The Home Bias Report

Contents

Foreword

Kully Samra
Vice President, Charles Schwab

People have a strong tendency to invest in things that they know, in businesses they recognise and in places they inhabit. In short, retail investors feel a strong pull to invest in what they understand best: their home market.

That is the hypothesis that we set out to prove in our Home Bias Report. Our report comprises quantitative research based on a poll of 200 UK direct investors with a minimum of £25,000 of investible assets. We define direct investors as individuals who invest directly into the equity and/or debt capital markets without the assistance of a financial adviser.

Our research indicates that the majority of UK people innately favour investing their capital within the UK market. We know that this investment characteristic we call “home bias” is not just a UK phenomenon. In the US, millions of Charles Schwab customers who use our platform to invest strongly favour their home market, and solely buy US equities and bonds. However, US retail investors with home bias benefit from investing in the world’s largest economy – one that is hugely diverse, liquid and accounts for 50% of the global stock market.

On the other hand, UK equities provide significantly fewer opportunities for value investing and present a far greater challenge in terms of ensuring one’s portfolio is sufficiently diversified. We would never advocate actively pursuing a home bias agenda. Diversification is a vital investment strategy which spans asset classes, regions and sectors. Critically, it offers the promise of better returns over time, helping to spread investment risk and expand opportunities by investing in different markets.

Foreword

The overarching message is clear – UK investors have a strong tendency towards home bias and should strongly consider other markets beyond their home shores. In particular, US equities should be considered as part of any balanced portfolio. The US market possesses huge economic dynamism and growth opportunities, not to mention the liquidity and range of companies to ensure, with the right strategies, diversification and risk offsetting.

Our survey suggests a degree of reticence on the part of UK investors to diversify, and in particular to buy into the US economy. This is partly, although not wholly, due to perceived political risks. However, we urge people when investing to look at the fundamentals rather than political headlines. The US economy is performing well, unemployment is low, wages are up and GDP growth is strong. These metrics, if they continue to move in the same direction, should be leading indicators of investment performance.

Many people will always have a subconscious bias towards their home market. But for UK investors, consciously or subconsciously adopting this investment position is likely to severely limit the growth potential of portfolios, whilst concentrating, and therefore increasing, risk.

We hope that you find our research of interest.

Key Findings

Equity optimism abounds: the bull run continues in the minds of investors	> The majority of UK investors (72%) are optimistic about the global stock market in the next year > Investors believe that the UK market will perform strongest over the next year (71%), followed by Europe (66%), and finally the US (65%) > Over half of investors (57%) think Brexit will have a positive impact on UK equities
When it comes to investing, the UK has a significant "home bias"	> 3 in 4 UK investors (74%) are looking to invest the majority of their assets in their home market > Only 7% are looking to make significant investments into the US > Investors are put off investing in the US market because of geopolitical tensions, politics, rising interest rates and high valuations
Despite market optimism, investors are nervous about buying equities	> 73% of investors say there is something that puts them off investing in equities > 32% say equity investing involves too much risk and volatility > 21% feel they don't have a strong enough grasp of business fundamentals to invest in stocks
The case for diversification is growing	> Investors feel Brexit is likely to have a negative short-term economic effect but 57% believe it will have a positive, long-term impact on UK stocks > 59% of respondents considered diversifying their portfolios in light of the Brexit vote > 45% of investors are worried about rising interest rates in the UK

