

Going Global: A Look at Public Company Listings

Trivia time: how many stocks make up the Wilshire 5000 Total Market Index (a widely used benchmark for the US equity market)?

While the logical guess might be 5,000, as of December 31, 2016, the index actually contained around 3,600 names. In fact, the last time this index contained 5,000 or more companies was at the end of 2005. This mirrors the overall trend in the US stock market. In the past two decades, there has been a decline in the number of US-listed, publicly traded companies.

Should investors in public markets be worried about this change? Does this mean there is a material risk of being unable to achieve an adequate level of diversification for stock investors? We believe the answer to both is no. When viewed through a global lens, a different story begins to emerge—one with important implications for how to structure a well-diversified investment portfolio.

When looked at globally, the number of publicly listed companies has not declined. In fact, the number of firms listed on US, non-US developed, and emerging markets exchanges has increased from about 23,000 in 1995 to 33,000 at the end of 2016. (See Exhibit 1.)

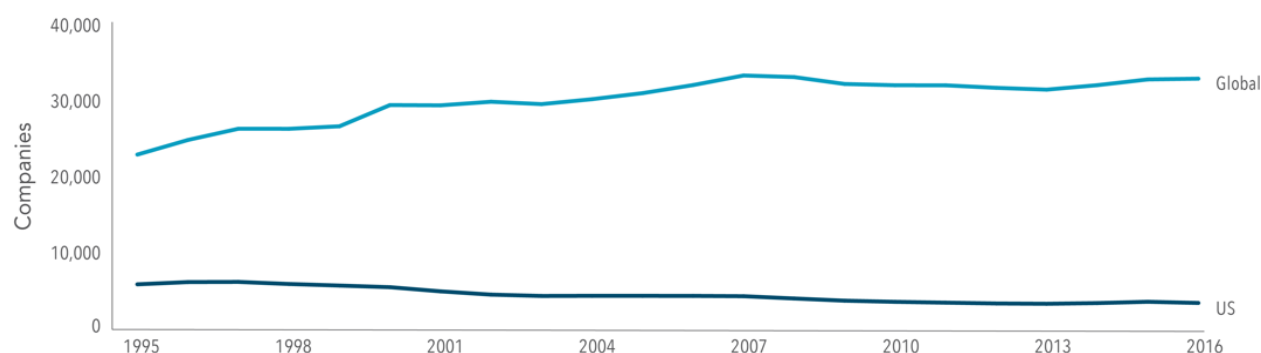
It should be noted, however, that this number is substantially larger than what many investors consider to be an investable universe of stocks. For example, one well-known global benchmark,

the MSCI All Country World Index Investable Market Index (MSCI ACWI IMI), contains between 8,000 and 9,000 stocks. This index applies restrictions for inclusion, such as minimum market capitalization, volume, and price. In comparison, **your portfolio's stock universe, at around 13,000 stocks**, is broader than the MSCI ACWI IMI.

While it is true that in the US there are fewer publicly listed firms today than there were in the mid-1990s (a decrease of about 2,500), the increase in listings both in developed markets outside the US and in emerging markets has more than offset the decline in US listings. Although there is no consensus about why US listings have decreased over this period, several academic studies have explored possible reasons for this change.

One line of investigation considered whether changes in the regulatory environment for listed companies in the US relative to other countries may explain why there are fewer listed firms. Another considered whether, since the 2000s, private companies have had a greater propensity to sell themselves to larger companies rather than list themselves. In either case, the implication for investors based on the numbers alone is clear—**the number of publicly listed companies around the world has increased, not decreased.**

Exhibit 1. Number of Publicly Listed Companies



Source: Bloomberg.

