

**THE GLOBAL INVESTORS**



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No one knows who was the first investor to risk his hard-earned capital beyond the boundaries of his own culture or nation, but we can be pretty sure about his motivations, since savvy investors always seek new and better ways to maximize their returns. Though international equity investment is relatively new, its roots in international commerce go back thousands of years.

Even the discovery of America was the result of intrepid international risk-taking. Contrary to myth, Columbus did not sail west merely to prove that the earth is round. Like many great explorers, he sought fabulous riches and found them.

As Thomas Saylor has written in his book entitled, *All About Global Investing*: "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 serendipity in recorded history. The entirely unintended discovery of 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 millennium."

Investors still look to the Far East and Asia in particular, for exceptional investment opportunities. With Asia's prodigious demand for infrastructure, communications, energy, health services, banking and every imaginable type of consumer good or service, Asia's commercial unfolding will perhaps be the world's single greatest economic development in the 21<sup>st</sup> Century. Enormous fortunes will be made as investors worldwide seek to profit, and a quarter of the world's population gets its first taste of capitalism. History is replete with the stories of men and women who ventured into uncharted waters and over distant lands in search of greater wealth.

In a publication entitled, *The Global Guide To Investing*, the editors of *London's Financial Times* describe the historical fascination with opportunity overseas. "The great trading cities of Alexandria, Constantinople, Samarkand and Beirut had their origins in pre-Christian times and became successful

through international trade and commerce, fostered by the investment of the merchant classes. The attendant risks and rewards were sometimes astronomical. A Genovese merchant financing a ship with a cargo of spices from East Africa could make a princely fortune if the ship returned safely, or alternatively, lose everything if it did not."

National boundaries have rarely been an effective barrier for investors who aggressively seek the greatest use for their capital. As the investment writer Adrian Day notes; great venture capital success stories like that of Sir Francis Drake have also had profound social and geopolitical consequences.

"A little over 400 years ago, in 1580, Francis Drake returned to London from his circumnavigation of the globe. He brought back with him a large cargo of gold, silver, diamonds, emeralds and spices. His backers, including Her Majesty Queen Elizabeth I, were probably the most successful investment syndicate in British financial history, earning a return of 4,700 percent. The impact of the voyage was tremendous; it eventually helped change the balance of power among the European nations. It laid the foundation for England's first empire in India, the Americas and Southern Africa. It rescued the government from a longstanding financial crisis and transformed the English economy. It boosted the fledgling capitalist system in England. And not least, this event was as John Maynard Keynes put it, the origin and fountain of all British foreign investment."

"Drake's methods are no longer available to us, but the opportunity for imaginative foreign investment remains. Just as Drake found some new addition to his treasure store on every step of his circumnavigation, so, too, can we discover some attractive investment opportunity in every corner of the world."

A fear of loss deters many investors from venturing beyond their own borders. But the great global investors accept, and even embrace, the risks of foreign markets; and they avoid what they perceive a far greater risk, that of missing the many opportunities available to those with a worldwide perspective.

Adrian Day makes a compelling argument for broadening your investment horizons in his book, *Investing Without Borders*. "It's no more logical for an American to look for values in America alone than it would be for a Swiss to look just within the borders of that small country. The Swiss don't limit themselves, and neither should you as an American. It's no more logical to invest only in America than it would be for me to invest only in Washington, D.C. just because I live there. Each is an equally arbitrary political jurisdiction. If you watch only the U.S. securities or real estate markets, you'll find genuine buying opportunities presented only several years as a cycle bottoms. But if you're watching those markets in 50 different countries, you'll be offered 50 times the chances to buy at the bottom and you'll see cyclical opportunities every few months. With such a large number of situations begging, you can afford to pick only the choicest ones which show promise of the greatest reward and least risk."

With about seven thousand publicly traded companies in the U.S., nobody can possibly know enough to take full advantage of all the opportunities in the U.S. alone. Furthermore, U.S. financial markets are among the freest, fairest and most accessible in the world. By contrast many overseas markets are less liquid, less regulated and often quite volatile. Given the assurances and opportunities available in the U.S., why bother to risk investing elsewhere? Both research and experience have shown that global investing increases opportunities, enhances returns and diversifies risk.

But there's another reason as well. The 21<sup>st</sup> century promises to be one of the world's most exciting eras for global investment. Diego Vatia, chairman of the global money management brokerage firm, International Assets, describes the outlook for global economic progress: "There are many exciting developments taking place around the world today. Communism and tyranny are being replaced by democracy. Central planning and other Marxist tenets are being replaced by capitalism. State controlled corporations are being privatized and forced to compete in a free market environment. Taxes, tariffs and

regulations are being brought down around the globe. These factors should dramatically increase prosperity in Europe, Japan, Latin America and Asia. In our opinion there has never been a better time to diversify investments around the globe."

Many observers share this optimism about our historical moment and the performance of international stock markets over the past generation makes a strong case for global diversification. The Morgan Stanley Capital International Index is an index of 21 stock markets, including Japan and most of the developed markets in Europe and elsewhere in Asia. This index posted a 15.1 percent compounded annual return for the 25 years after its inception in 1970.

This was nearly half again as good as the S&P 500's return of 10.7 percent during that period. In dollar terms, 13 of the 21 markets in this index outperformed U.S. markets over the period, sometimes by substantial margins. The one example, the Japanese market between 1948 and 1993 gave 20 times the return of the S&P 500. But perhaps the most surprising aspect of international investing is that it has outperformed the U.S. while also reducing overall portfolio risk. Financial markets in various countries often march to the beat of their own economic drummer. And a globally diversified portfolio can smooth the bumps found in geographically concentrated investments.

Jeremy Siegel's book on historical stock market performance, entitled *Stocks For the Long Run*, succinctly summarizes what institutional research has often concluded. " International equities must be part of any long-term portfolio of common stocks. This is not because foreign stock returns are likely to be greater than returns in the United States, although they may, but because foreign equities enable stockholders to diversify their risks far more effectively than portfolios containing only domestic securities. Although it is very difficult to motivate most investors to put this high a percentage of their stock portfolio into foreign stocks, slightly over one-half of a dollar investor's portfolio should be in foreign equities."

If these findings surprise us, perhaps it is because American attitudes can be a bit provincial. Living in the world's largest and most prosperous country, surrounded by two friendly neighbors and two vast oceans, Americans may be just insulated enough to believe that the financial sun rises over New York and sets in Los Angeles. Of course it doesn't. What's more, the U.S. market increasingly represents a smaller piece of the global pie. Back in 1970, the U.S. stock market made up over 65 percent of the world's total stock market capitalization. By 1995, it was less than 35 percent. The fall of Communism has let democracy and capitalism boom around the world, and many exciting investment opportunities now lie outside the United States.

Surveys show that most Americans have not diversified their investments internationally. Even those who have diversified typically hold only a small percentage of their assets in foreign stocks and bonds. Much of this may be caused by a lack of awareness or familiarity with other markets, but the overriding reason is probably that many U.S. investors assume international investing to be too risky.

Investment advisor and writer, Jim Rogers, puts it this way: "Even the most serious investors sometimes grow panicky at the idea of investing overseas. I guess that for some people the whole idea just seems, well, too foreign. But the truth is that it's not really that difficult to develop a workable strategy for overseas investment."

John Desauer, a global money manager and editor of the investment newsletter, *Investor's World*, advocates a worldly perspective in his book entitled, *International Strategies For American Investors*.

"Following stocks in Germany or Japan is really no different from following stocks in the United States. The basic rules are the same. The economic fundamentals that move stocks in Europe are the same as those that move markets in the United States. Money now flows freely from one market to another. Satellites and computers provide instant worldwide quotations. The

days when investors could focus on familiar home markets and feel secure are gone. No investor can afford anything less than an international perspective."

Technology is indeed making the world a smaller place. Satellite communications transmit news as it breaks virtually anywhere in the world, and U.S. investors can respond more quickly to events in foreign markets. This is especially important because the world's rapidly growing economies, and many of its most powerful and competitive companies, reside outside the U.S. For example, if a U.S. investor in 1966 had ignored international investments entirely he would have overlooked all ten of the world's ten largest construction companies, all ten of the world's ten largest banking companies, eight of the world's ten largest chemical companies, eight of the ten largest machinery and engineering companies, and seven of the ten largest automobile companies. This access to more and often greater opportunities is a compelling part of the rationale for global investment.

Another reason is diversification. John Templeton, founder of the Templeton Group of Mutual Funds, emphasizes the counter-cyclical nature of the world's financial markets. "Bull and bear markets are a continuing fact of life for all nations, but often not at the same time. Therefore, the investor who has diversified across many nations may not suffer the shrinkage in market value that afflicts investors in a single nation."

His sentiments are echoed by Jim Rogers. "You already know you shouldn't load up your investment portfolio with stock in just one company, thereby putting all of your eggs in one basket. So why, following the same logic, would it make sense for you to hitch your personal fortune to one national economy?"

This is particularly true when you recognize that so much of an American's financial well-being is already tied to the domestic economy. The income of an American working in the U.S. usually depends to some extent on the strength of the U.S. economy. His or her purchasing power is largely determined by local prices and the value of the dollar. And the prices of property holdings also are

greatly affected by U.S. inflation and interest rates. This subjection of income, purchasing power, and standard of living makes it a compelling alternative to diversify investments outside the U.S.

Of course, global investing does involve peculiar risks. For starters, information on foreign companies is harder to come by. Many corporations headquartered overseas feel no obligation to send annual or quarterly reports to foreign shareholders. And what you do get may be written in a foreign language. There also is the potential for liquidity problems. Not all foreign stocks can be bought and sold as readily as those on the New York Stock Exchange. This can make it harder to establish an investment position, and to get out of one.

Another consideration is foreign currency risk. When the investor keeps score in dollars he has to consider gains or losses of the currency in which a foreign stock is denominated. Historically an important advantage of foreign stocks was in hedging against a decline and the purchasing power of the currency in one's own country. Yet short-term movements in the currency markets are largely unpredictable and they can substantially diminish or improve the dollar value of foreign investments.

International investors also must consider differences in laws, taxes, transaction costs and accounting methods. As reported in the book entitled, *Global Investing the Templeton Way*, John Templeton describes the challenges of analyzing foreign companies. "The substantial differences in reporting criteria and timing of releases by corporations add to the complexity of comparative investment analysis. For example, some Swiss corporations do not consolidate their financial statements. Long-term financial leases are not capitalized by most European companies. In France there's no provision made for uncollectible accounts. In West Germany the emphasis in corporate financial reporting is on understating earnings, and unless major adjustments are made the unwary investor is likely to significantly undervalue West German stocks. To

approximate American-style earnings per share analysts have to make some 70 adjustments to the typical West German annual report."

John Templeton's experience shows that high returns on foreign stocks can come in the most unusual circumstances. For example, products made in Japan just after World War II were considered mostly junk; "made in Japan," was considered the trademark of an inferior product. But in retrospect, Templeton's investment in Japanese stocks at that time was a stroke of genius. The Tokyo market soared. Investments also held up in war-ravaged Germany, both during and after World War II.

According to Jeremy Siegel, "In the 12 years from 1948 to 1960, German stocks rose by over 30 percent per year in real terms. Indeed, from 1939, when the Germans began the war in Poland, through 1960 the real return on German stocks nearly matched those in the United States, and exceeded those in the United Kingdom. Despite the total devastation that the war visited on Germany, the long-run investor made out as well in defeated Germany as in Victoria's Britain or the United States. The data powerfully attest to the resilience of stocks in the face of seemingly destructive political, social and economic changes."

If the challenges of investing abroad seem daunting to some U.S. investors, they might find it wise to invest through an international mutual fund, or to use a money management firm specializing in global investing. Newsletters and publications that monitor international opportunities also can be a valuable resource.

