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Rosefinch Research | Embracing 3060 for tomorrow's stars

"Fortune may be the arbiter of one half of our actions, but she still leaves us the other half, or perhaps a little less, to our free will." -- Machiavelli

Focusing on 3060, expecting future stars, and embracing the "Mt Himalaya"-type opportunities

July FOMC officially discussed Taper for the first time, recognizing the economy is moving steadily towards full employment and price stability. In anticipation of future liquidity withdraw, global market risk appetite decreased with increased volatility. The long-end of the yield curve dropped; major US indices was choppy at high levels; USD index rebounded to new 2021 high; commodities showing downtrend with LME Copper and Brent oil dropping -5.4% and -6.9% in a week respectively; iron ore index also dropped over -13%. With external liquidity withdraw expectation increasing, domestic liquidity growth also slowed. On domestic policy front, after the "double reduction" in the education sector, there were policy-impacted drops in pharmaceutical, medical equipment, and white liquor sectors. With further A-share and HK market corrections, the SSE50 hit new 12-month lows while the Northbound Stock Connect flows turned to net sells and Hang Seng Tech Index hits historical low since its launch in July 2020. CNH also saw depreciating pressure to trade over 6.5 vs the USD.

We have pointed out in recent monthly pieces that even though post-Chinese New Year markets had clear corrections, there's still risk related to Fed's Taper talk. We see any 3Q domestic sell-off on back of Fed Taper to be healthy and indeed a good opportunity for future positioning.

China has maintained tight control over the Delta-variant risk with good result so far. The idea that we'll have to co-exist with Covid is gaining momentum. With China and US recovery cycles in different phases, we see steady development towards higher quality economy ahead. China and US rates correlation has continued to decrease. China also has maneuvering room in its monetary and fiscal policies. Recently Governor Yi has highlighted the need for "cross-cycle management" to ensure monetary supply and credit creation is roughly in line with economic growth. The recent policy shifts like "double reduction" in education sector did cause some oversea investments to withdraw. This in fact lets off some future sell-off pressure and released some pressure from one-off Taper related risk. As market increase their Taper exit expectations, the long-term view should be on how to position our core assets.

China's commitment to **"3060" - Carbon-peak by 2030 and Carbon-neutral by 2060** - affects many angles like climate change, economy, politics, culture, society, with long-lasting effects. Global warming has moved from scientific consensus to political consensus, with most governments now actively implementing policies. The process of achieving the 3060 goals is equivalent to the process to replace carbon-energy sector with manufacturing sector. It can improve China's energy safety, promote RMB's globalization, offset older demographics and consumption slowdown, replace part of infrastructure or real estate activities, and encourage economic transitions towards higher quality developments. Based on the erratic weather patterns this year, there may be further adjustments to the Paris climate agreement.

From investor's perspective, 3060 theme has high certainty, long time horizon, multiple sectors across both new emerging industries and upgraded old industries. On top of these there are other opportunities like key core companies or regional upgrades. The possibilities are endless! At Rosefinch, we focus on assessing future industry growth trends and increasing our long-term research capabilities. In addition to directly 3060-related sectors, there are other sectors with some overlaps like modern farming, biopharmaceutical, defense, consumer electronics, logistics, fintech, internet, etc. We'll continue our industrial-chain research and disciplined security investment to support the growth of the small seedlings to large trees and then to entire ecosystem. By continually adding value and improving our capabilities, we will increase our clients' return over the long term.

Immunization vs travel restriction

The global Delta-variant wave is spreading far and wide. England and Israel had achieved over 70% vaccination rate and still reported higher new cases. US daily case is approaching 200k again. While the severe cases and death rates remain low, there's increasing concerns about vaccine effectiveness and need for booster shots. US and England are now at the beginning of the end of their fight with Covid-19, with their future decisions likely impacting the global direction. In China, it had largely controlled the latest Delta-variant break out with now zero-daily case in hot spots like Nanjing. How we choose to deal with the coronavirus is a question that each country must answer, with ongoing debates raging between the "zero-tolerance" and the "co-existence" camps.

