Institutional Investor

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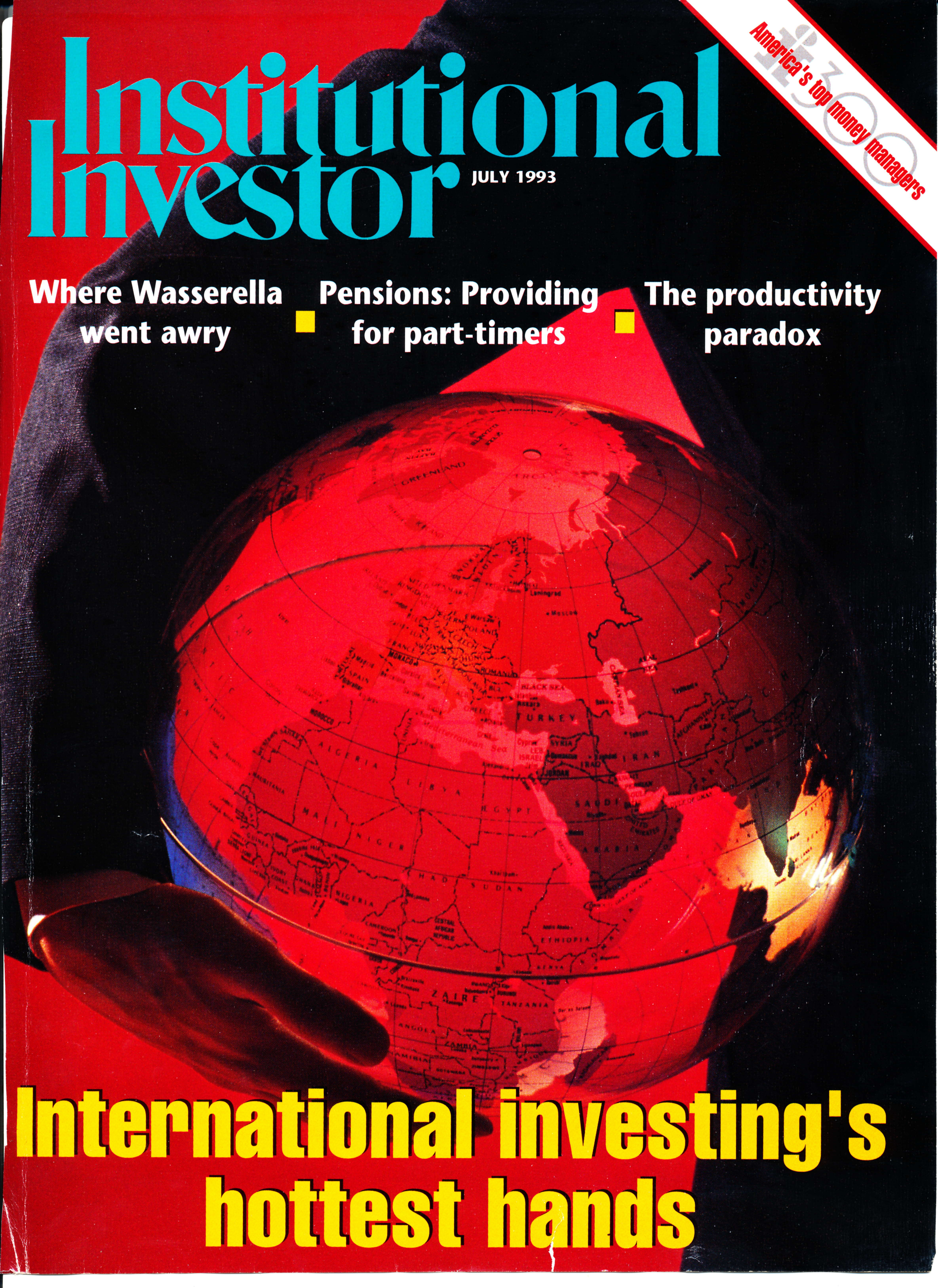
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International investing's hottest hands

