

**Managing currency
losses**

3 October 2018

The webinar will begin shortly...

Business & Management
20 minute lunch



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Managing Currency Loss

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Agenda



- ❖ Introduction to the FX Market
- ❖ Volatility and market movement
- ❖ Different ways of buying currency / hedging risk
- ❖ Practical Example
- ❖ Market Forecasts

The FX Market



- ❖ The Foreign Exchange market is the largest financial market globally - \$5.3 trillion traded per day
- ❖ FX Market vs Stock Market
- ❖ More than 85% of FX deals involve US dollar.
- ❖ Speculators vs transactional foreign exchange

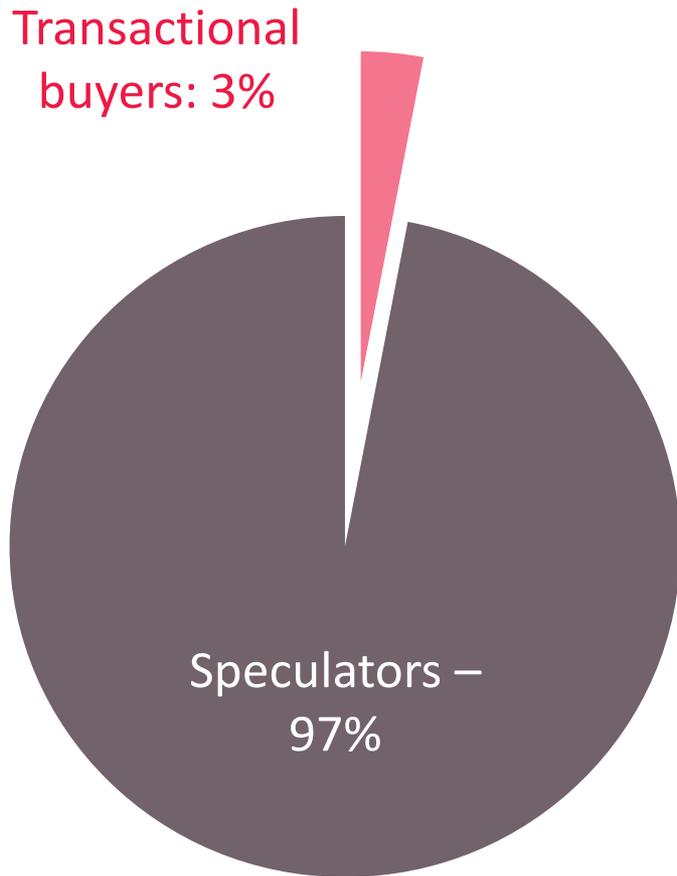


Poll Question 1

- ❖ What percentage of the market place are speculators as opposed to transactional buyers?

- ❖ Under 10
- ❖ 0 - 20%
- ❖ 21-40%
- ❖ 41-60%
- ❖ 61-80%
- ❖ 81-100%
- ❖ Over 90

The FX Market



- ❖ Perception, fear and greed.
- ❖ Markets fluctuate constantly, making it difficult for companies to plan.
- ❖ Fluctuations can significantly add to costs, or erode profitability on projects and deals.



GBP/USD - Market Movements 6 Months

- ❖ 12% volatility - High 1.4376; low 1.2661
- ❖ When buying USD with £500,000 this translated to a difference of **\$85,750** between the year's high and low.





GBP/EUR - Market Movements 6 Months

- ❖ 6% volatility - High 1.1599; low 1.0984
- ❖ When buying Euros with £500,000 this translated to a difference of **€30,750** between the year's high and low.





When Purchasing Currency

❖ Opportunity

- ❖ Exchange rates go in your favour
- ❖ Reducing costs
- ❖ Increasing profit margins
- ❖ Potential to boost revenue

❖ Risk

- ❖ Exchange rates go against you
- ❖ Costs increase
- ❖ Profit margins reduced
- ❖ Potential to reduce revenue



Different Ways To Buy Currency

Online			
Spot	Forward	Market orders	Options
Immediate delivery	Lock in to favourable rates longer term	Target a rate and minimise risk	Fixed rate with potential upside
			
Over the phone			

Spot Contract



- ❖ Allows you to trade 'on the spot'
- ❖ Spot contracts are useful if you need to purchase currency and make a payment quickly.
- ❖ Allows you to fix an exchange rate and settle your deal the same day or **up to two working days in advance.**

Spot Contract



❖ Advantages

- Total market participation (buy when suitable)
- Total flexibility (no risk of over purchasing)

❖ Disadvantages

- No protection from negative market volatility



Forward Contracts

- ❖ Fix a rate up to two years ahead
- ❖ Complete protection from volatility





Forward Contracts

- ❖ Usually a level of flexibility (drawdown)
- ❖ Purchase obligatory
- ❖ Credit implication





Forward Contracts

Advantages

- Total protection from volatility
- No premium

Disadvantages

- Purchase obligatory
- No market participation





Market Orders

- ❖ Need to purchase currency but not immediately
- ❖ Target a favourable rate through a market order





Market Orders

- ❖ A **limit order** allows you to set a target exchange rate
- ❖ Will trigger currency purchase automatically when rate is hit





Market Orders

- ❖ Conversely, a **stop loss** order allows you to set a 'worst case' exchange rate.
- ❖ Again, triggers automatically when hit.

