

Wealth Insights Q3 2025 Outlook

By KFH Capital Investment Company

Wealth Insights

Q3 2025 Outlook



In continuation with our quarterly insights wherein each quarter we look forward to answering some key questions our clients ask about the global economy and financial markets, the topics discussed during Q3 include:

1. Inside Precious Metals – Gold: We take a look at some of the different categories of gold ownership and why, despite all the hype in the financial media, gold is shunned by a large category of investors? We question this long-standing negative view and make the case for a strategic allocation to gold in multi-asset portfolio.

2. Why Carry Trades Matter Now: As interest rate cycles diverge across the globe, investors are turning to a classic macro strategy: the Carry Trade. By borrowing in low-yielding currencies to invest in higher-yielding ones, carry trades aim to capture the growing interest rate differentials. But how reliable is this strategy? What risks come with FX exposure? And does hedging help or hinder the risk-adjusted returns captured by carry trades?

We explore the performance of carry trades in the Japanese yen (JPY) and Turkish lira (TRY) from 2016 to 2024. For each currency, we examine:

- I. How the trade is structured and executed
- II. Historical returns and cumulative performance
- III. The carry trade in a portfolio context (effect on Sharpe ratios)

We also dive into FX hedging using forward contracts, assessing when hedging can be helpful.

Note: Carry trades are discussed in the context of general investment themes which are sometimes explained in terms of conventional finance (e.g. interest earned, forward contracts etc). Nevertheless, all themes mentioned can be accessed in a Shariah compliant way.

Also, all returns are expressed in USD terms. That is, currency moves and interest rate differentials are evaluated from the perspective of a USD-based investor

3. Views from Kuveyt Turk Portföy on the carry trade: We conclude with a Q&A on the Turkish lira carry trade with the **Chief Investment Officer at Kuveyt Turk Portföy, Dr. Bayram Veli Salur.**

Inside Precious Metals – Gold

Ownership

1. Central Banks

We will start with this category of sophisticated long-term investors who clearly see gold as a store of value. When we take a step back to look at the bigger picture, gold is – in a sense – a belief system. There is no income stream associated with the precious metal, and unlike silver, its industrial use is limited. However, it is a belief system that has been proven over thousands of years and is backed up by long term returns. Central Bank ownership of gold is an effective endorsement of the asset, and this belief system.

An interesting analogy: should central banks ever start holding “digital gold”, namely bitcoin, could that complement gold as a digital “belief system”? However, that controversial topic is best left for another publication.

The data below shows the gold holdings of major central banks as a percentage of their total reserves.

Country	Gold exposure (% of overall reserves)
Portugal	84
USA	78
Germany	77
Italy	75
France	75
Spain	25
UK	17
Australia	13
Switzerland	11
Japan	7
Norway	0

One of the first observations is the striking variation in gold exposure across countries. For instance, even nations with comparable historical ties to gold, such as Spain and Portugal, differ significantly, with gold representing 25% of Spain’s reserves versus 84% for Portugal. Norway stands out even more clearly, with its central bank holding no gold at all.

Wealth Insights

Q3 2025 Outlook



Norway's zero exposure to gold is shared by its sovereign wealth fund, commonly known as Norges (where information on asset allocation and rationale is publicly available). Below we outline Norges' rationale for not holding gold and humbly state our counterpoints to their position:

1) The Norges mandate has a focus on productive assets – the fund is designed to invest in stocks, bonds and real estate, which generate returns

KFH counter view: Gold has delivered an attractive 10.0% compounding annual return over the past 20 years, far superior to bonds and even equities (MSCI World Net Return: 8.0% compounded). But how much difference does a 2% compound annual return make? Over this 20-year period, gold has returned +536% compared to equities at +345%. No wonder Einstein allegedly called compounding the eighth wonder of the world.

2) Gold produces no cash flow – which conflicts with Norges' goal of funding Norway's welfare state

KFH counter view: While it is true that gold produces no cash flow, capital gains can be realized through sales. Also, Norges owns many of the world's biggest companies (they hold positions in virtually every major equity) that pay little or no income. This includes names like Nvidia, Amazon, and Baidu.

3) Norges already has inflation hedge – the fund's global equity and real estate exposure provides inflation protection

KFH counter view: Gold is not a short-term inflation hedge, but neither are equities, bonds and real estate. In 2022, as inflation surged, reaching a peak of 9.1% in the US, global stocks fell -18%, US Treasuries -12%, listed property -25% and gold was unchanged.

4) Norges' diversification philosophy - they prefer diversification through geography and asset classes rather than commodities

KFH counter view: We understand their view, but as you can see in our approach to diversification as set out overleaf, we believe gold adds to diversification.

To be fair, Norges is not alone among sovereign wealth funds (SWFs) in having almost no exposure to gold. While direct data on other SWFs' holdings is limited, available evidence suggests that most also maintain little to no allocation to gold. This may have been more understandable in the past, but for over 20 years, gold exposure has been easily accessible through ETFs. The first gold ETF, SPDR Gold Shares, was launched in November 2004.

Wealth Insights

Q3 2025 Outlook



What about emerging market (EM) central banks?

The table below sets out the gold exposure for a selection of EM central banks.

