

Your Liquidity: Defining the costs and benefits of cash investing

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The short-term fixed income market place has been rocked by a series of regulatory reforms that have greatly affected rates in the front end of the curve and investment behavior more broadly. This constant change coupled with an extremely volatile market has caught many investors in a tug-of-war between yields close to (if not) zero and the growing inevitability of rising rates, putting principal at risk.

In this session, we assess how the new regulatory reforms, the current investment landscape, and rising interest rates will affect risk, yield, and liquidity — and potentially alter the investment decisions treasurers will make.

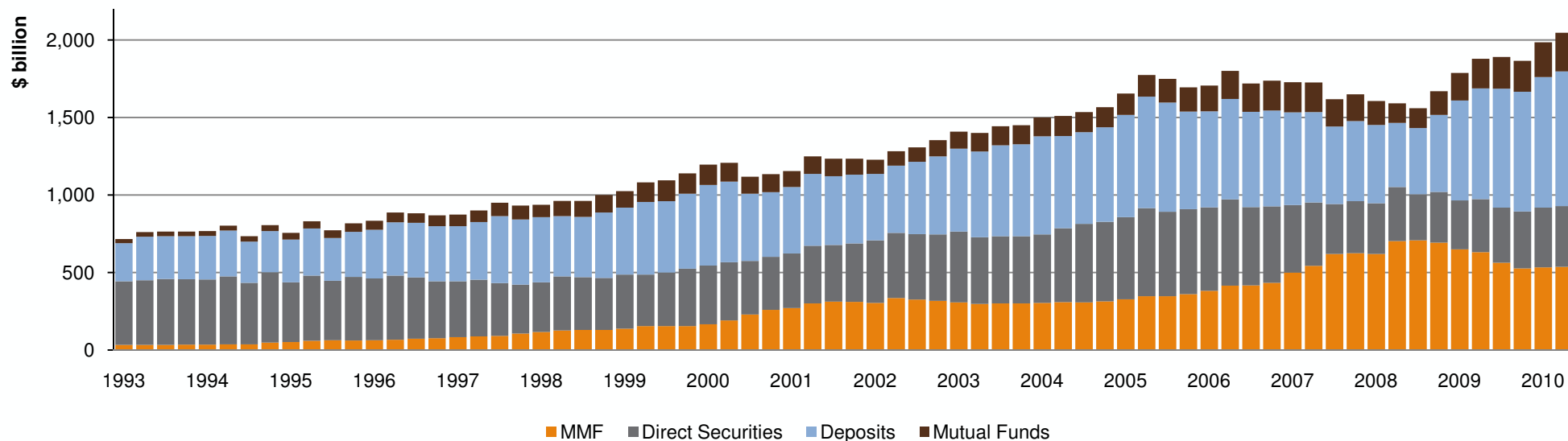
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- Considerations – weighing solutions

Industry overview – shifting view

Corporate cash wallets have grown to record levels

Corporate cash - wallet size and breakdown



Possible cash destinations:

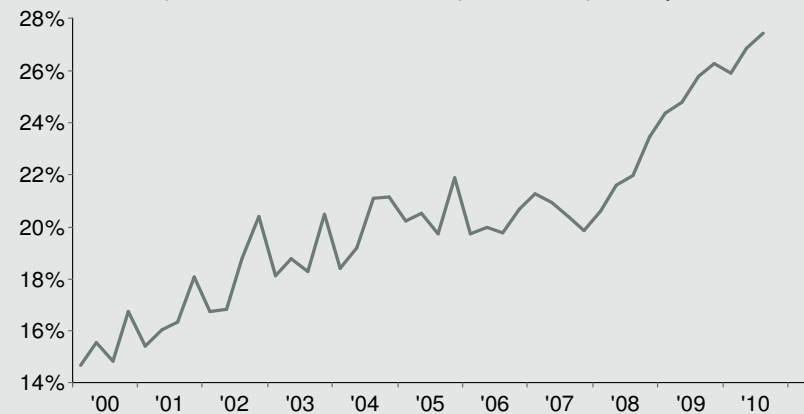
- Pay down debt / deleverage
- Invest back in business / M&A
- Increase stock dividends (up 12% in 4Q 2010) and stock buyback (up 80% in 4Q 2010)
- Re-risking / invest in longer term securities
- Keep more cash on balance sheet

Source: J.P. Morgan Asset Management. Data as of March 16, 2011. Direct securities include Repo, Credit market instruments, Commercial Paper, Treasury, Agency and Muni. 1993Q3 to 2010Q4. Chart for illustrative and discussion purposes only.

