

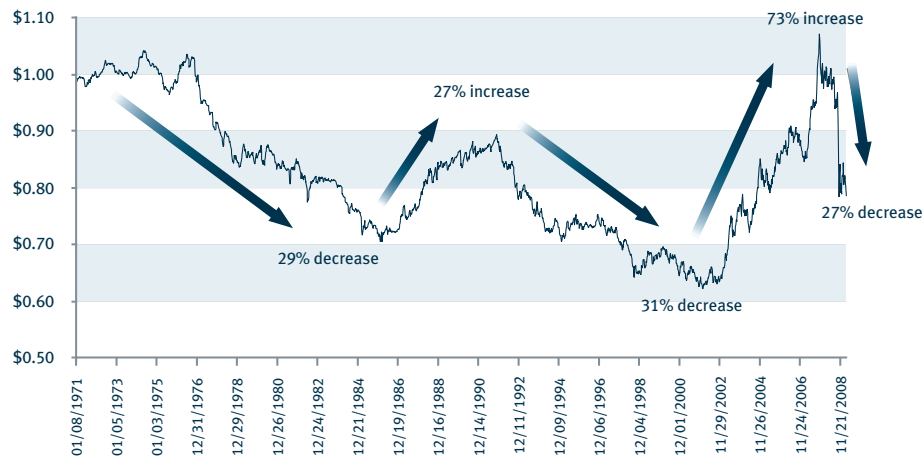
Canadian Dollar Fluctuations and Your Finances

The fluctuation in the Canadian dollar often dominates the daily financial news. Not so long ago, precisely in November 2007, not only did the Loonie trade at par with the greenback, but it even surpassed it to an historical level! Not since the '70 had the Canadian dollar been worth more than its U.S. counterpart. In light of these historical swings, it is important to ask yourself what impact these fluctuations can have on your investment portfolio.

HISTORICAL PERSPECTIVE

From a record low in 2002 to its peek in 2007, the Canadian dollar rose close to 75% against the U.S. dollar in just five years. Yet, since then, a correction of nearly 27% has lowered the value of the Canadian currency against the same U.S. dollar. This significant variation is not unusual, however; since 1971, the Loonie has gone through five major cycles, as shown in the graph below.

CHANGE IN THE CANADIAN DOLLAR VS. THE U.S. DOLLAR (1971-2008)



Source: Bloomberg

The graph shows that in 1991, after 13 years of fluctuations, the dollar had regained its 1978 level. The same holds true for the six-year period between 1982 and 1988. Therefore, whether over a long period or a short period, the currency's ups and downs tend to often cancel each other out, depending on the market events.

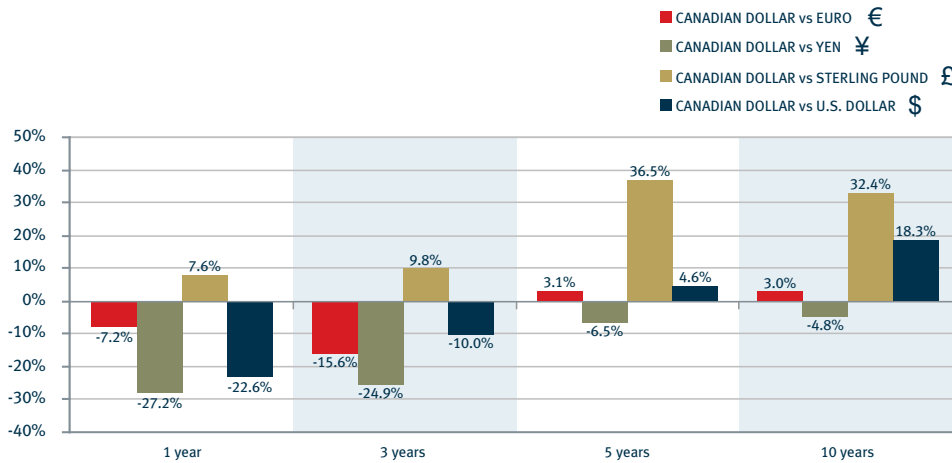
THE CANADIAN DOLLAR FROM A GLOBAL PERSPECTIVE

As for the stock markets, the foreign exchange market also went through an extreme volatility during the last years, when abrupt and unexpected movements often took several analysts by surprise. The fluctuations in the currencies can be imputed to several factors: the correlation of these with the prices of the raw materials, which discriminates the cyclic currencies during economic slowdown, the differences of interest rate between countries, state of the economic situation prevailing in the those countries, the fact that certain currencies can be recommended by the investors as value-refuge, and many others.

On a historic basis, it would have been difficult to foresee that the Canadian dollar could appreciate and depreciate so much. In these circumstances, while the Loonie weakened against the U.S. dollar and certain other currencies, such as the Yen and the Euro, it nevertheless remained strong against the sterling pound during the last three years as shown in the following graph.

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CANADIAN DOLLAR RELATIVE VALUE AS OF FEBRUARY 27, 2009



Source: Bloomberg

On the other hand, over a longer period, the situation turns out different. Consequently, we cannot deduct that the tendency of the Canadian currency against the U.S. dollar applies inevitably to all the currencies at the world level. In short, while the jolts of foreign exchange markets can produce interesting opportunities of investment, it is nevertheless important to refer to a qualified person to determine the best ways to limit the potential currency risks.

