

Thinking Out of the Box

Globalization is a fact that dramatically changes the rules of the game. These changes can be a true gift for investors who understand the forces of globalization and are not afraid to look forward into the next decades. In a game of shifting dominance, the Scudder Global Fund finds opportunities even at unexpected places, not only in long-term winners, but also in defenders under pressure.

Q: What is the investment philosophy of the fund?

A: In a seamless market place there cannot be a differentiation between emerging markets and developed markets. The intellectual premise of the portfolio is that globalization will change everything as we know it and great opportunities can be found anywhere.

Many of the major industries have already been surrendered to emerging markets, including mining, DRAM, electronic manufacturing services, IT services, generic pharmaceuticals. Autos and auto parts are also contested between the two worlds. Biotechnology is solidly in the hands of the US at this point, but also sees increasing competition from South Korea.

There are fewer and fewer companies in the developed markets with a competitive edge. But there are some: such as global brands like Nike, Porsche, or the luxury brands from Italy and Switzerland. Those are unique and it will take 10 to 20 years before the emerging markets have their own global brands.

When you look at the world and see manufacturing and research-intensive industries under attack, you have to decide what companies you want to own

– industrial companies in G-7 economies that are struggling to keep some margin, or the companies that are on the offense. In most sectors, there is probably one global supply chain winner that makes more sense to own. That winner can come from anywhere.

Q: So you are primarily looking across sectors to see where the likely future winners are?

A: Yes. This is the supply-chain dominance screening set. We look at supply chains such as cement, autos, DRAM, and then go on to value companies against their best peers. The marketplace for these products is clearly global, so we have to be global in the approach of picking stocks and completely agnostic as to where these companies are.

A very important investment approach in the portfolio is described as: disequilibria. This approach is based on the intellectual premise that whatever is not sustainable, eventually will not be sustained. An example of disequilibria is Volkswagen, which at the current cost structure, could become uncompetitive in 5 to 10 years, so they are trying to close the gap, cut costs, and enhance their

Scudder Global Fund

Fund Facts	
Symbol	SGQAX
Website	www.scudder.com
Address	Scudder Investments 222 South Riverside Plaza Chicago, IL 60606-5808
Tel. No.	(800) 621-1048
Inception	7/23/1986 (S-class shares) 6/18/2001 (A-class shares)

Portfolio	
Total Net Assets *	918
Avg Mkt Cap (\$ Weighted) *	\$ 34,841
Average Price/Earnings Ratio **	12.32
Average Price/Book Ratio	2.09
Turnover Ratio	79 %

Investment Information	
New Investment	Open
Min Initial Investment	\$ 1,000
Min Subsequent Investment	\$ 50
Min Initial IRA Investment	\$ 500

Risk (Against MSCI World Index - 3 Years ann.)	
Alpha	4.16
Beta ***	0.81
R-Squared	77.98
Std Deviation	12.14
Sharpe Ratio	1.25

Returns vs. Lipper Global Multi-Cap Growth Index		
	SGQAX	Index
Year to date	7.34 %	4.16 %
1 Year (Cum.)	27.38 %	20.15 %
3 Year (Ann.)	16.26 %	15.66 %
5 Year (Ann.)	2.77 % ****	0.38 %

Returns vs. MSCI World Index		
	SGQAX	Index
Year to date	7.34 %	2.78 %
1 Year (Cum.)	27.38 %	17.75 %
3 Year (Ann.)	16.26 %	14.62 %
5 Year (Ann.)	2.77 % ****	-0.84 %

Fees and Expenses	
Max Sales Charge	5.75 %
Max Contingent Deferred Sales Charge	0.00 %
Max Redemption Fee	2.00 %
Total Expense Ratio *****	1.69 %

Portfolio Management	
Oliver S. Kratz, PhD, lead manager	Aug. 2003

* Millions ** Next fiscal year, ex-negative earnings
*** Monthly average **** S-class shares
***** Net annual operating expenses through 11/30/05

Data through: 07/31/05
Source: Company Documents; Lipper



position. That is an interesting theme from a share price perspective, because it triggers consolidation, aggressive cost cutting, restructuring, management buyouts, or leveraged buyouts: a classical case of a company acting in defense.

