

Industry Review & Analysis

Share prices continue to get pounded as fund managers do everything in their power to protect investors' interests. All the while two foreign asset managers announce plans to enter the competitive fray.

The Olympic games provided no reprieve for the stock market

The Chinese went for gold last month and succeed with an impressive tally of medals. What the Olympic games didn't provide was a reprieve for fund managers (or any investor for that matter). Share prices took a massive header to finish the month of August down by nearly 15%. And the low hanging clouds remain ominously above with the CSI 300 Index shedding another 8.7% in the first week of September.

Fund managers are aggressively altering their allocation of assets

It is like a nightmare in which you are unable to awake, and if the growing ranks of Cassandra's are to be believed more pain is still to come. They argue that signs of slowing economic activity, the indirect affects from the ongoing global credit contagion, pressure on corporate earnings and - least we forget - the supposed tsunami of new shares hitting the market via the G-share reforms will continue to impair equity valuations.

allocation in favor of fixed income or cash). Later in the report we will detail the findings of our research. As a taste, the average equity fund has reduced its exposure to stocks from a high of 78.3% in Q407 to 69.8% as of June this year. Fixed income exposure, on the other hand is currently at 13% as opposed to 7.9% at the end of last year. And with yet another quarter preparing to end, it is unlikely that there will be any material deviation away from this strategy.

Foreign Interest

Tough times indeed and yet there continues to be keen interest to tap into the local funds industry among certain foreign asset managers and even local institutions. There was the announcement last month of UK-based Old Mutual reaching an agreement to acquire a 49% interest in

Industry Assets Under Management (RMB Billions)

	Current ¹	Share	2Q08	Share	1Q08	Share	4Q07	Share	
Estimated industry AUM now below Rmb2.0tr	Total Industry Assets	1,898.5	100.0%	2,086.7	100.0%	2,612.7	100.0%	3,272.2	100.0%
	Quarterly Δ	-9.0%		-20.1%		-20.2%		5.2%	
	Total Domestic	1,071.4	56.4%	1,190.4	57.0%	1,553.1	59.4%	1,951.3	59.6%
	Total Joint Venture	537.6	28.3%	575.3	27.6%	678.164	26.0%	838.5	25.6%
	Total Foreign Invested	289.5	15.2%	321.0	15.4%	381.405	14.6%	482.4	14.7%

SOURCE: Z-BEN ADVISORS Footnote 1: Estimates as of August 31, 2008

Z-Ben Advisors remains an impassioned believer that valuations in the mainland - tilting at windmills perhaps - are arguably cheap. If nearly 6,000 on the CSI 300 index was seen as being ridiculously overpriced, then we would counter with a market at 2,200 as being a rapacious bargain.

The industry remains appealing to foreign asset managers

For their part, fund managers aren't spending time debating where the market will trend. Everyone's full and undivided attention is being directed toward ensuring that assets are retained and, wherever possible, gathered. Along those lines, and with limited tools at the ready, fund managers - especially the "smart money" - are reverting to what Z-Ben Advisors has termed a strategy to de-equitize (a reduction in equity

ABN Amro TEDA. Soon thereafter two regional banks - Bank of Ningbo and Bank of Beijing - announced plans to apply for a greenfield fund's license with the latter of the two having entered into a JV agreement with Scotiabank Asset Management. Bold moves all around.

With 60 fund managers already slugging it out and the larger domestic fund managers solidifying their competitive position and grabbing market share then begs the question; isn't the industry already at, if not above, capacity? From a longer term perspective, Z-Ben Advisors doesn't think so. Even though current conditions might cause some to pause, demand for professional asset management and financial services will rise substantially over the coming decade.

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Those institutions willing to assume risk today should be fully compensated at a later date. Really though, does anyone want to ignore the Chinese market? Now that is truly a risky move.

An Ironic Twist

Foreign asset managers may very well be looking to break into the onshore Chinese funds industry. Domestic players, for their part, are going in the opposite direction and preparing to set up an operational base in Hong Kong.

Last month, Z-Ben Advisors highlighted the approval for both Southern and E-Fund to begin the process with a third firm - Harvest - joining the pack in August. The entire shift in strategic direction isn't the outcome of a more liberalized Qualified Domestic Institutional Investor (QDII) program. Such may be the case

As foreign firms push in, local managers are now expanding globally

Domestic firms will use their Hong Kong base to take advantage of QFII

longer term. For now, however, the real focus of those fund managers deciding to dip their toes beyond China's borders is to leverage access to the Qualified Foreign Institutional Investor (QFII) scheme.

