Currency Management

The Last Tool in the Central Banker's Toolbox

Brian Delaney

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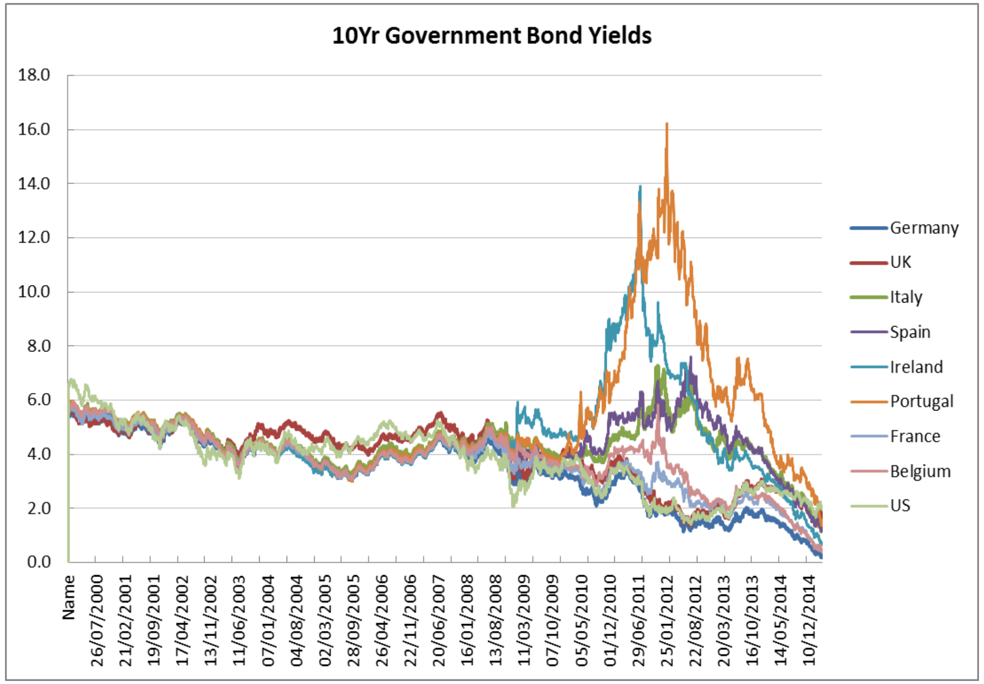
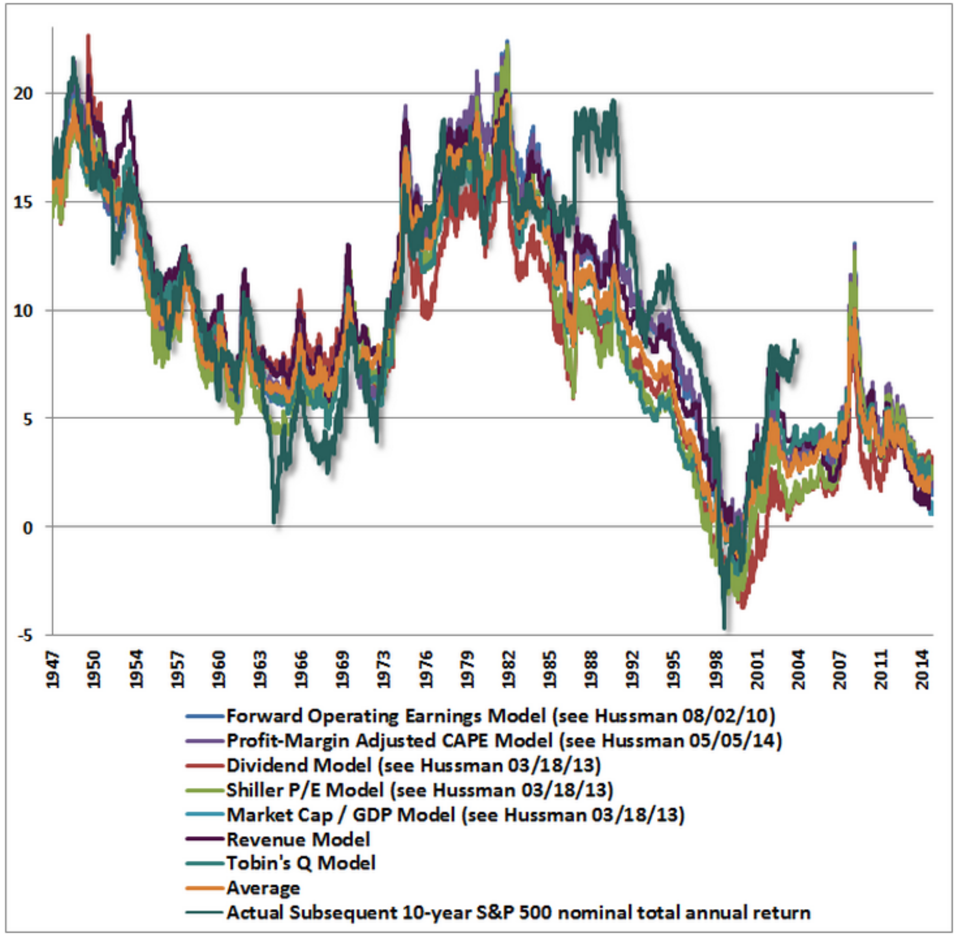
When interest rates hit zero... and QE has stretched market valuations...



