



CHILD HEALTH CORPORATION OF AMERICA

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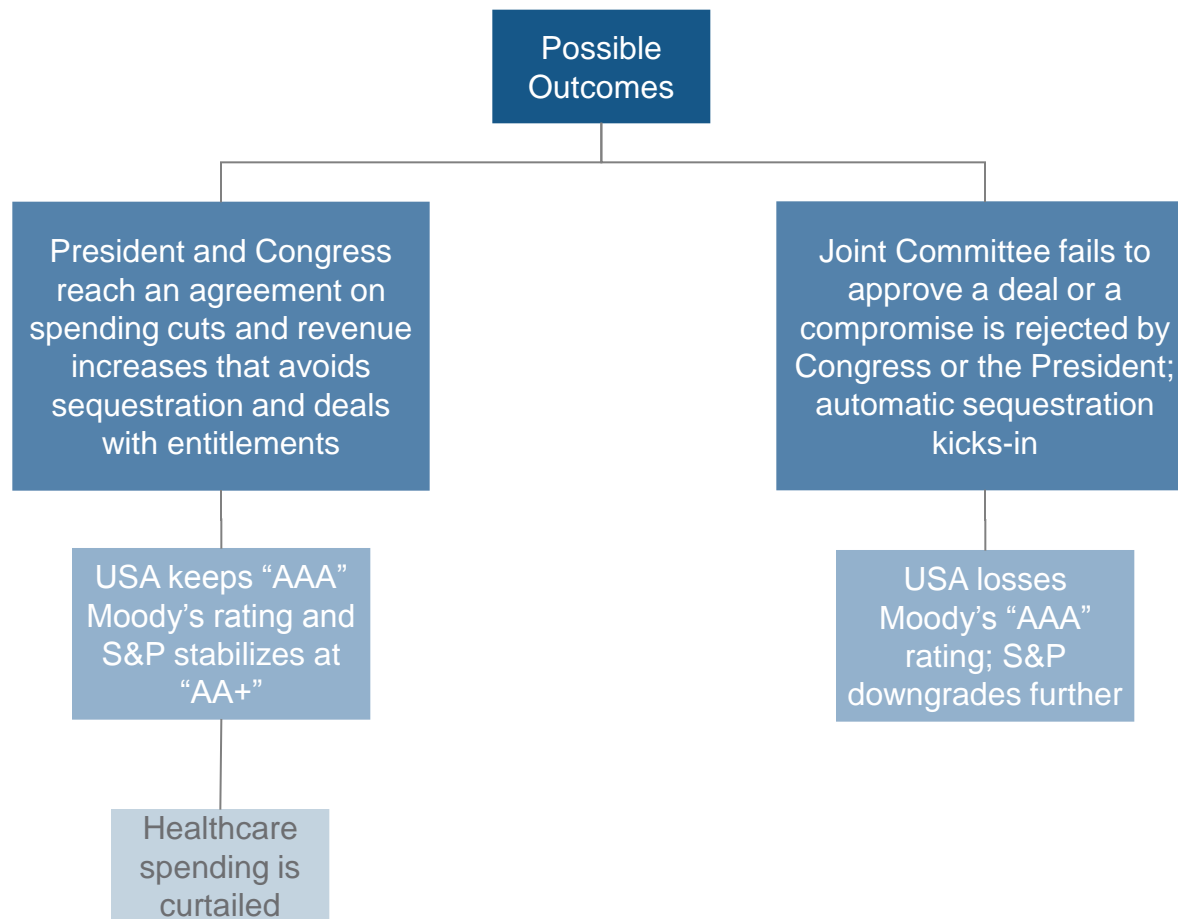
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The debt ceiling agreement opens the possibility of real reform, or could be the continuation of unsustainable policies

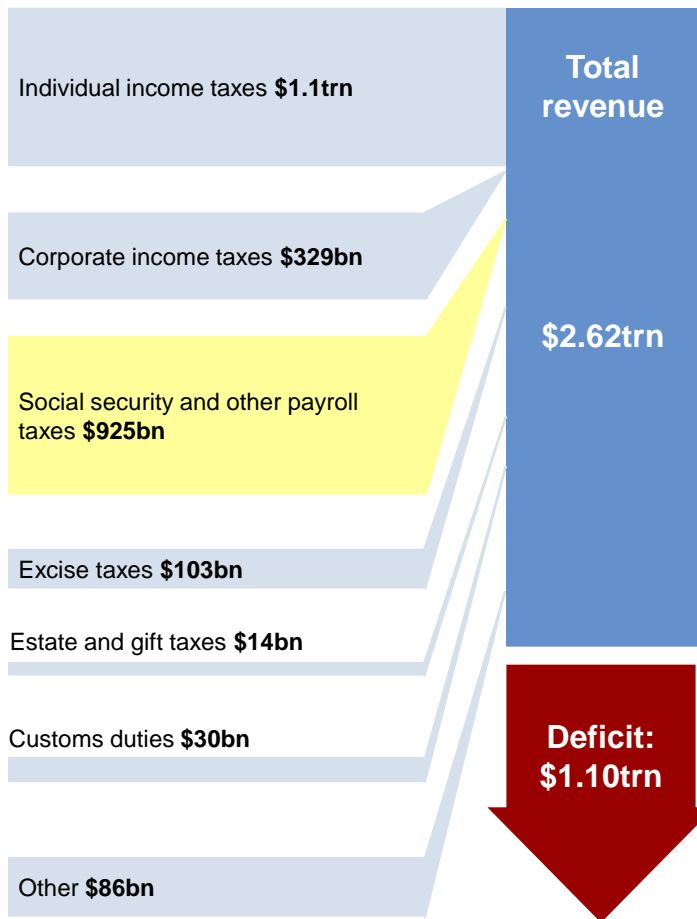


How did we get here?

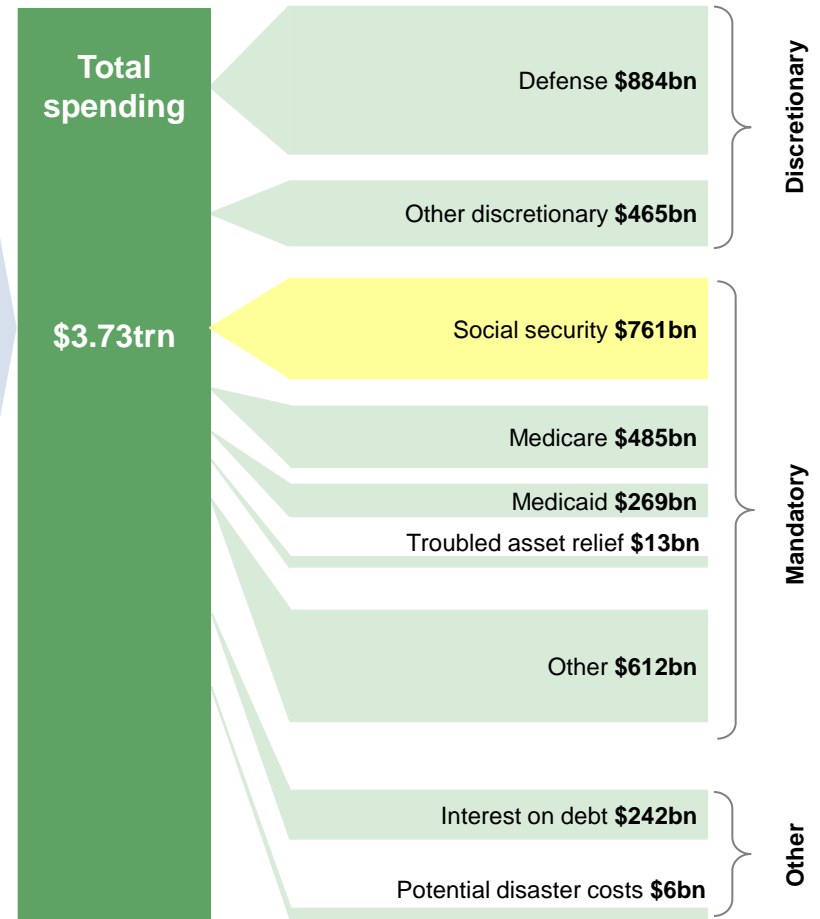
- The agreement to cut \$2.1 trillion of spending growth over 10 years is equivalent to 55% of the total estimated deficits for FY2012 to FY2016

