AN *e*-BURST OF INSPIRATION FROM THE BEST BOOKS

Tom Lydon

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FINANCIAL TIMES

Taking Advantage of International Investment Opportunities

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Countries around the world have had their share of economic prosperity and challenges that spill into both domestic and global markets. Peaks and valleys, expansions, and recessions are usually clearly defined and cyclical in nature.

You eliminate or minimize exposure to these countries in your portfolio to your own detriment, though, because nearly 70% of the global market capitalization is outside the United States. The United States still has a major portion, but both developed and emerging markets are increasingly seeking their piece of the pie.

Trade, currency, and economic issues all affect companies in different ways. Over time, countries encounter both challenges and opportunities that have positive as well as negative effects on their markets. Rarely do all countries and global regions enjoy prosperity at the same time and economic challenges at the same time. By identifying countries that are prospering during periods when their markets are trending in the right direction, investors have opportunities to diversify their portfolios and profit outside domestic markets.

As a result, some countries can be thriving while others are struggling. An increasingly global economy has made many countries dependent on one another in some way. That being said, opportunities can be found in all corners of the world, whether in a country that's

firmly established and operating or a country that's just gaining access to the technologies that will help it to grow.

In 2008, the United States had 29.9% of the global market cap, down sharply from the 43.7% it enjoyed in 2004. We can expect to see this number continue to shrink as more countries emerge and become serious players. Japan is second, at 8.2%; the United Kingdom has 6.8%; and China, an emerging market, has 5.4%. Other countries have a very small percentage of the global market cap—for example, Saudi Arabia had 0.9% in 2008. However, that's an 877.5% increase since 2004. Egypt had 0.2% in 2008, up 561.6% since 2004. This should tell you two things: The United States is not ruling the global economy as much as it once was, and other countries are growing at a blistering pace.

The argument between whether one should invest in a developed market or a frontier market resembles the "growth versus value" debate. Developed markets are already established and thriving, and they probably won't get much more powerful than they already are. However, frontier markets are starting at practically ground zero. If they are successful, they could deliver outsized returns.

Global markets offer investors the chance to access growth in other areas when domestic markets are weak. With some exceptions (most notably, the 2008 crisis), when things were solid in the United States, global markets were thriving, too. In 2005, returns in foreign developed markets in Asia, Latin America, and Europe soared and outperformed domestic markets, as shown in Table 1.

Table 1 Returns of Various Markets in 2005

United States	5.4%
Britain	14.1%
Canada	22%
Japan	36.9%
France	23.8%
Germany	22.9%
Hong Kong	4.2%
Switzerland	31.5%
Australia	17.1%

To invest in foreign markets, you can carve out regional markets and country-specific markets that operate on their own individual trends.

Emerging Markets

You can't blame investors for being drawn to international investments. As technology and money spreads around the world, it gives once far-flung and removed economies a chance to participate in a global boom.

Emerging markets have offered tremendous profits (and headaches) over the years. They're attractive because, as much as they're growing and as rapidly as they're growing, they've got even more room to expand. Popularity in overseas investments especially surges when things on the home front aren't so sweet and profits in other countries are. But to consider these areas of the world as only "fair-weather friends" is folly because they have a lot to offer in any kind of climate.

What is an emerging market? Definitions tend to vary, but often emerging markets are considered such because of their developments and reforms. China, an economic powerhouse, is still lumped into the emerging category because it's still working on reforms and policies. China is a country very much in transition, a hallmark of any emerging economy. You're probably not going to see Britain making too many

drastic changes to its economic policies, but this kind of thing is *de rigueur* in emerging markets.

Among the best-known emerging markets are the BRICs, a group of four powerhouse economies: Brazil, Russia, India, and China. The name emerged from a Goldman Sachs report in 2003 that speculated that, by 2050, these four economies would be wealthier than most major economic powers.

Smaller than emerging markets are frontier markets, which occupy the farthest reaches of the emerging-markets universe. Countries such as Vietnam, Thailand, and Zimbabwe occupy this space. These world markets are often in a state of political upheaval, often with sky-high inflation, very weak currencies, and markets that are heavily subject to local whims and prejudices. They offer high reward potential, but as you know by now, that comes with high risk.

