

# INVESTING ABROAD AT HOME: A FOCUS ON U.S. MULTINATIONALS

## FUND FACTS

### PAPP AMERICA-ABROAD FUND (PAAFX)

#### CATEGORY:

Growth

#### PERFORMANCE: (thru 9/30/98)

	Fund	Category
Compound Annual Return (%)		
1 Year	-5.0	-4.3
3 Years	19.5	14.6
5 Years	20.4	14.1

#### RISK: (relative to category)

Average

#### TOTAL ASSETS: (as of 12/98)

\$325 million

#### CONTACT:

Papp funds  
800/421-4004

[www.roypapp.com](http://www.roypapp.com)

*Does international investing really mean buying the stocks of foreign companies?*

*Most mutual funds that consider themselves "international" invest primarily in non-U.S. stocks to give investors exposure to foreign markets with growth patterns and market behavior that is not necessarily affected by the U.S. markets.*

*A different approach to international investing, however, is taken by the Papp America-Abroad Fund, which seeks international exposure by investing primarily in U.S. companies with strong overseas earnings. The fund believes that much of the world's economic growth is being driven by globalization, and that a majority of the best-managed global companies are based in the United States.*

*The fund, classified as a growth fund in AAIT's no-load guide, has fared well over the last three and five years, ranking among the top 25% of all growth funds through September 30, but has slipped over the last year, with a return of -5.0% compared to -4.3% for the category average. Currently, it has about \$325 million in total assets.*

*In early December, fund manager L. Roy Papp discussed the management of the fund with Maria Crawford Scott.*

### ***What is the investment objective of the America-Abroad fund?***

The investment objective of the fund is to have the highest, safest return we can get anywhere.

### ***Anywhere in the world?***

Yes, that's our objective. However, we find that the most attractive way to do this is to buy the large, multi-national American companies. It is safer than buying foreign stocks; the quality of the companies is much higher; we are familiar with the accounting; we don't get dishonest or rigged markets as often; we don't have a lack of information from the companies; and we do have SEC protection.

In addition to that, if you look at the economic growth we've had, it has been globalization and technology pushing our society. We think that is going to continue the next 20 years. If that is true, it is much safer and better to buy American stocks because we have the best companies.

If you take the 100 largest companies in the world based on sales, you'd find that only 24 of them are American companies. However, those 24 get 52% of the earnings of the top 100, so they are three times as profitable as the foreign stocks. They are much better run, and they are more oriented toward research. Of course, people say that the foreign stocks are cheaper, but that's nonsense—you're comparing mature or sunset industries to our stocks, which are not that type.

Lastly, you don't have the currency risks that you have with foreign stocks.

### ***Do you consider your fund an international stock fund?***

We do, and we compare ourselves to the world index. But Morningstar and Lipper and everybody else compare us to the large-cap American funds, and there is some justification—I understand what they are saying. They are saying that our stocks are going to be more affected by the American economy than by foreign markets. I also acknowledge that the trends can be different between a foreign country and America at any particular time.

On the other hand, we have had a tough year-and-a-quarter. Ever since July of last year when Southeast Asia took its dive, the prices and emotionalism connected with the kinds of companies we invest in have been impacted, so it has had an adverse effect on us. This year because of that we're only up 20%, whereas the S&P index is up 23½%. When you talk about the world index, it is only up 16%. Again, we beat the dickens out of the world index, which is really what we think we're doing, but we are very close to the U.S. numbers.

So, the Pacific Rim hurt us a little bit. Now, the other thing I'll point out, though, is that Southeast Asia has not had any impact on our economy.

***What are the selection criteria? What characteristics must a company have for it to be considered multi-national?***

The goal is to get 50% of the total portfolio's earnings from overseas or non-American sources, and we do that. We have minimum requirements for a normal company: 35% of its earnings has to be from non-U.S. sources. But if it is a company that has doubled their overseas activities in their last five years, then we can buy if sales, earnings or assets from non-U.S. sources is as low as 25% of their total.

***What is your investment criteria?***

First, we are growth stock buyers at a reasonable price. We don't want to pay 50 times earnings to buy something, but we want growth stocks. Second, we want very high quality with very low debt. Steiner Leisure is a perfect illustration—no debt at all. They have something like 10% of their book value sitting in cash, and they generate cash very substantially, so it is a safe company.

Other names that you might be familiar with are companies like Coca-Cola, which was there yesterday but now it is gone—we sold it finally after many years. It was our largest holding in 1994. Other companies are IBM, Interpublic (one of the two largest advertising firms in the world), Johnson & Johnson, McDonald's, Merck, Microsoft, Office Depot, State Street, American International Group, EMC, Emerson, General Electric, Hewlett Packard, Intel—these are all top-quality companies.

We also have a few smaller companies in here, so we are not entirely large cap. Actually, our third largest holding is American Power Conversion. They make power packs you put on computers in case the power fails. They have surge protectors. Hewlett Packard got in the business for about two years, and they got so little of it that they got out and they use American Power. IBM uses their equipment, so they are by far the largest company in the field. That's another example of the kinds of companies we look for. We not only want a dominant company, we want a leader and an innovator.

