

# UPDATE: Emerging tax and liquidity considerations for endowments and foundations

## New taxation of endowments signed into law

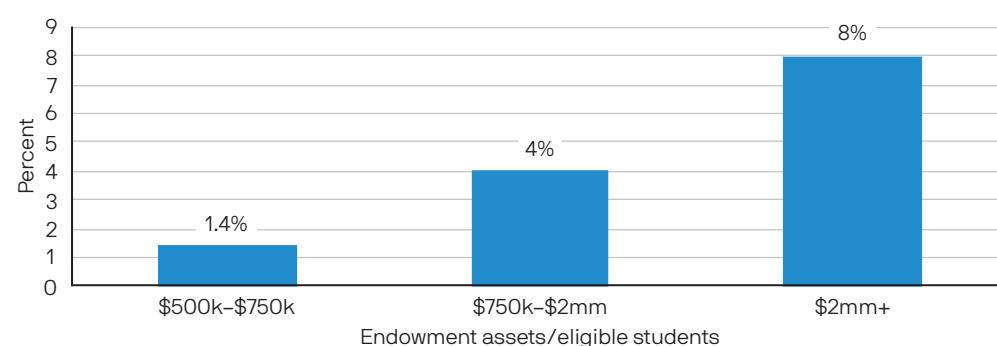
On July 4, 2025, the One Big Beautiful Bill Act (OBBBA) was signed into law, finalizing key changes to the taxation of endowments. The enacted legislation differs from the House's initial proposal in several important ways.

- The flat 1.4% tax on endowment investment income has been replaced by a graduated rate structure with bands of 1.4%, 4%, and 8%, determined by endowment assets per eligible student.
- The endowment excise tax's inclusion threshold was raised—only colleges and universities with over 3,000 full-time students are now subject to the tax (up from a 500-student cutoff in the House version).
- The House-proposed increase to the private foundation excise tax was removed entirely, leaving private foundations' net investment income tax unchanged.

These adjustments significantly narrow the scope of the new taxes compared to earlier proposals and may warrant a revisit of strategic planning assumptions across affected institutions.

### The flat 1.4% tax on endowment investment income has been replaced by a graduated rate structure

Exhibit 1: Excise tax rates



#### Inclusion criteria:

- Private college or university
- At least 3,000 tuition-paying students
- Assets/student > \$500,000
- >50% of students located in the USA
- International students on visa are no longer counted as eligible students

Source: One Big Beautiful Bill Act, J.P. Morgan Asset Management; data as of July 15, 2025.

#### AUTHORS



**Jared Gross**  
Head of Institutional  
Portfolio Strategy



**Mack Kline**  
Head of Endowments,  
Foundations and Healthcare



**Jean Walshe**  
Head of Endowments,  
Foundations and Healthcare  
Client Strategy



**Addison Muir**  
Associate,  
Institutional Portfolio Strategy

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*Please note that the remainder of this article was published in June 2025 before the legislation was enacted.*

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### In brief

- Congress appears poised to approve new legislation that would raise taxes on nonprofits, signaling a need for U.S. foundations and university endowments to stress-test and adapt their portfolio strategies.
- For institutions facing higher tax rates, portfolio adjustments may be necessary to balance the necessity of sourcing higher investment returns, which may come with increased risk, or accepting lower after-tax returns. Reduced distributions may be inevitable.
- Allocators at foundations and endowments can begin to prepare by considering the potential inclusion of various tax-efficient strategies, including ETFs, municipal bonds, tax-aware equity strategies and insurance solutions.
- As federal support diminishes more broadly, universities in particular may want to prioritize contingency planning and stress-test portfolios to ensure robust liquidity sources and safeguard their operating budgets from potential funding shocks.

## Congress appears poised to raise taxes on nonprofit institutions

Higher taxes on nonprofits appear imminent. A current legislative proposal seeks to raise taxes that foundations and endowments pay on investment income while also increasing the number of institutions subject to the tax. Simultaneously, the administration is reducing federal contributions to a range of university, healthcare and other related research budgets and withdrawing broader financial support to certain institutions on a case-by-case basis.

Elements of this shift remain uncertain—the legislative process is ongoing and certain governmental actions have already been or may be challenged in court—but the overall direction is clear: The operating environment for foundations, endowments and universities more broadly will become more challenging going forward.

This shift may demand a strategic change of approach. Until now, endowment and foundation allocators have been tasked with generating high real returns over a long investment horizon. The art of portfolio construction demands a balance between maintaining sufficient liquidity to support ongoing operating budgets and grant-making activities, while targeting potentially higher returns from illiquid private funds and more volatile public market strategies. Investment staff have successfully met this challenge over time,

but the simultaneous imposition of higher taxes on investment income and elevated uncertainty around liquidity needs will increase the degree of difficulty.

In this paper we gauge the potential impact of the proposed changes and offer some suggestions to make portfolios more resilient. There are a variety of tax-aware investment strategies that institutional investors could consider, as well as strategies that may help enhance liquidity and income across the full asset allocation. Operating fund managers focused on safe fixed income assets may need to grow their funds in response to the uncertainty around cash flows, and as a result should seek to maintain the most efficient blend of liquidity and yield.

