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With U.S. stocks at record highs, top- rated international fund managers Rupal Bhansali and Andrew Foster find values overseas.

Rupal Bhansali
Ariel International Fund

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CONSUELO MACK: This week on WEALTHTRACK, two highly rated international investors, Ariel's Rupal Bhansali and Seafarer's Andrew Foster discuss overseas opportunities to seize and risks to avoid. They are next on Consuelo Mack WEALTHTRACK.

Hello and welcome to this edition of WEALTHTRACK, I'm Consuelo Mack.
WEALTHTRACK has been promoting the benefits of global investing since our launch in 2005. The reasons are pretty obvious:
More than 95% percent of the world's population lives outside of the United States.
Seventy-six percent of the world's goods and services are produced in other countries.
Yes, the U.S. economy is the largest contributor to global GDP, accounting for nearly 25% of the world's $74 trillion economy but others are moving up. China accounts for about 15% of global GDP, having eclipsed Japan as the world's second largest economy several years ago. Japan's GDP footprint is now lagging at around 6%.
As far as future drivers of world growth, the U.S. is still a major force but others are growing faster.

Estimates are that China will generate 35% of the world's real economic growth, that's excluding the effects of inflation, during the next three years. The U.S. is estimated to contribute about 18% of additional growth. Followed by India's nearly 9%, the eurozone's 8% and surprisingly, Indonesia, the world's fourth most populated country is predicted to be the fifth largest driver of real economic growth in the world followed quickly by South Korea, Australia, Canada, the UK, Japan And Brazil. .

Again these are estimates but you get the point. There is substantial additional economic power coming from other countries. Given these global realities should U.S. investors with their well known and understandable home bias increase their foreign exposure? If so when and where?

This week's WEALTHTRACK guests are both successful global investors with a specialty in international markets. Rupal Bhansali is the Chief Investment Officer 0f International and Global Equities for Ariel Investments. She is also Portfolio Manager of two top rated funds which she launched there in 2011. The 5-star rated Ariel International Fund is ranked in the top 10% of its *Morningstar* Foreign Large Value category with its nine percent plus annualized returns. The 4-star rated Ariel Global Fund is in the top third of its World Large Stock category with 11% annualized returns.

Andrew Foster is the Founder, Chief Investment Officer and Lead Portfolio Manager of Seafarer Capital Partners which he started in 2011. In 2012 he launched his flagship Seafarer Overseas Growth and Income Fund which is focused on foreign markets especially in the developing world. It carries a *Morningstar* silver medalist ranking and a 4-star rating for its performance and shareholder friendly management. It is in the top 20th percent of its Diversified Emerging Market category with nearly seven percent annualized returns over the five year period. Before launching Seafarer foster spent several years as a Portfolio Manager and Director of Research at Asia mutual fund pioneer Matthews Asia.

I began the conversation with the question: how compelling are the investment opportunities overseas?

RUPAL BHANSALI: Well, I would certainly say that they are far more attractive than the U.S. market because the U.S. market has gone up a lot, as we know, in the last couple of years, and frankly it's roughly 2X the performance of international. So clearly there is opportunity there, but I think with all markets having gone up, it's really become a stock picker's market. So, you need to choose carefully.

CONSUELO MACK: Andrew, emerging markets is your specialty. So how compelling are the investment opportunities in emerging markets at this point?

ANDREW FOSTER: Well, I think they're moderately attractive, and the reason why is we've come through a period of very low growth in the emerging markets in terms of corporate profitability. It has accelerated a lot in 2017, but there's been a bifurcation. There's a small number of countries and sectors growing very rapidly. The rest are just recovering more slowly, and I do fear that folks that are investing in the emerging markets right now are really trying to chase that rapid growth and very high valuation which may not be sustainable.
I think if you're focused on the other tier of the market which is not experiencing as strong a recovery but is still more fairly valued, I think there are opportunities in that segment, but that may not be what people are focused on right now. So, I think there's a bifurcation between what people perceive and what the reality is.

CONSUELO MACK: Both of you are stock pickers, so I'll just say that right from the get-go, but in looking at the emerging markets' opportunity set versus the developed markets' opportunity set internationally, what's your view?

