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The Little-Known Facts of Investing

After a month, the market volume has finally recovered to trillion RMB a day. New energy stocks are still bubbling while ChatGPT becomes the new darling. The main market theme remains elusive though: is it the return of big consumption? Continuation of New Energy? Or coronation of digital economy? The market sentiment seems to turn on a dime where today's hot picks can be dropped over night, and the rapid thematic rotation becomes the new norm. Try as we may to understand investing, we're always distracted by the avalanche of data, news, and tips. Investing, which is an old, rigorous, and complex decision process, is now reduced to a simple click on the buy or sell button.

In the investment field, there are many classic books such as Graham's "Security Analysis", Buffett's Berkshire shareholder letters, Howard Marks' "The Most Important Thing", Qiu Guolu's "Hard Things in Investment." These books summarized some important investment principles and investment methods which shed lights on the process. Alas few investors have truly read the books in details. And those specifics of the investment process are often misunderstood or even unknown to the investors. For example, how much time does an analyst, or a Portfolio Manager spend on research? How is a stock chosen for the portfolio, and once done how do you track it? What's the difference between investing and researching? We'll endeavor to shed some light on these little-known facts of investing.

Who is the decision-maker?

For an active equity fund manager, the most important person is the one who decides which stock to buy and when to buy or sell it. Investors normally assume the portfolio manager makes the decision. And in most fund managers, this is indeed the case where the product is highly reliant on the portfolio manager's personal decision. It's no surprise therefore many fund managers promote "star managers" to promote the very personalized product.

Take the industry titan Fidelity, who is the founder of the star manager concept. Its most important star manager was Peter Lynch, who increased the asset under management 27 times in the 13 years that he was at the helm of the Magellan fund. Mr. Lynch's annualized return was a stunning 29%, or doubling the S&P returns over the same period. Fidelity also has the "European Peter Lynch" in Anthony Bolton, as well as Peter Lynch's successor Joel Tillinghast. Though aside from these names, there are very few managers from Fidelity that investors recall with clarity. And no one in Fidelity has replicated Peter Lynch's historical performance.

Peter Lynch wrote the book "One Up on Wall Street", where he postulated the retail investor can beat Wall Street institutions. But anyone who's done investing will understand, someone like Peter Lynch only comes along every few decades. Most fund managers rise and fall with the market beta, with the top list shifting every three to five years. Genius like Peter Lynch can only be discovered, and not developed. Or in Buffett's words: it's a 7-foot bar.

Aside from star manager approach, there's also another lesser used decision mechanism of partnership. In the partnership structure, analysts can freely recommend stocks, and the best analysts can become partners of the firm with substantial recognition similar to a PM. A stock's deep analysis is dependent on the analyst's research, and once committed, the holding period can be as high as 5-10 years. And this partnership model is what Rosefinch practices.

At Rosefinch, analysts will usually deep dive into a specific sub-sector and become its expert. Many of our analysts came from frontline business in the industry or from industry consulting firms, so their understanding of the industry is comprehensive and thorough. Rosefinch has over 40 analysts who are experts in their respective sectors, each with their specific niche area. At the same time, they form teams with others that research other parts of the same industry value chain, thus forming a formidable team of experts that understands the industry as well as, and sometime even better than the portfolio company CEOs. This team research on industry value chain truly makes the case for 1 plus 1 is greater than 2.

The two models of star manager and partnership may seem different in structure, but they have the same goal: when it comes to bottom-up equity investment, both models seek to uncover 10-baggers. For Rosefinch, we want to find the great companies and grow with them as they become starts of tomorrow. We also look to diversify by engaging in different major sectors like advanced manufacturing, TMT, consumer, and healthcare. While Peter Lynch is best known for his consumer stock picks, we emphasis more on advanced manufacturing, especially the areas of "dual-carbon" applications and digital economy.

It's worth noting that for "star manager" model, these funds tend to focus more on top-down macro timing, managing thematic rotations, or concentrating on specific sectors. To differentiate between the two models, we need to look at the fundamental differentiations between stock selection vs market timing, single stock or diversification, etc. For fund managers like Rosefinch who excels at stock picking, our core expertise and competitive advantage is stock selection, and not market timing. In Rosefinch, the best portfolio manager can also be the best stock analyst. The PM may look at the overall sector, while the analyst will focus on a sub-sector; the PM will manage a team, while the analyst does not.

At this point, some investors may raise some questions: I thought only the analysts do the research, and PM just do investment decisions based on analyst inputs? This may be a misconception caused by the title – after all, Graham, Buffett, Munger, Lynch are all excellent stock analysts. For fund managers that focus on bottom-up research, it's inappropriate to separate analysts from PMs. The key metric is whether the fund manager has selected 10-baggers for the investors, no matter the title.

