Benefits to an international investment passport

How investing globally can help reduce risk and increase investment opportunities.

INVESTORS TEND TO DISPLAY what is known as "home bias" – the tendency to stay focused on our own backyard.[1] Investing at home can be especially attractive to Canadians because of our relatively strong and stable economy. But are domestic investments always the right choice? Before putting too many eggs in one basket, consider the risks and rewards of where you choose to invest.

Investing too heavily in the Canadian economy

The Canadian economy, while probably most familiar to us, is relatively homogeneous. Three sectors – financials, energy and materials – make up nearly 70 per cent of the Canadian stock market.[2] This much concentration can potentially pose risks.

Picture the three sectors as pillars. If most of our economy rests on just three pillars, and one weakens, the entire structure wobbles, as recently demonstrated by Canada's oil industry. The oil crisis in 2015 affected the entire Canadian economy, and the resulting downturn is far from over.[3]

The second limitation is that our economy is comparatively small on the global scale. Canada represents a little more than three per cent of the world's markets. Compare the 247 companies in the S&P/TSX Composite Index to the 2,470 in the MSCI All Country World Index.[4] Going beyond our borders provides access to more top companies in all sectors.

What does this mean in practical terms? Say an innovation in the auto and truck manufacturing sector catches an investor's eye. The world's largest auto and truck manufacturing companies are not in Canada, but in Japan and Germany.[5] To gain exposure to the latest developments in this sector, the investor should look beyond Canada's borders.

The upside potential of going global

Investing across the world makes us less vulnerable to the ups and downs of one country's economy. According to Todd Millay in Forbes, "Owning both domestic and international stocks reduces the overall volatility

[1] insight.kellogg.northwestern.edu/article/theres_no_place_like_home
[2] Morningstar Direct, October 31, 2016.
[3] www.macleans.ca/economy/economicanalysis/life-at-20-dollar-oil-nation-divided/
[4] S&P Dow Jones Indices LLC, S&P/TSX Composite Index Factsheet, October 31, 2016, ca.spindices.com/indices equity/sp-tsx-composite-index/; MSCI Inc., MSCI All Country World Index, October 31, 2016., www.msci.com/documents/10199/8d97d244-4685-4200-a24c-3e2942e3adeb
[5] www.forbes.com/global2000/list/

of the portfolio since they do not move in lockstep. This diversification improves the risk-adjusted returns of a stock portfolio."[6]

Emerging markets' rapid rate of growth is another reason to invest abroad. Chinese and Indian economies are typically growing much faster than their North American counterparts. Globalizing our portfolio gives us direct access to that growth.[7] Investors with global exposure could be in a position to benefit from a wider range of potential upsides.

That's the basic premise behind diversification – it helps reduce risk and increase investment opportunities. Going back to the pillar analogy, a global portfolio rests on dozens of pillars across multiple industries and geographies. If one or two pillars fail, the portfolio is still well supported by many others.

[6,7] www.forbes.com/sites/toddmillay/2016/02/10/think-strategically-invest-globally-2/#6c0a965079b2
[8] retirehappy.ca/how-much-should-you-invest-globally/

How much to invest?

One theory of diversifying globally suggests investing domestically in proportion to your country's market capitalization versus the rest of the world.[8] This means that Canadians should be investing just over three per cent of our portfolios' equity portion in Canadian companies, and the rest globally. In more realistic terms, however, determining the right amount to allocate globally depends on an investor's time horizon, risk tolerance and financial goals.

Speak with an advisor

Regardless of where and how much Canadians invest, an advisor can make investment recommendations based on our individual life goals and risk profiles. No matter where we invest, success takes patience. It's a long journey, but good guidance can help us stay on the right path. ■

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