



To Hedge or not to hedge: Currency hedging considerations for ETF investors

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Is currency risk relevant to you?



Source: Scott Adams, Dilbert.com

Agenda



- Currency markets update: Changing balances
- ETFs & currency risk: How relevant is it?
- ETF industry: At cross-roads



Currency markets update: Changing balances

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Could this be you?

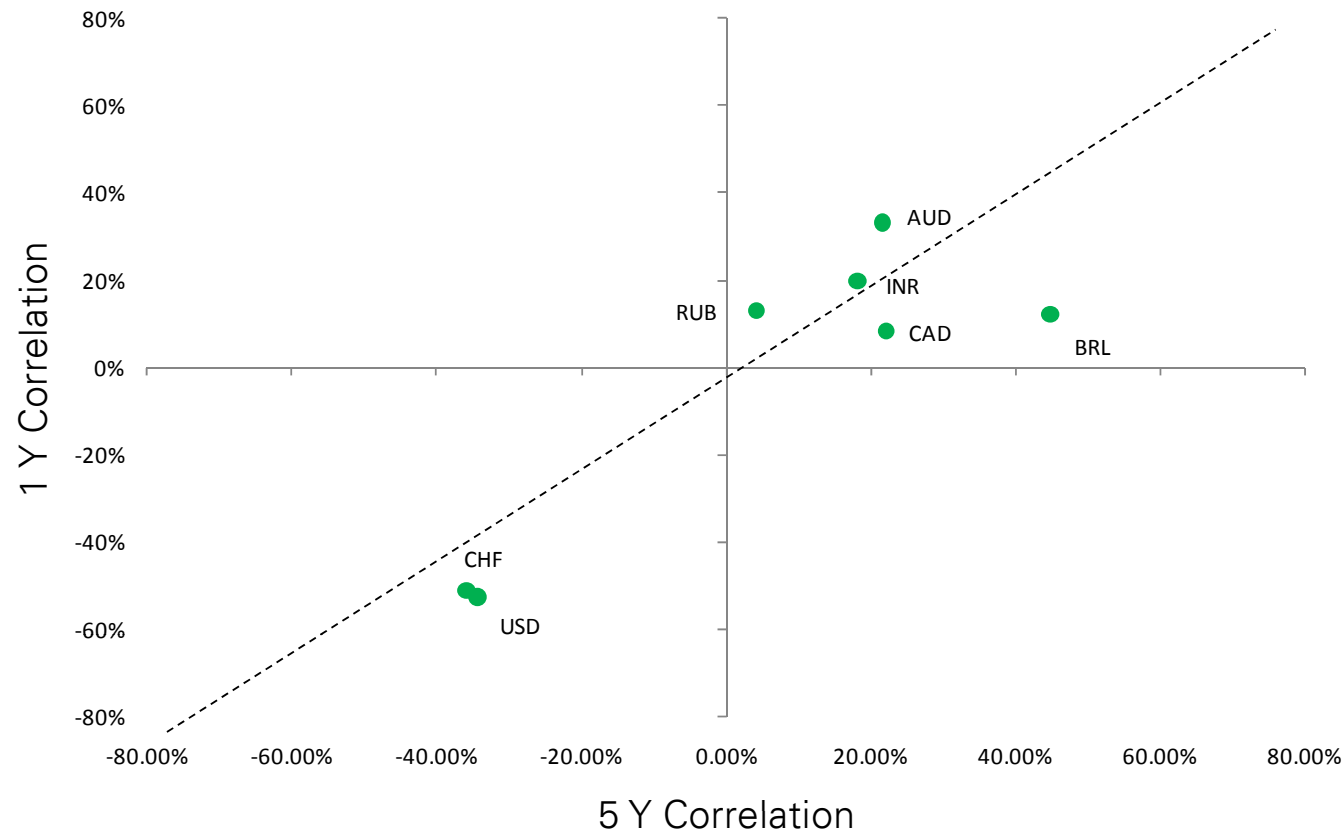


Equity returns: Local vs hedged returns



- Asset & currency risk: Two different types of risk
- Base currency of investor and target index asset native currency:
 - If they are the same: No currency risk
 - If they are different, there is currency risk
- Euro denominated returns are not the same as Euro-hedged returns
- Cost of hedging: Difference between forward and spot rates
 - Spot rate: Immediate settlement
 - Forward rate: Settlement at a future date

