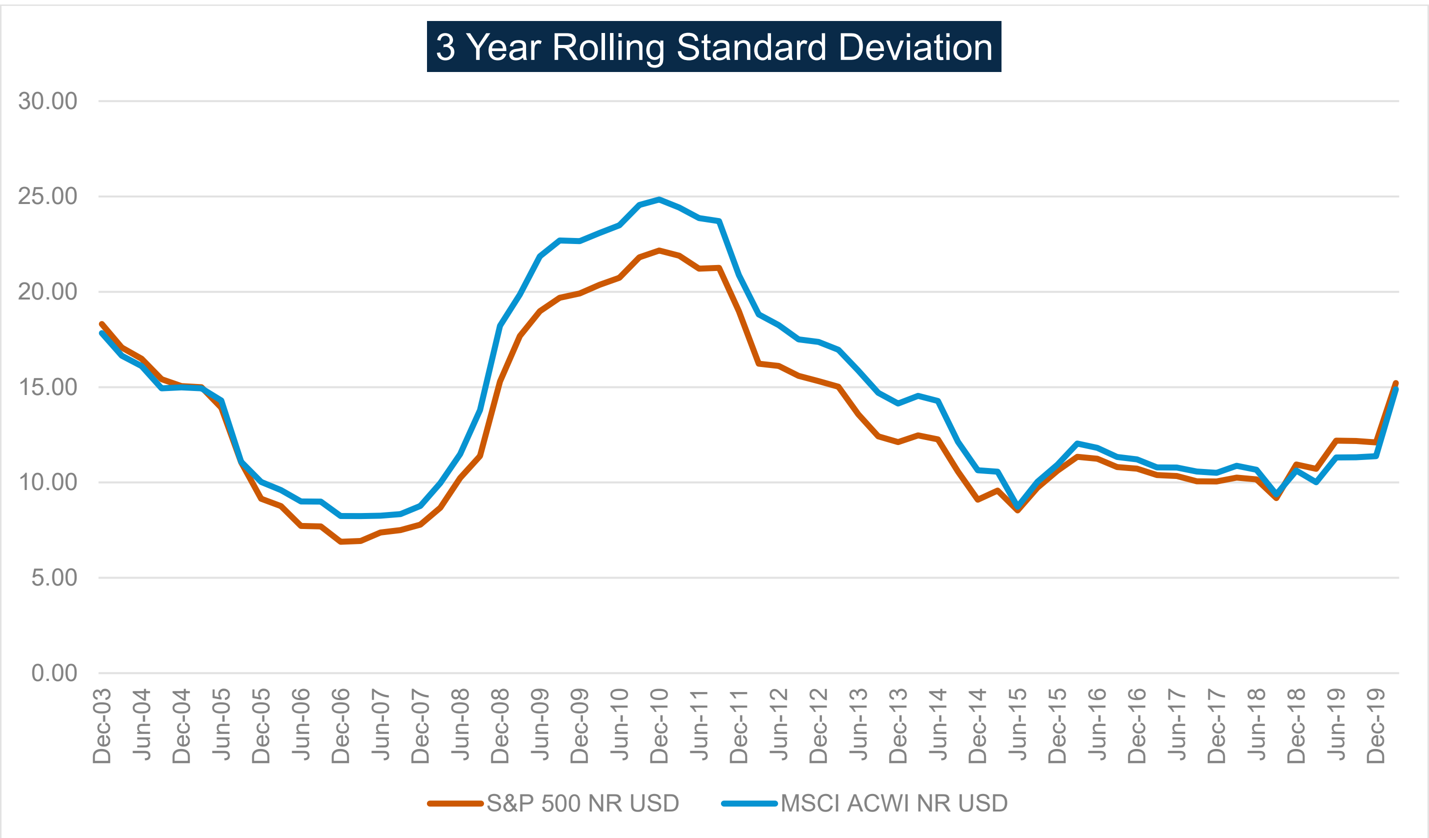
Common Misconceptions about International Equities

Harbor believes most U.S. investors are under-allocated to international equities due to familiarity bias. There are other reasons that U.S. investors may have ignored international stocks. For instance, some believe that international stocks carry greater risk than U.S. stocks, and that a portfolio of solely U.S. stocks offers enough diversification. These misconceptions may lead investors to miss out on key benefits offered by non-U.S. equities.

