[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

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The Toughest Day is Over

In the spring of 1997, the Chinese leader Deng Xiaoping passed away. Time magazine put his picture at its cover, even changing its customary red cover to black & white. In July of that year, Hong Kong returned to China's rule. We all have our memories of 1997, which invariably bring back emotions of days long past. Looking back, 1997 was but a brief moment in time. China's reform movement continued and rode the wave of globalization by growing its GDP 10 times during that 30-year period. Urban residents moved to new condos and the country dwellers build their own two-story dream houses. Now in 2022, we are seeing major geopolitical shifts as Russia-Ukraine conflict continues and US-China tensions remain. We can't help but feel reminiscent about the great leaders that ushered in the peaceful age of globalization. With the passing of major leaders of that period like ex-President Jiang Zemin, it feels like an age has ended.

Of course, end of one age means the start of another. When there's no clear mutually beneficial cooperation, there will be competitions across core technology and domestic markets. Only when both sides realize there's no clear winner or everyone become losers will they come back to the cooperation table. Politics has its own rhythm with neither permanent enemies nor perpetual friends. **Each new cycle will bring new opportunity, such as the real estate and globalization in the previous cycle. For China, this cycle will be the energy revolution and domestic substitution.** These opportunities will be incubated by the capital markets and eventually bring handsome rewards for investors with foresights.

Our future destiny is dependent on our own efforts. It's also dependent on the shifting sands of history. If we can't lead our time, then at least we need to keep up with it. We don't want to be playing catch up to the themes of our time, and certainly not be ran over while standing still. Back in Jan 1996, we read the first newspaper publication on Warren Buffett's value investing. In the 18 months since, as rates came off, savings rushed into stock market. The resultant liquidity inflow generated the A-share bull market that saw

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Shanghai equity index doubling by May 1997. The subsequent financial crisis saw Hang Seng dropping 40% in 2 years. Shanghai index traded sideways mostly, and then started its climb again as both valuation ratio and revenues shifted higher.

Capital market always dutifully reflect the changes in economy and investor risk appetite. The main factors impacting investor risk appetite are economic status and government policy. Because of this, David Double Play often happens when the market is most pessimistic. The typical scenario plays out like this: loose government policy (easy liquidity or supportive industry policy) leads to investor risk appetite which in turn recovers valuation and finally improved performance. In China, the scenario typically plays out in Hong Kong stocks first, where it's most sensitive to liquidity. Right now, in just over a month since Oct 24th, the Hang Seng Technology index has already rallied 41% with the latest weekly rally in the week ending on Nov 4th. Market rebounds can often happen faster than investors expect. By the time they load the bullet, the market had already taken off. And the A-share rebound is only just beginning. The Chi-Next is only up 6% from Oct 10th and CSI300 is only up 9% since Oct 28th. A-shares' valuation, relative value to fixed income, and risk premia are all at historical cheap levels.

According to Buffett, it makes little sense to try predicting market's short-term fluctuations. Both Buffett and Munger sees short-term predictions as poison – best to leave them at safer place and away from children and childish investors. **From the long-term perspective, A-share is in the bottom of the range. Those factors that drove the market lower are now reversing: policy is becoming more accommodating, fundamentals and risk appetites are recovering, demands are rising, and deflationary risk is receding.** Russell Napier said in his "Anatomy of the Bear" that major bear market is usually triggered by deflationary. So when deflationary risk recedes and risk premium reduces, it's time to buy stocks. A key lesson is that when the stock price is cheap enough, it trumps almost all other information.

In China, we are seeing new source of capital coming in the form of personal pension investment. These investments will generate trillions of RMB of long-term capital. In the near future, this capital will favor stable fixed income products with low equity exposure. But over time, we'd expect this capital to become cornerstone of A-share market. For the A-share market, this may be a historical transformation. The same scenario happened before in the US. Since announcing retirement account and 401K plans in 1974 and 1978, pension funds have become major participants in the US stock market which helped to reduce US stock volatility and increase its valuation.

With the World Cup in full swing, we shall share the joys and excitements. To use a football analogy: in the past months, we had to focus on being a good goalie to protect ourselves. Looking ahead though, it's time to be a good forward. The toughest day is over – winter is here, then spring must not be far behind.

 Email ir@rosefinch.cn

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

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