

Z-BEN ADVISORS

China Investment Management: Market Update

May 2009

Stir It Up

“History doesn’t repeat itself, but it does rhyme.” Thank you Mr. Twain because there is perhaps no better way to explain the environment facing Chinese fund managers today and an environment which has an eerie resemblance to that of 2006. Back then, market sentiment was rebounding off of lows hit in the previous year leading investors to exit in droves from low risk cash equivalent products (outflows totaling Rmb119bn to be exact). The same series of events took place in Q1 with a better outlook for the stock market causing investors to reassess risk and, in the end, reducing their collective exposure to money market funds by some Rmb169bn.

The difficulty, and why history may rhyme but not repeat itself in this example, was determining what investors actually did with all of the money. In 2006, the outcome was rather straight forward; proceeds were redeployed into equity mutual funds and almost Renminbi for Renminbi. This time around, we were stumped. Try as we might, we were simply unable to pinpoint where the money went. Some did leave funds as an asset class altogether, but we were left to simply concluded that the proceeds - not to be too cheeky - went everywhere and nowhere at the same time.

Initially we were going to end the discussion here and prattle on about the need to wait for the release of additional data over the coming months. Well, the wait ended up being short indeed. Events over the past week required us to take a fresh look at the robustness of end demand within the investing populace and whether appetite for equity mutual funds might be set to accelerate. We

Industry Assets Under Management (RMB Billions)

	Current	Growth	4Q08	Growth	3Q08	Growth	2Q08	Growth
Industry AUM	2,007.0	3.5%	1,938.9	5.2%	1,843.3	-11.7%	2,086.7	-20.1
Total Domestic	1,119.4	5.9%	1,057.5	0.4%	1,052.9	-11.6%	1,190.4	-23.4%
Total JV	887.7	0.7%	881.4	11.5%	790.4	-11.8%	896.3	-15.4%

SOURCE: Z-BEN ADVISORS

can already hear the chortling. How could this be even remotely possible? Hey, we would have agreed just a few days ago, but a new closed end fund launched by Beijing-based Changsheng Fund Management ended up shattering everyone’s expectations including Z-Ben Advisors’.

Who would have thought, after the drubbing inflicted on investors last year, that any fund manager would attract near record setting demand for an equity mutual fund. Long odds for sure, but last week the Changsheng Tongqing Innovative Fund reportedly raised Rmb15bn and achieved the results in a single day. Maybe we aren’t humming a tune similar to 2006. Perhaps we are returning to the glory days of 2007 where assets by the truck load were raised by just about every manager. Sounds idyllic, no?

Too bad the latest fund raising results by Changsheng are more likely to be product specific. In retrospect we should have surmised – given the product’s structure – that demand would have come in well above expectations. After all, it is a dual class product including embedded leverage. In a market where share prices continue to climb well off of last year’s lows, the appeal of leverage would have played a prominent factor behind investor demand. It wouldn’t have been the ultimate reason for buying though. For that we need to consider the baked in expectation of a quick and easy

Investors continue to stream out of MMFs

Changsheng stunned the market with a new Rmb15bn product

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A leveraged product?
Investors are playing a
dangerous game

gain once the shares list on the secondary market and a conclusion based on the approximate 15% premium to NAV for the only other comparable dual class product in the market. The Changsheng fund, so the theory goes, should also trade at a similar premium to NAV. So, buy shares at launch for Rmb1.00 and sell them at a later date for Rmb1.15. Simple, easy and very, very dangerous.

Investor are playing with fire. Firstly, the shares won't trade on the Shenzhen market for another several months leaving investors exposed to a correction in share prices or, at the very least, market volatility in the interim. At the same time, a possible sell of in equities would have an even greater negative impact on those products with built in leverage. In this type of scenario you are left to simply connect the dots: Any premium to NAV which may have existed will all but disappear and possibly turn to a discount.

Giving credit where credit is due, Changsheng properly read the market and launched the right product at the right time. What we would caution against is jumping to the conclusion that the results are an indication of end demand for equity mutual funds returning to the heady days of 2007. Highly unlikely. Appetite for equity exposure is certainly on the rise, but expect fund managers to keep raising assets in the more reasonable range of Rmb1.5bn to 2.5bn. Z-Ben Advisor will go out on a limb (although not the boldest of calls) with a prediction. In the coming weeks watch for a slew of rival fund managers to quickly jump on the bandwagon. If history is any indication, product development plans would have been tossed out the window last week. The latest and greatest new idea has been found. Now it is a race to be next to market.