## Higher taxes may adversely affect investment income

At present, U.S. foundations and a small number of private college and university endowments pay a modest 1.4% tax on net investment earnings. Those few schools that pay the current tax have significant financial resources (greater than \$500,000 of endowment assets per student), making the tax burden relatively inconsequential. To date, investors overseeing endowment management at these institutions have made very limited, if any, investment strategy shifts in response to the proposed legislation.

The House of Representatives recently passed a budget proposal that applies graduated tax bands to nonprofit investment income, with four tiers of 1.4%, 7%, 14% and 21% for endowments and 1.4%, 2.8%, 5% and 10% for foundations. **Exhibits 1A** and **1B** provide an overview of this legislative proposal, including the specific criteria used to determine the level of tax for a particular institution. Although further changes are possible, the Senate may also include a tax provision targeting nonprofits to raise revenue, offsetting costs from tax cuts elsewhere.

**Assessing the potential budget impact of higher taxes**

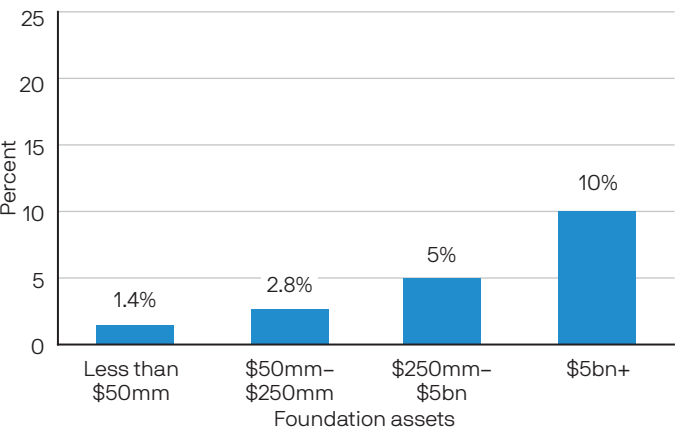
Current taxes (and those of the new proposal) are assessed on net investment income, which includes realized capital gains and dividends net of allowable deductions, such as advisory and brokerage fees. The revenue generated by the new proposal would be sensitive to both an individual institution’s tax rate and the level of its investment earnings.

The Joint Committee on Taxation, which provides Congress with analysis of pending tax legislation, estimates that the proposed changes to tax rates

**Congress is weighing a proposal to raise endowment and foundation taxes**

Exhibit 1: Proposed tax rates and inclusion criteria

1A: Foundation excise tax proposal



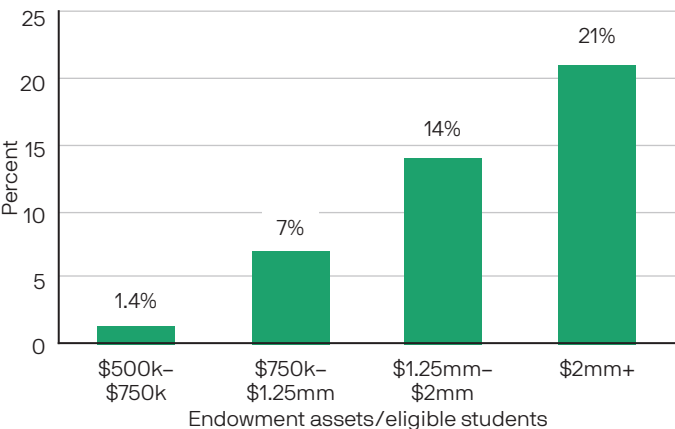
**Current inclusion criteria:**

- The entity is tax exempt [under 501(c)(3)].
- It is not a public charity.
- The entity is typically funded by a single donor or family and controlled by a small group.

**Changes to inclusion criteria:**

- The asset total is based on a given foundation’s total assets (not just investment assets), without reduction for liabilities.

1B: Endowment excise tax proposal



**Current inclusion criteria:**

- The entity is a private college or university.
- It has at least 500 tuition-paying students.
- Fewer than 50% of students are located in the U.S.
- If assets per student are > \$500,000, endowment is subject to excise tax.

