SOM *Macro Strategies*

State of The Markets: Recommended Trade Book

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SOM Macro Strategies

State of The Markets: Recommended Trades

Step 4: Find Asymmetric Trades

Update of Current And Closed Recommended Trades

			Initial Position					Current Or Closed Position				
Status	Trade	SOM Strategy	Date	Price	Value at Risk	Target Underlying	Target Net Payout Ratio	Date	Price	Realized Net Payout Ratio	Value at Risk	Potential Remaining Net Payout Ratio
Open	Short 5-yr HY CDS	Credit is Not a Bubble	5-Sep-17	330 bp	1.5	230 bp	3.38	2-Oct-17	320 bp	0.34	1.5	3.0
Continuation	Long basket of Greek Banks	Greece	25-Sep-17	1.3	0.3	2.4	4.2	2-Oct-17	1.3	0.1	0.3	3.1
Open	Long 30yr GGBs	Greece	24-Mar-17	68.2	6.8	108	5.8	2-Oct-17	85.3	2.5	8.5	3.8
Open	1/5 Payer Swaption 2.25% Strike	Position For Higher Rates	10-Aug-17	0.7	0.7	3.0% Yield	3.1	2-Oct-17	0.8	0.1	0.8	2.6
Open	Long Materials sector	Strategies For Trumpanomics	9-Nov-16	48.3	4.8	67.56	4.0	2-Oct-17	57.4	1.9	5.7	1.8
Open	Long Regional banks	Strategies For Trumpanomics	9-Nov-16	46.5	4.6	65.03	4.0	2-Oct-17	57.1	2.3	5.7	1.4
Open	Long Mortgage Insuers and Home Builders	Strategies For Trumpanomics	9-Nov-16	21.7	2.2	32.55	5.0	2-Oct-17	28.0	2.9	2.8	1.6
Open	Long S&P500	Strategies For Trumpanomics	9-Nov-16	216.0	10.0	270.00	5.4	2-Oct-17	252.0	3.6	12.6	1.4
Closed	Long basket of Greek banks	Greece	25-Mar-17	1.1	0.22	2.2	4.7	15-Aug-17	2.1	4.5	0.4	0.1
Closed	1/10 Payer Swaption 2.5% Strike	Position For Higher Rates	9-Nov-16	1.5	1.5	3.5% Yield	4.1	15-Jul-17	0.1	-0.9	0.1	76.0
Closed	Long Mexican Peso vs short Brazian Real	Brazil	8-Nov-16	6.1	0.03	5.20	4.9	3-Jan-17	6.3	-1.0	0.0	0.0
Closed	6-month Best-of-puts Euro, Yen vs USD	Strategies For Trumpanomics	9-Nov-16	1.0	1.0	Euro 1.05/Yen 120	4.0	9-May-17	0.0	-1.0	0.0	0.0
Closed	Long a 6-month 64000 strike put on Bovespa	Brazil	22-May-17	625	625	57000	2.5	22-Jun-17	1250.0	1.0	1250.0	0.7
Closed	Long a 6-month 61000 strike put on Bovespa	Brazil	1-Aug-16	600	600	54000	2.6	21-Dec-16	1275.0	1.1	1275.0	0.6
Closed	Short GBP vs USD	Strategies For BREXIT	1-Jul-16	1.3	0.03	1.20	3.3	11-Oct-16	1.2	2.8	0.0	0.5
Closed	Long a 6-month 17000/19000 call spread on Nikkei	Abenomics	9-Sep-16	6.5	6.5	19000	2.0	17-Jan-17	14.0	1.2	14.0	0.4
Closed	Long a 6-month 15000/17000 call spread on Nikkei	Abenomics	24-Jun-16	8.0	8.0	19000	1.4	9-Sep-16	18.5	1.3	18.0	0.1

Past performance is not indicative of future results

Recommended Trades: Open

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State of The Markets: Strategies for Trumpanomics

- ***Step 1: Macro Theme: Trumpanomics***
  - The goal of Trump's economic policy is to push real growth up to 3.5-4% and add 25 MM new jobs in the next 10–years
- ***Step 2: Fundamental Economic Framework***
  - Growth in the US is below historical norms because of slowing investment and productivity
  - Investment growth reflects in part the headwinds of US corporate tax policy and Dodd-Frank
  - Demographics and the impact of retiring baby boomers is a headwind to labor growth
  - Any policy must be massive to offset these hurricane force economic headwinds
- ***Step 3: Find Potential Catalyst***
  - If fully implemented, Trump economic policy would be massive enough to move the needle of economic growth
  - Corporate tax reform could push economic growth above 3% all by itself with relatively small increase in Federal debt
  - Dodd-Reform could push growth even higher by unleashing bank lending in housing and small businesses
  - Energy and infrastructure policy could add to this growth through a build out of US shale energy, particularly nat gas
- ***Step 4: Find Asymmetric Trade***
  - Trade : Buy US Equities
  - Trade : Buy US Regional Bank
  - Trade : Buy Mortgage Insurers
  - Trade : Buy Home Builders
  - Trade : Buy a Basket of Energy Infrastructure Equities
  - Trade : Higher Rates—Buy Payer Swaptions
  - Trade : Stronger Dollar—Buy Worst-of-Puts on Euro and Yen vs USD

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State of The Markets: Strategies for Trumpanomics

Step 4: Find Asymmetric Trades

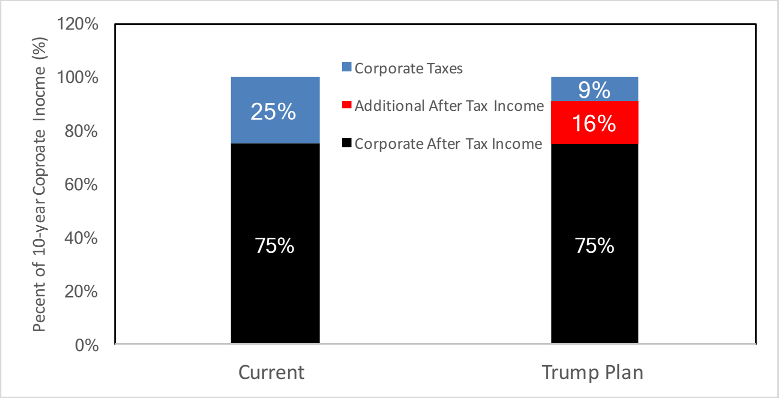
Trade : Buy US Equities—Lower Tax Rate And Economic Growth Create Earnings Upside

Trade Thesis

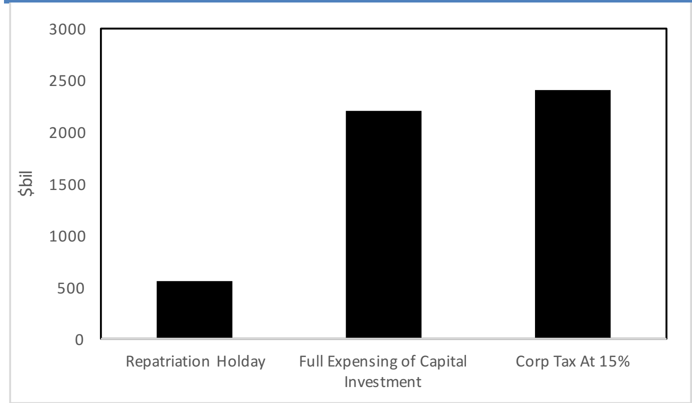
- Tax plan could add as much as $5 trillion to after tax corporate income over the next 10-years
  - Tax repatriation holiday, $0.5 trillion
  - Full expensing of capital investment, $2.1 trillion
  - Tax cut from 35% to 15%, $2.4 trillion
- Tax cut would add as much as 21% to after tax income
  - Could be more if economy grows faster from program
- Tax cuts could push equities substantially higher
  - Also push credit market tighter, particularly high yield

