THE VANCOUVER SUN

Don't let patriotism rule your investments

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FEBRUARY 26, 2011

Tuesday is the deadline for contributing to our Registered Retirement Savings Plans, leaving many of us doing some last-minute reflecting on how best to invest our funds.

We may feel inclined to be true to the Maple Leaf with our investments.

After all, there are many upsides to living in Canada: Tim Hortons doughnuts, Hockey Night in Canada and universal health care.

Investing in homegrown Canadian stocks can breed good feelings because of brand familiarity.

Evidence of this is the lack of foreign exposure in the RRSPs of Canadians, despite the fact that the foreign-content limits were completely eliminated in 2005.

In hindsight, the reluctance of Canadian investors to quickly increase foreign exposure after the restriction was lifted paid off as the Canadian dollar increased almost 25 per cent against the U.S. dollar over the ensuing five years (although, during the depths of the 2008-2009 financial crisis, the Canadian dollar briefly retreated to 2005 levels).

On a currency-adjusted basis, this helped Canadian stocks to trounce American stocks by about six per cent on an annualized basis over the last five years.

In addition to that, the strength of the Canadian dollar internationally was enough to wipe out all the gains if one had broadly invested in international stocks.

Sometimes doing nothing is doing a lot.

And in this case, staying put in Canadian investments worked. However, that strategy won't work forever.

As recent trends continue, there are some headwinds that will affect investors over-exposed to Canadian securities.

First of all, Canada has been in an ideal position as a resource exporter. With demand from China and the developing world for our raw materials, Canadian companies have been the beneficiaries.

However, if the pace of economic growth in the developing world slows just a bit, our economy will be vulnerable.

In economics, everything happens at the margin.

For example, the catalyst for the U.S. subprime crisis was not declining real estate prices, but a slowing in the rate of price appreciation.

The other headwind is the Canadian dollar itself.

As the dollar strengthens internationally, it becomes more difficult for Canadian exporting companies to make a profit, which will limit the upside for Canadian share prices.

The Canadian dollar is especially dependent upon trade flows compared with a reserve currency like the U.S. dollar that represents a safe haven in volatile markets as well as a sizable portion of reserves held by other central banks.

The Canadian dollar just does not have this cachet.

If a Canadian dollar that is above par is enough to slow down trade, it will fall in value internationally, improving the performance of international investments when adjusted for the currency change.

Finally, over the long term, it is important that a portfolio includes a diversified weighting across a number of different industries.

Although Canada is a developed country, it cannot compare in terms of the breadth of industries found in the U.S. and Europe.

It is common for investors to continue investing in areas that have already had a good run.

However, "rear-view investing" is one of the costliest mistakes an investor can make as new markets and sectors take over as the business cycle plays out.

Although investing in Canada has been rewarding over the last five years, it is time to break old habits and look forward in order to maximize RRSP returns.

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