
Clients asking for a world of trouble?

Herd behavior may be driving hunger for international investments

By **Jeff Benjamin**
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No matter which way you turn, there appears to be a solid case for investing outside the United States, and for some advisers it's just a matter of how much and for how long. "Five years ago my balanced portfolio would have a 25% allocation to international investments and it was a tough sell to get clients to think beyond the U.S. markets. Now I've got a 30% allocation and some clients want to go up to 50% international," said **Paul Baumbach, co-founder of Mallard Advisors LLC in Newark, Del.** The outsize performance of several international markets, combined with the dark cloud of systemic risks hanging over the U.S. financial markets, continues to fuel the appetite of investors, and some say this could lead to an international stock-market bubble. As stock markets in places such as China and parts of Latin America push toward 100% gains for 2007, investors have moved their money in stride with the performance. Through October, 2007 net flows into international mutual-fund strategies stood at \$68.5 billion, without a single month of net outflows, according to Lipper Inc. of New York. Over the same period, comparable domestic equity mutual funds had net inflows of \$2.8 billion, including four months of net outflows. Comparable global mutual-fund strategies that include both domestic and international securities had \$18.5 billion in net inflows over the period, with no months with net outflows.

ECONOMIC ANGST

"People are very concerned about the U.S. economy and the big effect on the U.S. dollar, and the natural place to go has been international," said Tom Roseen, a Denver-based senior research analyst with Lipper. "This has been the story all year, and I believe it will continue," he said. "But the prudent thing is still to keep asset-allocation levels in balance." Signs of a herd mentality with regard to the international markets are reminiscent of the technology bubble in the late 1990s, according to Paul Schatz, president of Heritage Capital LLC in Woodbridge, Conn. "There's certainly an advantage to being outside the U.S. right now," he said. "But I find it strange that clients are most interested in my international strategies when we see these absurd rallies, not during routine 25% corrections." Mr. Schatz, who oversees \$120 million in client assets, has increased his international exposure over the past two years to 25%, from 10%, and he plans to increase it even further. For many financial advisers, the run-up in the international markets creates a new set of challenges that involve both managing the level of participation and speculating on everything from the declining dollar to the unraveling crisis in the credit markets and the likelihood of a recession. "We've taken a step back, broadened our view and now we're actively looking outside the United States," said Gary Stroik, vice president and portfolio manager at WBI Investments in Little Silver, N.J. "Right now we're going pretty hard after international dividend-paying stocks," he added. "But we're not talking about certificates

of deposits here, so it's going to be rocky." Despite the recent performance of international investments, it is far from a strategy of buy-and-hold for those advisers tuned in to the effect the U.S. financial markets have on the rest of the world. Mr. Stroik, whose firm oversees \$250 million in client assets, has loaded up on foreign government debt in anticipation of a U.S. market decline, which he believes will at least temporarily drag down many of the international markets. At that point, he plans to load up on non-U.S. securities.

BOTTOMING OUT?

The Dow Jones Industrial Average's recent 10% correction, some of which the index has since recovered, is one indication to Mr. Stroik that the U.S. stock market is nearing the mid-point of a decline. Despite the Dow's gain of nearly 7% this year through the third week of November, advisers say the market has yet to feel the full impact of the credit crunch. "The biggest question right now is the credit problems," Mr. Stroik said. "That's why we plan to sit back and wait for some clarity." In the meantime, advisers and money managers are taking what the global markets are giving them, which can include a significant edge on the currency exchange rate alone. "It's not just about having a certain percentage overseas; you want to go where there are opportunities and there are a lot of markets that are cheaper than the U.S. market," said Paul Sutherland, president and founder of FIM Group in Traverse City, Mich. The firm's Utopia Growth Fund (UTGRX) has more than half of its \$68 million allocated to non-U.S. investments. Even the firm's most conservative fund, Utopia Yield Income Fund (UTYIX), has a third of its \$40 million invested outside the United States. The appeal is a no-brainer, according to Mr. Sutherland, whose firm manages more than \$700 million. "The declining dollar is a real strong case for investing outside the U.S.," he said. Consider, for example, that the 33.4% gain by the Brazil Bovespa Stock Index year-to-date through last Monday automatically jumps to 54.5% when you factor in the currency exchange rate. The Madrid stock exchange index, the IBEX 35, jumps from 8.4% to 22.5% after you calculate the currency exchange. Meanwhile, the Frankfurt stock exchange, measured by the DAX 30 Index, climbs to 29.3% from 14.7% after the ex-change rate. Concern over the value of the dollar led James Lunney, founder of The Wealth Strategies Group in Littleton, Colo., to invest in triple-A rated Australian government bonds. "I can get a very safe 6.5% yield by buying non-dollar-denominated government bonds," he said, "and even if I'm wrong and the dollar stays the same and the U.S. market keeps going up, I still make 6.5%." "I'm not greedy; I just don't want to drop 20% if the U.S. market goes down." Mr. Lunney, author of "Surviving the Storm" (McGraw-Hill, 2008), oversees \$200 million in client assets. He advises gradually reducing exposure to U.S. investments by at least 30% over the next year. "After that we want people to pay off as much debt as they can," he said. "And then we want to own some things outside this country." *Jeff Benjamin can be reached at jbenjamin@crain.com.*

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