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Adding a global lens to your investment portfolio

Take an institutional approach to global investing

Good investors understand the concept of diversification and its benefits in managing risk. However, although many do diversify with individual holdings, the majority fall short when diversifying from a global standpoint. That's understandable as it's natural to invest in what one knows, which most often means domestic companies with familiar products and services. But there is a lot of opportunity for investors who look farther afield.

Institutional investors and pension funds have long recognized this. The Canada Pension Fund (CPP), ranked as one of the 10 largest retirement funds in the world, has allocated only 16.7% of its equity holdings to Canadian investments, compared to 69.8% for foreign developed markets and 13.5% to emerging markets. For fiscal 2013 they had a 10.1% rate of return. The world's largest pension fund, Japan's Government Pension Investment Fund, has 43.5% of its equity investment allocated to international stocks and posted 10.2% for fiscal 2012.

Investors who stick to investing at home introduce a lot of risk to their portfolios. There are over 30 major equity markets globally and Canada represents less than 4% of world stock market capitalization. The likelihood of at least a few other countries outperforming Canadian markets in the coming years is strong and, just as it is rare for a specific asset class or individual equity to consistently outperform year over year, the same applies to stock markets. Diversifying globally helps spread the risk that Canadian markets may not provide the necessary performance to boost portfolio returns.

Adding a global lens to the portfolio guards against sector concentration. Nearly 80% of the S&P/TSX 60 is comprised of three sectors – financials, energy, and materials. By looking elsewhere investors gain access to sectors such as healthcare, which are under-represented in Canada.

Accessing markets worldwide allows investors to take advantage of global wealth trends. Credit Suisse reports that global wealth has reached an all-time high of USD 241 trillion and the average wealth per adult is USD 51,600. Analysts believe these numbers will increase 40% over the next five years, with emerging markets accounting for 29% of that growth. More wealth brings more funds available to invest, which bodes well for global markets.

For income investors, global investing provides an opportunity to boost overall portfolio yield. According to Guardian Capital, 58% of world market returns are derived from dividends. In some countries the numbers are even higher. In Australia 73% come from dividends and in the United Kingdom it's 63%. Although global

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dividends aren't subject to the Canadian dividend tax credit, investors can hold most global equities in registered plans for tax efficiency purposes.

Investing globally can introduce some risks, such as foreign exchange and liquidity, and transaction costs can be higher in some international markets. Investors can mitigate these risks by accessing global equities via managed products such as exchange-traded funds or mutual funds. These will provide diversified exposure to the global markets, thereby reducing liquidity concerns, and many can be bought with currency hedging. Transaction costs are often reduced by the sheer size of managed products and the resulting economies of scale.

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