

Industry Review & Analysis

Market sentiment is turning increasingly negative, but action is being taken. A number of new mutual funds have been approved and which should end up putting into place a hard floor for share prices.

There remains a delicate balance between supply and demand

China's market economy may be on its way to becoming a well-oiled machine but, this month, investors heard loud squeaks as the demand pump was primed. A flood of new fund launches were approved, including the first equity mutual funds in nearly a half year. On the supply side, other squeaks were heard from capital-hungry companies being herded into line by the various government authorities, which reminded listed firms that they should be wary of depressing markets with "imprudent" secondary issues.

In total, 20 new funds have been approved since the start of the year – arguably enough to stimulate demand for domestic stocks, in Z-Ben Advisors' opinion, so long as fund managers are able to find enough investors. That's not the certainty it was last year when heavily oversubscribed openings were the rule. Sentiment remains weak and which is expected to pressure fund managers in the near term as they compete for investors' attention.

Look for new QFII quota to be issued if share prices continue to slide

what about moving more of that growing foreign currency surplus out of the national reserve accounts? More than a dozen applications are understood to be in the queue for new Qualified Domestic Institutional Investment (QDII) products but demand on that scale may not yet exist: the latest products to hit markets, from fund manager **ICBC Credit Suisse** and rival securities house **China International Capital Corporation**, ended their fund raising activities with subscriptions totaling Rmb3.1billion and Rmb 0.4billion respectively and well below the issued quota

No fund provider has so far managed the feat of designing a QDII product that is both popular and easily differentiable from the mass. Instead, investors continue to be offered yet more semi-aggressive, home-biased funds. Given investors' widespread belief that QDII funds are effectively starting in a 5-10% hole, depending on one's view of the RMB/USD fu-

Industry Assets Under Management (RMB Billions)

Demand for QDII has all but evaporated

	Current ¹	Share	4Q07	Share	3Q07	Share	2Q07	Share
Total Industry Assets	2,777.0	100.0%	3,272.2	100.0%	3,111.0	100.0%	1,799.1	100.0%
Quarterly Δ	-15.1%		5.2%		72.9%		57.6%	
Total Domestic	1,649.3	59.4%	1,951.3	59.6%	1,840.1	59.1%	1,078.0	59.9%
Total Joint Venture	715.5	25.8%	838.5	25.6%	834.4	26.8%	496.4	27.6%
Total Foreign Invested	412.2	14.8%	482.4	14.7%	436.6	14.0%	224.7	12.5%

SOURCE: Z-BEN ADVISORS, CURRENT AUM IS AN ESTIMATE AS OF FEBRUARY 29, 2008

However, throw enough billions at a problem – in this case, drooping equity indices – and it's likely to disappear. And, if USD5-10bn of domestic money (the likely total cap for the eight new funds combined, once prospectuses are finalized) isn't enough to do the job, regulators can – and, in our view, are expected to – turn to the participants in the Qualified Foreign Institutional Investors (QFII) program, whose allocation needs for more China domestic equities haven't come close to being met. If the domestic demand tap is slow to spurt, foreign demand remains a veritable firehose.

So much for domestic demand engineering;

we can understand why they're underwhelmed. How much investor indifference will fund managers tolerate before one attempts something as (relatively) novel as a sector fund, a one-region fund or a style fund?

Moving on, and one of the drags on product innovation may be the number of respected, proven fund managers leaving the mainstream industry. An ever-greater number of domestic fund managers and JVs are losing talent to the newly-created "private advisory" industry. Again this month, we have seen a steady trickle of well-known names resigning to manage performance fee-earning vehicles for trusts, private

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CIC is aggressively working through the RFP process

equity funds and the like. Z-Ben Advisors believes the revolving door has only begun to spin: hedge funds' ability to pay managers for performance essentially decimated the ranks of traditional Western fund managers. While a broad swathe of alt-asset management opportunities are still inapplicable to China, more than enough exists for hotter long-only products to tempt dozens more managers into performance fee vehicles.

For a sharp contrast to fund managers' challenge to be creative, we might examine the long-ailing trust sector, which surprised many observers recently by sitting up in its sickbed and asking for soup. Last month we noted the unusual spurt of creatively-designed products being housed in trusts: highly aggressive asset allocation funds, branded by banks and managed (with performance fees) by either fund houses or private investment managers. That trend has continued in March. Clearly some domestic investors are both ready and willing to back a nov-

elty, especially one managed by proven talent.

