

GMO

North America | Europe | Asia-Pacific

CFA Society, Victoria

September 30, 2010

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GMO Overview



GMO's Edge: We blend proven traditional judgments with innovative quantitative methods, to find undervalued securities and markets.

Success Factors: Discipline, value orientation, investment research, risk control, size limitation.

Motivation/Focus: Private partnership founded in 1977; investment management is our only business.

Stability: GMO has a low turnover of investment professionals.

Current Scale: \$101 billion of assets under management:

Equities:	\$90 billion (\$61 billion non-U.S.)
Fixed Income:	\$12 billion
<i>Absolute Return</i> *:	<i>\$9 billion</i>
<i>Asset Allocation</i> *:	<i>\$35 billion</i>

More than 100 investment professionals and over 500 employees worldwide.

* Asset allocation and absolute return assets are accounted for within underlying strategies and should not be double-counted.

Represents assets from both GIPS and non-GIPS compliant firms. There are two GIPS compliant firms. The first is Grantham, Mayo, Van Otterloo & Co. LLC ("GMO"), an independent investment adviser registered under Investment Advisers Act of 1940. GMO's accounts are managed by investment management offices in Boston, MA and Berkeley, CA. GMO has total assets of \$92,957,357,614. The second firm is defined as GMO UK Limited. GMO UK was established to manage mandates primarily for UK and other European clients. GMO UK is authorized and regulated by the Financial Services Authority in the United Kingdom. GMO UK firm assets are \$3,177,620,310.

Source: GMO
As of 7/31/10

Agenda

- Should emerging markets trade at a discount, parity or premium to developed markets?
- Themes within emerging markets – domestic demand

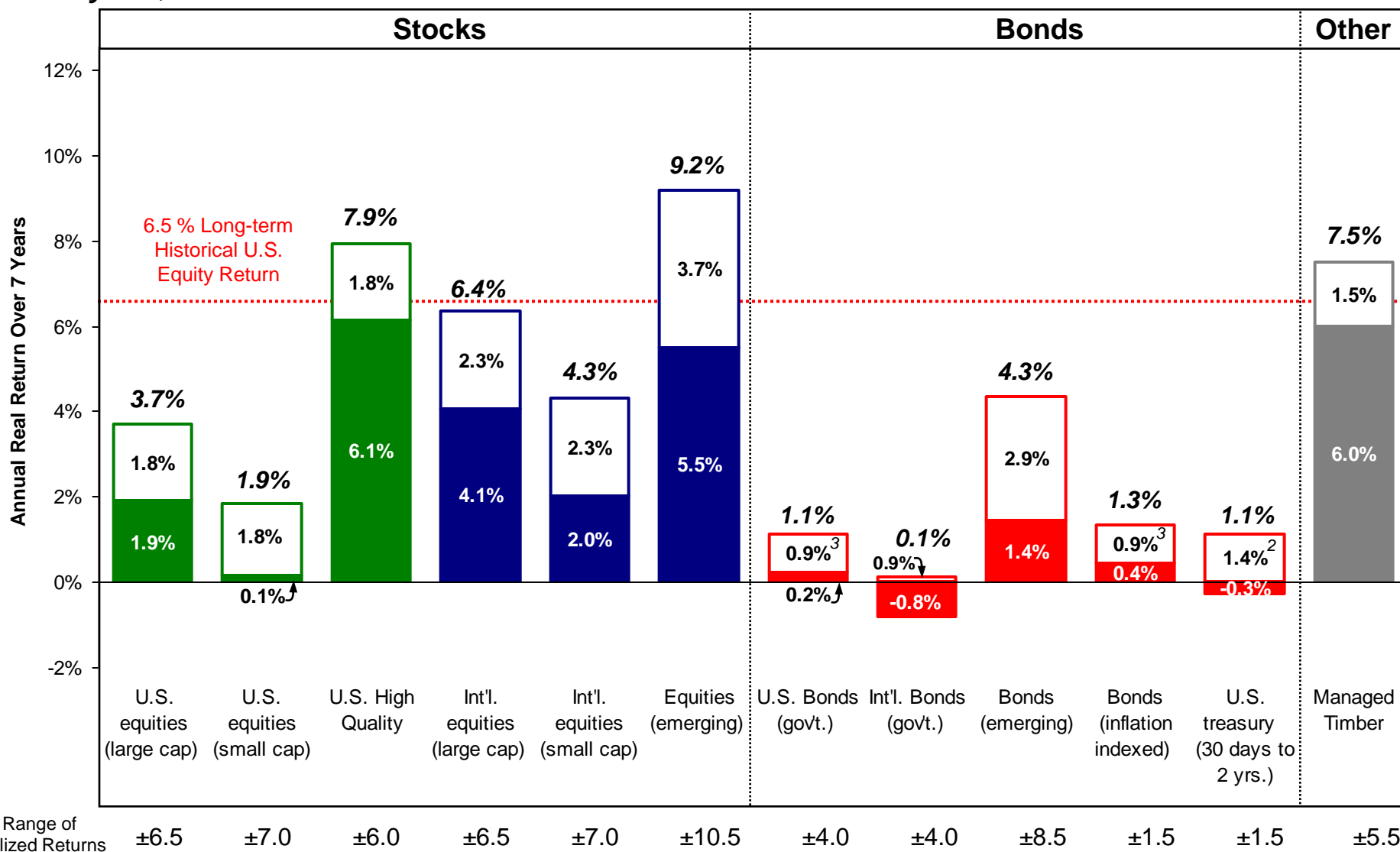
Emerging Markets

Should emerging markets trade at a discount, parity or premium to developed markets?

GMO 7-Year Asset Class Return Forecasts*

- Expected Value Added
 - Real Return (Asset Class Index)

As of July 31, 2010



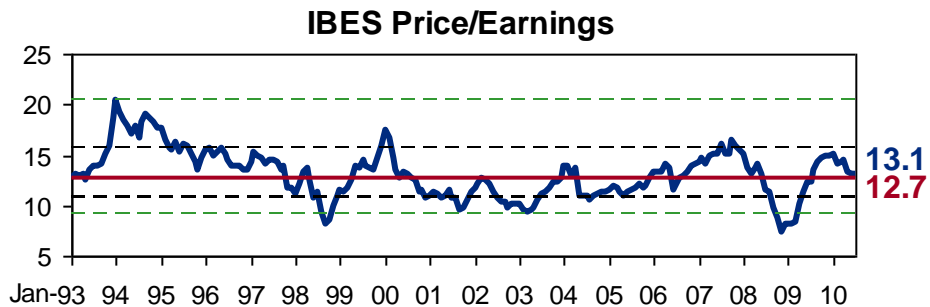
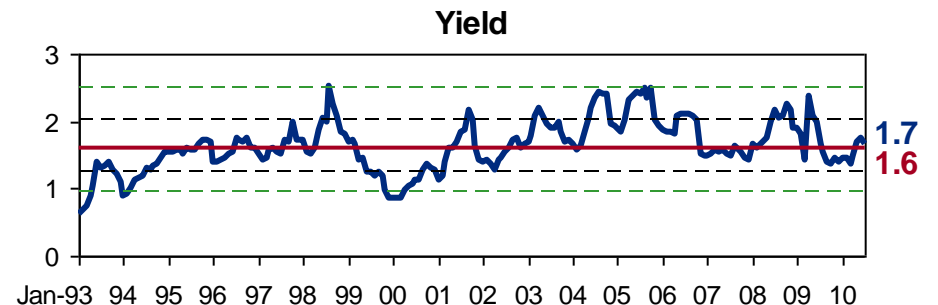
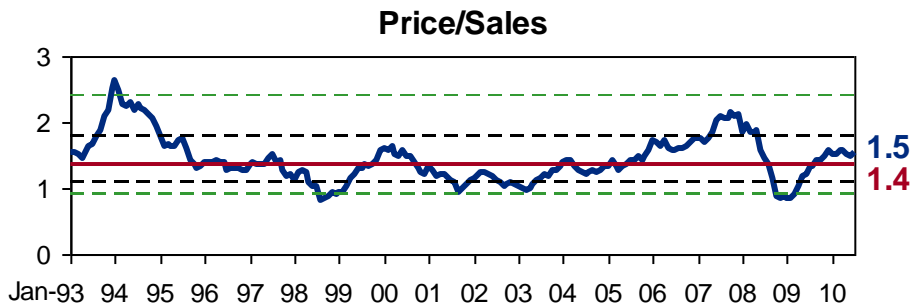
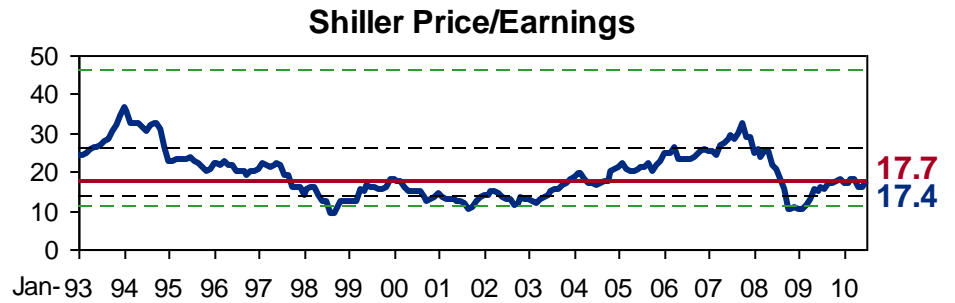
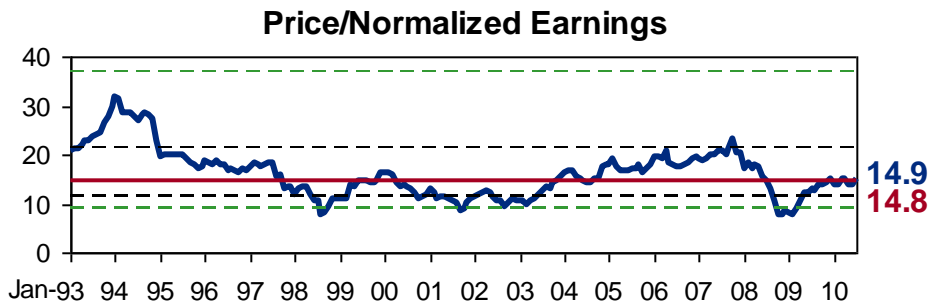
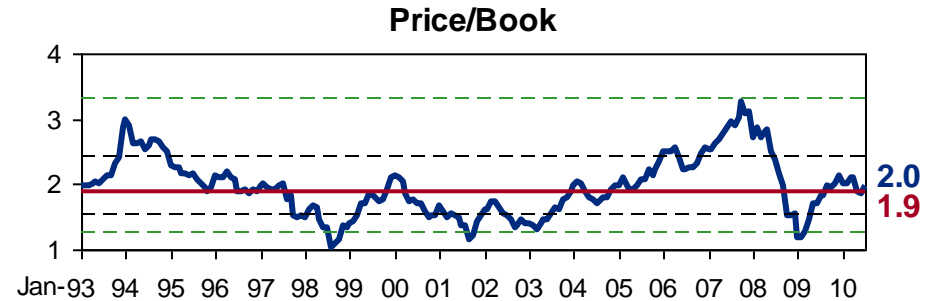
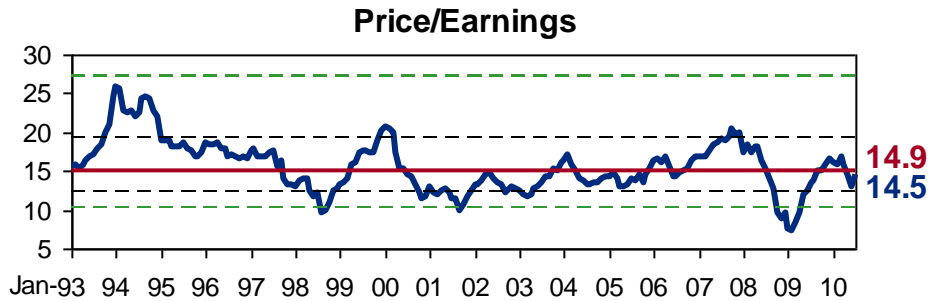
*The chart represents real return forecasts¹ for several asset classes and an estimate of net value expected to be added from active management. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Actual results may differ materially from the forecasts above.

