

## Rosefinch Research | 2023 Series # 11

### Monthly Commentary 2023 May



#### **Confidence is more important than gold.**

After the outbreak of the overseas banking crisis, the U.S. bond yields dropped, and together with GPT prompted the rally of U.S. tech stocks. In March, the U.S. core CPI increased by 5.6% year-on-year. In the face of resilient employment and sticky inflation data, the probability of the FED continuing to raise interest rates in May is still high, though with retail sales in March fell by 1% month-on-month, we'll likely see glower growth in major Western economies. The U.S. dollar index weakened and approached 100 again. Commodity prices in overseas markets rebounded as a whole with copper prices rising above \$9000. International oil prices rose sharply after OPEC+ production cuts, while gold price and risk-aversion sentiments increased. Under the new trend of deglobalization, the financial eco-system also reduced in its significance and binding power. Given the importance of US's financial soft-power in the world stage, this translates into a slight weakening of US, and less constraints for China.

Both CSI and STAR indices hit new highs for the year even before the release of positive macroeconomic data. AI-related stocks are the biggest stars recently with hot areas such as algorithms, computing power, applications, and data. As for the main economy, the first quarter data confirmed the relatively certain recovery trend. However, it's worth noting that during the 3 years of pandemic, balance sheet deterioration and future income pessimism have held back household expenditure. This year, credit and M2 have increased rapidly, inflation has continued to be weak, and private investment growth has remained low. The timing of the release of economic data in March has become a turning point for risk assets to position for coming months. The question is: is the economy recovering or is it entering into deflation? Rosefinch reviewed the liquidity trap stage in the history of the United States, Japan, and Europe. Although the

current Chinese economy has similar characteristics of weak demand and low inflation, there is more room for adjustment of policy interest rates, and there are signs of demand recovery. More importantly, energy transformation, digital economy, national security, and rural revitalization sectors are competitive and have further room to grow.

Structural problems can only be solved through reform. **What China currently lacks is not low-cost liquidity, but how to convert liquidity into confidence and actual purchasing power.** People live in hope, and the improvement of confidence cannot rely on pulsed demand-side shocks. It is more practical to allow the market to make the adjustments. The government can improve the business environment of enterprises, ensure fair competition, protect property rights and investment, and give the economic entities, especially private enterprises, time to breathe and recover. By improving people's livelihood, promoting consumption, focusing on stabilizing geopolitical expectations, government can allow the economy to adjust and recover.

Given the uncertain international situation, the major recent A-share theme was abandoning new energy and investing in AI. Between the globalization of China's high-end manufacturing and the independent and controllable domestic substitution, the valuation has become polarized. In the era of AI, "computation is decision." Before the computation is completed, maybe no one knows what the decision will be. Photovoltaic and new energy vehicles are the top echelon of China's high-end manufacturing prowess. Entrepreneurs continue to work hard and embrace hope. When market sentiments swing to extremes, investors need to remain rational.

In terms of the equity market, the cyclical characteristics of the capital market have been significantly weakened. Investors must improve macro and policy research, focus on the micro factors like industry outlook and corporate management teams, and build a comprehensive mapping of industry value chain so they can evaluate companies both through and across the entire industry. We see that returns are less dependent on asset allocation and more counting on industry or stock selection. It is therefore imperative to cut losses and adjust positions accordingly.

### **China is pushing for a multi-polar world.**

Dalio believes that the world is on edge with three major risks: the monetization of huge debts, social stress caused by the huge wealth and value gaps, and the conflicts between world powers. While US is creating a bipolar "with-me or against-me" world, China is pushing for a multi-polar world. On April 6, the tripartite meeting between China, France and the EU was held. President Xi Jinping and President Macron jointly attended the closing ceremony of the fifth meeting of the Sino-French Entrepreneurs Committee and delivered a speech, pointing out that China and the EU are two major forces promoting the multi-polarization of the world and have extensive With strategic consensus, common interests and a solid foundation for cooperation, China-EU cooperation is directly related to the prosperity of the Eurasian continent and the stability of the global structure. China will continue to view and develop China-

EU relations from a strategic and long-term perspective, support the construction of European integration, and support the unity and prosperity of the EU.