Risk is that nothing gets done

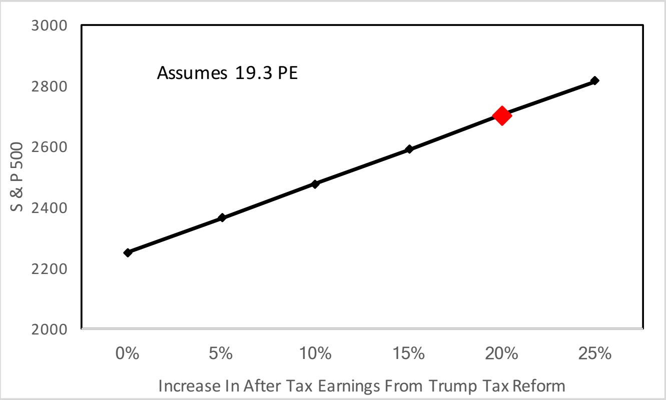
Fully Implemented, Trump Tax Plan Adds 20% to After Tax Income [1,2]



Tax Savings From Trump Corporate Tax Plan Over 10 Years [1,2]



Potential Impact of Trump Corporate Tax Reform on Equities



1. Jim Nunns, Len Burman, ect, "An Analysis of Donald Trump's Revised Tax Plan", Tax Policy Center, October, 2016
2. Entin, Fellow, "the Tax Treatment of Capital Assets and Its Effect on Growth", Tax Foundation Background Paper, April 2013

Past performance is not indicative of future results

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Step 4: Find Asymmetric Trades

Trade : Buy Regional Banks--Trump Corporate Tax Cuts + Financial Reform = Upside

Trade Thesis

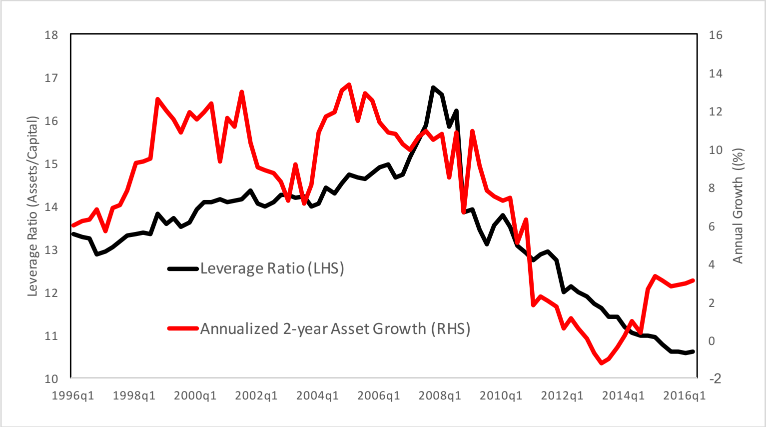
- DF reform could would help all banks but may focus on non-big 7
  - The criteria of "TBTF" does not seem to apply to regional banks
  - Reform could be either reduce the severity of the extreme scenarios or remove them from DFAST
- Trumpanomics increases earnings of banks
  - Lower tax rates would benefit domestic banks since they pay the full statutory rate
  - Banks could increase lending to riskier but higher margin borrowers
- Upside thesis is that banks price to tangible book would go up as banks used the reduction in regulation and lower taxes to increase their ROE
  - Extra capital that could be used to grow assets, particularly higher spread but riskier loans

Risk is that reform does not happen

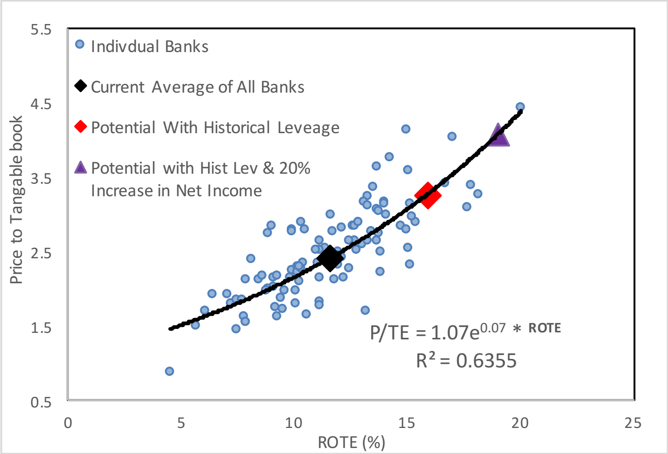
Reduction of Capital Needs From Loser Regulatory

- Return on Tangible Capital a prime driver of bank pricing
- Last year is an example of this pricing
  - Data covers 113 banks that are not G-SIB
  - Exponential regressions illustrates the relationship between ROTE, and Price to tangible book (PTB)
  - Historical leverage is based on data from 2000-2005
- As shown below, banks could rally substantially from current levels
  - Another 35% from current levels if leverage went back to historical norms
  - Another 60% if leverage went back to historical norms and net income grew by 20%

Asset Growth Has Slowed As Bank Leverage Has Fallen [1]



Banks Could Rally If Reforms Allows More Leverage And Risk [2]



1. FDIC
2. Yahoo Finance

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Step 4: Find Asymmetric Trades

Trade : Buy Mortgage Insurers

Trade Thesis

- Financial reform could involve pushing the substantial amount of public sector mortgage risk into the private sector
  - GSEs and FHA/VA have more risk to the severely adverse scenario than large banks
- Reform could restart the private mortgage securitization market, both prime and non-prime
- Mortgage insurers would benefit substantially from both

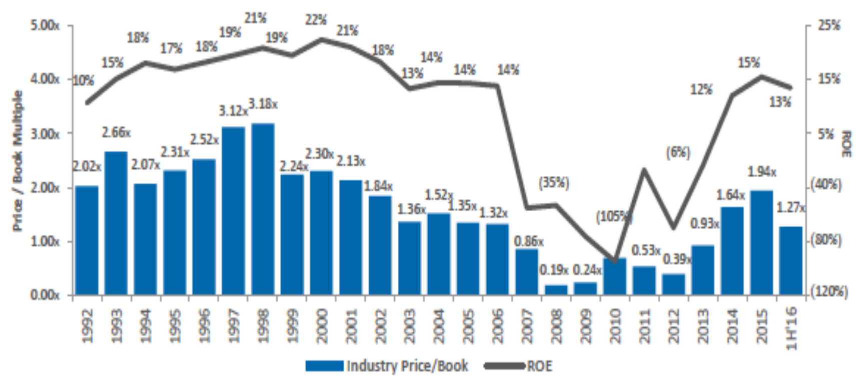
Risk is no GSE reform

Privatizing Some of The Risk of FHA/VA

- 400 to 500 billion year of high LTV lending with low FICOs
- FHA/VA do not incorporate MI
- Expansion to MI could mitigate the $115 billion adverse scenario risk

Privatizing GSE Risk [1]

- Pushing more of the GSE guarantee business to private sector
  - Deep Coverage: GSE would need to cover all high LTV loans to 50%
  - Deep coverage would increase private MI fees by 27%, but reduce borrower total fees by 18%
  - Deep coverage would transfer 75% of losses in the DFAST adverse severity scenarios
- Closing down of the GSE's opens up the pool insurance market for prime mortgages
  - 80% or lower LTV is x% of GSE market
  - Fees are … a year
  - Securitization would replace GSE guarantee with subornation or MI pool insurance



