AUSTRALIAN RESEARCH

MANAGED INVESTMENTS ANALYSIS

J.P. Morgan ASX 20 Growth

March 2009

Leveraged exposure to ASX 20 with a capital-protected loan and potential for enhanced returns

Aegis Measured by Performance

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Aegis Measured by Performance

Note: This report is based on the J.P. Morgan ASX 20 Growth PDS, dated 20 March 2009, together with other information provided by J.P. Morgan Investments Australia Limited as at March 2009.

Australian Managed Investments

Structured Products

J.P. Morgan ASX 20 Growth

Leveraged exposure to ASX 20 with a capital-protected loan and potential for enhanced returns

Offer Details

Offer Period	2-Apr-09:1-May-09
Issue Date	15-May-09
Maturity (years)	15-May-14 (5 years)
Min. Investment	A$9,000

Offer Overview

Product Summary

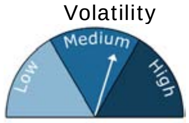
J.P. Morgan ASX 20 Growth (*ASX 20 Growth* or the *Product*) is being issued by J.P. Morgan Investments Australia Limited (*JPMIAL*). ASX 20 Growth is essentially an instalment warrant where investors commit A$9,000 of capital (the minimum instalment) to gain leveraged exposure to Dynamic Portfolio, which, at inception, will have a value of A$30,000. Investors also receive a swap agreement under which they will receive, at maturity, at least the greater of the Dynamic Portfolio value or the principal-protected amount of the A$22,500 loan. That is, the A$9,000 is not protected and is at risk. However, interest payments are tax deductible and investors receive franking credits on the 100% levered amount. Under assumptions based on historical experience of the past 10 years, the ASX 20 Basket would need to grow by 2.80% per annum to preserve the investor's initial capital. Investors are entitled to all dividends paid on the notional investment in the ASX 20 Basket, but these dividends are reinvested to enhance exposure to the Dynamic Portfolio. Consequently, capital growth is a function of the price performance of the ASX 20 Basket and dividends. Interest is capitalised throughout the term of the loan and there are no margin call requirements. The Dynamic Portfolio provides leveraged exposure to an equally weighted basket based on the 20 largest stocks by market capitalisation listed on the ASX (the ASX 20 Basket). Investors will receive the swap settlement amount if the market value on the expiry date is less than the expiry amount.

Risk / Return Profile

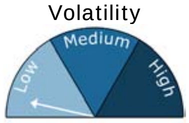
Capital Return

Income Return

Capital Return Volatility

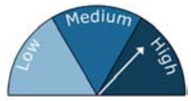


Income Volatility



Risk to Capital

Tax Effectiveness



Fees (paid to advisors), incl. GST, %

Up-front	None
Ongoing	1.8

Note: The above represent the advisor fees payable by investors.

Investment View

Investor Suitability

Investors should have a moderate appetite for risk and a long-term investment horizon. Investors should note the primary risk of the Product is the loss of the initial investment associated with deleveraging and/or low market returns. However, any loss of the initial investment is offset to some extent by tax deductions on interest and franking credits on the 100% levered amount (A$30,000). Investors may view the Product as margin loan–like, and, as such, must be comfortable with leverage. We consider the Dynamic Portfolio to have a moderate–high growth, moderate risk profile. Investors should note, however, that deleverage risk is high and the performance of the Product may bear little resemblance to the performance of the underlying basket of stocks (Figure 5). Investors should have a positive long-term view of the stocks in the Product, have a view that volatility will abate and be comfortable not receiving income over the period. The ASX 20 Growth should be considered a "hold until expiry" product. We consider the product as an attractive and efficient structure to access gearing with capital protection. ASX 20 Growth is classified as an instalment warrant and is super fund–compliant.

Recommendation

Aegis has assigned the Product with a **Recommended** rating.

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change, which may affect our investment opinion.

SWOT Summary

Strengths

- Up to 200% exposure to the initial amount invested in the ASX 20 Basket (including the loan amount).
- Seventy-five percent capital protection on the initial amount invested in the ASX 20 Basket and the potential for a rising level of capital protection.
- In the event of significant deleveraging during the initial investment period, the minimum 20% allocation to the ASX 20 Basket prevents an investor from being cash-locked and enables participation in the event of an uptick in the basket of stocks.
- The loan is fixed at a lower rate than an investor would currently be able to obtain in the market.
- The Product, whilst similar to a margin loan, requires no margin calls.

