Z-BEN ADVISORS

China Investment Management: Market Update

May 2010

Ignore the Noise

China's capital markets do provide a compelling ride. First to head south in 2007, first to recover in 2008, they are, at this very moment, delivering a predictable post-regulatory-change wobble that adds a new layer of uncertainty to one's outlook. While good for the circulation, thrill rides typically aren't helpful for long-term planning unless, of course, the planner is already inured to bumps and bruises. We can't calm markets for our clients but, in this report, we hope to provide a little bit of bubble wrap to cushion the bounces.

Fasten those seatbelts. It's going to be a bumpy ride

In Z-Ben Advisors' view, current market conditions are not especially surprising, nor strongly connected to global investor appetite. We also believe that their effects on Chinese FMCs can be predicted with some confidence. Why aren't we surprised by current market conditions? In large part, because we've seen this before. Regulatory attempts to cool an overheated property market were, in our view, the prime motive force behind both late 2006's Chinese stockmarket trough and its subsequent rocket ride. Many investment analysts outside China miss this fundamental link between property and mutual funds. Unlike almost every developed market (and many developing markets), these two asset classes are the only available, scalable risk options for the majority of Chinese investors, retail or institutional. Any measure which cools one inevitably warms the other.

Remember, China lacks a developed bond market and returns from fixed income assets almost never exceed the inflation rate by any significant amount. Indeed, money markets almost always deliver an annual rate of return below CPI. Offshore investing, while becoming more available, is not yet a widely used technique. PE is as difficult to access (and as difficult to exit) in China as elsewhere and alt investments are, at best, an embryonic industry here with little broad appeal. That leaves only two asset classes available to investors seeking CPI-plus returns: property and stocks (to which mutual funds remain the main route of access for long-term and strategic investment). This is why we often describe property cooling measures as one of the incubation conditions for a strong and lasting stockmarket climb.

Industry Assets Under Management (RMB Billions)

	1Q10	Growth	4Q09	Growth	3Q09	Growth	2Q09	Growth
Total Industry Assets	2,431.7	-9.1%	2,676.1	19.1%	2,247.7	-2.4%	2,302.8	14.7%
Total Domestic	1,378.2	-7.6%	1,490.9	18.0%	1,263.7	-1.3%	1,280.8	14.4%
Total Joint Venture	1,053.6	-11.1%	1,185.1	20.4%	984.0	-3.7%	1,021.9	15.1%

SOURCE: Z-BEN ADVISORS

Remember also that nothing in recent property regulatory announcements is intended to have any deleterious effects on capital formation, company spending, non-property investment or savings rates. PBoC, Ministry of Finance and State Council can more properly be considered to be taking a bet on the marginal benefits of another Rmb1bn worth of speculative property development versus the benefits of another Rmb1bn of speculative company investment. An empty office block currently contributes substantially less to the odds of Chinese economic growth, in their view, than might more working capital for the average listed company. All three of these government bodies recognize the centrality of both property and stock investing to their citizens' long-term ability to support themselves. Their response is not an attempt to reduce overall investment availability, only

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to redirect current investment flows.

Of course, such regulatory interventions tend to create a bit of chaos before they create a new order. Just as we saw in late summer 2006, the stockmarket has responded to a long-term stimulus with short-term indigestion and a spluttering cough. That's not entirely surprising, if we recall that the main techniques employed by professional (and, to some extent, retail) investors in China for producing outperformance are: first, well-timed asset allocation and, second, beta surfing. Change the risk/reward conditions for one asset class by government fiat and indigestion in all classes is the most likely short-term result. Without (in the Boesky sense) perfect information about government intentions, that's just one of the bumps to which planners in China must become inured. The most likely long-term result and the one which we feel planers should make central to their base cases, by contrast, is the one the government is attempting to arrange: a greater proportion of China's risk capital flowing towards stocks and mutual funds. Absent a 2009-scale global meltdown, this appears to us to be the most reasonable expectation for market conditions in the second half of 2010.

Sometimes hindsight can be 20-20.

That last comment brings us back to our second contention: that China's current market malaise is largely unconnected to global conditions. Despite a flurry of new product launches within the QDII program this year, substantially less than 10% of China's funds AUM is invested offshore, nor is that proportion likely to grow quickly in 2010. (Come back in two years and we hope to be telling you a very different story.) Moreover, with the exception of Chinese banks' upcoming recapitalizations, which will rely, to some extent, on Hong Kong support, China is making few demands on the world for risk capital. A global loss of appetite for stocks, in all but the most extreme cases, is unlikely to have visible effects on the domestic market. We accept, as do all investors, the existence and consequences of short-term mood contagion: a fat-fingered futures trader in Midtown Manhattan certainly can put a one-day dent in the CSI 300. We would argue very strongly, however, that China remains a mood-setter in the longer term, a conclusion for which the long-term lack of correlations between Chinese and western stockmarkets, as well as China's frequent leading position in long-term market moves, both provide evidence.