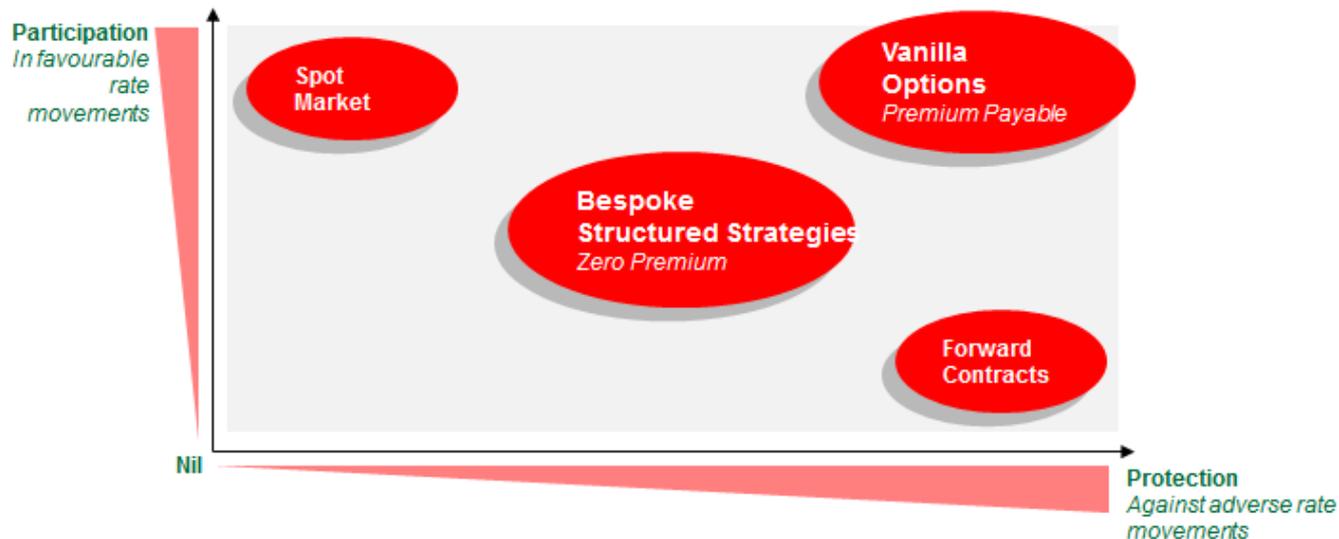




Options

- ❖ A **vanilla option** gives the holder the right *but not the obligation* to exchange one currency for another at a specified rate on a specified date in the future.
- ❖ Will always pay a premium
- ❖ FX options are regulated investment products that carry a higher level of risk than forward contracts

Risk-Reward Matrix of Alternative Hedging Strategies



Poll Question 2



Which products do you use the most:

