

SPECIAL RISKS OF FOREIGN CURRENCY OPTIONS

1. The value of any currency, including U.S. dollars as well as foreign currencies, may be affected by complex political and economic factors applicable to the country issuing that currency. The price of a foreign currency option is dependent upon the value of the underlying foreign currency relative to the trading currency as well as the value of both currencies relative to other currencies generally. Fluctuations in the value of the trading currency—whether it is the U.S. dollar (in the case of a dollar-denominated option) or a foreign currency (in the case of a cross-rate option)—will affect exchange rates and the prices of foreign currency options, even in the case of an otherwise stable underlying foreign currency. Conversely, fluctuations in the value of an underlying foreign currency will affect exchange rates and the prices of foreign currency options even if the value of the trading currency remains relatively constant. Investors should consider factors affecting the economies and currency values of both the country of origin for the trading currency and the country of origin for the underlying currency. Although these same considerations apply to dollar-denominated options and cross-rate options, cross-rate options involve factors affecting the economies of at least two foreign countries and may involve consideration by U.S. investors of factors affecting the U.S. economy as well. Accordingly, a U.S. investor in cross-rate options may need to consider a broader range of economic developments than a U.S. investor in dollar-denominated foreign currency options.

2. Even though the intrinsic value of an option is determined by the value of the underlying currency relative to the trading currency, investors who intend to convert gains or losses into U.S. dollars or other currencies may be particularly affected by changes in the exchange rates between their "home" currency and either the trading or the underlying currency.

EXAMPLE: Assume that an investor purchases a yen-denominated, at-the-money call option on British pounds by converting U.S. dollars to Japanese yen. The British pound then appreciates relative to the yen, and at expiration the exercise price is more favorable than the then current exchange rate between yen and pounds. The investor could realize a gain in yen by converting dollars to yen in order to purchase pounds at the exercise price and then reselling the pounds for