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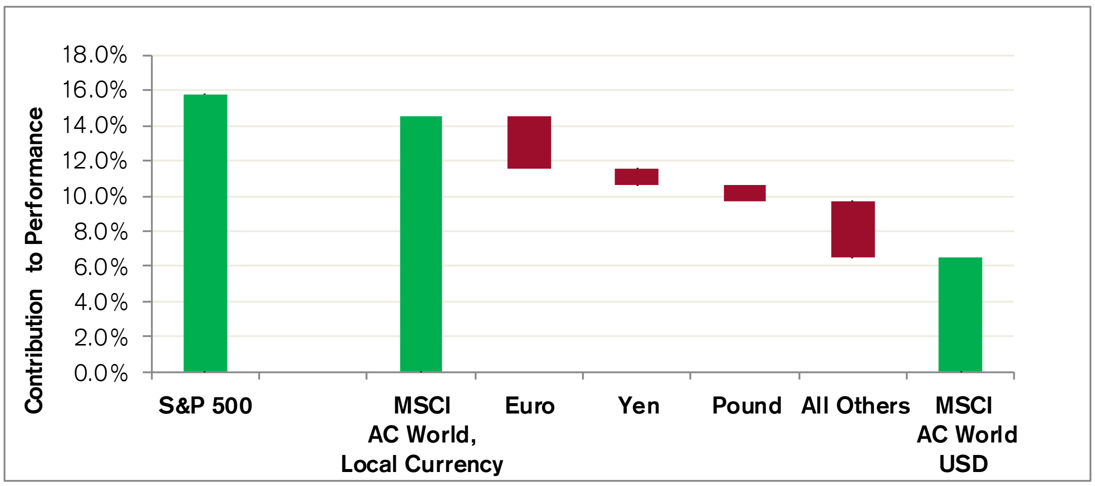
Currency Impact: Short-Term Pain, Long-Term Gain

April 2015

In this note, the portfolio managers discuss how the strength of the Dollar has been a headwind for US-based investors who own global equities.

- **The Dollar has significantly outperformed all other currencies.** This is a headwind for US Dollar-based investors who invest globally. While the MSCI All Country World index generated a +14.5% return in local currency terms, the index is only up +6.5% when translated back into US dollars.

Impact of Foreign Currency Depreciation on MSCI AC World Index (December 31, 2013 - March 30, 2015)



- In 2014, **the US Dollar experienced its single biggest annual move in 15 years.** In the 1Q15, the US Dollar continued appreciating. Over 2013-1Q2015, the dollar has seen two+ consecutive years of positive performance. **This has not happened since 2000/01, which was followed by three years of negative performance for the Dollar.**

One-Year Annual Returns (Trade Weighted Currency Indecies)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Highest Return	USD 5.8%	USD 4.9%	EUR 11.1%	AUD 21.1%	CAD 6.7%	CAD 5.0%	GBP 5.5%	CAD 15.5%	JPY 31.5%	AUD 19.2%	CHF 15.3%	JPY 5.8%	GBP 2.7%	EUR 6.5%	USD 8.5%	CHF 7.4%
	CHF 5.0%	CHF 3.2%	JPY 10.0%	CAD 19.6%	JPY 2.4%	USD 3.3%	EUR 3.8%	AUD 5.2%	CHF 12.9%	CAD 15.0%	JPY 12.6%	USD 2.9%	CAD 2.2%	CHF 5.8%	GBP 4.1%	USD 6.2%
	EUR (0.9%)	GBP 3.0%	CHF 6.2%	EUR 11.4%	CHF 2.1%	GBP (1.1%)	AUD 3.7%	EUR 3.9%	USD 10.6%	GBP 7.2%	AUD 5.4%	GBP 2.7%	AUD 1.9%	USD 1.8%	EUR 0.1%	JPY 2.7%
	GBP (1.7%)	EUR (0.1%)	AUD 3.9%	JPY 5.3%	EUR 1.5%	AUD (2.9%)	CHF (1.1%)	JPY 1.6%	EUR 8.2%	CHF 0.3%	CAD 4.4%	CHF 2.3%	CHF 1.3%	GBP 1.0%	CHF (0.4%)	GBP 2.1%
	CAD (2.1%)	AUD (1.9%)	CAD (0.1%)	GBP (2.6%)	AUD 1.4%	CHF (3.3%)	CAD (1.8%)	CHF (1.2%)	AUD (12.4%)	EUR (1.1%)	GBP (0.6%)	EUR 0.7%	EUR (0.9%)	AUD (5.9%)	AUD (1.1%)	AUD (3.2%)
	AUD (3.0%)	CAD (4.9%)	GBP (1.6%)	CHF (3.6%)	GBP 1.1%	EUR (6.7%)	USD (3.7%)	GBP (6.9%)	CAD (16.6%)	USD (5.2%)	USD (0.8%)	AUD (1.0%)	USD (1.6%)	CAD (7.4%)	CAD (4.8%)	CAD (5.7%)
Lowest Return	JPY (5.2%)	JPY (13.4%)	USD (2.6%)	USD (8.7%)	USD (4.5%)	JPY (11.3%)	JPY (5.3%)	USD (7.5%)	GBP (21.8%)	JPY (6.0%)	EUR (7.0%)	CAD (1.7%)	JPY (12.3%)	JPY (15.8%)	JPY (6.7%)	EUR (6.6%)