❖ Spot

❖ Forward

❖ Market orders

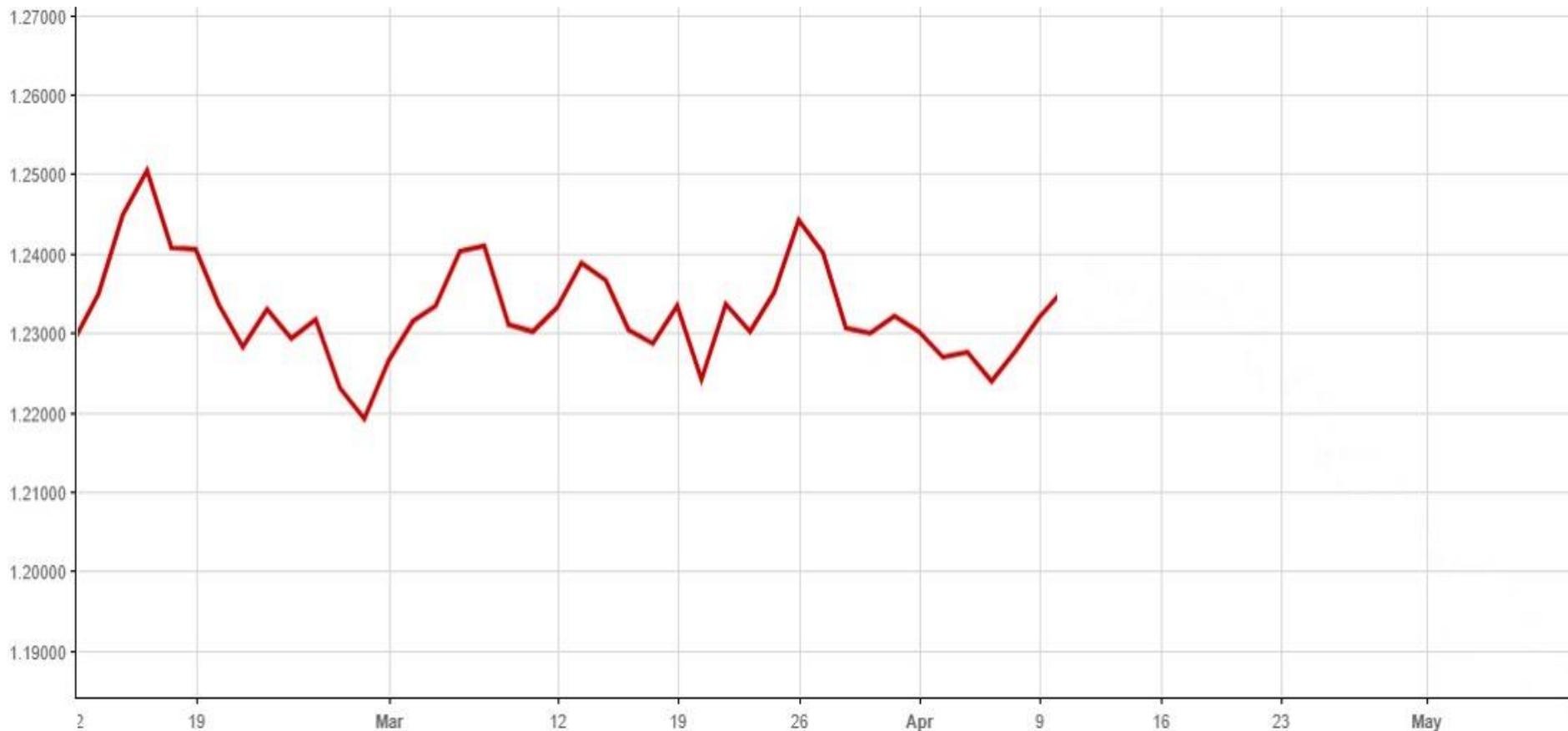
❖ Options

❖ Mixture



Example of a Business Requirement

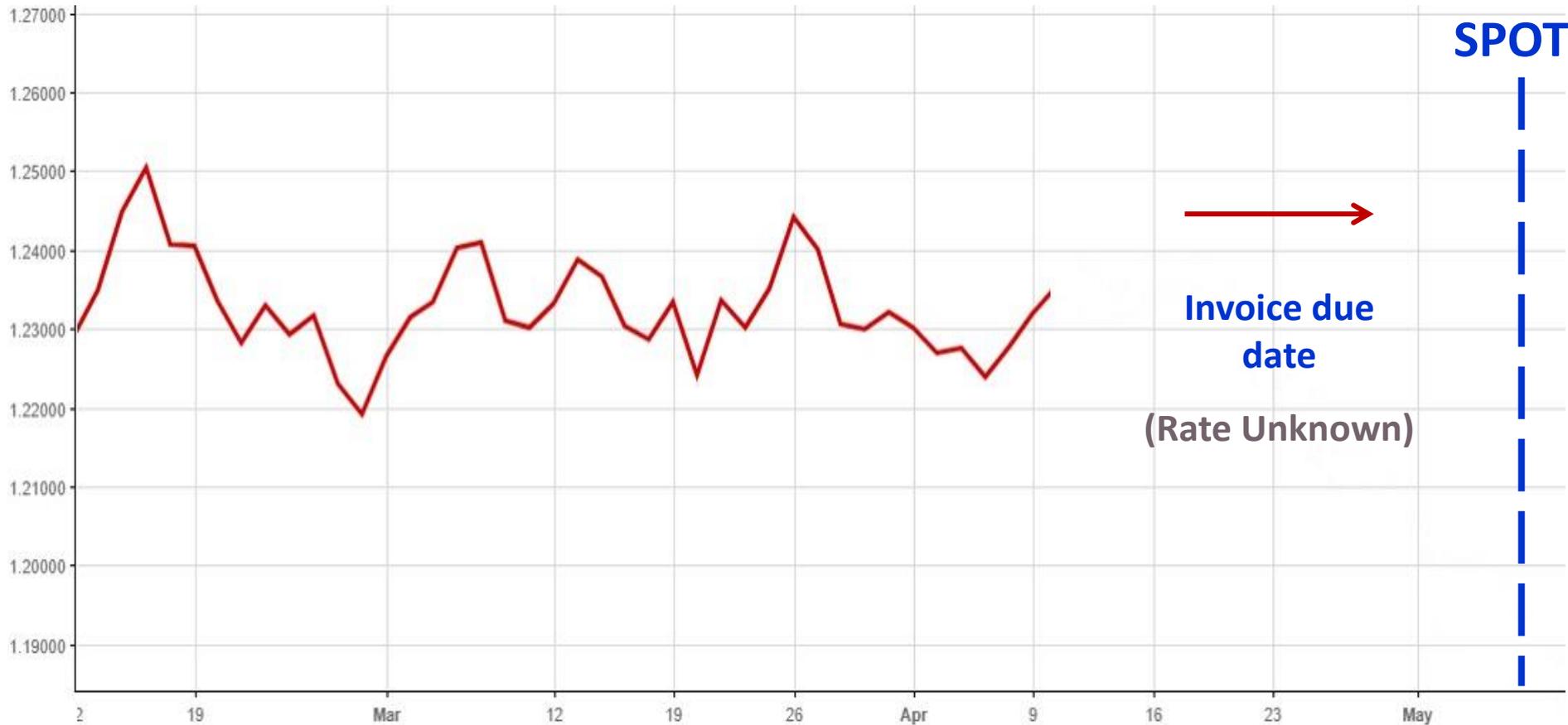
A business whose base currency is euros agrees a contract to buy raw materials from the USA at a cost of €500k. The spot rate on the day is **1.2340**. They have to pay the invoice in dollars in **4 weeks** - the rate is currently on an upward trend.