China is only marginally affected by global conditions

That's why we're confident in domestic markets' resilience, here's why we're confident we can see the next few strategic moves of China's FMCs. This year's mediocre markets did very little to daunt the ambitions of the largest players. We foresee no significant slowdown in their races to establish and develop Hong Kong offices, to lay ground work for later IPOs, and to tie up long-term foreign partners that can deliver both capital and strategic support. Sustaining each of these ambitions is the top-tier players' belief that their AUM and market share will be higher at the end of 2010 than it was at end of 2009. That self-belief isn't (and shouldn't be) shared by more than a handful of their smaller rivals. FMCs which haven't already established a wide fund range, reliable distribution partnerships and a recognized brand are currently hostages to market conditions, significantly less able to advance their strategic plans until a climbing market creates opportunities. Expect, first and foremost, the market share and strategic gaps between top-tier firms and their rivals to expand in 2010.

Fund managers continue to move ahead with various strategic plans

Plan for these outcomes and, we believe, you'll be mimicking the expectations of China's savviest fund investors and most successful FMCs. Endure the bumps and bruises that domestic volatility will inevitably inflict and you won't be distracted from what should be the main goals of any offshore asset manager in China. Better client relationships, improved access to distribution, and more productive partnerships are all possible in the current environment, although many foreign firms will use market conditions as an excuse not to make the effort. Our advice: don't be one of them.

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Policy measures and global economic trends pushed the CSI 300 down, with funds following suit. It is unlikely that fundraising will recover in the near future, and FMCs must prepare for a difficult period ahead.

Analytical Quick Hits

New QFII Quota Granted. SAFE recently granted Baring Asset Management and Ashmore Investment Management each a USD200m QFII quota. The two companies received QFII licenses in August 2009 and September 2009, respectively. The newly granted quota brought total QFII quota to USD17.07bn.

Manulife TEDA Awarded QDII Quota. SAFE recently granted Manulife TEDA USD500m in QDII quota. The FMC received QDII qualification last April. Since SAFE resumed issuing QDII quota last September, 17 companies in total have received quota, all of which will be competing for fund AUM.

The Second ICBC Credit Suisse QDII Fund. ICBC Credit Suisse started raise funds for its second QDII fund, the Global Enhanced Equity Fund, on April 15. ICBC Credit Suisse will also become the first FMC to have two QDII products on the market after the new fund launches, a move that other large firms will likely follow in the near future.

Institutions Now Allowed to Participate in Index Futures. CSRC issued regulations for mutual funds and brokerages to participate in index futures. Equity, balanced and guaranteed funds are allowed to use index futures. For brokerages, proprietary portfolio and pooled wealth-management products are allowed to participate in index futures. These institutions can participate in index futures only with arbitrage strategies.

Huijin Received Approval for Bond Issue. The State Council recently approved Huijin's plan to sell Rmb80bn in bonds on the interbank market. The proceeds of the bond sale will be injected into Export-Import Bank of China, China Export & Credit Insurance Corp and other state-run lenders. Several underwriters have already started working on the bond issue.

Central Huijin Appoints New GM. Mr. Peng Chun, current Vice President of BoComm, has been appointed to replace Mr. Xie Ping as new GM of Central Huijin. Mr. Xie will continue to serve as Deputy Manager of CIC. Mr. Fan Yifei, Vice President of CCB, will transfer to CIC as a Vice President.

NCSSF Announced The Second Batch of Global Investment Managers. NCSSF has announced 12 managers it appointed in 2009 to manage parts of its USD5bn+ offshore portfolio. Several of the firms disclosed have not been previously linked to NCSSF.

NCSSF Allowed to Expand Overseas Investment Channels. According to Mr. Dai Xianglong, Chairman of NCSSF, the regulators have allowed NCSSF to invest in overseas unlisted companies and PEs. The fund is now selecting investment managers. In the domestic market, NCSSF has invested in six PE funds, totaling Rmb5bn.

NCSSF Cut Stakes in Banks. NCSSF has reduced its stake in both BOC and ICBC this year in the Hong Kong market. NCSSF sold 30 million BOC H-shares, which brought down the fund's holding in the bank from 14.03% to 13.99%. Later, NCSSF reduced its position in ICBC's H-shares from 19.01% to 18.99% after it sold 15.3 million H-shares of the bank.

NCSSF May Invest in CCB. China Construction Bank is planning private placement to raise about Rmb45bn in Shanghai and Rmb30bn in Hong Kong. NCSSF may invest in the bank. In addition, NCSSF also promised to inject Rmb20bn into China Development Bank and Rmb15bn into ABC.

AIG-Huatai Changed Its Name. The fund house's name was changed to Huatai-PineBridge Fund Management. The reason was that the name of its foreign partner was changed to PineBridge Investments from AIG Global Investment. Funds from the house also underwent corresponding changes.

Two More FMCs to Join the Ranks. BNY Mellon Western FMC and Zheshang FMC have passed the last step needed to secure regulatory approval. The two firms may begin their operations as early as June, 2010. This will bring the total number of fund management companies in China to 62.

Beijing Chang An Group May Sell Its Stakes in China Post & Capital. Beijing Chang An Group, the third largest shareholder of China Post & Capital, is reportedly seeking to sell its 24% stake. China Post & Capital had Rmb48bn in AUM at end-2009. The other shareholders of the FMC are China Post Group and Capital Securities.

Senior Management Changes at Golden Eagle. Mr. Liang Weiwen and Mr. Zhan Songmao, Chairman and GM of Golden Eagle will leave the company. Mr. Liu Dong will act as the new chairman of the company. Mr. Yin Kesheng, the former CIO of Penghua, will take the job of GM.

