long Gamma, they are looking for big moves in the underlying stock/index/ETF/commodity in order to ‘scalp’ profits at a faster rate than time decay occurs. The effect of Gamma can magnify as an expiration approaches for strikes near the money, hence why some say “expiration week is Gamma week”.

Similarly, in our Options Shark Gamma Booster strategy, we get ‘long Gamma’ by purchasing Calls and Puts that are best positioned to get the maximum profits on a quick, strong directional move in the underlying. This is a fairly aggressive strategy on the risk/reward spectrum. However, this is where the biggest gains can often be found. Keep in mind that, on a real $ basis, we’re buying relatively “cheaper” options. So, the cash out of pocket (and maximum risk) can be lower than with other option strategies.

Please visit www.BigTrends.com for up-to-date market information, trader education and trade advisory services to suit every active trader. Please address any questions to ClientCare@BigTrends.com or call 800 244 8736. We’re here to assist you in reaching your trading goals.

Trade well! 
Price Headley and the BigTrends Staff