THE IRON CONDOR STRATEGY GUIDE

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HOW I TRADE IRON CONDORS

Nate Donnelly

FIRST…

It is most likely that traders looking to learn more about the Iron Condor already have a basic understanding of options and how they work.

However, in the event that someone reading this manual might NOT have a good understanding of options, option trading, and how options work – they are VERY STRONGLY encouraged to first gain this knowledge before proceeding – as the Iron Condor Strategy could be considered more of a complex option trading strategy where knowledge of how options work and the risks involved is essential to know.

A good course covering the basics of options and option trading can be found at the following link as well as by visiting the various links provided in the RESOURCES section found at the end of this manual.

OPTIONS 101 COURSE

Go to…
http://www.IronCondorStrategyGuide.com/101

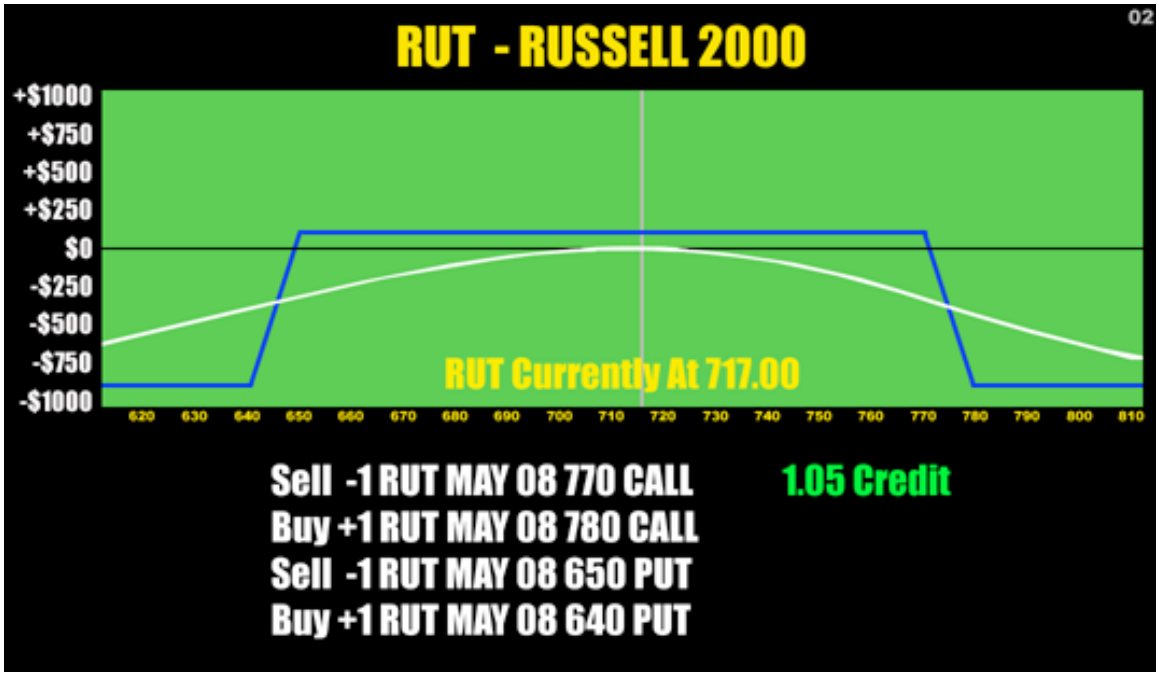
In addition, prior to trading options, traders are strongly encouraged to read the document entitled "Characteristics and Risks of Standardized Options" which can be downloaded from the Options Clearing Corporation website here:

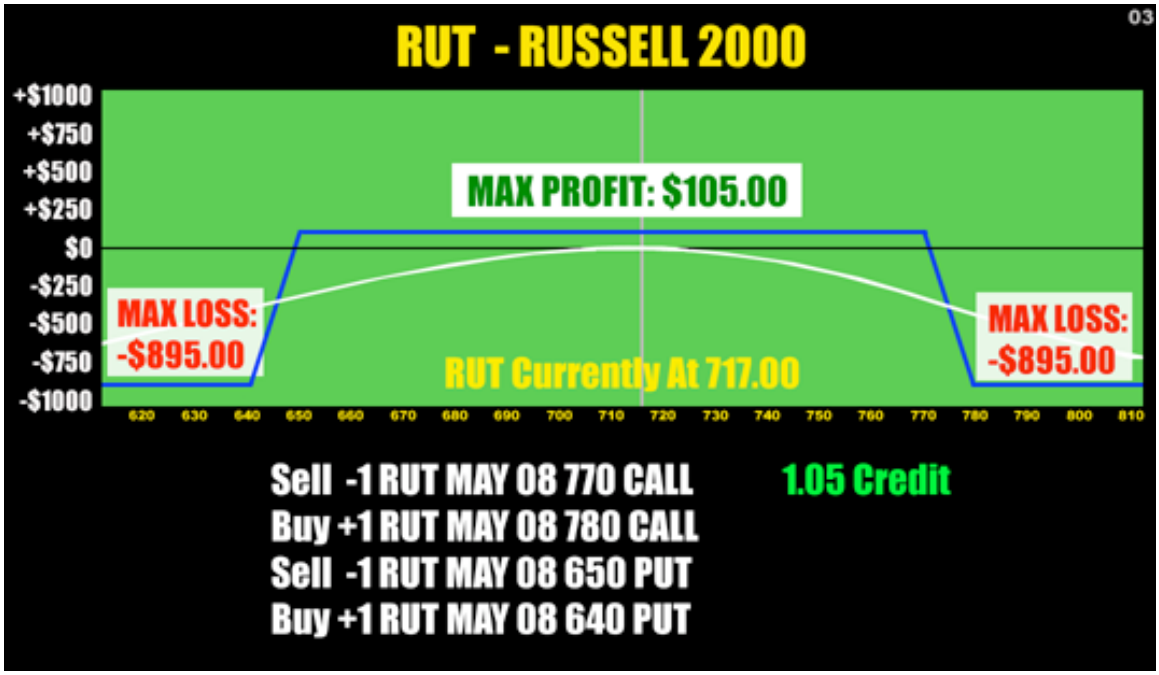
http://www.theocc.com/publications/risks/riskstoc.pdf

WHAT IS AN IRON CONDOR?

An Iron Condor is a neutral strategy that is made up of a bull put spread and a bear call spread on the same underlying.

This strategy benefits when the underlying stays within a price range (between the bull put spread and the bear call spread) for a period of time – until either the entire position expires worthless or until enough time passes where the bull put spread and the bear call spread can be bought back for a cheaper price then they were sold for because of time decay.





The Risk Graph above shows a 1 contract Iron Condor placed on the Index Product: RUT

With RUT currently at 717, this Iron Condor will make a maximum profit or $105 if RUT stays between 650 and 770 for the next 30 days (this is the area between the two red vertical lines on the Risk Graph).

If RUT moves over 770 – or below 650 - in the next 30 days, this trade could lose the max risk amount, which is 895.00 (unless of course it can be successfully adjusted).

There is around an 83% probability this trade will be successful (if RUT finishes somewhere between 650 and 770 at expiration).

If this Iron Condor was successfully held to expiration and the short options expired worthless and out of the money, this trade would profit the entire $105, which would represent a yield of around 10 percent in 30 days.

WHAT UNDERLYINGS DO I CHOOSE FOR MY IRON CONDORS?

Its possible to put Iron Condors on Stocks as well as Index products.

However, I prefer Index Products over stocks and here is why.

While the Iron Condor is a high probability trade, the risk to reward ratio is awful.

For example, the main Iron Condor examples I will be illustrating throughout this manual – which I will refer to as the 'Plain Vanilla Iron Condor' - has around a 9 to 1 risk / reward ratio – meaning I am risking 9 dollars to make just 1.

The only reason I am willing to accept this terrible ratio is because:

a.) it has around an 80% probability of winning, and
b.) if I use an Index I believe I am increasing the odds that I will more easily be able to manage and adjust it over an Iron Condor placed on a stock.

Why is this?

Primarily its because stocks have the possibility to make massive moves very quickly – more quickly than I am able to react (manage and adjust).

Take for example the 'Overnight Gap'.

Stocks can frequently make large gaps in price overnight. One day it closes at a certain price – the next day it opens far from where it closed the day before.

