



Career Risk or “Don’t Look Like An Idiot”

Many of you know I have my favorite gurus who help guide my thinking... just as (I’m hoping) you let me guide yours :-)

One such team that I respect and follow are the folks at Grantham, Mayo, van Otterloo & Co. (GMO), a Boston-based global money manager.

But before we get into GMO’s investment outlook let’s see why many money managers generally do not outperform the market.

Efficient Markets?

It is said that markets are efficient if, at every moment, prices reflect the true value of all known information.

Market efficiency is an attractive idea but with so many market participants across the globe, one wonders if all known information can get magically bottled into a single *true* price.

Many dispute market efficiency. Warren Buffett, for one, thinks it’s hogwash. He believes stock prices vary wildly from the underlying company’s true value, which gives him opportunities to buy stocks cheap.

So, if stock prices are not “efficient”, what causes this mispricing?

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Ben Inker, GMO’s head of asset allocation, suggests this mispricing is due to something he calls “career risk”. He defines “career risk” as a money manager’s mantra that says “Don’t look like an idiot”.

Money managers are more concerned about falling behind their peers than falling behind an index. Most do not want to go out on a limb and take the risk of being extremely wrong, or “looking like an idiot”.

Just as a boat's passengers move to one side to escape some perceived risk, and sometimes get hurt or fall in the water... money managers too move in herds and take prices to extremes that sometimes hurt those "on board".

They value their well-paying jobs and are averse to making non-mainstream investments that could make them superstars. To avoid "career risk", most crowd into the same investments - emerging markets, gold or silver today, housing stocks in 2005, tech stocks in 1999, and so on.

They'd rather play it safe than do what it takes to beat the market.

[GMO's Investment Outlook](#)

First, here's one of the reasons why I respect GMO. In the late 90s dot-com boom, GMO refused to buy stocks at the incredibly high prices everyone else was paying. This cost them a lot of clients. For a while there, they looked like complete idiots. However, they stuck to their guns, and after the bubble burst, they were considered superstars.

Now, let's hear it from GMO – the guys who don't give a whit about losing their jobs, and call it as they see it.

- U.S. and foreign stocks and bonds are unattractive - neither holds the potential to deliver decent returns after inflation.
- Markets have gone from "desperately overvalued" in mid-2007 to "very interestingly cheap" in March 2009 to "disappointingly overvalued" today.
- Stocks should typically earn 5.7% after inflation, and government bonds about 3%.
- Today, stocks are priced to deliver 3.8%. To yield 5.7%, prices will have to fall 29% from today's levels.
- Emerging markets are priced to offer 4.5% annually – slightly better than in the U.S.
- "But from GMO's perspective, the world is not a very exciting place for investors right now."

[GMO's Portfolio](#)

In spite of their anemic predictions, GMO is only 4% underweight in stocks. A quarter of their equity investments are in high-quality companies. Emerging markets are their next favorites. GMO has also been buying Japanese stocks after the tsunami washed down valuations.

They are staying away from bonds and have about 23% of their money on the sidelines.

Summary

Knowledge and insights are everything. GMO has both.

I view their predictions less as a declaration of war against stocks, but more as a cautionary reminder should stocks fly to much higher levels.

Market predictors follow the axiom:

Give a direction but never a time, or
Give a time but never a direction

No one really knows the timing of anything. So concentrate on the companies you own, not the market in general. If you think stocks are ridiculously over-priced, lighten up. If you think they are ridiculously under-priced, load up. Do just this and I'm quite sure you will do pretty well.