

# Trading the Iron Condor

*BetterTrades Instructor*  
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- **IRON CONDOR-**

- Two credit spreads on the same index
- Bull Put Spread and Bear Call Spread

- **CREDIT SPREAD-**

Option strategy in which one option at a particular strike price is sold and a less expensive option at another strike price is bought as an insurance policy. This creates a credit in your account.

# Spread Basics

- American style - can be exercised ON or BEFORE expiration day.
- European style - can only be exercised ONLY ON expiration day, no sooner.
- SPX (S&P 500), RUT (Russell 2000), MID (S&P 400 Mid cap), XEO (S&P 100) are all European (non early exercise)
- OEX (S&P 100) and stocks are American (early exercise)

# Spread Basics

- Based on expiration Friday's opening prices of stocks within the index.
- Can differ from Thursday's close by as much as 10 points.
- Settlement value determines option assignment.
- SPX, RUT, and MID have Thursday to Friday cash settlements.
- XEO, OEX and **SPXPM** have a Friday PM settlement (LAST trade)

- Bearish Opinion
- Expect the market to go down or at least stay down for certain level for a specified amount of time.
- Sell a call spread

# Bear Call Spread – Underlying at 1000

- Buying 1060 calls      2.50 x 2.80
- Selling 1050 calls      3.10 x 3.40
- Sell 1050 calls for 3.10 (bid)
- Buy 1060 calls for 2.80 (ask)
- Credit of .....\$.30 (Natural Credit)
  
- **NATURAL CREDIT**- The amount of credit the market is offering you at any given point in time.

# Negotiating

- Buy 1060 calls 2.50 x 2.80
- Sell 1050 calls 3.10 x 3.40
  
- Skim off 1/3 of the bid x ask spread from each option and add amount to natural.
- Take \$.10 from 1060 calls and take \$.10 from 1050 calls.
- Natural credit of  $.30 + .10 + .10 = .50$  Net Credit



- Bullish Opinion
- Expect the market to go up or at least stay above a certain level for a specified amount of time.
- Sell a put spread

# Bull Put Spread –Underlying at 1000

- Selling 950 puts 4.10 x 4.70
- Buying 940 puts 3.60 x 3.90
- Sell 950 puts for 4.10 (bid)
- Buy 940 puts for 3.90 (ask)
- Natural Credit of .20

# Negotiating

- Sell 950 puts 4.10 x 4.70
- Buy 940 puts 3.60 x 3.90
- Again take 1/3 of bid/ask spread of each option. Take .20 from 950 puts and .10 from 940 puts.
- Natural credit of  $.20 + .20 + .10 = .50$  Net Credit

# Complete Iron Condor

- BEAR CALL SPREAD
  - BUY 1060 CALLS
  - SELL 1050 CALLS NET CREDIT OF .50
- Underlying at 1000 – Total Credit of \$1.00
  - SELL 950 PUTS
  - BUY 940 PUTS NET CREDIT OF .50
- BULL PUT SPREAD

- **Cost Requirement**

Spread – Total Credit x # of contracts x 100

- **EXAMPLE:**

$$\$10.00 - \$1.00 \times 10 \times 100 = \$ 9,000.00$$

# Iron Condor Guidelines

1. Using a 10 point spread, obtain a MINIMUM of \$.50 NET CREDIT per credit spread.
2. Trade only broad based indices.
3. Delta of sold option should be .12 (negative .12 for puts) or below.
4. Delta of .12 (.08, .06, etc) shows that option has a 12% chance of expiring in the money.
5. Total iron condor credit collection should be \$1.00 - \$2.00.

# Iron Condor Guidelines

- Bearish days (increase in vol) give best opportunities for fills.
- Increase in volatility creates larger credits further out of the money (especially for the puts)
- Bullish days will create opportunities for creation of better call spread premium.