“Use” of cash remains low

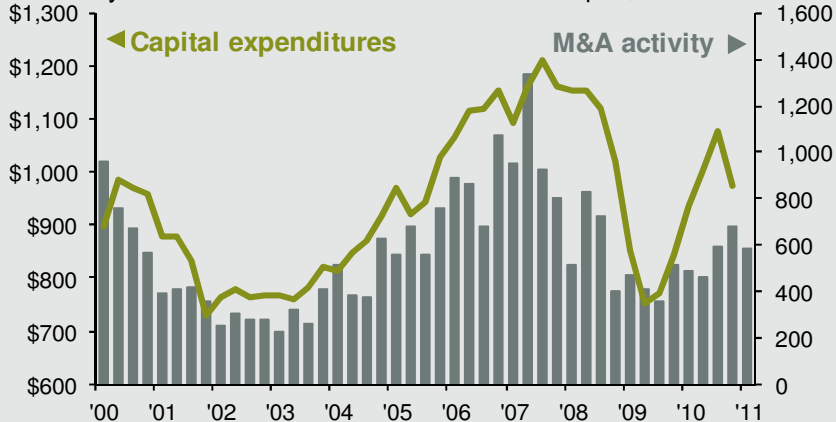
Corporate Cash as a % of Current Assets

S&P 500 companies—cash and cash equivalents, quarterly



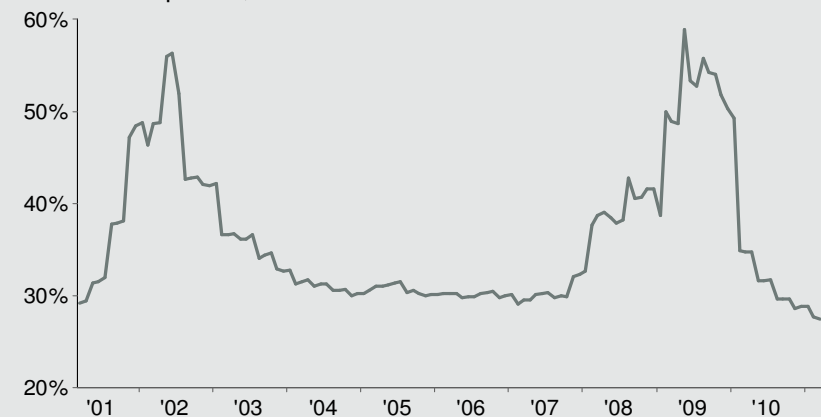
Corporate Growth

Quarterly deal volume and nonfarm nonfinancial capex, billions USD



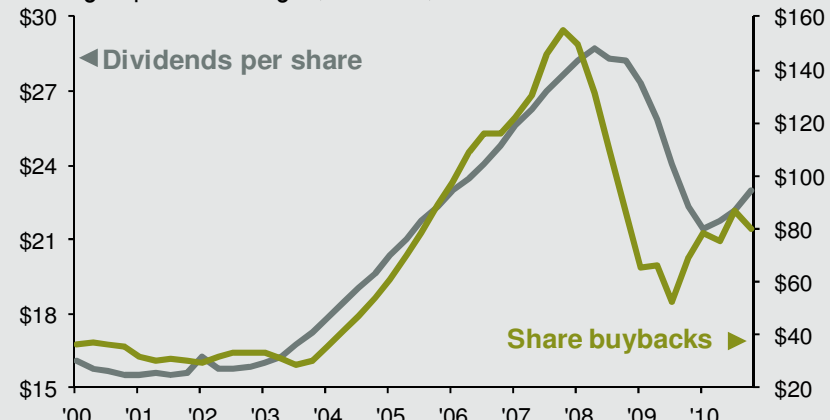
Dividend Payout Ratio

S&P 500 companies, LTM



Cash Returned to Shareholders

Rolling 4-quarter averages, S&P 500, billions USD



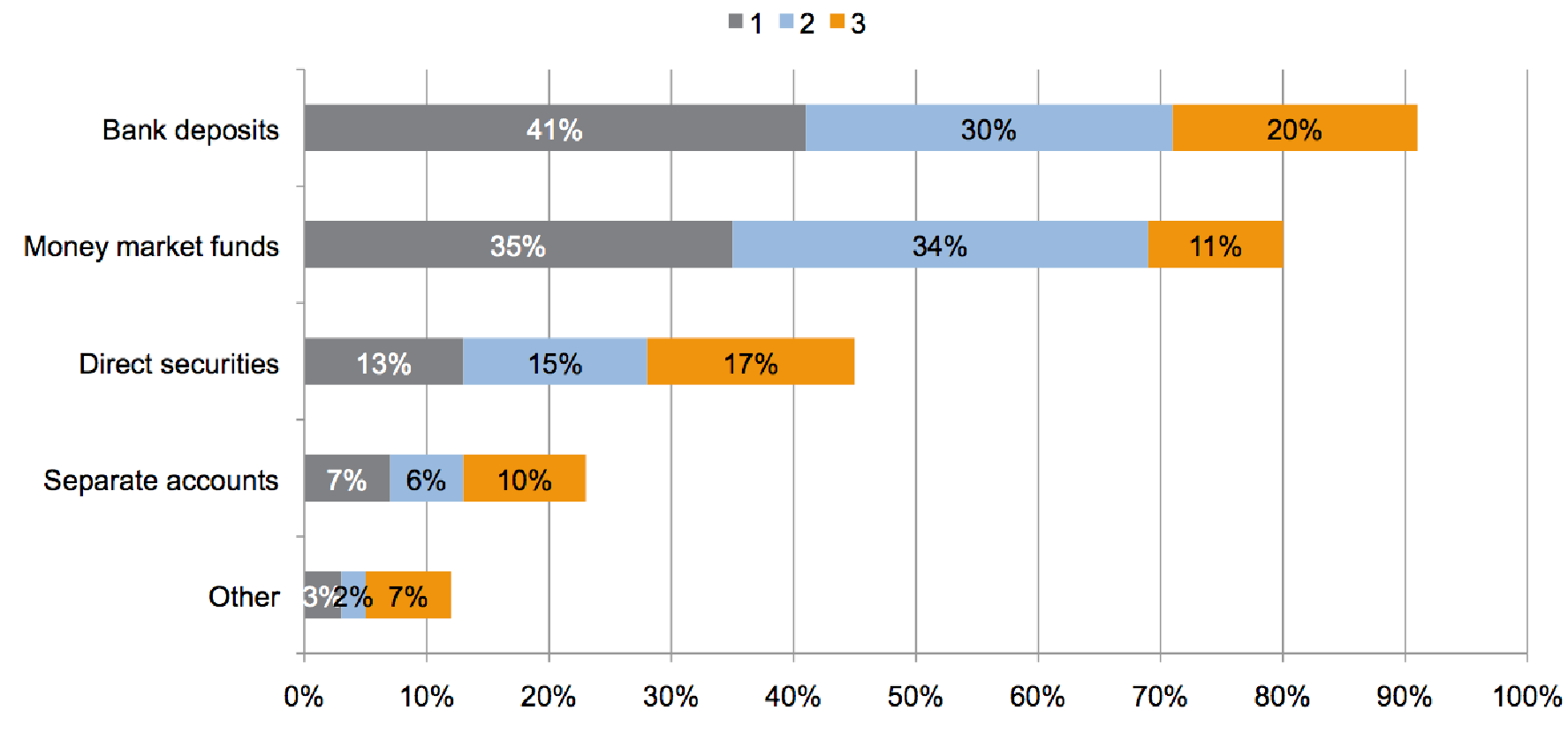
Source: Standard & Poor's, FRB, Bloomberg, FactSet, J.P. Morgan Securities, J.P. Morgan Asset Management.

(Top left) Standard & Poor's, FactSet, J.P. Morgan Asset Management. (Top right) M&A activity is quarterly number of deals of any value and capital expenditures are for nonfarm nonfinancial corporate business. (Bottom left) Standard & Poor's, FactSet, J.P. Morgan Asset Management. (Bottom right) Standard & Poor's, Compustat, FactSet, J.P. Morgan Asset Management. Data are most recent as of 3/31/11.

Treasurers are using a variety of investment vehicles

Highlights from the J.P. Morgan Global Cash management survey

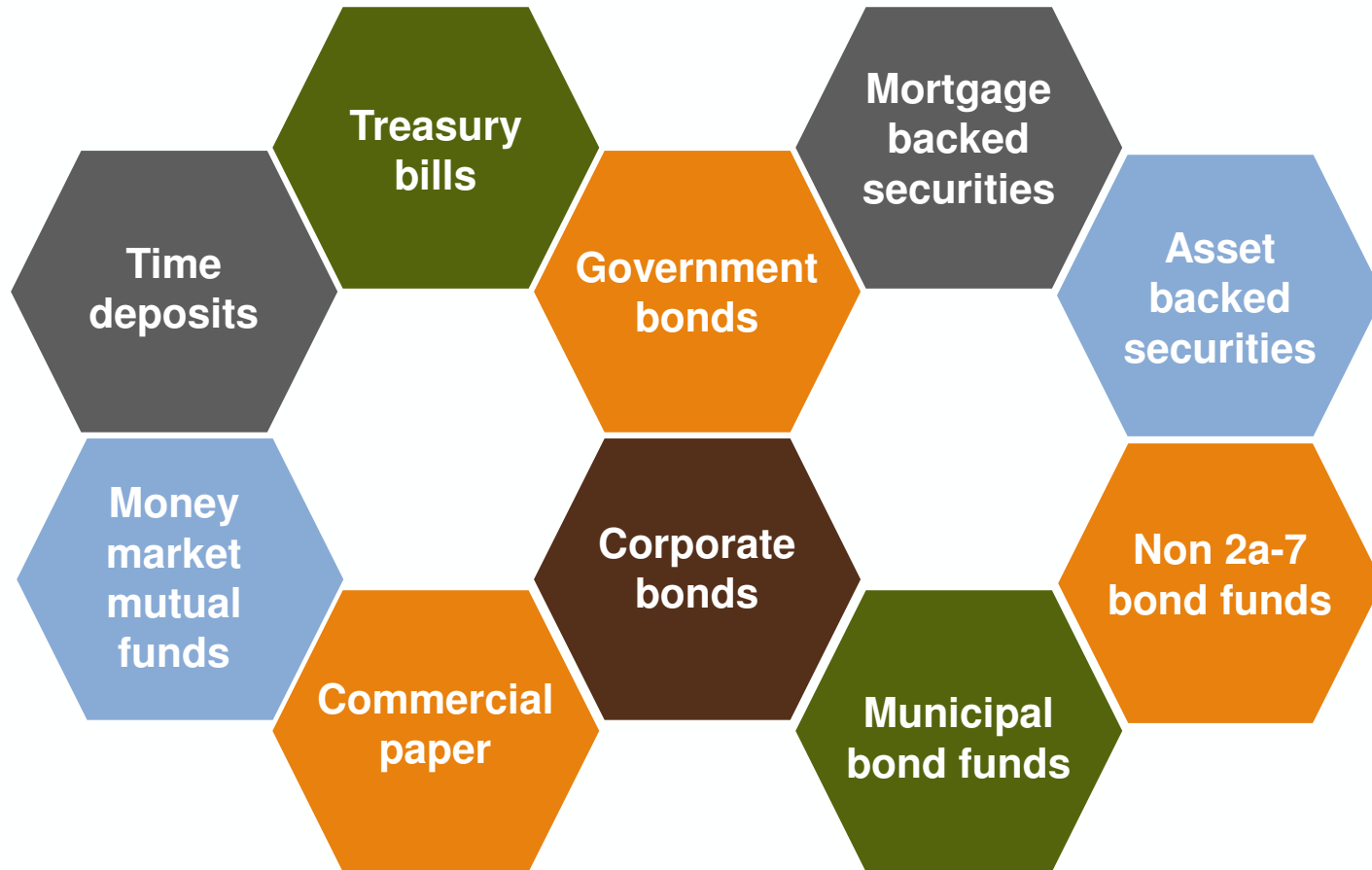
How is your surplus cash currently allocated? Identify your top three (by asset size), ranking them in order from 1 to 3.



Source: 12th Annual J.P. Morgan Asset Global Cash Management Survey, January 2011. Chart for illustrative and discussion purposes only.

