From: Daniel Sabba [redacted]
Sent: 10/14/2014 3:44:12 PM
To: jeevacation@gmail.com
CC: Paul Morris [redacted]; Vahe Stepanian [redacted] Tazia Smith [redacted]; [redacted]
Subject: Hi Jeffrey - follow-up on options for rates steepness in USD [C]

Classification: Confidential

Jeffrey,

It was a pleasure to talk today and looking forward to meeting when you get back to NY. Please see below for the rationale of the 5s10s steepener trade - I just repriced this for USD 1bn notional. As discussed, you pay 15bps upfront for an at-the-money-forward (ATMF) CMS option struck at 54.5bps. The current spot is at 71bps, so it is 16.5bps above the ATMF strike. Last week, before the FOMC minutes were released, the spot was 20bps above the ATMF strike level. The current roll is not as high as last week but, it still represents very cheap optionality which carries roll benefit and unlimited upside in the event of curve steepening at expiry.

Purchase options on USD curve steepness (CMS 5s10s ATMF curve caps)

USD curve steepness close to 5 year lows:

Indicative terms:

Notional	USD 1bn
Client buys	CMS curve cap on 5s10s in USD
Expiry	1 year
CMS 5s10s Strike	ATMF (54.5bps)
CMS 5s10s Spot	71bps
Upfront premium offer (mid):	15bps (13.5bps)
Terminal Payout:	Notional*Max (CMS 5s10s Terminal Rate-Strike, 0)
Settlement:	Cash

Trade Rationale and Implementation:

- Potential catalysts for steepening in the short term frame include:
  - Economic recovery and a pick up in inflation expectations, which are likely to be a prerequisite for the market to sustainably price a Fed tightening cycle
  - Conversely, given inflation breakevens are currently depressed, if a negative economic shock were to happen, it could imply a more accommodative Fed, which is commonly associated with a steeper curve
  - Deutsche Bank research on total return bond fund returns and rates derivate positioning suggests US steepeners are less crowded among real money investors
- While a steepening view can be articulated in various delta-one ways, CMS curve caps allow clients to express a steepening view with limited downside, where the maximum downside is the premium paid. The terminal payout is Notional*Max(Terminal Rate-Strike,0)