

Z-BEN ADVISORS

China Investment Management: Market Update

April 2009

Pulling Away

2008 was a year of avoiding disasters, enduring fee reductions and hoping the worst would soon be over. 2009, by contrast, is increasingly becoming a year when effort is rewarded, when customers are open to greater risks and new ideas, and when the industry's long-term growth trajectory is restored. For those willing to lead, customers are beginning to follow.

Last month we described the signs of stability and optimism which had become attached to the two shortest-term indicators of industry health: customer sentiment and equity market levels. This month, our efforts are focused on the steps domestic fund managers - and their foreign partners - are taking to capitalize on that strength. Equity funds are again being sold (and with tactics that may remind regular readers of 2006-07's heady days), QDII and QFII expansions are in train, new JVs are launching and long-term partnerships are being signed. A sense of relief derived from better-than-expected 2008 FMC profitability figures is adding to the determination to expand in 2009.

In our view, these developments should be a call to action for any Western firm which has not yet made a substantial or visible commitment to finding itself a role in the Chinese asset management industry. It's not a call that's being answered with much enthusiasm. To be fair, many firms who, given their size and experience, should be considered likely successes in China, are currently mired in home office problems. Projects not certain to deliver measurable ROI within a year simply aren't being considered, no matter how bright future prospects may appear.

Industry Assets Under Management (RMB Billions)

	Current ¹	Growth	4Q08	Growth	3Q08	Growth	2Q08	Growth
Industry AUM	1,974.5	1.8%	1,938.9	5.2%	1,843.3	-11.7%	2,086.7	-20.1%
Total Domestic	1,094.4	3.5%	1,057.5	0.4%	1,052.9	-11.6%	1,190.4	-23.4%
Total JV	880.1	-0.1%	881.4	11.5%	790.4	-11.8%	896.3	-15.4%

SOURCE: Z-BEN ADVISORS, CURRENT AUM IS AN ESTIMATE AS OF MAR 31, 2009

In Z-Ben Advisors' view, such policies, however understandable, are misguided. As you read through the following pages, we invite you to consider what their contents should signal to firms which have not yet made their presence felt in China to any meaningful degree. We note the surge of interest in domestic equity investing, we describe efforts to improve the performance and transparency of QDII products, we explore key changes in JV entry strategies and we assess efforts to fine-tune existing programs for inward investment and PM qualification. The overall theme: consolidation.

Consolidation is very good news for those foreign firms which have partnerships, shareholdings and business relationships with Chinese asset managers. For those who don't or, worse, have elected to postpone their pursuit, consolidation may be a disaster. At a time when assets are again beginning to flow into fund investments, regulatory emphasis has shifted from expanding the number of foreign participants to improving the quality of products and services those relationships have produced. The window for getting started in China is not only closing, it is closing at a time when there is increased evidence that volumes of business accruing to existing foreign partners will climb.

Current market conditions are sounding a call to action

For more information, please contact:

Derek Wang
Director, Research
derek.wang@z-ben.com

Ms. Peggy Xu
Associate, Sales
peggy.xu@z-ben.com

Z-BEN ADVISORS, LTD
Tongsheng Tower, 5/F
458 Fushan Road
Pudong New Area
Shanghai, China 200122
Email: info@z-ben.com
Phone: 86-21 6876-1650
86-21 6876-1651
Fax: 86-21 6876-1652

Prospects are brightening on both growth and valuation grounds

Closing, of course, is not the same as closed. There remain opportunities to structure partnerships for JVs, QDII, QFII and other joint investment platforms. However, that opportunity set is finite and unlikely to be enlarged significantly over the course of the next two to three years. Worse, the predictable steps to be taken in the next round of expansive regulatory policy - introducing domestic insurers as FMC JV partners, widening the QDII program, loosening foreign ownership restrictions on FMCs - will only benefit those who have spent two to three years cementing relationships in China.

In short, if foreign companies who wish to partner domestic asset managers aren't on the ground now, working to find future partners, forming the relationships that can lead to later investment, they may find themselves facing two unpleasant results. First, they may be all but shut out of the industry's growth for at least the next three years. Second, they may find themselves competing for the scraps left over by companies who put in three years of hard labor with no financial ROI to show for their efforts.

For our readers who already enjoy partnerships with Chinese asset managers, congratulations: 2009 looks to be a rewarding year. For those who don't: if you cannot immediately begin the work of building such partnerships, it may be time to remind head office that inaction is not a neutral policy. Every day's delay now significantly decreases the chance of future returns.

