Profit in Pullbacks: Mr. Money Maxwell's Hedging Guide

I'm Justin, founder of Good Kids Trading and Mr Money Maxwell. I've been investing and trading in the stock market for almost 30 years. I'm offering this guide for free as a small sample of what I provide members of Mr Money Maxwell's Insider Circle.

My Hedging Strategy

I want to share my general guidelines and thought process for hedging, so you can apply them to your own accounts.

My thought process is if I can make some money when stocks pull back that puts me ahead of 98% of investors. I'm not looking to sell at the top or buy at the bottom. I'm looking to make some profits as the market pulls back to help pay some bills.

Investment Horizon

I hedge my accounts differently based on the account type and investment horizon. The longer the horizon the less hedging because time in the market is more important than timing the market.

For retirement accounts: I'm comfortable taking bigger short-term drawdowns in my IRA accounts since I assume my positions will be higher in 10 or 20 years when I can access them tax free.

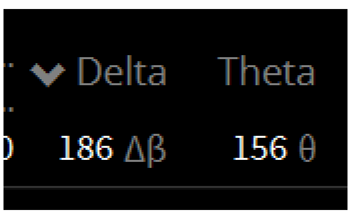
My taxable long-term account is hedged using collars and super collars, I'm also a big proponent of buying low and selling high. Selling high is a hedge because cash is a position. I will add the occasional put debit spreads in QQQ, given my long-term account is a tech-heavy portfolio.

For my trading account I am more aggressive with hedges, let's talk about managing delta.

Delta Management

The investment horizon for my trading account is shorter term; therefore, I focus on the overall delta, beta-weighted to SPY. I carefully track my accounts overall delta and theta.

I want to know how much my account will move as the market moves, and I want to know how much premium I will collect from time decay of my options sales which is measured in theta. This is a simple representation from one of my trading accounts.



Tasty Trade makes this so simple, but it's not that difficult in Think or Swim either. Google this if you don't know how. No reason for me to type it out when there is plenty of info out there on how to determine your accounts delta and theta.

I aim to hedge my deltas by 1/3 as a standard, but sometimes I'm more aggressive hedging half of my deltas. I adjust depending on my accounts sector exposure, chart analysis, and overall sentiment.

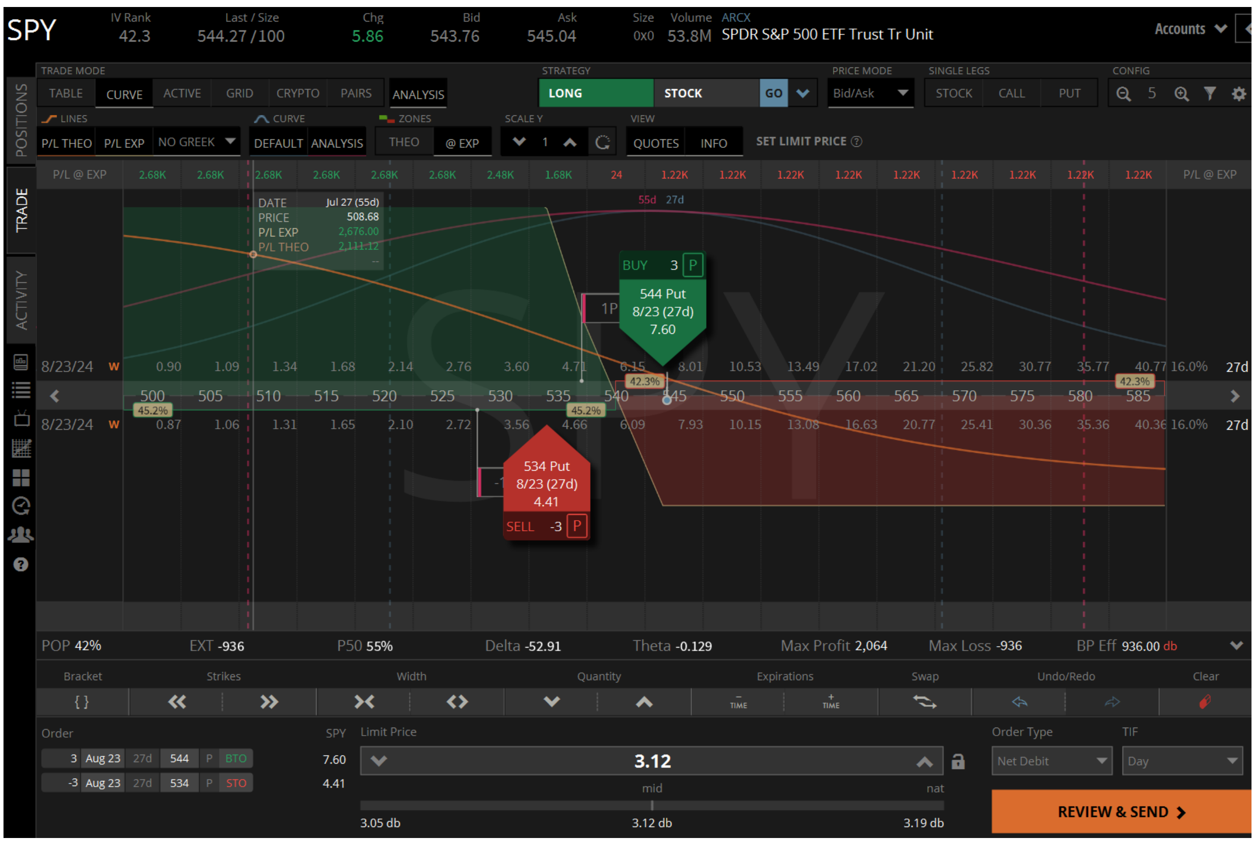
By reducing my overall delta even if I'm wrong and the market turns bullish I'm still happy because I keep positive delta. I trade on instincts, which come with experience. If you don't have experience yet, or even if you do joining the Good Kids Trading Discord is a great way to see what other's are doing. Let's get more specific with an example and look at how I hedged July 24, 2024.

