

**From:** Daniel Sabba <[REDACTED]>  
**To:** "jeffrey E." <jeevacation@gmail.com>  
**CC:** Paul Morris <[REDACTED]>, Stewart Oldfield <[REDACTED]>, Vahe Stepanian <[REDACTED]>, "Ariane Dwyer" <[REDACTED]>, Richard Kahn <[REDACTED]>

**Subject:** RE: Idea for US equity hedging... [C]

**Date:** Tue, 09 Jun 2015 15:05:48 +0000

**Inline-Images:** image001.jpg

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Classification: **Confidential**

Most investors are familiar with the usual negative correlation between bonds and equities, often relying in bond/equity portfolio allocations as a hedge. They believe their portfolios to be protected because they have observed equities sell-offs being followed by bond rallies and vice versa.

We wanted to follow-up on the hedges below in light of the recent price action. **Last week we observed two trading days with sell-offs in both bonds and equities in the US.** We think this is scenario worth noting given (i) the upcoming Fed lift-off, (ii) the potential reversal of a secular bull market in bonds, which started in the 1980ies, (iii) elevated equity valuations, a potential result of monetary policy stimulus.

With the hedge below, an investor can get up to 5x their premium in the event of a shallow sell-off in both equities and bonds. Happy to discuss in further details.

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**From:** Daniel Sabba  
**Sent:** Wednesday, June 03, 2015 9:43 AM  
**To:** 'jeffrey E.'  
**Cc:** Paul Morris; Stewart Oldfield; Vahe Stepanian; Ariane Dwyer; 'Richard Kahn'  
**Subject:** Idea for US equity hedging... [C]

Classification: **Confidential**

Jeffrey,

We wanted to share this US equity hedging idea with you. We think it is relevant since US equity indices are near historic highs, implied volatility in US equities is close to historical lows and there is potential for Fed liftoff in September.

David Bianco published the following on 5/22 (full report attached) about the possibility of a 5%+ pullback in the summer months:

*"We believe the probability of a 5%+ dip is high this summer and our tactical call remains Down given the S&P now at an even higher PE than a year ago, heightened uncertainty in 10yr yields, weak earnings growth and continued soft economic data. We haven't had a 5%+ dip this year. Historically 5%+ dips are common and happen at least once a year since 1960, except 1964, 1993 & 1995. It has been 916 trading days (3.6 years) since a 10% correction. Selloff triggers could be a further rise in 10yr yields especially if UE keeps falling amidst slow economic growth and Fed remains unclear on first hike timing, or a jump in the dollar upon the Fed expressing firm intentions to hike in Sept."*

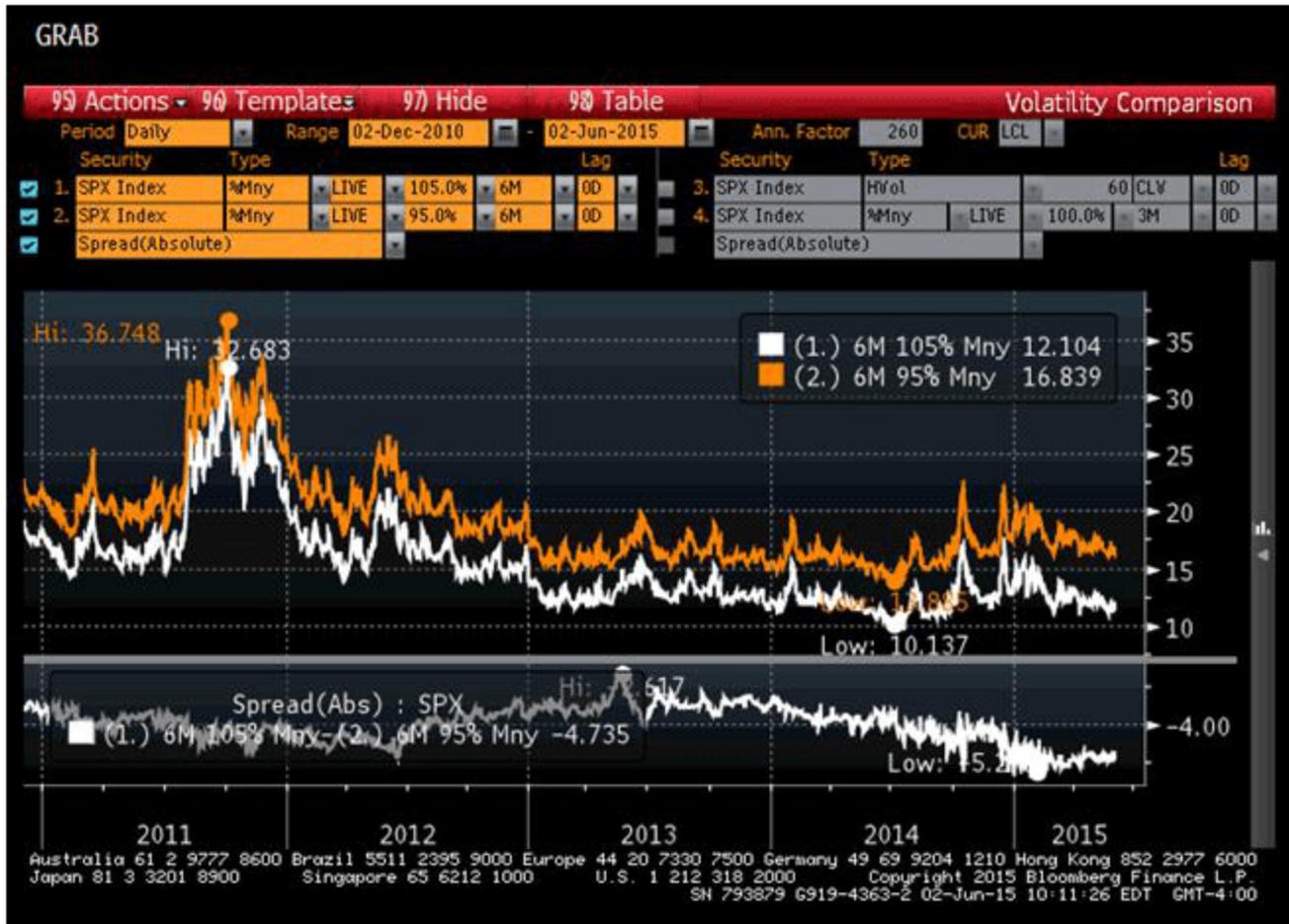
With that said, we looked at **OTC equity put spreads contingent on higher rates.** We priced in-the-money versions which would obtain its maximum payout (over 5x premium) with a 5% sell-off in SPX and higher 10y US swap rates (CMS, 25bps over its forward level).

**Indicative transaction terms (as of 06/03/2015):**

Client buys: OTC SPX 105%/95% Put Spread contingent on 10y USD CMS > atmf+25bps at expiry  
 Notional: USD50mm  
 Expiry: 18 Dec 2015  
 Offer (mid): 2.00% (1.60%)  
 Ref vanilla: 4.30%

Ref SPX future: 2115  
 Ref 10y fwd: 2.54%

**SPX Implied volatility levels close to historical lows**



Please let us know if you would like to discuss. Best regards,  
 Daniel

Daniel Sabba  
 Key Client Partners  
 Deutsche Bank Securities Inc.

Email [REDACTED]

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