Spot Contract

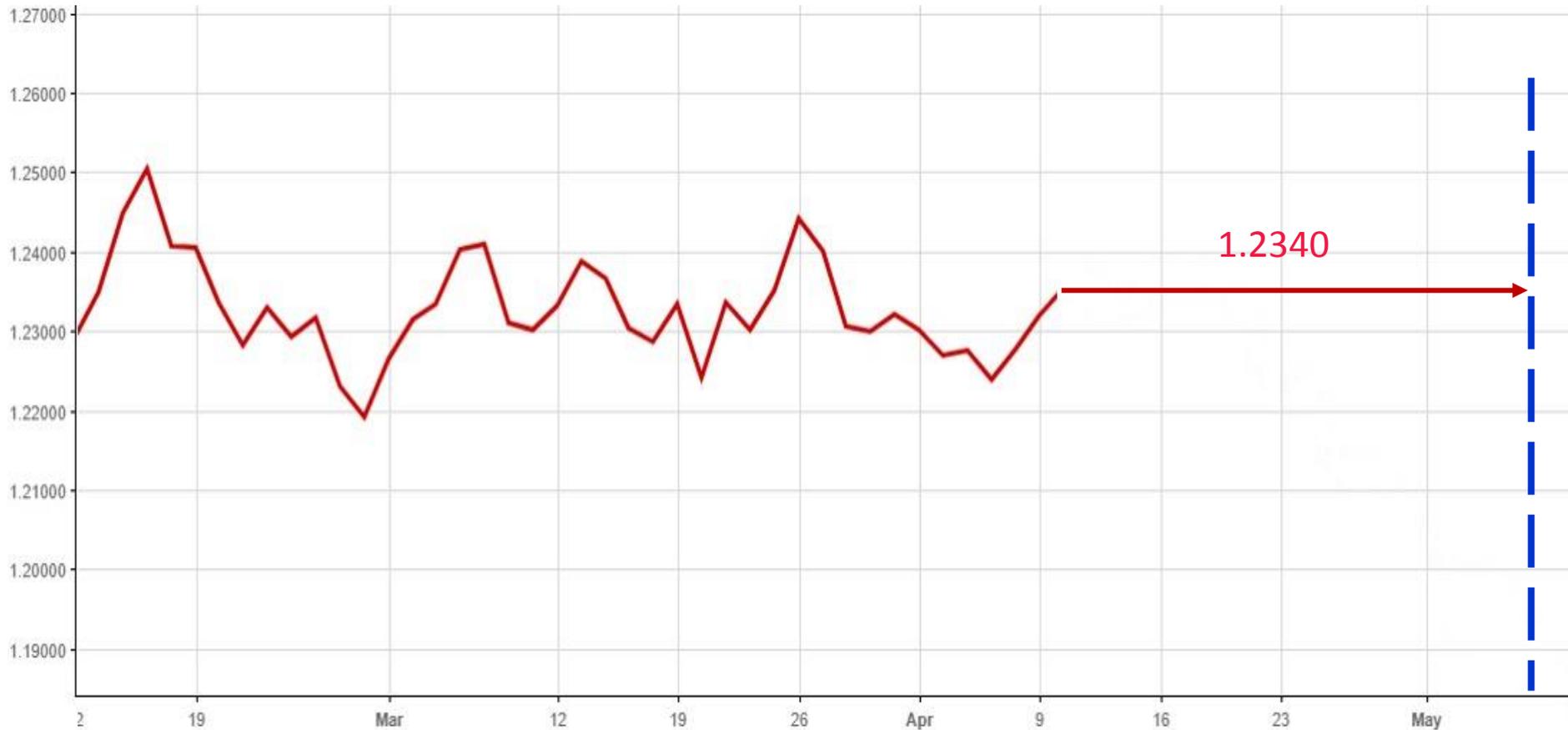
Buy on the day when the invoice is due.





