

CHAPTER 1

Opportunities Away from the Land of Opportunity

We have long been fans of investing one's money, in part, outside of the United States. There are many reasons into which we delve that help to further justify forays into foreign markets, but it has always struck us as being just plain common sense to at least consider other economies as places from which to make money. Complicating the issue of looking elsewhere has long been the 800-pound gorilla sitting squarely in the middle of the room: we are Americans who live in the United States. That simple fact has, in the last several decades, afforded us the best reason to simply disregard the consideration of other markets. The reality is that we have everything we need right here. The truth is that we still do. Certainly, recent events have made even the most U.S.-centered investor wonder what better opportunities might await him or her in the other corners of Planet Earth, but in the end, most people like keeping everything here, thank you very much. It is just simpler, cleaner, easier.

Historically, when it comes to our money, we just *feel* better when our money is here in the United States (or so we perceive it to be). After all, are there not thousands upon thousands of publicly traded U.S. companies from which to choose, to say nothing of the thousands of stock mutual funds, bond mutual funds, and real estate opportunities that exist here in the United States? Indeed. We do not have to learn a new language to invest here, we know (at least anecdotally) that the best technology . . . the best platforms are here, and the financial center of the United States is still, for the most part, the financial center of the world. As a people, we love to visit

other countries and exotic places, but most of us are very happy when we arrive home. It feels safe.

That intangible is largely what motivates us in everything we do—we do things because they *feel* right—even if they are wrong. We do it in interpersonal relationships, and we act accordingly in business and money relationships. To many Americans, investing our money outside of the United States just feels wrong. Historically, we have had discussions with multitudes of clients for whom foreign investment vehicles would have been an excellent fit, and yet many would exhibit a discomfort with the prospect on a level that we could not ignore. You can attack these objections with all of the left-brain logic you wish—but if it does not *feel* right—that is it.

Psychologically, many of us tend to see only the risks of such a move, rather than focus on the multitude of prospective rewards. At a root level, many people who eschew global investing do so because they feel physically more removed from their money.

It is largely the very historical success of the United States and its role, perhaps now more symbolic than real, as a world leader, that seems to have caused many to shrug off the wonderful opportunities available elsewhere. Principally, we believe that we have everything we need here, and we really do. It is historically rare that we find ourselves chasing the technology or opportunities found in other countries; instead, it has been the United States that has set the standards for trends and innovation for so long. In truth, that is changing, and has been changing for some time, but as we know, perception is reality, and the perception of so many is that the United States is still number one. We are as nationalistic as the next person when it comes to pride in one's country, but one must be careful not to permit that nationalism to blind oneself to the many glorious opportunities that exist elsewhere.

When you travel overseas, you see that the fascination with all things American remains very strong. Even many of the terrific products that are manufactured overseas, or made by companies that are otherwise based in foreign countries, and which are consumed by Americans, feel (there we go with *feeling* once again) very American.

It is our historical and cultural pride that remains perhaps our worst enemy from an investment perspective, but our relative geographical isolation plays a big part in all of that. Our role as a player on the world stage is ironic, considering how far removed we are from the rest of it. The “us versus them” mentality that permeates the thinking of so many Americans appears due, in no small way, to the fact that we have little occasion to consider other countries at all in our daily lives. Certainly we are bordered by Canada and Mexico, themselves geographically monstrous (Canada is

the world's second largest country by area, while Mexico, no slouch itself, is the 14th largest by area) but more negligible in terms of corporate influences: of the 100 largest corporations in the world (as of 2008), Canada and Mexico together have a total of one between them. Compare and contrast that with Belgium, France, Germany, Italy, Netherlands, Spain, and Switzerland, which are all countries continuously surface-connected by the same land mass with adjacent, accessible borders, and which among them have 36 of the world's 100 largest corporations—five more than the mighty United States. If you want to throw in Great Britain by virtue of its channel tunnel, then forget about it; Britain's contribution of 9 of the 100 world's largest corporations brings the aforementioned total to 45.

The point in citing this is that many folks overseas, particularly those who live in or around the highly developed European continent, have a knowledge of, and relevance to, one another that we in the United States have not been able to have with anyone else. Accordingly, their acceptance of considering transborder investing is not as markedly nativistic as our own.

In our opinion, we have been done a disservice by this segregation, at a number of levels. Culturally, Americans tend to miss out on some amazing things. We often “ooh” and “aah” at the grand sights brought to us courtesy of the Travel Channel, but leave our interest behind once the credits roll. For most of us, it is just all too inaccessible. You do not have to be a wealthy person to travel from, say, France, as a resident *of* France, directly to Germany and then back to France, because you can do it all by train in much less than a day. If you are an American living in the United States, you may not have to be wealthy, *per se*, to travel to France or Germany, but you will likely have to spend thousands of dollars in order to enjoy any sort of meaningful trip to Europe and its neighbors. The point is that the *relevance* of other countries and people to our own, when noting it in terms of real-world experience, is largely diminished in comparison to the relevance of other countries and populations to one another.

Compounding this problem is that some of the best opportunities to make money overseas, via direct investment on the appropriate platform(s), in countries that present some of the best opportunities, will require a concerted effort to become familiar with languages, cultures, flows of information, traditions, and so forth, that remain literally foreign to most of us. Granted, that is not really true in the case of what we call the middle ground instruments of foreign investing, like mutual funds and American Depositary Receipts (ADRs), but for those who want to go all the way and take advantage of the best, most organic opportunities

presented by the foreign marketplace, all of that is quite true. Staying stateside requires no such special effort or knowledge. U.S.-based companies are born, live, and breathe in a world we know and understand. Besides, there are lots of them. The number of stocks listed on the NYSE, NASDAQ, and AMEX totals about 6,000, and there are roughly 12,000 U.S. equity mutual funds at present. Our brokerages and trading platforms are highly evolved, and besides, the United States is, by history and reputation, the epicenter of the financial universe. Where else do you need to go?

Lots of places, actually. We are going to show you facts and figures a little later that illustrate how the United States is not the only game in town any longer, but you might also notice that the United States is still the biggest game in town. For example, (see Exhibits 1.1 and 1.2), of the world's 100 largest companies, those based in the United States comprise only about 30 percent of that list—but looked at another way, that 30 percent is far and away the largest representative, per country, of the listed companies; the next-largest percentage is attributed to Germany, at 13 percent. So it depends on how you choose to look at things: either you look at such a list and say, “70 percent of the world's largest companies are located outside of the United States,” or you say, “the United States, by itself, has 30 percent of the world's largest companies contained herein; why do I need to look anywhere else to invest?” Obviously, there is a lot more to investment decision making beyond such a basic criterion, but the fact is that such a perspective is shared by even some, more sophisticated investors.

The answer to the question just asked is another question: Do you want your investing to be easy, or do you want it to be profitable? This is a big part of deciding to officially and formidably step out of the relative comfort of the United States and move into more exciting, but more challenging, realms. The truth is that from the standpoint of investment return, the United States has long been a disappointment. We discuss that more specifically throughout this chapter, but the time has come, for those who have not already accepted what the authors believe is obvious, to devote a good portion of your investment efforts to foreign-based targets.

So what are the compelling reasons for going global with one's investments? There are several, and it is likely that you are well acquainted with something between “some” and “all” of them if you have made the decision to buy this book. That said, let us take a few minutes to examine what they are—closely, for the benefit of those who are reading because they heard it was generally a good idea to go global, as well as for the benefit of those who are not certain they want to go global at all—but are nonetheless intrigued.

