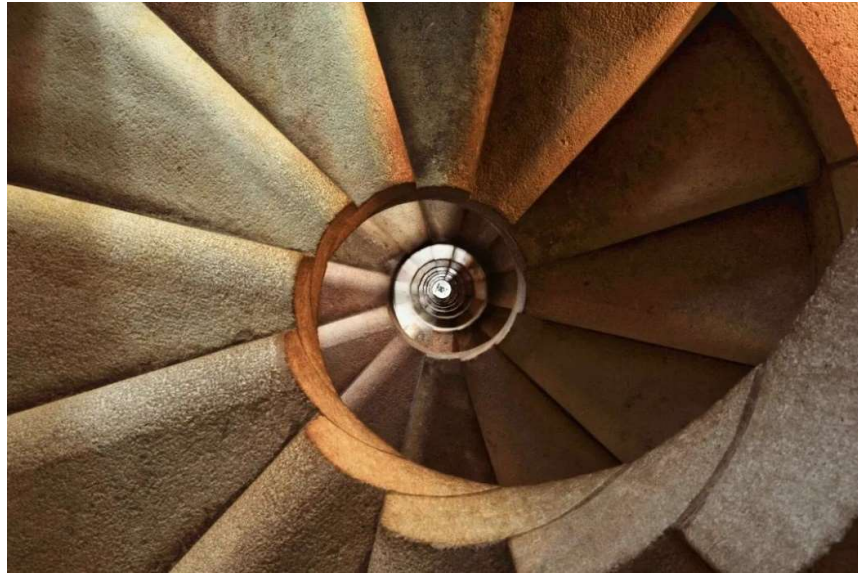


## Rosefinch Research | 2023 Series # 12

### Monthly Commentary 2023 June

#### On the Beginning and the Thriving of Humanity



"The virus still exists, and the pandemic has passed. The moment I stepped out of the airport, I felt deeply that nothing has happened, and yet everything has already happened." Dr Wenhong Zhang

#### **A-share partially reflecting economic expectations.**

In the first quarter of the United States, the GDP grew by 1.1% year-on-year, lower than expected. The consumer confidence index in April hit a nine-month low, the ISM manufacturing PMI remained in the contraction zone at 47.1%, the CPI increased by 4.9% year-on-year (the first time in two years that it was below 5%), and the PPI slowed down to 2.3% year-on-year.

The banking crisis continues to ferment, and the debt ceiling issue is also disturbing the market. The Fed has raised interest rates for the tenth consecutive time in May, totaling 500 basis points in this round. However, the US stock market performed well, with the Nasdaq rising more than 20% since the beginning of the year. Long positions in large US technology stocks are currently the most crowded trades.

China's domestic economic data in April was significantly weak, and the economic recovery encountered serious setbacks. M1 has low growth and M2 has high growth, indicating that credit is being saved rather than spent. Government bonds are the best-performing asset category, with the yield on the 10-year government bond approaching 2.7%. Domestic industrial products have unilaterally declined, and copper,

even supported by financial attributes and low inventories, has also begun to decline. Compared with the major stock indexes in Germany, Italy, France, Japan, South Korea, and Taiwan, which have risen by double-digits this year, the ChiNext and Hong Kong Hang Seng indexes have fallen, and the overall performance of A-shares has been flat. The renminbi has once again broken the 7-mark against the US dollar. **It is worth noting that the correlation between the renminbi against the US dollar and the ChiNext index since 2022 has been relatively high.**

**Crises are also a process of self-cleaning**, and the US economy has the ability and the resilience to deal with crises. Potential crises in China's economy since the reform and opening-up have been controlled, but the impurities caused by last 30-40 years' high-speed growth need to be cleaned up. Currently, the domestic economy is in the early stage of recovery, with sufficient money supply but insufficient growth. There is weak domestic demand and confidence, US suppression escalation, reduction in orders from foreign companies, and a huge scale of existing social debt.

Although M2 credit growth was high in the first quarter, a large amount of money was deposited in savings, and interest rates and the velocity of money circulation decreased. It did not convert into consumption and investment flowing into the real economy cycle. The central government has called for a precise understanding of the new requirements for economic development this year, to accelerate the construction of a modern industrial system with the real economy at its core, focusing on manufacturing, innovation, and integration, expanding domestic demand, and stabilizing external demand, while also focusing on preventing risks in key areas such as real estate and local debt.

Humanity may be "the best thing we have," whether it is pursuing a happy life, money, and status, or relying on inner drive to climb to higher places, to surpass ourselves, to change the world, and promote progress in human society. The market economy caters to human nature and creates highly developed productivity, but it also needs a system that complements the negative aspects of human nature, such as the rule of law, faith, and morality, to "make the most creative and ambitious people only do good things for us humans, not bad things."

