The Blow Off Top - Bottom Trade

The Optionomics Group, LLC

What is a Blow Off Top - Bottom?

All markets usually go through a trading cycle which consists of a congestion phase followed by a period of trending and then a blow off. Depending on the time frame that you are observing, blow offs can occur once or twice a day or they may only occur once in a decade. The important thing to understand is why the blow off occurs and how you can benefit. Almost all blow offs occur at the end of a trending phase that has seen investors become either too greedy or to fearful. If they are too greedy, they will keep buying as they race each other to the top of the market. If they are too fearful, they do the opposite and keep selling to race the other traders and investors to get out of the market. If it is a liquid stock it will fall until the market has a “final capitulation.”

If the current trend doesn’t resolve itself in a rounding top or bottom and prices begin to accelerate at a much steeper angle than a sustainable 45-degree rate, the market will most likely end in a blow off. The blow off phase of the market takes the least amount of time of any of the three phases but may result in the most price movement. The blow off occurs when the weak hands get squeezed to the limit. They can no longer fight the trend and they are forced to cover, most likely due to lack of capital or margin calls that must be met. During the blow off phase, price and time may become infinite, meaning price reaches a vertical move of close to 90 degrees. Every tick is either higher or lower, the weak hands become price insensitive and the only thing they are concerned with is ending the pain. The extent of the blow off attracts “new money” which replaces the old ‘weak hands’ which have now vacated their positions. The strong hands begin to take profits. They may also join the new money in changing directions. When this happens the classic “V” chart pattern is formed. Eventually everything returns to equilibrium and a new market pattern begins.

Classic “V” Blow Off Bottom

The above chart shows a classic 'blow off' bottom for TSLA. The stock had been in a steady decline for a couple of weeks and then gapped down reaching a low of around $244 on 04/02/18. As with most blow offs, the stock turned on a dime and traded back above $300 three days later. That is the kind of action you want.

How To Trade A Blow Off Top - Bottom

As with all Optionomics' Strategies and Trades, the Opinions and short-term trading signals provided by Market Edge (www.marketedge.com) play an integral part in trading blow off tops and bottoms. Market Edge follows over 4,000 stocks on a daily basis using a variety of propriety tools to produce computer generated alerts which signal when a blow off top or bottom pattern is forming. In addition, Market Edge has an uncanny ability to identify at which point a stock is close to or has reached its peak or through.

Nearly all traders know what a blow off pattern looks like. Unfortunately, most don't know how to take advantage of this great trading opportunity. They are paralyzed by the rally or break and cannot tell when the weak hands can no longer hold on. Market Edge removes this fear and allows you to take advantage of the situation as "new money" enters the market and the stock begins to go in the opposite direction. One thing is always common when a stock is in the blow off phase. Option premiums (Vega) go through the roof. The volatility may be double or triple the normal level as the weak hands get squeezed.

There are many trades that can be used when a stock is in a blow off phase. Rather than give you the choice of numerous trades, I will give you one that will mimic 99% of all blow off strategies without complicated execution parameters.

The Blow Off Horizontal Spread

This trade, as with all Optionomics recommendations has limited risk and either limited or unlimited reward depending on how the trade unfolds. When the blow off occurs, the premium levels in the options will be at their peak as the wrong side hands will have been squeezed to the maximum. Here's how you can take advantage of this situation.

Blow Off Top Horizontal Trade (Bearish): Let's assume that Market Edge has a bullish opinion for AAL which has been in an upward trend for a while but has gone vertical over the past week. The trade is setting up as a classic "short squeeze" and Market Edge is signaling that the stock is very overbought and that an upside blow off is in the works. The first thing you should do is to ***buy*** a deferred, ***ITM*** +1, +2 or +3 ***anchor put***. Whichever strike you use is a "traders' choice". There is no right or wrong answer. It is a matter of how much risk you want to take. I prefer to buy the next weekly serial ***(put).*** Since we are expecting a rapid price reversal to the downside, I would stay fairly close to the ATM. This will give you plenty of punch if the reversal occurs. The second step is to ***sell a bearish,*** weekly-vertical call credit spread in the expiring serial. This credit will help to finance the deferred put. If the trade doesn't hit immediately, you could continue to ***sell*** the weekly-vertical call credit spread. For this example, we will use AAL. The Total Cost for the trade is $3.58 which is the difference between the credit spread's strike prices ($1.00) minus the credit spread ($0.42) plus the anchor put debit ($3.00). The trade would look like the following:

Bearish - Blow Off Top Horizontal Trades

Stock	Open Date	Open Stock Price	Combo Short Call 06/25/20 Strike Price	Combo Long Call 06/25/20 Strike Price	Combo Long Put 07/02/20 Strike Price	Total Combo Spread Cost	100% Target	Max Risk	% Risk Capital Max Risk
AAL	06/21/19	$41.49	41.5	42.5	44.0	$3.58	$7.16	$4.58	2.3%

Blow Off Bottom Horizontal Trade (Bullish): If the stock is blowing off to the downside, you would do a mirror trade. You would ***buy*** a deferred ***ITM*** -1, -2 or -3 ***anchor call*** and then ***sell a bullish*** weekly-vertical put credit spread to finance the trade. As in the above example, I prefer to buy the next weekly serial ***(anchor call)***, but you can use any serial that you feel comfortable with. It is all about the amount of risk that you feel is appropriate. If you are aggressive, you may want to buy the call which is closer to the current ATM which will be more expensive. If the trade doesn't hit immediately, you would continue to ***sell the weekly put credit spread***. For this example, we will use ULTA. The Total Cost for the trade is $9.25 which is the difference between the credit spread's strike prices ($5.00) minus the credit spread ($1.80) plus the anchor call debit ($6.05). The trade would look like the following:

