Boom, Bust, & Blow-Ups

Options Trading Lessons from GME, NFLX, & TSLA

By: Jared Dillian

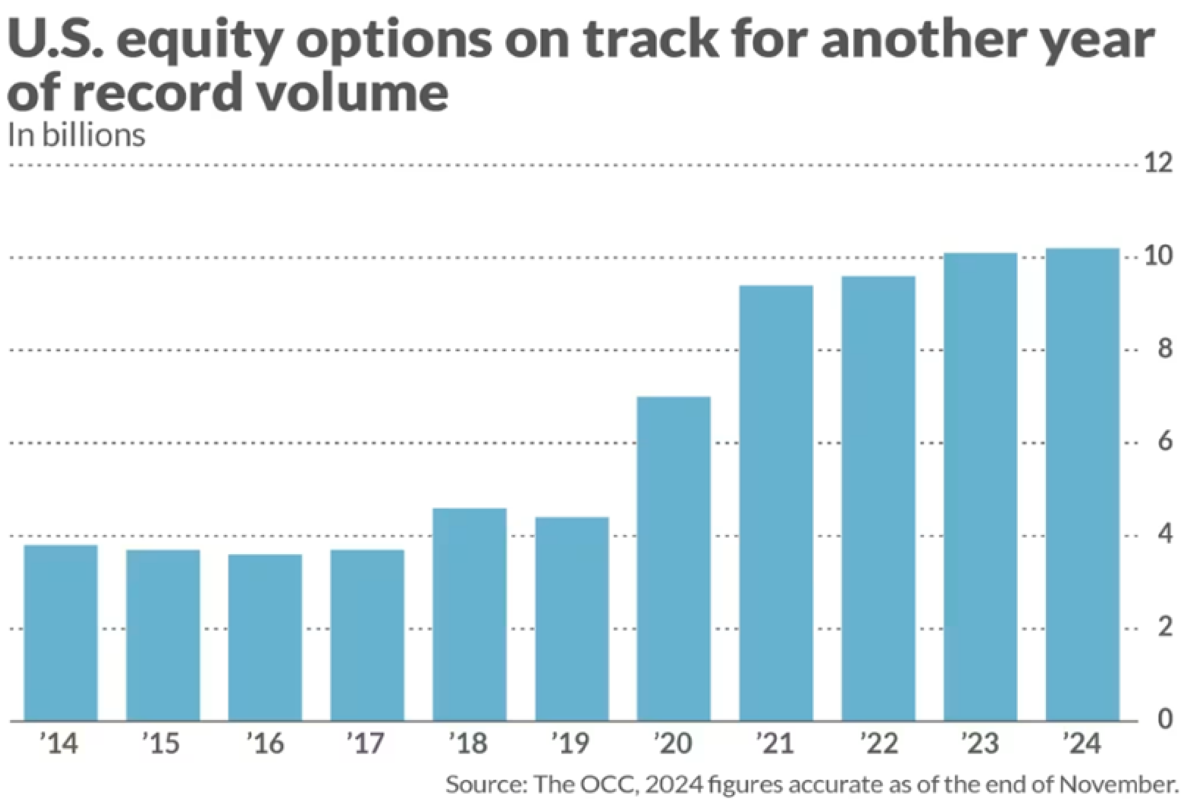
Intro

When I first learned about options, in 1999, I got really excited and wanted to trade them all the time. I was at the Pacific Options Exchange in downtown San Francisco—this was before my Wall Street days.

I have traded options a lot. I have lessons learned from 26 years of mistakes to offer!

But there are a lot of situations—most situations, in fact—where you're better off just buying the stock and not screwing around with options. It's easy enough to lose your ass trading stocks; you don't need options to make it worse.

Problem is, everyone wants to trade options these days. Everyone is trading options these days!



Source: MarketWatch

What happened? Well, COVID happened for one thing, and everyone was at home.

Also, Robinhood got everyone signed up for options trading, and they cut commissions on complex options to zero.

Just Because You Can, Doesn't Mean You Should

When something is free, people tend to overconsume it. Whether it's buffet food, health-care services, or zero-commission trades, they take as much of a free thing as they can.

So you've got a ton of people overtrading and chopping themselves to bits, and/or just blowing themselves up as they don't understand the complexity and risk.

This is not me being old-man-shouts-at-cloud.

There's an actual research paper out of the University of Florida, *Betting on Elusive Returns (2024)*, and what they found is bleak:

- After the introduction of zero-commissions, complex options trades by retail investors increased by 75.4%.
- Their trades on average yield negative returns of -16.7% over 3 days.
- They lose money on average over 1-, 2-, and 3-day periods.
- Complex options trading is elevated around earnings announcements…
- …And retail trader losses are 3 times larger on these trades.
- They prefer strategies with high volatility, embedded leverage, and "lottery-like features."

