

China Funds Management: Quarterly Update 4Q09 *Adrift Amid Expectations*

Q4 saw both robust inflows from new product offerings and unsustainable growth in money market funds. These two phenomena led to 19.1% AUM growth from new inflows while existing products were also supported by a 19% climb among mainland equities. This trend will likely not persist if equity markets, as expected, turn volatile in early 2010: funds with high levels of equity allocation will begin to feel the squeeze if they cannot reallocate quickly.

Fund managers must also ready themselves for the large volume of outflows that will occur in 1Q10, as artificially-generated money market AUM evaporates and shares leak out from large products that were launched in 4Q09. Those that survive a potentially punishing first quarter should be well positioned, however: strong performance in underlying equities over the course of 2010 should support a wide variety of new product launches, which regulators now appear more willing to allow. Product timing remains important but the rewards in 2010 will go to the most innovative firms: those that are able to develop alternatives in an increasingly saturated market.

All In

Despite considerable volatility seen in the CSI 300, many firms remain aggressively allocated, with equity products featuring historically high exposure to stocks.

1Q10 will likely see even higher levels of volatility, with a slight downturn already registered. If funds are not able to move rapidly out of equities, performance will suffer, simultaneous with increasing redemptions.

Index Invasion

Investors can't seem to get enough of the index fix, as numerous offerings from large fund houses drew considerable amounts of AUM.

This came in spite of lagging performance, as index funds underperformed the CSI 300 index by nearly 300 basis points. This is potentially the result of the relative youth of the segment, as many funds may have experienced cash drag.

Machiavellian Machinations

At Z-Ben Advisors, expectations for rampant fourth quarter growth in money market funds have become as normal as waiting for the annual spring festival migration by Shanghai denizens to their villas in nearby Hangzhou.

Like these vacationers, money market fund inflows will soon begin to leave, having inflated the year-end AUM of mid-tier FMCs in order to push them up the firm ranking tables.

Shock and Awe

Large domestic FMCs do nothing but impress with the scale of their large product launches. During the fourth quarter, **China AMC** launched its Prosperous Enhanced Equity Fund, which raised Rmb18.4bn in a single day.

E-Fund has shown itself to be a tenacious competitor, however, with aggressive equity allocation, solid performance, and a massive ETF/Feeder fund launch.

QUARTERLY HIGHLIGHTS

FMC Market Share Leaders

	Q4 AUM (Rmb bn)	Qrt Δ in Share (Basis Points)
Bank of Communications Schroders	92.4	43
Guotai	59.4	37
SYWG BNP Paribas	23.7	34
Dacheng	106.0	28
E-Fund	159.5	27

FMC Market Share Laggards

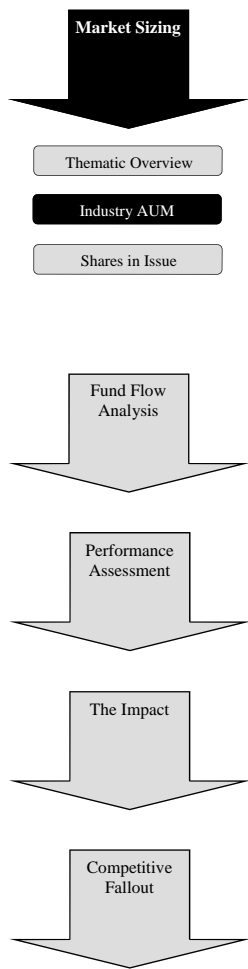
	Q4 AUM (Rmb bn)	Qrt Δ in Share (Basis Points)
Bosera	150.5	-53
China AMC	265.8	-40
China International	58.5	-37
Southern	122.3	-32
Great Wall	41.6	-23

Top Performing Mutual Funds

Product	Q4 AUM (Rmb bn)	Q4 Return
Yinhua Leading Strategy Equity Fund	0.7	30.67%
China AMC Large Cap Enhanced Fund	6.3	27.39%
Yinhua Core Value Enhanced Fund	25.9	26.02%
Yinhua Thematic Wealth Fund	9.0	25.78%
Fortune SGAM Large Cap Equity Fund	2.0	25.03%
China Post & Capital Core Enhanced Fund	16.5	24.48%
E-Fund Leading Enterprises Equity Fund	2.3	24.47%
SYWG BNP Paribas Consumption Growth Equity Fund	1.3	23.86%
China Merchants Leading Industries Equity Fund	3.0	23.06%
China Universal Enhanced Value Equity Fund	1.5	22.92%

BENCHMARK: CSI 300 Index **19%**

Industry AUM: Money market funds bubble again



Industry AUM grew 19.1% in the fourth quarter, the largest quarter-to-quarter jump since the end of 2007. Unfortunately, not all of the inflow experienced during the past several months is sustainable: one third of the net growth came from inflows into money market funds as FMCs sought to increase their year-end market share. We expect a large amount of this money market inflow to evaporate in the coming quarter.

