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J.P.Morgan

Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan Securities Ltd.
Oct 28, 2011

The J.P. Morgan View

Did markets overreact?

- **Economics** — We raise US Q4 GDP from 1.0% to 2.5%, after having done the same to Q3 over the past month.
- **Portfolio strategy** — Equities and credit may have overreacted to an EU Summit that was short on details, but we stay long risk assets as the EU is heading in the right direction, and we should get support from reduced US recession risks.
- **Fixed Income** — We remain defensive on Euro area peripherals, despite EU leaders' statement of intent.
- **Equities** — We close our underweight in China and move BRICs to an over-weight within EM, i.e long MSCI BRICs vs MSCI EM.
- **Credit** — All-time record US HY inflows signal further spread narrowing.
- **Foreign exchange** — European bank recapitalization could lead to repatriation on foreign holdings, but the impact on EUR will likely be small.
- **Commodities** — We expect the Brent-WTI spread to narrow further to $10/bbl by the end of next year.

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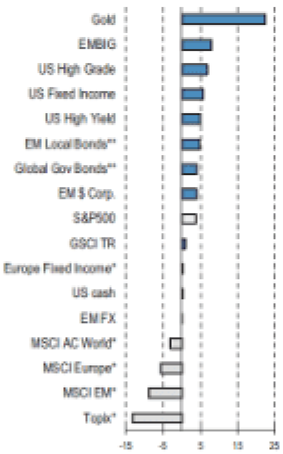
- Risk markets all rallied hard this week following the Euro Summit statement on Thursday morning that suggested a more determined commitment by EU heads of state to address the root causes of their debt crisis. **We retain a long risk position** — overweight riskier asset classes against defensive ones — on a judgement that Europe is finally recognizing what it must do to contain the crisis; that it is showing an increased willingness to implement such measures; that global investors remain broadly defensively positioned; and that you get badly penalised — through record low yields — if you choose to stay in safe assets.

- **This week's violent lurch up in equity prices took many market participants by surprise,** as they did not consider the EU Summit that impressive. In addition, the largest eurobond markets at the core of the crisis — Italy — ended down on the week as it saw weak demand at bond auctions today. If the Summit did not move us towards an eventual resolution of the EMU debt crisis, then surely equity and credit market overreacted and are due to fall back as fundamental disagreements emerge on the implementation of the Summit measures.

- **We do not think so and remain long risk.** Much has been written about how the **EU Summit Statement** is full of vague promises and short of concrete details, while glossing over still large disagreements between major stakeholders. We do not disagree (see Barr and Mai, *EU summit leaves plenty of gaps in €1tn of "firepower"* in today's GDW). The next few weeks and months will likely see a seesaw in perceptions of whether this new plan will do the job. At the same time, we are sufficiently impressed that the heads of states are committing to the main elements of resolution — Greek debt reduc-

YTD returns through Oct 27
%, 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 FX is ELMI+ in $.

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