NextFinance
One step further

Dividends : New strategies

Analysis, investment perspectives and strategies on dividend derivatives. Find the views of pioneers such as Jad Comair CEO of Melanion Capital, Eric Robbe, President of Laffitte Capital Management and Warenn Buntrock, Portfolio Manager of Amundi Funds Absolute Global Dividend in BFT Gestion ...

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Jad Comair : « We have much more interesting entry points to our dividend Futures strategies than those of our competitors in other asset classes »

Spin-off of the trading department of Société Générale, Jad Comair and his team have created Melanion Capital in order to provide investors with a new source of return on an innovative asset class , *dividend Futures*.

Next Finance: Last year you launched Melanion Capital, one of the first fund management companies dedicated to dividend Futures strategies. What is your experience, and that of your team on the subject?

Jad Comair: Our teams trade dividend futures since their inception in 2008, and quickly specialized on this product to become the undisputed experts. We are a spin-off of the trading department of Société Générale and we created Melanion in order to offer investors a new source of return on an innovative asset class.

Are there liquidity and depth on the dividend futures markets? What markets do you mainly trade? Equity Index Dividend Futures? Single Stock Dividend Futures?

The futures market dividend represents approximately $ 10 billion today. This is small compared to other financial markets, but significant considering its youth. We trade Equity Index and Single Stock Dividend Futures, mainly large market capitalizations (Blue Chip). The market is highly developed in Europe, where it was born, and Asia is following. However in the U.S., there is no dividend Futures since the CFTC and the SEC have not yet reached a compromise on the regulation of this product.

> “ each shareholder is 'long' an infinite series of dividends and , thanks to the dividend 'futures' , for the first time in history, investors can 'choose', on which dividend they want to be exposed. ”
>
> **Jad Comair, CEO, Melanion Capital**

You talk about a new asset class, could you explain why?

The dividend is a very familiar concept to investors, and many of them hold shares with the main objective being the return they will earn. Several studies show that stock returns come mainly from dividends rather than capital gains, thesis supported by the winner of the 2013 Nobel Prize in Economics, Robert Schiller, who considers that a share is an infinite sum of its cash flows and that we can easily dissect the share as a sum of future dividends paid (it is also by demonstrating that stocks were much more volatile than dividends paid, that he could developed his theory of non-efficiency of market dealers). All this to say, that each shareholder is therefore long an infinite series of dividends and , through dividend futures , investors can "choose" for the first time in history , on what they want to be exposed regarding dividend (instead of having them all by buying a share) , or just covering the dividend risk associated with the equities they have in the portfolio.

We believe that investors will continue to be interested in these products, which are simpler and easier to understand than stocks. Hence the potential of development in asset class in its own right and the rationale behind the creation of Melanion Capital, with the aim to be a world leader in this market.

How do you see the dividend futures market? You recently indicated that this market could experience the same revolution that the commodities or CDS market where the derivative market has exceeded the underlying. What could prompt investors to operate a cultural revolution and neglect stocks for dividend futures?

First you should know that since its inception in 2008, the market for dividend futures has grown exponentially in a post- Lehman environment where volumes of other asset classes were decreasing. The reason for this development is that dividend futures is an ideal tool to hedge against the risk of a dividend payment. However, if we look only in Europe, the 50 companies in the Euro Stoxx 50 will pay about 1,000 billion of dividends in the years to come. Imagine the amount of risk to be covered, in a market where these companies have on average cut their dividends since 2008 until today.

Beyond their use as a hedging product, dividend futures are so simple that they should encourage investors to prefer them to equities.

A final advantage is the low volatility of dividends with respect to shares, mainly due to the inefficiency of the stock market that relies heavily on psychological rather than fundamental.

> Dividends 'futures' on the Eurostoxx 50 anticipate a decline in dividends each year for the next 10 years. But all other asset classes (equities, interest rate, credit, inflation, etc ...) consider an economic recovery in Europe. So we have our entry strategies that are much more interesting than our competitors, trading highly priced assets today.
>
> **Jad Comair, CEO, Melanion Capital**

The interest on dividend futures actually seems progressing. This is evidenced by the new funds embarking on the niche. However, what is the attraction for investors?

Strategies for dividend futures, like any portfolio management strategy involve risks that need to be managed. The dividend futures strategy at Melanion Capital allows investors to have a new source of return with a very low correlation to traditional asset management strategies. In fact, because we work on a new asset class, we can offer very different performance in terms of timing and amplitude.

