



WHY YOU SHOULD STILL CONSIDER INVESTING ABROAD

Wouldn't you like to invest in a stock market that has returned nearly 30 percent annually four years in a row, where corporate profits are strong, interest and inflation rates are low, and the economy is the envy of the world? Why go anywhere else? That description, by the way, is not of the United States today, but of Japan at the end of the 1980s, shortly before it began its decade-long slide downward.

This is not to suggest that the U.S. economy and stock market will collapse any minute, or falter to the degree they have in Japan. What it does suggest is that when it comes to investing, markets tend to go in cycles. What is up today may be down tomorrow, and vice versa.

The problem is that no one knows for sure when a cycle is going to change. That's why Certified Financial Planner professionals routinely recommend that investors diversify among different types of investments, so that when one part drops, another part may climb. This approach over the long term can reduce overall risk while actually earning higher returns than by sticking with a narrow band of investments. In addition to investing domestically in a variety of stocks, bonds, real estate and cash equivalents, foreign stocks and bonds are also seen as part of that diversification effort.

Why not just ride the current winner—namely, the United States? Why invest anywhere else? Because no winner stays a winner forever, and no one knows when a new winner will arrive on the scene.

While the U.S. market has trounced international markets in recent years, there have been numerous stretches where foreign markets have outperformed the United States. Japan in the late 1980s is one example. The EAFE index, which is an index of large company stocks in Europe, Australia and the Far East, outperformed the S&P 500 index as recently as 1993 through 1995. From 1980 through 1989, EAFE returned a total of 678.4 percent compared with 400.4 percent for the S&P 500 during the same period.

Investment experts themselves debate the value of investing abroad. Some research suggests that the U.S. market is becoming more correlated with foreign markets—that is, the world's markets are acting more and more alike particularly in the short run. For example, when the U.S. market

dropped in the third quarter of 1998, so did the rest of the world. Experts attribute this in part to the increasing role of huge multinational companies that sell abroad. Consequently, they argue, there's less reason to invest overseas because you won't get the diversification you expected.

Other experts say that while the markets may drop in tandem in the short term, they still diverge in the long term. Furthermore, proponents point out that even if world markets are becoming more correlated, investors shouldn't ignore the fact that some of the best companies in the world lie outside U.S. borders. In fact, according to Wilshire Associates, of the nearly 36,000 stocks in the world, only 13,000 are based in the United States. Ignoring stocks in the rest of the world—Sony, Nestle, ING Group, Bayer, Galaxco and others—would be like investing in domestic stocks by picking only those stocks based in one geographical section of the United States.

What percentage of a portfolio should the average investor devote to foreign stocks? Many Certified Financial Planner practitioners recommend 10 to 20 percent, depending on your investment needs and your risk tolerance. Mutual funds are considered the best way for most American investors to invest abroad. It's difficult to pick, buy and sell individual foreign stocks as you would Microsoft or Wal-Mart.

As for which mutual funds to choose, that's become more problematic. In the wake of the battered Asian and Latin American funds, some financial planners are shying away from choosing regional funds or individual country funds. They prefer choosing one or two good broad international funds and let the fund managers make their best judgment as to what parts of the world they should go into. More skittish investors might consider global funds, which invest in the United States as well as overseas.

CFP practitioners agree that it's psychologically tough to keep a portion of your portfolio invested overseas when domestic large cap stocks appear to be the only calm in the storm the last few years. But keep in mind that investing weather is a fickle thing. The principles of diversification are based not on what's happening at any given moment, or even any given year, but what happens over the long term.

February 1999—This column is produced by the Institute of Certified Financial Planners, a national association representing the top financial planners in the country, and is provided by Joseph Hoffman, a local member in good standing of the Institute.