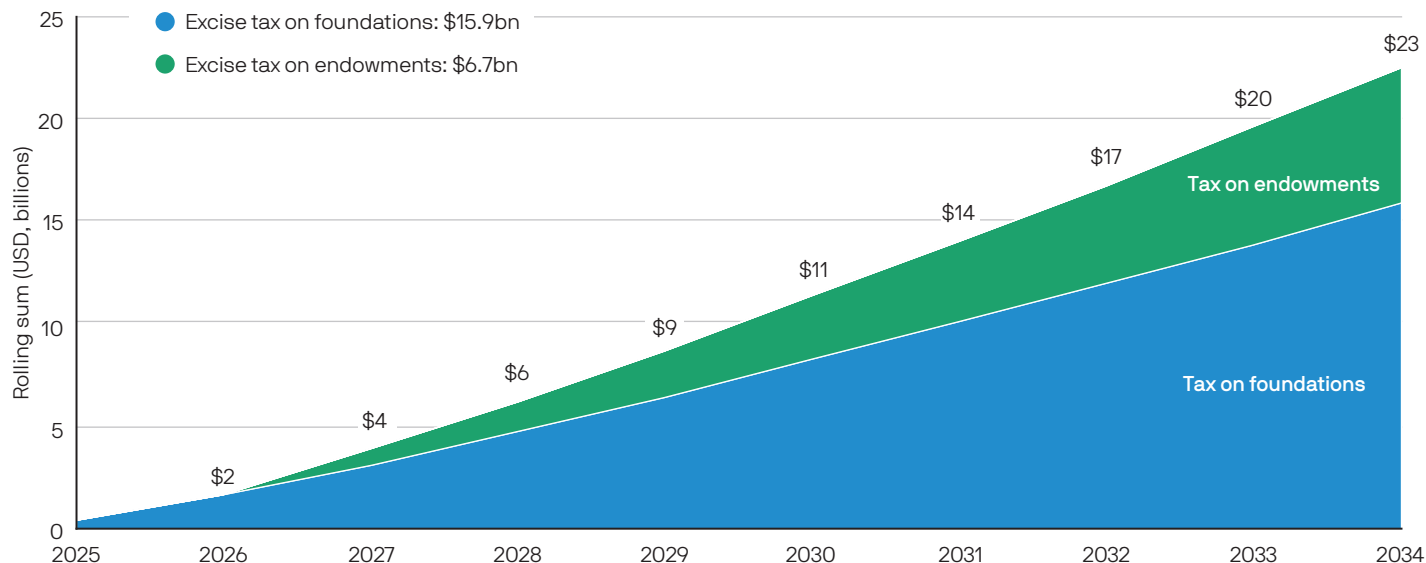
**Changes to inclusion criteria:**

- International students on visas are no longer counted as eligible students.
- Schools with formal religious affiliations are excluded.
- Income from student loan interest and royalties from intellectual property developed using federal funding are now included as net investment income.

Source: 2025 reconciliation bill, J.P. Morgan Asset Management; data as of May 29, 2025.

## The 10-year impact of foundation and endowment taxes will be significant

Exhibit 2: Estimated revenue generation of select provisions in reconciliation bill



Source: Joint Committee on Taxation, J.P. Morgan Asset Management; data as of May 19, 2025.

on endowments and foundations will generate approximately \$23 billion over 10 years. Foundations will be responsible for more than two-thirds of that total if the legislation is approved (**Exhibit 2**).

For individual foundations, an outflow of this magnitude could materially impact operations. By law, foundations are required to distribute 5% of their assets annually. Typically, these distributions are covered by investment earnings or, if necessary, by drawing down the capital base. Any taxes paid under the new provisions would offset a portion of this obligation, but the overall reduction in net investment income could potentially lead to a decline in assets over time.

Endowments have more flexibility than foundations when it comes to the annual support that they provide to their parent institutions, but in practice they are similar. Endowments target equivalent returns and distribute a significant portion of those gains to a school's operations. All else being equal, removing a portion of those returns with higher taxes will reduce the amount of financial support available.

Portfolio strategies may need to adjust—or targets need to change

Given the potential magnitude of tax impact, some institutions facing higher tax rates are likely to alter their investment approach. If they limit themselves only to their current asset classes, they face a choice: They can seek higher investment returns (which entail greater risk) to maintain a similar level of after-tax real return and stable distributions; or they can maintain a consistent portfolio strategy, accept lower after-tax returns and reduce distributions.

Exhibit 3 provides a simplified illustration of these trade-offs. As a baseline, the left-hand column shows an untaxed institution targeting 8% nominal returns (a 5% real return target plus 3% inflation). Holding inflation steady, the next three columns (2–4) show the higher returns needed to maintain the same level of real spending under the new tax regime’s proposed rates—assuming a 5% net investment income, 3% inflation, and no other adjustments. The 8% target return would rise to 8.4%, 8.8% and 9.2% respectively—all levels that would be difficult to achieve over the long term without an increase in portfolio volatility or illiquidity.

On the right-hand side, columns 5–7 illustrate the reduction in spending that would be necessary under the three tax regimes if asset returns were maintained

at 8% (again, leaving inflation unchanged). The level of real return would fall from 5% (baseline) to 4.7%, 4.3% and 4.0% at the higher tax rates. Such reductions would likely lead to reduced distributions and difficult operating adjustments. Of note: Foundations face a similar challenge, yet they lack flexibility to decrease expenditures because of the 5% distribution requirement.

