Insights

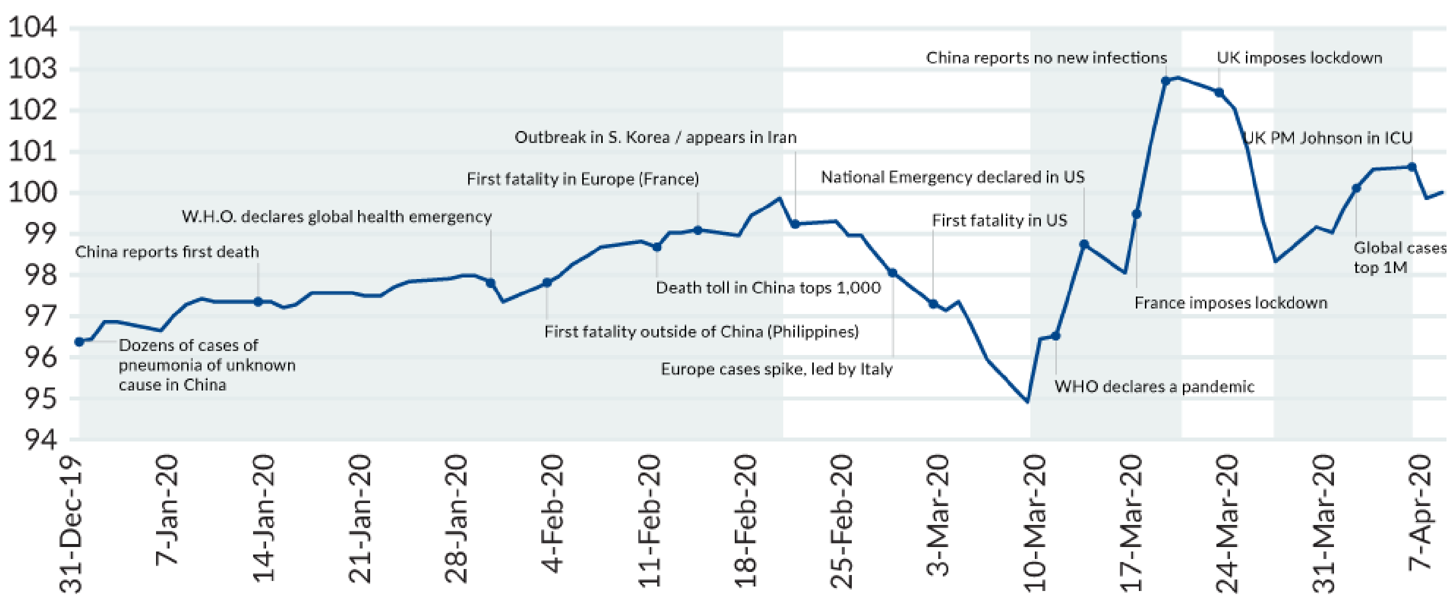
FX Perspectives

As 2020 advances amid the coronavirus epidemic, the financial market reactions have reflected the magnitude of concern felt by the world on a global scale, with currency risk weighing heavily on international investors. Since our previous paper in late February, risky assets have continued to be under pressure, with peak-to-trough drops of -34% in both the S&P 500 and MSCI World thus far this year. The safe-haven qualities of US dollar have attracted investors, particularly during the episodes of equity weakness, as periods of risk-off have dominated the marketplace.

We have updated the timeline below (Figure 1) through early April, tracking the Dollar Spot Index with corresponding events related to the coronavirus. While US dollar has appreciated overall during this period of uncertainty as both a safe-haven and funding currency, the volatile nature of currencies has been evident during these turbulent times.

Three periods of outsized appreciation have been shaded, with US dollar strength of +3.61%, +8.35%, and +2.36%, respectively. The periods of weakness, spurred initially by proposed US interest rate cuts and fears over stifled US growth followed by a strong reversal in the equity markets, punctuate the intra-period volatility experienced over the first quarter.

FIGURE 1: Dollar Spot Index - Coronavirus Timeline



Source: Bloomberg, The New York Times (https://www.nytimes.com/2020/02/13/world/coronavirus-timeline.html). Past results are not necessarily indicative of future results. Actual results may materially differ from those shown above. Please refer to the disclaimer page for important additional information.

