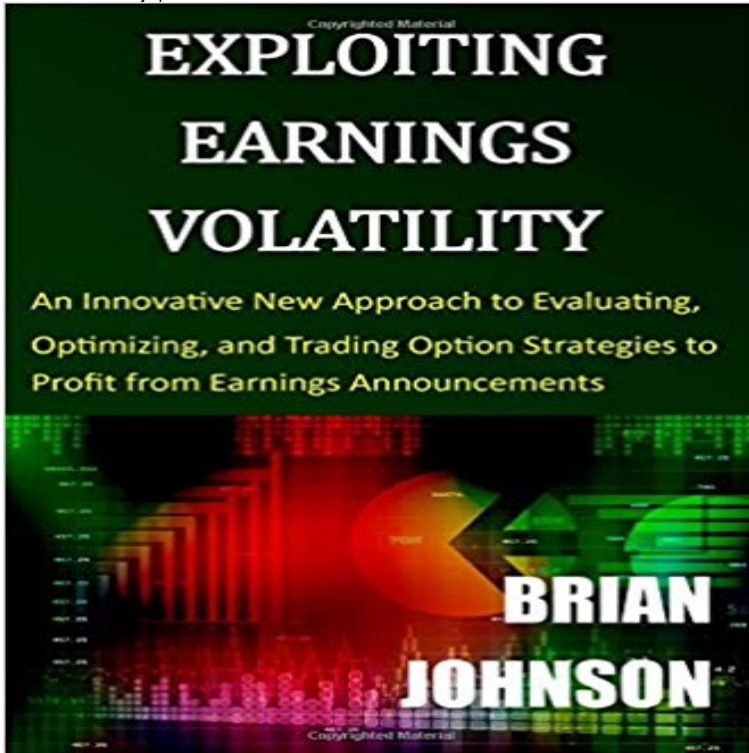


Exploiting Earnings Volatility: An Innovative New Approach to Evaluating, Optimizing, and Trading Option Strategies to Profit from Earnings Announcements



Exploiting Earnings Volatility introduces an innovative new framework for evaluating, optimizing, and trading option strategies to profit from earnings-related pricing anomalies. Leveraging his extensive background in option-pricing and decades of experience in investment management and trading, Brian Johnson developed this inventive approach specifically to design and manage option earnings strategies. In an Active Trader article titled Modeling Implied Volatility, Mr. Johnson introduced a formula for aggregating discrete volatility measures into a single metric that can be used with conventional option pricing formulas to accurately model implied volatility before and after earnings announcements. The practical application of this formula has profound implications for option trading and strategy development. Exploiting Earnings Volatility is written in a clear, understandable fashion and explains how to use this novel approach to 1) solve for the expected level of earnings volatility implicitly priced in an option matrix, 2) calculate historical levels of realized and implied earnings volatility, 3) develop strategies to exploit divergences between the two, and 4) calculate expected future levels of implied volatility before and after earnings announcements. Furthermore, Exploiting Earnings Volatility also includes two Excel spreadsheets. The Basic spreadsheet employs minimal input data to estimate current and historical earnings volatility and utilizes those estimates to forecast future levels of implied volatility around earnings announcements. The Integrated spreadsheet includes a comprehensive volatility model that simultaneously integrates and quantifies every component of real-world implied volatility, including earnings volatility. This powerful tool allows the user to identify the precise level of over or undervaluation of every option in the

matrix and to accurately forecast future option prices and option strategy profits and losses before and after earnings announcements. The Integrated spreadsheet even includes an optimization tool designed to identify the option strategy with the highest level of return per unit of risk. Written specifically for investors who have familiarity with options, this practical guide begins with a detailed review of volatility and an explanation of the aggregate implied volatility formula. A separate chapter provides a conceptual and mathematical explanation of True Greeks, accurate measures of risk and return sensitivity that reflect the real-world behavior of options. New option Greeks that are specific to earnings announcements are also introduced. Four chapters explain how to use the Basic and Integrated spreadsheets and two chapters document trade examples that use actual market data and analytical results from both spreadsheets to design a unique option strategy to exploit earnings-related pricing and volatility anomalies. The final chapter examines practical considerations and prospective applications of these innovative new tools. This book introduces a new analytical framework that may sound complicated at first, but is really quite intuitive. The formulas presented in the book are limited to basic high-school algebra. Mathematical relationships are also explained intuitively and depicted graphically. Most important, you will not need to perform any of these calculations manually. Exploiting Earnings Volatility includes a link to Excel spreadsheets that perform all of the calculations described in the book. The unique price and volatility behavior of options before and after discrete earnings announcements is an enigma to most option traders, even to many professionals. The aggregate volatility formula is relatively simple, but it has profound implications. When integrated with a real-world volatility model, it offers unique insights into earnings volatility, price

behavior, option strategy construction, and prospective value-added opportunities.

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