
From: Stewart Oldfield [REDACTED]
Sent: 4/13/2015 4:19:11 PM
To: Paul Morris [REDACTED]
Subject: RE: Portfolio Protection Idea - SPX Puts Contingent on 10y USD Swap Rates [C]

Classification: **Confidential**

I'm generally a fan of hybrid puts for clients who think rates will rise. These are usually held to maturity, but structuring as a spread rather than an outright put makes any early unwind even more complicated than usual for a hybrid.

From: Paul Morris
Sent: Monday, April 13, 2015 4:07 PM
To: Stewart Oldfield
Subject: FW: Portfolio Protection Idea - SPX Puts Contingent on 10y USD Swap Rates [C]

Classification: **Confidential**

What do u think?

Paul Morris
Managing Director
Deutsche Bank Private Bank
Office: [REDACTED]
Cell: [REDACTED]

From: Daniel Sabba
Sent: Monday, April 13, 2015 3:58 PM
To: jeffrey E.
Cc: Vahe Stepanian; Ariane Dwyer; Paul Morris; Richard Kahn
Subject: Portfolio Protection Idea - SPX Puts Contingent on 10y USD Swap Rates [C]

Classification: **Confidential**

Jeffrey – we wanted to highlight this transaction. I particularly like the a 1y 105%/95% SPX Put Spread contingent on 10y constant maturity swap > 3% at expiry explained below.

Transaction rationale:

- Many investors have benefited of the secular bull market for bonds started in 1981 to construct US equity/bond portfolio allocations that have yielded high risk adjusted returns. Investors have become reliant on what has often happened over the past three decades: a rally in bonds follows a sell-off in stocks, and vice versa.
- As tightening by the FOMC is perceived by the market as the next step, many investors have expressed concerns their asset allocation choices might no longer offer them the portfolio protection experienced in the past.
- This uncertainty was aggravated on the March 18th FOMC meeting, which didn't yield any directional cues, resulting in the "swelling of the tails" – both the probabilities of a rising rate scenario, and a falling rate scenario, have increased.
- The hybrids market allows participants to articulate an exposure to both equities and rates positions. An investor can purchase a 1y 90% put on SPX contingent on 10y constant maturity swap higher than 2.65% for 1% premium. The vanilla version of this transaction would be offered indicatively at 4%. This cheapening can be attributed to the attractive implied correlation between equities and rates.

A variation we particularly like: a 1y 105%/95% SPX Put Spread contingent on 10y constant maturity swap > 3% at expiry, which can be offered for 1.10% (the vanilla equivalent is offered at 4.3%). A terminal scenario of flat equities and 10y rates higher than 3% would yield a payout of over 4.5x, while a 5% sell-off in equities could bring payout ratios to over 9x.

Hypothetical Terminal Payout: