Question 2: Currency Hedging analysis

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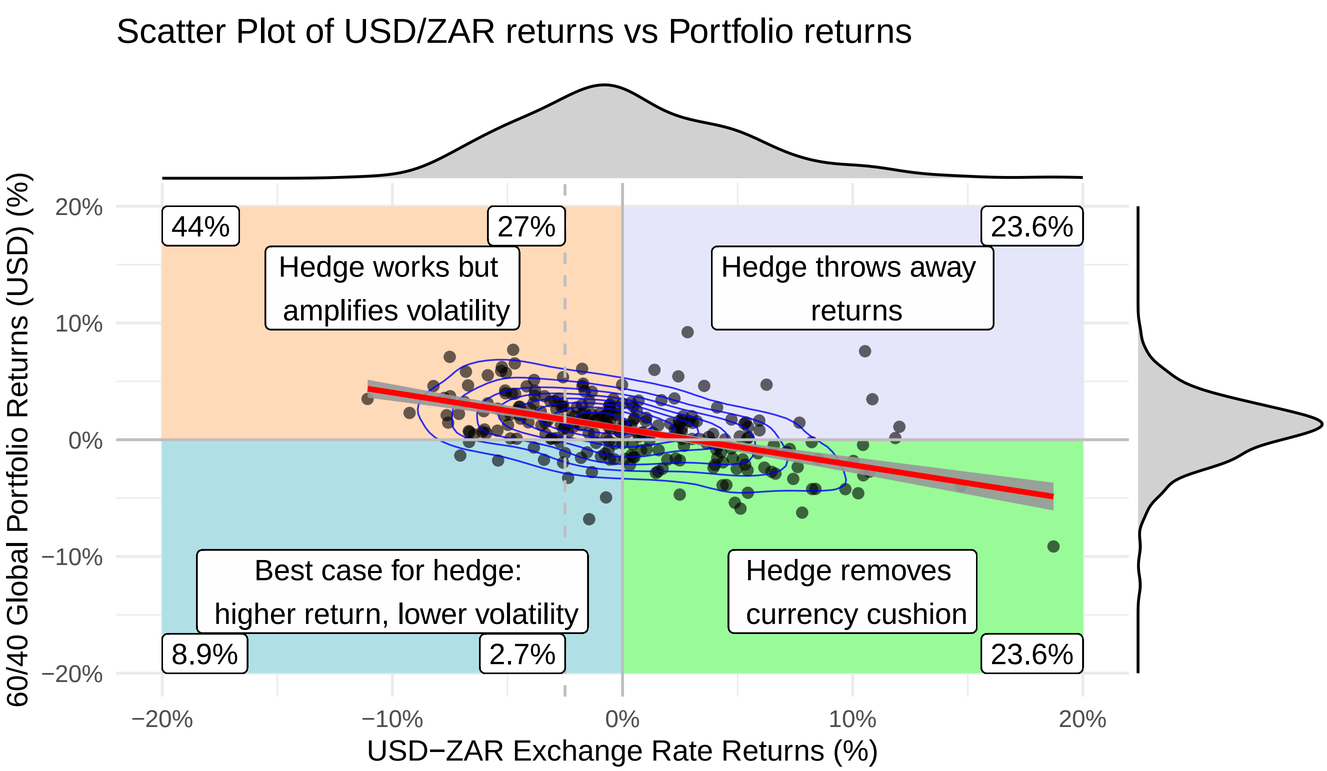
Abstract

This paper investigates the volatility paradox phenomenon whereby negatively correlated assets in a portfolio counterintuitively result in lower overall volatility than would be expected given the constituent assets.

1. The Volatility paradox

The figure below illustrates that global assets and the Rand have a demonstrably negative relationship over the sample period.



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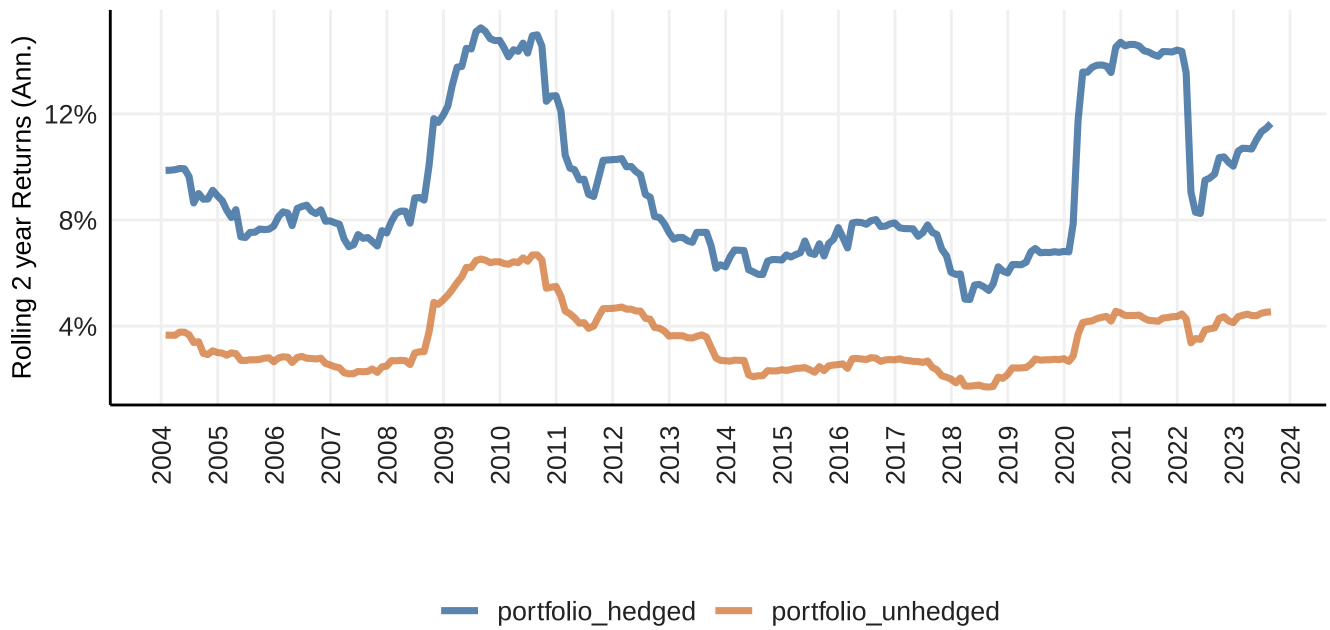
2. Rolling volatity

The figure below clearly illustrates that using the rand as a currency hedge increases volatility substantially.

Rolling 2 Year Annualized Standard Devation Comparison



Note:

This strengthens the argument against long term currency hedging for the purposes of reducing overall volatility by introducing a negatively correlated asset. One can at least say that in this very specific context the strategy does not appear to be effective.