Expat Dosh - Dollars or Dong? Pounds or Pesos?

Managing your money is hard enough when you are in your home country and using your own currency...

As an expat, you may find yourself constantly recalculating exchange rates. Because of their lifestyle, expats typically need to cope with multiple currency regimes due to mismatches between home currency, salaries, resident currency and assets held in various global locations.

Rapid movements in FX markets can wreak havoc with expat net worth and cash flow, and can lead to more permanent destruction in wealth if not handled carefully.

Unfortunately, it is very difficult for the typical expat to hedge currency risk, particularly for those operating in the emerging markets. Some strategic thinking and careful management, however, can go a long way in managing currency risk for many expats.

Identify a core currency.

This should be the currency in which your assets will eventually be spent. If you plan to retire in the EU., your core currency should be the Euro.

If you're not sure where you'll end up then the USD or a mixture of key reserve currencies (USD, Euro, GBP, JPY) can be used.

The key is to avoid a significant mismatch between your assets and the currency where those assets will be spent.

Hold an adequate emergency fund in your country of residence.

Ensure you have sufficient cash for day-to-day needs and emergencies in both the currency of your country of residence, and of your citizenship. If there were an emergency, these are likely to be the currencies you would need to access quickly and easily.

You don't want to have your reserve funds in a depreciating currency when you need them. In some cases it may be more appropriate to split emergency funds between other currencies depending on your specific situation and where the funds would likely be needed.

Beware of the currency risk in overseas investment property.

It is easy to be caught up in the expatriate experience and want to buy into the property markets where they live and work.

Be aware, though, that most property purchases represent a major part of many expats' net worth, often larger than their investment portfolio. If the property is not in your base currency, realize that you are exposing yourself to a major currency mismatch that can result in a significant loss if things don't work out.

A property in a country where the currency falls, effectively devalues the property, so you can lose in your core currency when you come to selling, as well as gradually decreasing rental income.

Equally, a mortgage on property in a country with rising currency value may prove increasingly difficult to service, if your employment income is not in the same currency. If there is no guaranteed rental income to offset the FX increase, this problem is simply made worse.

Avoid taking currency risk in the fixed income portion of the portfolio.

The fixed income portion of a portfolio is about preserving principal and managing volatility. Adding a currency mismatch can add unintended volatility to the overall portfolio. In general, fixed income should be in the expat's core currency, or several currencies to hedge. Bear in mind that there are global and specific country funds which hedge to another currency.

Don't hedge equity.

In a globally diversified portfolio, I would argue there is little need to hedge the equity portion. Unlike fixed income, currency adds little to equity volatility. The benefits of diversification and the higher returns of equity tend to dilute the effect of currency over the longer term.

If you really feel the need to hedge, use hedged mutual funds and ETFs.

It is very difficult and expensive to hedge currency risk for individuals, if not impossible.

Financial institutions have an advantage here, being able to access hedging strategies with very little cost (though should we see higher interest rates in the future, those costs would tend to increase).

There are many funds and ETFs now available which hedge back to one of the major reserve currencies.

Currency is not an asset class...

And should not be seen as a separate position in the portfolio. Currencies move relative to each other – that's it! They do not grow in value like equities or provide a cash flow like bonds. Most speculators who try to make money on short-term currency movements end up losing money, so leave it to the expert FX traders. Expats should view currency from a risk perspective rather than as a speculative opportunity.

Avoid multi-currency mortgages.

Multi-currency mortgages where you can choose and switch the currency your mortgage is paid in can look attractive, but may be a disaster.

This is pure currency speculation where the risk is far greater than any interest rate savings you may hope to gain.

The mortgage currency risk simply compounds the currency risk based on the property location.

Beware of high-yielding deposits and dual currency products outside your base and resident currencies.

Investing in high-yielding deposits denominated in other currencies is pure currency speculation. High-interest deposit rates usually go hand-in-hand with high inflation and depreciating currencies. You may win one percent on the interest rate, only to lose both interest and chunks of capital if the currency falls. This also goes for dual-currency deposits where you receive slightly higher interest rates by giving the bank the option to repay you in the weaker currency.

Consider currency risk in your employment negotiations.

This is especially important for those working in the emerging markets, where often the emerging market sees its currency drift downwards with time.

- Malaysian Ringgit. 2011 to 2015 fell 50% from 3.0 to 4.5 MYR/USD
- Philippine Peso. 2013 to 2018 fell 33.5% from 40.6 to 54.23 PHP/USD
- Vietnam Dong. 2010 to 2018 fell 31% from 17,815 to 23,347 VND/USD

However, exceptions also apply, and can be painful!

A salary in British Pounds or New Zealand dollars right now would be hurting those employees based almost anywhere, but if you are resident in Thailand, this is almost certainly painful.

For example, the GB Pound has gone from 55.02 THB on 13th August 2015 to 37.14 THB on 13th August 2019. That is a drop of 32.5%.

Similarly, the New Zealand Dollar has moved from 28.49 THB in July 2014 to it's current 19.84 THB, a drop of 30.3%

Rapid changes in exchange rate can result in a major loss of income that will not be covered by the employer unless negotiated ahead of time. It therefore makes for good practice to consider FX as part of any employment negotiations.

Salary payment in the currency of your residence for that proportion of income you expect to spend there, and the remainder in your core currency might be acceptable to an employer. But do ask at the contract stage, before it is too late.

While currency risk cannot be totally eliminated for many expats, careful planning can mitigate the exposure and the fallout if things get volatile.