

Global Investing

A Practical Guide to the
World's Best Financial Opportunities

Darrin Erickson



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GLOBAL INVESTING

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For Dawn
She walks in starlight

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P R E F A C E

For those of us who have traveled extensively or lived abroad, we know how remarkable and expansive the world is in which we live. In the early days of 1977, not long before my eleventh birthday, my father took a job in Iran, where he helped design and construct a pulp and paper mill. As difficult as it was to leave my friends behind, I would not trade that experience for anything. My family lived there among the Iranian people, as well as other ex-pats from around the world, for a little over a year. Looking back, I realize now how this incredible adventure shaped the way I view the world as well as my views on investing. By the time I returned home at the age of 12 I had lived in a foreign country, circumvented the globe, and visited Great Britain, Thailand, the Philippines, Hong Kong, and Japan. By the spring of 1978 I was back home in British Columbia, but my curiosity about the world around me was ignited.

These early life experiences initially inspired me to pursue bachelor and master's degrees in international politics at the University of British Columbia. Diplomacy, arms control, and the reunification of Germany were central political events at the time, so in June 1990, I naturally jumped at the opportunity to join an academic tour of the European Community, NATO, and SHAPE headquarters along with stops in Berlin and Warsaw. The energy at the time was palpable as the Berlin Wall fell and visitors from East Germany flocked to the West. Merely one week before Checkpoint Charlie was dismantled, I was able to travel through the infamous crossing, chipping off pieces of the Berlin Wall along the way for my souvenir collection. As a visitor I could sense the excitement for the possibility of a new and brighter future. Tremendous changes were on the horizon.

Prompted by the immense economic and business implications of these events, I entered an MBA program, where I was introduced to the wonderful world of finance. My first job in the investment industry was as a currency trader, which, as you can imagine, is heavily influenced by global factors. It was at this time that my fascination with the global financial markets became an obsession. I came to view the financial markets as a mathematical version of the world around us and the engine that keeps our modern economy running. Powered by the interactions of nearly 7.8 billion people and a multitude of businesses, the infinitely complex workings of the world economy create tremendous wealth and a massive pool of investment opportunities.

Economic growth is a primary driver of new wealth creation. Over time, greater amounts of wealth should result in an increasingly developed equity market, since a portion of newly created wealth is invested in productive financial assets, such as stocks. It seems logical then that our views on where to invest our capital should consider expected long-term economic growth as a source of wealth creation and increasing stock market capitalizations. As the value of the equity market increases in size, it gains in importance to the local economy and greater efforts are made to help protect shareholder rights and maintain the integrity of the market. It should come as no surprise then that wealthier countries tend to have more developed financial markets and greater total stock market capitalizations.

By using wealth creation as our basis for investing, we are attempting to “follow the money.” While the economies of developed countries are expected to grow their GDP by an average of 13% from 2022 through 2027, emerging and developing economies are expected to grow GDP by more than twice that amount at approximately 29%.¹ Viewing economic growth forecasts across the globe shows that the highest growth rates are expected in developing Asia, Europe, Africa, and Latin America. While developed market economies are not growing as quickly, they are home to a large number of leading global businesses, some of which derive a significant portion of their revenues from these same high-growth regions. Although the highest economic growth rates exist in emerging and developing economies, it is important to remember that the vast amount of wealth already accumulated in developed economies means that a significant percentage of new wealth will continue to come from these regions. Furthermore, even developed economies with slower long-term growth rates can experience short-term bursts of rapid economic growth.

