



Obama and the Teflon Men, and Other Short Stories. Part 1.

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With economies and financial markets, it seems that if you stare hard enough and long enough at the fog of battle, you occasionally get a glimpse of what may be going on when a favorable wind blows. This, for me, is decidedly not one of those occasions. It is obvious to all of us that these are momentous days in which government actions may well have make-or-break impact, but my confidence in government and leadership is at a low ebb. (Although I must admit my confidence has increased enormously in recent weeks in all areas outside of finance. Even in finance it has increased a little.) Economic advice for President Obama covers the waterfront, and even the near-consensus case for great stimulus is lacking in historical certainties or intellectual rigor. Everyone seems to be guessing at strategies and outcomes, knowing clearly that the best strategy would have been to have avoided getting into this pickle. The current disaster would have been easy to avoid by making a move against asset bubbles early in their lifecycle. It will, in contrast, be devilishly hard to get out of. But, we are deep in the pickle jar, and it seems likely that, in terms of economic pain, 2009 will be the worst year in the lives of the majority of Americans, Brits, and others. So break a leg, everyone!

It would be helpful at a time like this to have a Quarterly Letter that sounded convinced of something ... anything. So I apologize for overtly tickling around the edges. I do not apologize, though, for pointing you to the best thing I have read in *The New York Times* in a very long time: the article by Lewis and Einhorn¹ does a great job of summarizing where we are and how we got here, as well as offering some helpful advice for the future. My contribution is to address a few peripheral topics that have accumulated over recent quarters as more important topics have dominated. Half of the mini topics are covered in this Letter, and the other half will be posted in a few weeks.

1. The Story So Far: Greed + Incompetence + A Belief in Market Efficiency = Disaster

Greed and reckless overconfidence on the part of almost everyone caused us to ignore risk to a degree that is probably unparalleled in breadth and depth in American history. Even more remarkable was the lack of insight and basic competence of our leadership, which led them to ignore this development, or worse, to encourage it. Ingenious new financial instruments certainly facilitated and exaggerated these weaknesses, but they were not the most potent ingredient in our toxic stew. That honor goes to the economic establishment for building over many decades a belief in rational expectations: reasonable, economically-induced behavior that would always guarantee approximately efficient markets. In their desire for mathematical order and elegant models, the economic establishment played down the inconveniently large role of bad behavior, career risk management, and flat-out bursts of irrationality. The dominant economic theorists so valued orderliness and rationality that they actually grew to believe it, and this false conviction became increasingly dangerous. It was why Greenspan and Bernanke were not sure that bubbles – outbursts of serious irrationality – could even exist. It was why Bernanke, who had studied the bubble of 1929, could still not see it as proof of irrationality and could still view the Depression (à la Milton Friedman) as a mere consequence of incredibly bad, easily avoidable policy measures. Of more recent importance, it was why Bernanke could dismiss a dangerous 100-year bubble in U.S. housing as being nonexistent. It was why Hyman Minsky was marginalized as an economist despite his brilliant insight of the “near inevitability” of periodic financial crises. It was why the suggestion in academic circles of stock market inefficiencies, let alone major dysfunctionality, was considered a heresy. It was why Burton Malkiel could rationalize the 1987 crash as being an efficient response to 12 or so triggers. These triggers, however, had a trivial weakness: seasoned portfolio managers at the time had never even heard of most of

¹ Michael Lewis and David Einhorn, “The End of the Financial World as We Know It,” *The New York Times*, January 4, 2009. This article is available online at www.nytimes.com.

them. Never underestimate the power of a dominant academic idea to choke off competing ideas, and never underestimate the unwillingness of academics to change their views in the face of evidence. They have decades of their research and their academic standing to defend. The incredibly inaccurate efficient market theory was believed in totality by many of our financial leaders, and believed in part by almost all. It left our economic and governmental establishment sitting by confidently, even as a lethally dangerous combination of asset bubbles, lax controls, pernicious incentives, and wickedly complicated instruments led to our current plight. “Surely none of this could happen in a rational, efficient world,” they seemed to be thinking. And the absolutely worst aspect of this belief set was that it led to a chronic underestimation of the dangers of asset bubbles breaking – the very severe loss of perceived wealth and the stranded debt that comes with a savage write-down of assets. Well, it’s nice to get that off my chest once again!

2. Lost Illusions: The Loss of Perceived Wealth and Stranded Debt

During the market’s rise, I wrote about the fallacy of paper wealth, particularly as it applied to houses. At three times the price, they were obviously still the very same houses. How could we kid ourselves that we were suddenly rich and didn’t need to save for our pensions when we were sitting in the very same buildings we bought in 1974? With “wealth” built on such false premises, it is not surprising that we come to grief from time to time. But the good news is that, as we move back down to earlier prices, they are still the same houses. We have not lost wealth, but just the illusion of wealth. Illusions tend not to have very long-lasting effects, but they obviously can and do have very powerful short- and even intermediate-term effects. This particular illusion, which applied to stocks, real estate, art, and almost everything else, was grand indeed, and it directly over-stimulated consumption and indirectly over-stimulated imports. In the process, it suppressed both savings and investments of our own locally generated income. (Although there was plenty of foreign investment into the U.S. to fill the gap, which has its own long-term complications.)

Now the illusion of wealth has been lost, with formidably negative effects on animal spirits. My hero, Keynes, emphasized the importance of shifts in animal spirits in economics, and explained how shifts in such spirits could ruin the most carefully calculated investment decisions.

At times like this, animal spirits need nurturing. Obama’s election will help, at least for a while; talking up the power of stimulus will help (whether or not the power is really there), and avuncular, optimistic advice from influential figures will not go amiss.

But let us look for a minute at the extent of the loss in perceived wealth that is the main shock to our economic system. If in real terms we assume write-downs of 50% in U.S. equities, 35% in U.S. housing, and 35% to 40% in commercial real estate, we will have had a total loss of about \$20 trillion of perceived wealth from a peak total of about \$50 trillion. This relates to a GDP of about \$13 trillion, the annual value of all U.S. produced goods and services. These write-downs not only mean that we perceive ourselves as shockingly poorer, they also dramatically increase our real debt ratios. Prudent debt issuance is based on two factors: income and collateral. Like a good old-fashioned mortgage issuer, we want the debt we issue to be no more than 80% of the conservative asset value, and lower would be better. We also want the income of the borrower to be sufficient to pay the interest with a safety margin and, ideally, to be enough to amortize the principal slowly. On this basis, the National Private Asset Base (to coin a phrase) of \$50 trillion supported about \$25 trillion of private debt, corporate and individual. Given that almost half of us have small or no mortgages, this 50% ratio seems dangerously high. But now the asset values have fallen back to \$30 trillion, whereas the debt remains at \$25 trillion, give or take the miserly \$1 trillion we have written down so far. If we would like the same asset coverage of 50% that we had a year ago, we could support only \$15 trillion or so of total debt. The remaining \$10 trillion of debt would have been stranded as the tide went out! What is worse is that credit standards have of course tightened, so newly conservative lenders now assume the obvious: that 50% was too high, and that 40% loan to collateral value or even less would be more appropriate. As always, now that it’s raining, bankers want back the umbrellas they lent us. At 40% of \$30 trillion, ideal debt levels would be \$12 trillion or so, almost exactly half of where they actually are today! It is obvious that the scale of write-downs that we have been reading about in recent months of \$1 trillion to \$2 trillion will not move our system anywhere near back to a healthy balance. To be successful, we really need to halve the level of private debt as a fraction of the underlying asset values. This implies that by hook or by crook, somewhere between \$10 trillion and \$15 trillion of debt will have to disappear. Given where we are today, there are only three

