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Interactive Brokers Webcast

Neutral Spreads

May 17, 2017

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Neutral Spreads

Outline

- **Iron Butterfly**
- **Iron Condor**
- **Trading Examples**
- **Summary / Q&A**

Iron Butterfly

Introduction

- **Consists of a position in four different option contracts**
- **It may also be thought of as a combination of a bear call spread and bull put spread**
- **A call and put with the same strike price are sold**
- **Two options are also purchased – a lower strike put and a higher strike call**
- **The result is a neutral spread trade with a range of potential profitability**
- **The maximum profit would only be realized at a single price point**

Iron Butterfly

Basic Example

XYZ at 50.00

Long 1 XYZ 45 Put

Short 1 XYZ 50 Put

Short 1 XYZ 50 Call

Long 1 XYZ 55 Call

Bull Put Spread

Bear Call Spread

Both Bull Put and Bear Call spreads are credit spreads
Iron Butterfly will always bring in a credit

Iron Butterfly

Trading Example

XYZ Trading at 40.00 –

Neutral outlook for XYZ

Expect stock to trade in a tight range in 45 Days

Buy 1 XYZ 35 Put at 0.25

Sell 1 XYZ 40 Put at 1.70

Sell 1 XYZ 40 Call at 1.65

Buy 1 XYZ 45 Call at 0.30

$$- 0.25 + 1.70 + 1.65 - 0.30 = 2.80$$

Net Credit = 2.80

Iron Butterfly

XYZ 35 – 40 – 45 Iron Butterfly

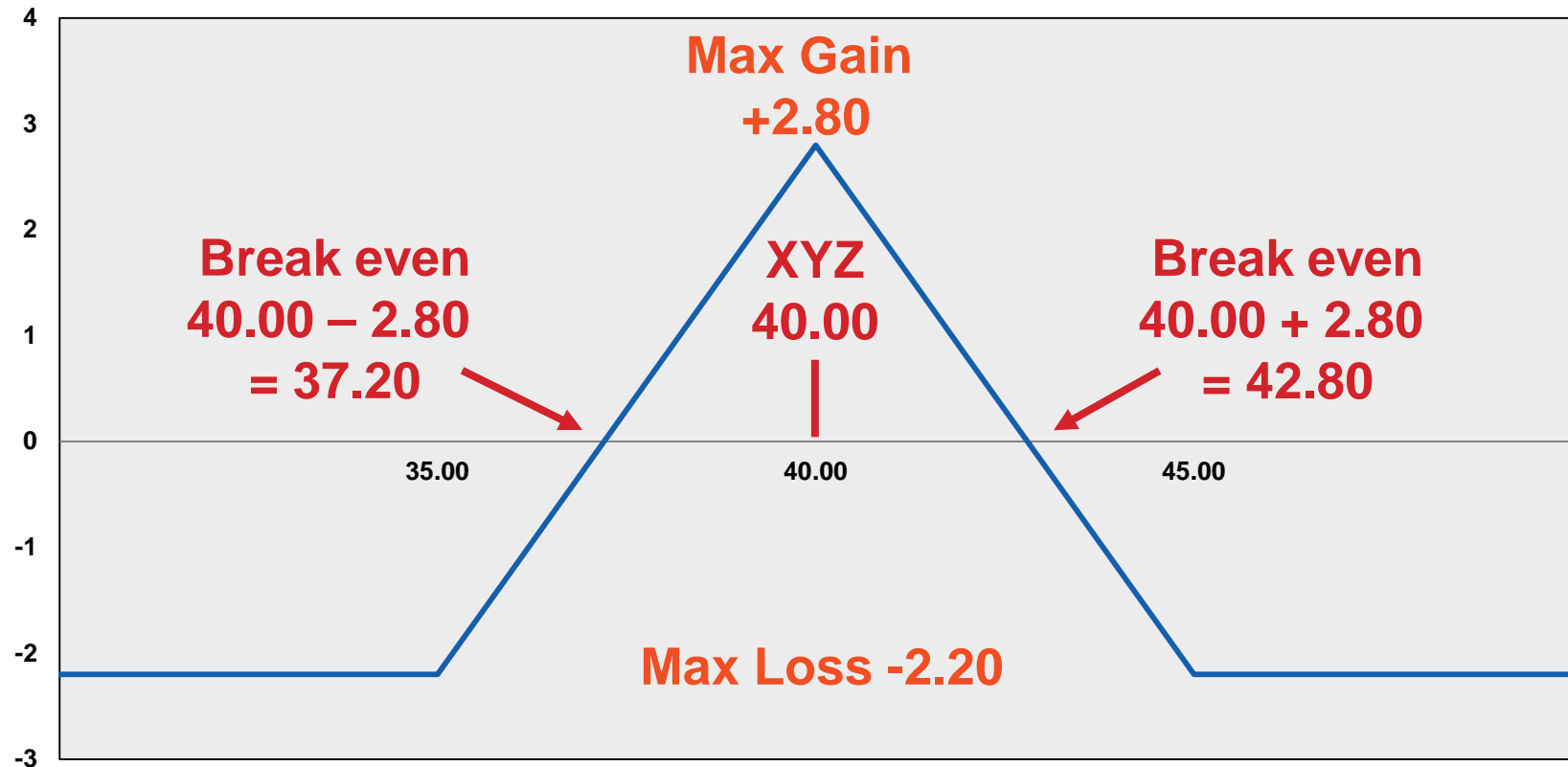
Payoff at Expiration –

Stock	35 Put	40 Put	40 Call	45 Call	Credit	P/L
30	5.00	(10.00)	0.00	0.00	2.80	(2.20)
35	0.00	(5.00)	0.00	0.00	2.80	(2.20)
40	0.00	0.00	0.00	0.00	2.80	2.80
45	0.00	0.00	(5.00)	0.00	2.80	(2.20)
50	0.00	0.00	(10.00)	5.00	2.80	(2.20)

Iron Butterfly

XYZ 35 – 40 – 45 Iron Condor

Payoff Diagram –



Iron Condor

Introduction

- **Consists of a position in four different option contracts**
- **It may also be thought of as a combination of a bear call spread and bull put spread**
- **Bull put strike prices are lower than the bear call strikes**
- **The center strike options are sold and outside strike are purchased**
- **The result is a neutral spread trade with a range where the maximum profit would be realized**

Iron Condor

Basic Example

XYZ at 47.50

Long 1 XYZ 40 Put
Short 1 XYZ 45 Put

Short 1 XYZ 50 Call
Long 1 XYZ 55 Call

Bull Put Spread

Bear Call Spread

Both Bull Put and Bear Call spreads are credit spreads
Iron Condor will always bring in a credit

