

Subject: 10yr \$/Y.... [C]  
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Date: Thu, 30 Jan 2014 18:26:32 -0500  
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Classification: Confidential

Jeffrey -

Below is the description and scenario analysis from Nav and team for the 10y USDJPY call option, strike 85 with American style KO at 90 (v spot). If you review and like the long-term position ("IRR" like trade, as Vinit said), our suggestion is to leg in, perhaps \$5mm notional x2 for total \$10mm notional.

Let's discuss the below in the morning (Fri) and depending on your review/the market we can potentially add the first leg.

Best Regards,  
Tazia

----- Forwarded by Tazia Smith, [REDACTED] on 01/30/2014 06:14 PM -----

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The trade below is a structure to reduce the cost of a near-dated USDJPY call and express a long-term bearish view on the yen; it's a trade that Vinit and Nav have been kicking around to take advantage of dislocations in FX and like it a lot

10y Expiry:

European style USDJPY 85.00 strike, call option which knocks out (KO) if \$Y trades at 90 at any time during the life of the option  
Spot Ref 102.5  
Mid market 4.0% of USD notional. Offer 4.35%  
Maximum loss is premium paid

Indicative level only. Subject to market movement. Source: DB FX London, 1/30/14.

Key Points:

- We find that buyers often cheapen call options by selling in-the-money knockouts - so if the buyers view is "too right" the option knocks out and becomes worthless
- Rather than "trying to be right, but not too right," consider buying call options which knock-out if spot trades down (ie. against your view) because in that case, you are wrong on the direction bet and probably do not want the option anymore.
- The challenge is that is no one ever pays much for the out-of-the-money KO feature so its almost never worth doing - except, in our view, in USDJPY 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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Tazia Smith  
Director | Key Client Partners - US

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