

# Globalization: A World of Opportunity



RBC Wealth Management™

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## Introduction

The investing landscape is in the midst of unprecedented changes because of the technology boom of the late 1990s, the maturation of financial systems, and the development of free-market oriented economies. As a result, globalization is shifting into high gear.

Today's globalization movement — which we loosely define as the interdependence of economies, financial markets, and labor markets — is frequently billed as something new and is often couched in lofty terms. But, it is actually the transformation of something very old. Shades of globalization have ebbed and flowed for centuries — from the Silk Road more than 2,000 years ago, to the European colonial empires between the 16th and 18th centuries. Most nations involved in today's globalization movement have played this game before.

*If General Electric is leveraging the growth of developing nations, individual investors should implement such a strategy as well.*

But critical distinctions exist between today's globalization era and the periods long ago. First, the movement is now open to the masses rather than just the elite. Centuries and millennia ago, only royalty, rulers, prominent officials, and explorers profited from globalization. Today, the average American can now become directly involved in the global investment arena and can captain his own “trade ship” in the form of an investment portfolio leveraged to the globalization movement.

Second, the pace with which globalization has transformed economies and the magnitude of the changes have been dramatic. Globalization has transformed regions that were economically inconsequential just 10-20 years ago. Now billions of people are being integrated into the free marketplace for the first time. We believe developments in the next 20 years could be just as dramatic.

Third, U.S. investors haven't fully considered or grasped the changes related to globalization, in our opinion. Even more importantly, few individual investors have embraced the investment opportunities associated with it. Many U.S. investors are underexposed to other regions of the world, particularly to developing nations.

Successful investors have long understood the importance of implementing diversification strategies across asset classes and sectors of the U.S. economy. Because there is no denying that the U.S. economy is now functioning within a much broader global arena, we believe it is time for U.S. investors to take diversification a step further. *Investors should broaden their view of portfolio management to include global markets.* It is prudent to be exposed to other major regions of the world, just like it is wise to be exposed to several major asset classes and sectors of the U.S. economy.

It is also prudent for investors to be exposed to what, in our opinion, is the sector of the global economy with the highest growth potential: developing economies, as they are among the biggest beneficiaries of globalization. While the U.S. economy should continue to set the pace and be the dominant player in the decades ahead, a meaningful share of global economic growth is now coming from outside of the United States. The shift in economic momentum could be exacerbated in the future because of the demographic challenges facing the United States and other developed nations such as Germany, France, and Japan.

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**Growth in the U.S. Labor Force  
Could Slow**

Year	Growth Rate
2005	1.2%
2010	0.6%
2015 - 2020 e	0.2%

Source: Bureau of Labor Statistics

When the baby boomers begin to retire in 2010, the growth of the U.S. labor force is forecast to drop to 0.2% during 2015-2020 from 1.2% growth today, according to Bureau of Labor Statistics projections. That rate is much slower than the 1.7% average that occurred from 1948-2004. Even more troubling, the 25-54 age group — often considered to be the most productive group of workers — could grow at a slower rate than the total workforce. Such a slowdown is of concern because labor force growth was an important contributor to U.S. economic growth

in the twentieth century. The workforce changes in Europe and Japan will be even more dramatic. (For more information about the demographic challenges of the United States and other nations, please request our 2004 report titled, *How the Coming Demographic Shock Could Alter the Investing Landscape*.)

The U.S. contribution to new global GDP growth could also recede from high historical levels. For example, from 1995-2002, the United States economy was the only large economy growing at a healthy pace. It contributed about 98% of the new growth that occurred during that period. But, as China's economy gained steam in 2003, the balance began to shift. The United States only contributed 22% of the new growth that occurred that year while China contributed 34%. Europe only contributed 6% of the new growth. In the decades ahead, we believe developing nations such as China and India will represent a significant portion of the new growth, so global economic growth is not likely to be as U.S.-centric as in the past.

While these changes will take decades to play out, we are on the cusp of them now. Multinational companies are already positioning themselves for these demographic shifts. They are beginning to discern that developing economies (such as Central and Eastern Europe, China, India, and Latin America) may offer better growth opportunities in the next 10-20 years compared to mature, developed economies (such as the United States, Japan, and Western Europe).

That is why industrial and financial titan General Electric is implementing a growth strategy that focuses on opportunities in developing nations. In a letter to shareholders in early 2005, General Electric's Chief Executive Officer, Jeff Immelt, wrote, "We believe that 60% of our growth will come from developing countries in the next decade versus about 20% for the past 10 years ... China remains important ... Our opportunities also stretch into Russia, India, Eastern Europe, Southeast Asia, the Middle East and South America." General Electric's goal is to almost double its Asian revenue by 2008 to \$33 billion from \$17.5 billion in 2004. The company anticipates that roughly 30% of that Asian revenue will come from China, 15% from Southeast Asia, and 9% from India.

If a proven corporate leader and innovator like General Electric is leveraging the growth of developing nations, individual investors should also consider implementing such a strategy, in our opinion.

U.S. investors should evaluate their stock, bond, and mutual fund opportunities through the filter of globalization in order to tap into the growth associated with other regions and nations. This report explains the unique characteristics of the modern day globalization era, and more importantly, it highlights the investment implications that shape it. It also outlines four keys to developing a successful globalization investing strategy.

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## Part I: Globalization Defined

The essence of today's globalization movement is its interconnectedness, not only among the nations and regions involved, but also among their peoples. "This is a different world," Federal Reserve Chairman Alan Greenspan told the Joint Economic Committee of Congress in June 2005. "It is a world in which we are all economically related," he added. It is a world in which globalization is connecting and reshaping economies, financial markets, labor markets, and trade. It is diffusing economic power. Following are the unique characteristics that shape today's globalization movement.

### ECONOMIES ARE MORE MARKET-ORIENTED AND INTERTWINED

U.S.-based multinationals are steadily moving into nations and regions that were shut off from the free enterprise system for decades because of communism (China, Central and Eastern Europe, and Russia) and socialism (India and Latin America). Those nations and regions are now open for investment, as they have begun to implement market-based or quasi market-based economic systems, which encourage private ownership and free enterprise.

These developing economies are quickly becoming intertwined with what is commonly known as the "developed world" — the United States, Western Europe, and Japan. Growth rates in one nation or region now affect others and the global landscape. In addition, many developing nations are growing at a faster rate than much of the developed world and are likely to represent a greater share of global gross domestic product (GDP) in the decades ahead, as the chart indicates.

The following nations or regions are implementing market-based systems:

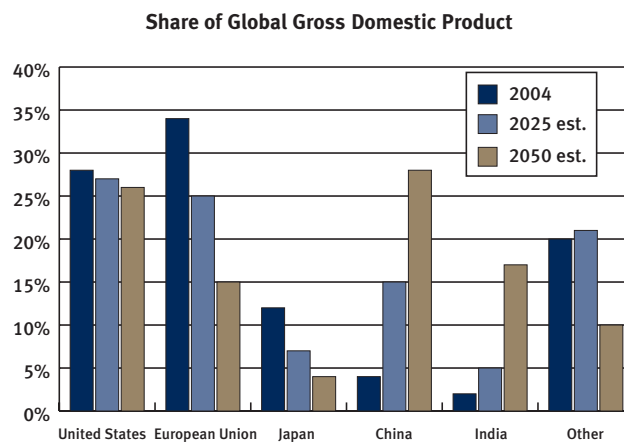
#### China:

During the Great Leap Famine in the 1950s and under the brutal Cultural Revolution in the 1960s, China suffered greatly. It is now overflowing with commerce and global trading, and large segments of the population are prospering. Before 2010, China could overtake Germany as the world's third

largest economy. Before 2020, it could become the second largest economy, leapfrogging over Japan. "The economic engine in China is just unstoppable," General Electric's Immelt told CNBC in January 2005.

After 30 years of economic reforms, China is no longer an undiscovered, mysterious place.

- 400 of the top 500 multinational companies have invested in China.
- 30 of the top multinationals have regional offices there.
- China's economy is now far more open to foreign investment and two-way trading than Japan.



