The case for international equities

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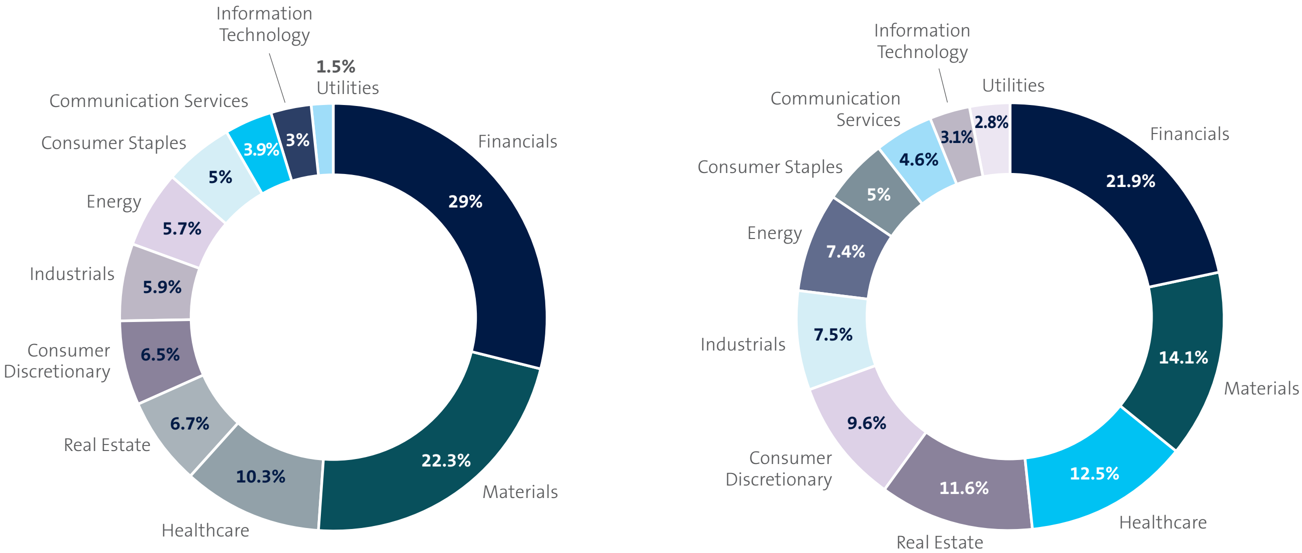
There's a big world out there – the case for international equities

Like many investors around the world, Australians tend to favour their home market but looking further afield can provide a number of benefits in terms of diversification, currency exposure, long-term returns and lower volatility. The global economic landscape is looking resilient with plenty of investment opportunities, giving investors extra incentive to include international equities as part of their core portfolio.

1. Avoid home bias by diversifying overseas

Despite the benefits of franking credits and higher dividend yields often associated with Australian equities, it's important to remember that domestic shares only represent around 2% of the global market[1]. This is a small pond to be fishing in for returns and it's very sector-specific too. As you can see in the sector chart below, the Australian equity market is heavily concentrated in financials and materials, which make up more than half of the domestic market, versus 36% globally. Having a significant home bias could therefore make investors vulnerable to sector-specific risks. Australian equities are also relatively more concentrated at the issuer level, with the top 10 stocks making up 48% of the Australian market, compared to 17% globally – see the issuer chart below. International equities can help to diversify across sectors, issuers and regions.

