Benefits of international portfolio diversification article review examples

Business, Marketing

Many financial experts believe that international portfolio diversification substantially reduces the risk of an individual's investment. Burhan Yavas gave this issue a critical look in his research entitled " Benefits of International Portfolio Diversification". Yavas showed that foreign investment is a viable means to spreading the risk of investment. Although foreign investment is advantageous for diversification, investors should investigate underlying aspects that determine the success of international portfolio diversification.

The research carried out by Yavas rightly concludes that investors should consider foreign investment as a feasible means to diversifying their assets because foreign equities offer decent returns. Therefore, it is crucial for individual and institutional investors to consider investing in overseas markets. Diversification of a portfolio is an essential skill, irrespective of the nature of business. This derives from the knowledge of the Capital Asset Pricing Model (CAPM) and Modern portfolio Theory (MPT).

A critical look at the research method used by Yavas reveals that it is commendable since it focuses on the daily closing values, from stock markets -which are at a distance, thus giving a fair overview on the interconnectedness of the world stock markets. The research takes place within an appropriate duration (January 1999- February 2002), and the results are reliable. Investors cannot enjoy the full benefits of international portfolio diversification if the foreign markets they invest in are interconnected (Yavas, 2007).

The researcher fully understands this fact and measures the degree of interconnectedness between the American, Japanese and Germany stock markets. This is crucial because it gives investors a fair overview on the level of interrelatedness between the three markets (Germany, US and Japan). Therefore, the results from the study can be used by investors to invest their money on the markets with insignificant interconnectedness in order to realize the full benefits of international portfolio diversification.

One of the important conclusions from the research is the fact that a crisis lowers the confidence within the global investment community. However, the effect withers overtime. As a result, investors should realize that the performance of mutual funds may vary, from time to time. Therefore, the decision to invest should also be informed by the economic growth indicators within the country. However, one of the main drawbacks of the research is the fact that it cannot be generalized to emerging markets since the researcher focused on three industrialized countries (US, Germany and Japan).

Emerging markets give decent returns on investment compared to the developed markets. However, the level of risk on investment in the emerging markets is high compared to the level of risk in industrial countries. Currency, also, plays a role that may increase or reduce the benefits of international portfolio diversification because exchange rates fluctuate with time. Investors should also be wary of entry barriers that diminish investible assets in the emerging markets.

The level of interconnectedness between international stock markets may increase to significant levels overtime due to the modern advances in technology and communication. Foreign markets are now more accessible than in the earlier years due to globalization aided by advances in communication technology and deregulation of foreign markets (Yavas, 2007). Consequently, investors may not realize the full benefits of international portfolio diversification. This means that individual and institutional investors should look for the most effective means to diversify internationally and incur minimum risks at the same time.

Reference

Yavas, B. F. (2007). Benefits of international portfolio diversification. Graziadio business review, 10 (2), 10-15.