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AUSTRALIA OR THE WORLD? FINDING THE RIGHT PORTFOLIO BALANCE

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EXECUTIVE SUMMARY

The second brief in this series asked how much equity a diversified portfolio should hold. It found that balanced allocations – particularly those with 30% to 50% in equities – offered the strongest overall compromise between return, downside risk, inflation protection and target-return success. This brief asks the next question: where should that equity exposure sit?

We keep the equity-fixed income mix unchanged and vary only the geography of the equity sleeve. “Current home bias” allocates equities 50% to Australia and 50% to global markets. “Reduced home bias” cuts Australia to 25%. “No home bias” removes the dedicated Australian equity sleeve and invests the equity allocation in the global benchmark. The fixed-income sleeve remains 50% Australian and 50% global aggregate bonds, with the global bond exposure hedged to Australian dollars.

The central finding: Under the current capital market assumptions, home bias wins the model because Australian equities are forecast to return 8.72% a year, compared with 6.30% for global equities. That 2.42 percentage-point gap is large enough to outweigh the modest risk relief from moving more capital offshore.

- Current home bias produces the highest expected return, Sharpe ratio, inflation-beating probability and target-return success at almost every mixed allocation.
- Reduced home bias represents a modest risk–return trade-off. For example, at 40E/60FI, the greatest simulated drawdown falls from 32.08% to 30.53%, while expected annual return declines by 24 basis points and the probability of trailing cash rises from 18.27% to 21.22%.
- A global-only equity sleeve scores poorly under these assumptions, particularly in equity-heavy portfolios. At 100% equity, its probability of a negative 10-year outcome is 5.15%, against 2.29% for the current home bias; its probability of achieving CPI+4% is 32.80%, against 46.30%.
- The equity-bond split remains the first-order decision. The modelled probability of a drawdown above 50% falls to zero for all three home-bias settings once fixed income reaches 40%. Home bias changes outcomes; fixed income changes their shape.
- The workbook scorecard ranks Current 40E/60FI first, followed closely by Current 50E/50FI, Current 60E/40FI and Current 30E/70FI. The narrow spread is better read as a balanced plateau than as a precise optimum.

The conclusion is therefore firm but conditional. The Current home bias setting is the strongest all-round allocation if investors accept the MCFS return premium for Australian equities. Reduced home bias is sensible for investors whose property, employment income or business wealth already leaves them heavily exposed to Australia. A global-only approach can also be rational – but its case rests on diversification, sector breadth and whole-of-wealth considerations that are not fully captured by this scorecard.

In one line: Choose the objective first, the equity weight second and the home-bias tilt third. Home bias wins this analysis – not the argument for all time.

1. FROM ASSET ALLOCATION TO HOME BIAS

Asset allocation and home bias are often discussed as if they were separate debates. In practice, they interact. A 50% Australian share inside a small equity sleeve is a modest portfolio tilt; the same share inside an all-equity portfolio is a major macroeconomic bet. The effect of home bias therefore scales with the amount of equity the investor owns.

This brief builds directly on the portfolio framework used in MCFS Research Brief (May 2026). We retain 11 strategic mixes, running from 100% equity to 100% fixed income in 10-percentage-point steps. We then test three equity-geography settings.

Table 1: Home-bias scenarios used in the analysis

Setting	Equity Sleeve	Equity at 40E/60FI	Fixed income at 40E/60FI
Current home bias	50% Australia / 50% global	20% Australia / 20% global	30% Australia / 30% global
Reduced home bias	25% Australia / 75% global	10% Australia / 30% global	30% Australia / 30% global
No home bias	0% Australia / 100% global	0% Australia / 40% global	30% Australia / 30% global

Note: "No home bias" refers to no dedicated Australian equity sleeve. Australia may still be represented at its market weight inside the global all-country index. The fixed-income mix is unchanged across scenarios.

