ISSN 2250-3153

Is International Investment Diversification Prudent to Either the Individual or Corporate Investor?

Caesar K. Simpson

Swiss Management Centre (SMC) University

Abstract- International Investment Diversification (IID) has been receiving widespread attention at both the academic and practitioner levels in recently time. Those in favor argue that international portfolio diversification is the source of an entirely different world welfare gain, distinguishable from both the gains from trade and the productivity gains from international factor movements. They argue further that there are other several potential benefits that make it attractive for investors to internationalize their portfolios. Although the implications of international diversification are well known, it is also well established in academic studies that investors consistently fail to exploit these effects, preferring to concentrate their investments in the equities of their home country, leading to what is popular known as "equity home-bias puzzle". It is in line with this debate that this paper presents a theoretical and empirical argument in favor of the topic*: Is International Investment Diversification Prudent to Either the Individual or Corporate Investor?* The paper established the fact that there exist both theoretical and empirical evidence that IID is prudent to both individual or corporate investor in the form benefits such as; Risk and reward; Diversification; New market; Expertise of International Venture Capitalist; Culture integration; and Microfinance.

Index Terms- Diversification, International investment, Equities, Portfolio diversification, Microfinance.

1. INTRODUCTION

The drift towards a greater incorporation of world capital markets, international diversification[1] of investment portfolios[2] has lately received extensive attention at both the academic and practitioner heights (Eun & Resnick, 1991). Initially, Grubel (1968) stretched the concept of modern portfolio analysis, initiated by Markowitz (1952) and Tobin (1958), to global markets (as cited in Eun & Resnick, 1991). He upheld that international portfolio diversification is the foundation of an entirely different world welfare gain, distinct from both the gains from trade and the productivity gains from international factor movements.

This understanding provided the motivation for a sequence of studies, such as Levy and Sarnat (1970), Solnik (1974), and Lessard (1976), which cooperatively established a resounding case for international portfolio diversification. The advocates of the International Investment Diversification (IID) contend extra that there are other numerous probable gains that make it striking for investors to internationalize their portfolios. These supposed benefits are the motivating dynamism and drive to engage in IID and they include; the participation in the growth of other (foreign) markets; hedging of the investor's consumption basket; risk and reward; diversification effects; and possibly abnormal returns due to market segmentation (Bartram & Dufey, 2001). political risks, costs and other institutional restraints and obstacles, for example, a host of tax issues, at best limit the possible merits, at worst contravene the benefits (Bartram & Dufey, 2001).

Even though the effects of international diversification are well known, it is also well recognized in academic studies that investors unswervingly fail to take advantage of these effects, favoring to focus their investments in the equities of their home country (Ruban& Melas, 2009). For instance, French and Poterba (1991) and Tesar and Werner (1995) projected the percentages of cumulative stock market funds invested in domestic equities in the inception of the 1990s to have been well above 90% for the U.S. and Japan and around 80% for the U.K. and Germany[3] (Michaelides, 2002). Cooper and Kaplanis (1994) stated that UK investors place 78.5% of their equity portfolios in domestic equities, against 10.3% of the UK market as a fraction of the world equity market capitalization (as cited in Ruban & Melas, 2009). Whereas comparative market capitalizations do not automatically agree to optimal portfolio weights[4], the wide discrepancy between domestic portfolio holdings and the weight of the domestic market in the world suggests a

[1]"Diversification is the process of investing a portfolio across different asset classes in varying proportions depending on an investor's time horizon, risk tolerance, and goals". (Thornburg Investment Management, n.d, para.1, as cited in Tebogo, 2011).
[2]A collection of assets (Amenc & Le Sourd, 2003, p.6)
[3] Cooper and Kaplanis (1986) argue that home bias seems to characterize smaller countries as well.
[4] The amount of influence that a portfolio security carries in terms of risk and or financial value (Greer, 2005, p.47)

diversification ineptitude. These include investor understanding and confidence for the local market on the one hand, and liability motivated investing deliberations on the other, as local assets can be a better hedge against investor liabilities than foreign assets (Ruban & Melas, 2009). This situation is popularly known as home-bias puzzle. Advocates of this reasoned that when the conditions of the real world are taken into consideration, further currency risks, political risks, costs and other institutional restraints and obstacles, for example, a host of tax issues, at best limit the possible merits, at worst contravene the benefits (Bartram & Dufey, 2001).

Nevertheless, the debate for international investment persist quite commanding: chances for real economic growth will vary among countries; diverse jurisdictions will follow dissimilar routes with respect to their social, economic, and political development (Bartram & Dufey, 2001).

This paper therefore presents a theoretical and empirical argument in favour of the topic*: Is International Investment Diversification Prudent to Either the Individual or Corporate Investor?* The rest of the paper proceeds as follows: Section1.1: History; Section 1.2: Current State; Section 1.3: Environmental Statement, Section 2: Discussion of the fact and issues; Section 3: Analysis of the facts and issues, Section 4: Conclusion; and Section 5: Recommendations

1.1 HISTORY

A comparison of the historical returns between on S&P 500 and MSCI EAFE Indexes as illustrated in Appendix 1 shows the international equities from the US perspective on the EAFE outperformed the domestic US equities on the S&P 500 from 1969 until they are caught and outperformed by the latter from the late 1990s until 2001 (Olma et al., 2004, as cited in Obiri, 2011). The increase in US Holdings[5] of foreign stock in the late 1990s can therefore be attributed to the historical performance of foreign stock prior to the late 1990s. This is due to the fact that investment decision making is usually based upon the historical performance of stocks (Bartram et al, 2001, as cited in Obiri, 2011). However, this is not always a good indicator of future stock performance as the better performance of the EAFE[6] from 1985 to 1991 in relation to the S&P 500; was not repeated in 1998 (Olma et al, 2004, as cited in Obiri, 2011). Empirical evidence shows that between 1973 and 2003 gains such as the USD$ 3-year annual return of 24.08% was posted by the MSCI EAFE against MSCI USA's 16.16% as well as the MSCI Emerging Markets annual return of 38.7% which was 20% better than the USA index (Strauss, 2005, as cited by Obiri, 2011).

