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The Current Foreign Exchange Crisis and Your US Dollar Investments

Trinidad and Tobago's economy suffered significantly due to the decline in oil prices since 2014, and coupled with shrinking output, energy revenues have drastically declined. Revenues from petroleum plummeted by over 90% over the last two years, from over TT$19 billion in 2014 to less than TT$2 billion in 2016. This has caused major challenges for the Government, which has had to respond by implementing fiscal adjustments in order to raise revenue and reduce expenses in order to successfully navigate the country through these challenging times.

This has not only affected the Government but citizens and businesses alike. As a result of the reduced inflows, the availability of foreign exchange (FX) has been drastically reduced, which is a major concern for most people in Trinidad and Tobago. The FX market has been tight since 2015 and the demand for FX is outstripping the supply, with no signs of improvements in the near future. This greatly affects the availability of US dollars.

In order to combat the lack of FX, it has been suggested by numerous sources to allow the TT dollar to depreciate against the US currency. In 2016, the International Monetary Fund (IMF) released a report which stated that by their estimates the Trinidad and Tobago currency remains substantially overvalued. The two separate methodologies used both indicated a sizeable real exchange rate gap. The Current Account model estimated the currency to be overvalued by 23% and the Real Exchange Rate Model produced an estimate of 50%.

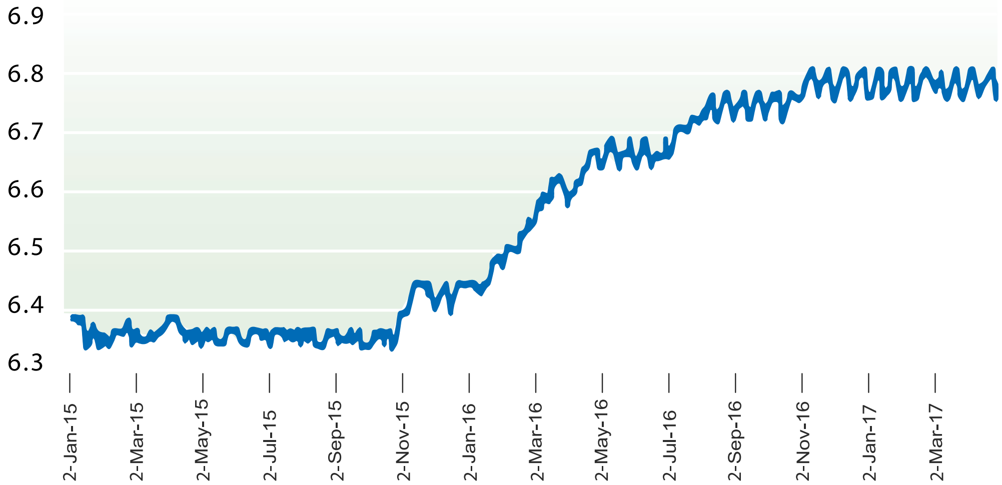
How the Foreign Exchange Market is Currently Managed in T&T

In April 1993, Trinidad and Tobago adopted a floating exchange regime, which means that the value of the Trinidad and Tobago dollar appreciates or depreciates in response to changes in supply and demand conditions in the FX market. The Central Bank of Trinidad and Tobago (CBTT) is responsible for the management of the FX market in the public's interest. However, the Central Bank also has the authority to intervene in the FX market to contain undue volatility in the exchange rate. According to their website, before a decision is made to intervene, a number of variables are assessed. These include current economic conditions, competitiveness of the exchange rate, short-term imbalances and the level of international reserves. Therefore, in essence, the FX system is a managed float.

In actuality, the Central Bank mainly manages the exchange rate through its regulation of the maximum market sell and buy rates, as well as through FX provision. Approximately one-third of the total market FX supply is from the Central Bank via discretionary, non-competitive allocations to licensed authorised dealers. The dealers' maximum sell rate is set by applying a fixed margin over the latest rate at which the CBTT sells FX to authorised dealers, which is known as the intervention rate. The minimum buy rate is set at the mid-rate for the prior day.

