PARA BELLUM ADVISORS

PRACTITIONER PAPER

FX Hedging for Buy-and-Hold Equity Portfolios

Why rolling forwards persist, when they fail, and how options add value under real-world constraints

By Mike Duncan, Para Bellum Advisors

Version 3, December 2025

www.parabellumadvisors.com

Executive Summary

Rolling FX forwards are not wrong for equities. They are structurally limited.

Most buy-and-hold equity portfolios hedge FX using rolling 1-3 month forwards. This approach gets routinely criticised as lazy or sloppy risk management. That criticism is incomplete.

Rolling forwards persist because they optimise for operational reality: deep liquidity, easy resizing, minimal unwind risk, and governance simplicity.

This paper explains:

- When rolling FX forwards make sense for equities – and when they do not
- Why tenor matching usually fails for indefinite exposures
- How carry dominates long-term outcomes, not volatility
- Why hedge ratios should be dynamic rather than static
- How FX options restore convexity and reduce pro-cyclicality
- How mandatory hedging changes the objective from optimisation to damage control

> *This framework is designed for practitioners implementing FX hedges in institutional equity portfolios.*

1. The Nature of FX Exposure in Equities

Equity portfolios present a unique FX hedging problem. Unlike bonds or loans, they have no contractual maturity, no principal repayment event, uncertain exit timing, and undefined holding periods. Yet the FX exposure persists for as long as the portfolio exists – in many cases indefinitely.

Economically, equity FX risk is long duration (it does not terminate naturally), open-ended (there is no fixed exit date), and path-dependent (cumulative returns matter, not just terminal values).

This creates an immediate problem: there is no "perfect" hedge. Only approximations that trade off different risks and costs against organisational constraints. Most academic FX hedging theory assumes a fixed horizon and known cashflows. Equities violate both assumptions. That is why standard hedging prescriptions – tenor matching, duration-neutral structures, full neutralisation – often fail in practice.

> *The task is not to eliminate FX risk. It is to shape it intelligently under real constraints.*

2. Why Rolling Short-Dated FX Forwards Dominate

Despite endless criticism from consultants and academics, rolling short-dated forwards remain the dominant FX hedge structure for institutional equity portfolios. This is not accident or negligence. It is organisational Darwinism.

Rolling forwards persist because they optimise for operational reality, not textbook elegance.

- **Deep liquidity and tight pricing:** 1-month and 3-month FX forwards trade in enormous size with minimal bid-offer spreads. You can hedge billions without moving the market.
- **Easy resizing with tactical reallocations:** Equity portfolios change constantly – new mandates, divestments, rebalances, manager changes. Short-dated forwards let you adjust hedge notionals without unwinding long-dated positions at a loss.
- **Minimal unwind risk:** If you need to exit a position, a 1-month forward is far easier and cheaper to terminate than a 5-year structure with deep negative mark-to-market.

For managed equity portfolios with active turnover, tactical tilts, or uncertain holding periods, long-dated FX hedges often create more problems than they solve.

> *Rolling forwards survive because they are robust, not because they are optimal.*

3. What Rolling Forwards Actually Do

Rolling short-dated forwards reduce short-term FX volatility, smooth reporting outcomes, and limit drawdown amplification from FX shocks – when equity markets fall and FX moves against you simultaneously, forwards prevent double damage.

They do not neutralise long-term FX risk, stabilise terminal base-currency returns, or remove FX path dependency. Cumulative drift and carry effects compound over time.

> *Rolling forwards shape volatility. They do not eliminate FX exposure.*

If your mandate is to reduce quarterly volatility and prevent extreme drawdowns, rolling forwards do exactly what you need. If your mandate is to neutralise long-term FX risk and deliver currency-independent returns, they do not – and nothing else will either, at least not without massive cost or tail risk.

Most governance debates conflate the two objectives, then blame the hedge when it delivers one but not the other.

4. Hedge Ratios: Reality, Not Dogma

There is no universal optimal hedge ratio for equities. Anyone selling you one is either misinformed or has a product to push.

Observed institutional hedge ratios vary by jurisdiction and mandate: 0-30% for growth-oriented portfolios with long investment horizons; 30-60% for most balanced mandates; 60-80% for liability-aware investors with shorter horizons or regulatory constraints; and 80-100% under mandatory hedging regimes such as Australian MySuper.

> *A static 100% hedge ratio is typically about optics, not economics. In some regulatory and trustee environments, optics are the binding constraint – and must be managed explicitly.*

Full hedging often fails because carry drag compounds (CHF or JPY base currencies paying away 2-4% per annum indefinitely), FX can provide natural diversification during equity drawdowns, and 100% hedges require constant resizing as equity values fluctuate, creating operational drag.

The right hedge ratio depends on base currency carry characteristics, liability structure and horizon, regulatory requirements, governance risk tolerance, and portfolio volatility and correlation patterns.

