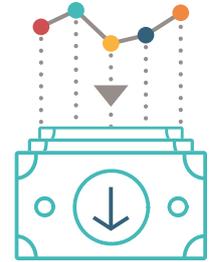


WHAT IS CURRENCY HEDGING? AND DOES IT MATTER?

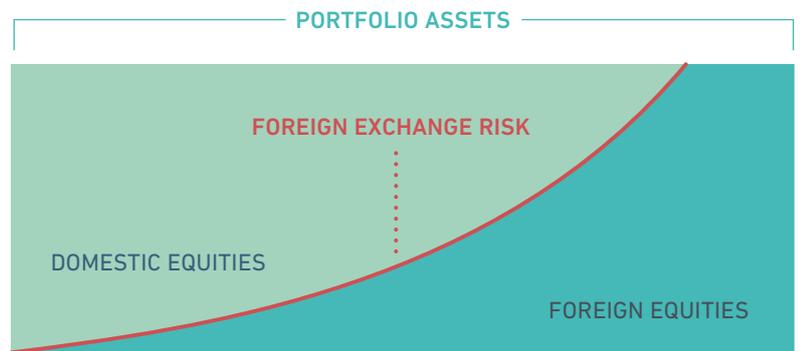
You may not realize it, but whenever you invest in a foreign equity, you are also, in a sense, making an implicit investment in a foreign currency as well.



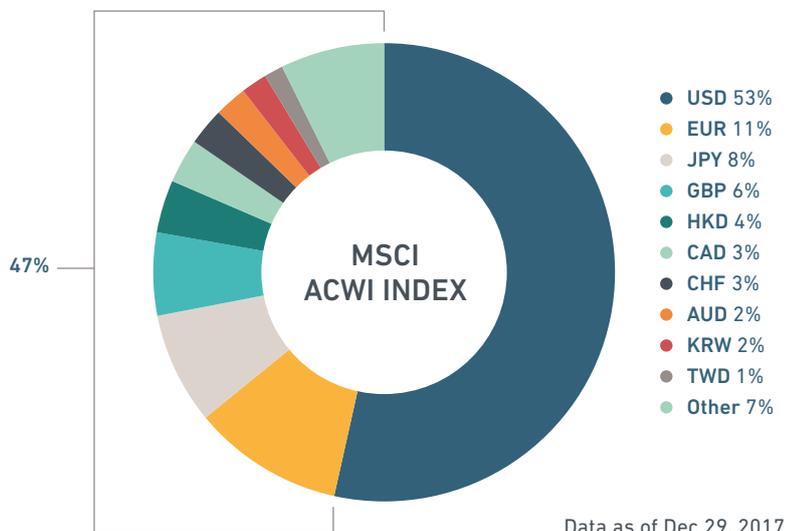
Currency hedging seeks to reduce exposure to foreign exchange risk while retaining the original equity exposure.



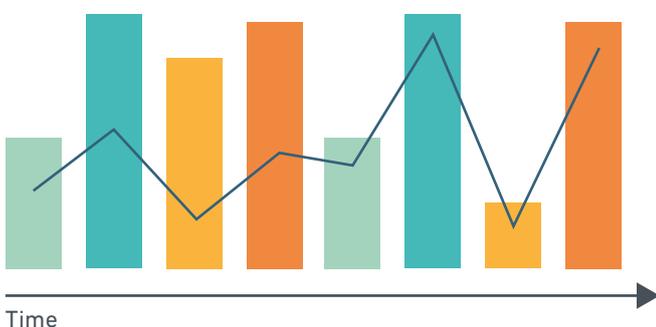
This approach has become increasingly prominent as investors across the globe continue to allocate greater portions of their assets to foreign equities, which in turn exposes them to increasing levels of foreign exchange risk in their portfolios.



For example, if a U.S. investor were to make portfolio allocations to foreign equities based on their weight in the MSCI ACWI Index, MSCI's flagship global equity benchmark, designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 24 emerging markets, nearly 50% of their portfolio would be impacted by foreign currency movements.



Depending on the time period, exchange rates can fluctuate substantially, which may have large and unpredictable effects on returns on foreign equities.



A variety of drivers can influence exchange rates or currency returns in the short run, including central bank decisions, changes in inflation, balances of trade, and cross-country capital flows. Different countries are often faced with widely differing economic conditions, which can influence the strength of a given currency.



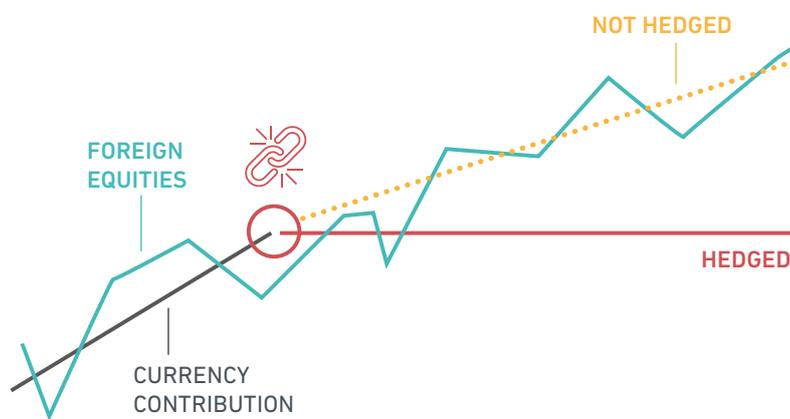
CURRENCY HEDGING IN PRACTICE

If the value of foreign equity rises in terms of a foreign currency, but the currency itself depreciates, this may mitigate the equity's gains. For example, take a hypothetical U.S. investor who bought shares in Daimler AG, the German auto manufacturer, in April 2014 and then sold those shares in May 2015.



When measured in Euros, the value of the investment rose by 23.21% over the 13-month time period. However, since the Euro-to-USD exchange rate declined from \$1.38 to \$1.10, that U.S. investor actually would have experienced an investment loss of 1.85%.

On the other hand, by utilizing a **currency hedge**, that U.S. investor may have attempted to reduce their foreign exchange exposure, to potentially reap more of the 23.21% equity gains without suffering from the full decline in the Euro-to-USD exchange rate.



Investing in foreign companies when the corresponding foreign currency depreciates reduces the gains from foreign investments. Conversely, if the foreign currency appreciates, then gains from the foreign investment are enhanced.

IS CURRENCY HEDGING RIGHT FOR YOU?

There are a number of important factors to consider when evaluating if currency hedging is right for you, including time horizon, investment goals, and market outlook. Hedging currency risk may reduce the volatility of equity investments and aims to provide risk control by allowing investors to separate currency risk from their equity asset allocations.



You will also need to decide on what level of exposure to foreign exchange risk you are comfortable with. A 100% currency hedge aims to eliminate all foreign exchange exposure, but you may decide you want some exposure to potential appreciations in foreign currencies. Under this scenario, you may choose to only hedge a portion of your foreign equities exposure.

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