

Hedging the Canadian Dollar.

When it comes to currency markets, there is just one certainty; volatility. The value of the Loonie will fluctuate against the value of the US\$ and other currencies. This has an effect on Canadian businesses from large multi-nationals right down to small business operators.

The impact of currency fluctuations is a double edged sword. For Canadian exporters getting paid in US\$, a stronger C\$ represents a direct cost as they receive less value for their receivables.

For Canadian importers paying for goods in Canadian dollars, the strong Loonie represents a windfall gain as they can now buy more with less.

Both sides of this currency equation can benefit from using futures contracts to hedge against adverse movements in the C\$. For the purposes of this article, we will focus on the relationship between the Canadian and US dollars.

For businesses exposed to a strengthening Loonie such as exporters, farmers etc, C\$ futures and option contracts can be used to protect against this rise. For example, XYZ co. has a contract to supply a US company that will be delivered on in 6 months. If the C\$ strengthens against the US\$ in the ensuing 6 months, they will receive less value for their product. For a \$1m contract, a 5% rise in the C\$ means they will receive \$50,000 less for their product than they would have had the C\$ stayed flat (i.e. had they been hedged).

The fact is that the C\$ will not stay where it is. Where it will be in 1 month, 6 months, 1 year, no one can say for sure. It's fine to have a bias as to whether you think the C\$ will be strong or weak, but in order to remove this risk, C\$ futures and options provide an easily accessible and extremely flexible tool.

C\$ futures are traded in contract sizes of \$100,000 so all or a portion of currency exposure can be hedged. For example, in the previously mentioned exposure of \$1m, 10 contracts would be used to hedge the entire exposure ( $10 * \$100,000$ ). If the co. wants to hedge only half of their exposure, they would use 5 C\$ futures contracts.

Conversely, a company paying for goods in US\$, a strong C\$ is a benefit. They would use C\$ futures by selling. This protects them against their buying power diminishing. With the C\$ trading at around 1.05 to the US\$, it represents much greater buying power than was possible even as recently as Sep 2010, when it was at 0.95 to the US\$. In order to preserve this buying power, C\$ futures would be sold.

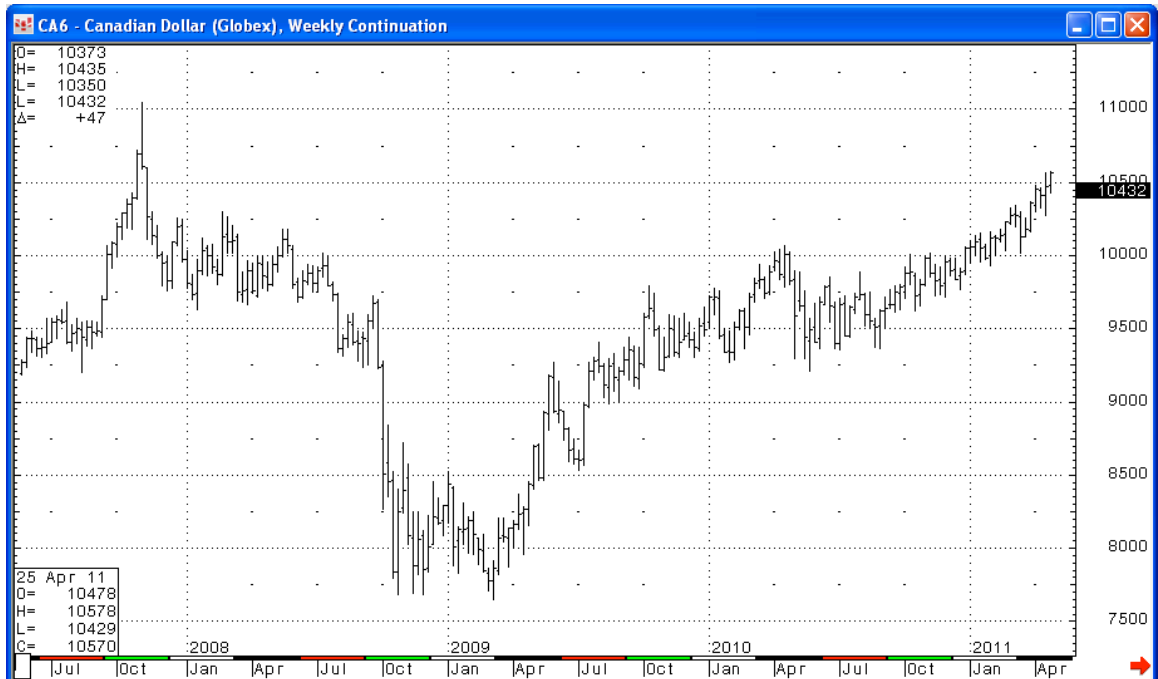
Option contracts are another way to hedge against C\$ fluctuations. Call options are used to protect against a strengthening C\$ while Put options are used to protect against a weakening C\$.

Advantages of futures markets are that they are extremely liquid and flexible. This provides ease of entry and exit and the ability to adjust hedges in the period of time that

they are required. Furthermore, the business that has hedged their C\$ exposure has the piece of mind of knowing where they stand, improving their budgeting and planning ability. C\$ volatility also provides opportunities for speculative trades and is one of the most widely traded currencies by speculators.

For more information, please contact .....

Below is a C\$ chart showing the range .7653 to 1.1043 from May 2007 to May 2011.



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