Source: *Keystone India*

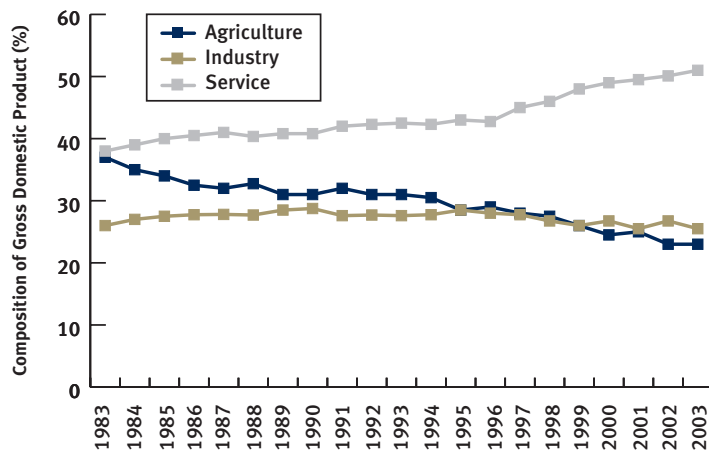
The most dramatic changes are seen in the lives of the Chinese people. The number of people with permanent residence status in urban areas soared 57%, to 466 million from 1990 to 2000. The urban population is even higher today. In addition, roughly 100 million people live in urban areas without official permission. Many of these people migrated from rural villages to the large, urban coastal provinces seeking jobs and a better life. Millions of them now have indoor plumbing and heat for the first time in their lives. They even have what young Americans would regard as the “necessities” of life — mobile phones and MP3 players. An office worker at a coastal factory can now send more money back to her family in the village than a crop would produce. “Never in world history have so many workers improved their standards of living so rapidly,” said William Overholt of the RAND Corporation. The size of China’s middle class could soon eclipse the total U.S. population, if it hasn’t already.

Ironically, approximately one-third of China’s private business people belong to the Communist Party compared to only 5% of the general population. But, in reality, many of these astute capitalists are “communists” in name only. They seem to take capitalism much more seriously than communist economic doctrine. Surely that is not what Mao or Marx had in mind!

### India:

With the help of a young population and a continuation of the government’s economic reforms, India could be forging ahead on a transformation of historic proportions. India’s economy could become the third largest in the world (behind the United States and China) by 2040 if it grows at an annual rate of 6.0%-6.5%, which has been its average growth rate the past ten years. Some economists and corporate executives believe India has the potential to grow even faster. In May 2005, General Electric’s Immelt told Indian business leaders, “Over the next five years ... India will be one of the fastest growing if not the fastest growing region in the world. That’s my expectation.”

**India’s Economy: Twenty-Year Transformation**  
*The Services sector has risen while Agriculture has declined.*



Source: World Bank; James Dean and Vivek Dehejia, “The Elephant and the Dragon: A Tale of Two Countries”

Recent history is on India’s side. In ten short years, India’s service sector revenue quadrupled, driven by its citizens’ ability to leverage technology and use global labor trends to their advantage. Services now represent more than 50% of India’s GDP. The advancements have sparked new industries and are transforming cities. Mini Silicon Valleys now exist in Bangalore, Chennai (formerly Madras), Pune, Hyderabad, and Kolkata where back office IT services are conducted and call centers operate for multinational corporations. The United Nations ranks Bangalore fourth in the world as a hub for technological innovation. Some global investment bankers compare India’s economy today to China’s economy *before* China’s most recent growth spurt.

India's long-term economic opportunities could be greater than China's, according to professors Tarun Khanna of Harvard and Yasheng Huang of the Massachusetts Institute of Technology. They cite India's solid economic infrastructure, sound banking system, stable monetary system, well functioning capital markets, and more advanced legal system. These frameworks are an advantage and engender investor confidence, in our opinion, as India seems committed to democracy and open markets.

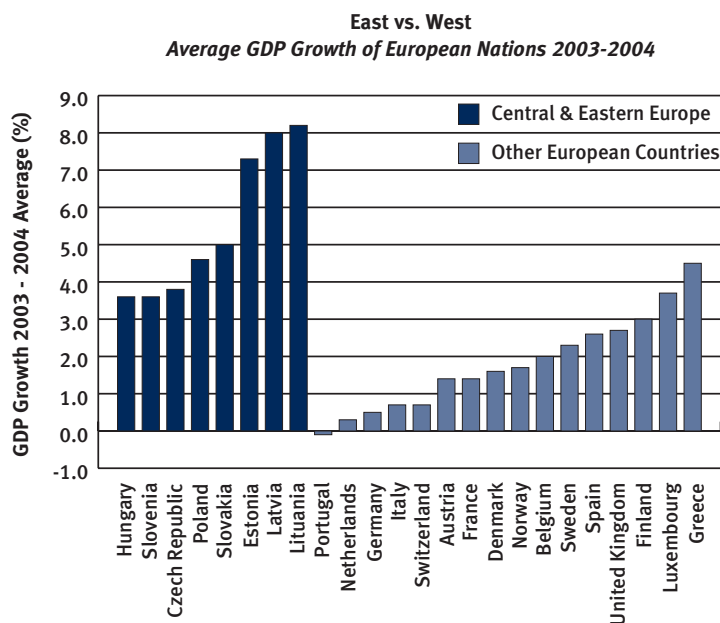
In addition, the professors point out that Indian companies are less subject to the whims of government mandates and control compared to Chinese companies. India's economic model effectively encourages entrepreneurial activity, they argue. Indian companies tend to have much higher return on investment at 16.4% compared to 12.8% for Chinese companies, according to *Business Week's* analysis of Compustat data.

### Central and Eastern Europe:

Globalization's imprint on Europe has been swift and dramatic since the fall of the Iron Curtain and the decision was made to expand the European Union. Nations that were often forgotten in the Soviet era — Hungary, Romania, Czechoslovakia (now the Czech Republic and Slovakia), Slovenia (formerly a republic in Yugoslavia), and the Baltic states of Estonia, Latvia, and Lithuania — are now among Europe's free market champions.

As a number of these nations prepared to join the European Union in 2004, they cut taxes, reduced regulations, and opened their markets for trade. Their new economic models are more market oriented than the region's largest economies such as Germany, France, and Italy (otherwise known as developed Europe), which have been constrained by costly retirement and social programs, high tax rates, and protectionist tendencies. The statistics illustrate the difference. Developed Europe's GDP only grew an average of 1.5% annually during 2000-2001. In contrast, Central and Eastern Europe's GDP grew an average of 4% during that time. In 2003-2004, Slovakia, known as the "darling of the multinationals," grew 5% per year, on average. Poland grew 4.6% per year, on average, during the same period.

Russia's economy has also been transformed to a more free-market oriented system. However, the nation's commitment to capitalism came under question when Vladimir Putin's government seized the assets of Yukos, which was, at the time, Russia's largest and most productive oil company. In our view, the Kremlin holds the key to Russia's future.



Source: World Bank, OECD, CIA World Fact Book

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### Latin America:

The region has been on a 30-year path of transformation from a statist model to open markets and more capitalistic-oriented economies. The path has not always been smooth, as Latin America has been challenged with debt crises, rampant inflation, poor decisions by corrupt dictators, and mismanagement by international organizations such as the World Bank.

*Latin America rebounded from a challenging period after implementing a string of pro-capitalist reforms.*

Following the mid-1990s economic crisis in the region, Latin American leaders implemented a string of pro-capitalist reforms that are reaping benefits today. Governments and populations are now advocates of free trade and foreign investment, and are more open to privatization of some state-owned monopolies.

Mexico is the region's largest economy. It now has far fewer state-owned enterprises — less than 200 today compared to 1,000 in 1982 — but still owns and operates Pemex, an oil monopoly. Mexico's trade with the United States and Canada has doubled since the implementation of the North American Free Trade Agreement (NAFTA) in 1994. Roughly 85% of Mexico's exports are shipped to the United States. Brazil, which is rich in natural resources, is the second largest economy in Latin America. Chile is another bright star in the region. Its economy has grown 19 of the past 20 years, partly because of low trade barriers and prudent debt levels. It has one of the world's only fully funded, private retirement systems.

More recently, leftist leaders have been elected in Argentina, Venezuela, and Uruguay, and another is rising in prominence in Mexico. So far, they have not threatened the region's capitalist reforms.

