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Global Investment Opportunities Group (GIO)

Investment Themes

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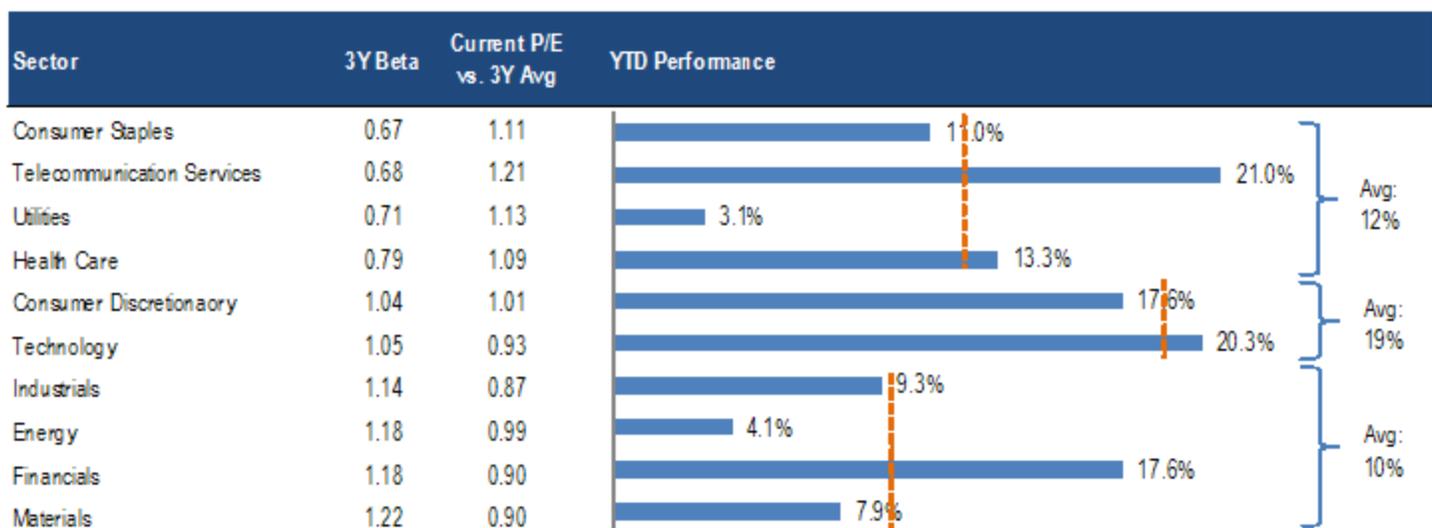
Positioning for a 4Q Rotation into High Beta

As we return from (an all too short) summer, US markets are up nearly 13% YTD. However, despite the seemingly strong performance, we believe there are still opportunities for new money in equity markets. First, the overall performance of the S&P 500 masks underlying composition as high beta sectors have generally lagged low- and market-beta sectors. Per the exhibit below, the sectors with highest betas (greater than 1.1 vs. the S&P 500) were generally the worst performing groups and up only 10% YTD on average. If you strip out Financials, the average drops to 7%. This compares with sectors with market betas up 19% and low beta sectors up 12%.

Second, we believe there are technical reasons to see support for high beta sectors. Through July this year, Equity Long/Short hedge funds were up 2.5% vs. 11% for the S&P 500 and 20% of hedge funds were still down on the year. Similarly, according to [a note by JPMS LLC's Equity Strategist Tom Lee](#), 32% of actively managed funds were underperforming their benchmarks by 250 bp or more and on average, large cap funds were underperforming by 111 basis points. Already trading desks are starting to see a reversal of flows with investors covering their equity underweights (see [JPM's Flows and Liquidity report from August 17](#)).

Lastly, while market valuations at 12.7x forward earnings do not feel particularly cheap, they are not expensive either relative to historic levels and, in fact, are in line with the average multiples for the last 3 years. Furthermore, like this year's performance, the overall market multiple masks underlying sector differences with most high beta sectors still trading at a 10% discount to 3 year averages versus market beta and low beta sectors which are in line or above historic averages.

We believe these factors provide support for a potential fourth quarter rotation into high beta stocks. Please contact your JPMorgan representative for implementation recommendations.



Source: Bloomberg.
As of August 31, 2012

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