

Investment Themes

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**NEW TRADE IDEA: Auto Replacement Cycle**

We believe investors should position themselves to benefit from an upcoming replacement cycle in the US auto sector. The depressed and below trend levels of US auto sales over the past three years as well as last year's production disruptions (earthquake in Japan) have created pent up demand which is now resulting in an acceleration in sales reports. Additionally, we are overdue for a replacement cycle as the last one was 12-13 years ago and is contributing to an ever aging fleet: Polk estimates the average car age is approaching 11 years, and we estimate that the average age of vehicles being retired is nearing 16 years. While some of this increase is due to technological advancements, we still expect the urgency to scrap old cars to increase as their maintenance costs rise, particularly when compared to historically low financing rates for new cars.

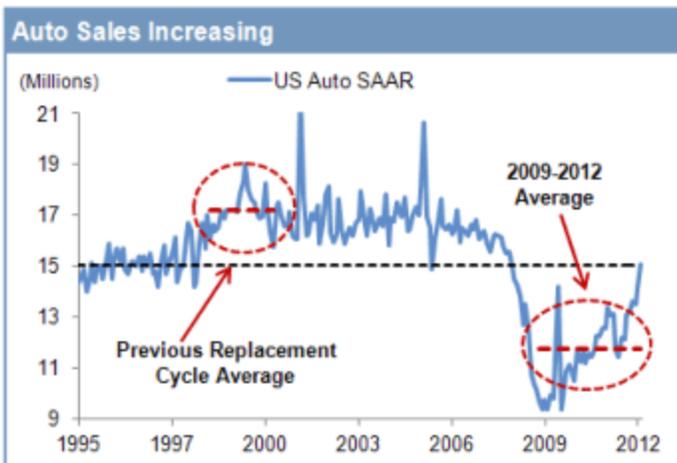
We have recently begun to see confirmation that this replacement cycle is happening. While US auto sales have been slowly recovering since mid-2009, recent improvements in employment have supported better than expected auto demand and helped accelerate sales. In fact, auto sales in February were reported at 15 million (on a seasonally adjusted annualized rate) which was 1 million better than both expectations and already impressive January results. We expect this trend to continue alongside strong US payrolls and increasing consumer confidence. Lastly, the sector has seen improving pricing power given the large amounts of restructuring and capacity cuts over the past three years and we believe management teams are more focused on profitability than gaining market share, making now an opportune time to increase exposure to this sector.

Risks:

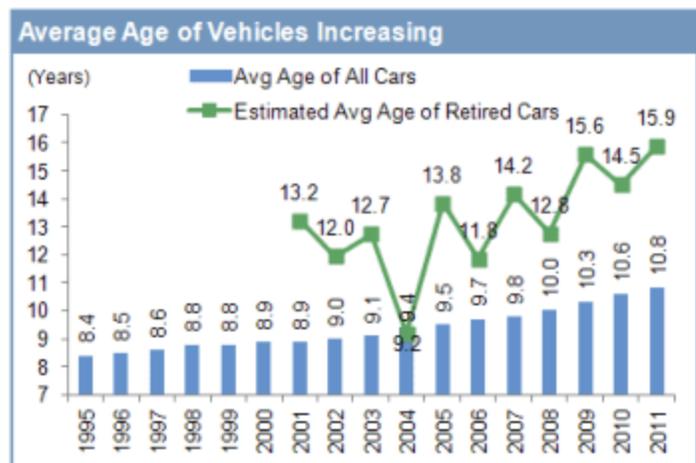
- Slowdown in US economic growth, particularly in employment.

Implementation:

- Original equipment manufacturers (OEMs) and auto parts suppliers with exposure to the US auto market and strong balance sheets.
- Supply constrained commodities used in passenger vehicles such as palladium.
- Please call you J.P. Morgan representative for specific implementation ideas.



