Senate Finance and Public Administration Legislation Committee
ANSWERS TO QUESTIONS ON NOTICE
SUPPLEMENTARY BUDGET ESTIMATES 2011-2012

Finance and Deregulation Portfolio

Department/Agency: Future Fund Management Agency
Outcome/Program: Outcome 1
Topic: Emerging market currency losses

Senator: Cormann
Question reference number: F48
Type of question: Hansard, F&PA Committee, page 37, 18 October 2011
Date set by the committee for the return of answer: Friday, 2 December 2011

Number of pages: 2

Question:

Can you please quantify the loss incurred by the fund over the last three years in relation to exposure to currency foreign exchange positions on emerging markets?

Answer:

In building a diversified portfolio consistent with its mandate the Board expects to have a proportion of the portfolio invested overseas and therefore, absent any hedging, exposed to foreign currency volatility. However, the Board's starting position is to consider investments on a fully hedged basis (back to AUD) and then consider the extent to which it wishes to maintain currency exposures as part of the program as a whole. The Board notes that there are long-term secular drivers that provide support to AUD strength, but that set against this are the risks to the Fund's liquidity position of hedging the foreign currency exposures back to AUD. The Board also notes that periods of AUD weakness can still be expected and that this volatility must be considered as part of a diversified portfolio.

The Board has determined that it will maintain an exposure to emerging market currency of 12.5% of the portfolio. This allocation to emerging market currency provides further diversification to the portfolio and offers a source of additional return from exposure to fast-growing economies.

As noted in the 2010/11 annual report, where an offshore asset is fully hedged to Australian dollars, a gain or loss on the currency hedging is expected to be fully offset (other than interest rate differentials) by the currency gain or loss in holding the underlying asset (as the currency is hedged). Currency gains or losses should therefore be carefully interpreted as the underlying asset is likely to also reflect the offsetting loss or gain when the asset is hedged.

Assessment of the performance of the emerging market currency portfolio should therefore not be seen in isolation from the performance of the broader portfolio and the need to construct a diversified portfolio that is robust under a range of scenarios over time, including periods when the AUD is stronger or weaker. The Board focuses on performance at the portfolio level and over the period since July 2007 the Fund has grown from $52.5 billion to $73.1 billion (as at end December 2011).

The Board continues to carefully consider its approach to currency issues as part of its prudent management of the portfolio as a whole.