Take a look at the following charts that gapped overnight and imagine having an Iron Condor placed on one of these stocks. One day the position is fine - maybe even making money. The next day I wake up and find that I am suddenly at my max loss point – and because it happened before the market even opened, I had absolutely no time or way to react, manage, or adjust.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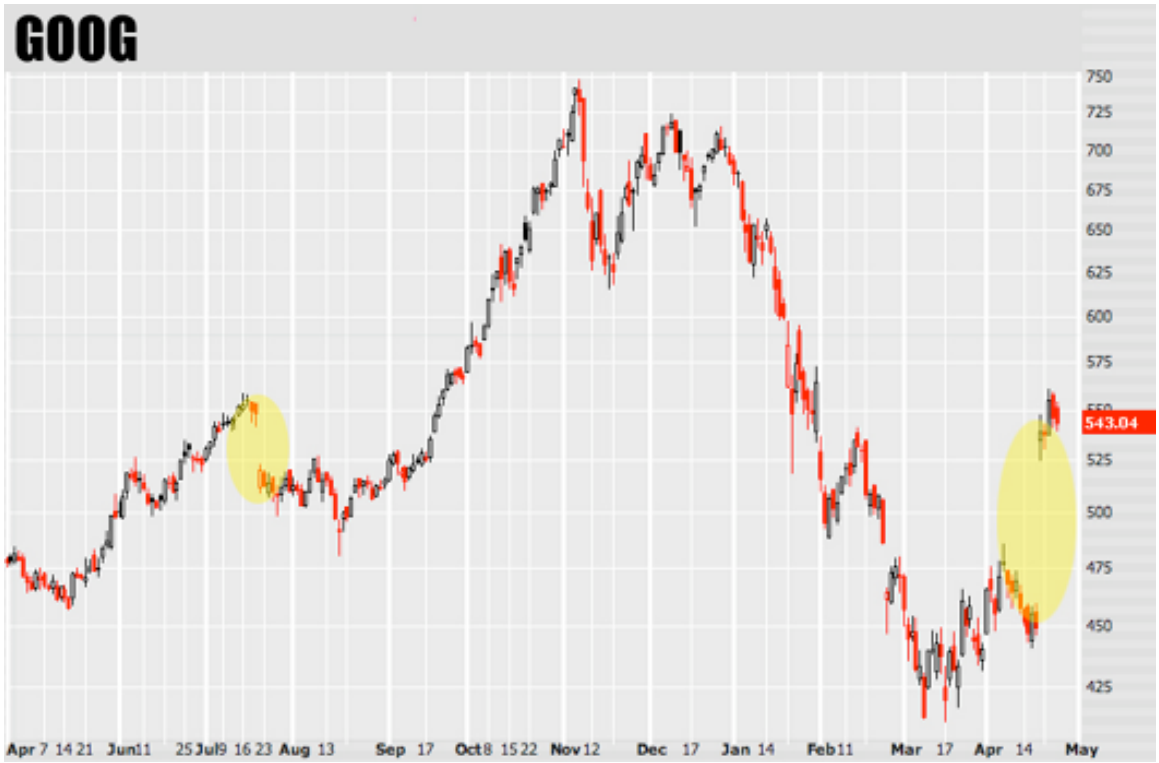
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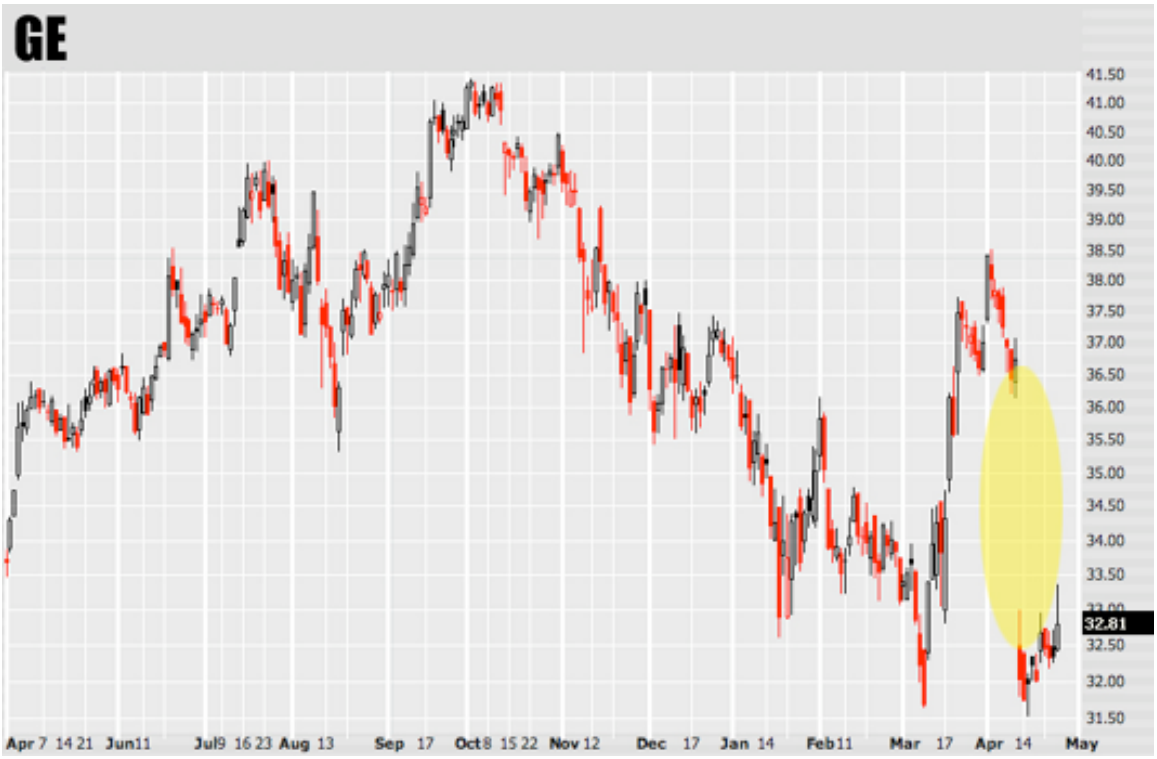


With Indexes – because they represent a basket of many different stocks – a sudden huge move – or a gap – is rare.

Yes they can move fast and quickly – and even gap – however I believe that even when these Indexes are moving fast – or the rare gap does occur – I'm allowed enough time and room to effectively react, manage, and adjust them.

This is the reason I prefer placing Iron Condors on Indexes over Stocks.

Some of the things I look for when selecting an Index to place Iron Condors on are:

a). I want them to be liquid. I don't want any problems exiting a position in a hurry if I need to.
b). I want them to be stable and range bound. The less volatile the better.
c). I want tight bid / ask spreads. Again, in a hurry I want to get out quickly and at a decent price.
d). I want them to be traded on multiple exchanges - and its even better if they are traded electronically. Again, if I need to get out in a hurry, I want to get it done quickly and at a decent price.

While I can not recommend any particular underlying someone else should use (please see disclaimer at front of manual) I feel there are a number of good index products which are appropriate for Iron Condor trading.

The Index product I personally use on a regular basis is: RUT – and again, while I do not recommend any particular underlying someone else should use, in order to help simplify the learning process I will be using RUT in the examples found in this manual which are for education and illustration purposes only.

WHEN DO I PUT AN IRON CONDOR TRADE ON?

For me, the Iron Condor is a tool to bring in steady and consistent monthly income.

Therefore, its important for me to put the trade on every month.

I don't want to be trying to 'predict' which months I think will work out and which ones might not.

This is a probability trade – and the main Iron Condor I use is a trade that I believe has around an 80% probability of success.

This means that if I put the trade on 10 times in a row, 8 of those times I expect to win – and 2 of those times I expect to lose (unless, of course, I can successfully adjust).

But once I start 'picking' which months I think will work and which months wont – and then trading accordingly, I start messing with the probabilities – potentially causing them to no longer work in my favor.

So in order to keep the probabilities working in my favor, I believe I need to consistently play every month.

(An exception to this would be if there was something extraordinary going on in the market - or the world - that could/would cause the market to act in extreme / extraordinary / irrational ways – for example in the Fall Season of 2008)

I've found the best way for me to do this is to come up with a systematic plan that I follow like clockwork.

So every month – at some point between 30 and 40 days from expiration - I place a new Iron Condor Trade – on the same underlying.

I don't want to put the trade on LESS than 30 days from expiration because I feel I will not be able to receive enough premium while getting away as far as I want to from where the underlying is currently trading at.