Fix The Rate – Forward Contract

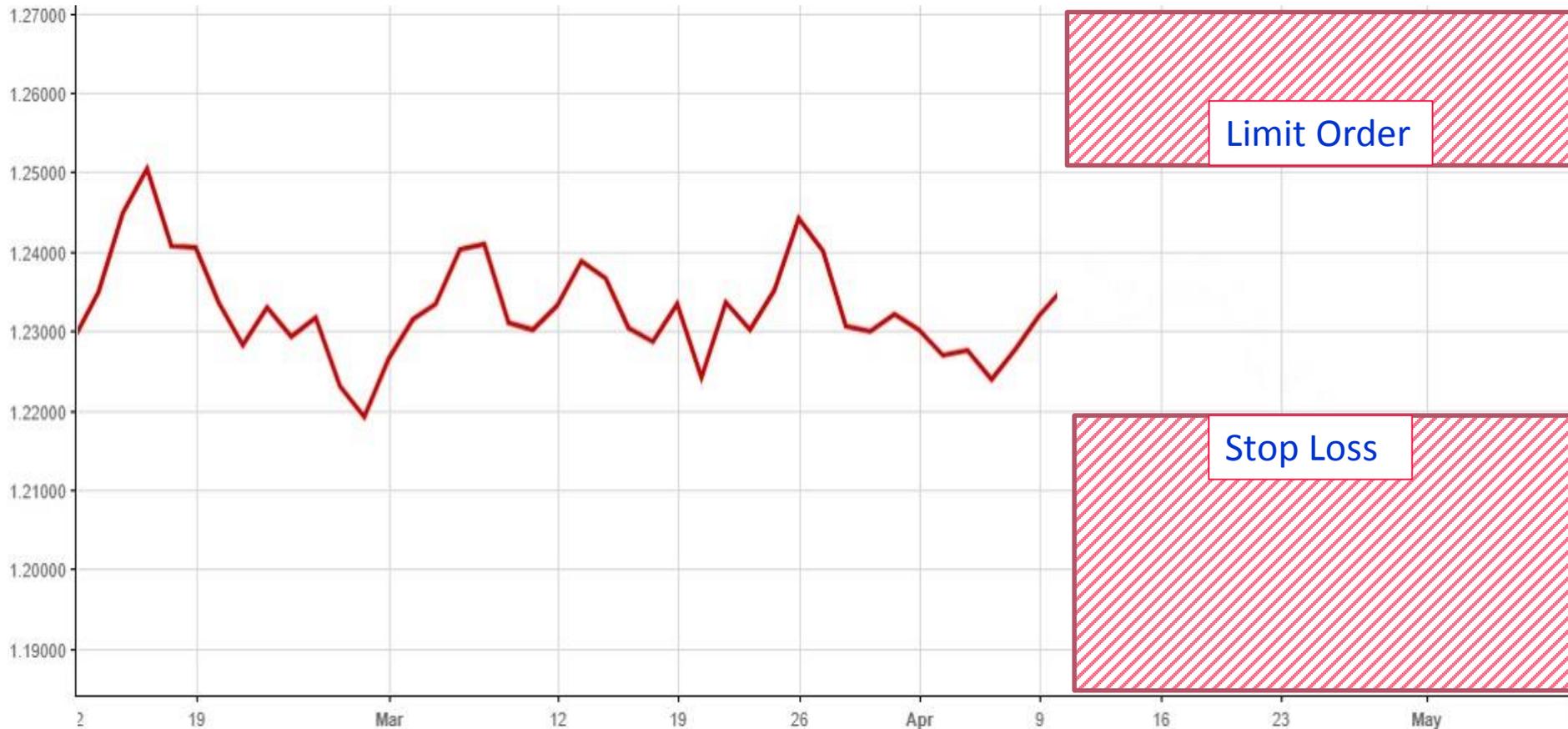
The company can secure the current rate for the four weeks at 1.2340





Target Rate - Market Order

The company can use market orders to target a rate by creating a limit order and stop loss





Which Strategy Would You Take?

This could depend on a business' attitude to risk, budgeted rates or preconceptions on the direction of the rate.





