

Money Matters

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Question of the Month: Should I Invest Globally?

By Aaron Skloff

Q: Whenever I think about investing internationally the hair on the back of my neck stands up, so I avoid it. By being too conservative am I missing the boat on good opportunities?

From coups in Columbia to debt defaults in Russia, it is easy to make blanket statements about the risks of international investing. Only after you peel back the onion do you learn the rewards more than outweigh the risks.

Imagine understanding the principles behind a Nobel Prize. Stop imagining – you can. Dr. Harry Markowitz was jointly awarded the prize in economics for his contributions to portfolio theory. His portfolio theory boils down to this: by combining asset classes that move dissimilarly to one another, you can reduce risk within your portfolio. In practical terms, a recession in the U.S. may not stop the stellar growth in China – they can act dissimilarly to one another.

If you can only remember one thing from this article, here it is: adding international investments to an all U.S. portfolio reduces risk and increases return!

Over the last 30 years ending in 2006, the S&P 500 (an index that represents the U.S. stock market) has generated an annualized return of 12.5%. During the same period, the MSCI EAFE (an index that represents the international stock markets) generated an annualized return of 12.8%. Although the MSCI EAFE generated higher returns, it did so with higher risk. Had you combined both indexes, you would have generated an “optimal” risk and return portfolio.

In the last 50 years, international stocks as a percentage of the world’s stock market value have more than doubled. Approximately 75% of all publicly traded companies around the world are outside the U.S. Investors who do not maintain investments outside the U.S. are missing tremendous investment opportunities.

The emerging markets include countries such as Argentina, Brazil, China and India. Although investments in these markets may entail greater political, economic and currency risks, returns have been stellar. Over the last 10 years ending in April, 2008, the S&P 500 has generated an annualized return of 3.9%. During the same period, the MSCI EM (an index that represents the 25 emerging country stock markets) generated an annualized return of 10.7%.

Not only does investing internationally provide access to some of the world’s leading companies, but the addition of international investments can reduce the risk of your portfolio while increasing its return. Diversify internationally and reap the rewards.

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