

# Behind the Markets: around the world with GMO's asset allocation team

Published 11 May 2023

## **Jeremy Schwartz, CFA**

Global Chief Investment Officer

On a recent episode of the Behind the Markets podcast, I had the opportunity to speak with Catherine LeGraw of GMO, a partner at GMO and member of the firm's asset allocation team.

We had a fantastic discussion about GMO's investment philosophy and her team's high conviction trades. Summing up the GMO process is a unifying philosophy focused on valuation and the belief that the price you pay for an asset is a strong predictor of long-term returns.

Many of the views we discussed stem from the GMO forecast for real, after inflation returns over the coming 7 years and Catherine graciously shared the February analysis with us here for our discussion recap.

Readers can go to the GMO website monthly around the middle of the month for updates to this chart.

## **Stocks vs bonds, or both?**

GMO's asset allocation team is more constructive across asset classes than a year ago, after the sell-off. About a year ago, bonds looked expensive near historic lows on interest rates. Today, there is more income to be had. While GMO was leaning more heavily into liquid alternatives last year, recently they are taking more equity beta risk and more duration risk.

Forced to choose, Catherine would pick stocks over bonds, but GMO likes both stocks and bonds more than they did last year.

## **The GMO model inputs**

Catherine discussed how valuation is a huge driver of these forecasts. Each forecast has two components:

1. An expected return absent any valuation change. It's effectively the expected return from fundamentals. So for equities, dividend yield and real growth. From bonds, it will be real yield.
2. The other component is expected return from valuation. GMO assumes all assets will return to a long-term fair valuation and builds expected repricing toward fair value.

## **'We still love value'**

GMO's work shows value is still quite cheap and it is the team's highest conviction view right now in terms of an active view. Catherine believes the value versus growth cycle could be just half way through a 4 year or so estimated cycle.

In Catherine's work, value still needs to outperform growth by about 40% to get to their team's acceptable fair value.

Their team has so much conviction in the long-term idea here, GMO launched a long value, short growth strategy back in 2020, signaling this would be a megatrend here.

### **International stocks offer a 'trifecta'**

Catherine sees a trifecta supporting overseas ideas.

3. The broad equities have a forecasted real return in the range of 5 to 7% for Europe, Japan, and those non-US developed markets.
4. If you're willing to tilt into the value half of these markets, the value spreads are particularly wide and can capture another 2 to 4% by tilting to value within these markets.
5. GMO sees non-US currencies as cheap, offering another 1 to 2% in currency appreciation potential against the US dollar.

### **0% real return for the S&P 500?**

Contrasted with a nearly double-digit forecasted real return for international value stocks, GMO sees the S&P 500 Index with zero real return. By contrast, the deep value part of the US market GMO sees in the 5 to 7% range—similar to the longer-term equity premium for US stocks as a whole. So this is saying the dominating growth segment is really dragging down the GMO forecasts.

### **Small value?**

GMO is tilting towards small cap value, so the value half of small cap, and quite likes Japan small cap value. In the US, small cap quality is their favorite factor at the moment.

To listen to our full conversation with Catherine, please see the following link:

<https://open.spotify.com/episode/5ruM9SrZcptnDL0H8n0IZj?si=tcLR7gSQTPWBsSGquFdN6A>

### **Related blogs**

+ [Behind the Markets: What do Contingent Convertible Bonds \(Cocos\) Tell us about the Possibilities of Further Bank Crises in Europe?](#)

## Important Risks Related to this Article

### Important Information

**Marketing communications issued in the European Economic Area (“EEA”):** This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

**Marketing communications issued in jurisdictions outside of the EEA:** This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

**For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.**

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.