Selling Iron Condors and Butterflies

Presented by:

Trading Strategy Desk

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Disclosures

- ✓ Options trading entails significant risk and is not appropriate for all investors. Certain complex options strategies carry additional risk. An approved options application and agreement is required to trade options. Before trading options, please read Characteristics and Risks of Standardized Options, which can be downloaded by clicking on the document located on the classroom wall. Supporting documentation for any claims, if applicable, will be furnished upon request.
- ✓ Examples in this presentation do not include transaction costs (commissions, margin interest, fees) or tax implications, but they should be considered prior to entering into any transactions.
- ✓ There are additional costs associated with option strategies that call for multiple purchases and sales of options, such as spreads, straddles, and collars, as compared with a single option trade.
- ✓ The information in this presentation, including examples using actual securities and price data, is strictly for illustrative and educational purposes only and is not to be construed as an endorsement, or recommendation.

Disclosures (cont.)

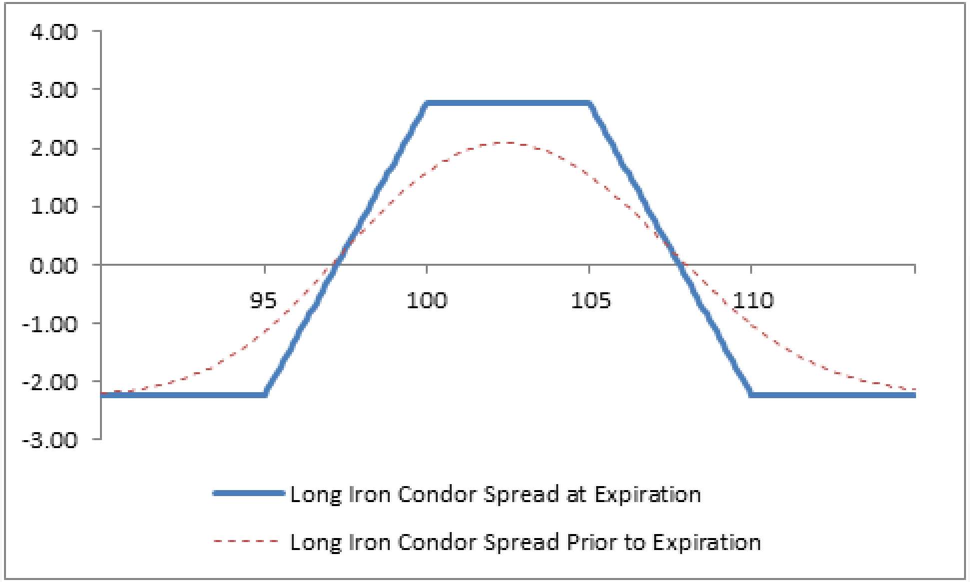
- ✓ Active Trader Pro PlatformsSM is available to customers trading 36 times or more in a rolling 12-month period; customers who trade 120 times or more have access to Recognia anticipated events and Elliott Wave analysis.
- ✓ Greeks are mathematical calculations used to determine the effect of various factors on options.
- ✓ Profit probability shows how likely a particular option trade (or combination of trades) will be profitable, based on a calculation that takes into account the price of the trade and the expected distribution of stock prices based on the 90-day historical volatility.
- ✓ Technical analysis focuses on market action — specifically, volume and price. Technical analysis is only one approach to analyzing stocks. When considering which stocks to buy or sell, you should use the approach that you're most comfortable with. As with all your investments, you must make your own determination as to whether an investment in any particular security or securities is right for you based on your investment objectives, risk tolerance, and financial situation. Past performance is no guarantee of future results.

Goal of this presentation:

Assist traders in understanding the similarities and differences in selling iron condors and butterflies.

