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J.P.Morgan

Global Asset Allocation
J.P. Morgan Chase Bank NA,
J.P. Morgan Securities Ltd.
June 29, 2012

The J.P. Morgan View

Mini-steps to Euro federalism

- **Asset Allocation** — Buy euro bank bonds as they benefit the most with the ECB as the new bank regulator and potential TARP money from the ESM.
- **Economics** — Q2 likely the weakest quarter this recovery, at 1.4%, but Q3 still looks like sub 2% for the world. UK growth is cut by 1/4% this year and next.
- **Fixed Income** — Long duration in EM, OW German Bunds cross-market.
- **Equities** — Near-term upside should benefit countries and sectors where positions are more depressed, i.e. Euro area equities and banks globally.
- **Credit** — Eurozone banks look to be the relative winner from the EU summit. We go long € financial bonds in the *GMOS* portfolio.
- **Foreign exchange** — Dollar moves into a range post the Brussels EI summit, but we retain a number of hedges against renewed euro weakness.
- **Commodities** — Hot weather in the US is pushing up corn and US gas prices.

- Risk assets are up on the week on **great expectations management** by the Europeans who had led the world to expect the worst from yesterday's EU Summit. In the end, the **EU stepped back from the brink.** Euro area leaders compromised on some of their disagreements in a manner that at least temporary eases the negative economic and financial dynamic, even as it not truly reverses them.

- **What did the EU Summit deliver?** Here is a top-level view. Our sister publications (*GDW, GFIMS*) provide more details. Overall, if 10 is what is needed to save EMU, and zero is where we started the week, then one could say we moved to 2 — a meaningful step, with many more to be taken, and a risk of sliding back when the details need to be filled in.

- We argued last week that the Summit ultimately needs to be judged on whether it moves the Euro area towards **fiscal and political federalism.** The Van Rompuy Report on a *Genuine Economic and Monetary Union* spells out a vision of the federalist end point, but received no agreement, besides an invitation to try again with more concrete proposals by October. Very little progress thus, except that the issue is now at least openly on the table.

- **Some progress towards federalism** was made by agreeing to a **single bank supervisor** under the ECB, to be implemented by year-end. The still future ESM would then be allowed to help recapitalize banks — a small move towards a much needed Euro-TARP. Also, a first step was taken towards dropping the seniority of official lending relative to the private sector in the case of the EFSF/ESM loan to Spain to recapitalize its banks. The subordination of private investors has been the main reason why official loans never stabilized the market. Northern EMU is not accepting this as a rule change, but one can argue that the cat is out of the bag.

- Equally important is that some steps are being taken towards ending the

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

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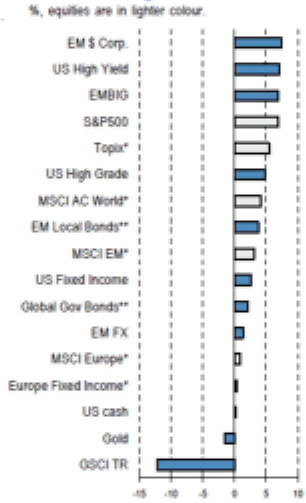
YTD returns through Jun 28
%, equities are in lighter colour.



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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