Over any given time period the best-performing stocks will be spread across every region of the world. Although the relative performance of different regions fluctuates over time, the free flow of investor capital within and between geographic regions will ensure that money will move to wherever the best investment opportunities exist. Furthermore, with more than 55,000 companies listed on public stock exchanges worldwide, there are plenty of investment opportunities available to the global investor. In addition to this vast pool of investable businesses, there are new businesses coming to the market every day. There was a total of 1,388 companies newly listed on an exchange worldwide in 2020, with a total market value of \$236.1 billion USD, and a majority of these businesses were located in emerging markets.²

Whether we acknowledge it or not, we live in a global economy, and we are subject to the forces that drive it. As an investor, do you need to own businesses from around the world to become wealthy? The answer is no. As you will see throughout this book, however, there are numerous benefits to investing globally. In response to the question, “Should you consider companies from around the globe in your investment process?” the answer is a resounding yes. Investing globally gives you access to a greater number of attractive businesses and the flexibility to take advantage of varying rates of growth around the world, and may also allow you to reduce the risk in your portfolio. The price you pay is hard work. Successful global investing requires you to be a voracious reader and to train yourself to see the big picture.

Building a great global equity portfolio requires you to think globally. To do this we have to shake off our natural tendencies and, in the words of Howard Marks, employ “second-level thinking” in our investment approach.³ Frankly, this is much easier said than done. To accomplish such thinking, we have to overcome instincts developed over centuries that were needed to survive in hostile environments. The same instincts that helped us survive as a species often work against us as investors.

My goal as an author has been to produce a book that provides anyone who reads it with the ability to navigate the global equity markets successfully, regardless of where they reside. While many books have been written on investing, relatively few have taken a global perspective. I have tried to make this book truly global in nature by being politically neutral and avoiding any form of regional bias. I have also attempted to bring together two distinct disciplines in my writing, the study of international relations as well as the study of finance. The two are inextricably connected and I hope you find this somewhat unique perspective helpful. Additionally, my intention

was to produce a book that all investors might find helpful in some way, especially those individuals who are new to investing. I have therefore tried to avoid industry jargon and overly complex financial concepts.

While there may be uncontrollable factors that prevent one from investing in a foreign country, perhaps the biggest obstacle to global investing is a lack of familiarity. Global investing may be unfamiliar territory, but it does not have to be scary. The same sound investment methods applied to investing in your home country can be applied to other regions as well, albeit with some additional work required on the part of the investor. If I am able to accomplish one thing with this book, it would be to help investors overcome their natural tendency to stick with what is familiar, and instead think globally when making investment decisions to take advantage of the best opportunities, wherever they may be.

There are numerous books from renowned investors that are worth their weight in gold, including writings from Warren Buffett, Ray Dalio, David Dodd, Charles Ellis, Benjamin Graham, Jeremy Grantham, Joel Greenblatt, Howard Marks, Charlie Munger, Jeremy Siegel, among others. Inspecting these volumes at the start of your investing career will greatly increase your odds for success. While I have not achieved the same financial success as these investing icons, I have persevered in an incredibly challenging career and have garnered a few gems of wisdom that I can pass along to the next generation of investors. My top recommendation to anyone who wants to invest on their own or better understand how their money is being invested is to read the works written by the authors noted above and heed their sage advice. Doing so will not prevent you from making mistakes, but it should protect you from disastrous investment decisions. My hope is that this book will build on what these authors have already shared with us by providing a complementary global perspective. I hope you enjoy the journey.

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ABOUT THE AUTHOR

Darrin Erickson, MA, MBA, CFA, is an accomplished equity portfolio manager with nearly three decades of investment industry experience. Over his career, Darrin has served as the lead portfolio manager for numerous equity mandates, including Global, North American, US large cap, US mid-cap, and Science & Technology, as well as long/short portfolios. Darrin holds a bachelor's degree in international relations and a master's degree in political science from the University of British Columbia, as well as an MBA from the University of Alberta. He holds the CFA charter and has served as a volunteer for CFA Institute in various capacities for more than 20 years. Darrin has made several television appearances, where he has shared his insights into the global financial markets.