Burtless (2006) evaluated alternative international investment strategies using historical annual return data covering the period from 1927 through 2005, the longest span of time for which comparable return data are available for a large sample of countries. In addition to the United States, his sample of countries includes Australia, Canada, France, Germany, Italy, Japan, and the United Kingdom. Measured in U.S. dollars, the market capitalization of companies traded in the stock markets of these eight countries accounts for about 84% of total world stock market. The result shows sizable differences in real returns across countries. One dollar invested in the Australian stock market in January 1927 would have yielded almost $280 to an Australian investor who survived to January 2006, whereas one lira invested in the Italian stock market in 1927 would have produced only 10.6 lira for an Italian investor in 2006. Investors in all countries have experienced periods in which equity returns were persistently above- or below-average. The persistence of equity returns is especially notable in Japan. Japanese investors enjoyed an extraordinary 15% annualized rate of return on equities between 1948 and 1989.

Holding shares in multinational companies (MNC) appears to provide an attractive and cost efficient vehicle for international portfolio diversification, because large MNC's are expected to benefit from financial economies of scale (Wright and McCarthy 2002). The results of Mikhail and Shawky's (1979) research provide evidence for the benefits of investing in MNC's. In their study, the average level of returns from their sample group of 30 MNC's is higher on both an absolute and a risk-adjusted basis than the aggregate return on the S&P 500 index[7] (Gupta, 2006). It is also argued that since differences exist in levels of economic growth and timing of business cycles among various countries, international portfolio diversification can be used as a means of reducing risk. In fact, the 1990s witnessed an explosion of international portfolio investment, especially among emerging markets. Mutual fund[8] companies such as Janus and Templeton achieved phenomenal rates of return on their investments during the mid to late 1990s. It should be made clear that while performances of these mutual funds over the long haul vary, it is still true that diversification reduces risk at a given level of return (Yavas, 2007). A simple analysis of data by Yavas (2007) indicates that during the study period (January 1999 to February 2002), the Unidirectional Moving Correlation Coefficients (UMCC) of NIK_t and DAX_t are not significantly different from zero (Appendix 3). In plain terms, Japanese and German markets are not correlated. The implication is that both Japanese and German investors can realize diversification benefits by investing in each other's' markets. The study also showed that the UMCC of Japan and the U.S. is likewise insignificant, implying that the American and Japanese investors may lower investment risk by investing in each other's markets (Yavas, 2007).

5. Appendix 2
6 Append 1
[7] Standard & Poor's 500 Index
[8] A mutual fund is a pool of investors' funds used as a financial instrument for investing in securities such as bonds, shares etc. (Jacobs, 2001. p1). Mutual funds are managed by a specialist investment management company (Jacobs, 2001, p.1)

1.2 CURRENT STATE

Notwithstanding the historical benefits of the International Investment Diversification, recent evidence shows that these benefits are decreasing over time as a result of increased integration of global financial markets (Chiou, 2009; Driessen & Laeven, 2007; Errunza, Hogan, & Hung, 1999; Longin & Solnik, 1995, as cited in Jiang, Ma and An, n.d). You and Daigler (2010) further demonstrate that the correlations among international markets vary substantially and exhibit a positive trend over time in their sample period, leading to a reduced benefit from international diversification. Emerging markets[9] are typically more volatile[10], less liquid, and less informational-efficient than developed markets, and there are many structural and institutional differences, as well (as cited in Jiang, Ma & An, n.d). Harvey (1995) illustrates that including securities in emerging markets helps reduce total portfolio risk by 6% for US investors as a result of the low correlation between emerging and developed markets (Jiang, Ma and An, n.d). Li, Sarkar, and Wang (2003) and Phylaktis and Ravazzaolo (2005) also evaluated the diversification benefits brought about by emerging markets and share a similar view.

On the contrary, De Roon, Nijman, and Werker (2001) argue that high transaction costs and short-selling constraints in emerging markets can easily erase these diversification benefits (as cited in Jiang, Ma & An, n.d). Driessen and Laeven (2007) explored diversification benefits from the perspective of a local investor, and found that investing abroad is particularly advantageous for investors in developing countries, and that most of these benefits are obtained from investing outside the home country region (as cited in Jiang, Ma and An, n.d). Chiou (2008) shows that investors in East Asia and Latin America benefit more from international diversification even when various constraints are considered. In recent years, the UK has seen a major shift towards global investing, either through separate UK and global ex UK mandates, or one mandate embracing both elements. There is evidence that many UK plan sponsors have reduced their domestic equity allocations to 50-60%, from a previous typical domestic allocation in excess of 70% (Motyl & Sweeting 2007, as cited in Ruban & Melas, 2009). In 2001, China was welcomed into the World Trade Organisation (WTO) and since then her economy had been growing at an accelerated rate as foreign direct investment started pouring into the country. That is, by joining the WTO China was able to give impetus to the economic reforms that begun in 1978 hence Chinese investors have been able to invest overseas and realize tremendous economic benefits through diversification (Jiang, Ma & An, n.d). All of the major U.S. indices ended the year 2006 having logged double-digit gains. However, even though Standard & Poor's 500 index turned in a 13.6 percent performance, an investor would have done better had he or she ventured outside the U.S. Using averages, domestic stock funds gained 12.6 percent in 2006 compared to 25.5 percent for international stock funds (Yavas, 2007). Not surprisingly, Charles Schwab, a leading U.S. - based broker[11], recommends that its customers rebalance their portfolios in favor of foreign equities (Yavas, 2007). Sonders (2006) asserted that many other financial advisors are also advising their clients to consider investment opportunities in overseas markets. While these recommendations by brokers may be specific to the current market conditions, globalization aided by advances in communication technology, abolition of capital and exchange controls, and deregulation in recent years, seem to have increased access to foreign markets.

