

## Global Markets Daily: EM FX — Optimising for Carry and Risk Exposure (Alves)

- Investor focus on carry strategies has picked up against a backdrop of declining volatility, and sluggish, but non-recessionary, global growth. In this *Global Markets Daily* we look at the carry return, the spot performance, and the sensitivity to risk of a set of FX carry baskets including long/short and long-only strategies.
- Relative value (RV) FX carry baskets are typically higher yielding (by using low-yielding shorts) than a long-only basket versus the Dollar, but the latter implementation has outperformed this year. Relatedly, we find that a USD-funded EM carry basket currently has a similar sensitivity to risk as a relative value long/short basket and a lower beta than an EUR-funded basket. These shifting correlations together with our constructive view on other EM currencies that typically screen as low-carry funders (such as CNH and KRW) argue for EM carry longs to be expressed outright versus the Dollar.
- When looking at other potential funders and the impact on carry and on risk-sensitivity, we note that other high-beta but low carry currencies such as CLP, ILS, AUD and NZD can substantially lower the risk exposure of an EM carry basket without a significant reduction in carry.
- Turning to the long leg, we think that BRL screens as the most attractive carry long given the outright carry level, its undervaluation signal and sensitivity to CNY. Nevertheless, because of country-specific risks across various high-carry currencies, we recommend investors hold a diversified carry basket that also includes MXN, INR and ZAR. ZAR shares many features with BRL so it can be an effective diversifier of country-specific risk without a significant shift in global risk exposures. Instead, we think that MXN and INR can offer greater 'global' beta diversification and resilience even as valuations are less attractive and central bank reaction functions have leaned more dovish. Finally, we think that a higher sensitivity to oil prices makes COP a less attractive long relative to other options, and the pricing of fiscal risks further out in the rates curve makes the risk-reward of shorter-dated carry structures less attractive relative to Brazil.

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### EM FX — Optimising for Carry and Risk Exposure

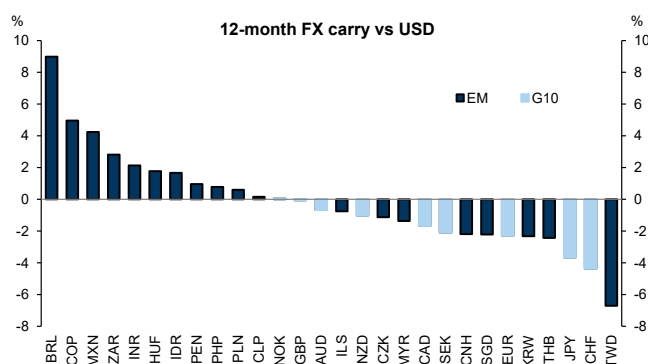
Investor focus on carry strategies has picked up against a backdrop of declining volatility, and sluggish, but non-recessionary, global growth.

And after a sharp recovery, global equity and high-beta currency returns have been more range-bound over the last few weeks, leaving carry accrual as a bigger driver of total returns, a pattern that could persist over the near-term. With this in mind, in this *Global Markets Daily* we look at the carry return, the spot performance, and the sensitivity to risk of a set of FX carry baskets including long/short and long-only strategies.

### **BRL remains the highest carry currency (followed by MXN and COP) and also stands out from a carry-to-vol perspective**

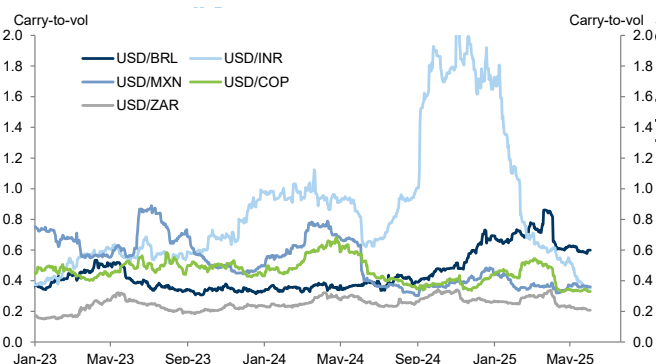
Across both EM and G10 currencies, the Brazilian Real (BRL) currently has the highest 12-month FX carry at around 9%, followed by the Colombian Peso (COP) and the Mexican Peso (MXN) at 4-5% ([Exhibit 1](#)). BRL also stands out from a carry-to-vol perspective ([Exhibit 2](#)) and the Indian Rupee's low volatility means that it has a similar carry-to-vol as MXN or COP.

