

Institutional Investment and Capital Market Union panel

Home bias and International Diversification Individual vs Institutional Portfolios

Bruno Gerard

Professor of Finance and Asset Management
BI Norwegian Business School

Fostering banking and capital market union.

ECB and EC joint conference, Frankfurt, May 3, 2018

Roadmap

- Home bias and international financial integration.
- Aggregate institutional investors international exposures across the world and US
- Individual international exposure decision
- Robo advice and international exposure
- Concluding remark

Does home bias matter?

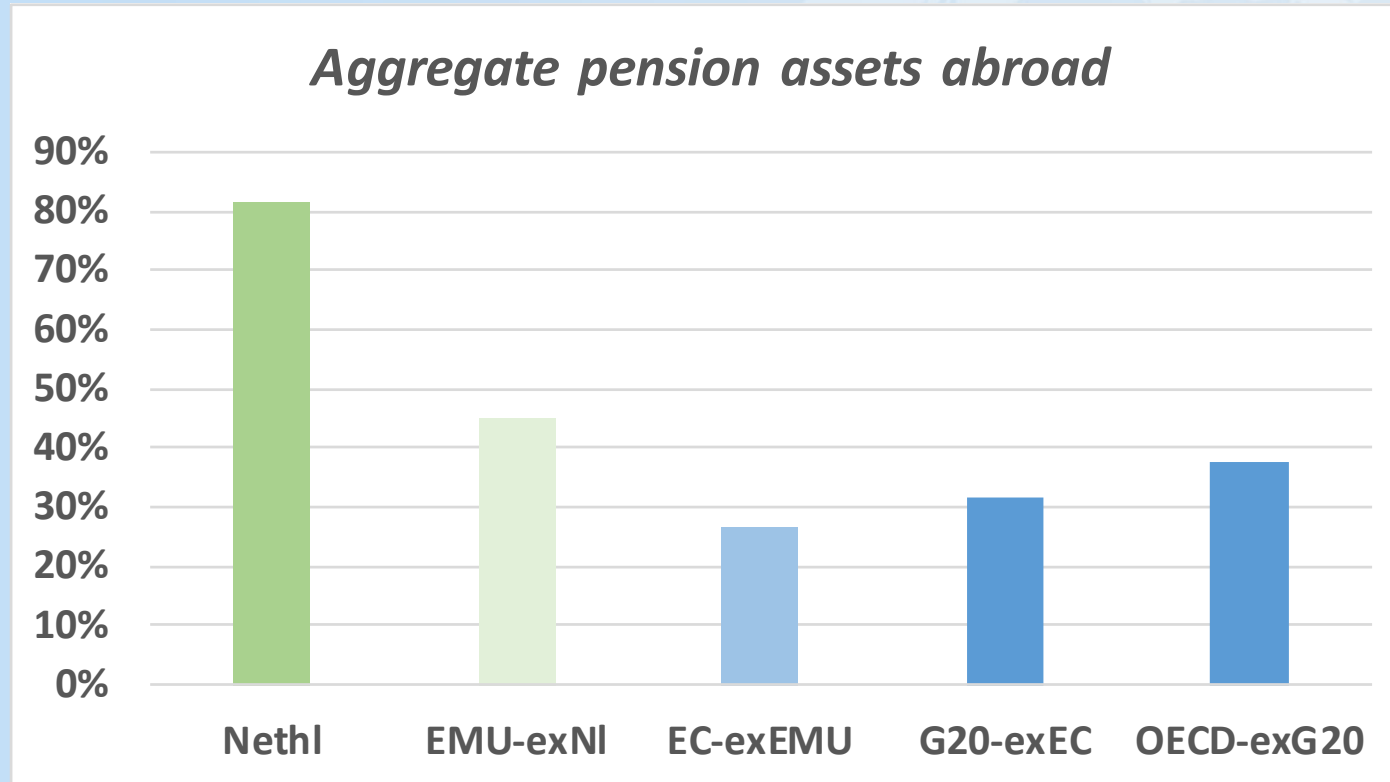
- Financial market integration
 - Improved risk sharing
 - More efficient allocation of capital.

