Forbes International
INVESTMENT
Special Feature
REPORT

8 MUST-OWN International Stocks & Funds for 2008

www.forbesnewsletters.com

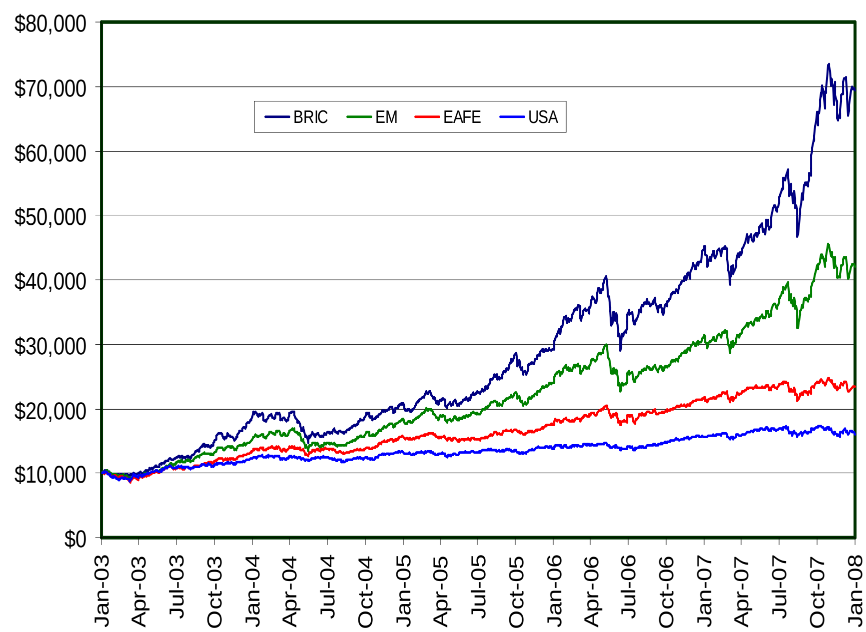
To say that international stocks have been on fire for the past few years would be an understatement. A $10,000 investment in the Morgan Stanley Capital International EAFE index, a widely-followed benchmark for stocks in developed markets such as Europe and Japan, would have risen to $23,000 over the past five years—nearly an 18% annualized clip. The same amount invested in the S&P 500 five years ago would now be worth just $16,000.

But the real excitement has been in the world's rapidly growing nations such as China and India. A $10,000 investment in Morgan Stanley's flagship emerging markets index over the five years ended in 2007 would have swelled to $42,000—a blistering 32% annualized clip. And if you were lucky enough to zero in early on the so-called BRIC phenomenon—meaning Brazil, Russia, India, and China—you'd now be sitting on nearly $70,000!

The big question for 2008: How long can these returns continue? We all know that stocks can't deliver 30%+ annual returns forever. And in the case of emerging markets, political risk always seems to be looming on the horizon. The assassination of Pakistan's opposition leader and former prime minister Benazir Bhutto in December was a grim reminder of this.

It is also worth remembering that these are the same markets that fell victim to the Mexican peso crisis and "tequila" hangover in 1994-95, the Asian meltdown starting in 1997, and the 1998 Russian debt default.

Value of a $10,000 investment over 5 years



Source: Morgan Stanley Capital International.

It is often said that the four most dangerous words in investing are "this time it's different." Anyone who bought into the "New Economy" thesis of the late 1990s learned that the hard way when the Internet bubble collapsed.

So I'm not going to tell you that things are "different this time." International investing is never risk-free, and after a long stretch of good performance you need to pick stocks carefully and make sure your portfolio is properly diversified. Having said that, there are still plenty of reasons to be optimistic about the outlook for international stocks in 2008.

For starters, there's valuation. It's very hard to call something a bubble when it is only trading at 16 times earnings, which is roughly what emerging market stocks are fetching on average. More importantly, these valuations are based on real economic and corporate fundamentals, not the sort of pipe-dreams that were characteristic of previous investment crazes. It also helps to keep things in perspective. While the recent returns on international stocks have been stellar, there were some pretty grim years in the previous decade. Looking at a longer horizon, over the past 10 years international returns have been less dramatic. By this measure, EAFE has gained just over 6% on an annualized basis and emerging markets have delivered 12% yearly returns. Again, nothing irrational about those numbers.

