

J.P. Morgan Asset Management – Currency-hedged share classes: A guide for investors

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WHY HEDGE CURRENCIES?

As an investor, exchange rates can have a significant impact on your returns - for better or for worse. For example, if you buy shares as a EUR investor in a US equity fund denominated in USD, your returns in EUR will be influenced by movements in the EUR/USD exchange rate. If the EUR weakens against the USD, your returns will be higher than the USD return once the investment is converted back into EUR. Likewise, if the EUR strengthens, your returns will be lower when converted to EUR than you would receive in USD terms. Because these returns are fully exposed to currency risk, they are described as “unhedged”.

Currency-hedged share classes

Some investors are uncomfortable with unhedged currency exposure and prefer to minimise currency risks. Currency-hedged share classes can help minimise the impact of foreign exchange movements on investment returns when you subscribe to a fund where the currency or currencies of its underlying assets are different to the investor’s own preferred currency.

At J.P. Morgan Asset Management, we use two different currency-hedged share class methods:

- **A net asset value (NAV) hedge:** This aims to minimise the effect of currency movements between the base currency* of a fund and the currency of the relevant hedged share class.
- **A portfolio hedge:** This aims to minimise the effect of currency movements between the currencies of the assets of the fund and the currency of the relevant hedged share class with the exception of currencies where it is impractical or not cost effective to do so. In other words, it looks through to the underlying currency exposures of the fund.

* The base currency of a fund is the currency in which the fund is priced.

	NAV HEDGE	PORTFOLIO HEDGE
Description	Systematically hedges the value of assets in the base currency of the fund into the currency of the hedged share class.	Systematically hedges the currency exposures into the currency of the hedged share class, unless it is impractical or not cost effective to do so such as for certain emerging market currencies.
Typical usage	Single-country funds, funds hedging back to base currency, funds with cash benchmarks and emerging market funds.	Funds with multiple currency exposures and limited – or no – currency hedging at fund level.
	<ul style="list-style-type: none">• JPMorgan Funds - America Equity Fund• JPMorgan Funds - Asia Pacific Income Fund• JPMorgan Funds - Emerging Markets Dividend Fund• JPMorgan Funds - Emerging Markets Debt Fund	<ul style="list-style-type: none">• JPMorgan Funds - Europe Dynamic Fund• JPMorgan Funds - Europe Dynamic Technologies Fund• JPMorgan Investment Funds - Global Dividend Fund
Returns	Investors should receive similar returns to those in unhedged share classes denominated in the base currency of the fund.	Investors should receive a return that mitigates the impact of foreign exchange movements in the fund.

You can find details of the hedging methodology for each particular fund in the Hong Kong offering document and specifically in the Additional Information section. Hong Kong offering document can be found at www.jpmorganam.com.hk¹.

Implementing the currency hedges

When a subscription is received into a hedged share class, one or more currency hedging transactions take place, which means buying currency forward contracts.

The profit or loss on a currency forward contract is always captured in the NAV of the relevant share class, but remains uninvested until the profits or losses are crystallised. This typically occurs on a monthly basis.

Where a profit or loss is made via a currency forward contract—whether realised or unrealised—it may be necessary to transfer cash or other liquid assets as collateral between the fund and counterparty to mitigate counterparty risk.

Over-hedged and under-hedged positions are kept under constant review. Unless due to factors beyond our control, over-hedged positions will not be permitted to exceed 105% of the value of hedged class and under-hedged positions will not be permitted to fall below 95% of the value of the hedged share class.

Examples of returns from currency-hedged share classes

NAV-hedged share classes

In the examples below, the fund's underlying assets are predominantly denominated in USD, while the fund's base currency is also USD. Therefore, the fund's base currency return is not significantly affected by currency movements.

Example one

SHARE CLASS	CUMULATIVE THREE-YEAR PERFORMANCE
A (acc) - USD	30%
A (acc) - EUR (hedged)	29%
A (acc) - EUR	56%

In example one, despite the large negative change in the EUR/USD exchange rate, investors in the EUR (hedged) share class have received returns broadly in line with the returns from the fund's underlying USD assets. Investors in the EUR (unhedged) share class have benefit from the large depreciation of EUR vs. USD because they have been prepared to take currency risk.

Example two

SHARE CLASS	CUMULATIVE THREE-YEAR PERFORMANCE
A (acc) - USD	-25%
A (acc) - EUR (hedged)	-24%
A (acc) - EUR	-44%

In example two, despite an appreciation in EUR vs. USD, the investors in the EUR (hedged) share class have received returns broadly in line with the returns from the fund's underlying USD assets. Investors in the EUR (unhedged share class) have suffered the impact of the appreciation in EUR vs. USD.

