ALL ABOUT GLOBAL INVESTING

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To the memory of Margaret Hawkins

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Preface

When the idea for a book on the subject of global investing first grabbed for a share of my attention some time ago, I decided to do some market research. No need to rush into things, I thought, since such a vital and seemingly popular topic would certainly have already been adequately covered by any number of authors. Upon checking the usual sources, however, I was surprised to find quite the opposite. Not only were there only a handful of books addressing the issue, but those that were available seemed mostly to contain information so arcane or dated as to be virtually useless for most individual investors. Thumbing through a typical volume, I would find myself thinking, "This is nice, but what do I *do* with it?"

And so I decided to write a book on global investing that was both authoritative *and* practical. But shortly after getting started, it became painfully clear to me why so little has been written on foreign markets. Having authored two previous books, both on the subject of U.S. securities, I thought I was prepared for the task of accumulating, digesting, and reformulating the mountains of information necessary to do justice to the subject. What I found, however, was that acquiring the kind of data necessary to uncover relevant information about overseas economies and markets is not only difficult and time consuming, but, in many cases, virtually impossible. Researchers and writers delving into things American are often spoiled by the magnitude and breadth of historical information available on all aspects of U.S. life, including its economy and financial markets. The American government may have many flaws, but data accumulation is not one of them. Keeping accurate records—or any records at all for that matter—is a problem for many foreign countries, particularly those only recently harboring aspirations of joining the First World of developed economies. Some nations, for example, do not have price histories on their primary equity-market index going back even a few years.

Fortunately, organizations such as the International Monetary Fund and World Bank have been taking copious notes for decades on hundreds of economies.

Together with equity-market data supplied by Wilshire Associates and the International Federation of Stock Exchanges, it is possible to piece together a picture of a country's economic and financial-market history that is fundamental to investors making informed choices. The fact that the Wilshire country indexes are each compiled under the same format makes comparisons of the various stock markets more useful. A comprehensive listing of all the data sources is given in Chapter 6, Understanding the Data.

A word about the selection of the data itself: This book has attempted to take a historical approach to the subject of global investing and the foreign economies that underpin the various financial markets. This is done for several reasons. First, books that address only the present circumstances in a given market run the risk of being both wrong and late. Not only are near-term predictions notoriously unreliable, but the lag time between when a book is written and when it is published would render such prognostications useless anyway. Second, attempting to make money in foreign markets by divining the short-term outlook is just plain bad policy. Timing any market—even the developed bourses of the United States and Europe—is virtually impossible, but basing investment decisions on short-term guesses of emerging markets is especially dangerous and counterproductive. Finally, when it comes to a nation's handling of its economy, past truly is prologue. To understand where a country is, it is absolutely vital to understand where it has been. And while it is certainly possible for a nation to change its ways (both for the better and for the worse), a study of history will always give an investor a better feel for the underlying conditions that an economy and its financial markets face.

Despite the advantages of taking a long-term, historical approach to evaluating foreign economies and markets, it is also necessary to recognize the limitations of such an outlook.

Data on the 21 stock markets contained in this book dates to January 1988, thus encompassing virtually the entire relevant history of many emerging markets. Before the late 1980s, for example, most emerging markets were simply too small (in terms of capitalization or number of listed securities) to generate useful data. But although the entire relevant existence of a number of markets may well be adequately referenced from the 1988 to 1994 period covered in this book, it is also important to realize that seven years is a mere blink of an eye in the context of what is to come. It is dangerous to assume that the intramarket relationships, correlations, and patterns formed over the past 7 years will necessarily remain unchanged over the next 7, or 17, or 27 years. Even the 30 years of history that form the basis of the economic sections of this book might best be viewed as only a recent chunk of information.

It should be pointed out that this book covers mostly the countries' stock markets and their underlying economies and politics, touching only indirectly on the bond exchanges of the various countries. This is done for both practical and theoretical reasons. Opportunities for regional or country involvement in credit markets are virtually nonexistent, making any examination of the issue moot. Also, the primary reason behind global diversification of an investment portfolio is to participate in the underlying growth of the world economy. This objective is best accomplished by being an owner, not a lender. As is the case with stocks and bonds in the United States, foreign stocks tend to outperform foreign bonds by a wide margin over the long term.

