6 Ways To Adjust An Iron Condor

Written by Adam Beaty

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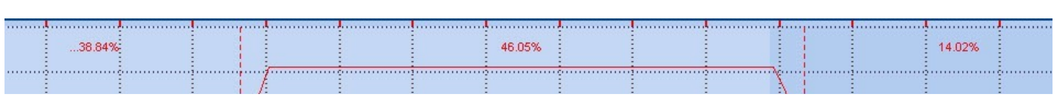
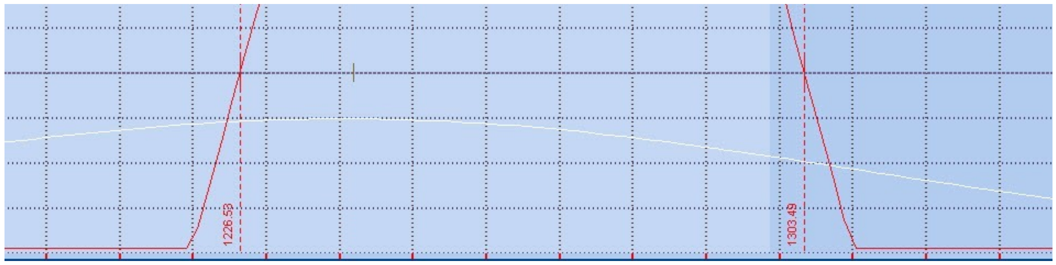
When you have a neutral outlook on a stock (not bullish or bearish) you can use an iron condor to extract profit from the lack of movement. We've already covered the basics of how and when to setup an iron condor so now we are going to move to a more advanced topic: adjustments.

Iron condors are high probability trades, meaning they have a high probability of success. The higher the probability of success the lower return we can expect. Most traders are okay with this trade off. The more you risk the higher return you expect and vise-versa. While you can win a lot of times with an iron condor it can take only one mismanaged trade to lose all of your winnings.

The nice part about iron condors is that they create a wide range to work in. This means that your adjustments and actions don't have to happen quickly but they do need to happen if the trade begins to turn against you. We will show you when you need to start making your adjustments, how to adjust to the upside, how to adjust to the downside and why you should never roll your position.





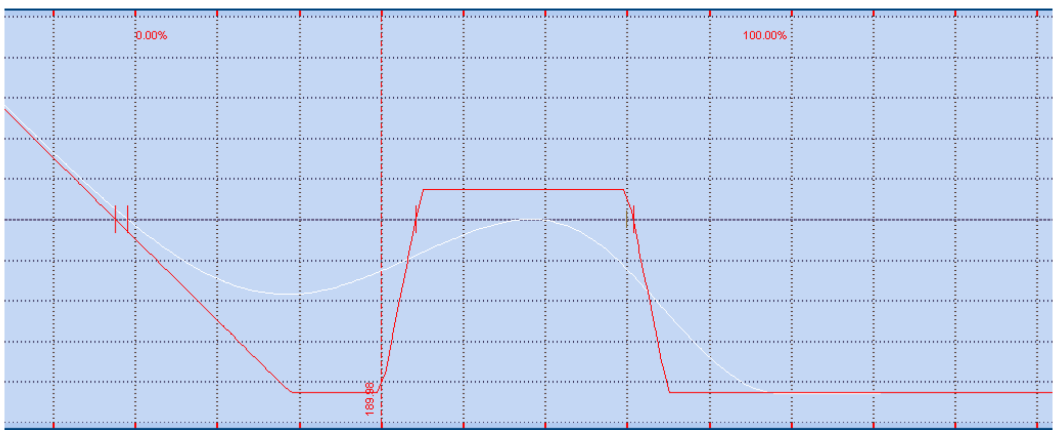
When To Adjust Your Iron Condor

Before you can even begin to adjust you need to have a plan of when to adjust. An iron condor is established for a credit versus a debit. Our first rule before placing the trade is that we establish a max loss. Our max loss should be no more than half of the overall credit. Here is an example.

The Option Prophet (**sym: TOP**) is trading at $50. We don't think it is going anywhere so we want to place an iron condor by buying the 37 put, selling the 40 put, selling the 60 call and buying the 63 call for a credit of 0.50. Right away we know our max loss is going to be 0.25 or $25 (0.50 / 2 = 0.25) for each iron condor we trade.