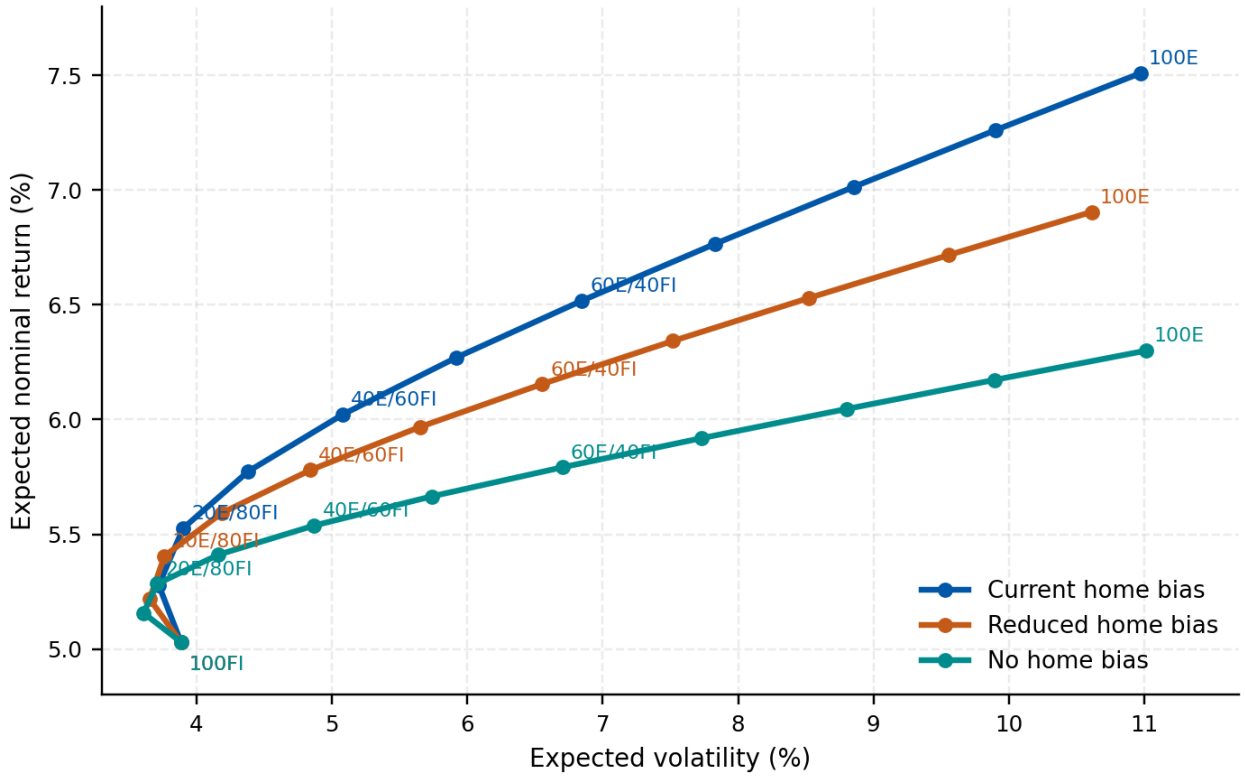
The experiment does not compare a fully domestic portfolio with a fully global one. It isolates the equity home-bias decision while leaving the bond portfolio untouched. At 40E/60FI, for example, the no-home-bias portfolio still holds 30% in Australian bonds. The labels describe the equity sleeve, not the investor's total country exposure.

2. THE MODEL FAVOURS AUSTRALIA – FOR A REASON

The result begins with the capital market assumptions. Australian equities are expected to return 8.72%, compared with 6.30% for global equities. Australian equities are also more volatile, with expected volatility of 13.61% against 11.01%. – but the two markets are not perfectly correlated. The assumed correlation is 0.584.

That combination creates an unusual but important result. A 50/50 Australian–global equity mix delivers 7.51% return with 10.97% volatility: a higher return and fractionally lower volatility than the global-only sleeve. The Reduced home bias has the lowest volatility (10.61%), but gives up 61 basis points of return relative to the Current home bias mix.

