

Aspirations

Live the life you desire now and in the future



Of course it's not good news for everybody. Exporters in particular can feel the chill from the strong currency. One area hurting is tourism; another is higher education with a drop in the number of overseas students wanting to study in Australia, undermining an export industry which earned \$18 billion in 2009.

Should you hedge?

To 'hedge' is to take steps to insure against loss. Some resource companies hedge against currency fluctuations, others don't: Rio Tinto hedges, BHP doesn't.

Because the Australian share market represents less than 3% of the world share market (MSCI), many investors seek exposure to iconic international businesses like Microsoft, Toyota or Apple. In doing so, these investors may feel some pain from a strong dollar and wonder if they need to hedge.

If your money is invested overseas there will inevitably be currency risk. Indeed, if the Aussie dollar were to rise enough, any positive returns could well turn south.

Let's take a simple example in Aussie dollars to illustrate the point. Say you had \$10,000 invested in US assets with a return after fees of 6 per cent and the dollar was at parity. Your return would be \$600. But if the Aussie dollar rose to US\$1.05 then the value of your \$10,000 capital investment would fall to \$9,524 and your \$600 becomes \$571. So instead of having \$10,600, your principal and return is only worth \$10,095. Conversely, if the dollar were to fall it would magnify your gain.

There is no right or wrong when determining if it is appropriate to hedge international investments. There is a small cost involved as with any form of insurance.

If you don't hedge, swings and roundabouts will inevitably influence the return in the short term but over time the currency impact on your total return will generally even out.

Parity may well be here to stay for at least the short to medium term but as in all races there are winners and losers. If you need any advice on your international investments please don't hesitate to contact our office to discuss your needs.

Parity But what now?

When the Australian dollar reached parity with the US dollar there was jubilation among some in the media, as if we had won a hard-run race.

Had we? And, if so, where's the prize? Why should we have this sense that we have achieved some holy grail?

The Australian dollar breached parity three times in as many months late in 2010; by New Year it was commonplace. The reasons vary: weakening currencies in the major economies of the US, Europe and Japan; strong commodity prices on the back of demand from Asia, and particularly China; the widening interest rate gap between Australia and other countries whose currencies are also traded frequently.

It's hard for overseas investors not to want to invest in fixed interest here when our rates are around the 6 per cent mark. Offshore rates are significantly lower. While our official rate is 4.75 per cent, the official rates of the US, Europe and Japan are all below 1 per cent.

Monetary easing in the US has kept the greenback under the hammer. The US Federal Reserve introduced its second quantitative easing program (named QE2 but bearing little resemblance to a luxury cruise). This has seen a flood of money onto the US market in a bid to stimulate the economy but there are plenty of doubters who believe it won't work the second time around. Printing money to stimulate national economies has a bleak history.

Another factor bolstering the Australian dollar is that we have displayed solid economic fundamentals, being the only OECD country to come through the 2008/09 crisis without going into recession.

Rebalancing world currencies

Some see the strength in the Aussie currency as merely a rebalancing of world currencies between those countries with high levels of consumption and/or private debt, and those with low debt.

Whatever the reasons, the strong Aussie dollar gives us the opportunity for cheaper travel overseas and to enjoy cheaper electronic equipment, flat screen TVs and cars. Lower prices constrain inflation, which should also help to limit any future interest rate rises as it will keep annual consumer price index (CPI) increases within the Reserve Bank's preferred 2 to 3 per cent range.

Other winners from a high dollar are those businesses reliant on imported materials as they can enjoy the benefits of lower input costs, and industries such as agriculture or mining which require imported machinery.

But can the strength last? Having broken through the \$US1 mark, will our dollar drop back? The balance of opinion seems to favour the dollar being around parity through 2011 – some even think as high as \$US1.10 due to the strength of demand for our resources.