GMO

QUARTERLY LETTER

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It's Everywhere, In Everything: The First Truly Global Bubble (Observations following a 6-week Round-the-World Trip)

Jeremy Grantham

From Indian antiquities to modern Chinese art; from land in Panama to Mayfair; from forestry, infrastructure, and the junkiest bonds to mundane blue chips; it's bubble time!

The necessary conditions for a bubble to form are quite simple and number only two. First, the fundamental economic conditions must look at least excellent – and near perfect is better. Second, liquidity must be generous in quantity and price: it must be easy and cheap to leverage. If these two conditions have ever been present without causing a bubble it has escaped our attention. Conversely, only one of the conditions without the other may cause an ordinary bull market but this is often not the case. For example, good or even excellent fundamentals with tightening credit often result in a falling market.

That these two conditions have been met now hardly needs statistical support, so widely accepted have they become. Never before have all emerging countries outperformed the U.S. in GDP growth over a 12-month period until now, and this when the U.S. has been doing well. Not a single country anywhere – emerging or developed – out of 42 listed by *The Economist* grew its GDP by less than Switzerland's 2.2%! Amazingly uniform strength, and yet another sign of how globalized and correlated fundamentals have become, as well as the financial markets that reflect them.

Bubbles, of course, are based on human behavior, and the mechanism is surprisingly simple: perfect conditions create very strong "animal spirits," reflected statistically in a low risk premium. Widely available cheap credit offers investors the opportunity to act on their optimism. Sustained strong fundamentals and sustained easy credit go one better; they allow for continued reinforcement: the more leverage you take, the better you do; the better you do, the more leverage you take.

A critical part of a bubble is the reinforcement you get for your very optimistic view from those around you. And of course, as often mentioned, this is helped along by the finance industry, broadly defined, that makes more money when optimism and activity are high. Hence they have every incentive to support rising markets as they do. But geography and culture can weaken the chain. The South Sea bubble was influenced by earlier speculation in France, but was distant and alien to the rest of the world. The great Japanese land and stock bubble was utterly persuasive to everyone in Japan, but completely unpersuasive to almost all of our clients. Seen through our eyes 10,000 miles away, it seemed obviously overdone and dangerous, didn't it? Even the 2000 bubble was really confined to TMT in the developed countries.

But this time, everyone, everywhere is reinforcing one another. Wherever you travel you will hear it confirmed that "they don't make any more land," and that "with these growth rates and low interest rates, equity markets must keep rising," and "private equity will continue to drive the markets." To say the least, there has never ever been anything like the uniformity of this reinforcement.

The results seem quite predictable and consistent. All three major asset classes – real estate, stocks, and bonds – measure expensive compared with their histories and compared with replacement cost where it can be calculated. The risk premium has reached a historic low everywhere: last quarter we showed that by using our 7-year forecasts to create efficient portfolios for high, medium, and low risk levels, the return for taking risk had dropped precipitously from September 2002 until May of last year. To be precise, the gap between our low and high risk portfolios on our 7-year forecast in September 2002 was 6.4% points and by May last year it was a paltry