Whatever strategy you may choose, a good starting point for international investing is to study the methods of the world's best global investors. Some of them, such as John Templeton and George Soros, have become international household names. While their individual techniques are varied, their premise is consistent and clear: superior returns can be achieved by removing the geographical restrictions to opportunity.

If there is one man in modern history who can rightfully be called the father of global investing it is John Templeton, founder of the Templeton Group of Mutual Funds. Even after retiring from day-to-day management of the funds that bear his name, Templeton's name remains virtually synonymous with global investing, and for good reason. His investment approach has been fantastically successful. If you had invested \$10,000 in his flagship Templeton Growth Fund at its inception in 1954, it would have been worth over 2.8 million dollars by 1996, 42 years later. By contrast, a savings account would have compounded to only \$48,600, U.S. bonds would be worth \$107,000, and a portfolio comprised of the Dow Jones Industrials compounding at slightly below 11 percent per year, would have grown to \$771,000, about one-fourth the value of the Templeton Growth Fund.

The kindly-looking elder statesman with snow-white hair and dignified bearing, describes the basis of his philosophy: "Despite the vast array of investment opportunities, many investors, professional and otherwise, never look beyond the confines of their own country's borders. They limit their analysis and selection to domestic instruments, missing the rich opportunities for portfolio diversification, superior returns and risk reduction through international investment. And those investors who do venture into the international arena are often discouraged when they discover that their broker or security advisor may know less than they do about foreign securities. Simple commonsense tells you that you will find more, and sometimes better, investment opportunities if you search everywhere in the world, rather than limiting yourself to one nation."

To Templeton, it boils down to the straightforward notion of not limiting your possibilities. "My job, as an investment counselor, was to find those stocks selling at the smallest price in relation to their value, and if I limited myself to the United Kingdom or the United States I could find many, but I could surely find more if I looked around the world. Not only does it give you a broader selection, but you also get better bargains looking in odd places. In London and New York share prices get out of line in value. But in other places they get

even further out of line; you get better bargains in addition to more bargains by looking worldwide."

Templeton combined this global approach with a highly disciplined search for value. Disinclined to bet on the direction of whole economies or stock markets, Templeton sought out the most undervalued individual companies in whatever market they happened to reside. And like legendary investors, Warren Buffett and Peter Lynch, he has never been a fan of market timing. Templeton says that market timing is one of those things that would be great if only it worked in practice.

This search for the best values in each market is often called a bottom-up approach. Investments are selected based on the outlook for a particular company, not that of a particular market or national economy. But it so happens that sometimes entire markets go on sale, offering a smorgasbord of more and bigger bargains, especially when the market is a country whose economic and investment outlook is uninspiring.

Templeton senses opportunity when investor sentiment is negative. In fact, he looks for values to be the best at what he calls the point of maximum pessimism. "If you buy where the outlook is good, you're not likely to get a bargain. Other people can see that, too. There are very few things selling for a small fraction of their true value. Look where the people are most pessimistic, that's the place to search. This doesn't require a lot of technical analysis; you just have to ask yourself under what conditions can you get something for a small fraction of its value. The answer is clearly, when people are desperately trying to sell. We accommodate them by buying. When they are desperately trying to buy, we accommodate them by selling."

Investing against the prevailing consensus is often called contrarian investing. Perhaps J. Paul Getty said it best when he remarked in his investment classic, *How To Be Rich*. "Buy when everyone else is selling and hold until everyone else is buying. This is more than just a catchy slogan, it is the very essence of successful investment."

Templeton attributes his greatest successes to contrarian investing. The surprising thing is that most people intuitively agree with methodology, but few actually practice it. Templeton explains why.

"Attaining superior investment performance has nothing at all in common with succeeding in 99 percent of other occupations. If you were building bridges and a dozen consulting engineers, experienced in bridge building, all gave you the same advice you'd be stupid not to build your bridge their way. In all probability if the experts all agree, their way is the right way to do it. You would build a better bridge at lower cost if you followed their advice.

But the nature of the investment selection process turns that scenario topsy-turvy. Let's assume that every securities analyst you see says that's the stock to buy. You might think that if all the experts are saying buy, you should, but you couldn't be more wrong. To begin with, if they all want it, they'll all buy it, and the price will build up enormously, probably to unrealistic levels. By the same token, if all the experts say it's not the stock to buy, they won't buy it and the price will go down. It's then, if your research and commonsense tell you the stock does have potential, that you might pick up a bargain. That's the very nature of the operation.

"It's quite simple, if everybody else is buying, you ought to think of selling. But that type of thinking is so peculiar to this field that hardly anybody realizes how valid it is. They say, 'I know you're supposed to look where other people aren't looking,' but very few actually understand what that means."

Many people assume that by investing in foreign markets they simply are accepting greater risk in the pursuit of greater returns. Perhaps this would be true if the investments were confined to only one or two foreign markets. But studies show that adding stocks from a variety of foreign markets actually reduces risk and volatility.

John Templeton elaborates. "Every major market in the world has bear markets about twice every 12 years. They do not, however, occur at the same time in different places. Therefore, if you help your client to be invested in many

nations the client will not suffer as much in bear markets as he would if the holdings are all concentrated in one place."

Keith Park of Global Strategies Group adds this explanation. "Although the world economies have become more interdependent, the idiosyncratic economic characteristics of different countries, due to such factors as maturity of economic development, tax structure and political stability, elicit quite independent equity market movements. In other words, a globally invested portfolio can significantly reduce its exposure to market risks, and at the same time enhance return."

It's important to note that in the short term foreign markets can be highly correlated with U.S. markets. A perfect example is the stock market crash of 1987. It started in the U.S. with a dramatic 500-point one-day fall in the Dow. Overseas markets then dropped like dominoes. Even the globally diversified investors were disappointed, at least in the short run. But as Black Monday eventually receded in time, global markets resumed their largely independent trends.

