

Active Currency Management: Building Better Portfolios

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Agenda

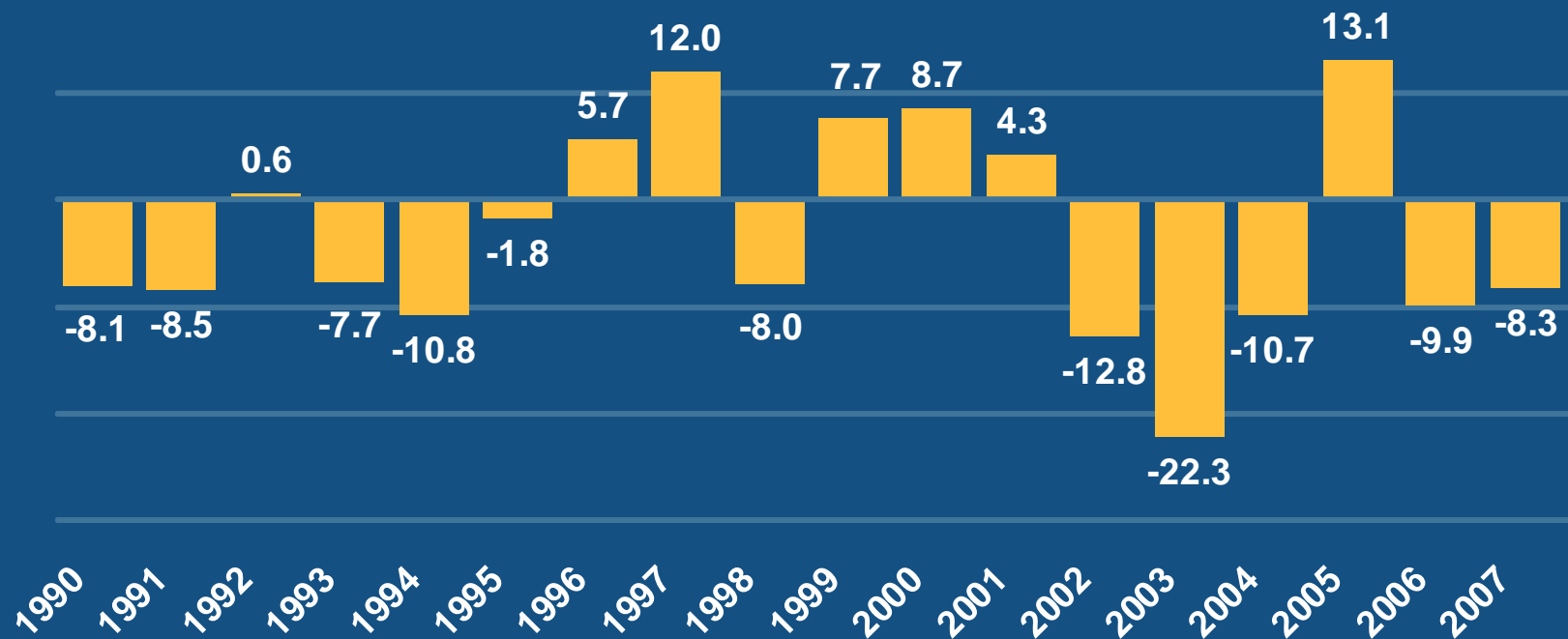
- The impact of currency
- What should we do with our currency risk?
- Exploring currency factors
- Active currency in practice



Assessing the impact from currency

- Minimal long-term impact of unmanaged currency exposures; however, shorter-term differences can be dramatic

MSCI EAFE HEDGED VS UNHEDGED ANNUAL RETURNS(%)



Can this dispersion be managed?

- Certain factors have a proven long-term influence on currency returns, much like those commonly seen in other asset classes