Poll Question 3

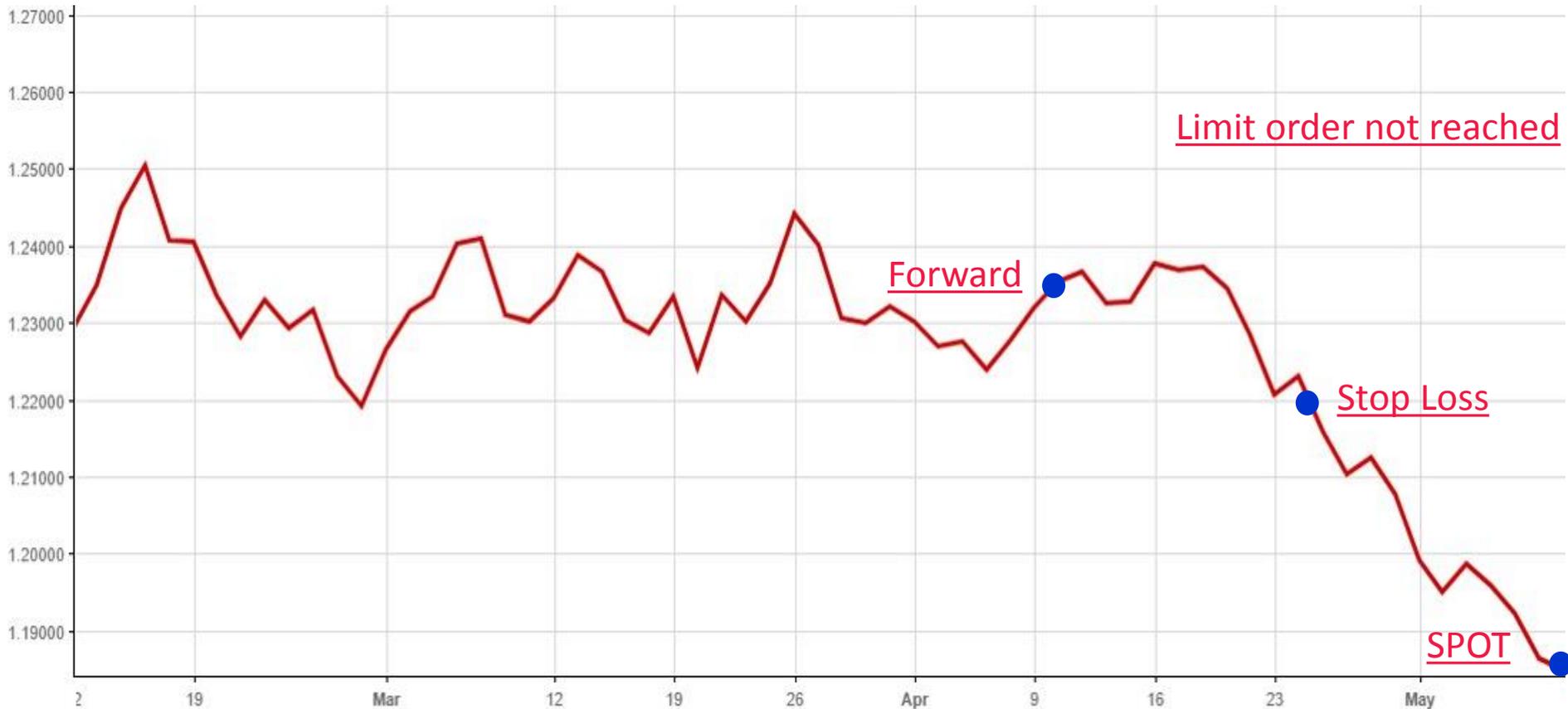
Which strategy would you take?

- 1) Buy on spot, and take risk of rate movement in the meantime
- 2) Put a market order in at a target price
- 3) Eliminate risk and take out a forward contract



Example of a Business Requirement

In this example, EUR/USD falls from 1.2340 to 1.1850.





Results

- ❖ In this example a client would have saved \$25,000 if they had fixed the rate with a **Forward Contract** (compared with SPOT).

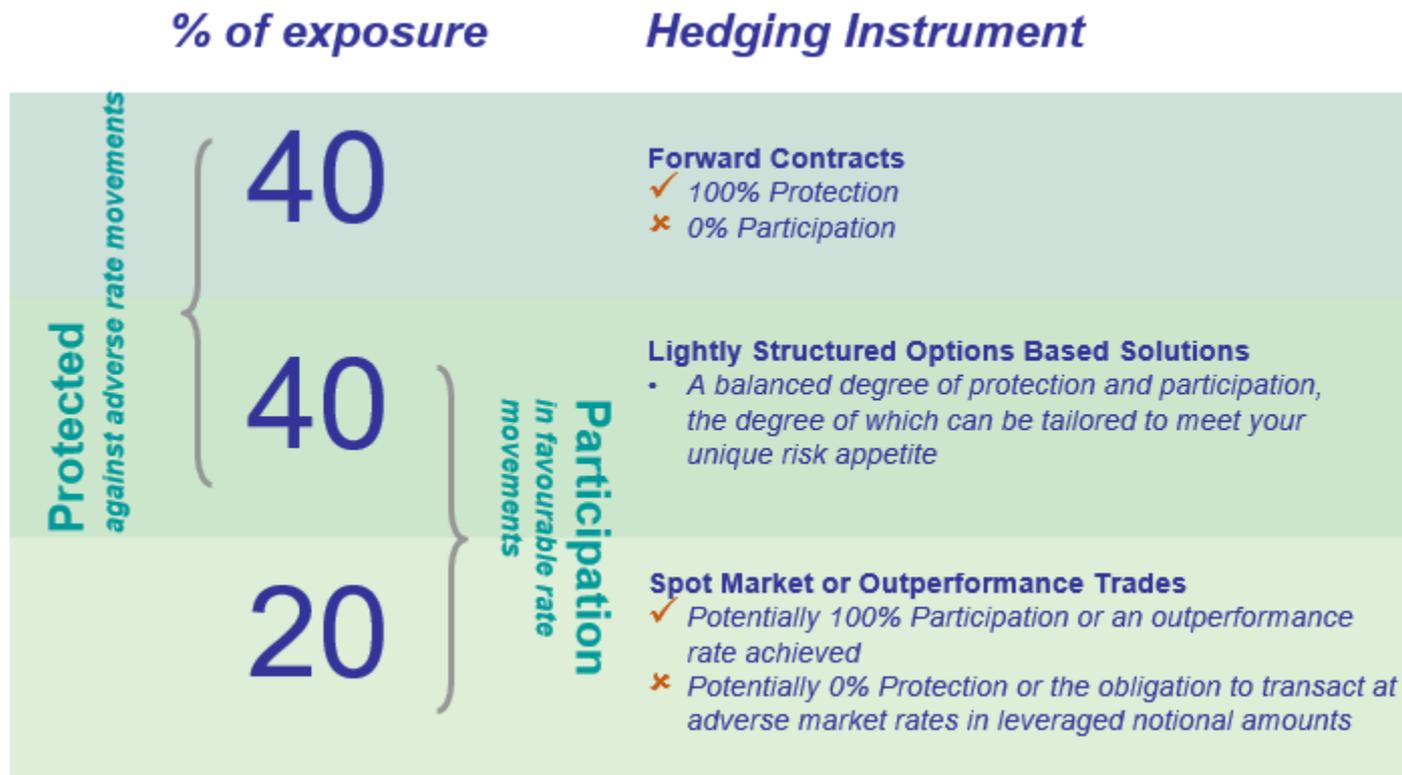
Action	Amount received	Difference
Forward Contract	\$617,000	+\$25,000
Market Order (stop loss)	\$610,000	+\$7,900
SPOT	\$592,500	0