And I don't want to put the trade on MORE than 40 days from expiration because I feel it begins to give the underlying too much time to actually move and make it to one of my short strikes.

And to make it more systematic and easy for myself – I always try to put a new one on at the same day from expiration every single month - or within a day or two - and on the same underlying.

One other thing I consider is how much capital I have to invest.

If I choose to place trades between 35 and 40 days out, I need to have at least double the amount of capital I plan to use in each Iron Condor trade – as the separate monthly trades might overlap with each other.

If I plan to use my allotted capital only in one Iron Condor trade at a time – I will need to place my trades 35 days out or less – so the trade will be closed out – or near closing out - by the time the next months entry time rolls around.

HOW DO I SELECT
WHICH STRIKES TO SELL?

When it comes time to select strike prices for my Iron Condor, there are 3 things I take into account.

They are: **Standard Deviation, Delta, and Support / Resistance Levels**.

STANDARD DEVIATION

To begin with, I want to make sure my Iron Condors short strikes are at least 1 standard deviation away from the underlyings current price.

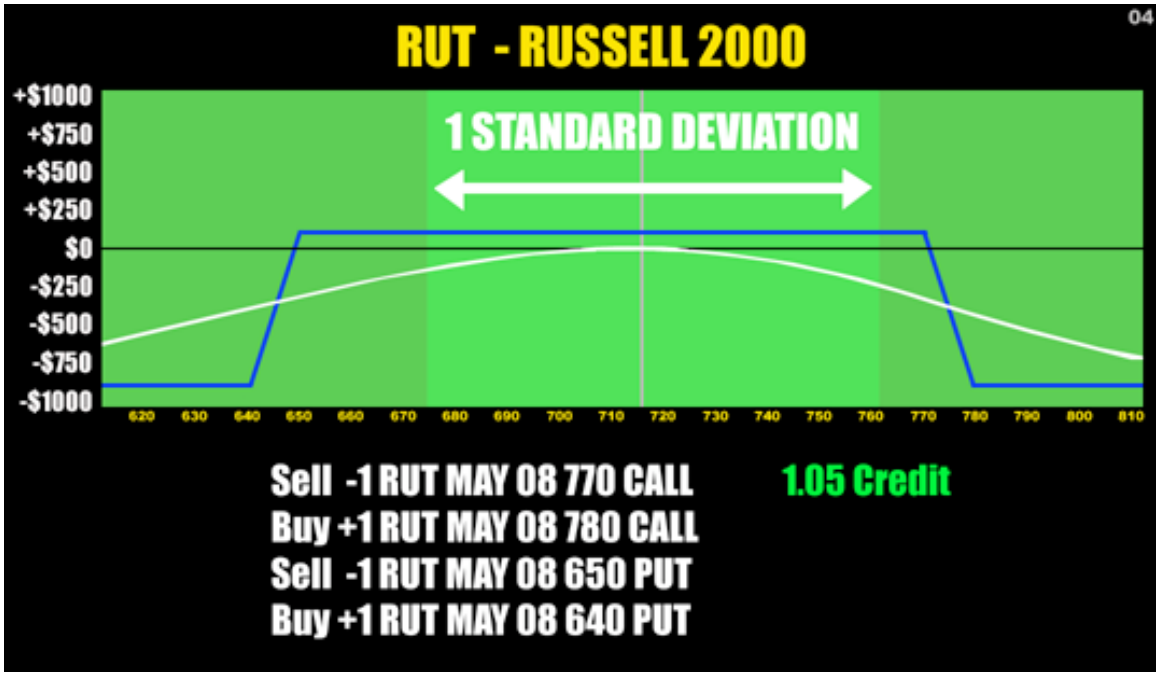
What is a Standard Deviation?

A Standard Deviation is a mathematical calculation I use to try and help predict the range I think an underlying is expected to move within a specific amount of time (time left before expiration).

There are several ways to determine what a standard deviation is for a particular underlying.

One way is to use a Standard Deviation Calculator for Options which can be found quite easily online.

Another simple way I've found is by using my Brokers Risk Graph Platform Screen.



In the Risk Graph above, the lighter green area shows 1 standard deviation – which is the range I expect the underlying can move within the next 30 days left until expiration.

Again, I want to make sure I place the short strikes of my Iron Condor outside this range – as has been done in the above example.

The further out I can place my spreads outside of this range while still bringing in an acceptable credit the better.

What is an acceptable credit?

For myself, its no less than 5% of my total risk amount for each side credit spread – or no less than 10% of my total risk amount for the entire iron condor.

So for example, when creating a RUT Iron Condor with 10 point wings (I never go wider than 10 point wings on a RUT Iron Condor), an acceptable credit for myself would be no less than .50 credit for each side credit spread – or no less than 1.00 credit for the entire iron condor.

This means that I will be risking 9.00 to make 1.00 on the trade.

This isn't a great risk to reward ratio – but as I said before, because of the probabilities and the ability to properly manage and adjust, its acceptable for me.

But just barely.

Personally, I feel that anything worse than this 9 to 1 risk to reward ratio is not worth trading.

So again, I want to make sure I bring in at least 5% of my total risk amount for each side credit spread – or bring in at least 10% of my total risk amount for the entire iron condor - while getting as far away from the underlying current price as I possibly can.

DELTA

A method I use to determine what strikes to sell is by looking at the Delta.

Delta is one of the Greeks. It represents how much a particular option will change in value given a 1 point move in the underlying.

I also use delta numbers to determine probabilities.

When I look at an option chain, I look at each strikes delta number – and I use this number to determine the approximate probability of the underlying being 'At The Money' or 'In The Money' on expiration day.

05

RUSSELL 2000 OPTION CHAIN

DELTA	BID	ASK	EXP	STRIKE	BID	ASK	DELTA
1.00	64.10	65.90	MAY 08	650	1.80	2.05	**-.08**
1.00	55.60	56.50	MAY 08	660	2.65	3.00	-.11
1.00	46.90	47.80	MAY 08	670	3.90	4.30	-.15
.92	38.70	39.50	MAY 08	680	5.50	6.00	-.20
.82	31.00	31.70	MAY 08	690	7.80	8.10	-.26
.71	24.00	24.70	MAY 08	700	10.70	11.30	-.34
.60	17.80	18.50	MAY 08	710	14.50	14.90	-.42
.49	12.60	13.20	MAY 08	720	19.20	19.90	-.50
.37	8.40	8.90	MAY 08	730	24.90	25.60	-.59
.27	5.10	5.60	MAY 08	740	31.60	32.40	-.66
.18	2.90	3.30	MAY 08	750	39.30	40.10	-.73
.11	1.60	1.90	MAY 08	760	47.90	48.90	-.77
.07	.95	1.15	MAY 08	770	57.10	58.10	-.81

Deltas of .07 and -.08

For example, in the Option Chain above, the May 08 650 Put has a Delta of .08 – and the 770 Call has a Delta of .07.

Therefore, I would consider the 650 Put Option to have a 8 percent chance of being 'At The Money' or 'In The Money' on expiration day, and the 770 call option to have a 7 percent chance of being 'At The Money' or 'In The Money' on expiration day.

Combined, (8 + 7) this tells me there is around a 15 percent chance one of my two short strikes will be 'At' or 'In' the money on expiration day and this trade could fail.

It also tells me there is around a 85 percent chance the underlying will stay within the range and this trade should be a success.

