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Our 2023 Outlook

<u>Rosefinch Founder Mr. Hualun Li's note:</u> 2022 has been an unusual year with violent market moves given the geopolitical and pandemic disturbances. Over the long-term, the true value creation still comes from growth of enterprises. No matter which nation's economic growth story, it's always the development and innovation of entrepreneurs that increases the enterprises' competitiveness. It's always a hopeful and rewarding journey when we're privileged to grow with the great entrepreneurs. We've come so far already, and we'll jointly create a better future together! As we come into end of 2022, we are sharing with you the Rosefinch "2023 Outlook" series. It's where we review the year and share our deep insights with investors. We hope our understanding of the market can create value for you via long-term profits and happy life.

In 2022, the global risk assets were under pressure. Since the 2020 pandemic, the US broad M2 grew at a rapid 25% pace. During the 2022 monetary tightening, M2 growth is reduced to about 0%. The sudden monetary tightening caused both stock and bond markets to drop, and led to US economic slowdown. China's 2020 M2 also increased, but only to a high of about 11%. As we get into 2022, China M2 growth actually increased to 12% as opposed to US's slowdown. US is now dealing with the inflation risk, which inevitably slows down the economy. China on the other hand is experiencing bigger downward demand pressure, which more than offset the supply shocks' effect, thus focusing more on the stagnation risk. Overall, this round of economic volatility is seeing continuous supply shocks, with a global recession a high probable event.

1. USD Cycle and Volatile Crisis

After the collapse of Bretton Woods international monetary system in 1973, Gold standards falls away to be replaced by USD standard. Since then, the USD cycle is inextricably linked to the global asset liquidity conditions, where often a large USD-appreciation cycle is accompanied by financial market volatility and even crisis. The first round of USD cycle caused Latam debt crisis; second round of USD cycle led to Asian financial crisis; the current third round of USD cycle is hitting Europe deeply. When we compound on top the Russia-Ukraine conflict and the massive EUR and GBP depreciation, we get significant inflationary pressure in Europe.

Source: Wind. This is chart of nominal USD index against major countries.

In the first 10 months of 2022, USD index rallied over 16% which is the largest annual rally since 1985. Behind the USD move was the FED's almost 4% hike to combat inflation, which in turn raised US Treasury yields. In addition, the Russia-Ukraine conflict and other geopolitical tensions increased the global need for safe assets. USD and UST, as safe assets, rose in response for this global demand.

It's worth noting that globalizations in the economies and financial markets are basic foundations for USD's recognition as the preeminent global reserve currency. As de-globalization takes place, the international monetary system is moving towards a multi-polar world where the absolute dominance of USD will reduce.

2. The Pivotal November.

Under the pandemic, even though China and US faced different inflationary pressures, both stock markets rose first and then retraced. From liquidity perspective, during the early to mid-2020, US fiscal expansion supported employment and economy, increased supply of safe assets, and compressed risk-free interest rate. These factors were positive for the stock market. After the onset of pandemic, China looked to credit expansion to increase overall demand, which is helpful to steady growth and friendly to the Chinese stock market in 2020 and 1H2021.

This year, as pandemic rebounded and Russia-Ukraine conflict took hold, there were worries about global supply chain breaking down. China saw weak demand which called for lower policy rates. The combination of weak economy and demand for safe assets saw Chinese stocks fell and bonds rallied. But all these changed in November, where many major global indices rebounded from their 2022 lows.

In November, some China-concept stocks rose more than 40%. Domestic commodity markets took off, and USDCNH touched 7.0 at one point. The Hang Seng Tech Index rose almost 50% from Oct 24th low of 2800 to the Dec 19th close. So what were the catalysts for the change in market sentiment? Besides changes in inflation and rate expectations, there was also the potential lull in fighting as Russia-Ukraine conflict enters its cold winter phase. Another factor is the change in China's pandemic policy where the re-opening will likely bring back resumption of consumption and increase in enterprises' investments. It's worth noting here that in the history of major civilized advancements, each episode brings new progress in the human history. In this pivotal moment, having faith in progress is perhaps even more important than having skills. Capital market has led the charge on this round by showing its conviction and foresight.

3. The Post-Globalization New Order.

Since World War II, there were two major events that united the world: the start of China' reform in 1978 and the collapse of the Berlin Wall in 1989. Will the Covid-19 and Russia-Ukraine conflict change the world's long-term outlook and increase de-globalization? US's biggest trading partner was EU prior to the pandemic. Now China is US's biggest trading partner with strong technology trades. When we look at manufacturing, it's not easy to return such activities back to US. Take photovoltaic industry as an example. US doesn't have complete domestic supply chain while having expensive construction cost. Even the US government can not force a complete stop in the photovoltaic trade and tech exchange with China.

