



PARA BELLUM ADVISORS

FAMILY OFFICE · MULTI-GENERATIONAL PORTFOLIO

Multi-Generational Portfolio

FX Overlay Redesign

SCENARIO TYPE	Family Office – Multi-Generational Portfolio
ASSET CLASS	Global Equities (unhedged underlying) with FX forwards overlay (multi-currency)
RISK FOCUS	Structural hedge drag, negative carry, over-hedging, roll leakage, governance drift across generations
PRIMARY OFFER	Hedge Rebuild™
RELEVANT SERVICES	FX overlay redesign · Currency-by-currency hedge ratios · EM hedge exit · Roll cadence redesign · Governance reset · Trustee-grade reporting

THE SITUATION

The overlay was put in place for all the right reasons. It was also quietly doing the wrong job.

A multi-generational family office had built a globally diversified equity allocation over time. As the allocation grew, currency became an anxiety line item – not because the family was trading FX views, but because drawdowns were being explained in USD and currency moves were visible enough to be blamed.

The overlay began as a governance comfort mechanism. It evolved into a default: fully hedge foreign currency exposure using rolling forwards. The intention was risk reduction and stability.

What was never revisited was the economics of maintaining that stance. The portfolio remained long-horizon and fundamentally equity-driven. The hedge became short-horizon, mechanically renewed, and cost-accumulative. The unresolved question was not whether hedging reduced FX noise in some quarters – it was whether the portfolio should continue paying a structural, compounding cost for certainty that was not actually improving outcomes.

HOW THE DRIFT SETS IN

Not through a bad decision. Through a reasonable one that never gets revisited.

Full hedging is easy to justify inside a governance process. It feels conservative. It sounds disciplined. It avoids awkward conversations about why the portfolio lost money on currency. So the hedge becomes less of a position and more of a policy.

Hedge ratio becomes a moral choice rather than an economic one – 100% feels like the only defensible number. The process becomes calendar-driven: rolling forwards treated as housekeeping, executed and confirmed with nobody rewarded for challenging the system. Ownership diffuses across portfolio, trading, and risk teams with no one explicitly accountable for asking whether the hedge is still economically coherent.

For a while, that drift is not obvious. Performance is driven by equities. Costs sit in the background. The leakage accumulates quietly.

WHAT TYPICALLY BREAKS

Over-hedging relative to the portfolio's horizon

A multi-generational portfolio is structurally long volatility and long mean reversion. A 100% FX hedge forces it to behave as if currency is a short-dated risk to be neutralised continuously – removing natural shock absorbers without proportionate benefit.

EM hedging that is economically irrational

Emerging market currency hedges can carry double-digit costs in certain regimes. Many family offices hedge EM because it feels prudent, not because it is economically coherent. The hedge often costs more than the risk it is meant to reduce.

Negative carry treated as background overhead

On many developed market currencies, hedging cost is an embedded rate differential plus roll mechanics. In persistently negative carry regimes, paying it at 100% notional becomes a structural return tax that compounds over decades.

No currency-by-currency logic

A single hedge rule applied across EUR, GBP, JPY, and EM is rarely defensible. These currencies behave differently in stress, carry differently through cycles, and correlate differently to equity drawdowns. One rule obscures all of that.

THE STRUCTURAL INSIGHT

The fix was not to turn off hedging or introduce tactical FX views. It was to rebuild the overlay so that it matched the portfolio's horizon, exposure profile, and governance needs.

The first step was restating the purpose in plain language: not reduce FX risk, but achieve smoother USD outcomes and controlled drawdowns without paying a permanent structural tax.

From there, the response moves from a binary hedge rule to a currency-specific architecture. Developed market currencies treated differently to EM. JPY treated differently to EUR. Hedge ratios selected based on carry economics, crisis behaviour, and correlation to equity drawdowns – not on what feels conservative.

A long-horizon portfolio does not need to trade FX every month. Resetting the roll cadence reduces leakage, reduces operational burden, and forces the hedge back into a governed process. Governance is then embedded so drift cannot silently return – tolerance bands, review triggers, and reporting that explicitly shows hedge cost, carry, and stress behaviour.

INTENDED OUTCOMES

- ▶ Each currency treated according to its own carry economics and crisis behaviour – the hedge posture becomes defensible currency by currency, not just in aggregate.
- ▶ Hedge costs made explicit and sized intentionally – negative carry visible, EM hedging only where it makes economic sense.
- ▶ Roll leakage reduced through longer cadence and designed execution windows – less trading, less friction, less operational overhead.
- ▶ The overlay becomes governable – moving from 'we hedge because we should' to 'we hedge because we understand what it costs and when it should change'.
- ▶ Portfolio stops leaking return through an inherited rule set that no one actively chose to maintain.

WHERE THIS APPLIES

Most relevant where meaningful non-USD equity exposure has grown over time; a default 100% hedge rule exists because it feels prudent; hedge cost is persistent but treated as background overhead; EM currencies are hedged without a clear economic rationale; and governance relies on hedge existence rather than hedge behaviour.

Less relevant where FX exposure is intentionally unhedged as a return driver; hedging is actively re-underwritten on a defined cadence; the portfolio has natural currency offsets through liabilities or spending; or exposure is small enough that hedge drag is immaterial.

TYPICAL ENGAGEMENT PATH

Hedge Rebuild™ – FX Overlay Reset. Diagnostic and redesign of an existing FX hedge programme addressing hedge ratios, carry economics, roll mechanics, and governance drift.

Secondary: Ongoing structuring support, monitoring framework, trustee-grade reporting. Scope confirmed following a focused diagnostic review.