From 2002 to 2007, the average diversified emerging markets stock fund gained about 25% annually. Comparatively, the Dow Jones Industrial Average returned around 5% a year during this same stretch. And in 2006, when the S&P chalked up 15.8%, emerging markets equities generated nearly twice those gains (see Table 2). Before that period, emerging markets were a little topsy-turvy, as shown in Figure 3.

Table 2 Best-Performing Emerging Markets, 2004–2007

Region	3-Year Gains, Annualized
Latin America	39.5%
Eastern Europe	34.6%
BRIC (Brazil, Russia, India, and China)	33.0%
Middle East	27.0%
Asia	18.8%
Overall emerging markets	24.9%

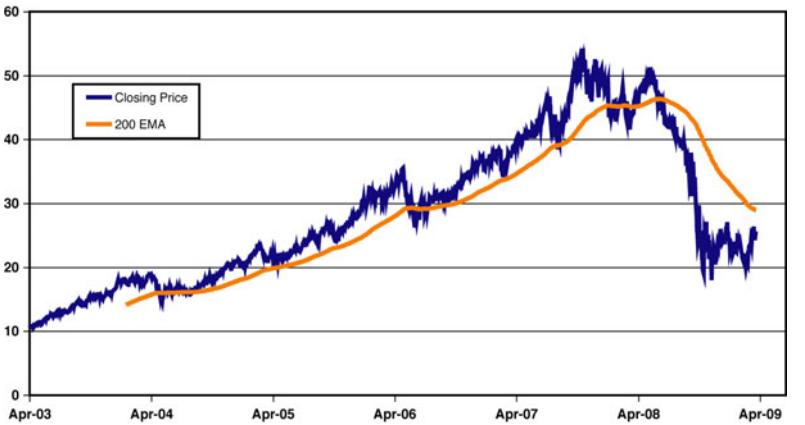


Figure 3 *iShares MSCI Emerging Markets (EEM) with 200-day moving average, 2003–2009*

Investing in Emerging Economies

The benefits of using a trend following strategy to access the fits and starts of emerging markets should be clear by now. No emerging economy is on a steady growth path, which is why the strategy makes even more sense here. You can use it to spot waves as they appear and to hop off as they peter out. Emerging markets are just that: emerging. For that reason, they provide opportunities not seen in developed markets.

They tend to be more volatile, there's more potential on the upside and, as you can see in the example of China, the downside can be even more devastating. Having an entry and exit strategy can help get you in and out of these exciting markets at more desirable times.

International ETFs

International Exchange Traded Funds (ETFs) are among the most popular and versatile funds in the ETF arena. Depending on the level

of exposure you'd like, you have a number of choices: regions, countries within a region or group (think BRICs), or a single country.

Whether you want exposure to an established market or one in its infancy, you can use ETFs in two common ways:

- Target a specific emerging market with a single-country fund, which can potentially deliver higher volatility but greater rewards when that country does well.
- Choose a region or class of emerging markets with a broad-based fund, which spreads the risk and volatility over several emerging-market countries.

Developed Markets

Developed-market ETFs can help provide some stability to an ETF portfolio. As I've said, these countries are well established and aren't looking for explosive growth. But on the flip side, catastrophic declines are unlikely, making their risk lower than that of a frontier market fund.

The fund types are similar to that of emerging markets: all-encompassing funds, regional funds, and single-country funds. One of the broadest funds available is the BLDRS Developed Markets 100 ADR (ADRD) (www.adrbnymellon.com/bldrs_overview.jsp), which has weightings in the United Kingdom, Japan, France, and Switzerland. The Claymore/Zacks Country Rotation (CRO) (www.claymore.com) is made up of 200 stocks selected from a universe of international companies listed on developed international exchanges. Country exposure includes Australia, Singapore, Spain, and Sweden.

