Momentum Driven Price Appreciation In Undervalued Option Contracts

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July 27, 2020

The investment world has a very short sighted perspective, operating in a manner that is completely dependent upon what is the next coming trend and quickly forgetting the last, as I have empirically verified for myself the entire summer. I was able to anecdotally prove to myself that there are a seemingly infinite variety of ways to make money from volatility based movements that are dependent upon open interest in certain contracts appreciating in a very aggressive manner in a very short amount of time. The most attractive part about this, while simultaneously being the most unfortunate part about this, is that it is easy to capture the opportunity upon it being visible but difficult to have faith in it when it doesn't garner enough attention for one to be comfortable with investing in it. For example, I witnessed this on more than a few different occasions over the summer, some occurrences more notable than others.

I will start with Virgin Galactic (NASDAQ: SPCE), wherein I saw a few short posts on the internet relating to the stock's technical pattern and the coincidental run of Tesla stock, which is at times used as a financial expression of SpaceX's performance, largely driven by the idea that Tesla stock is just a 'bet' on Elon Musk succeeding holistically in everything he does. I read most of the posts on July 13 and there were some that were being posted in the following days. From July 13 to July 15, the stock rose as Virgin Galactic went from $18.10 to $18.55; this was essentially the window of opportunity as momentum was developing and the rationalization behind a breakout was relatively clear from a technical and fundamental perspective.

End of week option contracts appreciated over 4000% from one day to the next and then everyone on the internet was talking about SPCE's sudden rise and rapid explosion. Of course, to find the play that some were proposing you'd have to have dug in a little deep and had some blind faith in a sense, but the anticipation for Tesla's earnings and the general 'feeling' that the market had in regard to space travel because of the stock being so cheap relative to the successful SpaceX flight that had happened recently resulted in a perfect storm.

I'd like to point out that despite Virgin Galactic and SpaceX having no direct relation, online communities of investors would convince you completely otherwise. I want to direct the reader's attention to a modern dilemma in markets and in general social relations; it matters little anymore if one is right, as long as one is being convinced. What I mean is that the objective truth matters very little if the subjective truth being expressed is overpowering the objective truth into submission, therein changing the reality into the subjective one. Although tongue-twisting, this is a prime tenet of reflexivity and a concept that we are witnessing every single day that angers many value investors as it disappoints them in that it rejects all they have been taught, but that empowers those who utilize volatility and liquidity to their advantage (which should be all market participants, theoreticality). Analogously, an interview quote from Denzel Washington seems fitting here; in the interview he is asked about fake news and what he opines, he answered along the lines of 'it doesn't matter if you're right, as long as you're first.' The markets suffer from this phenomenon and have been suffering from it more and more lately.

The reality is that chances like these to profit handsomely despite a tight time interval are more common than people think, granted that there is always research lying around that more-or-less has good risk management behind it. The end of week contracts for SPCE appreciated by a factor of 40, but the contracts that were a month out appreciated by a factor of 10 and arguably had much better downside protection in case the stock would suddenly drop or something. On top of this, general outlook for the only public space travel company was already valuing it much higher than what it was at in July 13; the consensus rating on SPCE is a buy rating with a target of $24, so it was not as if investors would have been taking an unusual amount of risk relative to the reward.

The next subject of discussion for these interesting situations involve Silver, I will use the largest physical silver ETF, SLV, as a proxy for the precious metal. From the week of July 13 to the week of July 20, Silver rose over 20%. To say that predicting this rise was 'easy' is an oversimplification, however, the argument for a stronger rise in the price of silver was strong and option contracts would have allowed a speculator to express this view efficiently. In general, the public markets know that Silver was undervalued and that the anticipation of more quantitative easing relative to how high the market was allowed for there to be some reasonable wonderment pertaining to the stability of the stock market.

