

Z-BEN ADVISORS

China Investment Management: Market Update

December 2009

Always Bet on Red

The experts were completely wrong in 2009

It is a long-held belief here at Z-Ben Advisors, a cornerstone of how we work with clients in fact, that no-one should bet against China. If you do, you will lose. This has been proven to be true time and time again. Even most of the eminent global economists were in error last year, propounding incorrect assessments of a contraction in Chinese GDP or, at the very least, hedging their bets by predicting a marked slowdown in growth. Sorry boys, but you too lose. Funnily enough, rather than admit an error in judgment (analysis?) these very same experts are now doubling down. Misallocation of capital, beggar-thy-neighbor export policies, and the like are the latest now named as the threats which are supposed to derail the economic juggernaut. If there is one piece of advice you should heed it is this: pay them no attention.

Time to shift away from ad hoc China strategies

We aren't here to force crowd down anyone's throat. Our job is simple (although complicated in execution): assess the tactical trends taking place in China and ensure that our entire client base has the necessary market intelligence to take advantage. And it is with this job in mind that Z-Ben Advisors has devoted an entire report to our outlook for 2010. The conclusions presented herein match the comments we made in our November report, only this time we have put some significant meat on the bones. Yes, there will be a considerable number of opportunities for all foreign institutions which place the Chinese marketplace in their strategic crosshairs. These opportunities, however, will only create business for firms willing to shift away from an ad hoc China development strategy.

Industry Assets Under Management (RMB Billions)

	Current ¹	Growth	3Q09	Growth	2Q09	Growth	1Q09	Growth
Total Industry Assets	2,412.6	7.3%	2,247.7	-2.4%	2,302.8	14.7%	2,007.0	3.5%
Total Domestic	1,360.8	7.7%	1,263.7	-1.3%	1,280.8	14.4%	1,119.4	5.9%
Total Joint Venture	1,051.8	6.7%	984.0	-3.7%	1,021.9	15.1%	887.6	0.7%

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SOURCE: Z-BEN ADVISORS, CURRENT AUM IS AN ESTIMATE AS OF NOVEMBER 30, 2009

On more than a few occasions Z-Ben Advisors positions have been said to be nothing more than bravado, or overconfidence. In fact, at no time do we prefer a rosy outlook simply for the sake of it. We are only as good as the research we deliver to clients and our track record isn't half bad. There is no need for us to roll the dice on Chinese growth. It is with a cold-eyed view of the coming year, therefore, that we have provided the forecasts in this report, including key projections such as fund industry AUM returning to its 2007 peak of Rmb3.2bn (USD470bn). Indeed, if investor sentiment were to turn even more enthusiastic we could see AUM reach Rmb4.0tr (USD585bn)

The positive outlook for 2010 goes beyond the mutual fund space and we need only look back to the past month for evidence. The QDII scheme has been aggressively reopened with the first new offshore product going to market today and more than a dozen other products already in the pipeline. Z-Ben Advisors' outlook for the QFII program is just as robust with billions in new quota set to be provided to foreign firms. CIC also won't lack for new funds: we project they will be given an additional USD200bn to invest.

Overall, we don't expect current momentum to lag any time soon. In fact, our outlook assumes a raft a new changes to financial services industry regulation and structure, including the long-awaited introduction of stock index futures and a trial program to test investors' appetite for REITS.

Such a fast pace can't be sustained forever, and with the Chinese political cycle ramping up towards the end of 2010, that momentum will begin to ebb in the second half of the year. Forewarned is forearmed: the iron is hot but will cool.

Success in targeting the Chinese market will, in our view, be determined by the quality of foreign asset managers' (and servicers') approach. In the past, and all too commonly today, such approaches demonstrated very little consistency: ad-hoc mixtures of headline-based target identification, sporadic trips to the Mainland and waiting for the phone to ring. Running China ideas up the flagpole to see who salutes is the best metaphor here, and one that has worked about as well as you'd expect. Z-Ben Advisors sees this approach to gaining access to potential fund flows (be that direct or indirect) as both out of date and well worth killing off. No matter how plentiful the opportunities are, no one firm has the resources to effectively chase after each and every one, nor is any firm likely to burnish its reputation by suggesting it can manage any opportunity for any customer.

