Belderman

Editor: Carl

National

Investing

Inter

Handbook

The

CHRISTINE R. HEKMAN is Associate Professor of Business Administration at the Peter F. Drucker Graduate Management College at The Claremont Graduate School. She received her Ph.D. degree from the University of Chicago and has served on the business faculties at the Claremont Graduate School.

The relationships between foreign exchange and international corporate financial management and the financial management of international corporations with special emphasis on non-U.S. firms are contained in numerous academic and professional journals and conferences. Christine R. Hekman has contributed to numerous international financial management conferences.
PORTFOLIO THEORY
THE ESSENTIALS OF RISK AND RETURN

A portfolio is a collection of financial instruments such as stocks, bonds, and other securities. The risk and return of a portfolio are determined by the risk and return of its individual components. The risk of a portfolio is typically lower than the risk of its individual components due to diversification. The return of a portfolio is typically higher than the return of its individual components due to the potential for higher returns from investments in riskier assets.

INTRODUCTION

INTERNATIONAL PORTFOLIOS
EVALUATION OF RISK IN
Chapter 10

244

Chapter 10

253
CROSS-CORRELATIONS

EXHIBIT 2: WORLD BOND INVESTMENTS

Chapter 10

256

EXHIBIT 1: WORLD EQUITY INVESTMENTS

Chapter 10

256
The assessment of exposure—the sensitivity of the investment’s value to changes in foreign exchange rates—is an essential step in the evaluation of the risk of foreign exchange risk. Total risk is the effect of changes in foreign exchange rates on the face value of the investment. The assessment of exposure—the sensitivity of the investment’s value to changes in foreign exchange rates—is an essential step in the evaluation of the risk of foreign exchange risk.

FOREIGN EXCHANGE EXPOSURE

Here, and throughout the chapter, the focus is on the assessment of foreign exchange risk and exposure. The exposure to foreign exchange risk is the risk that the value of the investment may change due to changes in foreign exchange rates. The assessment of exposure—the sensitivity of the investment’s value to changes in foreign exchange rates—is an essential step in the evaluation of the risk of foreign exchange risk. Total risk is the effect of changes in foreign exchange rates on the face value of the investment. The assessment of exposure—the sensitivity of the investment’s value to changes in foreign exchange rates—is an essential step in the evaluation of the risk of foreign exchange risk.

INTERNATIONAL SECURITY RISK

The source of international risk. The ability to evaluate international risk. The ability to evaluate international risk. The ability to evaluate international risk. The ability to evaluate international risk.

Chapter 10
GLOBAL COSTS/LOCAL REVENUES

FOODSTUFFS LTD

The effect on costs for Foodstuffs is just as for International Metals. The extent of local revenues are determined locally. Currently, we have increased our cost structure and experienced the same currency-induced pressure on our profitability expressed because all competitors are affected in the same manner as competitors with no more risk to changes in local prices, but almost totally insensitive to changes in local costs.

The sensitivity of Foodstuffs' operating results to changes in our currency position is determined by the extent of the company's local revenues and costs. A local currency used to denominate the local currency is less affected by exchange rate changes because the company's financial results are not affected by changes in foreign currency positions. However, if the local currency is denominated in a currency other than the company's local currency, the company's financial results are affected by changes in foreign currency positions.

The extent of Foodstuffs' exposure to changes in foreign currency positions is determined by the extent of the company's local revenues and costs. A local currency used to denominate the local currency is less affected by exchange rate changes because the company's financial results are not affected by changes in foreign currency positions. However, if the local currency is denominated in a currency other than the company's local currency, the company's financial results are affected by changes in foreign currency positions.
These examples illustrate the importance of investment multiples of more sophisticated exchange rate changes on the values of investment securities. They also illustrate the direct and indirect effects of events on the financial position of the company, as well as the potential implications for its future performance.

**Single-Factor Measure of Sensitivity**

The aggregate exposure coefficient as a measure of sensitivity is defined as the percentage change in the value of an investment, due to a change in the exchange rate for a specified currency, expressed as a percentage of the initial investment amount.

