

# China Funds Management: Quarterly Update 1Q10

## *Plop Plop, Fizz Fizz*

It was tough sailing for China's still young asset management industry in Q1: the stock market was down and it was the first time since 2Q08 in which the industry shed both AUM and shares in issuance simultaneously. At the same time end demand for new products waned as investors have taken a decisively wait-and-see approach to mutual fund investing. However, much of this was to be expected. Following a period of growth in MMFs, a quarter of outflows (concentrated heavily in MMFs) occurred. The fact that the stock market declined at the same time (usually a good sign for fixed income alternatives) did little to stem this tide of redemptions.

Make no mistake: the next quarter will bring continued difficulties for FMCs. A clear lull has set in in fund investing that may very well carry over into Q2, including a volatile (falling) stock market and continued pressure for new fund launches. Z-Ben Advisors has seen this before and realize it is easy to get caught into a trap of conservatism and herd-following behavior. However, there are also other signs to take note of. Organic growth (for good-performing FMCs) was a major trend in Q1 and firms that can time the market (both in terms of performance and product selection) will be well placed to grab major market share when the weather changes. Our advice: keep the gears turning and steer through choppy waters, the relief is coming.

### As Anticipated

MMFs suffered disastrous outflows, losing more than 100% of the inflow experienced in 4Q09. The asset class is now below 3Q09 levels and may slide further in Q2.

Many FMCs suffered severely due to the loss of their recently bulged MMF, however, none so greatly as **SYWG BNP Paribas** whose MMF lost 97% of its AUM.

### David Versus Goliath

Small-tier FMCs, wielding nothing but stones and slingshots, managed to score a surprising victory in the form of above average relative-to-peer performance. The reason was a strong showing from the small/mid cap sector which favors funds with less AUM.

This, in turn, allowed a number of small firms to leverage good returns into organic inflow and market share gains. Most notably, **Morgan Stanley Huaxin** had a standout quarter and jumped six places in the market share ranking.

### Q to the Izzo

QDII returned to the scene in Q1, bringing with it a fresh wave of hopes and disappointments for international asset managers dealing in China.

Although fundraising has been underwhelming thus far, QDII looks like it is hear to stay this time as policy makers gave positive signals for QDII in 1Q10: more quota granted and more new products approved for launch

### Differentiation Needed in Fixed Income

Q1 was a good quarter for guaranteed and bond funds, highlighted by both the slight inflow into bond funds and, more impressively, the **Yinhua Guaranteed Fund** which grew shares by 256%.

This might signal improved conditions for fixed income products. However, differentiation will be key as vanilla bond funds are unlikely to do well in today's market.

### QUARTERLY HIGHLIGHTS

#### FMC Market Share Leaders

	Q1 AUM (Rmb bn)	Qrt Δ in Share (Basis Points)
E-Fund	168.1	95
China AMC	253.9	51
Southern	120.9	40
ABC-CA	20.2	34
BOC	34.4	33

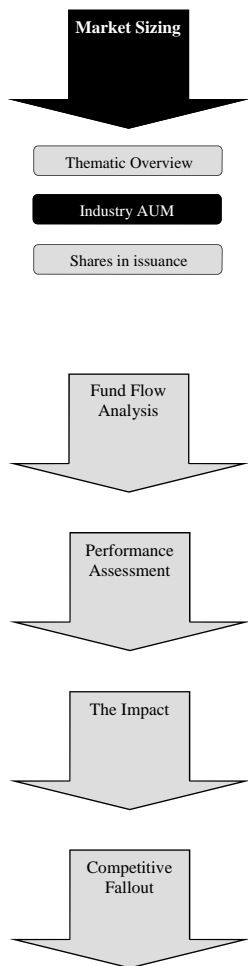
#### FMC Market Share Laggards

	Q1 AUM (Rmb bn)	Qrt Δ in Share (Basis Points)
Bank of Communications Schroders	66.8	-71
SYWG BNP Paribas	12.9	-35
Dacheng	88.3	-33
Guotai	46.6	-30
Bosera	129.4	-30

#### Top Performing Mutual Funds

Product	Q1 AUM (Rmb bn)	Q1 Return
Morgan Stanley Huaxin Leading Advantage Fund	2.68	8.92%
Harvest Thematically Enhanced Fund	15.1	8.38%
China AMC Enhanced Strategic Fund	2.7	7.89%
China AMC Large Cap Enhanced Fund	6.8	7.45%
Harvest Growth Fund	2.4	4.39%
China Post Core Advantage Balanced Fund	3.49	4.17%
Golden Eagle Small/Mid Cap Enhanced Fund	1.1	3.96%
First State Cinda Small/Mid Cap Equity Fund	1.9	3.30%
China Nature Flex Allocation Balanced Fund	0.2	3.18%
Huashang Prosperous Growth Fund	2.1	3.15%
<b>BENCHMARK: CSI 300 Index</b>		-6.4%

