CHINA AND THE WORLD: THE FUTURE OF ASSET MANAGEMENT

A special report looking at China’s fast growing fund management industry and how it may impact the world in 2019 and beyond
China’s rising importance in the global asset management industry

Global asset management: the leaders

China’s peak performers

China Asset Management Co
China Universal Asset Management Co

China’s financial market reforms — a staggering opportunity

Going offshore — how China’s asset managers are taking the leap

What the future holds for China’s asset management industry
CHINA ASSET MANAGEMENT REPORT

Exploring Opportunities for Both Domestic and Global Fund Managers in China’s Fast Growing Market
China’s rapid ascent up the global asset management ranks

China’s economic reforms began 40 years ago, following which the world’s most populous nation’s economy vaulted from 10th largest in the world to number two. By 2018, China had created a $25 trillion capital market, the second largest behind only the US, with $13 trillion in equity market capitalization on the Hong Kong, Shanghai and Shenzhen stock exchanges, and $12 trillion in various fixed income instruments traded in the interbank markets. ¹

Such capital market growth has naturally led to the rise of the domestic asset management industry. By the end of 2018, Chinese asset managers were closing in on their rivals in the US to take the second spot among global fund management markets. ² If China’s economy continues to grow, the country’s asset management industry will undoubtedly rival that of the US.

In this report, we look at the industry in the Mainland by tracking its past, looking at the present, and predicting its future. Read on to learn why China’s fund managers are on the rise.³

By Allen T. Cheng

Allen T. Cheng, a contributing editor to Euromoney Institutional Investor Plc., is the author of this report. Cheng was the Asia Editor of Institutional Investor Inc. from 2008 to 2018 and has more 30 years of experience as a financial journalist in the United States and Asia.

¹ Data from exchanges and China’s interbank markets
³ A significant portion of the report is from interviews. The citations/attributions given for the interviews are within the text
CHAPTER 1
China's rising importance in the global asset management industry

The 10 years since the global financial crisis of 2008 have been transformational for the asset management industry worldwide. A cohort of passive asset management houses have risen to the forefront, absorbing huge assets under management by offering lower fees and pushing active investment peers lower down the rankings table.

The two leaders that stood out by the end of 2017 were US-based Vanguard Group and BlackRock Inc, both of which rose to the top of global league tables by taking in massive inflows from US investors who put money aside on a monthly basis into their tax-deferred 401K pension savings accounts.

At the end of 2017, top-ranking Vanguard had $4.78 trillion of assets in the form of mutual funds and exchange traded funds, while second-place BlackRock and its iShares ETF affiliate had $2.74 trillion, according to Chicago-based fund industry research firm Morningstar, Inc. 1 Both held a combined $7.5 trillion in assets under management (AUM), almost equivalent to the $7.9 trillion held by the other top eight global asset management houses combined, shows Morningstar. Coming in third was Boston-based Fidelity Investments Inc, which had $2.29 trillion, and fourth was Capital Group’s American Funds unit with $1.54 trillion. The rest of the top 10 had less than $1 trillion each, according to Morningstar. 2

“The asset management industry is tied to pensions,” says Grant Kennaway, Morningstar’s Chicago-based global practice leader of manager research. “As 401Ks became popular and more employers offered 401K, those asset managers that catered to people’s retirement savings benefited the most.”


Shanghai-based data analytics firm Z-Ben Advisors have higher estimates than Morningstar. According to Z-Ben Advisors, AUM for the industry in China rose 12 percent from RMB 11.9 trillion from 2017 to RMB

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2 ibid
12.9 trillion in 2018.

“China is a nearly $2 trillion mutual fund industry,” says Peter Alexander, the managing director of Shanghai-based data analytics firm Z-Ben Advisors. “While there are risks facing China’s economy — be that over-leverage or capital flight — they are short-term outcomes of rapid growth over the past two decades. For the domestic mutual fund industry, what we find is AUM having reached both size and scale without the support of any pension flows. This is a first for any major fund market.”

The Chinese government has begun to experiment with a number of pension sector reforms, among them regulations that will, sooner or later, allow the nation to begin a savings scheme similar to the US 401K.

Those experiments, plus China’s population of several hundred million workers who will begin retiring in the coming decade or two, cast a spotlight on the huge potential for growth of the country’s mutual fund industry. So much so that, China is well on its way to becoming the world’s largest asset management market after the US, according to a 2017 study from Casey Quirk, a research practice owned by Deloitte Consulting LLP. ³

The US-based management consultancy firm, which was acquired by Deloitte in 2016, predicts that China will become the second largest asset management market by as early as 2019. Casey Quirk also expects China to attract half of the industry’s new asset net inflows in the coming two years, according to a news release issued by the firm. By the end of this year, the AUM in the China market may grow by up to five times to $17 trillion, up from $2.8 trillion in 2016, according to the study.

The firm’s 2017 whitepaper, titled ‘Leadership in Times of Plenty: Future Winners in China’s Asset Management Industry,’ reported that growth rates in China’s fund management industry will average about 15% a year through 2025 and slow to 12% a year from 2025 to 2030. The firm notes that $8.5 trillion in new assets will flow into the industry from Chinese investors between 2017 and 2030, and that net inflows in the Mainland will be about the same as the amount of net new flows of all other global markets put together over the same period.

“In contrast to the rest of the world, China is the only large, multi-trillion dollar asset management market that has seen net new flows in excess of 30% on average for the past five years,” Casey Quirk said when it released the report in November 2017. For local firms, this highlights the importance of aligning around a successful business model to capture future asset flows, according to the firm, which adds that for firms outside of China, collaboration with strong local players is crucial.

Casey Quirk, however, predicts that foreign firms will account for only 6% of the Mainland market by 2030, hindered in part by the preference among local investors for domestic asset classes and

### China’s Top Asset Managers by AUM (RMB Billions)

<table>
<thead>
<tr>
<th>Fund manager</th>
<th>Total AUM</th>
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</table>

Source: Z-Ben Advisors Ltd.
local firms. Casey Quirk adds that foreign firms that want to capture market share in China will need to set clear objectives, be flexible with their business models, make a commitment to put down roots there, and most important of all, seriously consider mergers and acquisitions.

There is no question that rapid progress in China and emerging markets is already benefitting the global industry, which continued to enjoy a strong surge in net inflows despite a volatile 2018, with robust growth seen particularly in major markets like the US and China. US net inflows topped $1.55 trillion in 2018, despite volatile markets in the last quarter, according to Morningstar. Net inflows for last year were dramatically down from 2017 — a year with one of the best growths with global net inflows topping a record $1.97 trillion, more than double the $835 billion estimated in flows in 2016.

The flows in 2018, led by the US, were followed closely by China, which had RMB 1.04 trillion ($1.57 billion) in net inflows for the full year of 2018, according to Z-Ben Advisors.

"China is obviously in an Asian context and global context a very important market," says Jacob Dahl, a Hong Kong-based senior partner and leader of the Asia banking practice at McKinsey & Co. He is also the co-author of the report, "Will the Good Times Keep Rolling for Asia’s Asset Managers?" "Roughly 40% AUM in Asia is in China. That means roughly 8% of global AUM is China. This means China is becoming a significant force in the global asset management industry."

What is impressive is that growth in Asia stands out. For the 10 years through 2017, AUM in Asia grew by 9% annually, capped by a strong 11% growth in China’s rising importance in the global asset management industry.
The management consulting firm concluded that the region’s industry was propelled by buoyant capital markets, investors shifting from deposits to investments, and friendly regulators. According to McKinsey, Asia is the world’s fastest-growing asset management market, capturing about 45% of global flows over the past five years. AUM across Asia rocketed by 11% year-on-year to a record $16 trillion in 2017, up from $7 trillion a decade ago. Asia now represents about 18% of the global total of $89 trillion, according to McKinsey, and revenue pools among asset managers are currently $66 billion, up 188% from 2007.

Like AUM, profits also grew to record levels in 2017. McKinsey elaborated in its ‘Will the Good Times Keep Rolling for Asia’s Asset Managers?’ report that revenues expanded not only from growth in AUM, but also from demand for higher-margin multi-asset products and alternative assets.

Emerging markets, especially mainland China, India and Malaysia, registered the highest flows over the past four years, says McKinsey. China, for example, saw net inflow of AUM of 12% at the beginning of 2017, far higher than any other regional market, spurred by a 21% rise in net inflows from retail investors.

Retail growth was the key driver as the wealth effect was felt across emerging Asia. The number of high net worth (HNW) households has grown by double digits — 21% compound annual growth rate from 2008 to 2017 — as has their wealth, according to McKinsey.

Institutional demand has also been strong across the region, expanding annually by 11% from 2007 to 2017, shows McKinsey research, with concentrations primarily in the more developed markets, such as Japan, Australia and Taiwan, which held 50% of the institutional pools, followed by South Korea and mainland China. Much of the institutional money comes from pension funds and insurers that make up about 65% of total Asian institutional assets. When looking at products, growth has been driven by rising interest in alternatives and multi assets, especially as wealthy customers develop a taste for hedged and asset-allocation strategies, according to McKinsey analysts, who note that even on the institutional side, demand for multi assets and alternatives has grown. Almost 70% of institutional mandates in 2017 were multi-asset and alternative investments.

High growth across Asia has propelled the growth of high net worth individuals. Hong Kong, says McKinsey’s Dahl, has more high net worth individuals than New York or London.

“This is a sign of rising high net worth individuals,” Dahl says. “We estimate 10 years from now there will be more high worth individuals in Asia than in the US or EU. This will be the largest wealth management market in the world.”

Take, for example, Shanghai-based China Universal Asset Management Co., which manages RMB 241.84 billion ($35.1 billion, excluding money market fund) in mutual fund assets as of December 31, 2018, the 6th largest fund house in China, according to Galaxy Securities Fund Research Center. It has been expanding aggressively into the high net worth individuals market for the past few years. In 2016, for example, China Universal set up a wealth management center, and began building a professional team providing customized asset allocation plans, as well as private wealth management services, for wealthy clients. The firm also launched a wide range of private pension programs that cater

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5 "Will the Good Times Keep Rolling for Asia’s Asset Managers," McKinsey, October 2018
to both individuals planning for retirement as well as corporate pension plans.

“In China, there is a market of 300 million people who need private pensions,” Chairman Li Wen says. “In the coming 10 years — with most people suffering low returns from their savings in banks — there is a huge demand and need to generate higher returns. That will drive huge demand for professional retirement planning investment programmes.”

The pension retirement market in China is, in fact, the single most important market that will drive growth of the asset management industry in the country, adds Li.

China Asset Management Co., another large asset manager, also known as ChinaAMC, launched a special wealth management unit targeting high net worth clients in 2016 to cater to China’s rising number of millionaires and billionaires.

“We set up the China Wealth Management Company to help high net worth individuals with financial planning,” says Li Yimei, ChinaAMC’s chief executive officer, said in an interview in her office in the company’s headquarters in Beijing. The company is the largest equity manager of mutual funds, and leads the market with a total AUM of RMB205.3 billion as of December 2018. It is also the largest equity ETF manager, accounting for 26 percent of the Chinese equity ETF market as of December 31, 2018. In addition, the company has been the largest corporate pension manager among fund management companies for 10 consecutive years, and serves more than 200 corporate pensions with a total AUM of RMB95 billion.

ChinaAMC’s Li said her firm developed in-house the first situational robo-financial adviser — a service called “Charlie” — to cater to China’s massive working population and help them plan for their retirement, children’s education, and investments.

“We launched Charlie, our robo-advisor, back in 2018, specifically to cater to those who need long-term financial planning,” Li says. “We see significant demand for this technology and service in China. There are so many out there who need to plan for retirement and children’s education, and they can use our help.”