ABOUT THE CONTRIBUTORS

Joseph Shaw, CFA, MSc RE, MBA, is a real estate investment expert with over 25 years of industry experience primarily focused on real estate transactions in the United States and Canada. Joseph also teaches at the Rotman School of Business and at Western University's Urban Development Program and has served as adjunct professor at both Johns Hopkins University and Ryerson University. He has lectured on real estate at Harvard University, for the Urban Land Institute, and for the Real Estate Property Association of Canada, consults as an expert witness, and is an active volunteer with CFA Institute.

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Joseph Zuiker, CPA, CA, CFA, has extensive international experience in investments and fund services, banking, financial accounting, regulatory reporting, business leadership, and risk analysis. Joe joined the Bermuda Monetary Authority in 2019 as a senior member of the Regulatory Supervision team, which is responsible for the supervision, regulation, and inspection of Bermuda's banks, trust companies, investment businesses, investment funds, fund administrators, money service businesses, and corporate services providers, as well as the credit union and Bermuda Stock Exchange. Joe has served as a volunteer with CFA Institute.

Adam Duncan is a research analyst with over six years of investment industry experience ranging from retail to institutional portfolio management. Adam has exposure to a multitude of asset classes, including equities, fixed income, real estate, infrastructure, and money market. He holds a Bachelor of Commerce (Honors) degree with a major in finance from the University of Manitoba and is a CFA Level III candidate.

INTRODUCTION

The purpose of this book is to help investors better understand the global financial landscape and how to best take advantage of the multitude of investment opportunities it provides. Although I have tried to make this book truly global and avoid any form of regional bias, I have referenced most data in US dollars throughout the book as a base currency due to its continued prominence in world finance.

Part One discusses why the most effective way to build wealth is through business ownership. In Chapter 1 we explore why actively selecting good, publicly traded businesses from around the world is the optimal way to obtain business ownership. We also touch on some of the greatest impediments to investment success and why thinking like a business owner can help you weather the toughest stock market environments. We conclude by sharing the characteristics that define a good business.

Part Two focuses on the global investment opportunity, including what is driving those opportunities and the implications for investors. Chapter 2 provides a history of the global economy and how we came to live in the digital age. We look at areas of the world where economic wealth is most likely to be created in the future and some of the spin-off effects of that wealth. Chapter 3 discusses world trade patterns, how trade is conducted, and what risks exist within the global supply chain network. Chapter 4 provides an overview of the world's financial markets and why they are critical to the global economy and everyday life for each of us. A special emphasis is placed on the world's stock exchanges and equity markets.

Part Three examines the key risks involved with investing globally, including market cycle risk, currency risk, and geopolitical risk, as well as how to manage

those risks. Chapter 5 discusses how market cycles are driven by the economic cycle, the risks that market cycles pose for investors, and how to best manage these risks. We also examine bear markets and suggest some measures that may provide a warning sign to investors that a bull market is nearing its end. Of particular importance is how to prepare for the inevitable periods when share prices fall significantly. The reader will learn that for an investor who is prepared, these “bear markets” are beneficial because they provide an opportunity to build even more ownership in good businesses. Chapter 6 discusses the benefits and risks associated with investing in stocks denominated in a foreign currency. Chapter 7 reviews different forms of geopolitical risk, how those risks can impact your investments, and how to best mitigate those risks.

Part Four discusses how to analyze companies and identify good businesses. Chapter 8 provides a detailed process for analyzing potential investment opportunities by assessing their earnings sustainability, growth prospects, valuation, investment risk, and balance sheet strength. We also review how a detailed analysis of a company’s profitability can aid investors in making better investment decisions, how to assess acquisitions made by the companies you own, and the importance of returning capital to shareholders.

Part Five provides the reader with a primer on each of the world’s major sectors and industries. Chapters 9 through 19 provide an overview of 11 global sectors and 91 major global industries. Each chapter is focused on a single global market sector and its constituent industries, specifically communication services, consumer discretionary, consumer staples, energy, financials, healthcare, industrials, materials, technology, real estate, and utilities. Companies are grouped into sectors and industries based on common drivers of profitability and sales growth. We explore key trends affecting each sector and industry, provide examples of global companies operating in each industry, and describe how to evaluate and compare these businesses.

