

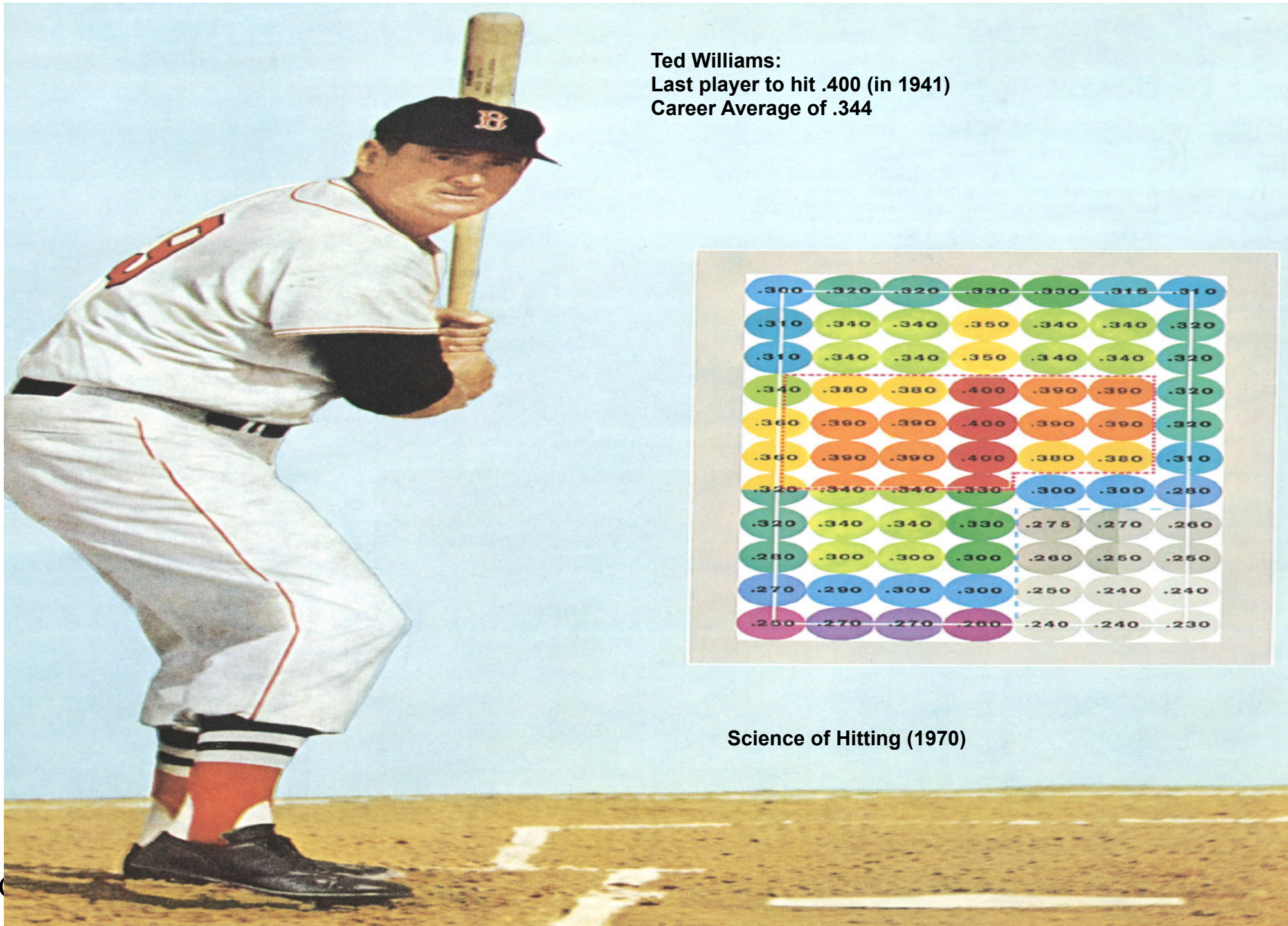
# GMO

North America | Europe | Asia-Pacific

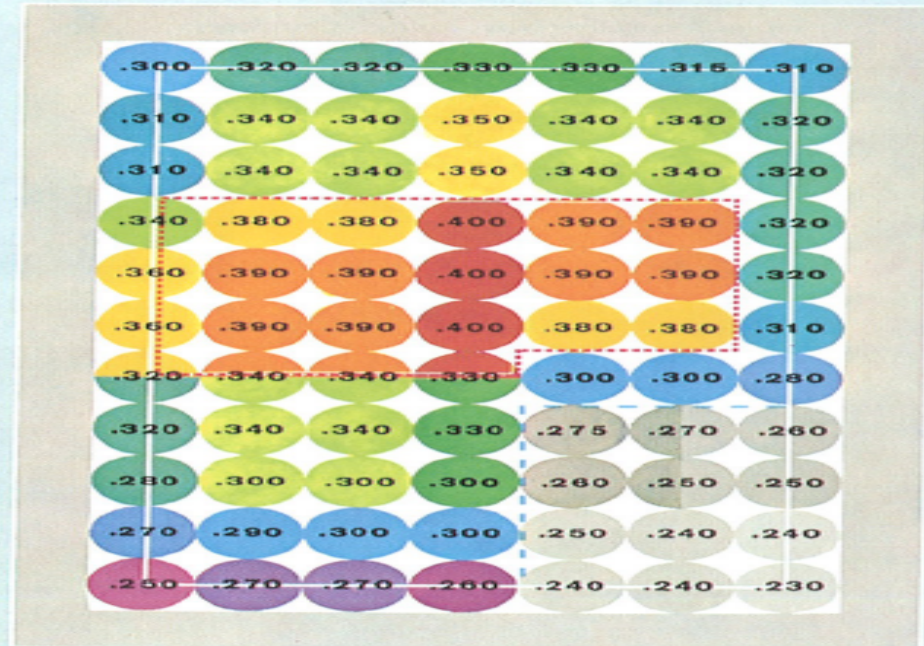
## **Waiting for the fat pitch, or, The Joy of Cash**

James Montier

February 2011



**Ted Williams:**  
Last player to hit .400 (in 1941)  
Career Average of .344



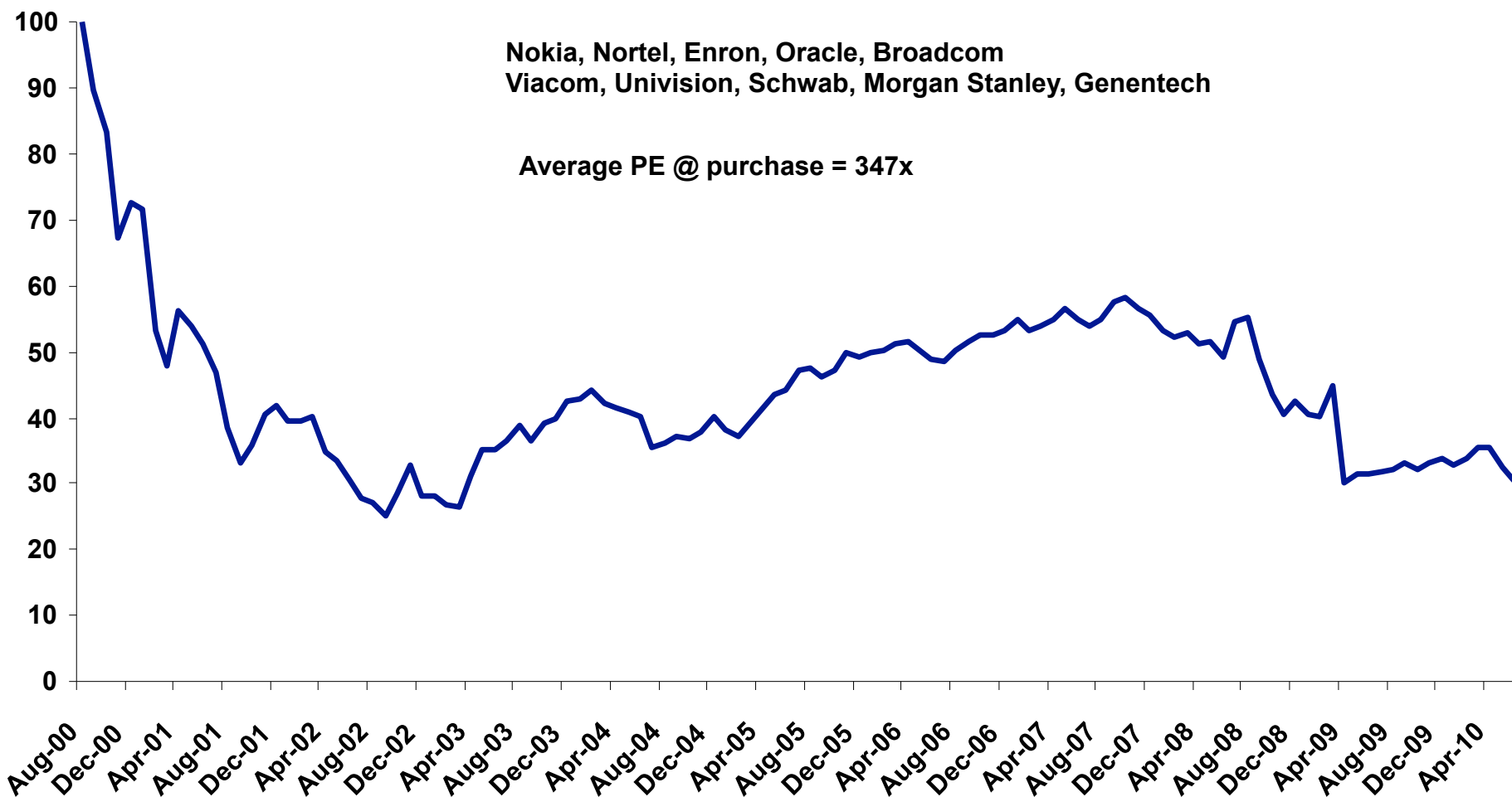
**Science of Hitting (1970)**

# The 7 Immutable Laws Of Investing

---

1. Always insist on a margin of safety
2. This time is never different
3. Be patient and wait for the fat pitch
4. Be contrarian
5. Risk is the permanent loss of capital, never a number
6. Be leery of leverage
7. Never invest in something you don't understand