The long-term success of markets outside the U.S. is ultimately a function of economic development, which has gotten a tremendous boost from the forces of globalization. Combine that with ever-increasing affordability of computing power, advances in broadband communications technology and it's hard to see the global development story reversing course anytime soon.

Bottom line: If you are interested in diversifying your portfolio, or seeking greater returns on international stocks, don't give up just because we've had a few years of good performance. Here's another way to think about it. Emerging markets now account for about half of the world's economic output and more than 80% of its population. Countries like China and India are growing at 10% while the U.S. is wrestling with the prospect of a recession. And yet, despite several years of red-hot performance, stock markets in the emerging world still account for less than 15% of the world's total market capitalization. To me, that suggests that there is certainly a *lot* of upside left before these markets reflect their true contribution to the global economy. Meantime, there will be some volatility, but that's only natural. But the big lesson of the past few years is that you simply cannot afford to ignore international markets, especially as the dollar continues to lose value.

In this exclusive report, we'll take a closer look at 8 international stocks and funds that are poised to benefit from booming global economic growth. All of these investments were hand-picked from our model portfolios in the *Forbes International Investment Report*. While I can't make any promises about the short-run, I believe that these stocks and funds have what it takes to outperform the broader benchmarks over the long haul. Although international investing has come a long way in recent years, most Americans remain severely underinvested overseas. Worse, I see far too many folks chasing the latest fads or last year's best-performing market. Don't fall into these traps. In a borderless world, all investing is global. And it's never too late to expand your horizons. ■

iShares Brazil (nyse: EWZ)
Brazil, Exchange-Traded Fund

BUY

When it comes to emerging markets, China and India tend to grab most of the headlines these days, but don't forget about Brazil. In 2007, this Latin market's shares soared more than 70%, putting it on par with China and India.

But it's not too late to get on board. If anything, the Brazilian economy appears to be picking up steam. Thanks in part to booming global demand for commodities, Brazil's economy grew at a 5.7% clip in the third quarter, its strongest performance in nearly four years.

For many years, Brazil was an economic basket case. Government spending was out of control, inflation was running at more than 2,000% in the early 1990s, and the country's currency, the *real*, was devalued sharply in 1999.

Those dark days are now ancient history. Inflation in Brazil is now comfortably below 4%, the country has paid back its IMF rescue loans ahead of schedule, and it is now a serious candidate for an upgrade to investment grade status—a development that would have been almost laughable just a decade ago.

Best of all, equity valuations still look compelling at roughly 15 times earnings. And with short-term interest rates at 11%, Brazil still has a lot of room to cut, which would be a major boost for stocks. There are a lot of great companies to choose from in Brazil, but for easy access, it's hard to beat the **iShares Brazil** (nyse: EWZ) exchange-traded fund. EWZ tracks the performance of nearly 70 leading Brazilian companies, including **Petrobras** (nyse: PBR), **Banco Itau** (nyse: ITU) and **CVRD** (nyse: RIO). ■

iShares Brazil (nyse: EWZ), $81

Chart Source: Prophet.net

Canon (nyse: CAJ)
Japan, Electronics

BUY

Consumer electronics were one of the few bright spots in an otherwise bleak holiday shopping season. Unfortunately, the companies that make the hottest products, such as Apple or Nintendo, have equally hot stock prices. **Canon** (nyse: CAJ) looks like a much better deal. At a recent $46, Canon fetches a multiple of about 13 times fiscal 2008 earnings estimates. That's cheaper than just about all of the major global players in consumer electronics and cheap relative to the Japanese market, which sells for about 17 times earnings. Of course, with cheap companies, as with cheap electronic goods, you sometimes get what you pay for. But Canon is no slouch when it comes to management quality or financial strength. It routinely ranks among Japan's best-managed companies and the numbers tell the story. Canon's return-on-equity is a healthy 16% compared with an average of less than 10% for most Japanese companies. By comparison, that's about the same level of return on equity as Nintendo, which makes the red hot Wii video gaming console. But Canon's ROE has consistently been in the mid-double digits for the past five years. Before the Wii came along, Nintendo's ROE languished below 10%. Canon's balance sheet is also rock solid, and the company has more cash in its coffers than debt. High definition (HD) technology is changing the game in cameras and camcorders in much the same way that it has changed television. While we may be watching sporting events and movies in crystal clear HD, many of us are still shooting grainy home movies and taking blurry snapshots. Greater picture quality will drive the next wave of upgrades in camera equipment, and Canon has something to offer professionals and amateurs alike. It's also a "borderless" company, with 75% of sales coming from outside Japan. Another bonus: Canon is especially strong in emerging markets, with the #1 market share in China and Russia. ■

