

## Investing *Beyond* Canada... *The case for global diversification*

Canada's economic fundamentals are positive. Interest rates are low, inflation is under control, unemployment is stable and political risk appears minimal. All in all, Canada is an excellent place to invest. However, Canada should only make up part of an investor's overall portfolio.

### What is Portfolio Risk?

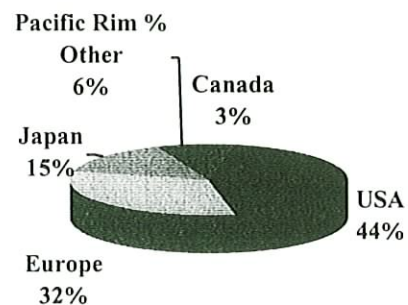
Portfolio risk is the volatility, otherwise referred to as standard deviation of an investor's portfolio. There are two types of investment risk: systematic and unsystematic risk. Systematic risk relates to volatility due to a particular market/economy. Examples include the rise of Canadian interest rates in the 1980's or the oil boycott to the United States in the 1970's. Unsystematic risk relates to volatility due to a particular security. Examples include the unanticipated lawsuits against Dow Corning or the fraudulent findings of Bre-x and the associated detrimental consequences to their stock prices.

### The Case for Diversification

Diversification reduces both systematic and unsystematic risk. Diversifying by geography reduces market-related/systematic risk as an investor's portfolio is divided across many different economies. Diversifying by maintaining a large number of securities (the concept of a mutual fund) reduces unsystematic risk as an investor's exposure to firm-specific issues is reduced.

### The Case for Global Diversification

Canada accounts for less than 3% of the world's market capitalization. That is, investing solely in the Canadian economy removes the opportunity to participate in over 97% of the world's investment potential. As discussed, geographic diversification reduces an investor's systematic risk. In addition, investing in an assortment of economies increases a portfolio's potential returns. In fact, over the past ten years, foreign investments have outperformed Canadian returns while reducing portfolio volatility.



Source: Morgan Stanley, 1997

This article was written by Elliott Levine. Elliott holds both his Honors (HBA) and Masters (MBA) Degrees in Business from the Richard Ivey School of Business at the University of Western Ontario. He is responsible for the well-publicized thesis on Canadian Mutual Fund Distribution channels and has been active in the mutual fund industry since 1991.



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