Conditional Option Trade: Developed and Emerging Market Equities

Developed market (US say) GDP rises prompting a reversal of quantitative easing, interest rate and fiscal policy. Domestic equities could rise or fall depending on sentiment at the time. Rates rise. The impact on emerging markets many of which operate a dirty float is that monetary conditions tighten substantially causing emerging markets to fall sharply.

Developed market GDP weakens prompting a continuation or an acceleration of quantitative easing and fiscal policy. Rates fall. Domestic equities could rise or fall depending on sentiment at the time. The impact on emerging markets with their dirty floats would be an magnification of their loose monetary conditions prompting further asset inflation and rising equity markets.

Buy the following option:

If spot touches an upper barrier (say 10% out of the money) or a lower barrier (again 10% out of the money), reference the domestic equity index, knock in a long strangle on an appropriate emerging market equity index with appropriate strikes.

Strikes and underlyings as appropriate. The barrier option can be designed to be asymmetrical depending on the technicals of the domestic index. In current markets, the cheap option would be to bet on domestic equities rising further, a contrarian trade, and thus having only an upper barrier.