



The Convergence of
Mutual and Hedge Funds

Open Architecture
Target Date Funds

Global Expansion

Actively Managed ETFs

The New Paradigm. Evolving Opportunities.

It is often said that through change, opportunities emerge. The past four years have brought unprecedented change to the asset management industry. New rules and regulations have been introduced in an attempt to prevent or at least minimize the reoccurrence of the financial crisis of 2008. In the face of this new paradigm, how can asset managers leverage new opportunities for growth?

In this document we explore four trends that are sure to have an impact on asset managers and the fund industry landscape. The convergence of traditional long only funds with alternative investment vehicles and the most efficient methods to process this new dimension in pooled funds. The increasing use of open architecture target date funds in defined contribution plans and the tools that asset managers need in order to meet the demand. The continuing role of globalization and the need for local market expertise. And finally, actively managed ETFs as the next wave of growth for this emerging asset class.

As we examine these developments, we hope our insights assist you in meeting new market demands as you continue to grow your business.

The New Conventional –

Open Architecture Target Date Funds

Retirement planning continues to gain attention as increased regulation and volatile markets call into question our readiness for retirement. Target date funds (TDFs) have emerged as a popular choice in defined contribution retirement plans as many pension sponsors rush to better address participant needs. In fact, target-driven solutions are expected to represent 60% of all defined contribution assets by 2015, capturing \$1.7 trillion in flows.*

Traditional TDFs have come under scrutiny as performance returns have fallen below expectations, raising questions surrounding transparency. As a result, the industry is demanding more clarity concerning risk, asset allocation at the target date, fees and performance expectations. Firms offering retirement options to employees are seeking to better manage their risk as fiduciaries by offering their participants open architecture target date funds. These professionally managed funds, which most individuals cannot afford to access directly, provide participants exposure to asset classes such

as commodities, inflation hedges and absolute return strategies in a bundled TDF that might not be prudent to offer as a stand-alone investment choice in the fund lineup. Firms have increasingly sought open architecture TDFs because they allow them to change the underlying portfolio manager lineups when new funds that offer better risk-return profiles arise. The flexibility also extends to offering commingled or other unitized portfolios as alternatives to mutual funds which traditionally carry low fees.

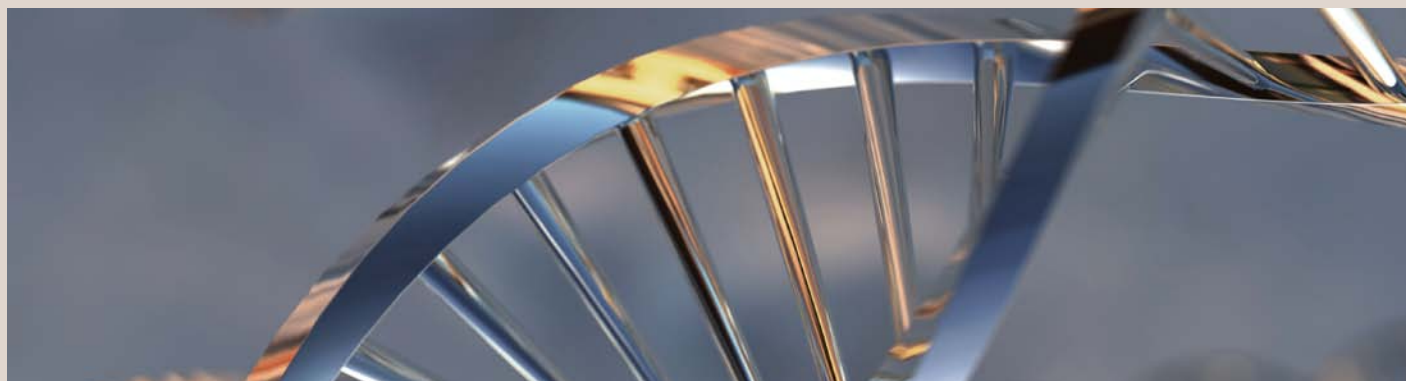
While plan sponsors want to deliver innovative solutions, the administration of custom TDFs is extremely complex and time-consuming. These custom investment options require a flexible and dynamic platform for the allocation of the cash flows arising from plan activity, as well as periodic rebalancing in order to closely track the intended asset allocation. The ability to systematically administer the allocation of routine cash flows and periodically rebalance funds is critical for a successful product implementation.

J.P. Morgan's solution:

J.P. Morgan CARSSM is an enterprise class platform that enables investment managers to create and deliver innovative fund of fund structures – particularly custom/open architecture target date funds – with extreme flexibility, efficiency and control. This fully automated platform is integrated with our custody, accounting and reporting services, and it operates interdependently with plan transfer agents.

