TRADING

# ODTE:
# the risky breakthrough of ultra-speculation

Ultra-short-term options, known as 'Zero Day Options' (or ODTEs), are options that expire on the day they are purchased. Unlike traditional options, which can last from a few days to several months, ODTEs allow investors to bet on market movements over very short periods. For the time being, they mainly concern the major stock market indices, but there is a growing desire to extend them to large caps such as Nvidia or Tesla, which could become a reality in 2025. But what are the risks? Valérie Noël, Head of Trading at Syz Bank, takes a closer look.

**What are the advantages of these zero day options?**

Used mainly by high-frequency traders and retail investors, these options offer the prospect of almost immediate and relatively high profits, but with an equally high level of risk. The idea is to exploit intraday variations in indices to generate quick profits - a tactic that particularly appeals to those looking to capitalise on sudden movements.

**These options have been hugely successful since they first appeared on the markets. Is this still the case?**

Since their launch in 2022, ODTEs have seen an impressive success, sometimes accounting for as much as 50% of the total volume of options on the S&P 500, according to JPMorgan data. This success continues to this day, although there are some nuances. For example, when the S&P 500 fell 3% on 7 August, investors preferred longer-term options, seeing them as a more reliable hedge against prolonged volatility. The share of ODTE options in the volume of options traded fell to 26% during this crisis, compared with an annual average of 48%. This phenomenon shows that, despite their popularity, these ultra-short options are not seen as an ideal hedging tool in stressed market conditions.

**The original fear was that the extreme volatility of these options would disrupt the proper functioning of the indices concerned. The verdict?**

ODTEs are inherently volatile, and some experts fear that they could, in specific circumstances, affect the stability of major indices such as the S&P 500. So far, the disruptions have not been as pronounced as some had feared, but caution is still warranted. Some analysts warn that these options have the potential to amplify volatility in the event of a market crisis. For example, the combination of strong take-up of ODTEs and other products such as ODTE ETFs could trigger a volatility crisis similar to the 'Volmageddon' of 5 February 2018. For the record, that day was marked by a sudden spike in market volatility that resulted in the loss of more than 90% of the value of some short-volatility ETP products. In other words, if these products are used disproportionately in panic situations, they could exacerbate market movements rather than stabilise them.

**There is now talk of extending these assets to private companies such as Nvidia or Tesla. Is this a good idea?**

Unlike indices, which are diversified by nature, the shares of these companies are more sensitive to sudden fluctuations. The ODTE applied to individual stocks could significantly increase the volatility of these securities, especially for companies already known for their sensitivity to market movements, such as Tesla. A spike in volatility could lead to instability not only in their share price, but also in the markets' perception of them - a crucial factor for large-cap companies that need to maintain investor confidence and a degree of stability. This raises the question of the appropriateness of offering this type of option on individual high-risk securities.

**Are there safeguards in place to avoid repercussions for the markets and the target companies? Or is it necessary to create them?**

Mechanisms such as limits on trading volume or restrictions on high volatility could help prevent flash crashes or violent fluctuations that could undermine market stability. In addition, regulators could consider imposing limits on the quantity of ODTE that can be traded during periods of extreme volatility to minimise the risk of a snowball effect in the event of a crisis. This would mitigate the potentially destabilising impact of these options on the underlying securities.

**At a time when short-termism is already the target of criticism, how is this expansion of ultra-short-termism perceived?**

This type of option feeds strategies focused on quick gains and increases volatility, which can make markets more fragile. Critics argue that this accentuates excessive speculation, to the detriment of a long-term view, posing challenges for both companies and investors over the long term. Ultimately, the perception of this trend towards the ultra-short term is mixed: it meets the needs of speculators but worries those who fear that markets are becoming increasingly prone to instability.

**Haven't we opened Pandora's box with zero day options, potentially setting the stage for future devastating flash crashes on the markets?**

Due to their speed and high leverage, these options could indeed trigger flash crashes under certain circumstances. For example, if a critical mass of investors decides to sell or buy ODTEs in a panic, this could trigger chain reactions in the market. With the rise of high-frequency trading technologies, the risk of snowball effects is heightened, highlighting the importance of increased regulation and oversight of these products. The authorities will probably need to take a closer look at this segment to ensure that innovation does not compromise the overall stability of the financial system.