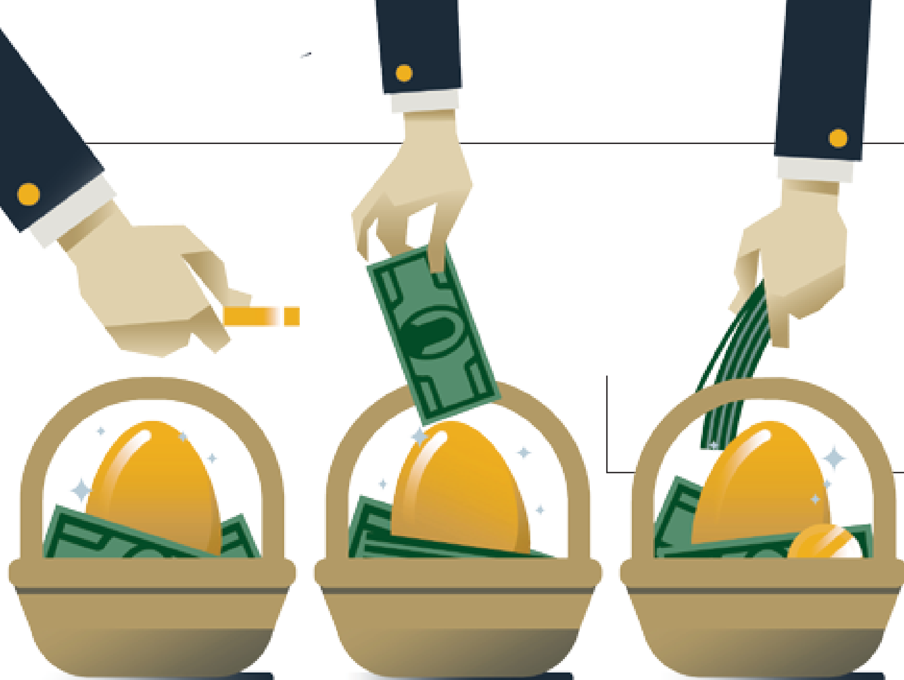

WORLDLY WEALTH

As I wrap up the last class session of my International Economics course, I am reminded of our interdependent, global economy. Much can be said about the value of trade between countries that brings an increasing amount of consumer choice in the markets, a new type of empathy for (or interest in) other countries, and the increasing interdependence of the overall stock markets. What does this increasing interdependence mean for our global array of stock markets?

It is generally accepted in financial planning to recommend a well-balanced, diversified portfolio. One should have a mix of stocks, bonds, and cash that suits one's risk tolerance, goals for the future, and personal choice. This balance is often diversified further to include both domestic and international stocks and bonds.

Merriam-Webster defines diversify as "to change something so that it has more different kinds of people or things." A common saying that encourages diversification is "Don't put all your eggs in one basket," which reduces the risk of breaking all the eggs if one basket is dropped. The Bible even covers this topic in Ecclesiastes 11:2, "Divide your portion to seven, or even to eight, for you do not know what misfortune may occur on the Earth."

Given that diversification reduces risk, the application of this term to investing is quite sensible. Historically, international markets have operated differently from the U.S. market. Returns to stock prices overseas have varied and not been highly correlated with the returns of our domestic market. This is one of the arguments for adding international stock to a portfolio. If the U.S. stock market drops, it may be offset by the stability of or increase in an alternate international market.

This, however, is not as true today as it was in the past. With increasing economic globalization and interdependence, changes in one market can effectively impact others. Since the 1970s, correlations between global markets and the U.S. market have increased — which means they move in the same direction more in today's global economy than previously. Indeed, the housing crisis in 2008 was a shock felt around the world.

Obviously, we are still advised to diversify internationally. We just need to do a bit of homework first. Here are some considerations for diversification of an investment portfolio: an investor can choose an allocation of investments denominated in different currencies; invest in different countries (various stock markets around the world); purchase specific shares of stock ownership in domestic or global firms, and specific bonds where the investor receives a fixed return (also called fixed income). Correlations have been historically low between stock indices of one country and bond portfolios of another.

The above are all good considerations for an investor to control risk in a portfolio. Whether you are a passive investor or an active investor, you may do well to consider finding a financial planner to help navigate the complicated system of financial investing.

ROBIN HENAGER (Brenau University), Ph.D., is an award-winning researcher and assistant professor in economics and finance in the School of Business at Whitworth University in Spokane, Washington. She is a University of Georgia graduate who focuses on financial literacy, financial education, and student debt. She also leads a peer educator program at Whitworth focusing on financial literacy for college students.