

## Industry Review & Analysis

Fund managers ended Q3 better than initially expected as the run to Pockets of demand are out there though and no matter the pain suffered retail investors will be back.

Ten months down and just two to go and you can almost hear the impending sigh of relief. But you can't really fault any fund manager for wishing that 2008 would simply end. It has been a year in which domestic and international events have hammered investor sentiment and, as a result, appetite for mutual funds. Worse, there isn't a voice to be heard arguing in support of a year-end fund flows rally. Now, all eyes are turning towards 2009.

On the good news front, initial estimates for Q3 assets under management (AUM) and fund flows presented in Z-Ben Advisors' previous report had the industry declining by nearly Rmb350m. Actual results disclosed at the end of October, however, had the drop in AUM at "only" Rmb243m. It was a highly mixed bag when the figures were assessed on a firm-by-firm basis, but the industry is still holding up.

Those attempting to time the market were caught out as conditions today are arguably worse, leaving fund managers in the position of throwing every product launch against the wall to see what sticks. Interestingly enough, that approach did work for two recently issued new products, both of which closed to subscriptions after only a few days. One of the products - China AMC Strategic Enhanced Fund - even ended its campaign after just one day (finishing with assets totaling Rmb1.58bn).

For Z-Ben Advisors, this shows conclusively that investors are still willing to allocate their finite capital into mutual funds so long as the right opportunity presents itself. As an indication of the long term asset gathering trend, this should not be downplayed: no matter the carnage wrought, retail demand for funds hasn't been as impaired as some industry watchers

Fund industry Q3 results came in (slightly) better than expected

### Industry Assets Under Management (RMB Billions)

	3Q08	Share	2Q08	Share	1Q08	Share	4Q07	Share
Total Industry Assets	1,843.3	100.0%	2,086.7	100.0%	2,612.7	100.0%	3,272.2	100.0%
Quarterly $\Delta$	-11.7%		-20.1%		-20.2%		5.2%	
Total Domestic	1,052.9	57.1%	1,190.4	57.0%	1,553.1	59.4%	1,951.3	59.6%
Total Joint Venture	508.5	27.6%	575.3	27.6%	678.2	26.0%	838.5	25.6%
Total Foreign Invested	281.9	15.3%	321.0	15.4%	381.4	14.6%	482.4	14.7%

SOURCE: Z-BEN ADVISORS

#### Seeing What Sticks

What is now taking place is a full scale run (a Hail Mary pass?) by all managers to gather whatever assets might be accessible. The environment is certainly different and especially when compared to 2007. In the plus column, that means access to CSRC product approvals. End demand, however, is - as it has been for the better part of the year - lacking.

A marked change in strategy to be sure as the product pipeline throughout the summer months looked to be slowing. Then, most managers were probably trying to time the market. Now, with the close of the year at hand, caution is being thrown to the wind with a total of 12 new mutual funds launched in September and another 14 going to market in October.

would have us believe.

#### No Irreparable Damage

With the year now winding down and fund managers looking at a mirror image of 2007, there are some voicing concern that fund flows over the next few years will be hard to come by. That argument certainly makes sense but it is still flawed from Z-Ben Advisors' perspective.

Recall that the massive mutual fund feeding frenzy of 2007 was almost wholly supported by end demand from retail investors. It was the first time that most individuals had ever heard of funds as an asset class and the siren call proved too great for most to ignore. Today these investors are looking at paper losses of upwards of 50%.

Fund managers are unleashing numerous new products:

- SEPT: 12 fund launches
- OCT: 14 fund launches

Pockets of demand can be found as evidenced from the latest product issued by China AMC

## Industry Review & Analysis

Burned, some investors may never return to funds, but not many

There will certainly be a contingent of these investors who will never again buy mutual funds. However, Z-Ben Advisors doesn't expect their numbers to be all that great. Retail investors in China have a tendency of segmenting out their investable assets between bank savings - which constitute an allocation of 80+% - and "play money" which gets invested into equities, funds and other, more volatile investments. Time and time again, previously burned investors have waded back in, ignoring any lessons from the past. It will happen again.

A shift in demographics should lead to steadier retail fund flows

Why can Z-Ben Advisors be so certain? There are two elements to take into account, the first of which is a demographic shift. Urban professionals have enormous discretionary income, which is not only growing at an exponential rate

but easily meets their daily needs. Lest we forget, debt service payments remain easily borne and, where they exist, so are mortgage payments. The second element is where this discretionary income is allocated. Older generations, faced with a fraying social safety net, chose to bank their savings. The younger generation, seeing paltry returns from bank savings are more willing to consider fund investment as the mainstay of their retirement savings.

