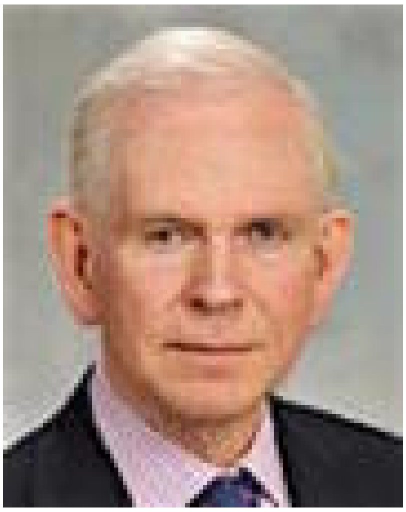
# Beware the Equity Bubble: Jeremy Grantham

By Jeremy Grantham *Wed, Jan 6, 2021*

*In his new quarterly letter, the master of value investing warns that all the classic signs of an overextended bull market are flashing red. He recommends value and emerging market stocks.*



The long, long bull market since 2009 has finally matured into a fully-fledged epic bubble. Featuring extreme overvaluation, explosive price increases, frenzied issuance, and hysterically speculative investor behavior, I believe this event will be recorded as one of the great bubbles of financial history, right along with the South Sea bubble, 1929, and 2000.

Most of the time, perhaps three-quarters of the time, major asset classes are reasonably priced relative to one another. The correct response is to make modest bets on those assets that measure as being cheaper and hope that the measurements are correct. The real trouble with asset allocation, though, is in the remaining times when asset prices move far away from fair value.

This is not so bad in bear markets because important bear markets tend to be short and brutal. The initial response of clients is usually to be shocked into inaction during which phase the manager has time to reposition both portfolio and arguments to retain the business. The real problem is in major bull markets that last for years.

I am long retired from the job of portfolio management but I am happy to give my opinion here: It is highly probable that we are in a major bubble event in the US market, of the type we typically have every several decades and last had in the late 1990s. It will very probably end badly, although nothing is certain.

The single most dependable feature of the late stages of the great bubbles of history has been really crazy investor behavior, especially on the part of individuals. For the first 10 years of this bull market, which is the longest in history, we lacked such wild speculation. But now we have it. In record amounts. Tesla’s market cap, now over $600 billion, amounts to over $1.25 million per car sold each year versus $9,000 per car for GM. What has 1929 got to equal that?

The “Buffett indicator,” total stock market capitalization to GDP, broke through its all-time high 2000 record. In 2020, there were 480 IPOs (including an incredible 248 Special Purpose Acquisition Companies, or SPACs) – more new listings than the 406 IPOs in 2000. There are 150 non-micro-cap companies (that is, with market capitalization >$250 million) that have more than tripled in the year, which is over three times as many as any year in the previous decade. The volume of small retail purchases, of less than 10 contracts, of call options on US equities has increased eight-fold compared to 2019, and 2019 was already well above long-run average.

Perhaps most troubling of all: Nobel laureate and long-time bear Robert Shiller – who correctly and bravely called the 2000 and 2007 bubbles and who is one of the very few economists I respect – is hedging his bets this time, recently making the point that his legendary CAPE asset-pricing indicator (which suggests stocks are nearly as overpriced as at the 2000 bubble peak) shows less impressive overvaluation when compared to bonds. Bonds, however, are even more spectacularly expensive by historical comparison than stocks. Oh my!

Even now, I know that this market can soar upwards for a few more weeks or even months – it feels like we could be anywhere between July 1999 and February 2000. Which is to say it is entitled to break any day, having checked all the boxes, but could keep roaring upwards for a few months longer. My best guess as to the longest this bubble might survive is the late spring or early summer, coinciding with the broad rollout of the COVID vaccine.

At that moment, the most pressing issue facing the world economy will have been solved. Market participants will breathe a sigh of relief, look around, and immediately realize that the economy is still in poor shape, stimulus will shortly be cut back with the end of the COVID crisis, and valuations are absurd. “Buy the rumor, sell the news.” But remember that timing the bursting of bubbles has a long history of disappointment.

So, I am not at all surprised that since the summer the market has advanced at an accelerating rate and with increasing speculative excesses. It is precisely what you should expect from a late-stage bubble: an accelerating, nearly vertical stage of unknowable length – but typically short. Even if it is short, this stage at the end of a bubble is shockingly painful and full of career risk for bears.

As often happens at bubbly peaks like 1929, 2000, and the Nifty Fifty of 1972 (a second-tier bubble in the company of champions), today’s market features extreme disparities in value by asset class, sector, and company. Those at the very cheap end include traditional value stocks all over the world, relative to growth stocks.

Value stocks have had their worst-ever relative decade ending December 2019, followed by the worst-ever year in 2020, with spreads between Growth and Value performance averaging between 20 and 30 percentage points for the single year! Similarly, Emerging Market equities are at 1 of their 3, more or less co-equal, relative lows against the US of the last 50 years. Not surprisingly, we believe it is in the overlap of these two ideas, Value and Emerging, that your relative bets should go, along with the greatest avoidance of US Growth stocks that your career and business risk will allow. Good luck!

*The original version of this article, available **here**, has been edited for length.*