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2019

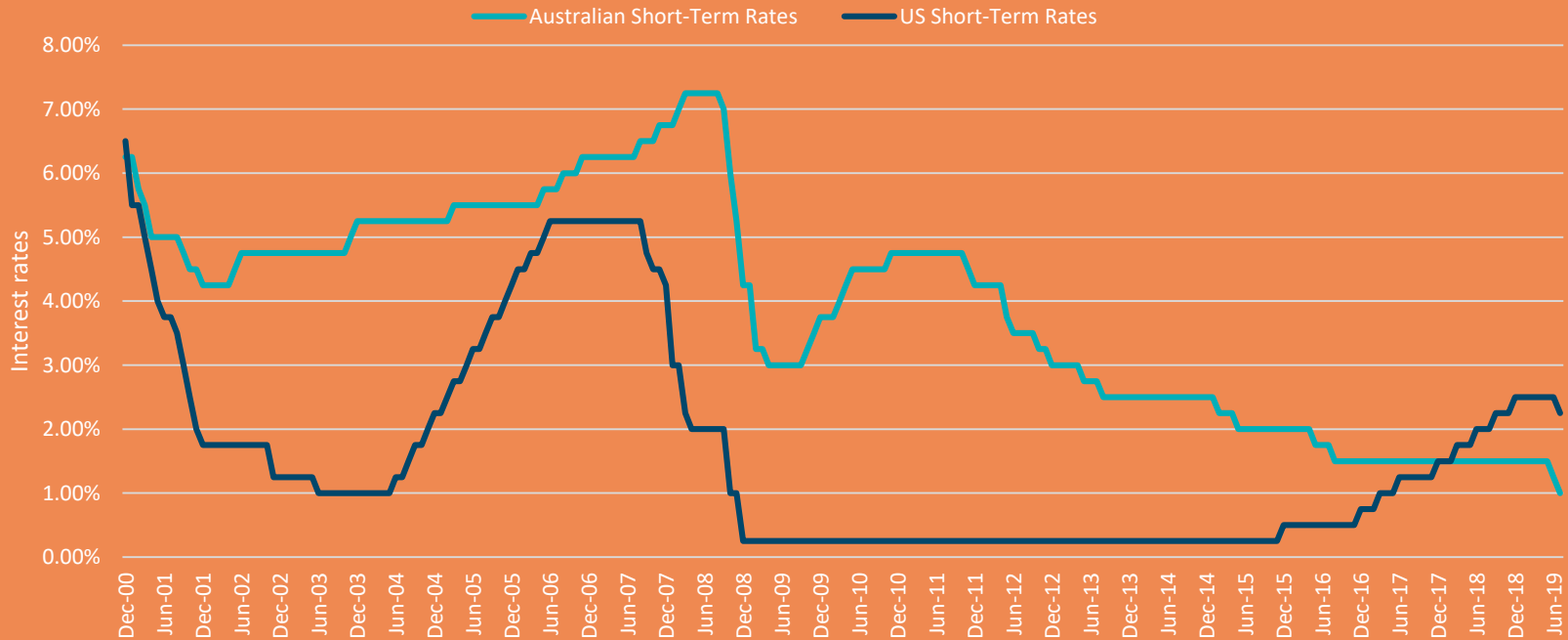
# How to Combat High Hedging Costs?

September 2019

The information contained herein is intended for institutional clients, Eligible Contract Participants, Qualified Eligible Persons and Wholesale Clients only and is for informational purposes only.



# Historical Interest Rate Differentials: Australia vs U.S.



Data from December 2000 to July 2019. Source: Mesirow Financial Investment Management. Past performance is not necessarily indicative of future results. Actual results may be materially different from the results achieved historically. Please refer to the disclaimer page at the end of this presentation for important additional information.

