

Rosefinch Research | 2022 Series # 15

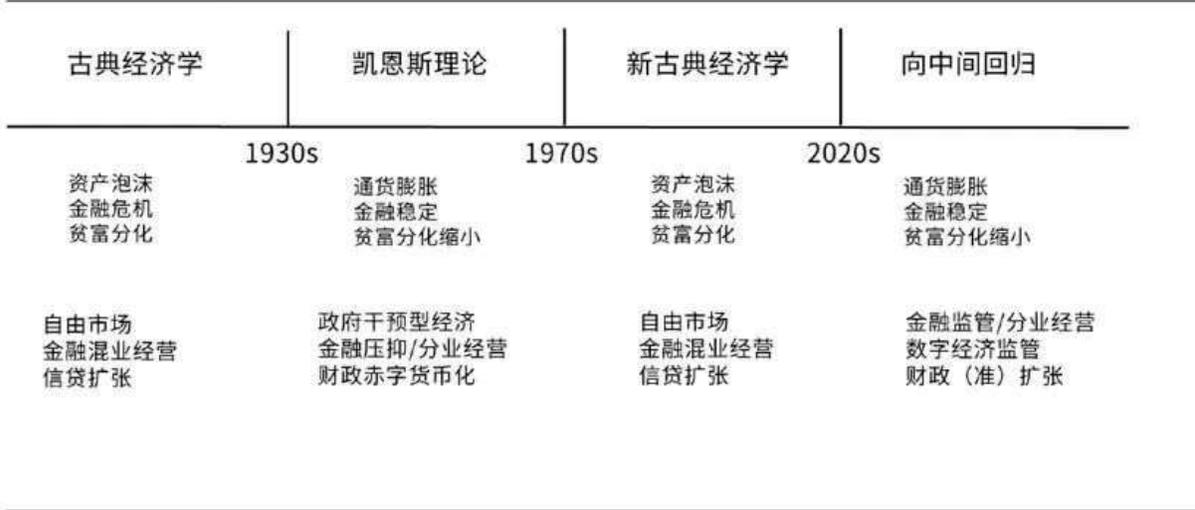
Pessimists may be Correct; But Optimists Tend to be Successful



Recently in the investment circles, macro views are being heavily studied. Equity investments traditionally done via fundamental bottom-up analysis, whereas the top-down equity strategies are more in the arena of macro hedge funds. The macro views are more for the general trends, the relative valuations and investor sentiments of entire markets or sectors, or for specific asset allocation and exposure levels. In most organizations, it's very hard to quantify the impact of macro views on investment, even during bull markets. But in bear markets, macro views on capital allocation and exposure levels can make a meaningful contribution. This in some ways is similar to the historical development of economic theories.

Since the great depression, the classical economic theories became ineffective, and John Keynes' "The General Theory of Employment, Interest and Money" in 1936 transformed the landscape and became the source of mainstream macroeconomic thoughts. In 1970s, US fell into stagflation, which signaled the end of the Keynesian economics that ruled for the previous 40 years. Some academics even pinned the cause of stagflation on Keynesian economics itself: the fiscal deficits grew continuously under Keynesian economics, forcing monetary policy to remain loose, causing high inflation environment. The market called for more liberalism, and the new classic economic theory became main-stream. 50 years later, the economic theory is reverting the middle group, with financial regulation and separating business lines taking main stage, and government stabilizing economy using fiscal expansion.

图表17: 大周期轮回



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In the last few centuries, it was a tug of war between the free-market classical economics and the government interventionist Keynesian economics when market becomes dislocated. This dynamic reflected the evolution of the main conflicts in economies and societies. Economic theory isn't always correct: it may solve the problem the society faces at that time, but not necessarily all problems that follow. Asset management products are similar: there's no product that's most correct, just most suitable for the investor. Economic theories will evolve with the world, just as the relationship between the government and market is changing constantly. This government vs market relationship is neither bipolar, nor fixed, but rather a pendulum that swings back and forth. History is full of such cycles: the individual circadian rhythm, the market volatility, the economic cycles, the handover of world powers, everything go through cycles like the pendulums.