Equity & Euro FX correlations

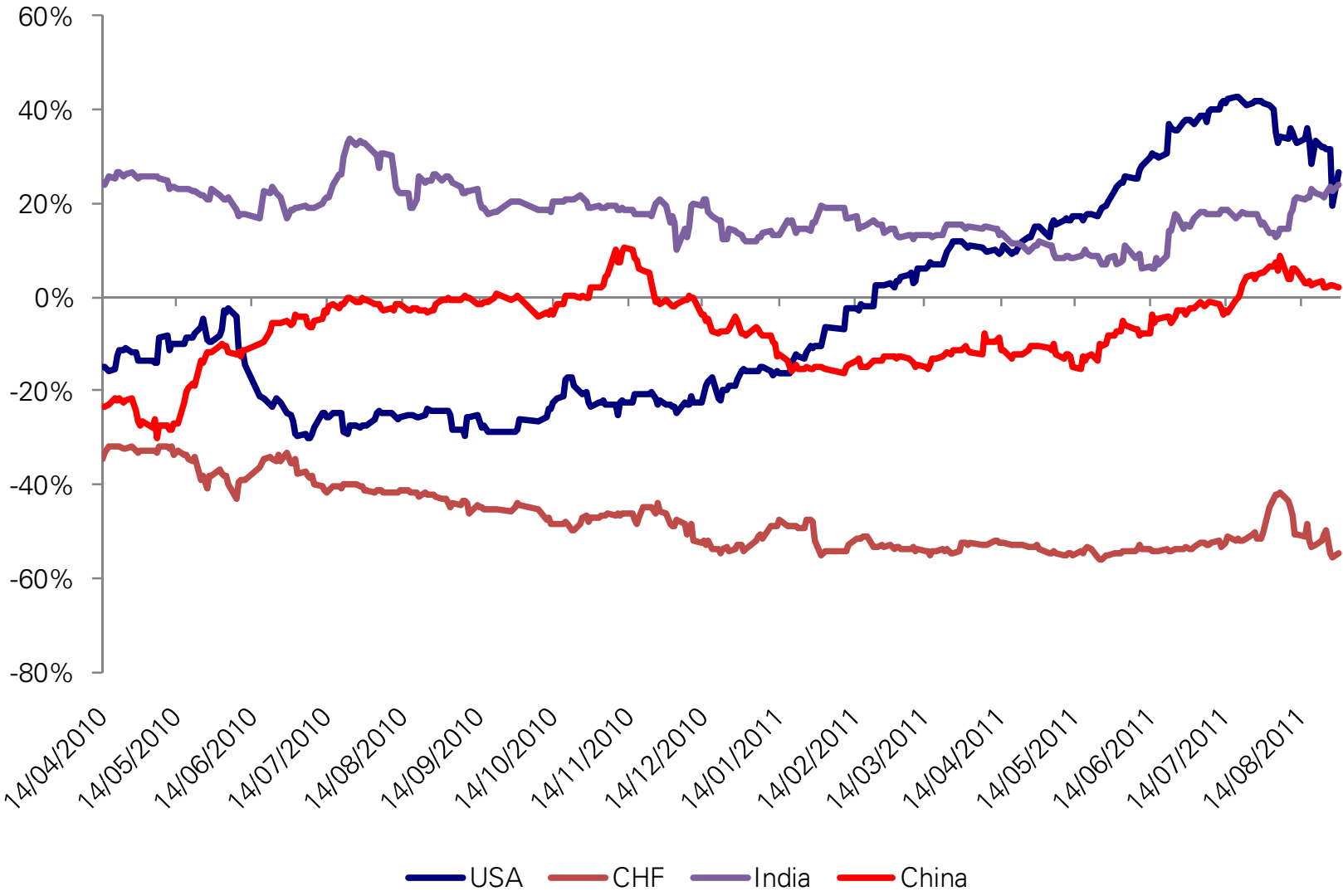


Source: Deutsche Bank, Bloomberg

- Relative competitiveness: EMs are stepping up the pressure on DMs
- Interest rate differentials: Countries with trade surpluses will raise rates faster than deficit countries



