



Why global equities?

People these days wake up and check their Apple iPhone or Samsung Galaxy. After using Colgate-Palmolive shampoo when showering, eating a breakfast that includes Kellogg's cereal and Danone yoghurt, using Johnson & Johnson dental floss to clean their teeth, putting on clothes washed with Unilever powder, they jump in their Toyota, Honda, Hyundai or BMW to head to work. During the day, they might catch up on the latest from friends on Facebook. At work they might buy something on eBay.com and use PayPal to secure Louis Vuitton shoes. Or perhaps it's a book on Amazon.com. All this is done on an IBM, Lenovo, or Microsoft laptop that is perhaps powered by an Intel chip. At night they might watch a Walt Disney movie on a Sony TV after playing tennis in Nike shoes.

The examples of how Australians use the products and services of foreign companies every day could go on and on. There's another angle to these companies, however, that many Australians may have overlooked. You can invest in them and potentially benefit from how people over the world use their products and service all day every day.

Global stocks are well worthy of consideration because stocks listed in Europe, Japan, on emerging markets and in the US offer diversification benefits and the potential for higher returns compared with investing in Australian equities.

Australian equities are not perfect

Australia boasts good companies too. Our mining companies such as BHP Billiton and Rio Tinto are world class. Amcor, Brambles, Computershare, ResMed, Seek and Westfield are global leaders in their respective fields. Other world-class local companies are Domino's Pizza Enterprises, Macquarie and Sydney Airport. These stocks have generally offered good returns over time too. The fact that Australia's biggest companies earn between 30% and 40% of their revenue from overseas means that Australians even get some exposure to the wider world when they invest in Australian equities. On top of this, franking credits give local investors an incentive to favour Australian equities over global stocks. When you own Australian stocks, there are no currency complications. The investing is all in Australian dollars and is done in the same time zone.

“ There are compelling reasons why Australian investors should consider an adequate allocation to global equities. ”

Despite all this, there are compelling reasons why Australian investors should consider an adequate allocation to global equities. In short, global equities offer the potential for higher returns while reducing the risk of an investor's overall portfolio by increasing diversification.

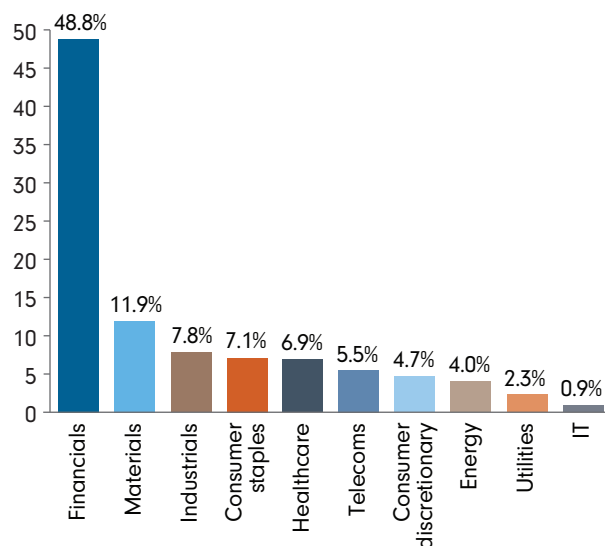
A few industries dominate

The first step towards building the case for investing in global equities is to first recognise the shortcomings of investing in Australian equities.

If you break down the most-watched barometer of the Australian share market by industry, it may come as a surprise to find out that nearly 50% of the S&P/ASX 200 Index comprises financial stocks. These are the stocks of the four big banks, insurance companies and listed property trusts. Another 12% of the index is materials, the sector where mining and mining-services companies fit.

So when you invest in Australian equities you are taking a sizable bet that financial and mining companies will do well. The flipside to this is that industries with potentially big futures such as IT and healthcare are barely represented or under-represented.

S&P/ASX 200 Index by industry (%)



Source: Fidelity as at 31 December 2015

A handful of companies dominate

Another shortcoming of investing in Australian equities is that the market is dominated by Australia's most well-known companies. The top-10 stocks comprised 51% of the index on the last day of 2015. The big four banks were nearly 31% of the benchmark! If one or two of these stocks stumble then the whole market is dragged down.

Think of it like this: If you invest only in Australian equity managed funds, you are more or less restricting yourself to about 20 of the world's 30,000 listed companies.

S&P/ASX 200 Index - top-10 holdings % of index

Commonwealth Bank	10.6
Westpac Banking	8.1
Australia & New Zealand Banking	5.9
National Australia Bank	5.8
Telstra	5.0
BHP Billiton	4.1
CSL	3.5
Wesfarmers	3.4
Woolworths	2.3
Macquarie	2.0

Source: Fidelity as at 31 December 2015

The other 97.6% of the world

Another observation that can be made about Australia is that it is a small country in terms of population and economy size. Our share market too is only a small part of the world market.