Figure 1: Expected return and volatility by home-bias setting

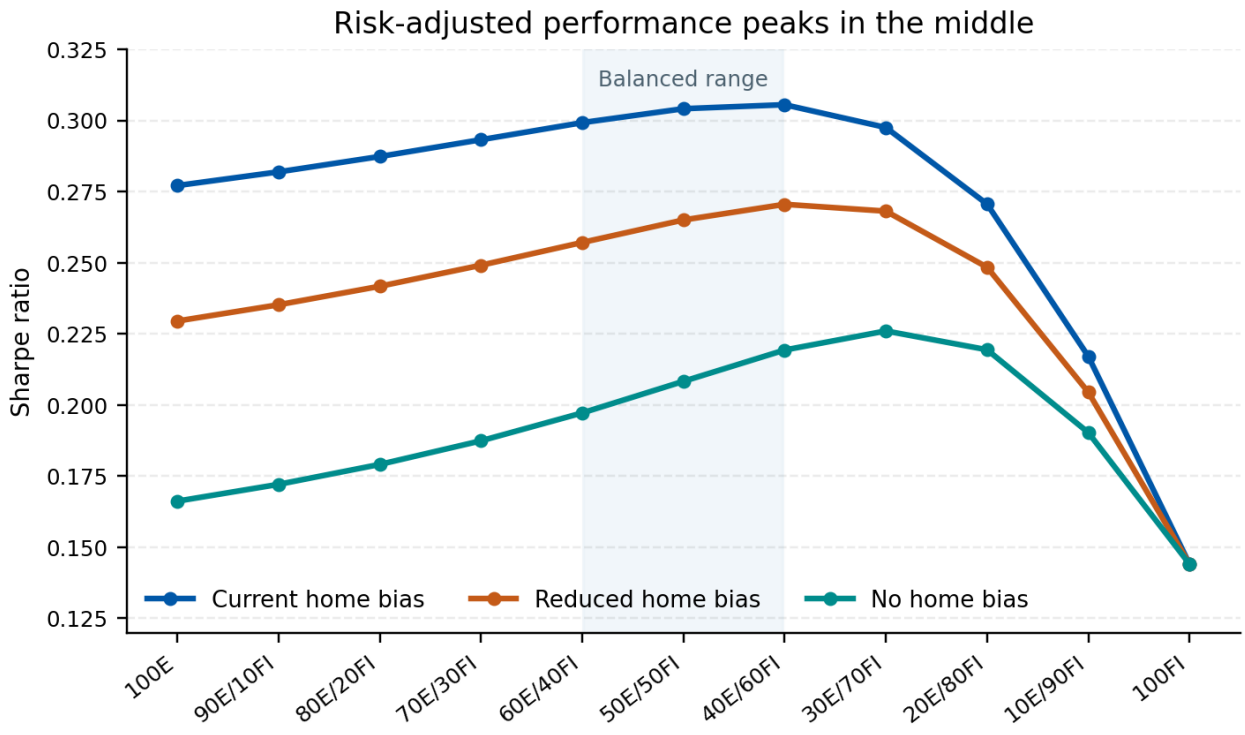


Source: MCFS capital market assumptions as at 31 March 2026; authors' calculations.

The return cost of reducing home bias is mechanical and scales with the equity weight. Relative to the global-only setting, the Current home bias portfolio adds 121 basis points of expected annual return at 100% equity, 73 basis points at 60E/40FI, 48 basis points at 40E/60FI and 24 basis points at 20E/80FI. At 100% fixed income, the three portfolios are identical.

Risk-adjusted returns tell the same story. The current setting produces the highest Sharpe ratio across every portfolio that contains equities. Its peak is 0.305 at 40E/60FI, narrowly ahead of 50E/50FI. Reduced home bias also reaches its highest Sharpe ratio at 40E/60FI (0.271). Without home bias, the best risk-adjusted performance shifts to the more defensive 30E/70FI portfolio, with a Sharpe ratio of 0.226.

Figure 2: Risk-adjusted performance peaks in the middle



Source: MCFS capital market assumptions as at 31 March 2026; authors' calculations.

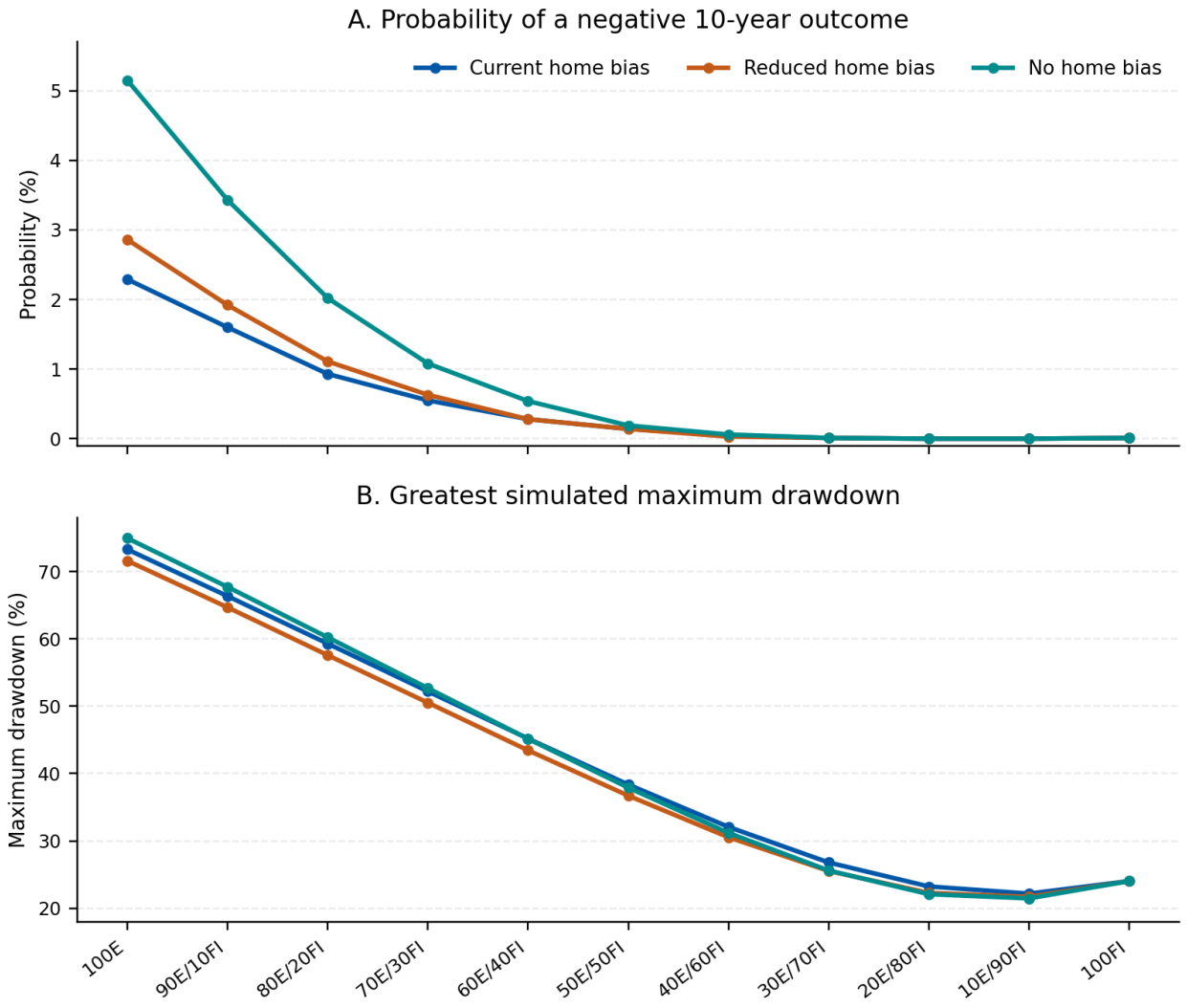
Practitioner reading: The Current home bias setting is not winning because "local is safer". It is winning because the assumed Australian return premium is large and the correlation with global equities is low enough to preserve diversification. Change that return premium and the ranking can change quickly.