Are International Equities Significantly Riskier?

The belief that international equities are significantly riskier than U.S. equities appears to be overstated and built on familiarity bias. The chart below compares the standard deviation of the S&P 500 Index of large U.S. companies to the MSCI ACWI Index of primarily large companies around the globe (Figure 1).

Figure 1



Source: Morningstar, May 2020.

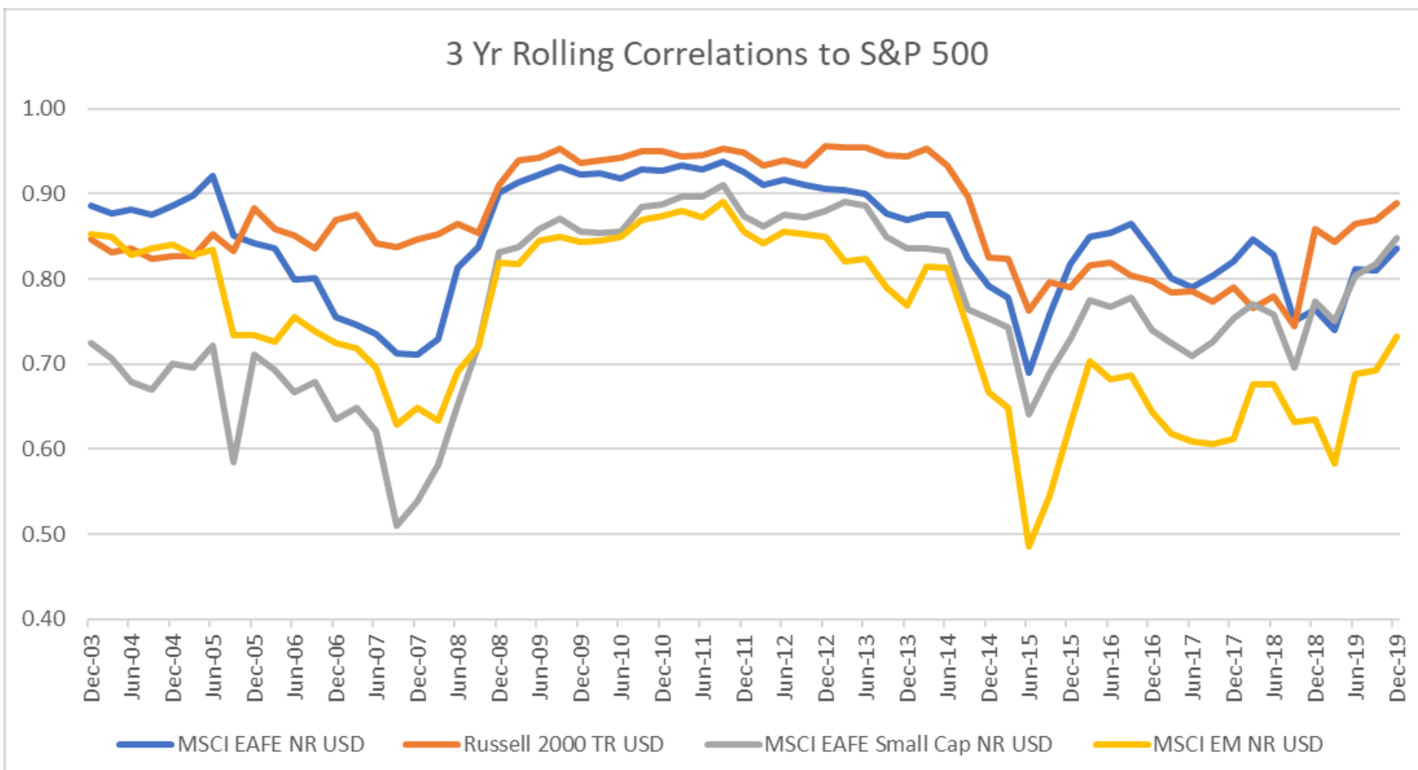
The volatility experienced by the MSCI ACWI Index has not been dramatically different from that of the S&P 500 over the long term.

