Please join us next Tuesday, March 15, at 11:00 am EST for a conference call on the "Ides of March" topics discussed last week (see box). Vali Nasr, Professor of International Politics at The Fletcher School of Law and Diplomacy, will join us. Mr. Nasr, a specialist on political and social developments in the Muslim world, is a Senior Advisor to the U.S. State Department on South Asia. You can get the dial-in information for the webcast from your coverage team.

As shown in the table below, as March began, the world was benefitting from a global recovery that was broadening and deepening. This recovery has run headlong into a series of events that were both foreseen and unforeseen. The eruption of political risk across the Arab world has been something of a surprise, although conditions leading to it were well understood for years. As for problems in the European Monetary Union and the impact of tightening policy in Asia, they have been familiar refrains around here for months, and were central to our 2011 Outlook. The whole point of the cover of the 2011 *Eye on the Market* was that removal of the stimulus tsunami was **never** going to be that simple, that parts of the recovery were very stimulus-dependent; and that the tsunami itself led to a variety of disruptions (e.g. rapidly rising commodity prices, particularly in the wake of the Fed's August 2010 Jackson Hole speech) whose regressive consequences were troubling.

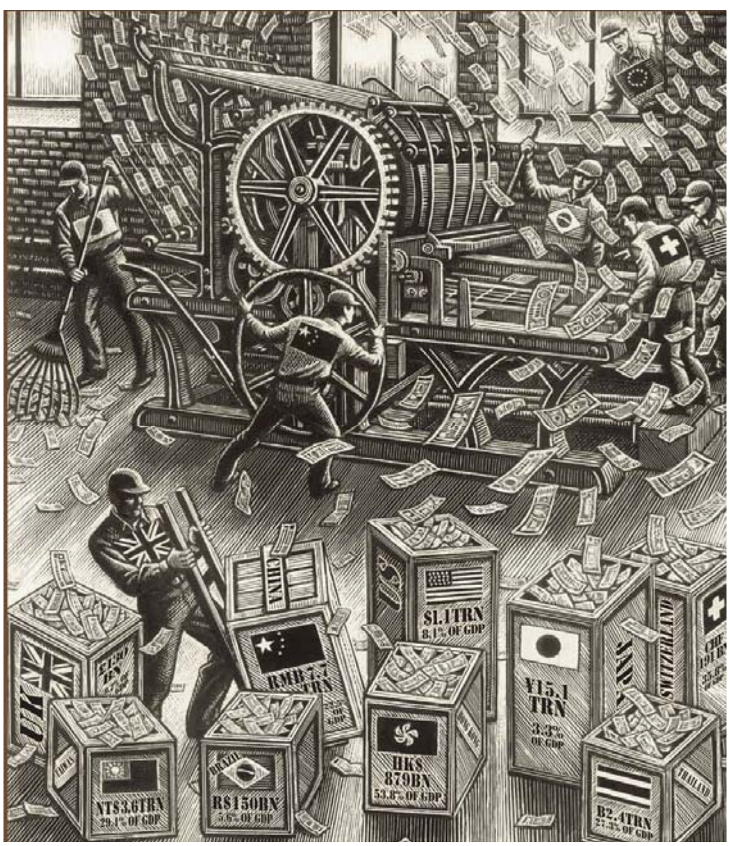
Global Recovery in the Works
% of Countries Growing Faster than 3 Months Prior

	3-Mar-11	Nov-10
World	**79%**	**38%**
Developed World	83%	17%
Asia	88%	50%
Central & Eastern Europe	75%	25%
Latin America	60%	60%