**Exhibit 1: BRL remains the highest carry currency by a wide margin followed by COP, MXN and ZAR**



Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

**Exhibit 2: BRL also stands out from a carry-to-vol perspective and INR carry-to-vol is similar to that of MXN and COP**



Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

### **Long/short FX carry baskets have a higher yield than a long-only basket but have underperformed YTD**

To assess the risk/reward of different carry strategies we start by constructing FX carry baskets. We construct two baskets based on a long/short carry strategy that goes long the 5 currencies with the highest carry and short the 5 currencies with the lowest carry. One version ranks across currencies within both EM and G10 and the other focuses only on EM currencies. In both, the re-balancing takes place at the start of each month based on the average 12-month carry over the prior month. We also construct a long-only strategy which reflects only the long side of the strategies expressed versus the Dollar (or another specific funder). Currently, this rule implies that BRL, COP, MXN, ZAR and INR are part of the long leg, EUR, JPY, CHF, CNH and TWD are in the overall short leg, and CNH, TWD, KRW, SGD and ILS are in the EM-only short leg.

Naturally, carry is higher for a strategy that combines positive and negative carry currencies with our long/short baskets currently yielding around 8% over 12-months. Instead, a basket that goes long the top 5 highest carry currencies versus the Dollar currently yields around 4.5%. This would yield close to 6% if it only included the top 3 currencies ([Exhibit 3](#)). Looking at the recent performance of these baskets, we find that

returns for long/short baskets outperformed through 2024 as the Dollar strengthened and, in general, exhibit lower return volatility. However, year-to-date spot returns for long/short baskets have been range-bound as both groups of currencies have appreciated versus the Dollar, whereas the long-only carry basket vs the Dollar is up around 6% so far this year in spot terms ([Exhibit 4](#)).

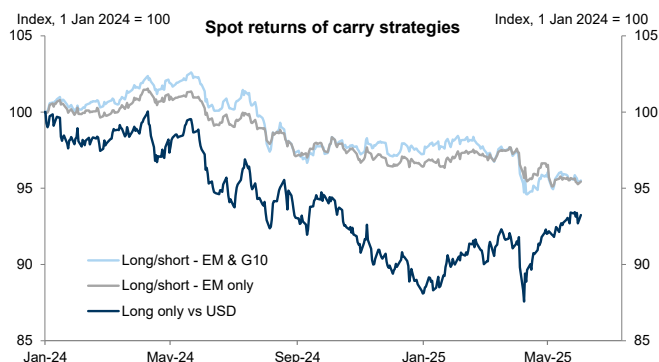
**Exhibit 3: Carry is higher for long/short baskets than versus the Dollar**



Currencies in universe include: AUD, BRL, CAD, CHF, CLP, CNH, COP, CZK, EUR, GBP, HUF, IDR, ILS, INR, JPY, KRW, MXN, NOK, NZD, PHP, PLN, RUB SEK, SGD, TWD and ZAR. RUB is excluded from January 2022 onwards.

Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

**Exhibit 4: Long/short FX carry strategy returns have been range-bound YTD as both groups of currencies have appreciated versus the Dollar**