Despite my attempt to keep this book as user-friendly as possible, I'm certain that the sheer quantity of information contained herein will at times stupefy the reader or even induce a kind of paralysis by analysis. Overwhelming quantities of information are unfortunately a fact of investment life. And when it comes to putting one's hard-earned money at risk in a market—much less a market half a world away—it is not possible to know too much. But it *is* possible to understand too little, and such a deficiency can be a by-product of being bombarded with minutia. And so, what follows is my attempt to distill the essence of the story down to its bare essentials, to put the whole idea in a form that will have you thinking not only "This is nice," but also "And here is what I'll do with it."

At its heart, it is a simple story. We are fortunate to live at a historically opportune moment, a time when a number of factors have combined to make investment in foreign countries both possible and highly worthwhile. In a more idealistic vein, it might be argued that, quite apart from investor profits, the most substantive benefits flowing from this rare alignment of the economic and political constellations will accrue to the people of the developing economies themselves, as living standards increase and at least some measure of discretionary income is created. The factors fueling this trend are not complicated; the discrediting and collapse of socialist economies in a kind of reverse domino effect have put governments in a race to privatize and grow their national wealth more quickly. Stock markets are the most efficient method for raising the kind of private capital needed to accomplish economic decentralization. As statism has collapsed, equity markets have emerged and companies have been born, all aided by a new information technology that allows for the transfer of trillions of dollars of wealth around the globe in mere seconds. Just as transportation systems began to link far-flung agrarian communities in the United States some 150 years earlier, information systems are now bridging the last earthly barriers of time and space. Sellers have met buyers as never before.

What you should do with this information is actually quite simple: *just be* *there*. Do not expect—and do not even try—to always be in the right place at the right time. Know that markets go up and markets go down. Accept that you'll never be able to tell exactly when they'll do either. Accept that progress in many foreign countries will ebb and flow and will ultimately be measured in decades, not in years. Accept that the same kinds of global liquidity gushers that push U.S. stocks to occasional extremes will do the same abroad, only with more startling effect. And accept that interest in global investing will come and go as money is made and lost. But also know that the current cycle of economic privatization and political liberalization is likely to last well into the twenty-first century. If you do not try to outsmart yourself, if you invest only for the long term, and if you place your money with qualified managers who have a history of success, the odds are good that you also will benefit along with the people in the countries where your investments ultimately are placed.

It is my hope that the information in this book inspires you to be present at the economic re-creation of our world.

THOMAS D. SALBR

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T. D. S.

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Introduction

Five centuries after history's most stunning accident, Christopher Columbus's original voyage of discovery is finally arriving at its intended destination. Land ho!

Underwritten by Old World money, the mission Columbus undertook five centuries ago was to gain access to the markets, products, and riches of Asia. As everyone knows, of course, what actually happened was the greatest example of economic serendipity in recorded history, the entirely unintended discovery of a nearly virgin continent so abundant in its own untapped wealth that full development would absorb much of the world's finances for the next half millennia. Five hundred years later, however, a new set of equally return-driven investors are finally overseeing the completion of the mission originally discharged to Columbus, setting a course to the Orient not on three creaky marine vessels but via electrons bouncing off orbiting spacecraft at virtually the speed of light.

Taken as a whole, the so-called Pacific Rim and Asiatic regions—loosely defined as the vast area from the Philippines in the east to Turkey in the west, from Australia and New Zealand in the south to Japan in the north—probably represent the most exciting, volatile, dynamic, and potentially explosive investment opportunity of our time. If the nineteenth century belonged to the United Kingdom and the twentieth century to the United States, it might be argued that to Asia belongs the twenty-first century—a time when, after 6,000 years of rich cultural history, conditions were at last ripe for a thorough economic blossoming of one of mankind's cradles of civilization. A primary reason behind the final realization of Asia's economic potential has to do with a fundamental tenet of capitalism: Sellers need buyers and buyers need sellers—and Asia has plenty of both. Simply put, Asia is where the people are and have been for most of recorded history. As early as 1650, more than half of the world's population lived in Asia; as of 1995, that number had grown to 60 percent. Already 9 of the world's 20 most populous nations are in the Asian/Pacific region, as are fully half of the world's 40 largest cities. At a combined 3.3 billion people, Asia's population is more than triple that of the United States and Europe combined. The hub of the Asian economic wheel, of course, is China, with its 1.2 billion people representing one-fifth of the world's population. But even without China, Asia is a behemoth; by 2020, non-Chinese Asian nations will be home to more than one out of every three people on earth.

