



Investing Plus

JPMorgan Asset Management's half-yearly newsletter for UK institutional clients.

It has been an interesting time over the last eight months, with the deepening credit crunch causing a high level of volatility across global financial markets. It's at these times that investors need not only to keep their focus on the longer-term goals of their investment strategy, but also to maintain a diversified portfolio that's able to ride out short-term periods of volatility.

At JPMorgan Asset Management we offer a comprehensive range of funds and strategies designed to give you all the tools necessary to build fully diversified portfolios.

With this in mind, in this edition of Investing Plus we've taken the opportunity to ask John Anderson, Head of JPMorgan Alternative Asset Management, to look

at one asset class which really does give investors access to an alternative source of return: hedge funds. John looks in particular at the reasons for the growing popularity of hedge funds, the risks involved and the best way to access their compelling growth potential.

We also revisit the subject of liability driven investing to take a look at how our Duration & Alpha products have fared during the recent market volatility. Simon Chinnery, Institutional Client Advisor, shows us how these funds have been a considerable success so far, helping pension schemes improve the stability of their funding position and reduce the volatility of their deficits while also providing the potential to generate additional investment returns.

Finally, we focus on another area of particular interest at the moment – namely the move from defined benefit pension schemes towards a more holistic 'combined benefits' approach to pension provision. Jonathan Watts-Lay, Director of JPMorgan INVEST, our workplace marketing business, shows us why he thinks Integrated Workplace Savings is the best way for employees to capitalise on all the options available to them.

I hope you find this latest edition of Investing Plus of interest.

Peter Ball
Head of UK Institutional Business

Better insight + Better process = Better results

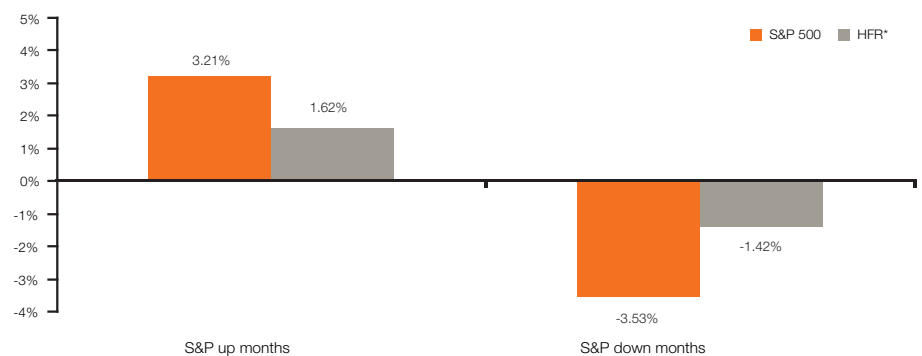
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Why have institutional Investors

An increasing number of institutional investors are being attracted to hedge funds as a way to diversify portfolios and enhance risk-adjusted returns. Hedge funds have historically delivered attractive returns with less volatility and less downside risk than equity related investments and helped institutional investors achieve greater diversification.

Hedge funds protect capital in down markets



* HFR Composite reflects performance of HFRX Global Hedge Fund Index (April 2003 – December 2007), HFR Fund Weighted Composite Index (January 1998 – March 2003). Indices are unmanaged, do not charge fees and are shown for illustrative purposes only. Contains performance as of December 31, 2007. Past performance is no guarantee nor necessarily indicative of future results.

The chart above shows (over a 10 year period ending September 2007) how hedge funds have outperformed traditional asset classes with approximately half the volatility of equities. In addition, hedge funds have historically protected capital when equity markets have sold off.

This ability to help improve the overall risk/return characteristics of a portfolio is one of the key drivers that have led institutional investors to invest in hedge funds.

Why are fund of funds the investment vehicle of choice?

Rather than directly investing in single hedge funds, a hedge fund of funds invests in a diversified portfolio of several hedge funds employing multiple investment strategies.

A fund of funds simplifies the process of choosing between separate hedge funds and blends together different strategies

to achieve a specific risk/return objective. It also provides greater diversification than a single manager.

The blending of strategies and asset classes aims to deliver a more consistent return than could be sought from individual hedge funds.

What are the key risks of hedge fund investing?

Hedge funds risks are different to traditional asset classes. While most investors focus on the investment attributes of a manager when considering whether or not to invest, perhaps equally important is how the manager operates the business. After all, when investing in a hedge fund, you are usually investing with a small business that is set up to support the investment activity of the manager.