Opportunities Away from the Land of Opportunity

EXHIBIT 1.1 Fortune Magazine's List of the 100 Largest Corporations in the World (as of 2008)

Rank	Company	Revenue (\$ millions)	Country
1	Wal-Mart Stores	378,799	USA
2	Exxon Mobil	372,824	USA
3	Royal Dutch Shell	355,782	Netherlands
4	BP	291,438	Britain
5	Toyota Motor	230,201	Japan
6	Chevron	210,783	USA
7	ING Group	201,516	Netherlands
8	Total	187,280	France
9	General Motors	182,347	USA
10	ConocoPhillips	178,558	USA
11	Daimler	177,167	Germany
12	General Electric	176,656	USA
13	Ford Motor	172,468	USA
14	Fortis	164,877	Belgium/Netherlands
15	AXA	162,762	France
16	Sinopec	159,260	China
17	Citigroup	159,229	USA
18	Volkswagen	149,054	Germany
19	Dexia Group	147,648	Belgium
20	HSBC Holdings	146,500	Britain
21	BNP Paribas	140,726	France
22	Allianz	140,618	Germany
23	Credit Agricole	138,155	France
24	State Grid	132,885	China
25	China National Petroleum	129,798	China
26	Deutsche Bank	122,644	Germany
27	ENI	120,565	Italy
28	Bank of America Corp.	119,190	USA
29	AT&T	118,928	USA
30	Berkshire Hathaway	118,245	USA
31	UBS	117,206	Switzerland
32	J.P. Morgan Chase & Co.	116,353	USA
33	Carrefour	115,585	France
34	Assicurazioni Generali	113,813	Italy
35	AIG	110,064	USA
36	Royal Bank of Scotland	108,392	Britain
37	Siemens	106,444	Germany
38	Samsung Electronics	106,006	South Korea
39	ArcelorMittal	105,216	Luxembourg
40	Honda Motor	105,102	Japan
41	Hewlett-Packard	104,286	USA
42	Pemex	103,960	Mexico

(Continued)

EXHIBIT 1.1 (Continued)

Rank	Company	Revenue (\$ millions)	Country
43	Societe Generale	103,443	France
44	McKesson	101,703	USA
45	HBOS	100,267	Britain
46	IBM	98,786	USA
47	Gazprom	98,642	Russia
48	Hitachi	98,306	Japan
49	Valero Energy	96,758	USA
50	Nissan Motor	94,782	Japan
51	Tesco	94,703	Britain
52	E. ON	94,356	Germany
53	Verizon Communications	93,775	USA
54	Nippon Telegraph & Telephone	93,527	Japan
55	Deutsche Post	90,472	Germany
56	Metro	90,267	Germany
57	Nestlé	89,630	Switzerland
58	Santander Central Hispano Group	89,295	Spain
59	Statoil Hydro	89,224	Norway
60	Cardinal Health	88,364	USA
61	Goldman Sachs Group	87,968	USA
62	Morgan Stanley	87,879	USA
63	Petrobras	87,735	Brazil
64	Deutsche Telekom	85,570	Germany
65	Home Depot	84,470	USA
66	Peugeot	82,965	France
67	LG	82,096	South Korea
68	Electricite de France	81,629	France
69	Aviva	81,317	Britain
70	Barclays	80,347	Britain
71	Fiat	80,112	Italy
72	Matsushita Electric Industrial	79,412	Japan
73	BASF	79,322	Germany
74	Credit Suisse	78,206	Switzerland
75	Sony	77,682	Japan
76	Telefonica	77,254	Spain
77	UniCredit Group	77,030	Italy
78	BMW	76,675	Germany
79	Procter & Gamble	76,476	USA
80	CVS Caremark	76,330	USA
81	UnitedHealth Group	75,431	USA
82	Hyundai Motor	74,900	South Korea
83	U.S. Postal Service	74,778	USA
84	France Telecom	72,488	France
85	Vodafone	71,202	Britain
86	SK Holdings	70,717	South Korea

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EXHIBIT 1.1 (Continued)

Rank	Company	Revenue (\$ millions)	Country
87	Kroger	70,235	USA
88	Nokia	69,886	Finland
89	ThyssenKrupp	68,799	Germany
90	Lukoil	67,205	Russia
91	Toshiba	67,145	Japan
92	Repsol YPF	67,006	Spain
93	Boeing	66,387	USA
94	Prudential	66,358	Britain
95	Petronas	66,218	Malaysia
96	AmerisourceBergen	66,074	USA
97	Suez	64,982	France
98	Munich Re Group	64,774	Germany
99	Costco Wholesale	64,400	USA
100	Merrill Lynch	64,217	USA

Source: Fortune magazine.

EXHIBIT 1.2 Countries Represented in the Top 100 List
 (In Order of Representation)

Country	# of Top 100 Companies
United States	31
Germany	13
France	10
Britain	9
Japan	8
Italy	4
South Korea	4
China	3
Spain	3
Switzerland	3
Netherlands	2
Russia	2
Belgium	1
Belgium/Netherlands	1
Brazil	1
Finland	1
Luxembourg	1
Malaysia	1
Mexico	1
Norway	1

Source: Based on data from Fortune magazine.

GOING GLOBAL WITH YOUR INVESTMENTS

Reason #1. It Is the Best Opportunity Remaining to Realize Substantial Portfolio Growth Over the Long Term

In order to grow, you have to have *room* to grow, and in the United States, there just is not the amount of room there used to be. This is something that does not really require a detailed analysis to prove. Even if you chose to rely on little more than your intuition, that should be good enough. Do you know anyone who does not own a car? Do you know anyone who does not have cable or satellite television? How about appliances? Who, in your circle of friends and acquaintances, does not own a washer, or a dryer, or a refrigerator? We certainly know anecdotally that those folks are out there in the landscape of the United States, but there are not many of them. When we *do* look at the data, we see that roughly 90 percent of households own a car, about 85 percent of Americans own a cell phone, and an astounding 99 percent of American households own at least one television set, while 66 percent of those households watch cable on those sets. Refrigerators? You find those in almost 100 percent of American households; same with cooking appliances, like a stove/oven—just about 100 percent.

Now, in China, just 5 percent of families own a car. In Russia, roughly 20 percent of adults own automobiles. In the Democratic Republic of the Congo, roughly 2 percent of the population has a cell phone. In all of Africa, there are currently more than 300 million people who do not have cell phone network coverage, and in Africa there are only 35 million fixed telephone lines on behalf of almost one billion people.

This is not a scientific evaluation but rather a short, random assessment of the state of difference between the United States and much of the rest of the world. The fact is that there remains a lot of Planet Earth that does not yet have what most of us take for granted. Now, there are many complicating factors that make access to goods and services more difficult in many parts of the world. In especially poor countries, like many of those on the African continent, the matter of owning or not owning a television set is not merely a simple matter of lack of access to a Sears; it is a matter of access to money. This means that in your analysis of good countries to consider with your investment dollars, there is going to be much more to it than simply finding those places that do not have very much, and throw a lot of money at them with the blind assumption that they have to take off at some point. You will want to perform the sound research that ultimately gives you an empirical basis for pursuing a foreign market and/or industry, and those results, combined with the application of

portfolio management strategies we discuss in a bit, will put you in an excellent position to reap the sorts of rewards for which hedge fund managers have become famous.

Before we continue, let us take a closer look at the principal types of markets you have to consider as a global investor. There are three fundamental terms that identify a given equity market in its growth from infant to adult: *frontier*, *emerging*, and *developed*. Let us take a moment to define and illustrate each.

