4th Quarter 2013 Investment Outlook

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Executive Summary

After a relatively uneventful summer, economic and financial markets have enjoyed a much livelier early fall. First, a few days into autumn, after spending four months preparing financial markets for a September "tapering" of the $85 billion per month of asset purchases (quantitative easing or QE), the Federal Reserve Bank surprised many investors with its decision to postpone any change in monetary policy. Naturally, markets responded positively to the news of continued monetary stimulus. The joy was short-lived, however, as investors quickly turned their attention to the stalemate in Washington over the federal budget and the debt ceiling. It is our view, now that fiscal issues are resolved for a time, that investors will turn their attention back to global economic growth, corporate earnings and interest rate expectations. We are optimistic that economic growth will be steady to higher looking into next year which could continue to pressure bond prices. U.S. stocks should extend their strong results through year-end and we expect international equity markets to play some catch-up (to the robust returns in the U.S.).

Key Considerations

- Due to the government shutdown, economic data may be difficult to evaluate for a couple of months. However, the growth of the U.S. economy appears poised to improve as tax-rate hikes from earlier this year lapse and slow improvement in the labor market continues.

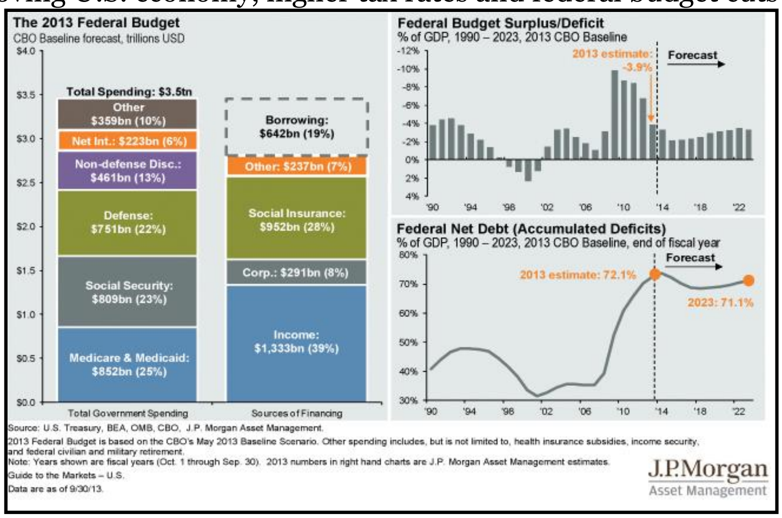
- Now that the budget/debt ceiling showdown is resolved (for a few months), investors' attention will return to monetary policy and corporate earnings. The nomination of Janet Yellen as the next Fed Chairwoman has investors prepared for an extension of current policy as she is expected to favor easy money policies.

- Foreign stock markets have been showing some relative improvement recently as Europe emerges from recession and China's economy appears to have stabilized.

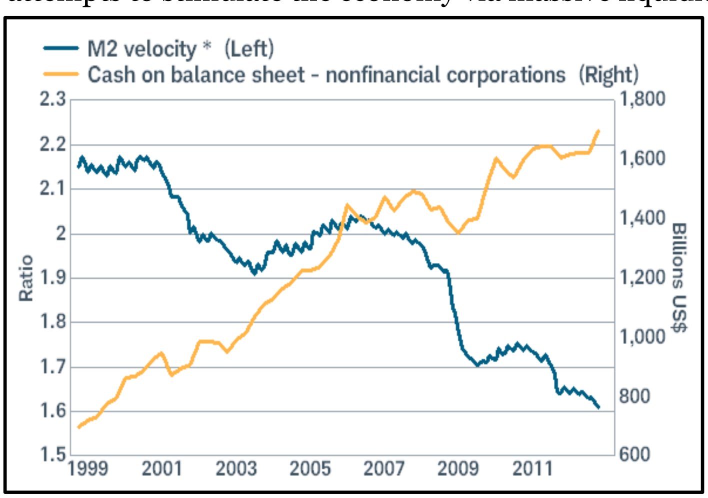
The Federal Reserve confused a lot of people in September when it deferred tapering asset purchases until a later date. The primary reason given for this delay was that the economy is not as strong as they anticipated earlier in the year. Secondly, the rapid rise in interest rates since May, when Fed Chairman Bernanke began floating the idea of a tapering, has apparently caused the housing recovery to stall. In addition, a number of Fed governors, including Janet Yellen, believe inflation is too low to warrant a withdrawal of monetary stimulus at this time. Finally, the Fed justifiably was concerned that contentious negotiations in congress in October over the federal budget and debt ceiling could impact consumer sentiment and effect economic activity in the fourth quarter. With Janet Yellen expected to receive easy confirmation as the next Fed chief, most economists have reset their forecasts to assume a continuation of the Fed's bond purchases at the current rate of $85 billion per month until at least December and probably into next year. And with Yellen at the helm, it could be two years before the Fed

