



Hedge via Options to reduce losses, risks



CURRENCY MARKET PREVIEW
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The world economy is currently flushed with instances of political grandstanding and geopolitical tensions.

The political fear in the US continues as Trump had asked Federal Bureau of Investigation (FBI) to drop investigation of Mike Flynn.

Legal and constitutional circles have been debating on whether it could be an obstruction of justice, but markets didn't wait for the answer.

This week's closing for currencies will confirm whether Trump rally has finished or not. The recently held CME Fed-Watch polls suggest that there is only a 69.2% probability that the US Federal Reserve (Fed) could hike rates in June, down from 90%, as per the previous poll. Euro's weakness is also finally coming to an end, the latest CFTC COT (Commitment of Traders) report has showed that investors have increased their net longs, which after a gap of almost three years has finally moved into positive territory.

The rupee has gained on the back of broad dollar weakness aided with factors like increased fund flows, softer inflation, policy stability, pro-business reforms push and attractive interest rates, to name a few. Given these factors, the rupee further strength-

MEASURE RISK

- Hedging when rupee is stronger against the dollar could cause confusion
- A stronger rupee could be ideal for importers and a nightmare for exporters
- Options have great leveraging power and work better in uncertain markets like India

ening against the US greenback is a very real possibility. This may sound to be a dream setting for the importers and a nightmare for exporters, but the decision to hedge at these levels, or wait for further appreciation/ depreciation of the rupee, could leave them even more confused.

In this period, a hedger needs to adopt systematic hedging approach with a defined hedge coverage ratio. It is imperative for them to measure and define the risk of each outstanding exposure.

Options have great leveraging power and in current uncertain markets like ours, Options work much better as compared to other instruments. As such, a hedger can enter into an Options strategy that will mimic a spot or forward/future position. If we were to compare cost of hedging in Options strategies over forward/future, the risk and cost can be reduced by defining border range of the underlying currency. The choice of Options strategy and efficiency in execution will be critical while executing the hedge strategy.

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