Country	Gold exposure (% of overall reserves)
Turkey	44
Russia	36
Egypt	28
Qatar	21
Kuwait	15
India	13
Bahrain	9
Saudi Arabia	7
China	6
Oman	4
UAE	3

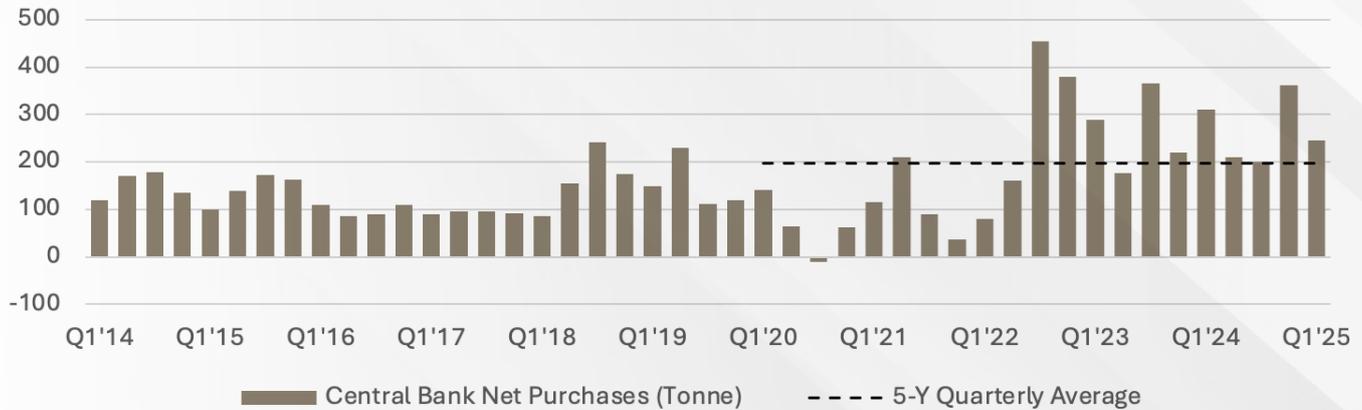
Source: World Gold Council

A common theme across both developed and emerging market central banks is the idiosyncratic nature of exposure to gold. It is understandable for historical reasons why the central banks of Portugal and Turkey may have significant exposure. However, in other countries, exposures can appear quite random.

One standout observation is China's relatively low allocation to gold, particularly in light of the freezing of Russia's non-gold reserves (e.g., U.S. Treasuries) following the invasion of Ukraine. While China was already expected to increase its gold reserves over time, these geopolitical developments appear to have significantly accelerated the process. In summary, increased gold accumulation by EM central banks has been a major source of demand, and this trend is likely to persist over the next several years.

The chart below shows a clear increase in official central bank gold purchases (as reported to the World Gold Council) particularly since 2021. It's worth noting that World Gold Council reporting is voluntary, and many analysts believe gold buying by some major EM central banks may be significantly underreported.

Central Bank Net Purchases



Sources: Metals Focus, World Gold Council

2. Pension Funds / Endowment Allocations and Warren Buffett

One of the curious aspects of allocation to gold is the general lack of holdings of the precious metal among sophisticated long-term investors.

As a prime example, here's what Warren Buffett has to say about gold:

"What motivates most gold purchasers is their belief that the ranks of the fearful will grow... Beyond that, the rising price has on its own generated additional buying enthusiasm, attracting purchasers who see the rise as validating an investment thesis. As 'bandwagon' investors join any party, they create their own truth — for a while."

For an investment genius, this seems surprisingly closed-minded. This goes against the thousands of years of gold's proven history as a store of value, as we set out earlier. This negative view is widely shared by investment consultants and endowment funds. Based on public statements and reports, here are some of the key points raised by endowment funds like Yale and Harvard to explain why they do not invest in gold:

1. Philosophical approach: leading endowments generally prefer:

- Real estate and infrastructure for inflation protection
- Private equity and venture capital for growth
- Timber and farmland as real assets.

2. Skepticism about gold's role: viewing it as non-productive compared to income-generating real assets.

3. Preference for operational assets: real estate, infrastructure, and businesses over store-of-value assets.

4. Focus on innovation exposure: venture capital and growth equity over traditional hedges.

This group of investors have a bias towards both corporate investing (public and private equity) and yield driven alternative assets. At KFH we are also advocates for these assets as set out in our Q1 and Q2 reports. However, at KFH we believe you can have the best of both worlds by investing in endowment style assets while maintaining a strategic exposure to gold.

Another way of looking at the limited exposure from this investor group is to consider them as potential future buyers. From this perspective, their current absence could be encouraging for gold's longer-term outlook, as it suggests room for increased demand. This is especially interesting and of relevance right now as some endowment funds are seeking to sell off less liquid private assets, often at a discount. Could it be that gold's liquidity is being underappreciated by these investors?

3. Other investors in gold and why?

In summary, central banks remain one of the primary investors in gold, with allocations rising in recent years. In contrast, the huge pension, sovereign wealth and endowment funds are still largely absent. The other major participants are multi-asset investors and private individuals. An example of a sophisticated multi-asset investor in the public domain is Bridgewater and their flagship “all Weather” strategy. According to the latest publicly available information, this strategy had a 6% weighting in gold.

Why You Should Hold Gold as a Strategic Asset in a Multi-Asset Portfolio

The key attraction of gold for a multi-asset portfolio is its combination of attractive long-term returns and low (or even negative) correlation with equity markets. Firstly, the table below sets out the return of gold relative to other major asset classes.

Annualized Returns as of End of March 2025

Asset class	20 years*	10 years	Gold exposure (% of overall reserves)
Gold	10.4%	10.2%	14.6%
Global Equity	7.9%	9.5%	16.1%
US Treasuries	2.6 %	1.0%	-1.7%
Real Estate (US REITs)	6.7%	5.3%	11.3%

*19.75 years reflecting the US REIT index start. Source Bloomberg

From the straightforward perspective of historic returns, gold has certainly been an attractive investment, albeit with significantly higher volatility than bonds. What makes gold particularly attractive in a multi-asset portfolio is the low correlation to equities.

The graph below shows how differently gold performs compared to equities (low to negative correlation).

