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**INVESTING IN FUNDS**
*Fundamentals of Investing*  
**Going Global: How Do You Get There from Here?**

**Some pros think U.S. investors should have half their stock portfolio in overseas shares. Here's what you need to know about making a move.**

By **KAREN HUBE**  
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A longstanding effort by many financial advisers and Wall Street market strategists to persuade Americans to think more globally just got another boost.

This month, Citigroup Inc. recommended investors put 55% of their stock portfolio in foreign stocks, in a series of new asset-allocation plans. That's a big boost from 30% in its current plans. With this move, Citigroup joins a growing camp of experts who believe that investors' portfolios should match the world's stock-market weightings to get the best risk-adjusted returns over the long run.



WSJ's Return On Investment columnist Brett Arends talks with personal finance editor Cybele Weisser about why you should be investing in global markets. He discusses how much of your portfolio should go abroad and how to diversify wisely.

The world has changed, and so too must investors, says Jeffrey Applegate, chief investment officer of Citigroup's Global Wealth Management unit. "The primary engines of growth have shifted away from the United States," he says. "Investors need to position themselves to take advantage of global opportunities."


For the typical mutual-fund investor, who holds 12% to 15% in foreign stocks -- or half that in a 401(k) -- holding 55% in foreign stocks would seem like a massive overweighting toward overseas markets. But in fact, mirroring the world markets is a neutral position on the markets because it places no bets on either domestic or foreign stocks, says Peter Bernstein, a Wall Street risk expert.

Indeed, investors' toe-dipping approach to foreign stocks leaves them more vulnerable to big swings in the value of the U.S. markets, and will likely underperform a world-weighted approach over the long run, Mr. Bernstein says.

Why change now? For many investment pros, the logic for loading up on foreign stocks is simple: U.S. stocks aren't as important as they used to be.

American stocks represented 66% of the world's market value in 1970 and have been declining bumpily since then, primarily as a result of the growth in emerging markets, according to Russell Investments, which uses Russell and Morgan Stanley Capital International, or MSCI, indexes in its analysis. Foreign stocks surpassed U.S. shares in 2005, based on the number of shares routinely available for trading, according to Dow Jones

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Indexes, and the Dow Jones Wilshire 5000 Index of U.S. stocks currently represents 43% of the Dow Jones Wilshire Global Total Market Index. Emerging-markets shares total 8.4% of the global index, roughly four times where they stood just four years ago.

**INVESTOR IQ**

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**QUIZ:**<sup>2</sup> Test your knowledge of trends in 401(k) savings plans. What are the newest features?

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3



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Still, it's not surprising investors are confused about how much to put into foreign stocks. Stock pros give widely varying recommendations -- usually anywhere from 20% to 40%. Those with lower allocations to overseas shares cite concerns about currency risk, a higher volatility of foreign shares and lax oversight of foreign companies.

But supporters of a world market-weighted portfolio argue that these concerns are either not relevant to long-term investors or are remnants of an older economy. Rene Stulz, an economics professor at Ohio State University, says it's fine for small investors with a long time horizon to ignore currency movements. He says worrying about

currency risk could prompt individual investors to try to time the currency markets and result in harmful transaction costs as they move money in and out.

As for the idea that a foreign portfolio is riskier than a domestic one, "the numbers don't back that up over the long term," says Christopher Davis, a fund analyst at Morningstar Inc. The standard deviation -- in the mutual-fund world, a measure of how much a fund's returns have bounced around its average return over time -- of the total U.S. stock market was 15.4 for the past 10 years, compared with 15.5 for foreign stocks, including those of emerging markets.

Of course, that's an average figure, so some foreign markets were indeed more volatile than the U.S. But a diversified portfolio of overseas investments will smooth out that risk, experts say, and present no greater volatility than U.S. stocks.

Some pros argue that a diversified portfolio also can ease concerns about lax accounting standards and securities regulation in overseas markets. They think such fears are overblown, but if you spread your money around the overseas sector, your exposure to any such risky situations is limited, Morningstar's Mr. Davis says. And Mr. Stulz of Ohio State University notes that any lax oversight practices are already reflected in stock prices.

One final concern is timing. Some experts aren't convinced that investors should move large sums abroad immediately, arguing that the problems plaguing the U.S. -- tight credit conditions, falling home prices and rising unemployment -- have yet to fully play out in overseas economies, meaning more declines could be ahead.