Chapter 1

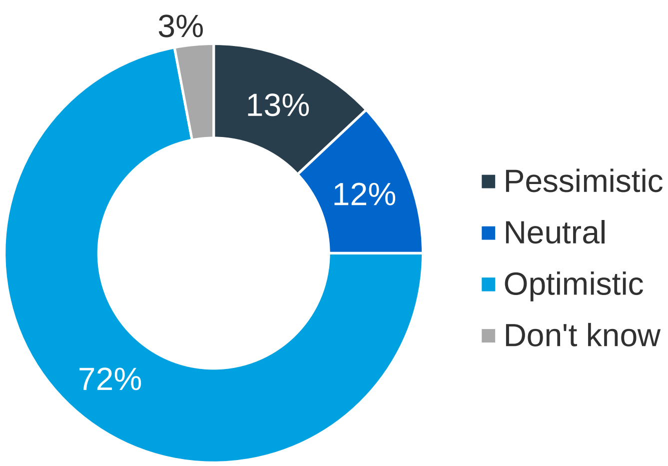
Equity Optimism Abounds

The bull run continues in the minds of investors

Despite volatility, geopolitical unease and changes to global monetary policy, UK direct investors – those who pick stocks or invest in funds themselves – remain overwhelmingly positive about the outlook for the global stock market over the next 12 months.

Only 13% felt pessimistic about the performance of equities over the next year, compared to 72% who said they were optimistic.

Percentage of investors who are pessimistic / neutral / optimistic for the global stock markets over the coming 12 months

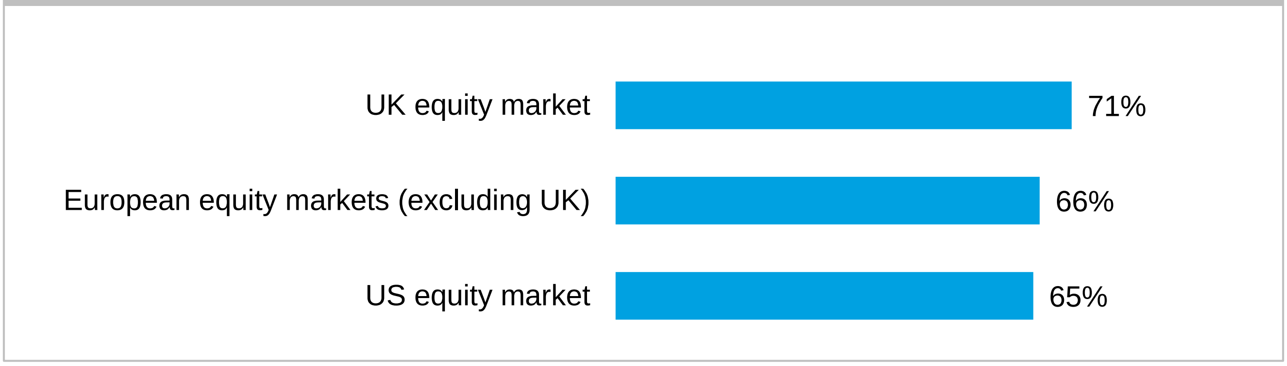


This positive outlook suggests direct investors in the UK are willing and ready to allocate capital and, in theory, should be considering which markets will generate the best returns. Interestingly, our research suggests that UK investors have comparable expectations for UK, European and US stock markets, despite the very different economic and political factors which are driving them. When asked how well they thought these equity markets would perform in the next one to three years, at least two thirds of investors rated all markets as positive.

Chapter 1

Equity Optimism Abounds

Expectations for equity market performance over the next 1–3 years



This equity optimism may be well deserved. The start of the year has witnessed a strong earnings season globally, with first quarter earnings from companies in Europe and Japan joining the United States in posting double-digit growth relative to a year ago.

There are many factors which contribute to the relative under or over performance of investments. Shifts in global monetary policy are expected to lead to stock market volatility and recent central bank announcements have made investors nervous to a degree. Many UK investors, it seems, are not ready to see the end of low borrowing costs; 45% of investors we polled are worried about rising interest rates in the UK.

Kully Samra commented:

"Many people are inherently positive about the future and this is also the case when it comes to investing. However, it is nonetheless surprising to see how upbeat UK investors are about the global economy, and especially the UK economy, given that the uncertainty caused by Brexit remains firmly in place. Against this economic backdrop we would caution investors against over-allocating to this potentially turbulent market.

"It's not only Brexit which is causing markets concern; the global economy is entering a new phase. Shifts in monetary policy globally are contributing to increased volatility. A more challenging investing environment requires a more disciplined and patient investing approach. In particular, the uncertainty around the future prospects of the UK should serve as a wake up call to investors who default to their home market. In a time of political and economic uncertainty in the UK and globally, international diversification is a prudent move."

