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JOURNAL OF INVESTMENT MANAGEMENT, Vol. 12, No. 4, (2014), pp. 117–118

CASE STUDIES

"Case Studies" presents a case pertinent to contemporary issues and events in investment management. Insightful and provocative questions are posed at the end of each case to challenge the reader. Each case is an invitation to the critical thinking and pragmatic problem solving that are so fundamental to the practice of investment management.

Jack L. Treynor, Senior Editor

GLOBAL INVESTING FOR THE VALUE TRADER

What Charlie's bosses wanted was a global equity portfolio with a passively managed portion and an actively managed portion. But because the money managers in Charlie's firm were value investors rather than information traders, his active trades would have to be based on value comparisons.

Home goods, because they are driven by their own country's demand, were subject to political, financial and economic variables specific to their own country. Value comparisons between different countries' home goods would have to recognize and account for any differences in these variables. On the other hand, because tradable goods had a common source of demand, even foreign stocks lent themselves to value comparisons.

If Charlie had been called on to compare manufacturers of the same home good in different countries, for example, he would have confronted different Fama-French factors. Value comparisons between different countries' home goods would have to recognize and account for any differences. But a passive investor could diversify across their parent countries' financial and economic variables without having to make those comparisons.

Conversely, because they have a common source of demand, tradables hold less potential for diversification than home goods.

Charlie's idea was to use home goods stocks for the passively managed portion and tradables goods stocks for the actively managed portion. Because they were all driven by global demand, it would be easier to make value comparisons among the tradable goods stocks. On the other hand, in a passively managed portion, he could diversify, not only across companies' specifics, but also across the macroeconomic variables of their parent countries.

Questions

Aren't some industries shifting from home goods to tradable goods (e.g., big home appliances?).

Does the global market for tradables have its own Fama-French factors?

In choosing between competing companies in different countries, should Charlie consider the real exchange rate?

What if a company that makes a home good use raw materials which are themselves tradables?

How should he deal with tradables companies that have valuable brand franchise in specific countries?

Is the host country's level of prosperity irrelevant to a company that makes tradables?

How much does Charlie need to know about the tradable companies' foreign competition?

Is the quality of their local securities markets irrelevant for his passive stocks?

What if the host country for one of Charlie's companies is politically unstable?