1. Bjurstrom, et all ' Analysis of Deep Coverage Mortgage Insurance", Milliman Client Report, October 2015
2. Shuster, "Intro to National MI", NMI Holdings Investor Day, 2016

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Step 4: Find Asymmetric Trades

Trade : Buy Home Builders

Trade Thesis

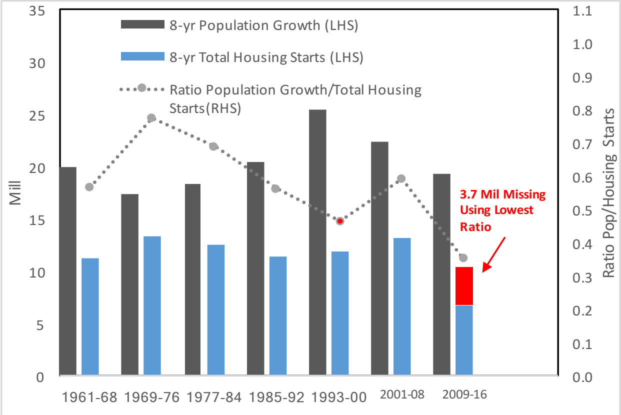
- Financial Regulatory Reform could open up non-prime lending
  - Non-prime lending has dried up given Dodd-Frank
  - Non-prime borrows one reason housing starts are so low vs historical norms
  - These borrowers have been going to for rent vs for sale
- For sale housing could surge if these non-prime borrowers get access to credit
  - There is already a deficit of 3.7 million new homes that need to be built
- Home builders have substantial convexity to the upside in this scenario

Risk is that structural issues are driving lower housing starts

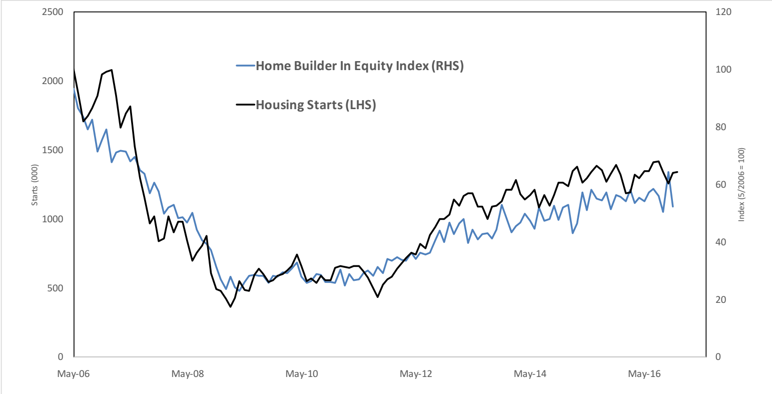
Starts Are Low As Non-Prime Borrowers Cannot Get Loans [2]

	Missing Purchase Loans Given Underwriting Standards of 2001			Total Missing	Market Value of Missing Home Purch
FICO	2012	2013	2014	2012-2014	($bil)
660 and below	592,691	876,223	1,007,062	2,475,976	$681
660-720	607,851	369,007	191,791	1,168,649	$321
720 and above	-	-	-	-	$0
Total	**1,200,542**	**1,245,230**	**1,198,853**	**3,644,625**	**$1,002**

Home Building Is Low Given Population Growth [1,2]



Builders Upside If Reforms Start Up The Non-Prime Market [1,4]



1. Data Access Through Fred, Federal Reserve Bank of St. Louis
2. Authors calculation
3. Bai, Goodman, Zhu, "Tight credit standards prevent 5.2 million mortgages between 2009 and 2014", Urban Institute, Urban Wire, Jan 2016
4. Yahoo Finance

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State of The Markets: Strategies for Trumpanomics

Step 4: Find Asymmetric Trades

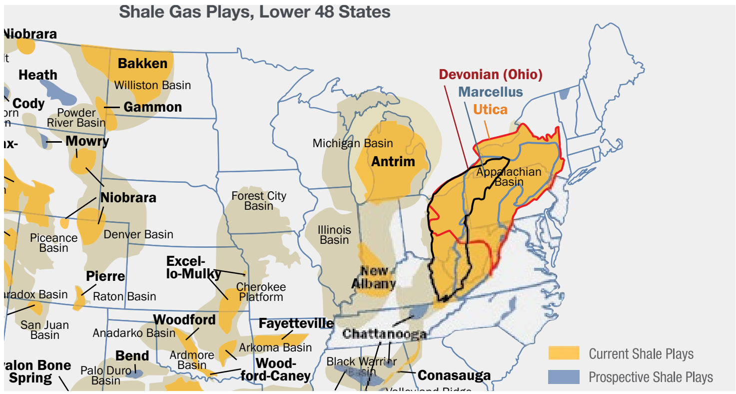
Trade : Buy Equities Exposed to Energy Investment--- The Manufacturing Renaissance of the Rust Belt

Trade Thesis

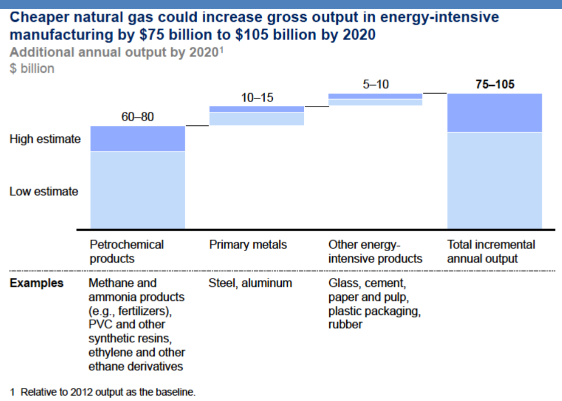
- The Rust Belt elected Trump
- Trumpanomics could solidify that vote by focusing on fostering a manufacturing renaissance of the Rust Belt based on nat gas
  - Marcellus is the new coal fields of the rust belt
  - Industry and cities can be rebuilt based on cheap and abundant Nat gas
  - 100% expensing of capital investment could turbo charge growth
- Buy equities that would benefit from this focus
  - Both upstream and downstream Nat gas companies
  - US steel related companies that will build the infrastructure
  - Chemical and other downstream companies that will use it

Risk is that reform never happens

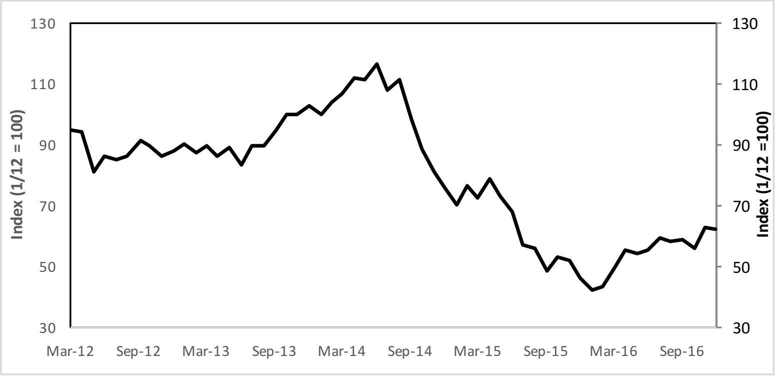
The Largest Source of Nat Gas is the Rust Belt: The New Coal [2]



Nat Gas Develop [1]



Portfolio Focused on These Industries Has Substantial Upside



1. Mckinsey Global Institute, “Game Changers: Five opportunities for US growth and renewal” July 2013 `
2. API, “Hydraulic Fracturing: Unlocking America's Natural Gas Resources” July 2016

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***SOM** Macro Strategies*
State of The Markets: Position For Higher Rates