On 31 December 2015, Australia, for instance, was just 2.4% of the MSCI All Country World Index, a common benchmark for international share managed funds. The other 97.6% of the index covered about 2,500 stocks found on 23 other developed and 21 emerging country stock markets.

1. Access to the world's most successful companies

This brings us to the first advantage of investing in global equities. International shares allow investors to gain access to the world's most successful companies including its iconic brands. These stocks have the potential to offer higher returns than Australian equities.

The top-10 stocks in the MSCI World Index include Apple, the oil company Exxon Mobil, Microsoft, Johnson & Johnson, General Electric and Nestlé, companies whose products you may use every day.

Interestingly, the top-10 stocks comprised only about 9.0% of the MCSI World All Country Index on the last day of 2015; the biggest 50 stocks amounted to only 25.5% of the index. Global equities, by nature of the number of stocks on offer, are far better diversified at a stock level.

MSCI All Country World Index - top-10 holdings % of index

Apple	1.7
Microsoft	1.2
Exxon Mobil	0.9
General Electric	0.8
Johnson & Johnson	0.8
Amazon.com	0.8
Wells Fargo	0.7
JPMorgan Chase	0.7
Nestlé	0.7
Alphabet	0.7

Source: Fidelity as at 31 December 2015

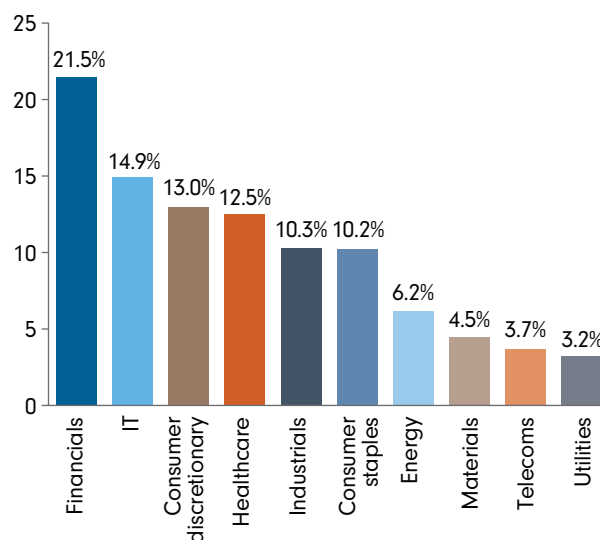
2. More industries to pick from

The second reason to invest in international equities is that they offer better industry diversification. Investors can access industries that aren't available on the Australian share market.

These include everything from long-standing industries such as car and aircraft manufacturers including Toyota and Boeing, to mobile phone makers such as Samsung of Korea, to electronics companies such as Sony and Philips.

At a broad level, you get a better balance of industries. Financials and materials only comprise 26% of the MSCI All Country World Index, not 61% like in Australia. IT is up at 15% of the index, not 1%. Healthcare is 13%, not 7%.

MSCI All Country World Index by industry (%)



Source: Fidelity as at 31 December 2015

3. You can diversify economic exposure

The third reason to think about international equities is that they can enable you to invest in developed countries that are at different points in the economic cycle than Australia or in emerging countries that are enjoying faster economic growth than Australia. This all adds to the diversification and potential returns of your portfolio.

Australia's economy might have done better than most other developed countries in recent decades but that won't always be the case. Having exposure to other countries will help offset the hit of the next domestic slowdown on your portfolio.

4. Spreading currency risk

The last reason why investing in international equities makes sense is that it enables investors to diversify their currency risk.

What does that entail? It means that when you invest in global equities your portfolio is not entirely based in Australian dollars because global stocks are bought in their local currencies.

If you have, say, a quarter of your portfolio invested in global equities, this portion of your portfolio is invested in assets that offer income streams in foreign currencies such as US dollars, euros, yen, pounds and even yuan. To change these assets into Australian dollars, you must sell them and then convert the proceeds at prevailing exchange rates.

“ Investing in international equities makes sense [in] that it enables investors to diversify their currency risk. ”

Assuming that few if anyone can predict exchange-rate movements, the diversification aspect to this is it can create a better match between your assets and liabilities. The assets side covers what you own or will own; that is, it can include your future wage earnings. Your liabilities side includes all the money you will spend in the future, including the amounts you will spend on imports in coming years.

The cost of these imports at any one time depends on prevailing exchange rates. Holding international assets will help compensate for the higher costs of imports should the Australian dollar slump. And remember it fell to as low as 47 US cents in 2001.

You can spread currency risk

- Portfolio construction theory, in part, is based on matching assets with future liabilities
- Your future liabilities will likely include spending on imports
- Investing in global equities can allow investors to diversify away from the Australian dollar

Hedging the currency effect

Investors can choose to forsake the currency-diversification aspect of investing in global equities by investing in a hedged global equity managed fund that largely neutralises currency movements. The effect of doing this is that investors only gain exposure to the equity returns generated by foreign share markets. In terms of their personal balance sheet, their holdings of foreign equities are effectively already in Australian dollars.

