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TRANSCRIPT

No Place Like Home? Revisiting US Portfolios

*Featuring: **Raina Oberoi**, Head of Index Solutions Research for the Americas*

Adam Bass (00:03):

This is MSCI Perspectives, your source for weekly research insights as investors respond to the COVID-19 pandemic. I'm your host, Adam Bass and today is December 3rd, 2020. This week, it's true what they say, there is no place like home. When it comes to investing though, a home bias can leave a world of opportunity out of investors' portfolios, literally. Raina Oberoi, head of index solutions research for the Americas explains.

Adam Bass (00:33):

Raina, welcome back to the program.

Raina Oberoi (00:35):

Thanks Adam.

Adam Bass (00:37):

You were actually one of the first guests that we had on Perspectives back when we weren't at all sure how long any of this was going to last. It was still very early on in the pandemic, New York City where you and I both live and many other cities for that matter we're locked down. As we speak, unfortunately, cases have picked up again around the world. And in fact, as we were talking before we started recording, New York City public schools have been shuttered again. But I have to say, to me it doesn't feel good, but it feels different nine months later. If you're lucky enough to be healthy, employed, have a roof over your head, you adapt. I was curious if you're feeling that way as well and how you and your family have somehow adapted or even changed your expectations for what normal means.

Raina Oberoi (01:29):

Yeah, Adam. I clearly recall when I was on this episode a while ago, I think it was in March and I remember at that time, my biggest concern was getting to a hair salon. But today it's obviously different and you're right. We're all creatures of habit. And it's funny that you actually mentioned the New York City public schools shuttering because my son actually is a second grader at a New York City public school and I surprisingly reacted to the news of schools closing a lot more calmly this time than I did back in March. I do think that we all evolved and adapted and what's normal continues to evolve for me and my family.

Adam Bass (02:10):

When it comes to investing though, during the pandemic and surprises there, you were on a panel recently and I heard you talking about the out performance of global companies versus a purely domestic focused company here in the US. What specifically did you see there?

Raina Oberoi (02:30):

Sure. Adam, I think the first we need to iron out is really the definition. What we know what we may classify as a US company just based on its location, actually may not be a US company and actually becomes a global company if it generates its revenues from multiple countries and regions. And I think this bifurcation is important for investors, who may be thinking that they are actually investing in US companies only, but that may not be entirely true. Now, there are a couple of examples where you can see this play out and based on this, we can say that in many cases, global companies have outperformed the more domestic oriented companies.

Raina Oberoi (03:13):

Firstly, if you actually look at companies with majority of their revenues coming internationally or outside their domestic market, and by majority I say in excess of 25%, these group of companies actually have outperformed companies where most of the revenues are coming from their domestic market. And we saw this in particular through the crisis in the first quarter of 2020. And so the pandemic actually has been a good test to see whether these global companies tend to be more resilient because their revenue streams are more diversified globally.

Raina Oberoi (03:47):

Now let's say you are an investor and you want to invest only in US companies and do not want to take an international view. The reality is that you really are exposed to the world beyond the US. Now, if you take, for example, the MSCI USA index and screen for companies that get majority of their revenue from the US and then take that same index and screen for companies that get majority of their revenue from emerging markets, you will see that the ones that are more exposed to emerging markets are getting their revenue from emerging markets have actually outperformed for the last couple of years. Again, the underlying universe here in both cases is the US but it's really not binary, whether you want US exposure or non-US exposure.

Adam Bass (04:32):

It's very interesting, especially considering the theme. And this leads to that, that you and your team had been looking at around the idea of the US investor and home bias. Buying investments that are or at least to the point that you just made, they believe are exposing them to companies and revenues in the US exclusively.

Raina Oberoi (04:55):

Sure. firstly, I think just broadly speaking, everyone has touted the benefit of international investing as diversification. But the question really is if you are a US investor and we've seen that the US outperformed global equities the last few years, why should you look outside? I think it's a way of thinking that my home market or my domestic market has given me the returns I want. The MSCI USA index has about give or take 600 securities. It's a fairly diversified pool so it's not like you're in a concentrated market and you've gotten the returns that you want so what's the reason to look outside? I think if you look one level deeper at the top 10 assets of the MSCI USA index, they account for 26% of that index and that is the highest it's been in about two decades.

Raina Oberoi (05:46):

Now, if you take that same measure and look outside the US and look at the MSCI World ex US index, you will see that the top 10 assets actually account for about 11% of that index. You can see that there is a more balanced pool of securities outside the US and that index, as opposed to in the US where just a few names are really driving the market as opposed to the broader market. Again, the idea is that if these pool of securities do not continue their run, does that actually put the entire US market in jeopardy?

Raina Oberoi (06:20):

The second reason I would say is something that we are seeing more and more is, and you may have heard this term a lot is thematic. What some people call mega trends. Now, as you're aware, MSCI does have thematic indexes and really what these indexes are, are designed to provide investors opportunities to benefit from long term structural trends. And I think the important part here is, everyone may define a certain theme or think one theme is important than the other. The crucial part is that thematic investing is not sector investing. It's not ESG investing, it's not factor investing. It's its own unique, crucial lens, which can give investors insights into how companies are going to change their business models and value chain and how can investors capture these longer term structural growth opportunities?