¹ Long-term inflation assumption: 2.5% per year.

² Alpha transported from management of global equities.

³ Alpha transported from management of global bonds.

Emerging Markets Valuations



	Mean	Value	Discount	Z-Score
Price/Earnings	14.9	14.5	3.1 %	0.1
Price/Book	1.9	2.0	-3.7 %	-0.2
Price/Normalized Earnings	14.8	14.9	-0.8 %	0.0
Shiller Price/Earnings	17.7	17.4	1.9 %	0.1
Price/Sales	1.4	1.5	-8.2 %	-0.5
Yield	1.6	1.7	2.1 %	0.1
IBES Price/Earnings	12.7	13.1	-2.7 %	-0.1

What Drives P/E Ratios? Going Back to the First Principles

The Gordon growth model

- $\text{Price} = \text{Earnings} / (\text{Risk Premium} - \text{Growth})$.
- $\text{Price/Earnings} = 1 / (\text{Risk Premium} - \text{Growth})$.
- In short, P/E is driven by Risk Premium and Growth.
- Thus, Risk, Growth, Profitability, and Corporate Governance are the things that matter.
- Let's look at the drivers of each.

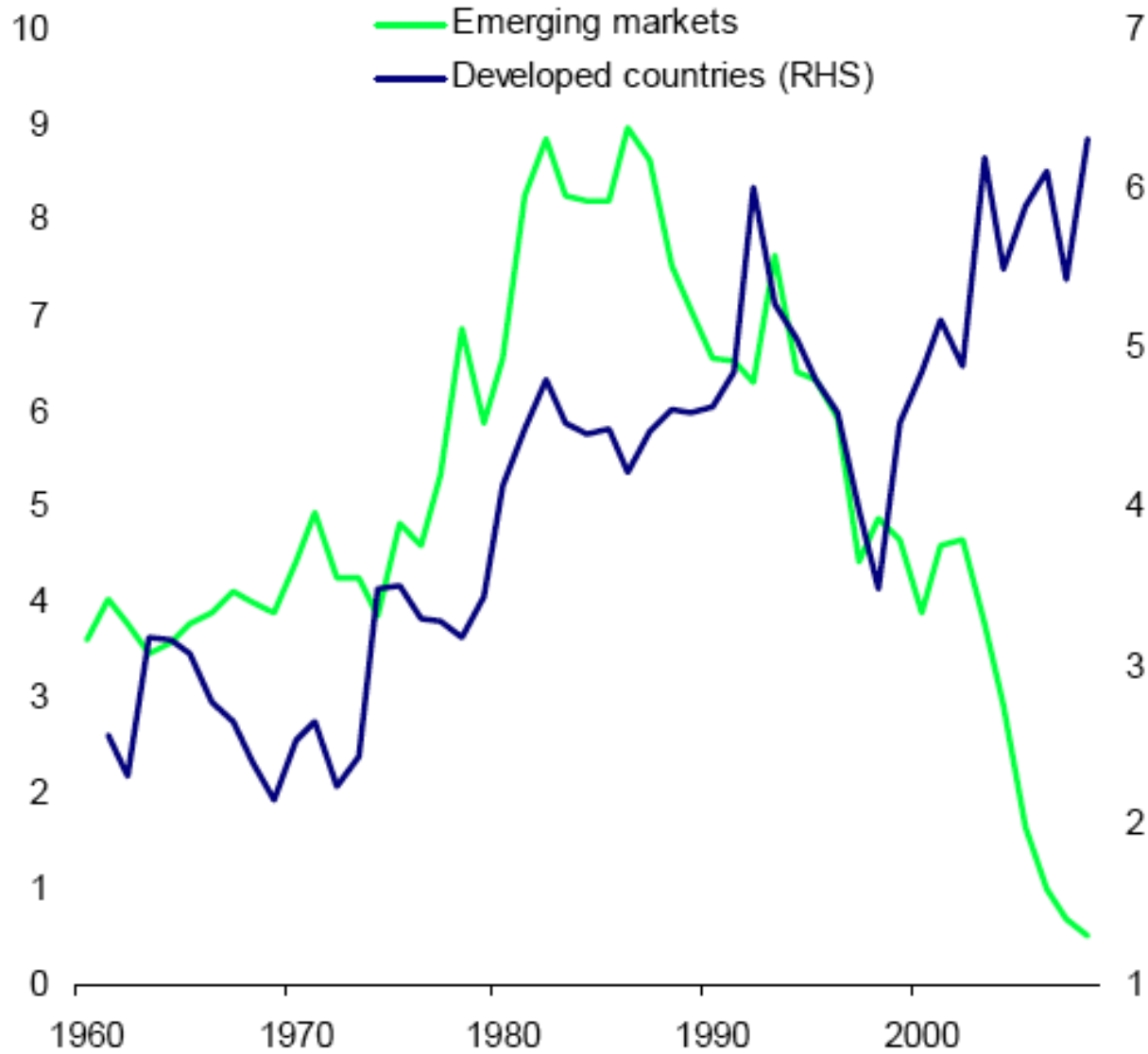
If Things Get REALLY BAD,

Who can write a check to save themselves?

Country	Region	Current Account Balance	Budget Balance	Foreign Reserves	Gov't. Debt	Overall Rank
China	Asia	4.1	-2.6	43.8	16.9	1
Taiwan	Asia	8.8	-3.1	87.2	32.5	2
Korea	Asia	3.0	-2.0	28.0	23.5	3
Russia	EMEA	5.2	-3.9	29.4	6.3	4
Thailand	Asia	6.6	-3.6	49.5	45.9	5
Chile	LatAm	-0.1	-2.2	13.3	6.1	6
Peru	LatAm	-1.8	0.2	24.4	24.8	7
Indonesia	Asia	1.5	-2.2	10.8	27.4	8
Malaysia	Asia	13.0	-5.3	40.9	53.7	9
Philippines	Asia	3.9	-3.7	25.1	58.7	10
Mexico	LatAm	-1.2	-1.0	10.0	37.7	11
Hungary	EMEA	-0.3	-3.9	35.7	78.0	12
Poland	EMEA	-3.0	-3.0	19.1	46.5	13
Israel	EMEA	2.4	-4.1	29.6	78.4	14
Colombia	LatAm	-1.6	-3.9	9.8	45.8	15
Brazil	LatAm	-2.7	-1.8	13.1	60.0	16
Czech Republic	EMEA	-3.3	-5.4	21.1	34.1	17
Germany	Developed	4.5	-5.2	6.5	72.1	18
Turkey	EMEA	-4.8	-4.5	14.8	46.3	19
India	Asia	-1.6	-5.5	15.9	58.0	20
Japan	Developed	3.2	-7.8	20.3	189.3	21
South Africa	EMEA	-5.0	-6.3	12.3	29.5	22
Italy	Developed	-2.4	-5.1	7.2	115.2	23
Ireland	Developed	-0.7	-19.0	1.0	57.7	24
United Kingdom	Developed	-1.1	-10.3	3.3	68.1	25
France	Developed	-2.4	-8.4	6.7	77.5	26
United States	Developed	-3.2	-8.8	0.8	52.9	27
Spain	Developed	-4.7	-9.9	2.2	53.2	28
Portugal	Developed	-8.0	-7.8	0.0	76.9	29
Greece	Developed	-7.2	-9.9	1.9	113.4	30

Risk: The Lost Decades Are Over

Vulnerability index levels*



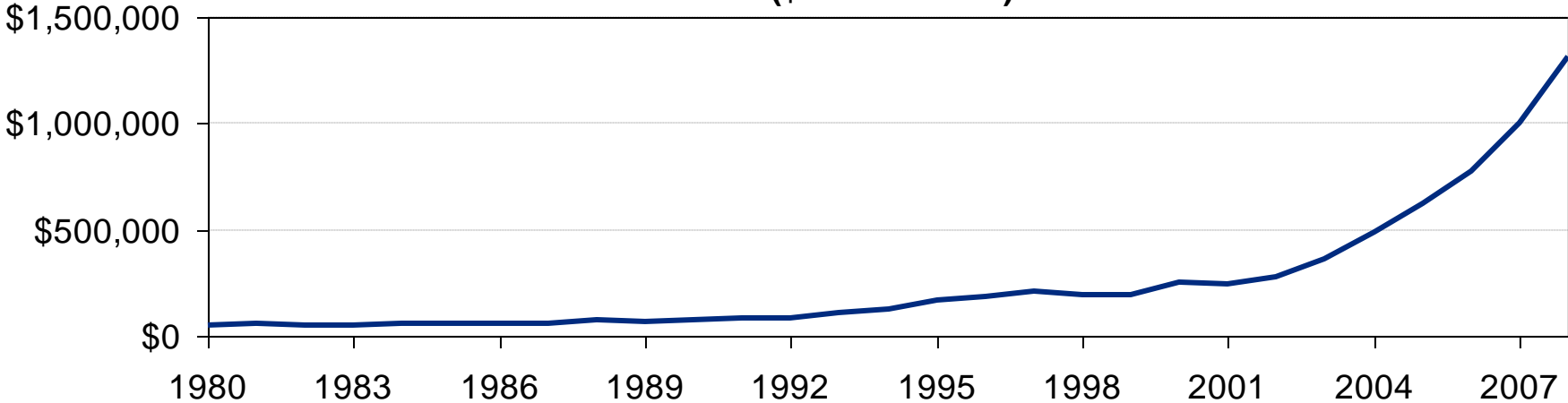
Risk Premium Has Come Down Substantially – Even in This Crisis