Macron said that the French side opposes "decoupling and breaking links" and hopes to create a more stable and open supply chain. In the 1960s, French President General Charles de Gaulle resolutely took the lead in granting diplomatic recognition to the People's Republic of China, regardless of the United States and the West's policy of encircling, blocking, and suppressing the People's Republic of China, becoming the first major Western country to establish formal ambassadorial diplomatic relations with China. The subsequent presidents of the Fifth French Republic also adhered to the independent concept of "Charles de Gaulleism" in their China policies. Today, the presidents of France and the United States also have different understandings of their China policies. China and France jointly issued a joint statement with 51 articles covering almost all fields.

There are other examples of China working with global partners for further cooperations. Saudi Arabia's cabinet approved the country's decision to join the Shanghai Cooperation Organization. Brazilian President Lula's first overseas visit, officially opened a visit to China, "to revive the friendly relations between China and Brazil." During his official visit to China, Prime Minister Lee Hsien Loong of Singapore promoted China and Singapore as an "all-round high-quality forward-looking partnership". At the 2023 annual meeting of the China Development Forum, IMF Managing Director Georgieva said that at the IMF, we are cautious about two things: first, break away from economic logic. We have reservations about introducing too many geopolitical factors into economic decision-making. Second, we are very opposed to moving all production back to domestic markets. "Remember, trade was not invented yesterday. The division of labor and trade has been improving people's lives for thousands of years, and it still does. It remains the cornerstone of a richer and safer world."

Premier Li Qiang delivered a speech at the opening ceremony of the BOAO Forum for Asia Annual Conference 2023: "Guided by the concept of a community with a shared future for mankind, we will inject more certainty into world peace and development. In the past few decades, the reason why Asia has achieved world-renowned development achievements is inseparable from the overall peaceful and stable environment. In order to achieve greater development in Asia in the future, there must be no chaos and war, otherwise it will ruin its own future."

### **The key to the digital economy is economies of scale.**

The Bureau of Statistics announced the economic data for March 2023 and the GDP data for the first quarter. GDP was +4.5% year-on-year, total domestic exports were +0.5% year-on-year, fixed asset investments was +5.1% year-on-year, industrial added value was +3% year-on-year, and the year-on-year growth rate of total retail sales of consumer goods rose from 3.5% in January-February to March's 10.6%. These data and the March PMI data together reflect an economy undergoing structural recovery.

Consumption, investment, and export have their own strengths and weaknesses. The growth rates of high-tech industry investment and infrastructure investment remained at a high level, and the year-on-year growth rates of private investment and private manufacturing investment both turned from positive to negative in March. The prosperity of scene consumption remains high, and there is still room for recovery in commodity consumption. Consumption recovers and prices drop, and interest rates return to volatility under the differentiation. The government debt pressure in many places is relatively high, and local leaders are actively promoting opportunities to attract investments. However, overly focusing on short-term targets may pile up long-term risk, and it will take a lot of vision and confidence to stick with a healthier long-term development plan.

All structural problems may boil down to a question of value adjustments, and structural problems can only be solved through reform. The first meeting of the 20th Central Comprehensive Deepening Reform Committee reviewed and approved the "Opinions on Strengthening the Subject Status of Enterprises in Scientific and Technological Innovation", "Opinions on Strengthening and Improving State-owned Economy Management to Support Chinese-style Modernization", "On Promoting Private Economy Opinions on Development and Growth, etc. The meeting emphasized that the reform of state-owned enterprises should be deepened, and efforts should be made to make up for shortcomings, strengths, and weaknesses, consolidate the bottom, and promote advantages, and build a state-owned economic management system with top-level overall planning, clear powers and responsibilities, efficient operation, and strong supervision. Point out that supporting the development of the private economy is the consistent policy of the Party Central Committee. It is necessary to fully consider the characteristics of the private economy, improve policy implementation methods, strengthen policy coordination, promote precise and direct access to various preferential policies, and effectively solve the actual difficulties of enterprises.