Hedging Example

Let's say my beta-weighted delta of my trading account is 300 delta. I'll look for put debit spreads to reduce my delta by 100. I prefer buying put spreads with at least 21 DTE, as I'm not a day trader. I want to avoid time decay, but I'm willing to pay more for longer expirations. I don’t normally buy naked puts, but a long put is very strong protection, it’s just expensive. Buy selling an option against the long put I don’t have insurance to zero, but I reduce the cost of the trade so I can buy more spreads instead of one put I can buy a few spreads.

If I want to reduce delta by 100, I would setup a $10 wide spread, but you can start with $5 wide spreads.

3 spy put debit spreads reduce my delta by 53 (that means I can add another hedge on QQQ, which I also did)



If we have 3 spreads let’s look at the chart:

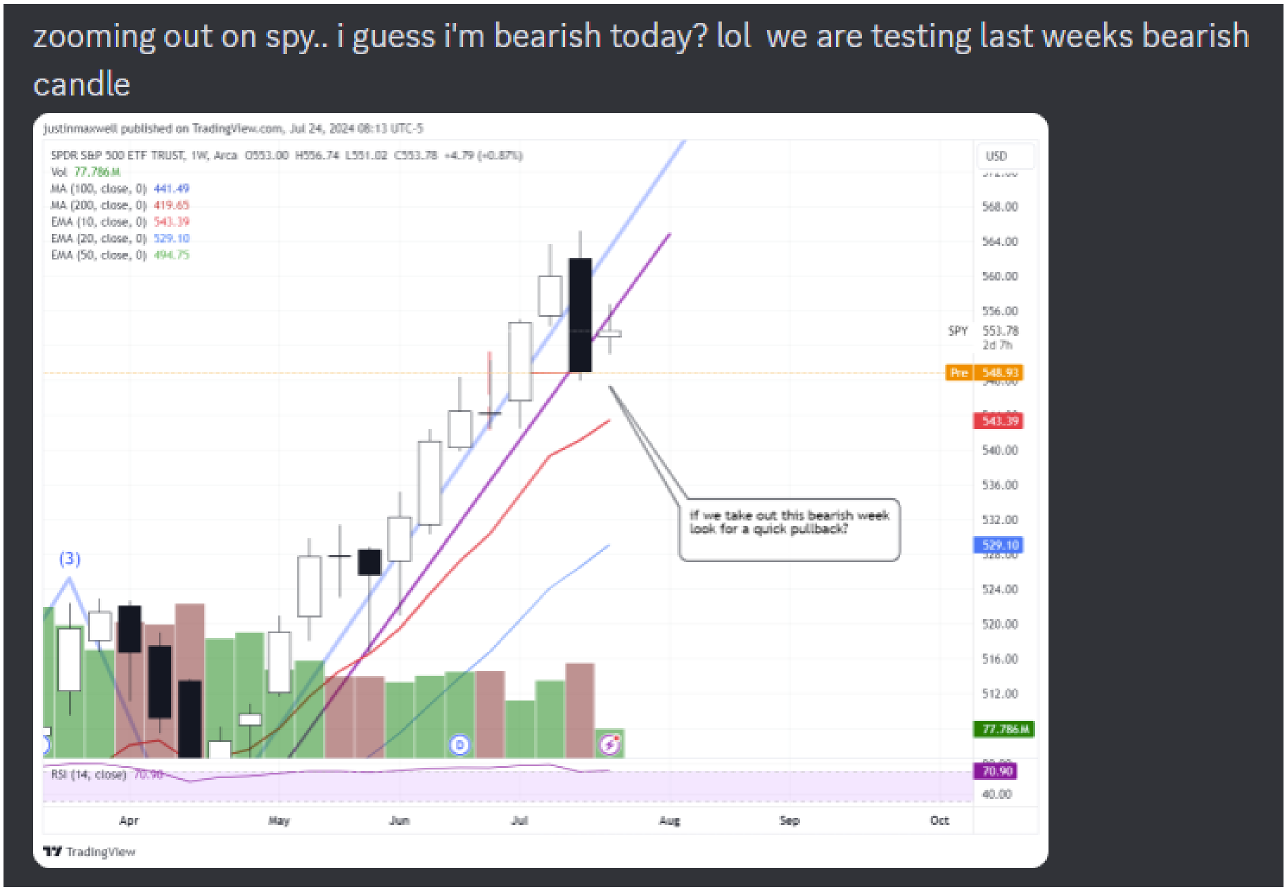
I want to take off my shorts based on where I think the stock might bounce (and where I am profitable). This is a hypothetical example above but the concept still applies.