Uncertainty around the future prospects of the UK should serve as a wake up call to investors who default to their home market

Chapter 2

The Home Bias is Real

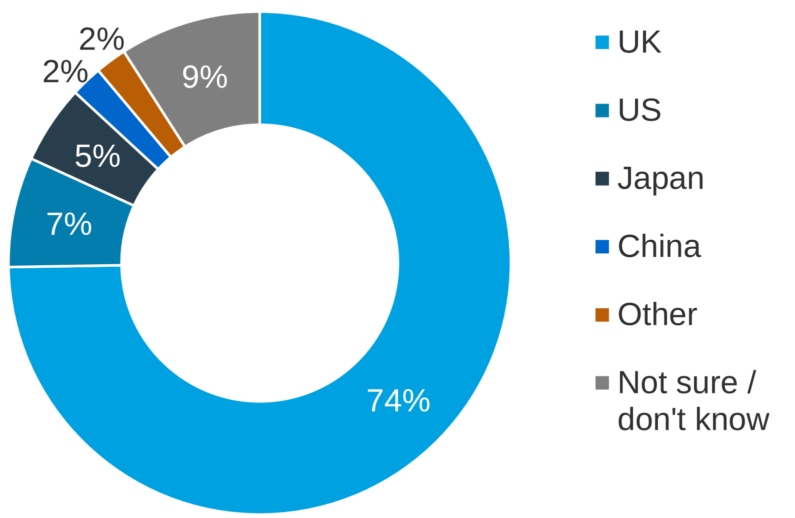
When it comes to investing, the UK has a significant "home bias"

Despite the fact that UK direct investors expect global stock markets to perform strongly over the next few years, this optimism is not reflected in the balance of their investments.

When asked in which market they are looking to make the majority of their investments in 2018, three quarters of UK direct investors (74%) picked their home market, compared to only 7% who are looking to make significant investment into the US, 5% to Japan and 2% to China. The fact that nearly one in ten investors did not know or were unsure of their favoured markets demonstrates how little investors are considering foreign equities compared to their own.

Three quarters of UK direct investors (74%) picked their home market

UK investors' market of choice for investments in 2018



The big question is: why does this concentration risk and, possibly subconscious, home bias exist? When asked why they were attracted to investing in their home market, a significant proportion of investors (48%) said that they felt most informed about companies in their own market; 40% wanted to actively support local companies by investing; and 39% felt they understood the dynamics of their own economy better than others.

Chapter 2

The Home Bias is Real

UK direct investors are therefore clearly more comfortable allocating money to economies and stocks with which they are immediately familiar, even if the data suggests there may be better returns elsewhere. Nearly three quarters (74%) of respondents agreed that there is long-term value in investing in the UK market, compared to 56% who said there is long-term value investing in the US market.

On the other hand, US shares have outperformed UK blue chip stocks over the previous five years, delivering an annualised gain of 12.9% compared with 7.1%.

Nearly three quarters (74%) of respondents agreed that there is long-term value in investing in the UK market

Kully Samra, Vice President of Charles Schwab, said:

"Home bias is a universal phenomenon, but our research suggests it is particularly pronounced in the UK. There are many reasons why this might be the case. A large part of asset allocation involves assessing how to maximise returns whilst mitigating risk. If investors feel comfortable and familiar with their home market, they are more likely to invest in it, even if this decision results in a less profitable, higher risk/return trade-off for their portfolio compared to investing in other markets.

"Over half of investors say that they see value in investing in the US. This is a high figure but significantly lower than the value UK investors ascribe to their home market. This sentiment in turn drives inflows, with only 7% interested in allocating capital to US stocks, compared to nearly three quarters backing UK companies. The S&P 500 has by far outperformed the FTSE 100 over the last few years, so this UK favouritism demonstrates how UK investors are actually weakening their portfolios and cutting themselves off from potentially superior returns."

There are many other compelling arguments in favour of diversification and US market should not be overlooked. It provides a great choice of assets in which to invest, access to transparent and liquid markets, as well as the benefits of robust regulation – all of which help to mitigate risk and maximise returns."