Monthly Research Highlights

2008 Fee Revenues: Counting the Cash Cows

Page 9

The mutual fund industry has finally completed the disclosure process of product annual reports for 2008. Summarizing the data in them, we found that the industry experienced strong revenue income, although AUM declines in the year were severe. A further examination of the data shows that institutional participation rose slightly, and last year's distribution strategy of selling bond funds to institutional buyers was, for many firms, less successful than initial subscriptions might suggest.

Marketing That Works: How to Sell an Equity Fund in 2009

Page 14

With interest in equity investing again on the rise, selling tactics for equity funds have come back to the fore of fund management companies attention. In this article, we review five years' worth of performance, asset gathering and asset retention data to demonstrate the effects of outperformance, dividend payments and share splits on AUM growth. The news for fund marketers: in the absence of long term (one- and two-year) outperformance, only a regular stream of dividends appears to be able to retain AUM. For those with strong long-term performance records, share splits may be able to spark the kind of asset-gathering burst last seen in 2007.

QDII Segregated Accounts: "We Can Do It For You Wholesale"

Page 18

New details were announced earlier this month outlining the expansion of the segregated accounts platform to allow overseas QDII investment. The initiative is being proposed to use the excess, or unused, quota that many fund managers which launched QDII funds in 2007 and 2008 still hold. This new platform will, in the short term, give firms a way to expand their segregated accounts business while growing their overseas investment management services. Z-Ben Advisors outlines the new rules and regulations and analyze how they will affect QDII investment industry.

QFII Update: Enter the (Domestic) Dragon**Page 21**

Three key events shed light on recent changes in QFII quota grant behavior and help bring the current state of the program into better perspective. First, a domestic fund manager has announced its intention to apply for a QFII license through its HK-based asset management joint venture. If granted permission other fund managers are likely to follow. Second, regulators have decided to re-open the QFII quota tap. Third, ten new institutions have been granted license to invest in the QFII program since October 2008. This report analyses the implications of these moves.

PM Regulation: Less Mobility, More Accountability?**Page 24**

Coinciding with high-level personnel changes, CSRC and the Securities Association of China (SAC), respectively, issued regulatory amendments and a portfolio manager registration system, in order to reduce conflicts of interest and bring PM turnover under control. In the long run, these efforts will no doubt make the investing environment more transparent. However, their effects on PM recruitment and mobility, as well as FMCs' ability to expand the pool of potential managers, are less certain. We explore the likely HR and management effects of the new registration system.

The Passive Response: FMCs Load Up On Index Funds**Page 27**

Interest in launching index funds is clearly rising, with six FMCs announcing domestic product launches. Four other fund houses are also attempting to introduce passive indexes through the QDII program. We explore the reasons for CSRC's willingness to allow so many launches in such a short space of time, analyze the likely drivers of the vogue for passive funds in QDII, and assess the competitive issues that will face many FMCs as they prepare for index launches. Expect substantially more competition in one of the most commodity-like spaces to be found in the funds industry.

Equity Income: Investors Demand Their Slice of the Pie**Page 30**

Call them demanding, but Chinese mutual fund buyers want both capital appreciation and income from their investments in equity funds. Coming out of a dreadful 2008, investors are increasingly sensitive to dividend distribution, and underestimating this newfound sensitivity has already caused a number of managers headaches and reputational damage. Z-Ben Advisors' recommendation? Pay dividends, pay them regularly, and don't forget to pay again, regardless of market conditions. And, for extra credit, start looking at equity income funds - currently an underserved area of demand.

JV Manager Review: Benchmarking Success**Page 33**

Which Sino-foreign JV is the best? This is one of the most frequently asked questions of Z-Ben Advisors and one which has been difficult to answer in the past. Today, we are pleased to state that we have a more succinct answer. Through the construction of an objective, quantitative and multi-dimensional model - as presented in our inaugural *Sino-Foreign Benchmarking Report* - Z-Ben Advisors has identified those JV managers whom have been the most (and least) successful in China. Our findings are summarized in this month's JV review.

Corporate Actions: Shuffling the Deck Chairs**Page 36**

Rampant turnover among portfolio managers may shortly become a thing of the past if recent regulatory changes take hold. The immediate implications, however, aren't yet clear. The same too for INVESCO Great Wall as the firm will now need to find a replacement for its long-serving, foreign appointed General Manager. Elsewhere, Lombarda China announced that it has filled a vacant General Manager position by poaching a key, and highly seasoned, lieutenant from China International. So it would seem that demand for talent remains firmly intact and perhaps even more so at the top.

