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Rosefinch Monthly | 2022 December

The Slow Bull Trudges On

" Great equity bear markets will occur as deflation, or the real risk of deflation, develops. As we shall see, the time to buy equities is when deflationary risk diminishes, and risk premiums start to contract. However, one of the key lessons of this book is that equities can discount almost anything when they are cheap enough." ~ Russell Napier

Our Main Thoughts:

- **Going forward as economy and corporate earnings recover, we may see the slow bull market since 2019 trudging on.**
- **We actually see China's manufacturing sector coming out of recent deleveraging with capacity and motivation for increased productions. The Chinese policies and financial markets are broadly supportive for manufacturing which had relatively healthy foundations that supports global competition. The medium-to long-term investment environment for Chinese manufacturing sector remains healthy.**
- **Long-term investment requires capability, and sometimes strong conviction. Currently, A-shares have PE, PB, equity/bond yield ratio, risk premium are all at cycle lows. The key will be picking the right industry and the right company.**

A-share Market May See Slow Bull Trudging On

Just as USD index peaked at 114, coinciding with bottom of major US and European equity indices at end of September, the USDCNH peaking at 7.34 also coincided with bottom of Chinese stock indices at end of October. Meanwhile, Canadian Central Bank and ECB sent dovish signals to the market, US inflationary data was better than expectations, and the global risk appetite clearly improved. Global assets finally had a sigh of relief as rates came down and stocks rallied. Those high-tech indices, including the Hang Seng Technology index, had an even stronger rebound. In 2022, we saw unprecedented devaluation of global currency against the USD. As USD index turns and USDCNH recovers 7.05, other currencies also appreciated. There's likely hood US economy will enter into recession in 1H23, while inflation expectation will continue to ease. Overall, we'd expect both USD and USD-rates to be near the top.

The main global concern is switching from financial tightening to economic slowdown. US stocks are already pricing in recession possibilities as NASDAQ and Chi-Next indices hit bottoms of -34% and -36% respectively. Much of the bad news or bad scenarios are priced into the price. The good news is then the market sentiment is very bearish. US stock is unlikely to hit new lows this year. The return of global bull market will have to wait for next year when the worries about global recession are replaced about optimisms about future recovery.

As for A-share market, the index-wide valuation is already at very pessimistic levels. Both wide and narrow liquidities are stable as Chinese interest rates remain low and market volume recovers. With policy, economy, exchange rate, and geopolitical stress points easing off, the market is gradually moving out of panic mode. In our previous monthly, we pointed out that subsequent improved economic performance and clearer policy expectations will be the foundation for the stock market rebound. Right now, we're seeing a rally driven by risk sentiment improvement, which means the path can be a bit more volatile.

In the G20 Biden-Xi meeting, Xi said US is practicing capitalism while China is practicing socialism, two different roads. While there's always competition in the world, it should be built on mutual understanding, healthy chases, and joint advancement. It should not be a fight to the death where one must lose. Xi also followed up in APEC meeting where he highlighted China's view that the core issue for the nation is to increase wealth for its citizens. China will aim to increase its middle-class to be over 800 million in the next 15 years. China has already experienced very fast growth in over 30 years before shifting gears around 2012 to slower growth that's now the new norm. The 2015 bull market was driven by leveraging, so it didn't change the underlying market cycle. A-share only saw its real bottom by end of 2018, which led to three years of slow bull market. The Chi-Next and STAR market reflected the transformation of the Chinese economy and benefited from the bull market. Then 2022 saw combination of pandemic, geopolitics, and other external factors the have suppressed the market till now. Domestic economy is facing weakness in both supply and demand.

Following almost a year of consolidation, A-share market is at risk recovery phase and should have passed its low point. Chinese manufacturing remains a key player in the global competition, supporting relative robustness of RMB, thus allowing an independent monetary policy. **Going forward as economy and corporate earnings recover, we may see the slow bull market since 2019 trudging on.** The A-share market now has over 5,000 listed companies with market capitalization of 85 trillion RMB. Government is pushing hard to improve market infrastructure, investor base, and investment philosophies. The equity market is well-positioned to be a contributing partner to the high-quality development of the Chinese economy. It's worth noting that with geopolitical volatility and the high-quality developmental needs, the market is moving away from the traditional finance and real estate model and moving towards technological innovation, manufacturing, and domestic circulation model. This may usher in some changes in the A-share investment framework. In the last few years, the A-share risk premium's correlation with short-term interest rate has decreased, but the correlation with USD-index has increased. This means domestic industries are turning towards the technology and manufacturing companies that are more linked with global economy. This also brings tremendous challenge to the leading entrepreneurs of each industry: they must avoid mediocrity, maintain excellence, continuously challenge themselves, and keep up both their ambition and their executions. One of the best qualities of excellent companies is their adaptability. These companies' founder or entrepreneur can lead the team to change their path in order to respond to the changing external and internal conditions. This applies to wealth management companies as well. We believe our core competency lies in staying focused. This is how we will add value to the investors in the long-term. And for Rosefinch, we will focus on the "3060+" opportunities that are related to China's 2030-2060 Carbon Goals. Our vision is to find and invest in the excellent companies as they grow into the stars of tomorrow. Through this process, we will be part of the successful development of our investors, the invested companies, and the entire industry.