A more sustainable, manageable and high-yielding approach is for foreign AMCs to evaluate which potential long-term customers and long-term opportunities are the best fit for the organization's strengths and culture, then target those areas exclusively. Readers would be surprised how few firms actually do this and we would go so far as to argue that having such a targeted China strategy in place provides a lasting strategic advantage. Firms that know what they should be doing (and who they should be doing it with) are far less prone to waste, frustration and overpaying for access - three of the cardinal sins of the disorganized, the inconsistent and the ineffective in China.

Quality of approach is now most important

Monthly Research Highlights

A Positive Note for 2010: A Year in Expansion is in View

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For the first time in years, 2010 will likely bear witness to a stable and orderly expansion of the funds industry. This report details our projections for best, worst and base case scenarios. Fund managers should take note: the potential upside, based upon our analysis, significantly outweighs the possible downside and, though AUM gains may be a given, 2010 will be a crucial year in determining the future growth trajectory of almost every individual FMC. Managers should take this opportunity to evaluate their positions, design appropriate strategies, and determine the best possible means of increasing resources to put those plans into action.

Product Cycle 2010: Que Sera, Sera

Page 12

If 2008 was the year of fixed income, and 2009 the year of index funds, what will 2010 bring? Though we are tempted to deem it the year of QDII, such a moniker would be disingenuous: while opportunities related to QDII are likely to abound, the segment will not feature outsize AUM intakes vis-à-vis more traditional equity products. Innovation within every segment will be critical, as competition grows more acute, and as market performance shifts underlying demand. Understanding these trends will be crucial for gaining AUM in 2010, and for laying a solid foundation moving forward.

Distribution Dynamics 2010: Breaking the Bank

Page 15

In 2009, the mutual funds distribution market experienced a rapid concentration of market share toward ICBC and CCB. In comparison, other channels remained static. The stronger dominance of the two banks is the core of mutual fund industry's future distribution outlook. For many FMCs, especially the mid- and small-tier firms, more channel congestion, higher distribution expenses and erosion of bargaining power will result. More than ever, FMCs need to develop viable alternative options. Z-Ben Advisors suggests two moves: better strategies to utilize banks' distribution resources and more in-house effort, especially for MCSA and institutional opportunities.

Competition in 2010: Hard Times for China's Mid-Tier FMCs **Page 18**

Expect grinding, slow-moving competition for fund assets in 2010, with an increasingly homogeneous mid-tier feeling the worst of the pressure. Absent large-scale market disruption (the CSI 300 doubling, or more), three things appear likely to be true of FMC competition next year. First, the largest nine firms will continue to grow, largely by soaking up everyone else's dissatisfied customers. Second, the smallest 20 firms will remain small, with their total market share increased primarily by new entrants. Third, most of the remaining 31 mid-tier firms will lose market share, victims of long-term underperformance and lack of strategic differentiation. For this group, holding market share constant in 2010 should be considered a victory.

Managing Talent 2010: Threading the Needle **Page 22**

Fund managers will be happy if the asset management industry sees another fast-growing year in 2010. But strong growth may also become a source of worry for them, as we believe business acceleration will easily consume extant HR resources and reserves, creating a mounting shortage of PMs. Pressure will come primarily from four directions: new product offerings, new business opportunities, intercompany competition and the private fund sector. A calculation formulated on our baseline assumptions for these aspects illustrates how deep the shortage will run next year. The question now is how FMCs will be able to find enough hands to meet this ever-mounting demand for expansion, while simultaneously trying to grow AUM through normal operations. The answer will be critical for many fund houses to survive fast growth in the coming year.

Market Entry 2010: Two Minute Drill **Page 25**

The first half of 2010 will be a crucial time for entry into the funds industry. With up to five stakes still available, the time left to pull the trigger on a purchase is severely limited as M&A activity will all but dry up in 2011. While other options remain – starting a greenfield or investing in a substitute platform – there is no real alternative to buying an established fund manager. International AMCs still debating an appropriate China strategy should take note, this option is by far the strongest play in the market but one that must be put into action now. This report examines the opportunities still on the table for international AMCs, and predicts on what buyers can expect market entry to require in 2010.

Scaling the Wall: Alternatives for International AMCs **Page 28**

2010 will be a watershed year for QDII and QFII, with myriad opportunities presented by the expansion of both programs. International asset managers without a direct stake in a fund manager can utilize a directed programmatic (QDII/QFII) approach to gain both direct and indirect exposure to mainland A-share markets, albeit with limited access to retail investors. This report includes projections for the pace of expansion in these programs and offers suggestions for pursuing complementarities among the wide variety of opportunities available.

