

# Trading Credit Spreads and The Iron Condor



# Trading Credit Spreads and The Iron Condor



**In order to simplify the computations, commissions and other costs have not been included in the examples used in these materials. Commission costs will impact the outcome of all stock and options transactions and must be considered prior to making a trade.**

**Any strategies discussed, are strictly for illustrative and educational purposes only and are not to be construed as an endorsement, recommendation, or solicitation to buy or sell securities.**

**Options involve risks and are not suitable for everyone. Prior to buying or selling an option, an investor must receive a copy of *Characteristics and Risks of Standardized Options*. Copies may be obtained from your broker or from The Options Clearing Corporation, 1 N. Wacker Drive, Chicago, IL 60606. Investors considering options should consult a professional tax advisor as to how taxes may affect the outcome of contemplated options transactions.**

- Credit Spreads
  - Call Credit Spreads Defined & Example
  - Put Credit Spreads Defined & Example
- Characteristics of Vertical Spreads
- Mechanics at Expiration
- Conclusion

*Buy or sell one* option and *Buy or sell an*  
option, stock or other product

Usually the same underlying

Usually the same expiration dates

Usually Different strike prices

A spread involves 2 or more positions

*Buy one* option and *sell another* option

Same underlying

Same expiration dates

Different strike prices

A Debit Spread – you pay to initiate the position

A Credit Spread – you receive cash (or a credit) to initiate the position

*XYZ is trading at \$88.90 per share*

Your outlook:

XYZ should be lower or unchanged in the next 28 days, but is not expected to move above \$90 per share.

**With XYZ trading at \$88.90 per share and you being neutral (not bullish above \$90), you could:**

- Sell 100 shares **SHORT**  
unlimited risk, high margin  
broker approval question
- Sell a naked call  
unlimited risk, high margin  
broker approval question
- Sell a Call Credit Spread

XYZ @ \$88.90 28 Days to Expiration

Sell 1 28-day 90 Call 3.50

Buy 1 28-day 95 Call 1.80

Net Credit 1.70

**This is a bearish call credit spread**

XYZ @ \$88.90 28 Days to Expiration

Sell the 90 – 95 call credit spread at \$1.70

Maximum Gain:

Maximum Risk:

Margin:

Breakeven:

What is this spread worth with XYZ at \$88.90 in 21 days? In 7 Days?

XYZ @ \$88.90 28 Days to Expiration

Sell the 90 – 95 call credit spread at \$1.70

Maximum Gain: 1.70

Maximum Risk: 3.30

Margin: 3.30

Breakeven: 91.70

What is this spread worth with XYZ at \$88.90 in 21 days?

In 7 Days?

Excludes transaction costs

The screenshot displays the 'Options Investigator: Tutorials' window. The main content area shows a disclaimer text:

**THIS TEXT HAS BEEN UPDATED 01.08.02**

-----

**Disclaimer**

The Options Investigator™ has been compiled by The Options Industry Council (OIC) for general information purposes only. Although every attempt has been made to ensure the accuracy of the information, OIC assumes no responsibility for any errors or omissions. Additionally, all examples are hypothetical fact situations, used for explanation purposes only, and should not be considered investment advice or the result of market experience. In order to simplify examples, commissions, taxes, and other transaction costs, margin requirements, and bid-ask spreads have not been taken into account. These factors will impact the outcome of stock and options strategies and should be considered in every trading decision.

Options involve risk and are not suitable for all investors. The information and tools in The Options Investigator™ discuss exchange-traded options issued by the Options Clearing Corporation. No statement herein is to be construed as a

The interface also features a table of contents on the left, a navigation sidebar on the right with buttons for 'glossary', 'notes', 'resources', 'strategies', 'simulator', 'print', 'about OIC', 'help', and 'exit', and a control panel at the bottom right with 'Back', 'Replay', and 'Next' buttons, as well as 'fontsize', 'audio on', and 'video on' settings.