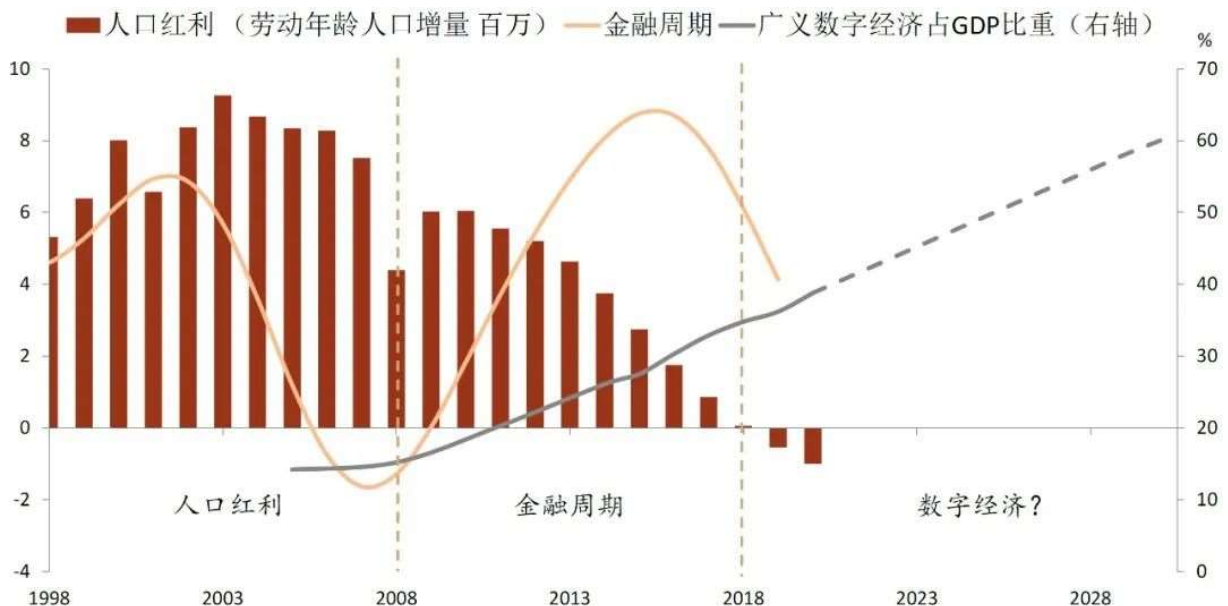
On April 14, Premier Li Qiang presided over the executive meeting of the State Council and pointed out that employment is the foundation of people's livelihood. "Consumption is the sole purpose of all production, and the interests of producers should be attended to only so far as they promote the interests of consumers." China needs to shift from investment-driven growth to consumption-driven growth and embrace green growth. Mr. Liu Shijin pointed out that the government should manage more consumption and less investment. Major adjustments should be made to the government's financial expenditure structure, gradually transforming from an economic construction-oriented government to a public service-oriented government.

In March, the export growth rate was +14.8% year-on-year, a sharp rebound of +21.6% month-on-month, and the import growth rate was -1.4% year-on-year, an 8.8% increase month-on-month. The trade surplus was 88.19 billion US dollars. Overall, the export trend is stronger than expected. On the one hand, overseas demand has maintained a certain degree of resilience, and there has not been a significant continuous downward trend. On the other hand, trade frictions have an impact on domestic exports, but the resale and capital goods demand from developing countries has formed some support. The trade relationship

between China and developing countries has gradually transformed from competitors to complementary parties, with some help from the Belt and Road Initiative as well.

From a structural point of view, the growth rate of the automobile and new energy industry chains is strong, which also verifies the logic of industrial upgrading and structural improvement. Furthermore, it is the correct trend for Chinese enterprises to go global to integrate China's supply chain with the world. We also need to differentiate two types of exports: exports from China and exports from Chinese enterprises. Chinese exports may maintain its global market share but is unlikely to increase given the current global environment. But the Chinese enterprises' export may increase, just like when Japanese companies built oversea factories to serve the global markets. Chinese enterprises can go to Vietnam, Indonesia, India, Mexico, and even Europe and the United States to build factories. Although they could not generate local GDP and exports, they could actually create corporate output value and profits, and drive up the domestic currency and stock market.

On April 7th, the State Council Standing Committee discussed policies and measures to stabilize international trade. The committee pointed out the need to stabilize exports to developed economies and guide enterprises to explore developing countries and ASEAN markets.