With three spreads I'm looking for 2 profit targets to make some money on a possible pullback.

Hedging in Action with a real-life example from GKT's Discord:

This week, I added negative delta to my trading account based on chart analysis. This was my first post 15 minutes before market open.

Next I looked at the weekly chart for spy.



You see how premarket we tested the bearish engulfing candle? You see that we're extended from the moving averages?

Have you already figured out profit targets for 3 spreads?

If you haven't stop reading right now. Look at the daily chart (and weekly chart) and decide where you might want to take off some spreads. This is how you learn.

I felt good about my decision to short based on how the moving average was not acting as support:

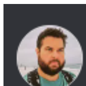
keeping those qqq hedges... why? look at how it cut through the 50 EMA... i'll watch it around the gap fill

I don't see much today team. going to just be patient here.

Do you see how the day's candle cut right through the green moving average in the chart above like it wasn't there?

That Gap fill is a good first target! People should have orders to buy there.

Where is my first target on SPY? I posted it in discord



$Maxwell 07/24/2024 10:38 AM

wanna guess my target for my spy short? green line?? will it hit it? i don't know... will it keep going down? i dont know.

At the end of the day most people who short shares want to cover because they don't want overnight risk. When people cover shorts they have to buy them to close. This causes the stock to bounce. I zoom into the 5 minute charts 30ish minutes until close. I posted this:

I pointed out the increasing "buying" but keep in mind this is mainly shorts covering for the day. This is often a good sign because sometimes you don't see this when people are REALLLY scared. I covered another 1/3 of my hedges here locking in 50% wins on my hedges.

The next day I do the same thing I actually look at the 5 minute just to get a sentiment. Not to necessarily make a trade. I posted this:

Do you see how i just zoom in and out to get a little better grasp on what the market is thinking? look at the doji on spy right at a moving average... break above or break below...

You see how the moving averages we use on all timeframes give us information?

My final target for my qqq was the moving average. And we did NOT hit it... So I still have my hedge on. I'm not always gong to be right, neither are you. But you can see how I hedge, and you can see how my posts in discord give you a heads up.

$Maxwell 07/25/2024 9:14 AM

i'm done for the day. i'll take off another level of hedges when QQQ hits the blue line. i'm letting some of them continue to run tho.

So far QQQ has not hit the blue line, I don't watch the charts. I set alerts and go about my day. If SPY and QQQ put in reversal candles and turn bullish I'll take off my last 1/3 of the hedge before it goes to zero.

Remember we can always add hedges on again when needed.

I hope you gained value from this. I’m posting this for free so you get a taste of what I offer subscribers of MrMoneyMaxwell.com Inside Circle.

For less than $2 a week you get content like this, a weekly newsletter, exclusive videos and more. I’ve been trading and investing in the market for almost 30 years. Let me help you make the market more passive and simple.

Hedging is a crucial aspect of trading, and I hope this example helps you understand my thought process. Remember, it's essential to have a thesis and remove mental wedges that hold you back from trading. With practice, you'll develop your instincts and improve your hedging skills.

-$Maxwell

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