Set a strategic band (e.g., 40-60%), bias it using carry economics, and adjust dynamically when dislocations appear. Static dogma creates predictable losses

5. Rebalancing Friction with Static 100% Hedge Ratios

Static hedge ratios create operational drag that is rarely quantified but often material.

> Portfolio: USD 200m S&P 500 equities. Policy: 100% hedged.
>
> Month 1: S&P falls 8%. Equity value: USD 184m. Hedge: still USD 200m. Over-hedged by USD 16m (8.7%). Action required: reduce hedge by USD 16m. Transaction cost: 5 bps = USD 8,000.
>
> Month 2: S&P rises 10%. Equity value: USD 202.4m. Hedge: USD 184m. Under-hedged by USD 18.4m (9.1%). Action required: increase hedge by USD 18.4m. Transaction cost: 5 bps = USD 9,200. You just whipsawed.
>
> Over 12 months of normal equity volatility (15% annualised): 6-8 rebalances needed. Cumulative transaction costs: ~40-50 bps. Over 10 years: ~4-5% of portfolio in transaction costs alone.

5.1 Dynamic Hedge Ratio with Bands

Policy: "Maintain 80-100% hedge ratio, rebalance when outside bands." With ±20% bands around a 90% target: an 8% equity fall pushes the ratio to 98% – still within bands, no action required. A 10% rise pushes it to 82% – still within bands.

Approach	Rebalances per Year	Annual Transaction Cost	Operational Burden
Static 100% hedge ratio	6-8 times	40-50 bps	High – constant resizing
Dynamic bands (80-100%)	2-3 times	15-20 bps	Reduced by ~75%

> *Cumulative difference over 10 years: 2-3% of portfolio value. The "precision" of 100% hedging is illusory – you are constantly chasing a moving target.*

6. Carry Is the Dominant Driver

Most FX hedge discussions fixate on volatility. That is the wrong variable.

Over long horizons, expected FX returns approximate zero while hedge costs do not. Interest rate differentials compound indefinitely, regardless of whether spot FX moves. Carry exists because interest rate differentials compound, while spot FX does not reliably offset them over time. Hedge costs are systematic and one-directional.

This asymmetry is why FX hedging outcomes diverge dramatically across base currencies. In low-rate base currencies (CHF, JPY), FX hedging foreign equities is structurally expensive – cumulative carry drag can exceed 30% over 10 years. In high-rate base currencies (AUD, NZD), hedging foreign equities may collect forward points, with volatility reduction coming with positive carry.

> *Carry is not a secondary consideration. It is the dominant driver of long-term FX hedge performance. If your governance framework mandates full hedging without reference to carry, you have hard-coded value destruction into the portfolio.*

6.1 Quantifying Carry Over Time: A Worked Example

Consider two identical portfolios with different base currencies, both hedging USD 100 million in S&P 500 equities at a 70% hedge ratio over 10 years.

	Portfolio A (AUD Base)	Portfolio B (JPY Base)
Average USD 3-month rate	4.5%	4.5%
Average local 3-month rate	3.0% (AUD)	0.1% (JPY)
Forward points	-1.5% p.a. (pays to hedge)	+4.4% p.a. (earns from hedging)
10-year carry (before compounding)	-15.0% cumulative	+44.0% cumulative
With compounding	~-16.5%	~+54%
Transaction costs (40 rolls × 5bps)	-2.0%	-2.0%
Total structural drag/gain on hedged 70%	-18.5%	+52%
Impact on total portfolio	-12.95%	+36.4%

The AUD investor gained nothing from FX movement but lost 13% from hedging costs. The JPY investor gained 36% from hedging the same exposure. That is a 49 percentage point difference purely from carry.

> *Same asset. Same hedge structure. Opposite economic outcome. If your governance framework mandates 70% hedging without reference to carry environment, you have either hard-coded value destruction or left material return on the table.*

7. FX as Natural Diversification: Asymmetric Correlation During Stress

Not all currency exposures amplify equity risk. Some provide natural hedging during drawdowns. During equity market stress, safe-haven currencies (JPY, CHF, sometimes USD) tend to strengthen, while risk currencies (AUD, NZD, EM) weaken.

For an AUD investor holding USD equities: during equity drawdowns, AUD typically weakens, providing a natural offset – equity falls but the FX gain cushions the blow. Hedging removes this diversification benefit. For a JPY investor holding AUD equities: JPY typically strengthens, amplifying losses. Hedging prevents this amplification.

Investor Base	Equity Exposure	Equity Return	FX Move	Unhedged Total	Hedged Total
AUD	S&P 500	-34%	AUD weakened 7%	-27%	-34%
JPY	S&P 500	-34%	JPY strengthened 9%	-43%	-34%

The AUD investor who hedged made equity losses worse by removing the natural FX offset. The JPY investor who hedged prevented amplification. Same crisis. Same equity exposure. Opposite hedging implications.

