# Currency Returns – Where do they come from and are they worth the risk?

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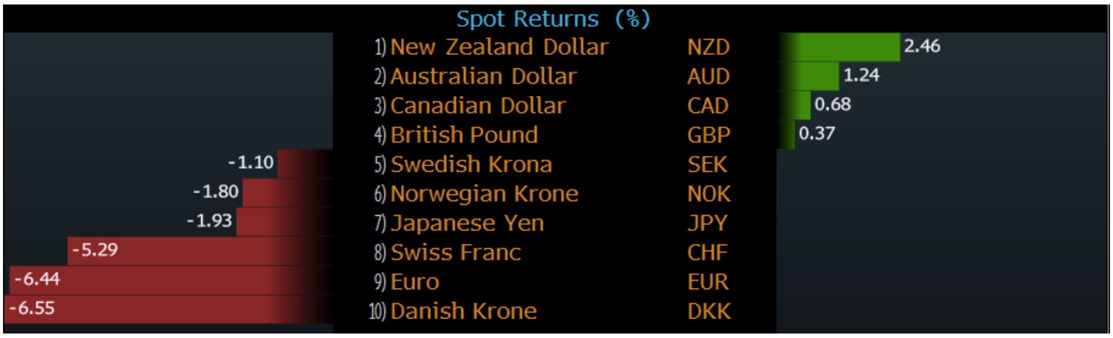
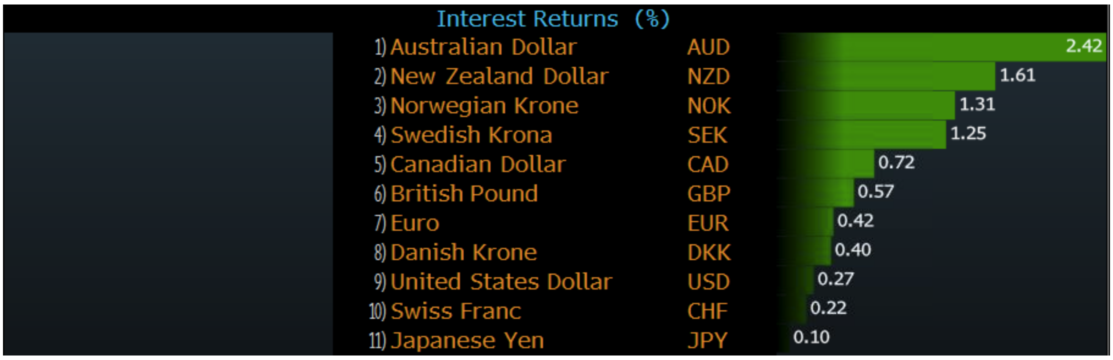
It is a fact that all currency returns are derived from either spot or forward returns. Spot returns are simply the headline or "TV" returns; the one everyone looks at, and generally marvel at the apparent randomness. That hasn't ever stopped millions of traders and fund managers trying to "beat the market" and generate returns from predicting Spot moves consistently.

There is also another form of return however; Interest rate, Forward or "Carry Returns" These are much harder for traders to capture, yet they are freely available and by their nature often drive Spot movements.

Let's take a look at the G10 universe of currencies and how they have performed year to date. We can show the returns derived from each Spot and forward, see how they are related, and how they combine.




The above table shows Spot returns, year date, vs. the USD. NZD has been the star performer, adding 2.46% versus USD, and handy 9.01% vs. the Danish Krone. Sadly, this would have been very difficult to predict on the first of January, and if you linked the Financial Crisis to the NZD you would have lost money.




This next table shows the Interest return from each currency. That is, owning each currency above and borrowing USD, and reaping the interest rate differential. You would have to have the positions on from the beginning of the year to earn those returns, much like to must have the money in the bank to earn any interest rate. We can see the AUD is the highest yielding currency – and a not insignificant 2.42 % year to date. Imagine you are a US pension Fund or a Sovereign Wealth Fund. 2.42% YTD for a AAA rated currency as an interest rate return look pretty attractive compared to 0.20 % for 2 Year US Treasuries. Any wonder the currency won't go down! And that leads us to our next slide, showing the combined returns.

| G-10 (per USD) | | Total Return | Spot Returns | Interest Spread Returns |
|---|---|---|---|---|
| 1) New Zealand Dollar | NZD | 4.03 | 2.38 | 1.33 |
| 2) Australian Dollar | AUD | 3.64 | 1.19 | 2.14 |
| 3) Canadian Dollar | CAD | 1.36 | 0.64 | 0.44 |
| 4) British Pound | GBP | 0.89 | 0.32 | 0.29 |
| 5) United States Dollar | USD | 0.27 | 0.00 | 0.00 |
| 6) Swedish Krona | SEK | 0.15 | -1.08 | 0.97 |
| 7) Norwegian Krone | NOK | -0.51 | -1.79 | 1.04 |
| 8) Japanese Yen | JPY | -1.82 | -1.91 | -0.18 |
| 9) Swiss Franc | CHF | -5.05 | -5.26 | -0.05 |
| 10) Euro | EUR | -6.03 | -6.42 | 0.14 |
| 11) Danish Krone | DKK | -6.14 | -6.52 | 0.13 |

So now we can see the total return YTD, and they sizeable when compared to other asset class returns. We can also notice something else – that interest rate returns are indeed worthwhile and often portend to spot gains as well. The key takeaway from this is that yield based returns are worthwhile and can be identified in advance; as opposed to spot moves which appear random most of the time. Clearly, there is a need to identify the tradeoff between spot and Interest rate risks and returns, which leads us on to the next section.

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