President's Budget Proposal for FY2012

Where the money comes from:



Where the money goes:



Source: Washington Post, using data from the White House of Management and Budget (Table S-4)

The deal improves the debt-to-GDP trajectory, but with few immediate cuts, much of the implementation is left for future congresses

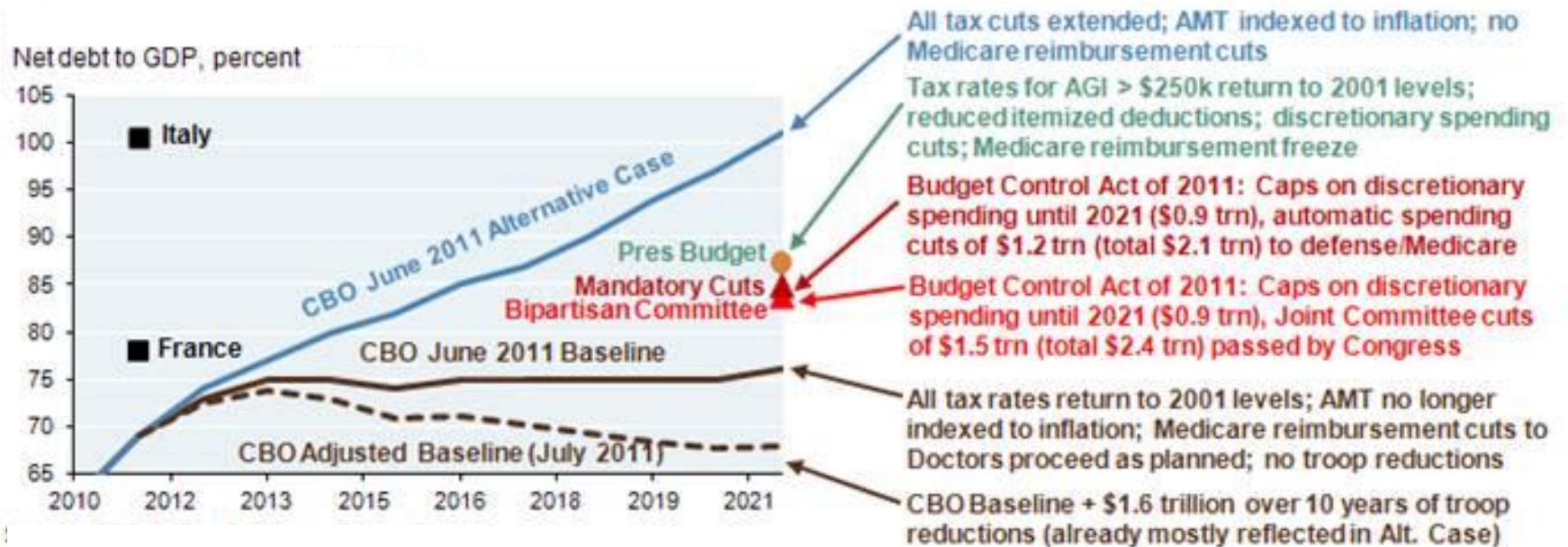
- CBO estimates initial cuts of \$21 billion in 2012 and \$42 billion in 2013
- The near term economic drag is small, but comes on top of fiscal tightening that was already scheduled to occur (the most significant being the payroll tax holiday)
 - Overall, federal fiscal policy may subtract 1.7% from GDP in 2012
- The deal, if implemented, improves long-term debt-to-GDP, but the ratio will still continue to increase

Change in federal deficit—2011 to 2012

	Cost		Impact coeff.	GDP impact	
	\$bn	% of GDP		\$bn	% of GDP
Change in deficit	(400)	(2.6)	0.67	(266)	(1.7)
Cyclical	(50)	(0.3)	0.00	0	0.0
Structural	(350)	(2.3)	0.76	(266)	(1.7)
Payroll taxes	(110)	(0.7)	0.67	(74)	(0.5)
Unemp. Insurance	(50)	(0.3)	0.90	(45)	(0.3)
Accel depreciation	(25)	(0.2)	0.00	0	0.0
State/local transfers	(50)	(0.3)	0.65	(33)	(0.2)
Infrastructure, etc.	(75)	(0.5)	1.00	(75)	(0.5)
August debt deal	(40)	(0.3)	1.00	(40)	(0.3)

Source: J.P. Morgan Economic Research

U.S. Long-Term Debt Scenarios



Source: J.P. Morgan estimates using data from the IMF and CBO

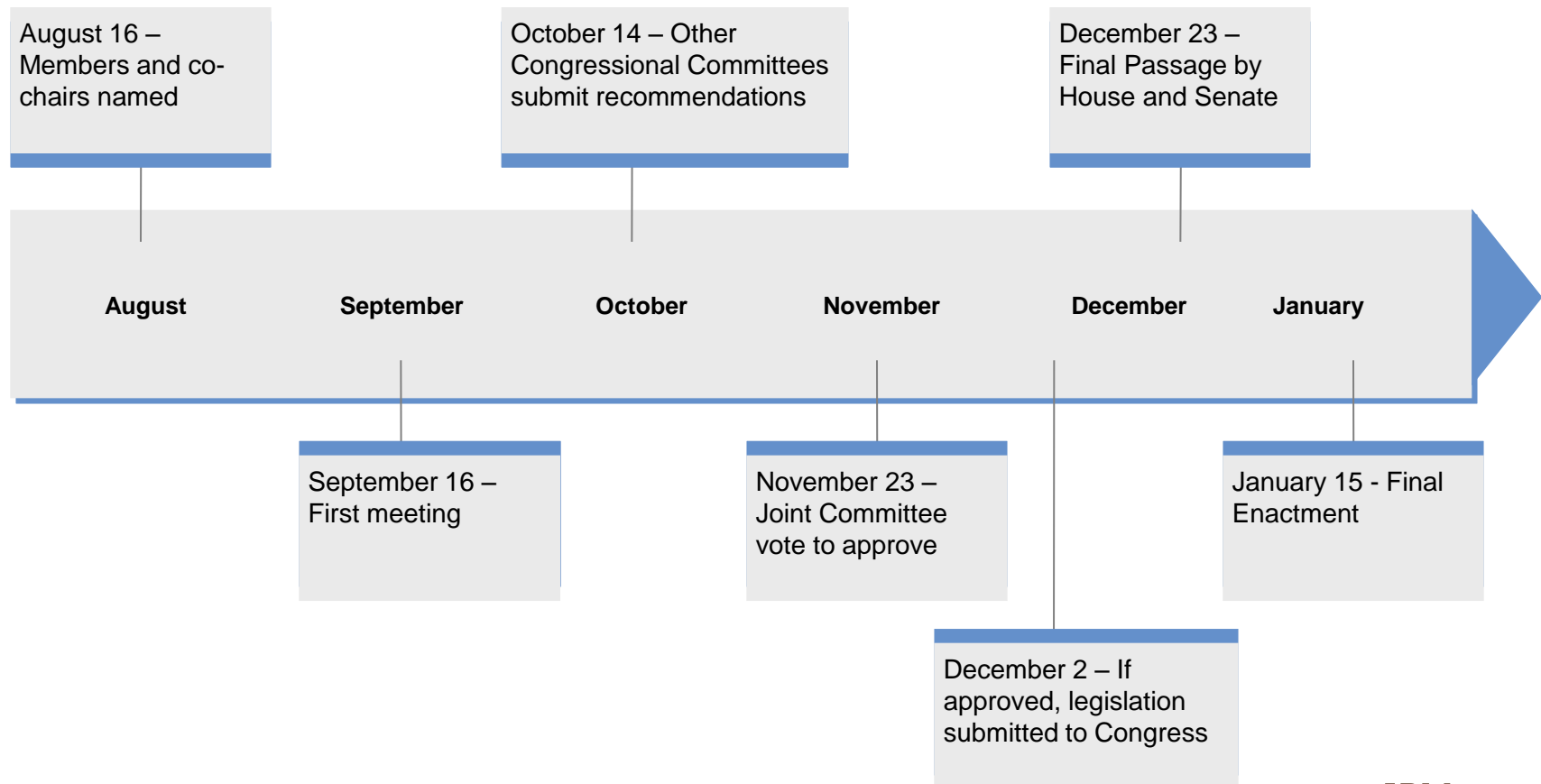
Timeline of the Joint Select Committee on Deficit Reduction

- Membership

- The Joint Committee will consist of 12 members of Congress, with three each appointed by Speaker Boehner, Minority Leader Pelosi, Majority Leader Reid, and Republican Leader McConnell.

