TURNER INVESTMENTS COMMENTARY

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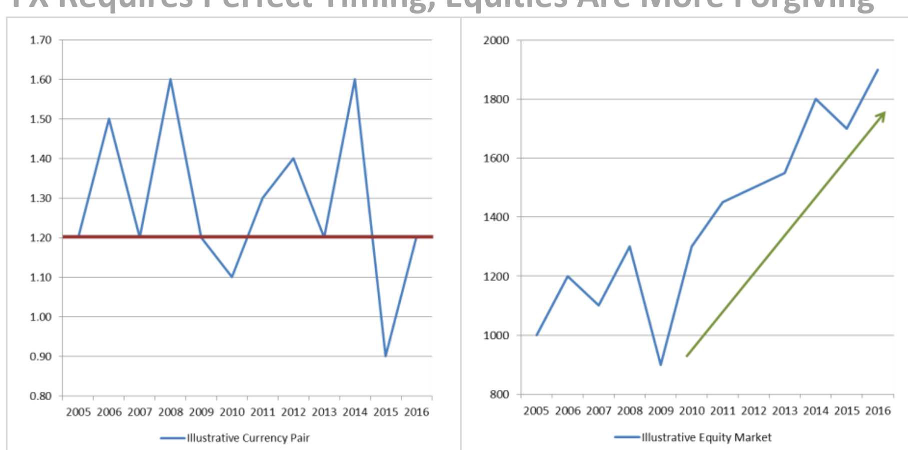
CURRENCY CONUNDRUMS

If you think equity markets are tough to call, they're nothing compared to foreign exchange (forex) markets. The recent plunge in the British pound following the Brexit vote only highlights this difficulty. Currency markets are the largest in the world with trading volumes of US$4–5 trillion per day; however, they're also incredibly volatile, often directionless and incredibly challenging to profitably trade.

One reason for this is that currency markets trade continuously, 24 hours a day, so there is little opportunity to pause and digest information. Properly monitoring positions requires constant vigilance, which is unrealistic for most retail investors. For example, much of the British pound movement during the Brexit results occurred in the middle of the night when most North American investors were asleep. Also, many forex strategies are powered by massive institutions using powerful trading algorithms, leaving most ordinary investors in the dust. Retail investors also usually receive unfavourable spreads, which makes profiting even tougher. The bid-ask spread is the difference between the price at which a dealer will buy a currency and the price at which it will sell a currency. The spread is how a dealer makes a profit. For small currency trades, the spread is set wide—an often crippling disadvantage.

FX Requires Perfect Timing, Equities Are More Forgiving



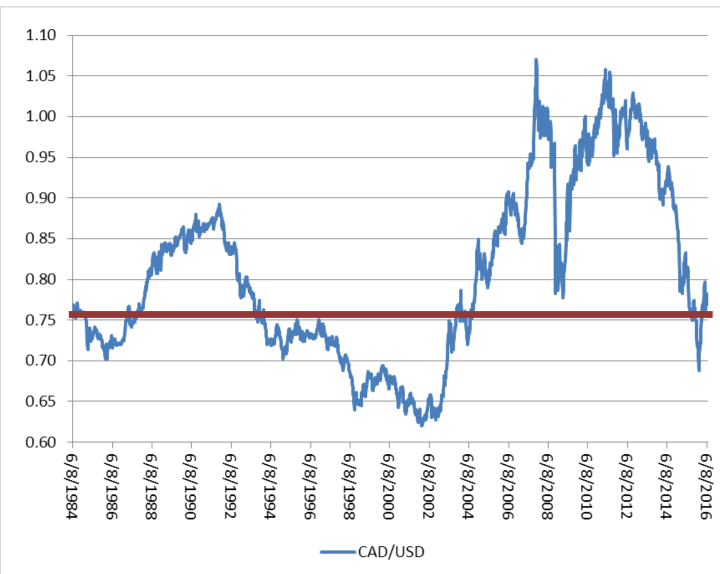
Source: Raymond James Ltd.