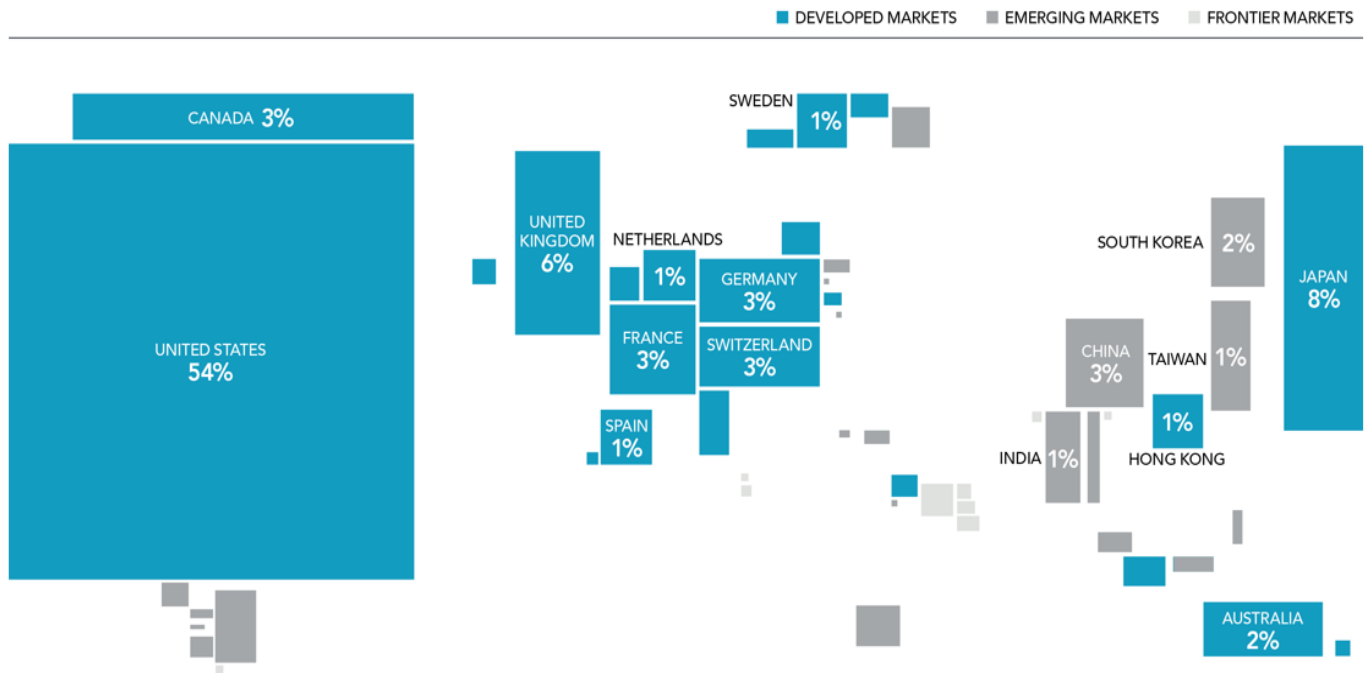
In the US, with thousands of stocks available for investment today, it is unlikely that this change will meaningfully impact an investor’s ability to efficiently pursue equity market returns in broadly diversified portfolios. It is also important to note that a significant fraction of the publicly available global market cap remains listed on US exchanges. As noted in Exhibit 2, the weight of the US in the global market is approximately 50–55%. In comparison, it was approximately 40% in 1995.

For investors looking to build diversified portfolios, the implications of the trend in listings are also clear. The global equity market is large and represents a world of investment opportunities, nearly half of which are outside of the US. While diversifying globally implies that an investor’s portfolio is unlikely to be the best

performing relative to any one domestic stock market, it also means it is unlikely to be the worst performing. Diversification provides the means to achieve a more consistent outcome and can help reduce the risks associated with overconcentration in any one country. By having a truly global investment approach, investors can capture returns wherever they occur.

While there has been a decline in the number of US-listed publicly traded companies, this decline has been more than offset by an increase in listings in non-US markets. While the reasons behind this trend are not clear, the implications for investors today are clearer—to **build a well-diversified portfolio, an investor has to look beyond any single country’s stock market and take a global approach.**

Exhibit 2. Percent of World Market Capitalizations as of December 31, 2016



Data Provided by Bloomberg.

Investment Shock Absorbers

Ever ridden in a car with worn-out shock absorbers? Every bump is jarring, every corner stomach-churning, and every red light an excuse to assume the brace position. You can drive a car

with a broken suspension system, but it will be an extremely uncomfortable ride and the vehicle will be much harder to control, particularly in difficult conditions. Throw in the risk of a breakdown or going off the road altogether, and there's a real chance you may not reach your destination. Owning an undiversified portfolio can trigger similar reactions.

In the world of investment, a **similarly bumpy and unpredictable ride can await those with concentrated and undiversified portfolios** or those who constantly tinker with their allocation based on a short-term rough patch in the market. Of course, everyone feels in control when the surface is straight and smooth, but it's harder to stay on the road during sudden turns and ups and downs in the market. And keep in mind the fix for your portfolio breaking down is unlikely to be as simple as calling a tow truck.

For that reason, the smart thing to do is to diversify, spreading your portfolio across different securities, sectors, and countries. That also means identifying the right mix of investments (e.g., stocks, bonds, real estate) that aligns with your risk tolerance, which helps keep you on track toward your goals. Using this approach, your returns from year to year may not match the top-performing portfolio, but neither are they likely to match the worst. More important, this is a ride you are likelier to stick with.

