JP Morgan Asset Management

Opportunities in Fixed Income

Leicestershire County Council

23 April 2014

Your presenters

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Agenda

Where are the opportunities in fixed income?

- High yield
- Loans
- Securitised products – Mortgages
- Emerging market debt
- Unconstrained strategies

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High Yield

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High yield market characteristics

Euro High Yield	As of 28-Mar-14
Size of market	USD 429bn
YTD performance	2.34%
2013 performance	8.84%
Yield	3.75%
Spread	325bps
Duration	3.78yrs
Maturity	4.64yrs
Rating	BB3

USD High yield	As of 28-Mar-14
Size of market	USD 1,253bn
YTD performance	2.67%
2013 performance	7.41%
Yield	5.27%
Spread	373bps
Duration	4.84yrs
Maturity	6.52yrs
Rating	B1

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Source: J.P. Morgan Asset Management, data as of 28 March 2014. HY – high yield. Yield is yield to worst. Spread is option-adjusted spread.

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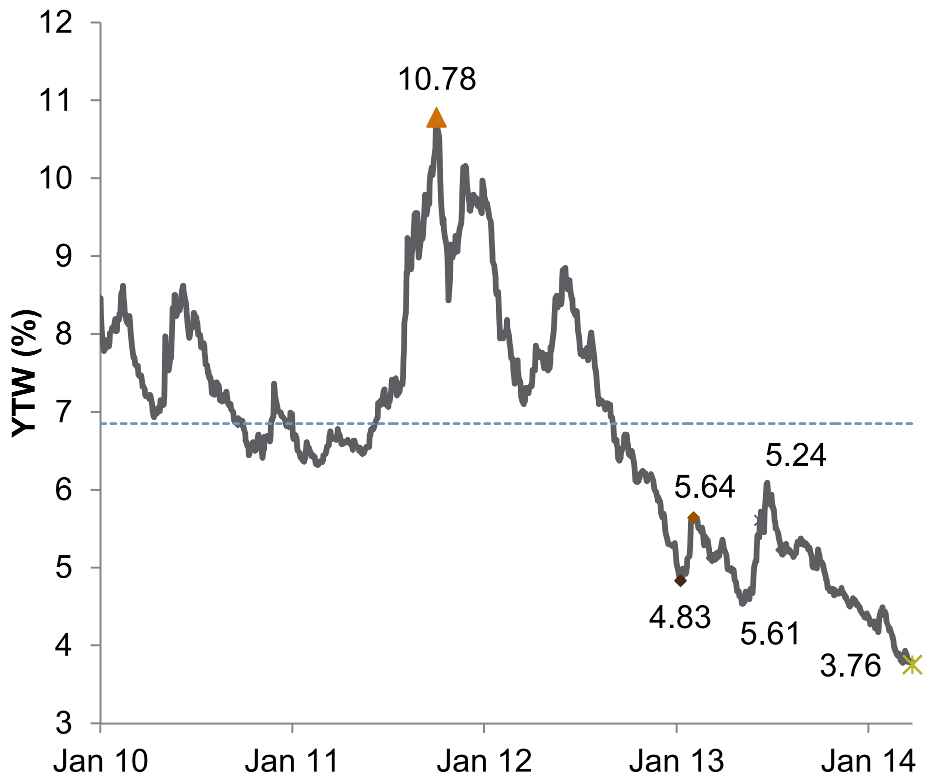
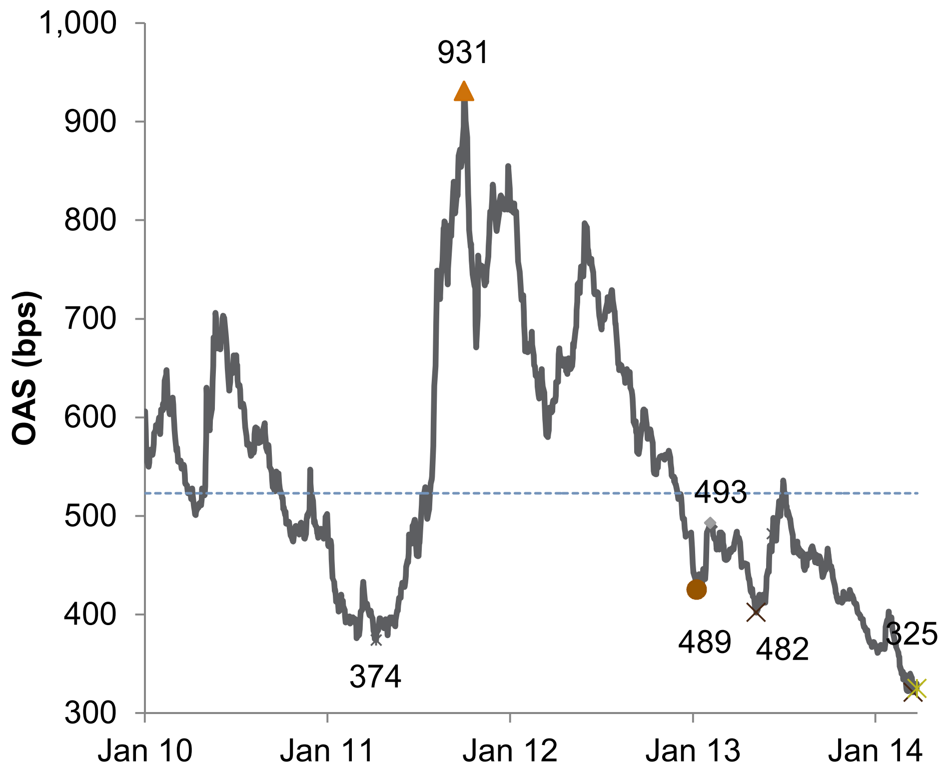
European high yield: recent history

Yields



Spreads



Source: J.P. Morgan Asset Management, data as of 28 March 2014. HY – high yield. Yield is yield to worst. Spread is option-adjusted spread.

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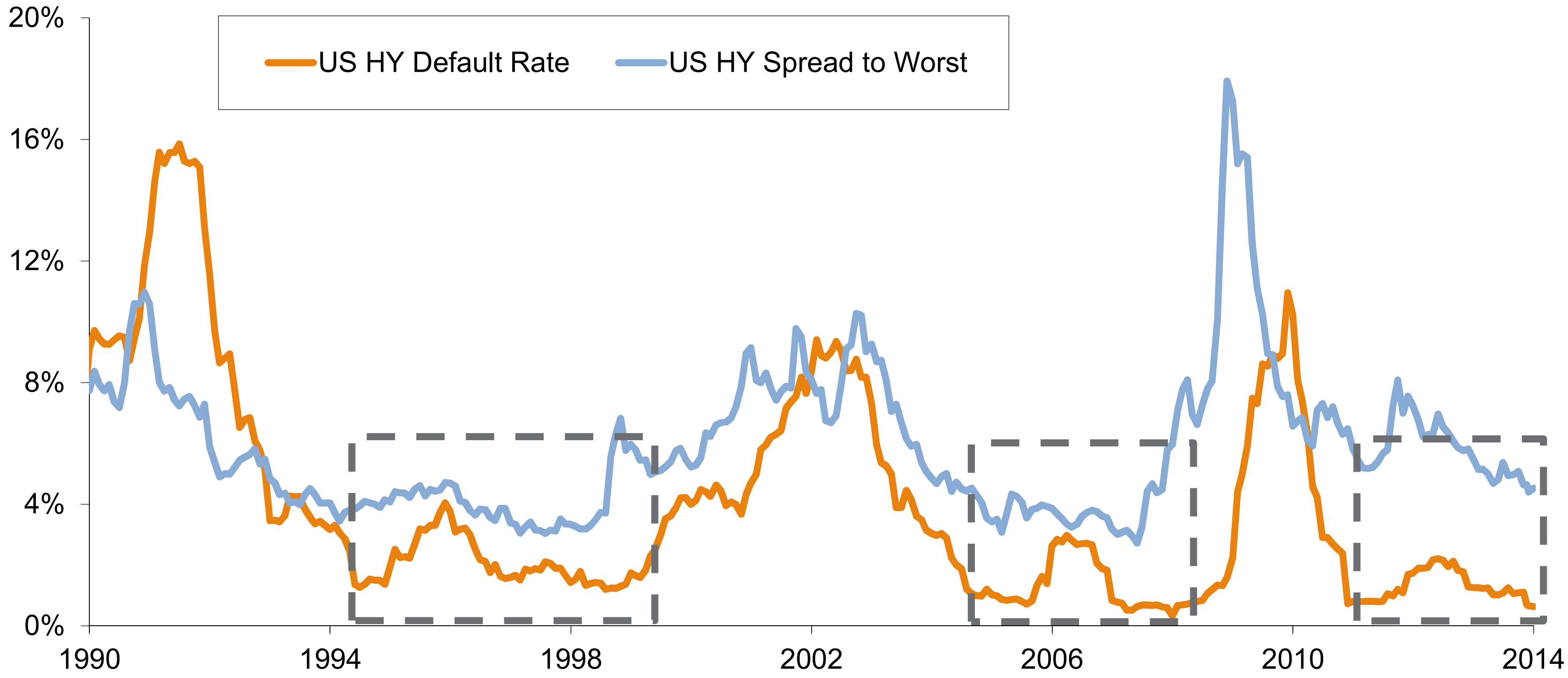
High Yield: fundamentals

