INVESTOR'S GUIDE 2002

Building a Global Portfolio

Expand your horizons. There are plenty of good investment opportunities in Europe and Asia. Here are some suggestions from our all-star analysts.

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With the U.S. in recession and AT WAR IN Afghanistan this may not be the best time to take risks with your investment portfolio, let alone venture outside the relatively safe havens of U.S. equities and bonds. Historically, in times of trouble money has fled to politically stable countries like the U.S. and Switzerland.

It's no different this time, but there is merit to looking outside traditional safety zones. Getting better returns often means taking more risks. And although markets seem to be increasingly correlated across the globe these days, why stick to one geographical area? If you're going to make a bet on, say, the recovery of the telecom industry in 2002 (and we're not saying you should), why limit yourself to WorldCom or Lucent? By expanding your horizons to Europe and Asia, you could do better. American auto companies Ford and GM may be in trouble, but Germany's BMW definitely is not.

But how do you pick stocks in countries where, even with better disclosure laws, information is sketchy? To figure that out, FORTUNE went to its own experts--teams of all-star analysts in Europe and Asia selected last spring based on their performance in 2000 (see "All-Star Analysts" in fortune.com). For a look at 2002, we've asked nine of our all-stars to pick their favorite stocks in their sectors of expertise, then tell us why they would outperform, and by how much, over the next year.

Not all of them had good things to say. Some are still in the midst of sorting out the economic damage. Angela Dean at Morgan Stanley in London says she doesn't have a single buy rating among European technology stocks. So perhaps one shouldn't invest in the sector at all? "That would be one conclusion," she says. In Asia, and Japan in particular, it's tough to get a handle on where the troubled banking sector is going. Roy Ramos, a banking analyst at Goldman Sachs in Hong Kong, says he's just trying to figure out which banks can keep up their earnings momentum in the face of slumping world economies and the increasing risk that loans won't perform.

That said, there are some promising investments outside America. So if you're not too timid to take a few adventures with your portfolio, here's what the all-stars say you should consider.

Although Dean says she has no official buy recommendations on European tech stocks, she likes Nokia. The sector is drowning in red ink and debt, she explains, but Nokia isn't. With one of the industry's strongest management teams and balance sheets, Nokia has an opportunity to gain strength in the downturn at the expense of its rivals. "Plus," she adds, "we may have improving fundamentals in the mobile phone industry next year." (Morgan Stanley does not have Nokia on its recommended list, so Dean won't provide a price target.)

Autos are a better story in Europe. "We actually are avoiding the big three U.S. automakers," says Greg Melich of Morgan Stanley in London, because sales volume is being artificially pumped up by price cuts and 0% financing. His top pick is German automaker BMW. "They are executing very well in a difficult environment," says Melich. Profit margins were better than expected in the most recent quarter, and the balance sheet has improved in a year when most automakers have been burning cash. By generating excess cash flow, BMW is able to invest in new products ahead of its rivals. BMW also gives U.S. investors a natural currency hedge. While the stock is quoted in euros on the Frankfurt stock exchange, a third of BMW's revenue comes from the U.S. So even if the euro weakens against the dollar next year, BMW's improved earnings from the U.S., as measured in euros, should offset any currency loss on the stock itself. Melich thinks BMW shares could rise next year by between 16% and 20%.

Best Bets

Seven stocks recommended by seven of FORTUNE's all-star analysts.

Analyst	Pick	Reason
Angela Dean	Nokia	Opportunity to gain in the downturn at the expense of its rivals.
Greg Melich	BMW	Balance sheet improved while most automakers burned cash.
James Golob	Vodafone	Operating margins and cash flow rose more than expected.
Nick Bertolotti	Mediaset	Controls 65% of the TV ad market in Italy.
Stuart Graham	Deutsche Bank	Finally addressing its bloated costs and expecting a new CEO.
Kiyotaka Teranishi	Pioneer	Undervalued relative to its peers.
Franklin Lam	Sun Hong Kai Properties	One of Hong Kong's best-managed real estate companies.

The non-American story in telecommunications services is similar to that of autos. While U.S. carriers struggle, the picture in Europe isn't quite so bleak. James Golob at Goldman Sachs in London says Vodafone stands out as a company with a strong management and balance sheet in an industry full of the walking wounded. Although the company took a $9.6 billion write-off in the last six months, Vodafone's operating margins, cash flow, and average revenue per mobile-phone subscriber rose more than expected. The stock has performed strongly since hitting a 52-week low in August, but Golob says there is still about a 35% upside in the price.

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With advertising in a slump, media is another depressed industry with potential for growth next year. J.P. Morgan's Nick Bertolotti likes Italy's Mediaset (yes, that's the company 48% owned by Prime Minister Silvio Berlusconi). He says the company, which controls 65% of the relatively underdeveloped TV ad market in Italy, is poised to benefit from recovery. Bertolotti sees an upside of 25% to 30% in the next year.

When it comes to banks in Europe and Asia, there isn't much to get excited about. Says Merrill Lynch's Yoshinobu Yamada in Tokyo: "Japan is on the brink of a financial crisis, and there are no stocks in the banking sector that would outperform next year." Goldman's Ramos says Asian banks fall into three categories: those that can sustain earnings growth, those that can sustain dividend yield, and those "bombed out" banks with restructuring plans that have a chance for recovery by 2003. It's the latter category that has the most upside. Ramos picks three, all of them traded in Hong Kong: Bank of East Asia, which, he says, could rise by 17%; Hana Bank, which could jump by 18%; and United Overseas Bank, which could grow by 21%.

In Europe, Stuart Graham at J.P. Morgan likes Deutsche Bank, assuming markets and the economy recover next year and the bank continues to fix its cost and management problems. Recent signs suggest the big retail and investment bank is finally addressing its bloated costs. More important, investment bank head Josef Ackermann is due to take over from Rolf Breuer as CEO next year. That will accelerate Deutsche's adoption of Anglo-Saxon management practices, which focus on rewarding shareholders rather than maintaining employment. One possible negative: rising credit costs as loans go bad. But Graham figures he's taken bad loans into account in his 12-month price target. The upside in the stock next year, he says, is about 16%.

Although Japan continues to puzzle investors, Goldman's Kiyotaka Teranishi does have one stock he likes: Pioneer. Based on earnings estimates for the next two years, Teranishi thinks the consumer electronics company is undervalued relative to its peers. Earnings should recover based on improved sales of digital equipment as well as savings from restructuring. He expects Pioneer to outperform the Japanese market by 10%.

While the sputtering economy has many of our all-stars less than enthusiastic about the market, UBS Warburg's Franklin Lam in Hong Kong is so bullish that he sounds like he's stuck in the year 2000. "You should be buying buckets of Hong Kong property stocks," says Lam. His argument: Mortgage rates have dropped by two-thirds, housing prices are 60% below their 1997 peak, and Hong Kong is attracting lots of highly paid professionals as a result of China's entry into the World Trade Organization. Add that up and you get a property boom, says Lam. Meanwhile many property stocks are trading at a 50% discount to net asset value.

Lam likes Sun Hong Kai Properties, one of the island's best-managed real estate companies, with a slew of residential and commercial properties. It builds about 25% of Hong Kong's housing units each year. The stock is trading at a 23% discount to its net asset value. Normally it trades at a premium. Lam figures Sun Hong shares have an upside of about 40%.

So there you have it. Still afraid to invest outside your own country? Our all-stars could make your journey a little less risky.