TD Asset Management

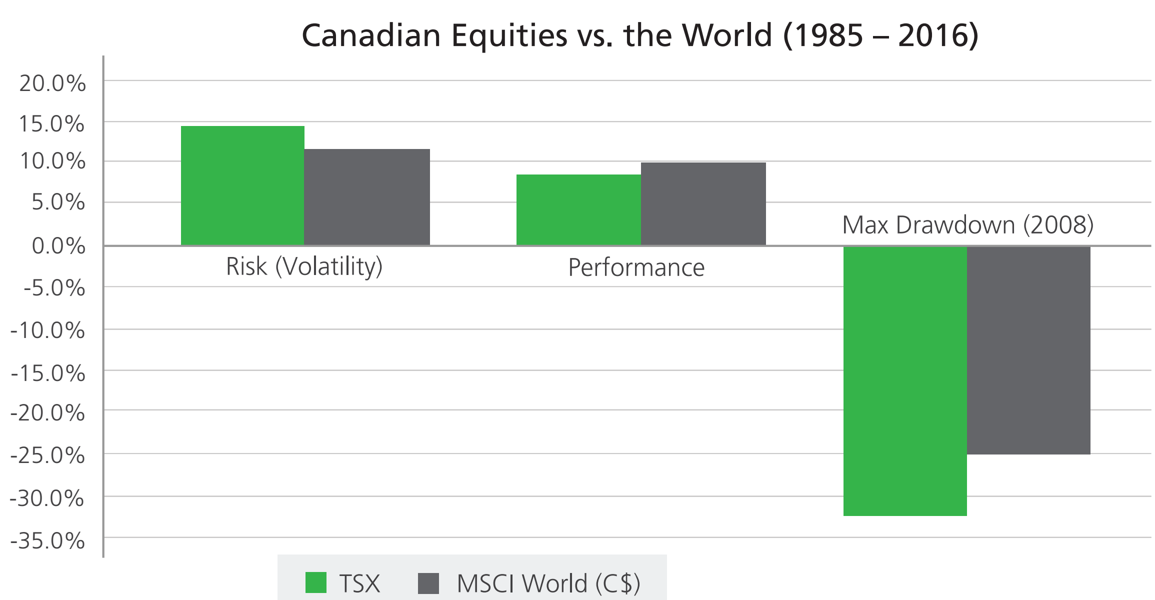
Global Diversification:
Avoiding Domestic Bias

Despite Canada's small global presence, Canadian investors tend to be influenced by a home country bias and average 65% Canadian equity allocation within their portfolios.[1] Canada's main equity benchmark, S&P/TSX Composite Index (TSX), comprises about 4% of the global equity market as represented by the MSCI World Index (MSCI World), and the Canadian economy contributes approximately 2.3% of global GDP.[2] Should Canadian investors continue to maintain this allocation level or look to more broadly diversify across the global equity marketplace? If increasing global exposure provides benefits, then what is the optimal allocation for Canadian equities within a portfolio?

How do Canadian equities measure up on a global scale?

Some investors believe that increasing international equity exposure within a portfolio will elevate risk levels due to possible unknowns associated with owning foreign currency assets. To clear up these misconceptions, we will examine how Canadian equites measure up against their global counterparts from a risk, return and asset allocation perspective. The data in the chart below shows that the TSX experienced higher volatility and underperformed the MSCI World over a 30 year period (1985-2016).[2]

The TSX also underperformed the MSCI World (in Canadian dollars) during a major drawdown period as illustrated in the chart. In 2008, the TSX declined approximately 33% while the MSCI World dropped approximately 25% in the same period, which further underscores the benefits of portfolio diversification to help minimize losses during significant market declines.



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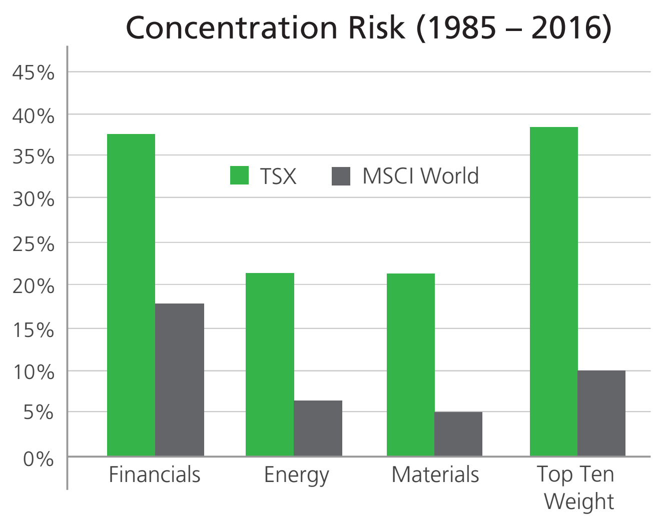
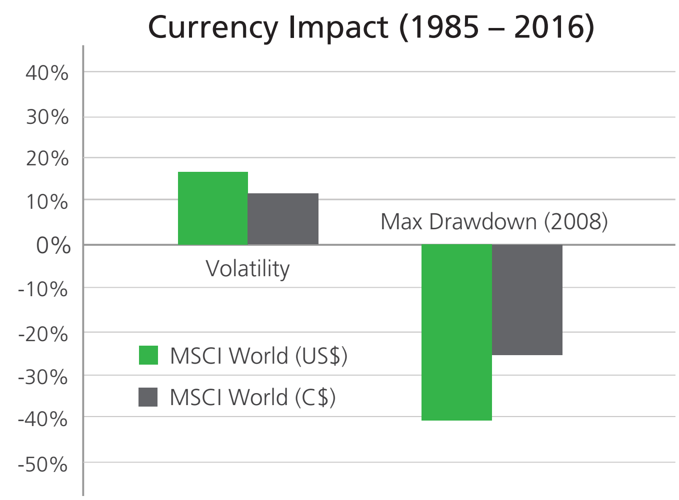
It is also important to note that the TSX has a significantly higher concentration to a few sectors and stocks relative to the MSCI World as shown below.[2] Broader diversification generally reduces concentration risk by reducing the potential impacts that an underperforming sector or asset type can have on an investment portfolio.

