



U.S. Dollar Option



What is the purpose of offering the US\$ currency purchase option?

Many mutual funds in Canada, including some offered by Fidelity Investments, are offered in both Canadian dollar (CDN\$) and U.S. dollar (US\$) purchase options. The US\$ purchase option is a convenience designed to allow investors who already hold U.S. dollars to invest directly in a mutual fund. If the US\$ purchase option were not available, the investor would have to convert the US\$ to CDN\$ first, resulting in foreign exchange costs. The advantage of using the US\$ option is that investors are able to avoid the costs associated with converting from one currency to another. But investors should be aware that buying a Fund's units in U.S. dollars does not affect the investment return and, in particular, does not hedge – or protect – against losses caused by changes in the exchange rate between the Canadian and U.S. dollars. If you wish to reduce your exposure to currency fluctuations, you should consider an investment in a Fidelity currency neutral fund.

Is there a cost to investors when calculating a price per unit in US\$?

No. There is no cost to translate a CDN\$ price to a price per unit in US\$. To determine a US\$ unit price, a fund uses a benchmark exchange rate with no cost or spread. For example, if the price per unit in CDN\$ is \$10.00 and the benchmark exchange rate is $\text{CDN\$ } 1.00 = \text{US\$ } 0.80$, then the price per unit in US\$ is \$8.00.

When I convert CDN\$ to US\$ at the bank, there is always a cost associated with it. Is that the case when I'm moving from CDN\$ to US\$ in a Fidelity fund?

That is not the case when moving from CDN\$ to US\$ option of a Fidelity Fund, which is really just a redenomination of the investment. The reason for this is the difference between translating and converting CDN\$ to US\$.

In order to change a CDN\$ unit price of a fund to US\$, the CDN\$ is translated to US\$. Translation is an accounting function that simply expresses a CDN\$ value as a US\$ value using a benchmark exchange rate. For example, if the exchange rate is $\text{CDN\$ } 1.00 = \text{US\$ } 0.80$, then you would translate $\text{CDN\$ } 100.00$ to $\text{US\$ } 80.00$. Therefore, there are no costs associated with translation.

On the other hand, when you go to the bank to exchange CDN\$ for US\$, an actual trade occurs, and the bank will convert one currency for another. Therefore, unlike translation, conversion involves an actual transaction in which money changes hands. The bank will charge a spread for providing that service, which is the cost of conversion. For example, if the posted benchmark rate is $\text{US\$ } 0.80$ per $\text{CDN\$ } 1.00$, the bank might give you $\text{US\$ } 0.79$ per $\text{CDN\$ } 1.00$. The same $\text{CDN\$ } 100.00$ would be $\text{US\$ } 80.00$ when you *translate* it, but if you were to *convert* it you would only get $\text{US\$ } 79.00$. The \$1.00 difference is what the bank charges for providing the currency conversion service.

Why do some fund companies talk about having "pure" or "true" US\$ funds?

Some mutual funds are now available *only* in U.S. dollars. These are sometimes referred to as "pure" US\$ funds. Typically these are U.S. equity, balanced or fixed income funds. The words "pure" and "true" in this context are really marketing terms. The economics of such funds are essentially the same as when you buy a regular fund using the US\$ purchase option. When you compare a "pure" US\$ fund with a US\$ purchase option, with the same underlying investments and associated fees, performance should in most cases be virtually identical.

I was told that funds that are not “pure” US\$ funds have to convert their portfolio to CDN\$ in order to determine the NAV. Is this not inefficient?

Although funds that are not “pure” US\$ funds do have to “convert” their portfolio to CDN\$ in order to determine a CDN\$ NAV, this is done by translation and is simply a bookkeeping exercise. It does not expose the US\$ option holders to any cost relating to the CDN\$/US\$ exchange on a nightly basis. Therefore, it is not inefficient to go through this exercise, as no foreign exchange costs are incurred.

How is the sale of the US\$ option of a fund taxed? How are the distributions taxed?

