Chapter 1
Why You Should Invest in Emerging Markets

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THEY DIDN'T TEACH THIS STUFF IN BUSINESS SCHOOL!

In the early 1990s, I made a fortune buying *open-end funds* in the "developing countries" of Asia and Latin America. In the process, I developed a systematic process that you too can easily follow to safely reap the rewards that these *emerging markets* offer. Particularly now as we enter the new millennium, these markets are especially ripe for making significant amounts of money.

You will be pleased to know that following my *investment* program for these country funds requires very little stock-trading knowledge. So whether you are a new investor or a sophisticated trader with years of experience, you can benefit from these strategies.

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open-end fund
the same as a mutual fund. A closed-end fund often is incorrectly referred to as a mutual fund; but actually it is an investment trust.

My system was designed to require only 15 minutes a day to manage, much less if you take the long-term approach. So you will not even need to quit your day job in order to maximize your investment returns. How did I gain this knowledge? It all started in college....

I became a business major primarily because I wanted to be successful making lots of money. It seemed very logical: Most of the wealthy people I had heard of (at that time, I did not actually *know* anyone wealthy) made their money in one form of business or another. Oh, and then there were doctors, but that's another story.

So, in 1983, at the age of 17, I entered my university as a business major. It wasn't too long--after an accounting class or two--that I felt a bit bored and creatively unchallenged as a business major. But more important, they were not teaching me how to make money; they were teaching me how to make *other people* money.

After graduating, my wanderlust spirit started to take root, so I looked for graduate programs in business in exotic locations. I selected the University of Hawaii in Honolulu. Hawaii was a respected international business school, specializing in the Asia-Pacific region. And I even got a full teaching assistantship, with tuition waivers. Now I could finally learn to make money!

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emerging market
a financial market of a developing country, usually a small market with a short operating history.

investment
an item of value purchased for income or capital appreciation.

Well, you would not believe it: They do not teach you how to make money in graduate school

either. As in undergraduate school, they teach you how to make other people money. In Finance, we learned how to calculate the "future value" of things. I never used any of this in business later--not even when I worked for a bank in Asia. In Managerial Accounting we learned about... you know, I cannot really remember. And Economics...well, we did learn about interest rates and inflation, but not how it applied to the real world.

So, I graduated with an MBA at the age of 23, and entered the real world to learn about business and how to make money.

After a year or so of working for a management consulting firm, first in Washington, D. C., and then in Toronto, I took the second big adventure of my life: I packed my bags and moved to Hong Kong and China in search of success and happiness. This would prove to be one of the most educational and interesting decisions of my life.

It was 1990, and the United States was entering a recession. As a relatively fresh MBA, I was not in great demand in the American work-force at the time. Young MBAs were the first to be cut from companies hit by the struggling economy. Europe was also hit hard. But Asia was booming. Not having secondary language skills, however, limited my choices. For example, Japan had its own MBA population and was a monolinguistic society. Hong Kong stood out among the Asian countries: highly capitalistic, American-friendly, English was a common second language, lax visa standards, and a desperate need of American management know-how. What a great opportunity to put my making-other-people-money skills to good use.

My second job in Hong Kong was where I first really learned about international finance and how to make myself money. I was hired as special assistant to the general manager of Standard Chartered Bank. Standard Chartered is a British bank with a long history in developing countries, particularly China and India. It was here, as the personal assistant to the bank's chief executive, that I got to see firsthand the daily operations of the bank's retail, corporate, treasury, stock broking, and private banking divisions. It also was here that I watched senior executives manage their own money from Reuter's terminals on their desks.

As you may know, Reuter's is an internationally respected news service, which sends live news, stock, and other financial information to special terminals for a *very* costly monthly fee (thousands of dollars, I believe).

I am very excited to tell you that now you and I can get most of this information free over the Internet. Later I will explain how you can receive live stock data at very reasonable monthly fees. This is a very special time for the personal investor.

