Twitter Thread by Aditya Todmal

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In NSE, 99.6% of the trading is done in derivatives.

But most of those traders don't know how to lower costs and increase returns.

Here's a breakdown on Options Synthetics: ■

Collaborated with @niki_poojary

To become a very good trader, we need a strong understanding of options and Futures with their payoff graphs.

Most people have no clarity regarding synthetics & are just too confused.

Let's begin understanding synthetics & how they can help us trade with a clear understanding!

Synthetics are formed by the mixture/combinations of any two of the following three.

1. Calls
2. Puts
3. Futures/Stocks

You don't even need to touch futures/stocks. Whatever kind of payoff graph you want, you can get via options only.

Fut buy + Put buy= Call buy
Ft buy + Call sell = Put sell
Ft sell + Call buy = Put Buy
Ft sell + Put sell = Call sell

Ft buy = Call Buy + Put Sell
Fut sell = Put Buy + Call Sell

Know this very well as this is a must to know.

There are four advantages to trade via synthetics.

Also, we'll look at 3 problems and 4 myths about strategies.

Let's begin, by looking at the advantages:

1) Increased Leverage

Synthetics increases your leverage due to lower margins.

For eg, you want to buy a stock you have to pay a huge margin.

Instead of that you can buy an ATM call and sell an ATM put.

Vice versa for selling.

Margins are drastically lower via options.

2) Charges are drastically lower

There is a cost to trade in futures in the form of huge STT charges, brokerage etc.

Options charges are way lower, so from a charged viewpoint synthetics make more sense.

3) Trade-in far month expiries for eg December

If you want to go long in July series now, can you go long in futures? No.

But you can sell puts and go long in July series now in options.

4) Mtm loss isn't settled through cash

We cannot short stocks in India, we need to trade via futures. Some traders don't like to trade in futures as they trade via collateral and mtm loss needs to be paid daily.

Synthetics takes care of that as u only have to pay when booked.

Problems:

1. Liquidity Issue - In stocks, there are liquidity issues when you try to use synthetics in ITM options.

2. Indian markets have low liquidity in contracts beyond the current month.

Eg: Reliance CMP is 2400

Covered call = Fut buy + 2600 call sell

Put sell via synthetics = 2600 Put Sell

Low liquidity here in the Put sold.

3. Mtm Loss needs to be paid in cash daily:

Options mtm losses can be adjusted against collateral till you don't "book" the loss.

Futures irrespective of if you book or don't book the loss, you still need to pay by cash daily.

Myths

1. Tripple Straddle has a huge advantage.

2. Inverted strangle has an advantage over strangles.

I couldn't have explained better than @SarangSood Sir this concept in his thread.

Read how he shows you how there is no advantage to both.

https://t.co/Gn6hjqIEzm

> A THREAD
>
> Topic: Why triple straddle has no real benefit.
>
> A triple straddle is essentially an ATM Straddle & one or two step away straddle on either side. The position is almost neutral strategy just like any other neutral straddle or strangle.
>
> 1/
>
> — Sarang Sood (@SarangSood) May 14, 2021

3. Futures "hedged" with puts

If you buy a call profit is unlimited, but if no movement occurs then the option will deteriorate in value.

If you buy fut and buy put, and if the stock doesn't move, the put goes to zero and fut doesn't give profit.

Both are the same.

Some people avoid option buying due to:

1. Low probability of success
2. Constant theta decay.

These same traders when they trade futures are buying puts as "hedges" too which is the same as buying options.

This is totally illogical.

4. Covered Calls

Can achieve the same via only selling puts.

When we buy fut and sell call to "hedge" we pay two margin requirements.

Selling a put requires only one margin.

Vice-versa for covered puts.

We hope we helped you clear some misconceptions/doubts regarding synthetics.

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@AdityaTodmal & @niki_poojary