Emerging sovereign debt spread over treasuries

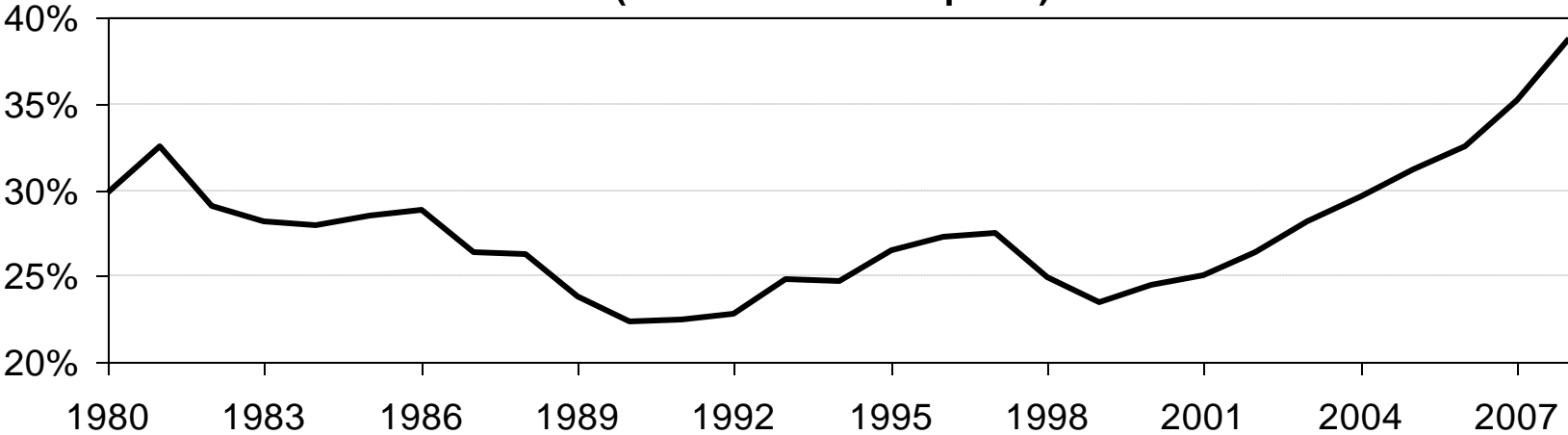


Risk: Intra-Emerging Trade Is Reducing Dependence on Exports to the West

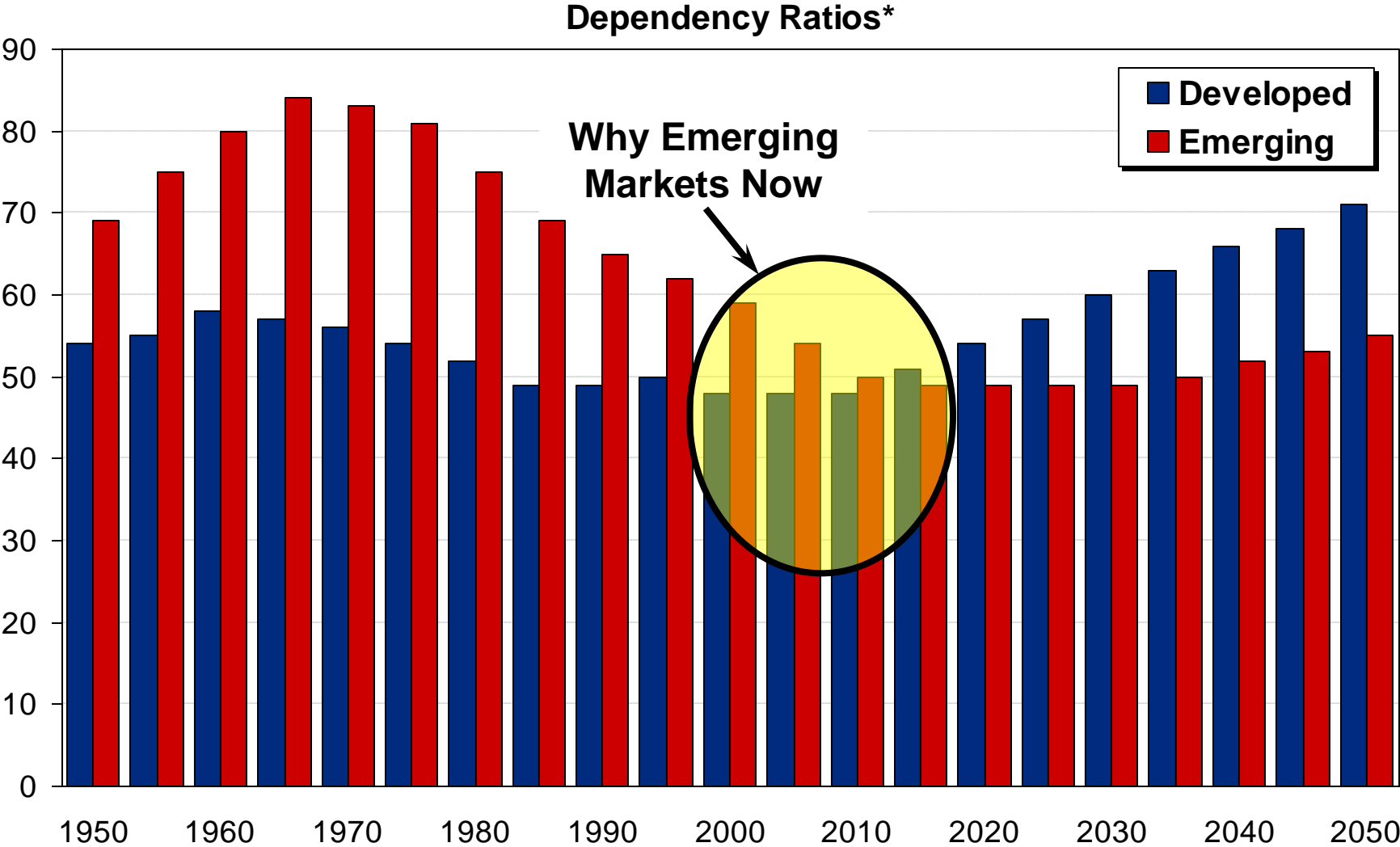
Intra-Emerging Markets Trade Has Exploded (\$U.S. Millions)



Emerging Exports to Other Emerging Countries (As a % of Total Exports)



Growth: Demographics Play an Important Role

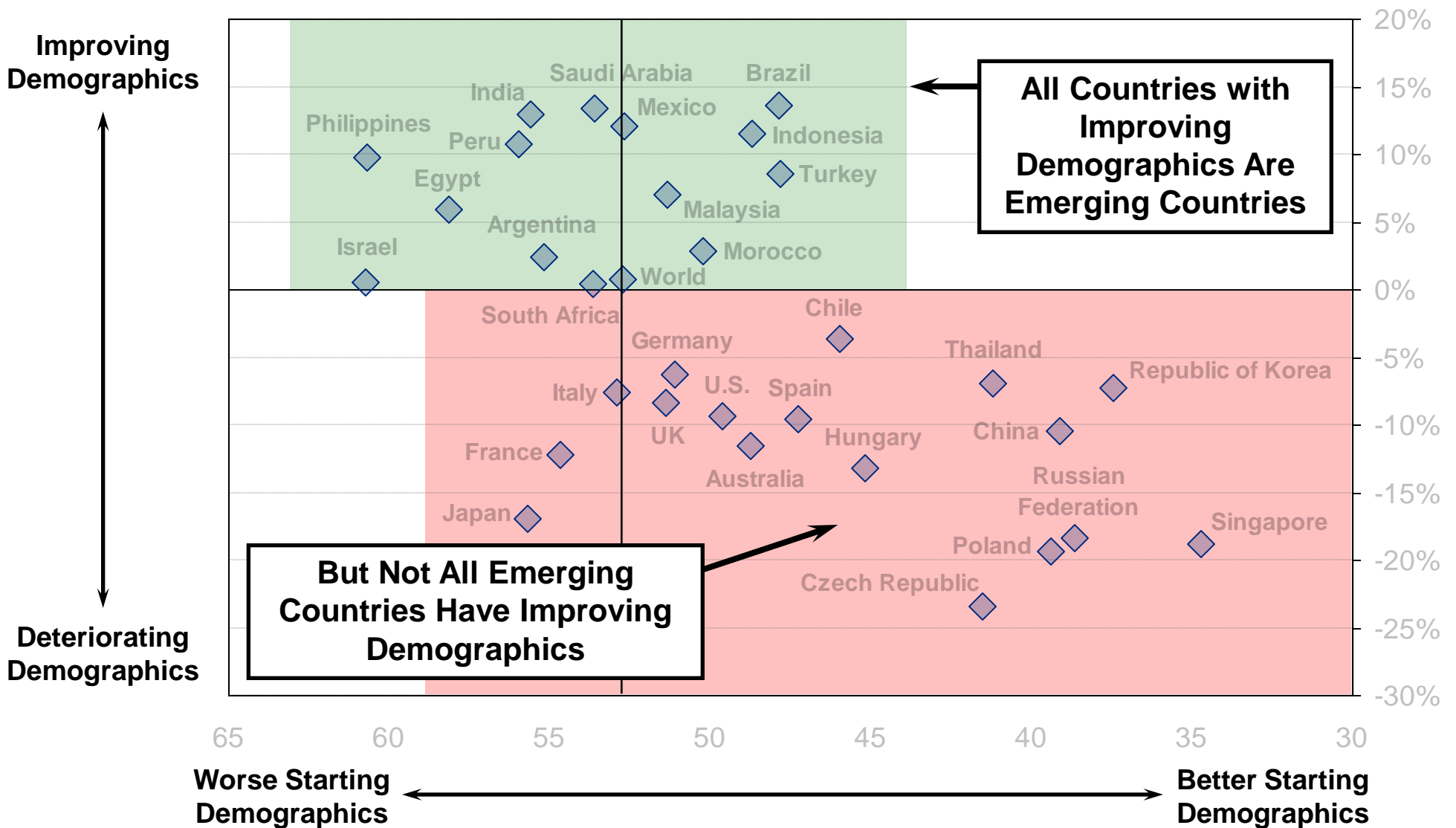


* Percent of non-working to working people.