JV Preview 2010: The Eastwood Analysis **Page 31**

JVs survived 2009's firestorm rather better than many expected: 21 of the 32 JVs in operation prior to 2009 gained market share, thanks to improved equity markets and an exodus from fixed income products. However, in 2010, Z-Ben Advisors expects fewer JVs to advance and their total market share will continue to contract. Only a small number of JVs appear to us to have sustainable advantages. Many more appear to be falling into traps which, admittedly, outnumber opportunities for JVs in China. Harsh as it is, we intend to highlight factors which separate the two groups, with forecast on 2010's most likely market share leaders – the Good, the Bad and the Ugly.

Corporate Actions: November

Page 34

The spotlight for corporate actions in November moved from portfolio manager changes to corporate shareholding restructuring. Hua'an and Boseran announced their new shareholders. For Hua'an, however, this may only be a temporary arrangement and Z-Ben Advisors anticipates more adjustments to its shareholding structure in the future. We also expect more M&A activity to be announced in the next few months. A slowdown in PM moves was unexpected, since the regulatory side remained quiet last month. This leads us to suspect the influence of CSRC's recent inspection on FMCs' internal HR compliance issue, which has revealed some problems.

Monthly Performance Review: Rollercoaster Ride

Page 55

The market was strong for the better part of November, until the rally was disrupted by the refinancing plans of banks and the Dubai default crisis. The CSI 300 Index registered a net gain of 7.05% for the month. There are some uncertainties as banks announced refinancing plans in tandem, while Beijing hints at tightening money supply in the coming year but, overall, portfolio managers remain committed to their equity exposure. High exposure also helped narrow the gap between fund and index returns. QDII products lagged for another month, as the Hong Kong market ended the month flat. China AMC was again a winner, now topping the YTD performance ranking.

Analytical Quick Hits

Hua'an won a Sub-Advisory Mandate from Korea Investment. Hua'an Fund Management has entered into a sub-advisory mandate from Korea Investment & Securities and its associated Korea Investment Trust for A-share market investments. Korean Investment Trust management received a QFII license in August, and is waiting for quota approval.

GTJA Takes over 20% Shares of Hua'an. Shanghai Feidian Investment has agreed to transfer its 20% stake of Hua'an FMC to GTJA Investment. Thus, Shanghai Electric Group, Shanghai International Trust, Shanghai Industrial, Jinjiang International and GTJA Investment and each hold 20% equity of Hua'an respectively.

China Merchants Securities Finally Sold Its 24% Stake in Boseran. The stake was sold to Tianjin Port Group, Shanghai Shengye Asset Management, Jingan Industrial Co. and Fengyi Industrial Development. Each company got a 6% lot at Rmb647m.

Manulife Buys a 49% Stake in ABN Amro TEDA. Manulife Financial agreed to purchase a 49% stake in ABN Amro TEDA at EUR105m from Fortis Bank, which prices the deal at 8.39% of ABN Amro TEDA's AUM. The new JV will change its name to Manulife TEDA Fund Management Company.

Deutsche Bank to Become The Biggest Shareholder of Huaxia Bank. Deutsche Bank plans to spend EUR81.6m buying a 3.43% stake in Huaxia Bank from Sal Oppenheim jr & Cie. Deutsche Bank will become Huaxia Bank's largest holder with a 17.12% stake.

Central Huijin won 38.815% Equity Ownership in New China Life. The Insurance Protection Fund announced that it agreed to sell a 38.815% stake in New China Life to Central Huijin for Rmb4bn, making Huijin becomes the biggest shareholder of the insurance company.

Aviva to Set up a JV with Central China Securities. Aviva has reportedly entered into an agreement with China Central Securities to set up a new JV asset manager. Aviva will hold a 49% stake in the new company and the remaining 51% will go to Central China Securities. Previously, Morley Fund Management, planned a JV FMC with COFCO and Dongguan Trust.

AMP Signed a MOU with China Life for Strategic Partnership. AMP has entered into a partnership with China Life Insurance for the asset management and pensions sectors. China Life Asset Management acts as AMP's local Chinese investment adviser. CLAM was appointed as AMP's local investment adviser for its QFII license in 2006.