Due to unusual weather patterns, new pandemic waves, real estate restrictions, employment pressure and slow consumption recovery, the July economic data points were noticeably weaker than expectations. There will probably be weaker economic growth in coming months, though unlikely to have dramatic collapse thanks to supportive fiscal policies. As global pandemic situation evolves and vaccination rates increases, how domestic policy changes will the key factor in determining future macro trends or expectations. In Complexity Economics, economy is another expression of technology and evolves along with the technological advancements. Unlike the credit-expansion policy post 2008, now the government is maintaining basic monetary and credit growth, supporting manufacturing activities to offset real estate slowdown, and focusing on higher quality developments.

Becoming core link in the global supply chain

On the day of India independence on August 15th, Modi announced the goal for energy-independence in 25 years. India is the world's 3rd largest energy consumer and oil importer. It wants to increase its renewable energy capacity five times by 2030 to reach its Carbon-neutrality target. China is the world's largest energy producer and consumer, so to achieve the 3060 goal will be a very demanding battle indeed.

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On Aug 16th, the head of China National Energy Commission Mr Zhang Jianhua published an article on People's Daily titled: "Supporting timely achievement of Carbon-peak and Carbon-neutral goals". He said: *we have less than 10 years to achieve the Carbon-peak goal by 2030. The 14th Five-year plan is a key pivotal period. We should increase substitution of renewable energy, include utilizing more green energy, actively pursue safe and effective energy-storage technology, push for hydrogen-energy and its scalable implementation.* On Aug 19th, Longi Green Energy Technology chairman Mr Zhong Baoshen gave a speech on "Photovoltaic shouldering the duty and glory of carbon-neutrality" where he said China photovoltaic industry will lead with technological innovation to support the sustainable growth in global economical, social, and environmental areas. As the unit cost of photovoltaic generation drops further, the industry should simplify the green-energy utilization process such as incorporating solar panel in construction sector and streamlining solar energy conversion into hydrogen. He showed the following chart, illustrating the four stages to Carbon-neutrality: 1) improving existing framework with flexible resources; 2) expand pumped storage power station; 3) chemical storage to support peak utilization; 4) green hydro energy.

Source: Longi Green Energy Technology

Recent government communications stated the anti-monopoly policies is an important government initiative to stimulate fair competition in the market place, create development space for the SME across markets, and better protect consumer rights. Government must balance regulation and growth. On the one hand, we need to establish clear "traffic lights" for the capital market by creating approval list and negative list with the goal of protecting data security, personal privacy, and government security. On the other hand, recognizing platform economy is a key component of advanced productivity, we need to leverage its superior resource allocation, increase technological advancement, improve people's lives, and participate in global cooperation or competition. The Ministry of Industry and Information Technology

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published a paper that provided clear guideline on data security for Smart Cars. Whether its from Kodak film to digital camera, or cellphone to smart phone, each technological advancement is an opportunity to change the race track. The new energy car has many implications to China: decrease oil reliance, reduce carbon emissions, build national brand, increase manufacturing capability such as Apply chain suppliers in China.

During the pandemic, the pain points of a globalized inflexible supply chain became magnified. Building a robust supply chain in the post-pandemic world is a national concern for many. The future global supply chain may become more regional around a few core economies, with more flexibility to adjust to demand changes. China had comprehensive local production chains and recovered quickly following the onset of pandemic. With the focus on "dual circulation", China has potential to become a core link of global supply chain: during periods of high global demand, China can increase production quickly by coordinating among industries and global upstream suppliers; and during period of low global demand, the large domestic market can still generate enough demand to support the running of local supply chain.

In financial market, we're also seeing dynamic changes as technology driven companies challenging the traditional capital-intensive security firms. There are many examples of innovative, low-capital, ecosystem driven companies taking on the old giants. In 2021 Charles Schwab overtook Goldman Sach's in market capitalization; East Money caught up with China Citic Securities; and Brazil online broker XP outgrew Japan's Nomura Securities.