Attractive characteristics within stocks

Strong cash flows

Low P/E, P/B ratios

High and rising ROIC

Dividend yield

Attractive characteristics within currencies

Interest-rate levels and trends

Portfolio flows

Technical factors

Valuation



Low correlation with other assets makes adding active currency intuitive

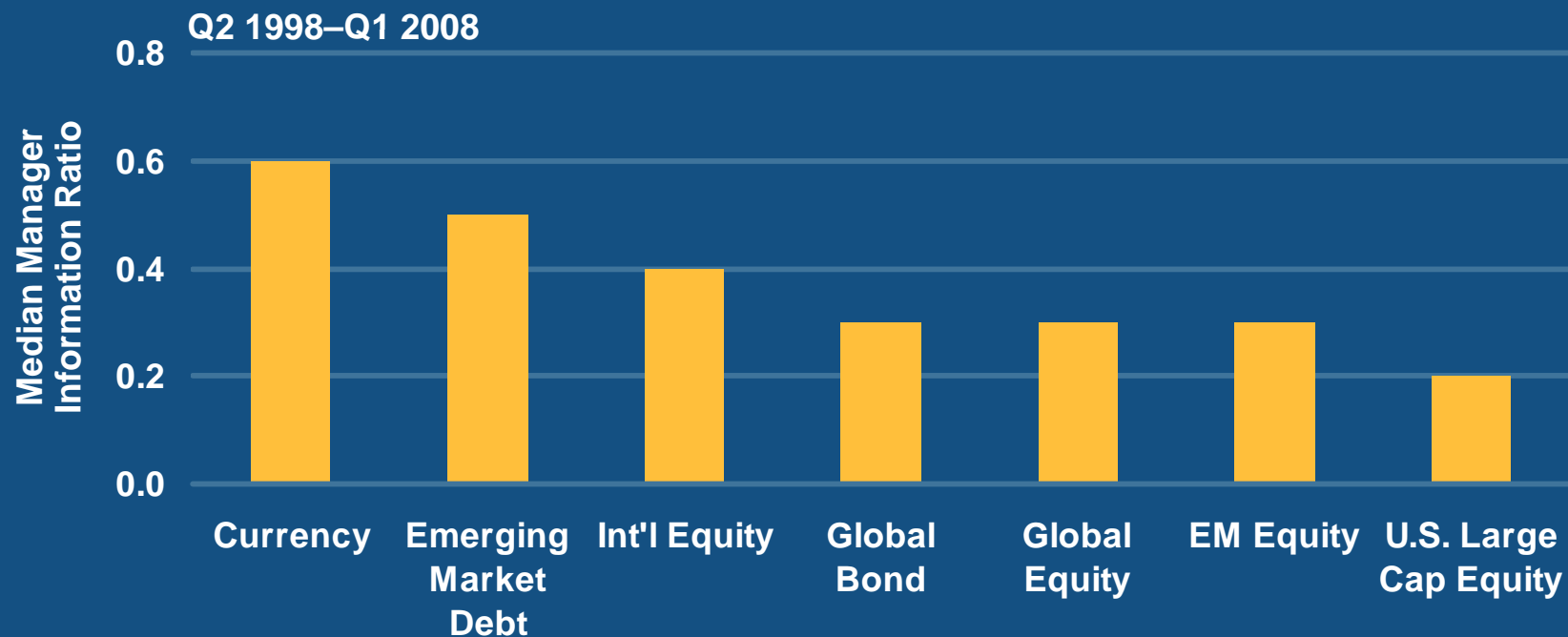
APRIL 1998–MARCH 2008

	PARKER FX INDEX	S&P 500 INDEX	MSCI EAFE INDEX - UNHEDGED	CITI WORLD GOV BOND INDEX - HEDGED	MSCI EMERGING MARKETS INDEX	JPM EMBI+	GSCI INDEX
Parker FX Index	1						
S&P 500 Index	-0.01	1					
MSCI EAFE Index – unhedged	0.10	0.82	1				
Citi World Gov Bond Index –hedged	0.12	-0.33	-0.33	1			
MSCI Emerging Markets Index	0.08	0.72	0.79	-0.32	1		
JPM EMBI+	0.07	0.53	0.51	0.03	0.65	1	
GSCI Index	-0.03	-0.01	0.13	0.04	0.21	0.14	1

Sources: Parker Global Strategies; Putnam Investments; Bloomberg; monthly data.



Currency yields attractive: Information Ratios (IRs)



Source: Mercer MPA.

Benchmarks: Currency (Mercer Currency Funds Median Manager); Emerging Market Debt (Mercer EMD Universe vs. JPM EMBI+); Global Bond (Mercer Global Fixed Hedged Universe vs. Citi WGBI Hedged); Global Equity (Mercer Global Equity Universe vs. MSCI World); Emerging Market Equity (Mercer Emerging Market Equity Universe vs. MSCI EM); U.S. High Yield (Merrill Lynch U.S. High Yield Index); U.S. Large Cap Equity (Mercer U.S. Large Cap Equity Universe vs. S&P 500).