- ❖ Nobody knows where the markets will move – if you have a budgeted rate, it's prudent to protect yourself, depending on your attitude to risk.



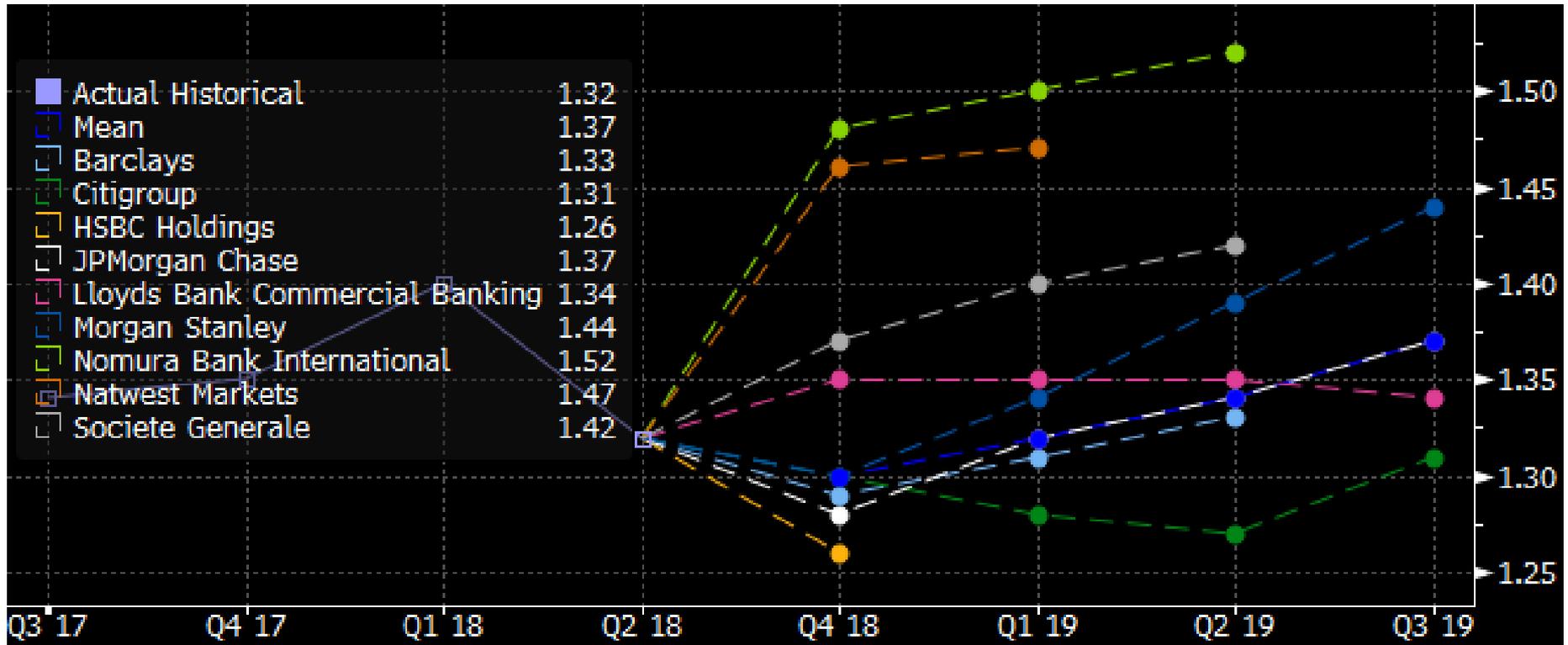
Hedging Strategy – Blended Approach

- ❖ The markets are unpredictable – not necessarily a right or wrong answer to which hedging tools to use
- ❖ Match your hedging strategy to your risk appetite / profile