Weaknesses

- Despite the ASX 20 Growth offering natural diversification, as dividends are reinvested, diversification is fixed at the time of investment.

Opportunities

- Investors have the potential for positive cashflow throughout the life of the Product in the form of enhanced returns from participation in franking credits and tax deductions on the interest component of the loan. We note investors gain levered exposure up to 100% of the A$30,000 loan at inception and participate up to this point, for taxation proposes. The additional leverage is a synthetic exposure, thus there is no participation for taxation (franking) purposes.

Threats

- Investors should note the primary risk of the Product is the loss of the initial investment. As only the loan is protected, the Product is essentially 75% capital-protected via the constant proportion portfolio insurance (*CPPI*) structure.
- Equity asset volatility will adversely impact CPPI-related performance in the Dynamic Portfolio. Investors should be aware that they are entering into this product at a time when market volatility is high, and, as such, deleverage risk is significantly increased throughout the initial investment period.
- The basket of stocks is not rebalanced, unlike the S&P/ASX 20 Index. Furthermore, as the weights of stocks in the ASX 20 Basket are equal, the performance of the Product is likely to differ significantly from the performance of the S&P/ASX 20 Price Index.

Product Fees (paid by investors)

	Product	Sector Avg.
Base Fees, % of Assets		
Up-front[1]	0	2.2
Ongoing[2]	1.8	1.9
Exit[3]	Up to 2.0	0.2

1. Adviser fee and borrowing fees are paid by JPMIAL.
2. Consists of 1) equity asset fee of 1.8% p.a. and 2) cash asset fee of 1.8% p.a., which together comprise an ongoing fee of 1.8% for the overall Dynamic Portfolio.
3. Early exit fees apply: 2% prior to 31 December 2010; 1% after 31 December 2010 and prior to 31 December 2012.

Total Fees, % of Expected Total Return*		
Up-front	0	3.1
Ongoing	13.8	15.4
Exit	0.0*	0.3
Total	**13.8**	**18.7**

Note: Based on an average total return of 10% p.a. over a 5-year term (fee calculation methodology updated).

*Assumes held to maturity and, therefore, no exit fees are incurred.

Performance Fees

None.

Indirect Fees / Product Costs

None.

Fee Commentary

We consider fees to be low in comparison to other products. Investors pay 1.8% for the CPPI structure and management fees, which are very low when compared to those for other similar structures. In addition, the fixed 6.97% p.a. interest rate is significantly lower than the current rate for a margin loan, which we consider comparable to the Product.

2. Structure

At inception, the application amount of A$9,000 will be utilised to fund two components: an instalment of A$7,500 and interest of A$1,500. The loan agreement will be then drawn down to A$22,500 to fund the purchase of a A$30,000 interest in a basket of 20 of the largest ASX-listed stocks by market capitalisation on behalf of investors (ASX 20 Basket). Investors simultaneously enter into a swap agreement with JPMIAL that entails the following:

- Swapping the price performance of the ASX 20 Basket in exchange for the greater of the market value of the Dynamic Portfolio and the capital-protected amount at maturity and
- Foregoing dividends from the ASX 20 Basket in return for participation in the performance of the swap agreement. However, all dividends paid on the notional investment in the ASX 20 Basket will be reinvested into the ASX 20 Basket.