Source: Bridgewater Associates

The Ides of March	
March 3	Protests in Qatif, East Province of Saudi Arabia
March 9	Irish Parliament reconvenes with mandate to revisit EU/IMF bailout
March 10	Moody's downgrades Spain to Aa2
March 11, 20	Days of Rage, Saudi Arabia
March 11	Eurozone summit (Heads of state)
March 14, 15	Eurogroup meeting (Ministers of Finance)
March 15	Federal Reserve Open Market Committee Meeting
March 17	Bundestag vote on consultation requirement
March 24, 25	Main EU leaders meeting to finalize a deal
March 1 - 30	Central Bank meetings in Brazil, Mexico, Norway, Indonesia, India, Taiwan, Korea, etc

Source: J.P. Morgan Private Bank

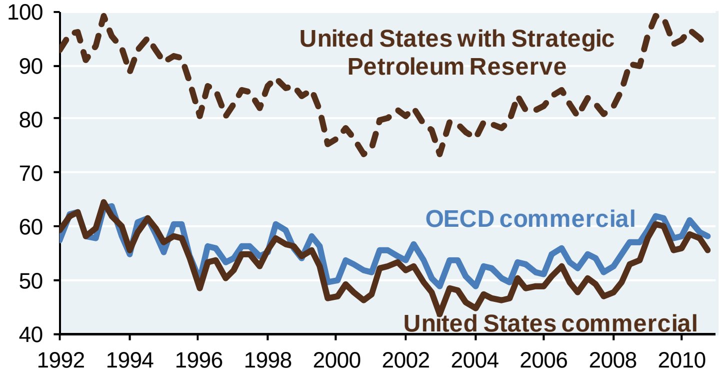


Instead of the traditional EoTM commentary, this week I wanted to share some charts on oil, Europe, equity markets and monetary policy that speak mostly for themselves. They are part of our rationale for holding less equity risk than what you might normally associate with a period of elevated profit margins, low P/E multiples in the developed world and a global rebound in both manufacturing and services. We continue to believe that certain styles of hedge funds (e.g., macro, merger arbitrage, credit), diversified commodity exposure and various forms of private lending (e.g. purchases of distressed European bank loans, well-collateralized loans to commercial property borrowers) are important complements to equities for the foreseeable future.

← **Figure 1: Printing Press**. The illustration represents the money created by various central banks since January 2008 to buy their own government bonds, or government bonds of other countries to limit exchange rate adjustments. Crates are labeled by amount created, and expressed as a percentage of GDP. (*Cover of the 2011 Eye on the Market*)

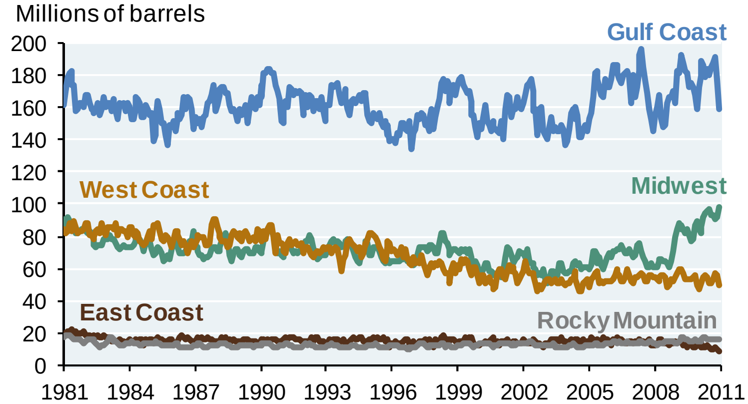
On oil, commercial inventories are at the high end of their historical ranges, and when adding in government Strategic Petroleum Reserves, the buffer against a supply disruption is even higher. However, there is resistance to releasing the SPR, and US commercial inventories tend to be concentrated in the Midwest, where they are not easily transportable to other areas to offset rising prices. It's undeniably true that the oil intensity of growth has fallen since 1980, but we are getting closer to levels of gas prices which have negatively impacted demand and consumption in prior cycles. As shown below, parts of Asia and Eastern Europe are worst situated to absorb a sustained oil price increase. As discussed last week, Saudi capacity is being relied upon to offset declines in Libyan production and potential declines in Algeria (although these have not happened to-date). We will focus on Saudi Arabia on next week's call. Earlier today, Saudi police opened fire on protestors, according to news reports.