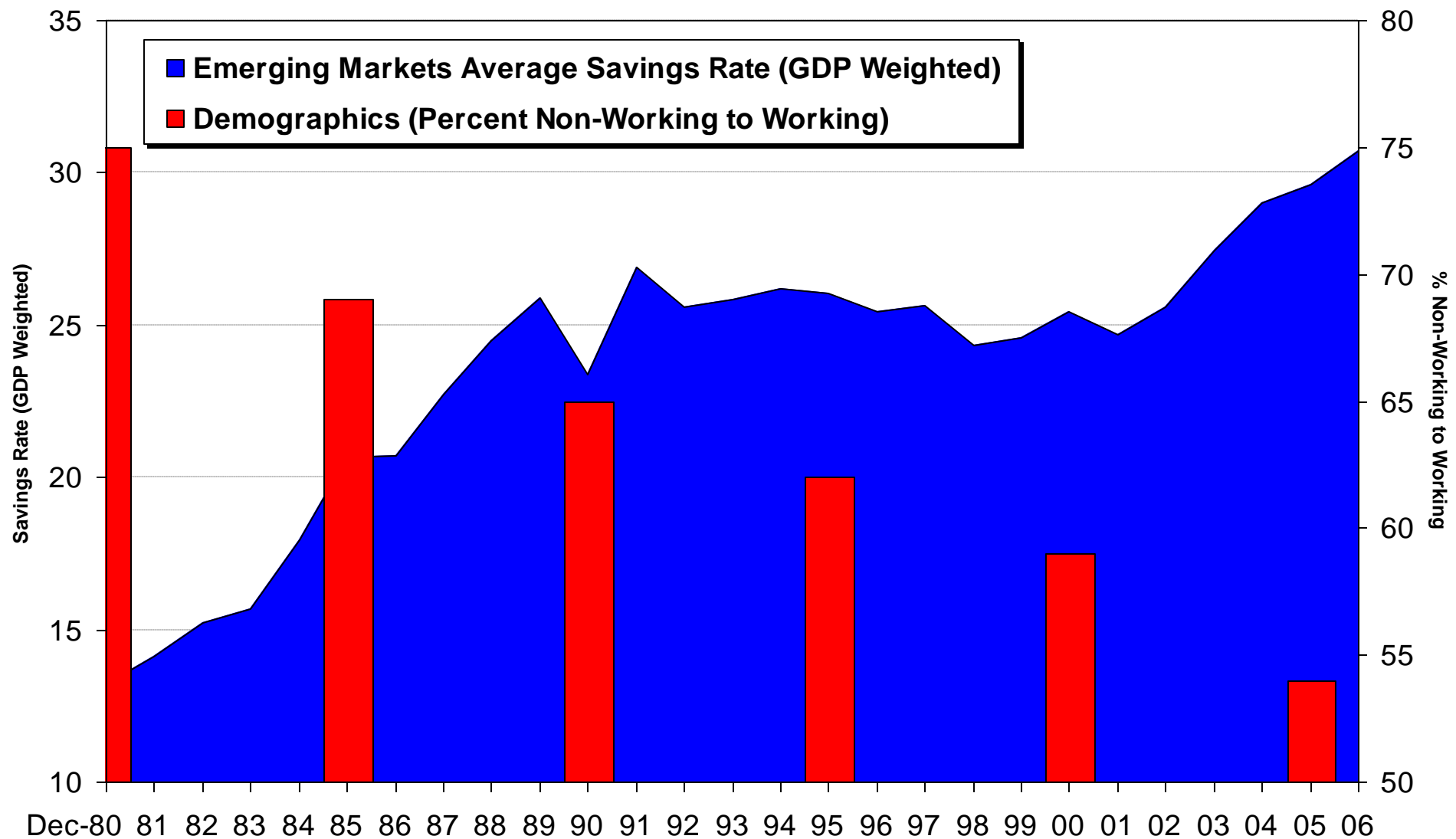
Source: United Nations

Growth: Demographics – the Next 10 Years

Starting demographics vs. changes

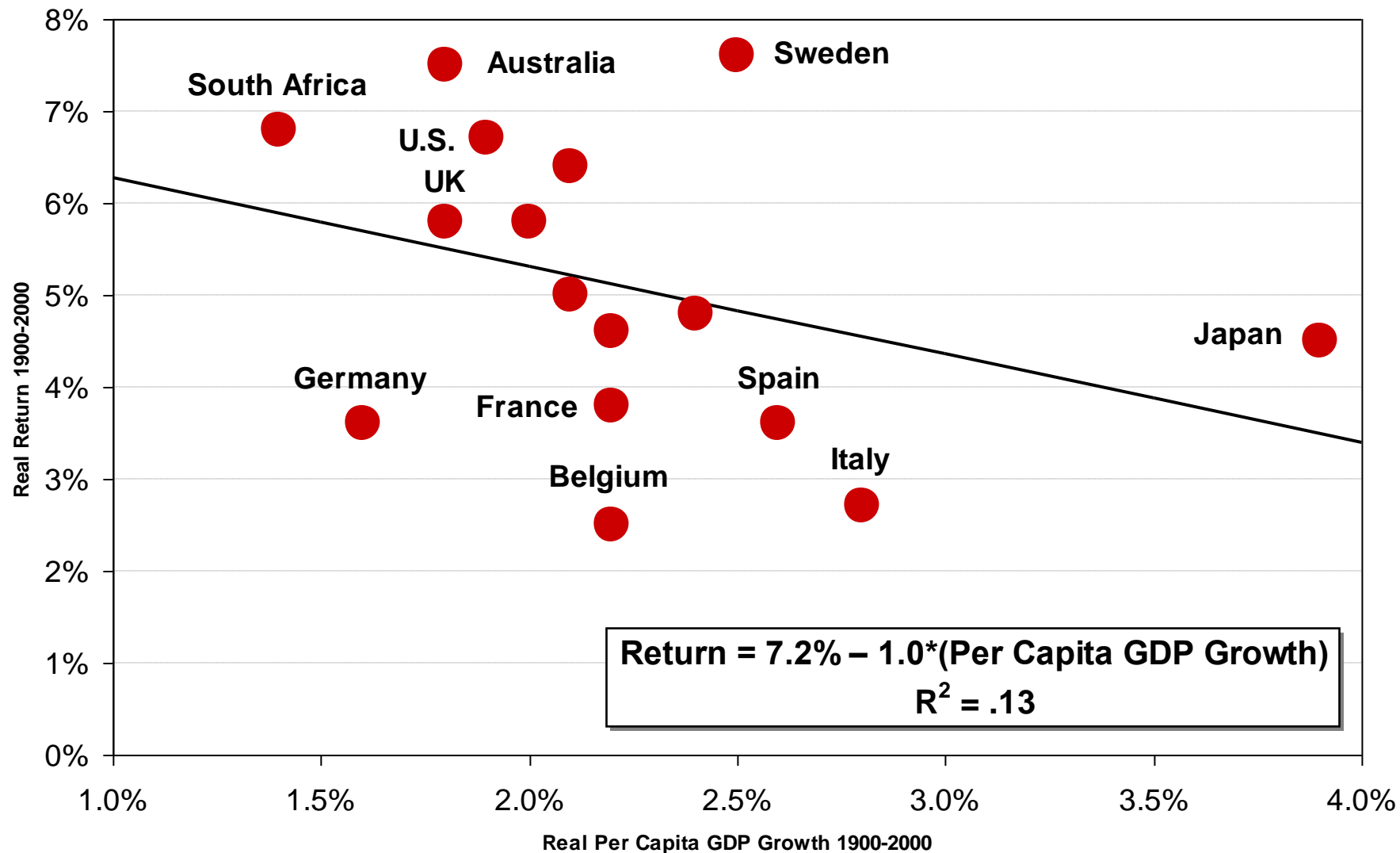


Growth: Savings Rates Are Tied to Demographics

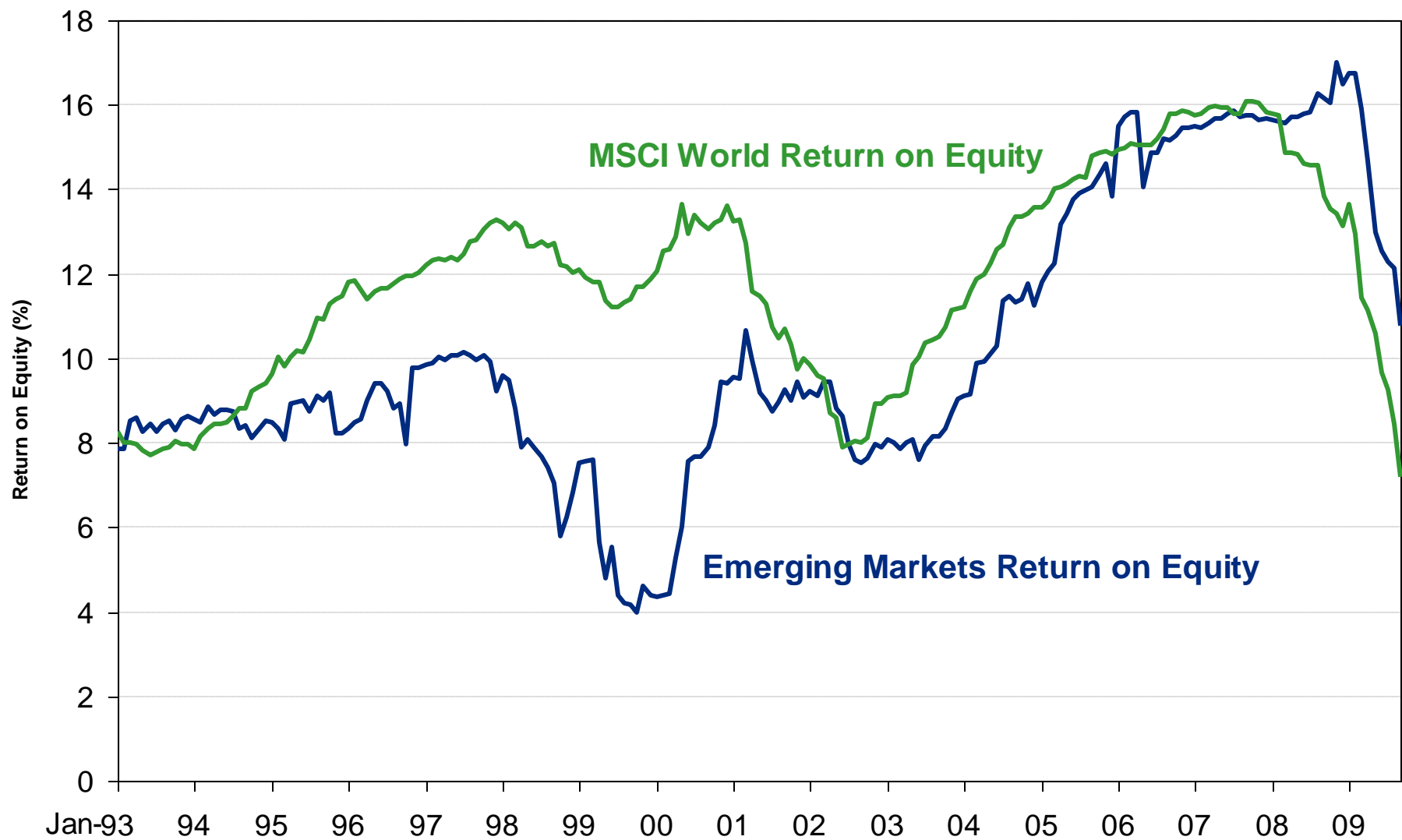


Growth: But Does High GDP Growth Translate to High Stock Returns?