Source: Goldman Sachs Global Investment Research, Bloomberg

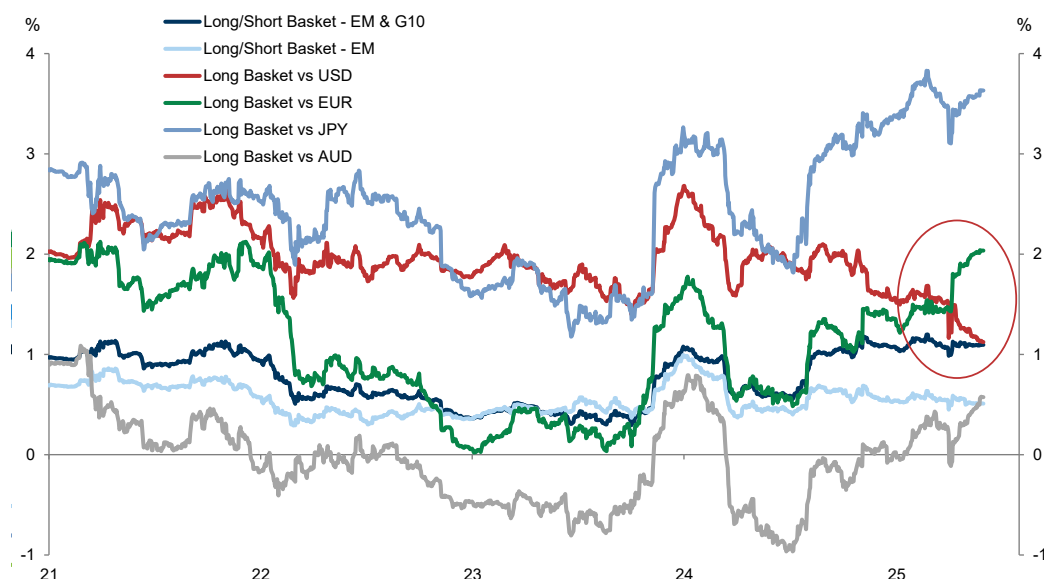
### **A USD-funded EM carry basket currently has a similar sensitivity to risk as a relative value long/short basket and a lower beta than an EUR-funded basket**

Turning to the risk beta of different carry expressions and how to optimise for risk sensitivity versus carry, in [Exhibit 5](#) we plot the rolling beta of a set of carry strategies to S&P 500 Index returns. Intuitively, a long EM carry basket funded with JPY has the highest correlation with risk, whereas funding with a high-beta G10 currency like AUD neutralises this beta to a large extent. Overall, relative value carry baskets have a more neutral sensitivity to risk as the long and short legs offset each other. However, we find that more recently **the risk beta of a USD-funded EM carry basket has been declining and is now similar to that of a relative value long/short basket.**

Conversely, EUR-funded EM carry positions now feature a higher and increasing sensitivity to risk sentiment making the Euro a less attractive funder than in the past.

**Exhibit 5: A USD-funded EM carry basket currently has a similar risk beta as a relative value long/short basket and a lower beta than a EUR-funded basket**

Beta of each strategy to a 10% move higher in the S&amp;P Index

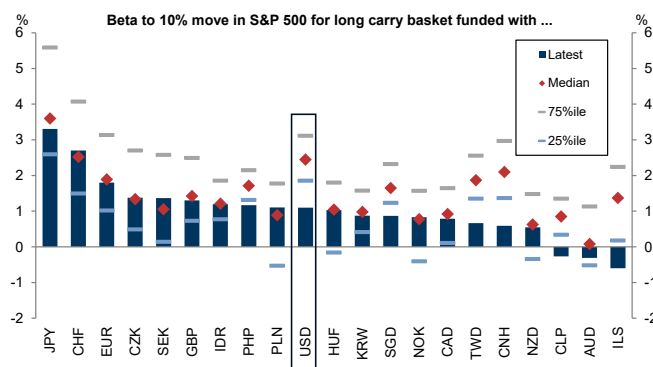


Betas are estimates over one-year rolling windows on daily returns controlling for changes in US yields, oil and copper prices

Source: Goldman Sachs Global Investment Research

This point on the Euro holds true when looking at a wider range of potential funders: currently an EM carry basket funded with EUR is the most risk-on expression after the JPY- and CHF-funded expressions ([Exhibit 6](#)). And, while this risk sentiment beta is close to its historical median for most funder options (that is, the dark blue bar is not far from the red diamond), it is close to historic lows for a USD-funded EM carry basket. Elsewhere, we find that both currently and historically funding EM carry expressions out of other high-beta (NZD, CLP, AUD and ILS) can substantially lower the risk exposure of an EM carry basket. And this comes at a limited carry cost ([Exhibit 7](#)). Among these currencies, we note that the interquartile range is in positive territory for CLP and ILS, whereas with AUD and NZD funding there have been instance when a rally in global equities has been associated with small negative carry basket returns. CLP may be a more natural funder within Latin America, especially if the BCCh returns to a more dovish stance. However, in a more positive global growth and trade outcome that features a clearer US-China trade détente and a stronger CNY, we would expect the Chilean Peso to be one of the outperformers within EM FX. We have found the Israeli Shekel (ILS) to be among the EM currencies most sensitive to US-specific growth pricing and a cross where the relative outperformance of EM growth does not have an offsetting impact. Therefore, in world where US risky assets underperform those in EM, then the Shekel could be a more attractive funder. One key risk to this view is a decline in country-specific risk in Israel that drives USD/ILS back closer to its fair value around 3.30.

