Strategic Impact of Currency Risk on US Institutional Investors

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Asset allocation for U.S. pension plans is changing to better reflect the profile of pension plan liabilities. While the majority of U.S. pension liabilities are denominated in U.S. dollars, increases in currency volatility (both perceived and real) are impacting these longer-term asset allocation decisions.

From a positive perspective, currency volatility offers increased portfolio diversification and so the potential to decrease overall portfolio volatility. In addition, pension funds are viewing currency market volatility as a source of returns in its own right. While in its early stages, the idea of currency as a potential asset class within their portfolios is under consideration by many pension plans.

Conversely, the potential for a prolonged period of U.S. dollar weakness has significant negative ramifications for pension portfolios if one accepts that currency weakness will contribute to inflationary pressures. This explains why many pension funds have created a new asset class for "inflation-sensitive investments" such as commodities, timber, and TIPs. If this weakness persists, there is concern that the U.S. dollar may lose its status as the world's reserve currency (if it hasn't already), resulting in structural changes that will impact the global investment environment. While such changes would be unpredictable and widespread, one example that will be discussed is the impact of currency risk on investment in global infrastructure projects necessary for economic growth.