Quarterly Investment Outlook

4th Quarter 2021 September 2021

ameliora
WEALTH-MANAGEMENT

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Advisor's Commentary

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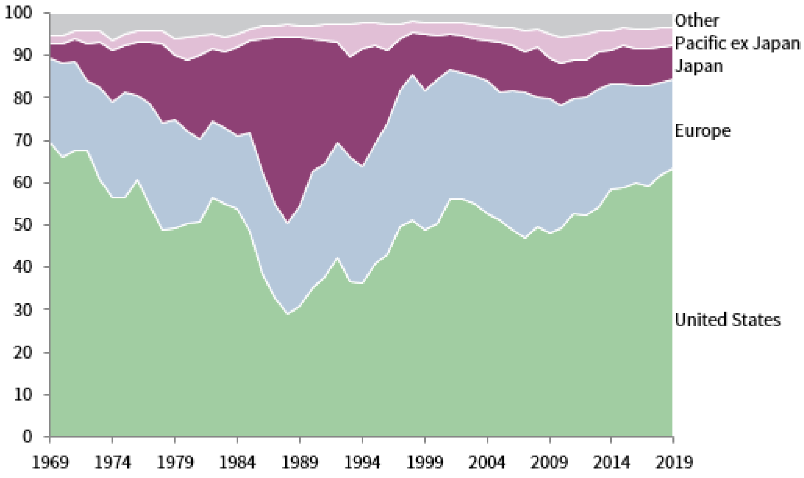
The only "free lunch" in investing, as often argued, is diversification. The notion of significantly reducing risk without compromising returns has merit. Well-diversified portfolios typically produce comparable returns to any one asset class at a fraction of the risk (please see our 2nd and 4th Quarter 2019 Investment Outlooks, found on ameliorawealth.com). Yet, the phrase is somewhat ambiguous because what actually constitutes proper diversification? Take the case of a homogenous asset class such as equities and the broadly diversified MSCI World Index, a reputable and widely followed index. This asset, or index, provides global equity exposure through different region, sectors, and currencies, i.e. arguably a highly diversified asset. However, as with most market-capitalization weighted indexes, the size of any underlying security dictates its absolute weighting in the index. Hence, when any of the constituents achieve increasingly greater influence, the diversification attributes of the index subsequently deteriorate.

MSCI World Index Historical Country Breakdown



Source: Cambridge Associates

Japanese Index Dominance Dragged Down the Global Stock Market the Most

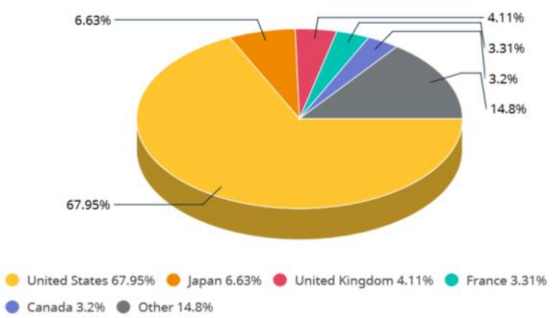
Comparative Performance from Japan Equity Market Peak in January 1990

Source: Bloomberg LP

In the late 1980's, Japanese equities held the largest weight in the MSCI World Index, roughly 45%, after a stellar decade of local stock market outperformance. However, Japanese dominance later pivoted and an ensuing crash saw the MSCI World Index fall far more than that of an equivalent index excluding Japanese companies. The run-up prior to the crash was so remarkable that the event is considered one of the biggest asset bubbles in history, from which the Japanese equity markets have yet to fully recover. In this case, however, it highlights how one of the "diversifiers", i.e. a particular region, actually amplified the concentration risk of an otherwise diversified index.

Currently, US companies dominate the MSCI World index with two thirds of the overall exposure. Not surprisingly, the largest sector is the technology industry stemming from the monstrous evolution of mega-cap stocks such as Apple and Microsoft. Furthermore, the top ten largest companies, almost a fifth of the index, are all American with mostly a technological tilt. In other words, the index is overwhelmingly concentrated in US growth stocks. In fairness, these US companies are far more global than those of Japan in the 1980's whose demise mostly stemmed from local market forces. Still, the MSCI World Index's obvious country and sector biases reveal significantly more concentration risk than diversification attributes, regardless of how international these companies are.

MSCI World Index Country Weights



Source: MSCI. As of 31.08.2021

Top 10 Index Constituents of MSCI World Index

Company	Weight	Mkt Value ($bn)	Sector	Valuation PE Ratio*
Apple	4.23%	2,370,922	Technology	25.60x
Microsoft	3.59%	2,215,390	Technology	32.48x
Google	2.95%	1,858,226	Communications	22.60x
Amazon	2.47%	1,693,350	Communications	42.59x
Facebook	1.51%	1,007,895	Communications	20.35x
Tesla	0.94%	740,687	Consumer Cyclical	111.22x
Nvidia	0.92%	531,150	Technology	48.10x
JP Morgan Chase & Co	0.81%	457,128	Financials	12.34x
Johnson & Johnson	0.76%	433,122	Consumer Staples	16.11x
Total	**18.18%**	**11,307,870**	**Top 10 Members**	**32.92x**
			MSCI World	18.70x
			Valuation Premium	76.10%

Source: MSCI, Bloomberg LP, Ameliora Wealth Management AG. * Forward Estimated Price to Earnings Ratio

Even more fascinating are the trillion dollar values of the top five companies in the world! These companies are undoubtedly some of the most remarkable businesses around and have maintained leadership in their respective industries for a long time. However, they also command significant valuation premiums after stellar stock price appreciations despite a pandemic. Leadership status always changes. ExxonMobil was once the world's largest company. Apple is now the biggest. As eloquently put by Scott Galloway: "It took Apple 42 years to reach $1 trillion in value and 20 weeks to accelerate from $1 trillion to $2 (March to August 2020)". The sky is usually *not* the limit in the stock market.

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