

# Currency risk

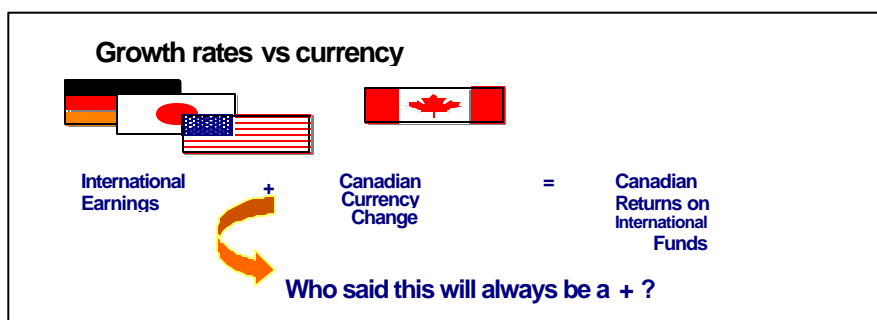
## How exchange rates affect the returns you see in foreign investments

While the Standard & Poor's 500 stock index was up to 28.7 per cent and NASDAQ advanced 50 per cent at the end of December 2003, the year-to-date average U.S. equity funds had 6.2 per cent return. Here's why.

\* Source: BellCharts

### Changes in Canadian currency affects the U.S. Funds performance

One of the risks associated with international investments is currency risk. The currency risk, also called exchange rate risk, can affect individual investors who make, or are considering international investments.



The risk is that the investment value will be affected by changes in the exchange rate. For example, if money must be converted into a U.S. currency to make an investment in U.S. holdings, changes in the value of the Canadian currency, relative to the American dollar, will affect the total loss or gain on the investment when the money is converted back to Canadian dollars. Currency risk can be beneficial or detrimental to the investment value.

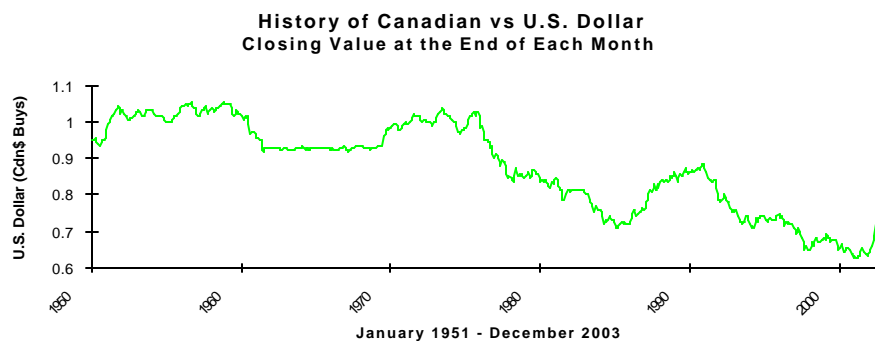
**The S&P 500's 28.7 per cent U.S. dollar gain represents a decline of over 9.6 per cent when translated into Canadian dollars. How does this happen?**

The Canadian dollar has gone up in value from 64.89 cents at January 2003 to 76.17 cents at the end of December 2003. In just a year, the Canadian dollar has appreciated by over 17 per cent versus the U.S. dollar.

For investors who own U.S. equity funds in Canadian dollar denomination, the rise of the Canadian dollar meant its value relative to the U.S. dollar has wiped out any market gain.

### History of Canadian vs U.S. dollar

*Closing value at the end of each month*



For example, an individual invested \$10,000 into the U.S. equity funds at the beginning of 2003 when the dollar was at 64.89 cents. The fund manager then purchased \$6489 of U.S. stocks. By the end of December, the U.S. stocks appreciated to \$6891.32 and the Canadian dollar rose to 76.17 cents. If the investor decided to cash out, the proceeds would be \$9047.29 after converting to the Canadian dollar.

While the investor's U.S. portfolio appreciated 6.2 per cent, the return on the \$10,000 Canadian dollar investment was -9.5 per cent.

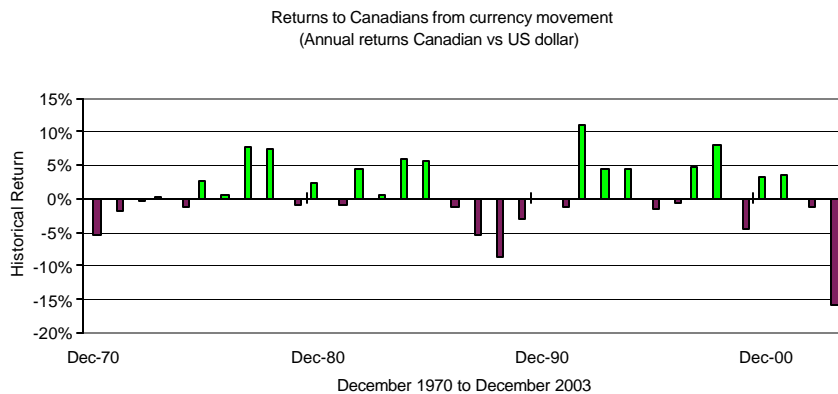
**What does this mean to investors? Where should they invest now? How much should be invested in foreign markets?**

Predicting the direction of the currency is impossible. The best thing for investors to do is to maintain a diversified portfolio, including some global diversification. While the world economies are more closely tied than ever before, there are still circumstances causing some countries to be in favour with investors and some to be out of favour. These rotations in preference, particularly when combined with the strategies of dollar cost averaging and diversification can lead to growth and wealth accumulation in the long run. The amount of foreign content in the portfolio depends on the individual investor's risk tolerance and investing time horizon.

Remember, how a portfolio fares in the market has less to do with what the dollar does, or even what the economy does and more to do with what you do to stay on track with your financial security plan.

Now is the great opportunity for you to contact your clients and address their concerns about exchange rates and fund performance. If you aren't calling them, who is?

**Returns to Canadians from currency movement**



1970 - 2003  
 Minimum -15.81%  
 Average 0.72%  
 Maximum 11.08%

Source: Bank of Canada

**The major U.S equity markets year-to-date performance as of December 31, 2003.**

- Dow Jones +25.3%
- S&P 500 +28.7%
- NASDAQ +50%

Source: BellCharts

The information provided is accurate to the best of our knowledge as of the date of publication, but rules and interpretations may change. This information is general in nature, and is intended for educational purposes only. For specific situations you should consult the appropriate legal, accounting or tax expert.