

Looking for carry but afraid of adding more outright longs? Why not try this?

Our preferred carry trades in indices, options and tranches

- **Constructive but starting to think the upside is not great?** – For many investors the main reasons to continue adding risk are, in our view, (i) the absence of visible widening catalysts in an environment of still ample liquidity provision and (ii) the fear of missing out and underperforming if they resist the temptation to add risk but many others do not. We think upside does certainly look more attractive in other asset classes like equity.
- **Synthetics, with spreads close to their multi-year tights, do look particularly stretched.** We believe this is causing many investors to have second thoughts about the attractiveness of adding further risk (as evidenced in the options market, with investors a lot more receptive than in the past to selling receivers).
- **Although we remain constructive, looking for carry away from pure outright longs has been one of our preferred strategies for a while.** Which are these trades and why would you do them?
 1. **3s5s duration weighted flatteners** if you do not mind some spread directionality but are worried about capitulation scenarios where default-risk becomes investors' main concern.
 2. **Selling no-delta short dated straddles** if you expect range-bound markets with spreads going nowhere, or even if they move aggressively then coming back quickly (e.g. latest EM sell-offs).
 3. **Selling delta-hedged equity tranche protection** if you are comfortable with default risk but worried about systemic risk.

The trades above are amongst our highest conviction ones in credit derivatives for this year. They are positive “carry” and seek to exploit dislocations in the credit market (e.g. steep curves or expensive vol) providing exposure to risks such as large spread movements (either way) and default risk. In our view, they represent very attractive carry complements to long risk portfolios; in fact, we believe they are more attractive carry trades than outright longs. They generally performed well in 2013 and have had a good start of the year, with better and more stable performance than outright index longs.

- We quickly review these trades below, including the links to recent publications where we analyzed them in more detail.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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More details in our recent publications:

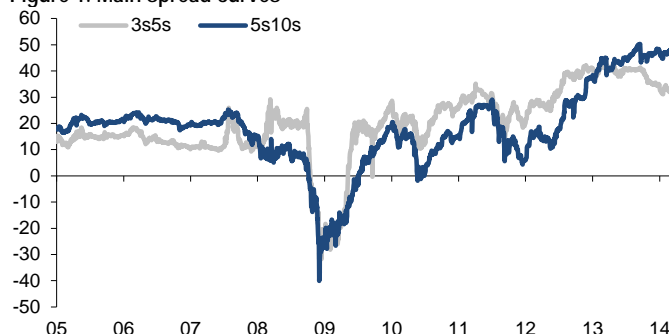
[Options vs. Curves: Playing with Tail Risk: Sell it where it's expensive & buy it where it's cheap](#)

[European Credit Outlook: The year of the Greater Fool's Game? \(Positioning & Trades\)](#)

3s5s Duration-Weighted Main Flatteners

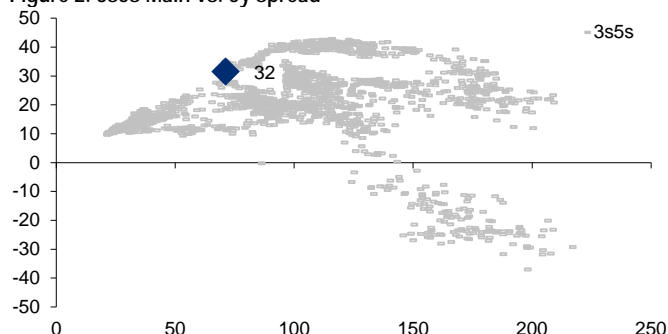
- **Rationale:** Front-end curves are so steep that duration weighted flatteners offer positive time value (carry + slide), positive default risk and protection in a full blown tail event.
- **Attractive if ...** One is worried about capitulation scenarios where default risk becomes investors' main worry.
- **Not attractive if ...** Your base case scenario is moderate widenings which don't materialise in forced-selling (you'll be better off with equity tranches if that's the case).

Figure 1. Main spread curves



Source: Citi Research, Markit. Using on-the-run indices. In bp.