New Product Review & Analysis: Safer but Harder to Measure**Page 41**

The asset raising results of the 15 products launched in March have sent an important message: end demand is recovering and rewarding fundraising activities. Equity-centric funds, once again, rose to be a major force in this tide, registering Rmb1.98bn on average for the eight funds launched. Also, fixed-income products are only a step behind with an average AUM of Rmb1.8bn raised at launch. That said, as more managers choose to seize the present opportunity of demand with more new product launches, the distribution channels are becoming severely crowded, once again.

Monthly Performance Review: The Rally Gets Another Leg**Page****60**

The month of March ended with Chinese equities up by 20% and the best one-month return since 2007. Investors certainly benefited from a raft of newly introduced micro-economic measures. All that remains is whether or not share prices have moved beyond the market's underlying fundamentals. Local fund managers are nibbling their finger nails in search of an answer. So far, cash is dragging performance down among equity mutual funds. Those portfolio managers which are quickest to react, rightly or wrongly, can be expected to best their slower rivals.

Analytical Quick Hits

New Indices for State-Owned Enterprises. China Securities Index Co. and the Shanghai Stock Exchange released three stock indices on March 30 to reflect the performance of centrally-administered state-owned enterprises listed on Shanghai and Shenzhen markets. The three indices are CSI Central State-Owned Enterprises Composite Index, CSI Central State-Owned Enterprises 100 Index and SSE Central State-Owned Enterprises 50 Index. ICBC Credit Suisse has been authorized to use SSE Central State-Owned Enterprises 50 Index for ETF products.

Three QFII Licenses Granted. CSRC granted QFII licenses to three foreign institutional investors in February: Hanhwa Investment Trust Management Co., Ltd, Emerging Markets Management L.L.C. and DWS Investment S.A. So far, a total of 79 QFII licenses have been issued.

Southern's HK JV Applying for QFII License. Southern FMC's joint venture in Hong Kong with Oriental Patron Financial Group, established in July 2008, applied for a QFII license. Currently, Southern-OP holds an asset management license in Hong Kong. Other Chinese fund companies with Hong Kong subsidiaries, such as E Fund, Harvest and China AMC, may follow suit.

Southern Planning QDII Index Product. Southern FMC has signed an agreement with Standard & Poor's to jointly develop QDII funds that track the benchmark S&P 500 Stock Index. This will allow domestic investors to invest indirectly in a range of US blue chip stocks.

PICC AMC Announces Rmb10bn Investment Plan. The insurance asset manager gained CIRC approval for its PICC-Tianjin Binhai New Area Traffic Project Debt Investment Plan. The firm will serve as the mandator and China Construction Bank will act as the guarantor. The firm will raise Rmb10bn, with one Rmb5bn five-year and one Rmb5bn ten-year investment products.

New Classified Closed-end Fund from Changsheng. Changsheng was approved to launch an innovative fund. It's a classified closed-end fund. The new fund will have two classes with one class being the preferred and the other leveraged. It will be closed for three years, and will be converted into a LOF upon maturity.

Huge Loss, Large Revenues. According to newly-released statistics, 424 funds from 60 houses lost, in total, Rmb1.5tr in 2008 while the market slumped by 65%. However, the fund houses earned record fees of Rmb30.7bn in total from fund management, 8.28% more than 2007.

Lombarda China Announces New General Manager. Lombarda China appointed Mr. Liu Jianping General Manager. Previously, Mr. Liu was Deputy Director General of Fund Supervision Department of CSRC. Before he joined in Lombarda China, he worked in China International as Chief Compliance Officer. Lombarda China's former GM was Mr. Luca Frontini, who left the company on May 1, 2008.

Bank of Communications Fund Sales Commission Declined. Fund distributors' annual reports showed more clearly how tough last year was for fund sales. According to Bank of Communications' 2008 Annual Report, the Bank earned Rmb853 by selling 407 mutual funds. Its commission dropped by 61.14%, from Rmb2.20bn in 2007.

BOC's Insurance Sales Commission Record High. In 2008, Bank of China's sales commission on insurance products hit a record high with Rmb1.11bn. At the end of 2008, BOC sold 381 insurance products from 29 insurance companies. BOC has become the largest distributor for Ping An, China Life, AIA, AVIVA-COFCO Life Insurance and others. Commercial banks are an important distribution channel for insurance products. During 2008, about 50% of total premium income came from bancassurance.