For most of its history, Asia has remained a mostly backward region economically. As recently as the 1960s, the label "Made in China" was a metaphor for cheap and generally unattractive goods. Hobbled by a widespread and endemic cultural resistance to outside influence, along with chronic political instability, the region's economies grew relatively slowly through much of the first half of the twentieth century, especially considering the small base from which they were expanding. Over the past 30 years, however, as Japan has recovered from the devastation of World War II and the older industrialized economies of the United States and Europe have reached maturity, the Asian economic giant has begun to stir. Between 1964 and 1993, Asian economies grew by an average of 484 percent, compared with 157 percent for the world's so-called industrialized nations and just 130 percent for the United States. Asian economic outperformance has accelerated sharply since a serious recession shook most Western economies in the mid-1970s; since 1973, average Asian real gross domestic product has grown by 6.7 percent per year, nearly triple the rate for the United States and other industrialized nations. The changing of the economic guard has become still more evident in the past decade; between 1984 and 1993, China, South Korea, Thailand, Taiwan, Singapore, Malaysia, Hong Kong, Indonesia, Pakistan, India, Sri Lanka, Australia, and Japan have each outgrown traditional economic superpowers Germany, the United Kingdom, and the United States by a wide margin.

That Asia should lead the world in economic growth heading into the twenty-first century is the result of a number of factors. By the mid-1970s, many Western economies had already become so large that their growth rates would have had to decline, if only because their large bases made rapid percentage gains all but impossible without intolerable inflation. And as real growth slowed in the mature economies, return on investment fell, sending capital elsewhere in search of new investment and new markets. Around this time, Japan began to compile enormous merchandise-trade surpluses with the United States, resulting in an ever-growing number of Japanese banks stuffed to their high-rise ceilings with yen. Discouraged from putting all their chips on the American market because of the weak dollar, Japanese investors looked in at least equal measure to the nearby Asian economies, many of which represented better values than those found in the United States and with less currency risk. Japanese banks, flush with the trophies of their merchandise-trade surplus, began to expand into such Asian cities as Hong Kong, Seoul, Manila, Bangkok, Taipei, and Kuala Lumpur. Deals cut by Japanese financial institutions soon powered impressive economic growth, which, in turn, led to the creation of large financial-services and high-tech industries in other Asian nations. Heading into the twenty-first century, some of the non-Japanese Asian economies are themselves beginning to export capital and investment. Asia's four so-called "Little Tigers"—Taiwan, Hong Kong, South Korea, and Singapore—are each now considered "developed" economies, meaning that per capita gross domestic product is above the $8,626 annual figure that the World Bank has established as the minimum criteria for inclusion as a First World economy.

Another factor in the relative rise of Asian economic power is the region's above-average ratio of investment to consumption. By its very nature, consumption is short-term and fleeting; aside from the immediate benefits of additional liquidity coursing through an economy, simply consuming a product does nothing to increase a nation's pool of capital, capital that in turn can be used to invest in new plants and equipment, thus raising productivity. And because improved productivity is the only true way to increase national wealth, countries that save and invest will usually outgrow those that borrow and consume. By that measure, Asia is the unqualified champion of the past three decades. Over the 30 years 1964 to 1993, the Asian nations profiled in this book (excluding Hong Kong and Taiwan, for whom comparable data is not available) have invested an average of 37 cents for every dollar consumed, compared to 29 cents on the dollar for the world as a whole and just 23 cents for the United States. And the 30-year averages actually understate the magnitude of the present disparity in savings and investment. As of the mid-1990s, Asia's investment-to-consumption ratio had reached nearly two and one-half times that of the United States and roughly double the world average. The clear leader in fostering savings and investment is Singapore, which as of 1993 had invested 84 cents for every dollar consumed, as compared to the U.S. ratio of a mere 20 cents for every dollar.