> *One-size-fits-all hedge ratios ignore this asymmetry. A blanket 70% policy might be over-hedging JPY exposure (destroying natural diversification) while under-hedging EM exposure (accepting amplification risk).*

8. Why Tenor Matching Fails for Equities

Tenor-matched hedging is the right answer for bonds. It is the wrong answer for equities. Bonds have a maturity date, a principal repayment, and contractual cashflows you can match to a hedge. Equities offer neither a maturity nor a principal repayment.

Extending hedge tenors introduces four problems for equity portfolios.

- **Termination risk:** If you hedge a 10-year horizon but the portfolio changes in year 3, you are forced to unwind a hedge with 7 years remaining. If FX has moved against the hedge, you crystallise a loss that has nothing to do with investment performance.
- **Counterparty credit consumption:** Long-dated FX forwards consume meaningful credit limits. For a $500m equity portfolio hedged at 50%, a 10-year tenor might tie up $15-25m of credit capacity.
- **Mark-to-market amplification:** Long-dated forwards have much higher DV01 and gamma. Small FX moves create large, unrealised gains or losses, which become operational and governance headaches even when economically neutral.
- **Illiquidity:** Outside G3 pairs, long-dated FX markets are thin. Bid-offer spreads widen materially, execution becomes lumpy, and resizing becomes expensive.

> *Short-dated hedges acknowledge the reality: equity FX exposure is indefinite, portfolios change constantly, and flexibility matters more than theoretical elegance.*

8.1 Termination Risk in Practice

An Australian super fund allocates AUD 400m to US equities (USD 260m at 0.6500 spot). The CIO implements a 10-year FX forward to match the stated horizon, locked at 0.6500. In year 5, a strategic asset allocation review requires divestment of USD 100m.

Option	Action	Consequence
Unwind USD 100m of the forward	Pay termination fees ~USD 150-200k	Crystallise accounting gain (taxable), trigger auditor questions, create attribution complexity
Keep the hedge, be over-hedged	Now 90% hedged vs policy 70%	Governance breach, Board approval required, opens questions about original sizing
Enter offsetting positions	Sell 5-year forward to offset USD 100m	Basis risk, doubles operational complexity, doubles credit limit consumption
Rolling forwards (what should have been done)	Simply reduce next forward roll by USD 100m	No termination fees, no governance breach, no accounting complexity

The cost of flexibility via rolling forwards: carry drag of ~1.5% p.a. over 5 years (~7.5% on the hedged portion). The benefit: avoided termination costs, governance issues, and operational complexity worth far more than 7.5% in institutional settings.

9. A Note on Cross-Currency Swaps

For hedges beyond 2 years, cross-currency swaps (CCS) are generally the superior instrument rather than rolling forwards. CCS offer better pricing on longer tenors (trading funding spreads rather than just forward points), lower all-in costs for multi-year horizons, and more efficient counterparty credit usage. Unlike forwards which only exchange notional at maturity, CCS can be structured with periodic cashflow exchanges that align with expected dividend receipts from the equity portfolio – creating a more natural economic hedge.

But they introduce complexity that warrants separate treatment: basis swap dynamics and pricing conventions, collateral and CSA implications, mark-to-market volatility and accounting treatment, termination mechanics and breakage costs.

CCS assume confidence about a longer holding period. Most portfolios have uncertain holding periods, active manager turnover, tactical rebalancing, and governance structures that prefer simpler instruments. For those portfolios – which is most of them – rolling short-dated forwards remain the pragmatic choice.

> *In practice, many portfolios overestimate their holding horizon. When behaviour does not match stated intent, CCS quickly become the wrong instrument. For genuinely long-dated equity exposures with stable allocations, CCS warrant deeper consideration. For everyone else, rolling forwards provide the framework you need.*

10. The Role of FX Options

FX options are not a replacement for forwards. They are a convexity tool.

Used correctly, they materially improve equity FX outcomes by addressing the structural weaknesses of rolling forwards. They add value in four ways: preserving upside FX participation when FX moves in your favour; protecting against extreme downside with asymmetric protection during tail events; reducing pro-cyclicality during stress; and avoiding forced re-locking of bad carry when forward points widen against you.

> You are hedging USD equities from an AUD base. Normal carry cost: 150 bps p.a. During stress, USD rates spike – forward points now cost 300 bps p.a.
>
> With rolling forwards: you must roll your hedge at 300 bps or go unhedged. If you roll, you have locked in double the normal carry cost for the next 3 months.
>
> With options: your existing put protection remains in place regardless of forward point movements. You can wait for carry to normalise before establishing new forward hedges. You are not forced to lock in terrible levels during temporary dislocations.
>
> This matters most during funding stress (March 2020, October 2008), when forward points can spike 200-400 bps for extended periods.