Frontier This term was first used in 1995 at the International Finance Corporation, the arm of the World Bank that procures investments on behalf of the private sector in developing countries. The term is somewhat nonspecific in scope, but it generally refers to the smallest of markets, the ones with maybe \$1 billion (at most) in total market capitalization and just a handful of stock exchange listings. They generally offer the greatest risk *and* reward to investors, given their size. In terms of risk, frontier markets subject investors to exponentially greater levels of normally understood global investment risks. You can see a full list of the frontier markets indicated a little further on, but for now, think places like Bulgaria, Pakistan, and Vietnam.

From a pure return standpoint, frontier markets are the ideal targets of longer-term, growth-oriented investors. Because of their standing as relative infants on the world economic and investment stage, frontier markets have the greatest growth potential, in a general sense. Additionally, their emergence as players in the investment community typically provides a low degree of correlation to investors from developed nations seeking that feature. It is important to note that frontier markets, while sharing a broad similarity in areas like market capitalization, can actually display disparate features on a country-by-country basis. In other words, there can be several, different reasons as to why a frontier market is actually that. For example, a country may qualify as frontier because its level of development is clearly beneath that of the emerging market representatives. This is the kind of nation of which we think when we think of a frontier market. Botswana is a reasonable example of such a country. Botswana has a splendid record in certain aspects of its economic development; it demonstrated a strong record of economic growth over the last one-third of the twentieth century (roughly 9 percent per year), and is understood to have the highest credit rating in Africa. That said, Botswana has a frighteningly high HIV/AIDS infection rate, so much so that the life expectancy of the citizenry at birth has been essentially halved since 2006. Botswana's history of independence dates back only to 1966, and roughly 30 percent of the population lives below the poverty line (contrast that to other frontier nations like Estonia and Lithuania, which see only about 5 percent of their

populations living below the poverty line). The quality of education continues to be an issue in Botswana, as well.

A nation may also be considered a frontier market on the basis that while it actually has achieved a high level of development, it is sufficiently small enough to be disregarded as an emerging market. An example of a country like this would be Lithuania. Lithuania has been a presence in Europe since the eleventh century, and during the fourteenth century was the largest country in Europe. A series of occupations by Russia, the Soviet Union, and Nazi Germany (notably the Soviet Union) went a long way to crushing the identity of Lithuania, which is why Lithuania has had some difficulty bolstering its standing in the world economic community. Nevertheless, Lithuania has maintained a strong democratic tradition, and has impressive national characteristics like a strong record of GDP growth among other European Union member nations, low unemployment, a modern infrastructure, a flat tax, a high literacy rate, and enjoys the highest rating of all the Baltic states by *The Economist's* Quality of Life Index. Sound like a frontier market to you? Well, it is, on the basis of its relatively small size, but the profile of Lithuania is one that makes it attractive to investors seeking a frontier economy without many of the usual rough edges.

A third form of the frontier market nation is one that may be otherwise progressive and developed, but that has only recently loosened the investment restrictions that characterize unsophisticated investment markets. Prime examples of this type of frontier market are the component nations of the Gulf Cooperation Council: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

Emerging Markets Emerging markets represent the middle step in the growth of a market: no longer a child, but not yet a full-fledged adult. The idea is that they will ultimately become true *developed* markets (see below), but remain in process to that end. The immaturity of the internal financial structure of an emerging market is a distinct feature, as is its evolution toward sociopolitical stability; the rise of internal political strife may not be as great as that found in a frontier market (like Namibia, for example), but it is certainly greater than that found in nations like the United States and Great Britain. Emerging markets are regarded as ideal territory for many growth-seeking global investors, precisely because they present a palatable mix of risk and reward.

There are essentially four features that characterize an emerging market. First, the emerging market nation, while not always a significant player on the global economic stage, is always one of the biggest, if not *the* biggest, factor in the region in which it resides; it may not have the singular ability to affect world economic climate (the way the United States does, for example) in any direction, but it is a market on which the other companion

countries in its region are dependent; it is characterized by a vast and growing market, one supported by a large population and large amounts of resources. Second, emerging markets nations are among the world's fastest-growing economies. Third, they are markets that are characterized by progressive reforms in the area of sociopolitical and economic policy; citizens may enjoy more freedoms than they once did, businesses may enjoy less government intervention, and foreign investment enjoys greater accessibility. The overall motivation of such changes remains the hunt for greater economic viability and prosperity that history has shown is not afforded within statist regimes. Fourth, while not possessed of the ability to catalyze global economic activity on their own (individually), they *are* already players on the world political stage, and are also powerful associates in the global economy. It is principally the first and fourth characteristics cited that differentiate emerging markets from frontier markets, as many frontier markets are also characterized by transitional political and economic reform climates as well as high rates of economic growth.

Developed Markets Developed markets are those that we readily identify as the largest on the globe and that have attained a substantial level of industrialization. From a socioeconomic standpoint, they are characterized by high levels of income and *human development*. Human development refers to the overall achievement of health and education by a nation's citizenry. It is from a narrower investment perspective that markets are strictly measured in terms of their development, and there are several criteria used in such measurement. For example, in developed markets, there is a high degree of regulation administered by formal bodies organized to that end. In developed markets, foreign investment is not dissuaded, but encouraged, and this is measured by the number and nature of rules put in place to encourage such investment; the ability of capital to flow freely across borders is always one of the strongest indicators of a nation's economic progress. Additionally, developed markets are characterized by free (nonlimited intervention by government) and modern exchange structures.

There is more. Matters of custody, clearing, and settlement are highly scrutinized, as well. Trade failure rates have to be low, and custody services have to be plentiful and up to date. Settlement must be generally three days or less.

A working derivatives market has to be in place, brokerage services have to be plentiful in number, market capitalization has to be of a certain requisite size, and liquidity cannot be an issue. There is more, but you get the picture. The developed markets are those you think they are, countries like the United States, France, Germany, and Japan. Developed markets, as a whole, present to us the classic case of stability over opportunity:

we prefer to make investments in safe economies, but we also know that those that have reached the highest levels of development have also seen a marked flattening in their growth curves.

MSCI Barra (www.msicibarra.com) is an excellent resource for investors seeking to tap into investment research, statistics, and performance analytics on behalf of their global investment goals. We turn to them now to provide a list of the countries they currently characterize as meeting the requisite standards for being frontier, emerging, or developed markets (see Exhibit 1.3).

EXHIBIT 1.3 MSCI Barra List of Developed, Emerging, and Frontier Market Nations (as of April 2009)

Developed	Emerging	Frontier
Australia	Argentina	Bahrain
Austria	Brazil	Botswana
Belgium	Chile	Bulgaria
Canada	China	Croatia
Denmark	Colombia	Estonia
Finland	Czech Republic	Ghana
France	Egypt	Jamaica
Germany	Hungary	Jordan
Greece	India	Kazakhstan
Hong Kong	Indonesia	Kenya
Ireland	Malaysia	Kuwait
Italy	Mexico	Lebanon
Israel	Morocco	Lithuania
Japan	Peru	Mauritius
Netherlands	Philippines	Nigeria
New Zealand	Poland	Oman
Norway	Russia	Pakistan
Portugal	South Africa	Qatar
Singapore	South Korea	Romania
Spain	Taiwan	Trinidad and Tobago
Sweden	Thailand	Saudi Arabia
Switzerland	Turkey	Serbia
United Kingdom	—	Slovenia
United States	—	Sri Lanka
—	—	Tunisia
—	—	Ukraine
—	—	United Arab Emirates
—	—	Vietnam

Source: MSCI Barra.

