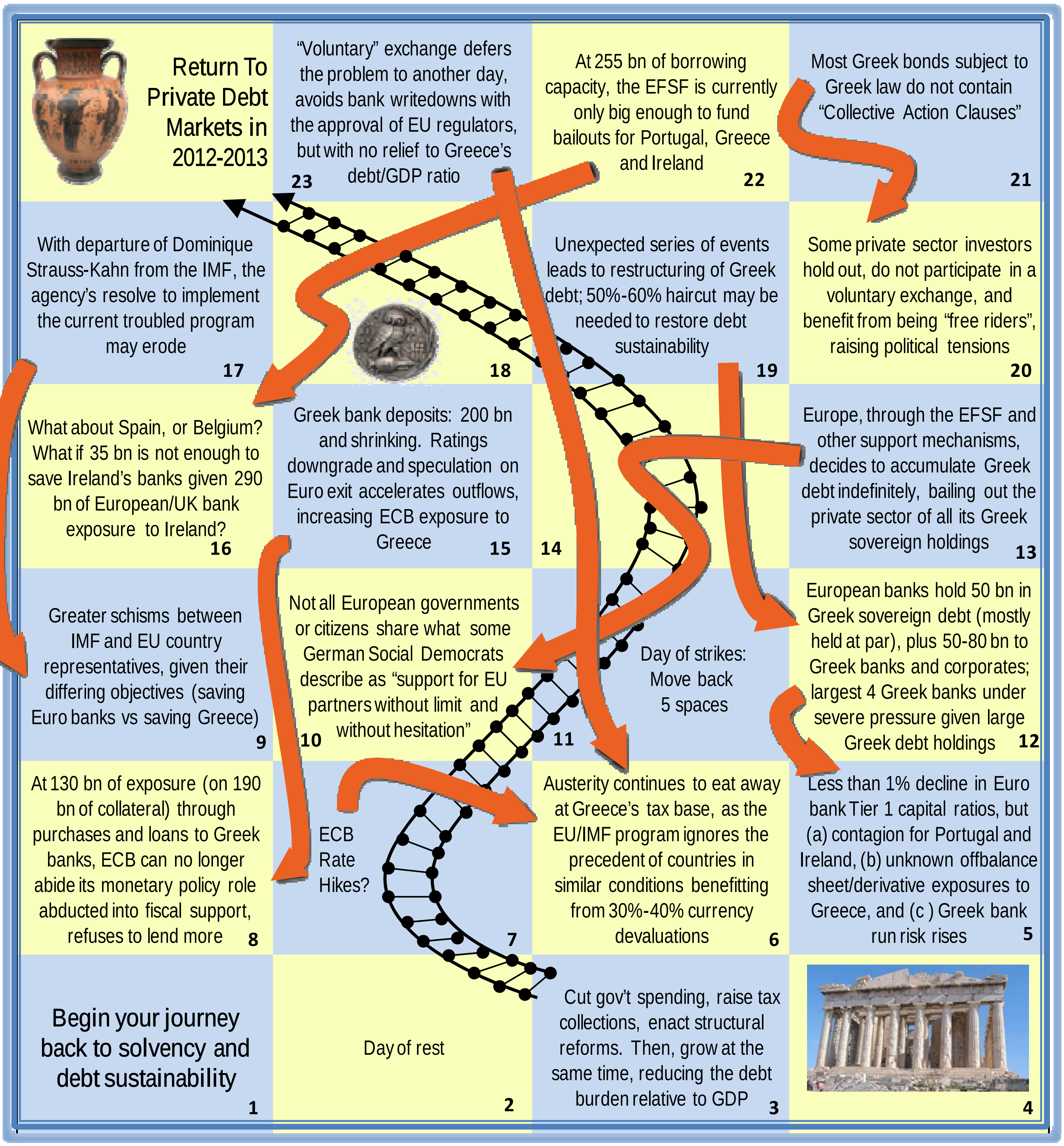
Snakes and Ladders. A year ago, Europe announced a framework for providing bridge loans to tide countries over until reform, austerity and renewed growth would allow them to come back to the capital markets in 2012. In the case of Greece, Ireland and Portugal, this does not appear to be working. If anything, as shown on page 2, austerity without an exchange rate adjustment is strangling Greece. As a result, we now enter a complex end-game best explained using a modified version of the ancient Indian board game "Snakes and Ladders", applied to Greece. The game is complex, since the IMF appears focused on saving Greece, while European policymakers appear mostly focused on saving European banks (see charts on page 3). Rumors this morning about another IMF-led package of an additional 30-60 billion Euros for Greece (perhaps collateralized by utility privatization proceeds) may push the problem out a year or so, but the game theory remains the same, since Greece is nowhere

