Market Crash 2020: Beware the Elevated Currency Risk When Buying U.S. Stocks

Description

The market crash of 2020 has presented numerous millionaire-maker opportunities to Canadian investors who have some cash on the side and are willing to pounce on a weak stock market as COVID-19 paralyzes equity and commodities markets globally.

The ongoing crisis came with a steep spike in currency risks which may limit potential returns and diversification benefits for Canadian investors.

The United States offers the largest and most widely diversified stock market in the world. U.S. equities, as measured by the **S&P 500 Index,** are down by over 30% from their recent peak valuation.

The S&P 500 (up by 110%) has significantly outperformed the Canadian **S&P/TSX Composite Index** (up just 5.6%) by wide margins over the past decade. There's good reason to believe it could do so again in the future, and even more so as the U.S. Federal Reserve goes on an unlimited asset-buying spree in an attempt to fight a COVID-19 induced recession this year.

This looks to be the best time to buy the dips on U.S. company shares and profit from an almost obvious upside when the pandemic subsides and the world economies come back to life from quarantines.

That said, the American dollar has surged. Canadians face an elevated currency risk when trading the U.S. stock market crash in 2020. This risk needs a critical evaluation.

An elevated currency risk exposures

The United States Dollar (USD) has appreciated by about 10.5% against the Canadian Dollar (CAD) so far this year. The USD/CAD currency pair currently trades near 1.44. We last saw such trading levels back in 2016.

This is good news to Canadian investors with USD-denominated investment accounts. The recent

USD currency appreciation cushions against portfolio losses in local currency terms.

However, portfolios are denominated in CAD for the majority of local savers and investors, which makes sense. The major portion of one's personal investments should ideally be denominated in one's spending currency.

Local investors might lock in a 10% currency depreciation loss when converting Canadian dollars to take advantage of beaten-down American stocks.

No currency losses may be seen if the local unit doesn't recover against the American dollar during one's investment horizon. Conversion risks on short-term trades may be therefore be low during the 2020 market crash.

However, currencies do have a tendency of swinging back to historical average trading ranges. This could happen with the local dollar unless a fundamental shift in economic structure and performance occurs.

If a return to near the historical USD/CAD: 1.30 average exchange rate happens before today's trades are closed out, a 10% currency loss may need be expected. Perhaps one should buy only those stocks where at least double-digit gains are expected during the investment horizon.

This shouldn't be a big problem, however — especially for long-term investors seeking diversification and an exposure to high-quality U.S. stocks that appear beaten down today.

Foolish takeaway

A sudden plunge of the CAD against the United States Dollar increases currency risk to Canadian investors looking to buy American stocks today.

That said, diversification benefits and some currency exposure might have cushioned early investors in the vast stock market down the boarder. Such benefits might be worth the risk, everything considered.

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