Even a casual observer can sense that the central problem with looking at the United States as a growth market is that it is highly mature and highly industrialized. Although there may be terrific growth companies that continue to open and provide grand opportunities for investors, one must eventually conclude that, as a whole, the U.S. market is not itself a good growth play. A hundred years ago? Absolutely. Now? Not so much. Opportunities still exist, of course, in the United States and in other developed markets throughout the world, but those markets, as a whole, are not as enticing, and the opportunities they *do* present require more work to discern and identify than was once required.

This is significant. Although an annualized return of 6 to 8 percent per year is something the average investor has been taught to accept as good, it is really not. In 2007, the S&P 500 index registered a total return of 5.5 percent, while South Korea's KOSPI Composite rose 32 percent. The South Korean market was by no means the best performer of 2007, but that is sort of the point in citing it; the KOSPI is but one of many that flattened the renowned U.S. markets, and it is hardly a world leader (at least that year). What may surprise many is that U.S. markets have *never* "won" the annual contest of best performing—even during heyday years like those framed in the decade of the 1990s. It does not matter what year you pick—we can find you a market that outperformed the U.S. markets.

We would wager that the idea of low-to-middle level single-digit returns being respectable investment returns stems directly from the aged idea that all investing is to take place within the United States.

What you seek now, in order to deliver to yourself a reasonable chance of seeing the regular double-digit annualized returns that so many U.S. domestic investors enjoyed in the 1990s (without having to exert much extra effort, we might add), are those modern-day versions of America 100 years ago. Not the countries that are already saturated with "stuff," but those countries that have long been the world's stepchildren in terms of wealth and economic growth, and have only recently begun to make meaningful strides toward free market economies and a concerted effort at progress and stability at all levels.

Reason #2. BRIC and the Changing Tide of Global Market Capitalization

There is a theory developed by Goldman Sachs in 2001 that serves as one of the strongest pronouncements to date in support of investors looking elsewhere to make their money. Goldman took the position that the economies of Brazil, Russia, India, and China (BRIC) are developing so rapidly that their collective rates of growth, combined with the facts that the four countries combined currently represent more than 25 percent of the world's

land area and more than 40 percent of the world's population, will, by year 2050, see the combined economies of the four nations subordinate the current economies of the presently richest nations in the world. What is interesting is that while Goldman did not formally suggest that the countries of BRIC would attempt to officially create some sort of economic union, it is clear that the four *have* taken steps to at least arrange a casual alliance. To that end, it is worth noting that on June 16, 2009, Brazil president Luiz Inacio Lula da Silva, China president Hu Jintao, and India prime minister Manmohan Singh all met with Russia president Dmitry Medvedev for what was described as their first *official* summit in Yekaterinburg, Russia. Among the topics discussed was how the four nations can better work together, as well as how they can help facilitate the continued evolution of other developing nations—both topics that should at least catch the eye of the more astute investor.

The BRIC thesis has its critics. One of the principal criticisms is that BRIC is really just “C,” with the “BRI” acting as nothing more than a same-syllable prefix; in other words, that the power is really wielded by China, and that Brazil, Russia, and India are just along for the ride. The critics point out that China's economy is larger than those of the other three *combined*, and that its exports and Forex holdings (reserves) are more than double those of Brazil, Russia, and India combined.

There are also other concerns, including a belief that China's admittedly impressive growth rates are not sustainable over the course of the coming decades. Brazil has been looked to for some time as a country to demonstrate some real economic power, but has only recently started to realize that potential. Will it continue? India's relationship with Pakistan is not good, and given that regional economic powers continue to thrive on the basis of cultivating relationships with neighbors, could that become an impeding economic issue at some point? Russia continues to have a difficult time inspiring confidence within the private sector with the leadership's insistence on taking direct control of companies. Should that trend continue with little abatement, it is difficult to imagine much investor confidence inspired.

Overall, as with any emerging and frontier markets countries, there's no guarantee of smooth sailing. Each of these countries still has a long way to go in terms of conquering many of the organic problems that has made each remain less than developed for so long. For one thing, while their populations may be looked to as strengths on the one hand, much of those populations remain in poverty. Widespread poverty has to be managed, and can lead to various types of “bumps in the road” during the course of this management.

Our position is that you should consider less the literal significance of BRIC, and give more weight to its role as proof of where economic growth

and power is headed. For example, the use of the BRIC acronym has led to the use of similar acronyms like BRICK (the K representing South Korea), BRIMC (the M representing Mexico), and BRICA (the A representing Arab countries), and there are other variations. The point is that there is an energy that has permeated the investment thinking of those seeking more fruitful territory than that found in more developed markets, and it centers on the emerging markets.

The relevance of BRIC opens the door to a wider discussion of global economic growth as measured by *float-adjusted market capitalization* (only those outstanding shares available to the public, and not including shares held by large owners, or restricted stocks, insider holdings, etc.). It is relevant to note that although global market capitalization grew from 2001 to 2007 at an annualized rate of about 11 percent, and at an annualized rate of roughly 6 percent in the United States, it grew at a rate of about 30 percent in BRIC. Again, intuition tells us that emerging markets countries are going to be absorbing market share from the developed nations, and that indeed seems to be the case. Here are some telling statistics, courtesy of Russell Investments (www.russell.com), regarding the change in global market capitalization:

- Although overall global market capitalization *doubled* between 2001 and 2007, U.S. market cap (as a proportion of global market cap) declined during that period from 57 percent to 44 percent; the market cap of all other countries combined grew from 43 percent to 56 percent.
- Developed markets represented roughly 85 percent of the global initial public offerings in 2002, while emerging markets represented the remaining 15 percent; by 2007 that balance had shifted noticeably, with developed markets accounting for about 64 percent of the global IPOs and emerging markets increasing their share to 36 percent.
- Japan, long the “U.S.” of the Asian market, saw its share of Asia’s market capitalization represent 70 percent; by 2007, that representation had fallen to 50 percent.
- Analyzed by sector, the emerging markets collectively registered increases across the board: in utilities, the market cap of emerging markets rose from 5 percent in 2001 to 14 percent in 2007; in energy, the percentages over that same period went from 4 percent to 13 percent; technology, 5 percent to 12 percent; and the biggest increase was noted in materials and processing, rising from roughly 7 percent of global market cap to about 17 percent of global market cap.

There are many more telling statistics, but these should suffice. The reality is that while trends suggest that market capitalization among developed nations continues to increase, it is doing so at a much slower rate

than before; conversely, the market share of emerging markets countries continues to increase. As for the effects of the Great Recession, it seems clear that these deleterious effects may be more pronounced on many of the developed markets, as we see in just a bit.

Reason #3. At Any Given Time, Another Region of the World Is Outperforming the Others in Investment Return

The reality is that from the standpoint of pure investment return, there are just too many accessible foreign markets that allow an investor to find a haven of quality performance when all around it are performing less well. Up to recently, accessing world markets was the primary impediment to capitalizing on them, but now that the problem of access has been made largely moot, we are free to roam the earth and hold the performance of world markets against one another.

2008 is both a great and horrible year to examine. On one hand, it was such an aberration that it is debatable how much weight the year and associated market performances should receive as a predictor of years to come. On the other hand, it happened, and it is possible that such a year may happen once again. The reasons may change, the severity may not be as great, but in the sense that it was universally rotten, that is an eventuality that will surely be visited on us again.

That said, was every single market simply abysmal in 2008? No, not really (see Exhibit 1.4). Depending on which index you cite, the U.S. equities market was down about 40 percent. That is bad, but there were many worse (see Exhibit 1.5) and many that were much better.

EXHIBIT 1.4 Best Performing Stock Markets of 2008

Country	Return
Tunisia	+10%
Costa Rica	-4%
Morocco	-6%
Venezuela	-9%
Botswana	-15%
Slovakia	-19%
Lebanon	-21%
Chile	-23%
Mexico	-25%
South Africa	-27%

Source: BBC World News.