The rule we follow when making adjustments is the "one-third rule". When we are down one-third of our max loss we make an adjustment. When we are down two-thirds of our max loss we make another adjustment and when we are down three-thirds that will be our max loss and we close out the trade.

All adjustments are made with the idea of reducing our deltas. When we open an iron condor our strikes are all out-of-the-money so our deltas will be small, usually between 10-15. As the trade begins to move against us our strikes begin to get closer to at-the-money and could even move in-the-money. As strikes move from out-of-the-money to in-the-money they will move closer to a delta of 1.00. This means that our losses will begin to add up quicker so our main goal is to reduce our deltas which will reduce how quickly the position can work against us. No matter how we adjust we will always look to reduce the deltas by half.



IRON CONDOR	SELL	-10	SPY	OCT 15	220	CALL	.80
	BUY	+10	SPY	OCT 15	225	CALL	CREDIT
	SELL	-10	SPY	OCT 15	195	PUT	
	BUY	+10	SPY	OCT 15	190	PUT	
SINGLE	BUY	+2	SPY	OCT 15	179	PUT	.40

First Adjustment: Buying Insurance

Iron condors are very susceptible to changes in volatility so it is important to enter the trade with volatility in mind. You never want to enter an iron condor when volatility is moving higher. Rising volatility will be the quickest way to *kill your condor*. Ideally you want your implied volatility to be flat or declining. It doesn't matter if volatility is high or low as long as it's not rising. The worst thing that can happen, from a volatility standpoint, is that you enter the position during low volatility and have volatility rise. Luckily, we can use insurance to help protect ourselves from this scenario.

If you are entering an iron condor when volatility is low, below 25%, you need to also go long puts as a way to insure the trade. When looking for your long puts look below your iron condor's put strikes at the same expiration as your overall position. You don't want to spend more than 10% of your credit to buy insurance.

If TOP is trading at $50.00 we have 10 condors at 37/40 puts (long the 37 strike and short the 40 strike) and 60/63 calls (short the 60 strike and long the 63 strike) for a 0.50 credit or a total credit of $500 . We see that the 30 put has a delta of 0.05 and cost us 0.10. If we want to insure our iron condor we would buy 5 long puts at the 30 strike for a total debit of $50.00. We figured this by taking 10% of our credit ($500.00 x 10% = $50) and used to that judge how many puts to buy ($50 / $10 = 5).

If the market begins to drop volatility will begin to rise and our 0.10 puts will climb in price substantially and help absorb the losses our iron condor will take. Most of the time we will want to close out our insurance when we close out the iron condor. There is no need to let the insurance run without it insuring any position so we will take whatever premium the long puts still have in them. There is one exception. If your long options, the insurance, are less than 0.10 per contract you want to go ahead and keep them on. With so little premium in them most of it will get eaten up by commissions when you close them and they could explode in price if volatility starts to climb.

There is a time you don't want to add insurance. When volatility is too high it won't make sense to add insurance on your position. With a higher volatility your wings will be a lot wider and probably for a higher credit than when volatility is low. If volatility begins to come in it will benefit your position but hurt any insurance you may have on. Save the insurance for low volatility, below 25%

IRON CONDOR	SELL	-10	SPY	OCT 15	220	CALL	.80
	BUY	+10	SPY	OCT 15	225	CALL	CREDIT
	SELL	-10	SPY	OCT 15	195	PUT	
	BUY	+10	SPY	OCT 15	190	PUT	
SINGLE	BUY	+1	SPY	OCT 15	217	CALL	.90
VERTICAL	SELL	-3	SPY	OCT 15	220	CALL	.20
	BUY	+3	SPY	OCT 15	225	CALL	CREDIT