3. BONDS DO MORE WORK THAN BORDERS

Home bias matters most when equities dominate the portfolio. At 100% equity, the global-only sleeve has a 5.15% probability of finishing the ten years below its starting value, compared with 2.86% for Reduced home bias and 2.29% for the current mix. Yet the gap collapses as bonds are added. By 30E/70FI, all three settings have a modelled negative-return probability of just 0.01%. At 20E/80FI and 10E/90FI, it is effectively zero.

Maximum drawdown makes the hierarchy even clearer. Across all three settings, the greatest simulated drawdown falls from roughly 72–75% at 100% equity to about 21–22% at 10E/90FI. The probability of a drawdown above 50% reaches zero once the portfolio holds 40% fixed income. Geography changes the margins; the bond allocation does the heavy lifting.

Figure 3: Downside outcomes across home-bias settings



Source: MCFS capital market assumptions as at 31 March 2026; authors' calculations.

Reduced home bias provides a consistent drawdown benefit through most of the growth and balanced ranges. At 40E/60FI, the greatest simulated drawdown is 30.53%, compared with 32.08% under the Current home bias setting. The global-only portfolio sits between them at 31.18%. In the most bond-heavy portfolios, the global-only setting becomes marginally better, but the differences are small.

There is also a useful warning at the defensive extreme. The greatest drawdown rises from around 21–22% at 10E/90FI to 24.02% at 100% fixed income. A small equity allocation can improve diversification even for investors focused on capital preservation. "More defensive" is not always the same as "less risky".

Table 2: The trade-off at 40E/60FI

Setting	Return	Vol.	Sharpe	Negative Ret	MDD	Beat CPI	Trail cash	CPI+1%
Current home bias	6.02%	5.08%	0.305	0.05%	32.08%	94.43%	18.27%	83.95%
Reduced home bias	5.78%	4.84%	0.271	0.03%	30.53%	93.70%	21.22%	81.25%
No home bias	5.54%	4.87%	0.219	0.06%	31.18%	91.50%	26.32%	76.35%

Note: "MDD" is the greatest maximum drawdown observed across simulations. Probabilities are measured over the ten-year horizon.

For a practitioner, this is where the choice becomes clearest. Moving from Current to Reduced home bias at 40E/60FI buys 1.54 percentage points of drawdown relief and 0.24 percentage points less volatility. The price is 24 basis points of expected annual return, a lower Sharpe ratio and weaker cash-relative and target-return outcomes. That may be a good trade for some investors. It is not a free lunch.