EXHIBIT 1.5 Worst Performing Stock Markets of 2008

Country	Return
Iceland	-94%
Bulgaria	-80%
Ukraine	-73%
United Arab Emirates	-72%
Serbia	-71%
Lithuania	-71%
Romania	-70%
Slovenia	-68%
Vietnam	-67%
Greece	-66%

Source: BBC World News.

Reason #4. Risk Reduction

Investing globally gives one the opportunity to benefit from both sides of the diversification coin. When we think of diversification, we think of it in terms of reducing risk as well as enhancing the opportunity for growth. Putting some of our money to work outside of the United States gives us the opportunity to do both, interestingly enough. Diversification provides two unique and seemingly disparate benefits from the same action. We spoke of the benefit of growth near the outset of the chapter. Presently, we want to turn an eye to the sometimes-controversial issue of international investing as a mechanism for reducing risk.

There is a long-held school of thought that taking your investable monies outside of the United States can only *increase* one's risk. Just the other day, we were perusing an article from someone who was intent on bashing the idea of international investing. The article stood out because it focused not at all on the opportunities, but exclusively on the *risks*. Although it is certainly true that there is some risk to foreign investing, the reality is that there is risk to all investing; after all, how did *your* portfolio of U.S. stocks do in 2008?

Remember that in order to properly use the tool of diversification to reduce risk, you have to actually *diversify*. In other words, you cannot allow yourself to begin chasing the next "hot" emerging, or worse, *frontier* market, and place all of your money accordingly. To diversify means just that, and it is done properly with a portfolio of equities that represent a wide range of industries and nations.

Let us look at this from a more general and philosophical point of view, as well as with the use of some real numbers. First, all countries are not the same. We realize this (somewhat ironically) in a day and age

where world economies are vastly more interconnected and directly correlated than they once were. That said, the disparity between macroeconomic trends in countless numbers of nation-states remain vast enough in a variety of areas to justify an interest in investing abroad as a means of lowering risk. In other words, while it is easy to point out the increased interrelationships between nations and say, generically, that we are all in this together, it is not quite that simple. Although there are close relationships in many respects, there remain vast differences in others. It is important to note that although there is a growing correlation among broad indexes and regions of the world (you can even see a growing correlation nowadays between emerging markets as a whole and the S&P 500), there is still a great deal of beneficial/low-correlation diversification available at the next-lowest levels of investment strata (from whole regions): the country level, and then further down at an industry level. Let us look at India for a minute. In 2007, India's benchmark BSE SENSEX climbed about 47 percent for the year—which is good, especially considering the S&P 500 index returned a whopping 3.6 percent to investors that year. Now, if you were inclined to bolster your telecom holdings in 2007 and had invested in Tata Teleservices, an Indian telecommunications company, you would have enjoyed a rather ridiculous 216 percent return, while your very American bet on AT&T that year would have yielded a solid 18 percent. Eighteen percent is nothing at which to sneeze, but we like 216 percent a bit better (as an aside, a bet on France Telecom that year would have yielded nearly 16 percent; it may be anecdotal evidence, but it is interesting that the leading telecom companies of two of the world's most developed markets returned roughly the same, while an emerging markets telecom like Tata exploded as it did). Assuming you had a principally U.S.-based, broadly constructed portfolio, but also had some key weightings in emerging markets companies like Tata, the risk you run of earning only a few percentage points of a return in 2007 is largely mitigated by owning an Indian telecommunications company that pounded out more than 200 percent that year.

Speaking of indexes, let us look at those, as a whole: If you owned the S&P for the two years of 2001 and 2002, you would have lost just more than 30 percent. If you had owned India's benchmark index, the SENSEX in 2002, you would have made only a little more than 3 percent, but if you had owned the S&P 500, you would have *lost* 23 percent. If you had owned *Pakistan's* benchmark index, the Karachi 100, you would have made 112 percent. As an example, then, if you had owned all three in roughly equal measure, your portfolio would have averaged a nice 30 percent return in a year when the good ole USA was not doing much for its native investors. Remember that risk involves concerns that are quite a bit different from the normally considered "stability of principal"; for

professional investors, risk is chiefly about *the risk associated with not seeing much of a return*. There lies the true meaning of risk.

Up to this point, our discussion of risk reduction has centered on justifying it through commonsense observation, even anecdotal evidence, but it can be quantified more definitively, as well. Risk reduction for pro investors is really about *correlation*, which is, quite generally, how variables move with and against one another; *positive correlation* means that the variables move together and in the same direction; *negative correlation* means that the variables move together but in opposite directions; *noncorrelation* means that the variables do not move in a defined and related way; in other words, they behave *random* to one another.

Generally speaking, risk reduction is achieved in greater measure as the investments you own attain higher levels of negative correlation. To a neophyte investor, Microsoft and Apple may be viewed as being not positively correlated because they are two different companies, but we know that is not true. Their positive correlation comes in a few ways, chiefly because they are both in the same industry and basically doing the same thing. Now, someone might suggest that KB Home and Pfizer are at least uncorrelated, because they sample apparently unrelated industries: home building and health care. Sounds good on the surface, but is it really true? Nope. Both companies, while in different industries, are U.S.-based companies, and both are listed on the New York Stock Exchange. In other words, you see less correlation than you would between KB Home and DR Horton (another builder), or between KB Home and Home Depot (building supplies), but you cannot escape the positive correlation that exists as a result of both companies persisting as U.S.-based entities that move and shake with the domestic economy. In 2007, the year that was the “calm before the storm,” KB fell about 50 percent, and Pfizer fell about 8 percent; in 2007, the S&P 500 Index was *up* for the year, 3.5 percent. Granted, 50 percent down is a lot worse than 8 percent down, but you notice that both were down, and the U.S. market as a whole was up (in fact, over the previous three years, KB and Pfizer were actually correlated to the tune of a .93 coefficient). A bet on Brazil’s Bovespa Index that year, however, would have seen you make 40 percent. Even the homebuilder Gafisa, representing the industry that was in the throes of coming apart worldwide, rose 5 percent during 2007, this in a year when leading U.S. homebuilders dropped roughly 50 percent.

In order to achieve a better level of noncorrelation/negative correlation, you have to diversify outside of the United States entirely. Those of you who are yelling right now, proclaiming that 2008 is proof that there is no safe haven, are reaching, in our opinion. The global economic implosion of 2008 was unique in many respects in a modern, post-WWII environment, and to point to it as “proof” that looking overseas to reduce risk is

a waste would be a dangerous conclusion at which to arrive. It is reasonable to assume that we will occasionally have highly unusual years when most, if not all, markets move the same way and to largely the same degree, but even 2008 gave us Tunisia, which was actually up 10 percent for the year, and countries like Costa Rica, which were down by so little in 2008 (−4 percent) that they could be viewed as “home runs” by most of the rest of the world for that year. The point is that even though there are years when there is widespread carnage, those periods are quite unusual, and it would be a mistake for you to invest (or *not* invest) on the basis of shorter-term, highly atypical movements. Besides, if you are investing like a pro, you should be able to sidestep a good portion of the trauma.