1.3 ENVIRONMENTAL STATEMENT

Previous research on socially responsible investment (SRI) [12] dates back to the work of Moskowitz (1972), (Lobe, Oithmeier & Walkshäusl, 2009). Since then, much research has been undertaken concerning the performance of ethical investing. Early studies for the UK simply compare the performance of SRI investment funds to common benchmarks. However, no matter what benchmark is used, a broad market index (Luther et al., 1992) or a small company index (Luther et al., 1994), no definitive out- or underperformance is found (Lobe, Oithmeier and Walkshäusl, 2009). Hamilton et al. (1993) investigated the performance of SRI funds in comparison to a randomly selected sample of non-SRI funds for the U.S. market. They found that the performance of socially responsible funds is not statistically different from the performance of conventional funds (Lobe, Oithmeier and Walkshäusl, 2009). More advanced studies on the performance of SRI funds apply a so called *matched pair approach*, which means that an SRI fund is matched to a conventional fund with similar characteristics, e.g. investment universe, fund size, and fund age[13] (Lobe, Oithmeier and Walkshäusl, 2009). Socially responsible mutual funds in particular have experienced considerable growth over the last decade (Lobe, Oithmeier and Walkshäusl, 2009). According to the Social Investment Forum (2007), the number of funds rose to 260 alone in the United States, whereas in 2007 approximately 11 percent of the total assets under management were involved in socially related investing (Lobe, Oithmeier and Walkshäusl, 2009). The scope of this investment approach therefore varies from an investment in ethically classified companies, e.g. environment friendly, charitable giving or profit sharing firms (*positive definition*), to the method

[9] Emerging markets are nations with social or business activity in the process of rapid growth and industrialization (Yavas, 2007)
[10] A measure for variation of price of a financial instrument over time
[11] Individual who bring together buyers and sellers of investments
[12] SRI refers to the practice of directing investments in ways which combine financial objectives with the commitment to social concerns, such as economic development, healthy environment, peace, or social justice (Haigh and Hazelton (2004).
[13] The aim of this approach is to appropriately consider management and transaction costs for the SRI fund and the conventional fund that serves as a benchmark.

of avoiding investments in unethical or sinful businesses by imposing constraints based on ethical principles (*negative definition*). Recently, several studies (Bauer et al., 2005; Derwall et al., 2005; Geczy et al., 2005) applied multi-factor models[14], as proposed by Fama and French (1993) and Carhart (1997) to evaluate the performance of SRI funds. Using an international sample of German, UK, and U.S. ethical investment funds, Bauer et al. (2005) found no evidence of significant differences in risk-adjusted returns between ethical and conventional funds (Lobe, Oithmeier & Walkshäusl, 2009).

In contrast, Derwall et al.'s (2005) study revealed an outperformance for an SRI constrained portfolio (Lobe, Oithmeier & Walkshäusl, 2009). Based on eco-efficiency scores, they construct two portfolios with high-ranked and low ranked companies. They found a significant and persistent outperformance for the high- ranked portfolio, suggesting an *Eco-Efficiency Premium Puzzle* in the U.S. stock market. Chia et al. (2009) support the findings of Derwall et al. (2005), employing a sample of international renewable energy stocks. They concluded that a statistically significant *green factor* seems to have emerged in recent years (Lobe, Oithmeier & Walkshäusl, 2009). Despite the recent discovery of an ecological premium, the vast majority of studies have not detected a significant gap between social and conventional fund performance. Two well-known theories in the finance literature, the Capital Asset Pricing Model (CAPM) [15] and the Modern Portfolio Theory (MPT), suggest that individual and institutional investors should hold a well-diversified

2. DISCUSSION OF THE FACTS AND ISSUES

2.1 Risk and Reward.

International Investment Diversification (IID) allows investors to reduce the total risk of the portfolio, while offering additional profit (reward) potential (Burtless, 2006). By expanding the investment opportunity set, international diversification helps to improve the risk adjusted performance of a portfolio (Yavas, 2007). An institutional investor can achieve a well-diversified portfolio because the amount of funds in the portfolio is large enough for in-house diversification. Individual investors with limited wealth will have to find another way that does not require substantial funds to diversify their portfolios (Yavas, 2007). Mutual funds offer a quick and relatively inexpensive way to diversify for small investors and others. It is also argued that since differences exist in levels of economic growth and timing of business cycles among various countries, international portfolio diversification can be used as a means of reducing risk (Yavas, 2007). In fact, the 1990s witnessed an explosion of international portfolio investment, especially among emerging markets. Mutual fund companies such as Janus and Templeton achieved phenomenal rates of return on their investments during the mid to late 1990s. It should be made clear that while performances of these mutual funds over the long haul vary, it is still true that diversification reduces risk at a given level of return. Despite the fact that Exchange rate risk poses a threat to international investing where risk averse investors are concerned (Michaelides, 2002), it may be hedged[16] for major currencies by selling futures or forward currency contracts, etc.

