

Subject: Depressed options volatility makes 'Renmimbi weaker' hedges very cheap | KCP Capital Markets [I]

From: Tazia Smith <[REDACTED]>

Date: Tue, 28 Jan 2014 12:24:03 -0500

To: jeevacation@gmail.com

Cc: Paul Morris <[REDACTED]> ,

Vinit Sahni <[REDACTED]> ,

Nav Gupta <[REDACTED]> ,

Vahe Stepanian <[REDACTED]>

Classification: For internal use only

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 quotad 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 [REDACTED] on 01/28/2014 11:58 AM -----

From: Nav Gupta [REDACTED] To: [REDACTED]

[REDACTED], Date: 01/28/2014 09:44 AM Subject: Depressed options

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.

These premiums are very low compared to the potential returns if USDCNH turns higher. Implied vol is approx. 3%

The complacency and positioning among FX and FX options participants in USDCNH is high
USDCNH

Used with permission of Bloomberg Finance LP

PBoC has significantly tightened money market rates to curb shadow banking and asset speculation

Shanghai interbank offered rate fixing - 1 month

Used with permission of Bloomberg Finance LP

The recent headlines on bad loans in China's shadow banking industry have raised concerns of a systemic event

China's trust industry has relatively high risk shadow banking products given the liquidity risks.

These products have seen rapid growth since 2010, reaching Rmb10.1 tn as of 3Q13 with a 2010-3Q13 CAGR of 55%.

Asian corporates have sold a significant quantity of options (to enhance returns) depressing implied volatility
IF USDCNH starts to retrace higher, option sellers will short cover options they have

Used with permission of Bloomberg Finance LP

KCP Capital Markets
Vinit Sahni | Nav Gupta | Vanshree Verma

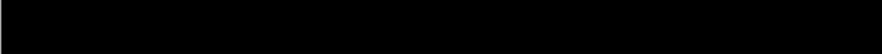
Nav Gupta
Managing Director

Deutsche Bank AG, Filiale London
Deutsche Asset & Wealth Management



Any proposed ideas are being delivered to you by the DeAWM Key Client Partners ("KCP") London desk for discussion purposes only, and do not create any legally binding obligation on the part of Deutsche Bank AG and / or its affiliates ("DB"). These ideas are for the consideration of the intended recipients of this mail only. The KCP London desk does not provide investment advice. All intended recipients are Professional investors (as defined by MiFID), who understand the strategy, characteristics and risks associated with any ideas proposed herein and will be able to evaluate it independently. All trades on proposed ideas shall be subject to the relevant internal approvals prior to execution.

This e-mail may contain confidential and/or privileged information. If you are not the intended recipient (or have received this e-mail in error) please notify the sender immediately and delete this e-mail. Any unauthorized copying, disclosure or distribution of the material in this e-mail is strictly forbidden.

Please refer to  for

additional EU corporate and regulatory disclosures.

Tazia Smith
Director | Key Client Partners - US

Deutsche Bank Securities Inc
Deutsche Asset & Wealth Management

A large black rectangular redaction box covers the contact information and any other text that might have been present below the company name.