Iron Condor Trade Setup Tips

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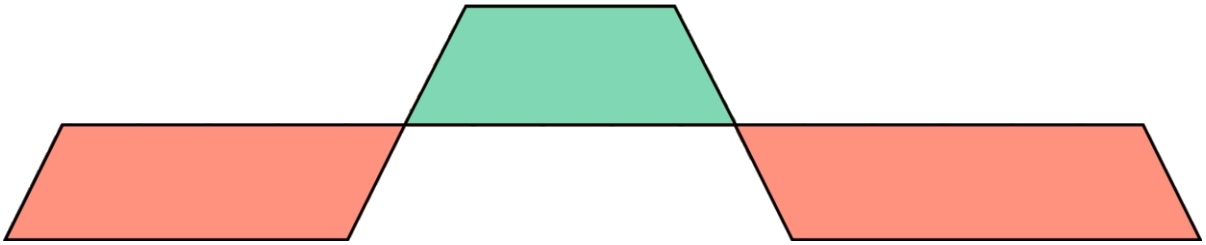
After determining which stock you'd like to sell an iron condor in, you'll have to make a few decisions when setting up that trade:

1) Which expiration cycle to use (how much time to expiration?)
2) Which strike prices to use (which calls/puts will I sell and which calls/puts will I buy?)

In this quick guide, I'll share with you some common trade setup approaches so that you can feel more confident when setting up iron condor trades of your own.



Choosing an Expiration Cycle

The easy part about most options-selling strategies is that traders often use time frames between 30-60 days to expiration.

That's because options experience lots of time decay (the loss of extrinsic value that occurs in all options as time passes) in the final weeks/months before they expire.

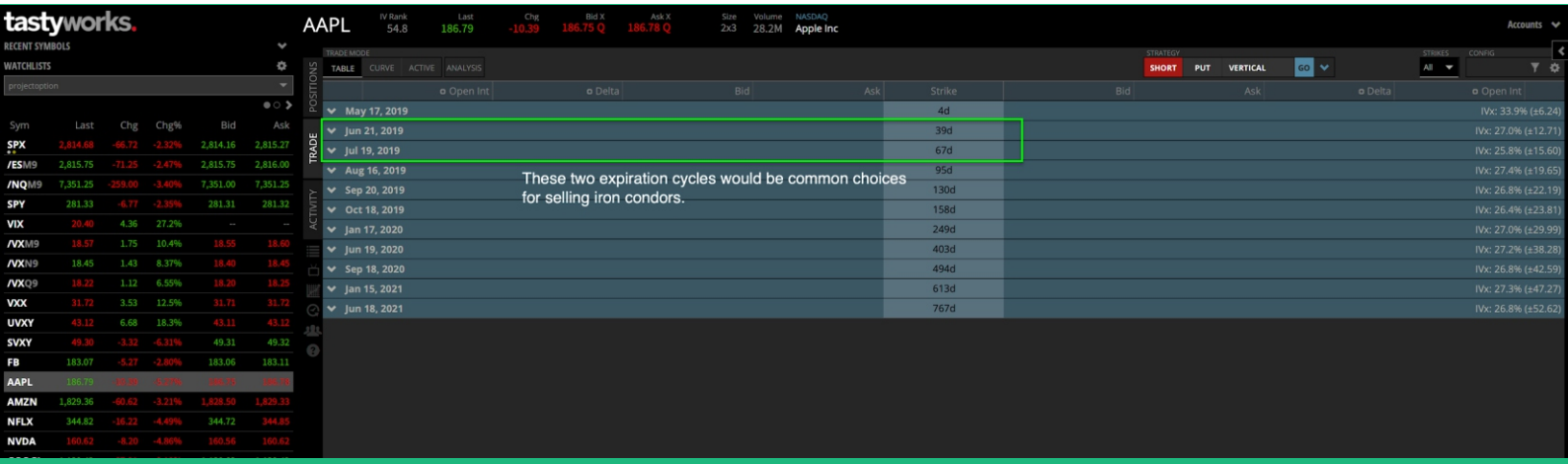
By selling options between 30-60 days to expiration, we can sell options that are both far enough away from the stock price to allow a decent range in which the stock price can move, but we also collect adequate amounts of option premium for selling those options.

When selling options with very little time to expiration, say 7 days, we'll have to sell options with strike prices very close to the stock price to collect any decent option premium, which means we'll leave the stock with a narrow range in which it can move before the position becomes unprofitable.

Tip #1: When selling iron condors, it's very common to use expirations with 30-60 days until expiration. Use this as a rough guideline and don't be afraid to branch outside of this range.

For example, a 28-day or 65-day expiration cycle would be just fine, but roughly 30-60 days is the target.

On the tastyworks trading platform, here are two expiration cycles in AAPL that fit the guideline:



Selecting Strike Prices

Using the 67-day expiration cycle from the previous AAPL image, let's look at a common way of selecting strike prices for a short iron condor trade.

Step #1: Select the short strikes, or the strike prices of the calls and puts that will be sold.

Step #2: Select long strikes (options that will be purchased) that are a certain distance from the short strikes. For instance, if I wanted $5-wide spreads in my iron condor position, the options I'd purchase would have strike prices $5 below the chosen short strikes.

For this example, I'll be using the option deltas to select my short strike prices.

