Z-BEN ADVISORS

China Executive Briefing

August 2009

Action Stations

A normal-for-China-looking market. Sustained (if occasionally choppy) improvements in asset prices. Major institutions – regulators, fund managers, investors – showing risk appetite and turning their attention again to foreign investment possibilities. A mild case of IPO fever. Investment time-scales moving in and capital preservation becoming less fashionable. Such are the characteristics on the plus side of the China equation when viewed by global asset managers.

Reduced capabilities may see growth opportunities lost

On the minus: far fewer staff with which to attempt a better China model. Reputational damage from association with failed parents, products or channels. Lack of familiarity with the fine details of the current environment, sacrificed to control costs. A flood of competitors all finding their courage at the same time. The lingering priority of short-term ROI.

All of the pluses we have numbered (and, indeed, the majority that we can see) are related to the China market's growth. Almost all of the minuses relate to reputation, strategy and ability. In Z-Ben Advisors' view, that's a heady recipe for failure: good strategic choices need to be made now, by asset managers with fewer resources to make them, for those market opportunities to be converted into real business. Only a small number of asset managers – fewer than ten, in our estimation – have so far constructed ongoing client and channel relationships in China that can be counted on to give them a valid overview of which opportunities are real and which illusory. For the rest, we struggle to see how their operations will deliver sufficient information to make good strategic choices.

Industry Assets Under Management (RMB Billions)

	2Q09	Growth	1Q09	Growth	4Q08	Growth	3Q08	Growth
Total Industry Assets	2,305.8	14.9%	2,007.0	3.5%	1,938.9	5.2%	1,843.3	-11.7%
Total Domestic	1,282.7	14.6%	1,119.4	5.9%	1,057.5	0.4%	1,052.9	-11.5%
Total Joint Venture	1,023.2	15.3%	887.6	0.7%	881.4	11.5%	790.4	-11.8%

SOURCE: Z-BEN ADVISORS

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For that reason, this issue of *China Investment Management: Market Update* focuses particularly on strategic opportunities and risks: forgotten bond funds, HNWI, new subsidiaries in Hong Kong, equity-centric product gaps, and record volumes of FMC buy-in opportunities on the horizon, among other subjects. Our purpose in highlighting these topics reflects our discomfort not only about many global asset managers' past China strategies but also two beliefs about what is likely to happen over the next six months.

First, we expect hyper-competitiveness among domestic FMCs for asset-raising. Current markets suggest a significant change from the relative stolidity of AUM rankings seen in the past 18 months. At least a handful of firms will achieve new AUM that entirely changes their fortunes, business plans and standings with partners. Another handful will fail to impress in one of the most generous markets going and the rate of their descent to obscurity will accelerate. Penny stakes are no longer in play.

Second, a small number of global asset managers will transform themselves from bottom-tier to mid-tier players in China, solely through the acquisition of a significant minority stake in a Chinese FMC. We expect a record number of such stakes to change hands in the second half of 2009 and their buyers will be taking a more aggressive view of what's possible in China than ever before.

Traditionally, when Chinese markets have run this hot, quantity of effort has vastly outweighed the quality of effort that global asset managers have made to take part. In small ways, at the margins of the industry, some successes have resulted from such shotgun approaches. Primarily, these successes can be found in then-opening channels, such as bank QDII lists. This time, we would argue forcefully, it's different: we see no new channels, no new product types, no new distributors and no new investment needs emerging. Rather, we are seeing more experienced Chinese parties seeking more specific forms of partnership with global asset managers of whose capabilities and reliability they have taken vastly better measure.

Global asset managers hoping to increase the volume of business they do in China or with Chinese investors can now be split into two camps: those who are getting it right (and grew both the number and quality of partnerships they enjoy in 2008) and the rest. We are confident that the first group faces few obstacles when accelerating its China efforts. We have serious reservations about the strategies we expect to see the latter group employ. We would propose identical arguments when discussing the fortunes of China's domestic FMCs.

The key idea that we feel must be understood: current markets are creating chances but not second chances. Those who resume their China push with only the tactics, approaches and environmental awareness they abandoned in 2008 are highly unlikely to succeed. Those who have adapted their strategies, whether for fund launches, channel management, messaging or partnership, to suit the current environment will leapfrog competitors. Times are unquestionably good in China right now. The question we ask our readers in this issue is this: are they good for you?

