Understanding currency hedging

At Kiwi Wealth, we use currency hedging to reduce the risk to returns that can arise from the change in value of one currency against another. Being exposed to volatile movements in foreign currencies adds another element of risk to our portfolios and to manage the risk we use a technique called currency hedging.

What is currency hedging?

The best way to understand hedging is to think of it as reducing or removing a particular risk. In the case of currency hedging, the risk is that if a currency changes in value it can adversely affect the returns on a portfolio. There are different instruments that a Manager can use to help manage this risk. One such instrument is a forward currency contract, in which the managers locks in the future value of a currency to the current rate of exchange. Currency hedging has also given an additional return thanks to New Zealand's interest rates, which are higher than most offshore rates.

Kiwi Wealth portfolios are invested globally, which means their returns in New Zealand dollars are exposed to movements in the exchange rate. In other words, the returns on overseas investments are muted by a rising Kiwi dollar. Alternatively – and more positively - the gains on overseas investments can be strengthened by a falling New Zealand dollar.

To partially protect against a rising New Zealand dollar, we hedge a proportion of portfolios to reduce exposure to the currency risk.

How does currency hedging work at Kiwi Wealth?

Kiwi Wealth fully hedges our NZ Fixed Interest strategy (including the Kiwi Wealth Fixed Interest PIE) so this portfolio is immune from movements in foreign currencies. With currency being so volatile the last thing we want is to have the most stable part of your portfolio disrupted by large adverse movements in foreign currencies.

The benchmark for hedging exposure to foreign currencies through the Kiwi Wealth Growth strategy is currently 50%, meaning that 50% of the portfolio is subject to movements in the New Zealand dollar against foreign currencies.

We don't hedge all of the Growth strategy currency risk because it can provide a useful diversifier for our New Zealand based clients who already have New Zealand dollar exposure, due to their incomes and homes being in New Zealand. Any exposure to foreign currencies through the Kiwi Wealth Fixed Interest strategy (e.g. through assets denominated in a foreign currency) will generally be fully hedged to the New Zealand dollar.