Iron Condor

Trading Example

XYZ Trading at 37.50 –

Neutral outlook for XYZ

Expect stock in 35.00 – 40.00 range in 45 Days

Buy 1 XYZ 30 Put at 0.15

Sell 1 XYZ 35 Put at 0.90

Sell 1 XYZ 40 Call at 0.95

Buy 1 XYZ 45 Call at 0.20

$$- 0.15 + 0.90 + 0.95 - 0.20 = 1.50$$

Net Credit = 1.50

Iron Condor

XYZ 30 – 35 – 40 – 45 Iron Condor

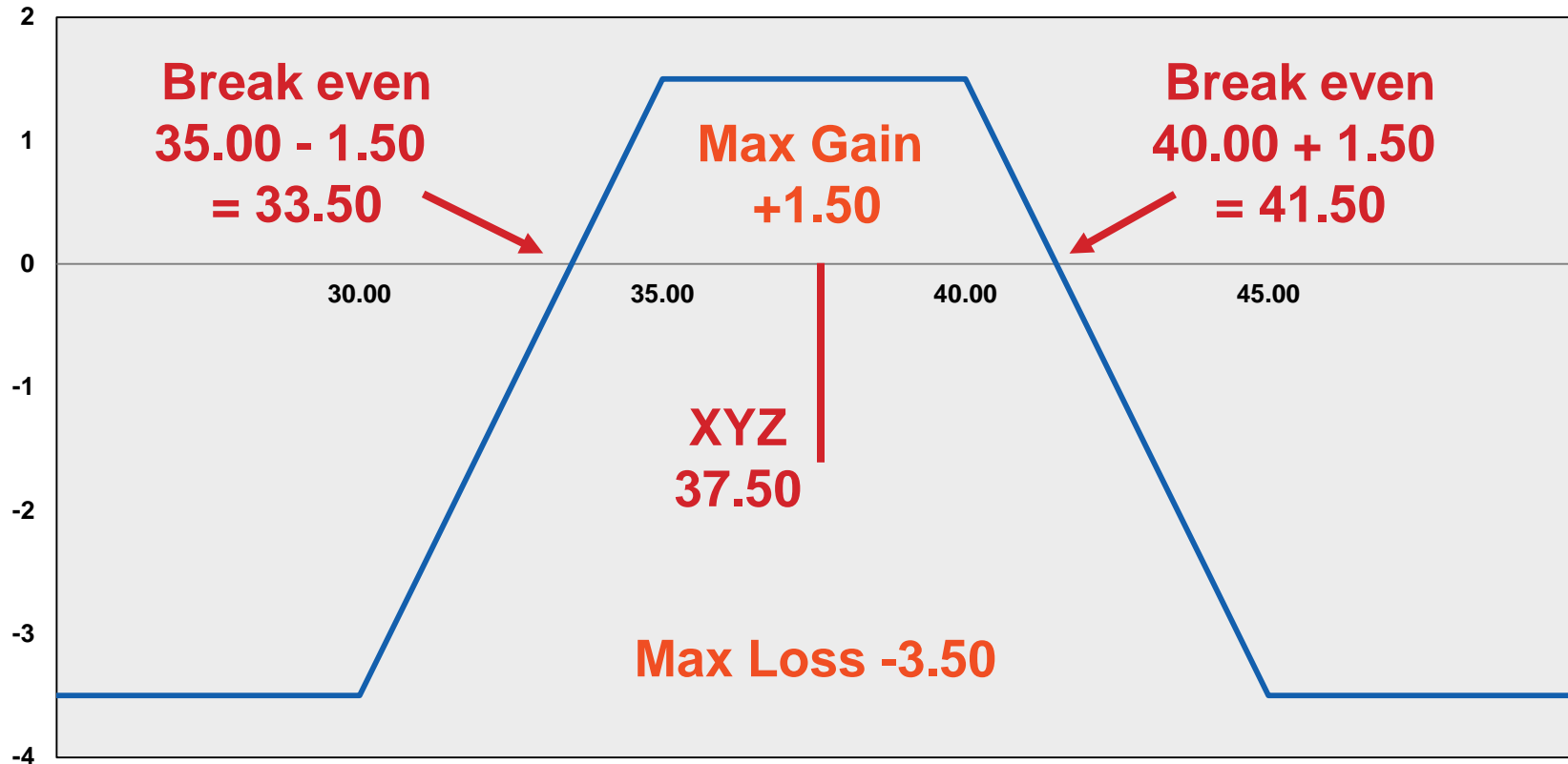
Payoff at Expiration –

Stock	30 Put	35 Put	40 Call	45 Call	Credit	P/L
25	5.00	(10.00)	0.00	0.00	1.50	(3.50)
30	0.00	(5.00)	0.00	0.00	1.50	(3.50)
35	0.00	0.00	0.00	0.00	1.50	1.50
40	0.00	0.00	0.00	0.00	1.50	1.50
45	0.00	0.00	(5.00)	0.00	1.50	(3.50)
50	0.00	0.00	(10.00)	5.00	1.50	(3.50)

Iron Condor

XYZ 30 – 35 – 40 – 45 Iron Condor

Payoff Diagram –



Iron Butterfly vs. Iron Condor

Strategy Comparisons

- **Iron Butterfly usually takes in more income than a comparable Iron Condor**
- **An Iron Condor will have a higher likelihood than the Iron Butterfly of realizing a maximum payoff**
- **The break even points are usually wider for an Iron Condor than an Iron Butterfly**

A picture may help with all this

Iron Butterfly vs. Iron Condor

Strategy Comparisons

Payoff Diagrams –



Weeklys and Iron Condors

Iron Condor

- The S&P 500 is at 1857 and we have a neutral outlook for the equity market for the next four weeks
- Based on this outlook we check out putting on an iron condor