This is not a return to
the heady days of 2007

Monthly Research Highlights

Déjà Vu All Over Again: Assessing Q1 Fund Results

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After rushing into safe havens at the end of last year, investors reassessed their tolerance for risk, turned tail and decided to dump both money market and bond funds at a rate not seen since 2006. To many, the rate of AUM growth also came in well below what had been expected. It was, however, the result of gains achieved in the equities market being counterbalanced by net outflows elsewhere. What remains to be seen, and is discussed here, is whether or not investors will return and use their ample cash proceeds to buy back into equity mutual funds.

Zero Return Investing: Strategizing the China Market

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The consensus is shifting (at last) and a greater number of people are concluding that China isn't about to fall off the cliff. Yes, the prospects for doing business in China are bright and substantial. Gratification isn't instant though and Z-Ben Advisors is left having to pour cold water on the party. Making money requires an investment of capital upfront and lots of time. With that in mind, Z-Ben Advisors presents a guide for evaluating the various strategies currently open to foreign institutions while at the same time ensuring that everyone's expectations are managed along the way.

China SWF Investment: A Dramatically Changed Game

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There has been a significant slowdown in China's two sovereign wealth funds over the past year. Both China Investment Corporation (CIC) and National Council for Social Security Fund (NCSSF) have been punished by losses in the few investments they had made. They reacted to adverse market conditions by first slowing, then all but stopping, the process of adding new elements to their overseas portfolios. Here, Z-Ben Advisors analyzes the impact this behavior has had on the portfolios of both funds and looks forward at their likely behavior over the next five years.

China's Insurance Assets: AMCs to Take Control**Page 19**

China's insurers emerged relatively unscathed from a difficult year, as they move out of equity (and funds positions) faster than the typical domestic equity fund in 2008. We further review our asset allocation forecasts for 2009 and beyond, drawn from our analysis of the annual reports. Also, we are beginning to see activities in the insurance AMC space, but this may be bad news for fund managers: ultra-low insurance AMC management fees, offered with CIRC's blessing, make competing products from non-insurers unattractive to insurers.

Direct Channel Access: Little Advantage, Entirely Overrated**Page 22**

There is no debate: Fund managers with direct access to a parent's bank distribution network are second to none when it comes to raising assets at launch. What is far from certain, however, is whether channel access can support a bank-backed manager in retaining those assets. Z-Ben Advisors' analysis, presented here, would indicate that there is no advantage whatsoever. Our research also uncovered something unexpected: When times are good, bank-backed managers are, in relative terms, far weaker in growing AUM. Distribution clout, in the end, appears to be vastly overrated.

Preemptive Differentiation: Innovation in DEDT Savings Plans**Page 25**

Fund managers and commercial banks have been focusing more of their collective attention towards DEDT programs. Highly attractive savings plans, DEDT is now being offered in numerous innovative and unique guises to better gain retail investors' attention. We present here an update along with how firms are integrating DEDT into their broader distribution strategies. Savings plans have, for too long, been overlooked by a great many. Newer variants are now broadening DEDT's appeal and could have a material impact on the rate of AUM growth for many fund houses.

The Advent of Arbitrage: A Whole New Game for ETFs**Page 28**

Quite unexpectedly, Z-Ben Advisors' review of Q1 product results uncovered enormous - an historic - turnover (some 400%) within the ETF product category. We present here several interwoven factors which are believed to have triggered the sudden increase in ETF turnover although centered on a growing number of investors taking advantage of price discrepancies. That's right. Arbitrage. Without question, these activities fall deep within the regulatory grey area. The prospects for easy gains, however, may be difficult to temper.

JV Manager Review: Greenfields in the Queue**Page 31**

Buying into the funds industry is now seen as too expensive. Better to seek out a viable local partner and apply for a greenfield license. Z-Ben Advisors, this month, looks at two such deals (Aviva and BNY Mellon) each of which are likely to receive regulatory approval later this year. Keep in mind, however, that both of these deals have been in process for some time. Foreign institutions considering a similar, start from scratch, strategy, would be well advised to factor in the lengthy time to market with our analysis identifying two important factors.

