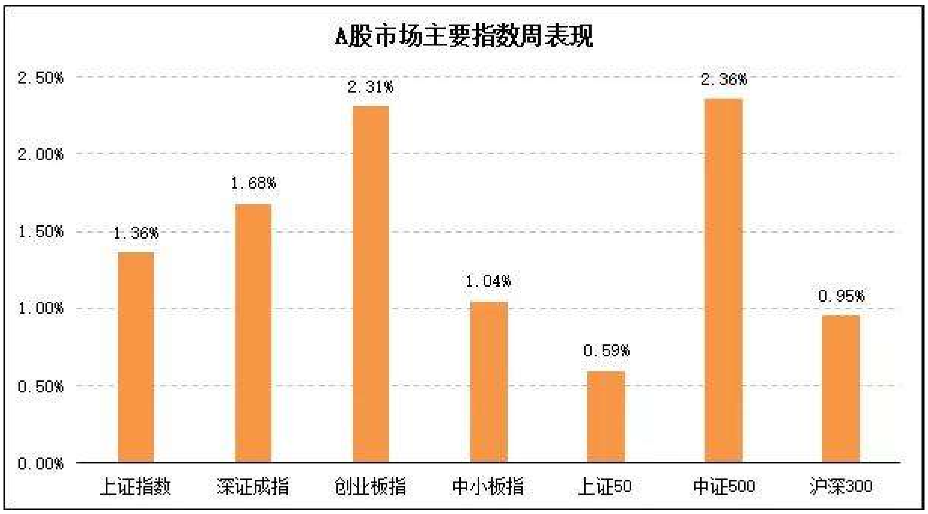
朱雀基金
Rosefinch Fund
[021]2030 5888 [021]2030 5999
58 Floor, New Bund Center, NO.555 West Haiyang Road/588 Dongyu Road, Pudong New Area, Shanghai
上海市浦东新区海阳西路 555 号/东育路 588 号前滩中心第 58 层，邮编：200126

Rosefinch Weekly

Capital to return to higher-certainty sectors

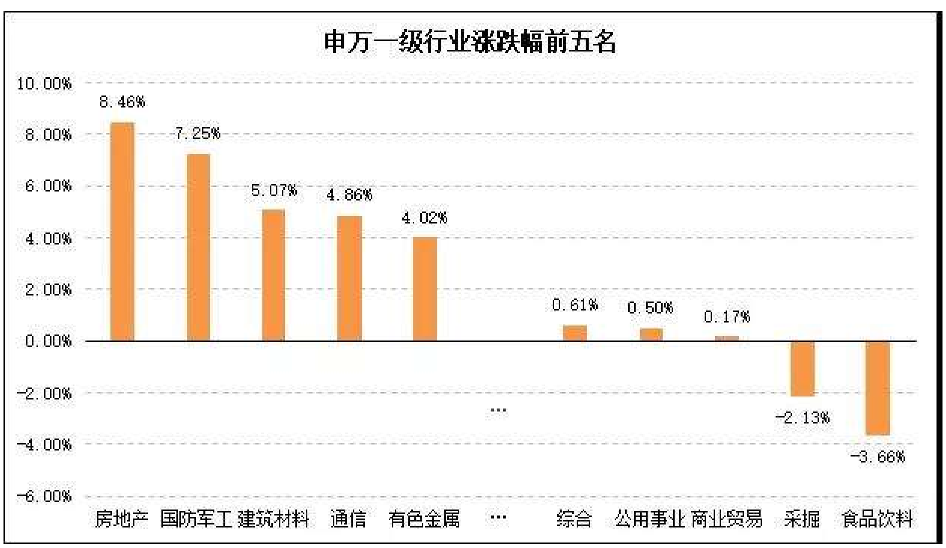
1. Market Review

For the last week: SSE was +1.36%, SZI was +1.68%, GEM was +2.31%, SSE50 was +0.59%, CSI300 was +0.95%, and CSI500 was +2.36%.



Source: Wind, Rosefinch.

Amongst the ShenWan Primary industries, 26 out of 28 rose with real estate, defense, construction material, communication, non-ferrous metal leading the way.



Source: Wind, Rosefinch

Email ir@rosefinch.cn

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Market volume now over 1 trillion RMB for the 16th trading day. Last week Northbound was net -2.69 billion RMB, and Southbound net -5.37 billion HKD.

