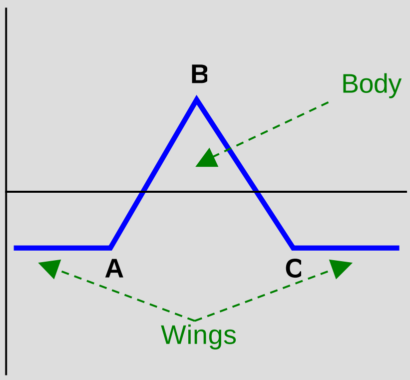
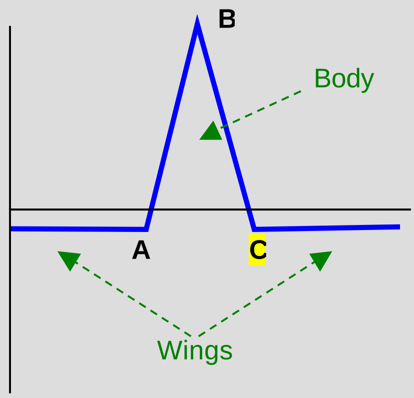
Wide Butterfly



Wide Butterfly Characteristics:

1. Strikes A and C are wider apart. B is equidistant from them both.
2. Greater Maximum Risk than with Narrow Butterfly
3. Lower Maximum Reward (as evidenced by height of B).
4. Higher probability of profit (because a wider span above breakeven)

Narrow Butterfly



Narrow Butterfly Characteristics:

1. Strikes A and C are closer together. B is still equidistant from them both
2. Lower Maximum Risk than with Wide Butterfly
3. Greater Maximum Reward (but low chance of achieving it).
4. Lower probability of profit (because of the narrow span)

So Step 1 is to find a price pattern with clear and distinguishable Support and Resistance. The wider the Butterfly, the less risky your trade will be in terms of probability of success, but the more risky it will be in terms of the net debit to pay for it.

(ii) Implied Volatility and Historical Volatility

In a perfect Long Butterfly world for you'll be looking for stocks that have experienced higher than their average Implied Volatility levels but where you expect the price action to calm down, leading to lower volatility levels for the duration of your trade.

This is easier said than done, since even lowering volatility levels doesn't necessarily help us with regard to the *direction* of price action and the success of a long Butterfly is dependent on price action remaining range-bound (and, depending on where you currently are within that range, price direction could be a vital factor). So, be aware that before you start looking at volatility levels in this way, you must ensure you're dealing with a price series with distinctive and strong support and resistance lines. Therefore, you should be looking at trades where the stock price is right in the middle of those support and resistance levels, equidistant from both. When this is the case, your lowest strike will be at