**Exhibit 6: The beta to risk of a USD-funded EM carry basket is near its historic lows, whereas it is in line with historical averages for JPY and EUR**



Long carry basket includes BRL, COP, MXN, INR and ZAR. Betas estimated over rolling 6-month windows since 2012 and controlling for changes in US yields, oil and copper prices.

Source: Goldman Sachs Global Investment Research

**Exhibit 7: Funding EM carry trades with high-beta but low carry currencies such as CLP, ILS, AUD and NZD can lower substantially the basket's risk exposure without a significant reduction in carry.**

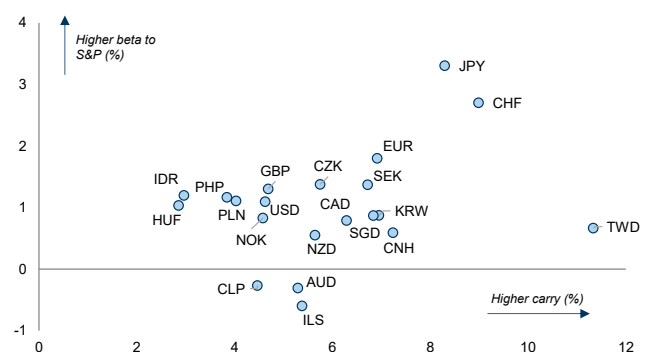


Chart displays the 12-month carry (x-axis) and the beta to the S&P (y-axis) of being long a carry basket (BRL, COP, MXN, INR and ZAR) versus each respective funder. Beta estimated over last 6-month and controlling for changes in US yields, oil and copper prices.

### **BRL screens as the most attractive carry long, but we prefer a diversified basket that neutralises country-specific risk**

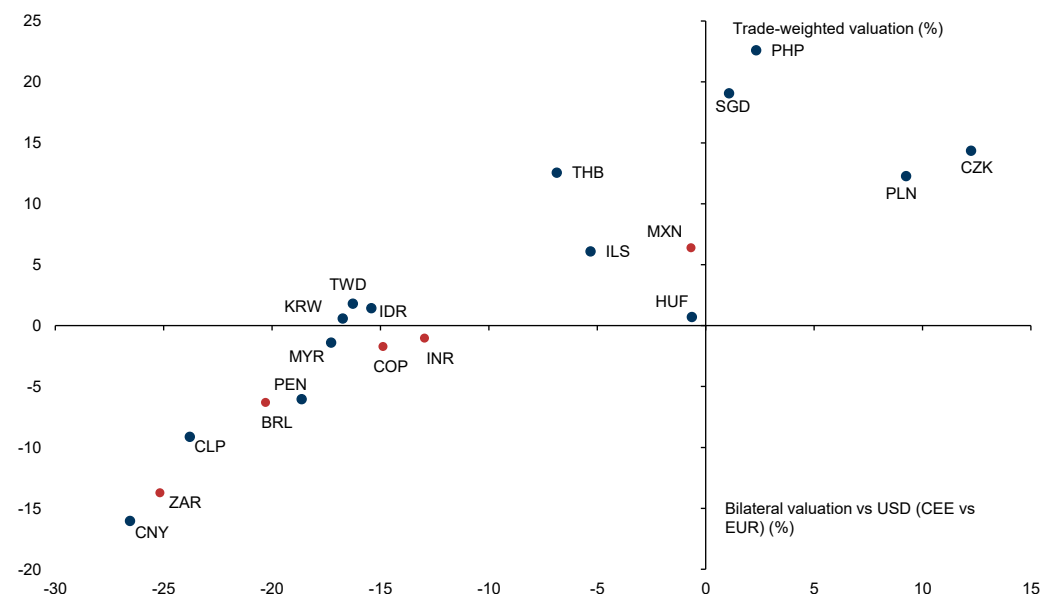
Turning to the long leg, we think that **BRL** screens as the most attractive carry long. It yields twice as much as COP and MXN, and we expect this differential to hold as Brazilian real rates remain elevated through the year. It is also one of the most undervalued EM currencies, both versus the Dollar and in trade-weighted terms ([Exhibit 8](#)), and one of the most responsive to the strengthening we expect in CNY. Therefore, while USD/BRL has been trading in a tight range over the last month, a broad Dollar move lower driven by a stronger CNY could catalyse a break of this range. The main risk to a long BRL position is fiscal headline risk, though we think higher real rates can cushion the currency more clearly from these developments than last year, especially as inflation news have turned more benign. Nevertheless, because of these country-specific risks, which also feature in other high-carry currencies, we recommend investors hold a diversified carry basket that also includes MXN, ZAR and INR.

