BUSINESS WEEK / APRIL 6, 1998

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# GOING GLOBAL: IS IT TIME TO TAKE THE PLUNGE?

INVESTING

For many years, the conventional financial wisdom held that American investors should place 10% to 20% of their portfolios overseas. But over the past year, with the U.S. stock market skyrocketing and many foreign markets blowing up, the maxim doesn't sound very sage-like. Remember the Asian markets' meltdown of last fall or the Latin collapse a few years earlier? Why take the risk of sending your money abroad when there's so much to be made at home?

Despite last year's debacle in the Asian markets, now's not the time to toss aside the advice. That's because it should continue to apply over the long run. A compelling combination of long-term economic fundamentals and short-term market conditions suggests that now is an opportune moment to broaden your investment horizons. Many overseas markets appear poised for a strong upturn. "If you look at valuation levels and growth prospects, maybe people should put a bit more than 20% of their portfolio internationally," says Robert Furdak, director of international strategies at Numeric Investors, a Massachusetts-based money management firm.

For most individual investors, the easiest way to get access to foreign equities is through mutual funds. Professional money managers, many of whom have analysts working around the world, can offer an edge when it comes to dealing with unfamiliar markets and exotic economies. In fact, so far this year, foreign-stock mutual funds have gained 13.93% vs. 13.17% for the Standard & Poor's 500 index, according to Morningstar Inc. A good number of closed-end funds that invest abroad are selling at substantial discounts to their net asset values, making them attractive investments.

**COPYCATS.** The history of stock markets shows they are are cyclical, with fat years eventually followed by lean ones. By almost every measure, U.S. stock market valuations are higher than just about anywhere else in the world. Shifting some of your assets overseas is one way to temper any damage that a plunge in the Dow Jones industrials might do to your portfolio.

But there's an even better reason for going abroad. Many foreign companies are emulating the practices of U.S. corporations by restructuring and reengineering their businesses. "A lot of the things American companies have been doing to improve efficiencies and operations are only starting to take place in some foreign markets," says George Murnaghan, managing director of Rowe Price-Fleming International, the mutual-fund company. Adds Laurence Siegal, director of policy research in the investment division of the Ford Foundation: "The rest of the world isn't going to sit on its hands while the U.S. runs away with all the money."

Indeed, Europe's industrial behemoths are restructuring with a vengeance. Mergers and acquisitions are rampant on the Continent. Latin American companies are also slimming down to become more competitive. Even Asia, while still mired in an economic and financial mess, has much going for it—many world-class companies, a well-educated population, and a disciplined workforce. "My own view on Asia, rather than throwing up one's hands as investors often do, [is] this is precisely the time that international diversification makes sense," says Burton Malkiel, professor of finance at Princeton University and author of *Global Bargain Hunting* (Simon & Schuster; $25). Notes Campbell Harvey, professor of finance at Duke University, "The really bad returns in Asia provide investors with an opportunity."

Problem is, international diversification is a tarnished idea these days. Any U.S. equity investors who did the prudent thing and diversified overseas over the past decade got lower returns for the effort compared with an investor who kept everything at home. Skeptics argue the benefits of international diversification are shrinking. The bonds of trade and capital are stronger after the end of the cold war and the embrace of freer markets by much of the developing world.

There's no question that seemingly local events can reverberate throughout the world economy with greater force than before, such as the U.S. stock market crash of 1987 and the Asia bloodbath of 1997. But economies and markets are far from marching in lockstep for any length of time, says Princeton's Malkiel. For instance, from 1989 to 1997, the U.S. stock market had an average an-

nual return of 16.6% compared with a –7.3% return for the Japanese stock market, according to figures compiled by Ibbotson Associates.

The good news for international diversification is that other forces are offsetting the trend toward tighter correlations between markets. Political and cultural barriers between nations are still formidable. Large parts of many economies remain relatively insulated from international competition. Monetary and fiscal policies can diverge greatly. "Statistically, correlations between markets are only somewhat closer than they have been," says Murnaghan of Rowe Price-Fleming International.

Most important, overseas diversification has worked as a risk-reduction strategy. For example, between 1970 and 1997, the Standard & Poor's 500-stock index had an average annual return of 13%. But the volatility of the index, measured as its standard deviation, averaged 17.3% a year. Over the same period, a portfolio composed of 70% U. S. stocks, 10% international stocks, and 20% long-term U. S. government bonds returned 12.5%—only a fraction less than an all-U. S. equity portfolio—while boasting a far lower volatility level of 14.1%.

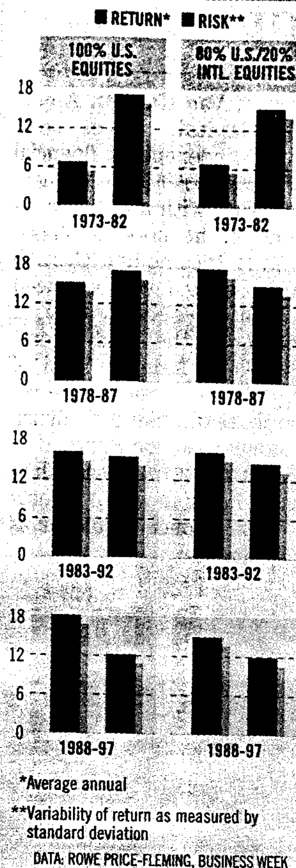
Yet diversification is not just a flight to safety. Fund manager Rowe Price-Fleming views the returns a slightly different way. It uses 10-year rolling averages to compare the return on a 100% U. S. stock portfolio with a portfolio that's 80% in U. S. stocks and 20% in international equities (chart). With the exception of the past several years, the diversified portfolio performed a tad better and with less risk.

## The Case for Investing Abroad

**THE KEY POINTS**

- The U.S. stock market has sizzled while the rest of the world has simmered. The risk/reward ratio currently favors plunking down some money overseas.
- Diversification pays. Unless there is a worldwide economic shock, stock markets don't move in lockstep over the long run.
- Investors can buy shares in some terrific companies at good prices, such as Japan's Konica, France's AXA-UAP, Brazil's Telebrás.
- The crash of the Asian markets presents some excellent buying opportunities.
- Some closed-end country funds are trading at big discounts to net asset value and are particularly attractive right now.

DATA: BUSINESS WEEK




Many economists say that people may be taking the wrong lesson from recent experiences with overseas investing. They note that while many investors took their money abroad, they failed to diversify it enough. In 1994, for example, a huge chunk of all U. S. overseas investment went to two countries, Mexico and China. Another common misstep is to diversify among countries within the same part of the world. The recent Asian debacle is strong evidence that regional effects are fairly strong. "Don't take 20% of your portfolio and bet" on a single region, says Duke University's Harvey.

**BEHEMOTHS.** Another popular strategy is to buy shares in Coca-Cola, Gillette, Procter & Gamble, and other U. S. multinational behemoths. Those giants, which operate in scores of countries, are certainly poised to benefit from global growth. But the share prices of the American multinationals are so influenced by the ups and downs of the U. S. stock market that they really don't provide all the advantages of international diversification. "If you really want diversification, you have to take a deep breath and take the plunge into markets all over the world," says Nariman Baravesh, chief international economist at S&P DRI.

To be sure, there are lots of risks associated with going overseas. Countries can devalue their currencies or clamp on capital controls. Accounting standards are weak and economic information poor. Political instability is a fact of life. Emerging markets are extremely volatile. Nevertheless, for long-term investors, the strategy that seems to make the most sense in a global economy is a global one.

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