

because long dated FX forwards trade so far below spot (due to the interest rate differential) that the 90 strike KO is worth a lot - arguably too much based on probabilities of where DB forecasts spot to roll up to.

Simple scenario analysis for USDJPY Call option, strike 85 with American style KO at 90

Spot Ref 102.51, 10y Fwd 77.10

This analysis implies that all else except spot remains equal (eg. volatility, rates)

At 90.0 and below the option is worth \$0. Full premium would be lost. Max loss is premium paid.

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Notes:

- premium decays positively if spot is unchanged

- the premium is sensitive to moves in spot - much more than a regular 10y option

- the mid price for a 10year expiry 85 strike USDJPY call (without any KO feature) is 10.5% and the mid price for a 1year 102.51 strike call is 4% and compared with either of these the option with the KO feature has better risk:reward in Nav's opinion

- we suggest sizing it to worst loss

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