Dimson and Marsh findings from 1900-2000



Profitability in Emerging Markets Has Converged with Developed

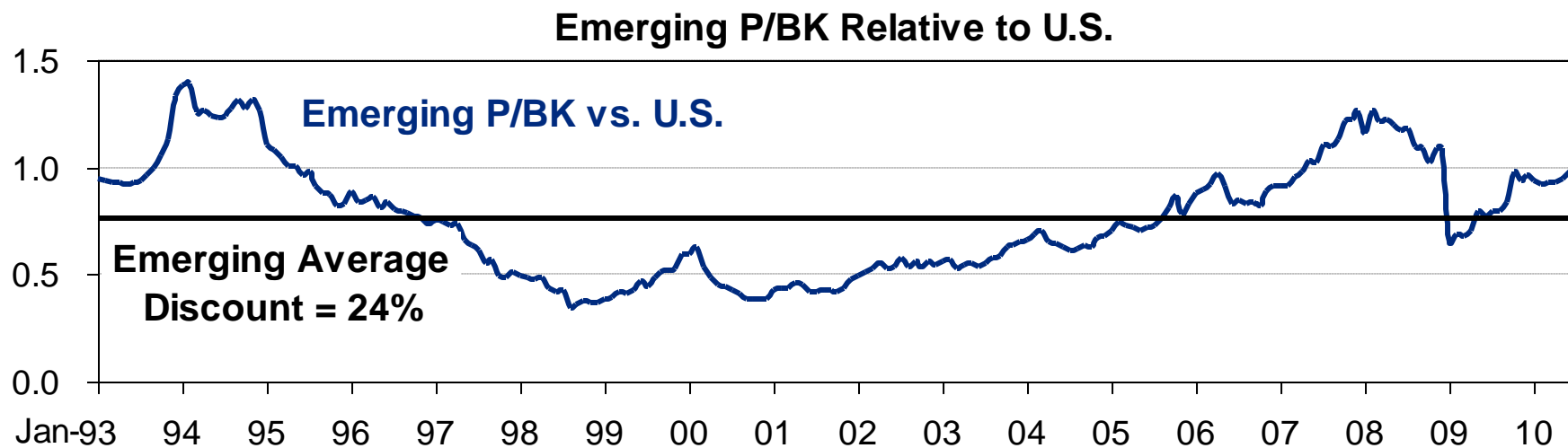
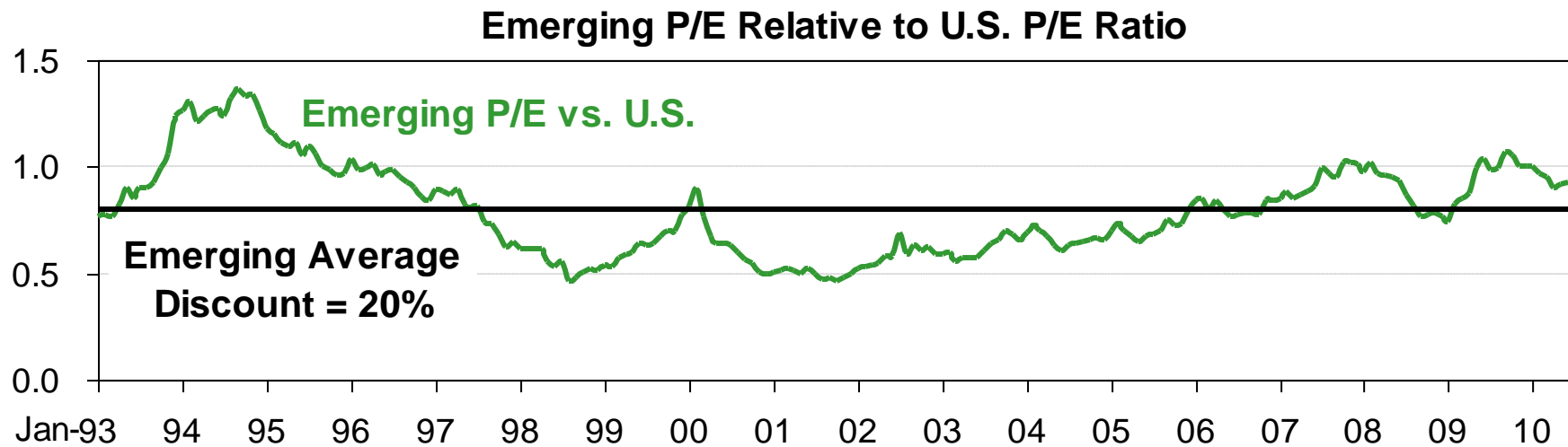


Why Profitability Has Converged

- Since the Tequila/Asia/Russia/Argentina/Brazil crises of the 90s, most countries (with the prominent exception of China) have opened their capital accounts and allowed their currencies to float.
- The same crises forced these countries to abandon industrial policy, allowing capitalism to work.
- Corporate governance has improved dramatically since the 90s.
 - Globalization of trade AND finance has forced standardization of corporate governance.
 - Figured out that they can get richer by getting a higher P/E than by stealing this year's earnings.
 - Generational shift to Western educated managements.

Should Emerging Markets Trade at a Discount or Premium?

In the 90s, the answer was easy. Now it's not as clear...



Pulling It All Together

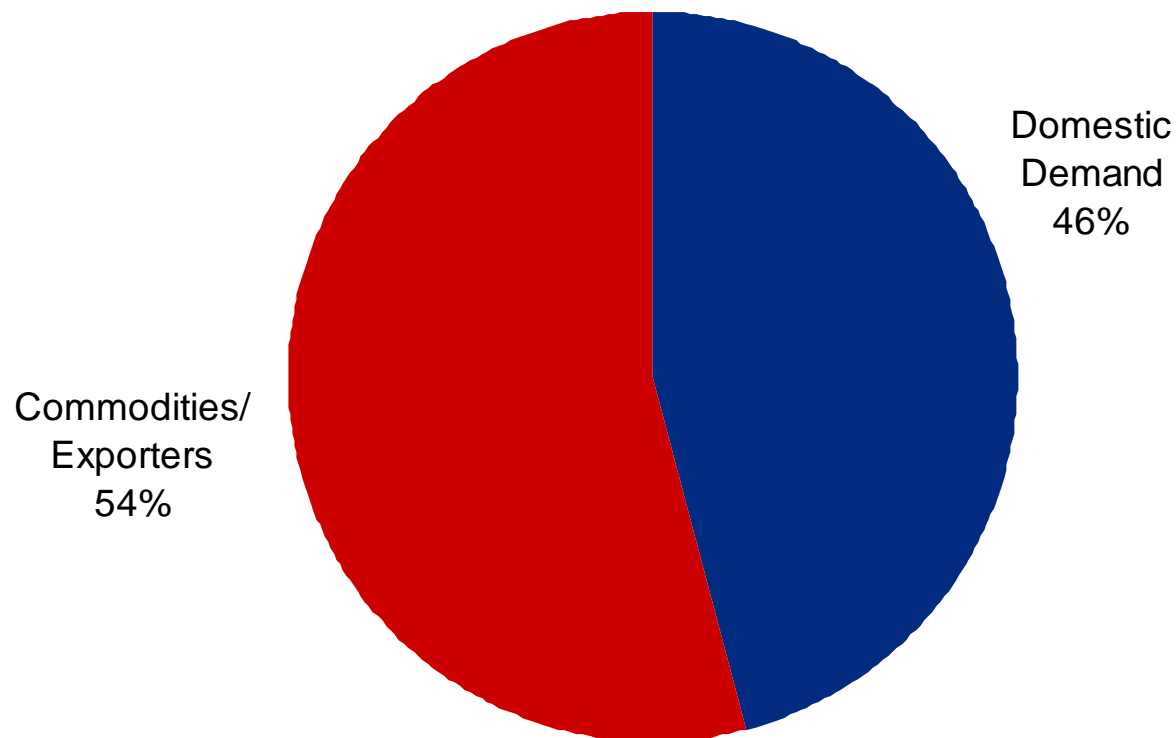
- With most emerging markets running “good” economic policies, actual and perceived risk has come down.
- Growth will likely stay strong, based on demographics and other factors.
- Profitability has converged with developed markets and is likely to stay that way.
- As a result, there’s a plausible case that emerging markets should trade at parity to developed markets in the medium term and at a HUGE premium in the short term (if Jeremy’s Emerging Emerging Bubble thesis is correct).

Emerging Markets

Themes within emerging markets – domestic demand

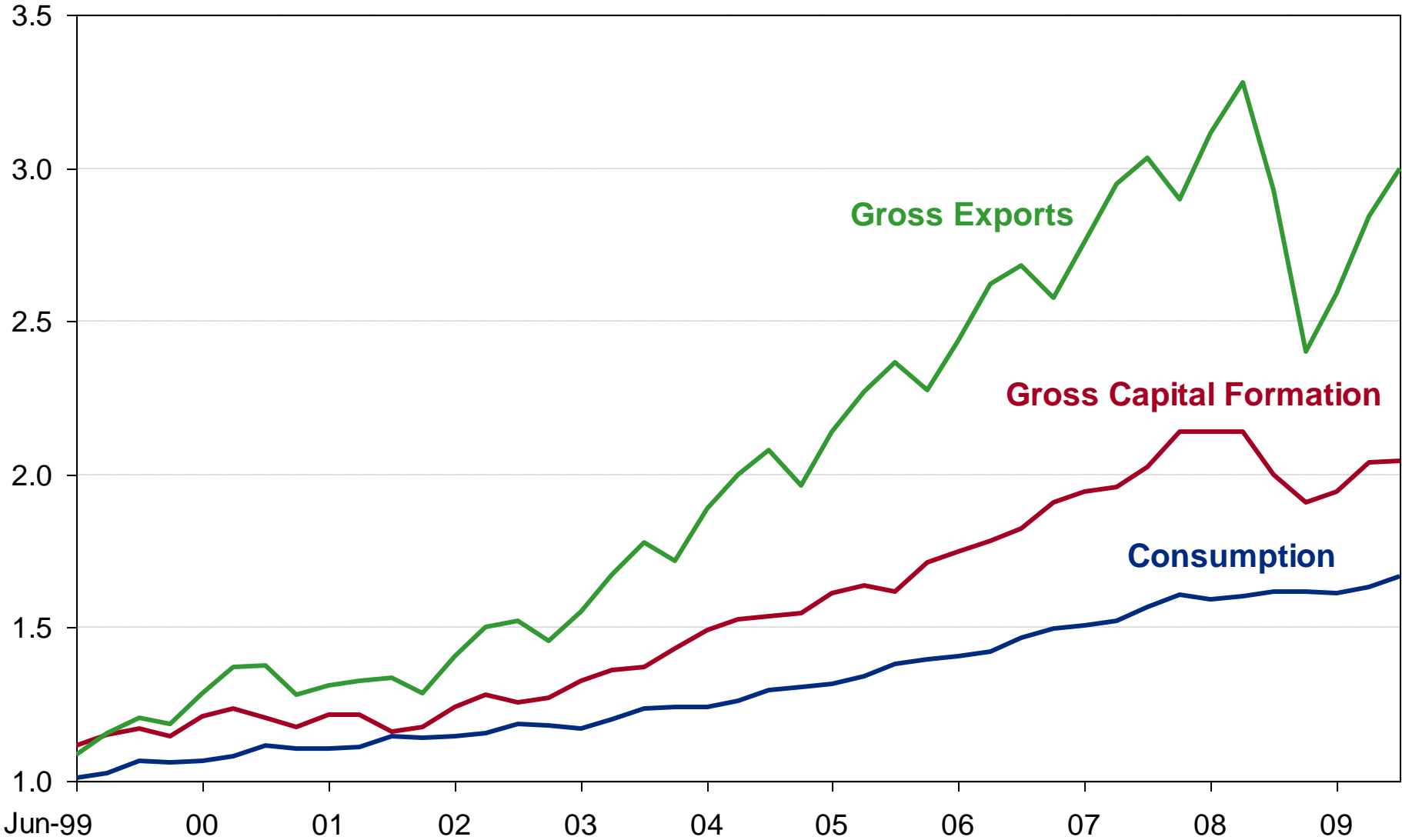
Indices Are Skewed towards Globally Sensitive Companies – Commodity Producers and Exporters