Portfolio Managers Under Investigation. Three portfolio managers from two Shenzhen-based FMCs are under investigation for suspected trading irregularities. They are Tu Qiang from Invesco Great Wall, and Han Gang and Liu Hai from Great Wall. All have resigned from their posts as of September.

New Regulations on Fund Evaluation. CSRC recently released regulations on the securities investment fund evaluation business: funds operating for less than three years cannot be evaluated (except money market funds); all the rating agencies are required to become members of the Securities Association of China; and all personnel in the evaluation business must be certified by the practitioner's qualification management system.

Fortune SGAM Plans for Japanese ETF in China. Fortune SGAM FMC inked an exclusive cooperation agreement with the Tokyo Stock Exchange at the end of October to develop an ETF under the QDII program. The fund will track the TOPIX Core 30 Index and be publicly traded in China.

Five New A-Share ETFs Launched in Hong Kong. iShares launched four sector-based A-share ETFs and one feeder fund in Hong Kong recently. These new funds bring the total number of iShares China-related ETFs to seven listed in Hong Kong.

Analytical Quick Hits

Socially Responsible Investing Index Launched. AEGON-Industrial FMC, China Business News, and Shenzhen Securities Information launched a socially responsible investing index. This is the first SRI index that includes stocks from both Shanghai and Shenzhen markets. Currently, China has only one SRI fund, from AEGON-Industrial.

SAFE Granted Additional QDII Quota. Bosera Asset Management and China Universal Asset Management have gained USD1bn quota each from SAFE. SAFE has granted USD3.5bn in total to four FMCs since it resumed issuing QDII quota last month.

Largest Feeder Fund Launched. E-Fund Shenzhen 100 ETF Feeder Fund raised more than Rmb19bn, the largest feeder fund and the second-largest new fund this year. This helped E-Fund replace Bosera to be China's second-largest FMC. Meanwhile, E-Fund's total AUM of index funds has grown to more than Rmb60bn.

First Leveraged MCSA Product. Franklin Templeton Sealand will launch its second MCSA product, which is the first leveraged MCSA product in the market. The product will be offered in two classes, and distributed by Fortune Securities and Everbright Bank, though only in the Shanghai market.

First Ever 50-year Bonds Issued in China. The Ministry of Finance sold Rmb20bn of China's first 50-year treasury bonds at a yield of 4.3%; issued via the inter-bank bond market and stock exchanges. These will trade on the inter-bank market and the two stock exchanges after December 2.

Bank Investments in Insurers Now Permitted. CBRC released rules on banks investing in insurance companies. According to the rules, each commercial bank can only invest in one insurance company. Banks are also banned from extending loans or issuing subordinated bonds to the insurer in which it holds a stake.

