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Stay Diligent in Our Times

"It is not the strongest of the species that survive, nor the most intelligent, but the one more responsive to change." ~ Charles Darwin

Our Main Thoughts:

- USD's global reserve currency status rests on twin pillars of economic globalization and financial globalization. As the world goes through de-globalization and as USD becomes weaponized, the US Treasury's "safe asset" role is diminishing.

- Recently, China market is experiencing an interesting period of simultaneous rebound in domestic stocks and domestic bonds. This scenario usually happens near the trough of economic cycles. We expect subsequent clarification on economic and policy expectations will further support the stock market's transition from a rebound to a pivot.

- Current valuations are similar to historical major bottoms. Other indicators like investor positioning or trading volumes are also near historical lows. We start to see opportunities in the stock market, and expect a possible longer-term bull market to emerge.

- Investors can't predict major geopolitical changes, macro-economic policies, and how these events impact the market. What investors can control, is how they can step back and ask: where will long-term growth come from? Change the focus, and they can find the opportunity.

- Successful companies of the future are those who can: provide solutions to climate change and other challenging social issues; improve economic efficiency through digitalization; service key strategic sectors like agriculture, energy, defense, etc.

- Despite the overall de-globalization environment, there is actually an increase in foreign FDI after the pandemic.

- Manufacturing is a key pillar of national strength, which will take time to rebalance. The global supply chain management is experiencing changes through the A-N-R-O model of Ally-shore, Near-shore, Re-shore, and Off-shore stages.

- Currently inflation is still not making significant impact to China's monetary policy. The government's policies will focus more on domestic fundamentals and global impacts.

- As globalization reverses, global monetary landscape will shift towards multi-polar system. The USD's total dominance will reduce over time.

- The real economy's growth will need financial system's support; the financial service will need to match corporate need; and the business models of asset management industry will need to incorporate common prosperity ideals.

Expectations are clearing up for a pivotal turn – we must stay diligent

In the period around the late August Powell speech, the US stocks rallied for 8 weeks initially and then fell for the subsequent 8 weeks. Hang Seng led the drop, then the US, and finally the A-shares. After the disappointing US Sep inflation data, even though DOW, S&P, and NASDAQ all reached 2022 new lows, they finished the day up more than 2% each. This price action showed market had priced in the poor data, with a net strong finish in a classic "sell rumor, buy fact" move.

USD's global reserve currency status rests on twin pillars of economic globalization and financial globalization. As the world goes through de-globalization and as USD becomes weaponized, the US Treasury's "safe asset" role is diminishing. It took many decades for USD to emerge finally as the undisputed global reserve currency, so the decrease in its role will also take long time. It'd be interesting to see if in the new information age, where everything seems to be moving faster, the energy transformation and regional conflicts can accelerate the pace of de-dollarization?

Rosefinch analyst team sees the USD-trend as a direct signal of global risk-appetite: its weakening reflects strengthening of all non-USD assets, including RMB assets. We already see risks to USD from changes in Russia-Ukraine war, looming European recession, drop in US inflation. It's worth noting that US economy will likely be officially in recession in the next 12 months, signaling the turning point on both the USD and the US rates. Charles Darwin once said: "It is not the strongest of the species that survive, nor the most intelligent, but the one more responsive to change." This applies not just in species, but also in companies and nations.

Recently, China market is experiencing an interesting period with simultaneous rebound in domestic stocks and domestic bonds. This scenario usually happens near the trough of economic cycles. We expect subsequent clarification on economic and policy expectations will further support the stock market's transition from a rebound within downward trend to a pivot to a positive trend. We're seeing a pickup in social financing in September, which came in at higher than expected and provided the support for the market. But in order to start an upward trend, we'll need other factors such as renewed confidence in real estate sector and improved Covid-19 situation. In terms of real estate policies, we start to see some impacts of recent friendly policies that were announced in September. As for Covid situation, we're seeing most major Chinese airlines announcing the resumption or increase of international flights. With the Covid policy softening on the margin, this should support tourist industry and reduce Covid policy's negative impact on the real economy. Once the domestic consumption and real estate rise, this can more than offset the slowdown in export. Given how weak 4Q21 data were, we expect to see noticeably improved data from Oct onwards.