US rate rally vs China A-share independence

China's July PPI rose +9% YoY and +0.2% MoM on continued supply-demand imbalance. We'll likely see sequential numbers coming off, though it's worth monitoring the CPI and core CPI with both exceeding expectations on sequential basis. The current inflationary pressure is mostly from the demand side, which makes it hard for monetary policy to control. From policy perspective, while we may not see sustained inflationary pressure, it may last longer than we initially expected. In the PBOC 2Q Monetary Policy Implementation report, it highlighted there was no inflation after the 2008 financial crisis but there is inflation after the 2020 pandemic. The key difference is whether there was increase in broader money supply. After the pandemic, most advanced economies engaged in extremely loose monetary policy and massive fiscal stimulus, which increased inflationary pressure. With market expecting accelerated government debt issuance in 2H21, PBOC emphasized the concept of "two wallets of central bank and fiscal policy", and the shortcomings of monetizing fiscal debt. PBOC's report further highlighted "effective implementation of monetary policy expectation management is based on the central bank's 'does what it says.'" China's interest rate is at reasonable levels and relatively low among the emerging or developing markets. Rosefinch's fixed income team expects bond market liquidity to remain friendly as monetary policy is unlikely to tighten. As for the equity market, the current emphasis on steady fiscal policy + steady credit creation, relative loose monetary conditions bodes well in support of market confidence.

US July CPI rose 0.5% mom as expected, though PPI continued to rise to record high of +7.8% YoY. As Delta-variant rages across the globe, there's continued price pressure on global supply chain and industry chain, such as lack of car semi-conductor chips, increase in raw material, decline in labor supply. Fed formally discussed Taper for the first time in July. So will Fed's hike become the next "Grey Rhino"? Oaktree Capital founder Howard Marks said: after 2008 Global Financial Crisis, every time Fed hiked it caused public anger. In 2019, rates started going lower and I think Fed missed their chance. But this time, with such strong economic recovery, I don't want to miss the opportunity to hike rates. Fed needs to consider how to be most beneficial for the economy, not how to let investors make money. If US hike rates, will that lead to China rate hike? Will it lead to domestic stock market correction? CICC recently did a research where they looked at macro, capital, and sentiment transmission mechanisms to show that even if US rates start to rally, China domestic rates can still maintain downward trend. Domestic stock market may fluctuate, but net result will be limited. It's probably that A-share will follow its own independent path.

Being Poor isn't Socialism: supporting "common prosperity" amid high quality developments

On Aug 17th, Secretary General Xi held policy meeting on key topics like supporting "common prosperity", preventing major financial risk, and stabilizing financial developments. He see "common prosperity" as a key component of socialist value and Chinese development characteristics. Common prosperity means prosperity for all people - it's not prosperity for a few, nor is it averaging for all, but implemented in multiple phases. Focus will be on basic supportive social networks for the people, though the whole process may be long, complex, and challenging.

Evaluation now requires foresight on the end

In the recent ESG Global Leader Summit, both Shanghai and Shenzhen exchange officials highlighted leveraging capital markets to achieve the Carbon-Peak and Carbon-Neutral goals. Meanwhile, in A-share market we are seeing massive historical dispersion from industrial, or single-stock, or Mutual fund net valuation perspectives. With global situations, social thoughts, evolving economies, and technological innovations as backdrop, the "inter-sector" and "intra-sector" dynamics are replacing the traditional "bull-bear" market lens. The market is usually the best observer, and change is still the biggest constant. This means higher challenges for the investor: it's more important now to have foresight on the endgame in order to evaluate the current companies. In short, buying the right company is more important than buying at cheap price. This requires the ability to make the correct assessment on the industry, otherwise it's better to not act. It will also require a deep understanding on both the company and the management team.

At Rosefinch, we focus on the entire 3060 industrial chain and look at the most important industry links for the best companies that we just can't miss.

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