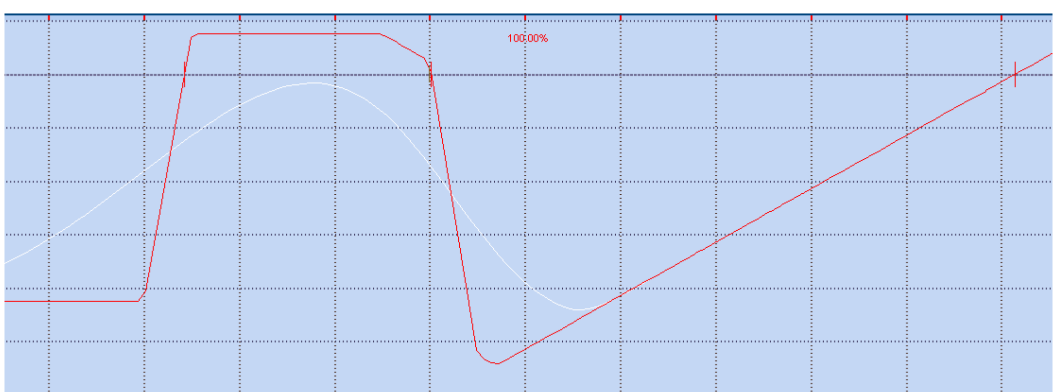
Upside Adjustment: Kite Spread

Our first upside adjustment will be the primary adjustment we want to use. To accomplish our goals this is a good cheap adjustment when the underlying begins to creep higher.

The kite spread consist of buying a long call below your call strikes and selling more call spreads to reduce the cost. The idea is to sell enough call spreads to reduce the cost in half for the long call. This is the advantage of using this adjustment. The cost is low and you are long gamma so if the underlying rallies your position will profit.

Looking at our example in the profit and loss diagram we can see that the kite spread gives us a buffer on the wings of our condor and also allows us to profit if the underlying begins to run.

The downside is that you are selling more spreads so you will add to your margin. Even though your margin and credits are changing you don't want to change your original adjustment and max loss plan.

