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THREAD ON IRONFLY

These days the most preferred strategy for option sellers due to improved margins is IRONFLY. It's essentially a short straddle with long strangle. Long strangle acting as 'WINGS', which help in capping the unlimited risk associated with a short straddle.(1/n)

You can also view the position as a combination of Cal & Put credit spreads, if that makes it more easy for you.

There are 3 important things to understand while trading this strategy:

1) Initial size of the Wings
2) Risk Management
3) Adjustments

(2/n)

Since we are selling an ATM straddle, the 1st question is how far our wings should be? Ideally i sell .50 delta straddle & buy .20 or .10 OTM strangle, depending on my view on volatility. So the distance of wings depends on the IV setup. Higher the IVs, greater the distance.(3/n)

If you don't understand greeks, then ideally with 30 days to expiry (dte), wings should be around 300pts either side. If your trading in weekly then it should be not more than 200pts. Higher the premiums, higher the distance as we have more cushion of theta. (4/n)

It is important to understand that we need to reduce the distance of wings with time so as to manage our RISK in gap openings or sudden volatile move. So for eg. if you started with 300pt wings with 30dte, the wings wouldn't give the same protection when there is 7dte. (5/n)

So as the premiums decay, we need to gradually reduce the distance of wings.

Now on to ADJUSTMENTS. When the index moves it is important to also move with it in this strategy. This is because if we

don't then the initial credit received will reduce drastically. (6/n)

An example. Nifty is trading at 13500. You sell 13500 straddle & buy 13800-13200 strangle. If Nifty moves 200pts up, your sold straddle will have lesser theta value & your strangle will have higher as 13800 cal will increase. So your overall credit will drastically reduce. (7/n)

So if market moves one direction, one sold option becomes ITM (means less credit) & one wing comes closer to ATM (means higher debit). So the overall theta received becomes less or even nil. That's a practical problem which is why adjustment is required to receive max theta.(8/n)

For how to do adjustments, best way is to treat Ironfly as a straddle with added protection. So try to keep the straddle near to ATM & when the wings are tested only then adjust them. This way you'll always have maximum credit received which is important in this strategy. (9/n)

What i have explained is a neutral approach on how to trade Ironfly with max credit received. Many try to trade it by exiting the losing leg & keep a TSL on the winning leg. Personally I'm not a fan of this way but that's because I don't want to trade direction like this.(10/n)

Many advocate Ironfly as an easy 4% strategy. It's not. Requires expertise in when to adjust & how much the wing size should be. With experience such issues can be dealt with. Overall it's a good strategy specially for those who want to take less risk with limited capital.(11/n)