Equity & Euro FX moving [120d] correlations



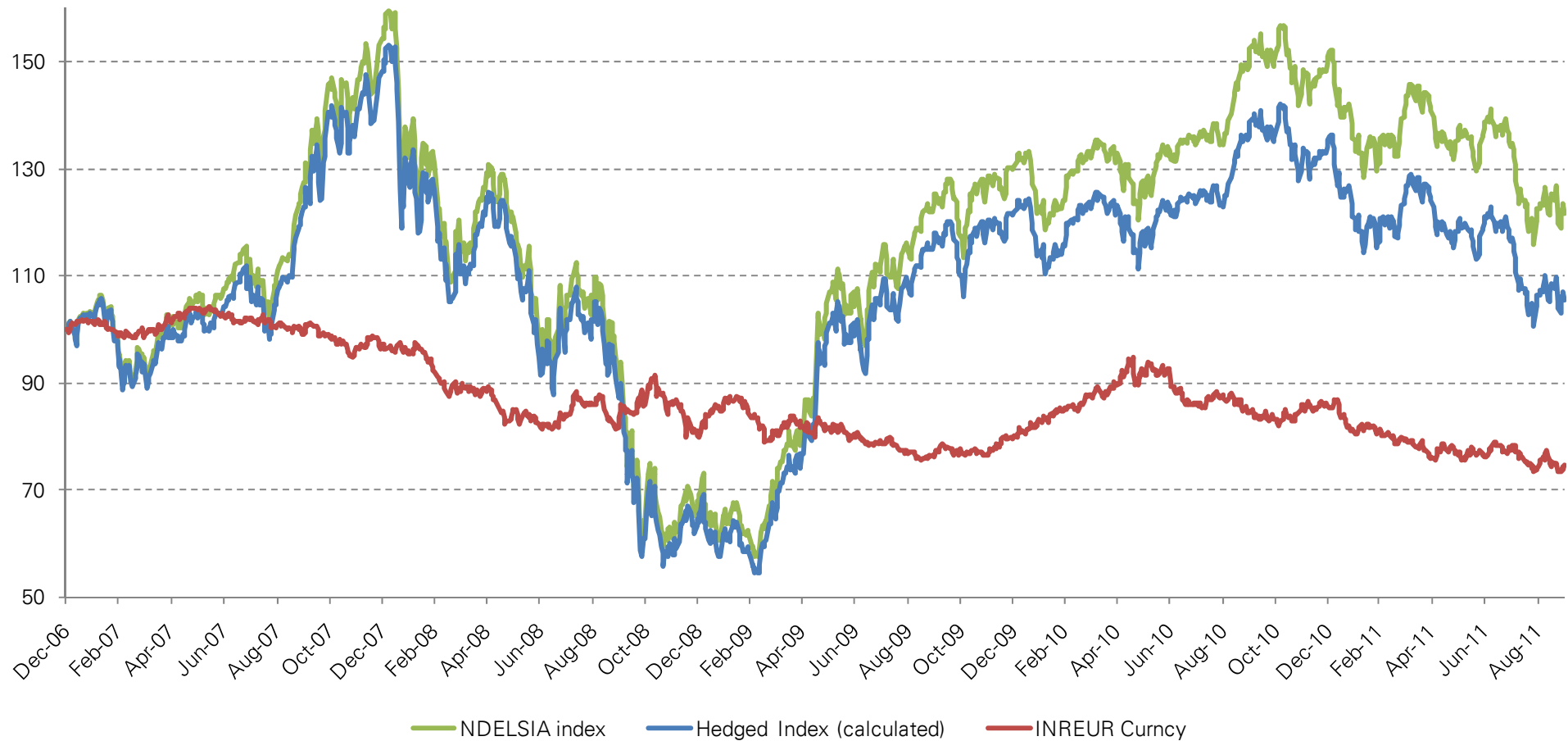
Source: Deutsche Bank, Bloomberg

A changing world: China



Source: Deutsche Bank, Bloomberg

A changing world: India



Source: Deutsche Bank, Bloomberg

A changing world: USA



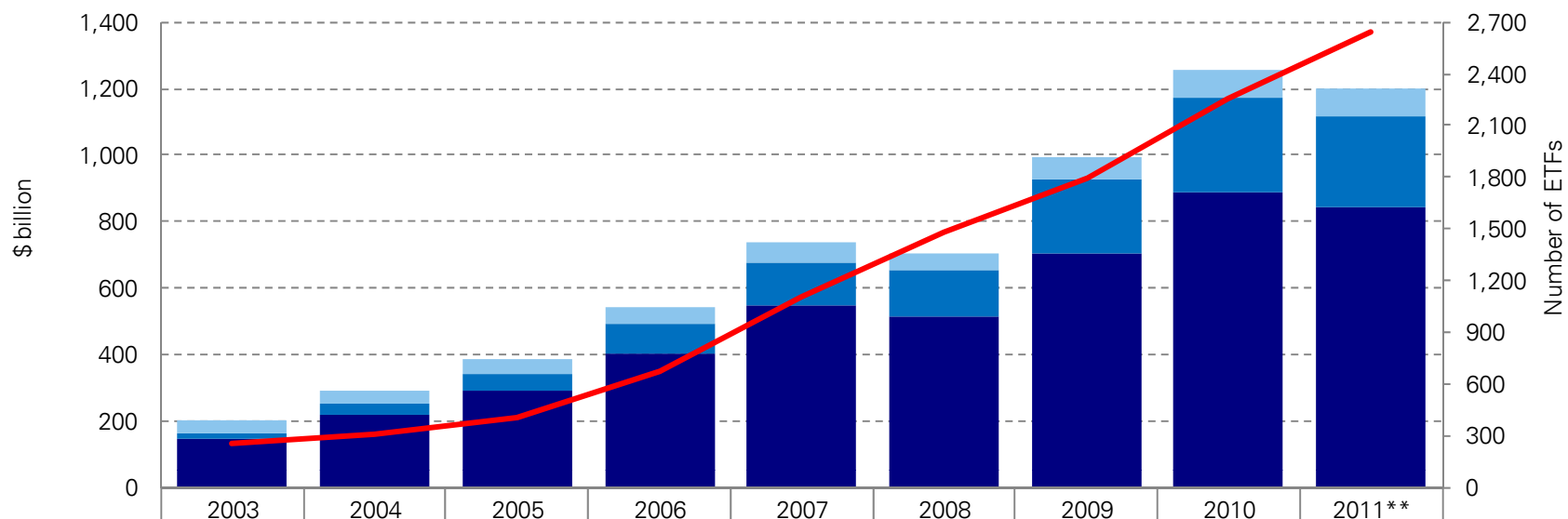
Source: Deutsche Bank, Bloomberg



ETFs & currency risk: How relevant is it?