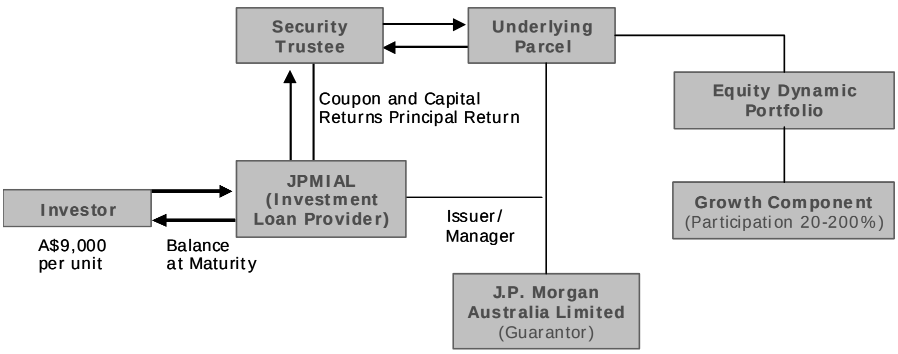
Investors are paying a management expense ratio (*MER*) of 1.8% per annum to gain leveraged exposure to the Dynamic Portfolio and for the CPPI structure. All other up-front fees, including the advisor fee and the borrowing fee, are payable by JPMIAL. The interest rate on the loan component is fixed at 6.97% per annum, payable yearly and capitalised after inception. The loan is limited recourse whereby JPMIAL's recourse to the investor is limited to the total amount received by JPMIAL on disposal of the ASX 20 Basket. Principal protection is designed to cover the outstanding value of the 100% loan at maturity. As a result, the investor's A$9,000 is not protected and is at risk. The interest component of the loan is pre-paid and essentially represents the interest payments over the five-year period. That is, 6.97% of the A$22,500 in the first year, capitalised for the period, resulting in total interest payments of around A$9,000 (equal to the investor's initial investment). This payment will then be essentially offset by tax deductions on interest and franking credits on the 100% levered amount (A$30,000). The initial exposure to the Dynamic Portfolio (ASX 20 Basket and cash) will be determined by the bond floor. The cash asset is a notional investment in cash that earns a return based on Australian dollar swap rates. It is expected that the initial exposure to the ASX 20 Basket will be 90%. During the term, participation rates may range from 20% to 200%. The Product will lock in 50% of the growth in the Dynamic Portfolio at the end of years three and four. The lock-in amount, which will be the greater of 50% of the growth in the Dynamic Portfolio and the previous lock-in amount, increases the level of capital protection. The methods for determining both the level of coupon payments and the rising level of capital protection are described overleaf. At maturity, instead of cash, the investor may elect to receive the basket of stocks as payment.

Key Exposure	
Underlying Exposure:	**ASX 20 Basket:** An equally weighted basket of 20 of the largest stocks by market capitalisation listed on the ASX, as at the issue date. Refer to page 7 for a list of the specific constituent stocks. **Cash Asset:** The cash asset is a notional investment in cash that earns a return based on Australian dollar swap rates.

Exit Details	
Expiry Date:	15 May 2014
Exit Facility:	At maturity, investors can choose cash or elect to receive the basket of stocks as payment.
Holder Early Redemption:	Investor may offer to sell their ASX 20 Growth to JPMIAL prior to the expiry date, on a monthly basis. Acceptance of the offer will be at the sole discretion of JPMIAL and on such terms and conditions as JPMIAL deems reasonable. ASX 20 Growth should be considered a "hold until expiry" product. Early redemption invalidates the capital protection component.

Investment Structure

Capital Growth at Maturity



Source: J.P. Morgan Investments Australia Limited/Aegis Equities Research

Product Leverage	
Used:	Under the CPPI structure, maximum exposure to the ASX 20 Basket is 200% and minimum exposure is 20%. The Product will lock in 50% of the growth in the Dynamic Portfolio at the end of years three and four. The lock-in amount will be the greater of 50% of the growth in the Dynamic Portfolio and the previous lock-in amount. The methods for determining both the level of coupon payments and the rising level of capital protection are described below.
Initial Exposure:	ASX 20 Basket: 90%; Cash: 10%.
Cost (incl. Fees):	None.
Recourse:	None.
Capital Protection	
Method:	CPPI.
Key Metrics:	Equity Asset: The maximum exposure is 200% and minimum is 20%. Bond Floor interest rate: AUD swap rate.
Lock-in Structure:	The lock-in amount is the greater of 50% of the increase in the value in the Dynamic Portfolio on each of the lock-in dates or the previous lock-in amount. The lock-in amount is added to the notional Dynamic Portfolio to give the lock-in value. The lock-in amounts are only calculated in years three and four.
Cost:	Costs include the annual fee charged by JPMIAL as a proportion of the ASX 20 Basket and the leverage costs.
Conditions:	Must be held to maturity.
Counterparty Risk:	The risk that JPMIAL fails in its obligation. Obligations are guaranteed by J.P. Morgan Australia Limited (S&P rating: AA).
Tax	
Disclaimer:	Tax consequences depend on individual circumstances. Investors must seek their own taxation advice. The following comments represent Aegis' expectation of tax for ordinary Australian taxpayers, but cannot be considered tax advice.
Capital gains:	A capital gains tax (*CGT*) event is likely to apply upon sale of the delivery securities. Investors will likely be eligible for the 50% CGT discount upon sale of the delivery securities, if held for more than 12 months.
Dividends:	On income account in the year earned. Franking credits from the constituent stocks of the ASX 20 Basket are passed through to investors.
Interest deductibility:	Yes – refer to Section 10 of the Product Disclosure Statement (*PDS*).
Legal Structure	
Wrapper:	Warrant
Security Trustee:	J.P. Morgan Portfolio Services
Offer Document:	The PDS, dated 20 March 2009, has been lodged with the Australian Securities and Investment Commission (*ASIC*), but is not required by the *Corporations Act* 2001 to be lodged with ASIC.
Returns	
Capital vs. Income:	**Growth Asset:** Capital only upon exit.
Investor Leverage	
Available:	75% investment loan.
Cost (incl. Fees):	Interest for investment loan is capitalised annually in advanced at a fixed interest rate of 6.97% p.a.
Recourse:	Limited recourse.
Risks	Refer to the *Risks* section in the PDS, paying particular attention to circumstances that may lead to you losing your investment. Key risks are as follows: 1. Risk of loss of initial investment; 2. Exposure to JPMIAL and the Guarantor; 3. Legal, tax and regulatory risks; 4. Volatility and interest rate risk; 5. Leverage risk; 6. Portfolio risk; 7. Early sale risk; and 8. Market risk of the ASX 20 Basket after expiry date.