- Goals

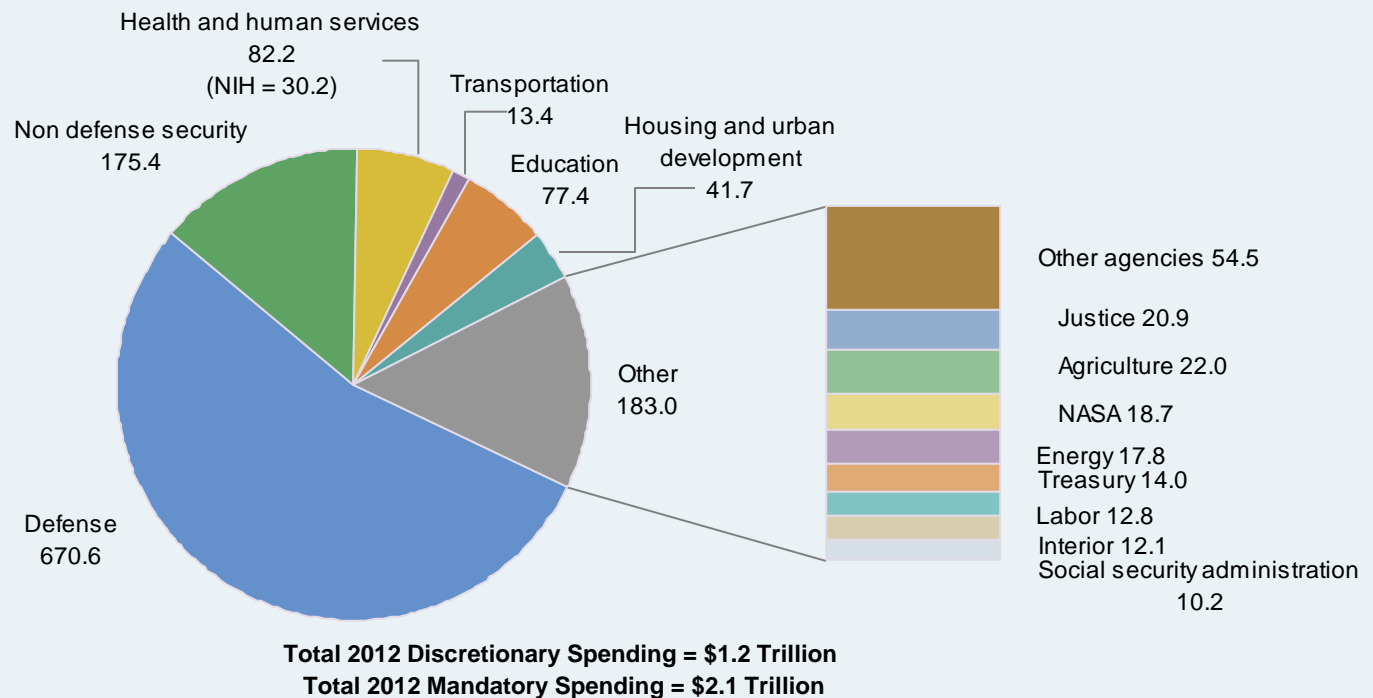
- Reducing the deficit by \$1.5 trillion over ten years. In order to avoid sequestration, the legislation language must reduce the budget deficit by at least \$1.2 trillion.



By walling off entitlements, discretionary spending will be hard hit (especially if the automatic sequester kicks in)

- The discretionary spending caps will “cut” \$400 billion out of projections for non-defense discretionary spending (with the possibility of up to \$600 billion more under the automatic sequester)
 - Appropriations for discretionary programs are assumed to grow each year with inflation. The bill does not “cut” in the traditional sense, but instead limits future growth
- Exempted from all reductions include Social Security, Medicaid, unemployment insurance, veterans benefits, food stamps, other antipoverty entitlements
 - The automatic cuts can hit Medicare, but not on the entitlement side. Cost-cutting can only reduce provider payments (something Congress has routinely overridden)

Components of Discretionary Budget Resources, FY2012(\$bn)



Source: White House Office Management and Budget (Federal Budget 2012 Summary Tables)

Defense spending is the other prime area targeting for savings

- The first round of cuts will include \$350 billion in defense savings, and under the automatic sequester, defense cuts would grow to \$600 billion over a 10-year time horizon
 - Not all the cuts will necessarily be borne by the Pentagon
 - “Security Spending” also includes Department of Homeland Security, veteran's affairs, international affairs, and the nuclear weapons portion of the Department of Energy
 - The initial \$350 billion in savings is not significantly different than the Presidents FY2012 budget proposal, which calls for \$400 billion in defense cuts over 12 years
 - That allows for the Pentagon budget to grow with inflation (but not above)
- If the additional cuts kick-in, likely targets would likely include weapons systems (the V-22 Osprey, the Virginia class attack submarine, the F-35 Joint Strike Fighter, and a new generation of bombers and ballistic missile submarines), but also cutting troop levels that change the nature of the missions the US military would be involved in
- The debt ceiling deal, does not factor in any savings from winding down the wars in Iraq and Afghanistan, estimated at some \$1 trillion in reduced spending over the next years

