

## INVESTMENT NOTE

October 2010

### Currency Wars

The Implications for International Investment

We all read the headlines throughout the summer; *“The Dollar is going to reach parity with the Euro”*. Pundits and investors alike agreed, the debt situation in the euro zones peripheral nations was unsustainable and a collapse of the European ‘experiment’ was a distinct possibility. The Dollar rallied nearly twenty percent in the first half of the year briefly surpassing 1.20 against the Euro (the first time in four years).



Suddenly, however, a reality dawned that it was not just in Europe that the economic recovery was fragile. Speculation and subsequent confirmation that the US Federal Reserve would be forced into further quantitative easing (the now nicknamed “QE2”) hit the brakes on the dollar’s rise, and slammed it firmly into reverse gear. Fears that such creation (or printing) of new money will undermine the currency’s value has seen the dollar fall by over 10% during September along.

Such extreme currencies moves are being similarly echoed across the globe. The Japanese Yen is at a fifteen year high against the Dollar and the Australian Dollar has hit parity with the Dollar. Despite an “official” widening of its trading range the Yuan refuses to strengthen against the Dollar. By maintaining its currency at such low levels against the US Dollar, the Chinese government is risking further political and trade sanctions and the so called “Currency wars” will reach a crescendo during the forthcoming G20 IMF meetings.

Even with a strong understanding of the economic forces at play driving such extreme currency movements one thing is clear; **the potential risk (and gains) for investors seeking higher returns (or yield) through international investing has increased.** If we look at a recent trend, the rise of the precious metal Gold, one can see the disparity between a US denominated investor and a Sterling denominated one – the later making less than one percent (in local currency) since May, against a US investor who would have enjoyed an eight percent return over the same period. Such disparities are common and fortunately often work in our favour. Our earlier forays into the US and Japanese markets were based on our outlook for Sterling weakness and produced excellent returns.

However, we often find ourselves at cross roads in the market where we have no clear outlook for a currency’s future value. During such times it becomes prudent to ‘hedge’ any undesirable currency exposure. Of course any hedging activity is not without its complexities and cost. Fortunately there are many more efficient routes now available to us. Our European equity exposure is gained through a currency-hedged fund, the Argonaut European Enhanced income fund, which will protect us should Euro weakness return. We all know that there is no such thing as a free lunch and the flip-side of such an investment is that we will not benefit so fully should the Euro continue to appreciate against the pound. A more recent investment, written about in detail last month, is our investment in Japan. Fearing that the Yen will fall from its current heady heights prompted us to invest in the Japanese equity market through a Yen-hedged fund, the GLG Core Alpha Japan fund.

**Often we have a firm outlook for currency movements, but at other times we believe prudence is in the best interests of our clients and we will look to remove any un-necessary risk from our investments though currency hedging and other techniques.**

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