From the market

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BNP PARIBAS

The bank for a changing world

Dividend Derivatives with **BNP Paribas**

BNP Paribas has been a leading participant in the trading of dividend swaps since their creation in the late 90s, and the driving force in the listing of the first Dividend Index Futures in 2008. Dividend derivatives remain one of BNP Paribas' core areas of expertise and the bank is regularly ranked number 1 in terms of global dividend futures market share. BNP Paribas' Equity & Derivatives Strategy team produces global dividend research publications and trade ideas.

Dividend futures was a highly concentrated market in the early 2000s, with only a few market participants; mainly fast money looking to capture high discounts from dealers needing to hedge their dividend risk generated from their structured products business. Since 2005, the dividend swaps market has taken off with 1) significant increase in volumes, 2) extension of maturities, 3) broadening range of traded indices, and 4) the development of single stock dividend swaps. 2008 saw a turning point in the dividend market with the listing of dividend futures, thus increasing transparency and enabling more market participants to access these "new" products.

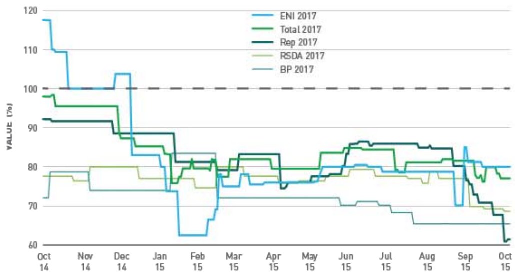
Dividend derivatives were first created to offer a solution to hedge dividend exposure from forward, option or structured product trading. This was largely a result of the massive take-off of structured products in European markets. Now dividends have become an asset class on their own!

Dividends offer an alternative to diversify a traditional portfolio. Investors have seized the opportunity to capture the embedded carry in dividends risk premium. In addition to opportunities within the index dividend curve, Single Stock dividends allow an investor to express stock fundamental views by gaining pure exposure to dividends, without direct exposure to the underlying stocks.

Over the last year, Oil and Gas Dividend Futures levels retreated in light of decreasing Brent prices. Investors feared that oil majors would need to sacrifice their dividends to match decreasing free cash flows. As we pointed out over the last months, we believe this has created an opportunity in Single Stock Dividend Futures. Oil majors have reiterated many times their commitment to current dividend levels in a lower-for-longer oil price environment. We continue to believe that decreasing costs and capex and the use of scrip dividends in the short-term will enable oil majors to maintain current dividend levels.

Single Stock Dividend Futures on oil majors show a 20% to 40% discount to our base case scenarios.

Figure 1: Oil majors implied dividends vs. base case



Source: Bloomberg, BNP Paribas

LAFFITTE CAPITAL MANAGEMENT

Access to various dividend strategies with **Laffite Capital Management**

Laffitte Capital Management is an asset management company that has focused on absolute return liquid funds since 2007.

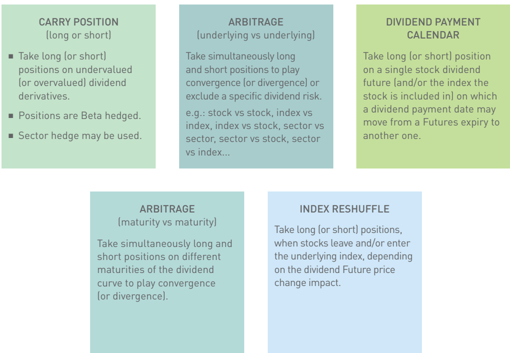
The investment team has a banking background with almost two decades of common expertise as proprietary traders for a French bank, where they developed arbitrage linked to equities and equity derivatives with a specific focus on index arbitrage.

The team members are considered as one of the pioneers of the dividend derivatives market, having historically traded OTC dividend derivatives in the late 90s.

The development of listed dividend derivatives was a great opportunity for them as they launched their own arbitrage daily liquid UCITS fund and they could at last make use of their expertise in a regulated fund.

In the Laffitte Index Arbitrage fund they replicate most of the common Long/Short equity strategies by using dividend derivatives. The range of maturities, nature of dividend derivatives, underlyings (single stocks, index, sectorial index) allow room for many arbitrage opportunities described below:

Figure 1: Laffitte Index Arbitrage Fund



The investment process is based on forecasts of the dividends of single stocks for the next 4-5 years with the timetable of the payments.

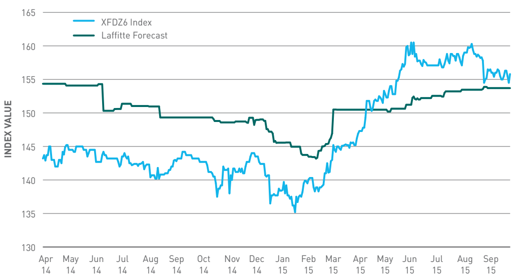
We perform a fundamental analysis by stock and by sector. We use various criteria such as EPS, Debt/Ebitda, level of the CDS, available cash, etc. In addition to this analysis, we collect the dividend policies of the companies which use three types of approach: pay-out ratio, yield or amount per share.

We finally challenge this guidance to confirm whether or not the dividend is sustainable, considering the fundamentals of the companies, the trend and the environment of the company's sector. As an example, the level of debt in the telecom sector in the past years has resulted in an impact on the dividends: almost all the companies cut their dividend (Telefonica, Orange, Deutsche Telekom, and so on).

Once this work is done for any component of an index, we can calculate the level of the dividends for a specific index and the curve of the coming years.

We can illustrate our arbitrage approach with a recent carry position on the CAC 40 2016 dividend futures. Our analysis detected that this contract was discounted compared to our forecasts. The chart below shows the levels of this contract and the levels of our forecast:

Figure 2: XFDZ6 market vs Laffitte Forecast



We opened the position in spring 2014 with a discount close to 8%, and we closed it last summer once the market was above our estimations.

We were able to do this arbitrage thanks to Euronext's launch in late 2009 of CAC 40 dividend contracts, which were not tradable on other platforms.

Euronext has proved to be a reliable partner for our business. It has worked to offer better pricing in order to provide us cheaper access to this kind of derivatives. Moreover, Euronext recently launched a wide range of single stock dividend futures which helps us to implement various new arbitrages (stock vs index, stock vs stocks, etc.).

Founded	2007
Country	France
Investment team	8 including 4 senior professionals (traders since 1990)
Focus	Absolute return UCITS fund
Range of expertise	Dividends, Equities, Derivatives, Merger arbitrage

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