

Subject: RE: DB FX trade idea: EURZAR-USDZAR correlation swap
From: Xavier Avila <[REDACTED]>
Date: Tue, 05 Dec 2017 11:17:19 -0500
To: "Paul Barrett ([REDACTED])" <[REDACTED]>
Cc: Stewart Oldfield <[REDACTED]>, Joshua Shoshan <[REDACTED]>, Martin Zeman <[REDACTED]>

From: Xavier Avila
Sent: Friday, December 01, 2017 5:55 PM
To: 'Paul Barrett ([REDACTED])' <[REDACTED]>
Cc: Stewart Oldfield <[REDACTED]>; Joshua Shoshan <[REDACTED]>; Martin Zeman <[REDACTED]>
Subject: RE: DB FX trade idea: EURZAR-USDZAR correlation swap

Paul, see below the note and analysis that Vimal put together. Attached also an indicative termsheet, where you can also see the mathematical Definition of Realized Correlation. Thanks and good weekend. Xavi

Following the call yesterday we have attached an example termsheet for a correlation swap.

We have also looked at 2 historical periods where USDZAR-EURZAR correlation realized at significantly lower levels, during 2010-2011 and 2015. Overlaying the realized correlation during those periods with USDZAR, EURZAR and EURUSD FX spot rates (each rebased to 1), we can see that lower realized correlation is driven by significant trends and moves in EURUSD particularly relative to ZAR. This coincided with EURUSD realized volatility rising relative to ZAR realized volatility. In other words EURUSD spot became bigger driver compared to ZAR spot.

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{cid:image002.png@01D36AB5.2B5E6DF0}

From: Xavier Avila
Sent: Friday, December 01, 2017 3:54 PM
To: 'Paul Barrett ([REDACTED])' <[REDACTED]>
Cc: Stewart Oldfield <[REDACTED]>; Joshua Shoshan
<[REDACTED]>; Martin Zeman <[REDACTED]>
Subject: RE: DB FX trade idea: EURZAR-USDZAR correlation swap

Paul, Vimal is working on the analysis and we'll send soon with the termsheet and mathematical calculations of implied and realized correlation.

See also below the same idea but in EURMXN-USDMXN, the strike is a bit lower but Vimal wanted to point out that the historical realized has gone also much lower than in the ZAR situation, so the potential for positive payout seems higher here than in ZAR.

Vimal also told me that we have seen clients do more the MXN and TRY crosses than the ZAR one, but typically MXN and TRY are currencies with more interest.

Talk soon. Thanks

Trade Idea

- Sell 1y EURMXN-USDMXN correlation swap at 77%
- Sell 2y EURMXN-USDMXN correlation swap at 77%

Rationale

- EURMXN-USDMXN implied correlations are close to the highest levels since 2007 (see graph 1)

- This has been driven by MXN implied volatilities trading at their highest levels relative to EURUSD volatility since the financial crisis, largely a result of concerns regarding the Mexico elections in 2018 (see graph 2)

- Since 2007 the highest 1y realized correlation is 87% and the lowest is 11%. For 2y the highest is 83% and the lowest is 44%. Whilst current levels of 1y and 2y realized correlations are close to their highest levels, 3m realized correlation has fallen from recent highs to now sit close to current strikes (see graphs 3 & 4)

- The correlation swap provides a limited loss way of fading elevated MXN volatilities and buying cheap EURUSD volatility, which could perform in the event of rising Italian election and Catalonia independence concerns

Graphs

Graph 1: EURMXN-USDMXN implied correlation at highs

Graph 2: MXN vols elevated compared to EURUSD vols

Graph 3: 1y realized correlation vs. strike

Graph 4: 2y realized correlation vs. strike

Sources: Deutsche Bank, Bloomberg Finance
L.P.

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From: Martin Zeman
Sent: Tuesday, November 28, 2017 12:42 PM
To: Paul Barrett ([REDACTED]) <[REDACTED]>
Cc: Stewart Oldfield <[REDACTED]>; Xavier Avila
<[REDACTED]>; Joshua Shoshan <[REDACTED]>; Liam
Osullivan <Liam.osullivan@db.com>
Subject: DB FX trade idea: EURZAR-USDZAR correlation swap

Paul,

this could be an interesting trade on ZAR without really getting directional exposure to it. The payout is defined as a \$amount per point of correlation. So that means selling the correlation at 80% for \$10k per point of correlation is a max loss of \$200k.

Let me know if you'd like to discuss.

Martin

Trade Idea

- Sell 6m EURZAR-USDZAR correlation swap at 80% (USD payout)
- Sell 1y EURZAR-USDZAR correlation swap at 80.5% (USD payout)

Rationale

- EURZAR-USDZAR implied correlations are close to the highest levels since 2007 (see graph 1)
- This has been driven by ZAR implied volatilities trading at their highest levels relative to EURUSD volatility since the financial crisis (see graph 2)
- Since 2007 the highest 6m realized correlation is 94% and the lowest is 41%. For 1y the highest is 93% and the lowest is 48%. Looking at shorter dated metrics, 3m realized correlation has fallen from recent highs to now sit close to current strikes (see graphs 3 & 4)
- The correlation swap provides a limited loss way of fading elevated ZAR volatilities and buying cheap EURUSD volatility, which could perform in the event of any Eurozone concerns such as the Italian election

Graphs

Graph 1: EURZAR-USDZAR implied correlation at highs

Graph 2: ZAR vols elevated compared to EURUSD vols

Graph 3: 6m realized correlation vs. strike

Graph 4: 1y realized correlation vs. strike

Sources: Deutsche Bank, Bloomberg Finance
L.P.

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Disclaimer: <http://globalmarkets.db.com/new/content/3045.html>

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