

**From:** GIO Group JP Morgan <gio.group.jp.morgan@jpmorgan.com>

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## Global Investment Opportunities Group (GIO) Opportunistic Investments

J.P.Morgan

August 2, 2010

### MID-TERM ELECTIONS

We believe this year's mid-term elections in the US offer support for holding risky assets despite the recent slowdown in economic data. Historically, performance of risky assets has been better in mid-term election year than the other 3 years in the election cycle. In a recent Eye on the Market, our Chief Investment Officer Michael Cembalest showed a chart showing consistently positive returns in the third year of the U.S. electoral cycle. The strong performance is also true for shorter investment horizons as the S&P 500 is typically up in the months following elections. While some of the performance is likely due to seasonality, 4Q returns are better in mid-term election years than the other 3 years with average increase of 8% vs. 2.5% in other years, respectively.

Historically the consistently strong performance has been due to the government's actions to boost sentiment ahead of elections but, as we pointed out in the Eye on the Market, our government's hands are more tied today than in prior elections for providing fiscal benefits. However, potentially offsetting the lack of stimulative promises would be removal of the specter of policy uncertainty. Recently there have been more articles and statements suggesting the current regulatory environment is hampering business investment as managers are wary to invest in projects with potential policy changes looming (a la healthcare and financial reform). However, if political gridlock increases as a result of Republicans gaining more seats in Congress, managers may feel more confident in gauging how onerous future legislation could be for their businesses which could in turn allow them to put some cash to work. Coupling this with a generally positive earnings season and resolution of some financial regulation changes, we remain biased for growth and risk while recognizing that markets could remain volatile near term.

### CLOSING TRADE IDEA: SHORT CHINESE RATES

We believe clients who are opportunistically positioned for rising Chinese rates should close out of positions as the government seems intent on using non-interest rate policy means to manage inflation. Concerns about Chinese inflation persist despite the latest inflation reading dipped slightly below the government's 3% target as this was driven by volatile food pricing. However, the government has been very active in heading off inflation by targeting specific sectors that are most worrying such as tightening policy in high-end property markets and setting coal price limits to manage electricity prices. As the government continues to pull non-interest rate levers to control inflation, and economic data disappoints to the downside, we believe the Chinese government has more room to push out a rate tightening cycle and will likely keep policy rates at current levels for the near term.



Source: J.P. Morgan Securities, Inc., Bloomberg. Data as of 08/02/10.

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