According to Statista.com, there are 1.47 billion smartphone users in China. With so many people with access to online services, it certainly makes robo-advisory an easy — and perhaps affordable way — for them to seek and find financial help. The huge market in China is undoubtedly an attractive proposition to all asset managers — domestic and foreign alike.
CHAPTER 2
Global asset management: the leaders

The global financial crisis of 2007 and 2008 was a cataclysmic event that led to the demise of Lehman Brothers Inc and the bailouts of major investment banks and insurers in the US and Europe. But the crisis was also the catalyst that helped one asset manager rocket up the ranks, eclipsing all rivals — The Vanguard Group of Malvern, Virginia. It is a predominantly passive manager that keeps its holdings in a large family of index and exchange traded funds.¹

In 2006, Vanguard’s AUM topped $1 trillion, and a decade later the figure more than tripled to $3.8 trillion. By the end of 2017, Vanguard had grown to $4.8 trillion. While its AUM plateaued in 2018 and even slipped a bit to $4.65 trillion by September 30, 2018, the firm continues to be the global leader.²

"Before the global financial crisis, many financial advisers assumed active managers would fare materially better than passive in a severe market downturn," says Grant Kennaway, Morningstar’s Chicago-based global practice leader of manager research. "But what they found was active managers did not provide their clients with the downside protection they expected during the crisis. As a result, advisers began to more closely question the merits of the fees they had been paying active managers and ultimately this contributed to a switch in flows to lower cost passive managers. Most of the growth post-crisis has been in passive investing, and Vanguard’s growth has simply been exponential in the past decade."

Founded in 1974 by fund manager John C Bogle, who began his career in 1951 at well-known fund manager Wellington Fund, Vanguard launched the First Index Investment Trust in 1975. This later became the group’s flagship Vanguard 500 Index.

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1 Morningstar Direct Asset Flows Commentary United States, September 2018
2 ibid
The fund was the first index mutual fund available to the investment public.

Bogle, who passed away on January 16, 2019, at the age of 89, grew Vanguard’s AUM and business by offering low management fees to investors — fees that on average were 0.11% or about a fifth of the industry average. More specifically, Bogle’s idea was that instead of beating the index and charging high costs, the index fund would mimic the index performance over the long run, thus achieving market returns with costs that are lower than the costs associated with actively managed funds.

In a March 2018 survey, Charlottesville, Virginia-based Chartered Financial Analyst Institute found that 41% of investment professionals in the Americas said fee pressure would be the most significant challenge for the industry in the next five to 10 years, versus a smaller 35% in Europe, Middle East and Africa and 28% in Asia.

“In the US, saving for retirement is the main driver of the fund management industry,” Morningstar’s Kennaway says. “Saving for a child’s college education, for life events, are also drivers. Many seek financial advice and most end up in mutual funds, especially exchange traded funds.”

Before the global financial crisis, household asset management houses such as Fidelity and T Rowe Price — both of which made their names as active managers — dominated the landscape. They have also been adopting passive investments in recent years in order to compete.

Rebecca Fender
The Future of Finance Initiative

The global mutual fund industry has its roots in the US, where fund management houses catering to both retail and large corporate investors were set up in the 1930s. However, the asset management industry didn’t take off until after the 1980s when the US government established the system of individual retirement accounts, with the most common type being the 401K. This allowed employees to begin self-funded retirement plans, taking the pressure off corporations that were previously putting aside money for staff pensions.

The US mutual fund industry that catered to IRAs, or individual retirement accounts, and 401Ks grew so quickly that the pension model and various variations began spreading to Europe and other developed markets, chief among them Canada, Australia and Japan.

“The US and Canada will continue to be very influential in global finance, given the size and sophistication of the existing investor base,” says Rebecca Fender, head of the Future of Finance initiative at the CFA Institute. For example, Fender says pension funds are the largest single category of assets under management, amounting to around $40 trillion at the end of 2016, with $22 trillion in the US. She points out that ongoing pension reform will continue and the shift to defined contribution plans in North America will help drive industry trends globally. She adds that many large pension plans are working together, along with the major fund houses, on issues of stewardship and
fiduciary responsibility to find efficiencies and ways for the industry to serve investors better.

Fender notes, however, that there are specific areas for growth in investment management in North America, which include wealth management, alternative assets and development of investment solutions, with investment products tied to investor goals and not dependent on a benchmark.

Culturally, individual investors in North America are still more interested in human advice versus entrusting their funds to a computer interface, according to Fender. “Accordingly, when asked about the most important strategic factor for investment firms in the next five to 10 years, 42% in the Americas say client centricity versus just 28% in Asia,” she adds.

Competition among the large fund managers in North America will continue to drive global trends, reckons Morningstar’s Kennaway. He notes that one of the developing trends in the US is a move away from funds that charge high upfront commissions to a market dominated by a wide range of funds that offer low fees, and in some instances, no fees at all.

Fidelity, for example, says Kennaway, began launching zero fee mutual funds and ETFs in the past year. The funds, which do not charge retail investors any fees, bring Fidelity revenue by encouraging investors to use its platform as well as from securities lending. Securities lending is the process where broker-dealers and hedge funds pay fees to borrow securities to short, avoid settlement failure, or profit from arbitrage opportunities.

“No fee funds are a highly innovative approach in the US asset management industry and one of the leading trends,” Kennaway says, adding that some major asset managers had already been branching out from pure fund management to offering a host of other revenue generation services to make up for a reduction of fee income.

Fidelity has long had a record keeping (fund administration) business by offering administrative services to corporate clients, Kennaway says. He adds that Vanguard has begun offering investment advisory services and BlackRock has started to sell financial technology software.

According to ‘Evolution of the Asset Manager,’ a landmark study published by wealth manager UBS back in 2012 but which still holds relevance today, the sector is being impacted by the following trends:

- The industry is undergoing profound changes in response to economic, demographic and industry-specific pressures
- The end of the benign economic backdrop known as The Great Moderation, with high growth and low inflation, has created a tougher environment for investors
- Increasing life expectancy and aging populations create further pressure as the baby boomer generation starts selling investments to fund retirement spending
- Low real returns on equities since the peak of the dotcom bubble in 2000 have undermined faith in the equity risk premium
- The secular bull run in bonds is approaching its natural limit as government bond yields in the US, Japan, Germany and the UK move closer to zero

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3 “Evolution of the Asset Manager,” UBS, December 2012
• The assumptions behind the Capital Asset Pricing Model (CAPM) and Modern Portfolio Theory (MPT), two academic models that have been widely used in the investment industry, look increasingly unrealistic

• Investors now have shorter time horizons and increased aversion to risk

• Emphasis is shifting away from performance relative to benchmarks towards investor outcomes such as income generation and avoiding large drawdowns (i.e. peak-to-trough losses)

• Focus is also changing from specific asset classes to holistic solutions to meet investors’ needs

• Investors based in emerging markets make up a growing proportion of the industry’s client base. As they have different characteristics to those based in developed markets, it is propelling global fund houses to expand into emerging markets in unprecedented ways

Furthermore, regulatory reform globally is “upending the competitive landscape as we know it,” notes Chantal Grinderslev, partner at Z-Ben Advisors. Since Chinese authorities announced in 2016 that they are allowing foreign asset managers to set up wholly foreign-owned corporate entities and begin selling products to high net worth Chinese investors, many global fund managers — including Vanguard, Fidelity and BlackRock — have expanded into China to capture growth momentum outside their traditional home markets. A total of 36 firms have set up shop in China, according to Z-Ben Advisors.

“Ignore all arguments that global managers can’t compete in China,” says Peter Alexander, the managing director of Z-Ben Advisors. “Foreign firms have a unique set of skills and experiences and can, without question, gain AUM and market share domestically.”

Asian markets are an important engine of growth for the future of global finance, and in all likelihood will be the principal source of growth for many global firms, says CFA Institute’s Fender. She points to the fact that Asian respondents to a CFA survey of financial institutions in early 2018 indicated they “were the most optimistic about growth” of asset management revenue globally in the next five to 10 years, with 67% expecting growth versus just over half elsewhere. 4

“More specifically,” Fender says, “the majority of our survey respondents in Asia expect to see growth in active core mandates, versus only about a third of investors elsewhere, where passive investing has grown significantly. In addition, Asia was the only region where a majority — 56% — expect continued growth in the number of investment professionals.”

4 “Investment Firm of the Future,” CFA Institute, May 2018
CHAPTER 3
China’s peak performers

Though only 21 years old, China’s asset management industry has been on a fast track to expand, with double-digit growth annually for the past decade.

The changes are stark. Until a few years ago, the industry was dominated by traditional equity-focused mutual funds. But in the past few years those funds were eclipsed by a single money market fund manager, Hangzhou-based Tianhong Asset Management Co, an affiliate of e-commerce giant Alibaba Group Holding. Tianhong’s AUM stands at RMB 1.59 trillion ($230 billion), with much of the funds invested in interbank money market notes. The AUM is nearly twice the size of number two ranked E Fund Management Co of Guangzhou, which has RMB 722 billion, according to Z-Ben Advisors.

“This growth is largely a function of the investor base,” notes Chantal Grinderslev, partner at Z-Ben Advisors, a Shanghai-based fund research firm. “The China mutual fund space is still 44% retail, with a predilection for active management, and 60% of mutual fund AUM residing with money market funds. That will change as the market continues to evolve.”

China’s nearly $2 trillion mutual fund industry has already surpassed that of Japan’s and is closing in on Australia, and the growth came about without the support of any pension-related fund flows, notes Peter Alexander, managing director at Z-Ben Advisors. The industry began in 1997 when regulators approved licenses for the first three asset managers, with the sector since getting a boost to 115 mutual fund managers, 44 of which are registered as joint venture companies that are owned and managed by teams of Chinese and foreign investment professionals.

“Most foreign investors we talk to ask if China’s industry is a developing or developed market, and we simply state that it is a high growth market,” says Alexander, who first arrived in Shanghai in 1996 as a project manager and then an executive at Everbright Pramerica Fund Management, before founding Z-Ben Advisors in 2004 to advise global asset managers. “The Chinese market is somewhat of an anomaly. It’s a key market for growth for global asset managers, but at the same time it is a market having all the same risks associated with running a business in an emerging market.”

Despite being the largest asset manager in China, Tianhong’s investment capacity beyond offering money market funds is limited, analysts say. As a result, a fairer comparison of China’s top mutual
funds would be to look at those who manage a portfolio of equity, fixed income and ETFs.

Chief among the top players are two funds that industry experts say stand out in terms of sophistication in investment strategy and depth of experience, particularly as active managers. They are China Universal Asset Management Co. in Shanghai, the country’s primary onshore financial centre, and China Asset Management Co in Beijing, the nation’s capital. Both the firms have continuously propelled a number of their funds into the ranks of top performing funds year in and year out. The two are in many ways representative of their peers: they are primarily active managers that cater a lot of their investment offerings to retail investors.

This demand for successful active stock selection in China has given a boon to the development and recognition of the Chartered Financial Analyst certification. There are currently 156,400 CFA charterholders around the world, but only 5,600 in China. But, according to Nick Pollard, the managing director of the CFA Institute in Asia, the future of CFA belongs to China. More than 40% of the 319,300 candidates studying for the CFA programme globally are Chinese nationals, indicating that the number of Chinese charterholders is set to grow rapidly.

“The Chinese market is professionalising, and the asset management industry is driving the professionalisation of the capital markets,” Pollard observes. “China’s influence will continue to grow for the foreseeable future — the market is gearing up professionally, impacting not only the China economy, but also the global economy.”

The demand for CFA certification will only rise in China, reckons LJ Jia, CFA Institute’s China country head. “In the past, if you have an engineering degree from a leading university, you had a great future. Now, it’s common for young people saying if you want a great future you need a CFA.”

