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And We Are Back

The turning point has arrived. In the past month, various updated Covid policy statements came out that dialed back the stringent policies of that past three years. The temporary testing stations are being removed, and travel restrictions are being lifted. The tough battle against the elusive Covid virus is finally taking a breather. On Dec 1st, the southern city of Guangzhou opened in-restaurant dining, which saw the income doubling the average day. Many restaurants are having long waiting lines outside – an unusual sight for the last three years. And we are back.

A-share also kicked off the pessimism with higher trading volume and quick recoveries as major indices got back to early September levels. In the investment world, it's important to track the difference in expectations. After market fully prices in the improved Covid policies, we are seeing less impacts from the rounds of new policy announcements. The main tension in the market is now shifting from Covid-zero policy before to now domestic economic recovery and actual infected cases. What path will the economy take?

According to Shenwan Research team, in the early days of re-opening, as airline and rail travels recover, household demand and income will recover as well. In the medium term, with infected number rising, the available labor force and earnings may both decrease, which will weaken the domestic demand. This seesaw action will continue for some time until in the long term, the economy recovers and the virus fades into the background.

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In the global market, when the virus spreads initially, the labor shortage may last one quarter or so, and the economic recover thereafter is not immediate. While it may eventually get back to long-term growth, the path may have many twists and turns. Stock market generated significant long-term returns for investors, but the few bull-bear cycles are very stressful times, especially when investors are trying to pinpoint the bottom. If we look at the past 20 years, whenever market rebound from historical lows the first time, most indices will actually retrace back down about 13%, or roughly 60% of the rebound magnitude. Of course, when we look at it in the longer picture, these are just bumps in the road of the slow bull market.

年份	第一波上涨后回吐时间起点	第一波上涨后回吐时间终点	回吐时间（天）	获利回吐时各大指数最大跌幅（%）				回吐幅度			
				上证综指	沪深 300	万得全 A	创业板指	上证综指	沪深 300	万得全 A	创业板指
2005 年	2005/9/20	2005/12/5	76	-12	-13	-16	-	0.65	0.76	0.71	-
2008 年	2008/12/9	2008/12/31	22	-14	-14	-13	-	0.66	0.59	0.49	-
2013 年	2013/3/6	2013/4/8	-	-	-	-	-10	-	-	-	0.27
2016 年	2016/4/15	2016/5/26	41	-10	-8	-12	-15	0.69	0.57	0.65	0.73
2019 年	2019/4/8	2020/3/19	346	-20	-15	-14	-15	0.76	0.52	0.45	0.93
均值	**-**	**-**	**46（剔除 2019 年）**	**-14**	**-13**	**-14**	**-13**	**0.69**	**0.61**	**0.58**	**0.64**

Source: Haitong Research, Rosefinch. Tracking retracements off initial rebound in various stock indices.

Understandably, the market rally is seeded during the deepest despair, and grew in the soil of uncertainty. "Two steps forward and one step back" is the norm, and also the most trying. Whether it's the 2018 bear market, mid-2021, or May-June in 2022, the market rebound also saw sizeable redemptions from the equity mutual funds.

Source: Wind, Rosefinch. Blue is equity index price; orange is equity fund shares outstanding.

During the US stock fall of 1973-74, Charles Munger's fund lost over half of its valuation. He recalled that the two years of market falling was actually building up the energy. Without those two tough years, there wouldn't the subsequent explosive rebound. Munger thought that when the market hit the hardest in 1973-74, his stock holdings were worth three times their actual market valuation.

Unfortunately, most retail investors are not Charles Munger. They can't hold on during the bear market, and they can't hold on during the bull market. The retail investors are focused on the PnL of the account, so they're whipped by the raw emotions and became canon fodder as market fluctuates up and down. Charles Munger, on the other hand, focuses on the valuation. When the market is falling, he'd look at future profits and not short-term losses, which gives him the courage to buy more when the prices drop further. The key for an investor to go from average to excellent is to shift the focus from trading account's PnL to the comparison between a company's intrinsic value and its market price. Just like when Munger stuck through two years of dark times and finally saw the arrival of US economic recovery and rate-cut cycle in 1975, China's equity market is also seeing its pivotal moment. 2022 has been a year filled with black swans where we had to cope with both domestic deflation risk and global FED hike cycles. Next year's macro picture may be the opposite: China's economic recovery coupled with US rate cycle topping off.

Chinese manufacturing sector remains the winner in the global competitions. It supports the relative steadiness of RMB, which in turns supports an independent monetary policy. As economy and corporate profits recover, we may see a continuation of the slow bull market that started back in 2019. When it comes to slow bull, what's important is to give it time, and not timing. As pandemic pressures waxes and wanes, economy will also see its ups and downs, and so the stock market will follow. During these key times, faith is more important than smarts. Faith means believe in the trend of our age, and not simply drift along with the market. In the early 21st century, financial and real estate sector advanced the urbanization; since 2010, consumer electronics and internet technology led mobile and internet waves; and in the 2020's, energy revolution and domestic substitution will be the main themes of this decade.

Faith also means focus on our own capabilities, and not get lost in the waves of hot tips. The market will go through violent sector rotations, which may seem like opportunities but actually can be just mirages in the desert and disappear quickly. To have repeatable and sustainable success, it must come from understanding deeply the industry value chains, digging out the most valuable links, and identifying the best investable companies. Whether it's life or investment, the rule is the same: develop resilience, so we can bend but not break when the shocks come. And we are back.

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

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