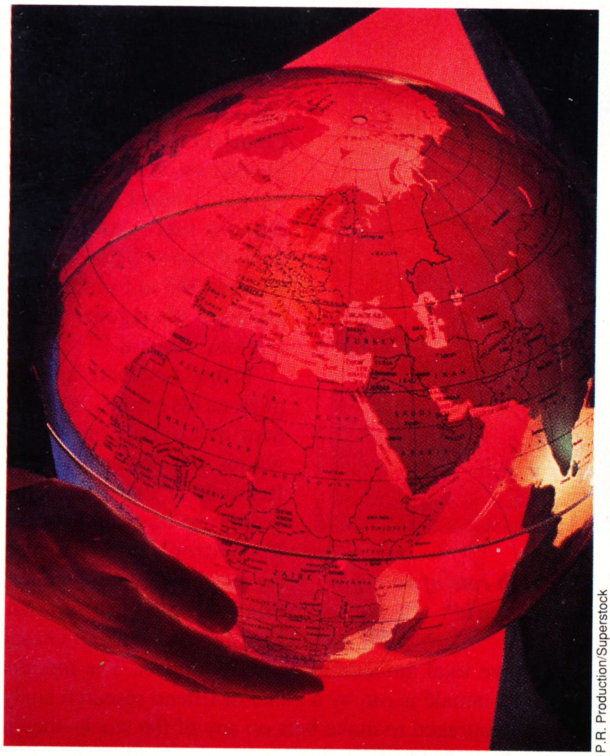
INTERNATIONAL INVESTING'S HOTTEST HANDS

Their styles may be worlds apart, but these five managers have all shown a sure touch for global markets.

BY ALYSSA A. LAPPEN

The wide world makes a dandy asset class. So more and more American money managers are discovering to their delight. U.S. investors poured a record $51.5 billion into cross-border and overseas markets in 1992, according to a recent report from the Securities Industry Association. That brings American investments in foreign`securities to $340 billion, nearly twice the sum of three years ago.

It was the equity markets that lured U.S. investors abroad, several decades ago in the case of the funds founded by pioneers like Sir John Templeton and Capital Guardian Trust Co. But today about 42 percent of Americans' total foreign commitment is in fixed income. Pension funds account for most of the rush overseas. But the general public, too, has been sold on international diversification: As of the end of April, assets in international and global equity and bond mutual funds available in the U.S. had passed the $80 billion mark.


P.R. Production/Superstock

The reasons why historically provincial U.S. investors have adopted a new worldliness are obvious. They have been driven offshore by the double whammy at home of too-low interest rates and too-high equity prices. U.S. pension managers and individual investors alike, moreover, have awakened to a concept long appreciated in places like Hongkong: The global village is a giant borderless trading bazaar offering numerous investment opportunities around the clock.

Increasing liquidity in overseas markets has also oiled the flow of capital into Europe, the Far East and Latin America. So have the growing completeness and frequency of corporate disclosures, as companies like Daimler-Benz seek listings on the New York Stock Exchange (see page 81). Serendipitously, demand for diversification among U.S. managers is rising just as many foreign economies are projected to expand twice as fast as the mature U.S.'s.

Despite the recent migration of money abroad, U.S. investors in foreign markets can still find plenty of elbow room among their peers. Less than 7 percent of the $5 trillion in U.S. institutional and mutual fund assets is now committed abroad. The greatest expansion plainly lies ahead. Stamford, Connecticut, consulting firm InterSec Research Corp. estimates that in another five years U.S. pension funds alone will have shipped $450 billion abroad, up from $152 billion at the end of last year.

Unlike so many boom-today-bust-tomorrow investment fads, the American attachment to international securities has all the earmarks of permanence. Yet few of the stellar managers of these variously exotic, frequently volatile, sometimes unpronounceable stocks and bonds have received the recognition given to their domestic-market counterparts.

Thus *Institutional Investor*, with help from Lipper Analytical Services, Morningstar, Nelson Publications and pension consulting firms like Evaluation Associates and Frank Russell Co., as well as from several clients and seasoned market observers, combed the returns of dozens of top money managers to find the standouts at international investing. We limited our choices to managers of funds registered with the Securities and Exchange Commission to ensure that the funds would be available to U.S institutional investors. (In the process, we had to eliminate some acknowledged superstars, like George Soros, because they manage offshore funds).

