INVESTOR

Global diversification: Consider expanding your investment horizons

Helping you make informed investing decisions

Don’t put all your eggs in one country’s basket

We’ve all likely heard about the dangers of putting all your eggs in one basket. As children, the proverb was used to teach us not to concentrate our efforts in one area or depend on one plan for success. But this familiar saying also holds lessons for us when we invest—and *where* we invest as well.

You wouldn’t entrust your financial stability to the future of one stock, or even of one sector, or even of one asset class. Few of us are likely to own only bonds, or only stocks. Most investors own a mix of stocks and bonds across a variety of different sectors. The logic of this is evident: Every asset class reacts differently to macroeconomic or political events, or to changes in market sentiment. When one asset class goes down, for example, another asset class may go up. When you hold various assets classes, the result is often a smoother ride for the investor, and a better night’s sleep.

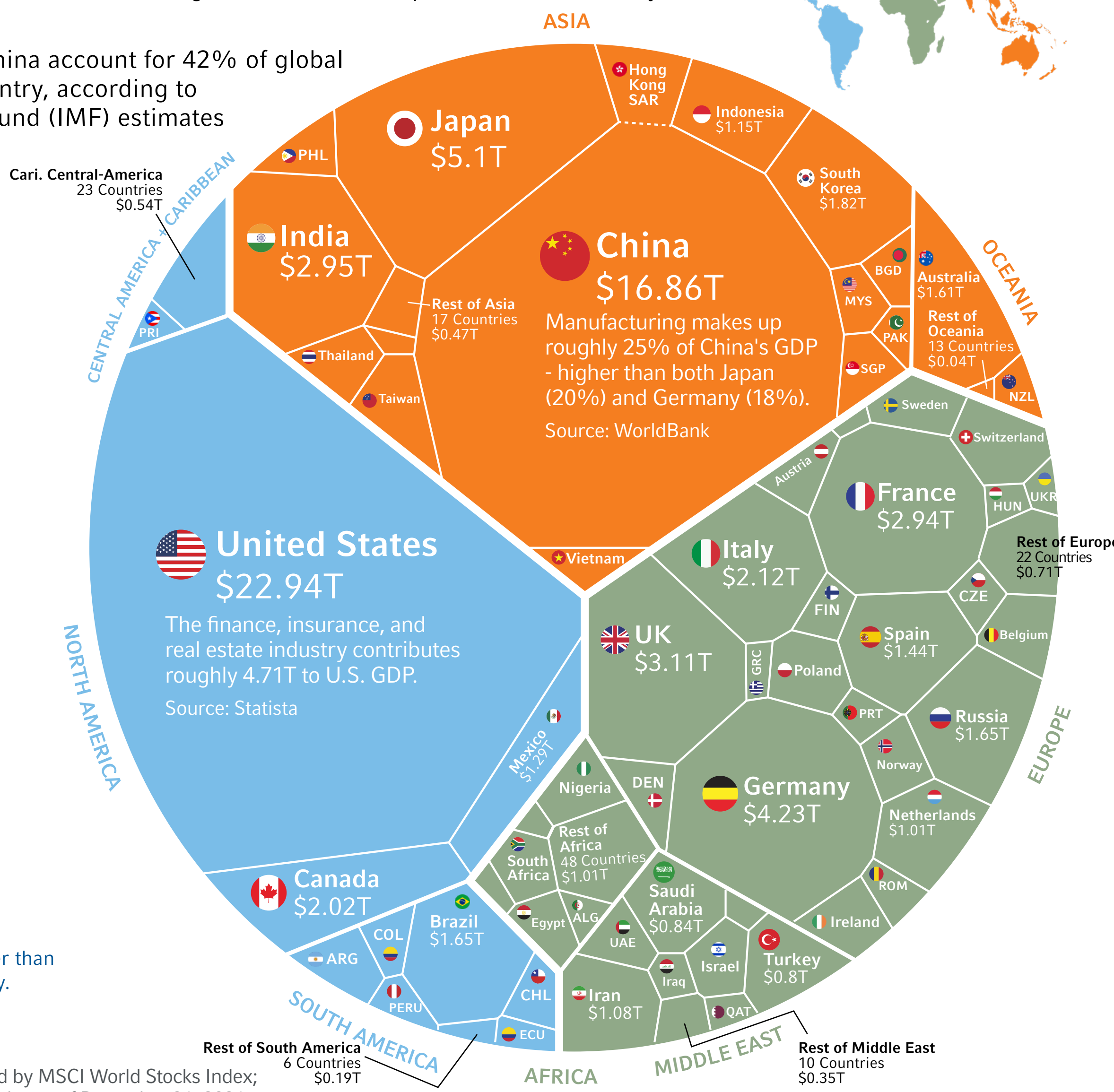
But many investors may overlook the crucial aspect of global diversification. We generally gravitate to the familiar, which means we prefer to invest in the stocks of companies we know—those that are listed on our domestic stock exchanges. This is known as *home-country bias*. Considering Canada represents only approximately 3% of world stocks[1], diversifying globally provides investors with significant additional investment opportunities.