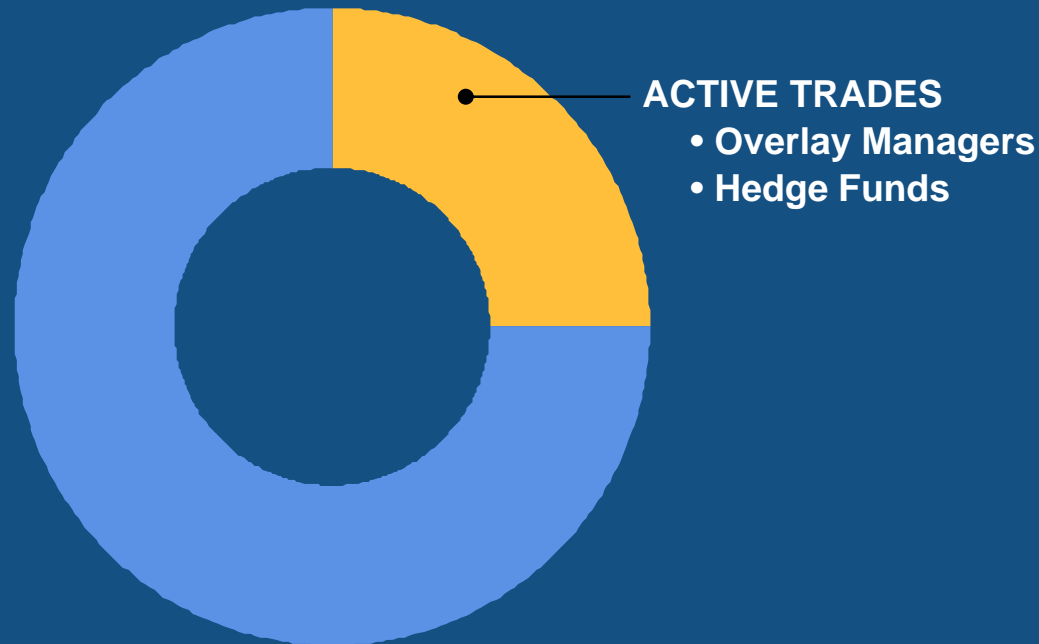
Annualized quarterly data.



The most liquid market in the world

- Daily transactions are dominated by non-profit-seekers

FX DAILY TURNOVER = \$3.1 TRILLION



Source: Bank for International Settlements, Triennial Report, 2007.



Currency management in practice

- Multiple factors influence exchange rates over short, medium, and long time horizons
- Challenge is to identify those factors and
 - Assemble them in a cohesive process
 - Ensure their effectiveness in exploiting inefficiencies
 - Build within a disciplined risk controlled framework
- Different rules for currency managers — greater focus on minimizing losses