The last section of the book, Part Six, brings all of the previous material together and reveals how to construct a portfolio of great businesses from around the world. It also provides some helpful tools and resources that every investor should keep on their radar screen. Chapter 20 reveals how to construct a portfolio of great businesses that will help you build wealth over time as well as protect that wealth during times of market weakness. The Conclusion provides a recap of the most important lessons I have learned in the course of my investing career with the hope that they will help you prosper in yours. Finally, at the end of the book you will find some indispensable tools and resources to help guide you on your global investing journey.

BUILDING WEALTH
THROUGH
BUSINESS
OWNERSHIP

Own Good Businesses

■ Business Ownership

The best way to build wealth is through business ownership. Think of some wealthy individuals. Most of them probably became wealthy by owning and operating a business. Even some of the most famous actors, singers, and athletes end up generating more wealth after their careers end by using their fame as a platform to start a business. Don't be concerned if you can't think of a lucrative business of your own to start. Become an owner of an already successful business that someone else founded! Owning shares in a company could potentially be as good as if you started the business yourself, but with significantly less effort. For anyone who has money to invest, share ownership (also referred to as stock or equity ownership) provides them with an opportunity to be a business owner. You may be surprised at how little money it takes to get started. This makes stock ownership the great equalizer when it comes to wealth creation. Accordingly, this book is focused on equity (stock) investing. If you start investing at an early age, owning good businesses for an extended period of time could be all you need to build significant wealth. Having a long time horizon makes wealth accumulation easier, but even if you only have a shorter time period the power of investing can still have a positive impact on your financial health. Financial securities that do not provide business ownership, such as bonds, are not addressed in this book, but it is important to note that these securities may have a place in your portfolio as well, depending on your personal situation.

■ Active versus Passive Investing

Even though they are popular among investors, we do not discuss index funds or exchange-traded funds (ETFs) in great detail. The reason for this is that index funds and ETFs are (primarily) passive investments that track the performance of a stock market index or sector with no consideration given to the quality of the underlying businesses. There are a number of actively managed ETFs available where the manager tries to own only good businesses, but I would urge investors to distinguish between active and passive investing and to fully understand the investment strategy being employed before investing.

While an index fund is a form of mutual fund, an ETF is essentially a cross between a mutual fund and a stock. Like a mutual fund, ETFs usually represent ownership in a group of companies from a specific region, country, sector, industry, or broad stock market index (such as the S&P 500, Nikkei 225 or MSCI World Index). However, while mutual funds tend to have higher fees and are bought and sold directly through a broker or the fund's manager, ETFs usually have low fees and are bought and sold on an exchange in the same way a stock is traded, making it easier and faster to buy and sell them. Today, there is an ETF for almost every type of investment imaginable, including bond indices, market sectors, commodities, and investment styles (like value or growth), as well as more obscure financial concepts, such as volatility.

The reason I exclude passive investments from this book is that they represent most or even all the companies in a specific group, which means you are buying the worst as well as the best businesses when you buy a passive ETF or index fund. Why would you want to invest any of your hard-earned money into substandard businesses if you do not have to? Active investment managers, on the other hand, try to separate stock market constituents into two baskets, the best opportunities and then everything else. In some cases, passive investments may be an investor's only option since investing in individual securities or an actively managed fund may not be possible or may be prohibitively expensive.

Furthermore, many indices, like the S&P 500, Euro Stoxx 600, or Nikkei 225, are market-capitalization-weighted, which means that a stock's weight in the index is determined by its size. The larger the company, the bigger it is as a portion of the index. ETFs that track these indices are therefore subject to concentration risk. As investors pile into an ETF, they force additional buying of the constituent companies, with most of the money (on average)

going to the stocks with the highest market values. A rapid increase in the price of a stock can cause the stock's weight in the ETF to become excessive. This is okay as long as the stock's price keeps rising, but when it falls, look out below.

