

Standing Tall Amid the Slump

ChinaAMC's defensive approach to asset management was key to rising above the financial meltdown.



Fan Yonghong, President and CEO

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It's in the toughest markets that businesses really shine. Last year, China's stock market was hit harder than almost any other in the world, plunging 70 percent. It made for a challenging time for investors and fund managers alike but throughout that downturn and the bounce that has followed, the same name has remained at the top of the industry: China Asset Management Corporation.

"In 2007, there weren't big differences among fund management companies," says Fan Yonghong, president and CEO. "But in 2008, with the drop in the financial markets, the difference became much bigger." ChinaAMC's funds inevitably suffered, but less than others, because the fund's portfolio managers had seen problems ahead, and had acted. "The financial tsunami was coming so at the end of 2007, we began to implement a defensive approach to asset management. By doing this, we avoided big losses – and investors see the difference."

ChinaAMC has been able to shine because of a corporate culture that emphasizes risk management, research and talent management. It's a company within which staff turnover is low, particularly at a senior level, and staff are closely engaged in producing the best possible returns for investors within a strict and comprehensive risk framework. That's why ChinaAMC had a market-leading share of 9.74 percent as of June 30 2009, and why its funds have consistently outperformed their peers.

ChinaAMC has been at the heart of the fund management industry's development. Founded in April 1998 with approval from the China Securities Regulatory Commission, it was one of the first three fund management companies to be established in China, and remains one of the biggest, with US\$36.6 billion (RMB250 billion) under management as of June 30, 2009 – a figure that will certainly have increased with the rally in Chinese markets since that date. Since its foundation, it has been at the forefront of innovation in Chinese asset management. It was one of the first fund managers to receive mandates from the National Social Security Fund, one of the nation's most important institutions; was a pioneer in corporate annuities; launched the first ETF on the Chinese mainland; and also brought international equity investment to China following the implementation of the Qualified Domestic Institutional Investor (QDII) program in China, launching a fund in October 2007.

Today it is a truly nationwide firm, with branches in Beijing, Shanghai, Shenzhen, Chengdu and Hong Kong, and with aspirations to expand across Asia. It has the broadest portfolio of products in the industry, with two closed-end funds and 22 open-ended funds alongside its institutional mandates; and it has been designated as investment manager by more than 110 corporate annuity clients.

People and Philosophy

So how has ChinaAMC maintained its leading position? Fan is

modest, attributing the leadership partly to luck but also highlights endeavor, staff relations and continuity.

"At ChinaAMC we have good employees. They work hard and are very engaged in the business," he says. "We have a very good business philosophy and highlight long-term investment management. We retain good people and try to nurture those talented people in the company. Also, we try to maintain a very good investment culture in the company so that people have the space to develop within it. The culture is very important."

This is particularly clear in the senior leadership of the company. "We have a core team that is very stable and this is very important

for sustaining the development of the company," he says.

Risk management has perhaps never been more important than in the current market volatility.

"In the investment business, risk is everywhere," Fan says. "But ChinaAMC has been very focused on risk management. All our employees have a risk consciousness and the concept is put into every area of business in this company."

He adds: "We have a risk management team but risk management is not just for those people. It's for every member of our staff. People combine business and risk in a very good way."

The goal of ChinaAMC's investment approach is to achieve active participation in market advances while protecting gains in market declines; that means careful risk management in order to get returns which are not just high, but reflect an appropriate balance between risk and reward.

Staff and risk management efforts are matched by one of the most comprehensive research capabilities in the industry. ChinaAMC has more than 120 investment professionals, one of the biggest such teams in China. Between them they cover 600 domestic stocks and all types of fixed income securities. There are also professionals devoted to international shares, quant analysis and trading.

This combination of endeavour, staff commitment, risk management and research means that investors who have put their money with ChinaAMC for the long term have been handsomely rewarded. Its Xing Hua closed-end active equity fund has returned a cumulative 640.38 percent since its inception in 1998 – a 20.61 percent annual return. Significantly, ChinaAMC has proven itself in bull and bear markets: in 2007 its Large Cap Select Fund, Dividend Fund and Stable Growth Fund were all the top-ranked funds among their peers, with several others in the top 10. In the down market of 2008, the ChinaAMC Return Fund was the best performer among all equity funds and balanced funds, with other five funds ranking in the top 20 of the 224 equity funds available in China.