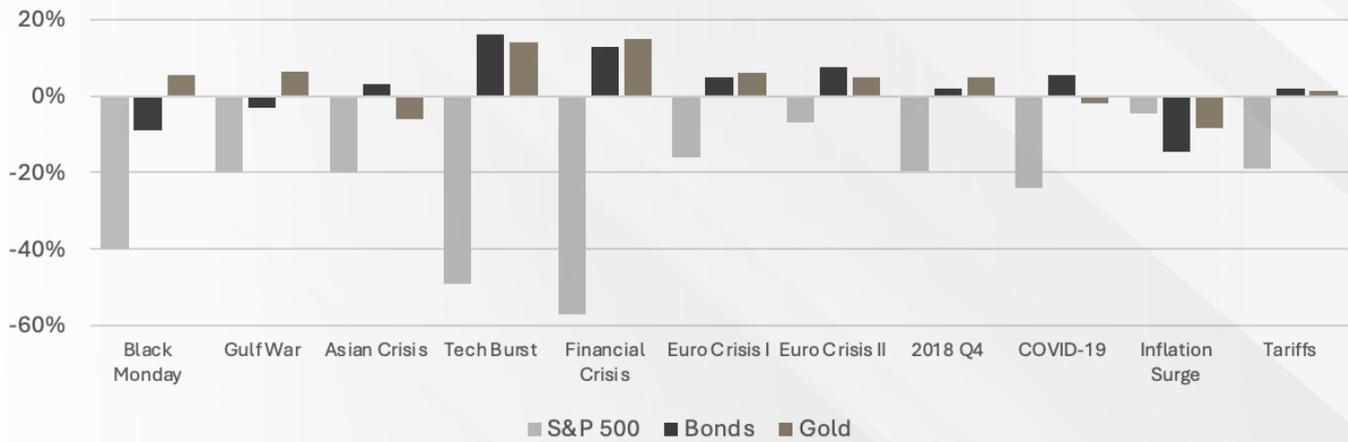
S&P 500 and Gold Futures 10-Year Rolling Correlation (1975-2025)



Source: Bloomberg; 100% correlation means the two assets move in perfect tandem.

Even more important is the standout performance of gold when you really need it – during an equity sell off. The graph below shows some examples of the performance of gold relative to equities and bonds during times of stress. It shows that gold can add more diversification benefit than bonds – another traditional hedge against equities – during downtrends in equities.

Gold's Performance in 11 Major Stock Market Drawdowns



Note: S&P 500 = SP1 futures; Bonds = TY1 (10-year U.S. Treasury futures); Gold = GC1 (generic 1st gold futures). Source: Bloomberg, Research Affiliates

The table below shows how the Sharpe ratio (Portfolio risk / reward ratio) improves a standard US balanced "60/40" portfolio (60% equities and 40% bonds) for up to a 20% weighting in gold. Over the past 20 years gold would have improved both the return and risk profile. However, even when you look over very long-term horizons using a lower return for gold (7.0%), a 17% allocation to gold improves the risk return / profile.

Sharpe Ratios of Portfolios with Different Allocations to Gold and a Balanced Portfolio

Allocation to Gold	Allocation to 40/60 Portfolio	Sharpe Ratio
0%	%100	0.95
5%	%95	1.00
10%	%90	1.03
15%	%85	1.05
17%	%83	1.05
20%	%80	1.05
25%	%75	1.03

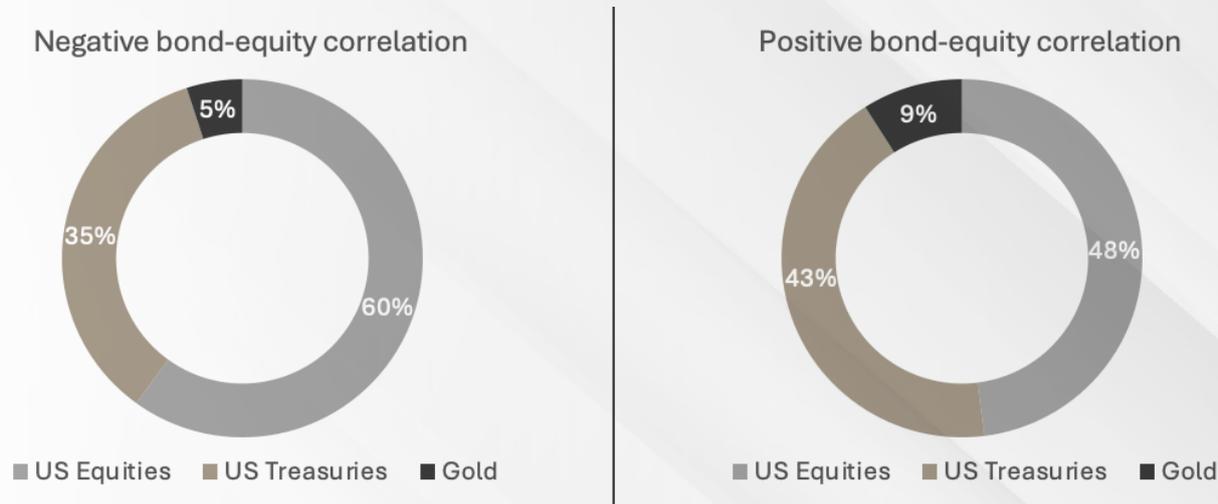
Source: Flexible Plan Investments

Gold vs Balanced Portfolio and an “Optimal Portfolio”

Allocation to Gold	Gold	Balanced Portfolio	Optimal Portfolio (%17 Gold %83 Balanced Portfolio)
Return (CAGR)	%7.01	%9.06	%9.06
Risk (standard deviation)	%19.73	%9.51	%8.64
Sharpe Ratio	0.36	0.95	1.05

Source: Flexible Plan Investments

What are the optimal weightings based on mean variance optimization (the optimal mix of assets for maximizing expected returns)?



Optimal Weights based on mean-variance optimization using monthly data from 31 Jan 1973 to 30 Apr 2025.

Source: Bloomberg, Portfolio Visualizer, World Gold Council

The charts show that historically, a more modest gold exposure (5%) was needed when bonds are working well as a diversifier to equity risk. In contrast, in a period like now when equities and bonds have become more positively correlated, a 9% weighting would be optimal based on this analysis. This fits our approach and suggested allocations.

Conclusion

Investing in gold tends to be for highly idiosyncratic reasons, with a significant portion of investors holding a negative bias toward the asset. This persists despite gold’s attractive risk-adjusted returns and, notably, its low correlation with equities. True hedges against equities are hard to find, and gold is one of them. Historically, even a 15% to 17% strategic allocation to gold in a balanced portfolio has helped reduce overall risk.