When evaluating correlations, we look at a range between -1 and $+1$; zero is the representation of noncorrelation. Move above zero to the positive, and you have positive correlation. Move to the negative-negative correlation. Although it is true that the broad market indexes of developed nations are more highly correlated these days, even (investable) emerging markets indexes are seeing greater correlation with those of developed nations; as an example, the Vanguard Emerging Markets ETF and the SPDR S&P 500 are positively correlated over the past one and three years with coefficients of .91 and .85, respectively. Even on a country basis, we are seeing higher correlations, especially among the more developed of the emerging markets countries; again, looking to investable indexes, the Powershares India portfolio, which is made up of the 50 largest companies on India's two indexes, is positively correlated over the last year with the SPDR S&P 500 with a coefficient of .83. Want to try South Africa? You might be surprised. iShares MSCI South Africa Index ETF and the SPDR S&P 500 are correlated over the last 1 and 3 years with coefficients of .84 and .91, respectively.

So, does the aforementioned tell us that the idea of diversifying across the water is really specious, as in an idea that sounds good in theory but falls apart in practice? Not at all, but it does suggest two things: that the real opportunities to diversify likely lay in frontier and small emerging markets countries more so than in foreign developed and large emerging markets countries, and that while you *can* realize some great diversification in developed and larger emerging markets countries, you oftentimes may have to find it at the individual company level (remember our example of Tata Teleservices).

Reason #5. The Existence of the Internet

We do not know if there is an official use of the abbreviations “B.I.” and “A.I.” to distinguish the time *before* the Internet from the time *after* it came into being and widespread use, but maybe there should be. The Internet is simply amazing, and as relatively new as it is, it has already become

unimaginable to consider the world without it. Its existence has revolutionized everything, and the realm of investing has been every bit the beneficiary of the Internet as anything else. This is particularly true with regard to global investing.

For U.S. investors looking to invest in U.S. companies, the process of investing in securities markets has been as developed and well formed as any. Information on companies has always been readily available and generally quite plentiful, even B.I. It is one of the benefits of living here. However, for investors seeking to move transborder, the information required to invest successfully was normally much more difficult to capture. Unless you were among the wealthiest and most sophisticated of investors, it was not possible or practical for you to realistically engage foreign markets directly. You were limited to doing your global investing in the form of mutual funds and ADRs, which are U.S. versions of foreign stocks. With the Internet, the ability to perform research, as well as facilitate brokerage activity, is becoming a breeze.

Research Now that virtually everything and everyone now has an Internet presence, obtaining information on anything is easy. Let us say that you are impressed with the advances made by Vietnam, and recognize the government's increasing friendliness toward capitalism. You know intuitively that the emerging consumer class will have an increased need for financial services products, including insurance. Before the Internet, how realistically could you have researched Vietnam insurance companies in an expeditious fashion? Not at all. Now, all you need to do is type those very same words into a search engine and go from there. Don't like the results? Alter your word choice. By typing the words "insurance companies of Vietnam" into your Google search mechanism, you will retrieve thousands of results. The results themselves are very telling, because they seem to suggest a common denominator of *investment*. For example, the first 10 results *we* retrieved included several analyses of the insurance industry in Vietnam from an investment perspective. One of the highest-ranked results was an article titled "Vietnam Insurance Sector: Untapped Potential" found on www.researchandmarkets.com. The article itself is part of a longer report that is for sale, but even the part you can access for free had a lot of information, to include a list of insurance companies in Vietnam. From there, you just continue your research.

This is a simple example, but it illustrates the point perfectly well. This kind of access, particularly to emerging and frontier markets, was simply not available like this prior to the advent of the Internet.

Investment Activity As we said earlier, the investment world, as a whole, has proven to be one of the Internet's biggest beneficiaries. Whether

it is research, tracking data, or establishing and maintaining a formal investment account, it almost seems like the Internet was *made* to satisfy the wants and needs of investors. The process of becoming an investor has been a distinct beneficiary of the Internet. Rather than deal with the hassle of opening accounts in person (or over the phone, which is about as time-consuming), the Internet allows us the ability to take care of it all, online, in the privacy of our own homes—day or night.

Account maintenance is also a breeze, thanks to the Internet. We do not now need the U.S. mail to review statements and confirmations; it is all online.

As helpful and convenient as the Internet makes life for the average person seeking a platform at Charles Schwab, TD Ameritrade, and others, the benefit is that much more striking for the investor seeking to work off a more globally favorable brokerage, or through a country-based brokerage entirely. For example, Interactive Brokers (IB) (www.interactivebrokers.com) is a 30-odd-year-old brokerage that has been a bit ahead of the curve as far as seeking penetration of foreign markets, and has now morphed into a brokerage that is directed principally at the global-centric investor. A handful of minutes spent at IB's web site will allow you to open an account and access, through that single account, a wide array of investment vehicles available in (currently) 17 countries. Interactive Brokers is an excellent choice for the global-minded investor, and the realistic availability of direct investment options in a number of international markets would have been much more difficult without such a site.

We happen to like Interactive Brokers as a platform, and its access to direct investment in numerous worldwide markets is a terrific asset, but some of you may find that to be less than adequate. Going back to our earlier example, if you want to take advantage of the rapidly improving investment climate in Vietnam, you will not be able to do it through Interactive—but you *can* do it through Saigon Securities Inc. The Bilateral Trade Agreement signed in 2000 between the U.S. and Vietnam has propelled Vietnam into an attractive and fertile piece of investment ground—but you have to be able to access it. You can through Saigon Securities—but without the benefit of the Internet that wouldn't likely be possible. (Go to www.ssi.com.vn, and click on the icon of a British flag in the upper right-hand corner; you may still need to contact them specifically for additional help, as their application is still largely in Vietnamese.)

We speak more later on about setting up accounts that allow one to more directly target foreign markets; the point we want to leave you with here is that before the existence of a polished Internet, it was pragmatically difficult to access any aspect of foreign trading directly in an expeditious manner. That is now all in the past.

Reason #6. Other Regions of the World Are Not Plagued by a “Wealth-Guilt” Complex

One of the consequences to being an investor in twenty-first-century America is dealing with an increasingly growing self-consciousness associated with wealth accumulation. The recent election of President Barack Obama in the United States is indicative of many things, one of which is a sense that the perceived “have nots” have had quite enough of the “haves.” Interestingly, it may be true that even some of the “haves” have had enough of *themselves*: polls show that Obama did very well on Election Day with both the highest and lowest wealth demographics. There is plenty of anecdotal evidence, at least, that suggests more than a bit of a backlash against the unbridled accumulation of wealth and its representations (material stuff), and this philosophical change is working in concert with the not-so-philosophical issue that buying things is much more difficult than it once was, given the persistent credit contraction that has found its way to the consumer level.

Americans, for better or worse, have long been concerned with how they are perceived by the rest of the world. By contrast, the rest of the world is not nearly as obsessed with that perception of selves. The significance here is great. If “wealth guilt” is a natural consequence of serving as a *land of plenty* for decades, those nations that have yet to enjoy that status for very long have not had a chance for that guilt to set in; for that matter, there is no assurance that it ever will. A 2007 survey by the *Economic Times* concluded that India’s luxury market could grow to roughly 10 times its current size by 2015, fueled largely by a perceived cultural respect for the idea of wealth accumulation. Although the size of the Indian luxury market might be small in comparison to that of other nations, there is ample room for growth, and a long-term inclination to guilt-free accumulation in India and throughout many other countries around the world may help to present some nice prospects to extra-national investors.

The truth is that political correctness is largely a feature of nations that have had it good for a long time; success often breeds self-consciousness, and the United States, in comparison to many other nations, has been successful for a long time. There remains a wide variety of other countries that have yet to face the guilt that prosperity brings, and so will remain great consumer bases on which for global investors to focus for some time.

