



AIM Private Asset Management

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Style Diversification in International Investing

International Growth vs. Value

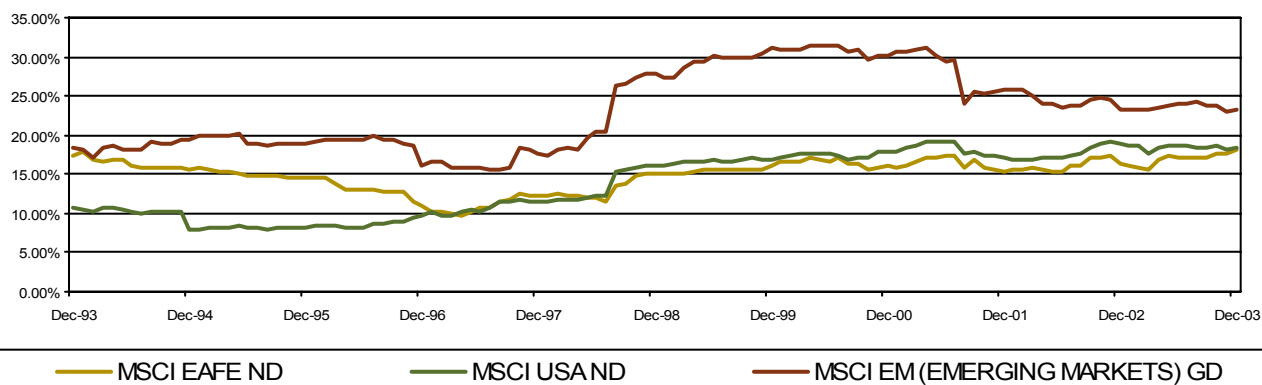
Now that foreign markets have outperformed the U.S. market for three consecutive years, investors are beginning to boost their allocations to international equities. While the case for international investing becomes more compelling – better growth rates, globalization, and attractive valuations relative to the U.S. – the subject of growth and value style differences in international investing is less clear. When it comes to investment style, we believe investors should approach international and U.S. investing in a similar fashion – that is, investors should have an allocation to both growth and value managers.

This advice is contrary to how many international equity portfolios have been constructed in the past. In fact, many investors believe “value always outperforms growth in international investing.” This perception, which we believe will not hold true in the globally integrated economy we have today, is based on two factors: 1) higher risk premiums prior to globalization favored value investing, and 2) flawed style benchmark construction.

Pre-Globalization International Investing

Prior to the 1990s, when the globalization of the world’s economies began to accelerate, risk premiums were generally higher in international markets. Political instability, closed economies, fragile financial systems and poor corporate governance created an environment that favored value investing. However, risk premiums are falling due to the development of legal, regulatory and accounting infrastructures, more stable political regimes, free market reforms, and economic growth. Indeed, the chart below shows that the volatility, or standard deviation, of returns in developed markets and in the United States has converged over the last decade and is now roughly equal. In a more developed, globally integrated financial market, investing in companies offering above-average growth potential should be expected to provide competitive returns.