A prime example of concentration risk in an ETF involves GameStop Corp. During the global pandemic, GameStop reached a low of \$2.57 on April 3, 2020, in part driven down by short sellers. A short seller is an investor who borrows shares in a company and sells them, with the intention of buying them back in the future at a lower price and returning the borrowed shares. The short seller thinks that the price of the stock is too high and that it will fall in the near future. However, GameStop became popular as a “meme” stock, and private investors aggressively bought the company's shares, driving up the price and forcing the short sellers to cover their short positions (buy back the shares they had borrowed) at higher and higher prices. Meme stocks are stocks that become popular on social media where investors share stories about stocks that are sometimes, but not always, based on fact. The combination of investors buying the shares to own them and short sellers buying to cover their positions can lead to a sudden surge in prices and trading volume, which is known as a “short squeeze.” In the case of GameStop, the short squeeze caused the share price to jump as high as \$347.51 when the markets closed on January 27, 2021. GameStop represented just over 1% of a popular retail sector ETF on April 3, 2020, but this rapid jump in share price increased the company's weight in the ETF to nearly 20% on January 27, 2021. A careless investor buying this ETF on January 27 would not realize that close to 20% of their money was being used to buy shares of GameStop at an incredibly expensive valuation.¹ This example also serves to highlight the growing importance of social media in investing and the risk of being short a stock that has the potential of experiencing a short squeeze. I discuss short selling more in Chapter 20, along with other advanced investment strategies, but would warn readers that short selling introduces new risks into your portfolio and should only be attempted after careful consideration by experienced investors.

Active investment management conducted in the manner described in this book can outperform passive investment strategies in the long run. Accordingly, this book is intended for investors who agree that the best way to build wealth is through ownership of good businesses, whether they invest for themselves, or they employ an active investment manager.

■ The Pitfalls of Investing

At its core, equity investing is simple: own good businesses in growing industries and buy them at attractive prices. This investment process, also referred to as “value investing,” reflects the investment philosophies shared by many of the world’s most renowned investors, such as Benjamin Graham, Warren Buffett, Howard Marks, Seth Klarman, Joel Greenblatt, and Jeremy Grantham. If we own businesses that are difficult to replicate, difficult to compete with, and that provide services and products that are difficult to live without, we can generate significant wealth over time and protect our portfolio from losses during periods of market weakness. Value investing does not restrict one to owning businesses that are not growing. Value investing refers to ensuring that you are not overpaying for the business and that you are getting good value for what you pay. Shares of companies that cannot grow are often inexpensive and will likely stay that way, earning them the nickname “value traps.”

Investing in good businesses involves a straightforward process, but it is not easy. The reality is that investing successfully is a complex and time-consuming task. To understand the myriad factors that can affect the performance of an investment, investors must be voracious readers and pay close attention to market and industry developments. Not only are investors required to assimilate vast amounts of data but they must also quickly understand the context and implications of new information. This is what Howard Marks refers to as “second-level thinking” in his book *The Most Important Thing*. For the global investor who must monitor the entire world, the job of gathering and analyzing market data is significantly more challenging. Despite the work required, investors who are keen to take advantage of all the world’s financial markets have to offer will find it to be a worthwhile endeavor. Whether we recognize it as individuals or not, we live in a global financial system. Businesses that we would consider domestic or local can be affected by developments that take place on the other side of the world. In this sense, any investor will benefit by staying informed of events that occur in other regions of the world. By thinking and acting globally, any investor will be better equipped to understand and mitigate risks in their portfolio, whether they invest globally or not.