Buy 1 SPX 20 Day 1840 Put @ 19.30

Sell 1 SPX 20 Day 1850 Put @ 21.60

Sell 1 SPX 20 Day 1865 Call @ 19.10

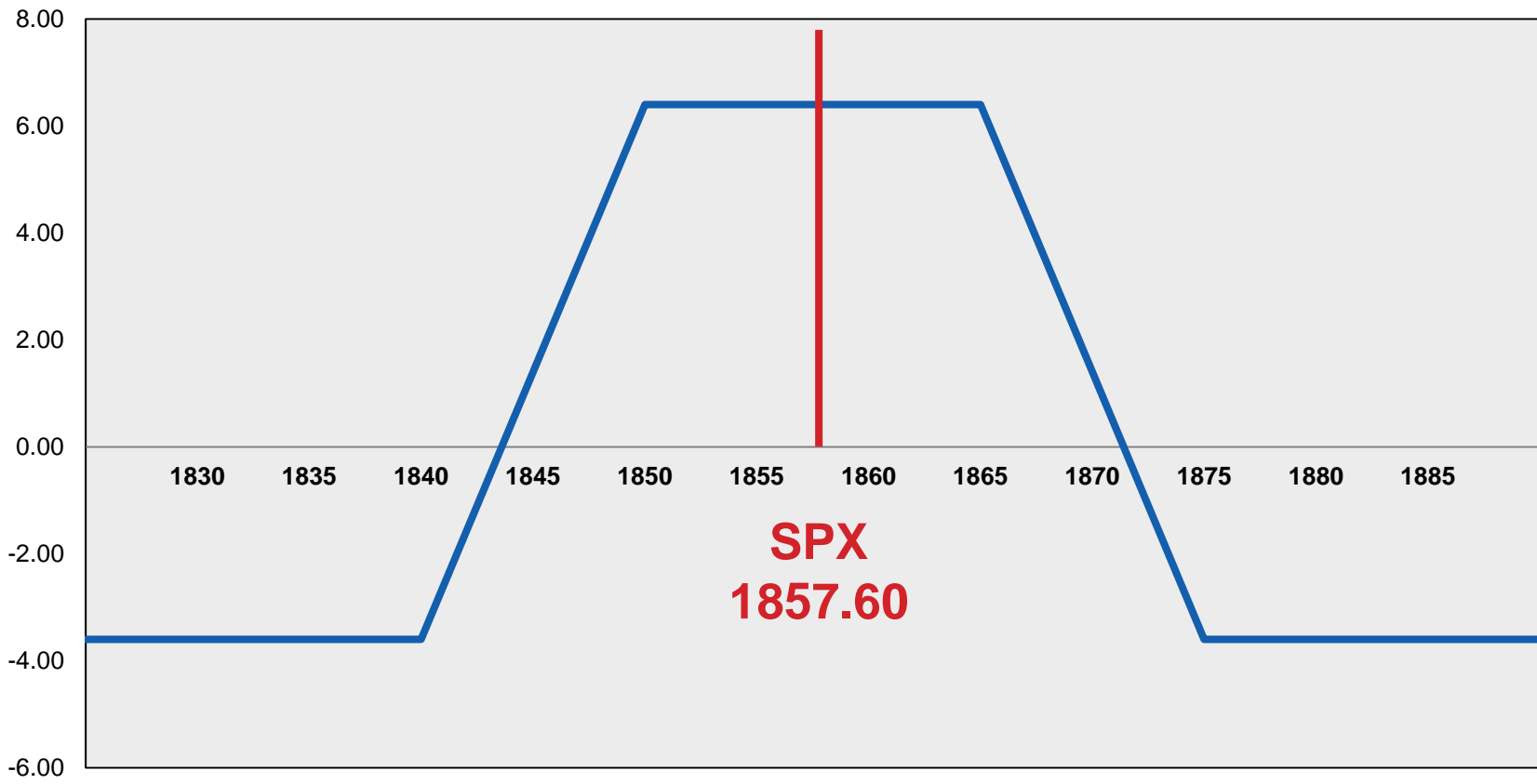
Buy 1 SPX 20 Day 1875 Call @ 15.00

Net Credit = 6.40

Weeklys and Iron Condors

SPX 1840 – 1850 – 1865 – 1875 Iron Condor

Payoff Diagram –



Weeklys and Iron Condors

SPX 1840 – 1850 – 1865 – 1875 Iron Condor

Weekly Expiration Comparison –

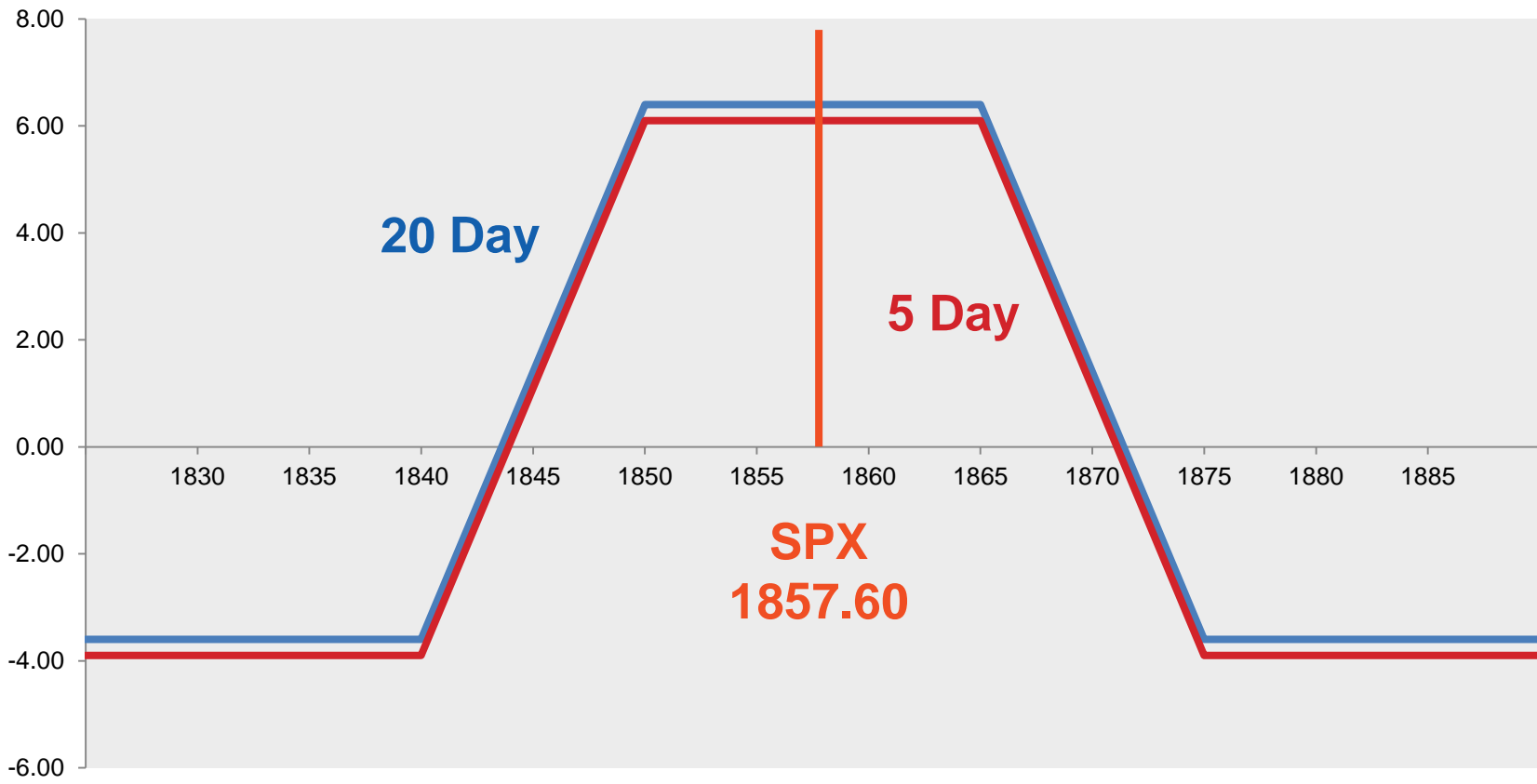
	SPX 1840 Put Ask	SPX 1850 Put Bid	SPX 1865 Call Bid	SPX 1875 Call Ask	Credit
5 Day	8.20	11.10	8.50	5.30	6.10
10 Day	12.80	15.00	13.00	9.00	6.20
15 Day	15.70	18.10	15.40	11.50	6.30
20 Day	19.30	21.60	19.10	15.00	6.40

Why trade a 20 day spread when you can trade a 5 day spread?

