

## Equity Strategy

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## Key calls

- **We are positive on equities as:**
- 1. Macro momentum has peaked, but our work indicates that historically equities have continued to advance over the next 12 months post these peaks. There are similarities to '04 in terms of market volatility during the transition from lead indicators peaking towards greater clarity regarding the sustainability of recovery. Slowdown in manufacturing is clear, but beyond profit taking at sector level, our **ISM framework** does not work as a sell signal for the overall market at this stage.
- 2. Our **Yield curve framework** is still giving a positive signal. Despite last quarter's flattening, the curve is still in the top 10% of record steep observations. To get around the problem of zero short rates, we found that the **10y-30y year spread was also a strong indicator of recessions**. Right now it is near record steep, a positive. Historically, it took 29 months between the peak in curve steepness and the next recession.
- 3. **Interbank stress has reduced markedly**, peripheral bond yields and CDS spreads have moderated.
- 4. **Profits are on the upturn**, although 2H surprises are likely to slow significantly.
- 5. Rotation away from inventory rebuild and fiscal support towards **increasing evidence of sustainability of recovery in private demand (capex, labour market, smaller businesses)**.
- 6. **DM inflation risks minimal**, allowing central banks to remain accommodative for longer, countering the headwind from fiscal consolidation.
- 7. **Equity valuations undemanding** in absolute terms and vs other asset classes.
- In terms of market catalysts, we think that:
  1. The fact that a number of key events are now behind us could act to reduce the tail risk that markets are pricing in going forward. US financial regulatory bill was passed, stress tests are behind us, there is more clarity on Basel3, July was the peak month of Spanish refinancing. The underlying problem is not going away, but at least the hurdles for next few quarters are getting easier.
  2. Chinese policymakers are turning more market friendly as CPI peaks and economic momentum slows.
- **Key risks:** "Double dip" near term. We see the five-year outlook to be far worse than the 12-month one.

## Key trades and themes

### ■ Regional:

- 1. **Re-enter EM vs DM exposure:** we started the year OW DM vs EM on the back of adverse EM growth – inflation tradeoff, but two months ago reversed it.
- 2. **OW Europe vs US:** European activity is resilient vs the US; the region is underweight in global portfolios and attractively priced.
- 3. **Reducing OW Dax vs Eurostoxx50:** OW Germany was our key regional trade this year, but we see it as a crowded call now.

### ■ Sectorwise:

- **Stay OW Cyclical vs Defensives** - despite their strong outperformance ytd.
- Rotate out of crowded, outperforming, expensive cyclicals (**Cap. Goods** downgraded on 27<sup>th</sup> July), as manufacturing momentum is slowing.
- Better risk/reward among non-consensus cheaper cyclical laggards (**Banks/Mining**).
- Key longs: Banks, Mining, IT, Discretionary.
- Key shorts: Utilities, Pharma.

### ■ Themes:

- **M&A to pick up:** our key theme for 2010 due to strong balance sheets and record low credit yields (see our 21st June report for details).
- **Dividend comeback:** we think the recent GE, AAL etc. dividend news is significant; we expect continued positive news flow on this front (see our 29th June report for more details).

# 1 - Macro momentum is peaking, driven by manufacturing slowdown

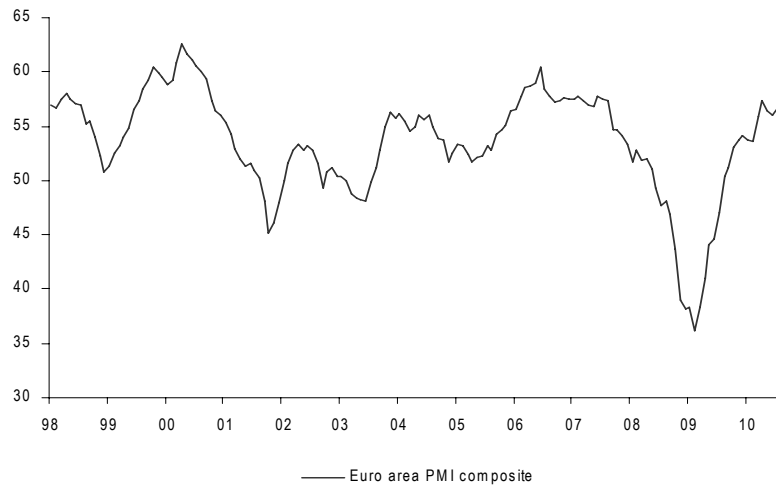
- The macro momentum is peaking, albeit from elevated levels, driven by the slowing in manufacturing activity

### Global manufacturing PMI



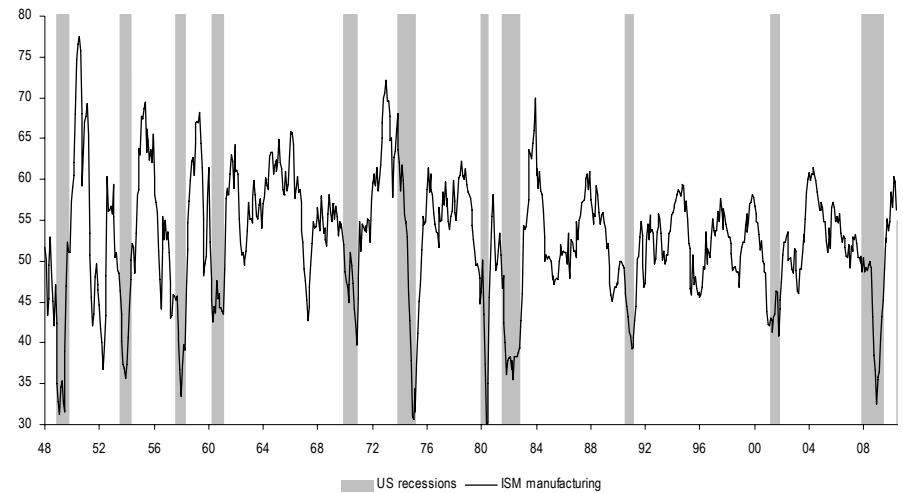
Source: J.P. Morgan

### Eurozone composite PMI



Source: J.P. Morgan

### ISM and recessions



Source: Datastream, NBER

## Peak in macro momentum does not mean equities need to fall

- The pushback we frequently hear from clients is: “ If you were using bottoming out in ISM and the improvement in its 2<sup>nd</sup> derivative as a reason to buy stocks last year, why are you not using the peaking in ISM and a rollover in macro momentum as a signal to sell?”
- Historically, the peak in lead indicators didn’t work as a sell signal at the market level

### Forward S&P500 perf when ISM goes above 60

	ISM	S&P500 performance				
		+1m	+3m	+6m	+9m	+12m
Feb 50	60.5	0.4%	9.1%	7.0%	13.3%	26.6%
Dec 54	63.8	1.8%	1.7%	14.0%	21.4%	26.4%
Oct 58	62.3	2.2%	8.0%	12.2%	17.9%	12.1%
Aug 61	60.7	-2.0%	4.8%	2.8%	-12.4%	-13.1%
Feb 72	60.6	0.6%	2.8%	4.2%	9.5%	4.8%
Feb 76	61.5	3.1%	0.5%	3.2%	2.4%	0.1%
Jul 83	63.6	1.1%	0.6%	0.5%	-1.5%	-7.3%
Dec 03	60.1	1.7%	1.3%	2.6%	0.2%	9.0%
Average		1.1%	3.6%	5.8%	6.3%	7.3%
Median		1.4%	2.2%	3.7%	5.9%	6.9%
Hit ratio		88%	100%	100%	75%	75%

Source: Datastream

### Equity performance after ISM peak

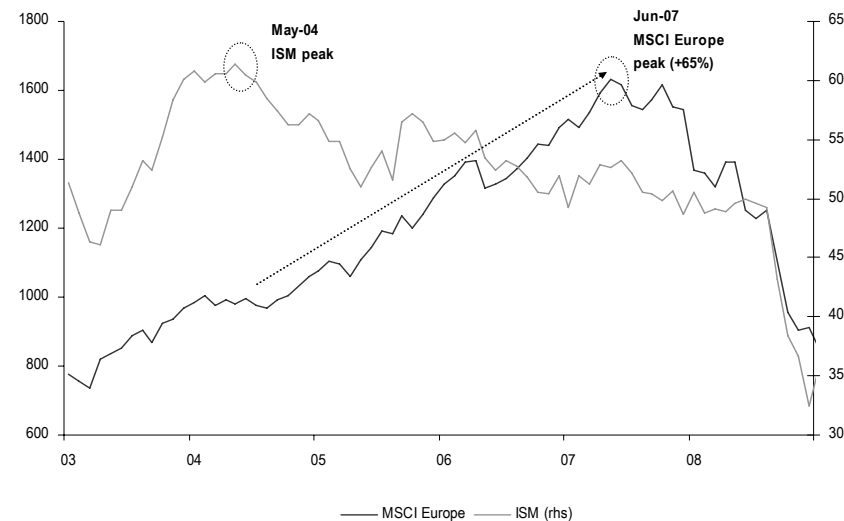
ISM peak	ISM	S&P500 perf		
		+3M	+6M	+12M
Jul 50	77.5	8.5%	20.8%	24.9%
Aug 52	60.4	2.1%	3.1%	-6.9%
May 55	69.5	14.3%	19.5%	20.1%
May 59	68.2	0.4%	0.1%	-4.7%
Dec 61	64.2	-2.2%	-21.3%	-11.7%
Mar 65	64.9	-2.1%	4.1%	4.2%
Apr 68	58.0	-0.7%	5.2%	5.7%
Jan 73	72.1	-6.7%	-6.9%	-16.9%
Feb 76	61.5	-0.2%	4.0%	0.6%
Jul 78	62.2	-3.8%	-0.7%	3.5%
Nov 80	58.2	-3.8%	-3.5%	-8.1%
Dec 83	69.9	-4.2%	-7.1%	1.4%
Dec 87	61.0	4.8%	10.0%	12.4%
Sep 91	54.9	7.2%	3.9%	7.0%
Oct 94	59.4	0.4%	9.8%	24.7%
Jul 97	57.7	-0.9%	5.7%	17.5%
Nov 99	58.1	-1.3%	3.7%	-5.9%
Jun 02	53.6	-12.5%	-9.2%	1.4%
May 04	61.4	-1.4%	6.3%	7.2%
<b>Average</b>		<b>-0.1%</b>	<b>2.5%</b>	<b>4.0%</b>
<b>Median</b>		<b>-0.9%</b>	<b>3.9%</b>	<b>3.5%</b>
<b>Hit ratio</b>		<b>37%</b>	<b>68%</b>	<b>68%</b>

Source: Datastream, J.P. Morgan, \*% of time performance is positive

# Looking at the past cycle, ISM peaked in 2004 but equities continued to rally for another three years

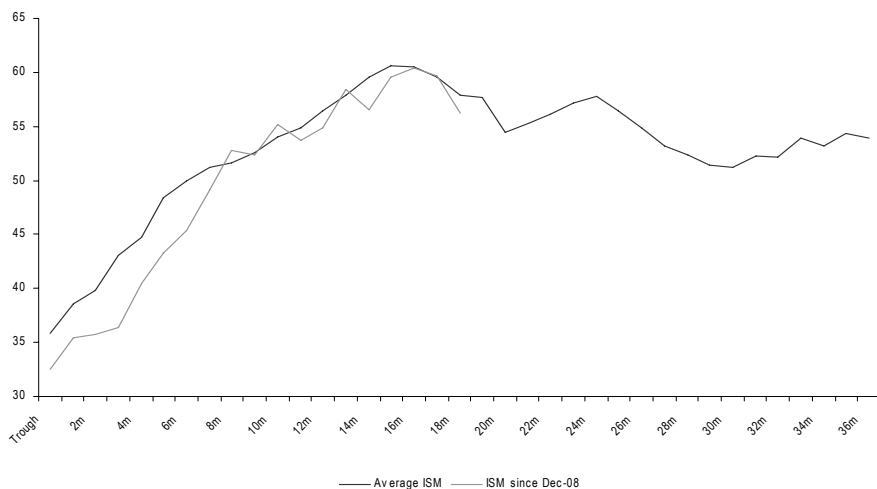
- Lead indicators almost always tended to peak within 1.5 years of an upcycle starting, but equities continued to advance most of the time
- In the last cycle ISM peaked in May 2004 at 61.4, just a bit more than a year after the market trough. The peaking in the ISM was coincident with short-term market volatility. MSCI Europe fell by 8% between March and August '04
- However, ultimately this was a good buying opportunity as equities moved much higher over the next few years

## MSCI Europe vs. ISM during the last cycle



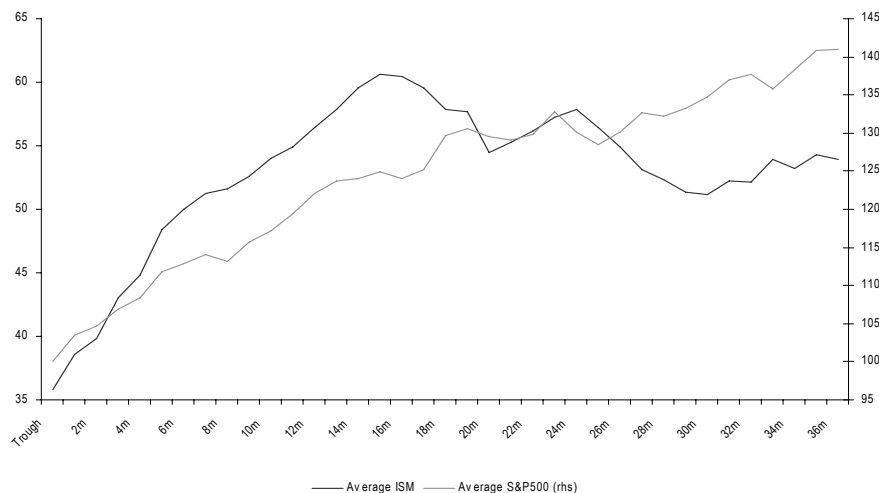
Source: Datastream, MSCI

## Typical ISM move during recovery vs. latest



Source: Datastream

## Typical ISM and S&P500 moves during recovery



Source: Datastream

## ISM framework – Great BUY indicator, but not a good SELL indicator

- Last year the key call was not to ignore the “2<sup>nd</sup> derivative”. It doesn't pay to sell stocks in 30-40 range of ISM, given the next 3, 6 and 12 months' equity performance is likely to be strong. This was one of the key catalysts to enter beta in Q1 '09
- Looking at the other side of the coin, equities tended to fall on the majority of occasions when the ISM started in the 65-75 range, but strength of signal is relatively weak
- The current ISM level does not mean outright “sell”

### % of time equities go up in different ISM ranges

ISM range	% of time	Hit ratio S&P500 Fwd return		
		+3m	+6m	+12m
25-30	0.1%	100%	100%	100%
30-35	1.6%	67%	92%	100%
35-40	5.1%	74%	84%	100%
40-45	7.5%	64%	63%	68%
45-50	18.6%	57%	64%	70%
50-55	28.3%	67%	69%	73%
<b>55-60</b>	<b>23.3%</b>	<b>65%</b>	<b>71%</b>	<b>67%</b>
60-65	10.5%	58%	62%	67%
65-70	4.0%	50%	57%	47%
70-75	0.4%	0%	33%	33%
75-80	0.4%	100%	100%	100%

Source: Datastream, J.P. Morgan

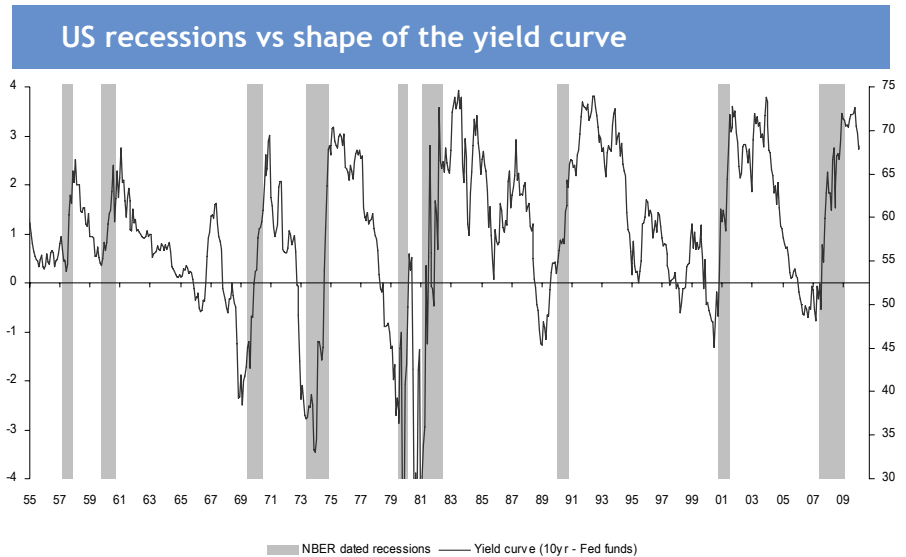
### Forward S&P500 perf in different ISM ranges

ISM range	% of time	average S&P500 Fwd return		
		+3m	+6m	+12m
25-30	0.1%	10.5%	23.9%	19.5%
30-35	1.6%	5.8%	10.7%	22.9%
35-40	5.1%	6.2%	14.0%	27.8%
40-45	7.5%	1.9%	4.2%	8.8%
45-50	18.6%	1.1%	3.1%	8.7%
50-55	28.3%	2.9%	4.9%	8.7%
<b>55-60</b>	<b>23.3%</b>	<b>1.7%</b>	<b>3.4%</b>	<b>6.7%</b>
60-65	10.5%	-0.2%	0.5%	1.4%
65-70	4.0%	1.3%	0.3%	1.5%
70-75	0.4%	-4.8%	-5.0%	-6.6%
75-80	0.4%	8.7%	18.8%	23.3%

Source: Datastream, J.P. Morgan

## 2 - What is the Yield curve really saying? Still constructive

- DM yield curves have flattened, but are still near record steep in the historical context
- Yield curve steepness peaks on average 2.5 years before the start of a recession
- Pushback of zero short-term rates. 10y-30y spread behaved similar to 10y-3m spread, inverting ahead of every recession, but it is at a record steep now.

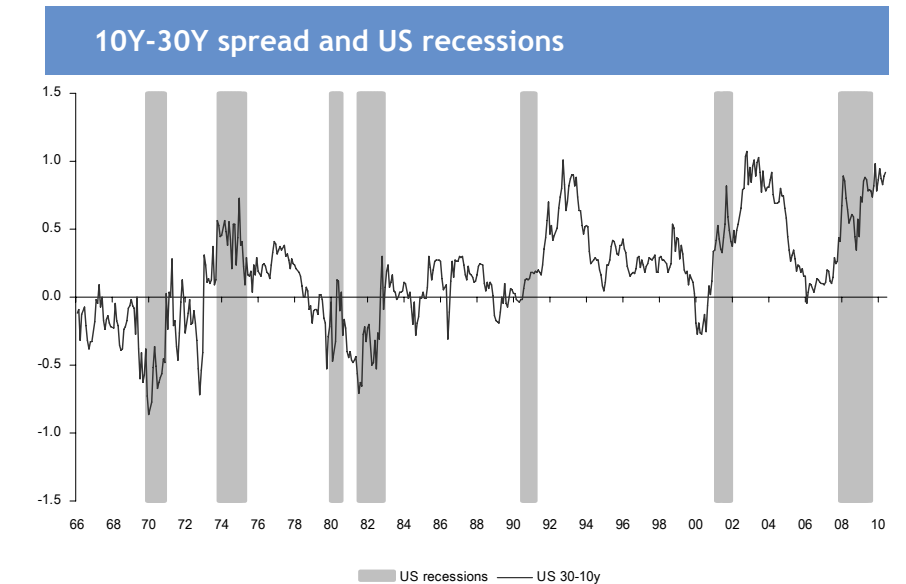


Source: Datastream, NBER

### Timing of recessions and peak of the yield curve

Peak of the yield curve	Start of Recessions	Difference (# months)
Jul-58	Apr-60	21
Nov-67	Dec-69	25
Jun-71	Nov-73	29
Sep-75	Jan-80	52
Sep-80	Jul-81	10
Oct-87	Jul-90	33
Jun-99	Mar-01	21
May-04	Dec-07	43
<b>Average</b>		<b>29</b>
<b>Median</b>		<b>27</b>

Source: Datastream, NBER



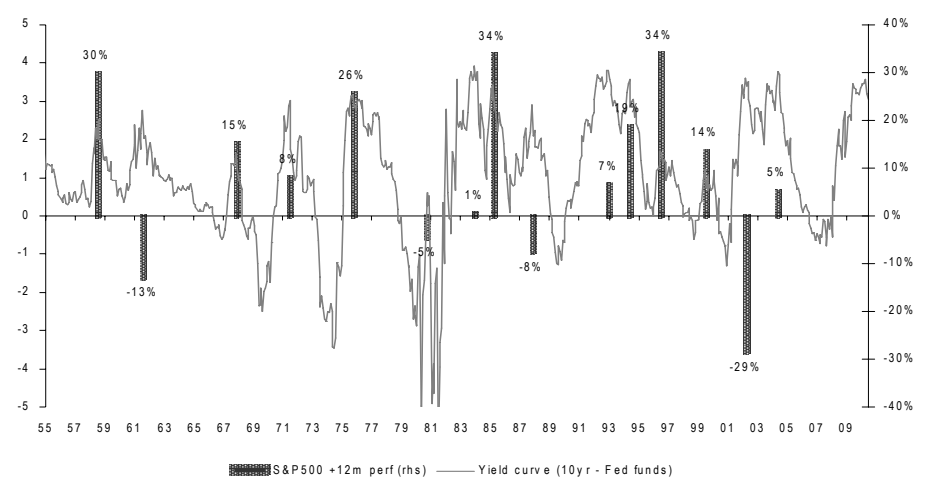
Source: Datastream, \*latest



# Yield curve and equity market direction

- The start of yield curve flattening is not an indicator of a poor equity performance ahead
- In the past 50 years, equities continued to rise 73% of the time after the yield curve peaked
- The current level of the yield curve is consistent with 10-15% annualized equity return
- Flattening/falling yields supports defensives and steepening/rising yields supports cyclicals

## 12m fwd S&P500 perf following the peak of the yield curve



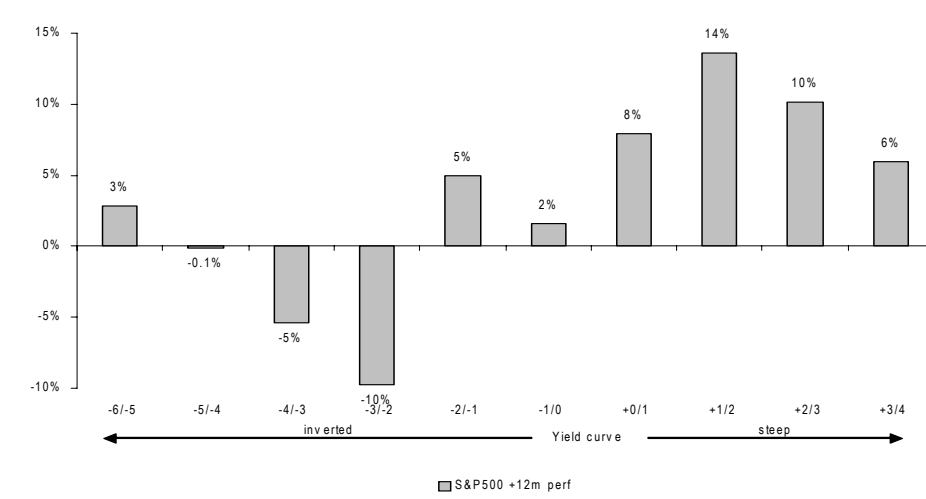
Source: Datastream

## Yield curve investment clock

	10 Year Rising	10 Year Falling
10-2 Steepening	<b>1. Recovery</b> <b>Strong OW:</b> Cyclicals (esp. Resources)  <b>OW</b> Financials (esp Banks) <b>Strong UW</b> Defensives (esp. Utilities)	<b>4. Slowdown</b> <b>Strong OW</b> Defensives (esp Staples and Pharma)  <b>UW</b> Financials <b>Strong UW</b> Cyclicals (esp Industrials & Discretionary)
	<b>2. Expansion</b> <b>Modest OW</b> Cyclicals (esp Industrials & Media)  <b>UW</b> Financials (esp Banks) <b>Modest UW</b> Defensives (esp Telecom, Utilities)	<b>3. Overheating</b> <b>Modest OW</b> Defensives (esp Telecoms) <b>OW</b> Financials <b>Modest UW</b> Cyclicals (esp Resources)
10-2 Flattening		

Source: Datastream, using US/European sectors and US 10-2year yield curve

## 12m S&P500 perf\* from different levels of the yield curve

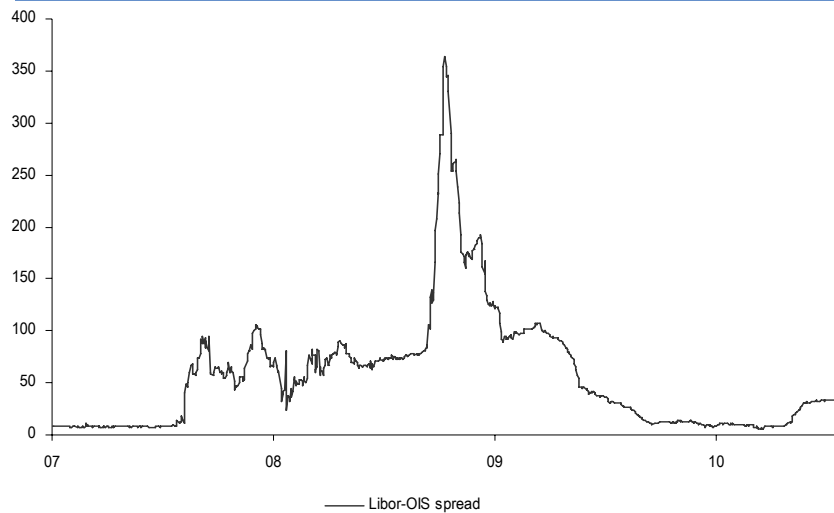


Source: Datastream, \*average since 1955

### 3 - Monitoring the stress in funding markets – the pace of deterioration is slowing

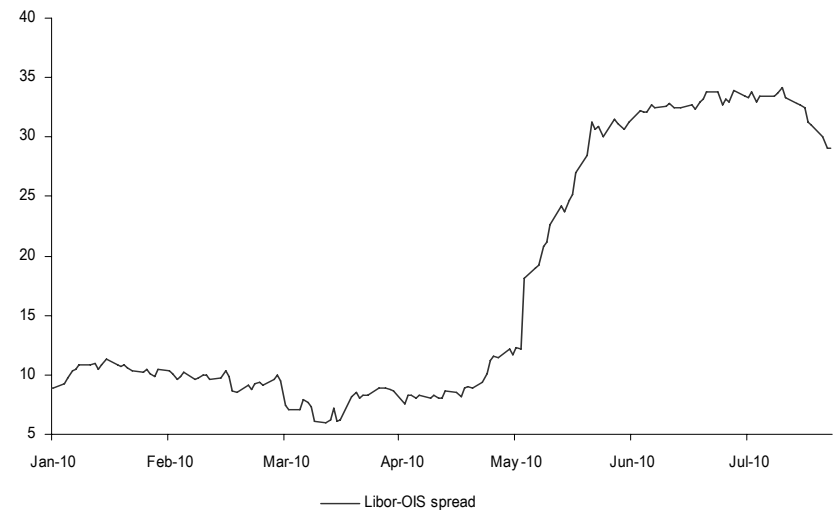
- Signs of bank funding stress elevated, but still way off the '08 levels
- Interbank market - Libor – OIS spread: Spread between 3-month Libor and overnight swap rate
- Bloomberg ticker: .LIBOROIS F *index*
- Peaked at 364 bps in October '08

LIBOR-OIS spread 2007-to-date



Source: Bloomberg

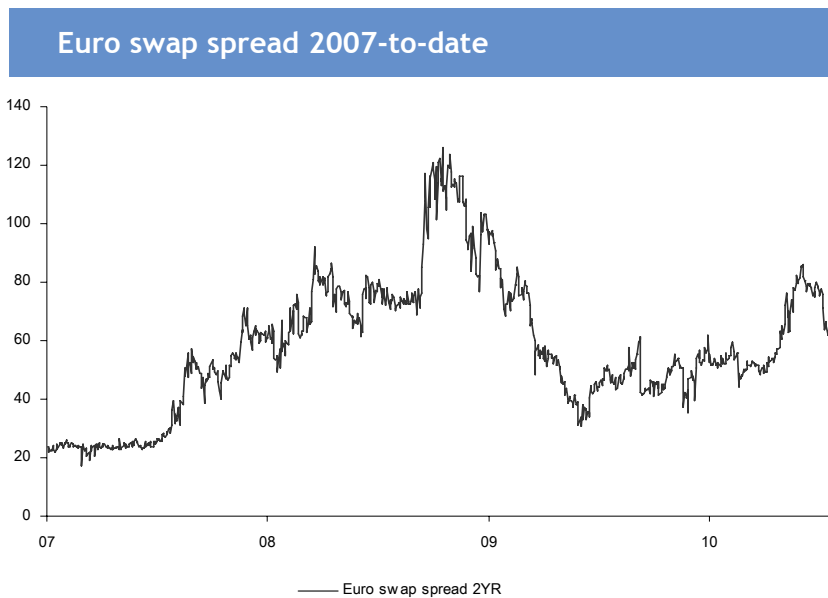
LIBOR-OIS spread year-to-date



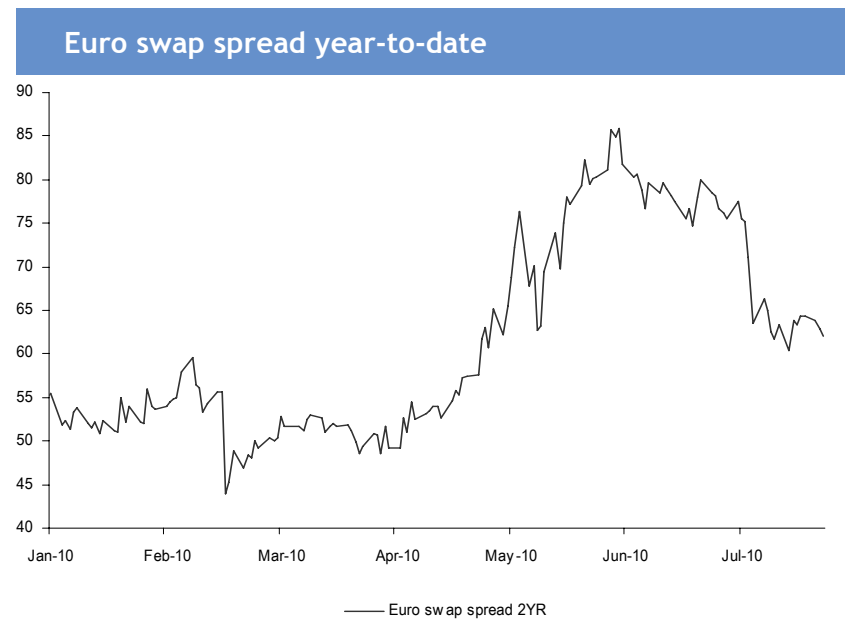
Source: Bloomberg

# Euro Swap spread

- Spread between two-year German bond yield and two-year swap rate
- Bloomberg ticker: EUSS2 *crncy*
- Peaked at 126 bps in October '08



Source: Bloomberg

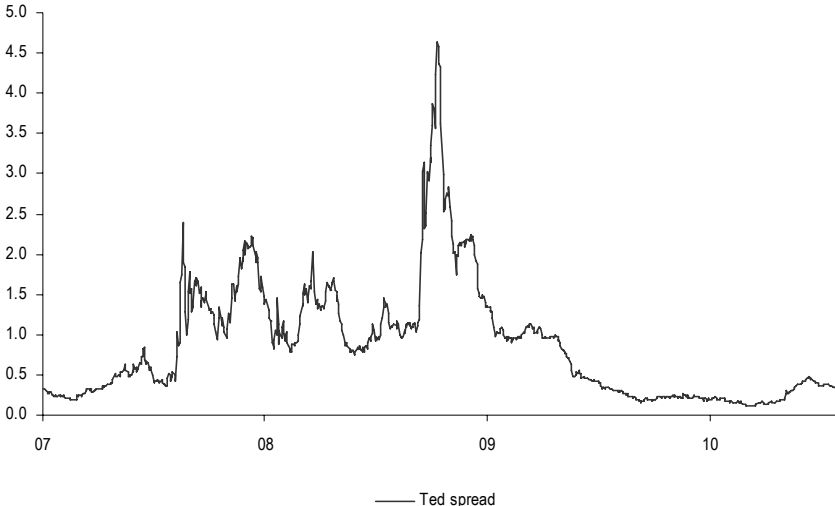


Source: Bloomberg

# TED spread

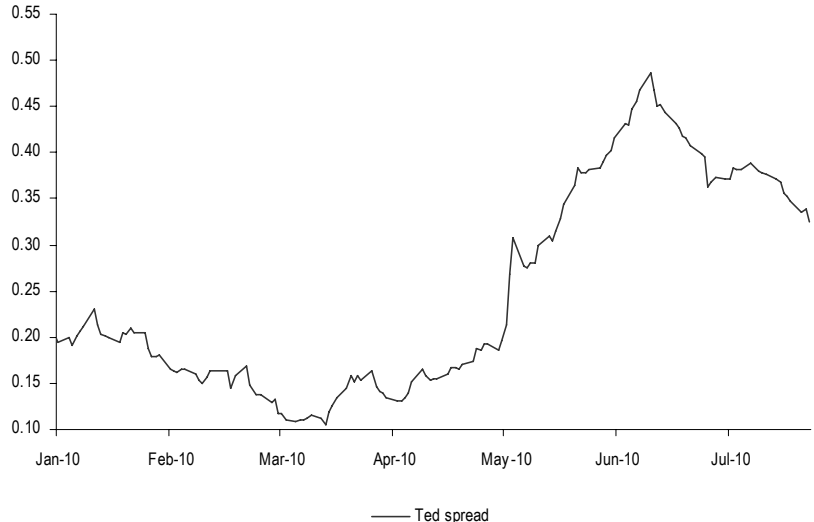
- Spread between 3m T-Bills and 3m LIBOR
- Bloomberg ticker: TEDSP *index*
- Peaked at 463 bps in October '08

TED spread 2007-to-date



Source: Bloomberg

TED spread year-to-date

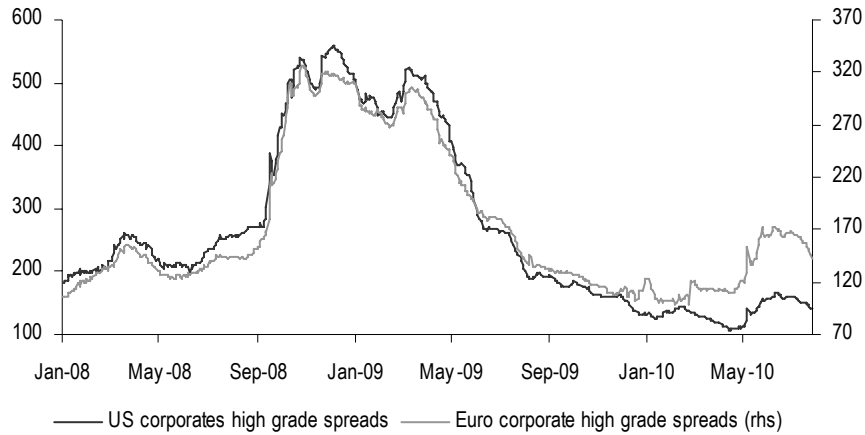


Source: Bloomberg

# Corporate credit spreads

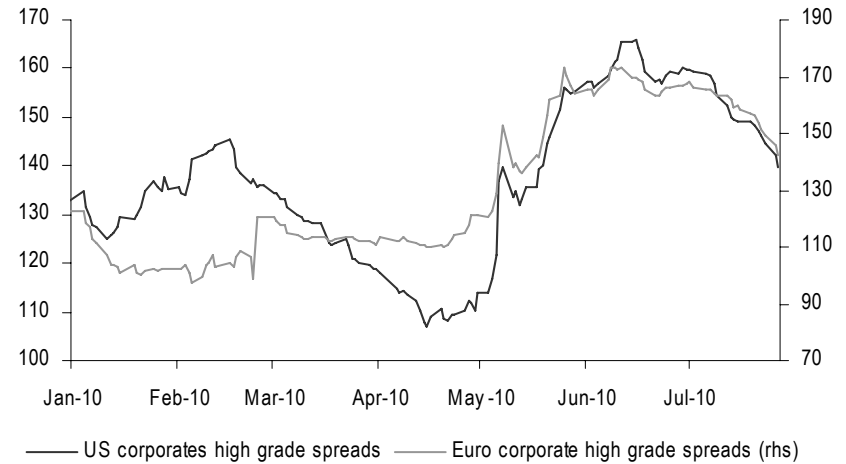
- Volatile, but significantly below '08 wides

US and Euro corporate high grade spreads 2008-to-date



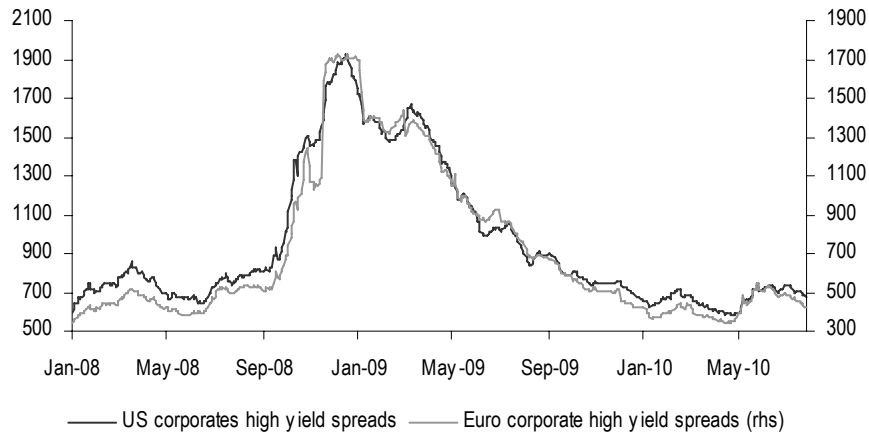
Source: J.P. Morgan

US and Euro corporate high grade spreads year-to-date



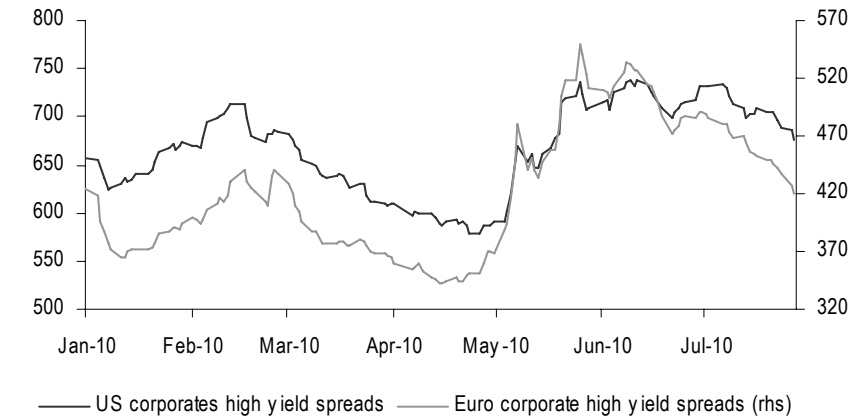
Source: J.P. Morgan

US and Euro corporate high yield spreads 2008-to-date



Source: J.P. Morgan

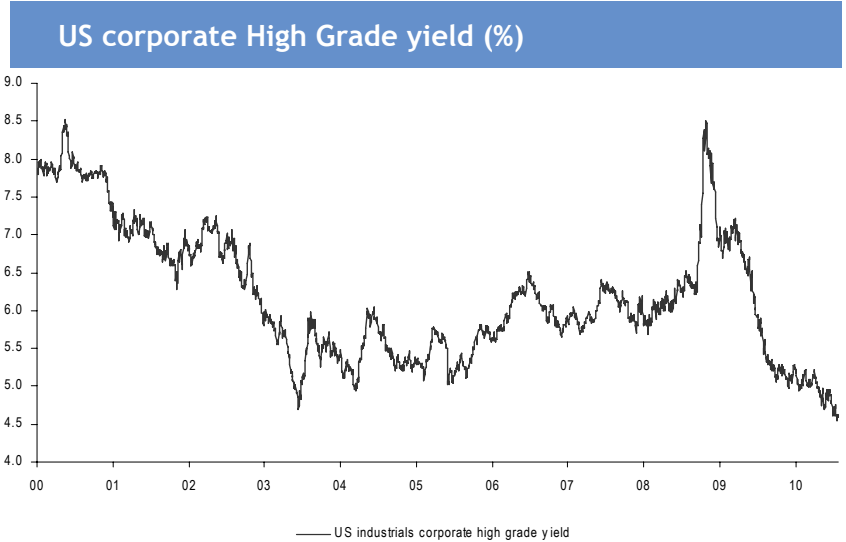
US and Euro corporate high yield spreads year-to-date