We also recognize that allocations to gold are very out of consensus, particularly among certain categories of long term investors that have no exposure to gold at all. As a result, we adopt a more conservative yet meaningful 8% strategic allocation in our balanced portfolio, an approach more aligned with historical mean-variance optimization.

Carry Trade

The Japanese Yen (JPY) Carry Trade

I. How It Works:

The JPY carry trade is the most popular and widely used carry strategy. It involves borrowing in Japanese yen and investing in higher-yielding assets or currencies, typically USD. The return is driven by the interest rate differential between the two countries (USA and Japan) and any FX appreciation/depreciation between USD and JPY.

While the basic mechanics appear straightforward, successful execution depends heavily on the stability of the exchange rate and the predictability of the central bank policy. The yen's historical role as a funding currency stems from Japan's persistently low interest rates and financial stability, making it a popular choice for leveraged carry strategies.

II. A Simplified Real-Life Example of JPY Carry Trade:

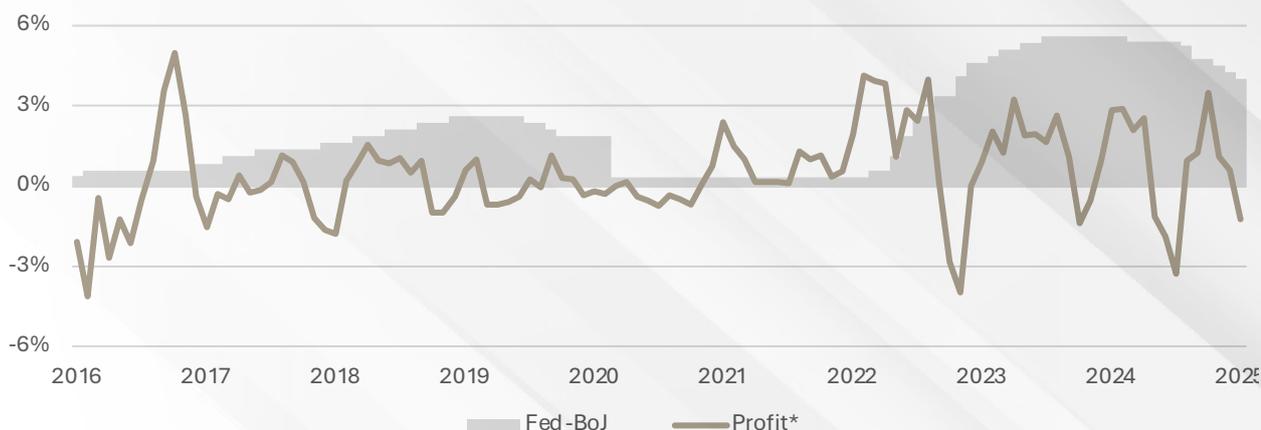
An investor engages in a carry trade by borrowing in Japanese yen (JPY), where the Bank of Japan's policy rate is 0.5% (as of 2025). This represents the funding cost. The investor then converts the borrowed JPY into U.S. dollars (USD) and deposits the funds in a U.S. account earning interest at the Federal Reserve's policy rate of 4.50% (as of 2025). This is the interest earned on the investment.

At the end of the investment period, the investor converts the USD principal and accrued interest back into JPY to repay the original loan. The difference between the interest earned in USD and the cost of borrowing in JPY, adjusted for any changes in the exchange rate, represents the profit or loss from the trade.

However, this theoretical arbitrage is never risk-free. The FX leg introduces uncertainty: if the yen appreciates against the dollar by more than the interest rate differential, the trade becomes loss-making. This is why carry trade is mainly considered a bet on both rate stability and currency direction.

III. Performance Snapshot: 2016–2025

Interest Rate Differential vs Monthly Returns



*Smoothed 3-month moving average profit. Source: Bloomberg

The chart above plots the interest rate differential (Fed rate – BoJ rate) alongside the monthly returns of the JPY carry trade.

Although the differential has remained consistently positive in recent years, carry trade returns have remained volatile and at times negative. The chart illustrates how FX fluctuations, particularly sudden yen appreciations, can significantly erode or even reverse carry gains, as seen during sharp drawdowns in 2022 where the yen appreciated around 12% between November and December, and 2024 where the yen appreciated around 11% between July and September.

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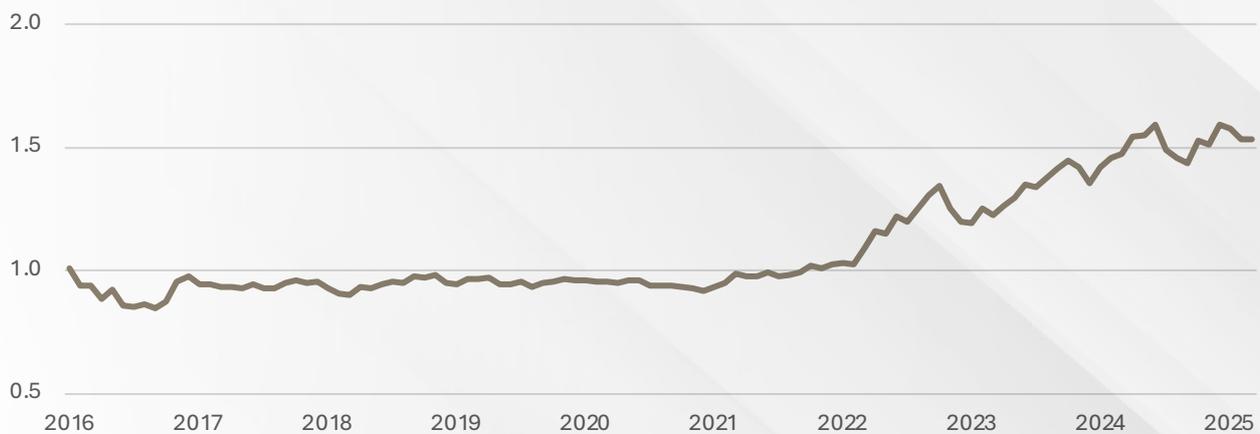
Q3 2025 Outlook



While a wider differential tends to support the trade over time, profits are not guaranteed and are highly sensitive to changes in exchange rates. This underscores the central risk of the JPY carry trade: even in a favorable rate environment, FX volatility can undermine performance. This is especially true during risk-off periods when global investors unwind risk positions, often triggering sharp yen rallies as positions are covered, a phenomenon sometimes referred to as the 'yen reversal'.

