

Finding investment opportunities in the global marketplace

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Global equity markets appear to be headed for another year of positive returns. Many of the factors that contributed to market gains in 2004 and early this year remain in

place. These include continuing global economic growth, healthy corporate profits, and attractive valuations in select world markets.

Strong demand from China for raw materials and other goods should continue to boost the fortunes of many companies that do business internationally.

However, TD economists and fund managers believe returns from global equities will be more moderate in 2005, with gains in the range of 5% to 10% in local-currency terms.

The problematic greenback

Of course, a healthy return in “local” terms can be significantly reduced by currency moves, as Canadian investors in U.S. stocks and mutual funds have recently discovered. The U.S. dollar lies at the root of currency concerns. It has weakened considerably against not just the Canadian dollar, but major world currencies such as the euro and the Japanese yen. Growing concerns about the ballooning U.S. trade and fiscal deficits have been putting pressure on the greenback.

For global investors, the volatility in exchange rates creates myriad challenges. Not only do the currency movements affect financial returns, but they also affect eco-

nomic performance. For example, a declining U.S. dollar boosts U.S. economic growth and corporate profits, which is good news for U.S. equity returns. But it also lowers the return foreigners receive when translated back into their local currencies, dampening foreign appetite for U.S. financial assets.

Meanwhile, the greenback continues losing ground against all currencies. Because of central bank intervention, China’s currency has not risen against the U.S. dollar. This means that floating currencies, like the Canadian dollar and the euro, have had to bear a greater burden of the decline in the U.S. dollar.

International opportunities

Regardless of currency fluctuations, global diversification remains an important strategy, especially given the small size of our Canadian markets.

Here is TD Economics’ outlook for some of the major geographic sectors outside of North America.

Latin America. Emerging markets, particularly in Latin America, provided superior returns in 2004. Looking ahead, strong domestic consumption, growing populations, and rising employment should

support markets in Brazil and Mexico.

Europe. Low interest rates, attractively valued shares relative to the U.S. market, and lower-cost labour in some of the European Union’s new member states are positives for Europe. Currency movements have sparked concerns that the region’s exports are less attractive, but corporate profits are expected to hold up relatively well in 2005.

Asia. The outlook for Asian equities is mixed. In Japan, the economy appears to be slowing, which could contribute to turbulence over the short term. On the other hand, Japanese banks are making good efforts to clean up bad loans, and the corrosive impact of deflation is waning. This bodes well for longer-term investments in Japan.

In the rest of Asia, Hong Kong, Singapore, South Korea, and Taiwan should see healthy economic and profit growth, setting the stage for market advances.

China and India continue to lead the world in terms of economic growth, driving demand for commodities and other goods and services. As a result, markets that benefit from strong commodities prices could be in for another good year, even if resource prices level off.

Finally, in a year when returns are likely to vary from region to region, investors might consider a strategy that avoids placing broad bets on individual countries or sectors. ■