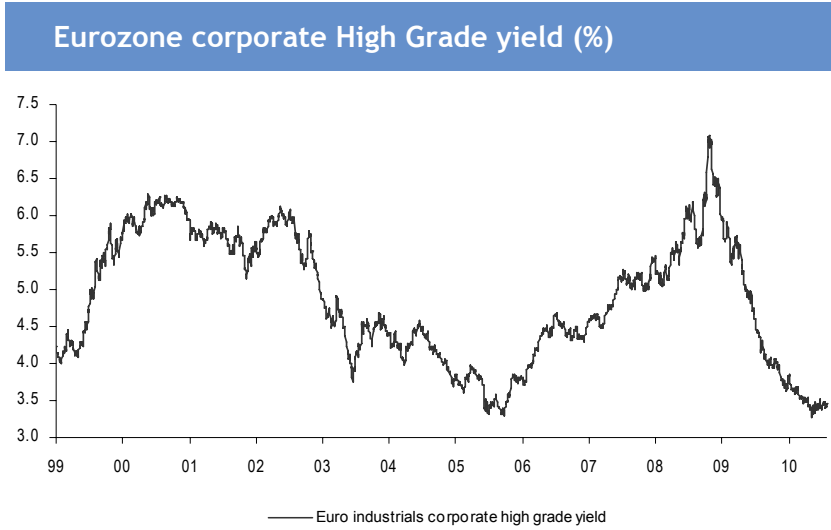
Source: J.P. Morgan

# Credit yields near record low

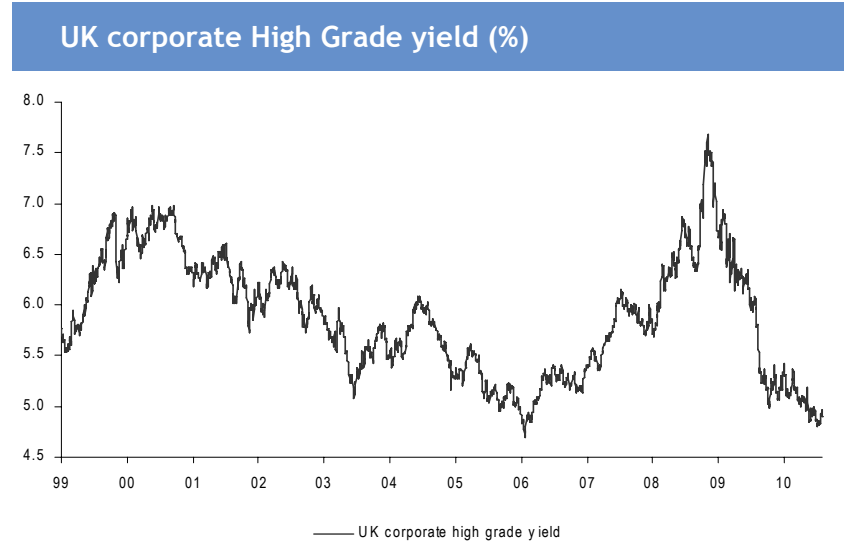
- While the spreads are widening, the total yield on HG corporate bonds in Europe is near record lows, thanks to the rally in government bonds
- Not '07-'08 backdrop, but '05



Source: J.P. Morgan



Source: J.P. Morgan



Source: J.P. Morgan

## The movement in bond yields and sovereign CDS spreads

- Self fulfilling prophecy: the more bonds fall, the more they should fall as it gets incrementally harder to meet the fiscal obligations
- Circuit breaker is needed, “credible and committed buyer of last resort”
- Most of the Southern European yields have moved off their 7<sup>th</sup> May peak due to ECB action

### Move in 5yr CDS spreads

5 Yr CDS	Current	Year Start	7th May	Move since 7/05 (bps)	Ytd Move (bps)
GREECE	697	283	939	-242	413
PORTUGAL	225	92	440	-215	133
IRELAND	208	158	263	-55	50
SPAIN	177	114	251	-74	64
ITALY	133	109	230	-96	24
BELGIUM	92	54	106	-13	38
AUSTRIA	75	84	85	-11	-9
FRANCE	62	32	78	-16	30
UK	56	83	100	-44	-27
NETHERLAND	39	32	53	-14	7
GERMANY	36	26	57	-22	9
US	34	38	43	-9	-4
FINLAND	24	28	30	-6	-4

Source: Datastream up to 27<sup>th</sup> July

### Move in 2yr government bond yields (%)

2 Yr BY	Current	Year Start	7th May	Move since 7/05 (bps)	Ytd Move (bps)
GREECE	10.0	3.7	17.4	-742	625
IRELAND	3.7	3.7	3.7	0	0
PORTUGAL	2.9	1.3	6.0	-304	160
SPAIN	1.8	1.5	2.9	-104	31
ITALY	1.7	1.5	2.3	-54	23
FINLAND	1.2	1.7	0.7	45	-51
UK	1.0	1.3	1.1	-2	-24
AUSTRIA	1.0	0.9	0.8	14	8
BELGIUM	1.0	1.6	1.1	-16	-59
NETHERLAND	1.0	1.1	0.5	46	-14
FRANCE	0.9	1.4	0.5	41	-42
GERMANY	0.9	1.3	0.5	36	-45
US	0.6	1.1	0.8	-18	-51

Source: Datastream up to 27<sup>th</sup> July

### Move in 10yr government bond yields (%)

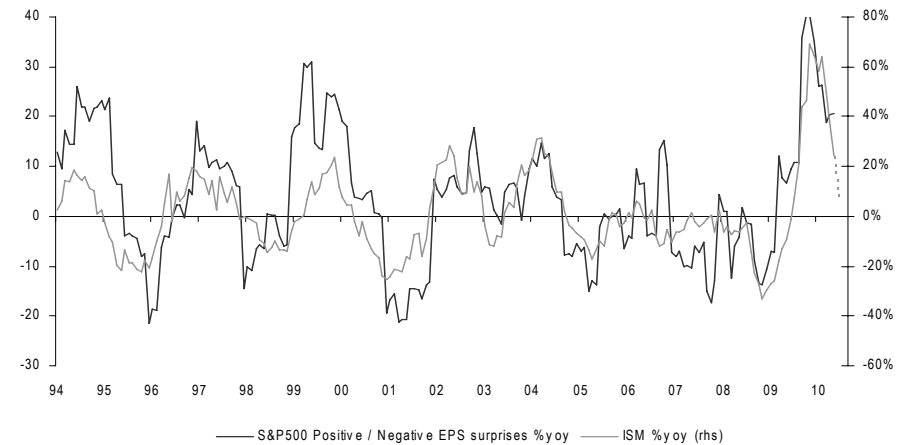
10 Y BY	Current	Year Start	7th May	Move since 7/05 (bps)	Ytd Move (bps)
GREECE	10.3	5.8	12.2	-194	450
IRELAND	5.2	4.8	5.8	-61	42
PORTUGAL	5.2	4.1	6.3	-110	116
SPAIN	4.1	3.9	4.4	-31	15
ITALY	3.9	4.0	4.3	-35	-7
UK	3.6	4.1	3.8	-18	-52
BELGIUM	3.3	3.7	3.5	-19	-38
AUSTRIA	3.1	3.7	3.3	-17	-57
US	3.0	3.8	3.4	-38	-79
FRANCE	3.0	3.6	3.1	-11	-55
FINLAND	3.0	3.6	3.1	-11	-60
NETHERLAND	3.0	3.5	3.1	-10	-60
GERMANY	2.8	3.4	2.7	5	-62

Source: Datastream up to 27<sup>th</sup> July

## 4 - Earnings remain a support, but size of surprises to slow in 2H

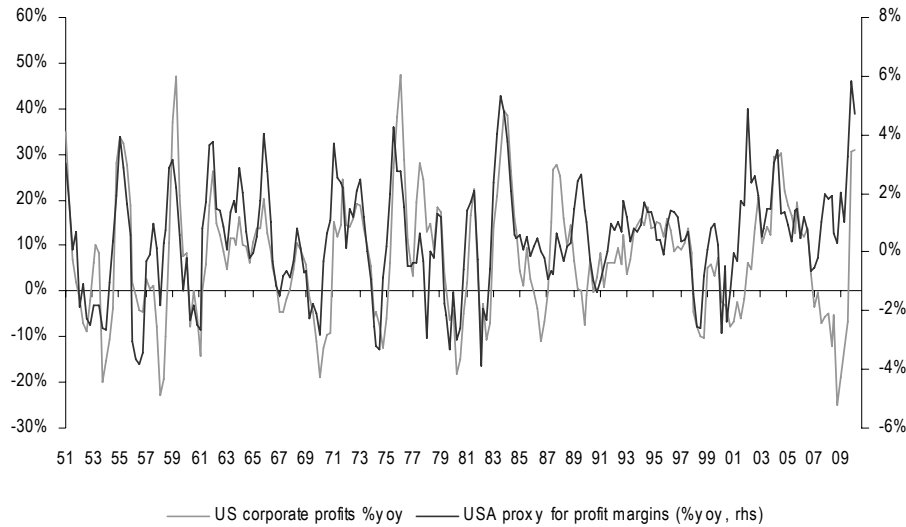
- Most of the leading indicators that we follow for earnings suggest further growth ahead
- The trends in IFO, yield curve shape, margin proxy etc, are bullish for near term profits, but 2H is likely to witness a rollover

Macro momentum vs earnings surprises



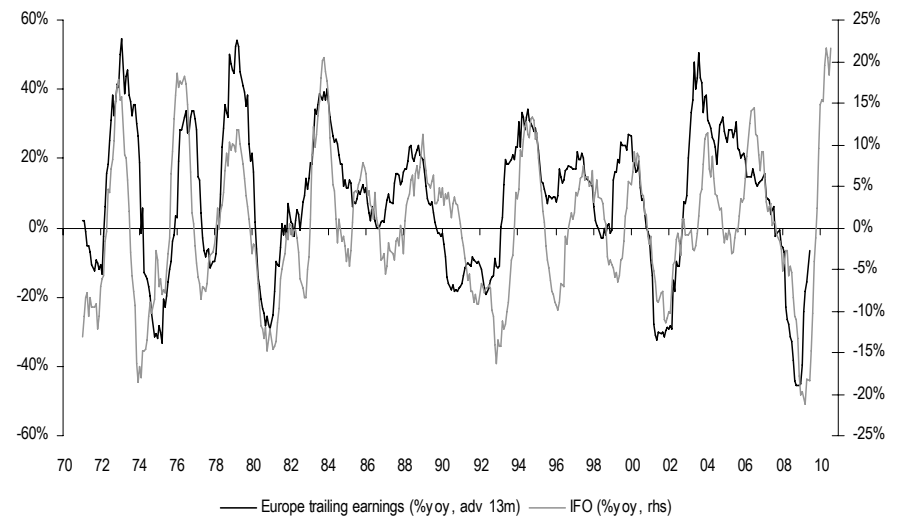
Source: Bloomberg, assuming July ISM at 52

US profit margins proxy\* vs corporate profits



Source: Datastream, BEA, J.P. Morgan, \* GDP deflator - Unit labor cost

IFO vs European profits



Source: Datastream



# EPS integer continues to move higher; Dominated by Cyclical

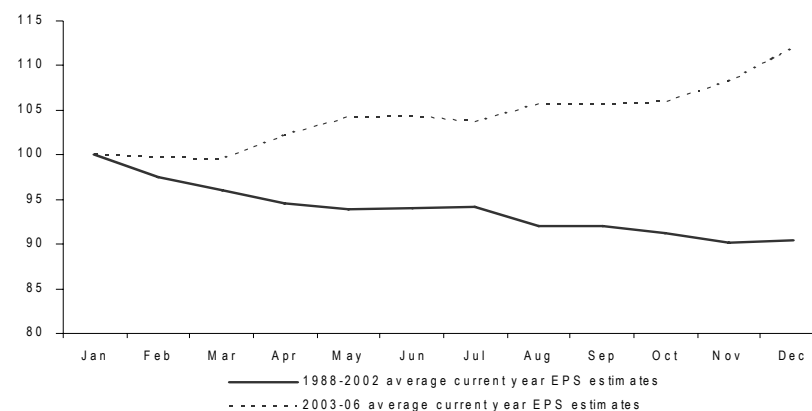
- European earnings integer moved up by 13% ytd. Cyclical showed the bulk of upgrades
- In the last cycle analysts were behind the curve

## YTD change in 12m Fwd sector EPS forecasts

Semicon	138%
Automobile	87%
Met&Min	48%
Chemicals	25%
Banks	22%
Cons Durables	21%
Transport	20%
Cap Goods	19%
Retailing	16%
HPC	14%
Hotels, Rest&Leis	14%
<b>Europe</b>	<b>13%</b>
Food Bev&Tob	10%
Food Drug Ret	10%
Software	10%
Div Fin	9%
Real Estate	9%
Energy	8%
Media	8%
Healthcare	7%
Insurance	1%
Telecoms	1%
Cons Mat	-2%
Utilities	-3%
Tech Hardware	-15%

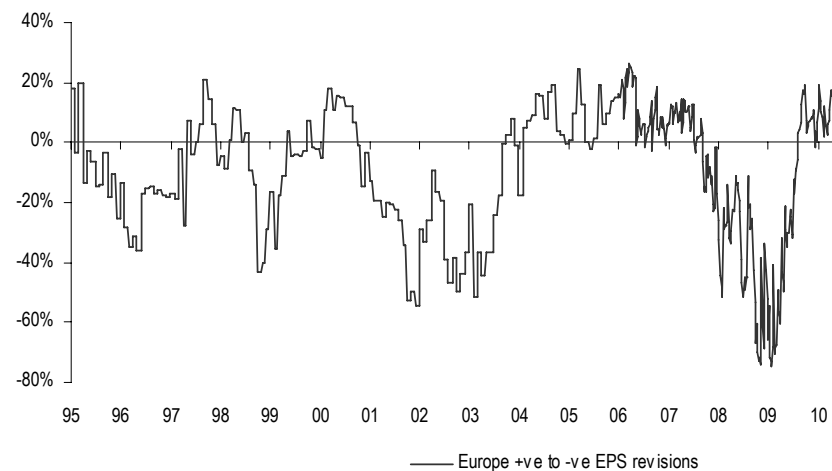
Source: IBES up to 27<sup>th</sup> July

## Typical EPS trajectory '88-'02 vs '03-'06



Source: IBES

## Europe EPS +ve to -ve revisions

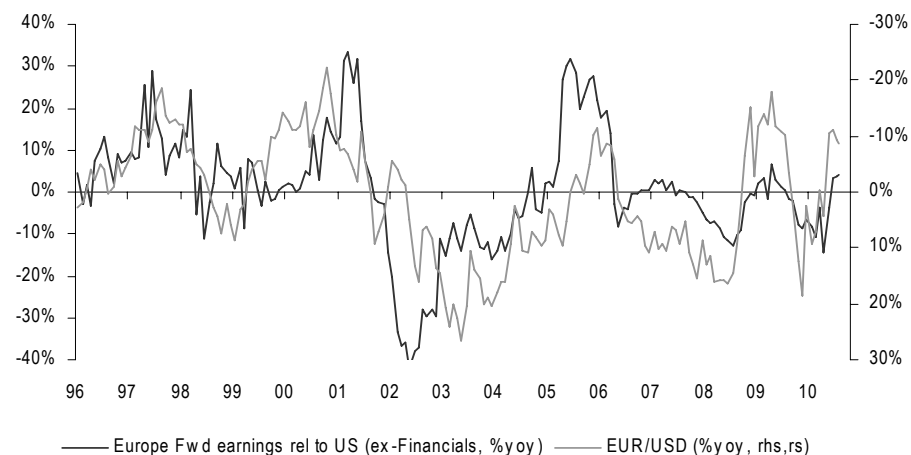


Source: IBES, J.P. Morgan

# Profit margins troughing at relatively high level, FX tailwind

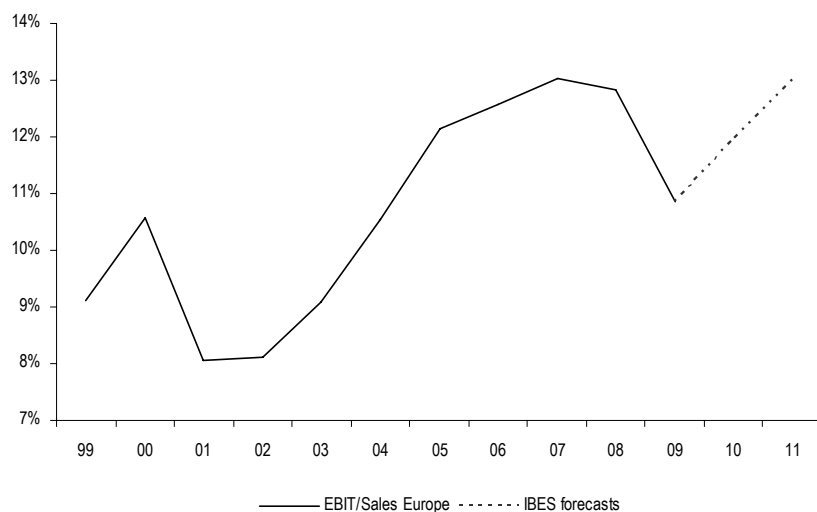
- Margins are troughing at relatively high levels in 2009, despite steep volume falls
- Corporate restructuring, aggressive cost control, top-line diversification, lower interest costs and taxes have contributed to margins holding up
- The weakening Euro is acting as a tailwind to European vs US profitability trends

## Europe vs US 12m Fwd earnings vs EUR/USD



Source: Datastream, MSCI, IBES

## European EBIT/Sales



Source: Datastream, IBES

## European P&L decomposition

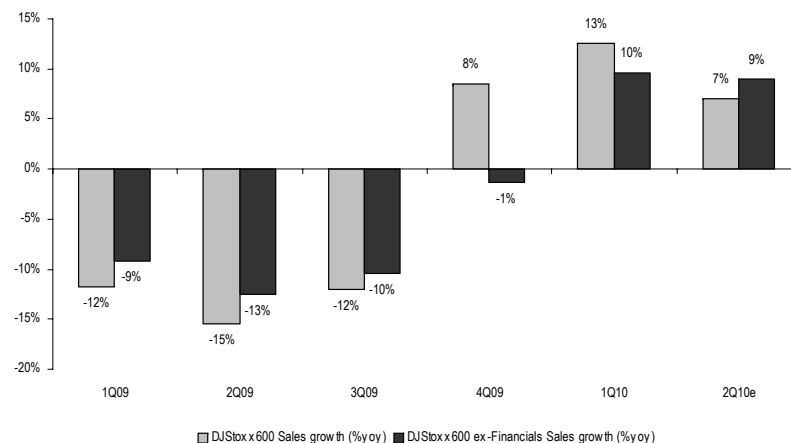
As % of Sales	2003	2004	2005	2006	2007	2008	2009
Staff costs	16.4%	15.5%	15.3%	15.0%	14.6%	14.5%	16.2%
COGS excl staff costs	51.1%	52.2%	51.6%	52.0%	52.1%	53.9%	51.0%
SGA costs	14.8%	14.0%	13.8%	13.5%	13.0%	12.6%	13.9%
Other expenses	1.9%	1.0%	1.1%	1.9%	1.1%	2.0%	3.0%
EBITDA	15.8%	17.2%	18.2%	17.6%	19.2%	17.1%	15.8%
Depreciation	7.4%	6.9%	6.0%	5.6%	5.6%	5.3%	6.4%
EBIT	8.4%	10.4%	12.2%	12.1%	13.6%	11.7%	9.5%
Interest	2.0%	1.7%	1.6%	1.7%	1.8%	2.0%	2.1%
Other income	0.0%	-0.1%	0.0%	-0.1%	-0.1%	-0.1%	-0.1%
Pretax Income	6.5%	8.7%	10.6%	10.5%	11.9%	9.8%	7.5%
Taxes	2.4%	3.1%	3.6%	3.6%	3.8%	3.4%	2.6%
Minority, disctd, etc	0.1%	0.0%	0.2%	0.2%	0.0%	0.3%	0.1%
Net Income	3.9%	5.6%	6.9%	6.7%	8.1%	6.2%	4.9%
Taxes as % of pretax income	37.5%	35.3%	33.6%	34.1%	31.9%	34.5%	34.7%
EBIT / Sales	8.4%	10.4%	12.2%	12.1%	13.6%	11.7%	10.5%
Net income / Sales	3.9%	5.6%	6.9%	6.7%	8.1%	6.2%	4.9%

Source: Datastream, Worldscope, J.P. Morgan

# Moving away from “low quality” beats

- The Q2 reporting season has delivered strong results, above street estimates on both the top line and bottom line
- Unlike Q2, Q3 and Q4 '09, where positive news flow was mostly margin related, the majority of corporates in both the US and Europe have surprised consensus revenue projections for Q1 and Q2

## European revenue growth



Source: Bloomberg, IBES, J.P. Morgan

## Summary of the US Q2 reporting season

	No. of cos reported	% reported	% cos beating EPS estimates	EPS surprise	% cos beating Sales estimates	Sales surprise
<b>S&amp;P500</b>	<b>301/497</b>	<b>61%</b>	<b>77%</b>	<b>10%</b>	<b>62%</b>	<b>0%</b>
Energy	24/39	62%	71%	9%	48%	-6%
Materials	25/31	81%	68%	7%	60%	1%
Industrials	46/56	82%	85%	9%	70%	0%
Discretionary	34/80	43%	88%	21%	74%	3%
Staples	19/40	48%	89%	2%	26%	0%
Healthcare	35/51	69%	77%	4%	60%	0%
Financials	58/80	73%	83%	26%	70%	7%
IT	46/76	61%	61%	4%	70%	2%
Telecoms	3/9	33%	67%	3%	0%	0%
Utilities	11/35	31%	55%	3%	55%	-3%

Source: Bloomberg

## Summary of the European Q2 reporting season

	No. of cos reported	% reported	% cos beating EPS estimates	EPS surprise	% cos beating Sales estimates	Sales surprise
<b>DJStoxx600</b>	<b>160/288</b>	<b>56%</b>	<b>59%</b>	<b>6%</b>	<b>70%</b>	<b>6%</b>
Energy	11/21	52%	64%	-5%	64%	15%
Materials	18/36	50%	50%	6%	56%	1%
Industrials	36/54	67%	58%	28%	69%	1%
Discretionary	16/26	62%	69%	24%	73%	3%
Staples	9/20	45%	56%	1%	70%	0%
Healthcare	9/22	41%	67%	-2%	100%	3%
Financials	25/62	40%	60%	16%	68%	9%
IT	15/18	83%	73%	-3%	71%	1%
Telecoms	9/14	64%	67%	5%	100%	4%
Utilities	12/15	80%	33%	-2%	58%	6%

Source: Bloomberg

# '10-'11 hurdle rate appears challenging, but achievable

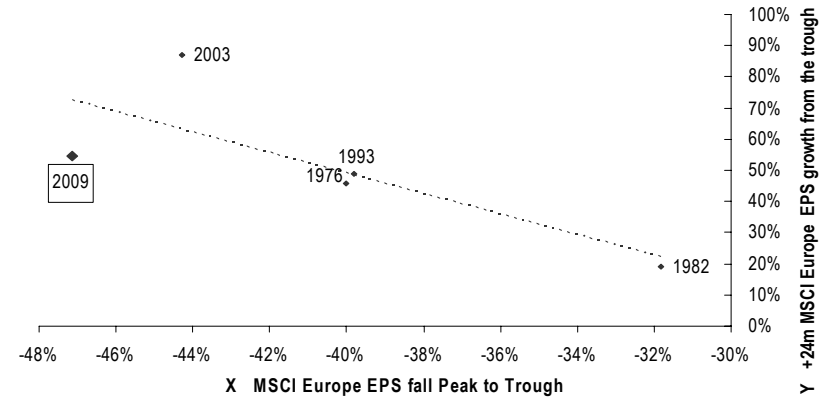
- '10 and '11 expectations appear aggressive at face value, but we believe operational leverage could be substantial
- Earnings rebound has historically been proportional to the size of the fall

## US and European consensus EPS growth forecasts

	Europe					US				
	'08	'09e	'10e	'11e	'11e vs peak	'08	'09e	'10e	'11e	'11e vs peak
<b>Market</b>	<b>-24%</b>	<b>-20%</b>	<b>33%</b>	<b>18%</b>	<b>-4%</b>	<b>-31%</b>	<b>1%</b>	<b>34%</b>	<b>16%</b>	<b>18%</b>
Energy	19%	-47%	34%	20%	-13%	24%	-54%	41%	21%	-21%
Materials	4%	-58%	80%	30%	1%	-11%	-47%	68%	25%	8%
Industrials	-9%	-32%	37%	20%	2%	-1%	-29%	19%	18%	1%
Discretionary	-26%	-54%	115%	25%	2%	-23%	18%	40%	18%	49%
Staples	8%	-9%	10%	11%	29%	1%	4%	8%	8%	22%
Healthcare	11%	10%	11%	6%	34%	10%	2%	7%	9%	21%
Financials	-70%	49%	56%	28%	-31%	-151%	-	-	30%	-12%
IT	-3%	-48%	59%	27%	-6%	11%	-5%	45%	11%	54%
Telecoms	12%	-2%	1%	4%	1%	-3%	-28%	1%	14%	-18%
Utilities	3%	-7%	-4%	3%	-11%	-1%	-3%	2%	4%	3%

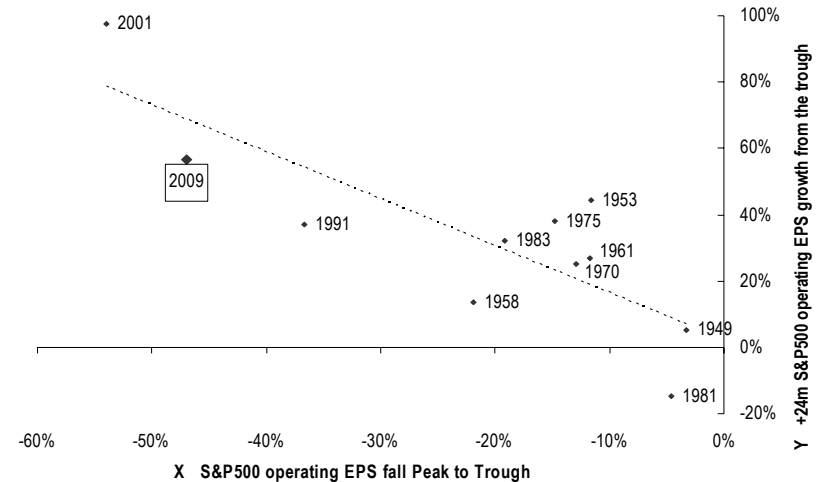
Source: IBES, % yoy as of 27<sup>th</sup> July

## MSCI Europe EPS fall and rebound around past recessions



Source: Datastream, IBES

## S&P500 EPS fall and rebound around past recessions



Source: Datastream, IBES

# Real GDP vs '08 peak => new high achieved at global level in Q2 '10

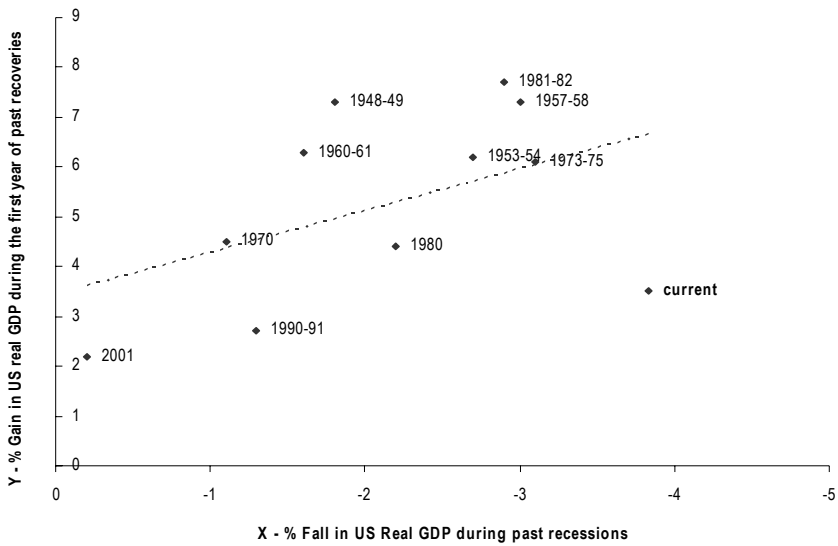
- US real GDP is expected to surpass its past peak in Q3 '10. For Europe, this should happen by the end of 2011 / start of 2012
- Historically, the size of GDP loss was proportional to the size of rebound => suggesting US real GDP should be growing 6-7%, rather than 3-4%

## When will GDP regain past peak

Region	'08 Peak	Expected/Reached new High
Global	08Q2	10Q2
US	08Q2	10Q3
UK	08Q1	12Q1
Euro Area	08Q1	12Q1
Germany	08Q1	12Q1
France	08Q1	11Q1
Japan	08Q1	12Q1
EM	08Q3	09Q3

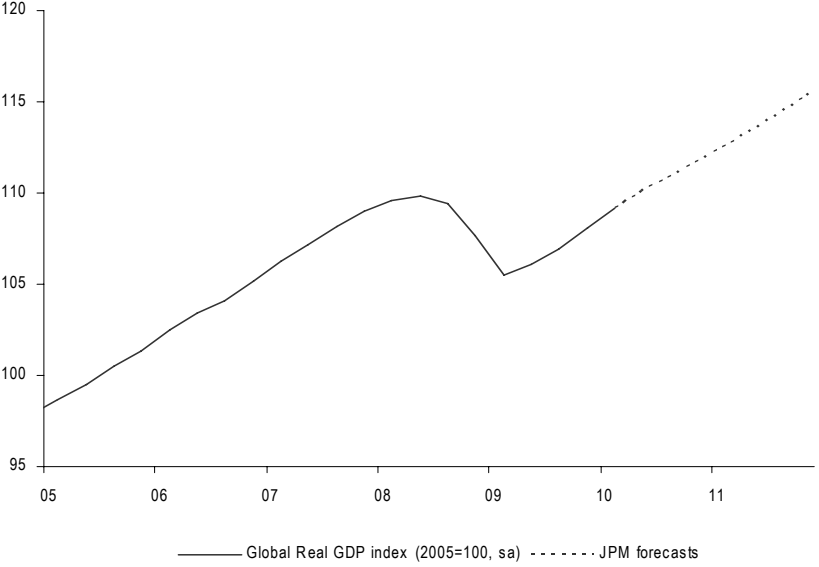
Source: J.P. Morgan estimates

## US real GDP rebound in the past cycles



Source: BEA, Blue Chip forecasts

## Global real GDP projections

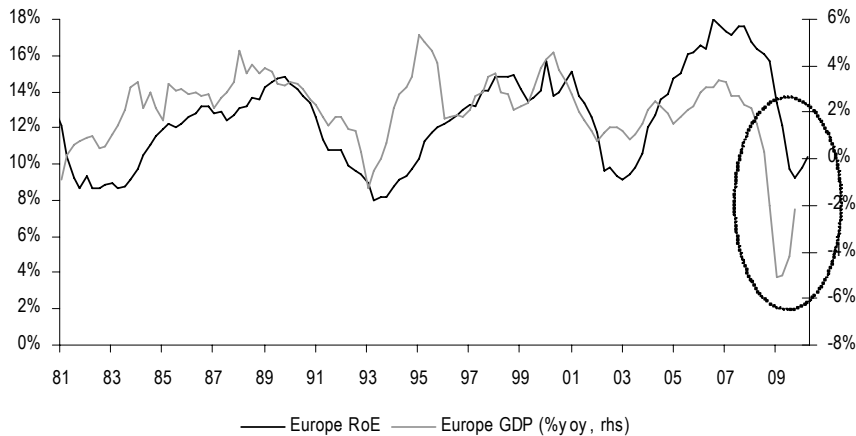


Source: J.P. Morgan estimates

# Profit margins in the long-term context

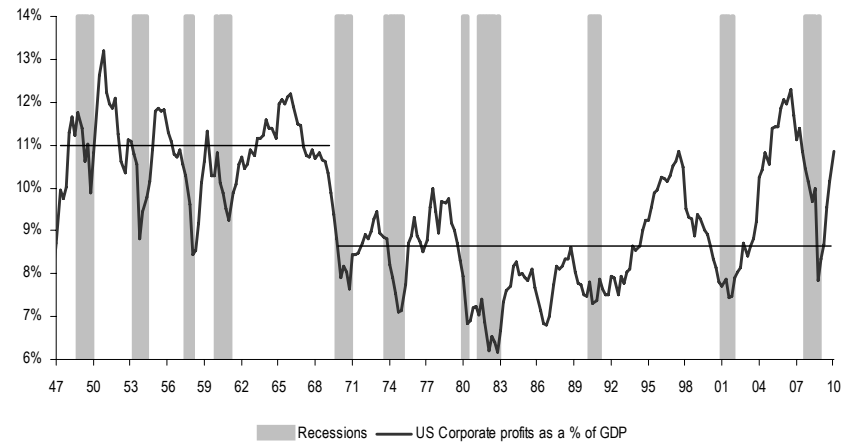
- Investors are sceptical about the magnitude of potential margin recovery
- We think margins will cyclically rebound, supporting valuation multiples
- Longer-term margins will depend on inflation, potential growth, etc
- 1950-60s displayed structurally high margins (although still cyclical) against a backdrop of low inflation, low risk-free rates and low wage growth. Some of these conditions might hold again

European RoE vs GDP growth



Source: Datastream

US NIPA profit margins

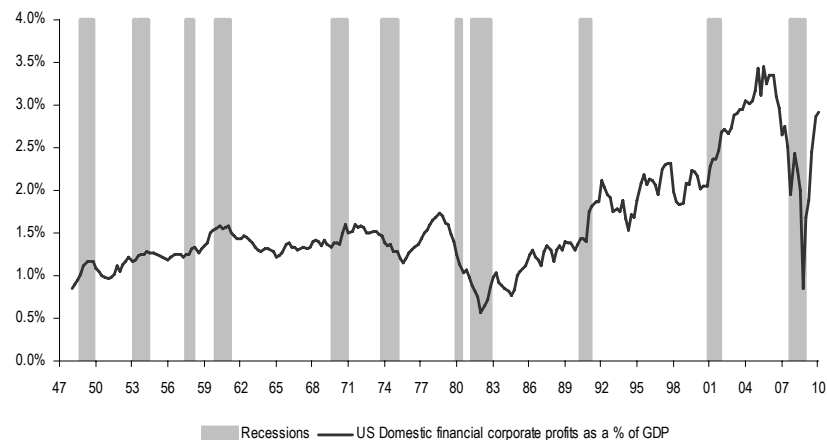


Source: Datastream, NBER

## NIPA profit margin breakdown

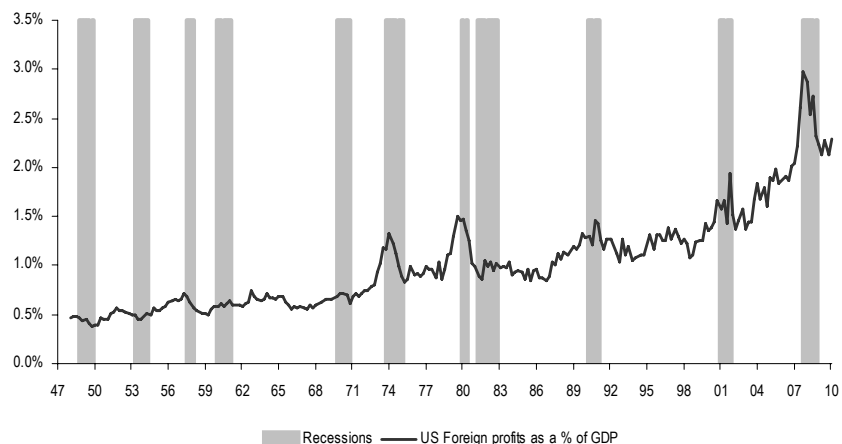
- Financials margins likely to be structurally under pressure, but short term they are supported by steep yield curves
- EM margins, to which both US and Europe are significantly leveraged, need not structurally weaken
- Domestic non-financial margins are not stretched

### US domestic financial margins



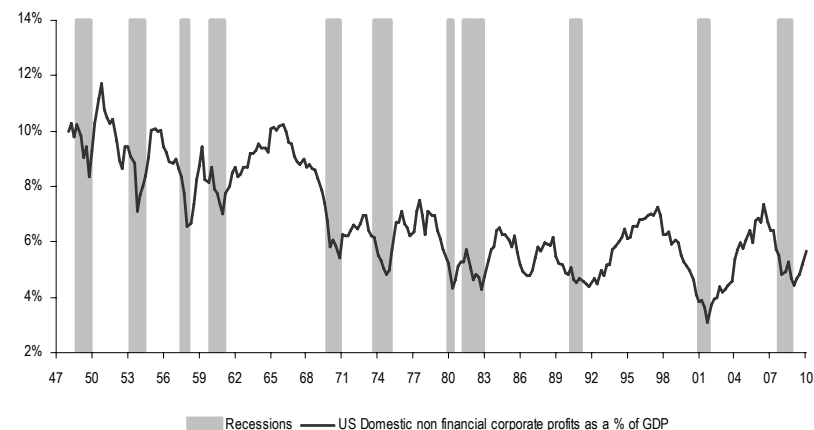
Source: NBER, BEA

### Foreign profit as a share of GDP



Source: NBER, BEA

### Domestic non-financial margins



Source: NBER, BEA

## 5 - Fiscal drag and an end to inventory rebuild vs. the improving private demand – capex, consumer, smaller businesses

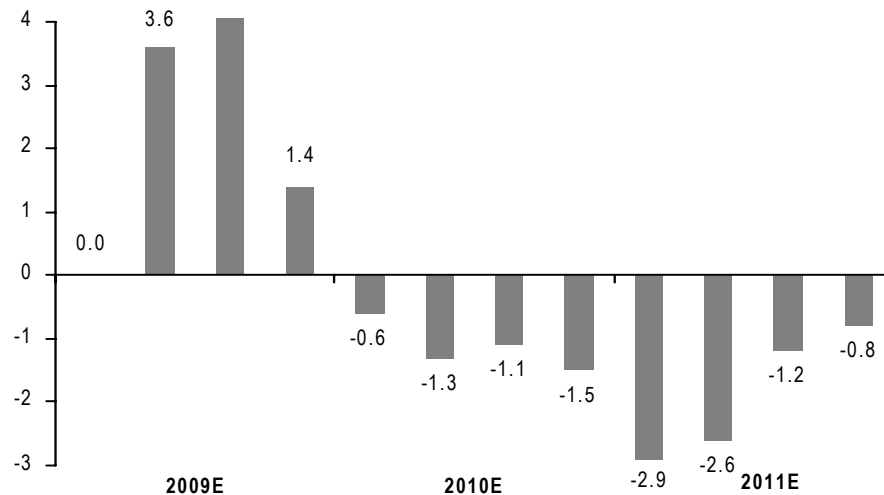
- The fiscal drag is likely to subtract an average of 1-1/4%-pt from GDP growth over the next six quarters and to become more significant from Q1 '11 onwards
- Inventory rebuild and the acceleration in production, which typically lasted four quarters, is coming to an end

### J.P. Morgan US GDP forecast

	2009, %q/q, saar		2010, %q/q, saar			2011, %q/q, saar		
	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q
real GDP	5.6	2.7	2.5	2.5	3.0	2.5	2.5	3.0
final sales*	1.5	1.7	3.7	2.6	2.8	2.3	2.5	2.9
Inventories*	3.8	1.9	-0.1	-0.1	0.1	0.1	0.1	0.0
Inventories**	-19.7	41.2	37.5	35.1	37.5	39.9	42.9	41.70
IP	5.6	6.1	7.9	3.5	4.0	4.0	4.0	4.5

Source: J.P. Morgan estimates \*as a contribution to GDP growth \*\*change in absolute level of inventories (ch \$bn, chained \$2000)

