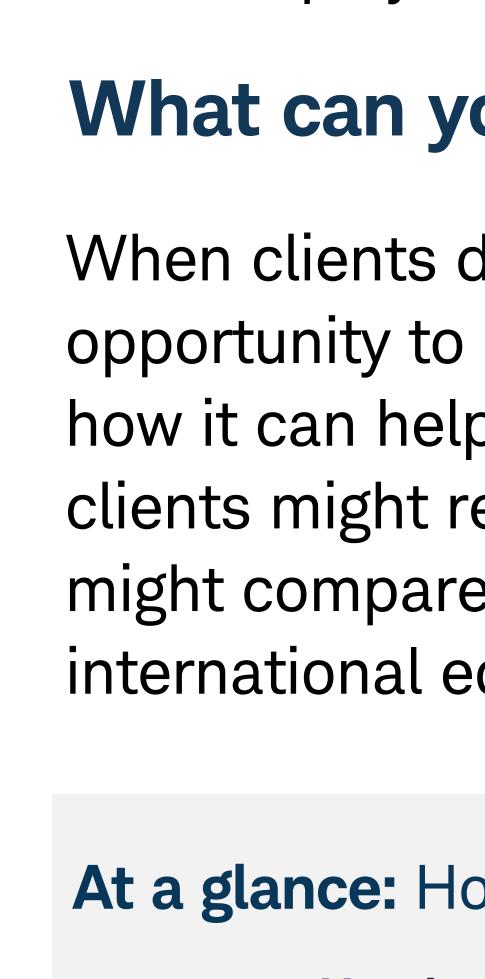


# Fundamentals of behavioral finance: Home bias

It's easy to stick with what's familiar—but doing so can harm client portfolios

## Key takeaways

- Home bias is the tendency to stick with what feels comfortable.
- For clients, home bias often results in too much exposure to U.S. stocks or shares of the company where they work.
- These overweight exposures can mute the benefits of diversification and increase risk.
- Advisors can potentially help clients address home bias by explaining the power of a well-diversified portfolio.
- Educating clients about home bias may lead to better long-term results.



In this series, we explore some of the most common biases exhibited by investors, and discuss how advisors can help their clients overcome them. This article focuses on **home bias**, an emotional bias that places unnecessary limitations on investor portfolios.

## What is home bias?

Also known as familiarity bias, home bias is the tendency to stick with what feels comfortable. It can lead to personal experiences and allegiances playing an outsized role in the decisions we make.

In everyday life, the home bias explains why we often stick with the same brands at the grocery store (even if another brand might be better), or place a bet on our local sports team (even if that team is less talented than its opponent). In investing, home bias is often exhibited by an investor's preference for domestic stocks or a concentrated exposure to their employer's stock.

The home bias can affect even the most sophisticated investors: the BeFi Barometer 2020 study, conducted by Cerulli Associates and sponsored by Charles Schwab Investment Management in collaboration with the Investments & Wealth Institute, found that more than 20% of advisors serving high-net-worth clients say those clients are significantly affected by home bias.<sup>1</sup>

## Why does it matter?

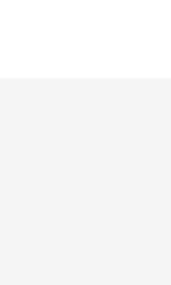
Home bias can concentrate clients' assets too heavily in one area, undermining the well-established benefits of diversification and ratcheting up risk.

For example, U.S. and international stocks aren't perfectly correlated: volatility in the U.S. equity market may not be fully shared by international markets, and periods of U.S. outperformance may be followed by dominance of international markets. Similarly, clients with heavy exposure to shares of their employer can suffer from a lack of diversification.

## What can you do about it?

When clients demonstrate a home bias, advisors have the opportunity to discuss the rationale for diversification and how it can help them reach their long-term goals. Some clients might respond strongly to data. For these clients, you might compare the international allocation of their portfolio to international equities' proportion of global market capitalization.