Private enterprises are combinations of various individuals with flesh and blood, full of personality and ambition. They are the source of market activity, the cornerstone of the market economy, and play an important role in economic vitality, employment, and government revenue. **If private enterprises have confidence, the economy will have vitality, employment will be secure, and the government will have tax revenue.** It is necessary to systematically give the market economy space and vitality, and to unleash the creativity and initiative of the whole society from the bottom up.

The long river of history is sometimes calm and sometimes turbulent. After humans made great progress in the industrial revolution, how should we deal with the coming AI intelligence upgrade? In history, technological progress has not necessarily increased happiness.

The results of the three-year anti-epidemic efforts will have a long-term impact on the domestic and global economy. "The world is once again at a crossroads of history." The US-China power struggle is a protracted one, and we should prioritize stability and risk prevention. Under the trend of deglobalization, globalized enterprises need to consider both development and security. Foreign-funded enterprises are concerned about their production and supply capacity in China, while domestic enterprises are also concerned about the safety of overseas markets and supply chains. On the other hand, we should actively seek counteracting measures, including the construction of internal circulation capacity, and long-term arrangements such as the outward relocation of industrial production and research and development activities.

High-quality developments in capital market mainly manifested in two aspects: market-oriented resource allocation and balanced incentive & risk control mechanism. To address the root causes, "establishing systems, non-interference, and zero tolerance" is necessary to prevent the market becoming simply a place for capital shuffling games. After the previous downturn, the A-share market has already partially reflected future economic expectations, including insufficient confidence. After all, compared with the bond market, which comprehensively reflects future economic expectations and present situation, the stock market reacts mostly to future expectations. Active fiscal and monetary policies are expected to jointly generate an expanding demand. Even if the subsequent economic momentum is still weak overall, we'll probably see more sector differentiation rather than universal downturn.

From the perspective of some fields we focus on, concerns about the new energy supply have already been fully reflected in valuations, but the energy revolution is still in its infancy, and the opportunity to improve consumption and innovation to enhance supply efficiency and capacity will be concentrated on the most advantaged companies. The structural growth trend of renewable energy is still strong. The lower-than-expected consumption has also been reflected in areas such as sports equipment and agricultural food, but if we have confidence in the subsequent economy and policies, we should look at advantaged companies with attractive valuation, and also the companies that benefit from changes in consumption habits and brand preferences brought by Generation Z consumers. The AI revolution greatly increases the possibility of AGI (general artificial intelligence), which will further promote industrial digitization, alleviate cost and efficiency issues, and create huge opportunities. There is also the aging population's healthcare demand and productivity growth.

Boldly hypothesizing and questioning, carefully seeking verification and exploration, entering the game with humility, and approaching the truth are the basis and foundation of qualitative judgments based on medium- to long-term industrial logic. At the same time, not only are high-return opportunities becoming scarcer, but securities investment competitors are also becoming increasingly fierce. Fundamental active investment can only adhere to values and growth, then carefully price and make decisions. Success may become more elusive once the desire to make quick trading profits arises.

**Wisdom is more important than courage.**

After the end of the Cold War, globalization emerged, consisting of two parts: market-driven economy and more democratic politics. Globalization was driven by multinational corporations and actively supported by the US government. China has also consistently supported the development of economic globalization since joining the World Trade Organization.

Globalization has intensified the polarization of domestic and international levels, while the digital economy has accelerated social polarization. Populism, born out of extreme liberalism, has become the basis for anti-globalization thinking. As a regressive historical trend, anti-globalization is born out of globalization. In 2016, Brexit was used by the government to oppose globalization. In 2018, the US-China trade war and the strategy of sanctions and decoupling were commonly used, forcing globalized companies to shrink their supply chains. The combination of the demand from small and medium-sized enterprises in relevant countries and the government's anti-globalization strategy has formed today's trend of anti-globalization.

In September 2021, Guterres spoke at the 76th UN General Assembly, saying, "I'm concerned that our world is moving in two different economic, trade and financial systems, in the development of different rules for technology; in the development of two different approaches to artificial intelligence, and ultimately in two different military and geopolitical strategies. Once this happens, it will be trouble. It will be more unpredictable than during the Cold War." In April of this year, Macron said in an interview that "Europe must fight for strategic autonomy" and should become a "third pole" force. Professor Yan Xuetong believes that Macron and Guterres's speeches mean that the world has already formed a bipolar world pattern, and he points out that the characteristic of this bipolar pattern is uncertainty.

In terms of economic scale, China and the United States rank first and second in the world, respectively, with diversified businesses in both countries. "The Chinese economy and other parts of the global economy are like conjoined twins", and more importantly, even though they each have their social problems, China and the United States are relatively stable politically. Wisdom is more important than courage!