### Estimated contribution of fiscal policy to US GDP growth



Source: J.P. Morgan economic research, % chg, saar

### Fiscal thrust and private final sales

%oya	DM	US	EMU	Japan	UK
<b>GDP</b>					
2009	-3.5	-2.4	-4.1	-5.3	-4.9
2010e	2.5	2.9	1.3	3.6	1.6
2011e	2.3	2.8	1.4	2.2	2.6
<b>Fiscal thrust (+ is stimulative)</b>					
2009	2.4	2.8	2.0	2.2	2.1
2010e	0.0	0.1	0.2	0.3	-2.0
2011e	-1.1	-1.3	-1.3	0.2	-2.4
<b>Inventory contribution</b>					
2009	-0.6	-0.6	-0.8	0.2	-1.2
2010e	0.8	1.2	1.2	-0.2	0.8
2011e	-0.1	0.0	-0.4	0.0	0.5
<b>Underlying private final sales</b>					
2009	-5.2	-4.7	-5.3	-7.7	-5.8
2010e	1.6	1.6	-0.1	3.4	2.6
2011e	3.5	4.1	3.1	2.0	4.4

Source: J.P. Morgan economic research



## The size of the needed fiscal consolidation, manageable at EMU level

- Putting Eurozone sovereign concerns into perspective, the primary deficit for Eurozone as a whole is no worse than those for the US, UK or Japan

### Primary budget position and debt (%GDP, 2009)

	Stability and Growth Program deficit	Deficit (Eurostat)	Primary deficit	Cycl-adj primary position	Gross debt
<b>Euro area</b>		-6.3	-3.5	-1.4	78.7
Germany	-3.2	-3.3	-0.7	1.5	73.2
France	-7.9	-7.5	-5.2	-3.3	77.6
Italy	-5.3	-5.3	-0.6	1.8	115.8
Spain	-11.4	-11.2	-9.4	-8.1	53.2
Netherlands	-4.9	-5.3	-3.0	-0.7	60.9
Belgium	-5.9	-6.0	-2.3	-0.9	96.7
Austria	-3.5	-3.4	-0.7	0.1	66.5
Greece	-12.7	-13.6	-8.5	-7.6	115.1
Ireland	-11.7	-14.3	-12.2	-6.8	64.0
Finland	-2.2	-2.2	-1.0	1.7	44.0
Portugal	-9.3	-9.4	-6.6	-5.2	76.8
Slovakia	-6.3	-6.8	-5.3	-3.4	35.7
Slovenia	-5.7	-5.5	-4.1	-0.5	35.9
Luxembourg	-1.1	-0.7	-0.2	1.0	14.5
Cyprus	-0.9	-6.1	-3.6	1.0	56.2
Malta	-6.6	-3.8	-0.6	-3.8	69.1

Source: J.P. Morgan economic research

### Fiscal positions (%GDP, 2009)

	Fiscal Balance	Primary balance	Cyc adj Primary Balance	Gross debt	Net debt
Euro area	-6.3	-3.5	-1.4	78.7	51.7
UK	-12.6	-10.7	-6.5	72.9	55.6
US	-9.9	-8.6	-5.3	83.4	53.0
Japan	-10.7	-8.6	-6.0	189.3	96.5

Source: J.P. Morgan economic research

### Fiscal thrust across the Euro area

	2010e	2011e	2012e
<b>Euro area</b>	<b>-0.2</b>	<b>1.3</b>	<b>1.2</b>
Germany	-3.1	0.5	1.5
France	0.2	1.9	1.2
Italy	0.1	0.8	0.7
Spain	2.7	3.4	1.8
Netherlands	-1.5	0.8	0.3
Belgium	1.3	0.6	0.8
Austria	-1.2	0.9	0.7
Greece	9.5	1.9	1.3
Ireland	0.9	0.8	2.1
Finland	-1.4	0.6	0.1
Portugal	2.4	3.8	2.1

Source: J.P. Morgan economic research

## Periphery facing a Herculean task, though

- The size of proposed Greek fiscal adjustment is ranking the top of historical achievements, at 12-13% of GDP
- Refinancing schedule to ease in H2

### ECB funding as % of total bank assets

	EMU	Greece	Ireland	Italy	Portugal	Spain
Dec-08	2.6%	8.3%	5.1%	1.4%	2.1%	2.7%
Dec-09	2.1%	9.2%	5.6%	0.7%	3.2%	2.0%
Jun-10	2.7%	17.3%	5.6%	0.9%	7.6%	3.9%
Change	0.1%	9.0%	0.5%	-0.5%	5.5%	1.2%

Source: National central banks, ECB aggregate MFI balance sheet, J.P. Morgan Fixed income research

### Previous fiscal adjustments\* in EMU

	Share of Eurozone GDP	Largest move % pts of GDP	Date	Real GDP Avg Annual Growth	Abs Perf (LC)	Perf Rel to MSCI Europe (LC)	Perf Rel to MSCI Europe (\$)
Belgium	4%	8.7	1982-84	1.1%	82.9%	4.8%	7.9%
Germany	29%	7.6	1996-98	1.6%	107.2%	10.3%	-6.1%
Portugal	2%	7.5	1982-84	0.0%	-	-	-
Netherlands	6%	6.7	1996-98	3.9%	116.3%	19.4%	0.6%
Greece	2%	6.4	1992-94	0.4%	20.0%	-10.2%	-29.2%
Ireland	2%	6.3	1982-84	2.1%	31.5%	18.4%	-
Italy	16%	6.0	1991-93	0.5%	38.5%	-22.6%	-38.3%
Finland	2%	6.0	1998-00	4.7%	444.9%	396.3%	338.1%
Spain	10%	3.1	1994-96	2.5%	44.4%	20.7%	17.8%
Austria	3%	3.0	1995-97	2.1%	12.4%	-68.6%	-73.5%
France	21%	2.9	1994-96	1.8%	10.2%	-13.6%	-15.7%
<b>Average</b>				<b>1.9%</b>	<b>90.8%</b>	<b>35.5%</b>	<b>22.4%</b>
<b>Median</b>				<b>1.8%</b>	<b>41.5%</b>	<b>7.5%</b>	<b>-6.1%</b>

Source: J.P. Morgan economic research, \* largest three-year moves in cyclically adjusted primary balances

### Government debt cost, maturity and redemption schedule

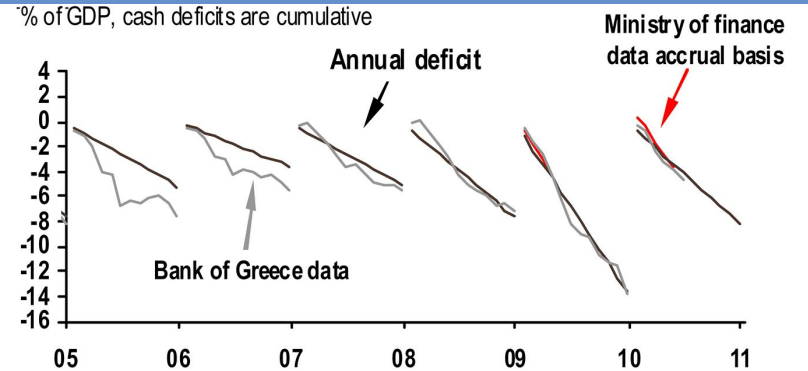
	10-year Bond yield (%)		Avg debt maturity (years)	Redemption schedule €bn, bonds (principal plus interest) and bills										
	Average in 90-ies	Latest		Jun-10	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	1Q11	2Q11	3Q11	4Q11
Spain	8.9	4.1	6.6	8.1	29.9	6.8	5.8	7.4	5.5	4.6	18.7	22.0	25.0	23.9
Italy	9.5	3.9	6.8	47.2	21.7	45.4	51.8	7.3	30.9	19.4	83.5	39.8	81.7	21.2
Portugal	7.8	5.2	6.5	1.6	4.5	0.0	3.1	1.2	2.6	0.0	6.4	12.4	0.4	1.2
Greece	7.9	10.3	7.4	0.0	7.5	2.0	1.0	3.3	0.1	0.1	12.3	10.4	12.0	7.0
Ireland	7.6	5.2	6.9	1.3	2.0	0.8	0.0	1.0	0.2	0.0	1.1	1.5	0.0	5.6
<b>Total</b>				<b>58.2</b>	<b>65.6</b>	<b>55.0</b>	<b>61.7</b>	<b>20.2</b>	<b>39.3</b>	<b>24.1</b>	<b>122.0</b>	<b>86.1</b>	<b>119.1</b>	<b>58.9</b>

Source: J.P. Morgan Fixed income research, Bloomberg

# Tracking the fiscal adjustment in the Euro area: So far so good

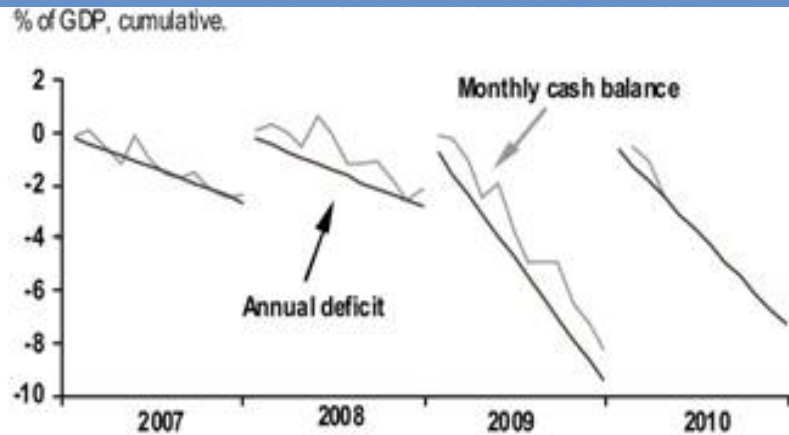
- The monthly budget data through June are now available for Greece and Spain
- It appears that public finances are on track to reach the respective government objectives of fiscal consolidation for this year

## Greek gov. cash deficit and annual fiscal balance



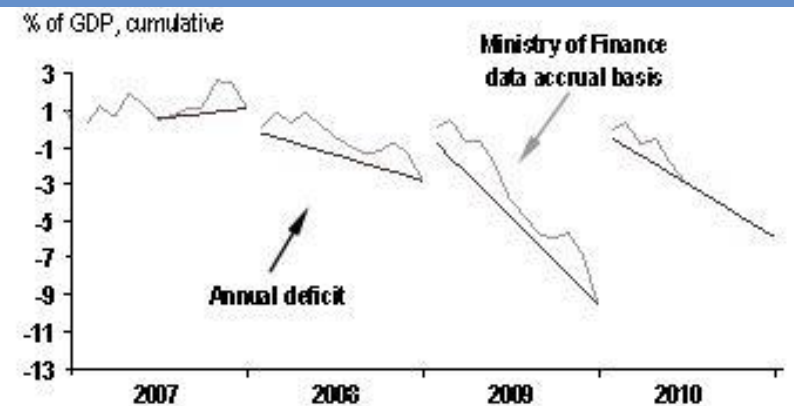
Source: J.P. Morgan economic research

## Portuguese gov. cash deficit and annual fiscal balance



Source: J.P. Morgan economic research

## Spanish gov. cash deficit and annual fiscal balance



Source: J.P. Morgan economic research

## Recovery so far: Eurozone is not the odd one out

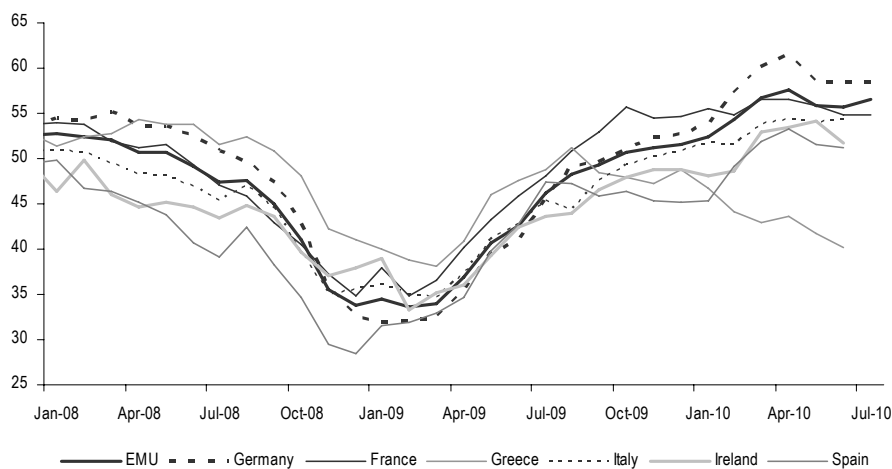
- Majority of macro indicators for June and July remained robust in Europe
- Within Eurozone, Germany, Austria, Netherlands and France appear in relatively stronger positions, while Greece, Spain and Ireland are weaker
- Only Greece is “double dipping so far”

### Manufacturing and employment indicators in EMU

	Share in Euro Area GDP	PMI Manufacturing Overall, sa	PMI Manufacturing Employment	Unemployment Rate
Germany	29%	61.2	54.0	7.1
Netherlands	6%	55.9	52.2	4.3
EMU	100%	56.5	51.7	10.0
France	21%	53.7	45.8	9.9
Austria	3%	59.0	54.8	4.1
Italy	16%	54.3	49.8	8.7
Ireland	2%	51.8	47.9	12.9
Spain	10%	51.2	46.2	19.7
Greece	2%	42.2	41.1	10.2

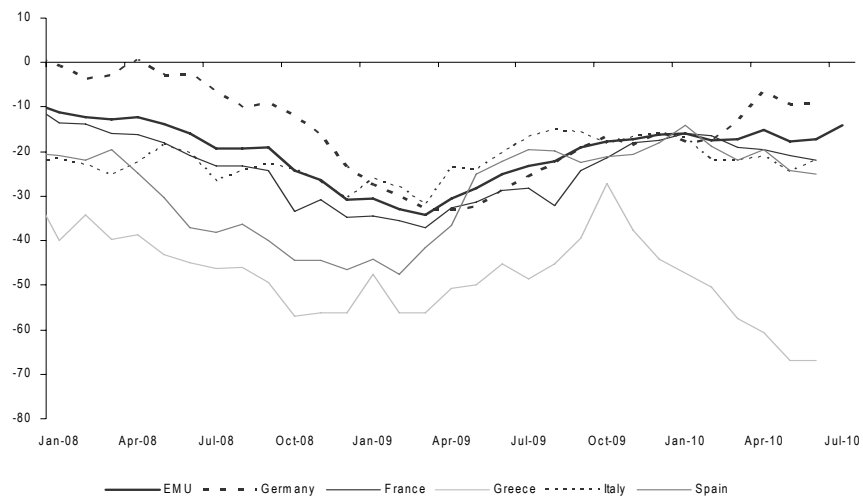
Source: Datastream

### EMU manufacturing PMI breakdown



Source: Datastream

### EMU consumer confidence breakdown

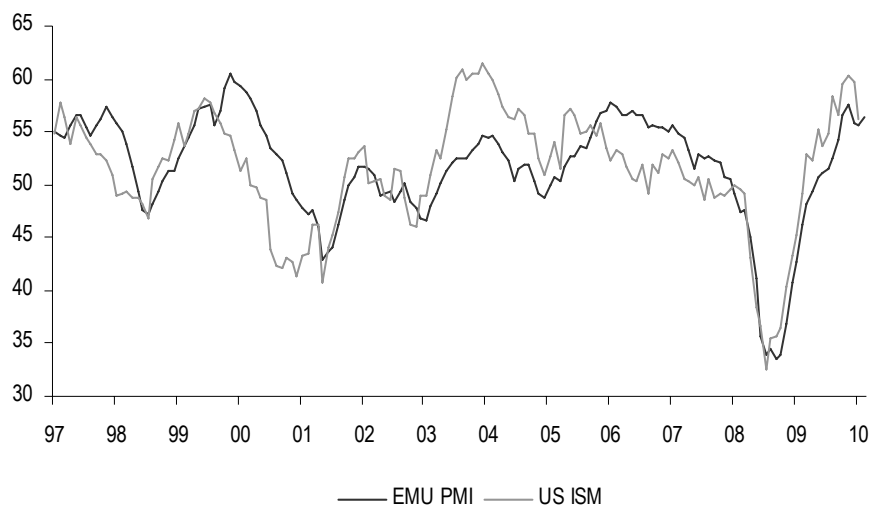


Source: Datastream

## FX boost and resilient macro momentum to counter austerity packages

- The economic underperformance of Europe in the early stages of an upturn has been a regular feature of past recoveries. However, the European data in this upcycle has been robust so far
- Eurozone composite output PMI index printed 56.7 in July, consistent with 3% real GDP growth, in contrast to Blue Chip forecast for 2010 which stands at 1%
- FX tailwind to offset fiscal tightening in periphery

### US ISM vs Eurozone PMI



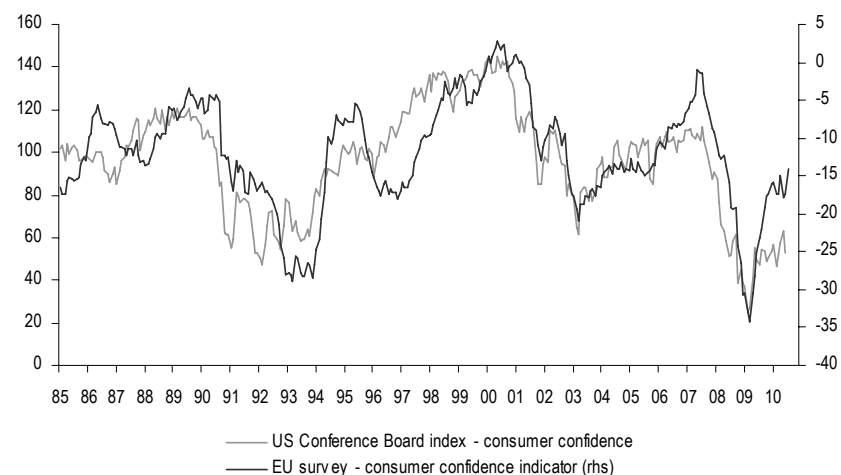
Source: Markit, ISM

### J.P. Morgan real GDP projections (%yoy)

	2010e	2011e	2012e
Euro area	1.3	1.4	1.8
Germany	2.2	2.2	2.0
France	1.6	1.4	1.8
Italy	1.2	1.3	1.7
Spain	-0.2	-0.1	1.5
Greece	-4.4	-4.2	1.0
Portugal	0.8	-1.0	1.0
Ireland	-0.8	0.6	2.0

Source: J.P. Morgan estimates

### US vs Eurozone consumer confidence

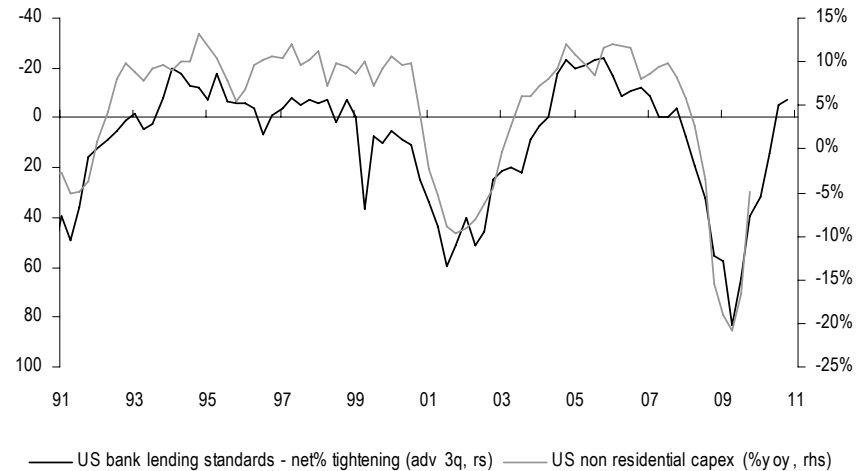


Source: Conference Board, European Commission

# Drivers of final demand – a) Remain bullish on capex

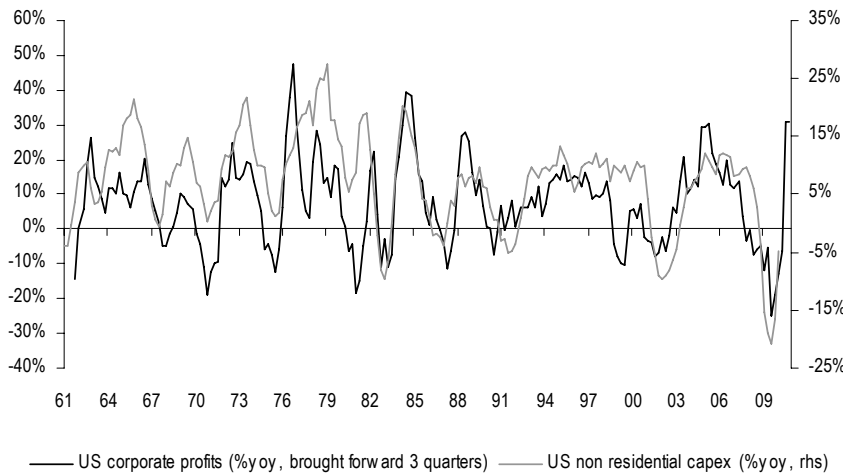
- We continue to see the key leading indicators of corporate spend: 1) change in bank lending standards, 2) turn in the profit cycle and 3) the momentum in utilisation rates, as supportive of stronger capex
- However, from equity market perspective, we have recently closed our long standing OW Capital Goods call (since Feb '09) as we believe it is a crowded trade

Lending standards vs non-residential capex



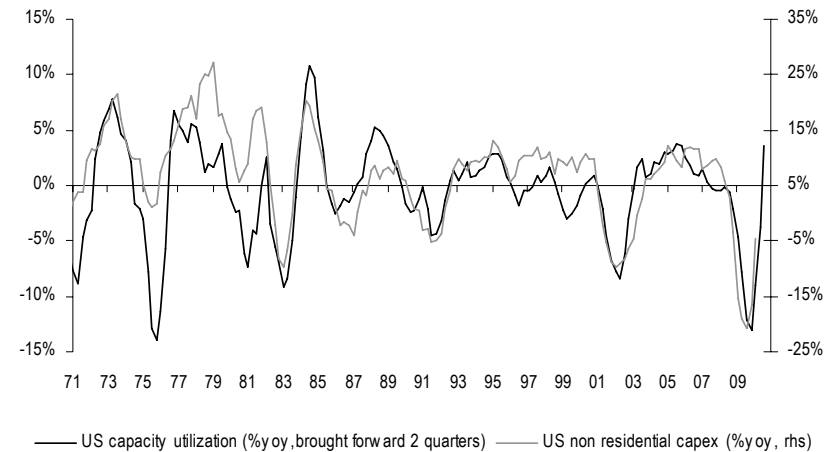
Source: Datastream, Federal Reserve

US corporate profits vs non-residential capex



Source: Datastream

US capacity utilization vs non-residential capex

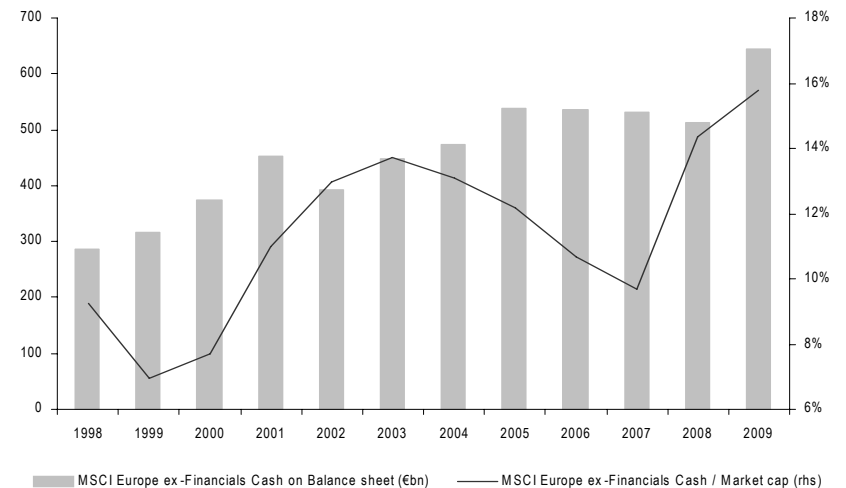


Source: Datastream

# Starting point favourable, capex share of GDP record low; corporate balance sheets cash rich

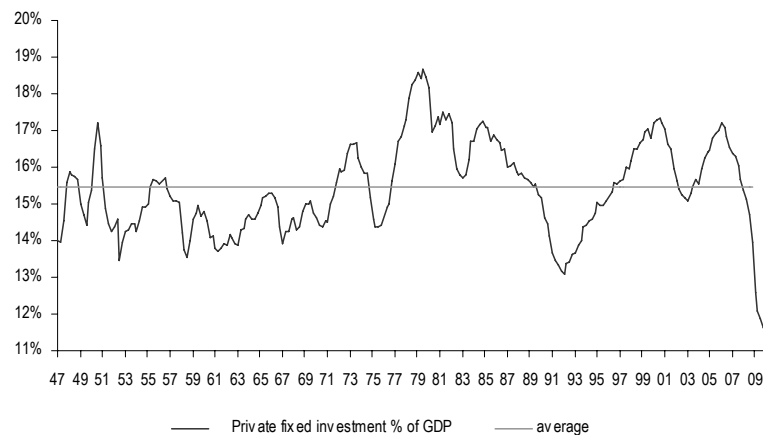
- The pushback is the low utilisation rate, but actual capex levels are also at record lows.
- Unlike the trough of the last cycle, when corporate balance sheets were under pressure, the cash on balance sheets is at record highs at present.
- This bodes well for M&A, dividends/buybacks and capex.

Cash\* on MSCI Europe\* balance sheets



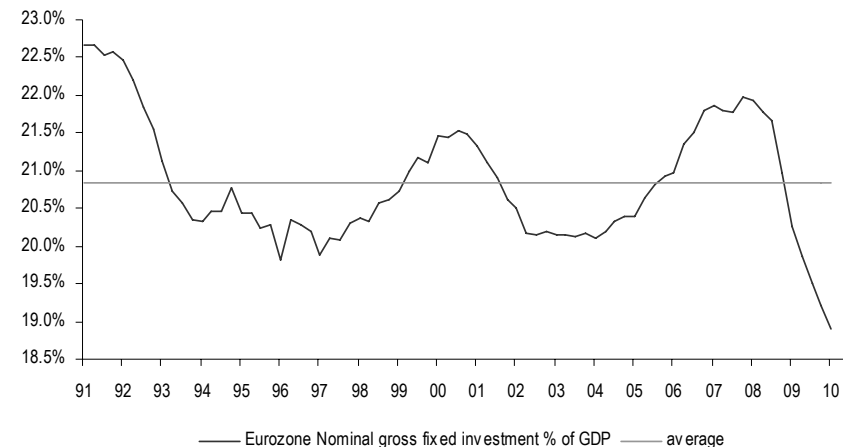
Source: Worldscope, \*bottom-up aggregated, ex-financials and companies with short record

US capex as a share of GDP



Source: J.P. Morgan

Eurozone capex as a share of GDP

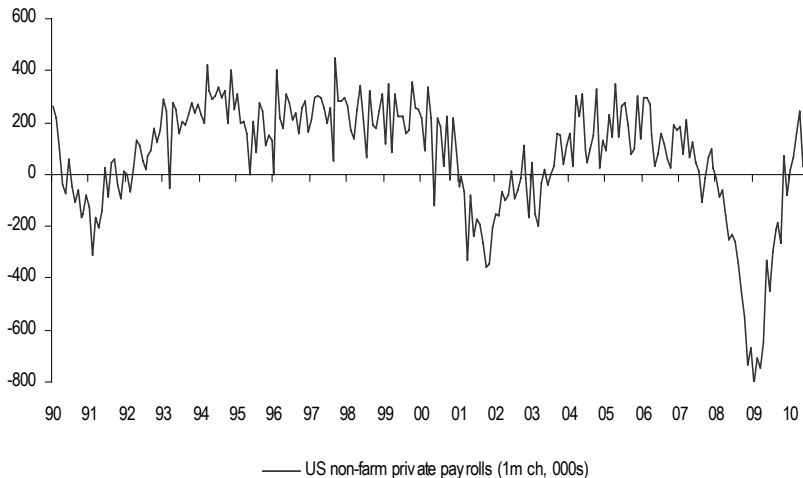


Source: Eurostat

## Drivers of final demand – b) Consumer needs to see further improvement in labour markets

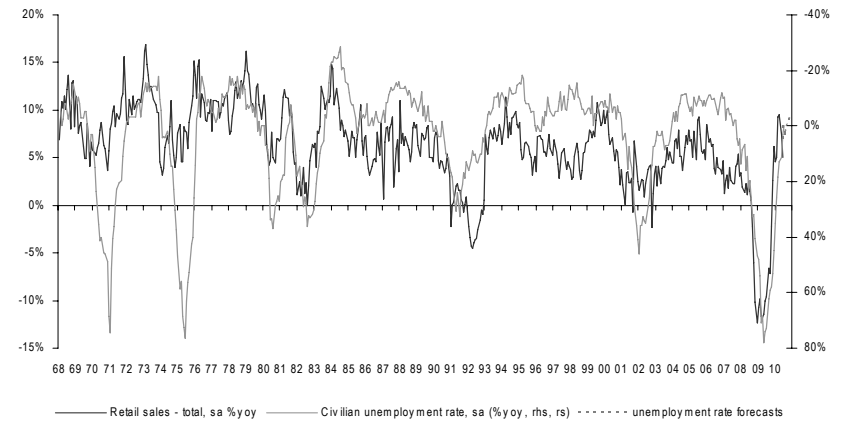
- Ultimately, the key condition for sustainable consumption growth is improvement in the labour market. Latest indicators are mixed, but on balance point up:
- 1. Jobless claims are stuck in a range at 460k; we believe 500k is breakeven for +ve payrolls; 2. Private payrolls in positive territory for six months in a row; 3. Productivity surge calls for stronger hiring; 4. ISM Employment index at 57.8 (near 40-year highs); 5. Challenger/Manpower surveys constructive

US non-farm private payrolls ('000s)



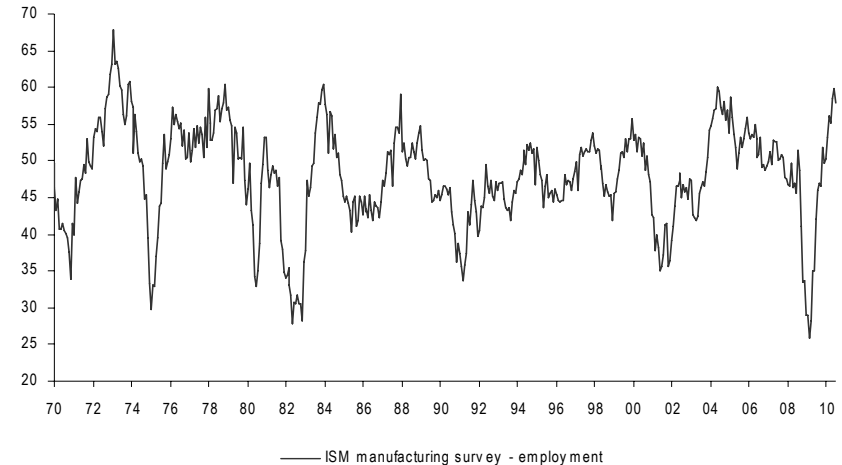
Source: Datastream

US Retail sales vs unemployment rate



Source: JP Morgan, Datastream

ISM employment component



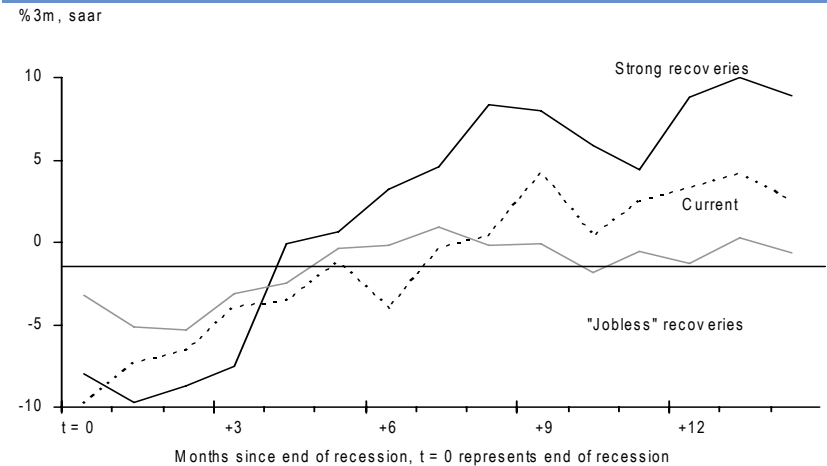
Source: Datastream



## “Jobless” recovery?

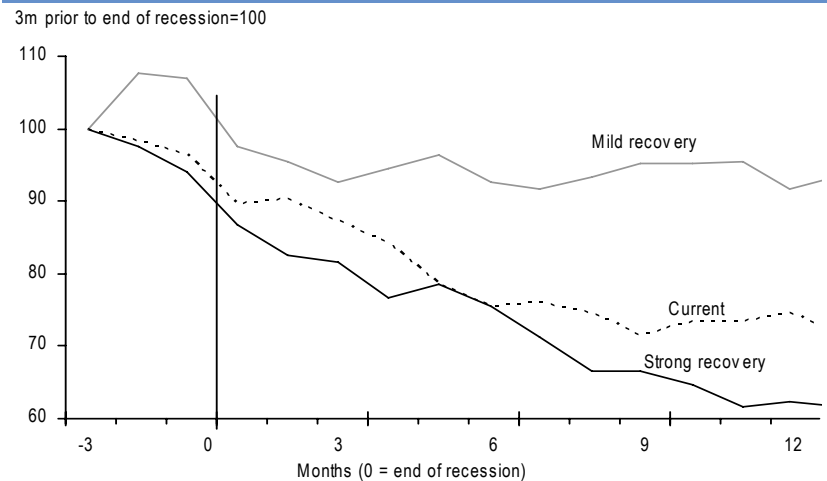
- We contrast the movement in hours worked and jobless claims to past recoveries, split into “strong” (1975 & 1983) and “weak” (1992 & 2002) labour recoveries
- The trajectory of hours worked and jobless claims momentum remains consistent with the path of historical “strong labour recoveries”

### US total hours worked, start of expansions



Source: J.P Morgan

### US jobless claims, start of expansions



Source: J.P. Morgan

## European labour markets are improving

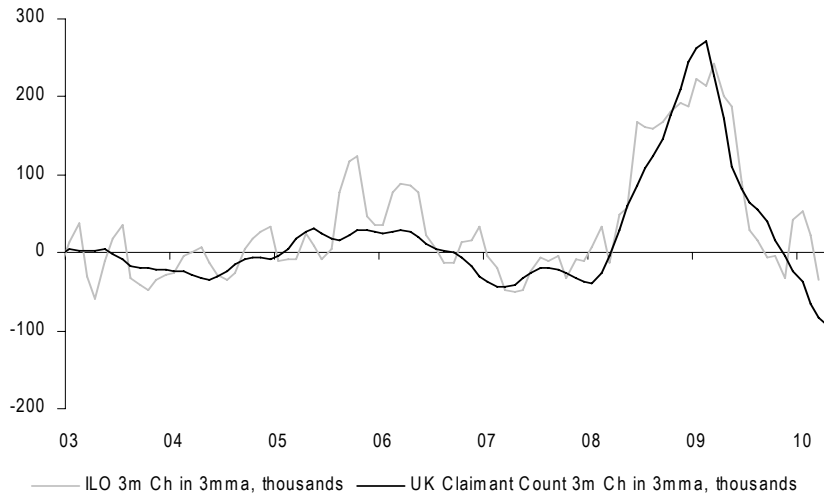
- The size of labour market adjustment in Eurozone was substantial, but there is a clear improvement in European labour market indicators evident
- The latest employment PMI reading at 50.9 is higher than in '03, '04 or '05, higher than at any point during the first three years of past cyclical upswings

### Eurozone employment PMI



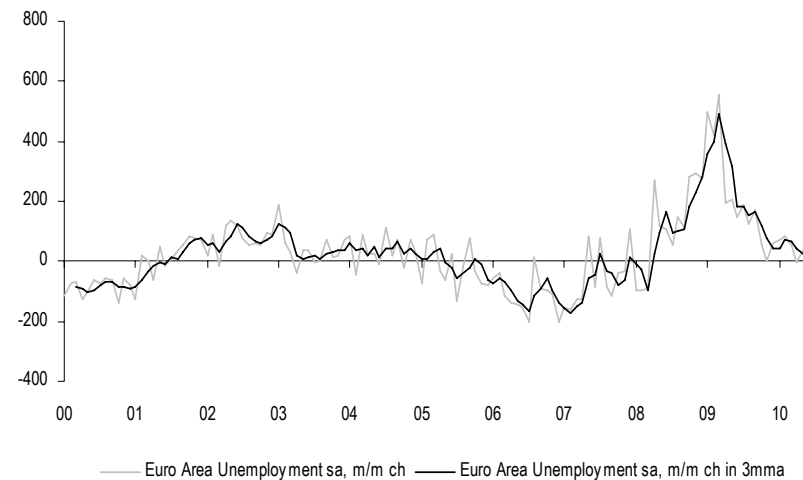
Source: JP Morgan, Datastream

### UK ILO & Claimant Count



Source: Eurostat

### Euro area unemployment change

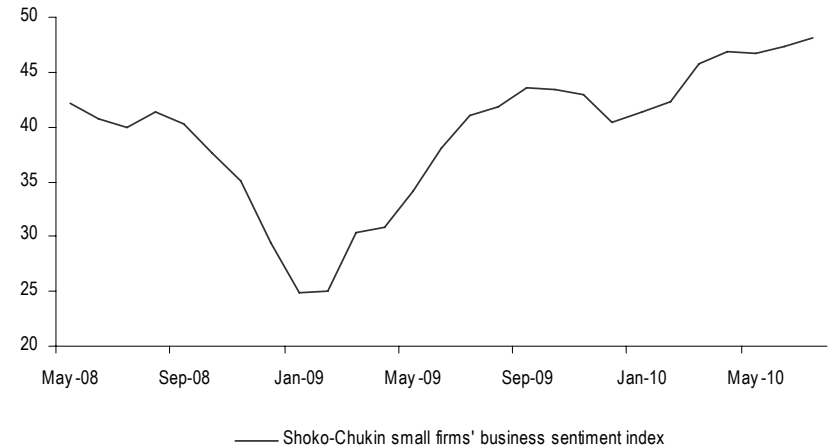


Source: Eurostat

## c) Recovery broadening to smaller businesses

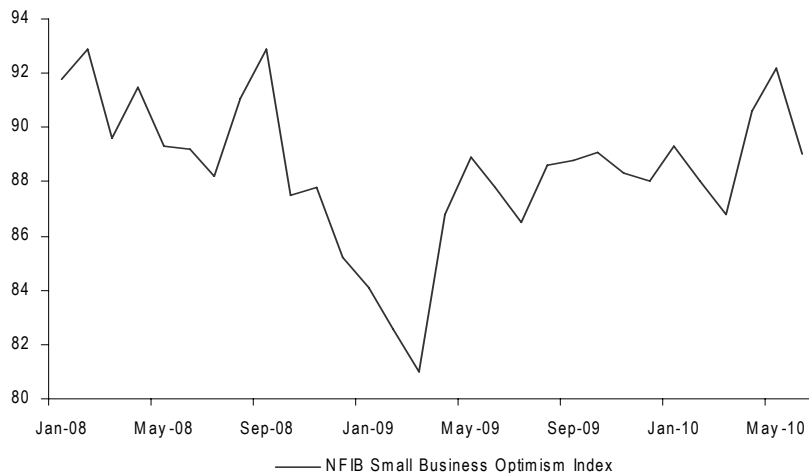
- Contrary to the consensus view that smaller companies will not see a recovery because they are cut off from access to credit, small cap surveys in all parts of the world have been on an uptrend