Corporate treasurers have a broad universe of investment choices

The challenge is to select the correct choice for each objective



The money market fund industry has consolidated in recent years

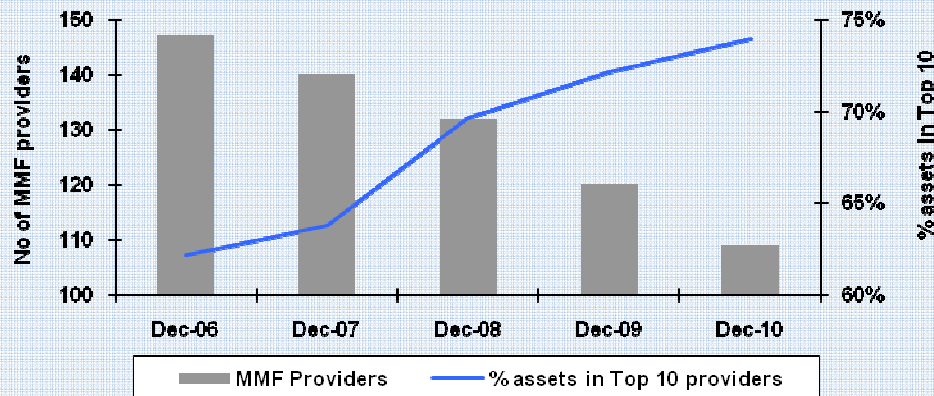
The top ten money market fund providers account for over 70% of assets

U.S. money market fund providers

Date	MMF Providers	Portfolios	Share classes	% assets in Top 10
Dec-06	147	725	1,776	62.14%
Dec-07	140	709	1,813	63.77%
Dec-08	132	673	1,748	69.60%
Dec-09	120	627	1,667	72.14%
Dec-10	109	577	1,613	73.94%

Market consolidation and AUM concentration

Date range: December 2006 to December 2010

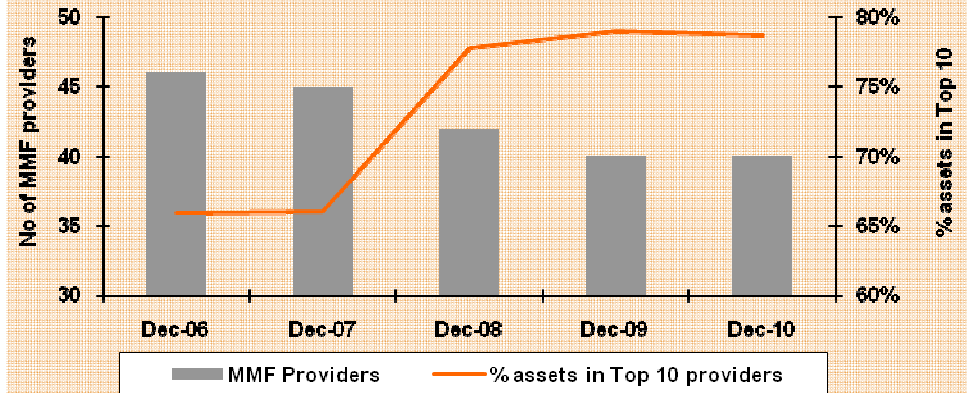


Offshore money market fund providers

Date	MMF Providers	Portfolios	Share classes	% assets in Top 10
Dec-06	46	124	414	65.92%
Dec-07	45	123	471	66%
Dec-08	42	125	492	77.85%
Dec-09	40	129	511	79.02%
Dec-10	40	127	546	78.76%

Market consolidation and AUM concentration

Date range: December 2006 to December 2010



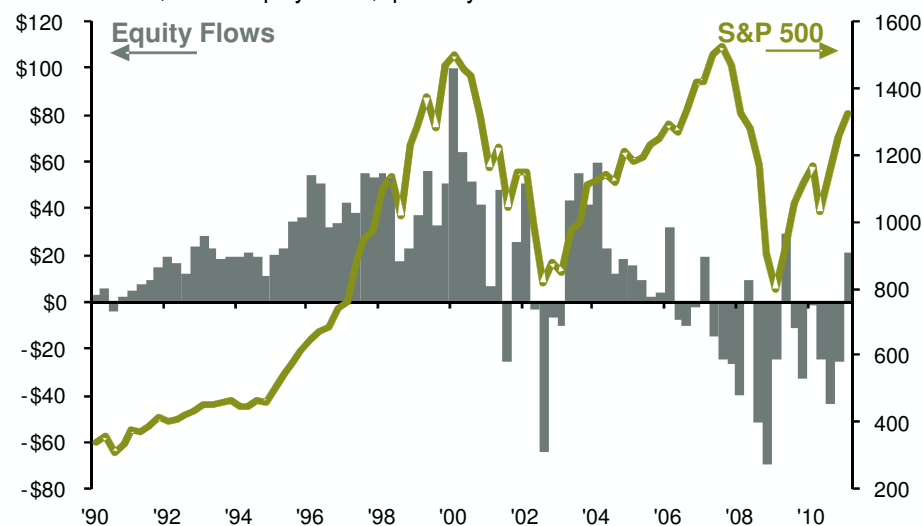
Source: iMoneyNet. Data as of year-end 2010. Charts shown for illustrative and discussion purposes only.

Fund flows

Billions, USD	AUM	Fund Flows												
		YTD 2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Domestic Equity	4,408	21	(96)	(39)	(152)	(48)	11	32	112	130	(23)	54	256	176
World Equity	1,552	12	59	31	(83)	138	148	104	66	22	(4)	(22)	53	11
Taxable Bond	2,182	23	230	307	19	98	46	26	3	39	124	76	(36)	8
Tax-exempt Bond	457	(17)	11	69	8	11	15	5	(14)	(7)	16	12	(14)	(12)
Hybrid	782	12	23	23	(18)	24	7	25	42	32	7	9	(31)	(14)
Money Market	2,741	(64)	(525)	(539)	637	654	245	62	(157)	(263)	(46)	375	159	194

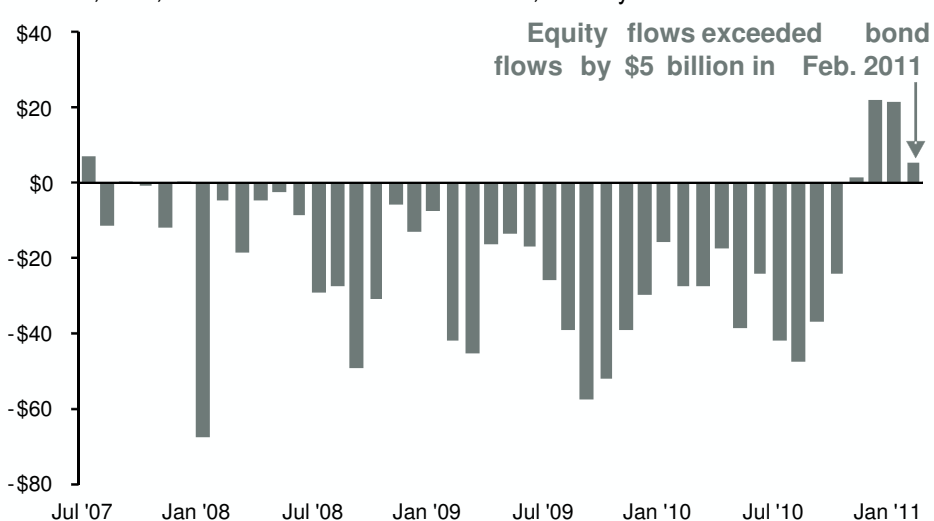
U.S. Equity Fund Flows and Market Performance

Billions USD, U.S. equity funds, quarterly



Difference Between Flows Into Stock and Bond Funds

Billions, USD, U.S. and international funds, monthly



Source: Investment Company Institute, J.P. Morgan Asset Management.

Data include flows through February 2011 and exclude ETFs. ICI data are subject to periodic revisions. World equity flows are inclusive of emerging market, global equity and regional equity flows. Hybrid flows include asset allocation, balanced fund, flexible portfolio and mixed income flows.

Data are as of 3/31/11.

Regulatory update – ongoing change

Regulatory changes are still coming...along with unintended consequences

- SEC has implemented many changes

- President's Working Group
 - Released a report in October 2010, aimed at studying the fundamental changes needed to address the vulnerabilities of money market mutual funds

 - Acknowledges that more can be done structurally

 - Eight specific policy options for further mitigation of systemic risks posed by money market mutual funds were analyzed (Liquidity facility, floating rate NAV, insurance, segregate retail investors)

 - No specific recommendation for action

 - Requested that the Financial Stability Oversight Council consider these policy options

- Basel III

- Frank/Dodd Legislation
 - New FDIC fee

An update on recent rating agency changes

Moody's

- New rating methodology and symbols for MMF effective May 20, 2011
 - Similar with current, but will append a “mf” modifier
- Introducing an analytical assessment of two distinct fund factors:
 - Portfolio Credit Profile (quality)
 - Portfolio Stability Profile (risks)
- Reflects consideration of other factors, such as sponsor quality, fund's management, and legal factors

Standard & Poor's

- Has submitted a proposal for new rating guidelines in January 2010
- Comments were due by March 26, 2010
- No final new rating guidelines have been announced

Fitch

- Has released updated MMF rating guidelines on October 5, 2009
- Appended a “mmf” modifier
- Limited liquidity: 10% O/N, 25% within 7 days
- Max WAM 60-days, max WAL 120-days, max asset maturity 397-days (2 years sovereign FRN)
- Introduction of Portfolio Credit Factor (PCF*)
- Consideration is given to the sponsor's ability and willingness to financially support its money market funds, if needed

Source: Moody's Revised Money Market Fund Rating Methodology and Symbols, March 10, 2011. S&P's Principal Stability Fund Rating Criteria, Jan 5, 2010; Fitch's Global Money Market Fund Rating Criteria, Oct 5, 2009.

* PCF (Portfolio Credit Factor) is a metric used by Fitch for the measurement of a portfolio's allocation to assets in terms of credit quality and maturity.

