

Julius Bär

JB CERTIFICATES ON THE CHF 3M LIBOR

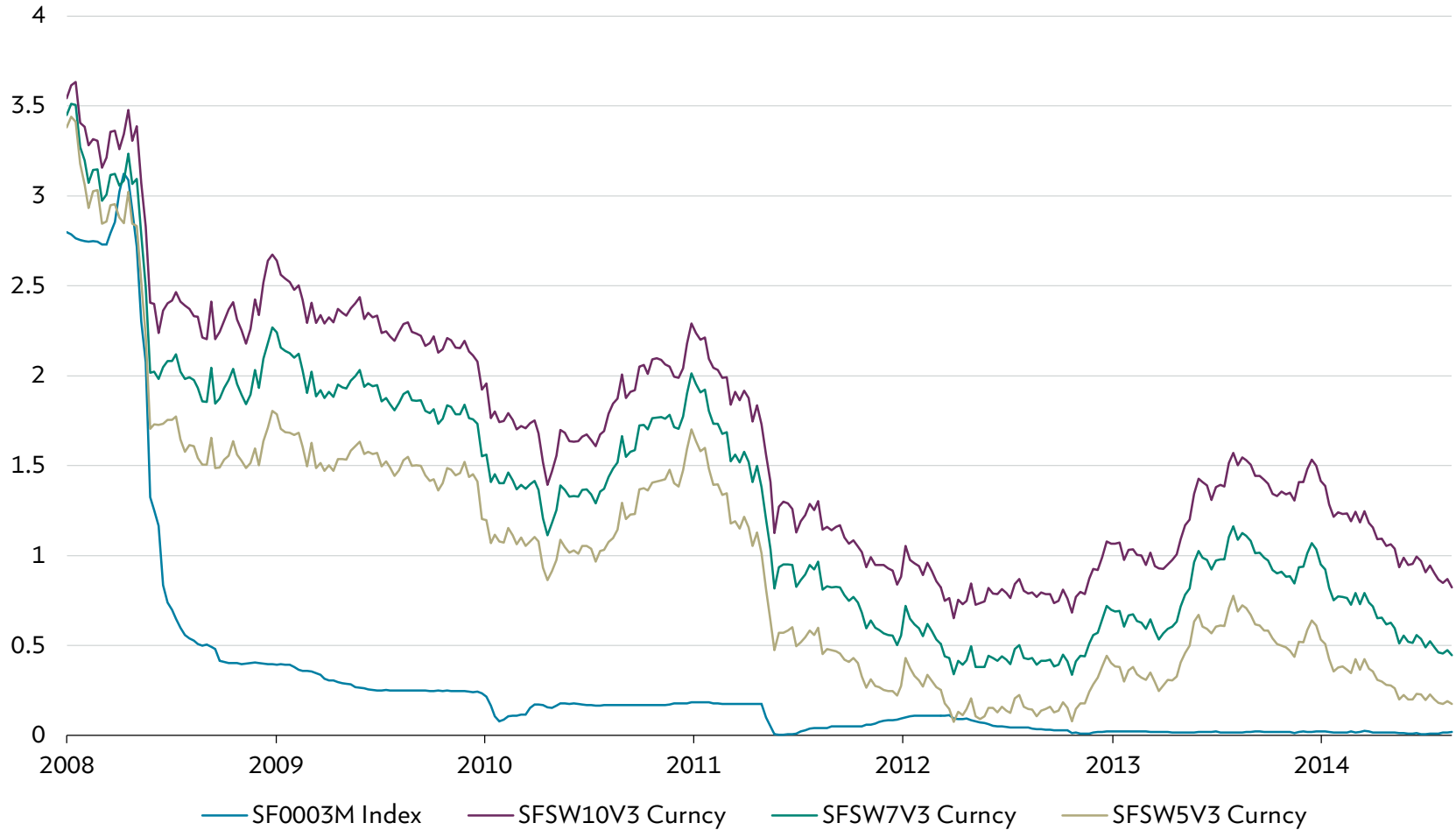
INVESTMENT OPPORTUNITIES IN A RISING INTEREST RATE ENVIRONMENT



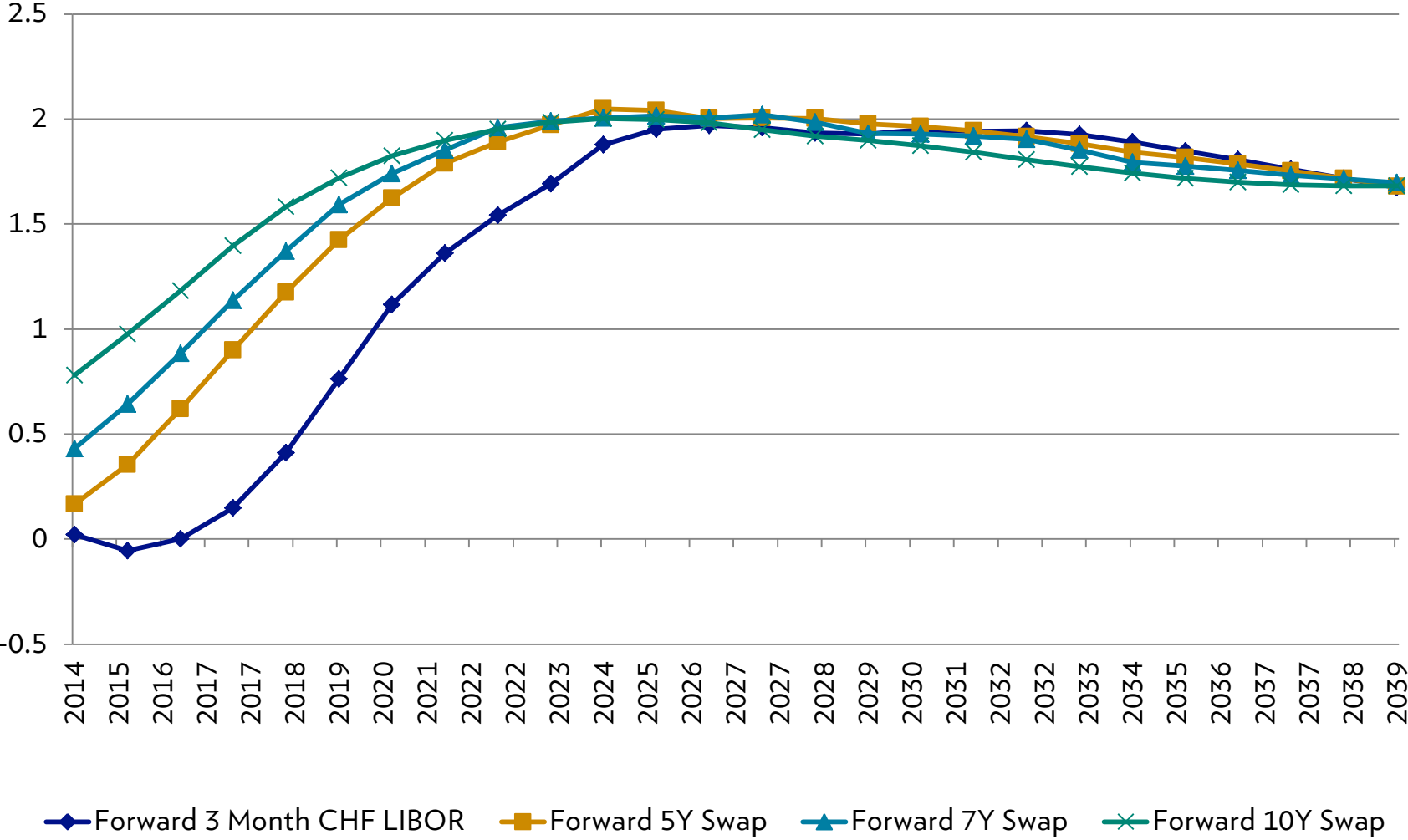
CURRENT MARKET ENVIRONMENT



CHF SWAP CURVE



FORWARD RATES



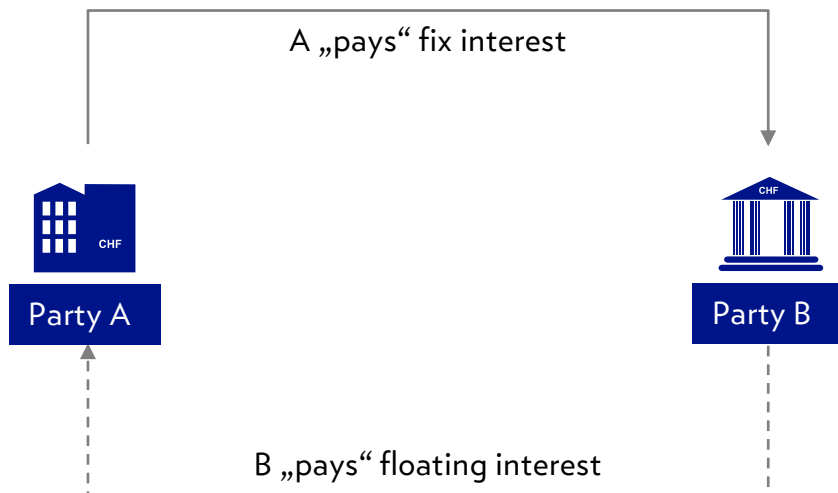
HEDGE AGAINST RISING INTEREST RATES

- **CHF rates are on all-time lows and future interest rates could increase soon again**