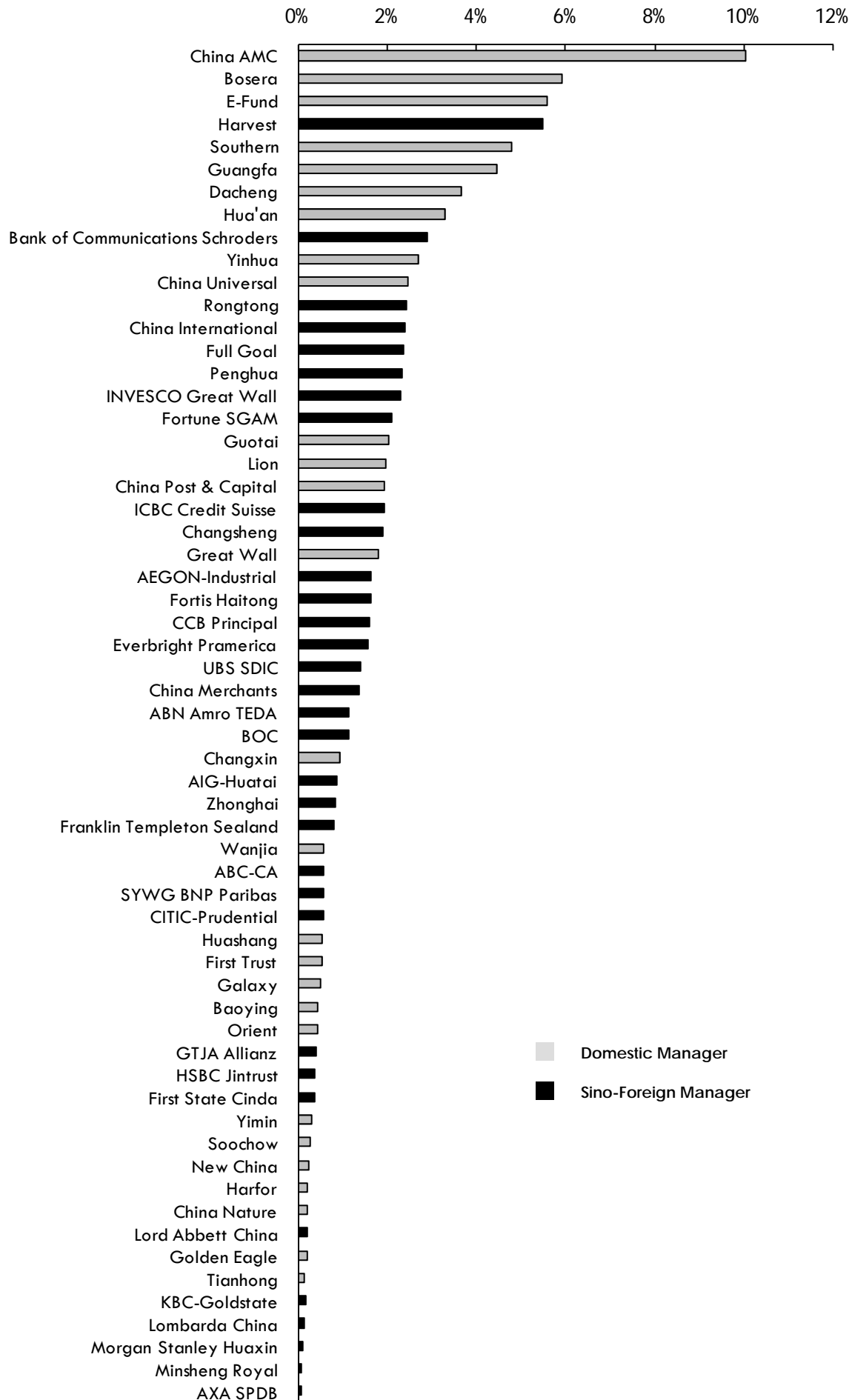
INDUSTRY AUM & MARKET SHARE NOVEMBER 30, 2009 (ESTIMATE)

DOMESTIC FUND MANAGERS				SINO-FOREIGN FUND MANAGERS			
	AUM				AUM		
	RMB Bill	Share	RANK		RMB Bill	Share	RANK
Baoying	10.96	0.45%	43	ABC-CA	13.93	0.58%	37
Bosera	142.69	5.91%	2	ABN Amro TEDA	27.33	1.13%	30
Changxin	22.51	0.93%	32	AEGON-Industrial	39.56	1.64%	24
China AMC	242.71	10.06%	1	AIG-Huatai	20.58	0.85%	33
China Nature	5.27	0.22%	52	AXA SPDB	1.73	0.07%	60
China Post & Capital	46.76	1.94%	20	Bank of Communications Schroders	69.42	2.88%	9
China Universal	59.35	2.46%	11	BOC ¹	26.91	1.12%	31
Dacheng	88.73	3.68%	7	CCB Principal	38.58	1.60%	26
E-Fund	134.91	5.59%	3	Changsheng ²	45.95	1.90%	22
First Trust	12.85	0.53%	41	China International ¹	58.03	2.41%	13
Galaxy	12.41	0.51%	42	China Merchants ¹	33.07	1.37%	29
Golden Eagle	4.87	0.20%	54	CITIC-Prudential	13.31	0.55%	39
Great Wall	43.43	1.80%	23	Everbright Pramerica	37.51	1.55%	27
Guangfa	108.02	4.48%	6	First State Cinda ¹	8.51	0.35%	47
Guotai	49.03	2.03%	18	Fortis Haitong	39.17	1.62%	25
Harfor	5.42	0.22%	51	Fortune SGAM	50.81	2.11%	17
Hua'an	79.95	3.31%	8	Franklin Templeton Sealand	18.93	0.78%	35
Huashang	13.15	0.54%	40	Full Goal ²	56.69	2.35%	14
Lion	47.82	1.98%	19	GTJA Allianz	9.91	0.41%	45
New China	6.04	0.25%	50	Harvest ²	132.51	5.49%	4
Orient	10.42	0.43%	44	HSBC Jintrust	8.69	0.36%	46
Soochow	7.03	0.29%	49	ICBC Credit Suisse	46.59	1.93%	21
Southern	115.58	4.79%	5	INVESCO Great Wall	55.23	2.29%	16
Tianhong	3.84	0.16%	55	KBC-Goldstate	3.75	0.16%	56
Wanjia	14.22	0.59%	36	Lombarda China	3.55	0.15%	57
Yimin	7.55	0.31%	48	Lord Abbett China	5.10	0.21%	53
Yinhua	65.25	2.70%	10	Minsheng Royal	1.98	0.08%	59
TOTAL	1,360.8	56.40%		Morgan Stanley Huaxin	2.72	0.11%	58
				Penghua ²	56.15	2.33%	15
				Rongtong ²	58.29	2.42%	12
				SYWG BNP Paribas	13.64	0.57%	38
				UBS SDIC	33.50	1.39%	28
				Zhonghai ²	20.22	0.84%	34
				TOTAL	1,051.8	43.60%	