Funds with more regional developed market exposure include:

- **iShares S&P Europe 350 (IEV)**—Tracks the S&P Europe 350 Index. Its top country weightings are the United Kingdom, France, and Switzerland. (www.ishares.com)

- **PowerShares Dynamic Europe (PEH)**—Tracks the QSG Active Europe Index. Its top country weightings are the United Kingdom, France, and Italy. (www.invescopowershares.com)

As with emerging market ETFs, some funds provide access to a range of developed markets, including these:

- **iShares MSCI Japan (EWJ)**—Tracks the MSCI Japan Index. Its top holdings include Toyota, Mitsubishi, and Takeda Pharmaceutical.
- **iShares MSCI Canada (EWC)**—Tracks the MSCI Canada Index. Its top holdings include Encana Corp (ECA), Royal Bank of Canada (RY), and Barrick Gold (ABX).
- **iShares MSCI Australia (EWA)**—Tracks the MSCI Australia Index. Its top holdings include BHP Billiton and Commonwealth Bank of Australia.

Emerging Markets

One of the simplest ways to access emerging markets is through all-encompassing ETFs such as the iShares Emerging Markets Index (EEM), which delivers exposure to countries such as Brazil, Taiwan, South Korea, South Africa, Israel, Turkey, Hungary, and China.

If you'd like to target a region, you can do this with funds such as the WisdomTree Middle East Dividend (GULF) (www.wisdomtree.com), SPDR S&P Emerging Europe (GUR) (www.spdretfs.com), PowerShares MENA Frontier Countries (PMNA), or SPDR S&P Emerging Asia Pacific (GMF).

The BRIC region has several ETFs available for investors to gain exposure. Among the most popular BRIC ETFs are:

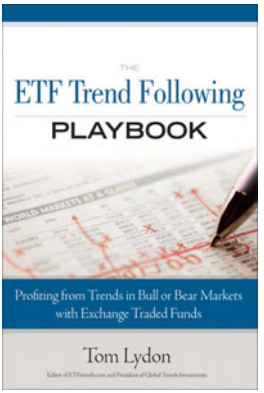
- **Claymore/BNY BRIC (EEB)**—Tracks the New York BRIC Select ADR Index. Its top holdings include China Mobile Limited (CHL), Companhia Vale (RIO), and Brazilian Petroleum Corporation. (www.claymore.com)

- **SPDR S&P BRIC (BIK)**—Tracks the S&P BRIC 40 Index. Its top holdings include China Mobile, Gazprom, and Brazilian Petroleum.
- **iShares MSCI BRIC (BKF)**—Tracks the MSCI BRIC Index. Its top holdings include China Mobile, Gazprom, and China Life Insurance.

How do you choose a fund? If you look under the hood, you'll see that countries within each fund have different weightings. If you'd like more access to, say, China, you might be interested in BIK because it states a 42.8% weighting. If you'd like more Brazil, you'd be interested in EEB, which has a 49.4% weighting for that country.

If you really want to focus on a single emerging market, dozens of funds are available to do this, including:

- **Market Vectors Russia (RSX)**—Tracks the DAXglobal Russia+ Index. Its top holdings include Mobile Telsys, Surgutneftegas, and Vimpel. (www.vaneck.com)
- **iShares MSCI Thailand (THD)**—Tracks the MSCI Thailand Index. Its top holdings include Bangkok Bank, Siam Cemebt, and Kasikornbank.
- **iShares MSCI Israel (EIS)**—Tracks the MSCI Israel Index. Its top holdings include Check Point Software Technology, Israel Chemicals, and Teva Pharmaceutical.
- **Market Vectors Indonesia (IDX)**—Tracks the Market Vectors Indonesia Index. Its top holdings include Bank Mandiri, Bank Rakyat Indonesia, and Unilever Indonesia.



If you liked this Element, you might like the book by Tom Lydon, *The ETF Trend Following Playbook: Profiting from Trends in Bull or Bear Markets with Exchange Traded Funds* (ISBN: 978-0-13-702901-3).

FT Press
FINANCIAL TIMES
Delivers

Vice President, Publisher: Tim Moore
Associate Publisher and Director of Marketing: Amy Neidlinger

Publishing as FTPress Delivers
Upper Saddle River, New Jersey 07458

ISBN-10: 0-13-706885-9
ISBN-13: 978-0-13-706885-2

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