

US Equity Strategy FLASH

While Bulls Evaporate, 10% Declines in 10 Days Tend to Occur at Ends of Sell-Offs

Equity markets have fallen 10% in the past 10 days. Outside of “bear” markets, this has happened 3 times since WWII—in 11/74 (post-Nixon, AT&T breakup filed), 10/97 (Asian crisis), and 8/98 (Long-Term Capital). The epicenter of the crisis this time is spreading of Euro-area sovereign credit concerns and also diminished US economic visibility. To boot, credibility of policy makers has been undermined by conflicts/delays in Europe and the US to boot, eroding confidence of “central banks to the rescue.” In the 3 earlier precedents cited, markets bottomed right after their 10-day rout, gaining 18% on average within 3 months (see Figure 3).

- **When markets plunge, constructive arguments can be dismissed.** When markets plunge like this, any constructive argument for stocks is easily dismissed as “blind to the facts” or “too simplistic and optimistic.” Similarly, the headwinds facing markets, from Europe and in the US, are more apparent and thus, the crowd is naturally negative and straying from that view leaves one insecure. However, consider the following.
- **Corporate credit stability contrasts with equity instability.** Equities are the junior piece of the capital structure and thus, historically, take their cues from credit markets. As Figure 5 through Figure 7 show, investment grade spreads (JULIZ Index GP <<GO>>), high-yield (CSSWUS Index GP <<GO>>), and quality spreads (BB-CCC or AAA-BB) are at better levels than at the start of 2011 (although wider than best levels in June). Moreover, US corporate credit has been meaningfully outperforming European (Figure 8) as credit holders differentiate developments across the pond (the steepness of US yield curve tells same story).
- **Yield curve saying no double dip.** Speculation has increased about the risks of a double dip in the US, which we see as misplaced today. Historically, US recessions were about overexpansion (consumer or business) followed by a contraction of liquidity—businesses/consumers have strong balance sheets and while the US bank system is extremely well-capitalized today, it is hard to imagine the right impulse exists to create a recession. Moreover, consider that the 30Y/10Y yield curve is steepening (Figure 9) and since 1956, has inverted in front of every recession with an average lead time of 16 months (Figure 11)—think about it, 10 of 10 recessions were preceded by an inverted curve.
- **Leadership of Consumer Discretionary stocks suggests Bull market intact.** In this bull market (and most others), Discretionary has led the turning points. The group peaked in 1/07 (9 mos lead, Figure 14), bottomed in 11/08 (4 mos lead, Figure 15), and outperformed since April and recently reached a cycle high (7/11, Figure 16). This is in contrast to a generally negative view on the US consumer (and even consumer spending trends), but the recent strength suggests to us that consumer spending should improve in 2H11.

US Equity Strategy

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STRATEGY VIEW:

- Never a down year in 3rd year of presidential term AND 3rd year of expansion
- Upside as credit eases in 2011E and Fed is patient
- Sector rotation greatest in third year of bull market
- Consensus tactical, Contrarian on style
- Credit Sensitives, Consumer Cyclicals, and Domestic Cyclical
- Like Large Cap, Low PE, Low Momentum

SECTOR RATINGS:

Overweight	Underweight
Financials	Staples
Energy	Utilities
Technology	
Materials	Neutral
Industrials	Telecom
Healthcare	Discretionary

See page 27 for analyst certification and important disclosures.

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- **1H GDP not a complete “horror show” and recent data are not all bad.** Looking at the component contribution (Figure 17) for 1Q, 99bp of the 150bp downward GDP revision is attributable to reduced contribution from inventories (and that was due to 4Q restatement). As for 2Q, GDP saw a 65bp drag from “Motor vehicles and parts” which reflects the auto shutdowns due to the supply chain disruptions of Japan. Since 1950, “Motor vehicle and parts” contributed 0.13% to GDP, thus a “normalized” contribution, and GDP/PCE in 2Q would have been 2.08%/0.95%, respectively (Figure 18) using this contribution. In other words, 1H11 was not too far from 2% GDP growth—not spectacular but further away from stall speed as well.
- **The gross dividend yield of the S&P 500 is within 35bp of the 10-yr yield (see Figure 17) – not seen since ’62 (ex briefly in ’08) – and tax-adjusted is 20bp HIGHER than 10Y. Plus, daily RSI at 24 (Figure 19) not seen since March ’09.** Now this is potentially falling on deaf ears. But consider this. One could own the S&P 500 and just the dividend received pays more money than owning the 10-year Treasury (after paying taxes). Additionally, when one looks at daily RSI, at 24, the S&P 500 was last at this level in March ’09 and October ’08.

Bottom line: there is essentially a buyers’ strike until markets regain confidence regarding sovereign issues across the pond. We are comfortable with the notion of 2H US GDP acceleration, barring a prolonged decline in stocks (causing negative wealth effect feedback loop) and thus also see our ’11/’12 EPS of \$97/\$105 as achievable. Nearer term, we think the constellation of supportive analysis above suggest equities are a good risk/reward here but acknowledge that withdrawal of liquidity is driving equity markets at the moment.

Relevant Sector ET Fs

Figure 2: Potential Catalysts

Monday 8/8	Tuesday 8/9	Wednesday 8/10	Thursday 8/11	Friday 8/12
Economics/Policy	Economics/Policy 7:30am NFIB survey (Jul) 8:30am Productivity and costs (2Q pre)	Economics/Policy 10:00am Wholesale trade (Jun) 10:00am JOLTS (Jun) 2:00pm Federal budget (Jul)	Economics/Policy 8:30am Initial claims (w/e prior Sat) 8:30am International trade (Jun)	Economics/Policy 8:30am Retail sales (Jul) 9:55am Consumer sentiment (Aug pre) 10:00am Business inventories (Jun)
Corporate Earnings: CFN, LUK, TSN	Corporate Earnings: DIS, IFF, SNI	Corporate Earnings: CSCO, CSC, M, NWSA,	Corporate Earnings: DV, KSS, JWN, SLE	Corporate Earnings: JCP
J.P. Morgan Events	J.P. Morgan Events	J.P. Morgan Events Aetna (AET) Investor Tour (Hartford, CT) Autos Conference	J.P. Morgan Events Terex Corp (TEX) Group Lunch Autos Conference	J.P. Morgan Events

Source: J.P. Morgan and FactSet.

10% in 10 days has been associated with crisis/events

The S&P 500 has fallen over 10% since July 22nd, one of the steepest short-term declines in stocks since World War II. As shown below in Figure 3, since WWII, the S&P 500 has seen a decline of 9.5% or greater within 10 days during a bull market only three times, and each instance has been associated with a crisis. In each instance, markets also bottomed right after the 10-day rout, gaining 18% on average over the next 3 months.

- In November 1974, the S&P 500 declined 9.7% from 11/7 through 11/20. During this period, markets were still digesting the after-effects of President Nixon's resignation three months earlier, as well as the US Department of Justice's antitrust lawsuit against AT&T filed in November 1974. Both events highlighted a period of political uncertainty and policymakers potentially being less supportive of corporates, an environment similar to today's.
- In October 1997, the S&P 500 fell 9.8% from 10/21 through 10/27. During this period, global markets were experiencing the effects of the Asian financial crisis, which created extreme uncertainty in markets and fears of a global recession, similar to the situation today.
- In August 1998, the S&P 500 declined 13.1% from 8/18 through 8/31. This extremely sharp short-term sell-off was the result of the near collapse of Long-Term Capital Management and the Russian financial crisis.

Figure 3: Declines of 9.5% or greater within 10 Days

During Bull Markets since WWII

	Date of Worst % off 10-day High	% off 10-day High	Fwd 3-mo Perf	Fwd 6-mo Perf
1	8/31/1998	-13.1%	21.6%	28.0%
2	10/27/1997	-9.8%	11.5%	23.7%
3	11/20/1974	-9.7%	21.7%	31.2%
	Mean	-10.9%	18.2%	27.6%
	Median	-9.8%	21.6%	28.0%
	% times up		100%	100%
4	8/4/2011	-10.8%	—	—

Source: J.P. Morgan and Bloomberg.

Declines of 10% within 10 days are extremely rare, only occurring 3 times during a bull market post-WWII...

Forward performance after these sharp declines was extremely strong, averaging 18% over 3 months and 28% over 6 months.

Historically, a decline of 8 consecutive days near end of sell-offs

Equity markets (Dow) fell 8 consecutive days (from 7/22 to 8/2). In total, there have been 21 instances but of those, only 6 occurred during a bull market. Those are highlighted in Figure 4 below:

- Of those 6 instances, markets bottomed within days (up to 4 days) in 4 of 6 instances;
- In 1926, equity markets fell for another month, leading to an overall 16% decline, and it was not entirely clear to us what was behind the protracted weakness. However, that sell-off was a precursor to a larger move that saw the Dow double within 2 years. As for 1956, equity markets fell for another 12 days, and that consolidation took place during a period of equity markets being range-bound for a 3-year period.

The forward implications are encouraging. The data below suggest markets are near the end of a sell-off when they fall for 8 consecutive days, and historically, they have gained double digits over the following 6-month period.

Figure 4: Instances of DJIA Declining for 8 Consecutive Days before turning up during a Bull Market

During Bull Markets since 1900

Consecutive Down Days					Market Trough					Fwd Perf from 8th Consec Down Day		Fwd Perf from Market Trough	
	Start of		End of										
	Consecutive	8 Days	Consecutive	# of	% Decline	Date of	Length of	%	Length of	%	Fwd 3-mo	Fwd 6-mo	Fwd 3-mo
	Days	Later	Days	Consecutive	during	Market	(Day 8 to	(Day 8 to	(Day 0 to	(Day 0 to	Perf	Perf	Perf
	Decline		Decline	Down Days	Consecutive	Trough	Trough)	Trough)	Trough)	Trough)			Perf
	Decline		Decline	Down Days	Down Days	Trough	Trough)	Trough)	Trough)	Trough)			Perf
1	2/18/1926	3/3/1926	3/3/1926	8	-10.3%	3/30/1926	27	-6.4%	40	-16.1%	-0.6%	12.0%	12.9%
2	5/18/1938	5/31/1938	5/31/1938	8	-7.9%	5/31/1938	0	0.0%	13	-7.9%	27.2%	36.5%	27.2%
3	5/4/1956	5/16/1956	5/16/1956	8	-4.6%	5/28/1956	12	-4.8%	24	-9.2%	5.1%	-1.2%	7.9%
4	3/24/1958	4/3/1958	4/3/1958	8	-2.9%	4/7/1958	4	-0.1%	14	-3.0%	8.7%	19.6%	9.1%
5	10/26/1967	11/8/1967	11/8/1967	8	-4.6%	11/8/1967	0	0.0%	13	-4.6%	0.1%	7.3%	0.1%
6	4/27/1989	5/9/1989	5/9/1989	8	-2.0%	5/9/1989	0	0.0%	12	-2.0%	13.8%	10.9%	13.8%
				Avg	8		7	-1.9%	19	-7.1%	9.0%	14.2%	11.8%
				% times up							83%	83%	100%

Source: J.P. Morgan and Bloomberg.