# Interest Rate Differential Forecasts

## Currency Forwards and Overnight Index Swaps (OIS)

### Implied Carry through Currency Forwards

	Implied 1 Year	Implied 2 Year	Implied 3 Year
Weighted Average	-0.216	-0.078	0.063

### Implied Carry through OIS Differentials

	EOY 2019 (%)	EOY 2020 (%)	EOY 2021 (%)
Weighted Average	-0.467	-0.317	-0.282

1. Currency weight MSCI World ex Australia as of 30 June 2019

2. Forward rates and OIS are sourced from Bloomberg as of 12 August 2019

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# Two Key Questions

1

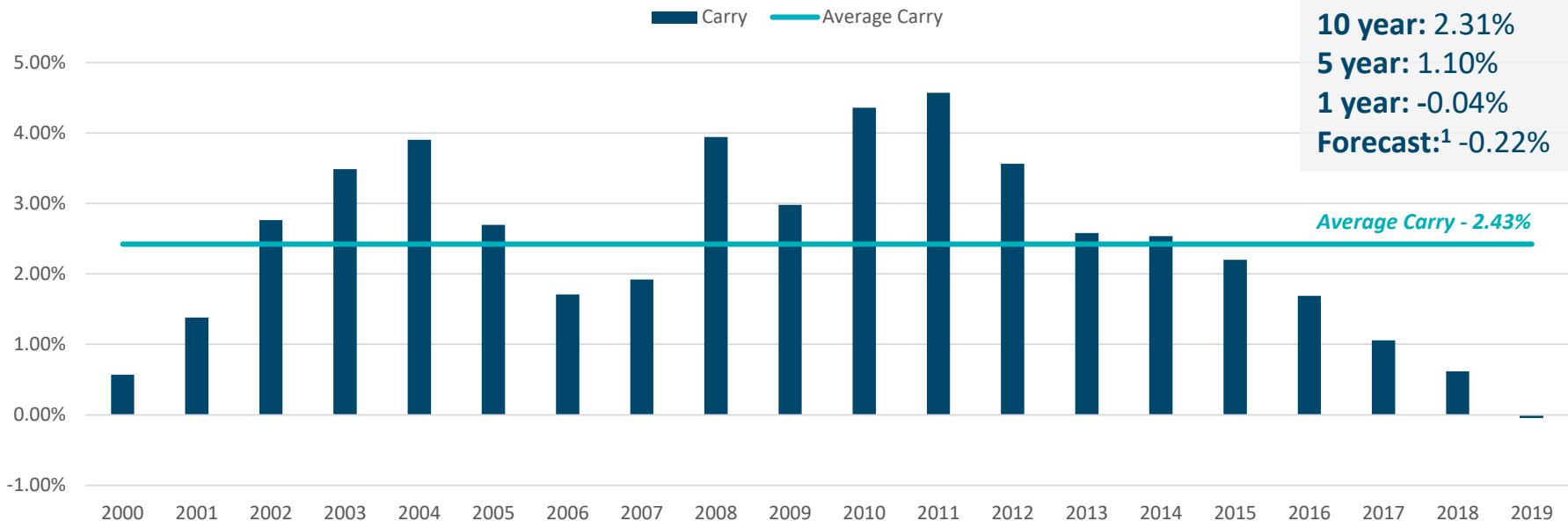
How has the carry from a currency overlay impacted returns in the past?

2

What is a cost-effective alternative to address the erosion of the carry pick-up?

# Annualised Carry from Passive Hedge

## Benchmark: MSCI World ex Australia



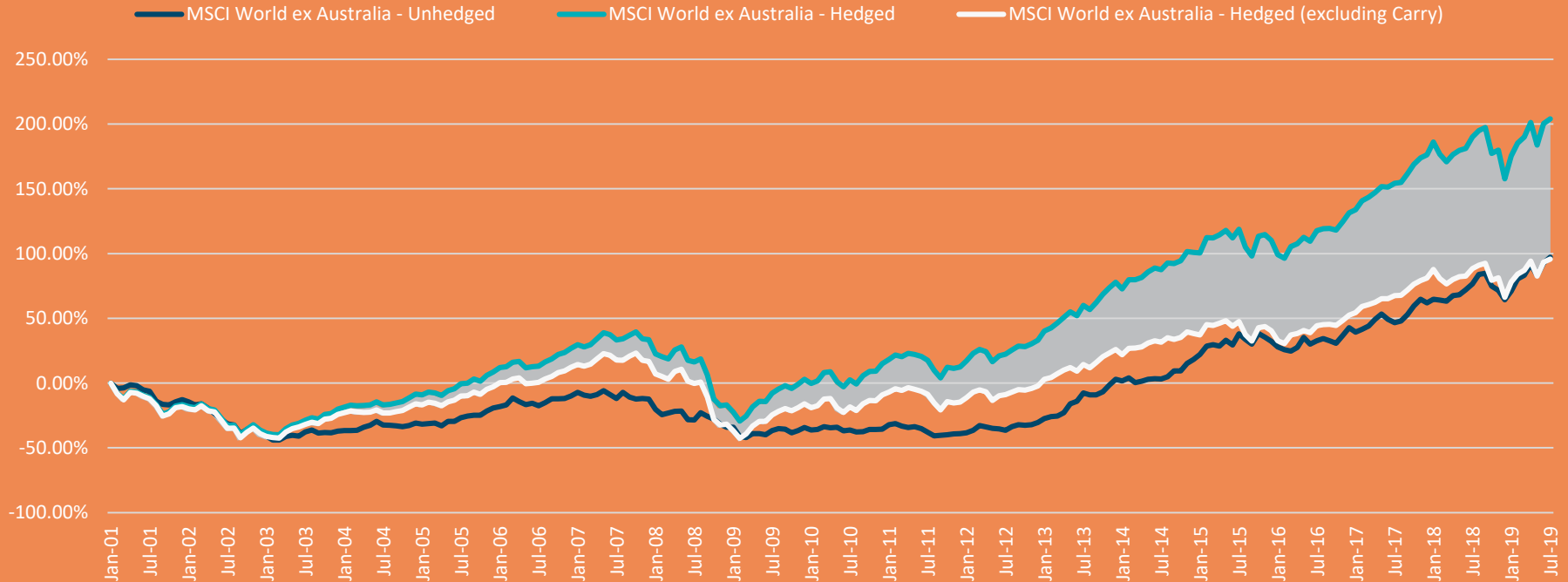
1. Based on implied carry from slide 3.

