

Rosefinch Research | Building the New Before Breaking the Old

“Monetary policy will not increase the supply of semi-conductor chips. It will not increase the amount of wind, and nor will it produce more HGV (heavy goods vehicle) drivers.” – Andrew Bailey, Bank of England Governor.

Unlike 1Q21's optimistic views on US economic recovery, the recent rallies in US yield curve and USD-index are more on the back of increased expectation of monetary tightening. USDRMB exchange rate has once again broke below 6.4. Oil is now above \$85, Asia price for Natural Gas rose 6 times in the last year, European Natural Gas price rose 10 times in the last 14 months, and even US price has gone to 13-year high. Wholesale electricity price in Spain and Portugal in September is 3 times as high as six months ago, and English electricity price is now a record 183.84 EUR or 7 times higher yoy. In China, after policy discussion on Oct 19th hosted by Vice Premier Zhen Han, thermal coal price dropped by half in ten days. It remains to be seen if the secure-supply policy can relief the gap between supply and demand. Offshore-priced commodities has some decline: Natural Gas had clear retracement, while copper and other commodities dropped more sharply. Overall, there was strong downward pressure in metals, while energy complex is still subject to supply constraints and therefore has more room to the upside. In Oct, both DOW and SP500 made historical highs, while NASDAQ was up 7.27%, and MSCI Europe was +4.54%. VIX is back at lowest level since Mar 2020. SSE50 and CSI300 are holding near lows of the year, Shanghai Composite and GEM are consolidating near highs. **Chinese equity market has already digested some negative shocks from domestic economic data, Real Estate sector, and energy quotas. Therefore, there's less fear of Chinese equity market systematic risk around next year's global economic growth and US monetary policy developments.**

Stock prices looks at long-term cash flow and market trends, while the commodity futures look at the short-term supply and demands. This difference leads to conflicting behaviors between cyclical stocks and commodity prices during the transition period from stagflation to recession. From investment timing perspective, recession can be a blessing in disguise because it will bring about better policy environment. In later part of recession, government will implement pro-growth and pro-upgrade industry policies, which are beneficial to A-share's innovative technology sector. China has persisted in creating the “dual circulation” development framework, deepened supply side structural reforms, and improved macro policy implementation. **Vice Premier He Liu commented in the Financial Market Forum: China is a Super-sized Economy with a lot of resilience.** The resilience comes from market competition, robust economic framework, correct economic reform policy, super-sized domestic market, and the passionate pursuit of a better life by the Chinese people. China will utilize the pivotal multi-layered capital market to perfect the financial support system for technological innovations. There have been some isolated problems within the real estate market, though overall risk is manageable. Reasonable financing needs are being met, and the overall real estate sector's healthy development won't change.

Recently government announced various policies to support thermal coal supply, perfect electricity pricing system, promote large wind or solar projects, and push consumption of renewable energy. As we enter 4Q, electricity supply will be prioritized for winter household consumption and production constraint will still be needed for high-energy-intensity industries.

Investment Reflects Values – A Multi-facet Review Focused on 3060+

Carbon-neutral is fundamentally a structural transformational upgrade, with economic, energy, financial, and social structural implications. **The 3060 strategy comes with over 100 trillion RMB investment needs, so it will require a combination of technological innovation, financial support, and industry policies.** This round of global inflationary pressure is rooted in the Western nations' ultra-loose monetary and fiscal stimulus to battle the pandemic. The dramatic increase in demand as well as the pandemic-induced broken supply chain saw inflationary pressure appearing at end of last year. The growth of renewable energy is fast but not sufficient to compensate the drop in carbon-energy investments. The escalating energy crisis may push global inflationary pressure to another peak soon. Back in the 1970s, the aggressive rate hikes in the early 70s didn't prevent the US inflation shocks in the late 70s. Will monetary policy effectively weaken inflation pressure and avoid recession? Choosing tighter monetary policy may exacerbate the fragility of global economy as it transitions its energy mix, thus potentially lay down long-term inflationary danger. The Western central banks are currently lagging their inflation policy responses in the 70s.

PBOC officials have said in the Financial Market Forum that carbon-reduction policy support is “addition” rather than “subtraction”. It's doing “addition” by support investment and construction of clean energy sector, thereby increasing overall energy supply capacity, not decreasing it. Financial institutions should follow market-driven, legal, and commercial principles to provide reasonable financing support to coal-firing projects or coal-industries. They shouldn't indiscriminately cut or refuse funding for coal-related projects. Financial market should provide a supportive role to energy supply security and transition to green low-carbon energy complex. Rosefinch believes current supply side issue may need a combination of industry policy and stable monetary policy to address.

There is a Taoist saying that: one's “way” is the gate to all wonders. To invest, one must stay true to the way of investing, and not saying one thing while doing another. To be a successful investor, one needs more than just the economic angle, but also the values. There were a lot of recent policy announcements that clarified the long-term development outlooks for education, pharmaceutical, platform economy, consumption, property tax, etc. Carbon-Peak and Carbon-Neutral are needed for our national economic transformations as well as for global response to climate change. It's worth noting that the traditional energy complex depends on existing resources, has high certainty along the production and distribution chains, and depend on indirect financing. On the other hand, the new energy complex depends on scientific innovation, venture capital, and capital market, needs judgements on company's core competitiveness, life cycles, and managers' entrepreneur spirit.