Corporate Actions: Policy Initiatives Take Effect**Page 34**

Dividend declarations were up in April while the number of announced changes in the role of portfolio manager were down (with one outlier found at Southern). Now that's a 180-degree shift. But then again, new policies were put in place the previous month and appear to be having an effect. At the same time, BNP Paribas, fresh off its final victory to acquire Fortis, will certainly have a busy summer with details provided. We also look more closely at those fund managers selling into the rally and taking in-house money off the table. Proprietary trading is beginning to go in reverse.

New Product Assessment: Rising Appetite for Equity Funds

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Another jam packed month with 13 products completing fund raising activities. It was a solid month as well with Rmb32.2bn worth of asset raised. Here we evaluate the results along with a growing bias favoring equity mutual funds. Oddly enough, our analysis also shows the bias beginning to move in the direction of retail participation. Short memories indeed, although to be expected given market conditions. Irrespective of where demand trends, Z-Ben Advisors is expecting product development to move aggressively in the direction of "innovation" (thank you Changsheng).

Monthly Performance Review: Losing (some) Momentum

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China's domestic equities market delivered amazing results in Q1 but left investors wondering if the rally was becoming long in the tooth. Then came April. A rocky ride which required investors to factor in the possible threat posed by Swine Flu. The benchmark CSI 300 Index did end in positive territory for the month but is unlikely to burst higher without the introduction of new supportive policies or economic data surprising on the upside. Still, it did come as a surprise - although long overdue - to find QDII funds registering the best performance in April.

Analytical Quick Hits

Banks to Acquire Insurers' shares. CIRC will launch a pilot program which will allow commercial banks to invest in insurance companies, in order to help banks diversify their business. It was reported that Bank of Communications and Bank of Beijing were approved to invest in China Life CMG and CPIC-ING, respectively. CIRC disclosed that ICBC and CCB have also applied to invest in insurance companies.

CBRC Prepared for REITs. Although detail regulations for REITs aren't yet issued, a number of financial firms have started preparing for the program. CBRC said three companies have been designated for the pilot REIT project in which trust companies will be responsible for fund raising and purchasing commercial properties. Harvest FMC was rumored to be involved in the pilot program as well.

E-Fund Launched Hedge Fund in HK. The firm's Hong Kong subsidiary launched a hedge fund in January. The fund was only offered to institutional investors. The subsidiary is also planning a second fund, also limited to institutional investors, to be launched in the middle of this year. This is a big step for domestic fund houses to develop overseas asset management business.

Aberdeen AMC Plans JV in China. A senior executive from Aberdeen disclosed that they are looking for a local partner to establish a JV. The firm is also negotiating with local firms for the QDII business and have a submitted application for QFII license and quota.

ABN Amro TEDA Won QDII Qualification. CSRC has granted ABN Amro TEDA its QDII license, increasing the number of FMCs with QDII license to 29. Everbright Pramerica also disclosed that they have developed a QDII product which will be invested in global equities.

Fortis Haitong QDII Fund Paid Dividend. Fortis Haitong announced dividend payment for its QDII fund. It will pay Rmb0.2 per ten shares. It is the first QDII fund to pay dividend. Although the fund suffered heavy redemption since its inception, it was the only QDII fund that had NAV over Rmb1.00 at the end-Q1.

First QDII Segregated Account Contract. BoComm-Schroders announced that they have signed a QDII segregated account contract with a famous domestic enterprise. However, the manager still needs to report to CSRC and apply for quota. This is the first QDII segregated contract since CSRC amended the rules.

NCSSF Broadened Investment Products. NCSSF distributed a notice to its investment managers notifying that some NCSSF portfolios can invest in local government bonds and medium term notes (MTNs). Fund managers are still barred by the CSRC from investing in MTNs for their mutual funds. However, the impact on the bond market may not be material because of the size of NCSSF portfolios and the attraction of these bond instruments.

NCSSF to Invest in more PE Funds. Mr. Dai Xianglong, Chairman of NCSSF, said the fund will invest in three to five additional private equity funds. The main targets are small and medium enterprises and businesses in the service industry. At the end of 2008, NCSSF's total assets under management registered Rmb562.5 bn.

First Healthcare PE Fund. CCB International won approval for a healthcare PE fund, which is the first PE fund focusing on medical and healthcare industry. The Fund will be co-managed by CCB International and Tongren Healthcare Co. The fund managers plan to raise Rmb6bn in the first phase and invest in pharmaceutical companies, medical equipment manufacturers, and healthcare institutions.

Analytical Quick Hits

Haitong Securities to Buy Bridge Trust. The firm announced that its plan to buy Bridge Trust. The size of ownership and price are still under discussion. If CSRC approves this deal, Haitong Securities will become the first brokerage to enter into the trust business.