Portfolio home bias symptom of

- Suboptimal risk sharing
- Suboptimal capital allocation

«Risk sharing through the capital channel can be enhanced by more widespread investment in mutual funds, and in private pensions and life insurance schemes.» ECB 2018 report, p16

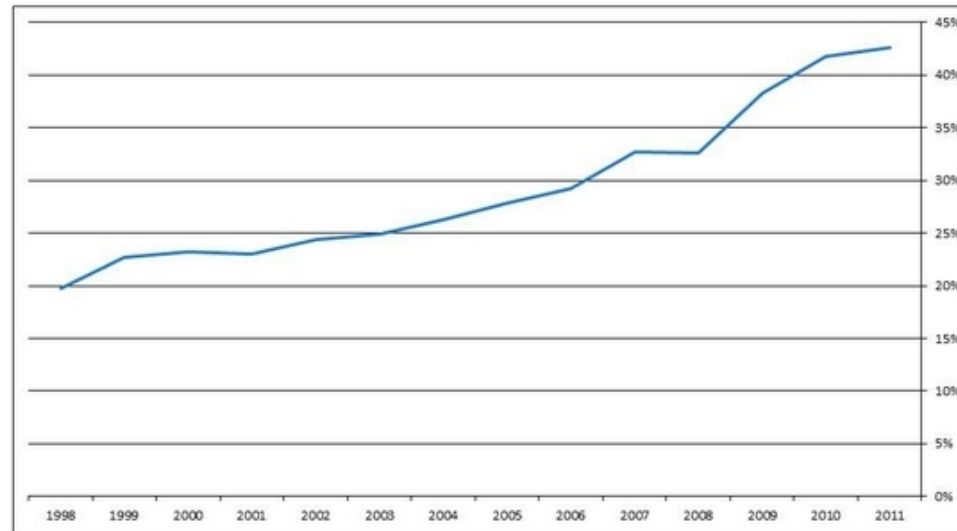
European and world pension funds international allocations



Source: Author computations and OECD Stat: Pension Indicators Database, End of Year 2015.

US pension plans international allocations

Percent of listed equities allocation to non-U.S. equities



Source: Pensions & Investments annual plan sponsor survey

Pensions & Investments

Data: Annual DB plan sponsor surveys

Source: Pension and Investments, November 2012: Asset allocations: past, present and future.

Size matters!