Monetary policy effectiveness is limited and only enforceable through the currency.



Prospective 10-year total returns for S&P 500 based on a variety of historically reliable valuation measures (RHS chart). Source: www.hussmanfunds.com

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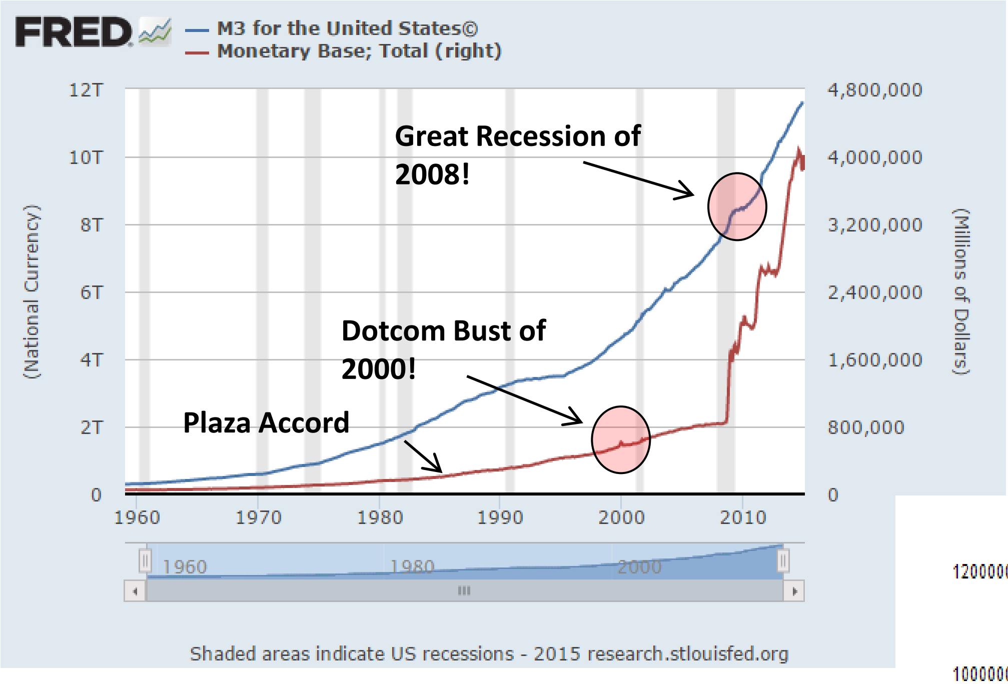
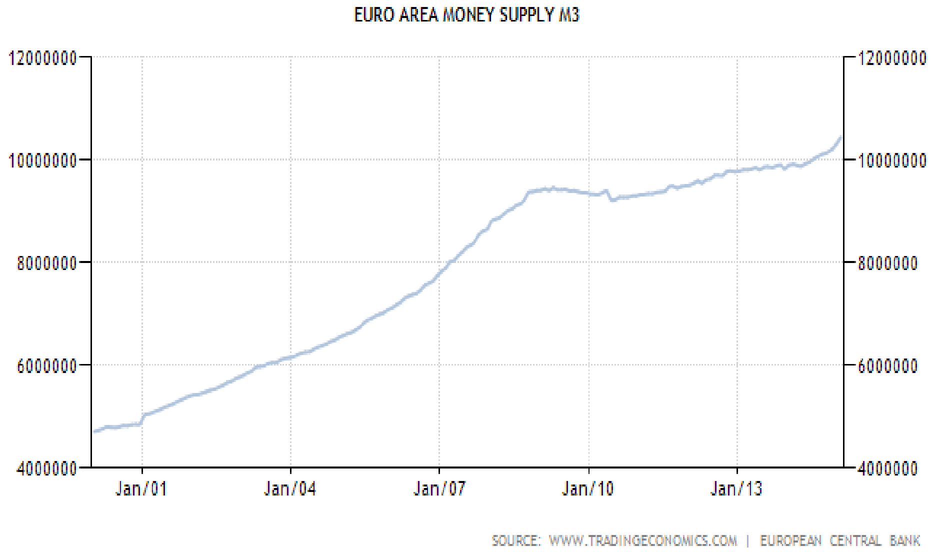


