Superannuation

How YFYS test will change currency investments

BY ELIZABETH MCARTHUR | THURSDAY, 2 SEP 2021 12:23PM

A panel at the Australian Institute of Superannuation Trustees (AIST) ASI 2021 conference has discussed how the Your Future, Your Super test and ESG will change funds' approaches to currency.

QIC head of currency Stuart Simmons said super funds could be getting more out of currency hedging strategies than they are right now.

In fact, he showed data indicating that currency can easily represent the second largest risk factor - after equities - in the balanced portfolios of Australian super funds.

"Higher hedge ratios have historically been associated with higher returns over the long run, driven largely by elevated AUD interest rate 'carry'," Simmons said

For example, he said there was a 30% difference in returns between fully hedged and unhedged global equities during the GFC and a 15% difference during the COVID-19 induced market volatility in March 2020.

This is relevant to how funds respond to the YFYS reforms, he said.

"In an era of YFYS performance tests, a fund's survival may hinge on getting more out of each asset class," Simmons said.

"All aspects of the investment framework are being examined. This also creates a big opportunity through the currency hedging framework and implementation techniques to manage risks and generate lasting and material outperformance to that benchmark."

Trying to outperform the benchmarks is one way to address YFYS, another is to hedge against the risk of benchmarks, and another is to focus on cost reduction, he explained.

Later in the discussion, Simmons suggested funds should avoid relying on the London 4pm rebalance - excess concentration of large one-way orders and potentially some speculative trading around fixing times has created distortion in some FX markets.

A more active rebalancing strategy can mitigate this. Simmons suggested a more responsive rebalancing strategy can add 40 basis points to a global equities portfolio over a "set and forget" approach.

Then, on the topic of ethics, Simmons emphasised adopting and adhering to the FX Global Code, saying it is also crucial for super funds to prove that they are trading currencies in responsible and ethical manner.

Mesirow chief executive Joseph Hoffman expanded on the role of ESG factors in super fund currency programs.

He argued that taking ESG into account in currency can actually add alpha to portfolios. With ESG integration becoming the standard, it is possible to look at ESG scores at a country level.

In turn, super funds can apply this ESG approach to the currencies corresponding with those nations.

"There has been such a huge focus on ESG in equities and bonds... ESG data can now be looked at at a country level, and incorporated into your currency analysis," Hoffman said.

Mesirow looked at the ESG scores of 28 countries in its research. It found that emerging market economies had some of the lowest ESG scores, and he argued this should be considered in currency strategies.

Financial Standard is the official media partner of AIST's Super Investment Conference for 2021.