华夏基金 ChinaAMC

BREAKING NEW GROUND IN CHINA'S ETF MARKET

ChinaAMC aims to provide the best solution for investors seeking to navigate the complexities of the mainland's securities markets.

China's history dates back millennia, but its stock market is just 15 years old. Even so, it has become Asia's second-largest securities market, and is modernizing with dizzying speed.

Recent reforms have gone a long way toward opening China's market to foreign investors. For the past two years, a Qualified Foreign Institutional Investor program (QFII) has allowed international buyers to purchase domestic shares denominated in local currency and traded on the Shanghai and Shenzhen stock exchanges. Earlier this year, authorities more than doubled the amount of cash foreigners could invest through the QFII program, from $4 billion to $10 billion. In April, regulators announced plans to float $300 billion in government-held shares of China's state-owned enterprises. These shares do not yet trade, but they constitute two-thirds of the market's total capitalization. Getting them into private hands has therefore become the centerpiece of market reform.

Other changes are in the works as well. Beijing's latest Five-Year Plan lists invigorating the capital and currency markets as a key task for the period from 2006 to 2010. And the long-awaited revaluation of the Chinese renminbi ended the currency's 10-year peg with the U.S. dollar, allowing it to float within a trading band against a basket of currencies.

All of this means China's capital markets are rapidly being transformed into a mechanism for allocating capital efficiently, making now a very good time to invest in China. Many institutions have chosen to do this through exchange-traded funds (ETFs) that track the country's highest quality blue chip stocks while minimizing transaction costs and management fees.

The mainland's first and best-known ETF is the China 50 ETF. Run by ETF pioneer China Asset Management Company, it replicates the Shanghai Stock Exchange (SSE) 50 Index, a basket of blue chip shares characterized by strong performance, good capitalization and liquidity, and low price-earnings multiples. "These 50 stocks represent the best of China," says ChinaAMC head of equity investment Shi Bo.

THE CHINESE NIFTY FIFTY?

Low costs are one of the many benefits ETFs offer to investors. Institutions wishing to buy Chinese equity funds typically must pay annual management fees from 1.2 percent to 1.5 percent; ETFs charge 0.5 percent. The China 50 ETF offers additional benefits by allowing investors to create and redeem shares using baskets of stocks rather than cash. This "in-kind" creation and redemption greatly reduces transaction costs and makes the China 50 ETF the best way for investors to track the SSE 50 Index.

At the same time, China 50 ETF units can be traded on the Shanghai Stock Exchange, enabling an efficient arbitrage mechanism to run between the primary and secondary markets. Investors can also use ETFs to implement a variety of strategies including asset allocation, stock reinvestment, and daily margin trading.

ChinaAMC President and CEO Fan Yonghong, leading the company to success.

By any measure, ChinaAMC's China 50 ETF has been an extraordinary success. During its IPO period from November to December 2004, it raised more than $657 million, making it one of the most successful equity fund IPOs in China. It tracks an index that has become one of the most important on the mainland, and its outstanding domestic market capitalization accounts for 46.62 percent of the Shanghai Stock Market in September 2005.

Moreover, the China 50 ETF is capably managed. Discount/premium rate and tracking errors are tightly controlled. From its initial listing through the end of September, its average daily turnover has been 3.39 percent. Trading has been active, with daily volume of 218 million RMB. The average discount/ premium rate has been 0.36 percent and average daily tracking error just 0.10 percent. In July, Société Générale issued a call warrant on the China 50 ETF, the first warrant based on China's A-Share market. Clearly, the China 50 ETF is recognized by retail and institutional investors, including those in the QFII program, as a financial product that meets the standards of the global fund management industry.

A PIONEER IN PRODUCT DEVELOPMENT

To develop innovative products tailored to the China market, ChinaAMC sought technical advice from State Street Global Advisors, a U.S. firm that created the first well-known ETFs in the mid-1990s. Encouraged by the success of the China 50 ETF, ChinaAMC has continued to develop new exchange-traded funds. It will launch the Asian Bond Fund (ABF) China ETF soon, as part of the Asian Bond Fund 2 program set up by 11 central banks in East Asia and the Pacific region. The ETF aims to match pre-expense returns of the iBoxx ABF China Index, launched in 2005 by the International Index Company. Created to bolster the development of China's bond markets, the ABF China ETF is unique: It is the first investment vehicle to have as investors not only China's central bank, but also different central banks and monetary authorities across the Asia Pacific region.

ChinaAMC is also developing a Small and Medium Enterprises ETF that tracks an index of small and mid-cap enterprises (SMEs) on the Shenzhen Stock Exchange (China's Nasdaq). It aims to capture the strongest elements of China's SMEs, which account for more than half of China's GDP and 60 percent of its exports.

Although other fund companies in China are developing ETFs, ChinaAMC's reputation as a market leader is solid. The company believes competition will push it to continue developing innovative products, ultimately benefiting its clients and all investors in the China market.

