Insights

Enhancing ESG portfolio returns

Could Currency Alpha be the answer?

Over the past decade, socially responsible investing has become a key objective of pension funds globally. Environmental, social and governance (ESG) risk ratings have enabled investors to incorporate non-tangible information about a company, such as environmental and employee welfare policies, into their investment decisions.

As the demand for ESG rated equity and bond funds increase, portfolio managers are consistently searching for ways to enhance the return to risk ratios of their funds versus those of their competitor’s. Although this is not always a straightforward task given that investing in non-ESG assets usually impacts the overall fund’s ESG rating in a detrimental manner. However, one possible solution could be an investment in currency alpha given its ESG neutral effect on the overall portfolio rating.

Currency Alpha

Whilst most portfolio managers are aware of the risks created by leaving the currency exposures of their international assets unhedged, far fewer are aware of the potential for returns that can be generated by investing in a currency alpha product. In addition, making an allocation to currency alpha has neither a positive nor negative impact on the ESG rating a credit agency gives to a fund, its impact is “ESG rating neutral” in that respect. This is an important point as many ESG managers seek ways to enhance the returns of their portfolios, and therefore distinguish themselves from their competitors, without the additional investment changing the ESG score of their fund.

An additional benefit of allocating to currency alpha is that such an investment does not necessarily require to be funded as managed accounts can be used. Therefore, an allocation to currency would not involve having to raise additional capital and/or liquidating part of the underlying investment in the ESG equities or bonds.1 The purpose of this white paper is to assess the impact on the risk and return of a typical ESG equity and ESG bond portfolio when an allocation to currency alpha is made.

[Read more]

1. Daily margin will be required if the currency alpha programme trades via futures or non-deliverable forward (NDFs) contracts.