Vanguard®

HOME BIAS and the CANADIAN INVESTOR

Are your clients getting the most out of global equity diversification?

Investors in most countries have what's known as "home bias"—a preference for domestic securities over foreign securities. For many investors, this bias persists even though it can result in a less diversified portfolio.

In countries with large and diverse domestic markets, the implications of a home bias may be small. In Canada—where equity markets are highly concentrated in certain securities and sectors—they can be significant.

CANADIANS FAVOUR DOMESTIC EQUITY

But the preference is far out of proportion to Canada's weight in the global equity market.[1]

Portion of domestic equity portfolios made up of Canadian equities

Canada's weight in the global equity market

Canadian home bias in the domestic equity market

1 The IMF's Coordinated Portfolio Investment Survey was used in conjunction with market-cap information to determine domestic and foreign investment. The investment holdings data for Canada can be categorized as either "foreign investment by domestic investors" or "domestic investment by domestic investors." The sum of these equals "total investment by domestic investors." The percentage allocated to domestic securities divides "domestic allocation by domestic investors" by the "total investment by domestic investors." Sources: International Monetary Fund's Coordinated Portfolio Investment Survey (2012) and Factset. Market cap data as of February 28, 2014; holdings data as of December 31, 2012.

CANADA'S EQUITY MARKET IS HIGHLY CONCENTRATED

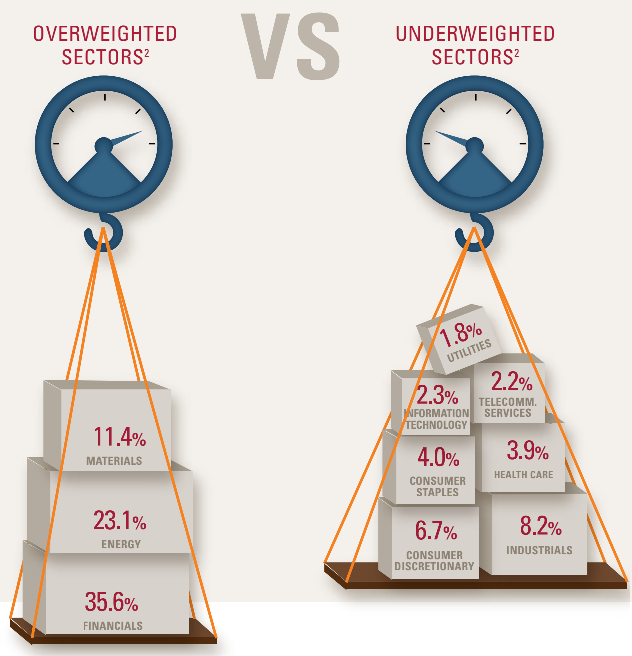
Relative to the global market, Canada's market is concentrated within a few large names. It is also significantly overweight in the energy, financials and materials sectors, and significantly underweight in others.[2]

Security concentration

Portion of Canada's equity market represented by **Canada's 10 largest equity names**.[2]

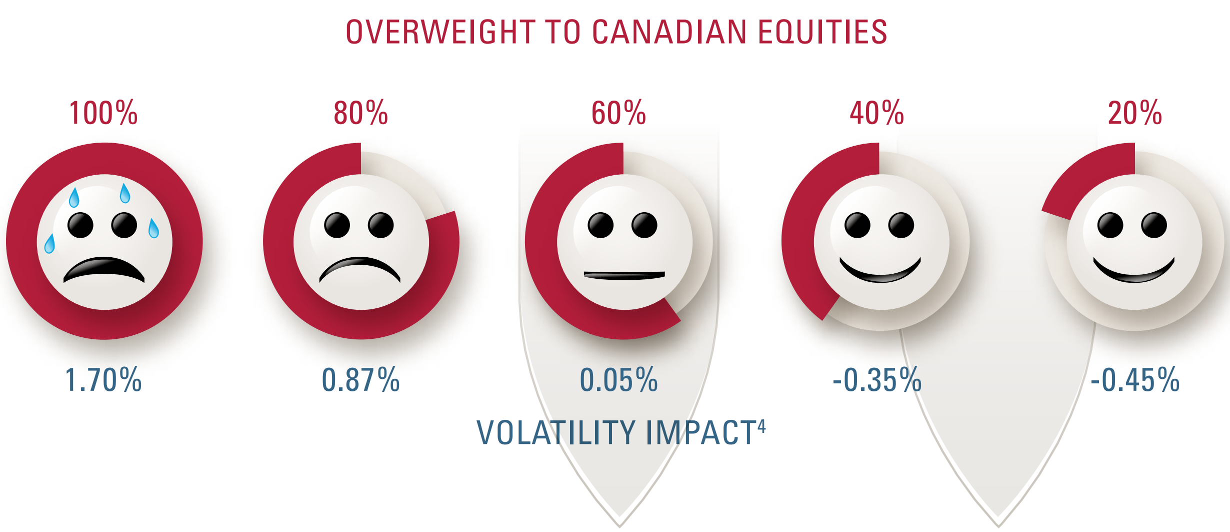
Portion of the world equity market represented by the **world's 10 largest equity names**.[2]

