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## The good and bad of currency fluctuations

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Planning a vacation in the United States any time soon? I have good news – it will cost you approximately 9% less compared to just four months ago as the U.S. dollar has depreciated 9% against the Canadian dollar.

There have been several unexpected events that may explain the sudden re-pricing of the loonie. First, Bank of Canada Governor Stephen Poloz raised interest rates twice this year: by 25 basis points in July and 25 basis points in September. The increase was unexpected by markets as the economic backdrop had not really changed: oil prices remained low, Canadian economic growth was relatively weak compared to previous recoveries and inflation was well below the central bank's target. The increase in rates narrowed the interest rate differential between Canada and the U.S. to 25 basis points from 75 and is expected to attract capital to flow to Canada. Second, U.S. growth prospects have weakened over the last few months. U.S. President Donald Trump was not able to introduce a replacement for Obamacare and there were no tax cuts or stimulus plans on the table. Third, it is expected that hurricanes Harvey and Irma will have at least a temporary impact on the economic growth of the regions affected, especially in the oil sector. Lastly, tensions with North Korea are creating uncertainties.

For those with investments in the United States, the recent depreciation of the U.S. dollar may have had an adverse effect on the values of their portfolios. For example, the S&P 500 Index, which measures the performance of the broad U.S. stock market, gained 4.5% in the last four months ending August 31. However, when the return is converted to Canadian dollars (after accounting for the depreciation of the U.S. dollar), it becomes a loss of 4.2%.

As part of our currency management program, we hedge currency fluctuations using derivatives. As a result, the impact of the U.S. dollar's recent decline on our portfolios has generally been less than if we did not hedge. We hedged approximately 50% of our U.S. dollar exposure in May, meaning that for every dollar of exposure to U.S. securities, we only had 50 cents of exposure to the U.S. dollar. We generally use a mean-reversion currency management model, which means we decrease U.S. dollar exposure when the dollar is expensive and increase exposure when it is cheap, based on both historical prices and economic fundamentals.

It is difficult to predict central bank policies and currency values. We expect rising interest rates and the stronger Canadian dollar to taper economic growth and inflation, which will in turn cause rates to rise at a more moderate pace. Following the U.S. dollar's fall, we have increased our U.S. dollar exposure. This will provide additional upside should the dollar revert back to the mean. We will continue to adjust our U.S. dollar exposure as the market value deviates further from its fundamental value.

*Combined top 15 equity holdings as of August 31, 2017 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:*

- |                               |                   |                           |
|-------------------------------|-------------------|---------------------------|
| 1. Canadian Natural Resources | 6. Suncor Energy  | 11. AltaGas               |
| 2. Microsoft                  | 7. Atco           | 12. Alphabet Class A      |
| 3. Apple                      | 8. Athene Holding | 13. Toronto-Dominion Bank |
| 4. UnitedHealth               | 9. Franco-Nevada  | 14. Symantec              |
| 5. Walgreens Boots Alliance   | 10. SNC-Lavalin   | 15. Bank of Nova Scotia   |