Global Investing: Benefits, Risks, and Approaches

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Outline

• Nature of the Great Recession - Recovery
• Economics of Globalization & Technology
• Approached to Global Investing
Current Business Outlook

• Industrial economies coming slowly out of the great recession due to the bursting of financial bubbles
• Double dip recession risk seem to have subsided. Some danger of currency wars
• Growth has resumed in developing markets, but Chinese growth may slow
• US exports are rising fast but imports still larger
• US and Europe growth 1-2%, China/India 8-9%, Brazil, Africa, Eastern Europe/Russia at ~5%.

Nature of this Great Recession

• Post-1989 Deregulatory and Debt Binge
• Tech and Globalization of Problems
• Reset-Related Uncertainty in New Normal
Understanding the Great Recession

- Nature of this Mess and Who’s Responsible
- New Reset - Cyclical+Secular Changes
- The Long Climb Back

Who’s Responsible? (the Blame Game)

- Greedy Bankers and Sleepy Regulators
- Righteous Ideologues like Alan Greenspan
- Those Darn Foreigners – Savers
- Look in the Mirror!!
- Continuing deregulation since 1989 – Unconstrained Keynesian Animal Spirits
Cyclical or Secular Changes?

Both

• Cyclical Recession overlaid with three major trend changes: Technology, Globalization, and OPM (debt) Addiction
• Unemployment mainly among non-college and middle management – all related to tech changes – so it is likely to be long-term
• Discretionary (consumer and business) spending is down; Value is again the king!
• A permanent shift in consumer and business behavior (a reset to a new “value” normal)?
Technology and Globalization

Tech
Moore’s Law - the overthrow of matter
Internet – Global Connectedness
Nature of work changing – less observable

Globalization
1989 Decline of Socialism – Rise of Markets
Reduced barriers/costs – Global Village
Wealth creation – Specialization/Trade
The Rise and Rise of the BRICS

The New Landscape

• There are **no domestic** businesses. All US Business are now competing with businesses from Canada, Mexico, China, India; Any country in the world really.

• Only need internet connections and a **hungry** and **educated** workforce; Knowledge is easily available; Capital and land don’t really matter so much; In fact, natural resource wealth is often a curse for a country.

• **Deleveraging** and **Value orientation** is likely for business (with many side effects). The era of unfettered free markets since the fall of the Berlin Wall is now firmly reversing course globally with greater government **regulation** globally.

Sources of Hope

• Emerging markets are already recovering; Chindia never really suffered

• There are some stirrings of recovery even in the developed economies like the US; Australia has already raised interest rates

• There remain lots of opportunities for growth – Businesses need to provide solutions to major problems – mostly at the intersection of social and technological trends
Recession: Looking Ahead

- Recession related to Tech, Globalization, and Deregulation-led Debt Binges
- Long Recovery Period - Already Starting
- But, Cannot Go Back – Will be a Reset
- More Regulation Going Forward
- Many New Opportunities for Growth

- How Is Your Portfolio Positioned for This?

Opportunities: Global Challenges

- As the Chinese say: Risk/Opportunity are Two Sides of the Same Coin – They are Linked
- Emerging Markets: High growth countries like China, India, Brazil, and others in Latin America, Asia, Eastern Europe, and Africa. Also have high risks.
- Borders disappearing – really! Declining transportation costs, increasing travel, cheap or free international communications; rise of the internet, etc. This creates both risks and opportunities
- Bio-Contagion: Bugs travel free – invasion by foreign flora and fauna; e.g., Asian carp in Lake Michigan, Fire ants in the mid-west, etc; HIV, Swine Flu, etc; Implications and opportunities for sterilization, containment, and destruction of bugs
Opportunities: Global Challenges (2)

- **Demographics**: Too many old people and not enough youngsters especially in industrial countries – rising life expectancies and declining fertility - problem most severe in countries like – Italy and Japan but others not far behind, e.g., US, Europe, and China. Young people will mostly be in emerging markets but will be needed in the Triad. Future growth in these countries likely limited by lack of human resources.

- This creates Opportunities for distance education, offshore jobs, and other young people needs; also need for offshore health care, travel, sports, entertainment, and for other old people needs

Opportunities: Global Challenges (3)

- **Warfare**: Many desperados always ready to fight; New forms like terrorism - gorilla warfare crosses borders; Opportunities in new more accurate weapons; Space warfare, Weapons detection and personnel screening; Facility and people protection; Financial controls; Internet attacks/defense, etc.