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Global ETF industry

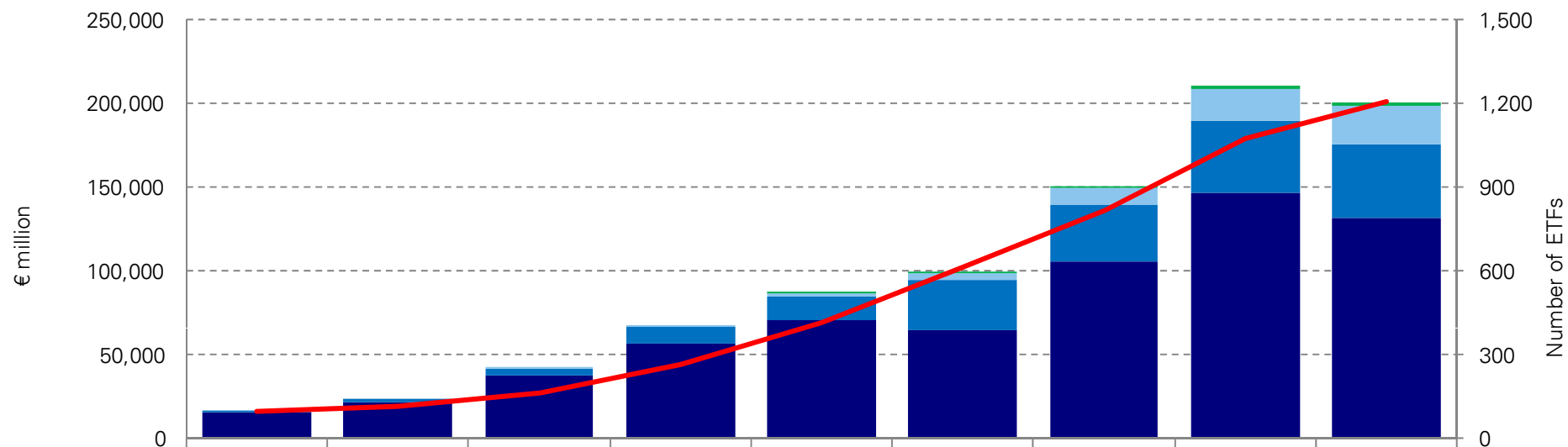


	2003	2004	2005	2006	2007	2008	2009	2010	2011**
Asia Pacific (\$)	34.8	39.9	42.8	48.4	60.0	52.2	64.4	83.5	87.2
Europe (\$)	20.5	32.3	50.0	89.4	127.1	137.8	226.2	282.5	269.1
US (\$)	144.1	217.4	292.0	404.5	548.8	516.3	701.5	889.4	845.1
US, Europe & Asia Pacific (\$)	199.5	289.7	384.8	542.3	735.9	706.3	992.2	1,255.4	1,201.5
Europe (€)	16.3	23.8	42.2	67.8	86.9	99.1	157.7	210.5	200.6
Number of ETFs*	251	304	409	671	1,109	1,478	1,797	2,251	2,643

Source: Deutsche Bank, Bloomberg

** As of 30/9/11

European ETF industry



	2003	2004	2005	2006	2007	2008	2009	2010	2011**
Other	-	-	-	-	97	168	1,031	1,987	1,903
Commodity	-	-	340	1,403	2,323	3,582	10,114	19,351	22,581
Fixed Income	801	2,032	4,015	9,377	13,759	29,741	34,331	42,320	44,286
Equity	15,532	21,789	38,035	57,070	70,856	65,234	105,424	146,891	131,833
Total	16,332	23,820	42,390	67,850	87,035	98,724	150,901	210,549	200,604
Number of ETFs*	100	114	163	267	418	616	820	1,076	1,210

