ABSOLUTE TREASURY

Corporations have Competitive Advantage in FX Markets

Market participants who treat FX as a business – banks, investors, speculators -- have the following major advantages:

Informational asymmetry and speedy access to information

Large investments in infrastructure

Access to myriad of liquidity sources

Global operations, constant monitoring of 24 hour/day market

Discretionary participation

Corporations meanwhile incur FX exposures as a result of conducting their core business internationally. Hedging, managing currencies is viewed as a cost of doing business which results in the following advantages:

No Return on Capital requirements

PNL typically measured annually

Accounting rules allowing for deferment of FX PNL reporting

High risk tolerance

Significant sized transactions

Long holding periods

Diverse currency portfolio with large global footprint

Therefore, Corporations inherently have extended patience and large capacity for volatility relative to other market participants. In other words, Corporations have strengths where other market participants have weaknesses, most importantly other participants have lower appetite for market volatility.

Corporations can monetize their advantage by selling volatility dearly when other participants are desperate to hedge/unwind their positions and, conversely, by buying cheaply when other participants are dumping volatility.

Another factor at play is US dollar's correlation to moves in market volatily. In general, US dollar appreciates during periods demand for volatility and weakens during periods of low demand for volatility.

In practice for currency conversion purposes - if discretion is available, Corporations sell USD when volatility is in demand and buy USD when volatility is being sold as in general, dollar movements are correlated to changes in market volatility, appreciating with higher demand for volatility and depreciating with lower volatility.

For hedging purposes, Corporations sell covered call positions" during periods of high demand for volatility and earn excess premiums and buy put positions when market participants indiscriminately sell volatility. In addition to vanilla options there are hedging instruments which one can use to "sell" volatility that, unlike vanilla options, have limited downside.

By optimizing management of currency exposures, Corporations have an opportunity to financially outperform peers that are not utilizing their inherent advantages in FX markets. Treasurers typically view currencies as a headache, meanwhile, it offers them the ability to visibly and positively differentiate.

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