

CANADIAN EQUITY DERIVATIVES

Quarterly Newsletter - April 2016

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Montréal
Exchange

GENERAL INFORMATION



Patrick Ceresna

Patrick Ceresna is the Chief Derivative Market Strategist for Learn To Trade Global (LTTG) and optionsource.net and has been a content provider and speaker for the Montreal Exchange for over 5 years. Patrick is a Chartered Market Technician (CMT), Derivative Market Specialist (DMS) and Canadian Investment Manager (CIM) by designation. Prior to becoming a partner at LTTG, Patrick spent ten years working at key financial firms in numerous trading roles including the trading of a large fund dedicated exclusively to options writing. Patrick specializes in analyzing the intermarket relationships of the broader derivatives market and the impact those trends have on trading and investment decision making.

2016 Trading Calendar

APRIL							MAY							JUNE						
S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S
					1	2	1	2	3	4	5	6	7				1	2	3	4
3	4	5	6	7	8	9	8	9	10	11	12	13	14	5	6	7	8	9	10	11
10	11	12	13	14	15	16	15	16	17	18	19	20	21	12	13	14	15	16	17	18
17	18	19	20	21	22	23	22	23	24	25	26	27	28	19	20	21	22	23	24	25
24	25	26	27	28	29	30	29	30	31					26	27	28	29	30		

- Listing
- Last trading day
- Expiration
- Equity & ETFs options
- Weekly options
- S&P/TSX 60 Index Options (SXO)
- Options on the US Dollar (USX)

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IS THE U.S. DOLLAR BULL MARKET OVER?

By Patrick Ceresna

The hyper volatility in the currency markets have ushered in a heightened uncertainty about the future direction of the U.S. Dollar. No one currency pair exemplified the volatility more than the \$0.10 swing lower and subsequently higher in the Canadian Dollar over the last 6 months. This has many Canadians asking “is the U.S. Dollar bull market over”?



Our evidence does not support it.

Our hypothesis is founded in the macro fundamental landscape of the slowing global economy and crisis' that is forming around the world. What is that landscape?

1. A China credit bubble that has burst
2. Economic deterioration in Japan
3. Deflation and geopolitical uncertainty in Europe

4. A commodity bear market driven by geopolitical uncertainty in the global energy markets

5. Emerging markets under material stress

So what is Janet Yellen to do? We have now seen a substantial shift at the Federal Open Market Committee (FOMC) driven by a changing narrative from a domestic employment and inflation focus to a narrative now focused on the deteriorating conditions in the global economy. This is no surprise to us. Many people assume a central bank is a central bank, but the American Federal Reserve is a special animal. It is special because the U.S. dollar remains the global reserve currency and the primary currency of global trade. Unlike any other central bank, the FOMC has substantial global implications for their monetary policy.

Understanding U.S. Considerations

Fact #1 – Over the last 70 years, the U.S. has designed and spearheaded a global financial system of trade centered on its currency.

Fact #2 – In order to spur global growth and trade, the U.S. must supply sufficient U.S. dollars to the world for that global trade to be conducted. The primary method of distribution of those U.S. dollars has traditionally been through America running a trade deficit, largely through the import of oil and basic goods. The alternative method of providing those dollars was through U.S. dollar denominated debt, often to emerging markets.

The divergent monetary policy between the FOMC vs. almost all other central banks around the world has ushered an unprecedented U.S. Dollar rally over the last 2 years, that has stressed the global economic system. Today, there is substantial stress coming from many emerging markets that are being required to maintain interest and principle repayments on their U.S. Dollar denominated debt in a substantially devalued domestic currency. But the biggest imbalance is very much centered on China. With China maintaining a fixed exchange rate to the U.S. dollar, it has endured a very strong currency for the last few years that has resulted in nothing short of a crisis in mainland China. This has led to an unprecedented decline in China's reserves as reports have suggested the capital outflow has surpassed \$1 trillion dollars in 2015. This capital outflow is evidence that market participants, particularly Chinese citizens know the situation is untenable and are very active in moving and investing as much money internationally while the Chinese government foolishly leaves the currency peg at unsustainably high levels.

