

Bonus Chapter 1

Broadening Your Horizons: International Stocks

In This Chapter

- ▶ Boosting your success with international and emerging markets stocks
 - ▶ Understanding the risks and rewards of international investing
 - ▶ Discovering ways to invest in individual foreign stocks
 - ▶ Investing online in international stocks with mutual funds and exchange-traded funds
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Thanks to the Internet, it's just as easy to invest in a small company in China as it is to buy shares of a giant U.S.-based company like General Electric or Coca-Cola. Efficient trading systems plug you into global stock markets and let you pick and choose international stocks that can instantly broaden your portfolio.

The Internet has cracked open global investment opportunities to online investors. The change is truly a breakthrough. International investments offer the ultimate in *diversification*, allowing you to spread your money around the globe and reduce your risk. By diversifying with foreign stocks, you can protect your portfolio in case a problem hits U.S. markets. Although most markets are interconnected and big problems ripple through economies worldwide, international stocks tend to wiggle when U.S. stocks jiggle.

In this chapter, I show you the benefits and unique risks of international investing. You also find out the different ways to add international stocks to your portfolio. Finally, I point you to online resources to find international mutual funds and exchange-traded funds, which are very good ways to go global.

Why Investing in Foreign Stocks Is a Good Idea

Good old-fashioned domestic stocks are the cornerstone of a diversified portfolio. A mix of value-priced small and large company stocks, easily available by buying an index mutual fund or exchange traded fund (ETF), is a great place for beginning investors to start. But as you refine your portfolio and look to make it really sing, it's time to start adding different international and emerging markets stocks to the mix.

What are international and emerging markets?

To make sure we're talking about the same thing, I want to define what I mean by international stocks. (The emerging markets definition comes in a sec.)

International stocks: Shares of companies based in nations in the developed world that have advanced economies. That includes nations such as the United Kingdom, Japan, France, Germany, Switzerland, Australia, the Netherlands, Spain, Italy, Sweden, Hong Kong, Finland, Belgium, and others.



International stocks are tracked using *international market indexes*. Just as the Standard & Poor's 500 index tracks large U.S. stocks, international market indexes track international stocks.

One of the most popular international market indexes is the Morgan Stanley Capital International (MSCI) EAFE. This index, usually just called the EAFE, tracks stocks of companies from *European, Australasian, and Far East* markets, hence the name EAFE. MSCI Barra (www.msclub.com), the provider of the index, offers additional information about the index on its Web site.

Okay, time for my emerging markets definition.

Emerging markets. The up-and-coming nations that are rapidly expanding and experiencing robust economic growth. Generally, investors think of nations such as Brazil, China, Mexico, South America, and Taiwan as examples of emerging markets.



U.S. and international stocks have an index. Guess what? So do emerging markets. One of the most popular indexes of emerging markets stocks is the MSCI Emerging Markets Index. MSCI Barra's Web site (www.msclub.com) contains more information about its emerging markets index. Another emerging

markets index that's closely watched is S&P's BRIC 40. The S&P BRIC 40 (www2.standardandpoors.com/spf/pdf/index/BRIC_factsheet.pdf) tracks stocks of companies hailing from Brazil, Russia, India, and China.

Advantages to investing overseas

Trust me, figuring out these new market indexes and international stocks is worth the hassle. Adding a bit of foreign market exposure to your portfolio gives you two major advantages:

- ✓ **Turbo-charged growth:** If you're invested internationally and the economy sputters in the U.S., you still have a chance to enjoy growth overseas. This is especially true with emerging markets stocks. Developing nations like China and Brazil are so early in their maturity that they're growing much faster than the United States.

Greater growth in emerging markets translates into the potential for greater returns. Emerging market stocks can deliver huge returns over time. For instance, emerging market stocks gained 29.2%, 30.3%, and 22.4% in 2006, 2005, and 2004, respectively. That blows away the S&P 500's returns of 15.8%, 4.9%, and 10.9% in the same years.