To qualify, managers needed size (portfolios had to be at least $100 million); longevity (records had to run at least five years); and consistency (any one year's decline could not exceed 25 percent). We focused on distinct categories of managers: international (strictly non-U.S.) equities; global equities (U.S. as well as non-U.S.stocks); emerging-markets equities; Pacific Basin equities; and global fixed-income securities.

In Europe, where markets have performed dismally, we could find no SEC-registered manager that has outperformed the Morgan Stanley Éuropean index. The best talent in this area may work out of the U.K. or the Continent.

As more U.S. money washes overseas, the trick for each of our five stars will be to continue to outshine the market averages as their asset pools grow.

DAVID FISHER: EMERGING MARKETS

COMPARISON SHOPPING IN THE THIRD WORLD

In the fall of 1985, David Gill, who then headed the capital markets department of the World Bank's International Finance Corp., called on David Fisher, who was president of Capital Research & Management Co. in Los Angeles. The IFC wanted the firm to consider managing a closed-end fund it was proposing to put together to raise money for emerging markets. Capital Research had a long and respected track record in international investing, but about the only traveling Fisher and his analysts had done to emerging markets was as tourists. He recalls: "This wasn't something we were sure about. A lot could go wrong. We had a good reputation and didn't want to screw it up in some funny country."

Nevertheless, Fisher, then 46, saw the merits of the idea and pushed for it. "I thought it was an attractive investment, and that the people we had would do well," he explains. "I thought we could learn something that would be helpful with our investment decisions in other places, and I thought it could raise the cost to compete with us." Three out of three isn't bad.

Steve LaBadessa

Capital International's Fisher: "The growth rate of emerging markets will be twice that of the developed world"

The initial public offering in June 1986 of Capital's closed-end Emerging Markets Growth Fund raised $50 million. "We had to claw to raise that much," Fisher remembers. By the end of the year, the fund was fully invested, and, oh, what a ride it has had. The pension funds of U.S. companies like AT&T, General Motors Corp., IBM and Atlantic Richfield Co. have seen their initial investments more than sextuple in value. As board members of the fund, their managers have also been understandably happy to add to the number of authorized shares and then quickly snap up a large part of them. In the five years ending April 30, the fund has returned more than 32 percent, compounded per year. Assets today stand at more than $2.3 billion, and the directors plan to issue another large block of shares soon. This time they might even let in a few additional newcomers.

Even for the often highly rewarding, albeit risky, emerging-markets arena, Fisher's performance is unusual. (The only other players who come close to matching him are Templeton, Galbraith & Hansberger's Mark Mobius and Antoine van Agtmael, a protégé of David Gill who left the IFC in 1987 to form Emerging Markets Management in Arlington, Virginia.)

Fisher's methods are as singular as his results. Now president of Capital International, which was set up by Capital Research in 1988 with Fisher's fund as its flagship, he divides his portfolio into five pieces. He and his three associates — Shaw Coda Wagner, Mark Denning and Harmut Giesecke — each have total autonomy over one portion. The remaining piece of the tamale is run by a panel of fifteen research analysts who are encouraged to make bets on any of the stocks they recommend or to hold off if they see nothing attractive. (Their remuneration is tied to their performance.) "We have not found investment truth," says Coda Wagner, "but we think that the system, which we also use in Europe and the U.S., for big- and small-cap stocks alike, happens to work well."

Fisher's team never makes country allocations. It follows a stock-picking approach, heavily based on comparing companies in the same industry in different developing countries. For example, in late 1990 research analyst Midori Aoki spent two months studying Brazil's Telecomunicações Brasileiras, stacking it against Teléfonos de México and other phone companies. Ultimately she weighed in heavily for what she considered a highly misunderstood stock, and in time it became the fund's largest holding. The shares have quintupled since Aoki first recommended them.

