portfolio construction forum

Trend to global investing still has much further to go

Dominic McCormick | Select Asset Management | 05 December 2014

Recently, I attended the Eureka Report - Around the World of Investing Forum which was held in conjunction with Platinum Asset Management. The growth of investing globally (at the expense of Australia's heavy home bias) is something I have written about over the last year or so.

Eureka Report can certainly gather a solid audience of self-directed/DIY investors together. It was a large full room of engaged (many aged) investors and I got the impression there was plenty of money there. However, the day confirmed my earlier thoughts that true global investing is very much still in its infancy for many DIY investors - and the industry servicing them.

The overwhelming impression from the day was that global investing, in any form, is very new to many (other than via Aussie stocks with global earnings). What is also somewhat surprising is the degree to which the day's focus was on "direct" investing overseas. It seems Eureka Report is targeting an audience that knows mostly how to invest in direct Australian shares and is trying to convert this approach to direct overseas shares because this is what they know. In the process, they seem to be bypassing - or at least downplaying - the approach to use managed funds, ETFs or LICs, or a combination of these. I suspect many of these direct investors will ultimately have bad experiences picking overseas stocks as most are likely to be very poorly diversified, owning just a few stocks only. Ultimately, many will choose to move to ETFs, LICs, and managed funds or a mix of these to achieve more diversification and for administration efficiency. (To some extent, I also expect this to happen with Australian stocks, but only after an extended period of poor performance from the banks given their dominance in self-directed investors' portfolios).

Of course, this direct focus was countered somewhat by the presence of Platinum Asset Management although they talked a lot about how they approached stock-picking and some of their current picks, rather than the case for their funds or more diversified approaches.

Many in the audience seem to struggle to move beyond Australia - there were questions about the view on Medibank Private (Platinum unsurprisingly had none) and even topics like potential energy independence in the US were turned into questions like "well, what does this mean for my Aussie oil stocks?" The view expressed in the following question by one investor in the follow up webcast perhaps summarises the opinion of many:

> "Given I am in income mode and I have an SMSF with a tax rate of 15%, why should I bother investing overseas when direct (local) stocks offer more attractive returns through the combination of dividends and franking credits?"

The diehard faith in this historically successful but poorly diversified approach, encouraged by the particularly good experience of the last two decades in Australian stocks, is somewhat scary to say the least.

The other interesting point at the program was the significant difference between the investment approach and current views of Eureka Report compared to Platinum Asset Management. Alan Kohler is excellent from the media perspective, but his bullish US (and India) - "the only two healthy economies" - while "scared" about China, Japan and Europe, seems very driven by momentum/consensus and current economics. And, (other than India) is almost the complete opposite of Platinum's more contrarian but valuation/opportunity-based view. Some investors probably left the day somewhat confused about where to invest.

In fact, Kerr Neilson heavily criticised the fixation on top-down economics and inflation/deflation drivers and highlighted the China six-year 60% bear market to earlier this year (despite having the world's best economic growth) as a clear example of markets being completely uncorrelated with economics (where the market compounded at negative 14% - the worst for any market in history - compared to negative 9% for US in the 1929 to 1933 bust/depression). He did this just before Eureka Report's economist gave his review of economies around the world.

Even the Eureka Report speakers are only gradually embracing global investing. Alan Kohler suggested his portfolio was 15% US/India and 8% global - a total of 23% is hardly an aggressive global share allocation. Robert Gottleibsen ended up talking more about the Australian situation after admitting that his major offshore play was Royal Dutch Shell many years ago. He spent time lamenting the limited local investable ideas in four growth areas he saw for the local economy - agriculture, tourism, infrastructure and health (I suppose indirectly pushing the case for global to better participate in these). In terms of investing in China, he stated "he'd be frightened about that".

Clay Carter who picks overseas stocks directly for Eureka Report subscribers mentioned 12 economic disruption trends and talked about specific stock opportunities arising from a few of these - for example, mobile internet, the internet of things, autonomous vehicles, etc. Many attendees were frantically writing down details of each of the stocks mentioned, presumably with the intention of buying soon.