- The Fed increased the monetary base by over $3TN in 6 years from 2008-2014.
- The ECB recently announced a €1TN asset purchase programme.
- What impact does money printing on such a scale have on global currency markets?

- US money supply (M3 left) has increased from $3.5TN in 1995 to $5TN in 2000, to $7TN in 2007 and to $12TN today.
- The Euro Area money supply (M3 below) has grown from €4TN in 2000 to over €10TN today.



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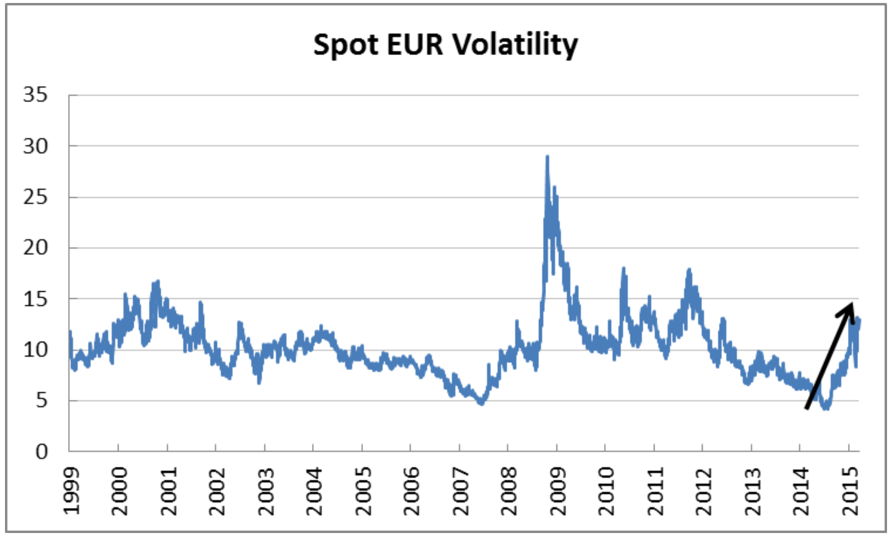
cally, interest rates served as a relative pricing mechanism for currencies

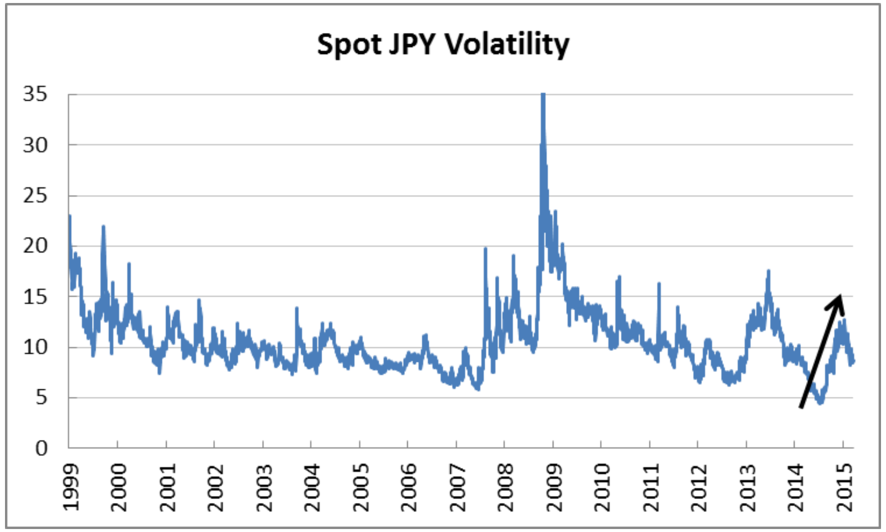
When investors are bullish on a currency, demand drives the exchange rate higher and interest rate lower until the currency appreciation offset s the lower interest rate earned on that currency.