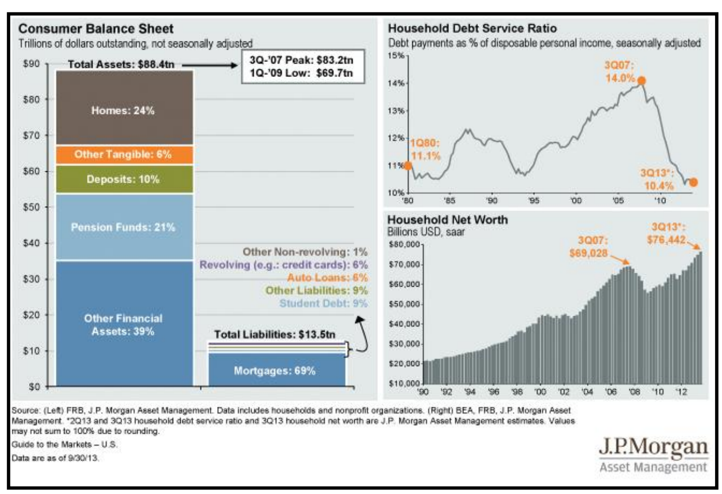
funds rate is raised from the current level of zero. If confirmed, Chairwoman Yellen is expected to initially focus less on an unemployment rate target and more on the inflation rate, having expressed concerns about the difficulty of engineering a recovery if we slip back into recession or flirt with a period of deflation. While this policy is open for debate as to its long-term wisdom and consequences, investors will likely be encouraged to continue taking on additional risk during a period of extraordinarily accommodative monetary policy.

A second issue which garners less attention but is also constructive for the economy and financial markets is the shrinking federal budget deficit. A slowly improving U.S. economy, higher tax rates and federal budget cuts due to the sequester have combined to cause the budget deficit to come down significantly from the previous fiscal year in both absolute terms, more than $400 billion, and as a percent of GDP (see chart at right). While political gamesmanship attracts a great deal of attention and highlights the deep divisions within our nation over the size and role of the federal government, divided government often constrains either party from misguided legislation. While neither party is enthusiastic over all aspects the fiscal policy changes enacted within the past twelve months under the duress of deadlines, the end result, while imperfect, has led to the first back-to-back shrinkage in the federal budget in many decades.



The U.S. economy grew by 2.5% in the second quarter and is expected to sustain real GDP growth between 2.0% and 2.5% for the final two quarters of the year. Even though the housing recovery appears to have leveled off in recent months due to a rise in mortgage rates, it has been one of the bright economic spots this year. Consumer spending has held up better than expected this year, given the slow economic growth and austerity measures taken earlier in the year. Average spending hardly tells the true story, since the upper end of the income and wealth spectrum has benefited from rising stock and housing prices, while lower income households have felt the pressure of higher payroll taxes. U.S. manufacturing is in the midst of a renaissance of sorts in recent years as a result of a depreciated dollar and a U.S. energy boom which has pushed natural gas prices to levels far below Europe and Asia. U.S. manufacturers are using these advantages to gain a competitive cost edge versus their global competitors for the first time in decades. Nonetheless, businesses have been cautious in spending their capital and are sitting on a record pile of cash, frustrating the Fed's attempts to stimulate the economy via massive liquidity as indicated in the chart below left:





However, new order reports and business confidence surveys may be signaling that corporations are about to increase their spending on productivity enhancing investments in order to compete more effectively on a global basis.