**Options Investigator: Tutorials**

**The Options Investigator™**

- +Getting Started
- +Options Basics
- +Introduction to Premium
- +Strategy Basics
- +Placing an Order
- +Test your Options IQ
- +Principal Factors Affecting Price
- +Options Strategies
  - +A Framework for Studying Strategies
  - +Strategy Selection Criteria, Common Ap...
    - Screening Strategy Alternatives
    - Key Sorting Criteria: Forecast, Goals
    - Example: Covered Call Write
    - Example (continued)
  - +Combining Options with Other Options
  - +LEAPS Recap
  - +Practical Risks Concerning Exercise & ...
  - +The Next Level

**The Options Investigator™**  
 OIC THE OPTIONS INDUSTRY COUNCIL  
 1-888-OPTIONS | www.888options.com

fontsize [up/down arrows]  
 audio on [green dot]  
 video on [green dot]

Back Replay Next

**EQUITY OPTION CALCULATOR - [Call / Put]**

Call / Put Important Information ODD OCC Help Exit

Inputs To Formula		Option Estimation	
Today's Date 1/9/02		American Exercise	
Price of Stock	63.000	Call	Put
Strike	60.000	Price:	5.345 2.242
Quarterly Dividend	.000	Delta:	.663 -.338
Div Date (m/d/yyyy)		Gamma:	.037 .038
Volatility	48.747%	7-Day Theta:	-.401 -.381
Interest Rate	2.000%	Vega:	.073 .073
Days To Expiration	33	Rho:	.033 -.018
Input Description Box: <input checked="" type="checkbox"/>			

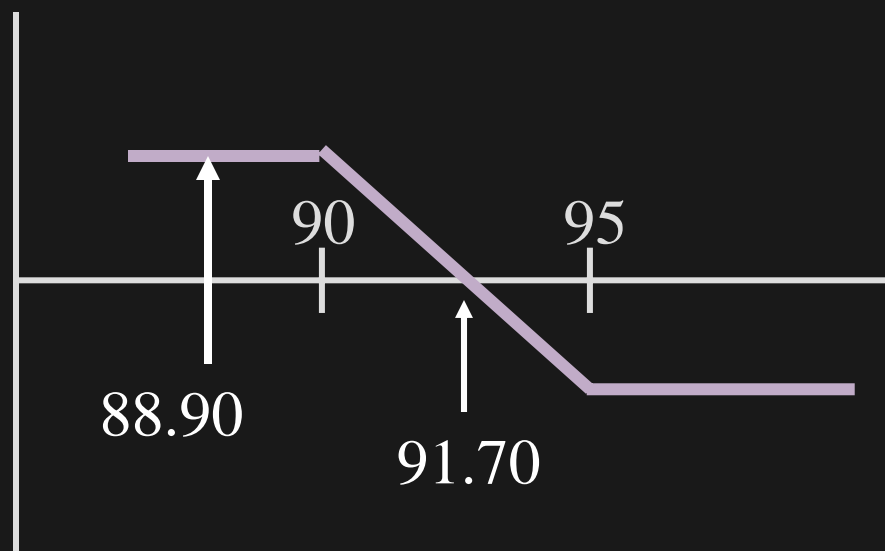
Welcome to Equity OpCalc ... (scroll down to read).  
 This program provides access to an equity option pricing model which will allow you to test and understand the dynamic relationships between the price of an option and the factors which affect that price. Once you have input all the factors of the option pricing model, Equity OpCalc will provide a theoretical value for the Put and Call you are pricing as well as other important values (delta, gamma, etc.), information about which can be found in the help file (see menu bar at top of the screen). In addition, the calculator will allow you to use the pricing model to derive an option's implied volatility.