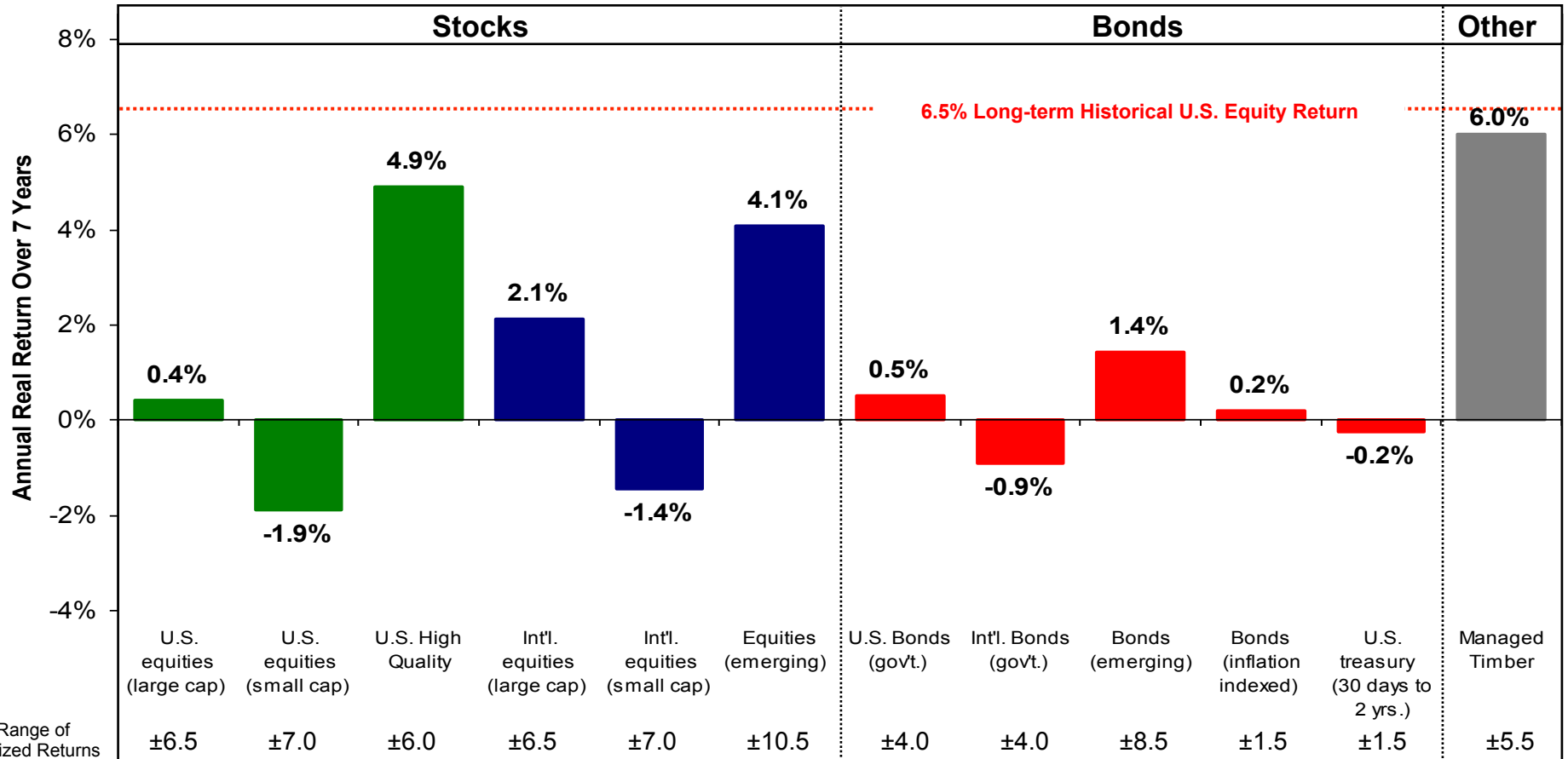
# Fortune's 10 To Last The Decade – 2000 - 2010



The securities identified above represent a selection of securities identified by GMO and are for informational purposes only. These specific securities are selected for presentation by GMO based on their underlying characteristics and are not selected solely on the basis of their investment performance. These securities are not necessarily representative of the securities purchased, sold or recommended for advisory clients, and it should not be assumed that the investment in the securities identified will be profitable.

# GMO 7-Year Asset Class Return Forecasts\*

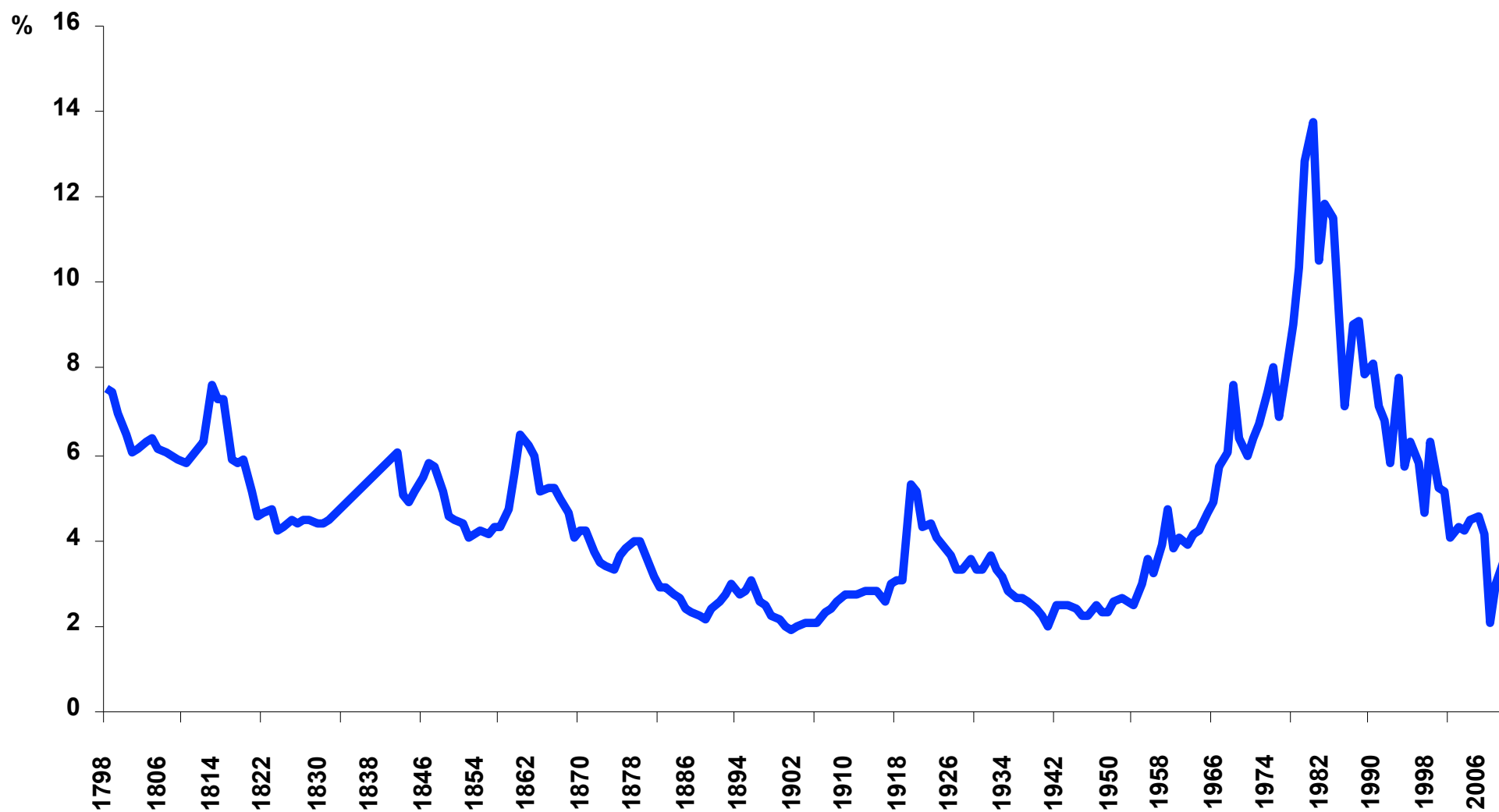
As of December 31, 2010



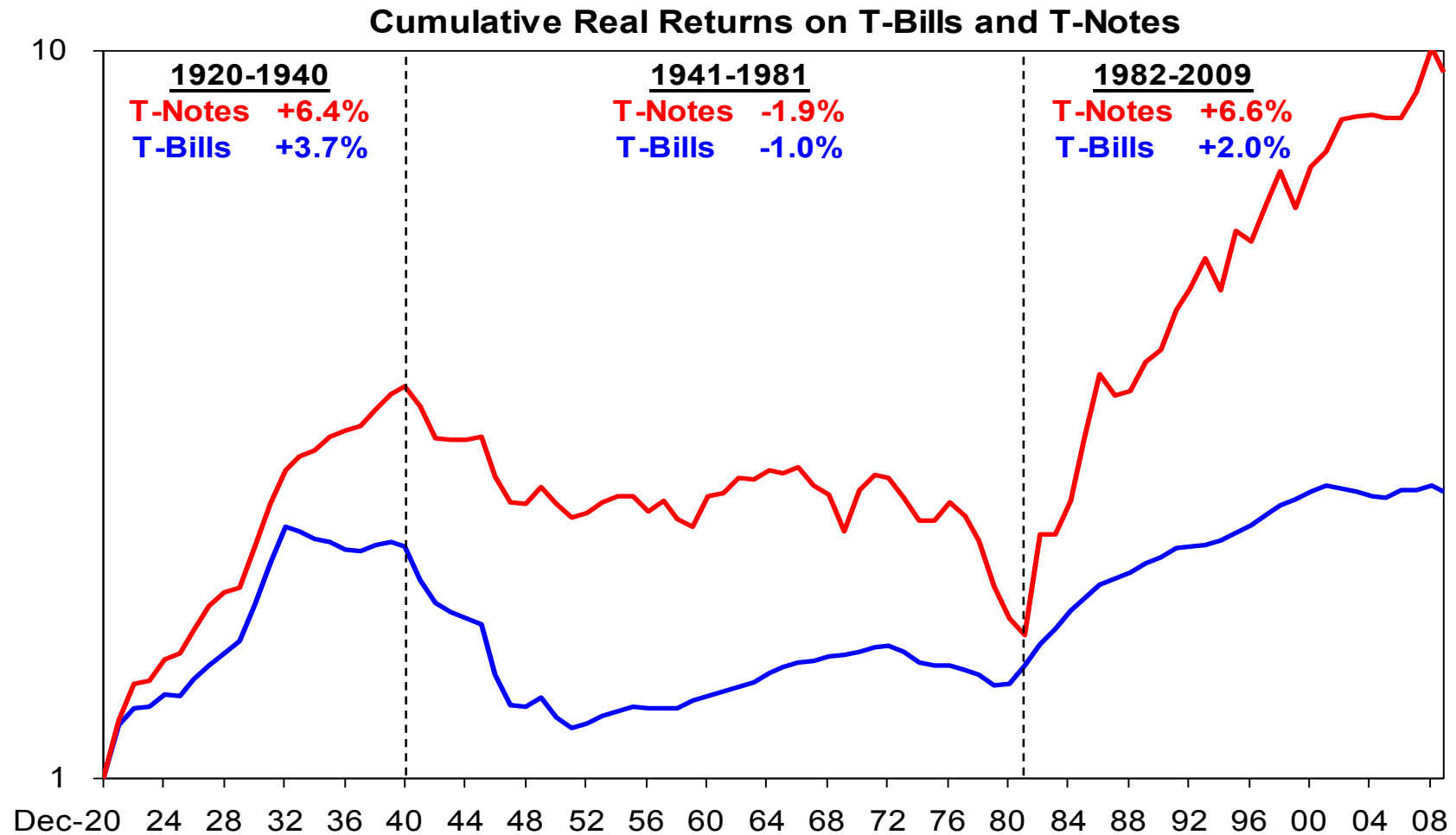
\*The chart represents real return forecasts<sup>1</sup> for several asset classes. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Actual results may differ materially from the forecasts above.

<sup>1</sup> Long-term inflation assumption: 2.5% per year.

