Your Employee and Family Assistance Program is a support service that can help you take the first step toward change.

How foreign investing can decrease risk in your RRSP

Most Canadians have grasped the idea that diversification across the three asset classes—cash, fixed-income and equities—is one of the keys to successful long-term investing for retirement. But to be truly effective, diversification needs to go beyond asset classes.

Benefits of foreign investing

For maximum performance potential and minimum risk, your portfolio needs geographic diversification. Here's why:

Look beyond our borders. Even when returns from Canadian equities are excellent, beware: Holding a 100 per cent Canadian portfolio in your Registered Retirement Savings Plan (RRSP) is potentially dangerous. Restricting your investments to just one country—even one with a healthy economy and good prospects for growth—leaves your portfolio vulnerable to the ups and downs of that one economy.

Suppose markets in Europe or Asia are taking off, just when Canadian markets are declining. If you're 100 per cent invested in Canada, you'll miss out on the foreign markets' growth and feel the full force of the domestic decline.

The performance factor. Canada is a small player in global terms, representing less than three per cent of the world's total capital markets. Restricting your investments to Canada means that your RRSP is missing out on almost 97 per cent of the world's investment opportunities. And even when Canadian market performance has been good, other markets can be performing even better.

How to get foreign exposure. You are allowed to hold up to 30 per cent of your RRSP's book value in foreign assets. Book value means the original cost of the assets in the plan (plus distribution adjustments), not their current market value.

An easy way to invest in foreign markets is through international mutual funds. They will give you foreign exposure, growth potential and diversification. A huge variety of international equity and bond funds are available; some focus on a single country or economic region, while others hold a diversified portfolio of investments from around the world.

Global investment options

Here is a selection of eligible investments with global flavour:

Canadian mutual funds. Every RRSP-eligible Canadian mutual fund has its own 30 per cent foreign content limit. Check the fund's simplified prospectus to find its foreign exposure.

You could, for example, put 30 per cent of the total amount you can contribute into a foreign content mutual fund, and the other 70 per cent of your contribution into a fully eligible Canadian fund that's fully using its limit. You then actually have 51 per cent placed outside Canada—30 per cent by you and 21 per cent through the eligible Canadian fund.

Clone funds. A clone fund uses custom-made forward contracts to track a specific underlying foreign fund. Clone funds approximate the foreign fund's performance (higher expenses mean they may make a bit less), yet are considered Canadian content.

RRSP-eligible index funds. These funds use derivative products to track at least one established stock or bond index. To count as Canadian content, they keep at least 70 per cent of their money in Canadian treasury bills or cash equivalents.

Certain Canadian equities. A growing number of top Canadian companies derive a large part of their earnings from foreign operations or exports—but their shares are still Canadian content. Examples include Bombardier, CanWest Global Communications, and Four Season's Hotels. You may hold these stocks directly, or some of your mutual funds may already invest in these types of companies.

Index-linked GICs. The returns of these Canadian Guaranteed Investment Certificates are based on the performance of foreign stock exchanges.

Corporate paper. Certain Canadian organizations, like the federal Export Development Corporation, have issued notes that base interest on the performance of foreign stock exchanges or certain sectors. These notes offer full foreign exposure, yet count as Canadian content.

Foreign-pay debt instruments. A wide range of bonds and stripped coupons from Canadian entities are denominated in foreign currencies, especially the U.S. dollar. For example, a Manitoba government bond issued in U.S. dollars acts like a bond from a U.S. issuer with the same credit rating, but counts as Canadian content. The same goes for foreign currency bonds from agencies such as the World Bank.

Labour-sponsored funds. For every $1 you invest in a labour-sponsored investment fund or qualified small business, you get $3 of additional foreign content. This could push your total foreign content limit as high as 50 per cent.

International exposure is necessary to generate the long-term growth you need in your RRSP, and help protect your registered portfolio from any market downturns in Canada. Unless you're among the Canadians who are taking full advantage of foreign content in their RRSPs, you may want to rethink your approach to foreign investing and become involved.