But while Asia may be the Main Street of the New Global Village, it is hardly the only street. In fact, three of the top four stock markets since 1988 are located not in the high-powered economies of Asia but in our own backyard, in the developing nations of Latin America. As is common after a period of intense and prolonged economic pain—a condition that characterized many Latin American economies in the late 1980s and early 1990s—fiscal responsibility is breaking out at long last in the lands south of the Rio Grande. First in Chile, then in Mexico, then in Argentina, and finally in Brazil, governments have adopted a "Hold the presses!" economic strategy, reversing the time-honored tradition of printing money to finance budgetary and trade deficiencies. But as the December 1994 financial meltdown in Mexico demonstrated, the transition to free and open markets will not be easy, smooth, or even guaranteed to succeed. Latin American economies are something akin to teenagers: volatile, changeable, excitable, unpredictable, yet often highly rewarding. The vastly different social ethos in many Latin American countries also comes into play, with its alternate vulnerability to authoritarian rule and periodic uprising in the name of political freedom.

If Latin American economies are the rowdy teenagers of the new world order and Asian countries its young adults, European states are the global senior citizens. Mature, stable, wise, dependable, and even fabled, the Old World economies of Germany, Switzerland, France, and Great Britain can still offer investors advantages not found in the younger hot spots of the global market place. The old playgrounds of Europe still have the fire to produce spectacular cyclical bursts, but mostly their appeal is in the high-quality products of their economy and the general predictability of their markets. The dogged insistence of many European nations to defend their currencies even at the expense of overall growth is a common characteristic of economic "haves"—those countries whose citizens already hold considerable wealth and whose main objective is simply to keep its value. The currencies of the five European nations profiled in this book gained an average of 60 percent against the U.S. dollar since 1964, and their average per capita gross domestic product of $22,000 is roughly equivalent to that of the United States. Reflecting the wealth and stability of their economies, European stock markets have by far the lowest downside volatility of the three global economic regions.

In any given year, the stock market of virtually any country could top the global honor roll as fickle liquidity flows quickly pass through one bourse on its way to another in a restless quest for relative value. But this year's beneficiary of mass euphoria could just as likely be next year's victim of collective panic. Over the long term, the performance of a country's stock market will tend to reflect the general health of its economy. And although it may not be possible to name with specificity which economies will lead the globe into the twenty-first century, it is possible to list several criteria that are likely to characterize those top performers. Keep in mind that economics is somewhat of a zero-sum game, that one nation tends to gain advantage at the expense of another in much the same way that one company gains market share over a competitor within an economy. While the aggregate output of the global economy will increase steadily over time, the distribution of real gains in global wealth is almost always nonuniform and related to factors that can be understood in advance. Those factors include financial strength (as measured by balances in budget and trade accounts), economic diversity, an educated workforce, a strong work ethic, a high investment-to-consumption ratio, a large middle class, political pluralism, moderate birthrates, and the governmental and private managerial ability to adapt to changing world economic conditions, especially as they relate to one's own position in the global economic food chain. Those countries that best achieve all or most of these criteria will be your economic winners and will usually have the best-performing stock markets over the long haul.