- A lot of **mortgage holders** as well as **bond investors** do not expect further significant rate drops from these low levels and want to **hedge** themselves against a possible rise in interest rates or **lock the current low levels in**
- Unfortunately there are **hardly any products available in the market** which allow investors to take advantage of rising mid-/long term interest rates with a small minimum notional

HEDGING WITH SWAPS VS. JB CERTIFICATES

A (PAYER) SWAP REDUCES INTEREST RATE RISK

Payer Swap = Pay fix interest
Receiver Swap = Receive fix interest

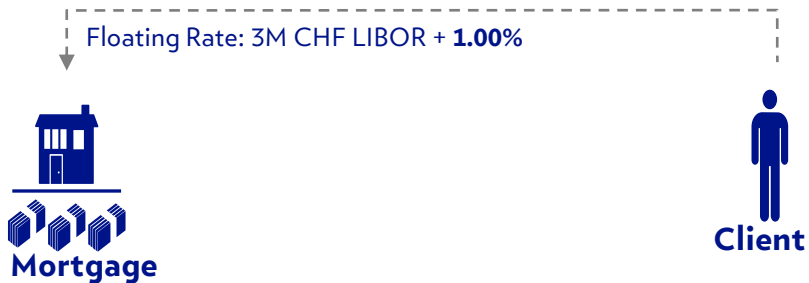


- **Swap** (engl.) = exchange
- Derivative contract between 2 parties
- Exchange of a fix payment versus a floating payment
- Predefined maturity
- No exchange of Nominal! Only interest payment

