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Trade Write-Up

SAR 1 Long 1 Year ATMF Straddles	August 20, 2015 Emerging Markets Foreign Exchange

Fundamental Rationale: Let me be clear at the onset, I do not believe the Saudi peg will change. This trade would likely benefit if the peg were to be lifted, but it is not the base case for initiating the position. Instead, the expectation is that the market will once again view USD/SAR options as a “cheap” way to play for a devaluation, in line with what has been occurring across the emerging market landscape. With limited liquidity and implied vols so much lower than any other emerging market currency, market participants have traditionally flocked to this pair at moments similar to this. You might think we missed the opportunity with forwards having jumped over the last 10 days, but in fact, it is that jump without a commensurate jump in implied vols that makes this an even more attractive entry point, particularly from the risk side of the risk / reward equation.

The idea is this. This situation can play out any number of ways. (1) The market extends this push higher in forwards without an accompanying shift higher in implied vols, and we trade the forward gamma. (2) The forwards continue higher, implied vols catch up and we capture the vega benefits. (3) The forward push peters out and everything reverts back to where it was just a few days ago, in which case we should make just enough to cover the spread. (4) The Saudi’s do what they’ve done in previous periods when speculators bet large on a deval, and they push it hard in the opposite direction, thereby flushing out all the longs before pushing the pair to new highs. This scenario would likely benefit this position greatest of all and is why we will leave an open order to fully delta hedge the USD put side at 3.74 in the forward outright.

Scenario 4 should answer the question many of you are likely asking, “Why buy the USD put?”, but there is another even more important reason. Because we are talking about a pegged currency with very low implied vols, this is the type of position PM’s like to put on in size. However, it’s important to remember that one of the primary causes for underperformance, particularly within the macro community, is an inability to stomach the “noise”, or interim p&l volatility, and when a pair has such low implieds, it takes almost no move in the forwards for you to experience serious pain and p&l swings. By purchasing the straddles, you dramatically reduce the impact of noise on your portfolio, thereby making a larger position far more palatable and allowing you to participate (and stay with it) in a bigger way should the expected move occur.

While the capital applied to this trade may appear large at 5% of AuM, the high probability of muted negative interim p&l volatility, and minimal final p&l if everything remains unchanged (thanks to the carry on the USD put option relative to premium paid), gives us the confidence to size the position as it is.

Pre-Mortem (Risk Factors): The greatest risk to this position is an official shift in the peg close to the strike without any follow through in forwards and/or implied vols. While I see this as the lowest probability scenario, it isn’t a zero probability.

Trade Details

Trade Date	Expiration		Currency	Option Type
August 20, 2015	August 23, 2016		USD/SAR	ATMF Straddle
C/P	Strike	Implied Vol	Lower Barrier	Upper Barrier
C & P	3.7791	1.25	N/A	N/A
Spot	Forward	Forward Outright	Price	CaR as % AuM
3.7506	0.0285	3.7791	0.9998% Total	5%

Reassessment Triggers	Expectations
1. Forward Outright = 3.80 (Flatten delta) 2. Forward Outright = 3.74 (Fully delta hedge the USD put) 3. Implied Vol = 4.0 4. Peg is adjusted = unwind 5. 6 months remaining	Spot – No strong opinion Vols – Higher Forwards - Either jump higher, jump lower or gravitate back to lower norm.

Options 101

What is a ATMF Straddle? ATMF means At-the-Money-Forward and simply refers to the strike which corresponds to the spot rate plus forward points for the date corresponding to the option delivery date. A straddle is the simultaneous purchase (or sale) of both a currency call and put.

