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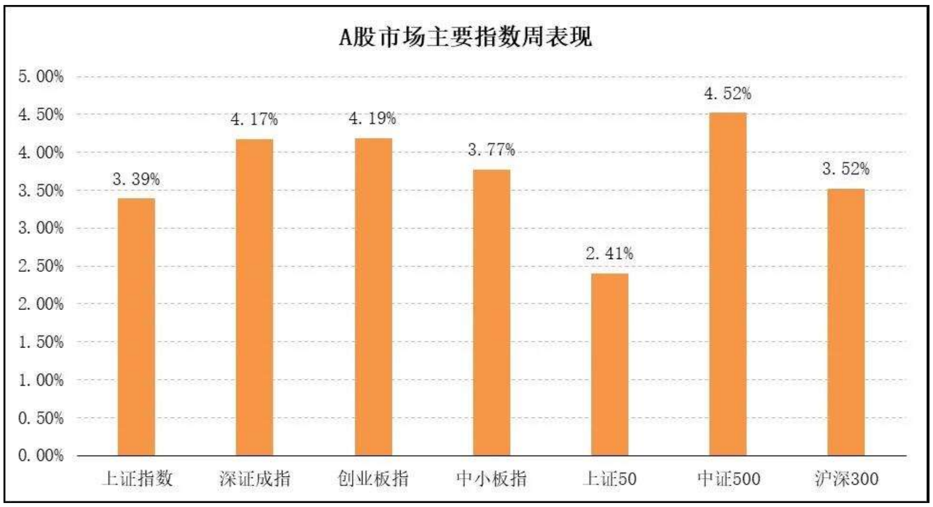
Rosefinch Weekly

Trillion RMB daily volume is the new norm

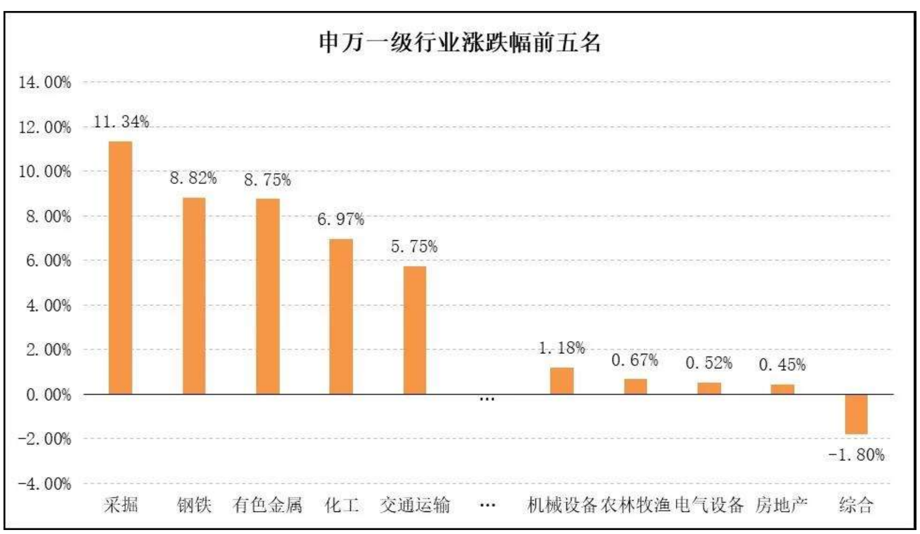
1. Market Review

For the last week: SSE was +3.39%, SZI was 4.17%, GEM was 4.19%, SSE50 was +2.41%, CSI300 was +3.52%, and CSI500 was +4.52%.



Source: Wind, Rosefinch.

Amongst the ShenWan Primary industries, 27 out of 28 rose with excavation, steel, non-ferrous metal, chemical, transportations the top 5 performers.



Source: Wind, Rosefinch

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Market volume kept increasing, with Northbound net +14.1 billion RMB, and Southbound net +8.2 billion HKD.

Source: Wind, Rosefinch. Blue is cumulative Northbound flow, unit is 100 million RMB; yellow is cumulative Southbound flow; unit is in 100 million HKD.