### TECHNOLOGY HAS WIRED THE WORLD TOGETHER

Technology is another hallmark of today's globalization movement. Most of the world's population — rich, poor, and otherwise — interacts in the global marketplace because of the technology buildout of the 1990s. We're wired together through fiber optic networks and we're linked together by satellites. As telecommunications companies such as Global Crossing built fiber networks, India, China, Malaysia, Hungary, Poland, and other developing nations got connected. Hundreds of millions of people are now able to interact with the developed world like never before.

When a pork processing plant manager in Timisoara, Romania, can send an e-mail to company headquarters in Smithfield, Virginia, that is received in seconds, it can dramatically increase productivity. Or, when an operations manager at a technology company in Round Rock, Texas, can call his electronics manufacturer in Guangzhou, China, for three cents per minute, it has a profound impact on how business is conducted. Suddenly, co-workers feel as though they are only a state or province away, not a world away.

With the aid of technology, small- and mid-capitalization companies can have global reach. They can now function like larger capitalization companies. For example, a U.S.-based mid-cap manufacturer of heavy hauling trucks and cranes can capture market share in the Chinese and Indian infrastructure industry just as effectively as its large capitalization rivals in the United States and Japan. Because of technological advances, it has never been easier for corporations — large or small — to buy components, sell products, build factories, or service customers thousands of miles and an ocean away.

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Product development and production methods have also advanced because of technology, facilitating timely delivery of custom products to market. A designer in New York can consult with a production manager in Shenzhen, China, and test market a product in Berlin, Germany, in a matter of weeks, rather than months.

Advanced, technology-driven supply chain management systems now enable products to quickly and efficiently get into the hands of consumers at the lowest possible cost. Supply chain management coordinates the flow of goods and services at every stage — from the raw material or idea phase, through production, through its transportation channel, to the wholesaler, and to the final retailer. Technology allows products to flow through synchronized distribution systems around the clock. Multinational companies continue to use technology to cut costs and produce goods at a cheaper price. We believe technological advances such as these will continue to help corporations sustain or expand profit margins.

### **COMPANIES NOW HAVE ACCESS TO A GLOBAL LABOR POOL**

Another unique characteristic of the modern globalization movement is the global labor pool. Shared labor — when companies from one country hire cheaper labor from another country — has been in existence in its current form since the end of World War II. So today’s use of Chinese, Indian, and Latin American labor is not a new concept. But, significant developments in the global labor pool in the past ten years have affected the investment landscape. Those changes have resulted in some of the most controversial elements of modern day globalization.

#### **The Size of the Labor Pool is Unprecedented**

The size of the labor force has swelled because of the roughly three billion people who are new entrants from China, India, Central and Eastern Europe, Russia, and Latin America. The massive working-age populations of China and India are having a significant impact. India should be able to supply new labor for years to come, as about 33% of Indians are age 14 and under. Roughly half of the population is age 25 and below, according to Keystone India, a consulting firm. There are roughly 170 million manufacturing workers in China — more than half of the total population of the United States. An economist at our national research correspondent forecasts that an additional 22 million workers will become integrated into the industrialized economy in the next ten or so years.

#### **Segments of the New Workforce are Highly Educated**

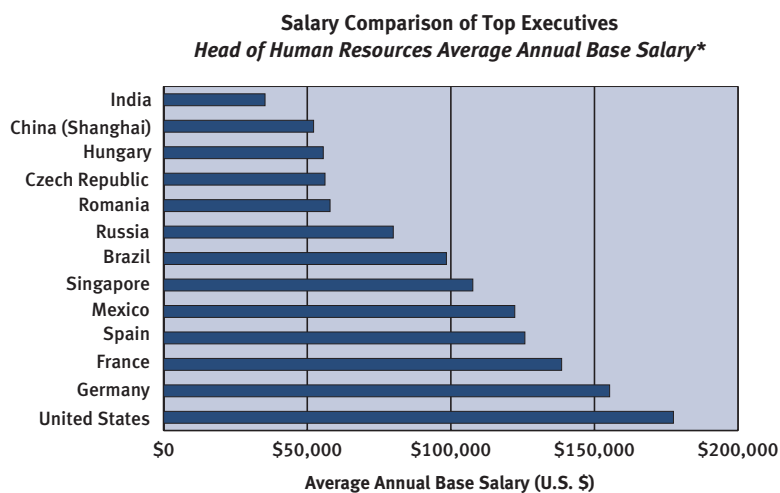
One thing the old Soviet system actually had going for it was an advanced educational system, including the areas of engineering, mathematics, physics, and other sciences. People from the outermost regions of Russia, the Czech Republic, Romania, and Slovakia are beginning to put their educations to work in the global marketplace for the first time.

*India has the most rigorous competitive university system in the world. Graduates claim America’s Ivy League schools are easy in comparison.*

In India, a wide education gap still exists among its citizens. A large percentage of children remain uneducated. Of the children who enroll in school, only 7% graduate high school, according to Indian government statistics. But, the educational system at the top end of society is impressive. India has the most rigorous, competitive

university system in the world, the Indian Institute of Technology (IIT). The seven-campus system accepts one out of every 50 applicants (Harvard accepts one out of every ten applicants), and requires prospective students to take a grueling entrance exam in physics, chemistry, and mathematics. Some high school students begin preparing for the exam at age 14. Graduates claim America's top-ranked advanced degree programs at elite Ivy League universities are easy compared to IIT's undergraduate program.

The number of engineering graduates from the IIT schools and the second-tier university system is hard to pin down, as there is a wide range of estimates (the data ranges from 120,000 engineering graduates per year to as high as 530,000 including three-year degree holders; in comparison there were about 76,000 engineering graduates in the United States in 2004). Numbers aside, India's upper tier and second tier educational system is rather advanced. Its students are able to compete with their American, European, and Japanese counterparts. Now that India's economy has begun to blossom, more young Indian engineers and scientists are beginning their careers in India rather than moving to the technology-rich Silicon Valley area of California. For the first time, they are able to use their skills in Indian-based software, IT consulting, engineering, pharmaceutical, and biotechnology companies. India's prime minister likens the metamorphosis to a "brain gain" for his nation instead of a "brain drain."



*\* Average of low and high annual base salary data  
Source: Mercer Global Pay Summary 2004/2005; RBC Dain Rauscher*

### Wages are Extraordinarily Low

The highly educated global labor force is working at a cheap rate, in terms of American standards. Indian engineers typically earn \$5,000-\$10,000 per year — enough to live a middle class lifestyle and own a car — vs. \$55,000-\$75,000 for an American engineer. Indian software developers typically earn \$6 per hour vs. \$60 per hour in the United States, although there is often a difference in skill level between these wages, according to the McKinsey Global Institute.

At the lower end of the wage scale, an Indian telephone operator typically earns \$1 per hour while an operator in the United States earns about \$12.50 per hour, according to Bardhan and Kroll. In the United States, a semiconductor chip designer may earn \$2,000-\$4,000 per month. In China, a worker doing the same job would earn \$120 per month.

Americans and Western Europeans are not only competing against Chinese and Indian workers. Central and Eastern Europe are becoming more active in the manufacturing sector. It is the world's second-fastest growing auto manufacturing region (second to China). Autoworkers earn \$3-\$6 per hour in Eastern Europe vs. almost \$29 per hour average in Western Europe (\$50 per hour in Germany) and \$26-\$37 in the United States. Volkswagon autoworkers in Slovakia are willing to work 40 hours per week at \$6 per hour vs. the 28 hours per week at \$50

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per hour their peers in Germany have negotiated. It is typical for autoworkers to log in 2,000 hours per year in Slovakia, the Czech Republic, and Poland versus 1,440 hours per year in Germany and France. Even though Eastern European wages look unmanageable by American standards, the low cost of living allows workers in the region to live decent lifestyles, especially as they move up the ranks.

Industries and companies that can hire cheap labor in developing nations can cut costs and widen margins. While this offshoring practice has gone on for decades, particularly in the manufacturing sector, we believe it will continue and accelerate in the services sector. For example, some major accounting firms based in the United States are now using Indian workers to handle basic accounting services such as tax preparation.

### **There is a Shortage of Skilled Workers**

Despite the high numbers of well-educated engineers in India and China who are willing to work at low wages, there is a global shortage of skilled workers, according to Deloitte Touche Tohmatsu. Multinationals that are on the cutting edge of globalization are involved in executing multi-year strategies, not one-time transactions. They are in need of local, skilled managers and workers who can forge ahead for a number of years to deliver a complex platform of products and services in overseas markets.

