INVESTING

[Global Strategies]

FINDING PEARLS IN FOREIGN WATERS

World markets **are bursting with opportunities.** We asked four top mutual fund managers for their favorite stocks.

FOREIGN STOCKS? Are you kidding? Not at all. Even though the markets are bumpy today, global stocks have outperformed U.S. equities since 2002, with the MSCI EAFE index, a widely followed foreign stock benchmark, delivering an average annual five-year return of 15%, vs. 6.2% for the S&P 500 (through Dec. 31). And the recent worldwide selloff hasn't dimmed optimism. While many markets saw declines of 3% or more in late February—and some strategists foresee more volatility ahead—few observers were surprised by the slide. "It's healthy to have a correction, because markets should not go up in a straight line," says Juliet Cohn, a manager at Principal Funds. Many market watchers, including Cohn, say the U.S. will continue to underperform the rest of the world. Among the trends that she and others say support continued strength overseas are the global capital glut and the weak dollar. Emerging markets are still attractive to many fund managers because of improving fundamentals and low inflation rates.

To uncover fresh opportunities abroad, we asked four top foreign

ILLUSTRATION BY MICHAEL CUSTODE

SMALL-STOCK FOCUS

A Hot Play in Homeland Security

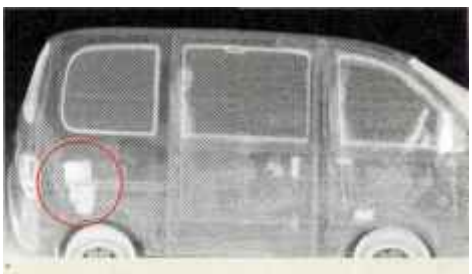
for homeland-security stocks have often run into companies with sky-high price/earnings ratios or ones with no profits at all. But American Science & Engineering (ASEI, $54), which makes X-ray equipment used by the Border Patrol, airline security firms, and the armed forces, stands out from the crowd: It is solidly profitable, with a reasonable P/E of 19, no debt, and nearly $13 a share of cash on hand.

The 39-year-old company's crown jewel is its patented Z Backscatter technology, which detects organic materials, like explosives, hidden within dense containers that traditional X-rays cannot penetrate. The Z Backscatter Van, a mobile screening system built into a delivery truck, is the company's most popular product.

American Science began to find its groove in 2003 when a new executive team, led by CEO Anthony Fabiano, took charge. Fabiano narrowed the product line to focus on security products and began aggressively expanding the company's customer base. Buyers include the Departments of Homeland Security and Defense, the Royal Thai Police, Britain's Revenue and Customs, and Hong Kong Customs. Sales rase by 16% in 2005 and by 85% in 2006, to hit $163.6 million. Net income more than quintupled, to $11.2 million in 2005, and nearly tripled in 2006, to $29.8 million. International orders accounted for about 25% of revenues in the company's most recent quarter, up from 12% in 2004.

That said, the stock can be highly volatile, with shares rising and falling abruptly on geopolitical news. Earnings gains slowed a bit recently, and the stock fell to near its 52-week low. But analysts say that tax issues crimped earnings, and they see strong growth ahead, making this an opportune time for adventurous investors to buy in. *—Katie Benner*

X-RAY SPECS ASEI's machines spot contraband.



mutual fund managers for their best ideas. (Unless noted, all stocks trade as ADRs on U.S. exchanges. You can buy stocks on foreign exchanges through some major brokerages, including Merrill Lynch, and discounters such as Charles Schwab.)

Sarah Ketterer is CEO of Cayseway Capital Management, where she pilots the International Value fund (CIVVX), up 18.6% for the five years through Dec. 31, vs. 15% for the EAFE. She is a classic value manager who has been focusing on unloved large-cap stocks. "We look for free or surplus cash. Managements have recognized that they need to return that cash to shareholders," says Ketterer. "I'll take that over earnings upgrades and momentum."

KETTERER says she likes cash better than earnings upgrades or momentum.

Ketterer says that the telephone equipment company Ericsson (ERIC, $36) has great global market share; 40% of all calls worldwide are placed through an Ericsson system. It has been a poor performer in the past 12 months, gaining only 5% as investors worried about a slowdown in telco. But she likes the numbers. "Ericsson generates a 25% return on equity," she says. "They have superior financial strength compared with their peers."

ERICSSON EQUIPMENT HANDLES 40% OF ALL CALLS WORLDWIDE.

