

China Fund Spy

a quarterly publication providing reliable information, valuable insights and objective analysis on the Chinese fund market.

Product Intro

MORNINGSTAR[®]

Editor's words

Dear Morningstar Client/Friend,

It would not be a stretch to say that China contains the hottest and most widely talked about emerging market in the world. Indeed, as the fastest growing economy in the world, China can boast an average growth rate of 10% for the past 30 years. China's combined equity market value recently reached \$3.07 trillion, making China the world's third largest stock market, trailing only the United States and Japan.

With China's dramatic growth in market prospects, comes the rapid development of its fund industry. Like the beginning of any new enterprise, the Chinese fund industry has inherent risks due to uncertainty, but also vast and promising potential. The key to tapping that potential is knowledge of the Chinese fund industry and the Chinese market. We at Morningstar would like to provide you with the information you need to explore China's limitless opportunities with our quarterly Morningstar China Fund Spy. Featuring four sections every issue, our analysts bring to light all the information you need to dive into China's fund industry.

To see a more comprehensive illustration of the issue, a Detailed Version Introduction is provided for you. Also, a Client Questionnaire is attached by us to hear your valuable comments and suggestions; we are continuously putting efforts to better serve your interest and needs. It is an exciting time for the Chinese economy. For you, institutional executives, international business developers, and asset managers, it is never too early to jump in. Consider the China Fund Spy as your guide and your reference.

Mike Fan

Editor

Analyst List

To ensure the highest quality and professionalism in the Chinese fund analysis, top analysts from Morningstar (China) Research Center are congregated to the publication of China Fund Spy. The main analysts include, but are not limited to the following:

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|-----------------------|--|
| Xiaoping Huang | Director of Morningstar (China) Research Center, Master in Management and Bachelor in Economics, over 10 years of experience in the investment industry. Ms Huang joined Morningstar China in 2003, and is in charge of the localization of Morningstar Fund Evaluation System in the Chinese Market. She chaired in the development and application of a series of research methodologies and instruments, and constructed the research structure of Chinese funds and fund companies. Ms Huang is the co-editor of China Fund Spy. |
| Haiqiang Li | Analyst of Morningstar (China) Research Center, Master of Economics, Major in Financial Engineering. Mr. Li's research areas include but are not limited to the tracking of funds and fund managers, and macro strategy. He also works in the consulting of portfolio management for institutions and acts as the co-editor of China Fund Spy. |
| Gavin Zhong | Analyst of Morningstar (China) Research Center, Master in Economics, 5 years of experience in the investment industry. Mr. Zhong worked in Pan-Index (Birmingham) Ltd., an Irish foreign exchange market maker, and joined Morningstar in 2006. He is specialized in the research of Chinese Open-End Funds and QDII Funds in China. |
| John Liang | Analyst of Morningstar (China) Research Center, Bachelor in Economics, 4 years of experience in the investment industry. Mr. Liang is mainly focused on the industry analysis of fund market and the tracking of overseas fund market. |
| Frank Sun | Analyst of Morningstar (China) Research Center, Ph.D. in Science. Dr. Sun is in charge of the Hedge Fund and Private Equity Fund research, and now working on the analysis and implementation of Morningstar U.S. Hedge Fund Evaluation System to the Chinese Hedge Fund Market. |
| Mike Fan | Analyst of Morningstar (China) Research Center, Master of Finance. Mr. Fan is mainly focused on the research of Chinese mutual fund market. He coordinated the launch of China Fund Spy, and is the editor of this publication. |