- **Pollution**: Gas emissions and other pollutants cross borders and cross oceans; e.g., Chinese pollution detected over US skies; International cooperation needed to control; expanding global market for pollution control
Opportunities: Global Challenges (4)

- **Sustainability**: Limits on trash dumps and resource availability; need to re-cycle; Driven by more than economics; Europe and CA in forefront; Huge opportunities in sustainability

- **Climate Change**: Too many green house gas (GHG) emissions; Global temperature rising; may or may not be connected but drivers are not just economics; Europe and CA at forefront; Huge opportunities in alternate energy, Carbon capture/storage; white roofs and parking lots, building insulation; etc.

Opportunities in Global Challenges

- Technology and Globalization are Mutually Reinforcing Obliterating Most Border Effects. This Opens Up Every Economy, Business, and Individual to Global Competition.

- Can be Challenging but Creates Many Global Problems that Require Solutions. As the Chinese say: Risk/Opportunity are Two Sides of the Same Coin. Many Opportunities Globally; especially in high growth emerging markets.

- How is your Portfolio Positioned to Gain From These Opportunities?
Approaches to Global Diversification

• I. **Asset Allocation** – How Much Global?

• II. **Four Approaches**
  Stocks Listed on Foreign Exchanges
  Foreign Stocks Listed/Traded in the US
  Global and International Mutual Funds
  US Multinationals
Why are Native-Americans Called Indians?

• In 1750, China and India each accounted for about 25% of global manufacturing output (together Chindia was 50%, and the global economic center)
• Then we had the Industrial Revolution and 250 years of European/US hegemony and Chindia, ruled by western powers, declined greatly
• In 1492, Columbus was looking for a shorter route to these rich eastern lands – so he called the natives he found after his long voyage – Indians!
• So, now I am a Cleveland Indian!?
Global Economic Architecture

How is your company positioned to take advantage?

Asset Allocation

• Asset allocation can reflect country shares of global markets. US Share of global markets declining; shares of emerging markets small but rising.
• Asset allocation can reflect country shares of economic growth – more in the rapidly growing markets of China, India, Brazil, etc.
• Can overweight selected high growth countries.
Stocks Listed on Foreign Exchanges

- Almost every country now has a stock exchange; but many are inefficient and can be manipulated by selected insiders.
- Difficult to follow foreign stocks – lack of comparable and sufficient information. Often huge differences in cultural, linguistic, legal and political systems.
- Custody and clearance of securities difficult and time consuming; brokerage costs for such transactions high.

Foreign Stocks Traded in the US

- Over 3200 foreign shares are traded in the US as ADRs on the NYSE, NASDAQ, OTC, and Private Markets (e.g., Sec. 144).
- Most information is available on Level I ADRs (NYSE or NASDAQ); less for Level II ADRs (OTC) and least for the others.
- About 400 Level I ADRs trade on the major US exchanges (NYSE or NASDAQ). These have appropriate Stock symbols etc.
3269 US ADRs for Each Country

US ADRs – Country Distribution
Global and International Mutual Funds

- Hundreds of mutual funds invest in non-US stocks and bonds (International) and in non-US and US stocks and bonds (Global).
- Many are closed-end (including ETFs) and so trade on stock exchanges like a stocks and have symbols. Others are open ended and must be purchased from the mutual fund or its representatives.
- Many are focused on a country or region while others have wider mandates.
- All provide professional managers who specialize in international investing, but at a cost (between 1% and 2% per year)
Profits from the Rest of the World/Total Corporate Profits (%), 1960-2008

Source: US Department of Commerce, Bureau of Economic Analysis

Foreign Sales of Selected US Companies-2009

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US Multinational Companies

- Many US companies obtain ever larger proportions of their sales and profits from outside the US. Buying their shares provides global diversification for a portfolio.
- Country distribution of investments by companies are not up to individual investors but is determined by senior corporate management.

Conclusions

- The recent great recession is likely to be long-lived and restructure the US economy
- While the US is expected to grow a bit faster than Europe or Japan, the greatest growth over the next 5-10 years is in Emerging markets like China, India, & Brazil; and over a longer horizon (10-15 years) in Africa and in selected countries in other regions.
- There are at least four major approaches to global diversification. Choice between them depends on investor knowledge and risk appetite.