It was also at this time that I jumped in and took my chances at stock market investments. My first risky investment was an $800,000 apartment I purchased with a loan from my bank; I quickly resold it at a profit a few months later. In 1990, without the Internet and online brokerage houses, if small-time investors like me wanted to get a piece of the action, we could do it through *mutual funds.* At the time, there were a handful of fund companies that specialized in open-ended emerging market mutual funds. (A little later I will discuss open-end and *closed-end funds* in detail). I took my profits from my real estate venture and invested them in India, China, Singapore--all of the booming Asian markets--through mutual funds.

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mutual fund
an open-ended fund operated by an investment company that raises money from shareholders and invests in a group of assets, in accordance with a stated set of objectives. Benefits include diversification and professional money management. Shares are issued and redeemed on demand, based on the fund's net asset value, which is determined at the end of each trading session. A

closed-end fund often is incorrectly referred to as a mutual fund; actually it is an investment trust.

In this process, I learned how to *leverage* my investments by taking *margin loans* from the fund companies. (I also will discuss these terms in greater length later.) For every dollar in profit I made, I took a loan out on it to invest more and more in these Asian funds. I made a fortune overnight. I was making so much money that I left my banking job so I could watch my money more closely. It was a very exciting time.

But then I learned a big lesson in life: What goes up, will eventually come down--especially stock markets. Being so new to the world financial markets, I did not realize that economies go up and they go down. Always, period. And they usually go down when everyone's getting rich, and no one expects it. After all, if we expected it, we could all get out in time. As I share with you these powerful lessons, you will see that we are entering possibly the most opportune time in history to make a fortune from stock investments in developing country funds. But first, before I go into all of this good stuff, let me cover some other topics to explain why you should invest in emerging markets.

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closed-end fund
a fund with a fixed number of shares outstanding, and one that does not redeem shares the way a typical mutual fund does. Such funds often are listed on a major stock exchange and trade like other securities. Unlike a typical mutual fund, a closed-end fund's share price can trade above or below its net asset value.

leverage
the degree to which an investor or business is utilizing borrowed money.

margin loan
a loan to purchase securities provided by a broker to clients.

SAFETY THROUGH DIVERSIFICATION

"Emerging markets are risky," you say. Well, I personally do not agree, but many financial experts may. But one thing all financial experts, managers, and planners agree on is that everyone should have a *diversified portfolio.*

Typically, *diversification* means having money invested in a variety of financial instruments: cash, *stocks, bonds,* real estate, and the like. The theory behind diversification is that we maximize our return over the long run by spreading out our risk. For example, some years stocks may perform poorly, yet the value of your home may rise. Or stocks dip and bonds go up. So, over the long run, your portfolio increases at a gradual rate (albeit a low rate if you follow typical investment strategies).

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diversified portfolio
a collection of investments all owned by the same individual or organization containing a variety of investments that are unlikely to move in the same direction.

diversification
a portfolio strategy designed to reduce exposure to risk by combining a variety of investments, such as stocks, bonds, and real estate, that are unlikely to move in the same direction at the same time.

stock
an instrument that signifies an ownership position, or equity, in a corporation and represents a claim on its proportionate share in the corporation's assets and profits.

The most successful financial advisors recommend that people have a mix of international investments in their portfolios. Some experts would even suggest that at times, average Americans should have up to 50 percent of their portfolios invested in international financial instruments. If you think about it, this makes sense: When Asia was in a recession recently, America was in a *bull market.* And when I was living in Asia and Asian countries were thriving, America was in a *recession.*

You will be surprised to know, however, that I have learned to make lots of money in emerging market funds in recessions *and* bull markets--and I will share these strategies with you later. (Other than property and cash, all of my money is invested in international instruments.) So, to summarize, diversification is a good thing. And investing in emerging markets is a form of diversification.

