Z-BEN ADVISORS

China Investment Management: Market Update

September 2009

Shake ’n Bake

Striking the right balance between abject terror of the market’s next move and smug satisfaction with AUM growth can be difficult, but it is also the prerequisite for appearing to know what you’re doing when managing funds in China. It has rarely been a more difficult time to achieve the right note of cautious optimism.

Neither markets nor competition are stable

Markets were brutally unkind to equity investors in August, as an unhappy confluence of IPO-driven volatility and fears of a tightening lending environment drove a 24.2% decline in the CSI 300. You’d never know it if assets under management for the industry were your only signal of the market’s health: total AUM fell only 4.4%, while newly-launched funds – the overwhelming majority of them equity-centric – contributed a whopping Rmb52.8bn to the total. Fund launch success, we know, is a lagging indicator of general investor sentiment: those getting out tend to leave existing funds well before the last bulls have arrived in new launches. However, it’s fair to say that equity fund popularity and equity market popularity haven’t often moved so quickly in opposite directions. Absent market stabilization (and that’s not an implausible hope, given the proportion of the CSI’s fall that can be attributed to changes in expectations of investors’ future liquidity), a reversion of fundraising to equity market means should be FMCs’ first worry.

It shouldn't be their only one, although the rest of the list is by far more pleasant to contemplate than the thought of a continuing equity correction. Chief among these other concerns should be the

Industry Assets Under Management (RMB Billions)

	Current [1]	Growth	2Q09	Growth	1Q09	Growth	4Q08	Growth
Total Domestic	1,243.6	-3.0%	1,282.7	14.6%	1,119.4	5.9%	1,057.5	0.4%
Total Joint Venture	961.1	-6.1%	1,023.2	15.3%	887.6	0.7%	881.4	11.5%
Total Industry Assets	2,204.7	-4.4%	2,305.8	14.9%	2,007.0	3.5%	1,938.9	5.2%

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

multiple (and multi-faceted) changes to the competitive landscape of investment products currently underway. And, at the top of that list, the explosion of multi-client segregated accounts deserves pride of place. Rarely has any new product been launched with such avid client interest or such well-organized opposition from distributors. The consequences of both look set to run for months and, in this month’s issue, we set out our view of their near-term effects, along with our assessment of the winners and losers of the competition’s opening shots.

Let us stress the point here to remove any doubts: although a number of competitive changes surfaced in August, none look to us to have the overall importance to FMCs as the birth of multi-client SAs. As AUM aggregators, as revenue generators, as proving grounds for manufacturing expertise, as client retention motivators and as a (semi-)level battlefield for publicly- and privately-managed funds, multi-client SAs have, in the few short days since their birth, already established themselves as the most important game in town. For those FMCs with skin already in the multi-client game, our assessment has a sting in the tail: the current state of competition is not a clear indicator of its future direction. Neither success nor failure in today’s skewed distribution environment are likely predictors of success further down the road. For those who have yet to organize a multi-client attack (and there aren’t many of you left), this is not a good time to bring a knife to the gun-

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fight: smaller firms, for once, may be on a better footing than their larger rivals in the race for multi-client AUM. Strike while the iron is glowing white.

New competition on a number of fronts

While multi-client SA is, without doubt, the most important competitive change in recent months, it's not the only one. However, like the changed ETF market, the new opportunities opening up in second-tier cities and the intensifying competition for insurance assets – three other subjects covered in greater detail in this month's report – FMCs are increasingly gaining access to new markets, albeit markets that are already well-populated with successful and resourceful competitors. For many of the industry's JV firms, this is unfamiliar terrain. (For older domestics, current competitive changes are perhaps better described as a significantly more difficult version of the initial war for assets, waged against less-advantaged — and, dare we say, less-competent — securities and trust companies.) In some areas, such as provision of management services for insurers, FMCs are not making significant gains. In others, such as forming ETF partnerships, gains are unequally distributed, with larger FMCs taking their customary outsize share. What matters more, in our view, is that further AUM gains made possible by regulatory changes are likely to be contested gains, a new experience for many FMCs and not one that all will welcome.

It's going to be a fascinating autumn. A full-scale brawl between FMCs, regulators and distributing banks is your starter; a wildly-gyrating equity market will spice every dish and dessert is certain to be withheld from FMCs who cannot mount a credible advance into some of the newer competitive fields that CSRC and other regulators have made available. Expect to see tears before bedtime. On the other hand, is there a more interesting market in the world in which to manage money?