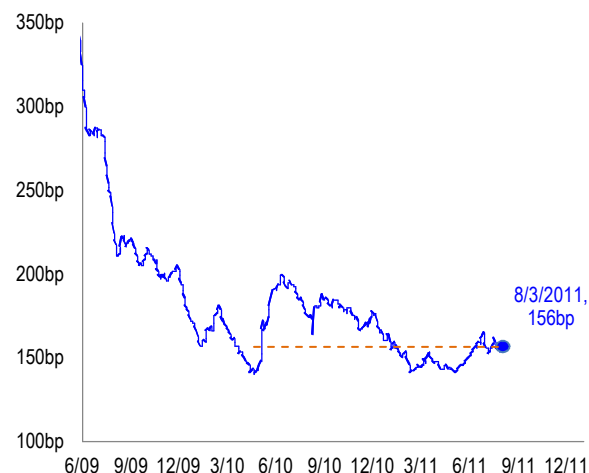
Key Investment Grade and High Yield are improving even as S&P 500 made new lows...

Equities are the junior piece of the capital structure and thus, historically, take their cues from credit markets. Investment Grade and High Yield spreads are good beacons to identify the level of risk that markets are expecting. Even as the S&P500 dips to new lows, key investment grade and high yield spreads continue to improve.

- As show in Figure 5 to Figure 7, these spreads are not only near their most narrow levels (lower spreads mean lower expected risk), they are currently better than they were last summer and are roughly back to where they were at the start of 2011.
- *The takeaway here is that credit markets are not seeing the level of risk that is being reflected in equity markets through the sharp sell-off in stocks over the last few days.*

Figure 5: US Investment Grade (JULI) Spread

JULIXEMS Index <<GO>>



Source: J.P. Morgan and Bloomberg.

Figure 6: High Yield Spread

CSSWUS Index <<GO>>



Source: J.P. Morgan and Bloomberg.

Figure 7: BB vs. AAA Spreads

BB: MOODCBA Index <<GO>>; AAA: MOODAAA Index <<GO>>



Source: J.P. Morgan and Bloomberg.

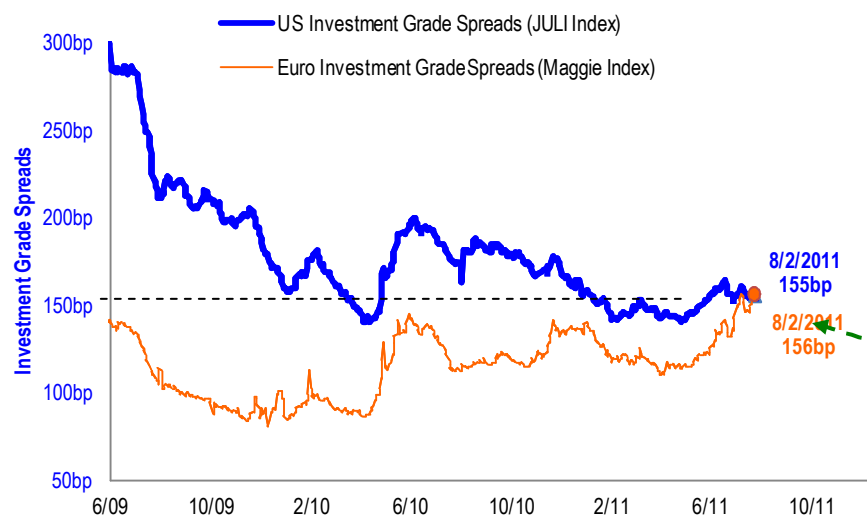
US investment grade is outperforming Europe investment grade

US Corporates have been meaningfully outperforming European Corporates as credit holders differentiate developments across the pond. Historically, US Corporates have seen higher spreads, and hence higher risk, compared to their European counterparts.

- Recently, there has been a convergence of these two spreads. US corporates are now gaining in relative attractiveness, and the gap between the US Investment Grade Spreads (based on the JULI Index, JULIEXM Index <<GO>>) and the European Investment Grade Spreads (based on the Maggie Index, JMGMIG Index <<GO>>) has narrowed.
- From Figure 8, both the US Investment Grade spreads and the Euro Investment Grade spreads have converged at 155bp, which also marks the first time convergence has occurred in the entire 10+ years of both series.

Figure 8: US Investment Grade Spreads vs. Euro Investment Grade Spreads

US Investment Grade: JULI Index; JULIEXM Index <<GO>>; Euro Investment Grade: Maggie Index, JMGMIG Index <<GO>>



Source: J.P. Morgan and Bloomberg.

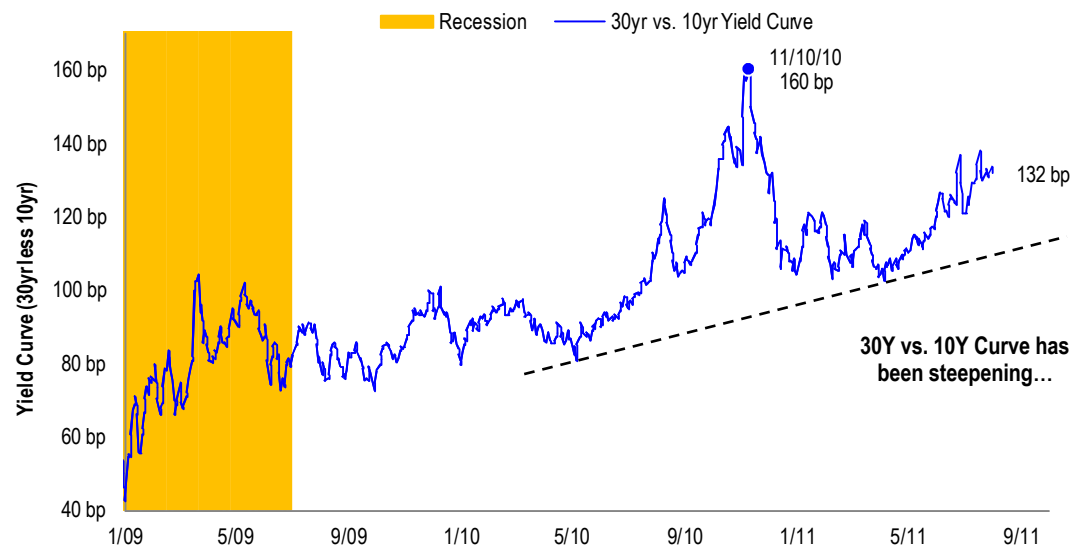
10Y vs. 30Y yield curve remains steep

Despite the weaker economic data and worrying macro headlines recently, the yield curve in the US (30yr minus 10yr) has actually steepened over the past year.

- The yield curve is currently at 132bp, up 50bp compared to mid-2010. This suggests that credit markets actually see stronger economic growth ahead than they did a year ago. This is in contrast to current macro headlines, which have reignited fears of a double-dip recession.

Figure 9: 30yr vs. 10yr Yield curve

Since 2009



Source: J.P. Morgan and Bloomberg.

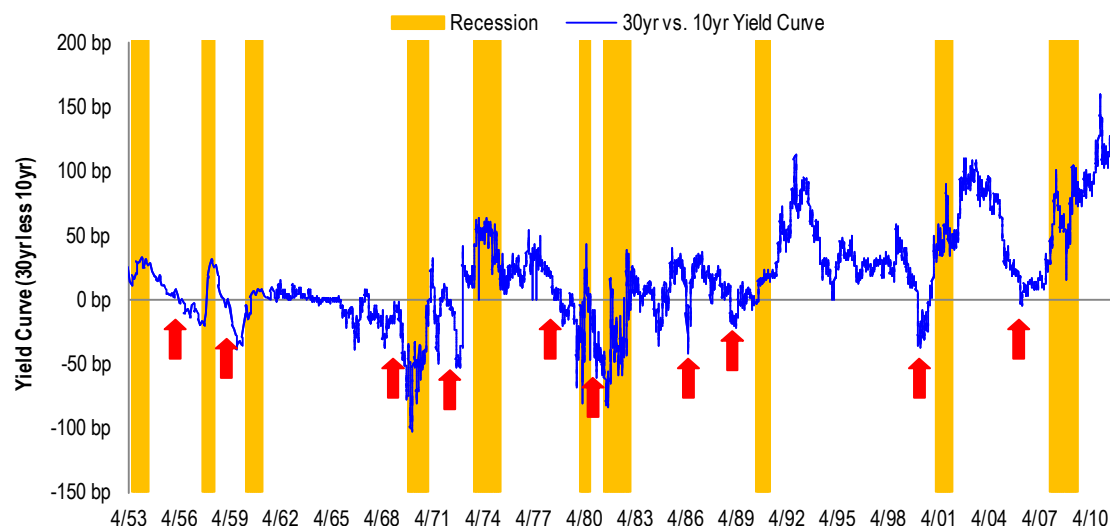
Steep Yield curve suggests low likelihood of double-dip recession

The yield curve (30yr vs. 10yr) is at one of the steepest levels ever, providing a lot of support to the economy. The 30/10yr yield curve also has had a very good track record of anticipating recessions:

- The yield curve (30yr minus 10yr) historically has become inverted 13-22 months before a recession started (Figure 11). The yield curve even became inverted 17 months before the 1987 market crash.
- In contrast, the yield curve currently is at one of the steepest levels in the last 35 years (Figure 10). In fact, the yield curve is in the 99th percentile of steepness. This suggests that a double-dip recession occurring in the near term is less likely.

Figure 10: 30yr vs. 10yr Yield curve vs. Recessions

Between 4/1953-2/1972, 20yr yield data is used in lieu of 30yr yields.



Source: J.P. Morgan, Bloomberg, Federal Reserve. (30 year Treasury yield data is only available from 2/1972)

Figure 11: Yield Curve Lead Time vs. Recessions

Between 4/1953-2/1972, 20yr yield data is used in lieu of 30yr yields.

