

Industry Review & Analysis

It has been some time since the markets made up smile. A reduction in the stamp duty followed by a nice 15% mini-rally did just the trick. Fund managers deploying cash may keep momentum going too.

Among this month's key tone-setting surprises was the finding that net subscriptions for domestic mutual funds actually rose slightly – up nearly 3% – in Q1. In a market where industry assets plunged more than 20%, that's a silver lining to cling to, for now...

Casual readers of domestic investment funds' results in Q1 might form an unduly positive impression of their managers' acumen. Every equity fund beat the market (in relative terms) and results were less widely distributed than had been the norm in previous quarters. With a few praiseworthy exceptions, these (again, relatively) good returns were achieved through a wholesale flight to cash. Some managers, **ABN-AMRO TEDA** notably, ran cash allocations higher than 24% in the quarter.

the main cause of their discontent could be a sustainable market rally.

At time of writing, we are experiencing the mild aftershocks of a convulsive mini-rally. After a week in which the equity market rocketed up 16.2%, there is widespread suspicion that a bottom may have been found, although that suspicion has not yet congealed into belief. That long-awaited (some would say government-driven) market fillip, the product of new regulations limiting non-bloc ex-G-share sales and cutting of the stamp duty, has also contributed to a new tone in stock market discussions. No bulls are yet stampeding but the herd is beginning to believe it may not be headed to the slaughterhouse after all.

For many months now, readers have seen us

Fund managers closed Q1 better than expected

Industry Assets Under Management (RMB Billions)

	1Q08	Share	4Q07	Share	3Q07	Share	2Q07	Share
Total Industry Assets	2,612.7	100.0%	3,272.2	100.0%	3,111.0	100.0%	1,799.1	100.0%
Quarterly Δ	-20.2%		5.2%		72.9%		57.6%	
Total Domestic	1,553.1	59.4%	1,951.3	59.6%	1,840.1	59.1%	1,078.0	59.9%
Total Joint Venture	678.2	26.0%	838.5	25.6%	834.4	26.8%	496.4	27.6%
Total Foreign Invested	381.4	14.6%	482.4	14.7%	436.6	14.0%	224.7	12.5%

Government action has led to a mini-rally in the stock market

SOURCE: Z-BEN ADVISORS

We have no issue with defensive portfolio management, nor with asset allocation decisions occasionally dominating portfolio selection. But 24% in cash? It is never pretty to see portfolio managers admitting that their best idea is the functional equivalent of notes stuffed under a mattress. It may not even be necessary when certain competitors, **China AMC** in particular, are achieving league-leading returns leaving less than 1% of their assets in cash.

The preponderance of cash in portfolios, we believe, is storing up problems for a later date. That point, we are confident, would be accepted by many managers. When, though, will that date arrive? Quite possible sooner than many managers are prepared to deal with, in our view, and

repeat the mantra: It's a stockpickers market. This (however momentary) pause in the stock price avalanche is creating entry points for stockpickers. Greater confidence that we are testing a bottom will create more. This is, in our view, a positive turn of events – and not just because we like to be right. An across-the-board decline in stock values has, in fact, flattened some weak companies while punishing others unduly. For stockpickers, opportunity knocks.

However, the shape of a market recovery – if, indeed, a recovery is at hand – should be of serious concern to many fund managers, who are perhaps less well-equipped for a gentle rise than a resumption of last year's rocket ride. That may seem an odd statement to follow our point about

Alpha is all around. It remains a stockpickers market

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How managers deploy cash should separate this quarter's winners from losers

cash-happy managers. Here's the logic: in the market's most recent trough – Q2 04 to Q4 05 – unit holders largely held on through the dip. But when markets rose and they were able to sell without taking a loss – Q1 06 – redemptions skyrocketed.

In a gentle recovery, as fund NAVs drift back up to par, we expect to see this admittedly illogical loss recognition-avoiding behavior return. Note that we refer here to an increase in gross redemptions – not net. These investors are not taking their money out of funds altogether, only removing it from the control of the manager they used during the lean months. Should last year's rocket ride resume, investors are more likely to stick with current funds in the hope of

wiping out all losses.

