

Quick Take: Currencies in the crisis

March 24, 2020

Divergent Responses

- As investors grapple with the uncertainty created by COVID-19, unsurprisingly, defensive currencies have held, dropping 2.4% against the U.S. dollar, while cyclical currencies, have lost 17.6%.
- Closer inspection, however, reveals meaningful dispersion of returns that offers insight into the nature of the crisis and the policy response. For example, between 02/20-03/20, commodity exporters' currencies have suffered, while currencies of commodity importers have relatively benefited (Thai bhat outperformed Norwegian krone by about +18%) on the promise of lower input costs.

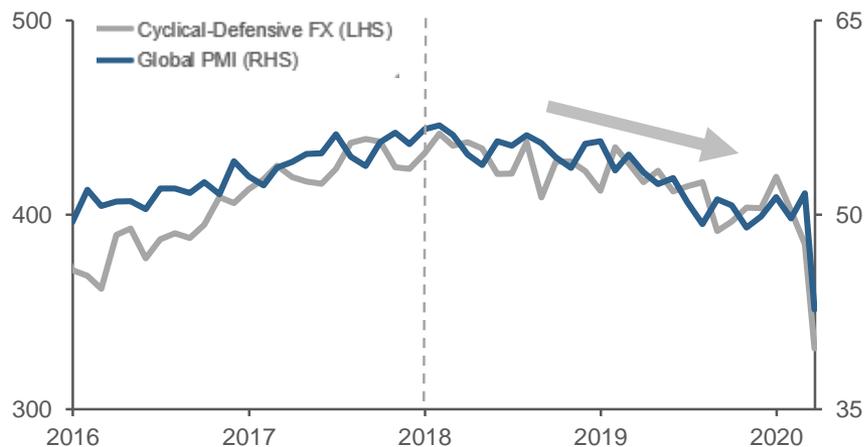
Stepping Back

- Currency sensitivity to changes in the macro environment (top chart) is not just a recent phenomenon. Cyclical currencies had been weakening since 2018, in sync with macro indicators -- a trend that accelerated over the last few weeks.
- We also observe that currencies show lower correlations than equity markets, an effect that becomes even more pronounced during crises -- including COVID-19.

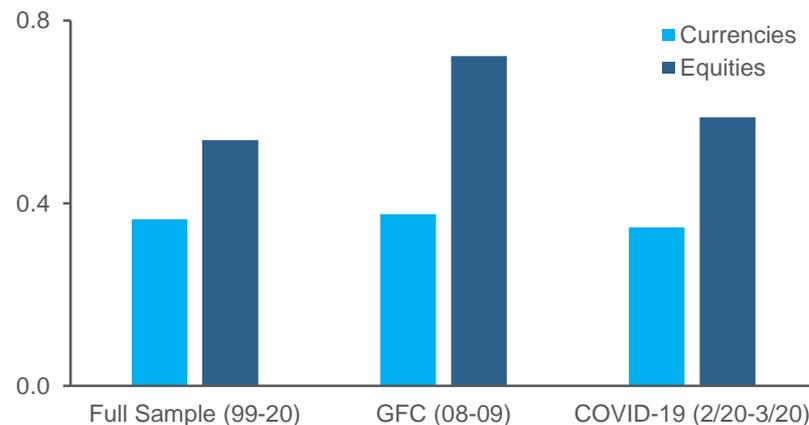
Looking Ahead

- Cyclical currencies, with their growth sensitivity, can offer valuable early clues to investors as markets process the global impact of the virus outbreak and the effectiveness of the policy response.
- Moreover, given the dispersion among their performance, both cyclical and reserve currencies offer investors a window into country-level economic impact and recovery prospects.

Currencies Tracking Macro Indicators



Cross-sectional Correlation



Both charts as of 03/20. Sources for both charts: MSCI, Bloomberg, Acadian Asset Management LLC. Top chart: Hedged Equities based on MSCI ACWI hedged back to U.S. dollar. FX basket is a levered long-short portfolio with long cyclical FX and short defensive FX. Bottom chart: Equity returns are hedged, excess. Correlations are 0.5y half-life exponentially weighted and cross-sectionally averaged. Equities and Currencies use the same universe - Cyclical FX: BRL, MXN, AUD, ZAR, NOK and Defensive FX: INR, THB, JPY, CHF. For illustrative purposes only.

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