Getting a handle on the impact of currency

Currency returns are an important factor impacting any Canadian investor purchasing a non-Canadian asset. Since the underlying investments of these assets are bought in a foreign currency, the appreciation or depreciation of the foreign currency against the Canadian dollar can either add or detract from the total return.

Local Return of Underlying Security + **Return of Underlying Currency vs. Canadian dollar** = **Total Return of Foreign Investment**

The objective of currency hedging is to mitigate the effects of foreign exchange movements, giving Canadian investors a return that approximates the return of the local market.

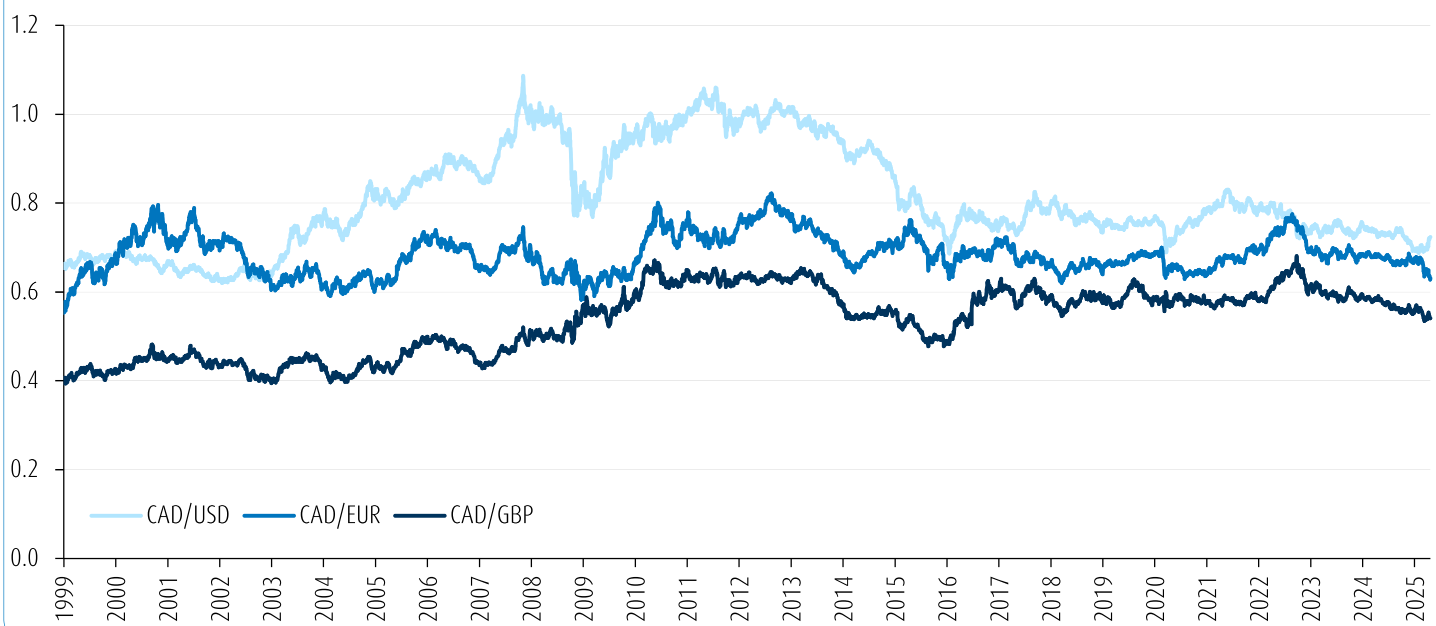
ETF providers offer both hedged and unhedged options giving Canadian investors more tools to efficiently execute their investment strategies. A common institutional approach is to use a blended application, typically 50% hedged, 50% unhedged. Portfolio managers may take an active approach to generate potential alpha* from moves in currency, while others may choose to remain 100% hedged and mitigate currency risks.

Hedging is accomplished by taking a short (sell) position in the foreign currency to match the underlying portfolio. If the underlying currency of the foreign investment loses value relative to the Canadian dollar, these losses would be offset by the gain in the currency forward contract†. Conversely, if the underlying foreign currency appreciates against the Canadian dollar, these gains would be offset by the losses in the currency forward.