Given a slow but steady market climb, we expect managers carrying the most cash to be hardest hit: they will certainly underperform their low-cash colleagues during the early stages of the rebound and will likely lag further behind if redemption pressures prevent them allocating fully back into equities. For asset-allocation driven fund managers, the current market poses a vexing problem: get out of cash now in the hope of avoiding future redemptions or hold firm and hope for either more falls or a sharp rise? For stock pickers, by contrast, the current market offers new and, potentially, very lucrative entry points.

Analytical Quick Hits

China Fund's Total AUM Down in Q1

By the end of the first quarter, collective AUM among Chinese fund managers dropped by 20% and totaling Rmb2.6tn. The outcome could have been, and arguably should have been, worse given that the equities market declined 29% during the period. Thankfully, investors didn't sell out.

Morgan Stanley approved too

Slipping a bit between the cracks last month was the CSRC approval for Morgan Stanley, along with China Fortune Securities to restructure Jutian Fund Management. The foreign party will hold 40% of the firm with 30% owned by its principal Chinese partner. The remaining shares will be held by three other local investors.

Stamp Tax Change Shores up Market

In a not so veiled attempt to boost the equities market, the decision was made last month to cut the stamp tax duty from 0.3% to 0.1%. And it worked. Share prices moved considerably higher - more than 9% - in the days following the changes.

NCSSF earned a return of 38.9%

It was reported locally that the NCSSF finished 2007 with AUM totaling Rmb516.2bn along with a realized gain for the year of 38.9%. Management remains committed to growth and is targeting the Fund's size to reach Rmb1.0tn by the end of the decade.

AEGON approved to buy in

The CSRC formally approved AEGON International to acquire a 49% shareholding in Industrial Fund Management. The newly structured firm will have only two shareholders with the remaining 51% held by Industrial Securities. The firm's registered capital was also increased to Rmb120m.

54th QFII License Issued

The 54th QFII license was issued last month to the Korean arm of US-based Prudential Asset Management. There hasn't been any formal announcement as to how much quota will be issued. The approval does indicate that the QFII program is once again opened for business.

Analytical Quick Hits

New QDII License

The CSRC has continued to expand the ranks of fund managers approved to operate in the QDII scheme. The latest to join the fray was Guotai Fund Management and bringing to 19 the total number of firms approved to participate.

Fund Raising Troubles

It's a return to the bad old days. Not seen in a number of years, two fund managers, namely China Nature and Galaxy, announced the need to extend the period for their recently issued new products by two full weeks. With uncertainty remaining, expect others to extend fund raising as well.

Morley and COFCO to JV, Again

Morley Fund Management, COFCO, and Dongguan Trust entered into a formal shareholder's agreement last month. The parties will be pressing ahead to establish a fund management company with the foreign party owning 40% of the underlying equity and the remaining 60% held in equal parts by the two Chinese shareholders.

Fund Splits Need Not Apply

According to a recent CSRC circular, fund managers will no longer need to formally apply before splitting a mutual fund's shares. All that is now required is a notification made to the local CSRC office. Considering current market condition and it is unlikely that many managers will act on the policy change.

First QDII Dual Consultancy

Yinhua was the latest fund manager to launch a QDII mutual fund but the first firm to appoint two separate foreign advisors. Based upon market reports, Morgan Stanley will assist the product in allocating assets while SEI Investment will assist in portfolio construction.

E-fund's Segregated Accounts

E-Fund signed a Rmb200m segregated account contract with Shanghai-listed Yaohua Pilkington Glass. It was also reported that the manager signed a Rmb250m contract with an unknown Shanghai-based joint venture corporation. The assets from both of the two accounts has already been fully invested into the market.

Chinese Banks Allowed to Invest in U.S.

The CBRC and U.S. Securities and Exchange Commission reached an agreement and which will now allow Chinese commercial banks to invest into U.S. stocks and public funds. This is the latest in a trend and follows CBRC agreements already entered into with Hong Kong Securities Institute, British financial authorities, the Monetary Authority of Singapore and Japan's Financial Services Agency.

SAFE Invested in BP & Total

While there has been no confirmation, it is readily agreed that SAFE Investment Corp. was the party behind the recent purchase of a 1% stake in British Petroleum and worth an estimated USD2bn. The agency was also reported to have bought a 1.6% stake in French oil conglomerate Total. The rationale: a potential hedge against rising crude oil prices and reduced exposure to the declining dollar.