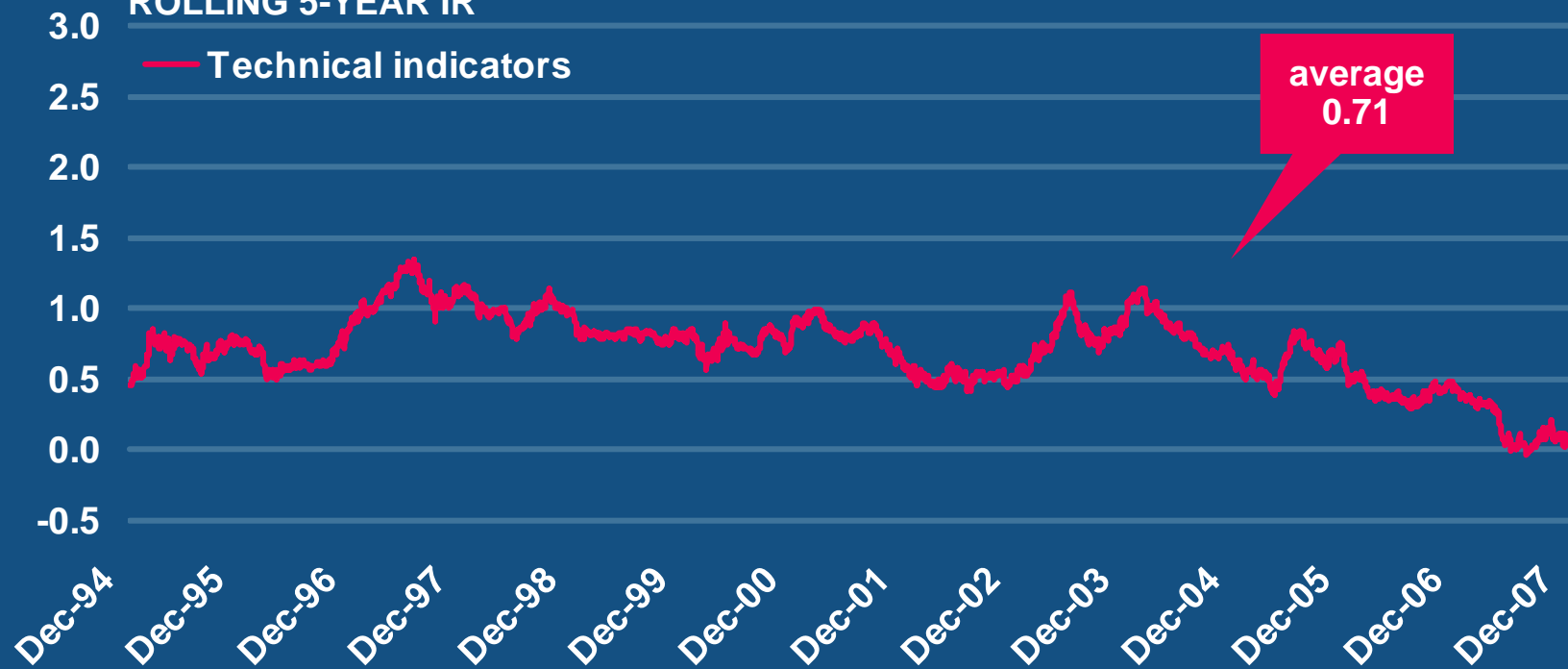


Short-term factors

➤ Short-run behavior

Non-fundamental influences

ROLLING 5-YEAR IR



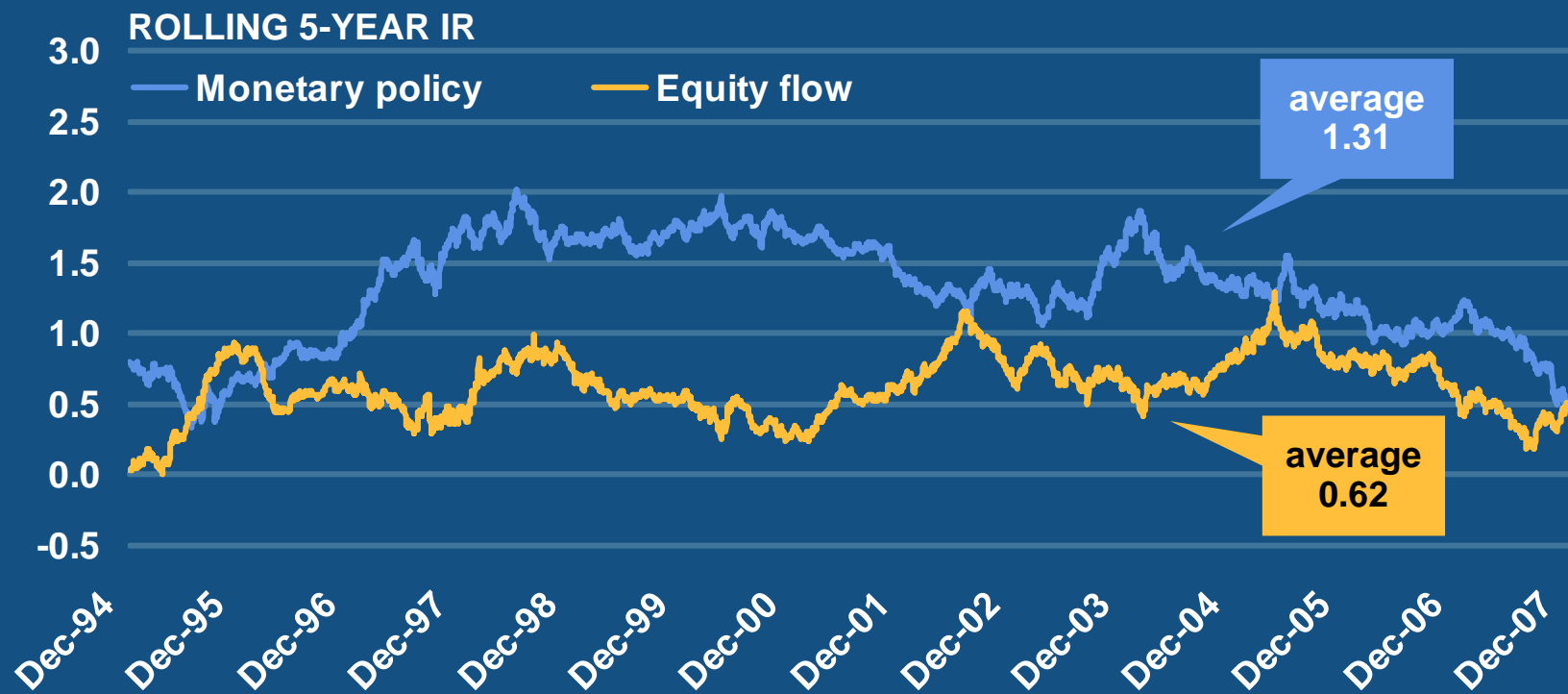
Source: Putnam Investments.



