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GLOBAL INVESTING RESEARCH REPORT

International Investing: Why U.S. Investors are "Boxed Out" of Big Global Profits

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It was a record stock sale, the biggest IPO the world had ever seen.

It involved the **Industrial and Commercial Bank of China** – the biggest bank in the world's fastest-growing market.

Goldman Sachs, the blueblood U.S. investment bank, headed the deal team and pocketed a cool $3 billion in profits from the Oct. 27, 2006 IPO.

And Goldman had only been a "strategic investor" in ICBC since April.

The state-run bank ended up selling more than $19 billion from the stock offering. But ordinary American investors couldn't even buy into the IPO.

Not one share.

You didn't miss out on this deal because your broker forgot to mention it to you, or had already doled out his tiny allotment of shares to his golfing buddy or the headmaster at his eldest son's private high school.

You missed this because of the SEC.

The reality is that U.S. retail investors weren't legally permitted to invest in ICBC because the China banking giant chose not to register with the U.S. Securities and Exchange Commission.

In short: They choose, you lose.

This particular registration rule has been around for some time – almost 75 years to be exact. But it's never really been viewed as a problem.

Unfortunately, that's about to change.

And the timing couldn't be worse.

Let me explain….

Federal Rules Make U.S. Retail Investors Two-Time Losers

At a time when global investing opportunities are as promising as they've ever been, there are now two sets of federal regulations that will keep U.S. retail investors from earning maximum profits on their

foreign investments.

The first piece of this two-tiered profit blockade is the SEC registration requirement we just mentioned.

And the second is the Sarbanes-Oxley Act of 2002 – or "Sarb-Ox," as Wall Streeters and journalists like to call it.

Let's take a closer look at both pieces.

The SEC registration requirement was a response to the financial shenanigans that fed into the Great Crash of 1929.

Sar-Box grew out of the finance-and accounting scandals that swept through Corporate America in the late 1990s and early 2000s – scandals in which international companies played almost no part.

Investors are feeling the fallout.

Someone once described the statement, "I'm from the government, and I'm here to protect you," as the most ominous and threatening sentence ever spoken.

Looking at the SEC regulation alone, I can't help but agree.

Granted, the rule was created to protect us from fraudsters. And there's no question that scams do exist (How about those Nigerian e-mails seeking your help to "unfreeze" the "royal" fortune trapped here in a U.S. bank account? The sender promises you a big cut and all you have to do is provide your bank account number, and some other personal information for "security" purposes).

Just days after the Berlin Wall fell, I had lunch with the Chairman (and owner) of the Sofia (Bulgaria) Stock Exchange, who quite candidly confided: "It is good business to be manager of the casino."

As it happened, he was reaping a small fortune in listing fees from Canadian mining companies that couldn't qualify for listing in Vancouver – at that time, the wildest stock exchange in North America.

But you're a smart person, right? You automatically "delete" those Nigerian e-mails. And you'd *never* touch some fly-by-night Canadian mining company that's listed on a private stock exchange in Bulgaria – right?

Well, the SEC doesn't seem to believe us …

Under the Securities Act of 1933, any public-stock offerings that make shares available to individual U.S. investors must first be registered with the SEC.

At the time, that rule seemed to make sense. You see, during the 1920s, as part of the speculative mania that spiraled into the Great Crash of 1929, there had been all sorts of scams selling fraudulent shares to the public, so this New Deal law was drafted to clean up that problem.

One side effect: Foreign-based firms that did not register with the SEC were also prohibited from selling their shares to U.S. individual investors.

But there are exceptions, of course.

For instance, there's one exemption for institutions, and another for private offerings for up to 50 people (which usually means partners and friends of the big investment banks).

But for Mr. John Q. Public – even intelligent, millionaire John Q. Public – there's no such luck.

So U.S. investment bankers and wealthy hedge fund investors were able to invest in – and profit from – the ICBC IPO, even though regular retail investors can't even purchase the shares.

For more than seven decades, this exclusion of foreign-stock listings really hadn't been an issue. The

U.S. economy reigned as the world's greatest growth story. And many of the countries abroad were underdeveloped and poor, and were drained by the decline of colonialism, wracked by war, or stifled by despotic forms of government.

No psychologically healthy (i.e. sane) American wanted to invest in foreign stocks anyway: Why should they when they could amass great wealth at very low risk right here in their own back yard?

While it's true that U.S. investors missed the occasional really great bargain in such markets as Sweden, it wasn't until Japan took off in the 1970s and 1980s that anyone suggested the SEC restrictions were causing American investors to miss out on anything.

When concerns intensified, some new products were created to tackle the problem. Some of the really big foreign companies whose names were familiar to American investors – Royal Dutch Shell, and Siemens, to name two – issued "American Depository Receipts," or ADRs, which were registered with the SEC and then made available for sale to U.S. investors.

ADRs had the same ownership rights as regular shares, and could even be converted back into the issuing company's shares at the designated depository – generally a large bank like JP Morgan Chase & Co.

The only thing preventing full arbitrage between the U.S. markets and the ADR issuer's home market was that the shares couldn't easily be converted into ADRs. This meant that ADRs could trade at a substantial premium to the share price, but at no more than a small discount – if the discount became large enough, arbitrageurs would buy cheap ADRs and exchange them into shares.

The first ADR issued by an "emerging-markets" company was by Japan's Sony in 1961. At the time, Sony was a medium-sized electronics company with great growth aspirations, and it quite shrewdly saw the ADR as both a financial instrument and a marketing tool that in combination would help it achieve its goal.