QFII Policies to be Revised

The Chinese foreign exchange regulator is to loosen its control over the QFII program. SAFE is revising rules concerning restrictions on QFII funds, and may extend the time limit on capital inflows and shorten the lock-up periods of the stocks that are held by QFII funds. Still, no timetable has been set for when the rules will be formally introduced.

INDUSTRY AUM & MARKET SHARE

MARCH 28, 2008: ACTUAL

DOMESTIC FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
AEGON-Industrial ⁴	33.2	1.27%	28
Baoying	16.9	0.65%	37
Bosera	166.7	6.38%	2
Changxin	28.3	1.08%	30
China AMC	227.9	8.72%	1
China Nature	6.3	0.24%	51
China Post & Capital	51.1	1.96%	19
China Universal	62.0	2.37%	16
CITIC	12.7	0.49%	40
Dacheng	103.8	3.97%	7
E-Fund	146.2	5.60%	5
First Trust	20.3	0.78%	35
Galaxy	16.4	0.63%	38
Golden Eagle	2.6	0.10%	57
Great Wall	53.3	2.04%	17
Guangfa	112.9	4.32%	6
Guotai	44.4	1.70%	24
Hua'an	92.4	3.54%	8
Huafu	6.0	0.23%	52
Huashang	10.0	0.38%	44
Morgan Stanley China Fortune (Formally Jutian) ⁴	2.7	0.10%	56
Lion	52.8	2.02%	18
New Century	1.7	0.07%	58
Orient	10.1	0.39%	43
Soochow	7.6	0.29%	48
Southern	153.5	5.88%	3
Tianhong	5.1	0.19%	53
Wanjia	11.4	0.44%	41
Yimin	9.9	0.38%	45
Yinhua	63.8	2.44%	13
Zhonghai	21.0	0.80%	34
TOTAL	1,553.1	59.45%	

SOURCE: Company Data, Z-BEN ADVISORS

JV FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
ABC-CA ³	-	-	N/A
ABN Amro TEDA	26.0	1.00%	31
AIG-Huatai	24.2	0.93%	32
AXA-SPD Bank ⁵	-	-	N/A
Bank of Communications	51.1	1.96%	20
Schroders			
BOC ¹	23.1	0.88%	33
CCB Principal	33.4	1.28%	27
China International ¹	81.7	3.13%	9
China Merchants ¹	45.0	1.72%	22
CITIC-Prudential	8.2	0.31%	47
Everbright Pramerica	44.5	1.70%	23
First State Cinda	10.8	0.41%	42
Fortis Haitong	40.6	1.55%	25
Fortune SGAM	67.6	2.59%	11
Franklin Templeton Sealand	19.8	0.76%	36
GTJA Allianz	8.8	0.34%	46
HSBC Jintrust	6.7	0.26%	49
ICBC Credit Suisse	48.9	1.87%	21
INVESCO Great Wall	74.2	2.84%	10
KBC-Goldstate	4.2	0.16%	54
Lombarda China	4.1	0.16%	55
Lord Abbett China	6.6	0.25%	50
SYWG BNP Paribas	16.4	0.63%	39
UBS SDIC	32.2	1.23%	29
TOTAL	678.2	25.96%	

FOREIGN INVESTED MANAGERS ²

	AUM		
	RMB Bill	Share	RANK
Changsheng	36.7	1.40%	26
Full Goal	62.6	2.39%	15
Harvest	153.4	5.87%	4
Penghua	65.4	2.50%	12
Rongtong	63.4	2.42%	14
TOTAL	381.4	14.60%	

