

## Industry Review & Analysis

Don't kill the messenger, but the outlook for 2009 isn't shaping up to be all that bright. Fund managers would also be well advised to take note as two important engines of AUM growth look to be sputtering.

Better times ahead for 2009? Maybe not

Good riddance! That, Z-Ben Advisors suspects, would best sum up the mood among Chinese fund managers as the industry works its way through the last remaining weeks of 2008. Bring on the New Year and with it better times. And if not that, then at least times which aren't as awful. Some glimmer of hope, if you will.

We very much would like to subscribe to just such a position. Still, and no matter how bright the longer term outlook for financial services in China may be, 2009 could quite possibly be yet another challenging year for the growing ranks of fund managers. And lest we forget, assets under management (AUM) will begin the year at far lower levels, meaning profitability is in for a close shave next year. Try as we might, when crunching the numbers for the coming year, Z-Ben Advisors found itself running around in circles.

Rmb3.27tr. The start of 2009, on the other hand, looks to have AUM somewhere in the neighborhood of Rmb1.65tr.

Truth be told, when Z-Ben Advisors finished guestimating where industry AUM would close 2009, we ended with a rather wide range between our best and worst case scenarios; AUM between Rmb1.7tr and Rmb0.9tr. Take your pick. Furthermore, and no matter how we sliced and diced the data, we kept arriving at the same conclusion: fund managers are facing a Catch 22 when it comes to industry AUM growth in 2009.

If the equities market remains under pressure, then AUM will decline, although with the likelihood of limited retail redemptions. Alternatively, and with the CSI 300 Index now looking to have perhaps found a floor, there could very well be a marked rebound in share prices, lifting

### Industry Assets Under Management (RMB Billions)

	Current <sup>1</sup>	Share	3Q08	Share	2Q08	Share	1Q08	Share
Total Industry Assets	1,689.6	100.0%	1,843.3	100.0%	2,086.7	100.0%	2,612.7	100.0%
Quarterly $\Delta$	-8.3%		-11.7%		-20.1%		-20.2%	
Total Domestic	946.2	56.0%	1,052.9	57.1%	1,190.4	57.0%	1,553.1	59.4%
Total Joint Venture	473.8	28.0%	508.5	27.6%	575.3	27.6%	678.2	26.0%
Total Foreign Invested	269.7	16.0%	281.9	15.3%	321.0	15.4%	381.4	14.6%

Best case scenario for AUM at end-09 is flat; Rmb1.7tn

SOURCE: Z-BEN ADVISORS, CURRENT AUM IS AN ESTIMATE AS OF NOVEMBER 30, 2008

### AUM Ceiling

Rightly or wrongly, the end of every year brings with it a plethora of "expert" predictions including those from Z-Ben Advisors. That being said, it was our intention to focus on those areas in which we have a higher degree of certainty in being correct, not projections for projection's sake. Interestingly enough, the exercise ended up being more than a little cathartic with our normal optimism losing some of its shine.

To the point, fund managers will need to contend with greater competition, a possible (if not severe) spike in retail redemption rates, distribution bottlenecks and, ultimately, enormous pressure on the bottom line. Pretty much the same environment as that in 2008. The difference, however, is AUM. This year, fund managers started with industry AUM at a respectable

asset values in the process. If such a scenario does transpire, however, it would probably lead to a rise in retail redemptions as investors find themselves in a position to sell out and recoup their previously unrealized losses. Z-Ben Advisors is now in the process of assessing whether or not a pick up in redemptions may now be upon us with a detailed *Flash Report* on the topic to be issued in a week's time.

Much like this time last year, fund managers would be well advised to plan for just such an eventuality. At the same time, their strategic plans may also need to take into account recent events, including two engines of asset growth for 2008 which may now be sputtering. We hate to admit it, but even the above-stated best case AUM projections for end-09 could very well need massaging.

Catch 22: Rising stock prices could be met with higher redemptions

## Industry Review & Analysis

Changes in monetary policy could make bond funds less attractive

### Losing Momentum

On top of the anticipated challenges facing all fund managers in 2009 AUM growth could find itself with even less support if demand for fixed income product alternatives were to evaporate. And the likelihood of such a scenario is now present given the recent, if not dramatic, reversal in monetary policy.

To a great extent, we are commenting on the indirect market fallout coming from a sudden shift in China's macroeconomic policies. Much like all developed and emerging markets, action is now being taken to stave off real economic impact resulting from the global credit crises. In China, that effort has centered on a reversal of a previously tight monetary policy, including cuts in interest rates. No doubt an appropriate course of action. The outcome of such moves, however, is a reduced attractiveness for all fixed income product substitutes, especially bond funds. Gains have been made for those investors fortunate enough to buy in earlier this year. However, there may simply be little time

Money market funds are having to compete with (non-taxed) bank savings

remaining for fund managers to coax in fresh demand.