# U.S. 10-Year Bond Yields – A Return-Free Risk?

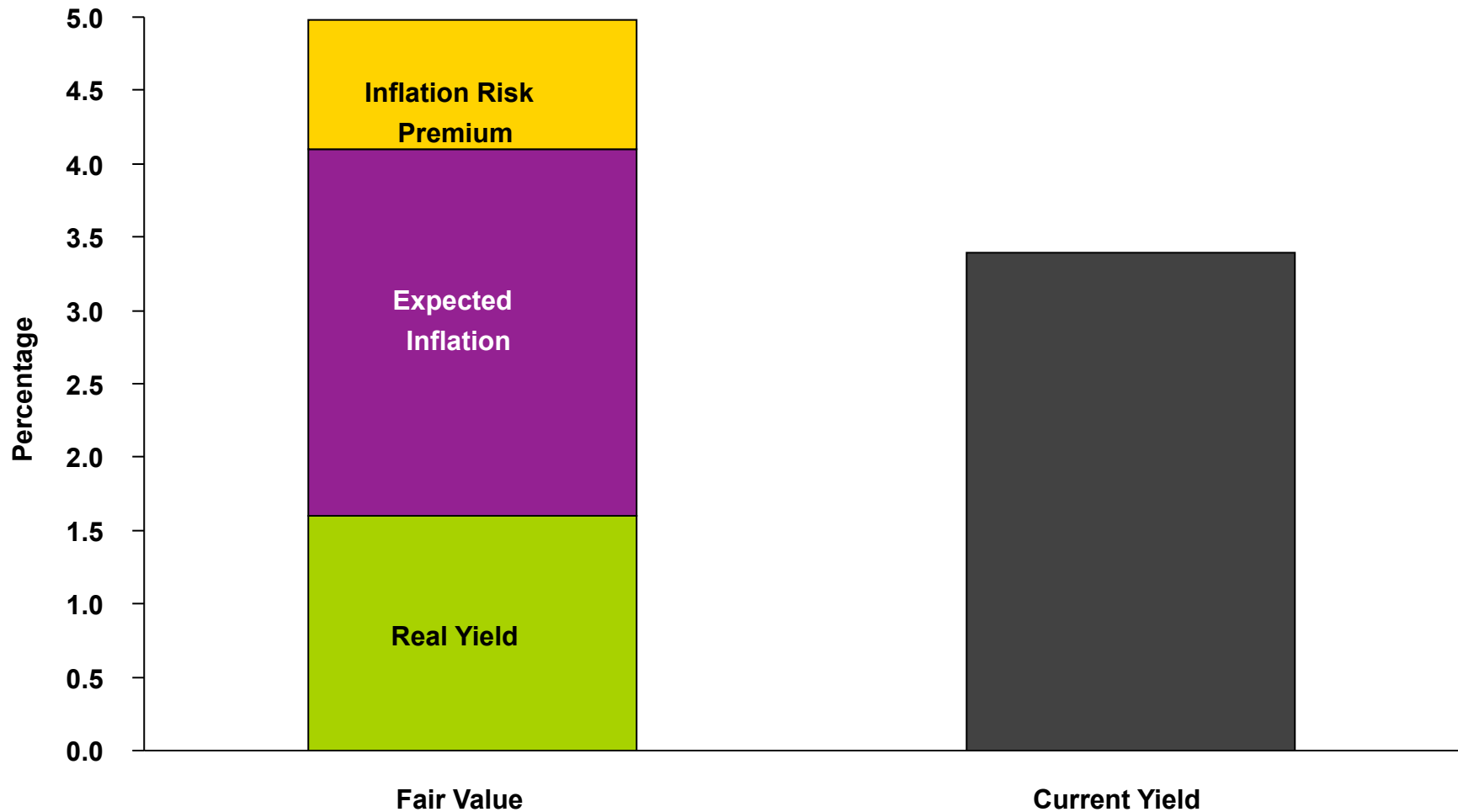


# What Happened To Bonds 60 Years Ago?



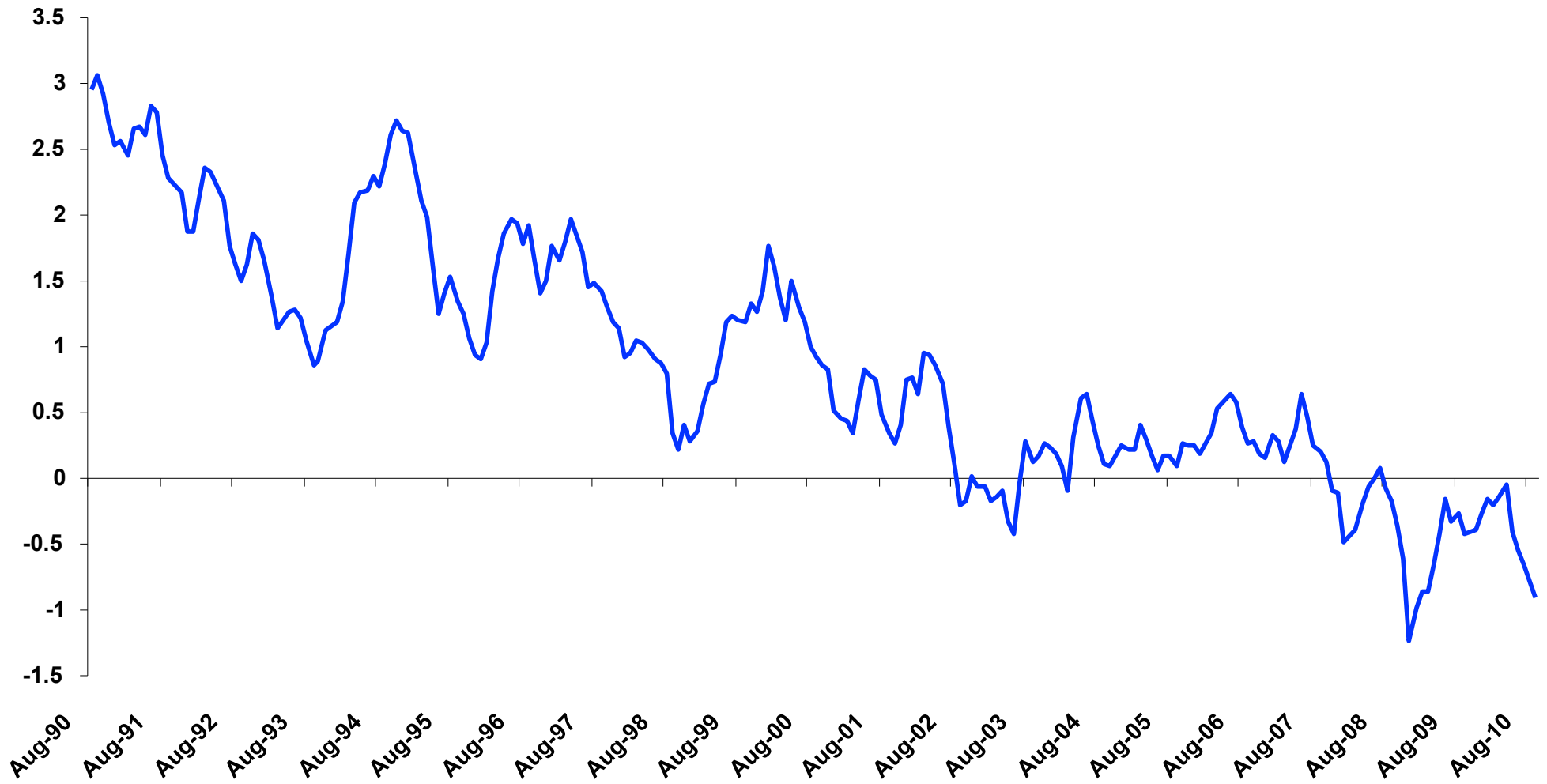
# Bonds – A Simple Valuation Approach

---



# Bond Risk Premium

---

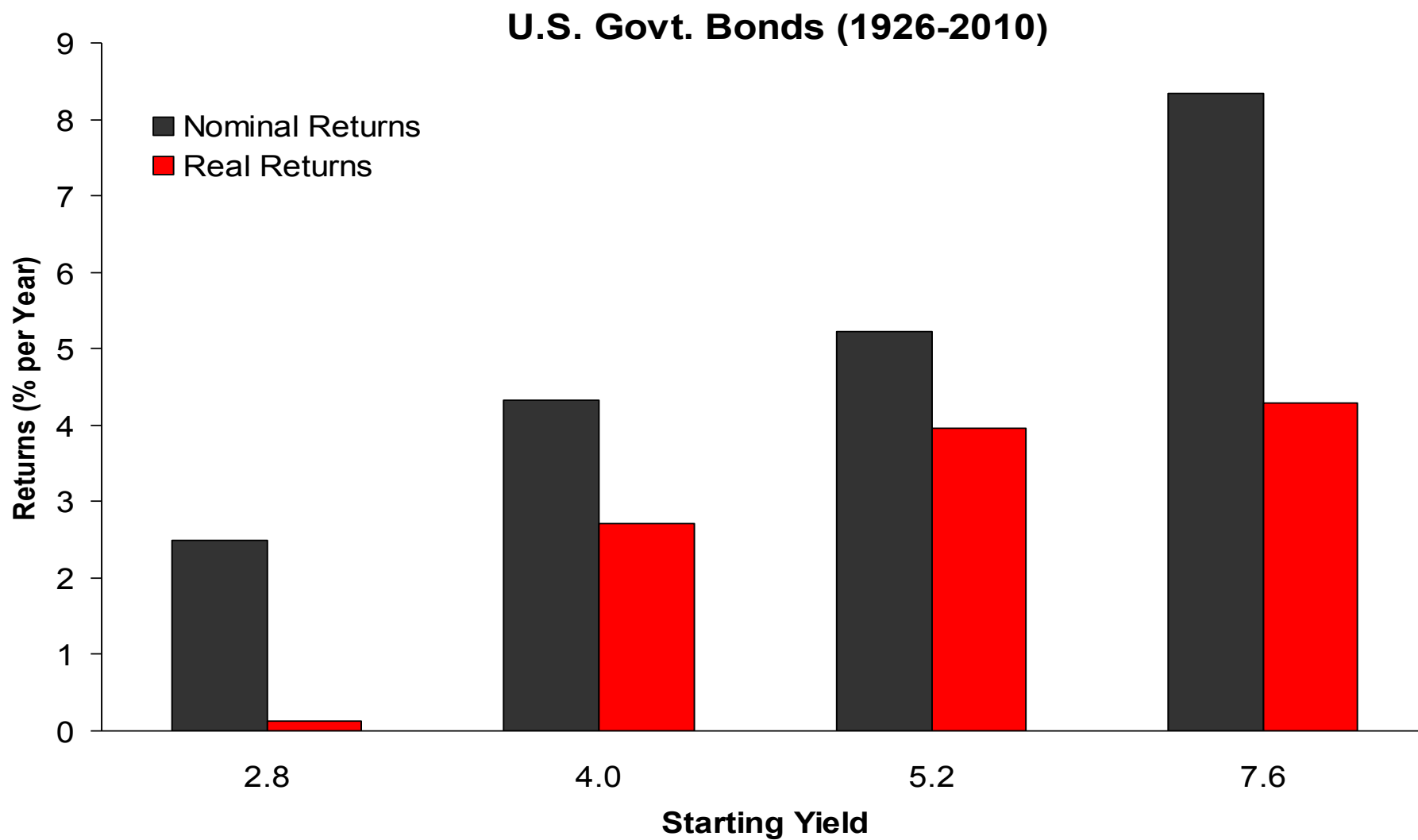


# Is The U.S. Turning Japanese?

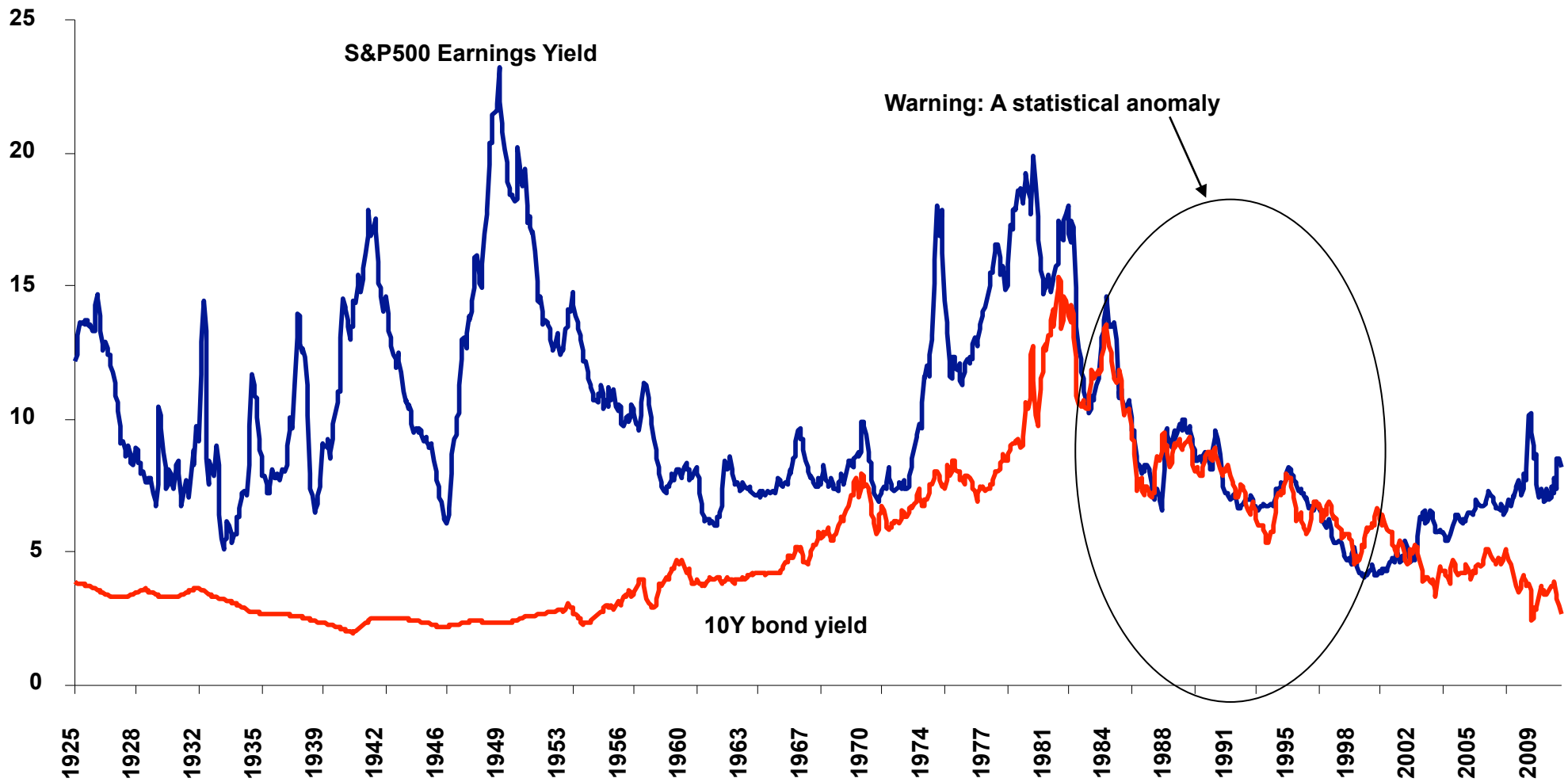
---