3. Investment Process

ASX 20 Growth

JPMIAL has selected the underlying assets for the Product. The ASX 20 Growth provides an equally weighted exposure to 20 of the largest stocks on the ASX by market capitalisation at the time of issue. The exposure is made of all the current constituents of the S&P/ASX 20 except for Origin Energy, which is replaced by Santos.

Figure 1. S&P/ASX 20 Index Weighting and J.P. Morgan ASX 20 Growth Weightings

Stock	Index Weighting, %	Stock	Product Weighting, %
BHP Billiton	20.63	BHP Billiton	5.00
Westpac	10.38	Westpac	5.00
Commonwealth Bank	9.31	Commonwealth Bank	5.00
National Aust. Bank	7.32	National Aust. Bank	5.00
ANZ Bank	6.60	ANZ Bank	5.00
Telstra	6.03	Telstra	5.00
Woolworths	5.61	Woolworths	5.00
Westfield Group	3.98	Westfield Group	5.00
Wesfarmers	3.94	Wesfarmers	5.00
CSL	3.53	CSL	5.00
Woodside Petroleum	3.53	Woodside Petroleum	5.00
QBE Insurance	3.49	QBE Insurance	5.00
Newcrest Mining	2.86	Newcrest Mining	5.00
Rio Tinto	2.84	Rio Tinto	5.00
Origin Energy	2.35	Santos	5.00
Fosters	1.79	Fosters	5.00
AMP	1.70	AMP	5.00
Suncorp-Metway	1.52	Suncorp-Metway	5.00
Brambles	1.31	Brambles	5.00
Macquarie Group	1.27	Macquarie Group	5.00

Source: Iress/J.P. Morgan

J.P. Morgan Investments Australia Limited

ASX 20 Growth is issued and managed by JPMIAL, a wholly owned subsidiary of J.P. Morgan Chase Bank. The primary business of JPMIAL is the issue of structured products and investments. JPMIAL currently has nine structured products on issue, excluding ASX 20 Growth, along with a range of warrants. The obligations of JPMIAL with respect to the Product are guaranteed by J.P. Morgan Australia Limited and JPMIAL.