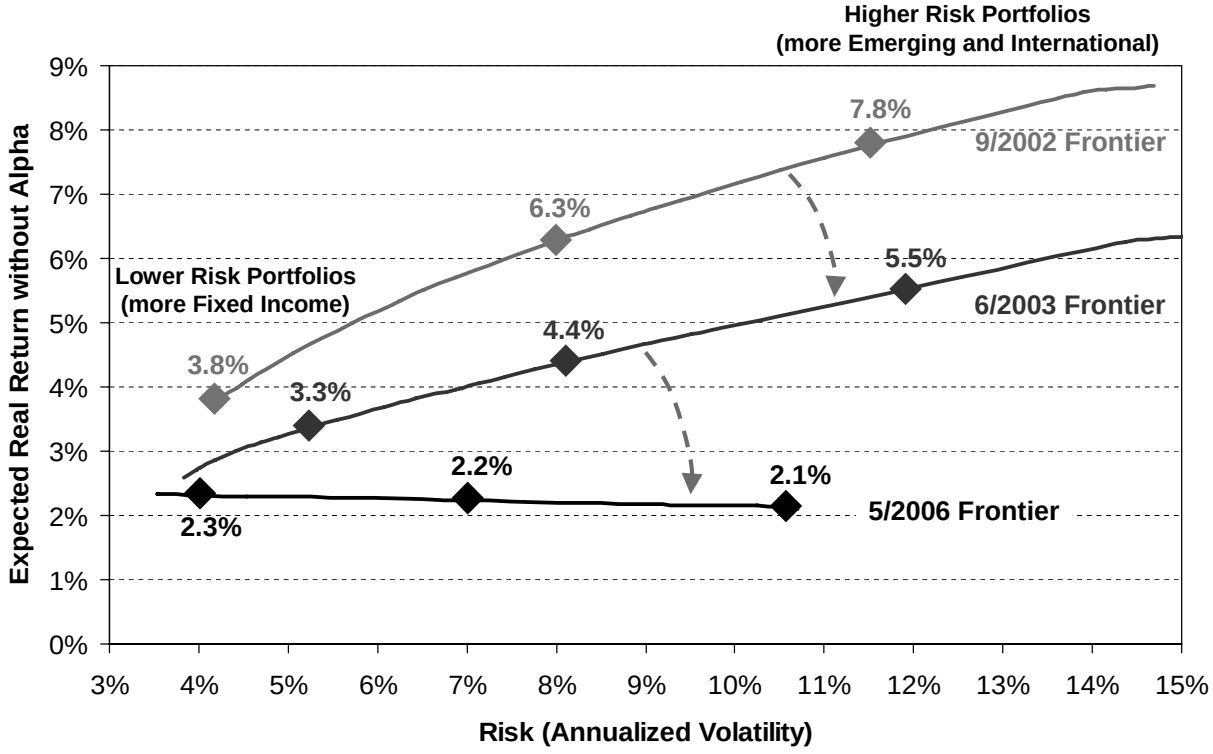
0.8%. But in Australia last month it was pointed out that we had missed the point, that all these portfolios included our expected alpha, which not surprisingly is higher for the risky portfolios (small cap and emerging) than it is for low risk portfolios (cash and TIPS). So Exhibit 1 reproduces the three points in time, using just the asset class forecast. As of May last year we now show – drum roll – the first negative sloping risk return line we have ever seen. Just think about it: if we are correct, the process of moving all asset prices smoothly to fair value over 7 years (which is how we do our 7-year forecasts) will have resulted in a world where investors are paying for the privilege of taking risk! If you believed this data you should, of course, put all your money in cash. In the real world, unfortunately, even if you believed it with every fiber in your body, you could only have a little cash on the margin because the career risk or business risk of moving more would be unsupportable.

So to recap and extend:

1. Global fundamental economic conditions are nearly perfect and have been for some time.
2. Availability of global credit is generous and cheap and has been for some time.
3. Animal spirits and optimism are therefore high and feed on themselves through reinforcing results and through being universally shared.
4. All global assets reflect this and are overpriced and show, probably for the first time, a negative return to risk taking.
5. The correlation in global economic fundamentals is at a new high, reflected in the steadily increasing correlation in asset price movements.
6. Global credit is more extended and more complicated than ever before so that no one is sure where all the increased risk has ended up.
7. Every bubble has always burst.
8. The bursting of the bubble will be across all countries and all assets, with the probable exception of high grade bonds. Risk premiums in particular will widen. Since no similar global event has occurred before, the stresses to the system are likely to be unexpected. All of this is likely to depress confidence and lower economic activity.

Exhibit 1

Absolute Return Portfolios Over Time – *The return to risk is shrinking*



Note: Based on GMO's 7-year asset class return forecasts. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance.

Source: GMO As of 5/2006

9. Naturally the Fed and Fed equivalents overseas will move to contain the economic damage as the Fed did last time after the 2000 break. But the heart of the last bubble, the NASDAQ and internet stocks, still declined by almost 80% and 90%, respectively. (The heart of the bubble this time is probably private equity. In 10 years, it may well be described as the private equity bubble just as 2000 is thought of as the internet bubble. You heard it here first!)