Figure 2. 3s5s Main vs. 5y spread



Source: Citi Research, Markit. Using on-the-run indices. In bp.

Trade details

Figure 3. 3s5s Main duration-weighted trade details

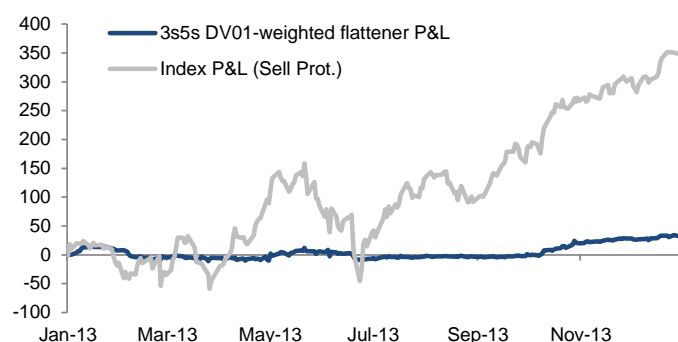
Tenor	Protection	Maturity	Spread (bp)	Coupon (bp)	Upfront (%)	Notional (€m)	Annual Coupon (€m)	Annual Upfront (€m)	12m Carry (€m)	12m Slide (€m)	12m Time (€m)
3y	Buy	20-Dec-16	41	100	-1.64%	-166	-1.66	2.72	-1.66	0.78	-0.88
5y	Sell	20-Dec-18	73	100	-1.26%	100	1.00	-1.26	1.00	0.18	1.18
			32	Total		-66	-0.66	1.46	-0.66	0.96	0.30

Source: Citi Research, Markit. COB mid prices yesterday.

P&L 2013 / 14: Small positive in 2013 and beating the index this year so far.

Figure 4. 3s5s Main flatteners vs. 5y index long – 2013 P&L

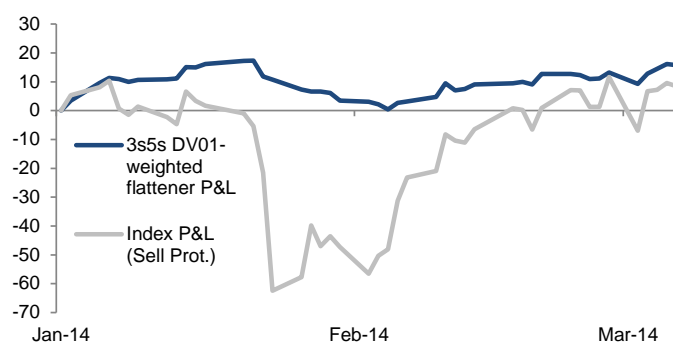
In cents of 5y traded notional (100c = 1%).



Source: Citi Research, Markit. Using on-the-run indices and rolling the curve position at roll dates and/or when the trade DVO1 ratio differs more than 5% from the current ratio. The index position is rolled at roll dates.

Figure 5. 3s5s Main flatteners vs. 5y index long – 2014 P&L

In cents of 5y traded notional (100c = 1%).



Source: Citi Research, Markit. Using on-the-run indices and rolling the curve position at roll dates and/or when the trade DVO1 ratio differs more than 5% from the current ratio. The index position is rolled at roll dates.

More details in our recent publications:

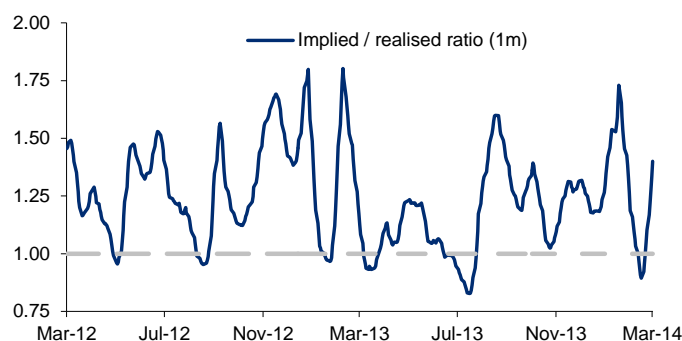
[iTraxx Options Views & Trades: Vol starts the year expensive - we start by selling receivers](#)

