OptionSellers.com

Summary and Final Report

Market and Loss Event from week of November 12th, 2018

Issued November 21, 2018

Overview

The events in the natural gas market last week were responsible for severe losses in the trading accounts of this firm.

You as a former client, likely have questions as to how and why this happened.

The purpose of this report is to describe what happened in the clearest terms possible.

Market Summary of Events

On November 12-14th, the US Futures Natural Gas Market experienced a price surge, climaxing in an 18% one day move on Wednesday, November 14th. This move covered a range of roughly 1000% of the average daily price move prior to this week.

Clients of OptionSellers.com held short call options in this market. We were liquidating these positions on the 12th, 13th and 14th. Unfortunately, the underlying market opened on the 14th in a "parabolic" move higher.

The move was so extreme that it not only overran remaining natural gas call position, it caused losses that depleted the portfolio margin and forced accounts into a deficit balance.

Timeline of Events

Previous Week – Nov 5-9

The week prior to the event, November 5-9, OptionSellers.com portfolios were diversified along typical prescribed guidelines.

Natural Gas Strangles (selling both a put and a call option) were a relatively new position. The put and call position were nearly equal in value. On November 5th, the natural gas short call position comprised about 16% of the overall position pie. It encompassed only about 9% of all available margin.

It was one of 10 different positions across the commodities sector. These other positions included:

Natural Gas Put Options

Gold Put Options

Gold Call Options

Crude Oil Put Options

Crude Oil Call Options

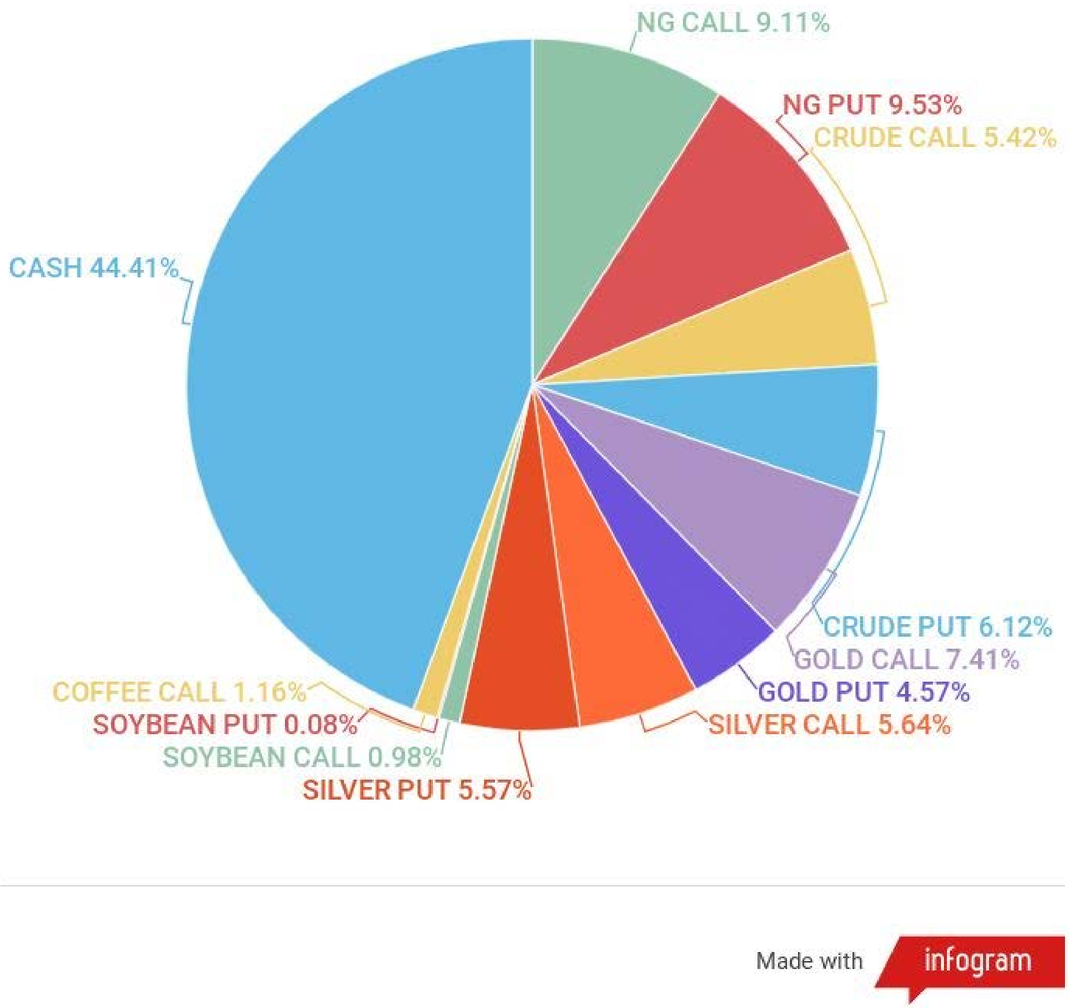
Coffee Call Options

Soybean Call Options

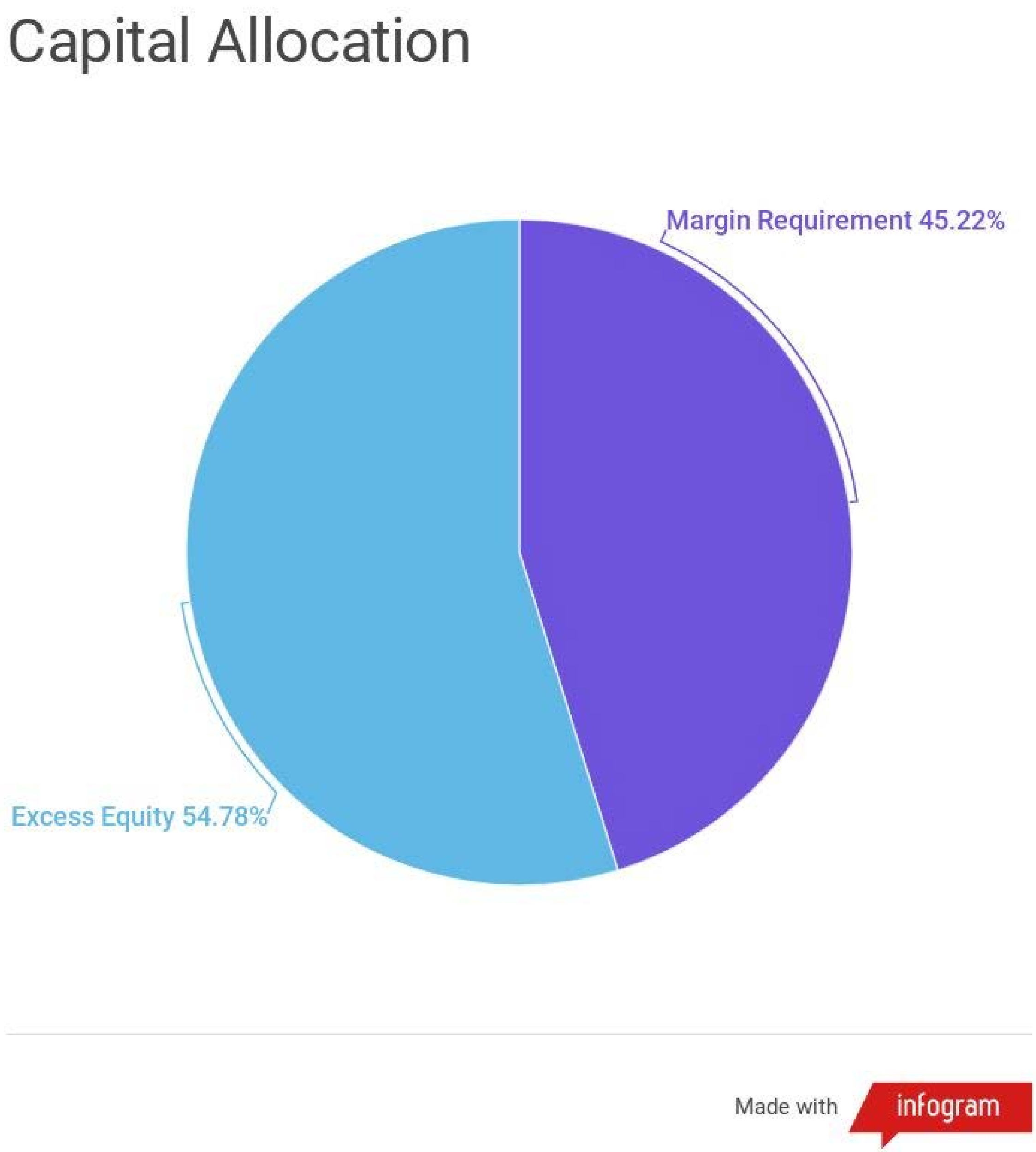
Silver Put Options

Silver Call Options

11/05/2018



Natural Gas was one of 10 different positions in the accounts. The week prior to the event, natural gas