



Investment Guide

Going Ape

Zack O'Malley Greenburg 12.08.08, 12:00 AM ET

A quarter of a century ago Princeton economist Burton Malkiel theorized that a blindfolded monkey throwing darts at a newspaper's financial section could select a portfolio on a par with one picked by experts. This sort of thinking is behind the enormous success of the Vanguard Group, which has been selling index funds for the past 32 years.

But does dartboard investing work well with foreign stocks? Are they as efficiently priced as the 500 in the S&P Index? However much you might have wanted an active manager for your international portfolio a few decades ago, nowadays it's hard to believe that lots of bargains are being overlooked in Tokyo and Paris. Computers, hedge fund operators and mutual fund analysts are picking over all but the smallest stocks.

"It used to be conventional wisdom that international markets were not efficient," says Nathan Gendelman, director of investments at the Family Firm, a Bethesda, Md. company that manages \$300 million. "But managers haven't really been able to prove that they can beat international indexes."

There is a lot of money to be saved going the passive route. International stock funds typically sport expense ratios of around 1.5%; some are as high as 2.5%. The exchange-traded index funds offered by iShares and the like typically charge less than half of that.

A percentage point or two looks small, but the savings snowball. If you assume an 8% gross portfolio return, a \$10,000 investment in a fund with a 0.5% expense burden would swell to \$42,000 in 20 years, while it would grow only to \$31,000 if the annual cost was 2%.

Some anecdotal evidence that you don't get what you pay for in active international management: Since January the iShares MSCI Japan Index is down 32%; by contrast the actively managed Fidelity Japan Fund is down 37%. The iShares MSCI Mexico Index is down 43% this year, while the handpicked Mexico Fund is off 51%.

Economists Laurent Barras, Olivier Scaillet and Russell Wermers, in a paper under review by the *Journal of Finance* on domestic portfolio managers, found that 1 in 7 active managers exhibited genuine skill before 1990, but by 2006 the figure had plunged to 1 in 166.

Skill, here, means beating a passive index fund, after fees, to a statistically significant degree. The authors suggest the drop was because of the departure of many top fund managers to hedge funds as well as the high fees charged by mutual funds.

If you want a passive foreign fund, you have two choices. One is an exchange-traded fund like the iShares MSCI EAFE Index Fund, a fixed basket of roughly 800 stocks that charges fees of 0.34% annually. The other is an index mutual fund. Vanguard and Fidelity offer a range of global and regional funds for international markets with expenses as low as 0.1%.

Over There and Overpriced

Some actively managed international funds underperform their passively run counterparts--and charge investors richly for doing so. Exchange-traded funds or index mutual funds typically have expense ratios half that of an international stock fund, which can add up to savings of thousands of dollars on a \$10,000 international portfolio held for 20 years.

FUND	TOTAL RETURN		ASSETS (\$Mil)	ANNUAL EXPENSES PER \$100
	YEAR TO DATE %	5-YEAR ANNUALIZED %		

Mexico Fund*	-50.8	14.0	539	1.07
iShares MSCI Mexico Index	-43.1	16.5	904	0.51
Fidelity Japan Fund	-37.0	-1.0	1,231	1.08
iShares MSCI Japan Index Fund	-33.9	-0.2	6,655	0.52
Singapore Fund*	-54.2	3.2	112	1.61
iShares MSCI Singapore Index	-49.1	6.9	1,202	0.51
Fidelity Emerging Markets	-59.5	8.7	3,405	1.05
iShares MSCI Emerging Mkts Index	-49.7	10.3	19,901	0.74
Wells Fargo International Equity-A**	-45.5	0.3	443	1.50
iShares MSCI EAFE Index	-43.4	3.4	32,817	0.34

Performance through Nov. 14. NA: Not available. Source: Lipper.