


 EMEA ETF
OPTIONS

Q2 2018

ETF options launch

iShares Gold ETC (IGLN LN)

Key stats: IGLN

USD3.3bn

Assets under
management

25

Total Expense Ratio
(bps)

8

Registered market
makers on IGLN LN

May 2018

Eurex options launch
date

New options contracts on iShares Physical Gold ETF (IGLN LN / \$ listing) launching in May 2018

In response to growing demand from European investors for implementing ETF options strategies alongside their ETF holdings, Eurex will be launching options on IGLN in May 2018.

Gold's time to shine

- 2018 YTD has shown that the record high risk-adjusted return environment of 2017 is well behind us with returns in 2018 more difficult to be found, and at a higher level of volatility (for e.g. VIX mean at 14.29 vs last year 9.87). Nonetheless we see volatility remaining in the low-vol regime, albeit at higher end of this regime range (Past performance is not a reliable indicator of current or future results.)
- Gold is a good diversifier in this type of environment given correlation with equities. For instance, the 30-day correlation between US equities (S&P 500) and gold has most recently been just in negative territory at -0.17 and the 120-day correlation at -0.02 indicating minimal correlation between the two asset classes.
- The caveat? The opportunity cost of holding gold outright may go up in a rate-rise environment, so investors may consider option strategies on gold as a more effective bet. In fact, based on data on large gold ETF option trading in the US, investors have been increasing demand for gold OTM calls, with demand reaching five year highs in April 2018.

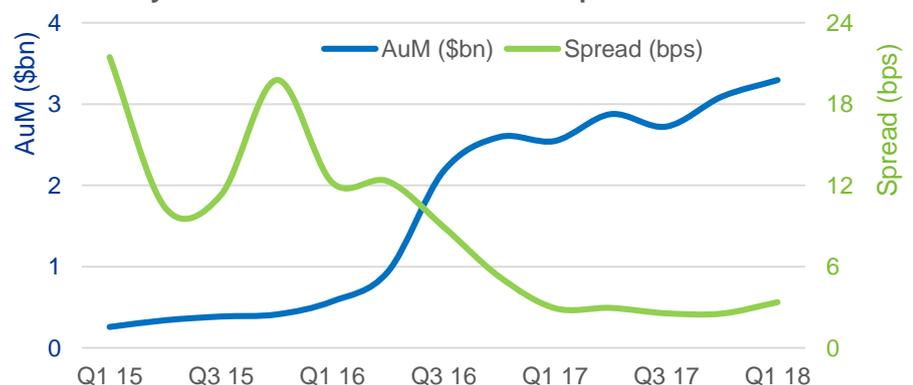
IGLN: the fastest growing gold ETP in Europe

Alongside being one of the cheapest Gold ETPs in Europe (25bps TER), IGLN is also the fastest growing; its AuM has increased by x17 to ~USD3.3bn over the past 3 years while spreads have fallen to ~4bps (see chart 1).

Key contacts

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Chart 1: 3 year evolution of IGLN AuM and spreads



(Source: Bloomberg, London Stock Exchange, OneTick- (08/04/2018))

Popular IGLN options implementations

1. Overwriting - yield generation

In an environment of low volatility, investors seeking extra yield on their portfolio may look to implement an overwriting strategy – selling out of the money (OTM) calls. This strategy tends to work particularly well with gold as call options on gold tend to be more expensive than puts (U shape volatility).

An overwriting strategy on gold therefore:

- Generates yield from an otherwise yield-less holding
- Reduces max drawdown of the overall position
- Caps the upside potential of the overall position, which also reduces volatility and improves risk-adjusted returns

Based on indicative levels as of 8th April 2018, a client would have received a ~1.98% premium by selling a 5% OTM call maturing in 6 months, (see highlighted box in chart 2).

Please note that by selling an OTM call option, investors cap their upside potential when the underlying market rallies beyond the selected strike price. Hence there are periods in which an overwriting strategy could be unprofitable overall.

2. UCITs eligible synthetic exposure

One key recurring limitation for clients running UCITs portfolios are compliance restrictions around options contracts that could lead to physical delivery of underlying gold bars. These restrictions prevent investors from holding gold commodity options and options on gold futures (since gold futures themselves are physically exercised).

Options on a UCITs eligible vehicle allows investors to obtain an unfunded exposure to gold. This strategy involves a client buying puts and calls at a same strike and maturity to replicate a long exposure – similarly a client could sell puts and calls to replicate a short exposure to gold. These options can then be exercised physically into UCITs eligible ETF shares or into cash via flex options.

Comparing IGLN (ETF) options with gold futures (GC1) options

IGLN options offer the following advantages over GC1 options:

1. Physically exercised into a UCITs eligible instrument
2. Smaller contract sizes (~USD2,600 vs ~USD120K) offer more flexibility
3. Flex options enable investors to exercise their options vs cash

IGLN options		GC1 options
Delivery	Physical: UCITs eligible vehicle	Physical: futures that themselves physically exercised into gold bars
Type	American	American
Flex available	Yes	No
Contract size	~USD2,600	~USD135K

IGLN LN	1m	2m	6m	1y
50%	0.00%	0.00%	0.00%	0.00%
60%	0.00%	0.00%	0.00%	0.01%
70%	0.00%	0.00%	0.00%	0.04%
80%	0.00%	0.01%	0.04%	0.21%
90%	0.01%	0.06%	0.30%	0.93%
95%	0.07%	0.20%	0.97%	2.01%
98%	0.39%	0.78%	1.89%	3.07%
100%	1.32%	1.97%	3.86%	6.15%
102%	0.62%	1.18%	2.96%	5.17%
105%	0.22%	0.56%	1.98%	3.97%
110%	0.05%	0.19%	1.05%	2.58%
120%	0.01%	0.03%	0.35%	1.17%
130%	0.00%	0.01%	0.14%	0.60%
140%	0.00%	0.00%	0.07%	0.33%
150%	0.00%	0.00%	0.03%	0.20%

Chart 2: Indicative premium matrix on IGLN options

Source: Morgan Stanley (08/04/2018)

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For investors in Denmark

For investors in Finland

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