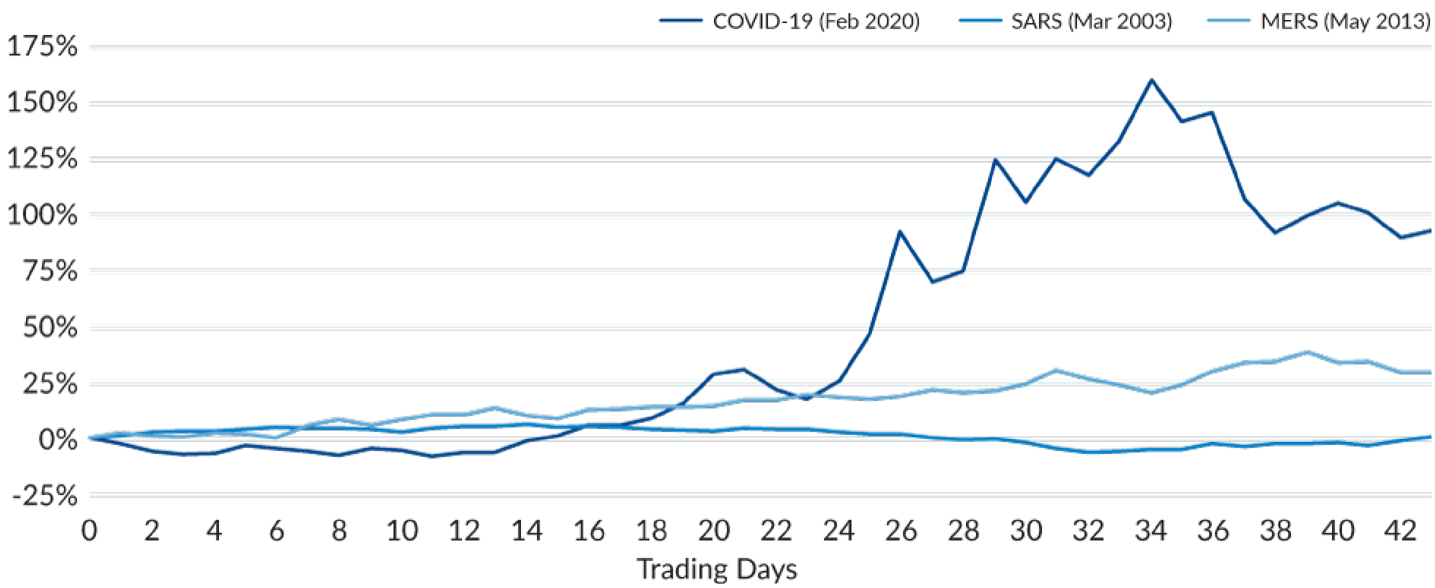
When we last looked in late February, we noted the surge in FX volatility from elevated uncertainty. When comparing COVID-19 to the other coronavirus variants, SARS and MERS, a common increase in FX volatility over a month's period during the early days of each outbreak was evident.

Updating over the next month, the JPM Global FX Volatility Index during COVID-19 has exploded beyond the 25% increase we saw before, peaking at a 160% increase from the start of February (Figure 2), dwarfing the moves in SARS and MERS over an analogous number of trading days.

The higher magnitude and growth of currency volatility during COVID-19 can be attributed to its infection rate and cross-country contamination, making this more of a global event than either SARS or MERS. COVID-19 infected more than one million people in three months; SARS infected just over eight thousand in eight months; MERS required a year to infect 108 people. COVID-19 has affected 209 countries and territories, while both SARS and MERS were highly concentrated in particular regions, with 87% of SARS concentrated in China and Hong Kong, and all cases of MERS linked to the Arabian Peninsula. COVID-19's global reach and evolutionary uncertainty threatens to keep currency volatility elevated and to pressure equity markets during this risk-on/risk-off dichotomy, until a more stable situation is reached across the globe.

Mesirow Currency Management continues to recommend having a currency risk management policy in effect at all times to mitigate currency risk and to control for downside protection in falling currency markets. Without such a policy in place, important and sizable investments in international markets are exposed to unforeseen high volatility periods such as the one we are experiencing with the coronavirus. Please stay safe during these uncertain times.

FIGURE 2: JPM Global FX Volatility Index - Virus Comparison



[DOWNLOAD]

Source: Bloomberg. Past results are not necessarily indicative of future results. Actual results may materially differ from those shown above. Please refer to the disclaimer page for important additional information.

Sources:

World Economic Forum - https://www.weforum.org/agenda/2020/02/comparing-outbreaks-coronavirus-mers-sars-health-epidemic

The New York Times - https://www.nytimes.com/2020/02/13/world/coronavirus-timeline

https://www.worldometers.info/coronavirus/

https://www.cdc.gov/about/history/sars/timeline.htm

https://www.npr.org/sections/goatsandsoda/2020/01/22/798277557/how-does-wuhan-coronavirus-compare-to-mers-sars-and-the-common-cold

https://www.cdc.gov/coronavirus/mers/us.html

repeat such patterns and/or be profitable or reflect the currency movements illustrated above.

Comparisons to any indices referenced herein are for illustrative purposes only and are not meant to imply that a strategy's returns or volatility will be similar to the indices. The strategy is compared to the indices because they are widely used performance benchmarks.