Don’t ignore global exposure

INVESTING INSIGHTS

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The 2017 Nobel Prize in Economics went to Richard Thaler for his contributions in the field of behavioral finance, an area which is getting growing recognition.

One of the most prevalent biases is that of investor’s home bias or the bias of investing only in one’s own country. A global phenomenon, it is starkly evident in India. Less than 0.20% of investors’ assets in mutual funds (December 2017) were held in global funds (about 42 of them). The issue: With the Indian market doing so well, why should anyone look anywhere else?

Granted. It’s a tough question to answer when the domestic equity market is buoyant. But as rational investment professionals, we should remind ourselves that diversification is an ongoing exercise and not a one-time activity. Remember the 2000 tech bubble or the 2008 financial crisis?

The reason to invest globally is the same reason why people invest in their home country - to earn potentially higher returns on investments. Investing in global funds aids diversification on multiple levels - asset classes, sectors, currencies and geographies.

Not all countries do well or lag in performance at the same time. A commodities driven economy like Brazil would do extremely well if the global commodity markets perform well; while UAE might do well with improvement in crude oil prices. Since global markets necessarily don't move in the same direction as the domestic market, spreading investments across geographies can reduce the overall investment risk from the volatility of the domestic markets.

Some advantages of investing in global markets are as follows:

– Access to specialised international markets
– Protection against loss by spreading investments thereby reducing risks
– Winners keep rotating; different countries outperform at different times
– Access to the expertise of international fund managers (if investments made in global fund of funds)
– Improve potential returns

Investing internationally also lets one capture investment opportunities that arise from fast-growing economies and markets whose currencies are appreciating against local currency. Not only does investing in international products increase the chances of getting higher returns, exposure to foreign currency helps meet future requirements, if any. For instance, if one wants to send their child to one of the foreign countries for higher education, taking exposure to products of that country / currency could help insulate the investments from adverse movement in currency.

How does an Indian investor take exposure to an international market?

Savvy investors may look for investments directly through Liberalized Remittance Scheme (LRS); which is a facility provided by the RBI for all resident individuals to the tune of up to $2,50,000 per person per year. For others, the mutual fund route is one option which offers simplicity as well as avoids the hassle of currency conversion.

- A ‘hybrid international fund’ allocates some portion of its assets to domestic equities and the other to international stocks. A 'feeder fund' which collects funds locally and deploys it internationally, completely into foreign stocks.

- Such funds may be more complicated than domestic funds. Apart from just asset class performance, the performance of global funds also depends on other factors like currency prices movements, how well the other economies are doing, the economic policies of those countries and the easy of repatriation or funds among other things.

- International investments may also come with higher transaction costs. Investors need to keep an eye on expense ratios when selecting international mutual funds, since these expenses are the easiest aspect to control when it comes to generating returns.

- The percentage of international funds in one’s portfolio depends on one’s risk tolerance and the long-term investment plan. Hence, global diversification for an Indian investor should be more of a strategic call than a tactical one; irrespective of whether those markets are doing well at a particular point.

With domestic markets scaling new heights every day, investing the entire portfolio in the Indian market exposes investors to country-specific risks. With growth coming back on the global landscape, exploring possible opportunities in global markets should be an option investors need to keep in mind in the current market conditions.