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bond
a debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing. The federal government, states, cities, corporations, and many other types of institutions sell bonds. A bond is generally a promise to repay the principal along with interest on a specified date (maturity).

bull market
a prolonged period of rising prices, usually by 20 percent or more.

recession
a period of general economic decline; specifically, a decline in gross domestic product for two or more consecutive quarters.

BUY LOW, SELL HIGH

As a child watching television, occasionally I saw a Smith Barney ad for financial services. In one, a man rode a roller coaster up to the top, stepped off before it zoomed downward, and said something about buying low and selling high.

In reality, with typical American stocks, this is difficult to do. During normal market conditions, most stocks have low *volatility.* That is, they do not make dramatic jumps up and down. So there are few good buy-low opportunities. Of course we should have purchased Amazon and AOL when they were mere dollars per share. We would be rich today. At the time when they were low priced, however, their names and potential were unknown.

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volatility
the relative rate at which the price of a security moves up and down; found by calculating the annualized standard deviation of daily change in price.

Investing in closed-end country funds in emerging markets provides a rich field of opportunities to buy at major lows and ride them up to their highs. The lows in these markets, as you will see, present much less risk than their American counterparts.

As an illustration, in 1999 the U.S. stock markets were at their peak--their highest in history. Remember: What goes up must come down! And I would not want to be in the U.S. market when it does crash. I have learned that the signs of a future stock market crash can often be read. The market has hit a recent all-time high; then it makes major downs with moderate rebounds. The culprits are usually *interest rates* and *inflation.* At the market's peak, more people are buying expensive homes, cars, and jewelry.

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interest rates
interest per year divided by principal amount, expressed as a percentage.

All of this brings flashbacks of my experiences in Asia before the major stock market crash and recession there.

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inflation
the overall general upward price movement of goods and services in an economy, usually as measured by the Consumer Price Index and the Producer Price Index.

Figure 1.1 shows the China Fund, which roughly follows Hong Kong's Hang Seng Index--the equivalent of the Dow Jones Industrial index in the United States. The rising trend line from January to December indicates how pleased investors must have been: The market doubled in a year! And it was not only investors in the Hong Kong stock market who thrived. Everyone's property value skyrocketed. There were Rolex stores on every corner, restaurants were packed, everyone was optimistic, and the economy was booming. Oh, and I was a very happy camper, too.

But now let us continue our story with Figure 1.2, which is a chart of the same fund, extended to the end of 1999. If you invested in a Hong Kong/China fund near its peak, in a rush of excitement to benefit from the booming economy, even now you would not have recovered your money. Now *that's* risk!

Now let us look at Figure 1.3, a chart of a U.S. *stock exchange,* Nasdaq. It tells a similar story: a country and its people gaining dramatic wealth in a short period of time. (According to a recent *Washington Post* report, one eighth of the households nestled in high-tech country make more than $150,000 per year and have savings of over $500,000).

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stock exchange
an exchange on which shares of stock and common stock equivalents are bought and sold.

Note Nasdaq's dramatic rise on the figure. Look familiar? Now *that's* risk too.

I can't predict where Nasdaq will go. It could double within the year--no one can forecast these things. But doesn't it remind you a bit of Asia in 1993/1994?

Now let us look back at Figure 1.2 from a different perspective. Since that time Asia has been in a long recession. It seems to be in the process of coming out of it as of now, and stock prices are quite low. Even if Asian markets drop further, most likely they will rebound in a short time. I believe Asian funds at this time are much less risky than American stocks and funds. There is less room to drop.

But one thing I can say with confidence: Emerging markets appear much less risky at this time than their American counterpart.

How could you *not* afford to invest abroad?

It's Easier Than You Think

A few years back, if a nonprofessional investor like you or I wished to purchase stock, we would have to get in our car, push off with our feet, go down to our Bedrock financial advisor, verbally place an *order,* a bird would fly to Rock Street with the order, and we'd have to pay outrageous transaction fees. Yabba dabba doo!

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order
a request from a client to a broker to buy (buy order) or sell (sell order) a specified amount of a particular security or commodity at a specific price or at the market price.

