52wk high: 23.81
VIX: 13.29 (+0.51)
52 wk low: 9.39
52wk high: 26.77
QQV: 15.32 (+0.01)
52 wk low: 13.00

The Daily Strategist

from McMillan Analysis Corp.

VOLATILITY TRADING

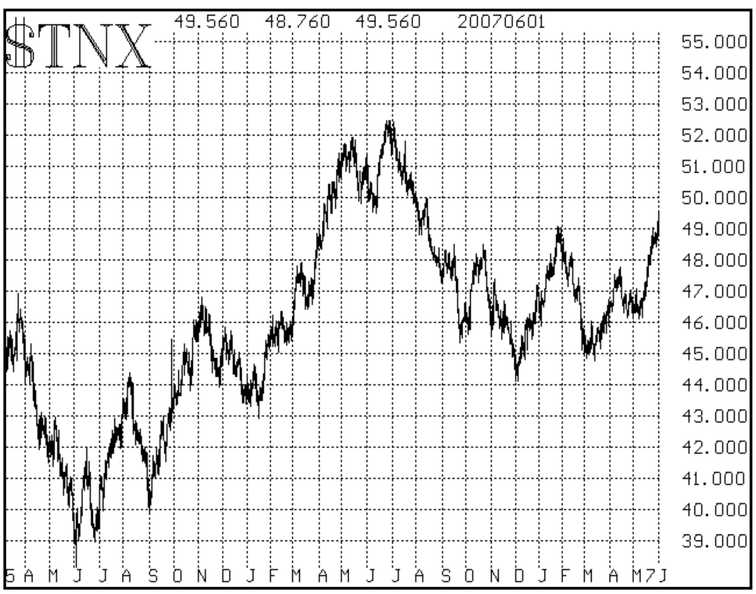
VXO: 12.73 (+0.22)

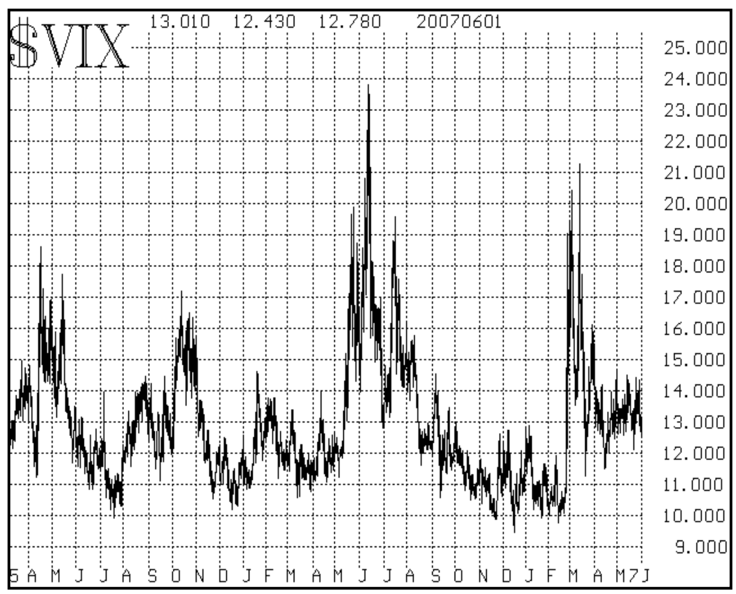
DAILY RECOMMENDATIONS

Monday, June 04, 2007

A late day spurt saw the **$SPX Index** close at yet another new record high today (1539). Strength in the **Energy sector (IYE; OIH)** inspired by a health rally across the Energy futures complex helped drive today's gains. The **Financial sector (IAI;IYF)** gained only a modest amount, as interest rate futures declined somewhat off recent highs. Therefore, sector participation in this rally toward new all-time (intra-day) highs **($SPX:** 1552) remains healthy.

Our technical indicators are still bullish: however, some of them are starting to reach (overbought) levels from whence sharp (market) pullbacks can now reasonably be expected. We are also keeping our eye on an interesting longer-term correlation between the **$VIX** and rising interest rates as a possible warning sign a more significant correction may be on the cards; and it may also explain why the **$VIX** has remained "elevated" relative to actual volatility. While there is no hard and fast rule, one can generally see that a peak formation, following a strong advance in interest rates often presages a subsequent rise in the **$VIX**. Interest rates have been steadily on the increase of late: however, they have not (yet) formed a spike peak; and therefore we are not going to assume a bullish **$VIX** position at this time – but we are keeping a close eye on this relationship.





