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Make These Stocks a Part of Your Portfolio

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The dollar is doomed. That was the case Brian Richards and I made not too long ago, and though we thought we'd be the targets of patriotic vitriol, it turns out that a lot of you agreed with us. Color us flattered.

We also gave you some advice in that column on how to protect yourself against a falling dollar: buying companies that do big business in other currencies. This is a list that includes multinationals such as **Costco** (Nasdaq: COST) as well as foreign corporations such as **Ituran** (Nasdaq: ITRN).

Today, however, I'd like to take that advice one step further to tell you my favorite way to get exposure to China specifically -- a country and a currency that are both going to strengthen over the long term at the expense of the United States.

But first, the big picture
One of the people we keep in touch with at *Motley Fool Global Gains* is a guy named Matt Hayden, whose Hayden Communications specializes in doing investor relations for small Chinese companies.

We've discovered over time that a lot of the companies we find interesting end up being Hayden clients and that Matt also does a pretty good job of giving us the heads-up on other companies we might be interested in. (Note to other IR reps: That's because he doesn't bombard us with info on every company he represents -- only carefully selected ones he thinks we might like.)

Anyway, Matt's out on the road now giving a presentation to skeptical American investors about why China remains a good long-term opportunity. Here's the short-short version ...

1. Although Chinese stocks look expensive, they get cheaper if you're willing to look at smaller companies.
Although Chinese stocks now trade on average for nearly 30 times earnings, small companies in rural China trade for just 18 times earnings. Given the long-term growth opportunities in this part of the country, that number still looks pretty good to me.

2. China has upside.
China's GDP is less than one-third that of the United States, despite having four times the population. It also has the lowest debt level (in terms of both government and individual consumers) of any major world economy. That means it has the resources and flexibility to spur further growth -- and one day we should expect the Chinese economy to be as large as or dramatically larger than that of the United States.

3. There are near-term catalysts.
Economic growth in China is not coming to an end. In the near term, we should see infrastructure building, the further emergence of a cash-rich middle class, the encouraged consolidation and privatization of state-owned enterprises in order to make the economy more efficient, and the expansion of social welfare programs to spur the spending of some of those citizen savings.

Put these facts together, and you end up with a long-term growth story selling for cheap -- one that also should have some stability amid 2009's economic turmoil.

And that's why analysts at Paribas, Blackrock, Carlyle, and guys like Jim Rogers have been pounding the table for China in their reports.

Here's what I *don't* want you to do
Now, a lot of folks get these arguments for investing in China and think to themselves, "Yeah, I should have some China." But then they think, " China's far away, the government is bizarre, and those milk scandals and whatnot have me sketched out about the quality of management." So they either end up doing nothing, or they end up buying an ETF such as the **iShares FTSE/Xinhua 25 Index**.

If this is you, here's my advice: *Do not buy FXI*.

There are lots of reasons we have this opinion at *Global Gains*, and Todd Wenning does a nice job of summarizing our thinking on this matter in an article called "The Wrong Way to Invest in China." If you don't want to click over, the gist is that FXI is dominated by moribund state-owned companies that (1) aren't in China's highest-growth sectors and (2) don't really care about the individual American investor.

In other words, buying FXI would have been akin to buying the Dow 30 in the mid-1990s, when you actually wanted to be making a bet on technology companies such as **EBIX** (Nasdaq: EBIX), **Intuit** (Nasdaq: INTU), and **Logitech** (Nasdaq: LOGI). Sure, you would have had some exposure, and a rising tide does lift all boats, but the Dow would have been a daft and inefficient way to make this investment.

Here's what I *do* want you to do
Of course, you're right to think that when you invest in China, you should be diversified. After all, there are enormous execution and other risks in the country that we -- as American investors -- can't 100% solve for.

But rather than buy an ETF, I want you to buy a basket of small, non-state-owned Chinese companies. As you might guess from the data above, these companies are selling for much cheaper than their NYSE-listed, state-owned counterparts are, yet they have more upside and are being run more dynamically.

And what I mean by a "basket" is this: You should own five to 10 small, non-SOE Chinese companies that, added together, equal about one or two full positions in your portfolio.

Go out and do it
The best way for American investors to play China for the long term is to create your own diversified basket of small-cap Chinese companies and make these stocks at least a small part of your portfolio today. If you need help filling out that basket, know that our *Global Gains* team recently returned from a research trip to China and released a special report detailing five stocks you should buy today to build a China rural boom basket.

To get that report, click here to join *Global Gains* today.

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This article was originally published April 19, 2009. It has been updated.

Tim Hanson is the co-advisor of Motley Fool Global Gains*. He owns no shares of any company mentioned. Costco is an* Inside Value *and* Stock Advisor *recommendation. EBIX is a* Rule Breakers *selection. Logitech is a* Motley Fool Hidden Gems *pick. The Fool owns shares of Costco and Logitech. Make the Fool's disclosure policy a part of your life.*

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