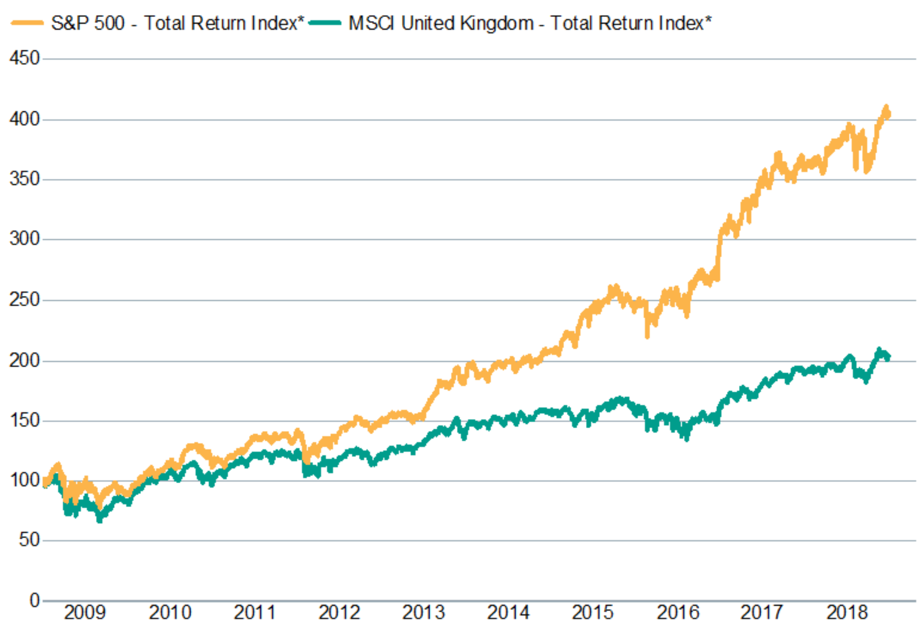
Home bias is a universal phenomenon, but our research suggests it is particularly pronounced in the UK

Chapter 2
The Home Bias is Real

FSTE 100 vs. DOW over the past four years

Data correct as of 22 June 2018

S&P 500 vs. MSCI UK over the past ten years



*Source: FactSet, MSCI, Standard & Poor's, as of 7/3/2018. *Indexed to 100 = 7/2/2008 using the British pound as the base currency.*

Chapter 3

Brexit: Challenging the Home Bias

The UK is about to undergo a seismic change which should call home bias into question for all investors. Leaving the European Union is likely to put some pressure on the UK stock market, as companies across all sectors may have to shift how they operate and trade globally. Such political uncertainty is expected to lead to heightened volatility and investors overweight in UK assets could find themselves at the sharp end of any market pull back.

Investors are surprisingly positive about the outlook for UK equities

Long-term positivity for UK equities

Given the continued uncertainty around the UK's future relationship with the EU, investors are surprisingly positive about the outlook for UK equities. The majority of UK direct investors (57%) think Brexit will have a positive impact on the UK stock market. This may be because the FTSE 100 generates almost 70% of its revenue from ex-UK markets and is therefore protected, to a large degree, from any political or trade fall out. These, often dollar denominated, companies have also benefitted from a weaker pound since the 2016 referendum vote.

57%
of investors think Brexit will have a positive impact on the UK stock market

Short-term Brexit concerns

UK investors may have high hopes for UK stocks in the future but, conversely, are reviewing their exposure to the UK economy in the short term. The share price performance of mid and small cap companies is highly correlated with the domestic market and economy, meaning events such as Brexit can have a serious impact. Only around 40% of FTSE 250 companies generate revenue from ex-UK markets.

Whilst large cap stocks in the FTSE 100 generate revenue from abroad, large companies headquartered in the UK must still be aware of how any post-Brexit trade deal would impact their cost of doing business. It is therefore perhaps not surprising that a significant number (59%) of UK investors say that Brexit has made them consider diversifying their portfolio away from UK stocks, even if only for the short term.