The value of tax-advantaged investments

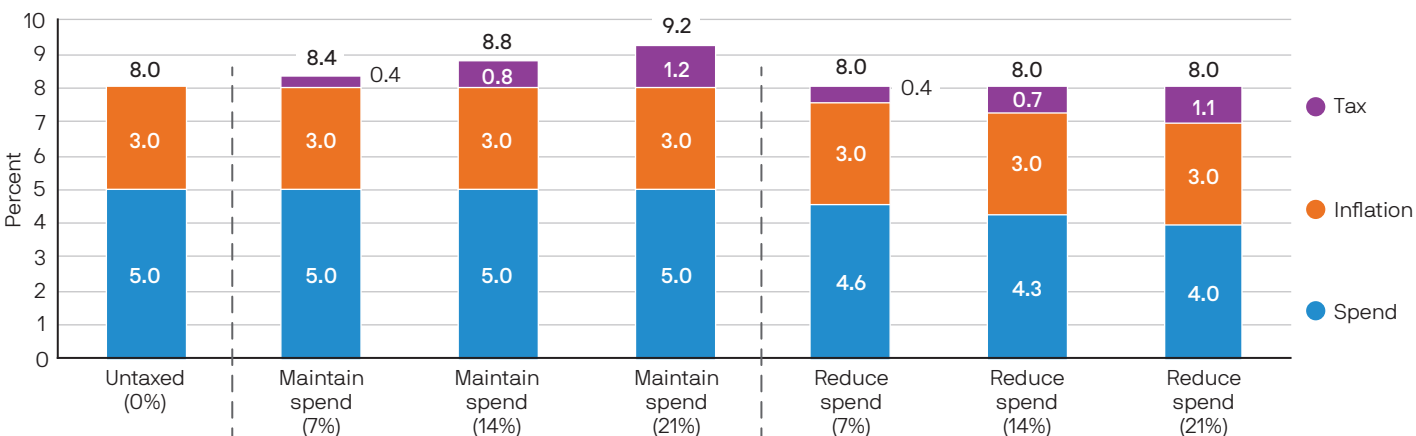
In the institutional investment world, where most asset pools are broadly tax exempt, such challenges are uncommon—but not unprecedented. Taxable private sector investors often use investment strategies designed to improve the after-tax return of their portfolios. Some of the most familiar options include:

- Exchange-traded funds (ETFs)
- Municipal bonds
- Tax-aware active equity strategies
- Specialized insurance strategies
- Offshore private fund structures

Importantly, some of these investment tools have the added benefit of improving liquidity and portfolio flexibility in response to operational uncertainty.

Taxing returns could require more investment risk or reduced spending

Exhibit 3: Returns and spending changes across various tax regimes



Source: J.P. Morgan Asset Management (portfolio strategy); data as of May 2025.

ETFs

ETFs give investors exposure to public markets, using active or passive strategies, with a high degree of price transparency and real-time liquidity. ETFs’ growth and proliferation reflect increased global investor demand, including demand from a wide range of institutional investors. That growth has deepened market liquidity and broadened the range of investment strategies available.

Historically, endowments and foundations have used ETFs to implement tactical views on markets, hedge manager exposures, access liquidity during market dislocations or gain market exposure during manager transitions. If the proposed legislation becomes law,

ETFs may offer an additional strategic use case: They provide a superior degree of tax-efficiency compared to traditional commingled mutual funds and separately managed accounts (**Exhibit 4**).

The primary tax advantage of ETFs comes from minimizing taxable gains triggered by the sale of the underlying securities in the fund. ETF shares are bought and sold on exchange or over the counter at the current market price, without requiring purchases or sales of the underlying securities.

ETF portfolio managers can also minimize transaction costs and find efficiencies within the portfolio by focusing on the tax lots of the underlying securities and optimizing transfers when they rebalance their portfolios.<sup>1</sup> These mechanisms can dramatically reduce transaction activity within the fund and limit exposure to realized taxable gains during an investor’s holding period.

Comparing the characteristics of investment vehicles

Exhibit 4: ETF, mutual fund and SMA characteristics

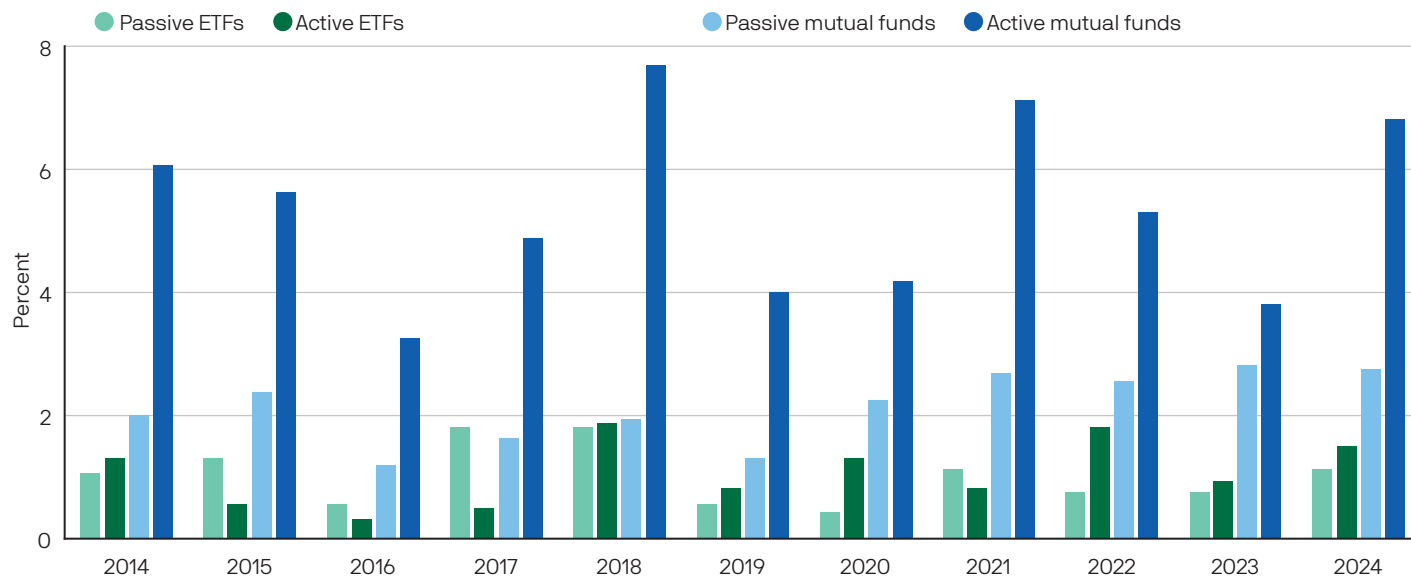
	ETF	Mutual fund	Separately managed account (SMA)
Diversification	Typically, a broad portfolio with many stocks or bonds	Typically, a broad portfolio with many stocks or bonds	May be limited to the size of the account
Tradability	Can buy or sell shares on an exchange throughout the day	Can buy or sell shares directly through the mutual fund company or brokerage account at the end of the day	Can buy or sell assets directly through the management company, typically on a best-effort basis
Access to assets	Throughout the day	End of day	Throughout the day
Tax efficiency	Capital gains are generally triggered by the individual when they sell ETF shares	Capital gains are triggered by the fund manager as gains are realized through sales inside the fund	Typically, capital gains or losses can be managed to investors’ needs
Fees	Expense ratio plus possible trading costs	Expense ratio, including 12b-1 fees, plus possible sales charge	Typically based on a percentage of account assets
Direct ownership of securities	No	No	Yes
Portfolio customization	No	No	Yes