Detailed Instruction of China Fund Spy Sections

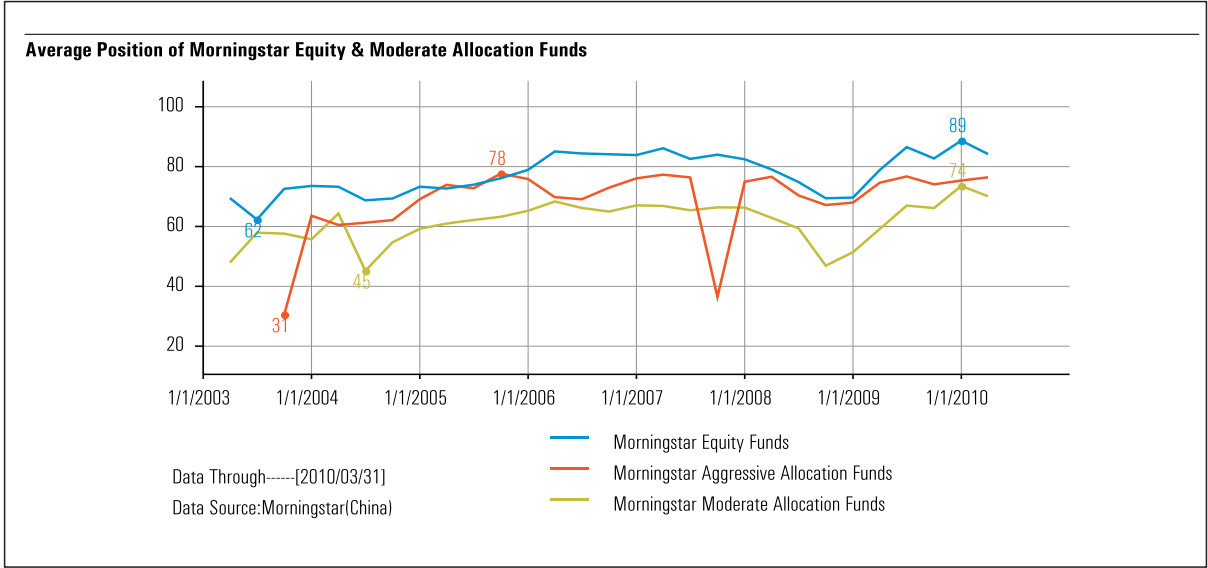
An Eye on the Market

Thoroughly researched and compiled, every issue of the Morningstar China Fund Spy contains a review of the Chinese market in the past quarter.

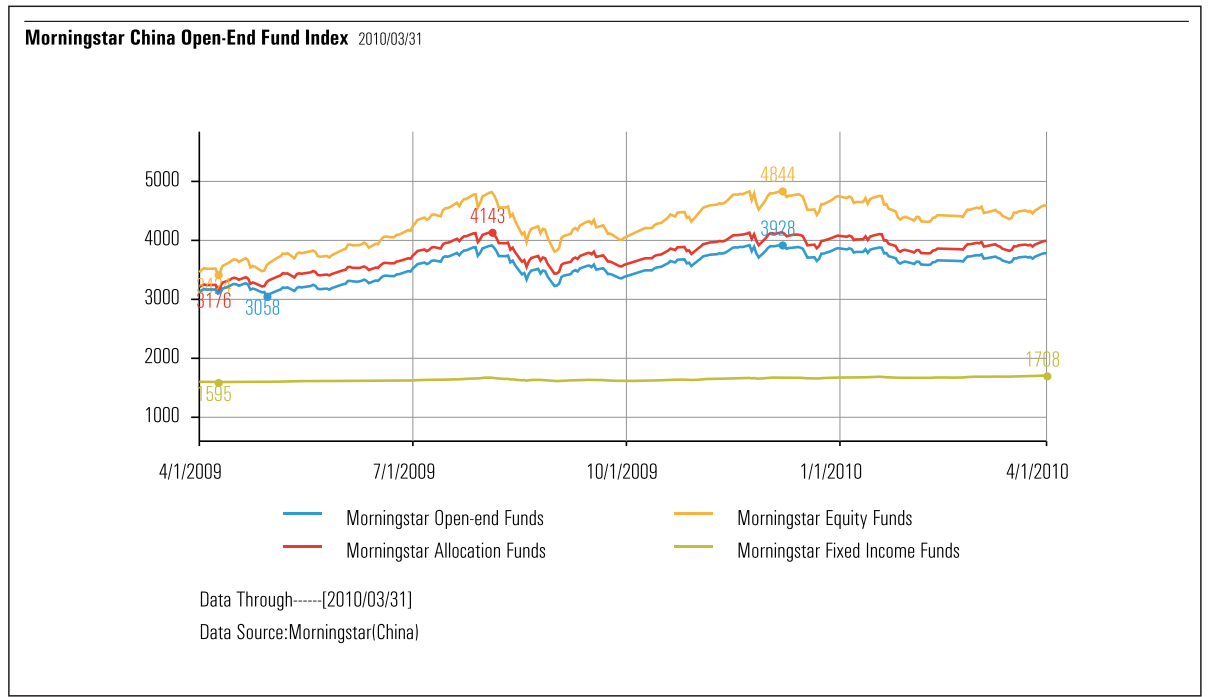
- Synopsis of the stock and bond markets; easy to understand charts that show which sectors performed well and which did not.
- Comprehensive fund data for open-end funds, closed-end funds, and ETF's, including NAV, Quarterly returns, and YTD returns.
- Detailed rankings within fund types, time series comparisons, and accompanying comments and explanations.

