
From: Ens, Amanda <[REDACTED]>
Sent: Friday, February 24, 2017 8:22 PM
To: jeffrey E.; Richard Kahn
Subject: RE: Cheap hedge

I wanted to follow up on the best-of-put idea we discussed a while back.

1. Markets are near all-time highs
2. Implied volatility is low (but tends to pick up in = sell-off, benefitting this trade)
3. Implied correlation is low (but tends to pick up in=a sell-off, benefitting this trade)

==> Best-of-puts thus look very attractive<=o:p>

Given high client interest recently in best-of-puts,=here is a list of the top 10 lowest premium strategies for 6 month 95% bes=of-puts struck on 3 sector ETF underlyings.

ETF underlyings + premium: &nbs=;

XLB .1

XLU .1

XLV .1

0.93%

XLB .1

XLU .1

XLY .1

0.99%

XLB .1

XLK .1

XLU .1

1.00%

XLE .1

XLU .1

XLV .1

1.00%

XLU .1

XLV .1

XLY .1

1.01%

XLB .1

XLF .1

XLU .1

1.04%

XLK .1

XLU .1

XLV .1

1.04%

XLI .1

XLU .1

XLV .1

1.05%

XLE .1

XLK .1

XLU .1

1.06%

XLF .1

XLU .1

XLV .1

1.07%

XLE .1

XLU .1

XLY .1

1.07%

XLB .1

XLE .1

XLU .1

1.09%

XLK .1

XLU .1

XLY .1

1.10%

XLF .1

XLU .1

XLY .1

1.11%

XLI .1

XLU .1

XLY .1

1.11%

Implied correlation (as measure by SPX vs its underlying components) has fallen to multi-year lows. This drop in correlation, as well as the drop in implied volatility cheapens the cost of this option.<=:p>

Generally, as markets fall in value, realized correlation has historically picked up. Given this is a put structure, an uptick in realized correlation on the downside makes the put more valuable.

Graph below shows the 1-month moving average correction based on price movements for XLB-XLU-XLY.

Source: Bloomberg

Regards,
Amanda

From: Ens, Amanda
Sent: Thursday, December 15, 2016 9:22 AM
To: 'Jeffrey E.'; 'Richard Kahn'
Subject: Cheap hedge

While we are still constructive equities and see further upside potential, given the large recent moves and our binary view of the markets for 2017 (+20% bull case / -30% bear case - see below), buying cheap tail protection to hedge a long equity portfolio is prudent.

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You can achieve significant savings on a tail hedge by monetizing the low correlations between sectors that we have seen in the multi-year bull market. In a tail event, correlations generally move towards 1 as you know very well.

Buy a best-of-put on 3 sectors: tech, consumer-discretionary and utilities

- * Underlying ETFs: XLK (Tech Selector Sector S=DR), XLY (Consumer Discretionary Select Sector SPDR), XLU (Utilities Select Sector SPDR)
- * Your payoff is on the best performing of the 3 sectors
- * 95% strike

- o 6 months: 1.0% premium

- o 1 year: 1.85% premium

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This is ~64% savings compared to a 6 month SPX 95% put (2.75%) and a 1 year SPX 95% put (5.1%)

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We like the best-of-put because all three sectors are near cycle or all-time highs and should all be vulnerable in a large market pullback, especially in a tail event. Even utilities, a defensive sector, are less safe in our view given elevated valuations and crowding. Our utilities analyst sees 10% downside to the sector with the 10y at these levels (2.62% today) and 16.7% downside at 3.0%.

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There is a high amount of potential leverage on this trade – for example, on the 1 year best-of-put, if the sectors were all down > 20%, you would have 8.1x payoff of your premium (15%/1.85%).

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<http://rsch.baml.com/r?q=Xs2Bc=MU6pTCNQsJR2M5Jw&e=amanda.ens%40baml.com&h=1PXT6Q> US Equity Strategy Year Ahead: 2017 – the year ahead: Euphoria or fiscal fizz? <http://rsch.baml.com/r?q=Xs2Bc6MU6pTCNQsJR2M5Jw&e=3Damanda.ens%40baml.com&h=1PXT6Q>

Savita Subramanian thinks 2017 could be anything but normal – Subramanian notes that if the market moves from skepticism to euphoria then the S&P 500 could trade as high as 2700 in a bull case scenario. Meanwhile, applying typical (not extreme) recessionary returns to current S&P 500 levels yields a bear case scenario of 1600. Her base case is a year-end 2017 S&P500 target of 2300.

10 Year Graph: XLY, XLK, XLU

Source: Bloomberg

Regards,

Amanda

Amanda Ens

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