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The $12tr addressable market

China's mutual fund market: 2027

January 2018

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Executive summary: **The $12tr addressable market**

The addressable retail mutual fund market is set for accelerated growth

In light of unprecedented reforms that will radically change China's fund management sector, it was imperative that Z-Ben Advisors fundamentally reassess the addressable market for mutual funds for the next decade.

- ***Mutual fund AUM of USD450bn in 2007 quadrupled to USD1.8tr in 2017***

  Growth drivers 2007-2017: Primarily the result of key interest rate reforms which resulted in an unprecedented and unexpected acceleration of bank disintermediation into cash-equivalent products by retail investors. (pg. 3)

- ***We expect a six-fold increase to USD12tr by 2027***

  Growth drivers 2017-2027: Increased depth and breadth within domestic capital markets, combined with the introduction of tax-incentivized pension programs, will lead to increased flows and a more mature market. (pg. 4)

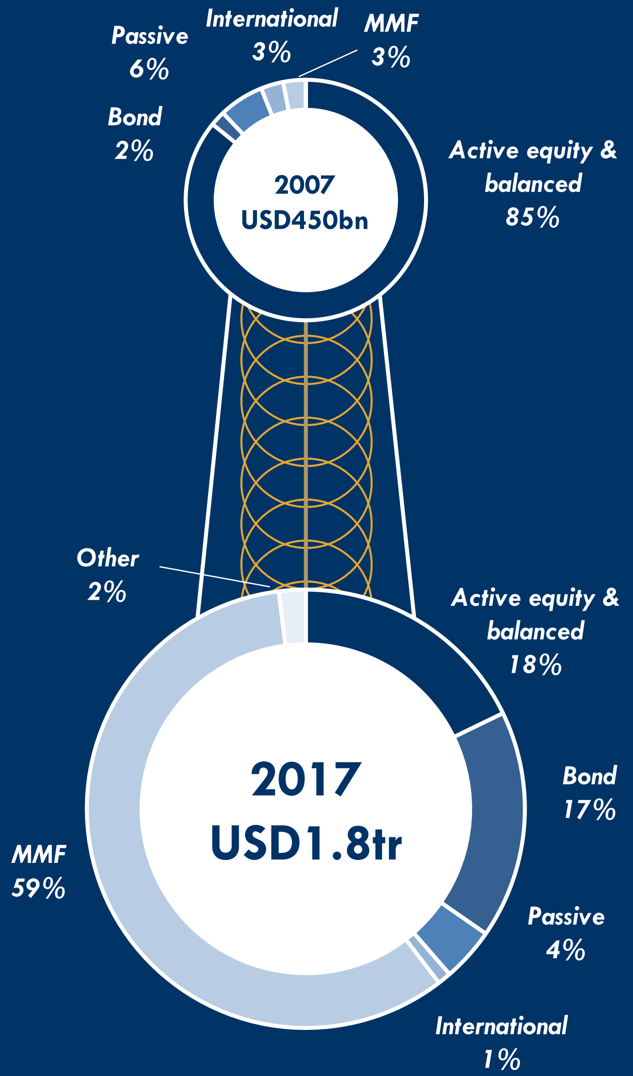
- ***Global managers are projected to command 25% of the market***

  Contrary to the current conventional thinking, global managers will be able to compete and gain market share in the domestic Chinese fund industry. Experience and a focus on core capabilities will set global firms apart. (pg. 5 & 6)

- ***The underlying economics are extremely compelling***

  There will be some pressure on fees, but not be to the extent currently witnessed in developed markets. Moreover, total industry profits are projected to reach USD32bn by 2027. The business case is both sound and very compelling.

2007-2017: An industry accelerating through liberalization



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Critical interest rate reforms

- *Chinese investors quickly sought out products offering better risk/return, cash-equivalent profiles. The trend has now reached a peak, much like in 2005, and with it investors are once again looking for alternatives.*

Real effects of bank disintermediation

- *Demand for funds moved from early adoption to full mainstream acceptance. Given rampant volatility in equities, the result was for investors to maintain very short time horizons.*

Businesses generating 30%-40% net margins

- *To be clear, foreign managers via JVs have made considerable money over the past decade. Given expected shifts in end demand, total industry profitability is set to rise from USD4.4bn in 2017 to USD32bn by 2027.*

