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Rosefinch Research | Company quality matters more than size

There were large movements this week with a large dip on Thursday. A few key factors were:

1. High commodity prices caused profit reduction and operating pressure for downstream companies.
2. While there were expectations of weaker economic numbers, some clear deterioration nonetheless soured market mood. The retail activities were only +2.5% YoY in August vs +7% expected and +8.5% in July. August industrial production was +5.3% vs +5.8% expected and +6.4% in July, showing there's more than just Covid-wave and electricity-constraints at work.
3. A large real estate company's liquidity situation continues to be fluid, causing a drag on the whole sector.
4. Ministry of Industry and Information Technology's statement that new energy car's costs are getting high caused retracement in new energy car industry chain companies.

Regarding the recent development in real estate company, we recognize that the real estate industry chain involves both downstream companies and the financial markets. Any negative development will have some impact, though unlikely to be an overwhelming systematic risk for the entire market. First, the debt issue for this company has been on the headlines for most of 2021, with plenty of time for market to digest and react. On the other hand, the government policy towards financial system is still one of risk-prevention. Even though government probably won't relax the leverage constraint guidelines on the real estate sector, they may give some tactical support in dealing with the situation. **This debt crisis won't become China's Lehman moment, so the impact to the stock market overall will be manageable.**

The new energy car industry's fundamentals remain sound, with relative high growth rate and clear long-term outlooks. But due to the higher baseline numbers, the growth rate will start to drift lower thus putting pressure on the whole valuation framework. There were some volatile movements recently, but it doesn't change the fundamental cost-performance ratio outlooks. The rise in upstream commodity pricing does cause concerns on mid-stream enterprises' profitability. We believe the raw material price pressure will ease towards turn of the year, thus unlikely to derail the long-term industry development trends. The 4Q production schedule still looks healthy, with the main driver being the roll-out of larger models. Therefore, any short-term stock market correction in this industry is a good entry opportunity.

Electronics industry, and especially semi-conductor, dropped because of some signs of slowing deliveries among consumer chips like memory chips, sensory chips, power management chips. Various consumer electronics manufacturers like mobile companies are reducing their output rates, while building up their stock. Now we see the consumer chip prices have stopped rallying, with a supply-demand balance likely in 4Q21. On the other hand, there's still severe shortage in automobile chips. The automobile chip production expansions are hard and slow, with multiple suppliers like Infineon and On Semiconductor announcing price increases recently. Various industry forecasts now expect automobile chip shortage to continue till end of 2022. Overall, we see a differentiation between these two types of semi-conductor chips due to their unique supply and demand situations. If the stock market starts an indiscriminate selloff of all chip manufacturers, it will bring investment opportunity for automobile chip companies.

During the 4Q21, any market correction is a great opportunity to position for next year. The capital market's relevancy and importance to the real economy is increasing continuously. It will support an efficient allocation of capital resources towards the structural transformation of the economy. As people increase their wealth allocation to equity type products, it has increased the overall market activity levels. From the macro level, if there's continued slide in economy, there will be more structural policy announcements to support people's livelihoods, employment, specialty development, and technological innovation. These policies will support the real economy, loosen monetary and liquidity conditions, and create a structural support to the equity market. Under the banner of "common prosperity", the policy guidance is towards raising the middle to low-income families' income levels. As consumption desire and disposable income increase, there will be a rebound in Consumer Staples.

At Rosefinch, we will focus on investment opportunities with long-term certainty. **We search through various industry chains to identify the new demands in areas that's aligned with government policy and find companies with core innovative edge to capture the long trend.** The main government theme of "3060" consists of achieving Carbon-Peak by 2030 and Carbon-Neutrality by 2060. The 14th Five-Year Plan of the Chinese government deals with the economic blueprint for 2021-2025. The plan highlighted the crucial development of new energy to replace the traditional carbon energy. There are clear roads ahead for subfields like photovoltaic, energy storage, and hydrogen energy. The well-defined future demands will bring certain growth and valuation support. We'll continue search for good entry opportunities for these companies amidst the market volatilities.

Market often worries excessively about the market capitalization of a company. But we believe the more important factor to consider is the company's quality. Regardless of the company being a small cap or mega cap, being in biopharmaceutical, electronics, or new energy company, as long as there's new demand or a second growth curve and an innovative capability to satisfy such demands, then it's a company worth investing in. And often, the best time to initiate such investment is during market corrections.