Weeklys and Iron Condors

SPX 1840 – 1850 – 1865 – 1875 Iron Condor

5 Day vs. 20 Day Payoff Diagram –



Weeklys and Iron Condors

Spreads and Time Decay

- **Short dated options offer a ton of flexibility in addition to more time decay benefits**
- **Traders may actually pin point their timing on trades using various expiration dates**
- **Traders may also have more opportunities to execute trades around different outlooks**

LNKD Trades

Bullish Butterfly

- February 5th LNKD Closed at 237.97 just before earnings
- About 5 minutes before the market closed there was a long call butterfly based on a bullish outlook for LNKD

Three year summary of LNKD earnings reactions

Max	Min	Abs Avg.	Last Q
21.27%	-12.93%	11.19%	-12.84%

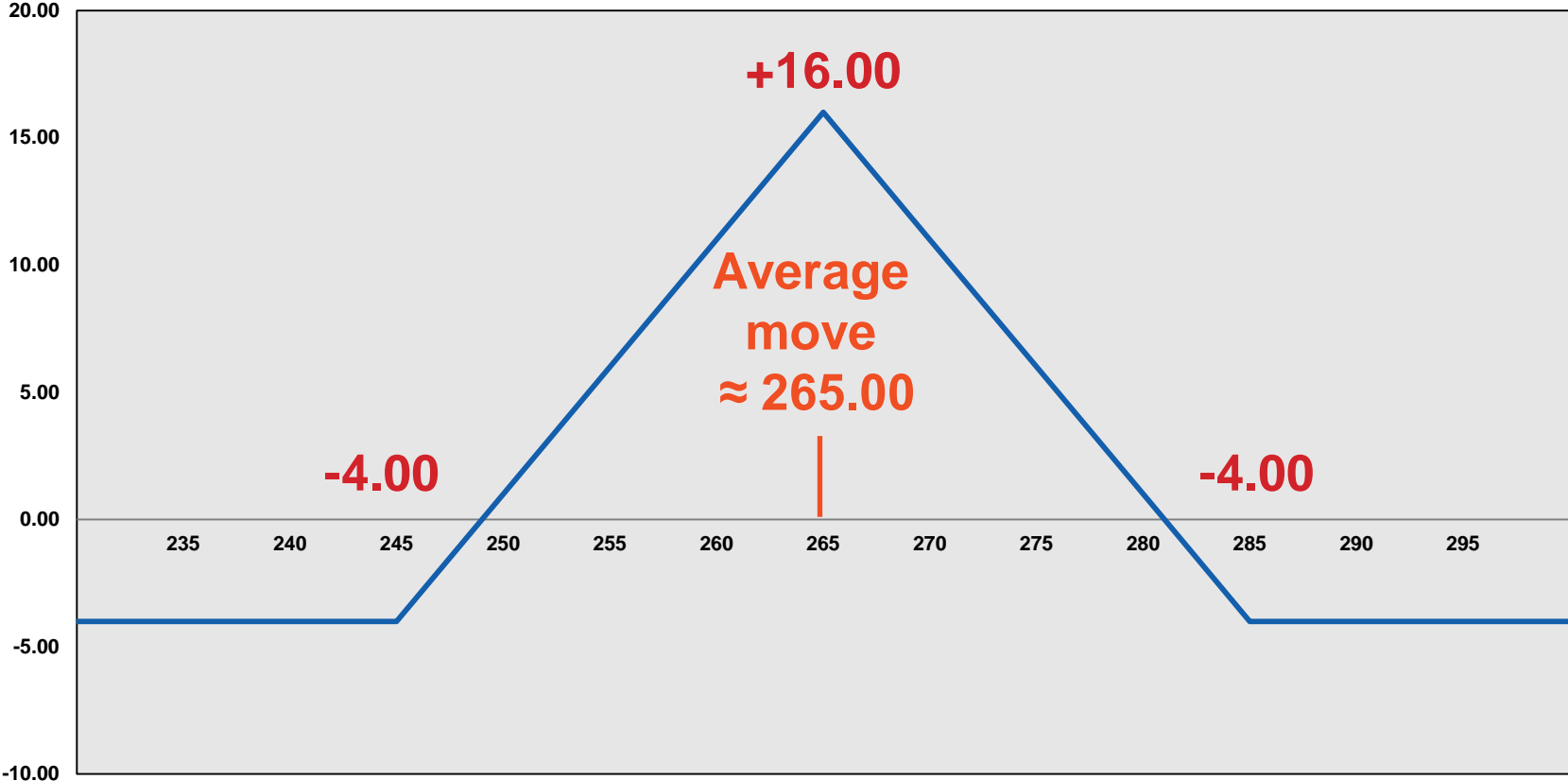
Buy 1 LNKD Feb 6th 245 Call at 6.94
Sell 2 LNKD Feb 6th 265 Calls at 1.63 each
Buy 1 LNKD Feb 6th 285 Call at 0.32
Net Cost = 4.00

Data Source: Bloomberg

LNKD Trades

Bullish Butterfly

Long LNKD Feb 6th 245 / 265 / 285 Call Butterfly



LNKD Trades

Bullish Butterfly

- LNKD Closed at 237.97
- Late in the day a neutral iron condor came into the market