Spreads



Source: J.P. Morgan Asset Management, data as of February 2014. HY – high yield

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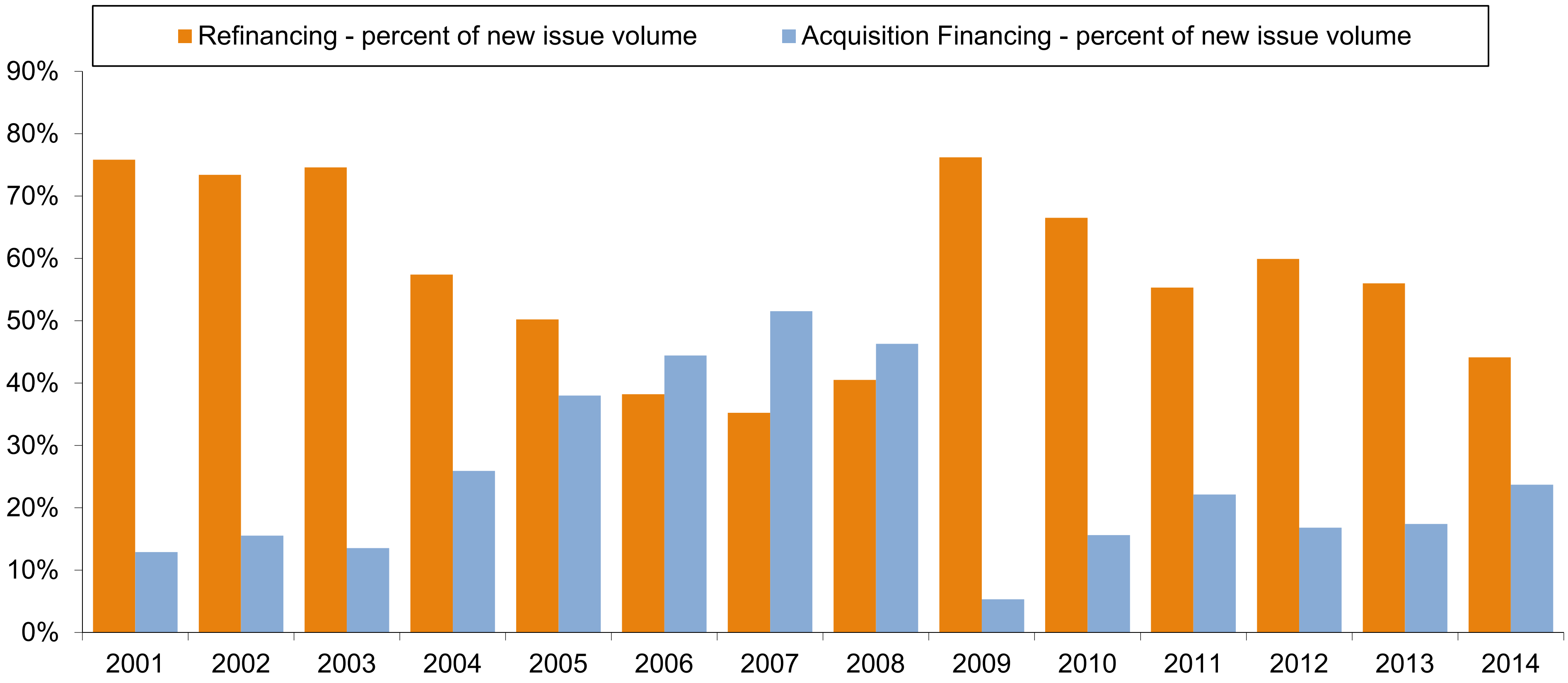
High Yield: technicals

Percent of issuance used for refinancing or acquisition financing



Source: J.P. Morgan Asset Management, data as of 28 February 2014.

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Loans

Attributes of Leveraged Loans and High Yield Bonds

	Leveraged loans 1st lien	High yield bonds	Equities
Ranking	Yes–1st ranking	Generally none	None
Security	Senior secured	Generally senior unsecured or lower	Junior
Covenants	More comprehensive, often with maintenance as well as incurrence- based	Less restrictive; incurrence limitations	None
Term	5-8 years	7–10 years	Open ended
Income	Cash pay–floating (LIBOR based), quarterly	Cash pay–fixed, semi-annual	Dividends– uncertain, usually cash pay
Interest rate duration	Limited	Moderate	N/A

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*Refers to protection against the borrower repaying the debt prior to when it is due. When a borrower has discretion to repay debt before it is due, it causes reinvestment risk for the lender. In addition, if the debt is repaid before it is due it may diminish/enhance the return, depending on whether the investment was purchased at a premium/discount.
Source: J.P. Morgan Investment Management Inc.

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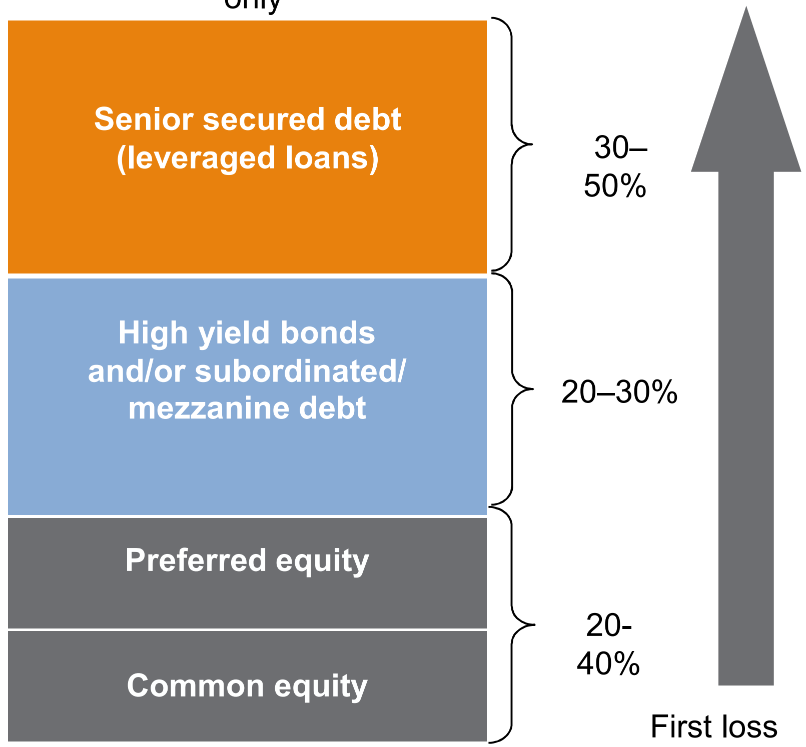
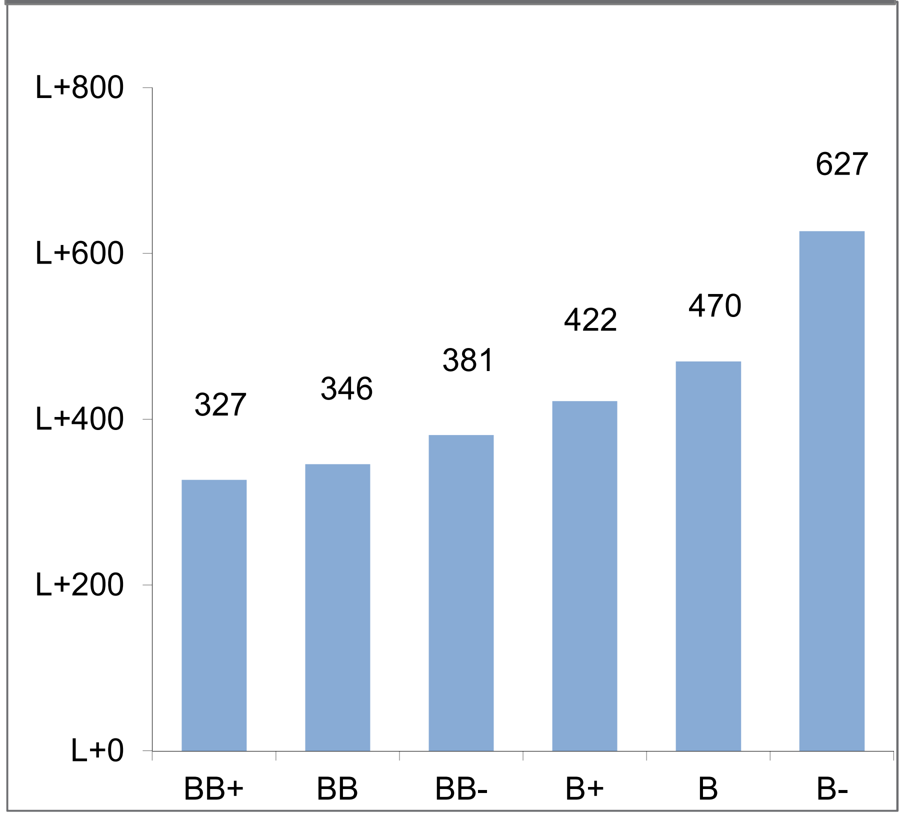
Leveraged Loan Overview

