Foreign Exchange

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We have all experienced the impact of foreign exchange, whether going south for a winter vacation or shopping online for the latest technology. Foreign exchange, often referred to as forex or FX, is the global marketplace for trading currencies. It plays a pivotal role in international trade and investment. Currencies are exchanged at a specific rate, known as the exchange rate, which determines the value of one currency in terms of another. These rates are influenced by a multitude of factors, including interest rates, inflation, geopolitical events, and market sentiment.

Consider the value of the Canadian Dollar in US Dollar terms over the past 20 years:

Consider the fluctuations of the CDN to USD over the past two decades:

Lowest: 20 Jan '16 - 0.68 **Highest:** 07 Nov '07 - 1.09 **Date Range:** 09 May '03 to 11 May '23

How do changes in foreign exchange affect your portfolio?

Like exchanging Canadian dollars to Mexican Pesos for a cold drink on your winter vacation, currency movements can also impact investment returns. Buying foreign investments also requires an exchange of currency. If you are buying shares listed on a US stock exchange, Canadian dollars are converted into US dollars to purchase the shares. Subsequent changes in the exchange will affect your overall rate of return from a Canadian dollar perspective in addition to changes in the underlying investment.

Assume you purchase a share of XYZ Co., which is listed on the New York Stock Exchange. The current price of the share is $100 USD, and the exchange rate is $1.35 CDN/USD buying the share will cost $135 Canadian. In a year's time, you decide to sell the security. The price of the share is still $100 USD, but the exchange rate is now $1.42 CDN/USD. Upon the sale of the stock and converting back to Canadian dollars, you now have $142 CDN, which is a $7 capital gain on the share even though the value of the share price of the stock didn't change. For a non-registered portfolio this currency gain will be subject to capital gains taxes.

If you are concerned about the effects of foreign exchange on your portfolio, you could consider an investment that hedges against exchange rate fluctuations. When an investment is hedged against exchange rate risk, mechanisms such as forward contracts, which are contracts to purchase a set amount of currency for a set price on some specific date in the future, are used to help reduce or eliminate the risk from currency fluctuations. These types of hedges are available in mutual funds, Exchange Traded Funds (ETFs) and Canadian Depository Receipt (CDR) investments. It is important to note that foreign exchange hedges are not put in place to make money, but rather to help reduce unexpected losses incurred due to fluctuations in foreign exchange rates.

The decision to invest in hedged investments comes down to your specific risk tolerance and ability to accept the impact of foreign currency changes on your portfolio. Your Edward Jones Financial Advisor can work with you to determine whether you should consider a hedged version of your investments considering your risk tolerance, current economic conditions, and your specific goals.