Some global investment bank analyzed the 20th CCP congress and noted the key themes of pragmaticism, continuity, and re-balance. In our view, the key to interpret the 20th CCP congress is to focus on areas where the congressional report repeated or emphasized. The official report clarified the long-term

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strategic direction and emphasized that "high quality development is the priority goal as we build a modern socialist country." We had taken the "cautiously optimistic" stance in Sep vs the previous "cautious" stance. **Current valuations are similar to historical major bottoms. Other indicators like investor positioning or trading volumes are also near historical lows. We start to see opportunities in the stock market, and expect a possible longer-term bull market to emerge.**

2022 is a year that frustrated forecasters on various political or macro topics. **Investors can't predict major geopolitical changes, macro-economic policies, and how these events impact the market. What investors can control, is how they can step back and ask: where will long-term growth come from?** Change the focus, and they can find the opportunity. We may be near the end game for the traditional economic development. Successful companies of the future are those who can: provide solutions to climate change and other challenging social issues; improve economic efficiency through digitalization; service key strategic sectors like agriculture, energy, defense, etc. For China, the 20th CCP conference had pointed towards "building modernized industry framework", with emphasis on manufacturing, high-quality, aerospace, transportation, internet, and digitalization. The companies that can generate sustainable profit-growth will be the foundation of a healthy global capital market. In Rosefinch's history, when compared to market-timing investments, we prefer the sustainable approach of tracking the changing times and growing with stars of the future. **We must stay diligent and be worthy of the great opportunities presented by our times.**

Manufacturing is a major pillar for national strength

In the past ten years, China's domestic GDP has grown from 54 trillion RMB to 114 trillion RMB, or second place behind US. China's GDP accounts for 18.5% of global economy vs 11.3% before. China's grain production, manufacturing sector size, and foreign exchange are the biggest in the world. Renewable energy capacity is already over 1.1 billion KW, or more than 30% of existing global capacity. Photovoltaic saw global demand increasing ten-fold from 30GW per year in 2012 to 280 GW in 2022. In that period, Chinese capacity has increased 20 times from 3.5 GW/Year to 70 GW/Year. From end of 2012 till Oct 2022, Chi-Next grew 241%; new energy index grew 256%, with photovoltaic subindex increased by 387% and new energy vehicle increased by 362%.

In October, US Department of Commerce's Bureau of Industry and Security (BIS) published a new export control rule that seeks to further restrict China's ability to obtain advanced computing chips, develop and maintain supercomputers, and manufacture advanced semiconductors. It was also the first time that the rule extended to US persons working in commercial sector. Market insiders expect US to demand the Chip4 members of Japan, South Korea, and Taiwan to seek approval for their China activities. There is also the concern on the Taiwan situation. Elon Musk sharing his thoughts that if there's local conflict with Taiwan similar to that of Ukraine, Tesla will get caught, Apple will be in big trouble, and the global economy may take a 30% hit.

What's interesting is that, despite the overall de-globalization environment, there is actually an increase in foreign FDI after the pandemic. The rolling 12-month FDI typically only rise by about 5 billion USD pre-pandemic, that number is now 30 billion USD. According to the government data, the 2022 Jan-Aug actual usage of foreign investment was 893 billion RMB, a +16.4% YoY. The advanced manufacturing industry utilized about 1/3 of these FDI. We see that given the recent energy shocks and relative cost advantage of Chinese manufacturing supply chain, more and more European companies are increasing their China capacity. For example, German BASF group just completed a 10 billion EUR manufacturing plant in Guangdong province. The plant allowed Germany to generate annual operational savings of over 500 million EUR.

Recently, Germany and France have objected to the high prices US natural gas suppliers are charging. The Russia-Ukraine conflict continues to impact global financial market, international trade, cross-border investments. The European energy infrastructure and industry chain framework are facing a rebirth under influences of geopolitics, energy crisis, and trade protectionism. In order to survive and to develop, the globally competitive Chinese companies must engage abroad. The global battery market, for example, has been dominated by China, Japan, and South Korean manufacturers. Now is the moment of "do or die." Industry experts see future growth of over 10 times in the next decade. In the fast-growing market, even to keep existing market share will require comprehensive competition across technology, size, cost, and supply chains.