	<i>Bond Yield</i>	<i>Agnostic Probabilities</i>	<i>Market Implied</i>
<i>Normal</i>	5.0	0.5	0.25
<i>Japan</i>	1.0	0.25	0.5
<i>Inflation</i>	7.5	0.25	0.25
<i>Expected Yield</i>		4.6	3.5

# Valuation Matters

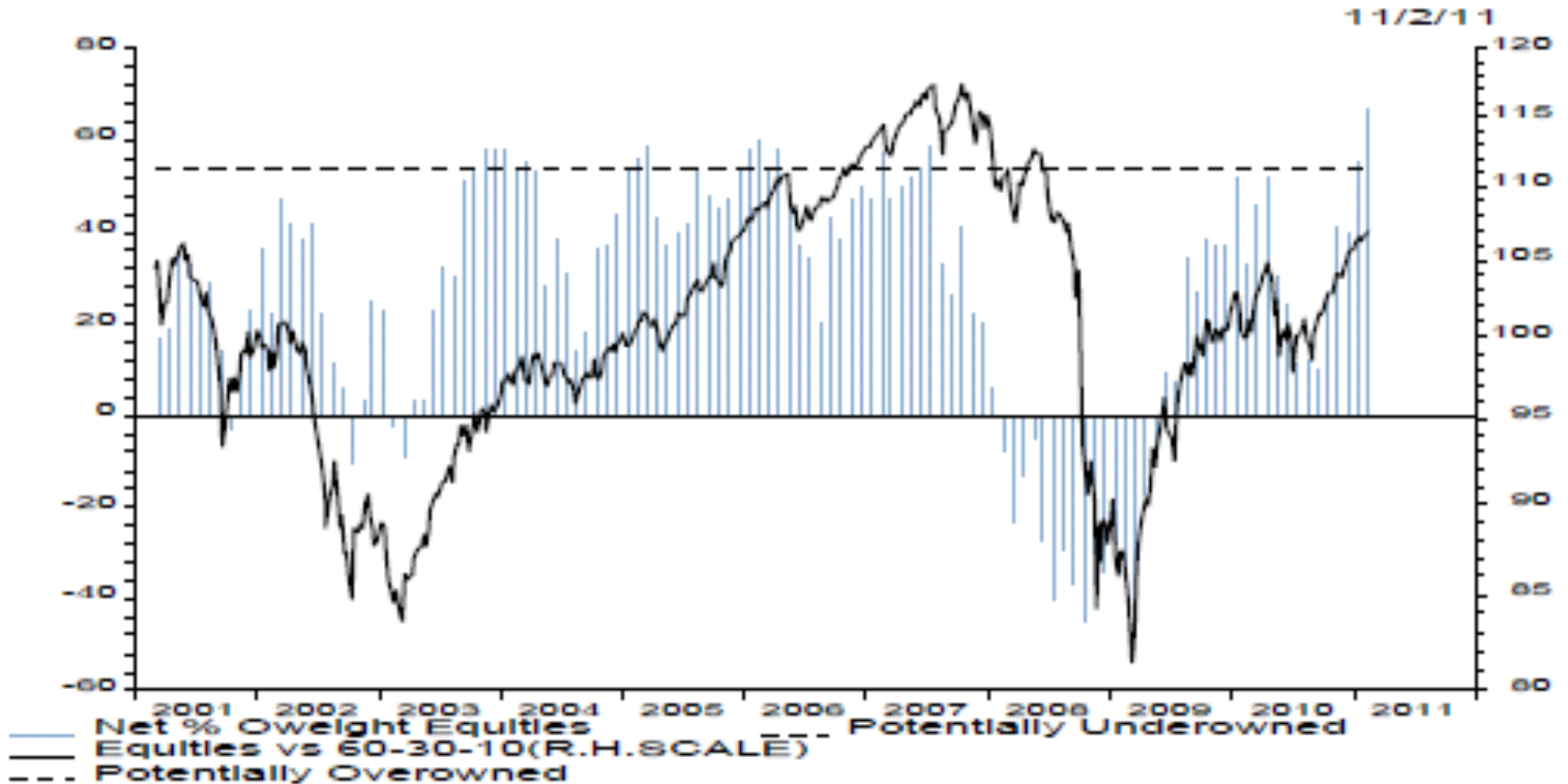


# The Fed Model: The two ugly step-sister problem



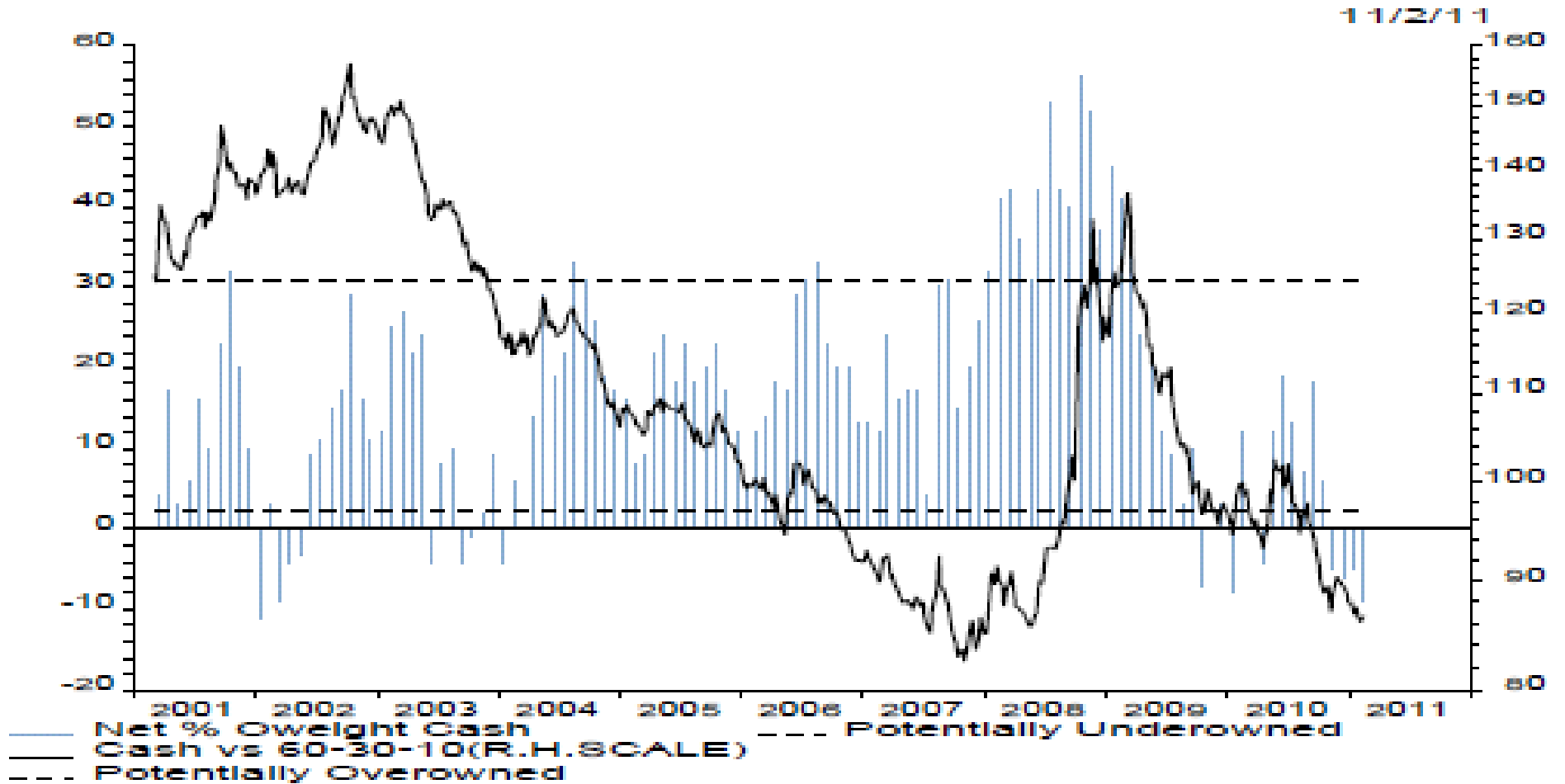
# Everyone loves equities...

