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Short Strangle (Sell Strangle)

The short strangle, also known as sell strangle, is a neutral strategy in options trading that involve the simultaneous selling of a slightly out-of-the-money put and a slightly out-of-the-money call of the same underlying stock and expiration date.

Short Strangle Construction

Sell 1 OTM Call
Sell 1 OTM Put

The short strangle option strategy is a limited profit, unlimited risk options trading strategy that is taken when the options trader thinks that the underlying stock will experience little volatility in the near term. Short strangles are credit spreads as a net credit is taken to enter the trade.

Limited Profit

Maximum profit for the short strangle occurs when the underlying stock price on expiration date is trading between the strike prices of the options sold. At this price, both options expire worthless and the options trader gets to keep the entire initial credit taken as profit.

The formula for calculating maximum profit is given below:

- **Max Profit = Net Premium Received - Commissions Paid**
- **Max Profit Achieved When Price of Underlying is in between the Strike Price of the Short Call and the Strike Price of the Short Put**

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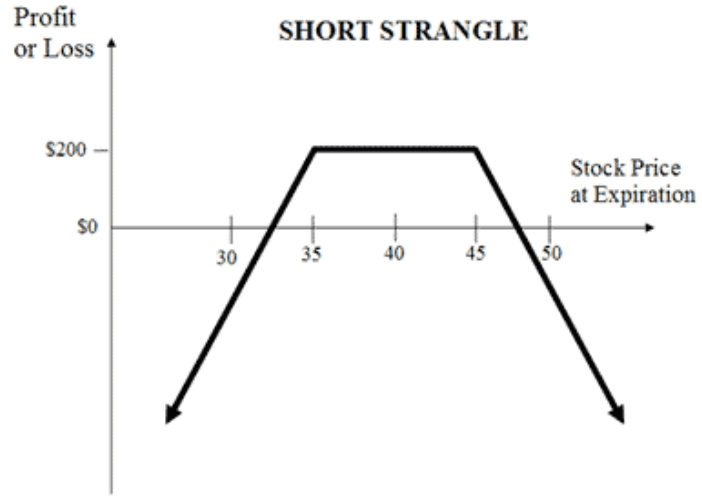


Short Strangle Payoff Diagram

Unlimited Risk

Large losses for the short strangle can be experienced when the underlying stock price makes a strong move either upwards or downwards at expiration.

The formula for calculating loss is given below:

- **Maximum Loss = Unlimited**
- **Loss Occurs When Price of Underlying > Strike Price of Short Call + Net Premium Received OR Price of Underlying < Strike Price of Short Put - Net Premium Received**
- **Loss = Price of Underlying - Strike Price of Short Call - Net Premium Received OR Strike Price of Short Put - Price of Underlying - Net Premium Received + Commissions Paid**

Breakeven Point(s)

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

- **Upper Breakeven Point = Strike Price of Short Call + Net Premium Received**
- **Lower Breakeven Point = Strike Price of Short Put - Net Premium Received**

Example

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

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 credit of $200, the options trader's loss 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 gets to keep the entire initial credit of $200 taken to enter the trade as profit.

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

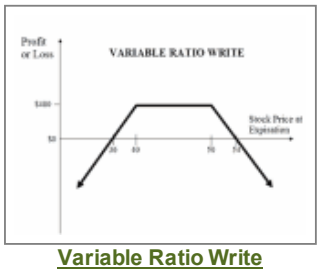
Commissions

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**.

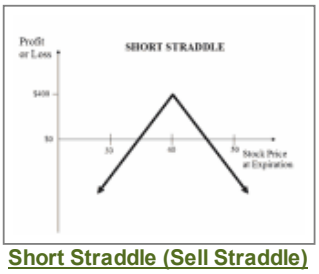
However, for active traders, commissions can eat up a sizable portion of their profits in the long run. If you trade options actively, it is wise to look for a low commissions broker. Traders who trade large number of contracts in each trade should check out **OptionsHouse.com** as they offer a low fee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

Similar Strategies

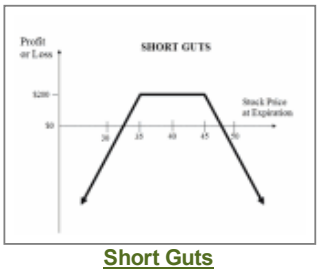
The following strategies are similar to the short strangle in that they are also low volatility strategies that have limited profit potential and unlimited risk.



Variable Ratio Write



Short Straddle (Sell Straddle)



Short Guts

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Long Strangle

The converse strategy to the short strangle is the **long strangle**. Long strangle spreads are entered when large movement is expected of the underlying stock price.

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