Economic growth is straining the global labor force such that skilled workers — people with visionary leadership, technical fluency, professional licenses, and above-average skill sets — are in short supply. Consider that while almost 4 million students are in China's colleges and 20% of those students earn engineering and science degrees, it represents just a small portion of the total 1.3 billion population. Many developing nations are experiencing high turnover rates in management positions. China's turnover rate is 30%-40% vs. the 5%-10% global average. McKinsey & Co. forecasts in the next five years, China will need to hire 75,000 executives with international experience. It only has about 5,000 such executives today. In India, multinationals are having difficulty filling senior positions. U.S.-based Internet search company Google said it planned to hire 100 researchers by the end of 2005. As of July, it had only filled about 25 positions. "The skill sets we're looking for are hard to come by in senior people," Google's principal scientist in Bangalore told *Business Week*.

Increasingly, U.S.-based companies are becoming more involved in providing staffing assistance and human resource functions for multinationals that are operating factories and services centers overseas. They are also recruiting executives for promising firms based in developing nations.

### **AN ABUNDANCE OF TRADING OPENS NEW DOORS**

Trade is another distinctive of today's globalization movement. Because of technological developments, interlinked economies, and labor availability in this new environment, an abundance of trading is occurring. Trade has been a major contributor of global GDP growth and has boosted the U.S.

economy. During the 1997-2004 economic expansion in the United States, exports contributed to 38% of the cumulative increase in GDP growth. "The facts are, the more we liberalize trade, the higher our standard of living," Federal Reserve Chairman Alan Greenspan told a congressional committee.

*"The facts are, the more we liberalize trade, the higher our standard of living,"*

*— Federal Reserve Chairman Alan Greenspan*

Multinational corporations and many small businesses are dependent on the free flow of goods. According to the World Trade Organization (WTO), world merchandise exports grew 7% per year, on average, from 1995-2000, much faster than global GDP growth. Latin America and East Asia (excluding Japan) were the strongest regions during that period, at 9.5% growth per year. In 2001, world merchandise trade exports dipped into negative territory because of the U.S. recession. Exports bounced back to 3% growth in 2002 and 4.5% growth in 2003. East Asia's exports grew much faster at 8.0% and 9.5%, respectively, during those years.

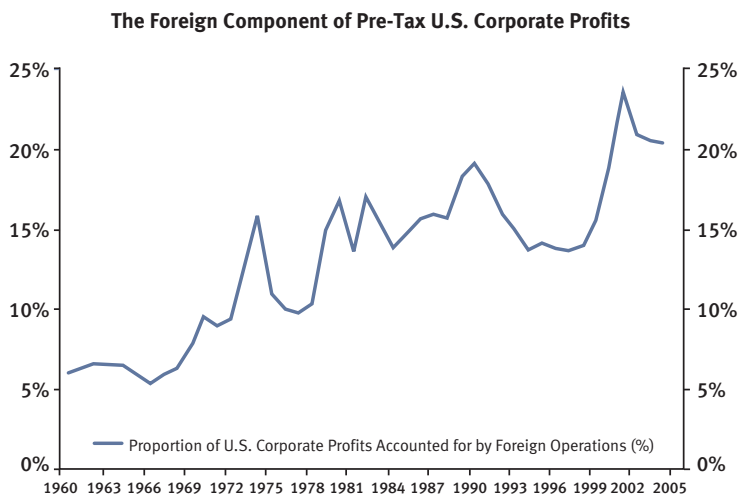
### Trade is Not a Zero-Sum Game

Concerns about the record U.S. trade deficit and cheap labor competition from China and India have sparked a backlash against globalization. In the process, a false notion has developed, in our opinion: the false notion that when trade occurs, one trading partner wins (China, the trade surplus partner) while the other loses (the United States, the trade deficit partner). We believe many of the fears surrounding this attitude are

based on misinformation and lack of information. When analyzing the trade deficit, it is important to consider the following key factors:

- **More than 40% of China's exports to the United States are products of U.S.-based multinationals.** In many cases, much of the profits go to the multinational companies (and their shareholders) that contract the work, not to Chinese companies that actually assemble the product or the Chinese government. Therefore, the activity of U.S.-based multinationals represents a significant share of the U.S. trade deficit. The products on the shelves of Wal-Mart alone represent more than 10% of imports shipped to the United States from China. Less than 10% of Chinese exports are Chinese branded products, according to Straszheim Global Advisors.
- **Companies are now able to use labor from multiple nations to develop and manufacture one product.** Many electronic products are manufactured in multiple locations, component by component, and then assembled at a completely different location. So in practical terms, when you read the label "Made In China," that doesn't necessarily tell the full story. It would likely be more accurate for the label to read: "Designed in America; components made in Malaysia, Taiwan, Japan, and Korea; product assembled in China."

This complicated web of production raises a hornet's nest of issues regarding trade statistics. With so many nations participating in production, which nation gets the credit? Do they share in the credit? Is it calculated accurately? As we've pondered these questions and studied the issue, we can argue that the trade statistics have not fully accounted for the multiple points of production. Therefore, the trade statistics and the trade deficit numbers are subject to interpretation, in our view.



Source: Federal Reserve, CSFB research

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- ***China and India are not “new threats.”*** These nations — often portrayed as “new” economic and trade competitors — have been at this globalization game on and off for thousands of years. In the 1830s, China and India may have accounted for up to 50% of the world’s GDP. In fact, some of today’s leading Chinese conglomerates are descendents of the “middlemen” or “comprador” import/export and supply chain management companies that operated during the 19th century. These companies were trade leaders long before Chairman Mao’s Communist revolution.
  - ***“China versus United States” is a false choice.*** Growth and success in developing nations does not come at the expense of the United States, in our opinion. If China or India’s economy thrives, we believe the U.S. economy and financial markets would benefit (we will have a larger, healthier market in which to sell our products and services; we will have cheaper goods to buy). If China’s economy falls into recession, it would negatively impact the United States, in our opinion, because major trading partners now have symbiotic relationships. Both nations can help or hurt each other depending on economic policies. Typically, the growth of one region (United States) helps fuel the growth of another region (China) and vice versa. It’s either a win/win or lose/lose ball game — not a win/lose scenario.

#### **FINANCIAL MARKETS ARE INTERCONNECTED, MORE ADVANCED**

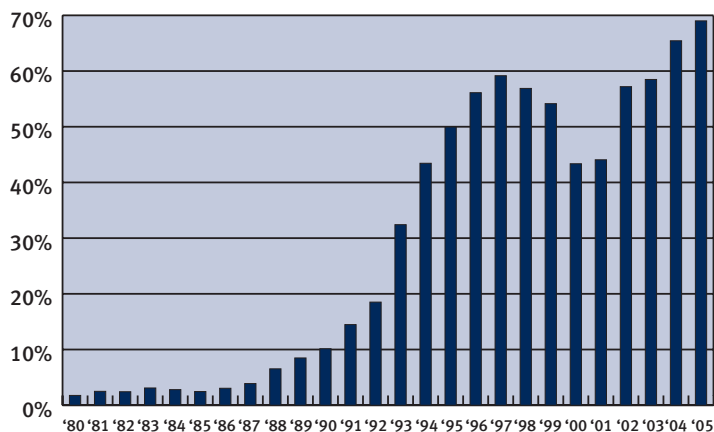
The transformation of financial markets is another unique characteristic of the modern-day globalization movement. Technology, the advancement of market economies, and trade have dramatically affected financial and capital markets around the world. Finance is now much more driven by risk-adjusted rates of return. Capital is more apt to flow to the most efficient places and takes risk into consideration instead of being so heavily influenced by government central planning, which proved to be a highly inefficient and flawed model.

The rise of the world’s global financial stock — the sum total value of bank deposits, equities, and government and private debt securities — has been extraordinary. According to the McKinsey Global Institute, it exploded to \$118 trillion in 2003 from \$53 trillion in 1993 and \$12 trillion in 1980. McKinsey forecasts it will soar to \$200 trillion in 2010. Global financial stock is now three times the level of global GDP. In 1980, they were roughly the same size. Private debt securities are the largest percentage and fastest growing category of global financial stock, representing almost half of the growth from 1993-2002. International private debt securities grew three times as fast as U.S. private debt securities, but remain a small portion of overall financial stock. About 80% of the global financial stock is represented by the United States (37%), Europe (31%), and Japan (12%). While China only claims 4% of the world’s share, its global financial stock grew the fastest from 1993-2003, rising at a compound annual growth rate of 14.5% vs. 8.6% for the United States.

