



## **GMO Reinterpretation**

**Have you ever wondered who advises the advisor?  
Here are the latest thoughts from one of my "Gurus".**

### **A Fearful, yet Speculative Market**

Last quarter, Jeremy Grantham, head of GMO LLC., engaged in what he called the forecaster's last resort, suggesting three main routes for the market and the economy.

The least likely route was the "everything is for the best in the best of all possible worlds" scenario.

"In this encouraging world, the economic recovery would be.... consistently better than expected. It would be, in short, the type of very strong recovery that normally follows a very severe wipeout. And one that was additionally helped along by unprecedented stimulus".

He admits that last quarter's poor market performance has not been encouraging for this goldilocks scenario, causing him to assign a low probability to this possibility.

The most probable major theme, to which he gives a 50% probability, would be a "reluctantly and irregularly recovering economy with interest rates staying at rock-bottom for the next 18 months or longer".

These low rates, along with the market's awareness that today's Federal Reserve will still have to save the economy if things go bad, could continue to create a long, steady incentive to borrow and speculate.

His key point is: While the economy responds reluctantly to low rates, the stock market responds with much more enthusiasm-leading aggressive hedge funds to borrow heavily and act more speculatively in their drive to make the maximum amount of money.

If this speculative scenario takes place, Grantham thinks the S&P could move all the way back to 1500 or 1600 which is much higher than its current value of 1100.

Unfortunately, he believes this might lead to yet another bust, one which would be spectacularly dangerous because the government's piggy bank would be empty, with no more money to rescue the market and the economy.

The final path to which he gives only a 21% probability is: In the next few months, two or three of a long list of potential problems would come home to roost knocking the S&P 500 down to about 900 or so (a 20% decline from today's level).

What we are seeing now is a struggle between those who are betting on a sustained-speculation theme and those who think two or three things will go wrong and crack confidence.

This struggle is an unusual one creating effects he hasn't seen before. On the one hand this market is "fearful" but at the same time "speculative". How is this possible?

Low rates tend to produce an aggressive feeding frenzy for institutional investors, but merely produce a feeling in ordinary individual investors somewhere between dejection and desperation. Individual investors hate to park money in cash which earns them nothing, yet are still thoroughly nervous, so surveys reveal about normal stock investing.

### My Thoughts:

Individual investors are feeling trapped between battling giants, as institutions fight it out with each other for dominance. It feels too dangerous to compete with goliaths for fear of getting trampled, so the strong tendency is to sit on the sidelines and watch them battle it out.

When the winner is determined, one hopes to join the victor and enjoy the spoils. Unfortunately, at that late date, there is little money making opportunity left, leaving the investor with mediocre returns and more risk.

The real key to money making if you can do it, is to see clearly through the fog of war and take your opportunity as the battle swings from one extreme to the other.

Alas, this is easier said than done, but armed with knowledge and patience, the savvy investor has a much better chance of creating greater wealth today than he has had in the last 10 years.