We are seeing all these events at companies that are structurally so poorly positioned, that there are two outcomes: The first outcome is atrophy; it can be calculated when the ultimate uncompetitive position and negative enterprise value will be reached. The second outcome, however, is a change into something bigger, which gives you scale to survive longer, or into something leaner and smaller, which gives you a competitive value proposition against the offender, or into something niche.

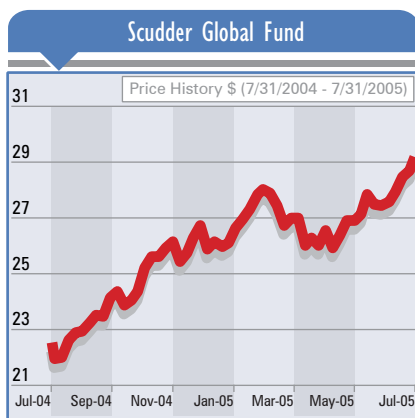
Porsche, for example, has very high cost structure because of expensive German employees, but has a product that is selling at a vast premium to competition, a unique brand name, and sustainable competitive advantages going forward. That's a niche business. Likewise, in the Western hemisphere, financial institutions are increasingly becoming niche businesses that have unique expertise. Goldman Sachs has high expertise in areas such as mergers and acquisitions or private banking. Such companies have certain intellectual properties that cannot be touched or a culture that has been nurtured over many years.

Q: *What makes your fund different from the other global funds out there?*

A: Many other funds are more based on asset allocation; often there are regional managers that are taking their regional decisions, but somewhat ignore the global perspective. Being the lead portfolio manager of the fund without a regional focus, I can compare all the investments and figure out what's the best without having to go through regional debates that can dilute the focus on the best ideas globally. There is no regional asset allocation discussion in this fund. The fact that I go through about 300 companies a year and have met thousands of companies over the past 10 years, helps putting the global picture together.

Most of our competitors in global equities have backgrounds in US or Europe and are just beginning to dabble around in the new world. But everyone is going to come to it because this is the story of the next 20 to 50 years. That's where the growth, the intellectual caliber, and the interesting valuations are. Probably people got a little tired of the emerging market crises that we had in the 90s, but if you look at the economic fundamentals today, it is very hard to see a major disaster coming from the macroeconomic front of a large emerging market.

I come from an emerging markets investment background, so I may be a little biased, but in today's world this is an advantage. How can you understand what is happening in the global econo-



my without understanding what is happening in the Pacific Rim or in Eurasia, including Russia? The whole debate has to become more complete. For an equity investor, there are few gifts and this is one of the biggest gifts – relative value, growth, profitability, and geo-arbitrage.

Lastly, at Scudder Investment we are taking portfolio construction and risk management very seriously. This is a discipline that comes from the very top of our organization and it penetrates throughout the firm. We are always looking to move on and enhance existing risk and portfolio construction approached based on Modern Portfolio Theory (MPT), arbitrage pricing theory (APT) and behavioral finance.

Q: *What do you think are the driving factors of globalization? I see it as driv-*

en by the access created from bilateral or global talks, the technology that enables it, and the natural desire of large corporations to become more competitive even at the expense of home markets. Do you see anything else behind the acceleration of globalization?

A: These three factors are clearly at the core of it. It is about empowerment, seeking growth, and big enablers like the Internet. There have been other important factors like the collapse of communism. China missed three industrial revolutions, so it is set to catch up. The way is obviously through media such as the Internet, technology transfer, and the global corporation. It is not unusual to see one Chinese company having 30 joint ventures with technology leaders of the world, which is a way of solving technology gaps at unprecedented speed.

In terms of the economy, labor productivity is highest in the emerging markets world because of the low rates. Capital productivity is still higher in the developed world, because the infrastructure is set up in a more seasoned way. But when you put labor productivity and capital productivity together, resulting in total factor productivity, it is a very powerful combination for the so-called emerging markets. If you take that development further, it may be scary for the US and Europe because they have everything to lose.

And the pace of the process is accelerating. Only in the past 3 years, Chinese companies were bidding for Maytag, buying the handset business of Siemens, Lenovo was buying the PC business of IBM. Everyone has to see that the battle is happening right now.

