

# CURRENCY MANAGEMENT SOLUTIONS

APRIL 2019

- > **Currency exposure** creates an unrewarded risk that we believe needs to be managed, but it also has the potential to be a diversified and uncorrelated source of alpha generation. We utilise quantitative techniques to offer a range of highly customisable currency solutions from passive hedging through to dynamic hedging.

# FOREWORD:

## CURRENCY, RISK AND REWARD

Managing currency risk has become extremely important for institutional investors as portfolios have diversified internationally. While geographical diversification is one of the keys to spreading investment risk, investors find themselves presented with another, unintended risk, that of international currency exposure. As such, the performance of investments will depend on both the asset returns and the fluctuations of international currencies versus the investor's domestic currency. Given the volatile nature of currency movements, the impact on returns can be material. Conversely, equally, skilful currency managers can exploit these opportunities to capture value.

At Insight, we offer a comprehensive and diverse range of currency strategies. These range from passive and dynamic hedging to our flagship fully customisable Currency Risk Management (CRM) strategy. Our currency solutions are designed with each client's risk sensitivities and performance targets in mind. We work closely with our clients to construct, implement and monitor currency solutions that seek to offer a combination of both downside protection and value add.

# AN INTRODUCTION TO INSIGHT'S CURRENCY MANAGEMENT SOLUTIONS

WE HAVE MANAGED CURRENCY RISK FOR GLOBAL INSTITUTIONAL INVESTORS SINCE 1991. THE CURRENCY SOLUTIONS TEAM IS RESPONSIBLE FOR APPROXIMATELY £37BN IN OVERLAY EXPOSURES.<sup>1</sup> OUR RANGE OF CURRENCY SOLUTIONS SPANS THE FULL SPECTRUM, FROM PASSIVE HEDGING TO FULLY CUSTOMISABLE DYNAMIC RISK MANAGEMENT. EACH PORTFOLIO IS TAILORED TO SUIT THE RISK PROFILE OF THE UNDERLYING CLIENT.

We are specialists in constructing tailored risk management solutions that accommodate clients' objectives and constraints with respect to their broader investment needs. We believe Insight has a market-leading currency solutions platform, one that encompasses a broad range of fully customisable products that aims to deliver comprehensive end-to-end currency solutions to our clients. This document provides an overview of Insight's core currency management capabilities and their key features. The diagram below provides a breakdown of our systematic currency strategies.

Each solution is highly customisable and can be tailored to seek a combination of both downside protection and value add. Our mandates are typically solutions-based with strategy design, monitoring and evolution being valued services in addition to the core execution and collateral management roles. The strategies are implemented using foreign exchange forward contracts and are designed in consultation with the client.

## Targeting the full spectrum of currency solutions

Investment style	Strategy	Features
Passive	Passive Hedge	<ul style="list-style-type: none"> <li>• Passively hedging underlying currencies directly and via tracking baskets</li> <li>• Regular monitoring and rebalancing to capture drift and minimise deviations</li> <li>• Flexibility of forward contract settlement tenors</li> </ul>
Risk Management	Protective Currency Hedging	<ul style="list-style-type: none"> <li>• Hedge ratio varies over time via mechanistic framework</li> <li>• Cash loss limit according to client constraints<sup>2</sup>; reduced collateral requirements</li> <li>• Linked to underlying exposures</li> </ul>
	Currency Risk Management	<ul style="list-style-type: none"> <li>• Factor information used to dynamically change ratios</li> <li>• Full hedge range from 0% to 100% with multiple, bespoke risk controls</li> <li>• Linked to underlying exposures</li> </ul>
	Emerging Market Currency Diversification	<ul style="list-style-type: none"> <li>• Diversifies concentrated base currency short position</li> <li>• Risk management with additional objective of reduced volatility</li> <li>• Retain underlying EM exposures</li> </ul>
Active Absolute Return	Quantitative Currency for Return	<ul style="list-style-type: none"> <li>• Systematic currency absolute return</li> <li>• Unconstrained factor-based approach: long/short with return target</li> <li>• Benchmark agnostic with limited or no inclusion of underlying exposure</li> </ul>

<sup>1</sup> As at February 2019. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. <sup>2</sup> This is not a guarantee to limit losses at any given level.

## PASSIVE

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### Passive Hedging

For a passive mandate, the level of hedging remains fixed at the strategic benchmark level selected. The objective is to deliver the benchmark return at minimal cost, with the focus on tracking error, liquidity risk management, counterparty risk management, operational efficiency, best execution and informative and transparent reporting. We aim to minimise tracking error relative to the benchmark by maintaining currency hedge ratios at the benchmark level and rebalancing as and when drift occurs. We have experience in managing complex rebalancing procedures involving multiple external sources and various custodian systems.

## DYNAMIC

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### Protective Currency Hedging

The aim is to maintain the client's strategic target hedge ratio whilst considering the cost of any negative cashflows associated with that hedge. Insight can manage the hedge ratio of the portfolio dynamically in order to prevent negative cashflows from exceeding a client specified limit. This is done by reducing the hedge ratio as the base currency of the client weakens over a pre-defined period.

