

Investors warned to hedge against currency fluctuations



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Investors could stand to lose money if they don't hedge their investment against the volatile currency when investing in global shares or commodities like gold, says local investment management firm NZ Funds.

NZ Funds chief investment officer Michael Lang says many New Zealanders who invested in global shares or commodities this year failed to benefit from the huge recovery in global share markets because the rapidly appreciating New Zealand dollar offset much of the gains.

Investors could stand to lose significant amounts of money should the dollar appreciate further without a matching increase in the price of global investments.

Lang says the MSCI world index rose 63.93% in the past seven months from its low on March 9 to October 31. But the NZD gained 44.5% against the US dollar over the same period. This means individuals who invested in the MSCI would only have generated a net return in NZD of 13.65% if they didn't hedge the currency.

Investors who put their money into gold would have lost a significant 21.89% of their money as a result of the 44.5% currency rise, despite gold actually increasing 13.4% in the past seven months.

"Unlike New Zealand companies that regularly trade with international partners and therefore have to consider the implications of an openly-traded, volatile currency, many local private investors and even some local investment managers are not wise to the dangers of owning offshore investments without a currency hedging strategy," Lang says.

Another of many examples illustrating the importance of currency hedging is the five year period between 2002 and 2007 when equities were in a strong bull market. Lang points out that between July 10, 2002 and October 31, 2007, the MSCI world index increased 167%, offering investors significant returns. However New Zealand investors who didn't have any currency hedging in place would have only generated a mere 40.14% return over the same period because the NZD rose 58.8% relative to the US dollar during that time.

Lang believes that currency is as important an asset class as shares or government bonds. "It is important to put the same energy and intensity into protecting against losses and generating gains out of the NZD as it is with other assets. A range of investment tools, including valuation models and momentum indicators can be used to help with currency management," he says.

NZ Funds has fully hedged its funds' against a rise in the NZD. "This has been the case since May 5 when NZ Funds hedged its clients' portfolios against any appreciation of the NZD above \$0.5770. Our models indicate that the currency has now become overvalued. Should the currency undergo a medium term correction our dynamic hedging strategy will automatically switch clients' exposure from being fully hedged to being partially un-hedged which ensures they are well positioned irrespective of the NZD fluctuations."

Lang is adamant that a passive approach to currency management is no longer an option.

"This year losses generated by passive currency allocations have been concealed by rising global share prices. However, there is no guarantee this will continue and investors could stand to lose money, despite good returns from offshore investments, purely as a result of currency increases."