GEOGRAPHY OF INVESTING

The MSCI All Country World Index is the broadest global equity index. It aims to capture about 85% of the total market capitalization (value) of global publicly available stocks. The U.S. stock market comprises nearly half of the index; developed Europe about a quarter of it; and emerging markets, as well as the Asia/Pacific region are each about 13%.

However, these country allocation statistics are all determined based on where a company happens to be domiciled. In an integrated world economy, the country of domicile is becoming less and less important.

Instead of looking at the MSCI All Country World Index from a country of domicile viewpoint, what would happen if you constructed the index based on where the various companies in the index generated their revenue? In that case, you would get a dramatically different result. The U.S. share of the index would drop to just over a quarter, down from nearly one-half. Emerging markets, on the other hand, would now be one-third of the index, more than 2 ½ times their current weighting.

Perhaps you own both "U.S." as well as "International" stock funds in your portfolio. Morningstar may inform you that your U.S. stock funds actually have 20% of their holdings in foreign stocks or that your international funds hold 15% in U.S. stocks – but this only reflects their country of domicile, it tells you nothing about where these companies actually make their money. It also doesn't give you any help in knowing what risks and opportunities your portfolio of funds is actually exposing you to.

Unfortunately, the tools available today to investors do not easily allow them to determine their portfolios global economic exposure, leaving us with old allocation tools and analysis in a world that has substantially changed.

There are many different ways a company's global economic footprint might be measured, such as revenues, payroll, assets, number of employees, etc. However, revenue is probably the easiest one to get access to, and even revenue has its challenges, as current financial reporting standards don't necessarily drill down deep enough to provide investors with the necessary information.

Certainly a company's country of domicile continues to be important, due to factors such as currency risk, political risk, regulatory risk, and taxation. In addition, despite the increasing globalization of even small and mid-size companies, you can't just invest in U.S. stock funds and gain access to all world markets and opportunities. In addition, some leading companies are not domiciled in the U.S. and can only be accessed by investing in a foreign stock fund.

However, in the coming years, expect to see more "objective-based investing" and less "geographic-centric" investing. What does that mean? Objective-based investing focuses on a desired strategy, such as dividends, dividend-growth, aggressive growth, trends or economic changes, etc., instead of just a geographic approach.

Individual investors don't have the tools or information – yet – to easily understand the true economic exposure of the companies in their mutual funds, but it is coming, and it will allow for a better analysis of your portfolio's risk and return characteristics and hopefully make for the development of better investment strategies.

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