Therefore, it is vital to complete not only investment due diligence but operational due diligence on prospective hedge fund investments.

diversified into hedge funds?

What are the various hedge fund strategies utilised?

- ▶ **Relative Value** – These funds seek to profit by buying undervalued securities and by selling short overvalued similar securities. The returns are due to the relative changes in pricing of similar securities. Strategies in this sector offer potential to generate consistent returns while minimising directional risk.
- ▶ **Merger Arbitrage/Event Driven** – The uncertainty of outcomes of corporate events, such as mergers, takeovers, bankruptcies and reorganisations, and the resulting mis-priced securities is the primary source of returns for this subgroup.
- ▶ **Distressed Securities** – The aim is to profit from the market's lack of understanding about the true value of deeply discounted securities. This strategy can provide very attractive performance during certain points in the economic cycle and generally low correlation with other strategies.
- ▶ **Opportunistic/Macro** – Managers attempt to anticipate and profit from global macro events and shifts in interest rates by investing in financial instruments whose prices will be impacted by these trends.
- ▶ **Long/Short Equity** – This strategy involves long and/or short positions in equity securities deemed to be under or overvalued. In a rising market, managers expect the prices

of their long holdings to appreciate more than their short exposure.

- ▶ **Short Selling** – This strategy, which seeks to profit from securities that are expected to fall in value, can help reduce direct and indirect equity exposure within portfolios (while effectively decreasing portfolio volatility and correlation to the equity and fixed income markets). In addition, short selling can help protect the portfolio against stress events and market dislocations.
- ▶ **Emerging Markets** – This strategy capitalises on the potential for substantial growth in less-developed economies by focusing on equities and debt in these markets. It therefore tends to involve high risks because not all markets allow short selling and only have limited liquidity, so hedging may be difficult or not available.

Conclusion – Fund of funds route can lead to hedge fund success

Hedge funds provide diversification benefits and offer a variety of strategies that far exceeds anything offered by a traditional mutual fund. But, at the same time, they present risks, which can vary enormously depending on the degree of exposure to broad market movements. It is therefore important to understand these risks and select investment vehicles that would tend to reduce these risks through sound risk management and portfolio construction.

The benefit of a hedge fund of funds is that typically the manager will do all of the work required in setting up and maintaining a safe and effective portfolio of hedge funds for you. When selecting a fund of hedge funds, it is important to select managers that have the resources to conduct proper due diligence and that they will constantly monitor all the funds they have invested in, while at the same time seek out new opportunities.

For further information visit www.jpmorganassetmanagement.co.uk/institutional or contact your usual JPMorgan Asset Management representative.



John Anderson
Managing Director
and Head of JPMorgan
Alternative Asset Management

JPM Life Duration & Alpha Funds

New accounting standards (particularly the introduction of FRS 17), increased life expectancy and new funding legislation have created significant challenges for defined benefit pension schemes, forcing them to focus on controlling their deficits.

The volatility in global stock markets over the last year and the recent drop in bond yields, have made deficit control even more difficult. In fact, the volatility of the last eight months has served as a reminder to trustees that the pension funding problem has not gone away despite the strong stock market gains recorded over the previous three years.

Against this difficult backdrop, JPMorgan's range of pooled Liability Driven Investment solutions have provided pension trustees with a way to manage their risks more effectively, while crucially also helping to provide them with the potential to generate additional investment returns.

Providing simple, effective answers to the funding challenge

Our approach to LDI is simple, efficient and cost effective, based on an innovative pooled fund structure which we've called Duration & Alpha (or D&A for short). There are four D&A funds in total providing two duration options (15 years or 30 years) invested on either a nominal basis or linked to the UK Retail Price Index (RPI).

These funds offer two significant advantages for pension trustees:

- 1. Stability** is achieved by giving a scheme's assets a similar duration and inflation profile to its liabilities. In our D&A funds we use swaps to synthetically achieve this duration matching – swaps are derivative contracts that allow a variable stream of payments to be swapped for a fixed stream of payments, thereby creating more certainty of return.
- 2. Deficit volatility** is potentially reduced because our D&A funds are linked to a diversified total return strategy which aims to generate consistent long term returns. This ability to produce additional returns is vital for schemes that need to grow their assets in order to address significant funding deficits.

Since launch, our D&A funds have navigated the high levels of volatility on global stock markets and the difficult bond market environment to produce attractive levels of alpha while ensuring that pension scheme liabilities are matched to assets at all times.