Compared with developing another Peter Lynch, it's much more credible and achievable to develop 10 sector-focused expert analysts who truly capture the critical opportunities in their respective sub-sectors. The returns may not be as high as Lynch, but the success rate will be considerable higher. Furthermore, when we combine these expert analysts together into industry-specific research teams, we enhance their combined output and increase the winning rate for the investors. **This is precisely what Rosefinch has done across the major sectors: find and develop the best expert analysts, form industry teams to find the great companies, and pass on this investment philosophy and culture through generations of analysts.** While this approach doesn't sound as glamorous, it is highly sustainable and repeatable. In fact, if the fund can achieve just the median return every year, after 20 years, the end result will be in the top 10% of all funds. For long-term investors, this surprising result may be the key for a more robust and successful future returns.

<u>What's behind a stock?</u>

A good team and a long-term persistent effort are behind a good stock. Investing is not an easy thing to do. Behind the decisions to hold or change a position lies years of research and follow up. Ten years of effort may be only preparation for that critical and timely decision. But these efforts go largely unnoticed by investors. A trailblazing asset manager once remarked that the fund products sold include consulting, trading, service, and other aspects which may be hard for fund investors to evaluate. Some fund investors may see it as a simple buy or sell decision – what's so hard about that?

Rosefinch spends time engaging with investors and will help investors to better understand the investing "food chain", break down the true meaning of long-term investment, so that they can better judge if the fund product is the right one for them. For bottom-up fundamental stock-picking firm like Rosefinch, we see investing as three stages: discovery, valuation, and monitor.

The first stage is discovery. Out of thousands of stocks, we need to find the ones that are most likely to grow into giant sequoias of tomorrow. This is a diligent process that requires patience, knowledge, and commitment. Even when we have analysts focusing on smaller sub-sector, there will still be dozens of companies in their field. We will do the background research, on-site due diligence, and cross-verification with other analysts in the same industry value chain. It takes a great deal of work to find the most promising companies at different stages of the industry cycle. In some ways, it's almost like physical labor where we have to put the sweat and tears into it, before we can finally reap the reward.

The second stage is valuation. We can use DCF, PE, PEG, or other models to provide a valuation. This is actually the most important part of the investment process: finding the company is just the first step! Many failed investments come from incorrect valuation of the company or incorrect understanding of whether you have an edge on the proper valuation of the company. Valuation is important, knowing how the rest of the market evaluate the company is also important.

The third stage is monitor. In Rosefinch, the analysts usually go on monthly trips to companies that they follow or recommend investments in. They will follow daily news flow too, which includes company specific news, industry technological innovations news, competitor news, etc. This ensures any changes in the company and its environment can be identified immediately. Unlike the broad market index investment where you can buy and forget, individual stock investment requires deep research and close monitor to reduce potential risks. Once the long position is established, your confidence in the stock will determine your action when the price drops – this is also where emotional stress takes its toll on uncertain investors, whereas investors who truly know the company will use the market selloff as golden opportunities to add.

The complexity of investment research makes it hard for casual investors to replicate fund managers' efforts, which is why simply following an investment guru's portfolio holdings won't necessarily make money.

Hold onto the great companies!

Once you find a great companies, you must hold onto them tightly! Great companies are just like great people – they are rare and far in between. Compare to not finding a ten-bagger, it may be even more painful to cut a ten-bagger too early. In a research report sponsored by BG, the author analyzed 60,000 stocks' returns between 1990 to 2008. The author found that only 811 companies, or 1.3% of total, attributed to the total net profit during that entire period. Arizona State's professor Hendrik Bessembinder did similar research. He noticed that between 1926 to 2016, the entire net gain of the US stock market came from the best 1092 stocks, where the top 90 companies (only 0.3% of total) attributed half of the profits.

Charles Munger once said: if you take away our 15 best decisions, we would have had a rather average return profile. Graham also said that over half of what he's made in his life came from one single stock. Buffett also compared investing to a punch-card: imagine you only have 20 holds in your card, and each investment decision is making one hole. If you take this 20-hole card in your investment life, your investment result will be much improved. Indeed their holdings reflect their philosophies. In most of their

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years, the top stock holdings rarely change. For Berkshire, the top holding has been Apple ever since 4Q 2017.