Source: J.P. Morgan Asset Management’s *Guide to ETFs*, May 2025.

<sup>1</sup> Under a 1.4% tax, a distribution of 5% of net asset value (NAV) would cost a modest 0.07% of assets in tax. Under a 21% tax, that same 5% distribution would consume 1.05% of assets.

## ETFs have consistently distributed fewer capital gains than mutual funds

Exhibit 5: ETF distributions as a percentage of NAV, by calendar year



Source: J.P. Morgan Asset Management's *Guide to ETFs*, May 2025.

In practice, few ETFs distribute capital gains at all, and those that do distribute only a small percentage of their net asset value, or NAV (**Exhibit 5**). Both active and passive ETFs distribute a lower percentage of capital gains than similarly allocated mutual funds.

### Municipal bonds

Some endowments and foundations employ “laddered” Treasury bond strategies—buying a series of Treasury bonds with staggered maturities—to provide a secure source of liquidity. This approach can be particularly valuable within a broader asset allocation that contains a high percentage of illiquid private investments. However, the income produced would be taxable under the proposed rules, making these strategies less appealing going forward.

Taxable investors could potentially limit their tax hit by using tax-exempt municipal bonds in lieu of Treasuries to provide structured liquidity. However, there are two key caveats:

- 1) Municipal bond yields are typically lower than those of taxable bonds, with the difference generally reflecting the tax rates paid by the investor community. However, the proposed endowment and foundation tax rates would be lower than those that apply to other sizable populations of taxable investors, resulting in a yield differential that would be too wide to produce a positive after-tax outcome.
- 2) The tax exemption applies only to the coupon interest, not to any discount to face value, or par. Because interest rates have risen recently, many municipal bonds have a low coupon but trade at a discount. Bond prices have a natural tendency to approach face value as the maturity date nears, and the resulting “pull-to-par” can produce a taxable gain.



Under the proposed tax rates, the tax-equivalent yields on municipal bonds are likely insufficient for nonprofits to achieve a favorable after-tax outcome relative to Treasuries. **Exhibit 6** shows the tax-equivalent yield on AAA municipal bonds to under various tax rates, compared to Treasuries across the yield curve. Only at high tax rates, or at the longest maturities, would the relationship become favorable.

Institutional interest in municipal bonds varies across tax brackets and is influenced by market conditions. Insurance companies, operating at a 21% tax rate, are frequent participants in this market, typically favoring higher quality bonds, which are plentiful because the supply of municipal debt is heavily tilted to higher quality segments. Tax-exempt investors will enter the market opportunistically when the yield differential narrows and the prospect of municipal outperformance increases.

Nonetheless, a better approach to structural liquidity might be to use actively managed short-term fixed income ETFs, which can deliver ready liquidity with a meaningful improvement in tax efficiency vs. other commingled funds. A combination of ultra-short and short-term investments could potentially allow for low-cost liquidity with materially higher after-tax yields than laddered Treasuries or municipal bonds.