First Trust of Trusts (ToT) by Ping'an Trust. Ping'an launched a ToT product, with minimum purchase of Rmb3m. Donghai Securities will act as the investment consultant. Ping'an also disclosed the private (hedge) funds in its pool, including Star Rock, Congrong, Huili AMC, Wudang Funds and so on.

Segregated Accounts Invest in Growth Stocks. Investment by segregated accounts seemed to be more active since the market rebound. The accounts showed up on the listed companies' top ten shareholders. For example, one of ICBC Credit Suisse's segregated accounts appeared on China Tungsten and High-tech Materials' top ten shareholders list. The price of this stock grew by 74% during the first quarter.

SSE 50 Index ETF Listed in Hong Kong. W.I.S.E. - SSE 50 China Tracker from BOCI-Prudential Asset Management was listed on the Hong Kong Ex-

change on April 15. It is the second ETF fund which tracks the performance of the A-share SSE 50 Index listed overseas. The fund raised HKD169m, with HKD18.9 per unit.

Shanghai Launched Mega Cap Index. Shanghai Stock Exchange (SSE) launched Shanghai Mega Cap Index, which traces 20 largest stocks on the exchange. SSE has authorized Bosera Fund Management to develop an ETF product with this index. In addition, other fund houses like ICBC Credit Suisse and AIG-Huatai are also developing ETFs based on other SSE indexes.

INDUSTRY AUM & MARKET SHARE MARCH 31, 2009: ACTUAL

DOMESTIC FUND MANAGERS				SINO-FOREIGN FUND MANAGERS			
	AUM		RANK		AUM		RANK
	RMB Bill	Share			RMB Bill	Share	
Baoying	11.27	0.56%	41	ABC-CA	5.47	0.27%	50
Bosera	124.44	6.20%	2	ABN Amro TEDA	20.74	1.03%	32
Changxin	21.34	1.06%	31	AEGON-Industrial	32.36	1.61%	25
China AMC ³	202.75	10.10%	1	AIG-Huatai	14.96	0.75%	35
China Nature	5.35	0.27%	51	AXA SPDB	1.48	0.07%	59
China Post & Capital	36.27	1.81%	21	Bank of Communications Schroders	49.05	2.44%	12
China Universal	44.34	2.21%	18	BOC ¹	21.89	1.09%	30
Dacheng	74.06	3.69%	7	CCB Principal	31.76	1.58%	26
E-Fund	100.81	5.02%	5	Changsheng ²	26.80	1.34%	28
First Trust	12.21	0.61%	37	China International ¹	54.88	2.73%	10
Galaxy	12.05	0.60%	38	China Merchants	34.40	1.71%	23
Golden Eagle	2.50	0.12%	57	CITIC-Prudential	11.62	0.58%	39
Great Wall	33.70	1.68%	24	Everbright Pramerica	30.48	1.52%	27
Guangfa	77.97	3.89%	6	First State Cinda ¹	7.01	0.35%	47
Guotai	36.39	1.81%	20	Fortis Haitong	35.61	1.77%	22
Hua'an	72.14	3.59%	8	Fortune SGAM	47.44	2.36%	14
Huafu	5.69	0.28%	49	Franklin Templeton Sealand	16.29	0.81%	34
Huashang	7.32	0.36%	44	Full Goal ²	46.77	2.33%	16
Lion	40.42	2.01%	19	GTJA Allianz	9.53	0.47%	42
New Century	1.37	0.07%	60	Harvest ²	115.18	5.74%	3
Orient	8.44	0.42%	43	HSBC Jintrust	6.56	0.33%	48
Soochow	7.22	0.36%	45	ICBC Credit Suisse	56.02	2.79%	9
Southern	107.62	5.36%	4	INVESCO Great Wall	47.20	2.35%	15
Tianhong	3.69	0.18%	54	KBC-Goldstate	5.22	0.26%	52
Wanjia	12.47	0.62%	36	Lombarda China	2.55	0.13%	56
Yimin	7.09	0.35%	46	Lord Abbett China	5.21	0.26%	53
Yinhua	50.45	2.51%	11	Minsheng Royal	2.72	0.14%	55
TOTAL	1,119.4	55.77%		Morgan Stanley Huaxin	2.11	0.11%	58
				Penghua ²	48.39	2.41%	13
				Rongtong ²	45.85	2.28%	17
				SYWG BNP Paribas	11.51	0.57%	40
				UBS SDIC	23.61	1.18%	29
				Zhonghai ²	16.92	0.84%	33
				TOTAL	887.6	44.23%	

