

Subject: [/] DB Derivs: Stock Replace Winners ahead of Earnings
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Lower delta risk during earnings with options

This quarter seems to be another where expectations are high and so beats will be shrugged off and misses get punished. Last week we had a note looking at stock reactions to earnings; The initial move on SPX and NDX constituents earnings last quarter were mostly negative, even on beats, before retracing the move higher over the following week or so; misses were hit harder, but also recovered (albeit less).

- Average 1 day earning move of beats = -0.11% and the average 1 week move -0.01%, but the 1M return was 2.5%: roughly in-line with the SPX return over the period of 2.4%
- Average 1 day earning move of beats = -1.22% and the average 1 week move -0.74%, but the 1M return was 1.14%: much lower than the SPX return.

The question remains if it will look like that again this quarter. The bad NFLX print may be a harbinger to other long-momentum, short-value, or long-growth stocks. Based on last quarter's earnings reactions as well as the possible contagion from factor rotation on the back of Netflix, stock replace winners ahead earnings.

SPX & NDX stock replacement candidates based on relatively low vol and outperformance over last 3 months

Trades:

- AMD - Buy Aug 17 strike calls for 96c (ref. 16.55, 48d)
 - o Replacing delta protects 5.8% down, which is the roughly the implied move
 - o Stock has high short interest, so the squeeze potential offers asymmetric risk to the upside
 - o Breakeven is 8.5 % away; implied move is 5.6% but it has historically

moved ~12%, with most big moves to the upside.

- M – Buy Aug 38 calls for \$1.78 (ref. 37.15, 48d)
- o Replacing stocks protects 4.8% down, more than the implied move (3.2%)
- o Breakeven is 7% away, but with the elevated short interest squeeze potential can take the stock through breakeven as has happened with retail stocks last earnings season

- ALXN - Buy Aug 140 calls for \$4.20 (ref. 135.60, 41d)
- o Breakeven is 6.5% away; implied move is 6.84%
- o Using Aug vol trading lower than the July weeklies right after earnings and allows time for higher earnings drift if this earning season develops similarly to last

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