- **Large portfolios**

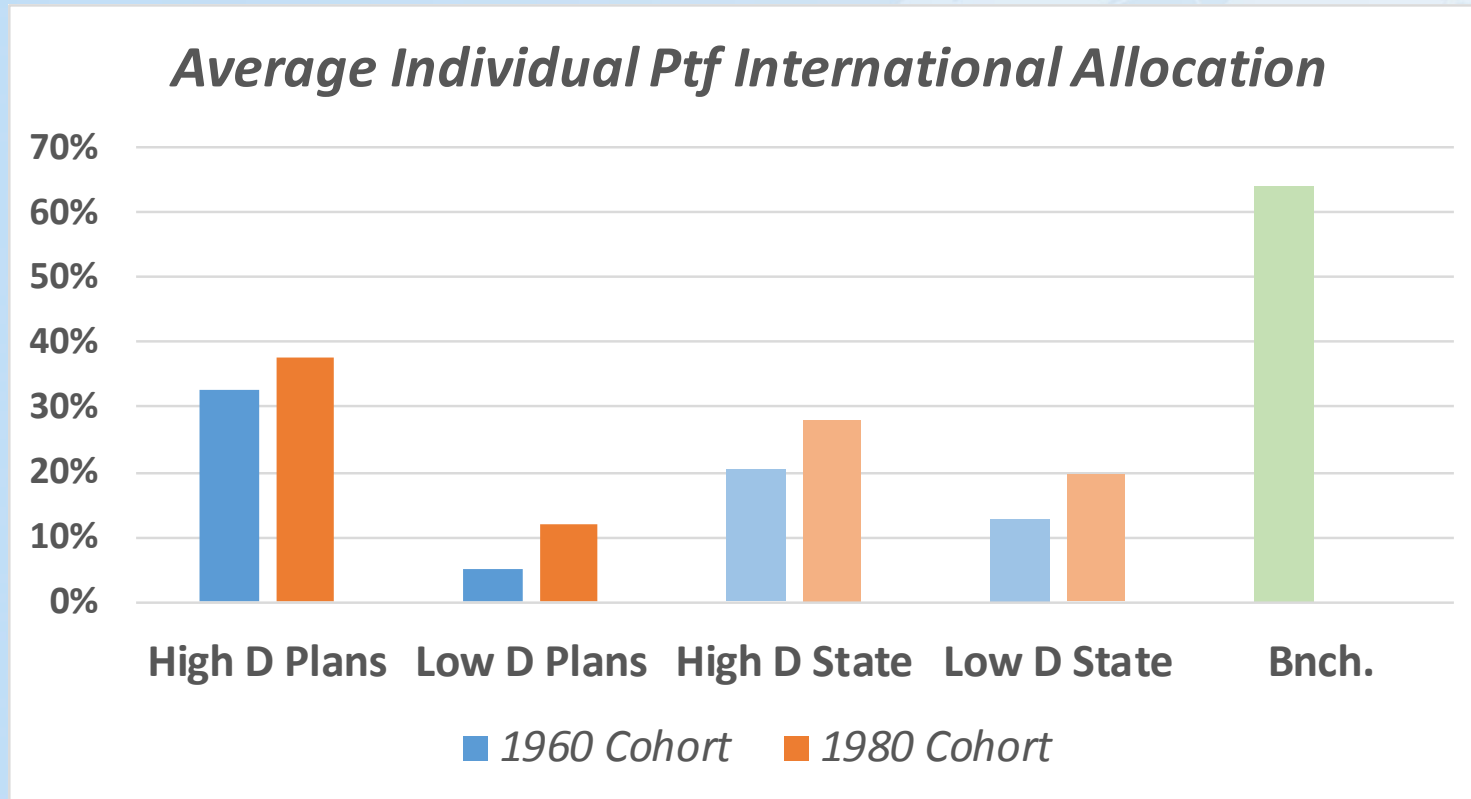
- More sophisticated managers
- More constrained by limited home market capacity
- Higher international exposure

- **Countries with large home markets**

- Less need to invest abroad
- Local market stronger driver of international returns

? What about individuals?