Of course the reality was not that bad, but the description is not too far off either. Before online investment services developed, most people placed orders through their financial advisors. And, because stock information was not as readily available as it is today, the average personal investor could not make educated investment decisions. We really were at a major disadvantage; only the rich and powerful could buy and sell trades on a minute-by-minute basis.

Now that has all changed. Although the Wall Street elite still share inside information that you and I will never be privy to, our investment power is almost on a par with theirs: We can get the same news Wall Street gets as it is released, get tick-by-tick stock *quotes* in *real time,* and purchase stock in a few seconds--all over the Internet in the comfort of our homes, without burdensome financial advisor fees.

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quote
the highest bid or lowest ask price available on a security at any given time.

real time
current, as with quotes or news; opposite of **delayed**.

Online investing may be intimidating to most Americans who have just started playing around on the Internet and always have relied on "professionals" to invest their money. But it should not be; it is very safe and very easy.

(By "safe," I mean that you can trust online brokers with your money; they have your investments insured by the government. But if you make crazy investment decisions, taking tips from your best friend's second cousin who knows someone who works on Wall Street, your money may not be very safe after all.)

In a later chapter I'll take you through the step-by-step processes of selecting stock *analysis* software, an online *broker,* selecting and placing orders to buy and sell stock, and how to monitor your portfolio. I will explain these processes in detail, to ensure that your jump into personal investing will be as trouble free as possible.

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analysis
the examination and evaluation of relevant information to select the best course of action from among various alternatives.

broker

an individual or firm that acts as an intermediary between a buyer and seller, usually charging a commission. To sell securities and most other products, a license is required.

And, if you are like me, you will be disappointed to learn that monitoring your investments takes only 15 minutes a day, once you get started.

Control Your Own Destiny (Or, at the Very Least, Your Money)

I learned the hard way. When I was making handfuls of money back in Asia, eventually I was given my own private banker. Because my account grew to over $500,000, my account was transferred upstairs to the "private bank." Like many Americans, I now received financial advice from an investment "professional."

Around this time it finally dawned on me: The rich get rich not with their own money but with other people's money.

As shown in Figure 1.1, times were great--the Asian stock markets were at an all-time high. But then, in early 1994, when the market started to drop, you would hope that your financial advisor would caution you, and possibly suggest you take some money out for a while to see which way the markets would go. You would expect them to inform you that the recent decision by the *U.S. Fed* to significantly lower interest rates could have dramatic effects on Asian stock markets.

U.S. Fed
the seven-member Board of Governors that oversees Federal Reserve Banks, establishes monetary policy (interest rates, credit, etc.), and monitors the economic health of the United States.

Well, I received no warnings at all. As my stocks tumbled and I lost a lot of my gains, my advisor, receiving her instructions from above, informed me that the drops were just temporary "market corrections." Looking back at Figure 1.1, that was sure one big correction.

So, why did the investment company I was using, and every other brokerage house I can think of, not tell their customers the obvious truth? The reason is that most financial advisors make their money from the total funds that they are "managing," not from how much money they make for you. When you really think about it, doesn't that sound ridiculous? Their only incentive is to convince you, by any means possible, to keep your money with them for as long as possible.

Did you know that less than 10 percent of *fund managers* ("experts" who buy, sell, and manage a mutual fund's portfolio) actually do better than a plain vanilla *index fund* (a fund that follows an index, such as the Dow Jones--so if the Dow goes up 10 percent, the fund's price does, too). These managers have MBAs from Ivy League universities, receive six-to seven-digit incomes and bonuses, and cannot even beat the market! (And where do you think they're getting their huge paychecks from?)

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fund manager
the individual responsible for making portfolio decisions for a mutual fund, pension fund, or insurance fund.

index fund
a passively managed mutual fund that tries to mirror the performance of a specific index, such as the Standard & Poor's 500. Since portfolio decisions are automatic and transactions are infrequent, expenses tend to be lower than those of actively managed funds.

