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LETTERS TO THE EDITOR

It's a misconception that currency hedging is necessarily expensive

Sir, Lex asserts, in "Currencies: money talks" (FT.com March 4), that "currencies follow long-term trends and are notoriously hard to predict", and that the "cumulative currency effect can be huge", but concludes that investors should "never predict currencies".

This is a false choice. Investors are inherently expressing a bullish view on foreign currencies when they typically buy foreign assets—without a hedge. If you have no view on a currency—and there are no theoretical reasons why currencies should add extra return to investors—why should investors take on the exposure and live with the uncompensated, unnecessary volatility?

Lex perpetuates a widespread misconception about currency hedging. Hedging is not necessarily expensive. The cost of hedging is essentially the short-term interest rate differential between markets and the bid/ask spread of trading hedges. Lex cites the euro-dollar pair. Currently the cost from using euro forward contracts on rolling monthly basis is 2-3 basis points per year. Currencies are the most heavily traded instruments in the world and the transaction costs decried as paying a "middlemen" are negligible for long-term investors. In addition, as US rates rise relative to Europe and Japan, dollar-based investors will be paid to hedge euro and yen exposure. To say the same thing, it looks like it will become "expensive" for investors not to hedge their euro and yen exposure.

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Hedge: Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Bid/Ask Spread: This is essentially the difference in price between the highest price that a buyer is willing to pay for an asset and the lowest price for which a seller is willing to sell it.

Forward contracts: Agreements to buy or sell a specific currency at a future date at an agreed upon rate.

Interest rates: The rate at which interest is paid by a borrower for the use of money.

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