GBP/USD Multi-Bank Forecasts

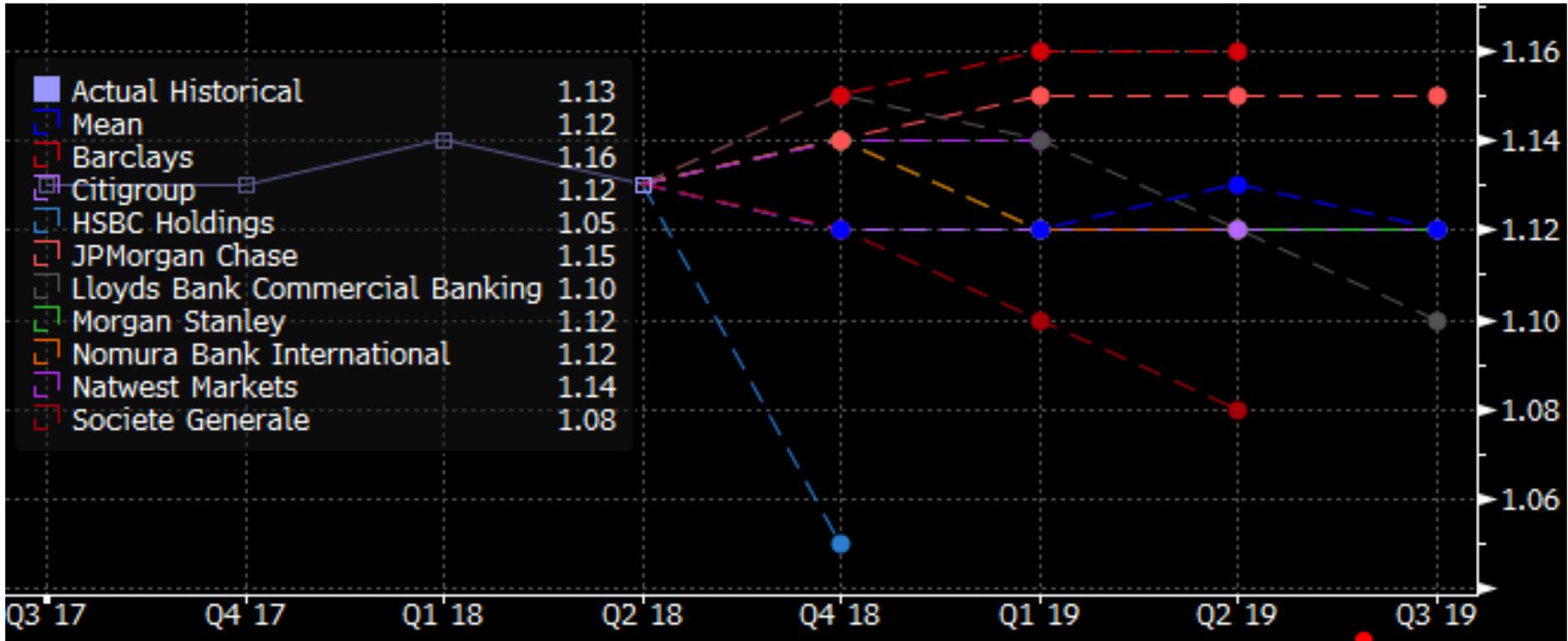


Currently: 1.30. In Q3:

- ❖ High – Nomura at 1.52
- ❖ Low – HSBC at 1.26
- ❖ Average – 1.37



GBP/EUR Multi-Bank Forecasts



Currently: 1.12. In Q3:

- ❖ High – Barclays at 1.16
- ❖ Low – HSBC at 1.05
- ❖ Average – 1.12

Current FX situation in UK



- ❖ Most UK companies still use their bank
- ❖ Rest with foreign exchange specialist - more competitive rates of exchange / expert guidance on the markets and hedging.
- ❖ Banks offering exchange rates that can be up to 1%+ worse
- ❖ Transfer Fees typically £20-£40

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Final Thoughts



- ❖ If you have budgeted for a certain rate of exchange, your profit margins can be seriously affected by a negative turn in exchange rate.
- ❖ Create a hedging policy for your Foreign Exchange
- ❖ Review policy regularly
- ❖ Get the best rates and service
- ❖ Free rate comparisons available
- ❖ Would you like me to get in touch? Please wait and fill out the feedback form afterwards – tick that you would like us to contact you.

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