Source: Wind, China Academy of Information and Communications Technology, Research Department of CICC. Red bar is labor population change in millions. Orange line is economic cycle. Grey line is digital economy as percentage of total economy. Dashed lines are linear estimates.

China's economy has experienced rapid development in the past few decades. From a fundamental point of view, from the 1990s to the first few years of this century, the "demographic dividend" was an important driving factor for China's economic growth. Over the past ten years, real estate and finance have supported each other, and the resulting procyclicality has weakened the short-term economic fluctuations and

strengthened the medium-cyclical fluctuations of the Chinese economy. The demographic dividend is already fading where last year, China's total population dropped for the first time. The financial cycle is also in a period of downward adjustment.

CICC's Dr. Peng Wensheng believes that digital economy is an aspect that deserves special attention: digital is a common technology, from digital industrialization to industrial digitalization, it has an impact on almost all economic activities. From the land of the agricultural society to the productive capital of the industrial economy, and then to the data of the current digital economy, the relative importance of other production factors has changed except for labor force, which is reflected in the economy-of-scale effect, which is the key to understanding the digital economy. The basis of the size advantage of large economies is basically its population size. This is because population is the basis for division of labor, and a large country with a population of one billion has more room for division of labor than a small country with a population of several million. In view of this, China's population size advantage is the biggest basis for China's future economic development.

The key to harnessing the digital economy for growth is to make good use of external economies of scale. First, promote the contestability of the digital economy. Secondly, use digital economy to promote real economic growth and allow its results to benefit all the people. This will also require close policy support and collaboration to create a virtuous feedback loop to create more value. Over Tesla's 2023 1Q review, Musk once again emphasized that the car is the carrier of the software eco-system. While maintaining a healthy business, he is willing to exchange short-to-medium-term profits for a higher market share and build a user base for future software value-added services. Although there are differences in the business model of software payment among new domestic forces, all of them have now placed software development at a strategic level. At the Shanghai Auto Show, Rosefinch felt that the efficiency of car companies in terms of design language and hardware configuration has improved significantly, and product cycle iterations have also become faster. As companies fight for survival, the low barriers to hardware and appearance design have intensified the degree of industry competition. Until intelligent design can produce a truly differentiated user experience, car companies can only choose the "cost-effective" route to survive. Legend, Huawei, and Xiaopeng have entered the era of "no-map" urban smart driving. After further developments in software engineering, the frequency of use and quality of experience will be further improved. Combined with the advantages of accumulated data, the car companies may eventually exit the raging price war.

At the 2023 Huawei Global Analyst Conference, Meng Wanzhou, the rotating chairman, said that digitalization is a common opportunity for the entire industry. In 2026, the global digital transformation expenditure will reach 3.41 trillion US dollars. Huawei predicts that by 2030, general computing capabilities will increase by 10 times, AI computing capabilities will increase by 500 times, the total number of global connections will reach 200 billion, the penetration rate of 10 Gigabit enterprise Wi-Fi will reach 40%, and cloud services will account for 87% of enterprise application spending. Siemens announced a partnership with Microsoft to use generative artificial intelligence tools to improve its industrial workflows, accelerating and simplifying Siemens' design, engineering, manufacturing, and operations processes.

This month the European Parliament voted 487-81, with 75 abstentions, to approve the rules for the new EU Carbon Border Adjustment Mechanism (CBAM), a mechanism designed to incentivize non-EU countries to boost their climate ambitions and ensure that EU and global Climate efforts will not be undermined by shifting production from the EU to countries with less ambitious policies. Products covered by CBAM include iron, steel, cement, aluminum, fertilizers, electricity, hydrogen and, under certain conditions, indirect emissions. Importers of these products must pay the difference between the carbon price paid by producing countries and the price of carbon allowances in the EU ETS. CBAM will be phased in from 2026 to 2034, at the same pace as the EU Trading System is phasing out free allowances.