Commercial and government oil inventories
Days of consumption



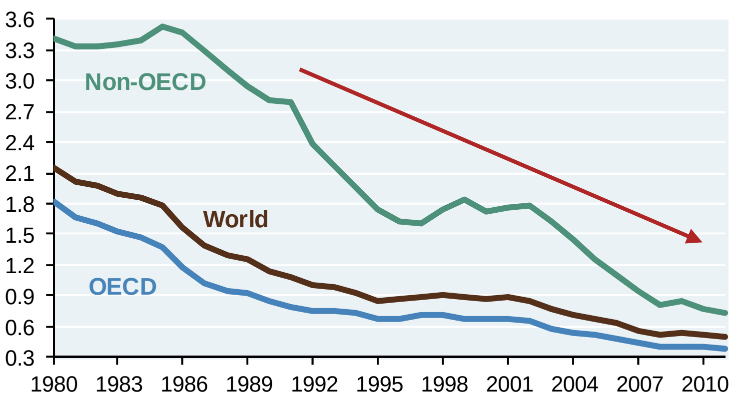
Source: EIA, J.P. Morgan Asset Management.

Commercial oil inventories by region
Millions of barrels



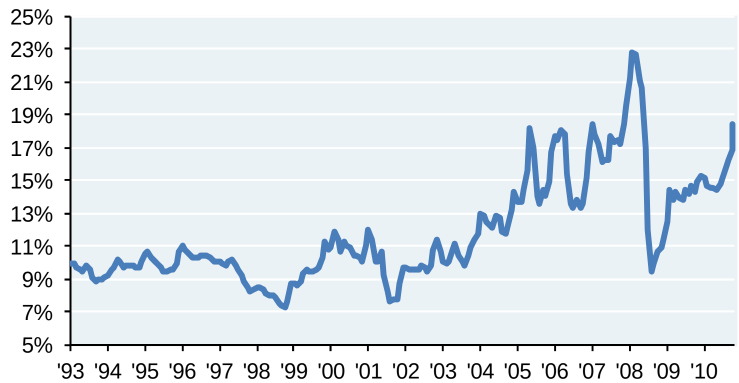
Source: Energy Information Administration.

Oil intensity declining worldwide
Billions of barrels/GDP



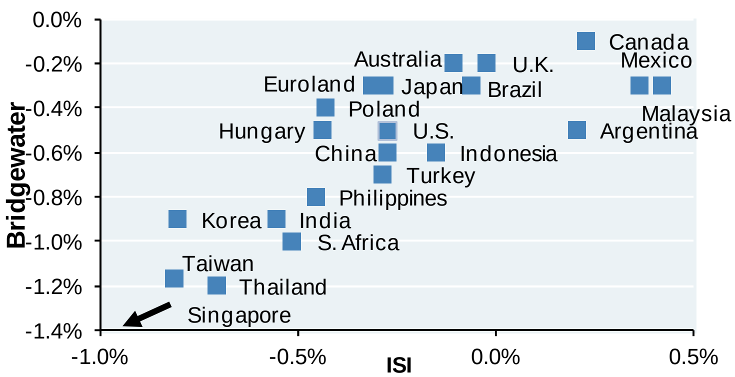
Source: ISI Group.

US retail gas prices as a share of average hourly earnings
Percent



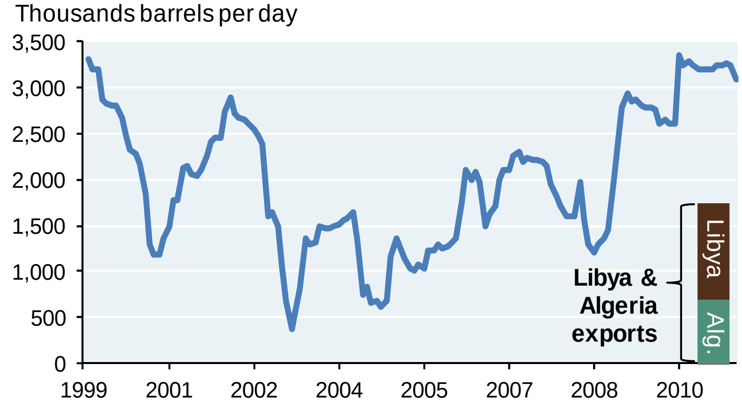
Source: U.S. Department of Energy, Bureau of Labor Statistics.