Do International Equities Help with Diversification?

Some argue that the globalization of the economy makes international diversification less necessary. They point to recent increased correlations between U.S. and non-U.S. stocks as proof. Correlation, which measures the degree to which securities move in relation to one another, helps show the diversification benefit of different securities. If two securities move very closely to one another, the diversification benefit of investing in both may be less. Conversely, if two securities are negatively correlated, one may provide a ballast when the other is out of favor.

While correlations between U.S. and non-U.S. stocks have increased over time, they have not done so in a straight line, and at times they have been quite low. As recently as 2017, one-year correlations moved briefly negative. Furthermore, we think there is reason to believe that correlations could decline going forward. The supply chain problems caused in the 2020 pandemic may cause some countries to rely more on domestic manufacturing capabilities, which could reverse some of the impact of globalization, which could in turn cause stock correlations to decrease in the future.

Figure 2



Source: Morningstar, May 2020.

As shown in Figure 2, correlations of non-U.S. stocks vs. the S&P 500 have varied from period to period and have held below 0.9 for much of the last 20 years across different non-U.S. indices. Correlations of non-U.S. stocks are about the same or better than U.S. small caps, represented by the Russell 2000 Index above. Lower correlations among emerging markets and international small caps can improve your portfolio's diversification profile.

Harbor
Trusted Partnerships › Trusted Solutions

Legal Notices & Disclosures

Standard Deviation (Std Dev) *of return measures the average deviations of a return series from its mean, and is often used as a measure of risk. A large standard deviation implies that there have been large swings in the return series.*

The S&P 500 Index *is an unmanaged index generally representative of the U.S. market for large capitalization equities. This unmanaged index does not reflect fees and expenses and is not available for direct investment.*

The MSCI EAFE Index *is an unmanaged index generally representative of major overseas stock markets. This unmanaged index does not reflect fees and expenses and is not available for direct investment.*

The MSCI EAFE Small Cap Index *is an equity index which captures small cap representation across developed market countries around the world, excluding the U.S. and Canada. This unmanaged index does not reflect fees and expenses and is not available for direct investment.*

The MSCI Emerging Markets Index *is a market capitalization weighted index of equity securities in more than 20 emerging market economies. This unmanaged index does not reflect fees and expenses and is not available for direct investment.*

The MSCI All Country World Ex. US Index *is a free float-adjusted market capitalization weighted index that is designed to measure equity market di in the global developed and emerging markets, excluding the U.S. This unmanaged index does not reflect fees and expenses and is not available for direct investment.*

The views expressed herein are those of Harbor Capital Advisors, Inc. investment professionals at the time the comments were made. They may not be reflective of their current opinions, are subject to change without prior notice, and should not be considered investment advice.

The information shown relates to the past. Past performance is not a guide to the future. The value of investment can go down as well as up. Investing involves risks including loss of principal.

Diversification does not ensure a profit against loss.

Stock markets are volatile and equity values can decline significantly in response to adverse issuer, political, regulatory, market and economic conditions. Investing in international and emerging markets poses special risks, including potentially greater price volatility due to social, political and economic factors, as well as currency exchange rate fluctuations. These risks are more severe for securities of issuers in emerging market regions. Stocks of small and mid cap companies pose special risks, including possible illiquidity and greater price volatility than stocks of larger, more established companies.

Distributed by Harbor Funds Distributors, Inc.