From: US GIO <[redacted]>
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Inline-Images: image003.png

J.P.Morgan

Global Asset Allocation
J.P. Morgan Chase Bank NA,
J.P. Morgan Securities Ltd.
Apr 20, 2012

The J.P. Morgan View

Seven puzzles

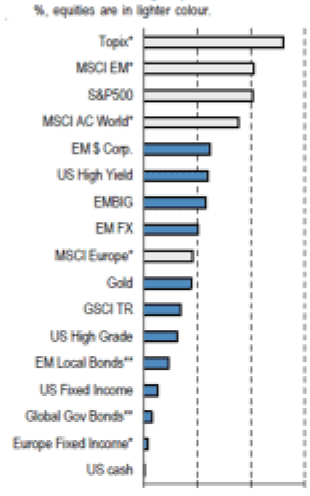
- **Asset Allocation** — No changes. Long equities and credit vs bonds and cash over next 3 months. Signals for next few weeks seem quite neutral.
- **Economics** — No forecast changes, but weaker data bias our 2.5% Q2 US forecast to the lower 2's.
- **Fixed Income** — We recommend bearish money market positions.
- **Equities** — Earnings expectations momentum favours US vs other regions.
- **Credit** — We stay overweight senior financials and LTII bonds.
- **Foreign exchange** — Low FX vol to stay. Focus trades on mean reversion.
- **Commodities** — We expect the spread to continue to narrow and stay long Dec-12 WTI vs. Dec-12 Brent with a $5/bbl target.

- In a week where a lot of price screens are reading UNCH (unchanged) and economic forecasts have not moved, we would like to focus on some longer-term issues — not views, nor concerns, but things that puzzle many of us. For each, we provide our best explanation, while admitting they remain puzzles. Each requires a much longer and deeper study.
- **Why has neither Greece nor Germany left EMU, yet?** Or even, why did they ever get in? The crisis has revealed the cost of giving up one's currency. Resolution requires massive deflation in the periphery and massive funding from the core. The reason countries joined into EMU and have not (yet) left is that monetary union was planned as the first step towards a political union — a US of E. The cost of abandoning EMU is not merely related to capital flight and creation of a new currency, but is paramount to ditching European integration, and moving back to the bad old days of a divided and quarrelsome Europe. EMU members will likely do everything they can to keep the union together, even as they will need more crises to push them that way.
- **Why has the euro not collapsed, yet, given a recession and EMU break-up risk?** The EMU periphery cannot devalue against the core, but would greatly benefit from a drop in the euro. The answer is likely that currencies are relative prices, and the fiscal situation in the US, UK, and Japan is as bad as in the Euro area, even as the latter has problems with internal funding. Each of these four currencies has fallen dramatically against the smaller G10 countries that are in better shape (CAD, CHF, AUD, NOK). The Euro area also has no external deficit, and funding problems may have led to capital repatriation, supporting the euro.
- **Why are US HG credit spreads still near recession levels?** US HG remains about 200bp above USTs, a spread level that before Lehman was only seen

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 Apr 19
%, 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 $.

www.morganmarkets.com

Renee E. Weissend
J.P. Morgan | Global Investment Opportunities Group
320 Park Avenue, Floor 14
New York, NY 10022
[redacted]