JPM Strategic Bond Fund

All data as at 31 December 2011 unless otherwise indicated

Market Environment

Eurozone peripheral bonds, notably Italy, showed intermittent strength in December, clearly buoyed by the introduction of the three-year long-term refinancing operation by the European Central Bank (ECB), some of which liquidity is clearly feeding through into government bond yields. Having plummeted prior to the European Union (EU) Summit on 9 December, Italian yields subsequently gave back most of their gains, but in the last week of the year seemed to stabilise around the 7% level (admittedly against a quiet end-of-year market backdrop). Spanish yields pursued a similar whipsaw trajectory to Italian bonds, but in contrast managed a second rally of ~80 basis points (bps) from their mid-month highs to finish the month close to 5%. French ten-year yields fell ~40bps peak-to-trough during the month before drifting slightly higher at month-end.

Core ten-year yields (Germany, the Netherlands, Finland, Austria) all rallied around 45-60bps and curves bull flattened at the front end, as cautious investors were perhaps induced to extend duration by the increased injection of ECB liquidity. In addition to the behaviour of eurozone government bonds, another encouraging sign has been the behaviour of the EUR/USD three-month cross-currency basis swap spread over the month. While volatile intra-period, the spread has succeeded in holding onto the gains that followed last month's co-ordinated central bank policy action to cut the cost of US dollar funding via central bank swap lines, ending the month at ~115bps, its tightest in the last six weeks.

US ten-year yields also rallied, ending ~20bps lower over the month. Economic data has been mixed – US housing data surprised on the strong side, initial jobless claims maintained their lowest levels since mid 2008 and consumer confidence continued to rise. However, US third-quarter 2011 GDP growth was revised down to 1.8% from 2% on the back of weaker healthcare and personal consumption expenditure. The dollar bloc rallied by a similar amount. In the UK, recently mounting concerns that the coalition government's attempts to improve the public finances might be in trouble were allayed somewhat by monthly public finance figures, which revealed that the deficit is tracking below the latest Office of Budget Responsibility projections and the Chancellor of the Exchequer should comfortably meet his fiscal objectives for fiscal year 2011/12.

The flight from the euro and euro-related assets was apparent in currency markets as the euro, Swiss franc and Scandinavian currencies were the weakest among the G10, while Hungary's forint (-7%) was the weakest among the major emerging market currencies. The dollar bloc currencies proved more resilient, only fractionally lower against the US dollar on the month. According to data for the JPMorgan GABI index, US credit produced total returns of +2.43% in December while euro credit only returned +0.94%. US agency and non-agency debt were both slightly positive on the month. The Merrill Lynch Euro High Yield constrained index returned a solid +2.95% but this followed a loss of -5.26% in November. By contrast, the ML US HY constrained index returned +2.48% after a loss of only -2.21% in November. In emerging markets, the sovereign hard currency EMBIG index traded in a 30bps range over the month and finished slightly wider at a spread to US Treasuries of ~425bps. Emerging market corporates were weaker, led by high yield, notably in Asia. The corporate CEMBI blended high yield/high grade index was calm over the month, finishing virtually unchanged at ~440. The HY/HG spread tightened sharply at month end to finish 50bps lower at ~450bps (790bps versus 340bps).

Performance Analysis

The JPM Strategic Bond Fund returned +1.65%* over the month. This is compared to the return of the Merrill Lynch Sterling Broad Market Index (UK00) of 1.83% and the return of three-month Sterling LIBOR of 0.14%.

*Fund return shown net of all applicable expenses, fees and taxes for 'JPM A – Net Acc' class. Please refer to the fund's prospectus for a description of the other available classes of shares, the performance of which will differ from that shown above.

Key Performance Drivers

Allocation to investment grade financials and to high yield boosted to performance last month. Positioning in UK Gilts and Australian government bonds also provided alpha, as did our long CNY/EUR trade. In contrast, our covered bond exposure came under pressure this month as the short-end of the EU swap spread curve remained at elevated levels.