We think **ZAR** shares many features with the Real — positive carry, deep undervaluation and high sensitivity to China-specific risk and CNY — so it can be a helpful diversifier of Brazil-specific risk without a significant shift in global risk exposures. We think that the outlook for **MXN** total returns is more mixed. On one hand, Banxico has continued to surprise expectations on the dovish side, leading to an erosion of carry, and the Peso generally screens as less undervalued than the other carry currencies ([Exhibit 8](#)). However, it has been appreciating in a soft Dollar backdrop and lighter positioning relative to BRL can make MXN more resilient to headline risk. Moreover, the Peso can be a helpful source of diversification within a carry basket because it provides exposure to the 'right-tail' of US growth outcomes. Similarly, **INR** tends to be less sensitive to risk drawdowns, has reverted to having one of the highest carry-to-vol ratios after a volatile few months, and has lagged the broad Dollar move YTD. Finally, we think that a higher sensitivity to oil prices makes **COP** a less attractive long relative to other options. As in Brazil, fiscal slippage risks have also been in focus but these have been priced in

further out in the rates curve relative to Brazil, which makes the risk-reward of shorter-dated carry structures less attractive.

**Exhibit 8: Across high-carry currencies, BRL and ZAR are the most undervalued, whereas USD/MXN is close to fair**

Valuation signal based on a 60:40 average of GSDEER and FEER models



Source: Goldman Sachs Global Investment Research



### Best Trade Ideas Across Assets

For pricing, charts, and a list of previous recommendations, please visit our [Trade Ideas page](#).

1. Stay long Indonesia 1Y SRBIs fully FX hedged, opened on October 3, 2024, at 6.82%, with a target of 5.70%, and a revised stop of 6.70%, currently trading at 6.26%.
2. Stay short THB/KRW, opened January 10, 2025, at 42.30, with a target of 39.0, and a stop of 44.0, currently trading at 42.21.
3. NSE India Consumption vs. NSE Infra outperformance pair trade, opened February 03, 2025, at 1.41, with a target of 1.70, and a stop of 1.25, currently trading at 1.28.
4. Buy SFRZ5 96.25 put vs sell 0QZ5 96.25 put (in net premium), opened March 7, 2025, at -0.03, with a revised target of 0.25, and a revised stop of 0.13, currently trading at 0.15.
5. Buy 30y TIPS on a beta weighted basis versus nominals (1:0.7x), opened April 17, 2025, at -0.77, with a revised target of -0.97, and a revised stop of -0.77, currently trading at -0.84.
6. Stay long 3y SOFR-UST swap spreads, opened May 2, 2025, at -0.30, with a target

of -0.23 and a revised stop of -0.30, currently trading at -0.27.

7. Stay long 3m10y USD payer on 3m 5s10s30s payer fly (return in bp running), opened May 2, 2025, at 0.00, with a target of 0.10 and a stop of -0.05, currently trading at 0.00.
8. Stay long 10y10y Gilts vs USTs, opened May 16, 2025, at 0.51, with a target at 0.10 and a stop at 0.71, currently trading at 0.30.
9. Stay long the sovereign USD bonds of Poland, Hungary, Uruguay and Jamaica as an equally weighted basket, opened May 20, 2025, at 0%, with a total return target of 3% and a stop of -1.5%, currently trading at 0.6%.
10. Stay long MSCI Korea (M1KR) in USD terms, opened May 21, 2025, indexed to 100, with a target at 115 and a stop at 90, currently trading at 103.7.
11. Receive July BoC meeting OIS, opened May 23, 2025, at 2.60%, with a target of 2.50% and a stop at 2.65%, currently trading at 2.59%.
12. Receive December 2025 BoE meeting OIS, opened May 30, 2025, at 3.85%, with a target of 3.50% and a stop at 4.12%, currently trading at 3.81%.



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