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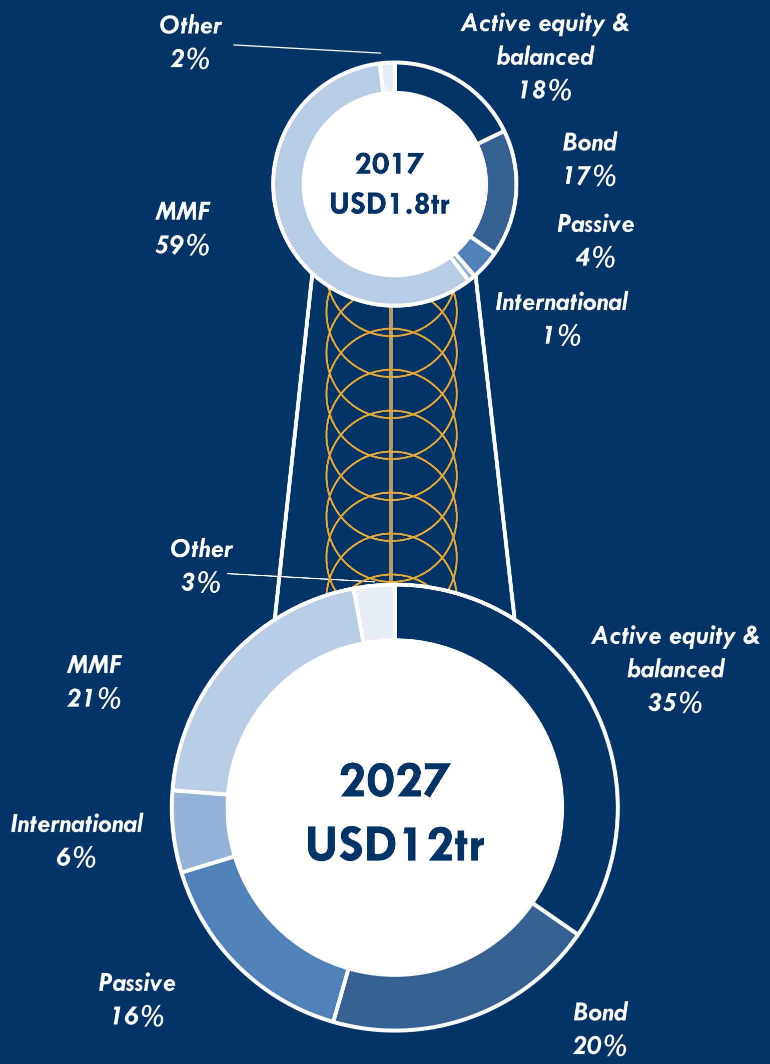
2017-2027: Long-term savings is *THE* driver of AUM growth



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A maturing capital market

- *A renewed policy focus on building depth and breadth within both the equities and fixed income markets will dampen volatility and attract long-term investors. This will be further aided by greater foreign participation.*

Commercial pension reform

- *China's fund industry achieved historic growth without the support of defined contribution pension flows. This will change in 2018 with pension flows into funds comprising 40% of total industry AUM by 2027.*

Valuing diversification and risk-adjusted returns

- *Retail investors will look to spread their various investments across all current asset classes. The historic "barbell" allocation will be replaced by a far less-concentrated approach to investment decision making.*

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2027: Global managers will take 25% of the market