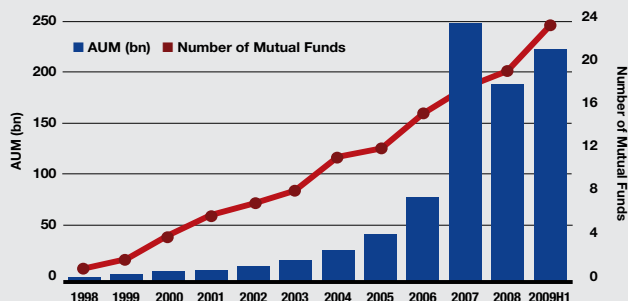
Innovation Pays

ChinaAMC has long had a full suite of investment options available, from local and international equities to bond products, but it continues to innovate. One of its current focuses is on passive products, reflecting a global trend toward investing in index-tracking funds.

The success of this approach was amply demonstrated in July when ChinaAMC launched a new index product based on CSI 300 Index which consists of 300 stocks on the Shanghai and Shenzhen stock exchanges. Within three days, it had raised a staggering US\$3.6 billion (RMB24.7 billion). Next, ChinaAMC will develop international exchange-traded funds and list them in China, for

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ChinaAMC Assets Under Management





Chinese investors to access the overseas markets more efficiently. Despite the poor performance of foreign markets in the last 18 months, Fan is certain there is a market for these products.

"Many investors wish to invest in overseas markets so they can diversify the risk in their investments," Fan says.

In launching the pioneering QDII fund in October 2007, ChinaAMC was unlucky with timing as the global financial crisis quickly damaged returns. But already, the fund is outperforming this year. "We have tried very hard to grab opportunities for QDII investments and the performance is getting much better," he says. As for the future of QDII, ChinaAMC was really a pilot fund, a first stage in the government permitting international investment opportunities to local clients. "The losses in the first stage may have some negative effect on the speed of new approvals of QDII products but fundamentally, there is no effect on the whole policy of investing overseas," Fan says. "The regulator will approve products according to their usual judgment on the market."

ChinaAMC also demonstrates some interesting trends in distribution. It mainly distributes products through the powerful banks and through securities companies but also uses a direct sales force within the country. Fan expects change to come to distribution in time. "In the future, there may be some new organizations emerging such as independent financial advisors as in the US and other countries," he says. Some have already been approved, although "currently they are too small and are incapable of competing with the big banks," he says.

Despite the difficulties of 2008, Fan is optimistic about the future for fund managers in China, noting that the stock market had already rallied 80 percent in 2009. "It's a totally different world," he says. And his optimism is underpinned by China's economy and the demographic trends within its population. "Firstly, the worst stage of the problem in the world economy has already passed," he says. "The recovery is in its early stage." And by global standards China looks remarkably healthy. "China should be the first to recover from the crisis," he says. "It had a very big negative effect on exports in China, which dropped about 25 percent, but China can rely on investments and consumption to help the economic recovery. We

expect GDP to grow 8 percent this year." While that is well down from the 11.4 percent peak reached in 2007, it is considerably healthier than almost any other world economy.

On top of that, Fan says, China's banks are very healthy, putting money into the system and helping the country develop.

But are investors sharing this confidence and returning to mutual funds? "In the past half year, some investors have joined the market and others have left. But recently, more and more investors are getting into the market, so the net inflow is increasing."

Besides, for the Chinese fund management industry – and ChinaAMC in particular – retail is no longer the whole story. "To begin with, we mainly focused on retail, with institutional as a supplement to the business," says Fan. "But the institutional business has become more and more important." That is a very welcome development for fund managers since institutional money tends to behave in

a different way to retail. It is more focused on long-term performance so it is less likely to move in and out of funds and therefore, easier to manage effectively.

