NON – DIRECTIONAL OPTION TRADING : INCOME STRATEGIES

Markets are manifestation of human psychology. The main role of market is to facilitate trade between buyers and sellers. Buyers will enter the market, if they feel price is too low and take it higher. Similarly, if the price is too high, sellers will enter and take them lower. Most of the time price keeps on moving within this ranges created by buyers and sellers. We can use income strategies (Writing options) to generate income on regular basis when market is trading in ranges.

DESIGNING THE SYSTEM

1. **Define Market type -** To generate regular income from writing, we need to define market type-Trending or in range. We can use following methods to define market is in trend or in range.

   a) Demand – Supply Zone using Price action.

   b) Put Call Ratio.

   Generally, 0.80 to 1.20 PCR is considered as trading zone market. Use PCR of 17 strikes to calculate PCR.

   c) Broad Weekly CPR. (For weekly options calculate CPR using Friday to Thursday data).

   d) Oscillators like RSI, ADX, Bollinger Band can also be used.

2. **Define range -** Trade what you see and not what you think.

   Once we know market is non-trending i.e., it is trading in range, we need to define our range. For weekly expiry find weekly range and for monthly expiry find monthly range. We can use following methods for deriving range.

   a) VIX.

   Volatility for a month can be calculated as :

   E.g. If Vix is 14.5 and nifty is at 17500 then range for the month will be:

   17500* (14.5/square root of 12)% = 733

   Monthly range is 17500 +/- 733 = 16767 - 18233.

   In the same way Range for the week can be found using 52 weeks in a year.

   b) Standard Deviation.

   c) Broad CPR:

   S1 - R1 Levels of Broad CPR acts as range

boundaries. If price starts trading beyond S1 or R1 levels, trigger Stop loss and exit trade.

d) Open Interest Analysis.

We can use option chain and option statistics to find the range. For weekly options use data of Friday and Monday to determine range and monitor data on Tuesday, Wednesday and Thursday to see if the range is same or range breakout has happened. If open Interest boundaries are changed, trigger stop loss and exit trade.

3. **Decide which option strategy to use**

Non-directional options trading is a type of options trading strategy that involves taking positions in both calls and puts on the same underlying asset, with the aim of profiting from the volatility of the asset rather than its directional movement. The advantage of non-directional options trading is that traders can make profits even if the underlying asset does not move in a particular direction. Instead, they profit from changes in volatility or changes in the implied volatility of the options themselves.

We can use following strategies:

a) Short Straddle

b) Short Strangle

c) Short Gut

d) Short Iron Condor

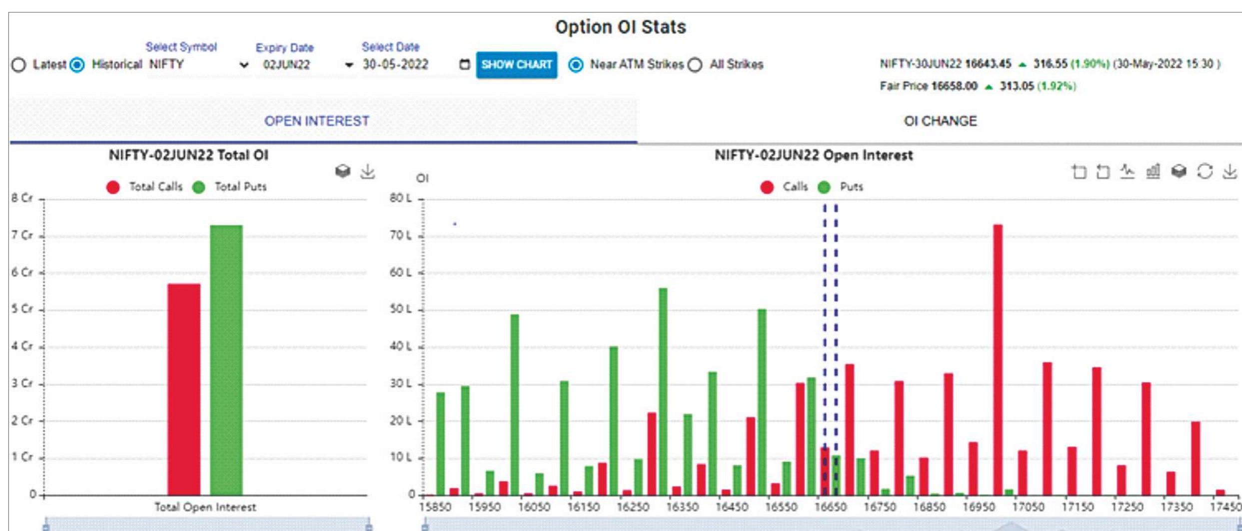
e) Short Iron Fly

Choose strategy wisely depending on market conditions and risk reward ratio.

