Should You Buy U.S. Stocks Now?

Description

The Toronto Stock Exchange is weighted heavily in financials and energy. Canadian investors could use more diversification by investing in sectors such as technology and healthcare, of which more choices are available on the American stock exchanges.

However, what might stop investors is the foreign exchange premium one must pay to convert Canadian dollars to U.S. dollars. It costs over CAD$1.37 to convert to US$1, while historically it has cost only about 20% more instead of 37%. So, it implies there's a 17% premium to convert the loonie to the greenback right now.

Does it mean Canadians shouldn't invest in U.S. stocks?

The short answer is, it depends. If you need the diversification and you find stocks at a huge discount to their fair prices, then it might make sense.

For example, **Apple Inc.** (NASDAQ:AAPL) may be a good opportunity for diversification. It earns over 60% of its revenue from outside the Americas.

Apple's shares fell 24% in the past year, and the primary reason for that is due to concerns about iPhone sales. However, the company has been doing a good job in building an ecosystem that interconnects its hardware, software, and services.

In the first quarter of this fiscal year Apple experienced overall revenue growth of only 2%, bringing total revenue to US$75.9 billion. However, foreign exchange had a big impact on it. If constant currency were used, Apple actually experienced overall revenue growth of 8%, bringing total revenue to US$80.8 billion. Its revenue growth is particularly strong in emerging markets and Europe.

At the end of the first quarter Apple also had an active installed base of one billion devices (iPhone, iPad, Mac, iPod touch, Apple TV, and Apple Watch) that have been engaged with its services withinthe past 90 days. The installed base drove more than US$31 billion in related purchases in fiscal year2015 (up 23% year over year) and almost US$9 billion in the first quarter of this fiscal year (up 24%year over year).

At about US$96 per share, Apple trades at about 10.7 times its earnings, which is not expensive for the US$540 billion market cap technology giant. Apple's normal trading multiple indicates it could trade between US$120 and US$135 per share, indicating its shares are discounted by 20-28% and could rise 25-40% from current levels. On top of that, it also pays a yield of almost 2.2%.

With a payout ratio that's under 25%, it could increase its dividend by 7-10% in the second quarter.

Conclusion

On a case-by-case basis, investors need to determine if a U.S. stock has a big enough margin of safety to overcome the premium required to convert the Canadian dollar to the U.S. dollar.

In the case of Apple, after applying the foreign exchange premium, there's about 3-11% margin of safety for the price you're paying.

Another consideration for investors is if there are Canadian stocks they don't have exposure to but are priced at a value. If there are, it might make sense to invest there first instead of paying a 17% premium for the currency exchange.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NASDAQ:AAPL (Apple Inc.)

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