10.1 Common Option Structures

Structure 1: Put Spreads

Setup

Buy put at strike A, sell put at strike B (lower). Example: AUD 100m in USD equities, spot 0.6500.

Buy AUD put at 0.6200 (4.6% OTM): cost 2.0%. Sell AUD put at 0.5700 (12.3% OTM): receive 0.5%. Net cost: 1.5% annually.

Payoff

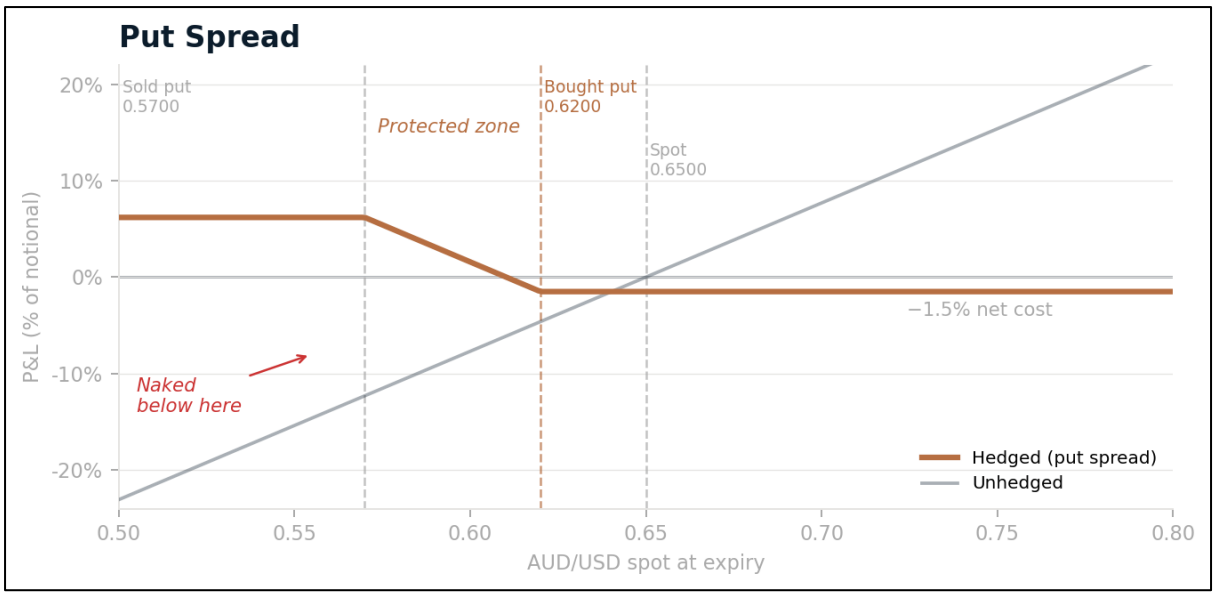
Protected between 0.5700 and 0.6200. Naked below 0.5700.

When to use

Primarily worried about moderate FX moves (5-10%), not catastrophic tail risk. Premium budget is constrained. Comfortable accepting risk beyond 10-15% adverse moves.

Vs vanilla put

Vanilla put at 0.6200 would cost 2.0% (33% more expensive). You give up protection beyond 12.3% to save 0.5% annually. Over 5 years, that is 2.5% saved – meaningful if extreme tails are unlikely.



Put spread payoff (AUD base investor). Buy AUD put at 0.6200 (4.6% OTM), sell AUD put at 0.5700 (12.3% OTM). Net cost: 1.5% annually. Protection is capped between 0.5700 and 0.6200 – below 0.5700 the sold put leaves the position naked and losses resume. Reduces premium cost versus a vanilla put by giving up protection beyond extreme moves.

Structure 2: Collars (Zero-Cost)

Setup

Buy put at strike A, sell call at strike B (higher), sized to net zero premium. Example: AUD 200m in USD equities, currently 50% hedged with forwards, spot 0.6500.

Buy AUD put at 0.6200 (4.6% OTM): cost 2.0%. Sell AUD call at 0.7150 (10% OTM): receive 2.0%. Net cost: 0%.

