

It's too late to hedge against a rising loonie

But it is a good time to buy U.S. investments



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As anyone with foreign investments knows, the soaring loonie is not necessarily good news. Unless you've invested in mutual funds that hedge back into the loonie, you've likely suffered currency-related losses.

The biggest losers have been Canadians with U.S. stocks or equity funds, says financial author Gordon Pape. He doesn't blame those burned for second-guessing the time-honoured wisdom that global diversification is a good idea.

While U.S. indexes are up 9% to 14% this year, only eight out of hundreds of U.S. stock funds beat the S&P 500 index in Canadian dollars, Pape finds. Seven were currency-hedged funds.

However, most of Canada's fund companies -- with some exceptions -- do not hedge, because of the costs of doing so and the belief that over the long run, currency effects cancel out.

Ian McPherson started a new currency-hedged fund company, Criterion Investments, in the belief they were wrong. He says Criterion's "stapled approach" to investments and currencies adds only 0.1% to annual costs.

Criterion's research shows over the last three years, Canadians who were invested in the MSCI World Index lost 27% from currency. The sagging U.S. dollar hurt, but two-thirds of that index comes from stocks outside North America. When Criterion took the U.S. dollar out of the mix it still found 15% extra volatility came from unhedged exposure to the yen, Euro,

Swiss Franc and British pound.

McPherson says the default decision is to hedge 50% of foreign currencies. If you believe there's only a 25% chance of the loonie going higher from here, you'd hedge 25% of your exposure.

Criterion doesn't yet offer a global fixed-income fund and it may not be necessary. Arguably, Canadians should concentrate their foreign content in equities, where the market and currency risk should eventually prove worthwhile.

Few of Criterion's rivals offer cross-the-board hedging, but some do in certain products. These include Mackenzie Cundill and ETF makers Barclays and Claymore Investments. Franklin Templeton doesn't hedge Templeton Growth Fund or its sister global equity funds. However, Franklin Templeton's Mutual Series hedge its U.S. and global funds.

Worrying about currency after the loonie's moonshot seems like locking the barn door after the horse has escaped.

B.C.-based certified financial planner Fred Kirby warns it's futile to extrapolate brief time periods into the far future.

"With perfect hindsight, Canadian investors should have been hedging their foreign exchange exposure" since the bear market in the U.S. dollar began in earnest in 2002. However, "just the opposite could be said for the immediate preceding decade when it was the U.S. dollar's turn to significantly advance."

The loonie now trades in the 95th percentile of its 50-year range.

"From a long-term historical perspective, now is not the time to be contemplating a currency hedging strategy against the U.S. dollar."

Investors can manage currencies in the same way they manage the risk of holding different asset classes.

Kirby says if the maximum exposure to any one asset class is 25%, Canadians can be unhedged for the first 25% of their foreign content but should hedge any exposure beyond that level to enjoy the diversification benefits.

Vancouver advisor Adrian Mastracci says if Canadians expect to retire with Canadian dollars as income, they'll keep most of their fixed-income exposure in domestic bonds or GICs.

With a 60% stocks to 40% bonds asset mix, they have 60% exposure to the loonie (the entire 40% bond position plus one third of the 60% in equities if a three-way geographic split of Canada, U.S. and International is maintained).

Wilfred Hahn, chief investment officer of Hahn Investment Stewards, thought the loonie "wildly overvalued" at US92¢, let alone beyond parity.

He views the current level as a "tragedy" and insists "at some point it must come down."

Hahn says he wishes he had hedged earlier but now is not the time to do so. More than ever, Hahn believes it's a good time to go global, including U.S. cash and, to a lesser extent, U.S. stocks.

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