93/02-Buy American

By Peter Lynch

The romance with foreign stocks continues. What started in the mutual funds has spread to the pension funds. The California Public Employee Retirement System poured $7.3 billion into foreign stocks in 1991, and, not to be left out, the New York State Teachers' Retirement System invested $750 million in 1992. Our largest 200 pension funds now have $75.6 billion invested abroad--more than seven times as much as they did in 1985.

In effect, U.S. pension managers are betting increasing amounts on the notion that foreign companies will outperform the home-grown variety that got us this far. The subtext is that Wall Street can no longer compete with the Paris Bourse or the Hong Kong Ordinaries. If what's made in America is second-rate, the story goes, then so are the companies that do the making.

Let me be the first to throw myself in front of this bandwagon. It is remarkably short-sighted to invest willy-nilly in foreign stocks when you could be investing in America. In the ten years since foreign stocks have become fashionable, U.S. companies have become more competitive. Even our railroads are beginning to look good.

U.S. railroads are a cherished symbol of great American ineptitude. My generation was raised on the idea that Americans couldn't run one, and that the purpose of the industry was to support large numbers of aimless individuals, a sort of welfare state on wheels. Behind each train was the red caboose, a vestigial organ tacked on by the unions in order to house the pinochle players sitting on the featherbeds.

Slowly but surely, the railroad companies have tossed out the featherbeds and eliminated the cabooses, and last year the industry's return on investment was the best in about 50 years. The average crew size is declining and the volume of traffic is increasing, as railroads are hauling more coal and grain. They are even taking some container business away from the truckers.

The railroad shares still sell at a large discount to the market, so Wall Street does not yet fully believe in this transformation. Nevertheless, companies such as Norfolk Southern, Burlington Northern, Union Pacific, and Conrail prove that America can make the trains run at a profit, and perhaps even on time.

The United States still leads the world in airplanes (Boeing) and in tractors (Caterpillar). Caterpillar is recognized worldwide as producing what once would have been called the Cadillacs of farm equipment--before Cadillac lost its place at the pinnacle of automotive craftsmanship. Detroit, says the tune from the bandwagon, has forgotten how to make cars.

Really? I'll grant you that it's difficult, if not impossible, to determine the nationality of a car, which has begun to resemble the military brat, raised a little here and a little there. That said, the most successful car product of the last decade did not come from the drawing boards in Japan or Germany; it came from Detroit. I'm referring to the Chrysler minivan, which sells twice as many units in the United States per

year as all the Volvos, Lexuses, and Infinitis combined. So if foreign car companies make such an obviously superior product, why did some 450,000 Americans buy Chrysler minivans last year, while only 70,000 bought Volvos?

Perhaps we should say that Caterpillar is the Chrysler minivan of farm equipment. And when it comes to the farm itself, U.S. agriculture has hardly been resting on its cornucopia. U.S. companies are leading the world not only in tractors, in fertilizers, and in food processing (< wam-co NYSE:CAG>ConAgra's stock is up almost fifteen-fold in ten years), but also in genetic hybrids.

You wouldn't think it takes much intelligence to come up with a seed, but the seed-making business now resembles the pharmaceutical business in its astounding complexity. New seeds must face years of clinical trials and run a gauntlet of government approvals before they can be sown.

We've already proven our ability to be among the best in the world of pharmaceuticals (Merck, Upjohn Co., and Bristol-Myers Squibb), and we're repeating the performance in agriculture with DEKALB Genetics and Pioneer Hi-Bred International. DEKALB has been producing hybrid hens since the mid '40s and hybrid swine (bigger litters, fatter porkers) for 20 years, and has recently made progress with its hybrid seed corn. The leading brand of hybrid seed corn in France is marketed by Pioneer Hi-Bred, a triumph in a country that treats home-grown food with the respect that we give our nation's flag. Calgene, Inc., is working on a genetically engineered tomato, Monsanto on a superior, pest-resistant potato that may inspire a rewrite of the famous ditty: You say potato, I say Monsanto.

Likewise, the U.S. steel industry, once left for dead in the Rust Belt, is showing signs of life, especially in companies such as Nucor, a spectacular enterprise that has introduced efficient mini-mills. Even the fallen mastodons, such as Bethlehem Steel, Inland Steel , and USX (the former U.S. Steel), are beginning to stir.