Staying objective and having the ability to effectively filter out inconsequential information or “noise” when monitoring the global markets is an essential but difficult task for investors. All human beings are subject to certain instincts (commonly referred to as behavioral biases) that make the

seemingly simple task of investing very challenging. As humans evolved as a species, we developed fixed patterns of behavior designed to ensure our survival. While these instincts help us survive, they can make us fail miserably at investing. A splendid example is our preference to be part of a larger group and follow the crowd; after all, there is safety in numbers. Wandering off on your own to hunt for food was risky for the earliest humans, a fact that led us to be hard-wired to associate with other people. It is psychologically challenging to invest in a way that you know is contrary to the crowd and goes against what you are reading and hearing from other investors. It is for this reason that truly contrarian investors are so scarce, and often so successful.

Confirmation bias is another instinct we need to overcome. It causes us to downplay facts that conflict with our existing beliefs about a company and instead focus on things that support what we already believe to be true. Part of the reason we do this is that we tend to believe that other people think the way we do. It is important to avoid making this assumption because people often do not think alike, and eventually business fundamentals will prevail. A company in a fast-growing industry may perform well for a while even if its technology or product offering is inferior to that of its competitors. However, a company's competitive positioning will eventually determine how its share price performs. Numerous examples of this occurred in the tech bubble. Many technology companies (including anything with a ".com" attached to its name) saw their share prices increase significantly in the late 1990s even though their longer-term business prospects were mediocre at best. Once investors came to their senses in the early 2000s and business fundamentals once again mattered, many of these companies failed.

Without exception, the noise investors are subjected to at market peaks is universally positive, which makes it difficult for them to sell stocks and lock in profits, exactly at the time it is most important to do so. Conversely, the commentary at market bottoms is universally negative, which makes it hard to buy stocks at precisely the moment you should buy aggressively. Of course, there are many other forms of behavioral biases. These include a reluctance to take a loss on an investment and the related desire to break even on a trade, which often causes investors to hold on to losing trades far longer than they should, eventually leading them to sell at an even greater loss. As people, we also typically prefer to invest in companies we are already familiar with, which results in a home bias. This means we tend to invest predominately in companies that we know and use on a regular basis and do not look further afield, even though better investment opportunities may be

out there. This is not to suggest that you should invest in a business you do not fully understand, simply that you look beyond your immediate region when deciding which businesses to invest in. If this book can accomplish one thing, my hope is that it helps investors overcome their home bias and look objectively for the best investment opportunities from around the world.

In my experience, the most common mistakes made by investors (professional or otherwise) include an underappreciation of business risks, overpaying for a business, focusing on short-term share price movements instead of long-term earnings fundamentals, and not considering the full set of global investment opportunities available to them. Last, a lack of preparation and forethought that considers how businesses perform in various stages of the economic cycle, and how their share prices behave in various stages of the market cycle, can lead investors to react emotionally and make poor investment decisions.

The first step to beating the odds and overcoming these pitfalls is to train yourself to think like a business owner. Thinking of your investments as businesses, rather than numbers on a page, changes the way you respond to unwelcome events and will naturally allow you to take a longer-term view, improving your chances for success in the process. If you spent your lifetime building a great business, would you sell it in the midst of a recession at a “fire-sale price” if you were confident the business would fully recover and continue to grow? Definitely not. It is true that you would not have spent a lifetime building the business if you acquired ownership by buying its common shares, but the financial consequences would be similar. The simple fact that share prices can deviate significantly from the true value of the business is why public equity markets are indispensable for building wealth. When share prices fall to fire-sale prices, buy ownership in good businesses.

■ Characteristics of a Good Business

If someone asked you to define a “good business,” what would you say? It seems like a straightforward question, but the more specific our answer needs to be the more challenging it becomes, and not everyone would answer this question in the same way. Furthermore, the most important business fundamentals vary significantly between different industries, so the characteristics of a good business will change depending on the industry in which it operates. This chapter is meant to provide the reader with a general overview of what attributes are present in all good businesses. Since there