

What is Unusual Option Activity?

Imagine you have a friend that knows the score to next year's Super Bowl. Your friend cannot tell you verbatim what the score will be, but you can watch what they are betting on and follow along.

Unusual Option Activity is like following a friend's bet – you're utilizing their due diligence.

On any given trading day, our algorithms and analysts scan the markets and identify dozens of option trades that are categorized as "unusual." **This does not mean that all of these trades are actionable, or even worth trading.** We must dig deeper, do our research, and consider multiple factors in order to make decisions on which activity is worth trading.

Also keep in mind that just because we see unusual activity in a certain option does not mean we go ahead and buy or sell that specific option! We look at multiple factors, including technical, fundamentals, news cycles, etc. and then determine the best strategy to take advantage of the trades that we think are worth trading!

We can not overstate the point above! Unusual Option Activity is an indicator, not a magic pill or "sure thing." It points us in the direction of where to look. The rest comes down to additional research, intuition, and using all of our combined skills as traders to make calculated trading decisions.

02/11/2019 10:44:46 AM	CL	Bullish Call Roll	65.43	20,030 August 67.50 calls bought for 2.95 above open interest of 112 contracts, 20,030 May 65 calls sold for 2.90 below open interest of 22,873. Stock 65.43.	Consumer Staples
02/11/2019 10:41:20 AM	EBAY	Bullish Call Roll	35.69	20,000 29March 36 calls bought for 1.20 above open interest of 2,322 contracts, 10,000 18April 32 calls sold for 4.20 below open interest of 42,868 contracts. Follows similar call roll-inups in Log in the past two weeks. Stock 35.69.	Retail and Wholesale
02/11/2019 10:37:06 AM	CATM	Bearish Put Roll	26.79	6,500 March 30 puts bought for 4.50 to 4.60 above open interest of 334 contracts, 6,500 March 35 puts sold for 8.20 to 8.30 below open interest of 6,500. Stock 26.79. EPS 2/21 after close.	Business Services
02/11/2019 10:31:33 AM	XBI	Bullish Call Buying	82.33	4,600 March 82 calls bought from 3.30 to 3.65 above open interest of 1,324 contracts. Stock 82.33-83.19.	Healthcare
02/11/2019 10:13:22 AM	CTL	Bearish Put Buying	14.22	10,000 February puts bought from 0.20 to 0.28 mostly in one print of 9,197 above open interest of 757 contracts. Stock 14.22. EPS 02/13 after close.	Utilities
02/11/2019 10:11:34 AM	MRK	Bullish Call Buying	77.30	18,415 June 82.50 calls bought in one print for 1.00 above open interest of 1,483 contracts. Stock 77.30.	Healthcare
02/11/2019 10:03:08 AM	KSA	Bullish Call Buying	32.05	3,000 June 36 calls bought in one print for 1.15 above open interest of 1 contract. Stock 32.05.	

Above: Sample data from the Unusual Option Activity Log. Each row is one unusual option trade.

Don't Trade Them All: How and Why We Filter Unusual Option Activity

We're looking for unusual option trades that look like somebody knows something. But what exactly does that mean? And how do we know? What clues do we look for?

Volume and Open Interest

Volume buying in a particular option does not necessarily indicate "secret knowledge," or in other words, does not indicate that the trader of that option knows something we do not.

However, broad sweeps of volume, across multiple strikes, wildly out-of-the-money or deep-in-the-money, can potentially indicate that "Smart Money" is behind it. We are especially interested in trades where Volume is greater than Open Interest in that specific option. For more on this, refer to our book *Follow The Smart Money*.

Time Frame of the Trade

We look for unusual time frames to expiration and wildly out-of-the-money trades that have no mathematical reason for existing. If someone is buying unusual amounts of a 10 delta option with 3 days to expiration, this does not make mathematical sense! It would be insane to buy such an option, as the odds of profit are mathematically low.

However, if the trader of those options knows something the rest of the market does not (which might cause the option to greatly appreciate in value in a short timeframe) then there is a possibility for explosive profits. Again, this is not always the case, but it is a consideration that we take into account when analyzing unusual activity.



Something Looks Off: Abnormal Trades

We also look for trades that are abnormal in respect to the underlying security. If on an average day, we see 5,000 contracts trading in a specific strike of a specific underlying, and then we see an order for 6,000 contracts—that is not anything unusual. If, however, we see a mathematically unreasonable amount of contracts traded (volume being greater than open interest) OR we see contracts bought with a very short time to expiration, then we want to look further into that trade.

We also look for prices that are unusual compared with what most buyers are currently willing to pay. If you saw two people exchange a widget, odds are the buyer wanted it more than the seller did if the exchange was for above the “going rate.”

Smart Money

“Smart Money” is money that is “in-the-know,” but that does not necessarily mean that they are skilled traders. Most of the time, we look for outright call or put purchases that are short term and out-of-the-money.

Smart Money doesn’t usually trade vertical spreads. Vertical spreads are limited risk, limited reward trades. Smart money wants to retire off the trade, not limit the potential reward. If you were “smart money,” why would you limit your upside?



Which Ones Should We Focus On?

Keys for Successful Unusual Option Activity Identification

- ▶ **Order is in the short-term.**
Why would you pay for more time than you need?
- ▶ **Order is an opening order.**
Above the open interest.
- ▶ **Straight call or put purchase.**
No hedging, no ties to another option order, a stock order etc.
- ▶ **Option selected is OTM (out-of-the-money).**
Pay as little as possible for maximum reward.
- ▶ **Order is of larger volume than average.**
Volume occurs every day in every underlying, but it must be unusually biased.