Shoko-Chukin small firms' business sentiment index



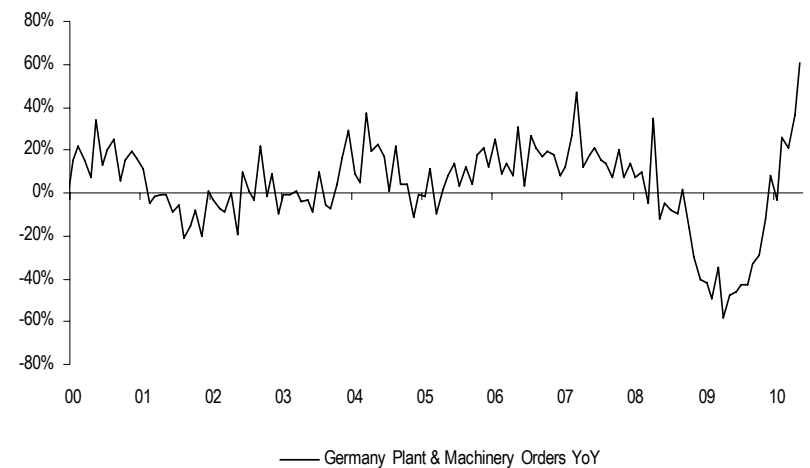
Source: J.P. Morgan

US Small Business Confidence



Source: Bloomberg

German VDMA machinery orders

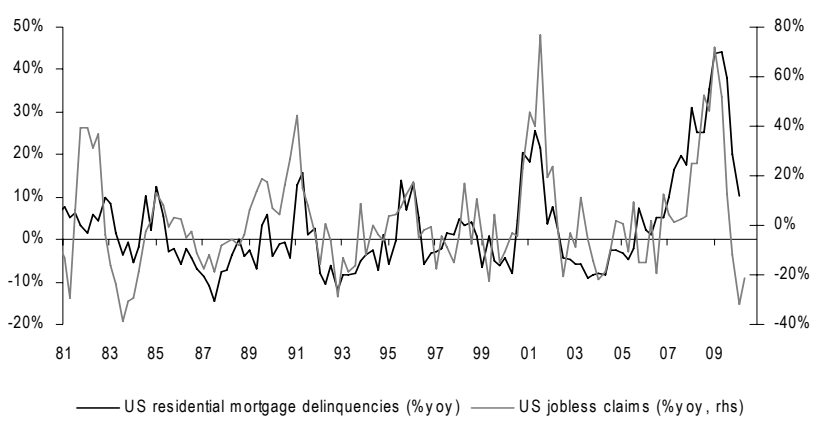


Source: Bloomberg

# Delinquencies peaking

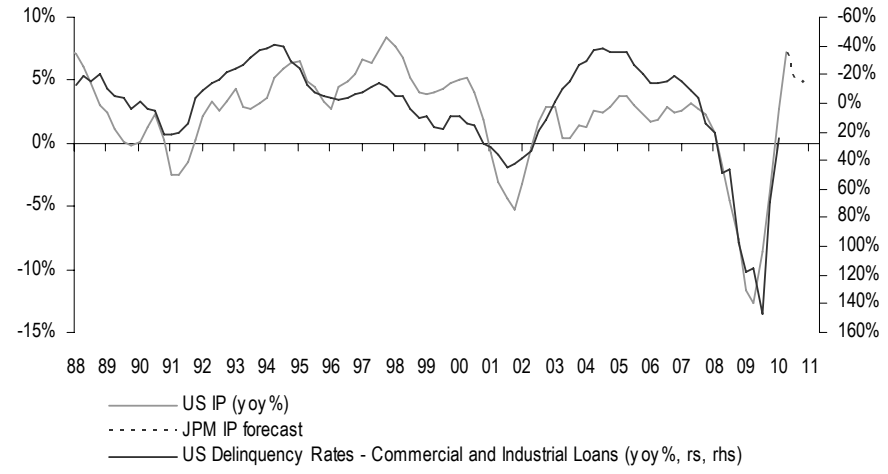
- Good correlation between macro momentum and delinquencies, suggesting delinquencies are falling in absolute terms now
- The turn in the credit cycle is the big positive for banks' profitability

US residential mortgage delinquencies vs jobless claims



Source: Datastream

US commercial loan delinquencies vs IP

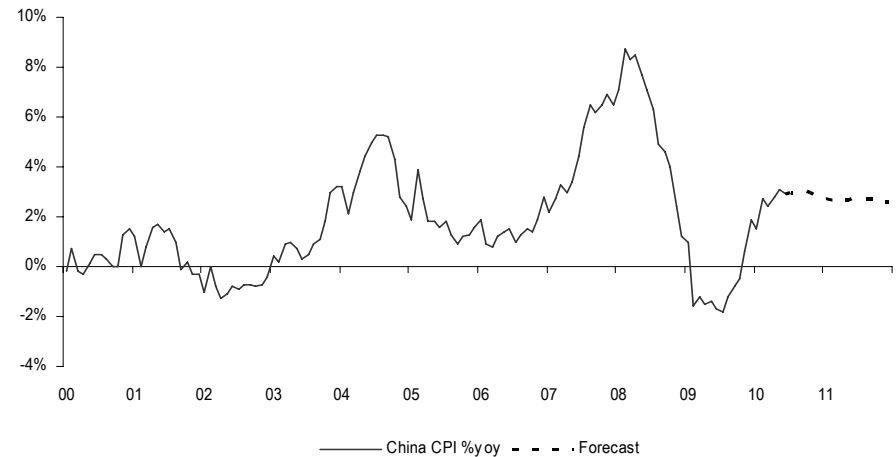


Source: Datastream, J.P. Morgan

# China backdrop – growth redistributes - policy tightening to slow

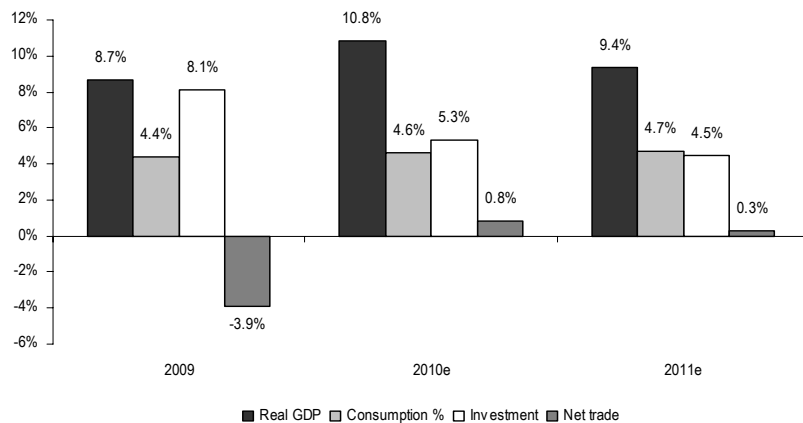
- Chinese growth slowing and rebalancing, but not expecting a hard landing
- Chinese inflation to peak in Q3 and to allow policymakers to relax the tightening process

## China inflation



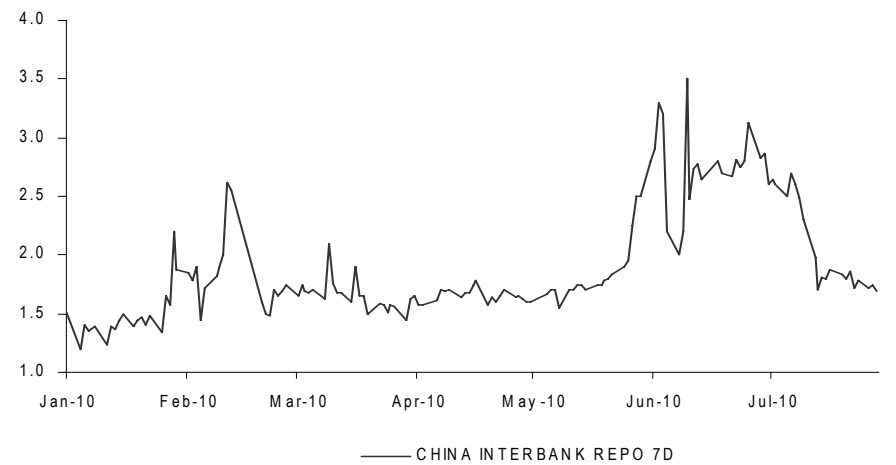
Source: Datastream, J.P. Morgan estimates

## China GDP growth and contribution breakdown



Source: J.P. Morgan economic research

## Chinese interest rates

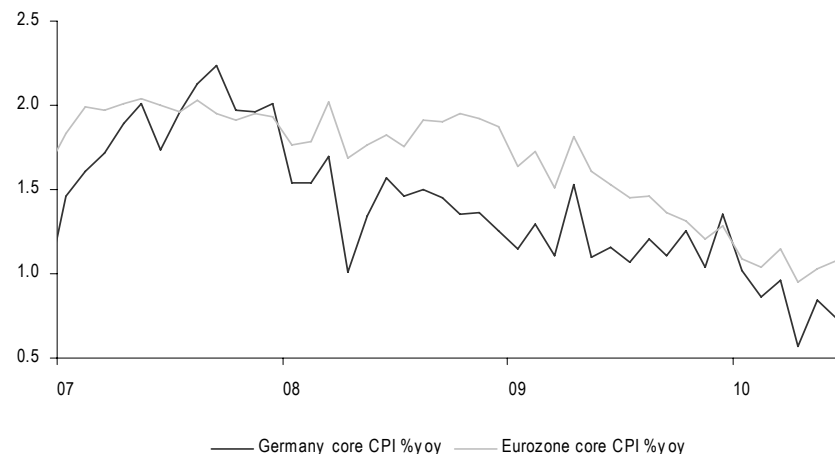


Source: Bloomberg

## 6 - Inflation risk limited, DM central banks to remain accommodative for longer

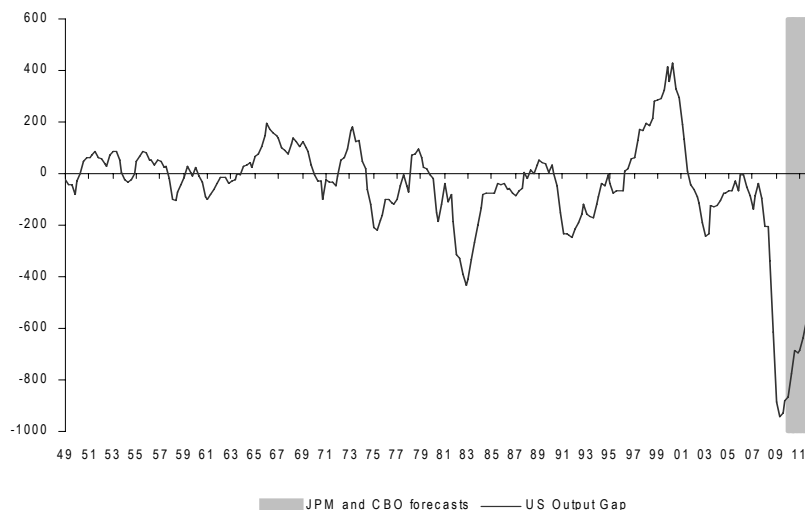
- Historically, core CPI would bottom out only with a long lag following the trough in activity, after more than two years, on average. This time around the output gaps are even more extreme
- Some pickup in inflation expectations would be welcome for Eurozone given the low recent inflation readings

Euro area vs German core inflation



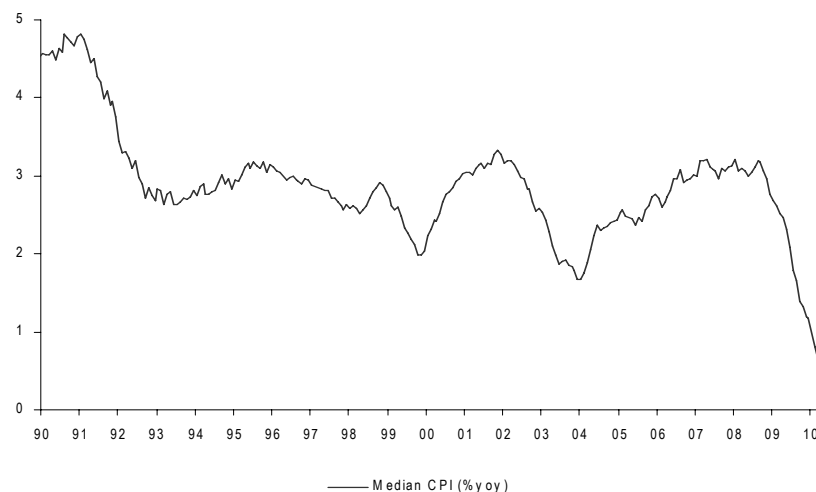
Source: Eurostat

US output gap



Source: Datastream, J.P. Morgan estimates

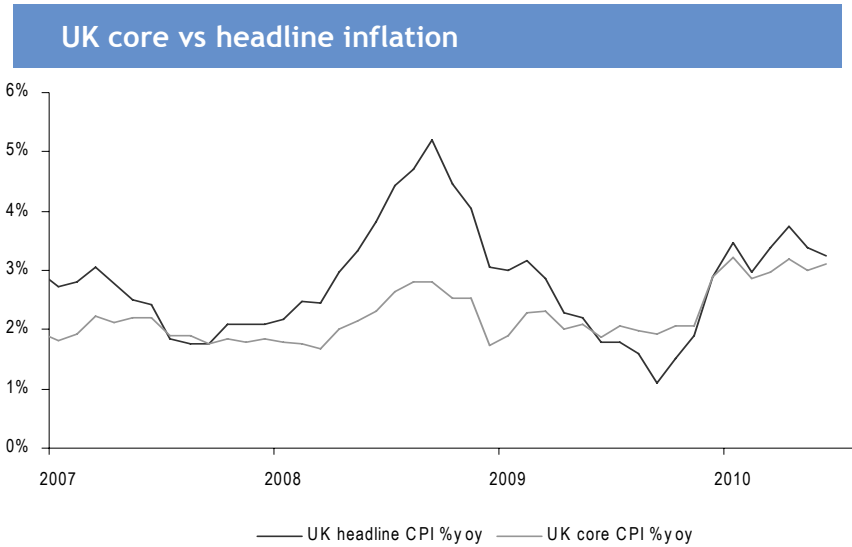
US median CPI



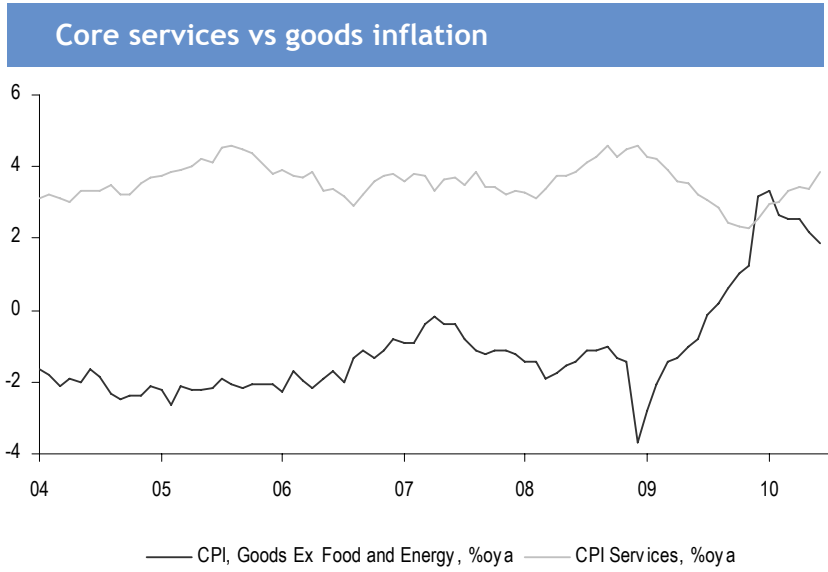
Source: Datastream, J.P. Morgan

# UK Inflation bucks the trend

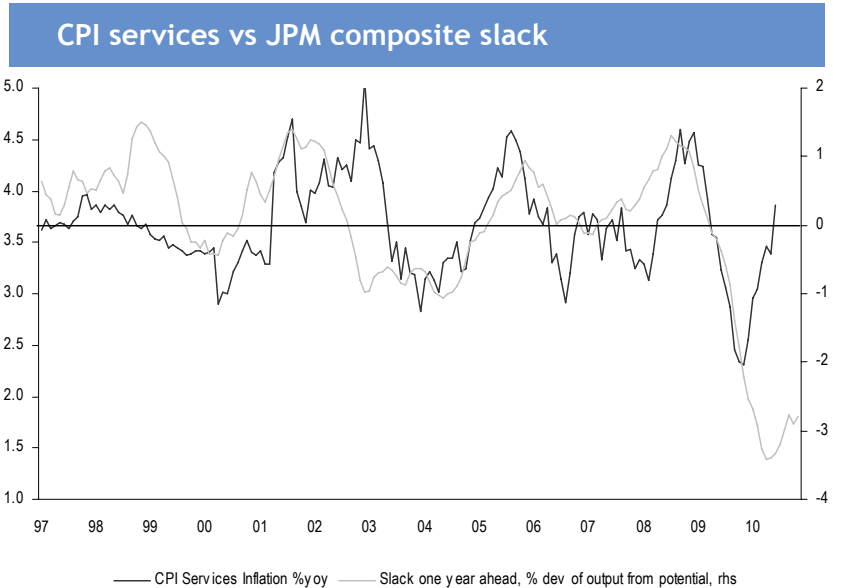
- While US, Eurozone and Japanese inflation remains on a firm downtrend, UK inflation remained uncomfortably high
- We expect UK inflation to peak out right now, and move to 1.5% yoy run rate by the end of this year



Source: ONS



Source: J.P. Morgan



Source: J.P. Morgan

# Timing of Fed exit: way too early to position for it

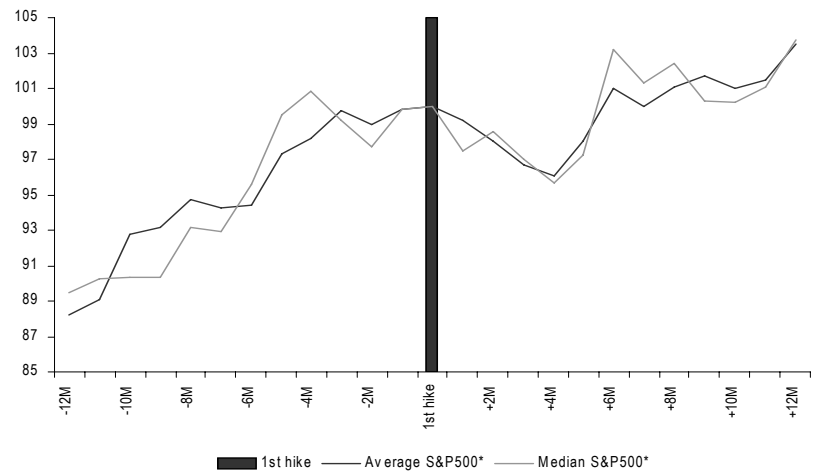
- JPM expecting start of policy normalisation in Q4 2011
- Equities have fallen every single time in the aftermath
- However, the equity uptrend has resumed following the initial weakness

## Non-farm payrolls at times of Fed hikes ('000)

End of recession	Payrolls	1st Fed Hike	Payrolls	# mths positive payrolls
Apr-58	-274	Jul-58	125	1
Feb-61	-127	Nov-61	222	7
Nov-70	-110	Jul-71	63	5
Mar-75	-270	Aug-77	238	26
Jul-80	-263	Oct-80	280	3
Nov-82	-124	Mar-84	275	7
Mar-91	-160	Feb-94	201	24
Nov-01	-292	Jun-04	81	10
<b>Average</b>	<b>-203</b>		<b>186</b>	<b>10</b>
<b>Median</b>	<b>-212</b>		<b>212</b>	<b>7</b>

Source: Datastream

## S&P500 performance around the first hike



Source: Datastream, \*re-based to 100 on the day before the 1st hike, since 1971

## S&P500 maximum fall following the first hike



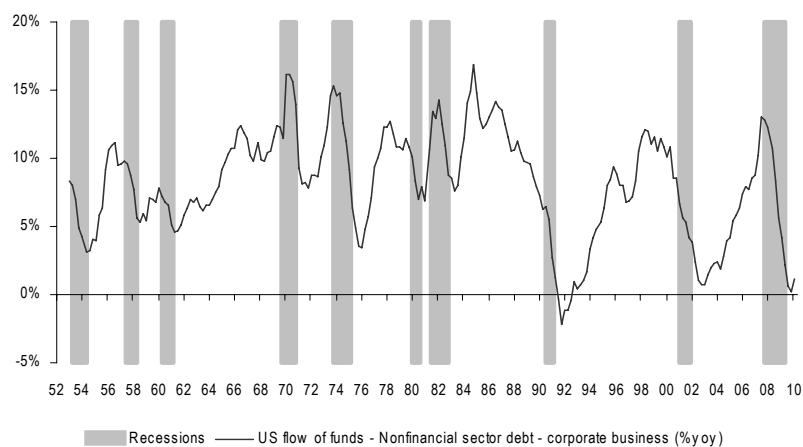
Source: Datastream, \*re-based to 100 on the day before the 1st hike



# “Money illusion” to show up again, credit growth not needed early in recovery

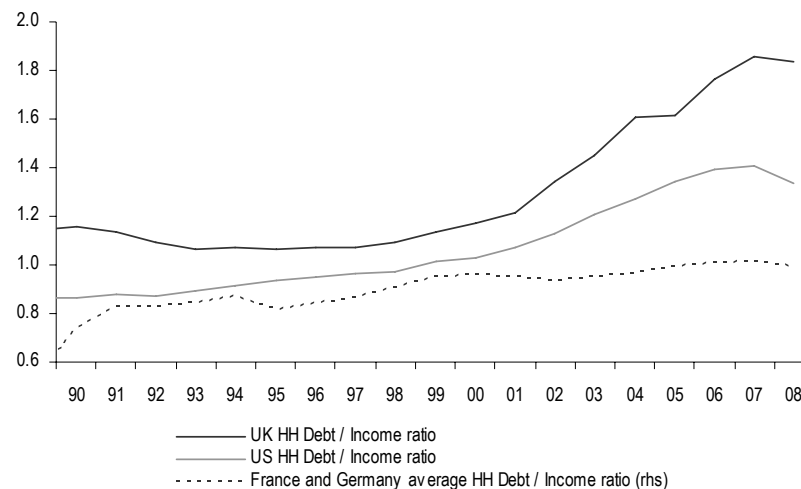
- Distinction between Stock and Flow of credit. The starting leverage is excessive, but it might not prevent the cyclical response to liquidity injection
- Economic participants to artificially feel better off again
- Actual credit expansion not needed in the early stages of recovery

## Corporate credit growth vs recessions



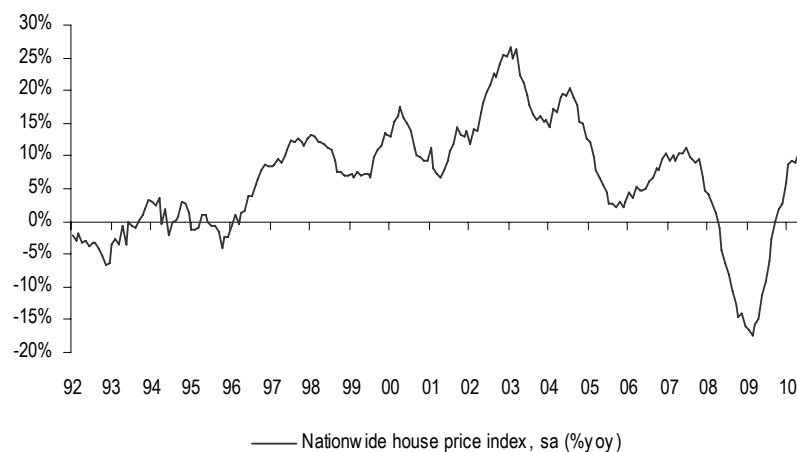
Source: Federal Reserve

## Household leverage



Source: ECB, BOE

## UK House prices

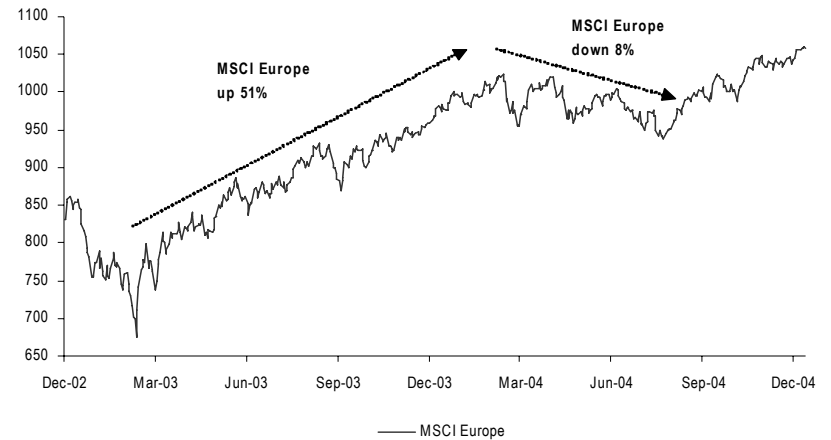


Source: Nationwide

# Looking at 2004 pause

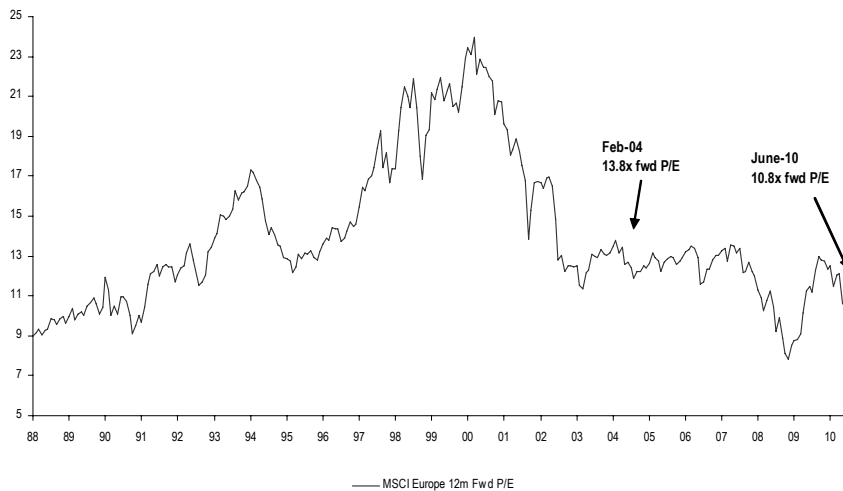
- Using the last recovery as an example, the initial equity gains were largely made from March '03 to Jan '04, with MSCI Europe up almost 50%. Subsequently, equities were flat for the ensuing 7 months
- However, in 2005 the equity advance resumed

## MSCI Europe in 2003-04



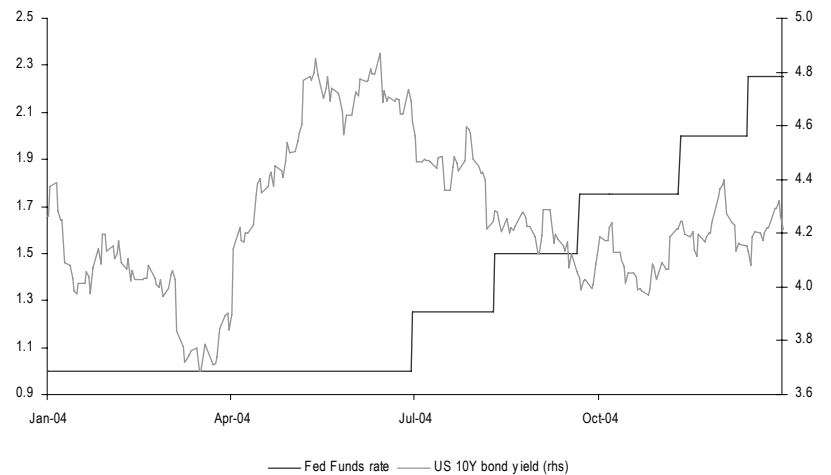
Source: Datastream

## Valuations in 2004 vs current



Source: Datastream, MSCI, IBES

## Fed funds rate and bond yields in 2004

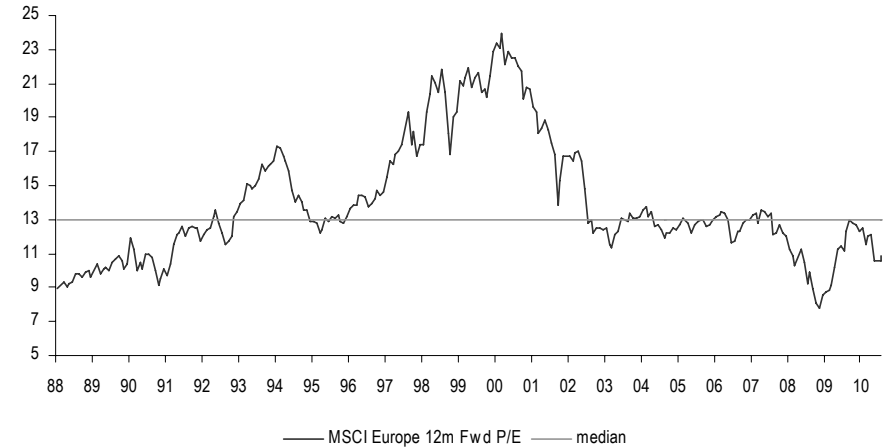


Source: Datastream

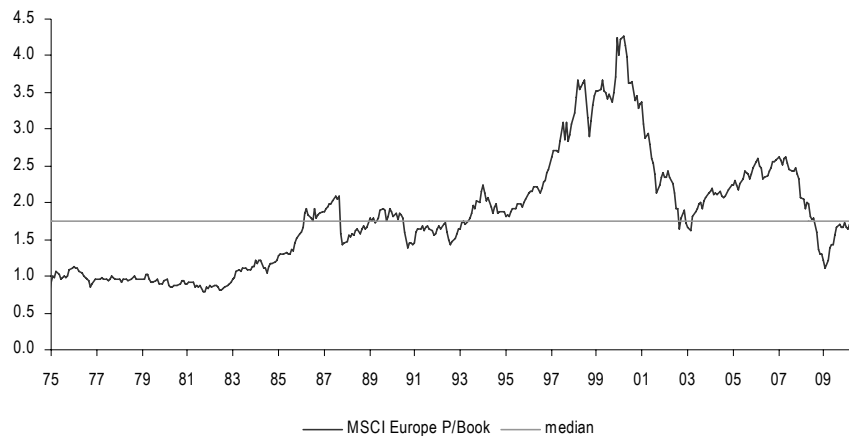
## 7 – Near-term valuations: at or below fair value

- The first stage of equity rebound is driven by multiple expansion. Despite strong re-rating in 2009, on a number of metrics stocks are still at or below historical fair value

MSCI Europe 12m Fwd P/E



MSCI Europe P/Book

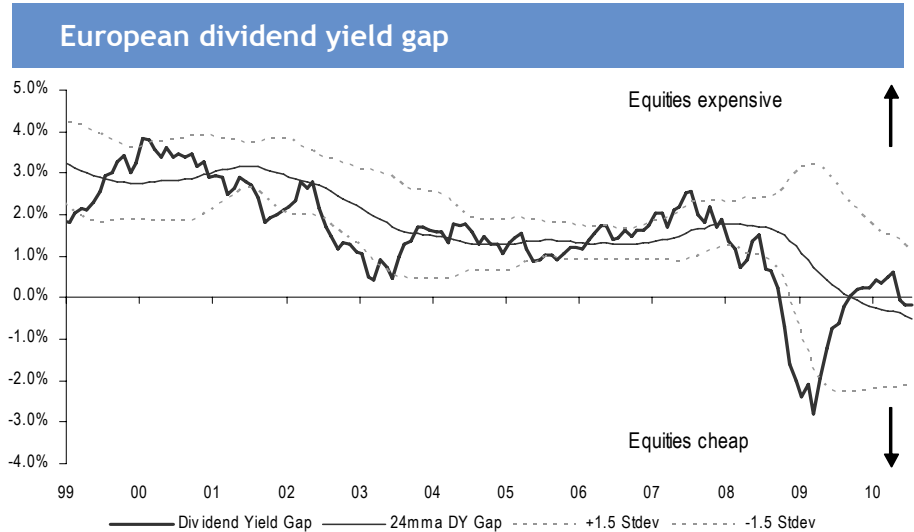


MSCI Europe P/Sales



# Yield gaps attractive: could drive asset allocation shift to stocks

- European equities still trade at the largest DY vs bond yield spreads since March 2003
- The drive for yield compression could push stocks to re-rate further



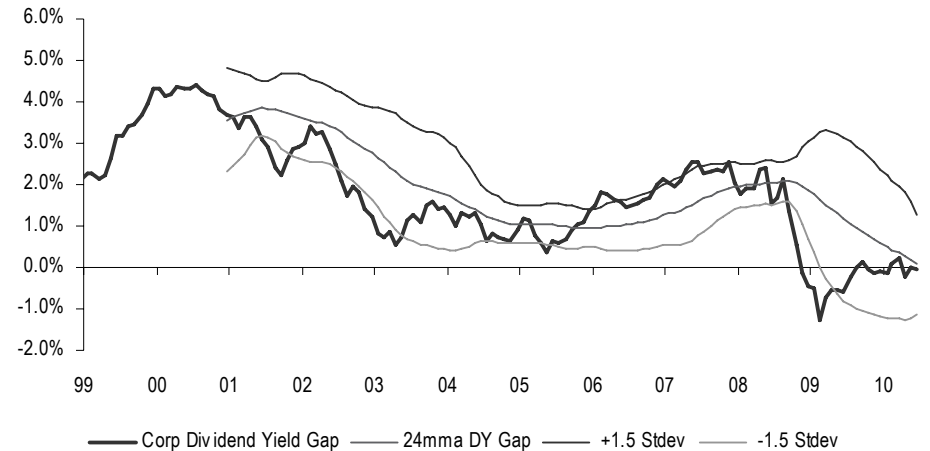
Source: J.P. Morgan

## Dividend yield vs corporate bond yield (%)

	Dividend yield	High grade yield	Difference	LT average
Utilities	5.9	3.6	2.3	-0.9
Telecom	6.0	3.8	2.3	-1.8
Energy	4.9	3.6	1.3	-1.5
Chemicals	2.7	2.6	0.1	-1.5
Staples	2.7	3.0	-0.3	-2.2
Real Estate	3.1	3.6	-0.5	-1.8
Technology	2.3	3.5	-1.1	-3.4
Building Materials	2.9	4.1	-1.2	-2.2
Capital Goods	2.3	3.5	-1.2	-2.1
Transport	2.2	3.5	-1.3	-2.1
Autos	0.8	2.6	-1.8	-1.7

Source: Datastream, J.P. Morgan

## Eurozone HG corporate yield minus dividend yield

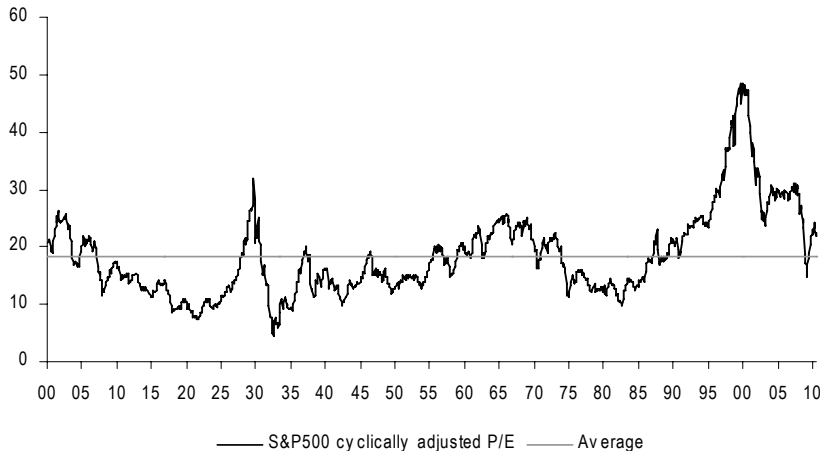


Source: J.P. Morgan

## Longer-term equity outlook: much more muted

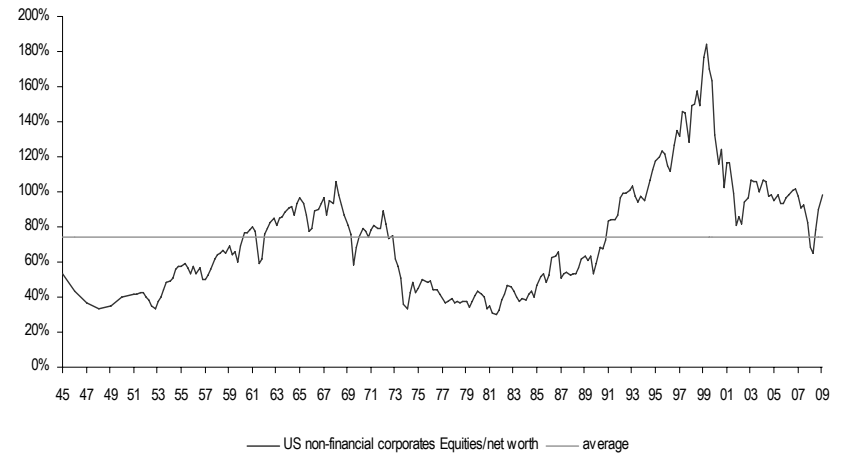
- While our tactical (6-9 month rolling horizon) view remains bullish, our medium term (2-3 years) outlook is much more cautious
- Using S&P500 10-year rolling earnings (at 49\$) and historical average P/E since 1900 (at 18.5x), gives S&P500 fair value at 900. Using the P/E average since 1945 (20x) gives fair value at 1000, and P/E since 1980 (24x) gives fair value at 1175. Historically, valuations remained “cheap” for a long time in the aftermath of structural bear markets
- Risks to the “ultimate carry trade”: lower potential growth rates, deflation, de-leveraging of consumer, fiscal consolidation, rise of real interest rates, protectionism, regulation, structurally weaker labour markets, no capital deepening etc

S&P500 cyclically adjusted P/E



Source: Datastream, Shiller data, J.P. Morgan

S&P500 Q - ratio

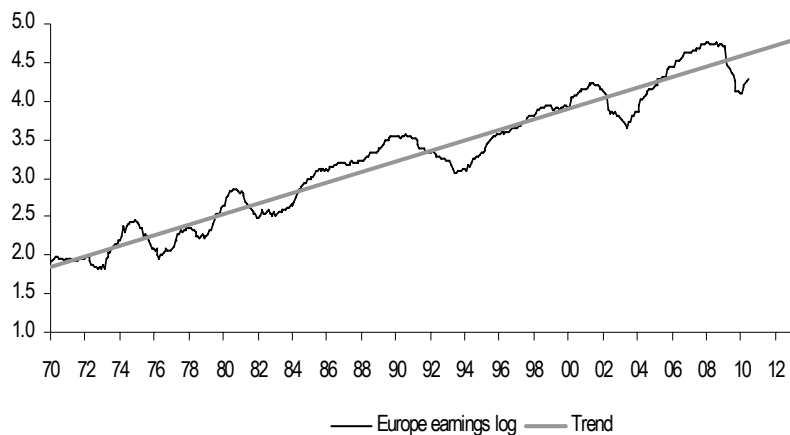


Source: Federal Reserve

## If we have full cycle, the upside could still be significant

- We have seen five EPS cycles over the past 40 years in Europe. The subsequent EPS peaks averaged 76% above the prior peaks, taking 7.5 years in between the peaks
- Assuming earnings in this upcycle follow the same dynamic, and assuming the average P/E that equities traded on peak EPS, we arrive at 100% upside from here over the next 4-5 years
- Clearly, this is not taking into account the structural drags present now, and could be seen as the “blue sky” scenario

MSCI Europe EPS integer vs trend



Source: Datastream, MSCI

EPS cycles and P/E at the time of peak EPS

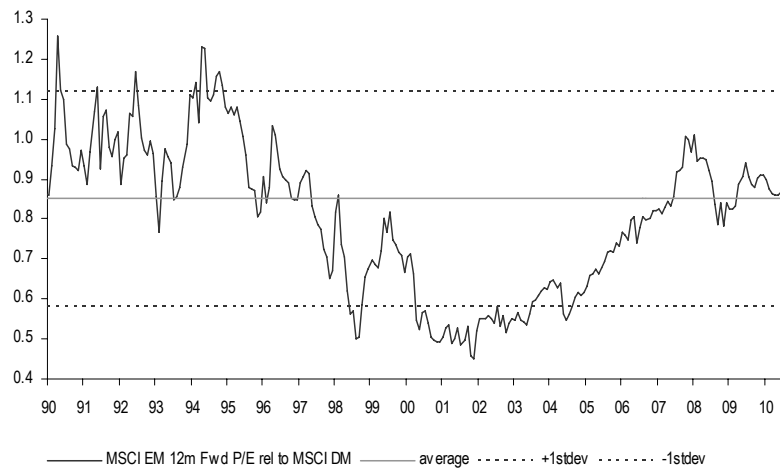
Peak date	Peak EPS integer	% above past peak	time taken to new high/years	P/E
May-70	7.2	na	n/a	11.7
Nov-74	11.8	63%	4.5	5.6
Oct-80	17.5	49%	5.9	6.8
Jan-90	34.9	99%	9.3	12.6
May-01	69.2	99%	11.3	19.6
Jan-08	117.0	69%	6.7	11.7
<b>Average</b>		<b>76%</b>	<b>7.5</b>	<b>11.3</b>
next peak? in 2015	205.6	76%	7.5	11.3