Three year summary of LNKD earnings reactions

Max	Min	Abs Avg.	Last Q
21.27%	-12.93%	11.19%	-12.84%

Buy 1 LNKD Feb 6th 225.00 Put at 4.58

Sell 1 LNKD Feb 6th 227.50 Put at 5.46

Sell 1 LNKD Feb 6th 247.50 Call at 5.82

Buy 1 LNKD Feb 6th 250.00 Call at 4.90

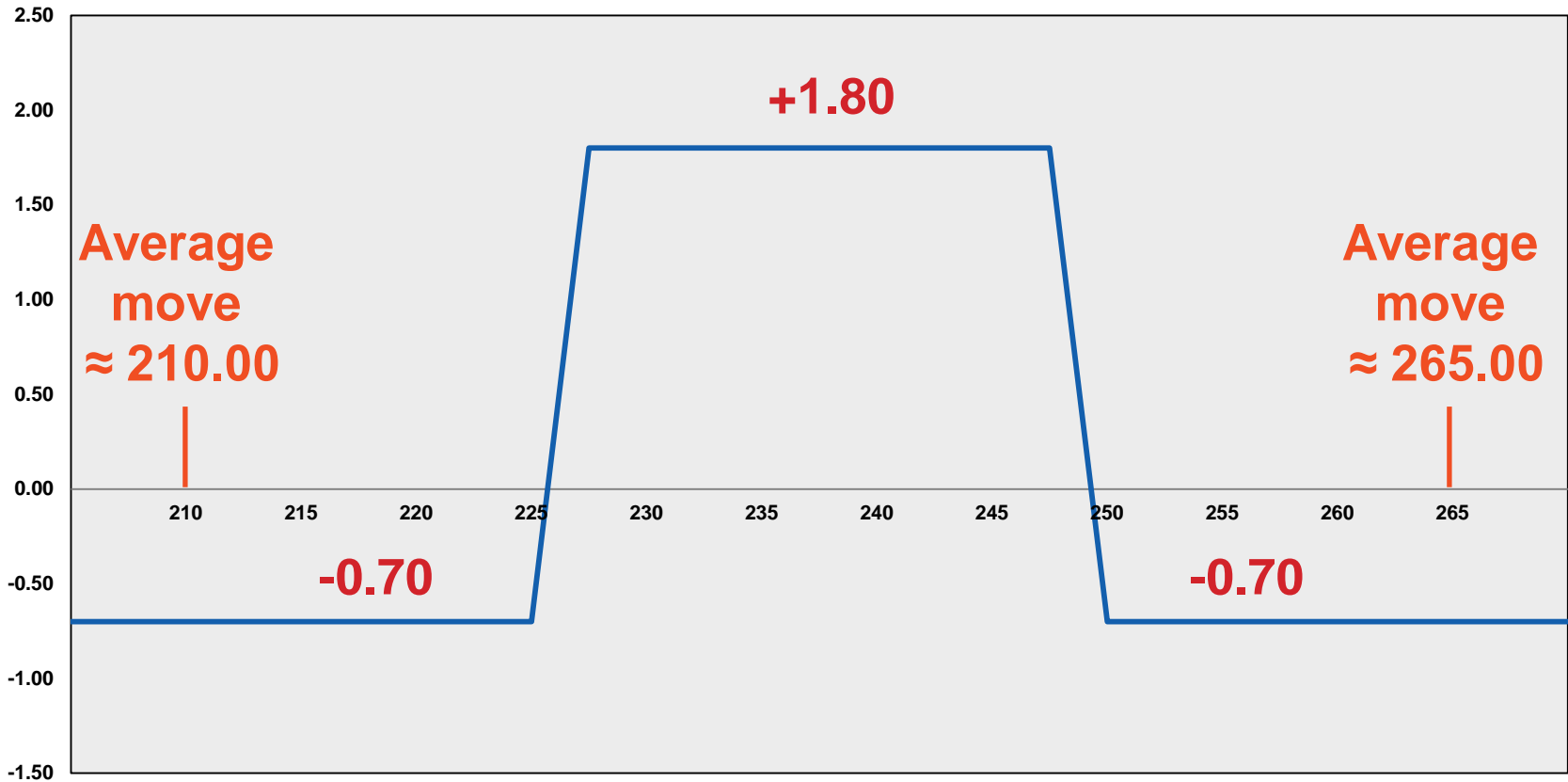
Net Credit = 1.80

Data Source: Bloomberg

LNKD Trades

Neutral Iron Condor

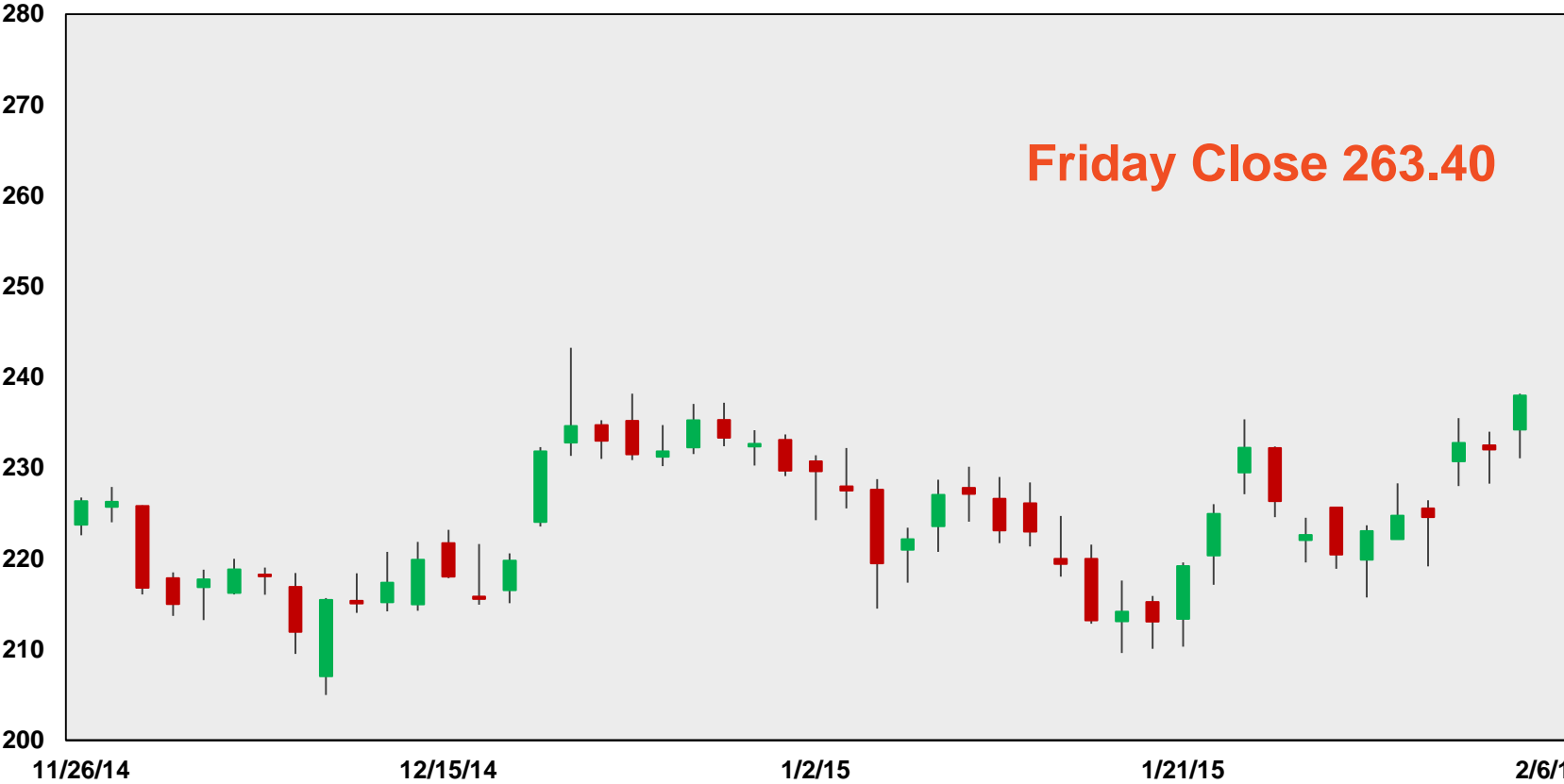
LNKD Feb 6th 225.00 / 227.50 / 247.50 / 250.00 Iron Condor



LNKD Trades

Price Action

Daily Prices



Data Source: Bloomberg

VXX Trade

Bearish Iron Condor

- Friday January 30th – VXX @ 36.87
- VXX was up about 20% over the last five trading days
- Just before the market closed for the weekend an Iron Condor was placed using VXX Weeklys