But as we enter a new year—with the global economy continuing to recover from the effects of the pandemic and many sectors returning to normal—adding geographic diversification to our portfolio may be something to seriously consider.

Global GDP

Gross domestic product (GDP) serves as a barometer for a country's economic health. It measures the total market value of final goods and services produced in a country during a given year.

Together, the U.S. and China account for 42% of global GDP. Here is GDP by country, according to International Monetary Fund (IMF) estimates (in USD).



Other country’s GDP:

Philippines	$0.39T
Thailand	$0.55T
Taiwan	$0.79T
Vietnam	$0.37T
Malaysia	$0.37T
Bangladesh	$0.36T
Singapore	$0.38T
Hong Kong SAR	$0.37T
Argentina	$0.46T
Colombia	$0.31T
Chile	$0.33T
Nigeria	$0.48T
South Africa	$0.42T
Egypt	$0.40T
UAE	$0.41T
Israel	$0.47T
Denmark	$0.40T
Ireland	$0.52T
Poland	$0.66T
Norway	$0.45T
Romania	$0.29T
Finland	$0.30T
Austria	$0.48T
Czech Republic	$0.28T
Belgium	$0.58T
Switzerland	$0.81T
Sweden	$0.62T

Only 18 countries have a greater than 1% share of the world economy.

Source: IMF (2021)

[1] Source: World stocks represented by MSCI World Stocks Index; Canada represents 3.3% of this index as of December 31, 2021.

Four reasons to consider diversifying globally

1. **Stock concentration.** Big tech now dominates the U.S. S&P 500 index, while energy and banks are the main drivers of Canada's S&P/TSX Composite index. But tech does not dominate in Europe. For example, the biggest companies in Germany's DAX index are carmakers and software solutions, while on the UK's FTSE index, it's a mix of energy, consumer goods, banking and pharmaceuticals. Japan's Nikkei 225, meanwhile, is dominated by car companies and consumer electronics. By diversifying globally, investors can avoid a single country bias also turning into an industry sector bias[2].
2. **The cycle may be right.** According to our latest Global Market Outlook, the rest of the world is overweight cyclical value stocks relative to the U.S., which has a higher weight to technology stocks. This suggests U.S. stocks should underperform the rest of the world. This theme didn't pay off in 2021, as the U.S. was the best-performing market. However, it could succeed in 2022 as COVID-19 fears recede and a more normal cyclical recovery takes hold.
3. **The location of your physical assets.** Your house and other physical assets are likely domiciled in your home country. They may represent a significant portion of your wealth and will be affected by your country's or region's economic fortunes. If most of your financial assets are also tied to that one economy, you run the danger of seeing all of your assets affected by the same factors. This is truly having all your eggs in one basket.
4. **Demographics tell the story.** You cannot ignore emerging markets. Yes, the U.S. is still the largest and most dynamic economy in the world—but it's unlikely to grow at rates logged by young economies that are rapidly industrializing. At the turn of the century, emerging markets were a niche asset class, but the environment and the opportunity set are very different today. Emerging markets now make up about 40% of the global economy, and according to the IMF, by 2035 they are expected to represent almost 60%[3].

The bottom line

No single country comes close to even half of the globe's total GDP. Investors who concentrate all their investments in their home country—simply because it's familiar—may be missing out on a world of diversification. And as the planet continues to become more integrated and emerging market populations join the ranks of consumers, it's likely we will continue to see market dynamics shift and the global opportunity set grow. Make sure that home country bias isn't the reason you're missing out.

The protective power of global diversification

At Russell Investments, we believe in diversification. We also believe that investing outside your borders can help further diversify a portfolio and smooth out returns. And we're not the only ones to hold this view. According to a 2018 study by Asness, Israelov & Liew in Financial Analysts Journal, over longer time horizons, "underlying economic growth matters more than short-lived panics with respect to returns, **and international diversification does an excellent job of protecting investors**."[4]

[2] U.S. stocks represented by S&P 500® Index, Canada stocks by S&P/TSX Composite index, German stocks by DAX index, UK stocks by FTSE 100 index and Japanese stocks by Nikkei 225 index.
[3] Source: Russell Investments, International Monetary Fund, as of October 31, 2019.
[4] Source: https://www.tandfonline.com/doi/abs/10.2469/faj.v67.n3.1

Russell Investments

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IMPORTANT INFORMATION

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