Unintended consequences of new regulations

How do these changes impact short-term investing



Investment landscape – rising rate environment

A tumultuous start to the year

- Revolutions in Northern Africa & the Middle East.
- Regime Changes in Tunisia and Egypt. NATO establishes a No-Fly Zone in Libya.
- Sovereign rating downgrades for Ireland, Portugal and Spain
- Earthquake and tsunami in Japan; nuclear crisis
- U.S. – most U.S. banks cleared to repurchase stock and increase dividends
- Housing prices in the U.S. continue to fall
- U.S. and global Q1 2011 GDP forecasts are revised lower
- Unemployment rate staying elevated

S&P 500 Index



Oil Prices



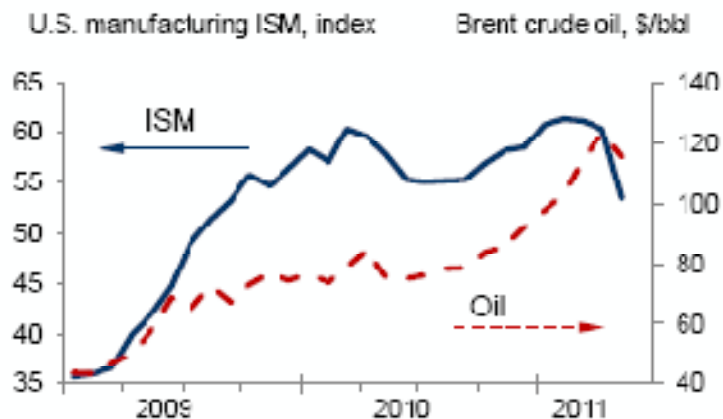
10-year Treasury yield



The above is shown for illustrative purposes only. Opinions and forecasts are based on current market conditions and are subject to change without notice.

What could keep markets down a while longer?

Oil and the Middle East hits confidence



U.S. corporations remain wary on hiring



Source for both charts: JPMS LLC; data as of June 2, 2011

- Unexpected rise in oil prices this summer weighs on confidence and spending
- Uncertainty – tied to debt ceiling, commodities, Europe and/or regulatory and tax environment keep firms cautious on hiring
 - Bloomberg consensus expects May non-farm payrolls to have risen by 165k, with the unemployment rate at 8.9%.....actual data printed at only +54k non-farm payrolls and the unemployment rate jumped to 9.1%

.....What will bring risk appetite back?

- Enough bad news priced in; JPMorgan IB just revised down Q2 GDP for second time this week (to 2%)
- Clarity on some “known unknowns”, such as Greece getting additional aid package (we see likely by end-June)
- Fed policy remains exceptionally accommodative
- More positive signs from Asia: Chinese inflation peaking in June and Japan growth starting to recover
- Extension of the debt ceiling passed by Congress

U.S. economy looks to be in position for solid growth for 1st half of 2011

Unemployment rates predicted to fall through 2012

Economic Outlook	Annual Averages			Q4/Q4		
	2010	2011	2012	2010	2011	2012
Real GDP	2.9	3.0	3.7	2.8	3.4	3.7
Private consumption	1.8	3.1	3.4	2.7	3.2	3.4
Equipment investment	15.1	11.2	13.5	16.4	11.7	13.7
Residential construction	-3.0	1.0	5.0	-4.6	5.0	4.8
Consumer prices (PCE)	1.7	2.2	2.7	1.2	2.9	2.3
Excluding food and energy	1.3	1.3	2.0	0.8	1.7	2.1
Unemployment rate	9.7	8.9	8.2	9.6	8.6	8.0

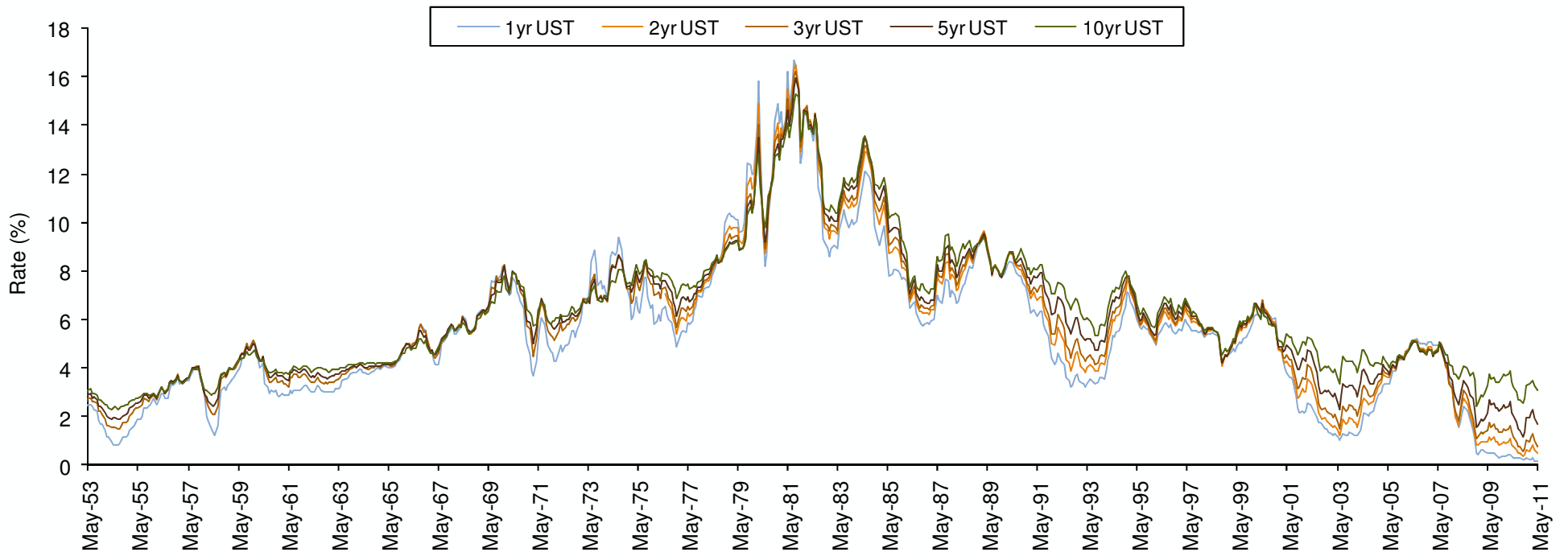
- The Obama administration's tax deal with Congress and the Federal Reserve's most recent asset purchase program continue to support U.S. economic growth in the first half of 2011.
- Slower-than-expected consumer spending and high commodity prices, particularly oil, have tempered consumption expectations some.
- Stronger growth should allow the unemployment rate to decline over the next two years, though it will remain elevated.
- Despite better economic growth, the high degree of labor underutilization should keep core inflation at the low end of the Fed's comfort zone for the next year, though we acknowledge some upside risk.
- The Fed is likely to stay the course on its current asset purchase program. An extension beyond June is highly unlikely.

Source: J.P. Morgan Securities. Forecasts as of March 7, 2011. Opinions and forecasts are based on current market conditions and are subject to change without notice. Chart for illustrative and discussion purposes only.

U.S. rates are currently at or near all time lows

1- to 5-year interest rates recently touched their lowest levels ever

Historic U.S. Treasury rates – May 1953 through May 2011



Source: US Federal Reserve; Bloomberg. Data as of May 31, 2011. Chart for illustrative and discussion purposes only.

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2-Year Treasury Street Forecasts as of June 3, 2011

2 yr Treasury	0.44	Barclays	Morgan Stanley	Goldman	HSBC	B of A	Internal	Jefferies	UBS	DB	CITI	Mizuho	CS
2011	Q2	0.70	0.55	0.60	0.90	0.50	0.70	0.65	0.80	0.30	0.65	0.80	0.70
	Q3	0.95	0.75	0.75	0.90	0.70	0.80	0.85	0.90	0.50	0.75	0.80	0.75
	Q4	1.10	1.25	1.00	0.80	1.00	0.90	1.10	1.00	0.50	1.00	1.00	0.85
2012	Q1	1.25	1.75	1.25	0.80	1.35	1.20	1.30	1.25	0.75	1.40	1.30	1.00
	Q2	1.35	2.25	1.50	0.80	2.00	1.20	1.50	1.50	0.75	1.70	1.30	1.00

6/3/2011		AVG	Min	Max	Median
	Q2' 11	0.65	0.30	0.90	0.68
	Q3 '11	0.78	0.50	0.95	0.78
	Q4 '11	0.96	0.50	1.25	1.00
	Q1' 12	1.22	0.75	1.75	1.25
	Q2' 12	1.40	0.75	2.25	1.43

