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Overviewing the Scope of International Portfolio Investment

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Abstract: In globalized scenario, economic activity has been characterized by a spectacular increase in the international dimensions of business maneuver. Rapid intensification of international trade accelerated the globalization of financial activity which brought about diversified investment opportunities that are no longer restricted to domestic markets, but financial capital can now seek opportunities abroad with relative ease. In view of this, the article tries to overview the scope of international portfolio investment in globalized world. Investing internationally provides not only increased stability to a portfolio, but also potential higher yields with less risk. Therefore, investors should diversify portfolio globally because it will offer improved stability of their financial profile as well as higher yields with less risk.

Key words: Portfolio, investment, international, diversification.

1. Introduction:

In globalized scenario, economic activity has been characterized by a spectacular increase in the international dimensions of business maneuver. Growing volume of cross-border transactions has integrated national economies of different countries bringing them close to each other. Higher degree of market integration has become possible due to reduced regulatory barriers among countries, lower cost of communications etc. This has been apparently reflected through the worldwide growth of exports and imports as a proportion of GDP of individual countries that has resultantly internationalized consumption patterns in different ways.A portfolio investment is a passive investment in securities, none which entails in active management or control of the securities' issued by the investor. Portfolio investment is investment made by an investor is not particularly interested in involvement in the management of a company. It is also the investment in securities that is intended for financial gain only and does not create a lasting interest in or effective management control over an enterprise. It includes investment in an assortment or range of securities, or other types of investment vehicles, to spread the risk of possible loss due to below expectations performance of one or a few of them.

Rapid intensification of international trade accelerated the globalization of financial activity which brought about diversified investment opportunities that are no longer restricted to domestic markets, but financial capital can now seek opportunities abroad with relative ease. Certainly, international competition for funds has originated a fiery growth in international flows of equities as well as fixed-income and monetary instruments. A grouping of investment assets that focuses on securities from foreign markets rather than domestic ones is termed as International portfoilio. An international portfolio is designed to give the investor exposure to growth in emerging and international markets and provide diversification. International investing includes such investment vehicles as mutual funds, American Depository Receipts, exchange-traded funds (ETFs) or direct investments in foreign markets. People often invest internationally for diversification, to spread the investment risk among foreign companies and markets; and for growth, to take advantage of emerging markets.

2. Motivation behind International portfolio investments:

International investments can be included in an investment portfolio to provide diversification and growth opportunities. International portfolios allow investors to further diversify their assets by moving away from a domestic portfolio. This type of portfolio can carry increased risk due to potential economic instability arising from emerging markets, but can also bring increased stability through investments in industrialized and more stable markets. Due to the integration of global financial markets, many companies already have operations in more than one country. The reasons behind investing internationally are as follows:

a. Diversification –Diversification is an indispensable investing principle. It protects a portfolio from being acutely affected by negative events isolated to only a few stocks. Diversification is a technique that reduces risk by allocating investments among various financial instruments, industries and other categories. It aims to maximize return by investing in different areas that would each react differently to the same event. Most investment professionals agree that, although it does not guarantee against loss, diversification is the most important component of reaching long-range financial goals while minimizing risk.

It spreads investment risk among foreign companies and markets. Portfolio diversification is the means by which investors minimize or eliminate their exposure to company-specific risk, minimize or reduce systematic risk and moderate the short-term effects of individual asset class performance on portfolio value. In a well-conceived portfolio, this can be accomplished at a minimal cost in terms of expected return. Such a portfolio would be considered to be a well-diversified. Therefore, diversification can help an investor manage risk and reduce the volatility of an asset's price movements. It can be remembered risk can never be eliminated completely but investors can reduce risk associated with individual stocks, but general market risks affect nearly every stock, so it is important to diversify also among different asset classes. The key is to find a medium between risk and return to ensures accomplishment of financial goals.

Although the concepts relevant to portfolio diversification are normally explained with respect to the stock markets, the same underlying principals apply to all types of investments.

b. Potential for Growth – It takes the advantages of the potential for growth in some foreign economies, particularly in emerging. There are many underdeveloped markets that are in the middle of large periods of growth. If investors can successfully identify these regions of the globe, they could bring in a substantial return on their investment.

c. Many Different alternatives-In today's investment market, there are many different options for investors to choose from if they want to get involved with international investment like mutual funds, exchange traded funds (ETFs), American Depositary Receipts (ADRs) and a number of other investment vehicles.

3. Different Types of International Investments:

There are numerous ways in which the ordinary investor can invest in foreign markets without having too much trouble. Here are a small number of the major types offered by most brokerages.