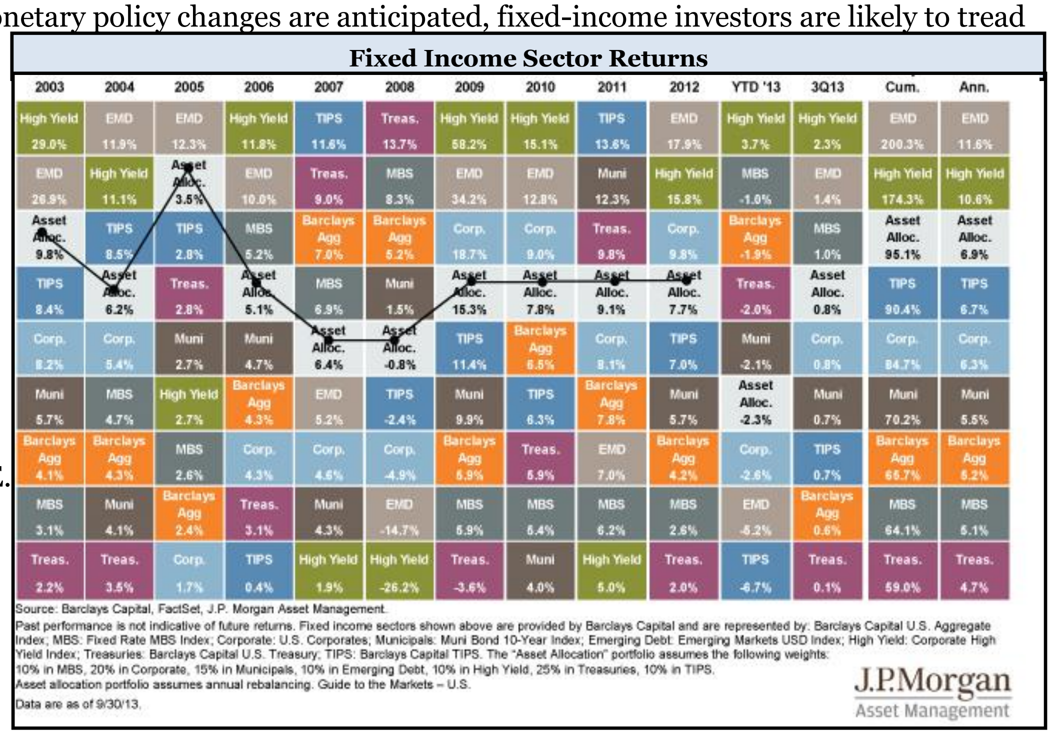
Outside the U.S., economic conditions appear to be showing signs of improvement. The European economy is no longer contracting as continued easy money policies by the European Central Bank (ECB), stronger growth in Germany and a smaller fiscal drag from the weaker economies lead to renewed, albeit slow growth.

China and Asia-ex Japan economic growth appears to be stabilizing at a still high, but slower rate than in previous years. Questions remain about the true health of the Chinese economy given its reputation for less than transparent access to raw economic data. In Japan, there is reason to remain optimistic that the Bank of Japan's (BOJ) massive QE program, intended to reverse a nearly twenty-year bout with deflation, is meeting with some success. An increase in the Japanese consumption tax in 2014 is creating some uncertainty over the sustainability of the recent improvement in economic growth, however improved consumer and business confidence is likely to prevail over time. If economic conditions begin to weaken, the BOJ stands ready to further increase QE with additional asset purchases.

Asset Class Commentaries

Bonds

With the economy growing at a moderate pace, inflation running below the Fed's desired rate and economic data in the months ahead clouded by the recent budget/debt ceiling debacle, we are unlikely to see any changes to monetary policy before year-end. However, after getting a taste of how quickly interest rates can change and bond prices can fall when monetary policy changes are anticipated, fixed-income investors are likely to tread carefully. In the near-term, we would expect the benchmark ten-year U.S. Treasury rate to range between 2.50% and 3.00%. If the economy does show some improvement next year in the range of 2.50%-3.00% GDP growth, interest rates are likely to rise further as investors would then expect a more rapid wind-down of QE. We remain cautious in our approach to fixed-income investing, preferring to assume credit risk rather than interest rate risk. In short, this means we would prefer