**For the Potential L.J. Investor, This Security Represents an Investment Opportunity.**

Changes in the British economy can affect the performance of international investments. In the example, the unexpected currency depreciation causes the value of the pound to fall. As a result, the dollar-based investor experiences a profit of 2.5% in the value of the pound. The initial appreciation of the pound based on a 2.5% profit of the British currency is equal to an initial $200,000, resulting in a profit of $5,000.

**Local Costs/Local Revenues**

When the British currency weakens unexpectedly, the dollar-based investor experiences a profit of 2.5% in the value of the pound. This, in turn, results in a gain for the investor of $5,000. In contrast, when the British currency strengthens unexpectedly, the dollar-based investor experiences a loss of 2.5% in the value of the pound. This, in turn, results in a loss for the investor of $5,000.

**English Animals**

Exposure to local or foreign exchange rates can affect the performance of international investments. In the example, the dollar-based investor experiences a profit of 2.5% in the value of the pound. This, in turn, results in a gain for the investor of $5,000. In contrast, when the British currency strengthens unexpectedly, the dollar-based investor experiences a loss of 2.5% in the value of the pound. This, in turn, results in a loss for the investor of $5,000.
The residual value, that unaccounted for by inventories and the
inventories' value exposed, at half the price, and therefore the value of the remaining half
will adjust to offset foreign exchange rate changes.

In measuring the extent to which pricing flexibility protects dollar
values, it is useful to consider the length of time required for complete
pricing adjustment. For example, if pricing adjustment requires half
of the inventory turn period, one might consider half of that inventory's
values at maturity. As yet, not fully determined, these
flows may be altered by changes in prevailing rates of International
Exchange. The exposure of these assets and liabilities must be
coordinated with the U.S. investor's perspective these values
are fully exposed to foreign exchange rate changes.

The remaining assets and liabilities reflect the values of cash flows
of nominal assets and liabilities (such as Accounts Receivable
and Long Term Debt) are not affected by fluctuations in the cur-
rency's value. From the U.S. investor's perspective these values
are fully exposed to foreign exchange rate changes.

Incorporating these lessons into a comprehensive system for
economic evaluation requires an assessment of the degree of local/glo-
al economic activity, the extent of local/global exposure to foreign exchange rate changes,
and the impact on the value of the firm's assets and liabilities.

Exhibits 4 and 5 show the methodology, by which these factors
are summarized in an aggregate exposure coefficient. These exhibits
display estimates of the aggregate exposure coefficients for Inter-
national Metals and White Horse Plc., Ltd., respectively.
INTERNATIONAL SECURITIES AND EXCHANGE EXPOSURE COEFFICIENTS AND
AGGREGATE EXPOSURE COEFFICIENTS

Chapter 10

268
those willing to invest abroad. 

findings in their substantial investment gains are still available for fund managers in properly designed portfolios. The implications of these

studies of foreign exchange exposure in hedged international portfolios have shown them to be relatively appropriate and

exposure coefficients are much lower than commonly

assumed. Studies of foreign exchange exposure have suggested that

either one of these or overlapping.

hold foreign securities seem unaffected by the risk foreign exchange risk is

that security. However, if the exposure is low or if it is the current portfolio,

is sufficiently high that remaining from portfolio, the investor should look for sufficiently high returns from

of the currency that the foreign exchange risk reduces other risks in the

of the currency that the foreign exchange risk reduces other risks in the

if the exposure of a particular security is high and the occurrence

exposure is foreign exchange risk.

on changes in foreign exchange rates and changes due

returns due to changes in foreign exchange rates and changes due

the incremental effects of this risk on the overall risk of the currency

exposure to foreign exchange risk. The combination of undertaking variability and

capture foreign exchange risk. The combination of undertaking variability and

able in the examine descriptive tests the basic variable in the test.

application to a measure of the variability of the underlying variable.

this assessment in an aggregate exposure coefficients enhances in

short-run and long-run effects of changes in the variable. Capturing

in such a way to capture both direct and indirect effects as well

in a practical sense, this assessment involves evaluating exposure

variable are strongly correlated with other influencing variables.

of changes in a basic economic or financial variable or whether changes in the

the portfolio is already strongly influenced by changes in the

the risk of the currency portfolio. This will depend on whether

2) Assess the extent to which basic economic or financial variables

of changes in a basic economic or financial variable, and in

Chapter 10
REFERENCES

NOTES