From: US GIO <us.gio@jpmorgan.com>
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Attachments: JPM_View_10.26.2012-pdf.zip
Inline-Images: image003.png

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The [redacted]. Morgan View

Lower fiscal uncertainty needed to unleash capital

- **Asset allocation** — Value dictates that long-term investors start switching from credit to equities, but low growth, fiscal uncertainties, still attractive credit spreads, and little sign of worsening credit fundamentals keep us overweight both equity and credit vs government debt, especially in higher-yield.
- **Economics** — Bottom in global growth is now 3-quarters wide. Rebound in Q1 requires lifting of fiscal risks in the US, in our view.
- **Fixed Income** — Favor EM local bonds over DM.
- **Equities** — UW US equities against Europe and EM Asia.
- **Credit** — EMBIG year-end spread target is lowered to 250bp, from 275bp, and CEMBI to 300bp, from 325bp.
- **Currencies** — We are long the yen, as the sell off appears overdone.
- **Commodities** — Low oil inventories and high uncertainty in the Middle East keep us long Brent time spreads.

- **Risk markets continue to yo-yo, with this week being down, while last week was up.** Bond markets are sitting out the last wiggle, with government yields barely changed on the week, and corporate bonds only a few bips wider. Most assets remain in their 2-month trading range.
- Range trading is hiding a lot of anxiety in markets and economies, recently focused on the US. We have argued that world growth is in a bottom formation, but the low part of this pattern keeps getting longer and is up to 3 quarters now (Q2-to Q4). The expected rebound has been pushed out now to Q1, and is softer than we originally thought. There are a whole host of forces holding back growth, but one negative that we believe explains both weaker corporate spending and still massive capital flows into fixed income must be **fundamental uncertainty about gov't policies**. The consumer has not been affected much, but our reading of institutional and company managers is that many have simply postponed major investments in real and financial capital until the fog lifts around the US and European fiscal crises, and the direction of China's economy.
- The recent rebound in **European and Chinese** equities suggests investors have become less worried about these two regions. It is probably too early to see the impact on capex, but we do expect this to show up in coming months and to support a growth rebound in Q1. The US fiscal crisis is now right upon us, with the Nov 6 elections letting voters express their views on tax hikes versus cuts in spending. Congress then needs to act urgently to avoid a fiscal tightening caused recession in January, and needs to continue next year on a 10-year fiscal plan, or Simpson Bowles Take 2, in our view. Our best estimate is that the elections do not provide a clear mandate for either side, that Congress does act to bring 2013 fiscal drag down to 2% of GDP, instead of 3.7% without action, but that a longer-term plan remains elusive, keeping a tab on investing by both investors and companies. If we were to get a US long-term fiscal plan next year, then it would surely create upside on stock markets, and be supportive to growth, both US and global, in our view.

See page 7 for analyst certification and important disclosures.

Global Asset Allocation

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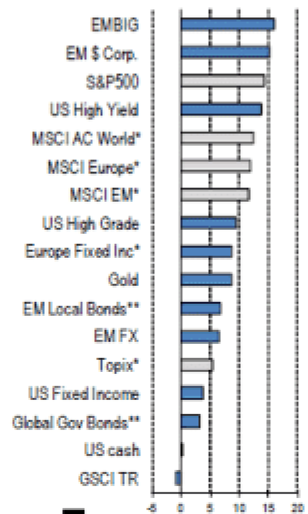
YTD returns through Oct 25
%, equities are in lighter color.



Source: [redacted]. Morgan, Bloomberg. See blue box on page 2 for description. [redacted]