David Darst, Morgan Stanley's chief investment officer, notes that matching the world's market capitalization skews a portfolio toward the troubled financial sector and away from health-care stocks, which are a defensive play. "The U.S. market currently has 16% financial stocks, while Europe and emerging markets have 22% to 24%," he says.

"We believe that longer term you do want to gradually increase the weighting [in your stock portfolio] to about 40% or more [foreign stocks], but there isn't any rush to buy into these markets, because you still have some rockiness and uncertainty ahead," he says. He wants to

see earnings estimates begin to improve and inflationary pressures ease in foreign markets before expanding exposure to them.

Of course, any argument to boost overseas allocations would have been easier to sell to performance-chasing investors last year, when foreign stocks were outpacing U.S. shares for the fifth consecutive year. Between Dec.

31, 2002, and Dec. 31, 2007, the average annual return of the Dow Jones Wilshire Emerging Markets Index was 46.5%, and the Dow Jones Wilshire Developed Markets, excluding the U.S., averaged 23.3% a year, in U.S. dollars. By contrast, the Standard & Poor's 500 returned an average annual 12.8%, while the Dow Jones Wilshire 5000 returned 14% a year. The figures include reinvested dividends.

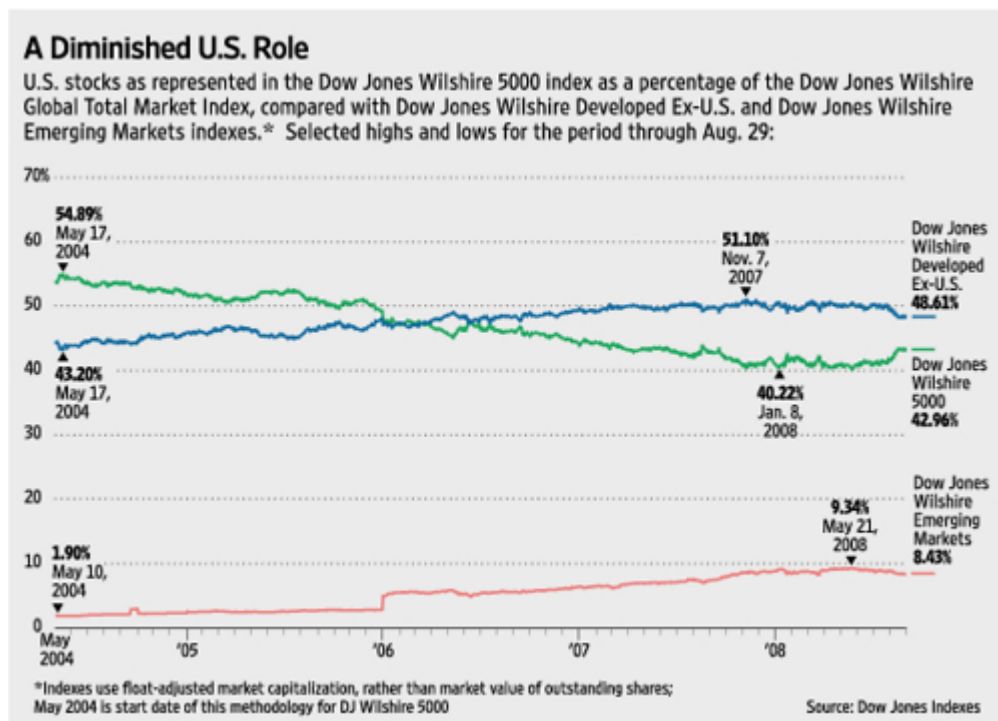
For the first eight months of 2008, though, the emerging-markets index was down 22.7%, and the index of developed nations declined 17%, while in the U.S. the S&P 500 index held up somewhat better, returning a negative 11.4%, and the Dow Jones Wilshire 5000 lost 10.3%.

Still, if you want to increase your foreign-stock allocation, financial advisers say not to spend too much time worrying about the timing. "This shouldn't be a tactical decision if you're going to hold your portfolio for 10 or 20 years," says Matt McGrath, an investment adviser at Evensky & Katz, of Coral Gables, Fla. By trickling money into a larger foreign-stock allocation, "today is as good a day as any to get in for the long term."

What's more, says Citigroup's Mr. Applegate, foreign stocks are likely to outperform domestic stocks in coming years, and emerging markets will be particularly strong. And, strategists note, it's easier than ever to invest overseas. While investors once faced limited and often costly access to foreign markets, most are now easily accessible through mutual funds with modest annual fees.