4. **Monitor changes in VIX**

Volatility measures market movement or non-movement. It is defined as the magnitude by which an underlying asset is expected to fluctuate in a given period of time. It is a major contributor to the price (premium) of an option; usually, higher an asset's volatility, higher the price of its options. High or low volatility gives traders a signal as to the type of strategy that can best be implemented to optimize profits. Generally falling VIX will add profit to your position and rising VIX will go against short strategy.

EXAMPLE



Ideal scenario to short Straddle / Strangle when price is in middle of highest CE and highest PE, and range is broad.

EXAMPLE

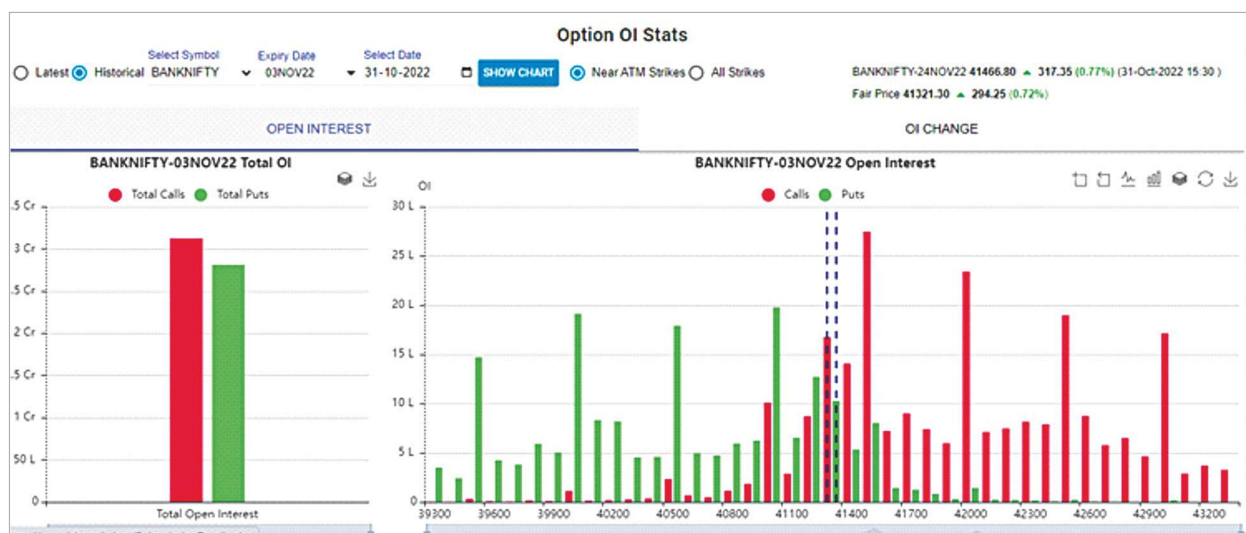
Nifty 16600 Straddle is down from 240 levels to 30. A short straddle involves selling both a put and a call with identical strike prices and expiration months. *A short straddle is a limited reward, unlimited risk strategy that profits if the underlying security trades sideways. Short straddle earns very large profits in neutral market condition.*

EXAMPLE

Nifty 16300 PE – 17000 CE Strangle is down from 50 to 0. Strangles are quite similar to straddles, except they use OTM options which changes the dynamics of the trade entirely.

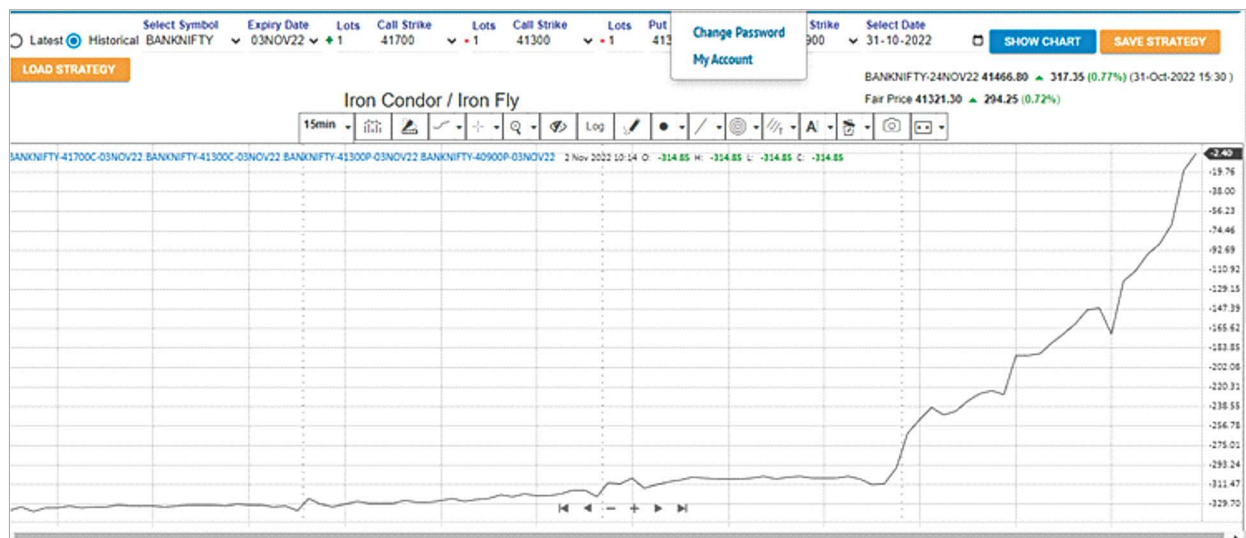
A strangle has a wider trading range but brings in a smaller credit than Straddle.