IFC EM Universe Classification by Investable Market Cap

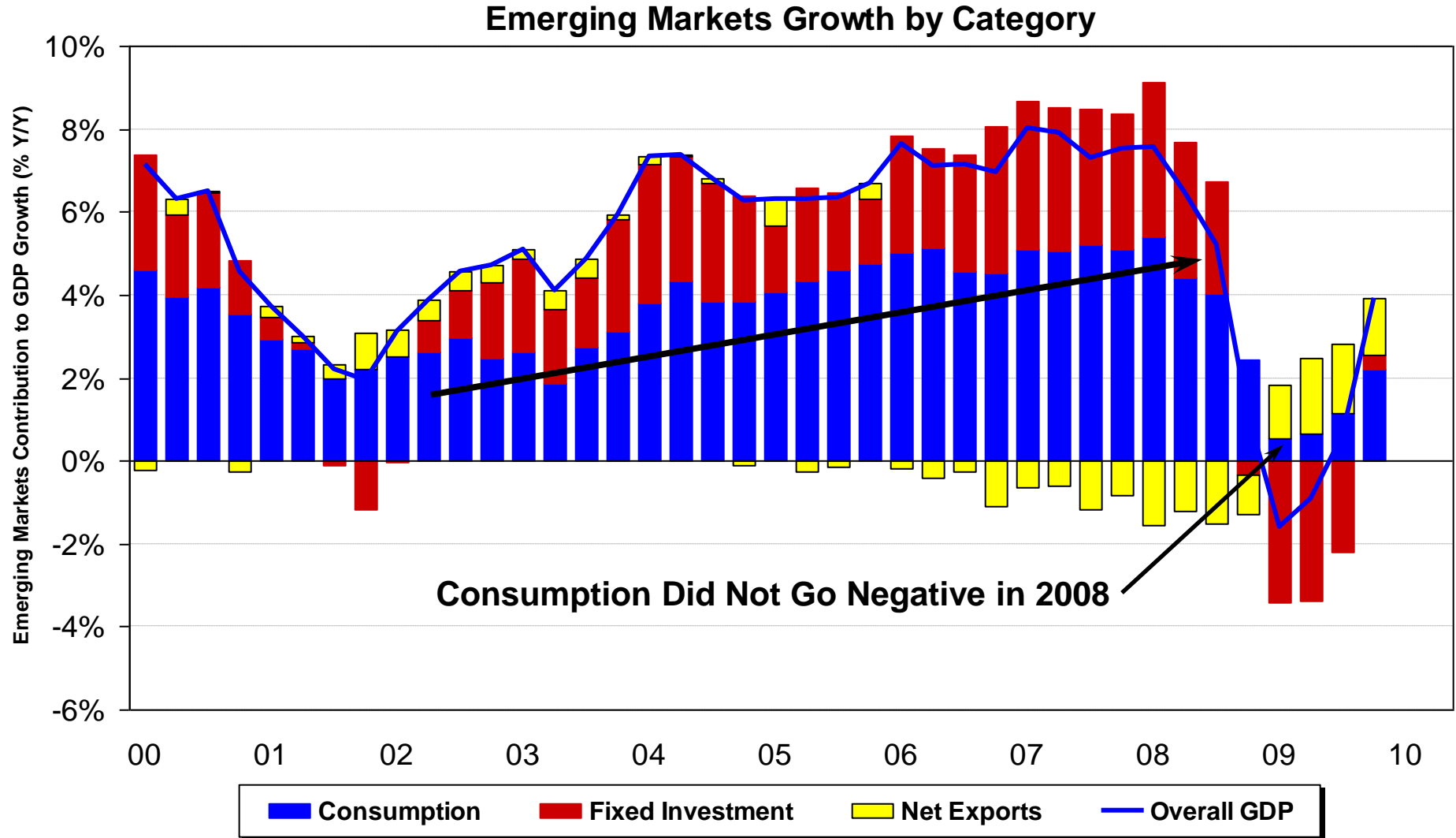


Exports Have Been the Main Driver of Growth...

Components of emerging market growth over last 10 years

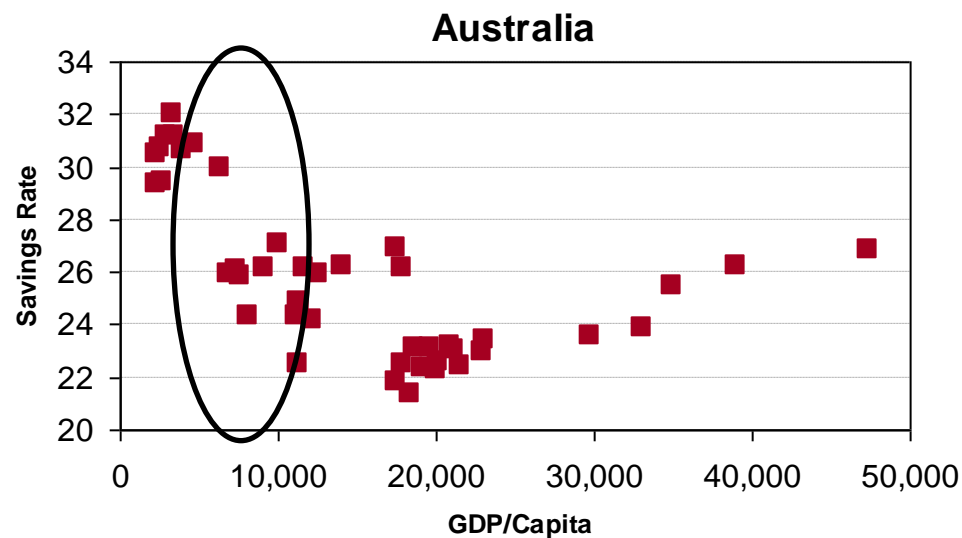
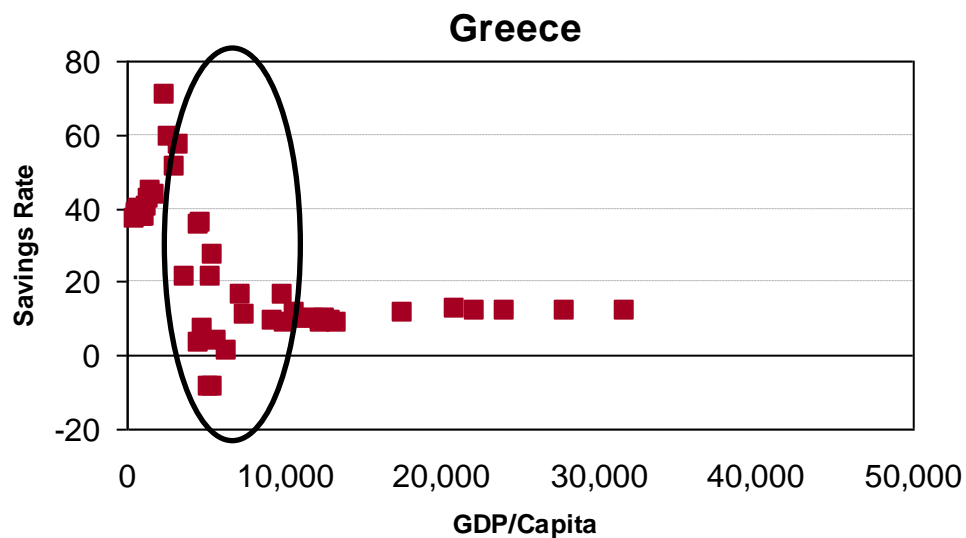
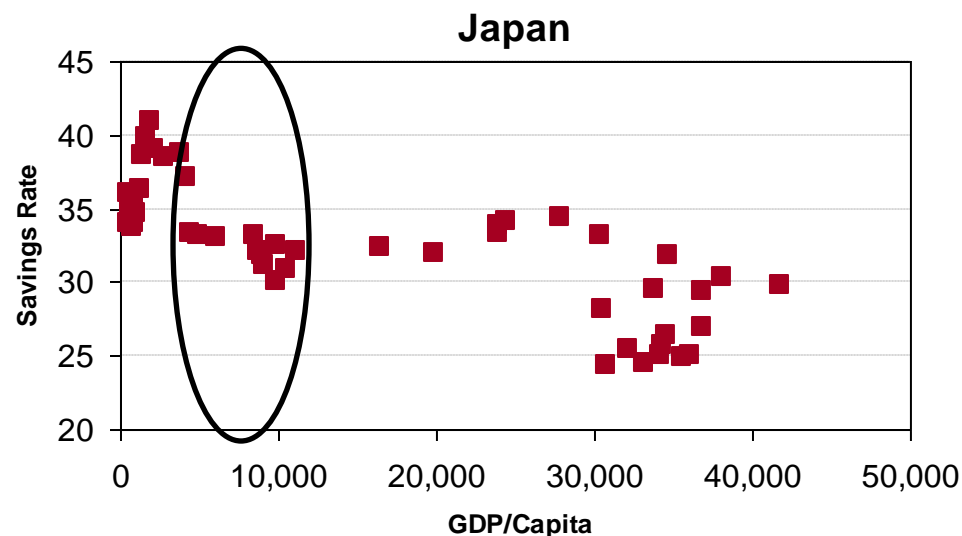
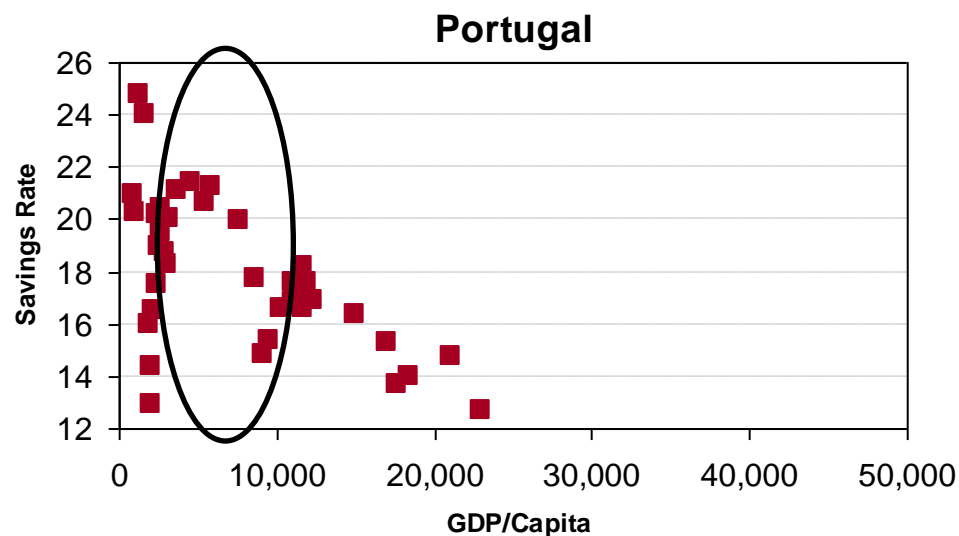


