IC Brief

Multi-Generational Portfolio FX Overlay Redesign

Scenario Type: Family Office – Multi-Generational Portfolio
Asset Class: Global Equities (Unhedged underlying) with FX forwards overlay
Situation Type: Long-horizon equity portfolio with mechanically rolled, full FX hedging policy
Primary Issue: Structural FX hedge drag caused by over-hedging, negative carry, roll leakage, and governance inertia misaligned with portfolio horizon

1. Decision Context

The portfolio is a globally diversified, multi-generational equity allocation designed to compound across decades.

FX hedging was introduced as a governance control to reduce visible currency volatility in reporting currency terms. Over time, this evolved into a default policy of fully hedging foreign currency exposure using rolling FX forwards.

On paper, the overlay reduces FX noise. In practice, it imposes a persistent, compounding cost.

The IC decision is **not whether FX hedging is appropriate**.

It is whether the **existing FX overlay remains economically coherent, defensible, and fit for purpose** for a long-horizon equity portfolio once carry, roll mechanics, and governance drift are fully accounted for.

This is not a tactical FX call. It is a **portfolio architecture and governance decision**.

2. What Changed

At inception:

- FX hedging introduced as a prudence signal, not a return tool
- Full hedge ratio adopted for simplicity and defensibility
- Rolling forwards treated as operational maintenance
- Hedge costs expected to be modest and incidental

Over time:

- Global equity exposure grew materially
- Carry costs became persistent rather than episodic

- Hedge rolls became frequent and mechanical
- EM currency hedging introduced without economic differentiation
- Ownership of hedge economics diffused across teams

The portfolio evolved intentionally. The FX overlay became **policy-driven and static.**

3. How the Risk Actually Manifests

The failure mode is not FX volatility. It is **economic drift**.

- Negative carry compounds quietly across currencies
- Roll leakage accumulates through frequent execution
- Hedging cost absorbs upside without materially reducing drawdowns
- EM hedges impose costs disproportionate to risk reduction
- USD experience persistently underperforms expectations

The hedge exists. It simply no longer improves outcomes in proportion to its cost.

4. What Surfaces on Review

When assessed as an operating system rather than a policy label, consistent issues emerge:

- Hedge ratios misaligned with portfolio horizon
- No currency-by-currency economic logic
- Full hedging removes natural equity shock absorbers
- Roll frequency increases leakage without added control
- EM hedging costs exceed plausible risk reduction
- No defined re-underwriting or review cadence
- Governance evaluates hedge presence, not hedge behaviour

This is not error or negligence. It is **structural inertia**.

5. Structural Assessment

This is **not**:

- A bad FX call
- A trading failure
- A volatility management problem

It **is**:

- A hedge design and governance failure
- Treating a long-cycle exposure as a short-dated risk
- Paying a permanent cost for perceived certainty

Any response must preserve:

1. Portfolio resilience across regimes
2. Governance defensibility for trustees and stakeholders
3. Simplicity and operational robustness

Blunt removal or tactical FX positioning fails all three.

6. Structuring Logic

Effective remediation focuses on **alignment, not activity**.

Key principles:

- Restate hedging purpose in plain, outcome-based terms
- Replace binary hedge rules with currency-specific logic
- Differentiate DM and EM hedging economics explicitly
- Reduce roll frequency and design execution windows
- Make carry, cost, and behaviour visible and reviewable
- Embed tolerance bands and re-underwriting triggers

The objective is not incremental optimisation. It is restoring disciplined, governed coherence.

7. Intended Outcomes

When addressed correctly:

- FX hedge costs become explicit and intentional
- Negative carry is sized, not assumed
- EM hedging is applied only where defensible
- Execution leakage is materially reduced
- Hedge behaviour is explainable in stress
- Governance shifts from policy to evidence

The outcome is not "making money from FX". It is **restored control over a silent return leak**.

8. IC Takeaway

This was not a failure of markets or judgement.

It was the predictable result of allowing a **comfort policy to become a permanent operating rule** without re-underwriting its economics.

FX hedges rarely fail loudly. They fail quietly – by continuing to exist after they stop making sense.

Treating the overlay as a governed portfolio tool restores control.

9. Applicability

Most relevant where:

- Global equity exposure has grown over time
- A default 100% hedge rule exists
- Hedge cost is persistent but poorly explained
- EM currencies are hedged reflexively
- Roll mechanics are frequent and delegated
- Governance focuses on hedge existence, not behaviour

Less relevant where:

- FX exposure is intentionally unhedged
- Hedging is actively re-underwritten on cadence
- Natural currency offsets exist
- Overlay economics are explicitly monitored

10. Engagement Path

Primary Offer: Hedge Rebuild™ – FX Overlay Reset

Structural redesign of an existing FX hedge programme, addressing hedge ratios, carry economics, roll mechanics, and governance drift – without introducing tactical FX risk or operational disruption.

Secondary / Ongoing:
Governance frameworks, monitoring, trustee-grade reporting, and periodic re-underwriting support as required.

A full structural narrative is available for readers who wish to review the underlying mechanics, trade-offs, and remediation sequencing in greater detail.

Disclaimer

Illustrative scenario for discussion purposes only. Not a transaction summary or client-specific case study.