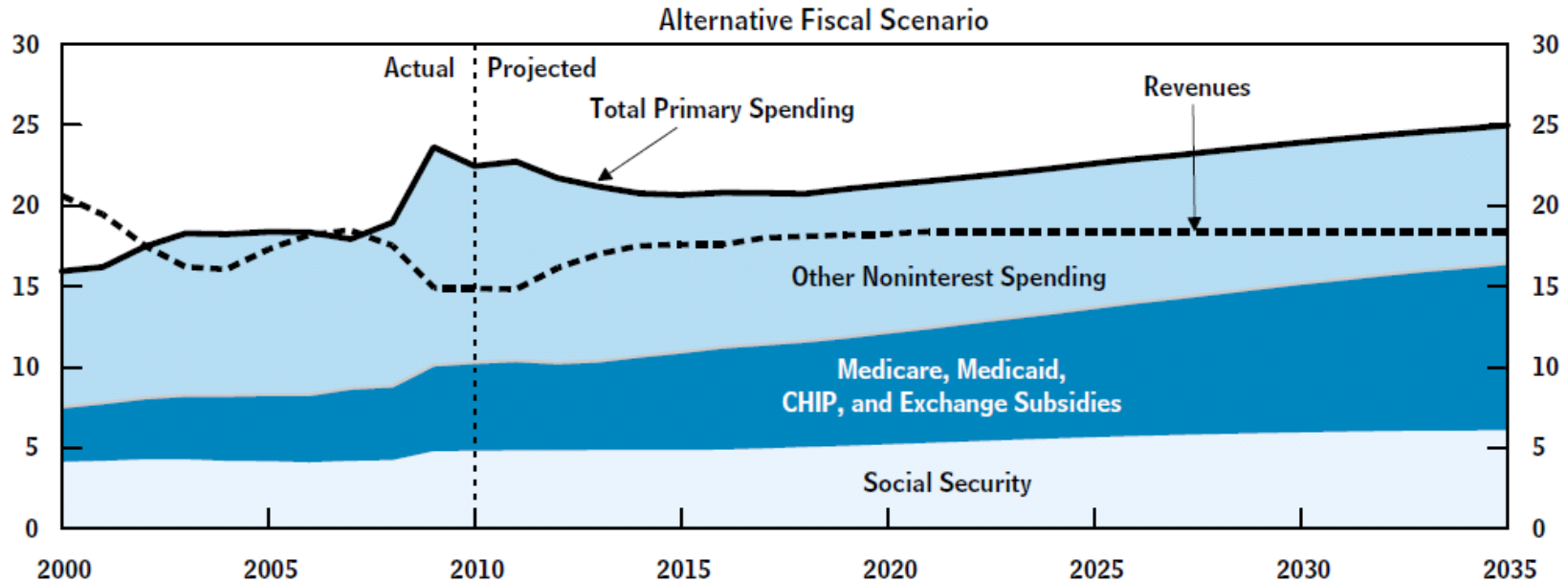
Department of Defense Budget

DoD Budget \$ in Billions	FY 2010 Actual	FY 2011 CR	FY 2011 Request	FY 2012 Request	FY11–12 Change
Base	527.9	526.1	548.9	553.1	+4.2
OCO	*163.1	159.0	159.3	117.8	-41.5
Total Budget	691.0	685.1	708.2	670.9	-37.3

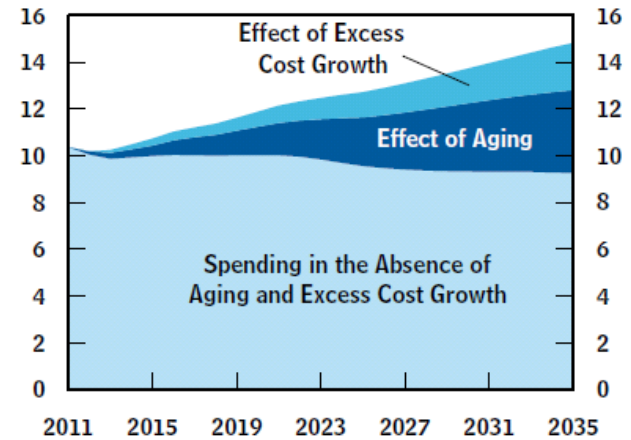
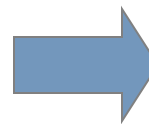
Source: United States Department of Defense, Fiscal Year 2012 Budget.

However, health care spending will be the major driver of spending growth

Revenues and Primary Spending, by Category, Under CBO's Long-Term Budget Scenarios (% GDP)



Sources of Growth in Federal Spending on Major Mandatory Health Care Programs and Social Security, 2011 to 2035 (% of GDP)

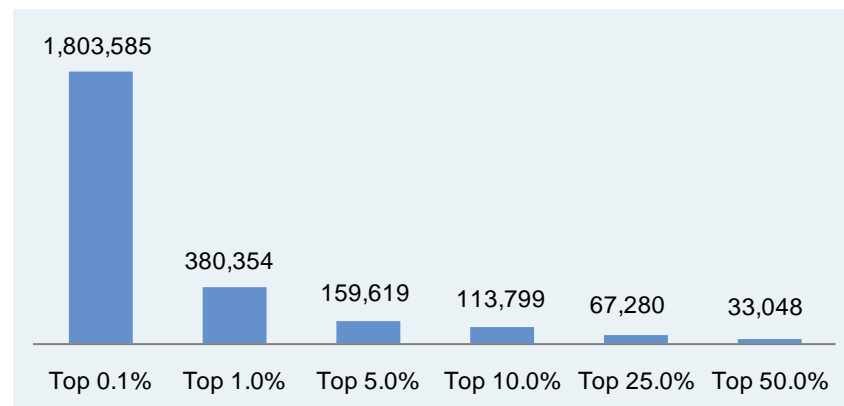


Source: Congressional Budget Office, "The Long-Term Budget Outlook", June 2011. Note, the alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period.

Revenue increases are also needed, but solely taxing the rich is insufficient

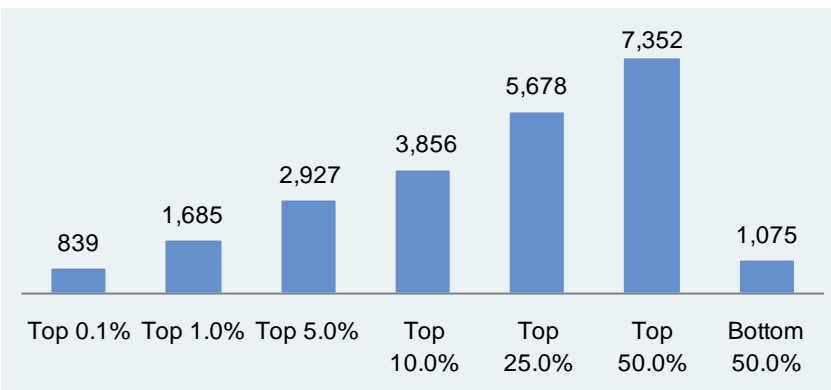
- By definition, the top 1% of taxpayers is a small number of people
 - Top 1.0% equals 1.4mm returns
 - Top 5.0% equals 7.0mm returns
- Even assuming no impact to marginal propensity to work or spend, a 50% increase on the effective federal tax on high income earners could generate:
 - \$95bn if limited to the top 0.1%
 - \$196bn if limited to the top 1.0%
- In reality, such a tax increase may garner far less revenue

Adjusted Gross Income Percentile Floors (\$)



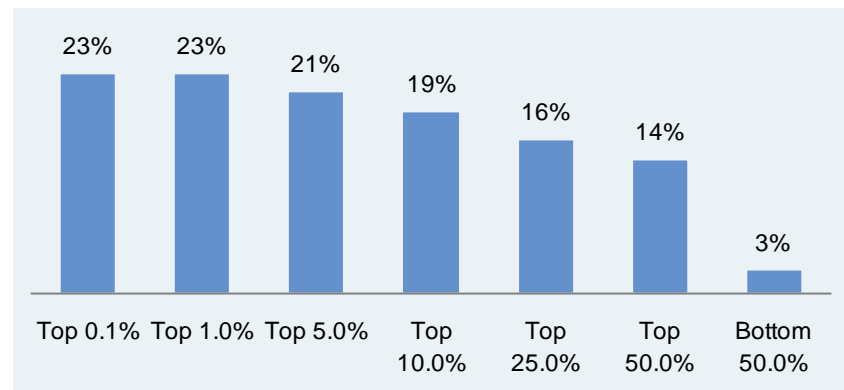
Source: IRS Statistics of Income (2008)
Note: Represents all tax returns with positive adjusted gross income

Adjusted Gross Income (\$bn)



Source: IRS Statistics of Income (2008)
Note: Represents all tax returns with positive adjusted gross income