Manufacturing is a key pillar of national strength, which will take time to rebalance. The historical rise of Great Britain was the first nation that rose on back of manufacturing. Since then, US, Germany, Japan, and now China are repeating the pattern. China has formed a complex, efficient, and effective industry chain ecosystem, which won't be easily replaced by trade war or sanction list. But over time, this may change. Bloomberg reports that US can potentially reduce its supply chain's reliance on China to under 40% by 2030. The global supply chain management is experiencing changes through the A-N-R-O model of Ally-shore, Near-shore, Re-shore, and Off-shore stages.

In the official report of the 20th CCP Congress, there were several sections that highlighted key priorities: Section 4 stressed the need to "quickly build new development framework, and push for high-quality growth." This will channel support to new growth engines of information technology, artificial intelligence, biotech, new energy, new material, advanced equipment, and environmental protection. Section 5 emphasized that innovation remains that key for the new developments, and must remain the core of the strategic development model. Section 10 gave further guidance on achieving carbon-peak and carbon-neutral, to deepen energy transformation, quicken construction of new energy infrastructure, perfect carbon-emission monitoring, improve carbon-credit trading mechanism, increase carbon-absorption capacity, and actively engage global climate change efforts. Section 11 highlighted the importance of agriculture, energy, and supply chain security.

<u>Financial system to support the real economy.</u>

China's Sep CPI was +2.8% YoY and +0.3% from August. The PPI was +0.9% YoY and -0.1% MoM. The shock of raw material prices is gradually decreasing. Rosefinch research team sees the main cause of current inflationary pressure to be from food prices. There's still an overall weakness in demand for service sector, especially in regions affected by the Covid policies or real estate weaknesses. The core CPI is likely to be subdued in near future. **Currently inflation is still not making significant impact to China's monetary policy. The government's policies will focus more on domestic fundamentals and global impacts.** China's demand contraction more than compensates for the supply shock, so that risk of stagnation is higher than inflation. Globally, we also see the multiple waves of supply shocks will likely lead to a global economic recession.

Professor Peng Wensheng looked at this round of USD appreciation from three perspectives. US's domestic economic cycle can't be the sole reason for such large exchange rate volatility. Russia-Ukraine conflict and droughts have pushed up energy, mining, and agricultural prices. The external trade is also supportive of USD rally. But as US fiscal and monetary conditions tighten, eventually this will lead to drop in total demand, and then onto drop in inflation. We're already seeing corrections in the rate-sensitive housing market. The upcoming US recession, if not already here, will bring about the turn in the US rates and exchange rate in the coming 12 month. This turn will likely be accompanied by bigger volatility. According to Bloomberg, as globalization reverses, global monetary landscape will shift towards multi-polar system. The USD's total dominance will reduce over time. As for the RMB, it's effective basket exchange rate only devalued by 1% YTD, and has revalued by about 10% since 2019, indicating that its not a weak currency. The recent RMB weakness against USD is due mostly to economic cycle and monetary conditions. Managing market expectations will reduce volatility, while over the long term, maintain steady growth and alleviate economic downward pressure will go a long way towards a stable exchange rate.

The real economy's growth will need financial system's support; the financial service will need to match corporate need; and the business models of asset management industry will need to incorporate common prosperity ideals. Compared with the previous 5-year planning cycle, China's direct financing is now 32% of all social financing. Since 2021, that ratio is already 36%. In the stock market, consumer and

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technology sectors account for 45% of total market capitalization in 2021 vs 22% in 2010. At end of 2019, our total household asset was 552 trillion RMB, with over 300 trillion in real assets – mostly in real estate assets; 178 trillion RMB in financial assets – mostly in low-risk deposits; so there's still substantial room for mid- to high-risk assets allocation.

The future capital market will need to reform and develop further to fully integrate with the real economy. This is necessary to support economy's high-quality development, which in turn can bring about a long bull market as A-share grows alongside China's modernization efforts. The asset management institutions much develop professional skills, and support the call to common prosperity by increasing the average household wealth.

At Rosefinch, we are embracing the future challenges by grooming and integrating the young talents into our partnership culture. We have formed strong lineups of key talents across major areas such as investment, research, marketing, and operations. **Our focus remains on continuously adding value: we will extend our skillsets in key industries, expand our ecosystem, and upgrade our core competitiveness. We look forward to adding value to you in the years to come.**

<u>We hope that by sharing Rosefinch's views, in a small way, we add value to your day.</u>