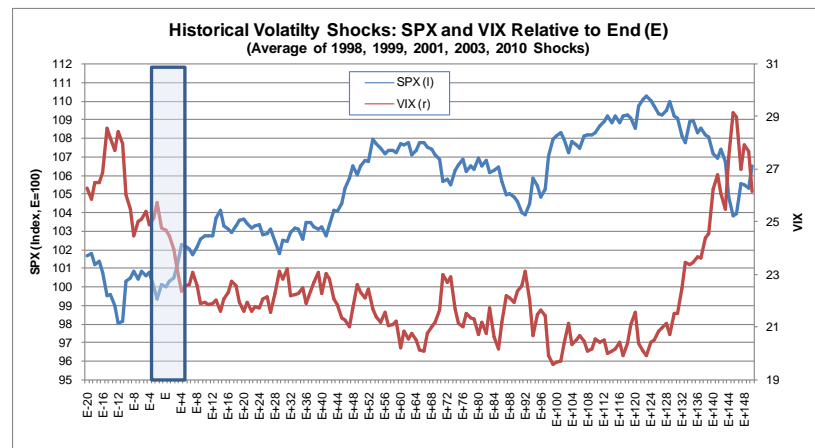


Morning Derivatives

January 3, 2012

We think it would be a mistake to enter 2012 without an appreciation for the state of the volatility cycle. Based on our framework, the almost five-month, high-magnitude shock likely ended December 16 when the **CBOE SPX Volatility Index (VIX, 23.40)** began a sustained decline below the 25 level. This marks a transition from the peak- to the trough-phase of the volatility wave, which suggests the period immediately ahead will be characterized by a grind lower for implied volatility and upward bias for U.S. equities. We expect higher-beta stocks and sectors to outperform in this environment. For broad market exposure, March 77/82 call spreads in the **iShares Russell 2000 Index Fund (IWM, 73.75)** fit with our thesis and, to reflect our view on volatility, we recommend long positions in the **VelocityShares Inverse VIX ETN (XIV, \$6.51)**, which additionally benefits from the VIX futures curve having returned to contango.

There have been five shocks over the last 20 years where VIX peaked above 35 (excluding the main shock in the fall of 2008). In the graph below, the end of these shocks (E) represents the point at which VIX began a sustained decline below 25. Also shown is the **S&P 500 Index (SPX, 1257.60)** indexed to 100 at the point E equals zero (shaded bar). Based on the average of these events,



once a shock ends, volatility remains subdued for almost 130 trading days while the SPX gains 10% over the same period. Against this benchmark, we prefer a shorter-term, more conservative view that focuses on the next three months (E+60). Historically, VIX descended toward its cycle lows at that point while the SPX appreciated 8%, on average. Exposure to a similar outcome can be expressed via three-month IWM call spreads and long XIV positions.

We think it's important to note that the signal we will be looking for to get more defensive is a post-trough rise in VIX back above its long-term mean around 20. As discussed [recently](#), from a volatility perspective, there

remains plenty to be cautious about. We expect the 4.5 year old high-volatility regime will surely remain intact through 2012 and possibly for several years more beyond that. Meanwhile, historical clustering of similar-magnitude shocks means the two recent VIX peaks in the mid- to high-40s foretell future events of similar magnitude. But that's for later in 2012.

