AAII Survey: Which Geographic Regions Hold the Greatest Investment Risk?

Geographical diversification is the practice of diversifying an investment portfolio across different geographic regions in order to reduce the overall risk and improve returns. There is a good amount of debate about the importance of investing in different regions of the world instead of investing on in U.S. companies or just North America.

Investing in individual international stocks presents unique challenges, including potentially different accounting standards and the taxation of dividends. As a result, most investors looking to invest internationally do so through mutual funds and ETFs. While research shows that international stocks create a more diversified portfolio, finding a low-cost mutual fund or ETF that invests in international stocks and produces consistent, long-term above-average returns can prove difficult. AAII's founder, James Cloonan, for example, excludes foreign ETFs from his Level3 Passive Portfolio. He believes that, over the long run, foreign stocks as a group provide lower returns and do not offer a significant reduction in real risk.

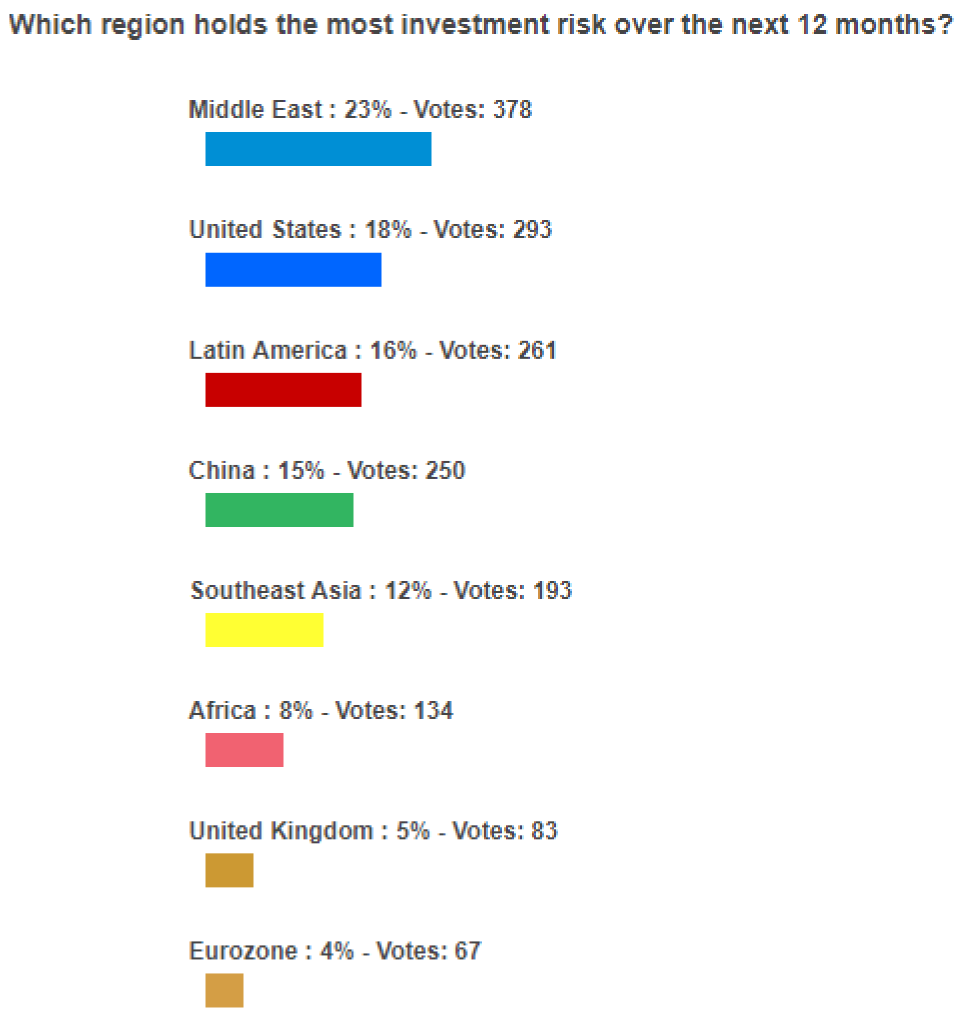
AAII Weekly Survey Question

That being said, many of our readers invest in foreign stocks, either directly or indirectly through mutual funds or ETFs. Therefore, we were curious to know which geographic region they believe will be the riskiest to invest in over the next year.

So our weekly survey question asked:

> Which region holds the most investment risk over the next 12 months?

Here are the results:



In all, 1,659 readers participated in the survey.