You read that right. QFII! Z-Ben Advisors cannot yet confirm how the approved fund managers will actually leverage their Hong Kong base of operations. The most logical starting point though will be to raise capital internationally, apply for (and probably receive quick approval too) a QFII participatory license and quota before redirecting the flows into Chinese domiciled mutual funds. And what better way to take full advantage of this opportunity than for the approved fund manager to use the capital to purchase shares of their own in-house products. Simply brilliant!. Keep an eye out too. This is probably only the beginning.

Analytical Quick Hits

China AMC/CITIC FMC Set to Merge

It was announced last month that the China AMC and CITIC FMC merger is (finally) underway. The process theoretically began in 2006, but took a substantial step forward in August. Solidifying its position as largest fund manager in China, a combined China AMC plans to use the CITIC FMC platform to manage non-public funds

Management. The Beijing-based JV plans to be capitalized with Rmb300m of which Bank of Beijing will own 67% with the remainder owned by the Canadian group. Separately, Bank of Beijing is also planning to acquire a 50% stake in Pacific-Antai Life Insurance in an attempt to further diversify its operations.

Old Mutual Buys into ABN Amro TEDA

Old Mutual announced that it had reached an agreement to acquire a 49% stake in ABN Amro TEDA from Belgium-based Fortis Investments. A cash contribution of a reported EUR165m values the manager at +16% of assets under management. A steep price tag, but possibly a bargain too once certain qualitative factors are considered. If the deal is approved by CSRC, it would then be the fourth time the firm has been restructured at the shareholder level.

Bank of Ningbo Also Planning a JV

Chen Xuefeng, Vice President at Bank of Ningbo, disclosed that the bank is planning to set up a JV fund management company. No partner or timetable, however, was provided. Management's goal is to reduce its reliance on revenue generated by the interest rate spread and diversify into fee oriented businesses and similar to those plans announced by Bank of Beijing and Bank of Shanghai.

Bank of Beijing Teams with Scotiabank

Bank of Beijing, China's largest city bank in terms of assets, announced plans to establish a fund management JV with Scotiabank Asset

NCSSF and CITIC Capital Plan a PE Fund

China's pension provider of last resort, National Council for Social Security Fund, and CITIC Capital are in discussions to launch a Rmb-denominated private equity fund. The parties will jointly invest Rmb1.0bn each with other local institutions investing into the fund as well. CITIC Capital will be appointed to manage the

Analytical Quick Hits

fund, although there have been no details provided as to the proposed fund's investment objective.

NCSSF Opened New Accounts

According to China Securities Depository and Clearing (CSDC), the National Council for Social Security Fund recently opened an additional 12 accounts on the Shanghai and Shenzhen A-share markets. The pension group now has 116 accounts registered at the CSDC and is expected to expand the number of fund managers (currently nine) approved to manage assets on NCSSF's behalf.

In the Cross Hairs: Inside Trading

Draft amendments to the Criminal Law have been submitted to China's top legislature. The objective is to put in place more stringent rules to punish individuals profiting from non-public insider information. If passed, those found guilty can face incarceration of up to 10 year and fines of up to five-times the illegal gains earned.

Amending the Insurance Law

A second draft amendment was also submitted only this time to liberalize the current insurance law and specifically the permissible scope of investment. The proposed amendment is seeking to include in the list of permissible asset classes real estate.

CSI 300 ETF Submitted to CSRC

Shanghai Stock Exchange and AIG Huatai submitted a joint proposal to CSRC for a CSI 300 ETF. If approved, it would be the first such ETF to track both the Shanghai and Shenzhen markets. Besides providing greater choice for investors, a CSI 300 ETF may prove to be a more useful tool for investors than current index funds if stock index futures are launched.

Lower Threshold for New QDII Applicants

Yet to be officially confirmed, CSRC may be considering a lowering of the size requirement for fund managers wishing to take part in the

Qualified Domestic Institutional Investor (QDII) program. The regulators are evaluating whether or not to bring down the size requirement for fund manager to qualify. The current minimum is AUM of no less than Rmb20bn. The proposed change would halve that to Rmb10bn.