	Date Yield Curve Inverted	Start of Recession	Months from Inverted to Start of Recession
1	7/1956	8/1957	14
2	5/1959	4/1960	12
3	1/1969	12/1969	12
4	1/1972	11/1973	23
5	10/1978	1/1980	15
6	6/1980	7/1981	13
7	5/1986	10/1987	17
8	11/1988	7/1990	20
9	1/2000	3/2001	14
10	2/2006	12/2007	23
Average			16
Median			15

Source: J.P. Morgan, Bloomberg, Federal Reserve. (30 year Treasury yield data is only available from 2/1972.)

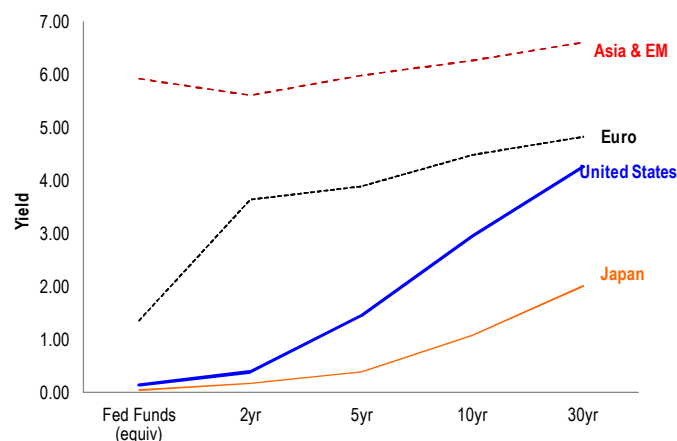
Global yield curves suggest less downside risk to growth in US than in Europe

The weak economic data and growing sovereign debt concerns in Europe have raised fears of an impending global recession. However, global yield curves suggest this downside risk is more concentrated in Europe while the US appears to have less risk of a double-dip recession.

- Figure 12 below maps the respective yield curves for the US, Euro, Japan, and Asia & Emerging Markets. This chart highlights how the yield curve in the US remains extremely steep, while both the Euro and Asia & Emerging markets have a relatively flatter curve. This suggests the US has a lower risk of downside to growth than Europe.
- Figure 13 further highlights several countries with 10yr-2yr spreads below 90bps, which suggests more downside risk for growth. Greece and Portugal stand out here with their inverted curves (Greece's 2yr is yielding 36% and Portugal's 1yr is currently yielding 18%). That said, beyond these 2 countries, the other 5 countries have relatively flat curves.

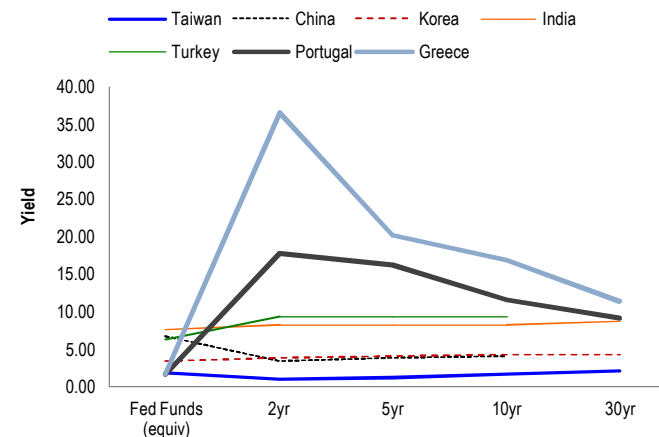
Figure 12: Regional Yield Curves

Aggregates are debt-weighted



Source: J.P. Morgan and Bloomberg. Note: Euro and Asia & Emerging Market curves calculated by weighting the respective composite yields by outstanding local government debt.

Figure 13: US: Yield curves of Countries with 10yr-2yr spreads below 90bp



Source: J.P. Morgan and Bloomberg.

US yield curve remains extremely steep, suggesting less downside risk for growth...

...while yield curves in Europe are relatively flatter, suggesting a relatively higher risk of a double-dip recession.

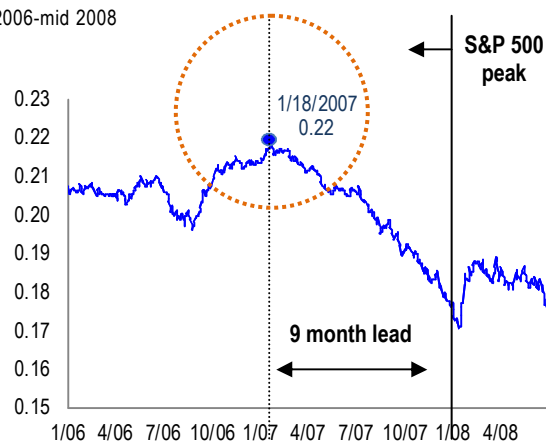
Consumer Discretionary stocks are outperforming...

One of the better directional indicators for the S&P 500 has been the performance of the Consumer Discretionary sector (S5COND Index GP <<GO>>). As shown in Figure 14 to Figure 16, Discretionary stocks have been important at key turning points in the past few years:

- In January 2007, Discretionary stocks began underperforming the S&P 500, which was 9 months before the bull market ended;
- In July 2008, Discretionary stocks began outperforming the S&P 500, which was 8 months prior to the start of the 2009 bull market;
- Recently, Discretionary stocks have been outperforming the S&P 500 and recently reached new highs against the S&P 500.

Figure 14: In '07, Discretionary peaked 9 mos ahead...

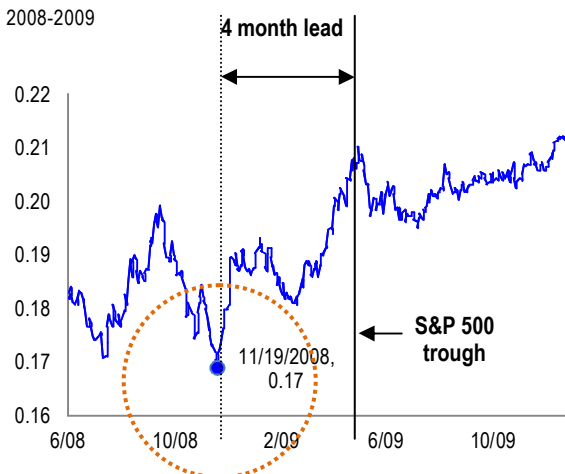
Consumer Discretionary price divided by S&P 500 price
2006-mid 2008



Source: J.P. Morgan and Bloomberg.

Figure 15: In 2008, Discretionary bottomed 8 mos ahead...

Consumer Discretionary price divided by S&P 500 price
2008-2009



Source: J.P. Morgan and Bloomberg.

Figure 16: Since April, Discretionary has been outperforming

Consumer Discretionary price divided by S&P 500 price
Past 12 months



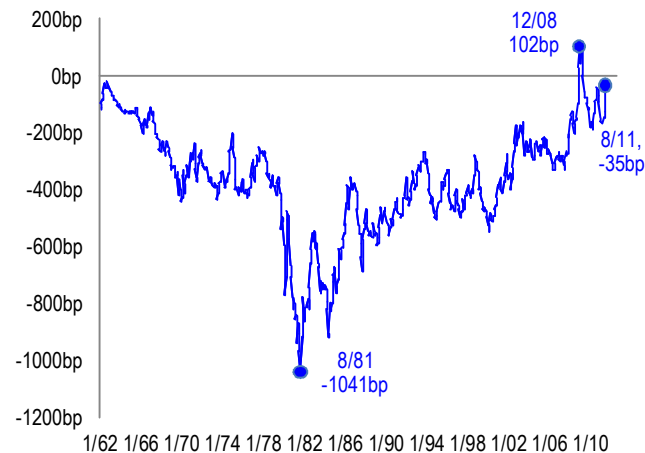
Source: J.P. Morgan and Bloomberg.

Dividend Yield of S&P 500 within 35bp of Treasuries

The gross dividend yield of the S&P500 is within 35bp of the 10yr-yield (see Figure 17). This is a level which has not been seen since 1962 (ex briefly in 2008).

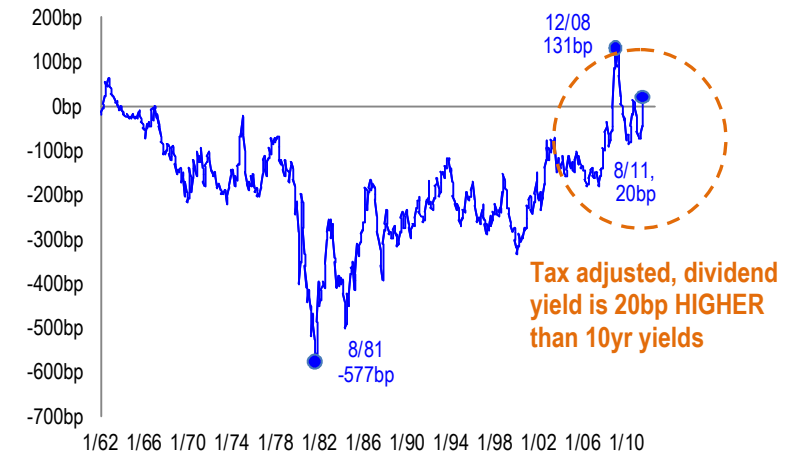
- Additionally, if we consider tax-adjusted yields (see Figure 18), the tax-adjusted dividend yield of the S&P500 is currently 20bp HIGHER than the 10yr yield.
- What this implies is that one could own the S&P500 and just by receiving the dividend, see a greater return than from owning the 10-year Treasury.

Figure 17: Gross: S&P500 Div Yield vs. 10yr Treasury Yield



Source: J.P. Morgan and Bloomberg.

Figure 18: Tax adjusted: S&P500 Div Yield vs. 10yr Treasury Yield



Source: J.P. Morgan and Bloomberg.

Current tax rate applied historically: 15% for Dividend gains, 35% for Capital gains (on Treasuries), assuming Short-term Capital tax gain applied to an Individual falling under the Ordinary Income Tax Rate 35% bucket..

