

Industry Review & Analysis

It has been a tough start to the New Year. But don't despair. Even though the prospects may look bleak, there are several variables which could reignite both an equities market rally and demand for mutual funds.

2008 has had a very rocky start

The full year results reported by Chinese fund managers shows 2007 was without question a phenomenal year. Industry assets under management (AUM) grew by just over 280 percent, finishing at greater than Rmb3.2trillion. Taking a closer look at the figures, though, we find that nearly all of the growth occurred during the first nine months of the year. Growth registered in only the single digits during the October to December period.

AUM growth remains under pressure

This deceleration in growth - as evident in the table provided below - was expected. There was the decision by the CSRC to step in and place tighter restrictions on new fund inflows and an appropriate move to protect the industry's longer term prospects. Growth was then subsequently impacted by a flood of initial public offerings and which ended up pushing equity prices well off of their October highs.

a turnaround in the A-share market in the weeks and months ahead.

Earnings Season

Of all the factors which could reignite both a rally in the equities market and demand for funds, the most potent would be greater than anticipated growth in reported full year earnings. The stage has already been set for a number of listed companies to surprise on the upside.

Earnings season has begun with more than a few companies reporting solid results. More critical to the discussion, though, are those companies which were required by law to pre-announce results if full year earnings growth was greater than 50 percent.

Do take note that the issued public report only requires management to disclose that profit for the

Industry Assets Under Management (Rmb Billions)

	4Q07	Share	3Q07	Share	2Q07	Share	1Q07	Share
Total Industry Assets	3,272.2	100.0%	3,111.0	100.0%	1,799.1	100.0%	1,141.4	100.0%
Quarterly	5.2%		72.9%		57.6%		33.2%	
Total Domestic	1,951.3	59.6%	1,840.1	59.1%	1,078.0	59.9%	704.3	61.7%
Total Joint Venture	838.5	25.6%	834.4	26.8%	496.4	27.6%	314.0	27.5%
Total Foreign Invested	482.4	14.7%	436.6	14.0%	224.7	12.5%	123.1	10.8%

SOURCE: Z-BEN ADVISORS

Investors are not (yet) redeeming shares

On a positive note, and even though the equities market has remained quite weak so far this year, there hasn't been any evidence of a material sell-off of funds by retail investors. If weakness does persist then the risk of redemption pressure will rise in tandem. For Z-Ben Advisors, the risk itself is marginal. There is even a strong possibility of a pick up in new inflows if share prices have finally bottomed out and begin to move higher.

Several factors could support a new rally in the equities market

Z-Ben Advisors remains positive in its outlook for the remainder of the year and is projecting better times ahead for fund managers (albeit nowhere near as bountiful as the past year). Conditions certainly do look bleak at the moment. What should not be discounted though are several factors - reviewed below - and which are expected to support

year was higher than 50 percent as compared to the previous year. What is not required is exactly how much higher earnings will be. While not in all cases, Z-Ben Advisors is expecting many of the companies pre-announcing results to formally disclose earnings which grew by a far wider margin.

Currently, investors seem to be discounting last year's earnings and are today focused on working out and projecting corporate profits for 2008. Even still, it is likely that share prices for many listed companies do not adequately reflect last year's substantial earnings growth.

Market Stimulus

The earnings story represents only the foundation support for a possible near term rally in the equities

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market. In addition there are other factors, two in particular, to consider which could end up stimulating end demand.

To start, the CSRC just announced the approval of two new equity oriented products and the first such approvals in nearly six months. It was a long time coming and the market reacted appropriately with share prices rallying slightly more than 8 percent on the day. At the moment it remains unclear if this is a one off event or a sign that the CSRC has loosened its grip over the new product pipeline. But based on where the market is currently trending and backlog of applications Z-Ben Advisors would expect additional approvals in the weeks ahead.

Then there is the all but imminent issuance of new quota under the Qualified Foreign Institutional Investors (QFII) program. Firstly, Z-Ben Advisors has been in error as no new quota (versus our projection of US\$1.0billion) has been issued since the program was formally trebled in size back in December. With each passing day, and again with the equities markets under pressure, the probability of new quota being dolled out increases. Investors would react positively to the news with share prices moving higher on the announcement.