Buy 1 VXX Feb 6th 33.00 Call at 0.37

Sell 1 VXX Feb 6th 34.00 Call at 0.68

Sell 1 VXX Feb 6th 36.50 Call at 1.91

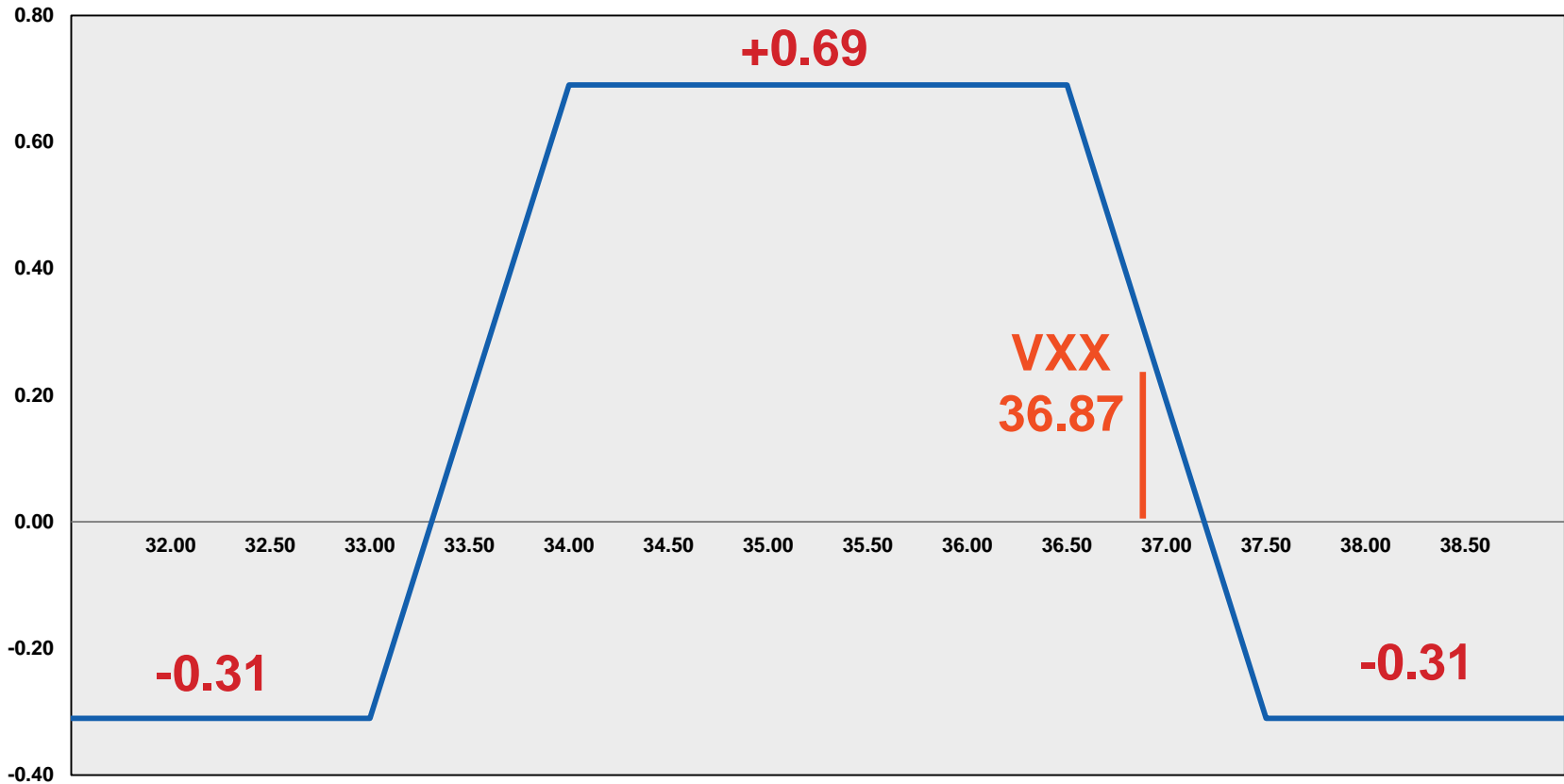
Buy 1 VXX Feb 6th 37.50 Call at 1.53

Net Credit = 0.69

VXX Trade

Bearish Iron Condor

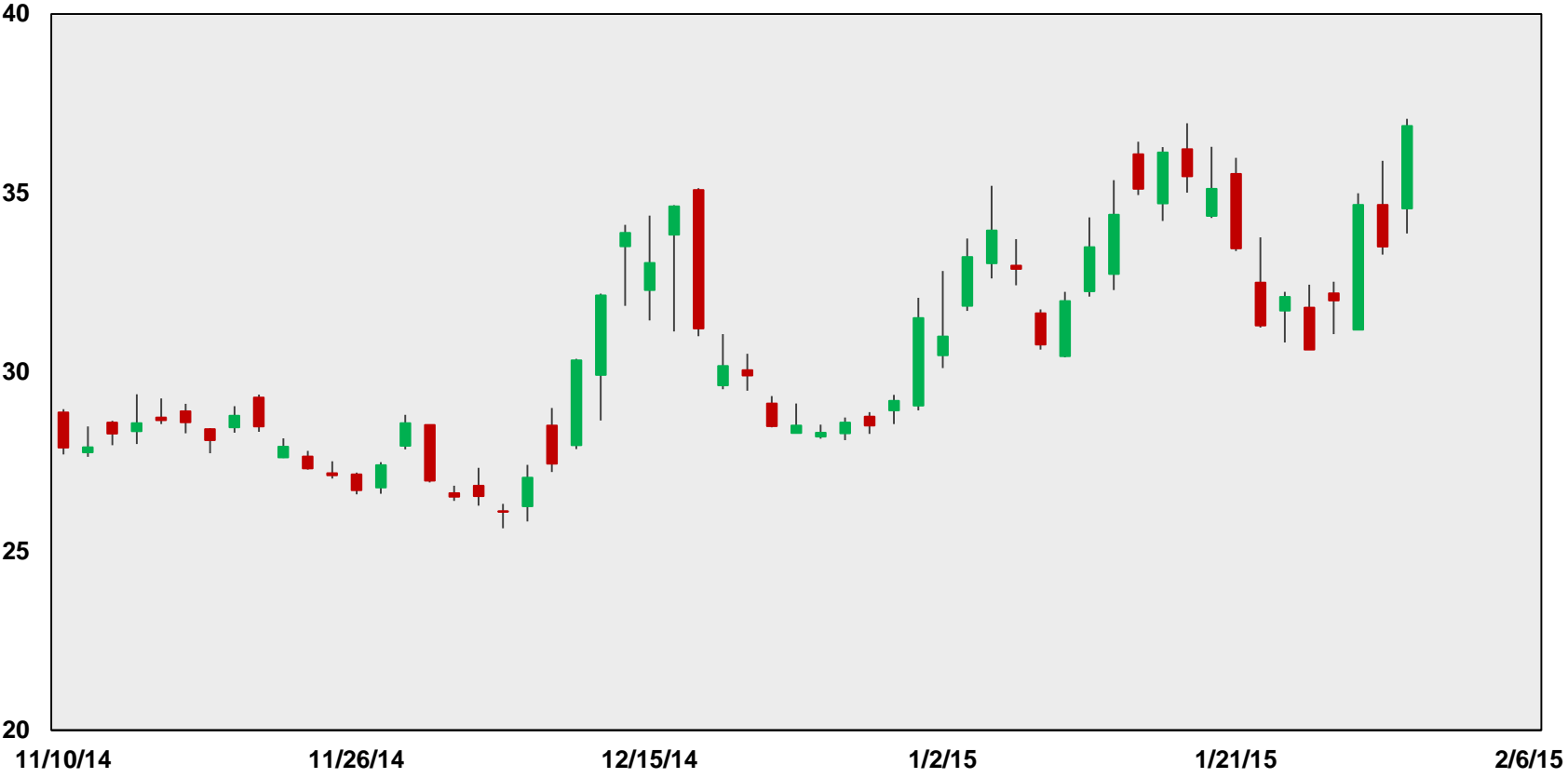
VXX Feb 6th 33.00 / 34.00 / 36.50 / 37.50 Iron Condor