Payoff

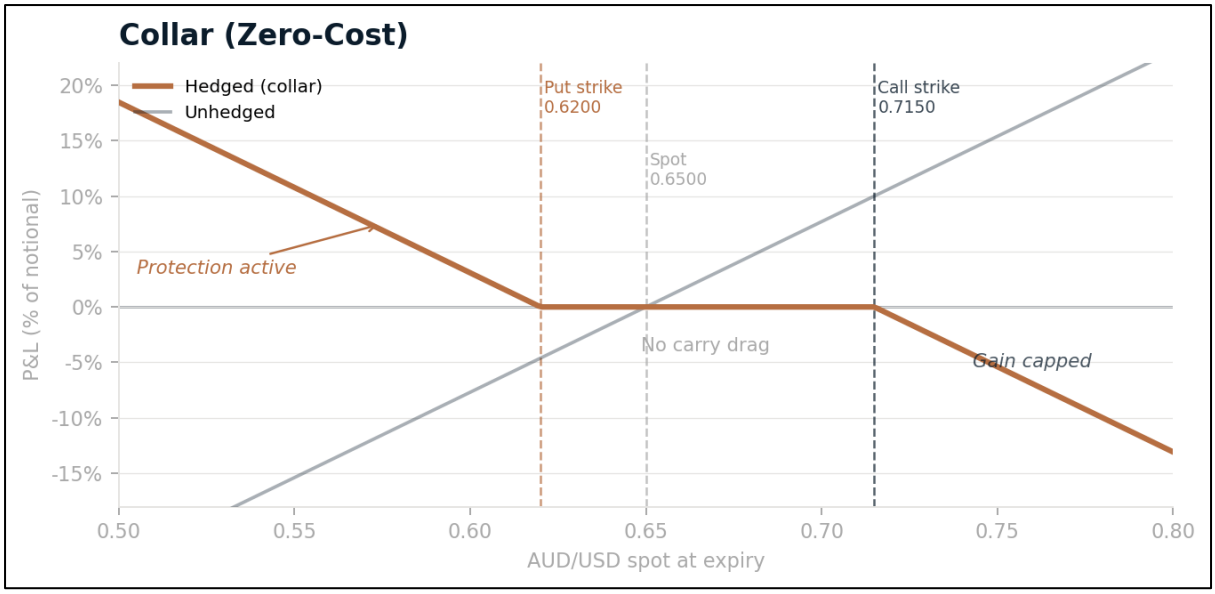
Protected below 0.6200. Participate in AUD weakness up to 0.7150. Capped above 0.7150.

When to use

Governance requires "hedging" but carry cost of forwards is painful. Believe FX will stay range-bound. Can tolerate giving up upside beyond 10% to avoid premium cost.

Comparison to 50% forward hedge over 5 years with 1.5% carry cost

50% forwards cumulative cost: 7.5%. Collar cost: 0%. Savings: 7.5%. Trade-off: capped upside at 10% AUD strength. Break-even: if AUD strengthens more than 17.5% cumulatively, forwards would have been better. For most paths, collar wins.



Zero-cost collar payoff (AUD base investor). Buy AUD put at 0.6200, sell AUD call at 0.7150. Net premium: zero. Full downside protection below 0.6200. No carry drag between the strikes. AUD gains are capped at 0.7150 – the cost of removing the premium is forgoing upside beyond a 10% AUD appreciation. Over most realistic FX paths, the carry savings outweigh the foregone upside.

Structure 3: Seagulls (Partially Funded)

Setup

Buy put spread, sell call to reduce cost further.

Buy AUD put at 0.6300 (3% OTM): cost 2.5%. Sell AUD put at 0.5500 (15% OTM): receive 0.5%. Sell AUD call at 0.7000 (7.7% OTM): receive 1.0%. Net cost: 1.0% annually.

Payoff

Protected between 0.6300 and 0.5500. Exposed below 0.5500 – forced to buy AUD at 0.5500 even if spot is 0.5000. Capped above 0.7000.

Critical risk

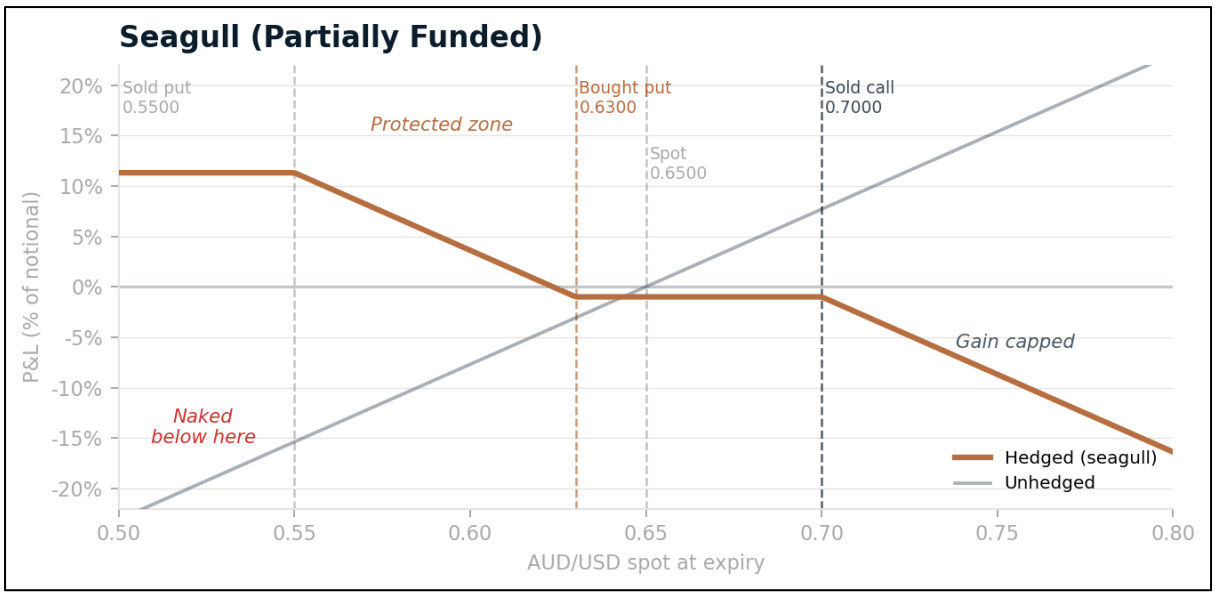
Below 0.5500, losses accelerate materially due to the sold put. During March 2020, AUD fell from 0.6700 to 0.5500 in 3 weeks (17.9% collapse). Any sold put above 0.5500 would have created amplified losses.