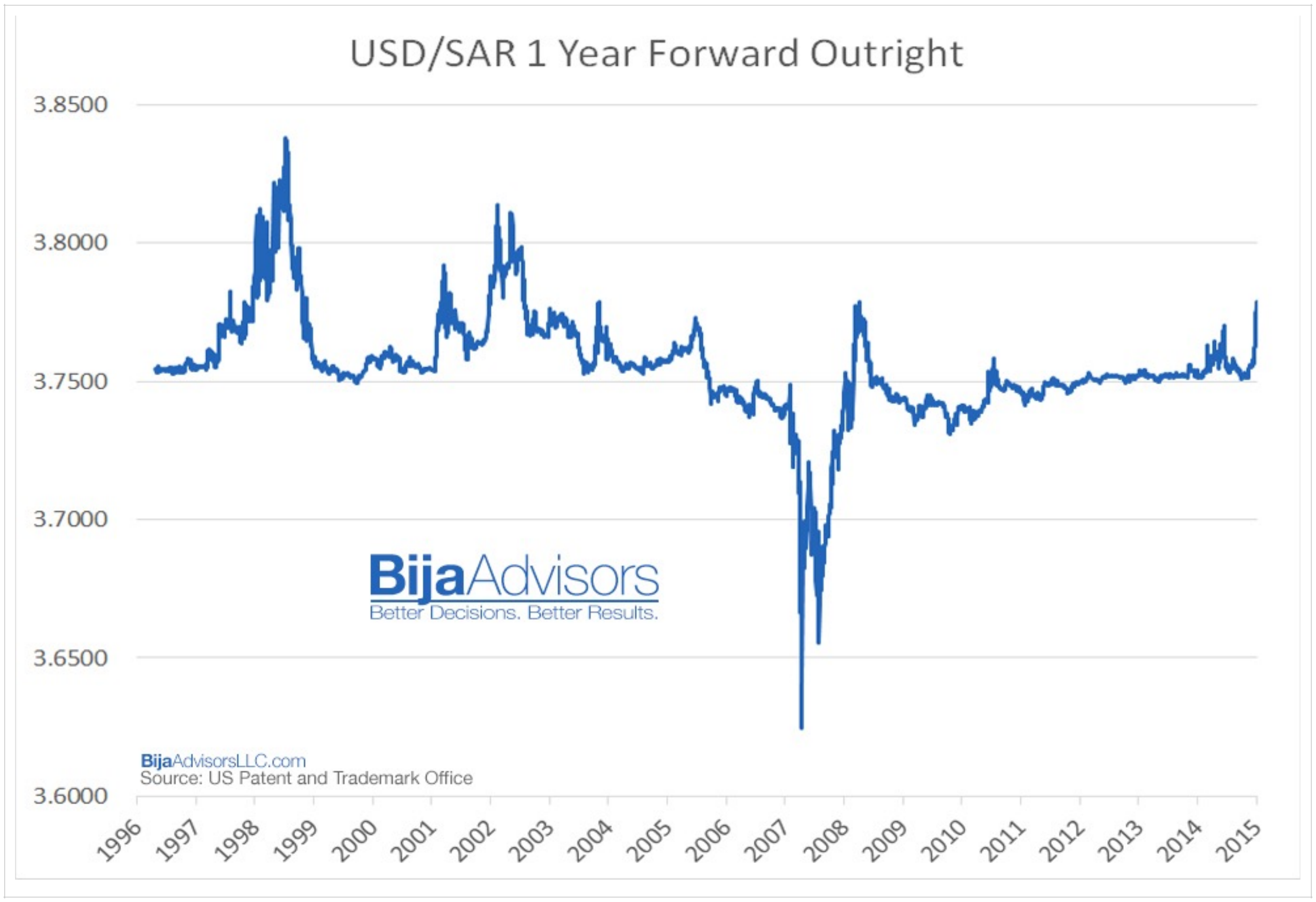
Post Mortem Analysis

Reason for Unwind

August 24, 2015: Although SAR1 has not hit any Reassessment Trigger, the primary reason for initiating the position was for vols to catch up to the move in forwards. I thought we wouldn't see that happen without another big spike in the forwards, but it did. Therefore, after 4 days in the trade, I am taking profit on the position today. Although a move in vols from 1.25 to 2.6 may not seem like a lot, because this position was vega intensive on a pair with very low implieds, and sized to reflect a combination of high conviction and the anticipation of very low interim p&l volatility, it didn't require a huge move to generate outsized returns.