59%
say that Brexit has made them consider diversifying their portfolio away from UK stocks

Chapter 3

Brexit: Challenging the Home Bias

Kully Samra said:

"Given the lack of visibility on what will take place over the negotiating table between the UK and EU in the next year, and the opaque nature of the future UK-EU trading relationship, investors would be wise to consider assets away from their home shores. Global markets are now at their most uncorrelated for years, which means that there are great investment opportunities overseas if people are willing to drop their bias towards domestic equities.

"Brexit does present a threat to UK equity investment – at least in the short term – so it is reassuring to see that people to some degree are considering allocating beyond the UK to de-risk their portfolios. However, our findings suggest that many may not yet have taken the first step towards truly global investing."

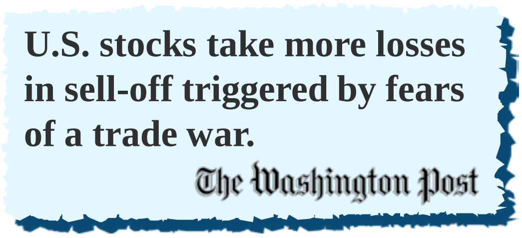
Brexit does present a threat to UK equity investment

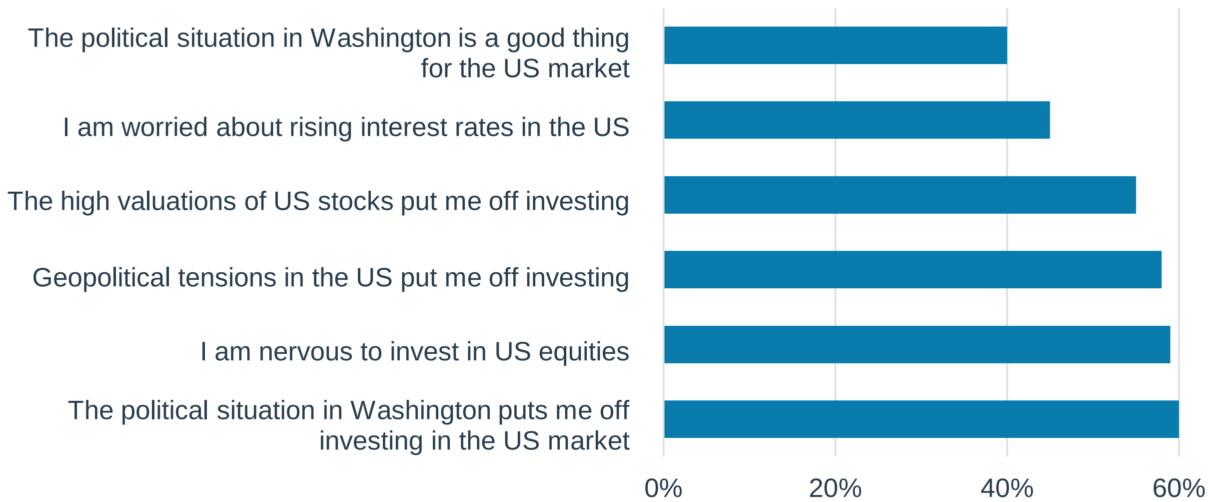
Chapter 4
Scepticism Trumps Diversification

UK direct investors are wary of buying into the US market due to perceived risks

This study has so far examined the importance of a diversified portfolio and the benefits of exposure to liquid, well capitalised, highly regulated capital markets. The US stock market epitomises such qualities. However, despite the potential high returns from US stocks, political tension in the USA has resulted in UK investors shying away from investing in American equities. 60% of respondents say that the political situation in Washington puts them off investing in the US market, and a further 58% agree that geopolitical tension has dissuaded them from investing altogether. A similar number (55%) think US equity valuations are a barrier to entry and 45% are concerned by the Federal Reserve's moves to raise interest rates and unwind its balance sheet.