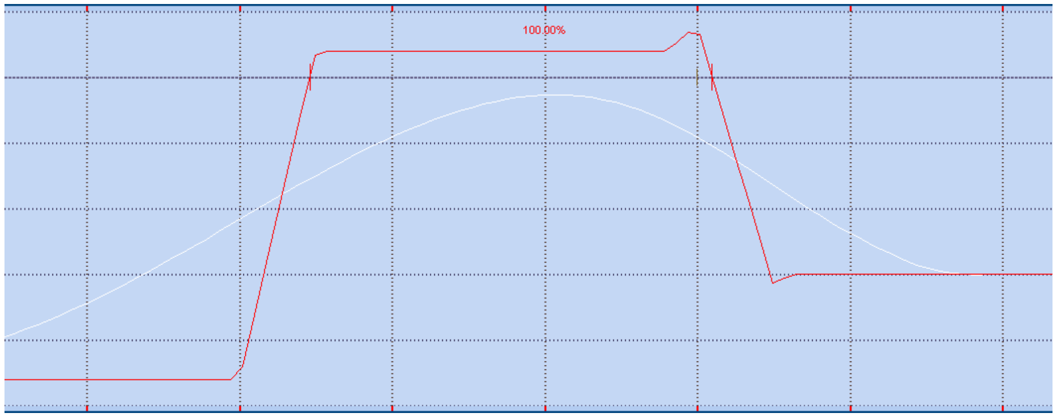


IRON CONDOR	SELL	-10	SPY	OCT 15	220	CALL	.80
	BUY	+10	SPY	OCT 15	225	CALL	CREDIT
	SELL	-10	SPY	OCT 15	195	PUT	

	BUY	+10	SPY	OCT 15	190	PUT	
SINGLE	SELL	-1	SPY	OCT 15	215	CALL	1.00
SINGLE	BUY	+2	SPY	OCT 15	227	CALL	.75

Upside Adjustment: Back Ratio

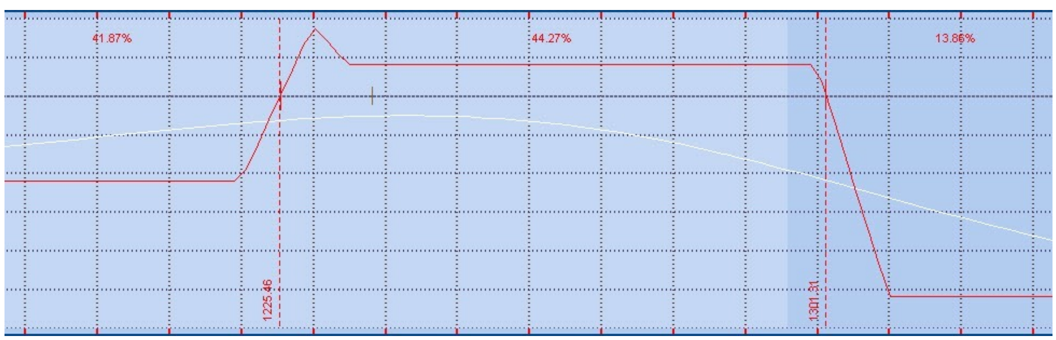
A back ratio adjustment, also known as a back spread, is a great adjustment when volatility is low. If your underlying is grinding higher there are good chances your volatility will still be low. To create a back spread you want to sell one near call and buy two calls outside your spread. It doesn't always have to be just one short to two longs. You want to try and keep the 1:2 ratio but you may need more to cut your deltas down. Depending on the size of your deltas you may need 1 short:2 long, 3 short:6 long or 5 short: 10 long.



IRON CONDOR	SELL	-10	SPY	OCT 15	220	CALL	.80
	BUY	+10	SPY	OCT 15	225	CALL	CREDIT
	SELL	-10	SPY	OCT 15	195	PUT	
	BUY	+10	SPY	OCT 15	190	PUT	
VERTICAL	BUY	+2	SPY	OCT 15	218	CALL	2.00
	SELL	-2	SPY	OCT 15	226	CALL	DEBIT

Upside Adjustment: Call Spread

Call spreads should be our last resort for an adjustment. If you think the market is going to really take off higher you need to add call spreads to your iron condor. The problem with call spreads is that they are costly. They will cut your deltas quickly, which is what you would want if the market blows through your strikes in a hurry.

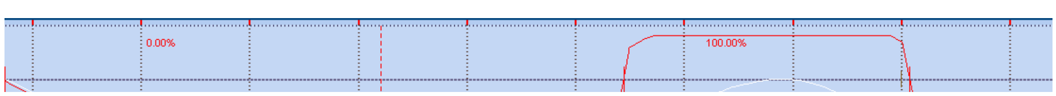


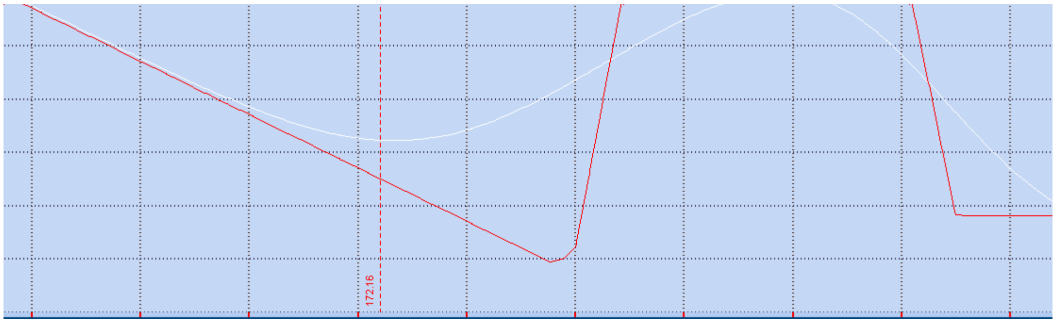
IRON CONDOR	SELL	-6	RUT	AUG 15	1300	CALL	3.48
	BUY	+6	RUT	AUG 15	1310	CALL	CREDIT
	SELL	-6	RUT	AUG 15	1230	PUT	
	BUY	+6	RUT	AUG 15	1220	PUT	
VERTICAL	BUY	+2	RUT	AUG 15	1235	PUT	6.45
	SELL	-2	RUT	AUG 15	1220	PUT	DEBIT

Downside Adjustment: Put Spread

Our downside adjustments are going to be very similar to our upside adjustments. For the downside we like to lean on our put spreads as the primary adjustment. Because of the way skew works our put spreads work much better than our call spreads.