Monthly Research Highlights

Q2 Industry Review: AUM Growth Accelerates Page 9

Industry AUM rose 14.64% in Q2 and is now up almost 20% - to Rmb2.30bn - from end-08. However welcome, this recovery in asset levels is not being achieved smoothly: almost all of the organic gains can be attributed to the few equity funds which have successfully exploited the domestic stock market's 72% rise since the beginning of the year (with a 27.07% gain boosting returns in Q2) even though equity fund performance lags equity market performance by record levels. Undoubtedly, a lumpy AUM recovery is better than none. And, lumps notwithstanding, the recovery is real and promises to last. As we'll explore in this review of Q2's activities, a number of firms are currently making very strong gains in equity AUM, shares in issue and market share.

Accessing Retail Demand: Improving But Also Increasingly Selective Page 12

Retail demand for equity-centric funds are improving and this, we find, particularly encouraging going into H209 since most institutional investors have already redeployed their capital. Improving demand, however, is not evenly distributed for all FMCs, and we find investors are increasing selective in mutual fund investments and increasingly sensitive to performance, FMC brand, and even product design in making their investment decisions. Attempting to derive strong AUM growth from retail investors has its drawbacks as well. Despite increasing sophistication in choosing investments, retail investors remain highly fickle, and FMCs may have to be very vigilant in asset retention in order to successfully execute this strategy.

Bright Lights, Big City: Chinese FMC Subsidiaries Enter Hong Kong Page 15

It has been a particularly busy quarter at the Hong Kong subsidiaries of Chinese FMCs: mergers, first fund registrations and a more general sense of gearing up for battle. These events are, perhaps, being watched more closely within China's fund management community than Hong Kong's, as the latter have seen a version of this Mainland attack before. In this article, we review the current activities of FMC Hong Kong subsidiaries and attempt to assess their progress, challenges and prospects from two perspectives: the Mainland view and the Hong Kong view. Unsurprisingly, expectations vary depending on where the viewer stands.

New Product Review & Analysis: The Higher Equity the Better Page 39

Fund raising activities gained substantial momentum in June and July, as CSRC approved a record number of equity and index funds, in support of the IPOs. Retail demand for equity funds were trending up, but trail in comparison to fully-invested index funds. Somewhat surprisingly, a couple of bond funds achieved good results in June, with the average fund-raising size reaching Rmb4.5bn, but fell again in July. Last but not least, CSRC approved the first ETF — ICBC-Credit Suisse SOE50 ETF — since October 2006, and Bank of Communications-Schroders is likely to follow suit soon with a Shanghai 180 Corporate Governance ETF.

Monthly Performance Review: A Glass Half Full? Page 66

Despite the odious one-day 5% loss at the end of the month, July ended as the strongest month in 2009 with a CSI300's 18% net gain and the combined Shanghai and Shenzhen trading volume reaching a historic peak of Rmb7.1tr. Thanks to aggressive equity exposure, a number of equity funds posted excess of 100% YTD (although most still lag behind the benchmark index), with a leveraged one registering 177% at end-July. Index fund and ETFs took the top rankings and, as expected, fixed-income products found themselves, again, at the bottom with the bond-fund index loosing 0.60% for the month.

Analytical Quick Hits

Ping An Buying into SDB. Ping An Insurance Group plans to acquire a stake of up to 30% in Shenzhen Development Bank through a private placement and the purchase of 16.76% stake held by the current largest shareholder, Newbridge Capital. After the deal, which will cost no more than Rmb22bn, Ping An will become the largest shareholder of SDB.

CSRC Approved China AMC to Absorb CITIC Funds. CITIC FMC will cease to exist after the merger, while China AMC will take over the four funds of CITIC FMC. This is the first fund industry merger in China, and was driven by the regulatory limitation on maximum ownership. China AMC is currently 100%-owned by CITIC Securities.

China Universal Approved to Set up Hong Kong Subsidiary. China Universal Asset Management recently announced that the company has gained approval from CSRC to set up a solely owned subsidiary in Hong Kong and becomes the sixth manager to do so. The Hong Kong unit will focus on offshore investment research, management and client service as well as supporting the QDII program.