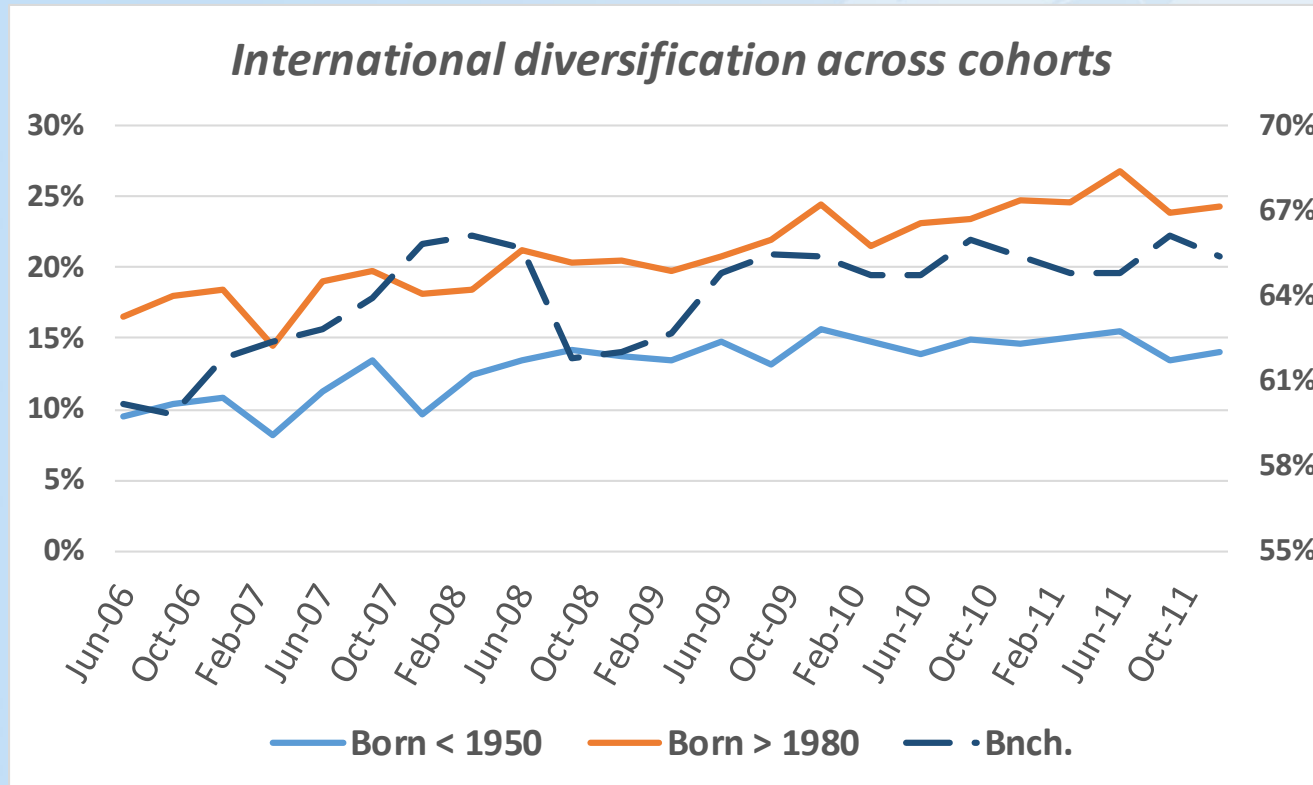
US Individual Retirement Accounts International Allocations



Data: 3.8 million US individual 401(k) accounts across 296 firms over the 2005-2011

Source: Table 1, Bekaert, Hoyme, Hu & Ravina (2017): "Who is internationally diversified? Evidence from the 401(k) plans of 296 firms", *Journal of Financial Economics* 124: 86-112

US Individual Retirement Accounts International Allocations



Data: 3.8 million US individual 401(k) accounts across 296 firms over the 2005-2011

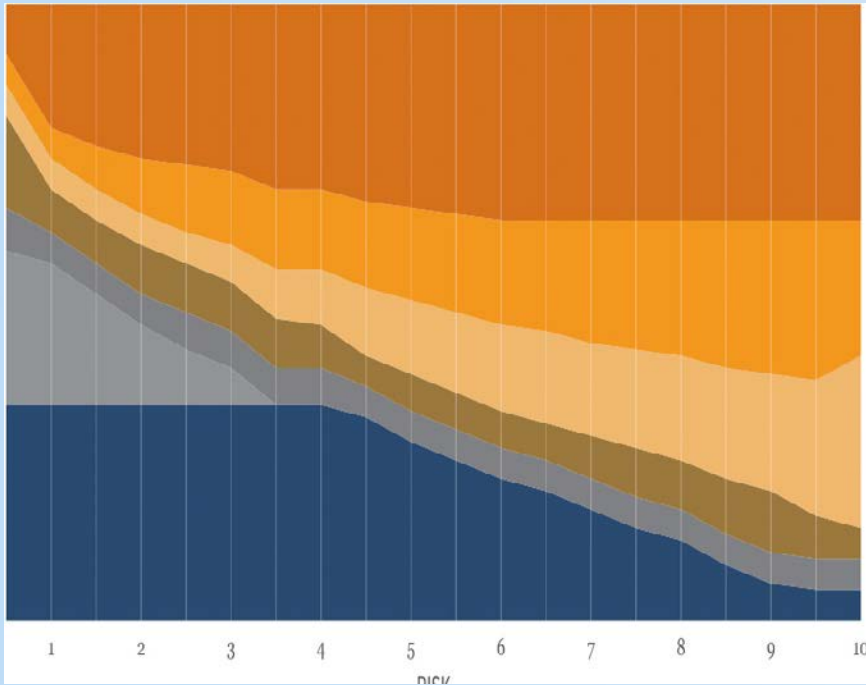
Source: Fig. 4 & 5, Bekaert, Hoyme, Hu & Ravina (2017): "Who is internationally diversified? Evidence from the 401(k) plans of 296 firms", *Journal of Financial Economics* 124: 86-112