Don't let the rapid economic and recent stock price growth of emerging markets intoxicate you. Emerging market stocks are very risky. Some academics consider emerging markets stocks to be some of the riskiest stocks you can buy. Putting all your money in emerging markets is a bad idea, just as putting your whole portfolio in U.S. stocks isn't optimum. Emerging markets can enjoy large returns, but they can swing wildly. Emerging markets stocks, for instance, fell 31.8% in 2000. Remember to keep your portfolio balanced and stick with your asset allocation plan.

- ✓ **Diversification:** It might seem crazy to load up on stocks of companies you've never heard of in countries you can barely find on a map. But the irony is that adding foreign stocks actually reduces your portfolio's risk.

Here's why: Foreign stocks don't move in lockstep with U.S. stocks. Sometimes when U.S. stocks are falling, foreign stocks don't fall as much, holding steady or even rising. You can find out how much foreign exposure is right for you by designing an *asset allocation*. You can read how to build the perfect asset allocation in Chapter 9.

Nearly all investors should have at least 10% exposure to international and emerging markets stocks. Many investors should have even more. Use the online tools in Chapter 9 to find out what percentage is right for you.



Where to find out more about international investing online

By now, you're probably ready to sign up for this international stock thing. But wait a second. Before you go any further, I want to give you the downside of being fully diversified. Just as foreign stocks can beat U.S. stocks, sometimes, the opposite also can happen. It's not unusual for foreign stocks to fall or lag behind domestic stocks in some years.

During times when foreign stocks are underperforming, they can drag down your overall portfolio. This is especially hard to take in years in which the major U.S. stock indexes like the S&P 500 are doing well. During those times, though, you'll have to resist the temptation to dump your foreign stocks. That's why it's best to use online resources to fully understand international investing. The following Web sites provide excellent global business and investing insights:

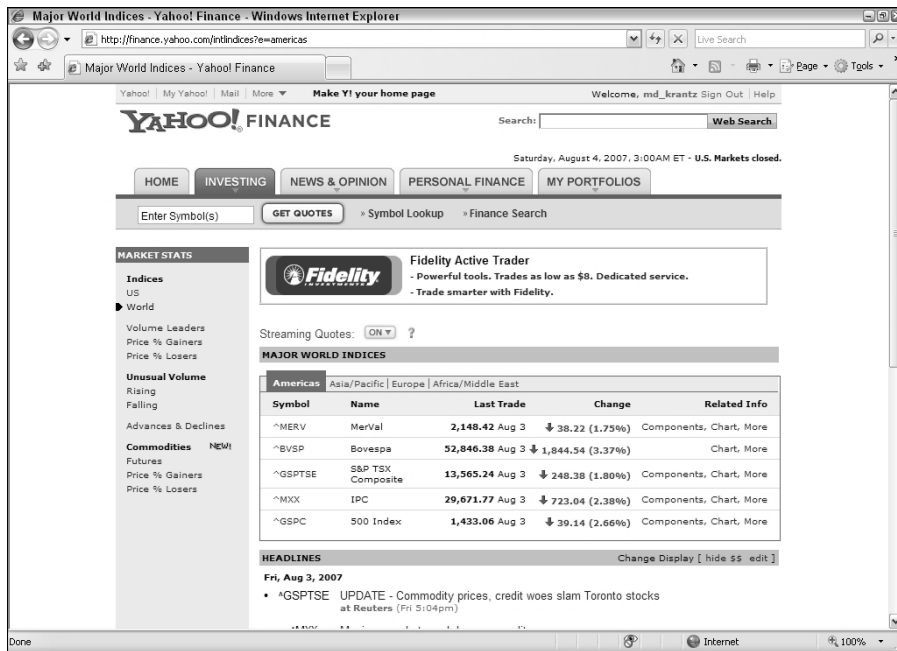
✔ **Yahoo! Finance:** (<http://finance.yahoo.com/intlindices?e=americas>) Yes, Yahoo! Finance has that international thing going, too. This part of the site lets you closely monitor daily movements of most international stock markets. You can check out daily closing values of major market indexes around the globe including the Americas, Asia/Pacific, Europe, and Africa/Middle East. Just click the region you're interested in, using the tabs under the Major World Indices heading. Figure BC1-1 gives you an idea of what the screen looks like.

