



Managing Currency

With the diversification into assets denominated in foreign currencies, currency overlay has seen huge growth in the last 24 months, as it has become clearly obvious that the currency attributes within a portfolio have a significant impact on its value at risk (VaR). Since 2005, J.P. Morgan has provided Passive Currency Overlay (PCO) services to both custody and noncustody clients—including pension and charity funds, asset managers, hedge funds and funds of hedge funds—and currently handles more than \$26 billion in assets under management.

Currency overlay segregates the currency component from other investments within a portfolio allowing its separate management overlaid over the top of other assets. Currency overlay programmes can be classified in two ways: **active currency management** and **passive currency management**. A combination of active and passive overlay is used when a fund seeks a balanced risk reduction and alpha generation.

Active Currency Management

Active mandates are suitable for funds seeking noncorrelated return (alpha) from currency risks. Active managers are given discretion to vary programme parameters with their objective to

beat a given benchmark. There are four main styles of active managers: fundamental, technical, quantitative and qualitative.

J.P. Morgan's Asset Management business was one of the pioneers in active currency management, launching its active currency product in 1989. This is a blended management style approach to active currency management, combining fundamental, technical, quantitative and qualitative decision making into a proven investment process for both developed and emerging market currencies. J.P. Morgan Asset Management offers pooled solutions, or segregated portfolios tailored to clients' specific requirements, with detailed currency attribution and reporting.

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of any size. Adam Weiner, of J.P. Morgan Investment Bank's Global FX Services & Solutions group, added: "Clients are constantly seeking efficient methods of managing

Passive Currency Management

The main objective is to neutralise FX market risk exposures to a client's base currency, arising from its investment in international assets denominated in currencies other than the base currency. Smoothing out the peaks and troughs associated with currency fluctuations on the value of international investments provides increased stability to asset values.

Passive Currency Overlay Mitigates Risk

Responding to requests and enquiries from clients to provide a cheaper and more flexible service than that traditionally provided by specialist currency managers to passively reduce risk, J.P. Morgan Investor Services, in conjunction with J.P. Morgan Investment Bank's Foreign Exchange & Rates division, has established a Passive Currency

Overlay (PCO) product to mitigate those currency risks through a systematic hedging process. David Brown, global head of Foreign Exchange for J.P. Morgan's Treasury & Securities Services,

said: "We are increasingly seeing demands from our custody clients and firms that don't currently use our custody services for currency hedging solutions, utilizing the liquidity, transparency, risk management and overall execution capabilities of our investment bank's FX business."

As one of the largest providers of liquidity to the currency markets worldwide, J.P. Morgan is acknowledged as one of the world's leading FX banks, with an estimated 8% to 10% share of the \$3.2 trillion per day foreign exchange market. This means J.P. Morgan is able to offer clients the PCO service at a low cost, with access to competitive rates, benchmarking and absolute transparency around all aspects associated with managing currency positions and market exposure on portfolios

their nonalpha risk to preserve their investment performance. Working in partnership with J.P. Morgan Investor Services, we are constantly exploring solutions to retain our first-class client servicing across our franchise."

Drawing on the FX liquidity and execution capabilities of J.P. Morgan's Investment Bank, and the operational and servicing strengths of the J.P. Morgan Investor Services franchise, the PCO product is designed to address all the needs of investors, namely: customized implementation and management, cost-efficiency, risk management, flexibility, transparency, reporting and customer service.

J.P. Morgan's PCO programme is a fully automated solution allowing clients to outsource the operational risk and cost of running a similar programme in-house, and complements J.P. Morgan Investor Services' current suite of FX products. It is a bespoke service designed for ease of setup and operation, with simplified documentation, no minimum portfolio requirements and no onerous ongoing management required on the part of the client. Using accounting valuation data provided to J.P. Morgan, we are able to establish hedging requirements in accordance with predefined programme parameters. The PCO product can be operated in conjunction with your existing custodian relationship, and it is not necessary for J.P. Morgan to be either custodian or fund accountant for those assets to be hedged.

FX forward contracts are used which are liquid and simple to transact and settle. The programme also allows clients to hedge exposure to restricted emerging markets currencies through the use of nondeliverable forwards (NDFs).

For further information on our **Passive Currency Overlay** program, please contact:

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Risk