

US investors u-turn on currency hedges

Once lured by currency hedged exposure to foreign equity markets, US ETF investors are withdrawing funds as the recovery in equities loses steam and dollar weakness erodes hedging incentives.

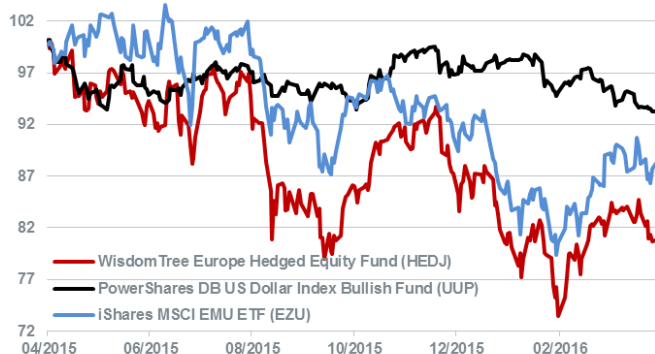
- ETF investors withdraw \$6.5bn from currency hedged ETFs
- Biggest hedged outflows emanating from Japanese and European ETFs
- Largest inflows going into bonds, gold, and UK funds hedged against Sterling movements

US investors exposed to equities in Japan and Europe have withdrawn over \$6bn from currency hedged ETFs thus far this year.

In **2015** currency hedged ETFs recorded significant fund inflows totalling almost \$60bn as investors made use of hedging features designed to mitigate currency risk, while maintaining exposure to foreign equity markets.

However, this trend seems to be unwinding fast and reveals investors efficient use of ETFs when faced with trend reversals. Strong outflows have occurred from US domiciled funds specifically, which have seen \$7.1bn of outflows thus far this year.

Europe Equity ETFs, unhedged versus hedged



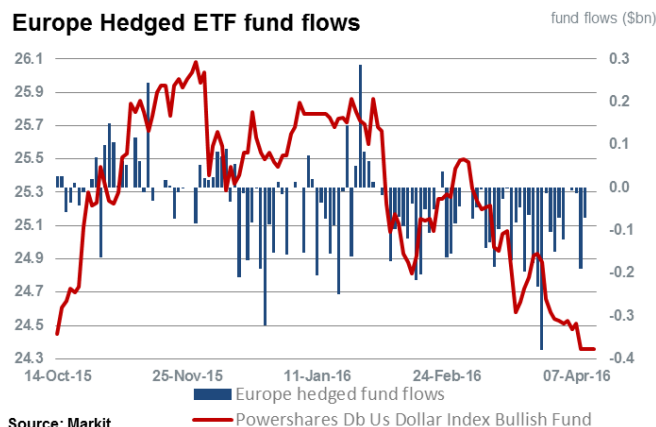
Source: Markit

Analysing return differentials of hedged versus unhedged ETFs, investors can be forgiven for not staying the course. On a total return basis, the weaker relative underperformance of the Wisdom Tree Europe Hedged Fund (HEDJ) compared to the unhedged iShares MSCI EMU ETF (EZU)

over the past 12 months is 7%. The underperformance is almost perfectly explained by the total returns of the Powershares USD index bullish fund (UUP) which shows a decline of 6.9% over the same time period.

Although hedged products have served their mandate well they do attract higher management fees. A recent stint of dollar weakness has meant investors in hedged products have reduced currency downside which also means sacrificing the upside. Paying for this pleasure has seen investors start to unwind positions as currency movements go against them.

Europe Hedged ETF fund flows



Source: Markit

Losing out on dollar weakness seems to be too much to swallow for a swathe of US ETF investors as outflows indicate investors are concerned around future dollar weakness than the strength.

Top ten currency hedged ETF outflows (\$mn)	Ticker	NAV CCY	YTD Inflow Outflow	AUM (USD)
WisdomTree Japan Hedged Equity Fund	DXJ	USD	- 3,344	8,913
WisdomTree Europe Hedged Equity Fund	HEDJ	USD	- 2,676	13,219
iShares MSCI Japan EUR Hedged UCITS ETF	IJPE	EUR	- 640	2,583
iShares Currency Hedged MSCI Germany ETF	HEWG	USD	- 476	667
UBS ETF - MSCI EMU 100 hedged to USD UCITS	EUUSBH	USD	- 407	1,043
Deutsche X-trackers MSCI EAFE Hedged Equity ETF	DBEF	USD	- 370	11,870
iShares Currency Hedged MSCI EMU ETF	HEZU	USD	- 275	2,094
UBS ETF - MSCI Japan 100% hedged to USD UCITS ETF	JPUSBH	USD	- 219	341
Deutsche X-trackers MSCI Europe Hedged Equity ETF	DBEU	USD	- 219	3,380
iShares MSCI Japan GBP Hedged UCITS ETF	UPH	GBP	- 217	325
Source: Markit			- 8,842	44,435

With the majority of currency ETFs domiciled within the US and \$50bn in AUM, USD funds represents the majority of hedged withdrawals. The biggest USD withdrawals have flowed out of European and Japanese equity funds totalling \$3.3bn and \$2.7bn respectively. However, the euro denominated iShares MSCI Japan fund has also tallied a significant \$640m of outflows thus far this year.

Currency hedged ETFs inflow YTD by country (\$)

	AUM	Fund Flow
United States	49,207,704,879	- 7,145,207,500
Canada	12,297,225,203	1,344,584,866
Ireland	11,758,123,894	- 681,618,776
Luxembourg	5,406,034,516	- 544,470,696
France	4,242,248,961	- 285,930,913
Switzerland	3,049,941,117	313,874,468
Jersey	1,421,722,221	411,181,480
Japan	169,412,845	5,735,919
Australia	253,134,704	57,625,288

Source:Markit

Some of the largest inflows year to date has been captured by smaller funds measured by AUM which provide hedged exposure to Bonds, UK large Caps, Gold and the S&P500.

Canadians are using hedged ETFs to protect against the Loonie with \$1.3bn of inflows seen year to date. The currency and country has battled lower oil prices however, recent

strength in the currency could cause similar reversals seen above with USD based investors.

Top ten currency hedged ETF inflows (\$bn)	Ticker	NAV CCY	YTD Inflow Outflow	AUM (USD)
iShares Currency Hedged MSCI EAFE ETF	HEFA	USD	390	3,721
BMO Mid-Term US IG Corporate Bond Hedged to CAD Index ETF	ZMU	CAD	327	457
UBS ETF - MSCI United Kingdom 100 hedged to CHF UCITS ETF	UKCHBH	CHF	312	574
db Physical Gold Euro Hedged ETC	XAD1	EUR	295	830
ETF UBS - MSCI United Kingdom 100 hedged to USD UCITS ETF	UKUSBH	USD	292	610
iShares Core S&P 500 Index ETF (CAD-Hedged)	XSP	CAD	287	2,740
iShares Global Corporate Bond EUR Hedged UCITS ETF	CRPH	EUR	192	1,022
iShares S&P 500 EUR Hedged UCITS ETF	IUSE	EUR	176	1,391
AMUNDI ETF EURO STOXX 50 UCITS ETF - DAILY HEDGED		USD	145	949
iShares J. P. Morgan \$ EM Bond EUR Hedged	EMBE	EUR	141	789
Source: Markit			2,558	13,085

Top ten inflows into hedged ETFs total over \$2.5bn in aggregate with some interesting funds attracting significant inflows relative to AUM.

CHF and USD investors have hedged exposure to UK equities which could indicate concerns regarding possible Brexit scenarios and European ETF investors have increased their investments into hedged dollar exposure to gold.

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