The World's Largest IPO. ABC is likely to list on stock markets in Shanghai and Hong Kong in Q3 this year. The bank may raise USD22bn to USD30bn from the IPO. ABC hired several firms as its underwriters for its IPO in the Chinese mainland and Hong Kong. ABC would only introduce the NCSSF as its strategic investor prior to the IPO.

Enterprise Annuities AUM Achieved Rmb252.5bn in 2009. The average annual growth for Enterprise Annuities has reached Rmb46.1bn over the past four years. EA portfolios achieved a 7.78% return in 2009, within which, FMCs performed the best with an 8% average return.

Zijin Invested in Inter-Citic Through a QDII Account in ICBC Credit Suisse. Zijin Mining Group, China's largest gold producer, announced a strategic investment of CAD18.56m in Canada's Inter-Citic Minerals. After the deal, Zijin will own 19.15% of the shares of Inter-Citic, and become the largest shareholder of the firm.

Taiwan Yuanta Plans to Set up an FMC in The Mainland. Yuanta Securities Investment Trust Company is in talks to set up a FMC in mainland China with an as yet unidentified Chinese company, though it was previously reported that Soochow Asset Management will be the mainland partner.

Demand for QDII Funds Still Weak. Guotai raised Rmb556m for its NASDAQ 100 Index Fund, which was comparable to other QDII funds launched this year. Although the demand

Analytical Quick Hits

remains weak, another new QDII fund, UBS SDIC Global Emerging Market Equity Fund, will start subscription on May 6, with several other funds potentially hot on its heels.

GTJA Allianz Increased Registered Capital. The registered capital was increased from Rmb100m to Rmb150m without shareholding change. It was the first house increasing registered capital since China International and Galaxy did last April.

Fortis Haitong Changed English Name. Fortis Haitong Investment Management Co., Ltd has changed its name to HFT Investment Management Co., Ltd since April 1st, 2010. The new name is an acronym for the company's Chinese name 'Hai Fu Tong'.

Bank of Beijing Officially Approved to Invest in Insurance Company. On April 28, CIRC approved Bank of Beijing to take over 50% stakes in ING Capital Life Insurance from Capital Group at around Rmb600m. At the end of 2009, the insurer owned Rmb4.55bn total assets. Bank of Beijing is the first small bank allowed to invest in insurance company.

First AMC Set up by Brokerage. Orient Securities was approved by CSRC to set up an asset management subsidiary, which will be the first brokerage AMC. Its registered capital will be Rmb300m. The new company will focus on asset management business including QDII.

INDUSTRY AUM & MARKET SHARE

MARCH 31, 2010 (REAL)

DOMESTIC FUND MANAGERS

FMC	AUM RMB Bill	Share	RANK
Baoying	9.3	0.4%	45
Bosera	129.4	5.3%	4
Changxin	21.6	0.9%	32
China AMC	253.9	10.4%	1
China Nature	4.4	0.2%	53
China Post & Capital	45.0	1.8%	21
China Universal	54.2	2.2%	15
Dacheng	88.3	3.6%	7
E-Fund	168.1	6.9%	2
First Trust	11.9	0.5%	42
Galaxy	12.0	0.5%	41
Golden Eagle	4.3	0.2%	55
Great Wall	39.5	1.6%	24
Guangfa	98.3	4.0%	6
Guotai	46.6	1.9%	19
Harfor	6.2	0.3%	51
Hua'an	80.6	3.3%	8
Huashang	14.3	0.6%	37
Lion	45.6	1.9%	20
New China	8.8	0.4%	47
Orient	9.7	0.4%	44
Soochow	6.6	0.3%	50
Southern	120.9	5.0%	5
Tianhong	4.0	0.2%	58
Wanjia	13.8	0.6%	38
Yimin	7.1	0.3%	49
Yinhua	73.8	3.0%	9
TOTAL	**1,378.2**	**56.7%**	