Market's internal dynamics are changing all the time. The WWII caused the breakup of Europe, but afterwards, European nations called for union to encourage national trades and circulations. China is trying to build the similar framework of a nation-wide marketplace. Even though there's only one China, there are inevitably smaller eco-systems isolated within each province or city. In the last few decades, the major enterprises or platforms are competing against each other across the regional lines. **By creating one nation-wide marketplace, removing administrative barriers, stopping unjust competition among major platforms, the nation-wide marketplace can create a freely mobile market for commodity and other key elements. It can stimulate economic vitality during recessionary periods, and increase enterprises' healthy competition.** From this perspective, a nation-wide marketplace is good news! Of course there's two sides to every coin. The most important issue with investment is to logically analyze the evolution of key issues or items, and search for undiscovered opportunities in the murky reality. When everything becomes clear, the opportunity will have gone. Overgeneralizations or blind criticisms may lead to disastrous results for investment. This is why Charles

Munger keep stressing: “avoid extremely intense ideology, because it cabbages up one’s mind.” Once we see history repeats itself, we can extract ourselves from the pessimistic emotions, and realize that this time is no different. Cyclical turning points give you overtaking opportunities. **Danger and opportunities go hand in hand during a crisis. If we believe we’re in the middle of a severe crisis, then don’t waste it!** These opportunities are rare indeed.

Adam Smith’s microeconomics and Keynesian macroeconomics are just like the bottom-up and top-down investment philosophies: there’s no absolute right or wrong, we can only see which one suits better through specific examples and situations. Keynes once said: “Practical men who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.” Macroeconomic situation may be depressing, but if you see the big picture and the long cycle, then you can understand history will repeat itself. **No matter how macroeconomics evolve, economics will ultimately come down to the productions of enterprises. This is exactly the key point of investment: find the truly competitive enterprises that can surf the waves of our times.**

You can only see who’s swimming naked when the wave recedes. The crisis doesn’t bring destruction to the enterprises, but differentiation. Even though good company may suffer valuation declines, their strong fundamentals will allow them to come out the crisis. Think about the story of Apple’s iPhone: it first started in June 2007. Between Jan and Oct in 2008, Apple’s stock price halved. And since then, it has grown by more than 166 times. **Economic recession or financial crisis may create short-term shockwave to companies’ stock prices, but it won’t destroy a company’s true value.**

In 2018, the trade war and rumor of phasing out of private-owned enterprises caused very pessimistic market sentiments in China. Many excellent companies’ valuations hit rock bottom. Then starting in 2019, China’s photovoltaic sector came out flying, with key segment leaders achieving 5 times stock growth in the next 3 years. It’s precisely truly valuable companies like these that create the investor returns. Arizona State University’s professor Hendrik Bessembinder’s research noted that most of the stock market’s returns in the last few decades came from a small handful of companies. The legendary fund manager Anderson from Baillie Gifford tries not to worry about short-term market moves or to second-guess geopolitics because this detracts from making good long-term investment decisions. “I’m probably more skeptical of my ability to make good judgments on that type of thing than I am on which companies and founders to back.” Anderson ignored naysayers and concentrated bets in early stages of some great companies, and stayed with them for many years before they became profitable. Buffett also said: owning some equity shares of a great company is better than owning 100% of an average company.

All the known risks can be priced into the security, so the biggest risk in investment is the unforeseen risk. Market has recognized the risks from Ukraine conflict and pandemics, thus with all the risk priced in, we’re now at reasonable valuation levels. In fact, we see many China fund management companies investing in their own products. As of May 10th, there were 67 fund management companies that bought their own products, with number of purchases over 130 times, and total amount of over 2 billion RMB. At Rosefinch, we are also putting money where we believe the value is. At beginning of year, we bought

30 million RMB of our equity fund products. **As of May 5th, Rosefinch related entities and staff own a combined 520 million RMB of Rosefinch-managed products, with over 50 million RMB from personal investments of senior managers, portfolio managers or fund managers.** Our confidence is built upon our capabilities, and our capabilities must be built before the AUM growth. Rosefinch today has stronger capabilities, more comprehensive strengths, more perfected partnership culture, more focused investment thesis, more trusting investor relationships, and more confidence that we're moving in the right direction.

Looking ahead, we will stay true on the 3060 theme with focus on two main areas: global leaders that supports human kind's upgrade, and industry leaders of China's nation-wide marketplace. It is said that it's darkest before dawn, and therefore very few people can hold on. Those who ran away quickly may not lose too much, but those who stayed with it will be more likely to win. **Keynes once said that our animal spirit came more from our spontaneous optimism than mathematical expectations. For investment industry, optimism may be a crucial and necessary quality. Pessimists may be correct, but optimists tend to be successful.**

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