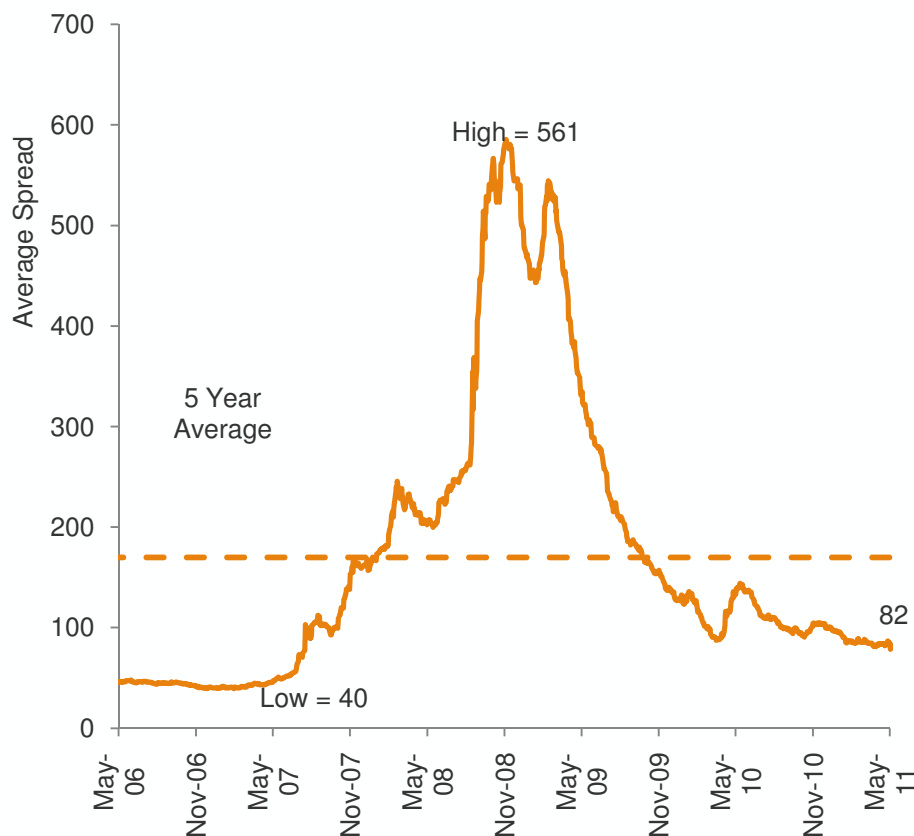
5/3/2011		AVG	Min	Max	Median
	Q2' 11	0.80	0.70	0.90	0.80
	Q3 '11	0.98	0.80	1.50	0.95
	Q4 '11	1.17	0.80	1.75	1.13
	Q1' 12	1.38	0.80	1.80	1.35
	Q2' 12	1.53	0.80	2.25	1.58

Difference		AVG	Min	Max	Median
	Q2	(0.14)	(0.40)	-	(0.13)
	Q3	(0.20)	(0.30)	(0.55)	(0.18)
	Q4	(0.21)	(0.30)	(0.50)	(0.13)
	Q1	(0.16)	(0.05)	(0.05)	(0.10)
	Q2	(0.12)	(0.05)	-	(0.15)

Investment Grade Credit

As of May 31, 2011

Barclays U.S. 1-3 Year Credit Index



- Modest spread widening in short corporate bond spreads in May did not cause them to underperform Treasuries
- Wider spreads in longer corporates (e.g. 3-5yr) led to underperformance by Treasuries
- Weak economic data, persistent peripheral Europe concerns and the resulting Treasury rally were the primary drivers of this poor performance
- Supply was large for May and met with strong demand, though secondary market demand lagged. We may look to add to risk on further weakness, but are being patient for now
- While we maintained an overweight position in corporate credit, emphasizing financials and BBB industrials, we reduced some of our exposure to names whose spreads we believe are more likely to widen due to a slowdown in global growth and heightened concerns around European sovereign debt issues

Source: Barclays Capital.

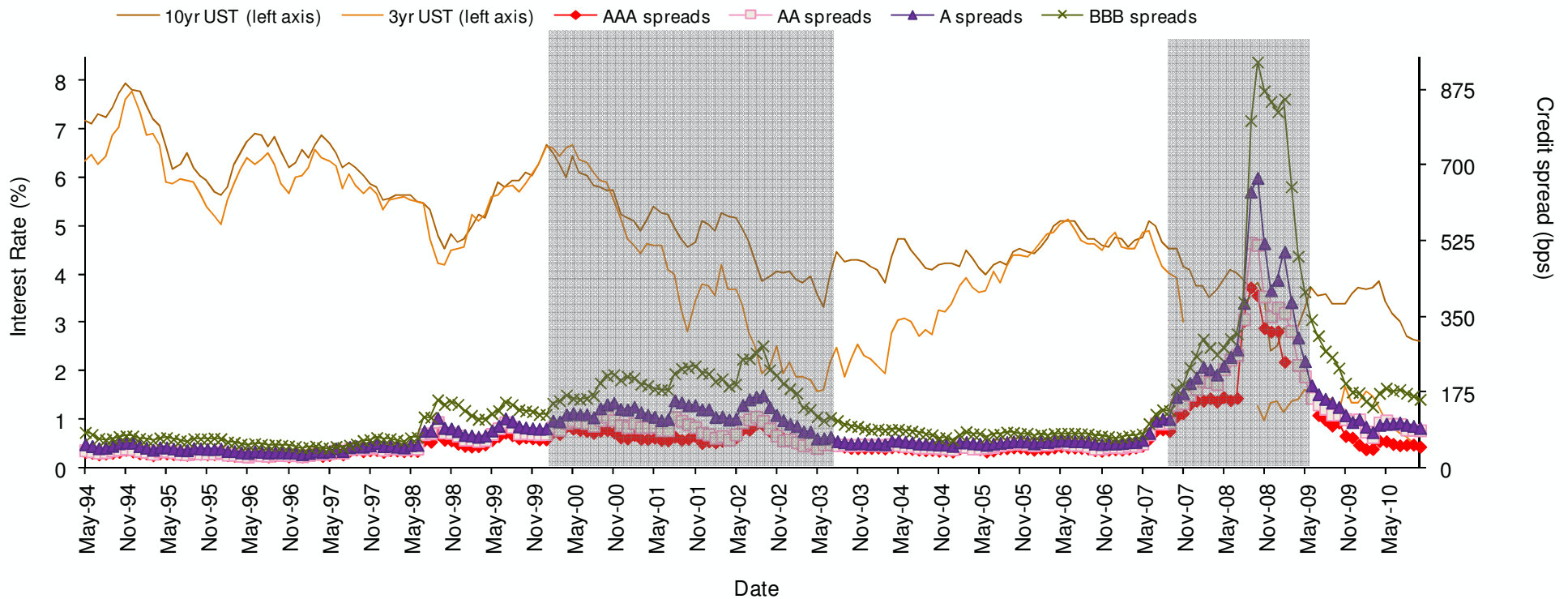
Opinions and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice

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Historic credit spreads

Historically, credit spreads have widened when rates are falling, and remain tight when rates are rising

Historic 3-year and 10-year U.S. Treasury rates versus 3-year credit spreads

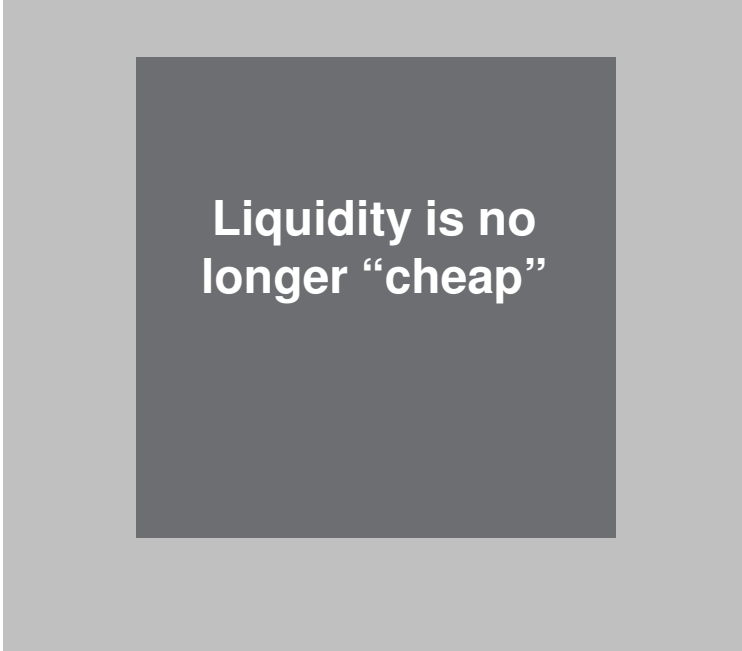


Sources: Bloomberg; Barclays; monthly data May 1994 through October 2010. Chart for illustrative and discussion purposes only.