Allowance for complete ownership

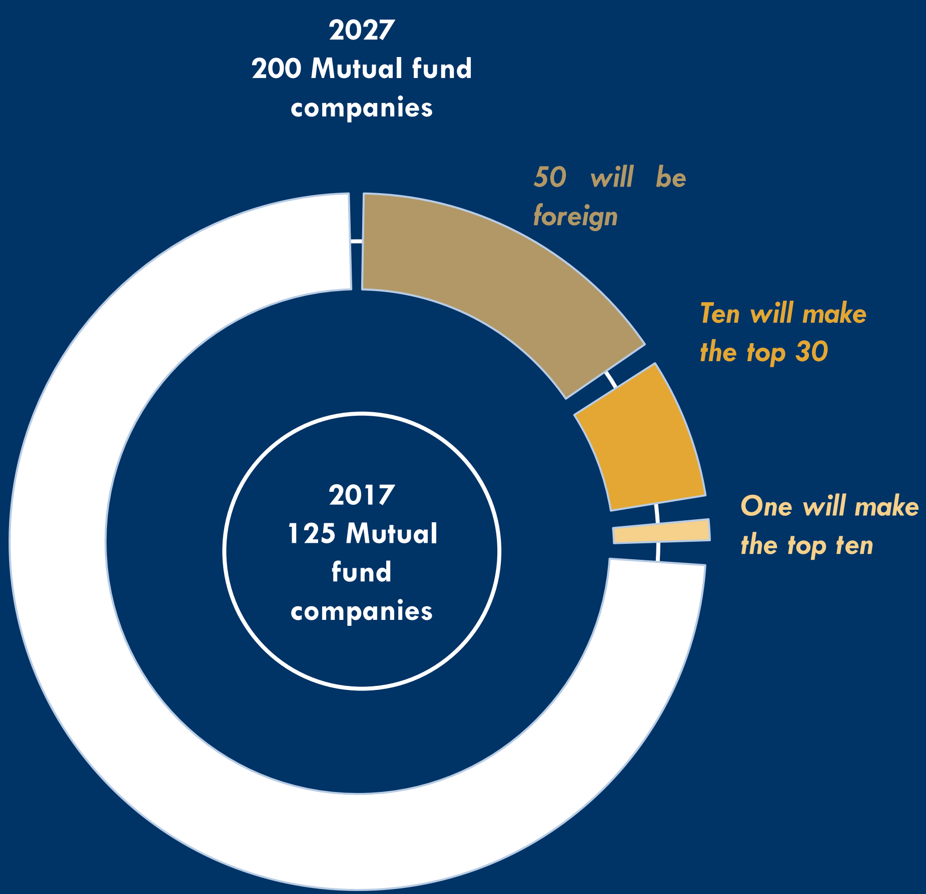
- *Changing policy is set to do away with minority-owned joint ventures, allowing global managers to control a retail fund management platform in China outright.*

Injecting process, procedures and best practices

- *We speak here of a global manager's key intellectual property that, once brought to bear domestically, will start the process of chipping away at local manager dominance.*

Core competencies and delivery

- *Locally, there remains a focus on being "everything to everyone". This results in real inefficiencies which can be readily exploited both tactically as well as strategically over the long term.*



Key competitive trends for the decade ahead

Flows rebalance into a broad set of investment solutions

- *Cash-equivalent solutions will experience a decline in overall share of industry AUM in favor of active equity and active fixed income as end-client demand continues to mature.*

Demand for passive exposure will remain on the margins

- *Broadly speaking, a unique risk-reward profile exists that differs from global markets. It is projected that there will be far less adoption of low-fee passive products – at least over the next decade.*

China will maintain an aggressive home bias

- *Flows into global products appear sizeable in absolute terms (USD715bn) but will represent no more than 6% of industry AUM. The largest, AUM needle-moving opportunity resides locally in the onshore market.*

Downward pressure on fees limited

- *We expect current fee levels will moderate over time, the trend will not be aggressive. Fees are expected to remain at relatively elevated levels.*

Industry consolidation and the rise of specialists

- *Of the current 125 managers, consolidation will take place but not for the purpose of scale. At the same time investment specialists will begin permeating the industry. Global manages will need to operate within these confines.*

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Key competitive trends for the decade ahead

2001
China joins the WTO foreign ownership limit: 33%

2005
Foreign ownership limit is raised to 49%

2015
China commits to allow 100% foreign-owned firms to be able to operate under the same rules as local private fund managers.

2016
China commits to gradually raise the permitted equity holding for foreign financial services firms in the securities and mutual fund sectors.

2017
Equity holdings for foreign financial services firms in the securities and mutual fund sectors are lifted to 51%

2018e
Majority stakes are taken by global managers

2018e
Commercial pension reform comes online

2021e
Shareholding regulations are further lifted and 100% stakes are acquired by global managers.

2027

ING establishes the first Sino-foreign JV fund manager

UBS becomes the first to hold 49% in a Sino-foreign JV fund manager

Aberdeen establishes the first 100% foreign-owned investment management platform.

Fidelity launches the first foreign-owned private fund.

China's investment management industry will have meaningful foreign participation.

25%

Market share controlled by global managers