BROADER CHOICES, BETTER PROTECTION

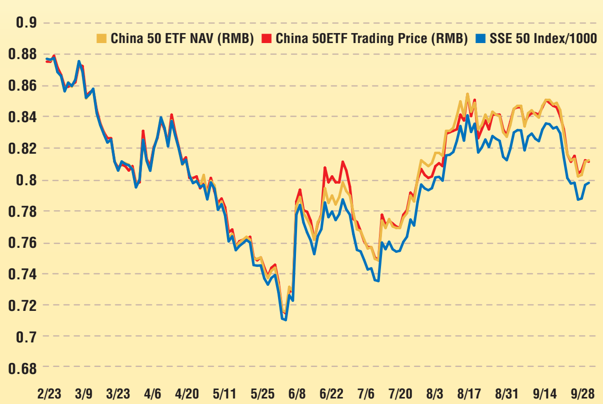
ChinaAMC's blueprint for growth is straightforward: to provide one-stop shopping for investors. "Our strategy is to lead the market in diversity of product types," says Shi. "We aim to have the most complete product line—a kind of fund supermarket."

In the eight years since its founding, ChinaAMC has created just that. It launched China's first pure bond fund, its first domestic ETF, and its first fund composed of stocks that pay dividends. Today ChinaAMC continues to develop a range of products to meet various investor needs. "Breadth of choice is our strongest selling point," says Shi.

Linked to that strategy of offering broad choices is ChinaAMC's desire to meet various investors' demands. The company does this by learning what clients want and then recommending products tailored precisely to their needs. "When we launch a fund, we don't try to maximize its size. Instead, we focus on protecting investors' interests," Shi adds.

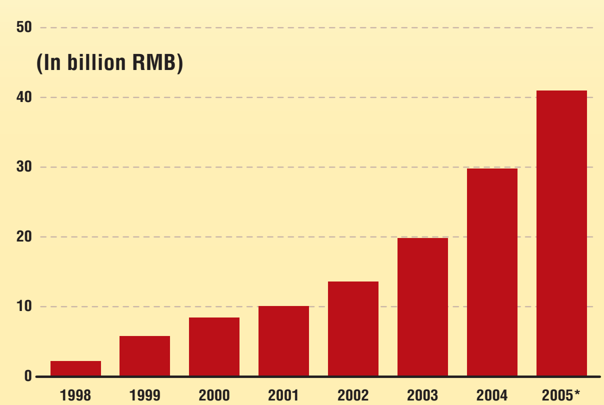
When China's stock market surged in the first half of last year, for example, ChinaAMC understood the risk borne by investors entering the stock market at that time. Although launching an equity fund was quite popular and would most likely see a great success, ChinaAMC bucked the trend by launching a money market fund aimed at providing investors with a more conservative option, protecting them from market fluctuations and rounding out the firm's product line. Shi says this willingness to break from the herd has allowed ChinaAMC to build a strong brand and establish a reputation for integrity.

China 50 ETF: Price and NAV closely track index-simultaneously rise and fall within all trading days



Source: ChinaAMC

Steady Growth in ChinaAMC's Assets 1998-2005*



Source: ChinaAMC *2005 figure through October

Interview with ChinaAMC President and CEO Fan Yonghong

In a recent interview, ChinaAMC President and CEO Fan Yonghong explains the company's success to date, and outlines its plans for future growth.

ChinaAMC is eight years old and today is one of China's largest fund management companies. You must be doing something right.

I believe several factors are behind our success. First is integrity. Our corporate value is: A Healthy Return on Your Trust. To earn that trust we must build credibility among investors. We do that in part by complying with all laws and regulations. A second factor in our success is that we've built a great team, very young but quite professional. A third point is corporate governance. We've set up structures to ensure transparency and integrity company-wide. For example, more than half the directors on ChinaAMC's board are independent. We are the first in China's asset management industry to do this.

You've chosen to specialize mainly, although not exclusively, in ETFs. Can you talk a bit about how you develop and market these products?

ETFs are quite new in China, and we've gone to great lengths to develop newer and better products geared specifically to this market. For our flagship China 50 ETF, which tracks the Shanghai Stock Exchange 50 Index, we enlisted help from ETF pioneer State Street Global Investors. With their input, we spent two years developing a product appropriate for this market. There were many regulatory hurdles, but with great support from the China Securities Regulatory Commission and the Shanghai Stock Exchange, ultimately

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—FAN YONGHONG

our design of the China 50 ETF gained wide recognition from domestic and international investors.

Because a good product needs good marketing, we adopted best practices from the global fund industry, organizing an ETF consortium and designating a team of master underwriters who contributed to our marketing efforts. We also spent time on promotions and publications. ETFs are complex, new products, and most investors in China are unfamiliar with them, so we publicized them heavily, partnering with the Shanghai Stock Exchange and putting on educational events nationwide. We've been quite successful in getting the message out.