In this area of Yahoo! Finance, you can see the name of different countries' stock market indexes and find out how much it rose or fell that day. To track long-term performances of these indexes, it takes only a couple of clicks. Just click the index' symbol in the list, such as ^MERV for the Buenos Aires' MerVal index. Next, click the Historical Prices link on the left side of the page, under the Quotes heading. The index' closing values going back for years pops up on your screen.

✔ **Historicalstatistics.org:** (www.historicalstatistics.org) This site houses a massive directory of market and economic resources for international investors. Just click the name of the country you're interested in on the left side of the page to call up a giant list of links to other Web sites with data and information about that country.

✔ **Economist Intelligence Unit:** (www.eiu.com) A research firm affiliated with *The Economist* business magazine, the Economist Intelligence Unit provides data and information about the economies of more than 200 countries. You must pay for most of the content on the site, but you can get some free insights if you click the Press Releases link on the left side of the screen. In the press releases area of the site, you can find summaries of international business studies the Economist Intelligence Unit has done.

Figure BC1-1: Yahoo! Finance lets you quickly scan foreign markets and see how stocks around the globe did.



- **International Monetary Fund:** (www.imf.org) The IMF offers detailed economic data about countries and provides comprehensive global data and statistics.
- **The World Bank:** (www.worldbank.org) The World Bank provides in-depth information not only about countries' economies, but also their political and social environments. These are also important considerations for investors, as I discuss at the end of the chapter when I mention risk.
- **Securities and Exchange Commission:** (www.sec.gov/investor/pubs/ininvest.htm) The SEC provides a complete guide to international investing that outlines the risks and rewards.
- **Global Financial Data:** (www.globalfinancialdata.com) An invaluable source if you're looking for very long-term historical data for investments in any country you can imagine, but you must pay for most of the data.
- **Bloomberg:** (www.bloomberg.com/news/worldwide) Bloomberg doesn't skimp when it comes to covering economic developments around the world. You can find numerous stories explaining how global market events can affect stock markets around the world, and Bloomberg's World Indexes section (bloomberg.com/markets/stocks/wei.html) lists daily performances of the world's major indexes.

- ✔ **Reuters:** (www.reuters.com/news/international) The venerable news service has a section of its Web site dedicated to international news and provides international markets news at <http://today.reuters.com/investing/worldmarkets.aspx>.
- ✔ **MSN Money:** (<http://ca.moneycentral.msn.com/investor/market/foreign.asp>) This corner of the MSN Money site shows you how major international stock markets and indexes are performing.
- ✔ **Economagic:** (www.economagic.com) Economagic collects economic data on most major countries. Economagic is also a helpful site when you're looking for information about the U.S. economy.

If you're relatively new to international markets, you might not be familiar with all the market indexes that track foreign markets. Table BC1-1 gives you an idea of some of the more popular foreign markets as well as the name of the index used to track them.

<i>Foreign Market and/or Index</i>	<i>Tracks Stocks In</i>
Bovespa	Brazil
CAC 40	France
DAX	Germany
FTSE 100	United Kingdom
Hang Seng	Hong Kong
MerVal	Buenos Aires
Madrid General	Spain
Nikkei 225	Japan
Seoul Composite	Korea
Shanghai Composite	China
S&P / TSX Composite	Canada

Taking the Plunge: How to Trade Foreign Stocks

Are you ready to add a little international flair to your portfolio? Now's the time to get the trades done online. I step you through the following four main ways to buy foreign stocks:

- ✓ **Investing directly through the foreign exchange:** If you want, you can instruct your online broker to buy the foreign stock directly from the foreign exchange that particular stock trades on. This might seem like the most direct way to buy non-U.S. stocks, but buying stock directly like this comes with serious headaches, including the need to convert your U.S. dollars into the local currency before the trade.
- ✓ **Buying American Depositary Receipts (ADRs):** Most of the larger foreign companies are available to U.S. investors as American Depositary Receipts, or ADRs. ADRs are shares that trade on a major domestic exchange that tracks the shares trading on the foreign exchange. If you buy an ADR, you indirectly own a share or a portion of a share of the foreign stock trading on the foreign exchange.
- ✓ **Buying an international mutual fund:** You can buy shares of an actively managed mutual fund run by portfolio managers trying to buy foreign stocks they expect to outperform. Or, you can buy an index mutual fund that tracks an international stock index, such as the EAFE. If you'd like to find out about how mutual funds work, check out Chapter 10 in the book.
- ✓ **Buying an international index mutual or exchange-traded fund (ETF):** Index funds and ETFs are baskets of stocks that track a particular market index. Several index funds and ETFs that are available can track international and emerging markets stocks. See Chapter 10 and 11 in the book to find out more about index mutual funds and ETFs.

