

Equity Derivatives Strategy



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Equity Volatility Snapshot

- We update the list of stocks with rich or cheap options according to the **Lehman Brothers Volatility Screen**. This screen allows investors to look for rich or cheap 1 and 3 month implied volatility at the single-stock level, within or across sectors, by analyst rating, or earnings release date. Our universe includes the constituents of the S&P 500, S&P 400 and the Nasdaq 100 indexes.
- In our backtest, we found three reliable indicators for identifying under- or over-priced options at the single-stock level: the implied – realized volatility spread, the implied – S&P 500 implied volatility spread and the implied – market-cap-weighted average sector implied volatility spread.
- We label an option as rich if each of these spreads is currently at least one standard deviation above the average of where the respective spread has traded during the past two years. Alternatively, an option is considered to be cheap if each of these spreads is currently at least one standard deviation below the average of where the respective spread has traded during the past two years. Please see our report titled *Identifying Rich and Cheap Implied Volatility* for additional details and our backtesting methodology.
- Investors can use the Volatility Screen to identify potentially attractive long or short volatility candidates. Alternatively, investors can express a directional view on the underlying by buying or selling options. Moreover, with our customized screening tool, investors can import their holdings or watch list to quickly analyze at-the-money implied volatility for stocks they are interested in.
- The updated Volatility Screen is available on Ryan Renicker's analyst webpage on LehmanLive (top right-hand corner of the page).

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Options Currently Having “Rich” or “Cheap” Implied Volatility