Fixed Income Sector Returns

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	YTD '13	3Q13	Cum.	Ann.
High Yield 29.0%	EMD 11.9%	EMD 12.3%	High Yield 11.8%	TIPS 11.6%	Treas. 13.7%	High Yield 58.2%	High Yield 15.1%	TIPS 13.6%	EMD 17.9%	High Yield 3.7%	High Yield 2.3%	EMD 200.3%	EMD 11.6%
EMD 26.9%	High Yield 11.1%	Asset Alloc. 3.5%	EMD 10.0%	Treas. 9.0%	MBS 8.3%	EMD 34.2%	EMD 12.8%	Muni 12.3%	High Yield 15.8%	MBS -1.0%	EMD 1.4%	High Yield 174.3%	High Yield 10.6%
Asset Alloc. 9.8%	TIPS 8.5%	TIPS 2.8%	MBS 5.2%	Barclays Agg 7.0%	Barclays Agg 5.2%	Corp. 18.7%	Corp. 9.0%	Treas. 9.8%	Corp. 9.8%	Barclays Agg -1.9%	MBS 1.0%	Asset Alloc. 95.1%	Asset Alloc. 6.9%
TIPS 8.4%	Asset Alloc. 6.2%	Treas. 2.8%	Asset Alloc. 5.1%	MBS 6.9%	Muni 1.5%	Asset Alloc. 15.3%	Asset Alloc. 7.8%	Asset Alloc. 9.1%	Asset Alloc. 7.7%	Treas. -2.0%	Asset Alloc. 0.8%	TIPS 90.4%	TIPS 6.7%
Corp. 8.2%	Corp. 5.4%	Muni 2.7%	Muni 4.7%	Asset Alloc. 6.4%	Asset Alloc. -0.8%	TIPS 11.4%	Barclays Agg 6.5%	Corp. 8.1%	TIPS 7.0%	Muni -2.1%	Corp. 0.8%	Corp. 84.7%	Corp. 6.3%
Muni 5.7%	MBS 4.7%	High Yield 2.7%	Barclays Agg 4.3%	EMD 5.2%	TIPS -2.4%	Muni 9.9%	TIPS 6.3%	Barclays Agg 7.8%	Muni 5.7%	Asset Alloc. -2.3%	Muni 0.7%	Muni 70.2%	Muni 5.5%
Barclays Agg 4.1%	Barclays Agg 4.3%	MBS 2.6%	Corp. 4.3%	Corp. 4.6%	Corp. -4.9%	Barclays Agg 5.9%	Treas. 5.9%	EMD 7.0%	Barclays Agg 4.2%	Corp. -2.6%	TIPS 0.7%	Barclays Agg 65.7%	Barclays Agg 5.2%
MBS 3.1%	Muni 4.1%	Barclays Agg 2.4%	Treas. 3.1%	Muni 4.3%	EMD -14.7%	MBS 5.9%	MBS 5.4%	MBS 6.2%	MBS 2.6%	EMD -6.2%	Barclays Agg 0.6%	MBS 64.1%	MBS 5.1%
Treas. 2.2%	Treas. 3.5%	Corp. 1.7%	TIPS 0.4%	High Yield 1.9%	High Yield -26.2%	Treas. -3.6%	Muni 4.0%	High Yield 5.0%	Treas. 2.0%	TIPS -6.7%	Treas. 0.1%	Treas. 59.0%	Treas. 4.7%

Source: Barclays Capital, FactSet, J.P. Morgan Asset Management.

Past performance is not indicative of future returns. Fixed income sectors shown above are provided by Barclays Capital and are represented by: Barclays Capital U.S. Aggregate Index; MBS: Fixed Rate MBS Index; Corporate: U.S. Corporates; Municipals: Muni Bond 10-Year Index; Emerging Debt: Emerging Markets USD Index; High Yield: Corporate High Yield Index; Treasuries: Barclays Capital U.S. Treasury; TIPS: Barclays Capital TIPS. The "Asset Allocation" portfolio assumes the following weights: 10% in MBS, 20% in Corporate, 15% in Municipals, 10% in Emerging Debt, 10% in High Yield, 25% in Treasuries, 10% in TIPS. Asset allocation portfolio assumes annual rebalancing. Guide to the Markets – U.S.

Data are as of 9/30/13.