Chart 18: Equities\*

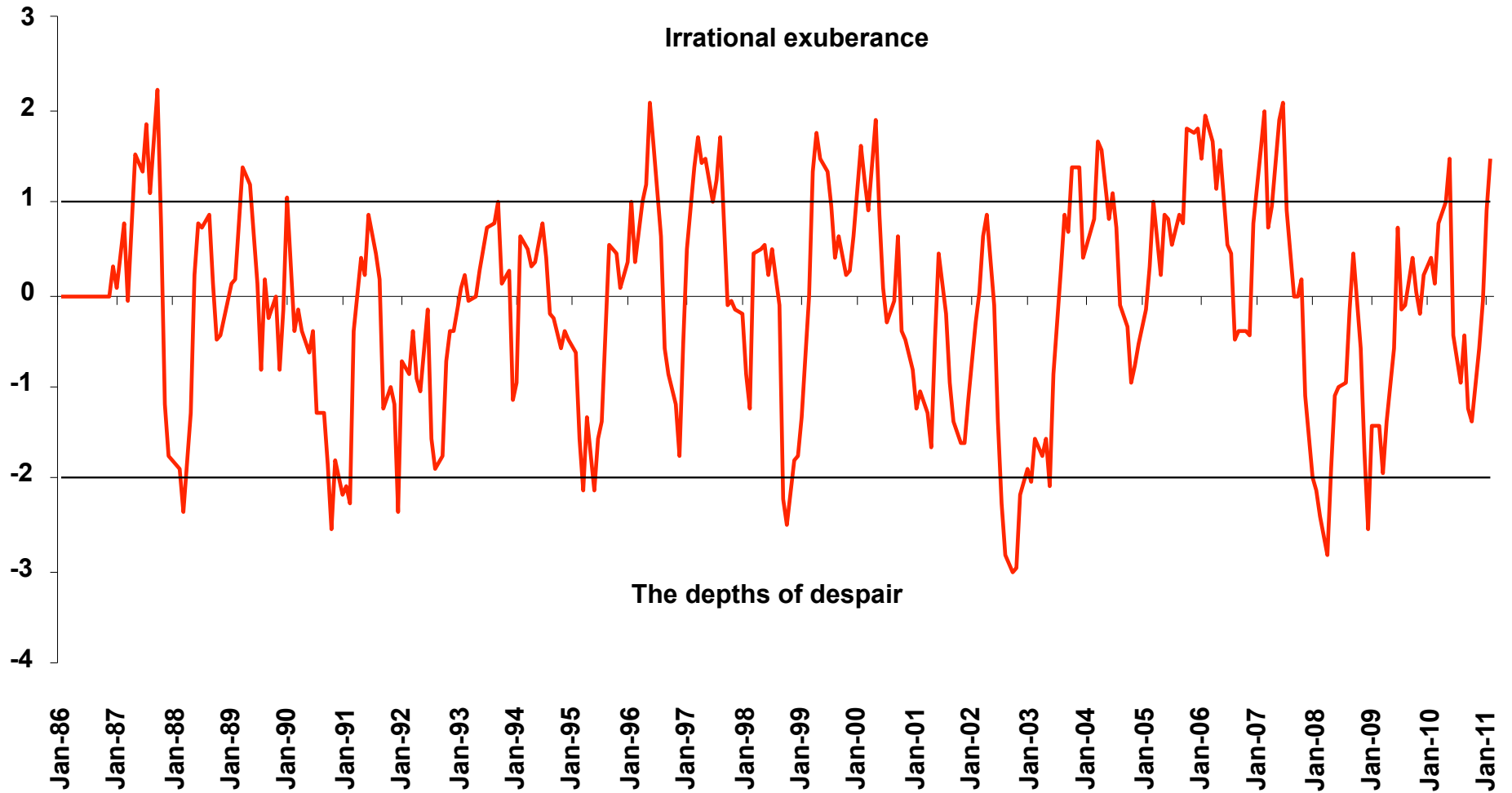


# And hates cash!!

Chart 17: Cash\*

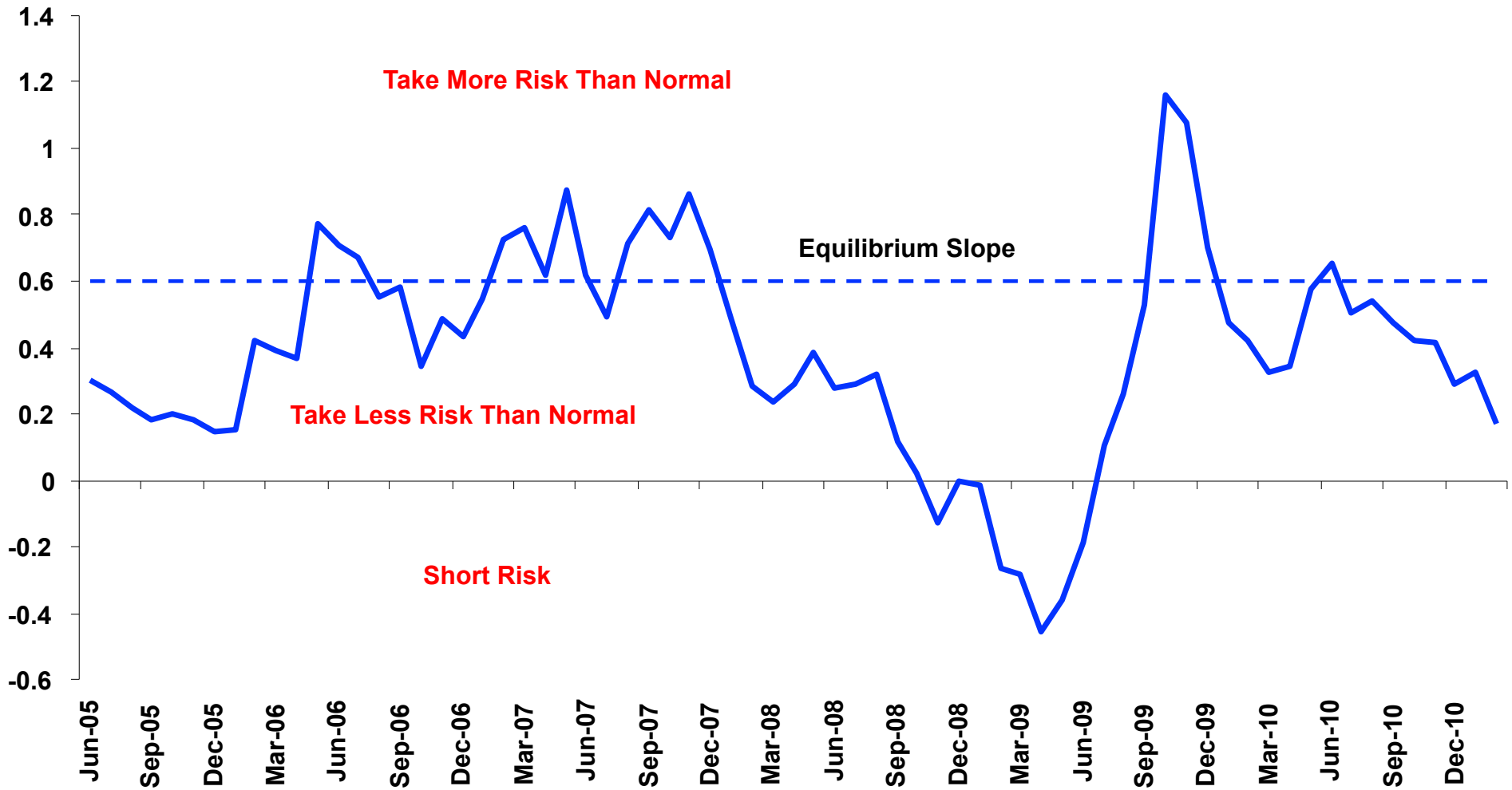


# GMO Fear and Greed Index



# Paltry payment for risk

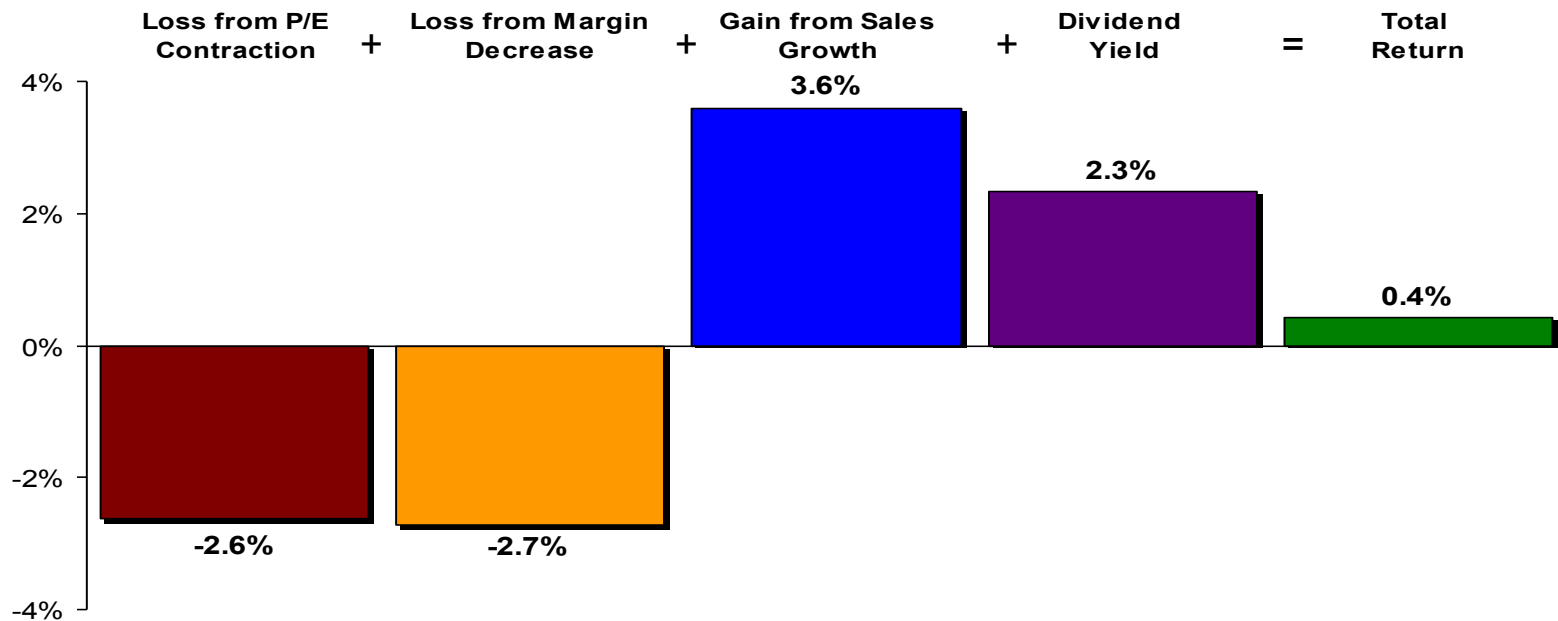
*Slope of the risk return line*



# S&P 500: Building A 7-Year Estimate

Components of annual return of S&P 500, with regression over 7 years

	P/E	Profit Margin	Real Sales per Share Growth	Dividend Yield
1926-1999 Averages	14.0	4.9%	1.8%	4.3%
Starting Levels	18.1	7.3%	1.9%	1.8%
Assumption for Next 7 Years	15.0 (Terminal Value)	6.0% (Terminal Value)	3.6%	2.3%