Consumption Has Become a Larger Part of Growth

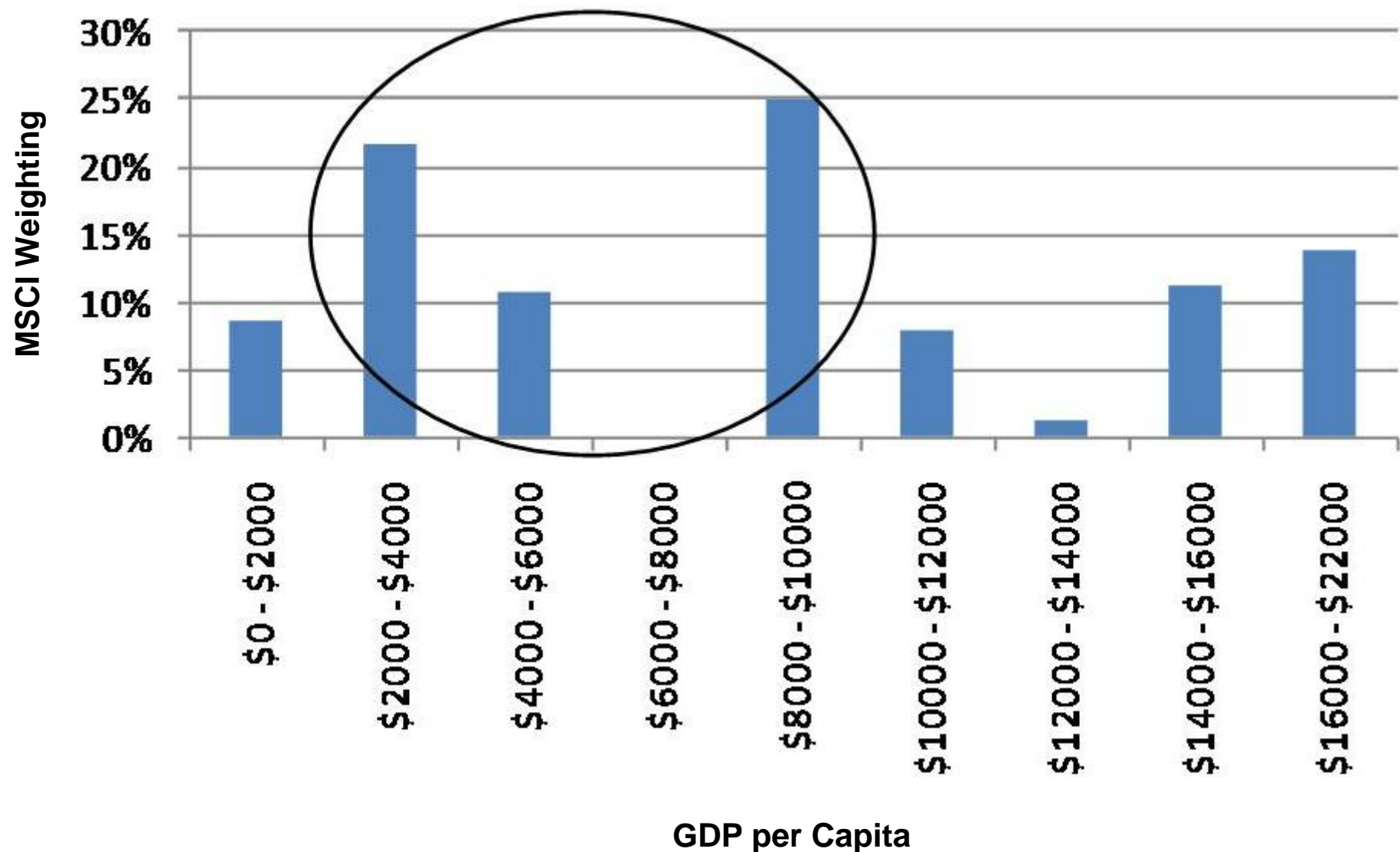


Savings Rates Drop Dramatically When GDP/Capita Reaches the \$3,000 to \$10,000 Range

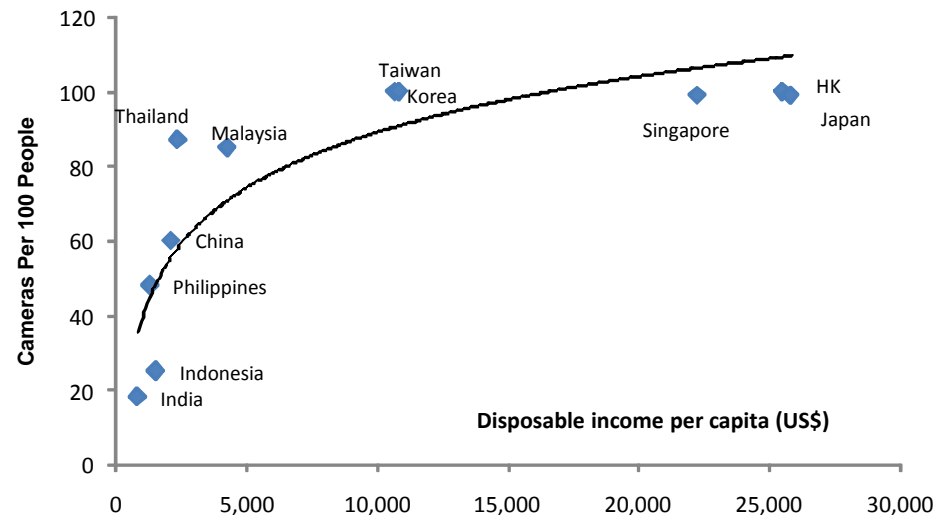
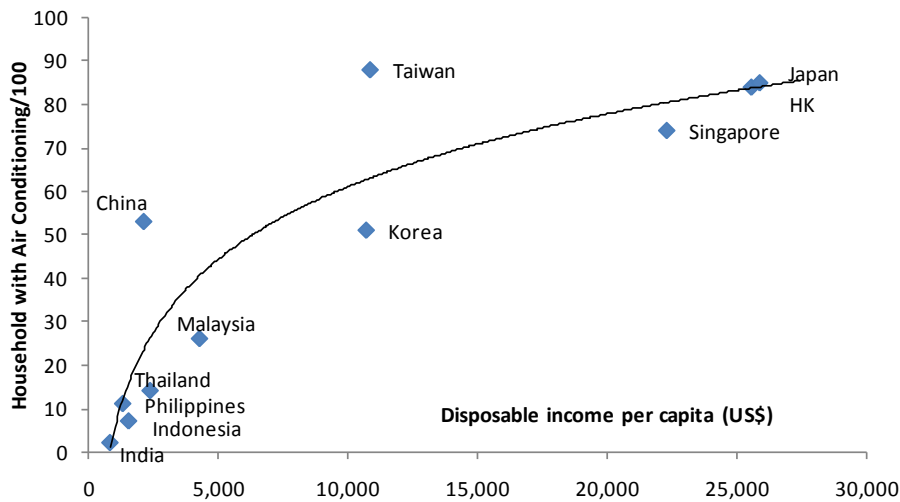
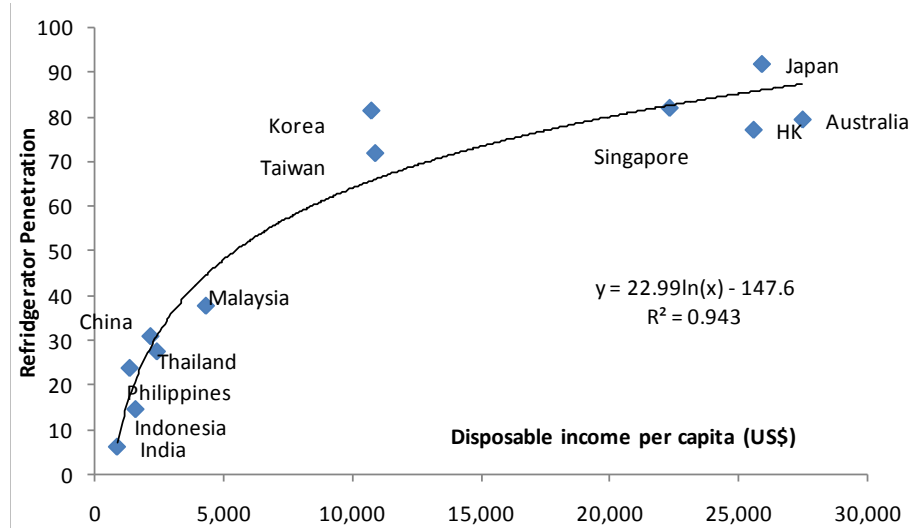
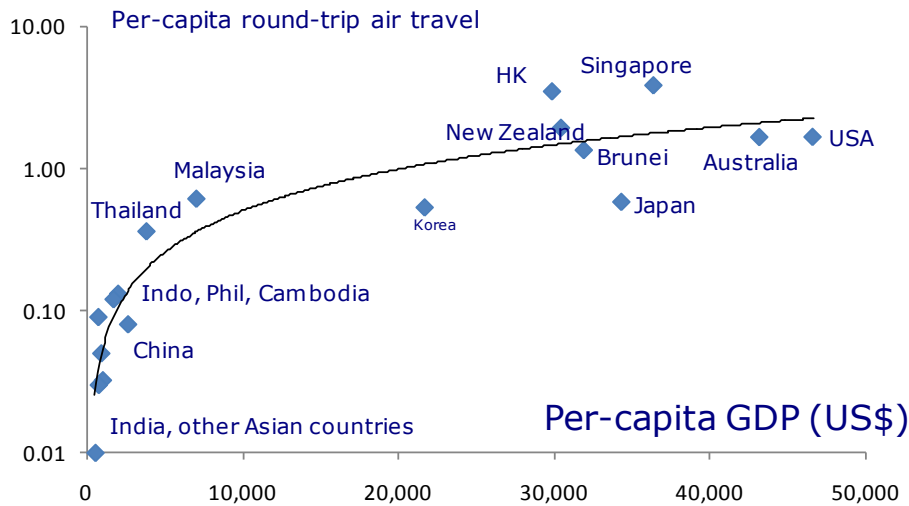
We've seen this in developed markets at a similar stage of development



And 50% of Emerging Countries Now in the Sweet Spot of Shifting from Savings to Consumption