This solution allows the investment manager to effectively outsource the operational burden associated with these customized offerings, while ensuring that their operational requirements are addressed in a straight through put environment with strong controls in place. Complex processes, including the allocation of daily cash flows and portfolio rebalancing across multiple funds and managers, can be executed in an automated fashion. Our clients can focus on achieving their investment goals on behalf of their own clients, leaving the operational complexity to us.

* Winning in the Defined Contribution Market of 2015, New Realities Reshape the Competitive Landscape, McKinsey & Company.





Global Expansion

As the global economy moves forward, emerging and developing markets continue to demonstrate the fastest growth rates. These markets have grown nearly twice as fast as developed markets over the last 10 years with the highest growth rates coming from Brazil, Chile, China, India, Mexico and South Africa.

European markets are evolving as well, with the Central bank's development of the T2S single platform settlement project making intra-European cross-border trading even easier and which will harmonize the multiple markets in the EU. In the Middle East, regulatory changes, including the liberalization of the Saudi Arabian and UAE markets should increase international interest in these less developed markets. The combined effect of these opportunities coupled with continued advancements in global communications and technology presents an ever-increasing value proposition for investors.

While asset managers explore opportunities for global expansion, they must also consider the challenges they may face. Specifically, given the level of complexity in the emerging markets, it is critical for asset managers to be familiar with local market practices including market entry, foreign exchange requirements and restrictions, regulatory reporting requirements and nuances relating to funding and settlement of transactions.

As 2011 confirmed, investors must also be prepared to manage through change and potential challenges in these markets. Issues relating to market volatility, liquidity challenges, complex tax and regulatory changes and potentially even political unrest are not unusual. For example, in the MENA region, the push for political change created a disruption in the securities market infrastructure. In Egypt, the political upheaval resulted in closure of the market for several weeks, and the lack of predictability created challenges for investors. In addition, the recent high rate of changes in local tax and KYC requirements has created obstacles across a number of markets including India, Brazil, Russia, and Indonesia.

How J.P. Morgan adds value

With \$16.9 trillion in assets under custody in 102 markets, J.P. Morgan offers extensive market information and direct custody and clearing to help asset managers achieve their investment expansion goals.

Our network management team ensures that global custody clients are well-equipped with the information and support they need to expand into new markets and manage change in existing markets.

Our comprehensive market coverage provides clients with direct access to market experts through emerging markets forums and learning events. Leveraging our extensive market information, we offer

insight into current events, local market practices and settlement risk exposures that may impact investment portfolios. Our in-depth expertise and ability to react quickly and communicate effectively with our clients as market developments emerge is highly valued by clients across a challenging market environment.

J.P. Morgan's Direct Custody and Clearing (DCC) provides direct access to select local markets. With plans to expand into more than 20 markets, J.P. Morgan's regional offices, focused on the institutional business, can provide asset managers with:

- access to local J.P. Morgan expertise and the assurance that assets are held with a J.P. Morgan branch or subsidiary
- more competitive cut-off times due to local market access and direct communications
- a distinctive client experience, with a country-centric approach to better understand your needs and offer appropriate solutions
- advocacy in local markets, with direct custody and clearing representatives who are well-established in leading industry groups, keeping clients abreast of market changes and providing solutions in line with market best practices
- integrated solutions across securities services products and markets.

Actively Managed ETFs –

The next growth area in the sector?

Exchange-traded funds (ETFs) are changing the investment landscape by expanding investor access, allowing advisors to monetize advice and providing a superior product structure. They have given individual investors access to asset classes and strategies once out of reach. ETFs allow investors to achieve asset allocation through portfolio diversification with lower costs, greater transparency and improved tax efficiency.

U.S. ETF assets have increased by 12 times over the past ten years, growing from \$88 billion in 2001 to \$1.202 trillion today. It is important to put this growth in context. The current U.S. mutual fund market with \$12 trillion is still the dominant form of investing in the U.S. However, the current ETF market is large and rapidly growing with 44 investment advisors across 1,440 funds. New entrants are cautious given the majority of assets are controlled by the top three advisors. Nevertheless, ETFs gathered nearly \$119 billion in new assets in 2011, doubling the inflows of traditional mutual funds.

Industry research shows that looking forward, six trends will most likely support the continued growth of ETF assets: renewed focus on low investment cost, shift to fee-based advisory by financial advisors,

regulatory emphasis on transparency, rising investor awareness of the product, increased use by institutional investors and ability to secure seed capital. It is also noteworthy that pricing pressure is increasing, with some of the latest broad-based ETFs charging 5bp expense ratios. At the same time, smaller players are designing specialized, innovative products that may find demand.