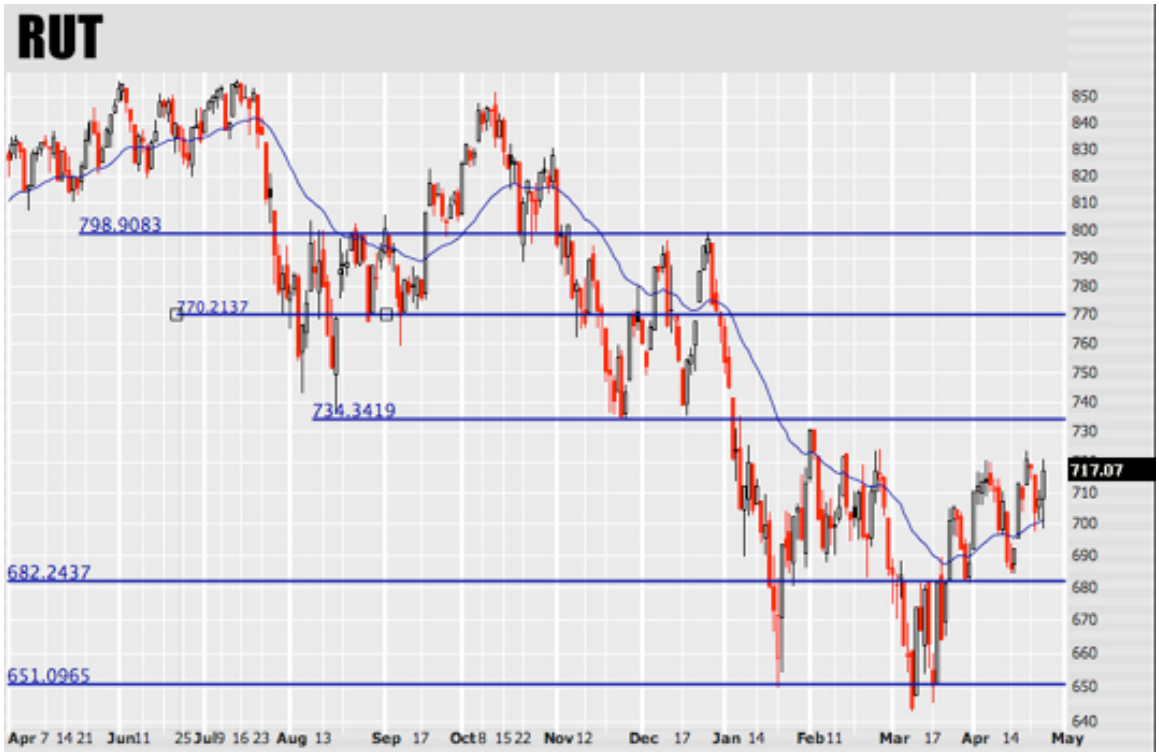
So if I wish to create an iron condor with an 80% or greater probability of success (the short strikes not expiring 'at' or 'in' the money), I would choose to sell a short put with a delta of -.10 or under and sell my short call with a delta of .10 or under.

I've found that by using deltas, I can very quickly determine the probability of success an Iron Condor trade I am considering to put on has - then tweak it accordingly so that it has the probability of success I wish it to be.

Personally, I always want to make sure that my short strikes (the strikes that I am selling) have deltas of .10 or under while still making sure I am bringing in a credit of at least 5% of my total risk per side credit spread – or bringing in a credit of at least 10% of my total risk for the entire Iron Condor.

SUPPORT AND RESISTANCE

The last thing I do before placing the trade is to pull up the underlying chart and take a look at nearby levels of Support and Resistance.



In the chart above, I find support at around 680 and 650.

I find resistance at around 734 and 770.

Ideally I want to try and sell the short strikes of my Iron Condor well beyond these close areas of support and resistance (the 680 and 734 levels) - AND, if possible - beyond the further out areas of support and resistance - as long as I can get an acceptable credit.

I feel the underlying could quite easily move to these closer areas of support and resistance - however once they hit these areas I believe there are strong probabilities that

these areas could create stopping points – and perhaps even reversals – or at least start a consolidation from the move.

If the underlying can force its way through these first areas of support and resistance, I would then expect the second levels of support and resistance to create a potential stopping point, reversal, or a consolidation of the move.

Bottom line is, when possible I want to try and sell the short strikes of my Iron Condor beyond strong areas of Support and Resistance - as I feel these areas can assist in keeping the underlying from reaching my shorts.

HOW I PLACE MY TRADES

Once I have selected which short strikes I am going to sell for my Iron Condor Trade (using the previously described criteria) I am ready to place my trade.

On an Index product such as the RUT, I always create my Iron Condors with no more than 10 point strike wings.

For example, if I were selling the 800 Call I would buy the 810 call above it for protection.

If I were selling the 610 Put, I would buy the 600 put below it for protection.

Personally I never widen these out more than 10 points when using the RUT – as it increases my risk.

Once I have selected which strikes I will be buying and selling, I usually first try to put my entire Iron Condor trade on as ONE TRADE.

My broker allows me to place all four legs of my Iron Condor together as one trade.

I start at the mid price – then wait and let it sit there for 10 to 30 minutes to see if it will be filled.

If it doesn't get filled, I might decide to give in a few cents and wait another 10 to 30 minutes to see it will get filled.

I continue doing this until I reach the minimal amount of credit I have previously decided to accept from this trade (5% of total risk per side credit spread or 10% of total risk for the entire condor).

Also – if I am unable to get filled – I might consider selling one leg at a time.

For example, I will place an order to sell the Call credit spread by itself – as well as the Put credit spread by itself.

When I leg in this way, if I am initially unable to get filled, I will give in a few cents on each side like before – only when legging in like this, I need to be a bit more careful not to accept less than my <u>overall</u> minimal amount I am willing to accept (5% of total risk per side credit spread or 10% of total risk for the entire condor) – as I am now dealing with two separate trades with different credit amounts instead of just one.

ONCE THE TRADE IS PLACED…

Once I have placed my Iron Condor trade – what do I do next?

I go and find other things to do with my time (rather than sit and stare at my computer screen all day).

That is one of the great things about these trades. For the most part, they require very little time actually trading.

I just need to keep my eye on my Profit and Loss to make certain I am not exceeding my MAXIMUM PAIN POINT (this is explained in the next several sections – and it is **NOT** the TOTAL LOSS AMOUNT that is possible in the trade!). I also keep an eye on what's happening with the underlying and the market in general – just so I can be aware if for some reason something bizarre starts happening or a big unexpected move starts to take place.

WHEN DO I TAKE MY IRON CONDOR PROFITS?

When I first starting trading the Iron Condor Option Strategy I would try to let them run all the way until the very end.

After I put the trade on, my plan was to just leave them be until expiration day where the options would expire worthless and disappear into option heaven.

I figured this was the smartest way to go, since I would bank the ENTIRE credit received – and I wouldn't have to pay any broker commissions to close out the trade.

But I don't think this way anymore.

After many sleepless nights, several near ulcers, and a number of close calls, I've changed the way I run my Iron Condor business.

Now – as soon as I place the trade, I set a contingent order to buy back the call spread - as well as the put spread - once I've made the majority of the profit in each spread.

For example, if I sold a RUT Iron Condor for a total credit of $1.00 – or .50 each side – I would set up a contingent order to buy back the call spread for .05 or .10 (or at the very most .20). Then I would set up a contingent order to buy back the put spread for .05 or .10 (or at the very most .20).

Crazy?

Personally I don't think so.

Sure I might make less than if I tried to milk them all the way through to the very end.

But not necessarily.

And even so, its not THAT much less.

By buying back, I've LOCKED IN the BULK of the profit.

AND - I've reduced my risk.

AND – I've created the potential for me to make even more on the trade than I originally planned – without increasing my original risk.

Here's an example:

I've found that many times during a trade, the premiums can drain quite rapidly. In fact, its possible for a spread to drain the majority of its premium in a matter of days.

Say I put an Iron Condor on RUT – 40 days from expiration - for a credit of $1.00 – or .50 each side.

Immediately after placing the trade, RUT drops down over a number of days.

3 days after I put the trade on, I see that I can buy back my CALL side of the Iron Condor for .10.

If I do nothing, I am choosing to risk my CALL spread margin for the next 37 DAYS for a measly $10.00 of remaining profit (per spread).

On the other hand, if I buy it back for .10, I lock in the bulk of the profit for the CALL side – making that ROI in just 3 days.

Then if RUT bounces back up – which it will often do after a drop - I no longer have any risk on the upside.

In fact, if RUT bounces back up high enough, I could RESELL the same CALL spread that I originally sold for the same original credit – or maybe even more – increasing my total ROI for the same RISK amount that I began with.

And even if I don't resell any spreads – but just buy them back at .10 to close out the entire trade – in most cases I will be out of the trade MUCH sooner than if I would be if I were to try and hold on until expiration.

It can also totally eliminate my exposure to 'Expiration Week Hyjinks', where options can start to act funny during expiration week via the Greeks.

Personally, this way of trading Iron Condors makes much more sense to me.

It frees up my capital sooner, can increase my ROI over number of days in the trade, reduces my risk, helps me sleep better at night - and takes care of those painful ulcers.

HOW DO I KNOW WHEN IT'S TIME TO ADJUST?

