Apple 2.0 Mac news from outside the reality distortion field

Is Apple's share price being manipulated?

21 comments

By Philip Elmer-DeWitt May 12, 2011: 1:00 PM ET

There's something very fishy about the weekly options market. Is it time to reel in the bad guys?

It was 3:48 p.m. on Friday April 29 and traders who had purchased Apple (AAPL) April 29 $350 "calls" -- options that gave them the right to buy Apple shares in blocks of 100 for $350 per share -- were sitting pretty. The stock was trading around $353.50 and those calls were worth more $350 apiece (the difference between the price of the stock and the so-called "strike price" of the option times 100).

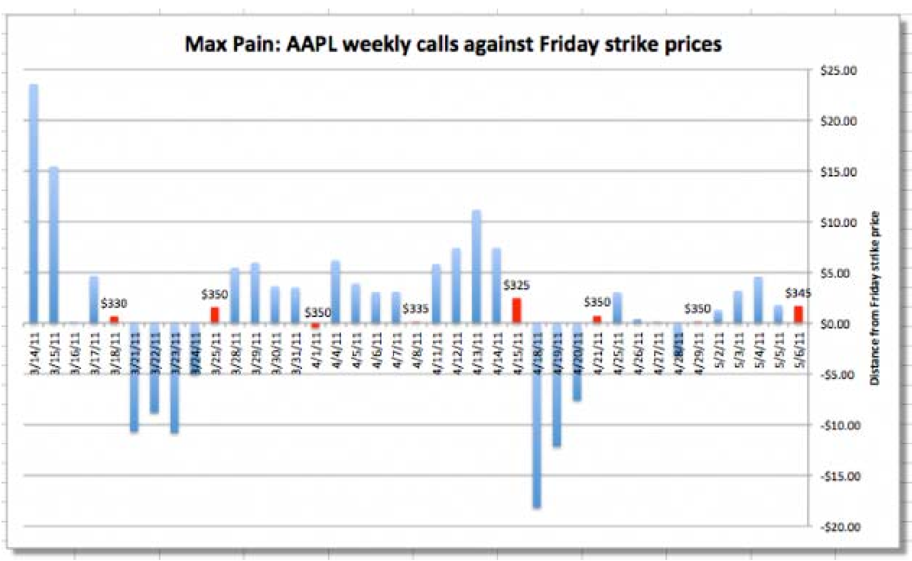
April 29, 2011: AAPL's share price fell to the 350 strike price in the last 12 minutes of trading

Then, in an extraordinary burst of trading -- exacerbated by the rebalancing of the NASDAQ-100 scheduled for the following Monday -- more than 15 million shares changed hands and the stock dropped below the $350 strike price just before the closing bell. Result: The value of those calls disappeared like a puff of smoke.

For people who follow Apple -- investors and speculators alike -- it was sickeningly familiar turn of events, one that has its own language and terms of art. The tendency for an underlying stock to close at or near an option's strike price at expiration is called "pinning." And the point at which a stock will close to the greatest detriment to anyone holding options at expiration is called max pain. There are websites, like maxpain.com, that will chart, free of charge, the max pain point for any stock for which options are traded.

Conventional wisdom has it that Apple's shares have been pinned to the max pain point nearly every Friday since weekly options trading began. Based on the stock's closing prices over the past two months, it certainly seems that way.

In the graph below, we've charted eight weeks of daily closing prices indicating how much higher or lower they were than the strike price of the calls nearest to that Friday's close (marked in red).



As you can see, the stock tends to gravitate toward the red closing strike price, either by moving down (reducing the value of the calls) or moving up (doing the same to the "puts," options that give the holder the right to sell a stock at a certain price).

Note that the daily chart tends to mask minute-by-minute changes. For example, you would never know, looking at the tiny red bar at April 29 in the chart above, what happened to Apple's share price in the last few minutes of trading that day.

There's a whole library of academic research documenting the max pain phenomenon. Perhaps the most famous is a 2005 study in the *The Journal of Financial Economics* that the *New York Times* reported on the following year. The authors, working at the University of Illinois, examined five and a half years of stock trades and found the pattern charted at right. The percentage of securities that closed within a few cents of the strike price of one of their options was too great to be attributed either to chance or to normal hedging activity. The shares, they concluded, had been manipulated.

Source: Sophie Xiaoyan Ni, Niel D. Pearson and Allen M. Poteshman via The New York Times

For the record, manipulating a stock in this way is illegal. The operative language can be found in Section 9 of the Securities Exchange Act of 1934:

> "It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—
>
> h. To effect either alone or with one or more other persons any series of transactions for the purchase and/or sale of any security registered on a national securities exchange **for the purpose of pegging, fixing, or stabilizing the price of such security** in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." (emphasis ours).

How is this manipulation being accomplished? Who is doing it? And why aren't they being punished? Those are very good questions, which we'll try to address in subsequent articles.

Posted in: **Apple**, **Calls**, **Financials**, **Manipulation**, **Max pain**, **Options**, **Pinning**, **Puts**, **Share price**, **Stock**, **Strike price**, **Trade**

More from Apple 2.0

Is Apple's share price being manipulated?

Surprise: 50% of iPad subscribers click "Allow"

Apple's iPhone 'dead in the water'? Really?

VIEW ALL

Join the Conversation

CNNMoney

Warning: A browser setting is preventing you from logging in. **Fix this setting to log in**

osxcloner, 11 minutes ago

Wallstreeters. Watch what you say and to whom and How you do it.

jmmxx, 33 minutes ago

Of course we do have to remember the basic scientific principal that coincidence does not equal causality.

While I certainly DO believe that there are likely incidents of stock manipulation, especially around Apple, I would like to point out that there are several alternative explanations for the data given.

1- In general: If you look at the outstanding number of call/put contracts for a given point in time, the volume typically clusters near to the... show more

grhgr, 37 minutes ago

Is Apple's share price being manipulated? Of course! Probably more than the average stock because of its high visibility. Ever notice how it gets a considerable bump up after Cramer the Clown makes a positive comment about AAPL? Scary!

BMWTwisty, 37 minutes ago

...and this is a surprise, how????

Thanks for shedding some interesting light, PED, on what everyone has suspected has been taking place for years. Good article. I won't hold my breath waiting for the gummint to do a damn thing about it, though.

1gale2, Today 02:58 PM

I do read Mr. Dewitt's presentation with interest but this one is dealing with a complicated aspect of investments. There are so many "sides" - .maximum pain for whom- for the option owner and writer. Right here we are talking about a limited population of investors and to propose that somebody is taking pain (remember the sellers of AAPL may not be same group of investors involved in this scheme) to manipulate the... show more

1 2 ... 5 Next