10. What is wrong with this logic? Something I hope.

11. Of course the tricky bit, as always, is timing. Most bubbles, like internet stocks and Japanese land, go through an exponential phase before breaking, usually short in time but dramatic in extent. My colleagues suggest that this global bubble has not yet had this phase and perhaps they are right. (A surge in money flowing into private equity might cause just such a hyperbolic phase.) In which case, pessimists or conservatives will take considerably more pain. Again?!

This Time It's Different

Yes, each bull market reflects its near perfection in a different way, with most accompanied by claims of a golden new era. Today the apparently infinite and cheap supply of Chinese labor, a truly colossal U.S. trade deficit, and the sheer uniformity of easy money and strong economics certainly give this one plenty of differences. But under the surface capitalism eventually grinds pretty fine. The return to capital and the cost of capital sooner or later get into line. Competition bids down returns. Confidence to spend capital finally recovers. Profit margins, at long last, become normal or even drop below normal. The workings of competitive capitalism are, in the end, an irresistible force and that is why everything always trends to normal and every very different bubble has always burst. And hey, if it happened in a smooth and regular way, how boring our business would be.

What Is the Catalyst for a Break?

Everywhere I went on my trip this was the question that followed my gloomy talk. But there usually is no catalyst that can be observed. We haven't agreed yet on a catalyst for 1929, 1987, or 2000, or even the South Sea bubble for that matter. On pondering the reason for the lack of a catalyst I offer a thought experiment (or tortured analogy). A market in equilibrium can be likened to a ping-pong ball sitting on a pool of water. You may have seen the fun fair trick of having ping-pong balls sitting atop jets of water that rise and fall with the power of the jets. The force of the jet can be likened to economic and financial conditions. The more nearly perfect the fundamentals and the more generous the liquidity, the higher the water jet raises the ball. At maximum force the ball is as high as it gets – a bull market peak. Then the jet is turned down a little, so it still represents a nearly perfect set of conditions but just the very slightest bit less perfect than it was – the jet is slightly lower and the ball falls. If bear markets start in nearly perfect conditions, far above average but just a little worse than the day before, what chance do historians have of finding the trigger? It is lost in a second derivative nuance. And, by the time conditions are merely well above average, the most leveraged and aggressive investors have registered the series of declines and are beginning to take evasive action. From here intelligent career and business risk management creates the normal herding or momentum, but in a seamless way as slight reductions in real conditions blend in with gamesmanship. Given all the uncertainties and the fact that conditions do not weaken linearly but in uneven and unpredictable steps, is it any surprise that we always miss market tops?

Having said all this, what are the special vulnerabilities this time that might work over a period of time to reduce the near perfection of today's market conditions? The first is easy: rising inflation. It constrains the Fed's support to any weakening economy, and the U.S. economy is indeed weakening. It directly lowers the traditional bond markets. Stocks may be real assets, but behaviorally it destabilizes stock investors and causes P/Es to fall. In the short term it tends to depress profit margins as corporations relearn how to pass through any cost increases. It wreaks havoc with housing and commercial real estate by lowering the possible leverage and therefore lowering prices. And perhaps most significantly this cycle, it lowers the feasible leverage in private equity deals and places many deals that can be done today out of reach, which in turn has dire effects on the current stock market.

The second possible catalyst is our old friend: profit margins. They are currently far above average globally and they will, of course, come down. A slowing U.S. economy and fewer pleasant global surprises will put pressure on profit margins. Possibly continued house price declines will slow the growth of credit, and consumption will grow less fast. There are leads and lags, and large retroactive changes to the profit margin data, so this factor is not so certain a death knell to the bubble as is inflation, but a couple of years of margin declines should do the job just fine.

The First Quarter's Stress Test

In late February we had a spot of trouble in the subprime market. ("Subprime …" – it already begins to sound familiar. Haven't we always talked about it?) And a Chinese red herring arbitrarily jumped in with a 9% market decline in one day, for no related reason. The combined effect was to create an echo of last May, where the carry trade pulls back for a few days and lets us see where the vulnerabilities are. There is a tendency to say, "Whoopee! We always bounce back! We're armor plated!" This seems like a bad idea. There is probably lots of information in these minor shocks, which may prove useful for a major shock. Last May's lesson, I believe, was not that emerging markets could bounce back, but that they could decline by 25% in three weeks in the face of the best year fundamentally in emerging's entire history. What might the decline have been on bad news? A 50% decline in 3 weeks? It just let us know the potential pain in really bad risk-liquidity events. I suggest taking a close look at one's entire portfolio on each of these shocks and checking for leaks in the boat – unexpected effects.