Going direct: Buying foreign stocks from the local exchange

If you're interested in buying Japanese stocks directly from the Tokyo Stock Exchange or British stocks from the London Stock Exchange, some online brokers let you do so. Generally, you need to add what are called *global* trading privileges to your existing account. For instance, E*Trade lets you add global trading privileges by clicking a link from the main account screen. (E*Trade's page at <https://us.etrade.com/e/t/welcome/globaltrading> provides instructions on how to add this capability to accounts in case you're interested.) E*Trade allows customers to buy stocks in six markets including Canada, France, Germany, Hong Kong, Japan, and the United Kingdom.



Buying foreign stocks directly from the local exchanges isn't usually a good idea. You may need to convert your dollars into the local currency, a transaction that will cost you fees from the start. Making direct foreign purchases even less attractive is the fact most brokers charge higher commissions for this service.

Going the ADR route to invest internationally

If you're interested in owning shares of a large, well-known foreign company, chances are good that you can buy an American Depositary Receipt. ADRs are created by large financial institutions that buy the foreign stocks directly from the overseas market and bundle them into a package you can buy on a U.S. market. ADRs are convenient because you can buy them using your current online brokerage account just as you'd buy any other stock. You can buy ADRs using U.S. dollars. JP Morgan's ADR.com (www.adr.com) provides data on ADR prices and also a glossary and other research tools.

Roughly 1,600 ADRs are available on U.S. exchanges, says S&P's Capital IQ. Table BC1-2 lists some of the largest foreign companies available as ADRs.

Table BC1-2 Large Foreign Companies Available as ADRs		
<i>Foreign stock</i>	<i>Symbol</i>	<i>Industry</i>
PetroChina	PTR	Oil and gas
Royal Dutch Shell	RDS-B (symbol might vary by broker)	Oil and gas
China Mobile	CHL	Wireless telecom
BP	BP	Oil and gas
HSBC Holdings	HBC	Financial
Toyota	TM	Automaker
BHP Billiton	BHP	Metals and minerals
Vodafone	VOD	Wireless telecom
Petroleo Brasileiro	PBR	Oil and gas
Glaxosmithkline	GSK	Pharmaceuticals

Source: Standard & Poor's Capital IQ



The convenience of ADRs comes with a price. The financial institutions that create ADRs charge fees for their services. The fees vary and are deducted automatically from dividends you would have received from the companies. Before buying an ADR, be sure you understand how much you're being charged.

Opting for an international mutual fund

In many ways, mutual funds were created for investing in things like international and emerging markets stocks. Buying a mutual fund that owns international stocks lets you bypass many of the hassles in dealing with foreign currencies. You won't even have to worry about locating sometimes hard-to-find information about foreign companies.

You can buy an actively managed international mutual fund and hope the portfolio manager is able to find the best foreign stocks. The other option is to invest in an international index fund, which owns a basket of foreign stocks as directed by an international index such as the EAFE.

You can find international mutual funds using the mutual fund-screening tools discussed in depth in Chapter 10 in the book.