At the same time, China's new energy industry including photovoltaics is facing dual pressures from overseas market uncertainty and domestic overcapacity. **The core driving force of the photovoltaic industry is "cheap" and "clean" energy.** With the steady decline of module prices, the price-performance ratio of photovoltaic power generation is prominent. Rosefinch is optimistic about the long-term growth space of the industry, while also carefully monitoring medium-term risks. Back in 2021-22, the rise in silicon material prices led to higher end-product prices and bigger industrial outputs. During that period, everyone jumped in to increase production capacity while very little new technological innovation took place, leading to the cut-throat competition today. In 2023, as an upstream supply bottleneck is released, domestic and foreign production capacities have begun to be gradually released. Thus the trend of price reduction is clear. On the one hand, price cuts will rapidly stimulate demand. Following the strong overseas demand in 2022, we're also seeing domestic demand begun to gush forward. But the pressure of power grid consumption has also begun to reflect in negative peak electricity prices in some areas and delayed construction of large solar farms. The industry will need to adjust to manage a higher percentage of solar energy outputs, which may lead to slowdown in demand growth in 2024. On the other hand, as industry cuts prices to maintain volume, it may face the risk of "deflation". This risk of a double-whammy in industry consolidation and profit erosion may increase as long as we delay the adjustment process. **In the long run, market consolidation is beneficial for market leaders to merge or acquire weaker competitors and maintain their dominance. It will also give those companies with new or advanced technology, innovative applications, or bottleneck capacities to achieve a more certain growing path.**

The photovoltaic industry will continue to promote the improvement of photovoltaic cell conversion ratio, the reduction of photovoltaic unit power costs and the expansion of the photovoltaic production capacity. The photovoltaic-electrolysis route, which uses photovoltaic power generation to produce green hydrogen by electrolysis, is also expected to become the cheapest green hydrogen production method. In the long run, the "photovoltaic +" system in which green hydrogen is deeply involved is the key to achieving carbon reduction and sustainable development goals.

**Build capability, develop eco-system, and stay rational in extreme market conditions.**

When the market goes to extremes, it is necessary to focus on rational judgment after repeated examination. The replacement of traditional energy by the manufacturing industry is a mid-to-long-term transformation. There are many aspects involved such as production overcapacity, technology innovation, resource bottlenecks, and conflict with current participants, but this transformation is part of the unstoppable march in human progress. In Rosefinch's 15-year history, we are fortunate to have experienced entrepreneurs promoting technological innovation to reduce costs and improve efficiency, move industry forward, upgrades management team, and expands global footprints. Today, we are more confident that industry competition will promote more efficient and meaningful development and give birth to stronger market leaders. In the mid-term, it is necessary to strengthen our vision and understanding of both renewable energy and affiliated fields. In the post-new energy development world, we want to compare and analyze profitability of different fields (wind, solar, energy storage, consumption) and each link (main industry chain, equipment, consumables, etc.) After all, it is very meaningful to invest in excellent companies that can achieve high growth rates over the long term. With the market adjustments, there are also other attractive companies in agriculture, aerospace, and medical services sectors who benefit from the new domestic circulation framework.

In the past five years since Rosefinch received our China Mutual Fund manager license, we have continued to focus on our core areas of expertise. Every market adjustment is an opportunity to study and analyze mistakes. Only by learning from these lessons can we make more sustainable long-term improvements. In an increasingly uncertain world, the future is becoming more and more difficult to predict. The foundation for success must rely on the strength of the entire team, relying not only on internal learning and improvement, but also on the help of external inputs to stand higher and see further. To succeed, we must have a strong circle of competence and a vibrant eco-system. Personal contribution and team collaboration are keys to sustainable success. We look forward to building a strong, engaged, passionate and responsible investment and research team to serve our investors and partners.

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

*We endeavor to provide timely English version of Rosefinch's publications. For any English translation of the original Chinese article, in case of any discrepancy, the Chinese version takes precedence.*

**Disclaimer**

The information and data provided in this document is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of any financial products or services. This document is not intended for distribution to, or usage by, any person or entity in any jurisdiction or country where such distribution or usage is prohibited by local laws/regulations. The contents of this document are based upon sources of information believed to be reliable at the time of publication. Except to the extent required by applicable laws and regulations, there is no express or implied guarantee, warranty or representation of the accuracy or completeness of its contents. Investment returns are not guaranteed as all investments carry some risk. The value of an investment may rise or fall with changes in the market. Past performance is no guarantee of future performance. This statement relates to any claims made regarding past performance of any Rosefinch (or its associated companies') products. All rights are reserved by Rosefinch Fund Management Co. Ltd and its affiliates.