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IT'S A SMALL WORLD AFTER ALL

Globalization has shrunk the world and enhanced an investor's opportunities.

When Walt Disney introduced the song *It's a Small World* to visitors at the World's Fair in New York City, it was 1964. Since then, the explosion in technology, transportation and travel that followed has made the world appear smaller while, at the same time, increasing our economic footprint. According to the World Bank, world GDP in 1964 was just shy of US $1.78 trillion. By 2011, the economic output of the world had grown to US $69.99 trillion, a nearly 40-fold increase while the world's population nearly doubled. During this period, thanks to those advances in technology and transportation, markets have become more integrated leading to globalization. Raw materials extracted from one country are refined in another country and turned into finished products in yet another. If you want to see how entrenched globalization is, simply walk around your home. From food to fashion and prescription drugs to electronics, what's on our shelves reflects international collaboration.

Some argue that globalization has been with us since the days of the Silk Road; others suggest it was the discovery of the New World by Columbus that really got globalization rolling. But globalization, in today's sense, is much more than international trade. At the heart of modern globalization are the integration of markets and the interdependence of economies. For investors, this has changed the rules of the game when it comes to investing internationally.

In the past, the goal of international diversification was to gain exposure to different countries and regions as economic performance tended not to move in tandem. But, as was written on October 8, 2012 in the Report on Business section of The Globe and Mail, "When China sneezes, other nations catch cold…" – in an integrated global economy there is significant correlation between the economic performance of various countries and regions. However, the current global economic slowdown has shown that while countries can be mired in tepid economic growth, many of their domestic companies can still turn an attractive profit.

A company's base of operations may not be the only factors in its success as it can be headquartered in one country and generate revenue and profits from around the world. Luxury goods makers, such as Hermès, may operate out of the low-growth eurozone but they have had strong sales through their exposure to the newly rich in the developing world. Swiss food giant Nestlé reaches markets around the world and is able to tap into economic growth wherever it is occurring. When certain countries or regions are under economic stress, investor sentiment turns against them and drives their stock market down, often pushing the shares of good companies down to bargain prices. In the long run, international investing is more about companies than countries.

Whenever the importance of exposure to international markets is discussed, much is made of the fact that Canada only accounts for about 3% of the world's GDP. The point being that 97% of the world's economic output is happening beyond our borders. Yet, Canada has consistently placed in, or near, the top 10 nations of the world as measured by GDP. A better argument in favour of international diversification comes from the concentrated nature of the Canadian stock market. The S&P/TSX index is dominated by three sectors – Energy, Materials and Financials, two of which are commodity-based and all three are tied to cyclical aspects of the economy. Furthermore, the Canadian market provides little in the way of exposure to several other sectors, including technology and healthcare. This lack of diversification means that you have to look elsewhere to add balance to your portfolio and participate in the wider economy. Another reason for investing outside of Canada is to gain exposure to those companies that lead the world in their respective sectors (think Coca-Cola, BMW and Samsung). Of Interbrand's Best 100 Global Brands of 2012, only BlackBerry and Thomson Reuters came from Canada.

Given the negative economic outlook for various parts of the world these days, it is understandable that many Canadian investors prefer to invest at home. Our economy has done better than most coming out of the financial crisis. And, our stock market had a strong recovery, prior to underperforming equity markets in the United States, Europe and emerging markets over the past year. As recommended in your investment policy, having an appropriate level of international exposure within a balanced portfolio provides you with greater diversification, access to additional growth potential and is key for managing risk – all important ingredients for long-term investing success.

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