calls comprised a 9.1% allocation of the portfolio (as per total value of options).



Margin requirement to hold the positions was about 45% of account capital. Thus, positions were backed by a 54% cash position.

Fundamental Reasons

The US Energy Information Association (EIA) latest data showed the agency estimated the average price of natural gas for 2019 to be $2.98. This had been lowered from the last report (which was $3.02).

From that report:

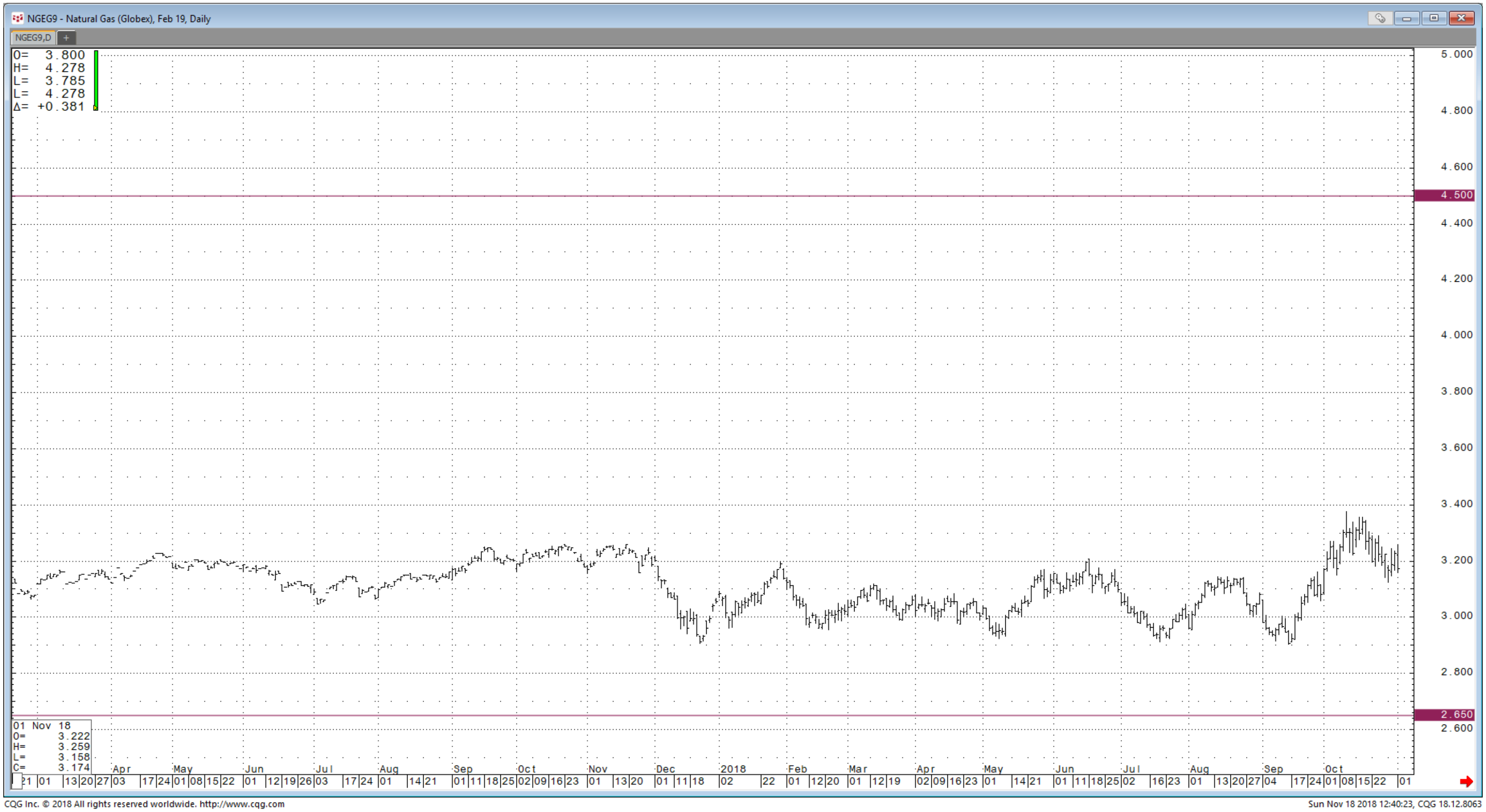
"Despite low storage levels, EIA expects strong growth in U.S. natural gas production to ***put downward pressure on prices in 2019****.* ***EIA expects Henry Hub natural gas spot prices to average $2.98/million British thermal units (MMBtu) in 2019****, down 4 cents from the 2018 average …"*

