
From: Ens, Amanda <[REDACTED]>
Sent: Monday, August 15, 2016 2:20 PM
To: jeffrey E.; Richard Kahn
Subject: RE: Preferreds, thoughts on fixed income, mandatory converts

Southern Trust Company bought

\$1mm AGN 5.5% 3/1/18 Pfd @ \$881.50 (6.2% strip yield) - \$0.50 better

\$1mm TEVA 7.0% 12/15/18 Pfd @ \$901.75 (7.9% strip yield) – same level

Thanks,

Amanda

Amanda Ens

Director

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From: jeffrey E. [mailto:jeevacation@gmail.com]
Sent: Monday, August 15, 2016 9:48 AM

To: Ens, Amanda; Richard Kahn
Subject: Re: Preferreds, thoughts on fixed income, mandatory converts

1 million each of AGN and TEVA

On Mon, Aug 15, 2016 at 7:34 AM, Ens, Amanda <[REDACTED]> wrote:

Jeffrey,

The account will be open today. Please find updated levels below; would you like to proceed with the purchases?

AGN 5.5% 3/1/18 Pfd @ \$882.00 (6.2% strip yield)

TEVA 7.0% 12/15/18 Pfd @ \$901.75 (7.9% strip yield)

FTR 11.125% 6/29/18 Pfd @ \$94.80 (12.0% strip yield)

AGN mandatory convert preferred

Ticker: AGN A Pfd

Coupon: 5.5%

Maturity: 3/1/2018

Pfd Price: 882.00

AGN stock ref: 251.50

Convert low strike: 288.00 (at maturity, if AGN is at or below 288, you get 3.4722 shares)

Convert high strike: 352.80 (at maturity, if AGN is at or above 352.7959, you get 2.8345 shares)

Strip yield: 6.2% (versus common stock which pays no dividend)

BofAML price target: \$294 (Buy, US-1 top picks list)

Upside to BofAML price target: 16.9%

If hold pref to maturity and stock is up 25%: 22.3%

If hold pref to maturity and stock is down 25%: -16.2%

QDI-eligible: No

Amount outstanding: \$5.06 bn

TEVA mandatory convert preferred

Ticker: TEVVF Pfd

Coupon: 7.0%

Maturity: 12/15/2018

Pfd Price: 901.75

TEVA stock ref: 54.14

Convert low strike: 62.50

Convert high strike: 75.00

Strip yield: 7.9% (vs common stock at 2.5% div yield)

BofAML price target: \$72.00 (Buy)

Upside to BofAML price target: 33.0%

If hold pref to maturity and stock is up 25%: 30.3%

If hold pref to maturity and stock is down 25%: -8.5%

QDI-eligible: No

Amount outstanding: \$3.7125 bn

FTR mandatory convert preferred details

Ticker: FTRPR Pfd

Coupon: 7.0%

Maturity: 12/15/2018

Pfd Price: 94.80

FTR stock ref: 4.90

Convert low strike: 5.00

Convert high strike: 5.875

Strip yield: 12.0% (vs common stock at 8.6% div yield)

BofAML price target: \$7.50 (buy)

Upside to BofAML price target: 53.4%

If hold pref to maturity and stock is up 25%: 33.5%

If hold pref to maturity and stock is down 25%: 1.1%

QDI-eligible: No

Amount outstanding: \$1.925bn

Assumes convert held to maturity; all coupons included

Source: Bloomberg

Thanks,

Amanda

From: Ens, Amanda

Sent: Tuesday, August 09, 2016 10:00 AM

To: 'jeffrey E.'; 'Richard Kahn'

Subject: RE: Preferreds, thoughts on fixed income, mandatory converts

Jeffrey,

Updated levels:

AGN 5.5% 3/1/18 Pfd \$895.50 (6.2% strip yield)

TEVA 7.0% 12/15/18 Pfd \$894.00 (7.9% strip yield)

FTR 11.125% 6/29/18 Pfd \$95.15 (11.9% strip yield)

We could trade today if we can deliver into your account at MS or DB. If you'd prefer custody at BAML, the institutional custody account is not open yet so we likely need to wait until next week. Sorry for the inconvenience. Please let me know what you prefer.