Another important contributing factor, however, was new product launches, particularly equity funds, which accounted for 54% of the total new money raised. This suggests robust underlying demand, despite considerable market volatility in the past several months, and stands as a positive signal for the industry.

Though volatile, the CSI 300 ended the quarter 19% above its opening level, a factor which pushed AUM expansion in equity funds (32% of quarterly AUM growth) and considerable gains in balanced funds as well (13% of net quarterly growth). Balanced funds suffered considerable redemptions also, as investors likely sought to reduce fixed-income exposure and increase pure equity exposure.

In Q1, however, we expect bond fund outflows to continue, though outflow rates have finally returned to their historical norm (1-2% per quarter). High levels of fixed-income redemptions throughout most of 2009 were primarily the reversal of considerable inflows into the segment at the end of 2008. As underlying capital market performance rebounded, investors have sought to increase their equity exposure rapidly, moving funds out of fixed-income to do so.

Exhibit 1.13: AUM growth stays strong...
Quarter-on-quarter change in AUM

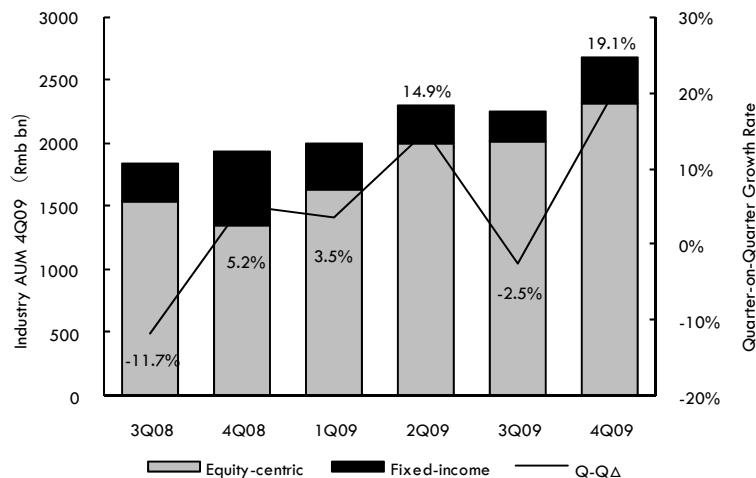
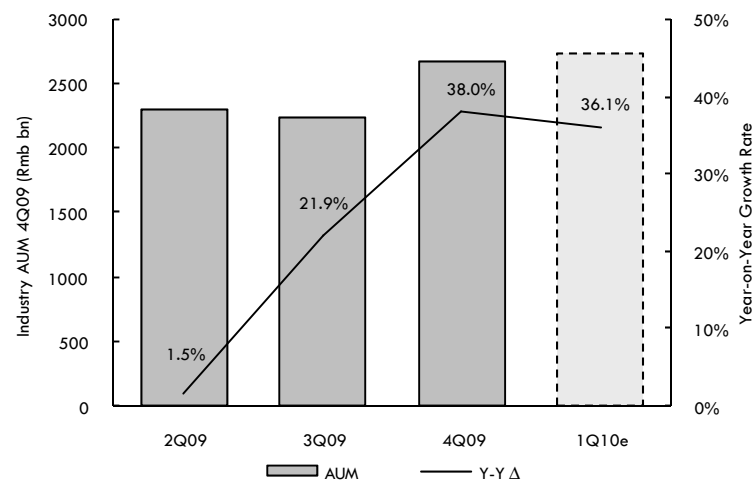


Exhibit 1.14: ...and will soon level off
Year-on-year change in AUM



Industry Fund Flows: Two-pronged assault

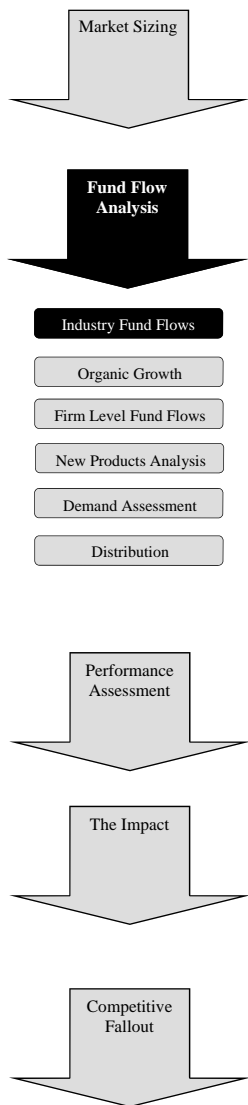


Exhibit 2.11: Back in the black
Fund Flows from different activities, 4Q09 (Rmb bn)