The downside with Iron Condors is that the Risk / Reward ratio is awful.

Even though they are a high probability trade and they work out fine MOST of the time – all it takes is that ONE time to completely drain my account and put me out of the game for good.

That is, unless I know how and when to properly manage and adjust.

Here is an Iron Condor Trade for example:

10 point strikes on the RUT, about one and a half standard deviations away from current price, between 30 and 40 days away from expiration.

Now, using the above RUT Iron Condor example – I could expect to take in a credit of around 1.00 on an average month. My risk would be 9.00.

Or, if I were to put on the above trade using 10 contracts, I would bring in a credit of around $1000.00 and be risking $9000.00

I am risking $9000.00 to make $1000.00

This risk to reward is awful.

I believe the above trade has around an 80% probability of success.

I expect it to work out fine 8 times out of 10.

It's the OTHER 2 times I need to be worried about.

Lets say I did the above iron condor for a total of 10 months – and I did absolutely NOTHING to manage or adjust. I just let the probabilities play out.

Here's what could possibly happen…

I profit $1000.00 for 8 months.

$1000.00 X 8 = $8000.00 PROFIT.

Not bad. That's almost a 100% return.

But then the other 2 months lets say I lose my max risk: $9000.00.

$9000.00 X 2 = 18000.00 LOSS

$8000.00 PROFIT – $18000.00 LOSS = 10,000.00 LOSS

Ouch.

Okay – lets say I don't lose my max risk. Lets cut it in half.

Lose $4500.00 X 2 = $9000.00 LOSS

$8000.00 PROFIT – $9000.00 LOSS = 1,000.00 LOSS

Obviously – in order for this strategy to work, I need to have a plan to protect – and keep – the profits I generate during my 8 good months – from the losses that will occur (and they WILL occur, believe me) during the 2 months that will be bad.

So what is that plan?

I need to know how to adjust.

But first I need to know WHEN to adjust.

So when do I adjust?

Lets go back to those numbers…

If I win $1000.00 8 times out of ten – HOW MUCH can I afford to LOSE 2 times out of ten?

If I can afford – both financially and psychologically – to just go back to break even at the end of ten months of trading, then my answer would be around $4000.00 per trade.

I could afford to absorb a loss of $4000.00, 2 trades out of 10.

At the end of ten months, I could be back at square one.

I win $1000.00 8 times, I lose $4000.00 2 times = $0 PROFIT.

On the other hand, if I CAN'T afford to have made say less then $5000.00 during a 10 month span – then the most I can afford to lose on a trade would be $1500.00

I win $1000.00 8 times, I lose $1500.00 2 times = $5000.00 PROFIT

THIS makes much more sense to me.

In the above example, $1500.00 equals about 1 and 1/2 times my original credit I received for the trade – or my expected monthly profit for the 8 good months.

I find this a good gauge to work off of.

I may even tighten it up to 1 times my original credit. But NEVER more than 2 times my original credit.

Anything more than 2 times my initial credit, I risk losing too much for my total income goal. And it could wind up putting me in a position where it would take me MORE than 2 winning months just to make up for the loss – which could be hard to deal with psychologically.

And anything less than 1 times my initial credit, I feel I am not giving the trade enough room to breathe and do its thing.

What this does is change the Iron Condors awful 9 to 1 Risk / Reward Ratio to a much more acceptable 2 to 1 – or 1 to 1 Ratio.

So – before I ever even put a trade on - I decide what that ratio is – or the MAX Amount of Dollars I am willing to lose while in the trade (in the above example it was 1 1/2 to 1 or $1500.00 Loss).

I call this loss number (or ratio) my MAXIMUM PAIN POINT.

Most times I believe it wont be hit.

But when it does (and it eventually WILL, believe me) – that's my cue its either time to get out of the trade entirely - or adjust.

AND – if I decide to adjust, I need to begin doing so BEFORE my maximum pain number is hit – to take into account slippage - and in order to give the new 'adjustment' position some room to breathe. If I am going to adjust, I usually begin planning/doing so when I am right around ¾ of the way to hitting my maximum pain number.

This way, by not letting my losses get out of control, I always know that worst case scenario (I wind up taking my Maximum Pain Number Loss) - based on the probabilities - I believe I should still be profitable at the end of ten months.

AND best case scenario (I successfully adjust) - I could pull out of a losing trade and make it profitable once more.

ONE LAST THING – if I ever find myself in a situation where I hit or somehow exceed my pre-determined Max Pain Point **BEFORE** I am able to react and adjust – I take off the trade and accept the loss. Once I hit – or exceed - my Max Pain Point Dollar Loss

Amount – that's it for me for that month. It's Game Over. No further adjusting, no holding on 'hoping' that it will come back.

Again, to do so I feel I risk losing too much for my total 'longer term' income goal - and it could wind up putting me in a position where it would take me MORE than 2 winning months just to make up for the loss.

I feel that this Risk Management Concept might be the MOST IMPORTANT part of the Iron Condor Strategy for me to fully understand and follow - religiously.

In a poor risk to reward yet high probability trade - like the Iron Condor - if I can just keep my losses under control and NEVER allow them to exceed my Maximum Pain Number (1 to 2 times my average monthly Iron Condor credit intake in the example above) - I believe in the long run I should be profitable.

I NEVER allow an Iron Condor Loss to exceed my pre-calculated Maximum Pain Number!

ADJUSTMENTS

There are various ways I can adjust Iron Condors - however – before I get into what the different adjustments are, I want to stress again HOW IMPORTANT IT IS I DON'T ALLOW MY LOSS ON AN IRON CONDOR TRADE TO EXCEED MY PRE-DETERMINED MAXIMUM PAIN POINT.

If I take only one thing from this entire manual – I believe this concept should be it.

Again, I believe the Iron Condor I trade has an 80% probability of success.

I expect it to work out fine 8 times out of 10. I expect it to cause problems 2 times out of 10.

As long as I can keep the losses on those 2 problematic trades under control – and NOT ALLOW THEM TO EXCEED MY MAXIMUM PAIN POINT – I believe that due to the probabilities, I should be profitable in the long run.

I NEVER allow an Iron Condor Loss to exceed my pre-determined Maximum Pain Point!

I believe this is KEY to success in trading Iron Condors.

ADJUSTMENT #1: ROLL UP / ROLL DOWN

This adjustment consists of Rolling Up / Rolling Down.

To use this adjustment, once I place an Iron Condor, I'd make note of the total credit I brought in, then decide what my Max Pain Point dollar loss number will be. Then as the trade progresses, I'd keep a close eye on my current Profit / Loss of the trade.

For example, lets say I place an Iron Condor and bring in a total credit of $1000.00. I then decide that my Max Pain Point will be equal to the credit I brought in: $1000.00 – meaning I will not allow a loss in this trade to exceed $1000.00.

If the trade moves against me and my Current Loss nears my Max Pain Point ($1000.00 in this example) –its time I adjust.

What I'd do with this adjustment is take off the spreads on the losing side of the trade.

Then, depending on market conditions, I would consider placing new spreads higher / lower than where they previously were.

For example, if I first sold a 800/810 Call spread – and it moved against me so much that I needed to adjust – I would buy back this spread – then consider selling another Call Spread further up. If I originally sold a 610/600 put spread – and it moved against me so much that I needed to adjust – I would buy back this spread – then consider selling another Put Spread lower down.

I'd select my new spread short strikes using the same criteria I used when I originally entered into the trade.

Once my 'good' side (the side opposite of the side I had to roll) reaches my .05 to .10 contingent buy back level and is bought back, I might consider selling new spreads on that side as well – to bring in more credit - selecting my new spread short strikes using the same criteria I used when I originally entered into the trade.

If I am within a week of expiration day I would NOT attempt to make an adjustment as I feel there is not enough time left to effectively do so - and I prefer NOT to be in the market at all during expiration week unless absolutely necessary.

If I DO find myself in a situation where I am in the market during expiration week I would close out my entire position at the very latest by Wednesday of expiration week regardless of where it is at profit / loss – wise – so I am NEVER in a trade on expiration day.

ADJUSTMENT #2: PARTIAL REMOVAL

Similar to the adjustment above, this adjustment consists of removing spreads on the losing side of an Iron Condor – but only removing SOME of them.

With this adjustment, I'd take off ONLY SOME of the spreads when a trades Current Loss nears my Max Pain Point dollar loss amount.