ways to restore a balance between current private debt levels and our reduced, but much more realistic, asset values: we can bite the bullet and drastically write down debt (which, so far, seems unappealing to the authorities); we can, like Japan did, let the very long passage of time wear down debt levels as we save more and restore our consumer balance sheets; or we can inflate the heck out of our debt and reduce its real value. (In the interest of completeness I should mention that there can sometimes be a fourth possible way: to somehow re-inflate aggregate asset prices way above fair value again. After the tech bubble of 2000 Greenspan found a second major asset class ready and waiting – real estate – on which to work his wicked ways. This time there is no new major asset class available and, although Homo sapiens may not be very quick learners, we do not appear eager to burn our fingers twice on the very same stove. As a society, we apparently need 15 to 20 years to forget our last burn. With so many financial and economic problems reverberating around the world and with animal spirits so crushed, re-inflating equity or real estate prices way above fair value again in the next few years seems a forlorn hope if indeed it is possible at all.)

Each of the three realistic possibilities listed above would be extremely painful, each is loaded with uncertainties, and even the quickest of them would take several years. Our path this time is likely to involve a hybrid approach: we will certainly take some painful debt liquidations; this crisis will almost certainly take far longer than normal to play out; and probably, before a new equilibrium is reached, we will see inflation rates that are well above normal.

It would be convenient if we could reach safety without having our global economy come to a complete standstill for a few years; without a wave of very high inflation and, ideally, without a dollar crisis or a trade war. All of them, unfortunately, are what a quant would call “non-trivial possibilities.” Traveling happily certainly has its virtues, but in these dangerous times it is probably better to be braced at least for the right order of magnitude problem that we face.

This is a good time to look at the Japanese crisis of 1989 to present since, along with the Great Depression, it is probably one of the two most relevant examples for today’s problems. The Japanese had an even bigger problem in write-downs of “wealth” than we have now. They had to write down perceived wealth by an amount equal to a stunning three times GDP! Even in 1929, we had to write off amounts equal to only three quarters of a year’s GDP,

as the stock markets then were less developed and housing was decidedly pre-McMansion. This time in the U.S., however, we must write down perceived wealth or capital by almost precisely one and a half times GDP, worse than the Depression but happily much less than Japan.

In this context, do not kid yourself that the Japanese did a terrible job in extricating themselves. Even the Japanese often express dismay at the costs they have paid due to their heroic level of public spending. I believe that this primarily reflects their original failure to realize how deep their hole was. It can also be admitted that their program, while probably right in concept, was not highly efficient. Bridges to nowhere have not been as stimulating or productive long term as a focus on energy conservation and oil and coal replacement technologies would have been. It was often said that the Japanese should have bitten the bullet as the U.S. did in its S&L crisis, taking a quick hit rather than dragging out the pain. How superficial and self-congratulatory those comments seem now. Faced with our own credit crisis, we discover there is no easy cure – the bullet turns out to be a grenade, which doesn’t fit as easily into the mouth. At about 4 to 1, the Japanese corporate sector went into the 1989 crunch with much higher leverage than the U.S. had ever seen. Remember too that their stock market, at 65 times earnings, was over three times our market’s recent highs and their land was at several multiples of ours. In 1989, Tokyo’s land per square foot was around ten times the value of Manhattan’s! So they had higher write-offs conflicting with much higher corporate leverage. If they had rapidly marked their assets to market, the entire corporate Japan Inc. would have been under water. And since we know that around a quarter of Japan’s market – their Sonys and Toyotas – was solvent, we can deduce that the remaining three-quarters was shockingly under water, using the types of rules we are attempting to apply to ourselves now. As the years passed, a few Japanese companies failed, but the great mass in the middle painfully clawed their way back to solvency. Somehow or other, Japan absorbed the greatest deleveraging in human history without incurring a severe depression. I can only hope we do as well!

Although Japanese corporations were in much worse credit shape than ours are now, the reverse is true for consumers. Japanese individuals went into the 1989 event with a very high savings rate and very high accumulated savings. In contrast, our households go into our crunch borrowed to the hilt (or beyond) and painfully under-saved. So our job is to nurture our average people in the

street and somehow restore the quality of their balance sheets, just as Japan (admittedly taking 15 uncomfortable years) did for its corporations.

To finish this section on an optimistic note (my civic duty), it is worth remembering that real wealth lies not in debt but in educated people, laws, and work ethic, as well as in the quality and quantity of fixed assets and the effectiveness of corporate organization. We, like Japan, are not proposing to destroy any of these assets. We, like Japan, have just tripped on make-believe assets and we now have to deal with chronic deleveraging and bruised animal spirits. When we have dealt with this crisis, all of our assets will still be sitting around waiting to be fully used once again. It is helpful to consider that after the Depression, the U.S. GDP got back on its original trendline as if the Depression had never occurred.

Also remember that although your portfolio is down 40%, just as you own the same house, you still control the same number of shares and hence the same fraction of long-term wealth that you had before. You simply overestimated your wealth before, believing that the companies you owned had quickly become twice as valuable. With an individual stock, this is rarely the case; on a broad market level, it is never the case. The good news is that with the market at half price, you now have much more powerful dollars. For consumption purposes, a dollar is always a dollar. Investment dollars, in contrast, are weak dollars in badly over-priced markets but powerful dollars in cheap markets. Today, investment dollars are a whole lot more powerful than they used to be. (In fact, to encourage business, we will make a special January sale on our own investment management services: we will manage the same number of global equity shares as last year for 40% less! Hurry, hurry, limited supply!)

3. Obama and the Teflon Men

I am naturally a contrarian and a nitpicker, so I found myself becoming a Republican in the Clinton era and a real pinko in the Bush era. But after exulting in Obama's election, I couldn't even reach his inauguration before finding fault! As an environmentalist, I am delighted that he has surrounded himself with the very top talent. I, for one, find Hillary Clinton an exciting choice to head the State Department. But in the critical financial arena, he appears to have brought in Rubinesque retreads, "yes men," or both, none of whom appeared to have seen the most obvious developing bubbles in the history of finance.

One can only admire Bob Rubin's ability to retain influence and have his protégés in powerful positions. Rubin is the guy who was last seen exhorting Citibank to take more leverage and keep swinging. No, come to think of it, he was last seen paying a visit to Hank Paulson, his relatively recent underling at Goldman Sachs. He pleaded with his old chum, with brilliant success, for an unprecedented bailout. He was part of the establishment that failed to express early, loud concerns over slipping financial standards, and in fact helped to create an environment where prudence was a career risk and CEOs felt obliged to keep dancing.