[iTraxx Tranches Views & Trades: Sell equity protection and sell straddles](#)

Sell front-month no-delta Main straddles

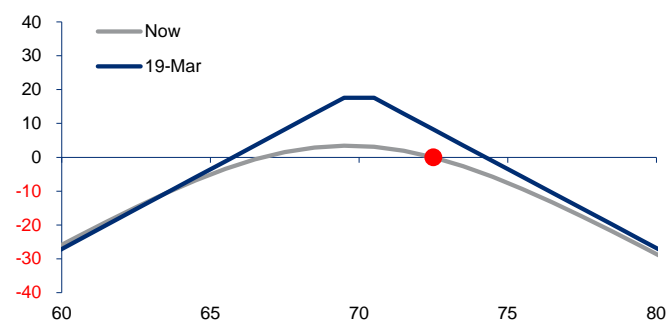
- **Rationale:** Position for a range-bound market, taking advantage of how expensive credit implied vol is (due to investors remaining better buyers of options for hedging purposes).
- **Attractive if ...** One thinks spreads go nowhere or, even if they move aggressively, then come back quickly (e.g. latest EM sell-off).
- **Not attractive if ...** One expects large spread gaps, either way, which do not retrace back quick enough, or strongly trending markets.

Figure 6. Implied to realised vol ratio in Main 1m.



Source: Citi Research, Markit. 10d moving average.

Figure 7. March Main ATM straddle sold – spread exposure In cents of traded notional (100c = 1%).



Source: Citi Research, Markit.

Trade details

Figure 8. March Main ATM straddle trade details – ~65/74bp breakevens at expiry – [Load the trade in our online options pricing tool](#)

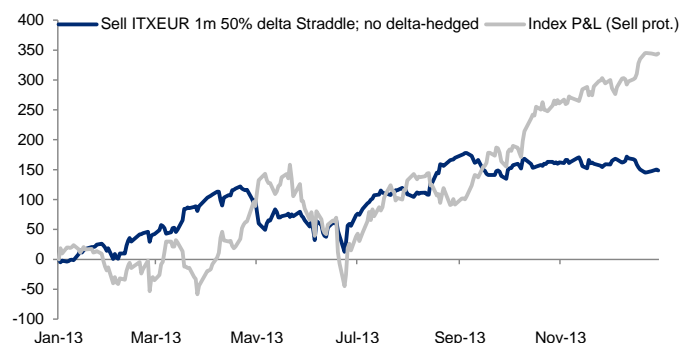
Type	Strike	Expiry	Price	Position	Notional	Upfront	Delta	Gamma	Theta	Vega	Vol %	% Notional Delta	% Notional Gamma	Cents Theta	Cents Vega
Receiver	70	19-Mar	3.3c	Sell	100,000,000	33,151	12,130	-3,426	3,926	-1,628	40.8%	25.7%	-7.2%	0.4c	-0.2c
Payer	70	19-Mar	16.6c	Sell	100,000,000	166,427	-35,133	-3,388	5,987	-1,628	40.8%	-74.3%	-7.2%	0.6c	-0.2c
Index		@ 72.5 bp		No position											
Total					199,578	-23,003	-6,814	9,913	-3,255						

Source: Citi Research, Markit. COB mid prices yesterday.

- **P&L 2013 / 14:** positive and stable in 2013 and beating the index this year so far.

Figure 9. No-delta straddles vs. 5y index long – 2013 P&L

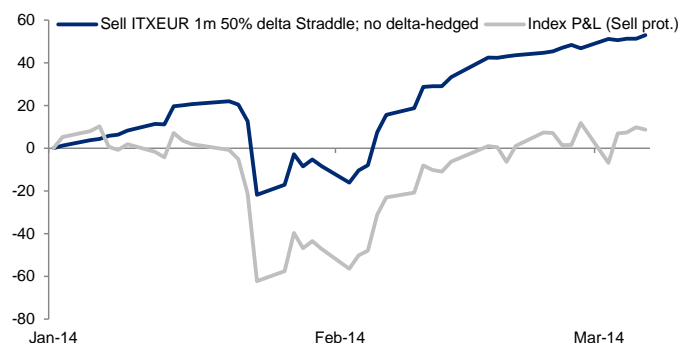
In cents of traded notional (100c = 1%).