Just as drivers of suspension-less cars change their route to avoid potholes, people with concentrated portfolios may resort to market timing and constant trading as they try to

anticipate the top-performing countries, asset classes, and securities. Here's an example to show how tough this is. Among developed markets, Denmark was number one in US dollar terms in 2015 with a return of more than 23%. But a big bet on that country the following year would have backfired, as Denmark slid to the bottom of the table with a loss of nearly 16%.

It's true that the US stock market (by far the world's biggest) has been a strong performer in recent years, holding the number three position among developed markets in 2011 and 2013, first in 2014, and sixth in 2016. But a decade before, in 2004 and 2006, it was the second-worst-performing developed market in the world.

Predicting which part of a market will do best over a given period is also tough. For example, while there is ample evidence to support why we should expect positive premiums from small cap, low relative price, and high-profitability stocks, these premiums are not laid out evenly or predictably across the map. US small cap stocks were among the top performers in 2016 with a return of more than 21%. A year before, their results looked relatively disappointing with a loss of more than 4%. International small cap stocks had their turn in the sun in 2015, topping the performance tables with a return of just below 6%. But the year before that, they were the second worst with a loss of 5%.

While diversification can never eliminate the impact of bumps along your investment road, it does help reduce the potential outsized impact that any individual investment can have on your journey. With sufficient diversification, the jarring effects of performance extremes level out. That, in turn, helps you stay in your chosen lane and on the road to your investment destination. It is our goal at Rockwood to collaboratively work to grow your hard-earned wealth via disciplined investor behavior.

The Deathtrap of Current Events

Return with us now to those thrilling days of yesteryear: the first six weeks of 2016. The equity market opened down on the first day of last year, and went pretty much straight down for the next six weeks. (For the life of me, I don't remember exactly why, which may give you a clue to where this little essay is heading.) At the end of the first week, financial journalism shrieked that it had been the worst first week in stock market history, **which was both narrowly accurate and largely meaningless.**



At the end of the month, the media celebrated “the worst first month in history”—something about China, and oil going down. And then, on February 11, the market completed—let me give this the proper journalistic emphasis—the worst first six weeks in the history of the world since the woolly mammoth went extinct, and no end in sight!

Then, for purposes of this discussion, came Brexit. Many (up to and including the incumbent US president) shouted through their megaphone—mainstream journalism—that were the people of the UK to vote to leave the European Union, a global economic disaster, centered in the UK but spreading across the entire world, would surely ensue.

Perversely, Britons voted to do just that. In horror, the S&P 500 closed the first day after this stunning news broke at 2,037. Then (again for purposes of this narrative) came the US presidential election. Mainstream media almost universally forecast that the election of Donald

Trump would usher in the end of all economic life on the planet as we know it. But in the next breath, they told us not to worry, because—depending on which media organ was your news source of choice—the probability of Mrs. Clinton’s election victory was between 77% and 99.9%. (I am not making this up.)

The day after Mr. Trump’s election, the S&P 500 closed at 2,163. For the record—and you’ll want to note this, because we’ll be referring back to it—the S&P 500 closed on February 11, 2016, at 1,829. As of President’s Day 2017, it has closed at 2,351. Raise your hand if you’re seeing a pattern here.

Yes, I see it too. But since there are several potentially valid conclusions that might be drawn from the facts we have just reviewed, I want to make sure you and I focus on the same one.

One cluster of conclusions, I suppose, would be that the mainstream media (a) are relentlessly biased to the negative, (b) have a very specific and uniform agenda when it comes to matters of geopolitics, and (c) always get it wrong. Another conclusion, in the words of Peter Lynch, is “The real key to making money in stocks is not to get scared out of them.” All true, but completely beside the point.

It is simply this: **never make long-term investment decisions based on current events.** Stated as a positive: long-term investment policy must always be derived from history, and never from headlines. The logical sequence of variables in all successful lifetime investing is **financial goals first, then a plan for reaching those goals in the time you have**, and then and only then a portfolio whose long-term historical record would, if continued, give you a high probability of reaching your goals.

You will not have failed to notice that significantly altering your portfolio in response to near-term economic or political phenomena—much less fleeing it altogether

when panic seizes the markets—appears nowhere in that sequence. And I devoutly hope that you take this to heart. Because I can tell you that, after countless years of dealing with markets and investors, every successful investor

I have ever known was acting continuously on a plan. And every failed investor I've ever known was reacting continually to current events.

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