His man Summers has proven he has some bite. Because he has written often for the *Financial Times* we at least know his public stance on matters financial. Well, let's put it this way: he runs no risk of being on any of the many lists of people who gave clear warnings of potential financial disaster. And dozens did. Summers was emphatically not a whistleblower. He did not rail against falling financial standards. What he did, with his allies Greenspan and Rubin, was beat back a heroic attempt in late 1998 by Brooksley Born, then boss of the CFTC in Chicago, to supervise OTC derivatives. They held her off, presumably in the Greenspanian spirit of "the less regulation, the better."

Obama appointed Gary Gensler to lead the CFTC. Gensler has a good reputation, but was hired into Treasury by ... you've guessed it ... Robert Rubin.

And as for Tim Geithner! The FOMC minutes are available, so at least we know what he added to Greenspan's and Bernanke's meetings. Over the Greenspan years, there were a few cautionary words from other members – a very, very few from a rather spineless group – and we know from the records how they were greeted. A typically precise response from Greenspan was: "So, this seems like a good time to break for coffee," or words to that effect. And we can study Geithner's objections to the Fed's long journey down the primrose path, but our study period will not be a long one, for he questioned nothing! He was, if anything, a cheerleader, and wrote in support of the new era of "Great Moderation." He, however, was not picked by Rubin. No, he was picked by Summers, who was picked by Rubin. These guys are very, very loyal!

Mary Schapiro, appointed to head the SEC, has been greeted with great enthusiasm by the financial industry precisely because she has been a great supporter of the

industry's financial well-being during her career, which has included positions at the SEC and the CFTC. She is seen as one who poses no threat by way of introducing nasty, inconvenient new regulations. Where is Brooksley Born when we need her? (In the interest of space, this anti-Schapiro section is brief. To help out, on January 15, there was a detailed criticism of her for being a softy in *The Wall Street Journal*, of all newspapers. Bush would have been proud to hire her!)

What a missed opportunity this all is. Obama was given a mandate that could have included some serious bottom kicking. We could have quickly taken quite a few steps down the long road leading to a credible financial system deserving of respect. The time to do that was now. Many readers will object that these are all bright – even very bright – people. And so they are. But our financial ship is not doing a passable imitation of sinking because of a lack of intelligence. What was lacking was the backbone to publicly resist the establishment's greedy joyride of risk-taking and sloppy standards. Even more important, perhaps, was the breadth of vision that was missing. There was plenty of intelligence, just not too much wisdom. So it would be very encouraging if there were someone included in Obama's appointments who had actually blown the whistle on the spiraling Ponzi scheme that our leveraged financial system had become (which is why the Madoff fiasco is such a fitting capstone to our troubles). If only there were someone with real toughness who could do unpopular things. Someone, say, like Volcker. Oh, wait a minute. Didn't he get a job? Or was that only a game to get obstreperous characters like me on board with the program? Unfortunately, I have a sneaking misgiving that Volcker was indeed window dressing for the Presidential campaign. Dollars to donuts he has not been pestered around the clock for advice so far. And I'll tell you one thing. You don't have to know him well to know that he'll resign within a year if they don't get serious. Since he is the only person on the team proven to have the right credentials – a preference for high standards of financial integrity and the backbone to push through unpopular but necessary actions – it would be a real shame to lose him entirely.

4. Disillusionment

The single word that probably best summarizes all of our feelings toward this last, truly miserable year is “disillusionment.” We have all been, I believe, serially shocked by the lack of competence and misguided philosophy of our top officials, who for years encouraged

rather than discouraged the bad tendencies in our financial system. We have been amazed at the third-rate job done by the leaders of our great financial firms, above all by their lack of moral fiber in restricting what could best be described as an orgy of moneymaking at any price. As stockholders, we also know we did little to put on the brakes; as individual clients and home buyers, we also did our bit to make it easy for greed to win out. We were willing gulls in an age of gullibility. Madoff has done historians a good turn by making it so clear that we were looking to make our 1.5% fees rather than looking to do hard analysis, and that collectively, even when we were suspicious, we were trying not to rock the boat. And, most significantly, our regulators were happy to leave no stone turned!

But it was worse than merely a decay of financial integrity. 2008 capped in incompetence what I am sure will be remembered as the most incompetent eight years of government in modern times, and a contender even if we include ancient times. Over an even longer period, as Paul Krugman would say, we tore up the social contract; through tax changes favoring the rich, we aided and abetted the strong global economic forces that already tended to concentrate wealth in the hands of the already rich. It was an uncharitable, unsympathetic, and avaricious era in which the cult of the individual trumped overall society, and the drive for wealth and the luxuries of life took precedence over more worthwhile and longer-lasting values. Most of our society got richer in the last 20 years, but there is not a hint of research that suggests we got happier, and plenty that suggests the reverse. In the process, we took some giant steps toward ruining the planet and had to live with the sight of many wealthy firms funding expensive PR programs that attempted to obscure the science and suggest that coal is clean and all is well. In short, we messed up on a very broad front, and last year was when it became impossible not to see it. If you ended the year without becoming disillusioned, you were not paying attention.

5. Small Arguments with Two Heroes

First, Warren Buffett. At about 950 on the S&P on October 16, he announced that he was a personal buyer of U.S. stocks because they were cheap and their prices reflected widespread fear. This is not typical for him, but he certainly did it in 1974. When he said it back then, every stock in our portfolio at Batterymarch yielded almost 10%! The portfolio P/E was below 7.5x. Even with hindsight, if you value the market in 1974 using our current methodology,

it was very much cheaper than it is today at 950, which is what we calculate as almost precisely fair value.

His recent announcement made the market seem so much more exciting than boring old fair value. So what are the possibilities? Was he performing a civic duty? Certainly, animal spirits are a critical component of any recovery, so encouragement to take risk from an authoritative source makes perfect sense. Does he believe that 1974-type cheapness can never return, or is very unlikely in this particular case? If that were the argument, we would disagree; we suspect that cheaper prices are not just possible but probable, although admittedly far from certain. Has he perhaps a tactical market timing model that produces his obvious excitement, despite these ordinary values? Most unlikely, given his style. Or are our numbers wrong? Perish the thought! In any case, it is all an interesting conundrum.

Second, Nassim Taleb and the Black Swan logic, which I have previously admired in public. Taleb is completely dismissive – in a way only he can be – of any near certainties. He implies that we have just suffered from an outlier event crashing up against standard risk modeling that only assumes that events will occur in an approximately normal way. He argues that modeling the 95% or 99% normal range in Value at Risk (VaR) misses the whole point: that the real game is played out in the final 1%. It's hard to disagree with this criticism of VaR, but is it relevant in this case? Was the recent breaking of our credit and asset bubbles a totally unpredictable outlier?