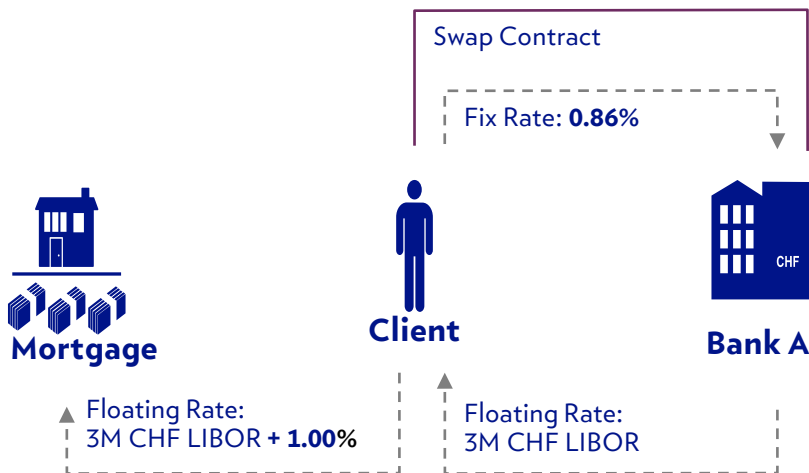
Example

- Party A pays „fix“ and receives floating payment
- At trade the pv of the floating is equal to the pv of fix payments
- If the sum of all received floating payments is higher than the fix payments Party A makes a profit. **Party A expects higher rates and Party B lower rates**

HEDGING OF A LIBOR MORTGAGE WITH SWAPS: FIX AND FLEXIBLE



- The client has a 3 month CHF LIBOR mortgage and pays Libor +1.00%
- The client is exposed to interest rate risk because interest payments increase as rates go up



- The client wants to hedge against rising interest rate with a swap for the next 10 years :
- 10 Year CHF Swap Rate versus 3 Months floating: 0.86%
- **Result:**
The client pays 1.86% fix for 10 years =
Corresponds to the interest rate of a fix mortgage (0.86% interest + 1.00% credit margin)

DISADVANTAGES OF SWAPS...

...and the optimal solution with JB Certificates

- **SWAPs**

- need additional documentation (ISDA, CSA)
- Minimum size of 2-3 Mio CHF equivalent
- Cash flows need to be monitored precisely
- High Bid/Ask Spread

- **JB Certificates are the most efficient tool to hedge interest rate exposure**

- Interest rate Certificates

- Securitized Swaps, i.e. offer the full range of maturities and liquidity of the Swap market (i.e. can be tailor-made) in different currencies
- No additional documentation needed (ISDA, SIX)
- No need for cash flow management (all cash flows are reflected in the price of the Certificate)
- Small Denomination (CHF 100)
- Listing on the Swiss Exchange ensures transparent secondary market
- No additional margins / margin calls

ACCESS TO THE SWAP MARKET WITH JB CERTIFICATES

Maturity Swaps	30.09.2019	30.09.2021	30.09.2024
Interest rate at fixing	0.18%	0.46%	0.85%
Actual implied interest rate*	0.11%	0.39%	0.75%
Issuer	Bank Julius Baer & Co. Ltd., Guernsey	Bank Julius Baer & Co. Ltd., Guernsey	Bank Julius Baer & Co. Ltd., Guernsey
Nominal Certificate	CHF 1.00	CHF 1.00	CHF 1.00
Price indicative (Bid)	CHF 2.26	CHF 4.76	CHF 9.22
Ratio	100	100	100
Stop Loss Limit	None	None	None
Valor/ISIN	24202075/CH0242020755	24202076/CH0242020763	24202077/CH0242020771

