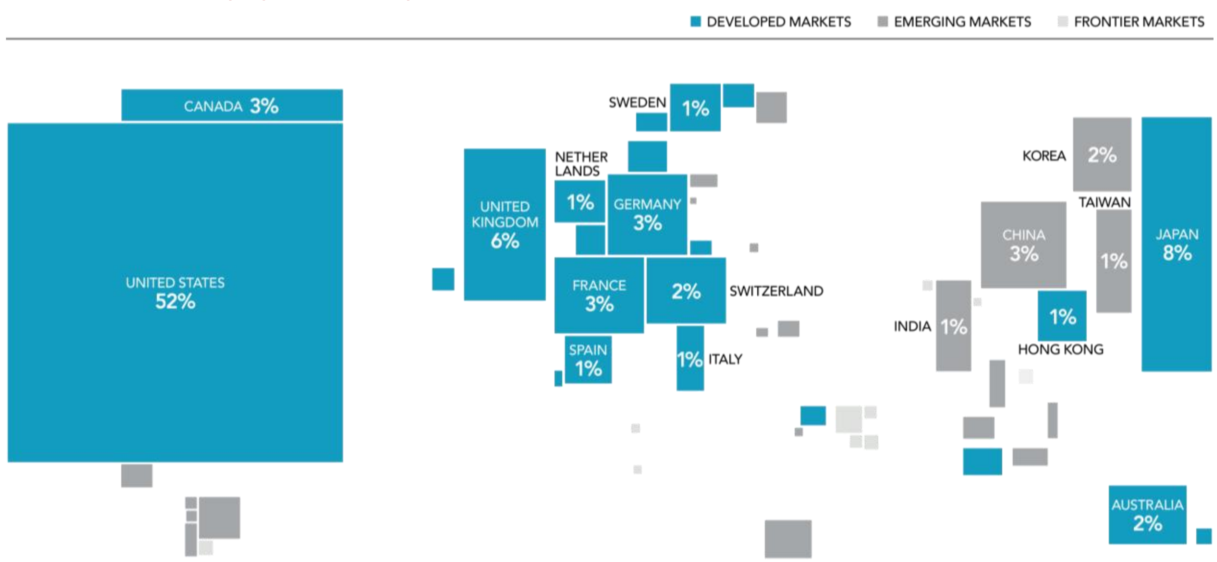
# Why It Makes Sense to Diversify Beyond US Equity Markets

Our approach to investing at Passive Capital Management is simple and straightforward. We focus on the things that we can control and do so with diligence and discipline. While there are many factors that go into a successful investment experience, we believe that it is critical to focus on a few key factors, which include asset allocation, diversification, rebalancing, tax efficiency, and costs. It is these key factors that allow us to capture the long-term returns offered by various global asset classes.

The diversification of a portfolio is a controllable factor of investing that allows us to capture returns from various correlated and uncorrelated global asset classes. While we cannot know in advance which global asset classes will zig and zag during a given period, you must have exposure to each to capture the various returns offered by the global equity markets. The goal of diversification is not to try to predict which global asset class will be the best, but to achieve consistent long-term positive performance while reducing the possibility of a devastating loss.

Multiple global asset classes offer the potential for positive returns over the long term, even though it has been easy to overlook them with the recent performance of the US equity markets. The US equity markets account for 52% of the global equity market capitalization, as evidenced by the chart below. But do not forget that the remaining 48% of global investment opportunity lies outside of the US including International Developed and Emerging Markets.

Exhibit 1. World Equity Market Capitalization




As of December 31, 2017. Data provided by Bloomberg. Market cap data is free-float adjusted and meets minimum liquidity and listing requirements. China market capitalization excludes A-shares, which are generally only available to mainland China investors. For educational purposes; should not be used as investment advice.

A solid case for global diversification can be made by looking at the past 20 years. Though past performance does not guarantee future results, it can help us recognize why global diversification is critical to long term investment success. From 2000-2009, a period often referred to as the “lost decade”, the S&P 500 Index posted its worst ever 10-year performance with an annualized return of -.95%. During the “lost decade” you can see, in the chart below, that it paid to be a globally diversified investor, with various international asset classes performing tremendously well.

Exhibit 2. Global Index Returns, January 2000–December 2009 & January 2010-December 2018

| | Total Annualized Return (%) (1/1/2000 - 12/31/2009) | Total Annualized Return (%) (1/1/2010 - 12/31/2018) |
|---|---|---|
| S&P 500 Index | -.95 | 11.73 |
| MSCI World ex USA Index (net div.) | 1.62 | 3.56 |
| MSCI World ex USA Value Index (net div.) | 4.05 | 2.70 |
| MSCI Emerging Markets Index (net div.) | 9.78 | 2.16 |
| MSCI Emerging Markets Value Index (net div.) | 12.08 | 1.04 |



Following the bottom of the Financial Crisis in March, 2009, could you have guessed how the next 10 years would look? Fast forward to present day and we saw quite a different story play out. While other global assets classes lagged, including International Developed and Emerging Markets, the S&P 500 rebounded handsomely with an annualized return of 11.73%. A perfect example of a zig followed by a zag and where a rebalanced, globally diversified portfolio would have captured these returns.

There is no crystal ball that tells us how the next 10 years will look, but we do know that one of the global asset classes will outperform the rest. The advisors at PCM understand this and construct globally diversified portfolios that position our clients with the best opportunity to experience long term success.

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