VXX Trade

Price Action

Daily Prices



Data Source: Bloomberg

HD Trade

Bullish Butterfly Spread

- HD reported earnings after the close Monday May 18th
- Butterfly spread was executed mid-afternoon when HD was trading at 113.76 (stock closed at 114.33)

Three year summary of HD earnings reactions

Max	Min	Abs Avg.	Last Q
5.69%	-2.43%	3.13%	3.98%

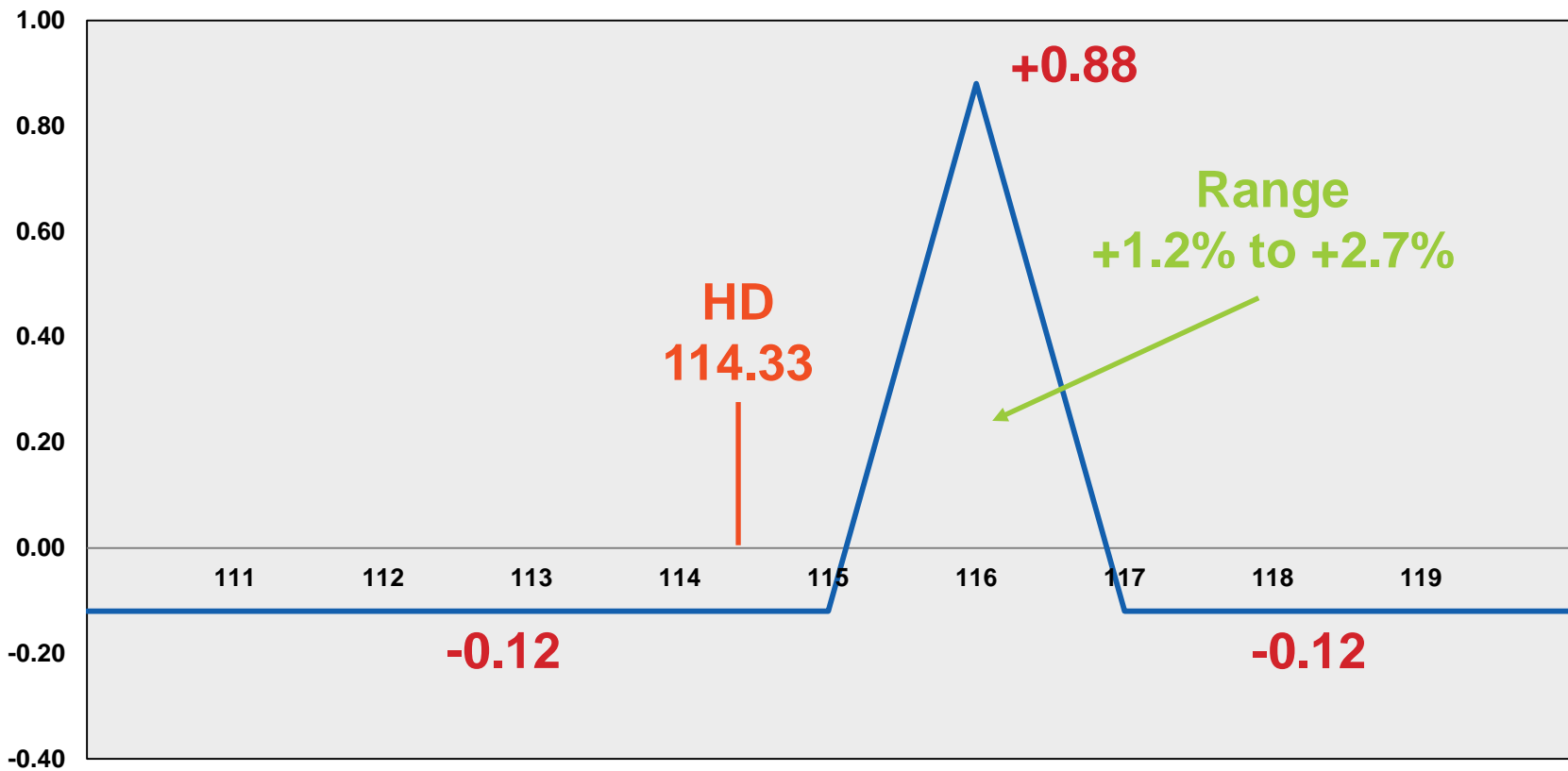
Buy 1 HD May 22nd 115 Call at 1.11
Sell 2 HD May 22nd 116 Calls at 0.74
Buy 1 HD May 22nd 117 Call at 0.49
Net Debit = 0.12