*Sell* a lower strike call and *buy* a higher strike

Sell 1 90 Call 3.50

Buy 1 95 Call 1.80

Net Credit 1.70



**With XYZ trading at \$88.90 per share and you neutral to moderately bullish (not bearish below \$85) you could:**

- Buy 100 shares  
\$88.90 risk, high margin
- Sell a naked put option  
high margin, broker approval question
- Sell a put Credit Spread

XYZ @ \$88.90 28 Days to Expiration

Sell 1 28-day 85 put 2.05

Buy 1 28-day 80 put 0.70

Net Credit 1.35

**This is a bullish put credit spread**

XYZ @ \$88.90 28 Days to Expiration

Sell the 85 – 80 put credit spread at \$1.35

Maximum Gain:

Maximum Risk:

Margin:

Breakeven:

What is this spread worth with XYZ at \$88.90 in 21 days? In 7 Days?

XYZ @ \$88.90 28 Days to Expiration

Sell the 85 – 80 put credit spread at \$1.35

Maximum Gain: 1.35

Maximum Risk: 3.65

Margin: 3.65

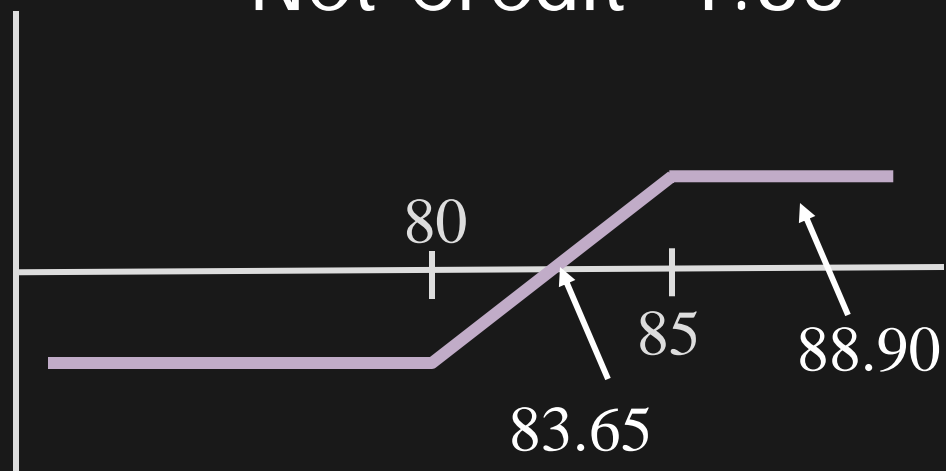
Breakeven: 83.65

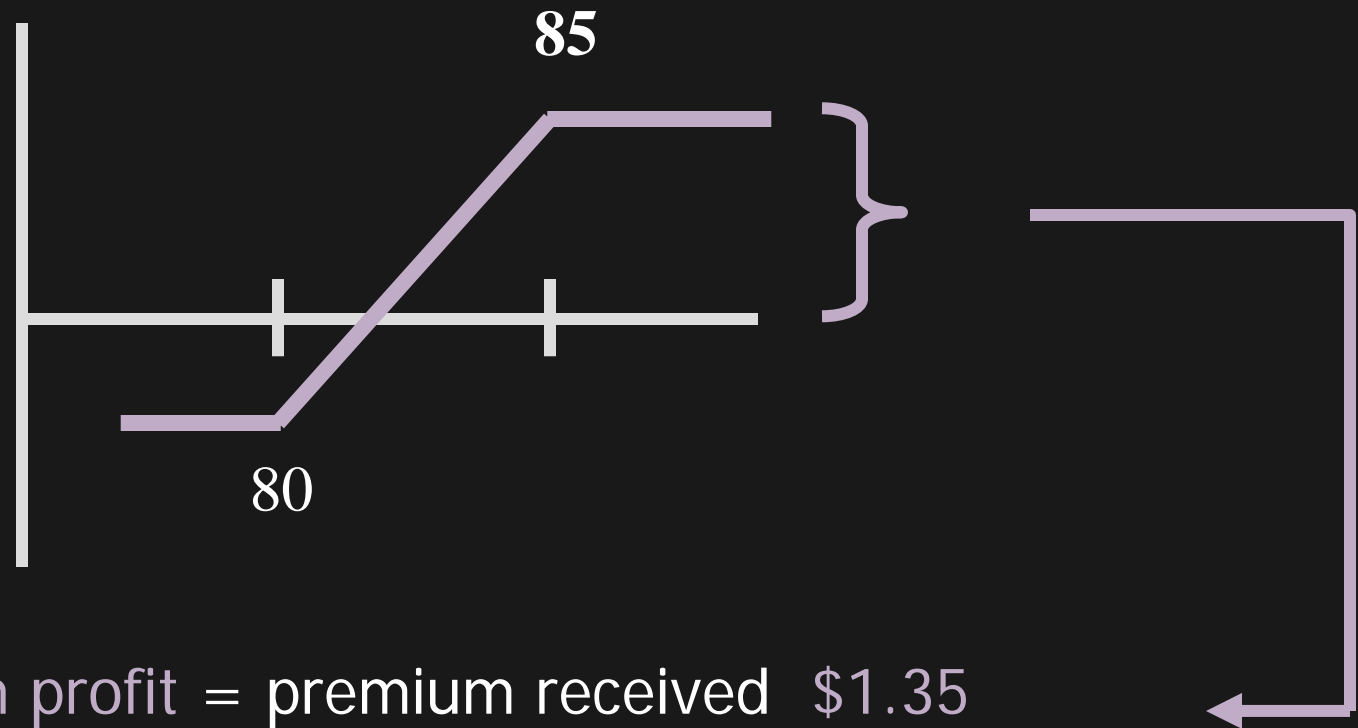
What is this spread worth with XYZ at \$88.90 in 21 days? In 7 Days?

Excludes transaction costs

Sell a higher strike put and buy a lower strike

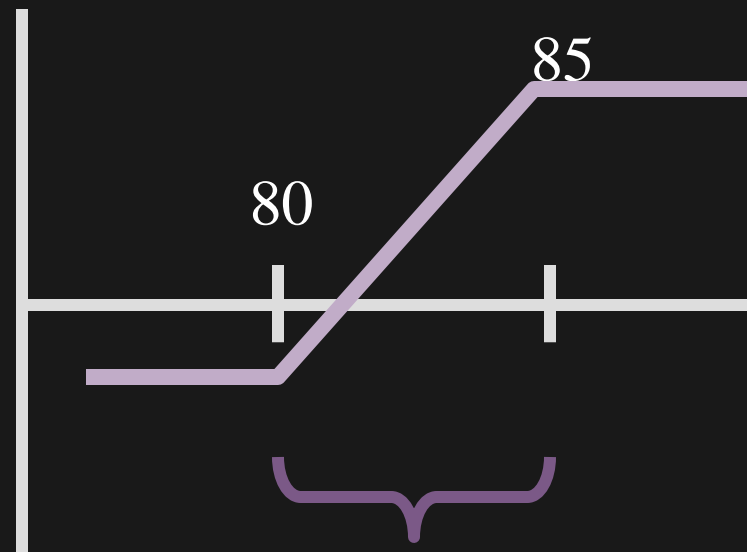
Sell 1	85 Put	2.05
Buy 1	80 Put	<u>0.70</u>
	Net Credit	1.35