Selling the Iron Condor

Buy 1 XYZ 95 Put at 0.70	(0.70)
Sell 1 XYZ 100 Put at 2.10	2.10
Sell 1 XYZ 105 Call at 2.35	2.35
Buy 1 XYZ 110 Call at 0.95	(0.95)
Net Credit =	2.80



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Outlook:
Neutral

Construction:
Buy lower put strike (i.e. 95)
Sell higher put strike (i.e. 100)
Sell lower call strike (i.e. 105)
Buy higher call strike (i.e. 110)

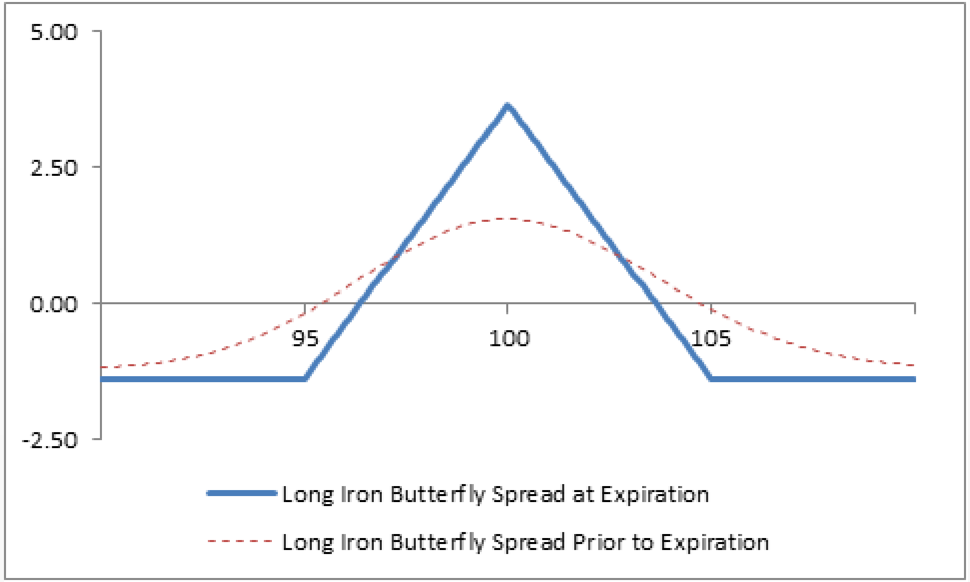
Max Gain:
Premium received

Max Loss:
Difference of strikes – premium received

Breakeven @ expiration:
Middle Put strike – Premium received
Middle Call strike + Premium received

Selling the Iron Butterfly

Buy 1 XYZ 95 Put at 1.20	(1.20)
Sell 1 XYZ 100 Put at 3.20	3.20
Sell 1 XYZ 100 Call at 3.30	3.30
Buy 1 XYZ 105 Call at 1.40	(1.40)
Net Credit =	3.90



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Outlook:
Neutral

Construction:
Buy lower put strike (i.e. 95)
Sell Middle put strike (i.e. 100)
Sell Middle call strike (i.e. 100)
Buy higher call strike (i.e. 105)

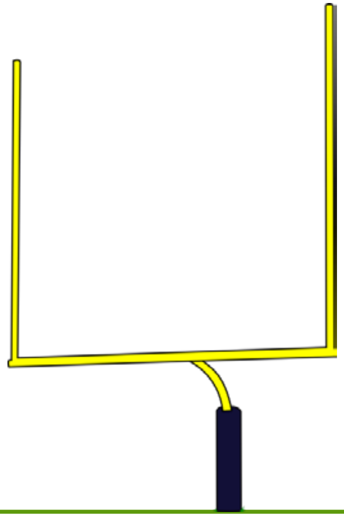
Max Gain:
Premium received

Max Loss:
Difference of strikes – premium received

Breakeven @ expiration:
Middle Put strike – Premium received
Middle Call strike + Premium received

How does these trades work?

- Typically sellers look for a security that they believe is range bound
- Outlook on price: You believe the underlying security will stay within the range
  - Support and Resistance levels
  - Statistical Probabilities
- Outlook on Volatility: Should expect a decrease
- Defined risk on both sides



Trader's View: Allow your outlook to define the appropriate option strategy, not the other way around.

