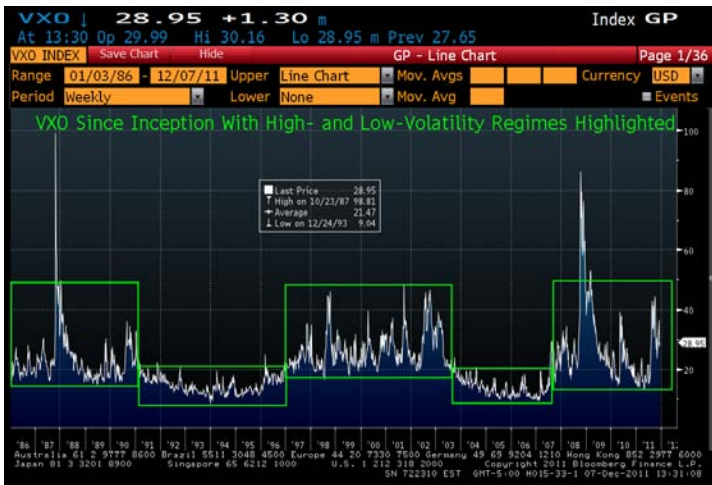


## Morning Derivatives

December 8, 2011

Over the last few days, we've focused on preparations for a possible sustained downtrend in implied volatility and upward bias for equities into early 2012. We'll adjust to an even more positive short-term view once the **CBOE SPX Volatility Index (VIX, 28.61)** is below 25, signaling an end to the volatility shock. Looking out beyond the next several weeks, though, we are significantly more cautious, and with this note, begin to lay out our volatility outlook for 2012.



For starters, let's pan out and look at the history of U.S. volatility cycles using the **CBOE OEX Volatility Index (VXO, 29.72)**, or old VIX, which provides several more years of data than the VIX. Since the VXO's inception in 1986, there have been five distinct regimes, two low- and three high-volatility. These low- and high-volatility cycles have been defined by VXO (and VIX) being range-bound at 10-20 and 15-45, respectively. There were also two super-spikes in volatility over that period (we think of them as main shocks) in 1987 and 2008, both of which occurred during high-volatility cycles.

We view these regimes as being well correlated with underlying economic cycles, particularly around recession troughs, when transitions from high- to low-volatility

cycles occur; the March 1991 and October 2003 transitions were coincident with, and two years after, the recession troughs, respectively. Meanwhile, the average duration for the cycles is 5.5 years, with the longest being the seven-year high-volatility regime from late 1996 to late 2003. Given that precedent, the current cycle, which we date to July 2007, could be another one to three years in length. That means even if spot VIX is able to sustain a decline in the coming weeks into an eventual 15-18 trough, the return of heightened volatility likely won't be far behind.

### MKM Research Coverage: Top 10 Option Volume Increases

Symb.	Analyst	Rating	Earn. Date	Total Option Volume			Volume 1 Day Ago		Open Interest 1-Week Chg. (%)		
				1 Day Ago	20-Day Avg.	% Chg.	Calls	Puts	Calls	Puts	Total
THQI	E. Handler	Neutral	2/2/2012	4,951	836	492.3	2,829	2,122	6.4	(0.3)	5.9
PHM	M.McGrath	Buy	2/3/2012	27,367	5,562	392.1	24,745	2,622	0.3	7.5	1.8
HTZ	C. Agnew	Buy	2/22/2012	10,444	2,850	266.5	9,887	557	(3.9)	0.4	(3.1)
DG	P. McKeever	Neutral	3/22/2012	10,714	2,959	262.1	3,018	7,696	41.0	513.9	139.0
CIEN	M. Genovese	Buy	12/8/2011	26,397	10,932	141.5	14,248	12,149	6.5	4.8	5.6
PH	J. Pokrzywinski	Neutral	1/20/2012	3,178	1,407	125.9	2,219	959	8.5	6.1	7.2
RYL	M.McGrath	Neutral	1/26/2012	1,378	692	99.2	875	503	6.7	1.1	3.2
JNPR	M. Genovese	Neutral	1/25/2012	11,676	8,076	44.6	8,521	3,155	2.3	(1.7)	0.8
LLTC	D.Berenbaum	Neutral	1/18/2012	3,562	2,571	38.6	3,550	12	1.5	0.5	1.2
LEN	M.McGrath	Buy	1/11/2012	7,490	5,509	36.0	4,417	3,073	2.5	9.7	6.3

Note: Green = Put/Call ratio <0.5; Red = Put/Call ratio > 2.0.

