

ON THE USE OF CURRENCY FORWARDS: EVIDENCE FROM INTERNATIONAL EQUITY MUTUAL FUNDS

BY WEI OPIE AND STEVEN J. RIDDIOUGH

Discussion by Amy W. Huber

The Wharton School

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THIS PAPER

- Excellent paper.
 - **Hand-collected data:** FX derivatives usage by US equity mutual funds that invest abroad, based on N-Q / N-SCR filings following [Sialm and Zhu \(2022\)](#).
 - **Interesting finding:** U.S. equity mutual funds do not use simple FX strategies to augment their performance.
 - **Careful rationalization:** [i] costly trading, [ii] tracking error.
- A must-read for those interested in FX.
- But also important for “Asset Management, Portfolio Choice, and Asset Allocation.”

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- Beyond this paper, as we look to further understand MV (through FX), one reflection and one puzzle:
 - Who is the agent to study?
 - What's up with the U.S.?

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- In standard portfolio problems: $W_{t+1} = W_t(1 + R_t^f + \theta R_{t+1}^e)$.

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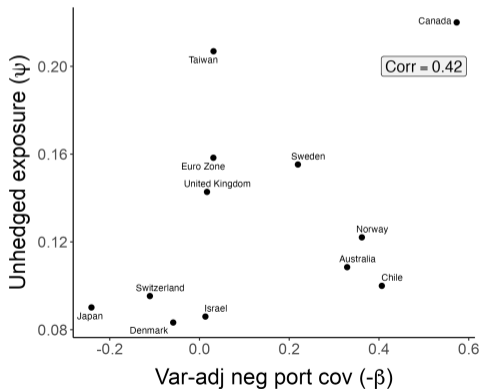
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- The true decision maker allocating θ is the household; mutual funds only define the menu.
- Can aggregation be a solution?
 - Plausible: all mutual funds together represent HH's portfolio.
 - More plausibly: aggregating across the entire financial sector of a country.
- Trade-off: many fewer observations, identification needs to come from country-level comparisons in the cross-section or time-series.

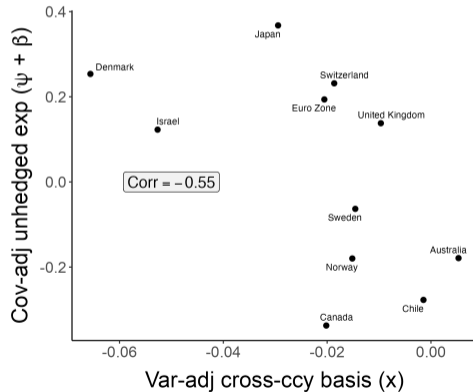
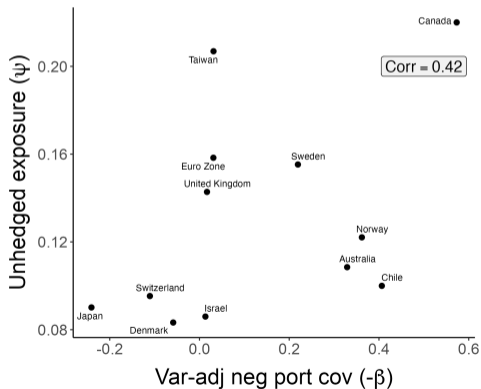
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 - Increases in negative covariance b/w FX and other assets' returns: natural hedge.



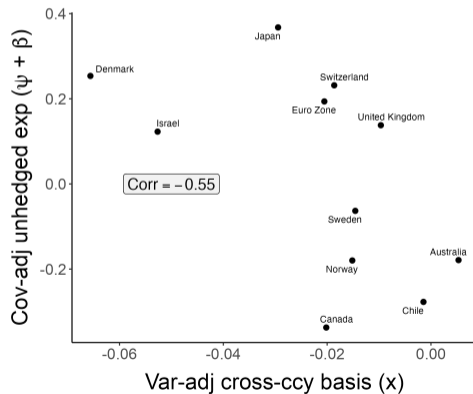
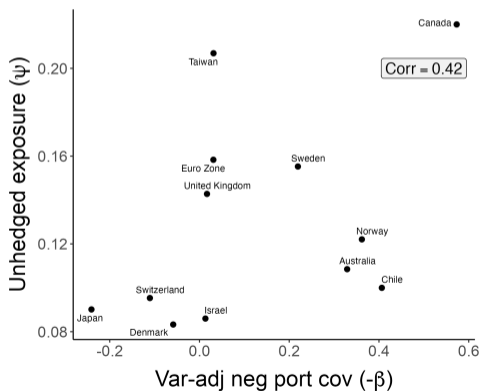
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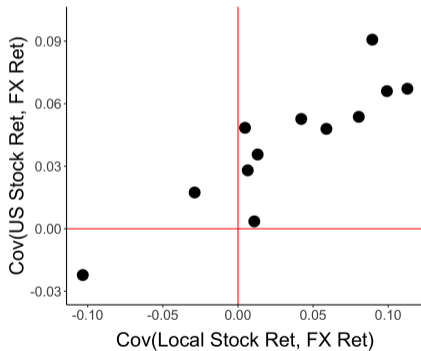
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 - Consistent patterns also hold in expected returns and in the time series.



