

IT'S A MISCONCEPTION THAT CURRENCY HEDGING IS NECESSARILY EXPENSIVE

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One of the most common myths about hedging foreign currencies is that it's expensive. Misnomers persist about the cost associated with the financial contracts that are used to hedge foreign exchange exposures. While there may be a desire to hedge, some investors mistakenly believe the cost involved *always* puts them at a disadvantage. Recently, Jeremy Schwartz, WisdomTree's Director of Research, and Marc Chandler, global head of markets strategy at Brown Brothers Harriman, debunked this myth in a *Financial Times* letter to the editor...



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LETTERS TO THE EDITOR

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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 decreed 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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