The J.P. Morgan View

Do US elections change anything?

Global Asset Allocation

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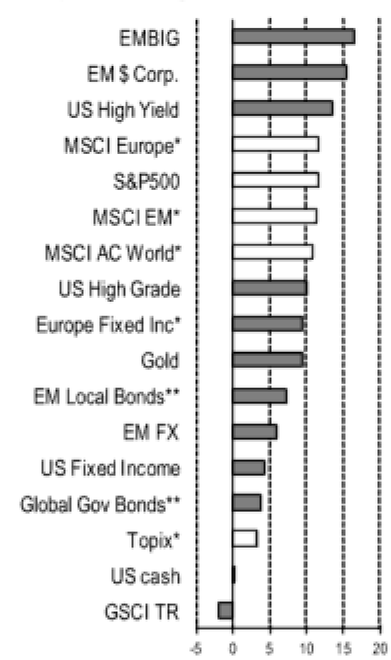
- **Asset allocation** — The equity market has priced out the Romney win scenario, but from these levels, our economic and market outlook and risks are unchanged. These keep us medium-term overweight equities and credit, despite the likely volatility as the fiscal cliff is negotiated. Within equities, we stay underweight the US, and move most of the overweight into EM Asia. We have moved some of our credit overweight from the US to Europe.
- **Economics** — The data flows continue to confirm that June/July was likely the bottom in global activity growth, and that we are gently lifting from those levels, even as it will take well into next year before growth returns to trend.
- **Fixed Income** — Look for yields to head higher, but focus more risk on spread compression trades.
- **Equities** — We focus our overweights on EM Asia, Cyclical stocks and US Home builders.
- **Credit** — We see the current dip as an opportunity to add risk.
- **Currencies** — Be long the dollar during the fiscal cliff negotiations.
- **Commodities** — A further set of better Chinese economic data keeps us long base metals.

- **Equity markets are taking the Obama victory quite badly,** with US stocks down some 4% on Wednesday and Thursday. This has pushed up global bond markets, and credit spreads are wider, but commodities are largely ignoring this turmoil. We don't think an Obama victory truly changes the economic outlook, or risks, but it does eliminate the Romney hope that appeared to have been in market pricing.
- **By definition, the Romney scenario is now priced out of the market.** The US elections confirm the status quo in Washington, and to us, they do so also for the broad economic and market outlook, from current levels. Hence, we do not see much reason to change our investment allocations, and remain medium-term overweight both credit and equities against cash, government debt, and commodities. We do so on the basis of value – still high risk premia – fading risks on fiscal policy in the US into next year; an expected rebound in global growth; and super easy monetary policy, with more QE coming if growth were to disappoint.
- In recent weeks, we have switched out of our long-standing US risk overweight, into an underweight, on the argument that the US had the most committed central banker, its growth has been least disappointing, and its fiscal risks were further into the future. This relative risk has changed, with Chinese economic data confirming that its economy is rebounding, while the ECB now creating a period a relative financial "peace". The US, in contrast, is at the start of intense negotiations on how to avoid a fiscal-cliff induced recession next year. Neither side of the aisle has an interest in being blamed for a recession. But markets will still be buffeted by a steady news flow on wide gaps between each side's position.

YTD returns through Nov 8
%, equities are in lighter color.



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

See page 7 for analyst certification and important disclosures.

- As a result, we stay underweight US equities and have moved risk from our US credit longs into Europe. Our initial US equity underweight was against Europe and EM Asia. Our recent downgrade of Q1 growth in the Euro area and better activity data in China made us move the lion's share of the overweight versus the US into EM Asia (see Wednesday's *Global Market Outlook and Strategy*).

- **Chinese activity data continue to surprise on the upside**. October data for IP, retail sales and fixed investment each came above our expectations. This creates upside risk, but no change yet, to our forecasts which already assume a gentle rise in quarterly growth rates from under 7% early this year to just above 8% in Q1. Better data reduce the need for renewed fiscal and monetary stimulus. The 18th Party Congress started yesterday, will last a week, and will be followed by the announcement of the next leadership. More important for the economic outlook will be the Annual Central Economic Working Conference that will be held in December. We expect it to support continued moderate fiscal policy, a neutral monetary policy, and further economic rebalancing towards domestic consumption. It may also lower the 2013 growth target to 7%. For more details, see Haibin Zhu in today's GDW.

Fixed Income

- **Bonds rallied strongly, in the slipstream of the tumbling equity market.** President Obama's re-election perhaps also diminishes expectations of a change in course at the Fed.

