What are Foreign Bonds?

Foreign bonds are fixed income securities that are issued in a country different than the company's country of operation or origin, using the currency of that second country. An example of this would be an Apple bond (an American company) issuing bonds in Canada, denominated in Canadian dollars, or a Canadian bank issuing in the U.S., priced in USD.

Advantages of foreign bonds

Issuing foreign bonds offers advantages for both companies and investors. For the issuer, foreign bonds allow them to raise capital in alternative markets, which can be crucial for funding operations. If a company has a facility in the foreign country, or requires that currency to pay for input materials, it can be easier to issue directly in that market to match that need.

Benefits to the investor depend on their location. If they are located in the issuer's domestic country, investing in the foreign bond provides an income stream in another currency. For example, a Canadian may wish to invest in a U.S. bond to receive US dollars to use when at their vacation home in Florida. If the investor lives in the foreign country, diversifying with a new foreign issuer is made simpler by the elimination of currency exchange risk. These investors do not have to worry about fluctuations in exchange rates affecting their returns while still benefitting from this diversification. This is highlighted in the Apple bond scenario in the introduction.

Currently, Canada accounts for less than 5% of the global debt market, meaning that a staggering 95% of the market remains untapped and underutilized if investors restrict themselves to CAD bonds. By venturing into foreign bonds, investors can access a broader range of opportunities and potentially enhance their returns. For instance, the yield on US treasuries may be higher than its Canadian counterpart, illustrating the potential for better yields in other markets.

Risks of foreign bonds

Investing in foreign bonds also has its associated risks that all investors should consider. Though highlighted as a potential benefit, dealing in a foreign currency can be a risk. When investors purchase foreign bonds with CAD, they may be subject to exchange transaction fees and the volatility of currency exchange rates, impacting returns. Today, Raymond James only allows investors to hold USD and CAD bonds in their native currencies. Therefore, if an investor buys a bond denominated in Mexican pesos, it will be converted to either USD or CAD, depending on the account in which it was bought. This conversion process can add another layer of complexity and potential cost.

Investing in foreign bonds exposes investors to additional risks, such as political instability, changes in government policies, or inflation in the country where the bond is issued. Such factors can impact the bond's performance and the investor's returns. Tax implications and reporting requirements are considerations when buying a bond in a foreign currency. Consulting a tax professional is advisable to navigate these complexities. In addition, foreign bonds may have lower liquidity than domestic bonds making it more difficult to sell in situations where investors need capital.

Overall, while foreign bonds can offer diversification and potentially higher yields, they also come with a range of risks that need to be carefully managed. If retail investors are looking to invest a satellite position into international fixed income, perhaps consider an ETF or mutual fund with a bond manager who specializes in this area. They would be well equipped to managing the risks with foreign bond investment while maximizing benefits. However, there are drawbacks from investing in unitized products – for a full overview of the pros and cons for each, please refer to *Choosing Between Baskets and Individual Bonds.*