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Home Bias – breaking down the walls

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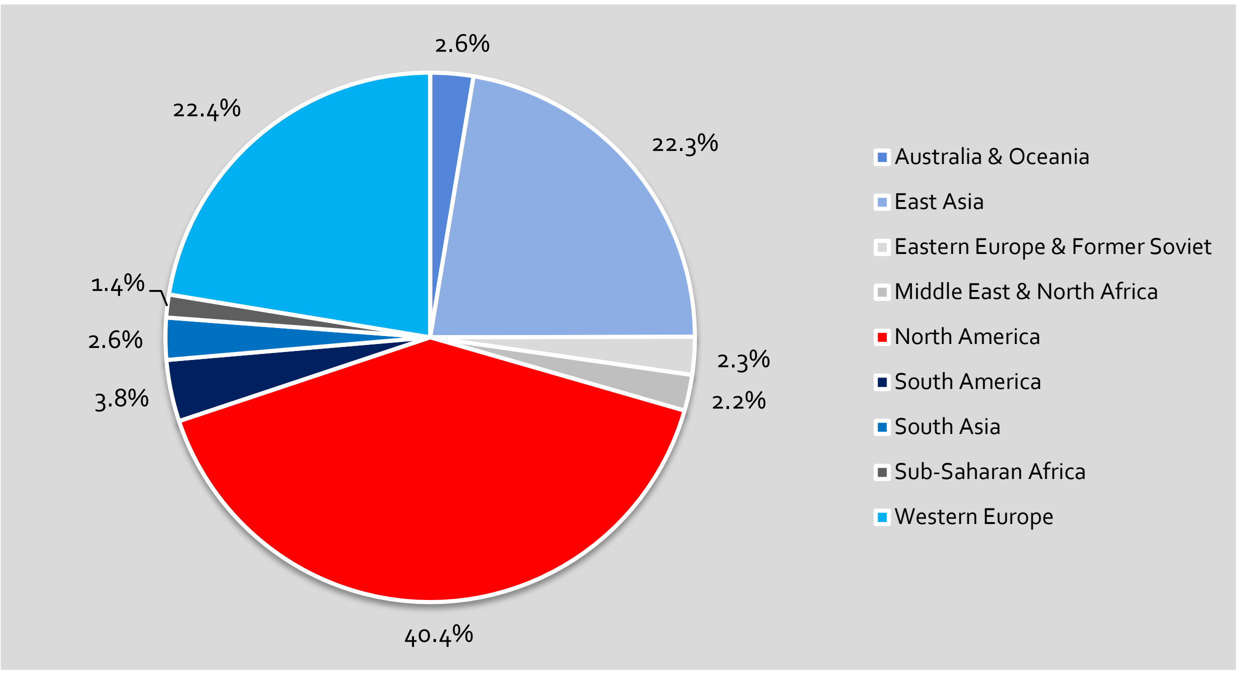
"I invest in South African equities and unit trusts because they are companies I know, trust and understand. They sponsor my favourite Super 15 team, I buy their products, I eat their food and their TV adverts make me cry."

Warm and fuzzy

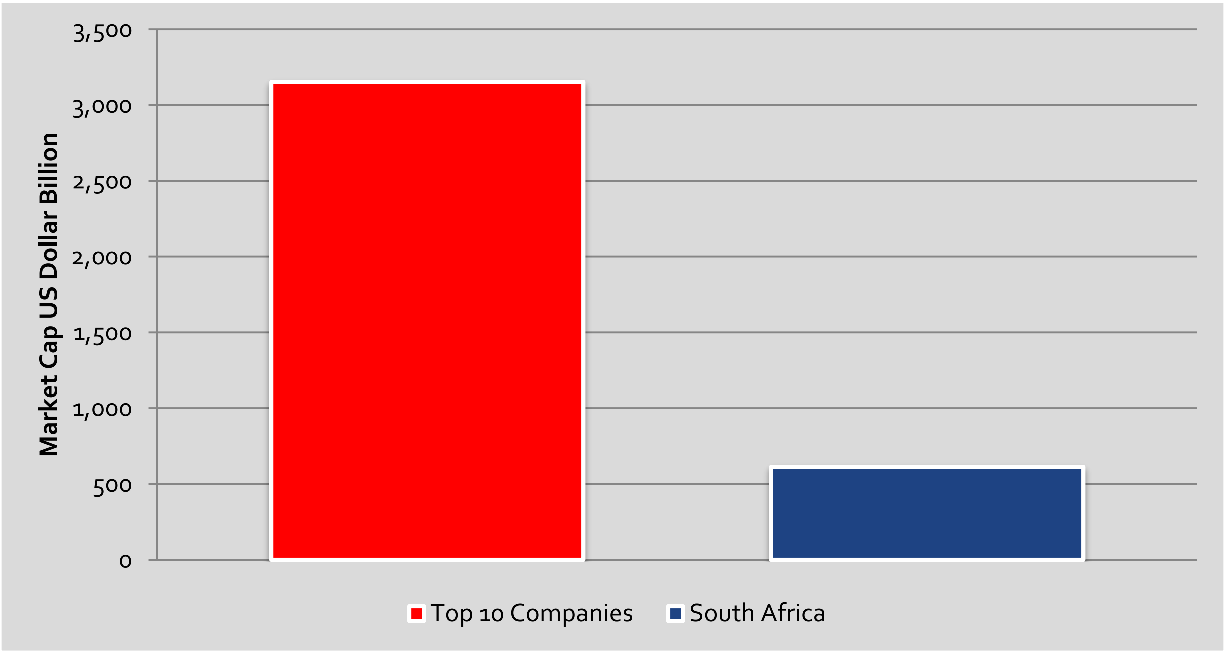
Repeated exposure to names or brands has been proven to elicit a psychological "warm glow". We lose our ability to become rational and once we have decided sub-consciously that we "like" something, it becomes difficult to change that opinion.