Having a deep bench of analysts with strong research skills and industry recognized accreditations helped China Universal Asset Management Co to pole vault two funds into Z-Ben’s ranking of top performers. They are the China Universal Medical Services Balanced Fund, which delivered 23% in the first six months of 2018, making it the third highest performing fund for the period, and China Universal Pharmaceutical and Healthcare Balanced Fund, which gave investors a return of 17%, the 11th highest ranking among top performing funds.

“China’s asset management industry is just 21 years old and continues to experience fast growth,” notes China Universal chairman Li Wen. “Yet the
### Fund Performance

#### Fund Manager Returns

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<td>Hongde Yuze One-year Periodically Open Pure Bond Fund</td>
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<td>9.86%</td>
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<tr>
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<td>Ping An Huizing Pure Bond Fund</td>
<td>Ping An</td>
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<tr>
<td>Bosera Bimonthly Pay Periodically Open Bond Fund</td>
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<td>China Life AMP Anji Pure Half-Year Periodically Open Sponsored Pure Bond Fund</td>
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<td>Truvalue Zunxiang Pure Bond Fund</td>
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*excluding QDII funds, funds with AUM below RMB200m and funds that existed for less than 1 year*

*source: Z-Ben Advisors Ltd.*
industry is still at the beginning stages of its growth cycle."

Li elaborates that the Chinese industry’s AUM at present is only about 14% of China’s GDP. In the US, the AUM stands at more than 110% of GDP.

“Many global experts think China’s industry in the coming 10 years could see growth as high as 10 times current levels,” Li says. “Whether China’s asset management industry can really grow this fast, we don’t know, but the key is the trend is there. Many investors are diversifying away from banks and bank deposits, and with the rise of the middle class being one of the key wealth creation factors, there will be rising need for retirement planning. As a result, there will be a huge demand for professional money managers, and that ensures the mutual fund’s role in the markets in China will rise in the coming decade.”

China Asset Management Co., or ChinaAMC, is another firm that takes immense pride in its research methodology and stock picking capabilities, and the firm highly values those who can help the firm achieve success in stock picking. “We always focus on investing methodology and research,” says Li Yimei, the Chief Executive Officer of the Beijing-based firm that was among the first three to get a license in China back in 1998. ChinaAMC’s controlling shareholder is CITIC Securities, China’s largest brokerage house and investment bank, an institution that is well known for its equity research.

“In the past 21 years, we have focused on honing our research, and continues to generate long-term risk-adjusted returns for our investors” says Li, who was one of the first Chinese women to earn a CFA accreditation in 2005. “We have developed both passive and active investment teams, and we are developing teams to service both domestic and international institutional clients.”

Among ChinaAMC’s top performing funds are the ChinaAMC Large Cap Select Fund, ChinaAMC Income Fund, ChinaAMC Return Fund, and ChinaAMC Dividends Fund and ChinaAMC Strategy Fund, each of which have maintained more than 10 year-track records, and delivered more than 16 percent annualized return since inception. ChinaAMC Large Cap Select Fund has achieved an annualized return of 24.46 percent in the past 15 years, according to a ranking by Chinese data firm Wind as of March 31st 2019.

U.S. funds industry research firm Casey Quirk estimated in its 2017 report that China will account for nearly half of the global industry’s net new flows, surpassing the UK by as early as 2019 to become the second largest asset management market. ¹ By 2030, China will reach over $17 trillion in addressable AUM, up from $1.7 trillion or so in 2018, according to the firm.

In contrast to developed markets such as the US, Europe and Japan, where industry growth has slowed to low single digits, China is the only large, multi-trillion-dollar market that has seen net new flows in excess of 30% per year, according to Casey Quirk. “We expect Chinese growth rates to average 15% per year through 2025, moderating to 12% per year for 2025 to 2030,” the firm said in its 2017 report, which predicted that some $8.5 trillion in new assets will flow into the industry from Chinese investors between 2017 and 2030, volume that would be equivalent to 50% of all global net inflows over the same period.

Individuals — retail and high net worth — will power China’s growth, accounting for over half of the China market AUM by 2030, according to Casey Quirk. It elaborated in its report that the use of asset management products will grow from less than 4% of investable assets in 2017 to 10% by 2030, which is comparable to the US market in the early 1990s.

“We owe the robust development of the industry to vision and continuous and refined guidance of Chinese regulators,” notes ChinaAMC’s CEO Li, who added that regulators have used industry standards and best practices in developed markets as a model for China’s development. “China’s fund industry

¹ “Leadership in Times of Plenty: Future Winners in China’s Asset Management Industry,” Casey Quirk, November 2017
is quite transparent because regulators have tried to adopt best practices from the advanced markets," Li says.

As China’s asset management industry matures, the position of incumbents will erode unless they develop, Casey Quirk says, explaining that competition will intensify in the years ahead and that incumbents can only succeed if they develop along three characteristics:

• Business model clarity: ‘Empire-building’ firms without a strategic focus will be weakened in the face of looming hyper-competition

• Systematic edge: This can be achieved through either superior investment skills, innovative products and fee models, or sophisticated distribution

• Scale orientation: Firms that consistently grow faster than the market today will have a competitive advantage in the future, when growth slows, and pricing starts to come under pressure

Casey Quirk has also identified five winning asset management business models of the future: 1. China champion — a dominant local brand with focus on addressing demand for domestic asset classes and domestic investor requirements; 2. Global leader — a top 10 global asset manager with comprehensive global investment and distribution capabilities anchored by the world’s second largest domestic client base; 3. Pan-Asia alternatives specialist — with expertise in illiquid asset classes across Greater China and Asia region; 4. China distribution specialist — with expertise in retail and HNW client engagement, portfolio construction and best-in-class outsourced investment products; and 5. Bespoke virtual portfolio manager — a technology-driven investment solution combining algorithmic security selection and personalised portfolio management.

China Universal’s CEO Zhang says his firm is exploring a range of business models and will seek competitive edge across the board. “At the end of the day, we are fundamental value investors. Our standards are global recognised standards, and we achieve success when we achieve strong returns for our investors.”

The best performing fund managers will rise to the top. That is because the government has begun to launch a pension reform programme that, over time, will make it mandatory for all Chinese people to invest for retirement. Only the most recognized managers — says Zhang — can win the big mandates from the National Social Security Fund, as well as corporate and individual investors.

The government is rushing pension reforms to keep up with the needs of a rapidly ageing population. According to data from China’s National Bureau of Statistics (NBS), by the end of 2017, the Mainland had 241 million people over the age of 60 years, accounting for 17.3% of the total population. That compares to 184 million in 2011, when retirees made up only 13.7%. The numbers indicate that China’s pool of senior citizens grew by about 10 million a year in each of the past six years.

But the rise in elderly population comes at a time of falling births. NBS data show that 2017 recorded only 17.23 million new births, down 630,000 from 2016, the year when the family planning policy was eased to allow all couples to have two children. Despite the easing of the one child policy, births still dropped unexpectedly.

Chantal Grinderslev, a partner at Z-Ben Advisors, observes that the underlying fundamentals of investor dynamics in China are now at complete odds with global trends and are at a precipice. “Investor needs are changing faster now than at any other point over the market’s 20-year history,” says Grinderslev, adding that primary among them is the need for pension savings, with commercial pensions having been first initiated in 2018.

The government has launched experiments giving
tax incentives to pension savings programmes in a few provinces — the Shanghai metropolitan area, Fujian province, and in the industrial zone of Suzhou in the Jiangsu province — that may widen nationally. Employees can save up to 6% of their monthly wage, or up to RMB 1,000 a month (whichever is higher), on a tax deferred basis into a programme that is similar to the US 401K programme, from which they can choose a pool of managers.

“The primary driver of AUM growth over the next decade will come from an aggressive pension reform program,” according to a research note from Z-Ben Advisors published in June 2018 when the reforms were introduced. Only Chinese insurers are permitted to participate at this time and the retirement solutions are all short- or medium-duration fixed income focused, Z-Ben notes. By mid-2019, the experiment in pension reforms are expected to become open to the entire mutual fund industry: “Slow and steady to be sure, but a tax incentivized program at the participant level,” it adds.

The experiment is still in its infancy but is expected to accelerate quickly once the programme is expanded to include China’s mutual fund managers in the middle of 2019, Z-Ben adds. “Expect muted asset accumulation initially, but the rate of growth will begin to accelerate in a year’s time on greater adoption as supported by geographic expansion and our projection of an increase in the minimum contribution. In addition, due to a real need for retirement savings, growth requires the introduction of higher-risk-profile solutions. It is here where fund managers will take centre stage, once permitted to join the program in 12 months’ time and by leveraging the fund-of-funds platform. At that point, all that will remain is to assess just how quickly assets will grow.”

Though China’s tax-deferred contribution programme is just beginning, it is not hard to see the impact on fund flows from a nationally rolled out individual retirement account platform to a working population of 750 million. When that happens, demand is expected to gravitate towards those asset managers that have a strong, long-term track record.

“While performance will be one key element for gathering assets, we expected that client servicing in this digital age will also be a crucial factor,” Z-Ben’s managing director Alexander notes. “Fund managers will, however, need to invest heavily to participate.”

The National Social Security Fund, the driver of China’s pension reforms, has played a key role in the professionalization of the nation’s asset managers, notes ChinaAMC CEO Li, elaborating that NSSF’s investment focus is long-term. She mentioned that ChinaAMC has been selected as one of the first qualified NSSF managers since the year of 2002. To this day, ChinaAMC has acted as the most experienced Chinese asset manager with the longest track records managing and serving NSSF and corporate pensions. Early in 2018, Li notes, ChinaAMC, has established a partnership with Fidelity International, a global investment management industry leader and pension specialist. ChinaAMC leverages on its leading local resources with Fidelity International’s global pension research and investment experience to jointly promote the development of Pension Target Date Fund products in China. The ChinaAMC 2040 Target Date Pension Fund of Funds is the first target date pension fund in China to provide investors with one-stop pension investment solutions. In order to serve investors with varying expected date of retirement, ChinaAMC expanded its TDF offering with the ChinaAMC 2035, 2040, 2045, 2050 Target Date Pension Fund of Funds. “China’s pension market has huge potentials,” Li says. “The long-term pension assets will have a significant impact on the structural change of China asset management industry. ChinaAMC is determined to invest heavily into long-term cultivation of investors’ awareness and participation in pension investments for the next 10 to 20 years.”
SPONSORED STATEMENTS
When China Asset Management Co was founded in 1998, it was one of the first three asset managers approved by Chinese regulators to enter the mutual fund business. The company has since become the go-to asset manager in the Chinese fund management industry, adding a number of feathers to its cap. For instance, ChinaAMC was one of the first investment managers to win mandates from the country’s pensions, the National Social Security Fund. Now the total AUM of the company has achieved Rmb 1.1 trillion as of March 31st 2019, making it the top mutual fund manager in China.

In 1998, ChinaAMC launched its first fund, ChinaAMC Xinghua closed-end fund and raised a total AUM of Rmb 2 billion. After that, it was one of the first three managers to launch open-end funds in China in 2001, raising a total AUM of Rmb 3.24 billion. Since then, it has gone on to launch more than 140 mutual funds with the AUM of Rmb 507.8 billion as of March 31.

In 2004, ChinaAMC became the first Chinese fund manager to initiate passive investments, launching an exchange traded fund called the China 50 ETF. The fund, which has Rmb 44.4 billion in AUM as of March 31, has become the largest ETF in China.

“Globally, passive and active managers are different companies,” says ChinaAMC’s chief executive officer Li Yimei. “We at ChinaAMC are a latecomer and we have been able to benefit from the experience of global asset managers before us. By offering a wide range of active and passive investment solutions, we target to successfully meet the demands of asset allocation from investors.”

Beijing-based ChinaAMC was also among the first major Chinese fund houses to welcome foreign ownership when its major shareholder Citic Securities sold a 10% stake to Power Corporation of Canada in 2011. Since then, Power Corp has acquired additional equity, even bringing in an affiliate, Mackenzie Financial Corp. Together, the two Canadian firms hold a 27.8 percent stake in ChinaAMC.

