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I've spoken regularly over the years about the importance of portfolio diversification - and 2012 looks to be shaping up to be another year where an appropriately balanced portfolio out-performs a "Canada only" mix.

This wasn't always the case. In fact, looking back over the past decade, a Canadian-focused stock portfolio generally beat the pants off an investment mix containing a healthy dose of U.S. and International equities. That's largely because 2000 – 2010 saw the "rise of the commodity" as economic growth in emerging economies (especially China) fueled a boom in all the good things that our country is famous for producing.

It's a bit of a shock to realize how much of our economy (and stock market) is concentrated in a few particular sectors. 77% (!) of Canada's equity markets are represented by Financials (i.e. banks & insurance companies), Energy and Materials (i.e. things cut down or dug out of the ground). Health care, technology, telecommunications, consumer staples, utilities – these business sectors have amazingly small representations in Canada's economy and equity markets.

Compare this to the U.S. equity market where financials, energy and materials stocks make up less than 30% of the market. The largest sector is technology at about 20% (Google, Apple, IBM etc.). Health care is #3 at about 12%, just behind financials.

Investors who focus primarily on the Canadian market are missing out on some particularly important sectors in the world economy – even when they are buying a "diversified" product such as a broadly-based Canadian mutual fund or Exchange Traded Fund. This not only leads to reduced opportunities and potentially lower investment performance (i.e. health care and technology stocks have done well over the past year) but increased risk – i.e portfolio volatility.

And it's the volatility of investment returns (not just absolute returns) that I believe more investors should focus on. The Canadian stock market, because it is so heavily concentrated in just a few sectors, is more volatile than most. Proper diversification – and for Canadian investors that means investing in assets located outside of Canada, is one of the key ways to reducing portfolio risk.