Banka Slovenije
in cooperation with
the Research Centre of the School of Economics and Business,
invites you to an on-line research seminar
on Wednesday 27 October at 14:00 CEST

Urban Ulrych
University of Zürich

will present the paper

Ambiguity, Optimal Currency Overlay, and Home Currency Bias

Authors: Urban Ulrych (University of Zürich), Nikola Vasiljevic (University of Zürich)

Abstract:

The paper addresses the problem of determining an optimal currency allocation for a risk-and-ambiguity-averse international investor. A robust mean-variance model with smooth ambiguity preferences is used to derive the optimal currency exposure. The theoretical part of the paper shows that the sample-efficient currency demand can be calculated as the solution to a generalized ridge regression. Through the lens of these results, we demonstrate that our model offers a new explanation of the home currency bias as the optimal currency allocation under extreme ambiguity aversion. The investor's dislike for model uncertainty induces a disproportionately high currency hedging demand. The empirical analysis demonstrates how ambiguity leads to a larger estimation bias and simultaneously narrows the confidence interval of the optimal currency exposure. The out-of-sample backtest illustrates that accounting for ambiguity enhances the stability of optimal currency allocation and significantly improves the risk-adjusted portfolio performance net of transaction costs.

How to sign up:

Please send an email to sign up for the seminar to seminar@bsi.si. You can sign up by Monday 25 October 2021.
Details about the on-line seminar will be sent to participants one day prior to the event via email.