*as of 26 August, 2014

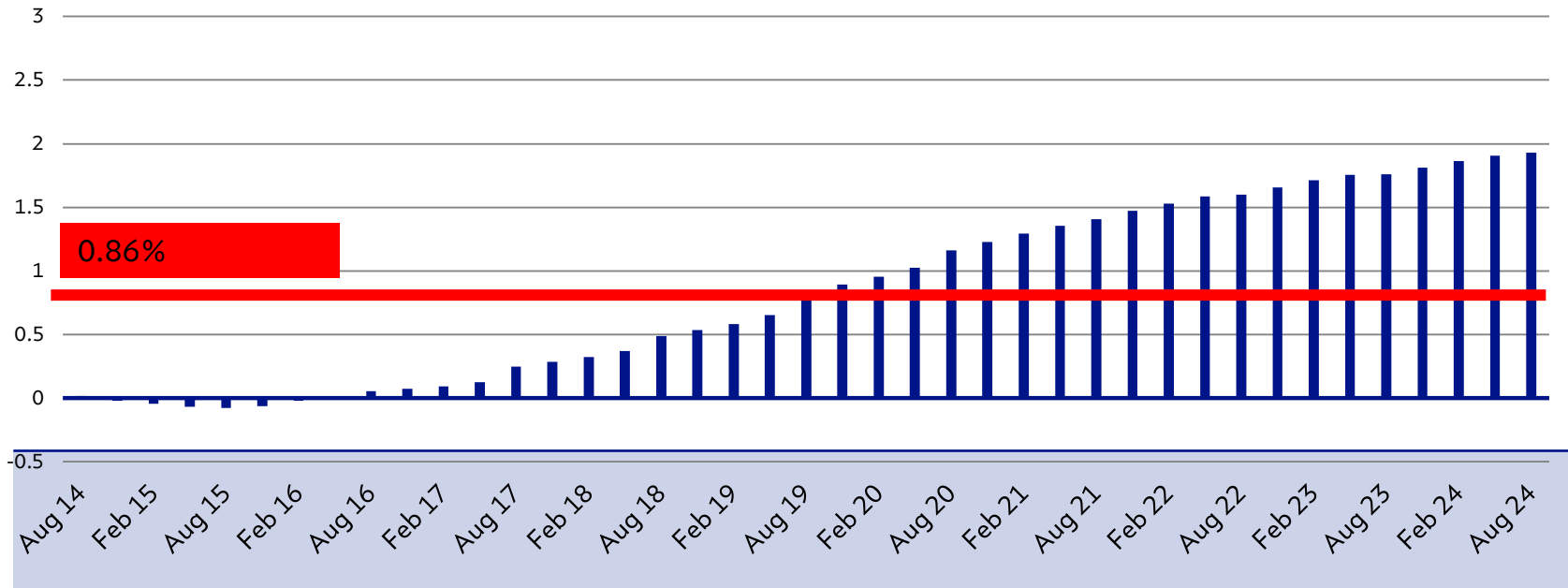
CONSTRUCTING JB CERTIFICATES

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Example: JB Certificates on the 3M LIBOR

- A JB Certificate on the 3M LIBOR is constructed through a securitized **payer swap and a floor option**
- All interest **payments are reflected in the price**, no cash-flow management needed
- Fixed term exposure to the 3M Libor by paying a one time **up-front amount**, no periodic payments needed
- The Certificate has **no Stop-Loss**
- The price of the Certificate rises when interest rates rise and drops when interest rates decrease
- The **JB Hedging Tool** facilitates the hedging process

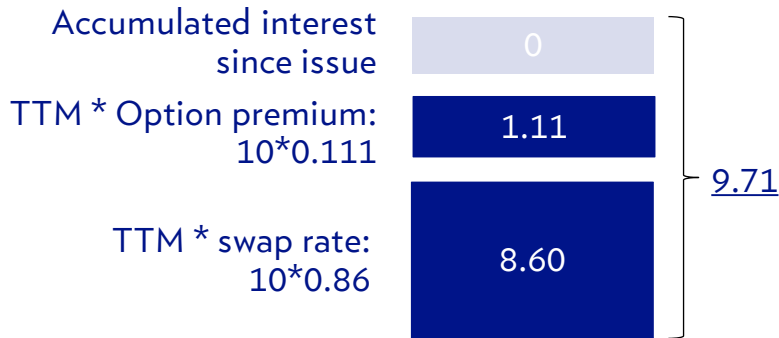
A 10 YEAR SWAP (FIX VERSUS 3 MONTHS FLOATING) VALUE OF 40 (!) IMPLIED 3-MONTHS-LIBOR FIXINGS