Adding foreign bonds in a global asset allocation can be attractive from a risk-return viewpoint because of their low correlation with domestic bond[17] and stock investments (Yavas, 2007). Empirical study (Hansson et al, 2009) revealed that when emerging market debt and corporate bonds are incorporated into internationally diversified government bond portfolios; the diversification benefits of the latter are not significant. However, if corporate bonds are currency hedged, then they offer significant benefits while emerging market debt provides returns that are worthwhile to a developed market investor

For international diversification to benefit companies and individuals, it is worthwhile that foreign investments be considered over a wider time horizon (Tebogo, 2011). This is because value adding activities are likely to bring visible returns over a longer term rather than a shorter term period, since wealth created can be measured by the present value of future returns over the life of a portfolio of investments. Furthermore, a UK perspective shows that, international investing over the last decade or so has provided higher returns and lower risk; where the investment has been over one year, three years, five years or ten years (Ruban et al., 2009) (see Appendix 4). A drop in pound Sterling (GBP) against MSCI World[18] local international currencies could have contributed to the lower level of returns (see Appendix 5).

---

[14] Multi-factor models provide important insights into the investment style of SRI funds by measuring the exposure to pricing risk factors, such as size, value and momentum.
[15] CAPM is an arithmetic tool that is used to determine the prices of securities in a country's financial market (Bartram et al, 2006)
[16] Currency hedging is an important dimension of international investing. For a comprehensive review of currency hedging see Chang (2009).
[17] A security representing the debt of the company or government issuing it.
[18] MSCI World is a stock market index. It is maintained by MSCI Inc., formerly Morgan Stanley Capital International, and is often used as a common benchmark for 'world' or 'global' stock funds

Schindler (2009) presented empirical evidence to show that in the real estate business there tend to be a lower correlation between domestic real estate indices and those of foreign markets. From an investor's point of view this is good news, as it means that when one market is performing poorly the other will be bullish. Schindler further advised that in the real estate market there is little benefit to be gained from investing all resources in the same domestic real estate market, which have been found to have a higher positive correlation.

2.2 Diversification

Investors are increasingly taking a global outlook when it comes to investment decisions, rather than being confined to domestic markets. Straus (2005) reported that as of August 2005 $84 billion was invested in international and global funds as opposed to $83 billion invested in the domestic US market, a situation that some experts considered to be a healthy shift towards global portfolio diversification. However, it is important that companies should not be chasing financial performance, without careful analysis of all the relevant economic indicators. Commentators, especially in the US, argue that some international markets investors often chase are actually riskier than domestic markets. Straus, however, further indicated that in recent years international and overseas markets have been outpacing the US domestic market, a situation that should ideally motivate US based investors to go global.

2.3 New Market

Economies of scale[19] are often cited as some of the benefits of internationalization of business operations. (Tebogo, 2011). That is, companies are able to sell in new markets leading to growth in the number of consumers. With an increase in the number of consumers it is possible to mass produce in order to meet the increased demand, which makes it possible for fixed costs to be covered by a larger volume of production. Effectively, the increase in production results in economies of scale since the unit cost of production is lowered; enabling investors to compete on the basis of cost (Tebogo, 2011).

2.4 Expertise of International Venture Capitalists

International venture capitalists[20] often have expertise that can be transferred to local companies in areas such as "providing product market support, professionalizing firm management, setting effective incentive schemes, and monitoring firm management..." (Chemmanur, Hull & Krishnan, 2010, pp. 2). However, they may face problems understanding local conditions, which may not be ideal for a successful business operation. The problems are often exacerbated when the entrepreneur and the venture capitalists are distantly located, implying that the venture is not in a position to monitor the progress of the projects well. Under such situations, it might not be very beneficial for the venture to team up with local entrepreneurs. This, therefore, tends to support those propagating regionalism as opposed to internationalization since geographic distance makes it difficult for benefits to be realized by local entrepreneurs; notwithstanding the fact that investing individuals and companies might still benefit financially (Tebogo, 2011).

2.5 Culture Integration

International investors need to come to terms with cultural differences, especially where companies or individuals have to move across continents. This situation, therefore, calls for diversity management, for effective management of investments. Diversity management has been credited with providing an enabling environment for employees to achieve their objectives in line with those of their employing organisations, leading to congruency (Groschl, 2009) and avoiding dysfunctional decision making. Despite the benefits of diversity management in increasing productivity, quality improvement, creativity and other positive developments the author noted that most companies researched tended to adopt diversity management as a way of avoiding discrimination charges. A typical example of an industry where diversity management is very evident is the hospitality industry. Groschl (2009) noted that in the case of the hospitality industry, diversity management has become a necessity because hotels operate in various countries, with different cultures.

2.6 Microfinance

International investors can benefit from microfinance[21] in their well-diversified portfolio, even if short-sales restrictions are taken into account (Galema et al., 2009). Especially when microfinance is seen as part of the bond share of this portfolio, investing in MFIs seems to be an attractive investment. In fact, many institutional investors invest in microfinance by means of a fixed income investment. Equity finance still constitutes a minor part of microfinance funding (Galema et al., 2009). Microfinance can provide an attractive investment opportunity EVEN if investors are only interested in risk and return. If it is taken into account that microfinance also has a social aim, and if this is valued by investors, investing in microfinance even becomes more attractive.

---

[19] Economies of scale are the cost advantages that enterprises obtain due to size, with cost per unit of output generally decreasing with increasing scale as fixed costs are spread out over more units of output (Tebogo, 2011)

[20] People or organisations that provide financial capital to early-stage, high-potential, high risk, growth startup companies

[21] The supply of financial services to individuals and families on low income (Ledgerwood et al., 2006, p.30) in developing countries that have political stability, steady legal structures and respect private asset contracts (Carolan et al., 2008); is known as microfinance.