I could go on. And the craziest thing is, you don't even have to use *complex* (i.e., multi-leg) options to blow yourself up. You can do it damn easily with common-or-garden options… because they are pretty complex too.

All that said…

I like options. I trade options. I'm doing an Options Masterclass (more on that later). But I will tell you something that 99% of people selling options courses will not tell you: ***Most of the time, you shouldn't trade options.***

If people take my course and decide that 95 times out of 100 they will resist the urge to put on an options trade, I will consider that a win.

Of course, free markets, baby. People are going to trade what they want. I just want to help people avoid blowing themselves up, because there are a million ways to do that with options.

So today, let's go where the volume is and look at 3 of the big options stocks, and what we can learn from them.

Enjoy.

Jared Dillian

GameStop (GME), the 2021 Short Squeeze

Probably the most famous options trade of all time. Everyone knows the story, fewer know the mechanics.

GameStop wasn't bankrupt, but it was a zombie. Basically, a video game store that doesn't sell video games because people can download them. Because of this, it had been heavily shorted by hedge funds. By late 2020, over 140% of GME's float was short—an extremely high level of short interest.

(How can that number be higher than 100%, you ask? This happens because when shares are borrowed and sold short, the same shares can be lent out again—resulting in overlapping short positions that total more than the actual shares outstanding.)

On the other side, retail traders, starting with Roaring Kitty from r/WallStreetBets (WSB) on Reddit, noticed this excessive short interest and began hoovering up GameStop stock and out-of-the-money call options to trigger a gamma squeeze—a scenario where market makers must buy more shares to hedge their positions, further driving the stock price up.

It was a phenomenon wrought from 12 years of ultra-low interest rates, a year of unprecedented fiscal stimulus, and people with a surplus of free time.

A Few Definitions Before We Get Into It

- **Call Option**

  A call option is a contract that gives the buyer the right—but not the obligation—to purchase a stock at a specified price (the strike price) before a certain expiration date. This allows traders to control a larger number of shares with a smaller investment compared to buying the stock outright.

- **How Call Options Fueled the Rally:**

  Each time a trader bought a call option, market makers (the sellers of these options) had to hedge their risk by buying the underlying stock. This additional buying pressure helped push the price even higher.

- **Gamma Squeeze**

  A gamma squeeze occurs when rising stock prices force market makers to buy more shares to hedge their short positions in options. As these market makers buy shares, the stock price rises further, creating a self-reinforcing cycle.

Source: [CenterPoint Securities]

How the Squeeze Unfolded

1. **Early Stages (Late 2020–Early January 2021)**
   - Investors, spearheaded by Roaring Kitty (Keith Gill), argued that GameStop was undervalued and had potential for a turnaround.
   - Retail traders on WSB began buying shares and call options, fueling the first stage of the squeeze.
2. **The Gamma Squeeze (Mid-January 2021)**
   - Market makers selling call options had to hedge by buying GME shares as the stock rose.
   - More demand pushed prices up, requiring further hedging—a feedback loop that sent GME skyrocketing.

3. **The Peak (January 27–28, 2021)**

    - GME surged from under $20 to over $483 per share at its peak—an increase of over 2,000% in less than a month.

    - Hedge funds with large short positions, including Melvin Capital, suffered billions in losses.

4. **Brokerage Restrictions & Collapse (Jan 28, 2021–February 2021)**

    - Robinhood and other brokers restricted buying of GME shares and options, citing capital requirements.

    - With buying power removed, the stock plummeted back below $100 within days.

Options Trading's Role in the Squeeze

- **Gamma Squeeze Mechanics:**

    - Market makers hedge by buying stock when selling calls → Stock rises → More hedging needed → Feedback loop.

- **Short sellers were forced to cover:**

    - As the price skyrocketed, short sellers had to buy back shares at higher prices, accelerating the rally.

- **Retail traders primarily used out-of-the-money calls:**

    - Calls with strike prices of $50, $100, $200+ saw explosive gains, delivering 10X+ returns for some traders.

- **Liquidity dried up once brokerages restricted buying:**

    - This broke the gamma squeeze cycle, leading to a rapid decline in price.

Who Won & Who Lost?

Winners:

- Early retail traders who bought shares or call options in late 2020/early 2021.
- Hedge funds such as Senvest Management, which bought in before the squeeze.
- Roaring Kitty (Keith Gill) reportedly made tens of millions on his long position.