There was some discussion of the above themes/sectors in the context of whether there were ETFs to participate in these. I believe ETFs or other fund structures will ultimately be the main way many investors participate globally. Australian investors will probably be happy to use passive ETFs when it is a specific bet on a country, region or sector, but for broad global investing or as a core, will use active funds such as Platinum or Magellan. Obviously, they need some help in selecting and weighting these. I believe LICs will hold the middle ground role, benefiting from being active and ASX-listed, but the choice is limited (about a dozen global-focused LICs), the company structure of most is a bit confusing, and the movement in discounts/premiums can have a big impact on return (which we clearly see as an opportunity).

Obviously, while Platinum were promoting their new global fund structure available on mFund - and it seems to be getting decent support - it remains unclear whether the mFund platform will take off more broadly as a route to global investment. Magellan have talked publicly about trying to get a global fund listed as a "active ETF" with full disclosure of the portfolio on a daily basis as one of the big sticking points with ASIC.

In the final panel session, Platinum's Kerr Neilson detailed some key holdings. He was particularly passionate that local investors have lost the plot by largely ignoring China/India (7% to 8% of world indices) despite a population of 2.5 billion people and China soon to be the world's largest economy (already there, by some measures). This was particularly the case regarding China given its relative and absolute cheapness from a Price-to-Book and PE perspective and emergence from a six-year bear market. This is obviously very consistent with our own view, as we noted in our recent article on China A shares.

Clearly, global investing still has a long way to go in Australia - even if some markets (such as the US) are in increasingly mature and potentially vulnerable bull markets that may lead to a volatile ride for many. I suspect periods like November where the Australian share market fell over 3% while global shares returned over 5% (helped by a weaker AUD) will be the biggest factor driving more interest in investing globally. Periods like this are starkly highlighting the concentrated nature of the Australian sharemarket, with almost two thirds in financial services and resources/energy.

Of course, as November suggests, the path of the AUD will go a long way to determining relative returns and therefore the inherent appetite for global investing. While the short-term path is clearly unpredictable, the AUD does seem still well above fair value on a long-term basis and subject to negative momentum that suggests more downside risk. One possible spanner in the works is the increasingly complacent consensus that the USD is now in a multi-year bull market. From a contrarian perspective, this and general pessimism about the AUD could mean markets surprise in the other direction at some point, at least for a period.

It will also be interesting to see the recommendations of final Murray Report due out this weekend, and whether they impact the relative attractiveness of local versus global investments. There are a range of issues that could have an impact:

- Requirements for more bank capital could reduce the attractiveness of a large part of the Australian sharemarket (and particularly the portfolios of many DIY investors);

- Restricting gearing on super (especially for residential investment) or gearing generally could cut the interest in residential property investment, making global shares more attractive; and,
- Limiting benefits of franking credits generally or for some investors again would reduce the relative attraction of local shares.

Of course, even some sensible recommendations may be too politically difficult to implement, particularly for a government that is not popular currently.

All in all, despite the contrasts/contradictions between the investment approach and views of Eureka Report and Platinum regarding the best places in the world to invest at the moment (that risked leaving some investors confused), this forum was a welcome step towards educating investors to think about a much broader opportunity set, and the basis to move at least a little away from Australia's pervasive and complacent home bias.

Given that many advisers are much further up the curve in global exposure, they are well placed to help many of these DIY investors if they ever reach out for assistance. Top of the list as candidates will be those DIY investors who blow up part of their portfolio trying to translate their happy experience (to date) in picking direct Australian shares into picking too few global stocks directly.

Dominic McCormick is Chief Investment Officer and Executive Director of Select Asset Management. Dominic has worked in investment management and financial services for 27 years and co-founded Select Asset Management in 2002. He has overall responsibility for investment strategy and research for Select's range of multi-asset, multi-manager portfolios, investing across the spectrum of traditional and alternative investments

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