However, Galema et al.,'s (2009) analysis also indicates that it is more attractive for microfinance investors to invest in Latin America than in Africa. These investors are also more likely to invest in microfinance banks than in NGOs[22]. Moreover, the analysis suggests that it is especially attractive to add MFIs to the debt part of the portfolio.

3. ANALYSIS OF THE FACTS AND ISSUES

3.1 Risk and Reward

Burtless (2006) illustrated that depending on the level of risk and return subsisting in an overseas portfolio of investment, it should be possible for investors to realize a higher level of return with a lesser amount of risk than is possible in the domestic market- for stocks consisting entirely of domestic assets. Despite the expected higher returns through diversification, Burtless (2006) posits that factors such as extended low performance of foreign markets could lower returns for investors especially those who are looking towards building their retirement assets. In addition, the other factor that could affect performance is the relatively low strength of some foreign currencies, especially when compared to the US dollar. Burtless (2006) specifically argues that were workers with foreign investments to retire at a time when the US dollar has and is significantly appreciating, or when foreign markets have been going through an extended period of poor performance that could adversely impact financial results on investments

The objective of any investment action is to attain the highest possible return for the lowest possible risk (Obiri, 2011). However, there are a lot of factors to consider in order for this objective to be achieved. This applies to all types of investors –individuals or organisations whether they are risk averse or not because even the most risk averse investor wishes to maximise return within a certain boundary of risk. It is therefore crucial to investors that their portfolios are mean-variance[23] efficient (Bartram & Dufey, 2001). Additionally, as illustrated in Appendix 6, a portfolio must be optimal in terms of matching risk to return (Bartram et al., 2001). As such, for the highest possible return, a given amount of risk is involved and vice versa and this is possible when combining international stocks and bonds in a portfolio (Bartram et al., 2001).

Also, international investment diversifications are not only subject to exchange risk and political risk[24], but there are many institutional constraints and barriers, significant among them a complexity of tax issues. These constraints, while being reduced by technology and policy, international investors must manage to overcome these barriers in an effective manner (Bartram & Dufey, 2001).

3.2 Diversification

Globalization, as characterized by the movement of goods, services, capital and other factors, has provided an impetus for international investment. This phenomenon is taking place even where investors are not keen on international diversification, and in some cases happens without the knowledge of investors. This is because a company based locally could either be foreign or domestic, and if it is listed on a stock market and one invests in it that inevitably means that diversification on an international level would have taken place (Tebogo, 2011)

3.3 New Market

Improvements in technology, communication and transportation have resulted in the flourishing of globalized trade, as well as international trade. These developments have led to an increase in demand for financial products, in view of relaxation of capital and exchange controls, as well as liberalized financial markets[25]. As such, investors are able to seek opportunities for investments in other regions making it easier for international diversification. In addition, emerging countries are becoming appealing to international investors, as they become increasingly accessible due to improvements in telecommunications and transportation systems (Tebogo, 2011).

3.4 Expertise of International Venture capitalists

Globalization, as characterized by the movement of goods, services, capital and other factors, has led to removal of numerous physical barriers to international investing providing an impetus for international investment. These developments have for example the relaxation of capital and exchange controls, as well as liberalized financial markets is leading increase in demand for investment opportunities by Venture Capitalist outside their home countries (Chiang & Lo, 2007; Tebogo, 2011).

---

[22] Non-Governmental Organisations

[23] A portfolio that has the highest potential return for a stated amount of risk (Choudhury et al., 2011).

[24] Political risk is based upon country factors such as government stability, social stability and the extent of government intervention in an economy (Brink, 2004, p.62).

[25] Relaxation of previous government restrictions, usually in such areas of social and economic policy. In some contexts this process or concept is often, but not always, referred to as deregulation (Sullivan & Sheffrin, 2002).

3.5 Culture Integration

There are arguments in some quarters that regionalism, rather than internationalization is more important in driving economic development and bringing wealth to corporations and individuals. The contention is that companies normally expand into neighboring states before going international, due to similarities in culture and geographic proximity (Akhter & Beno, 2011).

3.6 Microfinance

Another benefit of international diversification is being witnessed in the area of micro finance. (Tebogo, 2011) Historically, micro finance institutions have been playing a crucial role in the provision of finance to poor residents, especially in developing countries. These micro finance institutions have been instrumental in providing the requisite working capital for small businesses. In addition, a number of microfinance institutions were dependent on donations from private and public organisations, as well as aid agencies. In a number of instances this type of assistance was inadequate, for them to provide the necessary assistance. The landscape is, however, changing as international commercial banks are beginning to reach other parts of the world like never before to provide finance needed by microfinance institutions (Galema et. al., 2009). This illustrates the positive influence international diversification has on global economic development and the potential benefits that could accrue to small investors.

4. CONCLUSION

While some controversy exists among investment professionals regarding the benefits and costs of International Investment Diversification, there are therefore enough empirical evidences that both individual and corporate international investors can participate in the growth of other countries, hedge their consumption basket against exchange rate risk, realize diversification effects and take advantage of market segmentation on a global scale (Bartram & Dufey, 2001; Ruban & Melas, 2009; Burtless, 2006; Driessen & Laeven, 2007; etc.)

There is agreement that international equity portfolio diversification recommendations are based on the existence of low correlations among national stock markets. International diversification will result in risk reduction for a given return as long as the correlation coefficient between the domestic and the foreign market is less than one. Lower future correlation will provide deeper risk reduction.