Portfolio hedged share classes

In both these examples, the fund's underlying assets are exposed to a range of currencies (USD, EUR, GBP, JPY, etc), while the fund's base currency is USD. The returns of the USD (unhedged) share class are affected by foreign exchange movements and the strength in the currencies relative to the USD. In contrast, for the EUR (hedged) share class the currency exposure has been mostly removed and the volatility of returns as a result of currency movements has been reduced.

Example three

SHARE CLASS	CUMULATIVE THREE-YEAR PERFORMANCE
A (acc) - USD	10%
A (acc) - EUR (hedged)	30%
A (acc) - EUR	40%

In example three, the returns from the A unhedged share class have been negatively affected from currency movements in the non-USD-denominated assets. In contrast, the returns from the EUR (unhedged) share class has benefited positively from movements in currency movements in non-EUR-denominated assets. The EUR (hedged) share class has not been positively or negatively affected by currency movements vs. EUR.

Example four

SHARE CLASS	CUMULATIVE THREE-YEAR PERFORMANCE
A (acc) - USD	15%
A (acc) - EUR (hedged)	-10%
A (acc) - EUR	-23%

In example four, the returns from the A unhedged share class have benefited from currency movements in the non-USD-denominated assets. In contrast, the returns from the EUR (unhedged) share class have been negatively affected by movements in currency movements in non-EUR denominated assets. The EUR (hedged) share class has not been positively or negatively affected by currency movements vs. EUR.

Currency derivatives at the portfolio level to increase returns

Some of our funds may invest in currency derivatives at the portfolio level with the aim of increasing returns however none of the SFC authorised funds² are currently investing in currency derivatives for investment purpose.

In this scenario, we use a NAV hedge to minimise the effect of currency movements between the base currency of the fund and that of the hedged share class. However, there may still be some currency exposure at the portfolio level via currency derivatives.

Additional factors that affect currency hedging

Achieving perfect currency hedging is not possible, as several factors can affect the results, including:

- The size of the forward currency contracts and the NAV of the share class can often differ due to costs and practical limitations.
- Unrealised gains cannot be invested in underlying assets until settlement, leading to a loss of performance in a rising market. Conversely, unrealised losses can add to returns in a falling market.
- Short-term interest rate differentials between the currency of the share class and the currencies being hedged. For example, hedging from a currency with a low interest rate to one with a higher interest rate will create a gain.

Currency hedging transaction costs are ring-fenced so that each hedged share class bears its proportionate costs, rather than detracting from returns.

Risks of currency hedging

Currency-hedged share classes come with some potential risks for investors, for example:

- Achieving a perfect hedge is not possible and there is no guarantee that the hedging will be totally successful. Investors should therefore note that they may still have exposure to currencies other than the currency of the hedged share class.
- When investing in currency hedged share classes investors miss out on any positive returns from currency movements as well as avoiding the downside. For example, if you invest in a US equity fund hedged to EUR and USD strengthens against EUR, you will not benefit from this foreign exchange rate movement as you are not exposed to it. Likewise, if USD depreciates against EUR, you will be insulated against the negative impact of this movement.
- The use of derivatives in currency-hedged share classes may have an adverse impact on other share classes in the same fund. This is known as spill-over risk and occurs because derivatives are traded at fund level and cannot be traded for share classes. However, our procedures and controls are designed to minimise this risk by:
 - carefully selecting derivatives brokers
 - deploying cash collateral to protect the fund

Please refer to Appendix I for the list of share classes with potential spill-over risk.

Managed by currency experts

Currency hedging is a complex process and requires expert investment management. At J.P. Morgan Asset Management, our currency-hedged share classes are managed by our highly experienced Currency Management Team. Based in London, this 18-strong team of currency professionals manages assets of more than USD 286 billion on behalf of both pooled funds and segregated mandates, making it one of the largest currency overlay managers in the world (as at 31 March 2017).

1 The website has not been reviewed by the Securities and Futures Commission.

2 SFC authorisation is not a recommendation or endorsement of a scheme nor does it guarantee the commercial merits of a scheme or its performance. It does not mean the scheme is suitable for all investors nor is it an endorsement of its suitability for any particular investor or class of investors.

FURTHER INFORMATION

Please contact your usual J.P. Morgan Asset Management representative for a full list of funds with hedged share classes and the currencies available.

