

Module 8: Currency ETFs

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Topic 1: Currency ETFs

I want exposure to currencies

Currency ETFs give you exposure to the performance of a foreign currency against the Australian dollar.

For example, a US dollar ETF gives you exposure to the performance of the US dollar relative to the Australian dollar.



What is an exchange rate?

An exchange rate can be thought of as the price of one currency in terms of another.

For any given currency pair, the exchange rate can be expressed in two ways.

For example, the \$A/\$US exchange rate can be expressed as either:

- US\$1 = A\$1.0526, or
- A\$1 = US\$0.9500

The first way expresses the price of one US dollar in terms of Australian dollars.

The second way expresses the price of one Australian dollar in terms of US dollars. In Australia, this is the way we generally express exchange rates against the \$A.

The two rates are equivalent.

\$A vs.	A\$1 in terms of foreign currency		Foreign currency in terms of \$A
\$US	A\$1 = US \$0.9000	↔	US \$1 = A \$1.1111
GBP	A\$1 = £0.6300	↔	A\$1 = \$0.9000
Euro	A\$1 = €0.6300	↔	€1 = A1.3333

Currency ETFs track exchange rate movements

Currency ETFs track the value of the relevant currency but trade in Australian dollars.

For example a US dollar ETF tracks the value of the US dollar relative to the Australian dollar. This means that:

- if the \$US strengthens against the \$A, the price of the ETF will rise, and
- if the \$US weakens against the \$A, the price of the ETF will fall.

\$US vs. \$A	Price of \$US ETF
↑	↓
↓	↑

How are exchange rates reported in the news?

When you hear the Australian dollar exchange rate quoted in the media it is generally quoted in terms of its value against the US dollar.

For example, "the Aussie dollar rose overnight and is now worth 92 US cents". This means that your \$A dollar can buy 92 US cents. The stronger the \$A the greater your purchasing power if you go on a holiday to the USA.

It is important to emphasise with the example on the previous screen, the US Dollar ETF has an inverse relationship to this method of quoting, so when the \$A strengthens, the US dollar ETF will fall in value.

\$US vs. \$A	\$A vs. \$US	Price of \$US ETF
↑	↓	↑
↓	↑	↓

Example

On 1 March, A\$1 = US\$0.90.

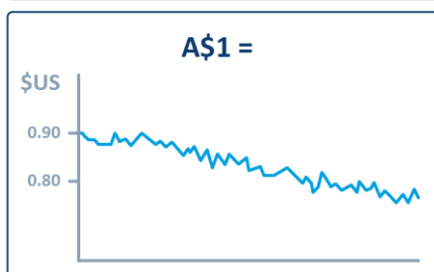
The price of a US dollar ETF traded on ASX is \$1.1111.

You believe the \$US will strengthen against the \$A (\$A will weaken) over the next four months, so buy US dollar ETFs.

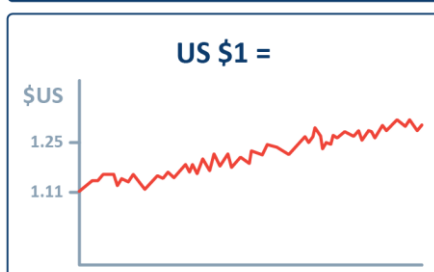
On 1 July, the exchange rate stands at A\$1 = US\$0.80.

The price of US dollar ETFs has risen to \$1.25.

A fall in the \$A



is the same as a rise in the \$US.
The price of your ETF has risen in line with
the increase in the value of the \$US.



Outcome

The \$US has strengthened against the \$A (the \$A has fallen against the \$US), and the price of your ETFs has risen.

Had the \$A appreciated against the \$US, the price of your ETFs would have fallen.

Advantages of currency ETFs

You can gain exposure to foreign currencies by trading directly on the foreign exchange market.

However, currency ETFs offer advantages for retail investors:

1. Convenient to trade on ASX
2. Cost effective: For retail investors, the spread between bid and offer prices for currency ETFs may be narrower than the spreads available when trading on the foreign exchange market. Also costs of purchasing currency ETFs and ongoing management expenses (MERs) may be lower than the costs of buying foreign currency directly.

