STUDY SESSION

9

Asset Allocation and Related Decisions in Portfolio Management (2)

When the strategic asset allocation includes exposure to global markets, non-domestic currencies create an additional source of portfolio volatility. The investment manager may choose to hedge the portfolio's currency exposures, at a cost, or to actively manage currencies as an additional source of portfolio returns. The first reading addresses how currency exposures can be managed to reflect a client's investment objectives and constraints.

When a strategic asset allocation is determined, benchmarks are specified to represent the performance of each allocation. The second reading introduces the topic of benchmarks, focusing on the use of market indexes. Later study sessions on the portfolio management of fixed-income securities, equities, and alternative investments will address additional, asset class specific issues, while the study session on performance evaluation will explore the theory and practice of performance benchmarking.

READING ASSIGNMENTS

Reading 18	Currency Management: An Introduction by William A. Barker, CFA
Reading 19	Market Indexes and Benchmarks by C. Mitchell Conover, PhD, CFA, CIPM

LEARNING OUTCOMES

READING 18. CURRENCY MANAGEMENT: AN INTRODUCTION

The candidate should be able to:

a analyze the effects of currency movements on portfolio risk and return;

b discuss strategic choices in currency management;

c formulate an appropriate currency management program given financial market conditions and portfolio objectives and constraints;

d compare active currency trading strategies based on economic fundamentals, technical analysis, carry-trade, and volatility trading;

e describe how changes in factors underlying active trading strategies affect tactical trading decisions;

f describe how forward contracts and FX (foreign exchange) swaps are used to adjust hedge ratios;

g describe trading strategies used to reduce hedging costs and modify the risk–return characteristics of a foreign-currency portfolio;

h describe the use of cross-hedges, macro-hedges, and minimum-variance-hedge ratios in portfolios exposed to multiple foreign currencies;

i discuss challenges for managing emerging market currency exposures.

READING 19. MARKET INDEXES AND BENCHMARKS

The candidate should be able to:

a distinguish between benchmarks and market indexes;

b describe investment uses of benchmarks;

c compare types of benchmarks;

d contrast liability-based benchmarks with asset-based benchmarks;

e describe investment uses of market indexes;

f discuss tradeoffs in constructing market indexes;

g discuss advantages and disadvantages of index weighting schemes;

h evaluate the selection of a benchmark for a particular investment strategy.