Today, as central bankers keep the major currency rates near zero, interest rates no longer discount future exchange rate moves.

Changes in spot currencies have become the only way to resolve the imbalance and spot currency rates are getting more volatile.

Central bank intervention is leading to price instability (in direct contravention of their mandate) and rising volatility in currency markets.





Today, interest rates no longer discount future exchange rate moves

CHF surged +40% vs. EUR in 2 minutes on 15th January 2015….

…. while the Swiss stock market plunged -20% in hours.

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Spot EUR is swinging aggressively versus USD and is -25% in last 12 months

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Spot USD has gained +62% versus JPY in three years

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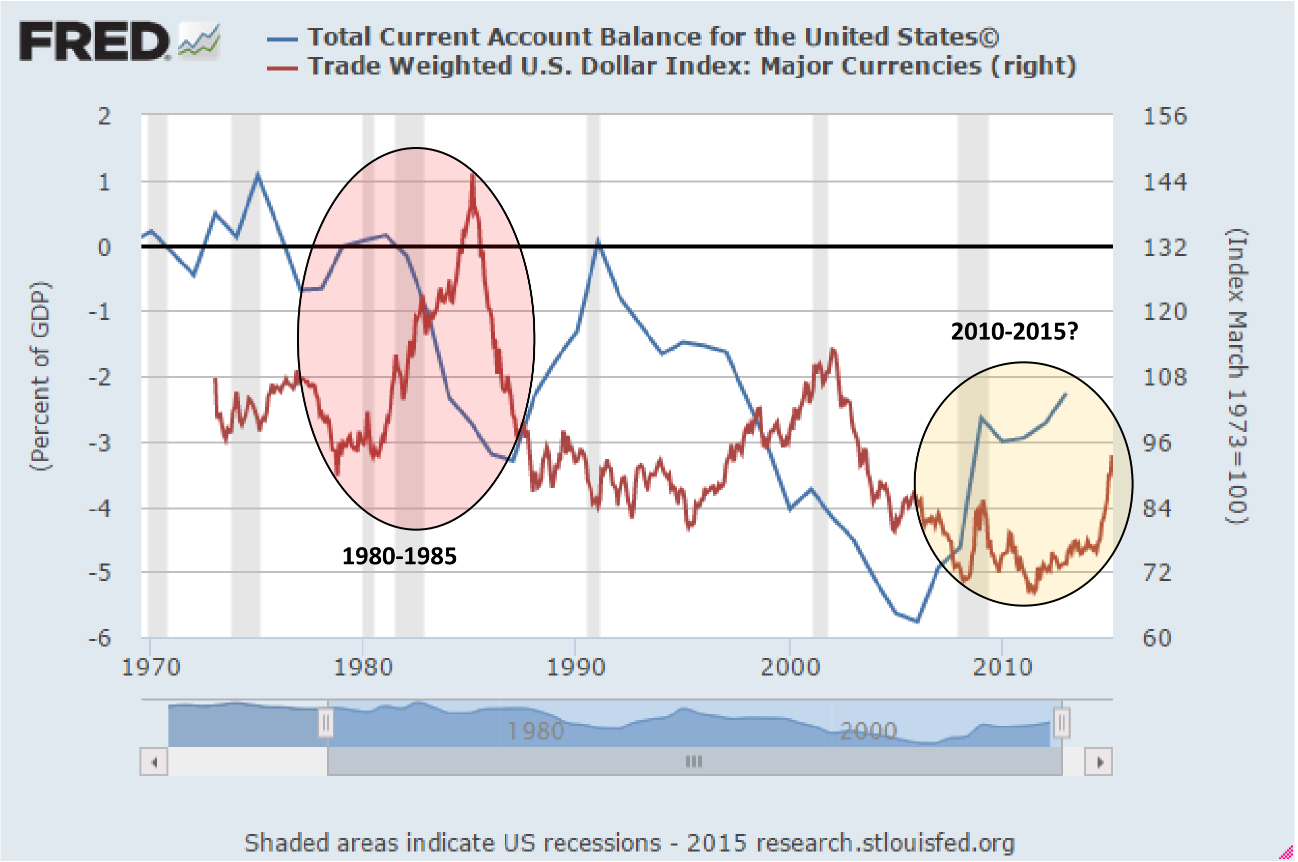
How long with the United States tolerate a rising USD before they take action?

