
From: Ens, Amanda <amanda.ens@bankofamerica.com>
Sent: Friday, August 5, 2016 4:06 PM
To: jeffrey E.; Richard Kahn
Subject: RE: MEGA Action: Post NFP Trades: Hedge US Credit, Buy Financials, Buy USD proxies, Buy Biotech

Jeffrey, sounds great. Would this afternoon after 1:30pm ET work for you? I'd also like to introduce my colleague Greg Kaldor (his bio is below.)

Greg Kaldor is a Managing Director in the Macro & Equities Global Alpha Group (MEGA) based in New York. In this position, Greg is responsible for generating robust and executable trade ideas through cross referencing our macro and equity research with positioning and flow data.

Greg joined BofA Merrill in Sydney, Australia in 1985 and has spent the following 30 years in a range of leadership roles across fixed income and currencies; trading and structuring FX interest rate products and now equities. Most recently, Greg held the position of Managing Director in FX Institutional Sales in New York, where he covered senior macro Portfolio Managers as well as writing strategically on alpha opportunities.

Prior to this role, Greg was the Global Head of FX structuring, a London-based position where he was responsible for running the firm's institutional FX sales business until 2008. Greg later joined a London-based hedge fund implementing systematic hedging strategies for FX markets.

Prior to this role, Greg was as an FX option trader and later an FX option structurer in New York.

Greg holds a Bachelor of Commerce in Accounting and Finance from the University of New South Wales in Sydney, Australia.

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From: jeffrey E. [mailto:jeevacation@gmail.com]

Sent: Friday, August 05, 2016 11:54 AM

To: Ens, Amanda; Richard Kahn

Subject: Re: MEGA Action: Post NFP Trades: Hedge US Credit, Buy Financials, Buy USD proxies, Buy Biotech

amanda lets talk today

On Fri, Aug 5, 2016 at 10:01 AM, Ens, Amanda <[REDACTED]> > wrote:

The Tail Hedge: Buy Puts on IG Credit. A Dec LQD 98% Put (\$120.00) costs 1.29% (\$1.55, ref: \$122.80, 7.6 vol, 38 delta) or sell JGBs.

MEGA Action: Strong US payroll data risks steepening of US yield curve - tail hedge US credit exposures.

- * Post Strong US Payroll Data we still see a December US rate hike.
- * Growing hike expectations will steepening the US and Japan yield curves. The question is how do Risk Parity funds handle "The Great Rotation" as US equities continue to look more attractive than Fixed Income?
- * Financials and Healthcare and Technology to outperform Utilities and Staples.
- * USD should also benefit as the US yield curve steepens.

- * There is a chart pack below.

What is the Trade?

1. The Tail Hedge: Buy Puts on IG Credit. A Dec LQD 98% Put (\$120.00) costs 1.29% (\$1.55, ref: \$122.80, 7.6 vol, 38 delta) or sell JGBs.
2. Financials Outperformance: Buy Regional Banks Call. A Dec KRE, 103% Call (\$42) costs 3.8% (\$1.60, ref: \$41.65, 23.0 vol, 36 delta)
3. Or buy a 6M ATM worst-of {XLF (financials) call, XLU (utilities) put} for ~1.38% (65% discount to the average vanilla option)
4. Post earnings – Buy Healthcare & Biotech on improved outlook: Buy Calls on Bio-Tech Index. A Dec 104% (\$310) IBB Call costs \$12.70 (4.1%, ref \$296.00, 26.0 vol, 41 delta)
5. USD Strength Trade: Short the BAML “Weak USD Winners Equity Custom Basket”, MLDIUSDC Index.

Rationale

US Payroll data was a very strong report showing that the economy can resume a higher trajectory of growth into the second half of the year and the Fed can deliver a hike in December.

- 1) NFP was up 255K with net positive revisions of 18K. The 6month moving average of 189K suggests a solid pace of growth.
- 2) Household jobs surged 420K, reversing the recent few months of weakness. This offset the increase in the labor force participation to 62.8 from 62.7%, which is an encouraging sign for the longer run trajectory of job growth.
- 3) Average hourly earnings increased 0.3%, leaving the yoy rate unchanged at 2.6%, showing that wages are sticking at a higher pace.
- 4) The Unemployment rate held at 4.9% while the underemployment rate (U6) increased to 9.7%.
- 5) Professional & business services saw the strongest job growth of 70,000, though this sector tends to account for a good portion of job growth generally. Only mining and logging (-7k) and information services (0k) were weak.

Post Q2 earnings results, Health Care is now in a strong position to outperform <http://rsch.baml.com/r?q=f3Kv0H2hhlw6fcYbuRtA&e=jeevacation%40gmail.com&h=7Ws4Wg> . The sector saw more positive than negative revisions to estimates on a three-month basis, more positive than negative revisions to sales forecasts and management has been most positive in guidance.

The Nasdaq Biotechnology Index (NBI) has surpassed S&P500 (up 13% vs. 5%) since the end of 1Q, thanks to increased M&A activity and solid 2Q earnings reported by the large-cap biotech companies as a group
<<http://rsch.baml.com/r?q=DcR3HFJAJ9Gr!8M4aKdamg&e=jeevacation%40gmail.com&h=oE91Sw>> . Recent NBI rally suggests a "real" turn in market sentiment post major sector sell-off beginning last August. 62% of S&P 500 companies have beaten on EPS, 52% have beaten on sales and 40% have beaten on both compared to full-quarter historical averages of 53%, 57% and 35%, respectively.

"Global Equity Volatility Insights

<<http://rsch.baml.com/r?q=GCfeDc!MVw2r!8M4aKdamg&e=jeevacation%40gmail.com&h=1H7UoA>> " from June 28 and suggests risk parity fund leverage is high and we do not think the relationships have changed significantly. As correlation between bonds and SPX increases, risk parity leverage increases.

The Bank of Japan's "comprehensive assessment" in Sep MPM is creating intense speculation

<<http://rsch.baml.com/r?q=QnrX!5ChBkWr!8M4aKdamg&e=jeevacation%40gmail.com&h=Hiu8QQ>> . BoJ may make QQE more flexible which would enhance policy sustainability risking steeper yield curve, stronger yen and weaker equity but bank shares to rise. If the BoJ does move to make policy more flexible, we think the focus will be on JGBs, rather than on negative interest rates.

Chart Pack:

Nasdaq Bio Tech Index: Buy Calls on Bio-Tech

US Investment Grade ETF, (LQD in white) and (Shares Outstanding in Green). Buy Puts on IG Credit.

In JGB Futures, 150.60 is an important level for all global fixed income.

Regional Bank ETF (KRE): Buy Calls on KRE

Short the BAML "Weak USD Winners Equity Custom Basket"

This chart is a danger for risk parity funds as bond/equity correlation swings positive.

Greg Kaldor
Managing Director

US MEGA (Macro Equity & Global Alpha)

Bank of America Merrill Lynch
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