Morningstar recently counted 747 stock funds that invest outside the U.S., compared with 3,213 U.S. stock funds. While the average expense ratio for the foreign funds is slightly higher than domestic ones -- 1.52% compared with 1.36% -- 30% of the foreign funds have expenses equal to or below the domestic group's average.

While a global approach makes sense intellectually, there is a huge psychological component that may make some U.S. investors reluctant to commit so much to foreign stocks, says Harold Evensky, a founder of Evensky & Katz. "It's hard to get investors to make big changes -- and there is a natural bias toward investing in companies they hear about in the news, even if they are investing in mutual funds and their risk is diversified."



For this reason, Citigroup will keep in place its traditional U.S.-centric asset-allocation model -- 70% in U.S. stocks and 30% in foreign -- as an alternative. "If you agree with our best thinking, the global-centric portfolio is the way to go," Mr. Applegate says. "But getting investors there is going to be a work in progress," and some will choose to stay in their comfort zones and overweight U.S. stocks.

The fact is, most investors have so little foreign exposure that they could benefit from beginning to expand it. "They could do a bit at a time, to suit their comfort levels," Mr.

Evensky says.

**The Next Step**

So, what's a game plan for individual investors who want to move more money abroad? First, consider how much foreign exposure you already have -- it may be more than you think. "Some U.S. funds have a smattering of foreign stocks," says Peggy Ruhlin, an investment adviser in Columbus, Ohio, who recommends dedicating 25% to 30% of a stock portfolio to foreign stocks. Many fund firms' Web sites include easy-to-access lists of their funds' holdings, and these also can be found on investment Web sites, including [Morningstar.com](http://Morningstar.com)<sup>5</sup>.

You may also have exposure to the global economy through multinationals like Exxon Mobil Corp., International Business Machines Corp., General Electric Co. and Johnson & Johnson -- but don't count that as direct foreign exposure, Mr. Applegate says. One reason to hold foreign stocks is to get currency diversification. With currencies of some developing nations poised to rise sharply in coming years, investors could miss big gains by assuming U.S. multinationals give them direct foreign exposure, Mr. Applegate says.

Investors constructing a portfolio for the first time may want to start by selecting a single global fund or ETF to get both U.S. and foreign exposure and later, as assets grow, add one U.S. and one broad foreign fund or ETF, Ms. Ruhlin says. While the stock-picking expertise at the industry's newer global funds has evolved in recent years, "you don't want to abandon [the U.S. and non-U.S. stock-fund categories] because that's where a lot of the talent is," says Tim Noonan, managing director at Russell Investment, which recommends up to a 33% allocation in foreign stocks.

For those investing in a 401(k) or other tax-deferred account, shifting money between funds to bulk up on foreign stocks won't have tax consequences. So, advisers suggest adjustments to a portfolio there first, to the extent possible. International-stock funds are one of the most popular offerings in 401(k)s, according to a 2007 survey by Hewitt Associates, a Lincolnshire, Ill., benefits-consulting firm.

If you've tapped out your opportunities there -- or if you're dissatisfied with your plan's offerings -- don't worry. This year's bear market may provide opportunities to harvest losses in taxable accounts to offset gains from other fund sales, to help you free up money to beef up your foreign holdings.

When it comes to actually picking funds, lower-cost global options include Fidelity Worldwide Fund and T. Rowe Price Global Stock Fund, both run by teams of stock pickers. In June, Vanguard Group Inc. introduced its first global index fund, Vanguard Total World Stock Index Fund.

Fidelity International Spartan Index and Vanguard Total International Stock Index are ultra-low-cost non-U.S.-stock index funds with low minimum investments for those setting up an automatic monthly or quarterly investment plan to augment a tax-deferred savings plan. Among ETFs, financial advisers often favor **iShares MSCI EAFE Index Fund**. Another ETF recommended by some advisers is SPDR MSCI ACWI ex-US ETF, which tracks an "all-country world index" that excludes U.S. shares. **Vanguard FTSE All-World ex-US Index Fund** can be bought as a mutual fund or ETF.

An option well liked by many financial advisers is American Funds EuroPacific Growth Fund, where stock pickers focus chiefly on Europe and the Pacific basin, looking for both small firms and large corporations.

While you're choosing among funds, remember to stay diversified. Carl Johnson, an investment adviser at Ames Financial Planning in Peterborough, N.H., cautions that even seasoned investors shouldn't place bets on specific industries or areas of the globe. "Don't try to figure out if the next big thing is Indian oil or cars or shoes," he says. "Just buy the whole stock market of India."

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