Source: Bloomberg. Past carry is not necessarily indicative of future carry. Actual carry may materially differ as it is a function of the interest rate differential present at the time.

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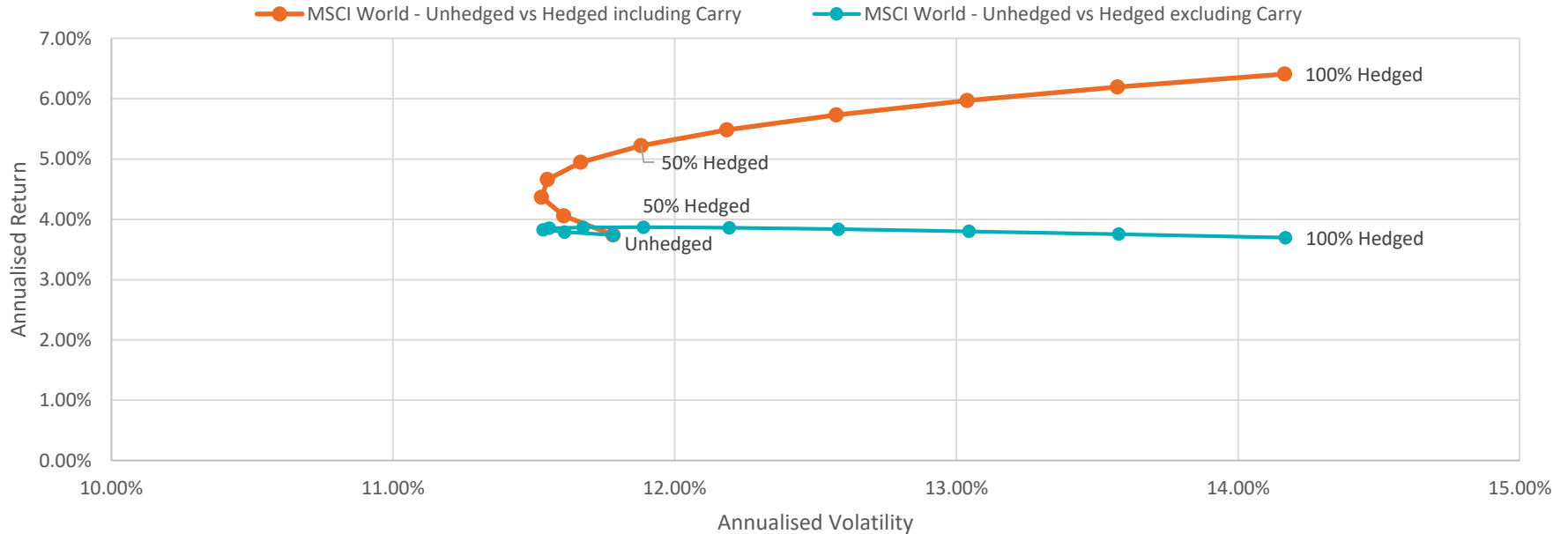
# Cumulative Returns

## Hedge Including and Excluding Carry



Source: Bloomberg. Past carry is not necessarily indicative of future carry. Actual carry may materially differ as it is a function of the interest rate differential present at the time. Please refer to the disclaimer page at the end of this presentation for important additional information.