Monthly Research Highlights

Multiple-Client Segregated Accounts: Ready to Rumble! Page 9

The long-awaited multiple-client segregated account platform was finally approved by CSRC in the middle of August, much to the delight of fund managers. With this new platform, we believe, FMCs will be better able to compete with other pooled investment accounts currently offer by brokerages and trust-based private funds. The challenge, however, is to come up with a mutually-beneficial distribution arrangement with banks, most of which currently are refusing to sell multiple-client products due to disagreements about performance fee-sharing arrangement.

Out of the Comfort Zone: FMCs' Branches in Smaller Cities Page 12

China's second-tier cities are growing rapidly and, therefore, their wealth-accumulation is catching up with affluent Eastern regions. Accordingly, the overall market high net worth investors (HNWIs) and institutional investors is expanding as well. Meanwhile, CSRC recently approved multiple-client segregated account (SA) platform, which gives FMCs broader product manufacturing capabilities and, thus, higher value proposition for these newly affluent. By setting up regional branches in these smaller cities, FMCs may be able to combine the new SA framework with a proprietary branch network to effectively acquire and retain large investors. Of course, fund managers should have a clear strategy and prioritized objectives for their own branches.

Managing Success: From Champagne to Supernova Page 15

Past success in the asset management industry does not guarantee continued growth or stable market share. Z-Ben Advisers examines firms two groups of firms, old giants that have fallen and fast risers which have run into operational difficulties, analyzing the risks firms face after success is achieved. In this process, we have identified three shifts in the competitive landscape since the industry's inception ten years ago. Fast risers face a different set of challenges as success is often destabilizing to a firm's investment team. The real question at hand in this strategic review: how to manage success?

Chinese insurers' total assets and therefore total investment have been growing in 2009, albeit at a slower rate. Meanwhile, insurance asset management subsidiaries (AMCs) are quickly learning the ropes of investing and are increasingly active players. These in-house asset managers may soon become direct competitors to FMCs in accessing insurance assets. Moving into 4Q09 and 2010, insurance companies should begin embracing alternative investments such as private equity, infrastructure and real estate investments, in accordance with recent regulatory liberalization.

Last month, China Investment Corporation (CIC) released its first annual report, noting a total return on capital of 6.8% in 2008 and a loss of 2.1% in its nascent global portfolio; returns that were, we're pleased to say, very much in line with the estimates we published earlier this year. The overall gain is entirely attributable to the success of CIC's domestic subsidiaries, Central Huijin and China Jianyin, which combined to produce the single largest line item in the income statement and which, more importantly, are likely to be the sources of some of the most attractive securities company and asset management partnership opportunities for foreign asset managers over the next five years.

For the past five months, the local fund industry continued to lose investment talents. The regulatory barriers CSRC erected months ago only slowed down PM changes within the industry, but proved futile in stopping experienced CIOs and PMs from leaving the public fund sector as private funds become more attractive for career development and compensation. Former mutual fund PMs have achieved enormous and rapid success running their own private funds in the past two years and this has demonstrated the value of starting one's own business. The move from mutual funds to private funds may probably be a trend difficult to tame. FMCs need to develop measures to manage their investment team stability.

A substantial challenge to QDII funds' primacy for foreign investment is now being mounted in Shanghai, where the Shanghai Securities Exchange (SSE) has begun the first stages of a program to introduce global ETFs to Chinese investors. On the domestic front, ETFs are gaining momentum and market share through the creation of feeder and innovative funds. In this article, we explore the consequences of both trends. Two points, however, should be made clear at the outset. First, the arrival of global ETFs will be a game-changer for the QDII program with significant impact on existing and planned QDII funds. Second, domestic ETFs are moving outwards quickly from their institutional customer base and are now presenting a serious challenge to index funds.

No fund marketing in China works better than NAV-based marketing: dividends, especially the mega- kind, are what opens wallets. From the marketing director's perspective, every fund in China can therefore be sorted into three groups: the dogs, which have NAVs so low nothing can be extracted from them; the stars, from whose fattened NAVs ample steaks can be sliced; and the rest, which the investment department can be relied upon eventually to place in one of the two other groups. JVs, compared to their domestic competitors, have a vastly better-stocked larder of NAV-marketable stars. In total, something like 6.85% of JV AUM is currently extremely useful to the NAV-based marketer, with nine firms in perfect position to begin expanding their AUM.

Corporate Action: M&A Activities set to Rise Page 34

A grand movement has began for the compliance of CSRC's rules, with Wanjia FMC the first to complete adjusting its shareholders and won CSRC's consent. Others, such as Bosera FMC, have followed up with proposals of shareholding auctions, etc. In that circumstances, we will probably see more corporate restructuring in the coming months. Senior management changes remained vibrant last month, with further losses of star portfolio managers, as well as general managers for some small FMCs. Employee incentive program through proprietary investments reappeared.

