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Just before 1 p.m. on June 9, 5,700 options tied to Clorox Co. (CLX) were bought on U.S. markets for about \$170,000. Traders snapped up the underlying stock and within half an hour, more than \$450 million had been added to the bleachmaker's shares.

Ten days earlier, RadioShack Corp., the struggling electronics retailer, jumped as much as 33 percent, adding \$40 million to its stock

capitalization, after someone purchasing \$600,000 in bullish call contracts ignited a rally in the equities. The stock rose to \$1.45 from \$1.32.



Photographer: Daniel Acker/Bloomberg

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Rallies in companies from Clorox to Molson Coors Brewing Co. show how options influence shares and create signals for traders. While equity derivatives have received scrutiny in recent years by regulators looking for evidence of insider advantages, investors scouring screens to turn split-second profits don't have time to think about where their cues are coming from.

"With big trades like these, you see a self-fulfilling feeding frenzy in the underlying stock," Daniel Brady, president of San Francisco-based trading firm Entropy Capital LLC, said in a June 10 phone interview. "People buy the stock and buy the calls and more people buy the stock and the calls."

Smart Money

It's never obvious who's buying options, though investors may believe it's people who have developed special insights into a stock, even illicitly. Years before last week's trades, transactions took place in Clorox contracts prior to takeover announcements by Carl Icahn that are now piquing the interest of federal regulators, a person familiar with the matter said.

"This is where the smart money plays, in the options market," Joe Kunkle, founder of OptionsHawk.com, a Boston-based provider of market data and analytics, said by phone. "You follow the large trades and you can take part in the gains without doing your research."

About 5,700 Clorox calls expiring in July with strike prices as high as \$95 were purchased in the two minutes after 12:46 p.m. in New York on June 10, according to Trade Alert LLC, a provider of

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options-market data. Shares of Oakland, California-based Clorox jumped after the transaction, rising as much as 4 percent, the biggest increase since September 2011.

RadioShack, Coors

On May 29, about 20,000 RadioShack calls expiring in October with a strike price of \$1.50 were purchased at 10:25 a.m., according to New York-based Trade Alert. The stock then surged, reaching \$1.75 a share in the biggest intraday advance since at least 1980. The shares finished up 9.9 percent at \$1.45.

An options trade on June 10 in Molson Coors sparked the biggest rally in 10 months in the stock. A trader bought 2,000 January \$75 calls around 10 a.m. and more than 11,000 calls changed hands in the first 30 minutes of the day, according to a note from Trade Alert. The maker of Coors Light and Molson Canadian rose 5.4 percent to \$70.71 by the close.

Aileen Zerrudo, a spokeswoman for Clorox, and Merianne Roth, a spokeswoman for RadioShack, declined to comment on the options trading. Colin Wheeler of Molson Coors and Kevin Callahan, a spokesman for the U.S. Securities and Exchange Commission, also declined to comment.

Debate about whether options market trades can be exploited profitably in equities has raged for years. A 2006 study by Massachusetts Institute of Technology professor Jun Pan and Allen M. Poteshman of the University of Illinois found that stocks with bullish options signals, such as low put-call ratios, beat those with negative signals by more than 1 percent a week.

Chat Rooms

Traders are paying more attention to options volume as it gets easier for analysts to study transactions and distribute the information through chat rooms, news feeds and e-mail blasts.

“We’ve seen a surge in options-focused trading and commentary in chat rooms, which may amplify the effect of unusual options flow,” Henry Schwartz, president of Trade Alert, said by phone. “It’s definitely become easier to watch options flow technology and broker’s platforms have evolved to the point where options flow that used to be well under the radar is now quickly caught by traders who specialize in that.”

Another way options influence equities is that market makers need to hedge the buying and selling of puts and calls with transactions in the underlying stock, according to a 2014 paper by Jianfeng Hu of Singapore Management University.

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Market Makers

“One big challenge for options market makers is that once someone trades against them, they need to hedge, and their counterparty also knows that,” Hu said in an interview yesterday. “Potentially, the counterparty can front-run their transaction in the stock market, which is very dangerous, particularly in large trades. So market makers must constantly adjust their hedging.”

Spending \$10,000 each to buy RadioShack, Clorox and Molson Coors shares in the minute after the options trades would have generated almost \$1,000 in profit if the positions were sold at the end of the day, according to data compiled by Bloomberg.

In some cases, options trading has represented activist investors building up a stake in a company they plan to take over, according to Trade Alert’s Schwartz. Other times traders are speculating a company is a good buyout candidate.

“It may be rumors, but it might also be the activist buying calls before his announcement,” Schwartz said by phone June 3. “It’s not uncommon at all. Most traders accept it as one of the drivers of activity. I don’t think it surprises anybody.”

Icahn Calls

Investigators are reviewing large option trades in Clorox before Icahn’s attempt to buy the company in July 2011, as well as trading by golfer Phil Mickelson and sports gambler William Walters in Dean Foods Co. in 2012, according to a person familiar with the matter. None of the three men has been accused of any wrongdoing.

More than 16,000 calls to buy shares of Clorox changed hands on July 11, 2011, the most since October 2010 and 10 times the number of puts to sell, as the shares rose 2.8 percent.

Icahn has said that he has “never given out inside information” and isn’t aware of the probe. He added that he “never purchased” or was “involved in any way with Dean Foods,” and that he never spoke to Mickelson.

Clorox Trades

“I have done absolutely nothing wrong,” Mickelson said in a statement, adding that he is cooperating with investigators. Mickelson isn’t the subject of a federal investigation into the Clorox stock transactions, the New York Times reported, citing four people familiar with the matter. Walters told the Golf Channel that he’s not involved in insider trading.

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Shares bought by market makers could have an exaggerated effect on stocks during periods of low trading volume, according to Brady of Entropy Capital. About 5.4 billion shares on average have changed hands on U.S. exchanges each day in June, 18 percent below the average daily trading volume through May this year.

Trading in Clorox shares surged to 4.8 million on June 9 after volume hadn't exceeded 1 million shares in any day since May 14, according to data compiled by Bloomberg.

"If there was more liquidity in the underlying stock, those kinds of trades would be absorbed more in the marketplace," Brady said by phone.

Because low stock market volatility has depressed options prices, investors are buying more calls to hedge or replace equity holdings in their portfolios, according to Michael McCarty, managing partner at New York-based Differential Research LLC. Market makers, who must sell the contracts to interested buyers in order to meet demand, are buying the stock of the company being traded to neutralize their positions, McCarty said.

"That's why you're seeing these big trades and the stock moving immediately," McCarty said by phone on June 10. "There are lots of participants in the market whose priority is to minimize pain."