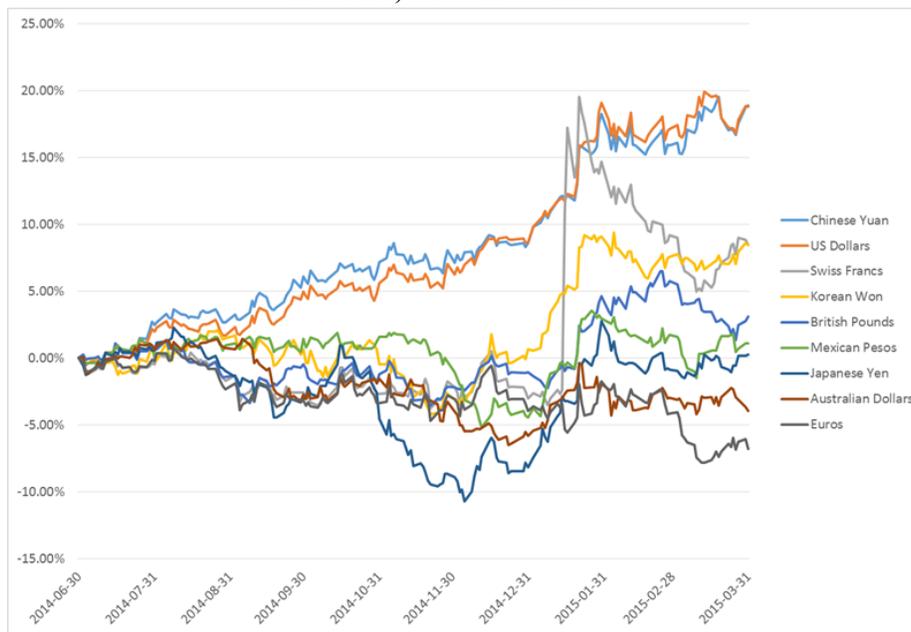


Oh, the Poor Canadian Dollar! Not Really.

We always look at the Canadian dollar relative to the US dollar, and by that comparison it does not look good. There has been a perception (probably correct) that the collapse in the price of oil is bad for Canada and that interest rates here will not be going up any time soon. This has had quite a negative impact on the Canadian dollar relative to the US dollar.

Obviously the US dollar is the most important foreign currency from our perspective, but it is hardly the only currency out there. Since the end of June last year, the Canadian dollar has performed about as well as many other currencies, as shown in the chart below:

**Change in the Value of Currencies Relative to the Canadian Dollar¹
June 30, 2014 to Present**



The two superstar currencies have been the US dollar and the Chinese Yuan, which have appreciated by nearly 19% since the end of June. The Chinese Yuan is linked to the US dollar, so its rise is simply because the Chinese government has decided to maintain this link. Overall, the rise of these two will make the products they produce more expensive to others.

At the other end of the spectrum we find the Euro, which has lost almost 7% relative to the Canadian dollar. So why is the Euro doing so poorly? Well, it would appear that the European Central Bank is doing its best to push down the Euro to help stimulate the Euro-Area economies by boosting exports, and they are doing this by forcing interest rates so low that any rational investor would go elsewhere.



Government Bond Yields²

	Euro Area				
	Germany	Netherlands	France	Spain	Italy
2 years	-0.26%	-0.20%	-0.17%	0.09%	0.11%
5 years	-0.15%	-0.08%	-0.04%	0.65%	0.58%
10 years	0.08%	0.16%	0.36%	1.46%	1.46%
	Other European		North America		
	Switzerland	U.K.		U.S.	Canada
2 years	-0.91%	0.59%	2 years	0.53%	0.64%
5 years	-0.50%	1.18%	5 years	1.33%	0.87%
10 years	-0.18%	1.59%	10 years	1.89%	1.42%

The government bond yields in the Euro-Area are not just low – in some cases they are even negative! Pity poor German investors; if they wanted to invest in a safe five-year government bond, they would have the enjoyment of *paying* the German government 0.15%/year for five years. That makes the paltry 0.87% in Canada look pretty good by comparison, and may also explain why some currencies are doing better and some worse than the Canadian dollar.

Given the choice between paying someone to hold your money and actually getting a return on your money, rational investors will look to get some return. In the Euro area on average, you have to pay governments to hold your money, so naturally investors will sell euros and buy other currencies in order to invest in bonds where a return can actually be earned. This buying and selling of currencies changes the supply and demand for them, which shows up as changes in exchange rates. This may explain why the Canadian dollars has done better than some currencies but worse than others. Government bond yields in Canada are better than those in the Euro area, but generally worse than those in the U.S. and U.K. Switzerland is a bit of an odd case as the Swiss Franc was tied to the Euro for a few years, but was set free in January resulting in a huge initial jump but a decline thereafter.

Ultimately, the changes in exchange rates is just a matter of the global economy sorting itself out. Europe is trying to help itself by lowering its exchange rate to help boost exports and get its economies moving. The U.S. (and China) appear to be the growth engines in the world and the place where people want to invest. Canada is just in the middle trying to figure out how it fits into the new reality – which will probably mean more exports to (less imports from) the U.S. and China and less exports to (more imports from) Europe.



From an investment perspective we are keeping an eye on the currencies, particularly the U.S. dollar as this is where the Alitis Pools have most of their foreign exposure. The appreciation of the U.S. dollar has added to the return in the Pools, but it is looking like the U.S. dollar may be topping out. In this situation, we have been looking to switch into investments in which U.S. dollar exposure is hedged back into Canadian dollars so that any decline in the U.S. dollar does not become a drag on returns.

Sources:

1. Pacific Exchange Rate Service, fx.sauder.ubc.ca, April 21, 2015.
2. Wall Street Journal, online.wsj.com/mdc/public/page/2_3022-govtbonds.html, April 21, 2015; Swiss Exchange, www.six-swiss-exchange.com/services/yield_curves_en.html, April 21, 2015; Bank of Canada, www.bankofcanada.ca/rates/interest-rates/canadian-bonds, April 21, 2015.



ALITIS

INVESTMENT COUNSEL

Head Office: Campbell River
 Satellite Offices: Victoria, Vancouver, Burnaby,
 Calgary, & Edmonton
 1- 800 667 2554 / www.alitis.ca

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