Losers:

- Melvin Capital lost billions, requiring a bailout from Citadel and Point72.
- Latecomers to the trade who bought near the peak and held suffered heavy losses—the stock crashed back under $100 within weeks.
- During the frenzy, options premiums soared. However, when the stock peaked and the rally subsided, the collapse in implied volatility caused these premiums to drop sharply. In many cases, options traders lost nearly 100% of their investment, as the value of their options plummeted even if the stock remained volatile.
- Robinhood's reputation took a major hit for restricting trades, leading to lawsuits and congressional hearings.

Key Lessons from GameStop

Gamma squeezes can create massive price distortions. Market makers being forced to buy shares accelerates stock moves beyond normal fundamentals.

Short squeezes can be deadly for hedge funds. When short interest is too high, any rapid price increase can trigger a cascade of forced buying.

Retail traders have power—but structural forces (e.g., brokerage restrictions) can cut off momentum. Robinhood's trading limits (i.e., removing the buy button) stopped the squeeze in its tracks.

Timing is everything. Those who got in early made fortunes; those who entered late saw massive losses.

Regulatory scrutiny follows extreme market events. The GameStop saga led to discussions about payment for order flow, market manipulation, and hedge fund influence over brokerages.

Netflix (NFLX) & Earnings

Full disclosure: I have never traded NFLX stock, never mind options on it. Streaming is all-you-can-eat, and that is a tricky model. I'd go as far as to say the economics don't make sense, especially when you're spending gazillions of dollars a year on new content.

Apart from anything else, pull up a long-term chart of Netflix (NFLX) and see if you could survive that many 70% drawdowns.

But that is not what we are here to talk about. We are here to talk about the goat rodeo that always happens around Netflix earnings, and the fates of the options traders who dive into the goat rodeo.

What Happens

Options traders love earnings season because it creates spikes in volatility. Here are some of the ways traders have structured their bets around Netflix earnings:

1. Straddles: A Pure Volatility Play

How It Works: A straddle involves buying both a call option and a put option at the same strike price—typically at-the-money—with the expectation that Netflix will make a big move in either direction.

Example: Winning (2013)

On January 23, 2013, NFLX was trading at $14.75 before earnings. After positive earnings, it went up by 42% on the same day.

Suppose you bought an at-the-money straddle, made up of a $14.75 call and a $14.75 put. Let's assume the combined premium for this straddle is around $1.50 per share.

After earnings and the stock increase, that $14.75 call then has an intrinsic value of about $6.20 ($20.95 - $14.75). So after subtracting the $1.50 premium, the net gain is roughly $4.70 per share—a return of over 300%.

Example: Losing (2024)

On July 18, 2024, Netflix was trading at $643.04 before its earnings report. This time, the stock closed the day at about $633.34—a decline of about 1.51%. A nothing burger, re-ally.

You'd bought a similar straddle as in 2013, hypothetically costing $12 a share. But because there was only a 1.51% move, neither the call nor the put option gained enough intrinsic value to offset the $12 premium. So you completely lose the premium, which, if you just had one contract, would be a $1,200 loss. Ouch.

2. Strangles: A Cheaper Alternative

How It Works:

A strangle is similar to a straddle but uses out-of-the-money options (a call above the current price and a put below it), making the trade cheaper but requiring an even larger move to be profitable.

Winning vs. Losing:

In a dramatic event like the 2013 surge, a strangle might capture significant gains if the move is large enough.

But in a nothing burger earnings event like July 2024, the limited move means both the call and put remain out-of-the-money, resulting in a total loss of the premium paid.

Other Risks (*Some* of Them)

- **Misunderstanding Implied Volatility (IV):** Ignoring the volatility crush that typically follows an earnings announcement. Even if the stock moves moderately, the drop in IV can deflate option premiums, wiping out potential gains.

- **Choosing the Wrong Strategy:** Opting for a cheaper, out-of-the-money strangle that requires a larger move to become profitable. In a quiet earnings environment, both options expire worthless, and the trader loses the entire premium.

- **Time Decay:** The expected move occurs too slowly or too late relative to the option's expiration. Time decay erodes the option premium, leading to losses even if the stock eventually moves.

Not too hard to see how retail options traders lose money on average, eh?

Just for good measure, here's a horrifying story of another way to blow yourself up with NFLX options:

~72K loss selling calls on NFLX

Until Nov, I was doing fine selling far OTM weekly naked calls on `NFLX`. However, the party did not last long, once the stock went on a tear after the (scripted?) Paul vs Tyson fight.

Selling naked calls is usually not recommended, but it can work out if - 1. The underlying is not very volatile, 2. You sell far OTM calls, 3. You have an exit strategy. In my case, I guess I did not have #3. I had been in similar situation few times in the past and rolling few weeks out worked well.

