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Options strategy: Selling an at-the-money straddle

By Dan Keegan

August 1, 2009 • Reprints

FROM THE ARCHIVES

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.

Commodities Equities Bonds Forex

1d 1m 3m 1y 5y all

Jan Feb Mar Apr Jun Jul Aug Sep Nov

Symbol Last Change (%)

Emini

2050.75

-2.50 (-0.12%)

Euro

1.09750

+0.00410 (+0.37%)

Gold

1077.8

+7.8 (+0.73%)

Oil

38.12

+0.26 (+0.69%)

Quotes by TradingView

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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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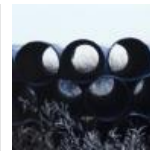
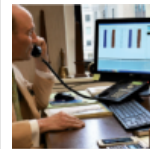
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About the Author

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