Effective Federal Income Tax Rate

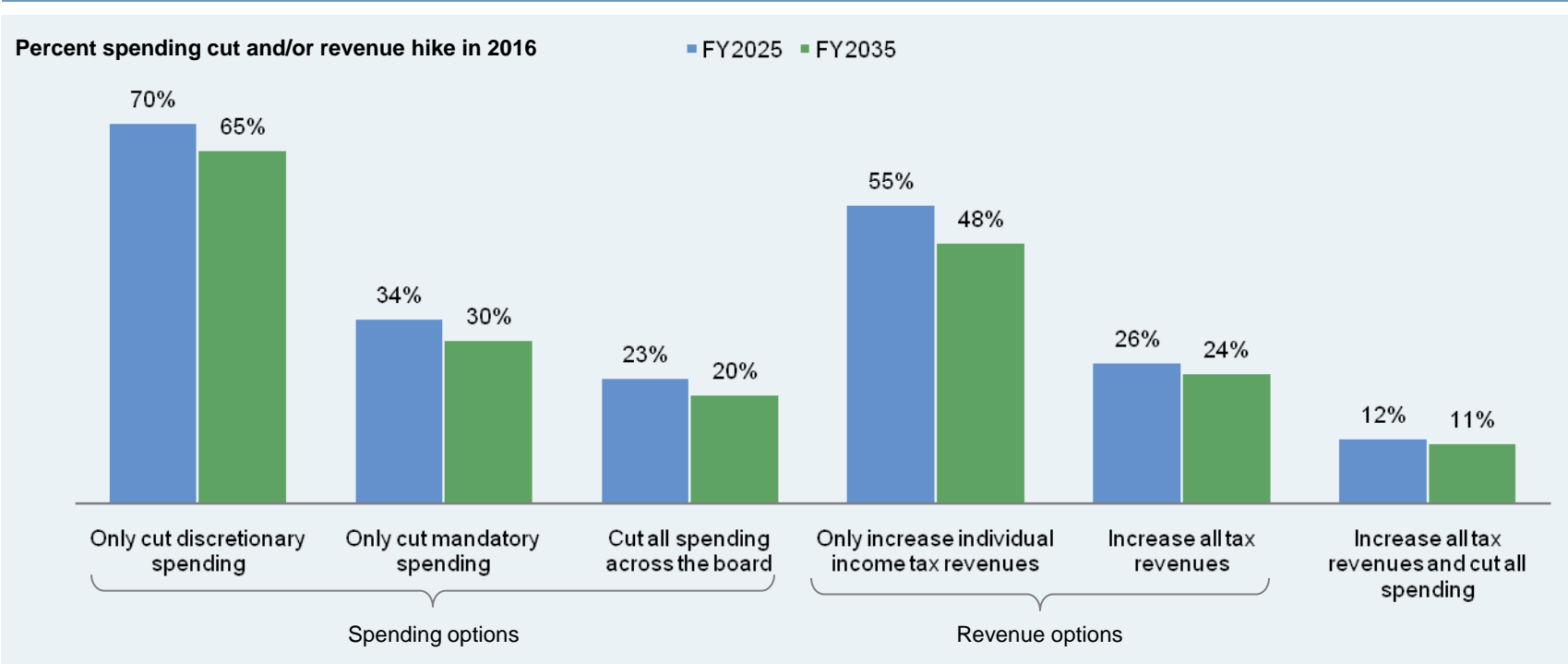


Source: IRS Statistics of Income (2008)
Note: Represents all tax returns with positive adjusted gross income

Under a multi-pronged approach to reduce debt, the required permanent spending cut and tax hike would be about 12 percent beginning in 2016

- Could mean cutting discretionary spending by about \$175bn (the equivalent of eliminating all federal discretionary spending in education, employment training, natural resources and the environment), cutting average monthly Social Security benefits by about \$160 per person, raising individual income taxes by about \$580 per person, in addition to other spending cuts and tax increases

Spending cuts and/or revenue hikes in fiscal year 2016 necessary to reach debt-to-GDP ratio of 60 percent in fiscal years 2025 or 2035



Source: Pew Fiscal Analysis Initiative, "No Silver Bullet: Paths for Reducing the Federal Debt", March 2011

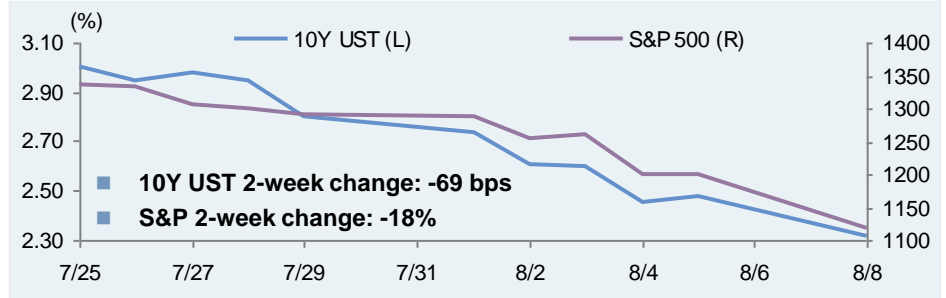
The S&P downgrade drew headlines, but broad underlying economic weakness caused the significant fall in rates and equities

Market Update

- S&P downgraded the U.S. Treasury debt rating on Friday, August 5th, citing insufficient steps taken by the government to reduce its fiscal deficit
 - U.S. Treasuries continued to rally this week in a flight to quality, despite the downgrade
 - On Monday, August 8th, 10-, and 30-year UST yields fell 24 bps and 19 bps, respectively
 - Last Tuesday, August 2nd, the President signed the Budget Control Act, which allows incremental debt ceiling increases of at least \$2.1 trillion and establishes over \$900 billion in initial spending cuts over the next 10 years
- In addition to fiscal policy contraction, markets have primarily responded to weak underlying U.S. economic data and continued concerns in Europe, with a significant pull back in equities and fall in interest rates
 - S&P has declined 14% over the past week
- Tax-exempt rates have been affected differently on the long end and short end of the yield curve in light of activity over the past week
 - 10- and 30-year MMD fell 29 bps and 40 bps last week, but lagged the rally in Treasury yields on Monday
 - After a brief run-up in daily rates last week, short-term rates have since settled following the resolution of the debt ceiling and the confirmation of the U.S. Treasury short-term rating of A-1+

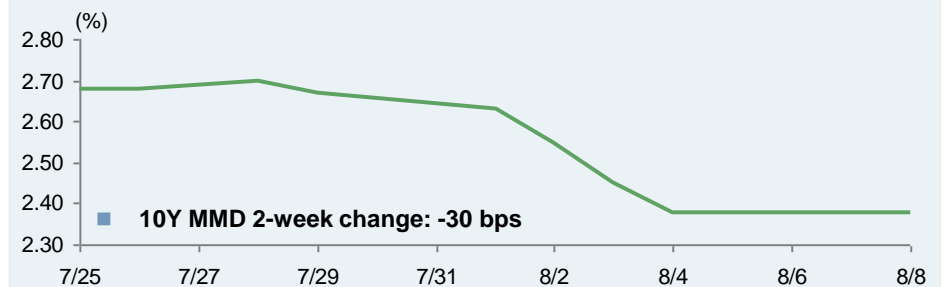
Source: Bloomberg and J.P. Morgan; rates as of 8/8/2011

U.S. Treasury and S&P 500 Index levels over the last two weeks



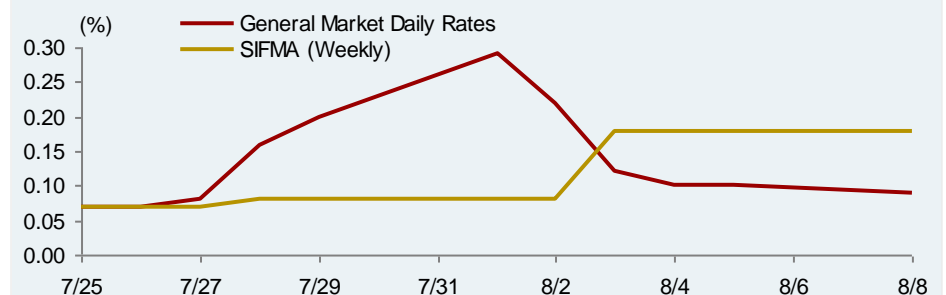
Source: J.P. Morgan and Bloomberg; rates as of 8/8/2011

