



## Hedge Funds Are Betting Against the Loonie. Here's Why

### Description

After the U.S. Federal Reserve upped interest rates this month by a quarter percent, many investors seem to think the loonie is ready to continue falling. According to the *Globe and Mail*, hedge funds and other large institutions are increasing their bets against the Canadian dollar. One senior economist from **Merrill Lynch** was quoted as saying, "there's definitely more downside."

What's with all the bearish sentiment and how should you be positioning your portfolio?

### Can't escape the crushing blow of oil

At \$0.72 versus the U.S. dollar, the Canadian dollar has been on a near six-year slide. Back in 2011 the exchange rate exceeded \$1.05 per U.S. dollar. Things have certainly changed since then.

One of the biggest detractors has been falling oil prices. The energy sector contributes significantly to the strength of Canada's overall economy and is responsible for roughly 25% of total GDP. Indirectly, through royalties, land payments, and corporate taxes, the oil and gas sector props up federal and provincial governments that use these funds to pay for essential programs and services such as health care, education, and CPP. This makes falling oil prices a double whammy

As oil prices fell from over \$100 a barrel to under \$40, Canada's economy has turned to disarray in many regions. Unfortunately, things may not change quickly. According to analysts from **Toronto-Dominion Bank**, "the sustained lower price environment is required to reduce investment in the sector further, eventually leading to the production declines necessary to work down the supply glut."

Without a return to higher oil prices, Canada's commodity-linked currency won't have a snapback any time soon.

### A tale of two economies

When an economy is strong, interest rates typically can be raised to fend off inflation and overinvestment. The opposite is true for a weak economy. Because one of the major influences of currency values is the prevailing interest rate, the divergence of the Canadian and the U.S. economy is

playing a big role.

Since the oil collapse, the Canadian central bank has lowered rates two times. Currently, it looks like the market is starting to expect yet another cut. Meanwhile, the U.S. began slowly increasing rates after roughly 10 years. Most believe that this dynamic is here to stay. If that's true and U.S. interest rates start to outpace Canada's, it will represent just another headwind to a rebound in the loonie.

### **What to do?**

Many sectors are hurt by weak currencies, especially companies that need to import materials or goods. This is because foreign materials are now more expensive to buy abroad and ship to Canada. Anybody that exports, however, is in an enviable position as they can produce for less and export to higher-cost countries.

A big exporter to the U.S. is dairy producer **Saputo Inc.** ([TSX:SAP](#)). Over 65% of sales are outside of Canada; many products are sold in the U.S. and Europe. The best news is that international sales are growing, up from just 50% of revenues in 2013. If, like many others, you're still worried about a weak Canadian currency, check out the stocks of big exporters such as Saputo.

### **CATEGORY**

1. Investing

### **TICKERS GLOBAL**

1. TSX:SAP (Saputo Inc.)

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