Source: Datastream, MSCI

## Regional calls: re-entering EM vs DM

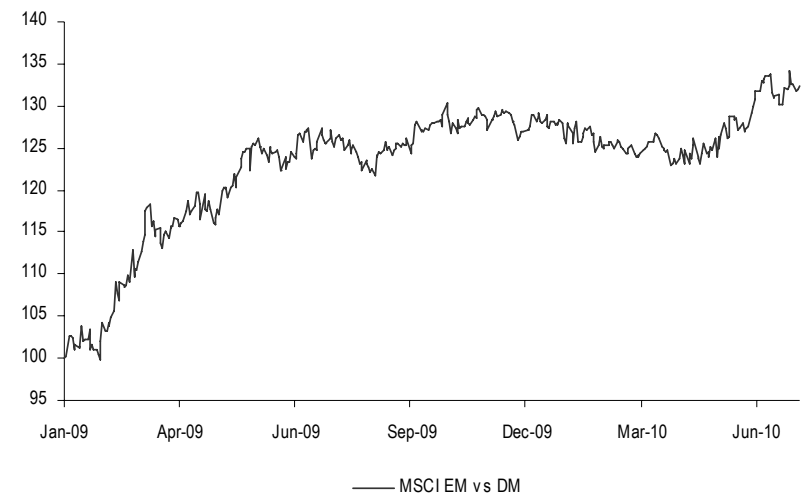
- We started 2010 cautious on EM vs DM exposure as we saw adverse Growth – Inflation tradeoff developing in EM this year.
- However, we reversed this call recently as we see a potential change in Chinese policy stance in particular, from tightening towards being more market friendly

### EM vs DM valuations



Source: Datastream, MSCI

### EM vs DM equity performance



Source: Datastream, MSCI

# OW Europe vs the US

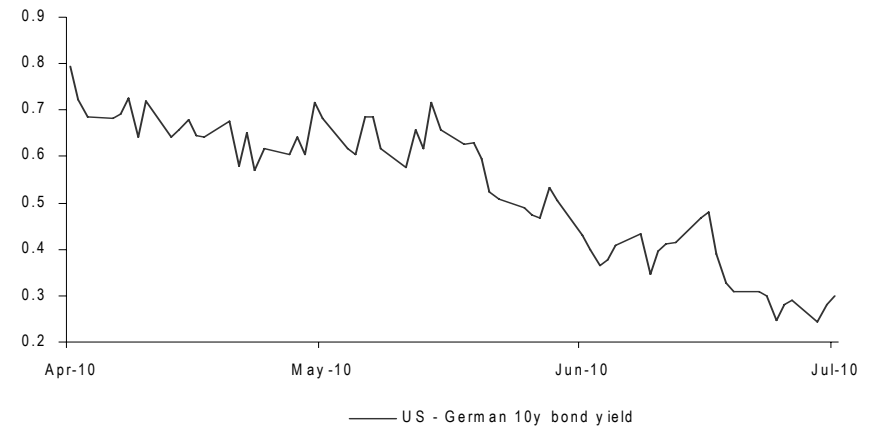
- We prefer European equities vs the US as we view them as under owned and relatively attractively priced
- In addition, European macro backdrop is proving to be rather resilient and interbank market stress is easing

## Europe vs US valuations

Market	Europe			US		
	12m Fwd P/E	P/Book	Div Yield	12m Fwd P/E	P/Book	Div Yield
Market	10.8	1.5	3.6%	12.2	1.9	2.2%
Energy	8.3	1.3	5.4%	10.4	1.7	2.3%
Chemicals	13.5	2.1	2.8%	14.3	2.8	2.6%
Construction Materials	11.7	1.0	2.8%	37.2	1.7	2.1%
Metals & Mining	8.4	1.5	1.5%	10.7	2.0	1.3%
Capital Goods	13.2	2.1	2.4%	13.7	2.2	2.3%
Transport	14.9	1.6	2.4%	15.2	2.6	2.1%
Automobile	11.7	1.0	0.8%	10.3	6.1	0.7%
Consumer Durables	17.3	2.9	1.5%	14.0	2.1	2.1%
Media	12.1	2.0	4.4%	14.1	1.7	1.6%
Retailing	14.6	2.6	3.5%	13.7	2.5	1.5%
Hotels, Restaurants & Leisure	13.5	2.3	3.4%	17.4	3.4	2.2%
Food & Drug Retailing	12.3	1.9	3.2%	12.1	2.0	2.1%
Food Beverage & Tobacco	14.4	3.4	2.8%	13.4	3.6	3.8%
Household Products	17.1	3.7	2.3%	15.0	3.4	3.1%
Healthcare	9.9	2.9	3.7%	10.5	2.2	2.3%
Banks	10.9	0.8	3.2%	13.5	1.1	1.2%
Diversified Financials	9.1	1.0	2.4%	10.4	0.9	0.8%
Insurance	8.3	0.9	4.7%	9.3	1.0	1.8%
Real Estate	15.8	0.9	3.5%	34.2	1.9	4.7%
Software and Services	15.5	3.2	1.5%	12.8	3.7	1.2%
Technology Hardware	12.9	1.9	3.7%	12.7	2.9	0.4%
Semicon & Semicon Equip	13.7	2.3	0.9%	10.5	2.6	2.3%
Telecoms	10.0	1.4	6.5%	15.6	1.7	5.7%
Utilities	10.4	1.3	6.2%	12.2	1.3	4.6%

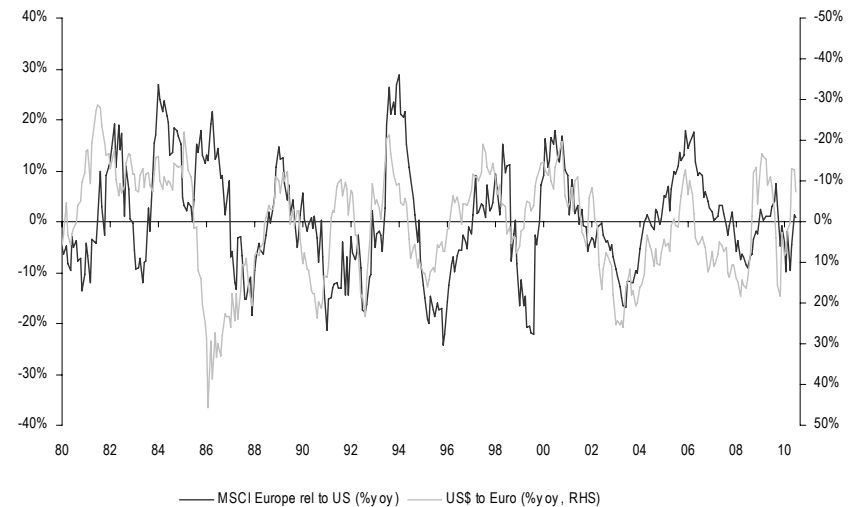
Source: Datastream, MSCI, IBES up to 28<sup>th</sup> July

## Europe vs US vs Bond Yields spread



Source: Datastream

## European vs US equities and EUR/USD



Source: Datastream



# Within Europe, reducing our preference for Dax vs Eurostoxx

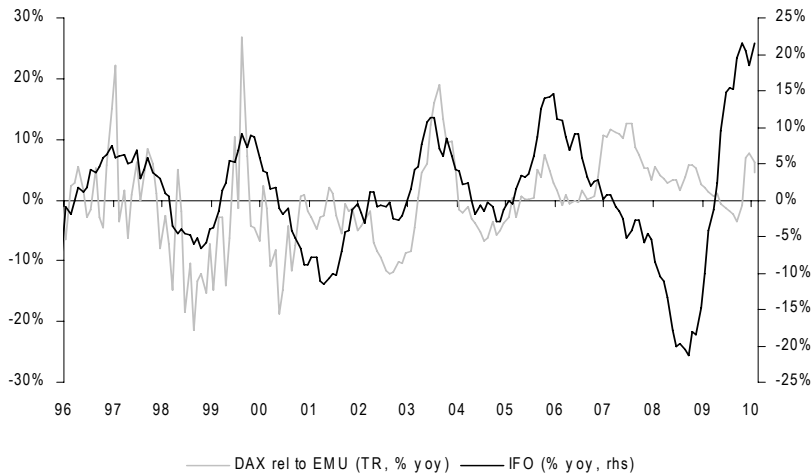
- German equities strongly outperformed the rest of Europe this year. We think that this will continue on a two-year view, but also that it is a crowded trade in the short term, and could suffer some reversals

## 2008 Chinese and German total exports

	2008 exports (US\$ trillion)
China	1.58
Germany	1.56

Source: Datastream

## Dax vs Euro zone and IFO



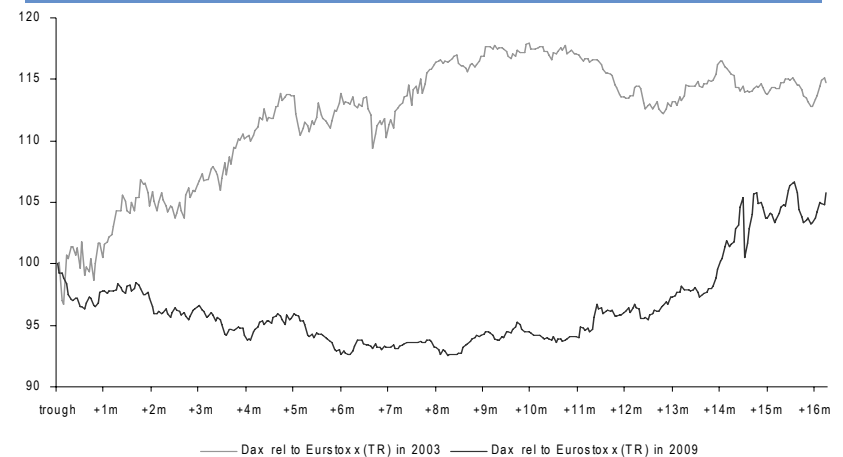
Source: Datastream

## Cyclically-adjusted primary budget position (%GDP)

	2009	2010e
Euro area	-1.4	-2.2
Germany	1.5	-1.7
France	-3.3	-4.3
Italy	1.8	1.4
Spain	-8.1	-6.2
Netherlands	-0.7	-1.8
Greece	-7.6	-0.6

Source: J.P. Morgan estimates

## Dax vs Europe, since March '09 and March '03



Source: Datastream, re-based to 100 on 12 March '03 and 09 March '09

## Sector valuations: Europe

### ■ Valuations favour Defensives

European sector valuations vs history															
	12m Fwd P/E			P/book			Cycle-adj P/E			2-year out P/E			12m Fwd P/Sales		
	Last	Median	% to median	Last	Median	% to median	Last	Median	% to median	Last	Median	% to median	Last	Median	% to median
<b>Europe</b>	<b>10.8</b>	<b>13.2</b>	<b>22%</b>	1.6	1.9	18%	14.7	21.2	45%	9.3	12.1	30%	1.1	1.1	0%
Energy	8.4	13.4	60%	1.3	1.5	13%	12.7	18.5	45%	7.2	13.1	83%	0.9	0.9	-4%
Chemicals	13.6	13.7	1%	2.4	1.7	-30%	21.8	17.3	-21%	11.9	12.6	5%	1.1	0.7	-33%
Cons Mat	11.8	11.9	1%	1.4	1.6	13%	12.5	17.3	38%	9.3	10.7	16%	1.0	0.9	-3%
Metals&Mining	8.3	11.3	35%	2.0	1.1	-43%	17.4	16.4	-6%	6.9	10.5	52%	0.8	0.5	-31%
Capital Goods	13.2	13.8	4%	2.1	1.9	-11%	18.1	22.3	23%	11.2	12.2	9%	0.8	0.5	-31%
Transport	14.9	14.1	-6%	2.0	1.6	-16%	17.1	23.1	35%	11.5	12.2	6%	0.6	0.6	5%
Automobile	11.8	11.7	-1%	1.2	1.2	-2%	11.7	12.9	10%	8.8	9.5	7%	0.4	0.4	-11%
Cons Durables	17.3	15.3	-12%	3.1	2.5	-19%	29.0	35.5	23%	14.8	13.2	-11%	1.6	1.2	-27%
Media	12.2	17.6	45%	2.8	2.7	-3%	15.9	28.9	81%	10.7	14.8	38%	1.3	1.6	21%
Retailing	14.6	16.2	11%	2.9	2.6	-10%	20.5	25.0	22%	12.9	14.2	11%	0.7	1.0	34%
Hotels,Rest&Leis	13.7	15.5	13%	1.5	1.5	1%	14.3	22.3	56%	12.2	13.7	12%	0.5	0.6	19%
Food&Drug Ret	12.3	14.9	21%	2.2	2.3	3%	19.3	27.7	44%	11.0	13.5	22%	0.3	0.3	17%
Food Bev&Tob	14.4	15.1	4%	2.9	2.1	-28%	24.5	22.5	-8%	13.3	13.8	4%	1.2	1.1	-10%
HPC	17.0	21.1	24%	2.9	2.1	-26%	22.5	22.2	-1%	15.6	19.1	22%	2.2	1.9	-11%
Healthcare	9.9	17.5	77%	3.0	2.8	-8%	19.1	27.0	41%	9.7	15.8	63%	2.1	2.7	27%
Banks	10.9	11.3	4%	1.1	1.2	11%	9.3	15.0	61%	8.0	10.1	26%	1.6	2.8	73%
Insurance	8.3	11.4	38%	1.1	1.8	64%	9.6	36.2	276%	7.1	10.8	53%	0.5	0.7	56%
Real Estate	15.9	20.5	29%	1.0	1.0	-7%	12.9	29.6	129%	14.1	19.3	37%	8.3	8.0	-3%
Software&Svs	15.7	25.8	64%	2.7	3.8	39%	26.5	35.7	35%	14.2	20.8	47%	1.7	2.5	49%
TechHardware	13.1	17.9	37%	2.0	2.2	12%	10.3	24.1	134%	11.1	15.7	41%	1.1	1.5	32%
Semicon	13.6	20.3	50%	3.0	2.4	-20%	27.7	25.3	-9%	11.6	17.5	51%	1.5	2.2	42%
Telecoms	10.0	14.2	42%	1.8	1.8	4%	16.0	22.7	41%	9.2	12.5	37%	1.3	1.5	8%
Utilities	10.4	13.4	28%	1.4	1.5	5%	15.7	21.1	34%	9.6	12.4	29%	0.8	1.3	70%
<b>Cyclicals</b>	<b>12.5</b>	<b>14.8</b>	<b>18%</b>	<b>2.1</b>	<b>1.7</b>	<b>-16%</b>	<b>17.6</b>	<b>20.5</b>	<b>17%</b>	<b>10.4</b>	<b>12.8</b>	<b>23%</b>	<b>0.8</b>	<b>0.7</b>	<b>-8%</b>
<b>Defensives</b>	<b>11.6</b>	<b>15.2</b>	<b>31%</b>	<b>2.4</b>	<b>2.2</b>	<b>-9%</b>	<b>19.3</b>	<b>24.8</b>	<b>28%</b>	<b>10.7</b>	<b>13.8</b>	<b>29%</b>	<b>1.4</b>	<b>1.4</b>	<b>-1%</b>
<b>Cyc. vs Def.</b>	<b>1.08</b>	<b>0.97</b>	<b>-13%</b>	<b>0.9</b>	<b>0.8</b>	<b>-7%</b>	<b>0.9</b>	<b>0.8</b>	<b>-11%</b>	<b>1.0</b>	<b>0.9</b>	<b>-6%</b>	<b>0.6</b>	<b>0.5</b>	<b>-6%</b>

Source: Datastream, MSCI, IBES. At cob 27<sup>th</sup> July 2010, 12m Fwd P/E and two-year out P/E since 1995, Cycle-adjusted P/E since 1983, P/Book since 1980, P/Sales since 2000

# Sector valuations: UK

## ■ Valuations favour Defensives

UK sector valuations vs history																
	12m Fwd P/E			P/book			Cycle-adj P/E			2-year out P/E			12m Fwd P/Sales			
	Last	Median	% to median	Last	Median	% to median	Last	Median	% to median	Last	Median	% to median	Last	Median	% to median	
<b>UK</b>	<b>9.9</b>	<b>13.0</b>	<b>31%</b>	<b>1.8</b>	<b>2.0</b>	<b>14%</b>	<b>14.2</b>	<b>19.4</b>	<b>37%</b>	<b>8.5</b>	<b>12.0</b>	<b>41%</b>	<b>1.2</b>	<b>1.3</b>	<b>8%</b>	
Energy	8.1	14.1	75%	1.2	1.4	14%	14.0	19.9	42%	6.8	14.0	105%	1.1	1.3	14%	
Chemicals	15.8	13.4	-15%	3.9	2.1	-47%	29.9	17.8	-40%	12.7	12.0	-5%	0.3	0.4	42%	
Cons Mat	-	11.5	-	1.4	1.6	12%	9.8	17.0	73%	0.0	10.4	-	-	-	-	
Metals&Mining	7.7	12.7	64%	2.7	1.8	-32%	24.1	17.7	-27%	6.5	11.4	75%	2.1	1.6	-26%	
Capital Goods	10.7	12.5	17%	1.9	2.2	13%	13.3	14.7	10%	9.7	11.0	13%	0.7	0.6	-7%	
Transport	12.6	13.7	8%	2.4	2.2	-6%	15.5	22.8	47%	8.4	11.6	38%	0.3	0.5	69%	
Automobile	-	12.8	-	2.3	1.7	-26%	8.5	16.8	97%	0.0	11.2	-	-	-	-	
Cons Durables	20.0	8.6	-57%	5.9	3.8	-35%	51.8	26.0	-50%	16.6	8.2	-51%	2.3	2.4	5%	
Media	13.7	18.6	35%	2.9	2.8	-3%	20.0	26.0	30%	12.0	16.0	34%	1.1	1.4	30%	
Retailing	10.6	14.5	37%	1.9	2.5	33%	12.1	23.9	97%	9.5	12.8	35%	0.5	0.9	85%	
Hotels,Rest&Leis	12.8	14.5	13%	1.3	1.4	1%	15.9	20.8	31%	11.7	12.8	10%	0.6	0.6	10%	
Food&Drug Ret	11.8	14.9	27%	1.8	2.3	22%	21.4	24.3	13%	10.7	13.4	25%	0.4	0.5	25%	
Food Bev&Tob	12.8	13.7	7%	3.1	2.7	-12%	24.1	20.6	-15%	11.9	12.7	7%	2.3	1.2	-47%	
HPC	15.5	18.3	18%	3.3	2.8	-16%	22.1	19.5	-12%	15.0	16.7	11%	2.7	2.1	-20%	
Healthcare	9.1	16.4	82%	5.3	5.6	7%	16.9	24.2	43%	9.1	15.1	65%	2.0	3.4	66%	
Banks	12.2	11.0	-9%	1.0	1.4	34%	6.9	17.0	147%	8.6	10.0	17%	1.5	2.7	74%	
Insurance	7.8	10.7	37%	1.4	1.8	27%	10.3	31.0	200%	6.7	10.3	55%	0.5	0.7	51%	
Real Estate	17.4	22.0	26%	1.0	0.8	-19%	13.7	29.6	115%	15.7	20.5	30%	7.6	7.9	4%	
Software&Svs	15.4	16.3	6%	2.7	2.7	1%	27.4	29.4	7%	14.9	14.6	-2%	4.5	4.7	4%	
TechHardware	-	18.0	-	2.5	3.5	41%	12.0	9.2	-23%	0.0	15.6	-	-	-	-	
Semicon	-	24.9	-	5.9	3.5	-40%	68.1	39.7	-42%	0.0	20.5	-	-	-	-	
Telecoms	9.5	14.3	50%	1.4	2.0	42%	15.8	23.1	46%	9.0	12.9	44%	1.3	2.2	67%	
Utilities	11.6	12.5	8%	3.0	2.4	-21%	17.4	16.2	-7%	10.6	11.4	7%	1.2	1.3	10%	
<b>Cyclicals</b>	<b>9.6</b>	<b>14.0</b>	<b>45%</b>	<b>2.6</b>	<b>2.0</b>	<b>-23%</b>	<b>19.7</b>	<b>22.4</b>	<b>14%</b>	<b>8.9</b>	<b>12.5</b>	<b>40%</b>	<b>1.6</b>	<b>1.5</b>	<b>-8%</b>	
<b>Defensives</b>	<b>10.3</b>	<b>14.5</b>	<b>40%</b>	<b>3.3</b>	<b>3.5</b>	<b>5%</b>	<b>20.4</b>	<b>22.7</b>	<b>11%</b>	<b>10.3</b>	<b>13.1</b>	<b>27%</b>	<b>0.9</b>	<b>1.0</b>	<b>12%</b>	
<b>Cyc. vs Def.</b>	<b>0.93</b>	<b>0.97</b>	<b>6%</b>	<b>0.8</b>	<b>0.6</b>	<b>-28%</b>	<b>0.97</b>	<b>0.99</b>	<b>2%</b>	<b>0.9</b>	<b>1.0</b>	<b>13%</b>	<b>1.8</b>	<b>1.5</b>	<b>-21%</b>	

Source: Datastream, MSCI, IBES. At cob 27<sup>th</sup> July 2010, 12m Fwd P/E and two-year out P/E since 1995, Cycle-adjusted P/E since 1983, P/Book since 1980, P/Sales since 2000

## Stick with Cyclical

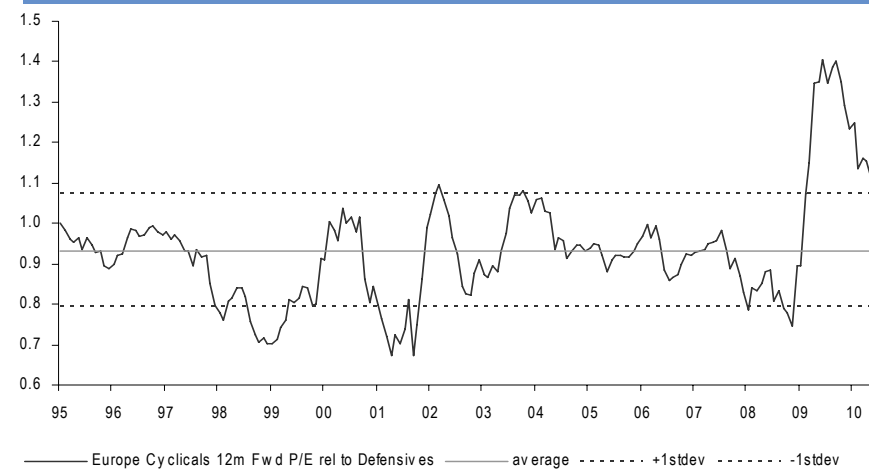
- Cyclical valuations remain elevated compared to Defensives in the historical context, although they have improved significantly vs their most stretched level, seen in September '09.
- While the valuation angle is not outright supportive for Cyclical, we think these will be tolerated as long as EPS momentum is on the clear uptrend.
- For Eurozone only, the 2010 consensus EPS integer for Cyclical has been revised up by 10% ytd, but has been downgraded for Defensives by 1%.

### Cyclicals vs Defensives valuations and performance

	12m Fwd P/E		Performance
	Sep-09	current	Sep-09 to current
Cyclicals	16.6	12.5	9%
Defensives	11.9	11.6	2%
Cyclicals/Defensives	1.40	1.08	6%

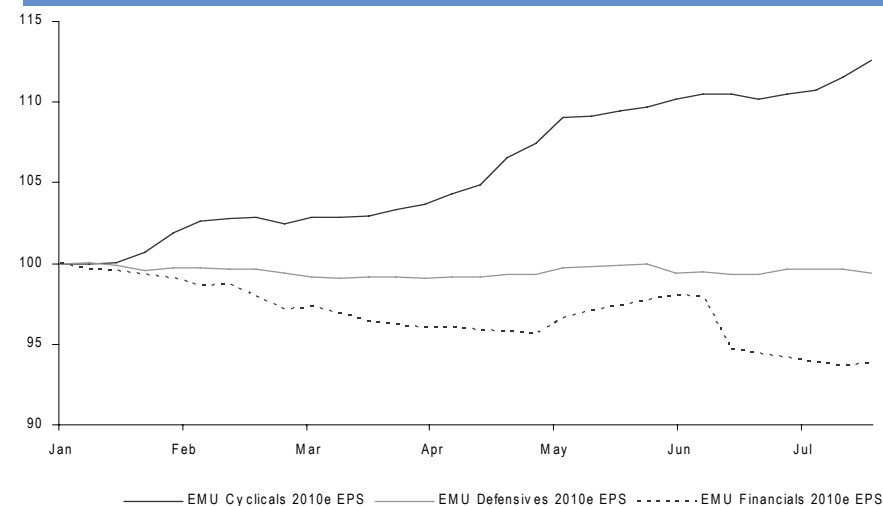
Source: Datastream, MSCI, IBES

### Cyclicals relative to Defensives fwd P/E



Source: Datastream, MSCI, IBES

### 2010 consensus sector EPS estimates



Source: IBES

## Exploring the potential EPS driven upside

- The potential cyclical upside?
- P/E multiples staying put or derating to 04-06 levels
- Assuming various EPS scenarios, Cyclical appear to consistently offer double the upside of Defensives

Potential cyclical upside at sector level								
	current 12m Fwd P/E	2004-06 median 12m Fwd P/E	Price upside assuming				Ytd perf	Perf since Sep-09
			Lowest P/E	12m Fwd EPS as of Jun- 2011	2012e EPS	Past Peak EPS		
<b>Europe</b>	<b>10.8</b>	<b>12.8</b>	<b>11.1</b>	<b>10%</b>	<b>19%</b>	<b>23%</b>	<b>-2.4%</b>	<b>0.4%</b>
Energy	8.3	11.9	8.3	12%	20%	32%	-13.1%	-8.1%
Chemicals	13.5	13.2	13.2	6%	14%	14%	1.8%	14.5%
Cons Mat	11.7	11.5	11.5	18%	35%	140%	-17.4%	-19.7%
Met&Min	8.4	10.3	8.4	13%	20%	22%	-5.9%	11.0%
Cap Goods	13.2	13.5	13.2	11%	21%	21%	7.7%	8.9%
Transport	14.9	13.4	13.4	11%	24%	38%	4.1%	7.3%
Automobile	11.7	9.9	9.9	10%	33%	33%	10.7%	11.5%
Cons Durables	17.3	13.3	13.3	-14%	-7%	-3%	17.7%	29.1%
Media	12.1	15.5	12.1	6%	12%	17%	3.8%	8.7%
Retailing	14.6	13.9	13.9	3%	11%	11%	8.5%	11.0%
Hotels,Rest&Leis	13.5	14.4	13.5	8%	17%	17%	8.4%	11.9%
Food Drug Ret	12.3	14.2	12.3	10%	19%	19%	0.5%	8.6%
Food Bev&Tob	14.4	14.5	14.4	7%	14%	14%	4.9%	15.4%
HPC	17.1	19.7	17.1	6%	13%	13%	2.0%	20.0%
Healthcare	9.9	17.4	9.9	4%	7%	7%	-8.6%	-0.9%
Banks	10.9	10.8	10.8	22%	42%	42%	-2.0%	-8.0%
Div Fin	9.1	11.1	9.1	12%	21%	21%	1.4%	-8.8%
Insurance	8.3	10.6	8.3	9%	15%	15%	-3.8%	-3.2%
Real Estate	15.8	21.7	15.8	3%	5%	5%	-3.8%	-7.5%
Software	15.5	21.7	15.5	10%	19%	19%	8.4%	4.2%
Tech Hardware	12.9	16.8	12.9	17%	27%	87%	-5.8%	-19.0%
Semicon	13.7	23.2	13.7	12%	17%	17%	14.3%	28.0%
Telecoms	10.0	12.5	10.0	3%	6%	11%	-3.6%	-0.7%
Utilities	10.4	13.3	10.4	4%	9%	21%	-12.7%	-11.7%
<b>Cyclicals</b>	<b>12.6</b>	<b>13.4</b>	<b>12.1</b>	<b>9%</b>	<b>19%</b>	<b>26%</b>	<b>3%</b>	<b>9%</b>
<b>Defensives</b>	<b>11.6</b>	<b>14.9</b>	<b>11.6</b>	<b>5%</b>	<b>10%</b>	<b>13%</b>	<b>-4%</b>	<b>2%</b>

Source: Datastream, MSCI, IBES, as at 28<sup>th</sup> July 2010

## Drivers of stock selection: value starting to outperform most recently

- The “low quality” has outperformed in the initial stages of the rally, within all sectors, Cyclical, Defensives and Financials. The initial out-performers can be characterized as the biggest fallers over the past two years, smaller caps, low ROE, low P/B, low P/E, -ve EPS revisions and relatively more leveraged names
- 1H of this year saw EPS momentum and quality as the key factors

### Factors that have worked for European outperformers

2010 Q3	Rel perf	MV weight	ND/Equity	%ch EPS	RoE	P/E	P/Book	Div Yield
Quintile 1	10%	18%	0.26	1%	10%	10.3	0.90	3%
Quintile 2	3%	16%	0.28	1%	12%	12.6	1.17	4%
Quintile 3	-1%	20%	0.41	1%	14%	12.9	1.77	4%
Quintile 4	-4%	21%	0.58	0%	15%	12.2	1.88	3%
Quintile 5	-9%	22%	0.26	0%	16%	13.7	2.10	3%

2010 Q2	Rel perf	MV weight	ND/Equity	%ch EPS	RoE	P/E	P/Book	Div Yield
Quintile 1	20%	17%	0.15	15%	16%	16.6	2.6	2.5%
Quintile 2	11%	23%	0.47	10%	14%	13.9	2.0	3.1%
Quintile 3	4%	18%	0.27	10%	11%	15.1	1.8	3.0%
Quintile 4	-2%	20%	0.56	4%	12%	12.5	1.4	3.9%
Quintile 5	-11%	19%	0.39	2%	10%	12.6	1.3	3.2%

2010 Q1	Rel perf	MV weight	ND/Equity	%ch EPS	RoE	P/E	P/Book	Div Yield
Quintile 1	17%	13%	0.26	10%	12%	14.5	1.8	2.5%
Quintile 2	8%	16%	0.30	7%	13%	15.3	1.9	2.7%
Quintile 3	2%	21%	0.46	5%	13%	14.8	2.0	2.9%
Quintile 4	-3%	29%	0.44	4%	13%	13.8	1.7	3.5%
Quintile 5	-12%	21%	0.44	0%	11%	13.3	1.3	3.4%

2009 Q4	Rel perf	MV weight	ND/Equity	%ch EPS	RoE	P/E	P/Book	Div Yield
Quintile 1	15%	19%	0.36	11%	15%	14.9	2.2	2.8%
Quintile 2	6%	27%	0.51	5%	14%	13.1	1.9	3.5%
Quintile 3	0%	23%	0.54	4%	13%	14.7	1.8	3.1%
Quintile 4	-7%	15%	0.42	1%	11%	13.7	1.3	3.1%
Quintile 5	-16%	14%	0.40	0%	9%	13.4	1.2	2.8%

2009 Q3	Rel perf	MV weight	ND/Equity	%ch EPS	RoE	P/E	P/Book	Div Yield
Quintile 1	22%	14%	0.41	2%	8%	10.9	0.9	3.0%
Quintile 2	7%	17%	0.31	1%	10%	12.1	1.2	3.1%
Quintile 3	0%	22%	0.67	3%	13%	12.6	1.7	3.5%
Quintile 4	-7%	24%	0.48	0%	14%	12.8	1.9	3.6%
Quintile 5	-17%	22%	0.42	-3%	16%	11.8	1.8	4.0%

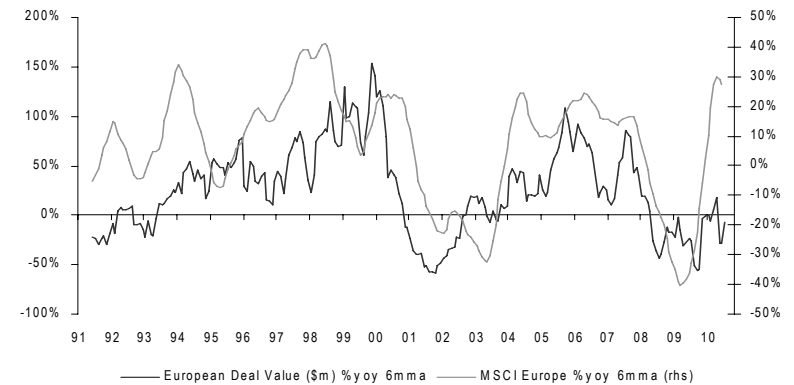
2009 Q2	Rel perf	MV weight	ND/Equity	%ch EPS	RoE	P/E	P/Book	Div Yield
Quintile 1	34%	13%	0.49	-9%	9%	7.1	0.6	4.5%
Quintile 2	14%	13%	0.33	-4%	11%	9.8	1.0	4.2%
Quintile 3	4%	24%	0.60	-4%	14%	10.6	1.5	4.4%
Quintile 4	-4%	22%	0.43	-2%	14%	10.1	1.5	4.4%
Quintile 5	-13%	29%	0.42	0%	14%	10.5	1.4	5.1%

Source: J.P. Morgan, MSCI, IBES, performance relative to sector, data is 12 months forward IBES estimates 54

## 2010 Theme: M&A activity to pick up

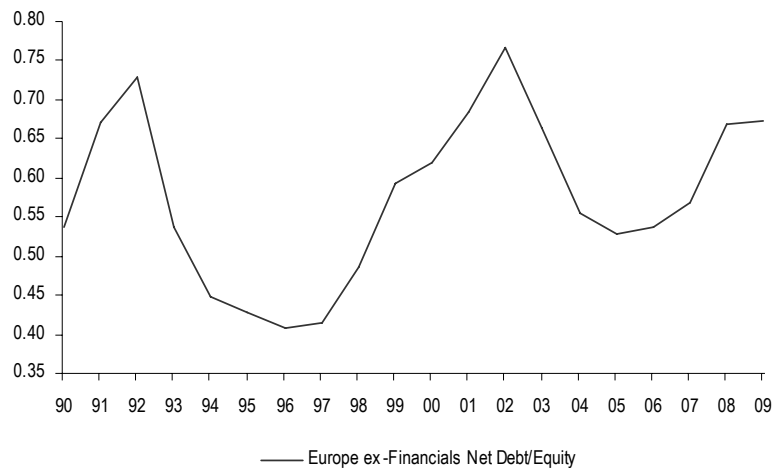
- Corporates are in a strong position (16% of market cap in cash, stronger profit margins and lower leverage than at the similar stage of the past cycle)
- Cost of financing is near record low
- Valuations and FX favour European targets (and UK vs continent) in cross-border deals
- Improving equity market leads to M&A

### M&A activity vs equity performance



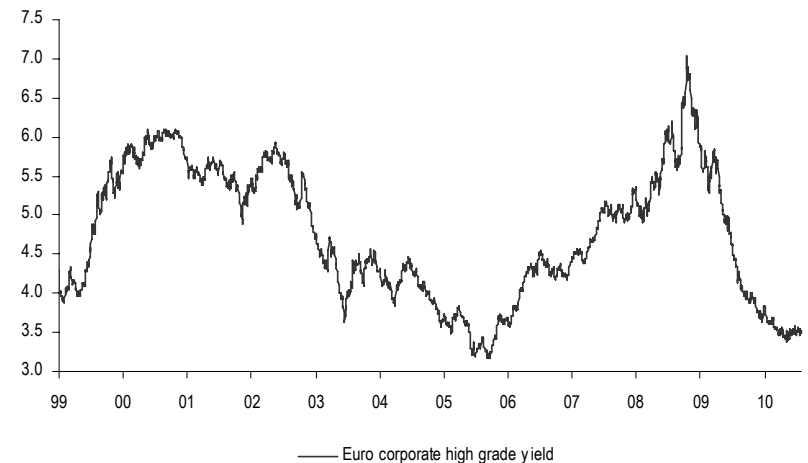
Source: Datastream, MSCI, Bloomberg

### European net debt to equity



Source: Worldscope

### Euro area corporate high grade yield\*

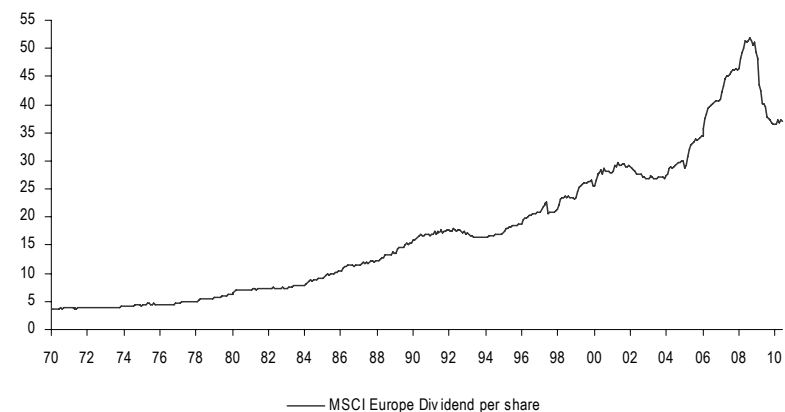


Source: J.P. Morgan, \* all maturities

## 2010 Theme: Dividends to start growing again

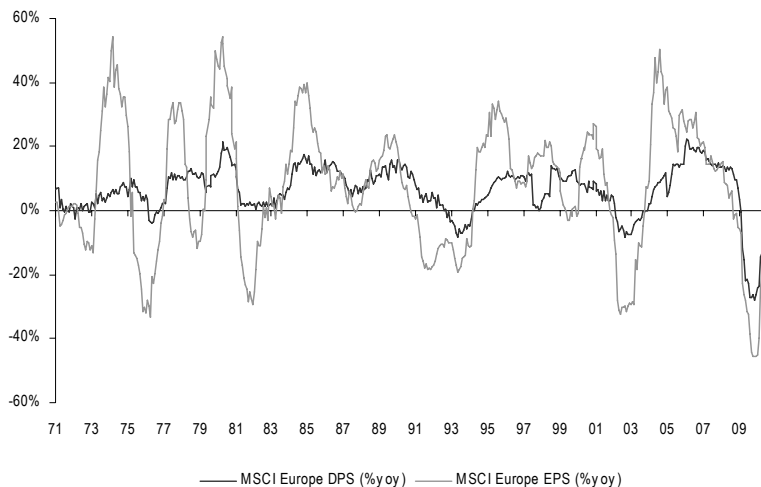
- Corporate balance sheets are in a strong position
- The earnings cycle is on the up and has historically been coincident with the dividend cycle
- Financials sector profitability is picking up
- We advise positioning in areas where dividends are likely to grow the most, i.e. Cyclical and Financials

### MSCI Europe dividend per share



Source: Datastream, MSCI

### European EPS and DPS growth



Source: Datastream, MSCI

### Dividend upside potential at sector level

	Payout ratio		2012e DPS upside
	04-'07 average	2012e	
Europe	43.8%	41.5%	5.7%
Energy	37.1%	40.5%	-
Materials	33.6%	26.4%	27.3%
Industrials	40.3%	37.9%	6.5%
Discretionary	41.9%	39.9%	4.9%
Staples	44.2%	46.3%	-
Health Care	42.1%	44.4%	-
Financials	45.3%	36.8%	23.0%
IT	37.9%	33.2%	14.1%
Telecoms	61.2%	71.4%	-
Utilities	58.1%	61.1%	-