### **Cyclical recovery and long-term economic structure may reunite.**

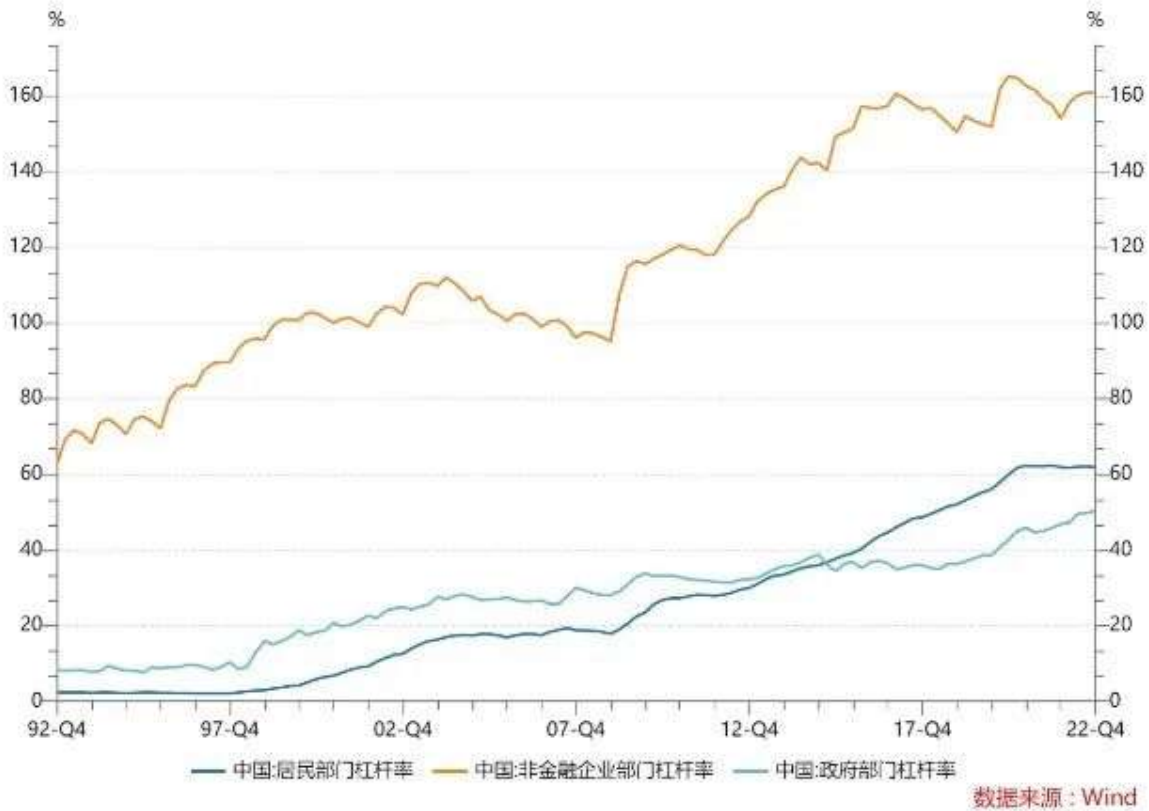
In April, China's CPI increased by 0.1% year-on-year, while PPI decreased by 3.6% year-on-year. The growth in social financing was 1.22 trillion yuan, lower than the expected 2 trillion yuan and the previous month's 538 billion yuan. Apart from the confidence of the private sector, there were no significant bright spots in either the structure or total amount of the data. Over the three years since the outbreak of the pandemic, China's macro leverage ratio has reached 295.9% by the end of 2022, higher than the United States' 257.4%, with further increases in the debt burden of the real estate sector and local governments.

	2019	2020	2021	2022	2019年以来的增速
全球	227.8	257.6	247.4	238.8	10.4
发达经济体	272.6	309.1	295.2	275.8	3.2
新兴经济体	189.6	214.7	208.4	208.0	18.4
美国	255.1	294.3	277.7	257.4	2.3
中国	263.1	292.0	284.7	295.9	32.8
中国 (CNBS)	246.6	270.9	262.8	272.9	26.3

\*Table of macro leverage across the world: row headings are global, developed nations, emerging nations, US, China, and Chin data by CNBS.

The potential growth rate is decreasing while the balance sheet recession persists. According to Rosefinch Fund's analysis, the stock of social debt is about 34 trillion yuan, mainly consisting of government bonds, municipal investment bonds, and a large portion of loans. If analyzed based on loans in the infrastructure industry, the scale is approximately 16 trillion yuan. The real estate sector mainly includes personal housing loans, corporate development loans, and a small portion of corporate bonds, which adds up to less than 5.5 trillion yuan. In terms of sectoral leverage ratios, household debt accounts for 61.9% of GDP, corporate debt accounts for 160.9%, and government debt accounts for 50.4%.





\*Leverage by type: dark green is household leverage ratio, yellow is non-financial business leverage, and light green is government leverage.

