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Racing Against Time

The new engines for economic development: 3060 and Digital Economy

The recently released manufacturing, construction, service, and aggregate Feb PMI data all increased mom and higher than the 50 thresholds. While the data may have based in Feb, but the March Covid outbreaks may cause some drag on domestic growth. The Ukraine situation and FED actions also add to the uncertainties. **We expect Chinese government policy to actively support the economy in 1H, with 1Q and 2Q becoming the biggest growth point in the whole year.** If the 5.5% growth target can be reached in the 1H22, then the policymaker may take the foot off the gas but keep a watchful eye. The economy may rally in 1H and then slow in the 2H as government focuses on steady growth rather than large stimulus.

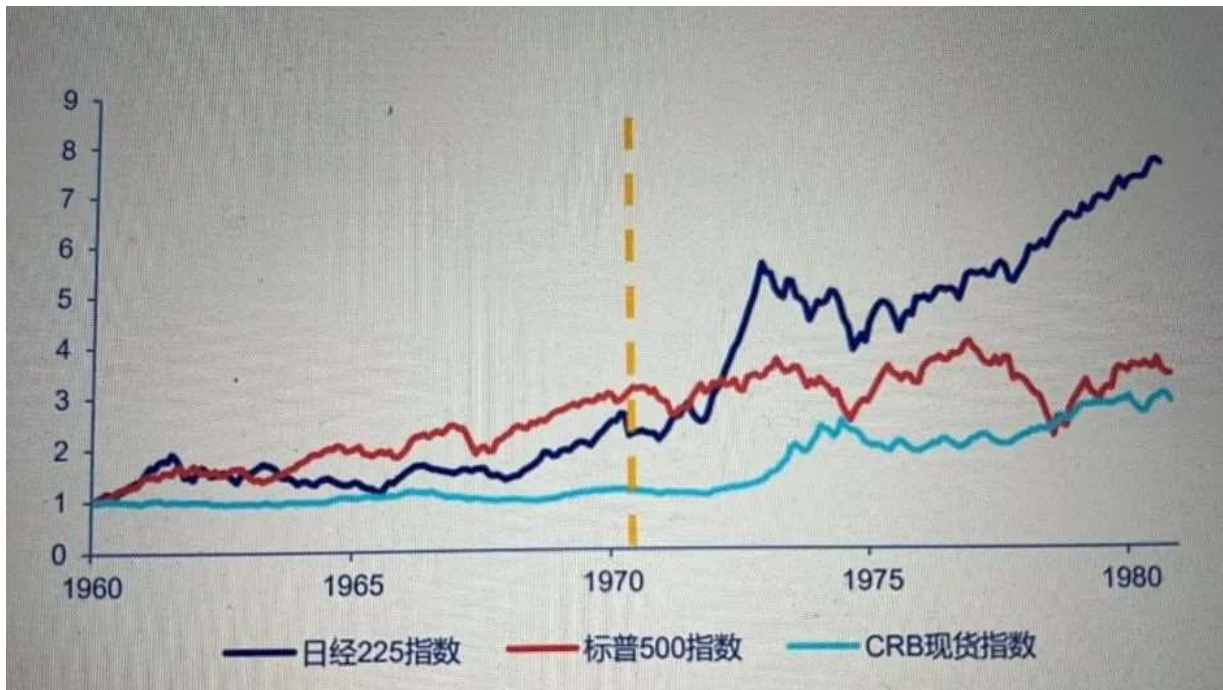
In 2020, China GDP was 14.7 trillion USD; in 2021, China GDP was 17.7 trillion USD. This 3 trillion USD GDP increase in one year was the highest China ever seen. This impressive data also indicates that Chinese economy is at a new growth phase. **China needs to maintain certain amount of growth, while simultaneously target higher quality growth. This higher growth can be achieved through basically stable macro economy, dynamic micro economy, and continued upgrade of economic structure.** While the macro policies can stabilize short-term economy, it's the structural potential that truly unleashes future growth. In the last 30 years, China's structural potential had been in its real estate market, infrastructural investment, and exports. Now the potential is from urbanization, digitalization, and the new Green economy. The new engines for the economic development will therefore be in the 3060 and the digital economy.