Source: IBES



# Top Picks

Name	Ticker	Price	YTD perf	Rating	JPM view
<b>Energy</b>					
BP	BP/LN	413.5 £	-31%	OW	Q2 results in line with consensus with strong cash generation. The stock is underpriced in our view since the peer adjusted loss in market value exceeds our worst case liability estimate by more than 15Bn \$.
BG Group	BG/LN	1,013.0 £	-10%	OW	We remain overweight ahead of 3 key triggers i) public certification of Brazilian pre-salt resource ii) resolution to the 'tax dispute' with Khazak govt iii) development sanction for QC LNG by year end 2010.
Statoil	STL/NO	126.0 NK	-13%	N	Strong oil price leverage and benefits from currency safe haven status (i.e. stronger Krona rather than Euro). Positive catalysts are continued exploration successes in NCS & recovery in European gas demand.
TOTAL	FP/FP	38.4 E	-15%	N	Total appears poised to deliver strong production growth in 2010 and the recovery in its downstream earnings is also a plus.
<b>Materials</b>					
ArcelorMittal	MT/NA	23.7 E	-26%	OW	Steel price momentum to underpin margins on 3Q. MT remains top pick given its operating leverage to rising steel prices and its competitive advantage in raw materials.
Rio Tinto	RIO/LN	3,355.0 £	-1%	OW	Rio Tinto remains compelling from a cashflow and valuation perspective, in our view, with free cashflow yield expected to exceed 16% based on our forecasts in FY 2011 and PER of 5.3x, reflecting under pricing by the market.
Xstrata	XTA/LN	1,032.0 £	-8%	OW	We expect Xstrata to continue best performance amongst big four based on exposure to favored commodities, best in class operational management and a strong growth pipeline.
Anglo American	AAL/LN	2,541.0 £	-6%	OW	The story still has some way to run at this stage. We expect platinum business to move down the cost curve. The self-help theory also still has legs with operational performance likely to be strong through H2.
<b>Industrials</b>					
Siemens	SIE/GR	74.4 E	16%	OW	We remain overweight on Siemens on a combination of attractive relative valuations and good earnings momentum. Relative to consensus, our PBT is still 7% ahead of Bloomberg average.
Schneider	SU/FP	86.4 E	6%	OW	Superior top-line growth potential based on an improved portfolio, higher EM exposure and ~30% exposure to late cyclicals should support growth relative to the sector in H2 2011 and beyond.
BAE Systems	BA/LN	320.1 £	-11%	OW	Growth drivers to start to re-emerge with strong sales in Programmes (Eurofighter and JFS) and International (Saudi Exports) to become more visible. EPS has held better than feared and we consider Rating to be the key for perf.
Man	MAN/GR	70.1 E	29%	OW	Significant improvement in the intrinsic business model, reduction of fixed costs, and improvement in commercial vehicles margins and sales performance are the core reasons to remain overweight on MAN.
Philips	PHIA/NA	23.4 E	13%	N	Strong growth from Q1 has continued into Q2. Near term expectations on earnings for Philips have risen materially but the company seems to be on track to deliver while the valuations remain undemanding.
<b>Discretionary</b>					
Daimler	DAI/GR	41.4 E	11%	OW	Truck margins seem to be on an upward trend markets, also new line of efficient engines in Mercedes could lead to a better price/mix and a positive surprise from Mercedes
LVMH	MC/FP	92.1 E	17%	OW	LVMH has the potential to post significant growth on tougher comps than peers with a strong operating leverage. Also the possibility of cash utilization at year-end could support the stock
Intercontinental Hotels	IHG/LN	1,107.0 £	24%	OW	Upbeat comments at NYU lodging conference, likely to be replicated in the forthcoming Q2 reporting season. Further impressive evidence on Holiday Inn re-launch is an important tailwind in the recovery of hotel cycle
ITV	ITV/LN	53.6 £	2%	N	Good strategy on digital channels with ITV2,3 & 4. Largest cost cutting guidance in media, UK advertising market to recover in '10 and grow by 4.3% leading to increased revenues in TV
JCDecaux	DEC/FP	19.9 E	17%	OW	JCDecaux remains top preference because of the structural growth potential of the outdoor industry, exposure to Emerging Markets, and growth due to contracts won in 08 & 09
<b>Staples</b>					
Anheuser Busch Inbev	ABI/BB	40.9 E	12%	OW	Long term value, multiple positive medium and long term catalysts for ABI. Capacity to exceed AB cost synergies target to 2.25Bn\$ from ZBB, headcount reduction & procurement.
Carrefour	CA/FP	35.0 E	4%	NA	
BAT	BATS/LN	2,197.0 £	9%	OW	The background to the industry remains extremely supportive. Innovation and mix improvements remain at the heart of the strategy rather than just volumes growth. Clear scope for a higher PE multiple in due course
Givaudan	GIN/VX	961.5 SF	16%	OW	Topline momentum to continue. Strong 1H'10 to lay ground for upgrades. With high teens EPS growth and a potential cash return, we think Givaudan's superior fundamentals deserve a premium rating
Nestle	NESN/VX	51.7 SF	3%	OW	Q1 sales bodes well for Nestle to sustain volume growth and EBIT margins expansion. Nestle is top pick amongst pan-European Food Producers since it is better placed to pass on the rising raw material costs in 2H'10
<b>Healthcare</b>					
Roche	ROG/VX	136.3 SF	-22%	OW	Strong sales performance across the board. Solid underlying growth of continuing business should put to rest concerns about a significant slowdown in the sales growth.
Novartis	NOVN/VX	51.0 SF	-10%	OW	Recent approval for Sandoz Generic in US to have positive impact. Novartis has a strong pipeline with several potential blockbuster candidates and the long term outlook remains underappreciated by the market.
Astrazeneca	AZN/LN	3,289.0 £	13%	N	Strong Q2 numbers, 5% upgrade to FY'10 EPS guidance, increase to the share buyback (though widely speculated) and positive Brilinta FDA AdCom could drive the share price up in our view.
<b>Financials</b>					
Credit Suisse	CSGN/VX	47.7 SF	-7%	OW	Continues to tick the right boxes: i) attractive business mix ii) strong capital position iii) less impact from IB regulatory proposals than peers iv) excellent and stable management team
BNP Paribas	BNP/FP	53.4 E	-4%	OW	In our view, BNP Paribas is well positioned for growth, remaining a counterparty of choice with strong cash flow generation and high gearing to a recovery in the credit cycle.
UniCredit	UCG/IM	2.2 E	-4%	OW	Shift from balance sheet repair to earnings progression. After significant decline in the stock price following sovereign risk concerns, UCG now trades at 0.7x P/NAV11E, we remain overweight especially on valuation.
Societe Generale	GLE/FP	44.7 E	-9%	OW	The group posted solid set of results with a better earnings mix, valuation is hugely supportive in our view. Also considering the ongoing provisioning improvement, Soc Gen can generate E8 per share in the long term in our view.
BBVA	BBVA/SM	10.5 E	-18%	N	BBVA is a solid option with Europe given its i) above average profitability ii) solid capital position highlighted in Bank of Spain's stress test iii) attractive international exposure through Mexico/Latam.
HSBC	HSBA/LN	656.3 £	-7%	OW	Cyclical & Structural optimism remains. Our basic premise of Cyclical recovery & structural uplift remain in place, also expected swing in earnings from lower provisions due to run-off and improvement of HFC.
Swiss Re	RUKN/VX	48.0 SF	-4%	OW	We see return to an AA- level rating in 2011 as a major catalyst. Also, We think the 37% discount to book value and 7% discount to NAV are simply too wide, we reiterate our OW rating
Ageas	AGS/BB	2.2 E	-17%	OW	Ageas remains ver undervalued in our opinion at 60% of BV. There are numerous areas of conservatism in the Ageas book value, and there is significant excess capital. We also note that the book value is highly tangible (no DAC)
Barclays	BARC/LN	334.1 £	21%	N	Trading on 0.8x 2011E P/NAV Barclays remains our favorite domestic UK bank. We believe BarCap will remain the main earnings driver.
<b>IT</b>					
Alcatel Lucent	ALU/FP	2.1 E	-13%	OW	Strong gross margins development, improved pension funding status, EBIT margins ahead of expectations, application and enterprise margin stronger than expected and services segment was also strong
ASML	ASML/NA	24.5 E	2%	OW	The company reported 17.5% qoq growth in 2Q and a guidance of 10% qoq gr in 3Q'10. With the under-capacity in DRAM & overall lack of capacity in semi market unlikely to end in 2H10, we remain Overweight on ASML
SAP	SAP/GR	35.5 E	7%	OW	2Q results solid, guidance more confident. Software & rel Svcs are expected to grow at 6-8% with management optimistic that customers continue to invest for growth. We remain OW on the cyclical growth story.
<b>Telecoms</b>					
Vodafone	VOD/LN	150.5 £	5%	OW	Macro driven recovery should support evolutionary improvements in growth. Further, scope for higher dividend payments on the back of better FCF guidance. We continue to see hidden value within Vodafone's portfolio.
KPN	KPN/NA	10.6 E	-10%	OW	Cost cutting and shareholder returns remain best in class. Operational leverage could offer medium term upside. Post April jitters, KPN will emerge with its core attractions (earnings growth, s/holder returns, valuation)
Telenor	TEL/NO	93.0 NK	15%	OW	Q2 results were mixed, but guidance upgrade and buyback announcements are positives along with cheap valuations make the stock an OW in our view
<b>Utilities</b>					
Centrica	CNA/LN	306.7 £	9%	OW	Centrica remains our top pick in UK Utilities, which has cleanest generation fleet in the UK and a fast growing energy services business.

Source: Datastream, MSCI, IBES, J.P. Morgan, Prices and Valuations as of COB 29<sup>th</sup> July, 2010

Please see the most recent company-specific research published by J.P. Morgan for an analysis of valuation methodology and risks on companies recommended in this report. Research is available at <http://www.morganmarkets.com>, or you can contact the covering analyst or your J.P. Morgan representative

# Stocks that derated the most since recent peak, despite +ve EPS trend intact

MSCI Eurozone and UK stocks with the biggest P/E de-rating since 15<sup>th</sup> April to 28<sup>th</sup> June

Stock	Country	Sector	Fall in 12 Mth Fwd PE since Mkt Peak	Price move since Mkt Peak	12 Mth Fwd EPS move since Mkt Peak	Stock	Country	Sector	Fall in 12 Mth Fwd PE since Mkt Peak	Price move since Mkt Peak	12 Mth Fwd EPS move since Mkt Peak
RESOLUTION	UK	FINANCIALS	-84%	-22%	22%	PIRELLI	ITALY	DISCRETIONARY	-91%	10%	11%
LONMIN	UK	MATERIALS	-38%	-26%	24%	GROUPE EUROTUNNEL	FRANCE	INDUSTRIALS	-55%	-25%	50%
TULLOW OIL	UK	ENERGY	-35%	-3%	48%	DEUTSCHE LUFTHANSA (XET)	GERMANY	INDUSTRIALS	-50%	-4%	87%
ITV	UK	DISCRETIONARY	-32%	-22%	24%	STMICROELECTRONICS (PAR)	FRANCE	IT	-47%	-18%	52%
THOMAS COOK GROUP	UK	DISCRETIONARY	-29%	-30%	3%	UPM-KYMMENE	FINLAND	MATERIALS	-41%	5%	87%
VEDANTA RESOURCES	UK	MATERIALS	-29%	-12%	21%	CIE.GL.DE GPHYQ.-VERT.	FRANCE	ENERGY	-39%	-32%	13%
EURASIAN NATRES.CORP.	UK	MATERIALS	-25%	-26%	3%	DAIMLER (XET)	GERMANY	DISCRETIONARY	-38%	13%	87%
CABLE & WIRELESS WWD.	UK	TELECOMS	-25%	-26%	0%	IBERIA	SPAIN	INDUSTRIALS	-35%	-2%	67%
WOLSELEY	UK	INDUSTRIALS	-24%	-7%	22%	ACERINOX 'R'	SPAIN	MATERIALS	-34%	-12%	34%
RIO TINTO	UK	MATERIALS	-23%	-14%	16%	ARCELORMITTAL	FRANCE	MATERIALS	-33%	-29%	4%
PRUDENTIAL	UK	FINANCIALS	-22%	-5%	24%	RAUTARUUKKI 'K'	FINLAND	MATERIALS	-33%	-11%	35%
ANGLO AMERICAN	UK	MATERIALS	-22%	-14%	13%	RENAULT	FRANCE	DISCRETIONARY	-32%	-1%	44%
KAZAKHMYS	UK	MATERIALS	-20%	-23%	0%	TF1 (TV.FSE.1)	FRANCE	DISCRETIONARY	-31%	-14%	34%
BHP BILLITON	UK	MATERIALS	-20%	-12%	12%	AEGON	NETHERLANDS	FINANCIALS	-30%	-13%	21%
SMITH & NEPHEW	UK	HEALTH CARE	-19%	-21%	1%	RAIFFEISEN INTL.BK.HLDG.	AUSTRIA	FINANCIALS	-30%	-6%	34%
HOME RETAIL GROUP	UK	DISCRETIONARY	-19%	-17%	0%	GAMESA CORPN.TEGC.	SPAIN	INDUSTRIALS	-29%	-29%	0%
LONDON STOCK EX.GROUP	UK	FINANCIALS	-18%	-14%	1%	ERAMET	FRANCE	MATERIALS	-29%	-21%	10%
XSTRATA	UK	MATERIALS	-18%	-19%	3%	SBM OFFSHORE	NETHERLANDS	ENERGY	-29%	-24%	3%
SCHRODERS	UK	FINANCIALS	-17%	-10%	6%	IPSEN	FRANCE	HEALTH CARE	-29%	-30%	1%
ROYAL DUTCH SHELL B	UK	ENERGY	-17%	-11%	11%	TELECINCO	SPAIN	DISCRETIONARY	-29%	-18%	13%
BALFOUR BEATTY	UK	INDUSTRIALS	-16%	-17%	1%	OUTOKUMPU 'A'	FINLAND	MATERIALS	-28%	-22%	9%
RECKITT BENCKISER GROUP	UK	STAPLES	-16%	-9%	6%	NESTE OIL	FINLAND	ENERGY	-28%	-11%	24%
BAE SYSTEMS	UK	INDUSTRIALS	-15%	-16%	0%	BMW (XET)	GERMANY	DISCRETIONARY	-28%	15%	64%
ROYAL DUTCH SHELL A(LON)	UK	ENERGY	-14%	-10%	8%	HOCHTIEF (XET)	GERMANY	INDUSTRIALS	-28%	-21%	6%
BRITISH LAND	UK	FINANCIALS	-14%	-3%	10%	EXOR ORD	ITALY	FINANCIALS	-27%	10%	57%
CARNIVAL	UK	DISCRETIONARY	-14%	-14%	3%	ASML HOLDING	NETHERLANDS	IT	-27%	-5%	28%
COBHAM	UK	INDUSTRIALS	-14%	-13%	1%	UMICORE	BELGIUM	MATERIALS	-26%	-4%	31%
WHITBREAD	UK	DISCRETIONARY	-14%	-9%	8%	MEDIASET	ITALY	DISCRETIONARY	-26%	-21%	6%
TESCO	UK	STAPLES	-13%	-11%	2%	SOCIETE GENERALE	FRANCE	FINANCIALS	-26%	-3%	11%
HSBC HDG. (ORD \$0.50)	UK	FINANCIALS	-13%	-7%	12%	OMV	AUSTRIA	ENERGY	-26%	-15%	12%
INVESTEC	UK	FINANCIALS	-13%	-8%	8%	BANCO COMR.PORTUGUES 'R'	PORTUGAL	FINANCIALS	-25%	-17%	0%
BG GROUP	UK	ENERGY	-13%	-10%	3%	VEOLIA ENVIRONNEMENT	FRANCE	UTILITIES	-25%	-22%	1%
LAND SECURITIES GROUP	UK	FINANCIALS	-13%	-9%	2%	AGEAS (EX-FORTIS)	BELGIUM	FINANCIALS	-25%	-21%	6%
GLAXOSMITHKLINE	UK	HEALTH CARE	-12%	-11%	1%	INFINEON TECHS. (XET)	GERMANY	IT	-24%	-1%	32%
JOHNSON MATTHEY	UK	MATERIALS	-12%	-3%	8%	VOESTALPINE	AUSTRIA	MATERIALS	-24%	-20%	12%
MARKS & SPENCER GROUP	UK	DISCRETIONARY	-12%	-8%	5%	QIAGEN (XET)	GERMANY	HEALTH CARE	-24%	-20%	4%
KINGFISHER	UK	DISCRETIONARY	-11%	-7%	4%	RED ELECTRICA CORPN.	SPAIN	UTILITIES	-23%	-16%	5%
NEXT	UK	DISCRETIONARY	-11%	-5%	6%	TECHNIP	FRANCE	ENERGY	-22%	-18%	7%
SERCO GROUP	UK	INDUSTRIALS	-11%	-11%	3%	JCDECAUX	FRANCE	DISCRETIONARY	-22%	-9%	19%
MORRISON(WM)SPMKTS.	UK	STAPLES	-11%	-9%	2%	PHILIPS ELTN.KONINKLIJKE	NETHERLANDS	INDUSTRIALS	-21%	-3%	25%

Source: Datastream, MSCI, IBES

## European stocks: US\$ exposure

- We advise to position portfolios for USD strength and positive DM growth surprise

### European stocks with >30% revenues US\$ denominated

Name	Ticker	Sector	% US\$ sales	Name	Ticker	Sector	% US\$ sales
DELHAIZE	DELB BB	CONSUMER STAPLES	72%	BAE SYSTEMS	BA/ LN	INDUSTRIALS	39%
FRESENIUS MED.CARE	FME GR	HEALTH CARE	71%	ROCHE HOLDINGS GSH.	ROG VX	HEALTH CARE	40%
TOMKINS	TOMK LN	INDUSTRIALS	65%	ASSA ABLOY 'B'	ASSAB SS	INDUSTRIALS	39%
PEARSON	PSON LN	CONSUMER DISCRETIONARY	64%	SAGE GROUP	SGE LN	INFORMATION TECHNOLOGY	39%
SYNTHESE	SYST VX	HEALTH CARE	64%	UBS 'R'	UBSN VX	FINANCIALS	38%
AHOLD KON.	AH NA	CONSUMER STAPLES	60%	NOBEL BIOCARE	NOBE VX	HEALTH CARE	37%
SMITHS GROUP	SMIN LN	INDUSTRIALS	59%	INVENSYS	ISYS LN	INDUSTRIALS	36%
ICTL.HTLS.GP.	IHG LN	CONSUMER DISCRETIONARY	54%	ROLLS-ROYCE GROUP	RR/ LN	INDUSTRIALS	36%
ASTRAZENECA	AZN LN	HEALTH CARE	51%	SYNGENTA	SYNN VX	MATERIALS	36%
DAIMLER (XET)	DAI GR	CONSUMER DISCRETIONARY	50%	BP	BP/ LN	ENERGY	36%
NATIONAL GRID	NG/ LN	UTILITIES	58%	PORSCHE PREF. (XET)	POR3 GR	CONSUMER DISCRETIONARY	35%
SMITH & NEPHEW	SN/ LN	HEALTH CARE	49%	SANOFI-AVENTIS	SAN FP	HEALTH CARE	35%
NOVARTIS 'R'	NOVN VX	HEALTH CARE	48%	MICHELIN	ML FP	CONSUMER DISCRETIONARY	35%
UNITED BUSINESS MEDIA	UBM LN	CONSUMER DISCRETIONARY	48%	ELECTROLUX 'B'	ELUXB SS	CONSUMER DISCRETIONARY	34%
GLAXOSMITHKLINE	GSK LN	HEALTH CARE	47%	IMPERIAL CHM.INDS.	ICI LN	MATERIALS	33%
HUSQVARNA 'B'	HUSQB SS	CONSUMER DISCRETIONARY	47%	ACERINOX 'R'	ACX SM	MATERIALS	33%
WOLTERS KLUWER	WLSNC NA	CONSUMER DISCRETIONARY	46%	ADIDAS (XET)	ADS GR	CONSUMER DISCRETIONARY	33%
COBHAM	COB LN	INDUSTRIALS	46%	NOVO NORDISK 'B'	NOVOB DC	HEALTH CARE	32%
UCB	UCB BB	HEALTH CARE	46%	GIVAUDAN 'N'	GIVN VX	MATERIALS	31%
AEGON	AGN NA	FINANCIALS	45%	SWEDISH MATCH	SWMA SS	CONSUMER STAPLES	31%
SWISS RE 'R'	RUKN VX	FINANCIALS	45%	DIAGEO	DGE LN	CONSUMER STAPLES	31%
CRH	CRH ID	MATERIALS	45%	DASSAULT SYSTEMES	DSY FP	INFORMATION TECHNOLOGY	31%
CINTRA	CIN SM	INDUSTRIALS	45%	NESTLE 'R'	NESN VX	CONSUMER STAPLES	30%
PUBLICIS GROUPE	PUB FP	CONSUMER DISCRETIONARY	42%	LAFARGE	LG FP	MATERIALS	30%
CREDIT SUISSE 'R'	CSGN VX	FINANCIALS	42%	SSAB 'A'	SSABA SS	MATERIALS	30%
ZODIAC	ZC FP	INDUSTRIALS	42%	IBERIA	IBLA SM	INDUSTRIALS	30%
TATE & LYLE	TATE LN	CONSUMER STAPLES	40%	INTERNATIONAL POWER	IPR LN	UTILITIES	30%

Source: Datastream, Worldscope, Bloomberg

## European stocks correlation to bond yields

- Cyclical sectors display the highest positive correlation to bond yields, as long as they are moving up for the “right reasons”

### European sectors correl to 10Y bond yields

	US 10y BDY	German 10y BDY
<b>Cyclicals</b>	<b>0.58</b>	<b>0.60</b>
Discretionary	0.33	0.13
Industrials	0.46	0.52
IT	0.19	0.22
Materials	0.35	0.48
<b>Defensives</b>	<b>-0.62</b>	<b>-0.55</b>
Staples	-0.48	-0.36
Healthcare	-0.46	-0.45
Telecom	-0.18	-0.22
Utilities	-0.53	-0.37
<b>Cyclicals vs Defensives</b>	<b>0.69</b>	<b>0.66</b>
Financials	0.17	0.05
Energy	-0.07	0.00

Source: Datastream, MSCI, since 1995

### Stocks + correlation with bond yields

Industrials	Correl to 10Y Bdy	Materials	Correl to 10Y Bdy
ALFA LAVAL	0.67	WACKER CHEMIE	0.63
PRYSMIAN	0.61	EURASIAN NATRES.	0.62
SANDVIK	0.52	THYSSENKRUPP	0.6
RENEWABLE ENERGY	0.51	LONMIN	0.54
GAMESA	0.49	SSAB 'A'	0.53
SKF 'B'	0.47	SSAB 'B'	0.52
SIEMENS (XET)	0.46	XSTRATA	0.51
MAN (XET)	0.46	ANGLO AMERICAN	0.5
ABB 'R'	0.45	BHP BILLITON	0.48
VESTAS WINDSYSTEMS	0.43	ANTOFAGASTA	0.48
ADP	0.43	VEDANTA	0.48
GEA GROUP	0.4	OUTOKUMPU	0.47
INVENSYS	0.4	VOESTALPINE	0.44
ATLAS COPCO	0.38	NORSK HYDRO	0.41
ADECCO	0.38	FRESNILLO	0.4
ATLAS COPCO	0.37	JOHNSON MATTHEY	0.4
PHILIPS	0.35	ERAMET	0.4
SCANIA 'B'	0.33	RIO TINTO	0.39
SCHNEIDER ELECTRIC	0.32	KAZAKHMYS	0.37
HOCHTIEF	0.32	UMICORE	0.35
METSO	0.32	HOLCIM 'R'	0.31
VOLVO	0.31	STORA ENSO	0.3
KONE	0.3	HEIDELBERGCEMENT	0.3
		ARCELORMITTAL	0.3
		RAUTARUUKKI	0.3
		AKZO NOBEL	0.3
<b>Discretionary</b>	<b>Correl to 10Y Bdy</b>	<b>Tech</b>	<b>Correl to 10Y Bdy</b>
THE SWATCH GROUP	0.47	ASML HOLDING	0.33
CHRISTIAN DIOR	0.46	STMICROELECTRONICS	0.32
LVMH	0.42		
HUSQVARNA	0.39		
BURBERRY GROUP	0.34		
FIAT	0.33		
ICTL.HTLS.GP.	0.3		

Source: Datastream, MSCI, since 1995

## European stocks: operational leverage screen

- We screen for the cyclical stocks that suffered the largest derating this year, display low leverage and high ROE

### Operational leverage screen

Name	Sector	Ytd PE Change	Ytd EPS Change	Operational Leverage	ND Equity	RoE
RIO TINTO	MATERIALS	-55%	93%	1.4	0.0	22%
BHP BILLITON	MATERIALS	-51%	72%	1.5	0.0	32%
TELECINCO	CONSUMER DISC	-43%	43%	2.1	0.1	36%
KAZAKHMYS	MATERIALS	-42%	25%	1.5	0.1	17%
ANTOFAGASTA	MATERIALS	-41%	34%	1.5	-0.3	21%
EURASIAN NATRES.COR	MATERIALS	-33%	38%	1.4	-0.1	21%
ACTELION	HEALTH CARE	-32%	3%	1.8	-0.7	23%
K + S (XET)	MATERIALS	-31%	39%	2.3	0.1	21%
TOMKINS	INDUSTRIALS	-29%	60%	1.4	0.0	18%
ZARDOYA OTIS	INDUSTRIALS	-23%	6%	1.4	-0.4	90%
SKANSKA 'B'	INDUSTRIALS	-20%	18%	1.8	-0.5	15%
NOVARTIS 'R'	HEALTH CARE	-19%	11%	1.1	0.2	18%
STRAUMANN HLDG.	HEALTH CARE	-16%	1%	1.6	-0.5	22%
INVENSYS	INDUSTRIALS	-16%	12%	1.2	-0.8	33%
SHIRE	HEALTH CARE	-15%	27%	1.3	-0.1	26%
GEBERIT 'R'	INDUSTRIALS	-15%	11%	1.1	-0.3	24%
ABB 'R'	INDUSTRIALS	-14%	13%	1.7	-0.5	18%
M6-METROPOLE TV	CONSUMER DISC	-14%	10%	2.0	-0.4	20%
ALFA LAVAL	INDUSTRIALS	-14%	22%	1.8	-0.1	22%
BAE SYSTEMS	INDUSTRIALS	-12%	5%	1.1	-0.1	28%
ELECTROLUX 'B'	CONSUMER DISC	-11%	20%	1.8	-0.1	20%
BEIERSDORF (XET)	CONSUMER STAP	-11%	10%	3.2	-0.6	17%
INDITEX	CONSUMER DISC	-10%	17%	7.2	-0.6	26%
BIOMERIEUX	HEALTH CARE	-9%	11%	1.2	-0.1	18%
PUMA RUDOLF DASSLER	CONSUMER DISC	-8%	7%	3.3	-0.4	17%
WACKER CHEMIE (XET)	MATERIALS	-7%	9%	3.8	0.1	18%
BALFOUR BEATTY	INDUSTRIALS	-7%	2%	1.1	-0.3	18%
SONOVA N	HEALTH CARE	-6%	11%	8.6	-0.1	23%
L'OREAL	CONSUMER STAP	-6%	12%	3.1	0.0	16%
SIKA 'B'	MATERIALS	-5%	29%	2.7	0.0	18%
NOKIAN RENKAAT	CONSUMER DISC	-4%	29%	1.5	0.1	17%
NESTLE 'R'	CONSUMER STAP	-4%	9%	1.2	0.0	20%
HENNES & MAURITZ 'B'	CONSUMER DISC	-4%	14%	2.0	-0.6	41%
HERMES INTL.	CONSUMER DISC	-4%	17%	4.3	-0.3	18%
ICAP	FINANCIALS	-3%	1%	1.5	0.0	18%
KONE 'B'	INDUSTRIALS	-2%	18%	2.6	-0.5	31%
LVMH	CONSUMER DISC	-1%	21%	2.9	0.1	16%

Source: Datastream, MSCI, IBES

# MSCI Europe constituents that showed largest EPS upgrades in the past month

## European stocks that showed outright EPS upgrades in the past month

Name	Mkt Cap (E)	12 Mth Fwd PE	Ytd Perf (%)	YTD EPS Ch(%)	-1m Price Perf (%)	-1m Chg in 12 Mth Fwd EPS (%)	Name	Mkt Cap (E)	12 Mth Fwd PE	Ytd Perf (%)	YTD EPS Ch(%)	-1m Price Perf (%)	-1m Chg in 12 Mth Fwd EPS (%)
ORKLA	6,583.9	11.05	-7%	-3%	15%	104%	VOLKSWAGEN PREF. (XET)	13,371.5	13.70	20%	46%	3%	8%
ROYAL BANK OF SCTL.GP.	34,600.5	36.91	82%	-	13%	100%	ALFA LAVAL	5,014.0	15.18	23%	40%	9%	8%
RENEWABLE ENERGY	2,266.9	29.13	-50%	-60%	4%	60%	NESTE OIL	3,158.9	12.52	-1%	35%	-1%	8%
PEUGEOT	5,583.2	9.03	1%	-	7%	50%	TOMKINS	3,426.1	13.84	79%	100%	32%	8%
GROUPE EUROTUNNEL	2,671.9	194.69	-14%	-	-5%	50%	WARTSILA	4,054.3	14.75	46%	19%	6%	8%
ALCATEL-LUCENT	4,868.0	30.68	-12%	-50%	-7%	40%	LVMH	45,396.8	17.52	18%	29%	-1%	7%
DEUTSCHE LUFTHANSA (XET)	5,859.3	20.79	9%	729%	7%	35%	HOLMEN 'B'	1,205.2	19.00	9%	14%	-4%	7%
COMMERZBANK (XET)	8,165.5	18.03	17%	-	15%	35%	MAN (XET)	10,289.7	17.04	34%	61%	5%	7%
BRITISH AIRWAYS	3,046.2	34.62	26%	-	3%	33%	TELE2 'B'	5,683.1	11.26	25%	38%	9%	7%
SWEDBANK 'A'	8,141.7	14.57	23%	-	8%	31%	HERMES INTL.	13,565.7	34.32	38%	25%	16%	7%
STORA ENSO 'R'	3,851.9	10.29	29%	154%	1%	30%	CIMENTOS DE PORTL.SGSPS	3,138.9	10.64	-27%	7%	2%	7%
SCANIA 'B'	5,679.9	13.48	58%	209%	9%	30%	SKF 'B'	6,027.7	11.91	22%	60%	-3%	7%
IBERIA	2,489.5	56.17	38%	400%	4%	25%	JCDECAUX	4,372.3	24.83	16%	116%	-2%	7%
VOLVO 'B'	13,871.8	15.00	59%	364%	1%	25%	THALES	5,363.7	11.13	-25%	-20%	-2%	7%
BMW (XET)	24,532.3	11.50	28%	128%	-1%	24%	SCA 'B'	6,739.8	10.98	20%	20%	13%	6%
DAIMLER (XET)	44,001.9	10.98	11%	147%	-4%	23%	TULLOW OIL	13,683.4	44.37	5%	113%	17%	6%
TUI (XET)	2,071.4	15.08	42%	-	8%	23%	SCHNEIDER ELECTRIC	23,587.0	13.53	7%	37%	0%	6%
RAUTARUUKKI 'K'	2,108.5	17.19	-7%	105%	17%	22%	EDP RENOVAVEIS	4,099.8	26.71	-29%	-5%	-6%	6%
ITV	2,490.2	11.60	8%	200%	-2%	20%	UNICREDIT	41,534.0	11.62	-4%	20%	11%	6%
LLOYDS BANKING GROUP	56,660.2	14.02	46%	-	22%	20%	KONE 'B'	7,945.3	17.74	19%	25%	6%	6%
SEB 'A'	11,433.3	14.06	22%	227%	16%	20%	WACKER CHEMIE (XET)	7,019.8	14.79	10%	14%	8%	6%
FIAT	10,720.4	16.66	-4%	51%	9%	18%	AGEAS (EX-FORTIS)	5,506.4	11.47	-17%	-5%	13%	6%
BANCO COMR.PORTUGUES 'R'	3,253.4	8.98	-18%	0%	9%	17%	SIEMENS (XET)	69,616.4	12.40	19%	44%	0%	5%
A P MOLLER - MAERSK 'B'	14,357.5	11.57	33%	191%	-3%	14%	BUREAU VERITAS	5,085.5	16.54	28%	15%	2%	5%
SANDVIK	11,773.9	14.13	18%	126%	-6%	13%	HUSQVARNA 'B'	2,310.0	13.96	3%	22%	2%	5%
UPM-KYMMENE	5,797.7	15.63	34%	92%	0%	13%	RANDGOLD RESOURCES	6,182.4	29.74	21%	68%	-15%	5%
INVESTOR 'B'	6,587.8	52.82	11%	125%	6%	13%	ADIDAS (XET)	8,667.8	15.09	10%	17%	1%	5%
CONTINENTAL (XET)	9,729.3	10.83	33%	118%	10%	12%	TERNA	6,363.6	15.61	6%	18%	6%	5%
ASML HOLDING	10,611.7	10.77	3%	113%	3%	12%	STMICROELECTRONICS (PAR)	5,766.0	10.28	-1%	307%	-7%	5%
RESOLUTION	4,196.7	6.95	-26%	290%	1%	11%	MODERN TIMES GP.MTG 'B'	2,813.0	15.91	37%	48%	2%	5%
TF1 (TV.FSE.1)	2,673.0	17.80	-3%	163%	11%	11%	PIRELLI	2,597.5	13.18	18%	24%	4%	5%
INFINEON TECHS. (XET)	5,631.5	12.63	34%	193%	2%	11%	BIC	2,724.1	13.50	16%	15%	-6%	5%
KESKO 'B'	1,995.1	18.15	29%	41%	8%	11%	NORDEA BANK	30,938.8	12.08	7%	40%	9%	5%
RENAULT	10,252.7	9.38	-4%	583%	7%	10%	DANSKE BANK	12,791.2	10.92	15%	130%	11%	5%
EXOR ORD	2,371.8	19.49	9%	114%	4%	10%	DEXIA	7,069.9	9.08	-10%	-38%	22%	5%
AKZO NOBEL	10,575.5	12.48	-2%	25%	2%	10%	SKANSKA 'B'	5,173.7	15.52	9%	33%	5%	5%
ACERINOX 'R'	3,360.6	13.04	-7%	58%	1%	10%	ADECCO 'R'	7,436.1	17.26	2%	49%	-3%	5%
TELECOM ITALIA	13,340.8	8.47	-8%	9%	6%	9%	STANDARD LIFE	5,487.0	10.70	0%	5%	10%	5%
RAIFFEISEN INTL.BK.HLDG.	5,472.1	9.96	-10%	191%	5%	9%	DSV 'B'	2,796.9	15.08	6%	11%	6%	5%
ATLAS COPCO 'A'	10,689.2	14.75	24%	54%	1%	9%	RANDSTAD HOLDING	6,081.2	16.00	3%	50%	5%	5%

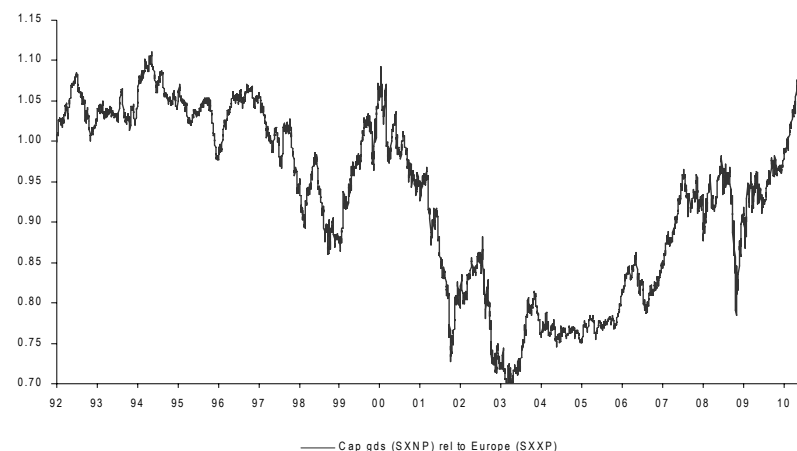
Source: Datastream, IBES, as at 28<sup>th</sup> July 2010

# INDUSTRIALS: NEUTRAL

## Downgraded Capital Goods to N on 27th July

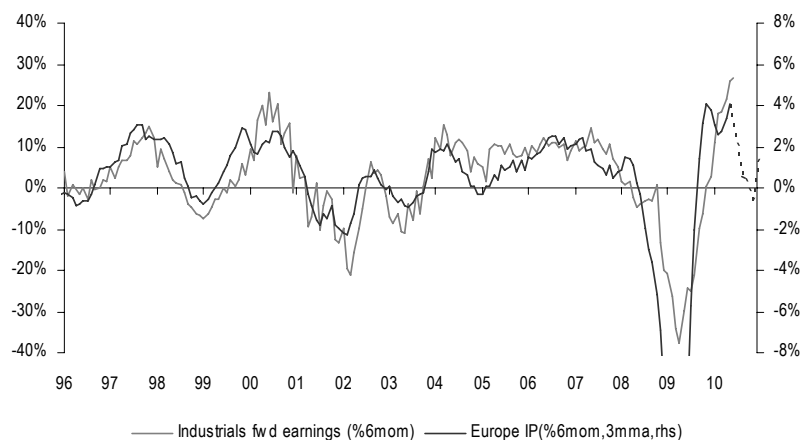
- We closed our long running bullish view on Capital Goods on 27<sup>th</sup> July, having upgraded the sector to OW in Feb '09
- OW Capital goods is the most crowded trade at present and the sector price relative is at 15-year high
- Manufacturing momentum is rolling over and consensus is already implying record high margins for the sector

### Capital Goods relative to Europe



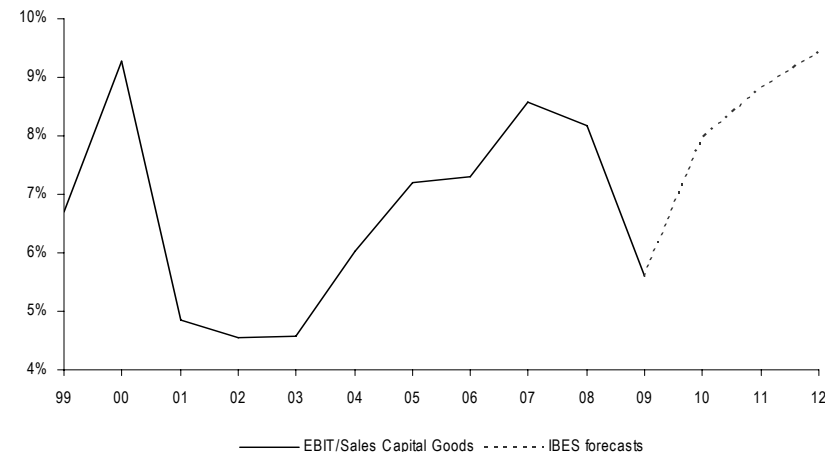
Source: Datastream, J.P. Morgan estimates

### Capital goods EPS momentum vs IP



Source: Datastream, J.P. Morgan estimates

### Capital goods EBIT margins



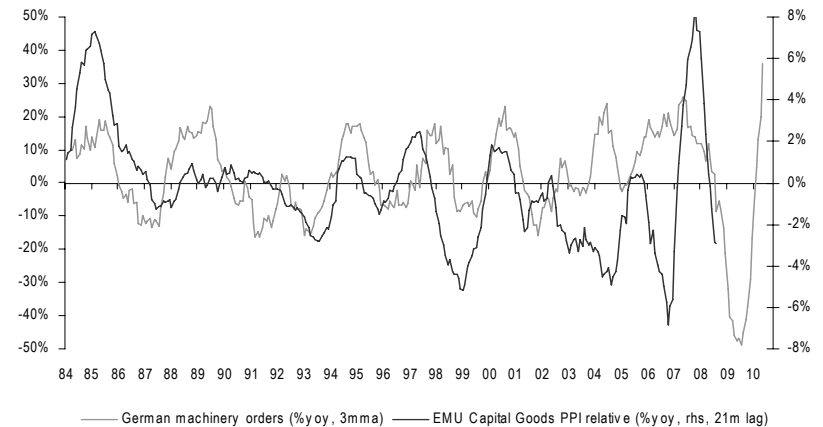
Source: Datastream, IBES

# INDUSTRIALS: NEUTRAL

## Pricing will get weaker, valuations are rich

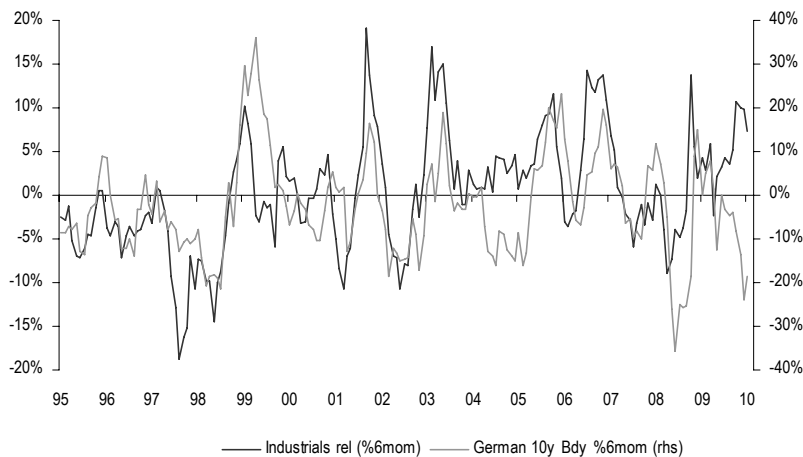
- Pricing lags the activity and is likely to get incrementally worse for Capital Goods
- Capital goods relative performance has decoupled significantly from bond yields
- Stretched valuations have been tolerated for some time, but might be seen as more challenging a hurdle in the backdrop of peaking of macro momentum