Source for all charts and tables in this document: Bloomberg, MKM Partners

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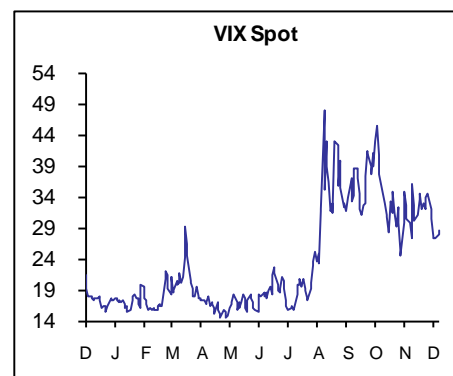
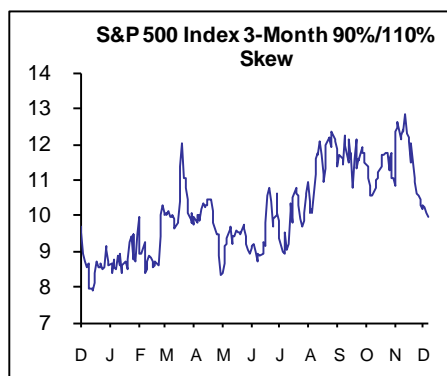
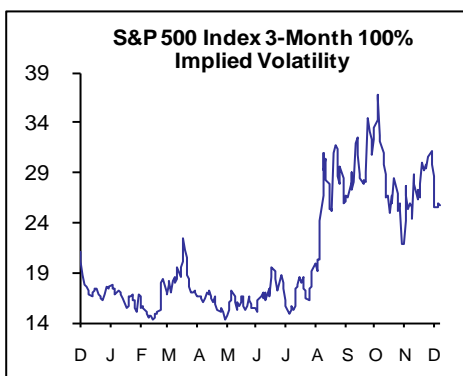
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See last page for analyst certification and important disclosures

## S&P 500 Index: Sector Option Volumes

Sector	Option Volume 1 Day Ago			Option Volume 20-Day Avg.			Option Volume Change (%)		
	Calls	Puts	Total	Calls	Puts	Total	Calls	Puts	Total
<b>S&amp;P 500 Index</b>	<b>2,858,607</b>	<b>2,111,854</b>	<b>4,970,461</b>	<b>3,958,995</b>	<b>2,220,216</b>	<b>6,179,211</b>	<b>(27.8)</b>	<b>(4.9)</b>	<b>(19.6)</b>
Consumer Discretionary	392,123	308,937	701,060	424,563	302,001	726,563	(7.6)	2.3	(3.5)
Consumer Staples	172,553	112,405	284,958	356,315	109,260	465,575	(51.6)	2.9	(38.8)
Energy	226,062	201,823	427,885	652,356	192,618	844,974	(65.3)	4.8	(49.4)
Financials	748,917	470,624	1,219,541	620,780	461,246	1,082,026	20.6	2.0	12.7
Health Care	194,139	167,712	361,851	214,056	124,103	338,158	(9.3)	35.1	7.0
Industrials	190,835	135,183	326,018	205,716	161,343	367,059	(7.2)	(16.2)	(11.2)
Technology	750,703	572,126	1,322,829	1,088,446	691,989	1,780,435	(31.0)	(17.3)	(25.7)
Materials	119,655	91,570	211,225	256,276	122,140	378,416	(53.3)	(25.0)	(44.2)
Telecom Services	47,033	43,482	90,515	72,035	45,417	117,451	(34.7)	(4.3)	(22.9)
Utilities	16,587	7,992	24,579	68,454	10,100	78,554	(75.8)	(20.9)	(68.7)

