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Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan Securities Ltd.
Dec 2, 2011

The [redacted]. Morgan View

Is this it in Europe?

- **Economics** — US growth upside due to ISM and a likely extension of the payroll tax cut is offset by greater weakenss in Asia. We downgrade China and Japan growth.
- **Portfolio strategy** — The runup to the Dec 9 Summit will likely push risk assets up, and, as before, could then easily lead to some disappointment, as details will be lacking.
- **Fixed Income** — The repeated pattern of high pre-summit hopes followed by disappointment argues for some caution on intra-EMU spreads.
- **Equities** — EPS growth outperformance has supported US equities this year. This theme of US equities outperforming is likely to continue into 2012.
- **Credit** — A spike in default rates suggests to maintain a low risk profile heading into YE.
- **Foreign exchange** — Stay short EUR/JPY and USD/JPY as hedges.
- **Commodities** — Iran tensions creates the risk of an oil supply shock. Buy brent calls and be long brent vs. base metals.

- After a week of bad economic and policy news, we got a big reversal this week, with better US activity data and signs of impending compromises on fiscal policy on both sides of the Atlantic. Equities, credit, commodities, EM FX, and euro area bonds all jumped back up, fully undoing the damage of the previous week. The dollar and major bond markets went down.

- Notice how the **German bond market has joined the risky assets family** in recent weeks. Bunds now rally when stocks go up. US Treasuries and the US dollar, as the real safe assets left, sell off when stocks rally. This will remain the case as long as Euro policy makers insist that any government in the Euro area can default, and that quantitative easing by the ECB raises the risk of inflation, even in an economy that is in recession.

- **How good was this week's news, and will it last?** Starting with the **US**, the failure of last week's Super Committee, despite strong signals that this was a low-probability risk, had made us quite pessimistic about the massive fiscal tightening coming in January. But now Congressional leadership is signalling they will likely extend the payroll tax cut for another year. If they do, then we will have to raise our 2012 US growth forecast from 1.7% to 2.5%, above current consensus. But given how fast the Super Committee blew up, we want to see the law signed before changing forecasts. And even then, postponing fiscal tightening does not eliminate the need for it. Under current tax law, and assuming the payroll tax cut is extended one year, total fiscal drag for the following year, 2013, would exceed 3% of GDP. It would thus likely push the economy into recession. This could in turn lead to more extensions of tax cuts, but this can surely not continue forever.

- Stronger US data this week — especially ISM — create more confidence that

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

Jan Loeys[AC]
[redacted]

John Normand
[redacted]

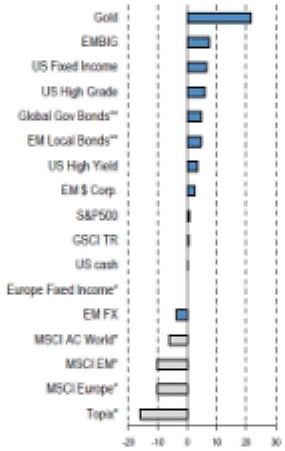
Nikolaos Panigirtzoglou
[redacted]

Seamus Mac Gorain
[redacted]

Matthew Lehmann
[redacted]

Leo Evans
[redacted]

YTD returns through Dec 1
%, 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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