Source: Deutsche Bank, Bloomberg

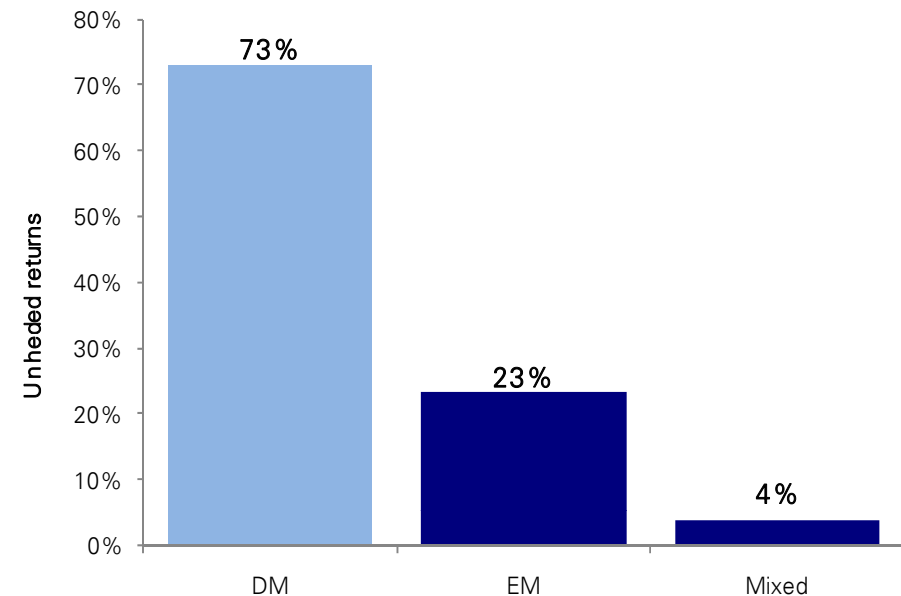
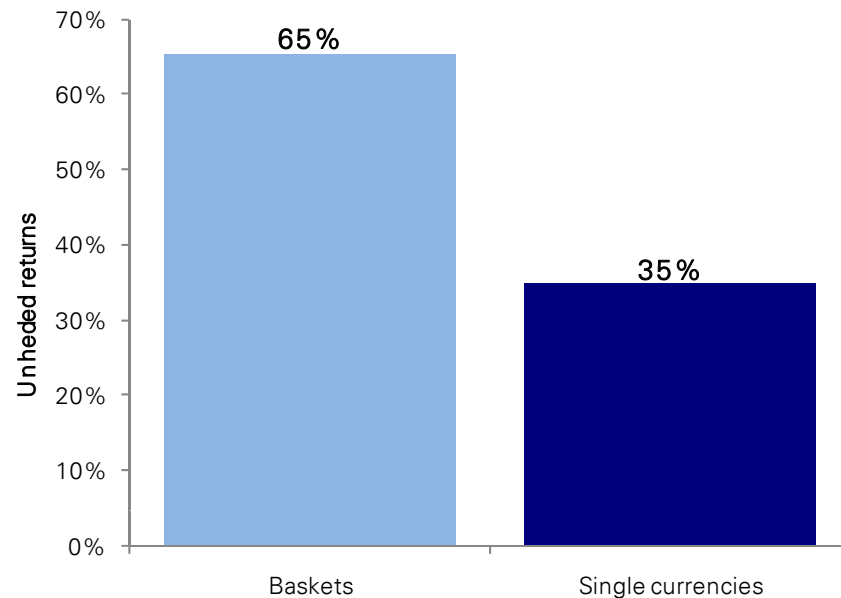
** As of 30/9/11

How does hedging work in ETFs?



- Physical replication
 - OTC: FX forwards (most common), FX options
 - Exchange-traded: FX futures
 - Hedging is done directly by the fund
- Synthetic replication
 - Through the TRS, the fund receives hedged returns
 - Hedging is outsourced to the TRS counterparty

