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J.P.Morgan

Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan Securities Ltd.
Nov 11, 2011

The J.P. Morgan View

How can risk markets rally in an ugly world?

- **Economics** — US data keep supporting a 2.5% pace in H2.
- **Portfolio strategy** — Heavy overweights in cash, that pays no yield, and less acute risks on US growth and Chinese inflation keep us overweight risk assets
- **Fixed Income** — We close tactical shorts in long end Treasuries, and keep only a value-based short in 2-year Germany.
- **Equities** — Both US and European companies have beaten Q3 EPS consensus by 4% on average.
- **Credit** — We keep a preference for long US vs. European credit.
- **Foreign exchange** — Large-scale ECB bond buying should not be a negative for the euro. But we keep hedges by being long JPY.
- **Commodities** — We close the short leg of our EM Asia vs. US relative trade and double up on the long leg. Be long brent, gasoil, gold, sugar, corn and wheat.

- After a quite volatile week, **risk markets are net up on the week,** and safe bonds are down, though by amounts that could be reversed in minutes. Let's just call it range trading, therefore. The great majority of institutional investors we see remain quite sceptical about risk assets as the politics of fiscal consolidation in a slow-growth world continue to be quite ugly. And the Euro Area is little closer to agreement on measures to stop their debt crisis, while now more openly debating whether it is better to just shrink the currency union.

- **How is it possible for risk markets to gain in a world with so much risk,** unknowns, volatility, disequlibria, and pure political ineptitude? One answer is to look at the main problem that end investors face — where do I get a return? The top chart on p. 2 shows that the yields on global cash and bonds remain near all-time lows. After tax and inflation, these yields are negative. Equity yields — earnings yields plus inflation— are, in contrast, high by historic standards, but obviously require you to buy a very volatile asset. The last month saw very significant inflows into equity, high-yield, and muni mutual funds, much of which we believe is driven by the dire returns on safe assets.

- Even more important than the low value of safe assets is that **concerns about the world are starting to edge down, in a very up-and-down fashion, from the end-is-nigh sentiment that prevailed this summer.** Fear of a US economy stalling has receded, but has not gone away, as H2 growth is rebounding to about 2.5%, from less than 1% in H1. This week alone, trade, claims and confidence all surprised on the positive side. That said, there remains no sign of compromise in Washington on deficit reduction for next year nor for the next decade.

- In China, the continued fall in inflation, and move to monetary easing are greatly reducing fears of a hard landing. This induced us a few weeks ago to

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

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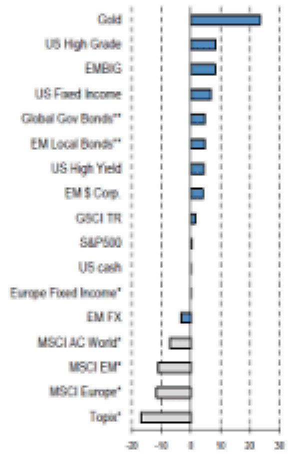
YTD returns through Nov 10
%, equities are in lighter colour.



Source: J.P. 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 FX is ELMI+ in $.

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