The Bottom Line

1. The FOMC must balance the needs of the global market place with the needs of the domestic economy.
2. The FOMC is in a lose/lose scenario that will end badly. It needs to raise interest rates to maintain its credibility and the confidence of participants. However, at the same time, it cannot inadvertently cause a global crisis by not respecting the complexity of the global landscape and particularly China's vulnerability.

So what has Janet Yellen and company done? They are trying to find the middle road, by weakening the U.S. dollar to give much needed relief the global players. Will it work? It is our opinion that this will fail.

What we believe to be true at this point in the global markets:

1. It is unsustainable for Japan and Europe in their current state to have strong currencies.
2. Even if China is getting a boost with the U.S. dollar decline, it is in the big picture untenable for China to maintain its existing currency peg and they will be forced to devalue the Renminbi.
3. While the economic situation in Canada has not worsened since the middle of 2015, the Bank of Canada and the government are still in favor of a structurally weaker Canadian dollar. It is likely that the BoC will try to take some of the momentum out of the Canadian Dollar rise if the strength persists.
4. It is likely that the Canadian dollar will remain strongly correlated with other commodity based currencies like the Australian Dollar, New Zealand Dollar, Brazilian Real, South African Rand and the Mexican Peso. These currencies are all likely to be inversely correlated to the commodity markets, which structurally remain weak and in the midst of a bear market.

We believe that the market, which is driven by global macro fundamentals, will defy global central bankers and their attempts to weaken the U.S. dollar. When the short term move is over, it is likely, once again, that the U.S. dollar will resume its bull market higher. If our thesis comes to fruition, there is risk of considerable intermarket implications that few market participants are currently accounting for.

Our Call:

1. The Canadian dollar remains vulnerable to retest the January lows at \$0.68.
2. The Euro trading to parity against the U.S. dollar is still on the table.
3. China devaluing against the U.S. dollar is still very much in play in 2016.

While Canadian investment advisors may use this opportunity to rebalance investors portfolios to hold more U.S. Dollars, there may be an opportunity to position one self to profit from a view that the Canadian dollar will once again weaken. One method by which to trade the view is to utilize the US Dollar options available through the Montreal Exchange under the ticker: USX

Each USX option represents \$10,000 U.S. Dollars and has a European style settlement.

One of the reasons I prefer to utilize the options is the asymmetry of the risk. With the USD/CAD having traded from \$1.4700 high down its current \$1.3000 level, there is room for a technical move that could easily see a \$0.0800-\$0.1000 retracement back toward the \$1.4000 level.

The June 17th \$130.00 (1.3000 level) call option is asking \$2.50 or \$250.00 per contract. The key to us is that the risk is defined to the maximum loss of the premium paid, in this case \$250.00 a contract. Equally, if the U.S. Dollar was to return back to \$1.4000, the option has the potential to return 4 times the risk. Speculation like this is not appropriate for everyone, but for someone with an appetite for a little risk, it is an interesting way to take a core stance on the macro view that the Canadian dollar will reverse its current short term strength.

Long Gold using the iShares Gold Bullion ETF (CGL)

With gold having had one of the strongest starts to a year in recent history, many investors are asking the question “Does this represents the end of the 4-year bear market? Has the tide turned?” Many gold enthusiasts are convinced that the current rally is just the beginning of what should be a meaningful rally toward \$1,400 an ounce. Equally, the skeptics are quick to try to instill doubt suggesting that this short term rally was technical in nature and that the bigger picture fundamentals leave room for gold to return back to \$1,000.

What is an investor to do?

This is where the asymmetry of options can allow an investor to take a risk defined position. In this example, the idea is to buy a deeper in-the-money call option on the iShares Gold Bullion ETF (CGL).

- The iShares Gold Bullion ETF is trading at \$10.98 (April 8, 2016)
- The \$10.00 September 16th 2016 call option is asking \$1.30 (\$130 a contract)
- The option represents \$0.98 intrinsic value (equity) and \$0.32 of time value

The rationale behind choosing that strike has to do with the high delta. Delta is the rate of change in the option relative to the underlying stock move. By buying a higher delta option, we have the opportunity to participate almost dollar for dollar on the upside. If you feel gold has upside and want to define your risk, this option may be the right way to participate.

