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Rosefinch Research | 2022 Series # 7

Is Time Still On My Side?

The year 2022 started with sharp selloff in the Chinese equity market. As more popular mutual funds hit new lows, many market participants are very stressed and pessimistic. **Some investors can't help but wonder: is time still on my side?**

Last year, A-share market already experienced a rollercoaster ride. At start of 2021, the consumer sector tanked, and market became more volatile. Investors rotated from consumer into new energy and biopharmaceutical stocks, and saw the market recover into the year end. Alas it was not to last, the biopharmaceutical sector now took the hit as CXO prospects dim. In this environment, it was common to see funds with retracements over 20% last year. Some funds lost the entire YTD gains in one month, while previous flagbearers lick their wounds after the corrections.

Chinese mutual fund investors have long suffered from "buy high sell low", which consistently hurt their account returns. After some experiences, these investors now understood unrealized PnL is just volatility. More of them have started to position from the long side, adding more as the market comes off. But, how do you know you're not catching a falling knife? Even the most experienced fund managers have trouble picking the market bottom. Take Berkshire's Charlie Munger: his first dab at Alibaba is already down -45%. Even though value investors do not focus on market timing, we still need to - as Howard Marks wrote in his book – master the market cycle. Based on the historical data, we can roughly see the market rhythms. First, we need to determine if the current situation is the extreme

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liquidation selloff. If this is a late-bull stage capitulation, then we should beware of getting buried. In our opinion, this time is probably not such an extreme case.

2007 saw the biggest bull market run in A-share history with Shanghai stock index hitting a historical high of 6124. The 2015 bull run took us to high of 5178. With the index around 3500 now, and without the margin exposures of 2015, the market is unlikely to be in the vicious margin liquidation selloff situation. Instead, what we see in 2022 is a typical slow bull market. Compared to 2019 and 2020 rallies, most market indices recovered well after a one-quarter selloff. The current correction's magnitude is very similar to those in 4Q18 and 1Q20. If you look at the historical performance of GEM, it's even clearer. After 2019, the GEM had multiple waves of slow rally followed by quick drop. The current drop is almost identical to that of last year. **Excess rally will bring correction, and excess selloff will bring rebound. Everything, including the market, has its cycles.**

GEM performance since 2019. Source: Wind, Rosefinch.

During the steady growth market, value may lead temporarily. But given the "non-speculation" real estate policy, the future sustainable growth will ultimately come from technology, with growth back in the driving engine for investments. Looking back, in 2018 Chinese equity mutual funds had average max drawdown of -27%. In the last 12 months, we've already had average max drawdown of -23%. In terms of duration, the equity mutual fund index started falling in Jan 2018, basically recovered by Apr 2019, and made new highs in Aug 2019. While the short-term shock from the sell-off can be very intense, the recovery time is actually not too long. The truth may be right in front of us: we may be very near the bottom. **In fact, the most worrisome investor profile is someone who can't participate in the beginning and who can't hold on in the deep correction.**

From long-term perspective, the big rally in 2020 wasn't necessarily a good thing for the investors. With an average 2020 equity mutual fund return of +42%, investors may get the wrong impression that "get rich quickly" is easy to do with equity investments. In fact, this is not the norm – it's more like a once-adecade move. In 2021, the average equity mutual fund had a more mundane +8% return, with some thematic funds suffering sizeable corrections as they retrace from the frothy returns of 2020.

Accepting changes and uncertainties and breaking linear thinking are signs of a maturing investor. Being mature doesn't mean being expert. The role of investment products is not to make everyone an investment manager, but to minimize investors' time and effort in growing their assets, so they can spend more time and effort in developing their work and enjoying their lives. **Without well-ingrained discipline and comprehensive investment framework, it's hard to survive the challenging and stressful episodes based on our self-control.** But it's precisely these challenging moments near the market's bottom that determine the bulk of the long-term investment return. Whether we're professional investment manager or average retail investor, we need to build up our investment framework. The investment manager's strategy can be top-down, bottom-up, thematic, balanced, blue chip, small or mid-cap. For the retail investor, you don't need to drill down to the building blocks of each invested asset, but you do need to know your own risk profile, tolerance level, investment time frame, equity/bond ratio, top-up strategy, stop-loss level, etc. By creating these components of investment framework, it'll help you to make decisions when you're emotionally compromised. It's basically impossible to make sound investment decisions when we're overwhelmed with our emotions – we can be euphoric when market is shooting through the roof, and too depressed when market is dropping through the bottom. One recent investment approach we've highlighted in previous articles is *recurrent fixed investing*: where you invest the same amount multiple times over time at fixed intervals. This approach minimizes emotional tugs that market fluctuations have on you.

Investment is a continuous learning journey. Even though delegating investment decisions to professional investment manager can give yourself the most freedom, you still need to arm yourself with the market basics as well as building the investment framework. The good thing is, once the framework is established, you will feel even more secure and liberated. Mean reversion is one of the oldest axioms of investment. As Rolling Stones once sang: "Time is on my side… yes it is!" But the pre-condition is that you have to hold on until it does revert. **Whether it's through systematic investment framework or sheer will power, we have to hold on until then – the world will belong to those who can.**