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J.P.Morgan

Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan Securities Ltd.
Sep 30, 2011

The J.P. Morgan View

Still too many banana peels

- **Economics** — Further cuts to growth forecasts, this time in Japan and EM Europe. US Q3 is tracking a 1.5% pace. We retain the view that Europe is sliding into recession.
- **Portfolio strategy** — Riskier markets are trying to rebound as many active managers are short. We find it too early to go long risk, as there remain too many banana peels in front of us, on which risk assets can slip.
- **Fixed Income** — Falling growth projections remain bullish for bonds.
- **Equities** — 2012 Eurostoxx50 dividends provide an attractive return to risk
- **Credit** — EU recession forecasts justify staying defensive.
- **Foreign exchange** — Be long JPY vs EUR and GBP. On the USD, we prefer to buy it against NOK.
- **Commodities** — We close our outright longs in copper, corn and wheat but we remain long gold and a basket of EM driven against a basket of US driven commodities.

- **Risk markets rallied early this week**, and bond yields rebounded strongly, as some of the feared event risks in Europe did not materialise. But they then lost ground again later in the week as investors have no confidence that underlying conditions in the world have improved.

- **We retain a defensive posture**, underweighting risky assets, as (1) the Euro area is far from creating the fiscal solidarity and discipline needed to resolve its sovereign funding crisis — even as it is now at least talking about these more openly— and likely requires a renewed crisis before its takes these actions; (2) whatever the outcome of the EMU debt crisis, Western Europe is likely now already sliding into recession; (3) the US is probably not in recession yet, but Congress seems too divided to prevent the main risk of recession coming from the massive fiscal tightening, that is on the books for 2012; and (4) Japan and Asia are now also weakening and will thus not be able to turn around the US and European economies.

- Investors are heavily underweight European assets as they see a significant risk that **EMU** members are unable to combine resources to battle their self-inflicted debt crisis. The required degree of fiscal integration implies surrendering much of their cherished national sovereignty and will not be taken in a single yea-or-nay vote. It can only come about through a long set of decisions and actions over the coming year by all the EMU member states. Each such decision constitutes a banana peel on which Europe could slip in its journey for a full resolution to the euro crisis. The best that can be said about the last few days is that nobody slipped on this week's bag of bananas. But there remains quite a few in front of us.

- **Over the next few weeks, we expect few major actions,** although still half a dozen EU countries have to ratify the EFSF enlargement. The decision on the next Greek package has been pushed out to later in October to give Greece

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

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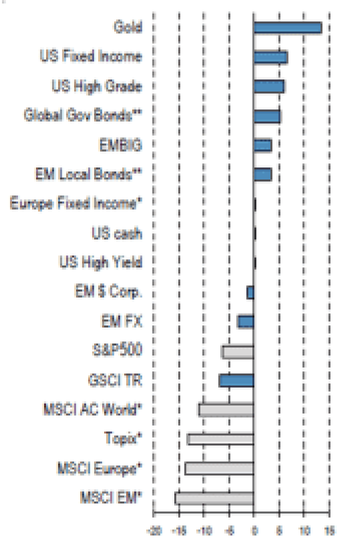
YTD returns through Sep 29
%, equities are in lighter colour.



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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