***Although you focus on U.S.-based stocks, the fund is***

***allowed to purchase ADRs.***

We are allowed to buy ADRs and we have three of them at this time. One of them is Hong Kong Telephone and that is self-descriptive. The second one we own is Astra, a Swedish drug company and, fortunately, in a day or so they are going to merge with Seneca, the British drug company, so the stock is up a fair bit. We're happy with it. The third ADR stock we own I don't think is really foreign—it is domiciled in the Bahamas, but their main operation and headquarters are in Miami, Florida. They operate in the Caribbean and North Atlantic, 90% of their customers are Americans, and the only stock that has ever been offered publicly was offered in the United States.

***What company is it?***

Steiner Leisure Limited, and the only thing they do is operate beauty parlors and spas aboard cruise ships—an industry growing about 25% a year. We bought it at a low price, and it's a company with no debt—zero. It's got very high quality statistics. And they have almost a monopoly on the industry.

Cruise ships scare me because the capacity is going up by 50% in the next three years. But even if the ships have to cut prices, it is even better for the beauty parlors and spas—they'll fill those ships one way or another. This is a way to be in the ships without taking a risk.

***What sectors of the market do you tend to be drawn to?***

We invest in high-tech companies of all types—we've normally had 25%–30% in that area. And we normally have about 15% in the drug area and 10%–15% in financials. We own no cyclical stocks, we own no commodity stocks, and we don't buy utilities normally although we own Hong Kong Telephone.

***Is that a result of your growth approach, or the multi-national focus, or a combination?***

It's a combination. First of all, if you're in multi-nationals, you are sort of forced into the larger companies because the American multi-nationals that are bought all over the place are the bigger companies. The smaller ones don't have as much activity abroad, so they don't fit our quotas.

***But you do have some smaller companies.***

Well, I mentioned one to you—American Power. We also own Molex, which makes electrical connectors. It's a good company, based in Chicago, with a great record. The stock normally sells at a price-earnings ratio that is 150% above average. However, they got into trouble last year not because the company did anything wrong—the earnings were up—but because 45% of their sales went to Southeast Asia: Japan, Korea, and Taiwan. Now the truth is they had 20% of their sales in Southeast Asia to American and Japanese companies where they assembled

a product and then shipped it out of the area to sell in the U.S. and Europe. That's why we bought it, because there was no real damage due to the situation in the Far East. The earnings are up this year as they were last year, yet the stock was way down and came down from 38 to 26. Now, fortunately, it is back to 33.

***How did you find a company like that?***

With a lot of work and difficulty and the fact that we have seven CFAs in the office and two of us, in addition to that, have 40 years of experience. We don't use screens. Steiner Leisure, for instance, would not have shown up on any screen because the company is so small—it is about \$200 million in market capitalization.

***What kind of growth are you seeking?***

We are looking for around 15% compound growth, but I'm not talking about one year, I'm talking about a longer trend, over a five- or 10-year period.

We also want consistent growth, but right now that's a phony number. In the last 16 years, we've only had one year of recession in the United States, so it is hard to find somebody who has not grown eight or nine years out of 10 because the economy has grown so much.

***Then you look primarily at projected growth?***

Yes. We look through the windshield, not the rearview mirror. We look at the numbers going back, but you really can't put a lot of weight on anything before 1982 because the society has changed so much. For example, we used to have a recession every 3½ years, and they were mostly inventory recessions. But companies don't have any inventories now—you can't have them. We have real-time inventories now, and it takes only a short time to get it in line.

***You mentioned that you're buying growth at a reasonable price.***

A market multiple is what we are looking for. We will pay a little bit more than a market multiple, but not much.

***On everything?***

On everything. We will make an exception every now and then but not often.

***What about the ADRs—why would you buy an ADR?***

When I can't buy that mix here in the States. For instance, I can't buy a Steiner Leisure here in the States—there is no such company.

***What would make you sell?***

Three things, basically. First, we would get out if we just out and out made a mistake.

Second, we may sell if the company sales or the industry has changed. For example, I used to own steel stocks in 1950, but I wouldn't touch them today. The same thing is true of the oils—it's a commodity. So these are some of the things we avoid, but if we make a mistake and the industry changes then we get out.

The third reason we sell is if the stocks become insanely over-priced—they are just too high, and that's why we sold Coke. It was our largest holding in the fund four years ago, and we carried a million dollars of it for the last couple years. When we sold Coke, the largest holding became Gillette. We have a million dollars in Gillette today. This is a \$330 million fund, so it is not significant and we normally keep 25 to 30 stocks in the fund.

***How do you reduce portfolio risk?***

We buy quality—the highest quality we can get—and stay in it. Our turnover rate is usually 12% to 15% a year, and we are very tax-efficient.

***What about in terms of the international exposure, are you more weighted toward companies in any particular area?***

The concentration is not specifically in a country or an area. I would prefer to have the management of these companies make the allocation of where they are going to be.

***Do you use any technical analysis or market timing?***

No. We don't think anybody can time the market. There have been many mutual funds started that were market timers. They don't exist because they all went under.

If you go back and you look at the various markets—70 years ago, 60 years, 50 years, 40 years, whatever period you want to take: The return on common stocks after inflation has been four times the return on bonds. Anytime you are not fully invested in stocks, you are in an inferior investment. ♦