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J.P.Morgan

Global Asset Allocation
J.P. Morgan Chase Bank NA,
J.P. Morgan Securities Ltd.
Jun 1, 2012

The J.P. Morgan View

Economy now adding insult to euro injury

- **Asset Allocation** — We are net short risk through UWs of the euro and Cyclicals. Retain OW of US and EM Asia stocks. Fund risk assets in euros. Prefer credit over equities and commodities. Retain longs in gold.
- **Economics** — Growth momentum has turned negative. Both EM Asia and US forecasts have been cut after disappointing PMIs and jobs data.
- **Fixed Income** — Path of least resistance is still to wider intra-EMU spreads.
- **Equities** — Stay long US vs euro equities, despite weak US jobs, as we have not yet seen the full impact of the escalating euro crisis on economic data.
- **Credit** — We move to OW EM $ Sovereigns vs. EM Corporates and Neutral European Senior Financials.
- **Foreign exchange** — Stay short EUR/USD, GBP/USD and EUR/CHF.
- **Commodities** — We remain neutral and prefer spread trades. Our highest conviction of these are short corn vs. natural gas and long corn vs. live cattle.

- As if Euro turmoil and indecision were not enough to push down risk assets, now comes renewed doubt about world growth. Our Global Manufacturing PMI today fell back to a just above December, which was the lowest point since the recession. Our economists have **cut their 2012 and 2013 global growth projections to 2.1% and 2.4%** this week, due to downgrades in the US, Brazil, and EM Asia, following cuts in the Euro area last week (charts p. 2 and table p. 6). Both are down 0.2% from 2 weeks ago, and are below potential.
- Much as we would like to see the double-digit fall in stocks from the March YTD peak as the bottom in the correction, the **near-term drivers still appear to be pointing downwards for risk assets.** Value and risk premia have gone from cheap to very cheap, but have not been not good timing signals. Both price and economic momentum are now negative. We do not see evidence of capitulation, with most tactical investors having moved to neutral on equities and credit, but not yet to short. And the policy cavalry does not seem in a hurry to ride to the rescue, in our opinion, assuming they have not run out of ammunition.
- **Is the economic slowdown temporary, or the beginning of a downward slide?** The lack of a single smoking gun for recent weakness argues for temporary, in particular as it has come with a dramatic fall in oil prices that will support consumption. We are thus taking a middle road that sees higher growth rates in coming quarters, from the low in Q2, but that only returns to the 2.5% pace of Q1 by Q3 of next year. This spells another year of below potential growth that should depress inflation and induce renewed monetary easing. We pencil in a QE/Twist extension in the UK and the US.
- Our impression from position data and investor discussions is that tactical investors have been switching from long to neutral on equities and commodities, while retaining some credit longs. Corporate bonds have outperformed (chart p. 1) as the impact of wider spreads has been offset by lower underlying

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

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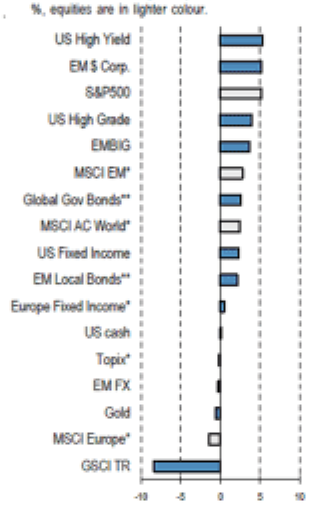
YTD returns through May 31
%, equities are in lighter colour.



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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