Over periods of three years or longer many foreign markets have shown a low correlation with the U.S. market. In other words, they have not moved in tandem with U.S. markets. Some foreign markets have even been inversely correlated, tending to rise when the U.S. market was falling. This variability over the long term is what adds the risk-reducing dimension to international investing.

As Keith Park puts it, "The average correlation is still significantly small enough to substantially reduce the variance of a globally diversified portfolio. Research conducted suggests that a globally diversified portfolio offers a lower volatility of its return, and at the same time a superior average return, vis-à-vis a well diversified domestic one."

Yet John Templeton's success did not result from mere global diversification. He became well known as a world-class stock picker. As a determined value buyer, Templeton tried to buy a dollar's worth of corporate assets when possible for 50 cents. Yet, as essential as the value approach has

been to Templeton's success, he has refused to be tied down to any single analytical approach. Templeton believes that no investment strategy or formula works effectively under all conditions. He sees investment analysis as an art that involves continual adjustments and refinements in one's investment methods.

What worked well in the past will almost certainly have to be modified in the future. "When I was a student under the famous Benjamin Graham, he taught me about using book values and to search for those companies selling for less than net/net working capital, that is where you are buying cash at a discount and everything else is thrown in free. And I've used it, but it won't work today. Not in America. Because you won't find any companies selling for less than net working capital.

"Ben was a very wise man. He had a splendid method, but if he were alive today he would be doing something else, relying on newer and more varied concepts."

Templeton's contrarian value-oriented approach demands one thing above all others, patience. Buying things cheap means buying them when they're out of favor. Many such stocks have no upward momentum and often quite limited short-term prospects. But that's okay with Templeton; if the fundamentals are intact and the business is improving, he's content to hold on. This value-oriented approach results in a very low level of turnover in the portfolio, thus reducing trading expenses and improving investment returns.

In addition to looking at stocks that are cheap in relation to underlying assets, Templeton also gives a lot of weight to future profit growth. As he explains it: "We've specialized in judging what each corporation might be able to earn five years in the future. Then we compare that to today's market price. Eighty to 90 percent of our competitors look out one year, and they're wrong a high percentage of the time. We find we're wrong less looking out five years because you don't base your estimate on where we are in the business cycle. We just assume conditions are normal, which makes it easier to measure

earnings power and not for today, but based on what that corporation is likely to grow.

"That is the other important factor, trying to estimate the rate of growth of each corporation. To do that you need to know its competition and the future of the industry or industries it operates in. Of course, you do look at its past growth rate, but it would be a mistake to project the past into the future. You have to study management's ability to continue that growth in earnings per share. Out of all the ways of looking at earnings we still come back to reported earnings net, after taxes, audited. The other ways of measuring earnings power have just not proved as good."

As for knowing when to sell, Templeton is just as direct. Rather than looking at technical factors, like levels of support or resistance, or looking at fundamental assessments like fully valued, or overvalued, Templeton sells when he needs the money to buy something cheaper. In essence if something is significantly less costly than present holdings, the present holdings should be replaced. It is simply a matter of relative values. Yet the ever-flexible veteran has enough experience to know that even this is an area of occasional compromise.

Templeton notes that it's often wise not to be too quick to sell a stock when the wind is just gathering in its sails. "We have a holding period of more than four years. I don't know any major mutual fund group which holds stock as long as we do. One of the things we've found over the years is not to act too soon. If the security has been going up steadily, don't think it's going to turn down quickly. We might hold a stock now to see how far it's going to go, even when we have found something better. I can't illustrate that better than with Missouri Railway. Two years after I sold it for five dollars, it was at a hundred and five dollars. I remember that investment well."

Yet despite Templeton's long-term perspective he was quick to react if new knowledge changed his point of view. Anyone can be mistaken, and the problem is only compounded if corrective action is not taken promptly when a

problem becomes apparent. Taking risks will lead to some losses and successful investors must manage both losses and profits.

Templeton's employee, John Schroeder, learned this from firsthand experience as described in the book, *Global Investing The Templeton Way*. "In the early 1960s, Templeton visited a small company located in North Carolina. The Templeton Growth Fund had made a modest investment in the company after the usual painstaking research of the financial fundamentals. And Templeton decided to meet the principals with an eye to possibly increasing the Growth Fund's investment stake in the firm.

"Generally on such trips Templeton delayed any decision-making until he returned home. But in this case, Schroeder said, 'He called me right after the meeting and said, 'Jack, sell that stock immediately.' I said, 'Why, I thought it was such a great company.' 'I thought so, too,' he said, 'but I've just interviewed the president and he has a great big bar in his office and a ticker-tape machine, and I don't trust him. Sell all of our stock.'

"After all of the numbers we had run and all of the work we had put into finding this company, he gave it the bounce as soon as he had this new slant. I'll tell you, that is decisiveness."

Like the legendary value investor, Warren Buffett, John Templeton insists that exceptional investment results come not from intuition, but from a long-term perspective combined with plenty of detailed analysis. Templeton always eschewed jumping on bandwagons, chasing hot stocks or following investment fads. It may seem somewhat pedestrian to crunch numbers and estimate future market share, but it does have one compensating advantage; it works.

As Templeton explains, "We avoid intuition, we apply arithmetic. We don't buy something because it feels good, we buy something because we work out the arithmetic and it looks more promising than anything else."

But of course superior market knowledge can produce good, quick instincts that are soundly based in the numbers.

"Let me give you an example, a number of years ago I read an advertisement for 500 acres of land within 100 miles of New York City at \$17 an acre. That's all I needed to know. I bought it that night on the telephone, without ever going to see it. With my background of knowledge of the area I knew that the price was so far out of line that it would be snapped up by someone else immediately. I didn't buy it on a hunch; I bought it on the arithmetic. I hadn't seen anything like it within a hundred miles of New York at even three times that price."

There won't be any more \$17 bargains in New York real estate. But new opportunities are constantly developing somewhere around the globe, and Templeton believes that the defeat of communism by democracy and capitalism will be a great boom to the global investor.