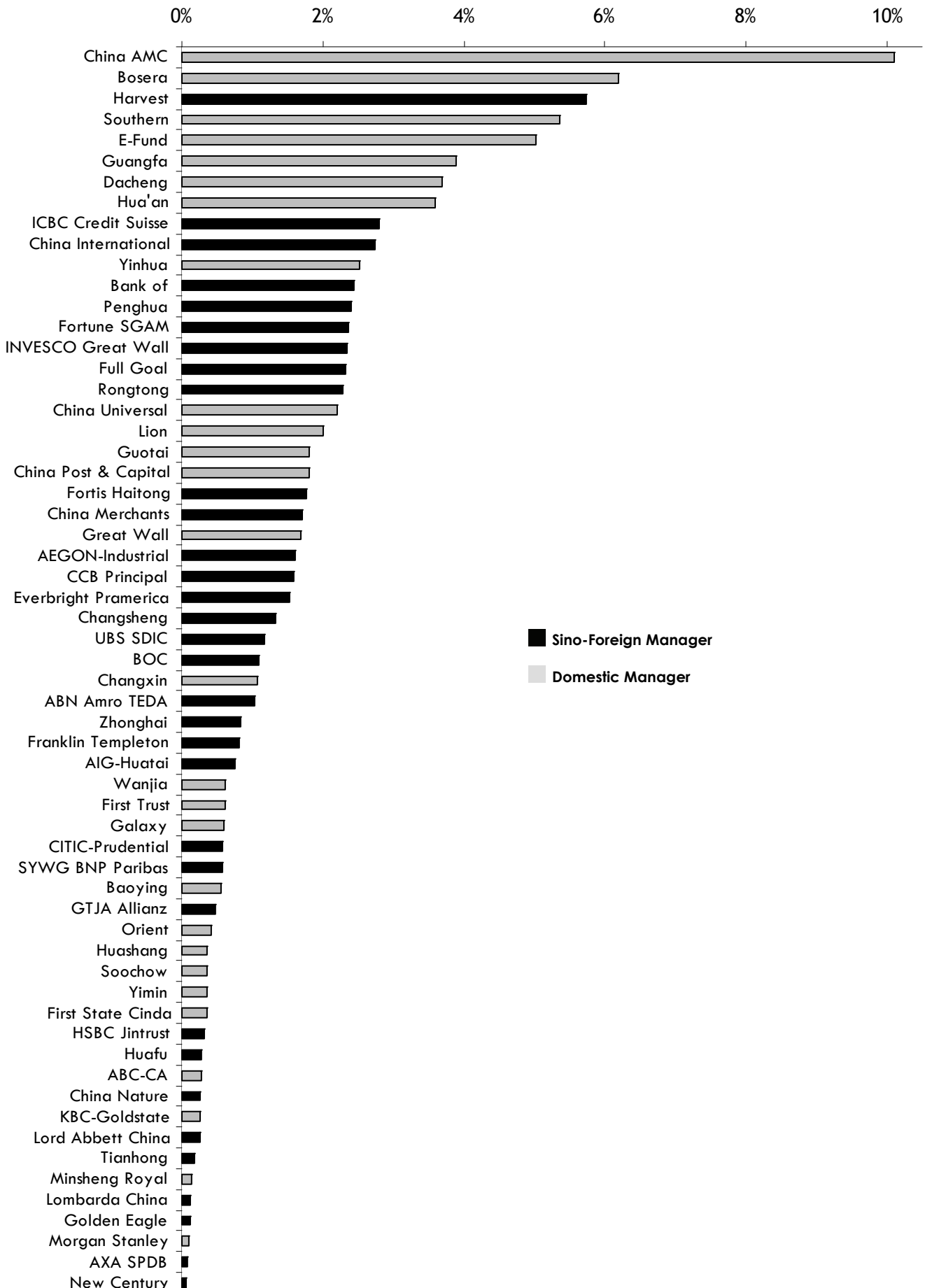
SOURCE: Company Data, Z-BEN ADVISORS

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. COMBINED AUM OF CHINA AMC AND CITIC FMC

INDUSTRY MARKET SHARE: March 31, 2009 (Actual)



SOURCE: Z-BEN ADVISORS