SOURCE: Company Data, Z-BEN ADVISORS

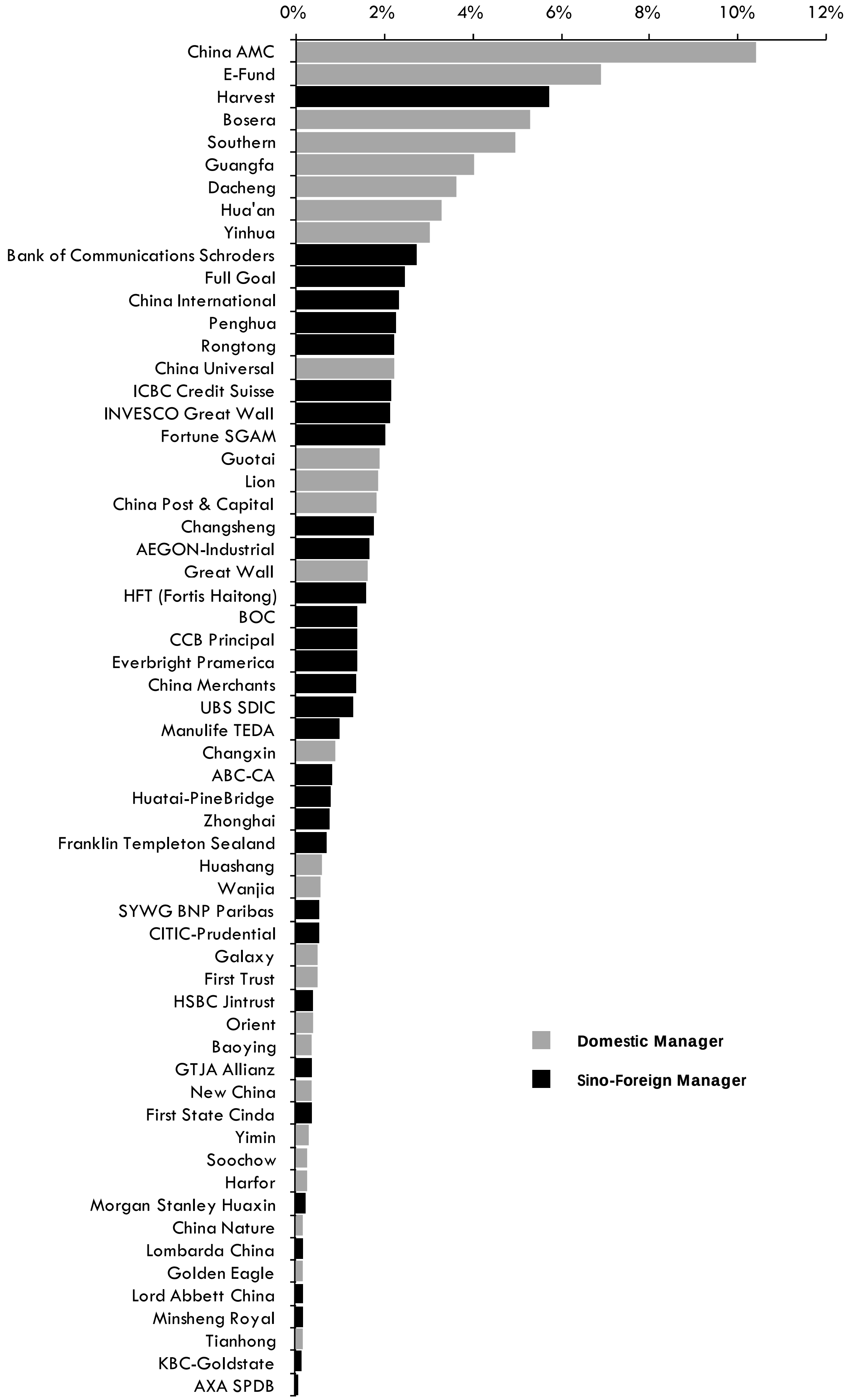
SINO-FOREIGN FUND MANAGERS

FMC	AUM RMB Bill	Share	RANK
ABC-CA	20.2	0.8%	33
AEGON-Industrial	40.9	1.7%	23
AXA SPDB	1.7	0.1%	60
Bank of Communications Schroders	66.8	2.7%	10
BOC [1]	34.4	1.4%	26
CCB Principal	34.4	1.4%	27
Changsheng [2]	42.9	1.8%	22
China International [1]	57.2	2.4%	12
China Merchants [1]	33.2	1.4%	29
CITIC-Prudential	12.6	0.5%	40
Everbright Pramerica	33.8	1.4%	28
First State Cinda [1]	8.8	0.4%	48
HFT (formerly Fortis Haitong)	38.7	1.6%	25
Fortune SGAM	49.3	2.0%	18
Franklin Templeton Sealand	17.3	0.7%	36
Full Goal [2]	59.7	2.5%	11
GTJA Allianz	9.2	0.4%	46
Harvest [2]	139.8	5.8%	3
HSBC Jintrust	9.8	0.4%	43
Huatai-PineBridge	19.2	0.8%	34
ICBC Credit Suisse	52.8	2.2%	16
INVESCO Great Wall	51.7	2.1%	17
KBC-Goldstate	3.2	0.1%	59
Lombarda China	4.4	0.2%	54
Lord Abbett China	4.1	0.2%	56
Manulife TEDA	24.4	1.0%	31
Minsheng Royal	4.1	0.2%	57
Morgan Stanley Huaxin	5.4	0.2%	52
Penghua [2]	55.5	2.3%	13
Rongtong [2]	54.7	2.2%	14
SYWG BNP Paribas	12.9	0.5%	39
UBS SDIC	31.8	1.3%	30
Zhonghai [2]	18.4	0.8%	35
TOTAL	**1,053.6**	**43.3%**	

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.

INDUSTRY MARKET SHARE: March 31, 2010 (Actual)



SOURCE: Z-BEN ADVISORS

Put Your Money Down: A Bet on China's Near Future

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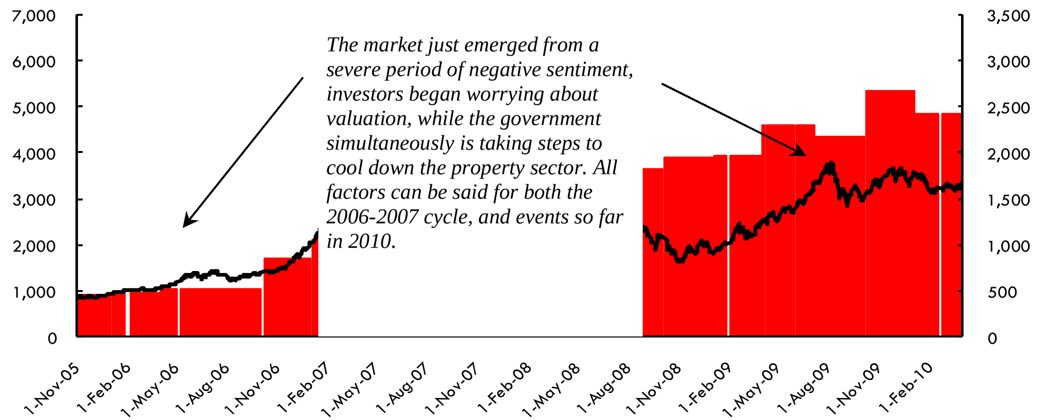
If timing is everything, it's time to make some very careful strategic decisions about how to deal with current regulatory cooling measure and accompanying market lull. We don't often make macroenvironmental judgments in this report, when we see such obvious patterns repeating, we feel responsible to point them out.

