From: US GIO <[redacted]>
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J.P.Morgan

Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan Securities Ltd.
Oct 21, 2011

The J.P. Morgan View

A beginning to the end of the euro crisis

- **Economics** — We raise Q3 in the Euro area by 1%, but lower 2012 China by 0.2%. A Euro area recession remains our forecast.
- **Portfolio strategy** — Stay long risky assets as activity data remain better than feared, and odds favor fiscal compromises in Europe and the US.
- **Fixed Income** — We move to flat duration in EM, as in DM.
- **Equities** — Open an overweight in EM vs. DM equities.
- **Credit** — We stay optimistic as the economic and technical picture improves. Near-record HY bond fund inflows lead us to close our UW CCC vs US HY.
- **Foreign exchange** — Stay long the yen.
- **Commodities** — The physical copper market is showing signs that the global demand picture is improving.

- Confusing rumors and counter-rumors on what the EU Summit would or would not deliver whipsawed markets all week, but leave credit and US equities net up. Most market participants refused to participate and are simply waiting for Europe to make up its mind. The normally high correlation between different risk markets in volatile periods was therefore not in evidence.
- **What can we expect from Europe next week?** This weekend will likely produce decisions on the Greek haircut (close to 50%) and quite possibly on higher capital ratios to be achieved by EU banks by the middle of next year. The decision on how to improve funding of illiquid sovereigns by leveraging the EFSF seems to have been pushed to a second summit on Wednesday. Some commitments on moving towards joint decision making on fiscal policy are also quite possible. Details on our views in Barr and Mackie, *The EU summit(s): where is the bazooka?*, in today's GDW
- The big question is **whether these summits can finally end the Euro-sovereign debt crisis** that began in the aftermath of the 2007-09 financial crisis. We think the odds are favorable that next week will define the **start of the end of the sovereign debt crisis,** but that this process will be drawn out, will have reversals, will not be obvious for some time, and will not prevent Europe from falling into recession again, as banks delever and austerity bites hard.
- It has been our view that **Europe needed to come right to the edge of disaster** before it would be forced to make the painful decisions necessary to reverse the crisis. Europe has the resources to achieve this. It just needs to have the political will to do so. This requires that the alternative is right in your face, and that procrastination is no longer possible. It is our perception that these conditions are in place today. The rest of the world is screaming for a solution as it sees the Euro debt crisis as a super Lehman that can bring all down. It is quite possible the rest of the world is willing to help though the IMF. We are willing to interpret the strong disagreements still evident between France and Germany and the postponing of the summit end to next Wednesday as signs

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

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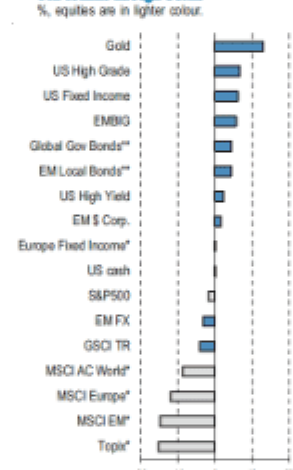
YTD returns through Oct 20
%, equities are in lighter colour.



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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