- The ECB and the Bank of England stood pat at their policy meetings this week, but the latter delivered a curveball today, announcing that its net coupon income from QE would be transferred to the UK Treasury from next year on. The near-term effect is a **slight monetary easing**, as the money will be used to reduce the amount of gilts in issue, similar to QE itself.

- Beyond that, this is another small step towards **perceptions that monetary policy is no longer independent from fiscal policy**, like the Bank of Japan's joint statement with two government ministers last month. Nobody knows the tipping point at which these perceptions feed into much higher inflation expectations, just that we'll know it when we see it.

- Core euro bond yields are towards the low end of the range, and we expect them to head higher. But we focus more risk on **spread compression trades**, via overweights in Euro area peripherals, US MBS, and EM local bonds vs DM.

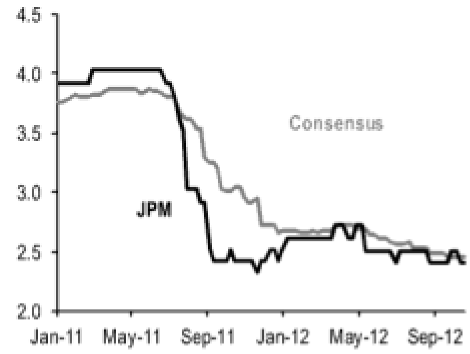
Equities

- Equity markets fell sharply post US elections, but we are not changing our strategy.

- From a month ago, we avoided directional longs in our GMOS model equity portfolio due to elevated positions by spec investors (see Charts A10 and A12 in today's *Flows & Liquidity*). We preferred to **focus instead on regional and sectoral trades**. We stay with the same strategy focusing our recommendations on EM Asia across regions, and Cyclical stocks and US Home builders across sectors.

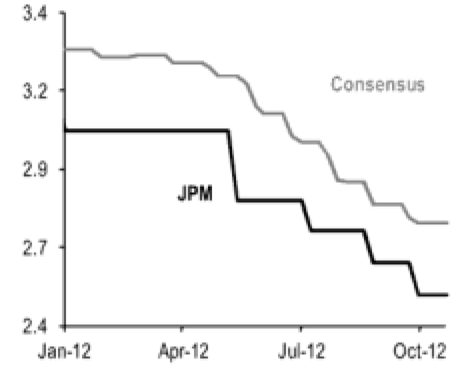
- The rebound in the October global manufacturing PMI is what keeps us **long Cyclical vs. Defensive** equity sectors. **Is this a high-beta trade? Not**

2012 global GDP growth forecasts: JPMorgan and Consensus



Source: J.P. Morgan, Consensus Economics. Consensus Economics forecasts are for regions and countries that we averaged using the same 5-year rolling USD GDP weights that we use for our own global growth forecast.

2013 global GDP growth forecasts: JPMorgan and Consensus



Source: J.P. Morgan, Consensus Economics. Consensus Economics forecasts are for regions and countries that we averaged using the same 5-year rolling USD GDP weights that we use for our own global growth forecast.

More details in ...

Global Data Watch, Bruce Kasman and David Hensley

Global Markets Outlook and Strategy, Jan Loeys, Bruce Kasman, et al.

US Fixed Income Markets, Terry Belton and Srini Ramaswamy

Global Fixed Income Markets, Pavan Wadhwa and Fabio Bassi

Emerging Markets Outlook and Strategy, Joyce Chang

Key trades and risk: Emerging Market Equity Strategy, Adrian Mowat et al.

Flows and Liquidity, Nikos Panigirtzoglou et al.

Description of YTD Chart on front page:

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 $.

necessarily. Last summer, as equity markets rebounded in June and July, Cyclical sectors actually underperformed. The thin grey line in the top chart shows that Cyclical sectors have recaptured only a quarter of the underperformance seen between March and August and thus provide a better entry point. Position indicators suggest that investors are underweight Cyclicals and overweight Defensives which is turn means that Defensive sectors are more vulnerable to position unwinding.

- We introduced an **underweight in US equities** in mid October to position for the US fiscal cliff risk. Obama's win makes it more likely that this risk will intensify into year-end. Across regions we favor EM Asia and Europe vs. the US. While the US is facing fiscal cliff risks, Asian equities are benefiting from concrete signs that economic activity is rebounding in China. European equities are benefiting from greater improvement in financial conditions, although they are more vulnerable to noise around the Greek and Spanish issues.