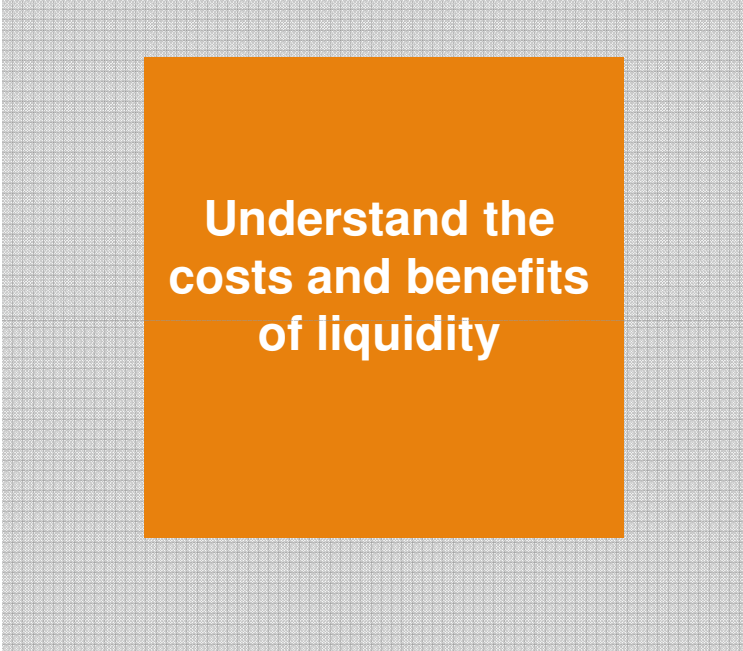
Considerations – weighing solutions

Defining the cost of liquidity

What should you consider when weighing solutions?



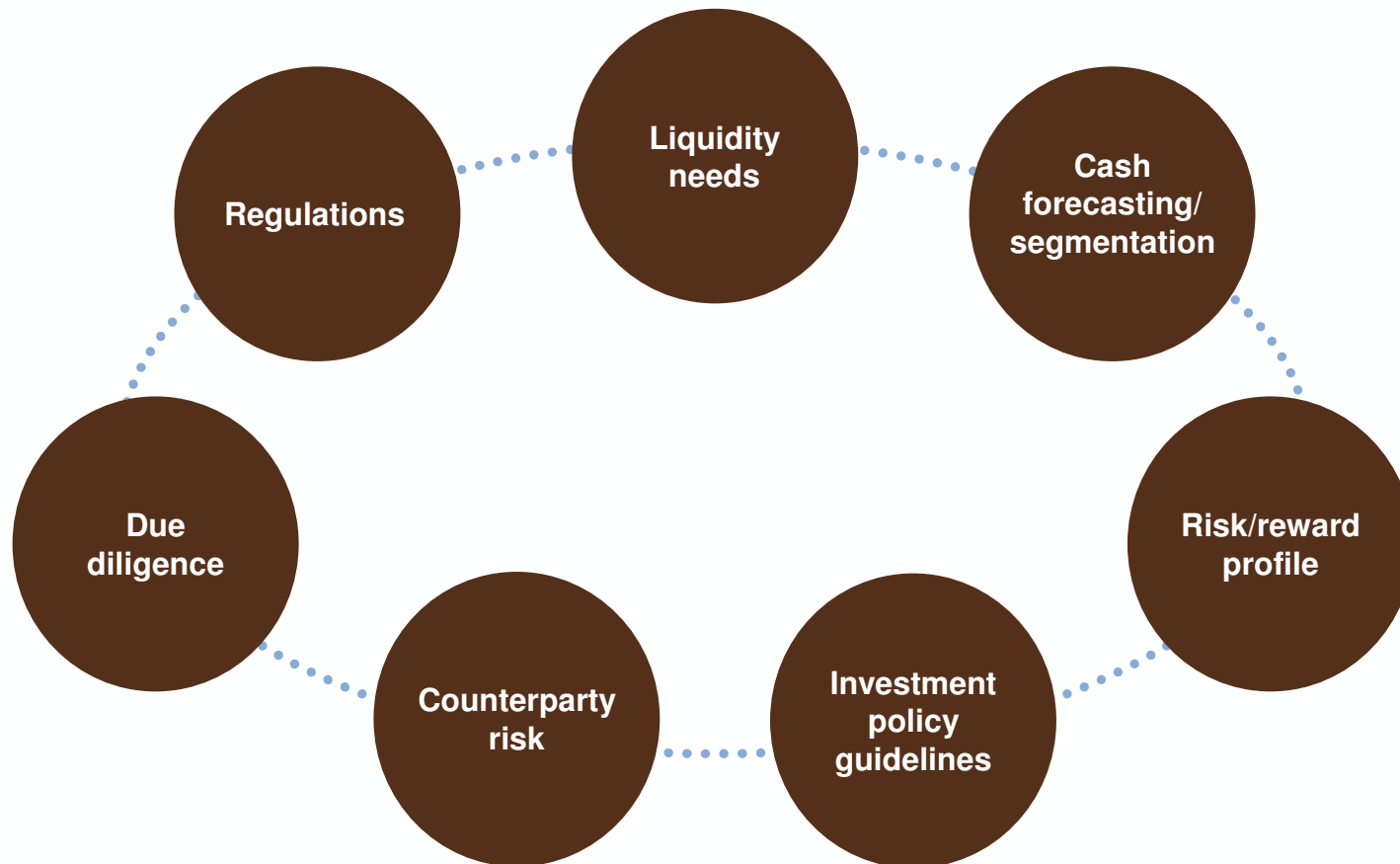
Liquidity is no longer “cheap”



Understand the costs and benefits of liquidity

Determining your global investment solutions

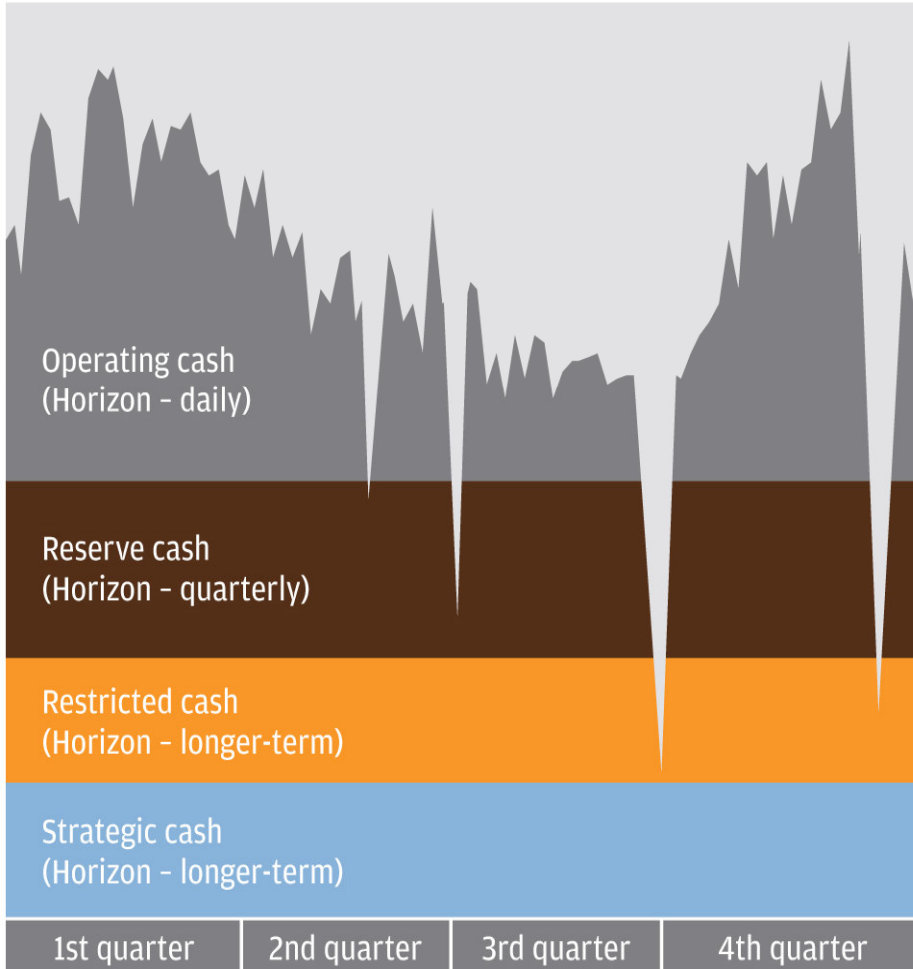
Appropriate cash investing for your organization requires a rigorous, ongoing evaluation of the following:



Segment and forecast your cash appropriately

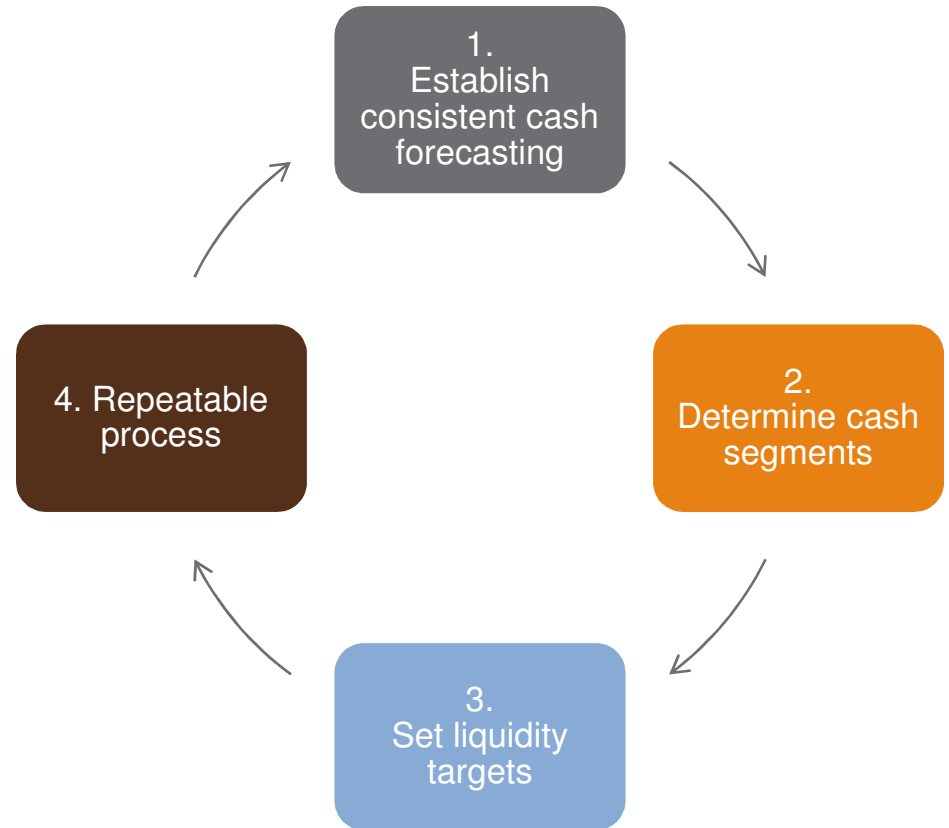
Continually monitor and repeat process to ensure an accurate forecast

Segment cash by liquidity needs and risk profile



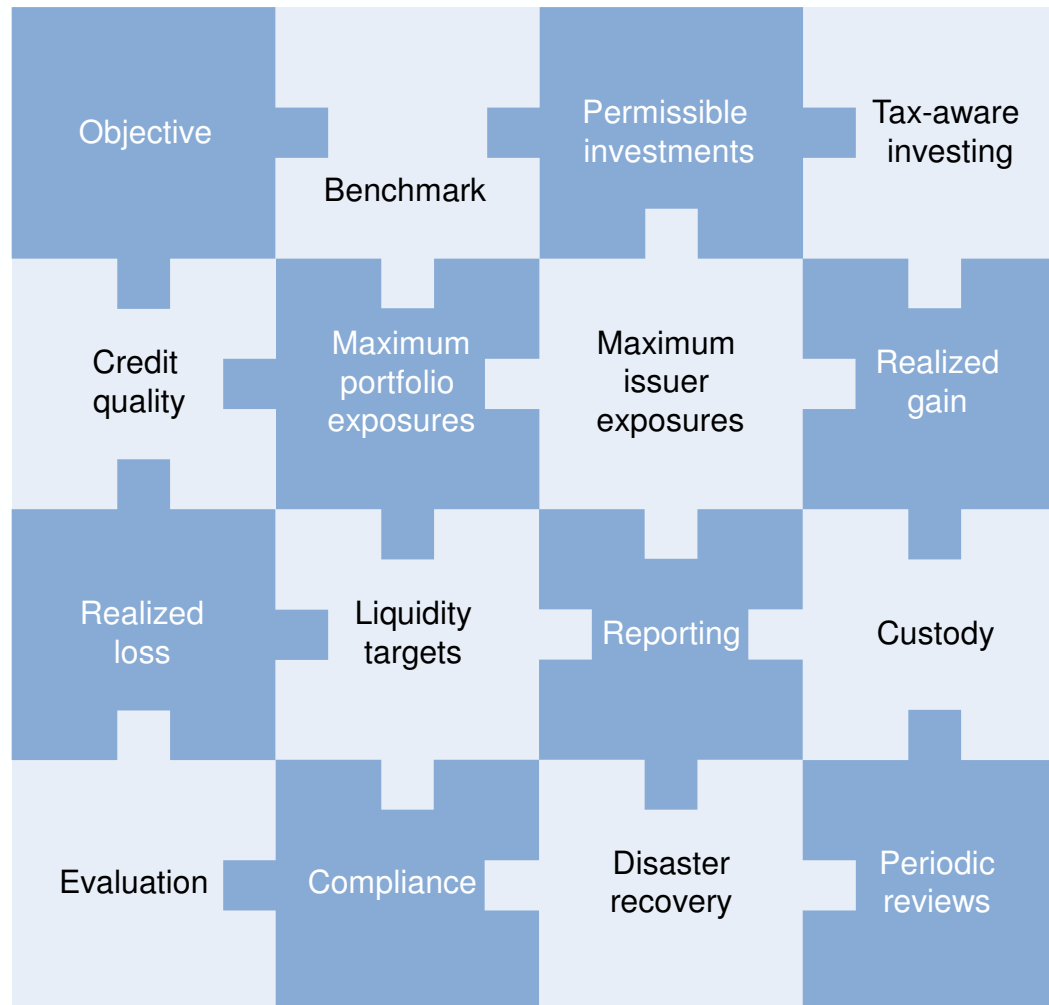
Charts shown for illustrative and discussion purposes only.

Implement a rigorous cash forecasting process



Review your investment policy

Secure approvals for any necessary adjustments



Use your investment policy as a guide

Select investments that match the broad investment parameters outline in your investment policy

Objectives

- Necessary liquidity
- Required preservation of capital
- Maximizing returns
- Fiduciary control
- Compliance
- Diversification

Benchmarks

- Risk and volatility tolerance
- Investment horizon
- Return expectations

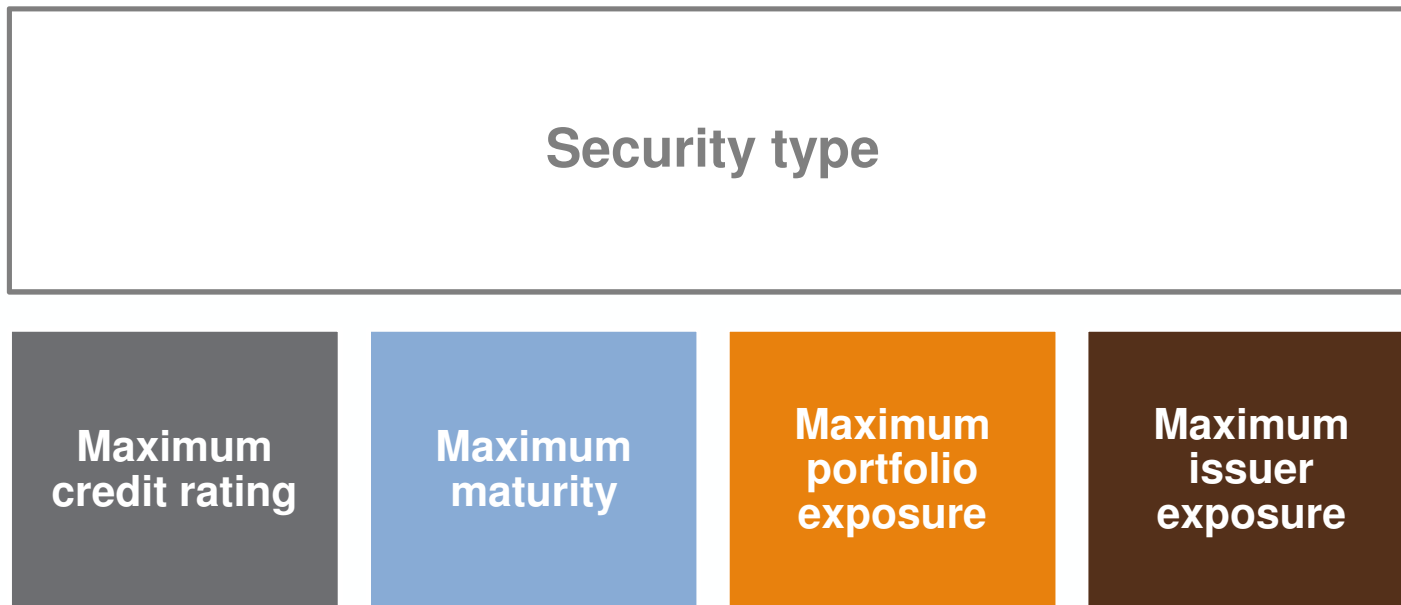
Scope

- Global coverage – or, are all subsidiaries and corporate entities separate
- Manage in-house, use external managers, or both
- Segmentation differences (e.g., working capital, reserve cash and strategic cash)
- Global policy – investment options in multiple currencies and jurisdictions

