Option Traders Sell Puts in US Consumer Stocks into October Slide

Into the early October declines on 10/2 we saw a common pattern with institutional option traders as the S&P 500 moved back near August lows, quickly erasing gains from September. The traders sold large blocks of puts to open with January 2020 expirations in nine large cap stocks that were mostly consumer-driven names. In Retail traders sold puts in Wal-Mart (WMT) and Target (TGT), two names that have outperformed in 2019 and tend to outperform in slower growth environments. In Home Improvement we saw put sellers in the retailers like Lowe's (LOW) and Home Depot (HD) as well as a key supplier Sherwin Williams (SHW). In credit cards puts were sold in Visa (V) and MasterCard (MA). McDonald's (MCD) and AutoDesk (ADSK) were the two others with large January 2020 put sales. The details of the traders are shown below.

Date	Description	Volume	Price	Delta	Impl Vol	Prob.ITM	Premium Collected	Symbol
10/2/2019	SHW 100 20 DEC 19 490 PUT	2,876	$9.40	-0.22	29.65%	25.75%	$2,991,040	.SHW191220P490
10/2/2019	LOW 100 17 JAN 20 97.5 PUT	8,212	$2.95	-0.26	30.38%	31.73%	$2,545,720	.LOW200117P97.5
10/2/2019	WMT 100 17 JAN 20 105 PUT	14,928	$1.34	-0.17	22.62%	20.16%	$2,089,920	.WMT200117P105
10/2/2019	MCD 100 17 JAN 20 190 PUT	7,198	$2.75	-0.2	20.55%	23.62%	$2,029,836	.MCD200117P190
10/2/2019	HD 100 17 JAN 20 210 PUT	4,019	$4.75	-0.25	23.94%	29.13%	$1,929,120	.HD200117P210
10/2/2019	MA 100 17 JAN 20 245 PUT	1,933	$7.05	-0.27	27.85%	32.22%	$1,430,420	.MA200117P245
10/2/2019	V 100 17 JAN 20 155 PUT	3,808	$3.45	-0.23	26.54%	27.11%	$1,332,800	.V200117P155
10/2/2019	ADSK 100 17 JAN 20 130 PUT	2,189	$5.55	-0.28	38.08%	35.09%	$1,269,620	.ADSK200117P130
10/2/2019	TGT 100 17 JAN 20 95 PUT	3,711	$3.15	-0.27	31.72%	33.11%	$1,243,185	.TGT200117P95

Looking at the option positions we notice traders were selling mostly -20 to -30 Delta puts with Implied Volatilities mostly in the 20-30% range and probability of expiring worthless and keeping the full premium collection near 70%. We also can see the chosen put strikes were around 10% OTM across these names. If you take the strike minus the option price you have the cost-basis / break-even level for reference.

If we look at the stocks chosen we also find some key themes, mainly mega-cap names over $50B, the lone exception is ADSK which also does not fit the consumer-centric theme and may not be related to the other eight. The stocks chosen are also high quality names with strong performance YTD and non-egregious valuations. The main eight all pay dividends and are considered to be low-volatility safer plays that should outperform in a more turbulent market. The "smart money" trades are essentially showing a willingness to own high quality businesses into another 10% decline while taking in multi-million dollars in premium.

Although naked put selling is not for everyone, I have had this conversation many times with peers regarding the allure of the strategy. In my opinion it almost never makes sense to buy an equity that trades liquid options because it is a much better strategy to sell puts and collect the premium the market is giving you while defining exactly the level you are willing to be a stock owner. It especially makes sense when names you want to own become oversold and implied volatilities rise with the overall market environment allowing for a higher premium collection. And it makes even greater sense when we are in a "baby with the bathwater" situation, basically equities all moving lower together due to a broader risk-off move and not taking into account the micro-level fundamentals of individual stocks. In the current case we are seeing markets weaken on concerns of slower global growth but the data has yet to show a slowdown for US consumers, an area that remains healthy, and also targeting names that outperform in slower growth environments. Looking at things from a more technical basis we have been in a sideways market for nearly two years so as markets move towards the lower end of the range, selling puts can be very effective where time decay of options works in your favor and these short bursts in volatility tend to fade.

In terms of risk-management, selling cash secured puts in always recommended over naked put selling, fully willing and able to take delivery of the stock. The other drawback often mentioned with selling puts is the lack of participation in an upside reversal outside of just the collected premium. One can offset this through a risk-reversal strategy which is a combination of selling out-of-the-money puts and buying out-of-the-money calls, and tend to be most attractive when done for a net credit so you are still utilizing the optimal dynamics of a put sale strategy.