Least we forget, China's sovereign wealth funds are embracing novelty with both warmth and a ready checkbook. By our reckoning, billions of dollars worth of externally-managed mandates will be awarded by China Investment Corporation (CIC) in the months ahead although probably not to the tune of USD30bn reported by a breathless press – not yet, at least. CIC will award core mandates such as global equity and Asia-Pacific sometime later this spring. Fixed income mandates will be hot on their heels – with foreign asset managers in the process of completing the RFP followed soon thereafter (and again, in our judgment), by alt-asset classes.

China's SWFs are moving fast to construct modern, well-diversified portfolios for the long run. China's domestic investors would do well to emulate them and we would hope domestic fund managers would be provided with the opportunity to follow in their lead.

Analytical Quick Hits

New Segregated Accounts

Fourteen fund managers were approved last month to begin developing segregated account services. The first batch of fund managers included Harvest, E-Fund, China Universal, ICBC Credit Suisse, Penghua, Guotai, Lion, Southern, and Zhonghai. The second batch, although not yet formally confirmed, included Bank of Communications Schroders, China AMC, CCB Principal, Hua'an, Changsheng, Boser, Yinhu, and Guangfa.

Large Caps' Refinancing

Ping'an Insurance Group and Pudong Development Bank announced plans last month for massive secondary offerings with current estimates targeting Rmb150billion to be raised. The refinancing plans ended up sparking market concern over the injection of too much liquidity with share prices falling on the news.

CSRC Takes Off The Brake

A total of 20 new funds were approved last month in an attempt to buttress the slide in share prices. Among the new funds, there were 8 bond

funds and 10 equity funds along with two innovated closed end products. The approvals were also heavily biased towards the industry's smaller fund managers. How much demand actually exists, however, remains to be seen.

CIC's Plan for Japan

CIC may make a third major offshore investment, this time into the Japanese market with some reports suggesting up to a sixth of its assets allocated into the market. That seems a bit of a stretch, but CIC may invest in Tokyo-listed stocks and buy a 'sizable stake' in one of the country's largest oil and gas companies, Inpex. The Fund is reportedly targeting investment yields of more than 6% a year.

QDII Investment Changes, again!

Plans to allow QDII products to invest in the A share market may be delayed. After "interrupting" the rules at the end of 2007, the CSRC commented last month that no such allowance would be made in the near term. A policy change wasn't, however, ruled out and could be implemented at a later date.

Analytical Quick Hits

QDII remains under pressure

Tough Climate for New QDII Funds

Investors are showing little interest in new QDII funds although perhaps not too surprising given the poor performance of the first four QDII funds. ICBC Credit Suisse has raised only RMB3.15bn for its new QDII fund: only 15 percent of its RMB22bn QDII quota. CICC's new fund raised only RMB370 million, far less than their expectation. The results could very well be behind the delay at both Fortis Haitong and Fortune SGAM to issue their own QDII products.

QDII: Chinese Banks Allowed to Invest in Japan

China and Japan signed a cooperation agreement allowing local commercial banks to create wealth management products that invest, indirectly, into the Japanese stock market. Previously, China has signed similar agreements with Hong Kong, the United Kingdom, and Singapore. The scheme is expected to be expanded further and to include Germany and even the United States.

The program continues, however, to be expanded

Institutional Investor Influence Grows

As was reported that month, Mr. Yao Gang, the Vice Chairman of the CSRC, stated that total institutional participation in the domestic equities market reach 50 percent. While not confirmed, the recent rise in participation is believed to have come from last year's massive surge in retail demand for mutual funds.

60th Fund House Approved

The 60th fund management firm was approved to formally commence operations by the CSRC. The JV, a partnership between Agricultural Bank of China, Calyon and Aluminum Corporation of China Limited - with ownership of 51.67%, 33.33%, and 15% respectively - caps a multi-year drive among commercial banks to enter the funds management industry. The timing of the manager's maiden product remains to be seen.