Déjà vu?

Comparing the 2006 Market Cycle to the Present



SOURCE: Z-BEN ADVISORS

- What we are currently seeing in this macroenvironment, including, most notably, a regularity clampdown on property speculation and a bear market, looks very much like conditions just prior to the industry's boom year in 2007. Therefore, the current lull in the industry mirrors the period just before the boom of 2007, a crucial period where winners were preparing to make massive jumps when the right conditions struck

- Two FMCs which indisputably made the most of the last lull were **China AMC** and **E-Fund**, whose PMs showed prescient timing in increasing both the size and aggressiveness of their equity bets. Moreover, both FMCs were able to leverage their success into strong brand awareness.

- On the other hand, firm's which are currently in suspended animation, waiting for a selling opportunity to appear, should benefit from a review of the fortunes of **Southern** and **Hua'an**, both of which spent 2006's stock market lull waiting for normal conditions to reassert themselves. Both have suffered a precipitous slide in the rankings tables since.

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1Q10 Industry Review: One Open Balloon and Others

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Huge outflow from money market funds, volatility in the stock market and weak new product offerings caused both industry AUM and shares in issue to drop last quarter. However, windy weather still lingers. Looking at Q2, Z-Ben Advisors believes that the stock may continue to be weak. That may like to cause industry AUM and shares in issue to shrink further. Investors may start fleeing from the endangered equity assets and move to fixed-income products for protection.

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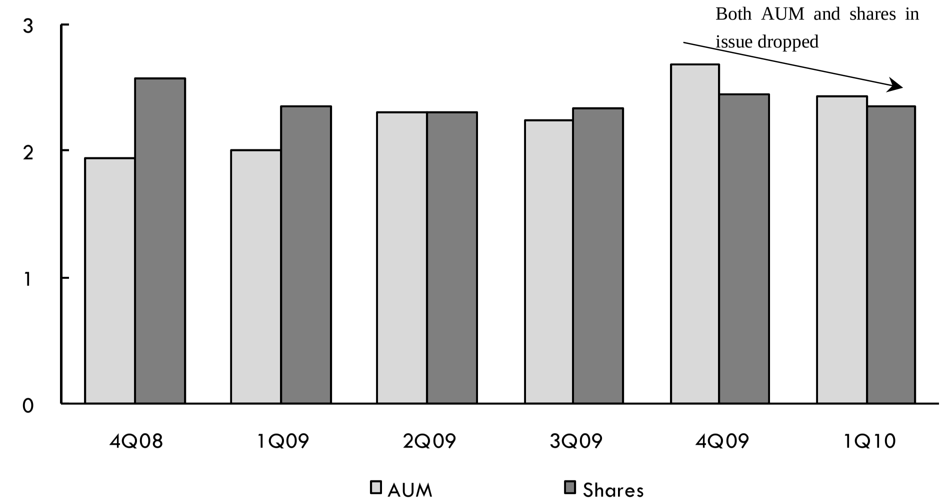
AUM and Share in Issue Both Hurt

Rmb, shares, tr



SOURCE: Z-BEN ADVISORS

- Industry AUM dropped by 9.1% and shares in issue declined by 4.14% last quarter. There are three reason for this drop: huge outflows from money market funds, which accounted for 98% loss of total shares, stock market volatility and lower fundraising results. Money market funds' inflows in 4Q09 were lost rapidly and completely in 1Q10. Inflows in 4Q09 were 141.21bn shares while outflow in 1Q10 was

- Outflows from equity-centric funds decreased and bond funds even enjoyed slight inflows. With the volatility in stock market, mutual fund investors slowed down investment activities.

- Market share change were impacted heavily by three factors: money market funds, performance and new product offerings. Mid-tiered firms that saw large outflows from money market funds lost positions heavily. Small firms that monetized short-term strong performance gained market shares. And only a few managers were able to leverage product launches since distribution has become increasingly difficult.

Get a Move On: Jam-Packed Schedule for Summer QDII Launches

Despite low investor appetite, managers no longer have the luxury of waiting for a better time to debut their QDII funds, since some 15 new products are expected to come out by this time next year. The space would be even more competitive once top-tier firms firms start launching their second QDII funds. Our advice: start early, take what you can get, now, and start building a strong performance trackrecord.