We believe that we live in a world where bubbles routinely form and where there are – in complete contrast to Nassim Taleb's belief – some near certainties. One is that bubbles will break. Bernanke should not have said, "U.S. house prices have never declined," thus implying that they never would. He should have said, "Never before has a three-sigma, 1 in 100, U.S. housing bubble occurred, and be advised that all such analogous bubbles in other asset classes and in housing in other countries have always burst." (Robert Shiller for the Fed! He would have said almost exactly that.) The bursting of the U.S. and U.K. housing bubbles, the profit margins, and the risk premium in global asset prices were all "near certainties." This was a White Swan, a particularly White Swan. Taleb's work will no doubt be correct when we have a genuine Black Swan, but this was most definitely not it. (Okay, Nassim. I can hear you thinking: this guy Grantham is a complete loser who has obviously missed my entire point.)

Recent Recommendations and Performance

Well, we got it about as right over the past few years as we're ever going to. "Avoid all risk." "Don't be too proud to own cash." "Let the other guys be brave." "Expect at least one major bank to fail (July 2007)." "Many financial companies will approach technical insolvency (January 2008)." Expect 50% of hedge funds to disappear and, after a lag, expect a major crisis in private equity where 2006 and 2007 investments should approach zero in value. More fundamentally, we called for persistent, below-estimate growth in economies, especially in China and the U.K. and, most particularly, we expected falling profit margins globally. These views were perhaps best captured in our belief that risk-taking was at the heart of the bubble, and that risk premiums were nearly certain to rise significantly. And, of course, house prices would fall and cause considerable trouble. If we had implemented as well as we got the big picture right, we would have had a year from heaven – at least from that part of heaven reserved for institutional managers: relative heaven. In fact, we did a mixed job in implementation: some very good, some bad, and some in-between but, all in all, we had a good year.

Re-introducing the Very First of Our 7-year Forecasts: Bullish Again!

For many years, we used a 10-year forecast for asset class returns. In January 2002, we made our first 7-year forecast, dated December 31, 2001. We moved from 10 to 7 years because research proved that it was closer to the average time for financial series to mean revert. The data is shown in Table 1.

As you can see, despite being called "perma bears," we overestimated the returns for global equities, except for emerging, where we were more or less spot on. Government debt – not surprisingly, given our crisis – also moderately outperformed our estimate.

Current Recommendations

Slowly and carefully invest your cash reserves into global equities, preferring high quality U.S. blue chips and emerging market equities. Imputed 7-year returns are moderately above normal and much above the average of the last 15 years. But be prepared for a decline to new lows this year or next, for that would be the most likely historical pattern, as markets love to overcorrect on the downside after major bubbles. 600 or below on the S&P 500 would be a more typical low than the 750 we reached for one day.

Table 1**The 7-Year Forecast from 7 Years Ago:
Bullish as Ever****Forecasts from December 31, 2001
vs. actual as of December 31, 2008**

Asset Class	Estimated Rank	GMO 7-Yr Forecast Dec-01 (% Real Return/Yr)	Actual 7-Yr Return*	Actual Rank
Emerging Mkt Equities	1	9.4	9.9	1
U.S. REITs	2	9.1	3.1	7
Emerging Cntry Debt	3	6.8	6.4	3
Int'l Small Cap	4	5.2	4.9	4
U.S. TIPS	5	3.5	3.9	5
Lehman Aggregate	6	2.9	3.8	6
Foreign Bonds	7	2.6	7.4	2
U.S. Small Cap	8	2.2	-0.5	10
EAFE	9	2.2	1.0	8
U.S. T-Bills	10	2.1	0.2	9
S&P 500	11	-1.0	-3.9	11

The accuracy of these forecasts does not guarantee that current or future predictions will be accurate either with respect to the ranking of those asset classes over a 7-year period, the absolute levels of real return, or results over shorter periods. The accuracy of forecasted rankings in the asset class forecasts generally varies from period to period.

* Actual real index returns are for 12/31/01 to 12/31/08 period.

Source: GMO

In fixed income, risk finally seems to be attractively priced, in that most risk spreads seem attractively wide. Long government bond rates, though, seem much too low. They reflect the short-term fears of economic weakness and the need for low short-term rates. We would be short long government bonds in appropriate accounts.

As for commodities, who knows? There were a few months where they looked like a high-confidence short, but now they are half-price or less, and are much lower-confidence bets.

In currencies, we know even less. It is easy to find currencies to dislike, and hard to find ones to like. There are no high-confidence bets, in our opinion.

For the long term, research should be directed into portfolios that would resist both inflationary problems and potential dollar weakness. These are the two serious problems that we may have to face as a consequence of flooding the global financial system with government bailouts and government debt.

Fearless Forecasts for the Long Term

Under the shock of massive deleveraging caused by the equally massive write-down of perceived global wealth, we expect the growth rate of GDP for the whole developed world to continue the slowing trend of the last 12 years as we outlined in April 2008. Since this recent shock overlaps with slowing population growth, it will soon be widely recognized that 2% real growth would be a realistic target for the G7, even after we recover from the current negative growth period. Emerging countries are, of course, a different story. They will probably recover more quickly, and will continue to grow at double (or better) the growth rate of developed countries. (See “The Emerging Emerging Bubble,” April 2008.)

**Footnote on the January Rule and
the Presidential Cycle**

In January 2008, I pointed out that the market had started the year with the worst five days ever recorded, and that the signal was “both impressive and bearish” in that down Januaries materially increase the probability of a down year. Well, that turned out to be a useful tidbit: “Worst-ever five days predict worst-ever year! Read all about it!” This year the five-day return was up a bit (saved by the last two hours), but the six-day return was down quite a bit. Ho hum.

The Presidential Cycle, as written about previously, has been completely ruined by Greenspan. He over-stimulated during the first two years, which are meant to be the time for tightening up, not only in 1997 and 1998, but also during this past cycle in 2005 and 2006. Both times this caused an extra-speculative surge in the typically stimulative Year 3s, in 1999 in the NASDAQ, and in 2007 in housing prices and ugly financial instruments. Both surges set off collapses during the critical election years, which are meant to be stable. In the coming Year 1 of the new cycle, we should be squeezing credit a little and tightening budgets so that we can re-stimulate in 2011 for the next election. What a joke! 2009 will be the greatest stimulus year ever, let alone in a normally restrictive year. So for the time being: Presidential Cycle – Rest In Peace!

Disclaimer: The views expressed are the views of Jeremy Grantham through the period ending January 21, 2009, and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security and should not be construed as such. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.

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Obama and the Teflon Men, and Other Short Stories. Part 2.

Jeremy Grantham

1. The Year of the Value Trap

Since time immemorial, the most successful value investors have been the bravest. The greatest advantage of value investing has always been that when your cheap stock goes down in price, it gets even cheaper and more attractive. This is the complete opposite of momentum stocks, which lose their momentum rating as they decline and hence become unattractive. But averaging down in value stocks can take lots of nerve and considerable ability in convincing anxious clients of the soundness of the strategy. For at least 60 years, those value investors who managed these problems and bought more of the stocks that had tumbled the most emerged with both the strongest performance and the most business success. (Of course, analytical skills also help, but let's assume that these skills were distributed evenly between brave and nervous investors.) Major market declines in the past set up the best opportunities for brave value managers: the 50% declines of 1972-74 and 2000-02. Value investors in 1972 and 2000 were also able to buy value stocks at their biggest discounts to the general market at least since 1945. In addition, averaging down in those value stocks that fell the most eventually added substantially to an already strong return. Those value managers with the best analytical skills within this group became the few handfuls of super-successful investors.