More QDII License Approved

Everbright Prudential and CCB Principal received approval to take part in the Qualified Domestic Institutional Investor (QDII) program. This then brings the total number of participating managers to 27 although only nine have so far launched a QDII mutual fund.

Harvest Heads to Hong Kong

Quickly on the heels of its competitors, CSRC last month approved Harvest to establish a base of operations in Hong Kong. It remain unknown how the firm will leverage the platform, but it brings to three the total number of Chinese fund managers now setting up shop in the Special Administrative Region.

Securities Firms Sell More Funds

End demand for mutual funds remains scant. Fund managers are taking proactive measures to reverse the trend including changes in their sales strategies. No longer is the focus on the banking channel. Resources are now being directed towards securities firms. Industry projections expect up to 30% of total sales to be made through securities firms and triple the rate in 2007

INDUSTRY AUM & MARKET SHARE

AUGUST 31, 2008: ESTIMATES

DOMESTIC FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
Baoying	11.0	0.58%	39
Bosera	119.8	6.31%	2
Changxin	19.3	1.02%	31
China AMC	186.1	9.80%	1
China Nature	4.4	0.23%	52
China Post & Capital	30.5	1.61%	23
China Universal	42.2	2.22%	16
CITIC	9.3	0.49%	40
Dacheng	71.8	3.78%	7
E-Fund	98.1	5.17%	5
First Trust	13.1	0.69%	36
Galaxy	12.1	0.64%	37
Golden Eagle	1.7	0.09%	58
Great Wall	35.9	1.89%	21
Guangfa	73.3	3.86%	6
Guotai	26.7	1.41%	28
Hua'an	64.9	3.42%	8
Huafu	4.4	0.23%	51
Huashang	6.4	0.34%	48
Lion	38.6	2.03%	19
New Century	1.3	0.07%	59
Orient	6.8	0.36%	46
Soochow	7.8	0.41%	42
Southern	104.4	5.50%	4
Tianhong	4.1	0.22%	54
Wanjia	8.7	0.46%	41
Yimin	7.2	0.38%	44
Yinhua	44.6	2.35%	14
Zhonghai	16.8	0.89%	34
TOTAL	1,071.4	56.44%	

JV FUND MANAGERS

	AUM		
	RMB Bill	Share	RANK
ABC-CA ⁴	6.8	0.0	47.0
ABN Amro TEDA ⁵	18.1	0.95%	32
AIG-Huatai	17.7	0.93%	33
AXA SPDB	1.2	0.06%	60
Bank of Communications	40.9	2.15%	18
Schroders			
BOC ¹	20.8	1.10%	30
CCB Principal	28.6	1.51%	26
China International ¹	62.6	3.30%	9
China Merchants ¹	32.5	1.71%	22
CITIC-Prudential	7.2	0.38%	45
Everbright Pramerica	29.3	1.54%	24
First State Cinda	7.5	0.39%	43
Fortis Haitong	37.2	1.96%	20
Fortune SGAM	49.1	2.59%	11
Franklin Templeton Sealand	16.3	0.86%	35
GTJA Allianz	5.7	0.30%	49
HSBC Jintrust	5.6	0.29%	50
ICBC Credit Suisse	46.9	2.47%	12
INVESCO Great Wall	52.3	2.75%	10
KBC-Goldstate	3.9	0.21%	55
Lombarda China	3.0	0.16%	56
Lord Abbett China	4.1	0.22%	53
Morgan Stanley Huaxin ³	1.9	0.10%	57
SYWG BNP Paribas	11.4	0.60%	38
UBS SDIC	27.1	1.43%	27
TOTAL	537.6	28.32%	

FOREIGN INVESTED MANAGERS ²

	AUM		
	RMB Bill	Share	RANK
AEGON-Industrial	29.2	1.54%	25
Changsheng	22.7	1.20%	29
Full Goal	44.7	2.35%	13
Harvest	108.1	5.69%	3
Penghua	42.9	2.26%	15
Rongtong	41.9	2.21%	17
TOTAL	289.5	15.25%	

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.

