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Option Strangle (Long Strangle)

The long strangle, also known as buy strangle or simply "strangle", is a neutral strategy in options trading that involve the simultaneous buying of a slightly out-of-the-money put and a slightly out-of-the-money call of the same underlying stock and expiration date.

Long Strangle Construction

Buy 1 OTM Call
Buy 1 OTM Put

The long options strangle is an unlimited profit, limited risk strategy that is taken when the options trader thinks that the underlying stock will experience significant volatility in the near term. Long strangles are debit spreads as a net debit is taken to enter the trade.

Unlimited Profit Potential

Large gains for the long strangle option strategy is attainable when the underlying stock price makes a very strong move either upwards or downwards at expiration.

The formula for calculating profit is given below:

- **Maximum Profit = Unlimited**
- **Profit Achieved When Price of Underlying > Strike Price of Long Call + Net Premium Paid OR Price of Underlying < Strike Price of Long Put - Net Premium Paid**
- **Profit = Price of Underlying - Strike Price of Long Call - Net Premium Paid OR Strike Price of Long Put - Price of Underlying - Net Premium Paid**

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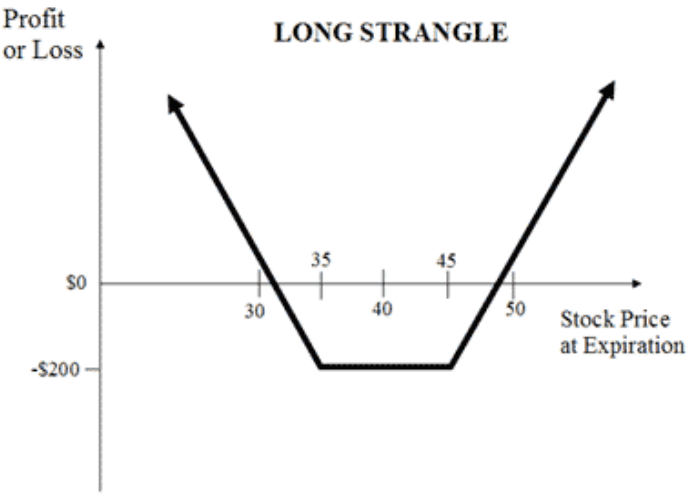


Long Strangle Payoff Diagram

Limited Risk

Maximum loss for the long strangle options strategy is hit when the underlying stock price on expiration date is trading between the strike prices of the options bought. At this price, both options expire worthless and the options trader loses the entire initial debit taken to enter the trade.

The formula for calculating maximum loss is given below:

- **Max Loss = Net Premium Paid + Commissions Paid**
- **Max Loss Occurs When Price of Underlying is in between Strike Price of Long Call and Strike Price of Long Put**

Breakeven Point(s)

There are 2 break-even points for the long strangle position. The breakeven points can be calculated using the following formulae.

- **Upper Breakeven Point = Strike Price of Long Call + Net Premium Paid**
- **Lower Breakeven Point = Strike Price of Long Put - Net Premium Paid**

Example

Suppose XYZ stock is trading at $40 in June. An options trader executes a long strangle by buying a JUL 35 put for $100 and a JUL 45 call for $100. The net debit taken to enter the trade is $200, which is also his maximum possible loss.

If XYZ stock rallies and is trading at $50 on expiration in July, the JUL 35 put will expire worthless but the JUL 45 call expires in the money and has an intrinsic value of $500. Subtracting the initial debit of $200, the options trader's profit comes to $300.

On expiration in July, if XYZ stock is still trading at $40, both the JUL 35 put and the JUL 45 call expire worthless and the options trader suffers a maximum loss which is equal to the initial debit

of $200 taken to enter the trade.

*Note: While we have covered the use of this strategy with reference to stock options, the long strangle is equally applicable using ETF options, **index options** as well as **options on futures**.*

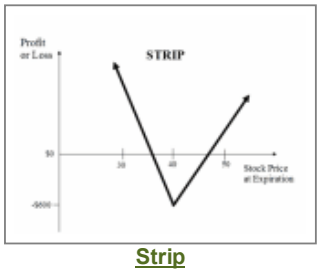
Commissions

For ease of understanding, the calculations depicted in the above examples did not take into account commission charges as they are relatively small amounts (typically around $10 to $20) and varies across **option brokerages**.

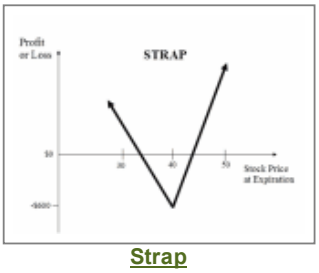
However, for active traders, commissions can eat up a sizable portion of their profits in the long run. If you trade options actively, it is wise to look for a low commissions broker. Traders who trade large number of contracts in each trade should check out **OptionsHouse.com** as they offer a low fee of only $0.15 per contract (+$4.95 per trade).

Similar Strategies

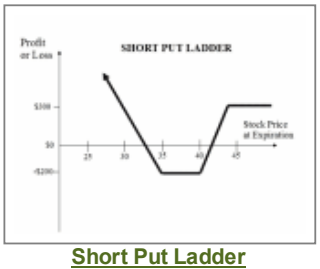
The following strategies are similar to the long strangle in that they are also high volatility strategies that have unlimited profit potential and limited risk.



Strip



Strap



Short Put Ladder

View More Similar Strategies

Short Strangle

The converse strategy to the long strangle is the **short strangle.** Short strangle spreads are used when little movement is expected of the underlying stock price.

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