FTR mandatory convert preferred details

Ticker: FTRPR Pfd

Coupon: 7.0%

Maturity: 12/15/2018

Pfd Price: 95.15

FTR stock ref: 4.90

Convert low strike: 5.00

Convert high strike: 5.875

Strip yield: 11.9% (vs common stock at 8.6% div yield)

BofAML price target: \$7.50 (buy)

Upside to BofAML price target: 53%

If hold pref to maturity and stock is up 25%: 33.0%

If hold pref to maturity and stock is down 25%: 0.6%

QDI-eligible: No

Amount outstanding: \$1.925bn

Thanks,

Amanda

Amanda Ens

Director

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From: jeffrey E. [mailto:jeevacation@gmail.com]
Sent: Monday, August 08, 2016 4:59 PM
To: Ens, Amanda; Richard Kahn
Subject: Re: Preferreds, thoughts on fixed income, mandatory converts

lets buy 1 m each

On Mon, Aug 8, 2016 at 4:55 PM, Ens, Amanda <amanda.ens@baml.com <mailto:amanda.ens@baml.com>> wrote:

For the institutional custody account I'm opening for you in the investment bank here, no leverage yet. We would need to set up prime brokerage and we're not there yet. If you plan to use a lot of leverage, I can try to get an exception; prime brokerage usually requires pretty high trading volumes. If we can simply execute the purchase and deliver these to your custody at MS or DB and use their margin, it should be the standard 50% for purpose lending; perhaps higher if you have a non-purpose line. Note that since mando convert preferreds are highly correlated to the stock, the vol is much higher than on a bank preferred. The AGN A Pfd is has a 19% 30-day vol (vs 24% for the common stock) and 30% 90-day vol (vs 41% for the common stock). For comparison, PFF had a 4.5-5% vol.

From: jeffrey E. [mailto:jeevacation@gmail.com <mailto:jeevacation@gmail.com>]
Sent: Monday, August 08, 2016 4:40 PM
To: Ens, Amanda
Subject: Re: Preferreds, thoughts on fixed income, mandatory converts

can we put leverage on them, if so what rate

On Mon, Aug 8, 2016 at 4:30 PM, Ens, Amanda <amanda.ens@baml.com <mailto:amanda.ens@baml.com> > wrote:

AGN mandatory convert preferred

Ticker: AGN A Pfd

Coupon: 5.5%

Maturity: 3/1/2018

Pfd Price: 881.38

AGN stock ref: 248.31

Convert low strike: 288.00 (at maturity, if AGN is at or below 288, you get 3.4722 shares)

Convert high strike: 352.80 (at maturity, if AGN is at or above 352.7959, you get 2.8345 shares)

Strip yield: 6.3% (versus common stock which pays no dividend)

BofAML price target: \$294 (Buy, US-1 top picks list)

Upside to BofAML price target: 18.4%

If hold pref to maturity and stock is up 25%: 24.4%

If hold pref to maturity and stock is down 25%: -15.7%

QDI-eligible: No

Amount outstanding: \$5.06 bn

TEVA mandatory convert preferred

Ticker: TEVVF Pfd

Coupon: 7.0%

Maturity: 12/15/2018

Pfd Price: 895.07

TEVA stock ref: 54.21

Convert low strike: 62.50

Convert high strike: 75.00

Strip yield: 7.9% (vs common stock at 2.5% div yield)

BofAML price target: \$72.00 (Buy)

Upside to BofAML price target: 32.8%

If hold pref to maturity and stock is up 25%: 31.3%

If hold pref to maturity and stock is down 25%: -7.8%

QDI-eligible: No

Amount outstanding: \$3.7125 bn

Assumes convert held to maturity; all coupons included

Source: Bloomberg

Amanda Ens

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From: jeffrey E. [mailto:jeevacation@gmail.com <mailto:jeevacation@gmail.com>]
Sent: Monday, August 08, 2016 4:14 PM
To: Ens, Amanda
Subject: Re: Preferreds, thoughts on fixed income, mandatory converts

send more detail of the bond

On Mon, Aug 8, 2016 at 2:26 PM, Ens, Amanda <amanda.ens@baml.com <mailto:amanda.ens@baml.com> > wrote:

Jeffrey, I continue to like the AGN, TEVA and FTR mandatory convert preferreds. While AGN missed on sales today, is was mostly due to noise around the last minute divestiture of their ANDA distribution business to TEVA. While the generics sale to TEVA was already built into most analyst models, the ANDA sale was not. Revenue thus looks in line. Botox and Restasis, two important products, are still growing at 16% and 21% respectively. AGN has an aggressive buyback program, targeting \$5bn this year and they should reach the full \$10bn approved by next year, market conditions permitting. Their pipeline looks strong; execution will be key going forward. There has been chatter in the market about them potentially doing a big deal such as BIIB but management said on the call that they're focused on being selective/disciplined and will likely target smaller stepping stone opportunities. Outside of buybacks, the company has about \$20bn of dry powder to invest for growth over the next 12-18 months, which could come in the form of acquisitions and/or debt repayment.

