

Date of the event:

On Thursday 04th November 2010
From 01:00 PM to 2:00 PM

Location:

Luxembourg School of Finance
University of Luxembourg
4 Rue Albert Borschette
2nd Floor
Modigliani Miller Auditorium (E02-003)
L-1246 Luxembourg

Registrations:

- Free seminar (with lunch included)
- Registrations by email before November 2nd, 2010
- At the following address : lsf-events@uni.lu

Information:

Ms Caroline Herfroy
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<http://www.lsf.lu/eng/Research/Seminars-and-Workshops>



The LSF is pleased to invite you to the following
lunch seminar:

***Optimal Passive Currency Holdings:
Equilibrium Currency Hedging Revisited***

***By Prof. Ian Cooper
London Business School***



**Thursday 04th November 2010
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Optimal Passive Currency Holdings: Equilibrium Currency Hedging Revisited

By Ian Cooper

The Luxembourg School of Finance

Is pleased to invite you to the

LSF Seminar

International investors can use foreign currency holdings to hedge the currency exposure of their risky asset holdings, to hedge their exposure to inflation, to speculate on currency movements, or to hold foreign currency as an asset based on its risk-return characteristics. The optimal choice depends on exchange rate expectations and investor preferences, both of which are unobservable. In order to get around this difficulty, Fischer Black proposed that the exchange rate expectations used to select the optimal currency policy should be consistent with equilibrium. From this he derived a result about the optimal amount of currency hedging, which he called the universal hedge ratio. Other authors have pointed out that his result requires several very strong assumptions, including all investors having the same risk aversion, equity portfolios, and wealth.

Despite these objections, assuming equilibrium expected returns is a powerful tool in estimating optimal currency positions for portfolios. The purpose of this paper is to use Black's basic approach, but incorporate more realistic assumptions. In particular I derive the optimal currency portfolios for investors that differ in risk aversion, equity portfolios, and wealth, but have equilibrium currency beliefs. The resulting currency portfolios can be estimated from observable parameters. I do this for a typical US investor. The optimal currency holding for a typical US investor is to hold long positions in foreign currencies. This policy differs significantly from other frequently advocated currency strategies. It may be viewed as a passive benchmark against which other currency strategies could be evaluated.