# Iron Condor Guidelines

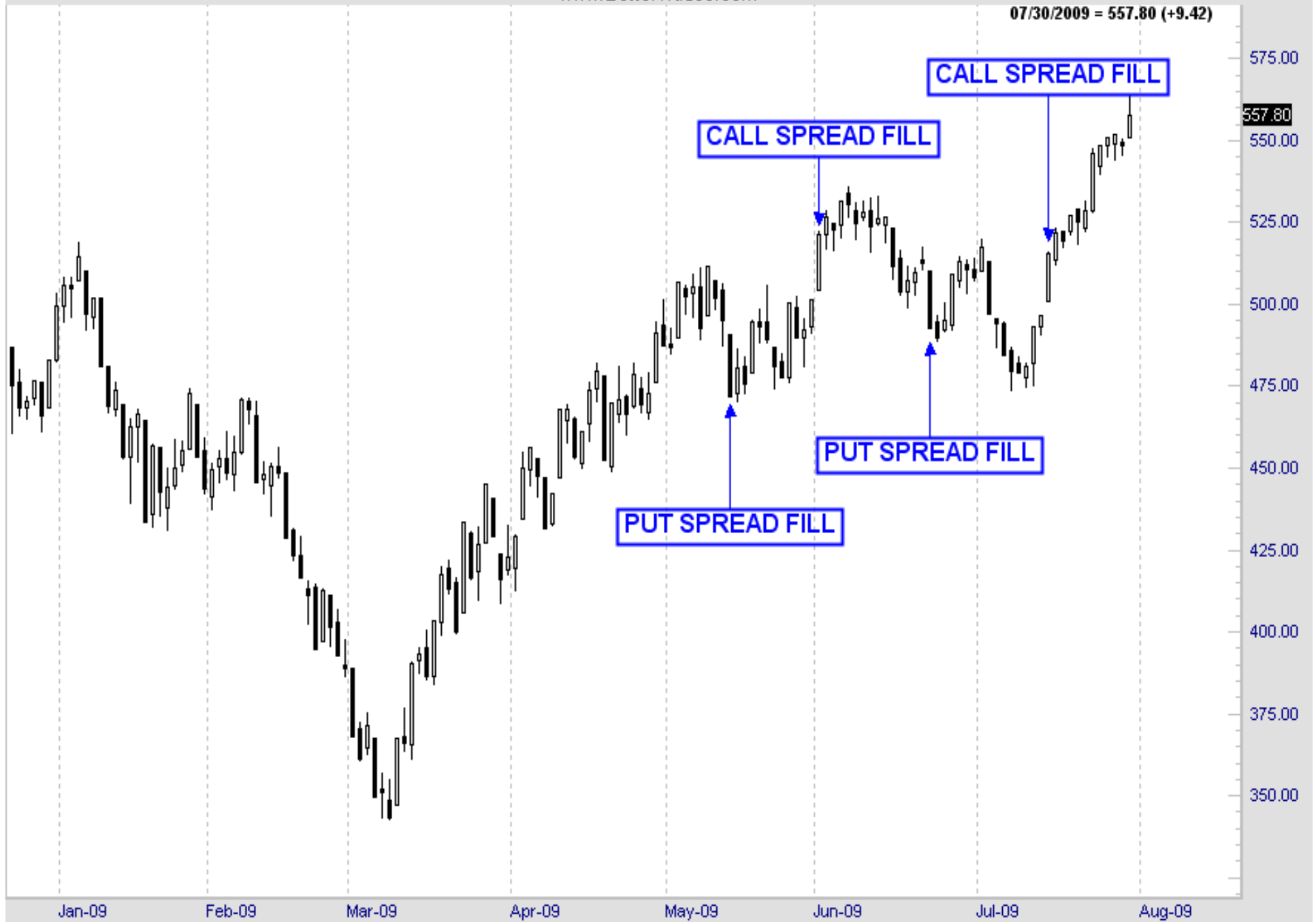
- Start looking for entrance opportunities about 7 weeks from expiration.
- Wait on large index moves up/down to get spreads filled.



# \$RUT: Russell 2000 Index (Daily bars)

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07/30/2009 = 557.80 (+9.42)



- Use option friendly broker.
- Use credit spread order screen to STO and BTO in one trade execution.
- DO NOT LEG INTO SPREADS!!!
- Only 1 x cash required for both spreads.
- Will let you use portfolio as collateral.
- Contact broker to determine what securities can be used to cover requirements.

# Early Exits

## MORE THAN ONE WEEK FROM EXPIRATION

- Delta of short option reaches  $.25$  for a call spread.
- Delta of short option reaches  $-.25$  for a put spread.
- At this point the sold option has a 25% chance of expiring in the money.

# Exit Practice

- Exit Bull Put Spread – Index @ 967

950p – 5.00 x 5.30

940p – 3.90 x 4.50

\*Don't forget to negotiate

5.00 x 5.30 = \_\_\_\_\_ spread / 3 = \_\_\_\_\_

3.90 x 4.50 = \_\_\_\_\_ spread / 3 = + \_\_\_\_\_

BTC 950p @ \_\_\_\_\_

STC 940p @ \_\_\_\_\_

Debit of \_\_\_\_\_

- \_\_\_\_\_ magic #

Total Debit \_\_\_\_\_

# Exit Practice

- Exit Bear Call Spread – Index @ 1031

1060c – 4.10 x 4.70

1050c – 5.10 x 6.00

\*Don't forget to negotiate:

4.10 x 4.70 = \_\_\_\_ spread/3 = \_\_\_\_

5.10 x 6.00 = \_\_\_\_ spread/3 = + \_\_\_\_

BTC 1050 @ \_\_\_\_

STC 1060 @ \_\_\_\_

Debit of \_\_\_\_

- \_\_\_\_ magic #

Total Debit \_\_\_\_

# Bad Settlement

- 1050/1060 call spread and 950/940 put spread for \$1.00 total credit
- Settlement is at 1052.
- Short 1050 call is \$2.00 ITM
- Cash settlement of -\$2.00 or -\$2000.00 on 10 contracts

# Rolling Up/Down

- If you exit a bear call spread early, you can enter another bear call spread at higher strike price (roll up)
- If you exit a bull put spread early, you can enter another bull put spread at a lower strike price (roll down)
- Repairs depend on market conditions and expiration time.