Monthly Performance Review: A Nosedive Page 66

After rallying for nine consecutive months, the broad CSI 300 index took a 25% nosedive due to concerns on monetary policy, loosing most of the gains made in June and July. As expected, index funds and ETFs got the worst hit, loosing 24% on average. Equity products suffered 19% decline and, due to their high equity exposure, fixed income products also took a 3.6% hit. Harvest, as one of the few managers to cut equity exposure aggressively at end 2Q09, saw its Thematic Enhanced Fund finished August as the best performing fund.

Analytical Quick Hits

CIC Reports 6.8% Return in 2008. Excluding domestic investment income, the company's overseas investment portfolio showed a 2.1% loss. Its investment income totaled USD23.95bn and net profit was USD23.1bn in 2008. CIC limited its losses last year by keeping 87.4% of its assets in cash or cash-equivalent products.

Foreign PE Started to Set up RMB Funds. First Eastern is the first international private equity group to incorporate a Shanghai subsidiary. This follows an announcement that Blackstone Group will establish its first regional, RMB-denominated private equity fund in Shanghai. Later, CLSA also announced it will set up a JV with Shanghai Guosheng Group to launch RMB-denominated funds.

Everbright Bank Approved to Raise Rmb11.5bn. CBRC approved the bank to raise about Rmb11.5bn via private placement from eight domestic investors, issuing more than 5 billion new shares at Rmb2.20/share. The firms are China Reinsurance, Aerospace Science and Technology Corp., Aerospace Science and Technology Financing, Baosteel Group, China Power Finance, Shenergy Group, Shanghai Chengtou Corp., and Guangdong Expressway Development Co.

Value Partners and Ping An Form an ETF JV in HK. Ping An will acquire a 50% stake in Sensible Asset Management at around HKD23.25m. SAM HK's first ETF is expected to track the FTSE Value-Stocks China, which was designed by Value Partners using its proprietary value model and launched in cooperation with FTSE last month.

Macquarie Got Approval for Trust JV. Macquarie was authorized to launch a trust JV with Beijing Sanjili Energy Co. and Beijing Rongda Investment. Macquarie will hold a 19.99% stake of the new company, named Sino-Australian International Trust Co. It can offer Yuan-denominated financial products and arrange domestic equity financing in China.

Merchants Securities to Sell 24% Stake in Bosera FMC. Merchants Securities plans to sell the stake at Rmb109.5 per share through the Tianjin Property Rights Exchange. The sale will reduce Merchants Securities' equity interest in Bosera to 49% from the current 73%, fully compliance with CSRC rules on FMC shareholdings.

Qilu Securities to Transfer 11% Stake in Wanjia. Shandong Qilu Securities recently got approval from CSRC to transfer 11% of Wanjia to Shandong SASAC Holding Company. The transaction will reduce Qilu's equity interest from 60% to 49%, fully compliant with CSRC rules on FMC shareholdings.

Four General Managers Changed. Four FMCs announced their GM changes. Invesco Great Wall and Orient appointed new GMs. China Nature and Huashang approved the resignations of their GMs, Mr. Zu Yu and Mr. Yu Luming, respectively.

CSRC to Allow Foreign Banks Distribute Funds. CSRC is revising rules to pave the way for foreign banks to enter the business. If approved, foreign banks may start to distribute mutual funds before the end of this year. It's reported Citibank is leading the program.

CSRC Stipulated Fund Rating Measures. CSRC proposed a new set of rules that will make registration and licensing compulsory for fund advisory, commentary and rating providers. Fund rating and advisory providers are expected to fully disclose their methodology in public before they can publish their results to end users. CSRC is open to public consultation until August 28.

Multi-Client SA Started. CSRC has issued detailed rules that take effect August 18 on multi-client SA fund products operated as managed funds, which can privately raise capital from up to 200 clients for each product. Each client must invest at least Rmb1m per fund product, and each fund product must be worth at least Rmb50m. SD&C has been accepting registrations of new products from managed funds since August 11.

China International FMC Won Segrageted Account Qualification. The firm won approval to provide segregated account services. The company said it has fully prepared for the new project. The product pool covers products of different risk classification, both onshore and offshore, with the latter utilizing its QDII quota.

CSRC Approved First Index Classified Fund. UBS SDIC was approved to launch the first CSI 300 Index Classified Fund, which is also the first new product the company will be launching this year. This new index classified fund will have three classes with different risk/return profiles It is also seemed as the most innovative fund in the market.

Analytical Quick Hits

New Fund for China Post & Capital. China Post & Capital Core Advantage Balanced Fund was approved by CSRC recently. It is the third fund for the company, also its first new product since 2007. The current AUM of the company's two existing funds is Rmb41.66bn.