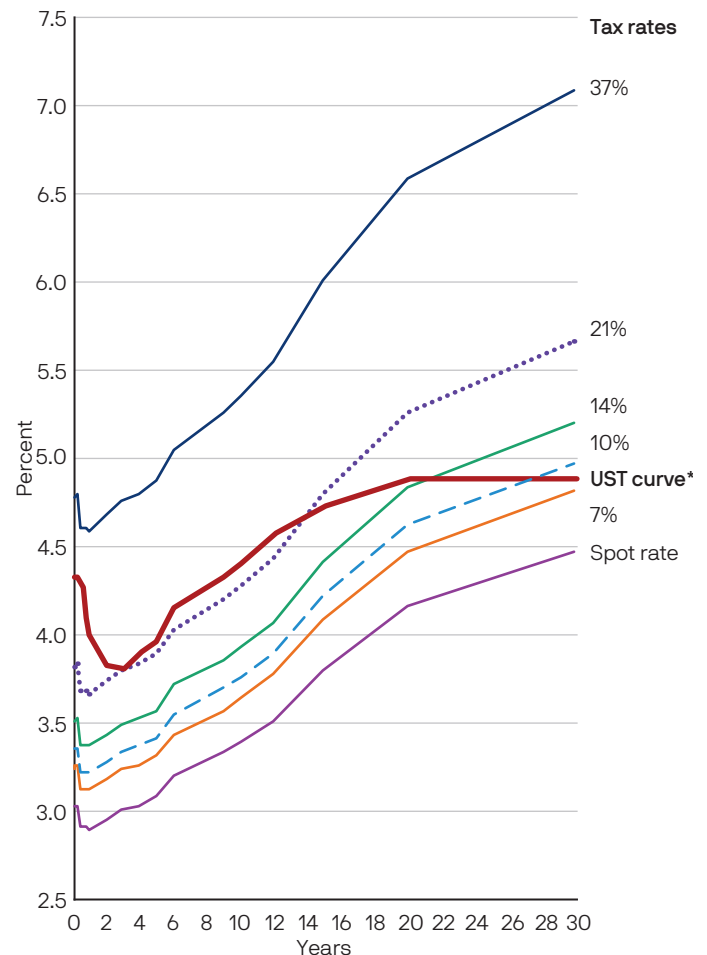
### Tax-aware active equity

Retail and high-net-worth investors often use tax-aware equity strategies to deliver positive after-tax outcomes. The underlying technique is straightforward: selling securities that have declined in value to generate a capital loss, which is then used to offset realized capital gains that would otherwise be taxed.

One challenge with this approach, particularly in light of an endowment's perpetual investment time horizon, is that equities generally have positive returns over time and the gains naturally outpace losses (even more so in a successful active equity program). In due course, the portfolio may exhaust the majority of losses while retaining unrealized gains that are taxable.<sup>2</sup>

### Comparing after-tax Treasury yields and municipal yields across the curve

Exhibit 6: AAA municipal bond yield curve vs. U.S. Treasury yield curve



Source: Bloomberg Finance, J.P. Morgan Asset Management; data as of May 6, 2025.

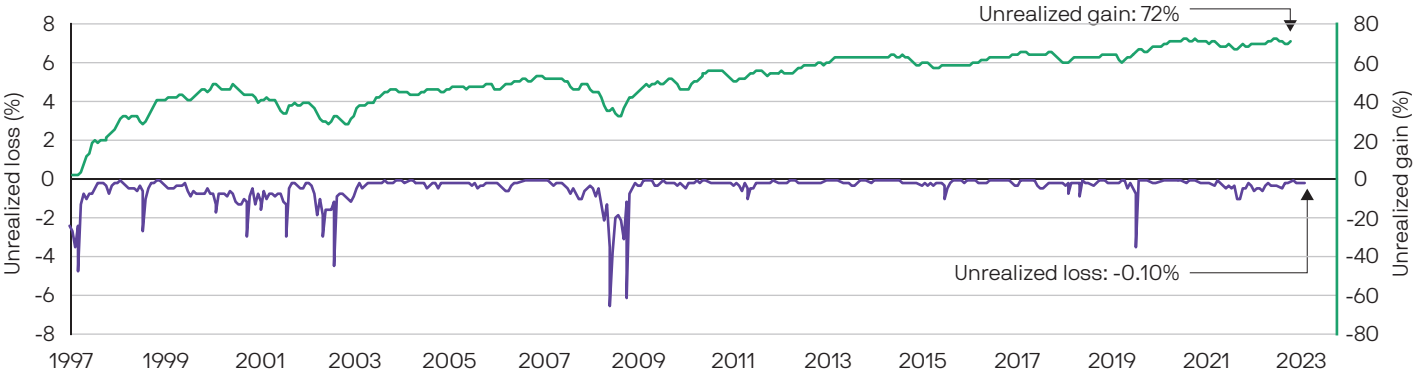
\*U.S. Treasury curve

<sup>2</sup> For large, appreciated equity positions, another tax-efficient liquidity solution might be the use of a variable prepaid forward contract.



Over extended time horizons, there are limits to tax-loss harvesting strategies

Exhibit 7: The growing differential between gains and losses in equities



Source: J.P. Morgan Asset Management; data as of May 2025.

**Exhibit 7** illustrates a historical investment in the Russell 1000 from 1997 to 2023. The magnitude and consistency of investment gains are striking when compared to the modest scale and episodic nature of losses. Thus, despite equities being among the most liquid of asset classes, an equity portfolio with embedded taxable gains can become unattractive to sell, even when conditions favor raising liquidity or rebalancing the portfolio.

A potential remedy to this problem would be to separate the tax-loss generation from the underlying equity portfolio with a long-short overlay. Unlike a long-only

portfolio that harvests losses only from its (hopefully) infrequent losers, a long-short strategy could make productive use of losses from both sides: long positions that lose value and short positions that gain value (**Exhibits 8A and 8B**). Ideally, managers could vary the scale of the long-short overlay to optimize the degree of tracking error and magnitude of tax savings.

A potentially useful feature of this overlay approach is that losses generated could be applied to gains from any part of the asset allocation—not simply equities. For endowments or foundations with large exposures to alternative assets, this could prove valuable.