Figure 1: Stocks Having “Rich” Options According to the Volatility Screen

Ticker	Name	GICS Sector	Lehman Company Rating	Lehman Sector View	Price	Expected Earnings Date	3-Month Implied Volatility	Std Devs from Mean (3-Month Implied vs Realized)	Std Devs from Mean (3-Month Implied vs Sector)	Std Devs from Mean (3-Month Implied vs S&P 500)	Rich/Cheap
ADTN	ADTRAN INC	Information Technology	1-Overweight	2-Neutral	29.71	1/24/2006	46%	1.3	2.2	1.5	Rich
AFL	AFLAC INC	Financials	3-Underweight	2-Neutral	46.42	1/31/2006	19%	1.4	1.0	1.3	Rich
ASN	ARCHSTONE-SMITH TRUST	Financials	3-Underweight	2-Neutral	41.89	2/2/2006	24%	1.8	1.8	1.8	Rich
BCR	BARD (C.R.) INC	Health Care	0-Unrated	0-Unrated	65.92	1/26/2006	24%	1.9	1.6	2.1	Rich
BLI	BIG LOTS INC	Consumer Discretionary	0-Unrated	0-Unrated	12.01	2/23/2006	40%	1.0	1.7	1.8	Rich
BRO	BROWN & BROWN INC	Financials	0-Unrated	0-Unrated	30.54	2/10/2006	28%	1.6	1.5	1.6	Rich
CEY	CERTEGY INC	Information Technology	1-Overweight	2-Neutral	40.56	1/26/2006	42%	5.8	4.5	4.8	Rich
DBD	DIEBOLD INC	Information Technology	0-Unrated	0-Unrated	38.00	1/26/2006	31%	1.5	2.6	3.0	Rich
ED	CONSOLIDATED EDISON INC	Utilities	2-Equal weight	3-Negative	46.33	1/27/2006	18%	1.1	1.3	2.1	Rich
GM	GENERAL MOTORS CORP	Consumer Discretionary	2-Equal weight	2-Neutral	19.42	1/26/2006	83%	2.5	3.4	3.4	Rich
GTK	GTECH HOLDINGS CORP	Consumer Discretionary	0-Unrated	0-Unrated	31.74	4/13/2006	35%	2.8	1.1	1.8	Rich
HRS	HARRIS CORP	Information Technology	1-Overweight	1-Positive	43.01	1/25/2006	31%	1.4	1.3	1.5	Rich
IVX	IVAX CORP	Health Care	2-Equal weight	2-Neutral	31.33	3/15/2006	59%	2.7	1.8	1.8	Rich
LEA	LEAR CORP	Consumer Discretionary	3-Underweight	2-Neutral	28.46	1/26/2006	44%	2.2	1.9	1.9	Rich
MAN	MANPOWER INC	Industrials	0-Unrated	0-Unrated	46.50	2/1/2006	27%	1.3	1.1	1.4	Rich
MAT	MATTEL INC	Consumer Discretionary	3-Underweight	1-Positive	15.82	1/31/2006	28%	1.0	1.1	2.0	Rich
NYT	NEW YORK TIMES CO -CL A	Consumer Discretionary	2-Equal weight	3-Negative	26.45	1/24/2006	24%	1.5	2.4	2.5	Rich
PCL	PLUM CREEK TIMBER CO	Financials	0-Unrated	0-Unrated	36.05	1/31/2006	23%	2.6	1.8	1.9	Rich
PGL	PEOPLES ENERGY CORP	Utilities	2-Equal weight	2-Neutral	35.07	1/27/2006	21%	1.3	1.2	1.7	Rich
SAFC	SAFECO CORP	Financials	1-Overweight	1-Positive	56.50	1/24/2006	21%	1.1	1.2	1.5	Rich
SFG	STANCORP FINANCIAL GROUP	Financials	3-Underweight	2-Neutral	49.95	2/1/2006	27%	1.1	2.3	2.3	Rich
SPG	SIMON PROPERTY GROUP INC	Financials	1-Overweight	2-Neutral	76.63	2/6/2006	26%	1.5	2.0	2.0	Rich
TCB	TCF FINANCIAL CORP	Financials	1-Overweight	2-Neutral	27.14	1/13/2006	25%	1.7	1.4	1.5	Rich
VRTX	VERTEX PHARMACEUTICALS INC	Health Care	0-Unrated	0-Unrated	27.67	2/9/2006	69%	1.4	3.7	4.0	Rich
VRX	VALEANT PHARMACEUTICALS INC	Health Care	0-Unrated	0-Unrated	18.08	2/24/2006	78%	3.5	5.9	5.8	Rich
ZION	ZIONS BANCORPORATION	Financials	2-Equal weight	2-Neutral	75.56	1/25/2006	19%	1.1	1.4	1.9	Rich

Source: Lehman Brothers, OptionMetrics, Bloomberg, FAME

Note: This screen does not exclude stocks with illiquid options. Investors should consider liquidity before entering into an options position. Stocks that appear as unrated are either not covered by Lehman Brothers fundamental analysts or are currently subject to research restrictions.

Figure 2: Stocks Having “Cheap” Options According to the Volatility Screen

Ticker	Name	GICS Sector	Lehman Company Rating	Lehman Sector View	Price	Expected Earnings Date	3-Month Implied Volatility	Std Devs from Mean (3-Month Implied vs Realized)	Std Devs from Mean (3-Month Implied vs Sector)	Std Devs from Mean (3-Month Implied vs S&P 500)	Rich/Cheap
ACS	AFFILIATED COMPUTER SVCS-A	Information Technology	1-Overweight	2-Neutral	59.18	1/20/2006	23%	-3.0	-1.7	-1.4	Cheap
AES	AES CORP	Utilities	2-Equal weight	3-Negative	15.83	1/19/2006	26%	-1.1	-1.6	-1.2	Cheap
ATK	ALLIANT TECHSYSTEMS INC	Industrials	2-Equal weight	1-Positive	76.17	2/2/2006	18%	-2.6	-2.3	-1.5	Cheap
BLC	BELO CORPORATION-A	Consumer Discretionary	0-Unrated	0-Unrated	21.41	2/10/2006	20%	-1.4	-1.5	-1.0	Cheap
GT	GOODYEAR TIRE & RUBBER CO	Consumer Discretionary	0-Unrated	0-Unrated	17.38	3/16/2006	36%	-1.9	-1.2	-1.0	Cheap
OMC	OMNICOM GROUP	Consumer Discretionary	0-Unrated	0-Unrated	85.13	2/22/2006	18%	-1.1	-1.7	-1.1	Cheap
PKI	PERKINELMER INC	Health Care	0-Unrated	0-Unrated	23.56	1/26/2006	28%	-1.0	-1.6	-1.5	Cheap
RHAT	RED HAT INC	Information Technology	0-Unrated	0-Unrated	27.26	3/31/2006	42%	-1.9	-1.3	-1.2	Cheap
SMTG	SEMTECH CORP	Information Technology	2-Equal weight	1-Positive	18.26	3/1/2006	34%	-2.9	-1.8	-1.5	Cheap