Future fund flows will be new allocations from the "safe" 80+% of savings, not the 20% of play money which fuelled 2007's market rally. Safe money will, undoubtedly, be harder to win and probably arrive more slowly, but it will arrive. Moreover, it's the kind of reliable, long-term, pension money fund managers prefer.

## Analytical Quick Hits

### Q308 Industry AUM Fell below RMB2tr

AUM of China's fund industry fell to RMB1.8tr in the third quarter, down from RMB2.1tr in the second quarter. The largest three fund managers remain China AMC, Bosera, and Harvest.

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### QFII Licenses Increased to 69

CSRC has approved four foreign financial institutions' QFII qualification during September. They were First State investment Management (UK) Limited, DAIWA Asset Management Co., Shell Asset Management Company B.V, and T. Rowe Price International, Inc. The total QFII licenses increased to 69.

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### New JV Fund House Approved

China Minsheng Bank has been approved to establish a joint venture fund management firm with Royal Bank of Canada and Three Gorges Finance Co. The three companies will hold 60%, 30%, and 10% stakes in the JV, respectively. This is the eighth bank-backed fund house in China. It was also the third bank-backed fund house approved to establish this year.

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### Fund-raising Finished Early

Two new funds were warmly welcomed by in-

vestors. One is the first creative closed-end bond fund, Full Goal Tianfeng Optimized Bond Fund. The Fund raised RMB2bn within three days. The other one is China AMC Enhanced Strategic Fund. It only took one day to raise RMB1.6bn. The biggest attraction of the Fund is that the portfolio manager is Mr. Wang Yawei, often called the best manager of China. He is also managing China AMC Large Cap Equity Fund.

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### Guidelines on QFII Funds

CSRC issued a guideline document on the setup and qualification of supervisors for QFII funds. The supervisor system was aimed to help QFIIs improve their compliance with laws and prevent rule-breaking behavior.

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### Hebei Securities Exits Rongtong

New Times Securities took a 40% stake in Rongtong Fund Management from Hebei Securities, which has been acquired by Caida Securities. The price was RMB1.25bn, RMB25 per share. After the transaction, New Times Securities will hold a 60% stake and Nikko Asset Management retains a 40% stake in Rongtong.

## Analytical Quick Hits

### **QDII Funds Suffered Large Redemptions**

During the third quarter, QDII funds' loss reached RMB16.5bn. These funds also suffered large redemptions. The worst affected was Southern's QDII fund, with buy-backs amounting to 1.2bn shares. Although only 387m shares of Fortis Haitong's QDII were redeemed, the net redemption rate reached 76.11% compared with the second quarter.

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### **CITIC Funds Change Hands**

After the fund shareholders' meeting's vote, China AMC will replace CITIC to be the new manager of all CITIC funds. The four funds include CITIC Classic Allocation Fund, Dividend Enhanced Equity Fund, Money Market Fund, and Stable Dual Income Bond Fund. After the change, the number of funds managed by China AMC will reach 25.

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### **CIRC Applied for Rmb200bn PE Quota**

It was reported that CIRC has applied to State Council for RMB200bn of private equity investment quota. This means that CIRC will allow private equity investment by insurance funds on a trial basis. Half of the quota will be used for equity investment in infrastructure and another half in other industries. According to the news, CIRC has already drafted measures and guidelines.

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### **PICC Indirectly Controls Harvest**

The People's Insurance Company of China will take a 32.35% stake in China Credit Trust from the Ministry of Finance. The move is meant to increase capital support to key state-owned financial companies. PICC will be the biggest shareholder of the trust company. It also gives PICC indirect control of Harvest Fund Management since China Credit Trust has 40% stake in it.

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### **Margin Trading and Short Selling Tested**

CSRC had the first testing for margin trading and short selling on October 25. Eleven securities firms, Shanghai and Shenzhen Stock Exchange, SD&C and custodian banks participated

in the testing. The second testing will be at the beginning of November. Securities firms can apply for the business from December 1 but CSRC will grant the qualification to no more than eight firms.

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### **Global Crisis Impacts on JV Fund Houses**

Some JV fund houses' foreign partners are suffering from the global financial crisis and have undergone shareholding changes. For example, after the deal between BNP Paribas Bank and Fortis Group, BNP Paribas SYWG and Fortis Haitong Fund Management's foreign partners' majority shareholders have changed. Aegon Group, one of AEGON Industrial Fund Management's shareholders, also has financial problems. So, these stakes in JV fund houses are attracting high levels of public interest.

