

CURRENCY HEDGED INDEXES

Why Do They Matter?

March 2015

- Currency exposure has substantially impacted the performance and the volatility of global equity indexes at times—both positively and negatively
- While there are periods in the investment cycle when investors may be comfortable taking on both equity *and* currency risk, there are other times when decoupling the two can be desirable
- MSCI has developed a range of hedged and currency indexes that reflect various ways to capture and/or hedge currency risk in an equity opportunity set
- Hedging currency exposure allows an investor to take currency risk out of the equation when investing in companies abroad

THE IMPORTANCE OF CURRENCY

- Currency returns, which reflect changes in exchange rates, can fluctuate considerably
- The US dollar, for example, has gone through multi-year periods of appreciation and depreciation relative to other major developed market currencies like the Euro and the Yen over the past few decades
- The effects of currency exposure on an international equity portfolio's returns and risk have been sizable at times

EFFECTS OF HEDGING

CURRENCY RISK IN THE PAST YEAR: EXAMPLES

- Over the past year (since March 2014), many major currencies have depreciated relative to the US dollar (USD)
- As the US dollar has strengthened over this period, hedging exposure to foreign currencies has benefited US investors holding stocks of foreign companies
- The unhedged MSCI Europe Index, for example, returned -4.94% from March 2014 to March 2015. Meanwhile, the currency hedged version returned 14.34% over the same period (see table)

Performance Characteristics of Unhedged & Hedged MSCI Indexes (USD)—(Mar 2014 – Mar 2015)

	Unhedged Index	Hedged Index	Unhedged Index	Hedged Index
	Annualized Returns		Annualized Volatility	
MSCI ACWI	5.42%	13.11%	8.49%	6.89%
MSCI ACWI ex USA	-1.01%	14.21%	9.27%	6.44%
MSCI EAFE	-0.92%	17.14%	9.25%	7.16%
MSCI EAFE Small Cap	-2.92%	14.61%	9.73%	7.73%
MSCI Europe	-4.94%	14.34%	11.10%	8.79%
MSCI EMU	-6.13%	19.88%	12.57%	12.10%
MSCI EMU IMI	-6.48%	19.42%	12.57%	12.20%
MSCI Emerging Markets	0.44%	7.38%	11.38%	7.78%
MSCI AC Asia Pacific ex Japan	6.33%	12.15%	10.57%	7.70%
MSCI Australia	-5.99%	11.48%	17.57%	12.04%
MSCI Brazil	-28.63%	-8.39%	29.42%	21.57%
MSCI Canada	-6.09%	7.15%	15.37%	8.42%
MSCI Germany	-2.61%	24.21%	13.50%	13.77%
MSCI Italy 25-50	-15.26%	8.32%	14.51%	15.17%
MSCI Japan	12.06%	29.51%	10.05%	11.04%
MSCI Korea 25-50	-4.93%	-2.65%	11.23%	8.41%
MSCI Mexico IMI 25-50	-7.67%	5.29%	15.79%	10.83%
MSCI Spain 25-50	-10.12%	15.34%	14.47%	10.96%
MSCI Switzerland 25-50	-0.61%	8.97%	9.97%	13.06%
MSCI United Kingdom	-5.51%	5.87%	12.19%	8.05%

Past performance is no guarantee of future results. Index returns assume reinvestment of all dividends. It is not possible to invest in an index.

WHY HEDGE CURRENCY RISK?

- Currency moves can be quite substantial depending on the time period
- From peak to trough (May 2007 to Feb 2009), the EUR/USD exchange rate lost nearly 50% of its value (see graph)
- Meanwhile, the precipitous decline of the EUR over recent quarters has resulted in strong performance for the MSCI Europe Hedged Index
- Currency losses can be large in magnitude when compared to equity market returns
- In the short run, currency returns can be driven by an array of factors, including Central Bank decisions, changes in inflation, the balance of trade and cross-country capital flows

Comparison of the MSCI Europe 100% Hedged to USD Index Returns (USD) versus the EUR/USD Currency (Jan 99 – Mar 15)



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MSCI CURRENCY HEDGED INDEXES

- MSCI has constructed hedged versions of a range of its market cap weighted indexes including base currencies such as the USD, CAD, EUR, GBP, JPY, and AUD
- MSCI Hedged Indexes represent a close estimation of the return that can be achieved by hedging the currency exposures of the parent index by selling foreign currency forwards at one-month forward rates
- The MSCI Hedged Indexes include all of the same securities as the underlying MSCI parent index and weight each currency in correspondence to the relative market cap weight of those securities

Learn more: [MSCI Currency Hedged Indexes](#)

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CONTACT US

clientservice@msci.com

AMERICAS

Americas	1 888 588 4567 *
Atlanta	+ 1 404 551 3212
Boston	+ 1 617 532 0920
Chicago	+ 1 312 675 0545
Monterrey	+ 52 81 1253 4020
New York	+ 1 212 804 3901
San Francisco	+ 1 415 836 8800
Sao Paulo	+ 55 11 3706 1360
Toronto	+ 1 416 628 1007

EUROPE, MIDDLE EAST & AFRICA

Cape Town	+ 27 21 673 0100
Frankfurt	+ 49 69 133 859 00
Geneva	+ 41 22 817 9777
London	+ 44 20 7618 2222
Milan	+ 39 02 5849 0415
Paris	0800 91 59 17 *

ASIA PACIFIC

China North	10800 852 1032 *
China South	10800 152 1032 *
Hong Kong	+ 852 2844 9333
Mumbai	+ 91 22 6784 9160
Seoul	00798 8521 3392 *
Singapore	800 852 3749 *
Sydney	+ 61 2 9033 9333
Taipei	008 0112 7513 *
Tokyo	+ 81 3 5290 1555

* = toll free

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