## S&P 500 Index: 3-Month Implied Volatility and Normalized Skew, and VIX



## S&P 500 Index: Top 15 Option Volume Increases

Symbol	Earnings Date	Total Option Volume			Open Interest		3-M ATM Imp. Vol. (%)		Spot Price	
		Yesterday	20-Day Avg.	% Chg.	Yesterday	1-Week Chg.	Yesterday	1-Day Chg.	Yesterday (\$)	1-Day Chg. (%)
LTD	02/23/12	103,315	9,410	998.0	84,867	1.4	34.6	(0.9)	44.0	2.1
XLNX	01/18/12	49,556	7,107	597.2	168,199	(1.2)	32.1	(2.8)	33.4	0.5
PHM	02/03/12	27,367	5,562	392.1	321,634	1.8	61.4	(2.9)	6.5	(0.5)
NYX	02/08/12	18,541	3,859	380.5	195,510	1.4	37.9	(2.2)	27.3	(3.9)
GCI	01/31/12	9,329	1,968	374.1	82,699	15.1	46.1	(0.8)	13.6	4.3
HUM	02/16/12	7,417	1,939	282.5	48,910	4.2	33.4	(2.2)	86.8	0.3
CB	01/27/12	5,026	1,364	268.4	66,931	1.7	22.7	(7.7)	68.6	0.8
SLM	01/19/12	11,511	3,286	250.4	126,397	1.1	49.0	(4.6)	13.4	1.4
EXPE	02/09/12	7,765	2,302	237.3	133,368	2.1	34.7	(0.7)	29.2	1.4
NWSA	02/02/12	35,151	11,584	203.4	486,112	2.1	36.0	(0.0)	17.7	(1.0)
MCK	01/31/12	2,923	1,023	185.7	42,941	1.3	28.8	(3.2)	80.8	0.1
UPS	01/31/12	45,425	16,094	182.2	526,643	4.2	21.9	0.1	73.3	2.1
AMGN	01/24/12	113,306	40,464	180.0	716,828	29.8	23.5	0.6	58.3	0.8
WFR	02/01/12	19,256	6,908	178.8	208,762	2.9	70.5	9.4	4.2	1.9
HRB	03/09/12	19,655	7,141	175.2	210,627	53.9	46.1	5.4	15.6	2.9

## U.S. Exchange-Traded ETFs: Top 20 Daily Increases in Cash Trading Volume

Symb.	Name	Spot Price					20-Day Avg. Cash Volume		Total Option Open Interest
		Spot (\$)	52-Week High (\$)	52-Week Low (\$)	200-Day Mov. Avg. Sprd. (%)	YTD Chg. (%)	Shares	Chg. From 20-Day (%)	Yesterday
VTI	Vanguard Total Stock Market ETF	64.9	71.1	54.6	(0.5)	(0.0)	3,885,735	123.63	2,125
ITB	iShares Dow Jones US Home Construction Index Fund	12.0	14.3	8.2	3.0	(8.9)	1,781,094	104.34	1,733
KRE	SPDR S&P Regional Banking ETF	23.9	27.5	18.3	(0.2)	(9.6)	3,609,601	78.07	69,739
VWO	Vanguard MSCI Emerging Markets ETF	63.0	50.9	34.2	(8.5)	(15.0)	30,186,188	64.44	31,985
RSX	Market Vectors Russia ETF	29.1	43.2	23.2	(17.6)	(23.3)	8,318,673	55.65	142,393
IWO	iShares Russell 2000 Growth Index Fund	85.8	99.4	68.6	(2.2)	(1.9)	2,588,182	53.63	13,208
XLI	Industrial Select Sector SPDR Fund	34.1	39.0	27.7	(1.5)	(2.4)	25,265,811	48.53	814,497
EWC	iShares MSCI Canada Index Fund	27.6	34.6	23.5	(8.9)	(11.0)	3,916,818	48.25	14,765
EWI	iShares MSCI Hong Kong Index Fund	15.9	20.0	13.3	(9.9)	(16.1)	7,895,045	38.45	105,955
BGU	Direxion Daily Large Cap Bull 3X Shares	62.1	92.6	39.2	(11.7)	(13.2)	3,223,216	34.15	8,413
MDY	SPDR S&P MidCap 400 ETF Trust	161.8	185.0	132.9	(2.9)	(1.8)	4,378,450	33.51	55,346
EWY	iShares MSCI South Korea Index Fund	55.8	70.0	44.7	(5.5)	(8.8)	3,855,054	33.09	76,942
SMH	Semiconductor HOLDRs Trust	31.4	35.0	25.8	1.0	1.9	8,116,409	30.86	105,802
FAZ	Direxion Daily Financial Bear 3X Shares	37.3	81.5	35.0	(22.5)	(21.0)	31,010,583	27.85	112,589
AML	Alerian MLP ETF	16.2	16.8	13.1	2.0	0.7	1,372,733	26.61	261
EFA	iShares MSCI EAFE Index Fund	51.5	64.4	45.5	(8.0)	(11.6)	29,174,046	25.23	1,363,690
TZA	Direxion Daily Small Cap Bear 3X Shares	27.0	68.3	26.2	(30.4)	(42.4)	36,158,678	23.75	75,759
VIG	Vanguard Dividend Appreciation ETF	54.9	57.8	46.5	2.1	4.3	1,561,755	22.84	353
EEM	iShares MSCI Emerging Markets Index Fund	40.0	50.4	33.4	(8.9)	(16.0)	73,277,199	20.73	3,426,576
EWG	iShares MSCI Germany Index Fund	20.4	29.0	17.0	(13.2)	(14.8)	5,163,021	17.56	50,943

