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J.P.Morgan

Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan
Securities Ltd
Dec 9, 2011

The J.P. Morgan View

One big step for euro-kind, but not the last one

- **Economics** — EMU takes big step towards fiscal integration, but is not yet closing the book on periphery funding.
- **Portfolio strategy** — A good EU Summit, better US data, fiscal compromise in US, and falling EM inflation combine with defensive positions to signal modest upside for equities into January. Add a long position in US equities.
- **Fixed Income** — We add shorts in the Euro area periphery, and longs in EM local bonds.
- **Equities** — 1) OW S&P500 vs. MSCIAC World 2) OWMSCI BRICs vs. MSCI EM 3) OW DAX vs. Eurostoxx50 4) Monetize extremities in derivative markets: be short skew, short correlation and short convexity bias.
- **Credit** — We stay defensive.
- **Foreign exchange** — Stay short EUR/JPY and USD/JPY as hedges.
- **Commodities** — We forecast a 12% total return for commodities in 2012 with a weak first quarter offset by a rally from Q2 onwards.

• Another volatile week with markets trading on each snippet of news or rumours coming out of Europe, while not paying much attention to better news from the US and China. A cold shrug from ECB President Draghi dragged risk markets down on Thursday, but a better-than-feared EU Summit today then brought a net gain for the week.

• The **EU Summit Statement made good progress on the October one** which was too general and impractical. Bringing the ESM forward by a year and adding €200bn of funding via the IMF can only help, but are not enough to end the funding crisis. Similarly, the commitment to enshrine balance budgets and 60% debt ratios in domestic laws greatly improves credit quality, but by itself does not guarantee that bond investors will come back. The hope that the ECB will in response start QE-ing in mass is consistently denied by ECB officials, and in the end only based on the conviction that ECB will blink when the alternative is the death of the euro.

• Hence, we must consider today as not the final response of EU policymakers, but only one of many steps towards eventual resolution. Angela Merkel has stated this process will take 10 years, but markets will likely dictate a much earlier conclusion.

• What is important for markets is to have confidence there will be an eventual resolution and not a chaotic break up of monetary union. Unfortunately, European policymakers will not and cannot give such guarantees as the threat of a breakup is part of the repair process. **There is purpose to the madness in Europe.**

• To see this, consider again the core problem of EMU. Over the past decade, worsening competitiveness in EMU South produced a large balance of

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

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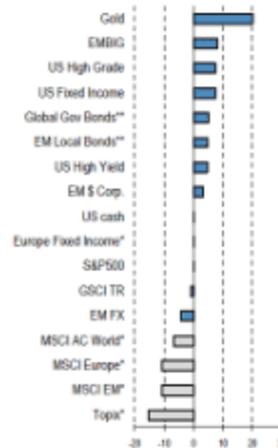
Nikolaos Panigirtzoglou

Seamus Mac Gorain

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YTD returns through Dec 8
%, equities are in lighter colour



Source: J.P. Morgan, Bloomberg. Returns in USD. *Local currency. **Hedged into USD. Euro Fixed Income is Invest Overseas Index. US HG, HY, EMBIG and EM \$ Corp are JPM indices. EM FX is BLM in \$.

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