The impacts of currency should not be overlooked

In theory, there is purchasing power parity (PPP)‡ between two currencies, to which they will revert to over time. In practice, however, currencies can trade beyond their PPP for extended periods of time, and not all investors are looking to hold an investment over the long-term. Over the short-term, the impact of currency can actually be quite substantial and can lead to added volatility. The chart below shows a historical look at the Canadian Dollar versus other major currencies.

Currency volatility – A long term picture of CAD vs other major currencies



Source: Bloomberg. Monthly value of CAD vs USD, EUR, GBP. As of April 22, 2025. Historical volatility is not an indication of future volatility.

The return of the Canadian dollar vs. other major currencies

Year	U.S. Dollar	Euro	British Pound	Japanese Yen
2010	5.41%	12.89%	9.28%	-7.96%
2011	-2.31%	0.85%	-1.89%	-7.35%
2012	2.96%	1.18%	-1.48%	16.06%
2013	-6.60%	-10.35%	-8.37%	13.39%
2014	-8.59%	3.84%	-2.83%	3.96%
2015	-16.01%	-6.43%	-11.22%	-15.71%
2016	2.96%	6.25%	22.92%	0.17%
2017	6.91%	-6.28%	-2.34%	3.04%
2018	-7.83%	-3.50%	-2.40%	-10.31%
2019	4.99%	7.37%	1.06%	4.00%
2020	2.01%	-6.36%	-1.03%	-2.99%
2021	0.75%	8.17%	1.71%	12.26%
2022	-6.75%	-0.86%	4.38%	6.24%
2023	2.34%	-0.81%	-2.84%	9.88%
2024	-7.93%	-1.80%	-6.28%	2.84%
20 Year Average Return	-0.50%	0.80%	1.63%	2.09%
20 Year Standard Deviation§	8.87%	8.26%	8.25%	12.18%

Source: BMO Asset Management Inc., Bloomberg. As of December 31, 2024.

A closer look at the impact of currency on Canadian returns

	S&P 500 Composite Total Return Index Hedged to the Canadian Dollar	S&P 500 Composite Total Return Index Unhedged to the U.S. Dollar
2009	24.08%	7.39%
2010	13.55%	9.06%
2011	1.71%	4.64%
2012	16.26%	13.43%
2013	33.33%	41.27%
2014	14.32%	23.93%
2015	0.91%	21.59%
2016	11.40%	8.09%
2017	21.16%	13.83%
2018	-5.70%	4.23%
2019	29.87%	24.84%
2020	15.79%	16.32%
2021	28.29%	27.61%
2022	-19.10%	-12.16%
2023	24.74%	22.90%
2024	23.85%	36.36%
Average	14.66%	16.46%
Standard Deviation¶	15.08%	11.80%

Source: BMO Global Asset Management, Bloomberg December 31, 2024.
Index returns do not reflect transactions costs or the deduction of other fees and expenses and it is not possible to invest directly in an Index. Past performance is not indicative of future results.

Currency risk: to hedge or not hedge

The decision can be based on a number of different factors that are specific to the investor.

1. **Investor outlook on the currency**
   As an example, an investor believes the U.S. dollar may appreciate against the Canadian dollar. If this individual is looking to invest in U.S. equities, an unhedged U.S. equity ETF may be more suitable. If the investor's assumption is correct, he will receive both the returns on the underlying securities and the gains on the currency. On the other hand, if an investor believes the foreign currency will depreciate against the Canadian dollar, a hedged U.S. equity ETF may be the better solution. Given his assumption is correct, the investor will get the returns from the underlying securities, however, the loss of the U.S. dollar relative to the Canadian dollar will be mitigated.

2. **Time horizon of the investor**
   Over shorter periods, it is more likely that currencies can deviate from their equilibrium values as measured by PPP. Given the higher unpredictability over shorter time horizons, hedging currency risk may be a consideration for these investors.

3. **Correlation of investments and currency**
   An understanding of the correlation** between investments and its currency may also impact the decision. Some currencies, such as the U.S. dollar, tend to be negatively correlated with equity markets. Consequently, the currency can provide an additional source of diversification for investors. An unhedged position can potentially reduce the volatility of the investors portfolio.