Cross-border equity flows have risen almost tenfold since 1989, according to McKinsey, at 18% per year. While most of the equity capital flows through U.S. markets, developing nations have begun to create financial institutions such as stock exchanges, bond exchanges, central banks, or have enhanced existing institutions. China is in the process of implementing much-needed reforms to its stock exchange and equity ownership system. More progress is warranted, in our opinion. Some emerging markets have fully developed exchanges. More than 6,000 companies are listed on India’s Mumbai Stock Exchange, which was founded in the 1870s, making it the oldest exchange in Asia.

The financial ties among nations extend beyond stocks and bonds. Currency and commodities markets are now responding more rapidly and more efficiently. Even real estate is linked. The housing boom experienced in the United States in the past few years has global origins. Prices began appreciating in Old Europe, Australia, and developing nations before they began to rise in America.

**Signs of Investment Optimism**  
**Net Direct Investment — Developing Asia**



Source: International Monetary Fund data as of September 2005.  
 Franklin Templeton Investments

Many nations have also experienced a rise in foreign direct investment (FDI), the process by which public and private companies invest directly in productive assets in other countries (excludes investments in stock). The United States is still the primary beneficiary of inbound FDI at an estimated \$107 billion in 2004, according to Organization for Economic Co-operation and Development (OECD) statistics. The United Kingdom was officially second at \$79 billion. China was third with \$55 billion, according to the International

Monetary Fund (IMF). China’s FDI would rise to \$89 billion, overtaking the United Kingdom, if Hong Kong were included. Brazil, Mexico, and India were at roughly \$18.2, \$16.6, and \$5.3 billion, respectively.

Because capital is flowing more freely, developing economies are now more balanced than they were just 5-10 years ago when they tended to be dominated by one industry — agriculture. Most developing nations now have a large industrial manufacturing sector (about 52% of China’s economy) or service sector (more than 50% of India’s economy).

These factors have combined to form a global financial system in which North America, Europe, and Asia are more synchronized than in the past and are dependent on one another. It seems not a day goes by that the U.S. stock market or bond market, or a major U.S.-based multinational company, is not impacted by global economic or financial news. The wide dissemination of information and the technological links between exchanges, brokerage firms, and institutions allows financial markets around the world to respond simultaneously and instantaneously.

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## Part II: Four Keys to a Successful Globalization Strategy

### USE DEVELOPING NATION EXPOSURE AS A PART OF TOTAL ASSET MIX

In recommending that investors take advantage of the globalization movement, we are NOT advocating a wholesale switch out of U.S.-centric investments into international stocks, bonds, and funds. We are recommending that investors reach their appropriate international allocation.

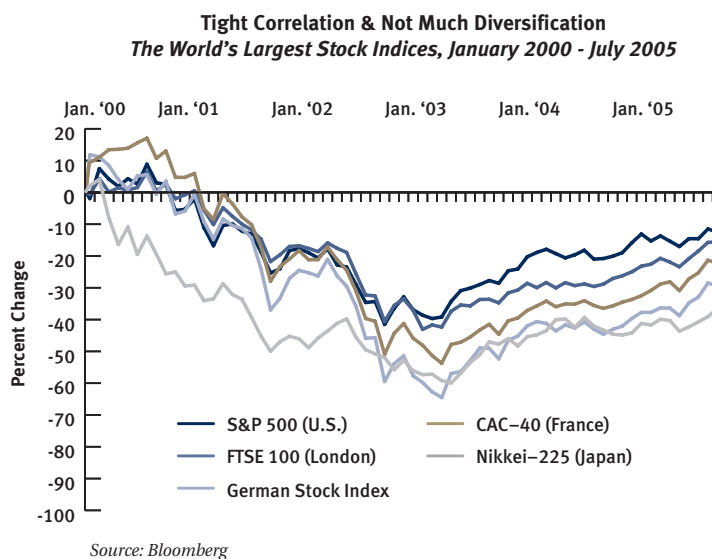
The vast majority of professional portfolio models already include an allocation for international exposure. Conservative recommendations typically run in the 10%-15% range of the total

allocation, but can be much higher, depending on the client's objectives. One of the main purposes of the international allocation is to diversify portfolios in case one region (the United States) weakens versus other regions.

There are two problems with this recommended allocation in terms of the "average" portfolio. First, the diversification opportunities have broken down for most clients. Stock market returns of the largest economies have become tightly correlated in the past 10 years (meaning, the returns and trading patterns are similar). From 1972-2000, the average correlation of major stock indices (similar to the S&P 500) among the United States, England, Germany, and France was about 0.5, according to a study conducted by professors at Yale. So, about 50% of the time, these markets would trade in a similar pattern. That 0.5 level provided U.S. investors with diversification. But, from January 2000 through March 2005, the correlation rose to about 0.8. That means these markets were trading together about 80% of the time, which did not provide investors with much diversification.

According to a New York Federal Reserve Study, developing markets have traditionally had a much lower correlation. For example, from 1976-1999, the U.S. market had a 0.05 correlation with Brazil (almost no correlation), a 0.32 correlation with Mexico, and a 0.37 correlation with Hong Kong. Lower levels of correlation provide investors with greater diversification because the markets tend to trade independently of one another. This issue is one reason we believe U.S. investors need to examine their portfolios to determine the level of exposure they should have to developing nations.

Second, many Americans don't fully take advantage of the international allocation. Portfolios tend to be highly concentrated in U.S. holdings, with a small percentage of Western European or Japanese exposure. Many Americans tend to be "underweight" the international allocation (have less than 10%-15% exposure) and overweight U.S. exposure. This type of allocation is known in the finance world as a "home bias." For example, international stock and bond funds held by U.S. investors represented only 7.9% of total stock, bond, and money market funds, on average, from 1994-2004, according to the Investment Company Institute.



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While the home bias allocation served investors well from 1980-2000 during America's strong growth period, we believe it may not serve as well in the decade ahead. We recommend investors check with their Financial Consultant to assess whether their current level of international exposure is appropriate or desirable.

### DON'T CHASE RETURNS

A second key to implementing a successful globalization strategy is to develop a long-term plan that is flexible enough to take advantage of opportunities as they arise. In other words, don't automatically chase high returns of the past. Today's hottest markets may not be the strongest growers 5-10 years from now. For example, Japan's stock market was hot from 1985-1989, rising 237% during that period. But, it fell 70% from 1990-2004. China's Shenzhen Index was strong from 1992-2000, rising 475%.

While many investors perceive that China's market has been hot recently because of the nation's strong economic growth, that is not the case. China's Shenzhen Index fell 51% from 2001-2004.



Source: Bloomberg

### LEVERAGE GLOBALIZATION INVESTMENT THEMES

A third key to successful investing in the globalization era is to leverage themes that take advantage of the changes that should occur in future decades. To capitalize on globalization trends and looming demographic challenges, we believe investors should consider key themes that are likely to shape existing and emerging industries. We have crafted a list of seven specific globalization investment themes that we believe will reward investors in the decade ahead. They provide practical ideas on how to invest in the unique characteristics of today's modern globalization movement such as economic development, technology, labor, trade, and financial market advancement. While the following seven themes are not an exhaustive list and while we anticipate new themes will emerge in the next couple of years, the list provides investors an opportunistic way to begin to align portfolios to the globalization movement.

*Investors should consider key themes that are likely to shape existing and emerging industries.*

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## Infrastructure Buildout

In many developing nations, local and multinational companies will build roads, highways, airports, subway systems, bus systems, railroads, ports, water systems, and expand electricity capacity. While China has been aggressively developing its infrastructure for more than a decade, it still lacks the sufficient transportation infrastructure to meet its future needs. A second major phase of infrastructure development seems to be in the offing. China plans to build 60% more roads and highways by 2020. It is also opening its railway system to foreign institutional investors.

*In China, a second major phase of infrastructure development seems to be in the offing. In India, infrastructure opportunities could also be significant.*

India's infrastructure opportunities could also be significant for U.S. multinationals because the nation is so underdeveloped. Some economists liken India's current state of development to China's position 10 or 20 years ago. Currently, India only spends about 6% of GDP on infrastructure and is plagued with bad roads, water shortages, power shortages, and numerous unfinished infrastructure projects. Dr. Manmohan Singh, India's pro-development prime minister and a highly respected economist, has reaffirmed his intention to increase infrastructure spending.

