Rosefinch Research | 2023 Series # 1

Who Will Withstand the Wave

Welcome to our first publication of 2023! We'd like to thank you for giving us the opportunity to share our views that give you useful insights and confidence in the dynamic capital market. As a long-term investor manager, we firmly believe that doing the best we can in our circle of control is the best way to maximize our chance of long-term success for our investors. And that means use our industry chain analysis, apply our research-focused investment process, and build our robust and sustainable platform to ensure careful management of investor's assets. We appreciate your support, and we look forward to building our partnership in 2023 and many more years to come!

1. Who Will Withstand the Wave

US stocks have rebounded for the past two months since the Oct CPI, and most assets have priced in the FED's slower hiking rates. Given the high expectation of US recession, most assets' sensitivity to lower inflationary data will reduce, with focus shifting to fundamental factors. In China, the supportive policies in Real Estate, New Energy, and pandemic transitions have propelled sizeable rallies across China oversea stocks by over 40%, Hang Seng Tech Index by 60%, and HSI by 36%. During December, as the pandemic wave hit across major cities, most households were focused on managing their family health which distracted market activities, suppressed confidence, and effectively tightened liquidity. The STAR and GEM markets fell significantly in December.

The A-share risk premium has retraced from Oct highs but remain in above-historical-average levels. The market needs to consolidate for some time while waiting for the peak of US hiking cycle and profit-margin

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recovery. The pandemic development's negative shock may last over one season. Domestic real estate is at best kept afloat with policies supporting liquidity for developers' survival. US's demand drop will drag down China's exports. These factors contribute to negative impacts on economic fundamentals and corporate profit outlook, though probably less harmful to the stock than to the commodities. As for the rates, PBOC will probably keep loose monetary conditions, so there's little actual pressure on short-term rates and long-term rates may rise eventually as future economic expectations improve.

Regarding the photovoltaic and New Energy Vehicle industry, there is the expected increase in supply as capacities come online, which in turn bring down industry chain prices and may impact short-term profitability. This downward pricing pressure will be painful for the near term, but ultimately helpful to the industry. **It's worth tracking who will withstand the wave – strong competition is the pillar of long-term healthy and sustainable industry growth.** Given the wide developmental space, the long-term profitability of various links of industry chain is determined by their competition strategy, which rests on their respective technological innovation, capacity build out, and enterprise management skills.

The bear market may blind our vision, where overly concern about market trend will lead to missing the entry opportunity. We are deeply aware that our valuation capability, especially during period of enhanced volatility, is fundamentally driven by our deep understanding of the industry and the company. **Our industry chain research team framework, industry-specific valuation models, and our "continuously add value"-vision are crucial in identifying those who are most likely to withstand the wave of our time.**

2. How to Avoid another World War

In December, Biden invited Ukraine president Zelensky to visit US and spoke in front of the US Congress. At the same time, Putin visited Belarus. The elderly US statesman Kissinger wrote an article: "How to avoid another world war." Perhaps we're getting nearer another pivotal point in the Russia-Ukraine war? From China's perspective, there are two main concerns. On one hand, China doesn't support the war, which has costed China economically, diplomatically, and politically. On the other hand, whatever China's response to the war, US will likely maintain its China strategy of encirclement and continue its sanctions. While the current Chinese policy of careful balancing act still carry a cost, it does minimize strategy fallouts and therefore likely remain the course till the end of the war.

US continues its push to blunt China's semi-conductor and AI industry developments by putting another 36 Chinese companies on the Entity List which has 600 companies. At the same time, Taiwan's TSMC has expanded its production base in US. Its founder Morris Chang said that as global geopolitical landscape shakes violently, it's completely changed the semi-conductor world where globalization and free-trade is effectively dead and unlikely to resume. In the near to medium term, Taiwan is still the core production base for TSMC, with higher capacity and more advanced products.

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The biggest game for human race is commerce and war. When globalization runs into obstacles like income disparity, employment, monetary system, technology blockade, it may eventually cause the collapse of global system of division of labor. In that system, any country can only be superior in part of the production process, and most countries are only competitive in small part of the process. So when one country is being choked, everyone suffers – including the perpetrator. This applies both in cases of advanced technology and in cheap labor. In the last 30 years, the globalization is best represented as the G2 model where China's high capacity and large labor force cooperated with US's large market and technological innovations. The G2 cooperation is also crucial in key topics like global climate change or geopolitical tensions. No country can solve all the global problems alone, which is why the G2's decoupling is a key risk for the global situation.