Sample capital structure
for illustration purposes only

% of total capitalization



Average Discounted Spread of Loans by Narrow Loan Rating. Data as of 2/21/14*



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Sources: J.P. Morgan, Credit Suisse. Data as of February 28, 2014 unless otherwise stated.
*Source: Standard and Poor's LCD & S&P/LST Leveraged Loan Index. Assumes discount from par is amortized evenly over a three-year life.

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Leveraged Credit Market Remains Healthy

Fundamentals	Technicals	Valuations
▪ Companies' balance sheets are mostly stable and leverage remains at reasonable levels ▪ Companies have refinanced at lower rates, reducing costs ▪ Underwriting standards generally remain credit positive	▪ HY bond new-issue volume totaled $16.6 billion for February, while loan issuance volume remained strong at $63 billion. ▪ Flows in high yield and leveraged loan funds were $2.2 billion and $1.82 billion respectively.	▪ Global issuer default rate finished February at 2.4% ▪ The prospect of continued liquidity helped drive positive flows ▪ Treasuries remained well bid amid tepid economic data which helped to support fixed income prices
solid	*mixed*	*supportive*

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* Data as of February 28, 2014
Sources: J.P. Morgan Asset Management, Barclays, High Yield 2% Index Credit Suisse Leveraged Loan Index, Moody's data
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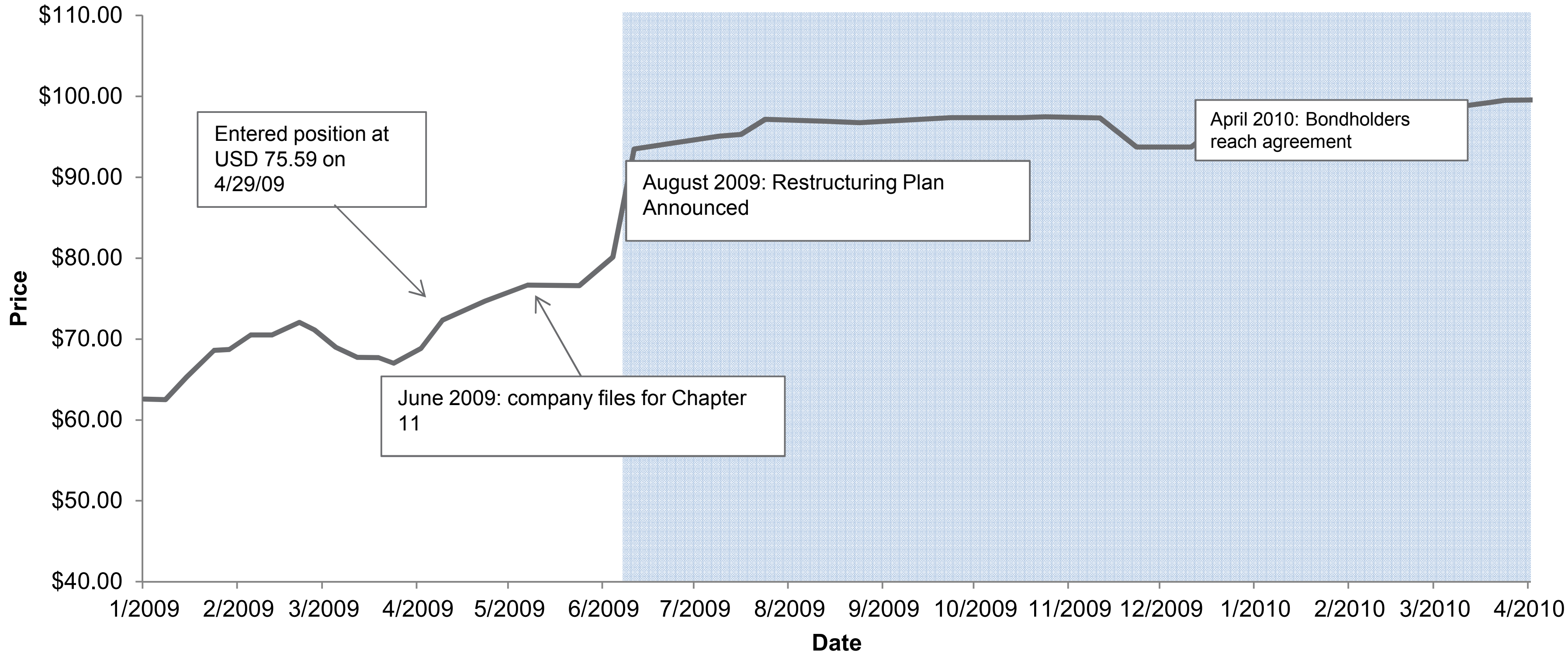
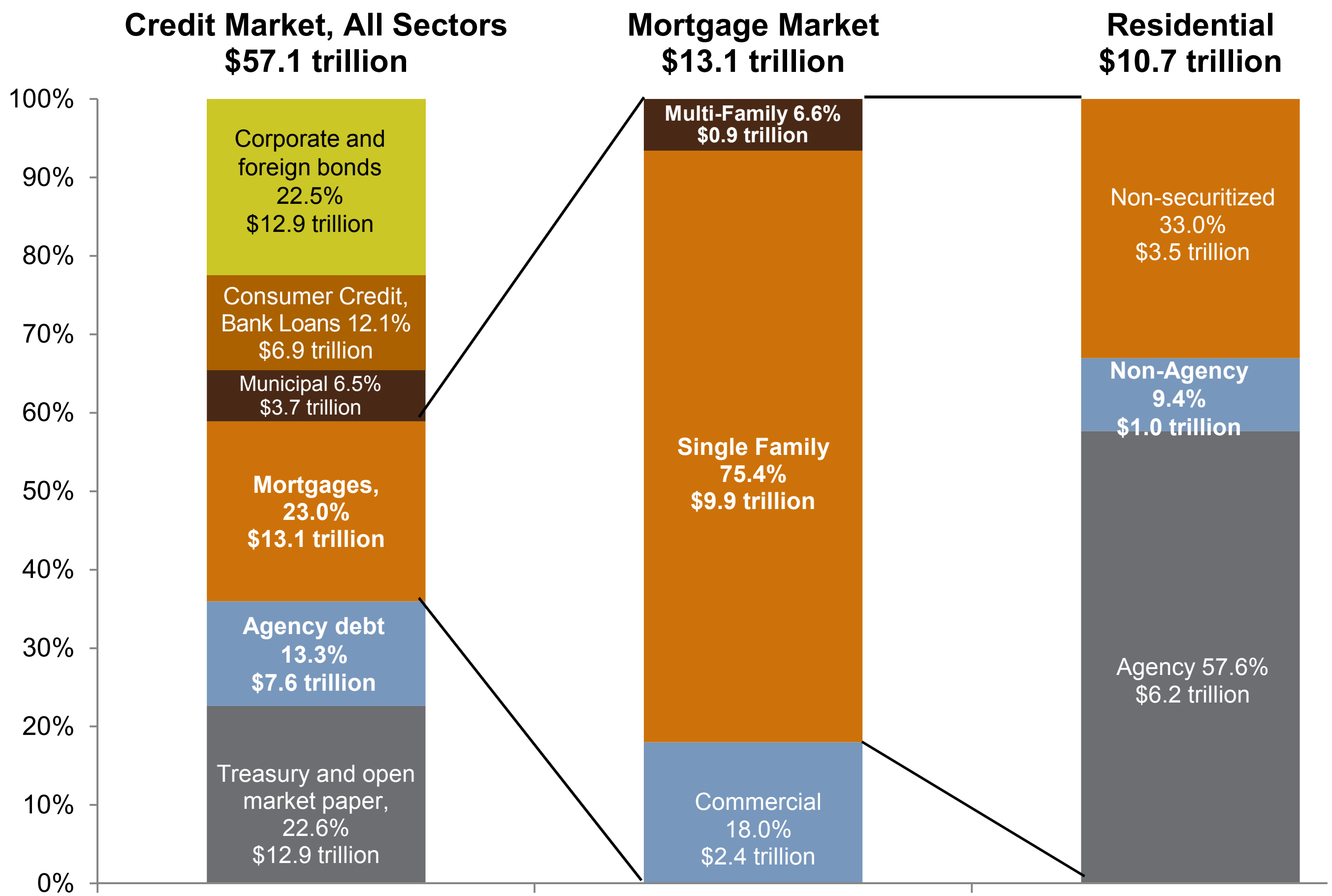
Investment Example – Price of Six Flags Term Loan