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
CSCO	M. Genovese	Buy	2/8/2012	508,101	105,421	382.0	493,241	14,860	(0.2)	(0.4)	(0.3)
ALU	M. Genovese	Neutral	2/10/2012	7,595	2,116	259.0	7,353	242	0.3	(0.2)	0.2
ROST	P. McKeever	Buy	3/16/2012	10,061	2,846	253.5	7,097	2,964	5.7	3.2	4.4
TJX	P. McKeever	Buy	2/22/2012	3,349	1,013	230.5	1,891	1,458	11.5	5.0	7.9
HAS	E. Handler	Buy	2/7/2012	4,972	1,588	213.1	833	4,139	1.2	10.5	4.7
EZCH	D.Berenbaum	Buy	2/10/2012	930	307	202.6	864	66	1.9	6.6	2.4
HOV	M.McGrath	Sell	3/1/2012	1,056	582	81.6	535	521	1.8	0.5	1.2
IMAX	E. Handler	Buy	2/24/2012	1,854	1,118	65.9	711	1,143	1.8	3.7	2.3
AUXL	J.Lecroy	Neutral	2/10/2012	537	329	63.2	137	400	0.6	0.0	0.5
NETL	D.Berenbaum	Neutral	2/2/2012	1,252	805	55.5	1,236	16	5.1	10.5	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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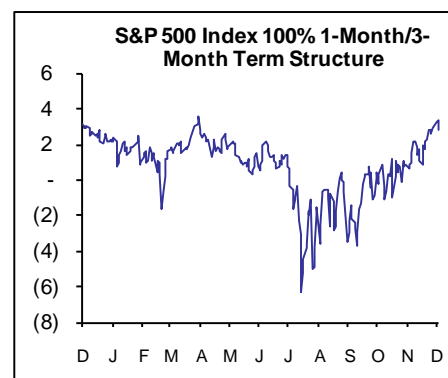
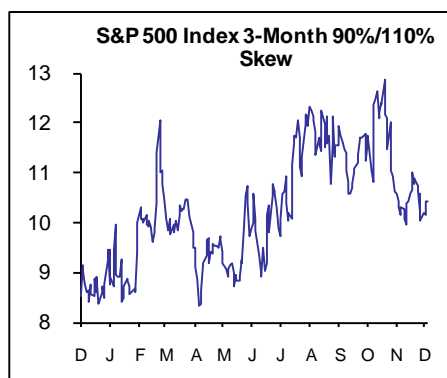
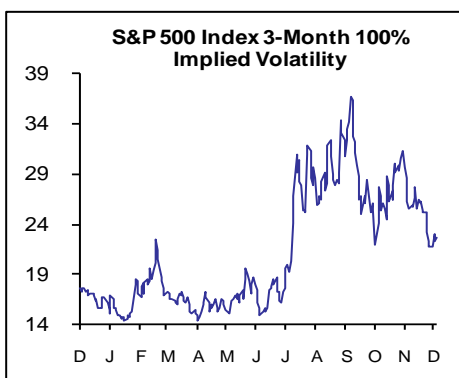
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S&P 500 Index: Sector Option Volumes

Sector	Option Volume 1 Day Ago			Option Volume 20-Day Avg.			Option Volume Change (%)		
	Calls	Puts	Total	Calls	Puts	Total	Calls	Puts	Total
S&P 500 Index	2,037,550	1,067,471	3,105,021	4,004,719	1,977,343	5,982,062	(49.1)	(46.0)	(48.1)
Consumer Discretionary	208,885	134,754	343,639	365,432	262,457	627,888	(42.8)	(48.7)	(45.3)
Consumer Staples	44,910	40,918	85,828	662,376	99,990	762,366	(93.2)	(59.1)	(88.7)
Energy	149,333	77,610	226,943	630,945	164,646	795,591	(76.3)	(52.9)	(71.5)
Financials	275,394	259,129	534,523	553,960	436,386	990,345	(50.3)	(40.6)	(46.0)
Health Care	125,115	70,371	195,486	263,362	119,277	382,638	(52.5)	(41.0)	(48.9)
Industrials	86,836	61,479	148,315	385,240	156,105	541,344	(77.5)	(60.6)	(72.6)
Technology	922,814	332,831	1,255,645	842,309	575,705	1,418,014	9.6	(42.2)	(11.5)
Materials	132,095	51,420	183,515	205,290	109,832	315,122	(35.7)	(53.2)	(41.8)
Telecom Services	82,622	28,572	111,194	68,635	41,537	110,172	20.4	(31.2)	0.9
Utilities	9,546	10,387	19,933	27,172	11,409	38,581	(64.9)	(9.0)	(48.3)

