ABSOLUTE RETURN CURRENCY MANAGEMENT

Actively Managing Currency as an Asset Class

STATE STREET GLOBAL ADVISORS

Alpha opportunities exist in the currency markets and a systematically focused approach can offer investors exposure to a diverse range of those opportunities.

OUR SOLUTIONS

With the search for alternative sources of return a key component in today's investment environment, treating currency as an added source of alpha can be appealing for many investors. Our Absolute Return Currency Strategy is a multi-style, multi-horizon currency strategy whose sole goal is to add alpha through a full market cycle.

We believe that alpha opportunities exist in the currency markets and that a systematically focused approach provides access to a sufficiently diverse range of those opportunities. The systematic process we've evolved ensures that the drivers are interpreted consistently through time and consistently with economic intuition.

Currency markets are also driven by a variety of factors that either cannot be quantified or can be quantified but are not repeated. So, in our view, it is essential that institutional investors dedicate a portion of their risk budget to an independent qualitative process. As such, within the Strategy, we allocate an average of 15%, and up to 30%, to a non-quantitative discretionary process.

Frequently, the Strategy is paired with a currency-risk-reduction strategy such as a passive currency hedge or our value-based Dynamic Strategic Currency Strategy.

This combination of strategies can help to reduce the currency risk inherent in international investing and reallocate some or all of the risk savings to a deliberately chosen portfolio of currencies with a higher expected return.

Who It's For

- Investors looking for an active strategy and wishing to profit from fluctuations in currency over time.
- Investors seeking a currency-focused standalone addition to an equity, fixed income or alternatives portfolio.

Why Use It

To access alpha opportunities from the currency markets cost effectively and achieve additional portfolio diversification.

STRATEGY COMPONENTS

1 A MULTI-STRATEGY SYSTEMATIC COMPONENT

The systematic component accounts for an average of 85% of the risk budget and is built around four primary strategies: Fundamental, Valuation, Carry and Technical. These are complemented by a risk-regime indicator and dynamic capital allocation procedure to vary the relative weights of the four primary strategies and their subcomponents. The final forecast of the systematic process is converted to trade a target portfolio via an optimisation that imbeds a variety of general and client-specific risk constraints.

HOW IT WORKS

Investors generally implement the Strategy through a separately managed account and provide us with a notional AUM, position limits per currency and an annual volatility risk target.

Mechanically, the Strategy is driven by a forecasted return for each currency; it buys (takes long positions in) the currencies with higher expected returns and sells (takes short positions in) the currencies with lower expected returns. The currency portfolio positions are taken via currency forward contracts.

We construct the portfolio on a risk-controlled basis using an optimisation process that includes each client's specific constraints and risk targets. Depending on regional collateralisation rules, little or no cash is required upfront although periodically, usually quarterly, we roll the forward contracts and the investor must receive (send) cash to settle the gains (losses) with each counterparty.

THE BENEFITS

- **Access to Country-Specific and Global Macro Opportunities** Currency provides access to potential alpha opportunities arising from factors including exchange rate policy, inflation, productivity, terms of trade, growth, country risk premium, geopolitical events and a host of cyclical factors.
- **Low Transaction Costs and High Liquidity** The high volume and ample liquidity of the currency markets results in low transaction costs compared to most other asset classes. As a result, currency provides a very cost-efficient tool to gain exposure to both country-specific and global macro drivers.
- **Capital Efficiency** the Strategy is most often delivered as a portable alpha. It is not necessary to divest substantial capital from underlying investments in other asset-class allocations.
- **Diversification** the Strategy tends to have a relatively low correlation with major asset classes as well as common indices measuring the performance of other active currency managers.

2 DISCRETIONARY STRATEGY

The discretionary portfolio is added to the target systematic portfolio to capture market drivers that fall outside the scope of the systematic process. The discretionary portfolio contributes an average of 15% of the risk budget.

3 RISK MANAGEMENT

Risk control is imperative. Strict position size and risk limits are in place to protect the portfolio. Hard limits, in addition to modelled risk limits using information from historical prices and implied volatility, help to provide an extra layer of downside limitation independent from the risk model. In addition, we utilise a put-option-like total strategy stop/loss limit.

ssga.com

State Street Global Advisors

D13360-2153420.1.1.GBL.RTL 0618 Exp. Date: 30/06/2019