# Managing Currency Exposure in Your Portfolio

Prepared by: Affin Hwang Asset Management

Emerging market (EM) currencies have taken a beating this year as rising US interest rates and softer economic growth pose a double whammy to the region. The MSCI Emerging Markets Currency index has tumbled by over 6.0% as the US Federal Reserve marches on with its tightening cycle to rein in inflation.

Against such a turbulent backdrop, it has become important for investors to also consider how fluctuations in currency values can impact their portfolio. In our latest Fundamental Flash, we look at the importance of managing currency risk and why investors should also diversify from a currency perspective.

## SAME MARKET, DIFFERENT RESULTS

Currency volatility can be a huge factor that impacts overall performance returns. With more pronounced movements in currency markets now, it has become doubly important on how an investor manages different currency exposure in a portfolio.

*Graph 1: Total Returns (%) of FBM KLCI from MYR and USD perspective.*

*Source: Bloomberg as at 30 June 2022, in MYR terms, on a total return basis.*

Graph 1 shows how the total returns of the benchmark KLCI differ greatly when seen from both a MYR and USD perspective. For example, a foreign investor who invests in the local market will yield lower returns when the value of the investment is converted back from MYR to the USD, where the local currency has been weakening against the dollar.

Conversely, when a local investor invests in a foreign asset and the corresponding foreign currency appreciates, the investor would reap higher returns from the investment. In Graph 2 below, a Ringgit based investor would yield higher returns when the value of the investment in Singapore equities is converted from SGD back to MYR.

*Graph 2: Total Returns (%) of Straits Times Index (STI) from SGD and MYR perspective.*

*Source: Bloomberg as at 30 June 2022, in MYR terms, on a total return basis.*

## TO HEDGE OR NOT TO HEDGE?

Some investors may opt to hedge their portfolios to minimise the risk of adverse currency swings and its impact to performance returns.

This is where an investor chooses to solely focus on investment gains/(losses) directly from the underlying asset into the portfolio as opposed to any currency movements. Thus, an investor can protect investment returns from adverse currency fluctuations and instead focus the bulk of his investment entirely on the performance of the underlying asset class.

On the flip-side, the investor would also forgo favourable forex movements when the portfolio is hedged as no currency gain is recognised.

There are different considerations that an investor should think about when deciding to hedge. Chief among them is the investor's own objective and risk appetite. A more aggressive investor may be able to tolerate a larger amount of volatility in his portfolio and may opt for an unhedged currency class.

On the other hand, a more conservative investor who requires a steady income stream may choose to invest in a hedged currency class to shield returns from unfavourable forex translation.

Some investors may also decide to take a view on a particular currency if it will strengthen or weaken and subsequently decide on how to hedge their position

accordingly. For instance, if an investor expects the USD to continue strengthening against the Ringgit, the investor may pick an unhedged currency class when investing in a US bond fund to clip the coupons and also benefit from currency gains.

However, investors should refrain from being too reactive or timing currency movements. It is extremely difficult to predict short-term movements of any currency with sufficient accuracy as there are a variety of factors that can influence a currency's direction.

These include monetary policy action, inflation levels, fiscal position, political stability, trade balance and overall attractiveness of the country's goods and services. It often involves a degree of speculation with some guesswork involved to predict the spot rate of any currency.

In the long-term, the value of a currency will reflect the fundamentals of the country and the resilience of its economy to withstand external shocks and outflows. What's more important is for an investor to focus on the fundamentals of the country that the investor is allocating in, which ultimately drive market cycles and performance returns.

## BUILDING A MULTICURRENCY PORTFOLIO

The aim of any investor is to build a well-balanced and diversified portfolio so that gains from one asset class can offset losses from another. This includes currency exposure, where currency gains from one currency can cushion losses from another.

For mutual fund investors, they can build a portfolio comprised of different currency hedged and unhedged classes to diversify their currency exposure.

For instance, an investor could consider starting with a 50:50 currency mix, where 50% of their portfolio is designed to take in currency translation exposure (e.g. USD, AUD perspective), whilst the remaining 50% is reserved for currency hedged exposure (i.e. RM perspective). This allows an investor to look past immediate currency concerns and also benefit from currency movements in either direction over the longer-term.

At Affin Hwang AM, we have a range of product solutions that are managed from various currency perspective including hedged and unhedged classes to help you achieve your long-term investment goals.

## Book an Appointment

Speak to us today on how you can build a portfolio that is globally diversified in terms of both asset class and currency exposure. Visit the link below or scan the QR code.
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