Generali to Buy 30% of Guotai. Generali will pay approximately EUR100m to China Jianyin Investments for 30% of Guotai AMC. Jianyin, a wholly-owned subsidiary of CIC, will, by virtue of its new deal with Generali, become fully compliant with CSRC ownership size restrictions, unlocking one of the major bottlenecks to the fund manager's growth.

PICC to Transfer into a Limited Company. The restructuring plan of the PICC was recently approved by the State Council. State-owned PICC will become a joint stock company by the end of July. This will help PICC pave the way for a listing.

Harvest Takes Over DWS' Asia Business. Harvest FMC has taken over Deutsche Asset Management in Hong Kong. DWS will delegate the management of its China and Asian equity funds to Harvest Global Investment, the HK subsidiary of Harvest FMC, and transfer some senior managers as well.

CIC to Oversee China Reinsurance. CIC has taken over the supervision of China Reinsurance's management team from CIRC, giving CIC the responsibility for naming senior managers. Central Huijin, a CIC unit, owns 85.5% of China Reinsurance by injecting USD4bn in 2007, and the Ministry of Finance owns the remaining 14.5%.

CIC Announced Several Investments. CIC announced on 16 June it will invest about USD159m in Australia's leading property trust Goodman Group, to help the company pare down its debt. On 3 July another investment was announced: CIC will invest approximately USD1.5bn in Canadian mining company Teck Resources buying 3m Teck Class B subordinate voting shares. Two weeks later, CIC agreed to buy a 40% stake in CITIC Capital, which is the first time that CIC has invested in a Chinese asset manager. CIC is looking for balanced, decentralized and passive investment that does not require participation in operations.

Listed Firms to Transfer Stated-Owned Shares to NCSSF. Some listed Chinese companies will have to transfer state-owned shares equivalent to 10% of their IPOs to NCSSF. The measure applies to 131 state-controlled companies that have listed on domestic markets, and also applies to companies that will list in the future. This policy is to help meet the growing pension obligations of NCSSF and to stabilize the market.

NCSSF Posts 9.99% First-Half Investment Return. NCSSF made a 9.99% return on equity investments in the first half. The Fund, whose assets exceeded Rmb660bn at the end of June, made a profit of Rmb51.2bn from investing in stocks. The fund's annual gain has averaged 9.6% since inception in 2000.

A-Share IPO Resumed. Guilin Sanjin Pharmaceutical Co. won final approval to list in the Chinese mainland stock markets, becoming the first company approved for an initial public offering in over nine months. The company listed on the Shenzhen Exchange in early July, and issued 46 million new shares in the IPO at Rmb19.8 per share. Afterwards Sichuan Expressway got approval from CSRC to launch an IPO in Shanghai market.

China Pacific Insurance Resumed HK IPO Plan. The IPO plan has shelved for about one year. CPIC plans to offer up to 1bn shares in Hong Kong, expected to be priced at around Rmb23.5 and could raise around Rmb23.5bn from the IPO. CPIC expects that the HK listing will help expand its business and help catch up with rivals China Life and Ping An. Carlyle Group, a foreign shareholder of the insurer, may benefit from the IPO.

Analytical Quick Hits

Six More QFII Licenses Granted. CSRC granted QFII licenses to six foreign firms in May and June: South Korea's Woori Bank Co., Bank Negara Malaysia, Lloyd George Management (Hong Kong) Ltd., Templeton Investment Counsel LLC, BEA Union Investment Management and Sumitomo Trust & Banking Company Ltd. So far, a total of 85 QFII licenses have been issued.

Templeton Gave Up QFII License. Templeton Asset Management, a subsidiary of Franklin Templeton Investments, withdrew from China's QFII program earlier this year at the request of China's securities regulator. On June 15 a new license was granted to Templeton Investment Counsel LLC. In the meantime, Franklin Templeton will continue to invest in China through other means, including private-equity investments.

CIRC Approved New Investment-Linked Accounts. CIRC approved applications by four insurers to open new investment-linked accounts, including China Life Insurance, Greatwall Life Insurance, CITIC-Prudential Life Insurance, and Pacific-Antai Life Insurance. Such accounts have been suspended for the past half year.