- ***Step 1: Macro Theme: Position For Higher Rates***
  - Interest rates are very low by historical norms given current economic growth and strong labor market
- ***Step 2: Fundamental Economic Framework***
  - Nominal GDP growth is determined by real GDP growth and inflation
  - Historically interest rates have been highly correlated with nominal GDP Growth
    - The Fisher equation
- ***Step 3: Find Potential Catalysts***
  - Real economic growth could accelerate, particularly given Trumpanomics
  - Tight labor market and both the success and failure of Trumpanomics could push up inflation
  - QE unwind and financial reform could remove barrier on yields moving closer to historical norms
- ***Step 4: Find Asymmetric Trade***
  - Trade : Buy 1/5 25bp OTM payer swaptions

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State of The Markets: Position For Higher Rates

Step 4: Find Asymmetric Trades

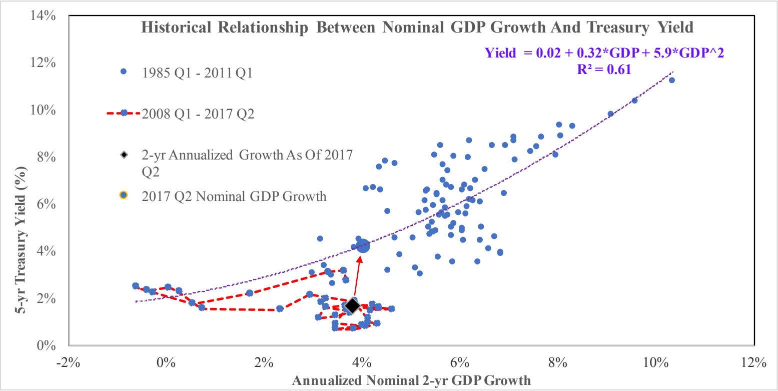
Trade : Position For Higher Rates--Buy Out-of-The Money 1y/5y Payer Swaptions

Trade Thesis

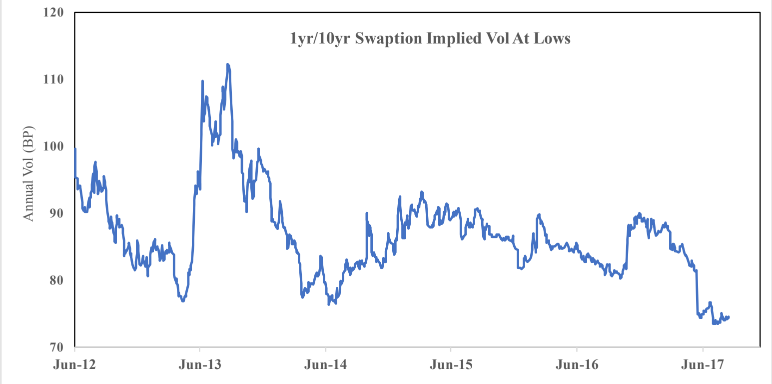
- Interest rates are below normal given current economic conditions
- Rates could move higher closer to norms
  - Real growth pickup, e.g. Trumpanomics
  - Tight job market or deficit spending pushes up inflation
  - QE unwind or financial reform reduces demand for duration
- Payer Swaptions are compelling
  - Vol is low by historical standards so it misprices the tail of significantly higher rates
  - Payouts could be north of 3 to 1

Risk is the the US is following the path of Japan

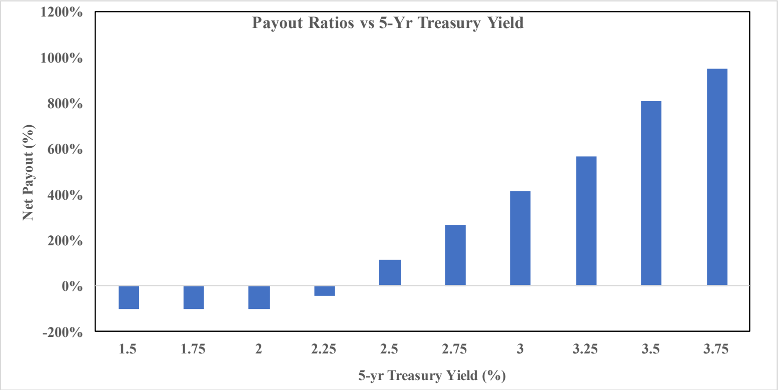
Nominal Growth Will Push Rates Higher [1,2]



Implied Volatility Not Rich By Historical Standards[1]



Performance of 1/5 Swaption [3]



1. CBOE, SRVIX Index of Implied Volatility of 1/10 Swaptions
2. St. Louis Federal Reserve (FRED)
3. Authors analysis

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State of The Markets: Position For Higher Rates

- ***Step 1: Macro Theme: Greece***
  - Greece has made significant strides in rebalancing their economy, but is it enough?
- ***Step 2: Fundamental Economic Framework***
  - Greece's economy was inflated by the access to cheap external capital
  - The bubble burst in 2010 leading to substantial reforms driven by the need to get EU/IMF program money
  - The result was a "Great Depression", with a surge in unemployment and NPLs
  - Now the economy appears to be emerging from this depression, while banks have been recapitalized and have a significant loan loss reserve
  - Growth could be supported by a rebound of growth in the rest of the EMU particularly from Germany
- ***Step 3: Find Potential Catalyst***
  - Greece could be on threshold of finally getting debt relief given their past and agreed to future reforms if the IMFs gets it way
  - Economic growth could turn Greek banks into earnings engines by slowing down the creation of new NPLs
- ***Step 4: Find Asymmetric Trade***
  - Trade : Buy Greek Sov Debt
  - Trade : Buy Greek Banks

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State of The Markets: Greece

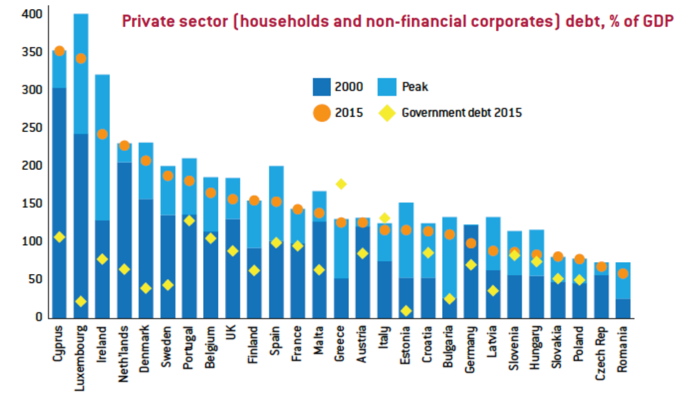
Step 4: Find Asymmetric Trades

Trade : Buy Greek Government Debt—GGB Yields Converge To Portuguese Yields

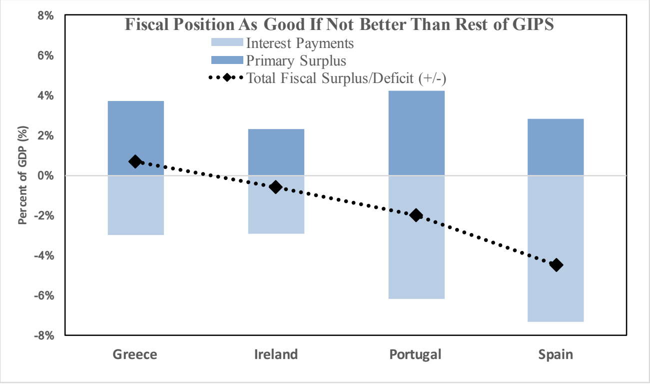
Trade Thesis

- Greece and EU/IMF agree on Bailout III but this time with ***debt relief***
  - Greek government and EU have agreed on economic program
  - IMF is needed but they demand debt relief
  - Key date May 5\22
- Greece will be on a sustainable path for paying back debt
  - GGBs small percentage of total Greek government debt
- Demand for GGBs increases
  - Little supply of high yielding GGBs, only 34.5 bill after 2017
  - ECB buys as part of PSPP
    - Already ECB lifted restrictions on using GGBs for repo