In addition to your expertise in ETF products, what advantages does ChinaAMC provide domestic and foreign investors in terms of services?

ChinaAMC's objective is to be a comprehensive provider of asset management services, and research plays a central role in delivering these services to our clients. With more than 30 full-time analysts, we have China's largest research team among our domestic peers. We cover all industry sectors and require our analysts to produce due diligence reports for each stock in which we invest. In short, we believe research creates value.

Research ties into another area in which we're increasingly specialized, and that's investment consulting. Developing a broader product range such as the China 50 ETF is a first step in providing service to investors and that's important. But we're also focusing on delivering top-flight research and investment consultancy to domestic and international investors. For many foreign investors entering China, the best way to acquire in-country research capability is by hiring a local consultant. This cost effective way provides comprehensive coverage of industry sectors as well as analysis and advice from local analysts who are intimately familiar with the market. We're putting a lot of energy into developing such consulting services.

A moment ago you mentioned corporate governance, a relatively new concept in China. Can you elaborate on what you've done to ensure transparency and good governance at ChinaAMC?

We've been a leader in establishing a corporate governance framework that ensures transparency and establishes checks and balances to protect investors, and have erected rigorous defenses against unethical practices. Our board of directors operates independently from an Investment Decision Committee composed of professionals with financial industry experience. We also have a special Risk Management Committee with power equal to that of the

Investment Decision Committee. Such structures ensure good governance while protecting investors.

Is it hard to find qualified people in China?

Sometimes it is. But our position as one of the country's largest and best asset managers has given us a well-developed talent pool from which to draw. Qualified professionals are the most valuable asset in this industry, so we strive to hire the best people and retain them for the long term. We look for people with international experience, and in fact 20 percent of our people have experience either working or studying in Western countries. We provide excellent training

ChinaAMC hires high-caliber people

and career development, as well as competitive compensation. And I believe our corporate culture, our values, attract high-caliber people. We're people-oriented, emphasizing teamwork and seeking staff from a diverse range of backgrounds.

What does the future hold for ChinaAMC and its strategic development?

After eight years, we've built a solid brand and a great team, providing a foundation for future growth. Our objective is to be a comprehensive provider of asset management services, so we'll continue developing innovative new products for this market. Besides the China 50 ETF, we're working on the Asian Bond Fund China ETF, to be launched soon. We're also co-operating with the Shenzhen Stock Exchange to develop a Small and Medium Enterprises ETF. Small and medium enterprises are the engines of China's economy, and those listed on the Shenzhen Exchange generally have strong growth prospects.

In addition, we're quite focused on internationalizing the company. We have been looking for a foreign joint venture partner and are actively seeking partnership opportunities with foreign financial institutions in China's Qualified Domestic Institutional Investors (QDII) program as well. Meanwhile, we're looking for further technical cooperation with foreign institutions in product design, risk management and other areas. All of these measures will help us grow the company and benefit its overall development.

ChinaAMC: LEADING THE INDUSTRY

- One of China's oldest and biggest fund companies, established in 1998 with AUM of more than 40 billion RMB (U.S. $4.9 billion)
- Manages the greatest number of funds in China, including 12 mutual funds and several mandates from the National Social Securities Fund
- Selected as sole manager of Asian Bond Fund China fund in 2005 by EMEAP, a group of 11 central banks and monetary authorities in East Asia and the Pacific region.
- Among the first fund companies licensed to manage corporate annuities in 2005
- Launched mainland China's first ETF in 2004
- Among the first fund management companies picked to manage China's National Social Security Fund
- Launched China's first pure bond fund in 2002
- Launched one of China's first enhanced index funds in 1999

INTERNATIONAL RECOGNITION

- Designated "China Fund House of the Year" in 2005 by AsianInvestor magazine
- China 50 ETF receives "Most Innovative ETF Award, Asia Pacific" of Global ETF Awards® in 2005
- China 50 ETFs wins "Most Innovative Product in China" award from Asia Asset Management magazine in 2005
- Voted "Best Fund Management Company in China" in 2004 by Morningstar and Shanghai Securities News

Any parting comments for foreign institutions considering investing in China?

I believe the government's flotation of its previously non-tradable shares will usher in a new era in the Chinese securities market, offering many long-term benefits to the capital markets and those who invest in them. China's stock market has been fluctuating for the past few years, but this period of adjustment has been healthy. Now, reforms are opening up Chinese commercial banks and insurance companies to competition, while expanding the types of products these entities can offer and the kinds of securities in which they can invest. In this respect, China really is virgin territory. At the same time, the country's corporate and securities laws are being overhauled. Overall, it's an excellent time for global investors to enter China—maybe the best time in history.

They say seeing is believing. I would encourage foreign investors to visit China and see for themselves the opportunities being offered here. ■

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