Period	Portfolio Value	Top 20 holdings history (left to right)																			
2022 Q4	$299 B	AAPL	BAC	CVX	KO	AXP	KHC	OXY	MCO	ATVI	HPQ	DVA	VRSN	C	KR	V	LSXMK	GM	PARA	MA	AON
2022 Q3	$296.1 B	AAPL	BAC	CVX	KO	AXP	OXY	KHC	MCO	ATVI	TSM	USB	DVA	HPQ	BK	C	VRSN	KR	PARA	LSXMK	GM
2022 Q2	$300.1 B	AAPL	BAC	KO	CVX	AXP	KHC	OXY	MCO	USB	ATVI	HPQ	BK	DVA	C	KR	VRSN	PARA	CHTR	GM	V
2022 Q1	$363.6 B	AAPL	BAC	AXP	CVX	KO	KHC	MCO	OXY	USB	ATVI	DVA	HPQ	BK	KR	C	VRSN	GM	PARA	CHTR	LSXMK
2021 Q4	$331 B	AAPL	BAC	AXP	KO	KHC	MCO	VZ	USB	CVX	BK	DVA	GM	VRSN	KR	CHTR	LSXMK	SNOW	V	AMZN	MA
2021 Q3	$293.4 B	AAPL	BAC	AXP	KO	KHC	MCO	VZ	USB	DVA	BK	GM	CHTR	CVX	VRSN	KR	V	LSXMK	SNOW	AMZN	ABBV
2021 Q2	$293 B	AAPL	BAC	AXP	KO	KHC	MCO	VZ	USB	DVA	CHTR	BK	GM	VRSN	CVX	KR	V	ABBV	LSXMK	AMZN	BMY
2021 Q1	$270.4 B	AAPL	BAC	AXP	KO	KHC	VZ	MCO	USB	DVA	GM	BK	CHTR	VRSN	ABBV	CVX	V	BMY	LSXMK	KR	AMZN
2020 Q4	$269.9 B	AAPL	BAC	KO	AXP	KHC	VZ	MCO	USB	DVA	CVX	CHTR	BK	GM	VRSN	ABBV	MRK	V	BMY	LSXMK	SNOW
2020 Q3	$235.9 B	AAPL	BAC	KO	AXP	KHC	MCO	USB	VZ	CHTR	CVX	DVA	WFC	VRSN	BK	GM	V	ABBV	MRK	BMY	AMZN
2020 Q2	$202.4 B	AAPL	BAC	KO	AXP	KHC	MCO	WFC	USB	DVA	BK	CHTR	VRSN	JPM	V	GM	LSXMK	AMZN	MA	COST	KR
2020 Q1	$175.5 B	AAPL	BAC	KO	AXP	WFC	KHC	MCO	JPM	USB	DVA	BK	CHTR	VRSN	DAL	LUV	V	GM	COST	MA	AMZN
2019 Q4	$242.1 B	AAPL	BAC	KO	AXP	WFC	KHC	JPM	USB	MCO	DAL	BK	DVA	LUV	GS	GM	CHTR	VRSN	V	UAL	LSXMK
2019 Q3	$214.7 B	AAPL	BAC	KO	WFC	AXP	KHC	USB	JPM	MCO	DAL	GS	BK	LUV	GM	VRSN	CHTR	DVA	UAL	V	MA
2019 Q2	$208.1 B	AAPL	BAC	KO	WFC	AXP	KHC	USB	JPM	MCO	DAL	GS	BK	GM	LUV	VRSN	DVA	CHTR	UAL	V	AAL
2019 Q1	$199.5 B	AAPL	BAC	WFC	KO	AXP	KHC	USB	JPM	MCO	BK	DAL	GS	LUV	GM	VRSN	DVA	CHTR	UAL	USG	V
2018 Q4	$183.1 B	AAPL	BAC	WFC	KO	AXP	KHC	USB	JPM	BK	MCO	DAL	GS	LUV	GM	CHTR	DVA	VRSN	UAL	USG	AAL
2018 Q3	$221 B	AAPL	BAC	WFC	KO	KHC	AXP	USB	MCO	GS	JPM	BK	DAL	LUV	DVA	CHTR	UAL	ORCL	VRSN	AAL	GM
2018 Q2	$195.6 B	AAPL	WFC	KHC	BAC	KO	AXP	USB	MCO	PSX	BK	DAL	GS	LUV	DVA	CHTR	GM	UAL	VRSN	AAL	USG
2018 Q1	$188.9 B	AAPL	WFC	BAC	KHC	KO	AXP	USB	PSX	MCO	BK	DAL	GS	LUV	DVA	CHTR	AAL	MON-OLD	UAL	GM	USG
2017 Q4	$191.2 B	AAPL	WFC	KHC	BAC	KO	AXP	PSX	USB	MCO	BK	LUV	DAL	CHTR	DVA	GS	AAL	GM	UAL	USG	VRSN
2017 Q3	$177.7 B	WFC	KHC	AAPL	KO	BAC	AXP	PSX	IBM	USB	MCO	CHTR	LUV	BK	GS	DAL	GM	DVA	AAL	UAL	VRSN
2017 Q2	$162.1 B	KHC	WFC	AAPL	KO	AXP	IBM	PSX	USB	CHTR	MCO	LUV	DAL	BK	DVA	GS	AAL	UAL	GM	LSXMK	VRSN
2017 Q1	$161.9 B	KHC	WFC	AAPL	KO	AXP	IBM	PSX	USB	CHTR	MCO	DVA	LUV	DAL	GS	AAL	UAL	GM	BK	USG	VRSN
2016 Q4	$148 B	KHC	WFC	KO	IBM	AXP	PSX	AAPL	USB	DAL	CHTR	GS	DVA	MCO	LUV	AAL	UAL	GM	USG	BK	VRSN
2016 Q3	$128.8 B	KHC	WFC	KO	IBM	AXP	PSX	USB	MCO	CHTR	DVA	DE	GS	AAPL	GM	VRSN	USG	WMT	V	BK	AAL
2016 Q2	$129.7 B	KHC	WFC	KO	IBM	AXP	PSX	USB	DVA	WMT	MCO	CHTR	DE	GS	AAPL	GM	VRSN	USG	VZ	BK	V
2016 Q1	$128.6 B	KHC	WFC	KO	IBM	AXP	PSX	WMT	USB	DVA	MCO	CHTR	DE	GS	GM	VRSN	AAPL	USG	SU	VZ	V