Medium-term factors

➤ Medium-run behavior

Macroeconomic influences



Source: Putnam Investments.



Long-term factors

➤ Long-run behavior

Long-run real exchange rate influences

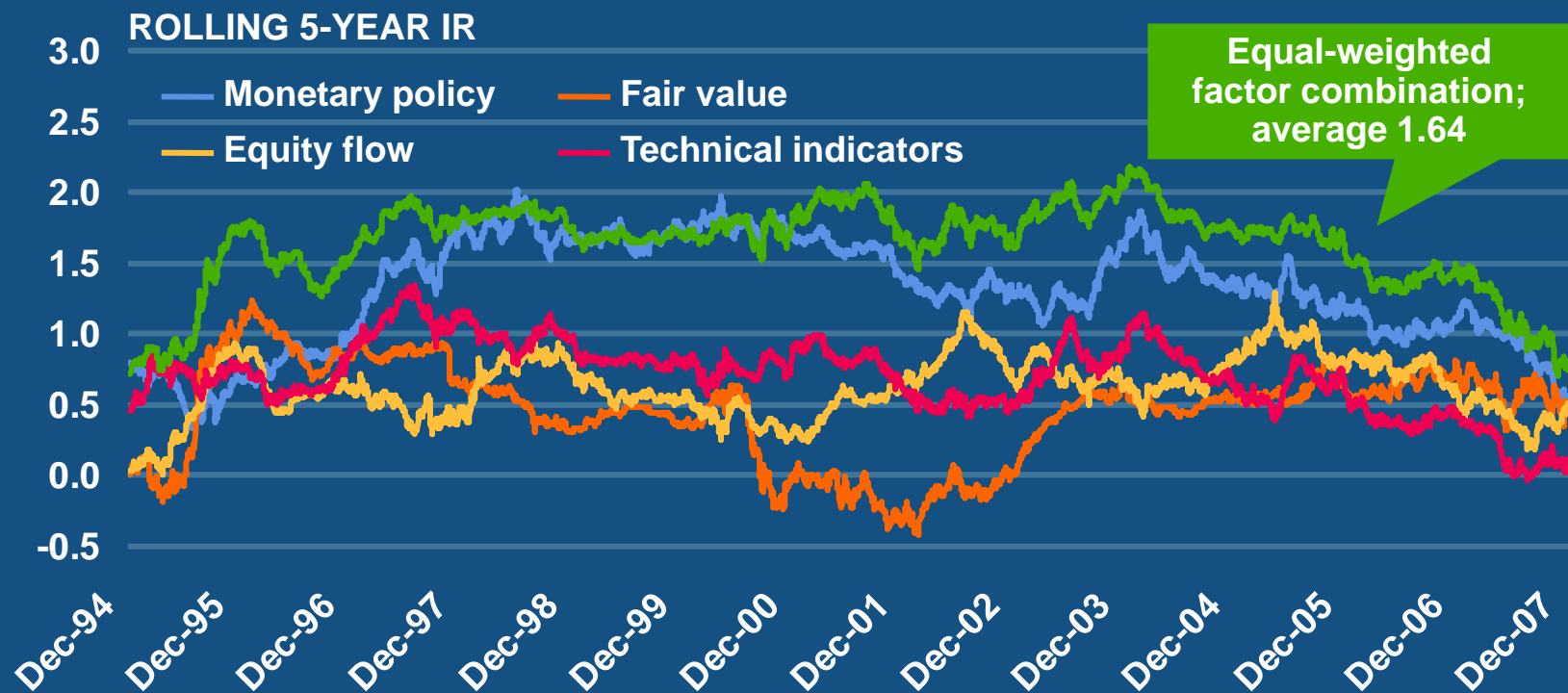


Source: Putnam Investments.



