From: Tazia Smith <[redacted]>
To: "jeffrey epstein" <jeevacation@gmail.com>, Paul Morris <[redacted]>
Subject: Re: Depressed options volatility makes 'Renmimbi weaker' hedges very cheap | KCP Capital Markets [C]
Date: Tue, 28 Jan 2014 17:40:19 +0000
Importance: Normal
Inline-Images: unnamed

Classification: Confidential

Understood, Jeffrey. long USDCNH calls was the trade, taking the other side of a crowded long/overvalued CNY and inexpensive entry:

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

USD

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Tazia Smith
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From: Jeffrey Epstein [[redacted]]
Sent: 01/28/2014 12:27 PM EST
To: Tazia Smith; Paul Morris
Subject: Re: Depressed options volatility makes 'Renmimbi weaker' hedges very cheap | KCP Capital Markets [I]

sorry, questions about what do you think about china , are silly,,,,,,,,, lets pick a trade , have some back up and move. I am a trader / investor not as atrologist

On Tue, Jan 28, 2014 at 12:24 PM, Tazia Smith <[redacted]> wrote:

> 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/db/dbcom on 01/28/2014 11:58 AM -----

From:	Nav Gupta/db/dbcom@DBEMEA
To:	[redacted]
Date:	01/28/2014 09:44 AM
Subject:	Depressed options volatility makes 'Renmimbi weaker' hedges very cheap | KCP Capital Markets [I]

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

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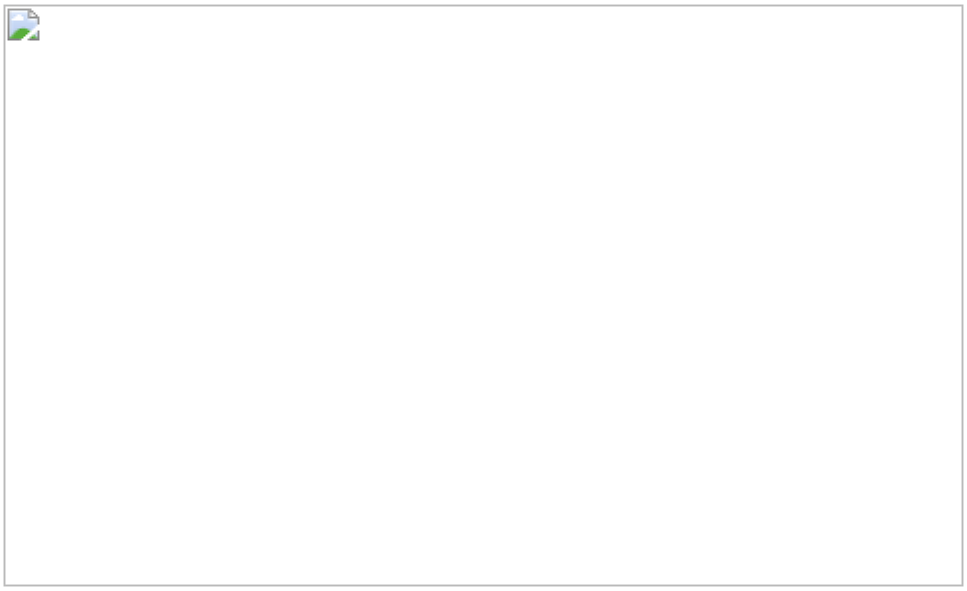
USDCNH spot = 6.029, 1y ATMF = 6.093

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



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

Shanghai interbank offered rate fixing - 1 month

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- 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

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