Source: J.P. Morgan, priced by Markit.

Securitised products – Mortgages

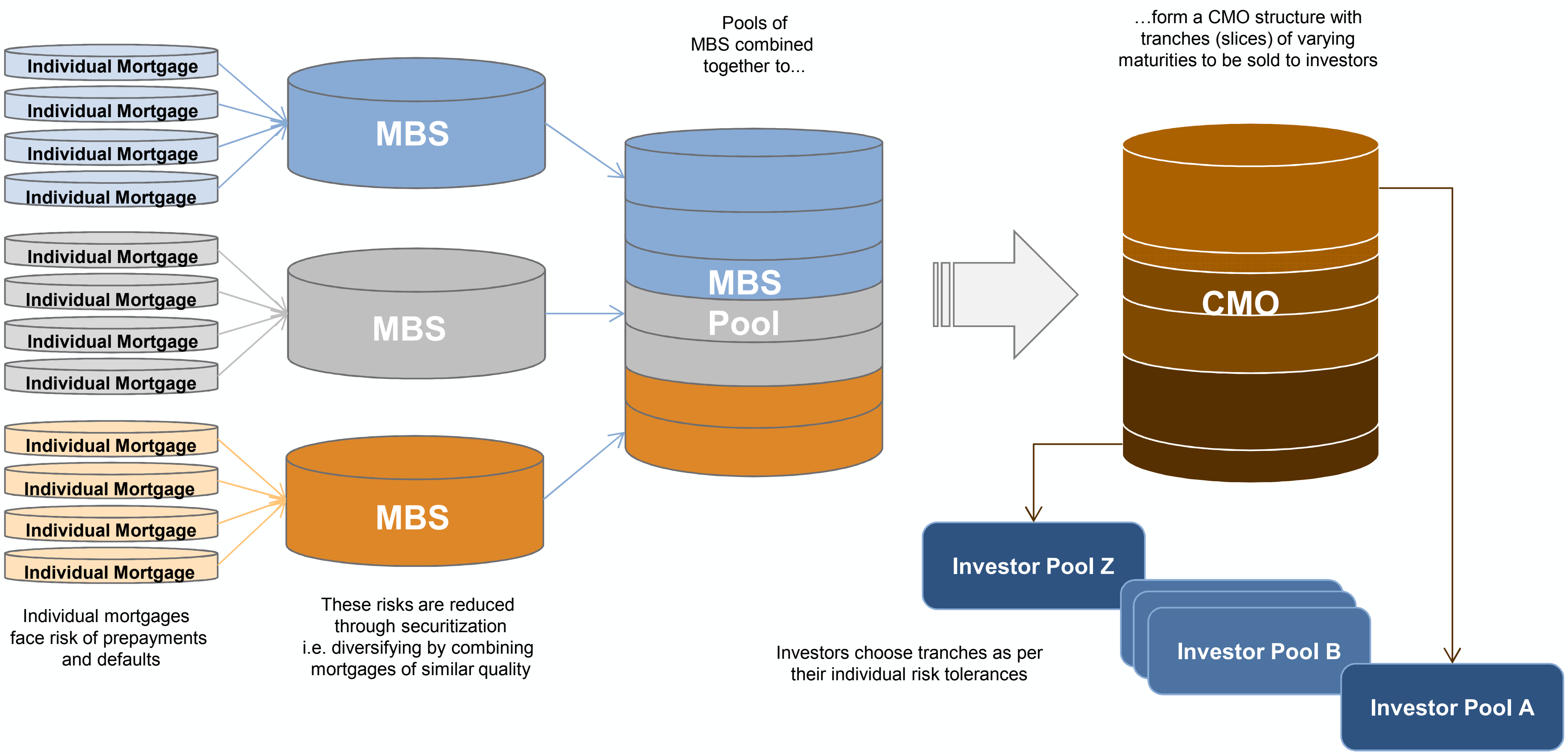
The U.S. mortgage sector is the largest component of the U.S. fixed income market with USD 13 trillion outstanding



Source: Federal Reserve Flow, of Funds, First Quarter, 2013 Results, JPM Securities.

Securitization of Mortgages

Securitization Explained



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Mortgage-Backed Securities Composite

All data as of February 28, 2014

Discretionary assets: $3.79 billion

Portfolio statistics

	MBS	Barclays MBS
Yield to Maturity	2.62%	2.54%
OAS (bps)	108	24
Weighted Avg. Life (yrs)	5.19 yrs	6.87 yrs
Duration	3.74	4.78
Average Quality	AA	AAA
Number of holdings	683	769

Quality Distribution*

	MBS	Barclays MBS
AAA	80.4%	100.0%
AA	2.1%	0.0%
A	3.0%	0.0%
BBB	4.1%	0.0%
BB and below incl. NR	10.4%	0.0%
Total	100.0%	100.0%

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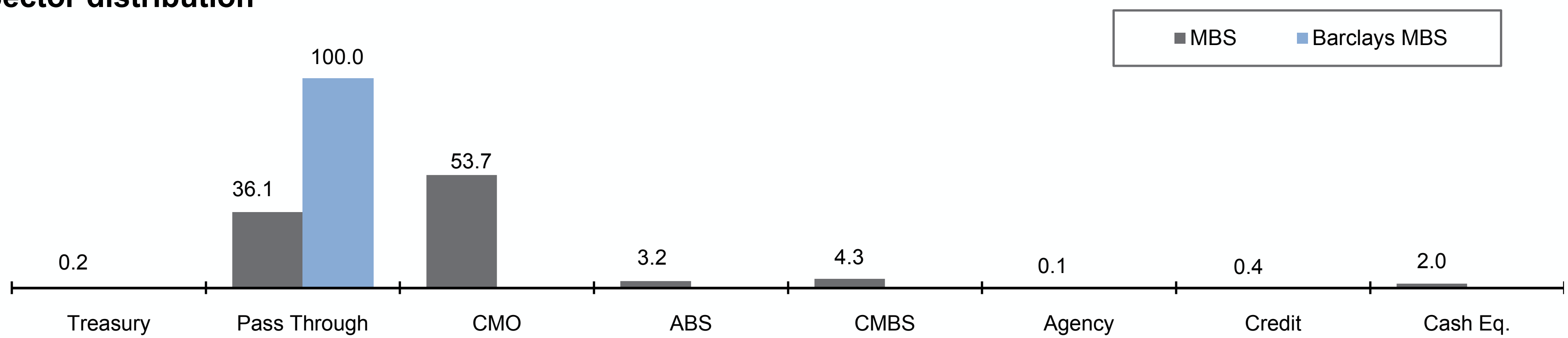
Sector distribution[1]



*See Appendix Disclosure Page regarding the quality rating methodology used above.