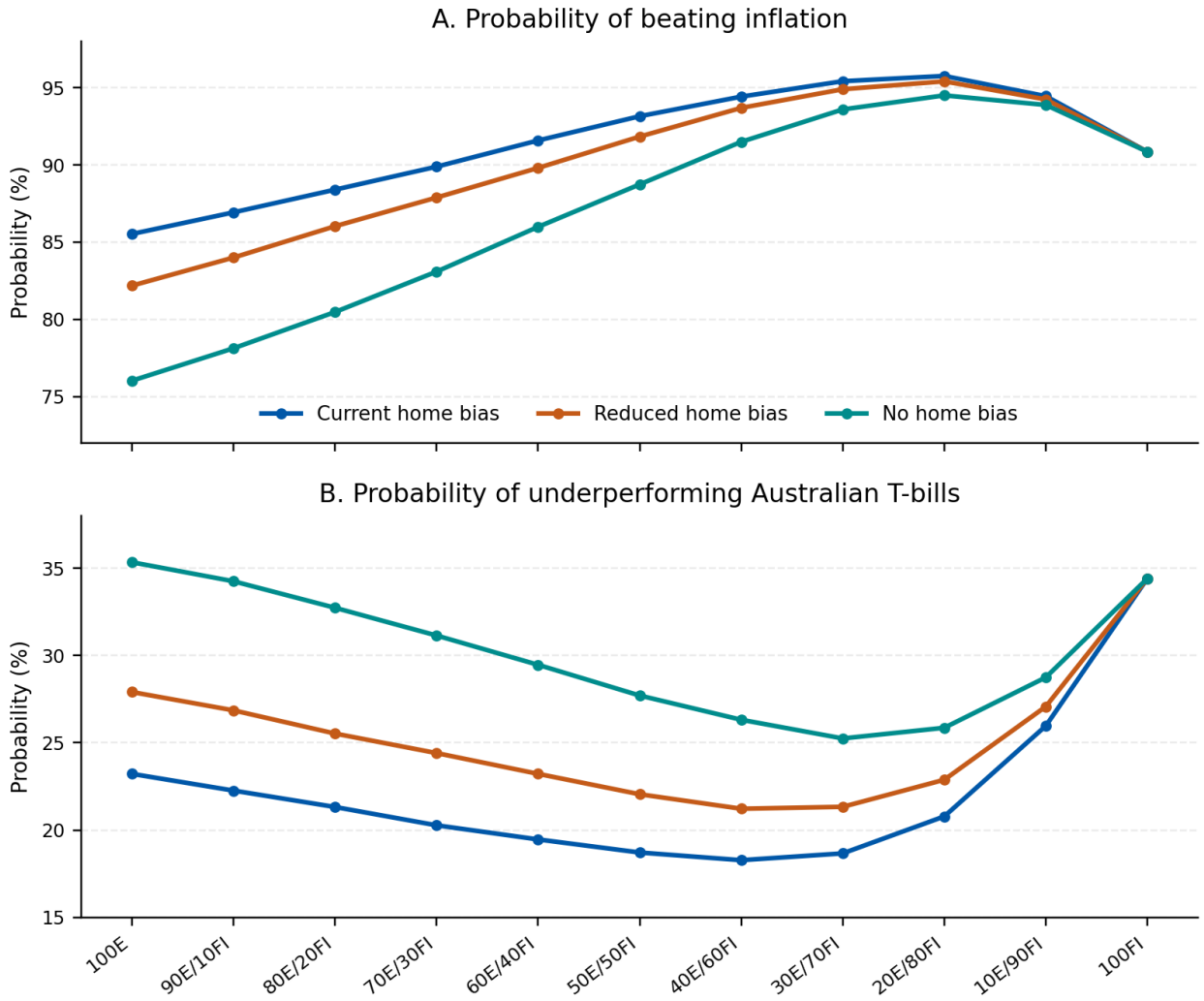
4. INFLATION AND CASH EXPOSE THE COST OF GOING GLOBAL

The Current home bias setting has the highest probability of beating inflation at every portfolio that contains equities. The strongest result is not at the equity extreme, but at 20E/80FI: 95.77% for Current home bias, 95.42% for Reduced home bias and 94.51% for No home bias. At 100% fixed income, the probability falls to 90.86% for all three.

That pattern reflects two forces. Bonds stabilise the path of returns, while a modest equity allocation raises the expected return enough to protect purchasing power. Remove equities entirely and the portfolio loses part of that buffer.

The same middle-ground logic appears against cash. The expected Australian T-bill return is 4.47%. Current and Reduced home bias reach their lowest probability of underperforming cash at 40E/60FI – 18.27% and 21.22%, respectively. The global-only setting bottoms at 30E/70FI, at 25.25%. The risk rises again in very defensive portfolios and reaches 34.42% at 100% fixed income.

Figure 4: Inflation protection and cash-relative outcomes



Source: MCFS capital market assumptions as at 31 March 2026; authors' calculations.

The practical point: Holding some equities alongside bonds provides a better chance of beating both inflation and cash than either extreme.

