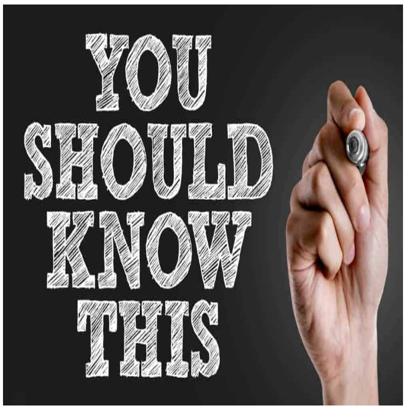

Home Field Bias: The Price of Overlooking U.S. Stocks

Description

Are you a Canadian investor who invests only in Canadian stocks? If so, I've got some good news and some bad news for you.

The good news is that you're quite normal. According to research by **Charles Schwab**, 45% of investors suffer from home-field bias — a bias toward investing in their home country's stocks. The bad news is that home-field bias is economically irrational, as it prevents you from achieving adequate diversification.

According to Schwab, the bulk of Americans' money is in U.S. stocks, indicating a high degree of bias. Anecdotal evidence suggests that home-field bias is prevalent in Canada as well. Recently, a list of the most widely owned stocks in Canada was published; only one foreign stock made the cut. So, it looks like Canadians are just as home-field biased as their American peers.

On the surface, home-field bias makes sense. Domestic companies are most familiar to domestic investors, after all, so the bias is consistent with "buying what you know." However, mathematically speaking, you limit your opportunities by sticking to domestic stocks. American stocks in particular are not to be missed, as they tend to outperform other countries' stocks over the long term.

Diversification benefits

The most obvious drawback of home-field bias is you miss out on diversification. Diversification means holding many stocks instead of few. Diversifying reduces your risk via the "don't put all your eggs in one basket" principle. The more stocks you hold, the less of an impact there is when one goes sour. If you stick to just one country, you're less diversified than if you'd bought index funds covering the entire globe.

So, by getting over your home-field bias, you may improve your returns. At any rate, you will certainly reduce your risk.

U.S. stocks tend to perform well

Another drawback to home-field bias is that you miss out on U.S. stocks. U.S. stocks are known for delivering stellar long-term performances, having outperformed the TSX over the last 10 years. Indeed, a good return for a Canadian stock is not so great when compared to America's S&P 500.

Take **Fortis** (TSX:FTS)(NYSE:FTS) for example. By Canadian market standards, it is a market beater, having outperformed the TSX by 1.5% over the last five years. If you factor in dividends, Fortis has outperformed even more than that, as its yield is higher than the TSX average.

However, Fortis is nothing special compared to the average U.S. stock. Over the last five years, it has underperformed the **Vanguard S&P 500 Index Fund** on a price-return basis. In that period, VOO has risen 62%, but Fortis has only gone up by 31%! Now, Fortis's yield is vastly higher than the S&P 500's is — on a total-return basis, with dividends re-invested, it compares to the U.S. stock index decently well. But the fact that the S&P 500 has outperformed a Canadian utility stock that is widely regarded as better than average shows you just how powerful geographic diversification can be.

Foolish takeaway

If you're like most investors, you probably suffer from home-field bias. It's only natural. We all like to support the home team, after all, and it doesn't hurt to buy what you know. But as the S&P 500 shows, you avoid U.S. stocks at your own peril.

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