Putting it all together

- Combining uncorrelated strategies provides more attractive risk-adjusted returns



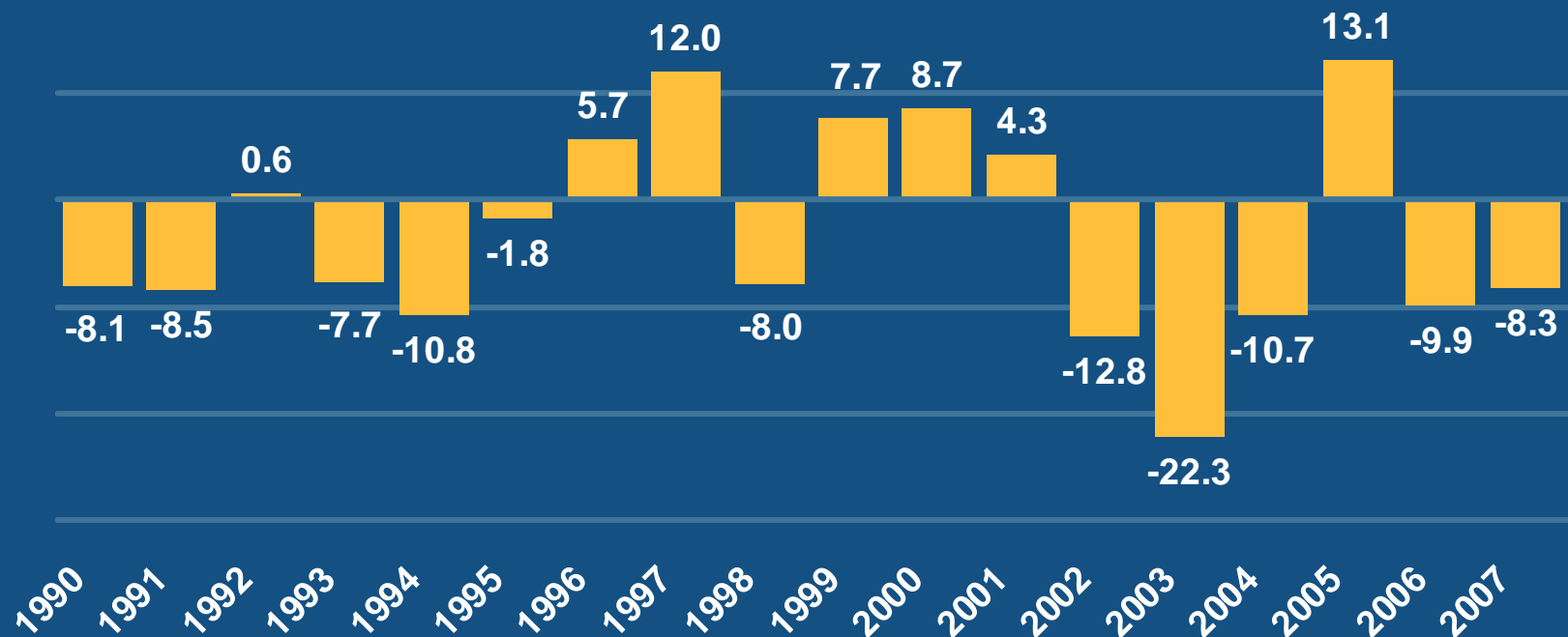
Source: Putnam Investments. Currency Manager performance is for illustrative purposes only and represents a Putnam-constructed, equal-weighted compilation of currency manager returns based on Mercer data, which has been utilized as the proxy currency alpha series.