## U.S. Exchange-Traded ETFs: Top 20 Daily Increases in Option Trading Volume

Symb.	Name	Total Option Volume			Open Interest		3-M ATM Imp. Vol. (%)		Spot Price	
		Yesterday	20-Day Avg.	% Chg.	Yesterday	1-Week Chg.	Yesterday	1-Day Chg.	Yesterday (\$)	1-Day Chg. (%)
RSX	Market Vectors Russia ETF	18,336	5,938	208.8	228,025	2.0	43.4	(1.0)	29.0	(6.2)
GDX	Market Vectors Gold Miners ETF	261,213	89,148	193.0	1,981,958	3.0	37.0	(0.2)	59.0	2.0
EWJ	iShares MSCI Japan Index Fund	22,990	10,048	128.8	992,602	1.1	21.8	(2.7)	9.3	(1.2)
EFA	iShares MSCI EAFE Index Fund	172,001	77,658	121.5	2,227,402	6.1	32.7	0.2	51.1	(0.5)
EWT	iShares MSCI Taiwan Index Fund	23,302	11,959	94.9	417,529	7.6	30.7	(2.8)	12.1	(2.3)
XLB	Materials Select Sector SPDR Fund	86,792	45,833	89.4	944,728	10.1	32.8	(2.4)	34.7	0.9
GLD	SPDR Gold Shares	277,730	207,354	33.9	5,304,663	4.1	24.9	na	168.2	0.5
XME	SPDR S&P Metals & Mining ETF	27,116	23,761	14.1	368,250	23.5	49.1	(0.4)	54.7	0.6
TZA	Direxion Daily Small Cap Bear 3X Shares	31,101	28,035	10.9	224,709	13.2	103.9	(1.8)	26.9	(0.4)
XHB	SPDR S&P Homebuilders ETF	7,850	7,906	(0.7)	515,777	4.5	37.0	(1.7)	17.2	0.2
FAS	Direxion Daily Financial Bull 3X Shares	31,013	31,644	(2.0)	450,044	4.2	127.2	(13.1)	66.0	(0.2)
VXX	iPATH S&P 500 VIX Short-Term Futures ETN	56,465	60,347	(6.4)	1,309,907	2.6	139.7	(10.5)	40.5	(0.4)
QQQ	PowerShares QQQ Trust Series 1	387,626	416,584	(7.0)	4,837,900	(0.3)	26.7	(1.0)	57.1	(0.3)
DIA	SPDR Dow Jones Industrial Average ETF Trust	44,690	50,631	(11.7)	846,301	9.0	23.9	0.6	121.4	0.4
XLI	Industrial Select Sector SPDR Fund	44,298	50,831	(12.9)	1,356,071	22.6	29.1	(1.2)	34.1	(0.0)
FAZ	Direxion Daily Financial Bear 3X Shares	26,270	31,281	(16.0)	298,229	9.4	97.4	(0.6)	38.6	0.2
XLF	Financial Select Sector SPDR Fund	388,081	463,224	(16.2)	9,519,497	2.7	36.2	(2.2)	13.2	0.1
TLT	iShares Barclays 20+ Year Treasury Bond Fund	29,399	35,284	(16.7)	589,039	4.6	19.9	(1.8)	117.3	(1.0)
UNG	United States Natural Gas Fund LP	25,433	31,046	(18.1)	1,381,035	3.1	37.0	4.8	7.7	0.7
IWM	iShares Russell 2000 Index Fund	383,394	475,068	(19.3)	4,953,949	7.3	34.8	(0.9)	74.8	0.1

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"Buy"	Security is expected to appreciate 15% or more on an absolute basis in the next 12 months.
"Neutral"	Security is not expected to significantly appreciate or depreciate in value in the next 12 months.
"Sell"	Security is expected to depreciate 15% or more on an absolute basis in the next 12 months.