Outsiders could view this as a return to bravery, but it was also a return to risk. The cheapest price-to-book stocks are those deemed by the market to have the least desirable assets. And Mr. Market is not always a complete ass. Because these companies are so often obviously undesirable and are seen as such by clients, they represent a career or business risk to the manager who owns them. This career risk is usually reflected in an extra discount that will deliver an extra return for bearing the career risk. This "career risk" return is in addition to the discount for buying lower quality companies with more fundamental risk. Problems arise when this pattern

of over-discounting and handsome recovery has taken place dependably for several cycles in a row. It begins to look like the natural, even inevitable, nature of things rather than merely the most usual outcome. The growth in the number of quantitative investors exaggerated this tendency because quants model the last 10 or 20 years (or even 40) without really requiring a full understanding of the very long-term pattern and why it behaves the way that it does. And none of us modeled data that included the last great value trap: the Great Crash of 1929.

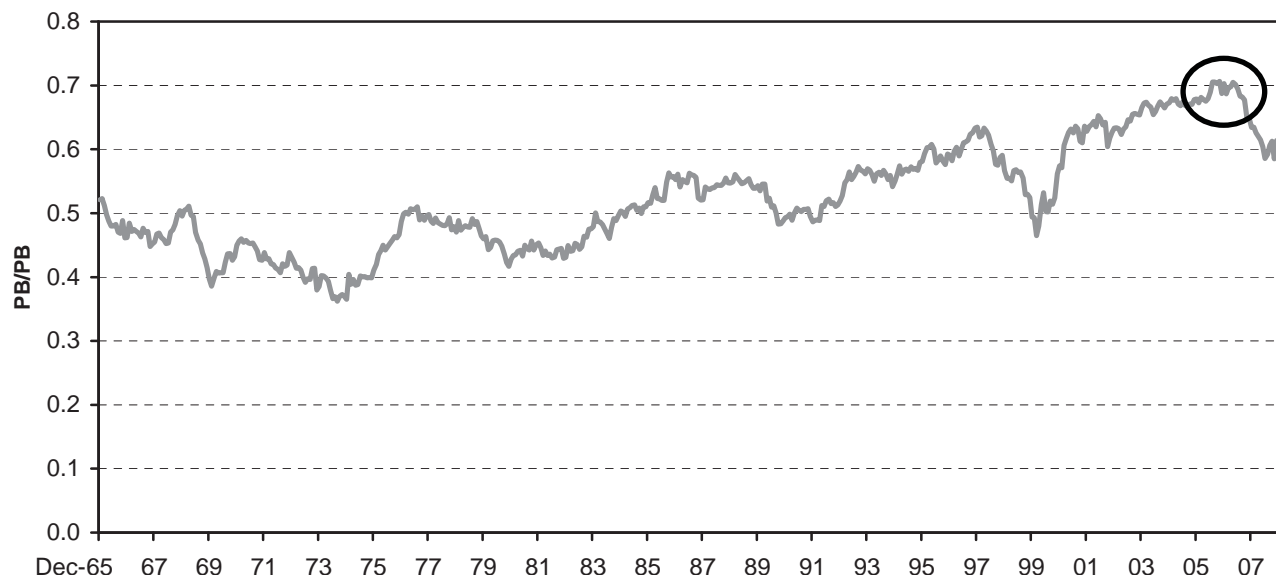
In mild economic setbacks, even the wounded value stocks recover fully. In substantial setbacks, a very small number fail, but not nearly enough to offset the large discounts. Only in the really severe economic setbacks do enough casualties occur to bring home a truth: price-to-book (P/B) and price-to-earnings (P/E) are risk factors. Buying them and averaging down routinely has an element of picking up not nickels in front of the steamroller – that would belittle the substantial returns – but, say, \$1000 bills in front of the steamroller. Because of the extra discounts for career risk in the long run (at least for those who are not dead), the strategy will probably still pay off even if the rare, severe fundamental crises are included. But investors should be aware that the fundamental part of the risk premium is justified by the pain of these outlier events and is absolutely not a free lunch.

The value problems of the last two years were particularly bad because of the outperformance that value stocks had between 2002 and 2007. They won for five years in a row, so that by mid 2007 the value/growth spread was about as unfavorable as possible for value stocks in the U.S. (see Exhibit 1). (We recognize that some value investors disagreed with this data when it was first presented. We were, and still are, puzzled by how they arrived at their more positive conclusion.)

To put a measure on how awful the value trap was during this time, please see the Fall 2007 edition of

Exhibit 1

Price to Book – Cheapest Quartile vs. Expensive Quartile



Source: GMO As of 1/31/09

the *Outstanding Investor Digest*. This publication concentrates on a dozen or so of the top value investors and is readable, interesting, and chock-full of insight. However, that particular issue is a heartbreaker as one after another of these superior investors put forward the case that – down 30% to 50% – AIG, Lehman, Wachovia, Fannie Mae, etc., were ridiculously underpriced, and represented enormous long-term franchise value that the nervous market was missing.

It has long been my view that the pricing of value stocks has a folk memory of the Great Depression when many cheap companies went bust and the expensive Coca-Colas survived the best. Remember, you cannot regress from bankruptcy. Using proprietary research data, we examined one fixed time slot: October 1929 to June 1932. With no rebalancing, the data showed a massive “value” wipeout in which high P/E stocks declined far less than low P/E stocks.

As we have pointed out before, one thing is certainly true: on fundamental measures of risk – level of profitability, volatility of profitability, and debt levels – stocks with low P/B and P/E ratios have much lower “quality” and should be expected to be hurt badly in a very serious economic setback such as the one we are now experiencing. And so it was that many of the very best investors had their very worst year in 2008, and were exceedingly happy to see the back of it. Whether 2009 will see a snapback for value is an important question, and not one that we can

answer clearly. On the one hand, value stocks are now at least much cheaper on a relative basis than they were a year ago. On the other hand, they can get a lot cheaper, and they face the worst economy since 1938. I would give them at best a 50/50 bet this year. (“Thank you very much for such useful advice!”)