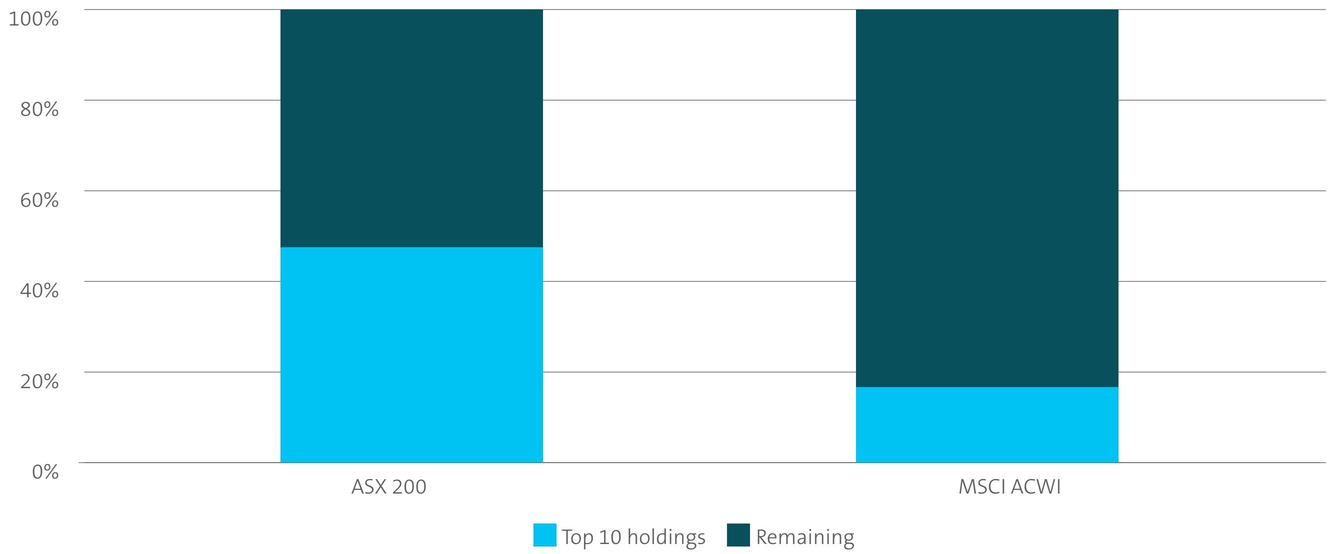
Sector concentration
ASX 200 vs. MSCI All Country World Index



Source: S&P and MSCI. As of July 2022.

1 Source: MSCI, as of July 2022.

Issuer concentration
ASX 200 vs. MSCI All Country World Index

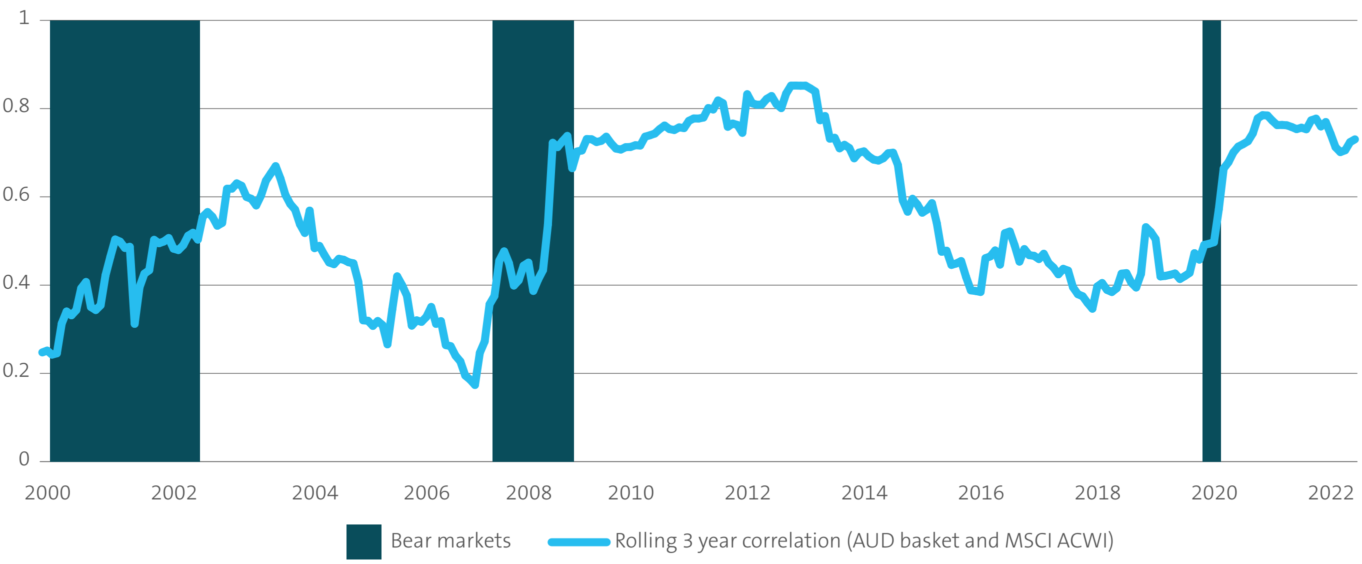


Source: S&P and MSCI. As of July 2022.

