

Forex hedging strategy for DRF and LSSF

As liquidity continues to remain tight in the market and interest rates are low, we will be repositioning our forex strategy over the next three months from a pure short dated forward contract to a combination of short dated forward contracts and longer dated derivative forex hedge.

Why are we doing it?

Until now, the forward contract strategy required us to provide a cash collateral of up to 3% of the amount hedged, which in turn generated interest. The prime brokerage now requires 12% to 15% in collateral in order to run the contracts. With the current negligible interest rates, this is akin to having 15% of your investments earning a minimum return, thus creating a drag in the Euro and Sterling classes.

We felt that it is prudent to move from our current strategy to one based on a series of long dated options of 2, 3 and 4 years coupled with a small portion remaining in short dated hedge contracts to match the forex exposure of net subscriptions and redemptions. This will enable us to mitigate the higher hedging costs for the Euro and Sterling classes.

What effect will this have?

This will introduce a small amount of volatility into the monthly prices. With our hybrid valuation methodology, the return is generally between 0.50% and 0.70% per month. Over the next 2-3 months this is likely to range from 0.15% to 0.85% per month.

Why do Euro and Sterling classes need to be hedged?

The portfolio of life settlement policies which form the underlying assets of the Funds are denominated in US Dollars. If unhedged, the returns for investors in Sterling and Euro share classes are exposed to the volatility of the currency market.

How does forward contract hedging work?

No upfront cost, but collateral is required. A forward contract locks in a forward rate today at which a currency must be bought or sold at some future point in time. A forward contract provides perfect coverage easily at a potential cost of having lumpy large cash outlays in order to settle the contracts. For example, if the £/\$ rate should move from 1.6810 to 1.4617, the Fund will need to settle £15m for every £100m hedged.

How does derivative hedging work?

No collateral required, but there is an upfront cost. A derivative financial instrument such as a forex option gives the owner the right but not the obligation to exchange money denominated in one currency for another at a pre-agreed exchange rate on a specified date. For example, a forward option is put in place at a strike price of 1.6810 and on the pre-agreed date, the spot price is less than the strike price, the Fund will then have the option of exercising the option and making a profit.

What are the advantages of options over forward contracts?

An option protects the value that the Sterling and Euro investors will receive in the future. The cost of the option is predefined and potentially can yield a profit if the forex rate moves in the anticipated direction. If the rate moves in the other direction, the maximum loss is limited to the cost of the option whereas with a forward contract, the cost can theoretically be unlimited.

If you should require additional information concerning this bulletin, please do not hesitate to contact us on +44 207 079 5853 or write us at info@groupcenturion.com

About Centurion

Centurion's current fund range includes one of the first micro-longevity funds in the market, established in 2002, which consists of physical (or cash) policies, a micro-longevity fund established in 2006 which combines both physical and synthetic policies, a micro-longevity fund of funds launched in 2003 and a macro/micro longevity fund of funds launched in 2009.

Fund Name	Type of fund	Domiciled	Quoted
Defined Return Fund PLC	Micro longevity with physical policies only	Cayman Islands	
Life Settlement Strategy Fund SPC	Micro longevity with physical and synthetic policies	Cayman Islands	Channel Islands Stock Exchange
Argent Fund SPC	Micro longevity fund of funds	Cayman Islands	Luxembourg Euro MTF
Centurion SICAV SIF — Longevity Fund	Macro/Micro longevity fund of funds	Luxembourg	