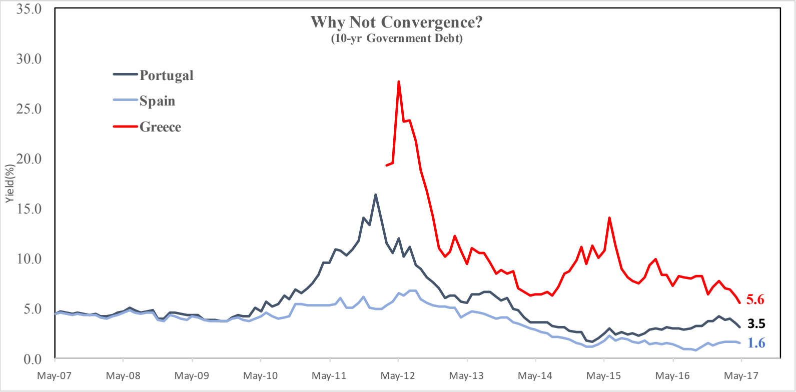
Taking Out Sov Debt Risk, Greece Debt Risk Also Looks Better [2]



Greek Fiscal Position Looks Better Than Rest of GIPs [1]



So, Buy Greek GGBs [3]



1. Eurostat
2. Demertzis and Lehmann, “ Tackling Europe’s crisis legacy”, Policy Contribution, Issue 11, 2017
3. Bloomberg

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State of The Markets: Greece

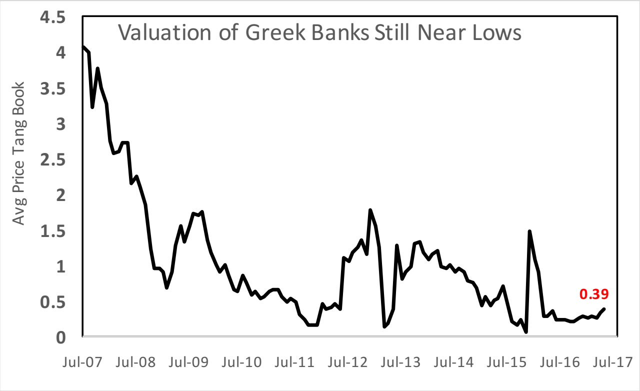
Step 4: Find Asymmetric Trades

Trade : Buy Greek Banks--NPL Problem Eases And Reveals Cheapness of Underlying Earnings Engine

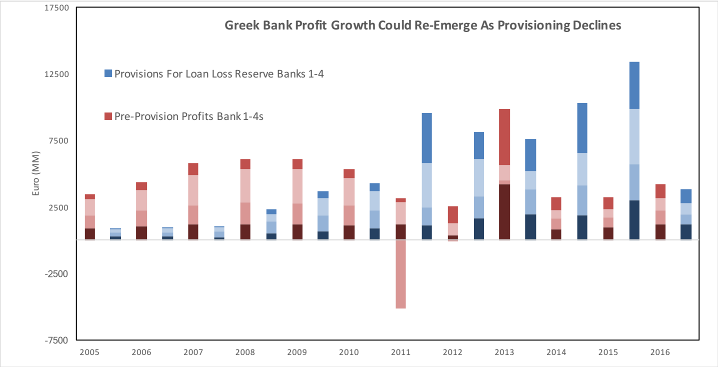
Trade Thesis

- The next EU/IMF Program will reduce Grexit risk
  - Deposits outflows should turn into inflows
  - Cost of funds/equity should fall
- Economic growth will reduce NPE risk
  - NPE growth should reverse
  - Defaults and severities should fall
- Greek banks are undervalued by many measures
  - Low price to tangible book should rebound as Gexit risk falls
  - Falling NPE reveal power of earnings engine
  - Loan loss reserves start flowing into capital making banks even cheaper

Putting the Recent Rally In Greek Banks In Perspective [2]



Solving NPL Problem Could Generate Substantial Earnings Growth [1]



Realistic NPL Realization Makes Greek Banks Look Even Cheaper [3]

Price To Remaining Tangible Book + LL Reserve After Scenario				
	Default Rate			
Severity	100%	76%	50%	25%
100%	-0.53	1.41	0.29	0.16
65%	0.53	0.28	0.19	0.14
50%	0.29	0.21	0.16	0.13
25%	0.16	0.15	0.13	0.12

1. Major Bank Earnings Reports 2004-2016
2. Bloomberg
3. Calculation by Author

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***SOM** Macro Strategies*

State of The Markets: Buy Corporate Debt--It's Not A Bubble And Tax Reform Could Tighten Spreads

- ***Step 1: Macro Theme: Is Corporate Debt A Bubble?***
  - Corporate debt has almost double in the last 10 years
  - Yet spreads, if anything, have tightened
  - Corporate credit fundamentals by some measures seem to have deteriorating close to recessionary levels
- ***Step 2: Fundamental Economic Framework***
  - On a fundamental basis nonfinancial corporate debt is not a bubble, credit risk has been falling and spreads if anything are too wide
    - With the exception of the energy sector
  - While debt has grown, leverage-–a prime indicator of potential credit risk—has fallen as equity market cap has grown even faster
  - Spreads are reasonable given fundamentals and current leverage levels unless leverage itself changes
  - A structural model of the optimal capital structure captures the linkages between leverage with the tax benefit of debt (see appendix)
- ***Step 3: Find Potential Catalyst***
  - Trump corporate tax reform has the potential to substantially reprice corporate debt by reducing the tax incentives for corporates to leverage
    - Trump plan is to cut corporate tax rates to 15% from its statutory 35%
    - Trump plan incorporates some reduction in the deductibility of the interest expense
    - Tax reform could reduce optimal leverage substantially
- ***Step 4: Find Asymmetric Trade***
  - Trade 1; Buy US Equities
    - Tax reform pushes up earnings and ultimately equity prices
    - Buy 30 delta 3-month calls
  - Trade 2: Buy IG corporates
    - Tax reform driven equity rally reduces leverage which could tighten IG spreads
  - Trade 3: Buy HY bond
    - Reform could drive a substantial deleveraging particularly of highly levered firms which could tighten spreads substantially
    - The tax shield is basically the only justification for having debt as part of the optimal capital structure
    - Reducing marginal tax rates and/or reducing interest expense deductibility could reduce the incentive to issue debt

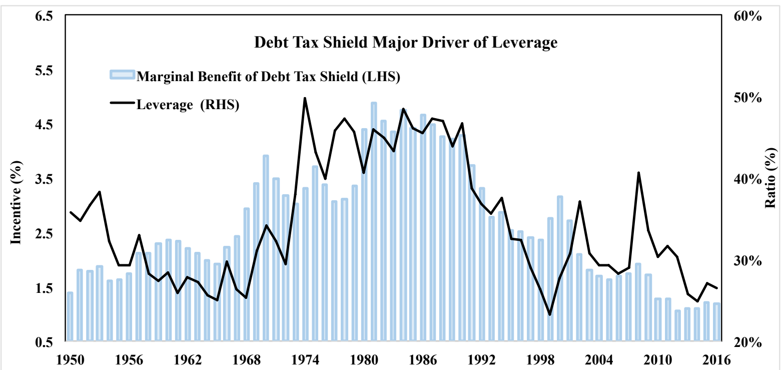
SOM Macro Strategies

State of The Markets: Buy Corporate Debt--It's Not A Bubble And Tax Reform Could Tighten Spreads