Other large fund positions include Bangkok Bank, Telecomunicações de São Paulo (São Paulo's local phone operator), Telmex, Philippine Long Distance Telephone Co., Siam Commercial Bank and Thai Farmers Bank. "Our colleagues in the developed-world markets look at utilities and banks as mature industries," says Coda Wagner, but at Capital they're viewed as the engines of growth for emerging economies.

Fisher and his colleagues, noting that their competitors in emerging-markets investing are not exactly fly-by-night boutiques, shrug off the notion that the trend is a fad and see only growth ahead. In 1986 only a handful of emerging markets allowed investments from the fund; now 21 do. Capital International has plans to invest as much as 2 percent of its assets in Eastern Europe through another fund.

Lest shareholders become overconfident that Fisher's team can continue to reward them in the way to which they have become accustomed, he cautions: "You don't compound at 33 percent per annum forever. That is unsustainable. But the growth rate of emerging markets will be twice that of the developed world. And valuations are actually at a modest discount to those in the developed world." His shareholders shouldn't be too disappointed.

DAVID BRENNAN: *PACIFIC BASIN EQUITIES*

GETTING THE HANG OF BEING A 'HONG'

Baring International Investment Far East, a subsidiary of the London merchant bank, is said by some, only half in jest, to be "one of the original *hongs* [trading houses] in Hongkong." It launched its New York Stock Exchange–listed closed-end fund — the Asia Pacific Fund — in 1987, and one year later put it into the hands of David Brennan.

A 35-year-old Englishman who has lived in the Far East for eleven years (ten in Hongkong), Brennan certainly seems to know his way around the neighborhood. His $163 million fund has grown at a compound annual rate of 22.4 percent for the five years ending April 30, compared with 14.8 percent for the Morgan Stanley Pacific (excluding Japan) index.

Admittedly, part of what makes the performance of this young managing director and chief investment officer sparkle is that the fund's charter requires him to stay the heck out of Japan and Australia. But, as he notes with disdain, he wouldn't be seen in either of those markets now even if he could invest in them. "Japan is still trading at 70 times earnings and growing 2 percent a year, compared with most of Southeast Asia, which is growing 7 percent a year and trading at multiples of only 10 to 25," he says. "What one has to bear in mind," Brennan adds, "is that we invest in some of the fastest-growing economies in the world — with growth rates exceeding twice that of the developed world."

Baring's Brennan: "We are focusing on those companies that are making significant bets across the border in China"

Brennan and his eight investment managers travel the region constantly, visiting the companies in which they invest. Brennan works top-down to select countries in the region that offer good opportunities, but then relies on old-fashioned, bottom-up fundamental research to pick companies. "Our primary focus is growth, but we use value as a filter to make sure we're not paying too much," he explains.

At present Brennan likes Thailand, where 63 million people labor for low wages but are clamoring for consumer goods. The country's GDP is growing at a solid 8 percent a year, but its stock market, which traded as high as 26 times trailing earnings in 1990, has fallen back to a cheap multiple of 12.

Brennan, who sticks mostly to large-cap stocks, relatively speaking, says that in Thailand this means $250 million or more. He owns the Bank of Ayudhya; consumer stocks such as Haadthip, the Coca-Cola Co. bottling franchise for southern Thailand; and Land & House, which, as its name suggests, builds housing for Thailand's growing middle class. He is also involved in South Korea (12 percent of his portfolio), Malaysia (20 percent) and Singapore (6 percent).

Brennan's heaviest holding, though, is in Hongkong: 43 percent of his portfolio. That's despite political jitters and the Hongkong market's apparent priciness relative to those in the rest of developing Asia. "We are focusing on those companies that are making significant bets across the border in China," he says. "The best businesses in Hongkong use Hongkong skills in combination with China's cheap labor. The big question is political, of course, but the big opportunity is economic, and the economic linkages are so strong that politics is fading into the background."

Brennan likes Li Ka-shing's Hutchison Whampoa because of its healthy position in real estate, trading, port operations and telecommunications — all businesses that are crucial to the economic development of China. Another holding is New World Developments, which is redeveloping parts of Beijing and has contracts that carry very attractive guaranteed returns to build airports in central China. Besides, those airports are sure to bring in more investors.