American Depositary Receipts (ADRs):

An American depositary receipt (ADR) is a negotiable security that represents securities of a non-US company that trade in the US financial markets. Securities of a foreign company that are represented by an ADR are called American depositary shares (ADSs).Shares of many non-US companies trade on US stock exchanges through ADRs. ADRs are denominated and pay dividends in US dollars and may be traded like regular shares of stock. Over-the-counter ADRs may only trade in extended hours.American depositary receipts are used by foreign countries unable to list on the NYSE or NASDAQ, which have domestic country regulations. ADRs imitate their domestic stocks very closely, and offer investors a way of investing internationally without actually buying stock from a foreign exchange.

Exchange-Traded Funds (ETFs):

An exchange-traded fund (ETF) is an investment fund traded on stock exchange, much like stocks. An ETF holds assets such as stocks, commodities, or bonds, and trades close to its net asset value over the course of the trading day. Most ETFs track an index, such as a stock index or bond index. ETFs may be attractive as investments because of their low costs, tax efficiency and stock-like features. ETFs are the most popular type of exchange –traded product. Only authorized participants, which are large broker -dealers that have entered into agreements with the ETF's distributor, actually buy or sell shares of an ETF directly from or to the ETF, and then only in creation units, which are large blocks of tens of thousands of ETF shares, usually exchanged in-kind with baskets of the underlying securities. Authorized participants may wish to invest in the ETF shares for the long-term, but they usually act as market-makers on the open market, using their ability to exchange creation units with their underlying securities to provide liquidity of the ETF shares and help ensure that their intraday market price approximates to the net asset value of the underlying assets. Other investors, such as individuals using a retail broker, trade ETF shares on this secondary market.These investments offer a wide variety of international flavors. Investors can buy ETFs that track most of the major foreign indexes, and they allow investors to obtain a return based on a specific foreign market without having too great of an exposure. Also, because they trade and work like any other ETF, they aren't expensive to trade and are relatively liquid.

International Funds:

International Stock Funds are comparable to international ETFs as they also provide for diversification but have same drawbacks and benefits that are associated with regular funds and ETFs. It should be remembered that in these international funds, a hired professional portfolio manager is in charge and decides what to place in the portfolio.

Foreign Securities:

Many brokerage firms will offer investors the ability to buy investments from different countries directly from the brokerage's international trading desk. So, if intending investors wants to buy a stock in a company that doesn't trade on markets, investors can inquire with brokerage to see if it will facilitate the trade for investors through one of the brokerage's affiliated international companies that has a membership on the foreign exchange or market. Because these trades are typically more expensive and less liquid than regular domestic trades, investors should carefully check out all of the other alternatives before they decide to do it this way.

Eurobonds:

A Eurobond is an international bond that is denominated in a currency not native to the country where it is issued. Also called external bond; "external bonds which, strictly, are neither Eurobonds nor foreign bonds would also include: foreign currency denominated domestic bonds. . ." It can be categorised according to the currency in which it is issued. London is one of the centers of the Eurobond market, but Eurobonds may be traded throughout the world.Not recommended for the beginner investor, these are bonds issued in foreign markets by domestic companies. Eurobonds don't always offer higher yields than domestic bonds, and they are only as secure as the company issuing them, but they are a way you can participate in a foreign fixed -income market. One of the main reasons that beginner investors should be wary of these bonds is that they pay a foreign currency that the investor will probably have to exchange.

4. Benefits from International Portfolio Investment:

By diversifying across nations whose economic cycles are not perfectly in phase-investors should be able to reduce still further the variability of their returns. Therefore, international investing offers more opportunities than a purely domestic portfolio. Another advantage of investing internationally is its attractiveness of investment overseas. Investing overseas might offer the investors the better return compared to the domestic’s return rate. In a nut shell, if an international portfolio is monitored wisely and carefully, it is the safest way to diversify investors’ portfolio in order to receive the highest return.There are numerous prospective benefits that make it striking for investors to internationalize their portfolios.

These seeming advantages are the driving force and motivation to engage in international portfolio investment. Explicitly, the attractions of international portfolio investment are based on (a) the participation in the growth of other (foreign) markets, (b) hedging of the investor's consumption basket, (c) diversification effects and, possibly, (d) abnormal returns due to market segmentation. All being equal, an investor will benefit from accessing a substantial portion of wealth invested in foreign securities as follows:(i) accessing the higher expected return, (ii) facing the lower variation of their returns, (iii) having the lower correlation of returns of foreign securities with the investor's home market, and possibly, (iv) having greater share of imported goods and services in their consumption. The most obvious advantage of international investing is the ability to reduce portfolio volatility. Foreign markets are becoming more welcoming to investors. In Europe and Asia, in particular, financial and tax systems are becoming more and more standardized and crystal clear. In addition, the vast new incursion of European pension investors promises well for the European equities markets. While it is a timing argument, European markets are on the front end of the pension boom that has largely run its course in the United States. The evidence seems to indicate that internationally diversified porfolios just flat outperform porfolios containing only U.S. equities. Furthermore, these higher returns have come without extra risk (measured for our purposes by standard deviation).