Sector concentration



PORTFOLIOS HEAVILY OVERWEIGHTED IN CANADIAN EQUITY CAN BE MORE VOLATILE

In part due to security and sector concentration, an all-Canada stock portfolio has historically been *more volatile* than portfolios with international equity diversification.[3]



Current overweight to domestic equity by Canadian investors[1]

Range of domestic equity overweights with the least historical volatility[3]

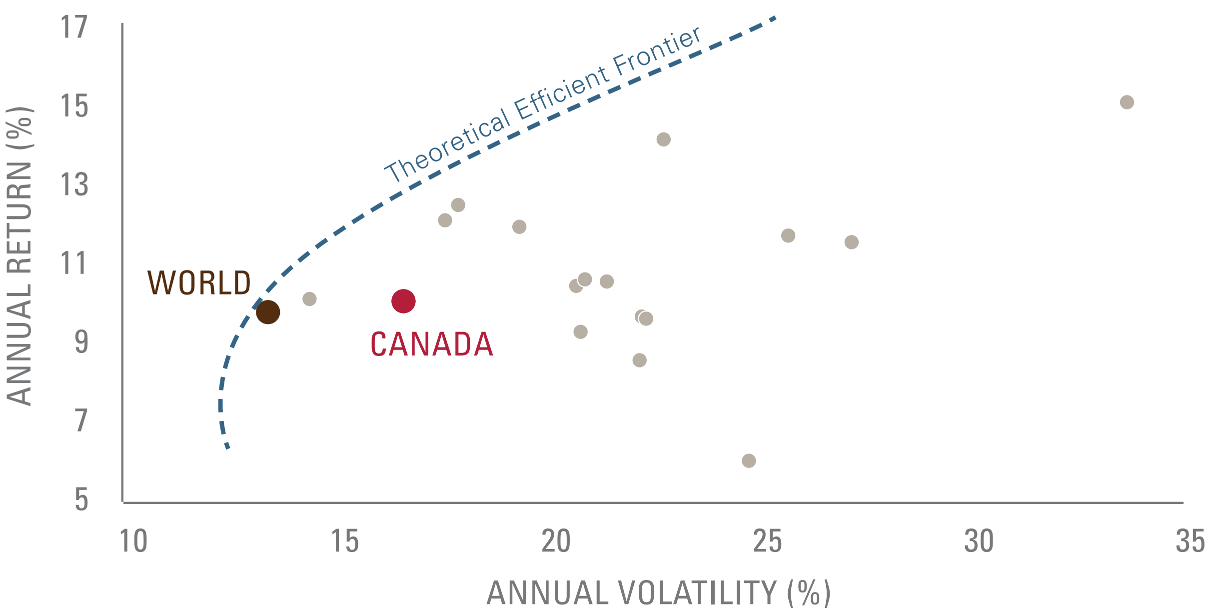
2 Canada equities represented by MSCI Canada Investable Market Index; global equities represented by MSCI ACWI Investable Market Index. Ten largest equity names were determined according to market capitalization. Data as of December 31, 2014. Sources: Vanguard calculations, using data from FactSet.

3 Shows the results of a minimum-variance analysis since 1985. Canadian equities are represented by the MSCI Canada Index; global equities are represented by MSCI World Index through 1987 and MSCI All Country World Index thereafter. All data are through February 28, 2014. Note that this analysis is backward looking and dependent on the time period examined. Sources: Vanguard calculations, using data from Thomson Reuters Datastream.

4 Specifically, the volatility impact from each degree of overweight to Canadian equity.

PORTFOLIOS CONCENTRATED IN ANY SINGLE COUNTRY ARE INEFFICIENT

Equity portfolios made up of a single country may deliver expected returns too low for the level of risk they take.[5]



THE BOTTOM LINE

Real-world considerations—taxes, transaction costs, liquidity—affect the decision to allocate to foreign investments. For Canadian investors, an allocation to domestic equity above the 4% suggested by market proportions may be reasonable.

Even so, it's clear that Canadian investors have been taking risks they could have diversified away. We believe most Canadian investors should consider reducing the home bias in their equity portfolios by increasing their allocation to global equities.

FOR MORE ON THE TOPIC

More information is available in Vanguard's research paper *Global equities: Balancing home bias – A Canadian investors' perspective* by David Pakula, David Walker,David Kwon, Paul Bosse, Vytautas Maciulis and Christopher B. Philips.

5 Index returns reflect the MSCI World Index and the respective MSCI indexes for each country in the World index. The efficient frontier does not reflect actual data or returns, and is theoretical in nature. Return data covers the period December 31, 1969, through March 31, 2014. All returns in Canadian dollars. The return points are historical, while the curve is purely theoretical and forward looking.

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Source: Thomson Reuters Datastream.

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