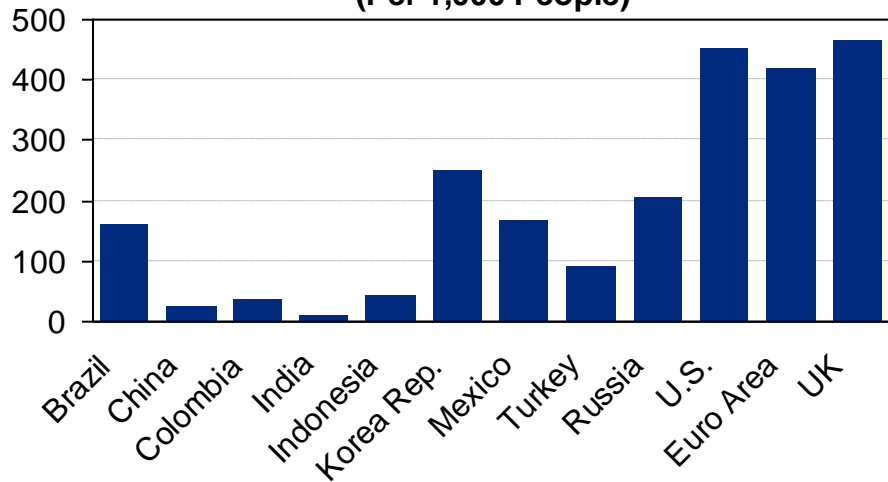


The Relationship between Income and Consumption Is Not Linear

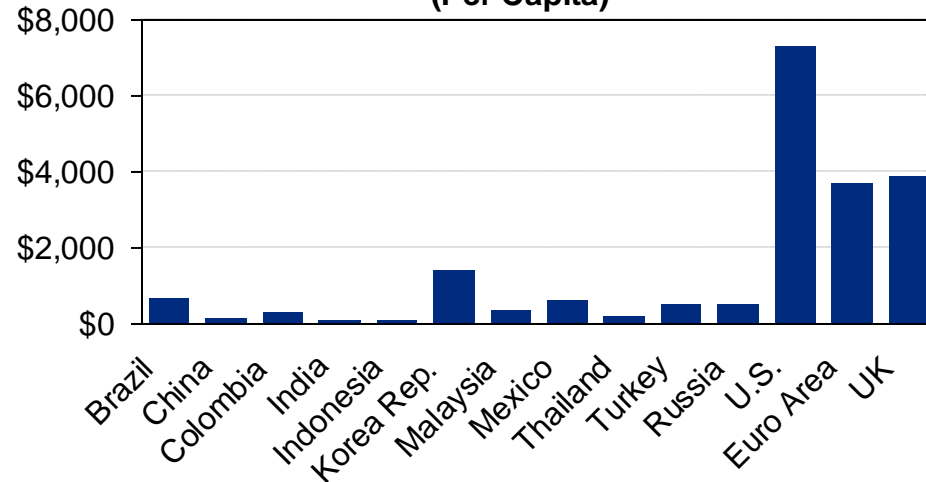


And Penetration Rates in Emerging Markets Are Still Very Low

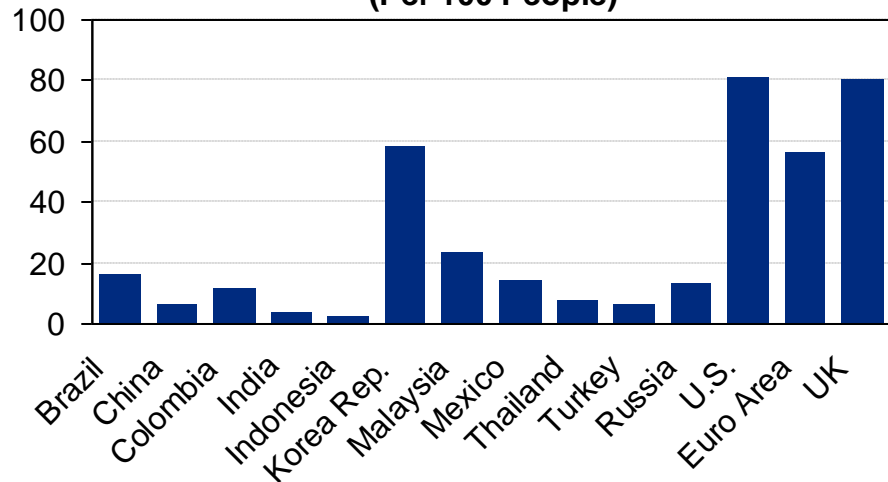
Passenger Cars
(Per 1,000 People)



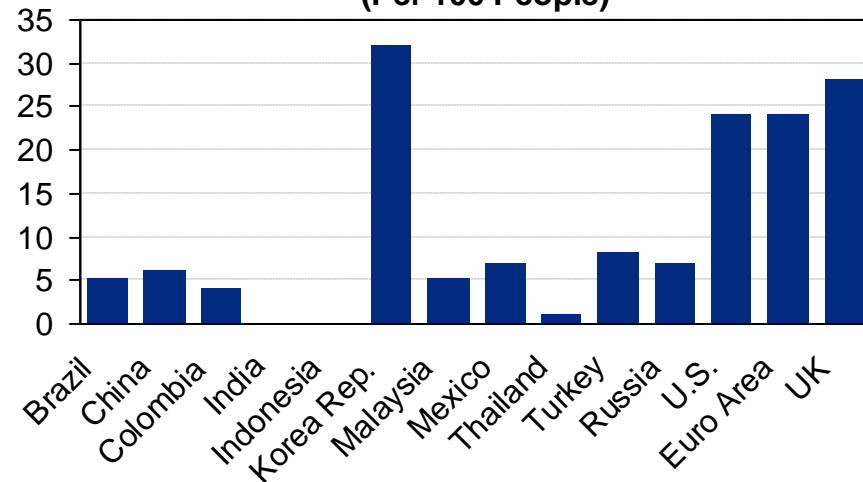
Health Expenditure
(Per Capita)



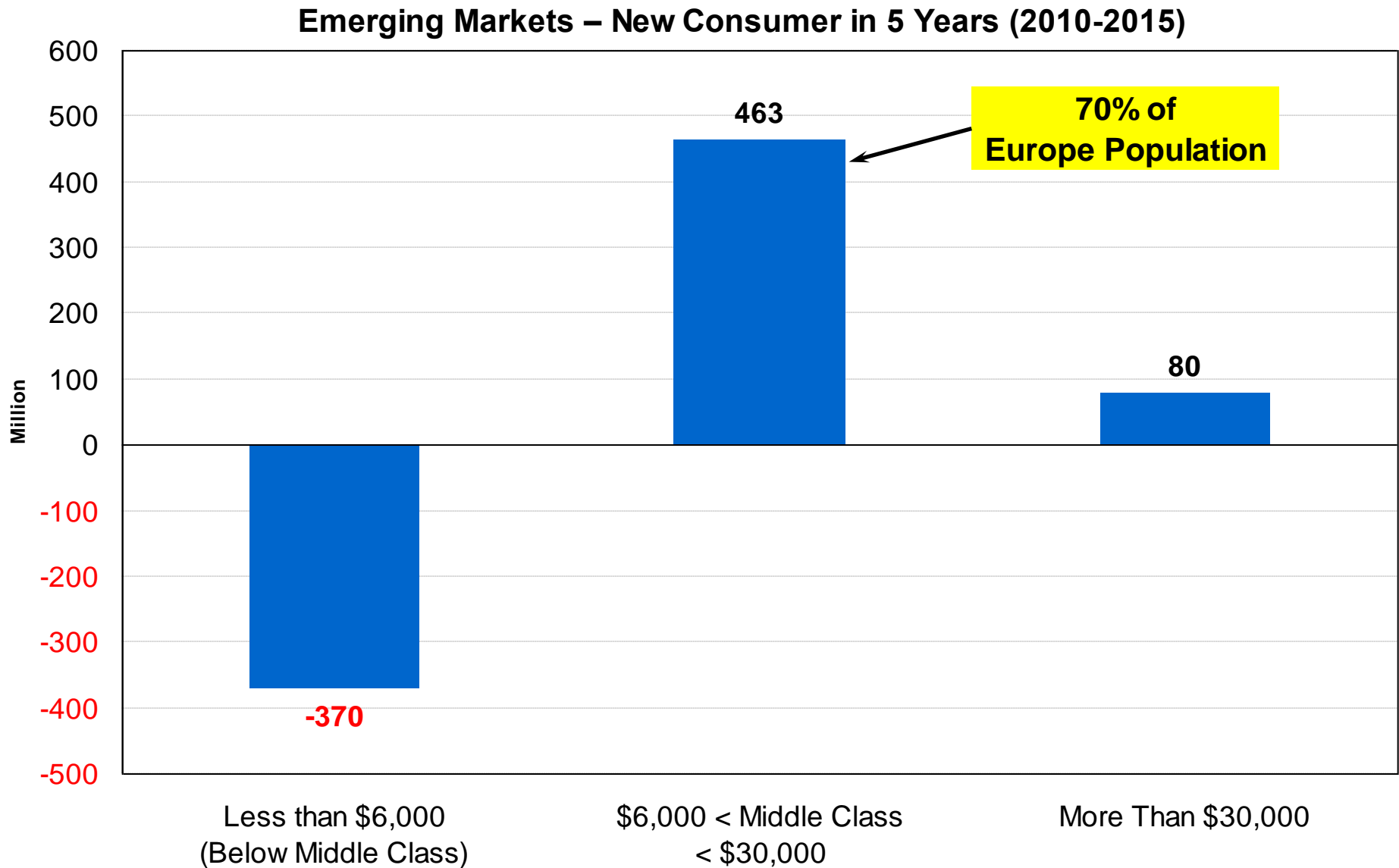
Personal Computers
(Per 100 People)



Fixed Broadband Internet Subscribers
(Per 100 People)

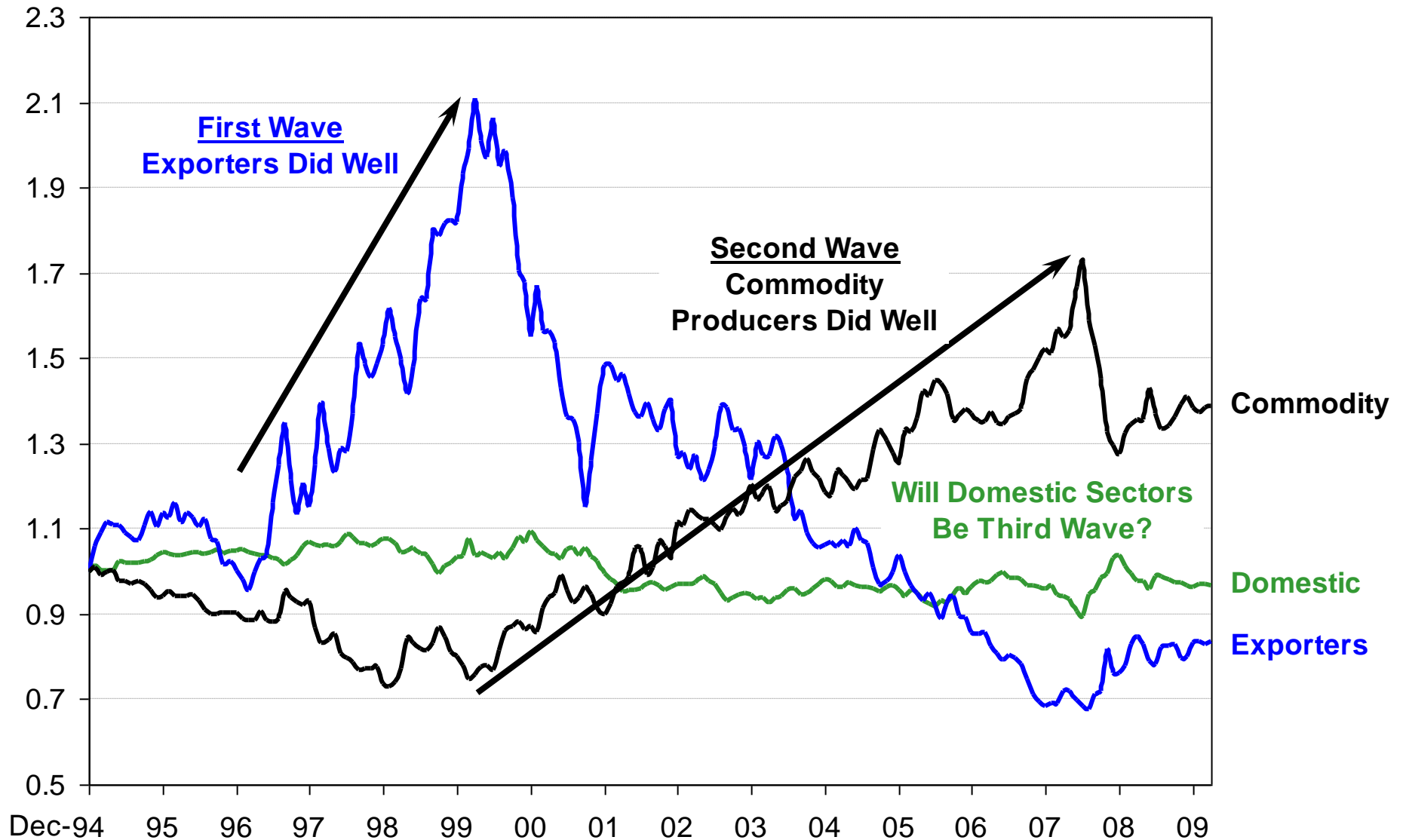


If Current Trends Persist, the Emerging Middle Class Will Increase by around 500 Million People in the Next 5 Years



The Third Wave?

Relative performance of domestic, export and commodity sectors in Emerging Markets



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