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.



A Positive Note for 2010: A Year of Expansion is in View

In 2010, stabilization may be the name of the game. For the first time in years, fund managers may find themselves in a position to actively plan and execute a strategy to aggressively grow AUM.

The AUM outlook for 2010 is arguably positive

If 2009 was a year of recovery, then 2010, in Z-Ben Advisors' opinion, appears likely to be a year of expansion. The industry's AUM, thanks to this year's 100% stock market gains, is approaching the Rmb2.5tr mark for end-09 and may regain the end-07 Rmb3.2tr high point at end-10: that 30% market upside is part of our base-case scenario. If underlying markets deliver in excess of 40% returns, total AUM could approach Rmb4.0tr in the best case. In the worst case, domestic markets could suffer a 15% correction, potentially depriving the industry of any growth in 2010.

In constructing these three scenarios, we combined projections of leading local equity strategists: strong first half macroeconomic conditions, followed by a potentially weaker 2H10. We assign our base case's 30% market gains a 60% probability; our best case's greater-than-40% rise in the CSI 300 a 25% chance; and 15% correction a 15% probability. We focus our discussions, however, on the potential routes FMCs can take in the next twelve months. Yes, the industry will grow. But the trade-off between profitability and market share gains (i.e. laying the foundation for future growth) will be more difficult than ever before. For firms whose objective is gaining stronger position, we lay out a number of imperatives for fund managers in the concluding section.

Establish a strong foundation for growth moving into 2010

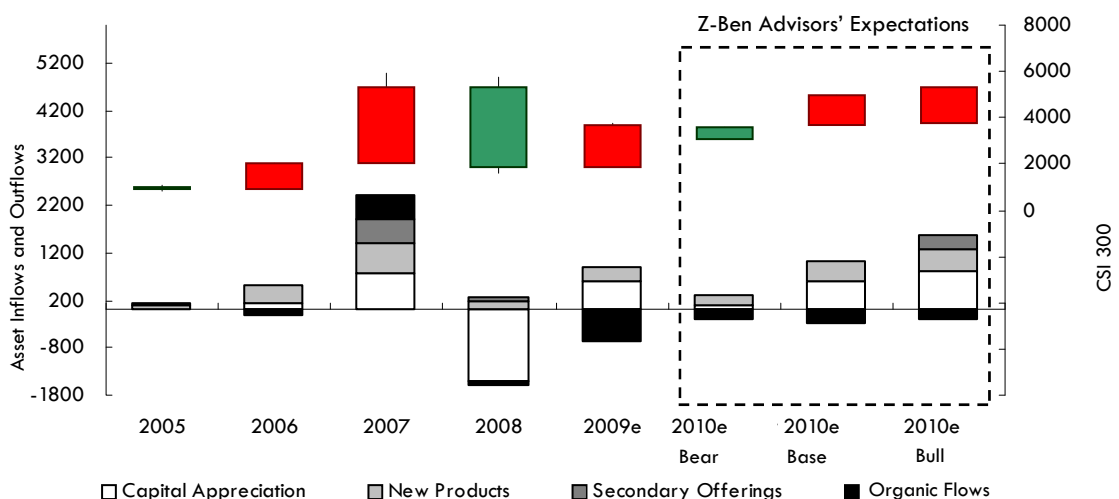
The Base Case

Let us start with the most likely scenario: the base case. A 30% rise in the CSI 300, given that roughly Rmb2.0tr of assets will be in equities across different type of funds by end-09, would add Rmb600bn to the current asset base, provided portfolio managers maintain the current average equity exposure of 80% in 2010. Assuming that the current rate of new product approvals is maintained – 135 new products with an average of Rmb3.1bn raised per product – FMCs could gain up to Rmb420bn from initial sales.