Covered Calls on Franco Nevada (FNV)

Throughout the gold bear market, Franco Nevada has been in a class of its own. The gold-focused royalty stream company has not only been able to weather the storm but able to make new 52 week highs in 3 consecutive calendar years over 2014, 2015 and 2016. With conditions becoming better in the gold mining space, Franco Nevada looks poised to be able to remain a solid investment.

While many investors are looking at the stock from a perspective of further upside gain, I, on the other hand see an opportunity to secure a solid income from the stock utilizing a covered call.

How does the trade look?

- Investor buys shares of Franco Nevada at \$84.77
- Investor sells the October 21st 2016 \$86.00 covered call which is bidding \$7.65
- This represents a 6-month cash flow of 9.02% (annualizing around 18.00%)

While many investors are looking purely at the upside potential, the stock represents an interesting proposition where we can attain a very lucrative income return without needing the stock to appreciate. The additional value is the protection one gains by having received the call premium. By having received the \$7.65 in premium up front, it reduces the breakeven of the investment to \$77.12 (\$84.77 - \$7.65). None the less, in a low yield environment, securing a lucrative 9.02% income over 6 months is an interesting way of adding some potential portfolio returns.



Canadian
WEEKLY
Options

Now available **ON 25 OPTION CLASSES**

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Bank of Nova Scotia (The)*

Barrick Gold Corporation*

Baytex Energy Corp.*

BCE Inc.

BlackBerry Limited

Canadian Imperial Bank of Commerce*

Canadian National Railway Company

Canadian Natural Resources Limited

Crescent Point Energy Corp.*

Detour Gold Corp.*

Enbridge Income Fund Holdings Inc.

Enbridge Inc.

Encana Corporation

First Quantum Minerals Ltd.

Goldcorp Inc.*

Husky Energy Inc.

iShares S&P/TSX 60 Index ETF

National Bank of Canada

Potash Corporation of Saskatchewan Inc.

Royal Bank of Canada*

Suncor Energy Inc.

Teck Resources Limited., Cl. B

Toronto-Dominion Bank (The)*

TransCanada Corporation



*Multiple weekly expiries

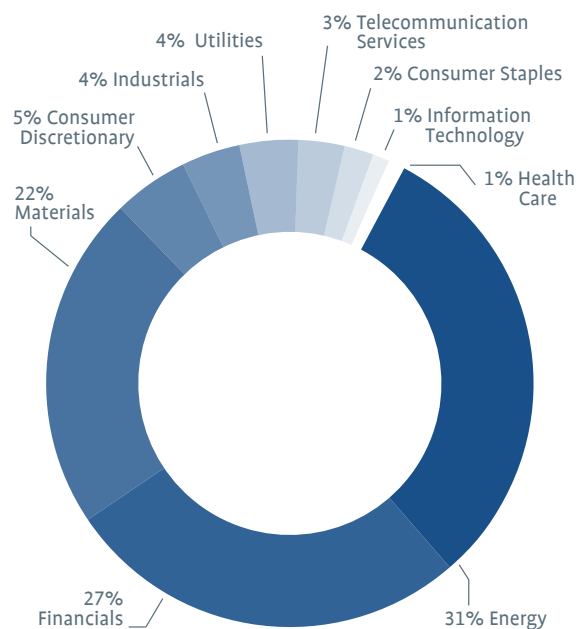
m-x.ca/weeklies

Top 10 Most Active Option Classes (Q1 2016)

RANK	SYMBOL	VOLUME	INSTITUTIONAL	RETAIL	INSTITUTIONAL %	RETAIL %
1	XIU	2,579,566	2,384,271	195,295	92%	8%
2	BNS	332,186	180,496	151,690	54%	46%
3	SXO	313,362	246,750	66,612	79%	21%
4	RY	283,061	91,613	191,448	32%	68%
5	TRP	255,871	216,958	38,913	85%	15%
6	SU	251,399	133,360	118,039	53%	47%
7	CPG	241,816	137,775	104,041	57%	43%
8	TD	224,990	86,339	138,651	38%	62%
9	CNQ	207,455	112,349	95,106	54%	46%
10	FM	199,779	134,692	65,087	67%	33%

