

Subject: Re: Jeffrey - latest prices with suggested sizes - Nav [I]
From: Paul Morris <[REDACTED]>
Date: Mon, 21 Apr 2014 13:59:03 -0400
To: Nav Gupta <[REDACTED]>
Cc: [REDACTED],
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Classification: For internal use only

thx pls stay on him, hope you're all well,

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Date: 04/15/2014 07:46
AM

Subject: Jeffrey - latest prices with suggested sizes - Nav
[C]

Classification: Confidential

Jeffrey,

Updated prices and proposed sizes.

1. Buy 10y BTP (March2024). 10y yield is 5bp lower today. I still like eur2mm here 3.125% YTM and suggest work a soft order to add eur1.5mm at 3.25%, eur1.5mm 3.35%.
2. EURUSD spot FX is 1.3802 from 1.3827 yesterday. Suggest buying 2week vanilla 1.40c at 5-6c in EUR 50mm notional (cost EUR25-30k)
3. position for a stronger dollar by buying 1y 5% OTM SPOT EURUSD binary puts at 21% of payout. suggest do half (eur500k payout costing $0.21*500k$) now, and the other half when spot 139-140
4. nationwide coco currently 6.42% offered. I suggest scaling in £2mm on an order at 6.5% and £2mm on order at 6.75%

thanks
Nav

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Date: 14/04/2014
18:17

EFTA01468429

Subject: Jeffrey - 4 trades I like - Nav
[C]

Classification: Confidential

Hi Jeffrey,

There hasn't been much I've really liked recently.
Here are four trades - 3 I like right now and 1 for now or soon.

1) BUY 10y BTPS @ 3.16% - This is a 3-6mth 'buy the rumour sell the fact' tactical trade to position for ECB QE (now)

The ECB is preparing both itself and markets for QE - Its senior board members have stepped up public comments over the past 48hrs. This is the clearest sign so far QE could happen and why I am writing to you now.

Ideally ECB wants to buy ABS from small to medium sized European companies but the outstanding available is relatively small so it will likely buy Eurozone Government Bonds. The spread between Italian BTPs and German Bunds has tightened significantly past 18months but old metrics of value make no sense in Europe because they rely on history when there was no QE.

While It's hard to get excited about 10y BTPs yielding 3.16% (164bp over 10Y German Bunds) I'd still have 5-10mm 10y BTPs in my portfolio both for the duration and spread compression potential. I prefer 10y over 5y because the recent nearly parallel spread compression has left 5s10s steep relative to 0-5s..

3 reasons i like this trade:

- i) macro investors view ECB QE as a second bite at the cherry. Everyone I talk to wants European risk assets having seen QE in the US.
- ii) ECB QE is probably still 3-6mths away which will keep credit bid. This will be a buy the rumour sell the fact trade
- iii) Credit has been bulletproof during the recent risk selloff because a) ECB QE expectations, b) G3 rate hikes are being pushed into the future while cash has nowhere else to go. This price action is telling - as and when equities recover i think credit continues to tighten

Yields of 10Y Italy, 10y Germany and the Yield Spread
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2) Tactically position for higher EURUSD - 2 week view (now)
BUY EUR50mm 2week expiry 1.40 strike European Style EURUSD Calls @ 6bp
(EUR30,000)

This is a low cost contrarian short term tactical call. Most investors myself included are bullish USD in the medium term (see trade 3) but in the very short term I see EURUSD higher because:

i) Despite ECB preparing the markets for QE, the price action of EURUSD (broadly unchanged) has been quite bullish compared to what one would expect
ii) Speculators don't appear long EURUSD to us. Majority are short or flat.
iii) implied volatility is 5.25% (offer for 2week options) which is very very low historically. So this is a penny option, highly convex, pain trade bet against other speculators betting on QE

If my view is wrong 6bp is lost. If i'm right i'd plan to exit in a week making 4-6x

Scenario Analysis - Premium in bp of EUR notional
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3) Position for a Stronger Dollar - 1year view (now or soon)
Buy 1y expiry European style digital binary option on EURUSD struck 5% below spot @ 21% of payout (which i think is too cheap)
Current strike (spot - 5%) would be 1.3120

At expiry if EURUSD has fallen by more than 5% from current levels the option payout is EUR1mm. Upfront premium is EUR210k.
The option is liquid and can be unwound at any time.

i) Yellen has done a poor job of communicating the Fed's thinking but its increasingly clear the Fed will brake later than usual
ii) Betting on higher US interest rates in the rates market isn't cost effective because the forward curve is already pricing in higher rates
iii) The Dollar hasn't appreciated yet because short rates in the US haven't risen meaningfully
iv) THE KEY POINT - FX volatility is very low in currency pairs like EURUSD where central bank policy on each side is increasingly diverging. The low vol makes this bet inexpensive to put on.
v) Because FX vol is so low betting now or soon with a one year time horizon costs very little. id rather be early than late here
vi) i prefer 1y expiry because this trade could take 6-12mths to play out

1Y EURUSD VOL: Low - but then again most most vols are

What I like about EURUSD is that central bank policy on each side is diverging

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This Table shows mid-market premiums (in % of notional) as spot and time change.

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19.5 is mid (offer is 21)

4) Scale into £4mm Nationwide (UK Building Society) 6.875% perpetual which yields 6.4% in GBP and is likely to be called in 5years

European Bank AT1 HyBrid Bonds (aka CoCo's) have rallied significantly. We were unable to get the BBVA issue at the right levels.

A very similar bond which has rallied 30bp less than the BBVA is the Nationwide (UK Building Society) 6.875% perpetual which currently yields 6.4% and is likely to be called in 5years time. It has a tier1 capital trigger of 7% and current tier1 capital ratio is 13% which is fair margin.

The Nationwide one i'm suggesting today is rated Fitch/S&P BB+, its parent is Fitch/S&P rated single-A

The BBVA bond we tried to buy earlier is rated Fitch BB-, its parent is S&P rated BBB-

I suggest scaling £2mm at 6.5% and £2mm at 6.75%. Transaction cost is 6bp from mid.

Yield to call of Nationwide 6.875% perpetual ISIN XS1043181269

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Tazia for any execution, Q&A to me.

Best,
Nav

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