`NFLX` had already surged ~12% from the latest earnings and RSI was >70, so I thought a pull back was imminent. I rolled and waited, but the stock kept breaking its resistances and making new ATH almost every other day. The commentary around price target upgrades to 1000 (really? WTH) also did not help. Soon, the unrealized loss reached a value that my brain could not digest and I decided to cut losses after one poor night of sleep. Its highly possible that I would have come out green had I waited, but who knows the future and its very hard when the mind works against you.

How I am feeling about this loss?
I am -30K down from the day I started trading options (f**k). The amount is big and it will take time to recoup the losses. Morale was definitely down for few days.

Lesson
Don't be over optimistic, even if you have experienced something similar in the past. Months of efforts can go in vain in a short time, especially when the risk is not defined. Have an exit strategy. Hope does not work well with options.

Source: Reddit

Naked calls, where you sell someone the right to buy a stock at a set price, even though you don't own that stock: never a good idea.

Tesla (TSLA) & Earnings

Yep—we're doing another earnings one, because retail traders *pile* into options before earnings, especially when high vol is expected.

What better stock to look at than probably the first in history with both a short cult and a long cult?

I've traded TSLA a few times, never from the short side. First bought it in 2013, at $180 pre-split, and sold it at $250. It is actually a pretty great stock to trade, because it vacillates between emotional extremes, and it is really about trading sentiment on Elon.

So, these emotional extremes obviously jack up to the max around earnings. Every quarter, tons of traders pile into short-term, out-of-the-money (OTM) calls and puts, hoping to cash in on a massive price swing after the company reports earnings.

Tesla has a history of moving **10%+** in either direction after an earnings release. When a stock moves like that, you can make **(or lose)** a lot of money in a very short period. But many traders make a crucial mistake: They don't understand **implied volatility (IV) crush**—the phenomenon where options prices collapse immediately after earnings, even if the stock moves in their favor.

Let's rewind to **Tesla's Q3 2022 earnings**.

- TSLA was trading at **$220** before earnings.
- Market makers priced in an **expected move** of about **9%** in either direction.
- This means options expiring that week were extremely expensive—high IV was baked into the price.

Say a trader buys **$250 calls** (betting TSLA will explode upwards) and **$200 puts** (betting it will tank). They're paying a premium of about **$10 per contract**. That means TSLA has to move beyond **$260 or below $190** just to break even.

The next morning, Tesla drops **6%** to **$207**—a solid move. But not big enough! The trader loses **100% of their premium overnight**.

Why? Because the stock didn't move as much as the market expected. And since earnings are over, implied volatility crashes, causing the options' prices to collapse.

This happens **every earnings cycle**—yet retail traders keep making the same mistake.

Key Lessons

1. **Earnings bets are not long-term investments.**

   Tesla's biggest post-earnings moves happen in the **first minutes** after the report drops. If you're playing options, you need to be right on both **direction** and **magnitude**—and you need to cash out fast.

2. **Options are priced for huge swings.**

   If a stock is expected to move **8%** and it moves **7.5%**, OTM options can still go to zero. The move wasn't big enough to justify their price.

3. **IV Crush is a killer.**

   The second earnings are out, implied volatility tanks. A contract that was worth **$10** before the report might only be worth **$2** after—even if the stock moves in the right direction.

4. **Hype isn't a strategy.**

   Just because thousands of traders are buying calls doesn't mean it's a good bet. It just means the premiums are even more inflated.

5. **Earnings trades are not about picking winners and losers.** They're about understanding expectations. Put it this way, if the market expects a home run, a triple isn't good enough.

More Examples

- **July 2021 Earnings:** Tesla moved **2%** after earnings, despite options pricing in a **6% move**. Calls and puts both got wiped out.
- **October 2021 Earnings:** Tesla jumped **10%**, but calls still lost money because IV collapsed. Many traders who held overnight saw their gains evaporate.
- **April 2023 Earnings:** TSLA fell **9%**, but the market expected a **9.5% move**. Even traders who were right on direction lost money.

Wrapping It Up

If you've made it this far, congratulations—you now know more about options than 90% of the people lighting their money on fire in the market. I'm not kidding.

If you remember anything, remember these points:

- Options aren't magic money machines.
- Earnings bets are harder than they look.
- You need to understand volatility.
- Risk management is everything.

Options trading isn't something you should just throw yourself into, and most of the time, you're probably better off sticking with stocks.

But if you are going to trade options, learning how to not blow yourself up is priority no. 1. That's why I put together the **Options Masterclass**—to make sure traders understand what they're getting into before they press "buy."

More on that soon.

Jared Dillian