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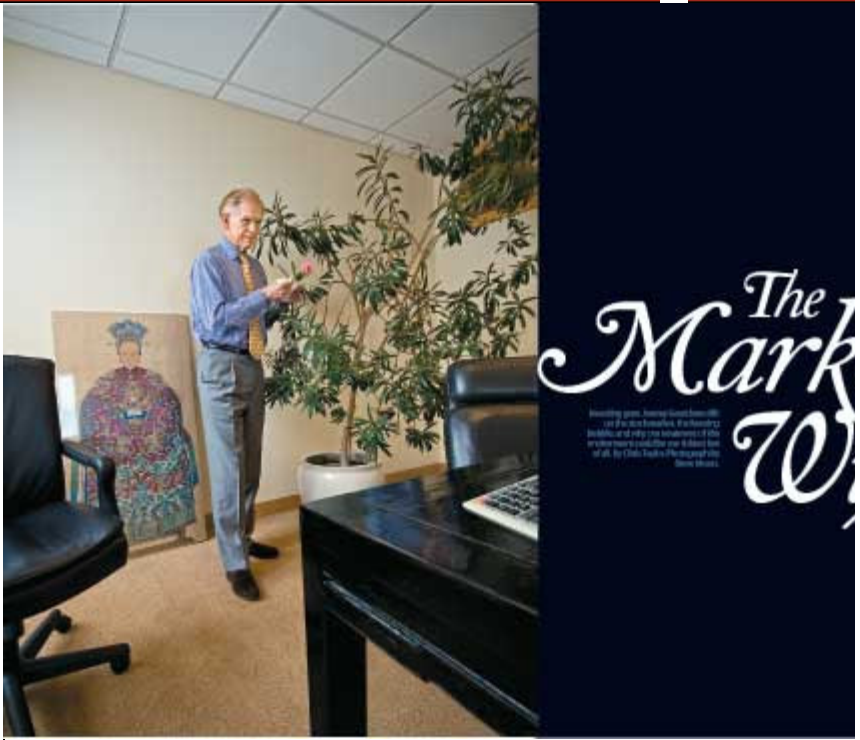
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### The Market Wizard

Investing guru Jeremy Grantham riffs on the stock market, the housing bubble, and of the environment could be our riskiest bet of all. **By Chris Taylor. Photograph by**

All you need to know about investing legend Jeremy Grantham sits just to one side overlooking the breezy wharves of Boston. It's a massive stone Buddha, standing ab and weighing hundreds of pounds, that made it all the way here from ninth-century

First, the Buddha's serene gaze implies "everything in moderation," meaning bubble go, but things always drift back to the middle. And second, Grantham, 68, got the st steal during the Asian currency crisis back in the late '90s, when antiquities from the selling. "So I called up Sotheby's after the auction and made a bid far below the res remembers. "They said, 'Yes, please!'"

Now that's the instinct of a true value investor.

And it's the kind of attitude that has made Grantham — chairman of investment-man Grantham, Mayo, Van Otterloo & Co. (GMO) and its \$121 billion in assets — the kind that other money managers listen to. Understandable, when you consider that he ha most revolutionary movements in modern investing. Investments that are indexed to performance? He was a pioneer. Small-cap investing, for people who want a piece o firms? His too. International investing, to take advantage of markets around the wor the first. Quantitative investing, for "numbers nerds" who are able to find value in re data? You get the picture.

"If there's anybody in this whole business who calls a spade a spade, everyone woul Jeremy Grantham," says John Bogle, an investing legend and the founder of mutual Vanguard Group. "He pulls no punches and is one of the top two or three individuals He's a straight shooter in a business where that's not a customary characteristic."

It's not cheap to profit from Grantham's market wisdom, unfortunately: The price of

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client, most of which are institutions, is a minimum \$10 million. But for the rest of us, he subadvises a number of mutual funds available to the general public through Evergreen Investment Management, John Hancock Funds, and the Vanguard Group.

Grantham isn't just a market geek, though the messy stacks of data on his desk might give you a different impression. He also has some amusing personal quirks, like his obsession with textiles, ranging from old Uzbek bridal embroideries to fifteenth-century swaths of Venetian lace.

