朱雀基金
Rosefinch Fund
[021]2030 5888 [021]2030 5999
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



# The Sun Will Rise Again

There was a story about 3 people going up to the rooftop in an elevator. When they got in the elevator, one started to jog in place, one started to do pushups, and one started to bang his head against the elevator door. After they arrived at the rooftop, they were asked: how did you get up here? And they said, respectively: "I ran up", "I pushed up", and "I was knocked out." The elevator joke is just one of many ways to describe market beta. Indeed, when there is a theme of the ages, the important thing is to be it and not necessarily what you did while in it.

From the global trend perspective, the 4th industrial revolution led by energy has arrived. We believe the 3060-themed carbon-related new energy, led by photovoltaic energy, will be the key driver going forward. Domestically, China has already finished the initial phase of building capacities. It's now moving into higher quality phase where innovation and not investment will transform the economy. We had discussed in our 2022 research paper #24 how the market beta is changing as we enter the Age of Carbon-Reduction. In this paper, we will dig into the question of how investment frameworks should adjust to the new economic transformations. Recently there were many theories and concerns about government policy and future directions. Many investors are feeling uncertain, so it's worth taking a close look at the dynamics between policy, investment framework, and investing itself.

## <u>The Misunderstood Market Force</u>

Aside from Russia-Ukraine conflict, there have been very large changes in the global policy front. First is the global consensus on Carbon-neutrality and ESG, the second is the combination of America's repatriation of manufacturing capacity and China's high-quality development. All these major changes are heavily influenced by the global governments.

- The rise of ESG is not a market phenomenon. It requires companies to put sustainable development at an important position, and not just economic benefits. This clearly adds to the cost for the companies, although it does benefit the sustainable development for the entire human race.

- US's repatriation of manufacturing capacity is not a market phenomenon. If it's a pure market decision, then the manufacturing base should be in China, where it has the most comprehensive industry production and supply chain, as well as competitive wage costs. US sees the return of manufacturing base as a boost to domestic employment, albeit at a higher input cost for the companies.

- China's high-quality development is also being actively guided by the government industry policies. Some policies enjoy subsidies, such as photovoltaic and new energy vehicles, while others are under restrictions, such as ban on privately-owned-enterprises in education sector. Government subsidy accelerates the growth of core industries to be globally competitive, while restricting POE participation served to even the education field for the average student.

When there is significant government involvement, it's impossible to have market-driven commercial behaviors. But we have been talking about market-driven economics so long that we take it to be the nature truth. We often quote Adam Smith: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our necessities but of their advantages." It is by the invisible hand of self-interest that a society of self-serving individuals can enjoy greater benefit for all. But lest we forget, it wasn't Adam Smith's invisible hand, but the Keynes's visible intervention that pulled the economy from recession and launched the field of macro-economics.

Pure market driven behaviors can't resolve its negative externality, just like a person can't pull himself up by his hair. And that is precisely what we are facing right now. The environmental pollution and the unsustainable energy consumption are creating existential crisis for the world. The widening rich-poor divide is pulling societies apart. The core-resources and technologies are weaknesses that have escalated into national security issues. All of these challenges can not be solved by the market's invisible hand alone, and some are indeed actually caused by the invisible hand. In this context, we can see that government policy becomes more important, fair sustainable developments becomes more important, and high-quality development becomes more important. For the investor, a careful and detailed analysis of the policy becomes the gap between the investor and the real world. For those investors overly reliant on market-view of the world, this may even become a blind spot. So when the blind spot leads to discrepancy between what investor knows and what the world is doing, there's fear and even despair. **Market can easily tank in the short-term as some investors cut holdings in time of fear, but this also gives other informed investors the opportunity with favorable valuation ratios.**

## Investment Framework: To Change or Not To Change

Even though the fundamentals are the main determinants of long-term return, in the short-term period of 1-2 years, the valuations fluctuation is what drives the volatility for growth stocks. This is something most investors would agree to, but many chose to forget it as we enjoyed the 3-year bull market for the growth stocks. From investment perspective, add positions at attractive low levels is a good opportunity. **But from investment framework perspective, do we generate return from growth or from volatility, that is a question for the managers.** If the manager wants to make money from volatility, then manager must consider liquidity and risk preferences. The manager must incorporate government policy and interest rates into the investment framework, because they impact the liquidity and risk. This is actually what macro hedge funds do: focus on the short-term and trade the volatility, and don't worry about the long-term where after all – we'll all be dead anyway! If the manager wants to make money from growth of the company, then the manager must insist on fundamental analysis, find the best company, and withstand the market volatility. Government's industry policy of support or restriction will impact the fundamentals of both the entire industry and the individual company.

