An analysis of the Home Bias phenomenon amongst UK investors

- The Home Bias Report seeks to unveil and analyse the anticipated “home bias” towards domestic equities in the UK market.
- Based on the assumption that UK retail investors are heavily overweight domestic equities, the research examines this concentration risk and explores why this, possibly subconscious, home bias exists.
- The survey also reveals UK investors’ innate risk aversion to stocks and shares investing and how this may be linked to the home bias phenomenon.
- Our report comprises quantitative research based on a poll of 201 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.
- 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.
The case for diversification is growing

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

The UK has a significant investing "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
Majority of investors are optimistic about global stock market in next year

- Despite volatility, geopolitical unease and changes to global monetary policy, UK direct investors remain overwhelmingly positive about the outlook for the global stock market over the next 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.
Investors have a positive outlook for equities globally

- 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.
- Many people are inherently positive about the future and this is also the case when it comes to investing.
- 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.

Percentage of investors who think the following equity markets will perform well:

- UK equity market: 71%
- European equity markets (excluding UK): 66%
- US equity market: 65%

How do you think the following equity markets will perform in the next 1-3 years?
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 their investing behaviour.

- Three quarters of UK direct investors (74%) are looking to make the majority of their investments in 2018 in their home market, compared to only 7% who are looking to make significant investment into the US, 5% to Japan and 2% to China.

- That nearly one in ten investors do not know or are unsure of their favoured markets demonstrates how little investors are considering foreign equities compared to their own.
Why does the Home Bias exist?

UK direct investors are 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.

Reasons for investing in their preferred market

- I feel most informed about companies in this market: 48%
- I want to support companies in this market: 40%
- I understand the dynamics of this economy better than others: 39%
- Other: 4%
- Not sure / don’t know: 3%

Why are you attracted to investing in your preferred market?
Brexit is challenging the Home Bias

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

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

- Given the continued uncertainty around the UK’s future relationship with the EU, investors are surprisingly positive about the outlook for UK equities.

- 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.

- Investors may be reactively or reflexively looking to diversify outside of UK shares simply in order to avoid Brexit turbulence rather than as part of a considered long-term diversification strategy.

What impact do you think Brexit will have on the UK equities market?
The political situation in Washington puts me off investing in the US market.

I am nervous to invest in US equities.

Geopolitical tensions in the US put me off investing.

The high valuations of US stocks put me off investing.

I am worried about rising interest rates in the US.

The political situation in Washington is a good thing for the US market.

UK investors have historically been nervous of buying into the US market due to perceived risks. 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.

However, despite the potential high returns from US stocks, political tension and rising interest rates have resulted in UK investors shying away from investing in American equities.

Whilst political sabre-rattling canomics and markets have had a larger impact on politics than the other way round.

Scepticism of US markets dissuades investors from diversification

Percentage of respondents who agreed with the above statements
The case for diversification

The US market has outperformed the UK market over the last 10 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.

The performance of global markets differs year over year.

Source: Schwab Asset Class Quilt TM, Global Market Performance.
Despite optimism around global stocks, investors are nervous about buying equities

- It involves too much risk and volatility: 32%
- It’s confusing: 22%
- I don’t have a strong enough grasp of business fundamentals to invest in stocks: 21%
- Equities are too expensive: 18%
- I don’t know how to go about investing: 15%

What if anything puts you off buying equities?

- As well as a home bias, the UK may well have an ‘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 flowed into equities in 2017*. 

- 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, despite the fact that equities are the best long-term way to create wealth and avoid erosion of returns due to inflation.

- Unlike fixed income, equity investment offers higher rewards but also higher risk. If investors do choose to allocate their capital to equities, they may be inclined to hedge that risk by investing in stocks they know and recognise – namely, UK companies – thereby entrenching the home bias even further.
How to overcome the Home Bias?

**Economic background and associated risks**

- A more challenging investing environment requires a more disciplined investing approach.
- In a time of political and economic uncertainty, international diversification is a prudent move.
- A home bias investment position is likely to limit the growth potential of portfolios, whilst concentrating risk.

**Achieving portfolio diversification**

- Look for markets which possess economic dynamism and growth opportunities, liquidity and range of companies.
- Pay attention to economic fundamentals rather than headlines.
- Remember that asset class diversification and regional variety are crucial for robust portfolio selection.
- Recognise any structural bias in a portfolio’s composition.
Overall methodology
An online survey conducted a short survey 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. We interviewed 201 UK investors with 25K disposable savings in April 2018.

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