Theories of asset allocation demonstrate that it is best to allocate its capital to assets with low correlation, so as to maximize its return - on -risk ratio. Thus, an asset allocation strategy that incorporates Melanion Capital diversifies its exposure while increasing the investor return -to- risk ratio (sharp ratio). In addition, because the futures contract is listed, the counterparty risk is much more limited than in stocks or bonds.

Beyond the interest for investors in terms of diversification, now in this market what are the sources of alpha that you can offer them?

Melanion initially have a very strong expertise in this market, because its team is specialized on these products since their inception in 2008, which allows us to capture a large part of present opportunities therein. In addition, we operate in a market where there is a very strong selling pressure on dividend futures; given the risk not covered I described later (1,000 billion over the EURO STOXX 50 only). To illustrate this selling pressure, you can refer to the Eurostoxx 50 dividend futures, which anticipate a decline in dividends in Europe each year for the next 10 years. But all other asset classes (equities, interest rate, credit, inflation, etc ...) consider an economic recovery in Europe. So we have our entry strategies that are much more interesting than our competitors, trading highly priced assets today.

Next Finance , 14 novembre

Eric Robbe : « Investors clearly understand the issue to be placed on this asset class »

According to Eric Robbe, President of Laffitte Capital Management, it is very easy to measure the tail risk on dividends strategies, which gives its full dimension to the robustness of the portfolio allocation in a management process based on the budget risk that one gives...

Laffitte Index Arbitrage launched in October 2012 is a "Market Neutral" arbitrage fund on global equities and derivatives specialized in arbitrage strategies on indices and dividends. The management team felt that the environment was so conducive to this type of strategies. Interviews with Eric Robbe, president of Laffitte Capital Management about the opportunities afforded by the dividends "Market" ...

Next-Finance: Do you consider "dividends" as a new asset class ?

Eric Robbe: Yes dividends are a new asset class, you can buy or sell dividend via derivatives (futures or options) and have exposure on dividends being exposed to the second order underlying. It is a real asset class in the sense that it is also de-correlated from other traditional assets such as equities, bonds and other money market products. The day when all asset classes are disrupted by an uncertain economic environment, the dividend is ultimately the only active asset that business leaders can manage, unlike their market price. This is a real communication tool for investors.

“ The day when all asset classes are disrupted by an uncertain economic environment, the dividend is ultimately the only active asset that business leaders can manage, unlike their market price. This is a real communication tool for investors. ”

Eric Robbe, Président, Laffitte Capital Management

Do you use dividend futures or dividend swaps ?

We mainly use listed dividend futures. The main advantage with respect to a dividend swap is the measurement of counterparty risk.

In one part your risk is shared in a clearing in the other part the risk is concentrated on a specific counterparty. As part of our management, it is more comfortable to deal with futures or options on dividends whose technical characteristics are known to all and whose risks are clearly identified.

Can you describe the different types of dividend strategies you implement?

We described on our website the outlines of the different strategies used in our management.

The main strategy is a carrying strategy, for example, you feel that your anticipation of dividend is underestimated by the market, you are buying the future on the underlying instrument to capture the difference between the actual market price and the market price at maturity , and that , for a given index or security. With different futures contracts (securities, indices, sectors) and options on dividends, combinations are numerous. Some products are priced beyond 2020, which also offers the possibility to implement calendar arbitrages strategies.

Futures markets allow leverage to the constraints related to the structure of the fund in the UCITS framework, the commitment measure (either linear or VAR) is very strict

The benefit from dividend strategies for a manager is based on its excellent readability both in the gains expectations offered than in risk management. It is very easy to measure the tail risk, which gives its full dimension to the robustness of the portfolio allocation in a management process based on budget risk that one gives.

> “ Futures markets to allow the lever to the constraints related to the structure of the fund in the UCITS framework, the commitment measure (either linear or VAR) is very strict. ”
>
> **Eric Robbe, Président, Laffitte Capital Management**

What is the feedback from investors that you have encountered? What is your outlook for the collection of funds?

Academic studies show that over a long period, the dividend is the essential part of the stock. At a time when investors are seeking new sources of asset pricing, and concomitantly the profiles of other asset classes do not provide the expected returns (low interest rates, the bond market at the end of cycle, stock market related to more and more volatile economic cycles with the anticipated reduction of accommodative monetary policies), investors clearly understand the issue to be placed on this asset class.

We launched Laffitte Index Arbitrage in August 2012. We were one of the first funds to offer this thematic about dividends operations as the main driver of return. Collection of funds has increased by over 50 % since the beginning of the year and we see a sharp acceleration from the past two months.

