

# CONSTELLATION CAPITAL MANAGEMENT

## Australia HomeGlobal™ equities

### Key Features

- addresses impact of globalisation
- provides a relevant home country bias
- resolves domestic stock/sector concentration

### Investor dilemma – Home Country Bias

Investors in most, if not all, countries have a significant home country bias in their portfolios. The familiarity of local stocks and other factors such as costs, regulatory regime and domicile of investors' liabilities are amongst the reasons leading to the home country bias.

Over recent years, there has been a trend to increase the portion of funds allocated to international assets, particularly to international equities which provide

- risk diversification and control,
- exposure to industries not available in the domestic equity market, and
- create further opportunities for adding value through active management.

Investors are torn between a home country bias and the benefits of international exposures.

### Investor dilemma – Impact of Globalisation

Over recent years, research shows that equity returns are being increasingly influenced by industry factors and they have become of similar importance to country factors in the pricing of stocks (even after the TMT boom/bust is excluded from the analysis). This change is mainly attributed to the influence of globalisation.

Thus it is interesting to note that the increased allocation to international equities has occurred in a period when globalisation in many industries is possibly reducing the diversification benefits of international equities.

This apparent contradiction presents a challenge for investors who implement the current domestic-international paradigm where the domestic stocks are benchmarked against, for example, the ASX/S&P 300 and international stocks against the MSCI ex Australia.

### Investor dilemma – Stock-Industry Concentration

Numerous countries have dominant stocks or industries. Australia is dominant in banking and mining industries. For example, when a fund allocates equities in approximately a 60:40 ratio to domestic and international markets, the domestic banks represent 19% (31%\*60%) of total equities, well above global weights, and this high exposure is further added to by an international weight in banks of 5% (approx 13%\*40%). One may well ask why add to the already high domestic exposure in banks.

Conversely, the low exposure to domestic pharmaceuticals and biotechnology stocks needs to be supplemented with exposure to international stocks. But the current domestic-international paradigm only results in a total exposure of 4% to pharmaceuticals and biotechnology, which is well below its global weight. The table below shows the imbalances of some industry exposures when using the current paradigm.

We hear many pension fund trustees ask “is the domestic benchmark appropriate for our members?”

Industry	Global	Domestic	Current Paradigm	Imbalance
Banks	13.4%	31.2%	24.0%	+10.5%
Mining	1.0%	10.9%	6.9%	+5.9%
IT Hardware	6.4%	0.0%	2.6%	-3.8%
Pharm & Biotech	8.7%	0.7%	4.0%	-4.7%

### What are the current choices?

- Traditional domestic-international paradigm; does not address impact of globalisation, stock-industry concentration or home bias
- Multinational-local country paradigm; eg FTSE Multinational/ FTSE Local indexes; there are numerous arbitrary parameters which need to be determined including the level of home country bias
- One world paradigm – eg FTSE Global Index; imagine an Australian superannuation fund with only 1.9% of equities invested domestically!

### A new paradigm is needed.

Constellation has developed a simple, robust and easy to implement approach referred to as the

#### *HomeGlobal™* method

which is applicable in all countries/regions and provides the following benefits

- introduces new and relevant country specific global benchmarks with relevant home bias
- resolves home country stock-industry imbalances
- responds to increased correlation of economies & markets
- facilitates global investment management
- provides an investment strategy more aligned with investor objectives, and
- addresses potential domestic political concerns.

## Australia HomeGlobal™ Portfolio

Constellation's HomeGlobal™ approach applies a test of adequacy at the industry level. The test of adequacy simply asks:

- “Is the domestic weight of an industry at least its global weight?”.
- If the answer is yes, eg banks, then the HomeGlobal™ method will allocate its exposure to banks in the domestic market at the global weight of banks.
- If the answer is no, pharmaceuticals and biotechnology, then the HomeGlobal™ method will allocate its exposure to the available weight of Australian pharmaceuticals and biotechnology, 0.7%, and fill the shortfall via international pharmaceuticals and biotechnology, 8%, to provide a total exposure pharmaceuticals and biotechnology of 8.7%, the global weight.

Applying the test of adequacy across all industries results in a portfolio (see table below) where the domestic allocation is a consequence of the test of adequacy; the

domestic weight in the Australia HomeGlobal™ Index is approximately 52%.

