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To: Undisclosed recipients:;
Subject: Eye on the Market, June 7, 2010
Date: Mon, 07 Jun 2010 19:55:52 +0000
Attachments: 6-07-10_-_EOTM_-_Wonderland.pdf

Eye on the Market, June 7, 2010

Topics: Europe, Spain and Wonderland; California solvency; US private sector payrolls; Chinese consumption

Market update: we continue to be concerned about Europe. In this week's report (attached), we look at Spain, Europe's next weakest link, and U.S. job growth, which has yet to re-ignite. I spent the last week on the West Coast, explaining our optimism on Chinese consumption, and why California is not insolvent. **While profits, capital spending and manufacturing trends are positive, unresolved legacy issues from the prior boom-bust argue against riskier portfolio allocations, which has been our overriding investment theme all year long.**

European banks, which are 3x-4x larger than U.S. banks relative to GDP, are under pressure. CP issued by non-U.S. banks in US markets continues to fall, and is down 20% this year (branch deposits of non-US banks are also falling). In Europe, bank borrowings *from* the ECB are rising, as are European bank deposits *at* the ECB. The latter suggests that banks are hoarding cash due to fears of being unable to access more, or are unwilling to take exposure to other European banks. Either way, a sign of distress. **The larger size of Europe's banks argue against using simple GDP weights to assess potential risks to global markets**. Due to a buyer's strike over the last month, European banks now have 3.5x as much debt to issue than U.S. banks over the remainder of the year.

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