Credit

- **US credit spreads edged wider in response to the fall in equity markets following the US elections.** US HG widened 7bp to 160bp, undoing around half of October's peak-to-trough moves. Similar moves registered in other USD credit markets. At 107bp, the CDX.IG is now back to early-August levels, even as the CDS-Bond basis moved back into negative territory with corporate bond spreads again moving above CDS.
- Credit spreads may be repricing the risk of a fiscal-cliff induced recession in 2013. For context, we expect the eventual outcome of the negotiations to lead to about 2% of GDP in fiscal contraction, not enough to tip the economy back into recession in itself, and considerably lower than the 4% drag under the full enactment of all revenue raising measures and spending cuts currently set to become law on Jan 1.
- From our point of view, the elections confirm the status quo both in Washington and in market conditions – i.e. we should expect more of the same and **it has been a great year for credit**. Therefore, **we see the current dip as an opportunity to add risk**, and expect spreads to continue to tighten into year end, albeit at a slower rate than in recent months. We stay down in quality and outline in *GMOS* this week some relative value arguments for Euro HY vs US HY. On that front, European credit shrugged off the election outcome, tightening marginally in the HG space and widening very slightly in the HY space.

Foreign Exchange

- The post-US election drama is unfolding as expected. Four more years with the same cast is delivering a higher USD versus most currencies but JPY due to deleveraging ahead of the fiscal cliff, and lower USD/CNY forwards due to avoidance of US-China trade conflict (see *An FX guide to America's toss-up election, FX Markets Weekly,* Nov 2). The only surprise has been that FX volatility remains so subdued (VXY unchanged at 7.4%) in a week when the trade-weighted dollar and equity volatility have rallied. Chalk it up to positioning, as most indicators suggest that institutions investors entered the US polls with aggregate USD positions close to flat.
- Now, sausage-making season begins. US recession is guaranteed if the fiscal cliff is enacted on schedule, and neither Congress nor the President welcomes

More details in ...

US Credit Markets Outlook and Strategy, Eric Beinstein et al.

High Yield Credit Markets Weekly, Peter Acciavatti et al.

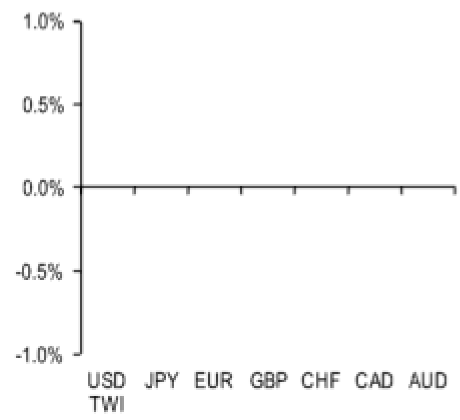
European Credit Outlook & Strategy, Steven Dulake et al.

Emerging Markets Cross Product Strategy Weekly, Eric Beinstein et al.

that outcome. But avoiding the worst case requires a short-term bargain plus a long-term compromise on a scale not seen in Washington since the Clinton-Congressional budget showdown of 1995/96. As with sausage making, this process won't be pleasant to watch. It would be easier to return in several weeks when the final product is ready, but for those who cannot avoid, ignore the likely volatility, and add to defensive trades.

- Washington needs at least a month to broker deferral of a decent part of the fiscal cliff before it can assume the monumental task of comprehensive fiscal reform next year, and the currencies most vulnerable to an impasse are expensive. If no grand bargain is reached before the end of the year, full implementation of the cliff implies enough fiscal tightening to drive the dollar up 3%-5% versus commodity currencies, given typical patterns during global growth shocks. Even if these tax increases are reversed later in the year, the first response would be a higher USD versus all currencies but the yen, given how long that investors are of cyclical currencies and how short they are the yen.
- Stay short USD/JPY and buy USD vs high-beta (AUD, NZD, SEK and GBP) in cash and options for a move of a few percent in coming weeks. In options, sell a 1-mo NZD/USD call (0.8250 strike, 0.83 RKI), buy a bearish 2-mo AUD/USD seagull (buy 1.03-1.01 put spread, sell 1.05 call) and buy a bearish 2-mo GBP/USD seagull (buy 1.57-1.55 put spread, sell 1.6250 call). Buy USD/SEK in cash.