Sony was right. The ADRs gave the company access to the single-largest pool of retail investors in the world, and the ticker's debut in New York helped the firm capitalize on the surging U.S. appetite for tech stocks. This heightened visibility in the financial markets gave Sony's marketing efforts a boost, too, increasing the interest in its expanding circle of consumer products.

From that point on – and up until 2000 – it was basically standard operating procedure for emerging-market companies to issue ADRs; that was especially true of companies in high-tech businesses, which were increasingly sought after by U.S. investors.

ADRs were playing a crucial role here in the U.S. market.

Then came Sarbanes-Oxley.

Boxed In By Sarb-Ox

Sarbanes-Oxley imposed onerous new requirements on listed companies, including a rule that a corporation must have international auditors review and sign off on its computer systems, an exercise that carries a minimum cost of $3 million to $5 million.

It's no surprise that new ADR issues are almost non-existent.

And the rule makes very little sense, when you really think it through: Why should international companies be so burdened, especially since the world's investor base is increasingly institutional, and private savings are growing exponentially in the emerging economies of Asia?

Unfortunately, the pool of ADRs that you can invest in is now quite limited.

Some very good companies – such as Hon Hai Precision Industries, the Taiwan-based

electronics firm that makes all three of the new video-game consoles that have taken the consumer market by storm – are off-limits to U.S. investors. These companies haven't bothered to register with the SEC, and don't have ADRs.

Let me emphasize that Hon Hai is not some simmering financial fraud: It's the world's No. 1 electronics manufacturer, and is a company so well-managed that **BusinessWeek** magazine has dubbed it a "profit machine."

The Problem Heightens, Potential Solutions Appear

U.S. retail investors find themselves "boxed in" by these two sets of regulations just as the international financial markets are exploding with profit potential.

The money flows we track here at **Money Morning** bear this out.

Today, the United States and Asia together account for 56% of the worldwide economy, or 28% each.

But in 25 years, the World Bank says, the U.S. share of the global economy will have slip to 24%, while Asia's share will soar to an estimated 55%.

Worldwide financial assets – estimated at $118 trillion in 2005 – will explode to more than $200 trillion by 2010, and forecasters say the bulk of that growth will come from newly capitalist markets in Asia and Europe.

For decades, U.S. investors have been told that international investments should comprise 5% or 10% of their holdings – and certainly no more than 15%. But real investing experts know that's poor advice.

*In fact, Jeremy J. Siegel, the respected Wharton Business School professor and author of the best-selling blockbuster, "***Stocks for the Long Run***," contends that international stocks should constitute 40% of an investor's portfolio.*

If you need further proof that the United States no longer dominates the world of finance, consider the IPO markets. The best stock deals were once the sole purview of U.S. companies. A look at the IPO of ICBC shows that this is no longer true.

Indeed, of the Top 10 IPOs of all time, only one is a U.S.-based company. And the $10.62 billion IPO of AT&T Wireless in April 2000 was only large enough to rank eighth on the list.

For some perspective, consider this: Last week's long-awaited IPO of buyout giant, **The Blackstone Group (NYSE: BX)**, raised $4.1 billion, making it the largest U.S. stock offering in several years and one of the largest in this nation's history. And it didn't even crack the Top 10.

Of those 10-largest deals, Japan has three and China two, while Italy, Russia, Australia, Germany and the United States have one each.

Why is that important? If these companies don't register their IPOs with the SEC, American investors will continue to be shut out of the new deals. And with the bulk of the economic growth taking place overseas in the years to come, it stands to reason that the majority of the new stock deals will be done there, too.

The upshot: U.S. retail investors could end up not being able to invest in some of the world's fastest-growing – and most-promising – global companies.

American investors certainly don't want to just stand by and watch as they're left behind financially. But what's an individual investor to do?

Avoid the Global Investing Shutout

Apart from open- and closed-end mutual funds, one promising new global investing option has appeared in the form of Exchange Traded Funds, or ETFs – baskets of stocks that are listed on a U.S. stock exchange. You can buy these, and they actually trade like stocks. What's more, since they can be created from – or broken up into – the underlying shares, they trade close to their actual net-asset value.

Nevertheless, ETFs are limited to baskets for which there is substantial U.S. investor demand. There aren't ETFs for individual foreign stocks, and if you decide that a small market like Estonia is exciting (it is) there may be no ETF option (there isn't).

The right solution would be for the SEC to come to an agreement with a few major international stock exchanges that have good regulatory oversight – London's International Stock Exchange, the Deutsche Bourse and Tokyo are great examples – and rule that anything listed on one of those exchanges could be sold to U.S. retail investors.

Then a company from a non-U.S. country could choose which big stock exchange to list on, and would be able to attract investors worldwide without having to put up with nonsense from all four stock exchanges and their local SECs.

For a U.S. individual investor, the right solution is to let Money Morning help you understand which companies you can buy, and which you can't, and to highlight evolving trends and investment opportunities from all over the world – including the newly emerging growth markets.

It comes down to this: **We do the research. You reap the riches.**

P.S. We've all seen how foreign demand – especially from China – has helped send gasoline prices into the stratosphere. Well all that overseas growth is having – or soon will have – a similar effect on the price of a commodity some analysts have described as "more precious than oil." The rising demand for this commodity is part of a projected $867 billion surge in global spending that can be directly attributed to white-hot growth in the emerging markets abroad. To learn how to get in ahead of the crowd and profit from this "new oil," CLICK HERE.

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