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Market Review 2010/03/31			
Open-End Funds			
Morningstar Leaders (YTD Ranking)			
Fund Name	NAV	Quarterly Rtn(%)	YTD Rtn(%)
Equity Fund			
Morgan Stanley Huaxin Leading Advantage Equity Fund	1.2107	8.92	8.92
CSFMC 500 Index Fund (LOF)	1.2420	5.61	5.61
GF 500 Index Fund (LOF)	1.0590	4.96	4.96
Aggressive Allocation Fund			
Harvest Theme Selection Fund	1.3330	8.37	8.37
ChinaAMC Strategic Select Moderate Allocation Fund	2.0520	7.89	7.89
ChinaAMC Large-cap Select Fund	10.7180	7.45	7.45
Moderate Allocation Fund			
Harvest Growth Fund	4.4920	4.40	4.40
China Post Core Advantage Moderate Allocation Fund	1.0530	4.17	4.17
Orient Dragon Fund	0.6823	3.98	3.98
Conservative Allocation Fund			
CSFMC Bao Yuan Bond Fund	1.1544	0.64	0.64

Morningstar sample ranking of leading funds, showing NAV, Quarterly Rtn(%), and YTD Rtn(%).



Morningstar sample time series comparing positions of different types of funds. Analyst comments include a discussion about rising property values and their likely impact on stock prices.



Time series data showing the growth of various Morningstar indices.

Detailed Instruction of China Fund Spy Sections

Expert Analyst Insights

Combining data with expertise, our analysts look at the composition of the market and of various funds to provide you with a streamlined guide of what you need to know.

- News blurbs about the fund industry, allowing you to get an idea of the temperature of the market.
- Funds which are new on the scene and the size of their IPO's, as well as the cash flows and returns of established funds.
- Rankings of the favorite stocks of funds and their respective returns.

Index Futures Stimulated Arbitrage on 3 Index Funds

The introduction of index futures on Apr. 16 boosted massive transaction volume on three Index Funds(IFs), including Harvest Shanghai & Shenzhen 300 Index Fund LOF(HSS300LOF), 180 ETF of Shanghai Stock Exchange(SSE 180ETF), and 100 ETF of Shenzhen Stock Exchange(SSE 100ETF), surging 141%, 389% and 76% respectively comparing to the previous day.

Industry professionals stated that, due to the absence of Shanghai & Shenzhen 300 Index Fund(ETF), the arbitragers used the combination of SSE 180ETF and SSE 100ETF as the spot market product. Also, triggered by spiraling instant premium provided arbitrage opportunity by purchasing ETFs in the secondary market. Senior traders in this market confirmed the practice.

These arbitrage transactions also drove the large release for HSS300LOF. According to the research results, the correlation between Harvest Shanghai & Shenzhen 300 Index Fund(LOF) and subject index for index futures is 99.99%, the