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### **Segregated Account Managers Return**

Some star portfolio managers, who were appointed to manage segregated accounts, are returning to mutual funds. Although CSRC doesn't allow segregated account managers to run mutual funds as well, it appears that some managers are running both. Yang Dali, SA manager of Zhonghai, was appointed to run Zhonghai Flexible Allocation Fund. Penghua appointed its SA Investment Director, Ji Hongtao, to manage Puhui Fund.

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### **Segregated Accounts Showed Advantage**

According to the third quarter report of Shanghai Yaohua Pilkington Glass Co., it only lost 0.86% of its assets under the segregated account managed by E-fund since its founding date of May 23. However, the CSI 300 Index fell by almost 40% during the same period. Although the return was negative, the performance was much better than equity mutual funds. To some extent, this showed advantages of segregated accounts, such as fewer investment limitations and more flexible asset allocation.

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## INDUSTRY AUM & MARKET SHARE

SEPTEMBER 30, 2008: ACTUAL

### DOMESTIC FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
Baoying	9.9	0.54%	39
Bosera	123.9	6.72%	2
Changxin	18.6	1.01%	32
China AMC	185.7	10.08%	1
China Nature	4.8	0.26%	51
China Post & Capital	30.3	1.64%	23
China Universal	43.1	2.34%	13
CITIC	8.1	0.44%	42
Dacheng	69.0	3.74%	6
E-Fund	99.1	5.37%	4
First Trust	12.3	0.67%	37
Galaxy	13.9	0.76%	36
Golden Eagle	1.6	0.09%	58
Great Wall	33.1	1.80%	20
Guangfa	68.9	3.74%	7
Guotai	27.9	1.51%	25
Hua'an	66.9	3.63%	8
Huafu	4.4	0.24%	53
Huashang	6.1	0.33%	48
Lion	36.5	1.98%	19
New Century	1.2	0.06%	59
Orient	6.4	0.35%	46
Soochow	6.3	0.34%	47
Southern	97.9	5.31%	5
Tianhong	3.7	0.20%	55
Wanjia	8.8	0.48%	41
Yimin	6.5	0.35%	45
Yinhua	41.1	2.23%	15
Zhonghai	16.8	0.91%	33
<b>TOTAL</b>	<b>1,052.9</b>	<b>57.12%</b>	

### JV FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
ABC-CA <sup>5</sup>	6.8	0.37%	43
ABN Amro TEDA	19.5	1.06%	31
AIG-Huatai	15.9	0.86%	34
AXA-SPD Bank <sup>4</sup>	1.1	0.06%	60
Bank of Communications Schroders	42.8	2.32%	14
BOC <sup>1</sup>	20.3	1.10%	30
CCB Principal	27.0	1.46%	26
China International <sup>1</sup>	58.7	3.18%	9
China Merchants <sup>1</sup>	31.5	1.71%	22
CITIC-Prudential	9.1	0.49%	40
Everbright Pramerica	26.6	1.44%	27
First State Cinda	6.6	0.36%	44
Fortis Haitong	32.2	1.75%	21
Fortune SGAM	45.6	2.47%	11
Franklin Templeton Sealand	14.6	0.79%	35
GTJA Allianz	5.3	0.29%	50
HSBC Jintrust	5.4	0.29%	49
ICBC Credit Suisse	45.4	2.46%	12
INVESCO Great Wall	49.3	2.67%	10
KBC-Goldstate	4.4	0.24%	52
Lombarda China	2.7	0.14%	56
Lord Abbett China	4.0	0.22%	54
Morgan Stanley Huaxin <sup>3</sup>	1.8	0.10%	57
SYWG BNP Paribas	10.2	0.55%	38
UBS SDIC	21.9	1.19%	28
<b>TOTAL</b>	<b>508.5</b>	<b>27.58%</b>	

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

	AUM		
	RMB Bill	Share	RANK
AEGON-Industrial	28.7	1.56%	24
Changsheng	21.6	1.17%	29
Full Goal	40.9	2.22%	16
Harvest	110.1	5.97%	3
Penghua	40.4	2.19%	17
Rongtong	40.2	2.18%	18
<b>TOTAL</b>	<b>281.9</b>	<b>15.30%</b>	

