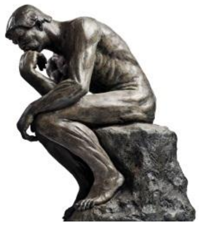

LWM Consultants Ltd

Meeting the Fund Manager

JPM US Equity Income Fund

During the year we continually monitor the portfolios and look to identify potential opportunities. The US sector has always been a challenging sector and we believe we have identified a good range of growth orientated funds including Schroder US Mid Cap, AXA Framlington American Growth and GAM North America.

With high levels of volatility in the global equity markets, we are looking to see if there is a fund which can provide less volatility in these markets and therefore act as a good counter balance to the growth funds. A traditional income fund will focus on delivering income and this is not what we would be looking for, however the JPM US Equity Income Fund adopts an equity income strategy.

This is important because the best performing stocks over the past 20 years have been those with above average dividend yields and below average pay-out ratios. But where many income funds focus on the dividends this is the third and final part of the process. Essentially the fund manager adopts a stock picking approach where the focus starts with quality (so looking at the management team, consistent earnings and companies with durable franchises), then looking at valuation and finally dividend yields. The minimum yield for a stock to be considered for inclusion in the portfolio is 2% but they may go below this if the quality and valuation is good.

We discussed two companies, Apple and Microsoft. Both are held for very different reasons. Apple when you take the cash out is trading at 8 times, this makes it very cheap and actually with the recent drop in price this has created buying opportunities. Interestingly the comment was that Apple doesn't control the whole market (android has two-thirds market share in the smartphone market), however if you have an Apple product you are likely to have other products from their suite that use their operating systems. However, on the reverse if you use Android systems you are likely to use their systems so there is a big opportunity with android tablets, etc. Microsoft is viewed by some as a broken company, but in reality they have a massive R&D spend and we will be buying the next generation of products. Apple is just starting to pay dividends and Microsoft has already been paying dividends of around 3%. The point is that the fund manager is looking at the quality and valuation of the company and the dividend at the end.

The teleconference was with Fiona Harris who is part of the US Equity Team. She has fifteen years' experience with JP Morgan and has been based in the New York office and more recently has come back to the UK. Her role is client portfolio manager; effectively she is the communication arm of the portfolio manager. She works with the portfolio manager and will attend company meetings so effectively she understands what is happening with the fund and can provide a valuable insight on how the fund manager is positioning the fund and what she is looking at.

The notes below provide a summary of the main discussion points.

Overview

One of the main concerns for me was the short track record, the fund has been running in the UK for 3 years and I could find no evidence of the fund manager managing any other funds. The fund manager is Clare Hart. She has been the lead fund manager since its launch in the UK in 2008 however she has run the same strategy in the US for ten years. With the success of the fund in the US this strategy was then brought across to Europe.

She manages around $6 billion of assets. The two sectors which she specialises in are REITS and Financial Services but she also started her career as a public accountant which means effectively she can understand financial statements so can get under the bonnet to identify potential problems.

We touched on the tie in to the firm – the bonuses are based on long term performance over a 3 to 5 year period and part of the bonus is vested in the funds themselves so effectively withheld. There is also a culture of fund managers digging into their own pockets and backing the funds they manage so they have a direct relationship with the clients in terms of performance.

There is a co-manager Jonathan Simon who hired Clare and is there to provide experience but he is not the decision maker. Both of them report Paul Quinsee who is the CIO and oversees the fund in-terms of risk management.

Clare is fundamentally a stock picker and she adopts her own philosophy, style and process to the management of the fund. I liked the comment that that they feel they still have the boutique feel but with the research capabilities of a global asset manager.

This is important. Clare has two dedicated analysts who analyse stocks which are not covered by the team of 26 US equity analysts. Their team of 26 analysts cover approximately 650 stocks. Additionally, the two analysts will also look at stocks JPMorgan perceive as missed opportunities. These are stocks that have done well, and at first glance seem to meet all their investment criteria. Clare will ask Shilpee or Andrew to review these stocks to ascertain if they missed a compelling investment opportunity and to try to understand why they didn't hold them. Behind this are a team of 26 career analysts. For example, Kathleen Stack has over 30 years experience and during that time has seen and met 5 different CEOs at Coca Cola. They now call her when there are changes to the management team.

