

CBOE 26th Annual Risk Management Conference Dividend Swaps, Options & Futures

March 2010



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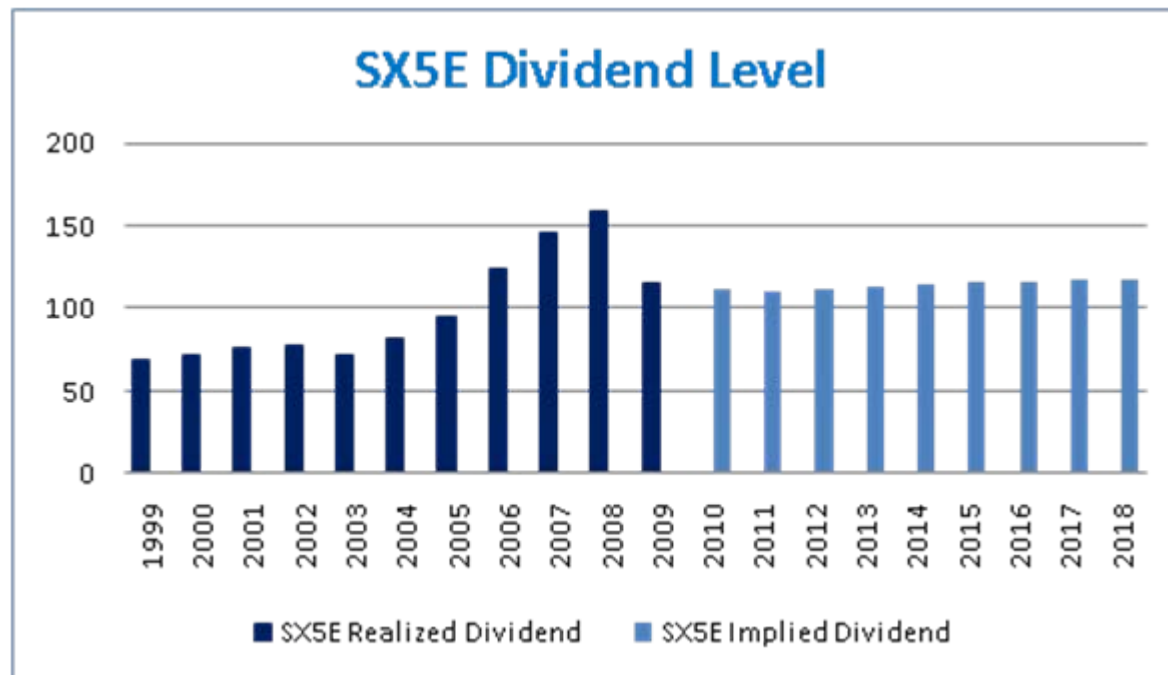
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I. Index Dividend Steepener Trade Example

SX5E Index 2011-2015 Dividend Swap Steepener (Illustrative)

Context & Opportunity

- SX5E implied dividends were one of the best performing assets class in 2009, dramatically outperforming their underlying stock index :
 - ✓ in 2009, SX5E 2010 implied dividend were up 59% versus 17% for SX5E.
 - ✓ That performance was mostly catch-up from extremely depressed level during the eye of the crisis as shown in Charles' slides.
- Yet, the implied term structure stays extremely flat, pricing quasi zero growth for dividends up to 5 Years forward, even though dividends have been historically positively correlated with inflation (see Charles' slides)



SX5E Index 2011-2015 Dividend Swap Steepener (Illustrative)

Trade

- Long €250k notional of 2015 SX5E index dividend swaps and short €250k notional of 2011 SX5E index dividend swap at a spread of 5 points.

Risks

- Mark-to-market risk as the 2011-2015 implied dividend spread could become further undervalued prior to that
- Pull-To-Realized effect will make the 2011 dividend less and less volatile as earnings get announced and hence be less of a hedge for the 2015 SX5E implied dividend position (the timeframe of the trade is to Dec 2010 at max)

Performance

- Base Case:
Expected at Year-End 2010
2015-2011 Implied dividend curve is trading at 15 points
 $\text{PnL} = (15 - 5) \times \text{€}250\text{k} = \text{€}2.5\text{mm}$
- Upside Case:
Expected at Year-End 2010
2015-2011 Implied dividend curve is trading at 20 points
 $\text{PnL} = (20 - 5) \times \text{€}250\text{k} = \text{€}3.75\text{mm}$
- Downside Case:
Expected at Year-End 2010
2015-2011 Implied dividend curve is trading at -5 points
 $\text{PnL} = (-5 - 5) \times \text{€}250\text{k} = \text{€} -2.5\text{mm}$

