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summaries

SIGMA INVESTMENT COUNSELORS

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PORTFOLIO DIVERSIFICATION BEYOND US BORDERS

Sadly, the tragic death and destruction happening in Ukraine illustrates the downside of geographic investment diversification particularly as it relates to political instability and risks of conflict. While we are strong proponents of diversification (it is bred in our souls and remains an essential staple of investment practice), sometimes too much of a good thing is a bad thing.

Investing in international equity markets requires an analysis of the country(ies) as well as the company(ies). This includes foreign exchange risk; interest rate and inflation risks; political leanings (capitalism, communism, socialism) and of course, the aforementioned geopolitical risks. Publically traded Russian companies today are being removed from various stock exchanges around the world. Ukrainian companies have been decimated both due to the physical toll of the bombing and the mass exodus of their most valuable asset, their people.

When it comes to investing in public markets, having all eggs in one basket, or a large concentration in one basket, is not the way to preserve and grow wealth. Our collective experiences at Sigma Investment Counselors have taught us over the long term that diversification is a key factor in influencing the ability of portfolios to preserve and grow the capital necessary for clients to achieve their long term financial goals. Within the public markets this means not only geographic diversification but also diversification across asset classes (equities, bonds, cash); industry sectors (industrials, healthcare, technology, etc.) various sized companies (large, medium and small); as well as companies from all regions across the globe (both developed and emerging markets). For those clients whose circumstances are supportive, diversification into alternative investments such as real estate or private equity is also appropriate.

No system is perfect. However, US capital markets represent a testament to the power of an environment where creativity and ingenuity can flow freely and those ideas are then supported and expanded by the power of capital markets operating in a free and transparent manner. The US represents only 5% of the global population, yet continues to be the global leader in economic activity, producing approximately 25% of the world's goods and services (GDP). In addition, US capital markets are far deeper and more liquid than anywhere else in the world.

There are many compelling reasons to invest in international markets. The rest of the world represents 95% of the world population and 75% of the world's good and services. Furthermore, many of the emerging markets have younger populations and a growing middle class. It would be irresponsible in our role as investment advisors to not analyze investment opportunities beyond our borders.

Over the past several years what has distinguished Sigma's overall equity performance versus many of our competitors is our decision to diversify our equity exposure across the globe but not blindly accepting the global benchmarks as the "measuring stick" or geographic asset allocation mandate of choice. Global benchmarks reflect the total public investment opportunity in global markets. Today the benchmark weighting is over 55% US companies with less than a 45% weight in companies across the rest of the world. Our portfolios remain significantly underweight international companies versus this benchmark. While recognizing the importance of diversification we also recognize that 99% of our clients are US domiciled and hence their future obligations will be in US dollars. Primarily for this reason, it is unlikely we would ever be close or at benchmark weight with regard to our portfolio weighing in direct international exposure.

Like everything, there is an ebb and flow to markets. There have been long periods when international markets have out-performed domestic markets. Twelve years ago the benchmark was reversed, with almost 55% of the benchmark represented by foreign companies and only 45% being US companies. Of late, the pendulum has swung back to better US market performance and a stronger dollar. Heading into the COVID crisis in February of 2020 our economy was in better shape than most and has rebounded better and faster than most of the rest of the world. The US stock market performance over that time has reflected that strength relative to other markets.

For now, our portfolios remain at the lower end of our range for exposure to both international developed and emerging markets. Over time we will increase portfolio exposures as we deem appropriate. And, while we will likely never match the benchmark exposures, our portfolios will be well positioned to participate when the tide turns and international equities outperform US equities.

We welcome all comments and questions.

Denise Farkas, CFA
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