

## Morning Derivatives

January 5, 2012

MKM Partners Industrials Analyst Josh Pokrzywinski has maintained a positive view of **Ingersoll Rand (IR, Buy, \$31.86, \$40 PT)** since initiating coverage in late 2010 due to the company's long-term prospects. That said, on a number of occasions we have recommended managing short-term risks in the stock via derivatives positions. At this point, Josh believes IR's residential HVAC issues of 2011 are behind it and thinks productivity gains through 2012 should increasingly benefit the shares. With skew near multi-year highs, we recommend exposure through the next two earnings cycles via June call spreads partially financed by the sale of puts.



We detail in the graph at left the various options trades we have recommended in IR over the past year. Three of the five were hedges against the impact of weakness in residential HVAC on earnings while the most recent two were meant to exploit elevated implied volatility given Josh's view that the stock would likely remain in its range since August. In a note yesterday, Josh lowered his 2012E EPS for IR to \$3.20 from \$3.30 due to FX adjustments and a more thorough modeling of the Hussmann sale. While 4Q11 earnings, expected February 9, may include the impact of additional residential HVAC destocking that could result in a downward adjustment to guidance, he recommends beginning to add long exposure around current levels. He thinks focus will shift toward the company's sizeable exposure to non-residential construction (55% of sales, primarily through HVAC and Security), which is beginning to turn, and appears underappreciated given IR's compressed multiple at 10.1x 2012E

consensus EPS. The combination of end market support and easy comparisons in the challenged residential HVAC business argues for multiple expansion up to a more typical 12x-13x P/E, which equates to Josh's 12-month \$40 price target.

With that in mind, and given six-month skew in IR is near multi-year highs, we recommend long directional exposure via the purchase of June 33/38 call spreads partially financed by the sale of 25 strike puts for \$0.70 on the package.

### 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
HTZ	C. Agnew	Buy	2/22/2012	10,337	1,622	537.4	8,468	1,869	4.4	0.9	3.7
DTG	C. Agnew	Neutral	2/24/2012	4,510	810	456.8	3,912	598	0.6	0.9	0.8
ROST	P. McKeever	Buy	3/16/2012	21,620	3,934	449.6	13,826	7,794	31.1	4.0	17.2
KSS	P. McKeever	Buy	2/24/2012	25,529	5,113	399.3	11,229	14,300	15.4	6.5	10.7
TJX	P. McKeever	Buy	2/22/2012	5,389	1,285	319.5	2,945	2,444	14.4	7.0	10.3
ADTN	M. Genovese	Buy	1/18/2012	3,714	981	278.5	2,485	1,229	5.9	8.1	6.6
AMRN	J.Lecroy	Buy	3/16/2012	6,807	1,805	277.1	4,194	2,613	1.7	3.8	2.0
AUXL	J.Lecroy	Neutral	2/10/2012	1,415	449	215.4	1,015	400	7.2	(11.2)	5.0
QCOM	D.Berenbaum	Buy	2/1/2012	104,853	33,838	209.9	34,329	70,524	0.7	1.0	0.8
LAMR	E. Handler	Neutral	2/23/2012	1,135	385	194.7	1,099	36	0.4	3.2	1.0

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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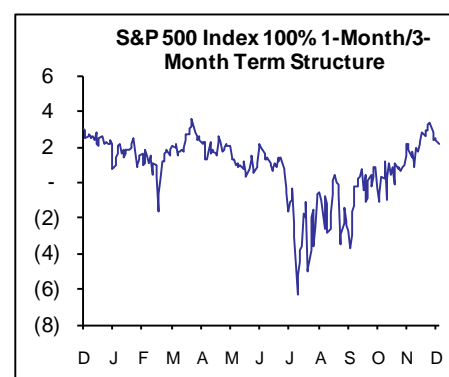
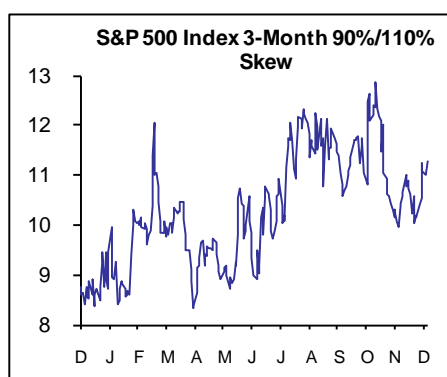
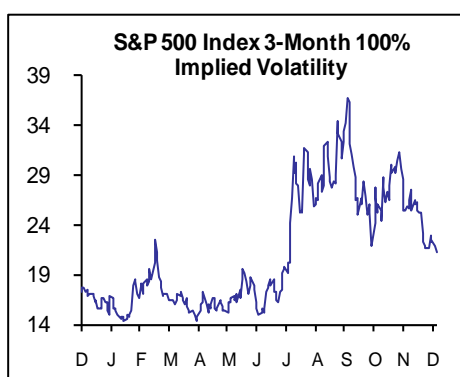
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See last page for analyst certification and important disclosures