**The post-pandemic recovery differs from the general economic cycle in that it has short-term cyclical characteristics and long-term structural impacts.** Dr. Peng Wensheng believes that from a cyclical perspective, the post-pandemic recovery differs from traditional economic cycles in that it is driven by consumption. From a medium-term perspective, to consider the sustainability and intensity of future recovery, we still need to return to the traditional economic cycle. From a structural perspective, the pandemic has exacerbated two traditional issues: income inequality and debt. In addition, geopolitical changes over the past three years have made China's economy more reliant on domestic demand, namely consumption and investment. The problem with investment is the heavy debt burden, while the problem with consumption is the slow growth of middle and low-income earners.

Therefore, macro policies need to combine cyclical and structural factors, shifting from investment to consumption and from finance to fiscal policy. The two sources of M2 changes are reflected in the synergy between fiscal and monetary policies, and the synergy between monetary policy and financial regulation. To reduce the degree of financialization, it is necessary to reduce the importance of credit and increase the role of fiscal policy, strengthening financial regulation operationally and increasing the expansion of central government fiscal policy. The new supply-side school emphasizes that the government should increase

investment in public areas such as education, healthcare, and innovation, which can both stimulate short-term economic growth and improve long-term growth potential.

### **AI's revolutionary impacts may exceed that of industrial revolution.**

We are facing two different real economies: one is a traditional economy with declining competitiveness and severe excess capacity, while the other is a digital economy with increased productivity. The digital economy's share of national wealth or GDP in major countries continues to rise, which means that the competition between China and the US is taking place not only in the natural spaces of land, sea, sky, and space, but also in a new space created by humans: the "cyberspace."

The core issue of the strategic competition between China and the US is digital technology. The US government passed the "Chip and Science Act" last July, legislating for scientific and technological competition with China. In addition to chips in hardware, the core of digital technology has transformed into GPT-4. On April 11, the Cyberspace Administration of China issued the "Management Measures for Generative Artificial Intelligence Services (Draft for Soliciting Opinions)," which stated that "content generated using generative artificial intelligence (AIGC) should reflect the core socialist values." G7 participants agreed on a "risk-based" regulatory approach to artificial intelligence on May 30. The "EU Artificial Intelligence Act" is currently considered the world's first widely applicable law for various AI technologies. The industry is calling for measures to avoid over-reliance on AI. The CEO of OpenAI suggested that AI regulation should establish an international organization similar to the Atomic Energy Agency to ensure non-proliferation and monitor all AI companies based on hardware and energy usage. All systems exceeding the capability threshold should undergo review.

Compared with the industrial revolution that began more than 150 years ago, which replaced and liberated human physical labor worldwide, this time, artificial intelligence is liberating and replacing human brainpower, which may bring even greater changes and faster speed than the industrial revolution and cannot be stopped. However, it is also a double-edged sword, releasing human potential while also testing human social wisdom. "One generation solves the problems of one generation." Government inclusive and prudent regulation is advantageous for technology to be responsibly promoted.

On April 25, the EU Council voted to adopt the Carbon Border Adjustment Mechanism (CBAM), and Europe's new trade barrier was officially legislated amid geopolitical background. Industries such as steel, aluminum, electricity, cement, and fertilizer are included in the first batch of carbon tariffs. On May 16, Biden vetoed the proposal to restore solar panel tariffs on four Southeast Asian countries passed by the House and Senate, citing that US domestic production capacity would not be ready overnight. The proposal will be returned to both houses for re-voting.

General Secretary Xi Jinping emphasized again in his speech in Shaanxi that we should promote the green and low-carbon development of the economy and society, accelerate the adjustment of industrial structure, energy structure, transportation structure, and land use structure, promote the green transformation of the

energy industry, and actively and prudently promote carbon peaking and carbon neutrality. Grid integration is currently a global challenge for the development of new energy. If 2020-2022 is the year of photovoltaic parity, then 2023-2024 is likely to be the first year of solar energy storage parity. Rosefinch Fund believes that auxiliary materials, solar energy storage parity, and grid integration are three clear areas to benefit from increased price competitiveness of solar energy storage.

Charlie Munger said, "We were a creature of a particular time and a perfect set of opportunities." Investors cannot choose their era, but Rosefinch Fund focuses on the main industrial sectors that promote China's economic efficiency, improve lifestyles, and achieve sustainable development. Under the increasingly complex and changing macro environment, this model emphasizes the characteristics of long-term development of superior enterprises and entrepreneurial spirit, enabling us to find long-term anchors in times of short-term confusion. The core of the model lies in the construction and continuous expansion of both the research team's capabilities and their industrial eco-system. It also requires selecting investment managers with matching expertise and personalities based on the demands and preferences of different clients. **Rosefinch Fund always strives to put human value first, so that our team members can thrive in doing what they love to do, while generating long-term value for our investors.**

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

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