J.P.Morgan Asset Management

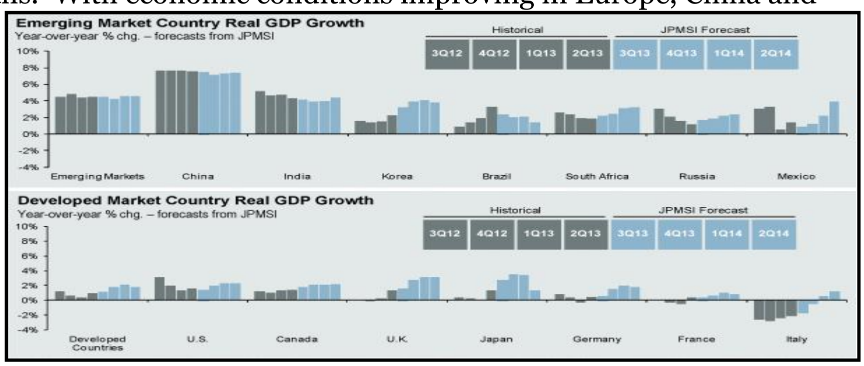
to buy a pool of short-to-intermediate-term lower grade bonds with high yields rather than longer dated, highly rated bonds. High yield or "junk bonds" tend to perform better in growing economies and have been one of the better-performing fixed-income categories when measured over various timeframes.

U.S. Stocks

Most U.S. stock indexes have generated year-to-date returns upwards of 20% through mid-October. Yet stock prices do not appear to be overvalued based upon traditional valuation metrics, and interest rates and inflation, important factors in valuing stocks, are expected to stay low. And while corporate earnings growth has been stuck in the mid-single digit range for over two years, expectations are for acceleration back to double-digit growth beginning in the fourth quarter of 2013 for several additional quarters. For these reasons, we continue to regard U.S. equities as an attractive place to invest. We believe biotechs, technology, consumer discretionary and industrials will provide the best relative performance in the months ahead.

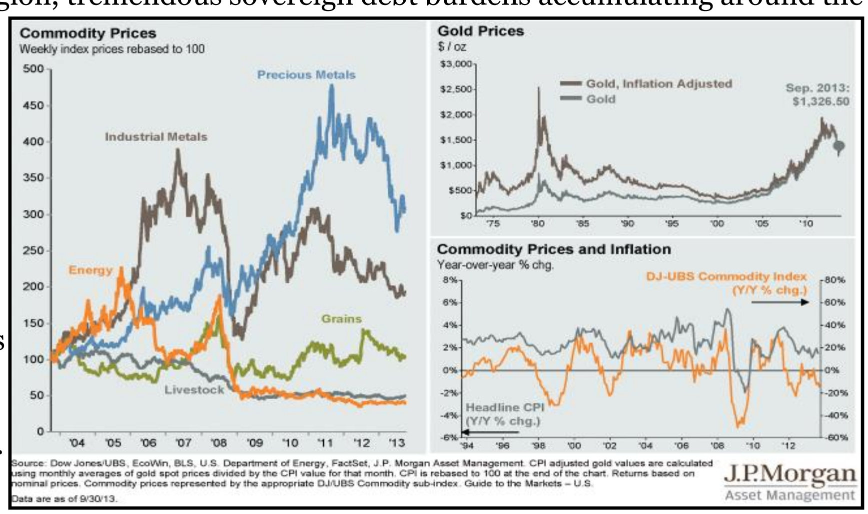
Foreign Stocks

After lagging behind U.S. performance most of this year, stock markets outside the U.S. have begun to show better relative results over the last few months. With economic conditions improving in Europe, China and Japan and valuation levels even lower in most cases than the U.S., there is reason to believe this trend could continue for a while longer. As indicated in our previous investment outlook, we have begun to move toward a more balanced approach toward foreign equity markets by reducing exposures to emerging markets and increasing allocations to developed markets.



