Cbus Policy

Currency Policy Summary

1. Purpose and objectives of the policy

The purpose of the Currency Policy (the Policy) is to support the Trustee's Investment Governance Framework Policy and set out a high-level overview of the objectives for managing the Fund's exposure to foreign currencies.

The principal objective of the Policy is to set out a strategic framework for managing the Fund's exposure to foreign currencies and to ensure the Fund has effective risk management controls in place.

The Policy is set by the Investment Committee and reviewed annually, or more frequently if required.

2. Responsibilities and accountability

The Trustee is at all times responsible for the Fund's investment, including managing the Fund's exposure to foreign currencies.

3. Objective

The objective of the foreign currency exposure is to moderately enhance the risk and return outcomes of the diversified investment options over the medium term, through adjusting the foreign exchange exposure with consideration of liquidity risk.

4. Currency beliefs and principles

Beliefs

- **Portfolio risk:** As the Fund has a material exposure to overseas investment, foreign currency exposure is an important source of portfolio risk and needs to be managed well so that it does not have an overly dominant impact on performance.
- **Diversification and downside protection:** Reflecting the nature of the Australia economy, the Australian dollar is typically viewed as a risk currency and tends to fall when equity markets fall and vice versa. As such, foreign currency exposure can be an important source of portfolio diversification. While both developed and emerging market currency exposure provides some diversification benefit, developed market currency exposure tends to provide greater downside protection.
- **Short-term Active Management:** It is difficult to consistently enhance portfolio returns through taking short-term currency positions, as many factors that influence currency values over the shorter term are difficult to predict, including activity in currency markets by parties without a profit motive. For example, central banks may intervene in currency markets to support their currencies.
- **Fair Value:** Over the medium to long term, Purchasing Power Parity (PPP) provides a reasonable measure of fair value for currencies. That said, currencies can deviate materially from such measures for many years. Generally, the PPP approach needs to be supplemented by other quantitative and qualitative assessments of the key drivers of the currency that are not captured by this approach (e.g. large quantitative easing programs).
- **Capacity to add value over the medium term:** As currencies tend to revert to their fair values over the medium term, there is an opportunity to manage portfolio risk and/or enhance the portfolio's returns through moderately increasing/decreasing foreign currency exposure when the Australian dollar is considered significantly expensive/cheap.

Note that this is a summary of the policy.

Date of this Policy: December 2017

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Principles

- **Currency exposure is assessed as a separate asset class:** Foreign Currency exposure provides important diversification benefits to the portfolio. The Fund considers the risk and return characteristics of foreign currency exposure separately to the investment characteristics of the underlying assets.
- **Downside Protection:** Foreign Currency exposure provides important downside protection benefits to the portfolio mainly by partially offsetting the listed equity risk (i.e. the Australian dollar tends to rise and fall with equity markets). With the aim of capturing this diversifying characteristic, Cbus fully hedges (where practical) the unlisted asset classes and the fixed interest sector so that virtually all of the foreign currency exposure in the portfolio reflects the unhedged component of the international equities asset class.
- **Neutral Exposure:** The neutral currency exposure is defined as the preferred currency exposure in the absence of any medium-term view on the relative attractiveness of the Australian dollar. This exposure is expected to provide material diversification benefits over the medium to long term and takes into account the Fund's liquidity requirements.
- **Active Positions:** Active currency positions reflect valuations, the expected impact of the investment cycle on the Australian dollar and risk (including downside protection for the broader portfolio).

Size of Active Positions: The size of the Fund's active positions will generally be heavily influenced by the extent to which the Australian dollar differs from its fair value. Active positions are designed so that they are not expected to have a dominant influence on the portfolio's performance.

Liquidity: Liquidity is a consideration when determining the appropriate level of foreign currency exposure, as currency hedging losses/gains will impact on the cash available in the Fund. For example, when the Australian dollar falls, the value of illiquid international assets will increase, this adds to the Fund's liquidity risk. Liquidity considerations are therefore an important aspect when determining the method of implementing the hedge.

Manager versus overlay: Cbus generally uses its currency overlay manager to hedge foreign currency exposures as required. However, some of Cbus' managers have a suitable hedging capability and they are used for hedging the foreign currency exposure of the investments that they manage for Cbus if they are considered better placed than the overlay manager.

Counterparty Risk: The Fund seeks to have exposure to a diverse range of highly rated counterparties to ensure that its counterparty risk in regard to the currency derivatives is not excessive or overly concentrated.

5. General approach to currency management

The general approach to managing the currency risks in each asset class is set out below:

- **Fixed Income and Alternative Debt:** Where appropriate, to fully hedge within the product by the investment manager.
- **Property, Infrastructure and Alternative Growth:** Where possible, the preferred approach is for the investment manager to fully hedge the underlying currency exposure. Where this is not feasible, the Trustee will overlay a full passive hedge using the Fund's currency manager.
- **International Equities** – the Trustee will overlay a partial passive hedge using its currency manager, with the aim of targeting a specific foreign currency exposure for the Growth accumulation option.
- **Australian Equities** – the currency exposure that results from managers in this asset class that have an allocation to overseas shares will typically be fully hedged by either the manager or Cbus.