But if there's one thing he's dead serious about, it's the world's casual ignorance of environmental crises. Much like his approach to the markets, he's peering long-term down the pike, and he doesn't necessarily like what he sees. Grantham, who has spent years for environmental protection with his wife, Hannelore, isn't sure enough people are listening.

"It just seems obvious to me," he says. "This is where we live, so why mess it up? Vandalism has been a part of society ever, so we need a version of the Manhattan Project to protect the environment. Climate change is serious — and irreversible."

### Playing Defense: Surviving and Thriving in a Downturn

If Grantham is as right about the environment as he was about the Internet bubble, he's got a big heap of trouble. In the late '90s, when tech stocks were skyrocketing and everyone was getting rich, he was practically yelling from the rooftops about the coming bust. He was the only one everyone out.

It cost his firm — big. As investors turned away from his conservative philosophy and went for the high-growth instead, GMO lost 45 percent of its assets under management at the time — but because of the market conditions, the company ended up sinking only 33 percent, from \$30 billion to \$20 billion. "The conventional wisdom brought the firm to its knees," Grantham remembers. He and his managers were seen as fuddy-duddies who had lost their way, old-fashioned cranks who didn't understand the realities of the new Internet age.

But in 2000, when the stocks all came crashing down, his value-oriented philosophy was vindicated. While the investors who had abandoned him were losing their shirts, the ones who stuck with him emerged from the bust relatively unscathed. "We looked like heroes," he says. "It was a pretty obvious bet. By any standard measure, everything was screaming at you to do it."

And that nicely sums up his approach to the markets. At any given moment, some stocks are rocketing to bubblelike proportions, and others may be out of favor and absolutely cheap. But you don't shovel your money into assets that are already ridiculously expensive. Everything will eventually revert back to the mean.

That instinctive caution has led many to tag Grantham a "permabear," someone who is pessimistic about the markets. He's not a fan of the term, though. A worrier, maybe, but we're in the middle of a long-term bear market, one that started in 2000 and that may not end until 2010, at the earliest. But according to Grantham, he's just calling the market as he sees it. The class is in a bubble, he'll say so. And right now, a lot of different assets are looking cheap. Stocks, bonds, real estate — generally speaking, all are valued higher than they should be.

### Looking Ahead: Where to Place Your Bets

That's not to say there aren't wise investments to be made, says Grantham. One of the best has been, and Treasury Inflation-Protected Securities are fairly valued. Emerging market equities in developing countries like India, China, Brazil, and so on — are probably the best long-term bets, and they're relatively cheaper than U.S. stocks.

His biggest idea for the moment: that superhigh-quality investments — perennial market winners like Johnson & Johnson, for instance, pose little risk and have a solid record of churning out value year after year — are a much better value than riskier ones. Because right now the market premium is "the lowest you'll ever see in your lifetime." In other words, you're not taking risks with your money, as you normally would. When this is the case, you should invest in proven moneymakers instead of the fluctuating small-cap growth stocks, because you're getting a bargain.

But the immediate question posed by anyone with a 401(k) is: How will the market perform next year? Grantham reminds us of the predictability of presidential cycles, which reveal themselves in the data. Historically, during the first year of a presidency, the market is up very slightly; in the second, it's down significantly; in the third, it rockets upward; and in the fourth, it's up more than it was in the first.

That kind of pattern isn't random. As they start to face reelection prospects in their second year, presidents tend to take a more conservative approach to the economy.



administrations tend to goose jobs, cut interest rates, and spend the cash necessary economy is humming when voters go to the polls. And here's the good news: We'll see the third year of the younger Bush's second term. If historical patterns hold, that could be a year for investors, although Grantham doesn't recommend you count on this. "In the end, value is more important than these technical indicators."

Of course, in Grantham's view, the fundamentals don't warrant such a powerful bull market. But he's enough of a realist to know that pure reason doesn't always win. "You don't get rich fighting Year Three," he quips.