As the most technologically advanced nation, US is the leading figure but not a monopoly of all technology or industrial capabilities. US government, however adamant, can not put an immediate stop to the sizeable China-US trade relationship. The return of manufacturing activities back to US is easier said than done. Take photovoltaic industry as an example: US still has clear disadvantages in antiquated technology, incomplete supply chain, low efficiency, and high construction costs. China has grown into the central pillar of global industrial supply chain, which must be upgraded and expanded to retain its relevancy. We saw some recent investments in human capital and infrastructural buildouts which will provide some advantages, but these can be best applied in the global supply chain and market-based systems. Even the dual-circulation framework will require a healthy international circulation for the domestic circulation to thrive. Most countries in the world hope to maintain an open economy. China is the same and has been trying hard to engage international markets and continue opening up economy. In practice, we noticed that those companies with global competitiveness can do well by increasing their global cooperations: the more they integrate into the global supply chain, the safer they become. And for those advanced technological parts that are unfortunately restricted by the US, the companies must source them elsewhere, until they can ably substitute with domestic products. This can become a great platform for global companies to participate in China's growth. In this scenario, China can be a creator of new global eco-system rather than just another passive victim.

During Dec 7-10th, China president Xi participated in a series of strategic meetings in Middle-East. In his meeting with Saudi Arabia, China expressed support for Saudi Arabia's "Vision 2030" and "Middle East Green" initiatives. There are a lot of cooperation areas across legal, education, hydrogen, investment, real estate, etc. There will be further strategic dialogues between China and Gulf states including in new energy, financial investment, technological innovation, and aerospace.

3. Beware of household leverage, stabilize future expectations and boost demand.

The November data appears weak both in quantity and in key components. Nov Retail Sales dropped to -5.9%, while Real Estate investment also shrunk significantly. Industrial production only had slight +2.2% and high-tech production was +2% as pandemic disruptions continued. Only infrastructure and some fixed-investments appeared stable. After a challenging 2022, Goldman Sachs forecasts China's GDP will grow from 2022's 3% to 2023's 4.5%. The reopening momentum may carry well into 1H24, where full year GDP can be 5.3%. In the US market in 2009, after the end of QE1, US household leverage ratio went into a downward trend that lasted until last couple of years. In China, after the pandemic and real estate corrections, we may have a few years of weak household leverage ratio as well. The key is to return economic growth to normal and reasonable rates. In order to achieve the growth targets by 2035, we must deliver on the actual growth as well as increase our productivity. This is why high-quality growth is crucial to achieving our 2035 growth goals.

Recently, we saw a lot of government policy rollouts such as improved pandemic policies; real estate financing policies; expanding domestic demand policies over 2022-2035; support platform economy policies; and many others. Recently vice president Liu He suggested that government aim for at least 5% growth in 2023, and try to at least achieve the annualized 5% growth over the next two years. The central government's economic forum meeting emphasized both long-term high-quality growth and short-term expectation management and demand boost. We therefore expect 2023's economic policy to be in a relatively proactive stance.

During the December's Central Economic Work Conference, it highlighted the need to both deepen supply-side reform and boost demands. It asked the local government to improve social future expectations and gain confidence via five main areas. One is to expand domestic demand. Two is to accelerate modernized industrial chain. For the main industrial chains, identify the core technology or key component, then concentrate resources to overcome the obstacles and achieve self-control and industrial chain security. Three is to both develop public economic and support private economic activities. Four is to attract and utilize foreign capital or investments. Five is to effectively prevent or resolve major economic or financial risks. **We believe China's macroeconomy will have a steady and improving outlook in 2023.**

4. US Inflation inflection point is here.

US Nov CPI continues to slow to 0.1% MoM and 7.1% YoY, even lower than market expectations of 0.3% and 7.3%. This continues the trend of inflation slowdown from October, further signaling the US Inflation inflection point is here. In the FED Dec meeting, the rate was hiked by 50 bps which was inline with market expectations. The dot-chart showed the current rate hike will peak at 5.1%, corresponding to 5%-5.25% region, then no rate cuts in 2023, with total of 100bps cut in 2024. Currently, the market is pricing in rate hike peaking at 4.75%-5%, with potential rate cut starting in 4Q23.

5. Reopening now driving asset pricing.

As we bid farewell to 2022, we are looking forward to the bright new world of 2023. The global economic entities are seeing marginal improvements in their main challenges: US inflation and its associated monetary tightening; European energy crisis triggered by Russia-Ukraine war; China slowdown from pandemic restrictions. Overall, we feel the reopening of China's economy will be the core driver for pricing

Chinese assets in 2023. Risky assets will outperform safety assets. We expect the slow bull market to return, rates may increase slightly, commodity demand will increase, and RMB will appreciate against the USD.

At Rosefinch, we focus on using our professional capabilities to ensure effective asset allocation and risk control. We will always try our best for our investors, so that we can have a rewarding path together in 2023.

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