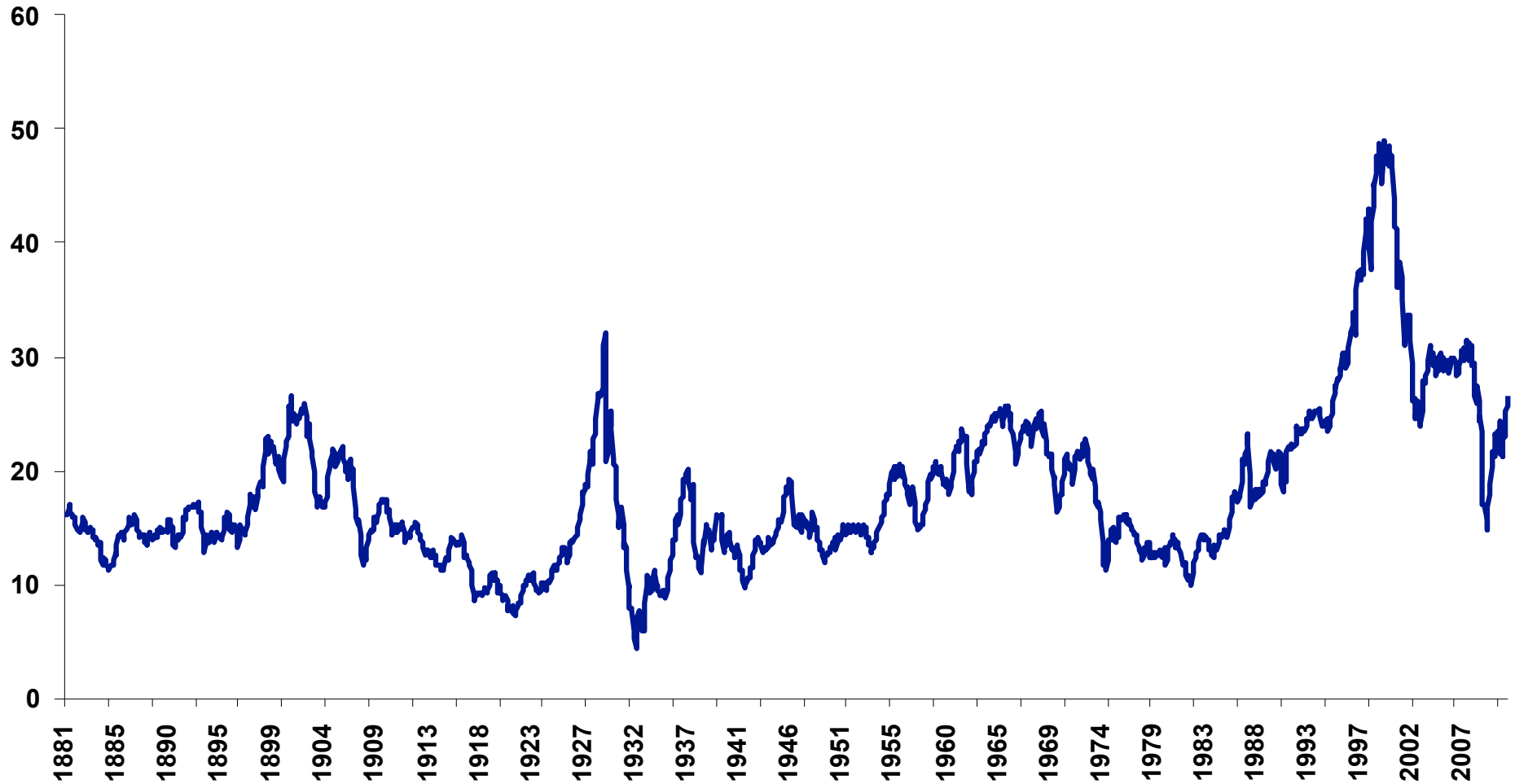


The chart includes forecasts that are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Actual results may differ materially from the forecasts above.

Source: GMO As of 31/12/10

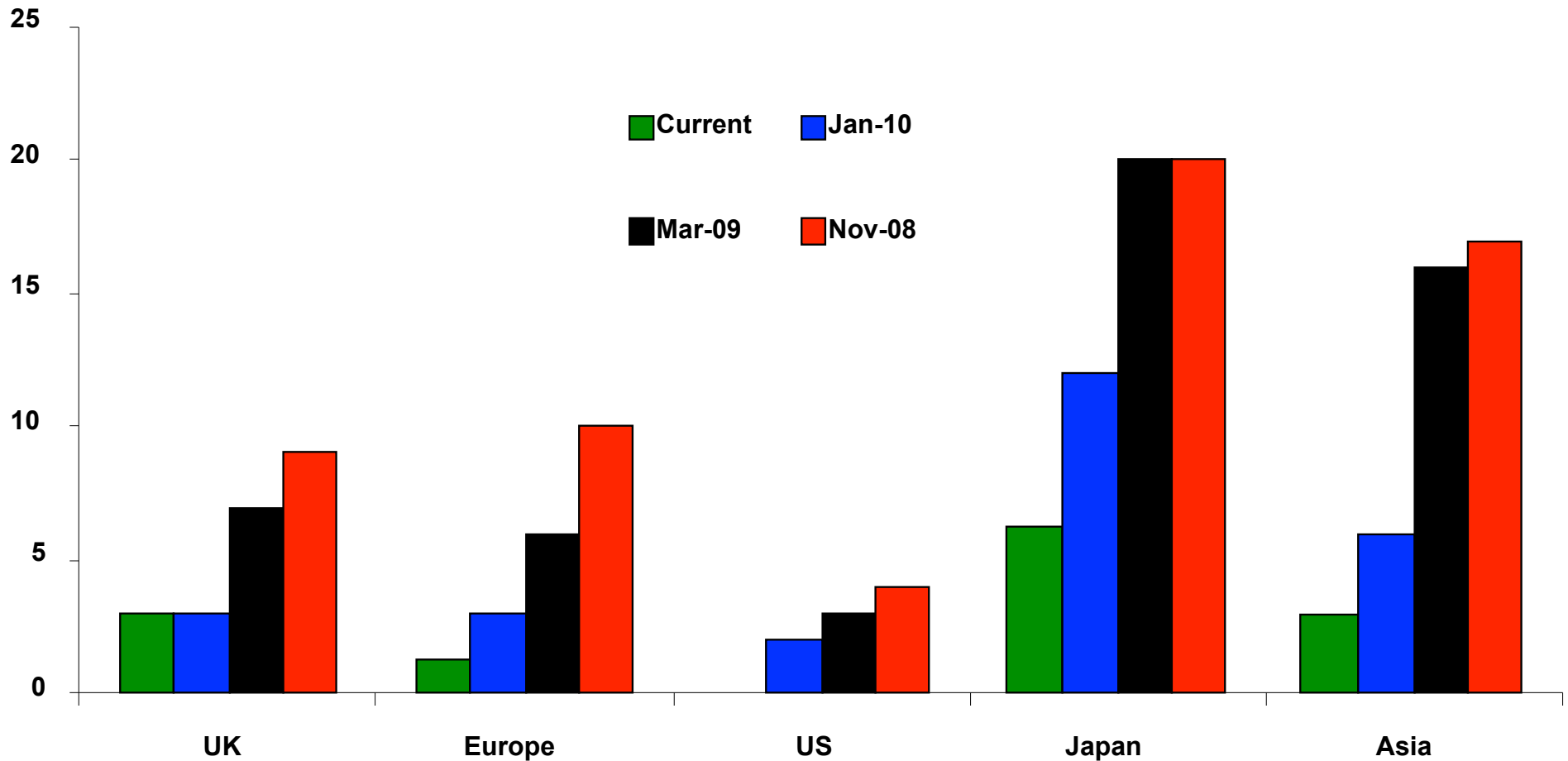
# S&P500 Graham and Dodd PE

*In the top decile of expense*



# Where would Ben Graham be shopping today?

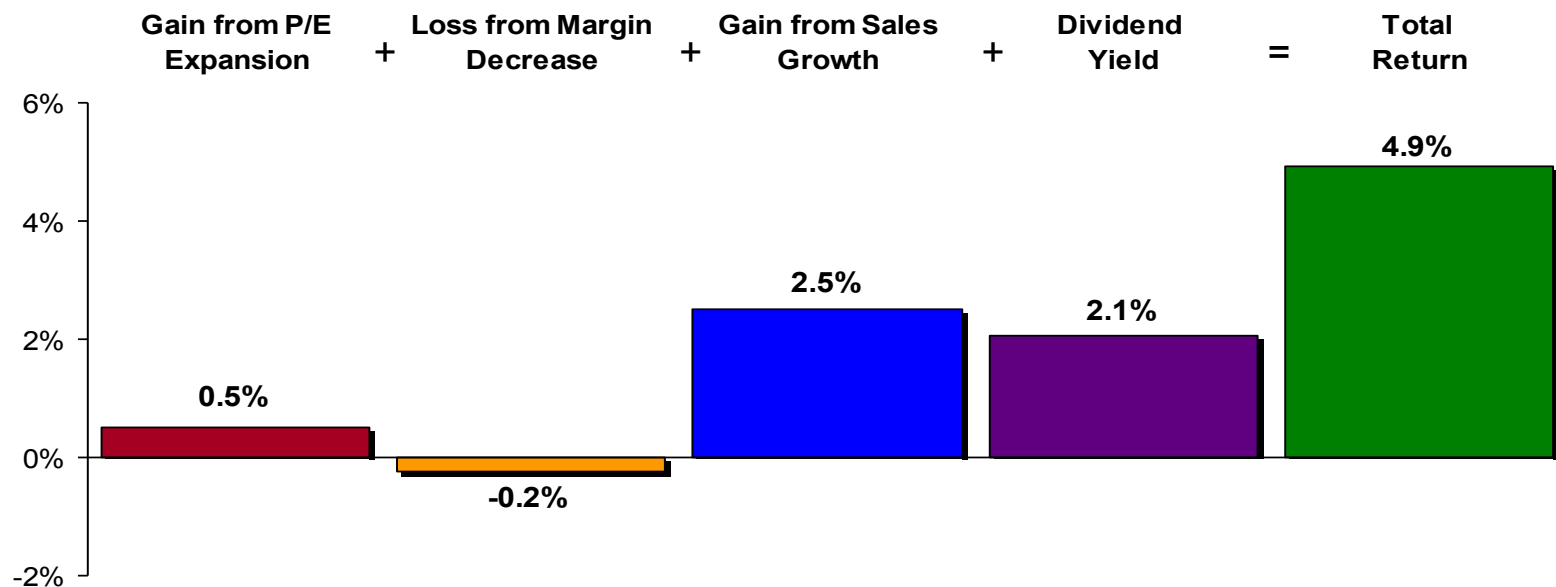
*% of stocks passing Graham's deep value screen (Large Cap)*



# High Quality: Building A 7-Year Estimate

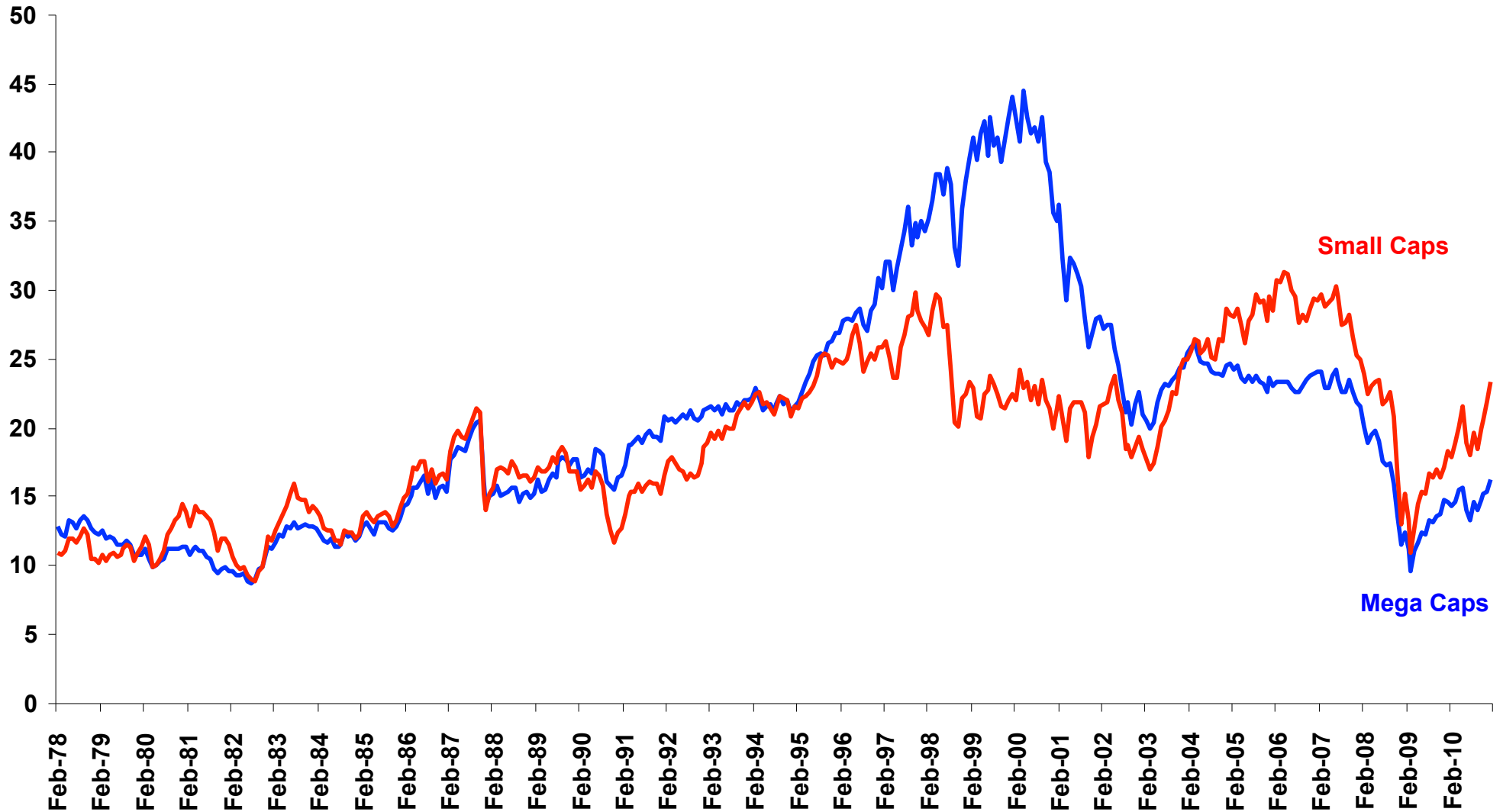
Components of annual return of high quality stocks, with regression over 7 years