Industrials have a team of eight but within this they specialise in different areas from transportation, utilities etc.

This depth provides a good support mechanism should anything happen to Clare but also for her to manage the fund effectively.

Before I cover the management style I will touch on performance against the S&P500. Since 2003 there have been three periods where the fund has underperformed and this really reflects the style.

2003 - Low quality, high beta stocks drive market returns
2007 - Growth outperforms value
2009 - Growth outperforms and low-quality, high beta stocks drive market returns beginning 9 March
The process for choosing stocks is important. Before they invest they go out and meet the management team. They also look to meet the management teams of stocks they hold at least once a year. Clare will go out and meet companies as this is part of her style but the analysts will also look to meet with the suppliers and management teams. So the key is quality and good management.

When looking at management they like equity participation, and for the management to dig into their pockets and invest in the company they manage. It was interesting to understand that a third of S&P companies have founding family investment and therefore there is a desire to carry that wealth onto the next generation but although this is important it comes back to how the good the management team is.

They won't overpay for a stock and they don't try to time the market. However, where there is a market sell off then they may use this to trim some good performing holdings and use it to add to other lower valued stocks.

Two examples of stocks, firstly McDonalds has consistently grown earnings and dividends over a 30 year period. Although they are struggling in the current environment JPM have strong conviction that the management team will get it right and therefore they will continue to back the stock. On the reverse they held an energy stock Duke Energy, which recently merged with Progress Energy, the CEO from Progress was due to become the CEO of the new company. When the takeover happened the new CEO was removed within 24 hours and received a significant pay off. Duke reinstalled their old CEO. JPM lost confidence in the management team and therefore sold out.

So management is important and valuation is the second factor. They won't overpay for a stock even if they like it. They are not looking short term but long term, the average holding period is 3 to 5 years with turnover around 15 – 30%. The key is the long term income stream and whether this can reward investors over time and then looking at the dividend is this sustainable and can it grow.

The long term strategy works in their favour, when companies know they are unit holders then the management is more open to meet them. They also find that management will call the analysts after changes are announced to gain an understanding of how the market may perceive the changes.

In summary the style is perhaps old fashioned in so far as it is about stock picking, and finding well managed businesses which can deliver sustainable earnings and stability over the long term. This is the hallmark of the strategy. There is a strong focus on risk / reward characteristics and this means that during periods where there is a focus on growth or low quality stocks this will underperform, so in the first quarter it has underperformed as low quality had a strong first quarter rally but at other times it will outperform. This counterbalance would work well with the other funds we hold.

The number of holdings is between 85 and 110, currently the holding is 90. The maximum weighting is 5%. When buying new stocks they will look to add a little at a time. Just touching on reasons to sell we mentioned a change in management but also overvaluation of a stock and sometimes it could be that they get it wrong. We discussed one example of a company (H&R Block which primarily provides tax returns and tax planning services for individuals) with ambitious growth plans, it started to open up branches and they believed strongly in the management team. However, competitors expanded online which knocked the business plan and many of the new branches failed to make money. It was less than 1% holding however it had to be sold. So selling reflects a number of factors.

Conclusion

This fund provides a good counterbalance to the growth funds we hold. It will underperform in strong up markets but it will outperform in other markets. The strategy has not changed over the ten year period to try and counter the volatility of the markets and this has paid well for the fund. Although this is an income fund this shouldn't be seen as the key element.

We touched on one area which had the potential to impact on the performance of the fund and this is the increase in dividend taxes. The reduction came in, in 2003. It could move to a position where dividends are taxed at the income tax rate (43%). However, two things for UK investors the dividend tax within the fund will remain at 15% and US citizens many receive dividends within a tax free environment so actually the impact will be small. Even with tests when dividends were taxed in the 70's at 70% and 80's at 50% the stocks outperformed.

The second area is the fiscal cliff, the general feeling is that there are three options – a fiscal cliff, a ledge and a ladder. If the cliff happened it would see an immediate decline in the deficit by 4% however this would plunge the US into recession. However a gradual decline seems to be in the works and there appears to be enough give and take to get a resolve. This was reflected in more stable markets this week.

So in summary following discussions with the team we believe there are opportunities to use this fund within the portfolios and we will be backtesting the portfolios to see how this can work in practice.