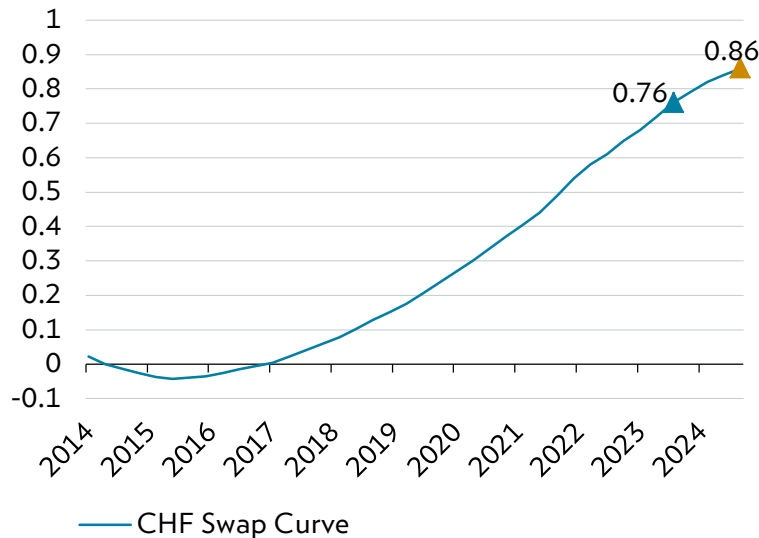
- The average of 40 implied CHF 3M Libor fixings is at 0.86%
- 0.86% p.a. is the par coupon of the 10 year swap so that **Present Value (PV) Fix Leg = PV Floating Leg**

PRICE TODAY AND ROLL-DOWN AFTER 1 YEAR

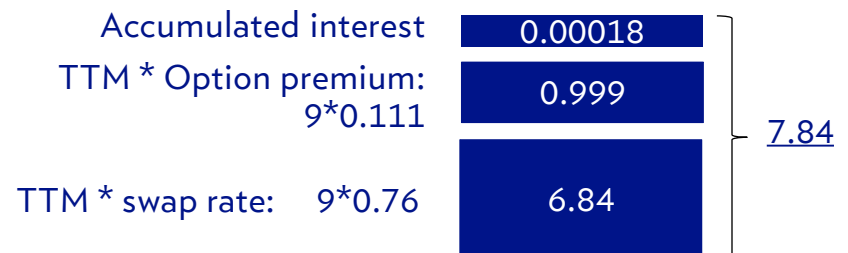
JB Certificates on the CHF 3M LIBOR



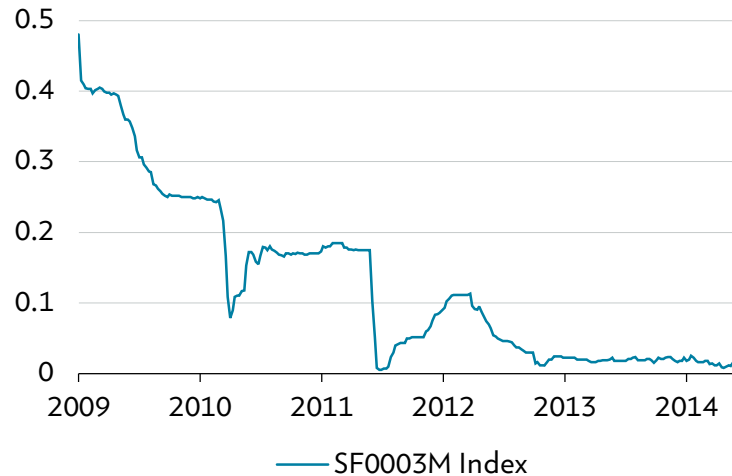
- **Price of the Certificate today**
- E.g.: JB 10Y Certificate on the CHF 3M Libor (Valor: 24202077)
 - Construction:
 - Time to Maturity (TTM) in 10 Years
 - 10Y Swap rate: 0.86% p.a.