In May of last year emerging was a big holding for us, but there was no real concern because we believed that in an extended decline the extra value in emerging would materialize as it did in 2002. And if the market recovered, emerging would storm back. This time we took unexpected pain in our fixed income investments, which in many of our asset allocation accounts had risen to 50%. We knew that in general our fixed income portfolios tend to prosper as risk premiums narrow, whereas our equity accounts have a hard time, and vice versa. It was just a question of degree. In asset allocation, in our desire to have more of fixed income's enviable alpha, we had probably reached for a bit too much of it to be compatible with the normal risk avoiding preference of our asset allocation portfolios. On examination it really came down to having accumulated, in the different portfolios, too much currency exposure, which in turn can get in the way of carry trade events. So after long consideration of alternatives, we reduced the currency alpha exposure. It may be an over-reaction, and you can never know for certain at the time (and indeed risk taking in general continued to prosper in the first quarter), but I don't think so.

I urge our clients to take a detailed look at all their portfolios' responses to these two jolts, for sometime sooner or later the shots will not be across the bows.

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GMO

SPECIAL TOPIC

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*Letters to the Investment Committee XI**

Let's All Look Like Yale
Part II: Yale Meets Goldilocks

Jeremy Grantham

Summary of Part I

Last quarter I made the point that a continuously large flow of funds from the traditional assets – U.S. stocks and U.S. bonds – towards diversifying assets – everything from emerging markets equity to infrastructure and private equity – was almost certain. This quarter it is time to look at the effects of this revolution in asset allocation on individual asset categories.

First of all, it is important to realize that the "let's all look like Yale" effect is not the only important driver of asset allocation. The other extremely important issue is the effect of sustained global liquidity combined with sustained rapid global growth, which has created an unusual Goldilocks effect where the economic and financial world are "just right," which in turn has led to an unprecedentedly low risk premium across all assets (see the first section of the quarterly letter) and broadly overpriced assets.

These two quite separate effects – Yale and Goldilocks – interact. The Yale centrifugal force unfortunately often coincides with the drive towards riskier assets stimulated by Goldilocks. Prime examples of this would be emerging country debt and equity and private equity, all both risky and diversifying. There are, in fact, few examples of intrinsically conservative investments where only the Yale effect holds. The obvious example would be forestry holdings, where even alone the diversifying effect has been enough to dramatically change the pricing. The worst effects, though, should rationally be at the intersection of these drivers to high risk and exotic diversification, and this is where we should expect to see the most extreme relative overpricing in coming years. Certainly in the last five years the outperformance of these categories has been extreme. Here is just a sample.

Cumulative Performance of S&P 500 and Other Assets from 3/31/02 to 3/31/07

S&P 500	35.5%
Russell 2000	68.1%
U.S. Low Quality Stocks	72.7%
Int'l. Small Cap Stocks[1]	191.8%
Emerging Equities[2]	221.4%
Lehman Brothers U.S. Government	28.1%
U.S. Junk Bonds	63.9%
Emerging Country Debt[3]	87.0%

Other than commenting on the broad outperformance of these newly desirable areas, a few categories bear special mention, either for their unexpectedness, such as timber, or for their potential dangers.

Let us start with **timber**. This has gone from an obscure asset favored passionately 10 years ago by a dozen or so institutions thought to be eccentric, to a fashionable new frontier 5 years ago favored by an incremental handful of avant-garde institutions, to a hot asset class today that is at least considered by most larger endowments and foundations. The impact on this small asset class – in 2000 Microsoft's market cap was larger than all the world's forests (what a nice arbitrage that would have been!) – was of course spectacular. The discount rate used in evaluating forest properties was as recently as 3 years ago about 8.5% in the U.S. and over 10% in New Zealand.