Source: Citi Research, Markit. Using on-the-run indices and rolling the option position at expiry. The index position is rolled at roll dates.

Figure 10. No-delta straddles vs. 5y index long – 2014 P&L

In cents of traded notional (100c = 1%).



Source: Citi Research, Markit. Using on-the-run indices and rolling the option position at expiry. The index position is rolled at roll dates.

Sell equity tranche delta-hedged protection

More details in our recent publication:

[iTraxx Tranches Views & Trades: Sell equity protection and sell straddles](#)

- **Rationale:** Not convinced about growth but certain about central bank liquidity support? Take levered IG default risk, with positively convex spread exposure.
- **Attractive if ...** your base case scenario is absence of defaults and idiosyncratic distressed stories, plus eventual systemic widenings.
- **Not attractive if ...** you are expecting single name distress stories in IG names.
- **Trade details**

Figure 11. iTraxx Series 9 Tranche Trade: Sell Jun-18 equity tranche protection, delta-hedged

Index	Tranche	Maturity	Upfront	Coupon (bp)	Par spread (bp)	Protection	Notional (€m)	Upfront (€m)	Coupon (€m)	1m time val.(€m)
ITXEUR S9	0-3%	Jun-18	21.54%	500	1,100	Sell	10	2.15	0.50	0.12
ITXEUR S9	Index	Jun-18	-4.14%	175	77	Buy	68.9	2.85	-1.21	-0.10
							Total	5.00	-0.71	0.02

Source: Citi Research. Indicative prices shown. COB mid prices yesterday.

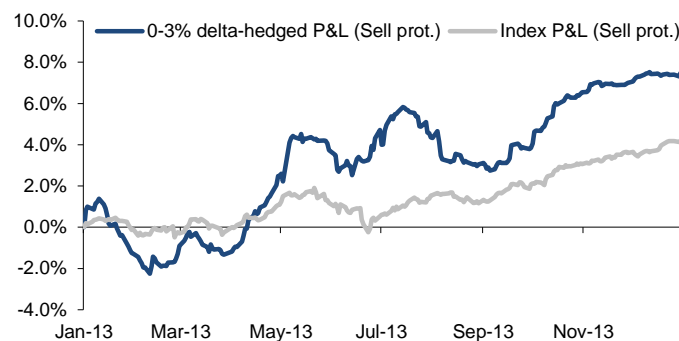
Positive time value: The 1m time value is ~20c of the tranche notional.

Negative jump-to-default: The jump-to-default¹ is ~11% of its notional (negative). Long correlation: If equity implied correlation falls 1% the trade will lose ~64c.

- **P&L 2013 / 14:** Strong performance in 2013 and strong start of 2014, with positive returns during the EM sell-off as well as during quiet weeks.

Figure 12. Equity delta-hedge vs. 5y index long – 2013 P&L

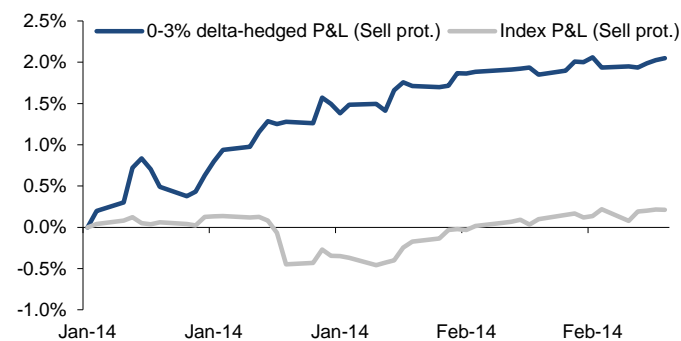
In % of traded notional. Series 9 Jun-18.