- USD Index is +38% since 2011;
- A +65% rally implies 120 on USD Index;
- Similar to level reached in 2001/2;
- Implies $0.85-$1.00 versus EUR.

A step back in history….. In the lead up to the Plaza Accord in 1985…..

- Volcker killed inflation by raising rates to 20% by 1981; *Led to a +65% rally in USD Index* vs JPY, DEM, FRF, GBP;
- By 1985, *US had -3.5% current a/c deficit* and 4.2% GDP growth, while Germany & Japan ran large current a/c surpluses but had negative GDP growth;
- Plaza Accord was successful at reducing US trade deficit with Europe but failed to alleviate US trade deficit with Japan;
- First time central banks agreed to intervene in currency markets.
- US devaluation was planned, orderly and pre-announced, so did not lead to financial panic.



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There are quite a few similarities between 1985 and today.....

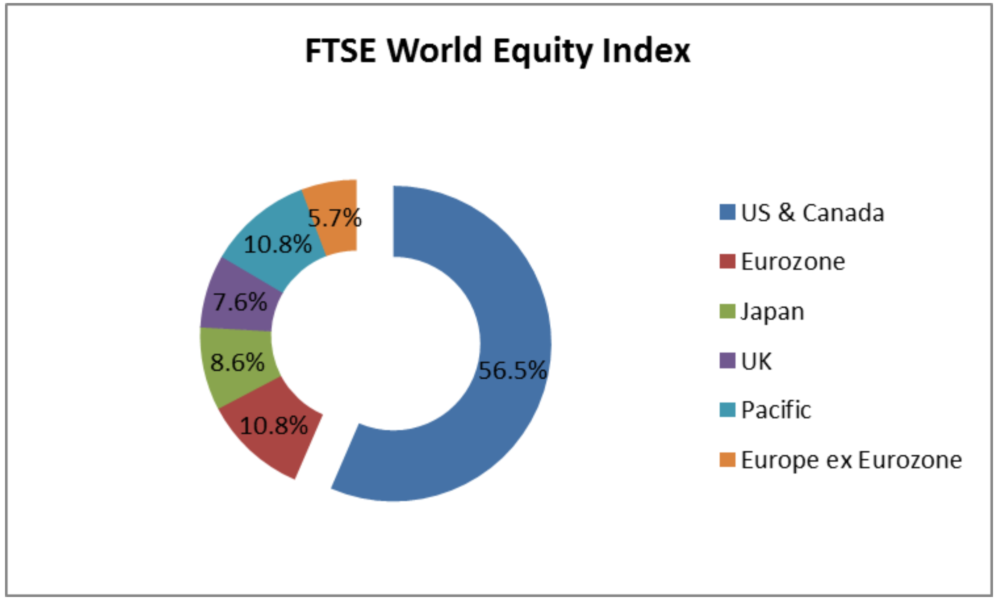
	1985	2015
US GDP	4.2%	2.4%
US current account	-3.5%	-2.6%
US Debt/GDP	**55%**	**102%**
US 10Yr Yield	**10%**	**2%**
US inflation	3.6%	1.6%
US unemployment	7.2%	5.7%
USD Index (trough to peak)	**+65%**	**+38%**
Key trading partners	Germany, Japan	China
Gold	$300	$1,200

It is reasonable to expect a rally in USD Index to 120 and EUR/USD at $0.85 - $1.00.

How should a Euroland investor managing their non-euro currency exposure?

