Twitter Thread by Subham Banka



Subham Banka
@subham_banka

Straddles Vs Strangles – A Thread

There have been some really interesting discussion points recently based on Euan Sinclair's assessment of RR in straddles vs strangles. Personally, I've always felt far more comfortable trading strangles. (1/n)

Straddles have the highest theta value and benefits more than strangles when there is a vol crush. Over time, straddles should have a net P/L greater than strangles. This, albeit, comes at the cost of a lower PoP and higher risk. (2/n)

Early in the expiry, rate of decay of OTM>ATM options. ATM options are in the middle of the bell curve and bulk of decay happens in the later stages. However, a 20% vol crush in a straddle may result in P/L greater than 100% of a 16 Delta strangle credit. Hence, (3/n)

Strangles are a vol+decay play, straddles are a far superior pure vol play. If one's thesis is an exaggerated stock reaction, excessive implied volatility and lower Rvol going forward, it makes much more sense to narrow short strikes. You get paid more for the same PoP (4/n)

Straddles also make more sense to deploy in very small priced underlyings, where the straddle break-evens are very close to that of strangles. Might as well collect the higher credit. (5/n)

The biggest risk in short options is directional risk. Straddles have a higher range of deltas than strangles. You could initiate a delta neutral trade today, and with a 1.5 SD move tomorrow, the trade could have +/- 30 deltas (6/n)

Strangles have a smaller range of deltas and have lesser directional risk. With the same move a 16-delta strangle would gain probably half the deltas (+/-15) (7/n)

As far as extreme moves are concerned, the loss is higher in percentage terms for strangles, but in absolute terms the straddle perhaps tends to have a larger P/L damage. I think Euan was referring to % increase in premiums (8/n)

So, are strangles a better strategy? Of course not. It boils down to comfort and risk appetite. I prefer deploying strategies with a higher PoP (strangles 70%+ vs straddles ~55%) and wider break-evens, even if it means lower expected net P/L (9/n).

I find it easier to manage strangles. Theres more room to defend & mechanics are more defined in terms of entry, exit, targets, adjustment levels. While every adjustment is a new trade, defence mechanics allow for a more mechanical approach and is a personal preference (10/n)

There isn’t even any theoretical edge to buying v/s selling options. How can there be a best strategy, irrespective of vol environment? The strategies that one is more comfortable with are the ones they should ultimately deploy. (n/n)