	P/E	Profit Margin*	Real Net Worth per Share Growth	Dividend Yield
Starting Levels	16.6	13.2%	1.9%	1.7%
Assumption for Next 7 Years	17.3 (Terminal Value)	13.0% (Terminal Value)	2.5%	2.1%



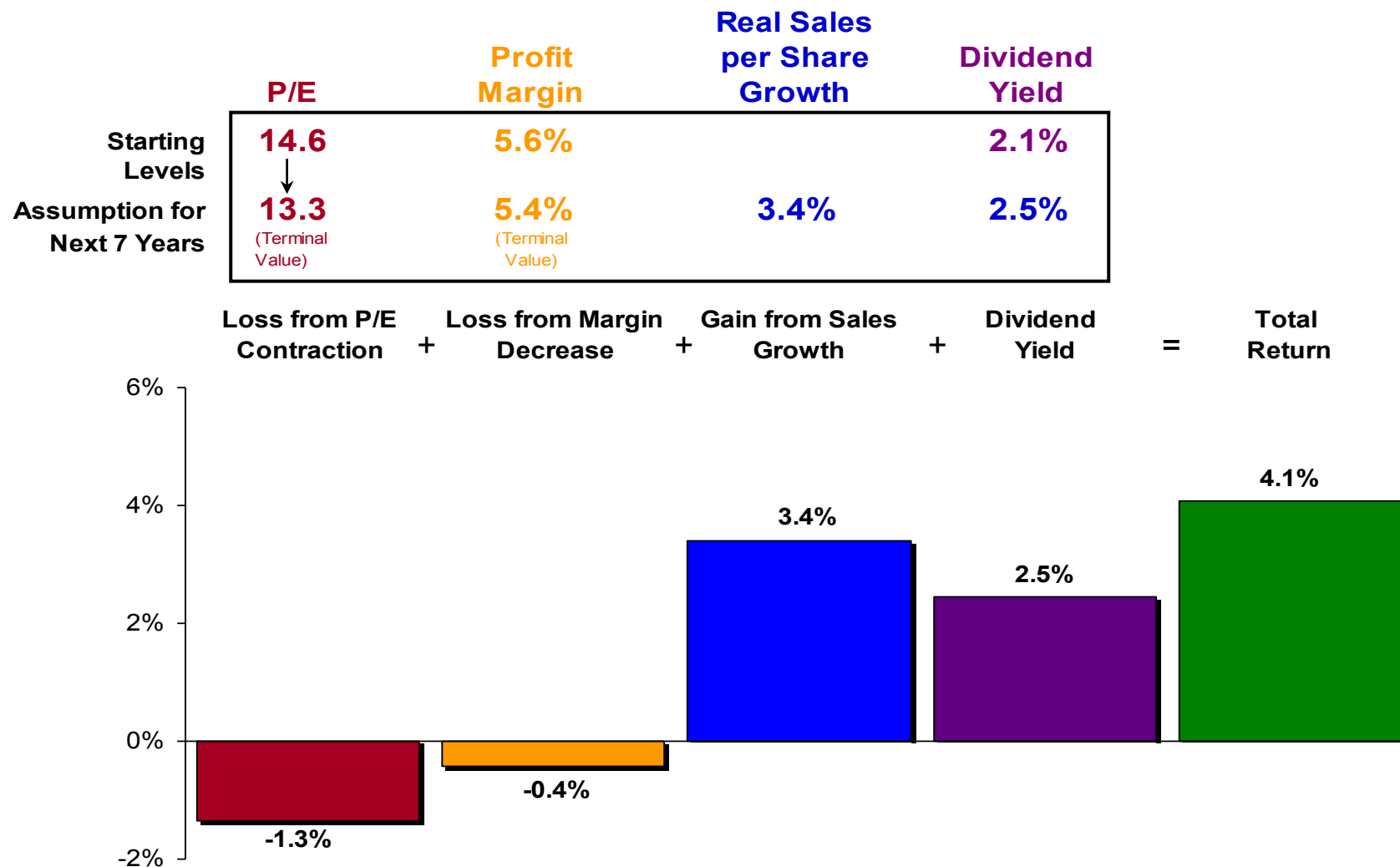
The chart includes forecasts that are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Actual results may differ materially from the forecasts above.

# US Mega Caps Are Cheap(ish), Small Caps Aren't!



# Emerging Equities: Building A 7-Year Estimate

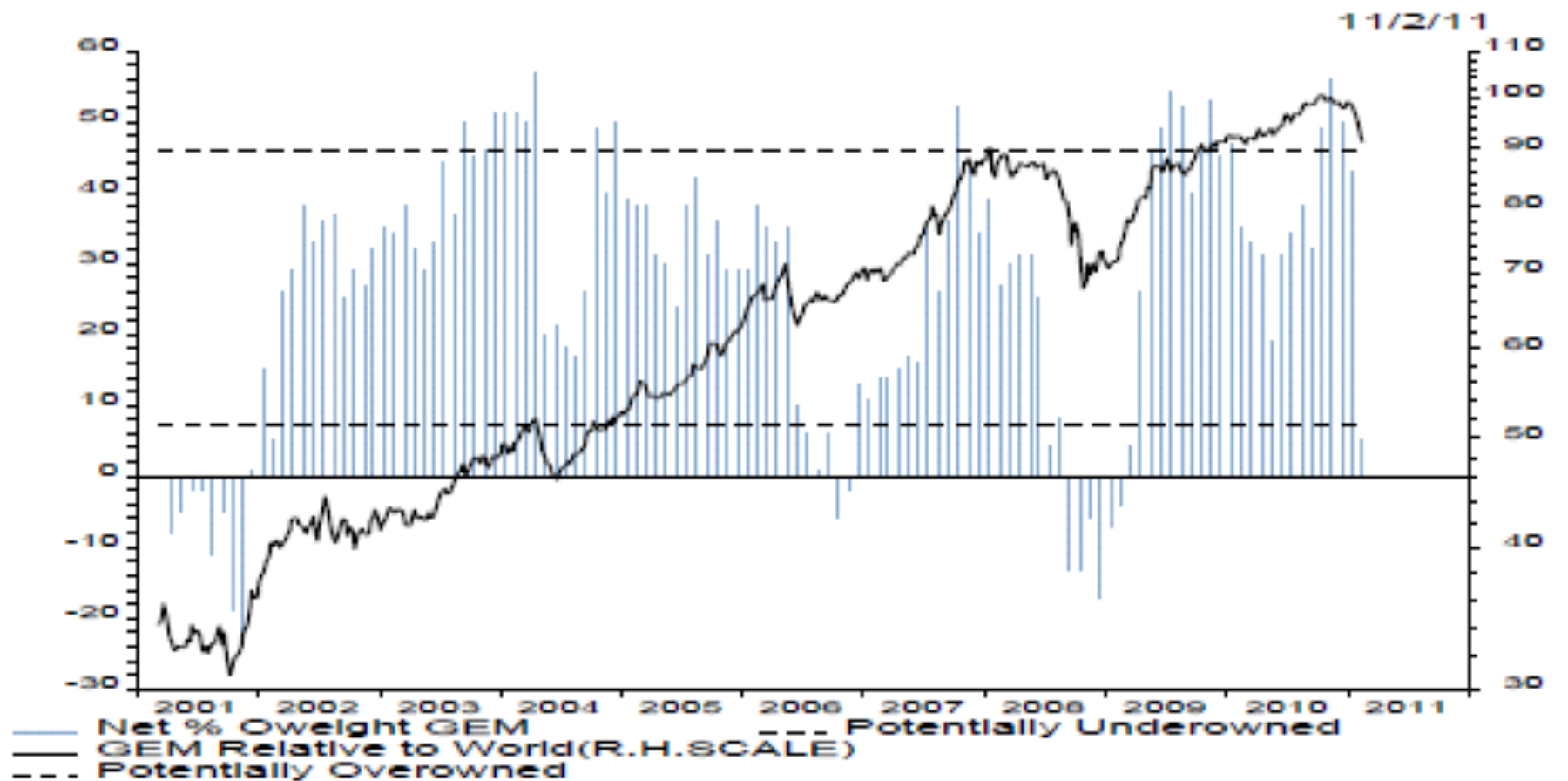
Components of annual return of emerging equities, with regression over 7 years