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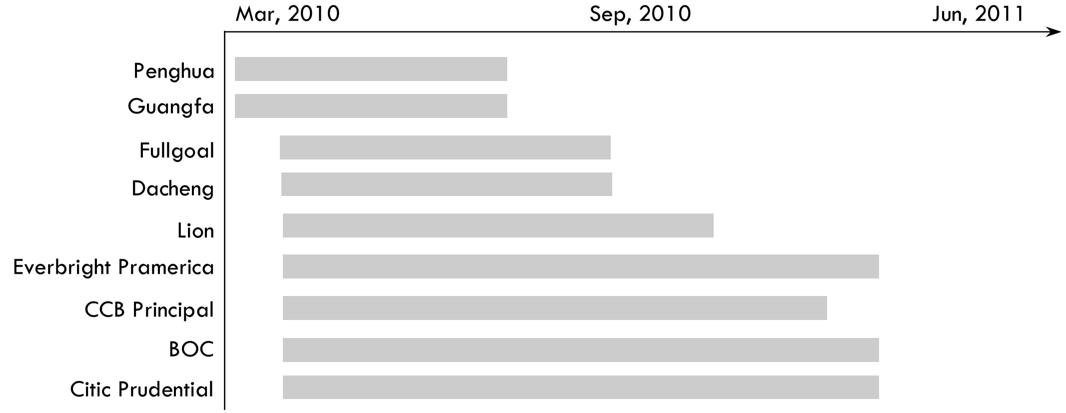
Waiting for the Go

Some 10 FMCs will debut their QDII Funds Soon



SOURCE: Z-BEN ADVISORS

- Launch totals are already low for the year, with E-Fund's uninspiring Rmb592m take for its Q1 debut. The principal of medority also held through for China Merchant and Guotai FMC, raising Rmb553 and Rmb556, respectively. While we have yet to discount the possibility of a breakout fundraising success, the balance of probability favors continued small launches.

- Start early and bet heavily because those that will be best positioned should investors interest re-emerge in early 2011 will be funds that have at least one year of performance to hype. Clearly the only way to be one of those funds is to waste no itme investing inflows in pursuit of solid returns.

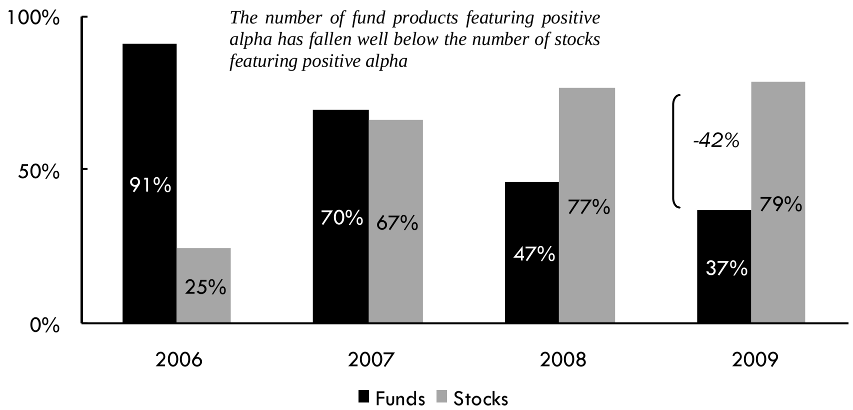
- FMCs should keep focusing on the mutual fund side, but should also start exploring other uses of their QDII quotas. ICBC-Credit Suisse recently rented its quota (USD200m in total) to a local mining company for its outbound strategic investment. HFT and Fortune SGAM were reportedly deploying their quota for multi-client segregated accounts.

The Amazing Disappearing Alpha: Industry Underperformance

No, it's not the opening act of a three-ring Greek circus. Rather, and unfortunately much less entertaining, it's an apt description for China's fund management industry, which has been failing to deliver significant levels of alpha since late 2007. This is the result of several factors: rapid PM turnover, increased levels of industry competition, and larger fund sizes that make it more difficult for PMs to leverage performance.

Disappearing Alpha

Percentage of Active Equity Funds and Stocks with Positive Alpha



SOURCE: Z-BEN ADVISORS

- This has had considerable impact on the industry: reduced capital appreciation, and slower overall growth as investors have wised up the raw deal fund managers are offering them. Most fund managers have not spent the necessary time and effort required to improve internal research and operating procedures that would allow firms to reverse this trend.
- Furthermore, as the industry grows larger, it has also become more stagnant in terms of adopting new strategies. For large firms, limiting the size of major funds can be an effective way to control liquidity pressure. This allows them to leverage performance into marketing for new products.
- Other firms have turned to indexation, to sidestep the need to market to increasingly discerning investors, who are now questioning exactly what an active management fee is for. Firms will have to improve their internal research capabilities, while waiting for regulatory reforms that allow fund managers to better retain skilled PMs.