Strategy performance since 1 January 2007

	12mths % return
JPM Life D&A (15yrs/2%) Fund	4.91
Merrill Lynch 15yr Zero-coupon Swap	3.86
Geometric excess return	1.01
JPM Life D&A (30yrs/2%) Fund	-2.15
Merrill Lynch 30yr Zero-coupon Swap	-3.26
Geometric excess return	1.15

Source: JPMorgan Asset Management, 31 December 2007. All figures are gross of fees. Performance for RPI linked funds is not illustrated as funds have less than 12 months performance data. Past performance is not a guide to the future. The value of investments and the income from them may go down as well as up and investors may not get back the full amount invested.

Matching liabilities and helping to reduce deficits

Our D&A funds are innovatively structured using swaps so that pension schemes can use each fund in appropriate proportions to gain the duration or inflation exposure that is most closely matched to their liabilities.

Duration and inflation targets are achieved using swaps arranged with a number of leading investment banks to reduce counterparty risks. The end investor is never called upon to meet collateral calls for the swaps, which are met instead by cash and gilts integrated into each D&A strategy.

Allocation between the four funds can be rebalanced as and when required by changes in a scheme's risk profile. And because liability matching and excess return potential can both be met from the same 'cash pool', the funds could be ideal for schemes with limited funds at their disposal, including schemes with significant funding deficits.

Addressing the funding gap using a total return strategy

Pension schemes with large funding deficits may require the potential to produce returns significantly in excess of the performance available from simply matching investments to their liabilities. That's why our D&A funds have been linked to a proven 'Total Return' strategy managed by the JPMorgan Asset Management Global Multi-Asset Group.

This Total Return strategy uses flexible asset allocation across cash, bonds,

convertibles and equities to aim for consistent positive annual returns of 2% p.a. above the London Interbank Offered Rate (LIBOR) over three years – net of fees. It's focus on capital protection and steady returns throughout the market cycle can make the strategy an effective solution for trustees worried about widening deficits during a market downturn.

Tailored to your scheme's risk profile

By using a combination of our D&A funds to ensure that assets and liabilities have approximately the same sensitivity to changes in interest rates and inflation, pension trustees can help reduce the funding volatility in their schemes and help limit the risk of a widening deficit.

As pooled life funds, JPM Life D&A Funds offer the reassurance of a familiar and tax-efficient vehicle, while the pooled structure can help pension schemes avoid many of the complexities of a segregated liability driven investment strategy – such as dealing with derivative counterparties.



Simon Chinnery,
Institutional Client Advisor

LDI pooled fund solutions

We've focused our attention on pooled strategies to take some of the complexity out of liability driven investing, helping to provide you with a more attractive and effective LDI solution.

We've kept our LDI offering simple, paring it down to the key essentials that we believe the majority of pension schemes require to put their funding strategy on the right track. The result is a simple, flexible choice of LDI solutions that can effectively address most pension schemes' key risks.

JPM Life D&A Funds

- Designed both to stabilise and improve funding levels
- Flexible enough to match most pension schemes' duration
- Leveraged structure ideal for cash-strapped pension funds
- Innovative total return feature to generate returns over liabilities

The move from Defined Benefits

There has been much media interest over the closure of Defined Benefits schemes as they have been replaced with Defined Contribution schemes, which have a lower perceived value.

However, there are savings vehicles which can be set-up to run alongside, offering flexibility and enhanced value. Such a scheme combining share schemes and pensions was called for in 2004 by The Employer Task Force on Pensions.

We believe 'Integrated Workplace Savings', developed by JPMorgan INVEST provides the answer, from linking company share schemes with pensions, to providing employees with all the options available to them at the point of retirement.

Share schemes boosting pensions

Employers should reveal the benefits of using share schemes to increase pensions. For example, if taking advantage of a share incentive plan (SIP), employees may buy shares from pre-tax income, giving them an effective 'discount' because of tax and National Insurance savings.

Unlike a contribution directly into pension, which attracts income tax relief, contributions made via the SIP attract two 'helpings' of income tax relief on the same initial outlay.

This has three significant advantages:

1. **Larger fund** from the effect of 'double tax relief'.
2. **Greater flexibility** in the years before the capital is committed to pension – attractive for people a long way off retirement.
3. **Tax effectiveness** delaying the final commitment to pension. If they are a Basic Rate Taxpayer they will attract basic tax relief. Delaying the contribution may mean that the

same initial outlay attracts higher rate relief as a result of salary increases through career progression.

