RISK PREMIUM FUND

Year Ending December 31, 2020

OVERVIEW

The GMO Risk Premium Fund seeks total return commensurate with the equity risk premium over a full market cycle with less volatility than global equity markets, primarily by selling put options on stock indices.

PERFORMANCE (%)

Net of Fees, Class III, Fair Value, USD	+1.99
Gross of Fees, Class III, Local Close, USD	+2.42
CBOE S&P 500 PutWrite Index [1]	+2.13
Value Added	**+0.29**

Major Performance Drivers

In the first quarter, cross-asset market volatility reached peaks which are typically only summited once or twice in a century. The sharp dislocations driven by public quarantines designed to slow the transmission of Covid-19, while necessary and prudent from a public health perspective, had profound effects on real global economic activity that took time for markets to fully digest. The two events that bear comparison are the market crash of 1929 and October 1987. Of course, each market selloff requires greater contextualization, but it is telling that realized volatility on the broad S&P 500 has only surpassed the index volatility highs of March 2020 during the crash of 1929 and Black Monday 1987.

The volatility peak of March was exceptional, even from the historical vantage point of over a century of equity returns. First quarter volatility levels exceeded those where markets contended with fundamental changes in Fed policy, the Great Depression, two world wars, the abandonment of the Gold Standard, the Volcker Fed tightening, multiple currency crises, and the recent mortgage-driven Global Financial Crisis (GFC). Remarkably, even the shock of the GFC, which was marked by broad impairment of public and private sector balance sheets, failed to deliver comparable levels of realized volatility.

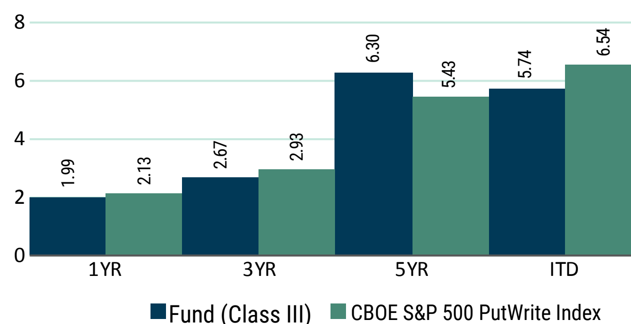
While the single-day selloff of 1987 was larger than that of the Covid-19 shock, the breadth of the first quarter market Value at Risk (VaR) shock arguably has had much more powerful knock-on effects that can be seen in sectors as diverse as the U.S. 10-year note and U.S. 30-year bond, funding markets, oil demand and supply, risk parity, and factor portfolios – not to mention the large number of trading days during which the market delivered elevated realized volatility. Indeed, there were few business days in March when the S&P 500 moved less than 3%.

Proactive fiscal policy, or more accurately financial disaster relief, and extremely forceful monetary policy from the U.S. Federal Reserve and European Central Bank supported markets and led to the repair of liquidity spreads as well as risk premia. Gross leverage in the system was substantially reduced, which set the scene to limit some volatility precipitated by VaR limits going forward.

Over the second and third quarters, markets shifted their focus from total virus infections and deaths to the rate of change of the Covid-19

Performance data quoted represents past performance and is not indicative of future results. The investment return and principal value of an investment will fluctuate so that an investors shares, when redeemed, may be worth more or less than their original cost. Current performance data may be lower or higher than the performance data provided herein. To obtain performance information to the most recent month-end, visit www.gmo.com. Gross Expense Ratio of 0.44% is equal to the Funds Total Annual Operating Expenses set forth in the Funds most recent prospectus dated June 30, 2020.

ANNUALIZED RETURN (%) AS OF 12/31/2020



Inception date: 12/14/2012
Includes purchase premiums and redemption fees impact if applicable.

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pandemic's spread. Key concerns included gauging whether new lockdown measures would impact the economy and markets, the risk of second-wave infections in Asia and Europe, and if the first wave in the U.S. would become a tsunami or a ripple. The unprecedented expansion of global central bank balance sheets as well as the gargantuan fiscal impulse from governments also reverberated through markets and proved to be the most important driver in price discovery of risky assets over the rest of the year. Fiscal and monetary interventions placed a bottom on aggregate demand and markets. This in turn led to a decline of financial and operational volatility, credit and trading spread tightening, and heightened liquidity. However, plenty of macro risks remained over the year, including a historically acrimonious U.S. general election, uncertainty over the size, scope, composition, or even consummation of another fiscal support package in the U.S., and a stall in the U.S. and European economic recoveries.

The fourth quarter revolved around two large catalysts: the U.S. general election and rapid vaccine approvals with higher-than-expected efficacy rates. Naturally, broad markets repriced, and equity style factors rotated swiftly in response to both developments. Interestingly, while implied volatility headed lower following a reduction in risk premium, the decline in volatility was much smaller than one would expect by only peering at equity prices. Indeed, while broad equity indexes performed well over the quarter – the VIX couldn't breach below 20 implied volatility points. Meanwhile, realized volatility was low and contained. Together this led to healthy and wide margins for volatility risk premium. We view this as encouraging and a sign of opportunities in this space.

The presence of retail investors on options markets continued to be evidenced by the difference in pricing between index volatility and single name volatility. In particular, retail investors bid on call options on high volatility single stock tickers, leading to differential pricing between single name skews and index skews (the difference between the implied volatility of a put less the implied volatility of a call), the latter market being dominated by institutional investors.

Over the year, the portfolio gained in absolute terms. Portfolio performance was directionally consistent with the performance of equities, which is to be expected given the positive beta to the broad market. This means that the portfolio declined in the first quarter as the market priced Covid-19 as a global pandemic rather than a Chinese shock to trade and supply chains but gained during the final three quarters, supported by a remarkable degree of fiscal and monetary stimulus, the pricing out of political risk premiums as we moved past the U.S. general election, and better-than-expected vaccine efficacy rates. However, given the strength of the equity market rally and a strategy beta lower than one, the portfolio lagged the equity market as expected. The portfolio has been supported by the higher levels of implied volatility adjusted for market betas and low levels of realized volatility leading to attractive levels of volatility risk premium, a development that we expect to continue over the New Year.

An investor should consider the fund's investment objectives, risks, charges and expenses before investing. This and other important information can be found in the fund's prospectus. To obtain a prospectus please visit www.gmo.com. Read the prospectus carefully before investing.

Risks associated with investing in the Fund may include Market Risk-Equites, Illiquidity Risk, Derivatives and Short Sales Risk, Management and Operational Risk and Counterparty Risk. For a more complete discussion of these risks and others, please consult the Fund's prospectus. The GMO Trust funds are distributed in the United States by Funds Distributor LLC. GMO and Funds Distributor LLC are not affiliated.

[1] The CBOE S&P 500 PutWrite Index is designed to sell a sequence of one-month, at-the-money, S&P 500 Index puts and invest cash at one- and three-month Treasury Bill rates. The number of puts sold varies from month to month, but is limited so that the amount held in Treasury Bills can finance the maximum possible loss from final settlement of the S&P 500 Index puts.