4. Performance Analytics

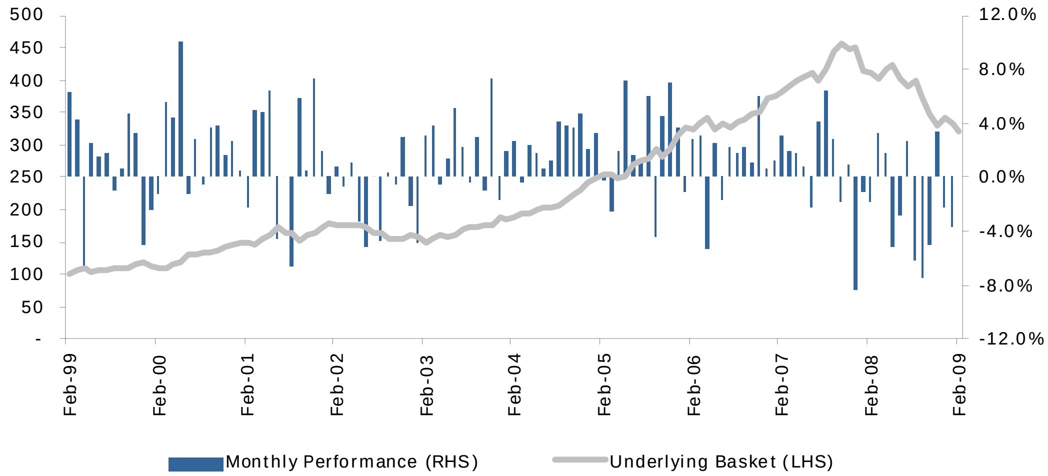
Historical Performance of ASX 20 Basket

Investors should note that the historical performance of the ASX 20 Basket is based on the current constituents of the S&P/ASX 20 Accumulation Price Index (the *Price Index*; with the exception of Origin Energy, which is replaced by Santos as outlined above) rather than the constituents of the Price Index throughout history. As such, there is essentially a selection bias inherent in the historical data, which will generate higher average returns relative to the actual index.

The key points are as follows:

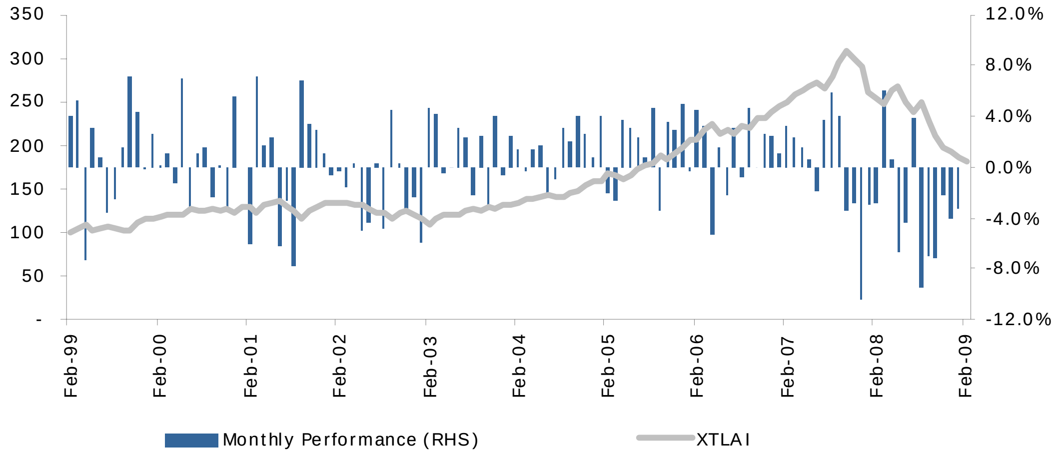
- We have analysed the ASX 20 Basket (equally weighted) for the 10-year period ended 27 February 2009 (including dividends). We note the one-year performance of the ASX 20 Basket is -22% and significantly skews past performance. Illustrating this, the range of the ASX 20 Basket monthly performance is 18% and skewness is -38%. The actual 10-year performance is 12.4% per annum; and
- The Price Index has generated lower historical returns than the ASX 20 Basket. In terms of risk, the Price Index typically generated higher risk levels than the ASX 20 Basket (see Figure 5). We attribute the underperformance of the Price Index to the equal weightings of the stocks in the ASX 20 Basket, compared to the weightings in the index and 'survivorship bias' of the ASX 20 Basket.