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Research Rally: Expanding Your FMC's Research Capacity

FMCs are making tough choices when it comes to their firm's research capacity. While the impact of research is difficult to gauge as a direct correlation to performance (there are many other factors that affect a fund's return), it remains an important element of a firm's asset-managing skills. Therefore, we have developed a ranking system to better understand the differences between FMCs in China in research

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2010 Best Research FMCs

Selected Data Points & Overall Ranking

FMC	# of Brokers Used	% of Fees To Top Brokers	% of Employees MBA or Higher	# of Employees Per Product	Overall Rank
China AMC	45	32.44%	51.08%	18	1
Bosera	34	34.22%	60.00%	12	2
Harvest	43	31.42%	55.06%	17	3
China International	25	37.63%	32.34%	15	4
Minsheng Royal	18	35.48%	63.33%	20	5
First State Cinda	15	40.50%	50.75%	17	6
ABC-CA	11	42.34%	51.72%	12	7
Southern	54	30.66%	52.90%	12	8
ICBC Credit Suisse	27	36.58%	64.86%	11	9
Bank of Communications Schroders	28	32.92%	62.70%	11	10
China Universal	36	32.66%	56.29%	15	11
AXA SPDB	13	41.93%	48.33%	15	12
BOC	24	34.52%	66.36%	12	13
AEGON-Industrial	35	33.46%	51.38%	14	14

SOURCE: Z-BEN ADVISORS

- Z-Ben Advisors methodology for determining the ranking was to use purely quantitative data points weighted based on the qualitative opinions of our research team. Our belief is that best way to gain a competitive advantage in the market is to focus on building an internal research team that can generate unique investment ideas.

- Many smaller firms did better than we had anticipated and one clear trend emerged: a strong showing from the JVs. To highlight, 70% of the top 20 firms on our ranking were JVs while just 35% of the bottom 20 had a foreign shareholder. Strategically speaking, we recommend that small- and mid-tier firms allocate a higher proportion of their brokerage fees to the 1st- and 2nd-tier securities firms.

- All FMCs must weigh multiple factors when deciding how they will approach research. Z-Ben Advisors advocates that firms bolster internal research teams and focus external resources (brokerages) on research over distribution. While we cannot be sure of the impact research makes, there are enough examples of successful firms that focus on research to at least say that it can't hurt to try.

Analog Alternatives: Seizing the Online High Ground

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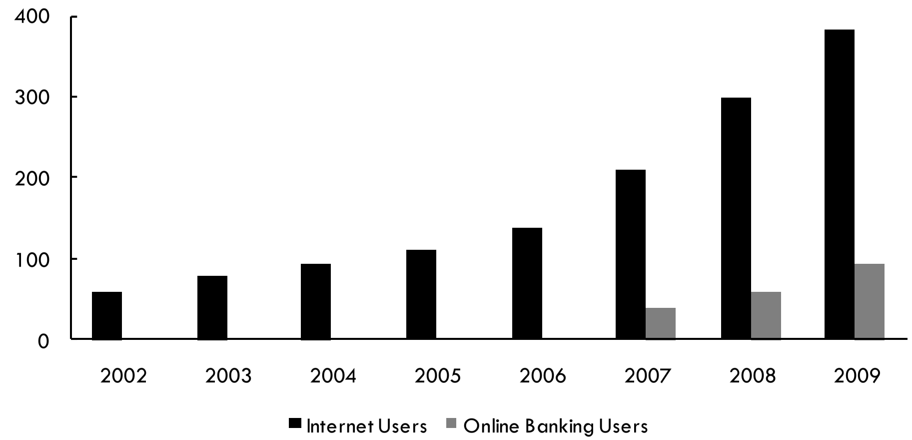
Fund managers have moved slowly to exploit opportunities available to them in terms of online marketing, and they risk ceding this territory to their competitors: banks and brokerages. With precious few channels left for reliable direct distribution, FMCs need to do all they can to court younger investors using the web. This segment is growing rapidly, and will continue to do so as they gain access to disposable income.

Significant Potential

Internet Users and Online Bank Users, millions



SOURCE: Z-BEN ADVISORS

- Unfortunately, FMCs have so far done a very poor job developing their online platforms, even though they possess several inherent advantages: the capacity to act as a tailored financial advisor to their retail clients – a sort of IFA for the masses – and the capacity to compete with banks and brokerages on fund product price.

- Banks, on the other hand, offer considerable convenience to their online users. Many retail clients are already much more used to using a bank's online platform to perform basic financial transactions. It will not be a huge leap for them to begin conducting more complex purchases via banks' websites, and if FMCs are unable to attract them to their own portals, they will still be at the mercy of large banks for distribution.

- Fund managers will need to use their online platforms to draw in new retail clients, while simultaneously expanding the types of services they are able to offer in order to expand the potential pool of clients. One step at a time, however, as before doing this, most fund companies will need to implement user-friendly interfaces for their existing online sales platforms.

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Caution Returns: Chinese Insurers Moving out of Equities

