

## Rosefinch Research | 2022 Series # 31

### What to Say as the Market Falls



Market recently has entered into another period of unease. FED hiked 75 bps for the 3<sup>rd</sup> time in a row; 10Y UST yields reached above 4% for first time since 2008; Nord Stream 1 & 2 suffered significant breaches. US markets saw both stock and bond markets tanking. Chinese assets saw further selloff as well, with CNH weakening 800 pips to beyond 7.26 vs the USD, and A-shares saw over 4400 stocks losing on the day. Even the traditional safe asset gold fell to a new two-year low.

**When everything is selling off, market expectations are sliding towards extreme pessimism.** There have been so many market selloffs this year that people are numb to the fund manager commentaries. Some mutual fund investors jokingly said: we don't need to treasure market corrections, because there are so many corrections... practically every other day!

So what do we say as the market falls?

The writer Haruki Murakami wrote a book titled "What I Talk About When I Talk About Running." In it, he said: whenever I run a marathon, I mostly go through the same experience. At about 30 km mark, I always feel that 'maybe this one will be a great time!' And then after 35km when my body's stored energy is depleted, I start to get angry at everything and anything. Then at the end, it's like cruising in a car with an empty gas tank. Yet despite the up and downs, every time shortly after the event, I'll tell myself "Let's do better next time!" This repeats time after time, the same thing happens year after year.

When the market falls, the same thing happens. As we look at the sharp rise in the mutual fund valuation, we feel that this time, finally, we're going to make some money. Once the selloff starts, we've already shot our bullets, so anger naturally rises, and we shout at all the fund managers. As it hits the bottom, we feel the same helplessness, holding onto the steering wheel with whitened knuckles, not sure if we can hold on till the end. Then after the rebound, all sufferings are forgotten. In fact, we're more determined than ever to time the market perfectly next time!

Joking aside, these are indeed some of the rollercoaster rides that mutual fund investors experience. As we parse through the many online comments, we noticed an underlying pattern: mutual fund investors wish fund managers can provide timely guidance through limiting or opening new purchases. Many retail investors know that they can't out-invest professional institutions. And if you can't fight them, join them. They'd buy mutual funds to invest in the market, yet they stay in the same "buy high, sell low" trap. Presently, the most pressing issue is for the fund manager to help break mutual fund investors out of this trap.

In the short term over the last two years, most of the investors' returns come from their entry point. From 2020 March to 2021 Feb, as market rates fell, core capital invested, the Baijiu index shot up 200%, then dropped 30% in one month, followed by volatile trading ever since. New energy sector kicked off the rally at about the same time, and held onto its momentum through Nov 2021 due to its stronger outlook and structural trends. Some sub-sectors even had their new highs in July, yet they too had some corrections in August. Questions is: has Chinese Baijiu or the New Energy sector had a change in their fundamental trends? Answer is no.

Baijiu has been the carrier of Chinese culture with steady and certain demands. New Energy is driven by Carbon-neutrality and energy transformation goals, which will remain the best market sector by outlook. China's photovoltaic sector is the undisputed global leader. What changed is the asset price.

Clearly, whether you are long-term investor or short-term investor, buying Baijiu fund at the peak of the market in Feb 2021 is a dangerous position. Long-term investor may smoothen the high cost over time, but short-term investors often have to cut the position and realize the loss.

These large volatile market conditions are very challenging for retail investors. They often buy funds near the highs, and redeem at the lows. The fund managers or investment teams will often buy their own funds at low points to boost investor confidence. Indeed, the self-purchases by the fund managers can become a contributor to the fund managers' compensation. Retail investors should see this as a signal of investment guidance. **To help the mutual fund investors to make money, fund manager must highlight investment risks when market is frothy, and remind investors to buy low when there's excessive pessimism in the market. Fund manager can communicate through purchasing fund directly, limiting new investor purchases, or sharing market views.**

According to Yan Xiang from Founder Security, the main theme of equity market investing is to find, at each pivotal moment, the direction of future economic structural transformation or industrial upgrade. As for the fund manager, the main theme is to find investors that's right for the manager, and help these investors to buy at the right time. So to combine the two, we must build out core capital assets within our capabilities, and we must link up with the core investors who are compatible. Over time, such core assets and core investors are changing.

Just like the US market, China's market also went through shifts across cyclical, consumer, biotech. Before 2008, the best sectors were real estate related coal, car, electricity, bank, and steel. After 2012, it's the consumer stocks, and after 2019, it's the advanced manufacturing.

The core mutual fund investors have also shifted. Retail investors have become more reliant on institutional expertise by investing via mutual funds. The rise of electronic fund trading has also improved information flow and transparency. But the mutual fund investor is not just after a black box, the investor also wants to know what the fund manager's investment philosophy is, what the manager's core capabilities are, so the investor can choose the appropriate fund and allocate the right amount of asset and time. Maybe this is the question we should talk about when the market falls. What's past is past, we can only face the uncertain future.

As all the asset classes are falling, market expectations are swinging back to extreme pessimism. Even if we can see how the market pendulum swings, very few can escape the clutches of the fear factor. **Nothing in life comes easily, and those who sows the seeds with sweat and tears will reap the reward with smiles.**

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