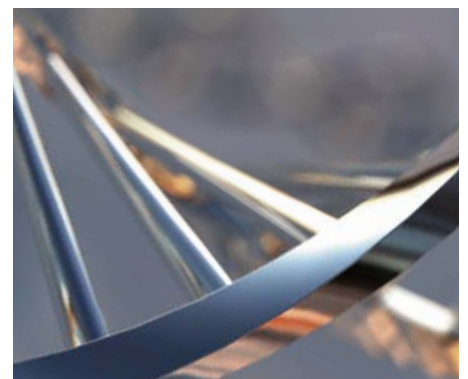
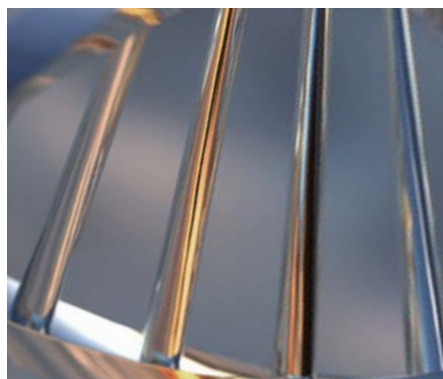
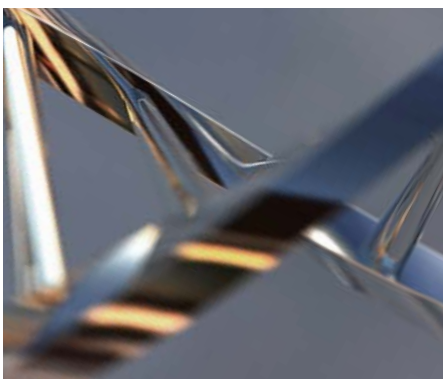
Alpha investors looking for greater than market returns could help re-characterize actively managed ETFs as the next mutual fund. With only 33 active ETFs listed in the U.S., there is plenty of pent-up demand. Active ETFs have been slow to come to market because of the long approval process and the requirement for daily disclosure of portfolio holdings. A further challenge for newly launched actively managed ETFs is the need to be on the market for three years in order to be eligible for Morningstar ratings. Nevertheless, the category is expected to grow with more than 34 new investment advisors having exemptive relief applications pending with the SEC. If active ETFs follow a similar acceptance as passive ETFs, it will motivate mutual fund managers to participate.

J.P. Morgan – A Leading Provider of ETF Servicing:

J.P. Morgan engages clients in a consultative process and offers a comprehensive suite of global services to help them launch and service innovative fund structures. We provide:

- **Services ETFs on four continents**, covering every asset class in the space
- **Provides additional authorized participant trading and structuring services** through J.P. Morgan's Investment Bank
- **Demonstrates technical innovation** – enabling us to service six industry “firsts” with recent expansion of our ETF alternative offering

Our integrated services include global custody, fund accounting, fund administration, transfer agency, securities lending, prime custody, derivatives collateral management, cross listing, sub-advisor solutions and basket settlement services to help clients mitigate risk, enhance returns and increase efficiency.





The Convergence of Mutual and Hedge Funds

Attractive opportunities come with complex challenges

The global economic climate and changing industry landscape have driven investors to review their strategies and asset allocations. These changing investor priorities have motivated both hedge fund and mutual fund managers to invest in new product strategies, creating significant growth of alternatives-style funds. Hedge fund managers have recognized the opportunity to improve and diversify their revenue stream by expanding to a new group of investors in the registered fund market. At the same time traditional asset managers have responded to the increase in investor interest in such strategies by offering new alternatives funds that offer more flexibility in both instrument type and investment and which are accompanied by higher fees. While managers embrace these opportunities, they may also find that they are faced with some unique challenges.

These new strategies represent an increase in complexity and require a higher degree of asset servicing and customized client support. In the context of this new model, hedge and mutual fund managers should ask:

What types of global services will I need?

Hedge fund managers may need education on market requirements and regulatory schemes as they develop a local presence or new distribution channels. There are additional complexities to launching a registered fund that employs alternative strategies, including shorting and the associated complexities of funding and financing, posting and movement of collateral and adhering to additional regulatory requirements.

Would I benefit from integrated asset servicing?

Managers of alternatives' strategies should consider the potential benefits derived from partnering with a single asset servicing provider that offers prime brokerage (financing, securities lending), global custody and derivatives servicing on an integrated, consolidated platform.

Do I require a new level of valuation services?

The daily valuation standards for mutual funds can seem quite rigorous to hedge fund managers new to the space. As these funds often engage in derivatives-based strategies, valuation becomes much more complex and may be outside existing service levels. Asset managers should seek a service provider with a range of pricing sources and in-house expertise to ensure valuations are performed with timeliness and accuracy.

J.P. Morgan is a global service provider with the experience and ability to guide you through the execution of your end-to-end strategy. We are the only major financial institution that is a market leader in both prime brokerage and global custody. Our firm's prime custody offering has been supporting hedge funds and regulated funds for more than ten years. As an asset servicing partner, J.P. Morgan can facilitate the development of a robust and efficient operating platform, allowing managers to focus on their core competency of managing assets.