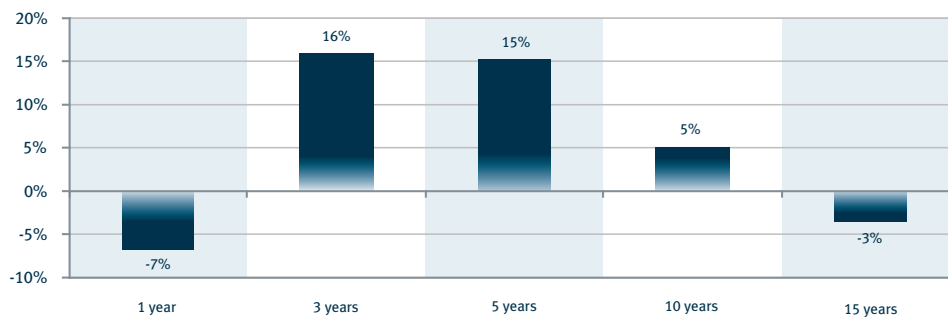
IMPACT OF EXCHANGE RATES ON PORTFOLIOS

The return on a portfolio consisting of foreign securities is affected not only by changes in the price of the equities or bonds held but also by exchange rates. For a Canadian investor, a stronger Canadian dollar means a decrease in the value of his foreign investments because, when reconverted into Canadian dollars, they are worth less. Conversely, a weaker Canadian dollar means an increase in the value of foreign securities. Many people question the soundness of investing abroad and assuming the risk of currency fluctuations. This question is often debated and there are good arguments for and against. Without examining the merits of the question in detail, there is a good reason why a Canadian investor should assume an acceptable level of currency risk: the Canadian dollar is very pro-cyclical.

This means that the Loonie tends to appreciate when economic growth is strong and stock market returns are above normal. Conversely, the Canadian dollar tends to depreciate when stock market returns decline. The impact of the exchange rate on the foreign component of investments will therefore be positive at a very opportune time. As long as the Loonie remains a pro-cyclical currency, exchange rate fluctuations will have a stabilizing effect on returns. They will be disappointing when returns are high, but favourable when returns are low.

Furthermore, while exchange rates greatly affect portfolio returns in the short-term, this impact tends to significantly decrease over time. This is why, for example, the gap between the return of the American S&P 500 benchmark index in Canadian dollars and U.S. dollars narrows as the period examined widens.

GAP BETWEEN THE RETURNS OF S&P 500 IN CDN\$ AND U.S.\$ AS AT DECEMBER 31, 2008



Source: Bloomberg

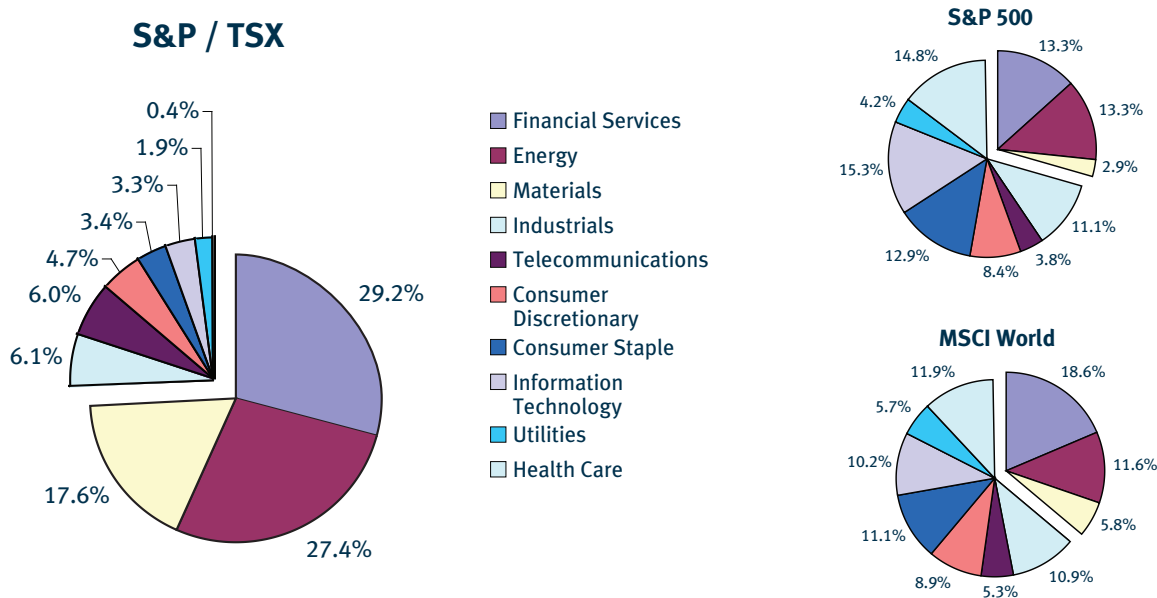
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SOME ADVICE

Beyond the advantages and the inconveniences of the exchange rate fluctuations, it can be profitable to detain international and American stocks or securities. Consider the following points.

Diversify the sectors in your portfolio

Canada' stock market offers poor sector diversification since it is so heavily weighted in Energy, Financial Services and Materials stocks.



Source: World Federation of Exchanges 2008

Think further than United States and Europe

Certain countries offer possibilities of growth with much less impact on currency exchange.

Snowbirds: use the income of American investments

By holding American investments, which produce income and return in U.S. dollars, you can use the funds to pay certain expenses when you are in the United States, eliminating the imbalance of currency exchange.

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When the value of the Canadian dollar rises, investors see the value of their foreign investments erode and vice versa. We need to remember that it is usually preferable to have a relatively long investment horizon for foreign investments. If this is the case, the impact of the currency will probably be less significant and the return on a foreign investment, with or without a currency hedge, will be similar.

National Bank Financial Group advisors receive training that takes these particularities into account. They can therefore help you build an appropriate portfolio. Meeting with your advisor and reviewing your portfolio at regular intervals will allow you to better understand the changes in your investments and the impact of currencies on them. Contact us.

Useful Links:

Currency Rates:

http://www.nbc.ca/bnc/cda/feeds/0,2722,divId-2_langId-1_navCode-9040,00.html

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