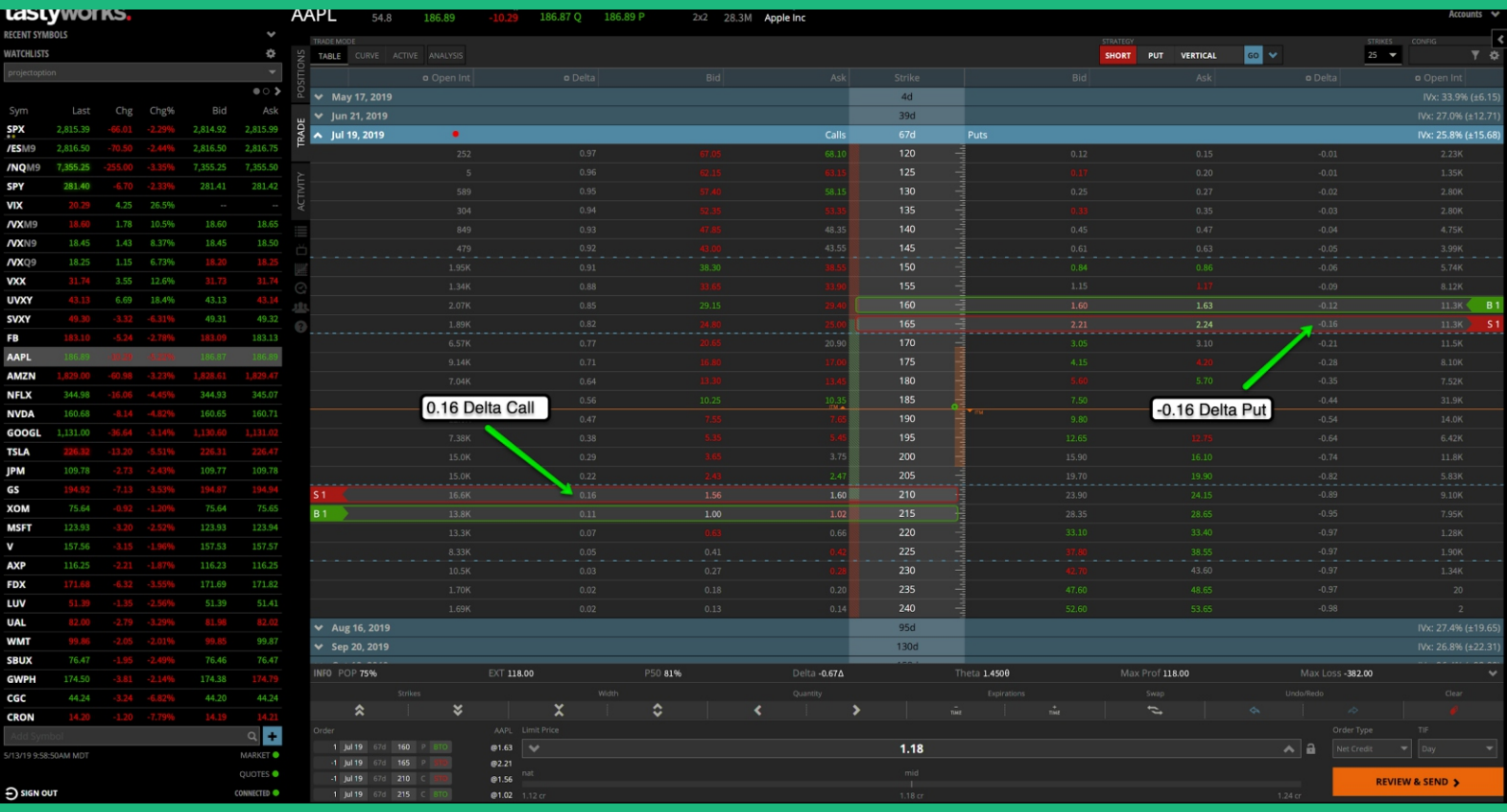
While the delta of an option tells us how much the option price is estimated to change with a $1 change in the stock price, delta is often an estimator of the option's probability of expiring in-the-money.

If I sell an option with a delta around 0.16, that option has an estimated 16% probability of expiring in-the-money, and therefore an 84% probability of expiring out-of-the-money. In the case of selling an iron condor, we want all of the options to expire out-of-the-money.

The 0.16 delta starting point is common for iron condors because selling calls and puts at the ±0.16 delta level results in a "one standard deviation" iron condor. That means that the iron condor has an approximate 68% probability of expiring worthless.

In statistics, "one standard deviation" encompasses about 68% of the outcomes around the mean/average. In the context of the stock market, the "mean/average" is the stock price at the time of entering a trade.

Here are the strike prices I might choose for an AAPL iron condor if I selected the 0.16 delta call and -0.16 delta put, and purchased options that were $5 further than those short strikes:



With AAPL at $186.89, the 0.16-delta call option in the 67-day expiration cycle is the 210 call. The -0.16 delta put option is the 165 put.

Therefore, my short strikes are 165 and 210. To sell a $5-wide iron condor (an iron condor with $5-wide spreads on each side), I'd purchase the 160 put and 215 call (shown above).

The result? An iron condor with $118 in profit potential and $382 in loss potential, but an estimated 75% probability of making money at expiration in 67 days.

The same approach can be used even with different delta values and spread widths.

For instance, a trader might want to collect more premium for an iron condor, in which case they might sell the 0.25 delta call and -0.25 delta put (which will be closer to the stock price) and purchase options $10 further than those strike prices.

The result of that approach would be an iron condor with a narrower range of maximum profitability, a lower implied probability of making money, but more profit potential and more risk due to having wider spreads on both sides.

Questions?

If you have any specific questions regarding any of this, please send me an email at Chris@projectoption.com.

I'm always happy to help!

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