RUPAL BHANSALI: Well, I concur with Andrew. It's a two-speed market. He called it bifurcation. I call it two speed, and we are certainly finding more opportunity around the world, emerging or developed, in the companies with more steady growth as the ones with more heady growth. So that's true of both emerging markets and international developed markets. Now between the two I think there's better opportunity in the international developed markets and Europe in particular. I think we know that Europe has been struggling for many, many years, and I think it's just on the cusp of its sort of recovery I think both from an economic standpoint but also from a political standpoint.

CONSUELO MACK: You each have investment themes. Let me just start with Andrew because one of your overarching investment themes right now is that you think that the emerging markets have actually decoupled or are decoupling from developing markets, from developed markets and in particular from the United States.

ANDREW FOSTER: I think the term "decoupling" is a loaded one, and it was in vogue ten years ago.

CONSUELO MACK: It was.

ANDREW FOSTER: Really, I thought it had very little bearing then, because the emerging markets were growing because they had coupled with the west in terms of capital flows and trade, but those couplings are weakening now in my view ten years later, and I think really there's a great deal more independence in the emerging markets in terms of setting divergent interest rate policies. The emerging market central banks are cutting. The currencies are much more independent from the U.S. dollar than they once were, and lastly the profit cycle is not as driven by the U.S. profit cycle as it once was, or at least that's what our data suggests. So, I wouldn't want to paint a strong case that decoupling is here to stay, but I think the asset class is behaving differently and feeding less off of the developed world. So that might have a diversification benefit for investors that wasn't really present from the asset class previously.

CONSUELO MACK: Rupal, the developed markets internationally, are they still very much coupled with the U.S., with what happens in the U.S., or are they kind of leading an independent economic and financial life of their own more now?

RUPAL BHANSALI: So, I would say the U.S. is an all-important market, and the U.S. dollar is an all-important currency, so it's hard to decouple completely from anything like that. It exerts a gravitational pull no matter what but, that said, you are correct. I think Europe is sort of operating at a different clock speed, and I think that because it operates at a different clock speed, i.e., it is slower, things tend to play out in slower motion in the international markets, and that means if you've missed out on some opportunities or trends in the U.S., you can actually take advantage of owning those in international developed markets just with a time lag, and we have a couple of ideas in our portfolio like that. Johnson & Johnson comes to mind in the U.S. market. In my global fund, I bought it about six years ago, and it's performed extremely well because at that time Johnson & Johnson had three divisions, all of which were underperforming and under earning. That was a very great setup in terms of upward rebating and potential. Now that's played out and that's great. We've taken profits and this is still a very good investment opportunity that we experienced. In the international markets, you have a very similar story in GlaxoSmithKline; three different divisions. All of them are underperforming. They're all out of favor, a very similar playbook, and yet that return profile is yet to materialize. So, when you have the opportunity to go abroad, you can own a Glaxo in your portfolio, whereas if you restrict yourself to the U.S., perhaps the best days of some of these stocks are behind them.

CONSUELO MACK: So, when you mention that you actually would buy a company where three of their major divisions are underperforming, that is considered to be kind of a contrarian point of view. You are a value investor. You think of yourself as being an unconventional thinker. So, tell me what are some you think the major unconventional themes that you are operating under right now.

RUPAL BHANSALI: So, I think for example many value investors traditionally have tried to own consumer staples and sort of very safe quality businesses of that sort, and of course Warren Buffett taught us that franchise and moat companies should be owned which is an excellent idea except that it's overvalued. So, you have to find different ways to find value in the markets, and you have to do it now.

CONSUELO MACK: But it's overvalued now because a lot of investors are looking for those kind of ...

RUPAL BHANSALI: Everybody's piled on, and it's a crowded trade, and frankly when everybody's looking somewhere, you have to look somewhere else. That's how investing really creates opportunities for you. I would say that instead of consumer staples, if you look at the telecommunications industry, today I would argue you can't do without smart phones. You can do without shampoo but not do without your smart phone.You lose your job. There's a recession. I think you'll have two smart phones, not one, and you'll pay your monthly bills, and it's interesting. The telecommunications industry is not viewed as a staple industry, and I think that it should be, but it trades at almost a 50 percent discount to the staple stocks, and this is an industry that I think has very high visibility in terms of secular recurring revenue streams and yet very undervalued with high dividend yields. So, you always as a value investor, as someone who's an unconventional thinker, few people think of telecoms as a new staple, but that's kind of why I wanted to bring this to bear. That's how you have to think as an investor. How do I create value for my clients? If you do it in the conventional ways, if you look in the conventional places, you're not going to find it. It's very crowded. So, you have to look elsewhere.