In response to the unavailability of FX, in November 2015, the CBTT adopted a conservative approach and began to allow the TT dollar to slowly depreciate. As a result, it depreciated by approximately 5.8% as at the end of April 2017 (see Chart 1). Previously, the USD exchange rate had been maintained within a narrow range of +/- 1.5% around TT$6.35/US$1.

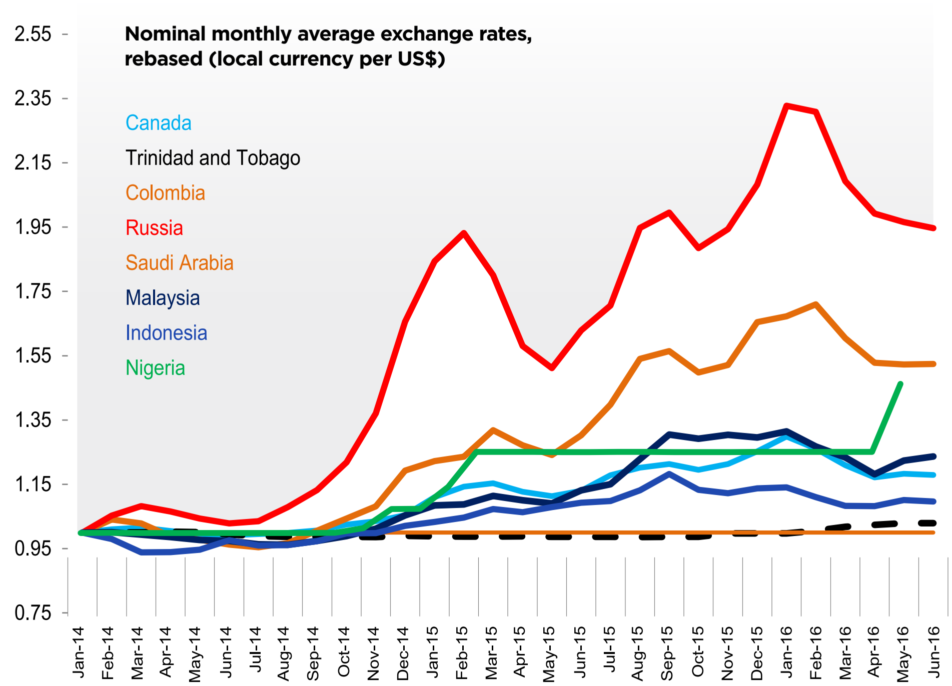
CHART 1 | USD Exchange Rate



Source: Central Bank of Trinidad and Tobago

Trinidad and Tobago is not the only country faced with the challenges resulting from the decline in oil prices. The Inter-American Development Bank released a report in October 2016 which looked at the responses other oil exporting countries took to counteract the declining oil prices. It stated that other oil exporting countries, in order to stabilise their economies, made the decision to nominally devalue their respective currencies, more or less in line with the importance that oil represents in their export and fiscal revenue. Except for Trinidad and Tobago and Saudi Arabia, oil exporters' currencies moved downwards over a range of 10% to 95% during the period January 2014 to May 2016 (see Chart 2).

CHART 2 | Nominal Devaluations by Oil Exporters



Source: Inter-American Development Bank – Diversification in Trinidad and Tobago – Waiting for Godot?

The report went on to explain that the main reason oil exporters decided to devalue their respective currencies was to increase oil revenues in local currency and thereby reduce the extent of fiscal adjustments e.g. tax increases, that might be required. Notwithstanding the positive effect devaluing the TT dollar would have on the coffers, this approach by itself would have a drastic effect on the country's economic environment; for e.g,, inflation is likely to increase if importers of foreign products choose to pass the increased import costs to consumers.

While the Government figures out the best course of action to help alleviate the FX shortages, without causing more harm to the economy, it is clear that how you choose to handle your current US dollars is extremely important.

Making Your US$ Work for You

The scarcity of US dollars in the challenging FX environment has resulted in many persons hoarding their US dollars in US savings accounts at banks nationwide which have minimal interest rates attached. This course of action, is not the most beneficial option as returns are extremely low. If, on the other hand, people choose the appropriate investment vehicle suited to their risk appetite from the wide range of available options, they open themselves up to the possibility of achieving greater returns. This course of action is not risky as there are many different avenues one can take to achieve this goal; many local institutions offer US dollar investments with higher returns than the typical bank rate.