Source: Lehman Brothers, OptionMetrics, Bloomberg, FAME

Note: Acquisition targets with very low volatility have been removed from this list. Stocks that appear as unrated are either not covered by Lehman Brothers fundamental analysts or are currently subject to research restrictions.

Volatility Screen Summary Output

Number of Standard Deviations Above or Below Spreads' 2-Year Average
If > 1 then "Rich". If < -1 then "Cheap"

Current 1-Month Implied Volatility

Ticker	Name	GICS Sector	Lehman Company Rating	Lehman Sector View	Price	Expected Earnings Date	1-Month Implied Volatility Standard Deviations from Mean				3-Month Implied Volatility Standard Deviations from Mean			
							Current 1-Month Implied	Implied vs Realized	Implied vs Sector	Implied vs S&P 500	Current 3-Month Implied	Implied vs Realized	Implied vs Sector	Implied vs S&P
A	AGILENT TECHNOLOGIES INC	Information Technology	1-Overweight	2-Neutral	35.30	2/14/2006	25%	0.5	-1.1	-1.2	29%	1.2	-0.8	-0.7
AA	ALCOA INC	Materials	1-Overweight	1-Positive	28.23	1/9/2006	28%	1.8	0.4	1.3	26%	0.8	-0.7	0.2
AAI	AIRTRAN HOLDINGS INC	Industrials	1-Overweight	1-Positive	14.92	1/25/2006	41%	-0.5	-1.1	-0.9	46%	-0.2	-0.6	-0.4
AAP	ADVANCE AUTO PARTS	Consumer Discretionary	1-Overweight	1-Positive	42.18	2/16/2006	26%	0.2	0.3	0.9	29%	-0.1	0.1	1.5
AAPL	APPLE COMPUTER INC	Information Technology	2-Equal weight	2-Neutral	71.11	1/12/2006	45%	0.8	1.1	0.9	44%	0.4	0.8	0.7
ABC	AMERISOURCEBERGEN CORP	Health Care	2-Equal weight	2-Neutral	81.93	1/25/2006	21%	0.7	-0.8	-0.2	23%	1.2	-1.8	-0.4
ABI	APPLIED BIOSYSTEMS GROUP	Health Care	2-Equal weight	1-Positive	26.79	1/27/2006	26%	0.8	0.1	0.5	28%	1.1	-0.2	0.6
ABK	AMBAC FINANCIAL GROUP INC	Financials	0-Unrated	0-Unrated	77.84	1/26/2006	19%	0.5	0.0	0.2	20%	0.2	0.2	0.5
ABS	ALBERTSON'S INC	Consumer Staples	2-Equal weight	2-Neutral	24.33	3/15/2006	24%	0.0	-0.5	-0.2	21%	-2.0	-2.0	-1.0
ABT	ABBOTT LABORATORIES	Health Care	0-Unrated	0-Unrated	40.17	1/18/2006	21%	-0.3	1.3	2.0	22%	-1.5	1.6	3.1
ACE	ACE LTD	Financials	2-Equal weight	1-Positive	54.80	1/31/2006	22%	-0.2	-0.5	-0.3	24%	-0.9	0.0	0.3
ACF	AMERICREDIT CORP	Financials	0-Unrated	0-Unrated	25.52	1/24/2006	25%	-0.2	-1.3	-1.2	30%	-0.6	-1.1	-1.1
ACI	ARCH COAL INC	Energy	1-Overweight	1-Positive	78.97	2/8/2006	36%	-0.2	-0.6	0.4	40%	-1.3	-0.4	1.1
ACS	AFFILIATED COMPUTER SVCS-A	Information Technology	1-Overweight	2-Neutral	55.53	1/20/2006	27%	1.2	1.1	0.4	25%	-1.8	-0.2	-0.3
ACV	ALBERTO-CULVER CO	Consumer Staples	0-Unrated	0-Unrated	45.79	1/27/2006	20%	0.4	0.2	0.8	21%	0.3	-0.2	0.9
ACXM	ACXIOM CORP	Information Technology	0-Unrated	0-Unrated	23.40	1/19/2006	44%	1.1	3.0	3.1	35%	1.2	1.7	2.1
ADBE	ADOBE SYSTEMS INC	Information Technology	2-Equal weight	2-Neutral	38.82	3/17/2006	30%	-2.4	0.4	-0.1	31%	-2.6	0.5	0.3
ADCT	ADC TELECOMMUNICATIONS INC	Information Technology	2-Equal weight	2-Neutral	24.04	2/28/2006	36%	-2.1	-1.4	-1.5	39%	-1.7	-1.4	-1.3
ADI	ANALOG DEVICES	Information Technology	1-Overweight	1-Positive	37.70	2/10/2006	25%	-0.5	-1.2	-1.2	28%	-1.0	-1.2	-0.9
ADM	ARCHER-DANIELS-MIDLAND CO	Consumer Staples	0-Unrated	0-Unrated	25.06	1/27/2006	24%	0.3	0.4	0.8	28%	0.7	1.2	1.7