Traders' sentiment levels remain bullish and in the 90th percentile. This is still supportive of the rally in **$SPX**; and as long as sentiment remains above the 90th percentile, we interpret this indicator as positive. And anyone who has been long the **Canadian Dollar (/CD; FXC)** over the past few months can attest to this interpretation of sentiment, as its sentiment readings have registered in the 90th percentile throughout the rally. The **$VIX** remains within the recent trading range of 12-to-14; and we would only interpret the **$VIX** as negative on a close above 14.50 or around the 10 level. The **CFE Volatility futures curve** remains steep and bullish, especially over the near-term. The reason being the near-term **June Volatility**

futures (/VX M) failed to match today's rally in the **$VIX** – which indicates that Volatility futures traders are not overly concerned about a market correction ahead of **June $VIX** option expiration (6/20/07). Beyond this time frame, the risk premium does increase by a relatively large amount; and as a result the **June/November Volatility futures spread** (sell **November,** buy **June**) has now widened out to an all-time (contract) high of around $1.65 credit. This is certainly a sizeable credit; and also indicative of an "extreme" overbought market environment. That said, this also appeared to be the case at a $1.25 credit; and hence until a catalyst emerges – e.g. a clear peak in interest rates – to change the trend, we are not going to deviate from our bullish market view of **$SPX** reaching a new all-time (intra-day) high **($SPX**: 1552). Though, with **$SPX** closing in on all-time highs, we continue to recommend taking partial profits on any long call positions; as the possibility of sharp, but short-lived market correction is increasing.

STRADDLE BUYS

Below is a table of our most attractive straddle-buy candidates:

Stock/Index /Future	Symbol	Und Prc	Straddle	Strd Prc	Days	%-ile of IV	50	Historic Movement Points	%	% Prob. Of touching B/E
Dec. Gold futures	**/GC Z**	689.50	Dec 690	51.20	127	14	25	95	95	91
Dec. Silver futures	**/SI Z**	1406.8	Dec 1400	171.00	127	5	22	95	95	86
Am. Science & Eng.	**ASEI**	54.55	Oct 55	9.60	97	1	24	95	95	84
Goldcorp.	**GG**	24.63	Oct 25	4.30	97	11	-3	95	95	82
NY & Co.	**NWY**	12.31	Oct 12.5	2.65	97	25	-7	91	88	79
Royal Gold	**RGLD**	27.30	Oct 25/30	2.65	97	4	11	92	91	80

Stock/Index /Future	Symbol	Und Prc	Straddle	Strd Prc	Days	%-ile of IV	50	Points	%	% Prob. Of touching B/E
None										

In addition to the straddle statistics presented above, the specific differences in implied and historical volatility are shown in the table on the right.

Stock/Index /Future	Symbol	IV	HV-20	HV-50	HV-100
None					

Following further research, we have added yet another dimension of analysis to our volatility-buying candidates: namely, buying straddles when implied **and** historical volatilities are increasing. In the following table, we combine that criterion with a high probability of historic movement, regardless of the current percentile of implied volatility.

Stock/Index /Future	Symbol	Und Prc	Straddle	Strd Prc	Days	%-ile of IV	Historic Movement Points	%	% Prob. Of touching B/E
Microstrategy	**MSTR**	102.51	Oct 100/105	14.90	97	3	75	77	82
Telefonos De Mexico	**TMX**	40.96	Nov 40	6.55	117	94	40	96	81

The table below depicts a scan of volatility to spot where the implied volatility of options on a particular stock has decreased sharply in a short period of time – specifically, IV must have decreased at least 40% in the last 25 days.

Stock	Symbol	Stock Price	Current IV	High IV in Last 25 Days	Percentile of IV
Compucredit	**CCRT**	36.25	28.65	48.21	1
Teletech Hldg.	**TTEC**	34.86	34.23	65.61	2
WholeFoods Mkt.	**WFMI**	41.41	27.38	46.49	28

Contact us at: 800 724 1817, Fax: 973 328 1303, e-mail: info@optionstrategist.com or visit our Web-site: http://www.optionstrategist.com

The table below depicts a scan of volatility to spot where the implied volatility of options on a particular stock has increased sharply in a short period of time – specifically, IV must have increased at least 50% in the last 15 days.