## 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>3,359,963</b>	<b>2,275,353</b>	<b>5,635,316</b>	<b>3,804,403</b>	<b>1,969,182</b>	<b>5,773,585</b>	<b>(11.7)</b>	<b>15.5</b>	<b>(2.4)</b>
Consumer Discretionary	462,772	348,538	811,310	373,033	260,972	634,005	24.1	33.6	28.0
Consumer Staples	124,996	112,535	237,531	666,112	101,965	768,077	(81.2)	10.4	(69.1)
Energy	207,590	166,913	374,503	309,438	159,228	468,666	(32.9)	4.8	(20.1)
Financials	695,703	455,357	1,151,060	582,118	430,847	1,012,965	19.5	5.7	13.6
Health Care	174,572	107,884	282,456	340,084	116,447	456,531	(48.7)	(7.4)	(38.1)
Industrials	147,776	127,460	275,236	383,139	151,795	534,934	(61.4)	(16.0)	(48.5)
Technology	1,259,792	735,291	1,995,083	871,303	582,137	1,453,440	44.6	26.3	37.3
Materials	164,646	130,173	294,819	176,521	111,607	288,127	(6.7)	16.6	2.3
Telecom Services	106,249	79,676	185,925	75,432	41,277	116,709	40.9	93.0	59.3
Utilities	15,867	11,526	27,393	27,224	12,908	40,132	(41.7)	(10.7)	(31.7)

## 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. (%)
DGX	01/24/12	6,887	701	882.2	21,791	0.9	26.3	(0.1)	57.7	(0.2)
EXPD	02/21/12	5,667	679	734.1	20,563	1.0	31.4	(1.8)	41.4	0.2
ROST	03/16/12	21,620	3,934	449.6	69,105	17.2	28.0	2.7	47.6	0.7
AET	02/01/12	14,818	2,848	420.3	91,110	1.7	29.9	(4.3)	43.2	1.9
TGT	02/24/12	50,906	9,818	418.5	317,430	2.8	22.1	0.1	50.0	(2.2)
KSS	02/24/12	25,562	5,113	400.0	141,393	10.7	29.2	1.5	47.4	(1.4)
SHW	01/26/12	2,427	501	384.1	15,688	14.9	23.9	(0.9)	91.9	1.0
WDC	01/18/12	23,964	5,072	372.5	136,120	2.6	48.3	(1.2)	31.3	1.0
TJX	02/22/12	5,389	1,285	319.5	43,045	10.3	25.2	1.9	64.4	1.1
PCS	02/24/12	10,363	2,556	305.5	52,691	59.9	61.1	1.1	8.8	(6.4)
DNR	02/23/12	4,364	1,098	297.4	32,366	11.3	45.7	(7.3)	16.8	2.9
LSI	02/23/12	2,712	694	290.7	49,510	10.0	41.5	0.5	6.2	0.8
URBN	03/07/12	8,737	2,336	274.0	68,789	6.2	39.5	(0.6)	28.4	2.4
VRSN	01/26/12	2,979	805	270.2	63,900	0.7	29.5	(0.6)	35.8	0.1
CTL	02/15/12	16,497	4,634	256.0	180,834	6.1	20.4	9.0	37.1	(0.6)