Data Source: Bloomberg

HD Trade

Bullish Butterfly Spread

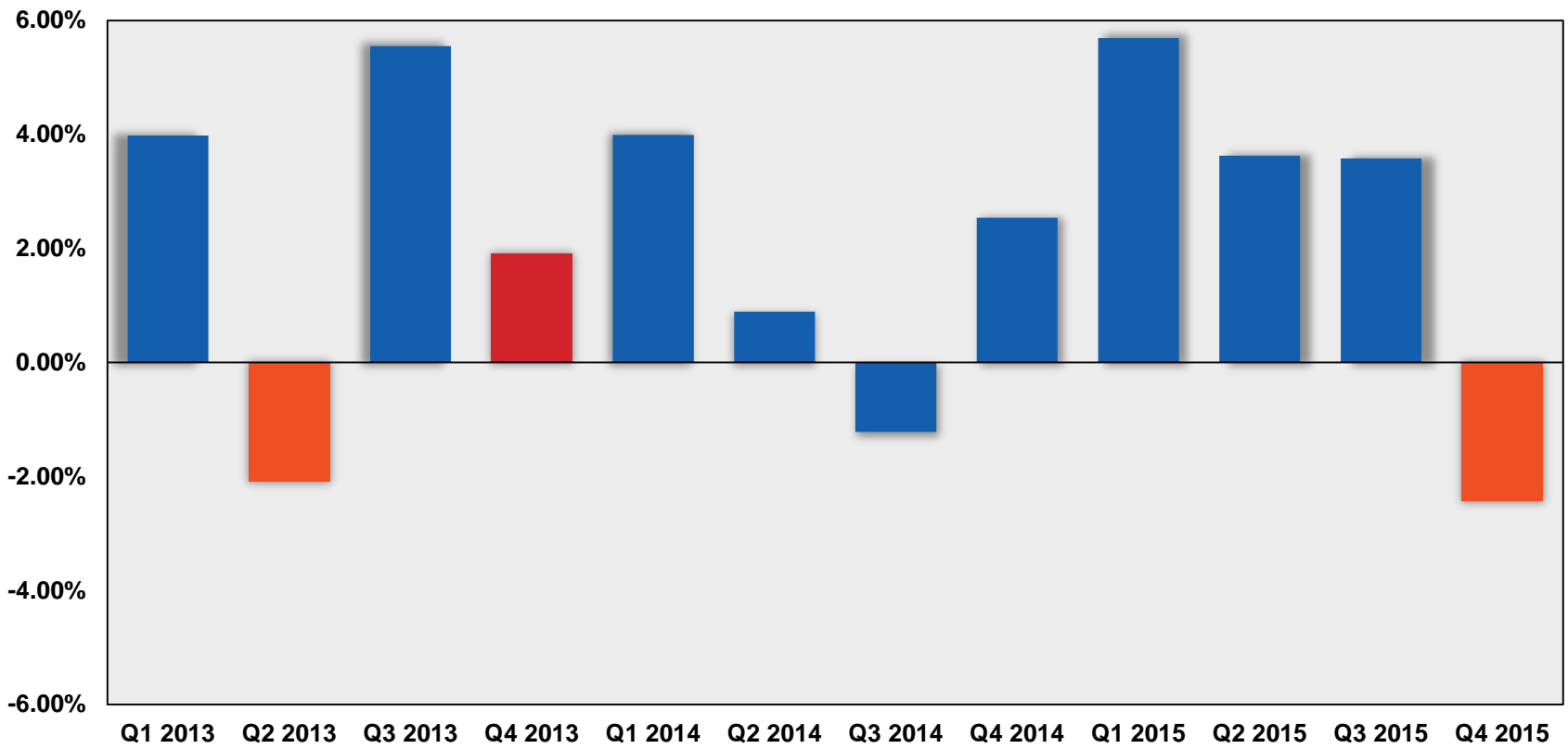
Long HD 115 Call / Short 2 HD 116 Calls / Long HD 117 Call



HD Trade

Bullish Butterfly Spread

3 Year Earnings History Breakdown –

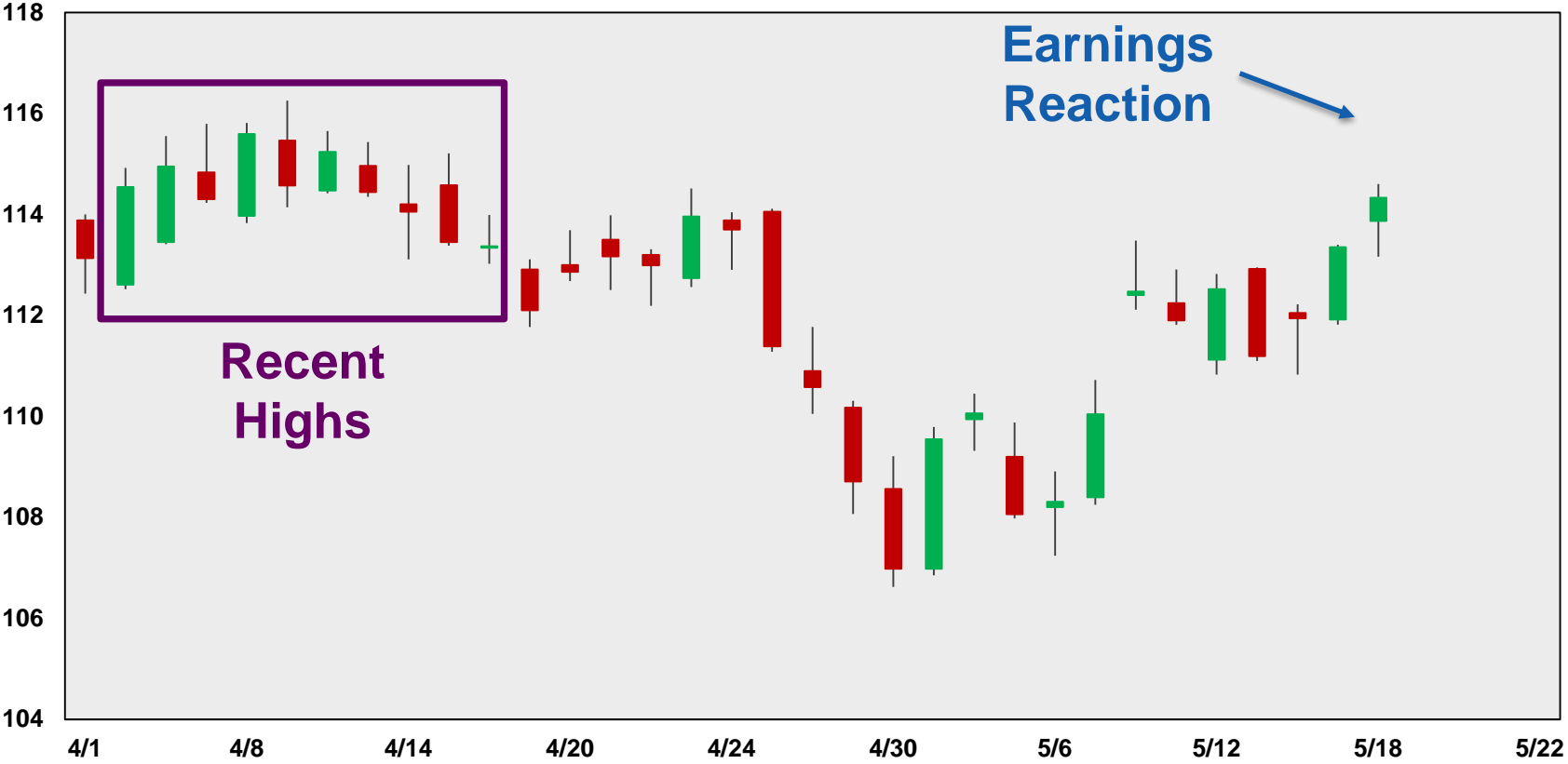


Data Source: Bloomberg

HD Trade

Price Action

Daily Prices



Data Source: Bloomberg

Neutral Spreads

Summary

- **Both Iron Condors and Iron Butterfly Spreads are useful trades when there is an expectation that an underlying market is going to be in a range**
- **The risk / reward characteristics differ slightly between the two spreads**
- **When selling shorter dated options there is a time decay benefit that makes Weeklys ideal for these types of spreads**

Neutral Spreads

Questions / Links / Contact

Questions?

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