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J.P.Morgan

Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan Securities Ltd.
Jan 20, 2012

The J.P. Morgan View

Momentum is broadening

- **Asset Allocation** — Stay long equities, and add EM FX longs.
- **Economics** — Initial signs that the soft patch in industry may end sooner.
- **Fixed Income** — Move to modest tactical overweight in Euro area periphery.
- **Equities** — The fact that the worst performing sectors of 2011, i.e. Financials and Cyclicals are outperforming YTD, is consistent with the January effect.
- **Credit** — Upgrade HG to neutral and overweight European Senior Unsecured bank debt. Maintain a long in US HY.
- **Foreign exchange** — Reduce defensive exposures.
- **Commodities** — We take profit on our Spring 2012 US natural gas puts.

- The rally in risk assets continues, in a stable and non-accelerating fashion. Most importantly, the **rally is broadening,** pulling along initial stragglers, such as EM currencies and credit. The dollar (DXY) and bonds had at first ignored the rally in equities, but are now reacting, by moving down.

- **We are comfortable remaining long risk assets** as the rally is still young and remains reluctant, investors have not had much time yet to build overweight positions, and there is decent fundamental support for the rally.

- **How can risk rally** with the global economy supposed to be weak, US earnings disappointing, Chinese real estate activity and prices coming down dramatically, European leaders making no progress towards a fiscal union, and Greek restructuring remaining an event risk? Otherwise put, **isn't the market getting ahead of reality?** The answer should be Yes, to some degree. Fundamental support for the 5% gain in equities YTD is thin on the ground. But market do not wait for full evidence and react at the first sign that the risk bias around these fundamentals is shifting, even if only marginally.

- **We are not raising global growth forecasts.** If anything, our 2012 world growth forecast came down 0.1% to 2.6% this week, as we expect payback from the stronger than expected Chinese Q4 GDP report. However, a number of forward-looking indicators — especially PMIs, US claims — are hinting that the bottom in growth that we are projecting for H1, and the following rebound, will arrive earlier than we currently forecast, and may already be on us. In addition, even more important for risk markets, is that the downside risk emanating from the EMU debt crisis, Chinese growth, and US fiscal gridlock are edging down. Finally, risk rallies can become self fulfilling as they improve wealth, sentiment, spending, liquidity, funding, and collateral values.

- **In China,** both Q4 GDP growth and the Jan PMI came in above expectations. The details, and especially rising inventories, do not convince us and we thus maintain that growth is coming down, even as we remain squaring in the soft landing camp. Global investors, who have been staying out of EM assets for fear of a hard landing in China, are now being forced to reduce their overweights, allowing EM equities to beat DM this month by over 3% MTD.

The certifying analyst is indicated by an AC. See page 7 for analyst certification and important legal and regulatory disclosures.

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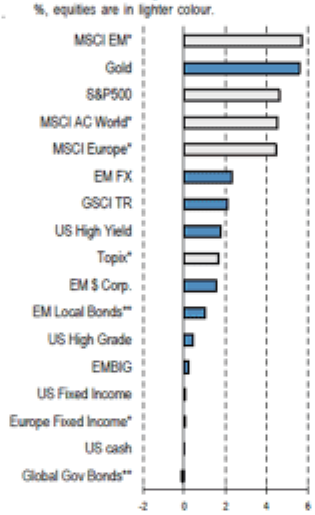
YTD returns through Jan 19
%, equities are in lighter colour.



Source: [redacted]. Morgan, Bloomberg. Returns in USD. *Local currency. **Hedged into USD. Euro Fixed Income is Iboxx Overall Index. US HG, HY, EMBIG and EM $ Corp are JPM indices. EM [redacted]