Figure 2. Historical Performance of ASX 20 Basket



Source: Iress/Aegis Equities Research

Figure 3. Historical Performance of S&P/ASX 20 Accumulation Price Index (XTLAI)



Source: Iress/Aegis Equities Research

Backtested Performance: ASX 20 Growth

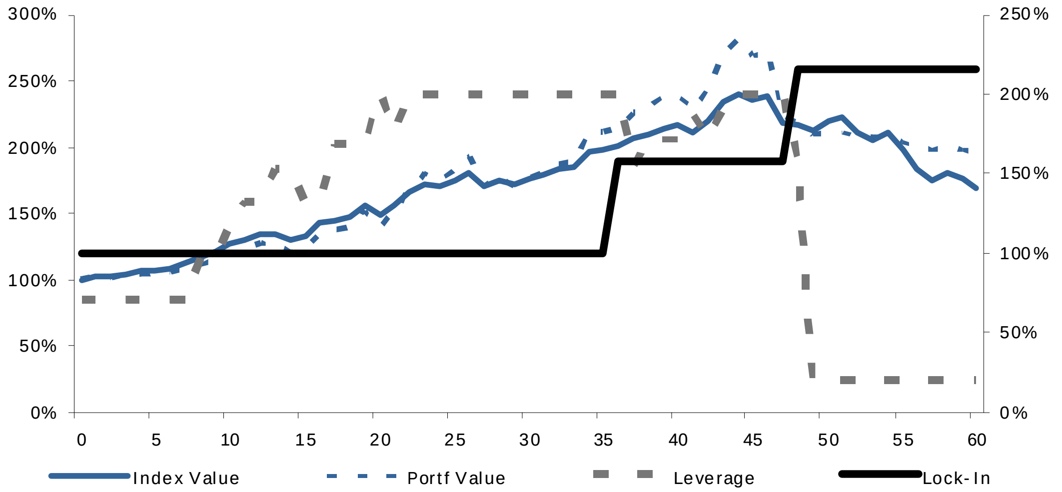
Figures 4–5 illustrate the backtested performance of the Product.

Investors should note the analysis is based on the historical performance of the ASX 20 Growth Basket. Historical performance is not an indication of future performance and the below figures do not represent the expected performance of the Product.

The key points are as follows:

- Over the five-year period from February 2004 through February 2009, the Product outperformed the Price Index by 8.3% per annum. Over the same five-year period, the Product also outperformed the ASX 20 Basket by 3.3% per annum;
- In terms of Return on Capital (the A$9,000 initial investment), the value of the Dynamic Portfolio at expiry was around A$59,000, which less the loan value of A$30,000 gives a total return value of around A$29,000. Therefore, the annualised return on investment on a pre-tax basis is 26.3% per annum (see below discussion for taxation implications);
- Out-performance can be attributed to leverage and lock-in events from months 35 to 45 when the ASX 20 Basket was exhibiting very high returns combined with the significant depreciation after that period. Leverage leads to higher volatility of the portfolio and results in higher risk. Nonetheless, the cash lock-in and deleveraging events, whilst skewing volatility, did actually de-risk the Product and resulted in out-performance; and
- Given the impact of a leveraged CPPI structure, over what is a relatively volatile underlying exposure, we consider the Product to be moderate risk, moderate–high return. Investors should note that the operation of the leveraged CPPI mechanism will lead to a significant de-coupling of performance between the Product and the underlying ASX 20 Basket, as illustrated in Figure 5.

Figure 4. ASX 20 Growth: Backtested 5-year period to February 2009 Index



Source: Aegis Equities Research

Figure 5. Backtested Performance History (including dividends)

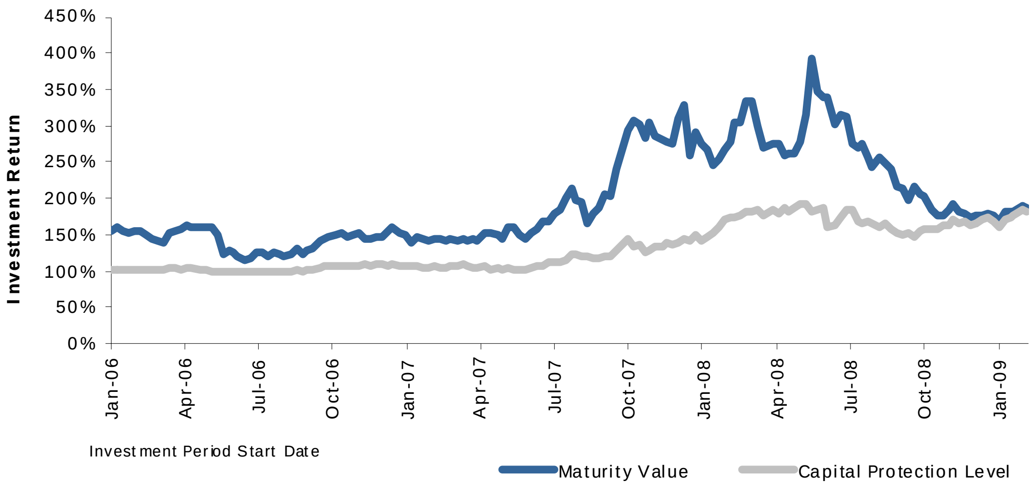
	The Product		ASX 20 Underlying Stocks		S&P/ASX 20 Accumulation Price Index	
	Return (% p.a.)	Risk, %	Return (% p.a.)	Risk, %	Return (% p.a.)	Risk, %
1-year	-9.4	9.9	-21.5	12.7	-28.6	15.4
2-year	-4.4	44.3	-8.0	13.5	-14.6	16.2
3-year	4.1	42.0	-0.1	12.6	-4.3	15.0
4-year	11.4	39.6	6.0	13.0	2.1	14.3
5-year	14.5	35.8	11.2	12.1	6.1	13.2