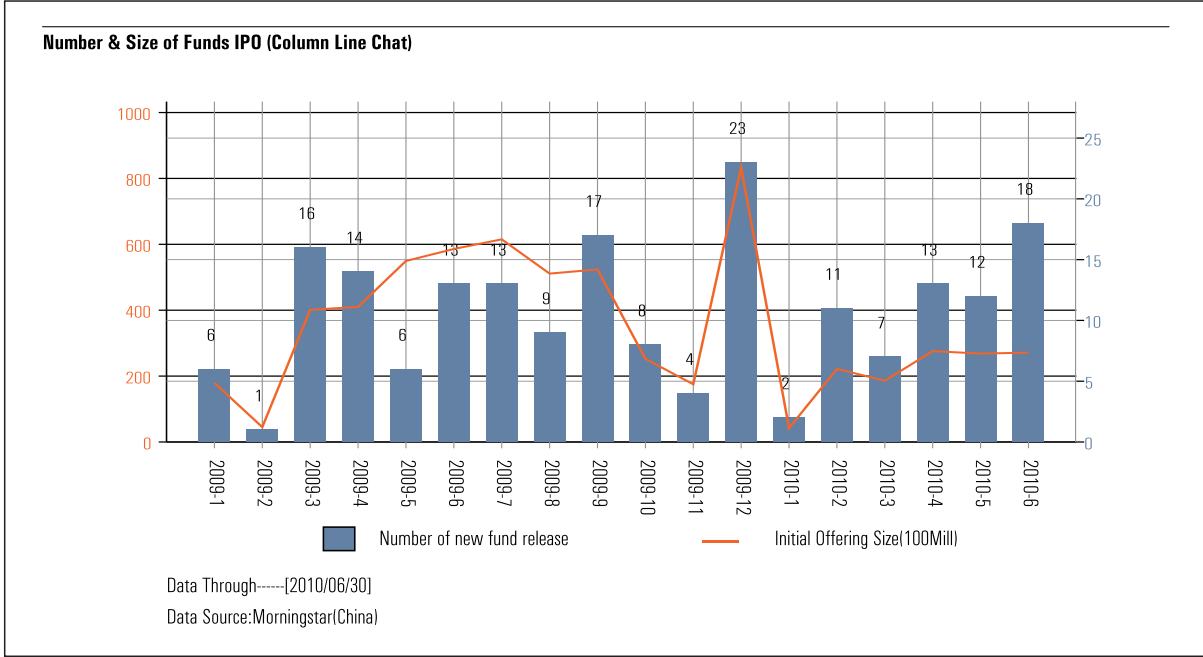
Fund Companies to Lock Talents

Facing the fierce jump-ship trend to private equity funds, many fund companies determined to lock in talent by all means. Large fund companies decided to increase the staff salary level by 50% ~ 70%, which was normally a small probability event throughout the industry. In times of recession, a performance-oriented salary system makes most staff's life rely on their basic salary. In order to keep talented professionals, other fund companies take steps to retain personnel, such as promotion to higher positions, lower internal assessment standards, allowance for more holidays, detaining yearend bonus, etc.

Industry insiders cast doubt on the effectiveness of the salary adjustments mentioned above for fund companies to achieve their purpose. After all, for mature fund managers and analysts, the sense of pride and ascription from companies and investment authority play a more important role in the jump-ship of talents.

Comments: Due to the dilemma between rapid expansion and shortage of talented professionals in this industry, to keep in talents, it is necessary and suggested for mutual fund companies to improve internal training and promotion mechanism, and find equilibrium between internal cultivation and outside introduction for their long-

Relevant news blurbs related to the Chinese fund market, coupled with analyst comments. The article on the left details arbitrage trading as a result of the introduction of index futures to the market, while the article on the right discusses the problem of talent turnover in many fund companies. It also includes analyst comments on how to prevent such turnover.



Multi purpose graph showing not only amount of IPO's in a given year, but their total initial offering size.

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Insights 2010/06/30

Products

50 Funds' Favorite Stocks

Stock Name	Holding by Funds(Mills)	Quarterly Rtn(%)
China Merchants Bank Limited	33968.44	-20%
Ping An Insurance (Group) Company of China	30871.02	-7%
Industrial Bank	22328.10	-31%
Shanghai Pudong Development Bank	21181.23	-22%
Suning Appliance	20074.66	-9%
China Minsheng Banking Corporation Limited	19327.57	-21%
Kweichow Moutai	15906.86	-20%
China Pacific Insurance (Group)	12385.75	-16%
Bank Of Communications	10420.57	-22%
Industrial And Commercial Bank Of China Limited	9541.79	-15%

Morningstar sample stock ranking by holding volume of mutual funds, and the corresponding returns.

Detailed Instruction of China Fund Spy Sections

Insiders Scoop

Our analysts are constantly seeking out notable managers of Chinese funds. In rare interviews, they share with us their goals and their strategies, their triumphs and their setbacks. We strive to link the human faces behind the data and the numbers of the market. Prominent investors have included: Tony Zhang, Fund Manager of FT Sealand Flexible Capital and FT Sealand Deep Value Fund, Tao Zhuang, Fund Manager of Huashang Prosperous Growth Stock Fund...

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People 2010/06/30

M: Personally, which one do you prefer: multi-fund-manager system or single fund manager system?

Z: These two years experience made me feel good about the double-fund-manager system, which is more complementary. You can encourage each other, discuss with each other, and communicate with each other on different information. The prerequisite is two people of the same high level. Huashang Prosperous would not have been so good without Jianbo.

Unclear Short Term Prospects, Much Anticipated Future

M: What do you think of the market in the second half of the year? Where do opportunities come from? What kind of investment strategy should we adopt?

Z: Big risks have passed. I believe the market will become more prosperous. The biggest variable in the second half of this year is whether inflation will exceed our expectation. There's no big opportunity in the next half year. We have to enter an era of stock selection.