Source: Citi Research, Markit. Daily delta-hedging.

Figure 13. Equity delta-hedged vs. 5y index long – 2014 P&L

In cents of traded notional (100c = 1%). Series 9 Jun-18.



Source: Citi Research, Markit. Daily delta-hedging.

¹ MtM if there is an instantaneous default in one of the names in the index.

Trade Recommendations Summary

We are not opening and closing any trades.

Figure 14. Open trades – Summary and P&L

Trade Description	Leg	Format	Direct.	Notnl.	Entry Upfront	Entry Spread	Coupon	Current Upf.	Current Spread	P&L*
Sell 1m Main straddles ***	Sell 1m Main straddles	Price	Buy	1.00	0.00%			0.32%		0.32%
09-Jan-14									Total	0.32%
Payer spread vs. index long ***	Buy 3m 25-60% pay spread	Price	Buy	1.00	0.00%			-0.04%		-0.04%
09-Jan-14	Sell index prot.	Price	Buy	1.00	0.00%			0.11%		0.11%
									Total	0.07%
SenFin vs. Xover Recs ***	Buy 3m SenFin Recs	Price	Buy	1.00	0.00%			-0.02%		-0.02%
09-Jan-14	Sell 3m Xover Recs	Price	Buy	0.29	0.00%			-0.82%		-0.24%
									Total	-0.26%
Flattener vs. OTM payer ***	3s5s flattener Main	Price	Buy	1.00	0.00%			0.08%		0.08%
13-Feb-14	Sell 3m 120bp Main payer	Price	Buy	0.75	0.00%			0.04%		0.03%
									Total	0.11%
Equity tranche vs. straddle ***	Sell Jun-18 S9 equity prot., DH	Price	Buy	1.00	0.00%			-0.01%		-0.01%
20-Feb-14	Sell 1m Main straddles, DH	Price	Buy	0.50	0.00%			0.06%		0.03%
									Total	0.02%
Equity tranche vs. straddle ***	Buy Jun-18 S9 9-12% prot., DH	Price	Buy	0.03	0.00%			0.04%		0.00%
20-Feb-14	Buy Jun-18 S9 12-22% prot., DH	Price	Buy	0.10	0.00%			0.09%		0.01%
20-Feb-14	Buy Jun-18 S9 22-100% prot., DH	Price	Buy	0.78	0.00%			0.00%		0.00%
									Total	0.01%
Mezz tranche long ***	Sell Jun-18 S9 3-6% prot., DH	Price	Buy	1.00	0.00%			0.07%		0.07%
20-Feb-14									Total	0.07%
Releveraging trade (H. Lorenzen)	Basket of low spread/leverage CDS	Prot.	Buy	1.00	-3.14%	35	100	-3.16%	34	-0.05%
24-Feb-14	Main NonFins	Prot.	Sell	0.50	-1.54%	67.219	100	-1.49%	68	0.00%
									Total	-0.06%

Source: Citi Research. Spreads and coupons in bp. * P&L expressed as % of the leg with notional equal to 1. ** Over the last month. Prices as of COB yesterday. *** We track the trade P&L by using an initial 0% upfront and a current upfront equal to the trade P&L in %. DH = delta hedged.

Figure 15. Open and closed trades summary statistics

Number	Open	Closed*	Percentage	Open	Closed*
In profit	6	16	In profit	75%	76%
In loss	2	5	In loss	25%	24%
	8	21			

Source: Citi Research. * Since 1-Jun-13. Excluding the trade ideas opened in the current publication.

