

Iron Condor Strategy



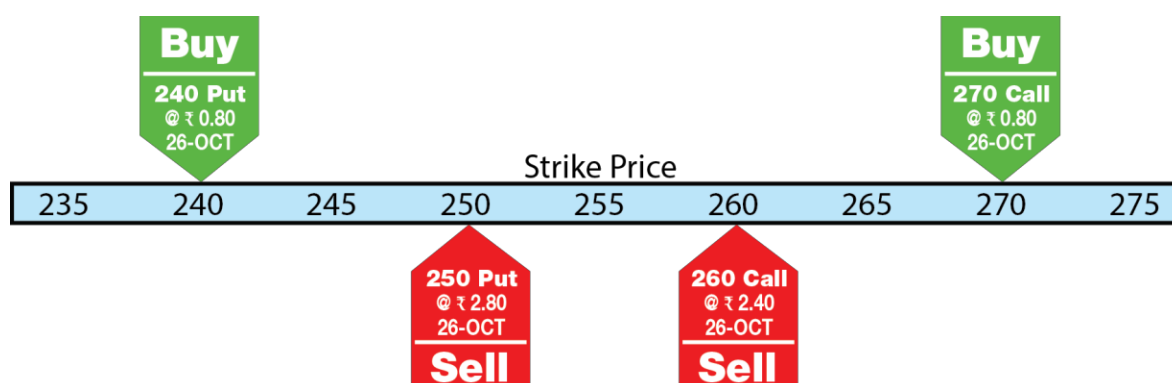
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In the previous units, we have discussed bullish and bearish strategies, that is, strategies that you can use when you have a directional view on the market. In this document we will discuss the strategy which you can implement when your view is neutral, that is, you expect the stock price to remain range bound.

Iron condor

The iron condor is a limited risk options trading strategy that is designed to have a large probability of earning a small limited profit when the underlying security is perceived to not move much.

The iron condor strategy can also be visualized as a combination of a bull put spread and a bear call spread. An iron condor involves options with the same expiration date and four different strike prices. For example, an iron condor is created on State Bank of India (SBIN) trading at INR 255 as follows:



Bull Put Spread

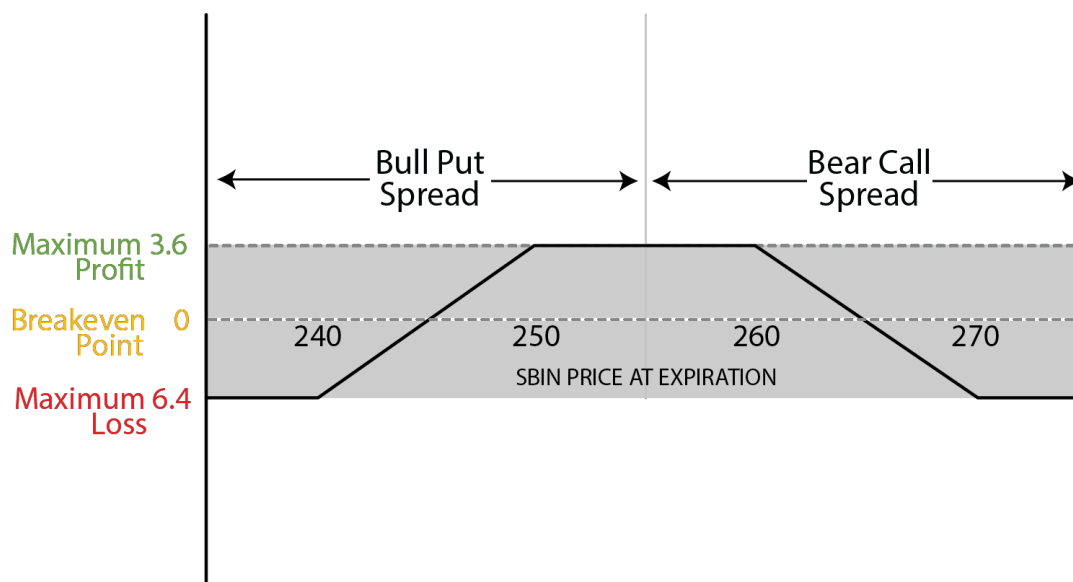
1. Buy a 240 strike put for INR 0.80
2. Sell a 250 strike put for INR 2.80

Bear Call Spread

1. Sell a 260 strike call for INR 2.40

2. Buy a 270 strike call for INR 0.80

This results in a net credit of INR 3.6 on initiation of the trade. The expiration date of the options is 26-Oct.



Payoff diagram of SBIN Iron Condor

From the payoff diagram, we can observe that:

Maximum Profit

1. Maximum Profit for the iron condor strategy is equal to the net credit received when entering the trade.
2. Maximum profit is attained when the underlying stock price at expiration is between the strikes of the call and put sold. At this price, all the options expire worthless.
3. Maximum Profit = Net Premium Received
= INR 3.6

Maximum Loss

1. This strategy starts to lose when the stock rises above INR 260 or falls below INR 250. Only one side will lose at the expiry, as the stock price can't breach INR 250 or INR 260 at the same time.
2. The maximum loss is achieved if the stock rises above INR 270 or falls below INR 240.
3. To calculate the maximum loss, we take the 10 points spread between the bull put spread (250 - 240) or bear call spread (270 - 260) and deduct the premium received from it.
4. Maximum Loss = Spread - Net Premium Received
= INR 10 – INR 3.6
= INR 6.4

When to trade this strategy?

This strategy is entered when the implied volatility of options sold is high enough to ensure that you collect a reasonable amount of premium as credit upfront, but at the same time you have to keep in mind that you should place the strike prices far enough so that they don't go in the money.

If you want to make and analyze a strategy on your own you can check out the following link: <http://optioncreator.com/>.