Gotcha: Analysis After The Activity Is Identified

We want to determine if the order makes any sense at all with some basic questions. Is it a viable trade? What is the minimum distance of the expected move, based on the unusual trade’s strike and cost? Is the underlying expected to report earnings soon? Is the FDA currently reviewing a drug’s candidacy? Is there an investigation going on?

These are all important questions to ask in order to determine if the trade is viable. There are plenty of unusual trades in the market every day, but there is a difference between gambling money, and Smart Money. A very notable way to determine if a trade is backed by Smart Money, is utilizing implied volatility.

Implied Volatility

Does the unusual order lift the implied volatility of the contracts in other expirations and strikes? A jump in volatility can indicate that the market makers are scared and/or suspicious.

Take the example of stock XYZ, whose options consistently trade 5,000 contracts per day on average. A market maker isn't going to view a 6,000 contract order as unusual – that's just run of the mill. But if a big player came in and wanted to place six (6) 5,000 contract orders (totaling 30,000 contracts all at once), and for increasing price...now that's something to worry about if you're making the market!

\$CLF keeps paying off for bulls

OPTIONS NEWS



On Nov. 19, 2018 Market Rebellion's tracking systems detected the purchase of 2,000 February \$10 calls for \$1.02 to \$1.05 with shares at \$9.97. Open interest in the strike was only 124 contracts before the trade occurred, showing that it was a new position. Those calls sold for as much as \$2.10 today, at least twice their purchase prices. The stock rose 21.46% in the same time period, illustrating the kind of leverage that can be achieved with options. It is the fifth winning trade in CLF posted on Market Rebellion in the last month.

Long calls lock in the price where a stock can be purchased, gaining with a rally and providing leverage to the underlying shares. The contracts can quickly lose value if the stock stalls or pulls back but also carry less risk than owning the shares themselves. CLF popped to \$12.17 on Feb. 12, 2019 before pulling back to close at \$11.67, still up 0.17% on the session. On Feb. 8, 2019 the iron-ore producer missed quarterly estimates but issued strong guidance.

So How Can We Trade It?

Potential Trades Off the Order



Buying the call or put that the customer bought.

- Especially if you can get it cheaper than what the initiator paid.
- Gives you an edge over the leading customer.
- Be sure to watch open interest as it adjusts over the coming days, to ensure liquidation of trade or rolling (a loser or winner) has not happened!
- Gives you the same risk-profile as far as dollar cost per trade goes.
- Following 1:1.



Buying an option in the same month, but deeper ITM.

- Market makers can/will adjust the spread on an active contract to reflect perceived risk.
- If customer is buying far OTM, likelihood of growing deltas is higher in the ATM or at least, closer to the money strikes. Remember gamma is highest in the ATM option.



Buying an option in the same strike, but further out in expiry.

- Millionaires and the "smart money" are humans too, and often even great paper can be right in direction, but wrong in time.
- Buying further out in expiry grants ability to turn trade into a diagonal/calendar spread, making the trade cheaper but NOT as a premium collection strategy. (Remember we are trading someone else's hunch, once the catalyst occurs, we're out!)



Buying an option in a further out expiry and further ITM

- Much like with "same strike, further expiry," you get additional time and a greater reaction on a point-for-point move against the underlying.



Buying stock, looking to roll into an option position.

- Some options trade on an underlying that is so cheap, it makes more sense to own shares, either for liquidity's sake or from a cost perspective.
- Gives you the opportunity to own stock without theta, and possibly roll into an option position when timing seems better to be long gamma.



Create a wide spread (vertical/diagonal) and buy deeper ITM, sell further OTM.

- Leverages upside activity, with a greater delta position.

Get Out: Closing The Trade

Remember that no matter what position you are in, as soon as the news or other catalyst happens, you're out! No real need to reflect ownership in the underlying as if it's an investment, it's a trade!

The first movement is always a knee jerk reaction as the market guesses, instead of analyzes, what the news means to the fundamentals. This is a benefit to those of us who are long options in the direction of the surprise move, as during that first move, the optionality of our options is at its highest, when there are so many unknowns by the market. *How far can it go? How long will it run?!* When this happens, you can roll your position on the open, or as soon as news hits intraday, when premiums are hyper-inflated, and wait it out for the digestion and see what the real move is, taking some of your profits with you.

More Information Before You Get Started

We welcome you to our Unusual Option Activity community! Here are a few items to go through before jumping in, chatting, and trading unusual option activity. Most of these can be found by logging in to the service on marketrebellion.com:

- Read Jon and Pete's book *Follow the Smart Money* in its entirety.
- Watch the Getting Started Video with Jon Najarian and our senior analyst Mike Yamamoto.
- Read the entire Unusual Option Activity FAQs in the Help section.
- Understand the shorthand we use in the chat room in the Education section.
- Be respectful of fellow traders in the chat!
- Listen to feedback from Market Rebellion Analysts and team members.
- Keep learning! Market Rebellion was designed to help you master the art of options trading!

The live trading chat room is for discussing trading ideas, unusual activity, technical analysis, fundamental analysis, or other daily market activity. **The live chat is not a learning center or a place to learn about trading.** If you're not understanding the value and/or how to use the data provided in Unusual Option Activity or cannot follow along in the live trading chat room, then you need to speak with one of our team members who can connect you with a coach and evaluate your trading level.

Trade Smarter!

For any questions regarding Customer Support or our Education and Subscription Services at Market Rebellion, please call us directly at (888) 982-8342 or email us at support@marketrebellion.com