"When history is written I think the year 1989 will go down as a major turning point; maybe of the same significance as Columbus' discovery of the new world. In 1989 the world was relieved of the two most serious worries we had in my lifetime. One was the fear of nuclear war. The other one was that the Russians might be right in saying their system was going to dominate the world. Now that's been relieved. Consequently the world is going to prosper much more quickly than it did before. There's going to be far more travel, far more transportation, far more commerce, far more international investing, far more production of goods in areas where production costs are lowest. The richness and variety of life will expand more rapidly.

"Now in trying to decide what a corporation is worth, we can take into account that these opportunities may have improved the future growth rate and therefore its valuation."

Another investor who has earned worldwide renown for his global prowess is the legendary hedge fund manager, George Soros. Perhaps Soros is not so much an investor as the consummate speculator. He has built his reputation managing the Quantum Fund; a hedge fund that capitalizes on opportunities in

stocks, bonds, currencies, precious metals and virtually any other publicly traded security, including options and futures.

Hedge funds get their name, because they not only buy long to profit from rising prices, but they also may sell short to profit from falling prices, thus hedging against potential bear markets. Soros is a slight, well-tanned man who speaks calmly. With an accent reflecting his birth in Russia and childhood in Hungary. His investment record is virtually incredible.

Ten thousand dollars invested at the inception of his Quantum Fund in 1969 would have grown over 25 years, with dividends reinvested, to an almost unbelievable 21.5 million dollars. His prescient calls in both equity and future markets have made him a leading investment guru, and his predictions and pronouncements have been known to move markets worldwide. As a short-term trader and aggressive speculator, Soros could hardly be more different from John Templeton. Where Templeton has sought long-term gains in the stocks of undervalued companies, Soros has sought to exploit short-term aberrations in the financial markets. And he has done it in the most aggressive way possible, by using leverage, borrowed money in the world's highly risky and volatile futures markets.

The triumph that turned Soros into an international business celebrity was a well publicized bet in 1992 against the so-called European exchange rate mechanism, which was seeking to maintain the value of Western European currencies against the German mark.

As Robert Slater describes it in his book about Soros, "In September 1992, Soros shrewdly sensed that Britain's mounting economic doldrums would force it to devalue the pound. He took a position of 10 billion dollars, much of that from his fund, the rest from loans, on the premise that Britain would have to devalue. When it did, on September 15, 1992, Soros earned nearly one billion dollars. He became an overnight superstar. I made a billion as the pound crashed, was the front-page headline written in huge black, bold letters in *London's Daily Mail*. The media could not get enough of Soros. He had made

the fastest billion in history, as one newspaper put it. Fleet Street dubbed him, the man who broke the Bank of England. Even had he wished to, Soros was unable to crawl back into his shell. He had made a larger sum in one day than most individuals would see in a thousand lifetimes."

In 1993 Soros earned a record breaking 1.1 billion dollars. A larger sum than any American citizen had ever earned in one year. It should be noted that this fantastic return was not achieved without risking a fantastic loss. With futures contracts, Soros could have lost even more than the original cost of his investment. But Soros is known for going with his instincts and placing huge bets. Whereas Templeton preached risk control through diversification, Soros achieved his great success by putting most of his eggs in one basket, and then leveraging the heck out of that basket.

In his book on Soros' trading techniques entitled, *Invest First, Investigate Later*, Robert Slater writes; "When George Soros believes that he is right about an investment, no investment position is too large. This is where he differs from other investors. Investors are often right in their observations of market trends, but because they lack Soros' self-confidence, at a certain point they grow fearful that their investment will grow bad. They take a position in the stock market, watch the price go up and up for a few days or a few weeks and then they get cold feet. 'This is too good to be true,' they'll say. 'I've got to get out before things change and I lose all my profit.'

"Soros scoffs at such thinking. The worst error an investor can commit in his view, is not to be too bold but to be too conservative. When someone tells him how much he or she has invested in a stock, Soros asks a critical question: 'Are you confident that the price will go up?' If the answer is yes, Soros then asks, 'Then why have you made such a small investment?'

Many investors take risks that generate an exceptional return, only later to regret that their small investment made the financial outcome insignificant. Yet few people have the temperament, not to mention the investment capital, to take risks like Soros'.

Slater relates an episode that illustrates this well. "Stanley Druckenmiller began to work at Quantum in 1988. Druckenmiller, who had taken over the day-to-day operations for Soros, had been unenthusiastic about the dollar so he took a large short position against the German mark. The position began to go in his favor and he was quite pleased with himself. Soros dropped into his office and discussed the trade with him. 'How big a position do you have,' he asked. 'One billion dollars,' Druckenmiller answered. 'You call that a position?' Soros said. A question that has become part of Wall Street folklore.

"Soros persuaded Druckenmiller to double his position, and just as Soros had predicted, even more profits poured into Quantum. 'Soros has taught me,' noted Druckenmiller, 'that when you have tremendous conviction on a trade you have to go for the jugular.' It takes courage to be a pig; it takes courage to ride a profit with huge leverage. As far as Soros is concerned, when you're right on something, you can't own enough."

If you're wrong, however, the results can be devastating. And Soros, like all risk takers, has had his share of losses. A good example is his experience during the global stock market crash of 1987. He wasn't caught holding the bag when the market collapsed. The problem came later when he simply overestimated the market's ability to bounce back.

As John Crane writes in *The New Money Masters*: "In the weeks before the 1987 crash, Soros had been saying in interviews that the Japanese market was wildly overpriced and had shorted Japanese stocks. But it was Wall Street that caved in first, catastrophically on October 17<sup>th</sup>. Two days later Soros is reported to have doubled his exposure to U.S. equities by plunging into over a billion dollars of index futures. After a brief bounce Wall Street crashed again and a panicky Soros had to throw in his hand."

The Quantum Fund has endured plenty of similar experiences, because investing for maximum total return invariably means taking outsized risks. And even for the world's greatest investors taking risks means taking occasional losses.