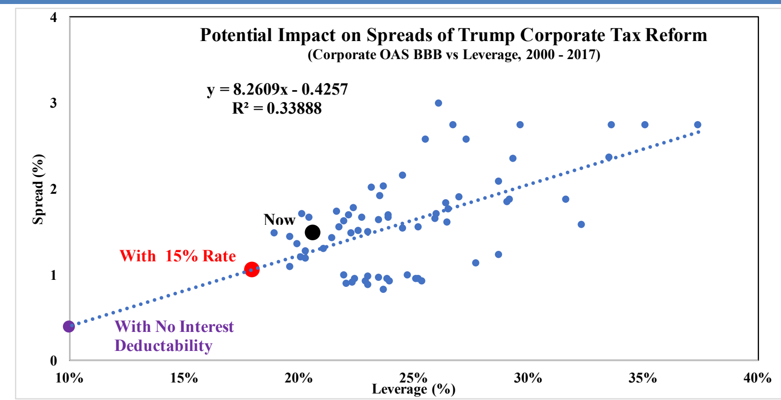
Step 4: Find Asymmetric Trades

Trade : Buy High Yield--- Spreads Could Tighten Substantially as Firms Reduce Leverage After Tax Cut

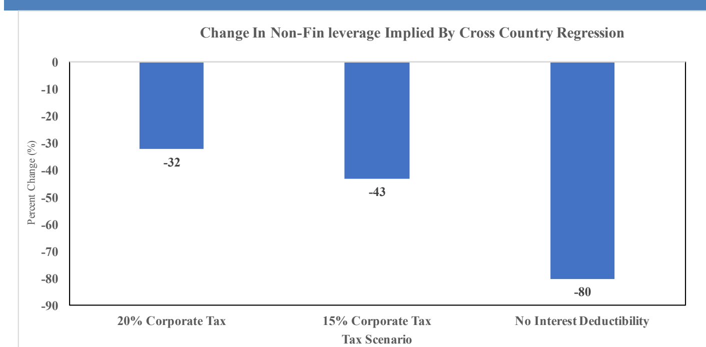
Historically, Leverage is Highly Correlated With Tax Benefits [1,2,3]



Based On US Data, Spreads Could Tighten Substantially[1,2,3,5]



Based On Other Countries, Deleveraging Could Be Substantial [4]



Based On Structural Models, HY Could Tighten More Than IG [5,6]

	Current			After Trump Tax Cuts And Optimal Leleveraging				
Rating	ICR	Leverage	CDS	Net Income Chng	Leverage	ICR	New CDS	Spread Tightening
A	8.5	33%	40	26%	15%	15.95	25	-38%
BBB	5.6	50%	100	21%	20%	12.64	50	-50%
BB	2.5	50%	165	15%	25%	4.74	65	-61%
B	1.6	73%	300	8%	35%	3.21	100	-67%

1. Board of Governors of the Federal Reserve, Z1 Data
2. Marginal Benefit is equal to Corporate yield x the effective marginal tax rate
3. Federal Reserve Bank of St. Louis, FRED Data
4. OFI Global Newsletter & Barclays Capital
5. Authors Calculations
6. Bloomberg DRSK Calculator

Recommended Trades: Closed

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State of The Markets: USA

Step 4: Find Asymmetric Trades

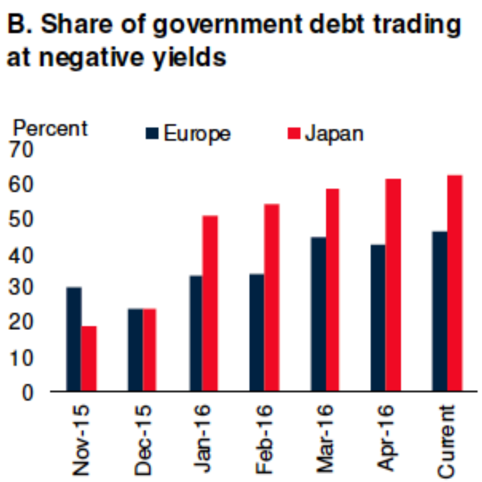
Trade : Buy Long-dated Deep-out-of-Money Calls in USD on Gold-- a Call on Further DM Easing Policies

Trade Thesis

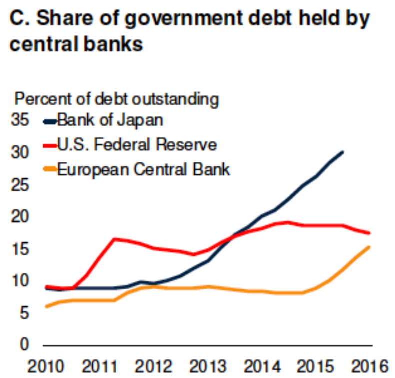
- Gold prices have been driven in part by DM monetary policies
- Gold could spike from further monetary policy moves particularly from the US

Risk is US economic growth could put upward pressure on rates and the USD

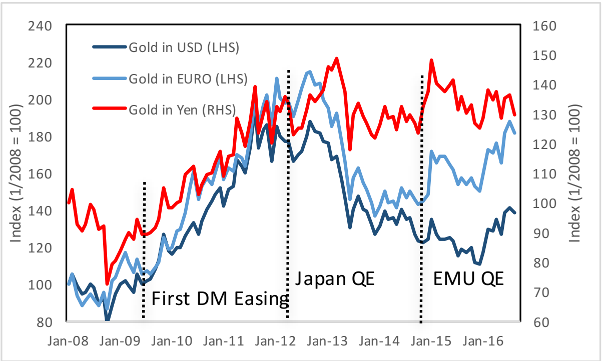
DM Monetary Policy For Rates[1]



DM Monetary Policy of QE[1]



Gold Has Followed DM Monetary Policy Moves[2]



1. World Bank, Global Economic Prospects, June 2016
2. Federal Reserve Bank of St. Louis (FRED)

Past performance is not indicative of future results

SOM Macro Strategies
State of The Markets: Strategies for Trumpanomics

Step 4: Find Asymmetric Trades

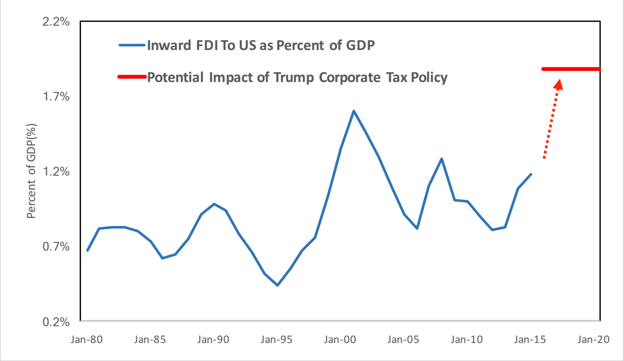
Trade : Stronger USD--Trumpanomics Could Strengthen The Dollar