Money market funds could also come under greater pressure, with managers not only challenged to raise assets but also encountering higher rates of redemptions. The reason for this again comes from recent changes in policy: specifically, the decision to remove the previous 20% tax on bank savings account. Historically this has been a key support for money market fund demand. In the current environment, the risk of investing in a money market fund may very well not be fully compensated if bank savings pay comparable yield.

Z-Ben Advisors will be the first to admit that no one should bet against China. In fact, that has been an ongoing theme for us over the years. A rally in the equities market and a firming of investor sentiment could arrive at any moment, albeit for reasons that escape us at the moment. A welcome reprieve no doubt but, in the meantime, it might still be best to batten down the hatches.

## Analytical Quick Hits

### Bond Funds Explosion

During this year, 28 new bond funds were launched and 6 are under subscription. That's more than the total number of bond funds launched in the previous seven years. Bonds have outperformed than stocks, but the main reason for the explosion may be CSRC's decision to provide an 'express lane' for new bond funds approval since the end of last year.

### Notification on Bond Investment Risk

CSRC distributed a notification on bond investment risk to all fund management firms and custodian banks. Considering the explosion in the number of newly issued bond funds this year, CSRC asked firms to pay more attention to the risks of the underlying fixed-income securities. The notice was also intended to prevent improper behavior by managers.

### QFII Licenses Reached 71

CSRC granted QFII approval to two foreign financial institutions in October. They are So-

ciete Generale Asset Management SA and Credit Suisse. The number of total licenses reached 71, of which 19 were approved during this year.

### NCSSF's Targeting Equities

NCSSF disclosed that there would be RMB150bn available for direct equity and PE funds investment. The maximum amount of direct equity investment is 20% of total NCSSF assets and 10% for PE funds. Currently, NCSSF has invested no more than RMB10bn in PE funds.

### New Index Funds Approved

CSRC recently approved two new index funds. One is Full Goal Tianding CSI Dividend Index Fund which is converted from a closed-end fund, Full Goal Handing Fund. The other is Guangfa CSI 300 Index Fund. These two new funds will increase the number of index funds to 19. Before these two, the last index fund approved was in November 2007: the Guotai CSI 300 Index Fund.

## Analytical Quick Hits

### The Smallest New Equity Fund

A new fund, Lord Abbett China Thematic Balanced Fund raised only RMB239m, which is a historical low for new equity fund raising. The number of total accounts is also at a record low, with only 865 accounts. With a fluctuating equity market, it's more difficult for small companies to raise fund.

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### Zhonghai Became 33<sup>rd</sup> JV Fund Firm

Edmond de Rothschild Banque won a 15.385% stake in Zhonghai Fund Management at a price of RMB150m. The stake was sold by Yunnan Tobacco Xingyun Investment. The other stakes, held by Zhonghai Trust & Investment and Guolian Securities, remain unchanged. After the deal, Zhonghai became the 33<sup>rd</sup> JV fund firm.

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### Enterprise Annuities Keeps Growing

Although the market has slumped by 70%, the enterprise annuity scheme kept growing during 2008. According to statistics from Ministry of Human Resources and Social Securities, current enterprise annuity total investment amounts to RMB44.7bn with 326 portfolios.

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### Insurance Funds Investing Elsewhere

China's State Council has approved insurance companies to invest in non-listed companies. This helps Chinese insurers widen their investment opportunity set while the stock market is volatile. CIRC will provide guidance on their investment directions. Large domestic insurers will be involved in the trial program.

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### Winter for Bank QDII Products

It's reported that CBRC suggested that commercial banks temporarily stop launching non-guaranteed QDII products to avoid offshore risks for investors. Some domestic banks stopped launching months ago. After more than one month's froze, ABN Amro launched a guaranteed QDII product later in November.

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### Banks May Set up PE Funds

Agricultural Bank of China has been approved to set up an agricultural industrial fund. This indicates that regulators may allow commercial banks to set up PE funds in the future. Currently, securities firms and NCSSF are allowed to set up PE funds.

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### Dacheng Pressed Distribution

Current fund distributors, such as banks and brokers, may face challenges. Mr. Wang Hao, General Manager at Dacheng disclosed that the company has submitted an application to CSRC to increase channels for fund distribution. Mr. Wang emphasized the potential advantages of insurance companies as fund distributors. Although PICC's hand can be seen in the application, insurers could offer a strong alternative to badly-clogged traditional channels.

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### Dacheng' GM Mr. Yu Hua Left

Dacheng Fund Management announced that its General Manager, Mr. Yu Hua, has resigned. Mr. Wang Hao, former Deputy GM, took Mr. Yu's place. It's reported that Mr. Yu has gone to Morgan Stanley Huaxin as their proposed GM. Meanwhile, Morgan Stanley Huaxin's GM, Mr. Xu Ming, has resigned.