[1]Measurements in percents. Index statistics compiled by running Barclays constituents through Yield Book models. Please see performance disclosures which accompany this presentation. Actual account characteristics may differ.

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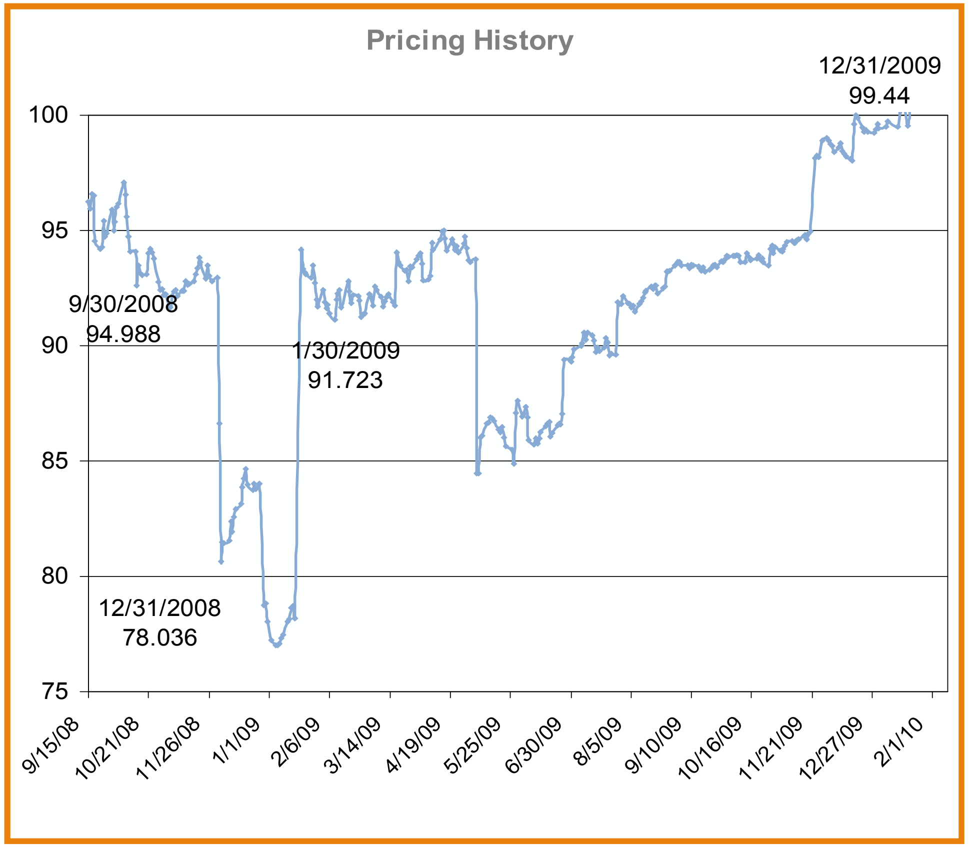
Non-Agency MBS Example

Deal Name	BAC Funding Corp 2003-3 1A33
Purchase date	12/2006
S&P Rating	AAA
Current Credit Support	5.27%
Vintage	2003
Loan Type	99.7% 30 Year Fixed Rate
Occupancy Status	97.4% Owner Occupied
Loan Size	Primary Jumbo at Issue
30 Day Delinquencies	0.88%
60 Day Delinquencies	0.14%
90 Day Delinquencies	0.14%
Bankruptcy	0.00%
Foreclosure	0.00%
FICO Score	
601-650	1.4%
651-700	12.4%
701-750	34.8%
751-800	48.3%
801-850	3.1%
Average FICO Score	746



Source: Bloomberg, Loan Performance and JPMorgan Asset Management
For Illustrative purposes only.

Last data point: 02/10/10

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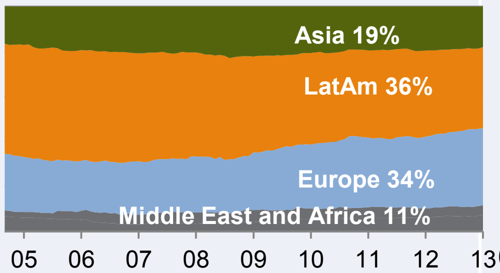
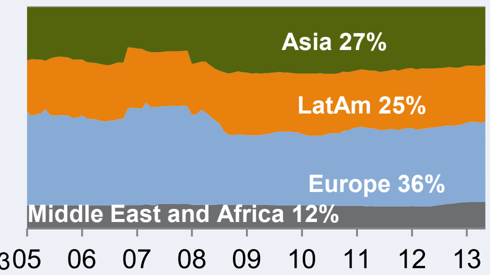
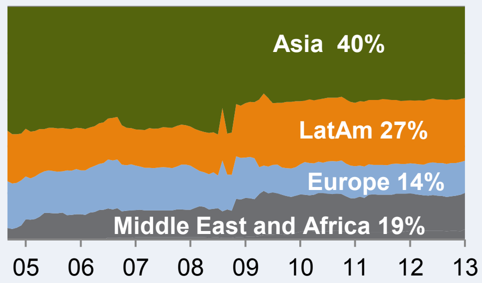
Emerging market debt

Emerging market debt – sector composition

Sector Strategy	Sovereign Debt	Local Currency Debt	Corporate Debt
Currency	USD	Local Currency	USD
Credit Quality (Moody's/S&P/Fitch)	Baa3/BBB-/BBB	Baa2/BBB+/BBB+	Baa2/BBB/BBB
Duration	6.49 years	4.56 years	4.72 years
Yield	6.06%	7.20%	5.19%
Market Value	USD 326 Billion	USD 896 Billion	USD 276 Billion
Historical Regional Distribution (%MV) Current values labeled			
Top 5 Countries (%MV)	Russia 5% Brazil 5% Philippines 5% Mexico 5% Turkey 5%	Brazil 10% Malaysia 10% Mexico 10% Poland 10% Russia 10%	Hong Kong 6% Russia 6% Mexico 6% Korea 6% India 5%

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Source: J.P. Morgan Asset Management. As at 31/12/2013.

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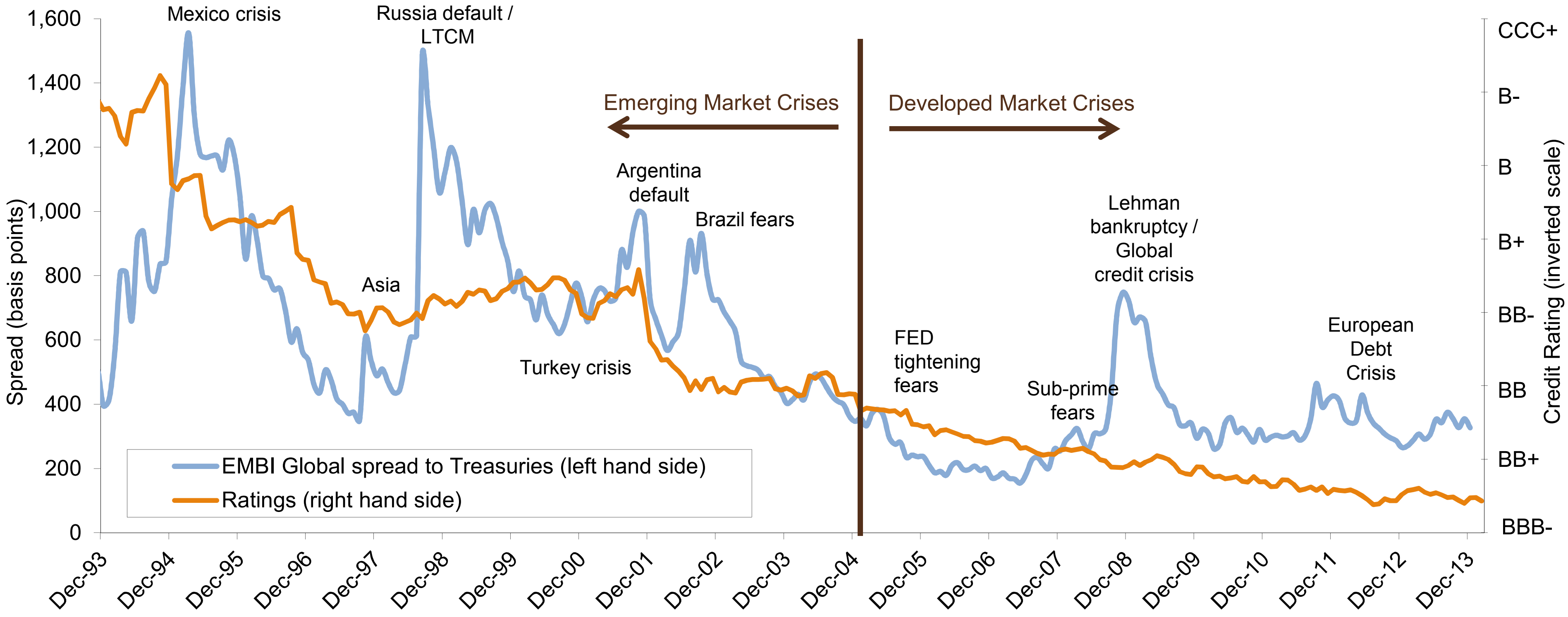
Spreads have widened out while ratings remain steady