Still Stanley Druckenmiller says the most significant lessons Soros has taught him is, "that it's not only whether you're right or wrong that's important, but how much money you make when you're right and how much you lose when you're wrong. The few times that Soros has ever criticized me is when I was really right on a market and didn't maximize the opportunity."

Soros has the views of a man with tremendous faith in his trading abilities and history has demonstrated that faith to be well justified. But Soros is more than simply an intuitive speculator. At school in London he studied philosophy, and his investment decisions are often the result of his philosophical musings. He believes that we are, all of us, caught up in a cultural and psychological web that invariably distorts our view of reality. As much as we might try to approach financial markets objectively, Soros is convinced we cannot. As a result he seeks to profit from the distorted perceptions of others as they manifest themselves in the world's financial markets.

"The major insight I bring to understanding things in general is the role that imperfect understanding plays in shaping events. Traditional economics is based on theories of equilibrium where supply and demand are equal. But if you realize what an import role our imperfect understanding plays, you realize that what you are dealing with is disequilibrium."

Human perceptions are flawed, and these misperceptions are reflected in prices on the world's financial markets. This is a familiar theme among the world's great global investors. For example, Templeton's interest in what he calls a point of maximum pessimism is calculated to identify and exploit emotional excesses. Successful investors almost instinctively see these all too human occurrences as opportunities.

John Desourer, the investment analyst and regular panelist on Wall Street Week with Louis Rukeyser says, "The defects, the flawed human reactions, the misconceptions, the wild markets, they are to be cherished. They assure a never-ending cornucopia of investment opportunity."

Robert Slater emphasized this in his book on George Soros; "When the gap between perception and reality is wide events often run out of control, a situation found typically in boom/bust sequences in the financial markets. Soros thinks of these sequences as manias, or in his words, 'processes which are initially self-reinforcing but unsustainable, and therefore eventually have to be reversed.'"

As a speculator constantly looking for opportunities, Soros has sought to capitalize on unstable market conditions, and instability is not always what it seems. It has often been said that stock market risk is highest when prices have steadily risen for a long time. This is when profits are great and fear is largely absent. For a hedge fund manager seeking to capitalize on unsustainable trends, this may be the point of greatest opportunity.

But market timing, the investment equivalent of weather forecasting, is difficult at best. And the markets, especially the futures market where Soros is most active, can severely punish a trader who is on the wrong side of events.

According to Robert Slater, "Soros admits that he is cautious about going against the herd. He follows the trend on most occasions, although he is always searching for the inflection point of a trend, that point where the trend changes, for that is the only time it makes sense to buck the herd. And yet, as a general rule, Soros believes that whatever hypothesis has captured the imagination of investors at any given time will be wrong. That is, it will be based on some flaw in the hypothesis.

"What Soros wants to know is whether a trend has been pushed to the point of excess. He is eternally searching for the trends inflection point. That is the only time it's safe to go against the trend. To do so at any other time is to take an enormous risk. Once Soros believes he has identified the inflection point, he can then break away from the herd by getting rid of his investment position. At that time he formulates a new investment thesis, based again on the belief that the herd is wrong."

Both Soros and Templeton refuse to get caught up in consensus gone awry. Their contrarian goal is to capitalize on such excesses. Templeton steps up to the plate when a company's stock has been sold down to what he considers unrealistically low levels. Soros becomes a big hitter when a market no longer reflects what he regards as economic realities. Soros is an independent thinker who rejects some of Wall Street's familiar tools including fundamental analysis, technical analysis and the efficient market theory.

Fundamental analysis holds that a company's shares should be bought based on earnings power, assets, market share or other fundamental values. But Soros believes that extraneous economic or political events can more dramatically affect share prices in the short term. He also feels that technical analysis, which anticipates future prices based on price history, has a feeble theoretical foundation, and therefore is of limited value.

As for the efficient market theory which claims that all relevant information about a company's prospects is already reflected in the market price of its shares, well, let's just say that George Soros has repeatedly outperformed the market, thus diminishing the validity of efficient market theory. Like other great investors, Soros is independent, even idiosyncratic, and as they say, the proof is in the pudding.

While some aggressive investors might find it tempting to invest in a global hedge fund, there are quite a few restrictions set by the Securities and Exchange Commission. The SEC requires U.S. investors in American hedge funds to have either a net worth of \$1,000,000, or an annual income of at least \$200,000 for two consecutive years. Most hedge funds have their own requirements, which are usually even more strict.

Soros' Quantum Fund, for instance, requires a minimum investment of \$1,000,000. Furthermore, it is not available to citizens or residents of the U.S. because it is domiciled outside the country and is not registered with the Securities and Exchange Commission. This allows the fund more operational flexibility and freedom from U.S. regulations and disclosure rules.

Many of George Soros's methods are actually quite sophisticated and difficult to understand. An amateur trying to duplicate his successes might be guilty of reckless endangerment. And yet much can be learned from his example; you should seek opportunity globally, use a disciplined approach, and if you're confident in your investment, make the size of it meaningful.

We've seen that the speculative techniques of George Soros could hardly be more different from the long-term outlook of John Templeton, yet they have one important thing in common; a penchant for giving. Templeton has become a generous philanthropist, giving to many worthy causes. He is especially well known for establishing the Templeton Prize for Progress in Religion. Templeton felt that Alfred Nobel, who bequeathed the famous prizes for physics, medicine and literature, had overlooked one of the most important areas of human endeavor, the spirit.

The Templeton Prize, given annually, carries a large, unrestricted financial award of over \$1,000,000. The first recipient was Mother Theresa in 1973, seven years before she won the Nobel Peace Prize. Another recipient was the famed Russian author, Alexander Solzheniysyn.

George Soros has gained renown for his massive contributions to foster economic reforms in Eastern Europe and the former Soviet Union. He also has contributed in the U.S. to fulfill an aggressive social agenda. According to *The New York Times*, "George Soros is the only American who rivals the great philanthropists of the 1890s; John D. Rockefeller, Sr., Andrew Carnegie and Julius Rosenwald. If you measure philanthropists by dispensed gifts, especially in proportion to income, Soros is the world's single, largest donor, individual or foundation."

