Learn about international investing

Investor education

Many Canadian investors have traditionally concentrated their investments in Canada. But including an international component in your portfolio can add diversification and help reduce risk. Use this guide to understand the risks and rewards of international investing as you work with your financial advisor to build a well-balanced portfolio.

It's a global market

Over the past several decades, the world's economies have evolved considerably. China and India have asserted themselves as global economic forces. The economies of countries in Latin America, Eastern Europe and Asia continue to develop, and some are ready to stand alongside Canada and the world's other established markets.

With about 97%[1] of the world's stock market value in the hands of companies that trade on non-Canadian exchanges, international stocks offer a significant opportunity to diversify your portfolio.

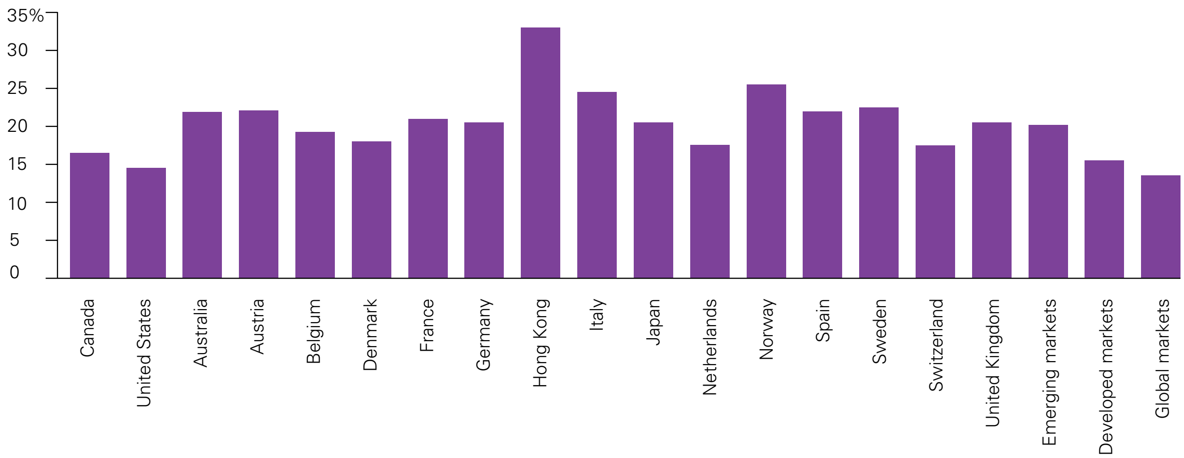
The benefits of diversification

International investing can help smooth the ups and downs of a portfolio that is concentrated in the Canadian stock market. This is because Canadian stocks and international stocks have not historically moved in lock-step. As long as international and Canadian stocks are less than perfectly correlated, investors can benefit from the reduced volatility that international diversification provides.

Figure 1 illustrates the benefit of global diversification by comparing the volatility of a global equity market index with that of a Canadian equity market index (and several other country indexes) since 1970.

1 Vanguard calculations using data from FTSE, as of December 31, 2016.

Figure 1. The volatility of international markets, January 1970–December 2016



Notes: Annualized volatility is calculated by using monthly total return series on a nominal basis. The following indexes represent each country or category's market-capitalization index: MSCI Canada Index, MSCI USA Index, MSCI Australia Index, MSCI Austria Index, MSCI Belgium Investable Market Index, MSCI Denmark Index, MSCI France Index, MSCI Germany Index, MSCI Hong Kong Index, MSCI Italy Index, MSCI Japan Index, MSCI Netherlands Investable Market Index, MSCI Norway Index, MSCI Spain Index, MSCI Sweden Index, MSCI Switzerland Index, MSCI United Kingdom Index, MSCI Emerging Markets Index, MSCI World ex USA Index, and MSCI World Index. The calculation is from the perspective of a Canadian investor, such that all equity indexes are unhedged and denominated in Canadian dollars. Data shown is for January 1970 through December 2016 with the exception of MSCI Emerging Markets Index which begins in January 1988.

Sources: Vanguard calculations based on data from Thomson Reuters Datastream and MSCI.

While Canada experienced less return volatility than most other developed countries during that period, the broadest global index (shown at the far right of the chart) realized the lowest average volatility—a good argument for broad international diversification.

Understanding correlation

One of the common ways economists compare the movement of foreign markets with the movement of the Canadian market is through return correlation:

- A correlation of 1.0 means that a country's stock market moves in exactly the same direction as the Canadian market.
- A correlation of zero means that there is no relationship between a country's stock market and the Canadian market.
- A correlation of –1.0 means a country's market moves in exactly the opposite direction of the Canadian market.

As **Figure 2** shows, none of the international stock markets listed was perfectly correlated with the Canadian stock market for the time period shown.

