



PARA BELLUM ADVISORS

EXECUTIVE BRIEF

FX Hedging for Equity Portfolios

What Actually Matters

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Executive Summary

Foreign exchange hedging in equity portfolios attracts strong opinions and surprisingly little clarity. Rolling short-dated FX forwards are often criticised as simplistic or mismatched. Yet they remain the dominant hedge structure across institutional equity portfolios globally. That persistence is not an accident.

It reflects how equity portfolios behave, how organisations are governed, and the real constraints under which investment teams operate. The issue is not whether rolling forwards are right or wrong, but whether their role and limitations are properly understood.

This brief sets out the practical economics behind equity FX hedging, the reasons common prescriptions fail, and how to think about structuring FX risk in a way that is both defensible and effective.

Equity FX Risk Is Structurally Open-Ended

Equity portfolios create a fundamentally different FX hedging problem to bonds or loans. There is no contractual maturity, no principal repayment, and no defined exit date. FX exposure persists for as long as the portfolio exists, which in many cases is effectively indefinite.

As a result, there is no such thing as a perfect FX hedge for equities. Every approach involves trade-offs between volatility reduction, carry cost, flexibility, and governance simplicity. Many failures in practice stem from applying fixed-horizon hedging logic to an exposure that has no natural termination point.

The task is not to eliminate FX risk, but to shape it in a way that aligns with portfolio objectives and organisational realities.

Why Rolling FX Forwards Persist

Despite frequent criticism, rolling short-dated FX forwards dominate institutional practice for good reasons. They are deeply liquid, cheap to transact, and scalable to very large portfolios. They allow hedge sizes to be adjusted as equity allocations change, and they minimise the risk of crystallising large mark-to-market losses when portfolios are restructured or mandates change.

Long-dated FX hedges may appear more theoretically aligned with long-term equity holdings, but in practice they introduce termination risk, consume counterparty credit, amplify mark-to-market volatility, and reduce flexibility. For portfolios with uncertain holding periods or active rebalancing, these costs often outweigh any theoretical benefits.

Rolling forwards survive because they are operationally robust, not because they are optimal in every dimension.

What Rolling Forwards Actually Achieve

Rolling FX forwards are effective at reducing short-term FX volatility and smoothing reported returns. They dampen the amplification that occurs when equity markets fall and currencies move against the investor at the same time. For governance, reporting, and risk-control purposes, this matters.

What they do not do is neutralise long-term FX risk. Over time, cumulative FX movements and interest-rate differentials continue to affect outcomes. Rolling forwards shape the path of returns, but they do not stabilise terminal base-currency outcomes.

Many governance debates arise because two distinct objectives, short-term volatility control and long-term FX neutrality, are conflated.

Hedge Ratios Are Not Constants

There is no universally optimal hedge ratio for equity portfolios. In practice, most institutions operate somewhere between partial hedging and near-full hedging, depending on base currency, liabilities, risk tolerance, and regulatory environment.

Fully hedged equity portfolios are often driven by governance optics rather than economics. Persistent carry drag, loss of diversification benefits, and constant resizing costs can quietly erode long-term performance. More robust frameworks treat hedge ratios as ranges rather than fixed points, allowing positioning to reflect carry economics and changing market conditions while remaining within governance limits.

Carry Is the Dominant Long-Term Driver

Over long horizons, expected FX returns tend toward zero. Hedge costs do not. Interest-rate differentials compound year after year and often dominate FX hedging outcomes. For investors based in low-rate currencies, hedging foreign equities can impose a persistent and material drag on returns. For those in higher-rate currencies, hedging may simultaneously reduce volatility and enhance returns.

Ignoring carry does not remove its impact. It simply embeds it invisibly into portfolio performance.

Why Tenor Matching Fails for Equities

Tenor-matched FX hedging is appropriate for assets with known maturities, such as bonds. For equities, it introduces new risks rather than eliminating existing ones. Long-dated hedges are harder to unwind, more volatile on a mark-to-market basis, and less liquid outside major currency pairs. Rolling structures acknowledge the reality that equity portfolios evolve and that flexibility has genuine economic value.

The Role of FX Options

FX options are not a substitute for forwards. They are a convexity tool. Used selectively, they allow portfolios to retain upside participation, protect against extreme downside scenarios, and reduce procyclical behaviour during periods of stress. In environments where carry is unfavourable or tail risks are elevated, options can materially improve risk-adjusted outcomes relative to forwards alone.

Their value lies in how they behave during the path, not in eliminating FX exposure entirely.

Implications for the Investment Team

FX hedging for equity portfolios is not about finding a perfect structure. It is about making trade-offs explicit, defensible, and aligned with real portfolio behaviour. Rolling forwards are not wrong. They are incomplete. Carry matters more than volatility over time. Hedge ratios should be flexible, not dogmatic. Options add value when used with intent. Governance clarity is as important as technical design.

The objective is not to eliminate FX risk, but to manage it intelligently under real-world constraints.

About This Brief

This Executive Brief is a companion to the Para Bellum Advisors practitioner paper: FX Hedging for Buy-and-Hold Equity Portfolios. The full paper covers carry modelling, hedge ratio frameworks, options structuring, and implementation approaches across currency pairs and portfolio types.

Available at www.parabellumadvisors.com/insights/

About Para Bellum Advisors

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

The firm focuses on hedge framework design, overlay mechanics, collateral efficiency, and portfolio resilience across FX, rates, credit, equity, and volatility exposures. Its work is practitioner-led, drawing on three decades of experience across trading, structuring, and portfolio management in APAC and globally.

Para Bellum Advisors is independent of product distribution and transaction mandates. Its objective is durable improvement in capital efficiency and liquidity resilience.

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