Capital goods pricing relative and volume growth



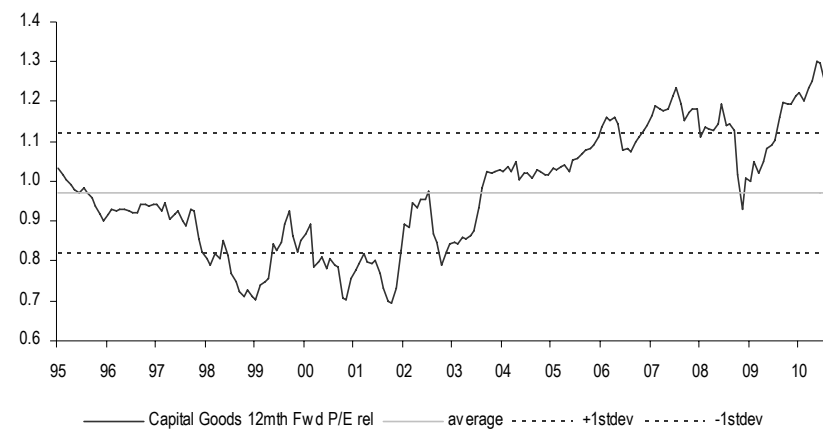
Source: Eurostat

Industrials relative and German 10-year bund yield



Source: Datastream, MSCI

Capital Goods 12m Fwd P/E relative



Source: Datastream, MSCI, IBES

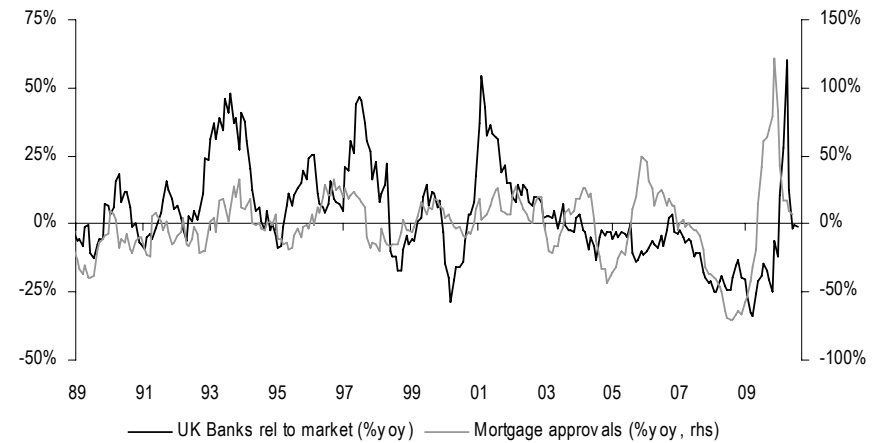


# FINANCIALS: OVERWEIGHT

## Cyclical positives to prevail vs current credit dislocation

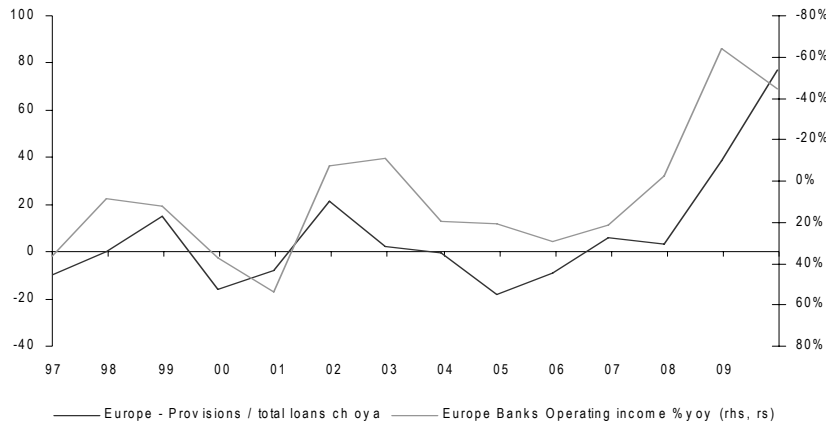
- Sector is still a consensus short, in our view
- Credit cycle at the inflection point
- Regulatory uncertainty is easing

UK banks relative and mortgage applications



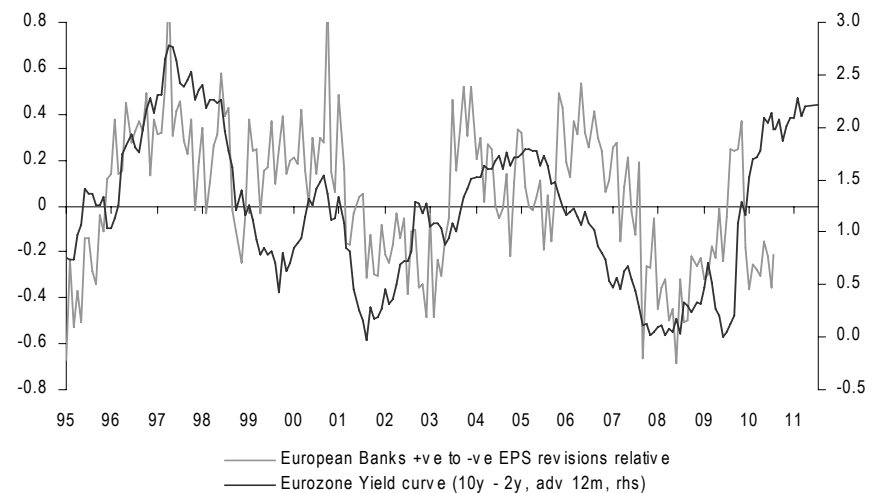
Source: Datastream

European bank provisioning vs profitability



Source: Datastream, Worldscope

European banks EPS revisions vs shape of the yield curve



Source: Datastream, MSCI, IBES

## BANKS: OVERWEIGHT. Pre-provision valuations attractive

### European banks pre-provision P/E and P/Book

	Price/Pre-provision operating profit 2010E	Price/Pre-provision operating profit 2011E	12 Mth Fwd PE	P/Book
<b>UK</b>	<b>3.6</b>	<b>3.4</b>	<b>11.9</b>	<b>1.0</b>
Barclays	3.4	3.1	9.5	0.8
HSBC	2.4	2.2	12.1	1.5
Lloyds TSB	-	-	14.0	1.1
Royal Bank of Scotland	4.9	5.0	-	0.4
<b>France</b>	<b>3.8</b>	<b>3.6</b>	<b>7.2</b>	<b>0.8</b>
BNP Paribas	4.0	3.8	7.7	0.9
CASA	3.7	3.5	6.5	0.6
Societe Generale	3.7	3.3	7.4	0.8
<b>Ireland</b>	<b>0.6</b>	<b>0.7</b>	<b>-</b>	<b>0.1</b>
Allied Irish Banks	0.5	0.7	-	0.1
Bank of Ireland	0.7	0.7	-	0.2
<b>Spain</b>	<b>4.0</b>	<b>4.1</b>	<b>10.9</b>	<b>1.0</b>
Bankinter	5.6	5.9	12.1	1.1
BBVA	3.6	3.4	8.1	1.3
Popular	3.3	3.4	10.6	0.8
Sabadell	5.4	5.7	12.8	1.0
Santander	3.8	3.5	8.9	1.3
Pastor	2.5	3.0	13.0	0.8
<b>Italy</b>	<b>3.5</b>	<b>3.2</b>	<b>10.8</b>	<b>0.5</b>
Intesa Sanpaolo	3.3	2.8	-	0.5
UBI	4.3	3.5	13.1	0.5
Mediobanca	4.7	5.3	9.3	1.0
Montepaschi	3.1	2.8	10.7	0.4
UniCredito	3.7	3.2	11.6	0.6
Banco Popolare	2.3	2.1	10.0	0.3
Banca Popolare di Milano	3.1	2.7	10.1	0.4
<b>Switzerland</b>	<b>7.0</b>	<b>5.7</b>	<b>9.0</b>	<b>1.5</b>
Credit Suisse	6.2	5.5	8.5	1.5
UBS	7.9	5.9	9.4	1.5

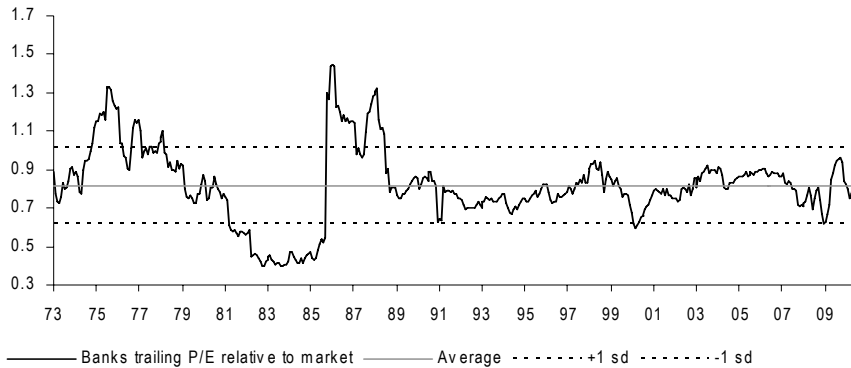
	Price/Pre-provision operating profit 2010E	Price/Pre-provision operating profit 2011E	12 Mth Fwd PE	P/Book
<b>Germany</b>	<b>5.1</b>	<b>3.4</b>	<b>12.3</b>	<b>0.7</b>
Commerzbank	2.8	1.9	18.0	0.3
Deutsche Bank	3.9	3.6	7.1	0.9
Deutsche Postbank	8.6	4.8	11.7	1.0
<b>Nordics</b>	<b>5.7</b>	<b>5.3</b>	<b>12.4</b>	<b>1.1</b>
Danske Bank	4.4	4.2	10.9	0.9
DNB	6.2	6.0	10.0	1.3
SEB	7.9	7.2	14.1	1.1
Swedbank	4.2	3.8	14.6	1.1
<b>CEEMEA</b>	<b>2.6</b>	<b>2.2</b>	<b>9.6</b>	<b>0.9</b>
Erste	3.6	3.2	10.7	1.1
Raiffeisen	2.8	-	10.0	1.0
KBC	1.4	1.3	8.0	0.7
<b>Greece</b>	<b>3.7</b>	<b>3.0</b>	<b>13.1</b>	<b>0.9</b>
Agricultural Bank of Greece	4.3	3.3	-	1.7
Alpha Bank	3.7	2.9	14.5	0.7
Bank of Cyprus	4.6	3.7	7.7	-
Eurobank EFG	2.8	2.6	14.2	0.8
Bank of Piraeus	3.2	2.7	16.0	0.6
<b>Benelux</b>	<b>3.8</b>	<b>3.1</b>	<b>9.1</b>	<b>0.7</b>
Dexia	3.8	3.1	9.1	0.7
<b>Portugal</b>	<b>3.4</b>	<b>3.1</b>	<b>8.7</b>	<b>0.7</b>
BCP	2.8	2.6	9.0	0.6
BES	4.0	3.6	9.2	0.7
BPI	3.3	3.1	7.9	0.8
<b>Europe</b>	<b>3.9</b>	<b>3.5</b>	<b>10.7</b>	<b>0.8</b>

Source: Datastream, J.P. Morgan, prices as at cob 29<sup>th</sup> July, 2010

# BANKS: longer-term context difficult

- Near-term picture more favourable than longer-term one, long term ROE to be muted

European banks P/E relative to the market



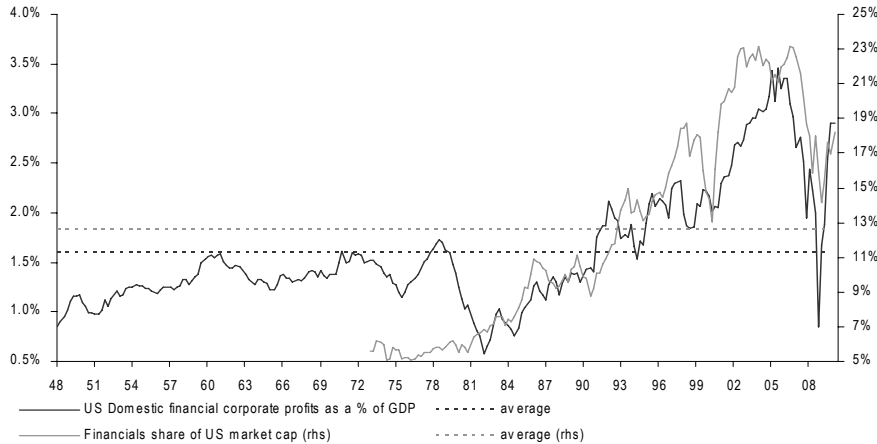
Source: Datastream

European banks P/Book relative to the market



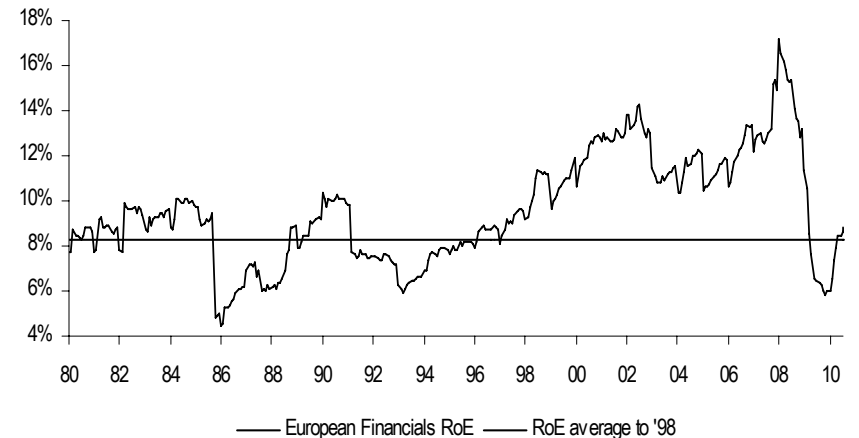
Source: Datastream

US financial corp. profits % GDP vs Financials % market cap



Source: BEA, Datastream

European Financials ROE



Source: Datastream

## Banks: Sovereign risk exposure and sensitivity

- Direct exposure to government bonds/loans for European banks is c. 7% of assets
- Banks with larger holdings of bonds are KBC, NBG and BNP (20%, 16% and 12%)
- Our analysts calculate that for each 100bp decline in government bond values, the sector would potentially see 1% of NAV erosion

### European banks' holdings (€m) of government bonds and NAV sensitivity

	Total	UCG	ISP	BP	UBI	MPS	BPM	MB	Dexia	CBK	BNP	CASA	SG	Danske	DNB Nor	Swed	Nordea
<b>Government securities</b>	<b>1,546,930</b>	<b>50,346</b>	<b>55,531</b>	<b>5,748</b>	<b>4,126</b>	<b>15,935</b>	<b>567</b>	<b>5,383</b>	<b>48,467</b>	<b>63,127</b>	<b>256,178</b>	<b>123,995</b>	<b>59,723</b>	<b>15,542</b>	<b>4,900</b>	<b>9,216</b>	<b>8,349</b>
o.w. domestic			36,650							n.a.				13,677	1,548	7,595	
o.w. Greece		immaterial	1,000			20				3,200	immaterial	850		nd	0		
o.w. other non domestic			17,881							n.a.				1,865	3,352	1,625	
Other Government risk									30,333	20,873							
Other public finance risk		10,713	2,374	41	0	50	0	168	298,989								
<b>Government securities</b>	<b>1,525,347</b>	<b>50,346</b>	<b>55,531</b>	<b>5,748</b>	<b>4,126</b>	<b>15,935</b>	<b>567</b>	<b>5,383</b>	<b>48,467</b>	<b>63,127</b>	<b>256,178</b>	<b>123,995</b>	<b>59,723</b>	<b>15,542</b>	<b>4,900</b>	<b>9,216</b>	<b>8,349</b>
o.w. trading	675,535	20,613	28,820	4,699	450	4,304	79	4,256	1,026	63,127	99,075	43,042	42,035				
o.w. AFS	610,562	21,499	22,815	794	3,676	11,628	488	1,125	46,294	0	143,367	63,365	15,950				
o.w. Held to maturity	69,207	8,234	3,896	255	0	3	0	1	1,147	0	13,736	17,588	1,738				
<b>Gvt bonds as a % of assets</b>	<b>8%</b>	<b>5%</b>	<b>9%</b>	<b>4%</b>	<b>3%</b>	<b>7%</b>	<b>1%</b>	<b>9%</b>	<b>8%</b>	<b>7%</b>	<b>12%</b>	<b>8%</b>	<b>6%</b>	<b>4%</b>	<b>2%</b>	<b>5%</b>	<b>2%</b>
<b>NAV sensitivity to 1% decline in value</b>	<b>2%</b>	<b>1%</b>	<b>2%</b>	<b>1%</b>	<b>1%</b>	<b>1%</b>	<b>0%</b>	<b>1%</b>	<b>4%</b>	<b>8%</b>	<b>4%</b>	<b>4.30%</b>	<b>2%</b>	<b>1%</b>	<b>0%</b>	<b>1%</b>	<b>0%</b>

	SEB	Erste	KBC	NBG	Alpha	EFG	SAN	BBVA	BTO	SAB	POP	BKT	AIB	BKIR	BCP	BES
<b>Government securities</b>	<b>7,896</b>	<b>16,715</b>	<b>69,632</b>	<b>21,500</b>	<b>3,476</b>	<b>12,332</b>	<b>38,200</b>	<b>27,000</b>	<b>6,000</b>	<b>5,000</b>	<b>6,516</b>	<b>2,233</b>	<b>2,783</b>	<b>11,475</b>	<b>4,800</b>	<b>2,660</b>
o.w. domestic	7,195		29,400				24,000	9,000	6,000	1,500	5,662	1,700	749	3,941	n.a.	n.a.
o.w. Greece			1,200	17,900	2,800	6,500	200	0	0	0	0	0	700	0	n.a.	n.a.
o.w. other non domestic	701		29,400	3,600	676	5,832	14,000	18,000	0	3,500	854	533	1,334	7,534	n.a.	n.a.
Other Government risk																
Other public finance risk		5560	9632													
<b>Government securities</b>	<b>7,896</b>	<b>16,715</b>	<b>69,632</b>	<b>17,900</b>	<b>2,800</b>	<b>6,500</b>	<b>38,200</b>	<b>27,000</b>	<b>6,000</b>	<b>5,000</b>	<b>6,516</b>	<b>2,233</b>	<b>2,783</b>	<b>0</b>	<b>4,800</b>	<b>2,660</b>
o.w. trading			8,056	3,000	100	260								0	2,300	0
o.w. AFS			39,439	8,100	100	3,432								0	2,000	1,055
o.w. Held to maturity			10,662	0	2,600	1,391								0	500	1,605
<b>Gvt bonds as a % of assets</b>	<b>3%</b>	<b>8%</b>	<b>20%</b>	<b>16%</b>	<b>4%</b>	<b>8%</b>	<b>3%</b>	<b>5%</b>	<b>5%</b>	<b>6%</b>	<b>5%</b>	<b>4%</b>	<b>10%</b>	<b>0%</b>	<b>5%</b>	<b>3%</b>
<b>NAV sensitivity to 1% decline in value</b>	<b>1%</b>	<b>2%</b>	<b>10%</b>	<b>3%</b>	<b>1%</b>	<b>2%</b>	<b>1%</b>	<b>1%</b>	<b>1%</b>	<b>1%</b>	<b>1%</b>	<b>1%</b>	<b>1%</b>	<b>2%</b>	<b>1%</b>	<b>0%</b>

Source: J.P. Morgan Banks research team, Company reports and J.P. Morgan estimates. \* Split of govt. securities across trading, AFS or HTM portfolios for NBG, Alpha and EFG only includes GGB holdings, as at 30<sup>th</sup> April 2010

## Banks: Potential capital loss in the context of '08 sub-prime crisis

- Immediate debt restructuring unlikely to achieve anything. Credibility needs to be regained first.
- Restructuring of debt further down the line is probable, but the losses might not need to be booked directly by the retail banks=> the “bad” exposures will be offloaded in the meantime to the ECB and the SPV
- Ytd, Eurozone sovereign bonds as an asset class actually appreciated and the ultimate potential loss likely to be far smaller than from the sub-prime crisis

### Banks writedowns and capital raised for subprime

	Writedowns & Credit losses	Capital Raised	New Capital / Losses
Worldwide	1771	1483	84%
Americas	1192	811	68%
Europe	538	537	100%
Asia	41	135	328%

Source: Bloomberg, Billion US\$

### Ytd Investment gains/losses on Govt Bonds

Ytd Investment gains/losses, on Government Bonds (€bn)	
Germany	31
France	29
Netherlands	8
Austria	7
Belgium	6
Finland	2
Italy	1
<b>Gains</b>	<b>84</b>
Ireland	-1
Spain	-3
Portugal	-5
Greece	-41
<b>Losses</b>	<b>-50</b>
<b>Net Gains</b>	<b>34</b>

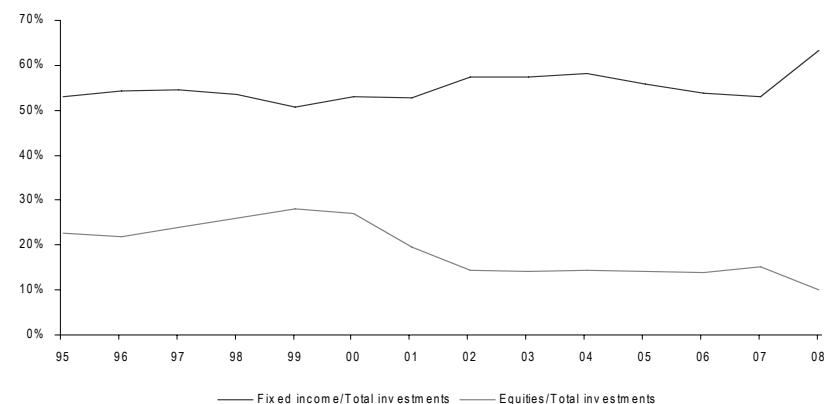
Source: J.P. Morgan Fixed income research, \*based on GBI indices, up to 27<sup>th</sup> July

# INSURANCE: NEUTRAL

## Bonds / Equity exposure

- The sector suffers from the environment of low yields and will be under pressure if/when yields start rising. Insurance is not leveraged to equity upside anymore

### European Insurance investments breakdown



Source: Worldscope, bottom-up aggregated

### Corporate bond gearing

4Q 09 / 1Q 10	Market cap	Corporate bonds on balance sheet	% A-rated or better	%BBB	% sub-inv grade	% N.R.	BBB % market cap	Sub-inv % Market cap	Period
Aegon	8,132	56,215	53%	38%	9%	0%	263%	62%	1Q 10
ING	29,304	69,000	81%	15%	2%	2%	35%	5%	4Q 09
Axa	32,598	146,000	73%	20%	5%	2%	89%	21%	4Q 09
Swiss Re (SFm)	17,808	17,537	51%	43%	4%	2%	42%	4%	1Q 10
Allianz	40,338	98,900	66%	24%	3%	7%	59%	7%	1Q 10
ZFS (\$m)	34,080	51,240	85%	14%	1%	0%	21%	2%	1Q 10
Munich Re	20,915	27,821	69%	26%	1%	4%	35%	1%	1Q 10
Generali	24,240	96,100	88%	9%	1%	2%	36%	4%	4Q 09
Baloise (SFm)	4,170	11,681	94%	5%	1%	1%	14%	3%	4Q 09
Swiss Life (SFm)	3,555	38,288	70%	22%	8%	0%	237%	86%	4Q 09
Aviva £m	10,265	30,234	60%	30%	4%	6%	88%	12%	4Q 09

Source: J.P. Morgan Equity Research Insurance team, Figures are in € million, unless otherwise stated, Mkt cap as on 29<sup>th</sup> July 2010

## Insurance: Sovereign credit exposure

Sovereign credit net exposure															
Shareholder	Equity	Sovereign credit net exposure (local currency, millions)											1+2+3 +4+5	As % SH equity	
		Portugal <sup>1</sup>	Italy <sup>1</sup>	Ireland <sup>3</sup>	Greece <sup>4</sup>	Spain <sup>5</sup>	UK	Germany	France	US	Benelux	Others			Total
Fortis	8,350	1,398	4,055	272	1,855	911	252	762	782	124	3,468	1,333	15,213	8,491	102%
Unipol	3,585	0	1,801	33	15	49	na	na	na	na	na	1,114	3,013	1,899	53%
Generali	16,652	600	6,513	304	749	576	na	2,768	1,449	na	na	3,323	16,282	8,742	52%
Mapfre	6,166	na	na	na	541	2,226	na	na	na	na	na	4,076	6,843	2,766	45%
Delta Lloyd	3,888	na	1,337	na	232	na	na	na	na	na	na	4,478	6,048	1,570	40%
ING	33,863	1,197	4,977	1	1,827	1,890	na	6,741	8,694	4,473	9,765	15,875	55,440	9,892	29%
Allianz	40,166	500	7,600	500	900	1,800	1,300	7,200	4,100	2,800	3,500	6,600	36,800	11,300	28%
SNS Reaal	5,042	na	819	na	149	447	na	2,011	1,713	na	1,564	745	7,448	1,415	28%
Axa	38,829	800	5,200	400	500	3,800	na	na	19,835	3,450	na	45,707	79,692	10,700	28%
Zurich -\$m	29,117	291	4,659	437	168	1,456	5,824	1,747	1,747	6,115	na	6,675	29,120	7,011	24%
Munich Re	22,049	222	1,334	667	667	667	1,334	7,557	1,334	3,334	na	5,112	22,225	3,556	16%
Aegon	8,053	32	80	77	52	999	352	na	na	7,713	6,503	90	15,898	1,240	15%
CNP	11,548	154	438	103	113	241	na	559	2,483	467	na	828	5,386	1,049	9%
Hannover Re	3,712	31	24	105	20	79	501	1,843	595	1,915	114	1,687	6,915	259	7%
Aviva - £m	10,356	140	na	na	70	350	1,877	na	na	2,057	na	7,352	11,846	560	5%
Swiss Life	7,208	26	102	64	38	44	na	na	na	144	na	4,380	4,797	273	4%
Swiss Re	23,201	32	105	134	582	22	8,120	na	na	20,300	na	11,304	40,600	876	4%
SCOR	3,894	na	34	-	-	-	606	281	563	895	50	763	3,193	34	1%

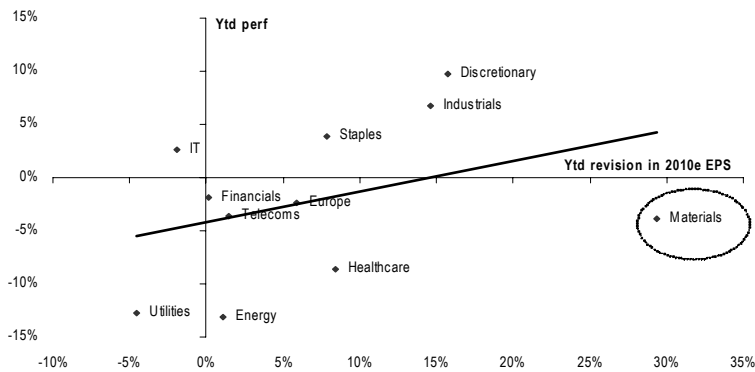
Source: J.P. Morgan Insurance research team, companies report, as at 6th May 2010

# MATERIALS: OVERWEIGHT

Metals & Mining top pick for '09, moved to N for 2010 and upgraded back to OW on 28th May

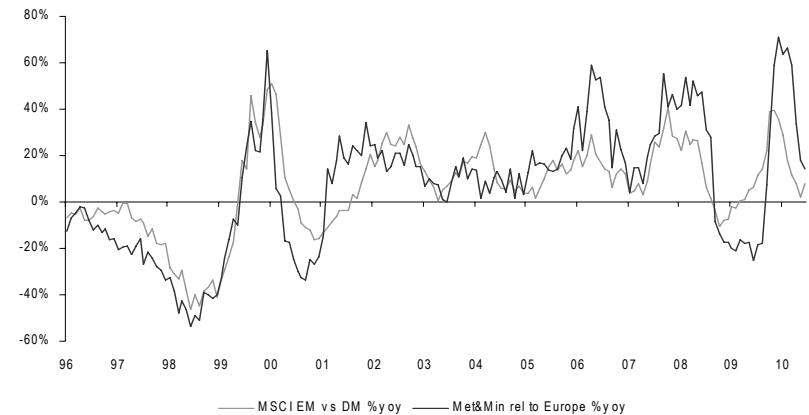
- Mining is the only Cyclical sector underperforming the market ytd
- Chinese inflation to peak in Q3 and to allow policymakers to slow down the tightening process

## Sectors ytd perf vs EPS revisions



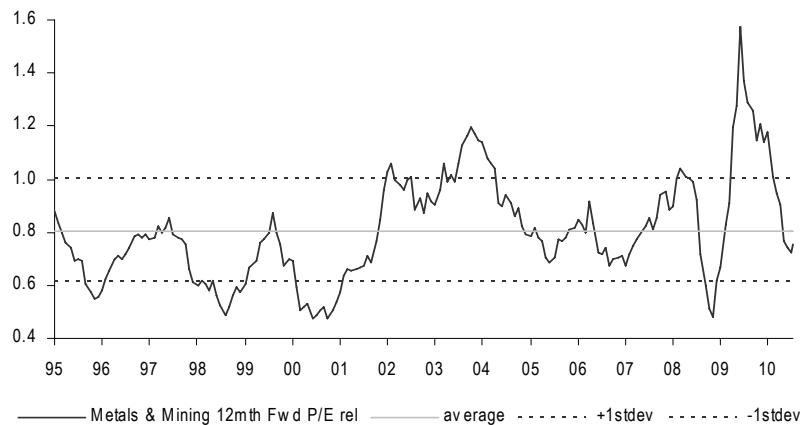
Source: Datastream, MSCI, IBES

## EM relative performance and Mining relative



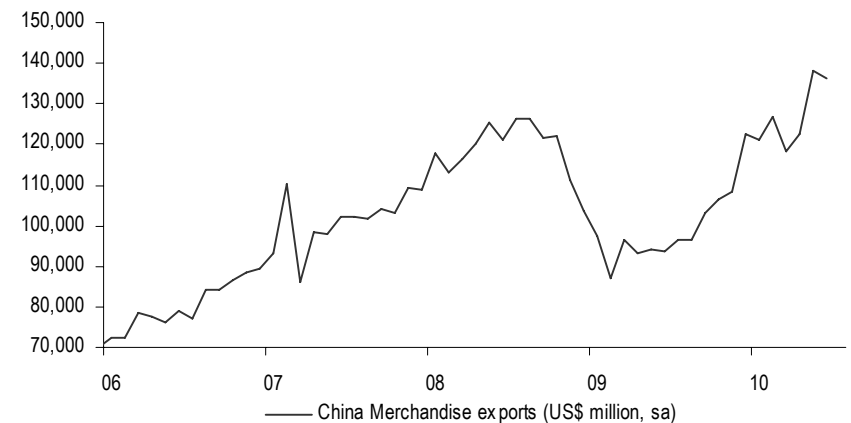
Source: Datastream

## Metals & Mining 12m Fwd P/E rel



Source: Datastream, IBES, MSCI

## China merchandise exports



Source: J.P. Morgan economic research

**J.P.Morgan** CAZENOVE

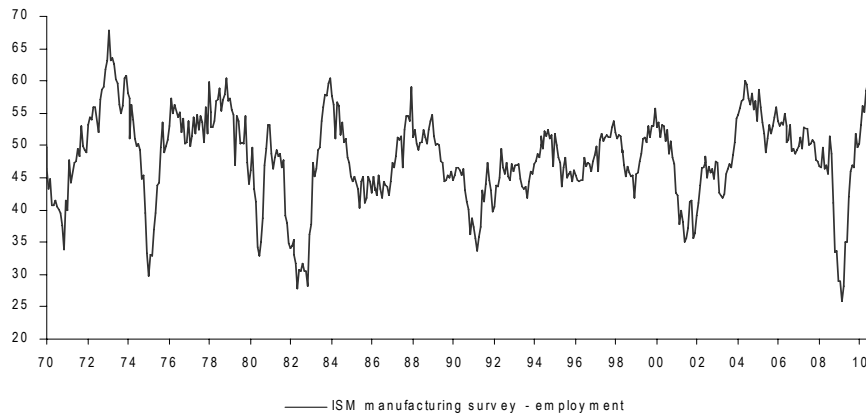


# DISCRETIONARY: OVERWEIGHT

## Labour market is the key

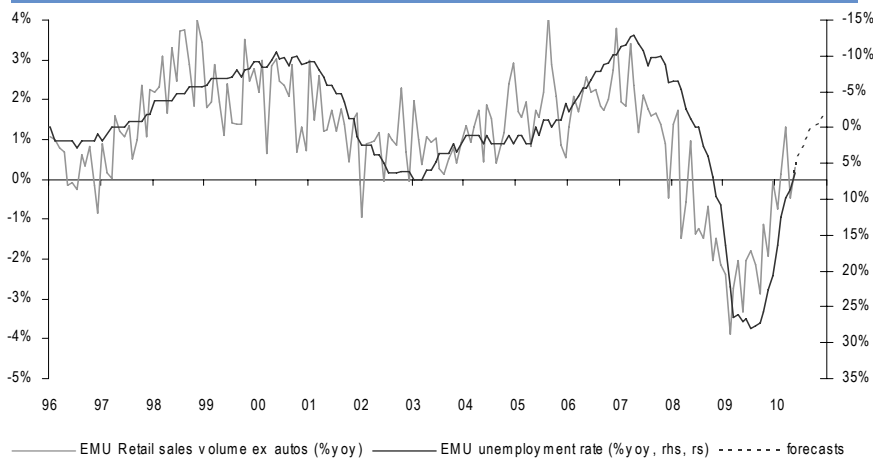
- The stabilisation in labour market and corporate profitability to drive the sector

ISM manufacturing employment



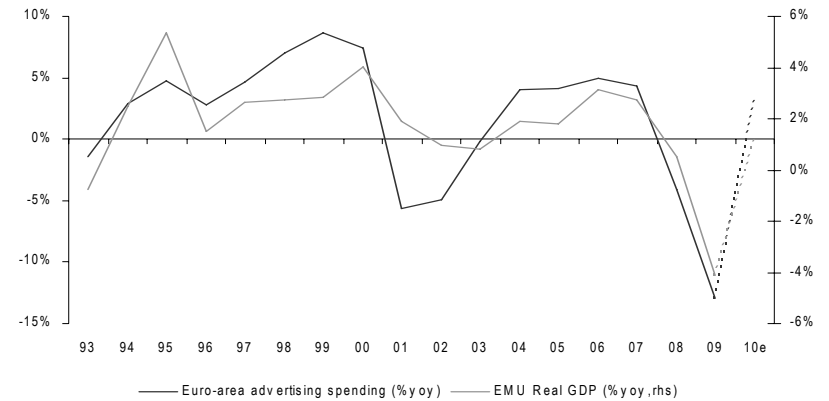
Source: Datastream

EMU Retail sales vs unemployment rate



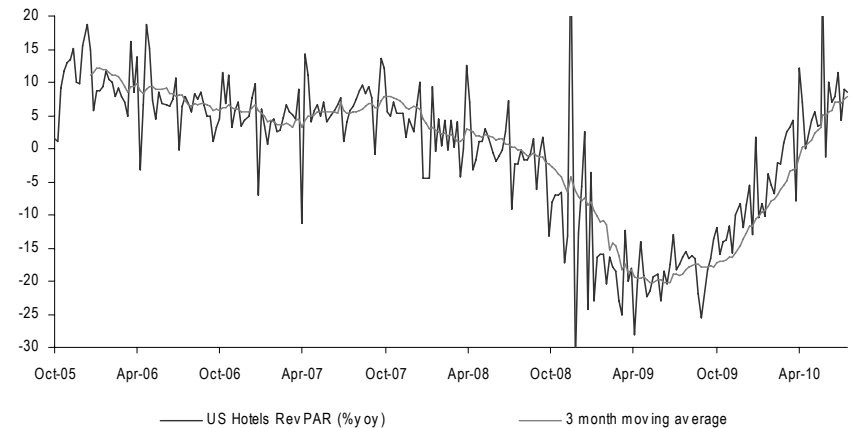
Source: Datastream, J.P. Morgan estimates

Eurozone Advertising spend vs GDP



Source: Datastream, J.P. Morgan estimates

US hotels revenues per room



Source: J.P. Morgan

## DISCRETIONARY: OVERWEIGHT

### European sectors relative performance in the 6 months following the first positive payrolls

+6m Europe	1975	1980	1983	1991	2003	Average	Median hit ratio	
Energy	2%	5%	15%	-4%	-4%	3%	2%	60%
Chemicals	3%	-13%	12%	1%	1%	1%	1%	80%
Construction Materials	2%	4%	-10%	-12%	-12%	-6%	-10%	40%
Metals & Mining	-12%	-3%	-6%	-14%	-14%	-10%	-12%	0%
Capital Goods	6%	-10%	-7%	-5%	-5%	-4%	-5%	20%
Transport	-4%	-5%	10%	4%	4%	2%	4%	60%
Automobile	6%	-24%	20%	-11%	-11%	-4%	-11%	40%
Consumer Durables	7%	-9%	6%	20%	20%	8%	7%	80%
Media	-1%	-9%	15%	12%	12%	6%	12%	60%
Retailing	-8%	6%	-5%	13%	13%	4%	6%	60%
Hotels, Restaurants & Leisure	4%	11%	-1%	5%	5%	5%	5%	80%
Food & Drug Retailing	-3%	10%	-15%	3%	3%	0%	3%	60%
Food Beverage & Tobacco	0%	-4%	-9%	9%	9%	1%	0%	60%
Household Products	2%	-3%	-15%	-1%	-1%	-3%	-1%	20%
Healthcare	0%	-1%	-7%	14%	14%	4%	0%	40%
Banks	0%	4%	-5%	-3%	-3%	-1%	-3%	40%
Insurance	-9%	14%	-2%	-5%	-5%	-1%	-5%	20%
Real Estate	-22%	3%	-13%	-8%	-8%	-10%	-8%	20%
Software and Services	46%	19%	82%	-3%	-3%	28%	19%	60%
Technology Hardware	22%	-24%	0%	-14%	-14%	-6%	-14%	20%
Semicon & Semicon Equip	-	-	-	-6%	-6%	-6%	-6%	60%
Telecoms	-2%	3%	-6%	3%	3%	0%	3%	60%
Utilities	0%	-16%	-16%	8%	8%	-3%	0%	60%

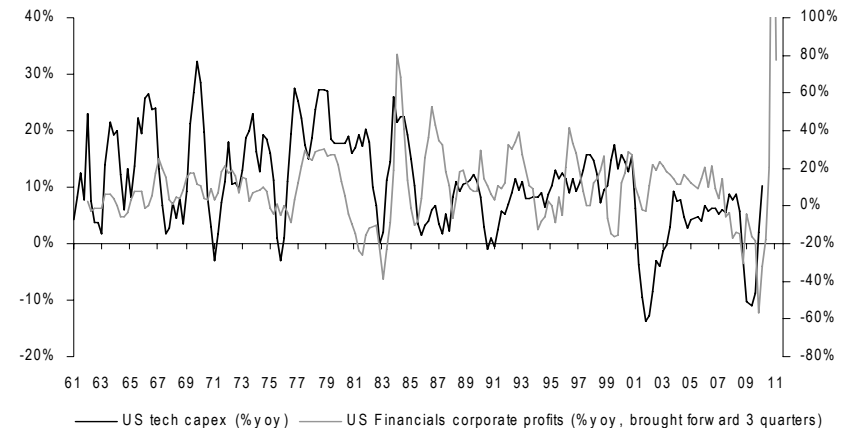
Source: Datastream

# IT: OVERWEIGHT

## Preference for semiconductors/Software

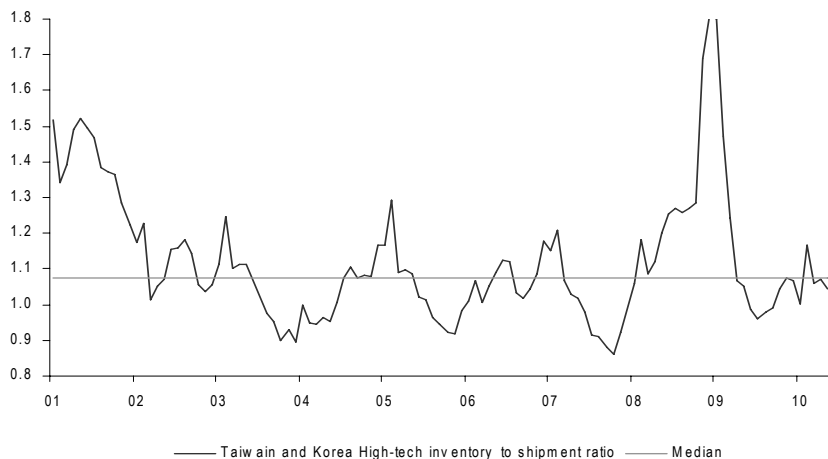
- Within the sector, we are most positive on semiconductors. They should benefit from significant operational leverage and USD strength
- The sector will benefit from a recovery in IT spend
- The inventories in the supply chain are not flashing warning signs yet