As of 28 February 2014

EM External debt spreads and average credit ratings (inverted scale)



Source: J.P. Morgan Asset Management.
Note: The J.P. Morgan Emerging Markets Bond Index Global (EMBI Global) is representative of the sovereign debt market.

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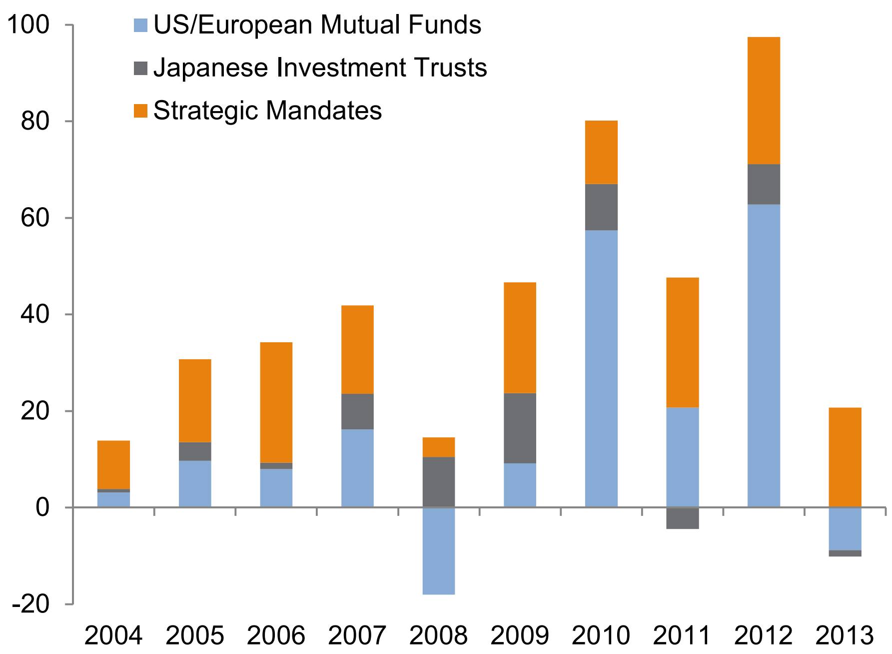
Strategic institutional investors continue to support the asset class

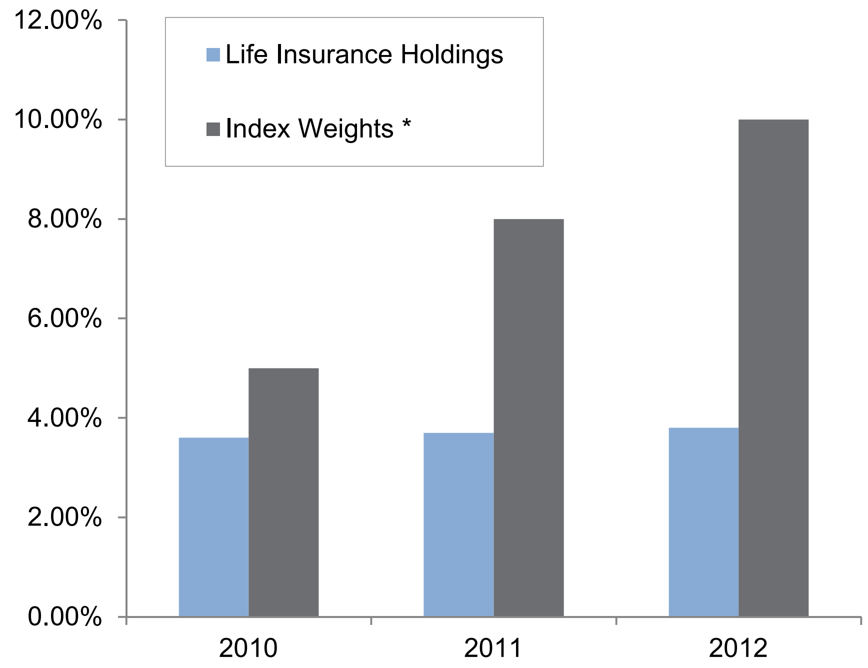
Strategic inflows remain supportive

USD billion cumulative, yearly



Source: EPFR, JPMorgan, SNL. As of Nov. 23

US Life Insurers' allocation to EM Corporates Remain Low



Source: J.P. Morgan Securities and SNL . * Share of EM Corporate Bonds in the combined US High Grade and US High Yield Indices. Insurers could use benchmarks with a lower EM allocation than JPM Indices. As at 31st December 2013

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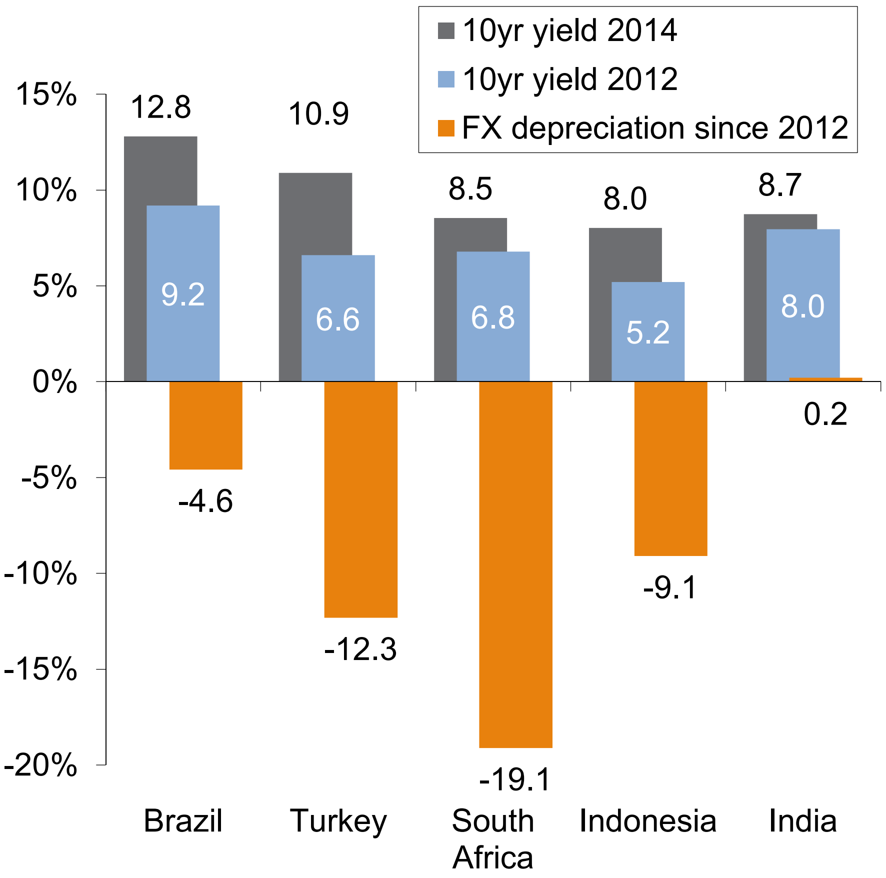
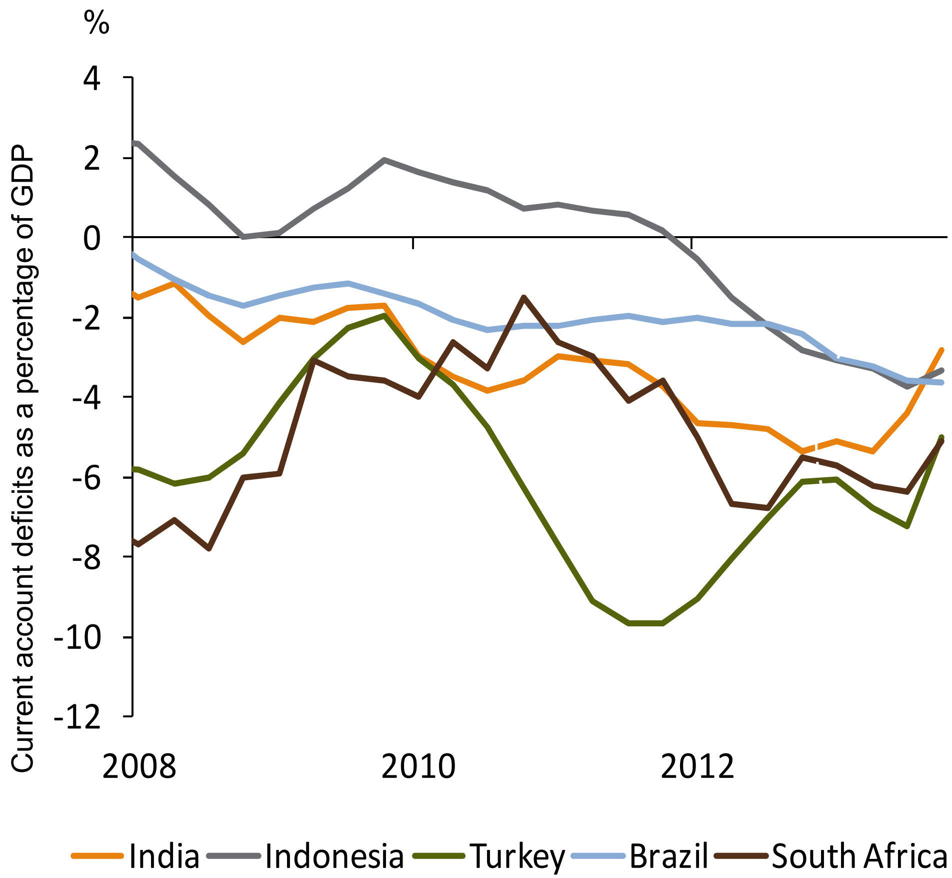
EMD: A fragile opportunity?