The HomeGlobal™ approach:

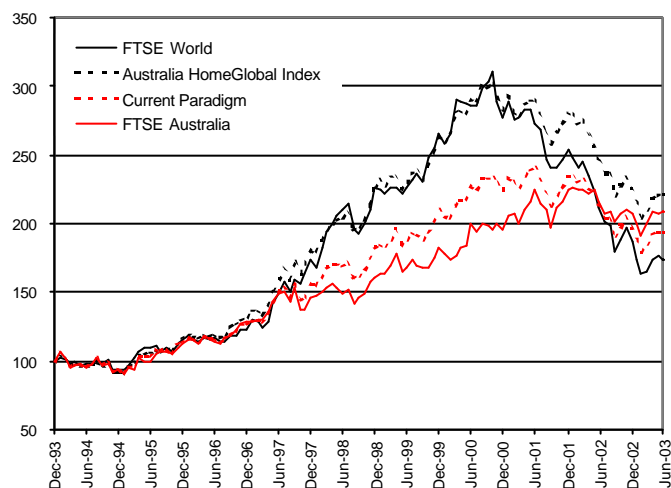
- provides a relevant home country bias; it takes from the domestic market what is needed, not what the market has to offer
- resolves domestic industry or stock concentration
- provides a portfolio with more balanced industry weights and a spread of country exposures, thus benefiting from the diversification benefits of both these factors
- provides a portfolio more aligned with investment strategy, not what local market “dictates”

A complete list of industry allocations is provided below, together with estimated performance over recent years using the FTSE classification system.

## Weigh globally – Invest locally

Industry	Market weights		HomeGlobal™ Weights	
	Global	Domestic	Domestic	International
Aerospace & Defence	1.1%	0.0%	0.0%	1.1%
Automobiles & Parts	2.2%	0.3%	0.3%	1.9%
Banks	13.4%	31.2%	13.4%	0.0%
Beverages	2.0%	3.1%	2.0%	0.0%
Construction & Building Materials	1.5%	3.2%	1.5%	0.0%
Chemicals	2.1%	0.8%	0.8%	1.3%
Diversified Industrials	2.7%	2.6%	2.6%	0.1%
Electronic & Electrical Equipment	2.4%	0.1%	0.1%	2.3%
Electricity	2.6%	0.2%	0.2%	2.3%
Engineering & Machinery	1.5%	0.3%	0.3%	1.3%
Food & Drug Retailers	1.2%	3.0%	1.2%	0.0%
Food Producers & Processors	2.2%	1.0%	1.0%	1.2%
Forestry & Paper	0.6%	0.5%	0.5%	0.1%
General Retailers	4.2%	2.4%	2.4%	1.8%
Household Goods & Textiles	1.3%	0.4%	0.4%	0.9%
Health	3.0%	1.6%	1.6%	1.4%
Investment Companies	0.4%	0.6%	0.4%	0.0%
Information Technology Hardware	6.4%	0.0%	0.0%	6.4%
Insurance	3.5%	2.2%	2.2%	1.3%
Life Assurance	1.0%	2.0%	1.0%	0.0%
Leisure, Entertainment & Hotels	1.4%	1.9%	1.4%	0.0%
Mining	1.0%	10.9%	1.0%	0.0%
Media & Photography	4.0%	8.7%	4.0%	0.0%
Oil & Gas	6.9%	2.7%	2.7%	4.2%
Personal Care & Household Products	1.7%	0.0%	0.0%	1.7%
Pharmaceuticals & Biotechnology	8.7%	0.7%	0.7%	8.0%
Real Estate	1.7%	7.4%	1.7%	0.0%
Software & Computer Services	4.2%	0.0%	0.0%	4.2%
Speciality & Other Finance	3.8%	1.9%	1.9%	1.9%
Steel & Other Materials	0.7%	1.0%	0.7%	0.0%
Support Services	1.9%	2.6%	1.9%	0.0%
Tobacco	0.9%	0.0%	0.0%	0.9%
Transport	1.5%	3.6%	1.5%	0.0%
Telecommunication Services	5.3%	1.9%	1.9%	3.4%
Utilities, Other	1.3%	1.2%	1.2%	0.1%
Total	100.0%	100.0%	52.4%	47.6%

Source: FTSE Global Equity Index June 2003, Constellation



Source: FTSE World Index, Mercer, Constellation

Dec 93 to Jun 03	Return * (pa)	Vol (pa)
FTSE World	6.0%	13.6%
FTSE Australia HomeGlobal™ Index	8.7%	11.3%
Current Paradigm	7.2%	11.3%
FTSE Australia Index	8.1%	12.3%

Source: FTSE World Index, Mercer, Constellation

\* assuming index returns for all exposures

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