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Opinion

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Going global no longer just a foreign concept

When 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.

That’s why it amazes me when some investors still cringe at the thought of buying foreign stocks and bonds for their investment portfolios.

That view persists despite the fact 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.

Why invest overseas

Global investing makes sense for several reasons. Perhaps most importantly, it provides diversification and helps reduce overall portfolio volatility.

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 .72 to .42) that having

exposure to both tends to add stability and increase overall returns.

Further, with the possible exception of several 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



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areas, such as Eastern Europe, India, and the Pacific Rim likely will grow much faster.

Finally, many foreign firms have dividend yields far exceeding

their U.S. counterparts.

For example, the average European company pays a dividend yield of roughly 2.45 percent, while yields for emerging markets 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 foreign exposure

is to buy one of the more than 2,100 U.S. mutual funds that invest overseas.

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 generally invest in both U.S. and foreign securities.

But mutual funds are only the tip of the international iceberg. Investors also can buy ownership interests in foreign stocks 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 a foreign stock.

Other options for U.S. investors seeking foreign exposure include exchange-traded funds, closed-end funds, separately managed accounts and hedge funds.

Possible pitfalls

Investing overseas isn't without risk. First, currency fluctuations can have a significant impact on investment returns.

For example, in 1997 the international MSCI EAFE index gained 13.82 percent when measured in local currencies, but only returned 2.06 percent to U.S. investors because of 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.

Political instability also can be a problem, particularly when investing in emerging markets such as Latin America, Africa and the Middle East.

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 extremely careful.

Despite these potential pitfalls, however, 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.

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