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New Electricity Infrastructure is the Carrier of Future Transformation

Chinese government recently announced 20 adjustments to the Covid-prevention Policy. This coincided with the first negative monthly expert growth in the last 29 month and another negative monthly retail sales number. These two negative rates pointed to a simultaneous decline in global and domestic demand. The recent data however did reflect some improvement in high-quality developments such as advanced manufacturing, especially in electronics, electric machinery, and automobiles. While the overall economy remains soft in its recovery, the structure of the whole economy is improving. In the current phase of national development, fast growth rate is no longer the sole criterion. Instead, there are a range of factors to consider, including high-quality development, common prosperity, environment protection, Carbon-peak and Carbon-neutrality, national security, and economic safety. The Chinese approach to economic development requires focusing on the real economy. Due to the pandemic, China grew 5.1% in the previous two years, and this year the first 3 quarters' growth was 3%. This means the 3-year annualized growth rate will be under 5% which is clearly an underperformance when compared to the nation's potential. We must turn around this underperformance.

We've heard some questioning of China's economic drivers, especially after real estate, infrastructure, internet, and digital economies seem to have peaked. Some see India, ASEAN, and some African nations follow China's footprints around 2000. They may see increase in the low-end productions shifting there, with the added bonus of US's promotion of supply-chain safety. **We actually see China's manufacturing sector coming out of recent deleveraging with capacity and motivation for increased productions. The Chinese policies and financial markets are broadly supportive for manufacturing which had relatively healthy foundations that supports global competition. The medium- to long-term investment environment for Chinese manufacturing sector remains healthy.** The falling of real estate and internet companies actually free up human resources and capital to better engage in the manufacturing space.

For China, the current focus on substituting fossil fuel is not only for the energy security, but also for the development of wind, solar, new energy cars. In all these fields, the leading companies are going to be pillars of future development as they are led by technological innovations. Many of these companies' second growth curve is closely related with the nation's strategic trend towards new energy. In the national blueprint of development, the "economy-energy-environment" triangle is shifting towards "new development-new electric infrastructure-carbon peak & carbon neutral" triangle. In this transition, whether its energy system turning low-carbon or clean energy planning and utilization, the new energy infrastructure is the key carrier of our future transformation.

Risky Assets to be Supported

In the summary report post the 20th CCP Congress, innovation was called the "core" and "top driver" for the economy. From financial market's perspective, encouraging innovation can come from capital market's effective interactions, especially those between primary and secondary markets. PBOC governor Yi Gang mentioned two main targets for financial reform: one is to improve financial structure by increasing direct funding component and increase long-term capital supply to match the diverse funding needs for different companies, the other is to deepen financial market reform by building out system, avoiding interference, and zero tolerance for abuse. Governor Yi called for the organic merger between Chinese characteristics and capital market guidelines that combines market force and government functions to better serve the real economy.

US's 2022 fiscal tightening may see more negative impacts flowing through in 2023. As US enters into recession, the fiscal stance may be more neutral while the monetary tightening will soften. As global liquidity improves, global risky asset prices will have less downward pressure. In China, this will translate into stronger growth and risky assets to be supported. In 2023, with China economy growing, USD and US-rates lower, it'll improve Chinese exports to non-US markets. Since 2021, domestic monetary policy has been largely accommodative. In 2023, there's likely to be continued monetary base growth which will be supportive for Chinese economy and stock market.

Long-term investment requires capability, and sometimes strong conviction. Currently, A-shares have PE, PB, equity/bond yield ratio, risk premium are all at cycle lows. The key will be picking the right industry and the right company. For Rosefinch, we strive to achieve clear strategic positions and continually improve our executions. In the key focus industries, we'll build up our capability, then develop our eco-system so that we maintain our market foresights and stick to our long-term investment approach. In practice, this means pay attention to both the market beta and the company alpha, so that we can invest heavily in the best companies. When it comes to building our capabilities, we hire analysts with hands-on industry experiences, and we encourage specializations. Majority of our analysts have worked in leading industry companies, and most of them have their own specialties. By building a team of experts, we hope to continue our excellent return records for investors and continually create value for you.

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