Among the areas around the world that show the most investment potential in the years ahead, are the rapidly growing markets of Asia, Latin America and Eastern Europe. One money manager who has been tremendously successful in these areas is Mark Mobius, head of the emerging market sector for Franklin Templeton, the company that now manages the mutual fund started by

John Templeton. Mobius strongly believes that the world's economic future lies in the hands of people in the world's developing markets. A well-spoken man with a clean-shaven head, Mobius lectures widely, and following in the footsteps of his mentor, John Templeton, frequently appears in my own television programs and newsletters.

Mobius has written a book entitled, *The Investor's Guide to a Merging Market*, which offers a persuasive case that investors should diversify some of their assets into the world's fastest growing markets.

Mobius begins by explaining that the case for emerging markets is largely a matter of demographics. "The overwhelming reality is the great imbalance in the distribution of the world's wealth when related to area and population. While the emerging nations cover 77 percent of the world's land area, and represent 85 percent of the world's population, only 23 percent of the world's gross domestic product is in those emerging nations. The underlying global trends, such as the greater availability of food resulting from advances in agriculture and new progress in medicine, combined with better health care in the developing nations, is resulting in significant declines in death rates and extended life spans. This is leading to a narrowing of the wealth imbalance as emerging nations with their economic growth rates move towards the developed countries in terms of per capita wealth."

It's easy enough to see why the world's emerging markets are growing so rapidly. They combine lower production costs and less expensive labor with a huge potential to consume more goods and services. Many such countries also have high savings and investment rates, and a young, well-educated workforce. When you add free market economic policies, and very limited burden for social welfare benefits, you have a recipe for booming economies.

Many Asian and Latin American countries have been growing at two to three times the rate of the world's more developed markets. Their stock markets over time have given even better returns, though with great volatility.

Jim Roeher, chief economist for Asia at CS First Boston, discusses these attributes in his book entitled, *Asia Rising*. "Returns are a lot higher in Asian markets than in Western ones, though you would naturally expect that from riskier markets. Far more important, a portfolio that mixes stocks from markets that do not move synchronously and have different volatilities will deliver a higher return with less risk than a portfolio made up of stocks from one market only.

"Since at least the mid-1980s, American and Asian stock markets have tended to move independently of each other, and their tenuous correlation has recently been weakening. This is a powerful long-term argument for American investors to put more, rather than less money, into Asia."

Of course, we've seen that investing in emerging markets involves risks that often negligible in more developed economies. Chief among these are a broad array of political risks, including nationalizations, confiscation of foreign businesses and properties, and coup d' etat. Governments in emerging markets have sometimes responded to complaints of investor losses by trying to prop up or manipulate the stock market. And their regulatory fervor has sometimes disrupted the natural functioning of the financial markets.

Some of these errors may be the result of inexperience; others are simply political maneuvering or corruption. Especially worrisome to some investors is that levels of disclosure in corporate reports often fall far short of requirements in developed countries.

Jim Roeher warns that this has simply been part of Asia's historical investment landscape. "For the most part, regulation and disclosure levels are not at rich world levels, even when they look on paper the standards are not enforced with the same zeal that they are in the West, and the markets are often distorted in odd ways. On the Jakarta stock market in 1994, for instance, foreigners owned less than a third of the shares, but accounted for more than three-quarters of the trading. Locals tend to think, rightly, that the corporate action is elsewhere than in publicly traded shares."

Because of the many differences between emerging markets and more established ones, it is especially important for foreign investors to deal with a firm that can provide more information than just a price quote or a trade confirmation. A knowledgeable fund manager or global money management firm can spread risk among a number of different nations and focus investments on sectors with the greatest competitive advantages, thereby making a world of difference.

Jim Rogers is another well-known global investors. He and George Soros founded The Quantum Fund with Soros as the trader and Rogers doing research. Like most hedge fund managers, Jim Rogers is willing to trade just about anything and has made money on investments ranging from rapeseed oil to Third World stock and bond markets. However, Jim Rogers is perhaps best known for his top-down global investment philosophy. He prefers to bet on whole markets or countries rather than individual companies, and he doesn't believe in doing it from a cozy office in New York.

Like John Templeton and Mark Mobius, Jim Rogers get out to see firsthand what is happening in different foreign markets. Meeting the people, seeing developments up close, and feeling the pulse of economic activity.

Rogers wrote a best-selling business book entitled *Investment Biker* that details his around the world motorcycle trip to gather investment information. The book is filled with reminiscences about investment triumphs made by looking in unexpected places. His contrarian bent is strongly implied in the story of an experience with the Austrian stock market.

"I had fond, fond memories of Austria and its stock market where I'd made one of my best coups. Six years before, believing the time was right to invest in Vienna, the sleepy former capitol of the Austro-Hungarian Empire, I had put out feelers by calling the New York office of Credit Anstalt, Austria's largest bank. I asked the manager how I could about investing in his country's stock market. 'We don't have a stock market,' he said. I laughed. This was music to my ears. The largest bank in the country and the New York rep didn't even

know he had a stock market. I knew there was one and that big changes were taking place in Austria.

"The bank manager's ignorance showed me how wonderfully obscure the stock market was; just what I like as an investor. I assured him that his country had a stock market and asked him if he could find out how I could buy shares. It was hopeless dealing with him, but that just wetted my appetite. The largest bank in Austria and no one knew how to buy shares on its stock market."

Rogers investment insight was dead on. His investment in the Austrian market grew five-fold in just three years. Time and again we see the world's greatest global investors looking for signs of under valuation. Opportunity may be caused by temporary economic setbacks, political disruptions, excessive pessimism or currency weakness and great investors step up to the plate while others wait for a more reassuring environment. Jim Rogers top-down approach is based on the conviction that if a country is doing the right thing politically and economically, its stock market will reward investors. Rogers is particularly opposed to government economic intervention and he exalts in the worldwide collapse in confidence in state run economies.