Source: Bloomberg



Source: Bloomberg, Polk

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## OUTSTANDING TRADE IDEAS

Trade	Rationale	Risks	Levels	Update
Long High Yield	<ul style="list-style-type: none"> <li>Market is currently pricing in high default expectations relative to history and JPMS LLC expectations of 2%.</li> </ul>	<ul style="list-style-type: none"> <li>Double dip in the economy driving higher defaults or default expectations</li> </ul>	HY CDX Spread: <ul style="list-style-type: none"> <li>Jan-5-2010: 485 bps</li> <li>Current: 546 bps</li> </ul>	<ul style="list-style-type: none"> <li>IB expects High Yield Spreads to tighten ~46bps from current levels to 570bps by YE-2012, continue to hold and opportunistically add</li> </ul>
High Dividend Stocks	<ul style="list-style-type: none"> <li>High dividend yielding stocks to benefit from investors searching for yield.</li> <li>Gap between dividend yields and bond yields are tighter than historical levels and near historical peaks making stocks cheap to bonds on a relative basis.</li> </ul>	<ul style="list-style-type: none"> <li>Liquidity/credit crisis sparking additional dividend cuts.</li> </ul>	Spread between <span style="background-color: black; color: black;">████</span> 500 Dividend Yield & 5Yr Investment Grade Bond Yields: <ul style="list-style-type: none"> <li>Jan-5-2010: -1.44%</li> <li>Current: -0.64%</li> </ul>	<ul style="list-style-type: none"> <li>Remains a core part of equity exposure and valuation remains attractive versus fixed income</li> <li>Focus on underperforming stocks/sectors</li> </ul>
Buy Brazil Inflation Linked Bonds	<ul style="list-style-type: none"> <li>Current inflation breakevens are likely low given need for large infrastructure investments.</li> <li>Political noise around upcoming elections likely to create entry points.</li> <li>Central Bank comments indicate pushing out of rate hike allowing inflation to run.</li> </ul>	<ul style="list-style-type: none"> <li>Earlier than expected Central Bank tightening keeping inflation low</li> <li>Elections</li> <li>Double dip in the global economy</li> </ul>	Brazil 2013 Inflation Breakeven: <ul style="list-style-type: none"> <li>Jan-5-2010: 5.4%</li> <li>Current: 6.08%</li> </ul>	<ul style="list-style-type: none"> <li>Brazil's CB rate cuts are likely to continue to pressure inflation upwards</li> <li>Inflation surprised to the upside in Jan '12</li> </ul>
Long Korean Won	<ul style="list-style-type: none"> <li>Capital account surplus.</li> <li>Leverage to economic recovery.</li> <li>Performance has lagged other emerging market currencies.</li> </ul>	<ul style="list-style-type: none"> <li>Double dip in global economy</li> </ul>	JPY/KRW: <ul style="list-style-type: none"> <li>Jan-5-2010: 12.44</li> <li>Current: 13.49</li> </ul> USD/KRW: <ul style="list-style-type: none"> <li>Jan-5-2010: 1140.50</li> <li>Current: 1125.78</li> </ul>	<ul style="list-style-type: none"> <li>Korea have expanded currency swap lines from \$13b to \$70b, signaling willingness to combat a EUR debt crisis spillover</li> <li>Targeting 1090 by Dec '12</li> <li>Korea's indicators look strong with strong current account surplus, expect BOK to remain on hold through 2012</li> </ul>
Long Brazil Equities	<ul style="list-style-type: none"> <li>Strong outlook for economic growth.</li> <li>Support from commodities exposure.</li> <li>Upward earnings revisions.</li> </ul>	<ul style="list-style-type: none"> <li>Volatility likely to increase with elections this fall.</li> <li>Valuations at the higher end of historical ranges.</li> <li>Inflation/policy tightening concerns.</li> </ul>	iShares MSCI Brazil <ul style="list-style-type: none"> <li>Feb-26-2010: 68.37</li> <li>Current: 67.56</li> </ul>	<ul style="list-style-type: none"> <li>Strong GDP expected: 5.7% in 4Q12</li> <li>Government taking steps toward market-friendly reforms (i.e. Pension reform)</li> </ul>
Long Russian Ruble	<ul style="list-style-type: none"> <li>Improving current account and strong GDP growth expected.</li> <li>Fund flows improving driven by high yields and constructive FX outlook.</li> <li>JPMS LLC forecasting 27.23 by year end.</li> </ul>	<ul style="list-style-type: none"> <li>High correlation to oil.</li> <li>CBR managing the currency appreciation.</li> </ul>	USD/RUB <ul style="list-style-type: none"> <li>Apr-26-2010: 29.11</li> <li>Current: 29.25</li> </ul>	<ul style="list-style-type: none"> <li>Resilient Brent prices and stronger than expected domestic demand, current account dynamic remains strong</li> <li>Flow momentum for RUB among the strongest in EM</li> <li>GDP growth is expected to expand by 3.5% yoy</li> <li>Putin election seen as a positive</li> </ul>

Note: Current levels are as of Mar 16, 2012.