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. (%)
PCS	02/24/12	24,253	1,998	1,114.2	37,105	14.1	53.8	2.8	8.7	5.3
TYC	01/27/12	14,057	1,983	608.8	78,105	0.7	28.1	(0.5)	46.7	(0.5)
CSCO	02/08/12	506,583	105,421	380.5	3,576,155	(1.2)	31.6	(0.3)	18.1	(0.9)
DFS	03/22/12	7,755	1,690	358.9	62,615	5.2	36.1	1.5	24.0	(0.6)
APOL	01/05/12	16,780	3,764	345.7	123,513	4.6	38.0	(0.8)	53.9	(0.4)
NWSA	02/02/12	22,497	5,735	292.3	501,541	(0.5)	30.7	(4.1)	17.8	(0.2)
ROST	03/16/12	10,061	2,846	253.5	60,594	4.4	26.6	1.4	47.5	(2.1)
TJX	02/22/12	3,349	1,013	230.5	40,286	7.9	23.5	(0.1)	64.6	(1.3)
HAS	02/07/12	4,972	1,588	213.1	54,250	4.7	30.6	(3.0)	31.9	(0.5)
FRX	01/18/12	8,214	2,703	203.9	106,866	(1.1)	27.0	0.3	30.3	(0.1)
TER	01/26/12	2,364	855	176.4	52,164	6.8	48.9	3.4	13.6	1.0
BSX	01/26/12	6,900	2,528	172.9	289,412	0.1	40.9	(4.8)	5.3	0.2
HCBK	01/19/12	2,699	1,015	165.9	70,575	0.1	39.3	(0.2)	6.3	(0.2)
HSP	02/14/12	2,418	938	157.7	20,977	6.5	48.6	(0.9)	30.4	(0.8)
NRG	02/22/12	6,340	2,722	132.9	86,156	7.9	32.8	(1.2)	18.1	(0.7)

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
AMJ	JPMorgan Alerian MLP Index ETN	39.0	39.4	31.5	6.6	0.0	2,537,533	116.83	4,078
ACWI	iShares MSCI ACWI Index Fund	42.2	51.0	37.1	(6.3)	0.0	1,673,274	90.21	50
DJP	iPath Dow Jones-UBS Commodity Index Total Return	42.2	53.2	40.5	(10.4)	0.0	1,316,645	79.28	355
SCZ	iShares MSCI EAFE Small Cap Index Fund	63.0	46.1	33.1	(12.5)	0.0	894,213	77.47	778
PSLV	Sprott Physical Silver Trust	13.4	23.0	11.5	(19.9)	0.0	1,033,780	57.78	-
VEU	Vanguard FTSE All-World ex-US ETF	39.7	52.3	36.7	(12.3)	0.0	2,182,560	53.60	1,077
UNG	United States Natural Gas Fund LP	6.5	13.0	6.4	(34.8)	0.0	16,327,960	52.76	532,541
AGQ	ProShares Ultra Silver	41.7	191.0	38.3	(53.8)	0.0	3,629,960	51.03	26,888
IEF	iShares Barclays 7-10 Year Treasury Bond Fund	105.6	106.7	91.1	5.6	0.0	1,229,930	50.99	39,831
RJA	ELEMENTS Linked to the Rogers International Commo	9.0	12.0	8.3	(10.8)	0.0	761,324	46.09	92
SHY	iShares Barclays 1-3 Year Treasury Bond Fund	84.5	84.8	83.6	0.1	0.0	2,343,689	38.55	1,268
EFA	iShares MSCI EAFE Index Fund	49.5	64.4	45.5	(10.1)	0.0	32,979,024	34.24	1,090,766
OEF	iShares S&P 100 Index Fund	57.0	61.3	48.9	0.6	0.0	1,126,004	25.00	3,085
GLL	ProShares UltraShort Gold	19.8	32.5	14.3	(2.7)	0.0	1,294,984	23.98	5,608
VNQ	Vanguard REIT ETF	58.0	63.3	47.1	1.0	0.0	1,969,275	22.19	3,459
DOG	ProShares Short Dow 30	38.8	46.8	38.5	(6.2)	0.0	818,510	20.31	614
SLV	iShares Silver Trust	26.9	48.4	25.7	(24.0)	0.0	21,976,914	18.36	1,336,235
PFF	iShares S&P US Preferred Stock Index Fund	35.6	40.2	32.9	(6.0)	0.0	1,299,228	18.32	14,885
ICF	iShares Cohen & Steers Realty Majors Index Fund	70.2	76.6	56.8	1.4	0.0	637,345	17.30	529
ZSL	ProShares UltraShort Silver	15.9	51.4	10.6	1.1	0.0	7,390,309	9.30	46,350