S&P 500 RSI is at levels last seen in March 2009

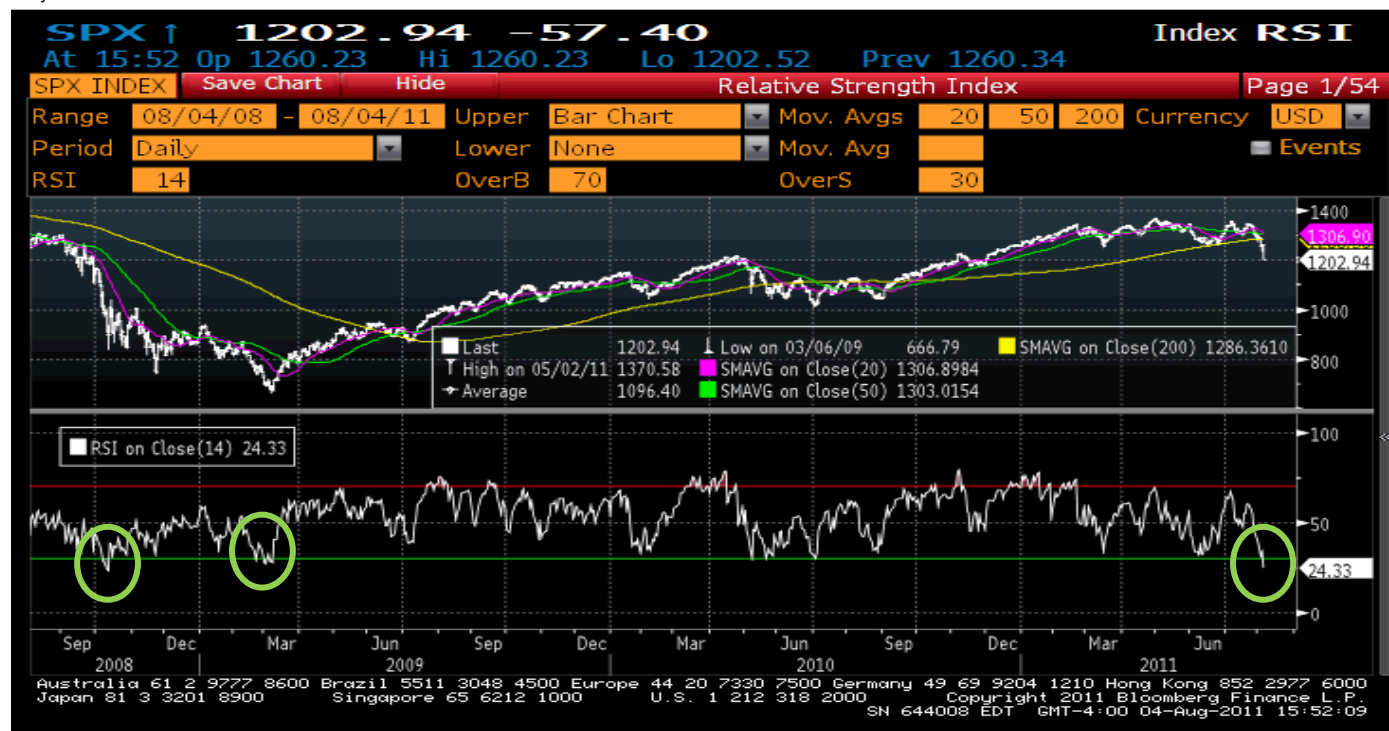
Nobody has to be told the S&P 500 is oversold.

But look at Figure 19, the daily RSI is now 24.33, a level last seen in October 2008 and March 2009 – and depending on which index you watch, marked key structural lows for the market.

- While we would hardly rest our thesis solely on this chart, given the constellation of factors, supports a view of markets nearing the end of their sell-off.

Figure 19: S&P 500 Daily RSI

Daily RSI



Source: Bloomberg.

GDP analysis: 1Q revision on inventory; 2Q reflects weak auto

Given the disappointments of 1Q (revised to 0.4%) and 2Q GDP (1.3%), we provided some simple tables in Figure 20 and Figure 21 below looking at the component contribution to GDP growth, using previous and revised data:

- See Figure 20: 99bp of the 150bp downward GDP revision is attributable to a markedly reduced contribution from inventories. The change in contribution from private inventories is a bit hard to understand. Under the previous estimate, private business inventories grew by \$52.2b, and now revised to a rise of \$49.1b—not clear how this caused a 99bp swing. **Finally, note that government spending was a 1.23% drag on GDP in 1Q11.**
- 2Q GDP saw a 65bp drag from “Motor vehicles and parts” which reflects the auto shutdowns due to the supply chain disruptions of Japan. Since 1950, “Motor vehicle and parts” contributed 0.13% to GDP, thus a “normalized” contribution, and GDP/PCE in 2Q would have been 2.08%/0.95%, respectively (Figure 21) using this contribution.

Figure 20: 1Q11 GDP Revision: Inventory is culprit

% contribution to real GDP growth, SAAR

	1Q11		Delta
	Previous	Revised	
GDP	1.90	0.40	(1.50)
Personal consumption	1.52	1.47	(0.05)
Gross domestic investment	1.46	0.47	(0.99)
Structures - non-res	(0.41)	(0.40)	0.01
Equipment & Software	0.61	0.60	(0.01)
Residential	(0.05)	(0.06)	(0.01)
Inventories	1.31	0.32	(0.99)
Net exports	0.14	(0.34)	(0.48)
Exports	0.97	1.01	0.04
Imports	(0.84)	(1.35)	(0.51)
Government	(1.20)	(1.23)	(0.03)

Source: J.P. Morgan and BEA.

Fiscal drag

Figure 21: 2Q11 GDP composition: Motor vehicle sales & parts hurt

% contribution to GDP growth, saar

	2Q11	2Q vs 1Q delta
GDP	1.30	0.90
Personal consumption	0.07	(1.40)
Motor vehicle and parts	(0.65)	(1.02)
Other durable/non-durable goods	0.72	(0.38)
Gross domestic investment	0.87	0.40
Structures - non-res	0.20	0.60
Equipment & Software	0.41	(0.19)
Residential	0.08	0.14
Inventories	0.18	(0.14)
Net exports	0.58	0.92
Exports	0.81	(0.20)
Imports	(0.23)	1.12
Government	(0.23)	1.00

Source: J.P. Morgan and BEA.

Using 50-yr average of a 0.13% contribution (vs. -0.65%), 2Q GDP would have been > 2%... and this drag is temporary

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[How Loan Growth Will Get Banks Working. Key to 1475.](#) — 4/29/11

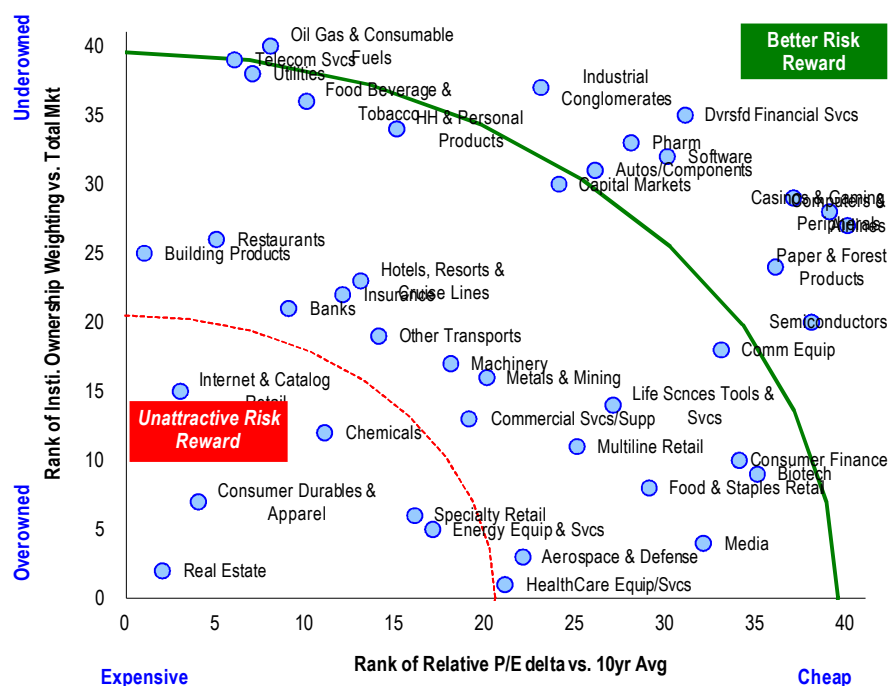
[Why Equity Response \(lack of\) to S&P AAA-rtg action is right](#) — 4/21/11

[How Supply Chain Hurts Industrials and Aerospace](#) — 4/15/11

Ownership vs. Valuation Matrices

Figure 22: Comparative Risk Reward of Industries: Ownership vs. Valuation Matrix

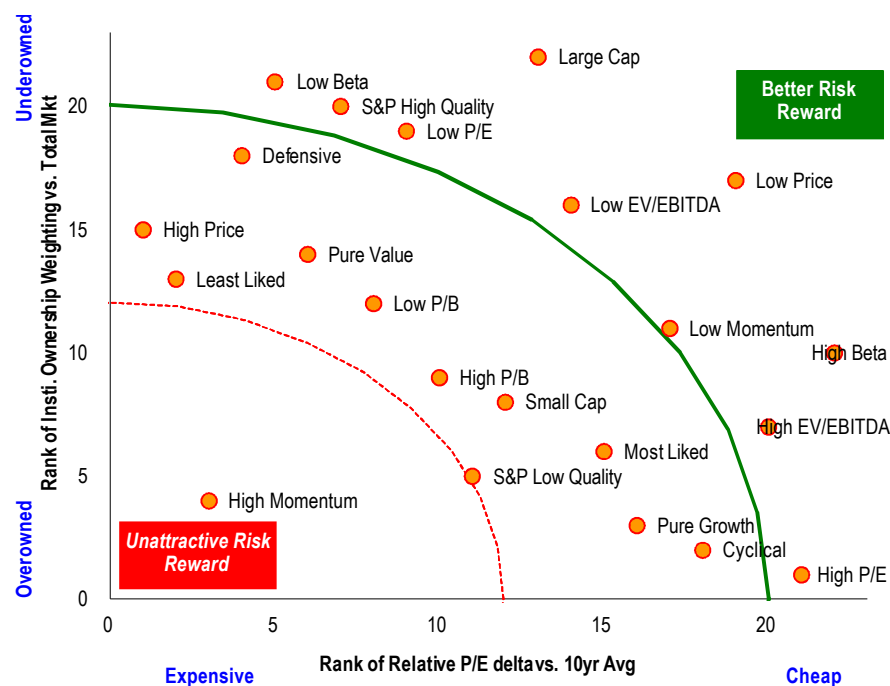
X-axis is relative valuation; Y-axis is institutional ownership



Source: J.P. Morgan and FactSet.