2. GMO’s Central Skill Set and Loss of Near Certainties

That last point leads neatly into one of my principal regrets: in recent years we have been spoiled by the market in that we were presented with investment opportunities that seemed to us to be near certainties, which we define as probabilities over 0.9. Our principal skill has been to study major upside outliers or bubbles in all financial series, trying to understand and recognize their patterns. That’s it. Not a profound exercise. In fact, my hero Keynes was quite disrespectful of this exercise. You are probably familiar with his famous quote from 1923, “But this long run is a misleading guide to current affairs. In the long run we are all dead.” What you may be unaware of is how it continues: “Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again.” Presumably, he would have been equally contemptuous of the reverse: the prediction that after a long calm, you had better be prepared for another storm sooner or later. I believe it is a rare example of Keynes simply being wrong in both cases. Ironically, for

someone who 13 years later wrote the Bible on career risk (Chapter 12 of his General Theory), his error in 1923 was because he underestimated the career and business pressure to keep dancing. In real life, Mr. Market usually acts as if the calm will go on forever, even though he presumably knows it cannot. It's so deliciously profitable until it isn't. And even when the music stops, you can still be considered a "prudent man" – you will have failed, with lots of company, in the traditional way. It turns out that shouting warnings about impending storms after a long calm is a very unpopular pursuit. Even being bullish when everyone else is finally bearish – i.e., predicting a calm after the storm – is not free of career risk.

Well, dear Keynes, that is what we do at GMO. We are specialists in warning of eventual storms after calms, and of calms after storms. In the last 10 years we have benefited from the opportunities offered by a world-record number of extreme storms and outliers, and in September 2007 I was able to warn of three bubbles in one sitting.¹ All of them were world records, and all were "near certainties" to break: extremely high U.S. house prices, extraordinarily high global profit margins, and the lowest risk premiums ever recorded! By then, we had already addressed the extraordinary bubble in U.K. house prices, and soon afterwards we hit the mother lode: a warning of a bubble in all asset prices everywhere. Talk about pigs in mud!

Now, regrettably in some ways, the outliers and near certainties are ending. It is still nearly certain that global profit margins will decline a lot further. But it is no longer certain that this belief is not reflected fully in stock prices. It is merely likely that it is not, and that stock prices will therefore decline to new lows. Perhaps the odds are 2 to 1, which is a very good bet, but far from the rare 9 to 1 odds of a near certainty. Similarly, U.S. house prices are very likely to decline their last 5% to trendline and, since it was an extreme bubble, to overrun by, say, another 10%. But, again, this is at best a 2 to 1 bet. Yes, a bet that U.K. house prices will continue to decline is a lay-up, but it has always been hard to play. Its main effect now will be to impose a lot more pain on a system already so weakened that it makes it very likely that more bailouts or the nationalization of U.K. financial companies will continue. Weakness in the pound was my favorite near certainty in the U.K., but that was at over \$2 to the pound. It is now at under \$1.50 and, like the other

bets, this one has also become a low-confidence bet, although one I personally still hold half of, principally out of consideration for future housing weakness. And the same goes for the yen. It was fundamentally cheap and, as the reverse of the popular and risky carry trade, it was a simple and powerful way of playing the movement against an ultra-low risk premium. It worked better than one could have hoped. But now, after a magnificent move, it is a low-confidence bet where I timidly cling to one-quarter of my original position, since I still believe there are a few more shoes left to drop in the anti-risk move. But there may not be many more.

The bets that global economic weakness was underappreciated – especially in China and the U.K. – were also near certainties, but, here again, perceptions have changed so fast that these are ordinary, decent bets now. This goes for economic policy as well. I was completely confident that "they," our noble leaders, were completely missing the point before. Now I'm not so sure. Yes, I disapprove of the swallow-the-whistle retreads in Obama's financial lineup, but these are brilliant (or, at the very least, very bright) people who know now that things are extreme. They may rise to the occasion. Their potential ineptitude is by no means a near certainty. Thank heaven! So, all in all, the wonderful world of "near certainties" has come to an end, and a pity it is for those in the prediction business.

3. On Exiting a World of Bubbles and Entering a World of Busts

Economic wipeouts and severe market over-corrections, should they arrive, are second best for us. It is true that they are outliers, but busts are not so dependable as bubbles. In contrast to Greenspan's reluctance and vacillation in recognizing bubbles and Bernanke's dismissal of their existence, bubbles do, of course, exist. More to the point, they always, always break, and their breaking is the most dangerous situation the Fed – or the whole economy, for that matter – ever faces. Similarly, strong economies and heroic profit margins always weaken. In crunches, you must lower the odds of regression back to normal to "nearly always." On rare occasions, you can stay down for the duration. If, like Zimbabwe, you really want to take your country back to the Stone Age, you can probably do it. (Thank goodness for term limits in the U.S.) Argentina, the fourth richest country in 1945, has taken its very best shot at resisting the tendency to revert back upward to normal, and is still trying hard. If you

¹ Danger: Steep Drop Ahead, *Fortune*, September 17, 2007.

are in a bubble, then competition in one form or another is guaranteed to chip away at exceptional opportunities, or confidence will suddenly break, or both. In a crunch, in contrast, no one will reliably come to your rescue or help you recover. You're on your own, and can continue to make mistakes, which we in the U.S. may very well do this time.

We at GMO have another problem: almost all of our work has been aimed at the study of bubbles or upside outlier events. Until eight minutes ago, the study of a real bust seemed, in comparison, academic. Now, however, we have thrown ourselves into studying the reverse. This very morning – true story – I unpacked The Panic of 1819, a new book by Murray Rothbard. As I write this at our large and untidy breakfast table, I can see the recently read The Forgotten Man by Amity Shlaes. It is a book about the plight of working men and FDR's erratic experiments with stimulus programs in the Great Depression. At GMO, we are now in full-court press mode, studying the patterns of economic and market lows and looking for predictive clues (with luck, see next quarter's Letter). But this is a relatively new effort after spending 12 years studying bubbles. Ah, well. Of course, this is all written assuming that we are indeed heading to extremes of undervaluation. It could be much worse: we could get stuck in a no man's land where stocks are around fair price and all certainties disappear. Please not.

4. On Accepting Blame and Ethics in General

I think it would be cathartic if all professional investors confessed to making a few mistakes. Lord knows, it has become a lost art. By degrees over recent years, we have become a culture that apparently never makes mistakes, or certainly never admits to them. Almost none of the CEOs who brought companies to their knees – or graves – accepted blame clearly and emphatically. Honchos at Lehman and Bear Stearns were victims, it seems, rather than incompetents. Hundreds of billions of stockholders' money was obliterated without clear apologies. Government agencies that nearly ruined us all have also admitted no mistakes. Greenspan only apologized for other peoples' shortcomings – he failed to realize how bankers would be so greedy in the short term and bereft of rigor and analysis. Really! More recently it is claimed that no one – neither the Fed nor the Treasury – had the legal authority to save Lehman. But such excuses were given only after it appeared to have been a disastrous decision. The last two years were very difficult

for everyone. In difficult times, people make mistakes. Why don't they say so? As a typical, if painful, example, I followed Paul Bremer (a classmate, no less!) to the podium at a pension conference. He had just returned from his catastrophic series of miscalculations in Iraq. All decisions had been the best that a difficult situation had permitted, he argued, with a tone that implied that anyone suggesting otherwise should be locked up. This was indeed the tone that characterized the whole last eight years of government. Are the Japanese the only people left with a code of honor? When you make mistakes, or even when the people you are responsible for make serious mistakes, you should surely admit it, at least once in a while. In cases of extreme error, of which we have just had an unprecedented number, someone might even offer to resign. Not a prayer. As a postscript, hot off the press (courtesy of Maureen Dowd in *The New York Times*) comes a shocking admission of guilt from former Vice President Dick Cheney on CBS Radio: "I think we made good decisions. I think we knew what we were doing." Dowd also reports that Rumsfeld said, "My conscience is clear." Surely anyone saying that doesn't have one! In terms of admitting no errors and denying all responsibilities, the Bush administration is certainly going out with a bang.

