LORING WARD

Portfolio Perspectives

Monthly Insights for Investors

What Can We Learn from A Supermodel about International Investing?

by **Sheldon McFarland,** Vice President, Portfolio Strategy and Research, Loring Ward

What happens when supermodels are unhappy with the dollar? They demand payment in euros, or at least that was the case in August, 2007, when Gisele Bündchen reportedly demanded Procter & Gamble pay her in euros for promoting Pantene hair products.[1] Unfortunately, she capitulated near the bottom, as many investors do when they try to time the market.

The U.S. dollar reached its low against the euro and the yuan in early 2008. Since then, it has staged an impressive rally, although it's taken a bit of a breather recently. There is reason to believe the dollar will remain strong, at least over the next year or two, as interest rates are likely to increase in the U.S. and remain low in places like Japan and Europe for the foreseeable future. But then again, exchange rates often take unpredictable paths. Just ask Gisele.

Yes, international investments have faced the headwinds of an increasing dollar recently but over the long term, we would expect the cumulative effects of foreign-currency changes to be zero. Also, international returns can stay negative for extended periods of time, but can turn positive quickly. In 2009, for example, a five-year decline for the international market index (MSCI EAFE Index) went from a five-year loss of 10.44% ending March 2009 to a five-year gain of 3.36% ending April 2009.[2] It only took one month to turn five years of loss into five years of gains.

Because international stock performance reflects both local market performance and currency movements relative to the U.S. dollar, a rising dollar can create headwinds for your portfolio's international investments.

This negative impact can last for years and they will have a cumulative effect on your portfolio's returns. For example, from 2010 through 2015, the cumulative impact of foreign-currency exposure on international value stocks was negative 18%. However, from 2000 to 2009, the cumulative impact of foreign-currency exposure on international value stocks was positive 29%.[3]

Some international investments hedge currency exposure to inoculate returns from foreign-currency declines. There is a significant cost to hedge foreign-currency exposure and the expected effect of foreign-currency exposure is zero over the long term.[4] In light of these two factors, we believe that most investors are not well served by currency hedging, which tends to burden their portfolios with unnecessary costs over the long term.

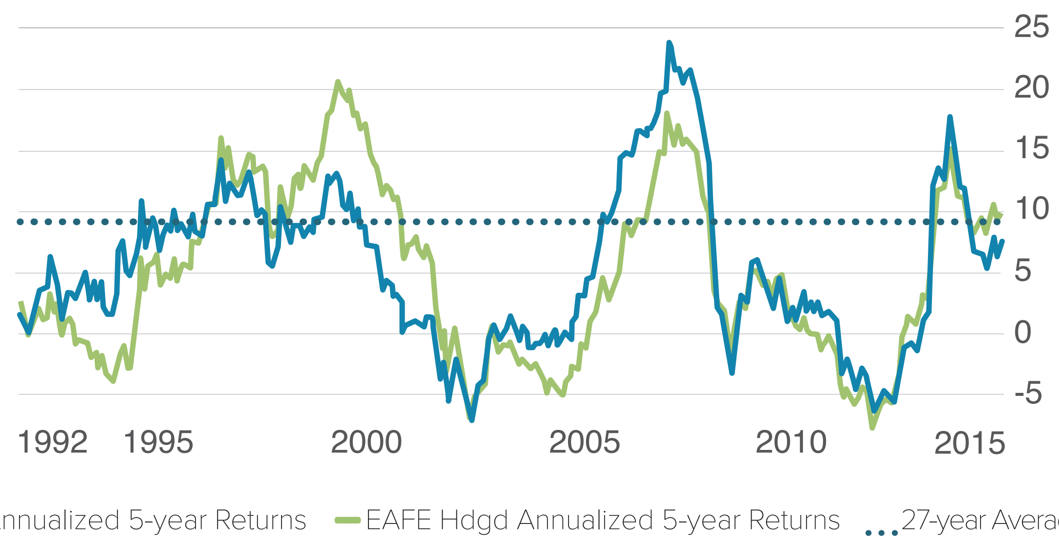
A recent research paper examined the history of the U.S. dollar's performance over the past 40 years and evaluated the returns of using either a currency-hedged or unhedged international stock strategy within a diversified portfolio.[5]

The results shown below suggest no significant difference in long-term returns between hedged and unhedged international stock strategies before fees are considered. As such, long-term investors may want to focus on choosing well-run, low-cost international stock funds for their portfolios and may not be as concerned about whether or not the funds hedge their currency exposure. After all, currencies theoretically provide no real returns.

There are lots of great companies domiciled outside the U.S. that will make great investments over the long term. Short term currency movements should not dissuade you from owning great companies, regardless of where they are domiciled.

International markets involve additional risks, including, but not limited to, currency fluctuation, political instability, foreign taxes, and different methods of accounting and financial reporting. As a result, they may not be suitable investment options for everyone.

Similar Returns Over the Long Term



The MSCI EAFE Index is a stock market index designed to measure the stock market performance of developed markets outside of the U.S. & Canada. The hedged index removes the effects of foreign currency exchange rates.

Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. Indexes are unmanaged baskets of securities in which investors cannot directly invest; they do not reflect the payment of advisory fees or other expenses associated with specific investments or the management of an actual portfolio.

[1] Adinolfi, Joseph, "Think Gisele Bündchen still wants to be paid in euros?", MarketWatch, March 2015.
[2] Morningstar Direct 2/2016
[3] Morningstar Direct 2/2016
[4] "The Impact of Foreign-Currency Movements on Equity Portfolios," Morningstar research paper, June 2015.
[5] Ibid.