Stock	Symbol	Stock Price	Current IV	Low IV in Last 15 Days	Percentile of IV
Arena Pharma.	**ARNA+**	13.95	**92.18**	37.08	95
Idearc	**IAR**	37.40	**46.05**	24.01	100
Infospace	**INSP^**	24.35	**61.25**	29.21	92
Take-Two Interactive	**TTWO***	19.98	**77.96**	45.80	100

*** earnings related volatility increase**

^ takeover-rumor/LBO target/court settlement related volatility increase

+ FDA or product-related volatility increase

VOLATILITY SKEWS

When a volatility skew exists, it can take one or both of two forms – a vertical skew, whereby different striking prices have distinctly different implied volatilities, or a horizontal skew, where different expiration months have vastly different implied volatilities. The best strategy for taking advantage of the horizontal skew is a calendar spread – buying the long-term options and selling the short-term ones. For vertical skews, the strategy depends on which way the skew is distorted and if the options are expensive or cheap. In the wake of the massive market meltdown, most of the issues listed in the table below exhibit *both* forms of skewing. The vertical skews in these stocks are reverse skews – that is, the *lower* striking prices have the higher implied volatilities. In these cases, the best strategies for a reverse skew are 1) a call backspread or 2) a put (ratio) spread. Since these stocks exhibit both skews, one might want to utilize *diagonal* spreads and combine the calendar aspect with the vertical aspect.

Example of a diagonal backspread:

XYZ: 55
Buy 2 XYZ Dec 55 calls
Sell 1 XYZ Sept 45 calls

Example of a diagonal put ratio spread:

ZYX: 35
Buy 1 ZYX Dec 35 put
Sell 2 ZYX Sept 30 puts

Note: the put ratio spread involves *naked puts* and thus has large downside risk.

For more information on the profitability and risks of these strategies, see the last issue of *The Option Strategist* or refer to the book, Options As A Strategic Investment.

Below is a table of our most extreme Volatility Skews (ranked according to most extreme skew):

Stock/Index /Future	Symbol	Underlying Price	Volatility Skew (%-ile of IV)
Pozen	**POZN* (8/1)**	15.55	**36.41 (14)**
Cleveland Cliffs	**CLF^**	87.71	**22.00 (75)**
Neurochem	**NRMX+ (7/16)**	6.30	**19.80 (95)**
Openwave Sys.	**OPWV^**	10.37	**19.02 (8)**

Contact us at: 800 724 1817, Fax: 973 328 1303, e-mail: info@optionstrategist.com or visit our Web-site: http://www.optionstrategist.com

Stock/Index /Future	Symbol	Underlying Price	Volatility Skew (%-ile of IV)
Take-Two Interactive	**TTWO* (6/11)**	19.85	**18.05 (100)**
Quality Systems Int'l.	**QSII* (6/7)**	40.11	**16.95 (33)**
Regeneron Pharma.	**REGN**	20.46	**13.60 (75)**
Guess Inc.	**GES* (6/5)**	46.61	**13.36 (99)**
Jos A. Bank	**JOSB* (6/6)**	41.38	**13.13 (91)**
Adobe Systems	**ADBE* (6/14)**	44.47	**12.54 (87)**
Imclone Systems	**IMCL**	40.32	**11.68 (98)**

+ FDA or product-related volatility skew
*** earnings related volatility skew**
^ takeover-rumor/LBO target/court settlement related volatility skew

COVERED WRITE ANALYSIS

Due to the popularity of our unique Covered Write analysis in *The Option Strategist* newsletter, we have decided to incorporate a daily version of this analysis into *The Daily Strategist* newsletter henceforth.

Stock	Symbol	Stock Price	Call	Call Price	Invt. ($)	Profit ($) (Cash / Mgn)	Anlzd. Exp. Rtn. (Cash% / Mgn%)
Adobe Systems	**ADBE**	44.58	Jun 22.5	2.70	41.94	0.53 / 0.48	25 / 43
Ameren	**AEE**	51.86	Jul 50	3.20	48.72	1.25 / 1.00	16 / 25
Computer Sciences	**CSC**	56.33	Jun 55	2.15	54.24	0.73 / 0.66	25 / 43
Dillard's	**DDS**	36.77	Jul 35	3.00	33.83	1.14 / 0.96	12 / 15
Dow Jones	**DJ**	60.16	Jun 55	6.00	54.22	0.75 / 0.68	33 / 58
Hilton Hotels	**HLT**	36.14	Jun 35	1.60	34.60	0.37 / 0.33	14 / 21
Qualcomm	**QCOM**	42.18	Jun 40	2.75	39.49	0.48 / 0.43	29 / 50
VeriSign	**VRSN**	30.32	Jul 27.5	3.60	26.78	0.69 / 0.55	14 / 20

*** Receiving dividend**
+ If called away for dividend

Contact us at: 800 724 1817, Fax: 973 328 1303, e-mail: info@optionstrategist.com or visit our Web-site: http://www.optionstrategist.com