Soaring loonie killing your U.S. returns? Read this

Rob Carrick

Globe and Mail Update

August 1, 2017
For Subscribers

When something goes wrong in a well-built portfolio, the best response is sometimes to do nothing.

Bonds or bond funds have been falling in price lately as interest rates rise, but you still need those bonds to hedge against stock market corrections and economic declines. Another example based on recent financial market developments can be seen in returns from unhedged exposure to U.S. stocks and funds. The Canadian dollar's recent surge has been a painful one for investors who hold U.S. stocks and funds that do not use hedging.

You did not make a mistake by holding unhedged exposure to U.S. markets. The underperformance of non-hedged stocks and funds stings, but it's just a passing setback that does not require you to make changes in your portfolio.

Hedging mutes the effect of currency moves so that you make more less what the S&P delivers in its home currency. Without hedging, you get distortions in your returns that work for you when the loonie dives and against you when it soars. For the first six months of the year, the S&P 500 has delivered a total return of 5.9 per cent in Canadian dollars and 9.3 per cent in U.S. dollars. In June alone, the index fell 3.3 per cent in Canadian dollars and made 0.6 per cent in U.S. currency.

Whether you go with hedged or unhedged U.S. holdings, you'll almost certainly feel like both a genius and a chump in the near term. The unhedged approach ruled over the past three years – the S&P 500 made 17.1 per cent annually in Canadian dollars and just 9.6 per cent in U.S. dollars. Now, unhedged stocks and funds are being trounced.

The reason to stop worrying about hedging is that things even out over the long term. Over the 20 years to June 30, the S&P 500 made 6.8 per cent in Canadian dollars and 7.2 per cent in U.S. dollars. Over the 30 years, the difference between the two approaches amounted to just 0.08 of a percentage point – 9.51 per cent for Canadian dollar returns and 9.59 per cent for U.S. dollars.

Troubled by the underperformance of your unhedged U.S. stocks or funds? One option is to buy some hedged U.S. exchange-traded funds or mutual funds and hope the loonie doesn't reverse course and start falling. A simple, sound approach is to just do nothing.

351 King Street East, Suite 1600, Toronto, ON Canada M5A 0N1

Phillip Crawley, Publisher