Another out-of-favor stock she likes is Sanofi-Aventis (SNY, $42). The French pharmaceutical company has a 5% global market share in drugs, she says, and it could generate about $65 billion in surplus cash over the next five years. The stock has suffered because the company has delayed the introduction of several new drugs. But now it's priced as though the company will never launch another product. "Nobody believes in the pipeline, and they haven't been able to explain their delays well," says Ketterer. To her, that means the stock has nowhere to go but up.

Rudolph Riad Younes, head of international equity at Julius Baer, helps run the International Equity fund (BJBIX), up 21.8% over the past five years, and the recently launched Internationa! Equity II (JETAX), up 28.6% in 2006, vs. 26.3% for the EAFE. Younes is a long-term investor who looks for good stocks of all sizes. He also seeks a balance between growth and value. "The only way to avoid being caught at the top when international stocks have already had such great gains is to diversify," he says.

Younes sees the Indian banking sector as attractive and cheap. "The market is concentrating on short-term issues like rising interest rates," he says. "But looking long term, this is the time to buy many of these banks." One top

choice is **ICICI Bank (IBN, $38).** With assets of $60 billion and 670 branches, it is the second-largest bank in the country and it's rapidly gaining market share in assets and deposits.

Juliet Cohn's Diversified International Equity fund (PINRX), is **up** 18.4% over the past five years. She has been bullish on small- and mid-cap companies, which have been outperforming big caps. But her main focus is finding companies of any size "undergoing positive change." Two of her current favorites are large caps. The Swiss pharmaceutical giant **Roche (ROG, $178** on the Swiss exchange) has been improving its profit margins thanks to higher-priced products, including oncology drugs. Much of the company's recent success stems from its 56% stake in biotech firm Genentech. "In a sense, Genentech makes Roche a growth company," she says.

HSBC WILL THRIVE DESPITE ITS SUBPRIME LENDING PROBLEMS.

Cohn praises **Nintendo** (which trades in Tokyo, with the ticker 7974, $266) for its Wii Console launch. Demand is so great, she says, that there are still shortages in the U.S. and Europe. But what she really likes is that Nintendo continues to dominate the fast-growing portable-game market with its Game Boy franchise.

"Given how much China's markets have gone up in 2006, a selloff was no surprise," says Andrew Foster, director of research at Matthews Asian Funds and co-portfolio manager of Matthews Asian Growth & Income (MACSX), up 21.2% over the past five years. He likes dividend-paying companies because the regular cash payouts dampen some of the risk that comes with investing in volatile Asian markets.

His favorite stock is Taiwan Semiconductor (TSM, $11), which boasts a 4.2% yield. "Growth has decelerated relative to its history," he says. "But it has excess capital on the balance sheet, it is still growing, and it's solidly positioned in global markets."

ROBYN TWOMEY

FOSTER says dividends are a good bulwark against Asia's market volatility.

He also recommends HSBC (HBC, $88), the globally diversified financial services giant, which yields 4.9%. "It is suffering from its exposure to the U.S. subprime mortgage market, but it's trading at a reasonable valuation, provided you don't believe the market is going to fall apart," Foster says. He also thinks the dividend is rock-solid and has the potential to grow over time. Still he warns, "volatility is par for the course in emerging markets." D

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BROKER WARS

Online Trades: How Low Can They Go?

If you haven't shopped for an online broker lately, you may not have noticed that fierce competition has driven stock-trading commissions to surprisingly cheap levels. Upstarts such as Just2Trade, SogoInvest.com, and TradeKing.com now boast commissions ranging from $2.50 to $4.95. Financial giants Wells Fargo and Bank of America have gone even further, offering a large number of free trades to customers with minimum balances of $25,000. The lowest of the low, though, may well be upstart Zecco.com. Launched last October, Zecco gives up to 40 free stock trades a month to customers with a minimum investment balance of just $2,500. Zecco says it will make money from interest income and margin spreads, as well as by charging a low fee for options trades. Zecco also hopes to attract advertisers to its financial portal site.

As prices go, you can't beat free—but trading costs are far from the only consideration when choosing a broker. Speedy and accurate trade execution, research tools, margin-lending policies, and solid customer service can outweigh the value of cheap trades. And getting a better interest rate on uninvested cash can more than make up for any commission savings. (Many default sweep accounts yield 1% or less, though much higher-yielding money market accounts are usually available.) What's more, if free commissions tempt you to trade more often, your returns could suffer. Zecco.com, for example, bills itself not just as a brokerage but as a financial community, and its site features a number of bloggers and discussion forums. One bad trade based on a hot tip from a blog post could more than wipe out any benefit of those appealing commissions. Just remember: Even a free trade can turn out to be expensive. — *Yuval Rosenberg*

Fonte: Fortune, v. 155, n. 5, p. 75-77, 19 Mar. 2007.