The Short Strangle

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Contents

1 The Short Strangle

1.1 What

- It involves the selling of one Call Option, and the selling of one Put Option simultaneously, on the same Underlying, with the same expiration date.
- It is a neutral strategy. You'll make money as long as the underlying does not move below the strike of the short Put, or above the strike of the short Call.

1.2 Recommendations

- We recommend the selling of the Options to be:

  OTM

  Around 1.5 SD away, with less than a 20% probability of being ITM upon expiration

  With 1.5 months to 1 week of life left on the Option

  If you want a purely neutral trade, both the Call and the Put Options should meet the same conditions: they should be the same in terms of probability of being ITM.

1.3 Risk/Reward

- Maximum profit: Limited to the premiums received, the premium from the sold call plus the premium from the sold Put.
- Maximum risk: Unlimited as long as the price of the Underlying keeps going up or down beyond either short strike price.
- Breakeven: Strike Prie of the Call plus premium received from both of the sales and the strike price of the Put minus the premiums received from both the sales.

  The Underlying must be between those breakeven points in order to make money.

1.4 Example: You sell the ORTY $40 Oct15 Call for $5 and you also sell the ORTY $30 Oct15 Put for $5

1. Scenario A

   In October, ORTY trades at $35. Since $35 is lower than the sold Call's strike price, and higher than the sold Put's strike price, both Options you sold are OTM and so they expire worthless. You keep 100% of the profit (the $5 you received when you sold the call plus the $5 you received when you sold the Put). Total profit of $10.

2. Scenario B

   In October, ORTY trades at $45. Since $45 is higher than the Call's strike price, the Option is $5 ITM. However, since you received $5 from the sale of it, you lose nothing. The Put you sold is OTM and has expired worthless. So, since you also received $5 from the sale of that now OTM Put, you're actually up $5 in total ($0 on the Call side and $5 on the Put side).

3. Scenario C

   In October, ORTY trades at $60. Since $60 is higher than the Call's strike price, the Option is $20 ITM. That is your loss on the Call side. The Put you sold, on the other hand, has expired worthless. Also, your loss is less since you received $5 from the sale of the Call and $5 from the sale of the now OTM Put, so $10 in total premium. So you end up with a loss of $10 (20-10).

1.5 When

- Look for Underlyings that have high IV Ranks (above 75). As this is a directionally-neutral, pure volatility play, this condition is essential to succeed.
- This strategy attempts to profit from both people excessive greed and fear. It is especially useful when dealing with Underlyings in which people expect big movements but are unsure of the direction (eg. an upcoming earnigs report). This uncertainty and expectation drives up the implied volatility an dtherefore the price of both Calls and Puts. so you sell both OTM junk Calls and Puts.
- you believe the expected movement won't be as significant as people think. History tends to prove that the predicted moves are usually less than the moves the stock ends up experiencing.

1.6 Pros

- Compared to just selling one of the Options naked, doing both at the same time gives you double the premium, without increasing your risk (as the Underlying can only move one way and at least one of the Option sold will expire worthless).
- You can make money if the Underlying falls, doesn't move, or moves up, as long as it doesn't move in such a significant way that the breakevens are crossed.
- You make money on time decay every day that goes by times 2, as you have two short Options.
- If you follow our recommendations, you are very likely to be successful, as the odds are in your favor. This is one of the strategies that carries the highest success rate in our studies.

1.7 Cons

- If the Underlying continues to increase or decrease in price significantly, so that your breakevens are crossed, you can be exposed to huge losses. However, the risk is the same as if you had just sold one of the two Options, as the Underlying can only move in one direction at a time.
- Brokerage firms will require significant cash or margin reserves before they let you sell a Call Option naked. But again, the requirements are the same as if you had just sold one of the Options.
- While your maximum profit is defined prior to entering the trade, your maximum risk is unkown.
- As it is a more complex strategy than selling Naked, be prepared to pay more in commissions and don't expect your order to get filed fast.

1.8 The Greeks of the Short Strangle

- Δ: Neutral

  If done properly, the price of the Underlying doesn't affect you unless it moves significantly.

- Θ: Very Positive

  You make money as time passes.

- Vega: Negative

  You lose money if volatility expands.