Adam Bass (07:11):

Can you give us an example?

Raina Oberoi (07:14):

Let's say you just want to invest in the US and US is obviously a very innovative country. There's a lot of innovation happening here. Some of the themes that you would get exposed to primarily are internet innovation, cybersecurity, genomics, et cetera. What you would not get exposed to as much would be themes like efficient energy or smart cities or future mobility, which are themes that are more prominent outside the US.

Raina Oberoi (07:40):

And then the last point really is sustainability. And before we got into this crisis, everyone still knew about environmental, social and governance characteristics in investment portfolios, but the general understanding was that ESG strategies or ESG characteristics can help mitigate some element of risk. And it was really that. I think what the crisis has shown us that ESG strategies, not only in one particular market, but globally, have in general suffered less drawdowns compared to the underlying markets. The crisis actually has been a good test for such strategies.

Adam Bass (08:18):

It's interesting on a few of those points, when you talk about the top 10 names in the MSCI USA index, one of the issues is that you're more exposed to maybe even just a handful of companies in the US when that's not your intent. And there've been many stories about a handful of stocks, technology stocks, the FAANG stocks or sometimes the FAAMNG stocks, not sure how to pronounce that when Microsoft is in the mix, driving a lot of this rally, is that some of what you're seeing as well?

Raina Oberoi (08:49):

Yeah, absolutely. The usual suspects, Apple, Microsoft, Amazon, Facebook, Alphabet. Whether you call them technology or communication services, all these stocks are really the ones that are driving a lot of the returns in the US market.

Adam Bass (09:06):

And for all of these aspects that you mentioned, whether thematics, sustainability or index concentration, is it even valid to still look at the world as US and non-US or as you alluded to, has the scope of opportunity and perhaps more importantly, how investors construct their portfolios, has that evolved beyond that way of thinking?

Raina Oberoi (09:29):

Yeah. I think it's still relevant that US investors in general do tend to over allocate to their US piece of the pie, as I would say. And I think for that, I always say that if history is any lesson for us, there have been times where obviously the US has outperformed, like we've seen any market as outperformed, but there've been times for long periods where the US has trailed international markets. And something that, again, puts things in perspective is that given the US rally and its stocks have obviously had a good run. If you look at the weight of North America or North American companies in global equity in terms of market gap, that 60% of the MSCI All Country World Index, the ACWI index. You would say, "Look, I'm just investing in 60% of the world already." But if you actually take that same logic and apply in terms of revenue, those same companies actually only produce 30% of the revenues generated by all companies in the ACWI index.

Adam Bass (10:37):

You'd be missing out on these sources of revenue, which makes total sense. I'm wondering, do you see the same kind of home bias from investors in other countries? Or is this a uniquely US way of looking at the world?

Raina Oberoi (10:52):

Yeah, we don't see as much of a home bias. I think it's particularly pronounced in the US and it's a lot to do with what we spoke about earlier. US has had a great run. It is a fairly big pool of securities to pick from. There's less reason for US investors to really look outside.

Adam Bass (11:14):

And keeping our focus there around the world, it's kind of tough to talk about the idea of globalization, investing globally, without talking about the de-globalization movement, whether it's the election of so-called populous leaders or protests outside gatherings, such as the World Economic Forum, there's some sense of a dissatisfaction with the idea of globalization itself. Any thoughts there?

Raina Oberoi (11:42):

I definitely think that de-globalization, as we call it, is detrimental for many reasons as we discussed and will hurt growth if we work in silos, but there are two camps here. Some believe that this crisis has actually accelerated de-globalization. The idea is that there will probably be companies that will want to be more self reliant, will try to rely on production at home as opposed to internationally. There will be governments who will impose restrictions on flow of goods and information. And maybe there are investors who will be convinced or asked to reduce their international portfolio allocation. All of that could very well happen, but there's another side to the story as well, which I actually strongly believe in is that this pandemic can actually be a strong case for globalization.

Raina Oberoi (12:37):

Now we're obviously all fighting the virus together for a long time and we'll be fighting it in the near future at least if not in the long term, but that's not possible for one country to do. Similarly, if you think about yet another pandemic, which is climate change, that's impossible for one country to tackle. It has to be a coordinated response across countries, across geographies, across governments and this collective action is the only way we could fight a virus or we could fight climate change. That to me is actually a very profound, structural way of looking at why globalization actually will strengthen and the case for that will continue to convince people that this is the way we want to go.

Adam Bass (13:25):

And as you mentioned earlier, whether we want to be, we are at this point, all connected, whether it's in terms of fighting a disease or in terms of how companies make their money across the world.

Raina Oberoi (13:40):

Yeah, absolutely.

Adam Bass (13:42):

Well, Raina, thank you so much for joining us. It's always a pleasure.

Raina Oberoi (13:46):

Thanks, Adam.

Adam Bass (13:48):

That's all for this week. Our thanks to Raina and to all of you for joining us. Be sure to join us next week when we'll continue our global focus. We talk Chinese corporate bonds with friend of the program, Andy Sparks. Remember, it takes just a moment to subscribe to the podcast, leave a comment or share with a friend. Until next week, I'm your host, Adam Bass and this is MSCI Perspectives. Stay safe, everyone.

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