Additionally, as illustrated below,[2] the currency diversification embedded in the MSCI World may benefit Canadian investors, particularly during periods of market crashes or corrections.

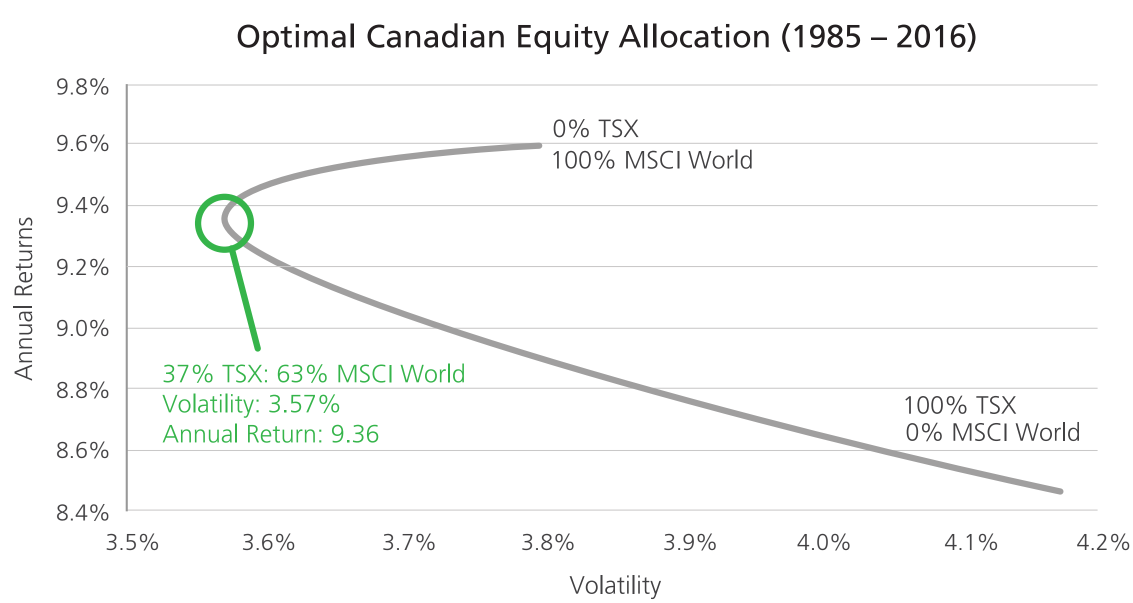




The sweet spot for Canadian equities: Long-term optimal portfolio allocation

Now that we better understand the potential risks associated with Canadian equity overconcentration, the question becomes: what is the optimal portfolio allocation for Canadian equities? Although the MSCI World is more diversified than the TSX, it is still highly concentrated at 45%[2] in three sectors and may not offer optimal allocation.

Looking at the chart below, the data suggests that an allocation of 30-40% TSX and 60-70% MSCI World results in the lowest volatility, the highest long-term risk adjusted returns and better sector and currency diversification.[2]



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Getting results through global diversification

Optimizing portfolio diversification is often the key to growing assets, minimizing risk and improving investment outcomes. Investors may want to select products designed with a long-term view that maximize global diversification and reduce sector or stock concentration risk. TD Asset Management Inc. (TDAM) offers a wide range of managed solutions designed to deliver the benefits of optimized long-term strategic allocation that can potentially enhance portfolio performance.

For more information on the benefits of global equity diversification and TDAM's managed solutions, contact your TD Financial Planner today.

[1]IMF Coordinated Portfolio Investment Survey, June 2016. [2]Source: TD Asset Management Inc. and Bloomberg Finance L.P, as at February 28, 2017. The information contained herein has been provided by TD Asset Management Inc. and is for information purposes only. The information has been drawn from sources believed to be reliable. Graphs and charts are used for illustrative purposes only and do not reflect future values or future performance of any investment. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance. Index returns are shown for comparative purposes only. Indexes are unmanaged and their returns do not include any sales charges or fees as such costs would lower performance. It is not possible to invest directly in an index. Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS. TD Asset Management Inc. is a wholly-owned subsidiary of The Toronto-Dominion Bank.

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