

GOING GLOBAL: A SINGLE FUND

WITH A WORLD TO CHOOSE FROM

By John Markese

As more countries trade with each other, international diversification does not have the pronounced benefits it once had. But while world stock markets occasionally all do the same short-term dance, they still do not move in unison over the long term.

Global funds have a certain appeal. Why restrict your fund manager to a country or region when the whole world can be searched for the most promising investments?

International funds for U.S. investors invest outside the U.S. Most domestic funds invest just in the U.S., but some make international investments under rather elastic investment objective statements.

Global funds, however, are invested in the U.S. and internationally as their investment mission, although country weightings are subject to change based upon changing portfolio manager investment strategies.

An alternative to a global fund is to invest in a fund that concentrates in the U.S. and an international fund, utilizing an investment expert in each geographical global subcategory. That sounds logical, but the fund investor would have to determine the allocation between U.S. investments and foreign investments, a function that global funds perform.

Of course, investing in a global fund, because it can move money anywhere in the world, may make it more difficult to determine at any point if you are geographically well-diversified and what percentage of your portfolio you have committed to the U.S. market.

A GLOBAL OVERVIEW

Because of their nature, global funds are diverse in performance and in country weightings. Table 1 details performance, risk, and fund country weightings for all global funds tracked by AAI's *Quarterly Low-Load Mutual Fund Update*. The one-year performances are generally grim for these global funds, with two exceptions, both global value funds: RS Contrarian posted a 12.8% annual return and Tweedy Browne Global Value returned 5.1%. The rest of the funds were in the red, some deeply. But a year ago, most international and domestic funds were near all-time highs, so the choice of this particular one-year time period is not the most flattering.

For comparison purposes, the Vanguard Total International Index and its subcategories are given in Table 1, along with the Vanguard Total U.S. Stock Index. An alternative to an actively managed global fund would be a combination of the Vanguard Total International Stock Index and the Vanguard Total U.S. Stock Index—combined, these two funds would create a global index fund. It's hard to beat this homemade global index fund on a diversification or low-cost basis. Arguably, if you were to hold this combination, no other stock funds would be necessary. But even if you held this combined index fund equivalent of a global fund, it would not have been much comfort over the last 12 months. As more countries trade goods and services around the world and more multi-national firms grow and penetrate new business markets, international diversification simply does not have the pronounced benefits it once had. But, while world stock markets occasionally all do the same short-term dance, they still do not move in unison over the long term.

The three-year and five-year average annual returns show significantly better performance figures, and both of course are inclusive of the one-year return figure. Two standout funds over three and five years were Gabelli

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Global Growth and Janus Worldwide fund.

The Gabelli Global Growth fund was formerly named the Gabelli Global Interactive Couch Potato fund, presumably because the fund concentrated worldwide in stocks providing interactive services through consumer electronic products. So the fund is in effect a global sector fund.

Janus Worldwide is a somewhat broader fund with sector emphasis in services and technology, but with familiar technology/services stocks such as Cisco, Nokia, Nortel and Telefonos de Mexico.

KEEPING AN EYE ON RISK

Before you make any performance judgments, look carefully down the risk index column. The risk index is

a measure of total variation in return of a fund over the last three years (standard deviation) compared to the average variation of the other funds in the international category. A risk index of 1.00 would be average, an index of 0.75 would be lower risk than average, and an index of 1.50 would imply 50% greater risk than average.

Because of its broad diversification in terms of industry sector and country, the Vanguard Total International Stock Index has a risk index of only 0.73. However, its emerging market subindex component has a risk index of 1.30. The Vanguard Total U.S. Stock Index, by comparison, has a risk index of 0.82 when compared to international funds—also less risk than the average. Pilgrim Worldwide Emerging Markets (the name alone should

sound risk alarms) has a whopping 1.75 risk index. Unfortunately, the fund also has negative returns, the worst return/risk combination.

Remember Tweedy Browne Global Value? Well, its risk index is 0.56, illustrating the point that stock, sector, and country weightings are the factors that create risk rather than simply the act of investing internationally.

And don't forget currency risk for all international investments. Foreign stocks in foreign markets are traded in foreign currencies and returns are after currency translation back to dollars. A strong dollar means lower returns on foreign investments, a weak dollar boosts returns.