### At a glance: Home bias

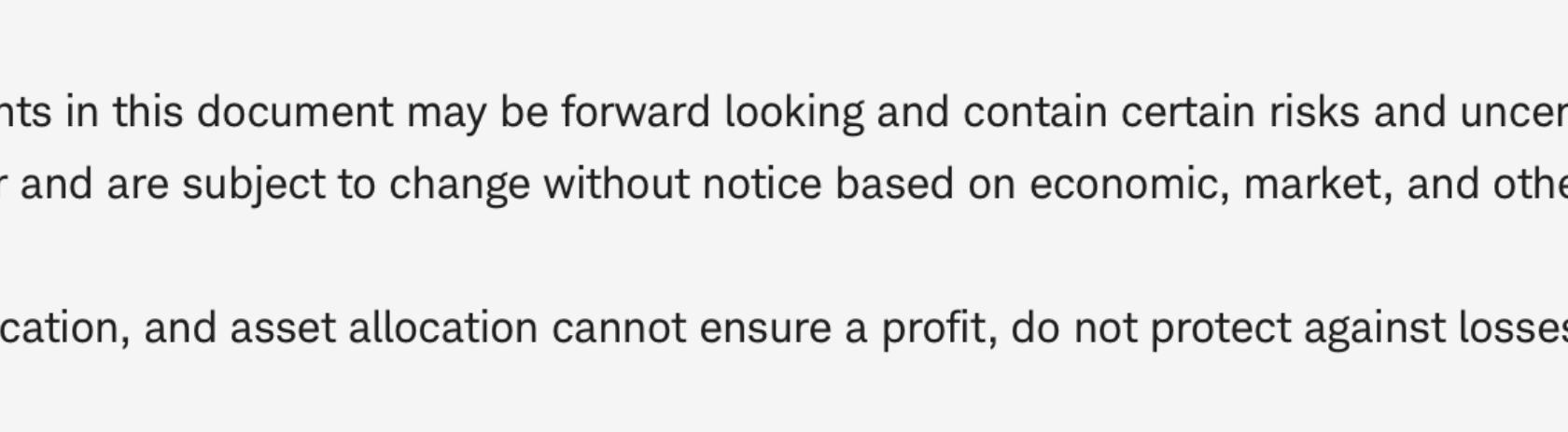


#### Head or Heart?

Home bias is emotional. It describes the tendency to stick with what's familiar.

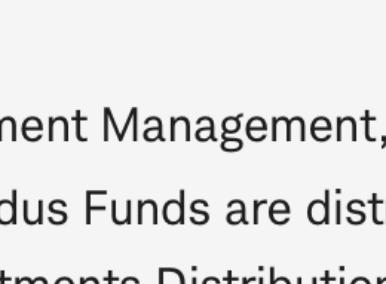
#### Who has home bias?

Advisors say...\*

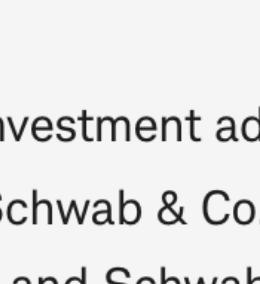


#### The big problem:

Limiting your options may mean missing out on opportunities.



U.S. stocks represent 54% of the global stock market\*\*



U.S. investors' average allocation to U.S. stocks is 70%\*\*\*

#### How advisors can help:

Steer investors away from over-emphasizing what's familiar, so they don't miss opportunities to enhance return or reduce risk.

\* Cerulli Associates, "BeFi Barometer 2020" Survey, July 2020.

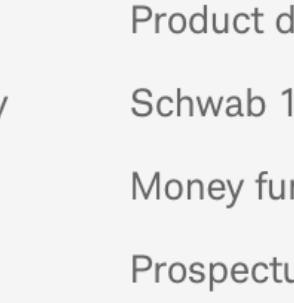
\*\* Charles Schwab Investment Management; MSCI AC World Index, as of 12/31/18.