We will now examine how \$1 invested in a JPY carry trade at the start of 2016 would have evolved:

Cumulative Performance of JPY Carry Trade- Monthly Compounding



Based on the chart above, a hypothetical investor who allocated USD 1.00 to a JPY carry trade with monthly reinvestment (compounding) would have grown their investment to USD 1.53 by the end of March 2025, which translates into an annualized return of about 4.9%, compounded monthly. Yet, this number masks an important timing effect: most of the gains materialized in 2022 onward, following the Fed's interest rate hiking cycle. This period marked a regime shift as the Fed began hiking the rates sharply while the BoJ maintained a loose policy. Prior to that, the strategy saw muted returns, reinforcing the importance of timing and macro alignment.

But return figures alone don't capture the whole picture. Sophisticated investors will ask: What level of risk was taken to achieve this return? To answer this, we turn to the Sharpe ratio, a widely used measure of risk-adjusted returns. It provides valuable insight into how the carry trade performs within a broader portfolio context by accounting for both return and volatility.

Sharpe Ratio of JPY Carry Trade

Year	Sharpe Ratio
2016	-0.07
2017	-0.62
2018	-0.34
2019	-0.11
2020	-2.17
2021	2.13
2022	0.93
2023	0.78
2024	0.91

Despite posting a respectable cumulative return, the JPY carry trade's risk-adjusted performance has been highly inconsistent. The Sharpe ratio turned negative in most years from 2016 through 2020, reflecting the drag of yen volatility and limited interest rate support during that period. In particular, 2020 marked a deep drawdown, with a Sharpe of -2.17, underscoring how destabilizing FX appreciation can be when rate differentials are minimal.

More recently, the story has shifted. As the Fed began its hiking cycle, the interest rate differential widened, finally providing enough cushion to absorb currency risk. Sharpe ratios rebounded into positive territory, suggesting reasonably attractive risk-adjusted returns given the underlying volatility of the strategy.

Yet even with this improvement, the data highlights a key takeaway: the JPY carry trade is highly cyclical, and its success hinges on both rate policy and FX market stability. Without sustained interest rate divergence, shorting the yen can be more risky than rewarding.

From a portfolio construction standpoint, the JPY carry trade may be best treated as an opportunistic allocation. It can offer meaningful returns when interest rate differentials widen and volatility is contained, but frequent FX reversals and the low-yielding nature of the yen demand active monitoring. Investors may consider it as a tactical overlay rather than a core holding, especially in environments of diverging central bank policy.

But what happens when the yield differential is far more compelling, say, between the U.S. dollar and an emerging market currency, but the FX risk becomes extreme? To explore this, we now turn to the Turkish Lira (TRY), a case where high nominal carry came with significant currency depreciation.

The Turkish Lira (TRY) Carry Trade

1. How It Works:

The Turkish lira (TRY) carry trade presents a sharply different narrative from the JPY strategy. While the interest rate differential has been persistently high (often exceeding 10%) the return profile tells a cautionary tale about FX risk in emerging markets. Unlike the JPY carry trade, the TRY carry involves borrowing in USD and investing in the higher yielding TRY. The return, just like any carry trade, is driven by the interest rate differential between USA and Türkiye, and any FX appreciation/depreciation between USD and TRY

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This structural difference, being long an EM currency rather than a G10 low-yielding currency, makes the TRY carry trade inherently more volatile and dependent on macro stability

2. A Simplified Real-Life Example of TRY Carry Trade:

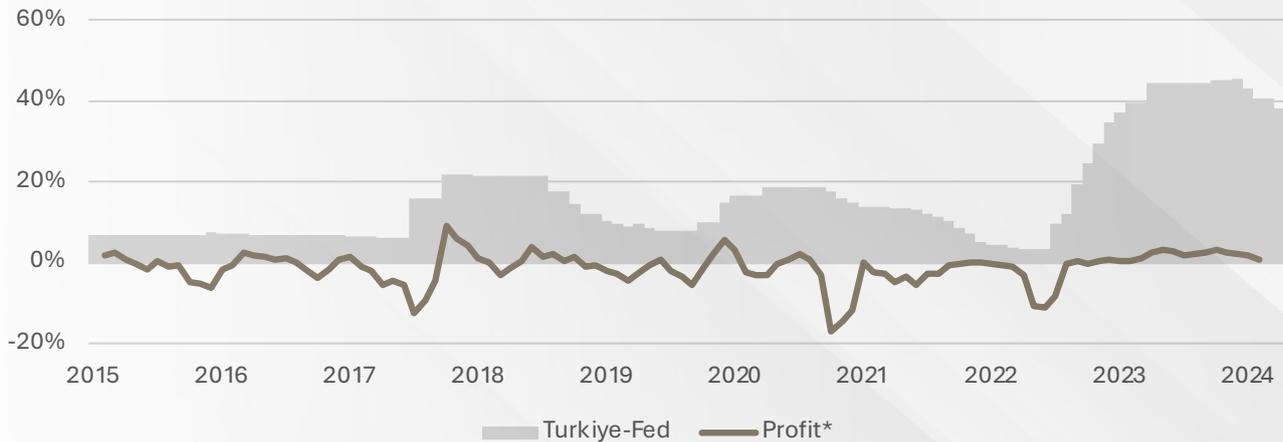
An investor engages in a carry trade by borrowing in USD, where the Fed policy rate is 4.5%. This represents the funding cost. The investor then converts the borrowed dollars into Turkish Lira (TRY) and deposits the funds in a Turkish account earning interest at the Turkish policy rate of 42.5%. This is the interest earned on the investment.

At the end of the investment period, the investor converts the TRY principal and accrued interest back into USD to repay the original loan. The difference between the interest earned in TRY and the cost of borrowing in USD, adjusted for any changes in the exchange rate, represents the profit or loss from the trade.