“We saw the success of global asset management markets, we saw the trends, and we saw the potential opportunities in China and created China Asset Management Corp by applying globally accepted investment management practices,” Li said during
a recent interview in her offices at the company’s headquarters in Beijing’s Finance Street district.

The firm serves more than 100 million retail investors and 45,000 institutional investors. It has more than 900 employees, including more than 200 in its investment team.

As of March 31, ChinaAMC’s QFII Relative Return Equity Strategy, established for more than seven years, helped a foreign central bank achieve an annualized excess return of 8 percent compared with MSCI China A Total Return Index since inception. ChinaAMC’s QFII Absolute Return Equity Strategy, established for more than six years, helped a foreign sovereign wealth fund achieve an annualized return of 12 percent since inception.

Under the guidance of major shareholder CITIC Securities — China’s largest brokerage firm and investment bank — ChinaAMC has focused on honing its investing methodology and equity research skills over the past 21 years. Such a focus on research helped ChinaAMC develop in-house active and passive investment expertise.

ChinaAMC has been actively seeking co-operation with various foreign investment experts to develop new products and strategies, says Li. For example, ChinaAMC worked with Seattle-based Russell Investments to develop a fund-of-funds strategy tailored for Chinese investors. Since 2017, ChinaAMC has launched a fund-of-funds business — funds that invest in other funds — raising 4.7 billion yuan from domestic investors in the largest in the first offering of public fund-of-funds raised in China. ChinaAMC has worked with trading risk management firm PanAgora to develop a risk parity strategy, and in 2017 launched the first risk parity strategy fund in China. ChinaAMC also co-operates with Microsoft Research Asia to co-develop a special artificial intelligence application for China’s financial services industry. In 2018, ChinaAMC has partnered with Fidelity International for the research and promotion of pension investments in China.

“From very early on, we knew R&D was important,” says Li. “We were aspired to be a market leader from the beginning. To do that we must keep up with global asset management trends, as well as domestic trends, and even more importantly is realising that product and service quality is key to the success of this process.”

The year 2017 was also when ChinaAMC officially joined the United Nations’ Principles for Responsible Investment, says Li. “We were the first full service asset manager in China to join UNPRI, and it strengthened our development. A strong asset manager must continuously upgrade itself.”

ChinaAMC already has plenty going for it. Its investment team is one of the largest among Chinese fund managers. The firm’s more than 200 investment professionals conduct 3,000 visits to listed companies annually, providing in-depth coverage on up to 80 percent of the secondary mar-
ket’s capitalisation in China. “Research Creates Value is ChinaAMC’s investment philosophy,” says Yang Kun, chief investment officer, adding that the firm focuses on active investment strategies. “We established one of the largest investment research team in the industry. Through macro trend analysis, strategy research and field research, we examine the fundamentals and investment potential of each investment target.”

Yang explains that every research project must be “systematic, proactive” and that every analyst must also have solid understanding of key market trends and the pace of industries’ change. “What we do is deep bottom up analysis of equities,” Yang says, elaborating that 70 percent of the investment decisions are made based on bottom-up research, while only 30 percent are based on top-down allocation.

China AMC’s methodology is in Yang’s words a “repeatable, accountable and reliable investment process that strives to provide investors with long-term and stable investment returns”.

Yang further notes that changes in China, especially in technology, occur very quickly. “So we need many analysts who can track these changes,” he says. Such strong research skills have allowed many funds to outperform. For example, ChinaAMC Shanghai-Hong Kong Stock Connect Hang Seng ETF, which delivered a return of 29 percent in the past three years, the No.1 highest performing among 109 Equity ETF Funds, and the ChinaAMC Dingmao Bond Fund (Class A), which gave investors a return of 10 percent in 2018, ranking the 5th highest performing among 304 Standard Bond Funds (Class A), according to a ranking by China Galaxy Securities as of Dec. 31, 2018.

In quantitative investing, ChinaAMC has 14 years of experience. As of Dec. 31, 2018, the firm’s equity ETF AUM accounted for 26 percent of the total China’s equity ETF AUM, ranking number one in China. Furthermore, ChinaAMC has worked with renowned Wall Street trading research firms Tobam and Rayliant Global Advisors to offer a smart beta strategy — a combination of smart and efficient market hypothesis and value investing methods.

ChinaAMC is one of the largest fixed income asset managers in China. To help with bond research, ChinaAMC built an in-house credit rating team of 18 analysts — one of the industry’s largest. The firm is also the sole manager for ABF China Bond Fund designated by 11 Asian central banks, notes Yang.

ChinaAMC, Yang says, believes outperformance in the Chinese capital market requires superior fundamental analysis and a strong market understanding. The combination of disciplined investment processes and strategy-appropriate risk management systems also enhance the risk/return profile of the firm’s portfolios, adds Yang, who points out that all analysts’ research reports must go through compliance before they can be forwarded to portfolio managers.

“We have a strict risk management system,” Yang says, adding that there are pre-, mid- and post-trade risk controls and that all data of proposed trades are put in pre-order check before execution. The execution of orders must be monitored by the risk management and compliance system, meaning non-compliant trading orders simply won’t be executed.

Furthermore, the firm conducts a post-trade execution process that includes risk analysis and audits, Yang says, explaining the firm uses widely accepted industry financial modelling systems — such as FactSet, Brinson and Barra — for attribution
To help it drive efficient day-to-day business and quantitative analysis, ChinaAMC employs 100 information technology professionals. The IT team, Yang says, gives the firm the ability to develop proprietary trading applications and systems of its own.

With its own platforms, and a solid market reputation, ChinaAMC has been recruiting a number of outstanding fund managers and researchers from rival firms as well as well-known universities.

Every year, the company hires from global top universities and conducts training internally, says Richard Pan, head of ChinaAMC’s qualified foreign institutional investment unit. In addition, the asset manager also hires mid-career professionals. For instance, Pan says, the firm hired a Microsoft Corp data scientist to cover the telecommunications, media and technology sector three years ago — the analyst had earned a degree from Harvard University in computation science. Despite hiring from top schools and major multinationals, ChinaAMC emphasises a group approach to investing and avoids recognising individual star stock pickers. “We focus on group learning,” Pan says. “We don’t rely on a star analyst or a star manager. We create a system that cannot rely on just one person but instead we believe in a system. A methodology, a training system that trains and incentivises a group of minds that help us execute the investment methodology to best service our investors.”

Even still, each analyst must prove his worth at ChinaAMC, Pan says. For example, well before analysts can derive a buy or sell, or outperform or underweight recommendations, they must submit an extensive report to their superiors — the reports sometimes run up to 100 pages and contain data on the company being studied, with data sets that take deep analysis of even revenues from smaller urban interior cities.

At the same time, Pan says the company encourages analysts to have global views and not just local views. “Though companies are local, analysts must also understand global trends, and global competitors,” Pan says. “They must analyse a business model thoroughly.”

For example, when ChinaAMC was researching Apple Pay, its analysts conducted cross-sector research, which involved members from the retail, finance, internet, internet payment, and consumer brand sector teams. Together, they came to a counter-intuitive conclusion — that Apple Pay technology was not innovational when compared to rivals in China as it relies on traditional point of sales, or POS, stations, which at present have low penetration in the country. This is because consumers’ use of smart phones gives a competitive advantage to payment systems that use smart phone scans, such as Alibaba Group Holding’s Alipay or Tencent Holdings’ WeChat Pay.

ChinaAMC’s track record and ability to take deep dive research and analysis has helped it win mandates from a number of global investors.

“A number of regional central banks have come and seek investment delegations with us through the qualified foreign institutional investor (QFII) programme,” says Pan, adding that ChinaAMC has been managing foreign mandates for more than a decade now. It manages assets for foreign institutional investors from various countries and regions, including Korea, US, Canada, Japan, Germany, Malaysia, Singapore, Hong Kong, Taiwan and Macau, with 90 percent of the foreign institutional assets from central banks, sovereign wealth funds and government pensions. “We hope to be a gateway for foreign institutional investors.”
Pan also elaborated ChinaAMC’s QFII research methodology is based on pure bottom up stock picking and fundamental research. Quantitative analysts tracking A-shares first whittle down the listed universe from more than 3,000 to 300 equities that have potential for investing. They then use a pure quantitative stock screening model based on key parameters and metrics including net income compound annual growth rate (NI CAGR) return on invested capital (ROIC), operating cash flow to enterprise value (OCF/EV) ratios, price to earnings ratio, and dividend yield.

Sector analysts then select 100 investable stocks from the screened shortlist, and conduct bottom-up research in four areas, Pan says. These are: 1. Determining the business model and competitive advantages along the value chain, 2. Measuring the firm’s operational and free cash flow, not only looking at the firm’s official financial accounting, but also paying particular attention to cash at the firm’s disposal. Moreover, ChinaAMC analysts avoid companies with high leverage and pay attention to net gearing, preferring those with low net gearing, 3. Paying close attention to valuation, with preference for fair value, and preference for firms with reasonable valuations compared to more expensive rivals in the sector. Analysts conduct extensive research to avoid overpaying for a stock, especially equities that are trading at high valuations. 4. Lastly, ChinaAMC analysts consider ESG issues of the company under investigation and give preference to companies with consistent corporate governance records and strong ESG performance.

After the four processes are completed, it is then and only then that portfolio managers work with the analysts to begin constructing portfolios with a macro/sector overlay. As part of the process, they communicate with the firm’s in-house economists before giving their equity recommendations — whether to be overweight or underweight.

Leveraged on a high quality and experienced investment team, ChinaAMC has accumulated insightful understandings about China market, which productively help to better serve oversea investors. “We believe Research Creates Value and our ultimate goal is to deliver satisfactory returns for investors.” Pan says.

According to a 2017 study by management consulting firm McKinsey & Co, ChinaAMC is indeed on the right track to success. In the study of 22 fast-growing regional fund managers, McKinsey found that having in-house investment management manufacturing ability is a hallmark of Asia’s top fund managers. Successful firms, McKinsey reckons, believe in a strong local capability to offer localised products. McKinsey also noted that as firms build local manufacturing skills as well as new capabilities, they should take into consideration that active investing skills remain in strong demand across the region, as seen across retail distribution as well as in recent mandates by leading institutions.

The inefficiency of Asian markets, McKinsey found, has allowed for alpha generation and thus been a source of strong returns for Asian investors, who have become used to success. In Asia, even passive manufacturers position themselves as active producers of alpha through thematic and smart beta solutions, McKinsey says. According to the firm — based on its own experience plus comments from many CEOs interviewed for the study — investment performance is key to not only attracting clients but also retaining them in the longer term. ChinaAMC appears to have taken that to heart.
The who’s who at China Asset Management Co

Ms Li Yimei, CFA, chief executive officer
Ms Li Yimei joined ChinaAMC in 2001. Before being appointed as the CEO, she served as executive vice-president and head of sales and marketing. She became the head of sales in 2007 and later the head of marketing in 2013. Prior to that, she served as senior vice-president of International Business between 2001 and 2004. Ms Li holds a Master’s degree in Public Policy from Harvard University and an MA in Economics from Renmin University of China.

Mr Yang Kun, chief investment officer
Mr Yang Kun joined ChinaAMC in 2006 as an analyst and was later promoted as a portfolio manager. Before joining the company, Mr Yang was an assistant portfolio manager at Baoying Fund Management, a manager in the investment department at Yimin Asset Management, and a manager in the finance department at China Foreign Economy and Trade Trust Co. Mr Yang holds an MBA from Peking University.

