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**From:** Ens, Amanda [REDACTED]  
**Sent:** Thursday, April 20, 2017 1:51 PM  
**To:** jeffrey E.; Richard Kahn  
**Subject:** Buy cheap downside: SPX puts contingent on rates

Jeffrey, Rich,

Given the current macro uncertainty, large recent move in rates, high correlation between SPX and 10y yields and resilience in equities, to the extent you still have long equity positions, we like buying SPX puts contingent on higher yields, which price at significant discounts vs vanilla puts.

In this example, we need the 10y swap to get back above ~2.35%, which is not a high bar considering it was above 2.50% just last month.

\* Sep 15th 95% Put contingent on 10y constant maturity swap rates (CMS) > ATMF +10bps (2.35%) at maturity: 74 bps offer, 61% discount to vanilla put

**Rationale:**

1. Recent economic data has been disappointing (march NFP, inflation, etc) and that has dragged yields lower. Over last month, 10yr yields have come in ~40bps – 2.16% now. It would take only a quick string of better data (and the bar is low!) for 10yr rates to sell off a bit (higher in yield)
2. SPX has been resilient during this period: down only 2% from all-time high in early March but this iron-clad performance should be hedged

**Catalysts:**

Over the coming weeks and months, SPX faces several headwinds – geopolitical risks (French elections, Syria, North Korea), domestic policy uncertainty (tax reform, protectionism) as well as earnings expectations for Q1.

Meanwhile, the Fed has started talking about shrinking its balance sheet, which should support 5-10yr yields even if risk got re-priced in the equity market.

**Favorable Pricing**

SPX/USSW10 implied correlation is still high: ~30%; above recent realized (graph below)

Investors worried about a pull-back in equities can leverage this correlation to get significant discount vs SPX puts.

Trades:

Sep 15th 95% Put contingent on 10y constant maturity swap rates (CMS) > ATMF +10bps (2.35%) at maturity: 74 bps offer, 61% discount to vanilla put

Sep 15th 95% Put contingent on 10y CMS > ATMF +25bps (2.50%) at maturity: 55 bps offer, 70% discount to vanilla put

Dec 15th 95% Put SPX put contingent on 10y CMS > ATMF +25 (2.54%) at maturity: 88 bps offer, 69% discount to the vanilla

We can easily price other strikes, maturities and iterations.

SPX/USSW10 90 day daily realized correlation

Source: Bloomberg

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