Taking all of the various factors together and it is highly unlikely that the broader A-share market

will decline much farther. It is even far more likely that the combination of these variables will, in the end, push the market higher and even back to record levels. So long as the assessment is correct, then, and by extension, end demand for mutual funds should rise as well.

At Risk

The entire scenario just laid out is not without risk. Share prices have been steadily falling for nearly four full months with no end in sight. A continuation in this slide is possible and there is no certainty of the CSRC approving any additional products in the near term. The same goes for the issuance of QFII quota. Z-Ben Advisors could even be wrong about the expected vitality of reported corporate earnings. And if that weren't enough, it is also possible that current conditions could worsen.

Retail investors have certainly grow weary of the prolonged slump in share prices. Up to this stage there hasn't been any evidence of their collective concern leading to mass redemptions from mutual funds. That could easily change though. Without a clear signal that the market's decline will come to a close in the immediate future means that there is an increased probability that retail investors will finally decide to pull the trigger and sell funds. Patience is wearing extremely thin.

The approval of new equity funds would benefit the market

Share prices will also gain on the issuance of QFII quota

Risks are evident. Equity prices could just as easily fall further

Analytical Quick Hits

Limited Redemption Pressure

There was a great deal of concern over the past month that weakness in the equities market would lead investors to liquidate mutual fund shares. Such was not, however, the case as Z-Ben Advisors research finds that redemption pressure remains limited. The risk itself does still remain.

QDII Performance Falters

Expectations were high, but a Hong Kong equities bias and deteriorating conditions globally led each of the four QDII mutual funds to report weak results. The upside; investors have yet to redeem shares. That could change once the NAV moves back above Rmb1.00

Deutsche Goes to 30%

At the end of the month it was announced that Deutsche Asset Management had agreed to increase its stake in Harvest to 30 percent. The pricing point per share was not disclosed, but based upon Z-Ben Advisors' research it probably came in at or above record levels based upon recent comparables.

Demand for QDII Funds Evaporates

It didn't come as too great a surprise to find demand for the latest QDII mutual fund - ICBC Credit Suisse China Global Opportunity Fund nonexistent. At a projected Rmb4.0 billion means additional pressure for those products next in the queue from Fortune SGAM and Fortis Haitong

Analytical Quick Hits

QDII Fund from a Securities House

The first offshore product developed by a securities firm - China International Capital Corp - was launched in the middle of last month. The results will be closely watched, but considering its focus on Hong Kong equities along with temped interest at this stage, demand is expected to be muted.

Consolidation at BOC International

While not formally approved, the fund manager announced that Bank of China would be acquiring the 83.5 percent stake in the firm from its two wholly-owned subsidiaries. It was a move widely expected by the market and could provide the fledging fund manager a much needed boost.

Bond Funds all the Rage

There is now a clear bias among both fund managers and the CSRC to promote lower risk inherent mutual funds. The drive into bond funds is also providing fund managers an opportunity not only to grow assets, but in many cases better diversify their portfolio of products.

Expanding Distribution

Not entirely confirmed, but there is a growing consensus that the CSRC is revisiting the concept of approving third party, independent distributors. Based upon how dominant commercial banks are in accessing the end client, any expansion in the architecture will be well received by all fund managers.

Changing the Fund Law?

While there has not been any confirmation, it is looking as though the current Fund Law will be formally amended at some point later this year. Areas such as an expansion in permissible asset classes and issuing equity to employees are just two of the pressing issues expected to be included in the new law

Insurance Assets to Rmb3.0trillion

It was reported last month that China's insurance industry finished 2007 with assets totaling just over Rmb3.0trillion. The bulk of these assets - upwards of half - are still held by the largest two firms; China Life and Ping'an.

Share Splits Still Top for Fund Raising

Even though the pipeline for new product approvals may soon be reopened, fund managers are once again splitting shares followed by a secondary marketing campaign. End demand, and even for many of the larger fund managers, has moderated.

Musical Chairs Among Managers

The year began much as it ended; rising numbers of senior managers leaving one firm for a competitor. The trend is not expected to abate anytime soon with the all fund managers needing to develop plans which can attract and retain talent.

NSCCF Assets Surpass Rmb1.0trillion

Last year's launch of China Investment Corp, ended up pushing the National Council for Social Security Fund (NCSSF) into the background. The massive institutional investors should not be ignored though and especially with a portfolio which now exceeds Rmb1.0 trillion.

