

Iron Fly or Short Straddle



We know through our numerous studies that high IV environments offer excellent opportunities to sell premium. On order entry we can choose whether to define risk, limiting downside, or leave risk undefined thereby collect a greater amount of premium.

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Iron Fly or Short Straddle



One potential trade to consider when IV is rich is that of a short straddle, which is an undefined risk play. A variation to a this trade is to define the risk through buying further OTM options, limiting both downside risk and potential profits, this trade is known as an Iron Fly.

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As a trade strategy during periods of high IV, what are the advantages or disadvantages of Iron Flys and Short Straddles? and how do the two compare to each other, as they both share the same call and put short strikes.

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We looked at AMZN, GOOG and AAPL. Over a period of 5 years identifying periods when IV rank crossed above 50%, we placed these two trades as close to 45 DTE as possible allowing all positions to run to expiration.

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On our entry dates, we did the following:

- Sold Iron Fly (3 strikes wide per side)
- Sold ATM straddle

Here's an example of how we set them up:

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AMZN - 6/27/13 - IV Rank = 58 Price - \$277.55

Iron Fly			Straddle		
Position	Strike	Position	Position	Strike	Position
	265	+1		265	
	270			270	
	275			275	
-1	280	-1	-1	280	-1
	285			285	
	290			290	
+1	295			295	

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	AMZN – Avg. IV Rank = 67.5		GOOG Avg. IV Rank = 63		AAPL Avg. IV Rank = 63.4	
	Iron Fly	Straddle	Iron Fly	Straddle	Iron Fly	Straddle
P/L	\$3,628.50	\$14,317.50	\$3,759.50	\$8,696.00	\$10,437.00	\$11,172.00
Biggest Loss	-\$465.00	-\$3,385.00	-\$657.50	-\$8,058.00	-\$915.00	-\$7,113.00
# of Winners	13/20	16/20	6/19	13/19	14/23	17/23
% Winners	65.00%	80.00%	31.58%	68.42%	60.87%	73.91%

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Both strategies over the course of the 5 years generated a positive P/L. As expected, the straddle had a higher probability of success when compared with the Iron Fly. However, we also saw significant drawdowns, which was also expected.

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For comparison, we decided to see how these strategies performed in periods of low IV. We looked at AAPL and identified when IV rank was below 50%. Here are the results:

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Avg. IV Rank: 37.83	AAPL	
	Iron Fly	Straddle
P/L	\$397.50	(\$12,040.00)
# of Winners	19-Jun	19-Nov
% Winners	31.58%	57.89%

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We see a dramatic difference in P/L and win percentage when comparing these strategies in high and low vol. periods. As a defined risk replacement for a straddle the Iron Fly has its merits. Depending on your risk tolerance, these strategies may be plausible for your portfolio, particularly in periods of high IV.