FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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Investing Overseas

Most of the world's economy is outside the U.S., so most of its investment opportunities are as well (especially given the current richly valued U.S. stock market--third highest in the world as of 6/30/22). Investing overseas is a great way to diversify your portfolio, especially since investments in foreign countries are not denominated in the U.S. dollar (so your total return is the return from the underlying investment plus the foreign currency gain or loss).

However, due to *home country bias*, most investors significantly overweight investments in their own country at the expense of foreign investments. It turns out that there are a number of good reasons (at least for U.S. investors) for doing so. First, there is less information available about foreign investments, and most foreign companies probably don't adhere to Generally Accepted Accounting Principles. Second, foreign investments are more difficult and costly to access and may not trade during all of the U.S. trading day. Further, many foreign countries do not have the rule of law, strong private property rights, and basic investor protections. Additionally, most foreign governments withhold taxes (generally at a rate of 10% to 35%) on dividends paid to foreign investors by corporations domiciled in their country. U.S. investors can't claim the Foreign Tax Credit on those taxes paid unless their shares were held in a taxable account, AND the U.S. and that country have signed a tax treaty. Finally, since most foreign countries aren't very free, taxes and regulations can be high, and the risk of nationalization/confiscation, political instability, inflation, war and currency controls can be significant.

People have a natural affinity for what they know and what is familiar and tend to shun what is different or foreign to them. (When I was a kid, my family used to vacation in the mountains of North Carolina, and the locals would refer to non-locals as "foreigners" even though we were fellow Americans.) However, U.S. investors who have little to no exposure to foreign countries miss out on most of the opportunities and have a less diversified (and thus more volatile and risky) portfolio.

With the U.S. dollar recently the strongest it's been in at least 20 years (which makes foreign stocks cheaper for U.S. investors), in recent weeks I've been finding a number of attractive opportunities overseas and have been adding hundreds of foreign dividend-paying stocks to my stock tracking spreadsheet. These stocks (called American Depositary Receipts, or ADRs) are denominated in U.S. dollars and trade on U.S. exchanges, so I don't have to have a brokerage account in a foreign country or exchange any foreign currency.

Now not every country is an investor's paradise. Most foreign countries are—as one recent U.S. President called them--"sh*thole countries" that would not be a safe and productive place for your capital. Like almost everything in life, this isn't a black or white question. I wanted a way to quantify and visualize this, so, since I'm a spreadsheet poet, I used a spreadsheet!

On this spreadsheet (which is a tab on my massive stock tracking spreadsheet), I track 37 different countries (including the U.S.). I use conditional formatting, which automatically colors each cell a different color (in a spectrum from bright red to bright green) based on the value in that cell, which makes it easy for me to notice very high and very low numbers.

The first column is the price/free cash flow ratio for that country's entire stock market as of the end of the last quarter (I then convert this number to free cash flow yield). Although this is helpful to know, I don't include it in the total score for each country since a country's stock market may be small and dominated by a handful of large utilities and banks, which I'm not going to invest in anyway.

Next is the tax withholding rate on dividends, which I also do not include in the country score since I may be buying the shares in an IRA. This rate is shown on the row of data for each stock, in case I'm using a taxable account to buy shares.

I sum the next six columns to produce an overall score for each country.

Column 1 is the country's overall Corporate Tax Score by the Tax Foundation, which includes a number of considerations, including tax rates, cost recovery and complexity. Scores are not available for nine of the 37 countries, so I put those in their own group. The best country was Chile (with a perfect score of 100), the worst was Colombia (34).

Column 2 is the country's overall Economic Freedom score by The Heritage Foundation.

This looks at four areas: 1. Rule of Law (property rights, judicial effectiveness, government integrity), 2. Regulatory Efficiency (business freedom, labor freedom, monetary freedom), 3. Government Size (tax burden, government spending, fiscal health) and 4. Open Markets (trade freedom, investment freedom, financial freedom). The best country was a tie at 84 (Switzerland and Singapore), the worst was also a tie, at 49 (Egypt and Pakistan).