Commodities & Real Estate

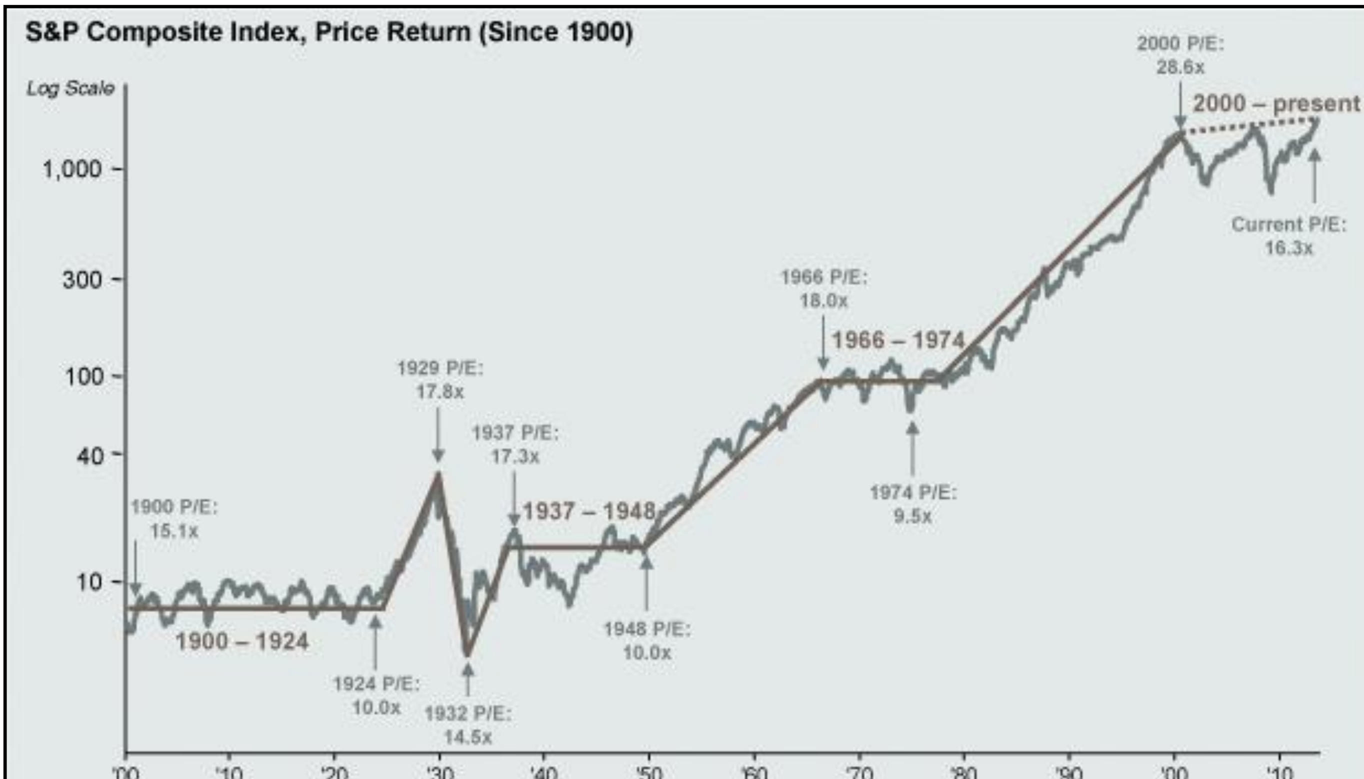
With strong demand for physical gold in emerging markets, especially India and China, seemingly endless money printing in every major economic region, tremendous sovereign debt burdens accumulating around the globe and stagnating global gold mine growth, it would be reasonable to expect that gold prices should be rising. However, after rising for twelve consecutive years, gold prices have tumbled this year. Our view is that rising real interest rates and better perceived opportunities in stocks have caused hedge fund managers who were heavily weighted in gold ETFs (such as GLD) to liquidate positions. Other commodities have had a rough ride this year as well, suggesting 2014 will be a defining year for the long-term trends in gold and other



commodities. With as much damage as these prices have endured this year, it would be surprising to see a major uptrend begin anytime soon. For this reason, we decided to reduce our exposure to gold earlier this year and now expect to further reduce or eliminate remaining positions in gold and other commodity funds in the months ahead, in most client accounts.

Summary

Volatile markets can be unsettling to some investors, but recent history has proven that, even in the face of various perceived risks, when fundamentals are sound, it is best to use pullbacks as buying opportunities. And it is best to set asset allocations based upon long-term objectives rather than short-term market expectations. Diversification, both within and across asset classes, is generally the best way to reduce risk in the long-term as opposed to attempting any type of market timing. We believe financial markets should extend their gains in the fourth quarter of the year, especially U.S. and foreign stocks. During this period, we expect to be busy continuing to shorten durations in bond portfolios, repositioning international stock holdings as indicated and reducing gold and commodity exposures. With regard to U.S. equities, our focus remains on identifying attractive growth companies selling at reasonable prices relative to their expected growth. Finally, for taxable investors, we will be reviewing the potential to offset capital gains taken to date with any available unrealized losses.



Source: Shiller, FactSet, J.P. Morgan Asset Management.

Data shown in log scale to best illustrate long-term index patterns. P/E ratios shown at price peaks and troughs use trailing four quarters of reported earnings and are shown as a one year average.

Past performance is not indicative of future returns. Chart is for illustrative purposes only.

Guide to the Markets – U.S.

Data are as of 9/30/13.

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