Chapter ONE

Invest Internationally for Yourself

Investing in anything involves careful consideration of risk and reward. You need to weigh the potential profit against the risk that something will go other than expected and generate losses. Thousands of investors make investment decisions every day. They assess the information that is available, consider their own circumstances, evaluate any new information to gauge whether it changes their view or belief, and decide to buy, sell, or hold a particular investment. If, for example, Apple releases a new version of the iPod, investors have to consider the impact on the company's financial outlook, assess whether the current price of the shares is too high or too low relative to that outlook, and evaluate how a computer/consumer electronics stock fits into their portfolio. Once these factors have been considered, a decision to buy, sell, or hold Apple shares is made.

This book argues that the same consideration should be given to shares in international companies. A thoughtful view on the outlook for a particular industry, company, or country might lead you to decide to look for a way to invest in stock of a particular international company. This book is your guide to identifying, buying, and following investments in international companies. Surprisingly few individual investors choose to use the hundreds of international stocks listed on the various exchanges in the United States to diversify their portfolios and profit from the tremendous economic growth worldwide.

This book focuses on investors buying individual stocks in non-U.S. companies. As it explains later, hundreds of non-U.S. companies have stocks that trade in the United States and are as easy for individual investors to buy as stocks from IBM, Coca-Cola, and Disney. Some investors might choose to use mutual funds to invest in international markets, but as you will see, this practice is of dubious value and can be quite expensive.

The world is shrinking—you need to be invested in international markets. If you look around this very minute, no matter where you are, you will see the effect of global trade and development. The computer I am using to write this book was made by a Japanese company and manufactured in China. The screen was produced in Taiwan and the keyboard is from a Korean company. The coffee I am drinking is from Indonesia and the mug was made in Thailand. My shirt was made in Macau, pants in Brazil, and underwear in Hong Kong.

The wine I had with dinner last night was French; the chocolate in the dessert was Belgian. Not that I have anything against things made in the United States—the taxis and subway cars I ride in are American, my house was built by excellent American construction workers, the bank that I use is a U.S. bank, my business cards were printed in New Jersey, and the plane I took on my last trip was made by a U.S. company. Think about it yourself. Take a minute to look around you. Chances are that a good portion of the things in your home, your office, and your life in general are imported or somehow influenced by global trade and the world economy. Your portfolio should be as well.

Conventional wisdom is that 20 percent of your stock holdings should be international. Most U.S. investors have far less than this. In fact, this percentage is a bit outdated, and I contend that, at this point, a third of your holdings should be in non-U.S. companies. Having a third of your holdings in international stocks better reflects the role of international companies, trade, and worldwide development in our everyday lives. Look around again and think about your life—more than a third of the things in your life are imported. Your portfolio should reflect that reality of modern life.

Why do so many individual investors ignore the tremendous opportunities in international equities? There are a number of misconceptions about investing in international stocks.

Investing in international stocks is too risky. Fear of the unknown keeps many people from buying stocks in individual international companies. There is a somewhat justified concern that the risk in international companies is higher than in U.S. companies. However, if the risks are higher, the rewards and potential profits are higher still. When was the last time one of your U.S. stock holdings doubled in a matter of weeks? It has probably been a while. Don't forget: There are risks, but there are risks in investing in U.S. companies as well. Remember Enron and WorldCom? Nobody would ever tell you that you should not buy stocks from a beacon of American business like IBM, Coca-Cola, Disney, Time Warner, Blockbuster, Microsoft, or Sears. Yet in half of these examples a three-year investment would have lost you money. My point is that while there are risks in investing in international stocks, there are also risks in investing in domestic stocks.

I can't invest in international markets; my broker deals only in U.S. stocks. Hogwash. Stocks in hundreds of international companies trade on the New York Stock Exchange (NYSE), American Stock Exchange (AMEX), and NASDAQ. Companies from China, Brazil, Poland, South Africa, and India trade in the United States just as easily as Citibank and General Motors. Details in Chapter 2 will show you just how many great options there are for investing in international companies in the U.S. markets.

How can I possibly understand an international company? Stocks that are listed in the United States are required to disclose information about their financial performance and the status of their business. Just as Google and Home Depot must tell the public about their business performance through quarterly announcements, foreign companies have to provide the SEC with periodic updates on the financial and operational performance of their business. Furthermore, not every person who owns shares in Google, for example, fully understands the details of the company's search technology. What they do understand is that the company earned profits of $592 million on revenue of $2.25 billion in the quarter ended March 31, 2006. You can certainly find out enough information about an international company to make a smart investment decision.

