



## Foreign Exchange & International Investment

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<http://www.ck-wong.ca/Money%20Matters/international%20investment%2020060308.pdf>

### Introduction

The art of investment includes risk management. Diversity on business sector and geographically are the common strategy. When diversify geographically it still can be divided into in country and international. These guiding principles are valuable and are maxims we should respect. Like all rules that are meant to be broken. We need to break it under wise circumstances; some of us are not young anymore, we do not have to rebel without a reason. This article will examine some of the situation the rule should be kept and when the rule can be broken.

#### ***“If it does not go up, don’t buy it”***

Sometime we get what we wish but packaged in a way that could disappoint us. When we diversify our investment to overseas, it is a simple strategy that hopes some countries do better than other that could compensate those do not. This maxim does not mean we invest indiscriminately. We should choose the prosperous country to invest. In the 1990, US was the place. Now Japan could be it. But it is ‘*could be*’ because it could only be confirmed retrospectively. Although a lot of indicators show the right reason but accident happens.

Another rule of thumb is “*follow the money*”. US is still the largest economy in the world. It has many viable and booming businesses. Many recommendations still suggests investing in US. If you do so, your wealth may be appreciated.

### Hidden Factor

When we deal with stocks in the country you live, the money you invest is the money you get back. However, when you invest in country you do not live, unless the currency of investment vehicle is the same as the country you are living, there is foreign exchange exposure. The profit you make could be more or less the face value when you convert it to home currency.

On top of this when you exchange the currency, there is a hidden charge for foreign exchange. Unlike trading shares, you actually buy and sell with the bank. The bank will charge you the service fee but also charge you a premium exchange rate that working to the bank’s advantage. This premium is ranging from 0.1% to 2% depending on the lump of money. For the worst case, if you make 4% profit, you can surrender all the profit to the bank.

## Currency Value

One of my friend believed he invested in the States and could spend the gain in the States because he visited it often, it is almost equivalent to living there. From 1990 to 2000, it worked beautifully when C\$ depreciated from U\$0.88 to U\$0.66.

Let's examine this paradox. Assuming you invested in the States in the year of 2000 using your Canadian dollar. The exchange rate was 0.66. So your C\$1 was converted to U\$0.66. Consider you found a winner which has grown 10% per year. For 6 years, your U\$0.66 becomes U\$1.16. A return of 77% is admirable. However, what is the value relative to C\$ which has appreciated to C\$1 equals to U\$0.88. Your U\$1.16 is now C\$1.32. A gain of 32% only or 4.5% annualized. This is hardly anything you would like to brag about.

You have to actively manage the foreign exchange exposure.

## Choose Wisely

When we invest abroad, foreign exchange must be taken into account. You are dealing with two risks, the stock and the foreign exchange. One should assess a country which has stable foreign exchange. Canadian \$, New Zealand \$, Japan ¥, Singapore \$, India Rupee, and Chinese ¥ are and will be shard currencies.

Opportunity cost must be included in the investment strategy. Other than the value of the company, management and execution efficiency, a modern investor needs to pay attention to the hidden and tangible factors. These hidden factors include the following:

- Political stability
- Currency stability
- Geographical stability
- Fairness to investor especially the foreigner
- Competitiveness maintenance