Drivers of Individual International Allocation

- Age (cohort)
- Salary levels
- Quality of international options available in plan
- Familiarity with other cultures/countries
- Education and financial literacy
- Availability and quality of investment (online) advice

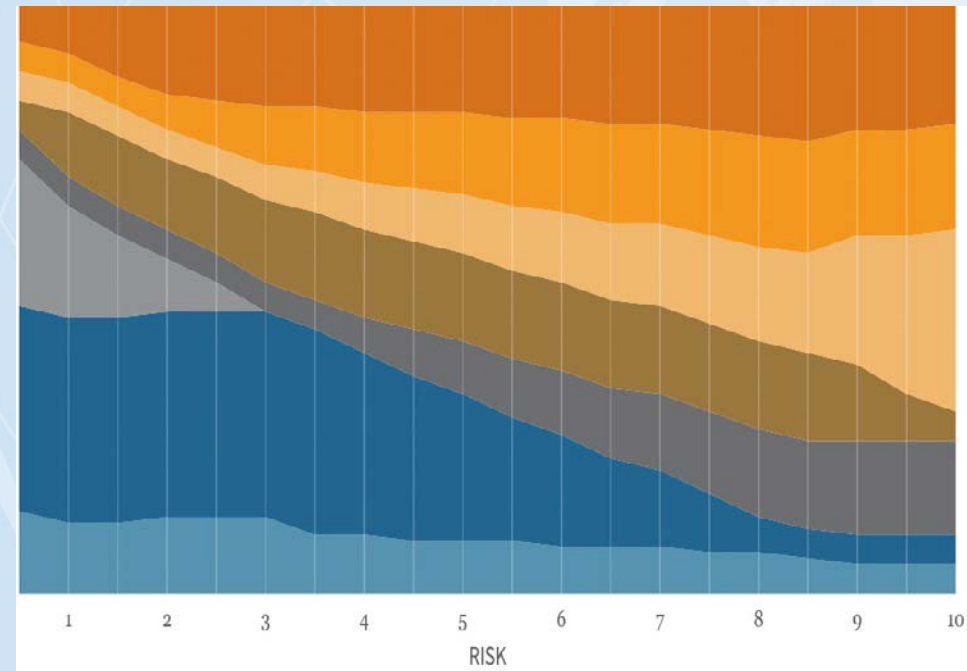
What is the typical online advice?

Robo-Advisor *Wealthfront* Allocations



Taxable Portfolio

Tax Advantaged Portfolio



Robo-Advisor Wealthfront Allocations

Risk	Taxable Portfolio			Retirement Account		
	Low	Med	High	Low	Med.	High
US Assets						
<i>US Eq</i>	20%	33%	35%	8%	18%	20%
<i>Div Stk</i>	7%	6%	5%	12%	15%	5%
<i>TIPS</i>	5%	6%	5%	15%	-	-
<i>Nat Res</i>	25%	-	-	-	-	-
<i>Muni Bnds</i>	33%	28%	5%	-	-	-
<i>Real Est</i>	-	-	-	5%	9%	16%
<i>Corp Bds</i>	-	-	-	36%	25%	5%
Total US	90%	73%	50%	76%	67%	46%
Non-US Assets						
<i>Dev Eq.</i>	5%	15%	22%	6%	13%	18%
<i>EM Eq.</i>	5%	12%	28%	6%	10%	31%
<i>EM Bnds</i>	-	-	-	12%	10%	5%
Total Non-US	10%	27%	50%	24%	33%	54%

Conclusion

«Risk sharing through the capital channel can be enhanced by more widespread investment in mutual funds, and in private pensions and life insurance schemes.» ECB 2018 report, p16

Individual and institutional international exposures can be encouraged by

- Improved financial literacy
- Good advice
- Good investment choices

Thank you.

Questions and comments welcome!