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. (%)
GDXJ	Market Vectors Junior Gold Miners ETF	20,494	12,502	63.9	288,106	12.0	50.1	(3.5)	23.9	3.8
XLE	Energy Select Sector SPDR Fund	77,235	57,491	34.3	1,405,924	6.0	29.7	5.5	69.2	1.0
SLV	iShares Silver Trust	174,922	143,978	21.5	3,540,028	2.7	43.5	5.1	27.1	3.0
XLY	Consumer Discretionary Select Sector SPDR Fund	5,766	5,688	1.4	374,064	1.9	23.3	4.5	39.3	1.0
AGQ	ProShares Ultra Silver	5,384	5,341	0.8	79,530	7.2	84.6	6.6	42.2	5.1
USO	United States Oil Fund LP	83,067	85,577	(2.9)	1,340,219	5.8	35.9	2.7	38.4	0.2
GLD	SPDR Gold Shares	245,458	257,237	(4.6)	4,779,007	3.4	22.1	na	150.3	(0.5)
QQQ	Pow ershares QQQ Trust Series 1	339,994	384,611	(11.6)	3,743,921	9.1	23.7	4.2	56.0	0.7
TLT	iShares Barclays 20+ Year Treasury Bond Fund	33,273	38,133	(12.7)	506,667	6.5	19.8	0.5	120.9	0.2
IWM	iShares Russell 2000 Index Fund	359,919	413,262	(12.9)	3,769,470	6.5	32.7	3.4	74.2	1.0
ZSL	ProShares UltraShort Silver	6,935	8,652	(19.8)	174,513	6.3	88.0	3.8	15.8	(8.1)
FAS	Direxion Daily Financial Bull 3X Shares	26,247	32,958	(20.4)	390,013	2.7	80.8	3.9	65.9	4.2
TBT	ProShares UltraShort 20+ Year Treasury	34,417	43,888	(21.6)	1,053,551	1.7	40.2	2.2	18.2	(0.4)
XLF	Financial Select Sector SPDR Fund	262,282	355,318	(26.2)	6,554,376	1.3	31.6	2.7	13.1	1.6
TZA	Direxion Daily Small Cap Bear 3X Shares	17,149	24,548	(30.1)	196,874	6.3	98.3	2.9	26.1	(3.2)
DIA	SPDR Dow Jones Industrial Average ETF Trust	31,982	47,355	(32.5)	764,527	5.1	21.2	5.3	122.5	1.0
GDX	Market Vectors Gold Miners ETF	58,923	87,984	(33.0)	1,471,054	6.8	37.6	4.5	51.2	2.3
VXX	iPATH S&P 500 VIX Short-Term Futures ETN	34,985	53,719	(34.9)	1,103,691	1.4	90.0	0.7	35.0	(2.5)
UNG	United States Natural Gas Fund LP	17,955	27,735	(35.3)	1,396,128	2.3	39.1	(0.5)	6.6	(2.9)
FAZ	Direxion Daily Financial Bear 3X Shares	19,207	30,588	(37.2)	306,152	4.5	88.9	1.6	36.8	(4.4)

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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 December 30, 2011: Buy: 45.6%; Neutral: 48.5%; Sell: 5.8%

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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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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