

From: US GIO <[REDACTED]>

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J.P.Morgan

Global Asset Allocation
27 July 2012

The J.P. Morgan View

Why so low?

- **Asset Allocation** — Stay long better yielding bonds and defensive equities.
- **Economics** — Activity data support a bottoming in global growth, but show so far little sign yet of the expected lift in H2.
- **Fixed Income** — Any ECB bond buying likely a temporary respite.
- **Equities** — Still widespread skepticism and negativity suggest short covering has further to go in equities. Europe benefits the most from this short covering.
- **Credit** — Taxable US munis offer spread pick-up amid the dash-from-cash.
- **Foreign exchange** — Moderate USD strength in Q3.
- **Commodities** — The poor outlook for agriculture production across the globe raises the risk of a reversal in the recent downtrend in EM inflation.

- Equities are slightly up on the week, and bonds are down as ECB hints of renewed bond buying offset more lackluster economic and earning news. Next week sees both the ECB and FOMC meet and an important market test for Spanish market access when it tries to issue bonds on Aug 2.
- Our overall strategy remains on course, with a focus on mid-risk assets, riding a course between low-yield cash and government debt on the low-risk side, and cyclical equities on the high-risk side. We thus prefer better-yielding equity-like bonds and bond-like equities, or corporate and EM bonds and defensive, higher-yielding equities. This strategy assumes low economic and earnings growth, with modest downside, but no recession, and continued monetary easing across the world. We will be wrong, if we get either much higher world growth and/or inflation, or a slide into a global recession.

- We will also be wrong if policy makers suddenly find the will and the means to become a lot more effective in boosting growth. DM fiscal authorities remain in deleveraging mode, subtracting over 1% from US, UK, and Euro area growth this year, and likely also next. There seems little appetite to abandon fiscal discipline currently, but we should be on the look out for any policy shifts. The Fed could again reach deeply in its tool bag, likely rate communication next week and QE3 in September, but is in our mind running out of ammo, and thus unlikely to come up with much that improves the economic outlook.

- Euro area policy makers surely have the means to reverse their recession and sovereign debt crisis, as they caused them, but seem to remain too conflicted and divided to reverse conditions. Next week, the ECB looks set to announce it will buy periphery bonds again, but unless it enters with overwhelming force (shock and awe), investors will likely use the opportunity to unload bonds to them. Today's rally in equities and sell-off in bonds comes on speculation that ECB President Draghi will upgrade the old SMP program into real QE, just as he upgraded last year's liquidity injections into a massive LTRO. Given Europe's policy maker unerring ability so far to disappoint at each juncture, we are in wait-and-forever hope mode.

See page 7 for analyst certification and important disclosures.

Global Asset Allocation

Jan Loeys ^{AC}



JPMorgan Chase Bank NA

John Normand



J.P. Morgan Securities plc

Nikolaos Panigirtzoglou



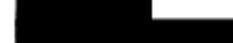
J.P. Morgan Securities plc

Seamus Mac Gorain



J.P. Morgan Securities plc

Matthew Lehmann



J.P. Morgan Securities plc

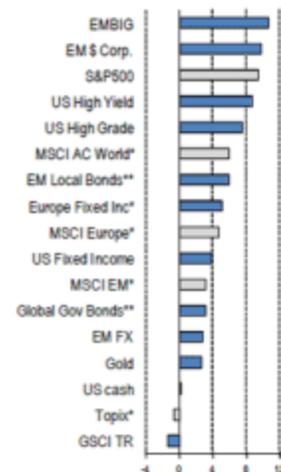
Leo Evans



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YTD returns through Jul 26

% , equities are in lighter color.



Source: Morgan, Bloomberg. See blue box on page 2 for distribution.



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