# Risk Return Profile Including and Excluding Carry



Source: Bloomberg. February 2001 – July 2019. Past carry is not necessarily indicative of future carry. Actual carry may materially differ as it is a function of the interest rate differential present at the time. Please refer to the disclaimer page at the end of this presentation for important additional information.

# What is a Cost-Effective Alternative?

## Currency Factor Strategy

### What is a Currency Factor Strategy?

- Currency factor strategy is typically designed to extract the three prominent style factors that influence currency – Carry, Value, and Momentum

### How does it work?

- Calculate the factor rule
- Rank the calculations
- Apply the appropriate weighting scheme

### What are the benefits?

- Transparent and low cost
- Low correlation to equities and bonds
- Efficient use of capital

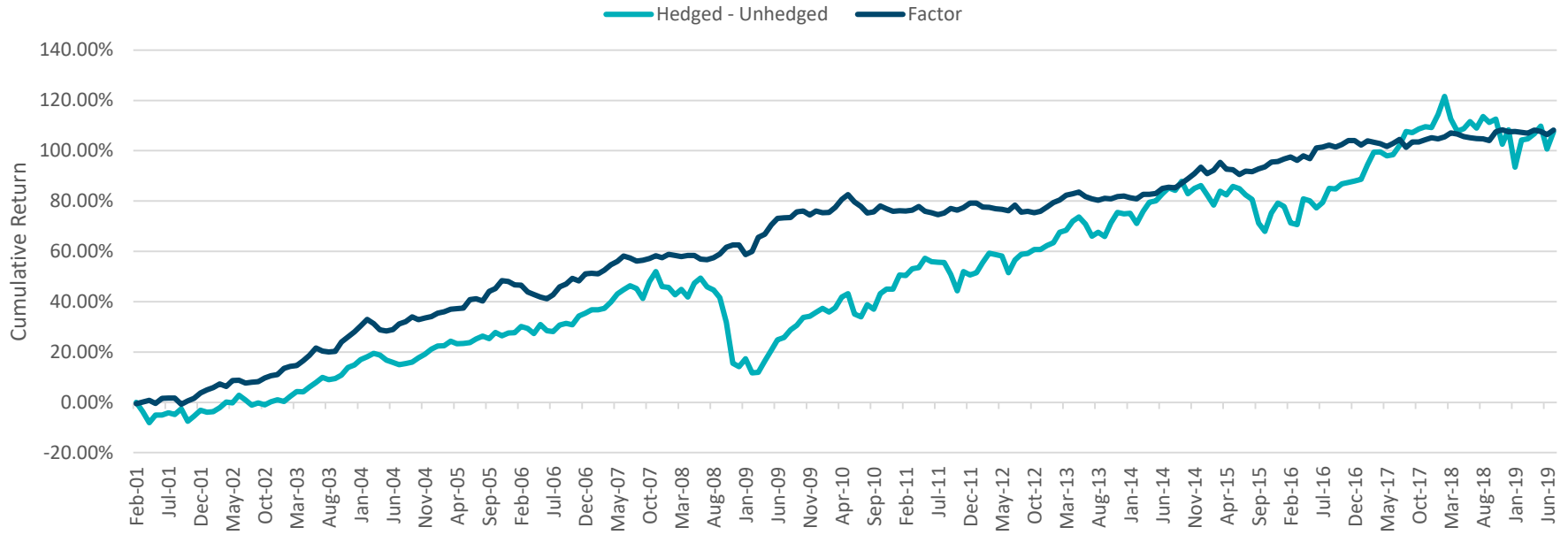
### Applications

- Can be paired with an existing passive hedging programme (e.g. passively hedge an existing portfolio and re-allocate to the currency factor strategy)
- Enables clients access to and participation in 'beta' from currencies within a transparent and risk-controlled framework