When to use

Need some protection but premium budget is very tight. Genuinely comfortable that catastrophic moves (>15%) are extremely unlikely or acceptable.

When NOT to use

During elevated macro uncertainty. If governance cannot tolerate downside acceleration. If you cannot monitor positions actively.



Seagull payoff (AUD base investor). Buy put at 0.6300, sell put at 0.5500, sell call at 0.7000. Net cost: 1.0% annually. Protected zone between 0.5500 and 0.6300. Below 0.5500 the sold put creates accelerating losses – the position becomes worse than unhedged. Gains are capped above 0.7000. Suitable only when catastrophic AUD moves below 0.5500 are genuinely tolerable. March 2020 saw AUD fall to exactly 0.5500 in three weeks – any lower and the sold put would have detonated.

Structure 4: Vanilla Puts (Protective Hedges)

Setup

Simple put option with no exotic features.

Buy AUD put at 0.6500 (at-the-money): cost 4.0% annually. Or 0.6200 (5% OTM): cost 2.0%. Or 0.5850 (10% OTM): cost 1.0%.

When to use

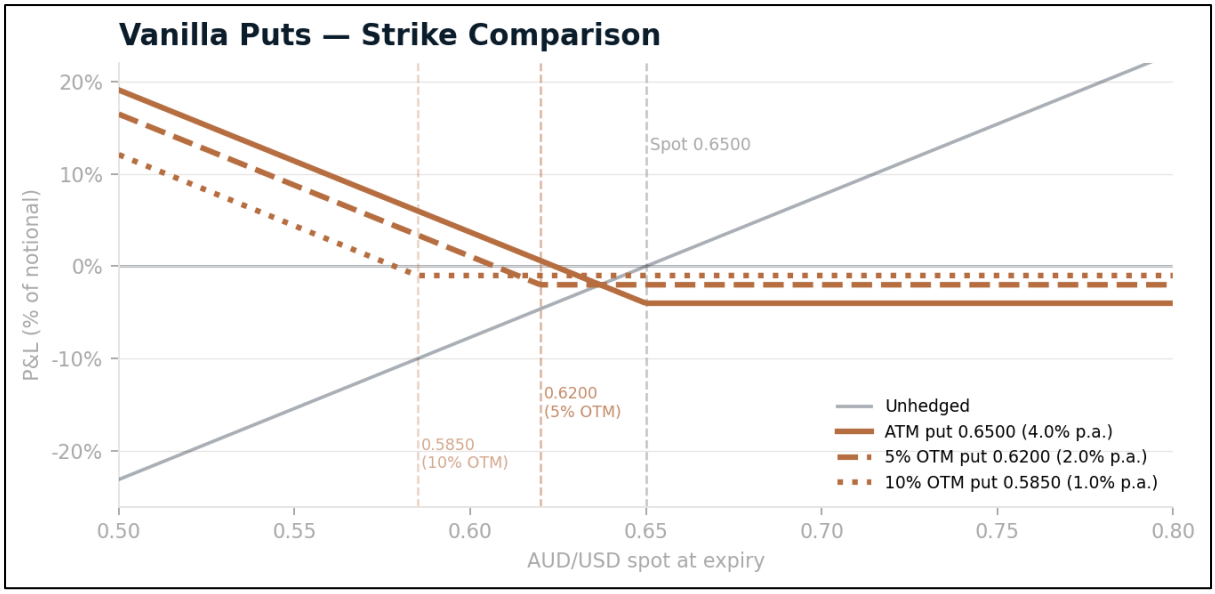
Downside protection is critical. Upside participation is valuable. Alternative to 100% forward hedge when carry is expensive.

Carry environment decision

If forward points earn you +4% p.a. (JPY base): use forwards. The carry is too attractive to give up.