"Stateism is the great political disease of the 20th Century with communist, socialist and many democratic nations infected to a greater or lesser degree. When the political history of our century is written, its greatest story will be how a hundred variance of stateism failed. "

Rogers cites statistical correlations between economic freedom and the rate of economic growth. His thinking is that business conditions and, therefore, corporate earnings growth will be better where companies are left unfettered by an interventionist government.

"Here's my advice, scout for nations that are living up to the ideals and principles that made America great, namely those with unshackled economies and free markets. Place your bets on these places. I promise that if you do this you will be amply rewarded. In fact, it's practically a sure thing, as long as you stick to this principle and choose accordingly. The openness of the political

system that people choose for themselves makes virtually all the difference in their future. By recognizing this, investors can capitalize on opportunities far beyond their own backyard."

Studies have indicated that economies grow more rapidly when countries open up by eliminating trade restrictions, lowering taxes, deregulating financial markets and reducing government bureaucracy. And Rogers takes a page from George Soros' book, when he finds opportunity he doesn't like being under invested.

"My attitude is, if you believe in a country you should buy shares of every decent stock on its exchange. If you've got the right concept going for you, they're all going to move up together."

These are certainly the words of a man looking at the economic big picture, as opposed to carefully selecting individual stocks. In the global financial markets there are indeed many ways to prosper. Jim Rogers has certainly made some big mistakes along the way, too, but he claims to have a secret weapon, his mother, as he searches for turning points in the market cycle.

In the book entitled, *The New Money Masters*, John Train describes how Rogers mother seems to be the perfect contrarian indicator. "When the curve of the stock prices rising the most steeply, the ratios often start approaching their worst levels. At the end, people are buying just because it is the thing to do. Rogers says that about then his mother will call to say she wants to buy the stock. Why do you want to buy, mother? Rogers asks. 'Because the stock has tripled,' his mother answers. 'No, mother, you're not supposed to do it that way,' Rogers will say, 'this is the most dangerous stage of the market.' Then the stock goes down and the entire sequence operates in reverse. Finally, Rogers' mother calls again, 'I want to sell the stock.' 'Why?' 'Because it's down 90 percent.' 'No, mother, you're not supposed to do it that way.'"

The story communicates an important investment reality; widespread optimism about the market is often a sign of a market top, both in foreign markets and domestic ones. People in the investment industry often refer to this

as the odd lot indicator. An odd lot is any amount of stock less than the round lot of 100 shares. And when a great deal of buying comes from people who cannot afford to buy a round lot, the odd lot indicator is ringing like a fire alarm.

In days past, getting stock tips from the shoeshine boy was believed to be a good indicator that stocks were fully valued. Now, look out when friends and acquaintances brag at cocktail parties about how much they're making in the market, and how the market can only go straight up. For those of us without access to Jim's mother, these can be dangerous signs along the road to riches.

The world's great global investors have achieved their results using techniques that are not only dissimilar, they are down right contradictory. Templeton and Mobius are long-term value investors, measuring their investment results over a period of several years. Soros and Rogers, on the other hand, are hedge fund managers who speculate, often with massive leverage to exploit short-term trading opportunities in various world financial markets. And yet by studying the views of such disparate investors we find many similarities. Each believes that successful global investing requires flexibility. None is so hidebound or dogmatic as to believe that one single form of investment analysis is sufficient.

Templeton, perhaps speaking for them all, emphasizes that successful, global investing requires much more than crunching numbers or looking at broad economic trends. You, or your investment manager, must also have an intimate knowledge of the countries in which you are investing.

"There must be a bedrock of hard facts about the life and times of the countries whose markets you are dealing with. The numbers don't exist in a vacuum. The global investor must see the world, not only in terms of PE ratios and dividends, but as the teeming, turbulent, planet-sized village that it is. Often the root of global investment opportunity lies in understanding the course of world events, rather than just fixating on purely investment oriented issues.

"You also have to understand the attitudes of the people. Are they socialists? Are they thrifty or are they spendthrifts? Are they feeling optimistic

or depressed? Why? Do they want to work hard? Are they facing grave social problems?

"Armed with all of this knowledge you can make an intelligent decision about the value of any global investment opportunity. That is a daunting challenge and the reason why global investment is really the preserve of professionals, not an arena for amateur dabblers."

Successful global investors rely on thorough analysis; none is comfortable with the investment community consensus. And they typically are contrarians, looking for opportunities where fear or greed have distorted prices. Time and again we hear Templeton and Soros speak of misperceptions caused by too much emotion or by complacency.

But perhaps most strikingly, these investors all refuse to let geographical boundaries constrain their investment possibilities. Had Templeton ignored international opportunities he would never have achieved great success in the emerging markets of Germany and Japan after World War II. Had George Soros been ignorant of the European exchange rate mechanism he would never have made one billion dollars in a single day by shorting the pound sterling.

For most investors who are beginning to tiptoe outside the borders of their own country, it is essential to emphasize diversification in international markets. Trying to pick the best foreign market at the best time can be just as daunting as trying to time the domestic stock market. Successful market timing can be excruciatingly elusive wherever it's tried.

In the book entitled, *All About Global Investing*, author Thomas Saler takes a sober, realistic approach. "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 will never be able to tell exactly when they'll do either. Accept that progress in many foreign countries will ultimately be measured in decades, not in years. Accept that the same kinds of global liquidity gushers that push U.S. stocks to occasion 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 21<sup>st</sup> 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 countries where you investments ultimately are place."

Global diversification has worked, both as a method of increasing returns and of reducing overall portfolio risk. In the words of Diego Vatia, Chairman of International Assets, "The results are incontrovertible; investors who have diversified their portfolios globally have accessed more opportunities, have increased their returns while reducing risks and have benefited from the inexorable drop in the value of the dollar since currencies were set free to float in 1971."

By using hardheaded analysis and unemotional discipline as the great global investors have done, we can all aspire to enhance our investment returns while reducing portfolio risk. And if we're successful, the world may truly be our oyster.