Bullish - Blow Off Bottom Horizontal Trades

Stock	Open Date	Open Stock Price	Combo Short Put 06/25/20 Strike Price	Combo Long Put 06/25/20 Strike Price	Combo Long Call 07/02/20 Strike Price	Total Combo Spread Cost	100% Target	Max Risk	% Risk Capital Max Risk
ULTA	06/21/20	$250.33	250.0	245.0	245.0	$9.25	$18.50	$14.25	7.1%

Managing Your Trades

Check the Optionomics web site on Monday, Tuesday and Wednesday around 3:00 pm EST to access the blow off trades. Managing the spreads is simple. Either hold the credit spread position and anchor put or call until Friday's expiration or sell the anchor put or call during the week. If the spread doubles, it is usually a good idea to close the trade and pocket the doe. A double occurs when the trade can be closed at twice the Total Cost amount and is listed on the trade ticket as 100% Target.

If the spread is worthless, the trade is over. If both legs of the spread are in the money, you can either buy the spread back within a tick or two of parity before Friday's expiration or allow the OCC to assign one leg and exercise the other leg for you**.** If only one leg of the spread is in the money, it is best to buy that leg back as it is your short leg and let the long leg run. In this scenario, you have created a ***'Free Roll'*** and if the stock goes your way, you have unlimited reward and limited risk.

What you can Expect

Frequency Of Play:	Weekly
Investment Option Time Horizon:	Three – Five Days
Maximum # Of New Plays Per Week:	Three - Five
Maximum # Of Open Positions:	Five
Risk Tolerance:	Medium
Option Experience:	Medium
Suggested Amount Of Risk Capital To Trade All Of The Traders Selections:	$20,000

Summary

The Blow Off Top - Bottom Trade is one of the best ways to benefit from blow off situations. When Market Edge indicates a Blow Off is likely, you sell a vertical credit spread and use your credit to finance an option in the direction of the probable Blow Off. These trades have limited risk but offer substantial reward over a short-term time frame. As with all Optionomics' trades, you should limit your risk to no more than 3-4% of your available risk capital. Using this guide line will assure you that over the long run, you will be able to take advantage of this great opportunity.

					Traders Worksheets							
Week Start:						**Market Posture:**						
Bullish Blow Off Bottom - Put Spread - Long Deferred Call - (Short Put Above Long Put)												
		Open	Short-Exp	Long-Exp	Open	Long-Deferred	Open	Open		Close	Close	Total
Open	Stock	Stock	ATM Put	ATM -2 Put	Spread	ITM - Call	Call	Combo	Close	Stock	Combo	Profit
Date	Symbol	Price	Strike	Strike	Credit	Strike	Debit	Debit	Date	Price	Credit	Loss
			/	/		/						
			/	/		/						
			/	/		/						
Bearish Blow Off Top - Call Spread - Long Deferred Put - (Short Call Below Long Call)												
		Open	Short-Exp	Long-Exp	Open	Long-Deferred	Open	Open		Close	Close	Total
Open	Stock	Stock	ATM Call	ATM +2 Call	Spread	ITM - Put	Put	Combo	Close	Stock	Combo	Profit
Date	Symbol	Price	Strike	Strike	Credit	Strike	Debit	Debit	Date	Price	Credit	Loss
			/	/		/						
			/	/		/						
			/	/		/						
Totals---->			**$ P/L**		**# Wins**		**# Loss**		**Win %**		**# Trades**	
Bullish Put Verticle Spread - (Short Put Above Long Put)											Close	Total
Open	Stock	Open	Short-Exp	Long-Exp		Open			Close	Close	Stock	Profit
Date	Symbol	Price	ATM Put	ATM -1 Put		Credit			Date	Spread	Price	Loss
			/	/								
			/	/								
Bearish Call Verticle Spread - (Short Call Below Long Call)											Close	Total
Open	Stock	Open	Short-Exp	Long-Exp		Open			Close	Close	Stock	Profit
Date	Symbol	Price	ATM Call	ATM +1 Call		Credit			Date	Spread	Price	Loss
			/	/								
			/	/								
Totals---->			**$ P/L**		**# Wins**		**# Loss**		**Win %**		**# Trades**	
Bullish One-Day Wonder Trade - (Short Exp Call Above Long Def Call)												
						Open			Close			Total
Open		Open	Short-Exp	Long-Def		Debit	100%	Close	Stock	Close		Profit
Date	Symbol	Price	+1, +2 Call	-1, -2 Call		Spread	Target	Date	Price	Spread		Loss
			/	/								
			/	/								
Bearish One-Day Wonder Trade - (Short Exp Put Below Long Def Put)												
Long Deferred Put Above Short Expiring Put						Open			Close			Total
Open		Open	Short-Exp	Long-Def		Debit	100%	Close	Stock	Close		Profit
Date	Symbol	Price	-1, -2 Put	+1, +2 Put		Spread	Target	Date	Price	Spread		Loss
			/	/								
			/	/								
Totals---->			**$ P/L**		**# Wins**		**# Loss**		**Win %**		**# Trades**	
						5						
Weekly Total:		**$ P/L**		**% P/L**		**# Wins-# Loss**			**Win %**		**# Trades**	