**Source: US Energy Information Association, Short term energy outlook, November 2018*

Because of this, the strangle appeared to be a safe and reasonable trade that fit into our typical guidelines.

While the strangles were entered at multiple strike price levels, the call strikes ranged from 4.50 to 5.75 in the February and March contracts. The chart below shows the lowest of these call strike levels.

February Natural Gas



Natural Gas chart on November 5, showing option strangle with lowest call strike.

Timeline of Events

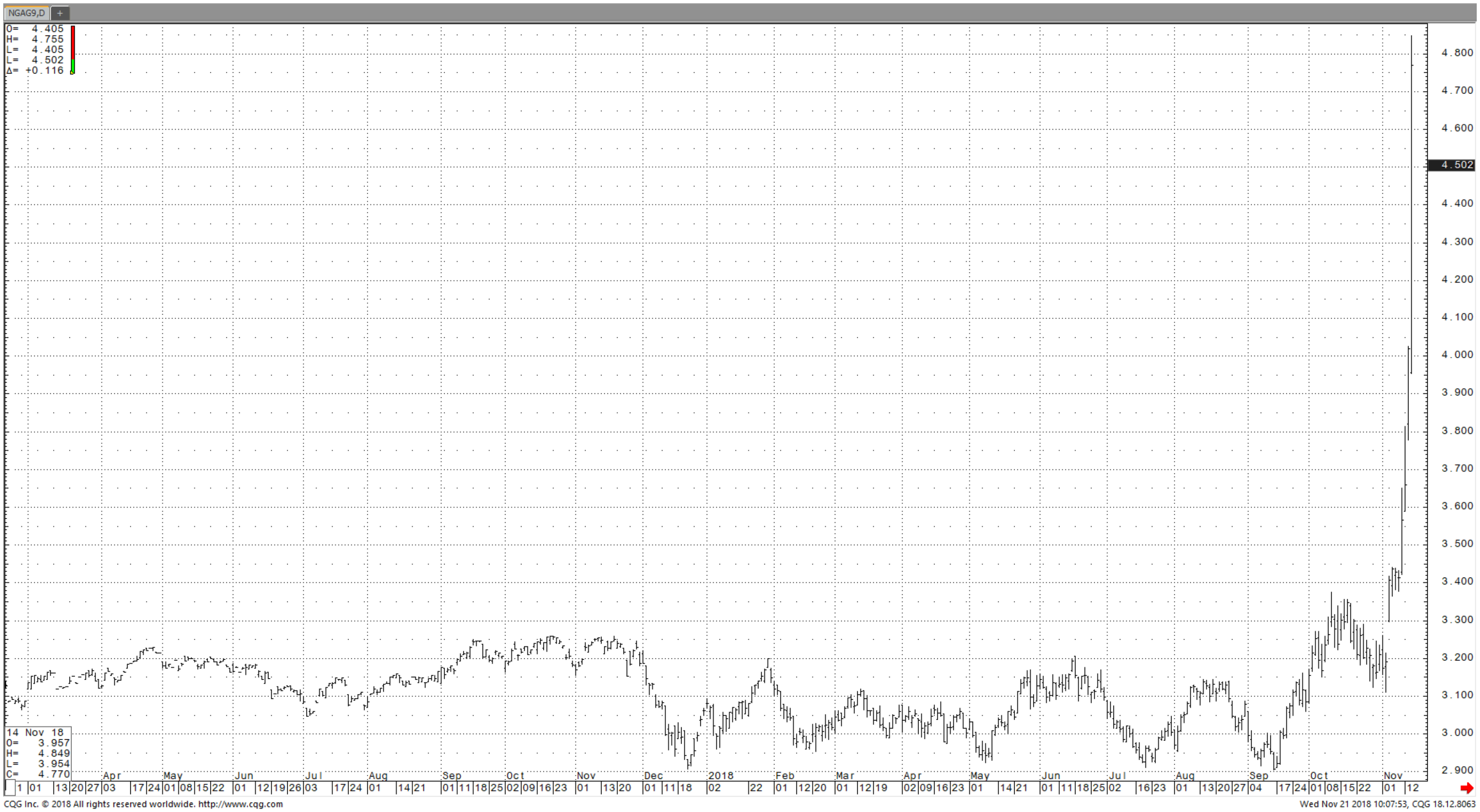
As of Friday, November 9th, Natural gas prices had started moving higher but not to the point where risk parameters had been triggered. Nonetheless, OS.com closed out some of the lower strikes as a precautionary measure, rolling them to higher strikes as part of risk management protocol.

However, Monday and Tuesday, November 12th -13th saw natural gas prices continue to strengthen. At this point, position liquidation began. While some strikes were rolled up on Monday, no accounts were on margin call at the close of trading Monday. On Tuesday the 13th, several accounts went on margin call and wholesale liquidation began. This liquidation was hindered as we began to experience some liquidity issues in the natural gas options market by Tuesday afternoon and also in the Tuesday night market. Thus, the remainder of the position was slated for liquidation on Wednesday, November 14th.

