

Business View | Bubbles and career risk

The dangers of left-brained bank bosses

AS THE global financial system fights desperately for survival, few people are more justified in saying “I told you so” than Jeremy Grantham, a Cassandra of the investment community since long before Nouriel Roubini became Doctor Doom.

Back in 2000, *The Economist* reported Mr Grantham’s comments at an event to mark the 75th anniversary of the publication of “*The Great Gatsby*”. The wealthy characters in the novel were “completely shallow,” he said—precisely the sort of “ineffable light-weights” who would have been unable to resist the temptation to join a crowd rushing into a stock market, and would accordingly have paid the price in the 1929 crash. As the article concluded, “He fears that a similar fate awaits today’s investors.”

Mr Grantham’s scepticism cost him plenty of business during the bullish years, as foolish investors preferred to share *Gatsby*’s belief in “the green light, the orgiastic future”. Yet, as *The Economist* reported this August, the mostly bearish ten-year forecasts issued in 1998 by Mr Grantham’s firm, GMO, “proved almost entirely correct”.

So Mr Grantham, a Brit based in New England, knows what he is talking about, which makes his latest GMO letter, “Reaping the Whirlwind”, a must-read. He predicts further house-price falls in America and Britain, a sharp reduction in corporate profits everywhere, and that the Chinese government will “stumble” faced with the “spectacularly complicated task of maintaining the highest economic growth rate in history”. Still, he admits to turning bullish on American shares, like another great investor, Warren Buffett, who last week wrote an op-ed in the *New York Times* advising people to buy them now. “If you wait for the robins,” Mr Buffett counselled, “spring will be over.”

Mr Grantham admits he will probably fall foul of the Curse

GMO



Jeremy Grantham of GMO

of the Value Investor, which is buying too soon. Yet he is convinced that “by October 10th global equities were cheap on an absolute basis and cheaper than at any time in 20 years.”


The most entertaining part of the letter is entitled *Where Was Our Leadership?* Mr Grantham asks, “Why did our leaders encourage the deregulation, encourage the leveraging and risk-taking, and completely miss or dismiss the growing signs of trouble and what we described as the ‘near certainties’ of bubbles breaking?” Why, indeed?

He offers two theories. The first he calls *Career Risk and Bubbles Breaking*. The bosses of banks continued piling on leverage and taking ever greater risks because they felt they would be fired if they did not. “It’s what I call the Goldman Sachs Effect: Goldman increased its leverage and its profit margins shot into the stratosphere. Eager to keep up, other banks, with less talent and energy than Goldman, copied them with ultimately disastrous consequences. And woe betide the CEO who missed the game and looked like an old fuddy-duddy. The Board would simply kick him out, in the name of protecting the stockholders’ future profits, and hire in more of a gunslinger from, say, Credit Suisse.”

The second theory reinforces the first, by combining the pressure for ever greater success with the selection of bosses ill-equipped to handle it. Mr Grantham believes that chief executives are “picked for their left-brain skills—focus, hard work, decisiveness, persuasiveness, political skills, and, if you are lucky, analytical skills and charisma.” Great American executives are not picked for patience, he points out, plausibly enough. “Indeed, if they could even spell the word they would be fired. They are not paid to put their feet up or waste time thinking about history and the long-term future; they are paid to be decisive and to act now.”

Only the rare person unconcerned with climbing the ladder, such as Mr Grantham, spoke out about the looming dangers. (Turning bearish before the crowd certainly can involve serious career risk—recall the late Tony Dye, who in March 2000 was fired as a chief investment officer at Phillips & Drew because he had moved out of what he rightly believed were overvalued equities and thus prompted many of the firm’s clients to quit.)

According to Mr Grantham, such people “have the patience of Job. They are also all right-brained: more intuitive,



more given to developing odd theories, wallowing in historical data, and taking their time. They are almost universally interested—even obsessed—with outlier events, and unique, new, and different combinations of factors. These ruminations take up a good chunk of their time. Do such thoughts take more than a few seconds of time for the great CEOs who, to the man, missed everything that was new and different? Unfortunately for all of us, it was the new and different this time that just happened to be vital.”

Ironically, those now in charge of the giants of the financial system are suffering from excessive risk aversion, scared of lending even to the bluest of chips. Now, says Mr Grantham, left-brained bosses—not the sort of cautious bureaucrat likely to appeal to the governments now overseeing the financial system—are just what is needed. “The typical CEO is precise-

ly equipped to deal with emergencies and digging out. Thus, Paulson was just the man to miss the point, but equally just the man—or at least a typically good one—to deal with a complicated crisis under stress.”

As Mr Grantham (or, to be precise, his wife) observes, the right- and left-brained should have come together on boards of banks, to keep fear and greed appropriately balanced. Yet, Sarbanes-Oxley and countless other initiatives intended to improve corporate governance seemed to have been largely ignored in the boardrooms of Wall Street, the City of London and Zurich. Let’s give the last word to Mr Grantham, who deserves his moment of schadenfreude: “What a shame that we have typically subverted this balance into a CEO fan club of old friends and mutual back-scratchers.”

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