   On the other hand, an investor may wish to currency hedge their Euro exposure given the currency has tended to move in the same direction as equity markets††. For currencies that tend to be positively correlated to equities, the currency can add additional volatility to the portfolio.

Correlation of asset classes and currency

Asset Class	U.S. Dollar	U.S. Equity	U.S. Fixed Income
U.S. Dollar	1.000	-0.415	-0.494
U.S. Equity	-0.415	1.000	0.466
U.S. Fixed Income	-0.494	0.466	1.000

U.S. Equity proxy: S&P 500 Index
U.S. Fixed Income proxy: Bloomberg U.S. Aggregate Bond Index 10 year correlation, as of December 31, 2024.

Source: BMO Asset Management Inc., Bloomberg, December 31, 2024.

4. **Cost of the underlying hedge**
   Currency forwards that are very liquid, such as the U.S. dollar, are less expensive to hedge. On the other hand, for underlying currencies that are less liquid, such as those for emerging markets, hedging foreign exchange exposure becomes more costly and less efficient.

   In recent years, ETFs have made accessing U.S. and international markets easier for investors. However, the decision on whether to hedge currency risk tends to be overlooked by many investors. As currency could significantly benefit or disadvantage the total performance of a foreign investment, it should not be taken lightly. The number of hedged and unhedged ETFs allow investors more opportunities to meet their investment objectives.

BMO ETFs Currency Road Map

Equity

BMO S&P 500 Index ZUE (hedged to CAD) · ZSP (unhedged) · ZSP.U (unhedged USD traded)	BMO S&P US Mid Cap Index ZMID.F (hedged to CAD) · ZMID (unhedged) · ZMID.U (USD units)	BMO S&P Small Cap Index ZSML.F (hedged to CAD) · ZSML (unhedged) · ZSML.U (USD units)	BMO NASDAQ 100 Equity Index ZQQ (hedged to CAD) · ZNQ (unhedged) · ZNQ.U (USD units)
BMO MSCI USA High Quality Index ZUQ.F (hedged to CAD) · ZUQ (unhedged) · ZUQ.U (USD units)	BMO Low Volatility US Equity ZLH (hedged to CAD) · ZLU (unhedged) · ZLU.U (USD units)	BMO Equal Weight US Banks Index ZUB (hedged to CAD) · ZBK (unhedged)	BMO US Dividend ZUD (hedged to CAD) · ZDY (unhedged) · ZDY.U (USD units)
GOLD BMO Gold Bullion ZGLD · ZGLD.U (USD units) · ZGLH (Hedged to CAD ETF)	BMO Dow Jones Industrial Average Hedged to CAD Index ZDJ (hedged to CAD)	BMO Equal Weight U.S. Health Care Index ZUH (hedged to CAD) · ZHU (unhedged)	BMO MSCI USA Selection Equity Index ESGY (unhedged) · ESGY.F (hedged to CAD)

Sector

NEW

BMO SPDR Select Sector Index ETFs

Available in Hedged to CAD (.F) or Unhedged

Mgmt Fee: 0.19%

Distribution Frequency: Annual

- ZXLR / ZXLR.F — BMO SPDR **Real Estate** Select Sector Index ETF. **Risk Rating:** Medium to High
- ZXLE / ZXLE.F — BMO SPDR **Energy** Select Sector Index ETF. **Risk Rating:** High
- ZXLU / ZXLU.F — BMO SPDR **Utilities** Select Sector Index ETF. **Risk Rating:** Medium
- ZXLK / ZXLK.F — BMO SPDR **Technology** Select Sector Index ETF. **Risk Rating:** Medium to High
- ZXLB / ZXLB.F — BMO SPDR **Materials** Select Sector Index ETF. **Risk Rating:** ZXLB: Medium, ZXLB.F: Medium to High
- ZXLP / ZXLP.F — BMO SPDR **Consumer Staples** Select Sector Index ETF. **Risk Rating:** Medium
- ZXLY / ZXLY.F — BMO SPDR **Consumer Discretionary** Select Sector Index ETF. **Risk Rating:** Medium to High
- ZXLI / ZXLI.F — BMO SPDR **Industrials** Select Sector Index ETF. **Risk Rating:** ZXLI: Medium, ZXLI.F: Medium to High
- ZXLC / ZXLC.F — BMO SPDR **Communication Services** Select Sector Index ETF. **Risk Rating:** ZXLC: Medium, ZXLC.F: Medium to High
- ZXLV / ZXLV.F — BMO SPDR **Health Care** Select Sector Index ETF. **Risk Rating:** Medium
- ZXLF / ZXLF.F — BMO SPDR **Financials** Select Sector Index ETF. **Risk Rating:** Medium to High