If this section is to be credible, I must do some confessing. Rats! Well here goes: I was not always effective in capturing, through implementation, the full benefits of top-down insights. The same could be said for our asset allocation group, to which I belong. With the benefit of hindsight, we as a firm took too much liquidity risk in one or two strategies, and tilted toward too much risk in others. Even those insights we got right, we could have played harder. I regret all of these shortcomings, and believe that we can do better. I and GMO promise that we will strive to be more effective help next time.

This has also been the very lowest point for ethical standards within the financial industry. Rather than go on at length, allow me to single out one issue: the fees charged by managers, including large and previously reputable European banks, who shoveled off clients' money to Bernard Madoff. Their legal documents are no doubt impeccable and make it clear they cannot be held liable for anything, including outright fraud. Of course, we must then ask what the 1.5% fee plus performance incentives were for, since they were not actually managing a dollar of the money. But that is not the point. Reflecting

high ethical standards, they should return all of the money for doing so shoddy a job. With even the merest hint of ethical standards, they should at least return their fees. Certain European private banks, for example, charged a substantial fee for investing their clients' money with Fairfield Greenwich Group, who, in turn, charged a lot to invest with Madoff, who actually did the "work!" At least Madoff had the decency to waive his fee. Settling for the principal was enough. You could call this a fund of funds of funds of Ponzi. Even if there had been a real investment at the end of the pipeline, this would have been iniquitous.

5. 7-Year Forecast and GMO's Current Strategy

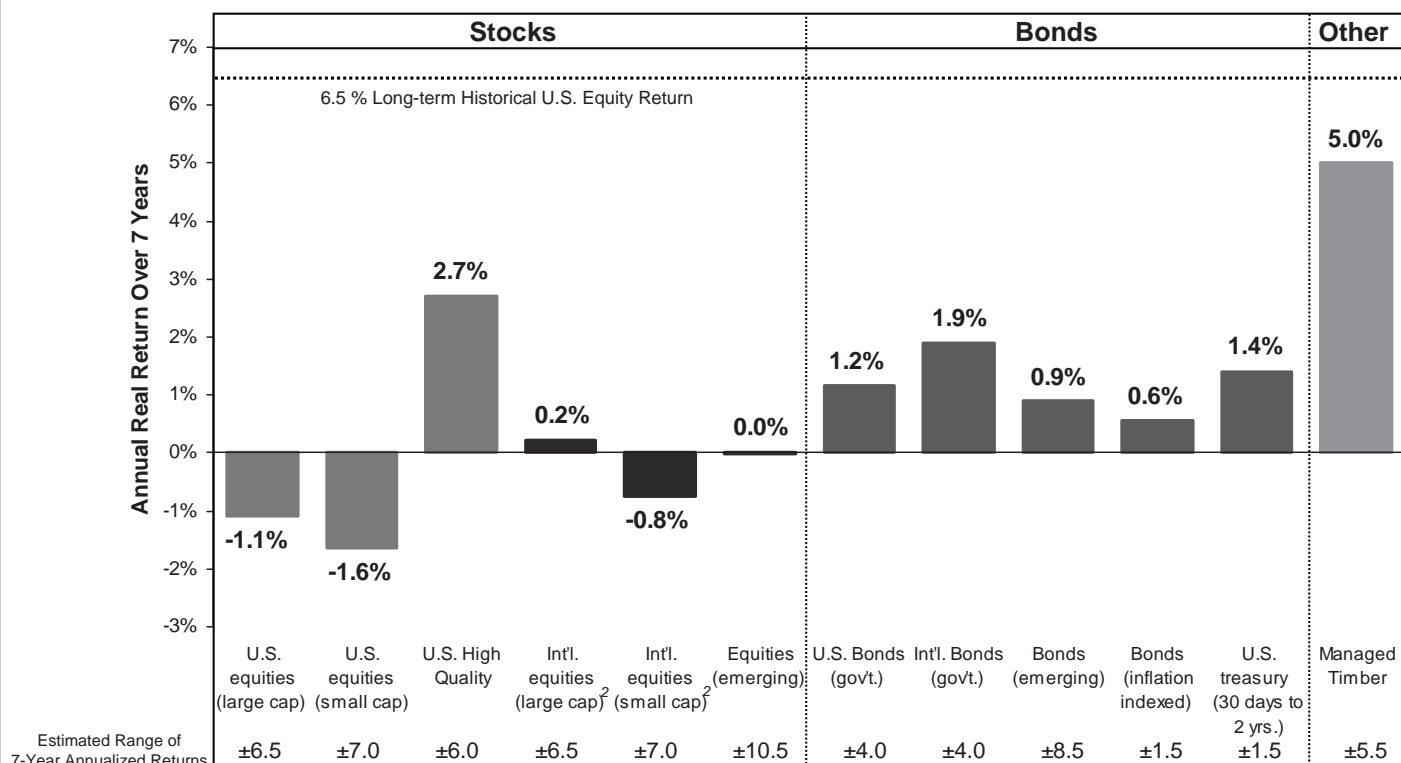
Our 7-year forecast as of December 31 is a very far cry from that of a year ago. Exhibit 2 shows what a dismal forecast we had for everything on December 31, 2007. Today all equities are moderately – one might say, boringly – cheap. The forecast for the S&P has been jumping around +6% to +7% real, with other global equities slightly higher. To put that in perspective, a

1-year forecast done on the same basis we use today that started in December 1974 would have predicted a 14% return (which, by the way, it did not deliver since the market stayed so cheap). For August 1982, the forecast would have been shockingly high – over 20% real! So do not think for a second that this is as low as markets can get. Now, I admit that Greenspan and 9/11 tax cuts caused the "greatest sucker rally in history" from 2002-07. We therefore cannot rule out another aberrant phase in which extreme stimulus causes the market to rally once again to an overpriced level for a few more years, thus postponing the opportunity to make excellent long-term investments yet again. But I think it's unlikely.

GMO has attempted to tiptoe through the land mines in asset allocation and to minimize regrets as described last quarter, caught between the potential regret of missing decent investment opportunities, and the potential regret of investing too much too soon and then watching our tactical 2 to 1 guess of a new low come true. In October, our Global Balanced Asset Allocation Strategy was at 39.8% in global equities, well below our 45% target

Exhibit 2

GMO 7-Year Asset Class Return Forecasts* as of December 31, 2007



*The chart represents real return forecasts¹ for several asset classes. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Actual results may differ materially from the forecasts above.

¹ Long-term inflation assumption: 2.5% per year.

² Return forecasts for international equities are ex-Japan.