2. Take advantage of currency exposure

As you can see in the chart below, the Australian dollar tends to move in tandem with global equities, particularly during market downturns. By depreciating alongside global equities in periods of market stress, the currency effect may result in more favourable international returns in unhedged terms. During the COVID market crash in 2020, the Australian dollar investor would have experienced a much smaller downturn of -10% investing in unhedged international equities, compared to -21% investing in their hedged counterpart, given the positive performance offset provided by the currency[2].

The Australian dollar tends to correlate positively with global equities



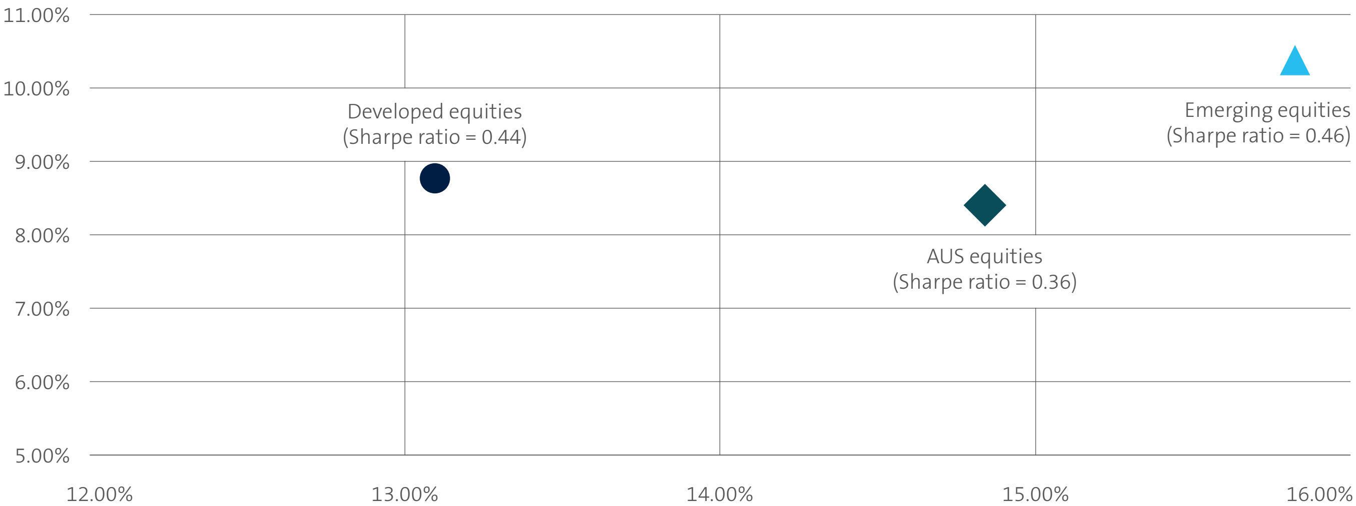
Source: Refinitiv. As of July 2022.

2 BlackRock, using data from MSCI. Unhedged international equities is represented by MSCI ACWI unhedged in AUD, while hedged international equities is proxied by MSCI ACWI in USD. Performance period is from December 2019 to March 2020.

3. Gain exposure to higher risk adjusted returns

The longer-term return outlook for international equities is positive and is expected to be higher than domestic equities on a risk-adjusted basis. Looking at BlackRock's 10-year expected returns in the graph below[3], Australian equities are expected to deliver +8.4% returns with a volatility of 14.8%. Investors could expect to achieve slightly higher returns with developed equities (+8.8%), alongside lower expected volatility. Emerging equities are expected to deliver somewhat higher absolute returns over the long-term, but with higher expected volatility.

