MARKETS

Jeremy Grantham wants you to check your optimism about the stock market

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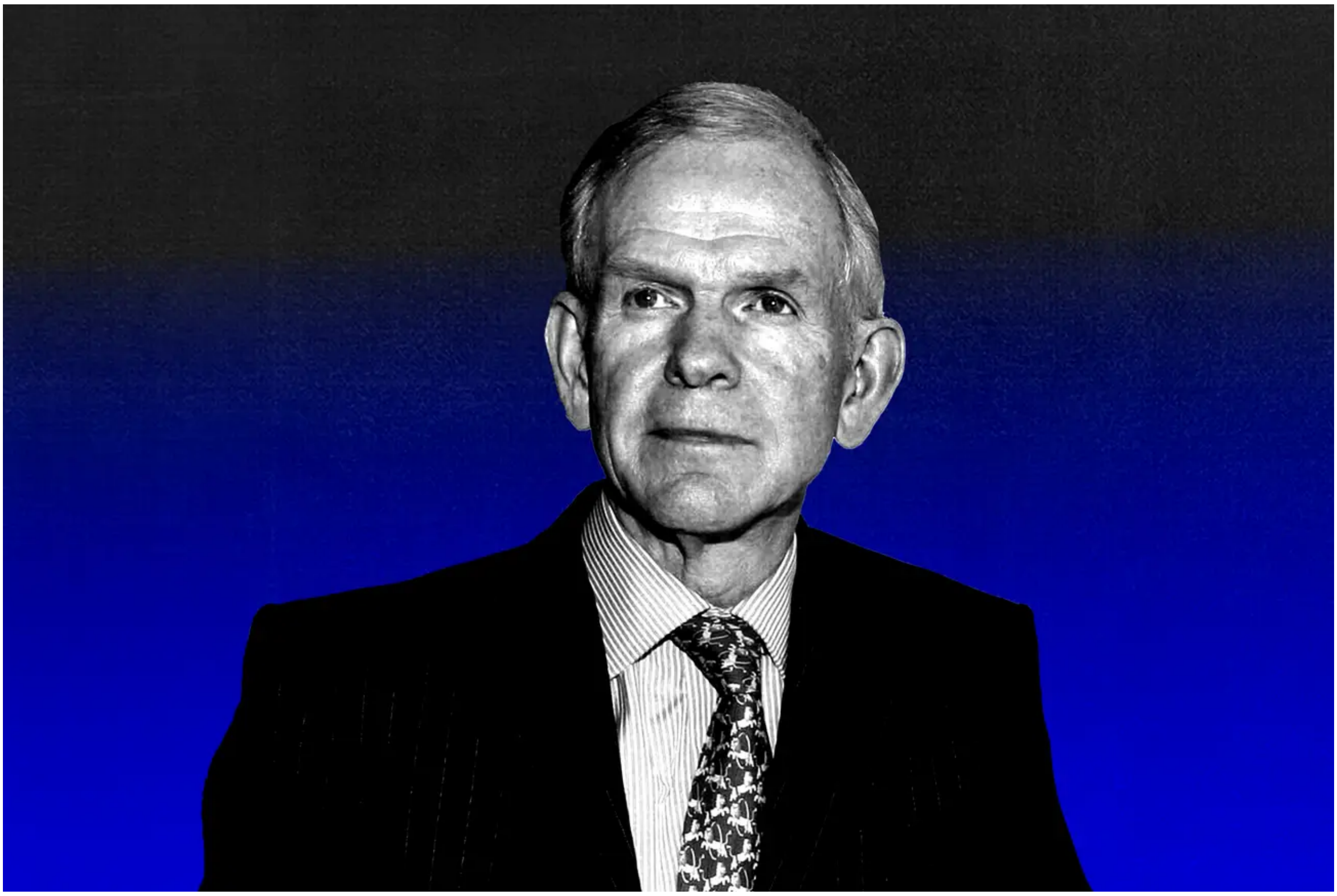

Fairfax Media/Getty Images; Jenny Chang-Rodriguez/BI

Jeremy Grantham is warning that stocks are in a "superbubble."

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his month, he shared with Business Insider why investors are potting bubbles.

l humans' optimistic nature, our short-sightedness, and Wall Street's incentive to be bullish.

Jeremy Grantham doesn't seem like an inherently pessimistic person.

Even while he presented his frighteningly bearish outlook for stocks in the coming years during a 30-minute interview with Business Insider earlier this month, the investing legend's tone of voice remained upbeat. He referenced funny films, and he laughed about the level of absurdity that market bubbles can sometime reach.

But when it comes to investing, the cofounder of the asset management firm GMO is certainly wary of misplaced optimism.

bottom in 2009 and rode the upside after the S&P 500 plummeted more than 50%. He had predicted the crash, just as he foresaw the dot-com bubble about a decade earlier.