36-Month Annualized Standard Deviation of Total Returns 12/31/93 – 12/31/03

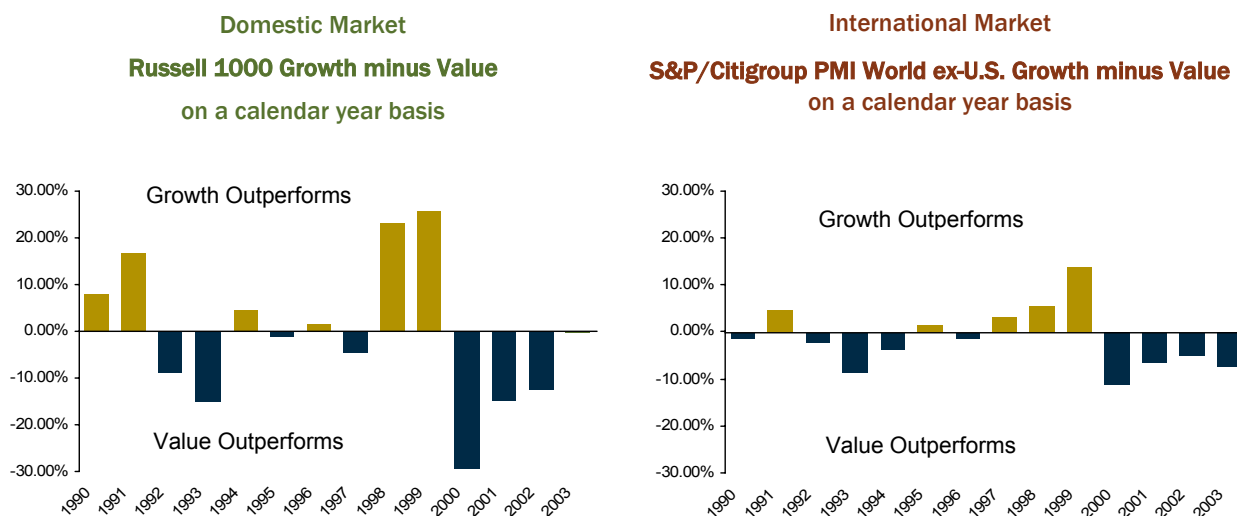


Source: Morgan Stanley Capital International. Past performance cannot guarantee comparable future results. Results assume reinvested dividends. An investment cannot be made directly in an index.

Style Benchmark Construction

Another factor influencing the perception that international value investing is superior to growth investing is flawed style benchmark construction. Prior to May 2003, MSCI constructed its growth and value style benchmarks using a single variable: price-to-book value. Stocks with a low ratio of price-to-book value were labeled value stocks, and those with a high ratio were labeled growth stocks. Because this ratio has significant limitations and does not measure growth characteristics, the MSCI style benchmarks have been biased to so-called value stocks. In other words, the MSCI EAFE Value index prior to 2003 likely included many stocks that an investment manager would define as growth stocks. As a result, many investors have incorrectly concluded that international value stocks usually outperform growth stocks.

Fortunately, a more robust style benchmark methodology provided by S&P/Citigroup has been available since 1989. The S&P/Citigroup style benchmarks utilize a multi-factor approach to more fully identify growth and value characteristics. In addition, these benchmarks evaluate a much broader universe: 51 countries and approximately 5,000 companies, compared to the MSCI's 21 countries and 1,000 companies. An analysis of the S&P/Citigroup growth and value style benchmarks shows much better performance of growth stocks since 1990. In fact, domestic and international markets have similar patterns of style rotation between growth and value, as shown on the chart below. Blending growth and value managers within an investor's international allocation is likely to deliver superior risk-adjusted returns over the long term.



Source: Zephyr StyleADVISOR. Each data point represents the percentage point difference between the Russell 1000 Growth sub-index and the Russell 1000 Value sub-index or the S&P Citigroup PMI World ex-U.S. growth and value sub-indices. This difference is obtained by subtracting the value sub-index return from the growth sub-index return. Accordingly "positive" data points reflect instances where growth outperformed value, while "negative" data points reflect those instances where value outperformed growth. For instance, on Russell 1000 graph, for 1998 the data point at approximately 23% indicates that growth outperformed value by approximately 23 percentage points for the 1998 calendar year : 39% - 16% = 23%.

We believe the pendulum is poised to swing back towards growth stocks following four consecutive years of value style outperformance. The valuation gap that formed between value and growth during the latter half of the 1990s has all but disappeared, and investors are now paying a below-average premium for growth. As the global economy slows in 2005 from the strong recovery experienced over the last two years, above-average growth opportunities are becoming more limited. It is in this type of environment that growth stocks historically have outperformed, because investors pay a premium for those companies that can deliver higher growth relative to the market.