Just like the JPY carry, The FX leg introduces uncertainty: if the Turkish lira depreciates against the dollar by more than the interest rate differential, the trade becomes loss-making.

Performance Snapshot: 2016–2025

Interest Rate Differential vs Monthly Returns

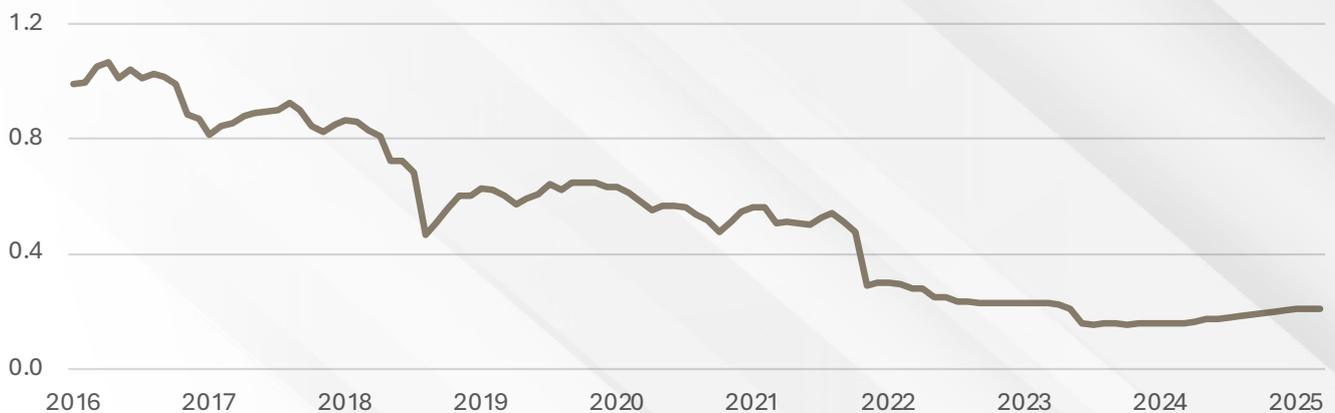


*Smoothed 3-month moving average profit. Source: Bloomberg

Despite extremely high interest rate differentials between Türkiye and the Fed in recent years, carry trade returns have remained subdued. The chart shows that even as the Türkiye–Fed rate spread surged, especially from late 2022 onward, profits stayed flat or even declined. This disconnect highlights the dominant role of FX depreciation in offsetting interest income. The lira’s persistent weakness, driven by inflation, political instability and unorthodox monetary policy, has repeatedly eroded carry gains, especially during episodes of capital flight. The pattern underscores a key message: high nominal carry is not a sufficient condition for profit. For investors, the Turkish lira trade demands not only careful timing but also robust risk management and a clear view on currency stability, without which even elevated differentials can produce minimal or negative returns.

We will now examine how \$1 invested in a TRY carry trade at the start of 2016 would have evolved:

Cumulative Performance of TRY Carry Trade- Monthly Compounding



Source: Bloomberg

Based on the chart above, a hypothetical investor who allocated USD 1.00 to a TRY carry trade with monthly reinvestment (compounding) would have their investment decline to USD 0.21 by the end of March 2025, which translates into an annualized return of about -15.8%, compounded monthly. The erosion of capital is overwhelmingly due to the persistent depreciation of the lira, which more than offset the high nominal interest income throughout the period.

This illustrates how returns in EM carry trades can be dominated by FX trends. Even with policy rates above 40%, currency depreciation can overwhelm the yield.

Despite consistently high local interest rates, the TRY carry trade has produced negative real and nominal returns for USD-based investors. This divergence between yield and actual performance reflects the core vulnerability in unhedged emerging market carry trades: when inflation is high and capital outflows pressure the local currency, nominal yields become unreliable indicators of expected return.

The TRY performance provides a key reminder that high yields alone is not alpha; without currency stability or hedging, it is merely volatility in disguise.

3. Sharpe Ratio and Strategic Implications

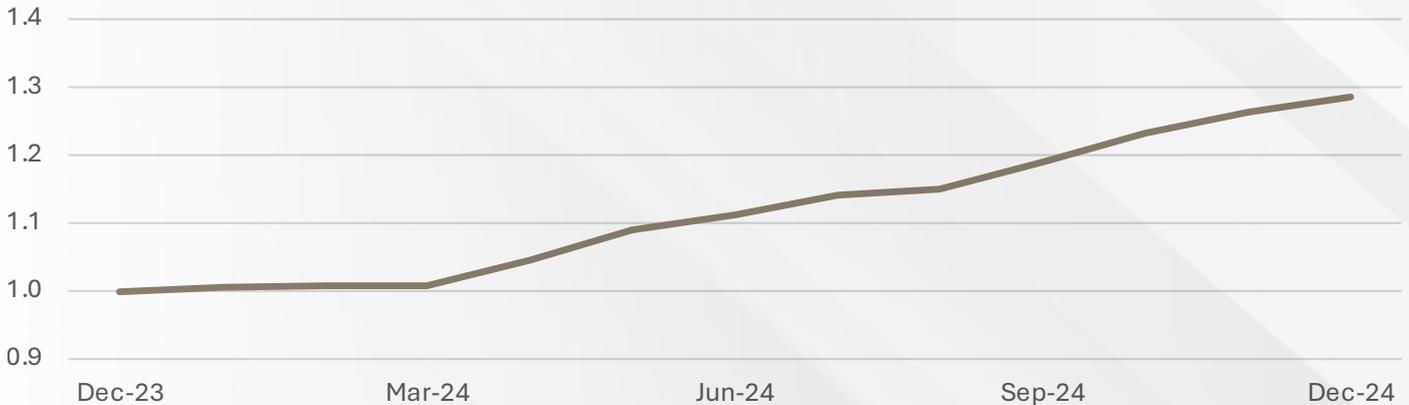
Much like the cumulative return, the Sharpe ratio profile for the unhedged Turkish lira carry trade has been persistently negative, highlighting the unfavorable risk-reward dynamic throughout most of the observation period. While the nominal yield appeared attractive, the volatility in TRY — particularly driven by FX depreciation — severely compromised the strategy's efficiency from a portfolio construction perspective.