A closer look at international markets

International markets can be divided into four geographic categories:

Americas includes Canada, the United States, and the other countries in the Western Hemisphere, among them Brazil, Mexico, Peru and Venezuela.

Asia/Pacific encompasses the Pacific and Far East and includes countries such as Australia, China, Hong Kong, India, Japan, Pakistan and South Korea.

Europe includes all the countries in Europe.

Africa/Middle East comprises countries such as Egypt, Israel and South Africa.

International markets are also grouped by their level of development:

Developed markets are fully modern industrial nations with well-established stock markets, such as Western European countries, Canada, the United States and Japan.

Figure 2. Correlation between Canada and major international stock markets, January 1970–December 2016

Notes: Cross-correlations are calculated by using monthly total return series on a nominal basis with respect to Canadian equities. See Figure 1 for the list of indexes used to represent each country or category. The calculation is from the perspective of a Canadian investor, such that all the equity indexes are unhedged and denominated in Canadian dollars. Data shown is for January 1970 through December 2016 with the exception of MSCI Emerging Markets Index which begins in January 1988.

Sources: Vanguard calculations based on data from Thomson Reuters Datastream and MSCI.

Emerging markets are nations generally evolving from agricultural to industrial economies or from government-controlled economies to a free market. Mexico, Brazil, Russia and China are emerging markets.

Frontier markets include countries that fall outside of traditional equity indexes. In contrast to developed and emerging markets, frontier markets typically include countries in need of significant improvement in areas such as market liquidity, infrastructure and political stability. Nigeria, Bulgaria and Vietnam are frontier markets.

The risks of international investing

Risk and reward are simple facts of investing. However, with international investing, there are some additional risks that you need to know about.

Currency risk. Foreign companies trade and pay dividends in the currency of their local markets. When Canadian investors receive those dividends or sell the investment, the cash they receive must be converted into Canadian dollars. If the Canadian dollar strengthens against the foreign currency, that currency will buy fewer dollars, and the return will be lower. On the other hand, if the foreign currency is strong compared with the Canadian dollar, this strength increases the investment return because the foreign earnings translate into more dollars.

Country risk. Political upheaval, such as civil unrest, military coups or wars, can disrupt nations' economies and markets. Sudden changes in a country's economic, regulatory or trade policies can also cause its stock market to soar or plummet.

Liquidity risk. Foreign companies are not subject to the same accounting, auditing and financial-reporting standards and practices as Canadian companies, and their stocks may not be as liquid as those of similar Canadian firms.

Other considerations of international investing include the possibility of higher trading costs and foreign withholding taxes.

International investing is a bit like international travel—the experience can be rewarding, though it's not without risk and uncertainty. Work with your financial advisor to establish an international investing plan that's right for you.

Vanguard

Vanguard Investments Canada Inc.

Connect with Vanguard®

vanguardcanada.ca

Commissions, management fees, and expenses all may be associated with investments in a Vanguard ETF®. Investment objectives, risks, fees, expenses, and other important information are contained in the prospectus; please read it before investing. ETFs are not guaranteed, their values change frequently, and past performance may not be repeated. Vanguard ETFs® are managed by Vanguard Investments Canada Inc., an indirect wholly owned subsidiary of The Vanguard Group, Inc., and are available across Canada through registered dealers.

Date of publication: April 2017

This material is for informational purposes only. This material is not intended to be relied upon as research, investment, or tax advice and is not an implied or express recommendation, offer or solicitation to buy or sell any security or to adopt any particular investment or portfolio strategy. Any views and opinions expressed do not take into account the particular investment objectives, needs, restrictions and circumstances of a specific investor and, thus, should not be used as the basis of any specific investment recommendation. Investors should consult a financial and/or tax advisor for financial and/or tax information applicable to their specific situation.

Information, figures and charts are summarized for illustrative purposes only and are subject to change without notice. While this information has been compiled from proprietary and non-proprietary sources believed to be reliable, no representation or warranty, express or implied, is made by The Vanguard Group, Inc., its subsidiaries or affiliates, or any other person (collectively, "The Vanguard Group") as to its accuracy, completeness, timeliness or reliability. The Vanguard Group takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this material.

All investments, including those that seek to track indexes, are subject to risk, including the possible loss of principal. Diversification does not ensure against a profit or protect against a loss in a declining market. While ETFs are designed to be as diversified as the original indexes they seek to track and can provide greater diversification than an individual investor may achieve independently, any given ETF may not be a diversified investment.

This material does not constitute an offer or solicitation and may not be treated as an offer or solicitation in any jurisdiction where such an offer or solicitation is against the law, or to anyone to whom it is unlawful to make such an offer or solicitation, or if the person making the offer or solicitation is not qualified to do so.

LAII_CA 042017