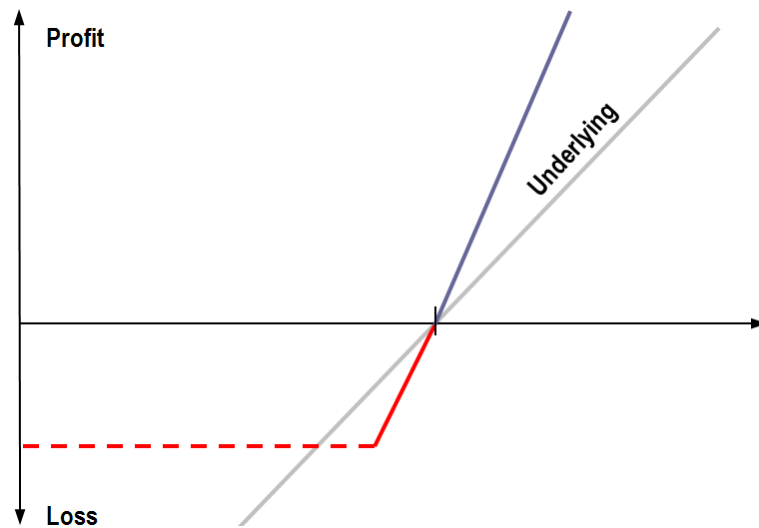
- **Price of the Certificate after 1 year**
- **Roll-down:** If within 1 year interest rates do not increase as expected at the fixing, the 10Y swap becomes a 9Y swap and the Certificate's value would decrease from 9.71 to 7.84 (example):



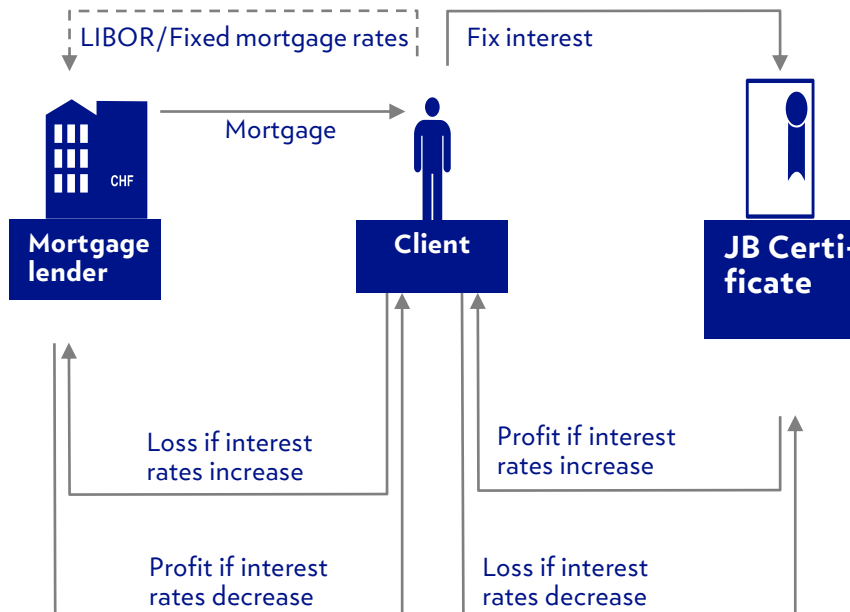
PAYOFF STRUCTURE AND FLOOR OPTION



- The Swiss National Bank (SNB) could lower the Libor target rate to negative levels from currently 0%
- The floor option protects the investor against losses in a negative interest rate environment
- The floor option limits the downside potential of the Certificate



GAIN INDEPENDENCE WITH A LISTED HEDGING SOLUTION



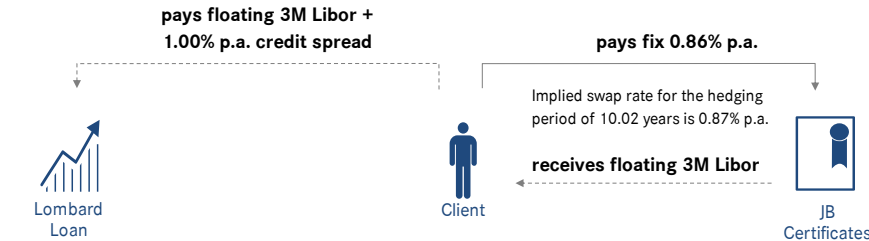
- **Absolute independence:**

- Mortgage holder hedges interest rate risk without involving the mortgage lender
- Full flexibility, no penalty fees if mortgage lender gets replaced
- Real time price quotes during trading time

