CURRENCY TRADING VOLUME SOARS: WHAT DOES IT MEAN FOR YOUR PORTFOLIO?

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Every three years, the Bank for International Settlements (BIS) conducts a survey of global foreign exchange (forex) trading. This survey represents the market's most comprehensive source of information on global forex trading volumes and turnover. During the survey period in April 2013, foreign exchange markets averaged $5.3 trillion in turnover per day. In April 2010, trading stood at $4 trillion, and in April 2007, $3.3 trillion. As markets continue down the path of globalization and market participants transact, hedge and speculate, global foreign exchange trading volume will continue to grow. Given this dramatic increase, investors should consider what role currencies play in their portfolios. In our opinion, the most interesting developments in the 2013 triennial survey had to do with emerging markets. For the first time, the Mexican peso and the Chinese yuan made it into the top 10 most traded currencies in the world. In fact, both currencies actually doubled their overall share of trading volume since the last survey. Also markedly increasing in trading volume since the last survey was the Russian ruble. In our view, this is a result of recent reforms Russian policy makers have made in order to increase local market access. **Currency Distribution of Global Foreign Exchange Market Turnover (%)**

Country	Currency	2010		2013	
		Share	Rank	Share	Rank
U.S.	USD	84.9	1	87.0	1
Eurozone	EUR	39.1	2	33.4	2
Japan	JPY	19.0	3	23.0	3
Great Britain	GBP	12.9	4	11.8	4
Australia	AUD	7.6	5	8.6	5
Switzerland	CHF	6.3	6	5.2	6
Canada	CAD	5.3	7	4.6	7
Mexico	MXN	1.3	14	2.5	8
China	CNY	0.9	17	2.2	9
New Zealand	NZD	1.6	10	2.0	10
Sweden	SEK	2.2	9	1.8	11
Russia	RUB	0.9	16	1.6	12
Hong Kong	HKD	2.4	8	1.4	13
Norway	NOK	1.3	13	1.4	14
Singapore	SGD	1.4	12	1.4	15
Turkey	TRY	0.7	19	1.3	16
S. Korea	KRW	1.5	11	1.2	17
S. Africa	ZAR	0.7	20	1.1	18
Brazil	BRL	0.7	21	1.1	19
India	INR	1.0	15	1.0	20
Denmark	DKK	0.6	22	0.8	21
Poland	PLN	0.8	18	0.7	22
Taiwan	TWD	0.5	23	0.5	23
Hungary	HUF	0.4	24	0.4	24
Malaysia	MYR	0.3	25	0.4	25
Czech Republic	CZK	0.2	27	0.4	26
Thailand	THB	0.2	26	0.3	27
Chile	CLP	0.2	29	0.3	28
Israel	ILS	0.2	31	0.2	29
Indonesia	IDR	0.2	30	0.2	30
Philippines	PHP	0.2	28	0.1	31
Romania	RON	0.1	33	0.1	32
Colombia	COP	0.1	32	0.1	33
Saudi Arabia	SAR	0.1	34	0.1	34
Peru	PEN	0.0	36	0.1	35
Other	OTH	4.7		1.6	
Total		200.0		200.0	

Source: Bank for International Settlements (BIS), Average daily turnover for April 2013.
Note: Because two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%.
Highlighted countries denote emerging markets.

Outside emerging markets, while the U.S. dollar has maintained its standing as the world's reserve currency, the eurozone's share of global forex trading fell markedly. However, this decrease in volume is not singularly attributable to a rise in trade of the U.S. dollar. Looking at the data more closely, the increases in trading have actually been more widely distributed. In 2010, only 15 currencies accounted for more than 1% of overall total trading volume each; today the top 20 most traded currencies account for at least 1% of total volume each. In notional terms, these 20 currencies now trade in excess of $50 billion, on average, each day. When compared to trading volumes of other asset classes such as stock and bonds, this level of interest and liquidity is remarkable. Although recent performance against the U.S. dollar has resulted in losses for many emerging market currencies, the rise in their importance to global trade is continuing. As many of these countries continue along the path of market liberalization and development, we expect the current trend of financial market globalization to continue. Commensurate with this rise in prominence, currency fluctuations are continuing to be a significant driver of total returns not only in emerging markets but also in the developed world. For many investors, this creates an additional element of complexity when assessing investment opportunities around the world. In our view, it may make sense for investors to take a more proactive, tactical approach in managing their exposure to foreign currencies. As liquidity continues to increase and investors become more informed, the ability to efficiently access non-traditional asset classes expands their opportunity set. With government policy still having a significant impact on many economies' future growth trajectories, policy makers are carefully weighing the impact of their decisions on their currencies compared to their trading partners'. In our opinion, investors should be undertaking the same type of analysis when managing exposures in their portfolio.

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Foreign Exchange (FOREX, FX) : The exchange of one currency for another, or the conversion of one currency into another currency.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.