Potential benefits evident in a long-short tax-loss harvesting approach

Exhibit 8A: Long-short tax loss structure

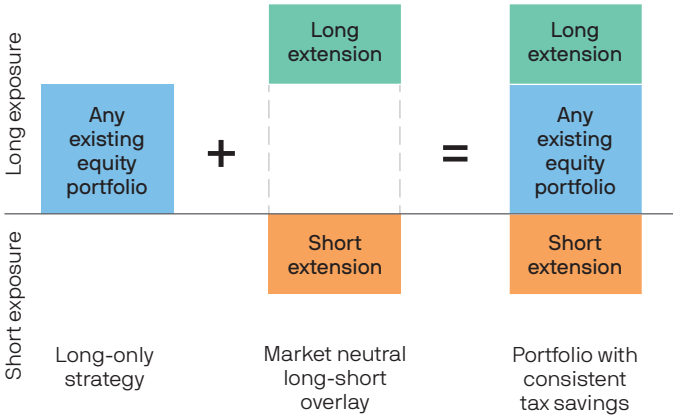
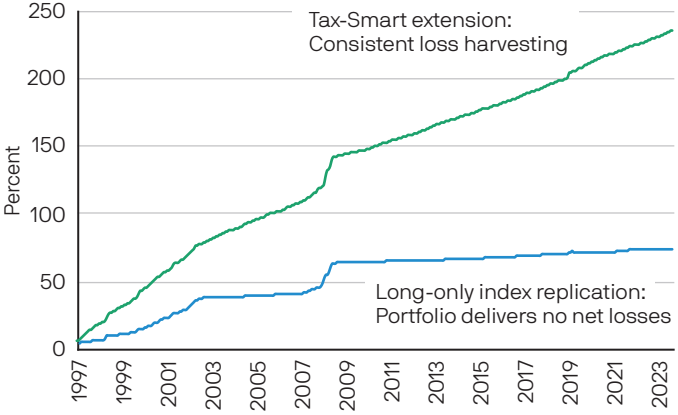


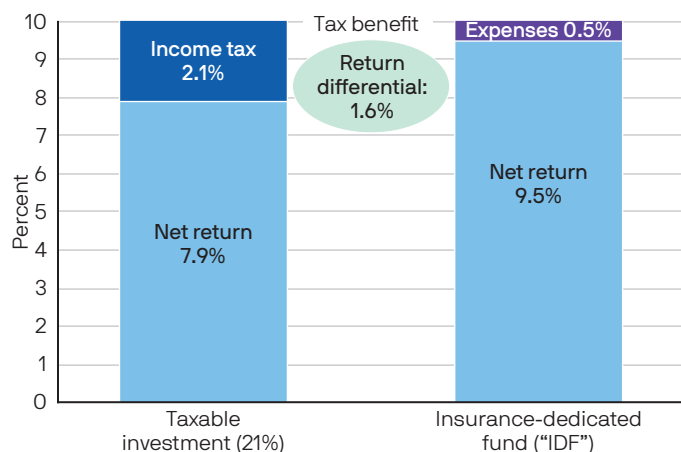
Exhibit 8B: Hypothetical cumulative net capital loss realized



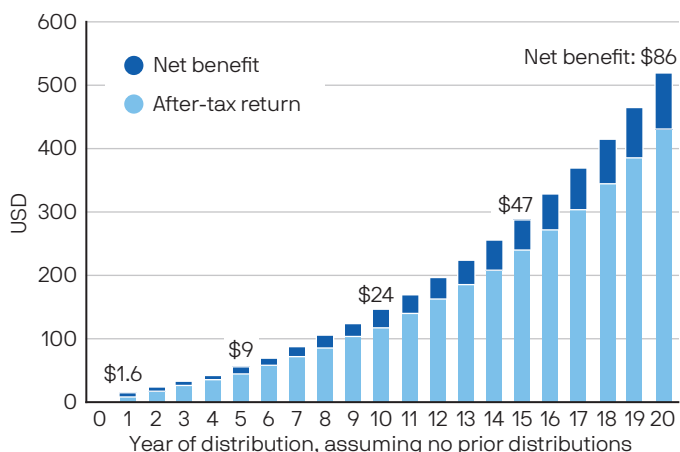
Source: J.P. Morgan Asset Management; data as of May 2025.

## Structured life insurance strategies containing high-returning asset classes can offer unique benefits

**Exhibit 9A: Net annual return differential for taxable investors using insurance solutions**



**Exhibit 9B: Cumulative gain for taxable investors using insurance solutions**



Source: J.P. Morgan Asset Management; data as of May 2025. Return is net of tax and tax benefit is net of IDF product fees. Exhibit 9A assumes a 10% annualized return and a 21% tax rate on distributions. Exhibit 9B assumes a 10% annual return, a 21% tax on distributions and a 0.5% product fee.

### Insurance strategies

Another tax-advantaged investment approach worth considering is a structured life insurance contract that invests an up-front premium in a portfolio of assets that appreciate tax free. Distributions, paid as “death benefits,” are also tax free. One notable feature of structured insurance contracts is that they can hold illiquid assets of the types frequently used by endowments and foundations.

**Exhibits 9A and 9B** illustrate the after-tax return differentiation of a structured life insurance strategy. The strategy requires higher fees, but that cost is outweighed by the tax savings over time.

A unique wrinkle in certain insurance strategies is the requirement that the entities purchasing the insurance—in this case, the endowment or foundation—have an “insurable interest” in the person or persons on whom the policy is written.