MMD movements over the last two weeks



Source: Municipal Market Data and J.P. Morgan; rates as of 8/8/2011

SIFMA Vs. General Market Daily Rates



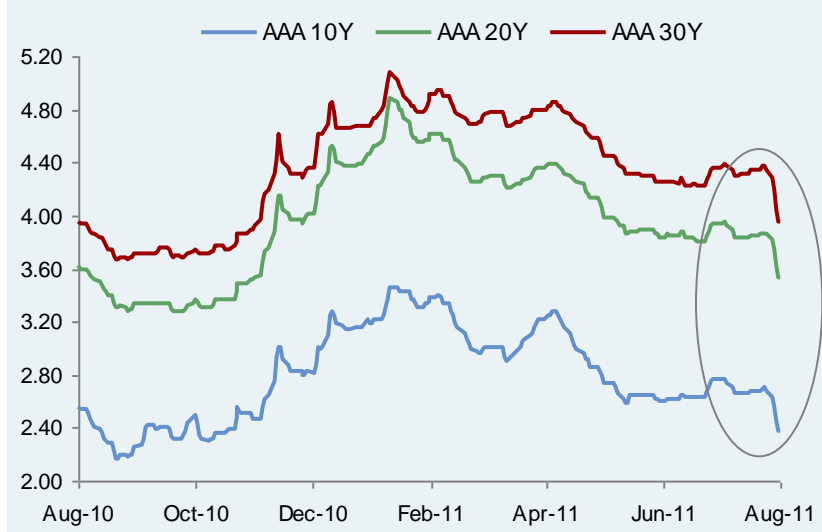
Source: J.P. Morgan, SIFMA; rates as 8/8/2011

Tax-exempt rates follow UST yields lower over the week; volatility is expected to continue on the back of S&P downgrade of the U.S.

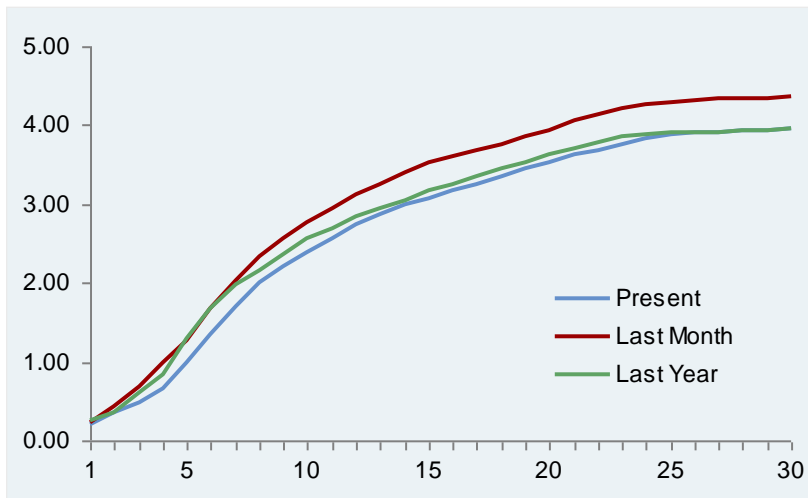
Tax-Exempt Fixed Rate Overview

- A flight to quality last week on the back of poor economic data caused U.S. Treasury yields to decline significantly over the week; tax-exempt rates followed the downward movement in UST yields and are expected to experience continued volatility in light of the U.S. downgrade
 - 5-, 10-, and 30-year MMD yields declined 16 bps, 29 bps, and 40 bps, respectively last week
- Long-term tax-exempt supply last week totaled \$3.8 billion, and is expected to decline this week to \$2.1 billion
 - Bond Buyer 30 Day Visible Supply Index is currently \$5.1 billion suggesting that new issuance may remain light through August
- Uncertainty in the municipal market may continue as impacts of the U.S. downgrade become absorbed, particularly for federally backed bonds

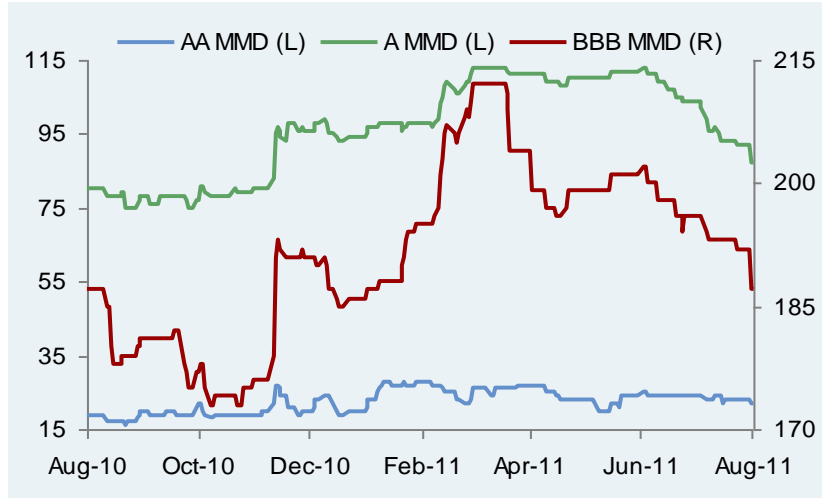
AAA MMD Rates (%)



AAA MMD Yield Curve (%)



10-Year Tax-Exempt Credit Spreads (bps)