Foreign participation is rising with the approval of a new JV manager

New Domestic Fund House Planned

Sinolink Securities is planning to establish a fund management company with General Tech-

nology Group and Handsome Electricity. Currently, more than 30 fund management firms are controlled by securities companies and last year's massive growth is once again piquing interest among those institutions which have yet to enter the market.

First Fund from AXA SPDB

The AXA SPDB Value & Growth Fund was approved by the CSRC and is now quickly preparing to go to market. This is the first fund from AXA SPDB and was included among the first batch of new open-ended funds approved by the CSRC since the start of the year. It has been a long time coming too as it has been nearly a half year since the firm was formally approved to operate.

Rongtong Stake Successfully Auction

New Times Securities ended up with the winning bid for the auctioned off 40 percent stake in Rongtong. The final pricing point paid, interestingly enough, came in slightly below what the market had anticipated and at an even lower level when compared to several transactions concluded at the end of last year. New Times Securities now owns 60 percent of the fund house with the remaining 40 percent held by Nikko Asset Management.

Management Changes for Segregated Accounts

Demand for skilled investment professionals has been an enormous challenge for all fund managers. It is an issue that isn't going away either as fund managers recently approved to develop a segregated accounts platform will need to fill additional seats. The question now outstanding is whether publicly run funds will suffer in the process as many fund managers are expected to reassign top in-house talent into the new business division.

INDUSTRY AUM & MARKET SHARE

FEBRUARY 29, 2008 - ESTIMATE

DOMESTIC FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
Baoying	18.0	0.65%	38
Bosera	181.0	6.52%	2
Changxin	29.3	1.06%	29
China AMC	212.9	7.67%	1
China Nature	6.9	0.25%	51
China Post & Capital	67.3	2.42%	15
China Universal	62.2	2.24%	16
CITIC	14.8	0.53%	40
Dacheng	117.0	4.21%	6
E-Fund	156.0	5.62%	5
First Trust	18.4	0.66%	36
Galaxy	17.4	0.63%	39
Golden Eagle	1.9	0.07%	57
Great Wall	60.5	2.18%	18
Guangfa	115.4	4.16%	7
Guotai	54.7	1.97%	20
Hua'an	93.1	3.35%	8
Huafu	6.2	0.22%	52
Huashang	9.9	0.36%	46
Industrial	32.2	1.16%	28
Jutian	3.4	0.12%	56
Lion	61.0	2.20%	17
New Century	0.7	0.02%	58
Orient	10.9	0.39%	44
Soochow	8.1	0.29%	49
Southern	162.6	5.86%	4
Tianhong	5.0	0.18%	53
Wanjia	11.3	0.41%	42
Yimin	11.0	0.40%	43
Yinhua	75.0	2.70%	12
Zhonghai	25.2	0.91%	32
TOTAL	1,649.3	59.39%	

SOURCE: Z-BEN ADVISORS

JV FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
ABC-Calyon ³	N/A	N/A	N/A
ABN Amro TEDA	29.2	1.05%	30
AIG-Huatai	24.3	0.88%	33
AXA-SPD Bank ³	N/A	N/A	N/A
Bank of Communications Schroders	44.8	1.61%	25
Bank of China ¹	21.9	0.79%	34
CCB Principal	26.9	0.97%	31
China International ¹	80.5	2.90%	10
China Merchants ¹	45.7	1.64%	23
CITIC-Prudential	8.6	0.31%	47
Everbright Pramerica	46.8	1.69%	22
First State Cinda	12.2	0.44%	41
Fortis Haitong	44.8	1.61%	24
Fortune SGAM	76.4	2.75%	11
Franklin Templeton Sealand	21.9	0.79%	35
GTJA Allianz	10.0	0.36%	45
HSBC Jintrust	7.8	0.28%	50
ICBC Credit Suisse	52.5	1.89%	21
INVESCO Great Wall	87.1	3.14%	9
KBC-Goldstate	4.1	0.15%	55
Lombarda China	4.7	0.17%	54
Lord Abbett China	8.3	0.30%	48
SYWG BNP Paribas	18.1	0.65%	37
UBS-SDIC	38.9	1.40%	26
TOTAL	715.5	25.77%	