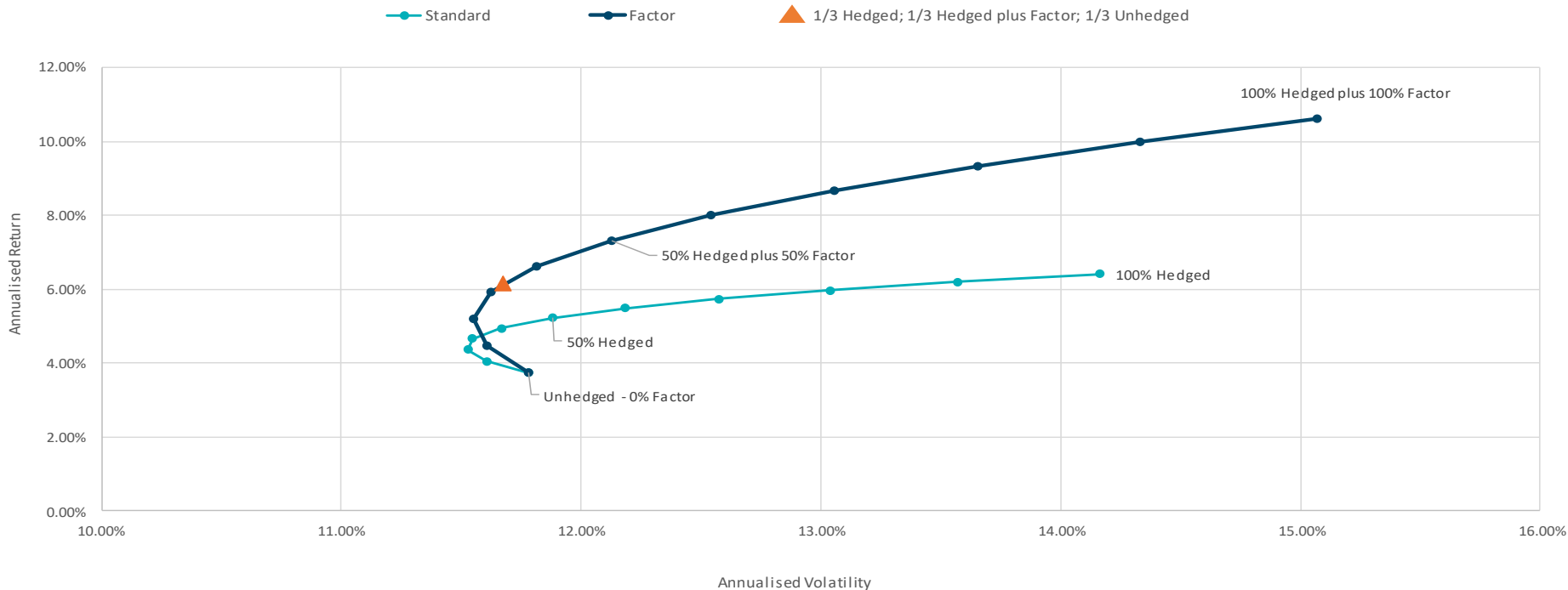
# Cumulative Performance

## Currency Factor Strategy vs Passive Hedge- Simulated Performance



Source: MFCM & Bloomberg. \*Performance for the Mesirov Intelligent Carry Currency Factor represents simulated trading using backfilled data and does not represent trading on behalf of an actual client. These returns are generated with the benefit of hindsight. Returns stated are gross of fees. Past performance is not necessarily indicative of future results. Actual results may materially differ from those shown above. Please refer to the disclaimer page at the end of this presentation for important additional information.

# Risk Return Profile



Source: MFCM and Bloomberg. February 2001 – July 2019. Past performance is not necessarily indicative of future results. Actual results may materially differ from those shown above. This is for illustrative purposes only and represents a benchmark and not client activity. This graph does not illustrate actual client experience or results. Please refer to the disclaimer page at the end of this presentation for important additional information.

# Summary



Carry has had a significant impact on portfolio returns in the past



Based on the predictive indicators such as the forward curve and the OIS swap curve, there is an expectation that there will be a cost to hedging or a very low carry pick-up



Alternative solutions that can be paired with a passive hedge to reduce the erosion in carry pick-up:

- 1 Active currency risk management
- 2 Currency Alpha
- 3 Tenor Management
- 4 Currency Factor Strategy
  - Low cost solution
  - Unfunded; efficient use of capital
  - Low correlation with bonds and equities
  - Easily paired with a passive overlay

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The MSCI World ex Australia Index captures large and mid cap representation across 22 of 23 Developed Markets countries\* (excluding Australia). With 1,587 constituents, the index covers approximately 85% of the free float-adjusted market capitalisation in each country.

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