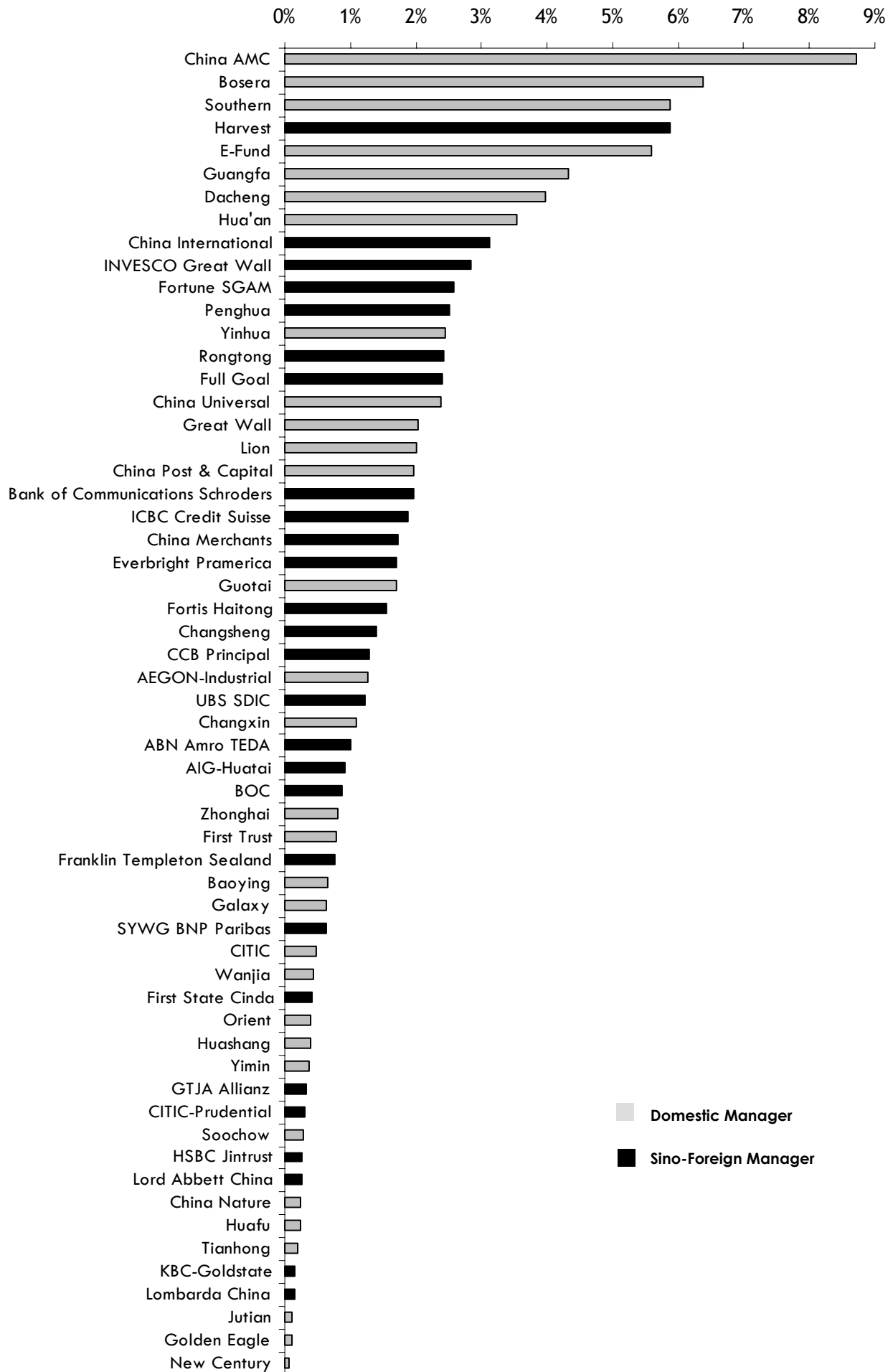
1 - ING INVESTMENT MANAGEMENT OWNS A 33.3% EQUITY INTEREST IN CHINA MERCHANTS; JP MORGAN FLEMING ASSET MANAGEMENT OWNS A 49% EQUITY INTEREST IN CHINA INTERNATIONAL; MERRILL LYNCH OWNS A 16.5% EQUITY INTEREST IN BOC.

2 - 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

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

4 - MANAGERS RECENTLY APPROVED TO RESTRUCTURE AND WHICH WILL, IN THE FUTURE, BE CATEGORIZED AS A JV MANAGER (MORGAN STANLEY CHINA FORTUNE) OR FOREIGN INVESTED MANAGER (AEGON-INDUSTRIAL).

5 - MANAGER IN THE PROCESS OF A MAIDEN PRODUCT FUND LAUNCH AND WHICH WAS NOT FORMALLY COMPLETED BY QUARTER'S END.



INDUSTRY MARKET SHARE: March 28, 2008

SOURCE: Z-BEN ADVISORS