Figure 23: Comparative Risk Reward of Styles: Ownership vs. Valuation Matrix

X-axis is relative valuation; Y-axis is institutional ownership



Source: J.P. Morgan and FactSet.

Macro at a Glance

Economic Highlights

Initial jobless claims drop to 400,000

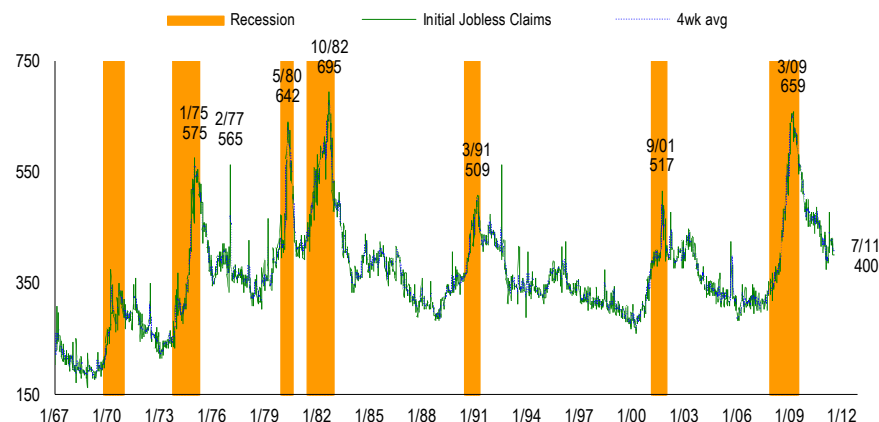
Initial claims for the week ending July 30th declined slightly to 400,000, down 1,000 vs. the prior week. The four-week moving average also moved down to 408,000, showing gradual improvement recently. While claims remain elevated, the recent trend over the past few weeks has been more encouraging.

ISM Manufacturing disappoints to the downside

The ISM Manufacturing index declined to 50.9 in July, a decline of 4.4 points. This is the lowest level so far during this economic expansion, reigniting fears of a double-dip recession. The details of the ISM report were also particularly discouraging. The new orders index fell below 50 to 49.2 for the first time since June 2009, and the employment index fell 6.4 points to 53.5. According to J.P. Morgan Economics, this dismal ISM report was likely due to several factors, including a weaker orders-inventories gap from June which signaled weakness in the months ahead, and also uncertainty around the US debt ceiling potentially holding back business.

Figure 24: Jobless Claims

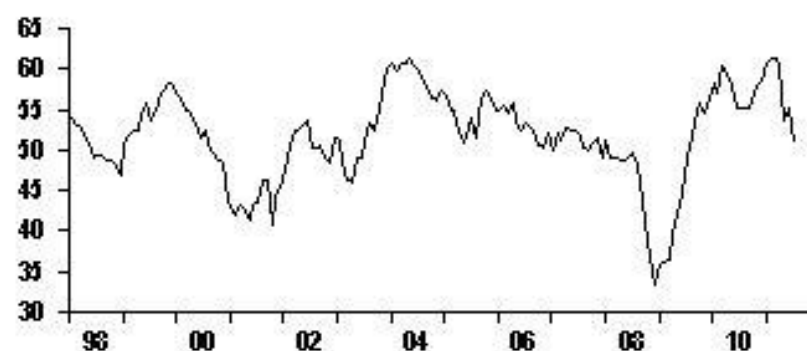
Since 1967



Source: J.P. Morgan and Datastream.

Figure 25: ISM Manufacturing

Index, sa



Source: J.P. Morgan Economics.

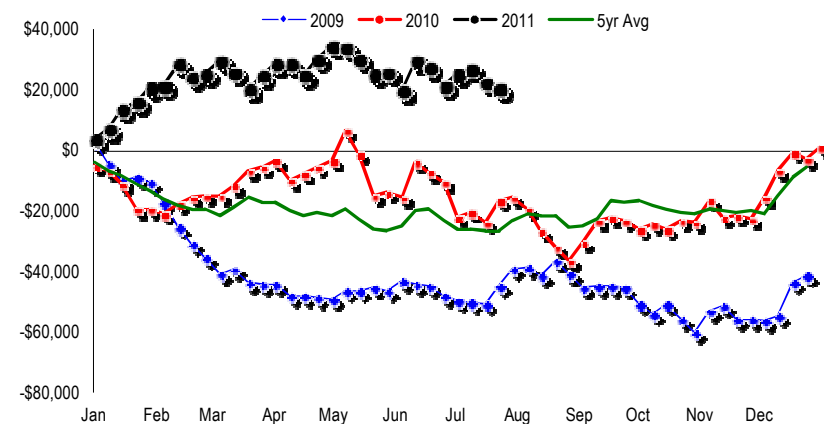
Fund Flows

US equity funds have seen outflows over the past few weeks, as investors have pulled money out of stocks, likely due to macro concerns related to slowing economic growth and also the uncertainty surrounding the US debt ceiling. US equity funds saw strong inflows early on in 2011 but have overall been relatively flat over the past several months. However, the YTD trend is still a vast improvement relative to the past few years, when US equity funds consistently saw outflows.

As shown in the figure on the right below, international bonds have seen the largest inflows YTD, followed closely by equity funds and US bond funds.

Figure 26: US Equities' Cumulative YTD Mutual Fund Flows

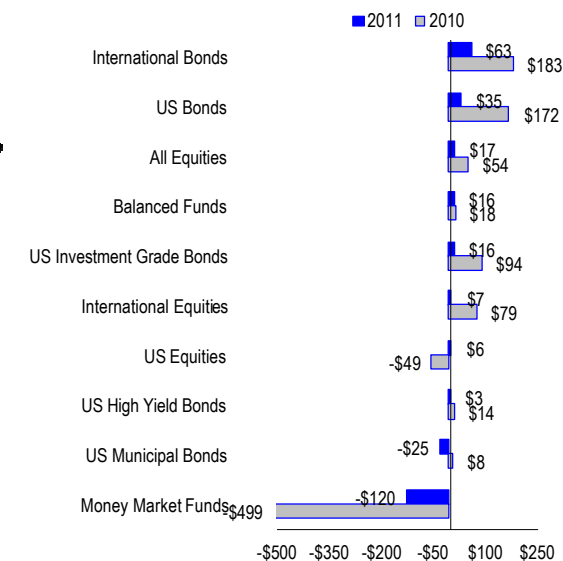
\$ millions, weekly reporting funds



Source: EPFR Global.

Figure 27: 2011 and 2010 Cumulative Fund Flows

\$ billions, monthly & weekly reporting funds



Source: EPFR Global.

Sector Roadmap

The table below maps the rolling performance of the 10 sectors of the S&P 500 and visually charts a roadmap of sector rotation. As shown below and as we have discussed in several past reports, sector rotation moved from “Risk Off” to “Risk On” in late 2010, and then shifted back to “Risk Off” more recently.

- **Defensives** continue holding their lead and have been consistently outperforming over the last few months.
- **Financials** has consistently been one of the worst-performing sectors over the past several months.

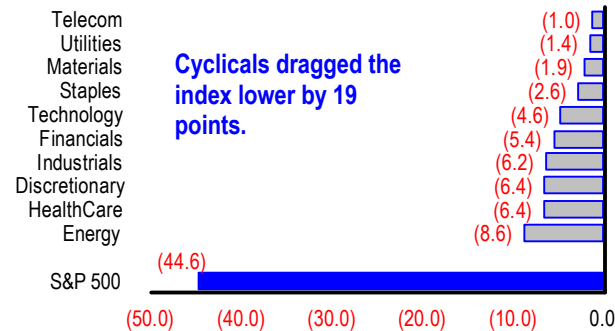
Figure 28: SECTOR ROADMAP: Trailing-Three-Month Relative Performance

	9/3/10	10/3/10	11/3/10	12/3/10	1/3/11	2/3/11	3/3/11	4/3/11	5/3/11	6/3/11	7/3/11	8/3/11
Cyclicals												
Materials	7.9%	7.8%	4.1%	4.7%	6.9%	4.4%	-1.7%	-1.1%	-2.1%	-1.0%	-1.4%	-0.7%
Industrials	0.3%	3.6%	-1.8%	1.6%	0.9%	4.1%	1.5%	3.6%	1.0%	-1.0%	-0.9%	-5.9%
Discretionary	-1.7%	3.1%	6.1%	5.2%	2.5%	-2.7%	-3.0%	-0.9%	2.9%	0.8%	3.8%	1.5%
Technology	-4.2%	-0.1%	3.9%	-1.6%	0.5%	-1.1%	-0.7%	-2.8%	-4.5%	-3.1%	-0.4%	3.6%
Near Cyclicals												
Financials	-1.6%	-4.9%	-8.1%	-9.4%	1.6%	3.7%	1.7%	-3.5%	5.2%	-6.8%	-6.0%	-4.9%
Energy	1.2%	2.4%		9.3%	9.5%	14.1%	11.1%	10.9%	3.2%	-2.3%	-5.1%	1.6%
Defensives												
Staples	2.3%	-1.9%	-0.1%	-5.2%	-5.7%	-8.4%	-5.7%	-2.6%	4.7%	7.5%	4.1%	3.4%
HealthCare	-0.6%	-3.2%	0.4%	-4.5%	-6.8%	-7.2%	-2.1%	-0.2%	6.6%	8.4%	7.5%	-0.5%
Telecom	10.5%	7.3%	3.1%	-4.1%	-4.5%	-7.2%	-6.6%	-2.8%	4.2%	7.4%	1.7%	-0.7%
Utilities	9.0%	0.0%	-4.2%	-12.0%	-11.1%	-8.2%	-5.7%	-2.9%	0.6%	5.3%	5.0%	5.0%
S&P 500	0.2%	12.1%	6.9%	10.9%	11.0%	9.1%	8.7%	4.8%	3.8%	-2.3%	0.5%	-7.1%

Source: J.P. Morgan and FactSet.

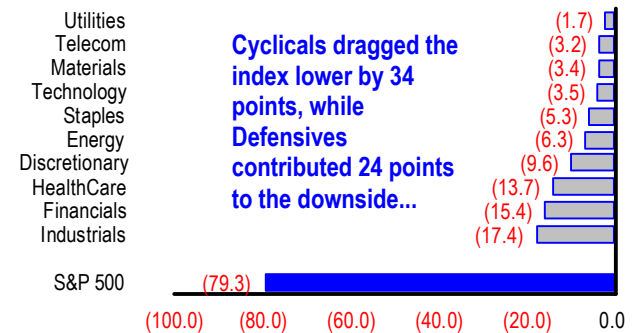
Index Performance Analysis

Figure 29: Sector Cont. to 5-Day S&P 500 Point Change (as of 8/3)



Source: FactSet and J.P. Morgan.