MARK TURNER: GLOBAL FIXED INCOME

A TRADING MENTALITY, A GLOBAL ITINERARY

The realm of fixed income is not a place where one would expect to find handsome gains year in and year out, much less returns that nearly match those of equities. But Mark Turner seems to have found a way to make bonds behave like equity for investors.

Before joining Putnam Investments last November to take over global fixed-income chores from Stephen Bartow (*Institutional Investor*, March 1993), Turner achieved a superb record during four years at Scudder, Stevens & Clark. His earlier record at AIG Global Investors was no less dazzling. The 40-year-old, London-born Turner led the $750 million Scudder International Bond fund to a No. 1 ranking in Lipper Analytical Services' global bond mutual fund universe for the three- and four-year periods through the end of 1991. A mere four-year-old when Turner left, the fund precociously realized compound annual returns of 16 percent under the portfolio manager. In the same 1988 to 1991 period, Salomon Brothers' World Bond index, by contrast, compounded at an annual rate of only 10 percent. Turner's was the only international bond fund to earn a five-star rating from Morningstar.

Turner is inclined to share the credit for the fund's success. "No one person does it all," he is quick to note. Bartow, who will stay on as a consultant until December, was himself no slouch. "We rely on the capabilities of our traders, who expedite everything and trade 24 hours a day. A lot of the markets trade deepest when we're asleep. People who want to control everything and can't delegate miss opportunities. Analyzing all this is beyond the scope of one mere mortal."

Shawn Henry/SABA

Putnam's Turner: "We see long-term bonds, by and large, as short-term investments"

Bill Haan, who heads the foreign exchange desk at Putnam, came with Turner from Scudder. In all the group is responsible for Putnam's $500 million Global Government Income mutual fund, as well as its $3.6 billion in institutional global bonds and $1.1 billion for other Putnam funds. Besides Haan, Turner has three portfolio managers, four traders, an emerging-markets analyst and one analyst who concentrates on global strategy.

"We see long-term bonds, by and large, as short-term investments," Turner continues. His team zooms in and out of securities, leaving a 250 percent turnover in its wake. That's necessary, says Turner, because the world is "not a very coordinated place." For example, while an economic recovery has begun in Japan, Germany has fallen off precipitously. In other words, one must run at times to keep up with sometimes volatile interest rates and currencies. Currently Turner has only about 5 percent of his portfolios in U.S. issues, since he regards the interest rate cycle as mature. He is most excited by Europe, where he has a 50 percent exposure — 10 percent in core European Community nations and 40 percent in countries like Finland, Sweden, Italy, Spain and the U.K. The balance: 15 percent in Canada, 20 percent in Australia and 10 percent in Japan. He and his group anticipate a drop in European interest rates this year that will duplicate last year's scenario in the U.S.

"Interest rates have to come down in the fringe areas of Europe where we're concentrating," he asserts. "We have a neutral view on the U.S. dollar against the deutsche mark, but we are positive on European currencies versus the deutsche mark. Germany is faltering as the others have depreciated their currencies and started increasing their exports."

Money has been pouring into global fixed income at such a rate that a year ago Putnam felt compelled to close the window to its institutional fund. (It's still taking assets from existing clients and will probably reopen to new clients shortly.) But its retail Global Government Income fund is still growing rapidly.

Turner warns that gains on bonds, his own funds' included, are now almost certain to come down. "Returns have been generated by inefficiencies in the markets," he points out, "but as more participants come in, the opportunities are reduced." He recalls nostalgically the heady returns out of Australia and New Zealand in the late '80s. On the other hand, he says hopefully, "more markets are coming onstream." What's caught his fancy lately? "We may see some good opportunities with the Greek drachma, where yields are upwards of 20 percent and inflation is only 14 percent."

Charles Brandes: Non-U.S. Equities

Ben Graham's Ambassador-at-Large

The name Brandes Investment Management does not leap to mind in tandem with Templeton, Galbraith & Hansberger, Capital International and Morgan Stanley Asset Management. It should.

