

Haven Currencies

Published on: 16 April, 2018 | Author: Investment Team

In September 2017, North Korea fired a missile over Japan and yet somehow, the value of the yen went up. The threat of a possible war could not change investors mind about the safe status of the Japanese yen. Was this caused by a reversal of a carry trade or because everyone views the yen as a safe currency and it rises because of a self-fulfilling prophecy. Essentially, is the yen safe because everyone assumes it is?

Carry trades are used by investors to arbitrage interest rates between countries. If Japan has lower interest rates than the USA, borrowing Japanese yen, converting it to dollars and buying the higher yielding security in the USA is a riskless way of making a profit, assuming exchange rates stay the same. The first half of a large carry trade can devalue the yen and the second half of the trade, known as a reversal, can lead to the yen rising in value as investors rush to buy it and return the borrowed yen.

The three main haven currencies are the US dollar, the Swiss franc and the Japanese yen. The latter two have shown [negative correlations](#) with global equities during previous market fluctuations. This is precisely why our position in undervalued Japanese equities is unhedged. Firstly, hedging is expensive and adds an extra layer of frictional cost which erodes returns. More importantly, a negative correlation to global equities acts as a hedge for UK investors.

What even qualifies a currency to achieve 'haven' status? Having a strong economy and stable political system certainly help but aren't enough. A deeply liquid currency exchange market is also needed and would explain why the economically strong and politically stable Scandinavian currencies don't have haven status.

The Swiss franc checks all boxes for a haven currency. It also helps that Switzerland is notoriously neutral and has not been involved in a war since 1815. Japan on the other hand checks almost all boxes to be classed as a 'true haven' currency with one important exception – its economy is not particularly strong so its status as a haven currency is questionable.

So, what exactly caused the yen to rise as missiles flew over Japan? Who knows. It could be because of a carry trade reversal, herd behaviour or both. Herd behaviour is not an exclusively human ailment – we have managed to program it into our machines as well. Algorithmic trading currently accounts for about [60%](#) of all trading and is a possible cause for the strange behaviour of the yen.

In any case, historical data showing the negative correlation of the yen to global equities should not be taken for granted. If the cause of the negative correlation is indeed just herd behaviour, the herd may one day wise up to the fundamentals and question the haven status of the yen.

Important Information: Any views, insights, or commentary are for general information only, do not constitute personal investment advice or research, and are intended for UK residents. They may not be appropriate in all jurisdictions. While sourced from information we believe to be reliable, we make no guarantee as to accuracy or completeness. Past performance is not a guide to future results, and the value of investments can go down as well as up.

Regulatory Disclaimer: Tacit Investment Management is the trading name of TIML Limited (No. 9228395), part of Tacit Holdings Limited (No. 10611211). Both companies are incorporated in England and Wales, with the registered office at 14 Hanover Square, London W1S 1HN. TIML Limited is authorised and regulated by the Financial Conduct Authority (FCA ref. 670184) and approves and issues this communication under Section 21 of the Financial Services and Markets Act

2000. Please note, tax and estate planning services are not regulated by the FCA.