A potential pool of suitable entities could be the donors themselves, whose donations could be pooled with endowment assets to pay the up-front premium. Donations could thus remain tax deductible, and returns could escape taxation, creating both a tax-efficient investment and a potentially useful endowment fundraising tool.

### Offshore private fund structures

The majority of tax-exempt institutions that invest in private market funds (most commonly hedge funds, real estate and infrastructure) do so through offshore “feeder” funds that are intended to block unrelated business taxable income associated with the underlying fund’s use of leverage. The pending legislation raises a new concern: the possibility that tax liabilities could be generated by the investment activity that takes place within the fund. Investors do not want to incur tax obligations from strategies with high internal turnover but potentially limited liquidity.

Focusing on hedge funds as a common private market exposure for endowments and foundations, it is believed that the current tax treatment of offshore hedge fund investments will continue, and that the use of offshore vehicles will permit the deferral of any tax liability on investment gains until redemption (either partial or in full). While this view is widely held, it has not been definitively confirmed by Internal Revenue Service regulations, and institutions should consult tax counsel given the potential for future guidance to alter this interpretation.

Broader liquidity concerns for endowments and operating funds

Today, the federal government covers more than half of universities’ research spending, much of which flows through the National Institutes of Health (NIH). In 2023, the NIH awarded more than \$35 billion in grants to institutions of higher education. The administration is seeking to reduce the level of federal support for higher education by cutting such direct research grants and subsidies from the NIH and other agencies.

The reclassification of eligible expenses under grant programs will shift a meaningful portion of program costs back to schools. Additionally, some universities remain at risk of a broader withdrawal of financial support by the federal government, although it is unclear what specific circumstances might trigger a federal response (or how extensive that response might be). Nonetheless, the risk remains that the federal government could potentially reduce or withdraw significant funding with little notice.

The reduction in outside support adds further strain to already-tight operating budgets, creating shortfalls that could exceed the capacity of current annual endowment spending policies. In the 1970s and ’80s, the average university budget received approximately 4% of its funding from endowment returns; that number has grown steadily, according to the “2024 Study of Endowments,” an industry-leading report from the National Association of College and Business Officers (NACUBO) and Commonfund. Today many larger, better-endowed schools’ budgets receive 15%–65% of their funding from their endowments.

With higher taxes threatening to reduce endowment asset returns—and a broad-based reduction in direct federal support—the liquidity position for many universities will become more challenging to manage. Over the long term, endowments’ strategic asset allocations may need to tilt away from private funds and back toward public markets. But in the short term, many universities are actively engaged in contingency planning, analyzing liquidity sources and stress-testing their portfolios for various funding shocks.

Here, we lay out a “waterfall” of liquidity options that are available to satisfy financial obligations (Exhibit 10). Some of these investments may be available to the operating pool; others may be used only in the endowment. A thoughtful strategy will have layers of liquidity that can be tapped sequentially, or as market conditions warrant, to satisfy external obligations and portfolio rebalancing needs. Even highly illiquid alternatives, such as private equity and private credit, should be included as potential avenues for liquidity given the widespread growth in secondary market volumes. Liquidity management can involve the full asset allocation.

Assessing the full spectrum of liquidity options

Exhibit 10: Potential sources of portfolio liquidity

Cash, money market funds*	Immediate liquidity, near zero risk
Short-term fixed income*	Higher yielding, low risk, active alpha
Distributable Income	Scheduled dividends, coupons, fund distributions
External capital	Donations, government support (declining)
Core bonds*	Efficient access to capital, portfolio diversification
Public equity*	Liquid markets, low transaction costs, high volatility
Contingent liquidity	Hedge payoffs (e.g., tail hedging)
Direct borrowing	Repo financing, external credit lines and/or debt issuance with potential ratings impact
Lower quality credit*	High transaction costs at the security level
Liquid alts redemptions	Notification requirements, potential manager gates
Illiquid alts secondaries	Wide bid-offer spreads, imbalanced supply/demand

Source: J.P. Morgan Asset Management.  
\*Public market asset classes where the use of ETFs can enhance liquidity materially.

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## Conclusion: Tailoring solutions to the challenges ahead

Potential changes to tax policy and federal financial support are prompting board-level discussions about investment strategy, spending policy, operations and potential budget cuts. For investment officers and those with oversight of foundations, endowments and operating assets, it would be sensible to plan ahead for the possibility of changing tax status and increasing liquidity. Since each institution's circumstances are unique, a tailored approach will be essential.

Skilled allocators at endowments and foundations can begin to prepare by considering the potential inclusion of various tax-efficient strategies and examining the full

spectrum of liquidity management solutions across all capital pools. Many of these investment approaches, though perhaps new to the nonprofit asset management community, have long and successful histories among taxable investors.

As allocations shift in this direction, it will be important for allocators to partner with seasoned asset managers who bring real-world experience in ETFs, municipal bonds, tax-aware equity, insurance solutions and liquidity management to the table. No single approach will be enough to optimize portfolios as endowments and foundations navigate the challenges ahead.

### J.P. Morgan Asset Management

277 Park Avenue | NY 10017

#### Next steps

Please reach out to your J.P. Morgan Asset Management team with any questions or to further discuss in detail.

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