However, the home companies that make us feel so warm and fuzzy comprise just 1.4% of the global market capitalisation of listed companies according to World Bank data. In fact, other familiar, but foreign, brand names that probably trigger positive thoughts are Apple, Google, Microsoft, Johnson & Johnson and Nestlé – all constituents of the top 10 companies by market cap list. The members of this top 10 group have a cumulative value over 5 times the size of the entire South African equity market.

Global Market Capitalisation Breakdown



Market Capitalisation – Top 10 Companies versus South Africa (USD billion)



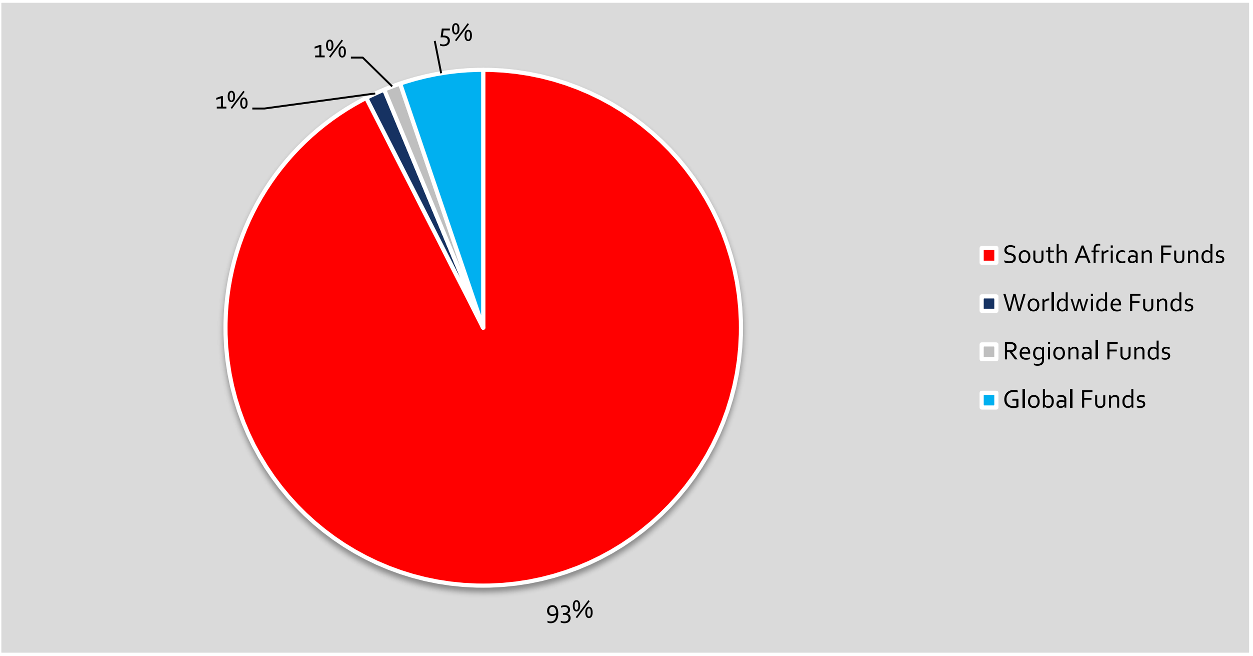
What makes us so reluctant to move beyond our meagre 1.4% of the global investment universe and start participating in the remaining 98.6% available to us? It is a much-researched phenomenon known as "home bias".

Home bias

Home bias is not exclusively a South African trait, but is prevalent among investors the world over. Historically, the South African regulatory system has made it even more difficult for investors to fight their sub-conscious brand loyalty and broaden their investment domain. Ironically, most investors and financial advisors would very happily extoll the benefits of portfolio diversification, however, most investor portfolio allocations would demonstrate that talk is cheap.

The South African Collective Investment Scheme industry shows that of the R1.4 billion assets under management, 93% of those are in "South African Funds" which by mandate have to comprise at least 70% of domestic assets.

Breakdown of South African Collective Investment Scheme Assets[1]



In much the same way that familiar brands and names make us feel comforted, the converse is true of anything that is new or different. Our psychological make-up is geared around sticking with the safe and familiar which is why so few of us as a human species are destined to be explorers venturing into the unknown. New or changing information is difficult and threatening. And when compounded with advertising from South African asset management firms and advisors who have a vested interest in keeping the *status quo*, South African investors remain trapped in a home bias well.

Sensibly biased

There are absolutely circumstances when a home bias approach is sensible. Large pension funds have liabilities that need to be paid in domestic currency and in order to have sensible asset-liability matching; their assets will be invested in the domestic market. The same is true on a smaller scale for individual investors – there are bonds to be paid and lifestyle expenses like entertainment and school fees and holidays which require funding. These cash outflows are all current and/or future liabilities and matching these domestic liabilities with domestic assets which have the ability to generate income is practical.

[1] Data source: ASISA – 30 September 2013. South African Funds – at least 70% of assets in domestic markets; Worldwide Funds – no limits on foreign/domestic split; Regional Funds – 80% exposure to specific foreign country; Global Funds – 80% of assets in foreign markets.

Often, the best income-generating asset is the investor themselves through the earning of salaries, bonuses and other remuneration. However, growth and capital assets need to be put to work in a sensible, rational manner wherever the best risk-adjusted opportunities exist.

Breaking down the walls

We know investment diversification is good, we know our market cap is small, we know our currency is volatile – no rational investor would argue with those statements. We need to consciously decide to overcome our non-rational attachment with domestic investing.

Challenge the home bias mind-set with your growth and capital assets and find your inner explorer, the world awaits!

Contact us to learn more

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