Institutional money is coming from pensions, corporate annuities, insurance companies, foundations and big companies and in all areas, it is growing. Insurers, for example, have been given greater freedom to invest their money outside of stable fixed income assets and fund

managers clearly benefit from that trend. The National Council for Social Security Fund (NCSSF) is growing in assets and also has more to give in mandates, having started its outsourcing process with ChinaAMC. And in particular, corporate annuities are an extremely promising area. "China's aging population is growing and taking care of those people is becoming an important issue for the government," Fan explains. "In the US they have the 401K plan; we have created a similar system in China. The government has some preferential policies to support the pension system and this will create more

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Upward They Go

Since fund managers were first licensed in China in 1998, the asset management industry has grown into a vibrant and sophisticated force. According to research consultancy Z-Ben Advisors, industry assets under management stood at US\$336.7 billion (RMB2.3 trillion) by July 1, 2009, with 60 fund managers active, including 32 Sino-foreign fund managers.

These numbers used to be bigger still: US\$468.4 billion (RMB3.2 trillion) at the top of the stock markets at the start of 2008 before falling to US\$284 billion (RMB1.94 trillion) by the end of that year during the global financial crisis. But the pace of recovery is already encouraging, supported by the increasing sophistication and wealth of retail and institutional investors in China, which is in turn leading to a greater appreciation of the value of mutual funds and ETFs.

This represents a huge pace of growth even after last year's reversals. As recently as 2006, the industry was worth US\$125.3 billion (RMB856 billion) and even that was 10 times greater than at the start of the decade. The industry is well on track to become one of the world's largest in a very short period of time.

Over the years, a wide range of funds has developed. Domestic equity funds, hybrid funds, cash and fixed income funds are widespread; index funds are growing in popularity; and under the QDII program, international equity funds are beginning to gain traction, though it will not be until world stock markets recover that great enthusiasm can be expected for these products.

Assets tend to be concentrated among a handful of big managers such as ChinaAMC. The top five control about one third of all assets under management. Consider that 130 million Chinese own shares – roughly twice as many as do so directly in the United States – and yet that is still only a 10 percent level of penetration among China's vast population.

developing opportunities for pension management." Today, the split between retail and institutional at ChinaAMC is about 70/30 and Fan expects the institutional component to continue to grow.

Evolution of an Industry

The fund management industry has undergone enormous change since ChinaAMC's foundation in 1998. Today, according to China Galaxy Fund Research Center, 60 fund managers are active in China. There are home-grown institutions, joint ventures with international partners and the competitive environment has never been more intense. "In the past few years, competition has been very hard," says Fan. "But the competitive landscape is still in the initial stage. It is like rowing your boat in the water. If you don't row forward, you'll go backwards. Currently, ChinaAMC is the number one in the industry but if we don't work very hard in the future, we are going to lose the position."

In that environment, branding is extremely important and the US\$3.6 billion (RMB24.7) billion subscriptions to the new index fund illustrate just how important a good brand can be. "Corporate branding is getting more and more important to investors," Fan says. "Performance is sometimes no different among companies"

– this is particularly true in an index fund – "so investors pay more and more attention to the brand."

That said, Fan recognizes that scale isn't everything in asset management. "Sometimes we need to control the scale," Fan says, noting that the new fund could have raised considerably more money. "If we don't control the size, we may end up with a very big fund but we need to look to create better returns for investors. If we feel size is not good for investor returns, we will close that fund to new investors. It's not simply that we just want to increase assets under management."

The same attitude is in evidence in ChinaAMC's reaction to the financial crisis. "At the turning point in 2007, we began to feel the problem and took measures to cope with risk," he says. "Some companies probably also realized the problems but they didn't take action. We took action, to drop the temperature, to slow things down."

That was not easy, since short selling is not possible in China. Instead, ChinaAMC had to build its defensive position through asset allocation.

The next step for ChinaAMC is to expand its reach internationally. "Although we are getting bigger and bigger in China, we are still a local firm and this is a key point: How are we going to develop in the next 10 years?" Fan says. Having developed a first class research team for investment in China, the company is now building a team with expertise in the Asia Pacific region through its Hong Kong subsidiary, a process he expects to take three years. "Our current target is to become an important regional asset management company," he says, and ChinaAMC's vision is to become a respectable asset management company with global influence.

Looking back on the last 11 years, Fan says there have been "lessons everywhere," but adds that "the happiest feeling is when we make money for investors. We have 13 million investors – nearly twice the population of Hong Kong – and many of them are not rich, so we are happy to make money for them. Improving their quality of life – that is our responsibility." ■



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