### **The Real World: Thinking and Investing Globally**

Grantham loves to make his investors rich — investors who reportedly include long-time clients John Kerry and Dick Cheney (although the tight-lipped company declines to discuss its performance). His fund has outperformed the market for seven consecutive years.

That's partly thanks to Grantham's global perspective, which helps him spot opportunities around the world. And that stems from his upbringing: A native of England, he studied at the University of Cambridge before making his way to Harvard Business School. As a self-styled mid-Atlantic person whose stubborn English accent remains, if only in watered-down form — he sees the U.S. as one piece of a much larger puzzle.

If American stocks are outlandishly expensive, for instance, look abroad. A prime example: In 1997, Grantham estimated that stocks in emerging markets were cheap. So he loaded up on equities in developing countries and they outperformed almost every other market.

It's those same global instincts that fuel his passion for protecting the environment — with the few hundred acres he and his family own in Panama that he's currently replanting with a variety of trees, and in larger ones, like with his foundation's newly minted prize that he awarded for environmental journalism. "He's a very smart philanthropist," says Carter of the World Wildlife Fund in Washington, D.C., the world's largest privately financed conservation group. "He's always pushing and prodding me to find the right solutions. Not just by the ground in places like East Africa or the Amazon, but in getting companies in the timber and paper in a more sustainable way. It's really remarkable."

Indeed, Grantham now dreams of harnessing the power of the media to change public opinion about the environment on an even grander scale, much like former vice president Al Gore did with his film on global warming, *An Inconvenient Truth*, which brought a key message to a wide audience. If public attitudes can be altered, Grantham hopes enough pressure can be put on government behavior. And then there might be some real hope that we will protect all the earth's resources before we realize it.

In this way, Grantham's approach to the environment is very much like his approach to investing: He searches for just the right opportunity — whether it's battling infestation in American trees in Panama — and runs with it. "He places bets on people and ideas the same way he places bets on money," Roberts says. "He looks for inspiring people who have great ideas, helps them, and then gives them the resources to take those ideas to scale. And he's been very successful."

Not that Grantham would trumpet the fact. He's not a limelight seeker; he's content to be seen at his cluttered desk, ferreting out the long-term trends that are going to change the world. "I just try to be right more often than not," Grantham says, smiling at the understatement. "And it's worked, I must say."



### **Master Class**

Jeremy Grantham may seem like an unassuming type with his avuncular sweep of rumpled clothes. But when it comes to saying what he thinks, he's brutally honest — about upending conventional wisdom. A Grantham classic: "Very hard work gets in

thinking." He's also famous for saying that just one or two good investing ideas a year (He's since amended that — to one idea every couple of years.) So we administered and asked Grantham for his unvarnished opinion of the hot-button issues roiling the

**On Oil:** "It's a finite resource meeting the world's most inept energy policy. It's not eventually going to pump it all, and yet American drivers can't stand a higher tax on live with gas at \$7 or \$8 a gallon, but Americans can't. It's a sacred cow."

**On Real Estate:** "Housing bubbles are rarer than stock bubbles, and right now it's the point ever. It's not as volatile an asset as stocks, but we're in the early stages of heading down more than it ever has before. In some markets, like Boston, it may go down in other markets, prices may simply flatten."

**On Hedge Funds:** "Hedge funds may have changed something serious about the way the markets. This is \$1.2 trillion, leveraged three-to-one. So it's actually \$3 trillion that can move on a dime — and does. They're also taking very good people, so we have to fight it out with them."

**On Bubbles:** "Bubbles will always happen, as people follow the rising asset class. Things get horribly overpriced. The only thing that's uncertain is the timing of when they end."

**On Bear Markets:** "Most money managers got into the business after 1982 and had a long wave of happiness. But the laws of nature have not been repealed. There are times the economy could unravel. But I stay optimistic because we have a history of muddling through, stay alive, duck, and wait for better opportunities."

An award-winning freelance journalist and a former senior writer for *SmartMoney*, he has also contributed to the *Financial Times*, *Money*, *Best Life*, *Reader's Digest*, and *U.S. News & World Report*.

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