For a more conservative investor, whose main goal is safety, and therefore the preference is to shy away from riskier investments, there are US dollar mutual funds which provide greater returns than the average savings account at the bank, thereby making them a more rewarding alternative. From UTC's product offerings, the US$ Income Fund is perfect for investors of this nature. It seeks to meet the needs of short to medium-term investors looking for potential to earn income while having access to their funds without penalties.

If as an investor, you are willing to add some riskier investments to your portfolio, the US dollar denominated bonds are a suitable option. As a result of the high risk, the interest is higher than that of a mutual fund but varies depending on the rating of the issuer and the investment grade of the bond. However, the downside to these are that they are not as easily assessible or as frequent.

The more aggressive investors, who have an even higher risk appetite, can consider adding US dollar equities to their investment portfolio. Local equity markets have been outperformed by US equity markets. Table 1 shows the quarterly performance of three major US stock indexes compared to Trinidad and Tobago's Composite Index for 2016 and the first quarter of 2017.

TABLE 1 | 1 2017 Stock Indexes Performance

Country	Index	Returns				
		Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017
Trinidad and Tobago	Composite Index	-2.51%	0.22%	1.87%	4.56%	2.01%
United States	Dow Jones Industrial Average	1.49%	1.38%	2.11%	7.94%	4.56%
	S&P 500	0.77%	1.90%	3.31%	3.25%	5.53%
	NASDAQ	-2.75%	-5.60%	9.69%	1.34%	9.82%

If you choose to invest US dollars in US equity markets, which have outperformed local equity markets, the possibility for potential returns is high. It must be noted, however, that the potential for losses is also magnified if the equity markets change course.

Even though an investor may be willing to take some risks, the thought of directly investing in the US stock market might be too daunting and risky, and as such, equity mutual funds are a good alternative. At UTC, we currently have the North American Fund – a medium to long-term investment – which offers diversification throughout the North American market. The Fund is invested primarily in equity and fixed income securities guaranteed by Governments and corporations in the North American region.

Despite the dreary FX situation facing the country, there are many avenues an investor can take to make the most of the current US holdings. Keep in mind that investments in US dollars could potentially earn dividends in US dollars, which in itself is a strong incentive to consider USD investments.

Investment Checklist

Ascertain your personal goals and objectives

Before you make any investment decisions, you must first have a thorough understanding of your goals as it will aid in determining the best investment instruments for you. Equities are a good investment for long-term goals as your portfolio will be protected from short-term fluctuations in the market.

However, for shorter investment goals, less volatile options such as fixed income or mutual funds are more appropriate.

Determine your risk appetite

Everyone is unique and as such, people have varying risk appetites depending on the level of risk they are comfortable undertaking. There is no right or wrong answer – greater risks have the potential for greater returns but also increased losses. Nevertheless, there are various investment opportunities suitable for different levels of risk appetites.

Understand current market conditions

Trinidad and Tobago's economy is constantly changing as it tries to readjust itself to the difficulties it is experiencing because of the decline in oil prices. It is therefore essential that you keep up to date with current market conditions. The more knowledge you have, the better prepared you will be to successfully navigate through all challenges that may arise.

Talk to your Financial Advisor

Your Financial Advisor will ensure that the decision you make on your investment portfolio is best aligned to your financial goals and objectives, as well as your appetite for risk. Your Financial Advisor will also be able to recommend investment strategies that will assist you through any market fluctuations.

Mail

Ms. Amoy Van Lowe
Vice President
UTC Advisory Services
3rd Floor, UTC Financial Centre
82 Independence Square
Port of Spain

Contact

(868) 624-8648 Ext. 8113

Email

yourwealthmanager@ttutc.com

About the Advisory Services Department

The Advisory Services Department of the Trinidad and Tobago Unit Trust Corporation was established to serve our valued clients seeking financial and investment advice and solutions from a trusted service provider. We will assist you in enhancing your personal wealth and financial well-being by providing you with financial counselling, investment advice and solutions.

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