Best-Kept Hedge Fund Secrets to Explode Your Wealth
By Jacob Mintz, Chief Analyst, Cabot Profit Booster

Hedge funds and institutions have been using options to get market leverage for years. Warren Buffett has been known to buy calls and sell puts to get bullish exposure. So have Carl Icahn and Bill Ackman. It’s essentially a look inside the portfolios of many of the top investing minds, months before the positions are made public.

When they make those trades, I pay close attention. I call it my “unusual option activity scanner.”

Using this scanner has been my most successful strategy throughout my 18-year options trading career. It’s an easy way to find the next hot stock. Here’s how it works.

When my proprietary options screener alerts me to a trader buying 10,000 calls and risking many millions of dollars, my alarm bells go off. Who is buying these calls, and why is he taking such a big position? Does he or she have insider information?

This Tripped My Unusual Option Activity Scanner

Let me give you an example of this type of unusual behavior. Back in July, I red-flagged Walt Disney (DIS) stock after a flurry of large call buys from institutions, over a roughly three-month period. Here were just some of those large options trades:

- Buyer of 7,500 June 150 Calls for $0.23 – Stock at 133
- Buyer of 2,200 July 145 Calls for $1.28 – Stock at 134
- Buyer of 5,500 July 145 Calls for $1.35 – Stock at 134.5
- Buyer of 3,300 September 165 Calls for $1 – Stock at 136
- Buyer of 2,000 October 140 Calls for $6.30 — Stock at 139.5
- Buyer of 2,500 August 150 Calls for $2.20 – Stock at 141.5
- Buyer of 8,000 July 150 Calls for $0.22 – Stock at 141.5
- Buyer of 12,000 July 150 Calls for $0.25 – Stock at 141

The DIS bulls were out in force, looking for the stock to move higher. And guess what? Disney stock shot to new all-time highs in late July (it’s at even higher highs today).

Here’s a more recent example, from unusual (i.e. very bullish) option activity I observed in salesforce.com (CRM) back in late September:

- Today - Buyer of 750 February 160 Calls for $7.35 – Stock at 151
- Monday – Buyer of 8,000 October 170 Calls for $0.36 – Stock at 153.5
- Monday – Buyer of 1,700 October 157.5 Calls (exp. 10/4) for $1.71 – Stock at 154.5
Upon seeing those unusual trades, I advised my Cabot Options Trader subscribers to buy calls in CRM. We made a profit of 60% in two months.

Now, onto more current activity involving ServiceNow (NOW). ServiceNow’s (NOW) stock chart looks like nearly every other hyper-growth stock's chart. 2019 started with an explosive run from January to mid-July, followed by a sharp decline July through October, and more recently a bit of a rebound. And last week a trader bought a large premium call position looking for the stock to rebound in early 2020. Here are those trades:

   Wednesday - Buyer of 2,700 ServiceNow (NOW) February 250 Calls for $21.60 – Stock at 252  
   Thursday - Buyer of 1,800 ServiceNow (NOW) February 250 Calls for $23.20 – Stock at 255

What I like about these trades is the net combined premium outlay of these two positions is approximately $10 million, plus the fact that the trader was willing to buy more calls, at a higher price, as the stock advanced on Thursday.

Just a couple days later, on Tuesday it was announced that NOW would replace Celgene in the S&P 500. This sent the stock higher by 11.50.

The 4,500 February 250 Calls purchased for an approximate price of $22 closed Friday at $39, or a potential profit of $7.65 million. In other words, the big hedge funds tend to know what they're doing when they make these huge call purchases. And you should take it as a potential buy signal.

And while straight call purchases are bullish, the trade structure that I find to be the biggest tell of the conviction these hedge funds have in a stock is an option trade called a “bull risk reversal.”

Bull risk reversals are a favorite tool for sophisticated hedge funds and are just about the most bullish trade you can execute using options because both components of the trade benefit if the stock heads higher: both the call buy is bullish and the put sale is bullish.

And what makes these trades so profitable (if they work) is that the premium collected via the put sale often pays for the premium paid for the call purchase.

**Bull Risk Reversals Explained**

Here’s how bull risk reversals work.

A bull risk reversal is typically used when a rise in the price of the underlying asset is expected. The strategy usually involves the sale of an out-of-the-money put and the purchase of an out-of-the-money call. The trade has unlimited profit potential to the upside and extreme loss potential to the downside.
For example, a January 20/25 bull risk reversal for a $1 credit would be:

Sale of January 20 Puts, and
Buy of January 25 Calls.
If the stock stays between 20 and 25, the trader collects the $1 credit.
If the stock goes to 20 or below, the trader will be forced to buy the stock at 20.
If the stock goes to 25 or above, the trader will exercise his right to buy the stock or simply sell his call for a profit.

Here is a profit and loss graph of this position:

The Bottom Line
Whether it’s a bull risk reversal or a straight call buy, when you see big money being spent in a bullish way, snatching up thousands calls or selling thousands of puts in one fell swoop, it means the big hedge funds or institutional investors like Warren Buffett or Carl Icahn have gotten bullish on a particular stock. I don’t automatically follow them into the trade. But it’s certainly something I closely watch, and a big factor that goes into my decision when making an options trade.
About the Expert

Jacob Mintz is a professional options trader and editor of *Cabot Options Trader*, *Cabot Options Trader Pro* and *Cabot Profit Booster*.

Using his proprietary options scans, Jacob creates and manages positions in equities based on unusual option activity and risk/reward.

Jacob developed his proprietary system during his years as an options market maker on the floor of the Chicago Board of Options Exchange, where he ran several trading crowds for nearly 10 years.

After a successful career on the trading floor Jacob was tasked with setting up a trading desk at a top-tier options trading company, trading against the most sophisticated hedge funds and institutions in the world.