Chanticleer

Why Jeremy Grantham is worried about markets and housing

Notorious bear Jeremy Grantham worries several highly speculative pockets of the market have already peaked and the 'pessimism termites' could eat away at broader confidence.

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For Jeremy Grantham, the co-founder of global fund manager GMO and arguably the world's most famous bear, the past year has been very different.

During what he admits has been an "overprivileged existence", Grantham has been able to spend more time communing with nature, reading, researching and relaxing.

"I was reduced to worrying about rather small things like amortising my tie supply. If I could wear three at a time, I would," he joked during a video interview at the

Morningstar Investment Conference on Wednesday.

Jeremy Grantham says the SPAC sector and tech stocks may have peaked. **James Davies**

But as the world emerges from the pandemic, the bear is coming out of hibernation. And he doesn't like what he sees in the market.

Grantham says historical lessons from past calamities – the crash of 1929, the dotcom bubble, the global financial crisis and Japan's lost decades – has left him with a simple message: "The higher you go, the longer and greater the fall."

His concern covers a broad sweep of asset classes.

Bond markets have never been this high "in the history of man". Property is "suddenly pretty bubbly in almost every market in the world". Equities are overpriced across the developed world but "heroically overpriced" in the US.

It won't take bad news to bring this down, it will take a slightly less optimistic outlook than we had last week.

— Jeremy Grantham

This world of rising asset prices might look fantastic, but it really only benefits retirees who are able to sell their assets. For everyone else, Grantham says this is a "fairly miserable world" where it will take twice as much money to buy the same house their parents built and twice as much to build a portfolio of assets.

He sees financial markets as akin to a ping-pong ball sitting atop a jet of water.

"We've turned the pressure up and up – more money, more moral hazard – and here we are at the peak."

But Grantham isn't looking for a big event or a big change in policy to send markets into reverse – a rise in interest rates that set off a taper tantrum, for example, or some sort of black or grey swan event.

"It won't take bad news to bring this down," he says. "It will take a slightly less optimistic outlook than we had last week."

The pessimism termites

He argues the history of sharemarkets suggests that what happens first is the most speculative assets start to fall and then "pessimism termites" slowly but surely start to eat away at the rest of the market.

In 1929,for example, high-beta stocks started falling long before the crash and were down year-to-date when markets tumbled. Similarly, high-beta stocks lost altitude well before the Nifty 50 crash of 1982.

Leading up to the dotcom crash, tech stocks had fallen 30 per cent but the rest of the S&P 500 increased, until eventually the "pessimism termites finally got the balance of the market".

Could a similar pattern be emerging now? Grantham thinks so, and argues what he calls the "super crazies" of financial markets are starting to roll over.

Investors in the electrification theme in general, and in Tesla in particular, have been hit over the last few months, with the car company's shares down 30 per cent since their peak in January.

Signs speculative markets have already peaked

The air has well and truly come out of the special purpose acquisition company bubble too, he says. The index of SPAC stocks is down 30 per cent since January, and nine of the last 10 SPACS to list are trading below their $US10 issue price.

Indeed, Grantham has had a close-up view of the SPAC fall. His personal foundation invested in a battery maker called QuantumScape that listed via a SPAC. Its stock peaked at $US132 in December, but is now trading at $US27.

"I found myself in the paradoxical position of warning people against SPACs, but the venture company we bought 10 years ago turned into a SPAC," he says.

The Nasdaq, Grantham says, likely peaked in February. While it is only down 2.5 per cent since then, this compares to a 6.8 per cent rise in the S&P 500.

“Super SPACs peaked in January, the Nasdaq peaked in February. Maybe in a few months the termites will get to the rest of the market,” Grantham says.

High house prices will eventually have to revert to mean too, he says, saying that the unproductive nature of housing makes it impossible to keep paying ever-higher amounts for what are essentially the same assets.

The lessons of Japan’s long property winter – land prices are still not back to where they were at the peak of Japan’s property frenzy in 1989 – and the US housing crash of 2009 still rings true.

“Eventually there will be a day of reckoning. The higher the multiple of family income the bigger the pain is likely to be, based on Japan and based on the US,” Grantham says.

Why lower asset prices may not be bad

He says lower asset prices are not necessarily a bad thing for investors in the long term.

“That’s how it works. You can have a high-priced asset or a high-yielding asset, but you can’t have both. I’d welcome lower asset prices, which I am confident will come.”

But adjustment will be painful and ugly. Grantham says asset prices would only need to fall halfway towards historical levels to set off “a major bear market”.

Maybe. The problem with a permabear like Grantham is that he always seems to be warning that some sort of calamity is just around the corner.

And while he got close to calling the peak of the bull market in 2008, many would say his best call was probably the bottom of the bear market in 2009 and the start of this everlasting bull market we're still in.

Further, as Grantham confessed on Wednesday, as a value investor, GMO is coming off a very tough 11 years, with 2020 the worst of the lot.

But it's notable that the fund is starting to get its groove back, with Grantham reporting his biggest funds are delivering top-quartile performance as growth fades and value regains primacy.

The value of an investor like Grantham comes from his ability to think in a long-term way, to step back from the weekly, monthly and quarterly movements in markets to mull long-term trends.

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He's been banging on for 15 years, for example, about the dangers presented by climate change. He warned in 2011 that commodity prices would stop declining as they've done for 100 years and start rising, as increased demand met scarcity of supply – a trend arguably playing out now in some commodities.

On Wednesday he added another big-picture worry to the list: toxicity from plastics and pesticides and the potential damage they have done to the world.

He's been closely watching sperm counts across the world, which he says are down 30 per cent in his lifetime; where few couples once had troubling conceiving, now 15 per cent of couples struggle, and the number is growing.

He expects more lawsuits against pesticide and plastics makers over the coming years, and greater awareness on the issue. "This is a completely underestimated shock that will play out over the next 10 or 20 years."

Is Grantham's bear market coming in a few months? Who knows – the power of cheap money from central banks has proved very impressive so far.

But even the biggest bull is a better investor for understanding how the biggest bear is thinking about the coming decade.

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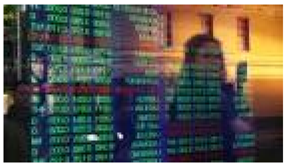

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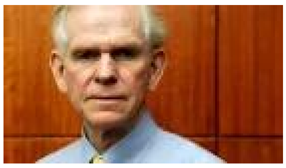

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