

Currency alpha programs can increase investment returns.

By Alfred G. Bisset, President

As a source of uncorrelated return, or alpha, which can increase an investment portfolio's total return, currency alpha programs have unique characteristics that fit the bill.

Adding foreign equities and fixed income to an investment portfolio reduces overall risk, while it permits some participation in the extra return currencies can provide over time. However, when those currency exposures are left unmanaged or are managed with a currency overlay program, the full potential currencies can provide remains untapped.

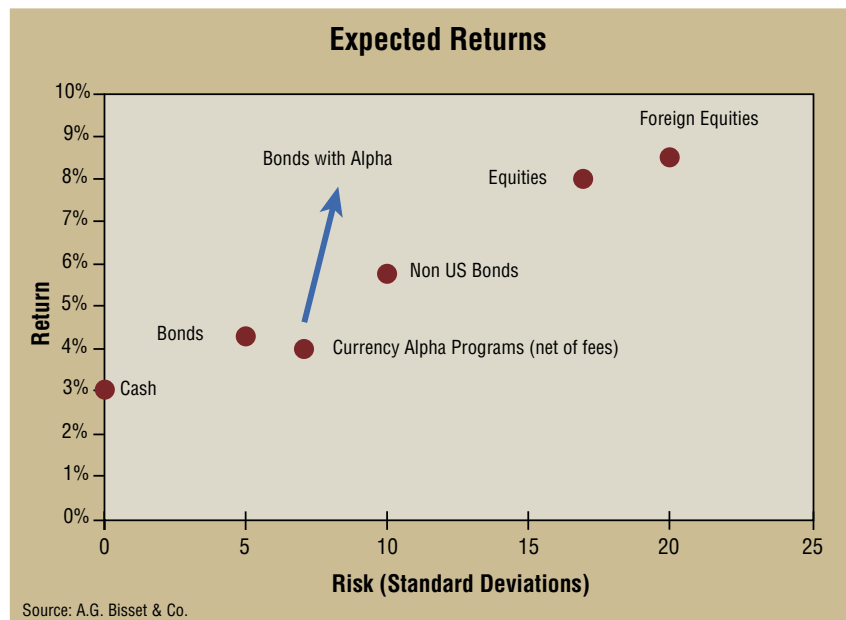
Pension consultants, like Russell/Mellon, Mercer, and Watson Wyatt, have found that the average currency overlay manager has produced excess returns, relative to their benchmarks, that have averaged around one percent per year in the past decade. That is more than the average excess return most active equity and fixed income managers have attained.

A currency alpha program, applied separately from any pre-existing currency exposure, can achieve excess returns that may annualize as much as four to five percent—with no leverage applied and with no up-front investment needed to reap the return.

To boost an investment portfolio's total return, a portion of its existing holdings must normally be sold and the proceeds reinvested in an alternative asset class, which has an expected return that exceeds that of the liquidated asset. Currency alpha programs, which are not hedge funds or fund of funds investing in currencies, do not need to meet that criteria. That is one reason a currency alpha program is a very attractive, uncorrelated source of alpha.

Because a currency alpha program is initiated like a currency overlay, with all long and short currency positions established with currency forward contracts, utilizing an FX trading line provided by a financial institution, the currency alpha return can be lower than that of any other asset in an investment portfolio and still increase the portfolio's total return. The currency alpha return is simply added on top of the other asset returns (see graph).

Another attractive feature of a currency alpha program is the nature of the return. Since currency price movements do not correlate with those of equities and fixed income, the addition of a currency alpha



program can reduce a portfolio's overall risk, while transparency and liquidity is maintained. The daily turnover in the global currency market is \$1.9 trillion, while currencies are priced continuously.

To profitably buy and sell currencies entails applying the same management and decision processes that are employed to hedge currency exposures actively. That is why currency overlay managers, like A.G. Bisset & Company—a two-time winner of Global Pensions magazine's "Currency Manager of the Year Award"—offers traditional currency overlay and stand alone currency alpha programs.

With equity and fixed income returns likely to be lower in coming years, when compared against those in the past decade, currency

alpha programs, with risk-profiles similar to those of stocks and bonds, will likely become as universally accepted and common as investing internationally is today. Forward-looking and innovative pension funds in the United States and Europe have already taken the first steps, and assets managed in currency alpha programs are growing very rapidly.



A.G. Bisset & Co., Inc.
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Contact Information

Alfred G. Bisset, President
Ulf J. Lindahl, Chief Investment Officer
A.G. Bisset & Co., Inc.
(203) 866-3540
inquiries@AGBisset.com
www.AGBisset.com