Mr Richard Pan, head of QFII investment
Mr Richard Pan has 21 years of investment experience. Before joining ChinaAMC in 2013, Mr Pan served as CIO and deputy CEO of Vstone Capital, overseeing its A-share investments. He worked as a director/portfolio manager at Manulife Asset Management from 2007 to 2011, managing its Greater China funds and QFII A-share fund. He also worked as a portfolio manager at United Securities from 2001 to 2004, and as a VP at Guotai Junan Securities since 1998. Mr Pan holds an MBA from Georgetown University in the US, an MA in Economics and BS in Engineering from Wuhan University.
Shanghai-based China Universal Asset Management Co. Chairman Li Wen and CEO Zhang Hui share a passion for long-distance running as much as they do for investing.

That is why for years the management duo put many members of their executive teams through the paces of a four-day, rigorous 112-Km race early every year on the outskirts of Dunhuang, an ancient Chinese city on the edge of the Gobi Desert. Moreover, among the firm’s 600 employees, about half run regularly, and among them about 100 regularly participate in weekly group runs. China Universal is famous in Shanghai for its passion for running: it is an official sponsor of the Shanghai International Marathon. In 2013, the firm put up a strong lineup of more than 130 staff as runners, the highest number among financial institutions that year. Many at the firm believe that investment is just like long-distance running, as mentioned by the well-known investor Warren Buffett in his 2017 book, co-written with partner Robert Munger, Buffett, Munger Marathon Investing.

During every race, the company makes sure executives not only race and build team spirit, they also collectively brainstorm on ways to better hone their spirit of perseverance for the sake of ultimately delivering top performance for investors.

"Everything we do at China Universal is focused on delivering results for our investors in the long term," says CEO Zhang. "That also means everything we do is for the sake of placing the client first. At China Universal, the client is first, our staff second, and our shareholders are number three — that is the order of our priority. We realize that all companies that interact with clients know that client is number one but the question is can they actualize it? We at China Universal make it our value to penetrate into every detail of our daily business."

in fact, it is precisely because of the “client first” values that China Universal does not blindly expand its AUM scale, Zhang says, chasing after the latest so-called hot investment trends in the markets. The firm always maintains a development pace that matches its investment abilities, choosing strategies in accordance with the company’s own professional expertise.

The rigorous training Li and Zhang have implemented has apparently worked: China Universal has seen its AUM zoom from zero in 2004, when the fund management firm was first founded, to top RMB 650 billion by the end of 2018. The Shanghai-based asset manager, which has more than 600 staff, manages 115 mutual funds in total across all major asset groups: equities, fixed income, balanced funds and exchange traded funds. According to data from Shanghai-based Galaxy Securities’ Fund Research Center, China Universal’s domestic active equity portfolio reached RMB 74.7 billion as of the end of 2018, the biggest in China’s mutual fund industry.

Unlike its peers based in Beijing, many of which are owned by major Chinese government financial holdings, China Universal has more humble
roots as a firm that traces its beginnings to three Shanghai-based municipal firms: Oriental Securities, China Eastern Aviation Financial Holdings, and Shanghai United Media Asset Management. Fully empowered by its shareholders, China Universal became the first among the top 20 mutual fund companies that completed the employee stock ownership plan (ESOP) — about 25% of shares had been given to staff in the plan.

China Universal launched its first fund — China Universal Advantage Selected — in early 2005, shortly after the Shanghai Composite Index fell below 1,000 points in the previous year. Despite persistent volatility of the markets in the years since then, the fund still achieve a CAGR of 17.85% in the past 14 years. Another flagship product, China Universal Value Selected, gained a CAGR of 16.53% since 2009. Not only has China Universal maintained outstanding investment record in China’s A-share market, it also achieved significant milestones in Hong Kong. One of its Hong Kong domiciled active equity fund, the CUAM China Hong Kong Strategy Fund, has gained 80.2% since launch in 2012, far beyond the Hang Seng Index (22.15%), ranking number one among peers in the past five years, according to data from Morningstar and Bloomberg.

Demand in the fund and others were so strong at times that China Universal had to restrict subscription during market highs to protect interests of existing fund investors. According to the statistics of various third parties, China Universal’s mutual funds helped investors to achieve a net gain of more than RMB 72 billion in the past 14 years. Over that time, the firm has given fund investors accumulated dividends of RMB 48.5 billion.

Though it was a local firm, the company realized early that it needed to follow international standards, says Chairman Li, elaborating that in 2009 China Universal joined the Asia Corporate Governance Association, becoming the first Mainland financial institution to do so.

Just like many global fund managers, China Universal has developed a diversified product offering, including equity funds, bond funds, money market funds, index funds, ETFs, guaranteed funds, and QDII (Qualified Domestic Institutional Investor) funds.

The firm has also led with innovation. Its e-commerce strategy began in 2008, at a time when most asset managers had not been aware of the revolution that internet could bring to the industry. In 2009, China Universal became the first fund house

### Performance of flagship products

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<td>Cumulative return (%)</td>
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</tr>
<tr>
<td>China Universal Value Selected Fund</td>
<td>Value</td>
<td>2009/01/23</td>
<td>357.49</td>
</tr>
<tr>
<td>China Universal China–Hong Strategy Fund</td>
<td>Value</td>
<td>2012/11/16</td>
<td>80.20</td>
</tr>
</tbody>
</table>

Source: China Universal, Wind; as of 31 December 2018

* Morningstar 5-year rank
to launch an online distribution platform known as *Xianjinbao (or Cash Pot)*, which operates through an electronic account that is connected to a money market fund. Cash Pot was four years ahead of the launch of the current China money market fund leader, e-commerce giant Alibaba Group’s internet finance platform, Yu’ebao. As China’s first platform for deploying e-commerce in the fund industry, Cash Pot provides investors with independent research and helps them to make investment decisions. By the end of 2018, the platform had gone on to attract over RMB 200 billion from 70 million investors.

Still, China Universal’s innovation in 2008 marks the beginning of the online account era in China’s mutual fund industry. This was the start of the shift away from the traditional product era that relied primarily on sales of funds through third party distributors, such as banks. In addition to mass retail clients, China Universal serves institutional and corporate clients. As of June 2018, the AUM of mandates from Chinese insurance companies managed by China Universal ranked first among all mutual fund houses. In terms of pension business, the firm currently has domestic and overseas National Social Security Fund (NSSF) asset manager qualification as well as basic pension insurance asset manager qualification.

Through its achievements, China Universal has gradually built up its branding influence. Zhang always reminds his team members that what they are distributing is different from simply selling a commodity or product, and that they must continuously add value to investors in order to gain their trust and build a household brand.

Zhang notes that not a single fund manager has achieved ultimate success of a universally well-known household brand in China and that China Universal is still working on this objective. He further notes that the competition is intense: while there are only around 130 major mutual fund management companies, there are some 20,000 so-called “sunshine private equity funds” that also tout their equity investment skills.

“In China’s asset management industry, there are no real brands at this time,” Zhang elaborates, adding there are more funds than listed companies. “There is too much competition. The most important thing is to let investors recognize us.” Zhang says the company is implementing a multi-pronged marketing strategy, “building China’s most recognized asset management brand.”

The marketing strategy uses multiple channels of communication and goes hand-in-hand with China Universal’s long-term philosophy that focuses on the needs of clients, Zhang says, “helping them to win investment gains, and constantly focusing on their needs”.

Zhang’s investment strategy can be summarized more or less as value investing, and bottom up
stock picking. “We are constantly looking for top performing companies that are underpriced,” he says.

Zhang and his investment team conduct in-depth analysis of the fundamentals of target companies, making medium- and long-term allocation to help portfolio managers achieve higher investments income returns and achieve steady value growth in the long run.

Zhang likens China Universal’s investment strategy to that of globally well-known active managers that first made their names as stock pickers — chief among them Fidelity Investments Inc. and T. Rowe Price Group Inc. “We focus on stock picking,” he says. “We will always look at the fundamentals of the companies we invest in.”

At the core of China Universal’s investment success is a focus on in-house training of its own portfolio managers.

Almost all of the firm’s fund managers have been trained in-house. The firm insists on recruiting outstanding graduates from well-known universities at home and abroad every year.

Zhang says he wants members of his investment team to follow and adhere to the philosophy of value investing, be patient and focus on fundamentals of an enterprise and at the same time observe macro trends to find key listed companies run by top entrepreneurs that are trading at discounts to its real value.

As soon as recruits enter the company, they are put into a rigorous training programme that focuses on the firm’s investment philosophy, investment methodology as well as team culture. As one of the largest and most profitable fund managers in the industry, China Universal can provide them with a growing corporate environment to stretch their wings in the long haul. CEO Zhang notes that fund managers who “grow up” in this environment have a “unified” investment philosophy and close friendship with colleagues who enter the company the same year. The process, he says, leads to team sharing and bonding and builds the overall “combat effectiveness” and stability of the team.

When it comes to training, Zhang believes that four points are particularly important. First, recruiting people with values, investment ideas and willingness to work in teams. “If a team does not have consistent values, it will inevitably be confused and unable to meet the target given to them,” “and investment performance and team development will not last long.”

The second, Zhang says, is to establish a long-term training system that fosters team spirit. After joining, new recruits are matched with experienced team members who help newcomers grow up quickly through “old and new” pairing. In the process, recruits are trained to “share, reinvent, reflect, and temper their research framework and investment methods,” Zhang says, adding that growth of both research analysts and product development staff is not a one-step process, but takes a long time to cultivate. “Therefore, it is very important to allow young analysts to make mistakes in a reasonable way and to gain experience in analyzing trends instead of focusing only on short-term results,” he adds.

The third is to create a good investment and interaction culture. For example, Zhang asks team members to ask “three daily questions”:

- Do I have a sense of humor today?
  If not, then ask myself, am I a boring person?
- Do I share today?
  If not, then ask myself, am I a selfish person?
- Do I exert my last 1% of effort today?
  If not, then ask myself, am I a mediocre person?
Whether research results can be effectively translated into investment performance requires more than the depth of research, according to Zhang, who adds that what is absolutely necessary is a good working atmosphere and effective interactive communication among investment research team members. Analysts needs to present analysis and data to colleagues on the investment team in a timely and efficient manner, and there must be open-ended discussion between analysts, portfolio managers and traders. "The opinions of the investment team can further promote more in-depth analysis and a higher degree of accuracy on the research side," says Zhang, noting that "this is a mutually reinforcing process."

The fourth, according to Zhang, is to establish a long-term, multi-dimensional incentive mechanism. In practice, the design of the incentive mechanism is actually not simple, he notes, adding that what is often assumed — that the more incentives involved, the better — is not necessarily true. Rather, Zhang says, the best mechanism may be the balance between long-term and short-term incentives, as well as incentivizing through other means, such as team morale, and recognizing excellence among members.

Successful investing, Zhang says, requires a long-term focused corporate culture and environment. If short-term performance is overemphasized, he says, it will inevitably amplify short-term risks and damage the long-term interests of investors. At the same time, the CEO says, successful investing requires a "team battle spirit." Outstanding performance of fund managers is inseparable from the research support and interactive sharing they receive from the entire investment research team, Zhang says, adding that it is also inseparable from the overall cooperation between the company’s front and back offices.

"Really excellent investment managers are often very self-motivated individuals," Zhang says. "The amount of money they can earn is never the key motivator. It is a sense of responsibility from the heart. For example, they may be more concerned about whether they have earned the respect of team members. Top investment professionals know it is also very important to continue to grow and to do the right things with a good group of people — so non-material incentives are also very important."

On the equity research side, China Universal established teams for healthcare and TMT in order to grasp the latest market opportunities. China Universal’s healthcare research team preceded the 2010 launch of the nation’s first active Pharmaceutical Industry Fund. In 2013, it launched the first cross-market healthcare ETF in China.

In 2014, it established the first company in the industry to focus on PE investments in the medical and healthcare sector. Today, the firm manages a product line covering both primary and secondary markets, and offshore markets, incorporating both active and passive strategies.