Trade Thesis

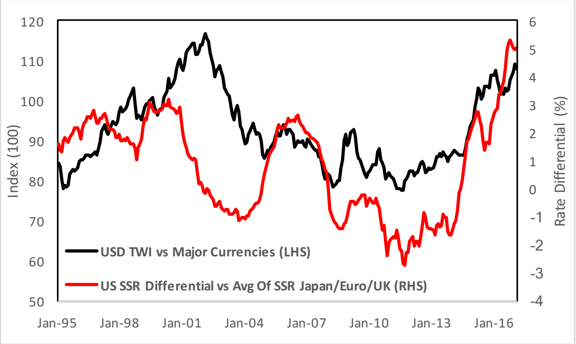
- Dollar strengthens as economy grows which could widen interest rate differentials
- An increase in foreign capital into the US strengthens the dollar
  - Trump corporate tax reform increases both the relative after tax returns of US investments as well as increasing the Investment opportunities
- Border tax pushes the USD higher to offset impact of the tax
- Best of Euro and Yen puts vs the USD is attractive because correlation is less than one
  - Euro and Yen should both be highly correlated under Trumpanomics

Risk is economic growth in Japan and Europe outpace that of US

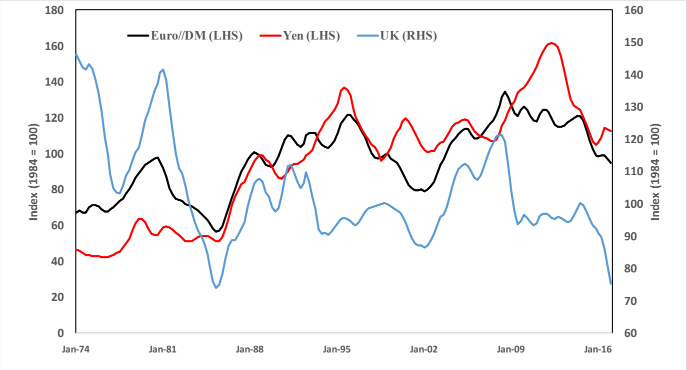
Trump Cut in Corporate Tax Could Create a Surge In FDI [3,4]



USD Could Strengthen From Rising US Interest Rates [1,2]



Dollar Could Strengthen Back To Its High Vs Euro/Yen[2]



1. Central Bank of New Zealand, SSR stands for shadow short rates, which adjust policy rates for the impact of QE and ZRP.
2. St. Louis Federal Reserve (FRED)
3. OECD Data Portal
4. Hufbauer and Lu, "Lessons for US Business Tax Reform from International Tax Rates", Policy Brief, Peterson Institute for International Economics, PB17.2, January 2017

SOM Macro Strategies
State of The Markets: BREXIT

Step 4: Find Asymmetric Trades

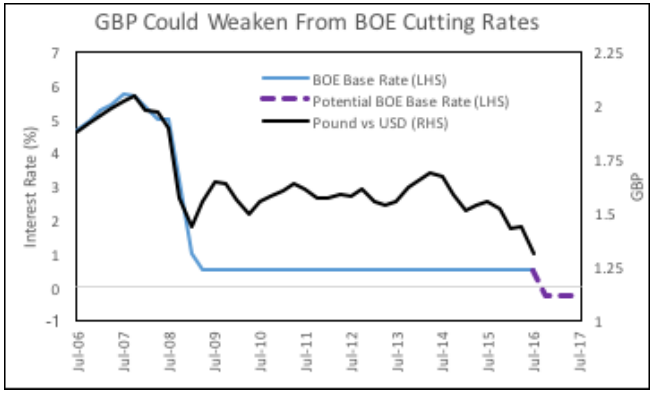
Trade : Short the GBP---BOE Will Need To Do More To Offset The Impact of BREXIT Starts To Unfold

Trade Thesis

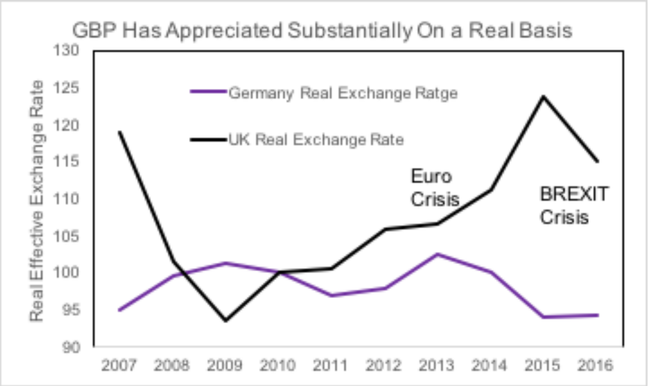
- BOE will ease monetary policy in response to increasing risk to their economy and financial system in the aftermath of BREXIT
- GBP could fall vs USD as BOE lowers rates or from capital flight
- Implementation is to short GBP at 1.33 with a stop of 1.37 and a target of 1.10 vs USD

Risk is that BOE does nothing and GBP goes back to pre-BREXIT level

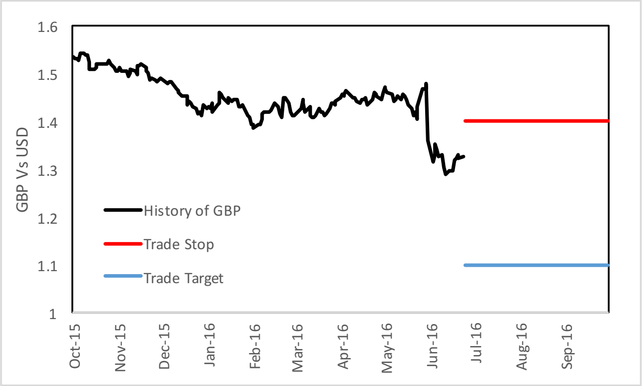
GBP Weaken In Response to The BOE Lowering Rates in 2008[2]



GBP Strengthen In the Aftermath of The Euro Crisis[1]



Trade Implementation, Targets and Stops[2]



1. IMF, Real exchange rate using country labor costs
2. BOE

Past performance is not indicative of future results

SOM Macro Strategies
State of The Markets: Abenomics

Step 4: Find Asymmetric Trades

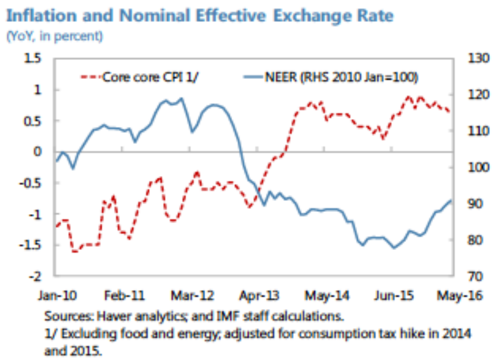
Trade : Buy Nikkei Calls--BOJ Will Need To Do More As The Impact of QE Ebbs

Trade Thesis

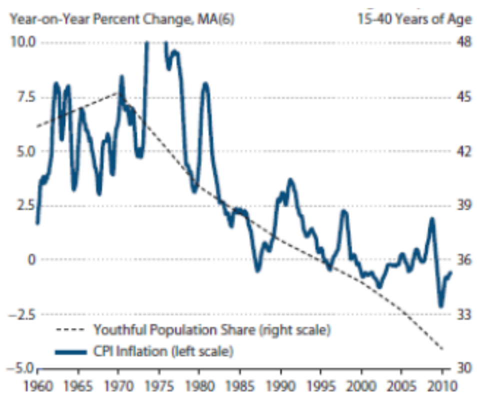
- Achieving the inflation target of Abenomics is impossible given demographics of Japan
  - Deflation and a stronger Yen reemerging as the impact of past QE ebbs
- BOJ will loosen monetary policy further, which will weaken the Yen
- Buy 6-month call spreads on Nikkei that will appreciate in the aftermath of BOJ actions

Risk is that BOJ does nothing and Yen appreciates and Nikkei falls over and beyond the FX impact