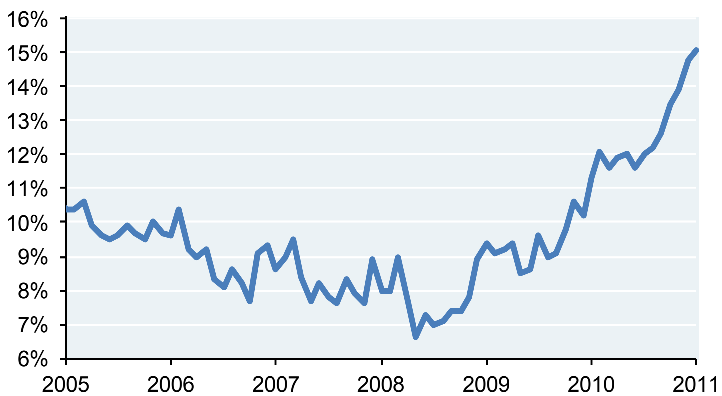
Snakes and Ladders (Φιδάκια και Σκάλες) *all figures in Euros*



near a trajectory of economic sustainability. Biggest risks which could accelerate the end-game: political cohesion breaking down, or a run on Greek banks. When the European debt crisis first broke, I was informed by some European colleagues that "*Greece is not Argentina*". They were right, although not in the way intended: when comparing budget deficits, current account deficits and debt ratios to Argentina 2001, Greece 2009 was twice as bad [*note: Argentina received 70% debt forgiveness*]. While it rarely makes sense to accelerate recognition of losses during a financial crisis, the austerity quid pro quos for sustaining the illusion of solvency may be deepening social, economic and political problems in the periphery. Despite their cheapness relative to the US, we remain underweight European equities; we generally do not own peripheral European sovereign debt in our core bonds funds, despite their currently depressed prices; and are focused for now on acquiring distressed portfolios of corporate, commercial and residential real estate loans from over-leveraged European banks.

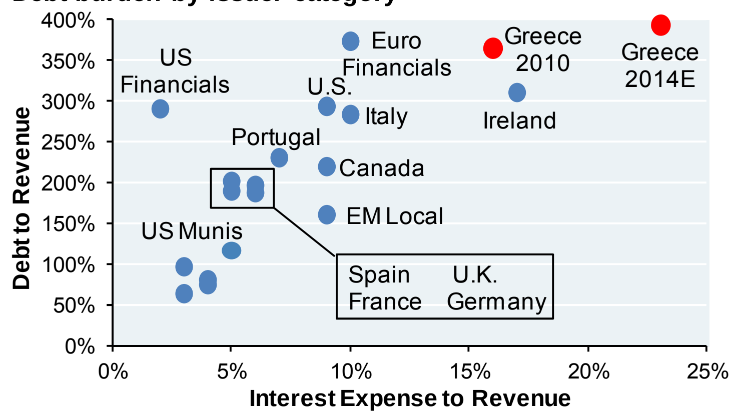
Status Report on Greek austerity program

Greece unemployment rate
Percent



Source: National Statistical Service of Greece.

Debt burden by issuer category

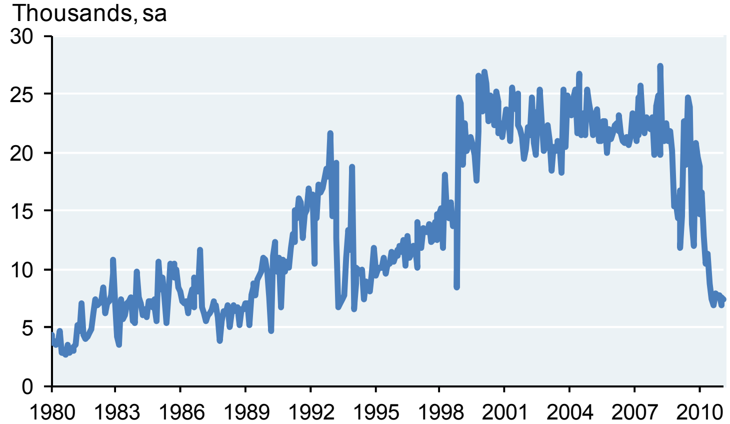


Source: J.P. Morgan Securities LLC, OECD, Eurostat, IMF. Japan's debt burden too high to be shown.

Greece bank deposits
Euros, Billions

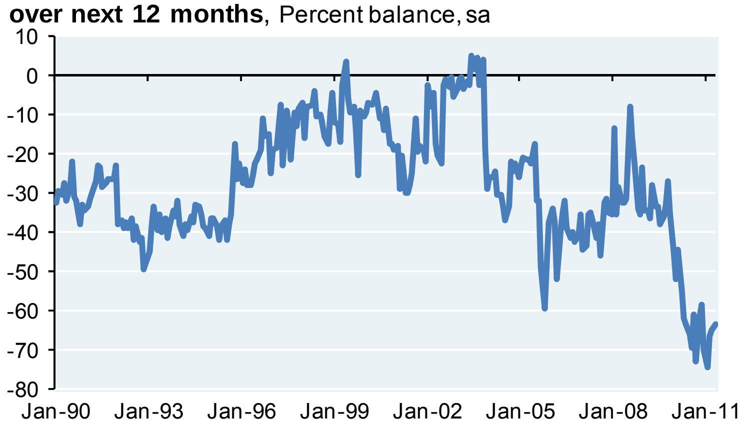
Source: Bank of Greece.

