

# Funds denominated in foreign currency - Does it matter?

If you think buying a fund denominated in a foreign currency is a bad idea, then read on.



**IN RECENT MONTHS**, there has been a strong influx of offshore funds denominated in foreign currency swamping the local investing community. However, at the retail level, the level of acceptance has been lacklustre. One myth is that, one would be exposed to foreign currency risks since the funds are denominated in foreign currency. But is it true that one avoids foreign currency risks if the fund is denominated in Singapore Dollars?

Let's take a simple example.

| SCENARIO | EXCHANGE RATE |      | VALUE OF FUND WORTH USD \$100 IN SGD |
|----------|---------------|------|--------------------------------------|
|          | USD           | SGD  |                                      |
| A        | 1.00          | 1.70 | \$170                                |
| B        | 1.00          | 2.00 | \$200                                |

Assume the Singapore Dollar suffered a depreciation from USD 1.00 : SGD 1.70 (Scenario A) to USD 1.00 : SGD 2.00 (Scenario B). Under that event, a fund worth USD \$100 would be valued at SGD \$200 (up from SGD \$170).

Does it matter if it was quoted USD \$100 or SGD \$200 to a Singapore Investor? The value of the asset to him would be the same and the effect of the Singapore Dollar depreciation is impacted, irregardless of the currency denomination of the fund. One cannot avoid foreign currency risks by buying a US fund in SGD dollars as the investment would be converted to USD to buy US assets.

So should investors base their investment decision on foreign currency risks? Well, it really depends on the underlying asset of the

investment. If the underlying asset is cash or money market instruments, foreign currency risks obviously take precedence over others, given the lack of volatility of these assets. Conversely, if the underlying asset is in equities, the situation may be different. For example, the recent slump in the USD has improved its exports competitiveness and the impact of the repatriated earnings in stronger foreign currency (e.g. Euro) has boosted its bottom line. Therefore, it may be worthwhile to invest in US markets despite its depreciating currency as long as the improvement in earnings outweighs any depreciation of the USD.

The ultimate question is, if there is little difference between a fund that is denominated in foreign currency or Singapore dollars, why not denominate the fund in Singapore dollars to avoid any potential confusion? Well, the main objective is to obviate the need for a feeder fund structure (middleman) to direct any investment funds directly to offshore funds denominated in foreign currency. These off-shore funds have generally larger fund sizes (normally in billions) and in turn enjoy greater economies of scale, resulting in lower operating expenses than most Singapore feeder funds (normally not exceeding 50 millions). While it takes a while for the investing community to accept funds denominated in foreign currency, it may be worthwhile to revisit it as these funds may possibly provide a more cost-effective alternative to most Singapore feeder funds.

**CHONG KOK PENG** is an Independent Financial Advisor with New Independent