Canon (nyse: CAJ), $46

Chart Source: Prophet.net

Desarrolladora Homex (nyse: HXM)
Mexico, Homebuilding

BUY

The U.S. housing market may be a mess, but things are very different just south of the border. While the U.S. has a housing glut, Mexico has a major *shortage* of more than 4 million homes. And while Americans increasingly struggle to make their monthly mortgage payments, more Mexicans than ever can afford to buy their own homes as incomes rise and mortgage rates have dropped from as high as 50% in the late 1980s, to less than 10% today. These trends have been a boon for **Desarrolladora Homex** (nyse: HXM), the only NYSE-listed homebuilder in Mexico. If you're looking to buy a house in Mexico, Homex is a one-stop shop. It doesn't lend money itself, but it shepherds home buyers through the entire mortgage process and builds a brand new house in just 7 to 10 weeks. Of course, these are not Beverly Hills mansions. About 90% of Homex's sales are entry-level, which in Mexico means a price tag of less than $40,000. The remaining 10% of sales come from higher-end models that run $150,000 or so. As Mexico's consumers continue to move up the food chain, Homex believes its product mix will be more like 75% entry-level and 25% middle-income, resulting in a huge boost to margins and profitability over the long run. In early January, Homex announced strong guidance for 2008 results, with expected sales growth of 16%-18%. Operating margins are expected to be even better than in 2007, or roughly 25%. For 2008, analysts expect $3.88 in earnings per share, a price-to-earnings multiple of less than 15. That's a pretty good value when you consider Homex's growth potential, robust profitability and innovative business model.■

Homex (nyse: HXM), $49

Chart Source: Prophet.net

UBS (nyse: UBS)
Switzerland, Banking

BUY

It was a rough year in the banking business in 2007, and even Switzerland's famously rock-solid institutions were rattled by the credit crunch. Perhaps none more so than **UBS** (nyse: UBS). The Zurich-based bank took a nasty $10 billion hit on its exposure to subprime mortgages in December, on the heels of a $3.5 billion write off earlier in the year. That prompted UBS to seek $11 billion in fresh capital from the Singapore government and a Middle Eastern investor to shore up its finances.

But look beyond the short-term turmoil, and there's a lot to be bullish about with UBS. For starters, there's asset management. With $2.6 trillion of invested assets, UBS is the world's largest money manager. While trading subprime assets is a casino-like business, asset management is a license to print money. Money management fees throw off a reliable stream of highly profitable income and with its global brand, UBS is aggressively expanding its presence in emerging markets where a lot of the world's new wealth is being created.

Meantime, UBS needs to clean house at its investment bank, where the subprime mess started. Chief executive Marcel Rohner, who took the helm last summer, is already starting to lay down the law, firing several high-ranking executives and announcing massive lay-offs throughout the business. These recent stumbles, among other factors, have prompted some activist investors to call for UBS to separate its asset management and investment banking activities as a means to boost shareholder value. A break-up scenario may be hard to envision given UBS's long-standing commitment to a "one bank" approach. But pressure from activist shareholders—and from the bank's new investors in Asia and the Middle East—may be just what UBS needs to get its house in order. This will obviously take some time, but contrarian investors can afford to be patient with UBS. At a recent $46, a ton of bad news has already been priced into the stock. UBS currently trades at just 9.3 times consensus forecasts for 2008 earnings and less than 2 times book value. In normal conditions, UBS can deliver return-on-equity north of 20%. It won't bounce back overnight, but when it does, UBS shareholders will be handsomely rewarded. ■

UBS (nyse: UBS), $46

Chart Source: Prophet.net

Matthews Asian Technology Fund (ticker: MATFX)
Mutual fund

BUY

While there's plenty of uncertainty in global markets at the outset of 2008, there are two notable exceptions: technology and Asia. Both the tech sector and Asia's economies look well-positioned to weather the storm in the coming year.