Also, we lost the advantage of size when China became a market economy, and when India began moving in the right direction. Anything that has scale as an advantage - which is pretty much everything - will be manufactured there or at least be introduced there at the best price. I think we can make the assumption that in 15 to 20 years there won't be an auto industry in the Western world except for niche providers.

Q: *Are there any industries that are sheltered from globalization and remain firmly in the hands of the Western world?*

A: Yes, there are themes, such as the middle class generation in the Pacific Rim or in Eurasia. People want to go to Rome, Paris, and get sense of the old Europe. I've been looking at a lot of infrastructure places, airports, providers, and hotels.

There will always be a financial institution in America, a bank in Germany, a pharmaceutical company, a leisure company, an airline, an infrastructure utility. There may be one strong company and five weak ones. The five weak ones are very interesting from an investment perspective, because they become the freaks of the industry. In some cases they act irrationally, shut down, or evolve into something completely different. This is where the disequilibria theme picks up and we have had some success in these stocks.

Q: *Could you describe the organization your research process?*

A: The process involves coming up with anchor ideas and quantifying them, because an idea is interesting only if it can be quantified. For supply-chain dominance, we look at increasing market share, margins or product superiority. Certain accounting and product details can be used for screening a vast number of universes. Disequilibria is the opposite, but it comes down to the ability of the management to make that important step. The virtual companies, such as Porsche or Monsanto, have a product, which enjoys high intellectual property rights, manifested in patents or in a brand name with unique appeal. These companies have low asset bases and high average employee salaries.

We screen for these specific metrics through thousands of names and come up with a short list that goes into another short list as it is run through our analysts. Our analysts are experts in validating the investment thesis once a rigorous screening has taken place. When we have something, we are on the phone and on the plane to talk to the

management firsthand before we pull the trigger. We don't do maintenance research, but instead in-depth research on a firm that suggests there is an opportunity to make money.

Last year, for example, we had the sense that European second-tier banks were going through a phase of despera-

"We don't do maintenance research but in-depth research on any firm globally that screens favorably for an opportunity to make money. Everyone is mission-driven and agnostic as to where to find the best investment on the globe; combing through global industry supply chains and managing portfolio construction as a hard science is what we do every day."



about **Oliver Kratz, PhD**

Oliver Kratz is the lead manager of the Scudder Global Fund. He also heads the global emerging markets team in New York. He has lectured in the US and Europe on topics of international securities pricing and information arbitrage. He studied in Frankfurt, Prague and Cambridge, MA. He has authored a book and several articles on asset pricing in frontier markets. Previous work experience include: McKinsey & Co, Brown Brother Harriman, and Merrill Lynch. He has been with the firm since 1996.

tion. Our screens showed many buy signals. So I went to Italy, Germany, Austria, and Netherlands and met CEOs and CFOs of European banks. After that trip we had a very concise idea of what was possible, so we started buying Capitalia, Commerzbank, the banks that have very little downside from a valuation perspective. Some of them have almost doubled since then.

Q: *What triggers selling a stock?*

A: There are certain investment theses that have shelf life of many years, while themes on the disequilibria front require quick actions. There are two ways of mis-pricing. One is at the static level, when a company is cheaper versus its intrinsic value. With such investments you have to be opportunistic. Once it becomes everyone's favorite investment idea, you have to move on. The other type is when the company has future promises that allow you to participate in the upside for years.

I like both types of investments and I think you need both in a portfolio. It is probably more difficult to find the disequilibria, but you can get fast materialization of the upside.

Selling a stock, just like buying it, is a function of portfolio construction, which at our firm is a hard science.

Q: *What kind of risk do you perceive and how do you manage it? Do you hedge the currency risk?*

A: For me risk management is being a better diagnostician of your portfolio than anyone else and understanding exactly what you do. It is more important to be comfortable with the type risk than the level of the risk. We know which issuers are the largest contributors to risk on an hourly basis. We quantify the value at risk, which is an absolute return measure of risk. We know the exposure to currencies and have to feel comfortable with them. When portfolio market moves have been extreme we call extraordinary risk management sessions with select team members. ■

TICKER Staff