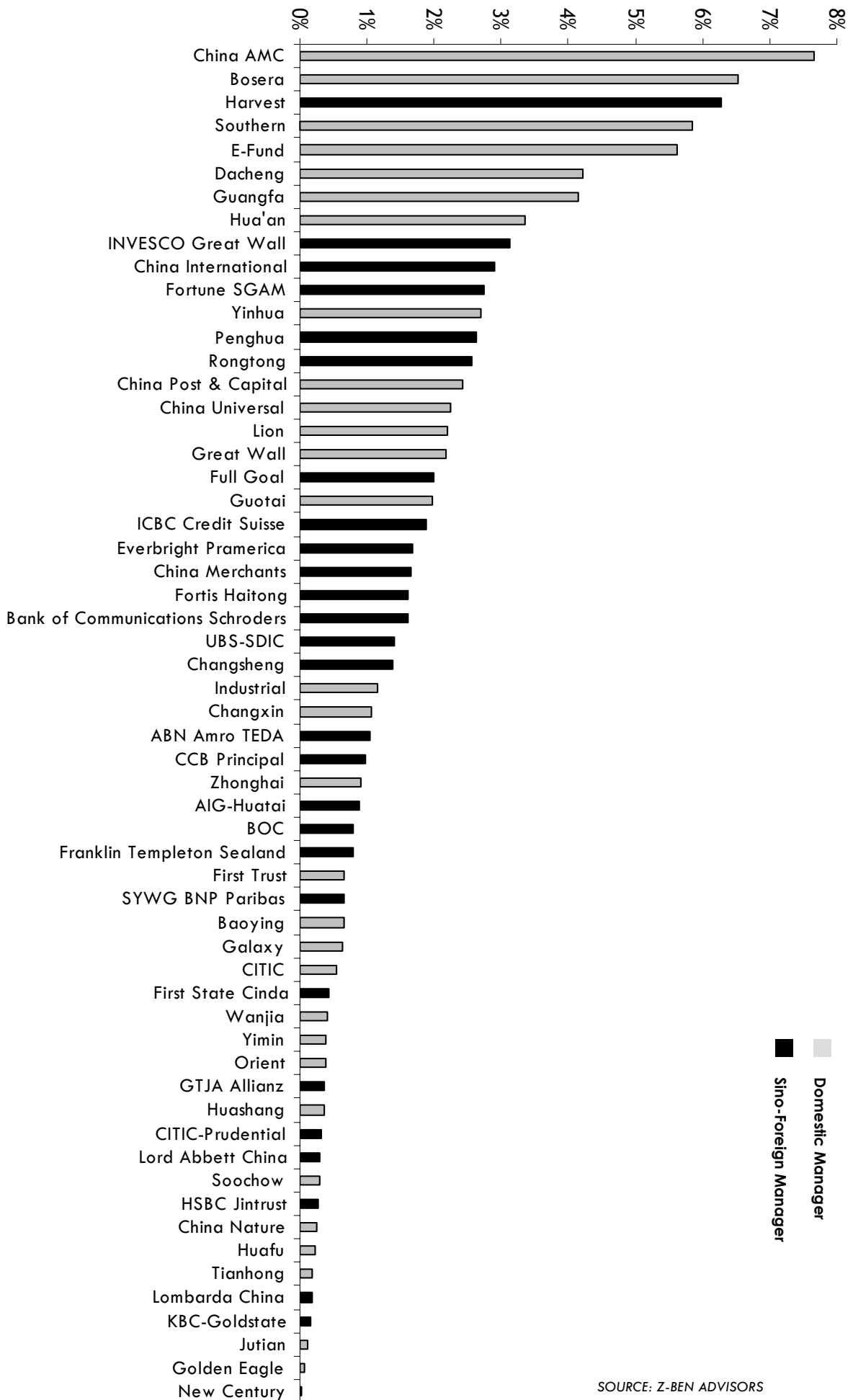
FOREIGN INVESTED MANAGERS ²

	AUM		2007 RANK
	RMB Bill	Share	
Changsheng	38.3	1.38%	27
Full Goal	55.6	2.00%	19
Harvest	174.1	6.27%	3
Penghua	72.9	2.63%	13
Rongtong	71.2	2.57%	14
TOTAL	412.2	14.84%	

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 BANK OF CHINA.

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

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



SOURCE: Z-BEN ADVISORS

INDUSTRY MARKET SHARE: February 29, 2008