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Options strategy: Selling an at-the-money straddle

By Dan Keegan

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Question: How do you benefit from premium erosion when you are still afraid of a breakout or breakdown in the market?

Answer: Sell an at-the-money straddle while buying both upside and downside protection.

The VIX, formally known as the Chicago Board Options Exchange Volatility Index, is frequently referred to as the "Fear Index." The VIX is a formula that takes into account the current market prices for all out-of-the money calls and puts for the first two nearby expiration cycles. It estimates the implied volatility of the S&P 500 index over the next 30 days.

Implied volatility is the reverse engineering process whereby the current prices of the options being traded in an underlying instrument imply the volatility of the underlying instrument. Historical volatility is the actual record of the volatility of the underlying instrument.

The "Fear Index" measures volatility in either direction. Investors anticipating a large and rapid upside move will move up their offer price for selling out-of-the-money calls. Investors will move up their bid price for purchasing out-of-the-money calls if they feel that the premium level justifies a large and rapid upward move. If investors fear a rapid downside move, the prices for out-of-the-money puts will be raised.

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About the Author

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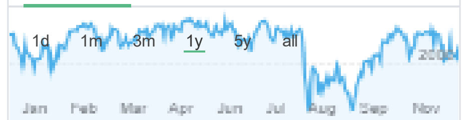

Symbol	Last	Change	(%)
Emini	2050.75	−2.50	(−0.12%)
Euro	1.09750	+0.00410	(+0.37%)
Gold	1077.8	+7.8	(+0.73%)

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Euro	1.09750	+0.00410	(+0.37%)
Gold	1077.8	+7.8	(+0.73%)
Oil	38.12	+0.26	(+0.69%)
Gas	2.042	+0.057	(+2.87%)
Corn	364'4	−1'0	(−0.27%)

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