For Munger’s Daily Journal, Bank of America and Wells Fargo Bank were long-time top holdings.

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Period	Portfolio Value	Top 20 holdings history (left to right)				
2022 Q4	$174 M	BAC	WFC	BABA	USB	
2022 Q3	$163 M	BAC	WFC	BABA	USB	PKX
2022 Q2	$175 M	BAC	WFC	BABA	USB	PKX
2022 Q1	$213 M	BAC	WFC	BABA	USB	PKX
2021 Q4	$259 M	BAC	WFC	BABA	USB	PKX
2021 Q3	$225 M	BAC	WFC	BABA	USB	PKX
2021 Q2	$213 M	BAC	WFC	BABA	USB	PKX
2021 Q1	$197 M	BAC	WFC	BABA	USB	PKX
2020 Q4	$125 M	BAC	WFC	USB	PKX	
2020 Q3	$98 M	BAC	WFC	USB	PKX	
2020 Q2	$101 M	BAC	WFC	USB	PKX	
2020 Q1	$100 M	BAC	WFC	USB	PKX	
2019 Q4	$175 M	WFC	BAC	USB	PKX	
2019 Q3	$156 M	WFC	BAC	USB	PKX	
2019 Q2	$150 M	WFC	BAC	USB	PKX	
2019 Q1	$148 M	WFC	BAC	USB	PKX	
2018 Q4	$137 M	WFC	BAC	USB	PKX	
2018 Q3	$159 M	WFC	BAC	USB	PKX	
2018 Q2	$161 M	WFC	BAC	USB	PKX	
2018 Q1	$160 M	WFC	BAC	USB	PKX	
2017 Q4	$173 M	WFC	BAC	USB	PKX	
2017 Q3	$154 M	WFC	BAC	USB	PKX	
2017 Q2	$152 M	WFC	BAC	USB	PKX	
2017 Q1	$151 M	WFC	BAC	USB	PKX	
2016 Q4	$146 M	WFC	BAC	USB	PKX	
2016 Q3	$113 M	WFC	BAC	USB	PKX	
2016 Q2	$112 M	WFC	BAC	USB	PKX	
2016 Q1	$114 M	WFC	BAC	USB	PKX	
2015 Q4	$132 M	WFC	BAC	USB	PKX	
2015 Q3	$124 M	WFC	BAC	USB	PKX	
2015 Q2	$135 M	WFC	BAC	USB	PKX	
2015 Q1	$129 M	WFC	BAC	USB	PKX	
2014 Q4	$135 M	WFC	BAC	USB	PKX	
2014 Q3	$133 M	WFC	BAC	USB	PKX	
2014 Q2	$130 M	WFC	BAC	USB	PKX	
2014 Q1	$129 M	WFC	BAC	USB	PKX	
2013 Q4	$119 M	WFC	BAC	USB	PKX	

We often hear the saying: don't reinvent the wheel. If you can't beat Buffett, just follow what he does! Each person is the average of the five people she learns from. When it comes to investment, perhaps it's enough to learn from Buffett, Munger, Fisher, Marks, and Lynch.

It is in our human nature to seek change. Fund manager may feel like wanting to know everything and capture every wave. But for those who have been in the investment world for a long time, we know that no one can pick all the winners all the time. Change is easy, but what's hard is to withstand the short-term appeal of mediocre companies, and keep long-term heavy positions on the great companies. This is what Rosefinch strives to do – even though it'd hard, but we will persistently do the hard but correct thing for our investors. When it comes to investing, we're not competing against other, but against ourselves.

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

We endeavor to provide timely English version of Rosefinch's publications. For any English translation of the original Chinese article, in case of any discrepancy, the Chinese version takes precedence.