

Rosefinch Research | 2023 Series # 8

Be Mindful of Our Mindset



“Yesterday is history, tomorrow is a mystery, but today is a gift. That is why it is called the present.” Kung Fu Panda

Corporate profits will have bigger impact to A-share market.

The better-than expected US data – NFP, CPI, PPI, Retail sales - paint a picture of a resilient economy and hot labor market. Feb PMI also show improvement in UK and Europe, with most countries back above 50. With the positive data, 10Y UST yield stopped the slide to 3.35% and came back to 4%. The 2Y yield is also back to 4.9%, largely reflecting higher FED hike expectations. USD index rallied from 101.5 to 105 as USDCNY approach the psychological 7.00 level. The higher rates expectations also saw large retracements in both Hang Seng tech index and NASDAQ China tech index, and the domestic Chi-Next and GEM indices all saw larger corrections than CSI300 and Shanghai index. Even though market is largely expecting an end to FED hike cycle by 1Q24, the high risk-free rate of near 5% is a high hurdle to cover for risk assets.

Before the Chinese New Year in late-Jan this year, the A-share’s investment logic is pretty clear: strong recovery expectation, post-pandemic consumption rebound, front-loaded credit creation, favorable government policy all point to increasing risk appetite. Global investors that were very bearish during the pandemic embraced the logic and jumped back in. The weaker USD also aided the flows to the emerging markets. But after three years of pandemic, domestic investors still have concerns about long-term

downward pressure. In the tug of war between optimistic global investors and pessimistic domestic investors, it looks like the structural pessimism is leading the cyclical optimism.

In the recent reports, we notice China's manufacturing activities are indeed recovering well, but people still hold a "wait-and-see" attitude on demand side. There's no shortage of active and aggressive policy support at various levels of the government, which should bode well for a solid year ahead. Going forward, the macro level impacts will lessen, while the corporate profits will have bigger impacts on the A-share market. For the Chinese economy, fairness, efficiency, and innovation will be the core factors for high-quality development.

We need to be mindful of our mindset and do our best. For things outside of our control, we must maintain optimism and confidence. For things in our control, we must be cautious and vigilant. Historically, even in the most pessimistic hours, ultimate success came from recognizing and proactively reaching for the opportunities. Having a positive mindset will remove the distractions of market noise and allow a deeper analysis of future possibilities. Looking ahead, in order to address the long-term trends of aging population and geopolitics, we must look at immigration, capital investment and technological innovations. Out of these three, capital investment via encouraging manufacturing to broaden global footprint may be the most effective approach. By encouraging globally competitive industries like photovoltaic and new energy vehicles to expand overseas, Chinese companies can help to raise the benefit for the global community and break down trade barriers.

Four boosters for high-quality development

The 2022 Central Economic Working conference established the blueprint for economic development, with emphasis on the high-quality development. The key issues include expanding domestic demand, prioritize recovering and expanding consumption, jump-start investing via government direct investing and policy support, keep supporting exports, increasing modernization of modern industries, securing economic circulation, and realizing industry upgrades.

In the 30 years before 2009, China's annual growth averaged above 10%. Yet in the last few years it was hard to maintain 6% even in 2019, before the pandemic. Clearly, there was a change in conditions that previously supported the fast growth. As China enters into higher income levels, the growth rate will run into more headwinds. Of course we will also have other opportunities along the path of socio-economic development. **There are four boosters for China's high-quality development:**

Firstly, China's technological capabilities are increasing. In 2021, China's Research and Development expenditure was 2.79 trillion RMB, 2nd only to the US. As a percentage of GDP, it was 2.44% which is close to OECD average level.

Secondly, China has a super-sized economy. From consumption perspective, China has the largest population with high urbanization rate and increasing domestic consumption. From manufacturing

perspective, China has the largest manufacturing capacity in the world across all products with relatively complete industry chain and highly efficient specializations. This comprehensive eco-system of manufacturing supply chain gives China strong global competitiveness.

Thirdly, China's labor force still has competitiveness. While it's true the labor cost is rising, but so is the productivity.

Fourthly, the new energy and digital economy industries are developing quickly and becoming quite sizeable. China's new energy sector, for example, is now making great strides. In the new energy vehicle sector, China sold 50% of global production in 2021. China's renewable energy sector also account for 76% of newly installed power generation capacity in 2022. The National Energy Bureau estimates that China's wind and solar power generation capacity by 2025 will double the 2020, and that the renewable energy new capacity will exceed 80% of newly added capacities.

If we look at the history of energy utilization, we saw that it took about 300 hundred years for coal to replace wood as the main fuel; gasoline took about 100 years to become the main source; and the next energy transition into new energy may take just as long. But with the global focus and consensus on reaching carbon-neutrality, we may achieve the transition within 30-40 years. The best area for scalable and efficient new energy will be the combination of solar energy and hydrogen storage. Indeed, we are eagerly waiting for industry standardization details and industry policy support from the China government. New energy will be a crucial sector for the future high-quality development of the Chinese economy.

Miraculous returns may come from just a few right decisions.

In Warren Buffett's latest annual shareholder letter, he said the satisfactory results from Berkshire was really only due to about a dozen really good decisions which averages about one every five years. Buffett wrote: "As soon as the flowers bloom, the weeds fade away. Over time, it only takes a few winners to perform miracles." Charles Munger said Benjamin Graham made over half of his profits from one single stock.

Business world is almost identical to nature. Just like many species in nature became extinct, many businesses will close too. Greatness is good. A great company will thrive across business cycles and become the miracle that long-term investors seek. At Rosefinch, we are disciplined about using industry chain logic, applying consistent investment process and methodology, and focusing on staying at the forefront of the industry innovation and trends. In practice, we find that analyzing great companies is the best way to learn, and in the process, they also become our partners in the investment journey. We notice that for each great company, their success originates from their founders. Aside from the industry experience or capabilities, the founders' motivation, passion, resilience, and courage are what provides the company's culture and sustainable development. When we look at the various industry leaders today that grew from humble beginnings from 20 or even 30 years ago, the core team and the inspirational leaders mostly stayed the same. Just like nature, the companies too will evolve and grow. As the management teams pass the baton

to the new generation, it can often bring new ideas and increased efficiencies which are new opportunities for our long-term investors.

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