Asset class return and volatility expectations

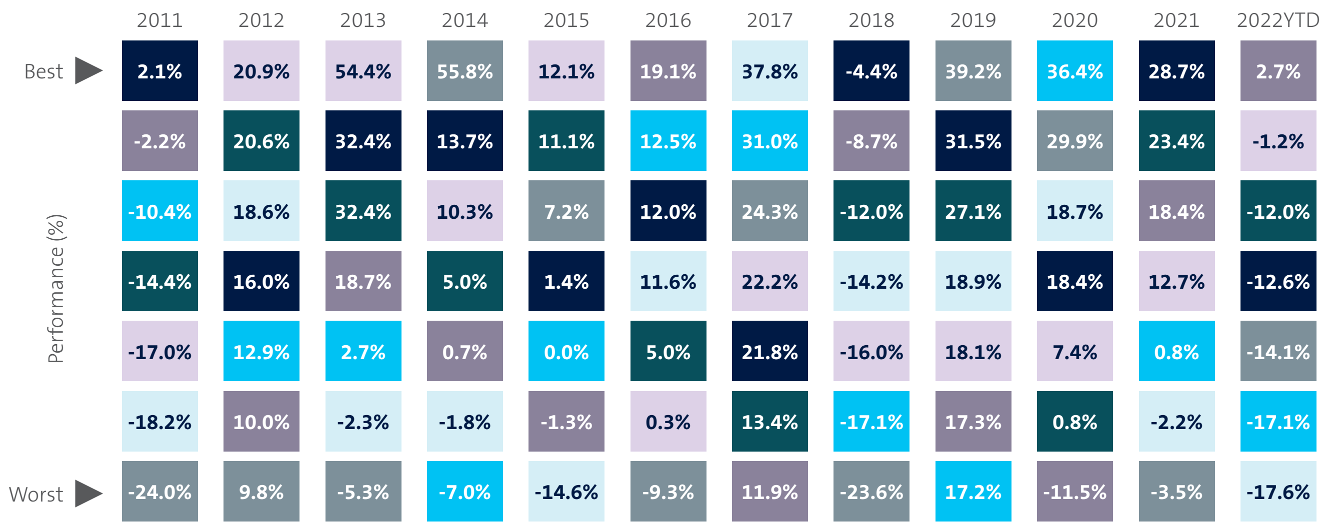


Source: BlackRock Capital Market Assumptions as of August 2022. This information may be subject to change and is not intended as a recommendation to invest in any particular asset class or strategy or as a promise – or even estimate – of future performance. Sharpe ratio is a measure of risk-adjusted returns and is calculated as the expected return (over cash) per unit of risk.

4. Smooth out volatility and adapt to changing market conditions

We know the performance of regions and sectors can vary over time. A dynamically managed international equity portfolio can help investors to increase exposure to stronger areas while reducing the impact of weaker areas. As the chart below shows, the best performing markets are quick to change, and an international equity portfolio that can adapt to different market conditions may help to smooth out volatility over time and contribute to portfolio resiliency across market cycles.

Best performing region within equities is dynamic and quick to change



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022YTD
Best	2.1%	20.9%	54.4%	55.8%	12.1%	19.1%	37.8%	-4.4%	39.2%	36.4%	28.7%	2.7%
	-2.2%	20.6%	32.4%	13.7%	11.1%	12.5%	31.0%	-8.7%	31.5%	29.9%	23.4%	-1.2%
	-10.4%	18.6%	32.4%	10.3%	7.2%	12.0%	24.3%	-12.0%	27.1%	18.7%	18.4%	-12.0%
	-14.4%	16.0%	18.7%	5.0%	1.4%	11.6%	22.2%	-14.2%	18.9%	18.4%	12.7%	-12.6%
	-17.0%	12.9%	2.7%	0.7%	0.0%	5.0%	21.8%	-16.0%	18.1%	7.4%	0.8%	-14.1%
	-18.2%	10.0%	-2.3%	-1.8%	-1.3%	0.3%	13.4%	-17.1%	17.3%	0.8%	-2.2%	-17.1%
Worst	-24.0%	9.8%	-5.3%	-7.0%	-14.6%	-9.3%	11.9%	-23.6%	17.2%	-11.5%	-3.5%	-17.6%

US S&P 500 | Euro Stoxx | UK FTSE 100 | Japan TOPIX | MSCI EM | MSCI Korea | China CSI 300

Source: Refinitiv. Data as of July 2022.

3 As of August 2022. This information may be subject to change and is not intended as a recommendation to invest in any particular asset class or strategy or as a promise – or even estimate – of future performance.

Introducing the new iShares Enhanced Strategic International Managed Portfolio

North's investment menu has over 250 international options, but we know it can be challenging for advisers to construct portfolios themselves, which is why we've seen rising demand for managed portfolios.

We've partnered with BlackRock to create a cost-effective and simple way to gain exposure to international equities using exchange traded funds (ETFs) and leveraging BlackRock's investment insights. Together, we've designed the iShares Enhanced Strategic International Managed Portfolio, a low-cost dynamically managed diversified portfolio that provides exposure to over 2,500 underlying securities.