On the other hand, if it is true, as some recent studies have shown, that cross-country correlation is increasing, due perhaps to the growing interdependence among the international markets, then benefits of international portfolio diversification may be overstated.

5. RECOMMENDATIONS

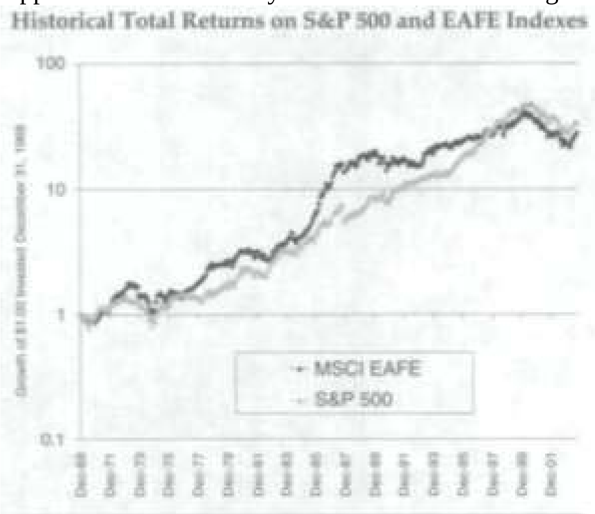
Even though these advantages might appear attractive, the risks and constraints for international portfolio investment must not be overlooked. Investors must employ strategic investment techniques to ensure that they minimize risks and maximise returns. Particular caution should be given to the choice of country; choice of market; the correlation between the securities and markets chosen; optimal portfolio weights; and portfolio balance to obtain maximum diversification benefits (Bartram et al., 2001). It is crucial to ensure that portfolios are mean-variance efficient, as the portfolio components derived from this method are relatively stable (Bartram et al., 2001).

It might be most sensible for the private investor to consider investing in international mutual funds, preferably those that are linked to a world capital market index (suitable indices) (Bartram et al., 2001).

Finally, this paper recommends that, all types of investors should carefully research the stocks and markets (Wiersema et al., 2008) that they wish to invest in or ensure that they employ the services of a reputable investment management company.

APPENDIX

Appendix 1 – The History of International Investing



Source: Obiri (2011)

Appendix 2 – US Holdings of Foreign Securities

(year-end 1998 and 1999, in billions of dollar)

	1998	1999
Total Holdings of Securities	2,052.9	2,583.4
Bonds	576.7	556.7
Corporate Stocks	1,476.2	2,026.6

Source: Scholl (2000).

Source: Obiri (2011)

Appendix 3 - Unidirectional Cross Correlation Coefficients

Table 2: Unidirectional Cross Correlation Coefficients

INDICES	Median Correlation Coefficients	Maximum Correlation Coefficients
NIK_t & DAX_t	0.225	0.341
NIK_t & SP_t	0.138	0.404
DAX_t & SP_t	0.528***	0.787
SP_{t-1} & NIK_t	0.347**	0.540
SP_{t-1} & DAX_t	0.237	0.426
DAX_{t-1} & NIK_t	0.300	0.413

***significant at α=.05; * *significant at α=.10.

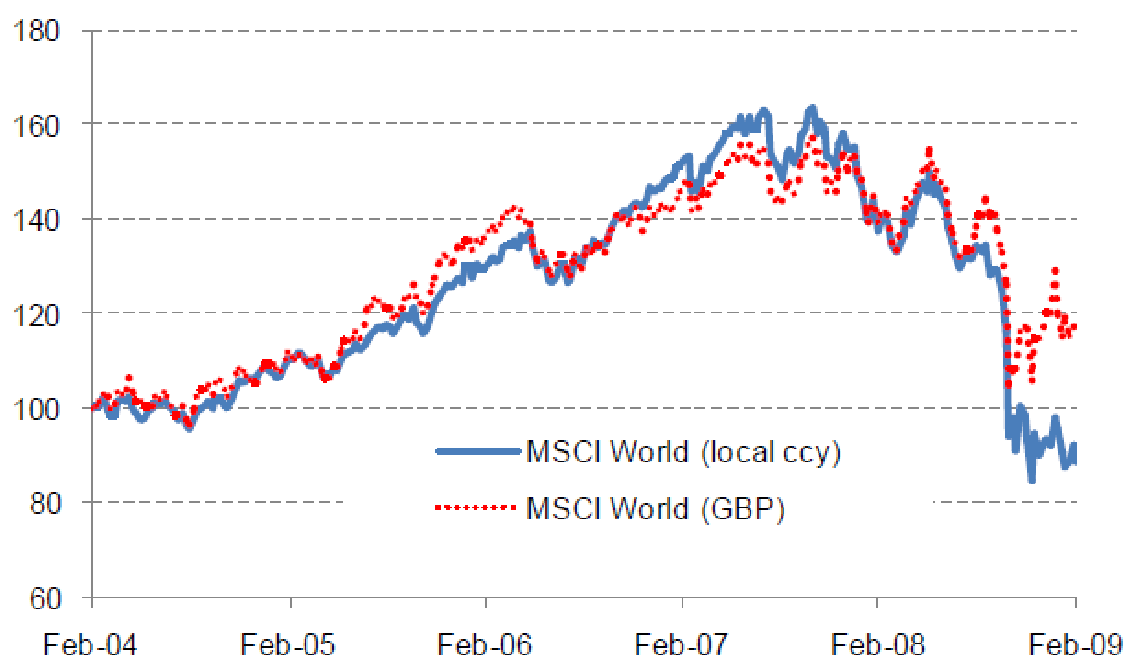
Source: Yavas (2007)