Strong asset inflows from secondary offerings are possible but not promising. The average NAV of equity-centric products has risen from Rmb0.90 at end-08 to about Rmb1.2 thus far. With base-case capital appreciation, that number could reach Rmb1.4 by mid-year, and Rmb1.6 by end-2010 – approaching mid-07's Rmb1.8 average. Possible gains for investors from dividends and share splits remain limited and, therefore, we expect secondary offerings to have minimal impact in 2010.

Gross redemption pressure is likely to be strongest under the base case scenario. Although a 30% upside would bring many underwater funds (i.e. those with NAV below Rmb1.0) back to par, retail investors could very well redeem their shares at par in order to reassess their in-

Breakdown Of Asset Inflows and Outflows (Rmb Billion)



SOURCE: Z-BEN ADVISORS

A Positive Note for 2010: A Year of Expansion is in View

vestment positions, unless markets gains are rapid and substantial. Organic redemption pressure could remain as a result, perhaps at the scale of Rmb300bn. **This, combined with Rmb1.2tr total inflows, suggests end-2010 AUM of Rmb3.2tr.**

The Best Case

If underlying markets deliver gains greater than 40%, total AUM could see a further Rmb800bn boost. In addition, if the CSI 300 begins approaching the 6,000 level, a new wave of investments could come with stronger sentiment. Therefore, stronger asset-base appreciation beyond Rmb800bn is not unlikely. Rapid market gains, however, may put regulators on edge, resulting in slower new product approvals, perhaps to fewer than 100 funds. The fundraising environment, to be sure, would remain robust: Rmb4.5bn on average. Therefore, we expect an additional Rmb470bn from new products in the best-case scenario.

With a 40% or greater gain, at least 40% of current equity funds will be well positioned for secondary offerings – at an average NAV of Rmb1.8. Consequently, at least Rmb200bn in secondary inflows can be expected. Stronger initial and secondary fundraising results, however, may come with higher redemption pressures. New and inexperienced investors are more likely, in the best case, to start buying fund products but assets from such investors, historically, have been the least sticky. Moreover, some of the investors who are currently holding underwater products are still likely to exit once they recoup their losses. Therefore, even with strong market performance, fund managers could see around Rmb200bn in net redemptions. **This puts our best-case year-end 2010 AUM at around Rmb3.9tr-4.0tr.**

The Bear Case

The least likely outcome in 2010 is for underlying stock markets to suffer 15% in losses. Portfolio managers could lower equity exposure quickly and significantly – to about 50%, akin to early 2008 – and prevent substantial AUM declines. Even so, at least a Rmb100bn-150bn

loss to the capital base is to be expected.

Regulators could try to counteract markets' decline by issuing more products, but in a much more punishing fundraising environment – Rmb1.0-1.5bn on average for equity products. Therefore, total inflows from new products could reach only about Rmb200bn. There is the possibility of regulators diverting new product approvals towards fixed-income funds. However, bond funds tend to be among the worst in retaining assets. Therefore, we are somewhat reluctant at this point to count on bond funds for a major asset boost to the industry. And, needless to say, the probability of any successful secondary offerings in a falling market is nil.

Redemption pressures, however, may not be as bad as other analysts might anticipate. New investors' participation will be extremely limited in a falling market, while the majority of those currently holding fund positions are more likely to take a long-term view of investments and are unlikely to redeem below par. Therefore, at the current AUM level, Z-Ben Advisors is not expecting industry net redemptions to exceed Rmb200bn. **Accordingly, the industry may end 2010 exactly at where it starts – Rmb2.5tr.**

Thinking Ahead for 2010

What do all of these projections mean? With the expected year-end AUM value at Rmb3.3tr, the industry, for the first time in two years, is on a solid upward trajectory. Save a few top-tier firms, however, a 30% growth potential in 2010, as opposed to 2007's 284%, will still present most FMCs with a very difficult trade-off: either protect margins and maintain current market position (i.e. grow at the same rate as the industry) or implement an aggressive expansion strategy and lay a better foundation for future growth, which will inevitably lead to lower margins. If the choice is the latter, then there are several urgent imperatives.