89% of the global equity benchmark is invested outside the Eurozone

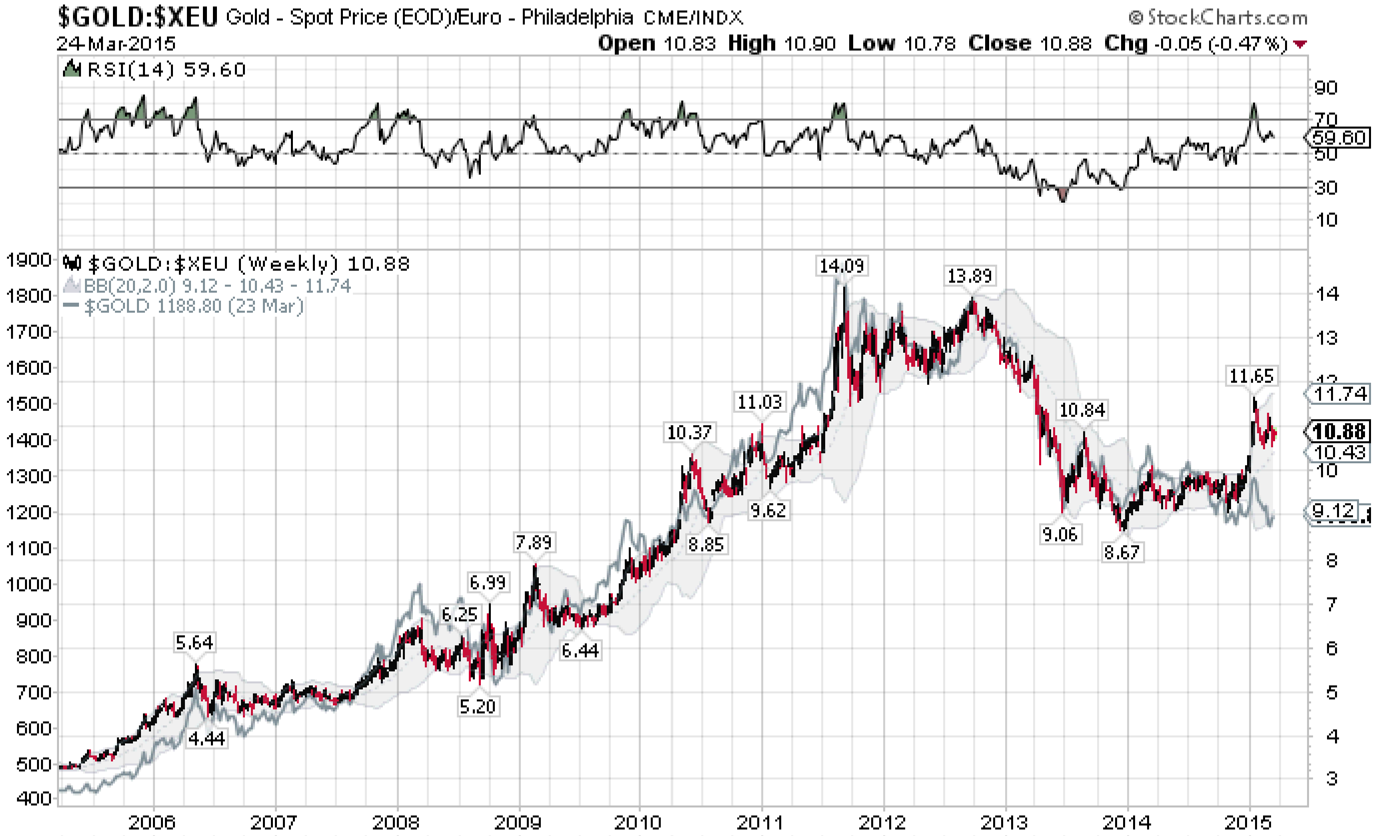
- Investment managers and trustees have tended not to take an active currency decisions when managing investment portfolios.
- As currency volatility increases, it may make sense to revisit the impact currency volatility has on portfolio performance.
- Hedging extreme currency moves has the potential to produce an additional source of return for the astute investor.



We recommend hedging to protect against extreme currency moves….

- Two Potential solutions:
- Work with your investment manager to implement a currency overlay strategy; or
- Invest in a mix of hedged and unhedged global equity share classes actively managing the allocation to each over time.

The safest currency of them all….



- Considered money for thousands of years;
- Just the last 45 years since Nixon removed the US from the Gold Standard….
- Store of value
- Diversification
- Insurance

	2007	2008	2009	2010	2011	2012	2013	2014	2015 YTD	Cumul.
Equities	-0.8%	-37.2%	27.2%	20.1%	-2.4%	15.3%	21.3%	19.8%	16.2%	**80.8%**
Bonds	0.5%	10.4%	4.1%	0.9%	3.9%	15.2%	2.3%	20.6%	6.7%	**83.7%**
Gold	18.6%	9.5%	20.9%	38.6%	13.6%	5.3%	-31.0%	11.6%	10.8%	**122.0%**

Thank You!