On the other hand, optimism can be deadly when conditions are poor. With the market near all-time highs and valuations at some of their most elevated levels in history, that's where Grantham believes the chips lie.

Since January 2022, he's been warning that stocks are in a "superbubble," and has called for the market to drop substantially while also delivering poor long-term returns. He recently told Business Insider he expects the S&P 500 to fall to at least 3,200 as a recession unfolds soon. In a more severe recession, the index could go as low as 2,200, implying a sell-off somewhere in the range of -32% to -53%.

...day seem to be heeding Grantham's warnings as investors ...he strength of the US economy and a newly dovish Federal ...he same exuberance about the market's upside prospects has ...nt in every prior bubble in history. And in hindsight, the warning signs always look obvious. So, why are we so bad at seeing these conditions develop in real-time and reacting to them?

For Grantham, it's partly a result of how humans have evolved.

"We're an optimistic species," he said. "I really believe it's been a part of our selection process that nervous, neurotic characters disappeared hundreds of thousands of years ago. And the bullish, optimistic types, pushing and driving for more of this and more of that with a positive attitude, are clearly going to do better in a tough marginal environment. So I think our species has been kind of polished up over hundreds of thousands of years or millions, depending on how you view it, to be optimistic."

Some experts agree. According to Tali Sharot, a neuroscience professor at MIT and University College London, humans tend to be more optimistic than rational.

"People hugely underestimate their chances of getting divorced, losing their job or being diagnosed with cancer; expect their children to be extraordinarily gifted; envision themselves achieving more than their peers; and overestimate their likely life span (sometimes by 20 years or more)," Sharot wrote in her 2011 book, "The Optimism Bias."

As Grantham said, that optimism can be a great thing in the business world and in investing. But ill-timed optimism, or too much of it, can be detrimental. According to a 2007 paper by Duke University economists Manju Puri and David T. Robinson, more moderately optimistic people tend to make better financial decisions than "extreme optimists," who "display financial habits and behavior that are generally not considered prudent."

...other source of optimism that Grantham thinks is a "huge ...vestors are ill-prepared for market bubbles: Wall Street's own ...l imperatives. Strategists at major firms are rarely bearish ...would be bad for their bottom lines, he said.

Pointing out the market's high valuation levels and the strong likelihood of poor returns "doesn't get you much business," Grantham said. "Why would you do that? I'm in the business of doing it. It's kind of my job description. But you wouldn't do it if you were trying to sell stock and other assets."

Wall Street strategists indeed tend to be more wrong to the upside than to the downside. According to a report from FactSet, in the 20 years from 2002-2021, strategists on average issued overzealous price targets in 13 years.

Grantham also said there's an element of short-sightedness among people generally, a condition we may not have evolved out of just yet.

"We are pretty close to the days when we were hunter gatherers," Grantham said. "Your focus is on getting as much as you can when you have the opportunity and not worrying too much about the next year."

Bears: An endangered species

The proverbial pack of bears that Jeremy Grantham has rolled with over the past couple of years is becoming increasingly extinct.

Morgan Stanley's Chief US Mike Wilson, while still bearish, only sees the S&P 500 falling by 5% to 4,500 next year. Wilson had a price target of 3,900 on the index for 2023 and said in July that he was "wrong" to underestimate stocks.

Michael Kantrowitz of Piper Sandler had a price target of 3,225 to start
ad to increase that target to a 3,600-3,800 range. He said in a
nts this week that he is open to the possibility of a
ve environment next year.

"I am not broadly bullish, but I can see the scenario that stocks continue to driver higher and broaden out with the big bad wolf back in his den (Powell)," Kantrowitz said.

JPMorgan's Dubravko Lakos-Bujas has issued the most bearish year-end price target for 2024 so far at 4,200. The median 2024 target, meanwhile, is up near 5,000.

On the economists' side of things, JPMorgan's Chief US Economist Michael Feroli ditched his recession call earlier this year. So did his Bank of America counterpart Michel Gapen. The Fed did, too.

After the consensus outlook for a recession in 2023, just 24% of economists that the National Association of Business Economics surveyed recently see a recession happening in 2024.

But even as the crowd turns more bullish on stocks and the economy, Grantham believes this is misplaced optimism and is sticking with his call.

Of course, being optimistic pays off much of the time in stocks, especially in recent years. Over the last 10 years, the S&P 500 has averaged an annual return of 12.39%. That means being overly pessimistic can also cost you big time. Those who have chosen to stay out of the market over the last 14 months would have missed a 33% rally.

But again, for Grantham, it's all about being optimistic at the right time when it comes to expecting favorable long-term returns. And despite what the animal spirits tell you, he argues that time is not today.

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