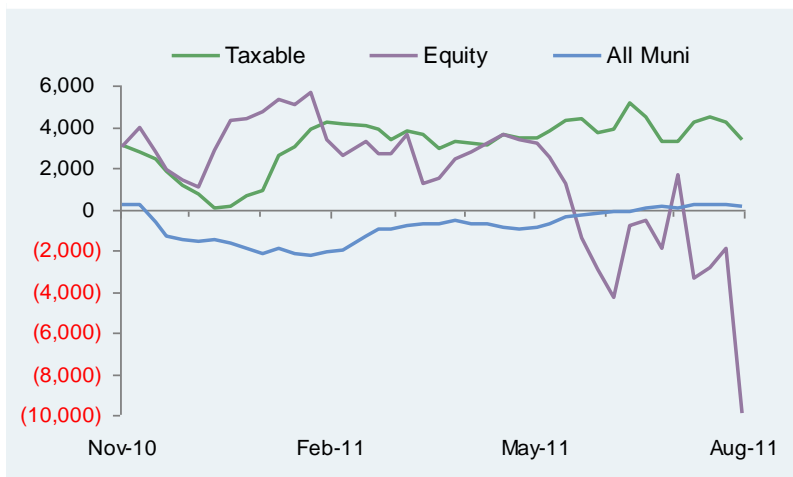


Municipal bond funds experienced heavy outflows of \$232 million last week

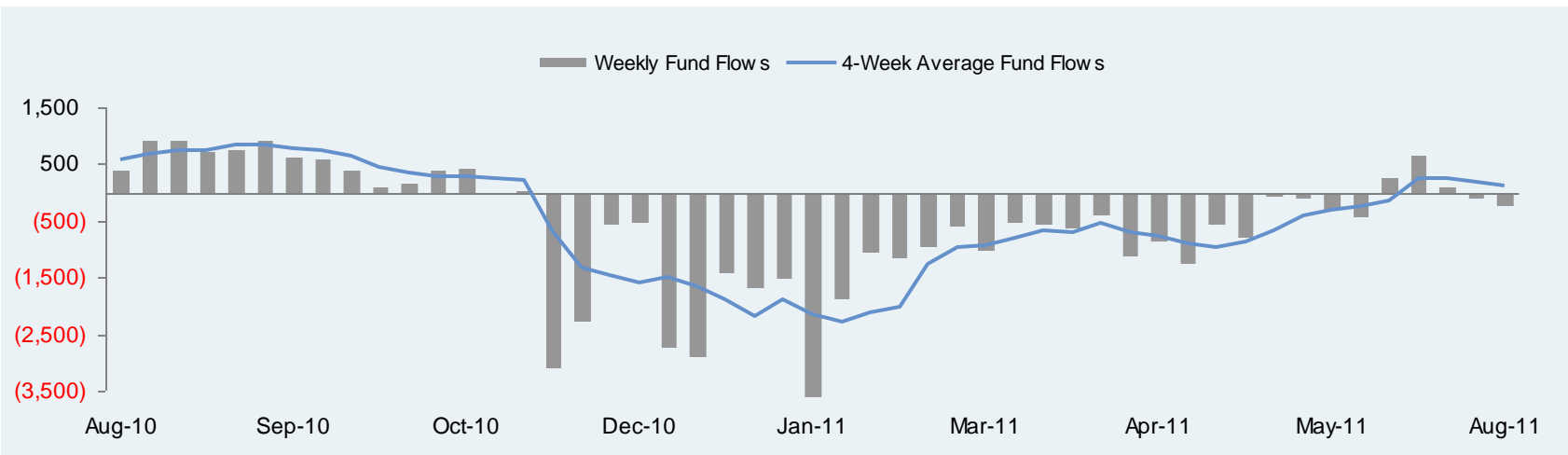
Municipal Market Fund Flows

- Term municipal funds¹ had the largest week of outflows in the past 2 months totaling \$232 million; however, 4-week average flows still remain positive at \$118 million
 - Long-term funds had outflows of \$726 million, while intermediate funds experienced inflows of \$314 million last week
- Amid significant market volatility, investors seem to be removing capital from more risky asset classes in a flight to quality
 - Equity funds reported outflows of approximately \$24 billion in the week ending August 3rd, while taxable fixed income funds had inflows of \$1.6 billion
 - After 7 consecutive weeks of inflows, high-yield funds experienced their second week of outflows in the past 9 weeks; outflows totaled \$117 million in the week ending August 3rd

4-Week Average Fund Flows (\$mm)



4-Week Average Fund Flows (\$mm)

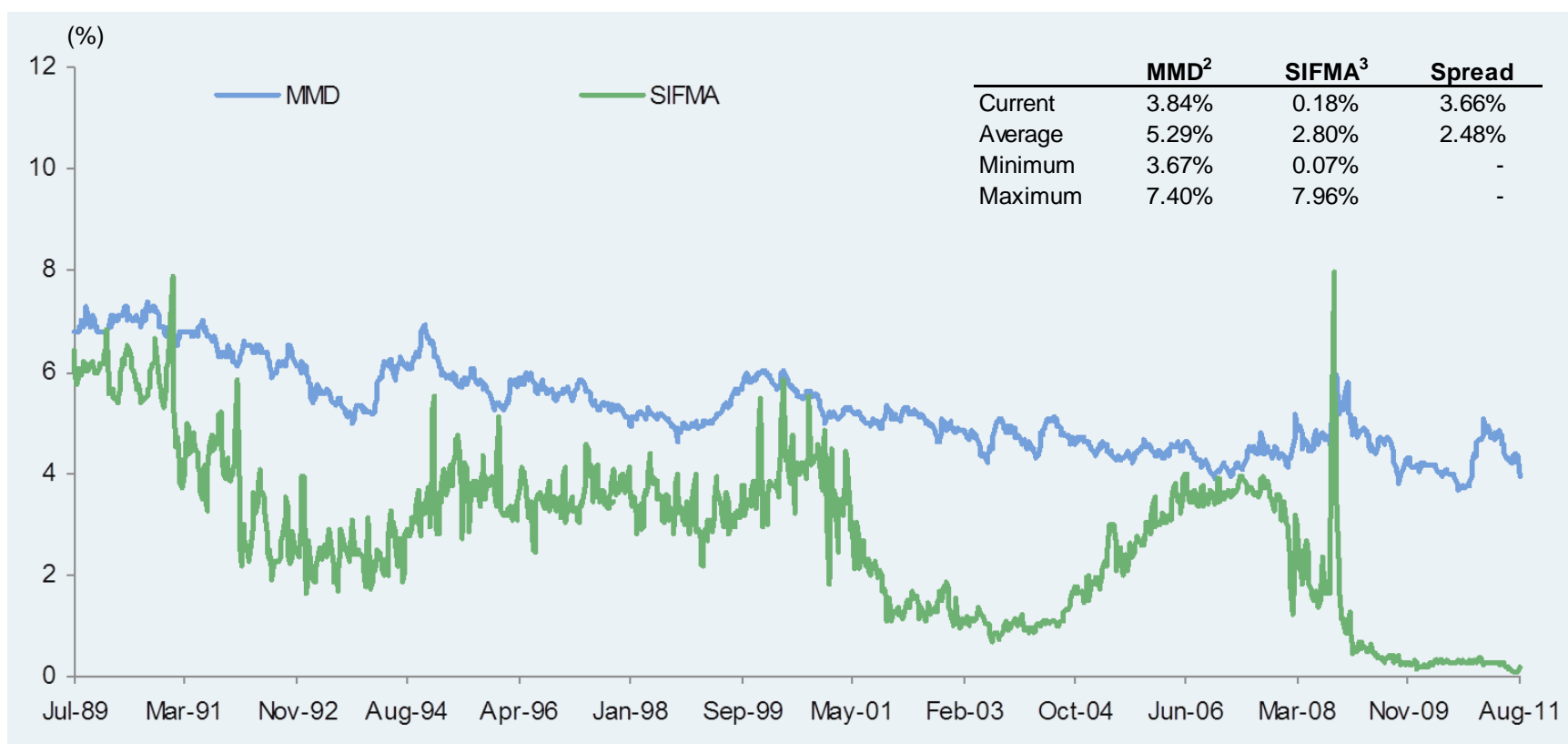


Source: Lipper FMI, iMoneyNet

¹ Reflects all tax-exempt mutual funds that report on a weekly and monthly basis, excluding tax-exempt money market funds

Historical tax-exempt rates are below historical averages

30-Yr AAA MMD versus SIFMA¹



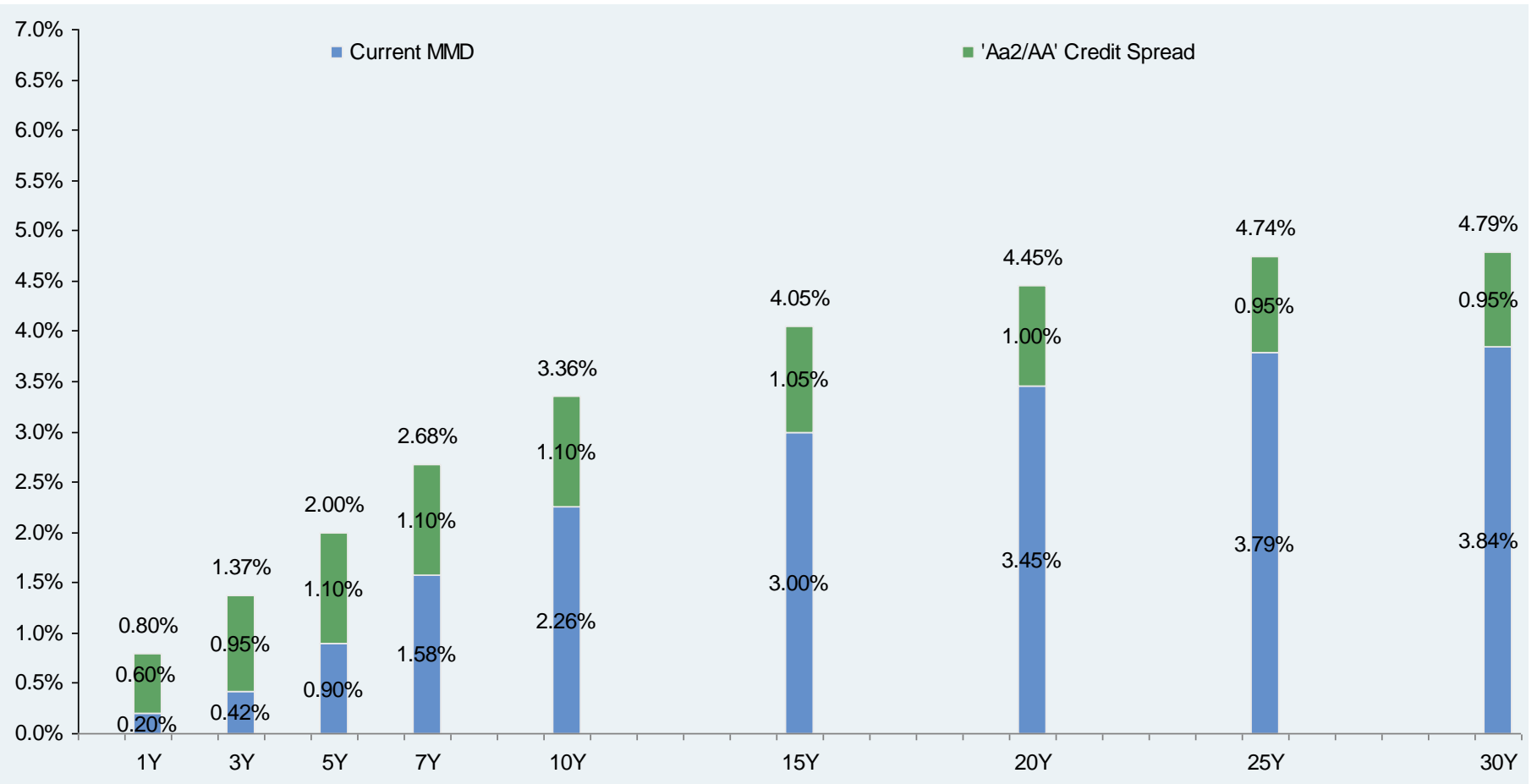
¹ Reflects market conditions as of August 10, 2011. Data from July 1989 to present.