Reason #7. The U.S. Is Highly Overleveraged

The use of leverage, be it on a micro or macro scale, can be a tricky thing. In the short term, unchecked use of leverage can rapidly elevate consumption of goods and services, but in periods of substantial *deleveraging* (like that

which helped to bring about the 2008 global economic crisis), those nations that are up to their necks in debt end up much like the odd man out in a game of musical chairs. Quite obviously, you can count the United States and its consumers as examples of the last man standing.

Other nations are not nearly as hamstrung, and it is those countries to which a smart investor will look for direct investment. As with other features of developed markets, leverage is partly a function of years of prosperity. Until that time fully arrives for them, frontier and emerging markets will simply not come to possess a mentality of lending. This is why although many of these markets have suffered from the economic downturn, those less leveraged are in a position to recover far more quickly. We see evidence of this already as the world slowly—very slowly—begins to recover from the Great Recession. Two of the world's darlings in the realm of emerging markets, India and China, have resumed their pre-Great Recession growth trend; both India and China were expected to grow at between 5 percent and 10 percent in 2009 (China retail sales climbed about 15 percent in Q1/09), while the debt-laden United States, Europe, and Japan all contracted substantially in Q1/09.

It is worth postulating that the low levels of savings in the United States are tied to an entitlement mentality that may be unique to America. The now-abandoned concept of purchasing a good or service only when you have the money to pay for it is alive and well in many other nations, but seems to be woefully missing here in the United States, as well as within other developed nations.

There are just too many good debt scenarios in too many other countries to take the United States seriously as a growth player in that regard. China and Brazil have plenty of room to lower interest rates, if necessary, and China has an enormous reserve (the largest on the planet at about \$2 trillion), although there are other, once-“backward” countries that can also brag about maintaining large reserves (Russia is at about \$400 billion). The idea of the United States having a reserve of any kind is laughable.

As for levels of personal household debt, the story is no better, and is actually worse: U.S. households are leveraged at an unbelievable average figure of just more than 100 percent of GDP.

In the end, countries that deal with massive debt on all levels simply cannot grow (see Exhibit 1.6). Three of the four component countries of BRIC (Brazil, Russia, and China) each have debt levels of 41 percent, 7 percent, and 16 percent (of GDP) respectively. Compared to the United States, these are countries that can breathe, plain and simple. What is more, many frontier and emerging markets nations, particularly Asia, seem to have an outright cultural aversion to carrying significant amounts of debt. Although it will be interesting to see how that behavior trends as prosperity continues to grow in these countries, for investors, these underleveraged parts of

EXHIBIT 1.6 Countries with 60 Percent or Greater Public Debt-as-Percentage of GDP

Country	% of GDP	Market
Zimbabwe	241	(undesignated)
Japan	170	Developed
Lebanon	163	Frontier
Jamaica	124	Frontier
Singapore	114	Developed
Italy	93	Developed
Seychelles	93	(undesignated)
Greece	90	Developed
Sudan	86	(undesignated)
Egypt	85	Emerging
Bhutan	81	(undesignated)
Belgium	81	Developed
Sri Lanka	78	Frontier
India	78	Emerging
Israel	76	Developed
Hungary	74	Emerging
France	67	Developed
Ghana	66	Frontier
Portugal	64	Developed
Germany	63	Developed
Canada	62	Developed
United States	61*	Developed
Morocco	60	Emerging

Source: CIA World Factbook.

**Note:* Recent unofficial data suggests the U.S. figure may be closer to 80 percent in the wake of recent stimulus spending.

the world are going to be important considerations as recipients of direct investment for the foreseeable future (see Exhibit 1.7).

Reason #8. Other Economies of the World Have Been Crushed Worse Than Ours—and Thus Remain Poised for a Bigger Turnaround

In a general sense, we recognize that the lower you go, the more opportunity there exists on the way up. Markets and indexes that are pounded can become very intriguing places for us to look, with rare exception (an aside: the NASDAQ Composite may be one of those exceptions; in 2000, the index hit its peak close of 5,048, and subsequently fell 78 percent over the next two years; more than nine years later, the index is still 63 percent

EXHIBIT 1.7 Countries with 15 Percent or Less Public Debt as Percentage of GDP

Country	% of GDP	Market
Oman	2	Frontier
Libya	4	(undesignated)
Estonia	4	Frontier
Chile	4	Emerging
Botswana	5	Frontier
Azerbaijan	5	(undesignated)
Wallis and Futuna	6	(undesignated)
Qatar	6	Frontier
Russia	7	Emerging
Luxembourg	7	(undesignated)
Kuwait	7	Frontier
Angola	9	(undesignated)
Kazakhstan	9	Frontier
Equatorial Guinea	9	(undesignated)
Ukraine	10	Frontier
Lithuania	12	Frontier
Cameroon	12	(undesignated)
Nigeria	12	Frontier
Saudi Arabia	13	Frontier
Uzbekistan	14	(undesignated)
Algeria	14	(undesignated)
Romania	14	Frontier
Hong Kong	14	Developed

Source: CIA World Factbook.

down from that same high). In comparison to the U.S.'s benchmark S&P 500 index, many nations whose markets were creamed much worse than the United States have already demonstrated great resiliency and a willingness to get back to making money.

As an example, look at two of the United States's biggest and baddest indexes: the S&P 500, the favorite index of fund managers, as well as the Dow Jones Industrial Average. The difference between the two is much like the difference between an actor and a movie star, but regardless, both have their own unique gravitas in the investment universe. For the calendar year of 2008, the S&P 500 fell 38 percent, and has returned, during the first half of 2009, a whopping 2 percent. As for the Dow, it backslid a relatively modest 33 percent in 2008, and has "recovered," if you can call what it is doing a recovery, in the first half of 2009 by posting a -4 percent return during that period. There are a variety of other factors to consider when evaluating to what degree a national market is poised for a big turnaround,

and we address why the United States has a longer road to travel than others, but as we see, from the narrow terms of equity markets recovery, other nations have done much better after more solid poundings of their own.

Take China, for example. The Chinese equities market might have been the most overheated stock market of the last several years. Come 2008, it all ended—at least for a little while. The Hang Seng's return in 2008 was –48 percent, which is considerably worse than the S&P 500. This year? The Hang Seng has roared back during the first half of 2009, up 28 percent during that period.

Look at India. Same thing. If we look at the Bombay Stock Exchange Sensitive Index, or BSE SENSEX, which is India's version of the Dow 30, we see a benchmark that was crushed in 2008 to the tune of a –52 percent return. That said, the BSE SENSEX also roared back in the first half of 2009, up 50 percent during the first six months of 2009.

There are plenty of other examples. Russia is another good one. The RTSI, or Russian Trading System Index, is a 50-stock composite of the RTS Stock Exchange, and 2008 saw *it* hammered down by 72 percent! The news in 2009? Halfway through the year it had gained 56 percent from where it ended 2008.

Pakistan? Why not? The Karachi dropped 58 percent in 2008, and has bounced back up 22 percent halfway into 2009.

Compare and contrast the numbers associated with these countries to those of the more-developed nations. For example, a look at the top five countries represented in the *Fortune* magazine's list of top 100 corporations in the world gives us the United States, Germany, France, Britain, and Japan, in that order. Their respective benchmark index performances follow in Exhibit 1.8.

As a general observation, it is fair to say that more developed economies were not hurt as badly by the Great Recession, and neither have they had rip-roaring performances in 2009. The simple truth is that

EXHIBIT 1.8 Top Five Countries and Their Index Performance

Country	Index	2008 Return	Return (First Six Months of 2009)
United States	S&P 500	–38%	+2%
Germany	DAX	–39%	–.04%
France	CAC 40	–42%	–2%
Britain	FTSE 100	–31%	–4%
Japan	Nikkei 225	–39%	+12%

Source: Based on data from *Fortune* magazine.

younger countries, those truly emerging or frontier, are excellent candidates to watch for money-remaking opportunities when those that are most solid historically face strong headwinds.

