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Market-Investing vs Market-Timing

Last week's capital market was a roller-coaster ride. On Mar 14-15, the Hang Seng Tech Index fell over 18% to near the bottom from Jan 2019. CSI300 dropped over 4.5% on single day, with over 3% private fund products approaching liquidation levels. The market was very pessimistic with no buyer in sight. The key event that changed the market momentum was the government meeting with a key declaration: "any policy with material impact to capital market must be coordinated beforehand with financial regulatory departments." Immediately afterwards on Mar 16th, Hang Seng Tech index rallied 22%, and another 7% the next day. CSI300 also had 3 straight days of rallies. The similar scenario happened back in Oct 2018, when Vice-Premier LIU He also held important government working group meeting and gave the market a shot in the arm that turned the market momentum for the next few months. The market retested the lows in first week of 2019 before embarking on the rally that lasted well into 2021.

We now hear questions now like: have we reached the bottom now? Will the market volatility continue? Will we see another liquidation? Actually, these are not the most important questions. **The most important questions are about the change in expectation and the recovery of confidence. The entire financial market and monetary system is built on foundation of confidence.** Aside from policy and macro fundamentals, there are other factors that impact confidence and future expectations. One key factor is the ultra-long cycles in the global political order. The US political scientist George Modelski advanced the long-cycle theory in world politics. He reviewed the last 500 years and identified 5 century-long cycles. Each cycle had its own hegemony country: Portugal in 16th century, Holland in 17th century, England in 18th and 19th century, and US in the 20th century.

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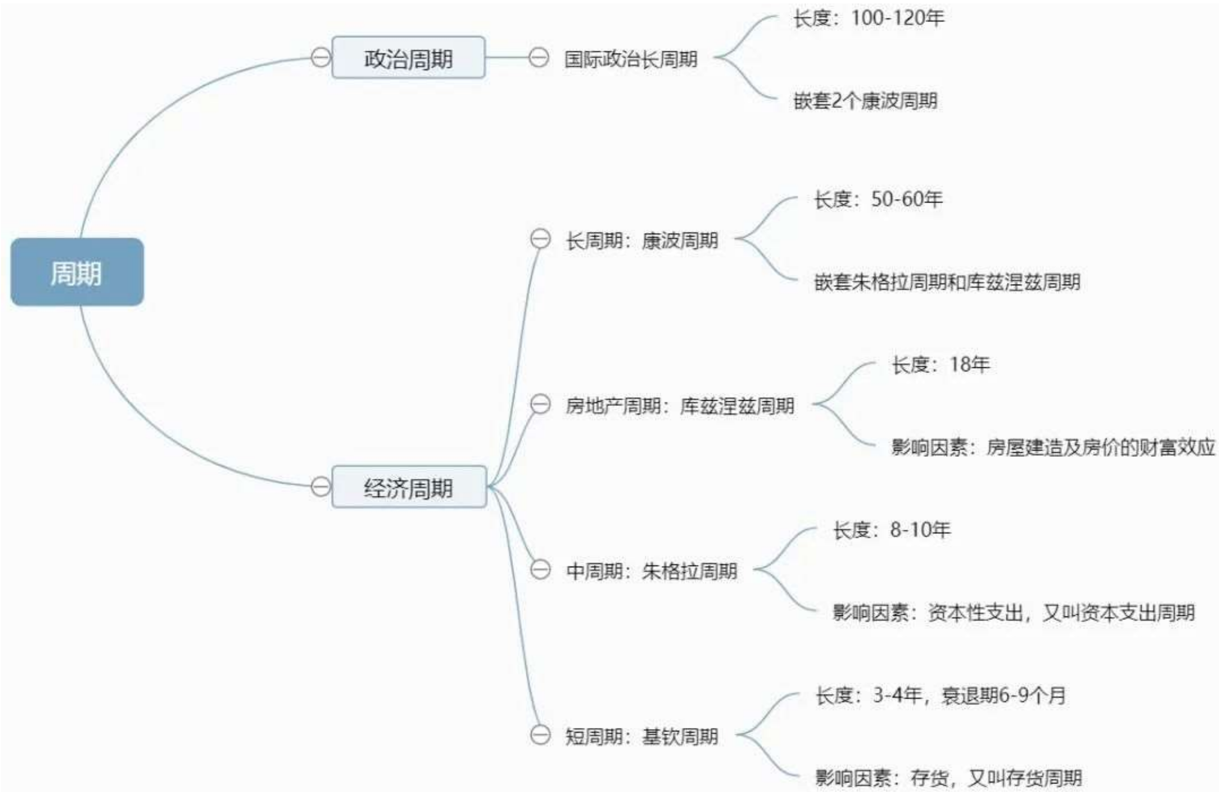

Source: Economist, Long Cycles in World Politics, Rosefinch. Top is political cycle, bottom is economic cycle.

There's wide consensus on impact of government policy to capital market. But very little research on political cycle has been incorporated into investment decision process. The political cycle is simply too long where even a life-time may not be sufficient to feel its change. According to Modelski, we're currently in the tail end of a political long cycle. Each change in the cycles or replacement of hegemony will see volatility in the world order, and often see major wars. Sometimes, this is also accompanied by pandemics like the case of Spanish Flu during the World War I.

