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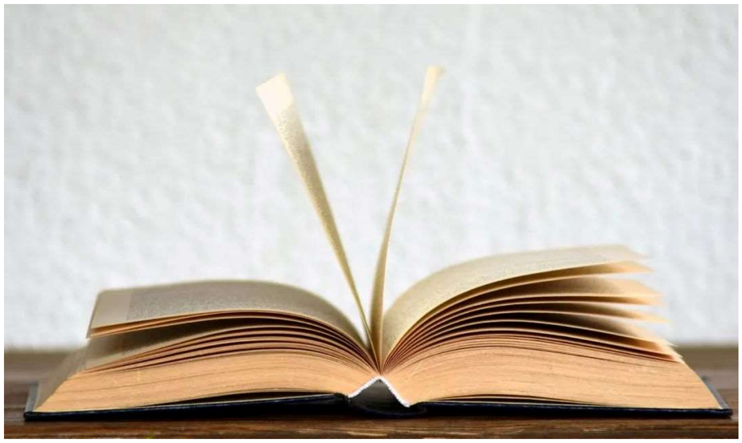
Carbon-neutral Goal to Break Stagflation Risk



Our CIO Mr. Liang Yuejun shared his thoughts on the market in the latest quarterly updates on one of Mutual Fund product. Since end of April, as pandemic policies evolved and Steady-Growth policies enforced, the A-share market recovered to be a stand-alone outperformer even while the global equity markets dropped. Mr. Liang looked at the underlying logic of the market dynamics, and shared his view of how to identify high-certainty opportunities in an uncertain market. Below are Mr. Liang's comments:

"Market performance in 2Q22 was a strong rebound after a weak start. In early 2Q, the major A-share indices fell quickly on back of pandemic impacts until the end of April. There was a round of clear upswing in May-June period, which is mainly a retracement from earlier drops on back of Ukraine conflict and domestic pandemic. Once the recovery runs its course, we expect the market to consolidate and return to the previous trend. In our view, the longer-term market has not changed. **We expect A-shares to be in a slow-bull market, with the macro-economic backdrop of Chinese economy shifting from high-growth into high-quality phase. This high-quality development will create structural opportunities that supports a slow-bull market.**

The Russia-Ukraine conflict and the domestic pandemic caused relatively large shocks to the supply chain, especially to the manufacturing sectors like the new energy companies. This pushed down the market in Mar-Apr period. Once the pandemic situation gets under control, we can see that the sector with the best growth certainty is still the new energy sector. The new energy sector companies may suffer from some pandemic-induced delayed payments, but the underlying strong demand landscape has not changed. Their shares therefore recovered very quickly from the sell-off.

In addition, the so-called "sector-rotation" investment theme may become less applicable now in the current economic environment. For those investors who experienced the post-2008 financial crisis and 2014-15 rally will be familiar with the A-share market's "sector-rotation" theme: as the economic cycle turns, investments start to chase upstream resource stocks, then moves to midstream companies, before jump into downstream consumer products. This sequence of sector-rotation was very well recognized, but it has a pre-condition which is the Chinese economy was undergoing fast-growth stages with real estate being the main engine. When Chinese economy exited the previous cyclical lows via significant real estate investments, it made sense that the companies that followed the real estate cycle will perform accordingly. But right now, we notice the economy is not as responsive to real estate cycle as before. Even with the implementation of supportive government policies, the real estate sector has been lackluster. This weakening of macro-demand therefore does not support a repeat of the sector-rotation thesis. The key for investment opportunities will therefore be outside of the typical real estate cycled companies.

We believe Carbon-neutrality-themed companies will be the driver for China to break free of the global stagflation situation. China's new energy transformation will significantly reduce China's reliance on traditional carbon-complex, alleviate inflationary pressure, and create new engine of high-quality growth for China. The new base of growth for Chinese manufacturing sector will come from China's early-mover advantage on advanced manufacturing activities linked to the new energy industry chain. The 3060 policies made clear the priority to create new energy capacities first and then replace the traditional carbon capacity. Such progressive policies will support domestic demand and provide fertile grounds for technological innovation, which in turn allow China's new energy technology and capacity to take leadership position in the global new energy supply chain. China's 3060-related technologies are reasonably advanced, with photovoltaic and wind technologies already achieving competitive per-unit generation cost vs the traditional energy complex. In the automobile sector, the new energy cars have already achieved over 25% market share, with the industry entering into high growth phase.

China's energy reserves have a profile of "rich in coal, poor in oil, and lack in gas". This profile makes China vulnerable to import inflation risk when global oil or gas prices rally significantly. China can improve national energy security by deploying low-carbon transformation. And if this can be done early on, it will allow the economy to grow more freely from the carbon-emission constraints.

Carbon-neutral theme has a number of interesting characteristics: it's investable, because it has steady growth outlook; it's growth, because there's new demand which will drive up PE ratio; it's technological innovation, because the sector is led by Chinese technology; it's also global, because Chinese supply chain can serve global demands. From energy evolution to consumption evolution to manufacturing sector transformation, Carbon-neutral theme will accelerate the evolution of the entire financial system. High-quality development, as represented by the new energy sectors, will be a central pillar of the future economic developments in China. Structurally, we will continue pursue 3060-themed high quality development opportunities**. 3060-themes will provide certain demand growth both in the short and the long terms. Achieving Carbon-peak and Carbon-neutral targets will be the driver for China to break through stagflation.** We will be fully engaged in uncovering the investment opportunities along the way."

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