Column 3 is the country's overall Ease of Doing Business score by The World Bank. This is based on the ease of starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. The best country was New Zealand at 87 (with Singapore a close second), the worst was Brazil (59).

Column 4 is the country's overall Corruption Perceptions Index score by Transparency International. This is based on data about bribery, diversion of public funds, officials using their public office for private gain without facing consequences, ability of governments to contain corruption in the public sector, excessive red tape in the public sector (which may increase opportunities for corruption), nepotistic appointments in the civil service, laws ensuring that public officials must disclose their finances and potential conflicts of interest, legal protection for people who report cases of bribery and corruption, state capture by narrow vested interests, and access to information on public affairs/government activities. The best country was a tie at 88 (Finland and New Zealand), the worst was Pakistan (28).

Column 5 is the country's Interpersonal Trust score by the University of Oxford. People are asked, “Can most people be trusted?” Studies have found that countries that have the most interpersonal trust tend to create the most value via commerce and are thus the wealthiest. The best country was Finland (with a score of only 74 out of 100, reflecting widespread global distrust), followed closely by Norway. The worst was the Philippines (with an abysmal score of 3), closely followed by Colombia (4).

Column 6 is the country's overall Global Freedom score by Freedom House. Sixty percent of the score is based on civil liberties (freedom of expression and belief, associational and organizational rights, rule of law, and personal autonomy and individual rights) and 40% is based on political rights (electoral process, political pluralism and participation, and functioning of government). The best country was a tie between Finland, Norway and Sweden (each with a perfect score of 100), the worst was Egypt (18).

There's a seventh column that I didn't include in a country's score because about half of the countries had no score, and I'm not sure how applicable it would be for an investor. It's the country's score for Internet Freedom by Freedom House. The best country was Canada (87), the worst was Pakistan (25), with Egypt a close second.

Is this country scoring system of mine perfect? No. Does it provide a lot of

Country	Total
Australia	430
Austria	435
Belgium	434
Canada	425
Chile	421
Colombia	276
France	397
Finland	493
Germany	435
Greece	376
Ireland	476
Israel	362
Italy	389
Japan	388
Luxembour	436
Mexico	287
Netherlands	457
New Zealan	460
Norway	484
Poland	407
Portugal	399
South Kore	380
Spain	407
Sweden	485
Switzerland	473
UK	447
USA	402
Brazil	*381*
Egypt	*379*
Indonesia	*371*
Malyasia	*369*
Pakistan	*321*
Philippines	*242*
Singapore	*353*
Taiwan	*421*
Thailand	*385*

good insights? Yes. I've included the overall scores above (remember that the second group of countries at the bottom do not include a Corporate Tax score). The best, freest countries are small (both geographically and population-wise), in the West (except for Taiwan), and homogenous (which increases trust). Also, most are currently at risk of being invaded by a powerful and much larger statist neighbor (Russia and China).

Generally, northern Europe seems like a good place to invest your capital. But that doesn't mean you should invest only in those countries. Remember that the score does not include the valuation of each country's stock market or its tax rate on dividends. The country score is just intended to identify attractive bodies of water in which you should probably spend more of your fishing time and efforts. It's still possible to catch fish in other ponds, but less likely. Also, remember that these 37 countries are among the cream of the global crop. Most countries are simply not investable for a number of reasons.

What You Should Be Doing Now

With the U.S. dollar near at least a 20-year high relative to other major currencies, now is a great time to be buying foreign investments at attractive dollar prices.

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I would love to hear from you! I thrive on feedback from readers. If you have any comments, suggestions, insight/wisdom, or you'd like to share a link to a great article, please email me.

Generally, I don't have time to answer questions about your specific situation, but if you have a general question that I think other readers also have, let me know and I will provide an answer in a future issue.

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