5. Risks inherent in International Portfolio Investments:

Globalization owing to technological progress has witnessed the diversification of industries and opening up of new business opportunities. Resultantly, investors can no longer overlook foreign investments, but they also must take into account the disadvantages that come with such a project. The focal point of such an undertaking is profit maximization by diversifying investment portfolios, but there are also many difficult issues involved with international investments.

Nowadays, international investing is not a new concept. Although it is well recognized that risk is related in any single investment, it is actually special when it comes to international investing. According to the SEC, there are several categories of international investment’s risk, such as, changes in currency exchange rate, dramatic changes in market value, political, economic, and social events, lack of liquidity, less information, reliance on foreign legal remedies, and different market operations. However, due to its attractiveness of return, international investing is an essence in today’s business world.International investing has some special risks that have been discussed below:

Changes in currency exchange rates:

Foreign companies trade and pay dividends in the currency of their local market. When the exchange rate between the foreign currency of an international investment and the U.S. dollar changes, it can increase or reduce your investment return. When buying or selling investment abroad, investors need to convert the money he gets from the local currency into U.S. dollars. During a period when the foreign currency is strong compared to the U.S. dollar, this strength increases investment return because foreign earnings translate into more dollars. If the foreign currency weakens compared to the U.S. dollar, this weakness reduces investment return because earnings translate into smaller number of dollars.

Spectacular changes in market value:

Foreign markets, like all markets, can experience dramatic changes in market value. One way to reduce the impact of these price changes is to invest for the long term and try to ride out sharp upswings and downturns in the market. Individual investors frequently lose money when they try to "time" the market in the United States and are even less likely to succeed in a foreign market. When investors “time” the market, they have to make two smart decisions -- deciding when to get out before prices fall and when to get back in before prices rise again.

Political, economic and social risks:

Political risk is sometimes defined as a country's willingness to maintain a hospitable climate for outside investments. Economic risk, on the other hand, is the ability of a country to pay its debts. The economic and political states of a country are codependent. If the economy of a country is strong but its political state is hostile -- or vice-versa -- it ceases to be appealing to foreign investors. The political decisions made in a country may result in its instability, causing the weakening of the economy and creating losses for both local and foreign investors. It is difficult for investors to understand all the political, economic, and social factors that influence foreign markets. These factors provide diversification, but they also contribute to the risk of international investing.

Deficiency in of liquidity:

Foreign markets may have lower trading volumes and fewer listed companies. They may only be open a few hours a day. Some countries restrict the amount or type of stocks that foreign investors may purchase. The investors may have to pay premium prices to buy a foreign security and have difficulty finding a buyer when they want to sell.

Dependence on Foreign Legal Remedies:

Legal processes in one country may not necessarily apply to the other country in which investment is based if investors encounter a problem with an investment made abroad. In such cases investors will be forced to rely on available legal remedies in the company's home country, which may prove expensive.

Insufficient Information:

Many foreign companies do not provide investors with the same type of information. Acquiring up-to-date information about a foreign company can not only take time and money, it also often difficult to come by. As a result, many foreign investors cannot make informed decisions about their investments of choice. Additionally, some companies may post their information in their local language and not in English. Foreign investors therefore have the added cost of translating this information to English in an attempt to get all the necessary fact about the investment.

Different market operations:

Foreign markets often operate differently from the major U.S. trading markets. For example, there may be different periods for clearance and settlement of securities transactions. Rules providing for the safekeeping of shares held by custodian banks or depositories may not be as well developed in some foreign markets, with the risk that investor’s shares may not be protected if the custodian has credit problems or fails.

6. Conclusion:

International diversification can provide immense benefits in the era of globalization. Investing internationally provides not only increased stability to a portfolio, but also potential higher yields with less risk. By investing in foreign securities, investors can participate in the growth of other countries and diversify the risk of a potential bearish market, hedge their consumption basket against exchange rate risk, realize diversification effects and take advantage of market segmentation on a global scale. Nevertheless, the risks of international portfolio investment can not be ignored. In an international context, financial investments are not only subject to exchange risk and political risk, but there are many institutional constraints and barriers like tax issues. Moreover, international stocks can be impulsive in the short-term– therefore, instead of buying international stocks to provide a possible short-term boost; they should be part of a long-term investment plan. Therefore, investors should diversify portfolio globally because it will offer improved stability of their financial profile as well as higher yields with less risk.

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