Long story short: would look to build a position through the AGN A mandatory convert preferred at a 6.3% current yield to March 2018.

Let me know if you have time for a call; I'm at [REDACTED].

Thanks,

Amanda

Amanda Ens

Director

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[REDACTED]

[REDACTED]

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From: Ens, Amanda
Sent: Thursday, August 04, 2016 6:30 PM
To: 'jeevacation@gmail.com <mailto:jeevacation@gmail.com> '
Cc: 'Richard Kahn'
Subject: Preferreds, thoughts on fixed income, mandatory converts

Jeffrey,

Rich mentioned you're interested in potentially buying preferreds. While they still pay a decent yield, I wanted to share some thoughts about why I would look at the more equity-like mandatory convertible preferred market instead. I've outlined a few points about fixed income, with some specific mandatory convert details further down. Would love to discuss in more detail at your convenience.

Is fixed income the next "accident" waiting to happen in markets?

- * Japanese buying of US corporate credit is slowing
- * Supply is increasing
- * Investors are trafficking as "tourists" in bond markets that they don't usually buy – unwind could be painful
- * Risk parity quant funds might need to rebalance if the correlation between bonds and equities turns higher
- * High yield keeps climbing despite falling oil prices
- * Poor liquidity in a crowded trade (Volcker rule and other structural changes)

The Japanese had been huge incremental buyers of US corporate credit this year but last week's data shows this fell buying has fallen towards zero. This is happening in a market where supply is increasing. Charts below.

I attended some buy-side meetings this week with our cross-asset and credit strategy teams and what really stood out to me was the relative acceptance of the continued theme of "tourism" in various credit markets ranging from US corporates to EM to European subordinated bank bonds to preferreds. With the incessant hunt for yield, there was even the joke that the yield craze has approached Pokémon-like levels. While the music could play on for a while, it seems that the risk-reward is more favorable at this point for US equities vs. fixed income. Equities are under-owned: institutions have net sold equities this year if you exclude buybacks, cash levels are at 15 year highs, investors have been buying protection but not much upside. Bonds don't seem to be pricing in sufficient risk premium, especially at the long end.

We've been closely following quant fund positioning, leverage levels and potential for forced selling in the future. With risk parity fund leverage high and bond-equity correlation moving from negative to ~zero now, the potential for rebalancing is on our radar. Risk parity portfolios own more bonds than equities (due to the lower bond vol), so there is more notional size of bonds to sell to rebalance, making US equities potentially less dangerous than the bond market. A few more details about risk parity funds are in the attached report (pages 9-11: Market impact of quant funds: Separating fact from fiction) and in the Risk Parity Risks in Fixed Income writeup further down.

Japanese buying of foreign bonds FELL again toward zero as of July 29 (vs LQD in yellow).

Mandatory Convertible Preferreds

As investors continue to search and stretch for yield, mandatory convertible preferreds stand out to me as an attractive yet often overlooked opportunity. In case you're not familiar with them, they are generally short-dated, pay a high dividend and mandatorily convert into common stock at maturity. Due to the mandatory conversion, they lack a bond floor and are equity-like with yield enhancement. You're "paid to wait" while the underlying company's fundamental

story develops, so they are attractive for names where we like the company's longer term prospects but are only neutral to slightly bullish in the near term. The yield, along with the conversion ratio sliding scale, can result in an attractively skewed upside vs downside profile for holding the mandatory convert vs the common stock.

Allergan, Teva and Frontier Communications are three names we have high conviction on and they have mandatory convert preferreds that I recommend buying.

Allergan (AGN) - BAML reaffirming BUY on AGN after the FTC approval of generics sale to Teva. We like AGN due to its healthy product mix, solid pipeline and flexibility to deploy capital to drive shareholder return. Next catalyst will be 2Q earnings/2H16 Outlook on 8/8. AGN is on our firm's US-1 list of best investment ideas.

Teva Pharma (TEVA) - BAML reiterating BUY on TEVA after the FTC's approval of AGN generics deal. We continue to like TEVA's positioning in generic pharma where scale and product diversity are increasingly important. TEVA remains one of our top picks in Spec Pharma.

Frontier Comm (FTR) - BAML reaffirming BUY after Frontier reported its first post-Verizon assets merger results. FTR's earnings miss was due to a decline in the legacy business but FTR is targeting increased deal synergies that should offset the decline in legacy business. We like FTR with its 8.6% dividend yield and estimated 56% dividend payout ratio in 2017. We continue to think the market is mispricing FTR.