About BlackRock

BlackRock is a global investment manager that has served the Australian market for over three decades, with a commitment to helping more people plan for their financial future. As a long-standing partner to large wealth organisations and financial advisers, BlackRock delivers tailored investment solutions, thought leadership and investment technology to help clients build resilient portfolios. BlackRock employs around 18,000 staff in over 35 countries.

BlackRock's investment philosophy

BlackRock believes superior investment outcomes are best achieved through a disciplined, objective process that seeks to harvest returns, while also accounting for risks and costs.

BlackRock produces long-term return forecasts for regions and sectors across the globe. These forecasts are balanced with proprietary portfolio and risk management systems to produce a diversified international equity portfolio that is benchmark aware with controlled levels of active risk. BlackRock integrates trading costs to help identify the optimal trade-off between expected returns, risks and costs.

The BlackRock team believes that certain market incidents cannot be fully explained quantitatively and need the vetting of experienced investment professionals by using horizon (long and short-term) and thematic insights.

Portfolio summary

	iShares Enhanced Strategic International Managed Portfolio
North code	NTH0296
Asset class	International equities
Investment style	Dynamically managed diversified international equity portfolio. A quantitative and discretionary approach determines the long-term strategic country and sector allocations, while shorter-term market-aware insights guide the dynamic tilting process. The portfolio adopts efficient implementation through transparent, low-cost ETFs.
Investment universe	Exchange traded funds (ETFs)
Investment objective	To match or outperform the benchmark return over a rolling five-year period
Managed portfolio benchmark	Morningstar Global TME NR AUD
Minimum investment horizon	5 years
Minimum investment amount	$500
Indicative number of assets	10-20 ETF holdings, with exposure to over 2,500 underlying securities
Investment management fee (pa of the portfolio balance)	0.26% p.a.
Portfolio income	Reinvested
Target growth/ defensive exposure	99%/1%
Minimum single asset position	0.5%
Maximum cash holding	10%
Expected turnover (pa)	20-50%
Expected tracking error (pa)	0-3%

How BlackRock builds managed portfolios

1. Setting allocations

Strategic country and sector allocations determine the desired long-term exposures and are guided by BlackRock's long-term return expectations, risk and correlation assumptions. BlackRock uses a mean-variance optimisation framework to determine optimal risk-adjusted strategic weights, while also controlling for tracking error against the benchmark. This process is repeated annually to update expected return and risk assumptions.

2. Using dynamic tilting

Tactical country and sector tilts relative to the strategic holdings are made 4-6 times a year based on market-aware proprietary signals including valuation insights, momentum and fundamental economic indicators. The tactical overlay process seeks to add value by deviating away from long-term strategic weights and responding to changing market conditions.

3. Using ETFs

The portfolio is constructed using a range of ASX-listed iShares ETFs that aim to track country and sector indices across both developed and emerging markets, along with smart beta exposures such as minimum volatility. These low-cost, transparent ETFs allow for efficient portfolio implementation and act as natural candidates for the dynamic tilting process. Being able to quickly respond to changing market conditions offers the opportunity to achieve enhanced risk-adjusted returns over time.

4. Keeping a hand on the wheel

Human insight and judgement are critical to avoid unintended exposures. BlackRock's Aladdin® technology helps us to better understand potential risk exposures with holdings-based analysis in addition to traditional, backward-looking performance analysis. They use detailed risk analytics and stress testing capabilities, in combination with portfolio manager insight to monitor portfolio health.

How dynamic tilting works in practice

Dynamic tilting helps the portfolio to respond quickly to changing market conditions. Here are a couple of recent examples.

- In early 2022, the portfolio was able to navigate the outbreak of the Ukraine war and soften the drawdown in global equities. Exposure to European equities was lowered shortly after the war began, while exposure to less-affected regions such as Japan was increased. While the international equity portfolio is not immune to drawdowns in global equities, dynamic tilting means that portfolio managers can keep a 'hand on the wheel' and respond to changing market conditions.
- In the first half of 2022, the worsening trade-off between high inflation and slowing economic growth created a tricky market environment. The team expected market volatity to remain elevated and so increased exposure to the minimum volatility factor to stay invested in global equities, while reducing overall portfolio risk and softening swings in returns.

For more information about the iShares Enhanced Strategic International Managed Portfolio, please contact your BDM or request a call back.

What you need to know

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