For tax purposes, capital gains and losses are calculated in Canadian dollars. As a result, if you buy and redeem units under the U.S. dollar option, you need to calculate gains or losses based on the Canadian dollar value of your units when they were purchased and when they were sold. In addition, although distributions are made in U.S. dollars, they must be reported in Canadian dollars for Canadian tax purposes. Therefore, all investment income is reported to you in Canadian dollars for income tax purposes.

For tax reporting, the CDN\$ value is determined based on the exchange rate on the ex-date, while capital gains/losses will use the sale price in CDN\$ using the spot rate on the date of sale (or settlement), minus the purchase price in CDN\$ using the spot rate on date of purchase (or settlement). Lastly, keep in mind that the gain/loss will be the same whether CDN\$ or US\$ units of a fund are held.

If I am invested in the CDN\$ version and the US\$ of the same fund, in the same series, will the returns I receive differ based on the currency purchase option difference?

The returns for both the CDN\$ and US\$ version of the same fund will be exactly the same once translated to the same currency (which is necessary for an “apples to apples” comparison). The difference between the stated CDN\$ and US\$ performance of the same fund will reflect the relative change in the currency exchange rate from the time of purchase to the time of redemption. The current spot rate will reflect the difference in the NAV of the two currency purchase options.

I understand that there are no costs associated with calculating the price per unit in US\$. However, I’m still worried that if I buy a fund that takes in both CDN\$ and US\$ from investors, there is going to be a cost to convert those CDN\$ inflows to US\$, so that the fund manager can invest in the U.S. I believe this will affect my returns. What should I do?

The costs for converting CDN\$ inflows to US\$ are so small that they are generally insignificant for overall performance. The reason is that when larger amounts or volumes are converted or exchanged, pricing tends to become more favourable. Because of the sizable amounts of currency Fidelity transacts in, we receive an institutional rate that is more attractive than the rate charged by banks to an average retail investor. Additionally, in most larger funds, only a very small percentage of a fund’s assets would need to be converted from CDN\$ to US\$ (or vice versa) on any given day, because daily flows in or out of a fund tend to make up only a small portion of its asset base.

Example (for illustrative purposes only)

TODAY

Let's assume that the CDN\$/US\$ spot rate is $\text{CDN}\$1.00 = \text{US}\1.00 and the price per unit for a fund in CDN\$ is $\$20.00$.

Suppose two investors want to purchase this fund in different purchase options: Investor A wants to invest $\$10,000$ in Canadian dollars and Investor B wants to invest $\$10,000$ in U.S. dollars. Given that the exchange rate is $\text{CDN}\$1.00$ to $\text{US}\$1.00$, the US\$ NAV of the fund would be the same as the CDN\$ NAV of the fund, so each investor would receive 500 units of the Fund at $\text{CDN}\$20.00$ for Investor A and $\text{US}\$20.00$ for Investor B.

ONE YEAR LATER

Let's assume that the CDN\$/US\$ spot rate is $\text{CDN}\$1.08 = \text{US}\1.00 (the CDN\$ has depreciated).

Suppose the NAV of the fund in CDN\$ has appreciated to $\$25.00$. Investor A, who has 500 units, will now have a total value of $\text{CDN}\$12,500$.

Given the current exchange rate, the US\$ option price per unit would be $\$23.15$ ($\text{CDN}\$25 \div 1.08$). Investor B has 500 units at a price of $\text{US}\$23.15$ per unit for a total value of $\text{US}\$11,575$.

It would appear that Investor B has underperformed Investor A; however, it must be taken into account that the CDN\$ has depreciated relative to the US\$ (or the US\$ has appreciated relative to the CDN\$). Taking the $\$11,575$ that Investor B has in US\$ and converting it back to CDN\$ at the current exchange rate ($\text{CDN}\$1.08$ to $\text{US}\$1.00$) gives the same value as Investor A ($\text{US}\$11,575 \times 1.08 = \$12,500$).

For more information, contact your advisor or visit [fidelity.ca](https://www.fidelity.ca)



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Fidelity currency neutral funds use derivatives to mitigate the funds' exposure to changes in exchange rates between the U.S. dollar and the Canadian dollar. The investment approach used by the funds, while effective in reducing exchange rate risk, will not completely eliminate the impact of currency fluctuations. The funds' returns will differ from the local currency returns of their underlying funds.