If forward points cost you -3% p.a. (AUD or CHF base): use puts. Cheaper than forwards and you keep upside optionality.

The choice is not "options vs forwards." It is "what structure fits my carry environment and risk tolerance?"



Vanilla put comparison – three strikes (AUD base investor, spot 0.6500). Solid line: ATM put at 0.6500 (4.0% p.a. cost). Dashed: 5% OTM put at 0.6200 (2.0% p.a.). Dotted: 10% OTM put at 0.5850 (1.0% p.a.). Deeper OTM strikes cost less but provide no protection until AUD falls through the strike. In unfavourable carry environments (AUD or CHF base) where rolling forwards cost 2-3% annually, a 5% OTM put at 2.0% p.a. is cheaper than a forward hedge while preserving full upside participation.

10.2 Accounting Treatment: Options vs Forwards

FX options and forwards receive different accounting treatment under IFRS 9/AASB 9. Forwards typically qualify for hedge accounting if properly documented, with changes in fair value deferred or offset against the hedged item. Options are more difficult – intrinsic value and time value must be separated, and time value decay goes through P&L immediately and cannot be deferred.

For portfolios that demand smooth quarterly reported earnings, forwards may be preferred even when options are economically superior – simply because they avoid immediate P&L volatility. This is a governance constraint, not an economic one.

Mitigation: use options for a smaller portion of total hedge (10-20%), focus on at-the-money or slightly OTM options (higher intrinsic value, lower time value), and document the trade-off explicitly.

11. Mandatory FX Hedging: When Regulation Overrides Economics

Some jurisdictions impose mandatory FX hedging requirements on institutional portfolios. Australia's MySuper framework, parts of Swiss pension regulation, and certain Asian insurance mandates all include prescribed hedge ratios or constraints.

> *When hedging is compulsory, optimisation stops. Compliance becomes the objective. The real task becomes minimising second-order damage while staying compliant.*

Practical responses under mandatory regimes include using rolling forwards for baseline compliance (liquid, operationally simple, meet regulatory tests), deploying FX options to reduce tail risk (reducing pro-cyclicality, forced rehedging at terrible carry levels, and amplification of equity drawdowns), using options to smooth RWA and capital volatility for insurers and banks, and being explicit about trade-offs in governance documents.

> *Under mandatory regimes, FX options become more valuable, not less. They are the main tool left for improving outcomes when strategy is dictated by regulation.*

11.1 Documenting the Cost Explicitly

When regulation forces suboptimal hedging, fiduciary duty shifts from "optimise returns" to "comply with rules while minimising collateral damage." Best practice: include this analysis in annual reporting.

Sample governance disclosure:

"Current policy requires 80% FX hedging. At prevailing interest differentials (USD +250 bps vs AUD), this costs approximately 200 bps annually on the hedged portion, or AUD 4 million p.a. on our USD exposure. Over 10 years at current rates, cumulative cost would be approximately 22% of hedged notional.

Alternative structures (60% forwards + 20% options) would reduce annual cost by approximately AUD 1.5 million while maintaining equivalent downside protection. However, they would require policy amendment to permit lower minimum hedge ratios.

The Board has determined that policy certainty and regulatory compliance outweigh the economic cost. This trade-off is documented and will be reviewed annually."

This creates a paper trail that proves you understood the economics, quantified alternatives, deferred to governance authority, and protected yourself when questioned later. Silence about suboptimal mandates does not protect you. Documentation does.

12. A Realistic Framework

A practical approach that works across most institutional equity portfolios follows five steps.

- **Set a strategic hedge band:** Not a point estimate. A range that reflects uncertainty about optimal positioning. Example: 40-60% for a balanced AUD-based portfolio with diversified equity exposures.
- **Bias it using carry economics:** If you are in a low-rate base currency (CHF, JPY), bias toward the lower end of the band. If high-rate (AUD, NZD), bias toward the upper end. Monitor forward points quarterly and adjust when dislocations appear.
- **Use rolling forwards for compliance and flexibility:** 1-month or 3-month tenors, rolled systematically. This handles governance requirements, audit trails, and operational simplicity.
- **Deploy FX options selectively for convexity and stress:** Not as a replacement – as a complement. Use put spreads or collars during periods of elevated tail risk, unfavourable carry, or expected mean reversion with uncertain timing.
- **Be explicit about trade-offs in governance documents:** Document why you are not hedging 100%, how carry affects long-term outcomes, what scenarios would trigger tactical adjustments, and how options improve risk-adjusted returns.

> *Transparency prevents governance battles when FX moves against you.*

12.1 Communicating FX Hedging to Governance

Most FX hedging failures are not technical – they are governance failures. The hedge did what it was designed to do, but expectations were misaligned.