Source: Aegis Equities Research

Rolling 5-year Performance: ASX 20 Growth

Figure 6 illustrates the backtested performance of the Product on a rolling basis assuming the five-year investment ended on the displayed date (the Y axis). As can be seen, for every five-year investment horizon, the Product has displayed a positive return. For five-year periods ending from about July 2007, the broad trend shows a rise in the level of capital protection over time. We note this analysis is based on the return of the initial loan amount (A$30,000) and when compared to the A$9,000 initial investment has produced solid returns.

Figure 6. Rolling 5-year Returns (%) (pre-tax)



Source: J.P. Morgan

Cashflow Calculation and Expected Return

We calculate the post-tax breakeven point under a 30% marginal tax rate, dividend yield average of 4.1% and franking of 80% to be 2.80% per annum. That is, to recover an initial A$9,000 investment, plus management fees, investors should expect, under a simplified scenario, the Dynamic Portfolio to return at least 2.80% per annum. This result is ultimately achieved through the positive gains via leverage. Given the exposure to the levered franking credits, the Product suits a higher marginal tax rate.

However, given the CCPI structure and lock-in events of the Product, high volatility and the yearly actual events will significantly alter the returns profile of an investment.

Figure 7. Cashflow Calculation and Expected Return (000s)

Yr	First Instal.	Loan Value	Interest (pre paid)	ASX 20 Growth Value	Dividend Re-invested	Franking Credit	Cashflow Before Tax	Tax Payable / Refund	Cashflow After Tax
1	$9.00	$22.50	$1.50	$32.10	$1.26	$0.40	$0.00	$0.35	$0.35
2	$0.00	$24.18	$1.68	$34.36	$1.35	$0.43	$0.00	$0.40	$0.40
3	$0.00	$25.98	$1.80	$36.77	$1.45	$0.46	$0.00	$0.43	$0.43
4	$0.00	$27.92	$1.94	$39.35	$1.55	$0.49	$0.00	$0.46	$0.46
5	$0.00	$30.00	$2.08	$42.11	$1.66	$0.52	$12.11	-$1.32	$10.78
							$3.11	**$0.31**	**$3.42**

Source: Aegis Equities Research

ASX 20 Growth: Monte Carlo Analysis

Expected capital and income performance under certain risk/return scenarios is assessed through a Monte Carlo analysis, based on pre-tax values and on the value of the A$30,000 loan. For the capital-return component, the analysis is based on four risk/return scenarios:

- 0% per annum price returns, 15% volatility;
- 10% per annum price returns, 15% volatility;
- 20% per annum price returns, 15% volatility; and
- 25% per annum price returns, 15% volatility.

In summary:

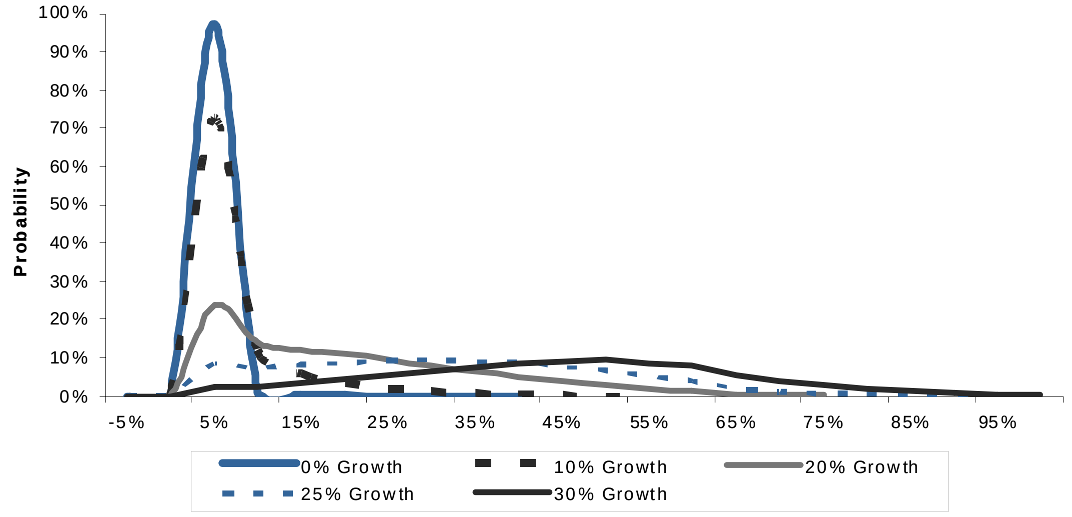
- **Capital Returns Performance:** ASX 20 Growth outperformed a direct investment in the basket of stocks in periods of negative and no growth; this was due to the CPPI structure. ASX 20 Growth underperformed a direct investment in the basket of stocks in moderate conditions (5% to 20%), which we attribute to deleveraging and fees. We note, however, the Product offers an attractive margin loan interest rate, which would not be attainable in the market; this should also be considered. In high market growth conditions (+25%), the ASX 20 Growth outperformed a direct investment.
- We note that moderate condition under-performance is largely a function of volatility. That is, under a market growth scenario of 20% growth and 10% volatility, the Product outperformed a direct investment.
- **Relative Risk-Return:** Investors in ASX 20 Growth essentially defer an income stream through the life of the Product to increase exposure to the Dynamic Portfolio. This, combined with the leverage (20%–200%) in the Product, increases risk significantly. Mitigating this is the CPPI structure; however, investors also need to consider that while capital protection limits downside capital risk, it also impacts upside potential.

Figure 8. Total Returns Summary

Capital Returns Scenario:	0% Growth	10% Growth	20% Growth	25% Growth
ASX 20 Growth (p.a.)	0.4%	4.7%	20.7%	31.7%
ASX 20 Basket (p.a.)	-0.4%	10.5%	23.3%	29.5%
Capital Protection at Maturity	101%	113%	179%	256%

Source: Aegis Equities Research

Figure 9. Capital Returns Probability Distribution



Source: Aegis Equities Research

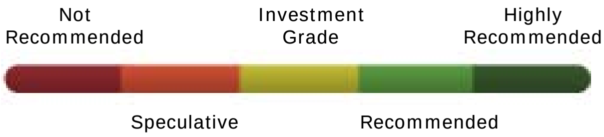
Appendix – Ratings Process

Aegis has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors.

Essentially, the evaluation process includes the following key factors: product management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

The Ratings

Our rating is based on the following scale:



Highly Recommended: indicates that Aegis believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and scored exceptionally in a number of categories. It has an attractive risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors.

Recommended: indicates that Aegis believes this is an above average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above average risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors.

Investment Grade: indicates that Aegis believes this is a suitable product that has met the aggregate requirements of our review process across a number of key evaluation parameters. The product may provide unique diversification opportunities, but may not stand apart from its peers. It has an acceptable risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors. In the previous five category rating system, this category was termed ‘Approved’.

Speculative: indicates that Aegis believes this is a product that has a number of positive attributes; however, there are a number of risks that make investing in this product a speculative proposal. While Aegis does not rule out investing in this product, investors should be very aware of, and be comfortable with, the specific risks. The product may provide unique diversification opportunities; however, concerns over one or more features means that it may not be suitable for most investors.

Not Recommended: indicates that Aegis believes that despite the product’s merits and attributes, it has failed to meet the minimum aggregate requirements of our review process across a number of key evaluation parameters. However, this does not mean that the product is without merit.

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The offer of the securities is made in the Product Disclosure Statement (*PDS*), and anyone wishing to acquire the securities should complete the application form in the PDS.

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