This view was well expressed on every corner of the internet and precious metals in general had been gaining traction because of increased fear and instability; to support this, Gold was rising fast in price as well and this made many investors realize that the pricing ratio between Gold and Silver was unusually low, so this was a frequent point being made when it came time to be looking for supporting points as to why Silver should rise in price. From a technical perspective, there was a very solid resistance line that many people will likely study in the future when it comes to analyzing a graph of Silver. That point was the $18 point in SLV; I can affirm this perspective practically, as a friend and I played short term put options on SLV rising above $18 and then dropping below it more than a few times for quick profits. Of course, this game quickly came to an end as he pointed out to me that once SLV had closed above $18 in a consistent manner, there would likely be a sustained rise in its price; none of us expected an explosion, however.

The volatility of these contracts and the sudden flow-in of volume resulted in many SLV call contracts appreciating well over 5000% in a very short time frame. This was relatively foreseeable, but once more, the dependency on such an aggressive move was difficult to foresee. The downside protection, however, was strong, granted that it was more likely that Silver would rise in price than the S&P 500 would rise in price, and besides, if Silver dropped, it is unlikely that the drop would have been so catastrophic as to hurt medium term option holders. In the long term, precious metals are always a safe bet as they are generally seen as a modern safe haven, and this reputation has become reinforced and even substantially improved upon now that the threat of strong M2 expansion via QE is ongoing.

A third instance of this situation, wherein there is a relatively clear move going to occur, but there is little attention being brought to the situation and profits can be made from simple move-ins to certain contracts because of momentum and a sudden rise in volume which leads to a rise in open interest, is occurring with Albertsons (NYSE: ACI). Despite there being no sort of change in the stock price, a sudden flood of demand came in for one particular contract in the options chain: the August 17.5 Calls for Albertsons, which appreciated from about $0.68 per contracts to $1.10 per contract in under a week primarily from a sudden rise in investor awareness. The company is set to announce earnings on Monday prior to open and there is an almost universal acceptance that they will substantially beat earnings; I personally see this being as another BJs situation when BJs announced earnings for the first time since the pandemic started and the company beat tremendously, with the stock rising over 20% in under a few days.

Albertsons has a nearly identical situation in that it is a slow moving stock with a low beta which is being underestimated by the entire market; more attractive than that, at least to option traders, is that the IV for the company leading up to earnings was under 100% which was somewhat unusual.

The rush for the demand in the August 17.5 calls resulted in an appreciation simply due to a spike in implied volatility and the subsequent Vega rise of the contracts. In the same period the options contracts appreciated over 50% and gained a tremendous amount of volume, the stock didn't even rise in price but rather maintained a small fluctuation channel that was more significant in determining how momentum was changing than it was for trying to forecast a delta based appreciation. With this being said, this opportunity seems like another obvious one that may be 'too good to be true,' despite the fact that all objective research demonstrates that the company should be appreciating significantly upon their earnings announcement and even if they do not, the contracts will still benefit from a stronger spike in IV from the sudden sell-off, assuming the market is disappointed with the company's earnings.

What I outline here is that there are many opportunities that are obvious to the naked eye that at times seem too good to be true, but in reality, are truly good. It is just that market participants turn the blind eye. In recent times, market participants have been moving in packs, swinging from one sector to the next and largely being responsible for the rise in average volatility in the past few months. The collectivist mentality has been becoming more and more prevalent as a result of increased uncertainty; in general, this is good for the trader because the trader always benefits from increases in volatility as it provides more opportunities for arbitrage and the like.

In my own anecdotal experience, I have found that markets have become more and more short-sighted in recent months than they have been in prior decades. The dominant philosophy of the market has *always* been to ignore anything further than six months out in the future; earnings are played like this, as are acquisitions, as are IPO valuations. Even the central bank has started operating with a six-month philosophy in that everything is essentially done to push problems back for half a year until some new temporary solution is found and then debts are refinanced (never paid off).

I wrote this article because many times it feels too easy or even ignorant to find an opportunity that nearly no one has jumped at, despite everything seeming to be there in a coordinated fashion. The market discovers fast and forgets even faster, but really, the markets are not a fan of strategy and reason, as can be evident from the current state of market volatility.