An article in the *Wall Street Journal* a few years ago highlighted some of these issues:

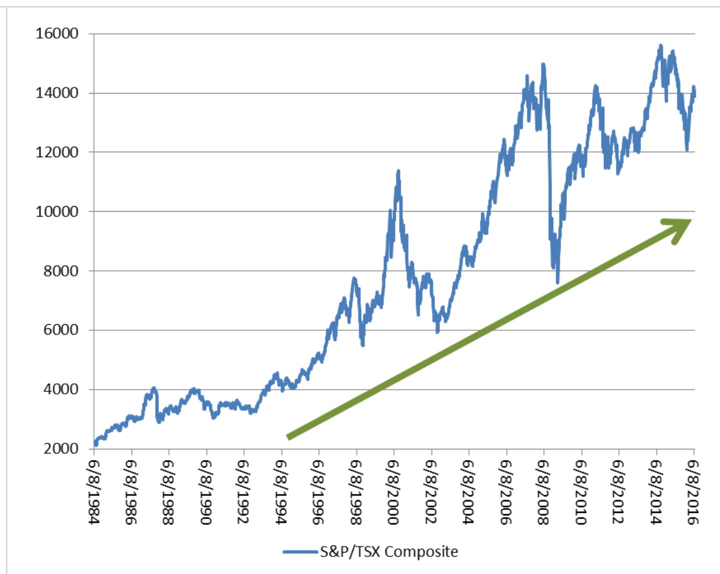
Only about 30% of all retail forex trades are profitable, according to Aite Group [an independent financial market researcher], largely because of traders' lack of education and experience in dealing with a market dominated by institutions. Commission costs, which run about $10 to $20 for a standard contract, also can add up quickly.

In fact, much academic research indicates that, over the long term, there is very little outperformance that can be garnered by employing currency trading strategies within a portfolio. Equity markets, while volatile, offer some directional predictability: over time, they tend to move higher. In other words, equity markets can be forgiving of mistakes. Not so with currency markets, particularly the CAD/USD currency pair. Historically, over the long term, the CAD/USD exchange rate actually goes nowhere. The CAD/USD rate tends to trade in giant 'W' or 'M' patterns (though, unfortunately, not predictable W and M patterns). This is why we currently have a Canadian dollar valued at *exactly* the same level as *32 years ago*. In other words, the only way to profit from currency trading is to continuously and accurately pick the tops and

In More Than 30 Years, CAD/USD FX Rate Has Gone Nowhere…



…While The Canadian Equity Market Has Advanced More Than 500%



Source: Bloomberg

bottoms of each advance and pullback. Eventually, you will be wrong, and the incorrect timing could create permanent losses. With equity markets, an incorrect entry point will, of course, cost you time, but it's very likely that, if you're patient, you'll eventually profit, most often within a year or two. With a poorly timed currency trade, you could easily go a decade or more in a loss position. For instance, if you'd bought US dollars in 2002 when the Canadian dollar was at about 62 cents, you'd still be waiting for your 'trade' to be in-the-money. Most equities also pay dividends, which can cushion the downside blow and at least pay you while you wait for a recovery. Currency pays nothing.

US DOLLARS: AN IMPORTANT DIVERSIFIER

We like to keep about 20% of our client portfolios exposed to US-dollar securities because this weighting acts as a diversifier and enhances returns when the Loonie weakens. Portfolio performance is calculated in Canadian dollars, so US-dollar ETFs become more valuable when translated back into weaker Canadian dollars. Effectively, the US-dollar component is a hedge against softness in our economy and/or a drop in the oil price. Needless to say, with a 30% plunge in oil, US-dollar ETFs were beneficial to your portfolio performance in 2015. Many of our clients also need US dollars, whether for something as simple as a Florida vacation or for more complex needs such as ongoing business expenses. Therefore having US dollars available is important, but we believe anything more than a ~20% weighting creates risk. If we believe you are subjecting your portfolio to excessive exchange-rate exposure, we will likely recommend scaling back your US-dollar weighting. After all, you primarily want market direction to dictate portfolio performance not an unpredictable and whip-sawing exchange rate. Taking frequent and heavy bets on currency direction creates risk, increases cost and is often fruitless. There were more than a few forex traders who got ‘pounded’ during the Brexit turmoil. It’s our job to make sure that the same doesn’t happen to your portfolio.

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