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J.P.Morgan

Global Asset Allocation
J.P. Morgan Chase Bank NA,
J.P. Morgan Securities Ltd.
May 18, 2012

The J.P. Morgan View

Q&A on Greek exit risk

- **Asset Allocation** — With little policy support before June 17 Greek elections, there is little supporting current risk prices. Cover remaining longs in risk.
- **Economics** — Data are tracking Q2 forecasts, but the recent fall in equities offsets the impact of lower oil prices. This pushes growth risk to the downside.
- **Fixed Income** — Stay flat duration, and hold EMU hedges.
- **Equities** — Take profit on Dax OW in Europe as risk of shorting bans is rising.
- **Credit** — We move underweight credit, and cover our remaining longs in the GMOS portfolio. Near-term, we look for relative value in CDS vs. equity.
- **Foreign exchange** — We use a 1.22 EUR/USD fair value for June on 50/50 odds of pro vs anti EMU results in the June 17 Greek elections.
- **Commodities** — This week's start-up of the Seaway pipeline between the US Midwest and Gulf Coast should help narrow the Brent-WTI Spread.

- **Risk markets all lurched down as one this week, and safe government bonds and the dollar all rose as one,** as markets positioned for Lehman-like contagion risk emanating from Greek election risks. Unfortunately, the June 17 date of these elections is still a month away, and Euro policy makers do not want to give the shop away even before the elections, for fear of strengthening the hands of those who are calling for a hard renegotiation with the Troika. That means little upside news over the month and markets being driven by positioning on different post election scenarios. With this outlook, and equities now flat on the all-important 6-month lookback, we need to neutralise remaining equity and credit longs.

- **Economic news remains broadly neutral** and are tracking our Q2 forecasts. Q1 GDP for both Japan and the Euro area came in better than expected at 0% and 4.1%, respectively. Forward looking indicators, including the last set of PMIs, and recent falls in global equity prices, give us no reason to raise the rest of the year, but with high Q1, the 2012 projections automatically move up. Over the past month, both oil and global equities are down about 10%. Further Greek turmoil would push down again. The equity fall, however, has a higher impact on economic activity than the same %fall in oil prices. Hence, we must now accept a negative risk bias on the economic outlook.

- Given the almost exclusive focus of global markets on the evolving Greek drama, we provide below a concise Q&A on Greek EMU exit risk. The box on p. 2 lists a number of recent reports from JPMorgan analysts on this topic.

- **Why do we care?** Greek elections are having many times the impact that the recent slowing in Chinese growth is having, despite China's economy being 30 times larger than the Greek one. The higher impact of local shocks depends on how they affect the world's two main "contagion conductors" — banks and oil. China has little negative on either, and thus the impact of its growth

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

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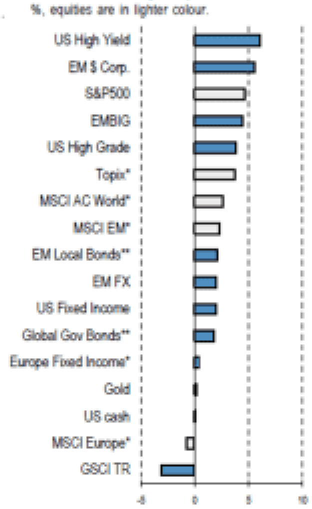
YTD returns through May 17
%, equities are in lighter colour.



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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