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Trade	Rationale	Risks	Levels	Update
Long EuroStoxx 50 Dividends	<ul style="list-style-type: none"> <li>Attractive levels as has underperformed broad equity markets.</li> <li>Limited downside from current levels which are pricing in full elimination of bank and insurance company dividends.</li> <li>Consensus estimates for EuroStoxx 50 dividends are 120 for 2012 and 124 for 2013.</li> </ul>	<ul style="list-style-type: none"> <li>Liquidity crisis or double dip recession in Europe.</li> <li>Regulatory risk affecting financial institutions.</li> <li>Index composition risk.</li> </ul>	<b>EuroStoxx 50 Dividend Futures</b> <b>2012 Contracts:</b> <ul style="list-style-type: none"> <li>Jun-9-2010: 89</li> <li>Current: 117.30</li> </ul> <b>2013 Contracts:</b> <ul style="list-style-type: none"> <li>Oct-14-2010: 105</li> <li>Current: 105.80</li> </ul>	<ul style="list-style-type: none"> <li>Expect 2012 to be a volatile year for the 2013 EuroStoxx 50 Div future contract, but continues to price in a significant cushion to JPM estimates</li> <li>JPM forecasts 122 for 2013 contracts</li> </ul>
Long Telecom Equipment Stocks (Internet Mobility)	<ul style="list-style-type: none"> <li>Large CAPEX investments are likely required to support growth in mobile internet usage</li> <li>Smartphones and tablets are expected to grow at 30-50% CAGRs over the next 3 years.</li> <li>Increased data usage on mobile devices such as smartphones and tablets.</li> </ul>	<ul style="list-style-type: none"> <li>Consumer recession.</li> <li>New technology or entry of low cost competitor.</li> </ul>	<b>Bloomberg US Telecom Equipment Index</b> <ul style="list-style-type: none"> <li>Oct-13-2010: 44.07</li> <li>Current: 60.80</li> </ul>	
Long Emerging Markets Inflation	<ul style="list-style-type: none"> <li>Strong demand for natural resources and agricultural goods driven by growing middle classes in Emerging Markets.</li> <li>Recent weather related supply disruptions adding to upward pressure on commodity prices.</li> </ul>	<ul style="list-style-type: none"> <li>Increased supply of commodities.</li> <li>Sharp slowdown in Emerging Markets economic activity.</li> </ul>	<b>S&amp;P Global Natural Resources Index</b> <ul style="list-style-type: none"> <li>Mar-30-2011: 4068</li> <li>Current: 3575</li> </ul>	
Long Infrastructure Stocks	<ul style="list-style-type: none"> <li>Expecting Engineering and Construction backlog to continue to steadily build</li> <li>Global LNG trade requires extensive infrastructure build out</li> <li>Strong CAPEX expectations for commodity companies</li> </ul>	<ul style="list-style-type: none"> <li>Global growth slows</li> <li>Commodity price declines</li> <li>Worse than expected public-sector headwinds</li> </ul>	<b>Russell 2000 Engineering &amp; Contracting Services Growth Index</b> Mar-31-2011: 788.97 Current: 776.49	<ul style="list-style-type: none"> <li>Private-sector strength expected to offset public-sector headwinds</li> <li>E&amp;C multiples still reasonable</li> </ul>
Long Dated Muni	<ul style="list-style-type: none"> <li>Muni to Treasury ratio should fall in early 2012, but remain elevated vs. historic norms</li> <li>JPMS overweight essential service munis</li> </ul>	<ul style="list-style-type: none"> <li>Unpredictable response of investors to: negative headlines and the economic response to fiscal consolidation needed at the federal level</li> </ul>	<b>JPM Muni Total Return USD 20Y</b> Oct-04-2011: 260.53 Current: 253.67	<ul style="list-style-type: none"> <li>Long-term issuances have been low driving longer-dated muni yields to new lows</li> </ul>
Long Globalization of Natural Gas	<ul style="list-style-type: none"> <li>Demand for natural gas steadily increasing</li> <li>Significant differences in global natural gas prices expected to drive globalization</li> <li>JPMS LLC estimates countries with LNG import capabilities will rise from 25 to 48 by the end of 2015</li> </ul>	<ul style="list-style-type: none"> <li>Significantly lower oil to natural gas spread</li> <li>Regulatory issues</li> </ul>	<b>Henry Hub to Global LNG</b> Feb-14-2012: Spread to Japan: 14.13 Spread to UK: 6.66 Current: Spread to Japan: 14.51 Spread to UK: 7.14	
Auto Replacement Cycle	<ul style="list-style-type: none"> <li>Pent up demand, industry restructuring and aging U.S. auto fleet</li> <li>Improvements in employment and economic data</li> <li>SAAR exceeding expectations</li> </ul>	<ul style="list-style-type: none"> <li>Slowdown in US economic growth, particularly in employment</li> </ul>	<b>DJ Auto &amp; Part Titans 30 Index</b> Mar-16-2012: 389.75	