Sharpe Ratio of TRY Carry Trade

Year	Sharpe Ratio
2016	-0.92
2017	-0.19
2018	-0.71
2019	0.26
2020	-0.85
2021	-1.18
2022	-2.44
2023	-1.55
2024	4.12

The annual Sharpe ratios were consistently negative until 2024, the only materially positive reading at 4.12. This reflects a lower depreciation of the lira, with a monthly average of 1.5% compared to 2023 average of 4.1%, combined with a wider interest rate differential. For context, a USD 1.00 investment would have grown to approximately USD 1.28 (monthly compounding) by end of 2024, a striking reversal from the near-constant losses of prior years. This performance window emerged because high yields were not immediately wiped out by FX depreciation, enabling a profitable outcome for USD-based investors.

TRY Carry Trade Performance for 2024- Monthly Compounding



Source: Bloomberg

However, this improvement remains fragile and comes after nearly a decade of drawdowns and volatility, where risk-adjusted returns consistently failed to justify the exposure.

This stands in stark contrast to the JPY carry trade, which despite periods of volatility, delivered a broadly positive cumulative return and respectable long-term Sharpe. In contrast, the TRY strategy, when left unhedged, has not functioned as a viable long-term return generator for USD-based investors.

Ultimately, TRY highlights a broader truth about EM carry: success is conditional not just on yield, but on stability, both macroeconomic and political. Without that foundation, returns remain speculative.

Hedging Currency Risk: Forward Contracts

One way to mitigate currency risk in carry trades is through forward contracts. A forward contract allows an investor to fix the exchange rate at which they will convert currencies at a future date, effectively protecting the trade from adverse FX movements. This ensures that the return reflects primarily the interest rate differential, rather than being dominated by spot FX volatility. However, this hedge comes with a cost: the forward rate is not neutral, but reflects the interest rate gap between the two currencies, which can reduce or even reverse the benefit of the carry in some cases.

Let's revisit the Turkish lira carry trade as a case study. Earlier, we saw how an unhedged strategy turned USD 1.00 into just USD 0.21 over the period, eroded by continuous depreciation in the lira. But when FX risk is hedged monthly using forward contracts, the same trade would have ended with USD 0.52, which is still a loss, but significantly less severe. The improvement reflects the ability of forwards to strip out some of the currency volatility and protect part of the yield.

We illustrate this in the chart below, which compares the cumulative returns of hedged vs unhedged TRY carry trade. The visual makes the benefit clear: while the strategy still carries risk, particularly due to roll costs and basis pricing, hedging meaningfully reduces the damage from extreme depreciation.

Hedged Vs Unhedged Cumulative Performance of TRY Carry Trade- Monthly Compounding



Source: Bloomberg

However, not all currencies respond equally to hedging. In the case of the Japanese yen, hedging ended up reducing overall performance. The unhedged JPY carry trade grew from USD 1.00 to USD 1.53, but when hedged monthly using forward contracts, the same strategy would have returned just USD 0.96. This result reflects the cost embedded in the forward premium, which, while risk-reducing, ended up systematically eating into returns in a low-volatility currency like the yen.

This contrast highlights a key insight for portfolio construction: FX hedging is not a universally additive tool. Its impact depends heavily on forward pricing, currency behavior, and the balance between risk reduction and return erosion.

Sophisticated investors need to treat hedging not as a default step, but as a strategic decision based on currency characteristics. In emerging markets, where volatility is high and depreciation risk is acute, hedging can significantly reduce downside risk. In developed markets with low volatility and expensive forwards, it may do more harm than good.

Conclusion:

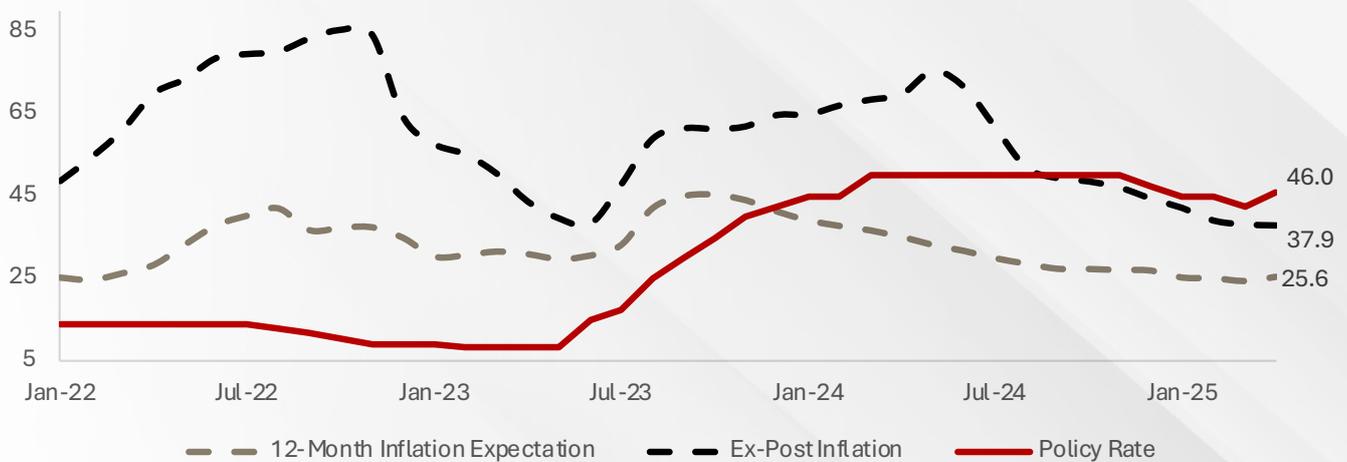
The data shows that historically the Turkish Lira carry trade has been a poor investment over many years. However, that has changed more recently as the Turkish central bank raised interest rates significantly in nominal terms and importantly in excess of inflation – this has been resisted previously. This strategy is now providing equity like returns (with the subsequent risks). We are in an envious position of having our team on the ground at *Kuveyt Turk Portföy* to assist in implementing and Risk Monitor the strategy.