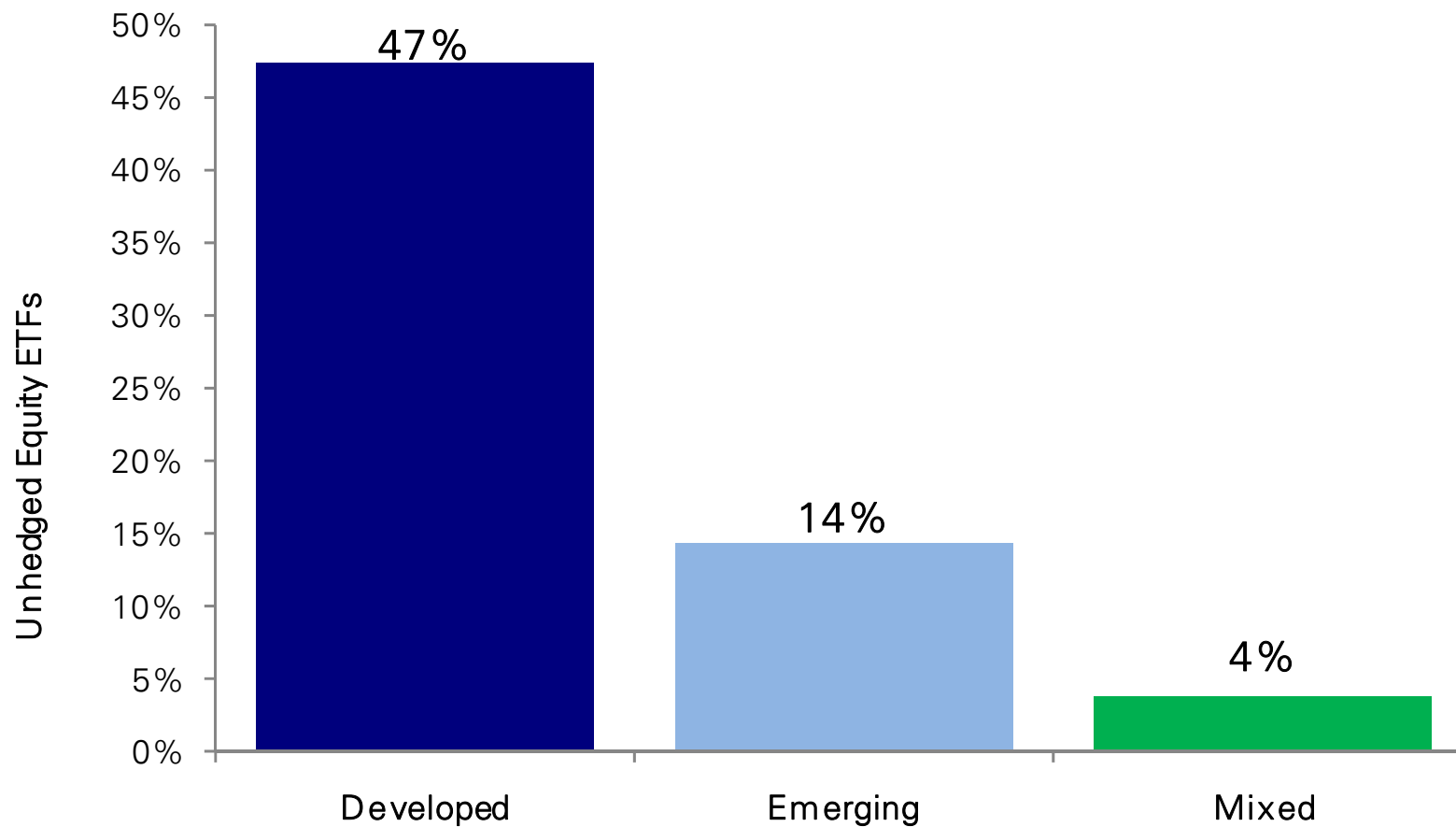
How relevant is currency risk for the European equity ETF investor?



Source: Deutsche Bank, Bloomberg

- **71.7%** [€94.6 bil.] of European equity ETFs are subject to currency risk
 - **0.4%** offer Euro or GBP currency hedged returns
- Currency risk is very relevant to the ETF investor

Baskets: DMs or EMs?