Representative Market Conditions

Figure 16. Historical spreads – iTraxx 5y on-the-run indices

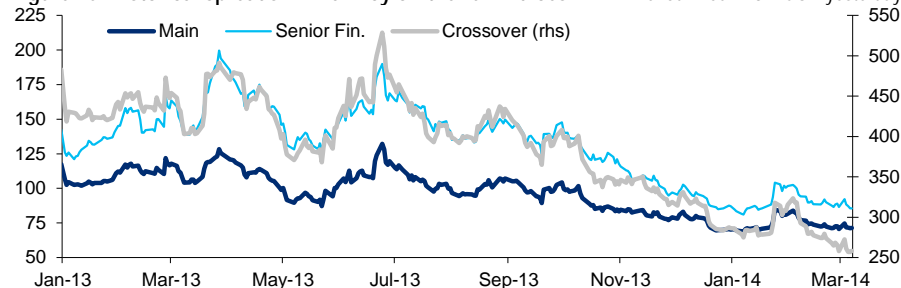


Figure 17. Closed trades since Oct-13 – Summary and P&L

Trade Description	Leg	Format	Direct.	Notnl.	Entry Upfront	Entry Spread	Coupon	Final Upfront	Final Spread	P&L* Total
Commerzbank sub/senior compr.	Sub CDS	Prot.	Sell	1.00	-5.65%	375	500	-8.03%	327	3.24%
Opened: 13-Aug-13	Senior CDS	Prot.	Buy	2.51	2.37%	150	100	1.95%	140	-1.49%
Closed: 14-Oct-13									Total	1.75%
RBS sub/senior compr.	Sub CDS	Prot.	Sell	1.00	-7.71%	339	500	-11.10%	254	4.25%
Opened: 13-Aug-13	Senior CDS	Prot.	Buy	2.02	2.80%	168	100	1.77%	139	-2.43%
Closed: 14-Sep-13									Total	1.82%
BNP sub/senior compr.	Sub CDS	Prot.	Sell	1.00	-14.42%	198	500	-16.21%	168	2.65%
Opened: 13-Aug-13	Senior CDS	Prot.	Buy	1.68	0.86%	118	100	0.26%	105	-1.30%
Closed: 14-Oct-13									Total	1.36%
S19 3-6% vs. S20 Crossover	Main S19 3-6% Jun-18	Prot.	Sell	1.00	-3.25%	422	500	-5.70%	366	2.99%
Opened: 26-Sep-13	Crossover S20 Dec-18	Prot.	Buy	1.00	-5.18%	386	500	-6.96%	343	-2.32%
Closed: 14-Oct-13									Total	0.67%
iTraxx vs. CDX IG super senior	Main S9 22-100% Jun-18	Prot.	Sell	1.00	0.60%	37	25	0.34%	32	0.29%
Opened: 26-Sep-13	CDX IG S9 30-100% Dec-17	Prot.	Buy	1.00	-3.54%	13	100	-3.43%	16	0.00%
Closed: 4-Nov-13									Total	0.29%
Senior Fin vs. Xover straddle	Xover Dec-13 400bp straddle	Price	Sell	1.00	2.64%			2.63%		0.00%
Opened: 9-Oct-13	SenFin Dec-13 140bp straddle	Price	Buy	2.05	1.29%			1.48%		0.40%
Closed: 15-Nov-13									Total	0.40%
325-350-375 Nov. Crossover Receiver Ladder	325 Xover Nov Rec	Price	Sell	2.00	0.18%			0.02%		0.32%
Opened: 23-Oct-13	350 Xover Nov Rec	Price	Sell	1.00	0.61%			0.47%		0.14%
Closed: 15-Nov-13	375 Xover Nov Rec	Price	Buy	1.00	1.45%			1.46%		0.01%
									Total	0.47%
CDX IG vs. Main Receivers	CDX IG S21 Nov 85 Receiver	Price	Buy	1.00	0.47%			0.62%		0.15%
Opened: 15-Oct-13	Main S20 Nov 100 Receiver	Price	Sell	1.00	0.52%			0.91%		-0.39%
Closed: Expired 20-Nov-13									Total	-0.24%
S19 Jun-16 0-3% vs. 3-6%	Main S19 0-3% Jun-16	Prot.	Sell	1.00	8.00%	839	500	3.88%	725	5.11%
Open: 26-Sep-13	Main S19 3-6% Jun-16	Prot.	Buy	2.00	-7.00%	234	500	-9.75%	132	-7.47%
Closed: 9-Dec-13									Total	-2.36%
SenFin vs. Main	Senior Fin. 5y S20	Prot.	Sell	1.00	0.60%	112	100	0.07%	102	0.61%
Open: 26-Sep-13	Main 5y S20	Prot.	Buy	1.35	-0.79%	84	100	-0.94%	81	-0.32%
Closed: 9-Dec-13									Total	0.29%
S9 super senior vs. light delta	Main S9 22-100% Jun-18	Prot.	Sell	1.00	0.18%	30	25	0.03%	26	0.19%
Open: 15-Nov-13	Main S9 index Jun-18	Prot.	Buy	0.33	-3.65%	93	175	-4.24%	77	-0.29%
Close: 14-Jan-14									Total	-0.10%
75-85 Main January strangle	75bp Jan Main receiver	Price	Sell	1.00	0.08%			0.19%		-0.11%
Open: 9-Dec-13	85bp Jan Main Payer	Price	Sell	1.00	0.13%			0.00%		0.13%
Close: 14-Jan-14									Total	0.02%
Sell Crossover Receiver	275bp Feb. Receiver	Price	Sell	1.00	0.32%			0.17%		0.15%
Open: 9-Jan-14									Total	0.15%
Close: 13-Feb-14										
iTraxx Main Eq. Notional Flattener	Main S19 3y	Prot.	Buy	1.00	-0.97%	65	100	-1.57%	33	-1.04%
Open: 5-Sep-13	Main S19 5y	Prot.	Sell	1.00	0.24%	105	100	-1.47%	65	2.15%
Close: 13-Feb-14									Total	1.11%
S9 6-9% vs. S20 Crossover	Main S9 6-9% Jun-18	Prot.	Sell	1.17	-0.25%	294	300	-3.19%	223	4.37%
Open: 15-Nov-13	Crossover S20 Dec-18	Prot.	Buy	1.00	-7.07%	344	500	-9.80%	274	-4.06%
Close: 19-Feb-14									Total	0.31%
3-6% vs. super senior	Main S9 3-6% Jun-18	Prot.	Sell	1.00	-5.50%	366	500	-5.34%	367	0.34%
Open: 14-Jan-14	Main S9 22-100% Jun-18	Prot.	Buy	9.00	0.03%	26.625	25	0.12%	28	0.60%
Close: 19-Feb-14									Total	0.94%
Main vs. SenFin vol ***	Sell Feb 70 Main straddles, DH	Price	Buy	1.00	0.00%			-0.02%		-0.02%
Open: 21-Jan-14	Buy Feb 80 SenFin straddles, DH	Price	Buy	0.50	0.00%			0.02%		0.01%
Close: Expired									Total	-0.01%

