

Look,  a big purple *rectangle!*

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Foreign investors drive loonie toward parity

By Joanna Slater
From Monday's Globe and Mail

Experts say Canada is "going to come much closer to a very stable debt dynamic very soon"

About two weeks ago, Paul Brain decided the time had come to bet on Canada.

From his perch in London, Mr. Brain had weighed the step for months. Attracted by the country's comparative fiscal rectitude, he was looking for signals of economic strength to emanate from the bond market.

Once that happened, he and his team - who manage about \$6-billion (U.S.) at Newton, an arm of Bank of New York Mellon Corp. - began plotting their move.

The object of their desire: the Canadian dollar. In a worldwide index that many global bond managers use as a benchmark, exposure to the currency is capped at about 1.5 per cent of the total. Mr. Brain doubled that figure and is looking to add even more.

He is one of a growing number of investors, including the world's largest bond manager, who see much to love north of the 49th parallel, particularly when compared to the neighbour to the south.

"Canada is going to come much closer to a very stable debt dynamic very soon, whereas the U.S. won't for as far as the eye can see." - Scott Mather, Pimco's head of global portfolio management

Canada isn't burdened by an enormous debt load and a ballooning deficit, a hobbled financial sector and a gloomy housing market. The economy is starting to add jobs, not lose them. Plus it's plugged into the global trade in natural resources, with its current of demand from faster-growing developing economies like China.

To cash in, investors are betting first and foremost on more strength in the loonie, which they believe will hit parity with the greenback.

Depending on the investor, the wagers also include buying various types of Canadian debt.

These days, it's uncommon to hear a bad word spoken about investing in Canada.

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At a lunch last week in midtown New York, David Rolley, who manages \$27-billion in global bonds at Loomis Sayles & Co., told the assembled audience that the Canadian dollar is one of the firm's favoured currencies.

Asked about Canada just before the meal, Mr. Rolley gave a two thumbs-up sign. "We're long on peace, order and good government," he said, only half-jokingly. Mr. Rolley has had a larger exposure to Canada than his benchmark index would suggest since last year. He's also buying the debt of selected Canadian companies.

When surveying a swath of developed economies, Canada stands out as a place with relatively benign dynamics when it comes to government spending ("You already had your fiscal crisis," said Mr. Rolley, alluding to the 1990s).

According to estimates from the International Monetary Fund, Canada's budget deficit will be 4 per cent of

economic output this year before tapering to 2 per cent in 2011. That in turn will help stabilize and even start to reduce the country's level of debt. Not so in the United States, Britain and Japan, where overall debt levels are predicted by the IMF to continue rising through 2014.

An Investor's Guide to Understanding the Economy by Gary Rabbior:

- **Part 1: How the money in the economy is managed** [<http://www.theglobeandmail.com/globe-investor/investment-ideas/investor-education/how-the-money-in-the-economy-is-managed/article1428287>]
- **Part 2: How inflation works** [<http://www.theglobeandmail.com/globe-investor/investment-ideas/investor-education/how-inflation-works/article1428332>]
- **Part 3: Avoiding the deflationary spiral** [<http://www.theglobeandmail.com/globe-investor/investment-ideas/investor-education/avoiding-the-deflationary-spiral/article1428375>]
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As a source of restraint in a time of overindulgence, Canada has attracted the attention of Pacific Investment Management Co. LLC (Pimco), the world's largest bond manager. In a recent piece, Bill Gross, the company's co-chief investment officer, singled out Canada and Germany as countries at the top of its list for investment.

Canada is "going to come much closer to a very stable debt dynamic very soon, whereas the U.S. won't for as far as the eye can see," said Scott Mather, Pimco's head of global portfolio management, where he oversees \$90-billion. "It's an interesting difference between two countries that have so much in common."

Mr. Mather is putting that view to work in a variety of ways. First there's a bet that the loonie will strengthen on the back of Canada's constructive fundamentals. What's more, the currency is gaining favour among global central banks that are looking to reduce their reliance on U.S. dollars in their reserve holdings. Russia's central bank, for instance, has started buying Canadian dollars.

"No doubt less-outspoken reserve managers are considering it and beginning to do the same thing," Mr. Mather said.

On top of buying the currency, Pimco is snapping up different types of Canadian government debt. Not all investors agree with this course of action: One of the reasons they like the Canadian dollar is because they believe the Bank of Canada will soon raise interest rates, providing further incentive to hold the currency. But higher interest rates mean lower bond prices.

The catch in this case, Mr. Mather believes, is that investors have raced ahead in anticipating rate hikes. He doesn't think they'll materialize in the size that the market expects. He also likes longer-dated government bonds, especially because they don't face the same risks as similar debt in the U.S. There, gigantic borrowing needs raise the spectre of higher long-term interest rates, pushing down bond prices.

A few demur from the bullish consensus, either staying away from Canada or betting against it. One hedge fund manager who has been selling the loonie - an unsuccessful trade lately, he admitted - pointed to the fact that Canada's current account balance, a broad measure of the difference between exports and imports, has deteriorated significantly. That means the country must attract capital flows to fund the gap.

Meanwhile, investors such as Mr. Brain remain enthusiastic. He thinks the Canadian dollar will surge through parity versus the U.S. dollar. In a world where a number of major currencies are tainted by rising debt burdens, he said, the loonie is one that belongs "in the beauty parade rather than the ugly contest."

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