Fund Positioning

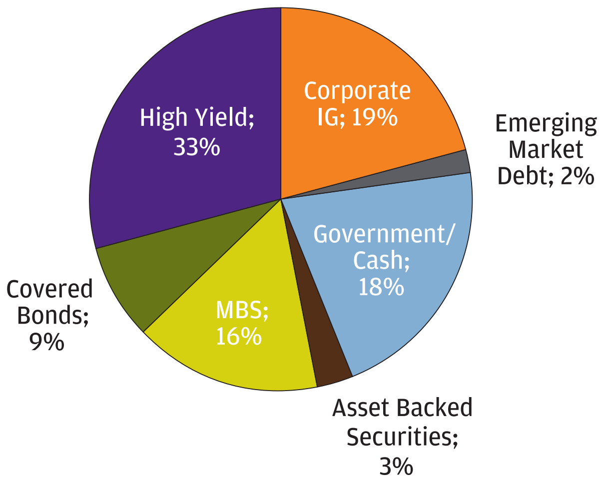
Headline duration was little changed over the month at ~3.2 years. We have slightly reduced allocations to US agency mortgage-backed securities and euro covered bonds and added to high yield, particularly in single B names. We consider that heightened political noise will continue to be a central feature of fixed income markets as we enter 2012. Ultimately this scenario is a favourable one for fixed income assets.

J.P.Morgan
Asset Management

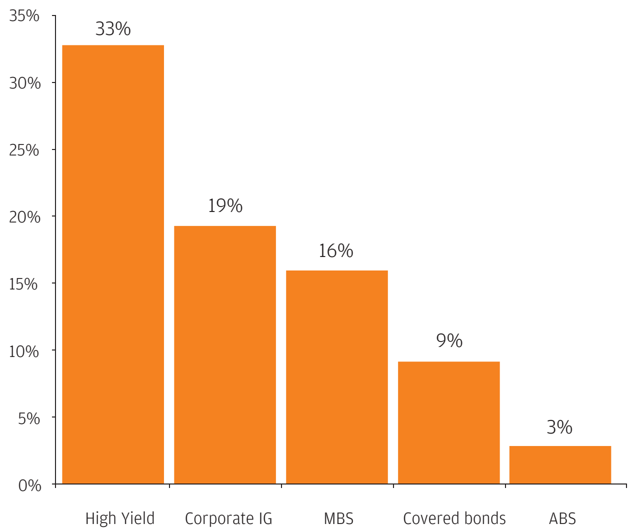
JPM Strategic Bond Fund

Portfolio sector allocation (% market value)

Capital

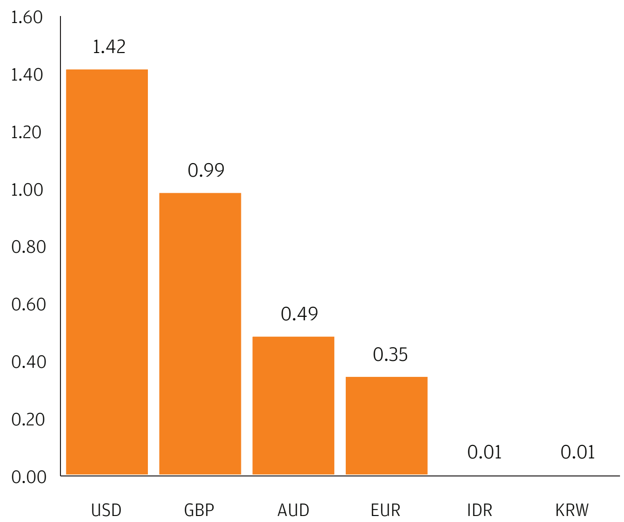


Credit Long/Short



Source J.P.Morgan Asset Management. Capital allocation of the fund excludes all derivatives. Credit Long/Short allocation shows exposure to credit sectors including credit derivatives and Mortgage TBAs.

Weighted duration distribution (years)