I'd use the 'Current Profit/Loss Line' on my risk graph (the white line on the risk graph examples in this manual which represent where the position is at TODAY) – as well as my potential max profit amount (the green line on the risk graph examples in this manual which represent where the position will be on EXPIRATION DAY) to help me determine how many of my spreads to buy back.

What I would be trying to do is raise up the 'Current Profit/Loss Line' (the white line on the risk graph examples in this manual) – in order to prolong my trade reaching my Max Pain Point – while at the same time keeping as much of my potential max profit amount as possible.

Once I bought back spreads, depending on market conditions, I might consider selling new spreads higher / lower choosing short strikes using the same criteria I used when I originally entered into the trade.

For example, if my call spread is the spread that is in trouble, I would buy back some of my call spreads. Then I might consider selling new call spreads higher up using the same criteria I used when I originally entered into the trade. If my put spread is the spread that is in trouble, I would buy back some of my put spreads. Then I might consider selling new put spreads lower down using the same criteria I used when I originally entered into the trade.

Once my 'good' side (the side opposite of the side I had to roll) reaches my .05 to .10 contingent buy back level and is bought back, I might consider selling new spreads on that side as well – to bring in additional credit - using the same criteria I used when I originally entered into the trade.

If I am within a week of expiration day I would NOT attempt to make an adjustment as I feel there is not enough time left to effectively do so - and I prefer NOT to be in the market at all during expiration week unless absolutely necessary.

If I DO find myself in a situation where I am in the market during expiration week I would close out my entire position at the very latest by Wednesday of expiration week regardless of where it is at profit / loss – wise – so I am NEVER in a trade on expiration day.

ADJUSTMENT #3: TAKE OFF THE SHORTS

This adjustment consists of simply buying back SOME of the SHORT strikes on my losing side.

When a trades Current Loss nears my Max Pain Point dollar loss amount, I would buy back just SOME of the short strikes (the strikes I have sold).

I would leave longs (the strikes I have bought) in place.

For example, if my call spread is the spread that is in trouble, I would buy back SOME of my call shorts, but leave my call longs in place. If my put spread is the spread that is in trouble, I would buy back SOME of my put shorts, but leave my put longs in place.

I would use the 'Current Profit/Loss Line' on my risk graph (the white line on the risk graph examples in this manual which represent where my position is at TODAY) – as well as my potential max profit amount (the green line on the risk graph examples in this manual which represent where my position will be at EXPIRATION) to help me determine how many of my shorts to buy back.

What I would be trying to do is raise up the 'Current Profit/Loss Line' (the white line on the risk graph examples in this manual) – in order to prolong my trade reaching my Max Pain Point – while keeping as much of my potential max profit amount as possible.

Once I had bought back spreads, depending on market conditions, I might consider selling new spreads higher / lower choosing short strikes using the same criteria I used when I originally entered into the trade.

For example, if I pulled call shorts, I might consider selling new call spreads higher up choosing new short strikes using the same criteria I used when I originally entered into the trade. If I pulled put shorts, I might consider selling new put spreads lower down choosing new short strikes using the same criteria I used when I originally entered into the trade.

Once my 'good' side (the side opposite of the side I had to roll) reaches my .05 to .10 contingent buy back level and is bought back, I might consider selling new spreads on that side as well – bringing in additional credit - selecting my new spread short strikes using the same criteria I used when I originally entered into the trade.

If I am within a week of expiration day I would NOT attempt to make an adjustment as I feel there is not enough time left to effectively do so - and I prefer NOT to be in the market at all during expiration week unless absolutely necessary.

If I DO find myself in a situation where I am in the market during expiration week I would close out my entire position at the very latest by Wednesday of expiration week

regardless of where it is at profit / loss – wise – so I am NEVER in a trade on expiration day.

ADJUSTMENT #4: ADDING A CALL / PUT

This adjustment consists of simply buying additional Call(s) /Put(s) on the losing side of my trade.

To make this adjustment, when a trades Current Loss nears my Max Pain Point dollar loss amount, I would buy one to several Calls / Puts on the problematic side of my trade.

For example, if my Call Spread is in trouble, I would consider buying a call (or calls). If my Put Spread is in trouble, I would consider buying a put (or puts).

I would use the 'Current Profit/Loss Line' on my risk graph (the white line on the risk graph examples in this manual which represents where my position is at TODAY) – as well as my potential max profit amount (the green line on the risk graph examples in this manual which represent where my position will be at EXPIRATION) to help me determine how many calls or puts to buy – and at which strikes to buy them.

What I would be trying to do is raise up the 'Current Profit/Loss Line' (the white line on the risk graph examples in this manual) – in order to prolong my trade reaching my Max Pain Point – while keeping as much of my potential max profit amount as possible.

Once my 'good' side (the side opposite of the side I had to roll) reaches my .05 to .10 contingent buy back level and is bought back, I might consider selling new spreads on that side as well – selecting my new spread short strikes using the same criteria I used when I originally entered into the trade.

If I am within a week of expiration day I would NOT attempt to make an adjustment as I feel there is not enough time left to effectively do so - and I prefer NOT to be in the market at all during expiration week unless absolutely necessary.

If I DO find myself in a situation where I am in the market during expiration week I would close out my entire position at the very latest by Wednesday of expiration week regardless of where it is at profit / loss – wise – so I am NEVER in a trade on expiration day.

WHICH ADJUSTMENT TO USE?

Although each of the adjustments can be effective, over time I have found that I prefer using only one or two – or sometimes a combination of several together when I find myself in a situation where I need to adjust.

Which adjustment to use is simply a matter of personal preference and becoming comfortable with them – and it will be different for each individual trader.

This is yet another reason why it is so important that while learning to trade Iron Condors / learning to make the various adjustments – it is **VITAL** to only paper trade and/or back trade without risking real money. The Iron Condor - as well as each of the adjustments – could act differently than how a newer trader might expect they would act if they have never traded them before. The last thing I would want is to be scrambling around in the middle of a sudden wild market discovering for the first time how an Iron Condor and/or a specific adjustment is acting - especially when I have real money on the line!

That is why when learning a new trading method, strategy, and/or adjustment technique, I should only paper trade without risking any real money. This way I am able to keep a very clear and sensible head - and am able to experience the entire process in a positive way and learn it thoroughly - without having the added pressure of losing real money.

By doing this I am then able to discover which method/adjustment works best for me and which one I like the most – and am most comfortable with - without having the added worry of making a mistake that could cost me real losses.

Then once I feel comfortable with a particular method/adjustment and feel I am ready to try it 'live', I should do so with a very SMALL part of my available risk capital.

I should then continue trading this small size for as many cycles as necessary until I feel completely comfortable making the trade and adjustments 'live' in the 'real world'

Once I feel completely comfortable making the trade and adjustments at this small size in the 'real world' I would then begin to consider increasing my size slowly over time.

HOW MUCH OF MY RISK CAPITAL DO I USE FOR MY IRON CONDOR TRADES?

Personally, I never want to use more the 10% of my total RISK CAPITAL (this is money I can afford to lose) on Iron Condor Trades – and I prefer to use 5% or less.

For example, if I were trading a $10,000.00 trading account (meaning this was $10,000.00 I could afford to lose), I would never want to have more than $1,000.00 tied up in Iron Condor trades at one time.

If I were trading a $100,000.00 account (meaning this was $100,000.00 I could afford to lose), I would never want to have more than $10,000.00 tied up in Iron Condor trades at one time – and I would prefer to be using only $5,000.00 or less.

SOME OTHER IRON CONDOR TRICKS

Following are some other ideas / methods I sometimes use while trading Iron Condors.

I don't use these every month. They're just part of my Iron Condor Tool Box for if and when I think I might need them…

The 'STAGGER IN STRATEGY'

Large sudden moves in the underlying can hurt an Iron Condor – especially when these moves occur right after the trade is first put on.

One way I could help potentially reduce the pain from these large moves that occur early in the trade is to stagger into my position.

For example, if I plan to put on a 10 contract Iron Condor at 35 days from expiration – I might instead put on a 5 contract Iron Condor at 40 days from expiration. Then I would put on another 5 contract Iron Condor at 30 days from expiration.

This way, if a large unexpected move does occur within the first few days of my putting on the first batch of the trade, my risk is reduced by only having that first 5 lot batch exposed - and I only have to concern myself with adjusting 5 rather than the 10 I was first planning to put on.