Valuations



Fundamentals



Source: J.P. Morgan Asset Management, Bloomberg. Data as of March 2014.

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Key Opportunities and Challenges for EMD in 2014

Opportunities

- Very attractive valuations
- Fundamental turnaround stories (Indonesia, India etc)
- Strategic Inflows will provide support

Challenges

- US Treasury rates volatility
- Commodities prices softening
- Capital flow vulnerability may persist

Source: J.P. Morgan Asset Management

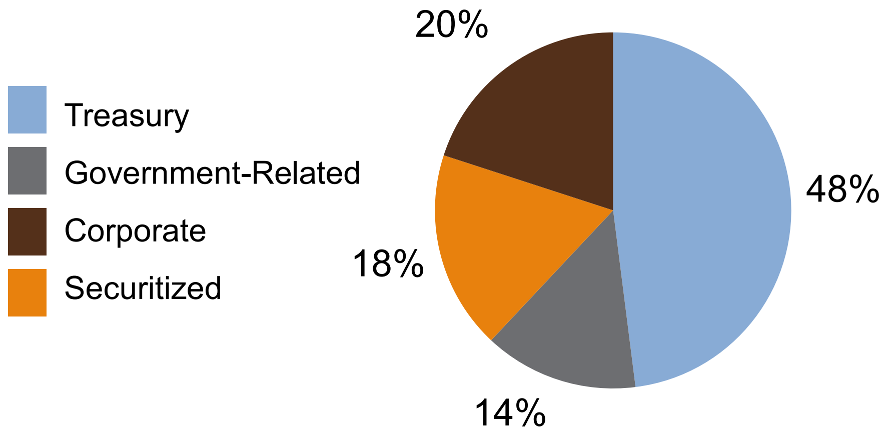
Unconstrained fixed income

Bond Benchmarks: Counterintuitive

Barclays Global Aggregate today and 10 years ago

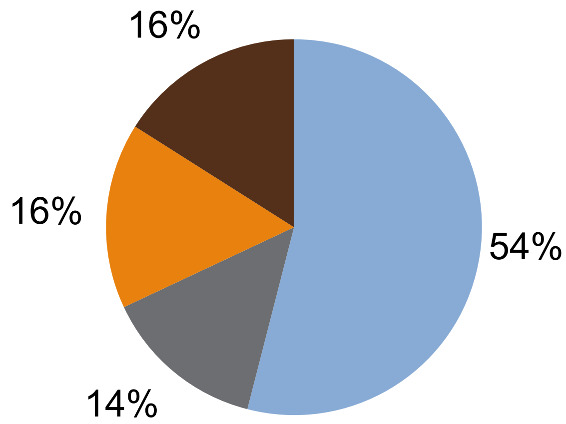
2004

- Duration: 4.9 years
- Yield: 3.32
- Sector breakdown:



2014

- Duration: 6.2 years
- Yield: 1.94
- Sector breakdown:



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Source: Bloomberg, data as of January 2014 and January 2004. Duration is modified adjusted duration: Yield is yield to worst.

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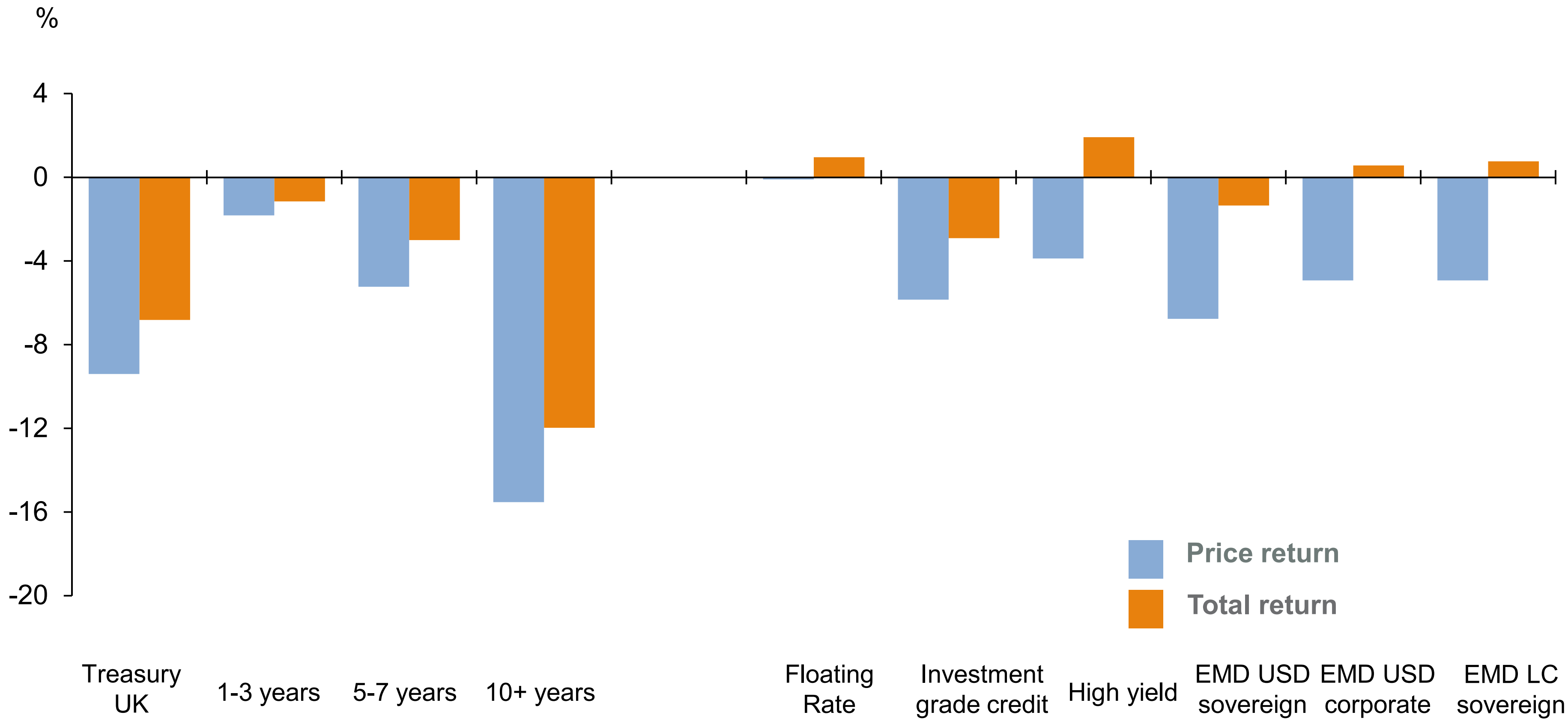
Government bonds aren't safe investments when rates rise