Let's take a look at the Option Greeks

- **Delta** (directional exposure):
  - As close to zero as possible
- **Gamma** (creating directional exposure):
  - Negative exposure means accelerates losses and decelerates gains
- **Theta** (Time decay):
  - Positive exposure means time passing helps the strategy
- **Vega** (Implied Volatility):
  - Negative exposure means that you want volatility to fall

*Greeks are mathematical calculations used to determine the effect of various factors on options.

Trader's View:

Selling delta neutral strategies is trading time decay and falling volatility, but beware of gamma

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How do they compare to each other?

Iron Condor	*Iron Butterfly*
Less premium received, higher max loss	More premium received, lower max loss
Higher probability trade	Lower probability trade
Further out break evens	Closer in break evens
Area for price to move, before testing strikes	Price is frequently testing strikes

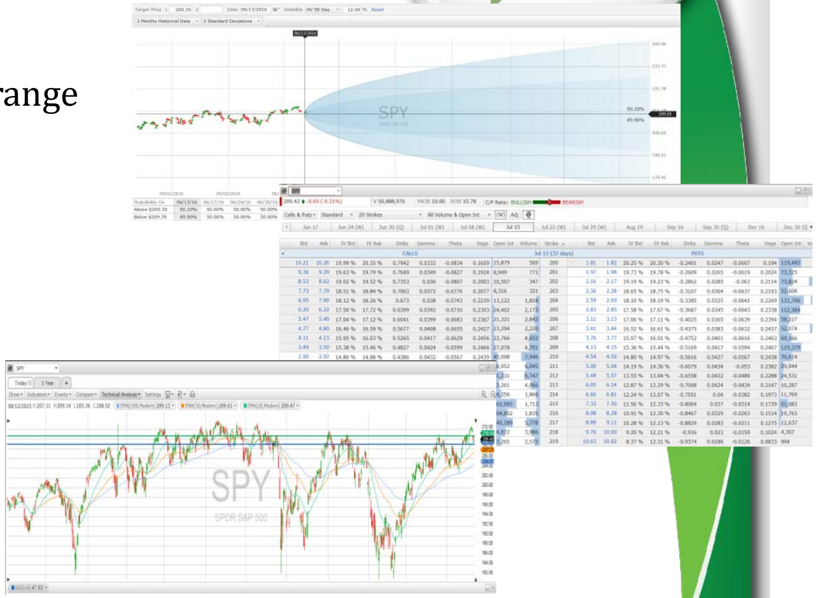
Trader's View: Although the trades are similar, the iron butterfly is a more aggressive approach.

Strike Selection

- Probability of security’s price movement
  - Trader often look for one or two standard deviation range
    - Probability Calculator or,
    - Delta on Option Chain

- Expected Move that option market is pricing
  - At the Money straddle total premium
  - Typically used around event based trades

- Identifying trading ranges
  - Recognia’s support and resistance function
  - Charts or Chart patterns



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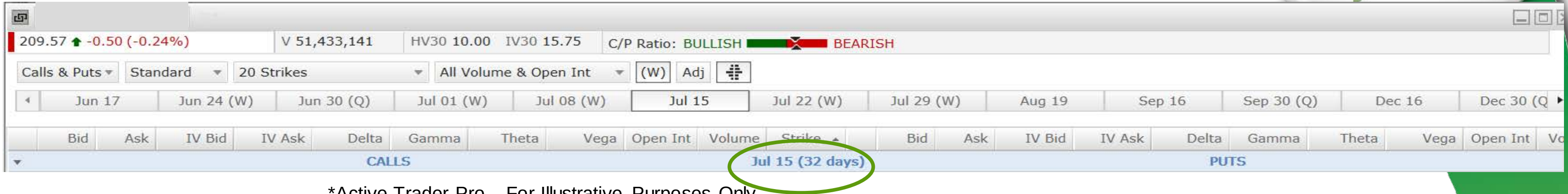
Trader’s View: Delta provides an estimate of the probability that the contracts will be in the money by the expiration date.

