



JEREMY GRANTHAM  
VIEWPOINTS

# REINVESTING WHEN TERRIFIED

*Jeremy Grantham* | March 2009

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It was psychologically painful in 1999 to give up making money on the way up and to expose yourself to the career risk that comes with looking like an old fuddy duddy. Similarly today, it is both painful and career risky to part with your increasingly beloved cash, particularly since cash has been so hard to raise in this market of unprecedented illiquidity. As this crisis climaxes, formerly reasonable people will start to predict the end of the world, armed with plenty of terrifying and accurate data that will serve to reinforce the wisdom of your caution. Every decline will enhance the beauty of cash until, as some of us experienced in 1974, 'terminal paralysis' sets in. Those who were over invested will be catatonic and just sit and pray. Those few who look brilliant, oozing cash, will not want to easily give up their brilliance. So almost everyone is watching and waiting with their inertia beginning to set like concrete. Typically, those with a lot of cash will miss a very large chunk of the market recovery.

There is only one cure for terminal paralysis: you absolutely must have a battle plan for reinvestment and stick to it. Since every action must overcome paralysis, what I recommend is a few large steps, not many small ones. A single giant step at the low would be nice, but without holding a signed contract with the devil, several big moves would be safer. This is what we have been doing at GMO. We made one very large reinvestment move in October, taking us to about half way between neutral and minimum equities, and we have a schedule for further moves contingent on future market declines. It is particularly important to have a clear definition of what it will take for you to be fully invested. Without a similar program, be prepared for your committee's enthusiasm to invest (and your own for that matter) to fall with the market. You must get them to agree now – quickly before rigor mortis sets in – for we are entering that zone as I write. *Remember that you will never catch the low.* Sensible value-based investors will always sell too early in bubbles and buy too early in busts. But in return, you may make some important extra money on the roundtrip as well as lowering the average risk exposure.

For the record, we now believe the S&P is worth 900 at fair value or 30% above today's price. Global equities are even cheaper. (Our estimates of current value are based on the assumption of normal P/Es being applied to normal profit margins.) Our 7-year estimated returns for the various equity categories are in the +10 to +13% range after inflation based on an assumption of a 7-year move from today's environment back to normal conditions. This compares to a year ago when they were all negative! Unfortunately it also compares to a +15% forecast at the 1974 low, and because of that our guess is that there is still a 50/50 chance of crossing 600 on the S&P 500.

Life is simple: if you invest too much too soon you will regret it; "How could you have done this with the economy so bad, the market in free fall, and the history books screaming about overruns?" On the other hand, if you invest too little after talking about handsome potential returns and the market rallies, you deserve to be shot. We have tried to model these competing costs and regrets. You should try to do the same.

**Jeremy Grantham**

Mr. Grantham co-founded GMO in 1977 and is a member of GMO's Asset Allocation team, serving as the firm's long-term investment strategist. He is a member of the GMO Board of Directors and has also served on the investment boards of several non-profit organizations. Prior to GMO's founding, Mr. Grantham was co-founder of Batterymarch Financial Management in 1969 where he recommended commercial indexing in 1971, one of several claims to being first. He began his investment career as an economist with Royal Dutch Shell. Mr. Grantham earned his undergraduate degree from the University of Sheffield (U.K.) and an M.B.A. from Harvard Business School. He is a member of the Academy of Arts and Sciences, holds a CBE from the UK and is a recipient of the Carnegie Medal for Philanthropy.

If you can't, a simple clear battle plan – even if it comes directly from your stomach – will be far better in a meltdown than none at all. Perversely, seeking for optimality is a snare and delusion; it will merely serve to increase your paralysis. Investors must respond to rapidly falling prices for events can change fast. In June 1933, long before all the banks had failed or unemployment had peaked, the S&P rallied 105% in 6 months. Similarly, in 1974 it rallied 148% in 5 months in the UK! How would you have felt then with your large and beloved cash reserves? Finally, be aware that the market does not turn when it sees light at the end of the tunnel. It turns when all looks black, but just a subtle shade less black than the day before.

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**Disclaimer**

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