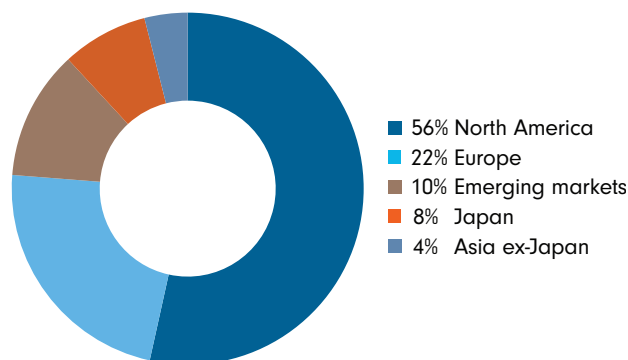
Your financial planner is the best person to advise you on whether or not to hedge some or all of your international equity investments.

Is now a good time to invest in international equities?

The MSCI All Country World Index can be split into countries or regions where the stocks are listed (according to their market capitalisation – the number of company shares multiplied by the price). About 53% of the index on 31 December 2015 comprised US stocks, about 22% are from Europe, 10% from emerging markets and 8% from Japan.

The question many might ask is: Why would I invest in an index full of countries with many economic hurdles to surmount? The answer is three-fold.

MSCI All Country World Index by country or region (%)



Source: Fidelity as at 31 December 2015

The world's leading companies are global in nature

The first is that many companies are global these days. Where they are listed and how their home economy is doing is less relevant than how the world is performing. General Electric, for example, earns 60% of its revenue from outside the US. Nestlé only earns 2% of its revenue in Switzerland – no surprise for a giant multinational. L'Oréal earns 62% of its revenue from outside Western Europe.

The second answer to the question about why you would invest in companies based in countries with struggling economies is that share prices might reflect the shape economies are in. That means you may be able to buy into good companies at a relatively cheap price.

The third answer to this question is that the countries and regions in the index have long-term potential and are home to many great companies:

US – Home of innovation

The US is the world's dominant economy and home to a well-diversified stock market. It's a country where shareholder value is enshrined as a goal. That means companies are managed with shareholders in mind. Reporting procedures are strict. Accounting is transparent. Stock options are a common way to align management with shareholder interests.

Europe – The world's largest economy

Europe taken as a whole is the world's largest economy. The region boasts the world's most technologically advanced industries. Economies such as Germany, France and the UK are home to great companies that are export powerhouses such as Barclays, Christian Dior, LVMH, Pfizer, Siemens and Vivendi. Peripheral countries such as Denmark, Latvia and Hungary have benefited from access to wider markets and are home to sound companies. Once again, because Europe's biggest companies earn much of their revenue from outside their home markets and Europe, many of them are doing much better than their home economies.

Japan – An export success

Japan's government is taking unprecedented action to revive the economy and Japan's corporate sector has undergone reforms. Japan's best companies have thrived and new ones have emerged, especially in the technology sector. Japan's biggest companies such as Canon, Honda, Nintendo and Sony are export juggernauts.

Emerging markets – Worth considering

Emerging markets represent diverse regions: Africa, Asia, Eastern Europe, Latin America and the Middle East. These regions have 80% of the world's population, 70% of foreign-exchange reserves, 50% to 90% of the world's supplies of oil, gas, iron ore, coal, copper, gold, nickel, uranium, bauxite, zinc, sell 40% of the world's exports and comprise 35% of global output. Their young populations, raw materials, growing middle classes, infrastructure needs, low labour costs and pro-business government policies mean they have vast investment potential.

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The Fidelity Global Equities Fund

The Fidelity Global Equities Fund is a core investment option that takes a benchmark-unaware approach to investing. This 'go-anywhere' approach allows the portfolio manager to take advantage of Fidelity research strength with global stocks.

The well-rated fund, which has a track record of more than 15 years, can invest in companies from all around the world and has loose portfolio constraints. Risk is managed by holding a diversified selection of thoroughly researched companies.

Key facts

- The fund aims to outperform the MSCI All Country World Index over the suggested minimum time frame of five to seven years.
- The fund is managed by Amit Lodha from Fidelity's UK-based Global Equity Team.
- The manager seeks to invest in companies that are positioned to deliver high earnings growth and capital returns, but where that potential is not yet fully reflected in the share price.
- The manager has access to the research of more than 400* investment professionals who can help him build a global view of companies.
- The portfolio holds between 80 and 120 of Fidelity's best global ideas.
- The fund is a bottom-up, actively managed fund. Portfolio concentration is driven by stock selection.

For more information on the fund, visit:
fidelity.com.au/funds/fidelity-global-equities-fund



Important information

*Investment professional number includes fixed income analysts and equity (including technical and shorting) analysts.

References to specific securities should not be taken as recommendations.

Investments in small and emerging markets can be more volatile than investments in developed markets.

Investments in overseas markets can be affected by currency exchange and this may affect the value of your investment.

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