The first step is to get the project development strategy right. For a growth-oriented firms, equity-centric and index funds should be the top priority (see *Product Cycle in 2010*, page 12) for more discussion). A key takeaway: launch as many equity and index funds as regulators allow

Rapid market gains may induce regulators to slow product approval

For the first time in two years, the industry is on an upward trajectory

A Positive Note for 2010: A Year of Expansion is in View

before the end of 1H10 to take advantage of retail investors' strong appetite for capital appreciation – while it lasts. Distribution costs, unfortunately, will rise significantly with some 130 products (base case expectation), not to mention a plethora of multi-client segregated accounts (MCSAs), competing for channel access (see *Distribution Dynamics in 2010*, page 15, for more details). However, with few alternative sales channels to match leading banks' capacity, paying higher costs may be a necessary evil to stay ahead of the market-share curve.

QDII growth will be rapid in 2010, creating numerous opportunities

Of course, preparation for QDII products, without exception, should take precedence for the 20-some firms that are in line to receive quotas. Make hay while the sun shines as there is no telling how long regulators' recent generosity will last. Even if the quota is small, it is an opportunity nonetheless, and managers should focus on establishing a performance track record and product differentiation. Naturally, the same level of aggressiveness may be advisable for foreign asset managers looking for QDII advisory mandates since opportunities are being taken up as fast as they are emerging. (We outline our QDII advisory expectations and strategies for how best to navigate opportunities in *Scaling the Wall*, page 27).

There should be little room given to modesty in terms of marketing and other promotional tactics if fund managers expect to translate new products into effective AUM boosts. Every identifiable performance success – 3M, 6M, YTD returns – must be exploited in order to generate strong inflows. Aggressive marketing campaigns must be followed up with strong dividend payments, especially for products with trailing performance, to prevent outflows.

2010 will be marked by an uncharacteristic level of predictability

To properly manage any expansion means that firms must find talent. This is particularly true if FMCs also have their eyes on the other non-core opportunities such as segregated accounts and advisory mandates (for trust products, bank products, pension mandates, etc). We outline our expectations of the challenges facing fund managers in finding the talent to properly manage expansion in *Managing Talent*, page 22). Front-loading on talent may not be a bad idea for fund managers going forward.

Of course, fund managers will be undertaking such expansionary efforts in an environment where operating costs are already rising. This, without a doubt, is problematic for FMC coming out of 2009 with depressed revenues. However, the longer fund managers wait for the rising tide to lift all ships, the higher the possibility of falling behind in market-share rankings. And, the lower the market share, the harder it is move back up the curve (please see *Competition in 2010*, page 18, for more discussion). Therefore, a lower profit margin for one year to open more future opportunities, in our opinion, seems more like a bargain than a trade-off.

An aggressive strategy will also be advisable for firms that are still contemplating an entry. If a greenfield JV is the chosen route, a line has already formed: the longer the queue, the longer the wait, perhaps as long as five years. Similarly, there are fewer and fewer potential acquisition opportunities remaining as the clock ticks. Rising AUM in particular, as well as the success of non-core businesses such as segregated accounts, would imply that firm valuations (as a percentage of AUM) are likely to increase rapidly, perhaps back to early-2008 levels. Therefore, if there is a plan for an acquisition, the time is now. (The opposite, of course, is true for those planning to divest from domestic FMCs.) We lay out our market-entry expectations for 2010 in detail in *Market Entry 2010*.

The good news is that the industry in 2010, compared to volatile 2008 and erratic 2009, will be relatively predictable (in a Chinese market context). Fund managers are less likely to have to conjure up an ETF out of thin air, or devise an innovative multi-client product in less than a month to catch up with rapidly-emerging market trends. Z-Ben Advisors would go so far as to argue that 2010 may be the first time in the industry's 12-year history when a pre-formulated, customized and detailed strategy can actually be executed – a rare opportunity that may or may not reemerge. How well FMCs make the most of these favorable circumstances, and how well firms can seize control of the overall situation to put themselves in a stronger position in 2010, may end up determining their fortune for years to come.

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