

## FX CHECK

Seppo Leskinen, SEB Merchant Banking Head of Hedge Fund Services , Global Foreign Exchange shares his views on why 2006 was such a tough market environment for FX managers and more...

**The FX market is one of the most efficient - how then do managers still generate lucrative returns?**

Not all participants in the foreign exchange market are profit seeking organisations. Typically central banks, corporates that need to hedge foreign payments and tourists do not or cannot maximise their profits. Naive strategies demonstrate that phenomena such as forward rate bias exist, and that they are profitable. Skilled managers exploit such opportunities to develop lucrative return strategies.

**Are FX managers exposed to cycles?**

There are clearly some strategies that are sensitive to certain market environments. Typically trend following strategies will not operate in non- trending markets. Very recently we saw carry strategies struggle when the JPY appreciated.

**Which phase of a cycle are we in now?**

One can identify the occurrence of various types of foreign exchange market conditions such as high and low volatility, trending or non-trending markets. At present the market is in a low volatility and ranging state.

**At which phase(s) is it hardest for a FX manger to perform? Why?**

**Are there other FX managers that would thrive in such in an environment?**

A majority of managers do find it difficult to perform in ranging and low volatility market conditions.

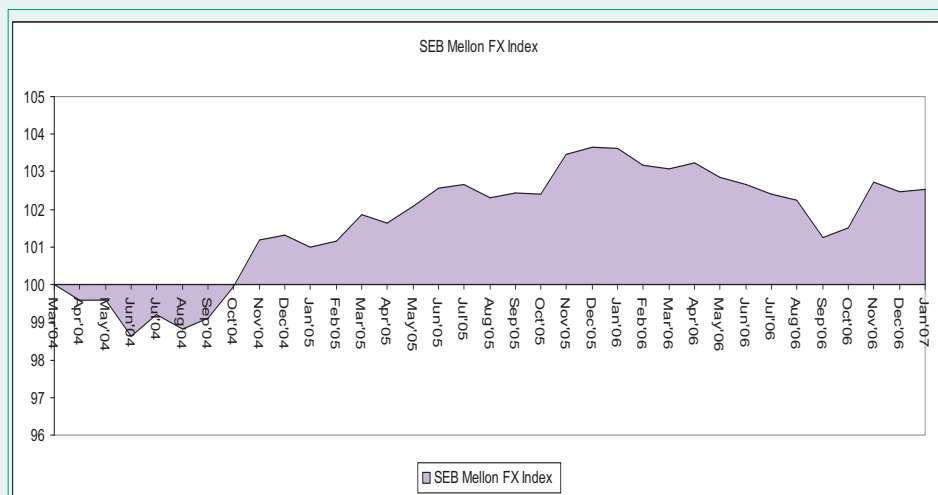
But then again, there are always good performing managers regardless of the market conditions. Discretionary managers and some short-volatility systematic strategies fall in this category.

**Was 2006 an unusually difficult year for FX managers? Why?**

We have some 85 currency managers on our platform FX MAP and we saw a negative result of 1% collectively. 2006 was the poorest currency performance year we have tracked thus far.

**Which managers were positioned to perform well in such an environment and did?**

We saw particularly good results from managers with a systematic approach that recognised the range-bound nature of the markets, but good discretionary managers also did well, as did some of the emerging market strategies we follow. Systematic trend-followers had a tough time. The strategy has delivered excellent results in the past, and so should not be dismissed, especially if investors see volatility returning to the market.



*The SEB Mellon Currency Index is made up of 85 "pure" foreign exchange managers who have a track record of at least 18 months, at least USD10 mn assets under management and who are unconstrained by benchmarks. The index differs from existing 'currency' indices in that the rules ensure that only currency return is admitted*

Source:SEB

**What are the trends in FX investing?**

Investors have realised that they can access currency alpha without the need to fully fund those investments. This makes currency a truly unique and portable alpha source. We are also experiencing the emergence of new strategies – those that reflect the prevailing low volatility environment, and some very sophisticated strategies which use advanced algorithmic models to trade.

**Where do you see the challenges going forward?**

We think that currency as an asset class is here to stay, and that currency will be seen as a vital component of any well designed investment portfolio. The challenge in such an environment will be managing capacity. Successful foreign exchange managers attract large volumes of capital - but this can be a double-edged sword as certain strategies have witnessed a "fall-off" in performance.

**How should one invest, to achieve "reliable returns" in FX markets?**

The answer, as in any asset class, is to take a very long term approach - choose managers very carefully and in accordance with a sound set of principles.