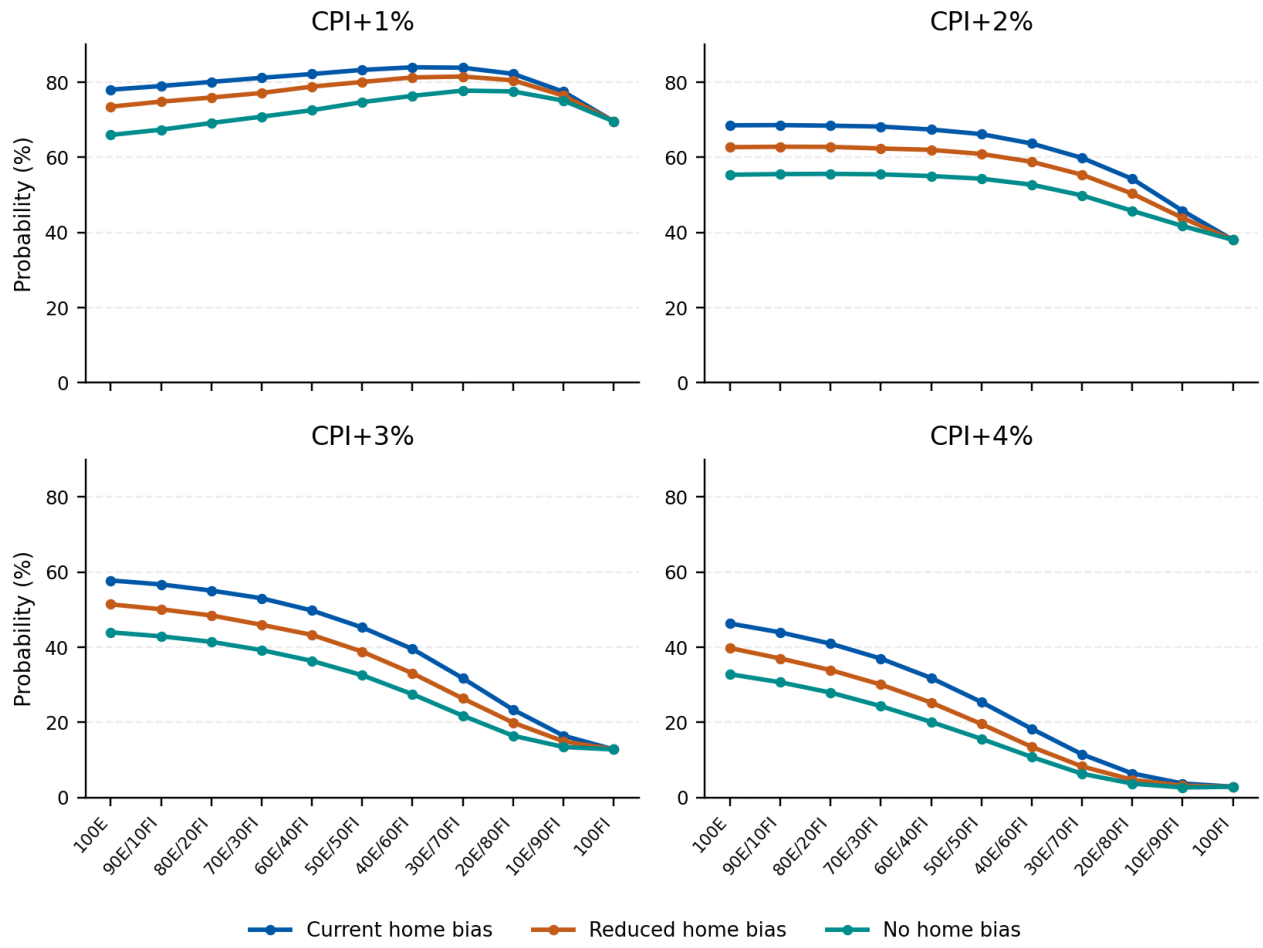
5. TARGETS CHANGE THE ANSWER

A portfolio is not designed in the abstract. It is designed to meet a spending need, a liability or a required return. The home-bias decision should therefore be judged against the target.

For a modest objective of CPI+1%, portfolios with roughly 30–50% in equities perform best. Current 40E/60FI has an 83.95% probability of success. Reduced home bias peaks at 30E/70FI, at 81.49%, while No home bias also peaks at 30E/70FI, at 77.74%. The stabilising effect of bonds matters more than maximum growth.

At CPI+2%, the optimal equity weight moves sharply higher, towards 80–100%. For CPI+3% and CPI+4%, the expected-return advantage of Australian equities dominates, making 100% equity the highest-success portfolio. The probability of achieving CPI+4% is 46.30% under Current home bias, 39.76% under Reduced home bias, and 32.80% with No home bias.

Figure 5: Probability of meeting real-return targets



Source: MCFS capital market assumptions as at 31 March 2026; authors' calculations.

The lesson is not that every investor with a high target should hold 100% equities. Higher success probabilities come with greater volatility and deeper drawdowns. Rather, portfolio design should begin with the investment objective. A low target rewards balance. A high target demands growth. Home bias then changes the odds within the chosen risk budget.

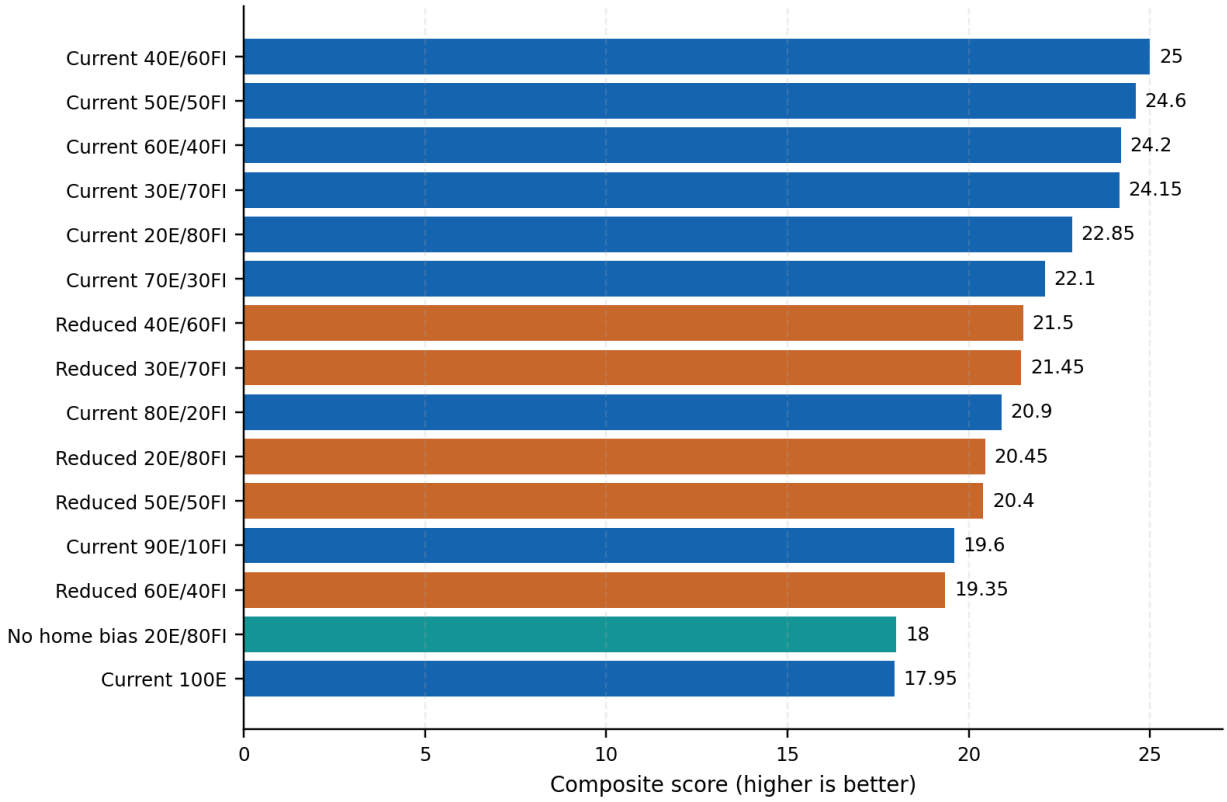
Decision sequence: Set the real-return target first. Choose the strategic equity weight second. Decide how much Australian equity risk to retain third. Reversing that order invites a portfolio built around familiarity rather than purpose.

