

INTERNATIONAL INTERESTS

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International Investing: The Risks and Rewards

A good portfolio that reduces risks and has exposure to more opportunity for growth is one that is diversified. Successful investors know the importance of being diversified—having a selected mix of investments across varied asset classes to try to maximize return and minimize risk. In fact, many Canadians practise diversification within their domestic or North American portfolios, but they may be missing what the rest of the world has to offer. After all, investment choices within Canada represent only 3 percent of the world's market capitalization.

Investors who want to be truly diversified should consider the opportunities of investing internationally while understanding the risks

Opportunities

Reducing Economic Risk

Investing internationally reduces the risk associated with investment returns being linked to the performance of a single economy. Economic cycles are what ultimately drive valuations within equity and fixed income markets; economies in different countries or regions are not necessarily expanding or contracting at the same time. This timing difference in business cycles can present opportunities within one region and offset negative performance in another.

Accessing the Top-Performing Company within a Particular Industry

Canadian investors who have diversified their portfolios across a number of industries may find that the best

companies in a particular industry are not found in Canada. While Canada has a strong financial industry, there are limited choices in other industries such as pharmaceuticals and retail. Investors looking for the best companies in each sector need to look to foreign companies and foreign markets.

A government can make changes to policy, such as taxation or ownership restrictions on foreign investment, that can have an immediate negative effect on foreign investments.

Inefficiency and Growth

Inefficient markets can provide attractive return potential to the more sophisticated investor looking in the right places, in particular in the emerging world where long-term growth rates can be more than double those available domestically. While this growth comes with greater levels of risk, a diversified emerging-markets approach, managed by an experienced professional, can help an investor reap these potential rewards. For instance, China had real GDP growth of 8.1 percent in 2002 vs. 3.3 percent for Canada.

Hedging against a weak dollar

In the past year, the Canadian dollar has seen a strong appreciation against the US

dollar. Over the same period of time, however, the Canadian dollar has depreciated against other currencies. By investing internationally, Canadian investors can be protected from weaker North American currencies.

Risks Associated with Investing Internationally

Political

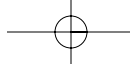
Political risk is associated with unfavourable changes in government policy and the general instability associated with investing in a particular country. A government can make changes to policy, such as taxation or ownership restrictions on foreign investment, that can have an immediate negative effect on foreign investments. Some countries or regions may be politically unstable, which also increases the risk to foreign investors.

Foreign Exchange Risk

Canadians investing in foreign markets are open to exchange rate risks. The devaluation of foreign currencies can easily offset the gains made in a particular investment. Many fund managers will try to hedge against this risk.

How to Invest Internationally

Today, investing internationally is as easy as it is to stay at home. Often Canadians first look to **US markets**. You might also consider **international mutual funds; listed, exchange-traded funds; or American Depository Receipts**, which represent shares in foreign companies. Or you can invest directly on **foreign stock exchanges**.



Mutual Funds

Most mutual fund companies offer different types of mutual funds for investing in foreign markets. The most basic are International and Global funds. International funds invest in opportunities outside of North America whereas Global funds invest everywhere including North America. Keep in mind that many Global funds invest over 50 percent of available funds in the United States, limiting the international exposure. In addition to International and Global funds, there are regional as well as country-specific funds available.

Exchange Traded Funds

International exchange-traded funds are an alternative to mutual funds. They invest in index equivalents of foreign markets. They usually have lower fees than mutual funds and give active investors the ability to move in and out of foreign markets more readily and at a lower cost than mutual funds.

American Depository Receipts vs. Foreign Markets

American depository receipts are a simpler way of investing in foreign companies than trading on the international market. The shares are traded in US currency rather than having to convert to another currency and in many cases, offer more liquidity than foreign markets.

Some experts believe that the benefits of international investing are diminishing as a result of globalization. Having exposure to international markets, however, is still essential when building a balanced portfolio that reduces risks and gives investors exposure to other opportunities. There are many investment vehicles out there that will help you achieve the international diversification that is appropriate for your needs.

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