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Appendix I

List of share classes with potential spill-over risk

Sub-Fund	Share Class
JPMorgan Funds - America Equity Fund	JPM America Equity A (acc) - AUD (hedged)
JPMorgan Funds - America Equity Fund	JPM America Equity A (acc) - HKD
JPMorgan Funds - America Equity Fund	JPM America Equity A (acc) - USD
JPMorgan Funds - America Equity Fund	JPM America Equity A (dist) - USD
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (acc) - HKD
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (acc) - USD
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (dist) - USD
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (irc) - AUD (hedged)
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (irc) - CAD (hedged)
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (irc) - EUR (hedged)
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (irc) - GBP (hedged)
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (irc) - NZD (hedged)
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (mth) - HKD
JPMorgan Funds - Asia Pacific Income Fund	JPM Asia Pacific Income A (mth) - USD
JPMorgan Funds - Emerging Markets Debt Fund	JPM Emerging Markets Debt A (acc) - USD
JPMorgan Funds - Emerging Markets Debt Fund	JPM Emerging Markets Debt A (irc) - AUD (hedged)
JPMorgan Funds - Emerging Markets Debt Fund	JPM Emerging Markets Debt A (irc) - CAD (hedged)
JPMorgan Funds - Emerging Markets Debt Fund	JPM Emerging Markets Debt A (irc) - NZD (hedged)
JPMorgan Funds - Emerging Markets Debt Fund	JPM Emerging Markets Debt A (mth) - HKD
JPMorgan Funds - Emerging Markets Debt Fund	JPM Emerging Markets Debt A (mth) - USD
JPMorgan Funds - Emerging Markets Dividend Fund	JPM Emerging Markets Dividend A (irc) - AUD (hedged)
JPMorgan Funds - Emerging Markets Dividend Fund	JPM Emerging Markets Dividend A (irc) - GBP (hedged)
JPMorgan Funds - Emerging Markets Dividend Fund	JPM Emerging Markets Dividend A (mth) - HKD
JPMorgan Funds - Emerging Markets Dividend Fund	JPM Emerging Markets Dividend A (mth) - USD
JPMorgan Funds - Emerging Markets Equity Fund	JPM Emerging Markets Equity A (acc) - USD
JPMorgan Funds - Emerging Markets Equity Fund	JPM Emerging Markets Equity A (dist) - USD
JPMorgan Funds - Emerging Markets Investment Grade Bond Fund	JPM Emerging Markets Investment Grade Bond A (mth) - USD
JPMorgan Funds - Emerging Markets Local Currency Debt Fund	JPM Emerging Markets Local Currency Debt A (acc) - USD
JPMorgan Funds - Emerging Markets Local Currency Debt Fund	JPM Emerging Markets Local Currency Debt A (irc) - AUD (hedged)
JPMorgan Funds - Emerging Markets Local Currency Debt Fund	JPM Emerging Markets Local Currency Debt A (mth) - HKD
JPMorgan Funds - Emerging Markets Local Currency Debt Fund	JPM Emerging Markets Local Currency Debt A (mth) - USD
JPMorgan Funds - Emerging Markets Opportunities Fund	JPM Emerging Markets Opportunities A (acc) - USD
JPMorgan Funds - Euroland Equity Fund	JPM Euroland Equity A (acc) - EUR
JPMorgan Funds - Euroland Equity Fund	JPM Euroland Equity A (dist) - EUR
JPMorgan Funds - Euroland Equity Fund	JPM Euroland Equity A (acc) - USD (hedged)
JPMorgan Funds - Euroland Equity Fund	JPM Euroland Equity A (dist) - USD
JPMorgan Funds - Europe Dynamic Fund	JPM Europe Dynamic A (acc) - AUD (hedged)
JPMorgan Funds - Europe Dynamic Fund	JPM Europe Dynamic A (acc) - HKD (hedged)
JPMorgan Funds - Europe Dynamic Fund	JPM Europe Dynamic A (acc) - USD (hedged)
JPMorgan Funds - Europe Dynamic Fund	JPM Europe Dynamic A (dist) - EUR
JPMorgan Funds - Europe Equity Fund	JPM Europe Equity A (acc) - USD
JPMorgan Funds - Europe Equity Fund	JPM Europe Equity A (dist) - USD