* The Letters to the Investment Committee series is designed for a very focused market: members of institutional committees who are well informed but non-investment professionals.

[1] S&P/Citigroup EMI World ex-U.S.
[2] S&P/IFCI Composite
[3] JPMorgan EMBI Global +

This was a ridiculously high real return for an asset whose virtues included that it was exceptionally diversifying – it has had a history of rising in all great equity bear markets – and in the context of a diversified forest portfolio, very safe: if the sun shines and it rains, the trees grow about on schedule. The discount rate today with forestry's new popularity and the general desperation to find high returns has fallen to barely over 5% and 6.5%, respectively, in the two countries. This represents both a wonderful windfall for existing owners (Harvard was rumored to have sold most of its U.S. forestry holdings in one big transaction) and a heart-breaking loss of a great opportunity for asset allocators like us.

Other commodities have changed perhaps even more profoundly. Their attractiveness hinged on great diversification characteristics. Both bonds and stocks are hurt by unexpected inflation – nominal bonds suffer directly and stocks suffer behaviorally – investors are unsettled and P/E ratios fall. In glorious contrast, commodities are positively correlated with inflation, and in a real inflationary crisis their prices are likely to rise far more than the rate of inflation as a scarcity of inflation protecting investments rapidly develops. This attractive case for commodities was formerly held back not only by unfamiliarity (and hence more career risk) but also by the well known dreary track record for price increases. As *The Economist* magazine has periodically reminded us, the 100 year history in just about all commodities has been of falling real prices, in the range of 1% to 1.5% a year as productivity gains have exceeded the naturally rising marginal costs of deeper wells and second-class land, etc. This argument was countered by what we can call the Goldman Sachs case: that there has been, notwithstanding falling commodity prices, a positive return to buying commodity futures. This theory is based on original observations by my usual hero, Keynes, that speculators who bought futures were rewarded by producers who were laying off their risks.

The intellectual case seems a little unconvincing since speculators by no means only go long – I am still personally short copper as we speak – but the historical numbers were not bad. Rolling long positions in the futures seemed historically to have good returns comparable to equities **if** you weighted your positions heavily to oil contracts, say equal to their relative market value, **or** if you only invested in contracts that typically paid you to roll (contracts said to be in "backwardation"). Many contracts however were not **typically** priced this way and cost the speculators to roll (said to be in "contango"). The data was moderately convincing, but not very convincing. But combined with undoubted diversification benefits and the institutional drive to have their portfolios be new and improved, the total package was deemed by some to be attractive. The final straw for breaking down resistance was the surge in growth rates of developing countries led, of course, by the all-time monster growth story – China. Incremental demand **for** commodities from these new sources of major growth has changed the relationship between technology improvements and demand so profoundly that most commodities now probably have price trends that are moderately up – say, 1 to 1.5% real a year. In the long term, this shift from a downward drift to an upward drift is very important. In the short term, recent great strength in most commodities may have already discounted this change for the next 20 years.

The rush of new investors drawn to commodities in the last 3 or 4 years has, in addition, pushed up the prices of the commodity futures in relationship to the commodity itself, perhaps by a lot: it may have permanently changed the shape of the futures curve so that few if any contracts may now routinely pay long investors to roll. In a neat irony the flood of new money attracted by the ability to roll contracts profitably may have ended that condition forever!

Venture capital is a tough market these days that always has plenty of competition, and I'm not going to kick someone when they're down other than to say that the returns have been poor now for quite a few years. In any case the flood of new money is for the time being more or less passing them by, which is a relatively good sign, for it is worth remembering that the size of the yearly cohort of investors is the largest determinant of future returns: small inputs predicting good future returns and vice versa. There is nothing that suppresses the success of a brilliant new idea more completely than having 12 nearly identical start-ups.

Infrastructure is the most recent area to attract rapid increases in capital partly, no doubt, in response to other opportunities becoming overpriced. In some of these pools the fees, both declared and submerged in the complex financial structures, go on and on so that infrastructure has become an extremely appealing proposition to the managers. And the supply of funds is such that infrastructure can appear in odd places, bidding up, for example, the pricing of very large forestry deals (although it's not clear from the early deals if they would know a tree if it bit them on the leg). As always, the effect of the much increased supply

of funds has been to take formerly handsome risk-adjusted returns down quickly to the lean and mean.