6. A SCORECARD, NOT A MANDATE

The workbook combines ten measures into a single ranking: Sharpe ratio; negative-return probability; greatest maximum drawdown; probability of a drawdown above 50%; inflation protection; cash outperformance; and success against four real-return targets. Each measure is ranked across all 33 portfolio combinations, and the ranks are averaged. The displayed composite score is 34 minus that average rank, so higher is better.

This exercise is useful because it forces the trade-offs into one view. It is also deliberately blunt. Equal weighting does not mean equal importance to every investor, and the four target-return tests collectively receive more weight than any single downside measure. The scorecard should be read as a diagnostic, not as an optimiser.

Figure 6: Top 15 portfolio combinations in the workbook scorecard



Source: Authors' scorecard using the measures reported in the workbook. Composite score = 34 minus average rank across ten measures.

Current home bias dominates the rankings. The top six portfolios all retain a 50/50 Australian–global equity split and span equity allocations from 20% to 70%. The highest-ranked portfolio is Current 40E/60FI, with a score of 25.00, followed by Current 50E/50FI (24.60), Current 60E/40FI (24.20) and Current 30E/70FI (24.15). The best reduced-home-bias portfolio, 40E/60FI, ranks seventh, while the best global-only portfolio, 20E/80FI, does not appear until fourteenth.

The narrow spread among the leading current-home-bias portfolios is more important than the precise ordering. The model is signalling a broad balanced zone, not a single magic number. A 40E/60FI allocation may top the table, but 50E/50FI, 60E/40FI and 30E/70FI all sit close enough that liquidity needs, governance constraints and investor behaviour can reasonably decide among them.

Table 3: Best-scoring portfolio within each setting

Setting	Portfolio	Overall rank	Score	Interpretation
Current home bias	40E/60FI	1	25.00	Highest all-round score; strongest cash-relative outcome
Reduced home bias	40E/60FI	7	21.50	Lower volatility and drawdown; gives up return
No home bias	20E/80FI	14	18.00	Best global-only score is defensive; equity return drag is contained
All fixed income	100FI	29	10.75	Identical across scenarios; weak on cash and high targets

Source: MCFS capital market assumptions as at 31 March 2026; authors' calculations.

7. PORTFOLIO CONSTRUCTION: WHAT PRACTITIONERS SHOULD DO WITH THE RESULT

Choose the growth budget before the geography

The equity–bond decision governs the portfolio's capacity to meet ambitious targets and its exposure to severe drawdowns. Home bias is a second-order lever. An investor who cannot tolerate a 30% drawdown should not try to solve the problem by moving from Australian to global equities; the bond allocation must do that work. Conversely, an investor targeting CPI+4% cannot compensate for too little equity by fine-tuning country weights.

Treat 25/75 as a risk-management compromise

Reduced home bias often delivers the lowest volatility and the smallest drawdown through the growth and balanced range. Its cost is visible but not prohibitive in balanced portfolios. At 40E/60FI, the expected-return sacrifice is 24 basis points a year; at 20E/80FI, it is just 12 basis points. Investors with substantial Australian property, employment income, private-business exposure or sector concentration may judge that cost worthwhile.

Do not confuse a global benchmark with a neutral personal balance sheet

A global-only equity sleeve is neutral relative to a global market benchmark, not necessarily relative to the investor's life. An Australian household may already be long the domestic economy through housing and wages, which argues for more offshore assets. Another investor may have Australian-dollar liabilities, value local dividend income or face tax circumstances that favour domestic equities. The appropriate home bias belongs to the whole balance sheet, not to the listed portfolio in isolation.