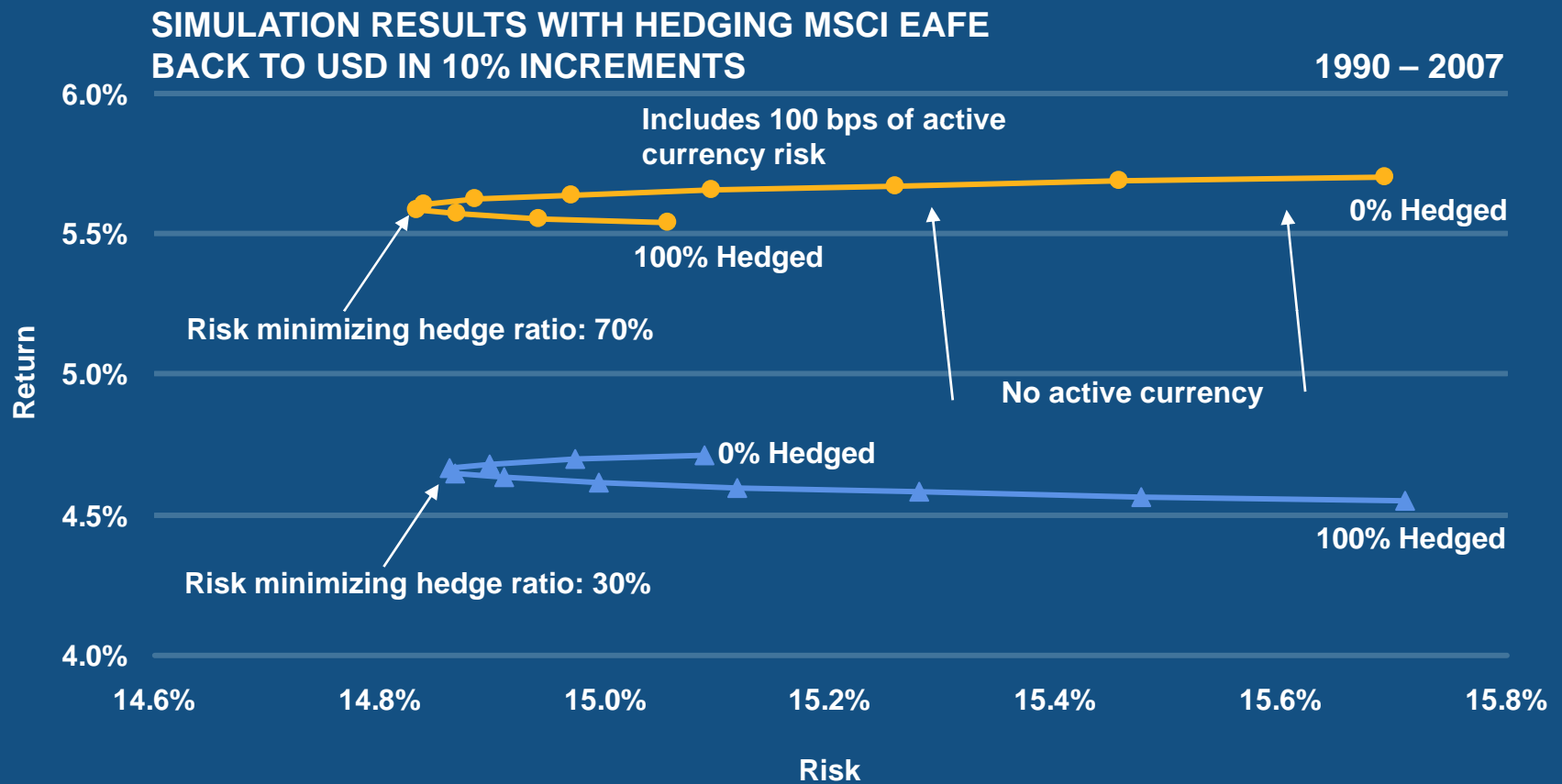
Assessing the impact from currency

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MSCI EAFE HEDGED VS UNHEDGED ANNUAL RETURNS(%)



Incorporating currency management



Source: Putnam Investments.

This illustration is intended to demonstrate the impact of currency on a portfolio and is not a representation of actual performance.



Summary:

Why active currency management?

- Over long periods, little risk/return impact; however, short-run impact can be dramatic
- Factors that drive currency returns differ from other asset classes; similarly, currency factors can be exploited
- Lack of correlation between currency and traditional asset classes translates into improved overall risk and return characteristics of your portfolio



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