Hedge funds are getting to be an old topic, but make for a remarkable story. An esoteric $35 billion enterprise 15 years ago with 800 funds serving rich individuals has turned into a $1.2 trillion enterprise with over 8,000 funds and numerous funds of funds increasingly owned by institutions as well as individuals. The trillion is leveraged several times and turns over far more frequently than 'old-fashioned' money, so that the percentage of trading represented by hedge funds has been said to be closing in on 50% of U.S. equities. The effects of this flood of money are numerous and significant. Hedge fund investing does not change the iron rule of investing: it is a zero sum game minus the fees and the trading friction. The total cost of regular long-only investing has averaged about 1% for institutions (½ fees and ½ transaction costs) and about 2% to individuals (⅓ fees, ⅓ transaction costs, and ⅓ selling costs). Hedge fund fees are of course a tad higher: typically about 1.5% fixed fee plus 1% transaction costs (typically ignored and often much higher) plus at least 20% of all the profits (including the risk-free rate that can usually be had free of charge). Today let's assume a 5% risk-free rate and 4% outperformance for a total performance fee of 1.8%. The total fees thus reach 3.3%, and the total costs including transactions total 4.3% for institutions, or almost twice the 'slippage' for long-only. Thus, the first consequence of increased alternatives, especially hedge funds and private equity, in a world that remains mercilessly a zero sum game **is an incremental drain on total assets**. The second effect is on the availability of alpha (or outperformance) to the winners in the poker game. Increased hedge fund money absolutely does not increase the available inefficiencies. They **at best** stay the same, so the same inefficiency is now exploited by more aggressive alpha-seeking dollars and is therefore **spread thinne**r. This effect of increased competition is also not by any means confined to hedge funds only, but is also affecting long-only investors. There is a nice irony here too: that the institutional drive into these new, more expensive vehicles may also lower the return available to those of their existing long-only managers fortunate enough to have a positive alpha.

But it is not only the case that the dollars chasing alpha increase. The other, closely related but clearly separate effect is, as mentioned last quarter, the enhanced flow of bright and even brilliant people drawn into our industry by the sometimes vast fees, and hence salaries, that until recently was a quiet backwater in terms of talent flow. With an increased inflow of more talented people, the standard of competition rises and rises until … well, to be honest, I'm not quite sure how the story does end. What for sure does not end soon is the flow of money, for a survey released last quarter based on interviews with large institutions said that these institutions expect to triple their hedge fund holdings in 4 years, which would make institutional hedge fund holdings larger even than those of individuals.

Private equity has been growing in the last 3 years even faster than hedge funds with the leading firms leap-frogging each other in the size of new funds raised, with several already well over $10 billion. **The dirty secret here is that their '2 and 20' fees are not justified by any positive alpha (or outperformance of the asset class)** at all. But, unlike traditional equity investing where outperformance is mainly dependent on style, and therefore mean reverting with good performance typically followed by bad, in private equity, returns are in complete contrast very sticky: there is a huge and remarkably consistent difference between the best and the worst of them, so this is an area where endowments and others with the **resources, talent, and pull** have exercised those advantages. Accordingly, the early moving and skillful institutions have picked the better managers that are now largely closed. These better managers have produced wonderful performance in the range of 20% to 30% compounded per year. In stark contrast, the larger, later arrivals have barely averaged a return that is even positive. More to the point perhaps, the cap-weighted average is **at best**, depending on the analysis you read, equal to the S&P 500. It does this, however, by sometimes leveraging over 4 to 1 in today's market. 2 to 1 leverage on the S&P 500, let alone 5 or more would have produced a much higher return, order of magnitude 21% compared to 14% max for private equity (source: Private Equity Performance: Returns, Persistence and Capital Flow by Steven N. Kaplan and Antoinette Schoar, November 2003). However, fees of '2 and 20' charged on 21% could account for this gap, so there may not actually be a negative alpha **pre**-cost – lucky investors! (Although there probably is.) LBOs are thought by several academics, in fact, to be a modest destroyer of real value. But let's be friendly: the case for private equity creating societal or long-term economic value at a company-by-company level is modest, and the case for the average invested dollar returning more than an equivalent leveraged S&P return is non-existent. What the industry on average offers is freedom from the traditional margin calls that on a similarly leveraged equity