Separate return conviction from diversification

The model's preference for Current home bias is driven mainly by a 2.42 percentage-point expected-return premium for Australian equities. That is a forecast, and a large one. Investment committees should test how the recommendation changes if the premium narrows, disappears, or reverses. A robust policy should survive more than one capital market assumption set.

Write implementation rules before the market tests them

Once the strategic mix is chosen, governance matters. Set rebalancing bands for the Australian and global equity sleeves; decide whether global equity currency exposure is intentional; account for tax, franking credits, fees and transition costs; and specify the evidence that would justify changing the strategic home-bias range. Without those rules, a long-term allocation can turn into a short-term response on whichever market has just outperformed.

Table 4: A practical interpretation of the three settings

Setting	Most defensible when…	What it buys	What it gives up
Current home bias	Investors who accept the Australian return premium and want the strongest modelled target success	Highest expected return and Sharpe ratio; best overall scorecard	Domestic market and whole-of-wealth concentration
Reduced home bias	Investors with existing Australian exposure or a stronger aversion to drawdown	Modest volatility and drawdown relief	Lower cash, inflation and high-target success

No home bias	Investors who reject the Australian return premium or prioritise benchmark neutrality and sector breadth	Maximum offshore diversification in the equity sleeve	Weakest modelled return-dependent outcomes under current assumptions

Note: The analysis is pre-tax and does not explicitly model franking credits, fees, transaction costs or investors' non-portfolio exposures.

CONCLUSION

The home-bias debate is often framed as a choice between familiarity and diversification. The portfolio evidence is more prosaic. Under the current MCFS assumptions, Australian equities offer a return premium large enough to improve most outcomes even after accounting for their higher standalone volatility. The current 50/50 equity split therefore leads the scorecard, with 40E/60FI the strongest all-round combination.

But the result should not be mistaken for a permanent endorsement of a large Australian weight. Reduced home bias buys genuine, if modest, drawdown relief and may be the better policy for investors whose wealth is already tied to the domestic economy. A global-only equity sleeve is also defensible when the aim is benchmark neutrality, sector diversification or less reliance on a contested Australian return premium.

The most durable finding is about the order of decisions. Fixed income determines how much pain the portfolio can absorb. Equity determines whether it can meet the target. Home bias determines where that growth risk is taken. For practitioners, the hierarchy is clear: objective first, equity weight second, home bias third.

Bottom line: Current home bias is the model's winner; Reduced home bias is the practical compromise; No home bias is a strategic diversification choice. The right answer depends less on nationality than on the investor's objective, balance sheet, and confidence in the return assumptions.

APPENDIX A: MCFS CAPITAL MARKET ASSUMPTIONS

A.1 Expected risk and returns by asset class (as of 31 March 2026)

All geometric returns are in AUD. Equity market returns are unhedged, while Fixed Income returns are hedged in AUD. The methodology integrates valuation, growth, inflation, and currency forecasts (see MCFS working papers for details).

Asset class	Nominal		Real	
	Return (%)	Volatility (%)	Return (%)	Volatility (%)
Australia Equity	8.72	13.61	5.38	13.65
Global Equity	6.30	11.01	2.96	11.07
AU Composite	5.38	3.40	2.04	3.55
Global Aggregate	4.68	5.70	1.27	5.89
Australia T-Bills	4.47	0.37	1.13	0.68
Australia Inflation	3.34			

A.2 Correlation matrix

Criterion	Australia Equity	Global Equity	AU Composite	Global Aggregate
Australia Equity	1	0.584	-0.052	0.211
Global Equity	0.584	1	0.057	-0.108
AU Composite	-0.052	0.057	1	0.422
Global Aggregate	0.211	-0.108	0.422	1

APPENDIX B. METHODOLOGY AND LIMITATIONS

The analysis uses the same 11 strategic equity–fixed income mixes as the MCFS Research Brief (May 2026). Each portfolio is assessed over a ten-year horizon using 10,000 Monte Carlo paths. Fat-tailed returns are modelled with a t-distribution with seven degrees of freedom. The fixed-income sleeve is split evenly between Australian composite bonds and global aggregate bonds; global fixed income is hedged to Australian dollars.

The portfolios are evaluated on expected return, volatility, Sharpe ratio, probability of a negative ten-year outcome, greatest maximum drawdown, probability of a drawdown above 50%, probability of beating inflation, probability of underperforming Australian T-bills, and probability of achieving CPI+1%, CPI+2%, CPI+3% and CPI+4%.

The results are forecasts, not guarantees. They depend on the capital market assumptions, correlations and simulation design. The analysis does not explicitly model fees, tax, franking credits, turnover, transition costs, liquidity constraints, investor cash flows or non-portfolio exposures such as residential property, employment income and private businesses. Correlations may also change during stress. The ranking scorecard assigns equal rank weight to each reported measure and is not a substitute for an investor-specific utility function or liability model.

REFERENCE

Le, T.H. and Ruthbah, U. (2026). “Can Diversified Portfolios Deliver? Evidence from MCFS Capital Market Assumptions.” Monash Centre for Financial Studies Research Brief, May 2026.

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