The list goes on, and there is a lot of room left in many of these various national markets for a big upside to come. As we have said, there is a variety of other factors to consider besides mere "crush factor" when evaluating the potential of a national economy and its associated securities markets to rebound solidly in the near-term future, but seeing especially beaten markets is a good place to start. The psychological component is such that the market "knows" it has scaled lofty heights before, and is therefore not looking at all-time highs with quite the same sort of wishful thinking it did when it had yet to reach them the first time (we accept, again, that the NASDAQ Composite from the beginning of this century may be a notable exception).

The countries that have responded particularly well in 2009, in addition to benefiting from having nowhere to go but up, and have other fundamentals well suited to their success, so this element cannot be disregarded in favor of focusing purely on the degree of "beat-down." For example, China, which has come back quite strongly in 2009, is characterized at present by a reasonably stable rate of inflation. The upshot is that, if needed, China can make aggressive rate cuts, as it has lots of room to do so. Additionally, there is the rate of savings among China's populace, the highest in the world by some measures. India presents much of the same promise to investors, in addition to its market tumble; in India, you have the combination of 50 percent of the population under 25, a rate of savings comparable to China's, and lots of needed infrastructure upgrades. These features are why it is badly hit *emerging* economies that tend to rebound well; the culture and profile of the country is such that it is primed to keep moving, whereas highly developed nations no longer benefit from the endemic need to move inexorably forward, even during difficult global times.

Reason #9. The Condition of the U.S. Economy for Years to Come Makes Looking Elsewhere a Smart Idea

Some will suggest that the very fact a market has been beaten down is the reason to look to that same market as an opportunity. It makes sense intuitively, and it is oftentimes a fair assumption. However, a severely beaten down market simply means that it is worth perhaps undergoing an examination. The *results* of that examination, one that includes consideration of factors well beyond the simple scope of market performance, will help to determine the weighting we choose to give to a national economy. For us, the overall prospective condition of the U.S. economy in the near term

is something that causes us to have an even greater interest in looking to other national markets for investment relief.

Trade Deficit The United States continues to manage a huge trade deficit, and although the U.S. trade deficit improved by about \$50 billion from 2006 to 2007, and again from 2007 to 2008, to rest at \$677 billion, it is still enormous. There are theoretical debates about the importance of the trade deficit to the national economy, but it is not really a matter of theory that spending more than one makes cannot persist interminably. There are those who will allege that ultimately paying is not a problem, because the United States can print as much money as it wants to, which is true, but most of us are aware that the result of such an approach is a devaluation of U.S. currency. A devaluation of our currency naturally results in a strengthening of overseas currencies, and thus a further strengthening of the positions of those who own foreign assets (be they foreigners or U.S.-based global investors). In other words, the typically considered “currency risk” that has been pointed to as problematic for so many investors would become fairly riskless, overall.

Aging Population The population of the United States is not what it once was, to be sure. We are getting older. It is estimated that those of us who are at least 45 years old will go from representing about 39 percent of the population in 2010 to representing 43 percent of the population in 2040. The significant effects of the 2008 financial crisis aside, we were already heading toward becoming a consumer base intent on contracting its spending. According to a 2005 Harris Interactive study, roughly 70 percent of people in their fifties who plan to move on behalf of retirement will do so principally to live out their remaining years in something more affordable. Studies have shown that the standard life-cycle model that illustrates that savings rates increase during working years but decline in retirement remains intact. However, it is reasonable to assume that the depletion of savings in retirement is by no means an indication of an increase in discretionary spending, but rather spending on essential goods and services. In other words, an aging population with lower savings rates does *not* suggest a populace that is going to buy lots of goods and services. This phenomenon (aging) is something that we will see in a number of developed, industrialized nations over the course of the coming decades, which is no real surprise. The further developed a nation becomes, the slower its birth rate, for a variety of reasons.

The matter of a decrease in discretionary spending is by no means limited to “stuff.” Also in decline will be investments in just about everything. With fewer funds being channeled into investments of any type, the momentum effect that rarely fails to cause an appreciation in asset values

would be missing. Goods and services, then, as well as financial market products, will likely be seen as less of a repository of the population's money in the United States over time.

An associated problem is that Baby Boomers, given their sharply growing representation of the population, will be tapping Social Security and other publicly funded resources at a rate not seen before. The resulting strain on the system, made worse by a shrinking worker base, and one that will likely be dealing with higher rates of unemployment going forward, should prove to be an ever-present drag on the United States's growth for many years.

Labor Costs/Outsourcing It is no secret that jobs in the United States are being shipped overseas with increasing frequency. It is likely that if called the customer service department on behalf of any of the goods you own, you found yourself speaking with someone from India, which has become a favorite whipping boy regarding the matter of outsourced U.S. jobs. There are two parts to this outsourcing. One part is that it is U.S. companies doing the outsourcing, so it is these same companies that are shoring up their own bottom lines and making themselves more attractive to investors; fair enough (after all, we're not saying you should be avoiding U.S.-based equities). The other part is the resulting accumulation of greater wealth and opportunities by populations in the countries to which more of this labor is being outsourced. We know that manufacturing jobs have been disappearing for decades. Now, we are seeing the *service* jobs that we thought would always remain on U.S. shores moving away, as well. Your authors could go off on a rant at this point about the unfortunate effects of what is taking place in the U.S. economy, but we will instead merely point out that what you see is more the basis for looking overseas with your investment dollars.

There is an even broader issue, beyond the simple matter of the United States. The question can be asked more generally if developed markets are not just a worse option right now, anyway. The Great Recession has pounded the daylights out of developed markets. There are many components to the headwind that the United States will be facing for years to come, beyond those mentioned earlier. Right now, individual states are in major financial trouble; California, by itself the world's eighth-largest economy (estimated), faces a \$24 billion-plus deficit, which represents about a quarter of the state's general fund. Britain has seen the outlook on its sovereign debt lowered from "stable" to "negative" by Standard & Poor's. France, with rising unemployment and collapsing growth, is currently in much the same position as the United States.

These troubles throughout developed nations prompt us to consider if, in fact, there is not an increased risk by *focusing* on the United States and

other developed markets. Although some developed markets appear to be successfully burrowing their way out of the underground (supposedly the United States is one of those), they have a long, long way to go. Even once they successfully extricate themselves from the primary and secondary effects of the financial disaster, the question is beckoned, “what then?” As we have seen from our discussions earlier, many of the frontier and emerging markets have acquitted themselves nicely in the earliest stages of the recovery, while the developed markets will continue to be slow moving. For example, China’s stimulus package, announced in the fall of 2008, totaling roughly \$600 billion, is targeted at housing, infrastructure, transport networks, and technical innovation. The cool thing is that while it is not sure from which source(s) China will find the money, it is worth noting that even if China borrowed all of it . . . which is highly unlikely . . . their national debt-to-GDP ratio would still come in at around 30 percent, while the United States’s is around 75 percent. In other words, China is much better prepared to start throwing money around than the United States, Japan, and a host of other developed markets.

GLOBAL INVESTING IS MORE THAN A FAD

We grant you that an entire book could likely be written on just why it is a good idea to become a truly global investor. The reasons we present here are the ones we think are perhaps among the more compelling, but what you should take from this chapter is that global investing will be much more than a fad; that given the long-term and perhaps permanent changes that are taking place demographically, politically, and economically in the world, that a global-centric portfolio will be the only reliable way that an investor can access, going forward, the kinds of returns we took for granted in the 1990s.