We have an iron condor on TOP at 1220/1230 puts and 1300/1310 calls for a credit of $3.48. TOP begins to move against us and head lower threatening our one-third adjustment rule. We need to cut our deltas in half so if TOP continues to move lower the losses will be less. We look at our strikes and decide to adjust by going long the 1235 put and short the 1220 put for $6.45 debit. This will help bring our deltas in and give us a nice profit potential if the underlying were to hang around our strikes. The reason we chose these strikes is because of cost. The successfully cut our deltas in half and they were the cheapest way to do it. Remember you are not trying to get fancy when you pick these spreads. You want to get the job done for the least amount of money.





IRON CONDOR	SELL	-10	SPY	OCT 15	220	CALL	.80
	BUY	+10	SPY	OCT 15	225	CALL	CREDIT
	SELL	-10	SPY	OCT 15	195	PUT	
	BUY	+10	SPY	OCT 15	190	PUT	
SINGLE	SELL	-1	SPY	OCT 15	197	PUT	2.12
SINGLE	BUY	+2	SPY	OCT 15	188	PUT	1.02

Downside Adjustment: Ratio Spread

The ratio spread is another good downside adjustment. It benefits really well when the market begins to drop and volatility begins to rise. You want to sell one near put and buy two out of the money puts. It doesn't always have to be just one short to two longs. You want to try and keep the 1:2 ratio but you may need more to cut your deltas down. Depending on the size of your deltas you may need 1 short:2 long, 3 short:6 long or 5 short: 10 long.

Why We Do Not Roll Our Iron Condor

A lot of traders want to go to the roll to adjust their iron condor. There are several main types of ways to roll a spread: vertical roll, horizontal roll and diagonal roll. A vertical roll consist of taking your spread that is in danger and entering a simultaneous order to close that spread and open another spread at the same expiration but further out strikes. Now right off the bat this seems like a great idea. However, to make rolls truly work you need to double the size of the adjustment. If you had 5 put spreads and you needed to roll them lower, vertical roll, you would pick up 10 put spreads.

The next type of roll is a horizontal roll. A horizontal roll consist of using the same strikes that are in trouble but moving them further out in time. You would want to enter an order to simultaneously close out your current troubled strikes and open another spread one month out but at the same strikes. We were never fans of this roll because it leaves you with the same risk but a lot more "hope". If your strikes were already in trouble they will still be in trouble even if you have more time. Now, however, you are hoping that the underlying turns around because it has more time. Build a trading system on hope and the market will show you how wrong you are.

The diagonal roll is a hybrid between the vertical and horizontal roll. This one will take the best of both worlds and combine them. You will close the troubled spread and open another spread a month out and with strikes that are further out-of-the-money. If you had to roll the vertical and diagonal are your best bets.

Rolling positions are bad because you are increasing your risk. You are either doubling your position size or allowing more time to an already failing position. The one thing you never want to do is roll your winning side closer in. A lot of traders like to take the side that isn't feeling any pressure and moving them closer to at-the-money. This allows them to take their profits and sell another spread thus collecting more credit. The problem with this is that the underlying could turn around and put pressure on that side. If you have a winning side leave it be. Don't turn a winner into a loser.

Conclusion

Credit strategies are great tools to have in your box for option trading. The main caveat with credit strategies is that you are sacrificing your return for a higher probability of success. There is nothing wrong with creating a lot of small winners. The one thing you can't do, however, is let one loss take away all your winnings.

Iron condors are great strategies because you get to trade a neutral strategy for a smaller margin. They do require maintenance though. If you let an iron condor run wild it can hurt your portfolio and cause a max loss in the position. Follow the "one-third rule" when trying to adjust. Remember that your max loss should only be half your credit. If you follow these rules and adjust accordingly you can protect your condors and limit your losses.

How do you like to adjust your iron condors? Tell us in the comments...

tony007 • 3 months ago

Great post!!
One thing that I find that works for me is if I sell a condor and one side gets pressured, i.e. delta moves from 20 to 30, I start to reduce the size of the contracts on the side that gets pressured to reduce deltas.
Ex, sell 10 contracts of an iron condor, if delta moves from 20 to 30 on the credit call side, I'll start to cut 3 contracts from the pressured credit call side to get closer to delta neutral, and I'll keep cutting if delta gets to 40, and then 50 etc.

Another thing would be to buy a debit spread on the credit call spread

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atbeaty Mod tony007 • 3 months ago

Great point Tony. There is nothing wrong with closing out pieces of your position to reduce delta and overall exposure.

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