SMART SOLUTION: INTEREST RATE CERTIFICATES

JB Service: Hedging Tool

Hedging a lombard loan with Julius Baer Certificates, the new structured portfolio (*)



Before hedging

Client credit spread (p.a.)	1.00%
Float costs loan (p.a.)	3M Libor + 1.00%

Indicative prices

5.01Y certificate price (CHF)	2.82
7.02Y certificate price (CHF)	5.30
10.02Y certificate price (CHF)	9.71

How to hedge (ISIN)

Num of 5.01Y cert (CH0242020755)	0
Num of 7.02Y cert (CH0242020763)	0
Num of 10.02Y cert (CH0242020771)	200'016

Computation

Investment (CHF) = (200'016 x 9.71) = 1'978'162 CHF
 Investment (% of portfolio) = 1'978'162 / 20'000'000 = 9.89%
 Implied rate (p.a.) = 0.86%

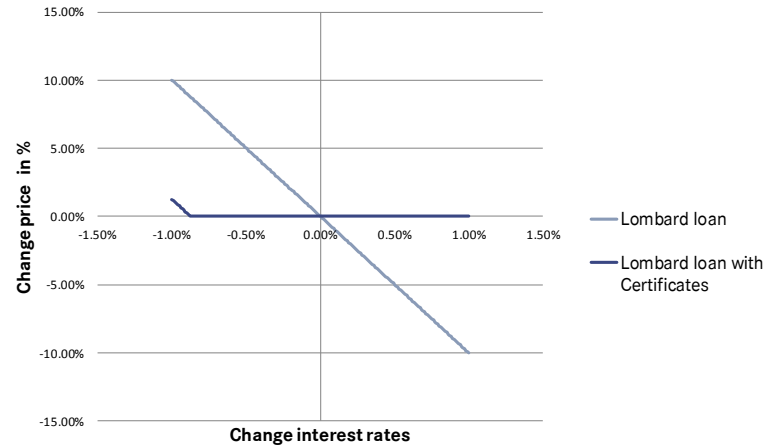
After hedging

Client credit spread (p.a.)	1.00%
Implied rate (p.a.)	0.86%
Fix costs loan (p.a.)	1.86%

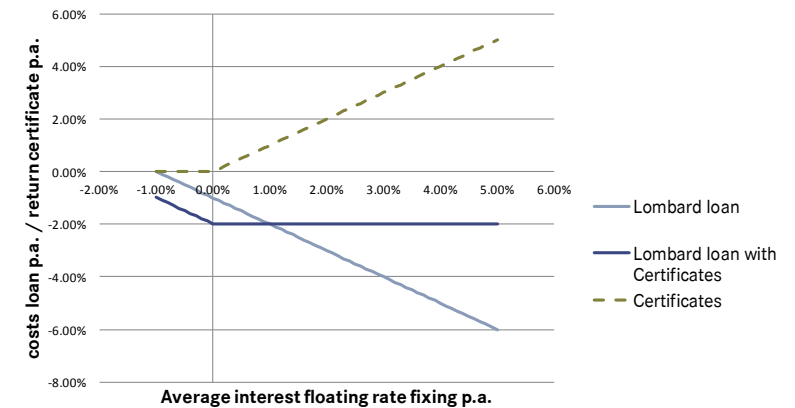
Investment and leverage

Loan value (CHF)	20'000'000
Investment (CHF)	1'978'162
Investment (% of portfolio)	9.89%
Implied rate (p.a.)	0.86%
Leverage (portfolio/investment)	10 x

Today → Price change if interest rates immediately move from their current level?



At Maturity → What is my payoff if the average of the floating rate is at a certain level? (**)



The intersection between the lines Lombard loan and Lombard loan with Certificates is the implied rate (p.a.)

CONTACT

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