It is too hard to assess the risk in investing in an international company. Given the availability of the same information on international companies listed in the United States as on U.S. companies listed here, this argument does not hold up. A bit of additional digging might be required to fully understand the political and economic situation in the countries in question that might impact the value of investments in these companies, but the Internet makes this much more manageable than it was a few years ago. Through Yahoo!Finance (www.yahoo.com), the Bank of New York ADR site (www.bnyadr.com), and Google searches, a wide variety of sources such as English-language news media, company profiles, industry information, and financial web sites can be found.

Political risk is too high. There is certainly an element of political risk in international investing that does not really exist in investing in the United States—the chance that something will change on the political front in a country where you are invested. That is why you should demand a better return in the international markets. Even within the various international markets, you should demand higher upside potential to make an investment in, say, Thailand versus Great Britain. Political risk is certainly there, but through diversification and adequate assessment of the risk-and-return balance, you should be able to properly account for it in your portfolio.

International companies cannot be trusted to provide reliable information. As you'll learn in Chapter 2, the information that an international company must provide to the public in order to be listed in the United States has to be checked by a reliable auditing firm and the company has to attest to the fact that it is accurate. This is not always foolproof, and there are certainly examples of companies providing unreliable information. Note, however, that this risk is not limited to international companies. Enron and WorldCom are good, albeit obvious, examples of the reality that U.S. companies don't necessarily always provide accurate information.

I would rather just use a mutual fund to invest in international markets. This strategy seems boring, but it can be appropriate for some people. Mutual funds offer the benefit of easy diversification and the fact that you can simply buy them and leave the management of the portfolio to someone else. Keep in mind, however, that over the longer term, something like 90 percent of actively managed funds do not do as well as the underlying index. Furthermore, buying a fund is like being a passenger in somebody else's car—the fund managers make all the decisions, get most of the glory, and have all the fun. Reading a quarterly report from your mutual fund tells you a bit about what is owned in the fund and how it has performed, but this is not nearly as interesting as following individual stocks that you hold in your portfolio yourself and making the decision of when to buy, sell, or hold them. Many people enjoy the challenge and have the time, energy, and inclination to buy individual stocks rather than mutual funds.

Remember that mutual fund companies charge fees for managing your money and tend to be somewhat conservative in their investment approach. The goal of a fund manager is for the fund to perform better than the market as a whole and to prevent big meltdowns in the portfolio. If the S&P 500 Index is up 5 percent in a year, the goal of a fund manager investing in those stocks is to have the value of the portfolio increase at least 7 percent in that same year. The extra 2 percent should cover the fees (the average expense ratio for an actively managed fund is about 1.5 percent) and indicates that investors did better by having that manager manage their money rather than just putting it in an index fund or some alternative that does not have many fees associated with it.

A 2 percent fee might sound low enough to be dismissed as inconsequential, but over a 10-year period, a 2 percent fee on an investment of $10,000 costs the investor nearly $6,000 in fees and forgone earnings. Some people prefer to leave individual stock picking to the professionals, but remember that they usually do not do any better than the underlying index—and it takes the fun out of investing, for those who enjoy it.

I'll just buy stock in large U.S. companies that do business overseas to get international exposure into my portfolio. Many individual investors believe that owning stock in companies like IBM, Disney, and Coca-Cola, which do business overseas, is an adequate way to get exposure to international markets. There are two things wrong with this notion. First, stock in those large multinational corporations tends to perform pretty much in line with the U.S. stock market. Second, though these companies might have some operations overseas, the bulk of their profits likely come from the United States.

Following international stocks is interesting and educational. Staying abreast of international news—especially international business news—is interesting and educational. There is plenty of international news available to anyone interested in reading it. You can't pick up a newspaper without getting some information about what is going on in the world. Reading the international news teaches us about other countries, industries, and people. Having information about the impact of growing wealth among the population of a country like India, China, Indonesia, or Brazil puts those people in some sort of context for us to contemplate and consider. How will the Internet develop in China? Do people in these countries have personal computers and telephone lines? Who is meeting the challenge of getting telephone service to rural parts of India and Pakistan? What is going on in Turkey as it joins the European Union? Chapter 4 discusses how to use the headlines to learn about trends, industries, countries, and investments that you might want to add to your portfolio. As the world shrinks and global developments impact our daily lives, investments can be a way to stay on top of these developments and help us learn more about the world around us—while profiting at the same time!