Appendix 4– Performance of MSCI domestic and International Indices in GBP

	1 year		3 years		5 years		10 years	
	Annualized return	Annualized risk	Annualized return	Annualized risk	Annualized return	Annualized risk	Annualized return	Annualized risk
UK	-28.78%	37.49%	-4.87%	24.27%	3.14%	19.65%	0.38%	18.85%
ACWI IMI	-24.29%	30.07%	-4.28%	20.16%	3.51%	17.20%	1.79%	18.19%
World Min Volatility	-10.53%	25.55%	-1.76%	16.83%	4.06%	14.37%	1.41%	13.76%

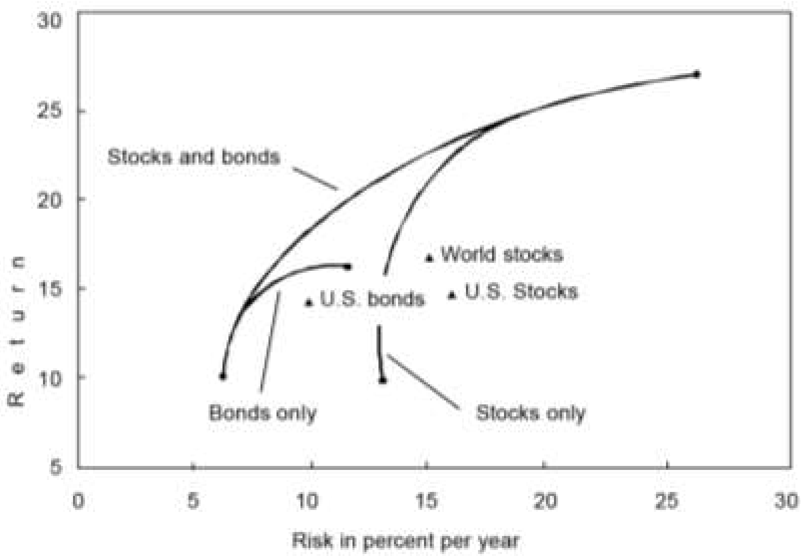
Source: Obiri (2011)

Appendix 5 – Currency Effect in World MSCI Index



Source: MSCI Barra
(As cited in Obiri, (2011)

Appendix 6 – Efficient Frontier for International Stocks and Bonds (USD, 1980 -1990)



Source: Obiri (2011)

.

ACKNOWLEDGMENT

I wish to register my profound gratitude to the Almighty God for making this possible. I also hereby wish to acknowledge the supports from my wife and children.

REFERENCES

[1] Akhter, S.H., & Beno, C. "An Empirical Note on Regionalization and Globalization". The Multinational Business Review, 2011. vol. 19, Issue 1, pp. 26-35.

[2] Bartram, S., M. & Dufey, G. "International Portfolio Investment: Theory, Evidence, and Institutional Framework". *Financial Markets, Institutions & Instruments*, 2001, vol. 10, issue 3, pp. 85 -155

[3] Bauer, R.; Koedijk, K., & Otten, R. "International evidence on ethical mutual fund performance and investment style". Journal of Banking and Finance, 2005, vol. 29, issue 7, pp.1751–1767

[4] Burtless, G. "Risk and reward of international investing for U.S. retirement savers: Historical evidence, 2006

[5] Carhart, M.M. "On persistence in mutual fund performance". Journal of Finance, 1977, vol. 52, issue1, pp. 57–82

[6] Chemmanur, T. J., K. Krishnan & Nandy, D. "How Does Venture Capital Financing Improve" Efficiency in Private Firm, 2010.

[7] Chia, C.P., Goldberg, L.R., Owyong, D.T., Shepard, P., & Stoyanov, T. "Is there a green factor?" Journal of Portfolio Management, 2009, vol. 35, issue 3, pp. 34–40

[8] Chiang, M., & Lo, C. "Are Venture Capitalist able to certify initial Public Offerings? Testing using intraday price behaviour." Investment Management and Financial Innovation, 2007, vol. 4, issue 4.

[9] Chiou, W.P. "Who benefits more from international diversification?" Journal of International Financial Markets, Institutions & Money, 2008, vol.18, issue 5, pp. 466-482.

[10] Chiou, W.P. "Benefits of international diversification with investment constraints: An over-time perspective" Journal of Multinational Financial Management, 2009, vol.19, issue 2, pp. 93-110.

[11] Cooper, I. A., & Kaplanis, E. "Costs of Cross Border Investment and International Equity Market Equilibrium." In Recent Advances in Corporate Finance. Jeremy Edwards, ed. Cambridge: Cambridge University Press, 1986.

[12] De Roon, F.A., Nijman, T.E., & Werker, B.J.M. "Testing for mean-variance spanning with short sales constraints and transaction costs: The case of emerging markets. Journal of Finance, 2001, vol. 56, issue 2, pp. 721-742.

[13] Derwall, J., Guenster, N., Bauer, R., & Koedijk, K. "The eco– efficiency premium puzzle" Financial Analyst Journal, 2005, vol. 61, issue 2, pp. 51–63

[14] Driessen, J., & Laeven, L. "International portfolio diversification benefits: Cross-country evidence from a local perspective" Journal of Banking and Finance, 2007, vol. 31, issue 6, pp. 1693-1712.

[15] Errunza, V., Hogan, K., & Hung, M.-W. "Can the gains from international diversification be achieved without trading abroad?"