Company Details

Rich/Cheap Metrics: 1-Month Implied Volatility

Rich/Cheap Metrics: 3-Month Implied Volatility

Volatility Screen User Interface

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Lehman Brothers Volatility Screen 19-Dec-05

Equity Derivatives Strategy
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Obtain Implied Volatility Analytics for an Individual Stock

Select Ticker

Apply Screen

Screen Universe for Rich/Cheap Volatility, By Sector, Analyst Rating, Earnings Period

Ticker	GE	1-Week Return	0.65%
Name	GENERAL ELECTRIC CO	1-Month Return	0.08%
GICS Sector	Industrials	3-Month Return	5.08%
GICS Industry Group	Capital Goods	Lehman Company Rating	1-Overweight
Index Membership	SPX	Lehman Sector View	1-Positive
Last Close	\$36.06	Expected Earnings Date	25-Jan-06

Implied and Realized Volatility (3-Month)

	3-Month Implied Volatility	66-Day Realized Volatility
Current	14%	14%
1-Week Change	-1%	0%
1-Month Change	-1%	0%
2-yr High	17%	15%
2-yr Low	3%	2%

Implied and Realized Volatility for Individual Stock Screened

Rich/Cheap Indicators (3-Month Implied Vols)

	Implied vs Realized Spread	Implied vs GICS Sector Spread	Implied vs S&P 500 Spread
Current Spread	0%	-6%	3%
Average	2%	-4%	4%
Std Dev	2%	1%	1%
Percentile	8%	2%	19%
Std Devs from Mean	-1.4	-1.8	-0.9
Rich/Cheap	Cheap	Cheap	-

Implied and Realized Rich/Cheap Indicators for Individual Stock Screened

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2-Neutral - sector coverage universe fundamentals are steady, neither improving nor deteriorating.

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