GARVAN
FINANCIAL PLANNING

Guide to…

International Shares

Why invest in international shares in addition to Australian shares? The two basic reasons are:

- diversification, and
- opportunity

Diversification

Rural Australians understand the importance of planting different crops as a form of prudent protection. Insects, disease, a fall in market prices - factors outside of a farmer's control - can place the farm and family at risk if a single crop is the sole source of income. Diversifying crops - growing alfalfa as well as grapes - certainly reduces the risk. But what if a drought hits the entire farm and everything is lost? For this reason, many producers who are subject to the vagaries of nature have geographically dispersed their operations. For example, some wine producers may plant vineyards miles apart or even in different states.

Investments are like grapes. Planting some of your investments far from home can produce, overall, better and more reliable returns. When diversifying, it makes sense to look not just across the country, but across the ocean as well.

Generally, it is desirable to have some investment diversification outside of where you are domiciled.

Opportunity

Australian shares represent little more than 2% of the global opportunities in equity investments. Some exciting industries such as aerospace, software development and semi-conductors are not well represented in Australia. Also, some medical research companies in Australia have considered bypassing the Australian Stock Exchange to list on the American NASDAQ. Paradoxically, international investment may be necessary to access stock in innovative Australian companies.

An easy way of gaining a wide exposure to many sharemarkets around the world is through a managed fund that invests in global shares. Professional managers can make the country and stock selection decisions for you with the objective of achieving returns at least in line with a global benchmark, such as the Morgan Stanley Capital International (MSCI) World Index. Investing in a managed fund can offer investors instant diversification within the asset class.

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Risks

International shares, like any growth asset, fluctuate in value. You may be surprised to know that the volatility of international shares has historically been no greater than Australian shares. However, they can be more volatile than Australian shares over some time periods. One reason why international shares may show less volatility than Australian shares is due to the benefits of diversification in an international portfolio. At the same time, international shares can potentially generate higher returns than Australian shares.

Changes in the value of the Australian dollar can have a significant impact on the value of international investments. When the Australian dollar declines in value, your international shares become more valuable. By the same token, when the Australian dollar is rising in value, investments denominated in other currencies are worth less. This assumes there is no hedging or currency protection in place.

The currency risk of investing in international shares should be kept in perspective. Firstly, by investing across a range of countries with different currencies, the risk is diminished through diversification. For example, the Australian dollar may be strengthening against a major currency such as the Japanese yen at the same time it is falling against the US dollar. Secondly, over longer periods of time such as ten to twenty years, the impact of currency can be overshadowed by the underlying changes in the sharemarkets.

The risks inherent in international shares suggest that a concentration in this asset class would not be suitable if you have a short investment horizon. It may also be inappropriate if you cannot tolerate fluctuations in the market value of your portfolio.

International shares can be highly advantageous as part of a diversified, long-term investment strategy.

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