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YOUR MONEY

While Alluring, Foreign Currencies Can Be Elusive

Dr. Jim Nickerson, a retired dentist in Fort Worth, bought shares in a yen fund and tracked it closely.

By JANE BIRNBAUM

Interest rates on savings accounts are falling. The dollar is weak. And the stock market is up one day and down the next. It is no wonder that even normally timid investors are hearing the siren song of foreign currencies.

The question is whether they should heed it.

While experts have different opinions about investing in foreign currencies, they all agree that such investments are not for the faint of heart.

"In today's uncertain economy, it is understandable that people may turn to foreign currencies in search of profit and a sense of control over their money," Nouriel Roubini, a professor of economics and international business at New York University, wrote in an e-mail message. "However, they may not realize it is a form of speculation, not investment, which may well end with lack of control and significant loss."

Experts like Peter Morici, an economist and a University of Maryland business professor, and Vivian Lewis, editor of the Global Investing newsletter, warn most small investors to steer clear of investing directly in the currency markets, which can rapidly move against them. It is a tricky arena, they say, dominated by fast-moving events and seasoned global players trading more than $1 trillion daily.

Information about foreign currency — and ways to purchase it online through certificates of deposit and exchange-traded funds and notes — has never been more available. That can raise expectations, says Paul Karger, a managing partner of Twin Focus Capital Partners, a money management firm in Boston.

Mr. Karger said he remembered an e-mail message from a high-net-worth client wanting to know why his cash was not in three-month Icelandic krona CDs paying over 11 percent interest.

“I wrote back that it looked tempting, but it’s more than a yield story,” Mr. Karger recalled. “People could start dumping the krona, and when he converted his CD back into dollars, he could wind up losing money.”

In late March, Iceland’s central bank, facing a credit crisis, raised interest rates to 15 percent to dissuade investors from selling the krona — precisely the situation Mr. Karger was concerned about.

Still, some experts think there is a place for foreign currencies in an average investor’s portfolio. Adrian Day, chief executive of Adrian Day Asset Management in Annapolis, Md., argued that investing in foreign currency can be part of a broader strategy to defend against what he views as a fundamentally weak dollar. Investors can purchase select foreign stocks and bonds, he said. They can buy stock in American companies with strong global sales. And they can hold some foreign currency.

“It should be seen not as a short-term investment that will make you rich, but as long-term insurance to hedge a weak dollar,” Mr. Day said.

The best time to buy foreign currency is when traders and investors are buying the dollar, in so-called dollar rallies, which may last up to six weeks, he added. That is when investors get the most foreign currency for their dollar.

“Novice buyers must consider what they are doing and their time frame,” Mr. Day said. “The danger is you freak out and sell after your first decline. You need to know why you are buying, then hold your position.”

The cost of investing in foreign currencies is higher than that of buying a regular CD or exchange-traded fund. Investors in foreign currency CDs pay to convert back into dollars, as well as penalties for unwinding their positions early. Investors in currency exchange-traded funds pay higher expense ratios than most exchange-traded fund investors.

Sophisticated traders with a lot of money sometimes buy foreign currency with a higher interest rate and simultaneously go into the futures market to sell it forward — meaning they contract to sell the same amount of currency at a specific price at a later date. In the parlance of such trading, that is a “single play.” The traders are insulated from a loss if the exchange rate moves against them, though they still reap the interest, said Peter Orr, a retired bond dealer living in Panama and Salt Lake City.

A “double play” — also known as an “open” or “naked” trade — is not hedged, which makes it both riskier and potentially more lucrative. “Here you’re profiting from the foreign currency’s higher interest rate plus the exchange rate as it appreciates against the dollar,” Mr. Orr explained in an e-mail message. But success depends upon the foreign currency’s continued strength.

About two years ago, Mr. Orr, an Australian who keeps a close watch on his native country’s economy, decided that going naked in the Australian dollar was a “no-brainer,” he wrote. “My strategy was the Aussie dollar would appreciate toward par with the United States dollar, so I would be making 6 percent on the Australian one-year treasury bills, plus a huge appreciation — from 72 U.S. cents on the Aussie dollar to, say, 90 cents."

Unfortunately, Mr. Orr said, he could not find a bank in Panama that would sell him Australian dollars. Today, each one is worth about 94 United States cents, and most Australian one-year treasuries pay 6.25 percent, he wrote.

Mr. Orr advised currency buyers to research foreign nations and their credit risks, determine at the start their own risk-reward ratio and tolerance to volatility, and have exit strategies, while watching their positions constantly.

Walt McManus, a real estate investor and former banker based in Towson, Md., said investing in foreign currency requires research and passion. "If you're just trying to make money," he said, "it won't work because without the passion, you won't understand the psychology of foreign currencies."

Five years ago, Mr. McManus's first purchases — EverBank CDs in New Zealand, Canadian and Australian dollars — represented more than 30 percent of his total invested assets. He recently sold his euro and yen CDs, and just rolled over Norwegian krone, Swedish krona and Swiss franc CDs.

In Fort Worth, Dr. Jim Nickerson has managed his own money since retiring from dentistry and oral surgery in 1986. After Rydex introduced its yen exchange-traded fund last year, Dr. Nickerson started buying shares that accounted for about 10 percent of his total invested assets of about $1 million.

The shares began rising steadily in July. As the dollar bottomed on March 17, they peaked.

The next day, they declined sharply. "I saw a significant reversal of direction, and I didn't want to give up those profits," said Dr. Nickerson, who during market hours had been checking the shares' real-time quotes every 15 minutes since buying them. "I pulled the trigger and took an $18,750 profit."

Creative thinking and being in the right place at the right time helped Julie Moeller make a triple play on foreign currency and real estate.

After a divorce in 2000, Ms. Moeller used the proceeds from her settlement to buy and rent out real estate in London, where she had been raising her three children. Then she moved home to the Detroit area.

"I knew the pound would be appreciating against the dollar, and it would be easier if I had money in pounds and spent it in dollars," she explained.

Last year, when Ms. Moeller calculated that London real estate, as well as appreciation between the pound and the dollar, had reached historic highs, she sold a home she had bought for the equivalent of $1.6 million. "Let's not be greedy," she recalled thinking. The house fetched almost $7.7 million.

While Ms. Moeller's investments are more diversified today, she remains enthusiastic about foreign currency. Having never traded it, she experimented early this year, buying $20,000 worth of shares in the Rydex yen exchange-traded fund. She held them almost two months, then sold for a gain of about $1,200.

Ms. Moeller understood the risk. "I was willing to lose the $20,000," she said.

According to Mr. Orr, foreign currency is extremely risky now in the midst of a “giant credit squeeze” and derivative problems that are sending many investors scurrying for the safety of Treasury notes. “My experience tells me that one needs to slow down now, and keep the powder dry,” he wrote.

Even those sternly warning average investors away from foreign currency do make exceptions. When told of a Chinese yuan exchange-traded fund planned by WisdomTree, Richard K. Lyons, a former professor of finance at the University of California, Berkeley, and now chief learning officer at the investment bank Goldman Sachs, called it “an interesting idea.”

Thinking an average investor can “do better than a spot trader at any large bank” is “basically ridiculous,” he said. “But the interesting thing about the yuan-dollar exchange is China’s central bank controls the yuan, and they’re allowing it to appreciate by decree, rather than by market forces.”