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# The Invisible Hand

## Combining Efficient Market with Determined Government

Due to increasing rates, inflation pressure, and weak tech earnings, NASDAQ had its largest monthly fall in April since Oct 2008 and S&P fell the most since start of the pandemic. The most widely followed Bloomberg bond index was -5.48% in April which was the lowest monthly return since the index's launch in Jan 1990. The index's YTD return is -11.3%. As of May 12th, the global equity market capitalization has dropped from 121 trillion USD to 99 trillion USD, while commodity prices continue to rally: wheat was up 53%, corn 32%, and ICE Brent +43%. The market is pricing in risk of economic recession as US stock market's focus shifts from FED to the real economy.

There was a temporary slowdown in Mar to May 2020, which was paved over by unprecedented monetary and fiscal stimulus as well as positive wealth effects from higher stock market prices. The current situation is the opposite: monetary tightening has begun, fiscal stimulus has run its course, and consumers are facing higher inflation and negative wealth effect from falling assets prices. For YTD, the USD index has rallied 7.4%. The ongoing geopolitical pressures have interrupted global logistic and supply chains. US economy is also affected by the ongoing trade tariffs which will contribute to high inflation rates. With this background, US yield curve and USD still have more room to rise, while US stocks are still in the 1st half of a bear market.

In China, 2021 saw three main pressures from demand contraction, supply shock, and weaker expectations. Add on top the Feb Ukraine conflict, tightening global liquidity, and Shanghai pandemic situation, it's indeed a challenging environment. Despite the turn in US stock market, A-shares have started its independent rebound since end of April. ChiNext has rallied 12% from it's 40%-drop off July 2021 highs. The trading volumes though still remain light, indicating some remain in wait-and-see mode.

From historical perspective over the last few centuries, every major economic crisis will bring changes in government vs market dynamic. In the great depression in 1930's, Keynesian macro economical theory replaced Adam Smith's micro-economics. After the stagflation of the 1970s, new classical economic theory

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came back in vogue with financial regulation, separation of business lines, and tightening rich-poo disparity becoming the main theme. Fiscal expansion became the favorite tool to stabilize economy. Of course, it's only when theory is put to practice that we can see the truth. In the information age today, complexity and change have exceeded mankind's historical experiences. While planned economy approach have failed, market economy must also respect the "trial by fire" approach. Policy-making and government-vs-market communication requires more effort and more capability.

Back in late April, we saw China's politburo meetings highlighting the need to hold pandemic in check, stabilize the economy, protect development, support steady real estate market, and encourage platform economy. **The goal is to achieve high quality growth, with the principle of encouraging the better collaboration between the efficient market and the determined government. The visible hand of the government must maintain stable framework, while the invisible hand of the market continues to improve the efficiency. Only then can we see a return of the dynamic and lively economy.**

In the geopolitically complex external environment, China is adapting a neutral and balanced approach with a practical separation between military and economic factors. The important diplomatic priority is still creating a peaceful environment for China's economic development. The globalization path is a natural path supported by scientific advancement and mankind's progressive development. While it may slow or even temporarily reverse due to some negative impacts, ultimately the benefits and the added value will influence most nations to make the rational decisions.

When uncertainty becomes normal state of affairs, what remains key is stability. We can achieve this by ensuring we can survive the long-term worst-case scenario. At Rosefinch, we have very strong fundamentals. In our three-year strategic plan, we put the organizational development as a priority. We are attracting key talents during the market volatility to strengthen our key business and management areas. In addition to pursuing more stable and certain investor base, we are also looking at how to match investor needs with our products. As uncertainty increases, we must consider not only profitability, but also risk-mitigation in extreme scenarios such as high inflation.

What remains strong is the group of superior companies that focus on 3060. On one hand, 3060 is the major engine for high-quality growth that delivers energy security and global cooperation. It's therefore worth us continuing our deep and sustained research. On the other hand, we'll follow Buffett's mantra to always buy good companies. We want to be what BG does, to deploy the best investment strategy to identify the few winners that can be true market leaders. We will track excellent companies that have key opportunities, and be vigilant on negative news. Our approach must remain cautious, even if we may miss out on some investments. We form industry-research teams and expect each analyst to become true experts of their respective industry chains. **By having these analysts cross-examine target company's position within the industry chain, we gain a more comprehensive picture on the investment and a more effective analyst team.**

## Our Weapon is Wisdom, Our Armor is Caution, and Our Source of Courage is Our Belief

The market bottom usually appears when people forget waves may rise too. We saw A-share bottoming on April 26th after low-valuation and policy-support improved the risk sentiments. In the next few months, as valuation re-rates various sectors and companies will differentiate further according to their fundamentals. Market is more likely to see more volatile trading than the "V" shape rebound in 2020. We need to monitor pandemic development, economic recovery, and political events in the fall. At the same time, there's the potential impact from US stock correction. But because A-share is under different monetary and valuation cycles, such global market impacts will prove temporary and not cause full-blown bear market.

For the moment, Shanghai stock index has returned to 3000 level last seen in 2008. The ChiNext index is off 1/3 from its high, but is still +100% from its 2019 low and +300% from its 2012 levels. **This indicates that high-quality growth is still the correct direction for future development, which will create the foundations for a favorable gradual bull market.**

In the next few years, A-share will see increases in both supply and demand. On the supply side, new listings will increase after the registration-based IPO system. At the same time, clear delisting policy will channel the market capital towards high-quality companies. On the demand side, domestic residents' asset allocation for stocks is only around 10%, so there's room for increased investment. As for the foreign investors with only 3% of A-share market, there's room for investor to increase exposure to the large China market. The most valuable long-term assets will still be the long-term cashflow generating shares. Whether it's a person or an organization, their growth often positively correlates with their ability to withstand risks and pressure. This growth can come from an accumulation of relevant experiences over time, or from strengthening through particular stressful episodes. **After all, carbon only form diamonds when it's under the intense heat and pressure deep in the earth's core. Each and every large market correction is a great opportunity for us to reflect and grow. Our weapon is wisdom, our armor is caution, and our source of courage is our belief.**