CONSUELO MACK: It's so interesting that Rupal mentioned dividends because in your Overseas Growth and Income Fund obviously income is important, and unconventional thought to me would be I'm looking at emerging markets for income, but in fact that's the case. So, what are the opportunities that you're seeing in the emerging markets as far an income stream is concerned?

ANDREW FOSTER: Well, I think one shocking thing is that there are quite a few dividends paid by emerging market companies. In fact, it's quite a bit. There are varying standards of corporate governance throughout the emerging markets, but it's quite traditional that a lot of these companies do pay fairly reliable dividends. For me the dividend is important as an acid test of the company's liquidity. It means that the company can share some of its earnings with me, and I think that's important in the emerging markets because people focus on the growth, and there is growth opportunity, but they tend to chase fast-growing companies some of which are great but many of which aren't really built for survivorship, and another definitional component of the emerging markets is frequent crisis and shock. So, companies that aren't built to withstand those shocks are less likely to survive them and realize the growth that you might have forecast for them or expected. So as a consequence, I really like dividend payers that have steady growth prospects and can pay me dividends because it demonstrates to me that they're at least more likely to survive those crises should they erupt, and they do erupt much more frequently than the developed world.

CONSUELO MACK: As the emerging markets emerge, I mean we've had guests come on and saying really that's a misnomer in that some of the emerging market countries have emerged... ?

ANDREW FOSTER: There's a huge spectrum of this state of economic development in these countries that are classified as emerging markets. So, there are some that are very wired, very plugged into the Internet, great engineering capabilities and education and high levels of income per capita, and then there's the other end of the spectrum as well and varying growth rates at the macro economic level, but what is actually definitional to me that they all share is poorly developed financial systems, and that means they're more prone to financial shocks, and that lead to the condition I was just mentioning. Where there are more disruptions in the financial markets, there's more volatility in the stock market, and companies can't always get the capital they need to survive and grow through those periods. Some go out of business. Some have their growth ambitions stunted. So, I would say that's what's definitional even when you're talking about say South Korea at one end of the development spectrum and Vietnam at the other. Even though they're very different, they still share this common feature: poorly developed financial markets.

CONSUELO MACK: Rupal, one of the things that you and I had talked about in a pre-interview was the fact that you think there are some misconceptions about American companies, talking about cash flow and dividends, that there is a perception out there that U.S. companies are very strong financially, that they're cash-rich, that they're extremely profitable. They came through the financial crisis, and they cleaned up their acts and everything else. You're saying not so fast. Explain.

RUPAL BHANSALI: Well, two things. One is I think people out of sight is out of mind. So, in the U.S. a lot of the financial problems are with Freddie and Fannie. They delisted from the stock markets, so people think our financial troubles are behind us, but they are not. They're just sitting out of sight. So, the listed banking sector is capitalized but not Freddie and Fannie, and we forget they're the biggest owners of the mortgages which went under in this country. So, I think that's a misnomer.

CONSUELO MACK: So, we shouldn't forget ...

RUPAL BHANSALI: We shouldn't forget. Now when I talk about the cash-rich attributes of global companies in general, but you asked about the U.S., it is misnomer because in the case of America there's a slew of companies who are in the top tier, I would say the top ten companies out of the thousands that exist in the market that are really the net cash-rich companies. Most of the other companies ...

CONSUELO MACK: For instance, Microsoft or Apple.

RUPAL BHANSALI: For instance, I mean Apple, Microsoft. Exactly. All the very big companies, Google, et cetera. What people forget when they talk about cash rich, they forget a lot of these companies are the very same companies including Apple and Microsoft, by the way. Even though they have a lot of high growth cash balances which are often quoted, they have debt against it. So, we always look at net cash, and actually the net cash balances even for the best cash companies are quite low, and secondarily for the vast majority of companies, they are highly indebted, and that's not just true of America. It's true of a lot of companies worldwide including emerging markets.

CONSUELO MACK: From an investment point of view then, tell us how you are investing to avoid these heavily indebted companies and take advantage of the companies that have really solid balance sheets.

