

The US hedging advantage

Potential to increase return while reducing risk by simply hedging currencies

For US investors, the management of currency risk in their portfolios has historically been an afterthought for a variety of reasons and assumptions, chief among them: zero expected return, portfolio diversification, and low materiality in the portfolio. We will touch upon each of these views, discussing their validity, evolution, and relevancy within the current market environment.

Zero expected return

Assumption – Currencies have zero expected return, so currency management is unnecessary as it will wash out in the end.

Historically, developed market currencies have not added or detracted meaningful return in multi-decade time horizons. Since the introduction of the Euro in 1999, EAFE currencies have gone full cycle, crossing the 0% return line again in early 2022 (Figure 1).

However, the impact over shorter time horizons is relevant as both plans and managers are often judged over periods as short as one to five years. Even with longer time horizons of ten years or more, volatile currency swings up to 50% have occurred, episodically adding or detracting significant value to the total equity portfolio.

FIGURE 1: EAFE CURRENCY RETURN



Source: Bloomberg, MSCI, Mesirow. Performance from January 1999 – December 2023. Past performance is not necessarily indicative of future results. Actual results may materially differ.

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The US hedging advantage

Efficient calls to increase returns while reducing risk by simply hedging currencies

For US investors, the management of currency risk is their portfolio. We have historically been an advocate for a variety of assets and allocations, chief among them: zero expected return, portfolio diversification, and low volatility in the portfolio. We will touch upon each of these items, discussing their utility, evolution, and relevance within the current market environment.

Zero expected return.

Assumption: Currencies have zero expected return, so currency management is unnecessary as it will add cost to the end.

Historically, diversified market returns have not added or subtracted meaningful return in multi-decade time horizons. Since the conclusion of the 1990s (1990-1999), currencies have generated value, reversing the US return low again in early 2007.

Data Source: Bloomberg Barclays Indices, Mesirow Currency Management, LLC. Data is presented in annualized returns. The chart represents the annualized 5-year return of the US dollar against all other major currencies. The chart is not intended to represent the performance of any specific investment vehicle. The chart is for informational purposes only and should not be used as a basis for investment decisions. The chart is subject to change without notice. The chart is not a recommendation or an offer to sell any investment vehicle. The chart is not a guarantee of performance. The chart is not a representation of the performance of any specific investment vehicle. The chart is not a recommendation or an offer to sell any investment vehicle. The chart is not a guarantee of performance. The chart is not a representation of the performance of any specific investment vehicle.

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