



## OVERCOMING HOME-COUNTRY BIAS

*Institutional investors continue to shift their focus toward foreign markets.*

BY ALEXANDRA JEMETZ

**For years, institutional investors** have been hesitant to invest abroad because of their unfamiliarity with foreign markets and companies. However, investors are beginning to shed the home-country bias embedded in their portfolio allocations and embrace the benefits of global diversification.

An oft-cited study by Joshua D. Coval, who at the time was at the University of Michigan, and Tobias J. Moskowitz of the University of Chicago Graduate School of Business, showed U.S. money managers preferred companies based closer to their own locations. The research, published in 1999, found “one out of every 10 companies is chosen because it is located in the same city as the manager.”

This is not an isolated issue for U.S. investors; this is a global phenomenon. For example, Canada represents 3% of the world’s market capitalization, suggesting (according to some financial theories) that Canadian investors should have 97% of their assets invested outside the country. A recent Greenwich Associates survey, however, found investor allocations to non-Canadian equities totaled only 30% in 2007, although that represented an increase from 24% in 2002. High concentrations of home-country securities also are found in U.K., Japanese and Australian portfolios.

### The Times Are Changing

There are signs, however, that institutional investors are shifting away from a home-country bias. For example, Greenwich research reveals an overwhelming majority of Canadian plan sponsors expect to decrease exposure to domestic equities in favor of foreign stocks and bonds during the next three years.

In addition, a number of investment consultants have called for institutional investors to be more aggressive in shedding their home-country biases, with some calling for a 50-50 split between domestic and foreign stocks.

The rationale for increasing foreign investments is widely acknowledged. The risk-reducing benefits of overseas diversification are well-published and rooted in varying economic and political cycles and social differences. In addition, access to well-run, high-quality companies can provide additional sources of return enhancement.

Still, global investing does involve additional considerations — such as currency, interest rate and inflation risks. In most cases, however, these factors can be mitigated with hedging strategies and investors should not let these concerns prohibit a closer examination of their foreign allocations.

### Outside the Comfort Zone

All of the above points must be taken into account in order to determine the appropriate allocation to non-domestic investments. Deciding whether the main goal of your pension plan, endowment or foundation is to maximize performance or reduce risk is a crucial step. Risk and return objectives are also key factors to consider.

In the end, the tendency to invest in something familiar is a hard habit to break. As companies and economies become truly global in scope, however, it is inevitable that investors’ allocations to non-domestic assets will rise. ❖



ALEXANDRA JEMETZ

Director of Canadian Research  
at Northern Trust in Toronto