EVALUATING AND MANAGING ILLIQUIDITY RISKS TO HELP BUILD STRONGER PORTFOLIOS

1 OVER THE PAST 50 YEARS, THE ROLES OF PUBLIC AND PRIVATE CAPITAL MARKETS HAVE CHANGED SLOWLY BUT PROFOUNDLY.

Since the 1960s, public equity markets have gradually morphed from being the primary source of growth financing for corporations to being more of an income-bearing asset for investors and an acquisition currency for corporations.

1960

Public equity markets

Funding future growth 〉 CORPORATIONS 〉 Funding current operations

Dividends when cash flow allows 〉 INVESTORS 〉 Stable dividend income flow

2018

<50% returns from dividends and buybacks

Public equity markets

Expected trend over the next 10 years

2028

>75% returns from dividends and buybacks

Public equity markets

In the year 2000, private asset equity equated to approximately **5%** of market capitalization of U.S. public equity markets

PRIVATE ASSET MARKETS

Smaller number of wealthy private investors funding high risk new ventures

PRIVATE ASSET MARKETS

Today, private assets equate to **>20%** of market capitalization of U.S. public equity markets

Many investors looking for superior risk-adjusted returns expanded private asset markets and provided large-scale funding of growth and innovation

2 INVESTORS LOOKING TO PRIVATE ASSETS FOR EXPOSURE TO GROWTH EXPECT ILLIQUIDITY RISK, WHICH IS GENERALLY COMPENSATED BY HIGHER RETURNS.

The illiquidity risk premium on private assets is a natural feature of their investment model for which investors are generally compensated over the cycle, subject to manager selection.

END OF INVESTMENT CYCLE

Illiquidity Risk

Higher Returns

PRIVATE MARKETS

E.G. PRIVATE EQUITY

COMPENSATED for illiquidity by higher return if investor stays the course

POSITIVE CASH FLOW

PRIVATE ASSET INVESTMENTS

3 INVESTORS IN PUBLIC ASSETS MAY ALSO FACE ILLIQUIDITY RISK, BUT IT MAY BE MORE CYCLICAL AND IT MAY NOT ALWAYS BE FULLY COMPENSATED.

Illiquidity Risk

Credit Spread

ILLIQUID PUBLIC MARKET

E.G. HIGH YIELD BONDS

! Possible uncompensated illiquidity ahead

BEWARE

The point at which excess returns on an illiquid public asset doesn't offset the probability of being forced to sell at a loss.

Illiquidity Risk

ILLIQUID PUBLIC MARKET

E.G. HIGH YIELD BONDS

Credit Spread

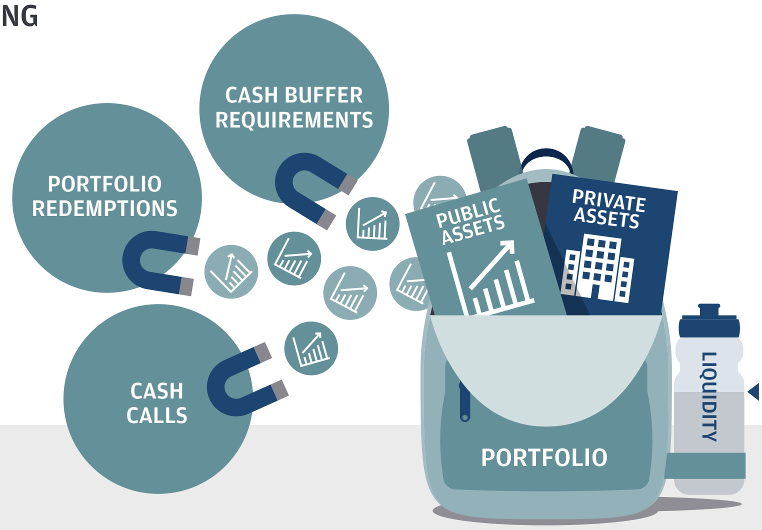
EARLY ECONOMIC CYCLE LATE

PUBLIC ASSET INVESTMENTS

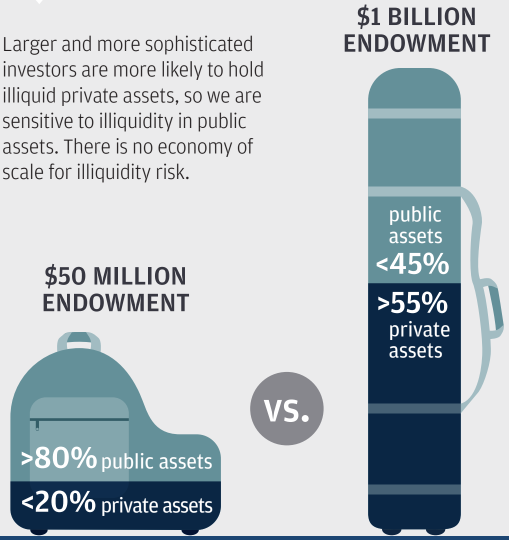
J.P.Morgan Asset Management

4 AS ECONOMIC CYCLES MATURE, AVOIDING UNCOMPENSATED PUBLIC MARKET ILLIQUIDITY BECOMES A PRESSING CONCERN FOR ANY INVESTOR IN PUBLIC AND PRIVATE ASSETS.

Investors with allocations to both private and public assets may face cash demands that are best covered from the public asset side of the portfolio.



Larger and more sophisticated investors are more likely to hold illiquid private assets, so we are sensitive to illiquidity in public assets. There is no economy of scale for illiquidity risk.



LARGE PORTFOLIO ADVANTAGES

More able to access investment managers proven to deliver above-average performance

LARGE PORTFOLIO DISADVANTAGES

Likelihood of a particular illiquid asset in portfolio. If forced to sell, trade size likely to be bigger

5 ACTIVELY PLANNING FOR ILLIQUIDITY RISK IN BOTH PUBLIC AND PRIVATE ASSETS WILL HELP MULTI-ASSET INVESTORS BUILD STRONGER PORTFOLIOS THROUGH THE CYCLE.

Recognizing and planning for cyclical illiquidity risk in public markets is prudent for any investor navigating a sophisticated multi-asset portfolio through the cycle.

An investor will always want to avoid being a forced seller in illiquid markets, private or public.

But in times of market weakness, it may be more desirable to preserve illiquid positions in private than in public markets.

J.P.Morgan Asset Management

NEXT STEPS

For more information, contact your J.P. Morgan representative.

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