\*\*\* Charles Schwab Investment Management; Asset Allocation for Moderate Risk Investors Databank, 2017. Cerulli Associates, in partnership with the Investment and Wealth Institute and the Financial Planning Association, 2018.

Older generations grew up during times when investing overseas often entailed a lack of transparency that brought greater risk. Times have changed, and the experience of investing internationally has become much more transparent and regulated. A little education about this evolution might help quell client fears.

Finally, some clients may benefit from a tighter media diet. The barrage of negative headlines from around the world can create a desire to keep investments close to home. But international markets—like domestic markets—are frequently weathering a seemingly constant flow of bad news. Reducing media consumption may help clients open up to the idea of investing beyond their traditional comfort zones.

Remaining in conversation with clients about the home bias can strengthen the fundamental elements of the financial planning process. Not only does this potentially help clients achieve better outcomes, it may help advisors forge more durable client relationships.



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Senior Vice President,

Chief Investment Officer, Passive Equity and Multi-Asset Strategies

Charles Schwab Investment Management, Inc.

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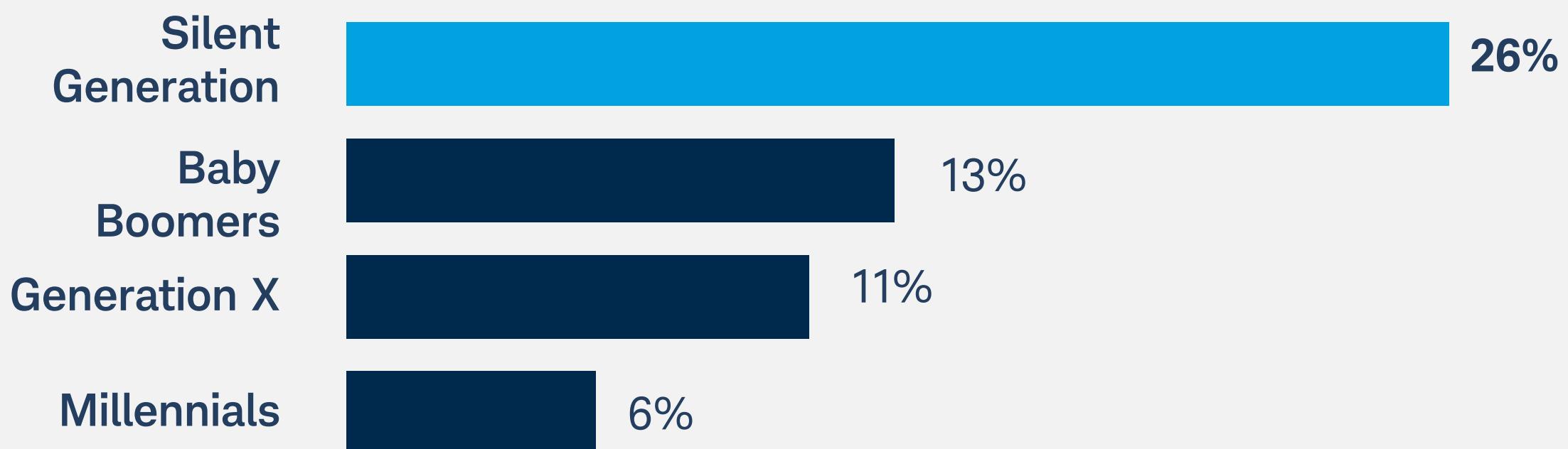


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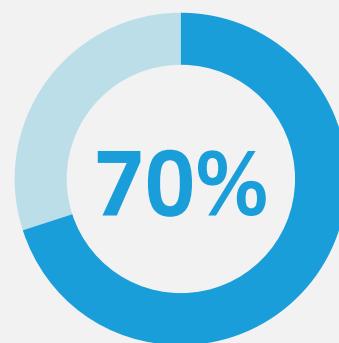


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