II. Single Name Dividend Swap Trade Example

France Telecom Single Name Dividend Future (Illustrative)

Context & Opportunity

- The Blue Chip Telecom stock France Telecom (FTE) presents an attractive implied dividend opportunity.
- 2011 FTE implied dividend level trades cheaper than what was paid in the last 3 years.
 - France Telecom implied dividend for 2011 is trading at a 8% discount to 2009 realized dividend, while Free Cash Flow is stable and the CFO of the company declared last November that a gross payout of € 1.4 (2009 and 2008 dividend) can be considered a “floor dividend”.
 - You can now implement this trade in listed dividend swaps (no need for ISDA etc...) (listed futures are not CFTC approved yet)

Trade

- Long 5mm shares of 2011 FTE dividend swap @ 1.29 (indicative) for a total market value of € 6.5 mm

Monitor	View	Alerts	News	Link To					Feedback	=f(x)
▲	🔊	Ticker	Name	Bid Size	Bid	Ask	Ask Size	Curr Px/volume	Chg on Dav	Pct Chg on Dav
◉		F1TE=Z0	France Tele SSDF Dec10	0	1.35	1.40	0	\$1.38	+0.02	+1.47%
◉		F1TE=Z1	France Tele SSDF Dec11	0	1.26	1.31	0	\$1.29	-.04	-3.01%
◉		F1TE=Z2	France Tele SSDF Dec12	0	1.26	1.35	0	\$1.31	-.02	-1.50%
◉		F1TE=Z3	France Tele SSDF Dec13					\$1.31	-.02	-1.50%
◉		F1TE=Z4	France Tele SSDF Dec14					\$1.31	-.02	-1.50%

Snapshot of Bloomberg screen with the Deutsche Telecom dividend futures markets.

France Telecom Single Name Dividend Future (Illustrative)

Risks

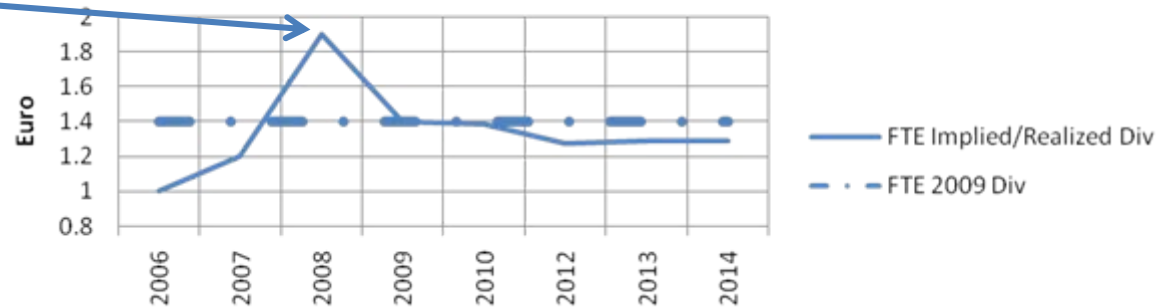
- Mark-to-market risk as dividends will not be announced until 2011, and could become further undervalued prior to that
- Loss if the single name dividend realizes lower than where it was bought

Performance

- Base Case:
FTE dividend pays 1.4 in 2011 (2008 and 2009 div)
PnL = € 550k
- Upside Case:
FTE dividend pays 1.45 (a 3.5% increase from 09) in 2011
PnL = € 800k
- Downside Case:
FTE dividend pays 1.2 in 2011 (2007 div)
PnL = € -450k