Journal of Finance, 1999, vol. 54, issue 6, pp. 2075-2107.
[16] Eun, C.S., & Resnick, B., G. "International diversification of investment portfolios: U.S. & Japanese Perspectives" 1991
[17] Fama, E., & French, K. "Common risk factors in the returns on stocks and bonds" Journal of Financial Economics, 1993, vol. 33, issue 1, pp. 3–56
[18] French, K. R., & Poterba, J., M. "International Diversification and International Equity Markets." American Economic Review, 1991, vol. 81, issue 2, pp. 222-26.
[19] Geczy, C.C., Stambaugh, R.F., & Levin, D. "Investing in socially responsible mutual funds". Working Paper, 2005.
[20] Gupta, R. "Benefits of diversification into emerging equity markets with changing correlations: An Australian perspective" International Review of Business Research Papers, 2006, vol. 2, issue 4, pp. 22-38
[21] Grubel, H. "Internationally Diversified Portfolios: Welfare Gains and Capital Flows" American Economic Review, 1968, vol. 58, pp. 1299-1314.
[22] Hamilton, S. Jo, H., & Statman, M. "Doing well while doing good? The investment performance of socially responsible mutual funds". Financial Analysts Journal, 1993, vol. 49, issue 6, pp. 62–66
[23] Harvey, C.R. "Predictable risk and returns in emerging markets" Review of Financial Studies, 1995, vol. 8, issue 3, pp. 773-816
[24] Jiang, C., Ma, Y., An, Y. "International diversification benefits: An investigation from the perspective of Chinese investors" n.d.
[25] Kempf, A., & Osthoff, P. "The effect of socially responsible investing on portfolio performance" European Financial Management, 2007, vol. 13, issue 5, pp. 908–922
[26] Lessard, D. "World, Country and Industry Relationships in Equity Returns: Implications for Risk Reduction through International Diversification" Financial Analysis Journal, 1976, vol. 32, pp. 2-8.
[27] Levy, H., & Samat, M. "International Diversification of Investment Portfolios" American Economic Review, 1970, vol. 60, pp. 668-75.
[28] Li, K., Sarkar, A., & Wang, Z. "Diversification benefits of emerging markets subject to portfolio Constraints" Journal of Empirical Finance, 2003, vol. 10, issue, 1-2, pp. 57-80.
[29] Lobe, S., Oithmeier, S., & Walkshäusl C. "Vice vs. Virtue Investing" 2009.
[30] Longin, F., & Solnik, B. "Is the correlation in international equity returns constant: 1960-1990" Journal of International Money and Finance, 1995, vol. 14, issue 1, pp. 3-26.
[31] Luther, R.G., Matatko, J., & Corner, D.C. "The investment performance of UK 'ethical unit trusts'" Accounting, Auditing, and Accountability Journal, 1992, vol. 5, issue 4, pp. 57–70.
[32] Luther, R.G.,& Matatko, J. "The performance of ethical unit trusts: Choosing an appropriate benchmark" British Accounting Review, 1994, vol. 26, issue 1, pp. 77–89.
[33] Markowitz, H. "Portfolio Selection" Journal of Finance, 1952, vol. 7, pp. 77-91.
[34] Michaelides, A. "International Portfolio Choice, Liquidity Constraints and the Home Equity Bias Puzzle, London School of Economics, CEPR and FMG, 2002.
[35] Moskowitz, M.R. "Choosing socially responsible stocks" Business and Society, 1972, vol. 1, issue 1, pp. 71–75
[36] Obiri, C. "Is International Investment Diversification prudent to either the individual or corporate investor?" 2011.
[37] Olma, A., R. & Siegel, L., B. "A New Framework for International Investing. *Journal of Portfolio Management*, 2004, vol. 30, pp. 55 -69.
[38] Phylaktis, K., & Ravazzaolo, F. "Stock market linkages in emerging markets: Implications for international portfolio diversification" Journal of International Financial Markets, Institutions & Money, 2005, vol. 15, issue 2, pp. 91-106.
[39] Ruban, O., & Melas, D. "International Diversification from a UK Perspective - *Exploring the Risk-Reduction Effects of Diversification for UK Investors" 2009*
[40] Schindler, F. "Long term Benefits from Investing in International Real Estate" Discussion paper No.09-023. Centre for European Economic Research, 2009.
[41] Solnik, B. "Why Not Diversify Internationally" Financial Analysts Journal, 1974, vol. 20, pp. 48-54.
[42] Sonders, L. "Best Ideas for 2007 and Beyond: Be the Smart Money," Charles Schwab & Co., Inc. 2006.
[43] Strauss, L., C. "Fund Buyers have taken to Globe-Trotting. *Lipper Mutual Fund Quarterly*, 2005, vol. 85, issue 41. p.3.
[44] Tesar, L., & Werner, I. "Home Bias and High Turnover." Journal of International Money and Finance, 1995, vol.14.4, pp. 467-92.
[45] Tobin, J. "Liquidity Preference as Behaviour towards Risk, the Review of Economic Studies" 1958, vol. 26, pp. 65-86.
[46] Wright, A., & McCarthy, S. "Does Purchasing Stock in Australian Multinational Corporations Create International Portfolio Diversification? Multinational Business Review, Spring, 2002, pp.79-83.
[47] Yavas, B., F. "Benefits of International Portfolio Diversification: Findings indicate that co-movements among the U.S., Germany, and Japan markets are significant, *2007, vol.* 10, *issue 2.*
[48] You, L., & Daigler, R.T. "Is international diversification really beneficial?" Journal of Banking and Finance, 2010, vol. 34, issue 1, pp.163-173.

AUTHOR

Caesar K. Simpson, BA (Hons), MBA, ACCA,
Swiss Management Centre (SMC) University, *simpsonck@yahoo.com or* caesar.simpson@student.swissmc.ch