On the digital economy, China has its unique advantages: it has a huge market with massive amount of data, and the digital infrastructure is built rapidly across the nation. Digital technology can improve service efficiency across the board, and at the same time it can enable existing agricultural and manufacturing sectors to increase productivity. Digitized services can naturally serve both domestic and global market and leverage resources across borders. In the government released white paper “Digital Economy Development Plan in the 14th 5-year plan”, China’s digitalized industry will increase from 7.8% of total GDP in 2020 to 10%. This means the annual increase of digital activity will be more than double than that of the overall economy. If we assume the digitalization of existing industries will also grow at similar rates, then the combined digital industry and the digitalization of existing industries will account for over 50% of total GDP by 2025, contribute over 1/3 of economic growth, thus become the heavy lifter for both total GDP and GDP growth.

On the 3060, which refers to China’s 2030 target for Carbon-Peak and 2060 target for Carbon-Neutrality, we see many global entities moving towards green energy. The current Ukraine crisis added a sense of urgency to Europe: EU proposed in March the REPowerEU plan which will reduce Europe’s reliance on Russian fossil fuel by 2030. EU also called for joint purchases of natural gas, LNG, and Hydrogen across EU members. EU commission also passed the CBAM Carbon Border Adjustment Mechanism that puts tax on imports’ carbon footprint. Germany plans to accelerate usage of renewable energy, with the goal of 100% clean energy by 2035. US’s Solar Energy Industries Association also called for strategic developments of domestic photovoltaic manufacturing. China also highlighted the importance of hydrogen energy in building the clean, safe, and low-carbon eco-system. The building of the new energy eco-system revolves around electric grids. **During the 14th 5-year plan, China will focus on building intelligent electric grid eco-system which requires advanced telecommunication, data, and control technology.** This new infrastructure built with high-voltage network will bring new demands for a range of areas such as electric equipment, new energy, electronics, computers, electric vehicles, etc.

Both the new energy revolution and the digital industry rely on the guidance and push of industry leaders. Compared to internet industry, these new activities are still in the major growth phase. As an example, the new car industry has evolved across both new energy and intelligent car areas. With over 300 million registered cars in China, how the market will grow and optimize present an exciting opportunity. **The only way to deal with the massive uncertainty around the once-a-century global transformation is to focus on our own certainty of continued learning and growth. We are all racing against time!**

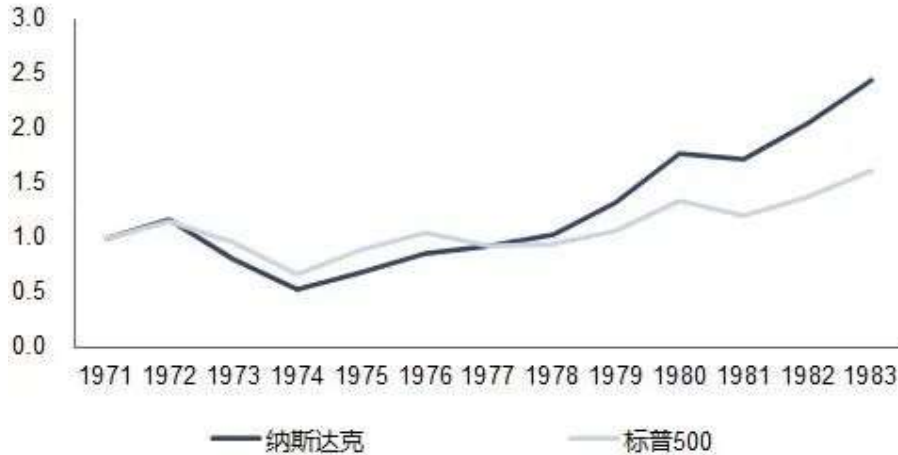
Historically during stagflation scenarios, the key is not how long it lasted, but how the government policies allowed the upgrade of economic structure. These different policies will lead to different economic outcome and stock market performances. For example, German suffered from imported inflation during the 1970s stagflation period. But it used its manufacturing niche to expand its export share which in turn provided strong support to German economy and its stock market. Japan experienced its own “Japanese miracle” from Oct 1965 to June 1970 when it took over Germany as the 2nd largest economy in the world. Similar to the later episode of China joining WTO in 2003, Japan took over manufacturing activities from Europe and US. Its market-share rapidly grew as home appliances and cars become widely consumed globally. With household names like Sony and Matsushita, Japanese stock market also clearly outperformed US stock market.



Source: Wind, Rosefinch. Blue is Nikkei; red is SP500; turquoise is CRB.