Name

Stock Ref

Pfd Level

Low Strike

High Strike

Current
Yield

Yield
Advantage over Stock

BAML
Ranking (Stock)

BAML
Price Tgt (Stock)

Stock Upside to
Price Tgt

Stock Up 25%: Pfd Return

Stock Down 25%: Pfd Return

Notional Outstanding

AGN (AGNprA) 5.5% 3/1/18

252.95

893.45

288.00

352.80

6.2%

6.2%

1 - Buy

\$ 294.00

16.2%

22.7%

-15.5%

\$5.06bn

TEVA (TEVVF) 7% 12/15/2018

53.50

886.08

62.50

75.00

7.9%

5.4%

1 - Buy

\$ 72.00

34.6%

32.6%

-7.8%

\$3.7125bn

FTR (FTRPR) 11.125% 6/29/18

4.85
93.85
5.00
5.87
11.9%
3.2%
1 - Buy
\$ 7.50
54.6%
33.6%
1.2%
\$1.925bn

Source: Bloomberg, BAML.

Up/down return vs underlying stock price +/- 25% assumes preferred is held to maturity

From Aug 2: Risk Parity Risks in US Fixed Income

Today's simultaneous weakness in the US bond long end and weakness in US equities is unusual of late and tells us there is implications for risk parity portfolios.

We expect a 165k change in Non-Farm Payrolls on Friday but a strong number sets up for some left hand tail risk in US Fixed Income.

Risk parity portfolios own more bonds than equities (due to the lower bond vol), so there is more notional size of bonds to sell to rebalance making US equities less dangerous than the bond market.

March 2017 ATM LQD vol is around 7.5% so a 100% Put costs ~3.2% which given the long term chart below and all time high in shares outstanding looks cheap.

Chart One shows hourly data of IEF (7-10y US Treasury ETF) and SPY (S&P500 ETF). Using 60 hourly data points, correlation has moved from around -80% a month ago to zero now. This means the volatility/leverage of risk parity portfolios is increasing and rebalancing is more likely to be required.

This is happening while the US yield curve is steepening with Investment Grade Supply increasing. Yesterday, \$23.4b of new investment grade credit priced, the highest daily volume in close to 3 months. As supply of duration has been increasing a few other topical IG issues are:

On July 28 Apple issued ~ \$7 billion

On August 1, Microsoft issued ~\$20 billion

Today, Alphabet ~ \$ 2 billion

Chart Two shows Investment Grade ETF, LQD, is at the top of a long term range with shares outstanding around an all time high. Hans Mikkelsen noted on Friday in "Credit Market Strategist <<http://rsch.baml.com/r?q=OaYw89Yo1IRsHX6GXUP0lw&e=amanda.ens%40baml.com&h=QasuWw>> " with Japanese inflows into IG market already at max strength there are mostly downside risks to US credit spreads associated with developments in Japan.

Chart three is from "Global Equity Volatility Insights <<http://rsch.baml.com/r?q=ctKMaUu0ebACucDgScvGRQ&e=amanda.ens%40baml.com&h=L4iNOg>> " from June 28 and suggests risk parity fund leverage is high and we do not think the relationships have changed significantly.

Chart One shows hourly data of IEF (7-10y US Treasury ETF) and SPY (S&P500 ETF). Using 60 hourly data points, correlation has moved from around -80% a month ago to zero now. This means the volatility of risk parity portfolios are increasing and rebalancing is required.

Chart Two: Investment Grade ETF, LQD, is at the top of a long term channel with shares outstanding around an all time high.

Chart three is from "Global Equity Volatility Insights

<<http://rsch.baml.com/r?q=ctKMaUu0ebACucDgScvGRQ&e=amanda.ens%40baml.com&h=L4iNOg>> " from June 28 and suggests risk parity fund leverage is high and we do not think the relationships have changed significantly.

Today on Bloomberg: Junk Debt Keeps Climbing Despite Plunging Oil Prices

After moving in lockstep with oil markets for much of the last two years, high-yield bonds have gone their own way and posted modest gains while crude entered a bear market in early June. The Bloomberg USD High Yield Corporate Bond Index has advanced more than 2 percent with help from energy debt that comprises about 16 percent of its value. The question now is whether turmoil in oil markets will drag down bonds of drillers and producers, taking the broader junk index with them, as defaults and bankruptcies pile up.

Source: Bloomberg 8/4/2016

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