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Rosefinch Weekly

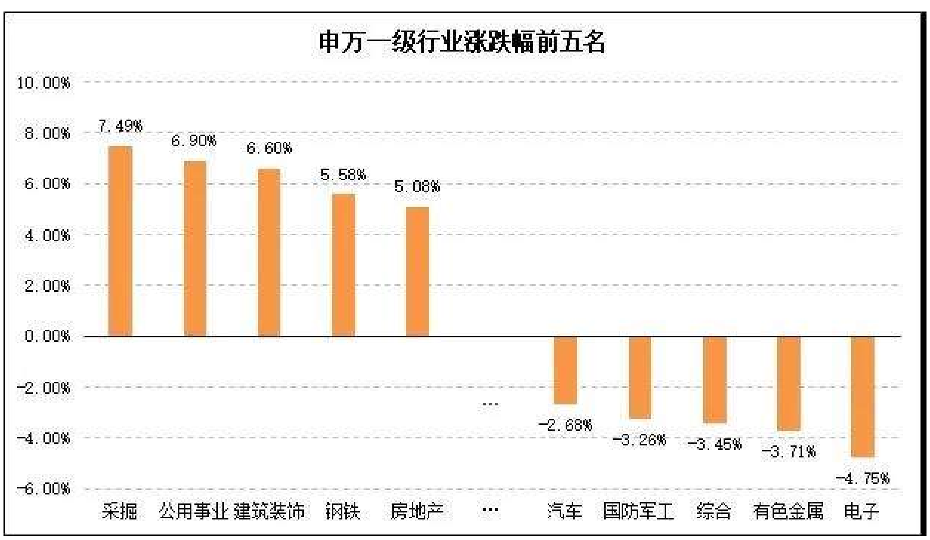
A-share volume hits new high; Volatility brings opportunity, not fear

1. Market Review

For the week, A-share market indices had varied performance: SSE was +1.69%, SZI was -1.78%, GEM was -4.76%, SSE50 was +1.69%, CSI300 was +0.33%, and CSI500 was +1.37%.

Source: Wind, Rosefinch.

Amongst the ShenWan Primary industries, 17 out of 28 rose with excavation, utility, construction decoration, steel, real estate the top 5 performers.



Source: Wind, Rosefinch

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Market volume increased, with Northbound net +27.9 billion RMB, and Southbound net -11.8 billion RMB.

Source: Wind, Rosefinch. Blue is cumulative Northbound flow; yellow is cumulative Southbound flow; unit is in 100 million RMB.

2. Market Outlook

Since August, we are seeing signs of stagflation with weaker economic data, high inflation numbers, and softer domestic demand compared to foreign demand. The market consensus was for a weak August, so the impact was minimal with attention now turned to Sep data. There may be improvement from August, but overall tone will likely remain soft. The downside risk is manageable since the structural macro policy remains supportive with plenty of bullets. The government policy discussions focused on structural cross-cycle policies and supportive policy towards real economy. Interbank market funding remains stable; monetary policy in short-term at reasonable levels; liquidity is sufficient for now. We may see a 4Q RRR cut to offset maturing MLF funding gap, but chance of rate cut is low.

The big news in China's capital market structure is the creation of Beijing Stock Exchange or BSE. It will combine with Shanghai and Shenzhen stock exchanges to create a multi-layered capital market eco-system. The focus of BSE is on small or medium enterprises with special characteristics of "professional, refined, unique, novel." It's likely to significantly improve the SME's funding channels via the capital market. The creation of BSE further confirms the importance of China's capital market in the development of high-quality economy and will be positive to the equity market investor sentiment.

Recently, A-share market volatility has increased with faster style changes. The volume has also reached the high of the year, which may very well be the new norm as ample liquidity supports equity market activities. Overseas, Fed has been effectively guiding market on future Taper movements, reducing market uncertainty and potential shocks. We also see Japan, Korea, and HK stocks rebounding from the lows as global investments return to non-US markets. Last week's Northbound net inflow was the 2nd highest weekly inflow this year at +27.9 billion RMB. In the current A-share environment of high volatility and fast style changes, the balanced allocation approach that follows policy guidance and industry outlooks will do well. We should be cautious on certain "hot" sectors with high valuation levels, while opportunistic on good companies that're having sharp valuation adjustments.

In terms of specific industries, we turn first to advanced manufacturing. This week's new energy sector had noticeably higher volatility. The main cause was differentiation of profit growth expectations on certain links of the new energy sector. Rosefinch's approach to new energy sector remains one of using cost-performance ratio to drill down on four areas: new technology, new scenario, main industry chain, and energy storage. New energy car sector has strong short-term outlook and long-term certainty. But this is already well-reflected in company valuations. In the August European new energy car registrations, out of reported data from 6 countries, total in August was +103k or +58% YoY, and -3% MoM, with penetration rate of 23%. The growth rate is slowing due to higher base. The slowing growth rate will bring some drag to the sector's valuation.

In defense industry, based on R&D cycle and "volume purchase" implementations, there's high certainty in next three years' outlook. Downstream demand will release profits in key links like upstream material and parts manufacturing. 2021 is likely a turning point for China's defense industry companies.

In TMT, the Shenwan industry fell -5% in last week, mostly from previous hot or core holdings. We had focused on Apple industrial chain companies, which had steady performance thanks to attractive valuations and clear 2nd growth curve. **This round of volatility brings opportunity, not fear.** We will continue focusing on Apple industrial chain, IOT, FinTech, industrial internet. In particular, we'll search through the lens of "3060" for TMT opportunities in 5G, AR/VR/MT, smart car, etc.

In Consumer sector, it had a relatively quick recovery in 2Q last year after ease in pandemic. There was significant growth of online sales, which created a high base for comparison this year. Take food and beverage sector as an example, the 2Q income growth is only +6.5%, with profit growth at +2.7%. The market has adjusted expectations on Consumer sector since start of year, so the valuation is near more reasonable levels now and worth tracking. We will focus on brand consumption, logistics, agriculture with overall framework of "dual circulation" and "3060". Key areas are "green", technological supply chain, cross-border, new consumption, and modern agriculture.

In Biopharmaceutical sector, there were some policy announcements regarding future medical service pricing system that raised concerns in the market. We take the view that the impact is likely felt more by the public hospitals, while the private medical service providers will have limited impact. After all,

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globally most countries maintain basic public health care and leave private hospital to determine their own pricing. This policy is very important to private hospitals, and we will follow closely.