Two views on the impact of an oil price shock
% decline GDP



Source: Bridgewater Associates, ISI Group

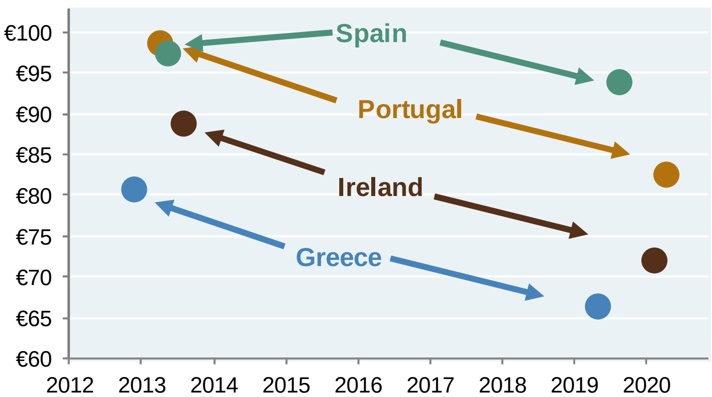
Saudi Arabia spare capacity vs potential supply loss
Thousands barrels per day



Source: Bloomberg.

On Europe, solvency problems in Greece, Portugal and Ireland are increasingly being factored into both bond and equity prices. This is a good thing, since it implies that some investors have already reconciled portfolios for potential debt restructurings to come (question marks remain on European banks, whose trading books and investment portfolios may account for sovereign bonds differently). On what to do next, both sides are pretty far apart and will have to compromise to avoid a very negative market reaction to upcoming EU summits. Comments from outgoing Bundesbank President Axel Weber this week are indicative of the challenges here: "*Strong German import demand is insufficient to compensate for the structural problems in the countries concerned, where painful adjustment processes have to take place…I know that the necessary measures are painful but they are also unavoidable*".

Price for benchmark government bonds
Euros



Source: Bloomberg.

Heading into the March Summit meetings

Debtors want	Creditors want
■ Maturing extension on EFSF and lower borrowing	■ Binding debt reduction plans
■ EFSF purchases of government debt in secondary markets	■ EU Commission monitoring of competitiveness and productivity targets, with fines for large imbalances
■ Increase in EFSF capacity	■ Constitutionally required sovereign debt limits
■ Senior bank loan haircuts	■ Tax harmonization

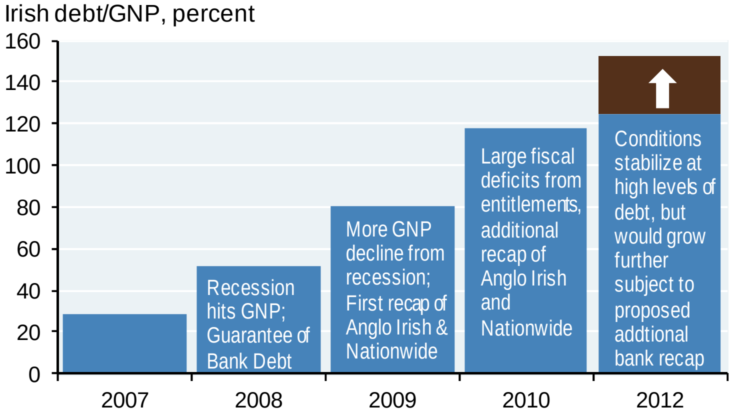
Europe cheap to US: price to earnings
Europe 10-yr trailing PE divided by US 10-yr trailing PE

Source: Factset, MSCI.