Greece car sales
Thousands, sa



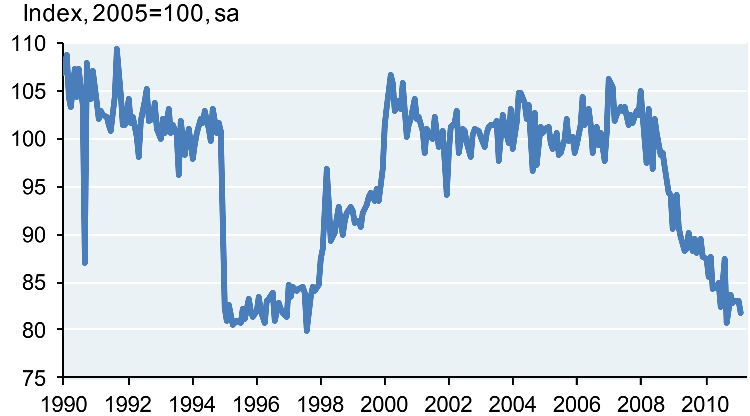
Source: National Statistical Service of Greece, J.P. Morgan Securities LLC.

Survey of Greece consumers: purchases of major items over next 12 months, Percent balance, sa



Source: European Commission.

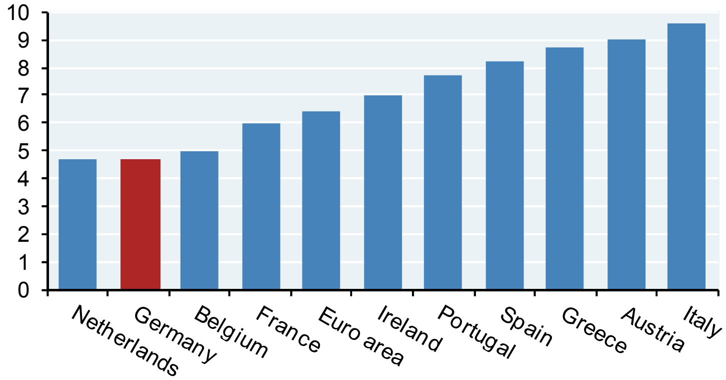
Greece Industrial Production
Index, 2005=100, sa



Source: National Statistical Service of Greece, J.P. Morgan Securities LLC.

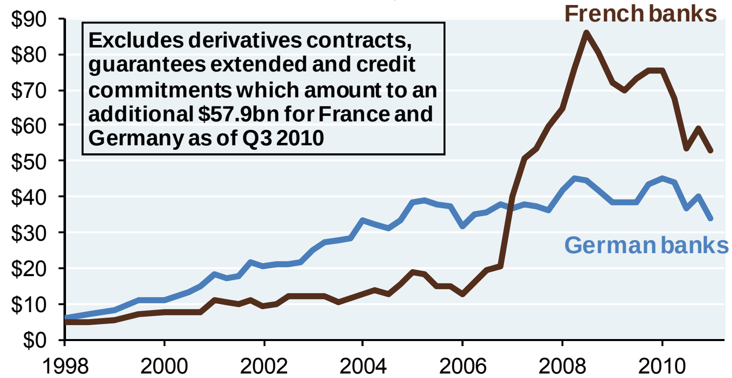
Two charts on European bank capitalization and exposure to Greece

European bank capital and reserves to total assets
Percent



Source: European Central Bank.

Bank claims on Greece
Immediate borrower basis - Billions, USD



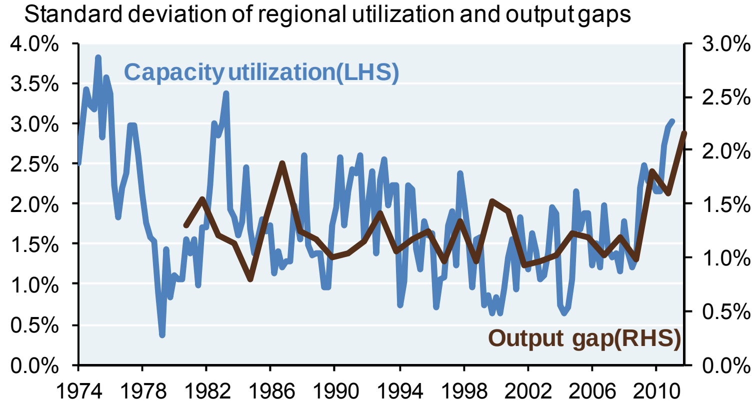
Source: Bank for International Settlements.

Will the ECB really raise interest rates when economic conditions are more divergent than they have been in decades?

Euro short rate
Percent

Source: Bloomberg.

Measure of European economic dispersion
Standard deviation of regional utilization and output gaps



Source: J.P. Morgan Private Bank, European Commission.

Michael Cembalest
Chief Investment Officer

ECB = European Central Bank; EFSF = European Financial Stability Facility; IMF = International Monetary Fund; SA = Seasonally Adjusted