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J.P.Morgan

Global Asset Allocation
J.P.Morgan Chase Bank NA, J.P. Morgan Securities Ltd.
Dec 16, 2011

The J.P. Morgan View

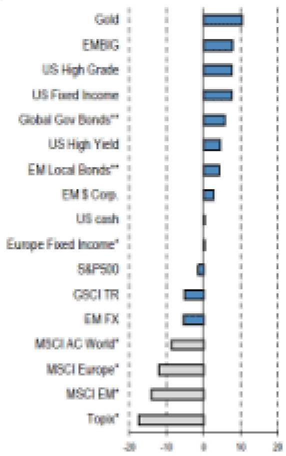
Returns and risks for 2012

- **Economics** — World growth slows to 2% next year, down from 2.6%. But growth should rise back to trend in H2. Inflation falls from 3.6% to 2.2%.
- **World portfolio** — A difficult Q1 should be followed by better returns on riskier asset classes as growth rebounds and major risks become less acute.
- **Fixed Income** — Coupon-like government bond returns and flatter curves. Euro area periphery risks to the downside, near term.
- **Equities** — Double digit returns in 2012.
- **Credit** — Strong credit fundamentals underpin bullish forecasts.
- **Foreign exchange** — A weaker US dollar and good returns on EM currencies.
- **Commodities** — Weak demand in Q1 should turn to a strong H2, helping commodities to a 10% total return for 2012.
- This is the **last issue** of the year. We wish our readers joyful holidays and a less stressful new year.

Jan Loeys[AC]
[redacted]
John Normand
[redacted]
Nikolaos Panigirtzoglou
[redacted]
Seamus Mac Gorain
[redacted]
Matthew Lehmann
[redacted]
Leo Evans
[redacted]

- For our last issue of the year, we present our 2012 outlook, focusing on the economy, asset class returns, risks, lessons, and strategy.
- **2011 was not a great year** for investors with global equities losing 10%, giving back 2010 gains, only partly offset by a 5.7% return on global fixed income (chart on right). Commodities are down 2% while the credit component of spread product produced significant losses. The world economy grew at a trend-like 2.6% in 2011, less than the 4% of 2010, and less than the 3.4% we had predicted a year ago.
- **2012 should turn out better for risk markets**, even as it will likely be volatile and start hesitantly, producing a mirror image to 2011's first-strong-then-weak performance. 2011 began with all of us bullish on growth and risk assets, and turned down by mid-year as we cut growth projections. 2012 will instead start with a surplus of bearish growth views and defensive positions. For the year as a whole, we see 2% global growth, split between 0.9% in DM and 4.7% in EM. The first half is set to produce only 1.5% growth, as Europe is in recession and China slows. The second half should see global growth back to a trend pace of 2.7%, but with upside risk.
- Charts 2-3 shows our expected returns by asset class, both outright and as an excess return over volatility. Equities are on top with returns around 20%, followed by credit and EM currencies between 5% and 10%, depending on quality. Only G10 government bonds and the dollar underperfom US cash. These return projections line up cleanly with relative risk/beta, with over half the riskier asset classes promising returns to risk ratios near 1.0.
- We had similar return projections a year ago. They badly disappointed and underline that 2012 will be a year of risk management. Fear will dominate greed early in 2012. Our best guess is that investors will never truly become bullish,

YTD returns through Dec 15
%, 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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The certifying analyst is indicated by an [AC]. See page 7 for analyst certification and important legal and regulatory disclosures.

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