

Beyond a “Zero Sum Game”

How Currencies Can Add Alpha and Lower Risk

In the financial markets, as in many other aspects of life, misinformation can be costly. This is especially true for the currency markets, where the conventional wisdom embodies a good deal of misinformation. If this misinformation is accepted at face value it can lead investors to overlook or ignore significant opportunities for alpha generation and risk reduction.

Provided below are three elements of conventional wisdom where we believe the wisdom ends and the misinformation starts. They are:

- Myth ¹: Currency markets are incredibly efficient; looking for value is a fool’s errand.
- Myth ²: Foreign assets should be left unhedged to improve diversification.
- Myth ³: Currency is a zero sum game. Whatever someone earns, someone else loses. On average we all break even.

MYTH ¹

Currency markets are incredibly efficient; looking for value is a fool’s errand.

This piece of conventional wisdom is often cited to support an assertion that the attractive track records of active managers can be attributed to simple timing and luck. Let’s take a look at what is efficient in the currency markets and what is not.