According to Wind Information Co., a leading Chinese provider of market news and data, China Universal has become one of the top 10 shareholders of dozens of listed companies in the healthcare industry, with profound accumulation and influence towards the market. The firm’s healthcare investment research team covers more than 200 listed companies, which span all sub-sectors and form a three-dimensional panoramic view of the industry. In addition, core members of the team have an average of more than 10 years of experience. Some, in fact, studied medical sciences and have a strong grasp of the overall operating context and develop-
ment trend of the healthcare industry.

In addition to health care, China Universal also built up dedicated investment and research team in TMT and consumption to track the frontier development of both industries. Related products have been launched and became top gainers. According to data from the Galaxy Securities Fund Research Center, China Universal’s Consumer Industry Fund rose 49.89% in 2017, ranking first among similar funds; in index funds, in 2017, the China Universal CSI Consumer Staples ETF rose by 59.53%, the top performing fund for consumer ETFs in 1-Year and 3-Year category.

Looking forward to the future, Zhang believes that pension programmes will bring crucial opportunities for the asset management industry. The Chinese government has begun experimenting with a defined contribution programme in a few locales that is similar to the US 401 K programme. China has a labor force more than 700 million and tens of millions will be preparing to retire in the decade ahead, says Zhang, and the key to success in the future is winning mandates for pension programmes from both corporate and private individuals.

Furthermore, China Universal is actually one of the few Chinese asset managers that have launched one of China’s first target date funds, Zhang says, adding that such funds — which are relatively common in developed markets like the U.S. — are still in their infancy in China.

“The demand for target date funds is huge in China,” notes Chairman Li, elaborating that the firm is in the process of investing in the build out of a pension and retirement savings online sales platform with an eye on using online sales as a major sales channel. “The retirement market in China is the single most important market that will drive growth in asset management in China,” Li says. “Many people will have to invest in the equity markets in order to prepare for retirement, and you can imagine how big this market will be.”

Investors preparing to retire need to think long-term in order to gain the most from equity investments, says Zhang, elaborating that between 1998, when the first mutual funds were launched in China, to 2017, the annualized return rate of equity funds averaged 16.5%, 8.77 percentage points higher than the Shanghai Composite Index average annualized return for the same period.

Zhang notes, however, that there is a strange phenomenon in China’s fund management industry. In the past 10 years, the total management scale of the industry has increased from RMB 3.3 trillion to RMB 13 trillion, but the scale of active equity mutual funds has dropped from RMB 2.5 trillion in 2007 to RMB 1.8 trillion now. This reflects investors’ lack of sufficient understanding of the long-term profitability of equity assets, says Zhang, who observes the experience of the United States, where more than half of the IRA assets are invested in stocks and equity funds, while the rest are invested in other forms of mutual funds. Therefore, from the long-term pension investment perspective, there will be
huge potential for professional equity managers in China. Among them, China Universal will no doubt have its strength and opportunities, as well as responsibilities.

When it comes to responsibility, the company has also been active in giving back to society through River•Children, an ongoing charity education program which has lasted for over 10 years.

According to Li, since its launch in 2008, the River•Children Program has covered 10 river basins in the middle and western parts of China, to help construct 10 well-equipped primary schools named after China Universal. “We have organized over 30 charity trips to provide volunteer services for more than 20,000 hours, trained more than 900 teachers and benefited over 10,000 students”, says Li.

In 2010, China Universal established the Shanghai China Universal Public Welfare Foundation, which is the first public welfare foundation initiated by a financial enterprise in Shanghai.

“Gratefulness” is one of the core values of China Universal, Li says, adding that the firm requires every employee to have sincere gratitude, actively give back to the society by joining various public welfare initiatives, and to participate in the various company sponsored initiatives.

For each of the past nine years, the firm has also issued a social responsibility report. “With the increasing value and responsibility of China Universal, we have been thinking about the responsibility of a company,” notes Li. “What is the meaning? We believe that social responsibility of the enterprise is the meaning of the existence of the enterprise and the source of the competitiveness of the enterprise as well. It is a higher pursuit than commercial success, and it is related to commercial civilization, social progress and human prosperity.”

“Only by giving back to society do we as a company realize our true value,” Li says.
China’s financial market reforms — a staggering opportunity

China’s announcement of expanded market opening to foreign financial companies — first made on November 10, 2017, a day after US president Donald Trump’s visit to China — could usher in a new era for global asset managers in the world’s second largest economy. Despite the ongoing trade war with the US, Chinese officials have made it pretty clear that they will be allowing foreign fund managers to form wholly-owned ventures to directly raise funds from China’s nearly $2 trillion retail mutual fund market, as early as perhaps 2020.

Peter Alexander, the managing director of Shanghai-based research firm Z-Ben Advisors, which has been advising foreign fund managers on their China strategies since 2004, believes Chinese officials remain serious about opening up the financial market to foreign institutions — in spite of the trade tensions with the US.

Regulators currently allow foreign financial institutions limited access to ownership in Chinese financial institutions, with a 25% cap on foreign ownership in banks, a 49% cap on asset management firms, and a 51% cap on brokerages and insurers.

A sign of liberalisation came in 2017 when foreign asset managers were allowed to set up wholly foreign-owned China ventures to raise funds from high net worth individuals and corporate clients.

According to Z-Ben Advisors, so far a total of 36 foreign asset managers — including Fidelity, Invesco and Vanguard — have taken advantage of reforms that allow them to set up wholly-owned China ventures to raise funds from wealthy domestic investors and institutional clients, a market worth about $2.5 trillion.

Before the liberalisation, some 44 foreign fund houses had already formed joint ventures with Chinese partners. The international firms held up to 49% equity stakes in these mutual fund companies targeting retail investors.

The new rules to be announced in 2019 will allow foreign fund houses to seek majority stakes of 51%, Alexander says. He added that officials have announced their intention to lift all caps by as early as 2020, allowing foreign venture partners to buy out their domestic partners or set up operations where they own 100% of the equity.

“China is the only market outside the US that can move the AUM needle,” Alexander says, adding that no other market in the world aside from the two can help global players immediately grow their assets as quickly.

Competition in China’s mass retail mutual fund market is far less intense than in the private high net worth and institutional market, he says, noting that there are only 125 mutual fund companies catering to a market of almost one billion people and 20,000 firms catering to a few million high net worth and corporate clients.
China is on its way to becoming the world’s largest asset management market after the US, according to fund research firm Casey Quirk\(^1\), a subsidiary of Deloitte Consulting LLP. The US-based management consultancy predicts that China will become the second-largest asset management market by 2019. It also expects the country to attract half of the industry’s new asset net inflows from retail and high net worth investors in the coming two years, according to a news release issued by the firm on November 7, 2018.

By 2019, assets under management in the China market will grow by up to five times to $17 trillion, up from $2.8 trillion last year, according to the study. Casey Quirk, however, predicts that foreign firms will account for only 6% of the China market by 2030, hindered in part by the preference among local investors for domestic asset classes and local firms.

Z-Ben’s Alexander is far more optimistic, believing that foreign players can have up to a 25% market share in a decade. “Foreign managers can certainly scale and can certainly be profitable,” he says. “China investors want to reward those who deliver returns. It is a meritocracy. Those who perform well will gain AUM and market share.”

Andrew Collier, who from 2009 to 2011 was the president of BOC International USA, the US subsidiary of China’s global investment bank, takes a slightly more cautious view, however. Foreign financial firms need to realise there is local resistance in Chinese provinces to foreign financial conglomerates gaining market share versus local champions, Collier says, adding that while regulators in Beijing may be handing out licenses, officials in local governments may seek to protect local players by imposing local bureaucratic obstacles.

“China is likely to delay full entry for foreign financial firms through non-tariff barriers,” Collier says. “Beijing may grant licenses but local governments will drag their feet.”

Collier, the Hong Kong-based managing director of Oriental Capital Research, which advises global hedge funds on their Asia and China strategies, cautioned that the timing of the announcement by vice finance minister Guangyao Zhu on November 10, 2017, a day after Trump’s visit to China, was part of a larger Chinese strategy in its US-China negotiations.

“I expect modest progress in insurance and investment banking with small investments at the outset,” Collier says. “Commercial bank lending is tightly controlled and hard for outsiders to crack. Smaller weaker banks will be open to selling but valuations are likely to be unrealistic and risk very high. It’s a step in the right direction but not a great leap.”

In the meantime, many global asset managers operating in China attest that the market has already become a key part of their global strategies. Half a

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dozen firms have set up China joint ventures, and 28 have recently set up 100% owned subsidiaries that operate under China’s wholly foreign-owned enterprises regulations. Of these, many have begun to use online methods to sell directly to Chinese investors, according to Mainland research firm Z-Ben Advisors. It added that eight global firms, including BlackRock, Singapore’s Fullerton Asset Management Co, and the UK’s Schroders, have turned to online distributor Howbuy.com to sell directly to high net worth individuals and corporate clients.

“That’s a sign of shifting tides among global managers, who are also branching out to push sales on their own,” says Z-Ben Advisors’ managing director Peter Alexander, who noted that many used prime brokerage firms in the past. “None of this is a coincidence; a steady stream of wholly-foreign owned enterprise registrations this past summer is precipitating product launches all at once.”

The market opening measures announced by China in 2017 give foreign fund houses immediate access to China’s $400 billion high net worth and institutional market, and by 2022 will allow them to own up to 100% of China mutual fund operations, Alexander notes. Different fund houses, however, use different strategies in their approach to chase the China dream, demonstrating diversity in how they view the opportunity. Of the 28 firms that have been granted wholly-foreign owned licenses, 17 had launched funds by the end of December, among them Fidelity International, alternative manager Man Investments, UBS and Hong Kong-based hedge fund Value Partners. Of the four, Fidelity has been the most aggressive with three funds launched between mid 2017 and early last year — an equity fund and two fixed income funds.

UK quant fund manager Winton Capital has been the most successful, according to Z-Ben Advisors, which noted that Winton’s China wholly foreign-owned enterprise launched in September and raised well in excess of $1.45 million by the end of December through an online sales platform.

Though online sale is an easy way to access investors, having sales people actually on the ground may be critically important in the longer term if foreign managers really want to make their presence felt.

“Indeed, distribution is more boisterously taking the wheel of onshore expansion strategies,” Alexander says. “It’s now apparent that more boots on the ground are required for sales growth. Global managers may even need to consider opening sales offices within the next 18 months if regulations do shift, requiring a closer relationship between manager and end investor. Such as it is, and as is much the case in China, there won’t be any short cuts to building a local asset management business. The cost – both financial and time wise – should be viewed as equitable though and [it will be] the price that will need to be paid by any global manager with meaningful growth aspirations in China.”
According to Z-Ben Advisors, only two Sino-foreign joint venture firms are among the top 10 fund managers ranked by AUM. Placing third is ICBC Credit Suisse Asset Management Co, a JV between China’s largest bank and the Swiss bank, and number four is CCB Principle Asset Management Co, a JV between China’s second largest bank and US insurer Principle Financial Group. A number of the major firms do have passive foreign shareholders with minority stakes, among them ChinaAMC, where Power Corporation of Canada and a subsidiary hold a combined 27.8% stake, and Harvest Asset Management Co, where Deutsche Bank owns a 30% stake.

“Currently though many of the foreign investors are not familiar with China market, they will of course become a challenge in the future,” China Universal’s CEO Zhang observes.

There is no question, Zhang admits, that global players entering China will bring with them advanced investment management experience and outstanding global talent. But that, in turn, actually helps improve the overall management of China’s asset management industry, Zhang says, adding that he believes China Universal can learn from the advanced experience of global counterparts and continuously polish its existing investment research and product innovation capabilities, and in turn continue to consolidate its core competitiveness. “Through our deep investment experience in the A-share market and a strong marketing network, we will fully interact with our overseas counterparts,” Zhang says with confidence.