Political tension in the USA has resulted in UK investors shying away from investing in American equities





Chapter 4

Scepticism Trumps Diversification

Investor expectations out of kilter with returns reality

The US stock market has seen a remarkable few years. The labour market remains tight enough to keep wage growth on an upward trajectory and the most recent earnings season has been received positively. This good news appears to be filtering through to rising inflation, although there is every possibility of price increases moderating in the near future. Consumers are gaining conviction in this economic expansion and personal spending is on the rise. Businesses are equally confident, with regional manufacturing surveys continuing to surprise on the upside. Whilst it is true that volatility does rise when investors have to deal with global geopolitical headwinds, patience and discipline are often better investment disciplines to adopt instead of an instant reaction to sometimes ominous-sounding headlines.

Headlines can often be a distraction from the fundamental investment case for US equities

Kully Samra said:

"Macroeconomic and geopolitical events have no doubt given stock markets some jitters over the past six months, but headlines can often be a distraction from the fundamental investment case for US equities. The US remains the most established, liquid, and capitalised market in the world. With abundant financial information and strictly observed reporting regulations, it is also highly transparent. Similarly, transaction volume, market capitalisation, and the sheer number of listed companies make it a unique investment opportunity.

The underlying economy is strong; unemployment is low, a tight labour market is leading to accelerating wage growth, corporate earnings are surpassing expectations and both productivity and sentiment indices are looking positive. Whilst political sabre-rattling can spook investors, we believe that economics and markets have had a larger impact on politics than the other way round."

Chapter 5

Fear Factor Hampering Equity Investment

Despite optimism around global stocks, investors are nervous about buying equities

The preference for investing in UK shares is driven, in part, by comfort and familiarity with domestic markets. However, it is worth examining the underlying connection between the ‘home bias’ and ‘asset class bias’. The UK sees far more capital allocation to bonds than stocks; according to the Investment Association, £14 billion of retail investment flowed into fixed income products, compared to £10 billion which went into equities in 2017*.

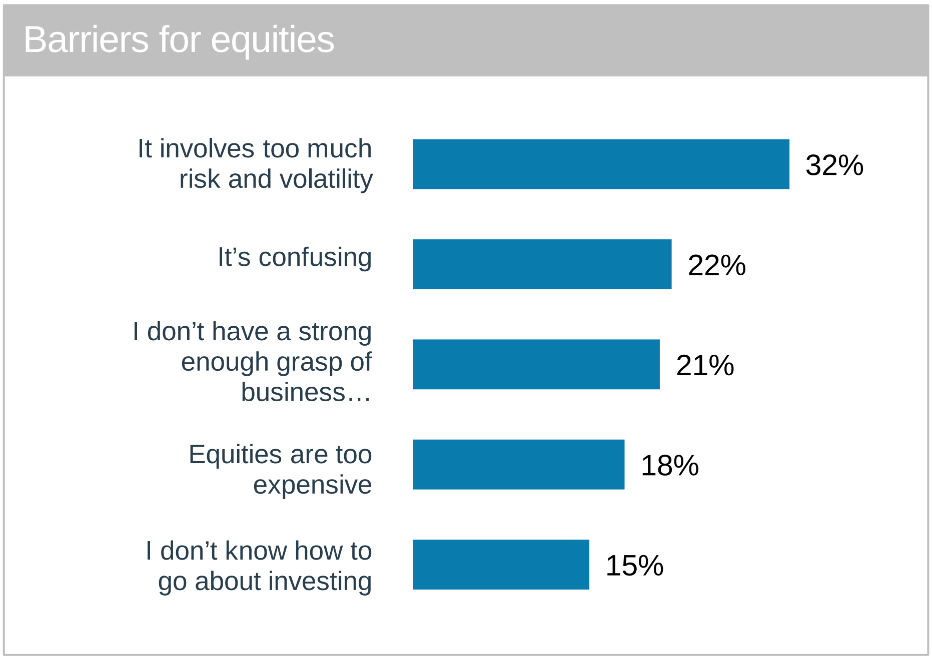
The majority of investors (73%) say that there is at least one thing which puts them off investing in equities

This data is mirrored by our research. The majority of investors (73%) say that there is at least one thing which puts them off investing in equities. Nearly a third (32%) think that equities carry too much risk and volatility to make investing worthwhile. Over a fifth (22%) find equity investing confusing and a similar number (21%) feel they do not have a strong enough grasp of business fundamentals to invest in stocks in the first place.