America's loss of the TV market to the Japanese has created the impression that America is unable to compete with the Japanese in electronics. In fact, our position in this industry is still strong at home and overseas. While it's true that the TV-manufacturing business has been captured by the Japanese, they aren't making money in it like they used to, so to this market we can say good riddance. Moreover, this popular theory that the United States can't compete in electronics is disproven by Motorola, a world-class supplier of semiconductors and the world's leading supplier of cellular phones and mobile radios. Their foreign operations account for 42% of sales, and they are the only non-Japanese supplier of car phones and pagers to Nippon Telegraph & Telephone.

As for who will control the computer business, I heartily endorse the opinion expressed by Alan Ryan in a recent issue of The New York Review of Books: "The mass production of computer chips now lies largely in the hands of NEC, Toshiba, and Hitachi, but it is widely believed that the American firm Intel will wipe the floor with them during the next decade."

We can't deny that the Japanese took over the camera business and became their own best customers, but, like TVs, cameras are not profitable per se. Film is where the money is, and although Fuji has made inroads with U.S. customers, its major U.S. competitor, Kodak, still has a higher market share for film in Japan than Fuji and all other Japanese producers have here. Cambridge, Massachusetts-based Polaroid, of course, continues to have a lock on the instant-gratification market worldwide.

Speaking of locks, Gillette maintains its global domination of the razor trade, and political and corporate leaders across every continent (if they happen to be male) begin their day by pulling Gillettes across their cheeks--prima facie evidence that the United States is doing something right.

Meanwhile, we continue to export our fantasies, from Mickey Mouse to Madonna, along with our soft drinks, our fast-food chains, and our retail outlets. It's culturally correct for all U.S. travelers abroad to groan in dismay as we pass a McDonald's in Paris or a Toys "R" Us in Heidelberg, but these are sights we ought to celebrate. The more of this sort of culture we can export, the stronger our economy, and the more likely we'll all be able to afford to travel to Paris to admire the Mona Lisa and wince at McDonald's.

Back at home, we're creating more promising small growth companies of the kind that are listed on NASDAQ. Europe is particularly short on these emerging-growth opportunities, as the European economies are dominated by oversized conglomerates of which only some are making a decent level of earnings. While it's true that Japan has become a haven for small-company growth stocks, these are often so overpriced that the investor has little chance to gain on the upside, and Japan in general is having its troubles these days.

This brings me to the ultimate reason to prefer U.S. stocks: Wall Street provides a level playing field that exists almost nowhere else. Things we take for granted here--the timely settlement of stock trades, the timely receipt of dividends, the accurate reporting of earnings--cannot be taken for granted by shareholders in Latin America, Europe, and the Pacific Rim. Regulatory authorities elsewhere, whether in Malaysia or Mexico City, don't protect investors the same way the SEC does.

Throughout the 1980s, I made a lot of money in foreign stocks for the < wam-co FUND:FMAGX>Magellan Fund. This successful foray had nothing to do with foreign companies being superior to U.S. companies. Foreign stocks were so poorly covered and the reports so sketchy that many of the best companies were selling for a fraction of their actual worth. I found bargains galore, even among the most famous conglomerates (Nestle, Volvo, Unilever, Montedison), with nary an analyst to trumpet their virtue.

The popularity of global investing has caused prices to rise and bargains to disappear, but the primitive reporting system still exists. When you buy foreign stocks, you almost have to do your own research, or else rely on a fund manager's doing his or hers. Managing a portfolio of foreign stocks is a much harder job than managing a domestic portfolio.

There's a patriotic argument I haven't mentioned. Every dollar sent abroad robs an American company of capital it could use to grow. Someday there may be a backlash against owning foreign stocks, just as we've seen against owning foreign cars. Protesters may burn shares of foreign companies on the steps of the New York Stock Exchange, the way they bashed Japanese cars in American parking lots.

You don't have to be a patriot to invest in America--merely self- interested. We have a great system of reporting to protect shareholders. We have great industry leaders (Nike, Walt Disney, Ingersoll-Rand, Sallie Mae, and Federal Express, to add a few more names). When General Motors falters, we have at least three other five-star generals, General Re, General Mills, and General Electric, to pick up the slack with their great records.

There's nothing wrong with investing abroad if you're familiar with the territory. Given a choice between investing blindly in the future of Germany or the Pacific Rim or taking a more educated risk on Supercuts

or Au Bon Pain (two of my recent favorites), I'll choose the latter every time. It's in the backyard that investors find their edge.

Peter Lynch retired in 1990 from managing the Magellan Fund, the best- performing of all mutual funds over a fifteen-year period. He is currently a trustee of the Fidelity Group of funds and has written a new book, Beating the Street, to be published this month by Simon & Schuster.

KEYWORDS: Stock Investing Strategies, Economy, International Investing