EUROMONEY

Corporates hedge their bets as market volatility surges

Paul Golden October 19, 2022

Recent volatility has encouraged many corporates to switch out of longer tenor instruments to increase their ability to react to market movements.

Photo: iStock

The sharp increase in the cost of options and forwards this year has had a notable impact on corporate hedging strategies. This has seen not only companies pulling back from hedging altogether, but also – perhaps more notably – a shift in the duration of the hedges taken out.

Many corporates are reverting to more straightforward linear hedging products such as forwards, which are more liquid and easier for chief financial officers (CFOs) to unwind should the market move against them. That is the view of Eric Huttman, chief executive of MillTechFX, who refers to a shift towards shorter tenors of FX forwards.

Eric Huttman, MillTechFX

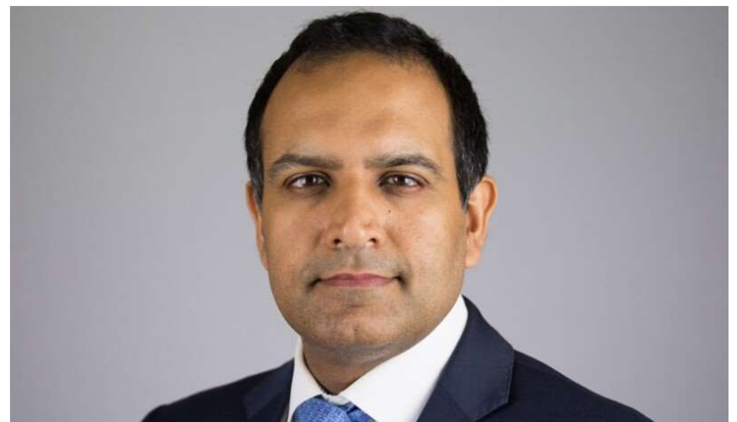
"Instead of locking in rates for 12 months or more, CFOs are increasingly using shorter-dated forwards with tenors below six months, which are then rolled at maturity to maintain the hedge," he says.

Vedanta Hedging also has seen a sharp reduction in the duration of hedges, with options contracts that were previously taken out for 24 months now moving to an average of three to six months.

"This is also because clients are having faster and more frequent conversations with their customers and suppliers about needing to reprice or rebase their fees," suggests the firm's chief executive Abhishek Sachdev. "There has also been a steep reduction in the use of extendable contracts."

Corporates have hit the delay button on hedges, given the acceleration in USD strength in most currency pairs, according to Thomas Anderson, managing director of moneycorp Americas.

"The rationale used to be 'these are great levels to put on hedges to sell USD', but it has now become 'I am waiting for the move to further accelerate before adding additional hedges'," he says. "The only noticeable effect on the tenors of hedges has been the preference to do spot instead of forwards or options, with the hope that USD remains supported going forward. This, of course, ignores a potential retrace in USD strength and is rather risky."



Abhishek Sachdev, Vedanta Hedging

This final point is a reminder that not all risk managers have the same experience. For clients that purchase USD, Monex Europe has seen an increase in corporates moving towards leaving their exposures unhedged, with the dollar's extreme levels being seen – perhaps hopefully – as driven by factors that should ease with time, explains group trading manager Michael Quinn.

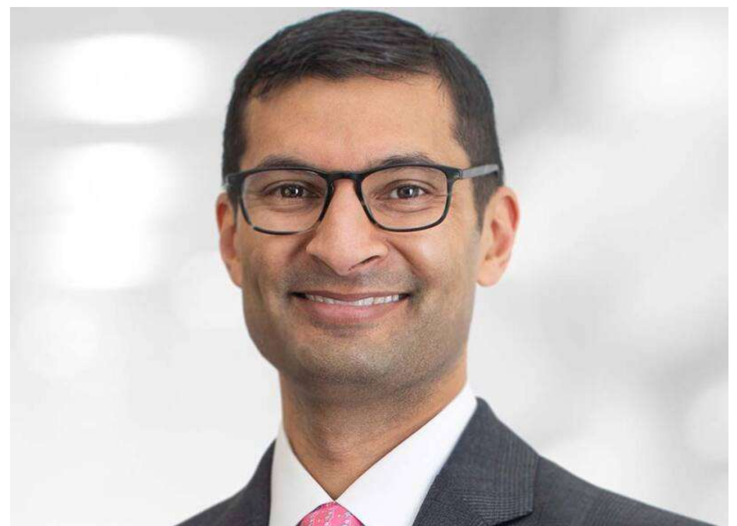
Michael Quinn, Monex Europe

"For clients that have benefited from the recent moves – such as USD sellers – there has been a noticeable uptick in appetite for hedging instruments," he says. "This is especially true for companies that historically have not hedged. Where they may have budgeted for the year on rates of exchange far less favourable than the current market, they are now keen to lock in that balance-sheet gain and reduce exposure to further volatility."

Scott Bilter, principal at AtlasFX, suggests there is no single answer to the question of whether corporates have reacted to the rising cost of options and forwards by either reducing their hedges or switching out of longer tenor instruments.

"Many are earning even more forward points, so there is no disincentive to hedge with long-dated forwards," he says. "Few have switched to options, given the higher costs, but an 'at the spot' strike price for a longer-dated option may have moved in their favour to slightly offset the volatility increase."

Amol Dhargalkar, managing partner and chairman Chatham Financial, says his clients have increased their hedging tenors and percentages as they look to reduce impact on future years' earnings and forecasts.



Amol Dhargalkar, Chatham Financial

He also says there has not been any notable increase in their use of flexible/open forwards – an observation echoed by MillTechFX's Huttman, who says clients want more flexibility within their programmes, not less, whilst at the same time controlling costs and maintaining transparency.

"The easiest way to do that is with straightforward FX forwards and rolls that can be automatically and electronically executed with embedded transaction cost analysis (TCA) to demonstrate best execution," he adds.

In contrast, moneycorp Americas' Anderson says 90% of his clients are now using open forwards and that volumes are up by 25% year-on-year – although he also notes that the average client hedging tenor is up by around 40% during the same period.

Thomas Anderson, moneycorp Americas.

Monex Europe's Quinn says flexible contracts continue to be a popular hedging tool amongst his client base and that with the macroeconomic picture globally having deteriorated during the past year, clients have less conviction in their own budgets and forecasting, increasing the utility and importance of flexible hedging solutions.

"We are seeing more use of flexible drawdown forwards where drawdowns can occur within a window of one to three months, for example," concludes Sachdev. "This trend started during the pandemic because of the need to delay purchases or sales due to supplier bottlenecks. We are also seeing clients buying more pure vanilla options as cheap hedges, which may provide disaster insurance in case of wild swings."

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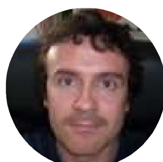

Paul Golden

Paul has written about finance since the early 2000s, with a particular emphasis on foreign exchange, treasury and wealth management. He is a regular contributor to several industry titles in addition to Euromoney.