Rosefinch Fund
朱雀基金
(T) [021]2030 5888 (F) [021]2030 5999
(A) 58 Floor, New Bund Center, NO.555 West Haiyang Road/588 Dongyu Road, Pudong New Area, Shanghai
上海市浦东新区海阳西路 555 号/东育路 588 号前滩中心第 58 层，邮编：200126

Rosefinch Research | 2022 Series # 2

Eight Questions for 2022

Looking back at the past 30 years in A-share market, the first 15-years was one of increasing volume as market developed, while the second 15-years was one of qualitative transformation as the stock market took on a pivotal role in the financial system. The top 20 companies by market capitalization today are no longer dominated by finance, petrochemical, or heavy industry names: the new energy, advanced manufacturing, and consumer companies are representing our economic development and quality upgrades. Last year saw many different episodes: consumer and biopharmaceutical sectors' fizzle, steel and coal names' rally, new energy names' jump, and the switch from blue chips to SME names. Some investors caught the right timing and saw stratospheric returns, while others can only watch the wake from the sidelines. Unlike the early 2021 rally, the 2022 opened with a few quick drops in the market. These drops reflect investors' concerns on economic slowdown. But there's not necessarily a direct causal relationship between economic outlook and investment returns. The market is complex, multi-layered, and dynamic. Many factors like economic growth, forecasts, technological innovation, company-specific fundamentals impact the specific stock price. In 2022, how is the economic situation? How will the market evolve? Can new energy sector's favorable outlook continue? Which industries may have new opportunities? Below are the 8 questions Rosefinch research teams address:

1. In 2022, how is the economic situation? How does it impact the equity market?

Email ir@rosefinch.cn

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In the Central Economic Work Conference in December 2021, the Chinese government highlighted the three major challenges of demand contraction, supply shock, and weak expectations. The consumption and investment growth rates are slowing, supply chains are disrupted, and various enterprises face key material shortages. In response, the central government announced initiatives for new growth framework, deepen reform measures, build sustainable innovation, push for high-quality development, maintain supply-side reforms, coordinate pandemic response and social economic growth. Government will maintain stable macro-economy, keep economic growth within reasonable levels, and maintain social stability. With economic slowdown expectations already factored in by the market and risk adjustments already taken place, we see no major China market risk in 2022.

2. In 2022, where is the monetary policy heading? Will there be sufficient liquidity for the market?

During the annual Central Economic Work Conference, the government identified the key policy priority of stability. The key policy pillars of achieving the stability goal are: loose monetary policy, fiscal stimulus, and marginal relaxation in the real estate credits. The old economic growth model of "real estate & infrastructure - government - indirect financing" is being replaced by the higher quality "tech innovation - company - direct financing". Within the general theme of economic stability, the looser liquidity condition is friendly to capital market. At the same time, PBOC announced specific policies to support the real economy. It's guiding financial institutions to increase credit support to SME, tech innovation, green developments.

3. In 2022, how big is real estate's risk to the overall economy?

Based on current leading indicators, the real estate investment rate will have a drag on the 2022 GDP. Due to base effect, the 1Q22 impact will be noticeable. Last year's Evergrande Group fiasco had a major impact to real estate debt market, especially to the high-yield market. Because this has been actively followed and digested by the market, further risk is priced in and future shocks will be limited. We saw active policy intervention that stabilized market confidence. The further cooperation among different government agencies will provide effective risk prevention, thus reducing possibility of systematic risk from real estate sector or impacting the financial system.

4. In 2022, which industries have the best outlook?

In 2021, we see large performance dispersions among different industries. In 2022, we may see similar divergences among different companies. In 2021, if you invested in new energy, you'd be making money. In 2022, this may not be true. With the macroeconomic growth slowing, the investment certainty is reducing, and choosing the right companies will be more challenging. To find the growing industry and company during a downward macroeconomic cycle, we turn to 3060+ related opportunities. There is very clear additional demand in carbon-reduction related industries, therefore the best companies will have relatively certain growth. In addition, we favor industries with relatively stable long-term demand, such as defense, agriculture, logistics, consumer electronics.

5. In 2022, is there more upside for new energy names?

We believe valuation is a dynamic process. We favor the 3060+ related investment opportunities because we see attractive medium- to long-term factors in carbon-reduction related themes. Given the long horizon and firm policy support, this is a great long-term investment theme. Of course high valuation is not solely due to long-term demand. The traditional energy starts with upstream resources, while the new energy focuses on manufacturing capacity. The new energy market will grow as costs advantages increase from technological advances. To maintain such advantages requires sustained innovative capability, which is rare among the new energy companies. In our view, 2022 is a turning year for technological innovation in the new energy sector. We therefore take a cautious view on the overall sector, but will focus on companies that maintain their edge in sustainable innovations.

6. In 2022, how do you see the initial selloff in the photovoltaic sector?

In the first few trading days, we saw some broad selloff in photovoltaic sector. We believe the truly innovative companies with strong technological capabilities will emerge stronger. In the medium to long term, under the 3060+ framework, the photovoltaic sector will have large growth room in the next 10 to 20 years. In the short term, 2022 may see more policy support, more volume, and new technologies. Most global forecasts for new photovoltaic generation capacity in 2022 is 200-220 GW, or +30% vs 2021. With future removal of supply chain bottlenecks, the 2022 demand can easily exceed current forecast. On company level, the leading companies are maintaining their advantages in cost-control, branding, and distribution channels. They also have strong inroads in next-generation technologies. With the global demand poised to increase dramatically, the leading companies will fully participate in such industry expansion.

7. In 2022, which areas are most favorable in the photovoltaic sector?

The key themes in the photovoltaic sector are to continuously reduce cost, increase efficiency, and expand volume. The future sector directions are: reduce upstream cost expectations, phase out outdated or uncompetitive production capacity, and expand applications of photovoltaic material. We will focus on the following four areas: 1) industry supply chain: 2022 will see large demand which may cause bottlenecks in supply chain. We'll look at supply chain links that require long-term planning for capacity expansion or have large energy demands; 2) new technological change: we estimate high technology will overtake PERC cell technology in the coming 1-2 years. 2022 therefore can be a banner year for companies dealing in the new technology's upstream equipment and material; 3) new applications: photovoltaic will likely diffuse into multiple industries and sectors, with the most prominent in the collaboration with building material. In future, photovoltaic cells can be a building material itself, presenting opportunities in rooftop or walls; 4) absorption: new energy has volatility in its electricity

Email ir@rosefinch.cn

stream, therefore new products are needed to manage and smoothen the absorption of such electricity into the grid.

8. In 2022, how will global pandemic and US rate hikes impact Chinese equity market?

In Dec 2021, FED announced it will likely have 3 hikes in 2022. Compared to FED's neutral to slightly tightening bias, PBOC is focusing more on domestic situation. The Chinese monetary policy is likely to be neutral to slightly loosening, since the global inflation and monetary policy will have limited impact to China. It's unlikely for China to be forced to follow US to hike rates, and in fact China may cut further despite US's hiking stance. On the pandemic front, even though Omicron has increased infectability, market is looking at its softer symptoms and hoping for normalization following the winter wave. We remain cautious though on the virus's impact on consumption intentions and labor supply balance. At the same time, as consumptions move from goods to services, China's 2022 export volume may be under pressure.