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**From:** Tazia Smith [REDACTED]  
**Sent:** 1/28/2014 12:24:02 PM  
**To:** jeevacation@gmail.com  
**CC:** Paul Morris [REDACTED] Vinit Sahni [REDACTED] Nav Gupta [REDACTED] Vahe Stepanian [REDACTED]  
**Subject:** Depressed options volatility makes 'Renmimbi weaker' hedges very cheap | KCP Capital Markets [I]  
**Attachments:** pic28392.gif; pic23948.gif; pic21293.gif; pic10638.gif; pic19660.gif; pic19296.gif; pic17510.gif; pic12803.gif

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Jeffrey -

Curious for your view on China. We're concerned about the defense of China's stability (even by our own Global Markets Research analyst, Jun Ma). China may be re-rating for longer-term stability as an 'emerged' market, but that our DB GEM Equity Strategist, Jean-Paul Smith, and his team may have the downside risk right in the nearer-term.

Bulls point to estimates that the AUM in the trust sector only totalling Rmb 10.1 trillion (arguably too low), and that 93% of AUM in trust products could be "backed" (38% by central government, 34% by local governments, and 21% by large financial groups). But Bears highlight that (a) bailouts by authorities won't be a sustainable solution to increasingly regular defaults, (b) they suggest the inherent moral hazard problem that will perpetuate high-risk borrowers leveraging the shadow banking system (vs. the proposed quota bond market issuance and bank securitization channels that the government intends to promote to increase transparency and liquidity), and, (c) bears also point out that local authorities, supposedly on hand to intervene in troubled loans, are themselves highly indebted (currently account for the highest proportion of credit in China, and news flow of local government/ LGFV debt rollovers is becoming all too common - according to DB GEM Equity Strategists, 1/28/14).

As Nav points out below, there is a crowded long China trade with leverage, financed by selling options. Calls on USDCNH present a convex payoff caused by investors selling too many options - timeframe on a move is uncertain which is why he picked 1y (2y options are not very liquid).

Please see below, let us know your thoughts.

Best Regards,  
Tazia

----- Forwarded by Tazia Smith/db/dbcom on 01/28/2014 11:58 AM -----

**From:** Nav Gupta/db/dbcom@DBEMEA  
**To:** [REDACTED]  
**Date:** 01/28/2014 09:44 AM  
**Subject:** Depressed options volatility makes 'Renmimbi weaker' hedges very cheap | KCP Capital Markets [I]

USDCNH call options underprice the possibility of higher USDCNH. This could result from unwinding of heavy positioning long CNH vs USD resulting from credit tapering, investor awareness of worsening bank asset quality and declining growth. The correlation between China and other EM is presently low. Sustained outflows from broader EM will likely impact China also

- 1) Buy a 1y expiry, 6.2 / 6.7 strike USDCNH call spread. Premium (offer) ~0.43% of USD notional. Spot breakeven 6.226
- 2) Buy a 1y expiry, 6.3 / 6.8 strike USDCNH call spread. Premium (offer) ~0.30% of USD notional. Spot breakeven 6.318

USDCNH spot = 6.029, 1y ATMF = 6.093

Indicative levels only, subject to market movement. Source: DB KCP London, 1/28/14.