



Global Investing in Uncertain Times

By Randy Burgess

Political risk has always been a factor in global investing, but lately -- with daily news from Iraq, Saudi Arabia, and Chechnya -- you can't miss it in the headlines. How can an investor evaluate global investments in uncertain times?

For insight, we turned to Rick Spillane, Fidelity executive vice president and head of global investment strategy, and Ian Bremmer, president of Eurasia Group, a firm which specializes in political analysis for institutional investors.

"When I started out in 1998, I had to explain to people what political risk was and why they should actually pay us money to analyze it," says Bremmer, a political scientist and former academic. "We no longer have to do that. Investors now understand that even relatively small activities, in countries we don't know very much about, can impact what's happening with their holdings."

Are Individual Investors Too Wary?

Many investors are affected by risk when considering international investing. Right or wrong, most of us feel we "know" U.S. brand name stocks and markets. By contrast, investing in unfamiliar foreign companies and markets seems riskier to many people.

Spillane notes that developed markets in Europe and Asia continue to offer excellent opportunities to knowledgeable U.S. investors. Pension funds, college endowments, and other U.S. institutions understand this, Spillane says, but private investors often don't.

"People are very familiar with international brands when they buy things -- Nokia phones or Honda automobiles, lots of other things -- but when it comes to investing in those same companies, they get hesitant. As a result, they lose something," Spillane says.

Research by Fidelity has found that while institutions with sophisticated asset allocation models average from 15% to 17% international exposure, individual

investors average only a little over 4%.

Yet significant international opportunities are available to the average investor, Spillane says. When dealing with stable regions and developed economies, the focus is on companies rather than countries, ideally providing the investor with security, performance, and some measure of diversification.

"For example, Honda and Toyota have been fantastic stocks over the last 15 to 20 years," Spillane says. "But if you were a U.S. investor investing in just the U.S. markets, you may have suffered from investing just in the domestic car companies. Likewise, in almost every industry there are more than a few great international companies that just don't make it into your portfolio if you focus only on the U.S. market."

When you move away from politically stable democracies such as those in Western Europe and Japan into emerging markets, or even into markets that at first glance seem on their way to becoming fully developed, focusing on companies often isn't enough. In fact, Bremmer says, a good definition of an emerging market is a market where political decisions matter more than economics and institutions.

"You can imagine a country where a majority of the population believes the elections are illegitimate and a recount is ultimately decided by the supreme judiciary," Bremmer says. "That happened in Taiwan just a few months ago, and the markets went down by 7%. Of course the same thing happened in the U.S. in 2000-2001, and nothing happened to our markets, and nothing happened to our credit ratings. That's the difference."

In January of this year, Eurasia Group partnered with Deutsche Bank to launch the Deutsche Bank Eurasia Group Stability Index (DESIX), a monthly index that calculates the political stability of 23 emerging market economies.

And Bremmer notes that political risk isn't always as clear-cut as it might seem. For example, he views Saudi Arabia as a major long-term political risk due in part to its highly oppressive government, but a very low risk for the next two or three years. "Yet you hear about a bomb in Saudi Arabia and oil prices go up," he notes. "There's no objective reason in terms of supply and demand, it's just that the markets are overly sensitive."

Hot Stories, Cool Analysis

Bremmer offers brief views on several countries and markets in the news:

China. "Investment banking research on China has gotten caught up in its own excitement. There's a bit of a bubble in China, and the present rates of growth aren't sustainable. I think the Chinese government understands that. If they have to choose between employment and growth, they're going to choose growth."

They're not going to let social instability get out of control. That means they have to limit things -- they have to put brakes on agricultural reform, and on urbanization. China still has a very inefficient Communist bureaucratic system. When you start talking about the need to react quickly to international market forces, the Chinese don't have that capacity, and that's also going to limit growth."

Brazil. "Before the recent elections, Brazilian President Lula was perceived by Wall Street as being a populist who was very dangerous. He was going to have to work with a broad sector of parties and select some pretty pragmatic folks domestically to deal with international issues, the IMF and so forth. And so what we ended up seeing was that Lula came into power and he was pragmatic. He became a good story for the markets."

Russia. "Terrorism is a much bigger risk in Russia long term than in the Middle East, and the markets don't reflect that. It's the one country in the world where you have a lot of unaccounted-for radiological material, a lot of scientists who aren't very well paid and have the technological wherewithal to use this material, and a lot of militants from Chechnya who'd like to use it."

Another long-term risk is that Putin is increasingly becoming the man of the country, with institutions increasingly dependent on him. He's a young guy, barely fifty, but when he eventually is no longer president, which at some point will happen, the key-man risk is going to be one of the largest risks in any country in the world. And the economy of Russia will be jumpy around that."

The oil market. "The major concern we have with oil prices on the upside going forward is the inability of the U.S. and the coalition forces to effectively defend the Iraqi oil infrastructure. We've been relatively fortunate so far, but if militants and terrorists begin targeting that infrastructure, it's likely we'll see a significant reduction in oil export capacity out of Iraq -- and that could bring oil prices well above \$50 a barrel."

Conclusion: Dipping a Toe in the Global Waters

The world remains risky, of course, and the Eurasia Group is likely to keep busy advising hedge funds, banks, and other major clients -- yet the opportunities remain as well. Spillane has these suggestions for private investors interested in broadening their horizons:

First, if you're uncomfortable researching individual stocks in global markets, you can start by picking a good international mutual fund, with a solid track record and respected research team. Fidelity offers an array of [international funds](#) from diversified to targeted funds that focus on specific regions, emerging markets, and small companies.

Second, try broadening your outlook by reading financial publications from other

parts of the world. The Web has made it surprisingly easy to read not just the *Financial Times*, but papers such as *The South China Morning Post* from Hong Kong, or the *Japan Times* from Tokyo. "It's a good way to get a less U.S.-centric point of view," Spillane says.

Learn more about [international investing](#).

International investing entails greater risk, as well as greater potential reward, when compared to U.S. investing. These risks include political and economic uncertainties of foreign countries, as well as the risk of currency fluctuations

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