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## CLOSED TRADE IDEAS

Trade	Rationale	Risks	Levels	Rationale for Closing
Short Agency Mortgages	<ul style="list-style-type: none"> <li>Mortgage rates are trading at historically tight levels to US Treasuries.</li> <li>Fed poised to end agency MBS purchases at the end of March.</li> </ul>	<ul style="list-style-type: none"> <li>Fed continues to buy MBS but ends purchases of Treasuries</li> </ul>	6% Fannie Mae 30Y Mortgage Spread <ul style="list-style-type: none"> <li>Jan-5-2010: -2 bp</li> <li>Fed-25-2010: 16 bp</li> </ul>	Given the move in spreads we are closing this trade as further upside is likely to be limited and accompanied by further government intervention.
2-10 Yield Curve Flattener	<ul style="list-style-type: none"> <li>Spread between 2Y and 10Y swaps are near historic highs</li> <li>Expectations for Fed tightening should drive sell off in 2Y bonds causing spread compression</li> </ul>	<ul style="list-style-type: none"> <li>Fed remains low for much longer than expected</li> <li>Fed ends purchases of US Treasuries or purchases do not offset issuance</li> </ul>	Spread between 2Y and 10Y swaps: <ul style="list-style-type: none"> <li>Jan-5-2010: 256 bps</li> <li>May-7-2010: 238 bps</li> </ul>	Profitability levels reached as pullback in risk drove a rally in long term rates. Fed is expected to maintain its "low for long" language but looking to re-enter the trade when posturing changes.
Long Palladium	<ul style="list-style-type: none"> <li>Strong demand and leverage to recovery in the global consumer.</li> <li>Supply challenges due to frequent production disruptions in Russia.</li> </ul>	<ul style="list-style-type: none"> <li>Double dip recession.</li> <li>Discovery of additional supply outside of Russia.</li> </ul>	Palladium: <ul style="list-style-type: none"> <li>Jan-5-2010: 420</li> <li>Mar-4-2010: 456</li> </ul>	Reached JPMS LLC target of \$450/oz.
Long Turkish Equities	<ul style="list-style-type: none"> <li>Favorable valuation versus Emerging Market equities.</li> <li>Valuation re-rating from structurally lower inflation and interest rates.</li> <li>Signing of IMF stand-by agreement could be a catalyst.</li> <li>Upgraded to BB in February.</li> </ul>	<ul style="list-style-type: none"> <li>Higher than expected increases in inflation or interest rates.</li> <li>Failure to sign IMF stand by agreement.</li> </ul>	MSCI Turkey (Local): <ul style="list-style-type: none"> <li>Jan-5-2010: 794,548</li> <li>Jun-9-2010: 778,537</li> </ul> MSCI Turkey (USD): <ul style="list-style-type: none"> <li>Jan-5-2010: 549</li> <li>Jun-9-2010: 493</li> </ul>	Increasing uncertainty on political front and market fundamentals. Likely to trade in line with the region.
Long Temporary Unemployment	<ul style="list-style-type: none"> <li>Temporary hiring has rebounded strongly and set to turn positive.</li> <li>Temp hiring recovery typically leads overall employment.</li> <li>Attractive valuation vs. prior expansions.</li> </ul>	<ul style="list-style-type: none"> <li>Temp hiring deteriorates.</li> <li>Double-dip recession.</li> <li>Increase in hiring costs due to political / regulatory changes.</li> </ul>	S&P 1500 HR & Employment Services Index: <ul style="list-style-type: none"> <li>Feb-26-2010: 59.55</li> <li>Mar-23-2010: 67.04</li> </ul>	Profitability levels reached as temporary employment turned positive on year over year basis and recommended closing positions due to lack of near term catalysts and valuations that were already pricing in improving temporary employment picture.
Long Chilean Rates	<ul style="list-style-type: none"> <li>Chilean interest rates are expected to rise due to higher inflation (strong copper prices).</li> <li>1Y swaps increase expected over the next year is 2x expected policy rate increase.</li> <li>Tightening by China could reduce need to raise rates in Chile.</li> </ul>	<ul style="list-style-type: none"> <li>Strong copper prices supported by China or solid global recovery.</li> <li>Strong local growth driving higher inflation."</li> </ul>	Receive fixed 1Y CLP rates 1Y forward <ul style="list-style-type: none"> <li>Feb-26-2010: 4.34%</li> <li>Jun-9-2010: 4.09%</li> </ul>	Rates have declined about 30 basis points and further decline is limited given consensus policy rate expectations.
Short Chinese Rates	<ul style="list-style-type: none"> <li>Inflation / overheating concerns driving policy tightening.</li> <li>Tightening came earlier than investment community expected.</li> <li>Strong growth should also lead to higher rates.</li> </ul>	<ul style="list-style-type: none"> <li>Benign inflation in China.</li> <li>Slow down in growth or double dip recession driving further stimulative government actions.</li> </ul>	1Y CNY Swaps Rates: <ul style="list-style-type: none"> <li>Feb-26-2010: 2.27%</li> <li>Aug-2-2010: 2.10%</li> </ul> 5Y CNY Swaps Rates: <ul style="list-style-type: none"> <li>Feb-26-2010: 3.74%</li> <li>Aug-2-2010: 2.91%</li> </ul>	Rates likely to remain low for the near term given slowdown in economic data, accommodative government, and policy measures addressing pockets of inflation in certain industries.