Compared to previous financial crisis, this round's shocks come from supply constraints. The challenge is now more complex and require not only traditional macro policy support, but also updated sustainable developmental policies. In the last 30 years, the globalization is basically a G2 model: China has the capacity and labor, while the US has a huge market. The Sino-US cooperation also supported US's technological innovation. This G2 model is currently at risk.

From China's perspective, it must have smooth dual circulation to allow fast developments in domestic circulation. Most nations of the world maintain open economies, and most of them are developing countries. China has been trying to reach the global market, so even if US doesn't open much to China, China will play a bigger role in the global stage. In practice, we know that the global competitive companies cooperate deeply with their partners. So even if some of their supply chains are "choked" by US policy or sanctions, there are other global suppliers, though it may take some time to replace the US suppliers. As we enter into post-pandemic age, the global recovery will be slow, which may not be all bad news to China. We're already seeing the positive side-effects of the pandemic as China's digital economy and new energy sectors have growth stronger over the past few years.

4. Private-Owned Enterprises' Dynamism and Capital's Motivation are Key.

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POE's dynamism and capital's motivation are fast becoming pillars of social development. Overall, China's economic structure and holistic development are more superior than Japan in the 1990s. in fact, China's current developmental background is more like the US in the 1980s.

The summary report from the 20th CCP congress put innovation as the core and top priority. From financial market's perspective, to increase innovation we must effectively utilize both primary and secondary capital markets. The congressional report called for improving capital market functions and increase direct financing proportions, which means capital market reform will the kickoff point for the virtuous cycle of financial and real economy growth.

5. The Slow Bull Returns in 2023.

The stock market is the barometer of socio-economic well-being. As China entered into the urbanization and industrialization phases, the key drivers for the 2006-2007 Shanghai Stock Exchange rally to 6000 were financial, real estate, and other cyclical industries like shipping. After 2008 financial crisis, Chinese economy transformed from investment-driven to consumption-driven. It consolidated around 2012 and entered into a new phase. The 2015's bull market was driven primarily by leverage, which is unsustainable. It took until end of 2018 to see the end of that correction, and the start of a new 3-year slow bull market. The market now reflects the diversity and vibrancy of the Chinese economy, where consumption, bio-pharmaceutical, electronics, new energy cars, photovoltaic and wind power, and semi-conductor industries are the front-runners.

Source: Wind. Blue line is Wind A-share Index; red line is GDP rate.

After strong rallies in ASEAN and India, China is well-positioned for further recovery in 2023. After over a year's volatile consolidation, the A-share is at risk-appetite recovery phase and has past its low point in the cycle. The emergence of a robust and efficient Chinese manufacturing sector bodes well for RMB's strength, which allows a more independent monetary policy, which in turn supports economic recovery and corporate profits. The slow bull from 2018 may yet continue.

6. Continue Progress and Stay the Course.

In the previous three historical industrial revolutions, two of them were basically energy revolutions. The current 4th industrial revolution is using data to encourage industrial revolution. This includes AI, robotic technology, quantum data, virtual reality, bio-tech, clean energy, etc. For China, aside from reducing its reliance on fossil fuel, it will benefit the most from advancements in photovoltaic, wind, hydrogen energy, intelligent car, and high-voltage. All these fields are supported and led by technologically innovative companies.

Capital needs to engage in technological innovations proactively and reasonably. The key is to achieve "3060" goals while keeping economic growth at sustainable levels. This can bring up new round of human cultural advancement. The core of wealth management is to earn the investor's trust and manage their assets. The core competitive skill is to be focused professional in what we do. Professional judgement is a good way to ensure efficient asset allocation and effective risk management. Achieve both, and we can better support the real economy and let the assets have effective returns.

Rosefinch's vision is to continuously create value. We work towards this goal by staying conservative while taking calculated risks; focusing on adding value and always having investors' best interest in mind; and doing what's right without worrying about competing against others. We started as one of the first partnerships in Shanghai, and we have successfully and smoothly completed the transition from Rosefinch Investment platform to Rosefinch Fund Management team who focuses on secondary market investments. We are pleased to see research teams forming tiers of talents, while management team and mid- to back-offices are experienced and established. Our young generation of future leaders will create even more limitless possibilities for the company.

In the past 15 years, we seek clear rational strategic positions and specialized execution efficiencies. We built our core-capabilities around specific focused sectors, and then grow the eco-system around them to maintain clear foresights and long-term investing. We capture the beta of our times and alpha of best enterprises by heavy positioning in our core stock pool.

Our future 3-5 years will be focused on the great companies in the 3060+ sectors. We want to find the best entrepreneurs and grow with them, so that we can support our investors, the real economy, and social developments. And when we achieve that, we would have also had a valuable and exhilarating journey. Thank you and we hope you will join us on this memorable and exciting path!

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

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