Unlike fixed income, equities offer potentially higher rewards but also higher risk. If investors therefore do choose to allocate their capital to equities, they are perhaps inclined to hedge that risk by investing in stocks they know and recognise – namely, UK companies – thereby entrenching the home bias even further.

*https://www.theinvestmentassociation.org/fund-statistics/retail-sales.html?what=table&show=19

Chapter 5
Fear Factor Hampering Equity Investment



Kully Samra said:

"The results of our survey so far have painted a picture of a patriotic UK investor who is highly optimistic about the outlook for global stocks over the next year. However, the picture is not as clear as it first may seem. Although UK investors anticipate that relative long term stock market performance will be positive, they are fundamentally wary of equities as an asset class. So, rather, a picture is emerging of a UK direct investor keen to buy into the stock market and keep abreast of macroeconomic trends, but who feels cut off from the equity capital markets due to the sheer complexity of the investing process. Just as UK investors should consider regional diversification, so too should they consider investing in a diversity of asset classes if they are to maximise returns."

UK investors are fundamentally wary of equities as an asset class

Chapter 6

Overcoming the Home Bias

An over-reliance on UK equities means investors are missing out on wider market opportunities

Our research shows that investors are far more likely to allocate their assets to UK assets than international alternatives, despite the de-risking opportunities afforded by having exposure to ex-UK investments.

This is not to say that UK investors should avoid domestic equities altogether. There are many reasons why the UK remains an attractive equity market. It boasts world class companies, large and liquid capital markets, and Brexit, against initial expectations, has not yet had the adverse effect on the stock market which many feared. Indeed, the FTSE 100 is up around 25% since the Referendum vote.

The concern is that an over-reliance on UK equities means investors are missing out on wider market opportunities and, in doing so, inadvertently exposing themselves to a high degree of risk. Despite its strong credentials, UK equities have underperformed the US market by about 5% over the past five years.

Investors may feel that being overweight in domestic stocks provides a hedge against global uncertainty. But UK companies do not exist in a vacuum; as mentioned, nearly three quarters of FSTE 100 company revenue is generated from overseas. Therefore, events in key international markets – and the confidence they do or do not inspire – can have a ripple effect on returns from UK investments.

Overcoming the Home Bias

Similarly, backing only one market makes investors more likely to be both over or under exposed to certain sectors. Home markets, for example, are likely to contain a more concentrated composition of sectors than the global market. If one sector underperforms, a portfolio which holds a wider set of securities across sectors will be better protected during a downturn. Diversification helps to offset risk. Recognising this structural bias is key for anyone who pick stocks or invest in funds themselves

Recognising this structural bias is key for anyone who pick stocks or invest in funds themselves

The diversity of any stock exchange is dictated by the mix of companies and sectors of which it consists.

For example, the FTSE 100's weighting to technology currently stands at 0.63%, compared to 25% in the S&P 500. US tech companies have performed strongly in recent months, driven in part by strong balance sheets, which could support mergers and other activities that enhance earnings. Additionally, business confidence has improved and the potential for cash repatriation could provide a boost to this sector, not to mention larger dividend payments. Investors who avoid – or indeed forget to consider – the US benchmark cannot get exposure to this outperforming sector and the associated high returns.

Regional variety is crucial for robust portfolio selection, however an investment environment such as the UK can sometimes mean investors are blinkered from other opportunities which might better serve their investment goals.