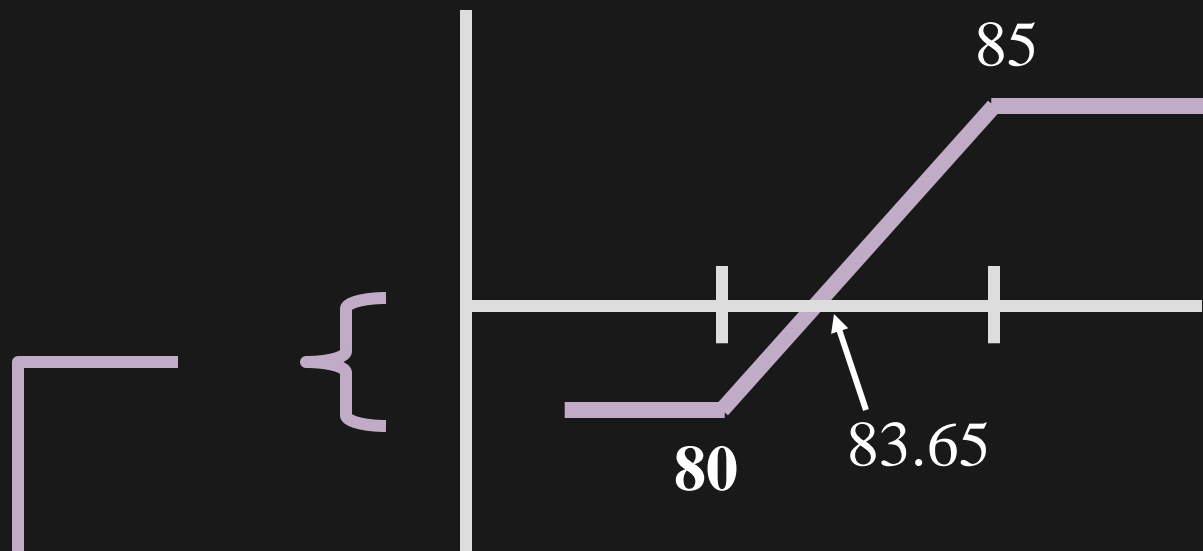


Maximum profit = premium received \$1.35

XYZ above \$85 in this example, both options expire



Stock price *between strikes* at expiration:  
Long put is assigned; short put expires;  
result = long stock



Maximum loss = difference in strikes (5.00) less premium received (1.35) = 3.65 below \$80 in this example short put assigned, long put exercised = no position

There are some investors who believe that a stock is not going too much higher OR lower – they are neutral on the stock and hope to benefit if there is not much price movement.

This is where a strategy known as **“The Iron Condor”** could be utilized

XYZ is trading at \$88.90, you think it will trade in a range of \$85 to \$90 over the next 4 weeks.

You could:

- Sell a naked out-of-the-money call and Sell a naked out-of-the-money put  
unlimited risk, high margin, broker approval question
- Sell an Iron Condor Spread

An Iron Condor is:

The sale of a call credit spread  
and

The sale of a put credit spread

The same underlying, the same expiration  
month, both spreads employing out-of-the-  
money options

XYZ @ \$88.90 28 Days to Expiration

Expected price range: \$85 to \$90

Sell the 90 – 95 call credit spread at \$1.70

Sell the 85 – 80 put credit spread at \$1.35

Net Credit \$3.05

**This is a typical Iron Condor**

XYZ @ \$88.90    Sell the 85-80 put credit spread and the 90-95 call credit spread at \$3.05

Maximum Gain:

Maximum Risk:

Margin:

Breakeven:

XYZ @ \$88.90    Sell the 85-80 put credit spread and the 90-95 call credit spread at \$3.05