RUPAL BHANSALI: Again as an unconventional thinker it's not just about having high cash in my portfolio. That's one way to go, and we have higher cash levels than we normally do, but I think also owning net cash companies gets you there, but the other way to think about this equation is a lot of people like to own companies with pricing power. That's always been the traditional definition of a franchise; does it have pricing power? In a deflationary world, nobody has pricing power and so, in fact, what you want to look for in your companies is, do they have the ability to improve productivity? Do more with less. This is why we consume so much technology and which is why tech companies are doing so well. They always give us more for less. Right? That's our expectation. Generally technological prices are deflationary in nature. That is the one industry that knows how to deal with deflation. The energy industry, oil industry is going through that now, how to deal with deflation. The commodity industry at large is going through deflation. Commodity prices are down. All of these companies, the ones who are going to be the winners are not the ones who wait for those oil prices to go up or those commodity prices to go up, but how do they improve their cost structure? Shale fracking in the U.S. improved their cost structure. That's why they're on the upswing. So, I think the equation in this deflationary world is look for companies who can improve productivity, do more with less, not necessarily those that have pricing power.

CONSUELO MACK: Andrew, survivorship. What are the key characteristics?

ANDREW FOSTER: For me survivorship is many things, but if I had to boil it down to a couple key characteristics, I look for high profit margins, and I use a margin called the EBIT margin which is earnings before interest and taxes. It's somewhat similar to an operating margin, and it also tends to be similar to cash flow in the company to equity holders. It's a little bit different from that, but it's a good measure to key off of. I look for high-margin companies because I think that allows them to withstand lots of different types of shocks.
I do as much as I can to look for steady growth rates, not necessarily very rapid growth rates that might flame out in a few years' time. I look for companies that have gone through stresses

in the past and have been resilient and grown steadily through those stresses. So, one of our bigger holdings right now that exemplifies this – it's not very much in favor right now – is a company called Infosys. Infosys has extremely high margins. People have been predicting the margins would fall for many years now, and they haven't, and meanwhile people have been predicting the company would slow egregiously, and it hasn't. It's not very much in favor because of some changes going on at the company right now in terms of its ownership structure, its governance structure, but I'm quite convinced that despite the challenges that this company has faced, it can continue to overcome those challenges as it's done so many times in the past.

CONSUELO MACK: Also, I might add in the Overseas Growth and Income Fund, you have a portfolio of 40 to 60 stocks mostly around 40. You know the companies well.

ANDREW FOSTER: Right. I see my mission as trying to find 40 to 60 great issuers in the emerging markets that offer this survivability and sustained growth characteristic, and I key off of the equities. But occasionally I will choose an instrument that is other than the equity that I think might afford my portfolio risk-adjusted preference.
So, a good example is preferred shares. Sometimes they offer the similar economic characteristics to the common stock but a much-improved dividend yield and a cheaper valuation. So, in some instances like that I might buy the preferred stock over the common stock or even a convertible bond for similar reasons.

CONSUELO MACK: What's your mission, Rupal, for the International Fund and the Global Fund? How would you describe it, and give us a couple of examples of companies that exemplify that.

RUPAL BHANSALI: Well, my mission is to deliver the highest rate of return for the lowest unit of risk that I can expose to. So, in terms of their business model I'm looking for how do they improve productivity. So, Microsoft is one of my largest holdings in the global strategy. Now you know why. We can't do without Excel and Microsoft Word and PowerPoint, and they've got a lot of growth ahead of them because of their Azure platform which is a cloud platform, and Amazon Web Services has been the early entrant there, but Azure is fast moving in and it's actually growing at 100 percent growth rates. Now for a company inside of this large company like Microsoft, this mega cap company, to have a business with that kind of growth potential is just fantastic. Microsoft is what I call an enterprise staple not a consumer staple, but now you understand. It's giving me the value that I'm looking for, the returns with low risk. Another good example of that would be the health care industry. I think people conflate all health care companies as if they all charge high prices and rip you off and so on and so forth. What people fail to really appreciate is that the drug costs are two percent of the cost of the entire treatment. It's hospitalization and the system costs that are the biggest. So, if you can actually take a drug that can give you progression-free survival or improve your health as opposed to having to end up in hospital or in emergency care or acute care, that's actually enormous productivity in terms of the savings in the system. Gilead, Roche, Glaxo, I mean these are all fine companies of health care, and they support high dividend yields which is great. So, you get the growth. You get the dividend, and you don't have to pay up for them.