Distribution of Ratings for Reports Issued by MKM Partners LLC as of November 30, 2011: Buy: 48.4%; Neutral: 47.3%; Sell: 4.3%

Risks: Risks associated with the achievement of revenue and earnings projections and price targets include, but are not limited to, unforeseen macroeconomic and/or industry events that weaken demand for the subject company's products or services, product obsolescence, changes in investor sentiment regarding the company or industry, the company's ability to retain or recruit competent personnel and market conditions. For a complete discussion of risk factors that could affect the market price of the securities, refer to the most recent 10-Q or 10-K filed with the SEC.

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1. Automatic exercise is limited: All expiring equity options closing in-the-money .01 or more will be eligible for automatic exercise per the contract terms of standardized options issued by the Options Clearing Corporation (OCC). Index options will be exercised automatically if they are in-the-money by any amount.
2. You may be required to request exercise of valuable options: You should note that long equity options that are in-the-money less than .01, or out-of-the money, are not automatically exercised. These options may be exercised, but you must specifically request exercise of these options by 4:00pm ET on the last day of trading before expiration.
3. Consider the risk of exercise or assignment: You should review your positions and consider whether your account can afford to take assignment (or exercise) based on your current equity. You may need to close expiring positions prior to end of the market day in order to avoid risk, or in order to retain the profit from an in-the-money position prior to expiration. In addition, please consider the possibility that short options positions may be exercised against you by the long holder, even if the option is out-of-the money.
4. Spreads face unique risks during expiration: Expiring spreads may require action if the long leg is out-of-the money less than .01, or out-of-the-money while the short leg is in-the-money. Although we use our best efforts to exercise offsetting, expiring long options, the customer is ultimately responsible for taking action on such positions and for the risks associated with any unhedged spread leg expiring in-the-money. In the event that you do not wish to exercise an expiring long leg, you must notify us by 4:00pm ET in order to prevent the possibility that we will exercise this long position on your behalf.
5. The assignment process: According to the policy and practice of our clearing agents, assignments are distributed on a random basis among all holders of eligible options among the accounts carried on their books. Please contact us if you need more information about this process. For any questions relating to the exercise process or regarding expiring options, please contact our Trading Desk at 203-861-9060.

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1. Early exercise and assignment can create risk and loss. Spreads are subject to early exercise or assignment that can remove the very protection that the investor/trader sought. This can lead to margin calls and greater losses than anticipated when the trade was entered.
2. Execution of spread orders is “not held” and discretionary. Spreads are not standardized contracts as are exchange-traded puts and calls. Spreads are the combination of standardized put and call contracts. There is no spread market in securities that is subject to such benchmarks such as “time and sales” or “NBBO” (National Best Bid/Offer), and therefore the “market” cannot be “held” to a price.
3. Spreads are executed differently from “legged” orders. Spreads are used by strategists as examples of risk protection, profit enhancement and as a basis for results and return on investments. However, these strategies assume that the trade can actually be executed as a spread, when market forces may and can make the actual execution impossible. Spreads are bona-fide trades and not “legged” or “paired” individual separate trades. For example: option prices on cross-markets are misleading for the spread trader. An option may be offered on one exchange and bid on another exchange that can lead the trader to believe that their spread trade should be filed, when, in fact, the bids and offers must be on the same exchange as all bona-fide spreads are routed on “one” exchange.
4. Spreads are entered on a single exchange and are acted upon by a market maker. Spreads are executed at the discretion of a market maker and, when cancelled or filled, require that the market maker take manual action and require manual reporting at times. Delays for reporting of fills and cancels may create additional risks in fast or changing markets.
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6. Past performance is no guarantee of future returns.

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