US Financials profits vs Tech capex



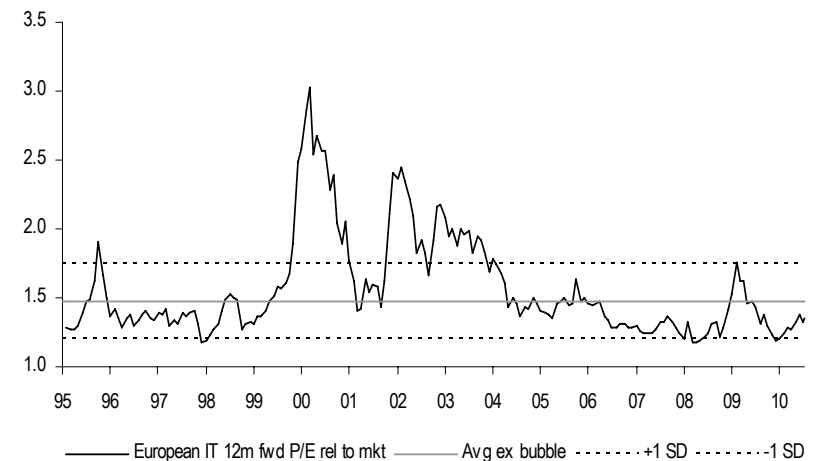
Source: BEA, Datastream

Taiwan and Korea High-tech Inventory/Shipment ratio



Source: J.P. Morgan

IT 12m fwd P/E relative



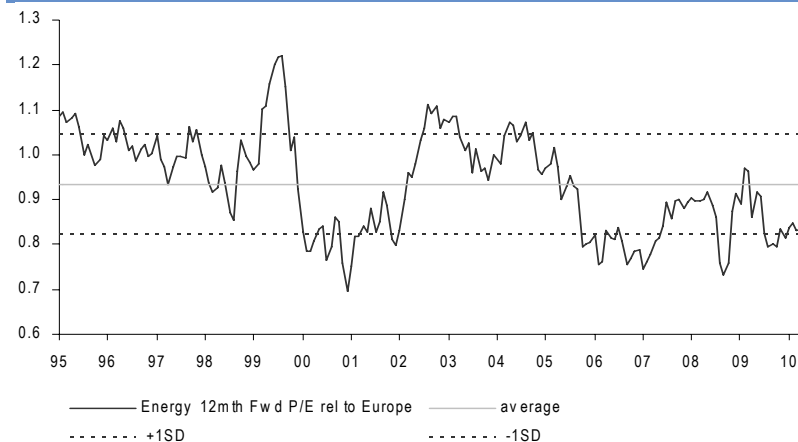
Source: Datastream, IBES

# ENERGY: OVERWEIGHT

## Cheap, high yield, +ve EPS momentum

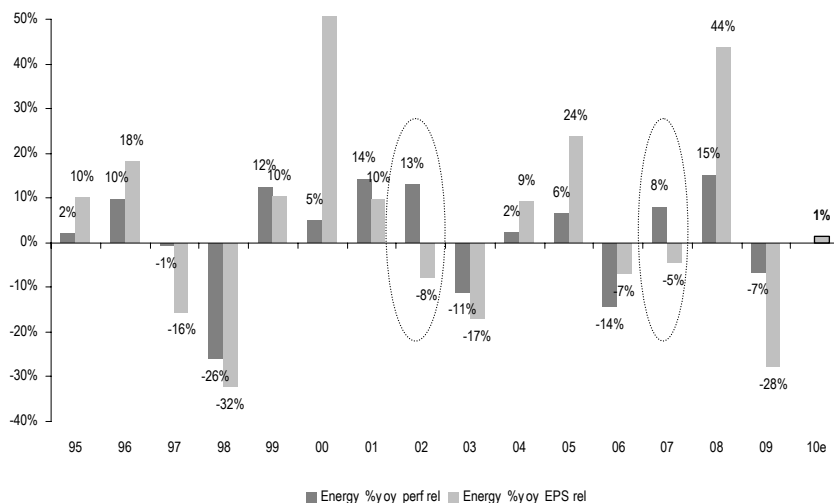
- The relative performance of Energy has displayed a tight correlation to relative EPS momentum
- Valuations are also attractive, Energy trades at a 25% P/E discount, near record DY relative at a 50% premium, and third most attractive equity yield vs credit yield

Energy P/E relative



Source: IBES

Energy annual perf vs EPS relative



Source: Datastream, IBES, MSCI

European sectors' dividend yield vs high grade yield %

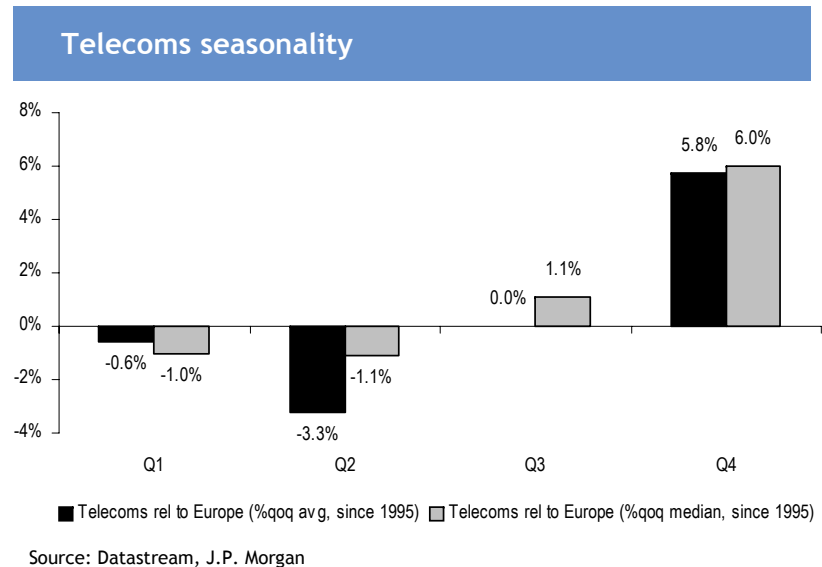
	Dividend yield	High grade yield	Difference	LT average
Utilities	5.9	3.6	2.3	-0.9
Telecom	6.0	3.8	2.3	-1.8
Energy	4.9	3.6	1.3	-1.5
Chemicals	2.7	2.6	0.1	-1.5
Staples	2.7	3.0	-0.3	-2.2
Real Estate	3.1	3.6	-0.5	-1.8
Technology	2.3	3.5	-1.1	-3.4
Building Materials	2.9	4.1	-1.2	-2.2
Capital Goods	2.3	3.5	-1.2	-2.1
Transport	2.2	3.5	-1.3	-2.1
Autos	0.8	2.6	-1.8	-1.7

Source: Datastream

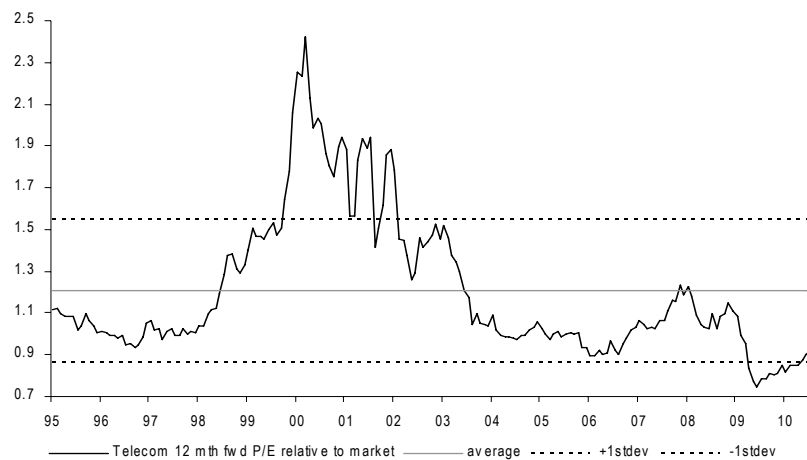
# TELECOMS: NEUTRAL

## Downgraded on 8th December

- Telecom displays the highest free cash flow yield among European sectors
- Seasonality usually supports the sector in Q4



### Telecoms 12m Fwd P/E relative to Europe



Source: Datastream, MSCI, IBES

### European sectors FCF yield

	2010e	2011e
<b>Telecommunications Services</b>	<b>10.3%</b>	<b>10.7%</b>
Healthcare	8.7%	9.6%
Consumer Staples	5.7%	6.2%
Information Technology	6.0%	7.9%
<b>Europe</b>	<b>4.2%</b>	<b>5.9%</b>
Consumer Discretionary	4.5%	6.1%
Industrials	4.4%	6.1%
Materials	4.5%	7.9%
Utilities	1.8%	3.0%
Energy	-0.5%	3.2%

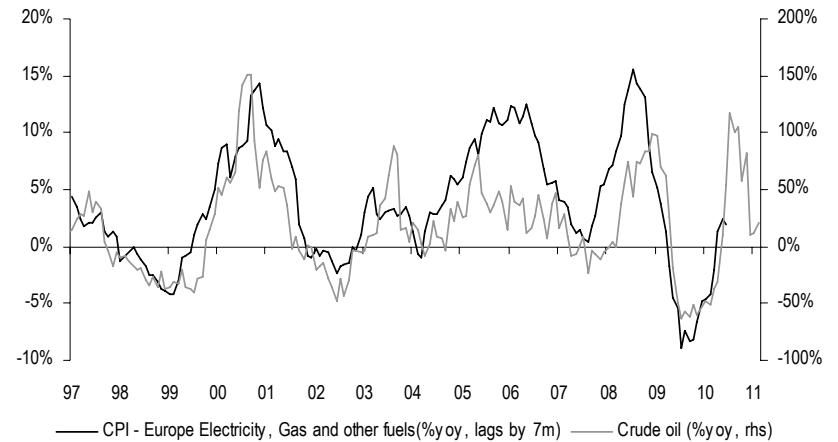
Source: Datastream, MSCI, IBES

# UTILITIES: UNDERWEIGHT

## Regulatory risks, weak pricing

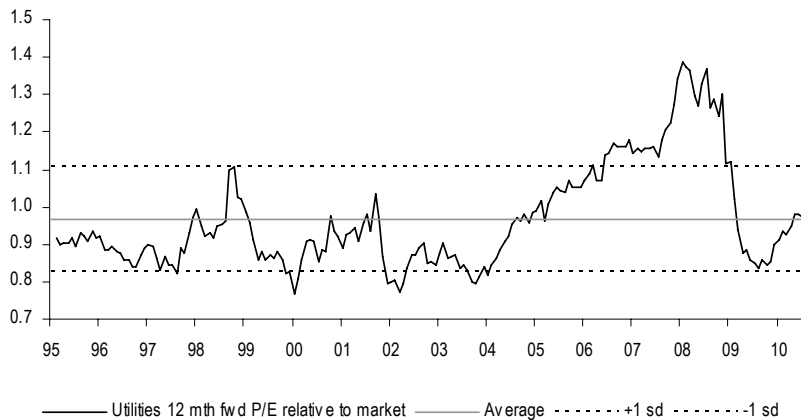
- Low FCF yield, high capex requirements, risk of rising taxation
- Valuations attractive, power usage stabilizing
- Gas oversupply to remain a concern in the medium-term

Power CPI vs Oil Price\*



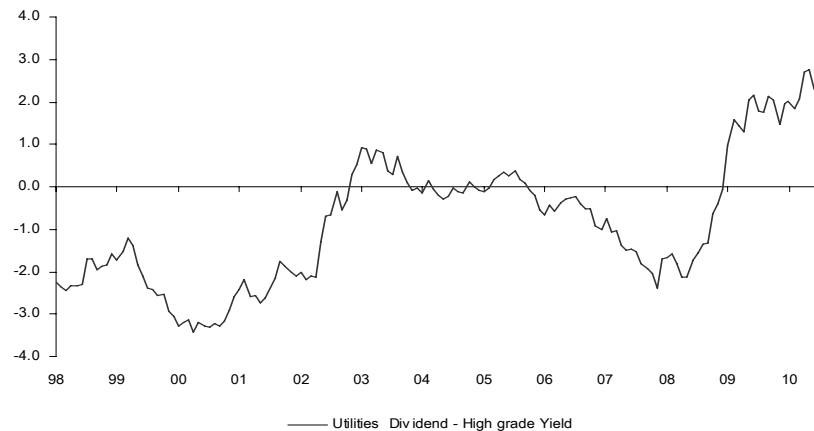
Source: Datastream, \* assuming 70\$/bbl WTI until year end

Utilities 12mth Fwd P/E relative



Source: IBES

Utilities dividend-corporate bond yield spread



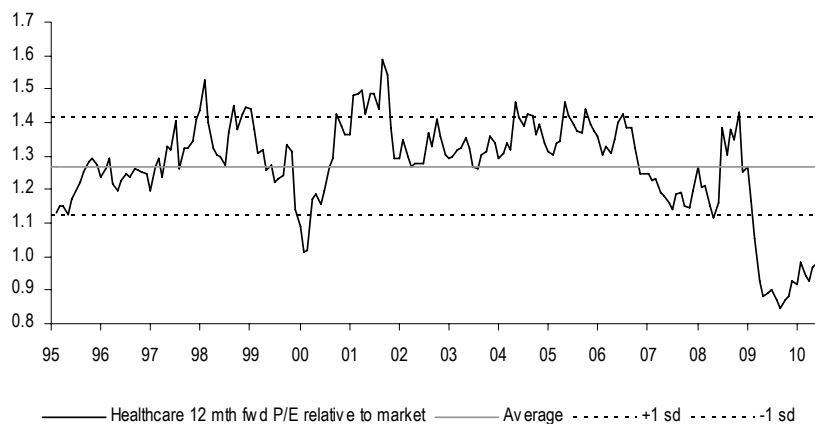
Source: Datastream, J.P. Morgan

# HEALTHCARE: UNDERWEIGHT

## Consensus long; faces political pressures

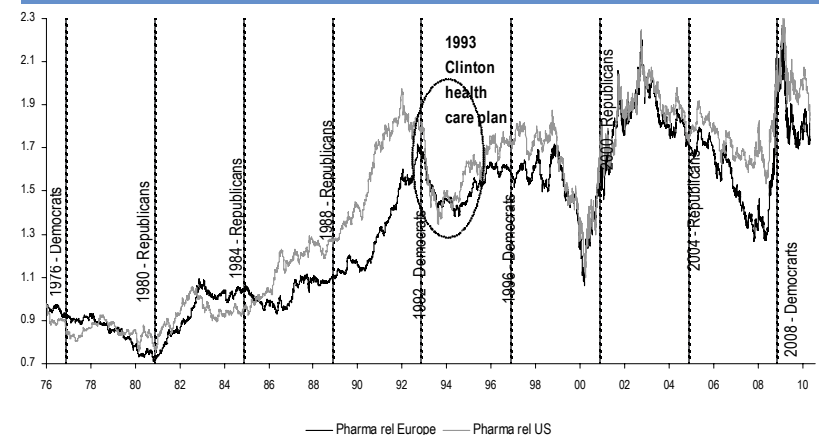
- We downgraded Pharma in December 2008
- Pharma faces a number of headwinds such as political pressures, pricing weakness and downgrades to long-term earnings outlook
- Historically, a Democrat victory was negative for the sector
- On the positive side, sector's valuations are attractive

Healthcare valuations



Source: IBES

Healthcare performance vs US presidential elections



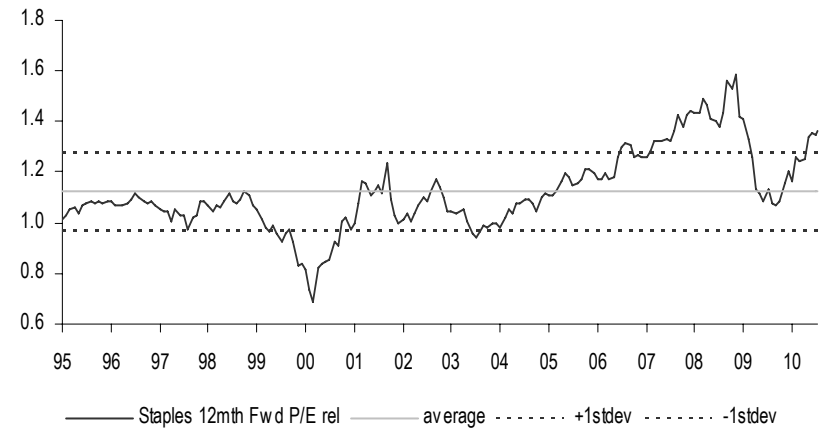
Source: Datastream, J.P. Morgan

# STAPLES: UNDERWEIGHT

## No-win situation; rich valuations a problem

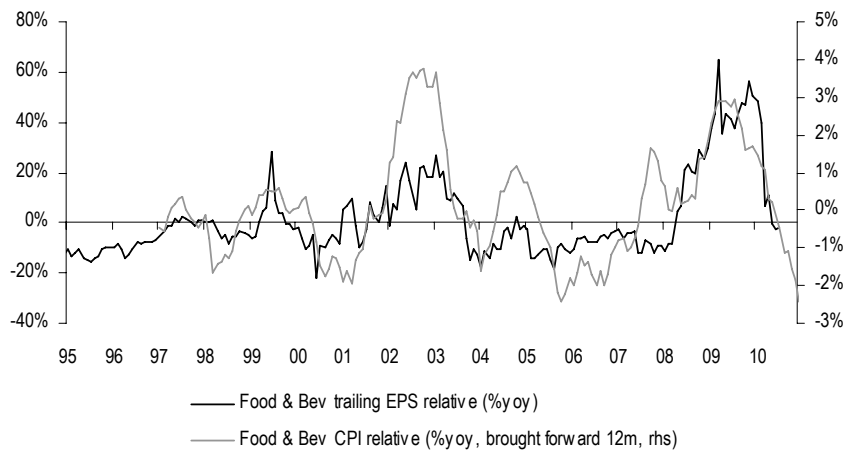
- The valuation overhang for Staples is still significant on a number of measures
- In addition, margin pressure is building
- Low food inflation is a negative for Staples' earnings

Staples P/E relative



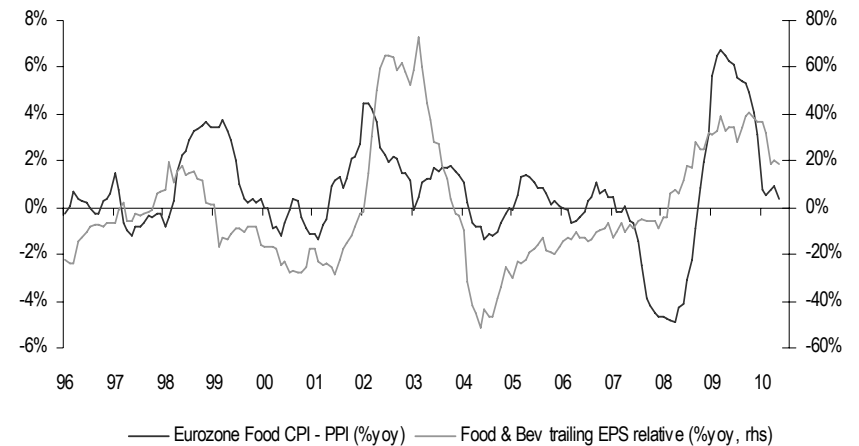
Source: Datastream, IBES

Staples earnings vs Food inflation



Source: Datastream, MSCI

Food CPI-PPI and Staples EPS relative



Source: Datastream, Eurostat



# The latest bear market in a historical context

- In past bear markets, the S&P500 posted median falls of 32% with a median duration of 14 months, compared to the recent 57% fall in 16 months
- Historically, the median fall of European equities was 35%, lasting “only” 6 months. In the latest bear market they fell 57% over 20 months

## European bear markets since 1970\*

Peak	Bottom	% fall	Length of fall (m)	Macro
Feb-72	Jan-75	-41%	36	US (Nov 73-Mar-75) and European Recession
Oct-87	Nov-87	-35%	1	Black Monday
Jul-90	Jan-91	-24%	6	US (Jul 90-Mar-91) and European Recession, S&L
Jul-98	Oct-98	-31%	3	LTCM
Sep-00	Mar-03	-58%	31	US (Mar 01-Nov 01) and German Recession
<b>Median</b>		<b>-35%</b>	<b>6</b>	
<b>Average</b>		<b>-38%</b>	<b>15</b>	
Jun-07	Mar-09	-57%	20	Financial crisis and 3rd oil shock

Source: Datastream, MSCI, \*market down 20% for more rom peak, daily data since '80, monthly before \*assuming March 9<sup>th</sup> was the low

## Past US bear markets since 1900

Peak	Trough	% fall	Length of fall (m)	Backdrop
Sep-02	Oct-03	-29%	13	US Recession (Sep 02-Aug-04)
Sep-06	Nov-07	-38%	14	US Recession (May 07-Jun-08)
Dec-09	Dec-14	-29%	61	US Recession (Jan 10-Jan 12 and Jan 13-Jan-14)
Nov-16	Dec-17	-33%	13	World War I
Jul-19	Aug-21	-32%	25	US Recession (Jan 20-Jul 21)
Sep-29	Jun-32	-85%	33	US Depression (Aug 29-Mar 33)
Sep-32	Feb-33	-41%	5	US Depression (Aug 29- Mar 33)
Feb-34	Mar-35	-32%	13	
Feb-37	Apr-42	-57%	63	US Recession (May 37-Jun 38)
May-46	Jun-49	-25%	38	US Recession (Nov 48-Oct 49)
Jul-57	Oct-57	-21%	3	US Recession (Aug 57-Apr-58)
Dec-61	Jun-62	-22%	6	US Recession (Apr 60-Feb-61)
Feb-66	Oct-66	-22%	8	
Nov-68	May-70	-36%	18	US Recession (Dec 69-Nov 70)
Jan-73	Oct-74	-48%	21	US Recession (Nov 73-Mar-75) and 1st oil shock
Nov-80	Aug-82	-27%	21	US Recession (Jul 81-Nov 82) and 2nd oil shock
Aug-87	Dec-87	-34%	3	Black Monday
Jul-90	Oct-90	-20%	3	US Recession (Jul 90-Mar-91), S&L crisis
Mar-00	Oct-02	-49%	31	US Recession (Mar 01-Nov 01)
<b>Median</b>		<b>-32%</b>	<b>14</b>	
<b>Mean</b>		<b>-36%</b>	<b>21</b>	
Oct-07	Mar-09	-57%	16	Financial crisis and 3rd oil shock

Source: Datastream, Data Shiller, Bloomberg, NBER \*assuming Mar 9<sup>th</sup> was the low

## The Dark Side: Scandinavian and Japanese experience

	Finland	Norway	Sweden	Japan	US
5 year performance to peak	-	276%	203%	216%	104%
Market peak to bottom	-75%	-54%	-57%	-62%	-57%*
Period	Apr 89 to Sep 92	Aug 90 to Aug 92	Aug 89 to Oct 92	Dec 89 to Oct 98	Oct 07 to Mar 09
Valuations at peak	12.8	15.6	23.9	60.7	17.8
Premium to last 5 yr average	#N/A	71%	36%	19%	-9%
Valuations at bottom	4.9	12.2	9.5	30.9	10.3
Real GDP (peak to bottom)	-12.3%	-4.1%	-5.8%	-	-1.7%*
Period	1989 Q2 to 1993 Q2	1987 Q2 to 1991 Q4	1990 Q2 to 1992 Q4	-	2008 Q2 to 2008 Q4
IP (peak to bottom)	-40.3%	-4.1%	-6.7%	-14.4%	-11%*
Period	Aug 89 to Jun 91	Sep 91 to Oct 91	Dec 90 to Feb 93	May 91 to Jan 94	Jan 08 to current
5 year change in house prices to peak	107%	96%	88%	134%	75%
House price fall	-41%	-30%	-20%	-59%	-27%*
Period	1989 Q2 to 1993 Q1	1987 to 1992	1991 Q1 to 1993 Q3	1991 to 2006	Jul 06 to current
Unemployment rate change	17.8%	5.0%	8.6%	3.5%	3.7%*
Trough unemployment rate	2.1%	1.3%	1.0%	2.0%	4.4%
Peak unemployment rate	19.9%	6.3%	9.6%	5.5%	8.1%*
10 yr yields peak to bottom	-6.6%	-8.0%	-6.7%	-7.2%	-3.2%
10 yr yields peak	13.0%	13.5%	13.8%	7.9%	5.2%
10 yr yields bottom	6.4%	5.6%	7.0%	0.7%	2.1%
Use of public funds as % of GDP	7%	3%	4%	14%	

Source: Datastream, Bloomberg, J.P. Morgan. Japan house prices relate to Tokyo residential land prices. \*latest

## Economic, Interest Rate and Exchange Rate Outlook

	Real GDP					Real GDP					Consumer prices			
	% oya					% oqa, saar					% oya			
	2009E	2010E	2011E	1Q10E	2Q10E	3Q10E	4Q10E	1Q11E	2Q11E	3Q11E	1Q10E	2Q10E	4Q10E	2Q11E
United States	-2.4	2.9	2.8	2.7	2.5	2.5	3.0	2.5	2.5	3.0	2.4	1.8	0.9	1.2
Eurozone	-4.1	1.3	1.4	0.8	3.0	2.0	1.0	1.0	1.0	1.8	1.1	1.5	1.5	0.9
United Kingdom	-4.9	1.6	2.6	1.3	4.5	2.5	2.5	2.0	2.5	3.0	3.3	3.5	2.5	1.7
Switzerland	-1.5	2.3	2.5	1.6	2.8	2.5	2.3	2.3	2.5	2.8	1.1	1.1	0.9	0.6
Japan	-5.3	3.6	2.2	5.0	2.8	2.5	2.5	2.2	2.0	1.5	-1.2	-1.4	-0.7	0.1
Emerging markets	1.1	6.8	5.6	7.5	5.7	4.7	5.2	5.8	6.0	5.2	5.1	5.1	5.2	4.9
Global	-2.5	3.4	3.0	3.6	3.5	2.9	2.9	2.8	2.8	3.0	2.2	2.1	1.9	1.9

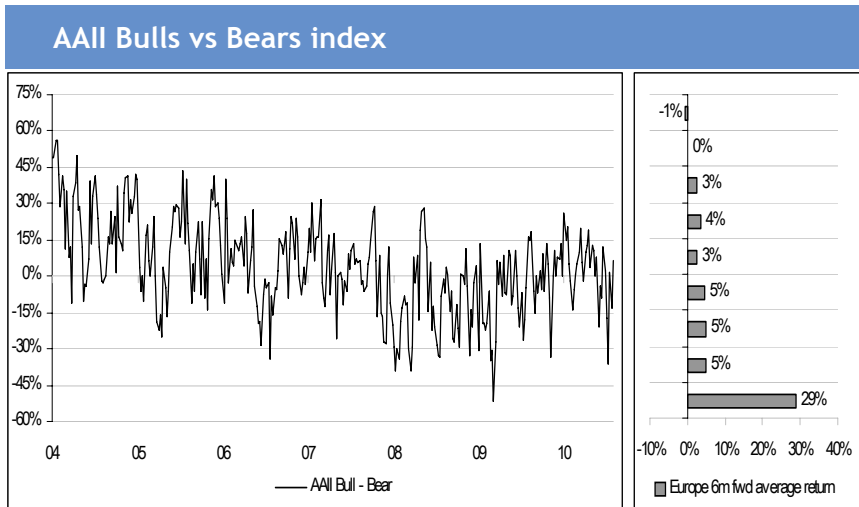
Official interest rate	Forecast	Current	Forecast for				
	next change		Sep 10	Dec 10	Mar 11	Jun 11	Sep 11
Federal funds rate	4Q 11 (+25bp)	0.125	0.125	0.125	0.125	0.125	0.125
Refi rate	On Hold	1.00	1.00	1.00	1.00	1.00	1.00
Repo rate	May 11 (+25bp)	0.50	0.50	0.50	0.50	0.75	1.00
3-month Swiss Libor	16 Dec 10 (+25bp)	0.25	0.25	0.50	0.75	1.00	1.25
Overnight call rate	2Q 12 (+15bp)	0.10	0.10	0.10	0.10	0.10	0.10

10 Yr Govt Bond Yields	Forecast for end of				
	July 28, 2010	Sep 10E	Dec 10E	Mar 11E	Jun 11E
United States	2.98	3.45	3.85	4.15	4.50
Eurozone	2.75	2.90	3.15	3.25	3.35
United Kingdom	3.57	3.55	3.90	4.10	4.25
Japan	1.08	1.30	1.40	1.50	1.55

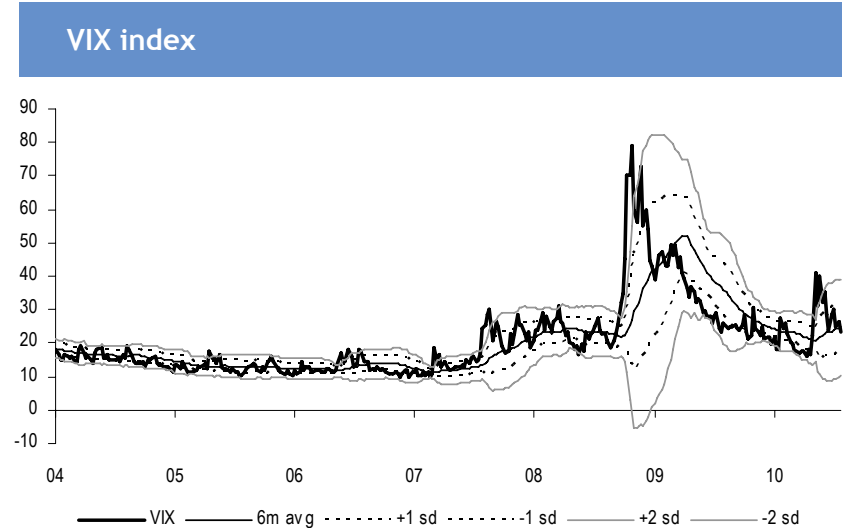
Exchange rates vs US\$	Forecast for end of						
	July 28, 2010	Sep 10E	Dec 10E	Mar 11E	June 11E	Sep 11E	Dec 11E
EUR	1.30	1.25	1.25	1.25	1.25	1.20	1.15
GBP	1.56	1.47	1.44	1.42	1.42	1.38	1.35
CHF	1.06	1.06	1.03	1.02	1.00	1.04	1.09
JPY	87.4	90	93	93	93	95	98

Source: J.P. Morgan estimates, Datastream

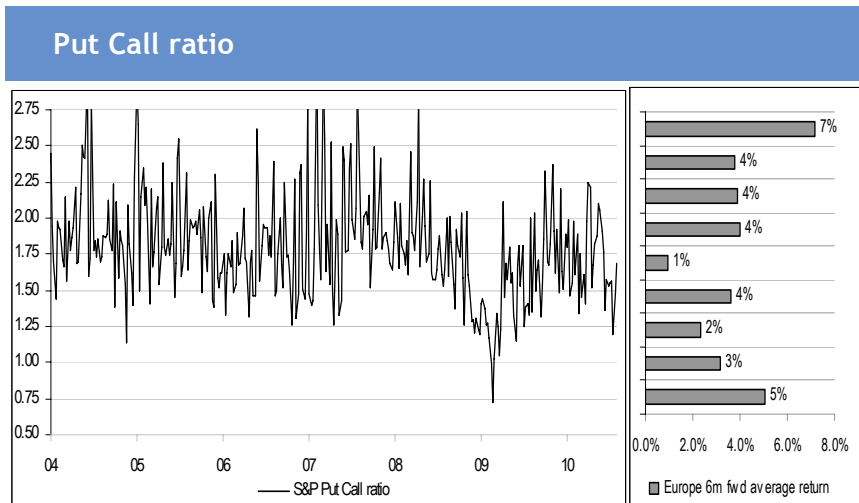
# Technical indicators



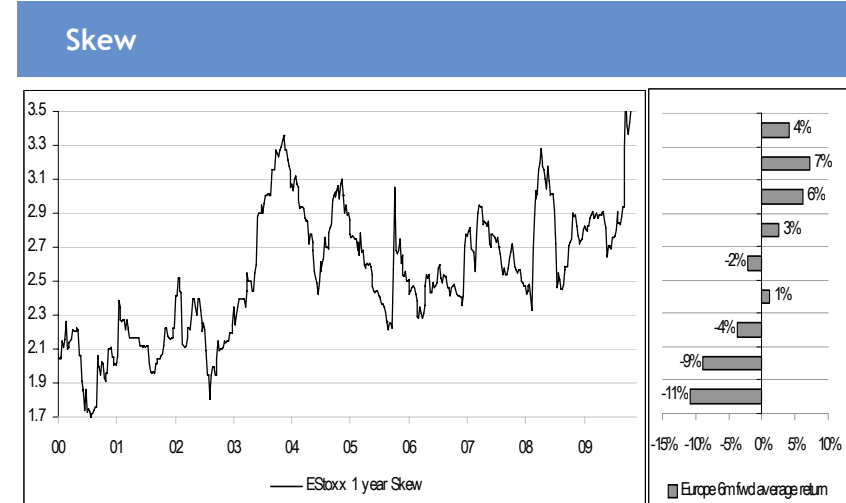
Source: Bloomberg, J.P. Morgan



Source: Datastream



Source: Datastream, J.P. Morgan



Source: Datastream, J.P. Morgan

# European Sector Allocation

Sector Allocation					
		MSCI Europe Weights	Allocation	Deviation	Recommendation
<b>Energy</b>		<b>10.2%</b>	11%	0.8%	Overweight
<b>Materials</b>		<b>9.3%</b>	11%	1.7%	Neutral
	Chemicals				=
	Construction Materials				=
	Metals & Mining				+
<b>Industrials</b>		<b>10.4%</b>	10%	-0.4%	Neutral
	Capital Goods				=
	Transport				=
<b>Consumer Discretionary</b>		<b>8.1%</b>	9%	0.9%	Overweight
	Automobile				+
	Consumer Durables				+
	Media				+
	Retailing				+
	Hotels, Restaurants & Leisure				+
<b>Consumer Staples</b>		<b>13.1%</b>	12%	-1.1%	Underweight
	Food & Drug Retailing				=
	Food Beverage & Tobacco				-
	Household Products				-
<b>Healthcare</b>		<b>10.4%</b>	9%	-1.4%	Underweight
<b>Financials</b>		<b>23.0%</b>	24%	1.0%	Overweight
	Banks				+
	Diversified Financials				=
	Insurance				=
	Real Estate				=
<b>Information Technology</b>		<b>3.0%</b>	4%	1.0%	Overweight
	Software and Services				+
	Technology Hardware				=
	Semicon & Semicon Equip				+
<b>Telecoms</b>		<b>6.8%</b>	7%	0.2%	Neutral
<b>Utilities</b>		<b>5.6%</b>	3%	-2.6%	Underweight
		<b>100%</b>	<b>100%</b>	<b>0%</b>	<b>Balanced</b>

Source: MSCI, J.P. Morgan

## European Asset Allocation

Asset Allocation				
	Benchmark weighting	Allocation	Deviation	Recommendation
<b>Equities</b>	60%	70%	10%	Overweight
<b>Bonds</b>	30%	25%	-5%	Underweight
<b>Cash</b>	10%	5%	-5%	Underweight
	<b>100%</b>	<b>100%</b>	<b>0%</b>	<b>Balanced</b>

Regional Asset Allocation				
	MSCI Europe Weights	Allocation	Deviation	Recommendation
<b>Eurozone</b>	50%	53%	3%	Overweight
<b>United Kingdom</b>	33%	30%	-3%	Underweight
<b>Others*</b>	17%	17%	0%	Neutral
	<b>100%</b>	<b>100%</b>	<b>0%</b>	<b>Balanced</b>

Index Targets		
	Index	YE 2010
<b>Europe</b>	MSCI Europe	1,300
<b>Eurozone</b>	MSCI Eurozone	185
<b>United Kingdom</b>	FTSE 100	6,150

Source: MSCI, J.P. Morgan, Datastream

\*Others include Denmark, Norway, Sweden and Switzerland

Note: We use the MSCI Europe index as the benchmark against which to determine our regional allocations. Our Overweight/Underweight recommendations reflect our belief that the relevant region will out- / underperform the index over the next six to 12 months.

# European Market Performance & Valuations

29-Jul-10

3M Performance	Market	Energy	Materials	Industrials	Discretionary	Staples	Healthcare	Financials	IT	Telecom	Utilities
US	-7.3%	-11.8%	-7.2%	-7.7%	-9.5%	-1.3%	-7.9%	-9.4%	-7.9%	3.5%	2.4%
Europe	-2.4%	-14.4%	-5.8%	-0.3%	2.7%	0.5%	-6.7%	3.0%	-7.1%	2.8%	-6.8%
UK	-4.8%	-19.1%	-5.3%	-2.9%	-0.4%	-2.0%	-0.1%	0.7%	8.6%	4.0%	-0.6%
Euro	-0.7%	-5.8%	-5.9%	0.4%	4.8%	2.5%	-9.4%	5.2%	-8.7%	0.8%	-8.8%
Switzerland	-4.0%	-	-10.3%	1.0%	4.2%	1.2%	-12.2%	0.3%	-11.2%	2.4%	-

## 12M Performance

US	12.8%	2.3%	12.2%	27.3%	26.1%	11.0%	2.1%	16.3%	14.3%	5.9%	6.5%
Europe	13.6%	0.3%	25.4%	27.8%	24.1%	23.2%	4.2%	12.3%	9.6%	10.5%	-0.9%
UK	17.1%	-0.8%	38.3%	27.3%	31.7%	19.9%	6.7%	19.5%	47.7%	23.8%	13.0%
Euro	10.9%	1.4%	18.1%	28.3%	20.2%	28.1%	6.2%	7.5%	5.9%	0.6%	-4.6%
Switzerland	9.9%	-	10.2%	19.1%	65.7%	20.3%	-5.7%	12.6%	-4.5%	11.5%	-

## P/Book (-1M)

US	2.0	1.8	2.6	2.4	2.6	3.1	2.3	1.1	3.4	1.7	1.3
Europe	1.5	1.5	1.6	2.1	1.8	3.0	2.9	0.9	2.4	1.5	1.4
UK	1.7	1.4	2.0	2.9	2.3	3.4	4.2	1.1	3.1	1.0	2.6
Euro	1.3	1.5	1.4	1.8	1.5	2.5	1.7	0.7	2.5	1.9	1.3
Switzerland	2.3	-	2.0	3.3	2.8	3.8	3.5	1.1	2.8	3.0	-

## 12M Frw Cons P/E pre GW

US	12.0	10.2	12.7	13.3	13.6	13.3	10.6	11.1	12.2	14.9	12.0
Europe	10.3	8.0	9.4	12.8	12.8	14.0	10.0	9.0	13.8	9.5	10.0
UK	9.5	7.8	7.4	11.5	12.3	12.7	9.2	10.2	19.3	9.1	11.3
Euro	10.2	8.3	11.8	12.6	12.3	14.4	9.6	8.3	13.2	9.5	9.6
Switzerland	11.3	-	12.9	15.7	16.5	15.9	10.2	8.0	15.2	10.6	-

## Cons 12M EPS% pre GW

US	21.5	27.6	41.0	18.9	24.1	7.8	8.5	54.1	17.4	8.7	3.2
Europe	23.2	24.7	43.5	24.4	46.7	10.6	7.9	36.3	32.3	2.4	-0.5
UK	25.1	27.4	45.8	13.4	10.8	9.4	1.2	64.7	15.5	1.0	-0.2
Euro	22.3	21.2	45.5	21.0	76.4	12.9	6.7	27.5	39.1	2.3	-0.6
Switzerland	20.3	-	13.8	9.0	25.7	9.1	14.6	41.2	82.4	0.3	-

## Dividend Yield

US	2.5	2.4	2.1	2.3	2.0	3.2	3.1	1.6	1.8	7.1	4.6
Europe	4.1	7.3	2.5	2.8	3.1	3.1	4.5	3.6	2.5	6.4	6.8
UK	4.6	7.9	1.8	2.4	3.3	3.7	6.1	3.5	1.3	5.6	6.3
Euro	4.4	6.9	3.3	3.3	3.2	2.8	4.5	4.0	2.8	7.4	7.0
Switzerland	3.1	-	2.4	2.7	1.0	2.8	3.8	3.1	0.0	5.2	-

	Forward ROE	12M fwd P/E	Sector neutral P/E	Discount	Sector neutral discount
US	17.1%	12.0			
Europe	14.9%	10.3	11.2	-14.1%	-6.3%
UK	17.8%	9.5	12.0	-20.3%	0.1%
Euro	12.6%	10.2	11.0	-14.4%	-8.1%
Switzerland	20.2%	11.3	13.0	-5.1%	8.9%

Note: Swiss calculations exclude Energy and Utilities sectors

Source: IBES, MSCI, Datastream

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