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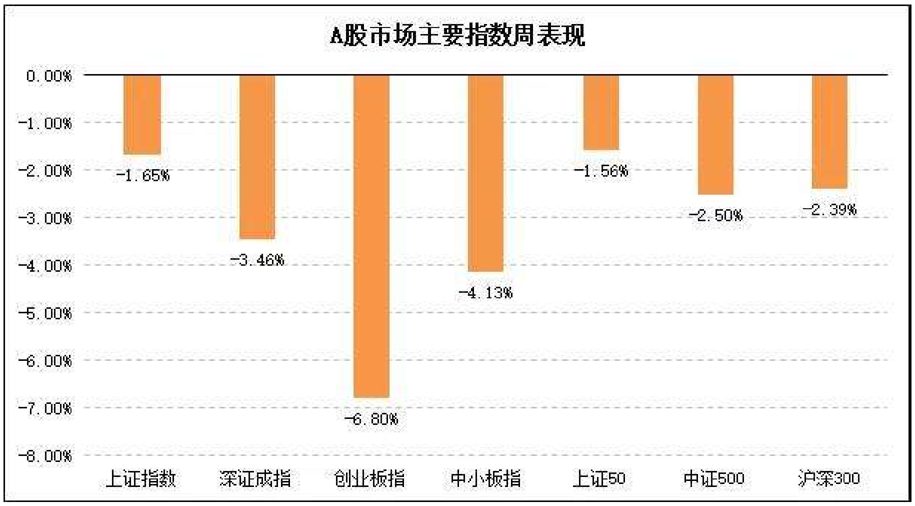
Rosefinch Weekly

Market Correction Driven by Sentiment, Not Fundamentals

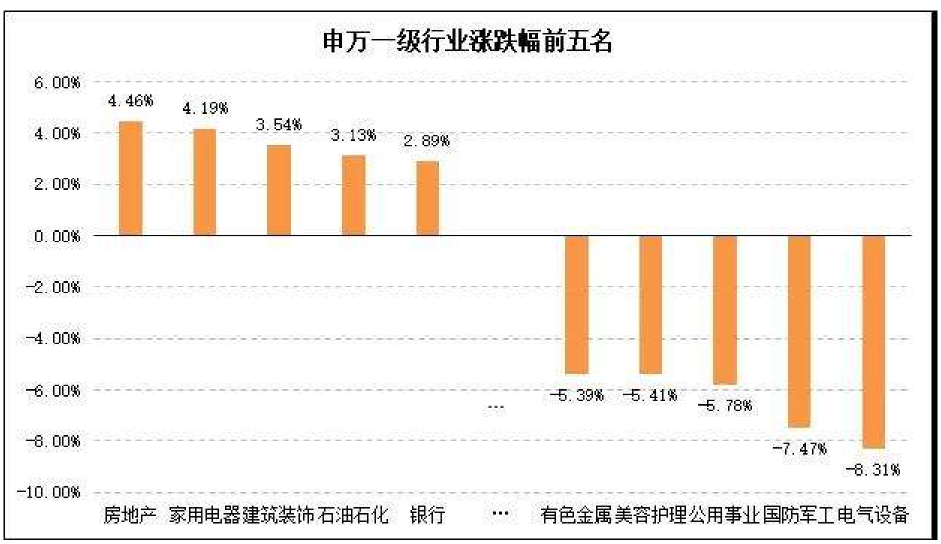
1. Market Review

For the last week: SSE was -1.65%, SZI was -3.46%, GEM was -6.8%, SSE50 was -1.56%, CSI300 was -2.39%, and CSI500 was -2.50%.



Source: Wind, Rosefinch.

Amongst the ShenWan Primary industries, 12 out of 31 rose with real estate, household appliance, construction decoration, oil & chemical, and banking leading the way.



Source: Wind, Rosefinch

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Market volume increased with last week Northbound net +6.2 billion RMB, and Southbound net -4.9 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

The Dec Caixin PMI was 50.9 vs previous 49.9, which was the highest level in 2H21. This shows signs of improvement in manufacturing activities which is in line with official PMI data. The government macro policy meetings kept a restrained tone and held back from large scale stimulus packages. Fiscal policy is expected to frontload some infrastructure developments, while keeping shadow debt situation in check. Real estate policy should allow reasonable living needs, support healthy industry, and cut back on speculation. Recently most major government agencies have focused on implementing the government 2022 guidance, making the stable economy a matter of political determination. To ensure support for economic activities, both traditional and new infrastructure will be well endowed: wind, solar, hydro plants, electricity grid upgrade, social welfare housing, and old neighborhood upgrades will likely benefit.

While US is entering into tightening mode, PBOC has stressed China's monetary independence. The priority will be on domestic economy. The split in monetary policies may lead to some limited RMB depreciation pressure. Government financial papers have warned companies to face potential RMB pressure from 4 areas: shrinking interest rate differential, changing relative economic growth rate, smaller trade surplus, and changing risk expectations. But so long as domestic economy remains stable, the exchange rate will not embark on a depreciating trend.

The first week of 2022 saw a drop in equity market with GEM -6.8% and SSE50 -1.56%. The macro-economic data and government policies did not change, while the market awaits the actual policy implementations in 1Q22. The current policy is similar to that of early 2019, but the market valuation is far higher, which makes it less likely to have a large risk-on rally. There are a number of factors that caused the first week correction: domestically there is a lot of institutional repositioning to switch from high to low valuation names. Last year's high-concentration, high-valuation stocks are moved to defensive, low-valuation stocks like construction or late-cycle real estate names. There's ongoing debate on the relative merits of various industries like photovoltaic companies, which arguably has become relatively expensive. After the market going through corrections on some high-valuation new energy stocks, the high-quality development theme will resume in 2022.

Looking back in 2021, the GEM stocks and US real yields showed clear negative correlation. The rally in US yields will put more pressure on growth stocks into 1H22. But because domestic and US monetary policy have decoupled, PBOC not only won't follow FED to hike, but may in fact loosen further to support stable economy. 1Q monetary liquidity will more than likely increase, so monetary condition won't be a sell-factor on the equity market. Even if we don't consider the favorable credit conditions in 1Q, the higher trading volumes should also show there's sufficient liquidity in the market. **In our view then, the early equity market correction was driven by sentiment, not fundamentals.** From another perspective: recently USD index has rallied but USDRMB exchange rate remained stable around 6.37, which did not reflect expectation of capital outflow after Fed tightening. The core issues are therefore need to adjust the high valuation names, tactical rotations at start of year, which was only amplified by FED tightening concerns. We remain focused on names that are aligned with high-quality developments.

We have recently published a number of articles as part of our 2022 Research series: please see the Market Insight section at http://www.rosefinchfund.com/en/index.html