² Municipal Market Data Index (MMD) is a daily index based upon actual trading activity of a series of par bond equivalent yields for bonds of varying maturities.

³ The Securities Industry and Financial Markets Association (SIFMA) Index is calculated by taking the weighted-average of the clearing rates for a pool of high-grade tax-exempt short-term issues with weekly resets. The SIFMA Index is a widely used proxy for high-grade weekly bonds.

Current indicative 'Aa2/AA' fixed rate yields

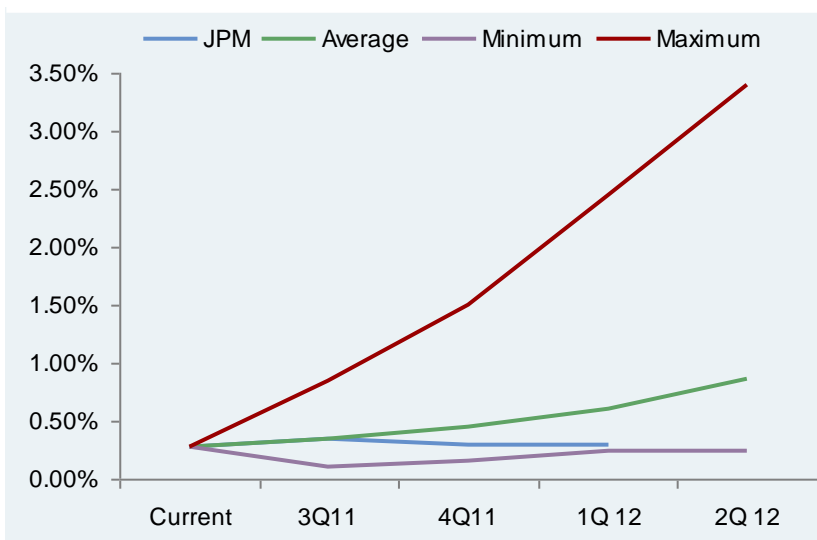
Indicative Current Fixed Yields (%)



Assumptions: Pricing as of August 10, 2011. Preliminary pricing subject to market conditions. Credit spreads for fixed rate bonds are based on current ratings for a Aa2/AA issuance.

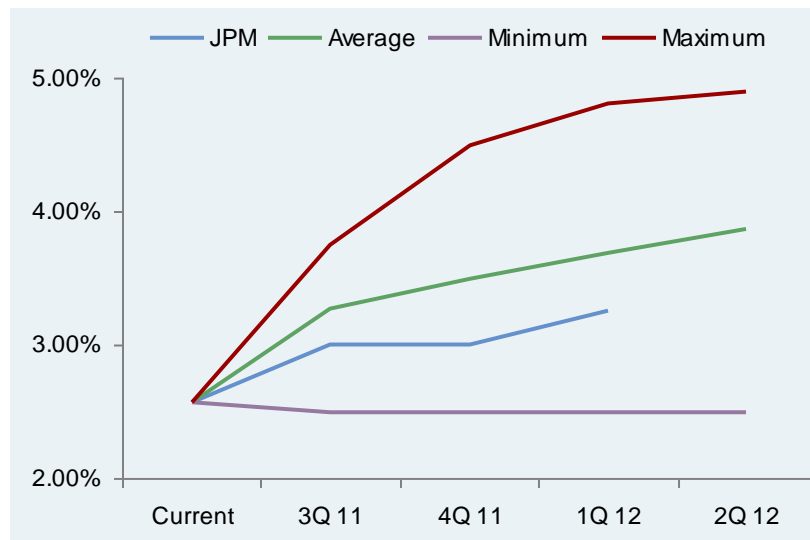
Interest rates are generally expected to increase in 2011

The Street's 3-Month LIBOR Forecast



Source: Bloomberg. Includes the forecasts of 34 institutions, August 5, 2011

The Street's 10-Year Treasury Forecast



Source: Bloomberg. Includes the forecasts of 60 – 70 institutions, August 5, 2011

JPM Interest Rate Forecast (%)

	8/5/11	9/30/11	12/31/11	3/31/12
	Current	3Q 11 Forecast	4Q 11 Forecast	1Q 12 Forecast
Security				
Federal Funds	0.14	0.12	0.12	0.12
3-Month LIBOR	0.27	0.35	0.30	0.30
3-Month T-bill	0.01	0.15	0.15	0.15
2-Year T-note	0.29	0.45	0.45	0.60
5-Year T-note	1.25	1.60	1.60	1.85
10-Year T-note	2.55	3.00	3.00	3.25
30-Year Bond	3.82	4.25	4.25	4.40

Source: J.P. Morgan

Economic Calendar for the Week of August 8th

	Monday	Tuesday	Wednesday	Thursday	Friday
Week of Aug 8th through Aug 12th		7:30: NFIB Survey 8:30 Productivity and Costs	10:00: Wholesale Trade & JOLTS 2:00: Federal Budget	8:30: Initial Claims & International Trade	8:30: Retail Sales 9:55: Consumer Sentiment 10:00: Business Inventories

J.P. Morgan Economic Forecast

Economic forecast

%ch q/q, saar, unless otherwise noted

	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	2010*	2011*	2012*
Gross Domestic Product									
Real GDP	1.3	1.5	2.5	1.5	2.5	3.0	3.1	1.4	2.6
Final Sales	1.1	1.8	2.7	1.6	2.5	3.1	2.4	1.4	2.6
Domestic Final Sales	0.5	1.7	2.5	1.7	2.4	3.2	2.9	1.2	2.7
Business Investment	6.3	4.6	7.4	9.4	8.5	8.5	11.1	5.1	8.7
Net Trade (% contribution to GDP)	0.6	0.2	0.2	-0.1	0.0	-0.1	-0.5	0.2	0.0
Inventories (% contribution to GDP)	0.2	-0.3	-0.2	-0.1	0.0	-0.1	0.7	0.0	0.0
Prices and Labor Cost									
Consumer Price Index	4.1	1.6	1.3	1.3	1.4	1.4	1.2	3.0	1.4
Core	2.5	1.6	0.9	0.9	1.1	1.1	0.6	1.7	1.1
Producer Price Index	7.7	1.0	1.3	1.3	1.5	1.5	3.8	5.5	1.4
Core	3.1	1.8	1.2	1.2	1.2	1.2	1.4	2.5	1.2
Employment Cost Index	2.8	2.5	2.2	2.0	2.0	2.0	2.0	2.5	2.0
Unemployment Rate (% , sa)	9.1	9.2	9.1	9.1	9.0	8.9	-	-	-

* Q4/Q4 change