I am also now in a position where I can decide if I want to put on the rest of the entire position (the other 5 contracts) or not depending on market conditions – AND - if I do decide to put the remainder of the trade on, I have a second chance to place the remaining 5 at what is now the ideal starting point on the risk graph then where my first 5 lot batch currently resides.

If a large move doesn't occur and the market remains relatively stable – I can simply put the remaining 5 contract Iron Condor position on at day 30 at or near where the first 5 contract position resides.

Personally I don't use this technique every month – just when conditions justify it.

The 'DOWNSIDE (or UPSIDE) RISK REDUCER'

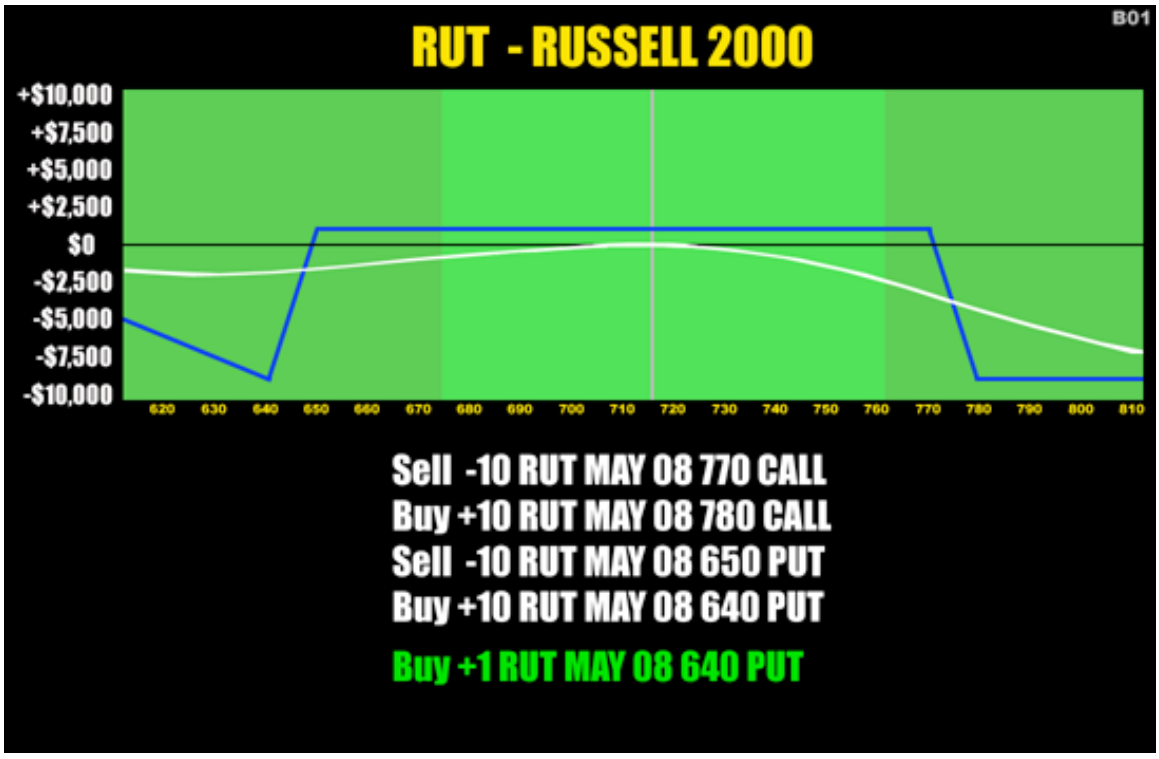
I have a fear of the downside.

Sure the market can explode to the upside and cause problems – but from my experience the upside moves are always much more manageable then the downside moves.

One way I've found to help reduce this downside fear while trading Iron Condors is in the way I set them up from the beginning of the trade.

By simply buying an extra long put (or puts) on my bull put credit spread at the time I place the trade, I've found that it can significantly raise my 'Current Profit/Loss Line' (the white line in the risk graph below) without destroying my potential profit amount.

Take a look at the graph below…



In the graph the 'Current Profit/Loss Line' (the white line) has been raised up significantly on the left side of the graph (the downside) – without destroying my total profit potential.

If there was a large sudden downside move, my pain would be reduced significantly compared to this position without the extra put(s).

And I feel I would have the time I need to make necessary adjustments before my P and L gets out of control.

AND – if there were a catastrophic move down, its possible that this trade could become extremely profitable – even if NO further adjustment were ever made. If I take a look at the expiration line on the left side of the graph, I can see that the blue line (the expiration day line) starts to move back up – and if I were to zoom back on this graph further, I would see that it continues to rise back above break even and then into extreme profit.

Yes – my MAX profit potential will be reduced by buying the extra put(s), but not by too much.

The new reduced profit potential is still a great return on my investment.

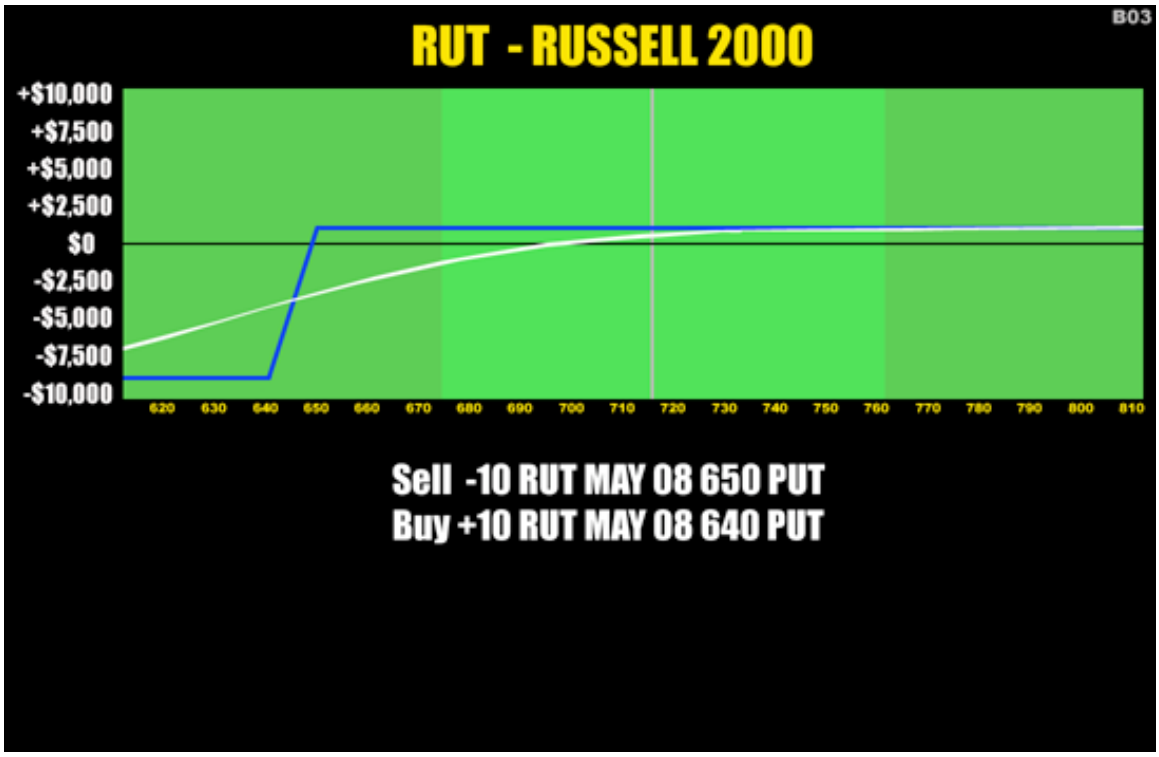
Personally I don't use this technique every month – just when conditions justify it.