INDUSTRY AUM & MARKET SHARE

DECEMBER 28, 2007: ACTUAL

DOMESTIC FUND MANAGERS

	AUM		2007	2006
	RMB Bill	Share	RANK	RANK
Baoying	20.7	0.63%	38	35
Bosera	221.6	6.77%	2	5
Changxin	34.3	1.05%	30	34
China AMC	248.0	7.58%	1	3
China Nature	8.5	0.26%	51	50
China Post & Capital	76.9	2.35%	15	41
China Universal	76.7	2.34%	16	26
CITIC	17.6	0.54%	40	32
Dacheng	139.9	4.27%	6	7
E-Fund	172.2	5.26%	5	4
First Trust	21.5	0.66%	37	37
Galaxy	19.6	0.60%	39	27
Golden Eagle	2.3	0.07%	57	52
Great Wall	72.3	2.21%	18	23
Guangfa	137.7	4.21%	7	6
Guotai	63.4	1.94%	20	18
Hua'an	108.7	3.32%	8	12
Huafu	7.5	0.23%	52	47
Huashang	11.7	0.36%	45	na
Industrial	37.9	1.16%	28	29
Jutian	4.1	0.13%	56	49
Lion	75.9	2.32%	17	22
New Century	0.8	0.03%	58	53
Oriental	13.1	0.40%	44	48
Soochow	9.3	0.28%	50	40
Southern	193.0	5.90%	4	2
Tianhong	6.0	0.18%	53	51
Wanjia	14.0	0.43%	42	42
Yimin	13.2	0.40%	43	45
Yinhua	92.3	2.82%	11	8
Zhonghai	30.5	0.93%	32	46
TOTAL	1,951.3	59.63%		

SOURCE: Company Data, Z-BEN ADVISORS

JV FUND MANAGERS

	AUM		2007	2006
	RMB Bill	Share	RANK	RANK
ABN Amro Teda	35.7	1.09%	29	15
AIG-Huatai	29.6	0.91%	33	38
AXA-SPD Bank ³	-	-	na	na
Bank of Communications-Schroders	55.4	1.69%	23	14
BOC International ¹	25.0	0.76%	35	31
CCB-Principal	31.7	0.97%	31	24
China International ¹	92.3	2.82%	10	11
China Merchants ¹	54.6	1.67%	24	25
CITIC-Prudential	9.7	0.30%	48	33
Everbright Pramerica	57.3	1.75%	22	43
First State Cinda	17.0	0.52%	41	na
Fortis Haitong	51.8	1.58%	25	20
Fortune SGAM	84.8	2.59%	13	16
Franklin Templeton Sealand	26.5	0.81%	34	39
GTJA Allianz	11.7	0.36%	46	44
HSBC-Jitrust	9.7	0.30%	49	36
ICBC Credit-Suisse	58.3	1.78%	21	10
INVESCO Great Wall	107.0	3.27%	9	9
KBC Goldstate	4.8	0.15%	55	na
Lombarda China	5.9	0.18%	54	na
Lord Abbett China	9.9	0.30%	47	na
SYWG BNP Paribas	21.6	0.66%	36	30
UBS-SDIC	38.2	1.17%	27	28
TOTAL	838.5	26.64%		

FOREIGN INVESTED MANAGERS ²

	AUM		2007	2006
	RMB Bill	Share	RANK	RANK
Changsheng	45.9	1.40%	26	17
Full Goal	64.1	1.96%	19	13
Harvest	207.0	6.33%	3	1
Penghua	78.5	2.40%	14	19
Rongtong	87.0	2.66%	12	21
TOTAL	482.4	14.74%		

1 - 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 INTERNATIONAL.

2 - BANK OF MONTREAL BOUGHT AN EQUITY INTEREST IN FULL GOAL THAT CURRENTLY STANDS AT 27.775%; DEUTSCHE ASSET MANAGEMENT PURCHASED 19.5% 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

3 - MANAGERS HAVING AN OPERATIONAL LICENSE BUT HAVE NOT YET ISSUED A MAIDEN PRODUCT.

INDUSTRY MARKET SHARE: December 28, 2007



SOURCE: Z-BEN ADVISORS