FX weekly change in USD



Source: J.P. Morgan

Commodities

- **Commodities are up some 1% this week, led by precious metals, which rallied almost 4%.** The strong gains in gold are probably due to the US election result as Obama's victory means no change to Fed policy and so continued QE and negative real yields. Gold also tends to gain when there is high fiscal uncertainty, just as it did last year during the acrimonious debt ceiling debate which cost the US its AAA rating. **We stay long gold.**
- Chinese economic data came out stronger than expected this week, providing support for our view that Chinese economic growth has bottomed and will rebound through next year. China's slowing activity growth has been a major drag on commodities over the last few years and the improving economy is what makes us **long base metals**.
- The expected rebound in Chinese growth does not imply that we will go back to the double-digit growth rates that we saw before the crisis, and immediately after. The periods when China's economy grew at a pace above 8% coincided with very strong price gains on commodities, as it boosted global demand. China's leadership is in the process of reorienting its economy towards domestic consumption and to reduce reliance on exports and capital investments. As a result, Chinese growth will likely settle in a 7%-8% range over the medium term, a growth pace that in the past has not put upwards pressure on commodity prices.

More details in ...

FX Markets Weekly, John Normand et al.
Commodity Markets Outlook & Strategy, Colin Fenton et al.
Oil Markets Monthly, Colin Fenton et al.
Daily Metals Note, Colin Fenton et al.
Agriculture Weekly, Dietz et al.

Interest rates		Current	Dec-12	Mar-13	Jun-13	Sep-13	YTD Return*
United States	Fed funds rate	0.125	0.125	0.125	0.125	0.125	
	10-year yields	1.63	2.00	2.00	2.00	2.25	2.6%
Euro area	Refi rate	0.75	0.75	0.75	0.75	0.75	
	10-year yields	1.35	2.00	2.15	2.25	2.25	3.9%
United Kingdom	Repo rate	0.50	0.50	0.50	0.50	0.50	
	10-year yields	1.74	2.20	2.30	2.35	2.35	2.9%
Japan	Overnight call rate	0.05	0.05	0.05	0.05	0.05	
	10-year yields	0.73	0.85	0.90	0.95	1.00	2.0%
GBI-EM hedged in $	Yield - Global Diversified	5.64	6.00				7.3%

Credit Markets	Current	Index	YTD Return*
US high grade (bp over UST)	161	JPMorgan JULI Porfolio Spread to Treasury	10.1%
Euro high grade (bp over Euro gov)	176	iBoxx Euro Corporate Index	9.5%
USD high yield (bp vs. UST)	582	JPMorgan Global High Yield Index STW	13.1%
Euro high yield (bp over Euro gov)	726	iBoxx Euro HY Index	21.0%
EMBIG (bp vs. UST)	294	EMBI Global	16.4%
EM Corporates (bp vs. UST)	337	JPM EM Corporates (CEMBI)	15.4%

		Quarterly Averages					
Commodities	Current	12Q4	13Q1	13Q2	13Q3	GSCI Index	YTD Return*
Brent ($/bbl)	110	105	112	105	120	Energy	-3.7%
Gold ($/oz)	1733	1725	1750	1775		Precious Metals	8.7%
Copper ($/metric ton)	7629	8300	8500	8700		Industrial Metals	-2.5%
Corn ($/Bu)	7.45	8.75	8.50	8.25		Agriculture	15.2%

Foreign Exchange	Current	Dec-12	Mar-13	Jun-13	Sep-13	3m cash index	YTD Return* in USD
EUR/USD	1.28	1.30	1.30	1.32	1.34	EUR	-0.8%
USD/JPY	80.5	78	79	79	79	JPY	3.4%
GBP/USD	1.60	1..61	1.60	1.62	1.63	GBP	4.1%
USD/BRL	2.03	2.02	2.02	2.00	1.98	BRL	-2.6%
USD/CNY	6.24	6.32	6.32	6.30	6.25	CNY	2.5%
USD/KRW	1091	1125	1125	1110	1100	KRW	8.1%
USD/TRY	1.79	1.80	1.75	1.75	1.70	TRY	13.3%

Equities	Current	YTD Return (local ccy)
S&P	1390	15.6%
Nasdaq	3014	21.2%
Topix	731	4.4%
FTSE 100	5770	8.6%
MSCI Eurozone*	143	15.8%
MSCI Europe*	1104	13.2%
MSCI EM $*	995	12.2%
Brazil Bovespa	58383	2.6%
Hang Seng	22111	22.7%
Shanghai SE	2117	-4.2%