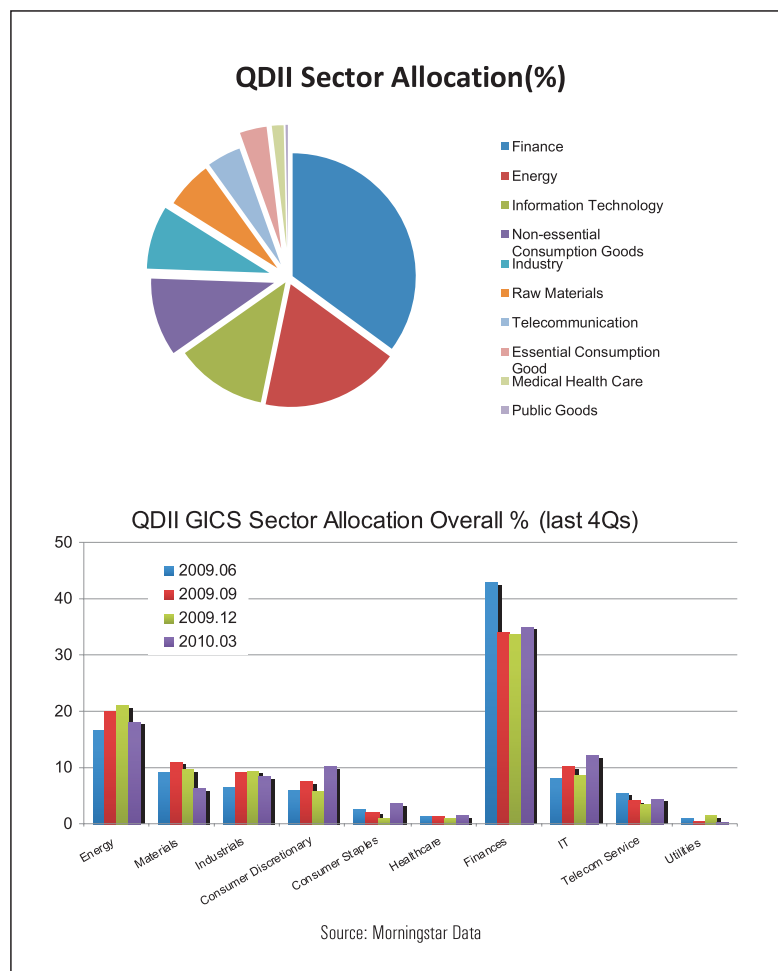
M: What do you think about Chinese short-term and long-term economic prospects? What is the greatest challenge for Chinese economy in the short and long run?

Z: To be frank, the short-term economic prospects are unclear. In my opinion, it is problematic for a country's economic growth to be too dependent on investment and monetary policy. Our government proposed economic transformation, but there is a lack of determination, and they ease the policies when trouble strikes. Such are some short-term challenges that whether real estate sector will become a huge macroeconomic burden and whether the previous massive lending boom will trigger uncontrollable inflation. In the long run, I'm still optimistic about the economic development of China, which is still in a relatively stable environment and in a low

Excerpt from an interview with Tao Zhuang, fund manager of one of the best performing Chinese equity funds in the 2010's market concussion. He expressed his concern and outlook on the Chinese economy in the near future.

In-depth Featured Report

Every quarter, there is one key aspect of the market that demands our attention and the attention of investors. A compilation of news, trends, and patterns, each featured article is unique and full of valuable information not easily gleaned from the usual outlets. Past articles have talked about the shrinkage of QDII funds, Morningstar 2009 Fund Award...



Data and charts from the featured article "Leakage Continued – QDII Funds Scan of First Quarter 2010". This article shows the changing composition of QDII funds in terms of sector allocation as well as their growing problem in net redemptions.

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(This form is also available at: <http://cn.morningstar.com/AboutUs/files/spy2010.pdf>)

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What sort of institution do you represent?

- Mutual Fund Company Private Equity Bank Insurance Company
 Private/Public Corporation Other

Are you a registered Qualified Foreign Institutional Investor (QFII)?

- Yes No, but planning to No

How satisfied are you with the publication as a whole?

(scale, from very dissatisfied to very satisfied)

- Very Dissatisfied Dissatisfied No Preference
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What section(s) of the publication do you find most useful/interesting?

- Market Review Insights People Feature

What section(s) of the publication do you find least useful/interesting?

- Market Review Insights People Feature

What types of data do you find most useful/interesting?

- Market Index Data Rankings Sector Performances Time Series Analysis
 Comments News Blurbs Other

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If Other, please specify:

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- Market Index Data Rankings Sector Performances Time Series Analysis
 Comments News Blurbs Other

If Other, please specify:

Do you believe that this publication has helped you achieve your investment goals? Why?

- Yes No

Do you rely on any other sources for information on the Chinese mutual fund industry?

- Yes No

If so, what are they?

What would help improve this publication?

Would you recommend this publication to other investors?

- Yes No

Do you believe that this report is reasonably priced? (\$1000/Quarter)

- Yes No

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