

Going Global - Concentrate on Company not Country

By Elaine F. Phipps, MBA, CFA, Portfolio Manager
Point View Wealth Management, Inc.
<http://www.ptview.com>

Investors are constantly trying to attain that holy grail of a diversified portfolio, one that can survive the ebbs and flows of a global economy. Traditional practice led to a concerted effort to put some foreign stock exposure into the mix, the goal being to hop onto hot growth markets and head off volatility back home. This international exposure has often been defined as a company's domicile. However, this may lead investors to overlook the sectors these companies are engaged in at the expense of geography. Our global economy has made it less important where you do business, as opposed to the type of business you are engaged in.

Globalization has broken down the natural and historic barriers of where a company can do business. Companies now sell their products to customers all over the world, deriving a large portion of their revenue and earnings from overseas markets. This includes many of the largest U.S. corporations, subjecting them to the winds of currency swings, overseas economic growth rates and foreign stock markets' gyrations. In addition, production facilities and work forces can be domiciled in many different geographies, affecting production costs and wages and benefits. What is more relevant is what a company does, not where it does it.

Today, the numerous world stock markets also move in tandem with each other. If we wake up to our morning coffee and hear the news of Asian markets stumbling, there is a good chance European and U.S. markets will follow. Buying foreign market securities no longer isolates you from the volatility that may be felt on the home playing field.

Sector allocation remains one of the more important drivers of portfolio diversification and return enhancement. You can look back in history, or to the present day, to see evidence of this phenomena. The dot.com crash of 2000 left few technology companies unscathed both domestically and internationally. In 2008, it mattered little which financial institution you owned – with the exception of those that went bankrupt – as the entire sector suffered. Fast-forward to 2016 and it is hard to find an energy or basics material company that is delivering positive returns to investors, whether is it headquartered in the U.S., Britain or Latin America.

So what does this mean? Not putting too many eggs in one basket or one sector, and not obsessing about geography. Sometimes finding the right sector balance is more important than finding the right geography or the right securities. Look at a company not as a foreign or domestic player based on the geography of its headquarters, but rather on the geography of its client base. Strive for diversification of sectors and don't try and time the market. Other key points:

Global news influences global sectors – Listen to the news, political discussions or read a financial publication, and you will clearly hear a take away message for the repercussions on a particular industry or sector. When Congress and political candidates talk about regulating drug

prices, pharmaceutical companies around the world suffer. When a major terrorist attack happens, travel related companies worldwide, such as airlines and hotels, see their share prices fall. Weak trade data from China pummeled basic materials companies headquartered all over the globe, as China has recently been a huge importer of raw materials. News of a global oil inventory glut continues to batter all energy related shares. It is impossible to pretend to be a domestic company and live in a silo, not feeling the effects of these events.

Economic winds blow afar- A sinking Chinese stock market makes Chinese consumers feel less secure. That may manifest itself in reduced purchases of everything from Coca-Cola, Fords, Coach bags and iPhones. Large economic players have a disproportionate effect on companies around the world given their strong consumer buying power. A slowdown in the Italian economy will not do as much damage to the worldwide economy as one will in China or the U.S.

The perils of playing geography – Many investors look to diversify geographies by purchasing ETFs of specific countries or regions. However, investors should heed the caveat to watch the correlation between them due to similar sector exposure. As an example, adding exposure to Taiwan may inadvertently add technology exposure, as that is a dominant industry in Taiwan. Purchasing a Hong Kong ETF will load you up on the financial sector as it contributes a large portion of GDP.

How does the U.S. stack up? - U.S. investors who do load up on country focused ETFs can diminish their risk somewhat if they also have a diversified portfolio of domestic companies. That is because the U.S. economy is more diversified than most countries in terms of major industries. While financials may be big in Asia and basic materials in Latin America, buying a smattering of Fortune 500 U.S. companies will run the gamut of industrials, healthcare, communications, consumer cyclicals/defensives, technology and utilities to name a few.

What are the major sectors? – As defined by S&P, sectors are noted as those that are cyclical: basic materials, consumer discretionary, financial and real estate; those that are economically sensitive: communications, energy, industrials and technology; and those that are defensive: consumer staples, healthcare and utilities. Try and proxy your portfolio to have a representation of all of these sectors. What percentages you choose to select will have to do with how closely you want to mirror the S&P 500 or how strongly you feel one sector will outperform another.

Which sectors do better at certain times? - While there are no hard and fast rules, cyclical sectors such as technology, industrials and consumer discretionary often outperform as the economy strengthens. Defensive sectors such as consumer staples, health care and utilities hold their own and more as markets decline. Financials tend to perform poorly at the end of an economic growth period, as interest rates climb. However buyer beware, as the big trick is figuring out where we are in the economic cycle in time to shift your sectors. A balanced approach is advocated.

What does this all mean for your portfolio? – Instead of trying to micro-manage international exposure, look for a mix of sectors which will expose you to the different industries that contribute to our global economy. If you pick industry leaders, you will by default have a mix of companies that have international exposure due to their diverse customer base, operations, trade

partners or all of the above. Keep those sectors relatively balanced, not allowing any individual one to grow out of proportion. Always look for solid companies with good growth prospects. Purchasing foreign firms as American Depository Receipts (ADRs) will enhance your liquidity. However, remember that even the strongest player in an industry may fall prey to global influences such as supply and demand, politics, acts of terror and consumer demand. In today's market, geography doesn't insulate you from global events.