Common Governance Misunderstandings

Misunderstanding 1: "100% hedged = 0% FX impact"

Reality: 100% hedged means zero impact from spot movements, but significant impact from carry costs, which compound over time and are material. A 100% hedged portfolio can underperform an unhedged portfolio by 10-15% over a decade purely from carry drag, even if spot is unchanged. How to explain: "Hedging eliminates directional FX risk but not hedging costs."

Misunderstanding 2: "If the hedge lost money, it failed"

Reality: Hedges lose money when FX moves favourably. That is the point – you paid for protection you did not need, like fire insurance on a house that did not burn down. How to explain: "Hedge P&L is not a measure of success. Risk reduction is. Evaluate hedging on whether it delivered the volatility profile you paid for."

Misunderstanding 3: "Hedge ratios should be set and forgotten"

Reality: Optimal hedge ratios change with the carry environment, volatility regime, and time horizon. How to explain: "Static hedge ratios are governance theatre, not risk management. Establish a strategic band and adjust dynamically within that range."

Annual Reporting Template

Metric	Target	Actual	Commentary
Hedge ratio (average)	60%	58%	Within policy band (50–70%)
FX volatility (hedged portfolio)	<10%	8.2%	Achieved objective
Carry cost (annual)	~2%	2.3%	Slightly above expectation due to rate rises
Hedge P&L	N/A	-AUD 12m	Reflects AUD strength; hedge performed as designed
Alternative (unhedged) outcome	N/A	+AUD 20m	Would have violated volatility policy (15.7% realised vol)
Transaction costs	<30bps	25bps	Within budget

Preparing for Difficult Questions

Q: "Why did we lose AUD 20 million on hedging over 5 years when FX barely moved?"

A: "FX moved 2%, which is small. But hedging costs – carry and transaction costs – totalled 15% over 5 years, which is large. This was disclosed in our framework document and is expected. The alternative was accepting ±12% FX volatility, which the Board determined was unacceptable. We delivered the risk profile you asked for. The cost is the price of that stability."

Q: "Why do we not just hedge 100% and eliminate FX risk entirely?"

A: "100% hedging eliminates spot risk but locks in maximum carry costs. At current interest differentials, that would cost an additional AUD 3 million annually – AUD 30 million over 10 years – for the marginal benefit of removing the last 30% of FX exposure. Based on historical volatility, the extra cost exceeds the expected risk reduction. We are happy to model both approaches for the Board to compare."

Q: "Our consultant says we should use 10-year FX forwards to match our strategic horizon."

A: "10-year forwards work well for bonds with contractual maturities. They work poorly for equities with uncertain holding periods. If we commit to 10-year forwards and need to adjust our equity allocation in Year 5 – which happens regularly during SAA reviews – we face material termination costs and governance issues. Rolling forwards preserve flexibility to resize without penalty. We pay ~1.5% annually for that flexibility, which we believe is worth it given historical turnover in our equity mandates."

Conclusion

Rolling FX forwards are not wrong for equities. They are incomplete.

Used alone, they suppress short-term volatility while bleeding carry and destroying convexity. Used alongside adaptive hedge ratios and targeted FX options, they become part of a coherent risk framework that acknowledges reality.

- Equity FX exposure is indefinite and path-dependent
- Carry dominates long-term outcomes
- Flexibility matters more than elegance
- Regulation often constrains economics

The objective is not to eliminate FX risk. It is to shape it intelligently under real constraints.

> *What professionals do: match the hedge to the exposure, accept trade-offs explicitly, document decisions, adjust dynamically. What amateurs do: apply one structure to everything, blame the hedge when it underperforms, change nothing.*

Further Reading

Para Bellum Advisors publishes practitioner papers and CIO Briefs focused on real-world portfolio construction, risk and capital efficiency:

www.parabellumadvisors.com/insights/

About Para Bellum Advisors

Para Bellum Advisors is an independent advisory firm specialising in derivatives structuring, structured finance, balance sheet efficiency, and capital optimisation for institutional investors and corporate treasury teams.

The firm works with lean investment and treasury teams managing complex, multi-asset exposures – long-dated assets, illiquid portfolios, and non-standard risk profiles – where structural precision makes a material difference to outcomes.

Its engagements typically involve designing and re-engineering hedges across FX, rates, credit, equity, and volatility; identifying and releasing trapped capital; and providing embedded structuring capability where permanent headcount is neither practical nor warranted.

Para Bellum does not distribute products or earn transaction volume. Its value is in structure: how exposures are designed, how capital is consumed, and how portfolios behave when conditions deteriorate.

The firm is practitioner-led, drawing on three decades of experience across trading, structuring, and portfolio management in banks, asset managers, and institutional balance sheets in Asia-Pacific and global markets.

For more information: www.parabellumadvisors.com

For discussion or enquiries: mike.duncan@parabellumadvisors.com

Connect on LinkedIn: www.linkedin.com/in/mikeduncan-structuring/