RF , 14 novembre

Amundi Funds Absolute Global Dividend aim for 150 to 200M€ in managed assets over a period of 12 months

According to Warin Buntrock, fund manager of Amundi Funds Absolute Global Dividend in BFT Gestion, the investors feedback is encouraging. As proof, the fund, launched on 15th April 2013, is today 65 million worth in assets under management...

Amundi Funds Absolute Global Dividend managed under delegation by BFT Gestion is a new sub-fund of the coordinated Luxembourg SICAV *Amundi Funds*. It offers investors a solution allowing them to capture the potential downgrade of estimated dividends compared to those who are actually paid by the companies. The more the markets undervalue dividends, the more the gains potential of the fund will be important. Warin Buntrock, fund manager, uses both dividend futures on the Euro Stoxx 50 Index, the FTSE 100, the Nikkei *225* but also dividend swaps on the U.S. S & P 500.

Warin Buntrock mainly implements directional strategies (to buy and to sell) on these indices. The investment horizon is relatively close (from 2014 to 2016), with opened positions, depending on the level of risk premium displayed in the market.

In addition to these directional strategies, he also uses relative value strategies:

- "dividend yield" strategies, such as the purchase of a dividend futures and the simultaneous sale of the Underlying Index;
- strategies to anticipate the curve steepening or flattening of the implied forward dividends curve;
- intermarket spread strategies for the same maturity between two different markets.

If he does not consider dividends as a new asset class, as they are intrinsically linked to the equity markets, he believes, however, that dividend futures help in establishing a pure strategy focused on the "dividend" component without being exposed to other equity risks.

Futures markets allow leverage and therefore bearing risks, a "strict" risk management policy was implemented, based on internal constraints in terms of market exposure. "Thus, the net exposure of the fund is always between -20% and +100%. These asymmetric boundaries are explained by the fact that we prefer to have a long bias due to the nature of the dividends market "said Warin Buntrock.

So far, investor’s feedback is encouraging. As proof, the fund launched on April 15th, 2013, now boasts 65 million euros in assets under management. The objective is to achieve an outstanding 150 / € 200 million over a period of 12-month.

Paul Monthe , 14 novembre

The call spread strategy funded by a put is popular!

According to Antoine Deix, Dividend Strategist at BNP Paribas, dividend derivatives are greatly democratized since futures and options were listed respectively in 2008 and 2010. These products now cover all types of investors ...

Dividend strategies, reserved a few time ago to a niche of sophisticated investors today concern all types of investors. According to Antoine Deix, Dividend Strategist at BNP Paribas, it is the listing of dividend futures and options in 2008

For all that strategies vary depending on the risk profile of the investor. "*Most investors take long positions on short to medium term maturities to take advantage of the convergence of implicit prices to their fundamental value. These positions are through futures or call spread; the call spread Strategy funded by a put is quite popular* "says Antoine Deix.

> " Currently, the Eurostoxx 50 dividends curve still shows a negative implied growth. Spreads between two maturities allow taking a position on this implied growth. "
>
> **Antoine Deix, Dividend Strategist, BNPP**

Hedges funds and sophisticated investors also set up "credit arbitrage versus Dividends", being long or short Credit indices versus dividend futures or swaps. "Credit and volatility are intuitive hedges, dividends being one of the first adjustment variables of a company in times of stress," says Antoine Deix.

In July this year, implied credit spreads for dividend swaps (maturing in December 2015) showed such a spread of 300 bps over the iTraxx Crossover. If a higher spread on dividend swaps seems justified (the company cutting its dividend before going bankrupt), the implied probabilities of default nevertheless indicated that credit was so much more expensive than the dividend swaps. **One of the strategies recommended by BNPP was then buying a swaption call on a dividend swap financed by the sale of a call on a CDS to capture excess spread swaps implied by the dividend swap.**

These new strategies and these new investors contribute to the overall growth of the dividend market.

These offer a unique aspect of convergence towards a settlement price (dividends announced by companies) independent of flows and market sentiments. They allow an investment in a fundamental view for a single maturity (the result of a calendar year).

"This feature and attractive risk premium levels have attracted many investors. Today dividends are an asset class in their own right and their attractiveness remains intact "concludes Antoine Deix.

Paul Monthe , 14 novembre

The inexorable growth of the dividends "futures" market

Dividend Futures give rise to growing interest among market professionals, including fund management companies based in France, as evidenced by the recent launch of strategies specifically dedicated to this market segment, particularly in Melanion Capital or Laffitte Capital Management for instance...