Q&A Session with Dr. Bayram Veli Salur, the CIO of Kuveyt Turk Portföy

1) What are the main ways a client can get exposure to the high TRY rate structure?

Turkey currently offers a positive real rate environment, which is a notable shift compared to previous years. Today, the policy rate is above both ex-post and ex-ante inflation expectations, making Turkish lira-denominated instruments increasingly attractive for investors.

Inflation vs Policy Rate



As shown, following March 2024, the policy rate has been significantly above ex-ante inflation expectations. This created favorable conditions for carry trade strategies, particularly as the currency remained stable. Since the summer of 2024, the policy rate has also been consistently above ex-post inflation.

Clients can gain exposure to this high-rate structure by investing in TRY-denominated assets such as money market funds, sukuk funds, or Sharia-compliant participation accounts. Alternatively, they can consider direct investments in TRY sukuk products.

For international investors, accessing these instruments through professionally managed, Sharia-compliant funds provide both operational convenience and tax advantages—as there’s currently no withholding tax for non-residents investing in these funds.

2) Has this been profitable historically from a USD base?

Yes, this strategy has been historically profitable from a USD base—especially since March 2024, when the Central Bank of Turkey raised the policy rate to 50%, initiating a period of currency stability. Even if we include the first three volatile months of 2024, the overall structure delivered a 28% USD-based return over a 12-month horizon.

The year 2025 started off strongly. However, currency volatility in March weighed on returns, leading some clients to unwind their positions and shift back into USD-based investments. We also observed some capital outflows from foreign investors, which contributed to a decline in central bank reserves. In response, the central bank raised rates again and reasserted its commitment to a strong positive real rate environment. This helped restore confidence and slowed dollarization. Since then, we’ve seen the currency stabilize again, and the carry trade has resumed working effectively since March.

3) How to deal with the sharp selloffs in TRY?

We do not expect a sharp sell-off in the Turkish lira under the current strong positive real rate environment. Large moves in the exchange rate would trigger a significant pass-through to inflation, which the central bank is clearly aiming to avoid.

Moreover, the current investor base is more balanced compared to previous years. Foreign investor participation in Turkish lira assets remains relatively limited, which in turn reduces the risk of sudden, large-scale capital outflows during periods of volatility.

In the event of market stress, the central bank has both the policy tools and reserves capacity to respond effectively. Given its recent track record and policy stance, we believe any potential volatility would likely be short-lived and actively managed.

4) Walk us through the basic mathematics today – what can you earn versus what currency depreciation would you expect over a quarter / year?

Let's break down the numbers. In 2024, TRY-denominated money market funds delivered an average return of around 53%, while the Turkish lira depreciated by approximately 19.7% against the US dollar. This resulted in a net USD-based return of about 28%, which is quite strong.

In the first four months of 2025, the fund return was 13.2%, while the lira weakened by 8.8%, yielding a net USD return of approximately 4.1%. Despite some currency volatility in March, the carry trade continued to deliver positive performance.

Now that the lira has returned to a more stable trajectory, the carry opportunity is once again becoming attractive. Daily and monthly simple returns on money market instruments are currently around 45%–49%. Meanwhile, ex-post inflation stands at around 38% and is slowing, and the 12-month forward inflation expectation is approximately 25%. This environment offers positive real returns, encouraging investors to remain in TRY-denominated products rather than shifting to dollar-based assets.

If current trends continue, we expect quarterly USD-based returns to stay in positive territory, particularly if currency depreciation remains moderate.

5) What are some possible Sharia-compliant ways of implementing the trade?

There are several Sharia-compliant ways to implement a carry trade in Turkish lira. Investors can access TRY-denominated money market funds or sukuk funds that are structured in full accordance with Islamic finance principles. Alternatively, they may choose to invest directly in TRY-denominated sukuk issued by the Turkish Treasury, participation banks, or local corporates. Lastly, Sharia-compliant time deposit products—commonly referred to as participation accounts—also provide a practical and compliant means to benefit from Turkey's high-yield environment.

6) Geopolitical risks to the TRY carry trade?

It's important to emphasize that returns from this strategy come with open currency risk. If there's a geopolitical shock or a major external development, the Turkish lira could weaken sharply, which might result in the loss of not only returns but also part of the principal. That said, we continue to apply this strategy because the central bank remains focused on fighting inflation rather than stimulating growth. This policy priority—anchoring expectations through sustained real rates—provides a supportive backdrop for the carry trade. Given the risks, we implement this strategy in a measured and diversified way, allocating only a portion of client portfolios to TRY-denominated assets.

7) How does KT Portföy employ TRY carry trade in portfolios in practice?

We employ the carry trade strategy across all portfolio types—including multi-asset and USD-based mandates—by maintaining selective exposure to TRY money market and sukuk positions, even within higher-risk funds. The yield pickup meaningfully enhances risk-adjusted returns.

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Q3 2025 Outlook



Our main vehicles are Sharia-compliant money market and short-term sukuk funds, which offer daily liquidity while capturing Turkey's elevated real rates. These funds have attracted significant inflows, contributing to the growth of our AUM to over USD 8.5 billion and positioning KT Portföy as the 6th largest Sharia-compliant asset manager globally, according to IFN rankings.

8) What is the Sharpe ratio of the position?

The Sharpe ratio of this position was exceptionally strong in 2024, exceeding 5, thanks to stable yet high money market returns and a relatively orderly USD/TRY trajectory. In 2025, however, the ratio declined to around 1.5, primarily due to elevated currency volatility in March. Despite this, the strategy has continued to deliver positive risk-adjusted returns, particularly when implemented within a diversified portfolio framework.

9) Can the Turkish Lira carry trade serve as a diversifier in a global equity portfolio?

Yes. The correlation coefficient between S&P 500 index's daily returns and TRY carry trade's USD based daily returns is 0.01 (between 2 January 2024 and 27 May 2025). Hence, there is almost no correlation between this strategy and global equity.

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