Figure 30: Sector Cont. to 1-Month S&P 500 Point Change (as of 8/3)



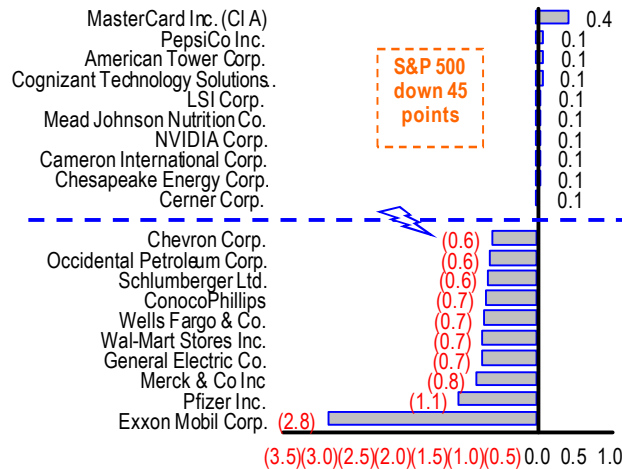
Source: FactSet and J.P. Morgan.

Figure 31: Stock Cont. to 5-Day S&P 500 Point Change (as of 8/3)

Ten Largest Positive Contributors and Ten Largest Negative Contributors

Technology had 4 stocks in the Top 10.

Energy had 5 stocks in the Bottom 10.



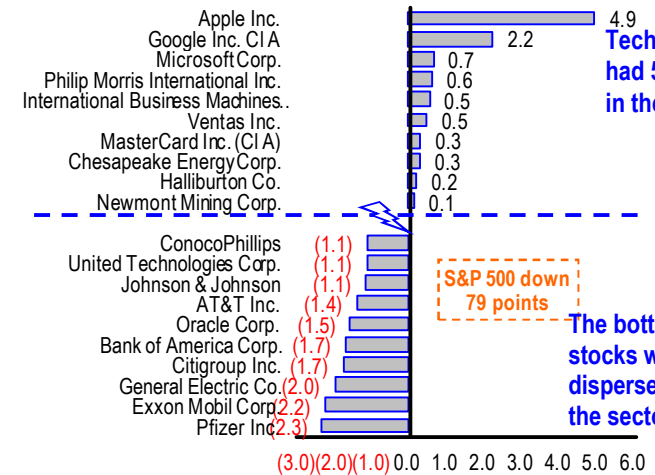
Source: FactSet and J.P. Morgan.

Figure 32: Stock Cont. to 1-Month S&P 500 Point Change (as of 8/3)

Ten Largest Positive Contributors and Ten Largest Negative Contributors

Technology had 5 stocks in the Top 10

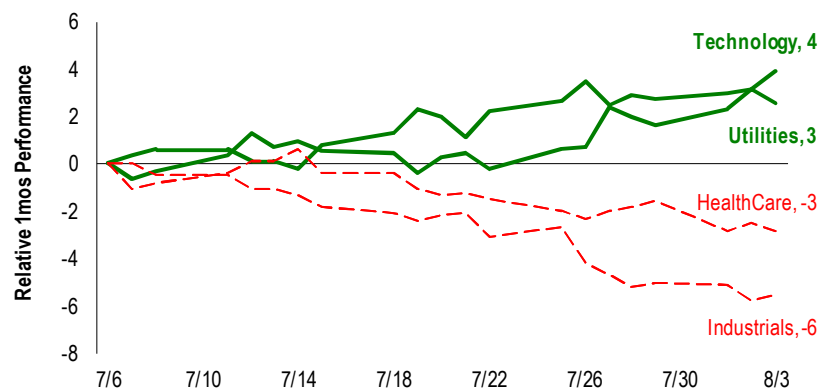
The bottom 10 stocks were dispersed among the sectors.



Source: FactSet and J.P. Morgan.

Figure 33: Best Two and Worst Two Sectors – Relative Performance over the Past Month

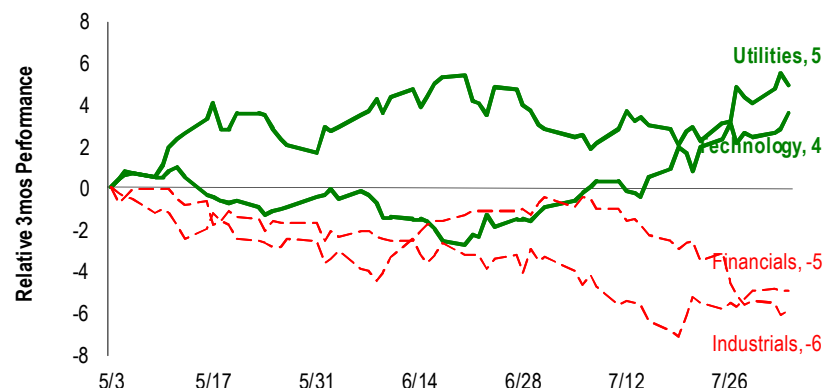
Performance Relative to the S&P 500



Source: FactSet and J.P. Morgan.

Figure 34: Best Two and Worst Two Sectors – Relative Performance over the Past Three Months

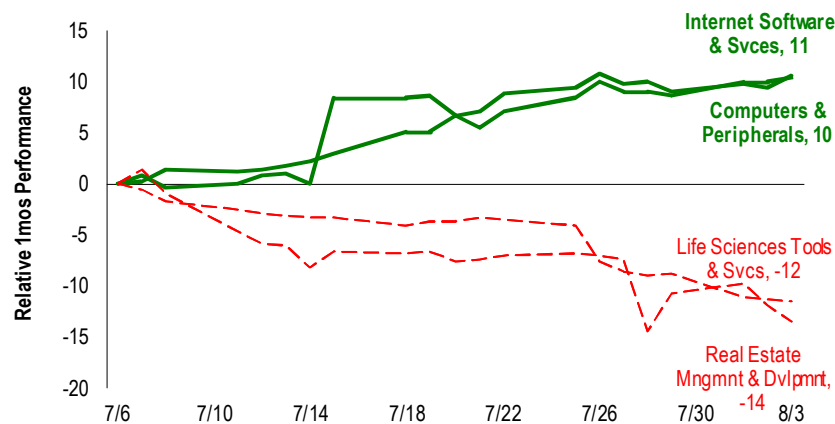
Performance Relative to the S&P 500



Source: FactSet and J.P. Morgan.

Figure 35: Best Two and Worst Two Industries – Relative Performance over the Past Month

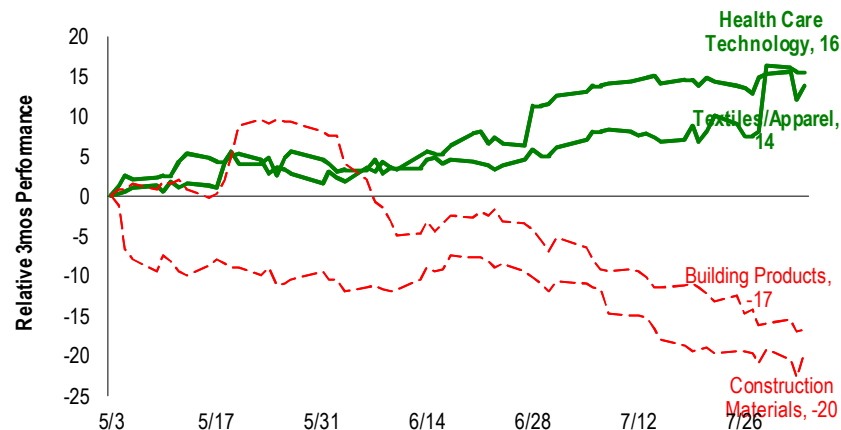
Performance Relative to the S&P 500



Source: FactSet and J.P. Morgan.

Figure 36: Best Two and Worst Two Industries – Relative Performance over Past Three Months

Performance Relative to the S&P 500



Source: FactSet and J.P. Morgan.

Style Roadmap

Below is a Style roadmap that plots the recent relative performances of 10 different style components (Beta, P/B, etc.). These are sorted by volatility (highest to lowest).

- Lower risk/volatility styles have maintained leadership recently as the market has pulled back.
- The best-performing styles were Lower Beta and Higher Price.