Analytical Quick Hits

Rules for IPOs on Growth Enterprise Board. CSRC announced requirements for the new Growth Enterprise Board, which will begin operations in May 2009. It will be a direct financing platform for innovative or small and medium-sized enterprises. The first listing on the GEB may take place this August.

New JV by Huaxia Bank and F&C. Huaxia Bank will establish a JV F&C Asset Management. The new JV will be located in Beijing with Rmb250m registered capital. Huaxia Bank holds a 70.5% stake and F&C owns 19.5% of the JV. A third partner will own 10%.

Yimin's Shareholding Will Change. According to its 2008 annual report, Chongqing Road & Bridge has signed an agreement to sell a 25% stake in Yimin FMC to Chongqing International Trust and China New Era for Rmb2.75 per share. The deal is still in progress. According to fund laws, shareholders of FMC shouldn't hold stakes in other shareholders. Currently, Chongqing International Trust is a shareholder of Chongqing Road & Bridge.

Central Huijin to Buy New China Life Insurance. Central Huijin was approved to buy a 38% stake in New China Life

Insurance from CIRC, which took 38% of New China Life following a 2007 investigation into alleged fund misuse at the insurer. CIRC paid Rmb2.7bn for its stake at Rmb5.99 per share. Zurich Insurance owns a 20% stake in New China Life, and Baosteel Group holds 17.27%.

Segregated Accounts allowed access to QDII and Interbank Bond Market. CSRC expanded investment channels for segregated accounts by approving offshore investment through QDII quota. Also, the program is now allowed to trade on the inter-bank bond market.

