The Options Playbook

Featuring 40 options strategies for bulls, bears, rookies, all-stars and everyone in between

- Home
- Options Basics
- Rookie's Corner
- Option Strategies
- Managing Positions
- Glossary
- Trader Network

The Options Strategies » Skip Strike Butterfly w/Calls

TRADE THIS STRATEGY

Skip Strike Butterfly w/Calls

AKA Broken Wing; Split Strike Butterfly

The Setup

- Buy a call, strike price A
- Sell two calls, strike price B
- Skip over strike price C
- Buy a call, strike price D
- Generally, the stock will be at or below strike A

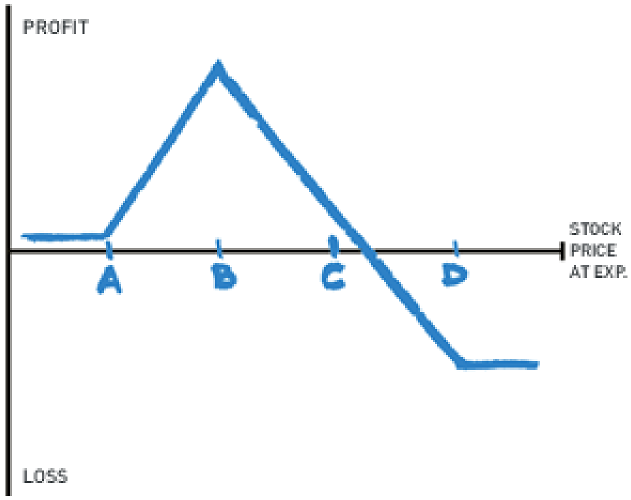
NOTE: Strike prices are equidistant, and all options have the same expiration month.

Who Should Run It

Seasoned Veterans and higher

NOTE: Due to the narrow sweet spot and the fact you're trading three different options in one strategy, skip strike butterflies may be better suited for more advanced option traders.

When to Run It



NOTE: This graph assumes the strategy was established for a net credit.

The Strategy

You can think of this strategy as embedding a short call spread inside a long call butterfly spread. Essentially, you're selling the short call spread to help pay for the butterfly. Because establishing those spreads separately would entail both buying and selling a call with strike C, they cancel each other out and it becomes a dead strike.

The embedded short call spread makes it possible to establish this strategy for a net credit or a relatively small net debit. However, due to the addition of the short call spread, there is more risk than with a traditional butterfly.

A skip strike butterfly with calls is more of a directional strategy than a standard butterfly. Ideally, you want the stock price to increase somewhat, but not beyond strike B. In this case, the calls with strikes B and D will approach zero, but you'll retain the premium for the call with strike A.

This strategy is usually run with the stock price at or around strike A. That helps manage the risk, because the stock will have to make a significant move upward before you encounter the maximum loss.

Options Guy's Tip

You're slightly bullish. You want the stock to rise to strike B and then stop.

Break-even at Expiration

If established for a net credit (as in the graph at left) then the break-even point is strike C plus the net credit received when establishing the strategy.

If established for a net debit, then there are two break-even points:

- Strike A plus net debit paid.
- Strike C minus net debit paid.

The Sweet Spot

You want the stock price to be exactly at strike B at expiration.

Maximum Potential Profit

Potential profit is limited to strike B minus strike A minus the net debit paid, or plus the net credit received.

Maximum Potential Loss

Risk is limited to the difference between strike C and strike D minus the net credit received or plus the net debit paid.

TradeKing Margin Requirement

Margin requirement is equal to the difference between the strike prices of the short call spread embedded into this strategy.

NOTE: If established for a net credit, the proceeds may be applied to the initial margin requirement.

Keep in mind this requirement is on a per-unit basis. So don't forget to multiply by the total number of units when you're doing the math.

As Time Goes By

For this strategy, time decay is your friend. Ideally, you


Some investors may wish to run this strategy using index options rather than options on individual stocks. That’s because historically, indexes have not been as volatile as individual stocks. Fluctuations in an index’s component stock prices tend to cancel one another out, lessening the volatility of the index as a whole.

want all options except the call with strike A to expire worthless.

Implied Volatility

After the strategy is established, the effect of implied volatility depends on where the stock is relative to your strike prices.

If the stock is at or near strike B, you want volatility to decrease. Your main concern is the two options you sold at strike B. A decrease in implied volatility will cause those near-the-money options to decrease in value, thereby increasing the overall value of the butterfly. In addition, you want the stock price to remain stable around strike B, and a decrease in implied volatility suggests that may be the case.

If the stock price is approaching or outside strike A or D, in general you want volatility to increase. An increase in volatility will increase the value of the option you own at the near-the-money strike, while having less effect on the short options at strike B.

Check your strategy with TradeKing tools

- Use the **Profit + Loss Calculator** to establish break-even points, evaluate how your strategy might change as expiration approaches, and analyze the Option Greeks.
- When using this as a bullish strategy, use the **Technical Analysis Tool** to look for directional indicators.

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Back to the top

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Rob Smith does not currently hold any positions in the securities mentioned in this post. ...

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- Rookies
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  - Covered Call
  - Protective Put
  - Collar
  - Cash-Secured Put
- Veterans
  - All Veteran Plays
  - Long Call
  - Long Put
  - Fig Leaf
  - Long Call Spread
  - Long Put Spread
- Seasoned Veterans
  - All Seasoned Veteran Plays
  - Short Call Spread
  - Short Put Spread
  - Long Straddle
  - Long Strangle
  - Back Spread w/Calls
  - Back Spread w/Puts
  - Long Calendar Spread w/Calls
  - Long Calendar Spread w/Puts
  - Diagonal Spread w/Calls
  - Diagonal Spread w/Puts
  - Long Butterfly w/Calls
  - Long Butterfly w/Puts
  - Iron Butterfly

- Long Strangle
- Protective Put
- Short Call
- Short Call Spread
- Short Combination
- Short Put
- Short Put Spread
- Short Straddle
- Short Strangle
- Skip Strike Butterfly w/Calls
- Skip Strike Butterfly w/Puts

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