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Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan Securities Ltd.
Nov 4, 2011

The J.P. Morgan View

Everyone is short risk

- **Economics** — H2 data are coming in less weak than expected.
- **Portfolio strategy** — We cannot be called bullish, but high risk premia and growth upgrades make us net long risk.
- **Fixed Income** — We hold Treasury shorts, and add a short in 2yr Germany.
- **Equities** — Focus risk on country trades: long EM vs. DM, long BRICs vs EM, long Japan vs. DM, long MSCI EMU vs. S&P500 and long DAX vs. Eurostoxx50.
- **Credit** — We move to UW US HG and prefer EM Sovereigns vs corporates.
- **Foreign exchange** — We still prefer USD/JPY and EUR/JPY to EUR/USD given the risk of further QE in the US.
- **Commodities** — The Thai floods may reduce global rice exports considerably, leading to a potential rise in EM food price inflation.

- Risk markets reversed part of their post EU Summit short-covering rally this week as the lack of details in the agreement settled in, and Greek politics played havoc again. But overall, equities remain up on two weeks ago, and are still above the 10-week range that had held between the crash early August and the middle of October, when we turned long risk.
- **Our long risk position does not mean we are bullish on the world.** It is merely the result of the observation that risk premia are sky high and higher even than early this year, and that everyone we see is bearish and underweight risk, combined with a judgement that uncertainty about the world seems set to come down from greatly elevated levels. Risk never goes away, but we feel that a modest improvement in economic activity data, and a rising-to-the-challenge by policy makers are set to reduce downside risk perceptions.
- **The main risk threatening markets remains the euro sovereign debt crisis though.** The crisis started two years ago, after the Greek elections, when the new incoming government massively revised up the deficit estimates from 6% to what is now known to have been 15.7%. In the two years since, the crisis has steadily escalated and broadened, and policy makers have not yet waved a magic wand to stop it. This raises the issue of **whether they can, whether they want to, and whether they can execute.**
- We would argue that the Euro Area (EA) has the resources, and the motivation to fix the crisis, but is less than competent in executing this fix, as it is not yet operating is a single decision making unit. The EA has the resources as it has enough domestic savings to handle a modest government deficit of under 5% of GDP, half that of the US, UK and Japan. The EA has enough motivation to fix its crisis as not doing so must lead to EMU disintegration and likely the EU, implying many times higher costs than is needed to fix the crisis. The main problem, and the reason why the crisis continues to linger, is that the EA is not operating as a single country with centralised decision making. The worsening

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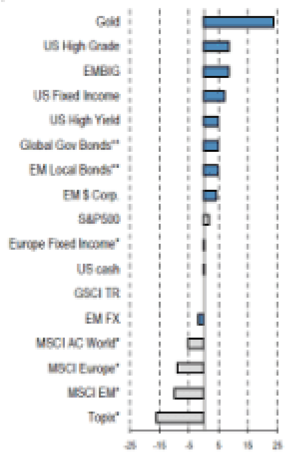
YTD returns through Oct 3
%, equities are in lighter colour



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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