Most companies are not in a position to allow transfer of stock from their share schemes directly into a pension – as they don't want to take on the additional administrative burden, cost and restrictions on levels of 'self-held' stock. Pensions Simplification came up with a solution – concurrency.

Concurrency and the Workplace SIPP

Since Pensions Simplification, pension schemes can run concurrently. This allows employers to maintain the existing company scheme whilst offering a Self Invested Personal Pension (SIPP), to run alongside it (known as the Workplace SIPP).

It allows employees to link share schemes and pensions, but also allows the transfer of stock. Regulations allow for tax relief to be claimed on contributions amounting to the lower of 100% of earnings (or equivalent) and £235,000 this tax year. However, many occupational schemes limit their employees to a level below this.

Retirement Options

But what options are available at the point of retirement? Employees have a 'choice' at retirement and can choose the most appropriate form of retirement income to suit their personal needs.

These include drawing retirement income – such as taking an annuity, Unsecured Pension (USP) – pre age 75, using a

to 'Combined Benefits'

combination of an annuity & USP, or an Alternatively Secured Pension (ASP) – post age 75. An employee can even take partial retirement and possibly work part time supplementing their income in any of these ways.

In November 2006, the Pensions Regulator expressed the need to offer employees an alternative to annuities while also supporting the need for education and guidance in the workplace. The onus is now on employers and trustees to ensure members understand these options at the point of retirement.

Summary

How are employees going to understand these new exciting opportunities? Only through a comprehensive financial education programme can a thorough understanding of these benefits and choices be gained. Employees will benefit financially whilst the employer engenders a greater degree of loyalty from their employees, as the provider of these benefits whilst at the same time adhering to the guidance of the Pensions Regulator.



By Jonathan Watts-Lay,
Director, JPMorgan INVEST

For further information, please contact JPMorgan Invest on 0800 028 3200 or by email at jpmi.uk@jpmorgan.com

News in brief

Sign up for the UK Institutional Investment Summit – The Selection

The JPMorgan Asset Management UK Institutional Investment Summit 2008 will take place on 22 April at our 10 Aldermanbury office in London. Entitled 'The Selection', we've put together a varied and interesting programme of speakers and break-out sessions aimed at providing attendees with a broad overview of the latest products and themes impacting the UK institutional market. Places are limited so please contact your usual JPMAM representative to reserve your place.

JPMorgan Asset Management at the Professional Pensions Show

Look out for the JPMorgan Asset Management team on stand number 22 at the Professional Pensions Spring Show 2008, to be held at Manchester Central between 14-15 May. We'll be showcasing our expertise, products and services, while the head of our currency group, Robert Stewart, will present on currency investing at the Best in Breed Showcase also to be held at the show.

For more information on any of the articles contact your usual JPMorgan Asset Management representative or visit www.jpmorganassetmanagement.co.uk/institutional.

Simplicity



Stability



JPMorgan Total Return Funds

A better default option for DC pension schemes

With the majority of members' contributions being directed into the default option, we believe that JPMorgan Total Return Funds offer a refreshing and more suitable alternative.

Total return funds are actively managed and have very clear objectives which are easily understood by members. The **JPM Life Capital Preservation Fund** targets cash +3%.

The **JPM Life Capital Appreciation Fund** targets cash +5%. Both aim to protect capital while delivering smoother investment returns.

Simplicity, stability, consistent long-term growth and a focus on making a positive return. Everything a default should be.

For further information about JPMorgan Total Return Funds or to download a copy of our DC whitepapers visit www.jpmorganassetmanagement.co.uk/institutional

Better insight + Better process = Better results

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For Luxembourg based funds, this document should be read in conjunction with the Prospectus, Simplified Prospectus and offering documentation which are available free of charge upon request from JPMorgan Asset Management (Europe) S.à.r.l., European Bank and Business Centre, 6 route de Trèves, L-2633 Senningerberg, Grand Duchy of Luxembourg in relation to the Luxembourg products and from JPMorgan Asset Management Marketing Limited for the UK domiciled products. Please consult your tax or legal advisor about any issues regarding accounting, legal or tax advice, or investment recommendations discussed here. Investors should note that, for Luxembourg funds the Rules of the Financial Services Authority and that the normal protections provided by the UK regulatory system may not apply.

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