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Rosefinch Research | 2022 Series # 16

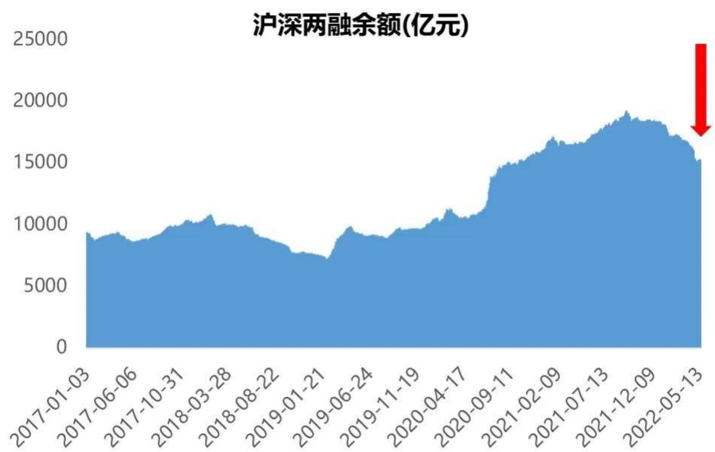
Onto the Next Station for the Market Cycle

Since the start of the year, the most frequently asked question is: has the market bottomed yet? The fund managers, sell side analysts, and finance-bloggers have provided an exhaustive list of "bottomed out" indicators: new social financing increases, historically low valuation levels, improvements in external liquidity measures, low market turnovers, "K" vs "W" recovery lines… We'll take a look at some of these measures in this piece.

Market valuation has indeed reached fairly low levels. As of May 15th, 2022, the Wind-A index (excluding financial and petrochemical) valuation level is now at 25, or the 16th percentile over the last 5 years. ChiNext and CSI300 have valuations of 47 and 12 times, which are at last five years' 37% and 23% levels.

Daily volume had reduced from above 1 trillion RMB average to 600 billion RMB, with corresponding low turnover rate. At the same time, external liquidity condition is improving as 10 year UST rate comes off the early May highs.

The social financing residual had peaked on Sep 10th, 2021, then steadily come off to the bottom on April 29th, 2022, and recovering after the May holiday week. The market normally turn before the data, reflecting the change in future expectations. As of April 26th, Wind-A, ChiNext, CSI300 have all hit recent lows, and subsequently rallied the next day.



Source: Wind, Rosefinch.

The question is: was April 26th THE market bottom?

We can only call the bottom thru rearview panels – when it's happening, hardly anyone notices. Back on Jun 6th, 2005, barely two weeks after the historical low of 998 on Shanghai stock index, the headlines on the Securities News were still "unchanged weak market" and "battle between bulls and bears". There was one small entry by the margin that said: "buy when market falls". This round may be the same: market will realize we just had the bottom only after valuation and leverage returns.

Some indirect signals may also reflect the change in market sentiments. FTSE China Bear 3X ETF is referenced on the top 50 market-cap China stocks on the HK Exchange, which can serve as an indicator

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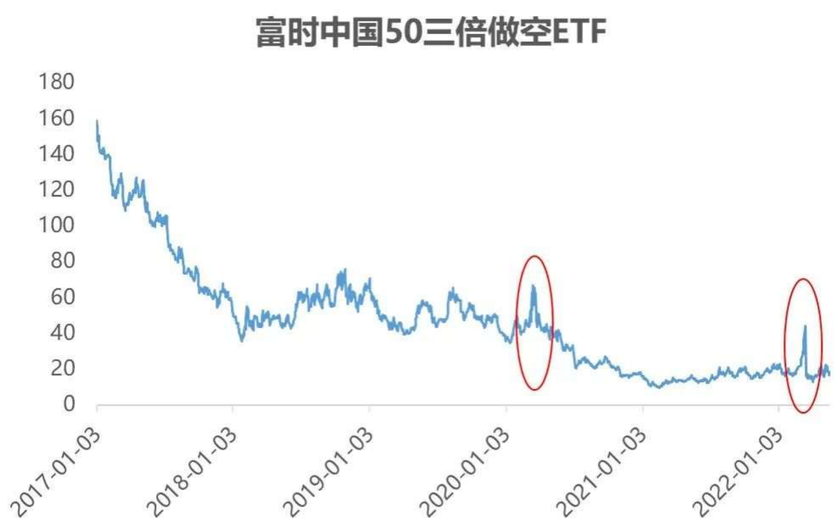
of foreign investors' confidence in China market. Between Feb 18th and Mar 22nd, the ETF experienced quick pulsive price action, rallying by 150% before calming down just like it did in 2020. Back in 2018, the same ETF spent the whole year at high levels, when the investor sentiments were quite pessimistic.



Many market commentators compare today's market with that of 2018, yet from the ETF's price action, current market is less like the persistent pessimism in 2018, and more like the pulsive move in 2020. Investors didn't lose the motivation, but rather just waiting for the best entry point.

It's just like shopping for fish at the wet market: there's always a buyer whether the fish is dead or alive. The clever buyer will wait for the moment the fish dies to capture the "dead" price while retaining as much as possible the "alive" quality. The difference between investing in stock and buying fish is that you don't have the same visibility in investing as you do in fish buying. You have to rely on price comparison and market behavior to determine whether the market has come around. Once the majority believes the bottom has been reached, capital flow will swarm in, and price will rally quickly.

The market's weak price action and pandemic-induced supply chain disruption can easily overwhelm the dim ray of sunlight in the early dawn. China's April retail sales was -11.1% YoY, but at the same time, the Jan-Apr online retail sales rose +5.2% YoY. In Rosefinch's Shanghai headquarters, we noticed that during the month with severe supply interruptions, Community-Group-Buying had explosive growth and accounted for lots of necessity consumption. Many neighbors are chatting about what to do after the pandemic: places to go, friends to see, things to buy. People are looking forward to online sales, travel plans, car purchases. Consumption is just like investment needs: after suppression will the rebound. Even if we can't have 8 meals a day, we can have 3 meals, 3 snacks and 2 fruit breaks! **People will always pursue a better life, and this desire is waiting to be released.** Economic data may be backward looking, but you can't miss the real demand. As our colleagues walk around our neighborhoods, we can feel the waiting demands ready to be unleashed.

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Market doesn't take long to go from dreary bottom to hot rallies, but when it turns, most investors will still be stuck in the pessimism of the previous fall. It's often hard to capture the turning point, so the best way is perhaps to adapt a positive mindset, so you can search for the opportunities.

After the darkness of 2015, the core assets rallied; after the despair of 2018, the new energy sector arrived. Whenever the A-share market became the most pessimistic, that's when the new driving forces will emerge. **"Where the next industrial opportunities are" is a more important question than "where the bottom is?"** Market dynamics change on a dime. You can't talk about investing without having experienced the up-and-downs and especially the darkest moments. From euphoria to unease, from unease to fear, from fear to panic or despair, then the slow rebirth of hope and optimism, such is the market cycle that goes through each station, one by one. In our long journey across cycles, reason and patience are both indispensable.