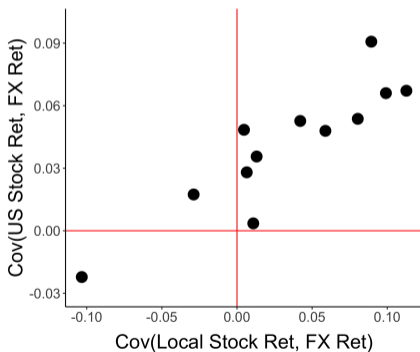
FOR THE U.S. INVESTOR


- $\text{cov}(r^{FX}, r^{\text{risky}}) > 0$.
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- CIP deviation > 0 .
 - Hedging generates extra profit!



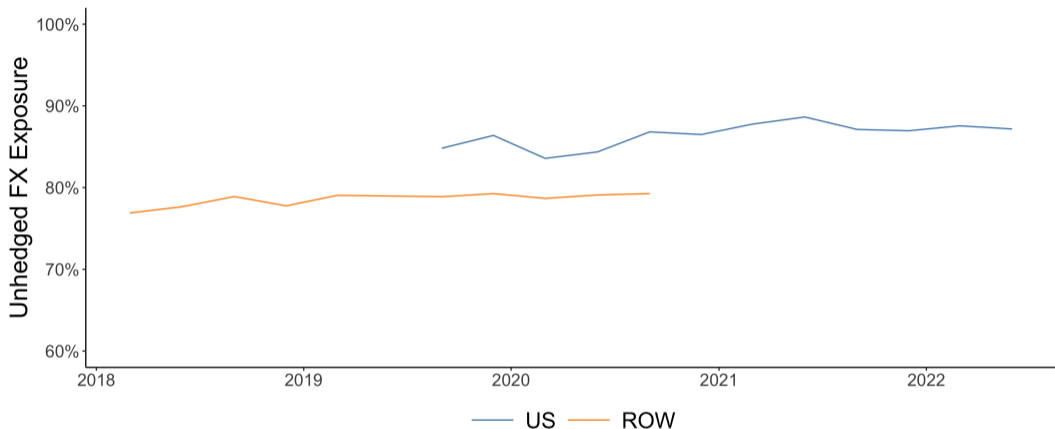
 The Economist
<https://www.economist.com> > 2023/04/20 > warren-buf... ⋮

Warren Buffett is shaking Japan's magic money tree

20 Apr 2023 — Mr Buffett has questioned the merit of currency hedging in the past. Its appeal today seems to be irresistible. Borrowing in yen is so cheap ... [Read more](#)

The yen currently trades at 134 to the dollar, but currency-futures maturing in March next year give investors the opportunity to sell at 127 to the greenback. That locks in a 5% return over little less than a year. The only cost is that the buyer must hold yen for the whole period. For investors who want to own Japanese stocks, the return to hedging is essentially a bonus.

THE U.S. PUZZLE



- US: equity + fixed income mutual funds' investment abroad (N-PORT).
- ROW: equity + fixed income MF in 12 currency areas' investments in USD.
- Is this revealing properties of the US household's aggregate wealth portfolio?

CONCLUSION

- Great paper that brings fresh data to generate new insights.
- Looking beyond, there is more to do to better understand the fundamental MV assumption.
 - Consider carefully whose decisions we analyze.
 - Investigate the puzzle of US mutual funds' under-hedging.
- Excited for more research in this area!

Du, W., and A. Huber. 2024. Dollar asset holdings and hedging around the globe. Working Paper.

Sialm, C., and Q. Zhu. 2022. Currency management by international fixed income mutual funds. Working paper.