The 'SKEWED CONDOR'

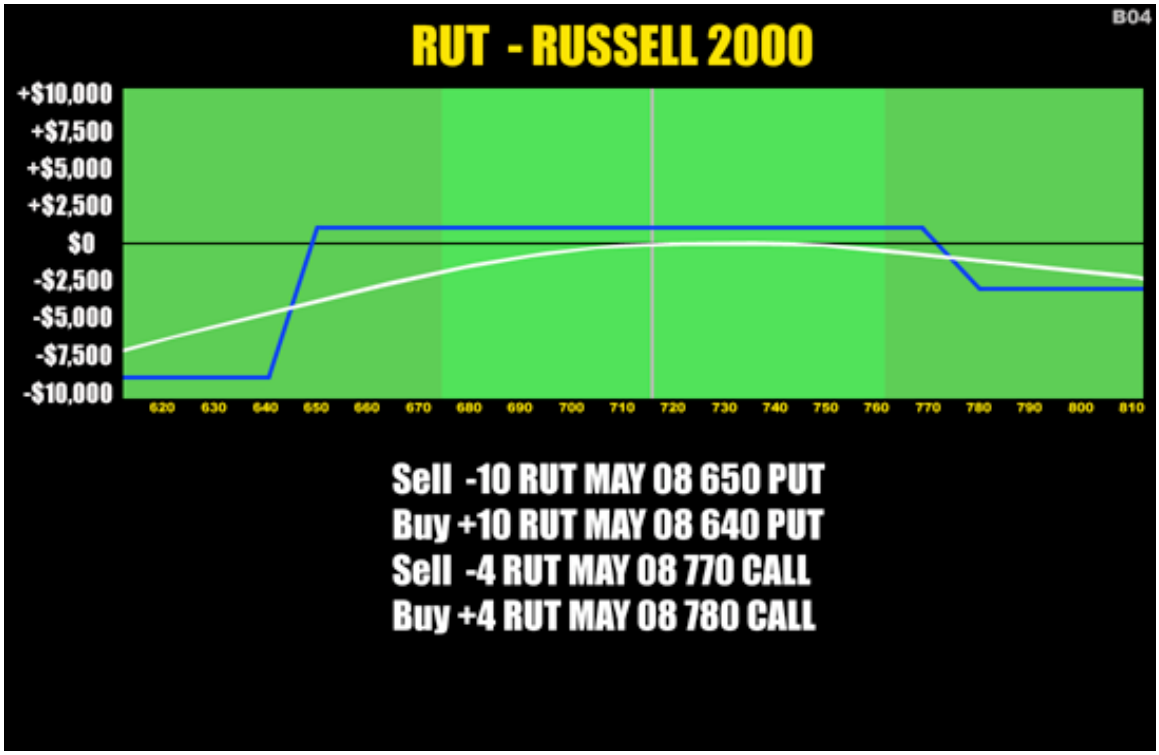
When I have a strong opinion about the direction of the market, I believe selling simple credit spreads are a viable strategy.

However, to help protect me if I'm wrong about the direction (which I usually am) I might use a Skewed Condor instead of just a straight Credit Spread.

For example, if I feel the market is going up, I might decide to sell a 10 lot Bull Put Spread like the one in the graph below…



However, if I wanted to protect my trade just in case I'm wrong about direction and the market moves against me, I might consider turning it into a Skewed Condor by selling just a few Bear Call Spreads above the current price – creating the following risk graph…



I feel this does several things…

It allows me to stay bullish and still make profit if the market stays where its at, goes down some, or goes up some.

It brings in more credit increasing my max profit potential.

It raises my 'Current Profit/Loss Line' on the downside (the white line on the graph) which will allow me more time and room on the downside to adjust if the market drops down.

It reduces my total max loss risk amount on the downside.

The only negative I see playing the trade this way is of course if the market explodes upwards.

If it does, I will need to adjust – however as the trade is already skewed bullish, personally I feel this trade would be quite simple to adjust.

Personally I don't use this technique every month – just when conditions justify it.

The 'PADDED' CONDOR

I use variations of this Iron Condor during extremely volatile times.

This Iron Condor is constructed by adding (buying) enough extra calls and puts on either side of the Iron Condor to bring the 'Current Profit/Loss Line' (the white line on the risk graph) up high enough so that if there was an extremely large move in either direction, I should not hit my pre-determined max pain point that would either force me to adjust – or to get out of the trade altogether.

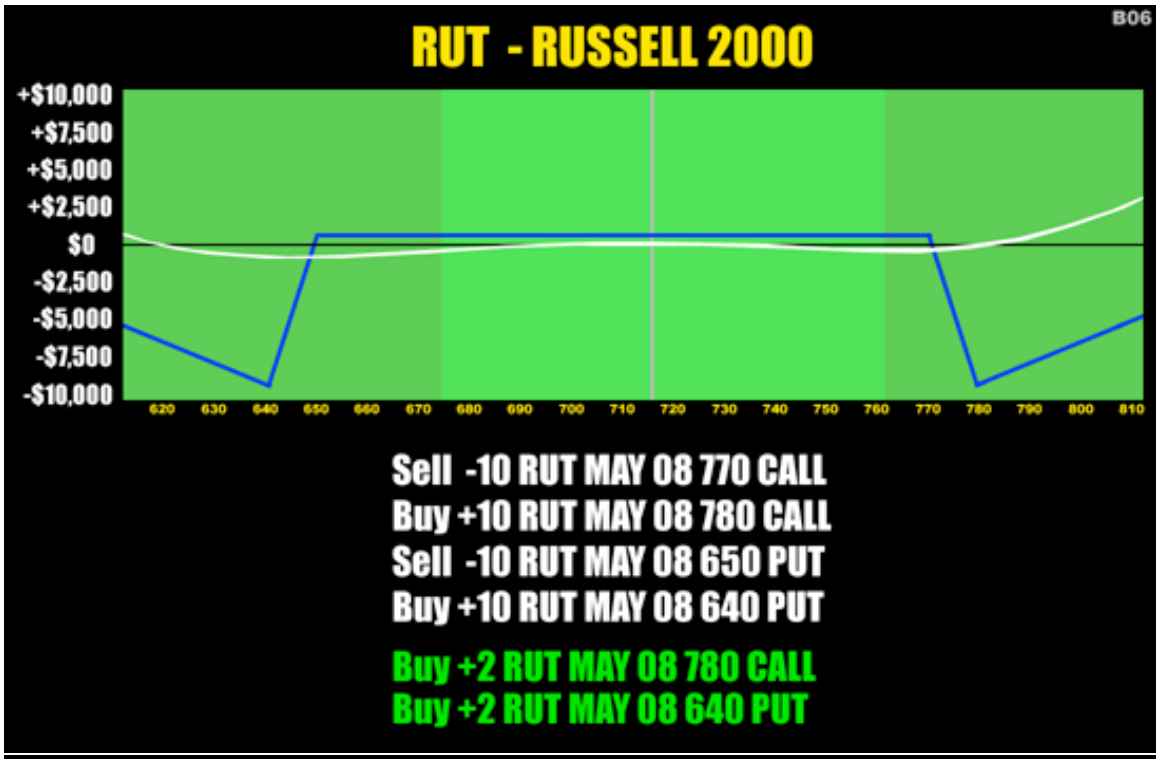
Yes – buying the extra longs does reduce the max profit potential – however the reduced profit potential is still good – and I believe this trade could withstand just about any sort of move the market could throw at me – at least during the first week or so.

As time goes by, the 'Current Profit/Loss Line' (the white line) will begin to droop on either side so I will need to be more watchful then I might be with other versions of the Iron Condor – however, at the same time, I feel that having those extra longs on either side could be of real assistance if and when I need to adjust.

Also because of the way the trade is constructed (with the extra longs) I might need to wait a little longer then I normally would to reach my profit.

Personally I don't use this technique every month – just when conditions justify it.

Below is the risk graph of this trade…


B06
RUT - RUSSELL 2000
+$10,000
+$7,500
+$5,000
+$2,500
$0
-$2,500
-$5,000
-$7,500
-$10,000
620 630 640 650 660 670 680 690 700 710 720 730 740 750 760 770 780 790 800 810
Sell -10 RUT MAY 08 770 CALL
Buy +10 RUT MAY 08 780 CALL
Sell -10 RUT MAY 08 650 PUT
Buy +10 RUT MAY 08 640 PUT
Buy +2 RUT MAY 08 780 CALL
Buy +2 RUT MAY 08 640 PUT

OTHER RESOURCES

OPTION INCOME SYSTEM – Excellent Options Educational Training Site for trading a variety of option strategies – including a focus on trading Iron Condors on ETFs.
Go to:
http://www.OptionIncomeSystem.com

INCOME TRADING COURSE – Great System for learning additional Iron Condor, Credit Spread strategies and techniques.
Go to:
http://www.IncomeTradingCourse.com

ThinkOrSwim.com – Not only a great Options Broker – also a great Education Resource Site. Resources on this site include Hours and Hours of top comprehensive option trading educational online seminars & webinars – including Free Video Webinars archived and updated with new content weekly.

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