With the **Matthews Asian Technology Fund** (ticker: MATFX), you get the best of both worlds. Based in San Francisco, Matthews has been specializing in Asian markets since 1994. Their technology fund, which invests across the entire spectrum of Asian countries, has been a stellar performer. With $245 million in assets, the fund has delivered annualized returns in excess of 25% over the past five years.

The fund invests in a mixture of both large-cap and small-cap companies, with varying degrees of exposure to "technology." Some holdings, like Chinese search engine Baidu.com and the Japanese social networking site Mixi, are pure technology plays. Others, like Korea's Samsung Electronics and Japan's Sony fall into the more mature camp of consumer electronics. Telecom is also among the fund's biggest holdings, with China Mobile and India's Bharti Airtel among the fund's top 10 holdings. Because of this diverse approach, the fund won't always deliver the eye-popping returns that were common during the Internet bubble era. And its exposure to mature Asian markets like Japan tends to offset some of the blistering gains in emerging markets like China. On the other hand, the fund's diversity also provides some cushion on the downside. ■

MATTHEWS ASIAN TECH FUND (MATFX), $9

Chart Source: Prophet.net

Infosys (nasdaq: INFY)
India, technology

BUY

Bangalore-based **Infosys Technologies** (nasdaq: INFY) has long been the poster-child for information technology outsourcing—the archetypical borderless company. While Infosys remains a dominant player in the outsourcing business, my fear is that such a simple characterization misses the real story—and investment opportunity—in this company's future. Infosys has come a long way from the routine grunt work it did for much of its early history. It now provides higher value-added services such as technology consulting, business process outsourcing (BPO), and even management consulting.

Such a firm is only as good as its people, and while Indian labor may still be cheaper than in the U.S., top-tier talent is getting more expensive. Infosys cherry picks the very best graduates of India's elite business and technology schools, and they are now going after some of the best and brightest students at U.S., European and Asian schools too. All of this costs money, and personnel costs—along with a strong rupee—have been taking a bite out of Infosys's profits of late.

That has weighed heavily on the company's stock price, which lost more than 20% of its value in 2007 while the Indian market surged more than 75%. At a recent $46, Infosys now sells for just 17 times estimated earnings for the fiscal year ending in March 2009. Meanwhile, Indian stocks sell for more than 25 times earnings, on average, according to S&P/Citigroup. But Infosys is hardly an average Indian company. It is arguably one of the best companies in India and perhaps all of the emerging market universe. Even after factoring stiff headwinds from the currency effect and higher wage costs, analysts expect Infosys to deliver 20% earnings growth next year. Plus, the company is debt-free and sports a healthy return-on-equity of better than 30%. A few years ago, people were saying that it was too late to get on board with Infosys. I think their business still has a lot of room to run, and at these prices it's a rare opportunity to scoop up a true emerging market gem. ■

INFOSYS (NYSE: INFY), $46

Chart Source: Prophet.net

Ericsson (nasdaq: ERIC)
Sweden, telecom equipment

BUY

If you missed the 1987 stock market crash, or just needed reminder of what it felt like, you got one last October. No, the U.S. market didn't plunge on the 20th anniversary of Black Monday, but Swedish telecomequipment maker **Ericsson** (nasdaq: ERIC) had its own mini-crash of 25% after announcing a quarterly profit warning. There's no question that Ericsson has had a few tough quarters. But I believe it is still a must-own name in any long-term international portfolio.