For investors, it's important to know the manager's investment framework, and know what the manager is trying to achieve – is it to grow with the company, or to capture market volatility? Yet often, investor may lose sight of this important distinction in the heat of the moment. William O'Neil had said that: even though personally I think the best way for personal investing is mutual fund, I don't know most people know how to do mutual fund investment. The most important part of successful mutual fund investing is to buy it, leave it, don't over-think and just wait to make the money. **Of course it's easier to say than to wait patiently through the toughest days. Perhaps that's why it's only with a thorough understanding of the manager's investment framework and a deep trust can the investor safely make it past the most difficult times.**

## This Time is No Different

Even though we know investors are making money from growth of companies, and the market volatility does not alter the fundamental outlook of the stock, the investors will still suffer from the pain of the portfolio drawdown, or the forced accumulation of position as market falls. When the market rallies, it's easy to believe it's the natural way going forward. The same is true when market falls. When Shanghai Stock index broke 3000, there were waves of bearish calls with some forecasting 1800. Some of the same people were calling for 10000 not so long ago in the last bull run. **As a patient and thoughtful observer of the market, we notice that such extreme sentiments often reflect extreme market movements. It's worth taking a step back and look at the historical episodes to gain some more insights.** What we are experiencing today had happened multiple times in the past. Shanxi Securities analyzed the previous market bottoms, such as 2H 2005 and 1H 2013, where the range was no higher than +30% but with significant drawdowns of up to 75%. The current market episode since May is similar in magnitude and may signal that we're near the bottom.

[021]2030 5888 [021]2030 5999
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

**空间已到位，结构已达标，需要点时间**

| 历史上的底部结构市 | 5日成交额占自由流通市值最大比重 | 上升期最大涨幅 | 回摆期最大回吐比例 | 回摆期上涨个股占比 | 时间跨度 | 上升时间：回摆时间(近似值) |
|---|---|---|---|---|---|---|
| 2005/7~12 | 15% | 30% | 70% | 5.3% | 6个月 | 1 : 2 |
| 2008/11~2008/12 | 22% | 35% | 50% | 14.6% | 2个月 | 2 : 1 |
| 2012/12~2013/6 | 14% | 28% | 75% | 20.8% | 7个月 | 1 : 2 |
| 2019/1~5 | 25% | 43% | 55% | 6.6% | 5个月 | 2 : 1 |
| *2022/5~2022/10/10* | *15%* | *27%* | *73%* | *16.0%* | *5.5个月* | *1:1.5* |

注：统计对象为万得全A指数

数据来源：Wind，山西证券研究所

Source: Wind, Shanxi Security Research. The categories are (from left to right): time period for the market bottom; 5d volume as % of free float; max return; max drawdown; % of stock with + returns; period; ratio of rally time over drawdown time.

When comparing stock with government bond, the current risk premium of CSI300 to 10yr CGB is now over 6.6%, near the historical extreme level. The relative value of stock investment is improving dramatically. The latent liquidity is also very ample, with 1H22 household savings at historical highs. The household saving is the reservoir for the stock market. We'd expect next year's global liquidity to further improve as market's FED expectations turn more dovish. On the companies themselves, we're already seeing a rebound in their fundamentals, which means next year will likely see a rally due to improvements across fundamental and liquidity. The best growth stocks may see revaluation both in their EPS and in their PE ratio. Meanwhile, the 3060-themed industries are still the most certain industries to receive government policy support.

After nearly half-year's volatile retracement, the equity market is at a very attractive region. The pendulum of investment cycle has swung nearly fully on the downswing, and is ready for its upswing. As an investor, you may choose to reduce potential future volatility by investing fixed amount over pre-determined time intervals. If you're already invested, then you can choose to wait patiently and avoid quick decision to exit. And if it gets stressful, have a look at the historical patterns to find some solace. **The sun always rises, and this time it's no different.**

**<u>We hope that by sharing Rosefinch's views, in a small way, we add value to your day.</u>**