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图表 1：国际政治格局的演变

主导国	崛起的战争	获得海权的时间	国际秩序的构建	制度创新	衰落的标志
葡萄牙	意大利战争（1494-1517）	1510	托尔德西里亚斯条约（1494）	组织远洋航行，建立全球基地网络等	西班牙兼并（1580），宗教战争（1576）
荷兰	西班牙战争（1579-1609，荷兰独立战争）	1610	与西班牙休战（1609）	自由贸易，阿姆斯特丹银行，股票交易所，东印度公司等	与英格兰的战争，与法国的战争（1672-1678）
英国	法国战争（1688-1713）	1715	乌德勒支和约（1713）	海军，欧洲均势，英格兰银行，国债等	美国独立，法国大革命
英国	法国战争（1792-1815）	1810	巴黎和约与维也纳会议（1814-1815）	反奴隶制，工业革命等	安格鲁-日耳曼军备竞赛，俄罗斯革命，大萧条
美国	一战、二战（1914-1918,1939-1945）	1945	凡尔赛条约（1919），雅尔塔协定（1945）	联合国，战略核威慑，多边合作，去殖民地化等	

注：获得海权指该国的海军实力在全球取得绝对优势。

数据来源：Modelski(1978), 兴业研究

Once the long cycle starts to change, it may be slow like turning around an oil tanker but its effects can be massive – people's fates will be rewritten, and things will not return to what they were. The Russia-Ukraine conflict, global volatility, US stagflation risks… these caused people's fear for high oil prices and capital market crashes. At the same time, opportunities are born out of the depth of despair.

During every change of political cycle, there will be two notable opportunities in the capital markets. First, during the chaos of war, there's the opportunity for over-sold assets to recover their value; second, as the cycles change, the new growth engine will become giants of their time. In the last few weeks the first opportunity was clearly demonstrated. The indiscriminate selling by investors will end, value will return, and the speed of recovery may be faster than most investors' expectations. The second opportunity will take longer to materialize. No matter how great the technology or how excellent the company, it will take time to grow and mature.

In the last century, oil dominated the global market and the fear of "oil crisis" was never far from our minds. As we enter into the Carbon-neutral age, this fear may be soon over. Solar energy is so abundant that if we cover the Sahara Desert with solar panels, it will generate enough electricity for the whole world. In the next few decades, achieving Carbon-neutrality is a near-certainty. It may become the growth engine for the next long-cycle. Carbon-Peak and Carbon-Neutral will not only be the economic

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growth engine, but also change the fundamental structure of the human energy infrastructure. And unlike the previous cycles, in this cycle, China will give birth to a group of world-leading companies. The Russia-Ukraine conflict acceleration the energy infrastructure's transformation. In Jan-Feb period this year, China's photovoltaic assembly exports increased 100% YoY, as EU called for reduction of Russian energy dependency by 2027 and accelerating its Green transformation. It's possible that future regional conflicts will benefit not only the military powerhouses, oil-rich nations, but also the new energy countries.

Those that change world's trend tend to be developing quietly on the side, until it sparks the new evolution. Whether or not we can catch the spark will test our holistic view and our commercial sensitivity. After we catch the spark, whether or not we can stay and grow with it will test our courage and patience. This is not an easy game – even among those who can see the opportunity, few have truly embraced it. For anyone who wants to be a long-term survivor in the market, you must find your niche. To some outsiders, they may find it hard to understand why you need a niche:

- What's so hard about "cigar butt" investing, isn't it just buying cheap stocks? (The niche here is the ability to do financial statement analysis and to calculate the true value of the company.)

- What's so hard about invest in the thematic stocks, isn't it just buying all the hot companies? (The niche here is to be disciplined. The thematic stocks can very easily over-extend and create bubbles, and you must stay close to exit door when more people rush in.)

- What's so hard about buying growth companies, isn't it just buy and hold companies supported by policy and wait for profits to roll in? (The niche here is to understand each company must withstand numerous pressure tests along its growth path, so you must have the intelligence and persistence to focus on the company's core edge and withstand the heartaches along the way.)

Every niche has its advantages but also its limitations. It's hard to make big money with "Cigar Butt" investing, but it has higher degree of certainty; there's bigger volatility with thematic investing, but it feels great to go with the trend; growth stocks have low success rate, but when it does, it's a huge pay day. **Before each investment, it's important to know what niche we're engaging. Before choosing an investment manager, it's important to know both what niche the manager brings to the table and what niche you have.**

So back to our original comments at the start: it's not important whether the market has reached the bottom. No one can precisely capture the lowest point in the market without being stressed and anxious as the market tests the bottoms. And it's more important to have the right framework than to know precisely where we on in the long-cycle. If you can't stand the roller-coaster ride of the market, then you can choose to do averaging investments to smoothen the cost base and get inner peace. **Investment is a long-term game, it's more important to be in the market than to pick the bottom. After all, it's better to be roughly correct than precisely wrong.**

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