At the very least, if you decide my emerging markets strategy is too risky for you, take control of your own portfolio and invest in index funds and *blue chips* (IBM, Microsoft, Mobil, etc.) You can buy these funds and stocks using the simple techniques that are discussed later.

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blue chip
stock of a large, national company with a solid record of stable earnings and/or dividend growth and a reputation for high-quality management and/or products. More generally, anything of very high quality.

If your mother did not tell you, let me: DON'T TRUST ANYONE WITH YOUR MONEY!

One of my friends, a physician, was telling me how much his salary was and how much more he would make if he hired another doctor to work out of his office. When I asked him how his investments were doing, he did not have too much information on them--his financial advisor handled them--but he did recall that his returns were not that great. Imagine: He spends so much time concerned about making more money as a physician but spends no time on his own investments. Can you believe that he is paying someone to gamble with his money--someone who has a 90 percent chance of not even beating an index fund.

Regardless of your job or profession, we must all become our own part-time financial experts (unless, of course, you really do not care about making money). It is imperative that we take the necessary time to learn the basics of investing and, at the very least, learn how to buy and sell simple index funds over the Internet. Look at it as a part-time job.

YOU CAN MAKE A LOT OF MONEY

I hope the last section motivated you to take over the reins of your financial future. Now, however, I would like to get back to the benefits of investing in emerging market funds. The primary incentive is that you can make a lot of money. And that is a pretty good benefit, I must say. I believe that you can make a fortune investing in emerging markets, compared with U. S. stocks. Let us look at Figure 1.4 so I can show you why.

The figure depicts one of my favorite stocks, the Indonesia Fund. This stock is an index fund that closely follows the Jakarta Stock Exchange. Take a close look at the figure and see if you can figure out why this would be a good medium- to long-term investment for the new millennium.

Now let us look at a U.S. index fund, shown in Figure 1.5. Because the WEBS index fund family has been around for only a few years, the figure does not go back as far as the Indonesia Fund. But the differences are obvious. Indonesia is at a 10-year low, and the United States is at an all-time high.

Now, no one knows where markets will go--they could go up or down or all over the place. But one thing I know: The United States surely has a lot of room to fall and make a huge splash. In contrast, Indonesia and most emerging markets are pretty much bottomed out; they have a lot of room to go up.

All of my money will be in emerging market funds in the coming years, as Asia comes out of its recession. Hey, it does not take a genius to see this (but why hasn't your financial advisor told you about this great news?). Remember, unlike a company, which can go out of business, these countries (and their funds) will always be around. (By the way, wars and natural disasters make for great shopping sprees. Now you can become a cold-hearted vulture like the financial barons.)

For a real-life example and projection into the future, consider a $10,000 investment in the Indonesia Fund in January of 2001. At that time, the stock price should be at least $4.25. With a margin loan, which we will discuss later, you can now purchase $20,000 worth of stock (stocks valued under 4 1/8 are not marginable according to Fed regulations). Now you own around 4,700 shares of IF (Indonesia Fund's symbol). Suppose, in a few months, the price rises to $6, your stock is worth $28,200 (4,700 shares times $6 per share). After paying back your loan, you've made $8,200--*an 82 percent return in only a few months!*

I am not making this stuff up! I do it every day. And remember, the markets are (and will be even in early 2001) bottomed out, so the risk is very limited. Of course you will want to keep buying up more shares with your profits and continue to take out additional margin loans and invest that money as well. This leveraging effect has amazing results.

(A reminder: There is a big down side to leveraging--when markets are high, and one is heavily leveraged with margin loans, leveraging can work against you in a big way. But again, that is why this is a unique and ideal time in global stock market history: Asian and other emerging countries have hit bottom; and U.S. interest rates are rising again--so you always will know the limits of drops.)

My prediction is that the Indonesia Fund will hit $10 a share--at least--by the end of the year 2001. Is that a good enough reason for you to invest in emerging markets?