Overall, the highest number of readers (23%) see the Middle East as holding the highest degree of investment risk over the next 12 months. This isn't surprising giving the tensions between the U.S. and Iran as well as the Gulf Nations rallying against Qatar.

I found it a bit surprising that the second-highest vote getter was the United States at 18%. With the U.S. economy chugging along and corporate earnings growing at a strong clip, it would appear that the climate is conducive to continued stock market gains. However, political risk is rising, as Congress and the president keep failing to get a legislative agenda on track and the areas that led to the stock market run-up after the election—health care reform, deregulation, tax reform and infrastructure spending, look more uncertain. Throw in the president's war of words against North Korea and it perhaps isn't so surprising that many readers think the U.S. holds a significant amount of investment risk.

In third place is Latin America with 16% of the vote. For most, the growing crisis in Venezuela, once one of the region's richest countries, weighs heavily. Throw in the president's recent comments about possible U.S. military intervention in the country, and that creates a lot of uncertainty and, thus, risk.

Fifteen percent of readers view China as holding the greatest risk in the coming year. A recent article from CBNC.com perhaps best sums up China at this point in time: “China’s economic problems are exactly why its global influence is expanding.” China’s leadership is trying to lessen its economy’s reliance on government spending and this transition has had some bumps along the way. To meet its target growth rate of 6.5% a year, China is looking to new global markets, while re-exerting itself militarily in the region. China is also looking to fill the void as the new administration’s “America First” policy has the U.S. pulling back from its global leadership role. China’s leadership doesn’t have a stellar track record when it comes to guiding the Chinese economy and any missteps could have serious consequences for the world’s second-largest economy.

Next, we arrive at Southeast Asia, which 12% of our readers see as the riskiest place to invest over the next 12 months. Had this survey been taken a little later, I feel confident that the region would have garnered more votes as the saber-rattling between North Korea and the U.S. intensifies. While full-scale war seems unlikely, the rhetoric coming from both sides certainly would give anyone pause to invest in the region in the coming months.

I was also a little surprised that the U.K. only received 5% of the votes. It appears that Brexit isn’t worrying investors too much, perhaps because they believe its impact is also being priced in.

Lastly, the Eurozone received the fewest votes at 4%. That doesn’t mean that the region doesn’t have its hotspots. The economies of Greece and Italy—the Eurozone’s third-largest economy—are a bit wobbly. In fact, a recent CNBC.com article states that many analysts see Italy as the “biggest threat to the stability of the euro zone economy.” This stems from ongoing issues with the Italian banking system, which is burdened with a tremendous amount of non-performing loans, estimated at 18% of total loans for Italian banks or equivalent to 20% of Italy’s GDP.

Weekly Special Question

To continue the conversation of geographic diversification, our weekly special question asked the following:

How important do you think geographic diversification is when it comes to portfolio building? Why?

In all, 114 readers offered their opinion on the subject. From these responses, we broke the responses down into three groups: (not all responses fell into these groups so the percentages below do not add up to 100%)

- Very Important: 46.4%
- Not important: 32.4%
- Somewhat important: 17.5%

So, while roughly one-third of respondents do not believe geographic diversification is important, roughly two-thirds do.

Here is a sampling of the responses:

- "For me, geographic diversification is not important. I focus only on global regions that I understand, i.e., the U.S, Europe and Canada."
- "First off, I don't like paying foreign taxes. I am also suspicious of the veracity of foreign reported data, specifically China. Lastly, all of the American based companies that I own are global anyway."
- "Geographic diversification is essential in today's world. As an unprecedented number of backward economies emerge from centuries of no growth, opportunities to invest have broadened. Much of the rest of the world is growing at a much faster rate than the U.S."
- "[Geographic diversification] is becoming less important. The world is becoming unified into one global unit. In the future, there will be less interest in actual banks and separate currencies, creating less need for diversification."
- "Not that important because most large cap companies are international anyway."
- "Geographic diversification is very important due to the rising middle-classes in various regions. They are becoming better educated with rising aspirations. Their health care systems are improving. Entrepreneurship is active with increasing access to financing."
- "Marginal. I would consider geographical diversification more important if I saw some evidence of actual, long term performance from the investments in those areas. There are spikes of growth from time to time, but the returns over time have not impressed me as to my advantage."

Everybody has an opinion! Why not give us yours? Participate in our weekly member poll, updated every Monday, and see the results online at http://www.aaii.com/memberquestion.