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### Full Goal's PM Left for Youngor

Mr. Li Wenzhong, Portfolio Manager of Full Goal Hansheng Fund, has resigned. Unlike other PMs leaving for PE funds, Mr. Li was reported be going to the investment company under Youngor Group. This shows that besides PE funds, industrial capital is also looking for talented managers in the fund industry.

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### State-owned AMC's Reformation

Two state-owned asset management companies, Huarong and Cinda, may receive capital injection from ICBC and China Construction Bank, respectively. It means that these AMCs may start commercializing. The future of Orient and Great Wall Asset Management is unknown. The establishment of the four AMCs aimed to take over and clear up bad loans from the state-owned banks.

## INDUSTRY AUM & MARKET SHARE

NOVEMBER 30, 2008: ESTIMATE

### DOMESTIC FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
Baoying	8.49	0.50%	39
Bosera	113.32	6.71%	2
Changxin	17.36	1.03%	32
China AMC	174.41	10.32%	1
China Nature	5.29	0.31%	48
China Post & Capital	24.66	1.46%	26
China Universal	40.68	2.41%	12
CITIC	7.80	0.46%	41
Dacheng	62.63	3.71%	7
E-Fund	89.15	5.28%	5
First Trust	12.37	0.73%	37
Galaxy	15.25	0.90%	34
Golden Eagle	1.42	0.08%	58
Great Wall	27.51	1.63%	22
Guangfa	63.17	3.74%	6
Guotai	24.83	1.47%	25
Hua'an	60.83	3.60%	8
Huafu	3.98	0.24%	53
Huashang	4.90	0.29%	50
Lion	31.47	1.86%	21
New Century	1.05	0.06%	59
Orient	5.64	0.33%	46
Soochow	7.15	0.42%	42
Southern	90.87	5.38%	4
Tianhong	3.50	0.21%	54
Wanjia	8.10	0.48%	40
Yimin	5.79	0.34%	45
Yinhua	34.58	2.05%	20
<b>TOTAL</b>	<b>946.2</b>	<b>56.00%</b>	

### JV FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
ABC-CA	6.4	0.38%	44
ABN Amro TEDA <sup>4</sup>	17.7	1.05%	31
AIG-Huatai	13.5	0.80%	35
AXA-SPD Bank	0.9	0.05%	60
Bank of Communications Schroders	39.8	2.35%	14
BOC <sup>1</sup>	20.5	1.22%	29
CCB Principal	27.0	1.60%	23
China International <sup>1</sup>	51.6	3.06%	9
China Merchants <sup>1</sup>	36.6	2.17%	16
CITIC-Prudential	6.8	0.40%	43
Everbright Pramerica	22.7	1.34%	27
First State Cinda	5.5	0.33%	47
Fortis Haitong	35.7	2.11%	18
Fortune SGAM	40.5	2.40%	13
Franklin Templeton Sealand	13.4	0.79%	36
GTJA Allianz	5.3	0.31%	49
HSBC Jintrust	4.7	0.28%	52
ICBC Credit Suisse	44.3	2.62%	10
INVESCO Great Wall	40.9	2.42%	11
KBC-Goldstate	4.8	0.28%	51
Lombarda China	2.1	0.12%	56
Lord Abbett China	3.3	0.20%	55
Morgan Stanley Huaxin <sup>3</sup>	1.7	0.10%	57
SYWG BNP Paribas	8.6	0.51%	38
UBS SDIC	19.4	1.15%	30
<b>TOTAL</b>	<b>473.8</b>	<b>28.04%</b>	

### FOREIGN INVESTED MANAGERS <sup>2</sup>

	AUM		
	RMB Bill	Share	RANK
AEGON-Industrial	25.2	1.49%	24
Changsheng	20.8	1.23%	28
Full Goal	36.6	2.17%	17
Harvest	98.7	5.84%	3
Penghua	37.5	2.22%	15
Rongtong	35.2	2.08%	19
Zhonghai	15.7	0.93%	33
<b>TOTAL</b>	<b>269.7</b>	<b>15.96%</b>	