President Charles Brandes has racked up compound annual returns of 22.9 percent after fees for the five years ending April 30 for his San Diego firm's non-U.S. equity portfolios. That compares rather well with a dismal 2.3 percent for the Europe, Australia and Far East index and 8.1 percent for the Lipper International index.

Rocky Thies

Brandes Management's Brandes: "As well as value has worked in the U.S., it has worked even better overseas"

"We don't have much competition, so it's not really all that difficult," says the soft-spoken Brandes with exaggerated modesty. What he means specifically is that few players in the overseas markets are dedicated to Ben Graham's value theories, a shortcoming that Brandes claims makes his job a lot easier. While others pick countries and then hunt for growth, Brandes stubbornly sticks to a bottom-up search for value stocks with high yields and low price-to-earnings, price-to-cash-flow, price-to-book-value and debt-to-equity ratios. "As well as value has worked in the U.S., it has worked even better overseas," he says.

San Diego may be better known for its zoo than for its international financial flair, but Brandes insists "you can invest from anywhere in the world." He and his managers and thirteen staff analysts rely on company visits, local research and data bases to keep up.

Both Brandes's reputation and his assets under management are growing. Although he began investing heavily in non-U.S. equities in 1980 — compound annual returns since then have been 19.7 percent after fees — his international commingled fund has expanded by nearly 50 percent in the past year, to $520 million, as word of his performance has spread. The fund's $100,000 minimum is modest for a private money manager, so Brandes's assets have been gathered largely via brokerage houses from wealthy individuals and smaller institutions. Attracting assets at a similar pace has been his $330 million global-equity fund, whose five-year compound annual return of 18 percent actually beats that of Lazard Frères Asset Management's Herbert Gullquist (see next page), though with the advantage of a considerably smaller asset base.

Clients love Brandes. As they say in New York, what's not to love? "Although there have been some years when value was out of favor, he has been outstanding," says Arthur Shingler, vice president for financial affairs at San Diego's Point Loma Nazarene College, who discovered Brandes six years ago and now has about $6 million invested with him.

Most of Brandes's performance has been through steady and spectacular gains, but he has minimized losses as well: In the killer year of 1990, the fund was down only 2.7 percent after fees. One reason for Brandes's consistency: He has avoided Japan for the past six years. "We only look at value," he deadpans.

Brandes will buy value wherever he finds it: "We are all over the world." Some of his biggest successes have been large-cap, well-known stocks like Teléfonos de México, which he bought in 1990 at $12 (it has since reached $49); Jardine Matheson Holdings, the Hongkong trading house; and Akzo, the Dutch chemicals and pharmaceutical giant. One of his recent picks, on the other hand, is little-known Tiphook, a London-based truck-and-container lessor whose American depositary receipts Brandes bought at about 11½ — just 4 times trailing twelve-month earnings — after the company announced that Europe's recession would hurt truck earnings.

Size might eventually become a problem for his fund, but as yet Brandes is not worried either about finding new ideas — "There's a lot of value overseas," he notes — or about liquidity, since the average market cap of his holdings is $10 billion. Whether Brandes can continue to outperform the markets by such a wide margin is another matter. But he thinks he has a better shot than most. "Our competitors often stick close to the indexes, and we move away from them," he explains. "Hongkong makes up 3 percent of the EAFE index, but we have a lot more of Hongkong than that. We also concentrate our portfolios much more, holding only twenty to 30 stocks." There's more than a Graham of wisdom at work here.

Herbert Gullquist: Global Equity

Defying Conventional Wisdom

As the 1980s faded out, the buzz among American equities managers was that the real investment opportunities had emigrated to foreign markets. As it turned out, however, anyone who tied their investments to the Morgan Stanley world index would have been sorely disappointed. Its compound annual return for the five years ending April 30? A decidedly ho-hum 6.1 percent.

That lackluster showing makes the performance of the global investment team at Lazard Frères Asset Management — headed by chief investment officer and Lazard partner Herbert Gullquist — all the more remarkable. Over those five years Gullquist's gang more than doubled the index, achieving an enviable return of 15.4 percent. They even managed to outstrip the Standard & Poor's 500 index.

