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# Great reasons for going global

**International equities have outperformed Canadian and U.S. equities**

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Two decades ago, international investing was in vogue. The stunning growth of Japan and the ongoing expansion of the European Union had created a compelling investment thesis.

Then, Japan's descent into a deflationary quagmire, the onset of the tech craze in the U.S. and, most recently, the commodities boom in Canada eclipsed international investing. Yet, based on an analysis by Toronto-based **Tacita Capital Inc.,** the rationale for international equities investment is solid.

From a long-term perspective, international equities have outperformed both Canadian and U.S. equities. The annualized return of the MSCI Europe Australasia and Far East index from January 1970 through August 2009 was 10.2%, ahead of the 9.8% and 9.5% returns of the S&P 500 and S&P/TSX composite indices, respectively. The annualized standard deviation of the MSCI EAFE index was 17.9%, less than the 18.4% of S&P/TSX composite index but greater than the 16.4% of the S&P 500. (All returns are calculated in Canadian dollars.)

A globally diversified portfolio comprising one-third each of international, Canadian and U.S. equities earned an annualized return of 10.3%, outperforming all of its individual equity asset-class components. This globally diversified portfolio also outperformed the 10% return of a North American portfolio comprising 50% each of Canadian and U.S. equities. Most important, with an annualized standard deviation of only 14.8%, the globally diversified portfolio was much less volatile than any single equity class and bested the 15.9% standard deviation of the North American portfolio. By far, a globally diversified portfolio that incorporates international equities has been the best performer on a risk-adjusted basis.

But it has not been all smooth sailing. With the bursting of Japan's equities bubble, international equities returns in the 1990s lagged those of Canada and the U.S. At Japanese equities' peak in 1989, they comprised about 65% of the MSCI EAFE index; their chronic dismal performance was a continual drag on international equity returns. Many active managers underweighting Japan in their portfolio mix during this period outperformed the index.

Those days are over. Japan's torturous secular market decline seems to have bottomed and it now makes up less than a quarter of the index. In fact, the MSCI EAFE index has outperformed the

S&P 500 over the past seven years, with an annualized return of 3.7% vs minus 1.5%, respectively. The resurgence of the Far East, sparked by China's and India's rapid growth, and the size and eastward expansion of the EU are fundamentals that cannot be ignored. Advisors constructing portfolios focused on superior long-term, risk-adjusted performance need to include international equities.

Exposure is available through an array of vehicles. There are more than 80 mutual funds in this category offering a plethora of share classes, including capital and F-classes. Several funds — such as TD International Index Fund, from Toronto-based **TD Asset Management Inc.;** and PH&N Overseas Equity Fund, sponsored by **Phillips Hager & North Investment Management Ltd.** of Vancouver — offer currency-hedged versions. Unfortunately, unlike **Morningstar Inc.'** s classification scheme in the U.S., international equity funds in Canada are not broken into style and size categories, so advisors will need to analyze funds in detail to identify appropriate selections.

There are two international equity exchange-traded funds available in Canada. iShares CDN MSCI EAFE Index Fund, offered by **Barclay's Global Investors Canada Ltd.** of Toronto, is 100% hedged to the C$. **Claymore Investments Inc.** of Toronto's Claymore International Fundamental Index ETF is designed to replicate the performance of the FTSE RAFI developed ex-U.S. 1000 index, an index of the top 1,000 non-U.S. companies as weighted by cash dividends, free cash flow, sales and book value. This FTSE index, which is value-tilted, has materially outperfomed the MSCI EAFE index over the past 20 years, so it is an attractive option for advisors focused on passive investing. **IE**

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