Raw materials are necessary for the infrastructure buildout. However, for some commodities such as steel, aluminum, and chemicals, China's raw materials capacity is growing rapidly. From our perspective, the government in Beijing now effectively controls the supply of some major commodities. If Beijing allows provincial and local government officials to oversupply the market, profit margins of some multinational commodity producers could shrink.

## Environmental Services/Cleanup

*This could be the fastest growing area of China's economy in the next decade.*

China's manufacturing base, electricity needs, and cities are growing at such a fast pace, the nation is in need of solutions that would clean the environment. China claims seven of the ten most polluted cities

in the world. Only half of its industrial and municipal waste is currently being treated. Thousands of rivers and water bodies could be toxic. While the Chinese government states that almost 80% of the nation's air pollution is caused by automobiles, we believe the nation's coal-fired power plants are also significant contributors to the gray haze that blankets its largest cities. In many cities, residents never actually see the sun, not even in the summer months. Environmental services and cleanup could be the fastest growing area of China's economy in the next decade, in our opinion.

## Health Care

The health care industry is growing faster in many developing nations, including China, than GDP. From a consumption standpoint, China seems like the most attractive market for United States- and Europe-based pharmaceutical and device companies. Some of them have already begun to build research and development facilities in China in order to more effectively serve the local market.

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From a local production standpoint, Indian companies seem to have the best prospects among the developing nations, as its generic drug industry is growing and its biotechnology industry is advancing. India is the top foreign filer of pharmaceutical patents in the United States.

### Consumerism

The middle classes in developing nations are growing, and they are buying items such as cell phones, makeup, apparel, appliances, televisions, and computers. China's middle class (about 150-300 million strong, depending on how you measure it) is embracing consumerism. It could double in size in 10 years. India's middle class population is becoming more oriented toward consumerism, but is a step or two behind China. Consumerism should benefit household products, food, beverage, restaurant, travel, gambling, luxury goods, electronics and technology companies.

*China's middle class is embracing consumerism.*

*It could double in size in 10 years.*

Local and multinational retailers should also benefit. China's retail industry became fully open to foreign chain store operators in December 2004. Leading retailers from Europe, Japan, and the United States

are now expanding their operations in China. The nation's retail industry is poised to grow faster than GDP for next few years, at least. India's retail industry is among the most highly fragmented in the world, dominated by mom-and-pop shops. Few large retailers are currently able to penetrate the market because of state and local government regulations that protect local retailers.

In East Asia, brand identity tends to drive purchasing decisions. While Chinese consumers don't necessarily care about the origin of a product (whether it's from Japan, America, Europe, or China), they are highly conscious of the brand of the product. Consumers in Malaysia and Taiwan also place high value on brands, according to a study conducted by Yankelovich, a consumer research firm.

### Technology

Increasingly, companies known as IT consultants are providing information technology (IT) services. It is common for large United States- or Europe-based multinationals to hire a consulting firm to coordinate its computer systems, specialized software needs, and other technology-related functions. Consulting firms may be based in the United States, Europe, or even in a developing nation such as India. Regardless of where the consulting firm is headquartered, increasingly, the labor source used for IT consulting projects comes from India because it is much more cost effective. This practice is commonly referred to as outsourcing.

Consumers in developing nations are also using technology to their advantage. E-commerce is expected to grow faster in some developing nations than in the United States and Europe. Approximately 35 million people in China are forecast to buy or sell over the Internet in 2007, up from 12 million in 2004, according to iResearch Inc.

Mobile phone networks and the number of mobile phone subscribers continue to grow in developing nations. China already has about 340 million mobile phone subscribers, which is more than the total U.S. population.

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## Financial Services

Multinational financial giants have already begun to invest in China's fragile banking system. Even U.S.-based regional banks are starting to take notice and are investigating the opportunities. If U.S. and European bankers can clean up China's bad loans, we believe significant opportunities could await. But,

*As Asians become more confident in the long-term sustainability of their economies, they may shift cash assets into securities.*

if nonperforming loans are much higher than the Chinese government is disclosing and if lending practices are not reformed, multinationals may be on the hook. In India, a limited number of U.S.-based financial institutions are beginning to stick their toes into the consumer banking market. Investment is in its early stages.

As financial instruments (equities, warrants, asset-backed securities, corporate bonds, futures) become more widely issued and accepted in developing nations, opportunities should increase for multinational investment banking firms. In addition, investment banks are likely to take advantage of cross-border merger and acquisition activity.

Retail brokerage opportunities may occur over the longer term, as residents of emerging nations become more invested in stocks, mutual funds, and bonds. Citizens of Hong Kong, Taiwan, Korea, and Singapore hold about 17% of assets in stocks compared to 20% for Americans. But, they hold about 52% of their assets in cash, much higher than 18% for Americans. As they become more confident in the long-term sustainability of their economies, they may shift cash assets into securities.

Insurance is another attractive industry. The global insurance market is expanding, and regulatory restrictions are easing. Insurance is a popular investment tool in some developing regions. Citizens of Hong Kong, Taiwan, Korea, and Singapore have about 14% of their total assets in life insurance investments compared to 3% for Americans, according to the Citibank Consumer Wealth Review of 2004.

As consumerism grows, the credit card industry could take off, in our opinion. In China, only 3% of consumer transactions are on credit.

## Logistics

The abundance of global trading has sparked a plethora of opportunities in the transportation industry. There are battles in the air and on the ground to deliver packages and documents to developing nations. Multinationals are rapidly expanding in China by adding distribution centers, air routes, and overnight service from the United States and Europe to China. Freight shipping and rail shipping should also benefit from the expansion of trade.

Supply chain management is another important element of global trade. Companies that can assist in managing logistics and supply chains for small and large corporations should benefit from globalization. Increasingly, United States-based companies are managing supply chains for multinationals operating overseas.

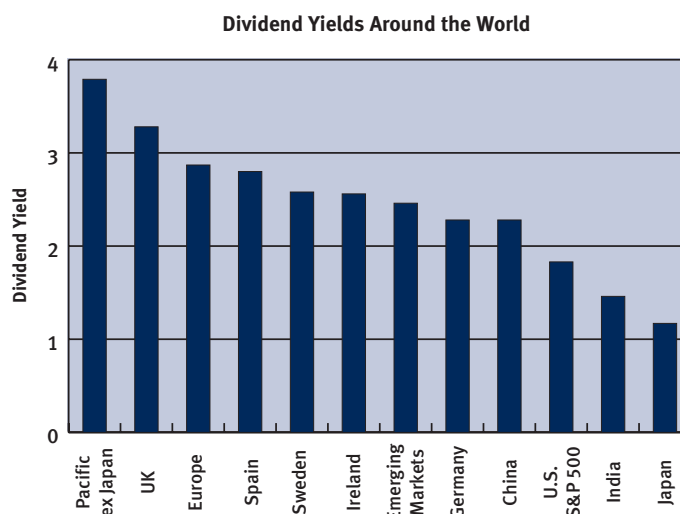
## CHOOSE INVESTMENT OPTIONS THAT FIT YOUR GOALS

Because of the vast opportunities associated with globalization — some of which are in countries with lesser developed capital markets — we believe it is important to carefully consider the following investment options:

- Individual Equities
- Money Managers
- Unit Investment Trusts
- Fixed Income
- Mutual Funds
- Exchange Traded Funds
- Structured Notes

We recommend investors use a combination of these options, rather than just focusing on one, in order to leverage the globalization investment themes and achieve an appropriate international allocation. Some of the options are better suited for different nations or different risk levels.

For example, individual equities of U.S.-based multinational companies that have exposure to China and India can provide an “indirect” play on globalization.



Source: Thomson Portfolio Analytics, Thornburg Investment Management

For more direct exposure to China, we believe mutual funds are the most effective approach. Professional fund managers can more successfully identify private companies in China and ferret out which of the state-owned companies are sound investments. For more direct exposure to India, investors might choose another route. Because India has a more mature capital markets system, investments in Indian companies through American Depositary Receipts (ADRs), closed-end funds or unit investment trusts might be appropriate. Investors who are seeking dividends or income might choose yet another route. Because many nations pay higher dividends than the United States, there are a number of dividend and income alternatives through exchange traded funds (ETFs), ADRs, structured notes, and fixed income products.

