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Funds Build Cash, Tiptoe into Purchases

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As foreign markets have dropped sharply, money managers are scrambling to find palatable buys and hang on to investors.

Global-stock mutual funds gave up $7.4 billion -- their worst week in both dollar and percentage terms in over seven years. Emerging-markets funds have lost nearly $40 billion this year, compared with $27.5 billion for U.S.-focused funds, according to researcher EPFR Global. Funds that invest in foreign bonds also have seen outflows in the last two months.

"This is pure, outright panic right now," says Rob Lutts, chief investment officer of Salem, Mass., investment advisory firm Cabot Money Management.

Mr. Lutts says many of his clients and even his staff are begging him to raise his more than 50% cash stake in $400 million of portfolios. Instead, on Friday, Mr. Lutts was adding to stocks like Chinese online search firm Baidu.com Inc. It has fallen more than 50% from its high last year to $190 this week, even though its customer base has been increasing at a 35% clip. Indian bank HDFC Bank Ltd. also is on his buy list, as it has dropped to $54 from more than $100 in May.

Pran Tiku, founder of advisory firm Peak Financial Management in Waltham, Mass., manages $300 million in emerging markets and other investments. He has some money in the Lazard Emerging Markets Equity fund, and is planning to keep it there despite 60% declines in many parts of the world.

Mr. Tiku is also starting to "tiptoe" into the iShares MSCI BRIC exchange-traded fund as emerging markets "have gotten decimated." Consumer staple firms Nestle SA and Unilever PLC are among his favorites in Europe because he believes their goods will remain in demand through a global slowdown.

Still, even Mr. Tiku is judiciously screening countries. He is staying away from Japan-focused mutual funds, which have been slammed in recent weeks amid concerns that massive government reforms are failing to fix the country's financial ills. He also is avoiding Argentina and Turkey, which haven't built adequate capital reserves to cushion recent panic.

Andrew Foster, acting chief investment officer at Matthews International Capital Management, says his firm is focused on companies like Taiwan Semiconductor Manufacturing Co. It has a lot of cash, a "whisper" of debt and a 7.1% dividend yield.

He believes outside of Japan, Asia should be able to stomach this decline better than the 1997-1998 crisis thanks to its trillions of dollars worth of capital reserves.

Foreign bonds have been hit hard by the turmoil, particularly because of their exposure to rapidly weakening foreign currencies. The average "world bond" fund, which includes funds that invest in both U.S. and foreign bonds, is down 7.15% since the start of the year, while the average fund that invests in emerging markets is down 29% during the same period, according to Morningstar Inc.

Managers of foreign-bond funds have lately been trying to reduce their exposure to foreign currencies, to avoid their funds from losing too much value.

Dan Vrabac, a portfolio manager for global bond funds at Ivy Investment Management, has been hedging most of his funds' foreign bond exposure since the summer. Mr. Vrabac says that things are likely to get worse, and is keeping a lot of his investments in cash and other liquid securities.

At T. Rowe Price Emerging Markets Bond fund, manager Michael Conelius is adding to foreign bonds that have gotten cheaper. But he is sticking primarily to bonds issued in U.S. dollars.

He has bought bonds issued by the Indonesian government, at 17% yields, as well as bonds of VimpleCom, a cellphone company in Russia, yielding up to 30%. He says many foreign government bonds, including those of Russia and the Ukraine, are trading at prices which suggest that these countries are going to default, but he doesn't think they will.

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