Use your investment policy as a guide

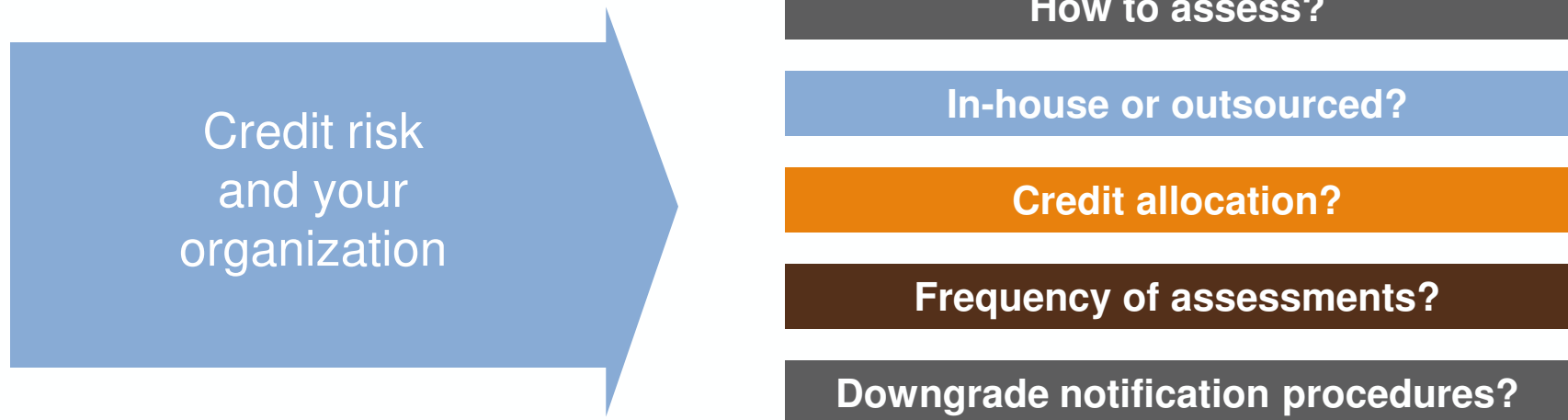
Review your permissible investments

- Your investment policy may limit the types of securities that are permitted along with a parameter for credit quality, maturity and diversification for each security



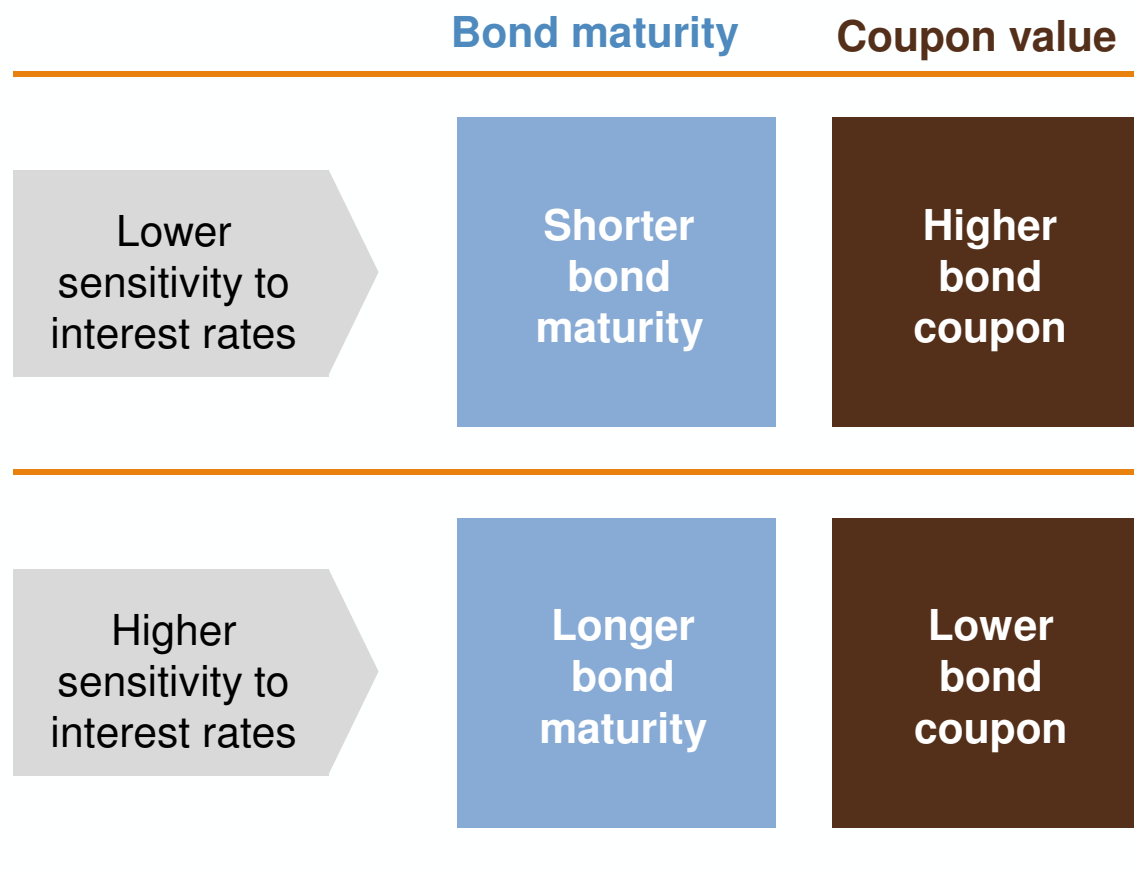
Define your appetite for greater credit risk

Organizations must carefully assess and manage credit risk within an investment strategy



Assessing your tolerance for interest rate volatility

Interest rate fluctuations can strongly impact the value of a portfolio with fixed-income security exposure



Current yields

As of June 7, 2011	1 Day	1 Month	3 Months	6 Months	9 Months	1 Year	2 Years	3 Years	5 Years
Prime Money Market Fund (Inst Shrs)	0.06								
US Government MMF (Inst Shrs)	0.01								
Tax Free Money Market Fund (Inst Shrs)	0.02								
AAA-GO's*						0.42	0.71	1.22	1.97
AA-GO's*						0.72	1.23	1.72	2.55
Pre-Refunded Securities*						0.42	0.68	1.02	
Treasuries		0.01	0.04	0.10	0.13	0.16	0.39	0.71	1.54
TLGP Paper							0.43		
Agencies	0.01	0.05	0.07	0.12	0.16	0.19	0.41	0.94	1.77
Commercial Paper (A-1/P-1) ABCP	0.10	0.15	0.18	0.26	0.37				
Commercial Paper (A-1/P-1) Financials	0.10	0.15	0.18	0.26	0.37				
Commercial Paper (A-1/P-1) Industrials	0.09	0.13	0.15	0.18	0.21				
Certificates of Deposit (A-1)	0.10	0.15	0.18	0.26	0.37	0.50			
Time Deposits	0.10								
AA Corporates				0.28	0.36	0.45	0.80	1.29	2.39
A Corporates				0.32	0.41	0.48	0.96	1.39	2.59
BBB Corporates				0.59	0.64	0.75	1.38	1.84	2.89
AAA-Rated Credit Card Receivables (WAL)						0.48	0.78	1.19	

*Muni Yields grossed up at a 35% tax rate

Sources: Bloomberg, J.P. Morgan Asset Management. Chart for illustrative and discussion purposes only.

Appendix

Biographies

- **James McNerny**, vice president, is a portfolio manager within the Global Liquidity business. In this role, James oversees approximately \$5bn in managed reserves portfolios as a member of the team that manages \$20bn in this strategy. An employee since 2000, James has previously served as a fixed income portfolio manager and product specialist in both London and New York, focusing on liquidity, short duration, broad market, extended market and total return products for clients throughout the EMEA and U.S. regions. James began his career as an analyst at the firm. James holds a B.S. in operations management from the University of Scranton and an M.S. in finance from London Business School. He also holds FINRA Series 3, 7, and 63 licenses.
- **Max Rodriguez**, vice president, is a client advisor in the Investment Management division of J.P. Morgan Asset Management. An employee since 2007, Max is responsible for providing comprehensive asset management solutions for liquidity, defined benefit, and defined contribution investments for U.S. institutional investors, including corporations, municipalities, not-for-profits and healthcare systems. Prior to this role, Max was a regional manager of the Subadvisory/Insurance Division of J.P. Morgan Asset Management responsible for client relationship management in the western region of the United States. In 1996, Max began working in both analytical and sales capacities in the insurance industry, investment banking, commercial banking, and investment sales. Previously, he was an investment consultant from Pacific Insurance Company; a financial advisor from Merrill Lynch-Global Private Client Group; assistant vice president in Technology Lending at City National Bank; an associate at Roth Capital Partners; and an associate at Long-Term Credit Bank of Japan (now Shinsei Bank). He has a B.S. in finance from Boston College and an M.B.A. from the University of Southern California's Marshall School of Business. He is member of the Orange County Society of Financial Analysts and holds a series 7 and 63 licenses. He is a CFA charter holder.

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