Estimated price impact of a 1% rise in local interest rates on selected indices



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Importance of dynamically diversifying across fixed income sectors

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	1Q14	Ten-yr Ann.
£ Local*	8.5% Linkers 8.5%	25.1% EM Debt 11.9%	2.9% Linkers 2.9%	8.5% Linkers 8.5%	45.1% Global Agg 5.6%	44.5% High Yield 60.9%	17.1% High Yield 14.9%	19.9% Linkers 19.9%	15.8% UK Corp 15.8%	7.1% High Yield 8.1%	3.2% Linkers 3.2%	9.8% High Yield 8.8%
	6.8% UK Corp 6.8%	13.3% High Yield 2.9%	0.9% UK Corp 0.9%	7.6% Global Agg 5.3%	26.5% Global IG -5.1%	15.4% UK Corp 15.4%	15.3% EM Debt 11.8%	16.8% UK Gilts 16.8%	13.4% High Yield 18.0%	1.8% UK Corp 1.8%	2.8% EM Debt 3.5%	9.1% EM Debt 8.3%
	6.6% UK Gilts 6.6%	11.5% Portfolio 7.3%	0.2% UK Gilts 0.2%	5.1% UK Gilts 5.1%	25.0% EM Debt -9.7%	12.1% EM Debt 25.9%	10.6% Portfolio 9.5%	11.3% Portfolio 11.1%	12.9% EM Debt 18.0%	0.5% Linkers 0.5%	2.5% UK Corp 2.5%	7.0% Portfolio 6.7%
	5.5% Portfolio 8.1%	9.0% Linkers 9.0%	-1.2% Portfolio 4.1%	4.9% Global IG 3.2%	13.6% UK Gilts 13.6%	11.2% Portfolio 17.3%	9.2% Global IG 7.2%	10.0% EM Debt 9.2%	7.4% Portfolio 9.6%	-1.5% Global IG 0.1%	2.5% Portfolio 2.8%	6.8% Linkers 6.8%
	4.8% High Yield 11.4%	8.5% UK Corp 8.5%	-1.6% High Yield 10.5%	4.7% EM Debt 6.5%	12.1% Portfolio -2.0%	6.4% Linkers 6.4%	8.9% Linkers 8.9%	6.4% Global Agg 5.4%	6.3% Global IG 10.9%	-1.9% Portfolio -1.2%	2.4% UK Gilts 2.4%	5.8% Global IG 4.9%
	4.2% EM Debt 11.8%	8.1% UK Gilts 8.1%	-3.1% EM Debt 10.5%	4.4% Portfolio 4.4%	3.7% Linkers 3.7%	6.1% Global IG 16.6%	8.9% Global Agg 4.6%	5.9% UK Corp 5.9%	2.6% UK Gilts 2.6%	-4.2% UK Gilts -4.2%	2.4% High Yield 3.0%	5.4% UK Gilts 5.4%
	2.1% Global IG 5.5%	7.9% Global IG 3.5%	-5.9% Global IG 3.6%	1.6% High Yield 2.0%	0.9% High Yield -26.4%	-1.0% UK Gilts -1.0%	8.8% UK Corp 8.8%	5.1% Global IG 4.8%	0.6% Linkers 0.6%	-4.4% Global Agg -0.1%	1.9% Global IG 2.6%	5.3% UK Corp 5.3%
	1.9% Global Agg 4.9%	6.8% Global Agg 4.3%	-6.5% Global Agg 3.6%	0.6% UK Corp 0.6%	-9.1% UK Corp -9.1%	-4.8% Global Agg 5.1%	7.5% UK Gilts 7.5%	4.0% High Yield 3.7%	-0.3% Global Agg 5.7%	-10.0% EM Debt -8.3%	1.7% Global Agg 2.0%	5.3% Global Agg 4.4%

Source: Barclays Capital, BoA/Merrill Lynch, J.P. Morgan, FTSE, J.P. Morgan Asset Management. *Returns are calculated in the currency of the underlying asset class if it is a single currency index otherwise they are hedged ('local currency') if the index contains assets in denominated in different currencies. Annualised return covers period 2004 to 2013. Linkers: FTSE UK Gilts Indexed Linked Government; UK Gilts: JP Morgan UK Global Bond, EM debt: JP Morgan EMBI+; Hight yield: BoA/Merrill Lynch Developed Markets High Yield Constrained, UK corp: Merrill Lynch Sterling Corporates; Global Agg: Barclays Global Aggregate; Global IG: Barclays Global Aggregate – Corporates. Portfolio weights; 35% Gilts, 15% EM debt, 15% high yield,10% index linked, 10% UK corporate, and 15% global investment grade bonds. "Guide to the Markets - UK". Data as at 31 March 2014.

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Unconstrained fixed income strategies

- Gaining popularity with institutional investors
- Avoid the tyranny of benchmark
- Attractiveness of total return strategies
- Best ideas, unconstrained approach to fixed income

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Appendix

GFICC Scenario probabilities and investment expectations: 2Q14

Expansion

Base Case (60% - unchanged):
- **Sub Trend Recovery continues into 2015**
  - GDP 2-4%; Inflation 0-2%

Global economy is still recovering, not yet expanding
- Economic recovery in US is broadening (excluding weather impact); Europe is stable
- Optimism offset by deteriorating trade surplus in Japan and tighter credit conditions in China
- Sufficient labor market slack will keep inflation at low levels
- US unemployment could reasonably be 1.5% higher than the reported data*
- Inflation risks are to the downside, as deflation is still a very real threat in peripheral Europe, and Japan exporting disinflation to the US
- Central Banks will remain accommodative until deleveraging occurs or inflation is evident
  - Foreign Direct Investment (FDI) inflows do not indicate pressures building

Strategy Implications:
- Yield and carry remain attractive
- European bank hybrid securities
- US reperforming/non-performing residential mortgage market
- Bank leveraged loans

Above trend growth (35% - unchanged)
- GDP >4%; Inflation >2%

- Accelerating US recovery leads to stronger EM as exports pickup
- Europe experiences real growth
- Increase in Japanese consumption is more than simply front running VAT hike
- Energy should recede with the Spring thaw, leading to stronger discretionary spending and less pressure on central banks to battle commodity price inflation
- Market volatility rises from abnormally low levels
- Market anticipates central banks normalizing rates

Strategy Implications:
- Short duration
- Floating rate credit
- Convertible bonds
- Short positioning in securities with negative convexity (agency MBS) and short volatility will be good hedges

Contraction

Crisis (5% - unchanged):
- **Disorderly movement in markets causes systemic impact and tail risk**

- Ukraine could destabilize both the emerging and developed markets as politics could escalate into global conflict
  - Our expectation is that US and EU will work with Russia to avoid escalation and disorderly and collapsing markets
- The Fragile Five (Brazil, Indonesia, India, South Africa, Turkey) represent risk, if credit conditions tighten, as they need to import capital
- A hard landing in China is a distant threat – PBOC is managing down credit fueled growth

Strategy Implications:
- Long position in G4 government bonds
- Short position in EMD

Recession (0% - unchanged)
- GDP <2%; Inflation <0%

- Overall expansionary policy of Central Banks makes the risk of recession over the next 3-6 months unreasonable
- Japan is at greatest risk of recession, where fiscal drag could offset trend growth

*Using the Yellen/Williams adjustment to the participation rate.

Source: GFICC Investment Strategy Team. As of March 13, 2014. Opinions, estimates, forecasts, projections and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. There can be no guarantee they will be met.

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