Options Fundamentals
Ep 14

Diagonals

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Disclaimer

This presentation is for educational purposes only. Nothing in this presentation is intended to be trading or financial advice.

What is a Diagonal?

- A Diagonal is a time spread where you sell nearer term options and buy an equal number of further term options

  - e.g. Sell 1 Jun / Buy 1 Jul – <u>different strikes</u>

- The front month is generally near the money and the back month is generally in the money

How do Diagonals Make Money?

- Diagonals are flexible in the way they make money.

  - They are positive theta with risk usually in one direction, but it can be in both directions (but not equal risk like a calendar)

  - They are usually positive vega, but it's possible to control the amount of vega risk including going negative

When to use Diagonals

- Diagonals do best when the IV is on the lower end since they usually benefit from rising volatility.

- Diagonals are good when you have a directional bias, but it's not strong and you want some flexibility

- This is determined by the width of the spread in time as well as the width between the strikes.
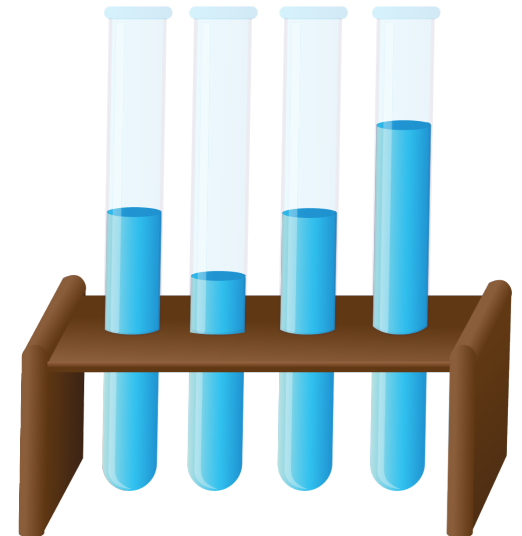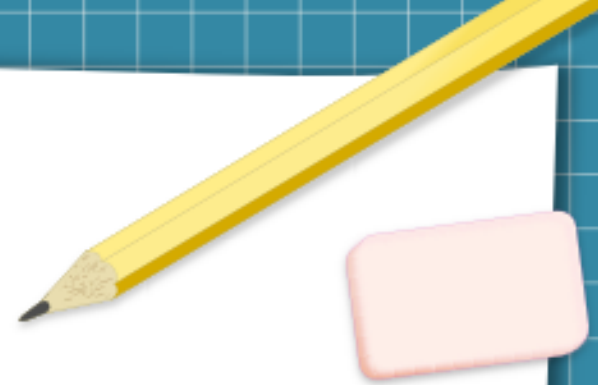
Diagonals as a Covered Call

- It is possible to use a diagonal as a cheaper version of a covered call.

- Use a high delta call further out in time as your long, and sell nearer in time closer to the money

- The deep ITM calls acts like stock at a cheaper price.
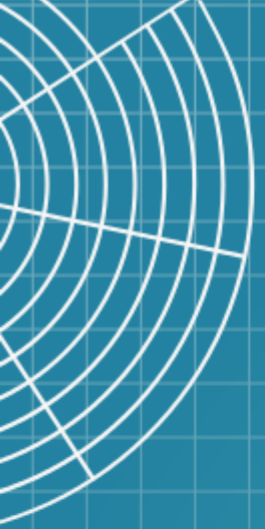
- Sometimes called a synthetic covered call or a "fig leaf"
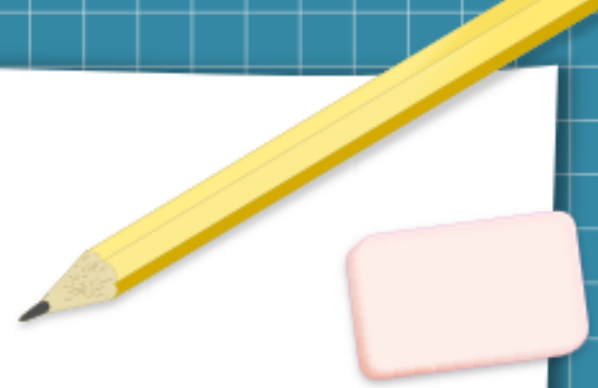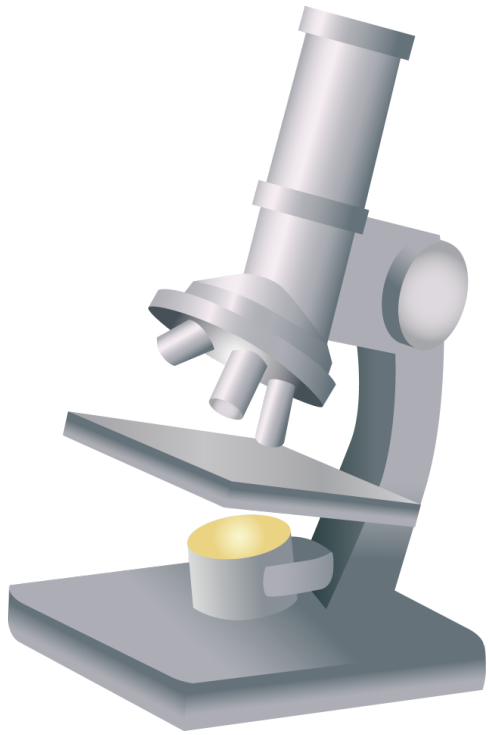
Off to the Lab!

Summary

- A diagonal is a time spread similar to a calendar but the long and short are at different strikes

- This gives it flexibility in terms of price and volatility risk

- It can be used as a substitute for a covered call or cash secured put without owning the stock

Thank you for your time. Let's keep talking!
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