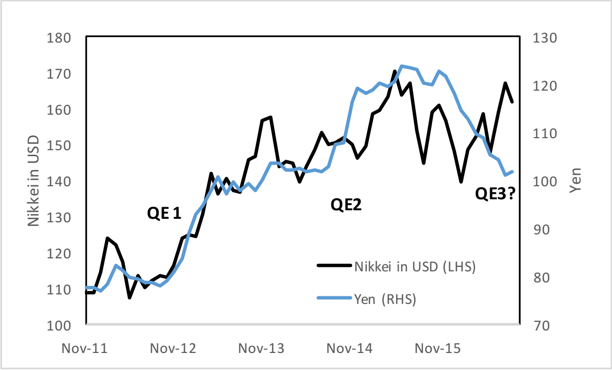
Inflation Has Followed Weaker Yen After Start of Abenomics[2]



Japan: Population and Inflation[1]



Nikkei Outperforms in USD in Japan QE/Weaker Yen[3]



1. Bullard, Garriga, and Waller, " Demographics, Redistribution and Optimal Inflation", Federal Reserve Bank of St. Louis Review, November/December 2012
2. IMF, Japan Article IV, June 2016
3. Yahoo finance

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SOM Macro Strategies
State of The Markets: Brazil

Step 4: Find Asymmetric Trades

Trade : Buy Puts on Bovespa---Rally To Its Highs Looks Unstainable Given Prospects For Growth

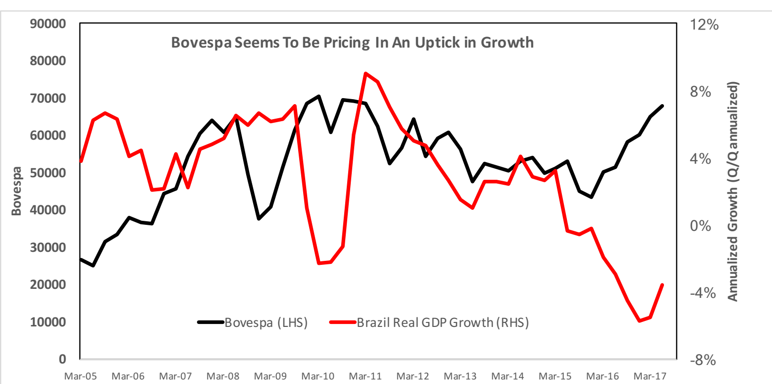
Trade Thesis

- Bovespa will sell off from its near historical highs as the substantial fundamental economic problems of Brazil takes hold
- Potential catalysis are a slower than expected economic growth, rising consumer and corporate financial stress, or an increase in political turmoil driven by reform, **Trade idea: buy 6-month 5% OTM puts on Bovespa For 3%**
  - Taking advantage of high interest rates vs dividend rates
  - On forward bases, Bovespa is near its historical highs
- ***Risk is Bovespa continues to rise and you lose option premium***

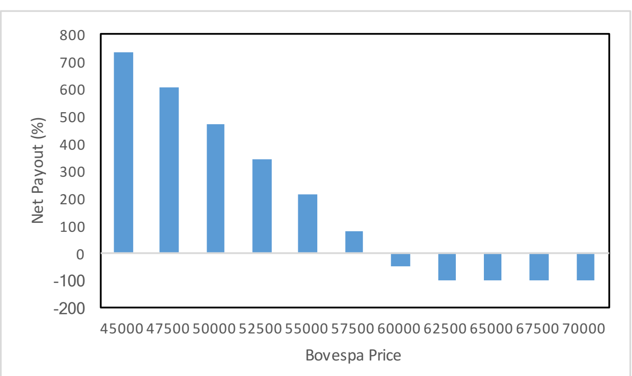
The Rally Over Last Year Driven By Vulnerable Sectors [1]

	Total Weights	1-yr Total Return
Sector/Index	100%	**26.9%**
Financials	***33.3%***	***34.5%***
Commodity	***21.3%***	***54.3%***
Consumer Staples	18.7%	1.4%
Consumer Discretionary	***6.0%***	***30.0%***
Industrials	5.6%	14.7%
Utilities	5.3%	13.0%
Information Technology	3.6%	-14.0%
Telecommunication Services	3.1%	24.0%
Health Care	1.7%	27.2%
Real Estate	1.4%	18.7%

Bovespa Rallied To The Historical Highs With Growth At Lows[1]



Potential Performance on 5% OTM Put on Bovespa



1. Bloomberg

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SOM Macro Strategies
State of The Markets: Brazil

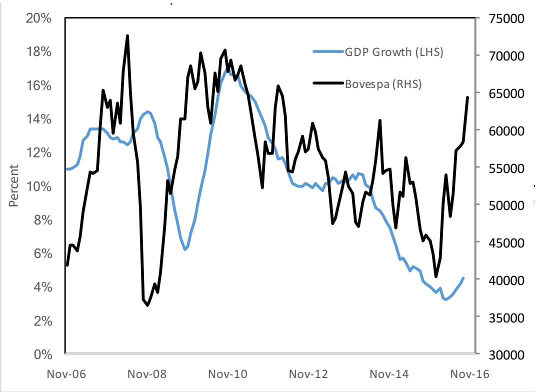
Step 4: Find Asymmetric Trades

Trade : Buy Puts on Bovespa—Equity Markets Do Not Reflect New Economic Realities

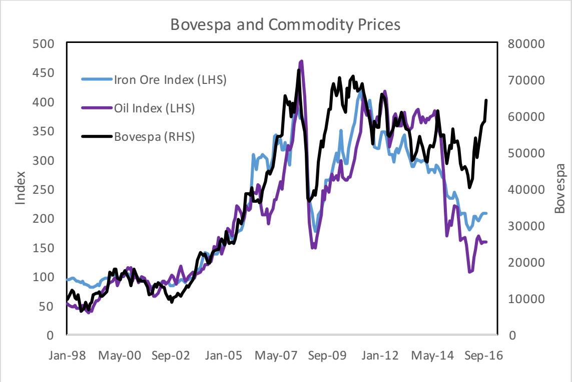
Trade Thesis

- Bovespa will sell off from its near historical highs as the substantial fundamental economic problems of Brazil takes hold
- Potential catalysis are a rise in political turmoil driven by reform, or a rise in defaults on corporate or household loans
- **Trade idea: buy 6-month 5% OTM puts on Bovespa For 3%**
    - Taking advantage of high interest rates vs dividend rates
    - On forward bases, Bovespa is near its historical highs
- ***Risk is Bovespa continues to rise and you lose option premium***

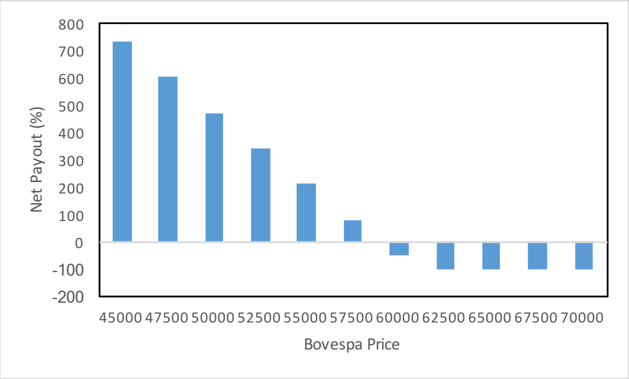
Ultimately Equity Markets Follow GDP[1,3]



Bovespa Does Not Reflect Commodity Prices [1, 2]



Potential Performance on 5% OTM Put on Bovespa



1. Yahoo Finance
2. UN Commodity Index
3. Central Bank of Brazil

Past performance is not indicative of future results

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