portfolio would sooner or later ruin you. As long as you can make your quarterly interest payments in private equity deals, you are okay. There is, however, a little snag. If our 7-year forecast were to turn out right – it just might happen one day – then U.S. equities would return minus 1.4% real per year as P/Es decline modestly over 7 years to their long-term average and profit margins decline substantially to theirs (standard GMO assumptions). The T-bill rate would, in contrast, likely be about +1.5% real, and average borrowing costs about 2.5% higher than that, or about +4% real. The incremental cost of debt at 4 to 1 leverage comes to over 2% a year even after tax deductions. 3.5% a year loss is not normally a disaster, but with only 20% equity, it wipes out all value in 6 years, other things being equal! In real life the losses would be hidden for a while by selling divisions, reducing research and advertising, and, above all, by treating depreciation charges as profit rather than necessary rebuilding costs. So the leveraged deals, even if GMO's forecasts were correct, would last longer than expected before defaulting, but only at the cost of hollowing out the acquired companies. And some managers would exit so fast by unloading their company that the clock ticking against them would have had little time to tick, and any hollowing out would be harder to spot, although usually still there. But for slow movers, default will probably be common. The good news for the managers is that they still get their 2% fixed fees. The good news for the investors is that at least there would be no carry! The effect of the current flood of money riding the wave of diversification and currently cheap and available debt will also serve to push initially high prices even higher. The real shocker here is the asymmetry of returns. The first deal is good: the managers make a fortune and the client does well. The second deal is good: the manager makes a second fortune (usually a bigger one on a larger fund) and the client does well. The third deal is a bust: the manager makes 2% and the client loses a bundle. Total returns: the manager makes two fortunes and 2%; the client probably makes some money but probably not commensurate with the risk. And this is known as alignment of interest, apparently so lacking in public companies. I wonder what this alignment would look like.

Summary

In general, more diversification is better than less. And it is as near a certainty as things get in investing that 10 years from now institutional funds in aggregate will be substantially more diversified than they are today. The flood of institutional money moving into foreign and emerging equity and alternatives will mean that these assets will be looking for excuses to be overpriced for they will, more often than not, be on the right side of supply/demand imbalances. Conversely, the sources of funds – U.S. blue chips and U.S. bonds – will be in the reverse position and will mostly be lower priced relative to fair value than the trendier 'newer asset classes.' An ominous report from Greenwich Associates, an investment research firm, in *The Wall Street Journal* of April 12, 2007 confirms just how powerful this asset movement is. 24% of institutions expect to lower their allocation to U.S. active equity portfolios versus only 4% that intend increases. But for private equity the increase intentions are 34% and the decreases 2%. It almost can't compute, but it will be exciting trying.

Of course in the longer run all assets are worth replacement cost and supply/demand imbalances do not change that. Ben Graham famously said that in the short run the market is a voting machine, but in the long run it is a weighing machine. In this sense replacement cost is Ben Graham's 'weighing machine' and supply/demand his 'voting machine.' Every time the supply/demand imbalance is interrupted, even if only for a short time, prices will trend towards fair value or replacement cost, sometimes quite slowly and sometimes very fast indeed. So we are probably in for an extended period of mispricing, usually in favor of the trendy assets, but with reactions that will sometimes likely be dramatic.

It is also worth remembering that some of these trendy assets are real asset classes like foreign and emerging equities, small cap equities, and timber. Others, like hedge funds and private equity, are merely the existing asset classes repackaged at higher fees, with less regulation and much greater leverage. They are not new asset classes and should be reclassified into their component parts, as I'm sure they will be routinely in a few years. Above all, these fashionable, repackaged assets are still part of a zero sum game and their higher fees are, in the end, your lower returns.

The really difficult task for investment committees is to steer a careful course between increasing beneficial diversification while being aware of the landmines caused by the intersection of the widespread move to risk taking and the trendiness of exotic investments. All in all we should fasten our seat belts. It's likely to be a bumpy ride.

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