For more information about the investment options mentioned above, see the Appendix section of this report.

## RISKS FOR INVESTORS

When investing in the globalization movement, it is important to consider the risks, just as you would with any domestic investment. In developing nations, a higher level of volatility tends to create risks. (In this instance, the term “volatility” means that companies and markets in developing nations have greater day-to-day movement or percentage changes relative to the major U.S. equity indices.) Volatility can occur due to the following factors:

- **Lack of Sophistication in Some Financial Markets of Developing Nations:** For example, China’s equity market is in need of significant reforms. Only a fraction of the shares are tradable and available to the public. The

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state holds a very high percentage of shares of China's largest companies, which has created an overhang on those stocks. Restrictions on foreign investors still exist. And, shareholders of Chinese companies have fewer rights and protections compared to shareholders in companies headquartered in the United States or other developed nations. China has begun to reform its system, but has further ground to cover, in our opinion.

- **Lower Accounting Standards:** Some emerging nations do not hold their companies to the same accounting standards that United States- and Europe-based companies are required to use. So, if investors buy an ETF of a basket of stocks that represent a nation and an accounting problem occurs at one of the companies within the ETF, the ETF would likely trade lower.
- **Lack of Transparency:** Some developing nations tend to be less forthright and transparent about their economic development goals. Companies based in those nations may also fail to consistently communicate in ways that a United States-based company would.
- **Lack of Reliable Economic Data.**
- **State Interference:** In China, about 50,000 companies are government owned either at national, provincial or municipal levels. They are called state-owned enterprises (SOEs). All companies on the Chinese Shanghai and Shenzhen exchanges are state-owned. Many Chinese companies that trade on the Hong Kong and NYSE are also SOEs. Among the companies in the China iShares exchange traded fund (symbol FXI), 24 of 25 are state owned. While being state owned doesn't necessarily mean the company is a bad investment, many SOEs have a more challenging time balancing the needs of their constituencies in the government, in management, and outside shareholders. They don't necessarily make decisions based on return on equity. Sometimes they receive favorable local regulatory decisions or direct cash from the government that influences them to fund projects that wouldn't otherwise be economically viable. The Chinese government often determines whether these companies are able to engage in acquisitions or whether they will be merged with other SOEs. To us, this is not reflective of a free-market process. It seems more reflective of a political process.
- **Arbitrary Tax or Regulatory Decisions by Government can Impact Industries or Companies.**
- **Currency Risks:** Some investments sold on U.S. exchanges, such as ADRs, and some mutual funds have currency risks. For example, while an ADR is denominated in dollars, the underlying stock trades in the currency of its foreign headquarters. If the ADR rises in the U.S., but the currency falls against the dollar, the gain can be wiped out.

In addition, there are often macro risks to consider — those that are influenced by government, political systems, economic, or health systems.

- **Trade Protectionism:** A backlash against globalization and some emerging markets has been growing in recent years, spawned by fears about job losses to China and India, and the United States' bloated trade deficit with China. Politicians and grass roots organizations in Washington have become engaged in the most high-profile protectionist trade rhetoric and China bashing in at least a decade. This protectionist tone has also re-emerged in France, Germany, and Italy due to competition with Chinese and Eastern European labor, and fears of losing their way of life in the midst of European Union reform and expansion.

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If the protectionist threat gains traction, it could be problematic for the globalization movement and could threaten global prosperity, in our opinion. Fed Chairman Greenspan wisely said, “A very major part of our current standard of living rests on our position in the global market.”

- **Global Financial Crisis:** They are not uncommon in developing markets, especially in the past 20 years. Historically, financial crises have often spilled over to major markets, including the U.S. stock market. Today’s most obvious risks related to this issue are in China, where the major banks are fragile due to risky or bad loans, many of which were based on real estate speculation and development. But, history indicates that financial crises typically pass. Leading domestic financial institutions such as the Federal Reserve and global institutions like the International Monetary Fund typically intervene.
- **Disinflation or Deflation:** Low wages, increased competition, and excess capacity can bring down prices, which can result in disinflation (when prices rise at a slower rate) or deflation (when prices fall). While that can be good for consumers, too much disinflation or deflation can be bad for corporate profit margins and can damage economies. Because China’s system currently allows local officials to determine manufacturing capacity, there is a risk that overcapacity could occur in commodity-based industries. Thus, unhealthy disinflation could result and negatively impact the global economy.
- **Health Care Crisis:** If a severe regional or global health care problem arises, such as a flu epidemic or pandemic caused by avian flu or another flu strain, investor confidence could weaken significantly, causing equity markets to decline.
- **Social and Political Instability:** Nations with emerging economies can fall prey to social instability, as the top end of society typically advances faster than the bottom end. The mass migration from rural areas to the urban centers could strain social conditions if nations fail to create a sufficient number of new jobs. In addition, governments with more rigid political systems, lingering communist political infrastructures, and a history of human rights abuses can be more vulnerable to instability.
- **Terrorism or War:** The advancement of technology, trade, and capital flows has also enabled terrorism to morph into a global movement. One catastrophic disaster could severely change the geopolitical environment and could completely alter the global economic landscape, possibly slowing, halting or reversing the trends of globalization.

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## Conclusion

*Investors should consider the investment objectives, risks, and charges and expenses of mutual funds, exchange traded funds, and UITs carefully before investing. Prospectuses containing this and other information about these investments are available by contacting your RBC Wealth Management Financial Consultant. Please read the prospectus carefully before investing to make sure that the investment is appropriate for your goals and risk tolerance.*

The U.S. economy — and U.S. investors, for that matter — are now functioning within a much broader global arena where economies are dependent, labor markets are intertwined, financial markets are linked, and trade abounds.

The globalization movement has expanded opportunities for U.S. investors to nations and regions not thought possible 10-20 years ago. It has opened doors beyond the developed world (the United States, Western Europe, and Japan) to developing nations and regions such as China, India, Central and Eastern Europe, and Latin America. Billions of people are being connected to the free marketplace for the first time, and U.S. investors can now be linked to them through credible investment alternatives.

This dramatic shift should change the way investors view their portfolios, in our opinion. Just like it is prudent to be exposed to several major asset classes and sectors of the U.S. economy, it is wise to be exposed to developing nations and regions in order to create a well-rounded, diversified portfolio.

Investment exposure to developing nations is particularly important now because we believe they could achieve the highest growth rates of the global economy in the next 10-20 years. They are among the biggest beneficiaries of globalization. It is necessary for investors to be properly allocated to that source of growth in order to maximize portfolio returns, in our opinion.

Investors should carefully consider whether their international allocation is poised to take advantage of the changes that are on the horizon as globalization advances in the next 10-20 years. We recommend exploring new opportunities in other nations and regions, particularly in the developing world. Your RBC Wealth Management Financial Consultant can help you develop a sound, flexible plan to take advantage of the globalization movement.

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## Appendix

### INVESTMENT OPTIONS

*We recommend investors use a combination of different investment alternatives to achieve an appropriate international allocation. A number of those alternatives are described below.*

#### **U.S. Multinational Companies**

*U.S.-based multinational companies offer an attractive, indirect way to capitalize on the growth of developing economies without the volatility and risk of a direct investment in a specific developing nation. The key is to focus on multinational companies that have a real presence and commitment (not just nominal investments) to developing economies such as India, Central and Eastern Europe, China, and Latin America. Revenue from developing nations (or the potential for future revenue) should be meaningful enough to impact profits. And, that revenue should be growing faster than a company's total revenue growth. Companies that leverage developing markets for cheap labor and production efficiencies should also be considered.*

*For long-term investments, we would avoid multinationals where the bulk of international exposure is centered on mature, demographically challenged economies (such as Germany, France, Italy, Japan), unless those nations begin to reform their retirement, labor, tax, and trade systems. Globalization requires investors to more closely evaluate multinational companies' sources of revenue and regional growth opportunities. It is important for investors to consider how a multinational is positioned within nations with strong growth prospects.*

#### **ADRs and GDRs: Foreign Multinationals and Foreign Companies on U.S. Exchanges**

*Europe- and Japan-based multinationals also provide attractive, indirect exposure to the globalization movement. U.S. residents can gain*