Source: Citi Research. Spreads and coupons in bp. * P&L expressed as % of the leg with notional equal to 1. *** We track the trade P&L by using an initial 0% upfront and a final upfront equal to the trade P&L in %.

Notes: The list of open trades reflects our current views; we have no plans to provide regular coverage or updates to these trades. P&L on trade ideas includes carry and roll costs but not trading commissions/costs. Results should not, and cannot, be viewed as an indicator of future performance.

Risks: When buying calls and puts (or receivers and payers) the maximum loss is the premium paid. When selling calls (or receivers), the maximum potential loss would occur as the index spread decreases but is limited by the index spread being floored at zero. For puts (or payers), the maximum potential loss (amount below the strike) would eventuate should the index price fall to zero. Sector index options are cash settled. The above calculations do not include any additional fees or transaction costs. Note that ratio writing would leave the writer uncovered in one leg of the trade.

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Analytics, Past Trade Ideas & Publications

Analytics – Available at Citi Velocity

Options	iTraxx Volatility Report CDX Volatility Report European Cross-Asset Volatility Report Volatility P&L Report – Credit Indices	Tranches	iTraxx Series 9 Tranche Report iTraxx Series 19 Tranche Report
Curves	iTraxx Curve P&L Report	Indices	CDS Indices Positioning Report CDS Indices Trading Volumes Report

Source: Citi Research.