Europe cheap to US: price to book
Europe price to book divided by US price to book

Source: Factset, MSCI.

Ireland: The Road to Serfdom
Irish debt/GNP, percent



Source: Irish National Treasury Management Agency, IMF, Private Bank

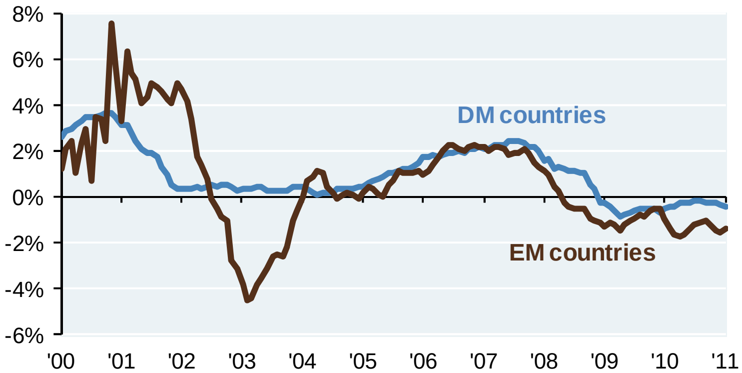
← **This is an incredible chart**. One can argue that Irish government debt was understated in 2007, as GNP was artificially inflated by the housing boom. Nevertheless, Ireland's decision to recapitalize banks to safeguard the European banking system has turned out to be a painful one. The EU was very much a partner on this decision, insisting on no losses for senior creditors of Irish banks. In GNP terms, Ireland is well on the road to serfdom.

Perhaps global investors should not worry too much about Ireland. After all, in GDP analogy terms, Ireland is to China as the Bahamas is to Ireland (in other words, Ireland is pretty small). But as a symbol of the still unresolved structural problems in the European Monetary Union, it looms large.

Past performance not indicative of future results.

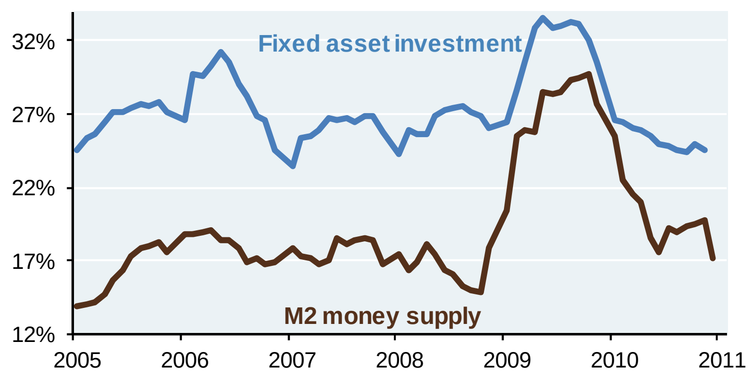
The exit from exceptionally easy monetary policy (not to mention fiscal policy) was always going to be complicated. In China, we are finally starting to see the impact of higher bank reserve requirements, slower money supply growth and slower fixed investment growth, as manufacturing surveys and imports have declined. Some of this is distorted by the Chinese New Year. But modestly slower growth in China[1] is here to stay and will be felt by the rest of the world, which acclimated itself to 10%-11% average growth from 2006 to 2010. As a starting point on financial market impacts, we have been looking at prior periods of monetary stimulus withdrawal in the US. **As shown, S&P returns were actually modestly positive during periods when the Fed tightened. In addition, in each case there was a subsequent equity rally, once monetary uncertainty was removed.** However, they were generally not accompanied by substantial fiscal tightening as well, and in the case of 1984 and 2005, the period of low interest rates led to private sector imbalances which would come home to roost within a year or two. All things considered, we are settling in for a period of single digit developed market equity returns for the next year or two.