### Currency Risk Management

The principal objective of a dynamic currency risk management strategy is to reduce the size of negative cash flows, while retaining or even improving upon the positive cash flows generated by the client's benchmark hedge ratio. Insight's dynamic Currency Risk Management (CRM) strategy aims to add value over the medium term by dynamically adjusting the levels of hedges, while delivering an asymmetric outcome (characterised by reduced downside risk and enhanced upside risk present in the client's underlying international currency exposures). The strategy's target hedge ratios are derived by a multi-factor approach consisting of Value, Carry, Momentum and Volatility signals.

CRM can provide a desired asymmetric outcome within the preferred constraints of the client. These constraints can be tailored to incorporate a client's risk sensitivities to cashflows, currency translation losses or benchmark relative underperformance.

### Emerging Market Currency Diversification

Insight believes that exposure to emerging market currencies can provide a positive outcome in the long term. Insight's approach to managing a basket of emerging market currency exposures reduces concentrated base currency exposure with an optimised basket of G7 currencies. This reduces volatility in the emerging market basket and increases the potential to gain from the long-term appreciation of emerging market currencies.

## ABSOLUTE RETURN

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### Quantitative Currency for Return

Our systematic currency absolute return offering is a multi-factor approach underpinned by established currency risk premia such as volatility, momentum, value and carry. Each factor is selected to target different characteristics of currency markets which, combined together, should result in a stable and well-diversified source of currency return.

Our Quantitative Currency for Return strategy utilises a broader currency universe with the primary objective of delivering attractive risk-adjusted returns. The strategy has a return-to-risk ratio of 1.1 and low correlation to other asset classes and can also be scaled to target different levels of return.



Each solution is highly customisable and can be tailored to seek a combination of both downside protection and value add

## THE TEAM

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- The Currency Solutions Team comprises 22 investment professionals globally<sup>3</sup> and is fully dedicated to the management of currency mandates with support from the broader Financial Solutions Group. It is divided functionally into research, portfolio management and trading responsibilities.
- The research team is led by James Coleman, and is responsible for maintaining and enhancing the investment signals which inform our risk management and absolute return solutions.
- The portfolio management team is led by Rabia Shirazi, Head of Portfolio Management on the Currency Solutions Team. The team has extensive market knowledge and in-depth experience of on-boarding clients, coordinating transitions, and portfolio restructures and rebalances. It oversees the day-to-day management of all of portfolios managed by the Currency Solutions Team.
- We have a dedicated, centralised currency trading team overseen by Richard Purssell, Head of Trading on the Currency Solutions Team. The team has considerable expertise in currency markets, derivative instruments and trading applications, allowing us to optimise trading activity with the goal of achieving the best results for our clients.
- Local client service representatives and product specialists support the Currency Solutions Team from regional offices in Australia and New York.

<sup>3</sup> As at 31 March 2019.

## SOLUTION DESIGN AND INVESTMENT PROCESS

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Each client's currency solution requirements are different and so Insight works in consultation with the client to understand the foreign currency exposures present in their portfolio, their constraints and their investment objectives to achieve a bespoke optimised portfolio construction.

Components from Insight's suite of existing strategies can be combined and overlaid with risk controls to design a robust and transparent investment process which can be monitored and appraised at each step of the investment life cycle.

Our investment process employs proprietary systems with a high degree of transparency and a host of diagnostic and monitoring tools which provide portfolio managers with full oversight of the investment process.

### Overview of investment process

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#### Exposure Assessment

- Identify and track the client's portfolio of international currency exposures
- Vast experience with multiple data sources – custodian, client and external managers
- Risk-controlled process with automated checks and validation

#### Active Positions

- Proprietary, quantitative model within a highly flexible framework to accommodate client customised parameters
- Multi-factor approach targets diverse characteristics of currency markets
- Portfolios can be tailored to assess risk, return and transaction costs based on encoded rules

#### Trade Execution

- Order generation, management and execution across counterparties on various platforms
- Pre-trade compliance checks built into our proprietary Currency Trading System (CTS)
- Independent Transaction Cost Analysis provided by BestX to monitor execution and transaction costs

#### Review and Control

- Portfolio management systems integrated for real time exposure monitoring
- Daily oversight and monitoring of currency exposure positions and hedges
- Timely and accurate performance measurement reporting



## IMPORTANT INFORMATION

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### RISK DISCLOSURES

Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

### ASSOCIATED INVESTMENT RISKS

#### Currency risk management

Currency hedging techniques aim to eliminate the effects of changes in the exchange rate between the currency of the underlying investments and the base currency (i.e. the reporting currency) of the portfolio. These techniques may not eliminate all the currency risk.

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.

Where leverage is used through the use of swaps and other derivative instruments, this can increase the overall volatility. Any event that adversely affects the value of an investment would be magnified if leverage is employed by the portfolio and losses would be greater than if leverage were not employed.

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