SOURCE: Company Data, Z-BEN ADVISORS

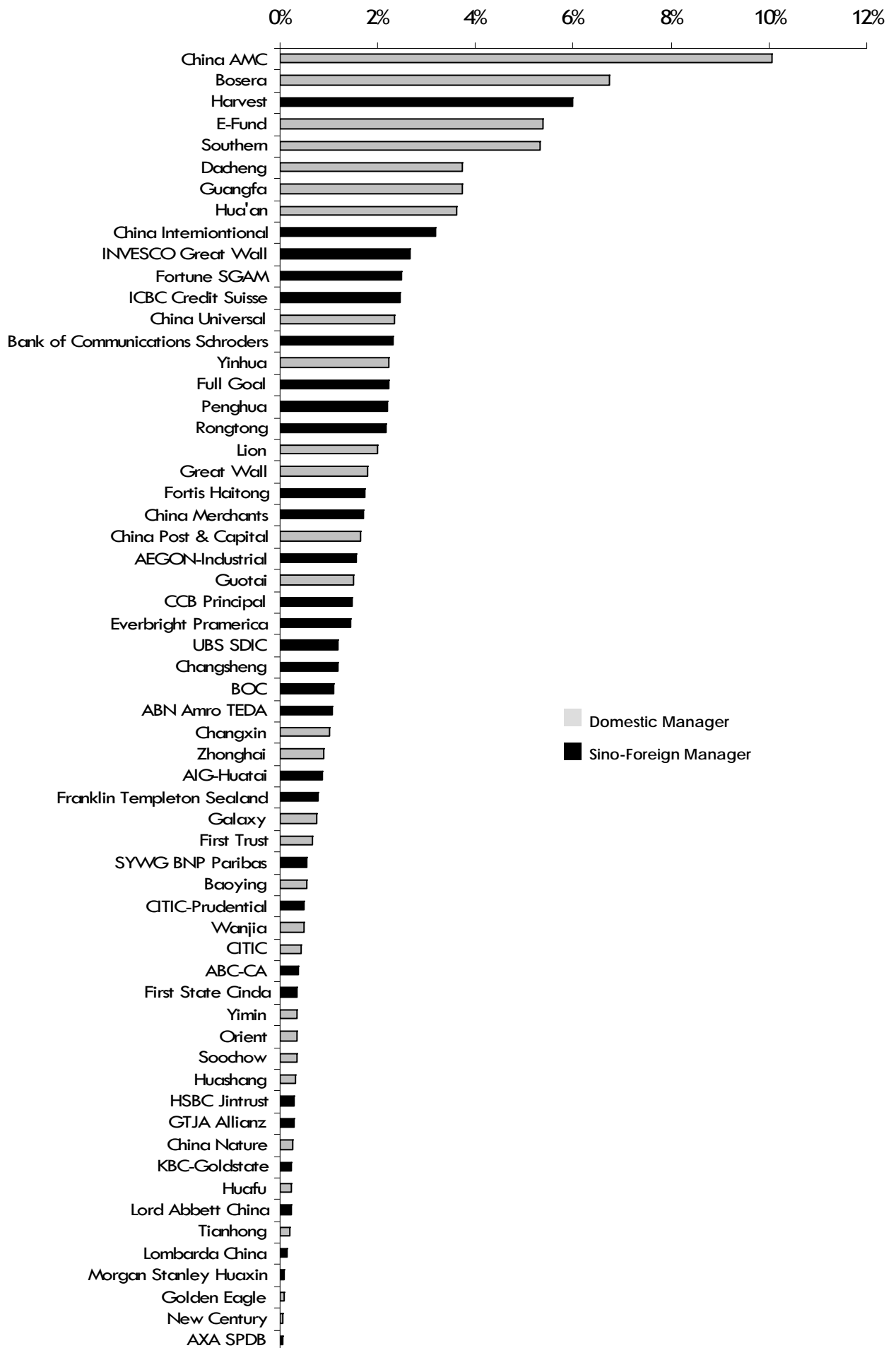
1 - ING INVESTMENT MANAGEMENT OWNS A 33.3% EQUITY INTEREST IN CHINA MERCHANTS; JP MORGAN FLEMING ASSET MANAGEMENT OWNS A 49% EQUITY INTEREST IN CHINA INTERNATIONAL; MERRILL LYNCH OWNS A 16.5% EQUITY INTEREST IN BOC; COLONIAL FIRST STATE GROUP OWNS 46% IN FIRST STATE CINDA.

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 - FORMERLY JUTIAN FUND MANAGEMENT

4 - AXA-SPDB AND ABC-CREDIT AGRICOLE BOTH RECENTLY FINISHED RAISING ASSETS FOR THEIR RESPECTIVE MAIDEN PRODUCTS.

5 - 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: September 30, 2008 (Actual)

SOURCE: Z-BEN ADVISORS