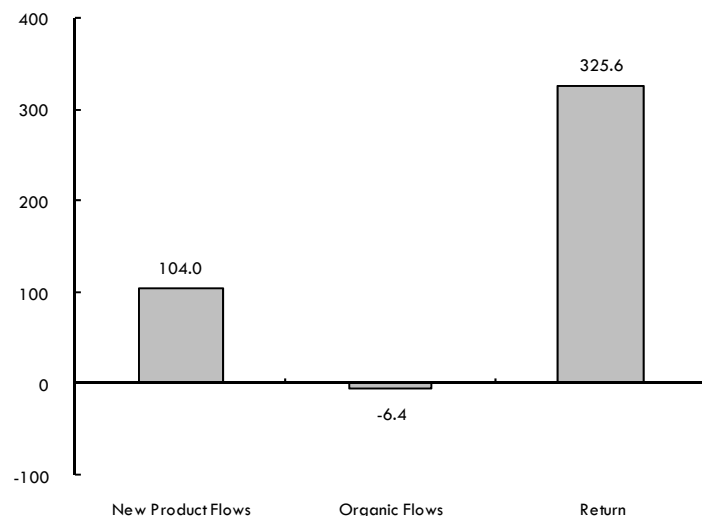


Exhibit 2.12: Bolstered by money market funds, equities
Fund Flows from different segments, 4Q09 (Rmb bn)

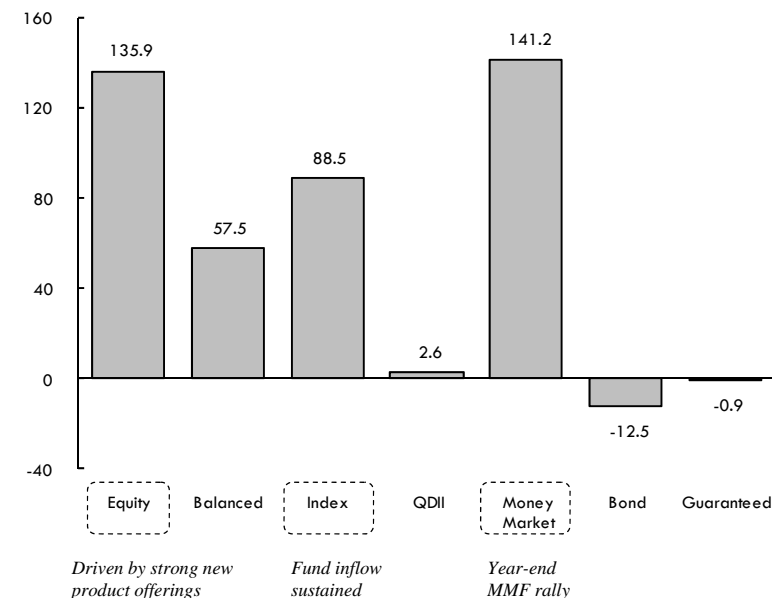


Exhibit 2.13: Fund flows quantitative analysis 4Q09 (Rmb bn)

	Q3 AUM	New Products Flow	Organic Flow	Return	Q4 AUM
Balanced	626.4	9.6	-48.8	96.8	683.9
Bond	90.8	0.4	-15.7	2.9	78.4
Closed-end	107.9	0.0	0.0	16.0	123.9
Equity	952.4	40.3	-66.5	162.1	1,088.3
Guaranteed	25.5	0.0	-2.3	1.4	24.5
Index/ETF	255.5	58.9	-11.1	40.7	344.0
Money Market	118.3	0.0	140.8	0.5	259.5
QDII	71.0	0.0	-2.7	5.3	73.6
Total	2,247.7	109.1	-6.4	325.6	2,676.1

- 4Q09 experienced strong inflows, robust capital appreciation, and solid underlying demand for new product offerings. Organic inflows, examined in aggregate, may be somewhat misleading given the extent of money market fund inflows, which many firms use as a means to boost end-of-year AUM.
- Flows into equity products were driven by new equity product launches, primarily index funds, which enjoyed very strong demand throughout the fourth quarter despite significant capital market volatility.
- Fixed income, on the other hand, experienced decidedly negative results, stemming from considerable net outflows and few new product offerings.

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