

DENVER  
**BUSINESS JOURNAL**

OCTOBER 13-19, 2006

## Investing overseas: Tips on how to 'globalize' your portfolio

**W**hen I first began investing in the 1980s, nobody had ever heard of "globalization." Now you can't avoid it.

In fact, do a Google search on the term and you'll come up with almost 100 million responses. There's no getting around it, the world is becoming a much smaller place and most business owners are being forced to think globally to survive.

That's why it always amazes me when these same business owners cringe at the thought of buying foreign stocks and bonds for their investment portfolios. That view persists despite the fact that the U.S. stock market now accounts for less than half the world's overall market capitalization, and will likely drop to less than a third of such capitalization by 2020.

Maybe it's simply that foreign markets seem, well, foreign to most U.S. investors, thus the "globalization" of investment portfolios still has a long way to go.

### **Why Foreign Investments Make Sense**

Global investing makes sense for a variety of reasons. Most importantly, perhaps, foreign stocks and bonds provide diversification and generally help reduce overall portfolio risk and volatility.



**DAVID A.  
TWIBELL**

That doesn't mean U.S. and foreign markets move independently from each other -- they don't. But their performance diverges enough (correlations run anywhere from 0.72 to 0.42) that having exposure to both tends to add stability and increase overall returns.

The idea that a mix of different, uncorrelated investments can decrease investment risk without sacrificing returns is the cornerstone of Modern Portfolio Theory. This somewhat revolutionary concept earned its creator, Harry Markowitz, the Nobel Prize in Economics in 1990. Since then, it has been adopted in various forms by a wide range of investment firms, nonprofit organizations, and institutional investors.

Further, with the possible exception of some developed European countries, most foreign economies are poised to grow at least as fast as the United States

over the next several years. And some regions, like Eastern Europe, India and the Pacific Rim, will likely grow much faster. This economic growth should provide a good backdrop for continued gains in overseas markets.

Finally, many foreign firms have dividend yields far in excess of their U.S. counterparts. For example, the average European company pays a dividend yield of roughly 2.45 percent, while yields for emerging market firms average 2.7 percent. Compare that to the S&P 500's paltry 1.65 percent yield, and it's easy to see how overseas investments can play a role even in conservative income-oriented portfolios.

### **How to Invest Overseas**

Perhaps the least complicated way for U.S. investors to gain exposure to foreign markets is to buy shares in a mutual fund that invests overseas. There are over 1,600 mutual funds that invest exclusively in foreign countries, and another 500 that invest a portion of their assets overseas.

Some focus on a particular region, such as Europe or the Pacific Rim, while others specialize in unique sectors like global energy or foreign bonds. If you decide to invest in international mutual funds, keep in mind an important distinction -- "foreign" funds invest exclusively outside the United States, while "global" or "world" funds invest in both U.S. and foreign securities.

But mutual funds are only the tip of the international iceberg. Investors can also buy ownership interests in foreign companies like Toyota, Nokia and Bayer directly on U.S. exchanges. These securities, called American Depository Receipts, are issued by U.S. depository banks and represent one or more shares of an underlying foreign stock.

Other options for U.S. investors seeking foreign-market exposure include exchange-traded funds, closed-end funds, separately managed accounts and hedge funds. All of these have pros and cons, and it makes sense to speak with an investment professional to determine which, if any, are appropriate for you.

### **Possible Pitfalls**

Investing overseas isn't without risk. Investors should understand the performance of a foreign country's stock market is only half the story. Currency fluctuations also have a significant impact on overseas investment returns.

When the U.S. dollar strengthens against a foreign currency, it decreases returns for U.S. investors in that market.

For example, in 1997 the Morgan Stanley Capital International Europe, Australia and Far East Index (MSCI EAFE) gained 13.82 percent when measured in local currencies, but only returned 2.06 percent to U.S. investors due to a rising U.S. dollar. Conversely, a falling U.S. dollar adds to overseas returns, such as in 1994 when a 1.78 percent loss in the MSCI EAFE turned into an 8 percent gain for U.S. investors thanks to a sell-off in the U.S. dollar.

Political instability can also be a problem, particularly when investing in emerging markets such as Latin America, Africa and the Middle East. Governments can change overnight in these regions, often causing significant market turmoil. When you compound this with the lack of liquidity in many of these markets, it can make for quite a bumpy ride if you aren't careful.

Finally, foreign markets often operate much differently than U.S. markets. There may be different requirements for reporting stock trades and safekeeping shares held by local custodians. Legal

access may also be restricted in some countries, which often leaves investors with little recourse if there is a problem with their investment.

Despite these potential pitfalls, foreign securities can be an extremely important and beneficial part of almost every investment portfolio. After all, the world is only going to continue getting smaller, which should mean plenty of investment opportunities abroad.

**DAVID A. TWIBELL**, is president of wealth management for Colorado Capital Bank in Denver, where he directs the bank's portfolio management and financial planning practice. Reach him at 303-814-5545 or [dtwibell@coloradocapitalbank.com](mailto:dtwibell@coloradocapitalbank.com).