Ericsson (nasdaq: ERIC), $23

Chart Source: Prophet.net

I have a hard time believing that any company's intrinsic value can swing 25% in the course of a single day simply because of a quarterly earnings miss. Part of the reason for Ericsson's shortfall was a delay in network upgrades by North American telecom companies. Unless you believe that Americans are going to suddenly stop using their cell phones to download music, watch video clips and other things that strain network capacity, then this is almost certainly a short-term problem. And it's no surprise that some telecom companies shelved their spending plans in last summer's uncertain credit environment.

Another knock on Ericsson is that margins will remain under pressure because they are selling a lot of gear in places like China and India where the competition is stiff and pricing is more aggressive. But Ericsson would be crazy to pass up on these important markets simply because it might crimp margins for a couple of quarters. Ericsson is building its business for the future and Wall Street—as is often the case—is being shortsighted. The explosion of data traffic and the worldwide build-out of mobile telecom networks, especially in emerging markets, is a long-term trend that will be in place for years to come, and

Philips Electronics (nyse: PHG)
Netherlands, diversified

BUY

When the big ball dropped in Times Square on New Year's Eve, it was lit up by **Philips Electronics** (nyse: PHG). Lighting products, including the light-emitting diodes (LEDs) that were used to usher in 2008, account for roughly 40% of the Dutch conglomerate's $40 billion annual revenue. Philips' other business units include medical equipment and consumer electronics.

Philips Electronics (nyse: phg), $43

Chart Source: Prophet.net

Brighter, more energy-efficient lighting is just one of the big trends that Philips is focusing on after more than a decade of restructuring its business. In 2006, Philips unloaded 80% of its volatile semi-conductor business for 6.4 billion euros ($9.6 billion). It has also been steadily selling off its holdings in Taiwan Semiconductor (nyse: TSM), which it hopes to unwind by 2010. After its latest sale of 800 million TSM shares in December, Philips still owns 5% of the chipmaker.

Meanwhile, Philips has been busy putting all of this cash to use in more efficient ways. In December, Philips announced a whale of a share buyback worth 5 billion euros ($7.2 billion). It also bought a handful of companies that will bolster its portfolio, including Respironics (home health care), Visicu (health care IT), and Genlyte (lighting fixtures). All of this is part of what the company calls its Vision 2010 plan. The goal is to double operating profit over the next few years by expanding operating margins from to 10%+ versus 7.5% today. Philips is also shooting for 6% annual revenue growth, which is hardly an unreasonable target. At a recent $43, Philips is selling for roughly 8 times operating income, but profits are expected to grow in the high teens. Even if Philips falls short of its 2010 goals, it still looks like there is a fair amount of upside, without a whole lot of risk. ■

Subscribe Now and Enjoy *Exclusive* Savings!

o Yes, sign me up for an *exclusive,* one-year Charter Subscription to the *Forbes International Investment Report* and future special reports. I understand that this newsletter will be sent via e-mail only.

o Enclosed is my check or money order for $195, payable to Forbes.

o Please charge my o Visa o Mastercard or o American Express.

o I would prefer to pay $24.95 per month, charged to my credit card.

Your satisfaction is 100% guaranteed. If you are not happy with your subscription for any reason, just cancel and receive a refund on the balance of your subscription term*. No questions asked. (*Monthly subscriptions not eligible)

Name ______________________________

Title ______________________________

Company ______________________________

Address ______________________________

City, State & Zip ______________________________

Telephone ______________ Fax ______________

Email address (required) ______________________________

Card Number ______________________________

Expiration Date ______________________________

Signature ______________________________

To place an order go online to www.forbesnewsletters.com/international, or call 1-877-733-7876 or fax this page to (212) 367-3371

Or mail completed order form to: Sian Evans
Forbes Newsletter Group:
90 5th Avenue, 4th floor
New York, NY 10011

The *Forbes International Investment Report* is published monthly by Forbes Inc. 60 Fifth Avenue, New York, NY 10011

Editor: John H. Christy III, CFA
Art Director: Gail Stoicheff

Forbes Newsletter Group
Vice President and Editor: Matthew Schifrin

To subscribe on the Web visit the Forbes.com Investment Newsletters:

www.forbesnewsletters.com/international

Or call 1-877-733-7876.

For editorial information, e-mail John Christy: jchristy@forbes.com