Expiration Selection



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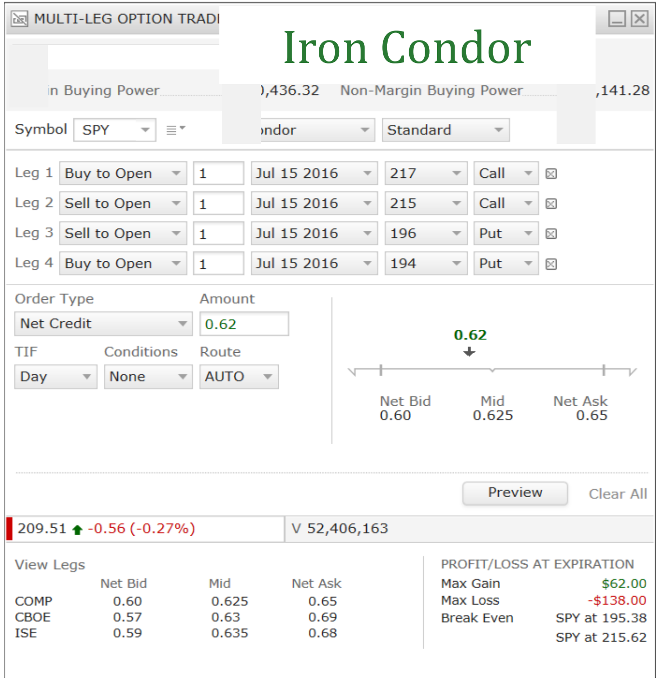
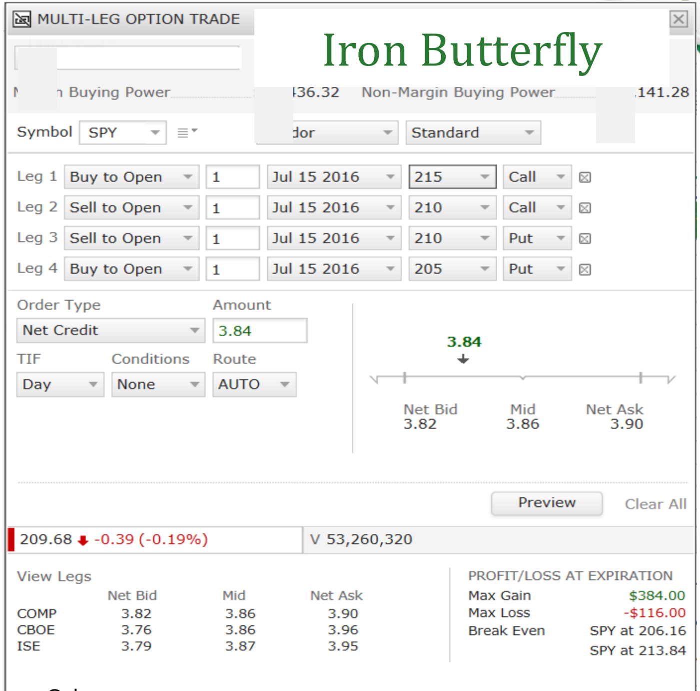
- Premium sellers will sometimes look for 30 to 60 days to expiration
  - Balance between premium being received and time exposure
  - Exposure to acceleration of time decay (theta)
- Event based?
- Dividend exposure?

Trader's View: Theta measures the change in the time value of the option's premium with each passing day.

Placing the Trade





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Trader's View: Lower right hand corner of the trade ticket gives you the max gain, max loss, and breakeven on the trade.

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Exit Strategy

- Profit targets
  - Dollar amount
  - Percentage of max gain
  - Go to expiration
- Loss targets
  - Dollar amount
  - Percentage loss
  - Strike getting tested
  - Delta target
  - Go to expiration

Trader's View: Clearly defined exit strategy can help protect your trade from your emotions.

Key Takeaways

- Understand what you are really trading
- Strike selection is achieved by choosing the exposure you want
- Expiration selection will be answered through the basis of the trade
- Have an exit strategy before entering the trade
- Having an outlook on timeframe, direction, and Implied Volatility is pivotal
- Having a trade process will help with evaluating these factors for every trade
- Fidelity provides the tools to help with research and analysis

Trader's View: Reason for trade can help provide clarity for your exit strategy.