Aside from energy and consumer staples that benefit from higher inflation, the industry with higher value-add can more easily reduce the stagflation pressure through its high profit margin. During the information revolution, the US government under Reagan and later Clinton deployed policies that promoted semiconductor and computer technologies which turned into higher productivity for the economy. Some representative companies like Intel, Apple, AMD all performed well along with the NASDAQ:

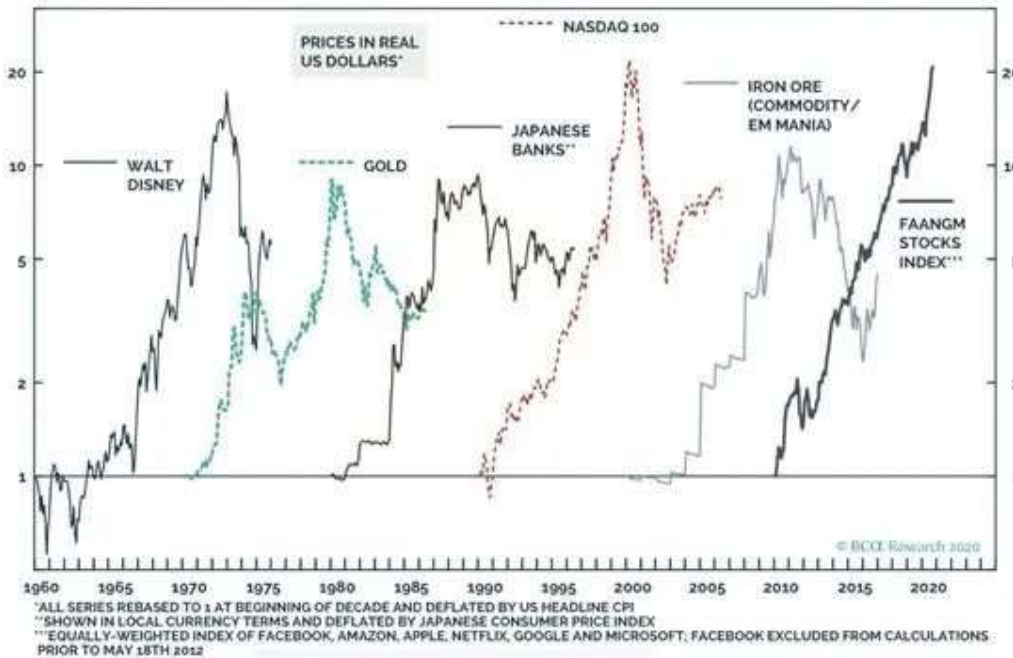
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Source: Wind, Rosefinch. Dark line is NASDAQ, grey line is SP500.

During the 1973-1982 stagflation period, Intel’s income rose from \$66 million in 1973 to \$900 million in 1982. Its Research & Development budget also grew from \$5 million to \$131 million by 1982, taking at least 10% of income to maintain its technological lead. This long-term strategic thinking led Intel to a 869% over the 1975-1982 period. In fact, we see other outstanding companies that successfully generate alpha for each of the ensuing decades, which created significant buffer against the external uncertainties.

History Of Manias Of Past Decades



China's Vice Premier LIU He stated that achieving high-quality development will come from accelerate building of new growth framework, deepen supply-side reform, resolutely uphold market reform principles. He added in statement last week that "any policy with potential impact on financial market must coordinate with financial regulators to maintain steady policy expectations and consistency." In a way, high quality development is what drives the capital markets, and A-shares have become a reflection and a driver for high quality development. To offset the potential stagflation risk, we must capture the opportunity of our times. Our best opportunities now are with the 3060 and its affiliated industry leaders who can become global champions in their respective areas. **As we position for long-term investments with these extraordinary companies, taking a disciplined approach will effectively help us to reduce the cost of entry and provide more upside for future value-realization. Rosefinch will take the macro environment in stride, stay mindful of medium-term trends, and actively pursue opportunities within our core capabilities.**

Buffett recently remarked that even if the current Ukraine situation escalate into another Cold War or even WWII, he will not liquidate his portfolio because you got to put your money somewhere. Another legendary investor Bill Miller of Legg Mason Capital Management once said: "Time, not timing, is key to building wealth in the stock market." **At Rosefinch, we focus on our core capabilities to evaluate companies. We remain vigilant about being over-confidence and demand cautious & reasonable valuations. By continuously improving our research models on industry chains, we hope to add value to our investors.**

You can find more information on Rosefinch website at
<http://www.rosefinchfund.com/en/index.html>

For investor related questions, please email to ir@rosefinch.cn

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