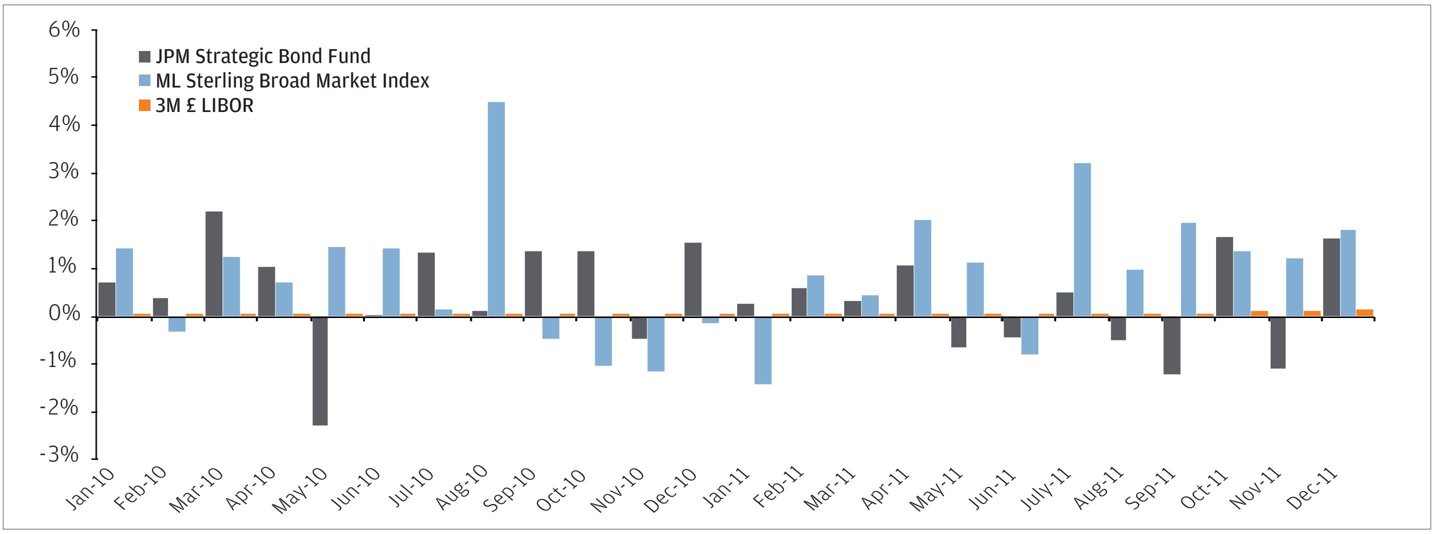
Source J.P.Morgan Asset Management.

Portfolio characteristics

Fund size:	GBP 337 million
Average yield:	4.99%
Average duration:	3.28 years
Average quality:	BBB+

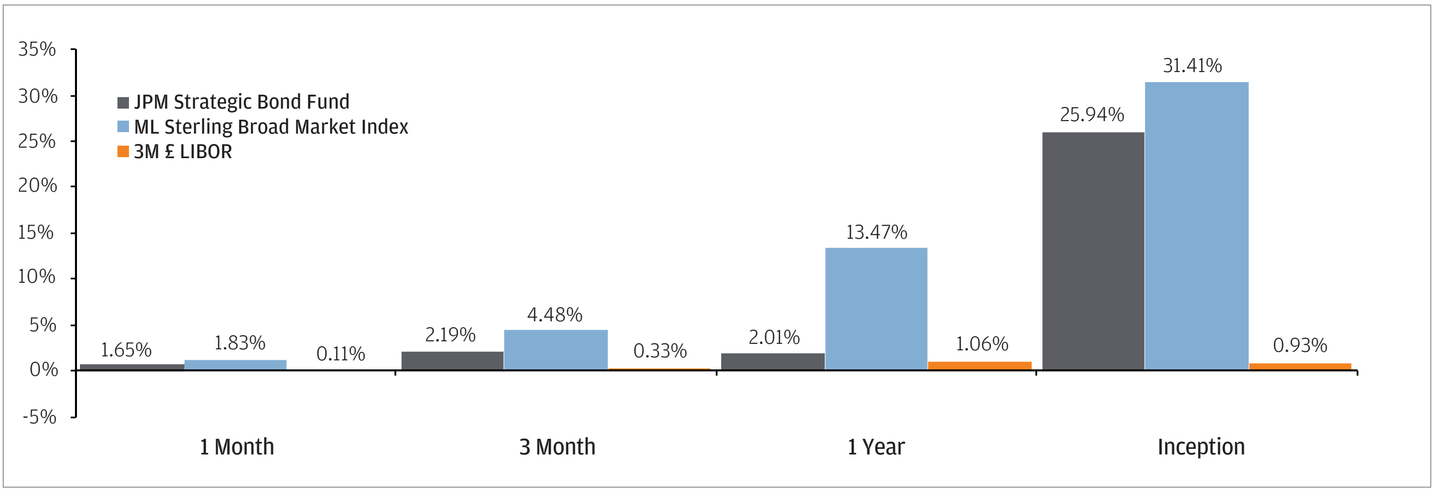
JPM Strategic Bond Fund

Monthly performance



Source: J.P. Morgan Asset Management. Fund return shown net of all applicable expenses, fees and taxes for 'JPM A – Net Acc' class. Please refer to the fund's prospectus for a description of the other available classes of shares, the performance of which will differ from that shown above. Fund inception date: 06 May 2009.

Period performance



Source: J.P. Morgan Asset Management. Fund return shown net of all applicable expenses, fees and taxes for 'JPM A – Net Acc' class. Please refer to the fund's prospectus for a description of the other available classes of shares, the performance of which will differ from that shown above. Fund inception date: 06 May 2009.

For more information please contact our brokerline 0800 727 770
www.jpmorganassetmanagement.co.uk

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