## Industry AUM: MMF bubble loses air



Industry AUM dropped 9.1% in Q1, following a healthy 20% inflow last quarter. At the same time, it was the first quarter since 2Q08 in which AUM and shares in issue dropped simultaneously, due in large part to a perfect storm characterized by a flee from MMF and waning demand in equity-centric products. Investors are taken a cautious, wait-and-see, approach which means for the time being AUM will remain stagnant until the market takes a more definitive direction.

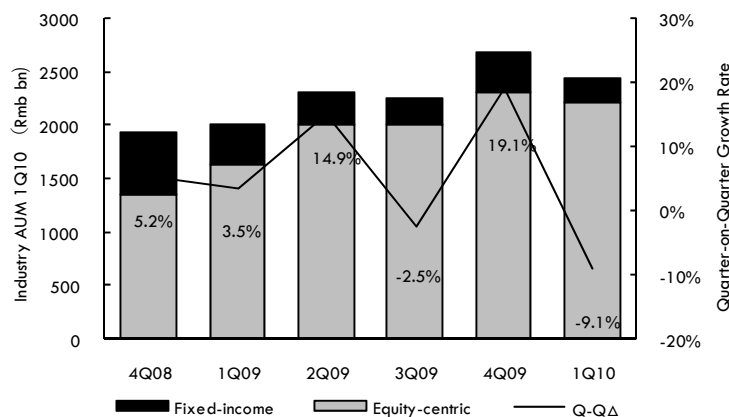
In the past, inflows into MMF and equity-centric products have had a symbiotic relationship for the industry, with one or the other supporting fund flows depending on exterior market conditions. However, an early move into MMFs last quarter wrecked havoc in the product type during a Q1 that would have traditionally been a strong period for cash alternatives (due to a negative return in the stock market). In fact, MMFs now represent a smaller absolute value, Rmb116bn, than it did before the inflow in 4Q09, Rmb118bn.

On the other side, due to the just mentioned correction in the stock market, enthusiasm for all but the best equity-centric funds has decreased. Demand for new products fell as well as investors preferred non-traditional product types. Once again, FMCs with a powerhouse distributor as a shareholder were able to overcome these obstacles and raise money despite poor conditions.

In the following quarter, we expect to see a continuation of the stagnation seen in Q1. Redemptions may be decreasing, however, it is unlikely AUM will flow in any significant amount as investors remain hesitant. Uncertainty may play into the hands of bond funds which could continue its rebound, albeit slightly, in Q2. Growth will come mainly from new product launches, however, FMCs will be hard pressed to differentiate themselves from the herd. Guaranteed funds, innovative closed-end funds and QDII are the best bets over the next three months.