EXPENSIVE MANAGEMENT

International funds are also more

TABLE 1. GLOBAL FUND INVESTMENT CHARACTERISTICS

Fund Name (Ticker)	Average Annual Return (%)			Risk Index	Exp. Ratio (%)	Countries (No.)	U.S. Stock Holdings (%)	International Stock Holdings	
	1 Yr.	3 Yr.	5 Yr.					Largest	Second Largest
Columbia Int'l Stock (CMISX)	-32.1	3.6	8.3	0.86	1.48	19	6.7	U.K.: 18.3%	Japan: 12.4%
Dreyfus Founders: Wld Gr/F (FWWGX)	-39.5	-3.0	3.9	1.00	1.53	17	42.0	Japan: 13.9%	France: 7.3%
Dreyfus Global Growth (DSWIX)	-42.4	-8.2	0.5	1.07	1.36	21	37.8	France: 8.6%	Japan: 8.2%
Fidelity Int'l Grth & Inc (FIGRX)	-26.2	4.0	8.4	0.85	1.05	31	8.5	U.K.: 15.9%	France: 7.4%
Fidelity Worldwide (FWWFX)	-18.4	0.3	8.0	0.74	1.04	28	43.2	Japan: 11.4%	U.K.: 7.9%
Fremont: Global (FMAFX)	-19.1	1.7	6.6	0.58	0.86	38	25.8	Japan: 6.2%	U.K.: 3.2%
Gabelli GI Growth/AAA (GICPX)	-46.2	10.3	18.1	1.23	1.58	12	47.7	Japan: 15.7%	U.K.: 8.8%
Janus Worldwide (JAWWX)	-38.4	6.9	14.3	1.03	0.86	18	36.7	Japan: 9.6%	U.K.: 8.4%
Montgomery Gbl Oppor/R (MNGOX)	-49.8	-3.0	6.9	1.18	1.90	16	23.0	U.K.: 15.3%	Japan: 12.4%
Montgomery Global 20/R (MNSFX)	-45.9	-6.8	5.3	1.02	1.80	13	21.6	Japan: 12.7%	U.K.: 12.6%
Pilgrim Wldwd Emerg Mkt/A (LEXGX)	-58.8	-10.8	-9.3	1.75	2.00	15	7.2	Mexico: 18.7%	Brazil: 11.8%
RS: Contrarian/A (RSCOX)	12.8	-0.1	-6.3	0.96	2.17	7	51.1	Canada: 38.8%	China: 1.8%
Scudder Global Fund/S (SCOBX)	-16.7	1.8	8.5	0.65	1.33	13	37.5	U.K.: 20.2%	Japan: 17.6%
Thomas White Int'l (TWWDX)	-24.2	-1.4	6.3	0.68	1.50	30	5.0	Japan: 16.6%	U.K.: 15.1%
Tweedy Browne Global Val (TBGVX)	5.1	9.6	15.4	0.56	1.38	20	12.0	Japan: 18.0%	U.K.: 11.4%
UMB Scout Worldwide (UMBWX)	-18.2	4.1	11.6	0.62	0.91	24	3.4	Japan: 13.8%	U.K.: 12.0%
USAA Inv: World Growth (USAWX)	-27.7	-1.5	6.3	0.80	1.12	31	35.5	U.K.: 9.8%	Japan: 7.6%
Vanguard Global Equity (VHGEX)	-3.2	5.4	8.8	0.67	0.71	24	33.9	Japan: 15.1%	U.K.: 10.9%
Benchmarks									
Vanguard Tot Intl Stk Idx (VGTSX)	-26.6	-1.1	na	0.73	na	48	0.8	Japan: 22.9%	U.K.: 18.1%
Vanguard Erpn Stk Idx (VEURX)	-22.6	-1.1	11.0	0.70	0.29	16	1.1	U.K.: 30.0%	France: 19.1%
Vanguard Pacific Stk Idx (VPACX)	-32.3	1.7	-6.1	0.94	0.37	9	0.3	Japan: 80.0%	Australia: 8.1%
Vanguard Em Mkt Stk Idx (VEIEX)	-32.1	-6.3	-5.1	1.30	0.58	23	2.8	S. Korea: 17.3%	Mexico: 15.1%
Vanguard Tot U.S. Stk Idx (VTSMX)	-24.4	1.8	12.4	0.82	0.20	9	1.0	na	na

Source: AAI's Quarterly Low-Load Mutual Fund Update, April 2001, and Morningstar.

expensive to run and fund expense is directly reflected in returns: the higher the expense, the lower the fund's return. The expense ratio explains what percentage of your investment is consumed in expenses, not including fund brokerage and transaction costs. The average domestic stock fund has an expense ratio close to 1.00%, but the average expense ratio for an international fund is closer to 1.40%.

Funds with expense ratios that are significantly higher than average must have superior fund management to simply overcome the higher costs—but they rarely do. Conversely, very low expense ratios are like money in the bank. However, don't select a fund solely on the basis of a low expense ratio—that won't work, either.

GLOBAL DIVERSITY

Just how global are these global funds? The last four columns of Table 1 are revealing. First, how many countries are represented in each fund? As a benchmark, there are

48 countries in the Vanguard Total International Stock Index.

What is the minimum number of countries a fund must invest in to be truly considered a global fund? Well, technically only two—the U.S. and one other country. But even seven may not really be enough when country weightings are considered. Take the RS Contrarian fund with its seven countries. It has 51.1% of its stock investments in the U.S., 38.8% in Canada and in third place is China with only 1.8%. This fund is really a U.S./Canada fund, not what most investors seeking a global fund would want.

The percentage of U.S. holdings for these funds ranges from a high of 51.1% to a low of 3.4%; the former fund is dominated by the U.S. stock market and the latter is not directly affected significantly by the U.S. stock market.

The largest and second largest international stock holdings by country can be informative for a fund when the holdings differ meaningfully from the composition of global markets. Look at the

Vanguard Total International Stock Index. Two countries dominate foreign markets: Japan and the United Kingdom. They are simply the largest non-U.S. stock markets. Flip-flops between Japan and the United Kingdom in the two spots are commonplace. But if you see Mexico and Brazil or Canada and China, it's a good bet you are not examining a traditional global fund, but rather one in which the manager is making significant country bets. And unlike a U.S. stock fund, country weightings can and do shift, sometimes dramatically.

GOING GLOBAL

If you do decide to go global in your fund selection, make sure your global fund matches your view of global stock markets and keep an eye out for global funds that are really global sector funds.

Probably the best source for all this information is the fund's annual report. Get it and read it before you send your money on an around-the-world adventure. ♦

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