SSE Socially Responsible Index Launched. This new index was launched on August 5, with a view to tracking companies with the largest social contributions. CCB Principal announced it would launch an ETF based on this new index.

One More QFII License Issued. CSRC granted a QFII license to Korea Investment Trust Management Co. in July. So far, a total of 86 QFII license have been granted, 11 of them this year.

Two ETF Feeder Funds Approved. On August 17, Hua'an received approval from CSRC for the issue of a ETF feeder fund linked to its Hua'an Shanghai 180 ETF. Bank of Communications Schroders announced that the regulator had approved its plan to launch a SSE 180 Corporate Governance ETF and its feeder fund.

Citibank Approved as Interbank Bond Market-Maker. Citibank has received regulatory approval to act as an interbank bond market-maker in China, becoming the second foreign market-maker after JP Morgan. The new role will enable Citibank to broaden its access to a variety of Yuan-denominated fixed-income products.

Bank of Shanghai Won the Custodian Qualification. Bank of Shanghai was approved by the CSRC and People's Bank of China to offer custodian service. It is also the seventeenth bank in China that is qualified to do investment fund custody business.

Fortune SGAM Upgrades Employee Incentive Program. Recently Fortune SGAM upgraded its Core Employee Incentive Program. All the senior management employees have subscribed to the company's non-money market funds for a total of Rmb6.83m at August 25.

INDUSTRY AUM & MARKET SHARE

AUGUST 31, 2009 (ESTIMATE)

DOMESTIC FUND MANAGERS

	AUM RMB Bill	Share	RANK
Baoying	10.92	0.50%	41
Bosera	137.70	6.25%	2
Changxin	20.41	0.93%	32
China AMC	227.08	10.30%	1
China Nature	5.07	0.23%	52
China Post & Capital	38.37	1.74%	24
China Universal	53.45	2.42%	13
Dacheng	82.56	3.74%	7
E-Fund	121.92	5.53%	4
First Trust	13.69	0.62%	37
Galaxy	11.46	0.52%	39
Golden Eagle	5.11	0.23%	51
Great Wall	40.58	1.84%	22
Guangfa	91.22	4.14%	6
Guotai	40.30	1.83%	23
Hua'an	72.21	3.28%	8
Huafu	5.50	0.25%	50
Huashang	8.85	0.40%	46
Lion	43.79	1.99%	19
New Century	4.54	0.21%	54
Orient	9.76	0.44%	42
Soochow	7.29	0.33%	48
Southern	108.65	4.93%	5
Tianhong	3.62	0.16%	57
Wanjia	14.69	0.67%	36
Yimin	7.03	0.32%	49
Yinhua	57.81	2.62%	9
TOTAL	**1,243.6**	**56.41%**	

SOURCE: Company Data, Z-BEN ADVISORS

SINO-FOREIGN FUND MANAGERS

	AUM RMB Bill	Share	RANK
ABC-CA	9.73	0.44%	43
ABN Amro TEDA	23.83	1.08%	30
AEGON-Industrial	35.27	1.60%	25
AIG-Huatai	19.05	0.86%	33
AXA SPDB	2.03	0.09%	59
Bank of Communications Schroders	56.42	2.56%	11
BOC [1]	22.09	1.00%	31
CCB Principal	34.42	1.56%	26
Changsheng [2]	41.04	1.86%	20
China International [1]	57.62	2.61%	10
China Merchants [1]	33.59	1.52%	27
CITIC-Prudential	13.54	0.61%	40
Everbright Pramerica	33.56	1.52%	28
First State Cinda [1]	8.30	0.38%	47
Fortis Haitong	40.63	1.84%	21
Fortune SGAM	45.49	2.06%	18
Franklin Templeton Sealand	15.13	0.69%	35
Full Goal [2]	54.68	2.48%	12
GTJA Allianz	9.28	0.42%	44
Harvest [2]	125.55	5.69%	3
HSBC Jintrust	9.13	0.41%	45
ICBC Credit Suisse	46.96	2.13%	17
INVESCO Great Wall	47.54	2.16%	16
KBC-Goldstate	4.35	0.20%	55
Lombarda China	3.94	0.18%	56
Lord Abbett China	4.59	0.21%	53
Minsheng Royal	2.94	0.13%	58
Morgan Stanley Huaxin	1.96	0.09%	60
Penghua [2]	49.36	2.24%	15
Rongtong [2]	52.04	2.36%	14
SYWG BNP Paribas	13.05	0.59%	38
UBS SDIC	25.48	1.16%	29
Zhonghai [2]	18.54	0.84%	34
TOTAL	**961.1**	**43.59%**	

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.

Z-BEN ADVISORS

China Investment Management:

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