Spot	Forward Outright	Implied Vol	Price	Rtn to Fund
3.7508	3.7926	2.6	2.08%	5.4%

Supporting Charts


USD/SAR 1 Year Forward Outright
3.8500
3.8000
3.7500
3.7000
3.6500
3.6000
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
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2009
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2011
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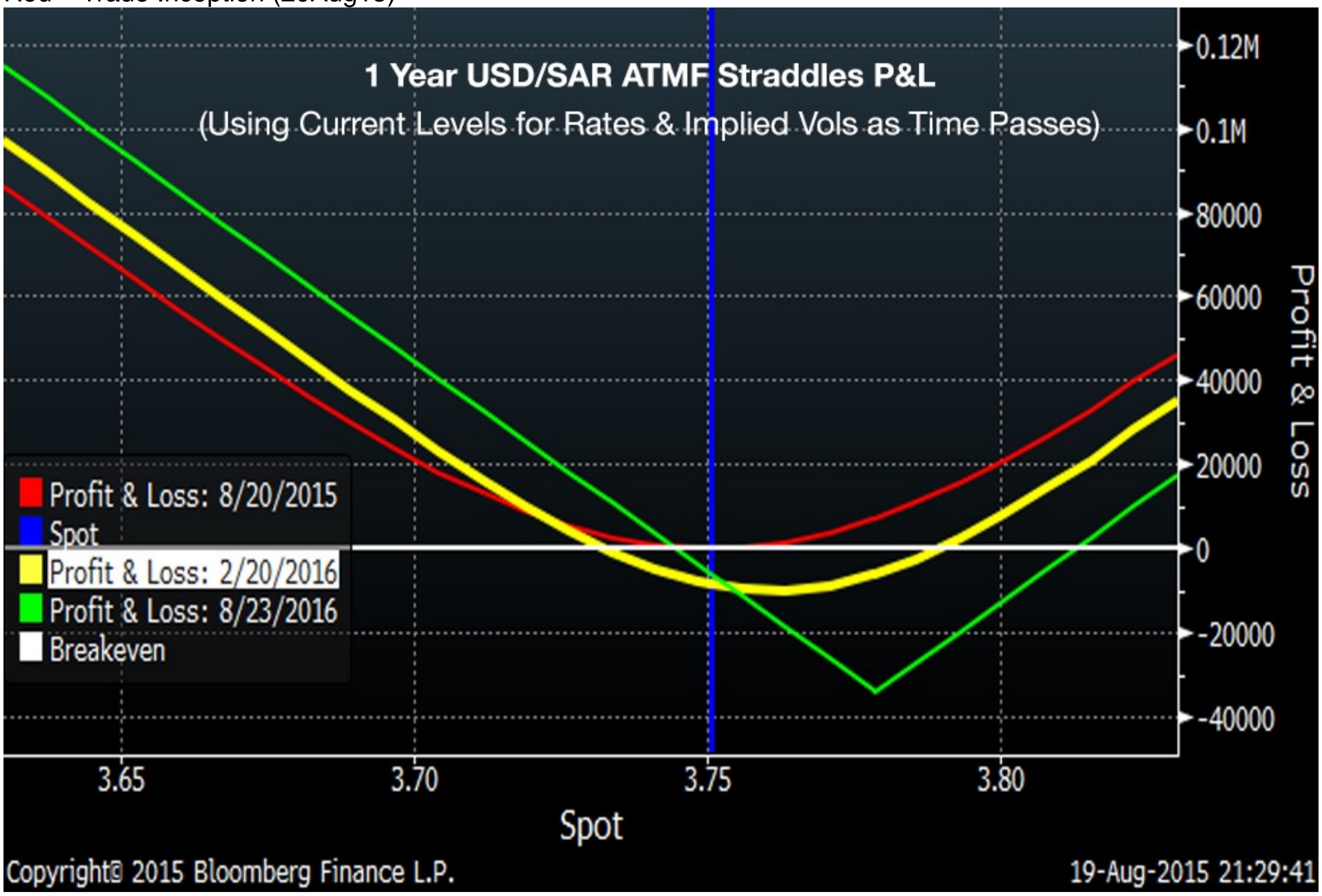
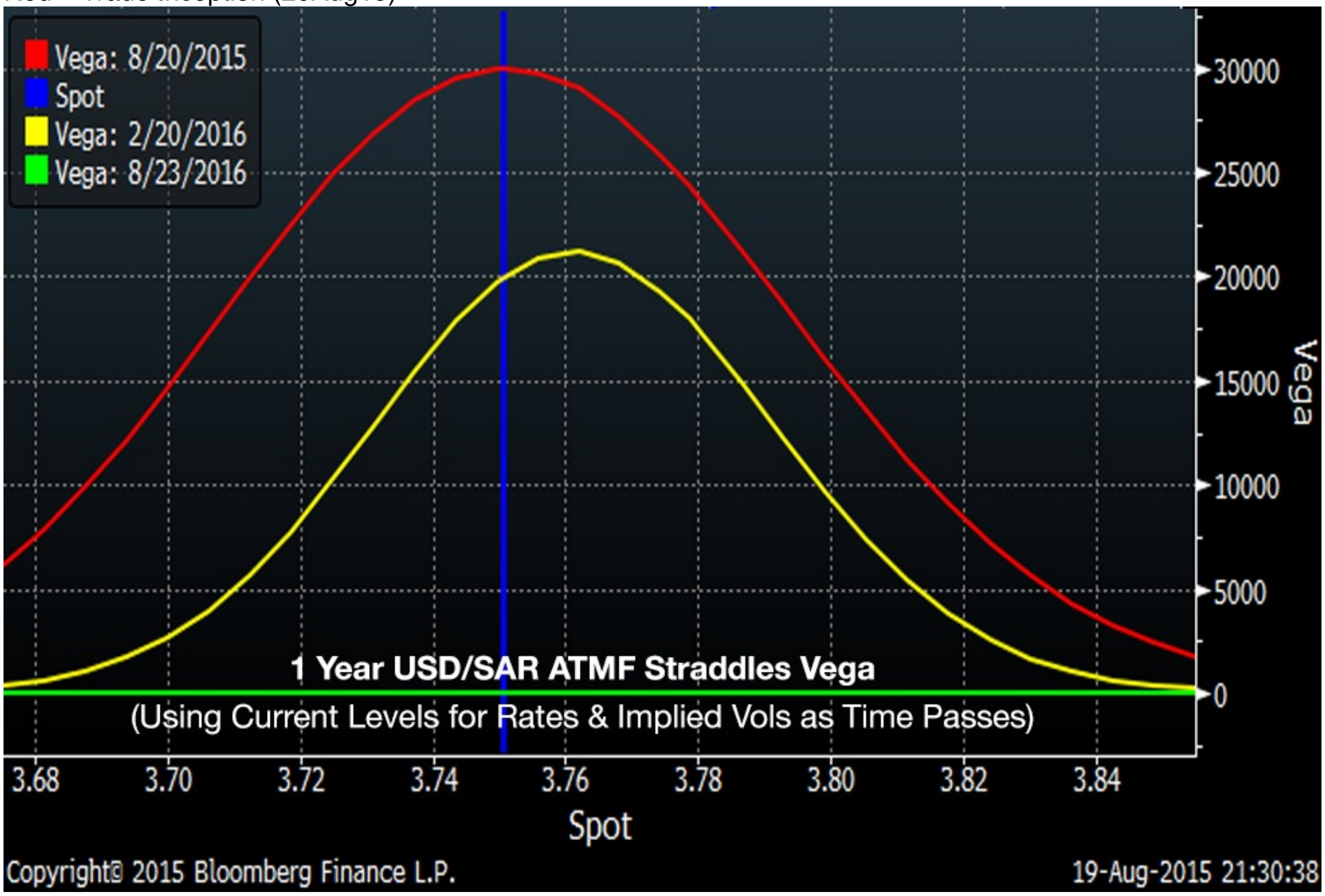
Source: US Patent and Trademark Office

Payoff Diagram: P&L at discrete moments in time for a given level in spot. Assumes current vol curve.
Green – Expiration (23Aug16)
Yellow – Midway to Expiration (20Feb16)
Red – Trade Inception (20Aug15)



Vega Diagram: Vega at discrete moments in time for a given level in spot. Assumes current vol curve.
Green – Expiration (23Aug16)
Yellow – Midway to Expiration (20Feb16)
Red – Trade Inception (20Aug15)



Bija Advisors LLC
Web: BijaAdvisorsLLC.com
Email: info@bijaadvisorsllc.com
Twitter: @BijaSeeds
Phone: 805 452 9429