*Levels/returns as of Nov 08, 2012
Local currency except MSCI EM $

Sector Allocation *	US YTD	Europe YTD	Japan YTD	EM YTD ($)
Energy	6.1%	-0.5%	-7.5%	3.4%
Materials	11.7%	10.3%	-5.0%	3.5%
Industrials	12.6%	**15.7%**	1.2%	10.5%
Discretionary	**21.0%**	**23.9%**	**4.5%**	10.8%
Staples	11.4%	13.1%	**13.8%**	**19.5%**
Healthcare	**18.4%**	**15.5%**	**15.0%**	**30.9%**
Financials	**25.6%**	**24.2%**	**23.0%**	**16.8%**
Information Tech.	**15.6%**	**16.1%**	-5.2%	**19.3%**
Telecommunications	**21.9%**	-3.4%	-1.3%	**12.2%**
Utilities	4.7%	8.2%	-20.4%	5.2%
Overall	**15.6%**	**13.2%**	**4.4%**	**12.2%**

Source: J.P. Morgan

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Global Economic Outlook Summary

	Real GDP % over a year ago			Real GDP % over previous period, saar							Consumer prices % over a year ago			
	2011	**2012**	**2013**	**1Q12**	**2Q12**	**3Q12**	**4Q12**	**1Q13**	**2Q13**	**3Q13**	**4Q11**	**2Q12**	**4Q12**	**2Q13**
The Americas														
United States	1.8	2.2	1.7	2.0	1.3	2.0	2.0	1.0	1.5	2.5	3.3	1.9	1.9	1.7
Canada	2.6	2.2	2.1	1.8	1.9	1.9	2.0	2.1	2.1	2.2	2.7	1.6	2.4	2.0
Latin America	4.2	2.9	3.9	2.8	2.4	**3.9** ↓	4.5	3.4	3.7	4.0	7.2	6.0	6.0	6.8
Argentina	8.9	2.7	3.6	2.4	-3.2	5.0	10.0	2.0	2.5	2.0	9.6	9.9	10.0	11.0
Brazil	2.7	1.4	4.1	0.5	1.6	4.8	4.6	3.8	4.0	4.3	6.7	5.0	5.5	5.6
Chile	6.0	5.4	4.5	5.1	7.1	3.0	4.0	4.0	5.0	5.0	4.0	3.1	2.5	3.1
Colombia	5.9	4.3	4.5	0.9	6.7	2.8	3.8	4.2	5.5	5.5	3.9	3.4	3.1	3.2
Ecuador	8.0	5.0	4.0	4.2	4.8	3.0	5.5	5.0	3.0	3.0	5.5	5.1	5.1	5.4
Mexico	3.9	3.9	3.6	4.9	3.5	**2.1** ↓	3.5	4.0	3.2	3.3	3.5	3.9	4.4	4.1
Peru	6.9	6.0	7.0	8.3	6.0	5.5	6.0	8.0	8.0	7.0	4.5	4.1	3.0	2.8
Uruguay	5.7	3.5	4.0	11.8	2.1	9.0	-9.0	12.0	7.0	9.0	8.3	8.0	7.6	7.2
Venezuela	4.2	5.0	0.0	10.1	0.6	3.5	0.0	-4.0	0.0	3.0	28.5	22.3	18.5	30.2
Asia/Pacific														
Japan	-0.7	1.7	0.1	5.3	0.7	-3.5	-2.0	1.0	1.6	1.3	-0.3	0.2	0.0	-0.2
Australia	2.1	3.5	2.5	5.6	2.6	1.5	1.8	3.8	2.5	1.8	3.1	1.2	1.7	2.7
New Zealand	1.3	2.6	2.9	4.1	2.3	1.5	3.5	3.7	3.3	2.0	1.8	1.0	1.4	1.5
Asia ex Japan	7.4	6.1	6.4	7.2	5.8	5.7	**6.2** ↓	6.3	6.5	6.8	4.9	3.9	3.4	**3.9** ↑
China	9.3	7.6	8.0	6.6	7.1	7.7	8.2	8.0	8.2	8.2	4.6	2.9	2.2	3.3
Hong Kong	5.0	1.2	3.2	2.4	-0.4	2.0	2.5	3.5	3.5	5.0	5.7	4.2	3.4	3.4