Structured Outcome

BMO US Equity Buffer Hedged to CAD – January ZJAN	BMO US Equity Buffer Hedged to CAD – April ZAPR	NEW BMO US Equity Buffer Hedged to CAD – July ZJUL	BMO US Equity Buffer Hedged to CAD – October ZOCT

Yield Focused

BMO Covered Call Canadian Banks	ZWB (hedged to CAD), ZWB.U (USD Units)
BMO US High Dividend Covered Call	ZWS (hedged to CAD), ZWH (unhedged), ZWH.U (unhedged USD traded)
BMO US Put Write	ZPH (hedged to CAD), ZPW (unhedged), ZPW.U (unhedged USD traded)
BMO Premium Yield	ZPAY.F (hedged to CAD), ZPAY (unhedged), ZPAY.U (unhedged USD traded)
BMO Monthly Income	ZMI (unhedged), ZMI.U (USD Units)
BMO US Preferred Share Index	ZHP (hedged to CAD), ZUP (unhedged), ZUP.U (unhedged USD traded)
BMO Laddered Preferred Share Index	ZPR (unhedged), ZPR.U (USD Units)

Fixed Income

BMO Short-Term US Treasury Bond Index	ZTS (unhedged), ZTS.U (USD units)
BMO Mid-Term US Treasury Bond Index	ZTM (unhedged), ZTM.U (USD units)
BMO Long-Term US Treasury Bond Index	ZTL (unhedged), ZTL.F (hedged units), ZTL.U (USD units)
BMO Short-Term US Bond	ZUS.U (USD units), ZUS.V (USD accumulating units)
BMO High Yield US Corporate Bond Index	ZHY (hedged to CAD), ZJK (unhedged), ZJK.U (unhedged USD traded)
BMO Mid-Term US IG Corporate Bond Index	ZMU (hedged to CAD), ZIC (unhedged), ZIC.U (USD units)
BMO Short-Term US TIPS Index	ZTIP.F (hedged to CAD), ZTIP (unhedged), ZTIP.U (USD Unit)
BMO ESG US Corporate Bond Hedged to CAD Index	ESGF (hedged to CAD)
BMO US Aggregate Bond Index	ZUAG, ZUAG.F (Hedged to CAD), ZUAG.U (USD Unit)
BMO Short-Term US IG Corporate Bond Hedged to CAD Index	ZSU (Hedged to CAD)
BMO USD Cash Management	ZUCM (unhedged), ZUCM.U (USD units)

* Alpha: A measure of performance often considered the active return on an investment. It gauges the performance of an investment against a market index or benchmark which is considered to represent the market's movement as a whole. The excess return of an investment relative to the return of a benchmark index is the investment's alpha.

† Currency forward contract: A financial agreement between two parties to exchange a specified amount of one currency for a prearranged amount of another, at an agreed upon future date.

‡ Purchasing power parity (PPP): a popular macroeconomic analysis metric used to compare economic productivity and standards of living between countries. (source: investopedia)

§ Standard Deviation: A measure of risk in terms of the volatility of returns. It represents the historical level of volatility in returns over set periods. A lower standard deviation means the returns have historically been less volatile and vice-versa. Historical volatility may not be indicative of future volatility.

¶ Standard deviation is average annualized from 2009–2024

** Correlation: A statistical measure of how two securities move in relation to one another. Positive correlation indicates similar movements, up or down together, while negative correlation indicates opposite movements (when one rises, the other falls).

†† Source: Bloomberg December 31, 2024.

BMO | Exchange Traded Funds

by BMO Global Asset Management

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