CONSUELO MACK: It's time for the one investment So what would your one investment for a long-term diversified portfolio be, Andrew…

ANDREW FOSTER: So, I think the most important thing that I think the average American investor needs to kind of play right now is the proportion of their portfolio that is tied to the dollar-based assets and dollar-based income streams. I would advocate a rethinking and a rebalancing at this stage.

CONSUELO MACK: Away from dollar-based.

ANDREW FOSTER: Away from. I think we've all been drawn into the performance of this market and all the different asset classes here, real estate, fixed income, equities, and I think it's time that folks look beyond this. So, I would advocate a strong international fund. I think if you're looking for an active fund, I think Rupal has done a phenomenal job constructing her portfolio. I've enjoyed watching what she's done with her strategy. I think some folks aren't sold on active management, so if they're not, I was going to recommend another fund called DFWIX, DFA Worldwide Ex US. It's a remarkable fund because it is able to capture 8,000 stocks for about 39 basis points, and whether you go active or passive, I say even more important than that right now is broadening your scope beyond the dollar's sphere of influence right now because it's critical that investors have that diversification in their portfolio and not get tied up too much in one market.

CONSUELO MACK: Which is why we wanted to talk each of you to make that point exactly. Rupal, what would your one investment be for a long-term diversified portfolio?

RUPAL BHANSALI: Well, I would strongly call out active as a strategy. I think that this phenomenon where the bulk of the flows are going passive means that people are simply taking risks that they don't realize they are taking. Everybody focuses on the low cost of passive. They don't realize what are the high risks of passive. Cost and risk are two different things, and the risks of passive can be valuation risk. If the market is rich, you're buying into valuation risk. You just don't call it that. Passive has got so much illiquidity risk because it's supposed to own everything, and if there is no taker on the other side when they want to go to sell, on the way out you'll be exposed to it. These things can cost you hundreds to thousand plus basis points of performance. My single biggest recommendation for people to consider in their portfolios, it's the unsung asset class of the day, cash.

CONSUELO MACK: Cash.

RUPAL BHANSALI: Cash is not even viewed as an asset class which is a strange, strange phenomenon. People think that debt is an asset class. High-yield is an asset class. All sorts of risk assets are deemed asset classes. Equities, emerging markets, whatever you want to call it, but they're all risk asset classes, and in a risk-on market, risky assets do well. But what if we have a reversal? I think the VIX reached an all-time 1993 low yesterday at nine or something. If the pendulum swings, and it always does, cash is the only uncorrelated asset class, and we saw what happened in 2008. In a bear market, correlations are the only things that go up. Cash is your only uncorrelated asset. So, I think people need to rethink the role of cash in their portfolios.

CONSUELO MACK: Well said. Thank you both so much for being with us.

CONSUELO MACK: Rupal Bhansali from Ariel Investments and it's great to have you back both of you, and Andrew Foster as well.

ANDREW FOSTER: Thank you.

CONSUELO MACK: From Seafarer Capital.

CONSUELO MACK: At the close of every WEALTHTRACK we try to give you one suggestion to help you build and protect your wealth over the long term.
This week's Action Point focuses on survivorship, not the company kind that Andrew Foster was talking about which definitely has its merits. This one is having your purchasing power survive low inflation. This week's Action Point is: **Own some inflation fighters in your portfolio.**

I got the idea from an article in *Kiplinger's Personal Finance* magazine which pointed out that even 2% annual inflation will take away a third of your purchasing power over 20 years. That's a wealth destroyer in retirement. Many WEALTHTRACK guests have recommended owning TIPS over the years, Treasury Inflation-Protected Securities where the principal adjusts with inflation. Kiplinger worries that as interest rates rise the value of TIPS bonds will decline so it suggests a less interest rate sensitive alternative, the Vanguard Short-Term Inflation-Protected Securities ETF, symbol VTIP. It is one of the cheapest funds in the category and focuses on tips maturing in less than five years. Thank you *Kiplinger's* for my Action Point.

Next week our guest is Matt Peron, Head of Global Equity at Northern Trust Asset Management and an expert in the hot area of factor investing. He says a lot of people are doing it incorrectly. He'll set the record straight.

In the meantime please visit our website WEALTHTRACK.com to see this program and others and hear our exclusive interviews with this week's guests.
Also feel free to reach out to us on Facebook and Twitter.

Thank you for watching. Have a great weekend and make the week ahead a profitable and a productive one.