*exposure to developing nations by investing in foreign multinational companies in the form of American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs). ADRs and GDRs are dollar denominated and trade on American exchanges such as the New York Stock Exchange (NYSE), the American Stock and Options Exchange (AMEX), or on Nasdaq.*

*Many Europe-based ADRs tend to be more leveraged to Central and Eastern Europe than United States-based multinationals, and thus, offer better exposure to the region. Some Japan-based ADRs provide attractive exposure to China and other developing nations in East Asia.*

*Many companies based in developing nations such as India, China, Brazil, Mexico, and Russia also trade as ADRs. Other than Russia, there are few ADRs of Eastern Europe-based companies and only a handful based in Central Europe that trade on U.S. exchanges.*

*Most of the China-based ADRs are state-owned enterprises, meaning they are primarily owned by the government, which limits the rights and opportunities for shareholders, in our opinion. Until the state-owned shares are offered to the public, these stocks could underperform because of concerns about share dilution. At this point, we prefer to play China through mutual funds or multinational companies. Many India- and Latin America-based companies tend to have far less government interference, in our opinion.*

*We encourage investors to be just as selective in choosing foreign-based ADRs as they would a domestic stock, and we would distinguish between income and growth objectives. Just because a foreign company has a large share of its home market (a foreign telecommunications services company, for example), doesn't mean it is an effective way to capitalize on the growth of that nation.*

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### **Stocks on Foreign Exchanges**

*Smaller foreign companies tend to list their stocks solely on their home exchanges, and thus don't trade on U.S. exchanges as ADRs. These stocks tend to be more difficult for U.S. investors to purchase and can be more volatile and much less liquid. Currency issues can also arise. Because of the proliferation of ADRs and other investment alternatives such as mutual funds, money managers, and ETFs — each of which has its advantages — we recommend investors avoid direct investments in foreign stocks that are not listed on U.S. exchanges.*

### **Dividend Investing**

*Investors who seek to implement a dividend strategy have a number of opportunities to leverage the globalization movement. Dividend yields tend to be higher in Europe and Asia than the United States, as the chart on page 20 reflects. In some countries, including Brazil, Chile, Colombia, Greece, and Venezuela, the government mandates that a portion of net income be paid out to shareholders as a dividend. In many Asian countries (including China), strict mandatory dividend policies are part of the corporate structure. An efficient way to access dividend investment alternatives is through a mutual fund that focuses its attention on global income ideas. Yield oriented investors can also invest directly in ADRs or a dividend-oriented ETF. In addition, a number of dividend-paying U.S.-based multinational companies are taking advantage of the globalization movement. For more information about why dividend investing is an attractive strategy, request our 2003 report titled, "Dividend Investing in the Post-Bubble Era."*

### **Mutual Funds**

*Investing in capital markets outside the United States, especially in developing nations, is made easier with mutual funds. They typically offer broad portfolio diversification and professional management, and are generally available with low*

*minimum investment requirements. Mutual funds that provide individual country or regional exposure, such as China or Southeast Asia, are readily available. Other mutual funds offer more diversified exposure to a cross section of developing nations, or a cross section of international markets that include developed nations (Western Europe, Japan). In addition, because it is nearly impossible to access the securities markets in some countries as a non-institutional investor, mutual funds or money managers (see below) may be the only way for individual investors to gain exposure to less accessible markets.*

*By mandate, some mutual funds seek to hedge currency risks; others do not. Employing currency hedges attempts to remove the risk associated with currency fluctuations. In market conditions when the dollar is appreciating in value versus other currencies, hedged mutual funds will tend to outperform similar unhedged mutual funds. Unhedged mutual funds are better positioned when the dollar is weak in the world market and typically offer greater diversification opportunities within a portfolio because of their lower correlation to the U.S. markets.*

*Mutual funds are generally professionally managed by skilled investment advisers who deploy significant resources to the overall portfolio management process. Members of their research staff often specialize at analyzing companies within specific regions, countries, or economic sectors around the world.*

### **Money Managers**

*Long-term investors may benefit from hiring a professional money manager to manage private accounts, which like a mutual fund, commonly offer broad portfolio diversification and professional management. RBC Wealth Management has access to a number of private money managers who specialize in international exposure. To help lower the costs generally associated with settling individual client trades outside of the United States, managed account portfolios are generally only invested in ADRs.*

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*Similar to a mutual fund, the private accounts are professionally managed by world class investment advisers who employ dedicated research staffs with specialties across regions, countries, or economic sectors around the world. Private money managers who specialize in foreign markets often have a physical presence overseas, making it easier for them to understand local market conditions directly, a definite benefit to the investment process.*

**ETFs: Country and Region Specific Funds**

*A number of exchange traded funds (ETFs) now focus on individual countries or regions. ETFs are an effective way to supplement a well-rounded international portfolio composed of U.S. multinationals, foreign ADRs, and mutual funds, in our opinion. They can provide more direct exposure to developing nations. ETFs are easily accessible because they trade on U.S. exchanges. Some country-specific ETFs mirror a widely followed equity index or a basket of stocks in a particular nation. For example, the ETF for Malaysia invests in companies primarily traded on the Kuala Lumpur Stock Exchange. Many ETFs have expense ratios below 1.0%. While most ETFs are not managed (meaning, the underlying stocks don't change according to the investing climate or opportunities), some managed products have been introduced recently. Because of ETFs, it is now as easy for the average American to invest in a basket of stocks in Taiwan, Singapore, or a host of other foreign markets as it is to buy shares of Exxon-Mobil or Home Depot.*

**Unit Investment Trusts**

*Unit Investment Trusts (UITs) provide a disciplined approach to foreign stock exposure. A portfolio of 20 or more stocks is professionally selected and then held for a defined period of time. The lack of active management and associated trading costs allow UITs to offer economical exposure to foreign markets.*

*UITs are often packaged as a single country trust, such as a trust that focuses on India, for example. Another option is a regional trust, which would provide exposure to Europe, Australasia (Australia and Asia), and the Far East, for example. Some UITs focus on specific investment themes and touch on key industries, such as the water infrastructure industry. Upon termination, investors are offered the choice to receive cash from the liquidated portfolio or reinvest in a new one at a reduced cost.*

**Structured Notes**

*These products provide access to opportunities in foreign markets and stocks that may not otherwise be directly available to U.S. investors. Structured notes are securities with principal and interest linked to a security, a basket of securities, an index, or a basket of indexes. A typical note might offer investors the principal protection of a traditional bond, and at the same time a coupon that, instead of paying at a fixed or floating rate of interest, will pay a return linked to a basket of international stock indexes. Like ETFs, structured notes are widely available in the United States and are liquid.*

*There is a breadth of product to choose from in the structured notes global market. Investors have the ability to construct a well-balanced international portfolio among notes that offer exposure to a multitude of tradable indexes and stocks around the world. In addition, structured notes have the additional advantage of customization. For those investors who are able to command economies of scale, financial institutions will customize an investment in structured notes specifically for their needs. This customization allows investors to create diversification (or concentration) among a region, country, issuer, sector, or duration/term.*

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### **Fixed Income**

*Debt issued by developing nations' governments (sovereign bonds) or corporations may be an opportunity for some investors with a strong understanding and tolerance for the volatility and additional risk that these investments bring. Because their markets are in transition and hence may not be stable, investors require a higher interest rate for money that they lend to developing nations' issuers, therefore yields on these bonds are generally higher than those available from U.S. treasuries or the U.S. corporate debt market. The possibility for some economies to fall back into political unrest could result in a return to nationalization, expropriation, and the collapse of the capital market. Therefore, investing in emerging market bonds should be done with regard to these risks and the fact that devaluation could result from investors merely speculating on the possibility of political disorder. Diversification among issuers and countries is advantageous since political uncertainties and other risks do not affect all markets equally.*

*Despite these risks, emerging market bonds have been the best performing U.S. dollar denominated asset class since 1994. For growth-oriented investors, adding dollar-denominated emerging market bonds to an equity portfolio may result in a significant improvement in overall return. For investors looking to add exposure without risk to principal, a UIT or structured note would be a more appropriate option.*

*Generally, we recommend investors seek opportunities in a combination of these investment vehicles in order to build a diverse portfolio that is leveraged to the globalization movement. To develop the most appropriate strategy for your portfolio and for specific investment ideas, contact your RBC Wealth Management Financial Consultant.*

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