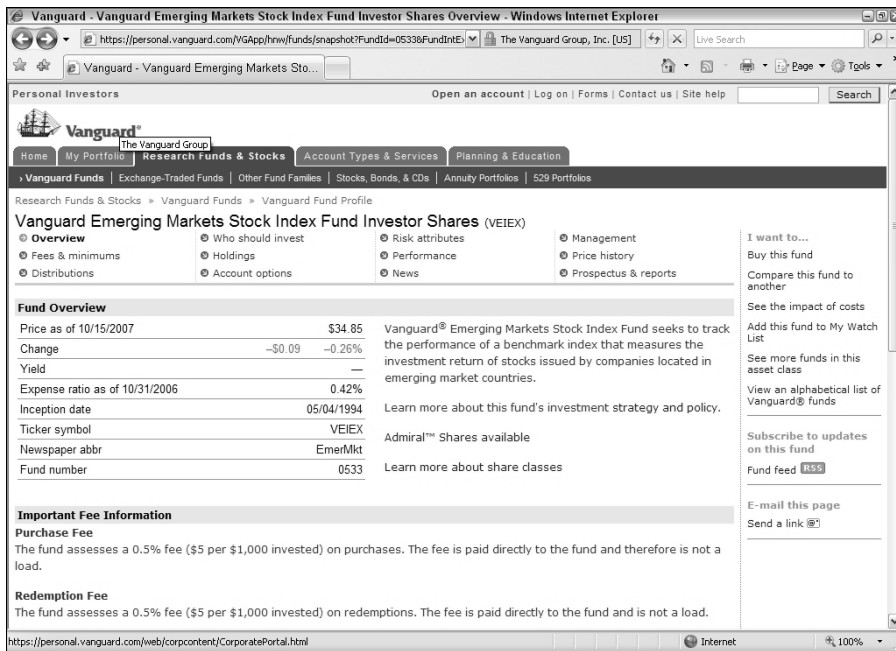
If you're looking for a low-cost index mutual fund that will expose you to international stocks, you might consider Vanguard's Developed Markets Index fund (symbol: VDMIX). It tracks the MSCI EAFE index and comes with a reasonable 0.27% expense ratio. If you'd like to buy just value-priced international stocks, Vanguard's International Value fund (symbol: VTRIX) will give you what you're looking for at a 0.45% expense ratio. Be sure you hold these funds for more than two months, though, or you'll get hit with a 2% redemption fee.

If you're looking for emerging markets, consider the Vanguard Emerging Markets Stock index (symbol: VEIEX, see Figure BC1-2). The fund's 0.42% expense ratio is one of the lowest you'll find. Just remember that there is a 0.5% purchase fee and a 0.5% redemption fee. And this fund, as well as many of Vanguard's international funds, have minimum initial investments of \$3,000. If you don't have that much to invest or if the redemption fees are a turn-off, you can consider investing in foreign stocks using ETFs, as explained in the following section.



International funds often charge higher fees than U.S. stock funds. Expense ratios of 1% or more are fairly common with actively managed international funds. International index funds often charge 0.5% or so.

Figure BC1-2: Vanguard's Emerging Markets Stock Index Fund will expose you to scores of companies based on some of the fastest-growing countries in the world.



Going international with ETFs

ETFs are extremely popular with investors who already have an account set up with an online broker. ETFs are mutual fund–like baskets of stocks, which you buy just like you’d buy an individual stock. You can find out more about ETFs and how they can add instant diversification to your portfolio in Chapter 11 in the book.

ETFs really shine when it comes to international diversification. Many international mutual funds have pricey expense ratios or strict restrictions. Even many of Vanguard’s international mutual funds require \$3,000 initial investments and charge fees if you sell the fund in less than two months.

ETFs are great ways to avoid these issues. You have many international and emerging markets ETFs to choose from, most with very low fees. And if you choose an online broker with no minimum deposit and low commissions, as described in Chapter 4, you can start building an international portfolio with very little upfront cash.

All the ETF screening tools discussed in Chapter 11 in the book can help you find the international ETF that’s right for you.



If you're looking for diversified international ETFs, look for ETFs with names that include "international" or "emerging markets." You can slice your international investment into finer pieces by investing in specific countries' companies, if that appeals to you.

Because you have so many choices, Table BC1-3 shows you some of the largest international ETFs, and Table BC1-4 shows some options for emerging markets ETFs.