CBRC Tightens Control on Wealth Management Products. CBRC issued a new circular banning banks from marketing wealth management products in stocks, equity mutual funds, equities of unlisted firms, and shares of listed firms that are not permitted to be issued or traded publicly. This circular aims to prevent banks from investing client funds in high-risk products or complicated financial products, and to protect clients with medium or low incomes.

Shanghai Bourse Selects Funds to Launch Global ETFs. The Shanghai Stock Exchange has selected around 10 fund managers as candidates for a final three to launch the bourse's first global ETF, a QDII fund tracing global indices. Chinese investors will be allowed to trade global stock indices via the ETFs. The indices could cover major US, European and Asian markets.

Postal Saving Bank of China Approved to Offer Custodian Service. Recently PSBC was approved by the CSRC and People's Bank of China, becoming the 16th bank in China that is qualified to do securities investment fund custody business. Founded in 2007, PSBC currently has more than 36,000 branches, more than twice as many branches as distribution giant ICBC.

INDUSTRY AUM & MARKET SHARE

JUNE 31, 2009: ACTUAL

DOMESTIC FUND MANAGERS

FMC	AUM RMB Bill	Share	RANK
Baoying	11.06	0.48%	42
Bosera	140.29	6.08%	2
Changxin	22.33	0.97%	32
China AMC	224.37	9.73%	1
China Nature	5.04	0.22%	52
China Post & Capital	41.66	1.81%	24
China Universal	50.51	2.19%	16
Dacheng	91.86	3.98%	7
E-Fund	115.61	5.01%	5
First Trust	14.20	0.62%	37
Galaxy	12.40	0.54%	39
Golden Eagle	3.49	0.15%	56
Great Wall	44.36	1.92%	22
Guangfa	98.21	4.26%	6
Guotai	42.91	1.86%	23
Hua'an	79.06	3.43%	8
Huafu	5.41	0.23%	50
Huashang	9.67	0.42%	45
Lion	47.40	2.06%	19
New Century	1.76	0.08%	59
Orient	10.24	0.44%	43
Soochow	8.13	0.35%	48
Southern	116.35	5.05%	4
Tianhong	4.03	0.17%	54
Wanjia	15.27	0.66%	36
Yimin	7.39	0.32%	49
Yinhua	59.70	2.59%	11
TOTAL	**1282.69**	**55.63%**	

SOURCE: Company Data, Z-BEN ADVISORS

SINO-FOREIGN FUND MANAGERS

FMC	AUM RMB Bill	Share	RANK
ABC-CA	11.20	0.49%	41
ABN Amro TEDA	25.90	1.12%	30
AEGON-Industrial	37.71	1.64%	26
AIG-Huatai	19.46	0.84%	34
AXA SPDB	2.15	0.09%	57
Bank of Communications Schroders	62.55	2.71%	9
BOC [1]	24.60	1.07%	31
CCB Principal	37.11	1.61%	27
Changsheng [2]	44.65	1.94%	21
China International [1]	60.25	2.61%	10
China Merchants [1]	37.83	1.64%	25
CITIC-Prudential	12.03	0.52%	40
Everbright Pramerica	36.05	1.56%	28
First State Cinda [1]	8.92	0.39%	47
Fortis Haitong	45.51	1.97%	20
Fortune SGAM	48.40	2.10%	18
Franklin Templeton Sealand	17.02	0.74%	35
Full Goal [2]	57.65	2.50%	12
GTJA Allianz	9.19	0.40%	46
Harvest [2]	122.91	5.33%	3
HSBC Jintrust	9.70	0.42%	44
ICBC Credit Suisse	48.70	2.11%	17
INVESCO Great Wall	53.74	2.33%	14
KBC-Goldstate	4.60	0.20%	53
Lombarda China	3.62	0.16%	55
Lord Abbett China	5.07	0.22%	51
Minsheng Royal	1.45	0.06%	60
Morgan Stanley Huaxin	2.13	0.09%	58
Penghua [2]	53.12	2.30%	15
Rongtong [2]	57.05	2.47%	13
SYWG BNP Paribas	14.11	0.61%	38
UBS SDIC	28.80	1.25%	29
Zhonghai [2]	19.99	0.87%	33
TOTAL	**1023.16**	**44.37%**	

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.

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China Investment Management: Market Update

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