2. Market Outlook

In recent trade data, China's August export was a record $294 billion, or +25.6% YoY vs July's +19.3%. When compared with pre-pandemic's August 2019 number, it's still a strong annualized +17%. There were lots of factors behind the high export number: the foreign supply chain is still being rebuilt; SE Asia nations are weathering another Covid-wave, causing restrictions on their manufacturing activities; inflation remains sticky with high transportation costs which directly attributes to the nominal export numbers. There's also robust global demand on pre-Christmas stock-up. Given the high input costs of various commodities, the high nominal export number doesn't mean high profits for the exporters. In fact, there's still clear headwinds against SME Exporters.

On inflation data front, China's August PPI was +9.5% YoY, higher than July's +9.0%, and is the fastest since Aug 2008. Raw materials like coal, chemical and metals are having clear impact on the PPI pressure. CPI though is relatively well-behaved with +0.8% YoY and core CPI (ex-Food and energy) is only +1.2% YoY vs +1.3% in July. Given the slower CPI growth, we see little inflationary pressure on the monetary policy. With PPI pressure remaining high, we'd expect monetary policy to maintain a supportive stance for the SME.

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On private financing front, August added 2.96 trillion RMB which was roughly in line with expectations. New credit creation was 1.22 trillion RMB, slightly less than market expectations. In terms of loans, notes financing added 280 billion RMB, which didn't increase significantly even with various bank promotions in mid-August; the residents' medium-to-long personal loans like housing loans did improve slightly from July but remains below 2019 level. From policy perspective, last week saw official reports on monetary policy with the main theme being to maintain relatively stable monetary policy. We see relatively low chance of PBOC rate cut. Overseas, RBA added to Taper; ECB slowed PEPP purchase and started to mention normalization of monetary policy; UK started tax hike to make up for budget shortfalls; US looking at increasing tax to pay for $3.5 trillion infrastructure bill. In the post-pandemic world, with increased leverage and higher taxation, we expect company profits and market sentiments to take some hits. In the next few months, the main risks to global equity markets will be slowing global recovery; higher taxation; and US debt ceiling.

For China equity market, last week saw most indices rallying with dividend stocks extending gains while growth names rebounding. CSI500 outpaced CSI300 and SSE50, showing clear distinction between the cyclical sectors vs non-cyclical names. Northbound was a net +14.1 billion RMB, while Southbound was a net +82 billion HKD. There were a few themes: cyclical sectors like steel, chemical and coal rallied along with the commodity prices, while expected expansive fiscal policy supported the outlook for infrastructural sectors like construction or transportation. Market is raising expectation for higher 4Q private financing, which if delivered will provide steady flow for a higher A-share market above Feb highs. The daily market turnover is now around 1.4 trillion RMB, which may very well become the new norm. Higher turnover means market may have different opinions, which is causing sectorial rotations rather than systemic risk. **Medium to high turnover rate and steady upward trend is a good environment to be in.**

The CSI Dividend Index is near record high with strong short-term optimism. GEM still need time to digest the valuation, with some component companies worthy of strategic allocations. The Mid-Cap and Small-Cap names in CSI500 or CSI1000 are highly resilient and well-supported by policy, therefore they enjoy high Sharpe-ratio, increasing domestic liquidity support, and higher trading volumes.

Because commodity pricing has strong transparency and high short-term certainty, there're a lot of capital flowing into the upstream names. The higher upstream pricing will squeeze profits for mid- to downstream companies, thus pushing down stock prices of these names. This is reflected in the August dichotomy between the high PPI and the subdued CPI. In the short term, there's no good alternative to the raw material shortfall, so we may see further differentiation between the upstream and mid/downstream companies' stock prices. Such differentiation indicates an unstable and unbalanced economy, thus the PBOC's structural loose policy will likely remain for now.

With manufacturing capacity constraints relative fixed, the resource-producing companies have limited upside in production volumes. We therefore must be cautious about how much optimistic pricing outlook is already reflected in the current price. For example, market is already taking into account the

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upcoming winter seasonal demand on coal, as well as the likely production restriction ahead of Winter Olympics. Because these companies' stock prices are so highly correlated to raw material prices, any price-negative news such as increasing supply or removing production-restrictions may cause fast reversals in price expectations and push the cyclical stocks back into the bottom of the cycle. Rather than chasing the latest cycle changes, we remain favorable of the long-term investable opportunities in wind, hydro or solar industries that support the national electricity generation needs.