

Exiting Losing Trades

Selling strangles has numerous benefits to the short volatility trader, such as:

- 🍒 All Positive Theta
- 🍒 All Short Vega
- 🍒 Larger Credit & Wider Break-evens
- 🍒 High POP
- 🍒 Flexibility of Management
- 🍒 Less Commissions



Exiting Losing Trades

As we know, these benefits aren't free. Here are the primary cons to selling strangles:

- Higher BPR = Lower ROC
- High Greek Risk
- Possibility of Catastrophic Losses



Exiting Losing Trades

While we normally discuss what to do with our winners, today we're going to examine possible trade exits when the trade goes against us.



Exiting Losing Trades

How much is our win rate affected when applying an exit rule for naked options?

How much room should we allow a losing trade to go against us?

Is there an optimal exit point for exiting a loser?

What difference does IV Rank have on existing losers?

Exiting Losing Trades

Study Parameters

2009 - Aug. 2014

- 🍒 In SPY, Sold 1SD on every trading day*
- 🍒 Closest to 45DTE

Exited trades at:

- 🍒 Expiration
- 🍒 Loss equal to 1x, 2x, 3x, 4x, or 5x credit received

**Tested daily entries for occurrences*

Exiting Losing Trades

For example, we collect a \$1.00 for the strangle, our exit points for losing trades would be when the strangle traded at the following:

1x: \$2.00

2x: \$3.00

3x: \$4.00

4x: \$5.00

5x: \$6.00



Exiting Losing Trades

Of the 1,313 occurrences, 1,090 (83% of the trades) never got to a 1x credit loss.

Of those that did, how many reached or exceeded each of the pre-determined exit points?

Exiting Losing Trades

All Occurrences	1x Loss	2x Loss	3x Loss	4x Loss	5x Loss
# of Exits Hit	223	103	67	38	23
% of Trades	17%	8%	5%	3%	2%



Exiting Losing Trades

At first glance, we see a large drop-off in the percentage of trades hit when moving from a 1x credit loss to a 2x credit loss.

The decreases become much less significant as we move from a 2x credit loss down to a 5x credit loss.



Exiting Losing Trades

Next, we compare the profit/loss, win rate and largest single drawdown for each exit strategy.

Is there an ideal exit strategy when closing a losing trade?

Exiting Losing Trades

All Occurrences	Exp.	1x Loss	2x Loss	3x Loss	4x Loss	5x Loss
P/L	\$95,678	\$96,860	\$99,275	\$95,064	\$94,776	\$96,084
# of Winners	1,097	1,006	1,068	1,079	1,087	1,092
% Winners	84%	77%	81%	82%	83%	83%
Biggest Loss	-\$1,325	-\$266	-\$340	-\$510	-\$680	-\$820



Exiting Losing Trades

Employing the exit strategy at 2x the credit received (on all occurrences) resulted in the best results.

While only sacrificing 3% win rate, the overall P/L increased by \$3,597 and the biggest lost decreased by \$985.



Exiting Losing Trades

Next, we compare the differences in high and low IV Rank.

Because of relatively low IV rank in SPY for the time frame of the study, we used an IV Rank above and below 35 to get adequate number of high IV occurrences (223).

Exiting Losing Trades

High IV Rank

IV Rank Over 35	Exp.	1x Loss	2x Loss	3x Loss	4x Loss	5x Loss
P/L	\$22,690	\$20,413	\$22,201	\$20,092	\$20,580	\$22,432
# of Winners	183	161	176	176	179	182
% Winners	82%	72%	79%	79%	80%	82%
Biggest Loss	-\$799	-\$266	-\$340	-\$510	-\$680	-\$760

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Low IV Rank

IV Rank Under 35	Exp.	1x Loss	2x Loss	3x Loss	4x Loss	5x Loss
P/L	\$72,987	\$76,447	\$77,073	\$74,971	\$74,195	\$73,651
# of Winners	914	845	892	903	908	910
% Winners	84%	78%	82%	83%	83%	83%
Biggest Loss	-\$1,325	-\$178	-\$328	-\$492	-\$656	-\$820



Exiting Losing Trades

Takeaways (1 of 2)

- For 1SD strangles in this test period, a 2x credit loss exit point was optimal overall
- In higher IV (IVR over 35), not managing the trades had the highest P/L, but barely beat the 2x credit loss exit.

Exiting Losing Trades

Takeaways (2 of 2)

- 🍒 In low IV (IVR below 35), exiting trades at a 2x credit loss resulted in higher P/L and a much lower max loss, while only decreasing win rate by 2%.
- 🍒 The worst drawdown over the period was a 14x credit loss. There were 4 other occurrences with more than a 10x credit loss.

Exiting Losing Trades

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