Figure 37: STYLE ROADMAP: Trailing-Three-Month Relative Performance

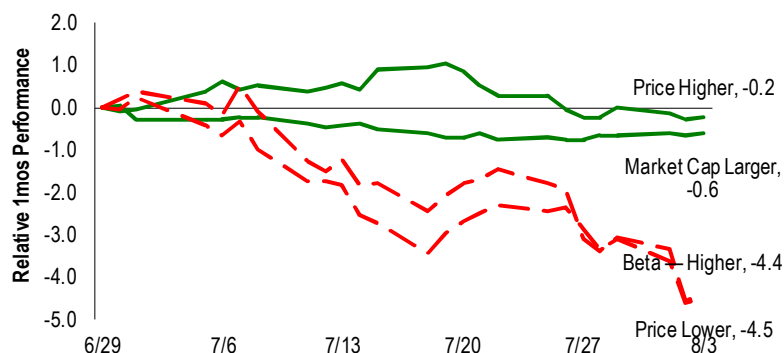
	9/3/10	10/3/10	11/3/10	12/3/10	1/3/11	2/3/11	3/3/11	4/3/11	5/3/11	6/3/11	7/3/11	8/3/11
High Volatility												
Beta — Higher	-0.7%	6.0%	2.4%	6.7%	8.4%	7.6%	3.9%	1.3%	-0.5%	-2.4%	-2.7%	-5.5%
Price Lower	-3.0%	1.2%	-0.7%	1.3%	2.8%	4.9%	4.7%	1.9%	1.4%	0.5%	-1.1%	-5.6%
Market Cap Smaller	-0.3%	2.8%	0.6%	3.1%	3.0%	4.2%	3.0%	3.1%	2.4%	1.4%	-0.3%	-4.7%
P/E — more expensive	-1.0%	2.0%	1.8%	4.2%	3.5%	3.0%	-1.2%	0.2%	-0.4%	0.1%	-0.4%	-0.1%
S&P Low Quality	0.0%	3.1%	2.0%	3.4%	2.8%	4.0%	3.2%	2.0%	0.5%	-0.1%	-1.0%	-3.4%
EV/EBITDA — more expensive	0.5%	3.4%	3.5%	5.3%	4.1%	3.2%	1.6%	0.1%	-1.4%	-1.5%	-1.9%	-1.9%
Broken (low P/200d mavg)	2.2%	2.9%	-0.1%	2.2%	3.2%	5.9%	2.6%	1.1%	2.9%	4.2%	2.5%	-2.6%
Citigroup Pure Growth	2.7%	5.9%	7.5%	7.9%	3.3%	1.3%	0.0%	1.7%	2.7%	2.4%	3.1%	0.5%
Cyclical	-0.7%	4.0%	3.6%	5.6%	3.0%	2.1%	-0.1%	0.7%	0.4%	-0.1%	0.5%	-2.6%
Least Liked	0.4%	1.0%	-0.8%	-1.6%	0.7%	0.9%	-0.3%	-0.8%	-0.2%	1.1%	0.3%	-1.3%
P/B — more expensive	2.7%	3.2%	4.2%	3.2%	0.3%	-1.7%	-2.5%	-0.8%	2.5%	3.5%	3.5%	1.3%
Low Volatility												
P/B — cheaper	-0.1%	1.0%	-2.0%	-1.2%	2.0%	2.9%	2.7%	0.8%	-0.8%	-0.4%	-2.5%	-5.0%
Most Liked	0.9%	1.4%	0.7%	0.2%	1.4%	0.3%	-0.5%	0.6%	1.1%	1.0%	0.9%	-0.9%
Defensive	1.5%	-1.7%	-0.1%	-4.4%	-4.9%	-4.2%	-1.4%	0.8%	-5.7%	-7.6%	5.9%	1.1%
Citigroup Pure Value	-1.7%	-1.1%	-0.3%	-4.0%	-0.8%	3.0%	3.9%	2.4%	1.5%	1.5%	0.0%	-3.5%
Momentum (high P/200d mavg)	0.1%	1.8%	2.0%	1.0%	0.9%	-0.3%	-0.5%	2.7%	0.0%	-1.4%	-2.6%	-0.4%
EV/EBITDA — cheaper	-0.5%	1.8%	-0.1%	0.3%	0.5%	2.0%	2.2%	2.3%	3.0%	3.2%	0.6%	-2.7%
S&P High Quality	0.5%	0.5%	-0.2%	0.0%	-0.7%	-1.1%	-1.7%	0.1%	2.2%	2.1%	2.6%	0.1%
P/E — cheaper	0.6%	1.1%	-0.3%	-0.3%	0.5%	2.5%	3.6%	3.6%	2.0%	1.3%	-0.8%	-3.8%
Market Cap Larger	0.1%	0.3%	0.7%	0.1%	-0.5%	-0.4%	-0.2%	0.2%	0.5%	0.3%	0.5%	-0.1%
Price Higher	2.5%	2.2%	3.0%	1.8%	0.4%	-0.3%	-0.7%	2.3%	1.7%	2.1%	1.9%	2.5%
Beta — Lower	2.3%	-1.5%	-0.2%	-4.3%	-5.4%	-4.9%	-2.7%	0.3%	3.6%	6.2%	3.7%	1.8%
S&P 500	0.2%	12.1%	6.9%	10.9%	11.0%	9.1%	8.7%	4.8%	3.8%	-2.3%	0.5%	-7.1%

Source: J.P. Morgan and FactSet.

Style Analysis

Figure 38: Best Two and Worst Two Styles – Relative Performance over the Past Month

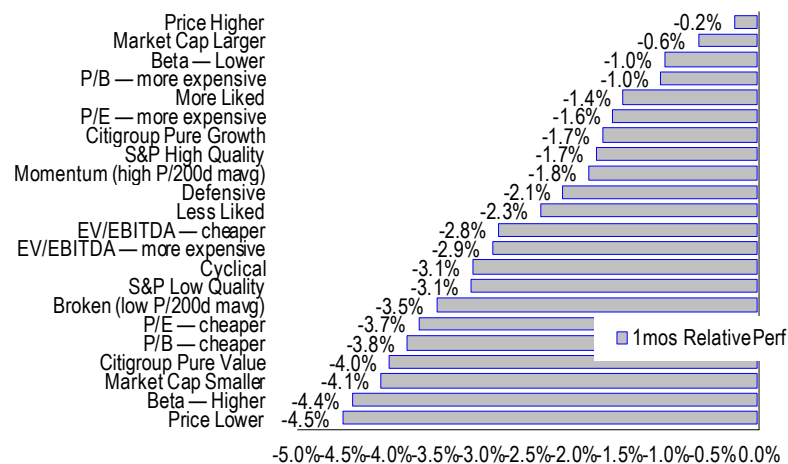
Performance Relative to the S&P 500



Source: FactSet and J.P. Morgan. Note: Performance is for the top quartile and bottom quartile of stocks in each style.

Figure 40: S&P 500 Style Relative Performance over the Past Month

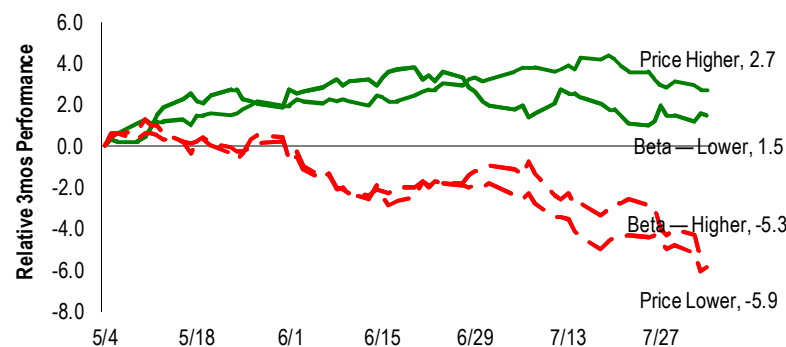
Performance Relative to the S&P 500



Source: FactSet and J.P. Morgan. Note: Performance is for the top quartile and bottom quartile of stocks in each style.

Figure 39: Best Two and Worst Two Styles – Relative Performance over the Past Three Months

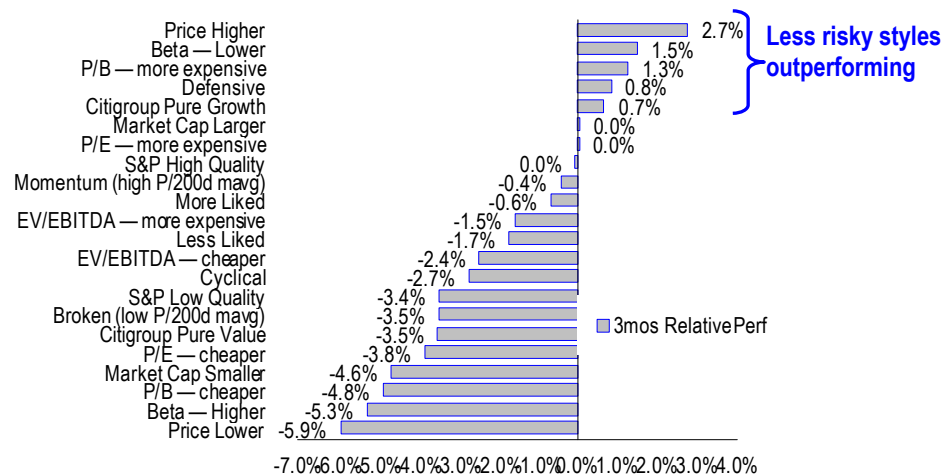
Performance Relative to the S&P 500



Source: FactSet and J.P. Morgan. Note: Performance is for the top quartile and bottom quartile of stocks in each style.

Figure 41: S&P 500 Style Relative Performance over Past Three Months

Performance Relative to the S&P 500



Source: FactSet and J.P. Morgan. Note: Performance is for the top quartile and bottom quartile of stocks in each style.

52-Week Highs/Lows

Net 6% of stocks hitting 52-week lows vs. 52-week highs

The sharp sell-off in stocks recently has pulled more stocks to 52-week lows than highs in the past week, with a net negative percentage of stocks hitting 52-week highs vs. 52-week lows in the past week. At the sector level, Energy was the only sector to see a meaningful net percentage of stocks hitting highs (10%).

Figure 42: Net 23% of Stocks Hitting 52-Week High vs. 52-Week Low in Past Five Days – Sectors

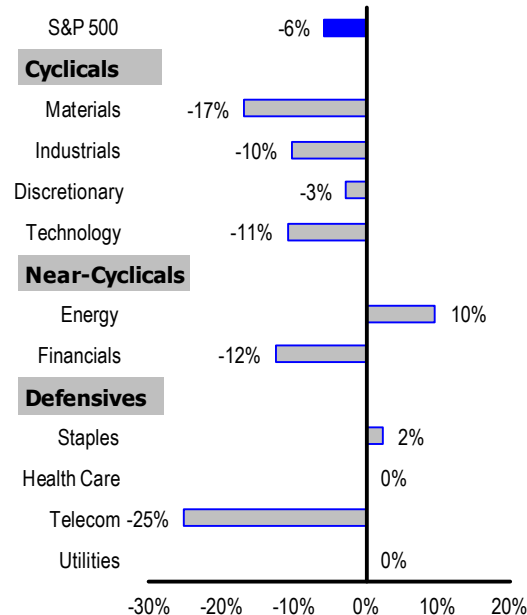
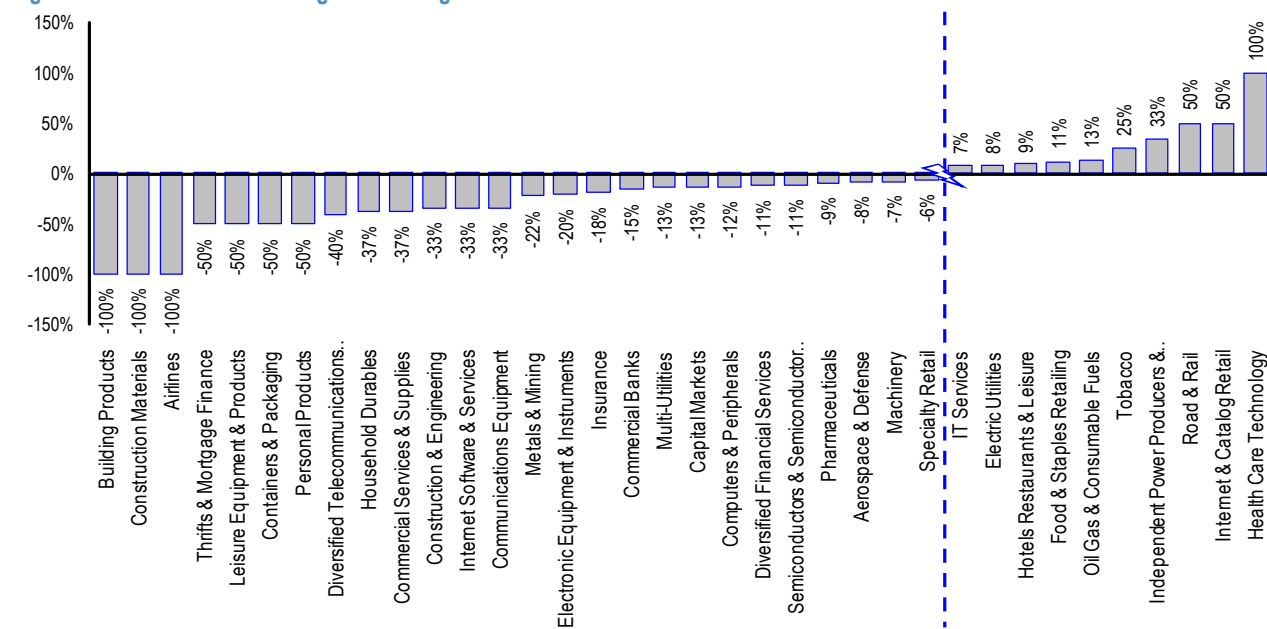