Gary Spector

Lazard Frères' Gullquist (left) and Reinsberg: "The main thing we try to do is apply domestic disciplines offshore"

Gullquist, in good Lazard tradition, is circumspect about his stock picks, to say the least. Asked to reveal some of his latest finds, he assumes a knowing grin and remains silent. Nevertheless, in the first interview that the 55-year-old, Northwestern University–educated American has granted to the press in eleven years at Lazard, he did reveal a few of his trade secrets — along with a bit of history for perspective.

A dozen years ago the accepted wisdom was that one could take a bottom-up approach to investing onshore but not overseas, where country decisions had to come first and individual stock selection last. Gullquist, who joined Lazard in 1982 from Oppenheimer Capital, where he had been a partner and chief investment officer, thought that "wisdom" nonsense. In 1985 he spearheaded Lazard's global investment capability by persuading a few long-standing clients to sign on and set out to prove that value-oriented stock picking could be practiced anywhere. "The main thing we try to do is apply domestic value disciplines offshore," explains Gullquist, who emphasizes his points with staccato phrases: "Bottom-up. Group action."

The Gullquist team relies on strict fundamental analysis to find undervalued stocks that look cheap relative to cash flow, assets, book value and earnings — earnings being consigned to the bottom of the list — wherever the companies may be based. Gullquist downplays earnings because accounting discrepancies around the world tend to distort them country to country. European companies are notorious for using hidden reserves and other dodges to minimize taxable profits.

Today Lazard manages more than $600 million in global equities in fifteen separate institutional accounts and a commingled fund for clients like the Hercules Pension Fund and the Common Fund. To cover the world requires a far-flung research group. Gullquist has 25 analysts in New York, and can call upon the expertise of professionals at Lazard Brothers & Co. in London, Lazard Frères et Cie. in Paris and the firms' offices in Tokyo, Frankfurt and Milan. His team, whose 28 members speak twelve languages among them, submits ideas for peer-group review. "We are the chiefs," Gullquist says of himself and his two partners. "We have the final say, but we try not to use it." General partner John Reinsberg, 37, joined Lazard from GE Investments in 1991, and general partner and chief operating officer Norman Eig followed Gullquist from Oppenheimer.

One fruit of the team's research — S.M.H., the Swiss company that makes Swatch and other watches — ripened improbably enough during the Persian Gulf war. The connection? In late 1990, when the U.S. was threatening to bomb Iraq and leisure and business travel around the globe came to a virtual halt, S.M.H.'s stock took a drubbing from investors because the company sells a lot of Swatch watches at airport stores. Gullquist's team, able to understand Swiss accounting, determined that the company's *sachanlagen* (fixed assets) were one quarter of its *versicherungswert* (its insured value — an indication of true value). So he bought, scaling back gradually as the stock tripled.

Earlier this year his experts spotted Volkswagen as a likely prospect. The stock had fallen to less than half its former value and was trading at a steep discount to book value because of high costs and other well-publicized problems at the company. "We began to buy just before José Ignacio López de Arriortúa, the General Motors Corp. purchasing czar, came in," says Gullquist. That gave the stock a considerable boost. He also mentions Sears, Roebuck and Co., which he bought in mid-1992, when the stock was selling near book. After Sears management backed away from its long and ill-advised love affair with its financial subsidiaries and refocused on retailing and on cutting debt and costs (see page 71), the shares rose 25 percent.

Gullquist also engages in a good deal of "valuation arbitrage." In the past he bought American depositary receipts of companies like Royal Dutch Petroleum, Unilever and Elf Aquitaine at values as low as one third of their U.S. counterparts. But he still effectively buys dollar bills at a discount by acquiring foreign companies, like the Spanish bank Argentaria, when they list on the NYSE.

Though Gullquist rarely hedges his current positions — "We don't position ourselves as currency experts," he says — he did have the foresight not long ago to cover the forex risk on several Spanish stocks he liked. That was a good move: In mid-May the peseta was devalued by 8 percent.