FTE changed the frequency of its dividend from an annual to a bi-annual payment

France Telecom Realized & Implied Dividend

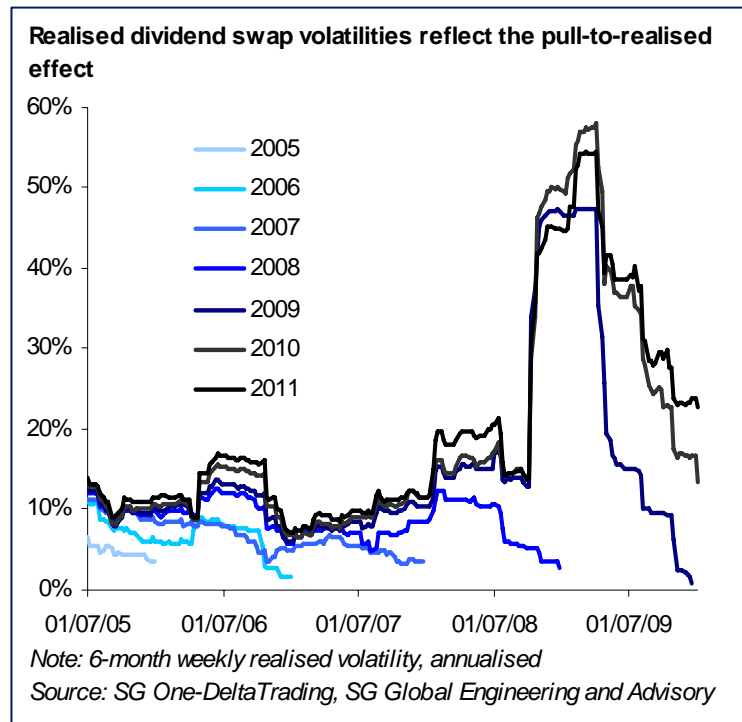


III. Options on Dividends Trade Example

Sell Straddles on SX5E 2011 Dividend Swap (Illustrative)

Context & Opportunity

- 2011 SX5E Implied dividend will start to become stickier as more quarterly earnings get announced
- Most of European 2011 dividends are paid out of 2010 earnings early in 2011 by one annual dividend payment
 - ✓ about 80% of the SX5E dividend points get announced by March
 - ✓ The chart below illustrates what we call the “Pull-To-Realized” effect and you can see how fast the realized volatility of the Current Year Index Dividend dies out



Sell Straddles on SX5E 2011 Dividend Swap (Illustrative)

Trade

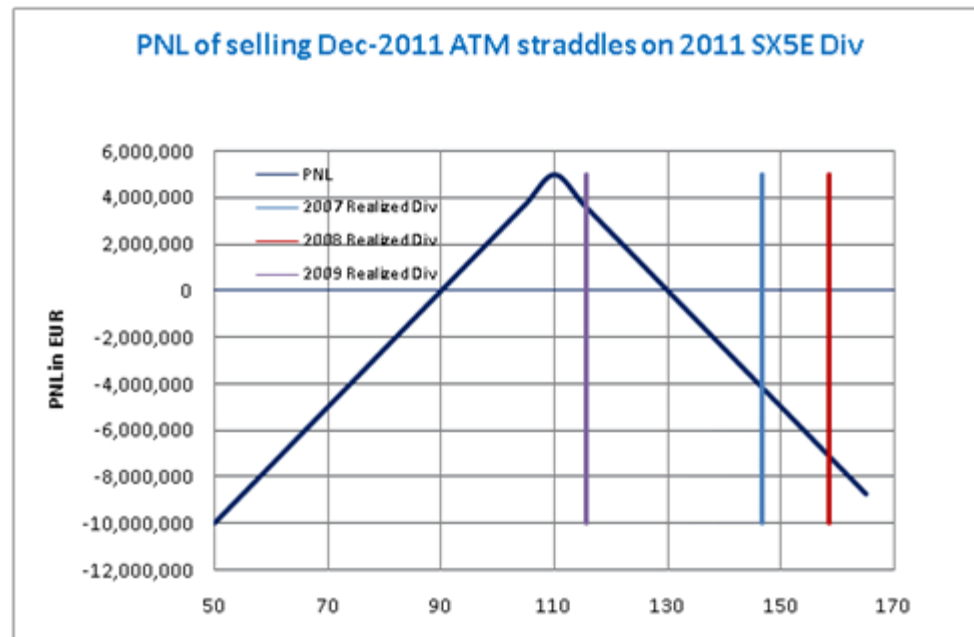
- Sell € 250 k of Dec-2011 maturity straddles on SX5E Index 2011 Dividend, 110 ATM strike for 20 points, that corresponds to ~ 20% implied vol

Risks

- Mark-to-market risk as the trade is exposed to changes in dividend prices and other Greeks sensitivities.
- Strong recovery or severe dip which would cause dividends to realize out of the [90-130] range in 2011.

Performance

- You make money as long as you stay within the [90-130] range at expiry, outside, you loose € 250k a point



A few comments :

- Dividend swaps on SPX index and US single names can also be traded OTC
- Liquidity on the US dividend swaps is lower compared to the one of their European counterparts
- Options on quarterly SPX dividends will be launched by CBOE on March 5th 2010.

IV. Q & A