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Home bias – Risks and side effects

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A strong focus on the home market or even on a few large stocks has recently weighed heavily on performance for investors in Switzerland—what can be done?

Several important events are likely to shape the investment environment for investors in the near future. On the political front, the US is set to elect a new president in what could be a contentious election. On this side of the Atlantic, parliamentary elections in various European countries are creating an even more polarized political landscape. At the same time, we are seeing rapid developments in artificial intelligence (AI) and expect the Federal Reserve to begin cutting interest rates, following the lead of several other major central banks that have already started their easing cycles.

Given the diverging policy directions of central banks and increasing (geo)political uncertainties, we think diversification will be crucial. Spreading investments across a variety of asset classes, regions, and sectors could help structure a portfolio to seek higher returns per unit of risk taken or to lower exposure to volatility for a given return target. For investors in Switzerland, diversification also means not overallocating to the domestic market and avoiding heavy concentration in a few large stocks. Often, investors tend to buy what they think they know and what seems familiar. However, such a home bias can be costly. For instance, an investor who has been invested in a portfolio consisting of the three largest Swiss SMI stocks since 2010 would have achieved a return approximately 20 percentage points lower than someone who held the Swiss Leader Index (SLI) over the same period. The SLI comprises the 20 SMI stocks and the 10 largest stocks from the SMIM index, which includes mid-cap stocks. Additionally, the maximum weight in the SLI is capped at 9%, further broadening the diversification of investments.

However, better diversification within the Swiss equity market is only half the battle in terms of attaining an optimal portfolio structure. Investors who have also diversified their equity exposure internationally have performed significantly better. Those who allocated their investments according to the MSCI World Index realized a return 35 percentage points

higher than the aforementioned SLI. This is mainly because the global equity market has a significantly higher allocation to the particularly well-performing technology sectors. Investors who engaged in global technology stocks in 2010 have roughly grown the value of their investment ninefold since then. In contrast, the wealth increase for an investment in the three largest Swiss stocks was not even a third as high.

We believe the risks and adverse side effects of an excessive home market bias can best be avoided by building a broadly diversified strategic asset allocation at the core of an investment portfolio, while keeping it consistently on track with regular rebalancing.

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