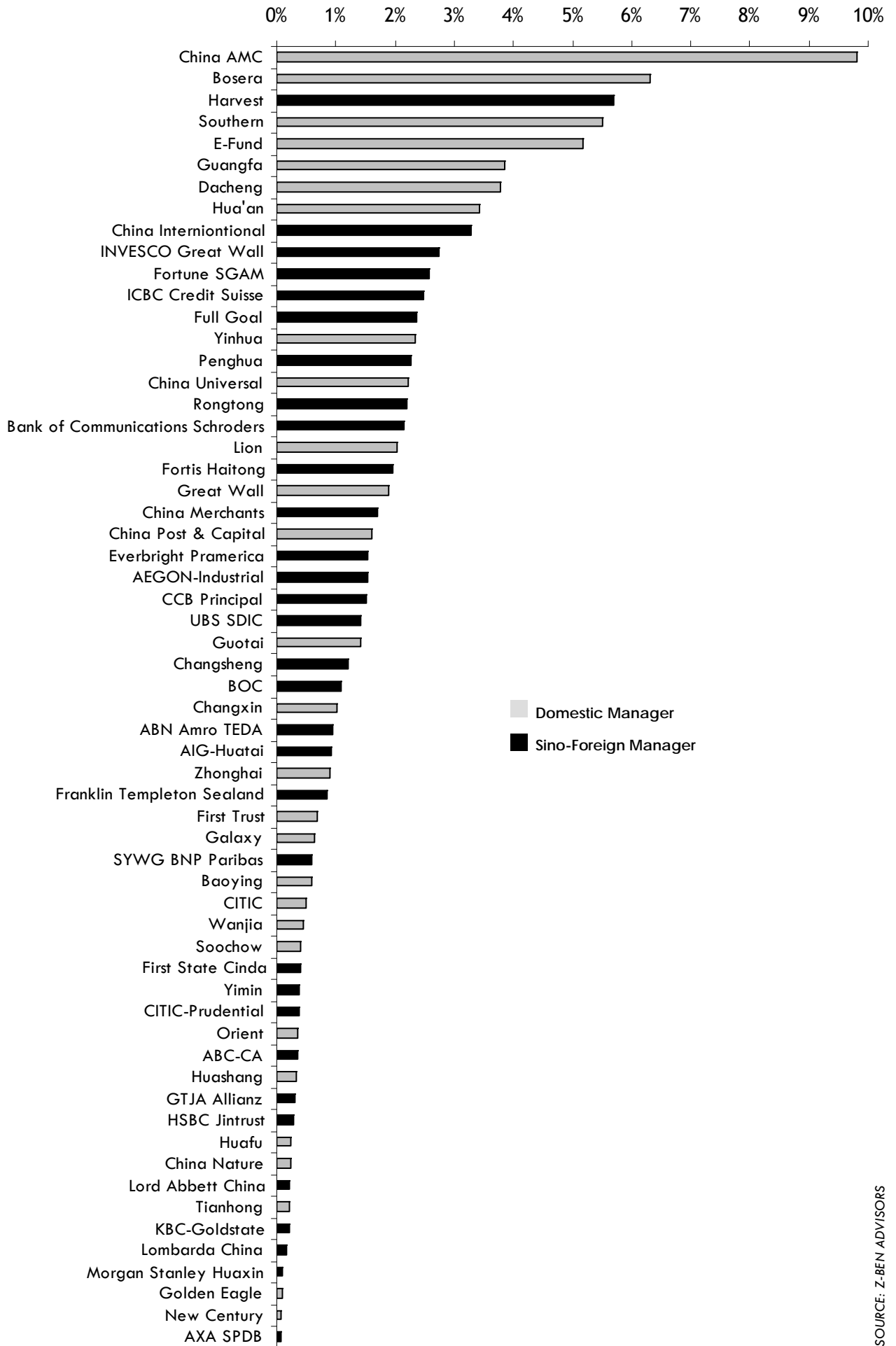
2 - BANK OF MONTREAL BOUGHT AN EQUITY INTEREST IN FULL GOAL THAT CURRENTLY STANDS AT 27.775%; DEUTSCHE ASSET MANAGEMENT PURCHASED 30% EQUITY INTEREST IN HARVEST. DBS ASSET MANAGEMENT ACQUIRED A 33% STAKE IN CHANGSHENG WITH NIKKO ASSET MANAGEMENT BUYING A 40% POSITION IN RONGTONG. EURIZON FINANCIAL GROUP OWNS A 49% STAKE IN PENGHUA.

3 - FORMERLY JUTIAN FUND MANAGEMENT

4 - ABC-CA 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: AUGUST 31, 2008 (Estimated)



SOURCE: Z-BEN ADVISORS