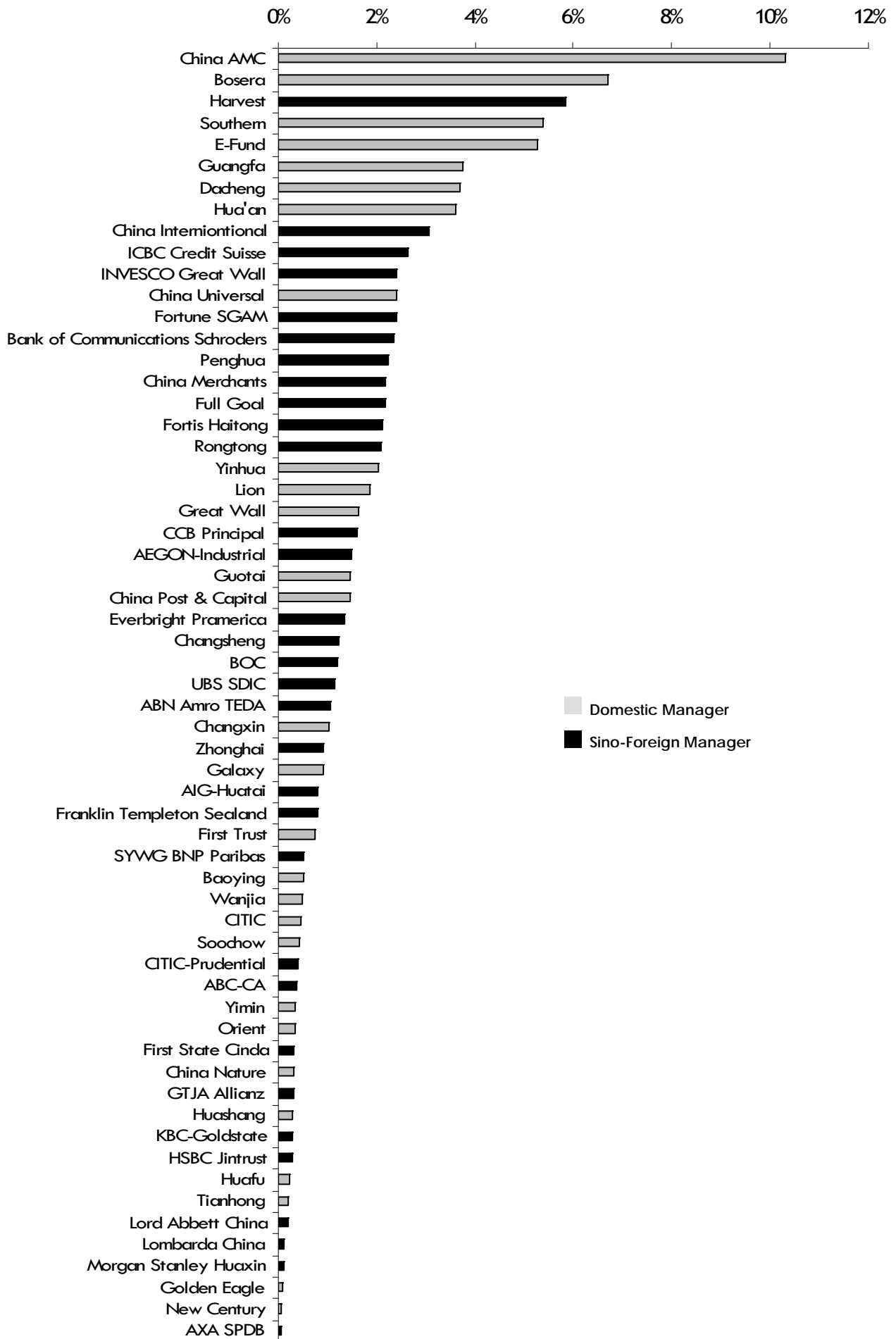
SOURCE: Company Data, Z-BEN ADVISORS

<sup>1</sup> - ING INVESTMENT MANAGEMENT OWNS A 33.3% EQUITY INTEREST IN CHINA MERCHANTS; JP MORGAN FLEMING ASSET MANAGEMENT OWNS A 49% EQUITY INTEREST IN CHINA INTERNATIONAL; MERRILL LYNCH OWNS A 16.5% EQUITY INTEREST IN BOC; COLONIAL FIRST STATE GROUP OWNS 46% IN FIRST STATE CINDA.

<sup>2</sup> - BANK OF MONTREAL BOUGHT AN EQUITY INTEREST IN FULL GOAL THAT CURRENTLY STANDS AT 27.775%; DEUTSCHE ASSET MANAGEMENT PURCHASED 30.0% EQUITY INTEREST IN HARVEST. DBS ASSET MANAGEMENT ACQUIRED A 33% STAKE IN CHANGSHENG WITH NIKKO ASSET MANAGEMENT BUYING A 40% POSITION IN RONGTONG. EURIZON FINANCIAL GROUP OWNS A 49% STAKE IN PENGHUA.

<sup>3</sup> - FORMERLY JUTIAN FUND MANAGEMENT

<sup>4</sup> - FORTIS GROUP HAS AGREED TO SELL ITS POSITION IN ABN AMRO TEDA TO UK-BASED OLD MUTUAL ASSET MANAGEMENT. THE DEAL HAS YET TO BE APPROVED BY THE CHINESE SECURITIES REGULATORY COMMISSION.



INDUSTRY MARKET SHARE: NOV 30, 2008

SOURCE: Z-BEN ADVISORS