Options Trading Volume by Sector

Q1 2016



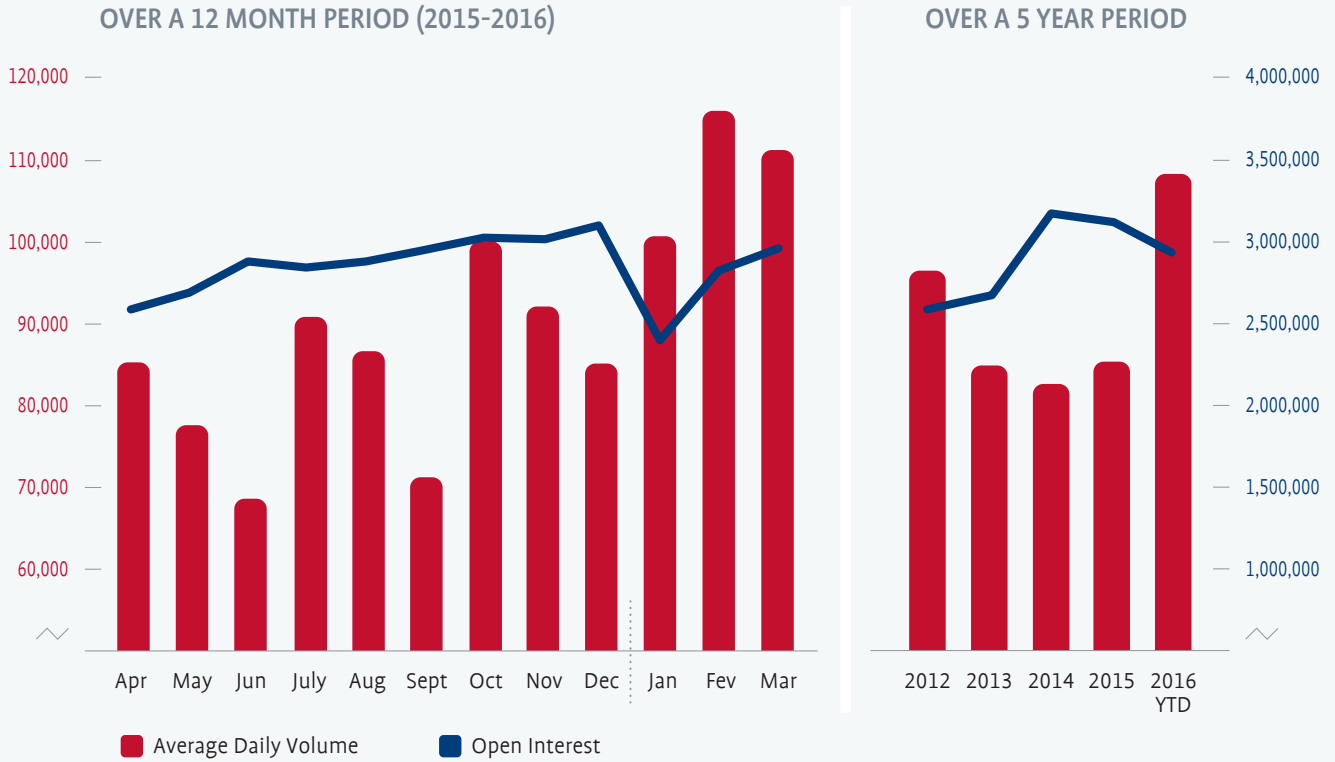
Source: Bloomberg

Note: Options volume from delisted or acquired companies are excluded.

