

From: US GIO <[REDACTED]>

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J.P.Morgan

Global Asset Allocation
17 August 2012

The J.P. Morgan View

H2 growth risk upgraded to neutral

- **Asset Allocation** — Reduced downside risks induce us to add cyclical risk, by covering long duration positions in Bund and EM local markets, covering UW's in Cyclical, and switching our outright long High-grade into a spread long vs USTs and into HY.
- **Economics** — We are upgrading the H2 growth risk bias from negative to balanced on early signs, from the US, China, and Brazil, that demand is recovering, though from depressed levels.
- **Fixed Income** — Cover long duration positions in Bunds and EM.
- **Equities** — We raise our short-term target for the S&P 500 to 1,475. Given the upgrade on our global growth risk bias, we also close our OW of Cyclical vs Defensives.
- **Credit** — The bond sell-off has hurt outright bond positions. We move 50% of our outright long US HG position to vs USTs, and move the remaining into US HY outright. The divergence between CDS and the VIX also leads us to go long vol and buy.
- **Foreign exchange** — Keep relative value exposures, such as short AUD/NZD, long NOK/SEK and short GBP/NOK.
- **Commodities** — Central banks continued to expand their gold reserves in Q2.
- **NO VIEW NEXT WEEK** — Team is on vacation. Next issue is Aug 31.

- Another week of equities rallying and bonds selling off across the world. The initial phase of this move was driven by position squaring, in response to what we called last week tantalizing signs of a growth lift and no news on the twin US and European fiscal crisis. But now there are more signs of investors putting on outright bullish positions.
- For these growth bullish and pro-risk market moves to continue, we believe we need to get fundamental support, both from better economic activity data and fading fiscal event risks. There is no news on the fiscal front, but further signs that the expected lift in activity from the lows in June is likely talking place. As a result, our economists are upgrading their risk bias around H2 growth from negative to balanced (see today's *GDI*). This is very far from being outright bullish on economic growth. Our headline projections for world growth in the second half of this year still stand only at 2 1/4%, which is a full percentage point below what we consider trend, or potential growth.
- But beyond economic data, risk markets will also likely be driven by the continued twin fiscal crises in the US and Europe. In the US, the presidential campaign is morphing into a debate on fiscal policy and the role of government in society. Recent polls are even. We believe the gyrations in these polls over the next 1-2 months will be one important factor that will drive the relative performance of equities versus bonds, both in the US and elsewhere.

See page 7 for analyst certification and important disclosures.

Global Asset Allocation

Jan Loeys AC

[REDACTED]

JPMorgan Chase Bank NA

John Normand

[REDACTED]

J.P. Morgan Securities plc

Nikolaos Panigirtzoglou

[REDACTED]

J.P. Morgan Securities plc

Seamus Mac Gorain

[REDACTED]

J.P. Morgan Securities plc

Matthew Lehmann

[REDACTED]

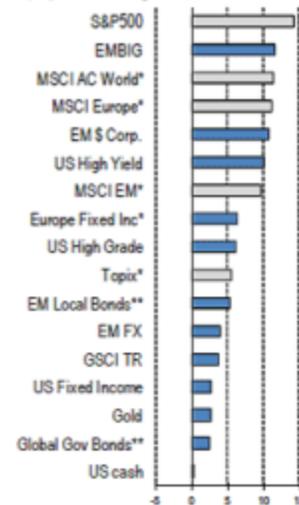
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Leo Evans

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YTD returns through Aug 16
%, equities are in lighter color.



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

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