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Long Indonesia Rupiah	<ul style="list-style-type: none"> <li>Strong fundamentals with trade and current account surpluses.</li> <li>Benefiting from commodities exposure.</li> <li>JPMS LLC target: USD-IDR of 8,650 by year end.</li> </ul>	<ul style="list-style-type: none"> <li>Government intervention.</li> <li>Return of political instability.</li> </ul>	IDR <ul style="list-style-type: none"> <li>Feb-26-2010: 9,343</li> <li>Feb-14-2012: 9,049</li> </ul>	Limited upside outside of carry
10Y Swap Spread Widener	<ul style="list-style-type: none"> <li>Swap spreads much tighter than historical levels with 10 year swap spreads dipping into negative territory for the first time recently.</li> <li>Very short term trade on technical rebound.</li> </ul>	<ul style="list-style-type: none"> <li>Correction to historical norms can take a long time.</li> <li>Swap spreads become more negative.</li> </ul>	10Y Swap Spreads <ul style="list-style-type: none"> <li>Mar-30-2010: -5 bps</li> <li>May-7-2010: 5 bps</li> </ul>	Market corrected.
Long Palladium	<ul style="list-style-type: none"> <li>Demand remains strong with improving auto sales in the US, China, and Brazil.</li> <li>Supply remains constrained.</li> <li>JPMS LLC forecasting an average price of \$600/oz for 4Q10.</li> </ul>	<ul style="list-style-type: none"> <li>Pullback in auto demand.</li> <li>Discovery of a new mine.</li> </ul>	Palladium: <ul style="list-style-type: none"> <li>May-4-2010: 515</li> <li>Oct-14-2010: 600</li> </ul>	Reached JPMS LLC target of \$600/oz.
Long EuroStoxx 50 Dividends	<ul style="list-style-type: none"> <li>Attractive levels as has underperformed broad equity markets.</li> <li>Limited downside from current levels which are pricing in full elimination of bank and insurance company dividends.</li> <li>Consensus estimates for EuroStoxx 50 dividends are 122 for 2011 and 135 for 2012.</li> </ul>	<ul style="list-style-type: none"> <li>Liquidity crisis or double dip recession in Europe.</li> <li>Regulatory risk affecting financial institutions.</li> <li>Index composition risk.</li> </ul>	EuroStoxx 50 Dividend Futures 2011 Contracts: <ul style="list-style-type: none"> <li>Jun-9-2010: 93</li> <li>Oct-14-2010: 114</li> </ul>	Extended shorter term contracts to longer maturity contracts
Long Airline Stocks	<ul style="list-style-type: none"> <li>Seasonal benefit from buying in September/October and selling in April/May</li> <li>Structural benefits from improved cost discipline, increasing revenues and pricing power, and plans to delever balance sheets</li> </ul>	<ul style="list-style-type: none"> <li>Double dip recession</li> <li>High oil prices coupled with weak economy</li> <li>Decline in bookings.</li> </ul>	NYSE Airlines Index <ul style="list-style-type: none"> <li>Nov-17-2010: 48.70</li> <li>Feb-14-2012: 40.61</li> </ul>	Stocks hurt by higher oil prices and weakening confidence in the economy. Recent fleet orders also bring into question management discipline.

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