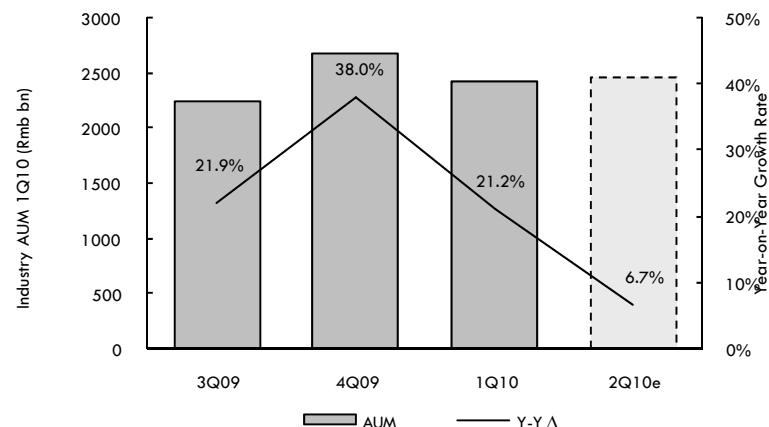
**Exhibit 1.13: AUM down sharply**

Quarter-on-quarter change in AUM

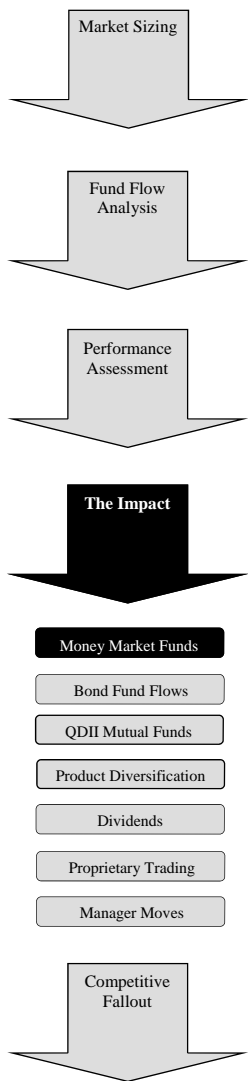


**Exhibit 1.14: Less growth year-on-year**

Year-on-year change in AUM

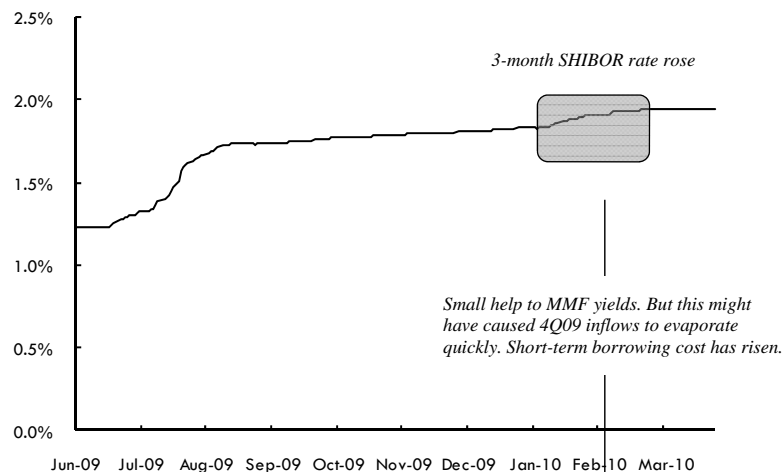


# Money Market Funds: Walk of shame



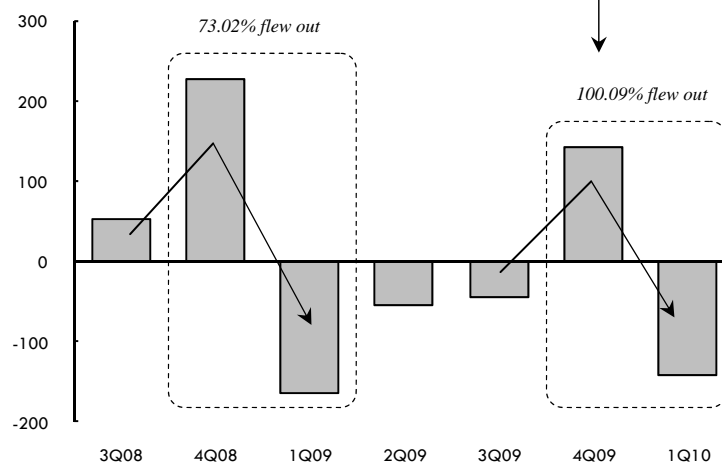
**Exhibit 4.11: Mild increase**

SHIBOR 3 Month Rate



**Exhibit 4.12: Another drop**

Net purchase of money market funds since 3Q08 (Rmb bn)



- Due to the expectation of tightening monetary policy, SHIBOR increased mildly in the first quarter. As a result, money market funds registered a 0.4% gain, slightly high than that of 4Q09's 0.3% gain.
- As we expected, there was a huge amount of fund outflows from money market funds. The circumstances surrounding the outflow from 3Q09 to 1Q10 is pretty much the same as that of 3Q08 to 1Q09. Notably, there was even more outflow in 1Q10 than the inflow in 4Q09.
- Firms which experienced huge outflows are exactly those who pushed large amounts of inflows into their money market funds at year-end 2009 to boost total firm size. Specifically, **Harvest, Bank of Communication Schroders and Dacheng** each had outflows of more than Rmb10bn.
- However, large outflows did not have much of an impact on the market share of these firms. On the other hand, the market share of mid-tier firms (such as **SYWG BNY Paris, ICBC Credit Suisse and Fortune SGAM**) are more influenced by the loss of shares in their money market funds.
- The wave of redemptions was so widespread that some firms that did not boost their money market fund AUM also saw significant share loss in Q1, such as **Huatai-PineBridge, China Nature and Baoying**.
- We believe there will be a more stable fund flows in the money market segment in the next quarter. And, if the central bank raises the interest rate in Q2 or Q3, we also expect money market funds to deliver a higher yield.

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