The following is a summary from the webcast, “4Q 2011 Global Markets Outlook: Volatility and Market Implications,” held on October 5, 2011, with Rebecca Patterson, Chief Markets Strategist, J.P. Morgan Asset Management, Institutional.

In this webcast and using slides from the new 4Q Guide to the Markets, Rebecca Patterson explored the events and trends that are likely to shape the months into 2012. (The relevant page numbers in the Guide to the Markets, or GTM, are also included.)

A Soft Housing Market and the U.S. Fiscal Outlook Are Weighing on the U.S. Economy and Markets

• While housing affordability has become more attractive, the bigger issue—mainly for people with less income and savings—is getting access to the credit and cash to get the new mortgage and/or refinance. Housing may be bottoming out, but the turn in trend has not yet appeared (GTM, pg. 21).

• A soft housing market is important on a few different levels:
  - A soft housing market restrains broader consumption; without consumption, businesses are less likely to hire more workers to meet demand.
  - Falling real estate values limit small business owners’ ability to borrow, which hurts the overall job market.
  - The high unemployment rate is part of the housing bubble collapse (GTM, p. 22). To see job growth, we need greater confidence among consumers and CEOs.

• The U.S. fiscal outlook is weighing on markets and confidence.
  - While not our base case, the U.S. debt/GDP ratio could climb to 82% by 2021 should current laws be extended, higher than in any year since 1948 (GTM, p. 19).
  - There is skepticism that the fiscal super committee—given timing and political polarization—will ride to the fiscal rescue (GTM, p. 20). The base case is that little compromise emerges before next November’s U.S. elections.
- The hit to confidence from politics, still soft housing and labor markets, lead us to believe that U.S. growth into next year will remain subtrend.

**European Crisis: Fiscal Challenges**

- Greece is stuck in a vicious cycle. Greece can’t afford to borrow to finance its budget deficits, and it has no growth to reduce the debt/GDP ratio (GTM, pg. 43). European policymakers say they will help Greece but only if it sticks with the austerity program. However, more fiscal austerity slows growth, which further pushes up the debt/GDP ratio.

- Markets aren’t convinced that Europe has the situation under control. That skepticism is being reflected in peripheral spreads to German Bunds, interbank lending markets and European equity markets, the latter led mainly by financial stocks given that European banks have large exposure to each other’s sovereign and private bond markets (GTM, p. 44).

- European policy makers are talking about the need to recapitalize banks to reduce contagion risks and allow them to continue to tap the markets. While such action would help risk appetite, we are unclear how quickly such a plan can be executed.

**What This Means for the Broader Global Economy**

- We expect subtrend growth in the U.S. and European economies (as well as in Japan and the U.K.) given what we see as a new fiscal world order (tighter fiscal policy across these countries) and political uncertainty. We do not forecast a developed market recession but see high near-term risks around Europe. We think the U.S. is on the edge, between subtrend growth and a quarter or two of modest contraction. Global GDP growth has averaged around 3.2% over the last 20 years or so (our investment bank looks for global GDP this year at 2.5% and next year at 2.0%).

- Easy monetary policy, structural emerging market demand and slightly more moderate commodity prices can help cushion soft growth in the developed world:

  - Emerging markets are playing a larger role in global GDP and a growing role in global consumption. The rise of China and other emerging markets reflects a structural shift in the global economy. This also helps U.S. corporate earnings strength given that 12% of S&P revenues come from emerging markets (GTM, p. 40, 41).

  - Central banks are another support to growth. The Fed’s “Operation Twist,” for example, is a move to help housing. To the degree central banks help cushion growth slowdown in the future, it is more likely to come from emerging markets (GTM, pg. 42).

  - Within commodities, a decline in crude oil prices has taken some pressure off retail gas prices, helping the U.S. consumer. Oil and food prices have also moderated, helping to ease global inflation pressures. But further downsides for commodities are limited given emerging market demand, rising production costs and central banks’ use of commodities (such as gold) as a source of diversification (GTM, p. 53).

  - Another positive note: in the U.S., corporate balance sheets and profits are strong (GTM, p. 25). With cash balances at record levels, firms could increase dividends, share buybacks and engage in M&A (GTM, p. 13).

**What Do All These Macro and MicroFactors Mean for Markets and Your Investment Strategy?**

- History gives us a sense of what asset classes should be doing in different economic regimes. While we can rule out a high inflationary environment, it’s not clear whether we are in a low but rising inflationary world or a disinflationary world (GTM, p. 27). That may be one reason for the extreme volatility across asset classes of late.

- Valuations are attractive with U.S. large cap growth stocks among the cheapest (GTM, pg. 10).

- Historically most years have had some sort of intra-year sell-off, but that did not mean the year overall was a wash for stocks (GTM, p. 58).

- For investors who have an equity allocation that is strategic, the next few years’ macro outlook suggests thinking about
the best ways to add smart risk in these volatile, low growth, uncertain times. Some strategies:

- High quality, high dividend equities, both U.S. only and global: Dividends are rising and more firms are paying out dividends, which can help offset low government yields and be a source of capital appreciation (GTM, p. 52).

- Large-cap growth stocks, especially in the U.S, many of which get their revenues from overseas and from emerging markets.

- Emerging market equities: We believe recent selling in EM equities was technical as managers needed to take profits on positions to reduce risk and increase cash. An actively managed EM strategy should take advantage of current valuations as well as countries and sectors where growth is decoupling (GTM, p. 46).

- Within fixed income and credit, be careful about currency exposure with government bonds (GTM, pg. 31). In a risk averse world, the dollar is likely to rise so what you make in yield outside the U.S., you could quickly lose on the currency. Look for bond managers who can actively hedge FX risks.

- Consider high yield bonds. With spreads of 800 basis points over Treasuries, we think there is more than enough risk priced in—even in the event of a mild recession (GTM, pg. 36).

- The long-term case for emerging market debt remains strong as the growth differential to DM countries continues to widen (GTM, pg. 38).

- With the U.S. dollar, remember that this is a balance of payments story (GTM, pg. 48). Longer term, look at opportunities for more dollar diversification, such as emerging Asia.

- Corporate defined benefit plans and endowments face lower funding status, but companies are in better shape to manage their deficits (GTM, pg. 61). Investors need to work out an investment strategy around managing interest-rate risk and managing return-enhancing assets. De-risking doesn’t have to mean reducing risky assets, but it can also be implemented through an increase in the duration of assets.

- Don’t hide in cash. A well diversified portfolio will give better risk-adjusted returns over time (GTM, pg. 49).

REPLAY INFORMATION
A recording will be posted until November 5, 2011.

- U.S. and Canada: 1-866-357-1405
- Outside U.S. and Canada: 1-203-369-0111
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