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

2. Market Outlook

China's Communist Party (CPC) concluded its 6th Plenary session of the 19th Central Committee meeting on Nov 11th with a communique that reviewed its major historical achievements and highlighted its goals going forward. It calls for 2nd century of CPC's new developments, with specific emphasis on "establish new development phase, implement new development thoughts, construct new development framework, push for high quality development, comprehensively deepen reform, coordinate and advance people's prosperity, country's strength, and China's beauty."

We also saw announcements of carbon-reduction policy tools, with PBOC encouraging financial system to target support for green projects via structural credit-facilities. This reflects the guideline to "push for high quality development", with Green financing becoming a potential partial replacement of credit activities in real estate sector. While the short-term impact is limited, the long-term structural support to reduce green financing cost and guide financial assets towards green economy will be much more significant.

The current policy on real estate sector is using short-term correction in real estate policy to ease liquidity problems and prevent systematic problems. It's not a return to the old approach of leaning on real estate as the growth engine. PBOC's recent statement clarified its priority to "maintain steady monetary policy, provide cross-cycle guidance, consider fiscal policy continuity across year end, better support consumption investment recovery, check excessive price hikes, and stimulate high quality growth of economy."

Real Estate is a core area of concern for both stock and bond markets. Previously the PBOC provided communications calling for banks to satisfy reasonable demands by releasing housing loans, with little improvement in real estate companies' liquidity. The recent debates on developers' loan, acquisition loan and loan extensions have raised market expectations to policy loosening. Previous drops in black commodity, real estate dollar bonds and stocks reflected bearish views on such expectations. Last week's quick rebound was more of an emotional release and adjustment, but not necessarily the pivoting turn in this downward trend yet. The underlying policy loosening is focused on liquidity issues: by opening some financing channel to alleviate real estate developers' capital problem, these developers can buy time to monetize inventory and increase funding source, thus reduce liquidity squeeze, and prevent large scale contagion amongst real estate companies. With more housing loans getting approved, the developers can recoup investment. But the overall real estate environment is still tough with only those with deep pockets like state-owned developers daring to accumulate more land assets. The policy loosening only reduces the slope of the downward trend, not reversing it. We remain cautious on real estate related investments. Until we see clear change in the real estate trends, new capital will likely search for higher-certainty investments. New energy still has favorable outlook, but higher valuations bring higher volatilities. The profit-split may shift towards middle- to down-stream, thus causing the upstream lithium or silicon producers under-perform car parts manufacturers or photovoltaic assemblers.

China's Oct PPI rose to a 26-year record of 13.5% but will likely come off as industrial material costs come down. Oct CPI rose 1.5%, fastest pace since Sep 2020. The soft demand means there's little inflationary pressure. As PPI-CPI gap closes, it may improve marginally profitability for middle- and down-stream companies. Overall, there's still profit pressure given the relatively high PPI levels.

[Expert Drill-down: Real Estate financing policy loosens slightly but unlikely to address the credit issue fully, thus improvement on such investment is limited.]

Recently there has been a lot of market talk about real estate financing policy loosening centered around loans and bonds. From banks' perspective, there's been a quickening of personal loan approvals and developer investments. There's some talk that acquisition loan may be exempt from the "Three-Red-Line" restrictions, but these loans are small in scale, involves long and complex approval process, thus hard to improve short-term liquidity for acquirer. Bond quota recently was released further, with more state-owned enterprises' bonds the more preferred choice for the market. This is unlikely to benefit significantly the high-yield issuers. Overall, the short-term policy improvements are more favorable to the less-leveraged state-owned enterprises. The real estate market remains weak and reduces planned investments. There's unlikely to be large scale increase in leverage in this restrictive regulatory environment. The core problem for credit situation remains the tight regulatory restrictions on down

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payments which severely reduced capital turnover. The restrictions are likely to remain in place and even tighten for those companies with credit problems. The financing policies are also impacting high-leverage companies where invested capital will be harder to recycle. Credit risk is unlikely to improve in the coming 1 or 2 quarterly, especially with upcoming peak in USD bond redemption in 1Q22.

Last week CBIRC maintained its policy to prevent housing bubbles and restrict real estate credit expansion. The recent temporary measures do not mean a shift in policy direction. To maintain healthy development of real estate sector needs to protect consumer rights, ensure timely construction and delivery of housing units. Overall credit restrictive policy will likely remain. From risk prevention perspective, some short-term correction is useful to offset previous severe policy shocks, but the long-term goal to correct high-leveraged real estate operating model must also be kept in mind. The balance is somewhere in between.