# Emerging Markets – oh what a fickle world!

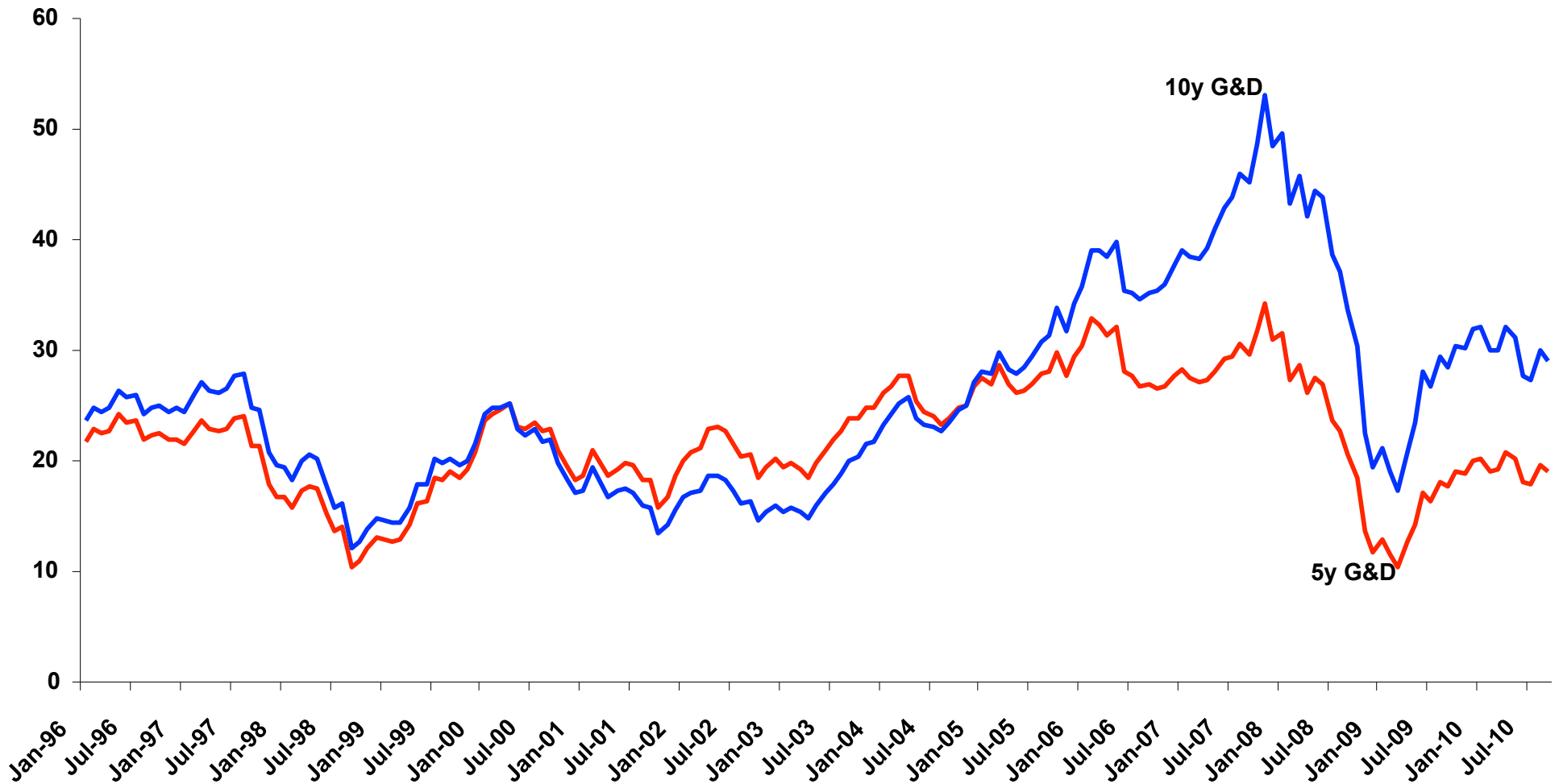
*Talk about the momo tribe*

**Chart 37: Global Emerging Markets Equities**

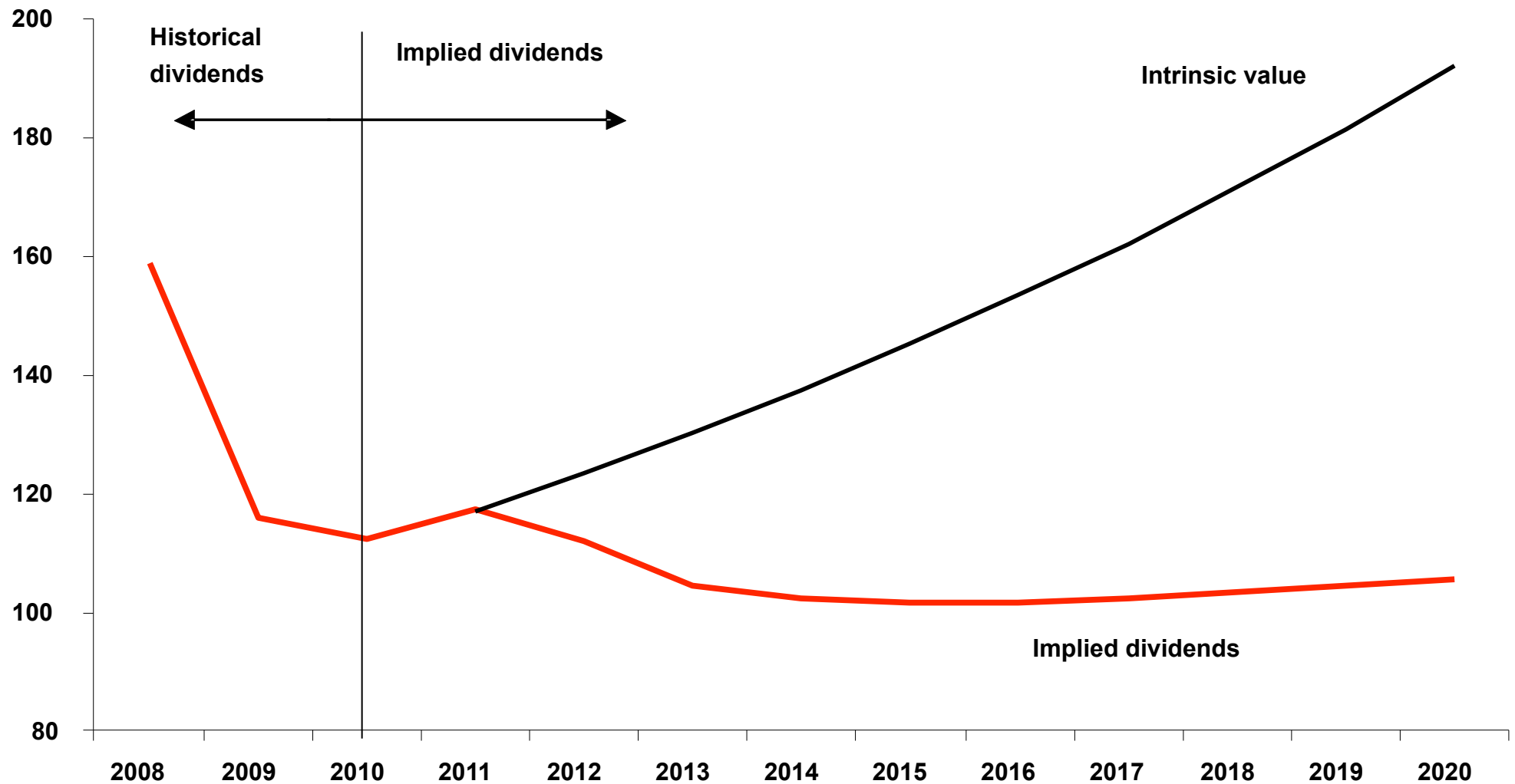


# Emerging Valuations (PE, x)

*Take your pick*

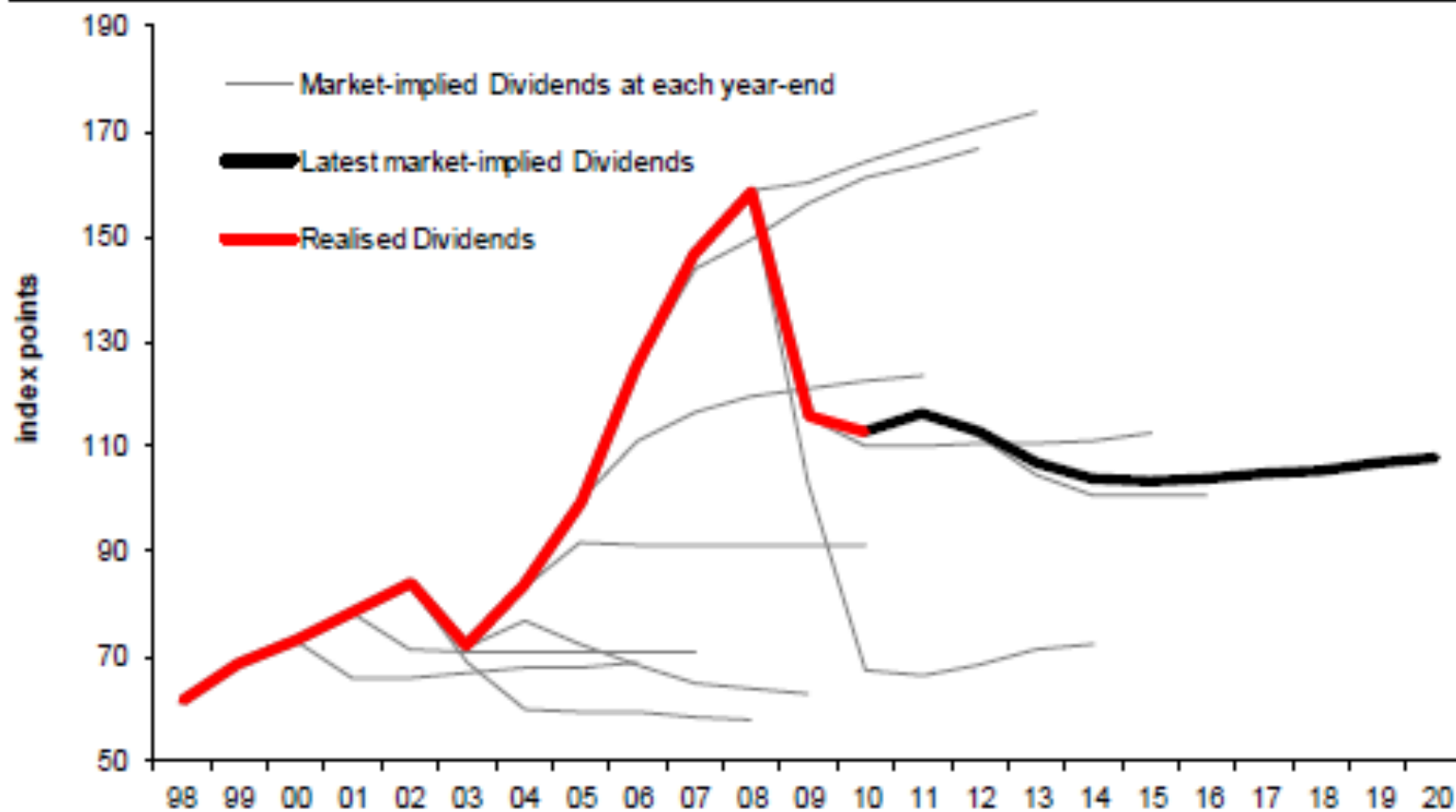


# A Conservative Estimate Of Fair Value



# Implied Dividends Are A Useless Forecaster Of Actual

EuroSTOXX 50's Dividend Futures



Note: OTC mark-to-market shown for history prior to Eurex listing.  
Source: Bloomberg, SG One-Delta Trading

# Conclusions

---

*Those with the enterprise lack the money and those with the money lack the enterprise to buy stocks when they are cheap  
– Ben Graham*

- *You need both cash and courage*
- *'Investors' today are acting with a surfeit of the latter, and a dearth of the former*
- *Remember the sage words of Winnie the Pooh – Never underestimate the value of doing nothing!*

# Final thought

---



# Disclaimer

---

Performance data quoted represents past performance and is not predictive of future performance. The foregoing does not constitute an offer of any securities for sale. Returns are presented gross of management fees, net of transaction costs and include the reinvestment of dividends and other income. If these expenses were deducted performance would be lower. For example, if the strategy were to achieve a 10% annual rate of return each year for ten years and an annual advisory fee of 0.75% were charged during that period, the resulting average annual net return (after the deduction of advisory fees) would be 9.25%. A GIPS compliant presentation of composite performance has preceded this report in the past 12 months or accompanies this presentation, or is also available at [www.gmo.com](http://www.gmo.com). Actual fees are disclosed in the Prospectus for each fund and are also available in each strategies compliant presentation.

Performance is shown compared to broad-based securities market indices. Broad-based indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly into an index.

# GMO

North America | Europe | Asia-Pacific

[www.gmo.com](http://www.gmo.com)

---

GMO LLC  
40 Rowes Wharf  
Boston, Massachusetts 02110  
Tel + 001 (617) 330-7500

GMO UK Limited  
One Angel Court Throgmorton Street London EC2R 7HJ  
Tel: +44 20 7814 7600 Fax: +44 20 7814 7605/6

Issued by GMO UK Limited Authorised & Regulated by the Financial Services Authority