INDUSTRY AUM & MARKET SHARE MARCH 31, 2009: ESTIMATES

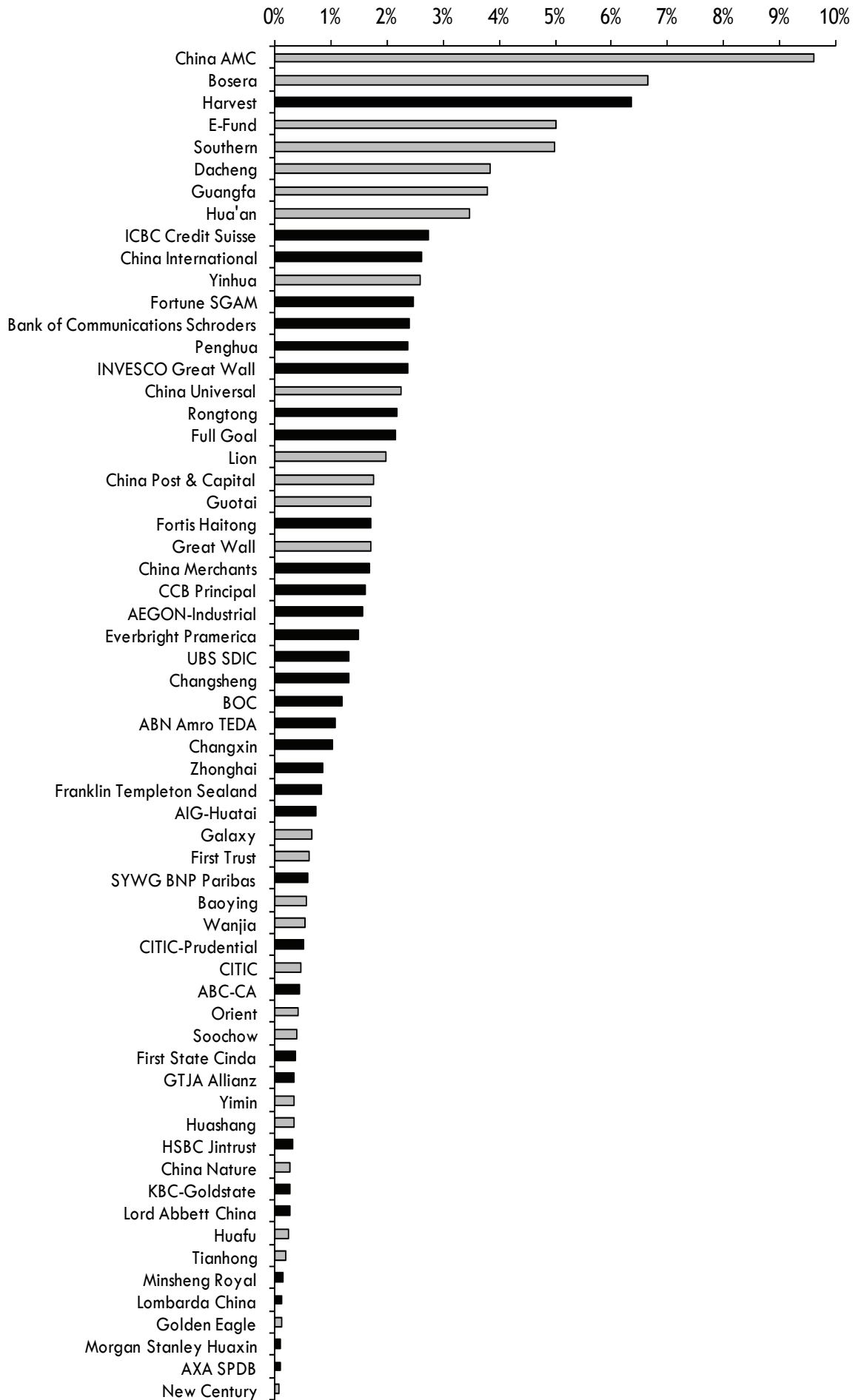
DOMESTIC FUND MANAGERS				SINO-FOREIGN FUND MANAGERS			
	AUM				AUM		
	RMB Bill	Share	RANK		RMB Bill	Share	RANK
Baoying	11.07	0.56%	39	ABC-CA	8.51	0.43%	43
Bosera	131.25	6.65%	2	ABN Amro TEDA	21.09	1.07%	31
Changxin	20.14	1.02%	32	AEGON-Industrial	30.89	1.56%	26
China AMC	189.59	9.60%	1	AIG-Huatai	14.57	0.74%	35
China Nature	5.38	0.27%	51	AXA SPDB	1.82	0.09%	60
China Post & Capital	34.65	1.76%	20	Bank of Communications Schroders	47.38	2.40%	13
China Universal	44.30	2.24%	16	BOC ¹	23.47	1.19%	30
CITIC	9.05	0.46%	42	CCB Principal	31.82	1.61%	25
Dacheng	75.62	3.83%	6	Changsheng ²	26.16	1.32%	29
E-Fund	98.97	5.01%	4	China International ¹	51.56	2.61%	10
First Trust	11.76	0.60%	37	China Merchants ¹	33.35	1.69%	24
Galaxy	12.72	0.64%	36	CITIC-Prudential	9.98	0.51%	41
Golden Eagle	2.27	0.12%	58	Everbright Pramerica	29.31	1.48%	27
Great Wall	33.49	1.70%	23	First State Cinda ¹	7.00	0.35%	46
Guangfa	74.65	3.78%	7	Fortis Haitong	33.67	1.71%	22
Guotai	33.82	1.71%	21	Fortune SGAM	48.98	2.48%	12
Hua'an	68.41	3.46%	8	Franklin Templeton Sealand	16.23	0.82%	34
Huafu	4.58	0.23%	54	Full Goal ²	42.71	2.16%	18
Huashang	6.44	0.33%	49	GTJA Allianz	6.95	0.35%	47
Lion	38.86	1.97%	19	Harvest ²	125.31	6.35%	3
New Century	1.28	0.06%	61	HSBC Jintrust	6.29	0.32%	50
Orient	8.11	0.41%	44	ICBC Credit Suisse	53.92	2.73%	9
Soochow	7.65	0.39%	45	INVESCO Great Wall	46.96	2.38%	15
Southern	98.35	4.98%	5	KBC-Goldstate	5.34	0.27%	52
Tianhong	3.70	0.19%	55	Lombarda China	2.59	0.13%	57
Wanjia	10.40	0.53%	40	Lord Abbett China	5.15	0.26%	53
Yimin	6.68	0.34%	48	Minsheng Royal ³	2.72	0.14%	56
Yinhua	51.17	2.59%	11	Morgan Stanley Huaxin	1.91	0.10%	59
TOTAL	1,094.4	55.43%		Penghua ²	47.04	2.38%	14
				Rongtong ²	42.80	2.17%	17
				SYWG BNP Paribas	11.47	0.58%	38
				UBS SDIC	26.28	1.33%	28
				Zhonghai ²	16.87	0.85%	33
				TOTAL	880.1	44.57%	

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; BLACK ROCK 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. LA COMPAGNIE FINANCIERE EDMOND DE ROTHSCHILD BANQUE OWNS A 15.385% OF ZHONGHAI.

3 - MINSHENG ROYAL FUND MANAGEMENT RECENTLY LAUNCHED ITS MAIDEN FUND.



INDUSTRY MARKET SHARE: March 31, 2009 (Estimates)