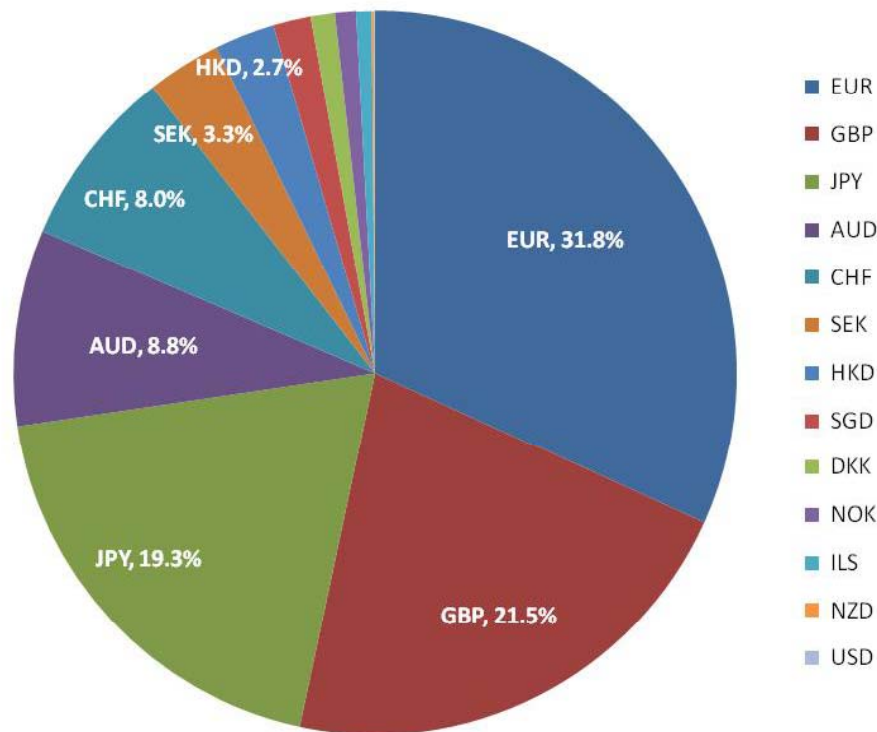


Source: Deutsche Bank, Bloomberg
* As of 30/9/11

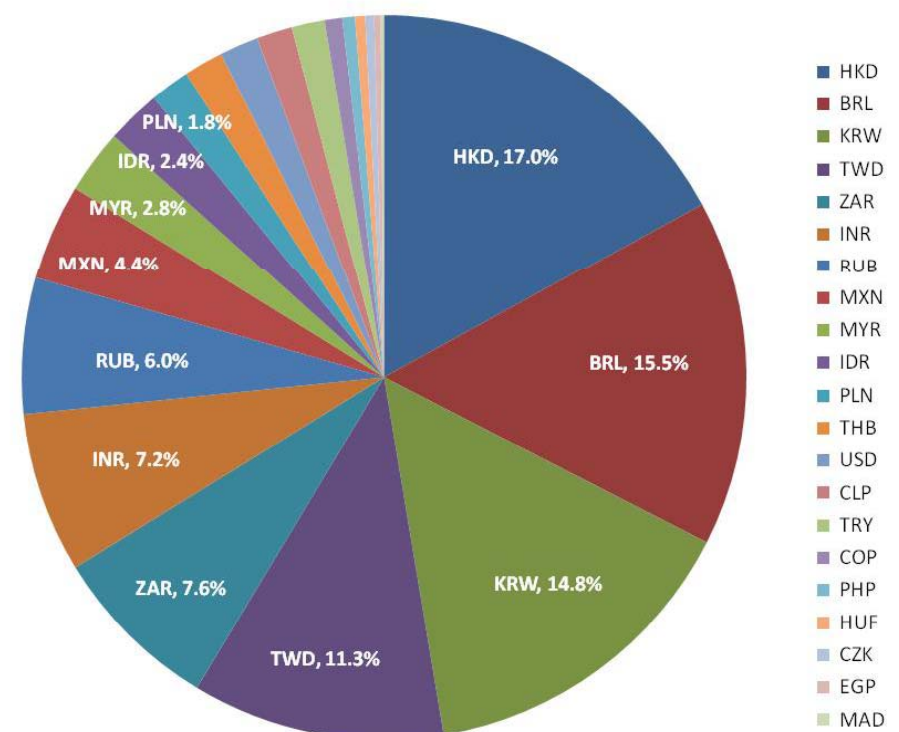
Baskets: How diversified are they?



MSCI EAFE



MSCI Emerging Markets

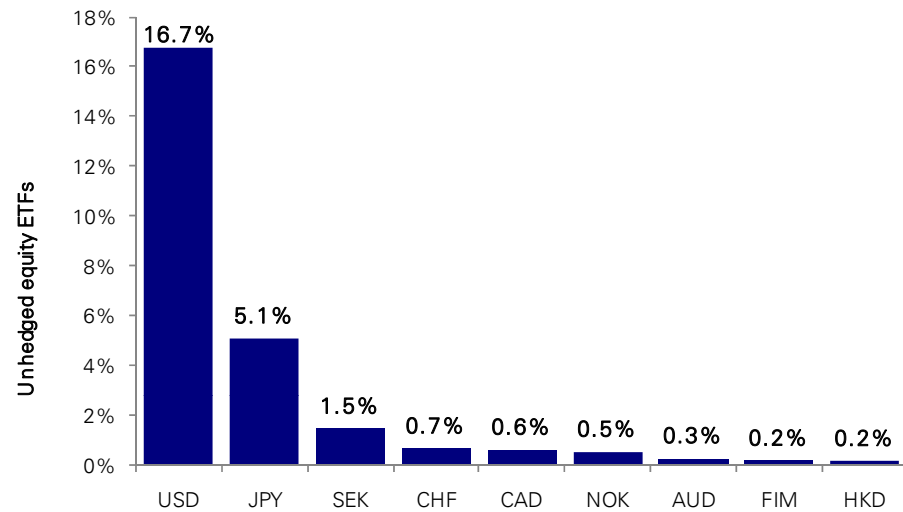


Source: Deutsche Bank, Bloomberg

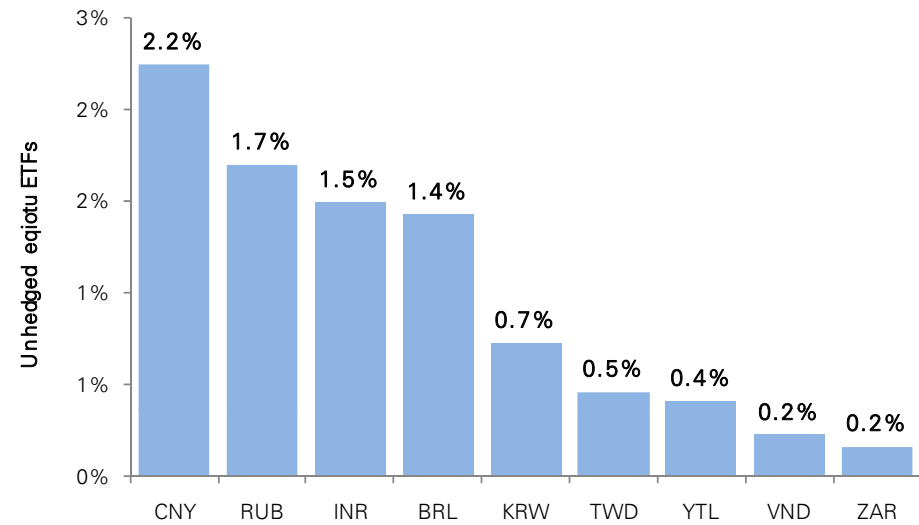
Single currencies: EM or DM?