Source: GMO

minimum (itself lowered from 50% in the previous year with clients' consent). We are now at 55% against a 65% norm and a 75% maximum equity position. If the market stays moderately below fair value, our current intention is to move "creeping like snail" toward a neutral 65% by late summer. If prices pull ahead of fair value, we will freeze and stay underweight. If prices plummet to new lows, we will invest more rapidly according to a prepared schedule, e.g., at 600 on the S&P, invest in another several percentage points of equities, etc. This plan minimizes our potential regrets and leaves us feeling as little discomfort as possible, given the strange world in which we now live.

6. GMO and Big Bets

Dick Mayo and I bet on small caps and hard-core value in the Nifty Fifty blue chip market of 1972. Being young and rash, and having a senior partner – Dean LeBaron – who admired flash, we put 100% of our money into small cap value before either small or value existed as sub categories. We were measured against the S&P, which made for a bumpy, but eventually very successful, ride.

We took that philosophy with us to GMO and refined it, with one refinement being to add a little more moderation, but not too much. In 1987, for example, in EAFE accounts (where we were one of the earliest players) we went to zero in Japan against a Japan weight in the EAFE benchmark that rose to 65%! More recently, for the last 10 years we had a handsome overweight in emerging equities and a minimum weight in U.S. equities, reflecting our 10-year-ago forecasts of +10.9% real for emerging and -1.1% real for the S&P. (This 12.0% difference for 10 years would have compounded so that every \$1.00 in the S&P would be matched by \$3.10 in emerging. This gives you some idea of the degree of aggressiveness in the forecast. And 10 years later, on October 1, 2008, there was \$3.20 in emerging for every \$1.00 in U.S. equities. Ta da!) But our biggest bet recently has been on quality stocks in the U.S. – a bet on the great franchise companies. Our U.S. Quality Strategy became more than 90% of our U.S. equity money in our Global Balanced Asset Allocation Strategy. And 50% of the quality stream was injected into our venerable U.S. Core Strategy. This was the first important override of our U.S. quant model in its 29-year history! We used to call the Japanese underweight a once-in-a-lifetime override. It was done – of course – three years too soon, and cost us 10% a year against a dramatically rising EAFE market. It then gained us almost 20% a year as Japan crashed. At the

end, we had added over 4% a year and lowered the real absolute volatility as opposed to the benchmark volatility. Our timing of injecting quality into U.S. Core was better than the timing of the Japan bet as we won last year by 11 percentage points on a divided basis. (This is the number that determines your compound advantage: for example, a 10-point gain in a year when the market doubles is worth only 5% compounded, and a 10-point gain in a market that halves is worth 20%. I wish there were a convenient, accepted terminology for this.) The bet on quality was perhaps U.S. Core's once-in-a-lifetime override.

Perhaps the biggest and most painful bets in GMO's career, though, were against the 2000 Growth Bubble. In asset allocation, we had the allowed minimum percentage (50%) in global equities, and within that 50% minimum, we had a minimum exposure to U.S. equity. Further, within that minimum U.S. position, we had the minimum exposure to growth stocks and large caps. And, as we've been bragging recently, some of our long-term forecasts were bizarrely accurate. Yet in the short term – two-and-a-half painful years – we delivered low double-digit returns in a high double-digit world, and lost the quickest 60% of our book of asset allocation business on record!

In early 2006, I was asked at a Boston Security Analysts Society forum what the secret was to our rapid growth of assets then (*sic transit gloria*). I replied that it was the easiest question of the evening, and added, "We are simply willing to lose more business than the other guys." By this I meant that we are extremely attached to the idea that we make very big bets on those relatively rare occasions when we have very high confidence. I believe that career and business risk – the fear of losing clients – dominate our business, and it is so hard to sidestep that the big bets will always be available and will always be career threatening. And that is the turf we have staked out: make the "near certain" bets as large as we can, sweat out the timing problems, and pray for patient clients.

7. On the Joys of Buy and Hold

Jeremy Siegel and I have had several debates, and he has always been the bull. In late 1999, he was nervous about Internet stocks and a few tech stocks, but felt that the S&P would muddle through with an about-normal return. In his honor, I have always named two of our exhibits "Stocks for the very, very long-term." In the first exhibit, which we've used before, we show that buying at both the peak of 1929 and the peak of 1965 would have sentenced investors to identical 19-year periods of

waiting to get their investment back in real terms, with precisely zero positive return. Two 19-year periods in only the last 80 years, in a country that was spared the worst of global misfortunes! The second exhibit shows a 26-year round trip in Japan from 1982 until today that made no gain, and a 19-year period in Japan from 1989 until today that cost the investors 78% of their money! Now patience is a virtue, but this is ridiculous! Heavy buy-and-hold equity positions are fine for long-lived computers, but for impatient humans – given as we are to waves of overconfidence and abject fear – they are simply dangerous and unsuitable.

The buying and holding of a fixed portfolio mix with annual rebalancing is okay, I suppose, for individuals who are intimidated by making changes. And even for these individuals we had better hope that they don't panic and abandon stocks completely when all risky assets fall together as they did recently. But for institutions with access to professional advice and with long investment horizons, surely a fixed mix is aiming too low. If the last 15 years has taught us anything, hasn't it taught us that asset classes can be incredibly mispriced, along the lines of the 35 times inflated earnings for the S&P in 2000? Why would you ignore these opportunities to sidestep trouble? It is surely sensible to be fairly static when pricing is normal or even halfway normal, but when very large mispricings occur, should we not reasonably move away from extremely overpriced assets toward more attractive ones? Markets are very mean-reverting over longer horizons, and sophisticated clients always proclaim their patience. Asset allocation based on serious action at the extremes and inactivity the rest of the time has a good

record and can be done quite simply. Let me give you an example of the power of asset allocation that is very close to home: GMO has a solid implementation edge in our broad range of equity funds and in emerging debt, which has equity-like features. Our average equal-weighted alpha for all equity funds is around 2.0% per year, after all costs, and cap-weighted is somewhat higher. This is one of the best records for a broad range of funds. Yet, despite our very decent implementation edge, in our 16-year-old Global Balanced Asset Allocation Strategy, over 80% of the total outperformance of the benchmark and over 60% of the reduction in volatility has come from moving the mix of assets, rather than from our implementation. (For the record, the total is about +2.9% a year over the benchmark, with a 22% reduction in volatility for an efficiency rating – return compared to volatility, or Sharpe Ratio – that is 3.5 times the benchmark, or .49 compared to .14). Asset allocation is simply much easier than adding alpha to a fund, since there is more to sink your teeth into. Counter-intuitively, asset classes are more inefficiently priced than stocks. There is a large and relatively efficient arbitrage between stocks, and the career risk of picking one stock versus another is quite modest. In contrast, when picking one asset class against another, it is painfully clear when mistakes have been made. This immense career risk makes it likely that there will always be great inefficiencies, for investors are reluctant to move money across asset boundaries. Consequently, there is great advantage to be had in getting out of the way of the freight train, rather than attempting to prove your discipline by facing it down. The advantage is in both higher return and lower risk.

Disclaimer: The views expressed are the views of Jeremy Grantham through the period ending February 11, 2009, and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security and should not be construed as such. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.

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