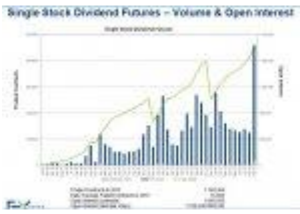
Moreover, the main organized markets have understood this keen interest, multiplying in recent years, the number of financial instruments available on this topic.

The German derivatives exchange - Eurex - initiated the movement in June 2008 being the first to have launched such a product. Based on the Euro Stoxx 50 index, today it is one of the key instruments of its range of derivatives products on its electronic platform. Indeed, on average, nearly 15,000 contracts are exchanged daily since the beginning of the year.

The open interest (ie, the number of futures contracts unsettled) Overall exceed 700,000 contracts at the end of last September, corresponding to a nominal value of € 8 billion (see graph below above).).

With this success, Eurex has continued to introduce new instruments on the same concept in recent years, including the creation of dividend futures on individual stocks or sectors but also options like with future dividends being the underlying asset.

Again, for all these new products, the enthusiasm of the players is present. Thus, the average daily volume of transactions recorded in 2013 and the current level of the open interest, amounted respectively to 10 000 and 1 600 000 million contracts for single stock futures,



5000 and 1 150 000 million contracts for options on dividend futures of Euro Stoxx 50 index for example

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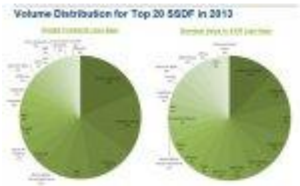
Proof of the growing interest of stakeholders for these products, the number of underlying available on single stock dividend futures widens year by year. Today, dividend futures on the Swiss and UK equities are now traded and not just the only constituents of the Euro Stoxx 50 index, as originally.

It is now possible to intervene on Europe's largest market capitalizations, although the majority of traded contracts at the moment involve securities such as Banco Santander, Vodafone, Telefonica, Banco Bilbao Vizcaya Argentaria (BBVA) or Axa, according to recent statistics provided by Eurex.



In short, many new products that should appeal to operators and continue to increase the number of transactions recorded on this type of product in the future; liquidity often attracting new players in the market.

RF , 13 novembre

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What is a dividend "future"?

A dividend future is a forward contract traded on an organized market, allowing taking a position on the amount of dividends paid by a publicly traded company to its shareholders for a specific maturity date. It is not necessary to hold shares in the company to intervene in this type of futures contracts.

That gives the opportunity to some market participants such as arbitrageurs and speculators to take a position, depending on their expectations on the evolution of the amounts that will actually be received by shareholders (see below the calculation of performance)

The performance of dividend futures depends on:

- During life, the changing expectations of the level of cash dividends and the announcements made by the companies about the future dividends. If expectations or advertisements are better than one day to another, the Future contract will appreciate based on this new information (and vice versa if expectations or news are negative).
- At maturity, the difference between cash dividend earned on that year and anticipated dividend when buying the Future contract.

As with any forward contract, it is possible to take a long position (buying) or short (selling), while benefiting from the leverage offered by organized markets, through the mechanism of guaranteed deposit that worth much less than the futures contract. Obviously, the presence of the clearing house guarantees the successful completion of transacttions, conducting daily margin calls from all market players throughout the duration of their operations.

A distinct advantage for operators to not have to deal with a potential counterparty risk, as may be the case on the OTC market. Yet it is on the OTC market that appeared first dividend swaps in the early 2000s. Since then, the interest of stakeholders to these financial instruments has continued to grow, allowing institutional investors to protect themselves in advance against an anticipated decline in dividends paid by various companies held in their portfolios invested in the equity markets. However, it remains that the most active players in this market are investment banks, generally keen to hedge the "dividend" risk they carry in their books via derivatives sold to their customers, such as stock options, for example.

With this keen interest in recent years, a number of organized markets have decided to launch dividends futures and thus compete with the OTC swap market. **Today, such contracts are exchange-traded, especially on EUREX, NYSE Euronext, MEFF, Borsa Italiana IDEM, London Stock Exchange, Tokyo Stock Exchange, Hong Kong Exchanges and Clearing Limited or Singapore Exchange.**

The range of products offered to market players is now relatively large, through "dividends" futures on the biggest market capitalizations of the stock market, industries or market indices without mentioning the listed options available on these same futures contracts.

In short, now a wide range of products is available in many organized markets to meet the needs of various practitioners acting to hedge, arbitrage or speculate.

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