

**From:** Richard Kahn <[REDACTED]>

**To:** "jeffrey E." <jeevacation@gmail.com>

**Subject:** Fwd: AAPL – Implied vols at extreme low levels. Replace long AAPL positions with cheap call options


**Date:** Tue, 16 Aug 2016 17:31:46 +0000

**Attachments:** Global\_Equity\_Volatility\_Insights.pdf; AAPL.pdf

**Inline-Images:** image002.jpg; image003.jpg; image005.png; image004.jpg; image001.jpg

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Richard Kahn  
HBRK Associates Inc.



Begin forwarded message:

**From:** "Ens, Amanda" <[REDACTED]>

**Subject:** AAPL – Implied vols at extreme low levels. Replace long AAPL positions with cheap call options

**Date:** August 16, 2016 at 1:26:33 PM EDT

**To:** Richard Kahn <[REDACTED]>

Rich,

I'm not sure if you own AAPL but in case you do, I wanted to share our recommendation to replace long AAPL positions with cheap call options to lock-in profits from the recent 14% rally after Q3 earnings.

**AAPL implied vol at extreme low levels => buy upside calls.** A two year look back for 2-month ATM implied vol is in the 1<sup>st</sup> percentile. The company is supposed to announce details for the iPhone 7 around Sept 7<sup>th</sup>, prior to October option expiration and we believe implied volatility is too low. After the last 5 earnings reports (excluding the earnings event move), AAPL has realized 19%, 21.5%, 27.5%, 32.5% and 19.75% - we thus see limited downside to being long October vol at ~18.8%.

- **Stock replacement: Buy Oct 21<sup>st</sup> expiry AAPL 115 calls @ 1.60 (1.4% premium)**
  - or buy the Oct 21<sup>st</sup> expiry AAPL 110 calls @ 3.55 (3.2% premium)

If you would like to have exposure through Oct 24<sup>th</sup> earnings and the elections, we could look at November but the vol is about 2.5 vol points higher.

- **Buy Nov 18<sup>th</sup> expiry AAPL 115 calls @ 2.65 (2.3% premium)**
  - or buy the Nov 18<sup>th</sup> expiry AAPL 110 calls @ 4.70 (4.3% premium)

## Why replace stock with call options?

Post AAPL earnings on Jul 26<sup>th</sup>, nearer-dated (1 month to 3 month) implied volatility declined sharply. 2 month ATM options are basically at 5 year lows. It's not to be ignored the company holds a sizeable cash position on the balance sheet which can have a volatility dampening effect on the shares. However, there may still be a key catalyst - the company is supposed to announce details for their next generation iPhone prior to October expiration and we believe implied volatility is too low. Based on last year's timing, Apple is expected to host an event this year around September 7<sup>th</sup> to announce their new phone. The phone would typically come available for purchase a week or so later.

According to our research analyst, through our own analysis and conversations with the buy-side:

- Positive catalysts needed are:
  1. Better features than expected (unlikely)
  2. Pricing of iPhone
  3. Announcement of a much improved watch (possible)
  4. New macs (not a needle mover)
- Negative catalysts could be:
  1. Sell on the news on iPhone 7 announcement
  2. Early order sell out trends, if weak, can be negative ahead of Oct expiry

I should also note that cash repatriation policy might change after the elections; a repatriation tax reduction could impact AAPL's return of capital to shareholders significantly (\$153bn cash, 80% outside the US, cash is 28% of AAPL's market cap as of 1Q16). We can discuss our research on this further if you're interested.

## Vol Surface

AAPL – Two year look-back for 2 month ATM implied and 2 month implied - realized spread, all screen very cheap 1<sup>st</sup> percentile and 19<sup>th</sup> percentiles respectively (see details and charts below). Seems the options market is pricing the next product release announcement (iPhone 7, etc.) as not much of a catalyst at all. The current low level of implied volatility has been carrying well with realized volatility higher than implieds on 30-, 50- and 100-day basis. We expect implied vols to find a floor, and realized volatility continue to support this over the coming several weeks as we approach the new product release. This options backdrop provides an opportunity if you are looking for ways to add leverage or reduce risk into the event (stock replacement with call options.)

### 2 year look back of 2 month atm implied vol (absolute) – 1st percentile low



Source: Bloomberg


### 2 year look back 2 month implied – 40 day realized spread 19<sup>th</sup> percentile cheap

Source: Bloomberg

Regards,  
Amanda

## Amanda Ens

Director  
Bank of America Merrill Lynch  
Merrill Lynch, Pierce, Fenner & Smith Incorporated



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