Rosefinch has accumulated expertise over the years and now focuses on “3060+”, where we research across many perspectives: we look at both private and public markets for fundamentals and relative valuations; we evaluate the company track record like industry experts; we assess competitive landscape and each industry leader's comprehensive capabilities. Using these diverse perspectives, we then determine the company's long-term baseline and upside potential. **It's been three years since Rosefinch became a Mutual Fund manager in China. We will stay true to our vision to “continuously create value” by focusing on 3060 strategy and deepening our industrial research.**

Birth of Oral Coronavirus Mediation

Merck & Co. recently released phase three test result which showed oral medication can reduce Covid hospitalization and death rates by over half and applied to FDA for emergency authorization. Merck and partner Ridgeback Biotherapeutics announced that they've signed agreement with UN to share this drug with the 105 low to medium income countries. The emergence of oral medication can prevent hospitalization or severe complications for mild infection patients. There are now over 100 Covid-19-targeted small-molecule drugs. With more effective drugs in the development pipeline, there is light at the end of the pandemic tunnel. Based on the current information, it's highly likely that the coronavirus will become a long-term contagious disease like the seasonal flu. And just like treating the flu, future coronavirus treatment will be a combination of vaccine and treatment drugs.

White House announced that starting Nov 8th, it will reopen US borders to 33 countries including China, India, and European countries. It will remove some restrictions on the Canadian and Mexican borders. India also reopened on Oct 15th for chartered tourists; Thailand allowed quarantine-free entry for visitors from 46 countries on Nov 1st. China's Center for Disease Control and Prevention Director GAO Fu also said that China may consider opening borders if vaccination rate goes above 85% by early 2022.

On Oct 4th, US Trade Representative Katherine Tai gave a speech titled "New Approach to US-China Relationship". She said: "the U.S.-China trade and economic relationship is one of profound consequence. As the two largest economies in the world, how we relate to each other does not just affect our two countries. It impacts the entire world and billions of workers. This bilateral relationship is complex and competitive. President Biden welcomes that competition to support American workers, grow our economy, and create jobs at home." She noted that in the years China joined WTO since 2001, when US brought cases against China in WTO successfully, China changed its specific practices but not its underlying policies.

Manufacturing Superpower Becomes Energy Superpower as Energy Crisis Propels Energy Innovation

US's 3Q real GDP grew at 2% vs 2.6% expected and previous 6.7%. This was the slowest pace since 2Q20. China 3Q GDP was +4.9% yoy vs 2Q's +7.9%. Sep PPI was +10.7% vs Aug's 9.5%, a record high for China. With pork and other food prices going down and pandemic-induced soft service prices, China's Sep CPI was +0.7%. This divergence of 10% between PPI and CPI is the widest on record. With the supply constraints and new order declines, the Sep manufacturing PMI fell below the 50% line to 49.6%. China Statistics Bureau spokesperson highlighted that since 3Q, there's increased challenges both globally and domestically. Globally, the pandemic is still spreading, economic recovering is slowing, and global commodities are at high levels. Domestically, some areas are severely affected by either pandemic or flood, or both. There's also pressure from the ongoing economic transformations.

In the past 40 years, Chinese economy had a 9% growth rate, with service sector now clearly outpacing the manufacturing sector. **China is moving from a manufacturing superpower towards an energy superpower.** On Oct 24th, Xinhua News published editorial highlighting "Carbon-Peak and

Carbon-Neutral” policy goal is an important strategic decision to address energy resource constraints, achieve long-term continuous development of the Chinese people, and commit to human race’s shared goal. The editorial clarified key goals for 2025, 2030, 2060 and reiterated the central role of the party in leading the relevant implementations. On Oct 26th, the state council published the “2030 Carbon-Peak Plan”, provided detailed guidelines on Carbon-Peak. For example: cross-regional renewable energy percentage is at least 50%; 2025 urban building renewable energy replacement rate at 8%; newly constructed public or factory buildings have solar roof covering at least 50%; by 2030, wind and solar generation capacity to be 1.2 billion kilowatts. There were also specific mentions about hydrogen energy, with detailed demands and guidelines across the entire industry chain. In addition to strategic design and government guidance, this exciting policy will rely on millions of market participants to collaborate and implement.

Compared to the oil crisis of the past, we saw sharp price jumps in silicone, lithium, and natural gas. First there was no military conflict of supply shutdown, it was mostly caused by market supply and demand; second the impacted prices are natural gas, coal, and electricity, rather than oil; third the Europe is most severely affected, even though it’s the most advanced in the energy transformation. **The global energy structural adjustment is having growing pains: the renewable energy’s growth isn’t sufficient to offset carbon-complex’s production decreases due to drop in capital investment.** There’s also heavy dependency of renewable energy on environmental factors, while natural gas has been heavily utilized in this transition period.