EXAMPLE



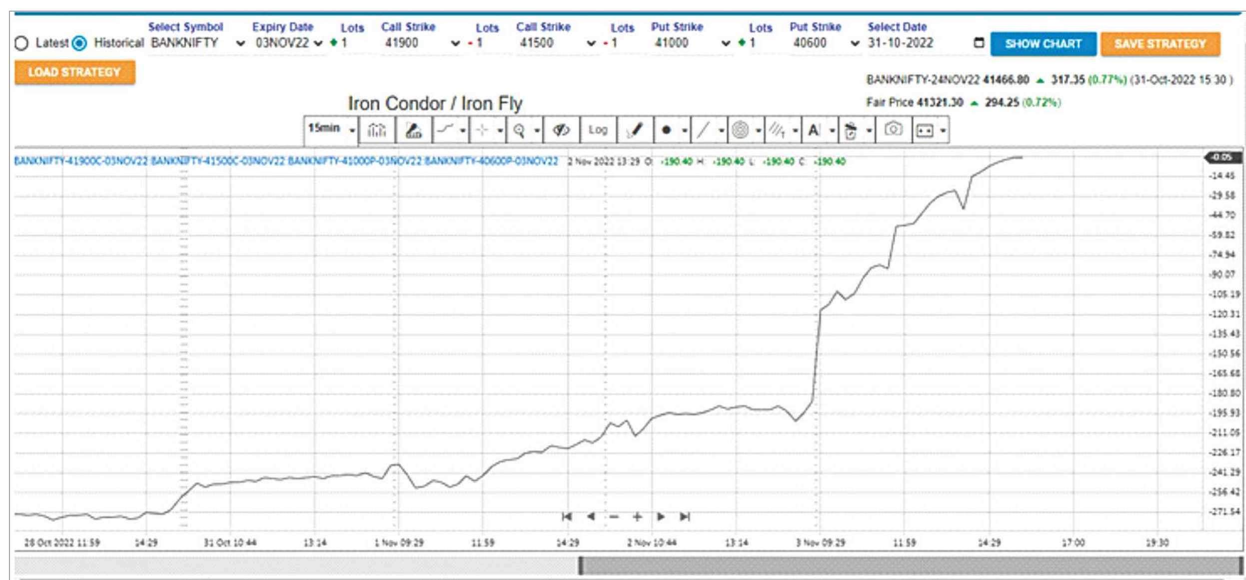
When the range is narrow, its safer to hedge Straddle / Strangle and convert it to short Iron Condor / Iron Fly.

EXAMPLE



Bank Nifty + 41700ce - 41300ce - 41300pe + 40900pe Iron Fly is down from 325 to 3. Short Straddle when hedged with long Strangle get converted to Short Iron Fly. *It is hedged position hence limited risk strategy. Due to hedge position, margin requirement is reduced and hence we have better risk reward ratio.*

EXAMPLE



Bank Nifty + 41900 CE - 41500 CE - 41000 PE + 40600 PE Iron Condor is down from 240 to 0. When Short Strangle is hedged with long distance long Strangle, we have Short Iron Condor. *It is a hedged position and hence margin requirement is less and generates better risk reward ratio.*

About the Author

Pinky Lapasia is a Commerce Graduate from Mumbai University and a qualified Chartered Accountant. She has completed CMT (USA). She has vast experience of over 16 years in Equity and Derivative Markets. She is a skilled swing Trader and Investor as well. She has in-depth knowledge of Dow-Theory, Traditional Chart Patterns, Harmonics and Neo-Harmonics, Advanced Candlestick Analysis, Index Options Data Analysis, Trading Psychology and Money Management. She is currently working with Rajchandra Capital Services Pvt. Ltd. Pinky is a member of the Advanced InvesTrade Forum.

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