Developed Markets



Emerging Markets



Source: Deutsche Bank, Bloomberg

List of ETFs offering hedged equity returns



BBG ticker	Launch date	Exchange	Asset currency	Hedge currency	ETF Name	TER	Un-hedged version* TER	Diff.	AUM (€ million)
1 IUSE LN	04/10/10	LSE	USD	EUR	iShares S&P 500 Monthly EUR Hedged	0.45%	0.40%	0.05%	229.2
2 IJPE LN	04/10/10	LSE	JPY	EUR	iShares MSCI Japan Monthly EUR Hedged	0.64%	0.59%	0.05%	151.7
3 XKSP GR	20/01/11	DB	USD	EUR	db x-trackers S&P 500 Euro Hedged Index ETF	0.30%	0.20%	0.10%	111.7
4 IGWD LN	04/10/10	LSE	Basket	GBP	iShares MSCI World Monthly GBP Hedged	0.55%	0.50%	0.05%	84.8
5 IWDE LN	04/10/10	LSE	Basket	EUR	iShares MSCI World Monthly EUR Hedged	0.55%	0.50%	0.05%	45.6
6 IGUS LN	04/10/10	LSE	USD	GBP	iShares S&P 500 Monthly GBP Hedged	0.45%	0.40%	0.05%	34.7
7 M9SQ GR	17/02/11	DB	JPY	EUR	RBS Market Access TOPIX EUR Hedged Index ETF	0.50%	NA	NA	8.5
8 M9SW GR	17/02/11	DB	USD	EUR	RBS Market Access S&P 500 EUR Hedged Index ETF	0.30%	NA	NA	8.1
9 M9S2 GY	26/09/11	DB	Basket	EUR	RBS Market Access MSCI EM LatAm (Brazil ADR) EUR Hedged Index ETF	0.65%	NA	NA	3.3
10 M9S1 GY	26/09/11	DB	BRL	EUR	RBS Market Access MSCI Brazil (ADR) EUR Hedged Index ETF	0.60%	NA	NA	3.2

* Unhedged ETF tracking the same index and offered by the same ETF Provider

Source: Deutsche Bank, Bloomberg



ETF industry: At cross-roads

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ETF industry: At cross-roads



- In a tough economic environment, tools to more accurately extract returns will only become more popular
- ETF industry next steps: Moving up a gear?
 - Currency risk: a growing consideration
 - Asset allocation: precision is the name of the game
- ETFs continue to be at the forefront of innovation
- Regulatory scrutiny into ETFs

Deutsche Bank ETF research coverage



Comprehensive ETF market review and outlook

- Weekly ETF market review - statistical reports by region (Europe, US, Asia)
- Monthly & Annual global ETP market review and outlook reports, with analysis by region
- ETP Product Directories (global and by region, updated every month)

Thematic ETF research

- August 2010: The changing face of equity bet investing: ETFs, Futures and Total Return Swaps
- August 2010: Do ETF trackers track? European Equity ETF tracking error under the microscope
- January 2011: Part fund, part stock: ETFs in a path to unlocking global asset liquidity
- June 2011: Fixed Income ETF Tracking Effectiveness: Hitting the target?
- July 2011: In the ETF Labyrinth, where does the thread begin?
- August 2011: Currency risk in equity ETFs: To hedge or not to hedge

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[Christos Costandinides]



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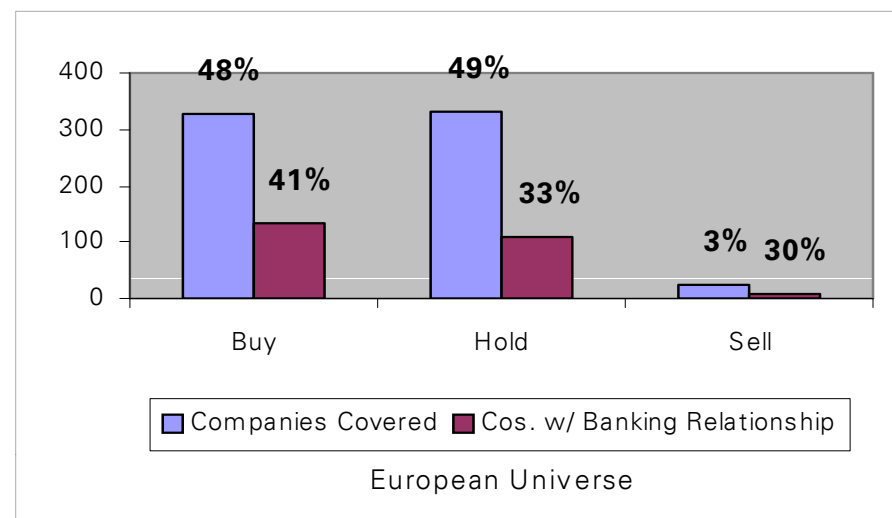
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