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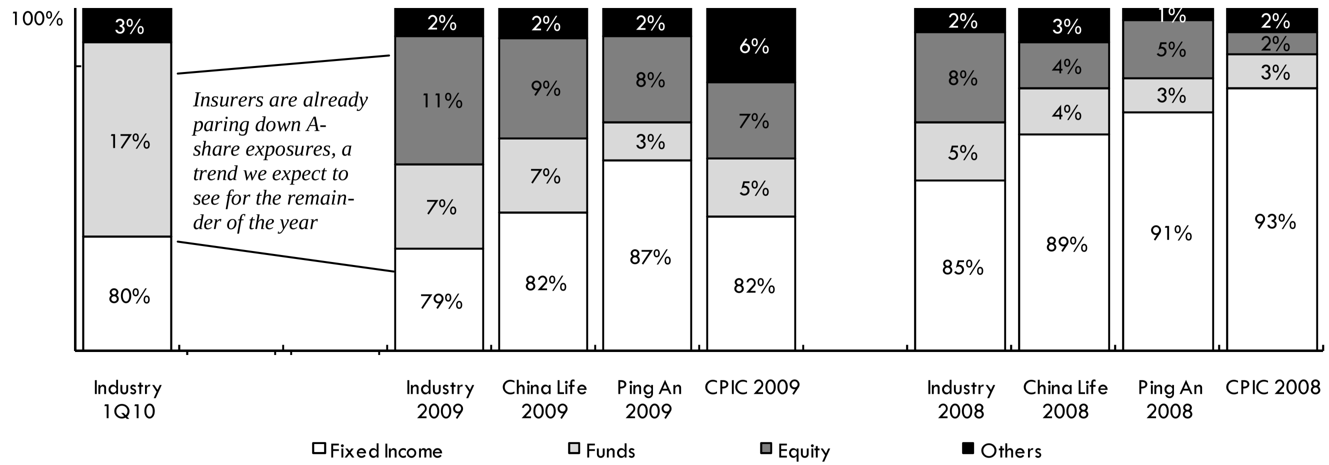
Faced with faltering local markets, Chinese insurers are paring down their A-share exposures. This, however, does not mean that insurers are risk-adverse. Sitting on some Rmb1.0tr worth of cash and equivalents, those asset managers that can offer other reasonable options than having to revert back to fixed-income stand to benefit. The time's right for aggressive expansion into alternatives and outbound invest-

Equity Aversion begin to Show

Insurance Firms' Asset Allocation Preference



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- New accounting rules will likely compel insurers to scale back their investment-linked and bancassurance plans, which would slightly slow the rate of industry premium growth. However, refocusing on traditional plans means that insurers will have more a predictable and consistent premium revenue stream. Therefore, the need to significantly discount insurers' asset growth in 2010, in our opinion, is unwarranted.

- With equities faltering since late 2009 and recent restrictions on property investment is expected to weigh down market sentiment further, many leading insurers are already paring down their A-share exposures. This trend doesn't necessarily translate to a return to fixed income instruments. Insurers may find the time is right for aggressive expansion into alternatives and foreign investments.

- For foreign asset managers wishing to promote their sophisticated investments services, the best way to take advantage of the current market dynamics is to help local insurers educate and convince domestic regulators on the merits of diversification. Those firms that can provide reasonable investment alternatives to insurers, especially with strong risk management skills, will stand to benefit

Joint Venture Review: Heading for Venus

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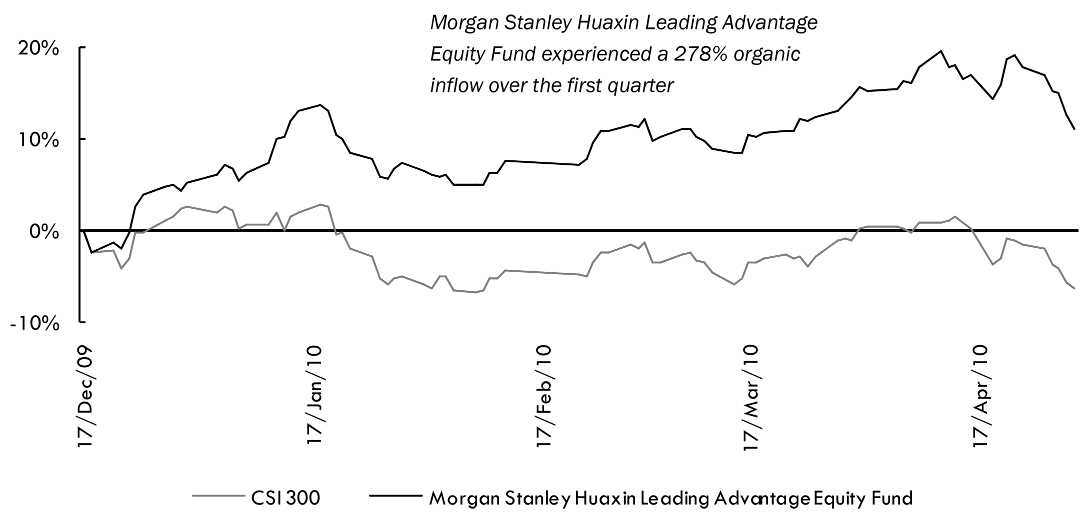
Within the space of three months, Morgan Stanley Huaxin, previously one of China's smallest FMC, has witnessed its AUM double, and possibly triple, depending upon new product launch results. This comes after nearly two years of the firm languishing as one of China's smallest JV fund managers, and one which was also beset by significant shareholder issues.

Making a Mark

Morgan Stanley Huaxin Equity Fund Performance



SOURCE: Z-BEN ADVISORS

- Many of Morgan Stanley Huaxin staff changes in 2009 consisted of external hires. This process of localization appears to have been managed smoothly, and is largely responsible for the recent performance record of several of the firm's funds. Having already drawn considerable inflows, it will soon be time to see if the firm can leverage this showing to draw new product inflows.

- Small firms, especially JVs, face a number of structural barriers, as they have difficulty finding strong distributional relationships to market their new products. This means that such firms must typically pay larger trail fees, and enjoy smaller new product AUM. Typically, small firms also find managing PM turnover more difficult.

- Morgan Stanley Huaxin may serve as another example that there is some hope for small firms, at least the ones that are actually able to deliver performance. Without the same liquidity pressures that large firms face, a skilled PM wielding a relatively small fund is in some ways better able to quickly exploit investment opportunities.

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