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A Guide To Safe Financial Sex

BY DAN DORFMAN

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So, how do investors protect themselves?

That question is surely on many minds after the recent series of triple-digit Dow Jones Industrials losses, culminating in yesterday's decline of 387.1 points.

"It's a wise man who does not venture all his eggs in one basket," the legendary battler of windmills, Don Quixote, was told by his trusty squire, Sancho Panza. Some pros suggest this comment aptly applies to investors with all-American portfolios. That, in turn, raises a knotty question: How much of a portfolio should be invested in overseas markets?

"In this market, you need a bulletproof vest, which is international diversification," Los Angeles money manager and day trader Arnold Silver, told me. "I tell my clients that 20% to 25% of their funds are going into foreign markets, that if they're going to have financial sex in this kind of volatile climate they need a condom."

That means, he said, a bigger representation of foreign stocks and active playing in emerging markets, particularly the world's four most exciting markets, Brazil, Russia, India, and China, known as the BRICs.

Mr. Silver, whose firm, A. Silver Associates, manages about \$110 million of wealthy clients' assets, views the market's recent string of triple-digit shellackings as a wakeup call to investors to seriously consider the hedging value of a more substantial international portfolio. Among his personal investments, he said, close to 50% is presently centered in overseas markets.

"I don't know what's going to happen with the sub-prime mortgage mess or the turmoil in housing and I don't know anyone who does," he said. "So how can anyone be comfortable with an all-American portfolio? My feeling is they can't be and shouldn't be."

Money manager Lou Gerken, whose San Francisco-based firm, Gerken Capital Associates, manages and advises institutional clients with about \$1.4 billion of assets, is even more conservative on American stocks in his personal portfolio; in fact, he doesn't own a single one, he told me, explaining it's largely a matter of growth, what with economic growth rates in the emerging markets two to three times greater than those in America and Europe.

He notes, too, that it's not as easy to capture value in the American market as it is in the emerging markets because too many professional investors, namely some 10,000 hedge funds and 3,000 private equity and venture funds, are chasing the same American and European stocks.

Mr. Gerken is so gung-ho on the emerging markets that his firm, which already includes the outperforming \$50 million Greater China Fund, is planning to introduce another EM venture, the Latin American Fund, on September 1. He notes that many investors may be unaware of it, but from 1999 to the present, the Latin American markets have outperformed the Asian markets, excluding Japan, and have done it with half the volatility. The new fund will feature investments in Mexico and Brazil, the two largest countries in the region, which represent about 80% of its gross domestic product, as well as in Argentina, Chile, Columbia, and Peru, all growing markets.

Mr. Gerken didn't say it in so many words, but he intimated pretty strongly that it was crazy for investors not to be involved in the EMs. "About 25% of a portfolio is a respectable target," he said. He believes the next money-making wave in EMs will likely be realized in South Africa.

Global investment whiz Jim Rogers, a former sidekick of George Soros, has been a consistent winner in foreign markets. Mr. Rogers, who is planning to move to an English-speaking country in Asia, said he "expects things to get considerably worse in America," and is short Fannie Mae and the homebuilders. His favorite foreign investments, all currencies, are the Chinese renminbe, the Japanese yen, and the Swiss franc.

Analyst Michael Larson of Weiss Research of Jupiter, Fla., is another advocate of EMs, but he hoists some cautionary flags. In particular, he takes note of such risks as an unexpected rally in the dollar, potential credit and political problems, and the sudden emergence of great market volatility. "You'll see hiccups along the way, but much faster economic and stock market growth overseas necessitates aggressive diversification across foreign markets," he said. Through diversification, he said, "you're diversifying away from a weakening American economy saddled with rising housing and mortgage problems. About a 20% to 30% portfolio representation [for overseas markets] makes sense to me."

Investors, he added, should also take cognizance of the fact that the American market has become a laggard, last year placing only 56 among the world's top performing markets. His three favorite markets, each of which can be invested in through an exchange-traded fund, are China (ETF symbol FXI), Brazil (EWZ), and Canada (EWC).

Money manager Tim Kochis sees overseas outperformance versus America — a trend he expects will remain in effect at least several more years — spreading to more countries, among them Pakistan, Thailand, Korea, and Poland. Mr. Kochis, the chief executive officer of Kochis Fitz, a San Francisco-based manager of \$2.5 billion of institutional and wealthy individuals' assets, has anywhere from 25% to 45% of each client's holdings invested in overseas markets.

He sees periodic bumps in the road, such as terrorism and natural disasters, but he views them as temporary roadblocks. "You go with outperformance and outperformance is abroad," he said. For the average investor, his favorite overseas plays are a couple of funds — T Rowe Price Emerging Markets and the Vanguard Total Stock Index Fund.

dandordan@aol.com

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