*Returns calculated based on the annual change in Morgan Stanley's Trade Weighted FX Index available on Bloomberg

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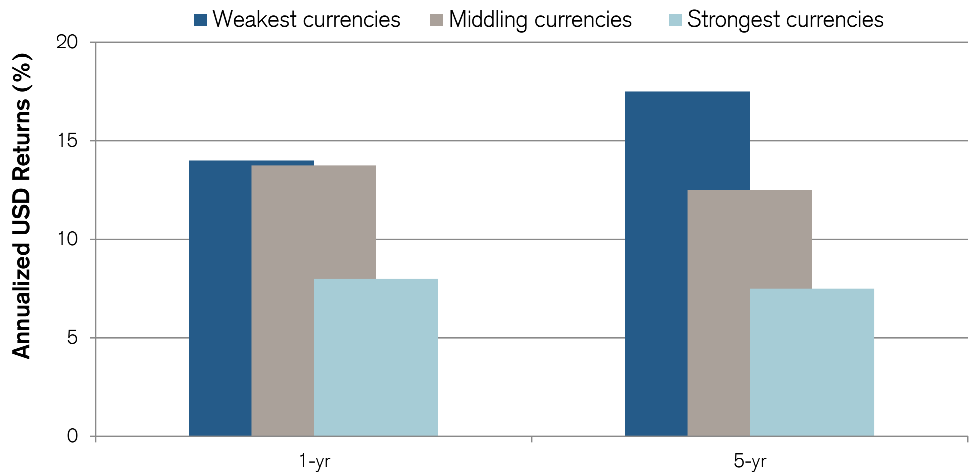
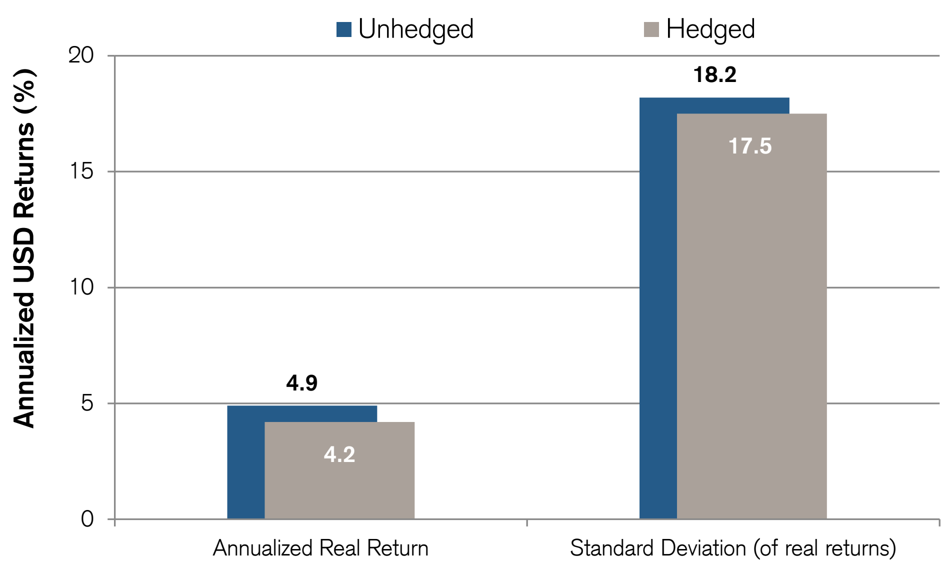
- It is very **difficult to predict future currency moves**, which **tend to be short-lived and highly mean-reverting. In fact, Credit Suisse research shows that equities performed best after currency weakness, not strength.** The Credit Suisse study[1] showed that **the equities of weak currencies outperformed the equities of strong currencies by 6% in the one-year periods following exchange rate changes and by 10% in the subsequent five-year period.** Equities can prosper after currency weakness through higher corporate cash flows and earnings which are boosted by increased competitiveness and export opportunities.

Equity Returns and prior exchange rate changes



- The same Credit Suisse study also showed that **hedging reduces risk adjusted returns.** Investors, who remain unhedged, generated an annualized real return of 4.9% on 18.2% of volatility in global developed equity markets between 1972 to 2012. On the other hand, USD based investors who hedged their foreign currency exposure, generated an annualized real return of 4.2% on 17.5% of volatility. The study did not include hedging transaction costs, which would naturally reduce returns further.

Risks to local versus dollar-based investors



- What does this mean for global investors? **We recommend remaining currency unhedged if an investor has a sufficiently long time horizon (3+ years).** Over the short-term, currency moves certainly can negatively impact performance. But over the long-term, exposure to foreign currencies has been very beneficial, particularly following periods of currency weakness.

[1]Elroy Dimson, Paul Marsh, Mike Staunton "*Currency Matters*" Credit Suisse Yearbook 2012

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