# Rolling Up/Down

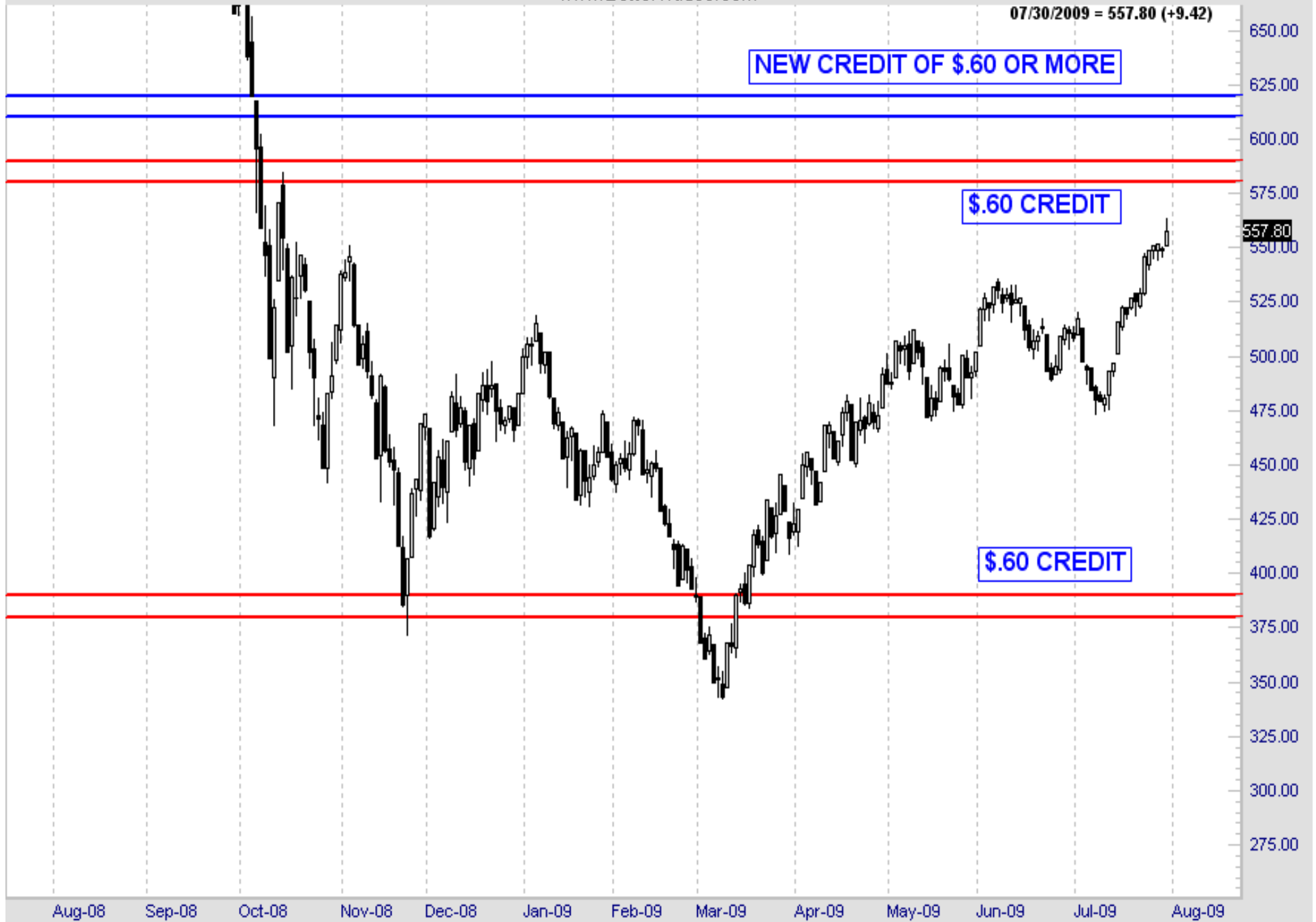
- Take in at least the same amount of credit as you held on original spread (i.e. \$.60 on original spread, take in \$.60 on roll up/down)
- Gain an extra 30-40 points between index value and short option of new spread.
- Roll up/down into next expiration month (rolling out) if adequate cushion isn't available.
- Can increase number of contracts when rolling.



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# Rolling Up/Down

- In this example, \$1.20 original credit was taken in.
- Assuming the exit cost of the call spread was \$1.60 and \$.60 credit was received on the roll up, the total profit potential is now \$.20.
- $\$1.20 - \$1.60 + \$.60 = \$.20$

Register for John's Next Class

# **Managing the Iron Condor**

Thursday, March 15

8-10 p.m.

Regular price: \$149.95

Special price: \$99

You must register online to receive the  
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