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It’s time for RRSPs to apply for travel visas

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Truth Leem/Reuters

The geographic diversification of RRSP investments is as important as remembering the contribution deadline date.

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Over the last couple of years, the geographic diversification of RRSP investments has become as important as remembering the contribution deadline date.

We Canadians may feel inclined to be true to the Maple Leaf with our investments. After all, there are many upsides to living in Canada: Tim Horton’s doughnuts, Hockey Night in Canada and universal health care.

Investing in home-grown Canadian stocks can breed good feelings because of brand familiarity. We have seen evidence of such “investment nationalism” reflected in the lack of foreign exposure in Canadians’ RRSPs in recent years, even though foreign-content limits were completely eliminated in 2005.

The reluctance of Canadian investors to immediately increase foreign exposure after the restriction was lifted initially paid off as the Canadian dollar increased almost 25% against the U.S. dollar over the next five years (although, during the depths of the 2008-2009 financial crisis, the C$ briefly retreated to 2005 levels).

On a currency-adjusted basis, this helped Canadian stocks to trounce American stocks by about 6% (annualized) over those five years — until last year. In addition to that, the strength of our currency internationally was enough to wipe out all the gains if one had broadly invested in international stocks.

But last year, the strategy of “Investing Canadian” began to break down. And, if recent trends continue, a number of factors could adversely affect investors who are overexposed to Canadian securities.

First of all, while Canada has benefited from being a resource exporter in the face of increasing demand for our raw materials from China and the developing world, the pace of economic growth elsewhere is slowing. And our economy will be vulnerable.

The other factor is the C$ itself. It is particularly dependent upon trade flows compared to a reserve currency like the US$, which represents a safe haven in volatile markets and represents a sizable portion of reserves held by other central banks. The C$ does not have this cachet. If we continue to see stress and anxiety over Europe, the US$ will benefit disproportionately relative to the C$.

In addition to avoiding pitfalls, there are also some benefits to diversifying out of Canada, especially into U.S. securities. In general, the stocks of U.S. companies represent better value than Canadian stocks. Also, a number of U.S. stocks represent good inflation hedges to protect against the fallout from the numerous money-printing policies pursued by an increasing number of central banks. Many companies should be able to keep increasing dividends during an inflationary episode, something bonds don’t do. All of this will increase investor interest in U.S. stocks.

It is common for investors to continue investing in areas that have already had a good run. However, ‘rearview investing’ is one of the costliest mistakes an investor can make as new markets and sectors take over in a business cycle.

Although investing in Canada has been rewarding over the last number of years, it is time to break old habits and look beyond our border in order to maximize RRSP returns.

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