China Asset Management Co.’s CEO Li Yimei says. “With 21-year investment experience, we believe our accumulated professional investment and research team have deeper understanding of China’s markets. In addition to competition with global asset managers, there will still be many opportunities for domestic and abroad cooperation between us. ChinaAMC has been actively seeking partnership with foreign investment experts, such as Fidelity International, Russell, PanAgora, TOBAM, and Rayliant Global Advisors, etc. We are capable to help global firms to localize their international experiences and develop the products and strategies tailored for Chinese markets.”

“ChinaAMC also cooperates with global firms on the development of various offshore products and strategies,” Li says, adding as an example, ChinaAMC worked with Mackenzie Investment of Canada to launch an all China equity fund in Canada, becoming the first overseas A+H+ADR fund advised by a Chinese firm. “In the near future, ChinaAMC will collaborate with NNIP of Netherlands to launch A-share sustainable investment strategies in Europe,” she says. “With our capabilities in investment, research and service in Chinese market, there are plenty of opportunities to work with global firms.”
Chinese asset managers began expanding offshore in 2008, when a handful of firms were given approval to set up shop in Hong Kong by regulators in both Beijing and Hong Kong. Few have made bolder moves, however, and have instead focused on step-by-step organic growth in Hong Kong. A few in recent years have also decided to set up offices in Singapore and as far as New York and London.

But no asset manager has made a bigger splash, say by making a substantial offshore acquisition. Peter Alexander, managing director of Z-Ben Advisors in Shanghai and a long-time observer of China’s asset management industry, says he has not yet seen a single Chinese asset manager stand above peers offshore.

“There are no real examples of success so far,” Alexander says, adding that he once thought Chinese fund management firms would quickly become really serious players in managing China themed money and rival global institutions. “But that didn’t happen, at least not yet,” he says. “Many Chinese asset managers didn’t invest in due diligence, co-ordinate with consultants or even fully understand how asset owners work through the process of selecting a manager. There simply hasn’t been the required investment made by Chinese managers to properly target global asset owners seeking China exposure. All the while, a number of foreign managers have invested and become proficient in running China equities.”

It is true that not a single Chinese fund management house has made a big move — unlike some major Chinese financial conglomerates that have blazed a global trail of acquisitions. Firms like Hong Kong-listed, Shanghai-based financial conglomerate Fosun International Ltd, for instance, made a mark by acquiring a range of offshore assets. Chief among them were Portuguese insurer Caixa Seguros for $1.36 billion in 2014 and French resort operator Club Med for $1.09 billion in 2015.

Beijing-based insurer Anbang Insurance Group went on a $30 billion global shopping spree, buying a portfolio of assets, including the famous Waldorf Astoria Hotel in New York for $1.95 billion in 2015. Hainan-based HNA Group, which owns a range of assets including Hainan Airlines, also went on an international acquisition spree.

Anbang and HNA have run into problems, however. Regulators in Beijing investigated Anbang’s former chairman Wu Xiaohui for alleged corruption and put him in jail in 2018, subsequently taking over the property and casualty insurer, including its prized asset the Waldorf Astoria Hotel. HNA, meanwhile, has a wall of debt problems, which it has been tackling recently by jettisoning assets to pay off debts.

Though most managers have been taking small, but firm, steps offshore they have also avoided getting involved in significant controversies.

Take, for example, China Asset Management Co (HK) Ltd, the Hong Kong subsidiary of ChinaAMC, which built an offshore AUM of $7.2 billion in the past decade. It made a small imprint in history by announcing in November 2018 that it was launching a China A-shares Shariah compliant fund in
A number of China-A shares Shariah compliant funds do exist in the market place, but the previous ones were launched by Malaysian banks with the assistance of Chinese fund managers — among them the Maybank Bosera Greater China ASEAN Equity-I Fund, which was launched in 2015 by Kuala Lumpur-based Maybank with the assistance of Shenzhen-based Bosera Asset Management Co. But ChinaAMC’s fund is the first Shariah compliant fund ever led by a Chinese fund manager. The fund, which was launched in collaboration with Kuala Lumpur-based RHB Investment Bank Berhad, demonstrates that Chinese fund houses are diversifying outside of their home markets and are gaining a higher degree of sophistication and understanding of investors’ needs offshore.

Shariah-compliant funds, in fact, are quite alien to Chinese fund managers. They adhere to strict Islamic finance principles, including avoiding buying equity in companies deriving income from gambling or in the sales of alcohol, tobacco, pork products, adult entertainment or military equipment. The principles also restrict the use of some mainstream financial instruments such as debt financing, charging interest or the use of derivatives.

"China A-shares is a market with deep alpha," Raymond Jing, a portfolio manager of ChinaAMC (HK) who is overseeing the portfolio, said in a company statement at the time of launch. Jing noted that the current valuation of China equities has reached a historical low level, and that the low valuations are tempting, especially for some of the sector leaders with strong year-on-year earnings growth. "By combining our A-share expertise with RHB Asset Management’s Shariah capability, we aim to capture these opportunities for investors in Malaysia as well as in Southeast Asia," Jing said.

Beijing-based Harvest Fund Management Co, which manages RMB 950 billion in AUM, is another example of a firm that is taking a methodical approach to international markets. It announced in October 2018 that it was expanding globally and that it had formed a strategic partnership with financial newswire and equity trading platform operator Bloomberg LP.

Harvest, which has a fund management subsidiary in Hong Kong and sales offices in New York and London, will implement a wide range of Bloomberg’s financial information and technology innovation across its operations, the company said, especially to enhance its investment research capabilities and advance its data-driven asset management business. With 1,300 employees, including 300 investment professionals managing more than 100 mutual funds, Harvest executives say they have tremendous needs for data-driven processes.

"As the leading asset management company in China, Harvest Fund is ready to compete globally," Henry Zhao, chairman of Harvest Fund, said in a joint news statement in October announcing the strategic tie-up with Bloomberg. To support its international business development initiatives, Harvest Fund will use Bloomberg’s global real time and reference data sets, including economics, fund, equity, bond and corporate fundamentals. Harvest Fund will also employ Bloomberg’s comprehensive suite of multi-asset analytical tools and seamless trading technologies to strengthen its equity and bond investment research capabilities, as well as work with Bloomberg on research management, data integration and distribution, and indices, the company said.

1 News release, ChinaAMC, Nov. 16, 2018
2 Joint news release, Harvest and Bloomberg, Oct. 16, 2018
“For fund houses that are embracing a global expansion path, consistent firm-wide use of quality data and integrated investment technology systems are a necessity,” Bing Li, head of Bloomberg China, said in the joint statement. “We are delighted that Harvest Fund has chosen to deepen their relationship with us to strengthen their capabilities in smart investment and data management. This partnership enables us to help them prepare for future growth and also reflects Bloomberg’s long-term commitment to the China market.”

According to US fund research firm Casey Quirk, Chinese fund managers are just at the beginning of their global march. In the next 10 years, or by 2030, there is a real possibility that one or two Chinese firms may break into the global top 10 rankings of fund managers. 3

“Only one or two Chinese firms will break into global top 10 by 2030, managing assets for Chinese and foreign investors,” according to the report titled ‘Leadership in Times of Plenty’, which listed five business models of future successful managers in China — among them ‘China Champion’, a firm dominant in the local market, and ‘Global Leader’, a firm that is top selling globally.

“Like China Champions, Global Leaders will also enjoy protected market access, but having an internationally proven global product set goes a long way in securing offshore allocations of onshore clients,” the report says.

Casey Quirk notes that another model of success for Chinese fund managers is the “Pan-Asia Alternatives Specialist”. Its 2017 report says that firms that match high risk appetite and long investment horizon assets with non-traditional investment opportunities are currently facing a funding gap. But Casey Quirk added that it has no doubt that some Chinese asset managers will go on to become pan-Asia firms. “A regionally-based firm is better positioned to take advantage of emerging Asia’s market inefficiencies owing to the region’s unique political and economic landscape,” Casey Quirk says.

“Promising underlying drivers and rich returns are also incentivizing local investors to put money into an Asia-focused alternatives strategy.”

Some Chinese firms may choose to go that high-technology route to become a ‘Bespoke Virtual Portfolio Manager’, a firm that takes a “leapfrog model that brings low-cost, scalable investment offering to retail investors”. Casey Quirk says that Alibaba Group Holding affiliate Tianhong Asset Management Co’s administered online savings institution known as Yu’eBao has already become the world’s largest money market fund with an AUM of RMB 1.74 trillion ($250 billion). Yu’eBao is an “algorithm-driven investment engine” that fund managers may want to emulate, Casey Quirk reckons.

In fact, before e-commerce giant Alibaba launched Yu’eBao as an online savings offering for its 40 million online merchants in 2013, Shanghai-based China Universal already had launched an online fund sales platform. Known as China Universal’s “Xianjinbao,” which transliterates into Cash Pot, the online platform has attracted an AUM of more than RMB 200 billion ($28.7 billion) since 2009. “From as early as 2008, China Universal determined that the Internet would be a key strategy for us,” China Universal’s CEO Zhang Hui said. “Even before Alibaba began its online savings strategy, we saw the power of the Internet and we began harnessing it.”

China Universal Chairman Li Wen says the firm is taking a serious look at global markets and is considering a range of options to catapult the firm into foreign markets.

3 “Leadership in Times of Plenty,” Casey Quirk, 2017
"We could set up more offshore subsidiaries, or we can acquire through merger and acquisition," Li says. "China Universal set up operations in Hong Kong back in 2009, and the operations there grew strong and firm and has built a team with Hong Kong equity and fixed income expertise. This team has delivered strong performance, and it’s given us confidence to expand our offshore presence."

Li and Zhang say China Universal is looking at the U.S. and EU market. In the EU, in particular, China Universal has launched a UCITS SICAV in Luxembourg investing China high grade bond through RQFII scheme, and is planning to launch another UCITS fund investing in China equity. "We also don’t rule out setting up a company in London, for example," Li says.

Despite the US-China trade friction, China Universal is looking at setting up a corporate entity there.

Another option is the company may look finding a U.S.-based strategic partner, an asset management firm. "The US China trade friction has not lessened our interest in the U.S. The U.S. market is very large and we believe the trade friction is short term and we cannot ignore the U.S.

At the end of the day, internationalization is very important to China Universal, according to the firm’s top executives. "Our internationalization is not only one way — we are not only looking for foreign mandates investing China," Li says. "We are also looking for foreign partners to manage our account to fulfil the global allocation needs of domestic investors."

It is not surprising that China Universal may be looking to hand out mandates of its own, as the Shanghai-based asset manager is almost guaranteed to become far bigger tomorrow than it is today, given annual double digit growth of the Chinese asset management markets. According to McKinsey, there is a “Great Wall of Chinese capital” coming.  

“As the nation creates a more vibrant investment market and opens up to foreign asset managers, we estimate that over $6 trillion in additional assets will become available to asset managers,” according to a report titled ‘Will the Good Times Keep Rolling for Asia’s Asset Managers’. Authors of the report did add a caveat: “We see volatility in the growth outlook due to the uncertain timing of expected regulatory moves, market volatility, and policy shifts across Asian markets, particularly in China.”

Still, Jacob Dahl, a Hong Kong-based senior partner and leader of the Asia banking practice, McKinsey & Co, says China has become an important market not only in the Asia context, but globally. "Roughly 40% AUM in Asia is in China," Dahl says. “That means roughly 8% of global AUM is China, which is becoming a significant force in the global asset management industry. We expect growth going forward in the coming five years will be 17% a year. So that means China asset managers will become big not only on an Asia scale, but are also getting big on a world scale and five years from now they will be even more significant.”

There is no doubt then, at least from McKinsey’s perspective: the day when Chinese capital will become a powerful force in the global asset management industry is coming, and the construction of the “Great Wall of Chinese capital” has only just begun.