## 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
RWM	ProShares Short Russell2000	29.3	38.2	28.4	(6.0)	(1.3)	4,192,266	156.15	472
DZZ	Pow erShares DB Gold Double Short ETN	5.1	9.3	3.8	(10.2)	(6.0)	3,781,473	126.93	-
IYR	iShares Dow Jones US Real Estate Index Fund	56.5	63.0	46.7	(1.2)	(0.5)	12,839,118	105.57	461,723
IEF	iShares Barclays 7-10 Year Treasury Bond Fund	63.0	106.7	91.1	4.5	(0.9)	1,788,923	104.36	39,851
PFF	iShares S&P US Preferred Stock Index Fund	36.3	40.2	32.9	(4.2)	1.8	2,070,454	76.78	15,257
IWN	iShares Russell 2000 Value Index Fund	66.6	77.0	53.4	(1.5)	1.4	2,700,237	59.44	8,665
HYG	iShares iBoxx \$ High Yield Corporate Bond Fund	89.6	92.9	77.9	0.9	0.2	3,009,972	59.24	19,320
JNK	SPDR Barclays Capital High Yield Bond ETF	38.6	40.7	33.9	(0.3)	0.5	5,633,132	54.01	12,317
BND	Vanguard Total Bond Market ETF	83.3	84.2	78.7	1.5	(0.3)	2,227,391	52.98	227
ICF	iShares Cohen & Steers Realty Majors Index Fund	69.4	76.6	56.8	0.2	(1.1)	956,142	52.08	569
UNG	United States Natural Gas Fund LP	6.7	13.0	6.4	(31.9)	4.0	16,268,333	51.00	526,584
MOO	Market Vectors Agribusiness ETF	48.8	57.9	39.9	(4.4)	3.5	1,164,359	48.82	29,643
ITB	iShares Dow Jones US Home Construction Index Fur	12.3	14.3	8.2	6.5	3.2	1,487,079	45.93	1,798
LQD	iShares iBoxx Investment Grade Corporate Bond Fun	113.8	115.7	106.8	2.0	0.0	1,641,304	40.62	18,519
USO	United States Oil Fund LP	39.8	45.6	29.1	6.2	4.4	13,815,830	39.09	614,605
RJI	ELEMENTS Linked to the Rogers International Commo	8.8	10.5	7.9	(4.8)	2.9	891,826	31.58	59
RSP	Rydex S&P Equal Weight ETF	47.0	52.3	39.0	(0.8)	1.4	960,816	29.93	527
VNQ	Vanguard REIT ETF	57.5	63.3	47.1	0.1	(0.9)	2,393,809	25.77	3,531
IWB	iShares Russell 1000 Index Fund	70.4	76.5	59.2	0.6	1.5	1,571,613	23.89	1,454
SDY	SPDR S&P Dividend ETF	54.2	55.7	45.7	2.9	0.5	1,279,278	21.67	2,012

## 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. (%)
FXI	iShares FTSE China 25 Index Fund	78,847	51,688	52.5	2,308,569	2.1	32.0	1.3	36.0	3.2
XLK	Technology Select Sector SPDR Fund	22,392	17,959	24.7	701,127	(1.1)	22.2	(0.6)	25.8	1.4
UNG	United States Natural Gas Fund LP	34,312	28,168	21.8	1,399,436	1.8	39.8	(0.2)	6.5	0.2
USO	United States Oil Fund LP	106,322	88,482	20.2	1,407,638	11.0	36.0	0.8	39.7	4.1
TBT	ProShares UltraShort 20+ Year Treasury	50,509	44,722	12.9	1,063,612	3.5	39.4	(1.1)	18.6	2.9
EWI	iShares MSCI Taiwan Index Fund	6,614	5,920	11.7	172,593	1.0	29.0	(1.0)	11.8	1.1
EEM	iShares MSCI Emerging Markets Index Fund	206,994	186,933	10.7	4,520,647	5.8	33.7	na	39.1	3.1
IYR	iShares Dow Jones US Real Estate Index Fund	48,851	45,442	7.5	659,249	3.0	26.6	(0.8)	57.2	0.6
SSO	ProShares Ultra S&P500	15,764	16,931	(6.9)	104,098	11.1	44.6	1.1	47.8	3.1
SLV	iShares Silver Trust	131,716	149,968	(12.2)	3,584,638	4.8	42.5	(0.6)	28.8	7.0
XLE	Energy Select Sector SPDR Fund	47,094	55,293	(14.8)	1,261,762	(9.4)	29.4	(0.3)	71.1	2.8
AGQ	ProShares Ultra Silver	4,517	5,645	(20.0)	79,256	8.9	83.5	1.0	47.7	14.5
FXE	CurrencyShares Euro Trust	18,877	25,098	(24.8)	469,025	5.4	14.9	(1.2)	130.0	0.9
TLT	iShares Barclays 20+ Year Treasury Bond Fund	28,128	38,533	(27.0)	524,345	10.6	19.5	(0.7)	119.4	(1.5)
GLD	SPDR Gold Shares	182,926	260,020	(29.6)	4,642,245	1.6	22.6	0.7	155.9	2.6
XLI	Industrial Select Sector SPDR Fund	31,249	47,283	(33.9)	969,837	2.4	26.2	1.3	34.5	2.2
EWZ	iShares MSCI Brazil Index Fund	41,146	63,957	(35.7)	2,253,838	2.0	33.7	(3.0)	59.7	4.0
FAS	Direxion Daily Financial Bull 3X Shares	19,924	31,897	(37.5)	393,245	6.2	82.0	(1.0)	69.3	6.8
XLF	Financial Select Sector SPDR Fund	207,506	335,215	(38.1)	6,706,041	2.8	31.3	1.0	13.3	2.6
VXX	iPATH S&P 500 VIX Short-Term Futures ETN	29,871	51,145	(41.6)	1,105,131	2.3	90.5	0.5	33.7	(5.2)

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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.
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