Free money period gradually coming to an end
Policy rates adjusted for inflation, percent



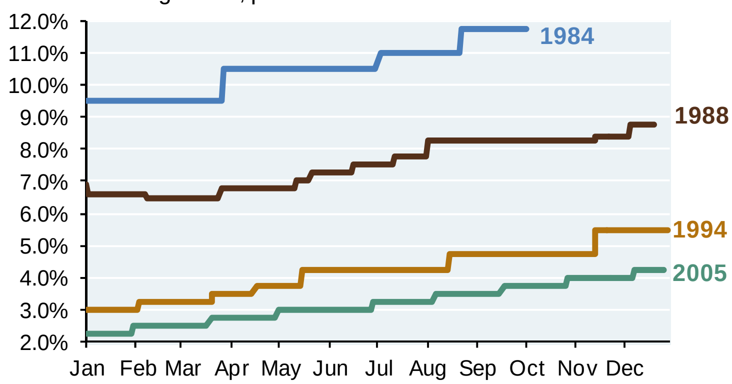
Source: J.P. Morgan Securities LLC.

Evidence of China's slow-down
Percent change - yoy



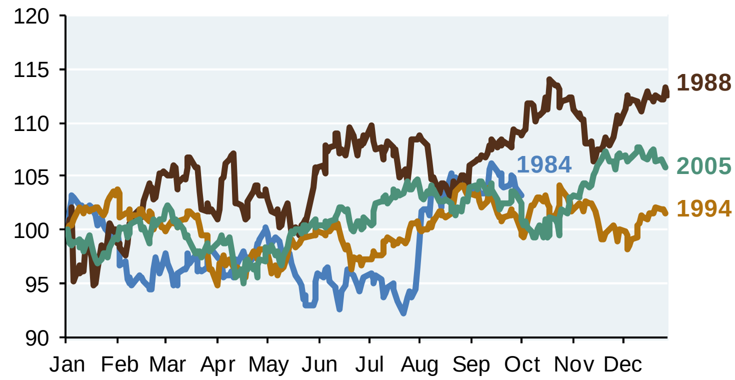
Source: PBOC, China Economic Information Network.

Fed tightening periods
Fed Funds target rate, percent



Source: Bloomberg.

U.S. equity markets during Fed tightening periods
S&P 500 Index, January = 100



Source: Bloomberg. Past performance not indicative of future results.

The largest oil disruption of the last 30 years was the Iranian revolution (5.5 mm bpd), followed by the Iran-Iraq war and invasion of Kuwait (~4 mm bpd each). As we will review on the call, we do not believe a similar crisis is in store for Saudi Arabia. But in my lifetime, I recall how quickly permanent fixtures of Enver Hoxha, Erich Honecker and Nicolae Ceaușescu disappeared. One day, shale gas fed into natural gas-driven power plants will support electrification of cars, or perhaps fuel a fleet of compressed natural gas vehicles. Until then, geopolitical oil risk will be part of the landscape. As investors, we have to position accordingly. Regarding monetary policy, Central Bankers did the rational thing by trying to restart global demand, and in many ways, it worked. But that doesn't mean the transition to a private sector-driven economy is going to be a smooth one. **The global private sector still inhabits a world more affected by government policy than any other in the last 300 years.**

Michael Cembalest
Chief Investment Officer

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[1] The new 5-year plan calls for a 7% growth target. Barry Eichengreen at Berkeley notes that the transition to slower growth in fast-growing economies comes sooner with a high ratio of elderly to active labor-force participants, increasingly the case in China due to increased life expectancy and its one-child policy. Slowdowns also tend to come earlier in economies with undervalued currencies, given the potential for external shocks. On the labor force, JPMSI estimates that only 3% of China's rural labor force is still a source of potential migration ("*China's Internal Contest for Labor: Winners and Losers*", March 3, 2011), another sign of the end of a period of massive surplus labor.

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