Recent Trade Ideas

Single names vs. Index	Releveraging Trade	24 Feb 2014
Tranches vs. Options -	Sell protection and monetize the positive convexity by selling straddles	20 Feb 2014
Tranches -	Buy 9-100% S9 Jun-18 protection, delta-hedged	20 Feb 2014
Tranches -	Sell 3-6% S9 Jun-18 protection, delta-hedged	20 Feb 2014
Options vs. Curves -	Flatteners vs. OTM payers	13 Feb 2014
Options -	Sell Main vol, buy SenFin vol	21 Jan 2014
Tranches -	More mezz, less seniors - 3-6% vs. super senior	15 Jan 2014
Options -	SenFin vs. Xover Recs	9 Jan 2014
Options -	Payer spread vs. index long	9 Jan 2014
Options -	Sell 1m Main straddles	9 Jan 2014
Options -	Sell Crossover Receiver	9 Jan 2014
Options -	Sell strangles and go on holidays: Position for spreads to stay in the recent range in mid-January	9 Dec 2013
Tranches -	Sell S9 Jun-18 6-9% protection vs. Xover 5y S20	15 Nov 2013
Tranches -	Sell S9 Jun-18 22-100% protection vs. light delta	15 Nov 2013
Indices -	Long risk Senior Fins. vs. short risk Main	5 Nov 2013
Options -	Crossover receiver ladders	23 Oct 2013
Options -	Long risk CDX IG vs. Main via Receivers	15 Oct 2013
Options -	Buy Senior Financials straddles vs. sell Crossover straddles	9 Oct 2013
Tranches -	Long risk equity vs. short risk 3-6% in S19 Jun-16 (3y)	26 Sep 2013
Tranches -	Long risk S19 Jun-18 (5y) 3-6% vs. 5y S20 Crossover	26 Sep 2013
Tranches -	Long risk iTraxx S9 Jun-18 (10y) super senior vs. short risk CDX IG S9 Dec-17 (10y) super senior	26 Sep 2013
Indices -	Equal Notional 3s5s Flatteners: Adding cautious longs by selling forward protection	5 Sep 2013
Single Names -	Sub/Senior compression trades in European banks	13 Aug 2013
Options -	iTraxx Senior Financials vs. CDX IG via Receivers	7 Aug 2013
Tranches -	Sell Jun-16 3-6% Series 19 protection vs. Buy Jun-18 Series 9 index protection	9 Jul 2013

Source: Citi Research.

Latest European Credit Derivatives Views & Trades Presentation: [Slow grind tighter from here - What are the best carry trades?](#)

Other publications

New 2014 CDS Definitions - What's new? What's changing? Why? When? How?	26 Feb 2014
iTraxx Roll - Potential Changes: Crossover number of constituents will increase to 60 names	10 Feb 2014
2014 European Credit Outlook: Strategy // Positioning and Trades	13 Jan 2014
Global Structured Credit Outlook: A Rockier Ride (R Roy, A Basu, K Malhotra, R Brauchler)	20 Dec 2013
2013 Trading Volumes in European Credit: CDS Indices, Single Name CDS and IG Bonds	5 Dec 2013
Credit Options - What did investors do in 2013? What will they do in 2014? (2013 European Credit Conference Presentation)	4 Dec 2013
Credit Index Options 1-0-1: Launching our option pricing tool @ CitiVelocity (2013 European Credit Conference Presentation)	2 Dec 2013
Europe Returns: Assessing value across flow and structured credit assets	22 Nov 2013
iTraxx Tranches Views & Trades: Mezz may be back next year	15 Nov 2013
Financial CDS to get a re-vamp	7 Aug 2013
Hedging menu: payer spreads, 3s5s flatteners and Jun 15/18 equity tranche flatteners	28 Mar 2013
What bail-in means for CDS	11 Feb 2013

Source: Citi Research.

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Appendix A-1

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