November 14th

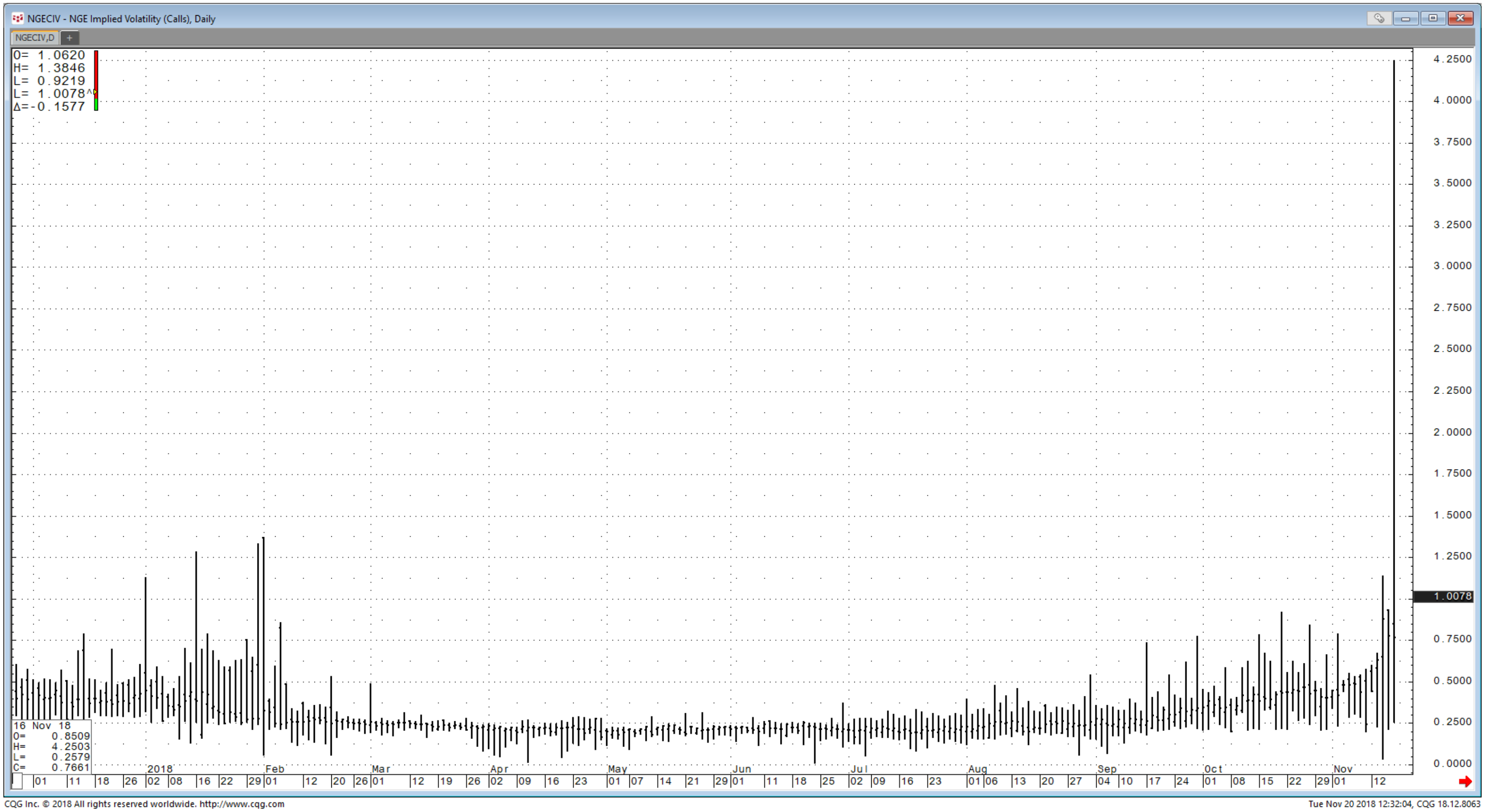
On Wednesday, November 14th, the natural gas futures market opened in a parabolic move higher, gapping up in a move nearly 1000% of its normal daily trading range. As a result, the remaining positions in the account experienced a sharp increase in value as volatility surged nearly 400% in a single session.

February 2019 Natural Gas



Natural Gas Move on November 14th.

Natural Gas Option Volatility



Natural Gas Call Option implied volatility surged from .75 the previous day to 4.25 on November 14th – a 400% increase.

Effects

The premium inflation, even in the higher strikes, eclipsed not only all of the safety cash margin but all of the money in the account. While the remaining natural gas positions were able to be closed on the 14th, a debit cash position left in the account meant no margin to hold all other positions. At this point, the clearing firm ordered forced liquidation on Thursday the 15th which began that day. All positions remaining open at close of business on the 15th were transferred by and to the clearing firm that evening.

The result was a “flat” account with a debit balance.

Conclusion

The positioning model, the risk management strategy, and the liquidation process were all conducted within stated company and program risk guidelines.

What happened appears to have been a black swan event that simply overwhelmed system safeguards.