Trading Strategy : Intraday Momentum trade on short covering/long unwinding

Strategy Identifier : Intraday_Momentum_OI

Type of Strategy : Wealth Creation, Long Volatility

Trading Logic :

- Strategy works on changes in open interest.
- Increase in open interest of any option near spot price implies that the option strike is solidifying its position as support/resistance.
- Decrease in open interest similarly indicates weakening of support/resistance at the strike.
- Core Idea is to identify the direction in which open interest is getting reduced as that leads to short covering or long unwinding. If the change direction is identified a momentum trade can be initiated in that direction.

Market & Instrument

- Nifty Index (good intraday volume and volatility)
- Can be later extended to BankNifty and other liquid stocks in the expiry week.

Expiry

- Closest

  (Note – Might need to be revisited for Monday and Tuesday based on the test results)

Candle Timeframe

- 3 min/5min

Entry Timeframe

- After 9:30
- Reenter whenever conditions exist before 2:30

Indicators Used

- Options Open Interest
- VWAP

Entry Rules

- Identify 10 strikes (5 below spot, 5 above spot) from the nifty spot level.
- Calculate strike level for Max Call Buildup (MaxOICallStrike)

- Calculate strike level for Max Put Buildup (MaxOIPutStrike)
- Calculate Distance from Spot
  - CallStrikeDistance = MaxOICallStrike – Spot
  - PutStrikeDistance = Spot – MaxOIPutStrike
- Identify CallOrPut
  - Call if CallStrikeDistance < PutStrikeDistance else Put
- If Call (Long Entry)
  - Choose CallStrike as nearest to Nifty Spot on the upper side (For e.g. if Spot is 25965 choose 26000). Keep on Updating CallStrike till entry is found
  - From 9:30 onwards
    - Calculate Change in Call OI at CallStrike.
    - If Call OI at CallStrike is unwinding then check if the option price is trading above VWAP.
      - If Option Price > VWAP, Buy Option
- If Put (Short Entry)
  - Choose PutStrike as nearest to Nifty Spot on the lower side (For e.g. if Spot is 25965 choose 25950). Keep on Updating PutStrike till entry is found
  - From 9:30 onwards
    - Calculate Change in Put OI at PutStrike.
    - If Put OI at PutStrike is unwinding then check if the option price is trading above VWAP.
      - If Option Price > VWAP, Buy Option

Stop Loss

- 25 percent of the initial option price till the time the option does not gain 10 percent value. Wide range is kept at start to allow the market to settle down. After the option price becomes greater than 1.1 times of buy price exit rules defined below would kick in.

Target / Exit Rules

- Time-based exit: All positions to be exited between 2:50 and 3:00 PM
- Price-based exit : Profit to be trailed by 10% of the option value once the level of 1.1 times the buy price is reached.

Position Sizing

- Risk 1% of total trading capital per trade
- Calculate position size based on stop loss distance and risk amount

Trade Management

- Do not add to losing positions
- Strategy is suited to event days

Appendix

Short Covering:

Short covering occurs when a trader or investor buys back the securities they had previously sold short in order to close out their short position. A short sale involves selling a security that the seller does not own, with the expectation of buying it back later at a lower price to realize a profit. When the trader buys back the security, it's called covering the short position.

For example, let's say you sell short 100 shares of XYZ stock at ₹100 per share, expecting the price to drop. Later, the price falls to ₹90 per share. You can buy back the 100 shares at ₹90 per share, returning the borrowed shares, and pocket the ₹10 per share difference as profit.

Long Unwinding:

Long unwinding, on the other hand, occurs when a trader or investor sells securities they had previously bought (or are "long" on) in order to close out their long position. This typically happens when the trader expects the market to decline or wants to book profits.

For instance, let's say you buy 100 shares of XYZ stock at ₹100 per share, expecting the price to rise. Later, the price reaches ₹120 per share, and you decide to sell the shares to book profits. This would be an example of long unwinding.

In summary:

- Short covering: Buying back securities to close a short position (previously sold).

- Long unwinding: Selling securities to close a long position (previously bought).