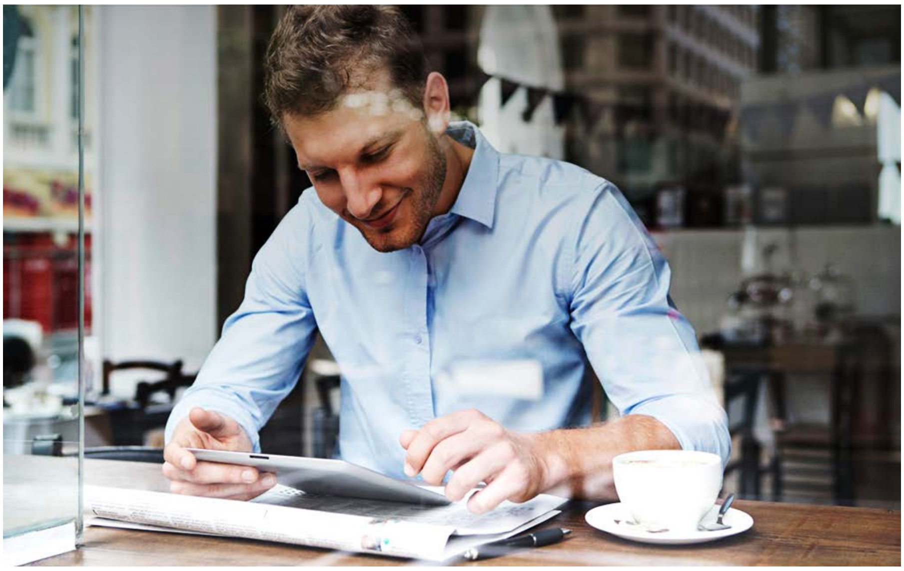
Chapter 7

Owning your Tomorrow

The findings of the Home Bias Report demonstrate some of the potential pitfalls into which direct investors can fall, particularly over-allocating to their domestic market because of familiarity and an instinctive trust towards what they know best. But Home Bias is just that, a preference in a certain market regardless of whether or not it will deliver significant returns.

The report therefore illustrates the importance of challenging those innate partialities towards certain markets and asset classes, and actively engaging with one's wealth.

We believe that investing, when done right, can enable people to take ownership of their financial future. They can do this by making informed decisions as to where their money is invested, remaining engaged with the performance of their portfolio, and taking steps to understand the decisions which influence investing outcomes.



Making informed decisions around asset allocation allows investors to determine what financial success looks like to them, and gives them the opportunity to decide how they will achieve these outcomes. When investors are actively engaged with how their money is managed and where it is allocated, then they can truly unlock the growth that stock ownership provides, thereby making more informed decisions and generating better returns.

At Charles Schwab, we believe in the power of investing to help individuals create a better tomorrow

Chapter 7

Owning your Tomorrow

Charles Schwab is a champion of equity investing and the US market with a track record to prove it. As specialists in US equities, the company has provided guidance to millions of clients in the US and all around the world, providing regular, detailed, data-led analysis on the US market and its impact on investors.

Helping investors understand US equities for over 20 years,

We have worked with UK clients for over 20 years, helping investors understand US equities, navigate this mammoth global market and maximise their returns.

At Charles Schwab, we believe in the power of investing to help individuals create a better tomorrow. We have a history of challenging the status quo in our industry, innovating in ways that benefit investors and the advisors and employers who serve them, and championing our clients' goals with passion and integrity.

About Charles Schwab

The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with more than 345 offices and 11.1 million active brokerage accounts, 1.6 million corporate retirement plan participants, 1.2 million banking accounts, and $3.38 trillion in client assets as of May 31, 2018.

Through its operating subsidiary, Charles Schwab, U.K., Limited, the company provides investment products and services to help individuals in the U.K. access and navigate the U.S. market. Investors can take advantage of Schwab's online tools and resources as well as work closely with its U.S. licensed professionals in London. More information is available at schwab.co.uk.

Charles Schwab, U.K., Limited is authorized regulated by the Financial Conduct Authority. Firm Reference Number 225116. Registered in England and Wales No. 4709153. Registered Office: 78-84 Colmore Row, Birmingham, B3 2AB

Methodology

The research is based on an online survey, conducted by YouGov on behalf of Charles Schwab, conceived to understand the perceptions of investors in the UK and to validate the hypothesis of home bias (i.e. favouring investing in the UK over other markets), and their attitude to investment and the equities market. The interview cohort comprised 201 UK investors with a minimum of £25,000 in disposable assets. The polling took place in April 2018.

(0718-86L0)