India	6.5	5.6	6.0	6.1	5.3	5.2	5.0	5.8	6.0	6.8	8.4	10.1	9.8	9.0
Indonesia	6.5	5.7	3.5	**4.7** ↑	**6.0** ↓	**4.9** ↑	3.0	3.0	4.0	4.0	4.1	4.5	3.9	2.2
Korea	3.6	2.3	3.2	3.5	1.1	0.6	3.5	3.0	4.0	4.5	4.0	2.4	1.9	3.0
Malaysia	5.1	**5.0** ↑	**3.7** ↑	5.8	5.9	2.5	**3.5** ↑	**3.5** ↑	3.0	3.5	3.2	1.7	1.1	1.2
Philippines	3.8	5.3	3.5	12.6	0.9	1.2	1.2	4.5	4.5	4.5	4.7	2.9	2.3	2.3
Singapore	4.9	**1.5** ↓	**2.5** ↓	**9.5** ↓	-0.7	**-3.9** ↓	**3.2** ↓	**4.9** ↓	**1.6** ↑	**4.1** ↓	5.5	5.3	**4.5** ↑	**4.0** ↑
Taiwan	4.0	1.2	3.4	1.6	2.2	3.5	3.8	3.5	3.5	3.8	1.4	1.7	2.1	1.8
Thailand	0.1	5.8	2.7	50.8	13.9	2.0	1.5	1.5	2.0	2.0	4.0	2.5	3.3	3.0
Africa/Middle East														
Israel	4.6	3.0	3.1	3.1	3.4	2.0	2.8	4.9	6.1	6.1	2.5	1.6	1.3	1.5
South Africa	3.1	2.2	2.7	2.7	3.2	1.6	-1.3	5.4	3.3	3.6	6.1	5.7	5.6	5.8
Europe														
Euro area	1.5	-0.4	0.1	0.0	-0.7	0.0	-1.5	0.0	0.8	1.3	2.9	2.5	2.5	1.9
Germany	3.1	1.0	**1.1** ↓	2.0	1.1	1.0	**-1.0** ↓	1.0	2.0	2.5	2.6	2.1	2.1	1.8
France	1.7	0.1	-0.1	0.1	-0.1	**0.0** ↓	-1.5	-0.5	0.5	1.0	2.6	2.3	1.9	1.3
Italy	**0.6** ↑	-2.3	**-0.5** ↑	**-3.2** ↑	-3.3	**-1.5** ↓	**-2.0** ↑	-0.5	**1.0** ↑	**1.3** ↑	3.7	3.6	3.2	2.3
Spain	0.4	-1.3	**-1.7** ↓	-1.3	-1.7	-1.2	-2.5	**-3.0** ↓	**0.0** ↓	**0.0** ↓	2.7	1.9	3.4	2.9
United Kingdom	0.9	0.0	1.8	-1.2	-1.5	4.1	0.5	1.5	2.0	2.5	4.6	2.8	2.6	2.5
Emerging Europe	4.8	2.6	**2.6** ↓	2.4	1.3	**0.4** ↓	**1.8** ↓	**2.7** ↓	**2.4** ↓	**3.7** ↓	6.4	5.0	**6.0** ↓	**6.3** ↑
Bulgaria	1.7	1.0	1.5	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	1.7	-1.1	0.9	-3.1	-0.8	-1.2	-1.3	2.1	1.0	4.3	2.4	3.4	2.9	2.4
Hungary	1.6	-1.2	0.5	-3.5	-0.9	-1.0	-1.0	1.0	1.5	1.8	4.1	5.5	5.8	4.7
Poland	4.3	2.3	**1.6** ↓	2.4	1.6	0.5	**0.5** ↓	**1.3** ↓	**2.3** ↓	**3.0** ↓	4.6	4.0	3.1	2.5
Romania	2.5	0.0	0.8	0.5	1.9	-2.4	-1.2	1.2	-0.4	3.2	3.4	1.9	4.7	6.4
Russia	4.3	3.6	3.0	3.7	1.5	**1.0** ↓	3.0	3.5	3.0	4.0	6.7	3.8	**6.8** ↑	7.4
Turkey	8.5	2.8	3.7	...	...	...	...	...	...	...	9.2	9.4	**7.3** ↓	**7.5** ↑
Global	3.0	2.4	2.5	3.0	1.8	2.0	1.9	2.4	2.7	3.2	3.8	2.8	2.8	2.8
Developed markets	1.3	1.2	1.0	1.7	0.4	0.6	0.2	0.9	1.4	1.9	2.7	1.8	1.9	1.6
Emerging markets	6.1	4.7	5.1	5.4	4.3	**4.5** ↓	**5.0** ↓	5.1	5.2	5.6	5.7	4.6	4.4	**5.0** ↑

Source: J.P. Morgan

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