Maximum Gain:    3.05

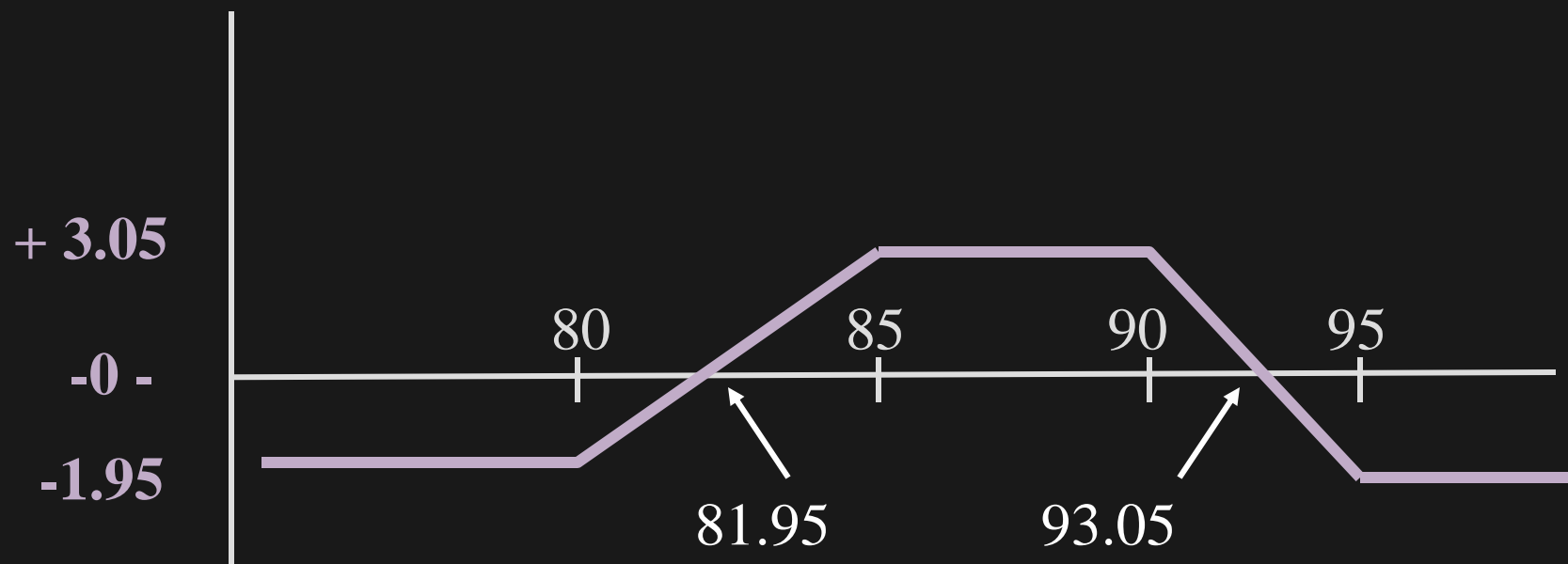
Maximum Risk:    1.95 \*\*\*    Let's discuss

Margin:            6.95

Breakeven:        93.05 and/or 81.95

Excludes Transaction Costs

Sell the 90-95 call credit spread and the 85-80 put credit spread for a net credit of 3.05



- **Commissions (in and out)**
- **Margin**
- **Stock price between strikes at expiration**

e.g. XYZ at \$92.50. Short call is assigned; long call expires New position:  
Short 100 shares

or

e.g. XYZ at \$81.00. Short put is assigned; long put expires. New position:  
Long 100 shares

- **Iron Condor** – either or both of above could happen

- **Conclusions:**
- Lower cost (risk) than selling naked short options
- Limited profit potential
- Commission intensive
- Must have a specific time and price forecast
- Iron Condor - 2 chances to "get scared"

To learn more about options, visit us at:

[www.888options.com](http://www.888options.com)

Or, contact us direct at:

1-888-OPTIONS

Send your questions regarding this webcast to:

[Options\\_Institute\\_Webcasting@cboe.com](mailto:Options_Institute_Webcasting@cboe.com)

## The Options Industry Council

1-888-OPTIONS  
Investor Services

### Web Sites:

[www.888options.com](http://www.888options.com)

[www.amex.com](http://www.amex.com)

[www.cboe.com](http://www.cboe.com)

[www.bostonoptions.com](http://www.bostonoptions.com)

[www.iseoptions.com](http://www.iseoptions.com)

[www.pacificex.com](http://www.pacificex.com)

[www.phlx.com](http://www.phlx.com)