Table BC1-3		
Select International ETFs		
<i>ETF Name</i>	<i>Symbol</i>	<i>Expense Ratio</i>
iShares MSCI EAFE Index Fund	EFA	0.35%
iShares MSCI EAFE Value Index Fund	EFV	0.4%
SPDR MSCI ACWI ex-US ETF	CWI	0.35%
Vanguard FTSE All-World ex-US	VEU	0.25%
Vanguard Europe Pacific ETF	VEA	0.15%
WisdomTree DEFA Fund	DWM	0.48%

Source: ETFConnect.com

Table BC1-4		
Select Emerging Market ETFs		
<i>ETF Name</i>	<i>Symbol</i>	<i>Expense Ratio</i>
iShares MSCI Emerging Markets Index Fund	EEM	0.75%
Vanguard Emerging Markets	VWO	0.3%
SPDR S&P Bric 40	BIK	0.5%
SPDR S&P Emerging Markets	GMM	0.6%

continued

Table BC1-4 (continued)

<i>ETF Name</i>	<i>Symbol</i>	<i>Expense Ratio</i>
BLDRS Emerging Market 50 ADR Index	ADRE	0.3%
WisdomTree Emerging Markets High Yield	DEM	0.63%

Source: ETFCconnect.com

Understanding the Unique Risks of Investing Internationally

By now, you probably see why international investing is such a good idea. And thanks to mutual funds and ETFs, adding international exposure to your portfolio is as easy as buying a U.S. stock. I want to impress upon you, though, that foreign investing comes with some unique risks. None of the risks are deal killers, but they're still important for you to be aware of, including the following:

- ✓ **Currency risk:** When you invest in foreign countries, you're taking on a hidden risk: exposure to rising and falling values of foreign money. When you invest in a company in a foreign country and the value of that country's currency rises, that makes your investment worth more. Why? When you sell the investment or get dividends, you receive money in the foreign currency. But you can't buy food or pay the rent with the foreign currency. You need to turn those dividends and payments back into U.S. dollars. To get dollars back, you must use the foreign currency to buy dollars. If that foreign currency rises in value compared to the dollar, you can buy more dollars, which boosts your return. Unfortunately, though, the opposite can happen, too. If the foreign currency declines in value, your returns take a hit when you buy dollars.



Oanda.com (www.oanda.com) is a helpful online resource to find out more about currencies and exchange rates. Under the Currency Tools heading on the left side of the screen, you can find online calculators that convert one currency into another and compare the values of hundreds of currencies. You can also download long-term exchange rate data by using the FXHistory link.

- ✓ **Political risk:** An emerging nation might be a safe and stable place to invest until a new regime is voted into power. Practically overnight, a nation can go from being a welcoming place for outside investors to



being both hostile and destabilized. There's also the risk of civil unrest and war, which can greatly affect the value of your investment.

- ✓ **Regulatory risk:** Some foreign countries don't have the same level of regulatory and financial oversight over companies doing business in their borders than the developed world does. Accounting rules, for instance, might be more lax in some countries, which might increase the chances of fraud.

Many foreign firms are required to file financial reports with the SEC. It's always a good idea to check to see whether a foreign company has filed regulatory reports before investing in it. (Chapter 2 in the book explains how to look up a company's regulatory filings online.) Look closely to see whether the company has filed a form called the 20-F, which contains its full-year performance and is one of the more complete reports foreign companies file. The SEC provides a full list of the forms some foreign companies must file at www.sec.gov/about/forms/secforms.htm#intl. For more information on international securities regulation, the International Organization of Securities Commissions (www.iosco.org) is a good resource.

- ✓ **Tax risk:** The taxation of foreign investments is a complicated area. First, most foreign countries tax corporate profits and dividends paid to investors, just as the U.S. does. Those tax rates might be higher or lower than U.S. tax rates. Furthermore, the tax due by foreign governments is usually taken or *withheld* from any money due to investors, such as a dividend. For instance, if an ADR pays you a \$1 a share dividend, you might receive only 90 cents after a 10-cent-a-share withholding is subtracted. The institution that creates the ADR might also charge a fee to pay the taxes to the foreign government.

The U.S. government might also tax your gains from international investments. And for many taxpayers, the U.S. tax rate charged on dividends received by foreign companies will be higher than the tax charged for dividends paid by U.S. stocks. Luckily, the Internal Revenue Service allows taxpayers to take a foreign tax credit to help defray these taxes.

If you're interested in how foreign investments are taxed, check out TurboTax's page on the foreign tax credit and how to claim it on your tax form at www.quicken.com/cms/viewers/article/taxes/53458. The Internal Revenue Service provides information as well at www.irs.gov/businesses/small/international/article/0,,id=97060,00.html.