China has some unique factors at play: the inversion of high input price (market thermal coal) and low output price (controlled electricity) is a direct cause. It was triggered by the evaluation on the “Energy consumption dual control” policy implementations. The uneven economic recovery also worsened the short-term conflict. It’s becoming important for policy rollouts to carefully evaluate systematic impacts. On the Oct 8th State Council executive committee meeting, Premier Keqiang LI emphasized the need to secure energy supply and protect industry supply chain stability. It was further specified that market electricity price fluctuation should be no more than 20%; large solar and wind projects should be prioritized; newly added renewable energy is temporarily exempt from overall energy quota. On Oct 12th, NDRC published guideline on electricity pricing from coal-firing generators. On Oct 19th, National Energy Bureau published policy on promoting renewable energy projects. The State Grid also held meeting to ensure winter electricity supply. During the meeting, the chairman Baoan XIN said in promoting energy transformation, the direction is towards clean energy and low carbon, the baseline is energy supply, the key is energy security, and the core is energy independence. The energy shortage has become the catalyst to move coal electricity to the market pricing.

Every historical energy crisis ultimately pushed for energy innovation and new energy developments. Even if clean energy era arrives, it doesn’t mean traditional energy must make an early exit. In the 70s, when US couldn’t maintain the gold-peg, it ended the Bretton Woods. Within a year, the USD devalued over 10%, and CPI went from 2.7% in 1972 to 7.8% before the first oil crisis. When FED started the hiking cycle to check inflationary pressure, it also sent US economy to recession. The domestic oil industry also suffered, thus indirectly caused high inflationary pressure when the 2nd oil crisis hit. Today the Western governments use fiscal stimulus and targeted industry support or trade policy.

Currently, China's carbon emission is more than Europe and US combined. Rosefinch research team believes the current energy consumption control and higher energy prices are conducive to new energy station constructions. Globally, Europe reached Carbon-peak in 1979, US reached Carbon-peak in 2007, and China is due to reach Carbon-peak in 2030. China plans to go from Carbon-peak to Carbon-neutral in 30 years, while it will take US 43 years and Europe 71 years. China's carbon-reduction commitments are more challenging than US or Europe. Structurally, China's electricity generation takes up 44% of carbon emissions, US is 28%. **To achieve the 3060 goals, China must vigorously develop clean energy.** In the near term, due to energy consumption control and high energy cost, both coal-electricity price and photovoltaic price are at high levels. In the medium term, there's been over-capacity of some links in the photovoltaic supply chain, which may reduce solar panel production cost. In the long term, as technology improves and efficiency increases, the solar-electricity cost may reduce significantly. On the other side, once environment cost and carbon-credit costs are considered, the thermal power generation cost may rise further.

China to lead the world in economic growth; asset management is built around talents

When global stock market bottomed on Mar 24th, 2020, the total market capitalization was 61.58 trillion USD. As of Oct 28th, 2021, it's 119.58 trillion USD. In other words, there has been creation of 58 trillion USD of equity market wealth. Covid-19 interrupted people's lives, but most investors embraced the opportunities. As US interest rates go up, stock market will be pushed by profits. The high market expectation means US stock face some pressure going forward. In comparison, **3060 is dependent on technological innovation and advanced manufacturing, with robust industry logic, huge potential, and high certainty over the long term.**

In the next 5 years, China's annual GDP growth will be 4% to 5%, this is the largest growth story in the world. To China, it needs to build a deep, effective, and comprehensive capital market to resolve its bottleneck: energy, semi-conductor, USD. CSRC has announced the basic outline for the Beijing Stock Exchange. Shenzhen Stock Exchange CEO SHA Yan said China's capital market reform has entered a new phase: to discipline illegal security activities, improve capital market eco-system, and support key pivotal roles that capital market plays. Recently, there's been more incidences of IPO shares trading below IPO prices. This stems from last month's IPO system reform at both Shanghai and Shenzhen exchanges. These reforms make IPO pricing to be more reasonable, thus removing the effective "IPO profit guarantee" and forcing investors to analyze new IPO opportunities carefully.

The venerable investment manager Baillie Gifford believes the real investors think in decades, not quarters. Their goal is not AUM growth, but continued improvements in investment capability and customer service, which will lead to the former. The European initiated ESG investment concept has become mainstream and accepted value. **3060 involves clean energy transformation, which means it can be a good role model of ESG investing.** More and more investors are realizing that investment research can't be only about the economics, but also backed by values. Capital's intrinsic value is the present value of its future cash flows. But the key question is how to make the future cash flows sustainable? Company is a social organization, so it's important to have perspectives both from social angle and from commercial angle. Rosefinch has grown in the last 14 years and just moved into our new

office in Bund Center in Shanghai. We are now at our most confident and most competitive phase. Any company's continuous growth requires strategy and talent, this is especially true for asset management. Our "Seven Stars" system of team research model is becoming more robust and natural. We also expanded number of teams so more members can grow into leaders. Our strategy of "inner capability + outer eco-system" is reinforcing our strengths in key sectors. Rosefinch Fund Management has emphasized the "active equity" management model and "3060+" direction. **As the team moves forward together, we invite you to join our investor community and allow us to "continuously create value" for you!**

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