In this book, you'll find information to help you make those kinds of determinations for yourself or to help you hire people who have compiled long-term track records of success in making exactly those types of calls. Chapters 1 through 5 give you the background on the foreign stock markets and information and guidelines for wisely and profitably investing your money in those markets. Chapter 6 explains the data presented in Chapters 7 through 27—the "country" chapters—each of which deals with the political and economic picture of one country. The 21 countries treated in Chapters 7 through 27 have a combined market capitalization of $8.87 trillion, or 99.3 percent of the value of all non-U.S. equity markets as of year-end 1994. From those nearly $9 trillion worth of companies are surely some of the best-managed, fastest-growing enterprises available on the global marketplace. As you consider the occasionally mind-numbing quantity of choices available, always keep in mind the single most important message of this book: *Just be there.*

CHAPTER 1

There's Always a Bull Market Somewhere

Imagine that you've compiled a list of prime investment opportunities. You've checked them all out, jotted them down, and are ready to start buying the most promising among them. But before you buy, you complete one final step: You pull out a pencil, grab a ruler, and proceed to draw a line through 58 percent of the list. You indiscriminately cross out more than half of the businesses for no investment-related reason.

If such a selection process seems counterproductive, it is, nonetheless, no different than the approach that the overwhelming majority of Americans take to building their stock portfolios. Despite a strong but uneven surge in enthusiasm for investing overseas in the first half of the 1990s, most U.S. investors continue to exclude almost 6 out of every 10 investment opportunities simply because they are not U.S. investments. While there are signs that investors are beginning to think at least somewhat more globally—Americans added approximately $1 billion a week to their foreign holdings throughout 1993—most portfolios remain significantly underweighted in foreign stocks. As of year-end 1994, Americans held $331 billion of foreign equities. Given that U.S. investors owned $5.89 trillion of the $6.23 trillion value of the the U.S. stock market at year-end 1994, best estimates would put the total amount of American overseas portfolio investment at just 5.3 percent of total assets.

Three decades or more ago, such an oversight would not have meant much. In 1960, U.S. stocks represented roughly 78 percent of the aggregate market value of the world's corporations. In other words, more than three-quarters of the world's investment opportunities at that time were in the United States. Buying only U.S. stocks meant excluding just a small minority of investment opportunities. Over the past 35 years, however, the value of U.S. stocks relative to the rest of the world has fallen steadily; by 1995, the American equity market represented just 42 percent of the $14.89 trillion aggregate value of the world's stock markets. Reflecting the strong relative growth of non-U.S. commerce, 61 of the world's 100 largest corporations are foreign-based, including 91 of the 100 largest banks and 30 of the 50 largest insurers. American investors without at least some degree of foreign-stock ownership are effectively placing off-limits between one-half and two-thirds of all publicly traded corporations.

Arbitrarily excluding 58 percent of the world's businesses from your stock holdings is only part of the story. *Where* those businesses are located is equally important. Many of the investment companies necessarily excluded from U.S.-only equity portfolios happen to be operating from the fastest growing economies in the world—economies that have growth rates that dwarf that of the United States and that have the potential to continue to outgrow the United States well into the twenty-first century; economies that now are being deregulated and are opening their doors to foreign capital and goods for the first time; economies that are developing stock-and-bond exchanges and that are geopolitically positioned to be prime beneficiaries of the enormous economic stimulus resulting from the opening of the vast Chinese market. Over the past three decades, the annual inflation-adjusted rate of economic growth in the United States not only has lagged that of other industrialized nations, but has been barely half of the growth rate for the economies of developing nations. In particular, many Asian countries represent especially attractive investment opportunities, with long-term gross domestic product (GDP) growth rates nearly triple that of the United States. The relatively pedestrian growth in the U.S. economy is directly translated into a substantial loss of economic market share: Over the past 30 years, the American share of the global economic pie has shrunk by *42 percent* relative to developing nations and by 20 percent compared to the world as a whole.

Given the slower rate of economic growth in the United States, it should come as no surprise that the performance of U.S. stocks has lagged as well. In 1993, for example, U.S. equities came in *last* compared to the 21 developed stock markets that comprise Morgan Stanley Capital International's Europe, Australia, Far East (EAFE) index. In 1994, U.S. stocks did only marginally better, placing 15th after returns were converted into dollars. Over the more than 25 years since Morgan Stanley Capital International (MSCI) has kept proprietary indexes on the world's developed stock markets, the United States has underperformed 13 of the 21 markets in U.S. dollar terms. Relative to world bourses as a whole, Morgan Stanley's U.S. index stood at 488 (Base: January 1, 1970 = 100) as of