

Subject: Re: [/] Trade Idea: Tax Reform Pure-Play / Long-Short Basket Pair [C]

From: Paul Barrett <[REDACTED]>
Date: Tue, 26 Sep 2017 18:26:56 -0400
To: Martin Zeman <[REDACTED]>
Cc: Vahe Stepanian <[REDACTED]>, Xavier Avila <[REDACTED]>, Joshua Shoshan <[REDACTED]>, Stewart Oldfield <[REDACTED]>, Davide-A Sferrazza <[REDACTED]>

I have an RTY vs SPY outperformance option on.

Would take a look once the docs are in place. Looks interesting. Is it one bullet swap or two separate legs?

Paul Barrett

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[REDACTED]
[REDACTED]

On Sep 26, 2017, at 5:13 PM, Martin Zeman <[REDACTED]> wrote:

> Classification: Confidential

<image006.jpg>

Paul,

I want to highlight the below trade idea on the US Tax Reform from the Delta Force team. It's a very smart way to play the tax reform expectations in the US and that trade has already started performing in this 2-week update from Power Fraser who runs the team. It can be traded in a swap format and the highlights are below.

Buy DBUSTXHI / sell DBUSTXLO on swap for beta-neutral, sector-neutral, rates-neutral exposure to a corporate tax cut

1. This trade idea initiated on September 13 and is moving significantly today, $+1.8\sigma$

2. DB's Asset Allocation Strategists published an updated report on this trade which included some new baskets:

- Top 50 / Bottom 50 from the SPX-ex-REITs-and-UTES, chosen by effective tax rate after manually adjusting for deferred tax assets – "modified" tax reform on our Monitor

- Top beneficiaries of repatriation based on offshore cash and "buyback alpha score" i.e. stock's statistical tendency to outperform when doing a buyback

We've updated our Trump Policy Monitor, replacing some dead things with our various iterations of tax reform sensitivity. Available for your Launchpad if you want to monitor these trends intraday.

Reminder that we also think Size is a surprisingly good proxy for tax rate so IWM upside works well. IWM outperformance vs SPY today looks small, but becomes much more significant after controlling for sector skews ($+1.3\sigma$), consistent with our model.

Lots more room to go if this starts to look like a real possibility.

<image011.jpg>

ORIGINAL TRADE IDEA PUBLISHED SEPTEMBER 13:

Buy DBUSTXHI / sell DBUSTXLO on swap for beta-neutral, sector-neutral, rates-neutral exposure to a corporate tax cut

<image002.png>

We're getting increasing chatter around the potential for success in tax reform before year end for the Trump administration. (Hey, it could happen!) Our customers are asking us how to trade. We still think IWM vs SPY is the cleanest but we've also seen demand for baskets.

We've seen a variety of constructions of this trade,* aiming to create exposure to tax reform, many of which result in taking a material sector bias and often an implicit interest rates view (for instance, Banks vs Utilities has a huge DV01, as we've highlighted before). And rates have been a widow maker all year.

DB's suggested construction:

- Compute effective tax rate for every company in the S&P 500 on a 5 year trailing basis
- Remove REITs and Utilities sectors due to unique tax treatment
- Remove Telcos due to tiny universe of stocks (n=4)
- Identify the top 10 and bottom 10 stocks from each remaining sector by tax rate and construct as a equal-weight long-short pair.
- Result is DBUSTXHI and DBUSTXLO, tradable on swap in >\$100mm/side/-

day, 1ML flat / 1ML + 30 as a pair

Resulting construction looks like the below, in each remaining sector. Full composition available on Bloomberg.

Avg effective tax rate on "low" names: 17% Avg effective tax rate on "high" names: 45%

<image003.png>

S&P 500 Effective Tax Rates, compiled from IBES/Factset/Bloomberg by DB Global Asset Allocation Team

IB us if you're not currently permissioned to see DB indices and we'll turn you on. If nothing else, you'll be able to see if the market is starting to react to tax reform potential. 1 year realized vol of the package is <5% so a 30bps move is average and a 60bps move is significant. 1% is yuge.

*Including DB's own research department which had previously constructed a simple ranking of the 50 highest and lowest tax payers; DBUSHTAX and DBUSLTAX. Also available on Bloomberg for your review, and tradable.

Martin

<image004.gif>

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