Figure 43: Net % of Stocks Hitting 52-Week High vs. 52-Week Low – Industries



Source: FactSet and J.P. Morgan. Note: Calculated as (# of stocks hitting 52-week high minus # of stocks hitting 52-week low in past five days) divided by total stocks in that industry.

Source: FactSet and J.P. Morgan. Note: Calculated as (# of stocks hitting 52-week high minus # of stocks hitting 52-week low in past five days) divided by total stocks in that sector.

Analyst Upgrades/Downgrades

As for the Street's view, upgrades outnumbered downgrades in the past week, with a net 34 upgrades overall and a healthy 18 industries with net upgrades.

Figure 44: Net Upgrades in the Past Five Days – Sectors

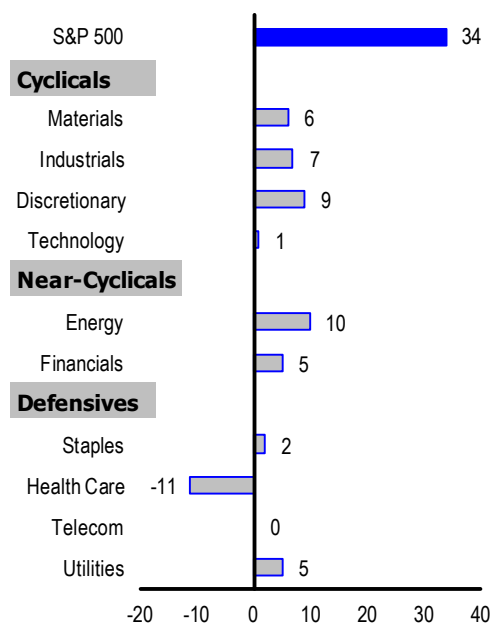
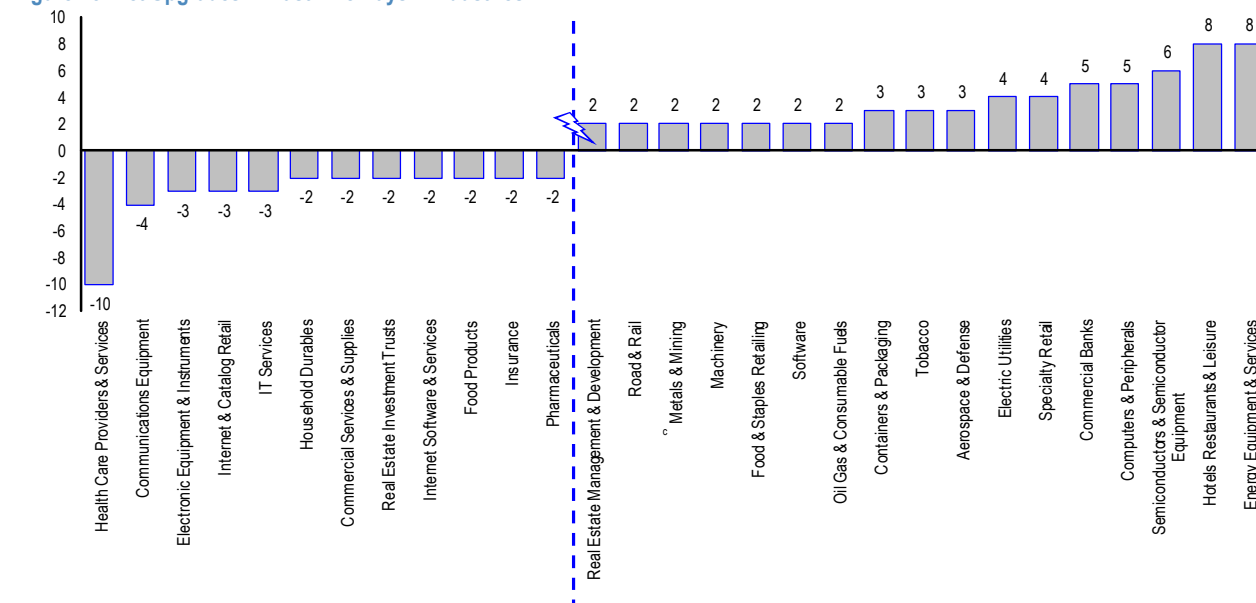


Figure 45: Net Upgrades in Past Five Days – Industries



Source: J.P. Morgan and FactSet.

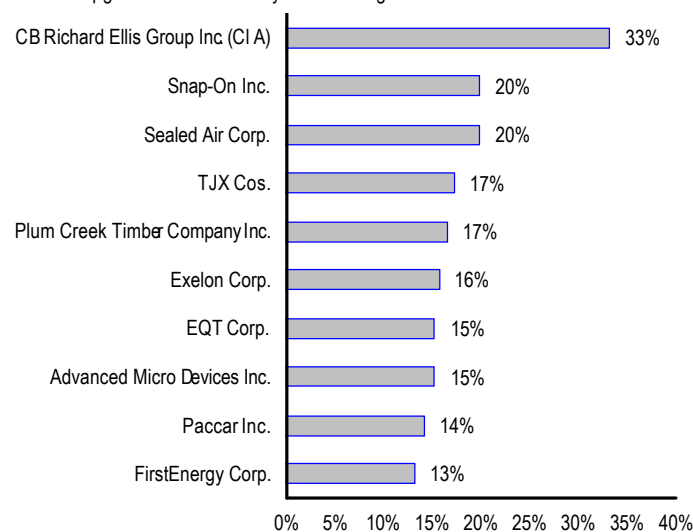
Source: FactSet and J.P. Morgan.

Stock Highlights: Upgrades and Downgrades

We looked at which stocks have been upgraded and downgraded the most in the past five days by looking at net upgrades (upgrades minus downgrades) as a percentage of analysts covering a stock. Upgrades were spread across several sectors. Conversely, Financials was the most represented on the Ten Most Downgraded Stocks with 4 stocks making it to the list.

Figure 46: Ten Most Upgraded Stocks

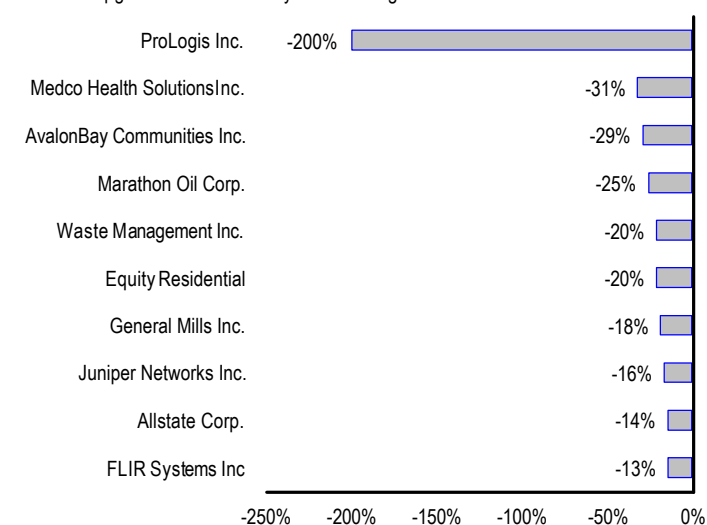
Net # of Upgrades as % of Analysts Covering Stock



Source: FactSet and J.P. Morgan.

Figure 47: Ten Most Downgraded Stocks

Net # of Upgrades as % of Analysts Covering Stock



Source: FactSet and J.P. Morgan.

Analyst Certification: The research analyst(s) denoted by an "AC" on the cover of this report certifies (or, where multiple research analysts are primarily responsible for this report, the research analyst denoted by an "AC" on the cover or within the document individually certifies, with respect to each security or issuer that the research analyst covers in this research) that: (1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers; and (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

Important Disclosures

Explanation of Equity Research Ratings and Analyst(s) Coverage Universe:

J.P. Morgan uses the following rating system: Overweight [Over the next six to twelve months, we expect this stock will outperform the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] Neutral [Over the next six to twelve months, we expect this stock will perform in line with the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] Underweight [Over the next six to twelve months, we expect this stock will underperform the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] The analyst or analyst's team's coverage universe is the sector and/or country shown on the cover of each publication. See below for the specific stocks in the certifying analyst(s) coverage universe.

J.P. Morgan Equity Research Ratings Distribution, as of June 30, 2011

	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	47%	42%	11%
IB clients*	50%	46%	32%
JPMS Equity Research Coverage	45%	47%	8%
IB clients*	70%	64%	52%

*Percentage of investment banking clients in each rating category.

For purposes only of FINRA/NYSE ratings distribution rules, our Overweight rating falls into a buy rating category; our Neutral rating falls into a hold rating category; and our Underweight rating falls into a sell rating category.

Equity Valuation and Risks: Please see the most recent company-specific research report for an analysis of valuation methodology and risks on any securities recommended herein. Research is available at <http://www.morganmarkets.com>, or you can contact the analyst named on the front of this note or your J.P. Morgan representative.

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