JPMorgan Funds - Europe Small Cap Fund	JPM Europe Small Cap A (acc) - EUR
JPMorgan Funds - Europe Small Cap Fund	JPM Europe Small Cap A (acc) - USD (hedged)
JPMorgan Funds - Europe Small Cap Fund	JPM Europe Small Cap A (dist) - EUR
JPMorgan Funds - Europe Dynamic Technologies Fund	JPM Europe Dynamic Technologies A (acc) - EUR
JPMorgan Funds - Europe Dynamic Technologies Fund	JPM Europe Dynamic Technologies A (acc) - USD (hedged)
JPMorgan Funds - Europe Dynamic Technologies Fund	JPM Europe Dynamic Technologies A (dist) - EUR
JPMorgan Funds - Global Dynamic Fund	JPM Global Dynamic A (acc) - USD
JPMorgan Funds - Global Dynamic Fund	JPM Global Dynamic A (dist) - USD
JPMorgan Funds - Global Government Bond Fund	JPM Global Government Bond A (acc) - USD (hedged)
JPMorgan Funds - Global Real Estate Securities Fund (USD)	JPM Global Real Estate Securities (USD) A (dist) - USD
JPMorgan Funds - Global Unconstrained Equity Fund	JPM Global Unconstrained Equity A (acc) - USD
JPMorgan Funds - Global Unconstrained Equity Fund	JPM Global Unconstrained Equity A (dist) - USD
JPMorgan Funds - Greater China Fund	JPM Greater China A (acc) - USD
JPMorgan Funds - Greater China Fund	JPM Greater China A (dist) - HKD
JPMorgan Funds - Greater China Fund	JPM Greater China A (dist) - USD
JPMorgan Funds - Income Fund	JPM Income Fund A (acc) - USD
JPMorgan Funds - Income Fund	JPM Income Fund A (mth) - HKD
JPMorgan Funds - Income Fund	JPM Income Fund A (mth) - USD
JPMorgan Funds - Japan Equity Fund	JPM Japan Equity A (acc) - USD (hedged)
JPMorgan Funds - Japan Equity Fund	JPM Japan Equity J (dist) - USD
JPMorgan Funds - Korea Equity Fund	JPM Korea Equity A (acc) - USD
JPMorgan Funds - Total Emerging Markets Income Fund	JPM Total Emerging Markets Income A (acc) - USD
JPMorgan Funds - Total Emerging Markets Income Fund	JPM Total Emerging Markets Income A (irc) - AUD (hedged)
JPMorgan Funds - Total Emerging Markets Income Fund	JPM Total Emerging Markets Income A (mth) - HKD
JPMorgan Funds - Total Emerging Markets Income Fund	JPM Total Emerging Markets Income A (mth) - USD
JPMorgan Funds - US Aggregate Bond Fund	JPM US Aggregate Bond A (acc) - EUR (hedged)
JPMorgan Funds - US Aggregate Bond Fund	JPM US Aggregate Bond A (acc) - USD
JPMorgan Funds - US Aggregate Bond Fund	JPM US Aggregate Bond A (dist) - USD
JPMorgan Funds - US Aggregate Bond Fund	JPM US Aggregate Bond A (mth) - HKD
JPMorgan Funds - US Aggregate Bond Fund	JPM US Aggregate Bond A (mth) - USD
JPMorgan Funds - US Growth Fund	JPM US Growth A (dist) - USD
JPMorgan Funds - US High Yield Plus Bond Fund	JPM US High Yield Plus Bond A (acc) - USD
JPMorgan Funds - US High Yield Plus Bond Fund	JPM US High Yield Plus Bond A (mth) - HKD
JPMorgan Funds - US High Yield Plus Bond Fund	JPM US High Yield Plus Bond A (mth) - USD
JPMorgan Funds - US Value Fund	JPM US Value A (dist) - USD
JPMorgan Investment Funds - Europe Select Equity Fund	JPM Europe Select Equity A (dist) - EUR
JPMorgan Investment Funds - Global Dividend Fund	JPM Global Dividend A (dist) - USD
JPMorgan Investment Funds - Global Dividend Fund	JPM Global Dividend A (mth) - USD (hedged)
JPMorgan Investment Funds - Global High Yield Bond Fund	JPM Global High Yield Bond A (acc) - USD
JPMorgan Investment Funds - Global High Yield Bond Fund	JPM Global High Yield Bond A (irc) - AUD (hedged)
JPMorgan Investment Funds - Global High Yield Bond Fund	JPM Global High Yield Bond A (irc) - CAD (hedged)
JPMorgan Investment Funds - Global High Yield Bond Fund	JPM Global High Yield Bond A (irc) - NZD (hedged)
JPMorgan Investment Funds - Global High Yield Bond Fund	JPM Global High Yield Bond A (mth) - HKD
JPMorgan Investment Funds - Global High Yield Bond Fund	JPM Global High Yield Bond A (mth) - USD