4 “Will the Good Times Keep Rolling for Asia’s Asset Managers?” McKinsey & Co, October 2018
What the future holds for China’s asset management industry

The asset management industry in Asia, particularly China, will provide growth momentum for the entire global industry for decades to come. So says Jacob Dahl, a Hong Kong-based senior partner and leader of the Asia banking practice at McKinsey & Co, and a co-author of an October 2018 report titled ‘Will the Good Times Keep Rolling for Asia’s Asset Managers?’ that looks into the future of the industry in the region.

One of the chief reasons, Dahl and McKinsey believe, is that Asia wealth creation momentum will continue, especially as the region continues to grow, and as the middle class and newly-minted high net worth individual class turn to equity markets to fund their retirements and other aspirations. According to the report, the region has the fastest growth in number of affluent and high net worth individuals globally. The report likens this to a “new wealth horizon” play in Southeast Asia and China.

“We expect the wealth market — total personal financial assets, much of it held by banks and insurers — in Asia to more than double by 2025, when it will become the world’s largest with almost $30 trillion in personal financial assets, overtaking North America (about $29 trillion) and Western Europe (about $15 trillion),” Dahl says. “In Asia, China is growing the fastest, with India close behind. High net worth individuals get a lot of credit for this growth, but rapid GDP growth and the entrepreneurial nature of the people in these regions are also producing a strong affluent cohort.”

Dahl adds that China and India are certainly heavy-weights, but Southeast Asia is also coming on strong. Even in secondary markets in the region, such as Indonesia, Malaysia and Thailand, asset managers are managing around $600 billion for the wealthy and that AUM is expected to “grow rapidly” in the near future.

High net worth individuals are looking for well diversified portfolios, and many may turn to global fund houses for investment solutions, according to McKinsey and Dahl, who note that wealthy investors want access to global portfolios and global solutions. They are looking at not only equity, but also balanced funds and more absolute return funds. “You will see high net worth individuals needing a higher sophistication of products,” Dahl says, elaborating that this demand will create more opportunities for the fund industry in Asia and globally.

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1 “Will the Good Times Keep Rolling for Asia’s Asset Managers?” McKinsey & Co, October 2018
“Everybody benefits from this — local players, global players and even start-up fund managers,” Dahl adds. “The reality is many of the local players will work with international players in order to get more sophisticated products. As a result, there will be more symbiosis, but there will also be competition.”

Dahl also sees regulators in the region, particularly those in China, and in smaller markets of Singapore and Hong Kong, becoming more sophisticated. “They are looking at money across borders and we are seeing more harmonization of regulations across the region.”

While there are political uncertainties and possible delays in implementation of market opening reforms in China due to the US-China trade war, Dahl believes the delays are short term. “In the longer term, the opening up in China will continue, and we will see foreign players getting significant market shares.”

McKinsey’s report sees the Chinese asset management industry being the primary driver of growth, with asset managers in China representing 37% of Asian AUM and more than 41% of fund industry revenues. Furthermore, AUM in China is expected to grow at 17% or more annually at least through 2021.

Growth in China, the report says, is a result of the significant wealth effect in recent years, including aging demographics driving higher demand for retirement solutions, as well as a regulatory push towards the development of a professional asset management industry that adheres to global standards. Institutions like insurers and commercial banks are growing the fastest, according to McKinsey, which elaborated that insurers and banks tend to lack active investment capabilities, especially in equity-related assets, and that they are increasingly outsourcing professional fund managers.

McKinsey also notes that Chinese digital financial services companies have transformed the retail market, initially through online sales of money-market instruments, and now by adding a bouquet of active funds as well. Regulators have fast-tracked growth in asset management by clamping down in the past year on the so-called “shadow banking” sector — financial companies that are not licensed as banks and yet are taking online and offline deposits by offering attractive interest rates higher than banks. Regulators, adds the report, are also reopening quotas for offshore products, and opening doors for more foreign players to enter the market.

Dahl reckons there are three ways for both local and global managers to succeed and achieve considerable growth in the years ahead.

- The offshore opportunity: Domestic and global managers can serve the region’s major asset owners, says McKinsey. Among them are sovereign wealth funds like China Investment Corp, which has $940 billion in AUM, and the funds administered by China’s State Administration of Foreign Exchange, which so far has placed 16% of the nation’s $3.14 trillion foreign exchange reserves in the hands of professional fund managers. McKinsey says Safe may increase its outsourcing mandates up to 20% of the nation’s reserves in the years ahead.

- The offshore-to-onshore opportunity: Many onshore Chinese financial institutions seek offshore products to invest in, McKinsey says. These flows are regulated through quotas like the Qualified Domestic Institutional Investors (QDII) programme, which are reset at intervals by regulators. McKinsey notes that in early 2018 — two years after the last reset — a new quota of about $103 billion was awarded to a handful of managers and that some managers
with joint ventures in China have benefited tremendously from both their own quota allotment and that of their joint venture partners. Other offshore-to-onshore opportunities include mutual recognition of funds schemes, Qualified Domestic Limited Partnerships for alternative investments, and the equity, fixed income and ETF “stock connects” between mainland China and Hong Kong that allow investors in China and abroad to access Mainland and Hong Kong exchanges. Though the stock connect investments currently stand at about $90 billion, many CEOs who spoke to McKinsey expect significant relaxation of the QDII quotas in the coming few years.

• The onshore opportunity: The biggest opportunity for foreign and domestic managers, McKinsey says, is the chance to serve Chinese investors through an onshore presence. While minority-owned joint ventures have long been the only way to do this, the recent introduction of majority ownership in joint ventures and wholly-owned foreign entity licenses have attracted many foreign managers into China. McKinsey notes that this is not surprising given the Chinese mutual fund market has quadrupled in the past five years to $1.7 trillion by the end of 2017 and is expected to reach close to $3.2 trillion by 2022. Even then, McKinsey notes, mutual funds would hold only 8% of personal financial assets in China. The firm also says that a sizable chunk of the $4.5 trillion of capital currently in China’s shadow banking products will be migrating to licensed products under the watchful eyes of the regulators.

• Digital disrupters: McKinsey notes that China has undergone digital disruption at the hands of fintechs and ecosystem players such as e-commerce giant Alibaba’s Ant Financial, insurance giant Ping An, which has been a driver of fintech innovation, and internet giant Tencent. So far, their biggest successes have come in money market and deposit products.

• Fintech: With regulators discouraging flows into fund managers that offer only simple money market fund products, McKinsey says it’s no surprise to see more retail fund offerings on these companies’ mobile apps. In addition, many now offer AI-based robo advisory, which will automatically select funds based on investor profiles and demand. As more assets move from cash to funds, the big fintechs and ecosystem operators are aiding China’s shift to a cashless society. How asset managers position themselves to serve these fintech platforms will be critical, not only in China but also in other Asian markets where fintechs are gaining ground.

The observations come from a McKinsey survey last year that included interviews with 22 of the fastest-growing fund managers in Asia, both local and multinational companies, who account for 30% of the AUM across the region. By identifying their common characteristics, McKinsey found that they shared a few traits that made for a “recipe of success”.

All take a long-term perspective, with a stable management team and strategy, and they all have made big bets on China, the foundation of the industry’s strong growth across Asia. Other moves were more surprising, McKinsey notes, elaborating that some local fund managers built programmes to develop their people, and generally place a premium on talent management. “And they have all invested in new digital and analytical capabilities, primarily for retail marketing and to lower costs,” it adds.

Though the Asia marketplace is certainly changing,
McKinsey argues the common traits shared by the 22 managers it surveyed will be just as valuable in the years to come. “Firms that demonstrate these attributes will be well positioned to capture the macro opportunities our research has revealed,” McKinsey notes.

At the top of the growth curve of those interviewed are eight firms that grew 28% on average. All had AUM of less than $100 billion in 2013, McKinsey notes, but by 2017, six of the eight had vaulted over that threshold and captured about 10% of total AUM growth in Asia.

In the middle are four firms that grew at 11% — a fair bit under the average of almost 14% across all Asian firms, McKinsey notes. These are medium and large firms; all had more than $100 billion in assets in 2017.

At the bottom of the growth curve are 10 firms that managed only 2% of annual growth, well below the industry average. At a couple of these firms, the AUM actually dropped from 2013 to 2017.

What is clear is that a strong distribution partner is necessary for success in China, McKinsey notes, elaborating that beyond that a few other attributes are also essential:

* A reconfigured risk appetite: In several countries, particularly China, managers need a greater risk appetite. Unlike many of the more developed markets, the same risk management restrictions and governance do not apply in the same way to China. Governance needs to allow quick adaptation to evolving regulations and market conditions, with some creative product designing required to capture shadow banking assets.

* Quick adaptation to evolving regulations: While recent changes are promising, the system retains a lot of ambiguity and restrictions, McKinsey notes.

Regulators are intent on opening the financial sector, but real impact will take time. Thus, a “wait and see” approach may not work, and procrastinating carries a substantial risk of missing the window. Instead, asset managers need to move ahead with a clear plan and an experienced team that understands the regulatory system and can actively engage with local regulators.

* Get the partnership right: In China, foreign players must use joint ventures to serve the public fund market, McKinsey notes. Even those that set up a wholly foreign-owned fund firm still need strategic partnerships with local distributors, such as banks, securities firms, wealth management companies, and/or digital platforms. Historically, while a few JVs with local majority shareholding have proven successful, McKinsey has seen more cases in which the foreign entities eventually withdraw from the JV due to poor performance and management conflicts arising from mismatch of goals. It is thus important to get the partnership right at the very beginning, McKinsey advises, adding that they must prioritise finding the right partner, aligning both parties’ mid- to-long term goals and expectations, agreeing on roles and responsibilities, and setting up a governance structure that can deal with issues that arise.

* Long-term outlook: A commitment to the business is a prime ingredient of success, McKinsey says, adding that the fastest growing firms have their CEOs and management teams in place for a long time. Their strategy is stable, and not subject to passing fads, or the influence of managers who know they will rotate out soon and are intent on leaving their mark. One CIO explained the problem with rapid rotation this way: “A lot of the biggest opportunities, as big and as profitable as they are, are probably going to happen once I’m retired.” Successful firms have worked to align their stakeholders around a long-term vision, and backed it up by committing resources. As part of this long-
term commitment, McKinsey says these firms have developed a sound regulatory strategy, which is absolutely necessary when regulation is both a headwind and a tailwind.

Chantal Grinderslev, partner at Z-Ben Advisors, adds: “Liberalisations and restrictions are being implemented in equal number, and when the rules are being rewritten, everyone has to shift gear. Regulators, managers, even the end-investors themselves. Matching your learning curve to that of the market will be critical to capturing flows.”

Also worth noting are three attributes of winning firms in China, according to research house Casey Quirk. “As the Chinese market matures and buyers become more discriminating, we expect to see clear winners start to emerge,” the firm said in its 2017 study, ‘Leadership in Times of Plenty’. The attributes are:

1. Business model clarity: A clear sense of purpose and focus will be a competitive advantage against managers who dabble at everything. The relevant question to ask, the firm says, is: Who are our clients and what do we do for them?

2. Systematic edge: Excellence and leadership in at least one key area — be it product design, investment process and return consistency, or client engagement. The relevant question to ask in this instance is: What do we have that no one else has?

3. Scale orientation: Leadership in the Chinese market will require size and scale — so build up business lines and capabilities that can scale up. Scale will also help insulate firms from pricing pressures when growth slows. And the question to ask is: How big can this product area or distribution channel become?

There is no question that firms — whether domestic or foreign — that take a long-term approach to fund management and constantly adjust their business strategies in accordance to market needs can be winners in China. In the not too distant future, being top of China’s asset management industry may even make you a leader in the US. Why? Because fund managers who are winners in China may very well have a chance to be a dominant player in the world.
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