From: US GIO <us.gio@jpmorgan.com>
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Inline-Images: image003.png

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The J.P. Morgan View

Patience during political season

- **Asset allocation** — No changes in our medium-term, value-focused strategy to be long assets with high risk premia, equities, credit, and carry trades, even as upcoming political events will likely create shorter-term volatility.
- **Economics** — No major forecast changes, although increasing uncertainty around US fiscal cliff posturing creates downside risk on US Q4 and Q1.
- **Fixed Income** — We prefer German Bunds to US Treasuries.
- **Equities** —US earnings season favors domestically-oriented stocks and US Financials.
- **Credit** — We expect further spread tightening in US HG as the lack of credit supply brought about by QE3 is not fully priced in.
- **Currencies** — We launch a Chinese *Economic Surprise Index*.
- **Commodities** — Stay long Brent time spreads on Middle East uncertainty.

- **Equity markets are trading heavy**, and are giving back most of their gains of the past 1-2 weeks, despite no clear change in fundamentals. Other risk markets, such as credit, commodities, and the euro periphery, are not following equities this time, indicating we are largely seeing profit taking after the hefty rally in stocks over the last four months.
- **There are no meaningful changes in growth forecasts this week**, except for moving 1% in growth from Q4 to Q3 in the Euro area, due to better IP data in Q3 which we do not think will last. But as a result, global growth in Q4 at 2% is now barely different from the previous two quarters. In GDP terms, there is not as much sign of a rebound as we had hoped, even as the underlying PMI orders and inventory data do hint at this coming rebound.
- We are only at the beginning of the Q3 **earnings** season, but what we have is in line with subdued expectations for small oya drops. Profit margins then hit new highs and world growth has since fallen below potential. But global equities are up 10%. Why? We have argued that equities and other risk markets can rally despite lackluster growth as they offer high risk premia against events that will not all come through. Hence, if the world turns out less ugly and volatile than what most feared, as is our view, then investors will over time gradually switch some of their defensive holdings into better-return, but riskier asset classes.
- This risk-premium-focused strategy into equities, credit and carry assumes volatility will remain subdued and markets will be buffeted by only modest adverse shocks. We don't see huge volatility from data or earnings surprises, with macro volatility having collapsed over the past 2 years, and aggregate earnings now also showing almost no movement anymore. This leaves us with the **political surprise factor**. Here we have to tread more carefully as the next few weeks will see another EU Summit, US elections, and Chinese leadership change, each of which with potentially momentous impact.

See page 7 for analyst certification and important disclosures.

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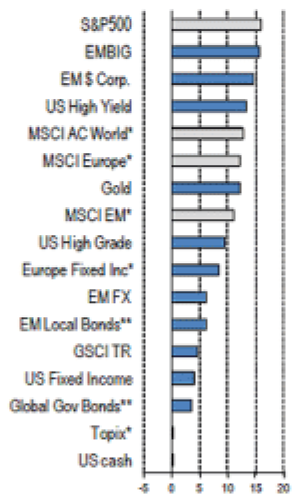
YTD returns through Oct 11
%, equities are in lighter color.



Source: J.P. Morgan, Bloomberg. See blue box on page 2 for description.