

Update of Analysis of HUI Option Open Interest

By Adrian Douglas

This is a follow-up article to my essay entitled “Explosive Rise in Gold Mining Shares Has Been Coming – Now We Know Precisely When”

<http://www.lemetropolecafe.com/pfv.cfm?pfvID=5010>

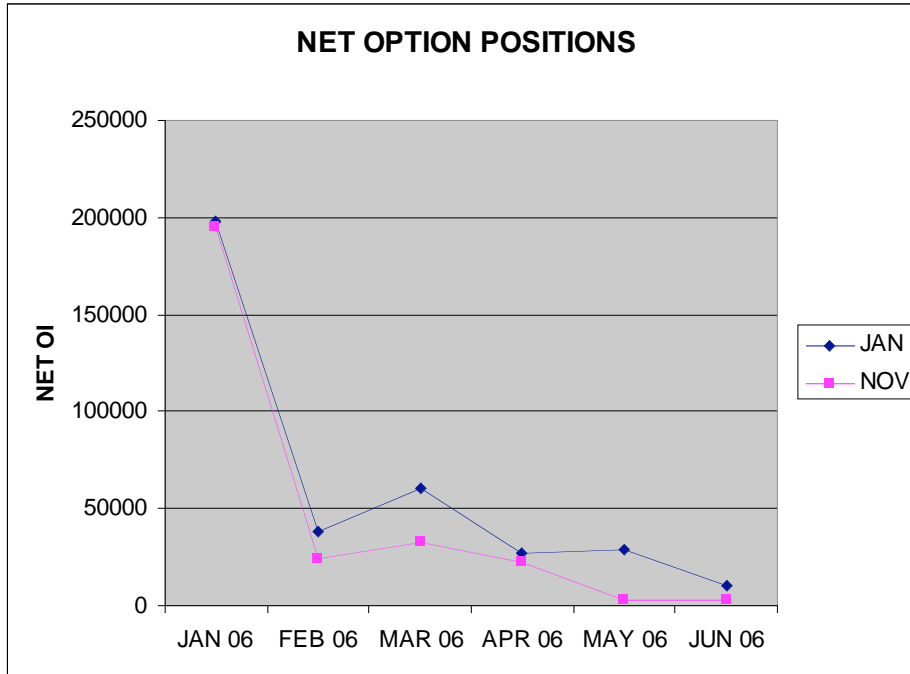
In that article published November 13, 2005 I showed that there was an unusually big build-up of call options across the mining stocks that make up the HUI. I concluded that some big money investors were positioning themselves for a large move in January 2006 because it was the Jan Calls where most of the calls were concentrated.

After that article some café members e-mailed me and pointed out that January may be showing an unusually high call option open interest because it is a LEAP month. For those not familiar with options long dated options beyond one year expiry are called LEAPS and these are typically available for the month of January. I responded that some of the volume could be accounted for by that but I had been watching the OI of some stocks options and they had dramatically increased in the September to November timeframe and so I knew a lot of the increase in some shares was not due to long ago LEAP purchases.

I have now looked at the option positions again. The graph below shows the net positions (call volumes minus put volumes) for each month as they were in November and as they stand today.

What can be seen is that there is still a huge net call open interest in the January options. The net position has increased slightly but this masks the fact that calls have increased from 423,000 to 489,000. Because a similar amount of Puts have also been purchased the net position has not changed. But even while there are other months to choose from with longer expiry, the build up in call options has continued for January. Other months do show a net increase in call volume but the January call volume has increased by 40% more than the largest increase seen in any other month! This is new buying and not related to long ago purchases of LEAPS it also suggests that January is a highly favored month for a large move in the HUI.

During the November to end of December period the sentiment indicator published by Hulbert (HGNSI) which quantifies the bullishness of gold newsletter writers dropped from 50% to 28.6%. So the increase in call volume is not irrational exuberance of the general public, on the contrary, it suggests contrarian investment going against the general flow.



The HUI option positions are still indicating a very bullish outlook for gold mining stocks. These option positions could well explain why the majors have been moving recently and not the juniors. Most juniors do not have option chains available for purchase. Only the majors and large cap juniors have options available. Option writers would need to do some delta hedging and purchase stock against these calls.

If the build-up in options is indicating a big move then ALL the gold mining stocks are going to follow because many have large short positions accumulated in them which will need to be covered and the panicked shorts will create a buying frenzy.

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