

Absolute Return Currency Strategy



An alternative return-source with
low correlation to traditional asset classes



Introducing our absolute return currency capabilities

In an environment characterised by low expected returns, investors continue to seek ways to improve their multi-asset portfolio returns through more dynamic allocations, diversification and opportunities to add value in non-traditional areas. In this paper, we explain why now is the time to consider a new approach to managing currency exposure and the different ways you could incorporate Russell Investments' Absolute Return Currency Strategy into your portfolio. Read on to learn more.

The challenge

Currency management is an often-overlooked aspect of multi-asset portfolio management. Some investors simply believe that it is a zero-sum game and therefore can be ignored. Others view it as difficult to access a cost-effective currency strategy that adds value. However, what is often unappreciated is that currency can present very attractive return characteristics, with little to no correlation to traditional asset classes. For this reason, investors can potentially add value by incorporating a currency strategy into their portfolio – a strategy specifically designed to deliver alpha and lower total portfolio risk.

There is widespread academic evidence showing that currency factors can offer meaningful, persistent and relatively uncorrelated return sources. Russell Investments believes that, Carry, Value and Trend are the three currency factors that are best placed to generate these positive returns at moderate volatility over long periods:

- **Carry** captures the tendency of higher-interest-rate currencies to generate higher returns than lower-interest-rate currencies, as a compensation for higher risk.
- **Value** takes advantage of the tendency of currencies to mean-revert to a level of long-term economic equilibrium, such as purchasing power parity.
- **Trend** exploits the propensity of currency returns to persist over short-to-medium-term horizons, so that past returns have some predictive power for future returns.

While each of the currency factors, in isolation, has experienced periods of significant negative returns, these falls do not often occur at the same time across the three factors. As such, we believe there is an advantage to investors in accessing a strategy that blends all three currency factors. A rules-based approach offers a cost-effective way to access these risk premia.

The benefits of a well-planned currency strategy



Return sources, especially attractive given expected returns from traditional assets are low.



Currency factors (Carry, Value and Trend) offer opportunities for positive returns.



Russell Investments' **world-class implementation** ensures cost-efficient capture of currency factors.

Why is now the right time to consider currency factor investing?

In today's challenging markets, investors are keen to explore all means available to improve multi-asset portfolios returns, including more dynamic allocations, diversity and opportunities to add value in non-traditional areas. Another way is to be a more discerning buyer of skill, leading to the increased consideration of transparent, rules-based smart beta strategies in areas where the investor can gain exposures to systematic and replicable factor returns more cost-effectively.

Our internal analysis shows that Carry, Value and Trend explain a substantial part – as much as half – of successful active currency manager returns over the last decade. We also find that only about 15% of active currency managers generate alpha that goes over and above exposure to these three currency factors.

Given that the currency markets are also liquid, with low trading costs, this creates a powerful basis for a transparent rules-based strategy. Such strategies should offer simple, fundamental capture of the currency factors that is not over-engineered and thus susceptible to hindsight bias. Such a systematic, rules-based approach lends itself to low-cost management and thus more efficient capture of these factors than the majority of active managers.

Putting strategy into practice

Investors can incorporate the Absolute Return Currency Strategy into their portfolios in different ways:

1. As an absolute return strategy
2. As part of their currency overlay program

In each case, the strategies are implemented with currency forwards, which is a very efficient use of capital. This allows the rest of the portfolio to remain invested in equities, bonds and other long-only asset classes with minimal impact to the rest of the portfolio. Making intentional decisions on currency can be a valuable return source. This is especially important when expected returns from traditional asset classes are low.

We designed the Absolute Return Currency Strategy to be a robust and transparent rules-based strategy, providing efficient and diversified exposure to Carry, Value and Trend factors. Over the last 20 years, this strategy has achieved strong returns with low correlation to traditional assets. As such, it offers investors the opportunity to enhance multi-asset portfolio returns with modest or no additional risk. While the core version of the Absolute Return Currency Strategy offers a robust investment solution, there is also scope for investors to design custom versions or to consider an enhanced version of the strategy, using volatility indicators to vary the weight of Carry.

Recognised as a leader in customised portfolio solutions

Currency Manager of the Year



Top Tier Broker



Past performance is not a guide to future performance.

For more information

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