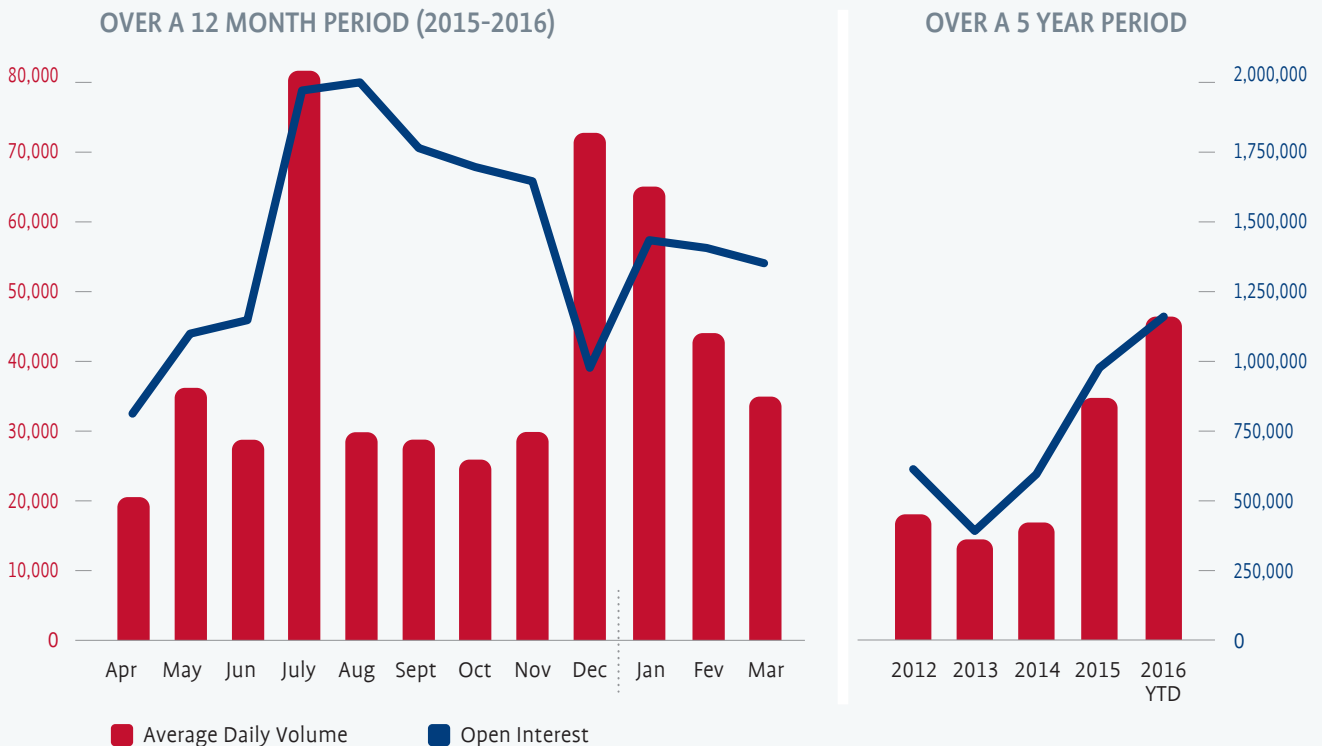
Most Crossed Option Classes

RANK	SYMBOL	CROSS VOLUME
1	XIU	2,384,271
2	SXO	246,750
3	TRP	216,958
4	BNS	180,496
5	CPG	137,775
6	FM	134,692
7	SU	133,360
8	CNQ	112,349
9	ZEB	96,788
10	RY	91,613
11	NA	90,317
12	TD	86,339
13	EFN	82,651
14	HSE	80,877
15	FTS	77,862
16	ENB	77,844
17	CM	73,168
18	BCE	66,998
19	BMO	66,975
20	DGC	62,997

Equity Average Daily Volume and Open Interest



ETF Average Daily Volume and Open Interest



Trading Tools

COVERED CALL
Calculator

OPTIONS
Calculator

TMX Trading
SIMULATOR

Useful Links

GUIDES

- » [Equity derivatives](#)
- » [Index derivatives](#)
- » [Currency derivatives](#)
- » [Equity options tax regime](#)

MX INDICES

- » [S&P/TSX 60 VIX Index \(VIXC\)](#)
- » [MX Covered Straddle Writers' Index \(MPCX\)](#)
- » [MX Covered Call Writers' Index \(MCWX\)](#)

OTHERS

- » [Options List](#)
- » [Put/Call Ratios](#)



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